

Weekly economic update

22 – 28 January 2007

First statistical data for December 2006 that were released last week confirmed that Polish economy has been in a trend of strong revival, which is more and more passing through the financial situation of households, but still does not seem to yield serious inflationary pressures. Industrial output growth, even though weaker than forecasted, was biased down by lower number of working days than in corresponding month of 2005, while the relevant adjusted growth rate reached 10.5%YoY, which seems to be in line with forecast of GDP growth above 6% in Q4 2006. The companies are apparently planning further rapid expansion as the increase in employment accelerated in December to new record 4.1%YoY, and at the same time the growth in enterprises' loans improved to 14.6%YoY, the highest in six years. Higher employment and higher wages (up 8.5%YoY in December) imply that households' disposable income is also increasing faster and faster, which will be a strong support for private consumption growth in the coming months. Especially, that households' credit is also maintaining very high rate of growth. What is important, notwithstanding this situation the rate of inflation stays low, which favours realisation of our base scenario assuming no interest rate hikes in the coming months.

High wages, employment and credit do suggest that retail sales data to be released this week could deliver another positive surprise. Therefore, market consensus forecast of ca. 13%YoY seems to be rather cautious and even in case of our prediction of 14.2%YoY growth the risk is on the upside. Core inflation data will probably show slight increase in December's indices, which is anticipated by the market and in our opinion does not pose a threat for the NBP's medium term inflation target. The list of data releases abroad is also shorter than last week and on the top of the agenda there will be Ifo activity index in Germany and new housing market data in the US.

At the last meeting in January, the Sejm should finally pass the 2007 budget in order to avoid a situation when the President Lech Kaczyński will be again forced to mull over the parliament's dissolution.

Economic Calendar

Time GMT	COUNTRY	INDICATOR (importance level)	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
MONDAY (22 January)							
10:00	POL	Auction of PLN900m of 52-week T-bills (M)					
13:00	POL	Core inflation (H)	Dec	%YoY	1.7	1.7	1.6
TUESDAY (23 January)							
13:00	POL	Business climate (M)	Jan				
13:00*	POL	Retail sales (H)	Dec	%YoY	13.0	14.2	13.6
5:00	JP	BOJ minutes (M)					
15:00	USA	Richmond Fed services index (M)	Jan			-	8.0
WEDNESDAY (24 January)							
10:00	POL	Switch auction (M)					
THURSDAY (25 January)							
11:00							
13:30	GER	Ifo index (H)	Jan		108.9	-	108.7
15:00	USA	Home sales (H)	Dec	m	6.25	-	6.28
FRIDAY (26 January)							
9:00	EMU	M3 money supply (H)	Dec	%YoY	9.1	-	9.3
13:30	USA	Durable goods orders (H)	Dec	%	1.0	-	1.6
15:00	USA	New home sales (H)	Dec	m	1.05	-	1.047

Importance level: (H)igh, (M)oderate; Source: Reuters, BZ WBK * publication time not confirmed officially

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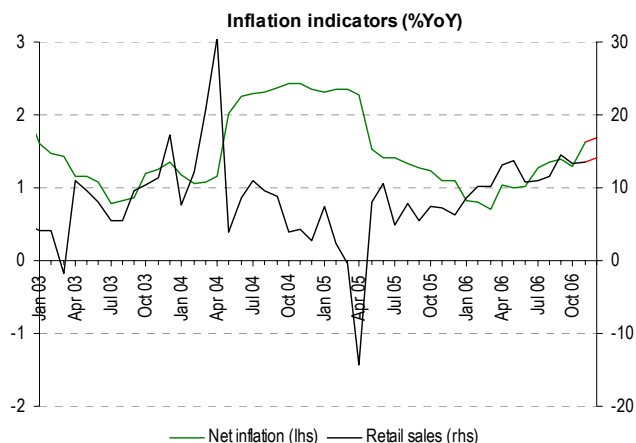
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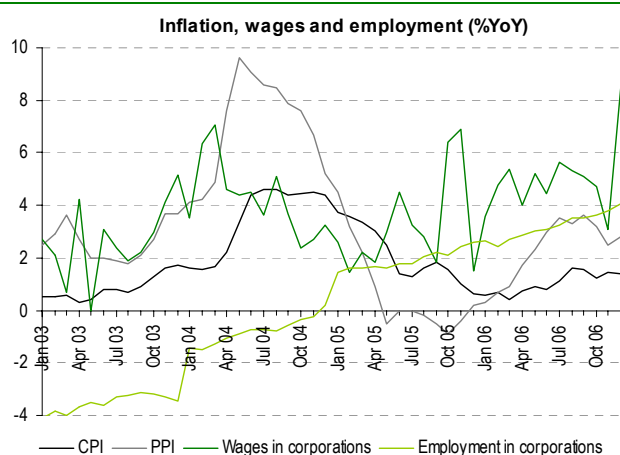
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What's hot this week – Peaceful week in terms of data releases

