

# Weekly economic update

26 February – 4 March 2007

Last week brought upbeat information on the economic activity in January. Based on them, we estimate that GDP growth in 1Q07 accelerated again, exceeding the level of 6.5%, at which economic growth in the final quarter of 2006 is estimated. At the same time, January's PPI and detailed data on wages in the enterprise sector showed that one should expect stronger wage pressure and increase in inflation. However, we still think that inflation acceleration will be gradual and moderate (among others thanks to persisting high productivity gains confirmed by results of LFS for 4Q06) and there is no serious threat to the inflation target in the medium-term. Thus, one should also not expect swift rate hikes. As regards the February's MPC meeting, no rate hike is commonly expected. It will be important what the MPC will say in the official statement after the meeting. We think, given recent macroeconomic data, that the Council will maintain rhetoric suggesting the central bank's readiness to react in case there is serious threat to the inflation target. GDP data for 4Q06 will be released only two days after the MPC meeting. Therefore, except from comments of the MPC, in the forthcoming week the Polish market will be impacted mainly by many crucial data releases abroad. However, we do not expect significant change in investors' attitude towards emerging markets and the Polish market in particular.

## Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level)	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
<b>TUESDAY (27 February)</b>							
9:00	EMU	M3 money supply	Jan	%YoY	9.5	-	9.7
13:30	USA	Durable goods orders	Jan	%	-1.5	-	2.9
15:00	USA	Consumer confidence	Jan		110.0	-	110.3
15:00	USA	Home sales	Jan	m	6.24	-	6.22
<b>WEDNESDAY (28 February)</b>							
	<b>POL</b>	<b>MPC meeting – decision</b>		<b>%</b>	<b>4.0</b>	<b>4.0</b>	<b>4.0</b>
10:00	EMU	Economic sentiment index	Feb		109.0	-	109.2
10:00	EMU	Final HICP	Jan	%	1.9	-	1.9
13:30	USA	Preliminary GDP	Q4	%	2.5	-	3.5
13:30	USA	Core PCE	Q4	%	-0.3	-	2.1
14:45	USA	Chicago PMI	Q4		50.0	-	48.8
15:00	USA	New home sales	Jan	m	1.1	-	1.12
<b>THURSDAY (1 March)</b>							
<b>10:00</b>	<b>POL</b>	<b>Switch auction</b>					
9:00	EMU	Manufacturing PMI	Feb		55.6	-	55.5
10:00	EMU	Preliminary HICP	Feb	%YoY	1.9	-	2.0
13:30	USA	Core PCE	Jan	%YoY	0.2	-	0.1
15:00	USA	Manufacturing ISM	Feb		50.0	-	48.3
<b>FRIDAY (2 March)</b>							
<b>9:00</b>	<b>POL</b>	<b>GDP</b>	<b>Q4</b>	<b>%YoY</b>	<b>6.5</b>	<b>6.5</b>	<b>5.8</b>
<b>9:00</b>	<b>POL</b>	<b>Fixed investment</b>	<b>Q4</b>	<b>%YoY</b>	<b>19.5</b>	<b>19.4</b>	<b>19.8</b>
<b>9:00</b>	<b>POL</b>	<b>Consumption</b>	<b>Q4</b>	<b>%YoY</b>	<b>5.3</b>	<b>5.1</b>	<b>5.5</b>
15:00	USA	Final Michigan index	Feb		93.7	-	96.9

