

Weekly economic update

25 December 2006 – 7 January 2007

We would like to wish all our readers a happy Christmas and prosperous New Year. The next issue of the weekly economic update will be available on Friday, 5th January 2007.

The Monetary Policy Council kept rates on hold, but said in the statement (for the first time) that monetary tightening may be needed to keep inflation close to the target in the future. At the same time the MPC suggested that inflation prospects for the next twelve months improved recently, which gave them some comfort in the adopted wait-and-see approach. Still, there are some risks for inflation in 2008 (already priced-in by the market, to some extent), but it seems a probability of inflation exceeding the target persistently is still below 50%, according to the Council. That's why rates remained stable and we believe this will be the case in the following months if upcoming economic data do not change the economic picture. Last week we saw a number of data releases, which confirmed that high economic growth (strong production and sales) does not create significant risk for inflation exceeding the target.

Economic Calendar

Time GMT	COUNTRY	INDICATOR (importance level)	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
TUESDAY (26 December)							
Second day of Christmas							
15:00	USA	Richmond Fed services index (M)	Dec		-	11.0	
WEDNESDAY (27 December)							
15:00	USA	New homes sales (H)	Nov	m	1.0	-	1.004
THURSDAY (28 December)							
15:00	USA	Consumers confidence (H)	Dec		102.0	-	102.9
15:00	USA	Homes sales (H)	Nov	m		-	6.24
FRIDAY (29 December)							
9:00	EMU	M3 money supply (H)	Nov	%YoY	8.6	-	8.5
15:00	USA	Chicago PMI (H)	Dec		51.0	-	49.9
TUESDAY (2 January)							
13:00	POL	Current account (M)	Q3	€ m		-863	-1 184
13:00	POL	Trade balance (M)	Q3	€ m		-1 305	-646
15:00	USA	ISM – manufacturing sector (H)	Dec			-	58,9
	USA	FOMC minutes (H)				-	
WEDNESDAY (3 January)							
10:00	POL	Auction of 2Y bonds (not confirmed)					
THURSDAY (4 January)							
10:00	EMU	Preliminary HICP (H)	Dec	%YoY	1.9	-	1.9
15:00	USA	Factory orders (H)	Nov	%		-	4.7
15:00	USA	Non-manufacturing ISM (H)	Dec			-	58.9
FRIDAY (5 January)							
10:00	EMU	Business climate (H)	Dec		110.6	-	110.3
13:30	USA	Non-farm payrolls (H)	Dec	'000		-	132.0
13:30	USA	Unemployment (H)	Dec	%		-	4.5

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

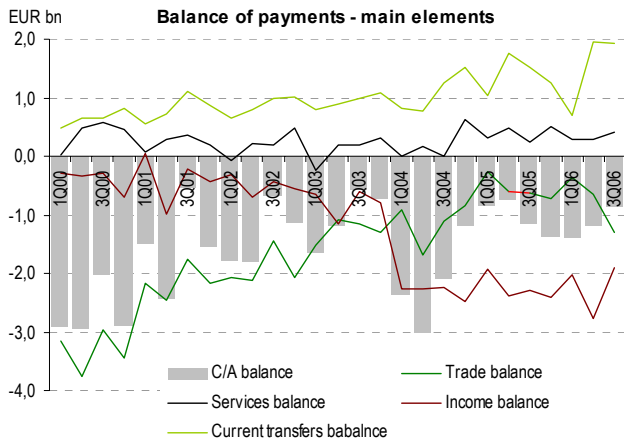
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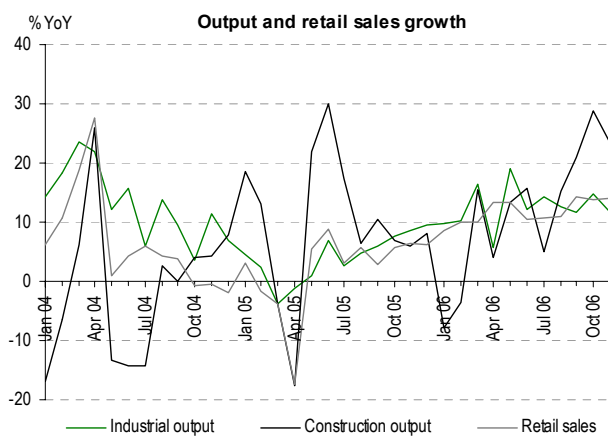
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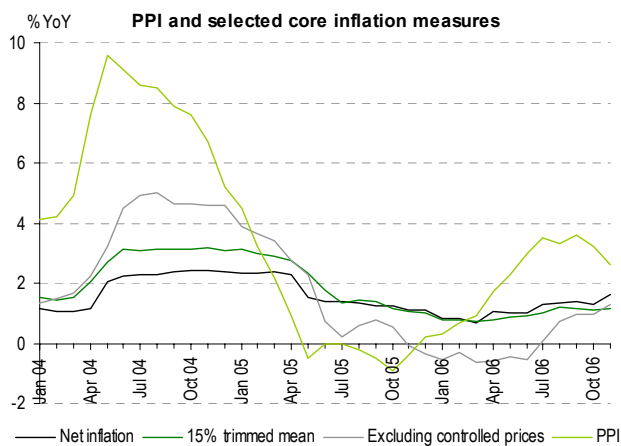
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What's hot this week – Will Christmas period be calm on the market?

