

# Weekly economic update

24 – 30 July 2006

Good labour market statistics and better than expected output figures for June supported our expectations of high GDP growth in 2Q06 (we assume it reached at least 5.2% posted in 1Q06). PPI data confirmed we face a period of gradual, but rather limited acceleration in inflation. An opinion about favourable inflation prospects was expressed by MPC's Andrzej Sławiński, whose view often determines decision of the rate-setting panel. However, the key event for the markets last week was – resulting in the market strengthening expected by us, despite stronger than we predicted output figures – testimony of Fed Chairman Ben Bernanke. A tone of his speech supported hopes for a pause in monetary tightening in the US. As a result, more risky assets, such as equities and emerging market currencies and bonds, has recovered. The EURPLN dropped clearly below 4.0 and domestic bond yields notably declined as well.

In the nearest week we get another portion of June data (retail sales and core inflation), but more important for the market will be the new inflation projection of the NBP and tone of statement after MPC meeting. Comments from rate setters suggests that the new inflation will worsen to some extent, but this will not change the opinion dominating in the Council that there is no need for rate hike at least until the end of this year. Data from the US will also be important for moods on the Polish market.

## Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD	FORECAST		LAST VALUE
				MARKET	BZWBK	
<b>MONDAY (24 July)</b>						
9:00	POL	Auction of PLN1.0bn 52-week T-bills				
	POL	Business climate (M)	Jul			
12:00	POL	Core inflation (M)	Jun	%YoY	1.0	1.0
<b>TUESDAY (25 July)</b>						
8:00	POL	Retail sales (M)	Jun	%YoY	11.6	9.2
8:00	POL	Unemployment (M)	Jun	%	16.0	16.0
	POL	MPC meeting (M)				
14:00	USA	Consumer confidence (H)	Jul		104.7	-
14:00	USA	Home sales (H)	Jun	m	6.6	-
<b>WEDNESDAY (26 July)</b>						
	POL	MPC meeting – decision (M)	Jul		4.0	4.0
8:00	GER	IFO index (H)	Jul		106.0	-
<b>THURSDAY (27 July)</b>						
9:00	POL	Switch tender				
12:30	USA	Durable goods orders (H)	Jun	%	1.1	-
14:00	USA	New homes sales (H)	Jun	m	1.19	-
<b>FRIDAY (28 July)</b>						
8:00	EMU	M3 money supply (H)	Jun	%YoY	8.7	-
12:30	USA	Core PCE (H)	Q2	%	-	-
12:30	USA	Preliminary GDP (H)	Q2	%	3.0	-
12:30	USA	Preliminary GDP deflator (H)	Q2	%	3.4	-
13:45	USA	Final Michigan (H)	Jul		83.0	-

\* Importance level: (H)igh, (M)oderate; Source: Reuters, BZ WBK

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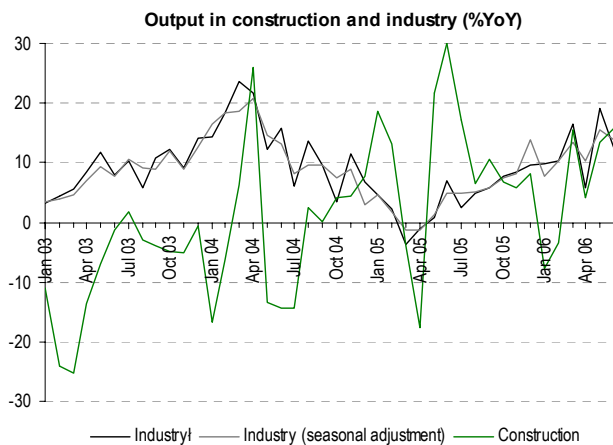
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## What's hot this week – What will the new inflation projection show?

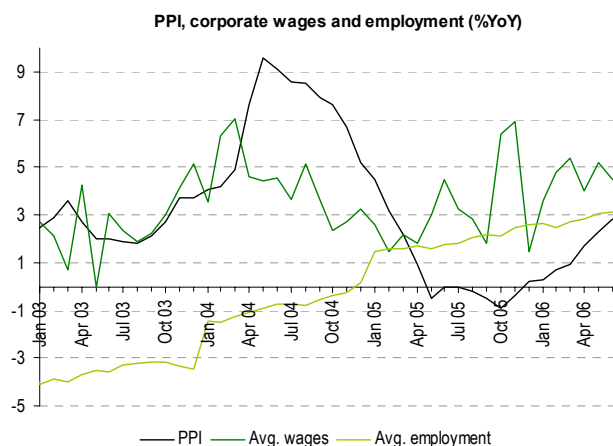


- The data due for release in the nearest week should confirm that the Polish economy expands at fast pace (high retail sales) with continuously constrained inflationary pressure (stable and low core inflation).
- However, the most important event for the Polish financial market next week will be a publication of the new *Inflation Report*, including the new inflation projection of the central bank.
- A few MPC members suggested that the new projection will show faster return of inflation to the target. The previous projection indicated that return will take place in early 2008 and the new one is expected to show the return will take place in around 3Q07. The important thing is, however, whether the new projection will show significant risk of inflation running above the target in subsequent periods. Only this could trigger serious talks of swift rate hikes.

