Bank Zachodni WBK

Weekly economic update

4 - 10 December 2006

GDP figures surprised again, showing 5.8% growth in Q3, boosted by strong private consumption demand (5.5%YoY) and almost 20%YoY upsurge in fixed investment with a moderate negative impact of net exports. It seems likely that GDP growth will remain above 5.5% in Q4 and should reach ca. 5.5% in the entire 2006. While for the MPC hawks the data were another sign that monetary policy tightening was needed, it seems that the majority of the Council members may still remain unconvinced about threat for medium-term inflation target, as soaring investment implies an increase in potential output in the medium term, which would limit the effects of demand-pull pressure on prices. One should also notice that in the MPC's communiqué released one day before GDP data release, the Council suggested the figure might be a positive surprise (and this did not cause a rate hike), and thus higher than 5.5% economic expansion should not be perceived as a new important element in the MPC's economic picture.

Nevertheless, recent macroeconomic data, especially Labour Force Survey statistics, brought some arguments gradually shifting the balance of risks towards less inflation-friendly environment. The key question for the MPC, however, is not "whether inflation will rise?", but "to what extent?", as reaching the target of the bank at 2.5% should be well desirable by the Council. In our opinion, if the new data do not show that faster demand growth and tighter labour market could trigger excessive pressure on prices, it could turn out that current interest rate level would be enough to stabilise inflation around 2.5% target in the medium run. Especially as it seems that starting point of inflation increase this year will be lower than previously expected, mainly amid zloty strengthening. According to the Ministry of Finance, inflation perspective for the following months is favourable (2.2% in 1Q06, we expect 2.5%) and if such scenario materialises positive mood on the bond market may be maintained.

Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD	UNIT	FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (4 December)					
11:00	**POL**	**Auction of PLN1.0bn of 52-week T-bills (M)**					
10:00	EMU	PPI (M)	Oct	% r/r	4.1	-	4.6
		TUESDAY (5 December)					
9:00	EMU	Non-manufacturing PMI (H)	Nov		56.5	-	56.5
13:30	US	Unit labour costs (H)	Q3	%	3.7	-	3.8
13:30	US	Labour productivity (H)	Q3	%	0.1	-	0.0
15:00	US	Factory orders (H)	Oct	%	-1.6	-	2.1
15:00	US	Non-manufacturing ISM (W)	Nov		56.7	-	57.1
		WEDNESDAY (6 December)					
11:00	**POL**	**Auction of PLN3.0-4.0bn of 2Y OK1208 bonds (H)**					
		THURSDAY (7 December)					
12:00	**GB**	**BoE meeting – decision (H)**	**Dec**	**%**	**5.0**	**5.0**	**5.0**
12:45	**EMU**	**ECB meeting – decision (H)**	**Dec**	**%**	**3.5**	**3.5**	**3.25**
13:30	US	New jobless claims (H)		'000		-	357
		FRIDAY (8 December)					
13:30	US	Non farm payrolls (H)	Nov	'000	110	-	92
13:30	US	Unemployment (H)	Nov	%	4.5	-	4.4

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

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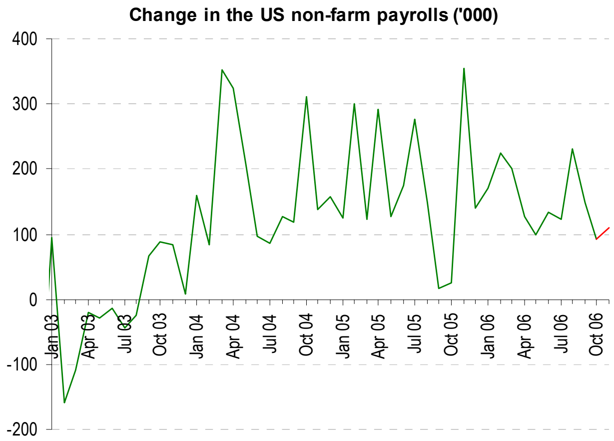
What's hot this week – Bond auction, ECB meeting and data abroad



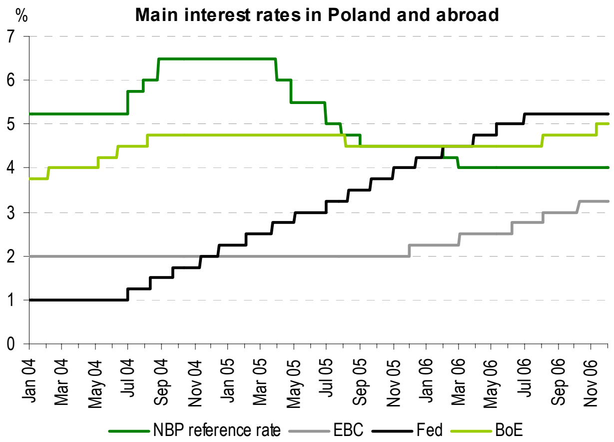
▪ As usual, in the first week of the month we will not see many important information on the domestic market and the only interesting event will be the two-year bonds auction. In spite of high supply there should be no problem with demand for these papers.