Source: Reuters, BZ WBK

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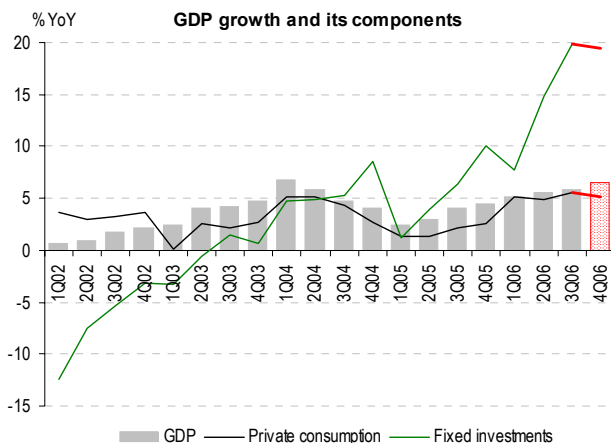
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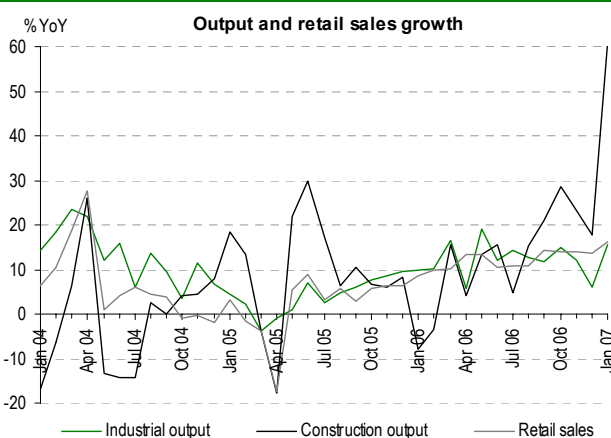
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## What's hot this week – MPC meeting and GDP data

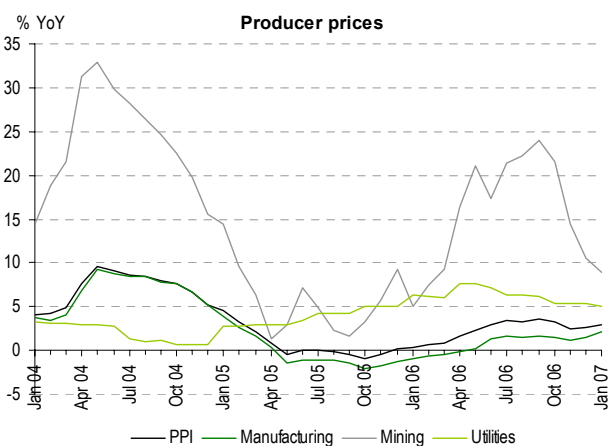


- The most important events for the domestic market this week are MPC meeting and GDP data.
- It is commonly expected that the MPC will keep interest rates on hold in February, but there is uncertainty concerning a tone of the MPC statement.
- Based on preliminary data on GDP growth in 2006 as a whole that were released at the end of January, we estimate that GDP numbers for 4Q06 alone will show 6.5%YoY rise with investment growth of 19.4%YoY and private consumption rise at 5.1%YoY.
- Apart from MPC meeting and domestic GDP figures, participants of the Polish market should also pay much attention to crucial data abroad. The key focus of attention will be on US data on the housing market, revised GDP numbers and ISM for manufacturing.

## Economy last week – Very strong economic activity indicators



- In January, industrial output rose 15.6%YoY, construction output surged 60.8%YoY and real growth in retail sales was 16.2%YoY. Thus, all the most important economic activity indicators surprised clearly on the upside.
- Based on excellent figures for January, we estimate that GDP growth in 1Q07 accelerated, reaching nearly 7%.
- Very strong economic activity with some slowdown in employment growth (indicated by both monthly data from the enterprise sector for January and LFS data for the whole economy for 4Q06) translate into lower growth rate of unit labour costs.
- This supports our scenario assuming no swift rate hikes. However, the risk for inflation prospects connected with the labour market still exists as labour market conditions becomes more and more tight.
- Although the registered unemployment rate seasonally rose to 15.1% in January, in annual terms there was acceleration in the scale of unemployment fall to 2.9pp. At the same time, detailed data from the enterprise sector showed an acceleration in wage growth in manufacturing to 8.5%YoY which suggests that wage pressure is mounting. Therefore, we think that relation between wage growth and productivity gains will gradually worsen in future.
- The negative signal is also higher than expected PPI inflation in January which reached 2.9%YoY with clear acceleration in price growth in manufacturing, despite falls in fuel prices. This may suggest enterprises became more willing to hike prices.
- However, one should remember that inflationary pressure is still limited and the current inflation indicators are low. Therefore, we still do not see a serious threat to the medium-term inflation target.



