Bank Zachodni WBK

Weekly economic update

20 – 26 November 2006

The set of macroeconomic data released last week validated our point of view on monetary policy prospects, according to which there was no need to hurry with interest rate hikes amid lack of deeply-rooted pressure on prices. While inflation drop to 1.2% in October was temporary and in the next month one should expect to see a gradual rise again, the lower starting point means that the risk of CPI breaking the target significantly in 1Q07 is not excessive. Wage growth that decelerated below 5%YoY in October also does not seem to be very dangerous for the inflation perspectives, although when coupled with record-high employment growth it warrants continuation of very rapid private consumption expansion. At the same time, a number of information (e.g. rapid growth of foreign trade turnover, credit boom) confirms that the last months of the year will see equally fast economic growth than H1.

The data due for release this week should deliver confirmation of very fast GDP growth in the last quarter of the year. According to our forecast industrial output growth accelerated to 17%YoY, which is the second best result this year and the most optimistic forecast on the market (consensus forecast is at 13.6%). It is also much above 11.7%YoY seen in September, however in our opinion such result reflects continuation of upward trend that was established in previous months. Even better result (output growth above 20%YoY) should be reported in construction sector. Retail sales growth should also remain fairly strong, signalling solid consumption demand at the start of fourth quarter. Such optimistic picture of economic situation will be supplemented by unemployment data showing a decline in October below 15% for the first time in almost six years. Despite very strong signals of fast economic expansion, the data should not re-invoke worries about excessive inflation growth, because core inflation measures as well as PPI index are very likely to slow down in October, signalling lack of strong price pressures.

Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD	UNIT	FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (20 November)					
10:00	**POL**	**Auction of PLN800m of 52 –week T-bills (M)**					
13:00	**POL**	**Industrial output (H)**	**Oct**	**%YoY**	**13.6**	**17.0**	**11.7**
13:00	**POL**	**PPI (H)**	**Oct**	**%YoY**	**3.4**	**3.5**	**3.6**
		WEDNESDAY (22 November)					
10:00	**POL**	**Switch auction (M)**					
15:00	US	Final Michigan (H)	Nov		**93.5**	**-**	**93.6**
		THURSDAY (23 November)					
13:00	**POL**	**Business climate (M)**	**Oct**				
13:00	**POL**	**Core inflation (H)**	**Nov**	**%YoY**	**1.3**	**1.3**	**1.4**
9:00	GER	Ifo index (H)	Nov		105.2	-	105.3
9:00	EMU	Current account (M)	Sep	**€ bn**	-3.5	-	-6.9
		FRIDAY (24 November)					
9:00	**POL**	**Retail sales (H)**	**Oct**	**%YoY**	**14.8**	**13.1**	**14.5**
9:00	**POL**	**Unemployment (H)**	**Oct**	**%**	**14.9**	**14.9**	**15.2**

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

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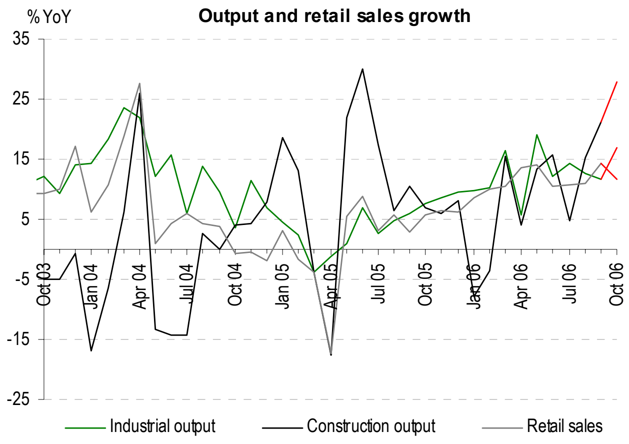
What's hot this week – Last set of data ahead of MPC meeting



▪ Economic data due this week should confirm the strength of economic growth at the end of this year.

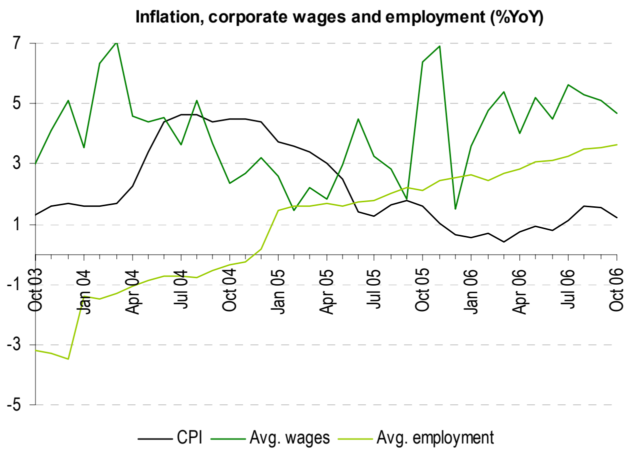
▪ We expect to see 17%YoY industrial output growth, which is the most optimistic forecast on the market (median at 13.6%), however given positive difference in working days such result seems to be a continuation of trend seen in previous months. Construction is expected to post even higher rate of production growth.