## Economy last week – Polish economy in excellent shape



- Although June's data on industrial output (12.4%YoY rise) suggests slower pace of economic expansion (given 19.1%YoY output surge in May), one should remember that May figures were positively affected by higher number of working days (in annual terms) while in June the effect was adverse. In the light of this, June figures are as impressive as almost 20%YoY jump in May.
- Positive signal was also visible in the construction where output rose by 15.7%YoY, the strongest this year.
- All in all, output figures confirmed our estimates indicating GDP growth in 2Q06 reached at least 5.2% posted in 1Q06.
- PPI inflation accelerated to 2.8%YoY in June. However, it is hard to judge whether this is permanent tendency and whether PPI may filter through into CPI stronger than to date.



- Data on average wage and employment growth exactly matched market expectations, indicating 4.5%YoY and 3.1%YoY growth, respectively.
- Wage growth in June decelerated as compared to May, but average growth in 2Q06 was exactly the same as in 1Q (4.6%YoY). As average employment growth in 2Q06 accelerated to 3.0%YoY from 2.6%YoY in 1Q06, there was also an acceleration in growth of total wage bill, although only marginal real terms amid rising inflation.
- All in all, the data suggested that firming of labour market conditions is a permanent trend and it gradually gains strength. This supports our assumptions that private consumption will be an important driver of fast GDP growth this year. At the same time, however, wage growth does not seem excessive given our estimates showing robust rise in labour productivity.

## Quote of the week – MPC is in comfortable situation

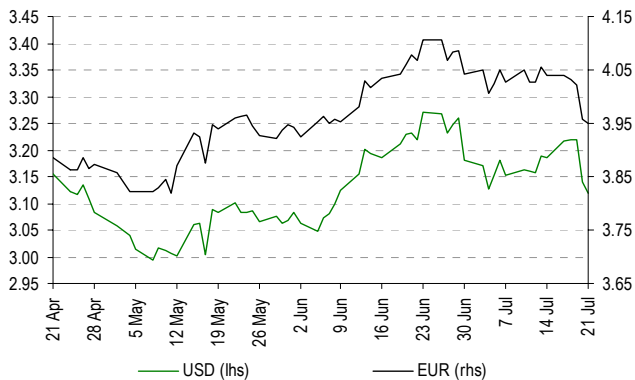
**Andrzej Sławiński, MPC member; PAP, 18 July**

*The Polish central bank has comfort in monetary policy due to low inflation and continuously high level of real interest rates. (...) All factors should cause that inflation will rise, because we have economic expansion, but this will happen gradually. Inflation will gradually return to the target, and the way to the target is quite distant. (...) I think that all the changes will balance and food prices growth this year will be similar to multi-year average. (...) With increasingly open economy, enterprises are afraid of price competition and this affects their wage policy.*

Professor Andrzej Sławiński, regarded by the market as a moderate and influential member of the MPC (his view is usually consistent with a view of majority rate-setters), suggested he is not particularly concerned about medium-term inflation prospects. His statements seem to confirm our view it is too early to talk about rate hikes in Poland. There are many factors suggesting that medium-term inflation prospects are still favourable and we still do not see a need for a monetary tightening in the coming 12-months.

## Market monitor

Zloty exchange rate

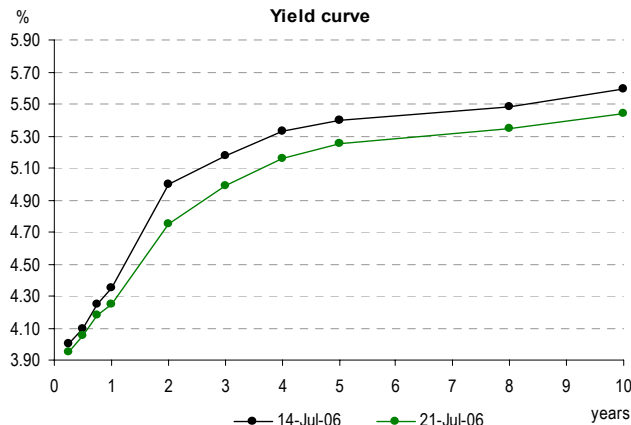


## Bernanke increased the appetite for risk

At the start of the previous week the Middle-East conflict negatively affected the emerging market currencies. However they recovered as the appetite for risk increased due to the Wednesday's testimony of Fed's Ben Bernanke, which appeared less hawkish than expected. During the week the zloty gained ca. 1.7% against the euro and ca. 2.2% versus the dollar.

