Bank Zachodni WBK

Weekly economic update

13 – 19 November 2006

After a two weeks break in data releases, this week will bring much new information from the economy. The most important will be the inflation data. Market consensus shows that the CPI growth decelerated to 1.3%, that is slightly above FinMin forecast of 1.2%. Thus, if the latter forecast appears real, it can have a positive impact on the fixed income market. Similarly, wage growth is forecasted to decelerate, what can calm fears about uncontrolled labour cost growth in companies. Money supply data should be neutral for the market, though positive for growth perspectives, confirming solid credit revival. On the other had, balance of payments data for September is likely to confirm strong, around 20%YoY, import and export growths, alongside still relatively low current account deficit at €300m (about 2.1% of the 12m GDP).

This week can also be interesting taking into account events in politics. Beside local elections results, one cannot exclude that we will get to know the official candidature for NBP chairman position, that the President promised to reveal after the elections. The most frequently mentioned is professor Urszula Grzelońska, who should be welcomed rather neutrally by the market , though we shouldn't exclude other nominations.

Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD	UNIT	FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (13 November)					
19:00	USA	Federal budget (U)	Oct	€ bn	-45,0	-	-47,45
		TUESDAY (14 November)					
13:00	**POL**	**Trade balance (U)**	**Sep**	**€ m**	**-266**	**-150**	**-453**
13:00	**POL**	**Current account (U)**	**Sep**	**€ m**	**-309**	**-300**	**-610**
13:00	**POL**	**Money supply (U)**	**Oct**	**%YoY**	**12,1**	**12,6**	**13,0**
13:00	EMU	Preliminary GDP (U)	Q3	%	2,7	-	2,7
13:30	USA	PPI (H)	Oct	%MoM	-0,4	-	-1,3
13:30	USA	Retail sales (H)	Oct	%MoM	-0,2	-	-0,4
		WEDNESDAY (15 November)					
11:00	**POL**	**Auction of PLN1.5-2.5bn of 5Y PS0511 bonds (H)**	**Oct**				
13:00	**POL**	**CPI (H)**	**Oct**	**%YoY**	**1,3**	**1,2**	**1,6**
10:00	EMU	Industrial production (H)	Sep	%YoY	4,5	-	5,4
		THURSDAY (16 November)					
13:00	**POL**	**Wages (H)**	**Oct**	**%YoY**	**4,6**	**4,9**	**5,1**
13:00	**POL**	**Employment (H)**	**Oct**	**%YoY**	**3,6**	**3,5**	**3,5**
6:00	JP	BOJ meeting – decision report (M)	Nov				
10:00	EMU	Final HICP (H)	Oct	% YoY	1,6	-	1,7
13:30	USA	CPI (H)	Oct	%MoM	-0,2	-	-0,5
14:00	USA	Capital net flows (H)	Sep	$ bn	72,5	-	116,8
14:15	USA	Capacity use (H)	Oct	%	82,0	-	81,9
14:15	USA	Industrial production (H)	Oct	%MoM	0,3	-	-0,6
		FRIDAY (17 November)					
13:30	USA	Build permits (H)	Oct	m	1.61	-	1.638
13:30	USA	House starts (H)	Oct	m	1.7	-	1.772

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

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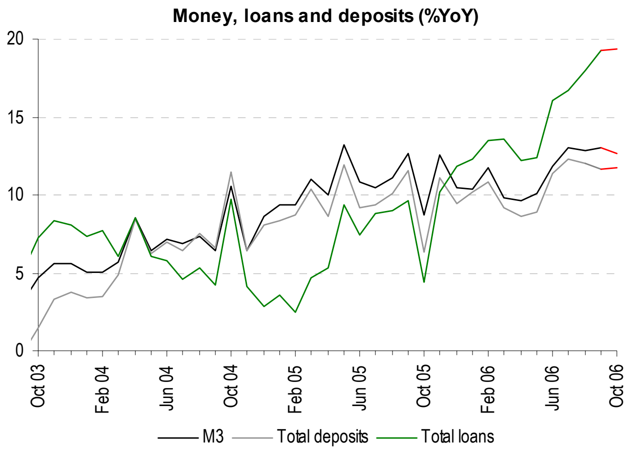
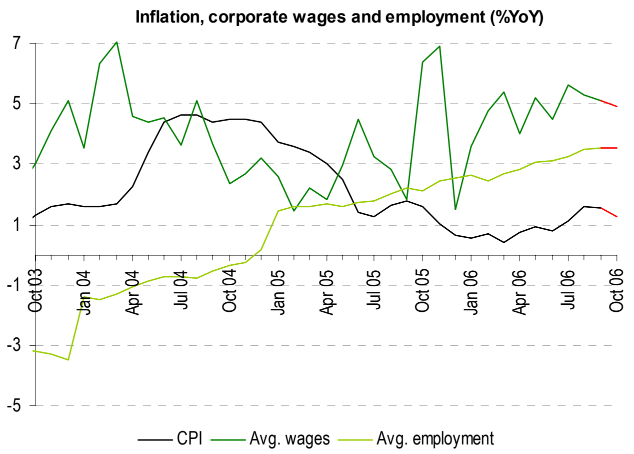
What's hot this week – Busy week after lengthy pause