▪ In case of retail sales, market consensus is higher than our forecast, but both results imply solid consumption rise.

▪ Despite strong activity data, inflation worries should not be reinforced, as both PPI and core inflation will show lack of fundamental pressure on prices.

▪ Unemployment rate should maintain downward trend, falling to 14.9% in October.

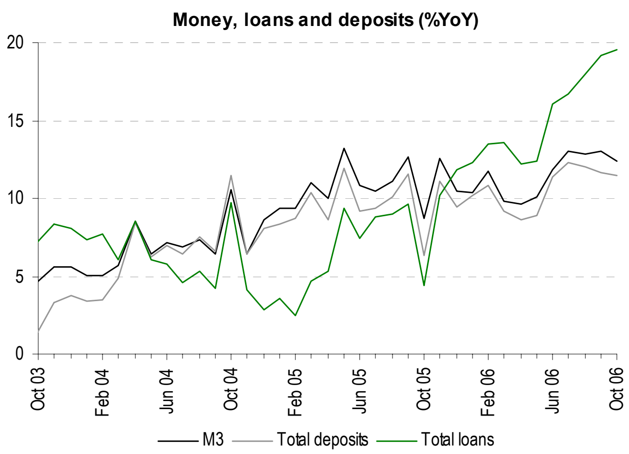
Economy last week – Strong pressure on inflation still not visible



▪ Inflation fell in October from 1.6% to 1.2%, in line with FinMin and our forecasts. Even though it is a temporary drop and CPI will be rising in next months, lower starting point for the growth implies that a risk of breaching 2.5% target in 1Q07 has decreased.

▪ Wage growth decelerated to 4.7% in October from 5.1% in September. At the same time, employment growth accelerated to record-high 3.6%YoY. Wage bill in corporate sector increased 8.5%YoY in nominal terms and 7.2% in real terms. It shows that pay rise remains solid, but it does not get out of control and still does not outpace significantly productivity gains.

▪ Both publications validated our view that there is no need to hurry with interest rate hikes in the nearest months.



▪ Budget deficit after 10 months of the year reached only 54.4% of annual plan. Even though the realisation of the deficit will advance in the next two months, at the end of the year the gap should be over PLN2bn below plan.

▪ Balance of payments data surprised with €195m current account surplus thanks to record-high EU transfers. Export rose 17.3%YoY, and imports 19.1%, while the trade balance was in €300m deficit. The results of foreign trade for Q3 show that contribution of net exports to GDP in this period was moderately negative.

▪ Money supply growth decelerated slightly, but loan growth advanced further in October. Apart from fast rise in households credit (30%YoY), also loans for enterprises accelerated and reached double-digit growth (10.3%YoY) for the first time since early 2001.

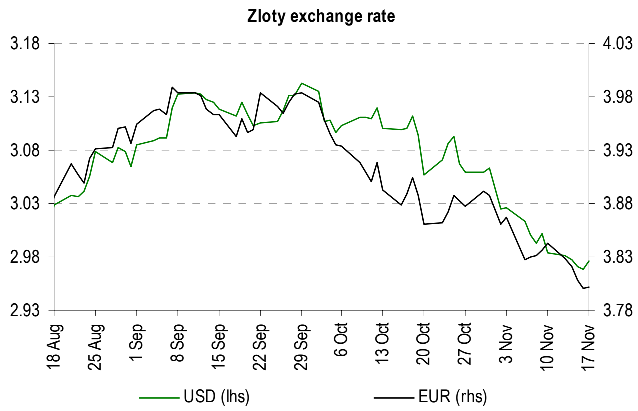
Quote of the week – Majority of MPC members still against rate hikes

Stanisław Owsiak; MPC member, Reuters, 16 November

In the coming several quarters there is no need to tighten monetary policy. Inflation is still low. The council, whether hawks or doves, cares about low, stable inflation but restrictive monetary policy cannot (be allowed to) harm the country's development particularly when no inflation threats are visible. Why shouldn't the economy grow at 7-8 percent with inflation near the target or within the range as with some of our neighbours?

Stanisław Owsiak's comments confirm our view that current economic situation does not call for monetary tightening. Although the MPC members from the hawks' caucus, e.g. Marian Noga and Halina Wasilewska-Trenkner, keep saying that a rate hike should be implemented right now, but such opinion is not shared by the majority of Council members, as in their opinion – which was confirmed by Owsiak – the inflation projection presented in the last NBP report was too pessimistic.