Zloty is going to be under the influence of the foreign, especially US data at least until next Fed's meeting early in August, as they may significantly change the moods toward the emerging markets' assets. We assume, that in the nearest time the zloty will rather move back above the 4.0 level and may fluctuate in range 3.92-4.02 against the euro (with support level at 3.94 and 3.92), while 3.08-3.18 vs. dollar.

Yield curve

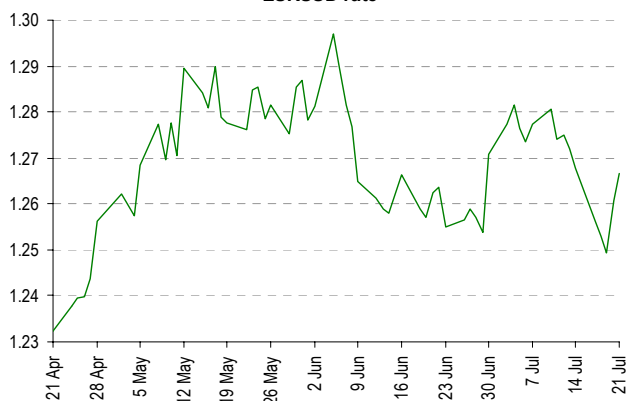


## MPC members and Bernanke strengthen bonds

In the first day of the week after interviews with Andrzej Sławiński and comments of Marian Noga from the MPC suggesting no need for rate hikes this year the fixed income market strengthened moderately. Government papers' yields slumped substantially after Ben Bernanke's statements, which contributed to strengthening in the core and emerging markets.

The comments of the MPC members support our view on next monetary policy decisions. In our opinion, the MPC will leave rates unchanged at least until the end of year. Next week the MPC's communiqué, inflation projection as well as retails sales and core inflation are going to be key factors for the debt market. Core market may still heavily weigh on the emerging markets sentiment.

EURUSD rate

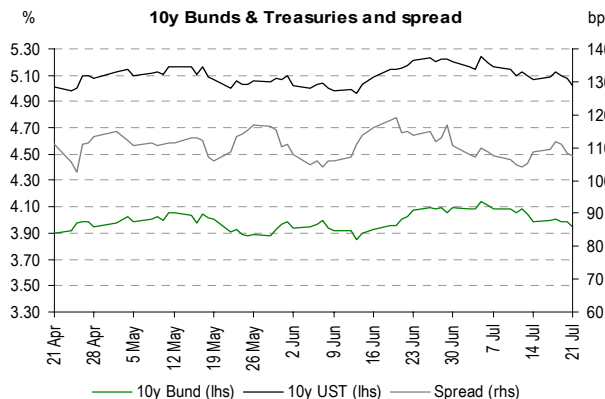


## Bernanke offsets the Middle-East turmoil effect

In the first part of the week the dollar was gaining against the euro (to below 1.25) despite mixed US data, while the main reason was the inflaming conflict between Israel and Lebanon. However later on after Bernanke's speech expectations towards further rate hikes in US diminished and the dollar significantly depreciated versus the euro to over 1.26.

The EURUSD rate is still going to feature quite high volatility with regards to release of economic data influencing the expectations on further rate hikes by Fed. Ifo index and M3 money supply figures are going to be the most important for the euro, whereas the US GDP for the second quarter as well as the slowing housing market figures may be crucial for the greenback.

10y Bunds &amp; Treasuries and spread



## ... and strengthens core markets

The US bonds weakened after the production and PPI data, though afterwards significant strengthening came in after statements of the Fed's chairman confirmed by the tone of FOMC minutes. In effect since previous Friday 10Y Treasuries yields fell from 5.07% to 5.02%. The volatility of Bunds prices was much lower, and 10Y yields fell from 3.99% to 3.95%.

Next week the most important for the core markets are going to be data from US economy on the housing market as well as Q2 GDP, with crucial for Fed PCE index. Consumer confidence and final Michigan are going to be also important. In the euro zone the most essential will be Ifo (after low ZEW last week) M3 money supply that may influence on the August rate hike expectations in the EMU.

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