- After a two weeks break in macroeconomic data publication, we will get to know a large portion of important statistics in the coming days.
- Balance of payments data for September should confirm strong, around 20 percent, import and export growths, alongside still relatively low current account deficit at €300 mln (about 2.1% of the 12m GDP).
- Money supply growth in October also surely remained high (12.6%YoY), due in large scale to ongoing expansion on the credit market.
- The most important data will the CPI growth to be published on Wednesday. Finance Ministry's forecast did not completely convince analyst who forecast inflation fall to 1.3% from 1.6% in September. The realization of our forecast at 1.2% could cool market's rate hike fear.



- Labour market data will be as important as inflation figures for the monetary policy. We are awaiting the upkeep of fast employment growth at 3.5% and light deceleration in wage growth to 4.9% YoY, which, similarly to CPI fall could have a positive impact on the debt market.
- This week can be also interesting in respect of other events. Apart the fact we will get to know the local elections results (that should have no impact on the market), it is possible that we will finally get to know the name of the candidate for the NBP chairman position. The most frequently mentioned is professor Urszula Grzelońska, who should be welcomed neutrally by the market, though we shouldn't exclude other nominations, especially that the latest professor's statements were not in line with the thesis that the new NBP chief has to represent another school of economic thought than Mr Balcerowicz.

Economy last week – European Commission disappointed with Poland's budget

European Commission's forecasts

	2005	2006	2007	2008
	General government balance (% of GDP)			
Excluding pension reform costs	-2.5	-2.2	-2.0	-1.8
Pension reform costs	1.9	2.0	2.0	2.1
Including pension reform costs	-4.4	-4.2	-4.0	-3.9
	Public debt (% of GDP)			
Excluding pension reform costs	42.0	42.4	43.1	42.7
Pension reform costs	5.3	6.9	8.0	8.9
Including pension reform costs	47.3	49.3	51.1	51.6
	Macroeconomic forecasts (%)			
GDP growth	3.2	5.2	4.7	4.8
HICP inflation	2.2	1.4	2.5	2.8
Unemployment rate	17.7	13.9	12.2	11.6

Source: Autumn 2006 Economic Forecasts, European Commission

- The latest forecasts of the European Commission predict Poland's fiscal deficit to fall to 1.8% of GDP in 2008 from 2.2% this year. But under EU rules, the Polish government will no longer be allowed to exclude the cost of pension reform from the country's deficit since April next year, adding about 2.0 percentage points to the gap.
- Thus, the Commission is likely to criticise Poland in its report next week for insufficient efforts to curb fiscal imbalances, calling for more decisive action. Fortunately, it is unlikely that Poland would face financial consequences of EU's critique in a form of freezing a part of the regional development aid in the near term.
- According to the labour ministry, unemployment rate dropped to 14.9% in October, confirming strong revival on the labour market and good prospects for private consumption.

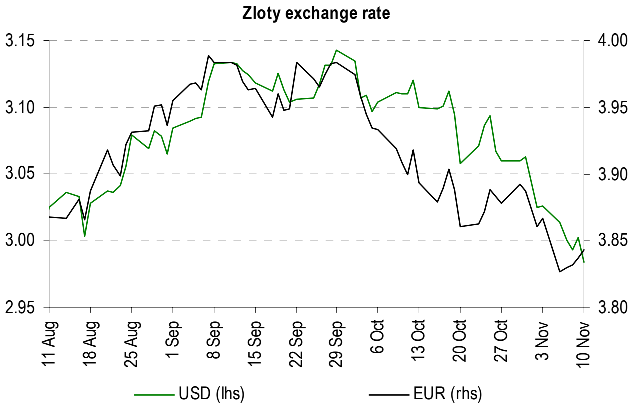
Quote of the week – What could persuade MPC to raise rates?

Marian Noga; MPC member, Reuters, 8 November

In my opinion, the Monetary Policy Council should raise interest rates in two 25 basis-point steps in the first quarter of next year to prevent an overshoot of the inflation target. What could persuade the majority to change monetary policy would be data available in mid-January that would show third quarter economic growth of 5.5-5.6 percent, a rise in inflation to 2.0 percent in December and a marked drop in unemployment and labour productivity. I believe that someone who assumes rates will rise next year by 75 or even 100 basis points is very wrong.

Noga's comments do suggest that he was among those who voted in favour of 25 bp rate hike in October. One cannot rule out that if the new data point to different course of economic situation in future, this will change dominating opinions within the MPC. However, taking into account our medium-term forecasts of inflation we believe that majority of MPC members will not go for a rate hike. Still, even if small rate hike in 2007 takes place, it will not be the start of tightening cycle, but rather a fine-tuning move.

