

# Weekly economic update

10 – 16 July 2006

Last week the Polish market remained under influence of global markets trends. While at the beginning of the week better sentiment towards emerging markets caused quite significant zloty appreciation (the level of 4.0 was temporarily broken), Wednesday's correction driven by American report, suggesting strong labour market data, sent the EURPLN rate to above 4.06. Employment increase in the U.S was, however, lower than expected and caused euro (and zloty) strengthening at the end of the week. Overall, the Polish currency was traded in the relatively narrow range and it seems that similar situation will take place this week. We expect the EURPLN rate to be traded in 3.98-4.08 range.

As regards the bond market, after a significant strengthening on Monday amid lower inflation forecast of the Ministry of Finance and improved sentiment in the region (influence of June's Fed communiqué as well as positive inflation surprise in Turkey), bearish mood in core markets on Wednesday sent the Polish yields higher as well.

This week the most important information will be the release of CPI inflation for June on Friday. If the forecast of the Ministry of Finance materialises (as it was the case in the last couple of months) this would be positive news for the yield curve, especially its short-end. Assuming CPI inflation would reach the level of 1.5% by year-end, it is hard to expect, in our opinion, interest rates hikes this year, which are currently priced-in by the market.

Remaining data this week (balance of payments for May and money supply for June) should be quite neutral for the market, although they will confirm fast economic growth – high trade balance turnover and higher activity on the credit market. As regards data abroad the most important seem to be Friday's figures in the U.S.

## Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
<b>MONDAY (10 July)</b>							
9:00	POL	Auction of PLN1.0bn 52-week T-bills (M)					
14:00	US	Wholesale inventories (H)	May	%	0.6	-	0.9
<b>WEDNESDAY (12 July)</b>							
9:00	POL	Auction of PLN0.5-2.0bn DS1015 10Y bonds (H)					
9:00	EMU	GDP revised (H)	Q1	%YoY	1.9	-	1.9
12:30	US	Trade balance (H)	May	\$ bn	-64.95	-	-63.43
<b>THURSDAY (13 July)</b>							
12:30	POL	Current account (M)	May	€ m	-343	-740	-154
12:30	POL	Trade balance (M)	May	€ m	-192	-550	62
12:30	US	Jobless claims (H)		'000		-	313
18:00	US	Fed budget (M)	Jun	\$ bn	21.65	-	22.92
<b>FRIDAY (14 July)</b>							
12:00	POL	CPI (H)	Jun	%YoY	0.9	1.0	0.9
12:00	POL	Money supply (M)	Jun	%YoY	11.3	11.7	10.1
12:30	US	Import prices (H)	Jun	%	0.3	-	1.6
12:30	US	Retail sales (H)	Jun	%MoM	0.4	-	0.1
13:45	US	Preliminary Michigan (H)	Jul	pts	84.0	-	-

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

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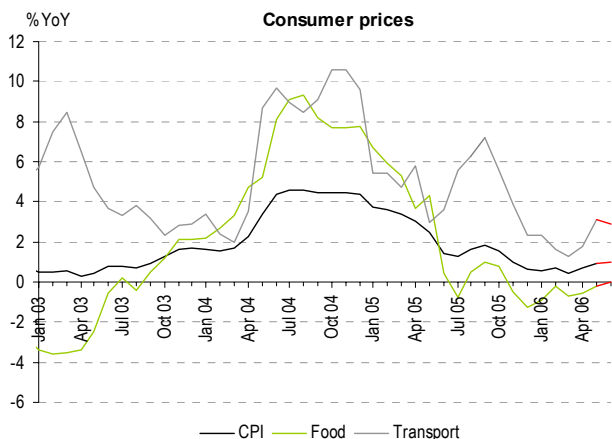
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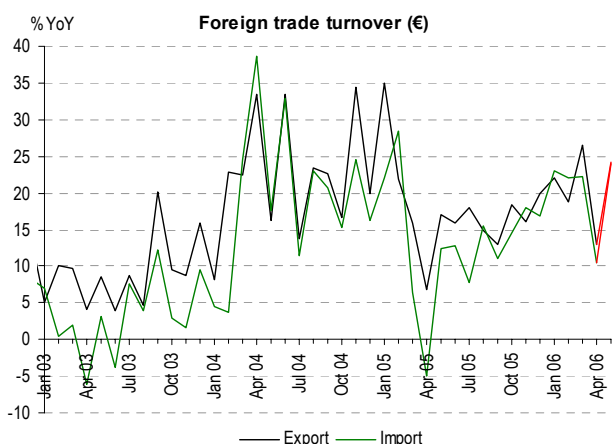
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## What's hot this week – Will the Ministry of Finance be right again?