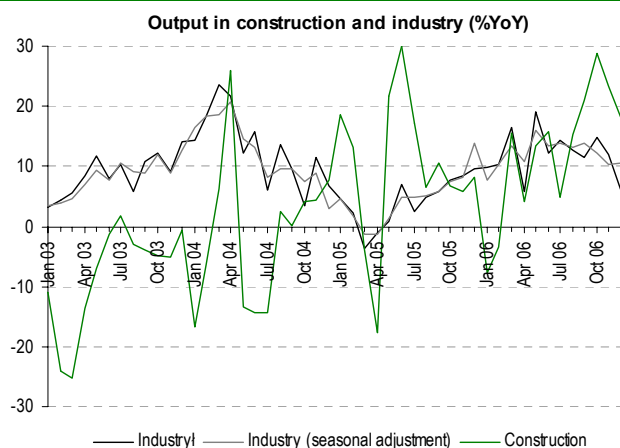


- After a week crammed with important information, this week will see moderate number of data releases.
- Core inflation probably picked up slightly in December (net inflation to 1.7%), but it is already expected by the financial market.
- Retail sales data will be a hint on the scale of consumption demand revival. After strong rise in wages and employment and high loan growth in December, it is possible that the sales growth will be a positive surprise for the market, especially amid cautious consensus forecast of 13%YoY.
- At the last meeting in January the Sejm is going to approve the 2007 budget after discussing Senate's amendments.
- Foreign markets will focus on German Ifo index, US housing market data and euro zone's money supply.

Economy last week – Economy getting stronger, inflation staying low



- CPI growth in December was at 1.4%YoY, the same as in November, while market predicted an increase. It was entirely caused by decline in food and fuel prices, so the data did not change the perspectives of core inflation. The latter is expected to rise, but moderately, without creating big threat for the NBP's 2.5% inflation target.
- PPI growth advanced from 2.5% to 2.8%YoY in December, but it resulted mainly from low base effect, as since August producer prices have been falling in monthly terms.
- Labour market data were some kind of counterbalance for low inflation numbers, as they showed record high 4.1% jobs rise and 8.5%YoY wage growth, much above forecasts. Wage growth was boosted partly by one-off base effect, but notwithstanding this the data suggested big improvement in households' income, which could be a strong support for



- Slowdown in industrial output growth to 5.7%YoY in December was caused by lower number of working days. After seasonal adjustment, production growth reached 10.5%YoY, which still represented solid expansion in industry, so we do not treat the data as a signal of weakening growth in the economy. We maintain prediction of 6.1% GDP growth in 4Q06.
- November's balance of payments data surprised with higher current account deficit, but export growth remained very strong and trade balance was low, so we do not see threat to external stability of the Polish economy.
- Fitch rating's upgrade to A- was justified by excellent macroeconomic performance and will support Polish zloty and bonds in the short run.

Quote of the week – Interest rate hike possible, but not certain

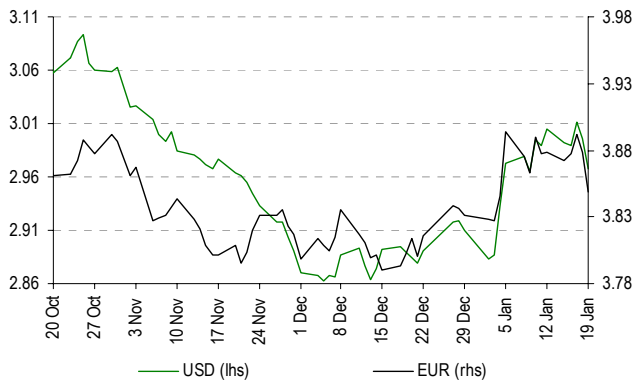
Andrzej Wojtyna, MPC member; Reuters, 17 January

There are no clear reasons which would persuade the council to move at the moment, but the balance of risk has moved a little towards a greater likelihood of raising rates, as we (the council) wrote in our December statement. I do not rule out that such a necessity may appear even in the first quarter of this year, but in my opinion the macroeconomic situation will not force us into large rises. For now there are no strong reasons to fear a substantial rise in wage demands. Even when they appear, they are coming after substantial rises in profit and productivity.

Andrzej Wojtyna identified a shift in balance of factors affecting future inflation in a way that increases likelihood of interest rate hikes. Nevertheless, at the same time he said such decision was not justified yet, as a rise in wages and domestic demand was coupled with developments in the economy that limit negative impact on the consumer prices. We assume the majority of MPC members share such point of view that goes well with our base case scenario, assuming lack of interest rate hikes in the near term. Although definitely some MPC members will keep voting for a hike, like e.g. Dariusz Filar who recently maintained a view that inflationary pressure was rising.

