

Weekly economic update

26 June – 2 July 2006

Macroeconomic data for May have surprised the market once again, showing much better results than expected. Strong rise in industrial production and retail sales and situation on the labour market improving at increasingly fast pace, support expectations that economic growth rate in the second quarter will be equally fast as in the first one. Meanwhile, inflation data show that demand-side pressure on prices still does not look especially risky for the central bank. Unfortunately, news from the politics have been less encouraging and dismissal of finance minister Zyta Gilowska could imply that bearish moods on Polish financial market will stay for some time. This week crucial events for the market will be meetings of the central banks – Polish Monetary Policy Council on Wednesday, and US Federal Reserve on Thursday. The decisions of the banks should not surprise: MPC is likely to keep reference rate on hold at 4.0%, while Fed is expected to deliver 25 pb rate hike, to 5.25%. Nevertheless, trends on the markets could be determined by statements of both central banks and potential suggestions regarding monetary policy prospects. Finance minister's dismissal and recent developments on the financial markets changed a bit the assessment of perspectives of Polish financial market. While previously we predicted that zloty exchange rate should be at ca. 4.03 to euro in 3Q06, and bond yields could bottom out, currently it seems that market weakening could be deeper and more durable.

Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
MONDAY (26 June)							
14:00	US	New home sales (H)	May	m	1.16	-	1.198
TUESDAY (27 June)							
8:00	GER	Ifo index (H)	Jun	pts	105.0	-	105.6
14:00	US	Consumer confidence (H)	Jun	pts	102.5	-	103.2
14:00	US	Home sales (H)	Jun	m	6.66	-	6.76
WEDNESDAY (28 June)							
	POL	MPC meeting – decision (H)	Jun	%	4.0	4.0	4.0
THURSDAY (29 June)							
9:00	POL	Switch auction (M)					
8:00	EMU	M3 money supply (H)	May	%	8.8	-	
12:30	US	Core PCE (H)	Q1	%		-	2.0
12:30	US	Final GDP (H)	Q1	%	5.4	-	5.3
12:30	US	GDP deflator (H)	Q1	%	3.3	-	3.3
12:30	US	Jobless claims (H)				-	308.0
18:15	US	Fed meeting – decision (H)	Jun	%		-	5.0
FRIDAY (30 June)							
12:00	POL	Balance of payments (M)	Q1	€ m	-	-1,2	-1,1
9:00	EMU	Preliminary HICP (H)	Jun	%YoY	2.5	-	2.5
9:00	EMU	Economic sentiment (h)	Jun	pts	106.3	-	106.7
12:30	US	Core PCE (H)	May	%MoM	0.2	-	0.2
13:45	US	Final Michigan (H)	Jun	pts	81.0	-	79.1
14:00	US	Chicago PMI (H)	Jun	pts	59.0	-	6.5

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

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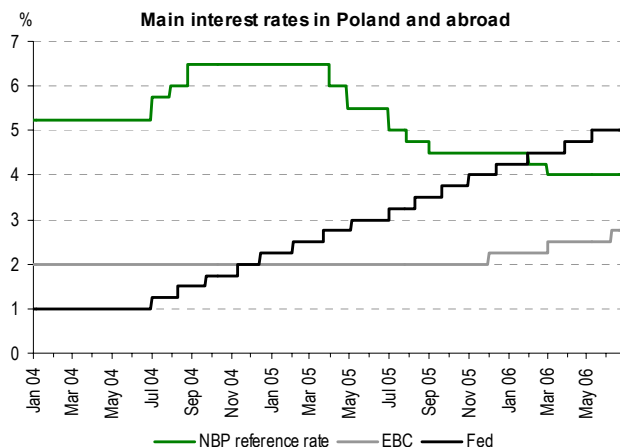
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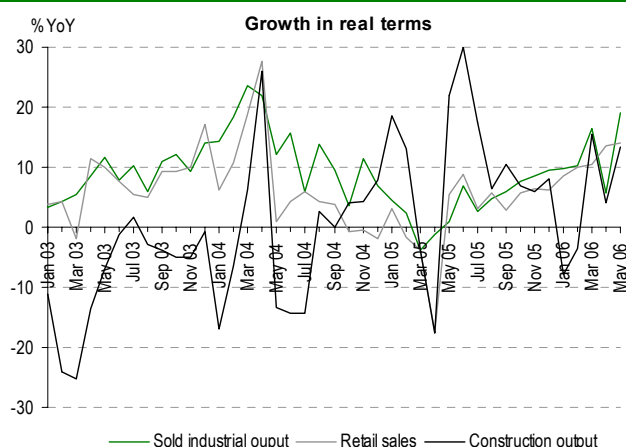
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What's hot this week – Week under the sign of interest rates