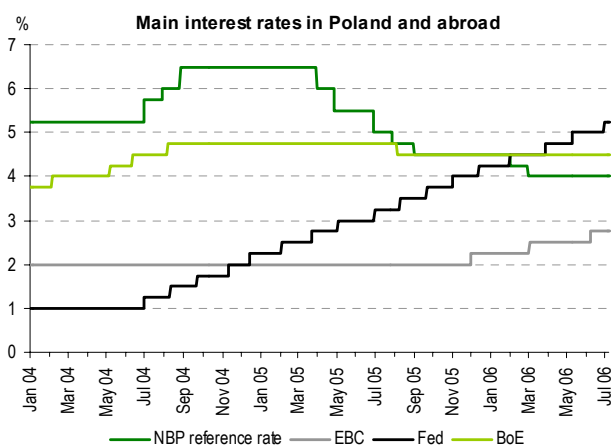


- The most important information this week will be Friday's release of CPI inflation for June. Also, money supply and balance of payments data will be published.
- Expectations as regards inflation were defined by the forecast of the Ministry of Finance (0.9% YoY). Our estimation is slightly higher, but it is worth to mention this was lowered after the ministry presented its assumptions, especially as regards food prices.
- Please recall that forecasts of the Ministry of Finance were accurate in the last couple of months and if the situation repeats also this time, this would be positive news for the yield curve, especially its short-end.
- Assuming CPI inflation would reach the level of 1.5% by year-end, it is hard to expect, in our opinion, interest rates hikes this year.



- Balance of payments data did not bring much attention of financial markets in the last couple of months, as there were no major changes in external balance trends.
- Current account deficit maintains at the very low level (below 2% of GDP), especially if we take into account strong acceleration in domestic demand. On the other hand, Polish exports still continues to rise robustly.
- In our opinion, such situation was also maintained in May. Though trade and current account deficits were higher than monthly average year-to-date, the similar situation was observed last year.
- We expect two-digit growth in both exports and imports (actually, of even above 20%YoY).
- Monetary statistics should show a continuation of acceleration in deposits and credits.

## Economy last week – ECB rates unchanged, weaker U.S. labour market



- Bank of England and European Central Bank maintained official rates unchanged at 4.5% and 2.75%.
- In the communiqué the ECB emphasised the interest rates are still low, inflation expectations are contained, while the ECB is going to "exercise strong vigilance so as to ensure risks to price stability over the medium term do not materialise". This strengthened expectations that the ECB will raise rates at the next meeting scheduled for 3<sup>rd</sup> August.
- Data from the U.S labour market were below market expectations (revised recently after the ADP National Employment Report) as non-farm payrolls rose by 121,000 as compared to market consensus of 185,000.
- The unemployment rate amounted to 4.6% in June, which was the same level as recorded in May.

## Quote of the week – No risk of inflation explosion

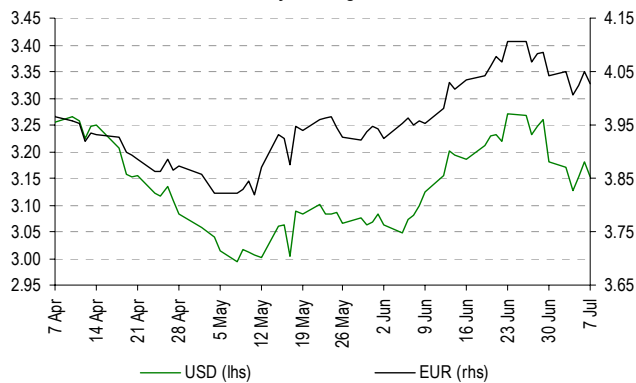
**Krzysztof Rybiński, NBP deputy governor; PAP, 6 July**

*Inflation path for 2006 should be consistent with inflation projection, although firmer labour market conditions pose some risk to medium-term inflation prospects. The latest LFS survey for 1Q06 showed both rising employment and falling labour activity, which may be dangerous for inflation if next quarters do not show that accelerating employment rise is at least to some extent offset by an increase in labour activity. Even if negative tendencies are maintained, one should not be afraid of "inflation explosion".*

It is quite clear that even if NBP representatives are aware of threats to inflation, there is no fear of "inflation explosion". Rybiński emphasised there were many question marks regarding inflation prospects, such as the zloty exchange rate, crops and regulatory changes. Rybiński's comments shows he is quite confident about medium-term inflation outlook and do not suggest a possibility of significant worsening of NBP inflation projections. In our view, inflation will gradually increase in 2006-07, but risk that it could permanently exceed the target is limited.

