

# Weekly economic update

19 – 25 June 2006

Last week emotions on the Polish financial market were at least equal to those during the World Cup. Situation may be even more interesting in the following days, as we will see another portion of economic data (although it is a pity that the Polish national team is already out from further games). While during the last, shorter than usual, week the focus of attention was on higher-than-expected inflation figures, in the next couple of days labour market report, production and PPI data will be of key importance in Poland. Given the fact that recent weakening in emerging markets (including Poland) was driven by increased global risk aversion, Polish market will also focus on a couple of interesting information abroad, especially as regards U.S. housing market. Sentiment towards emerging markets remains poor, which was reflected in weakening on the stock exchange, fixed income market and the zloty level, which exceeded 4.06 against the euro. We agree with MPC's Filar, who said that the zloty should be supported by positive economic situation, but this means only that the Polish currency will be relatively stronger than currencies with weak fundamentals (e.g. Turkish lira). On the other hand, Polish politics may add fuel to the flames, as budget assumptions for 2007 do not look impressive (quite high revenues and spending targets). We maintain our forecast that the average rate of the zloty in the third quarter will be above 4.0 against euro. As regards the fixed income market, strong data on employment and wages as well as high production growth should not be supportive, but given the fact that the spread between Polish and core markets yields increased substantially recently, we think that a question whether it is not time to buy Polish bonds at today's levels will be more frequently asked.

## Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
<b>MONDAY (19 June)</b>							
9:00	POL	Auction of PLN1bn of 52-week T-bills (M)					
12:00	POL	Wages (H)	May	%YoY	4.6	4.5	4.0
12:00	POL	Employment (H)	May	%YoY	2.9	2.8	2.8
<b>TUESDAY (20 June)</b>							
12:00	POL	PPI (H)	May	%YoY	2.1	2.6	1.6
12:00	POL	Industrial production (H)	May	%YoY	13.4	16.6	5.8
12:30	US	Build permits (H)	May	m	1.953	-	1.9
12:30	US	House starts (H)	May	m	1.84	-	1.849
<b>WEDNESDAY (21 June)</b>							
9:00	POL	Auction of PLN1.8-2.9bn 5Y PS0511 bonds (H)					
<b>THURSDAY (22 June)</b>							
12:30	US	Jobless claims (H)		'000		-	295
<b>FRIDAY (23 June)</b>							
	POL	Business climate (H)	Jun				
8:00	POL	Retail sales (H)	May	%YoY	11.8	13.0	13.2
8:00	POL	Unemployment (H)	May	%YoY	16.5	16.5	17.2
12:00	POL	Net inflation (H)	May	%YoY	1.1	1.1	1.0
12:30	US	Durable goods orders (H)	May	%	1.0	-	-4.4

\* - poziom ważności: (W)ysoki, (U)miarkowany; Źródło: Parkiet, Reuters, BZ WBK

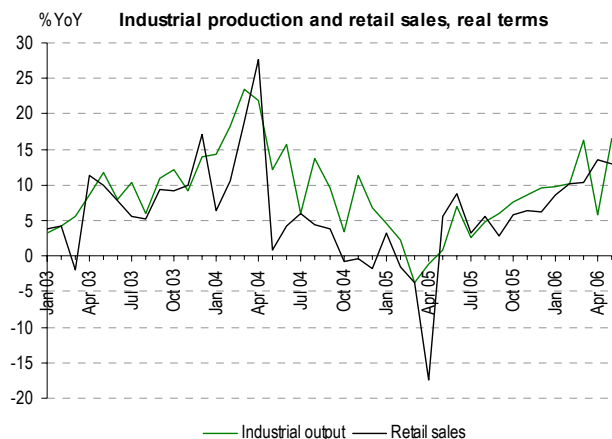
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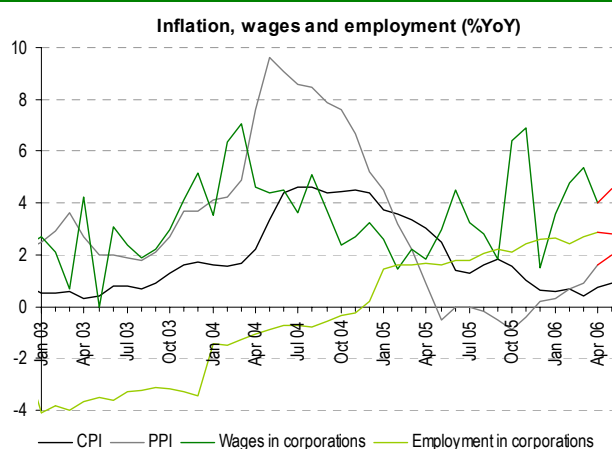
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**What's hot this week – May data positive, but not for bonds**

- Next week we will see data from the labour market (wages, employment, unemployment rate), data concerning economic activity (production, retail sales and CSO business climate) as well producer prices.
- In our opinion, data will confirm quite positive situation of the Polish economy with quite substantial employment creation, moderate wage growth and good results in output and sales.
- Data would not be positive for the fixed income market, but they should not support the zloty neither, as it is influenced recently by global markets flows.
- As regards PPI inflation, after higher-than-expected CPI reading (details below) there is a risk that producer prices rose more than predicted by market analysts (of ca. 2%) as well.