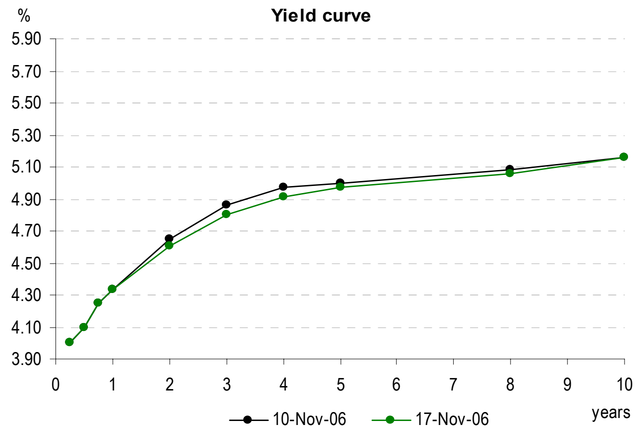
Market monitor



Zloty below 3.8, the strongest since March

▪ In the last week the sentiment toward the emerging markets remained positive amid US data. Further forint appreciation and record strong Slovak crown against the euro as well as goods data from the Polish economy contributed to zloty's strengthening below 3.8 against the single currency and below 2.96 versus the dollar. Since the last Friday the EURPLN fell by 0.7%, and USDPLN hardly changed.

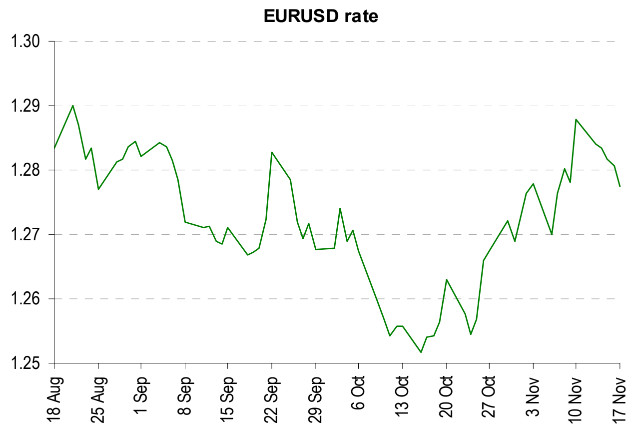
▪ At present there seems to be no reason for the FX market to feature a significant correction. Economic data and moods in the emerging markets and especially in the region may further support the zloty. 3.75 is going to be the next support level for the EURPLN rate. Next week EURPLN should fluctuate in range of 3.75-3.85, and USDPLN of 2.93-3.03.



Strengthening continued

▪ On Monday the Polish debt market was under negative influence of Urszula Grzelońska's comments on euro adoption and a correction in the core markets. However later on yields of Polish government papers continued the downward trend after CPI data, the strengthening in USA as well as some MPC members' comments. At the end of the week there was a slight correction, which followed the core markets.

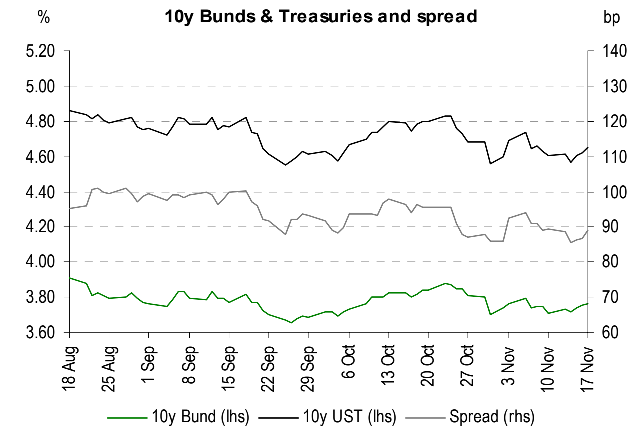
▪ In the nearest couple of days the moods in the bonds market will be influenced most of all by the domestic data. In our view on Monday there may be a correction after strong production figure, while the retail sales data may be also of high importance. It seems that the potential for further drop of yields substantially narrowed.



EURUSD correction

▪ After a significant rise of the EURUSD rate to almost 1.29 on the news on possible diversification of the Chinese currency reserves there was a correction. The dollar strengthening was continued after the release of New York activity index and FOMC minutes. Another correction followed the soft CPI, though the TIC's data and Fed's Micheal Moskow comments supported the US currency, which appreciated in the course of the week by 0.4%.

▪ This week the calendar of data publication is rather light. The Ifo index reflecting the business sentiment of German enterprises will be the most important for the relation of euro against the dollar, especially with regards to the very weak ZEW index. The US final Michigan index will be also important as it will show the sentiment of US consumers.



Slight weakening in the core markets

▪ Inflation data (PPI) from US contributed to significant strengthening in the US market. This was opposed by quite positive tone of the New York Fed index, which together with Fed's member Michael Moskow comments resulted in a weakening, despite lower than expected CPI. Philly Fed index also negatively influenced US bonds. Yields of 10Y Treasuries rose from 4.6% to 4.65% and Bunds to 3.76% from 3.72%.

▪ Weaker than expected Ifo index may support the euro zone bonds, while the Michigan index is going to be the most important for US bonds. Recent data weakened market expectations for early rate cuts in US. In our view, monetary policy easing may commence in the Q2 2007, when the slowdown in the housing market will influence other sectors of the economy.

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