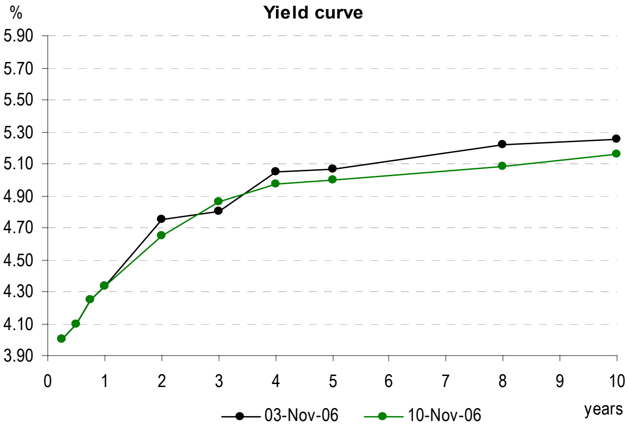
Market monitor



Zloty in narrow ranges at strong levels

▪ After US labour market data released in the previous week and growing expectations on "soft landing" of American economy, sentiment towards emerging markets considerably improved. In the last week, zloty remained at quite strong levels and fluctuated in a 3.815-3.845 range. During the week, the EURPLN rate fell by 1.5% and USDPLN by 0.4%.

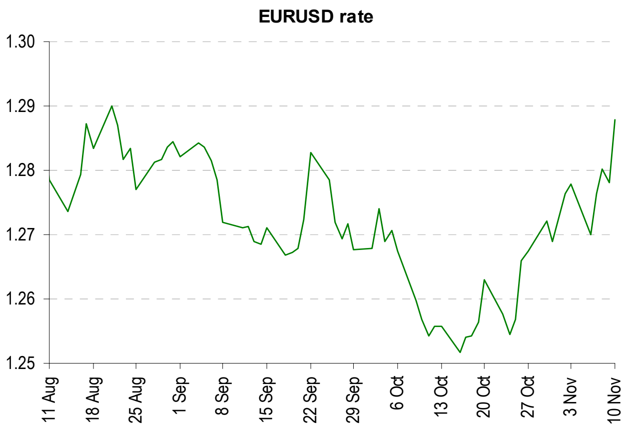
▪ Linked to the mood improvement in the region, amid further good figures from Poland and the US, zloty can strengthen further. We believe that zloty can test the 3.8 level in a short time and in the next week it should trade in range of 3.8-3.9 against the euro and 2.95-3.05 against the greenback.



Further yields falls

▪ Last week lacked any releases of important data in Poland as much as abroad. After lowering of inflation forecast by the Ministry of Finance, Polish debt strengthened further amid falling yields on the core markets and growing foreign investors demand on emerging markets assets. Polish bonds yields fell by approximately 10bp.

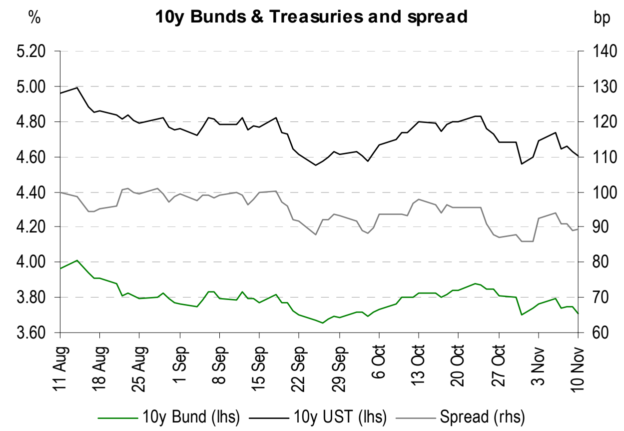
▪ In the coming week, inflation data can strengthen debt, if it is in line with our forecast and the forecast of the Ministry of Finance. Influence of the moves on the international markets will be also of key importance, especially, with regards to the publication of the CPI and PPI inflation indicators in the United States.



Dollar weakening

▪ After the EURUSD rate came back below the 1.27 level after data of the US labour market the dollar kept weakening against the euro last week, among other things in face of the Congress elections in the US. The American currency weakened against the euro to above 1.28 and at the end of the week the exchanged rate got close to 1.288 after information about possible diversification of the currency reserves in China.

▪ Macro data indicating the scale of the US economy slowdown, including among other things industrial output figures and real estate market statistics, will be key for the dollar. Inflation data will also be crucial, especially core PPI and CPI indicators. A light correction can occur on the EURUSD rate in the short run, however we expect further rise in the medium term.



Strengthening in the core markets

▪ After the weakening in the core markets with regards to the non-farm payrolls data in U.S. released in the previous Friday yields declined, despite the elections to the US Congress. Slight weakening occurred after narrower than expected trade deficit and better than expected labour market data, however later there were some another rise in prices. Yields of 10Y Treasuries and Bunds fell to 4.6% and 3.72%.

▪ In the next few days US inflation, housing market and industrial production data are going to be key factors for the core markets. With expectations of rate cuts in US by at least 75 pb in 2007 we assume, that yields in the core markets may still fall during the next couple of months.

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