Market monitor

Zloty exchange rate

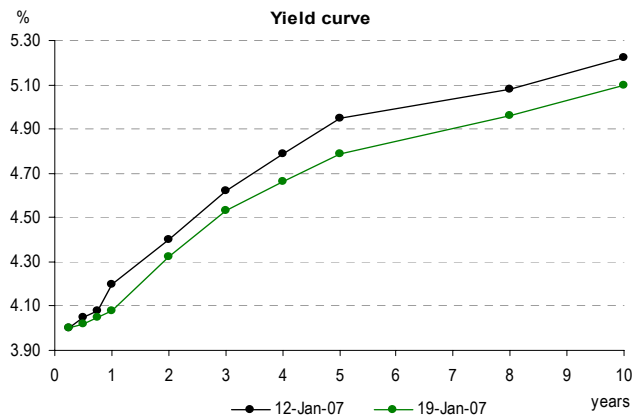


Rating upgrade strengthens zloty ...

At the start of the week zloty remained relatively stable, and afterwards slightly weakened on technical correction and expectations of rate hike in Japan. BoJ left rates unchanged and Polish currency significantly strengthened after Fitch rating upgrade of Poland to A-, which was accompanied by new records at WSE. During the week the EURPLN rate fell by 0.6%, and USDPLN by 0.9%.

The rating upgrade reflects positive fundamentals and it may support the zloty in the medium and long-term perspective. In the short term there are still some technical signals showing possibility of slight weakening, which may depend on the situation of US economy and sentiment toward the emerging markets. We assume that the EURPLN rate will trade this week in range of 3.81-3.91 (3.85 -support, 3.91 – resistance), and USDPLN 2.94-3.04.

Yield curve

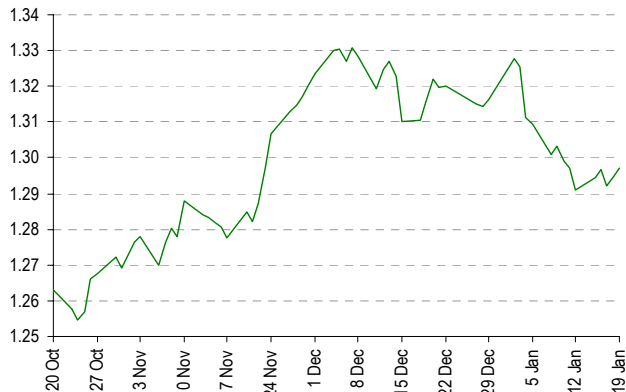


... and bonds; CPI supports the short term

In the past week Polish bonds strengthened significantly. At the start of the week the fixed income market was positively influenced by the CPI data, which was below forecasts. After very strong labour market data there was some correction. An upgrade of Poland's rating by Fitch agency strengthened the long end of the yield curve and contributed to a slight flattening of the curve. Since last Friday 2-10 spread fell by 10 bp to 75.

In the coming days the investors attention will concentrate on the retail sales and core inflation. They may result in rise in yield and further yield curve flattening. In the second part of the week the behaviour of the core markets is going to be the most important for the Polish bonds amid several essential data.

EURUSD rate

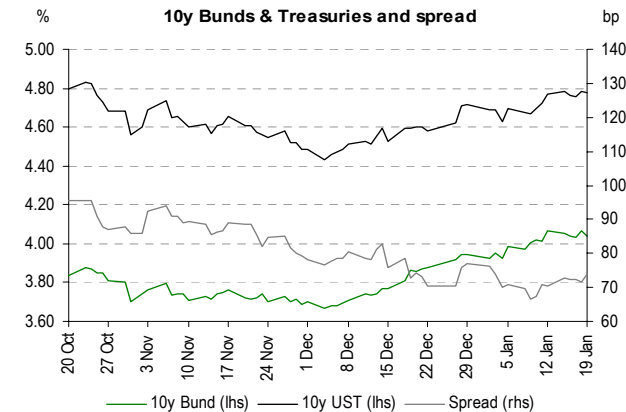


Dollar stabilises at strong levels

On Monday the investors' activity in the international markets was limited due to market holiday in United States. In the last days the EURUSD rate fluctuated in a quite tight range above 1.29. The greenback strengthened after PPI and housing market figures. Since the previous week the dollar marginally depreciated against the euro especially on technical sale and position adjustment as well as Ben Bernanke's warnings against US fiscal situation.

We still assume that next data from United States are going to indicate a slowdown of US economy, what will contribute to dollar's weakening. The start of the week may be rather calm and the market will focus on Ifo index (may support the euro) as well as further figures from the US housing market (home sales). The market will await the Fed's decision in the final week of January.

10y Bunds & Treasuries and spread



Slight changes in the core markets

Despite a rise of 10Y yields in the core market to 4.8% (Treasuries) and 4.1% (Bunds) during the week after better than expected data from the labour market in US (PPI, industrial production also higher) there was some strengthening on Friday. Yields of 10Y US and German bonds fell on Friday to 4.75% to 4.04% against 4.77% and 4.03% on previous Friday.

In the nearest days Ifo index will be crucial for the euro zone bonds as it will put light on the current situation in the German business (ZEW was above forecasts) against good data from the EU-12 countries. In United States investors will focus on the housing market data especially taking into consideration last week's data, which were better than expected.

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