## Market monitor

Zloty exchange rate

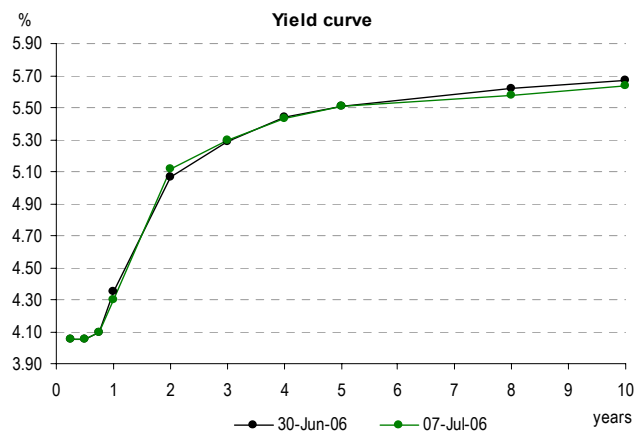


## EURPLN slightly above 4,0 level

At the beginning of the week zloty gradually strengthened against the euro and the dollar together with other emerging market currencies among others after lower than expected inflation in Turkey. Good U.S. data during the week and missile tests in Korea resulted in a correction in the markets of emerging markets, however at the end of the week the investors moods improved again. The EURPLN rate fell since last Friday by ca. 1%, while the USDPLN by 2%.

While the zloty may slightly appreciate awaiting low CPI inflation figure and with buying of Polish government bonds, data from U.S. are still going to be important for the market and the sentiment toward the emerging economies. In our view the EURPLN and the USDPLN rates may fluctuate in ranges 3.98-4.08 and 3.08-3.18.

Yield curve

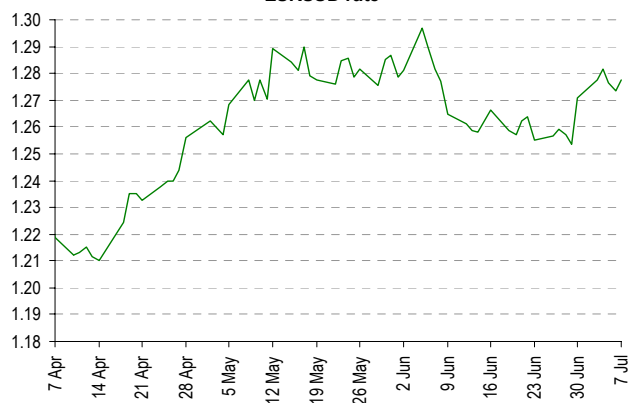


## Debt prices almost unchanged

The fixed income was strengthening in the first part of the week, similarly to the FX market. However, later on a correction occurred after the rise in core markets' yields, negative influence of the situation in Korea and finance minister's comments, that the central bank in the conduct of its monetary policy should follow the international trend of rising interest rates and about willingness to postpone the term of the lowering the budget deficit beyond 2007.

In the coming week essential economic data are going to be released, while the debt market may strengthen ahead of the release of CPI inflation due on Friday. The core markets will also have some influence on the Polish market, as the data published abroad may slightly improve sentiment toward the region.

EURUSD rate

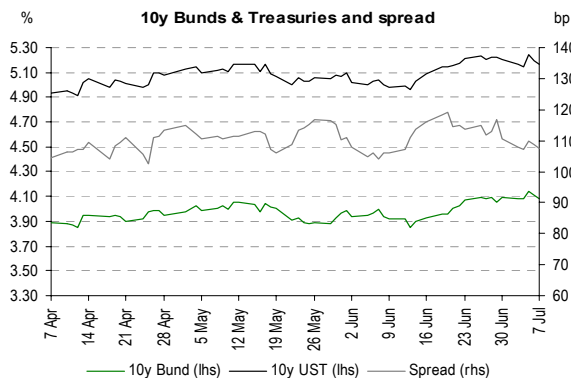


## Euro stronger after ECB and non-farm payrolls in US

At the beginning of the week the EURUSD rate fluctuated at quite stable level with regards to limited activity with Independence Day in United States. Better than expected data in US during the week contributed to the dollar's strengthening slightly above 1.27, though after the ECB's communiqué and non-farm payrolls in US the euro regained some strength.

Next week data released in United States will be the most important for the relation of euro against the greenback, indicating the risks for growth and the inflation (import prices). Slightly less important may be the U.S. trade deficit. In our opinion with reference to the slowing economy reflected in the released data the dollar may still weaken against the single currency to 1.30 by year-end.

10y Bunds &amp; Treasuries and spread



## Situation quite stable in the core markets

The data released in US in the first part of the week contributed to Treasuries strengthening, while Bunds gained despite stronger PMI activity indices. Low ISM and non-farm payrolls effected in rise of U.S. bonds prices. German papers strengthened after ECB's communiqué. During the week yields of US government bonds slightly fell from 5.20% to 5.19%, and Bunds from 4.09 to 4.08%

Amid ECB's communiqué in our view the central bank is going to raise the interest rates to 3.0% at the end of Q3 and to 3.5 at the end of Q4. Next week the market will focus on the US data, though it seems they are not going to be decisive as far as further rate policy is concerned, thus core markets may slightly stabilise near current levels.

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