**Economy last week – Higher inflation, quite high budget revenues and spending**

- Positive economic situation was also visible in data on money supply and balance of payments released last week. Though both exports and imports decelerated (to 13% and 10.4%YoY from above 20%), data indicate good external situation – surplus in trade, services and transfers balances, while current account deficit (of €150m) generated by high deficit in income balance.
- Despite inflation rose in May more than expected by the market (from 0.7% to 0.9% against consensus of 0.8%), this was quite neutral for bonds and for the zloty.
- Main factors responsible for higher CPI were food prices (up 1.3% MoM) and fuel prices (up 3.4% MoM). Prices of other goods and services were relatively stable. This was reflected in net inflation figure, which according our estimates remained stable at 1.0% in May. Data were neutral for the monetary policy.

**Budget parameters and macroeconomic indicators**

	2006	2007
Revenues (PLNbn)	195,282	213,140
Expenditures (PLNbn)	225,829	243,140
Budget deficit (PLNbn)	30,547	30,000
Budget deficit (% of GDP)	3.0	2.7
GDP (%YoY)	4.6	4.6
Domestic demand	4.7	4.9
Investment (%YoY)	8.5	10.0
Unemployment rate (% end-year)	15.9	14.4
Inflation (% annual average)	0.8	1.9
NBP reference rate (% year-end)	4.0	4.0
EURPLN	3.90	3.90
USDPLN	3.14	3.10

Source: Ministry of Finance

- While one could have hoped that the government will try to take advantage of fast economic growth and reduce fiscal imbalance more decisively, the government set the next year's deficit exactly at PLN30bn.
- While macroeconomic assumptions seem quite conservative (we forecast slightly higher GDP growth), the revenues' target growth should be regarded as quite ambitious, as the ministry counts on over 9% rise in total revenues and almost 12% jump in tax revenues.
- The next year's targets may become less challenging if this year's revenues top the assumed value and the GDP growth in 2007 is closer to our forecast of 5%, but some risk remains.
- It seems that higher revenues were needed to spend more as planned growth in budget expenditures amounts to almost 8% (almost 6% in real terms).

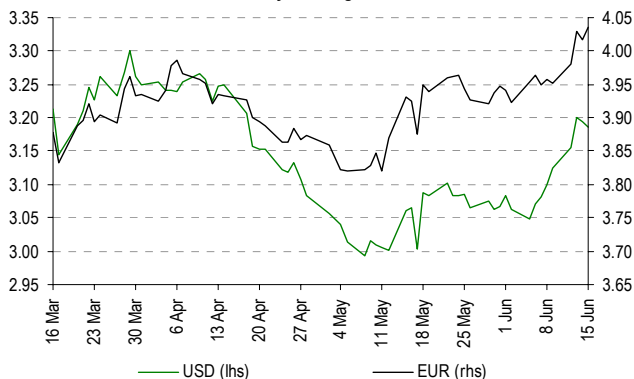
**Quote of the week – Inflation increase mild, zloty weakening transitory****Stanislaw Kluza, deputy finance minister; Reuters, 14 June**

*We think that inflation may rise to 1.0-1.1% in June and to stabilise in July and then to ease to 0.7-0.8% in August-October period. If the zloty does not weaken sharply. At the end of the year, inflation may rise again, this time because of base effects, to 1.3-1.4%. (...) Recent zloty weakening is not justified by Polish economic situation. I think that when situation on global market stabilise investors will buy zloty again, as Poland is one of the strongest economies among emerging markets.*

Given that FinMin's inflation estimates were accurate in recent months, they are likely to strongly drive market expectations for following months. Actually, our predictions are consistent with inflation path assumed by the Ministry of Finance, although our year-end target is slightly higher. As regards situation on the FX market, we also agree with the ministry, as we forecast EURPLN rate above 4.0 on average in Q3 but at the same we see a strengthening of the zloty to ca. 3.90 by year-end.