- The coming weeks should be quite calm on the financial market, especially that the only data published will be balance of payments for Q3, which should not be significantly different from monthly figures for Jul-Sep.
- Even though politicians also have a Christmas break, there is a chance that President nominates a new candidate for the governor of NBP. This may also happen in January. Then, there may be no much time remaining before the end of Leszek Balcerowicz's tenure (January 10th).
- Foreign calendar seems a bit more interesting, where data publications will start as soon as on Tuesday when Polish market will be still on holiday.
- Figures from housing market seem crucial in the after-holiday week, while FOMC minutes and American labour data seem key for the beginning of 2007.

Economy last week – GDP accelerates, inflation still low

- Though both production and retail sales growth were below expectations in November, the results were very good, confirming fast economic growth in the last quarter of the year.
- Construction growth decelerated from 28.7% YoY to 23.4% but it is still a fast expansion pace, suggesting that investment activity remains high.
- It seems that even optimistic GDP growth forecasts for the fourth quarter of the year need to be revised upwards because a 6% result seems to be realistic. The deputy head of CSO suggested it and forecasts of the Ministry of Finance have also changed.
- Business climate indicators for December suggest that economic expansion continues in the end of the year.



- In line with our expectations net inflation rose in November to 1.6% YoY from 1.3% recorded a month earlier. This was below market consensus forecast of 1.4%. Other core inflation measures also recorded increases in November, though the 15% trimmed mean rose by a mere 0,04 pp to 1.15% YoY. The average level of all core inflation indicators amounted to 1.3%
- Producers prices rose by 2.6% YoY in November, which was below expectations. It seems that favourable commodities price development and strong zloty have been determinant in maintaining low prices. Prices even fell (by 0.3% MoM) in manufacturing sector and their annual growth amounted to only 1.3% YoY.
- Inflationary pressure is not very visible yet at the producers level, as of course at consumers price. Again, retail sales grew faster in real term than in nominal terms.

Quote of the week – Inflation will rise, the question is by how much

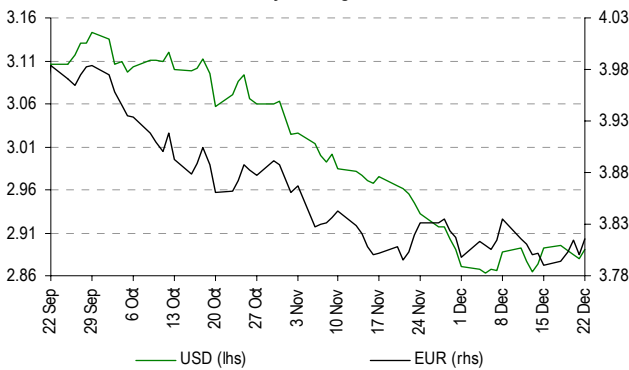
Andrzej Sławiński, MPC Member, PAP, 21 December

Structural changes will bring with time increase in potential output, thus growth level that does not bring inflationary pressure will be higher. (...) For the moment, one should assume that growth pace can remain above the economy's potential, which can bring inflationary pressure and, as a consequence, necessity of monetary policy tightening, which was presented in the MPC's communiqué. In my view, there is high probability that such a necessity arises.

Professor Sławiński refers to a key sentence in the last communiqué, confirming that a rate raise risk exists. However, changes occurring in the economy (foreign direct investment inflow, productivity growth, higher market openness which allows bigger competition) raise potential GDP growth pace in the long term, though inflation increase will take place in the meantime. In our view, the level, to which inflation will grow is the key, and according to our forecasts, inflation target is not threatened.