▪ As regards economic data, focus will be on US labour market data, though a number of economic activity indices will be published as well (mainly on Tuesday) and they will be important to asses the scale of US economy slowdown.

▪ Interest rate hike by the European Central Bank is widely expected and the market will concentrate on the statement to consider the scale (and timing) of further tightening.

▪ In emerging markets Turkish inflation release (on Monday) may be important as in the past this figure used to influence currencies in the region.

Economy last week – Flat rates despite strong growth

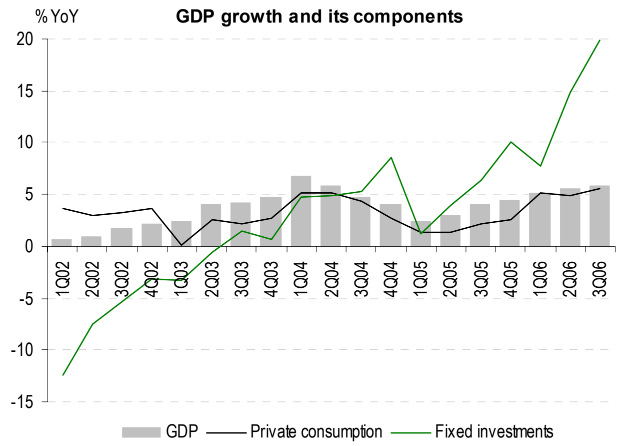


▪ Interest rates remained unchanged, as apparently, the Council's assessment of medium-term inflation prospects did not change much since the previous meeting.

▪ Unfortunately, once again the statement did not make it clear what are the Council's inflation predictions beyond 2007. Thus, it is hard to assess how much the inflation outlook of the MPC differs from NBP inflation projection.

▪ In the statement the MPC presented estimates of economic growth in the third quarter, saying it was probably higher than 5.5%, especially due to further investment revival. Despite this it decided to keep rates stable.

▪ We stick to the view that the monetary policy will remain on hold for at least next several months, waiting for more convincing signals from the economic data to come.



▪ After surprisingly high economic growth in Q3 it seems GDP growth in the final quarter of this year will remain strong, probably slightly above 5.5%, which would imply that the entire 2006 will also end up with ca. 5.5% rise.

▪ High investment increase bodes well for growth forecasts and additionally may limit pressure on price growth by leading to higher potential output.

▪ Pace of investment growth should remain strong in the subsequent quarters - inflow of foreign direct investments and EU funds and the fact that the investment-to-GDP ratio is still quite low (below 20%).

▪ Private consumption growth is likely to remain strong in the near term, mostly due to widening stream of households' income (rising employment plus higher wages) and high credit availability.

Quote of the week – Will zloty strengthening help Polish exporters?

Jarosław Kaczyński; Prime Minister, PAP, 29 November

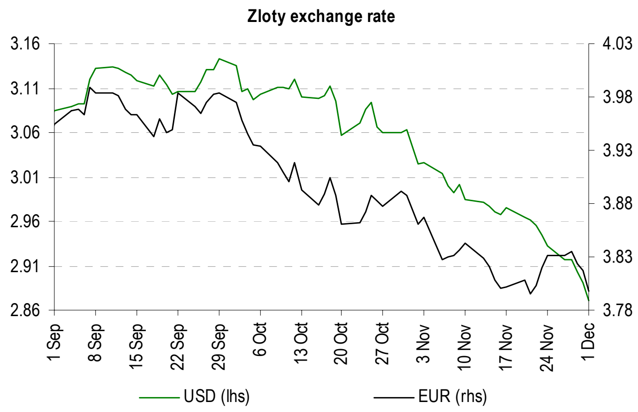
I think that hurry in this case [euro adoption] may be harmful. Introducing euro right now means removal of protection for Polish exporters. (…) Zloty is currently undervalued. Euro is not worth 4.0 zloty, it is worth less.

Piotr Soroczyński; deputy finance minister, Rzeczpospolita, 1 December

Until the end of February the zloty will appreciate. Euro may cost less than 3.70. Then, the zloty may start to weaken.

The reasons mentioned by the Prime Minister, justifying his view should be rather used as arguments for soonest possible euro adoption. While it is hard to disagree that there are many fundamental reasons for zloty strengthening in the long run, one has to admit that apparently keeping floating exchange rate in such situation would not be the best solution to protect exporters from loosing international competitiveness. In any case, this kind of statements (deputy finance minister joined PM two days later) may lead to faster trend of zloty appreciation.