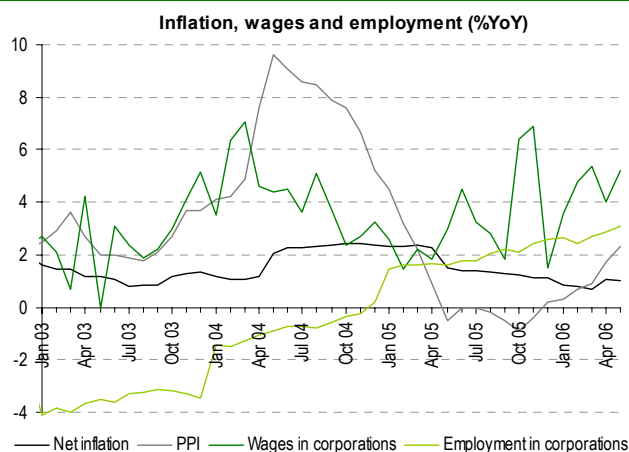


- This week the focus of attention will be on the meetings of the central banks.
- On Wednesday, the decision of Polish Monetary Policy Council will be announced. We do not expect a change in official rates, but the official communiqué will be crucial and whether it will include a suggestion if the balance of risk for future inflation has changed recently under influence of last data releases and/or trends on financial markets.
- Fed meeting will conclude on Thursday. The market predicts a 25 bp rate hike, but in this case also the statement will be much more important as investors will seek any hint regarding monetary policy prospects.
- Quarterly balance of payments figures will be released on Friday. Some revisions are possible, but should not be very significant for the market.

Economy last week – Impressive news from the economy, less so from politics



- Macroeconomic data for May surprised the market with better than predicted results one more time.
- Industrial output soared 19.1%YoY and 15.6%YoY after seasonal adjustment. Construction output increased 13.4%YoY (7% seasonally adjusted). Worth of retail sales increased 13.7% and 14%YoY in real terms. All those growth rates were the highest since pre-accession boom in 2004 and among the highest since late nineties.
- Those figures bode very well for estimates of economic activity in the second quarter, confirming our prediction that GDP growth should reach ca. 5% in 2Q06 and entire 2006. CSO deputy president Halina Dmochowska said on Friday that “there are many premises that the second quarter will see high GDP growth”.



- Very good news came from the labour market. Employment in enterprises increased 3.1%YoY, which is the best result in history. Wages rose 5.2%YoY against average 4.4% increase in January-April. Wage bill in corporate sector rose 8.4%YoY in nominal terms and 7.6%YoY in real terms. Unemployment rate fell to 16.5%, the lowest level for over 5 years. It confirms our forecasts of fast consumption rise in the remainder of the year.
- At the same time, there is scarce evidence of building inflationary pressure. Although PPI growth accelerated to 2.3%YoY, it resulted mainly from hikes in manufacturing and energy sectors, while prices in manufacturing are still stagnant (only 0.2%YoY rise). Similar picture is confirmed by core inflation – net inflation remained in May at 1%YoY, well below 2.5% inflation target.

Quote of the week – Finance minister's dismissal materialised

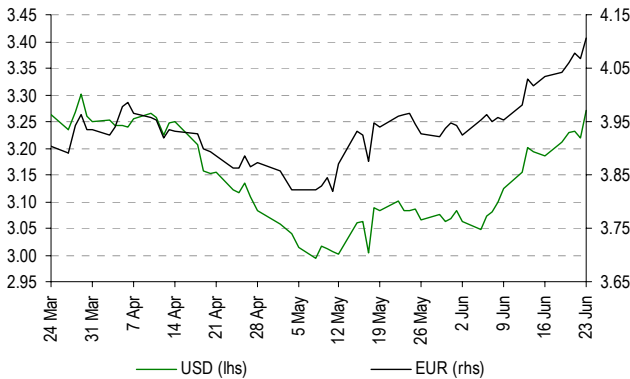
Kazimierz Marcinkiewicz, Prime Minister; PAP, 23 June

The situation is dramatic and untypical. The motion concerns my closest associate. Nevertheless, the rules that we have adopted in the government are clear. I asked for dismissal of deputy PM Gilowska and appointment of Piotr Wojciechowski for the post of finance minister. (...) Budget anchor is still binding and macroeconomic situation is encouraging to invest in Poland. I can calm down all investors about situation in the country.

Rumours about finance minister's dismissal that have been reappearing for some time, have finally materialised. Regardless of the true reason of her resignation, the situation implies higher uncertainty for the market as regards future of fiscal policy. It is hard to judge the new candidate as he is not known to the market. However, given that he does not have large political backing nor a respectable reputation, his effective power in the government and ability to affect a shape of government's policy could be quite limited.