Market monitor

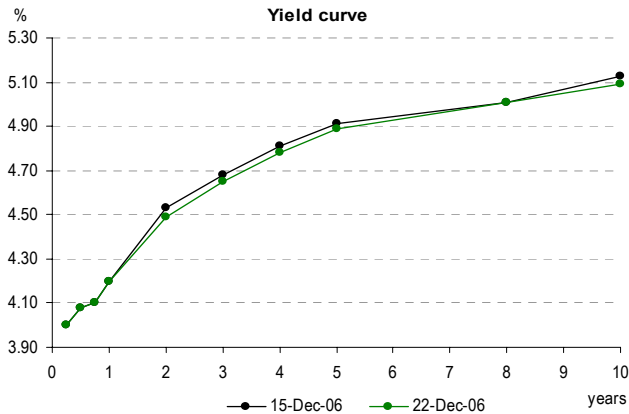
Zloty exchange rate



Zloty was quite stable ahead of Christmas season

- At the beginning of the previous week zloty weakened with regards to the turmoil in the Thai financial market, which influenced other emerging markets. Soon afterwards the situation in Thailand stabilised and zloty slightly recovered. The EURPLN rate rose by 0.8%, while USDPLN rate fell by 0.4%.
- The end of the year should be rather stable, and the activity may be limited. In the nearest week zloty should stabilise at present levels. In the first days of next year situation in the FX market should be similar and Polish currency may slightly strengthen again, unless significant correction in the debt market occurs. We expect the EURPLN rate will stay in range of 3.75-3.85, while the USDPLN rate may trade between 2.83 and 2.93.

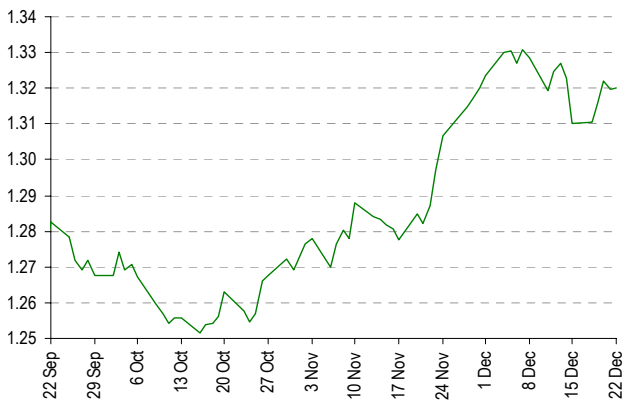
Yield curve



Bonds are still strong

- Last week bond yields declined by ca. 2 bp despite weakening in the core markets. Significant strengthening occurred after the release of lower than expected producer prices data. Industrial production and retail sales (both below the consensus) also supported the market. The MPC left rates unchanged and hawkish statements in the communiqué were rather ignored by the market players.
- Ahead of New Year's Day nothing special should happen in the financial markets. At the beginning of next year the situation may be also stable, though behaviour of debt core markets may have some influence on Polish bonds, especially taking into consideration new data releases in US. Recent comments of the MPC members may result in some correction in the nearest weeks.

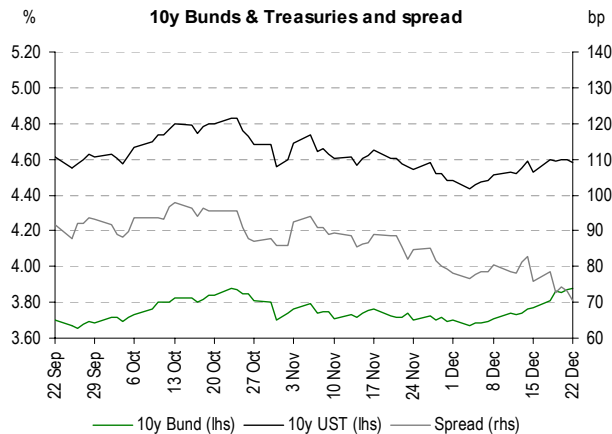
EURUSD rate



Euro gains on hikes expectations

- In the last days the single currency appreciated against the dollar (ca.1%) mainly in reaction to higher than expected Ifo index. The ECB's president comments also supported market expectations of further monetary policy tightening in the euro zone. After higher than forecasted PPI and better than expected data from the housing market there was some correction and dollar firming, though it was stopped by the weaker Q3 and stronger Philly Fed index.
- After Christmas, the sessions in the international markets should be rather calm, though several essential data are going to be released. The activity in the financial markets may rise, when the FOMC minutes, ISM index and labour market data see the day light. The EURUSD rate may stabilise in range of 1.31-1.33, with the risk of going up to 1.35.

10y Bunds & Treasuries and spread



Core markets slightly weaker

- Yields of 10Y US government bonds rose in the previous week by 3 bp to 4.55%. The weakening resulted from especially PPI figures, while GDP data and Philadelphia. Activity index gave some support. German Bunds weakened in reaction to high Ifo and comments of Jean Claude Trichet. 10Y yields rose by 6 bp to 3.86%.
- We assume that the slowdown visible in some sectors of the US economy will influence other ones, among others the labour market, resulting in 75 bp rate cuts by Q3 next year. At the end of 2007 we may see some economic recovery leading to rise of US bond yields. Rates in the euro zone will rise by 25 bp in Q1 2007. Next week market moves should be rather calm amid low liquidity, though if the US housing market data are much different from the consensus the volatility may rise. First week of the year may bring more liquidity and important events (FOMC minutes, ISM indices and non-farm payrolls).

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