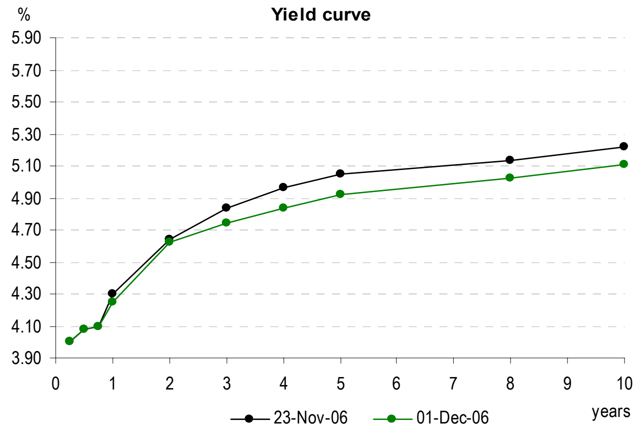
Market monitor



Zloty strengthens again

▪ Last week zloty initially was relatively stable against main currencies, though gradually strengthened. At the end of the week very good Q3 GDP data and the forecast of the Ministry of Finance of a EURPLN drop to 3.7 till February supported Polish currency. Zloty gained since previous Friday 0,7% vs. euro and 2,3% vs. the dollar.

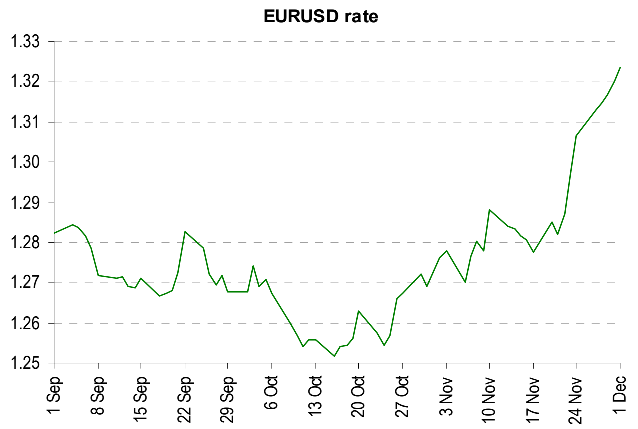
▪ Very strong GDP figure as well further positive perspectives of economic situation (Q4 GDP may also surprise upwardly) as well as good sentiment toward the region will still positively influence the zloty. The EURPLN rate may fall further, and this week it should stay in range of 3.75-3.85, while USDPLN in 2.83-2.93. Another important support levels for the EURPLN rate are the range of 3.78-3.79 and 3.75.



Bonds yields fall

▪ Gradual strengthening occurred also in the debt market, and bonds yields declined by 7-9 bp during the week. Prices gains appeared despite high GDP and news on high supply of government's papers in December. Bonds were supported by the falling yields in the core markets.

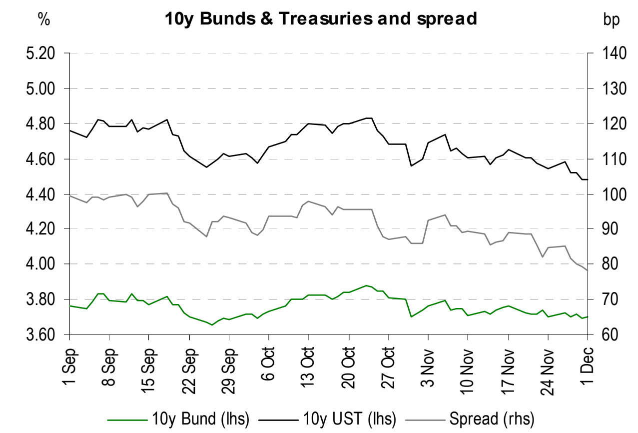
▪ It seems that after significant strengthening in the debt market since the start of October (thanks to core markets, expectations delaying potential rate hikes) bonds are quite expensive though positive mood in the bond market may hold if the forecasts of the finance ministry are fulfilled. Labour market and GDP data did not convince the MPC of necessity of soon rate hikes. Amid lack of domestic data this week the figures released abroad and situation in the core markets will have strong influence on Polish bonds.



EURUSD above 1.33

▪ Last week the dollar stayed at weak levels, as durable goods orders and consumer confidence figures had negative impact on the dollar. The greenback gained after revised GDP data, however good GDP for EMU, weaker Chicago PMI and ISM contributed to further rise of the EURUSD rate, which increased during the week by 1.6% to 1.33.

▪ After breaking essential technical levels by the EURUSD rate, we expect that the dollar may depreciate further, with regards to economic slowdown and expected rate cuts in US, as well as rate hikes in the euro zone (next one already on Thursday). In the nearest days the US labour market data as well as PMI, ISM activity indices are going to be the most important for the euro-dollar relation.



US yields fall thanks to weaker data

▪ Weak US data (durable goods orders consumer confidence, Chicago PMI) resulted in a fall of long-term Treasuries yields (10Y yields fell by 8 bp to 4.47%). The market slightly weakened after good GDP data, though this move was rather temporary with regards to lower inflation data (PCE). Prices of 10Y Bunds did not change substantially.

▪ Several important figures were scheduled for next week, especially from the US labour market. Economic activity indices may confirm economic weakening in US, and the market is going to focus also on the ECB meeting (expected rate hike). The ECB's communiqué may include some suggestions on further moves and tightening especially with reference to the stronger euro.

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