Market monitor

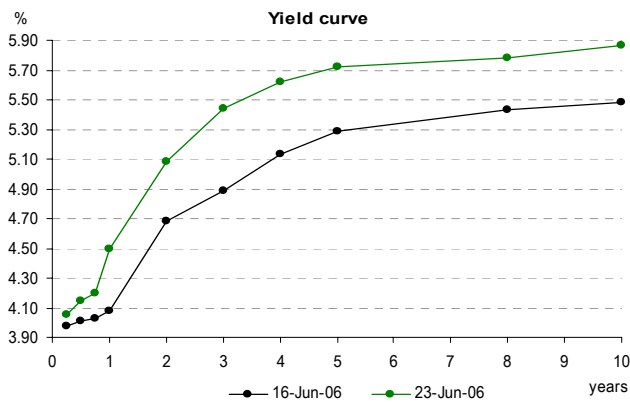
Zloty exchange rate



Zloty the weakest in 11 months, above 4.1 vs. euro

- Zloty weakened since the beginning of the week, with poor sentiment towards the emerging markets, rate hike in Hungary, and results of elections in Slovakia. Slovakian central bank intervention in the FX market slightly supported the region, however the dismissal of the finance minister resulted in zloty weakening against the euro even above 4.12. EURPLN rose during the week by 0.9 %, while the USDPLN rate by 2.7%.
- After a series of bad news in the region there came one in Poland. Deputy PM Gilowska's dismissal may be a sign of increased risk of negative changes in the budget's structure, though it seems that the deficit level seems not to be in danger. The EURPLN rate may fluctuate in 4.06-4.16 range and USDPLN rate between 3.25 and 3.35.

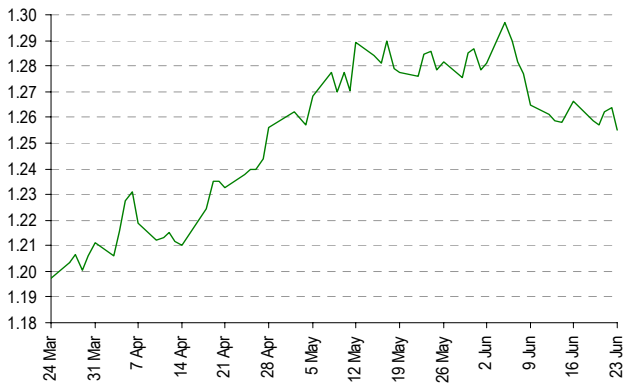
Yield curve



Further bonds weakening

- The continuation of the emerging markets sell-off contributed to further weakening of domestic bond market, which was fuelled by very good labour market and production data. The finance minister's dismissal was another factor, which effected in significant weakening of government papers and rise of FRA rates.
- At the next weak meeting, the Monetary Policy Council will most probably not change the interest rates. We assume as well that the FRA rates, which discount several rate hikes in next 12 months are overshot. We do not expect monetary policy tightening until the end of this year though our forecast of bond yields levels increased after the dismissal of finance minister Zyta Gilowska.

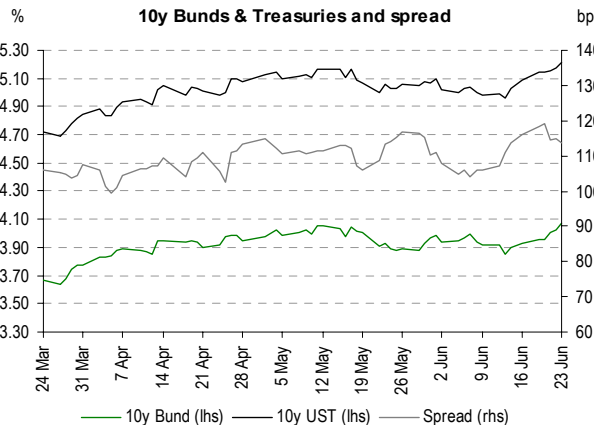
EURUSD rate



Another dollar's strengthening before Fed's decision

- At the beginning of the week the EURUSD fluctuated in a quite narrow range above 1.25, though the statement of the ECB president on high growth and low rates level in EMU slightly strengthened the euro. At the end of the week the dollar regained some strength again amid expectations of rate hikes in U.S. as well as with regards to the sell-off of the emerging markets currencies and flight to safety.
- We assume that after rate hikes in U.S., Fed is going to pause with further monetary policy tightening and rate hikes in the euro zone will work in favour of the single currency. Initially the EURUSD should stabilize to come back to rising trend in further periods. We expect the EURUSD rate to rise to 1.30 till the end of 2006.

10y Bunds & Treasuries and spread



Yields rise amid FOMC meeting next week

- Amid small number of economic data releases the volatility in the core debt markets was limited and U.S. bonds gradually weakened before the next week's Fed meeting, speculating on even 50 bp rise. Yields of 10-year Treasuries increased from 5.1% to 5.2% and Bunds from 3.92% to 4.05%.
- Next week the Fed's decision and especially the communiqué is going to be crucial for the core and emerging markets as well as the global investors moods. We still assume that Fed raises Fed Funds rate by 25 bp and pauses with further hikes till the years end, though the market partly discounts another rate hike in August. The market may be influenced by the housing market data, GDP in U.S. as well as money supply and preliminary inflation in the euro zone.

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