**Market monitor**

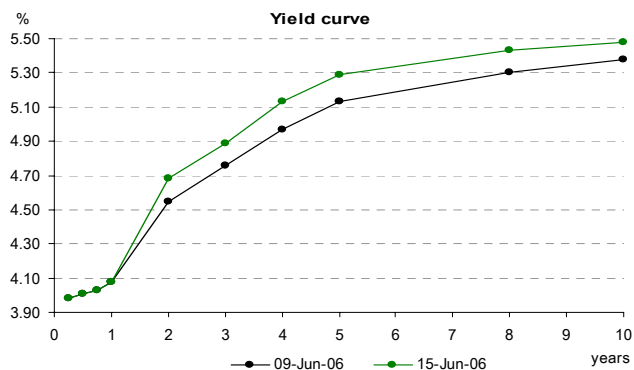
**Zloty exchange rate**



**EURPLN above 4.0, at the 7-month high**

- During the last week zloty significantly weakened and broke 4.0 against the euro, which was connected with the continued sell-off of the emerging market's assets sell-off. Additional negative factor for the region might have been package of reforms in Hungary that disappointed some investors as well as deterioration of Hungarian credit rating, which on Thursday caused the EURPLN rate to soar to 4.07. Since previous Friday zloty depreciated by 2.5% vs. the euro and vs. the dollar.
- Although at the end of the week the sentiment of investors toward the emerging markets slightly improved, the scenario of further steps in Fed's monetary policy is not settled, this is not a positive factor for the emerging currencies and the zloty. We estimate the EURPLN rate to trade in range of 3.98-4.08, and USDPLN in 3.14-3.24.

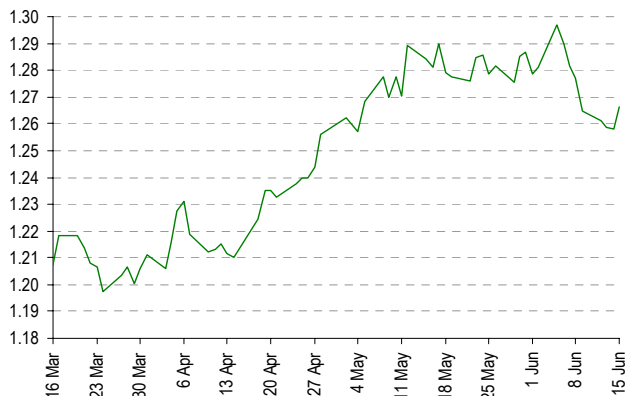
**Yield curve**



**Further weakening of Polish debt**

- Bonds prices were falling since Monday following the yields rise in the emerging markets. Inflation data appeared to be above forecasts, though the market almost ignored them. Further weakening came in after significant yields rise in the core markets and Hungarian credit rating downgrade at the end of the week.
- Labour market and industrial production data may be essential for the Polish market. We assume that after the release of the latter the market may slightly weaker. The domestic market may be influenced by the situation on global markets as well, although a small number of releases may put more focus on Polish data.

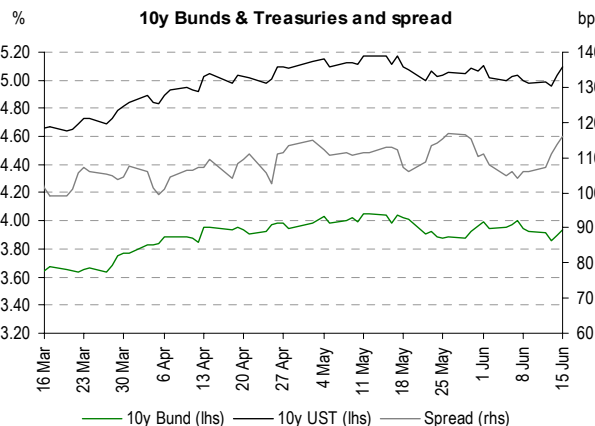
**EURUSD rate**



**The dollar weakened at the end of the week**

- The dollar strengthened ahead of U.S. CPI and PPI figures, and reached the strongest level against the euro for over a month. Despite high core CPI the dollar slightly weakened, as investors started to take profit. Low net capital flows and economic data that slightly decreased fears on U.S growth were also negative for the dollar, which helped more risky assets to recover.
- Despite the belief of some of the market players of another rate hike in August this does not go in line with the dollar's strengthening, which might suggest that the greenback's appreciation correction may soon go to an end. We expect the EURUSD rate to approach 1.30 at the end of the year. Next week housing market data may important for the EURUSD rate.

**10y Bunds & Treasuries and spread**



**Treasuries yields rise on stocks rally**

- 10Y U.S. government papers in U.S. weakened before the inflation data, though later on there was some strengthening connected with sell-off in the sock markets. Treasuries and Bunds prices rise was limited by higher than expected U.S. core inflation figures. Economic data that weakened fears of slower growth in U.S. contributed to stock and commodities markets' recovery at the expense of bonds. Thus during a week 10Y yields of Treasuries soared to 5.11%, and of Bunds to 3.92%.
- Next week housing market data may be quite important as they may show further signs of U.S. economic slowdown. Durable goods orders may be also essential. We assume that with regards to the prospects of economic growth in U.S. and stabilization of inflation in U.S. the Fed rates are going to rise to 5.25% and stay unchanged till the year's end.

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