## Quote of the week – MPC starts to think about rate hikes

**Andrzej Sławiński; Radio PiN, 20 February**

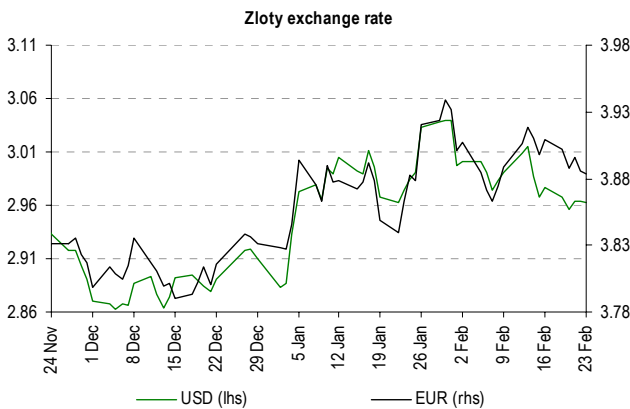
*One of our allies is globalisation which decreases enterprises' possibility to transfer costs into prices. The second ally is surprisingly high productivity growth. However, there is also the central bank which should slowly start to think about monetary tightening so that inflation behave properly. In my opinion inflation will increase gradually and slowly, so I do not see a need for large changes in rates.*

**Bloomberg, 20 February**

*The January wage increase [stronger than expected] raise the probability of a pre-emptive hike in interest rates to buy insurance against higher consumer prices.*

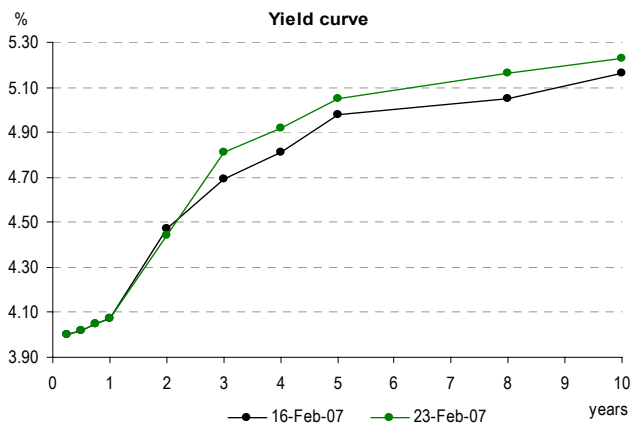
Comments of prof. Sławiński indicate that he expects (and probably the majority of MPC members as well) increase in inflation, but on a limited scale. This is consistent with our view. Among factor that should counteract higher inflation Sławiński mentioned effects of globalisation and fast rise in labour productivity. However, MPC member stressed the role of central bank in case of strong wage growth, but we think this is just a rhetoric aimed more at keeping inflation expectations low rather than a hint one should expect with rate hikes.

**Market monitor**



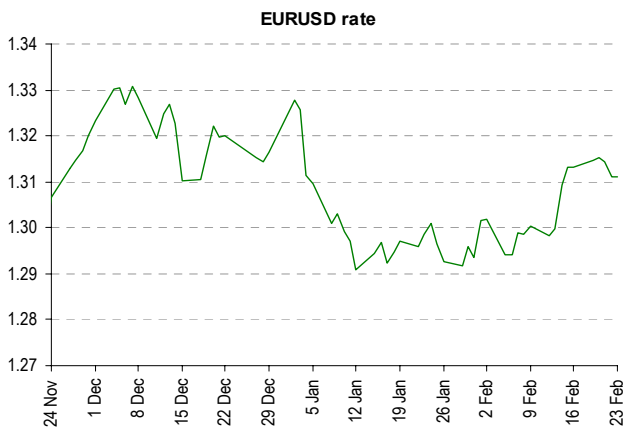
**Zloty slightly stronger but still stable**

- This was another week when zloty traded in a very narrow range this time slightly below 3.90 and in the last few days it gradually appreciated. Very good data from the economy and sentiment in the stock markets as well as the fact that zloty underperformed region currencies could have had positive effect on the Polish currency. Since the previous Friday the EURPLN rate fell by 0.7%, and USDPLN by 0.4%.
- The GDP data to be released next week may be better than expected and may positively influence zloty. Foreign data (especially revised US GDP) may be also important as they will influence the emerging market currencies. We forecast the exchange rates ranges for this week of 3.85-3.95 for the EURPLN and 2.9-3.0 for USDPLN.



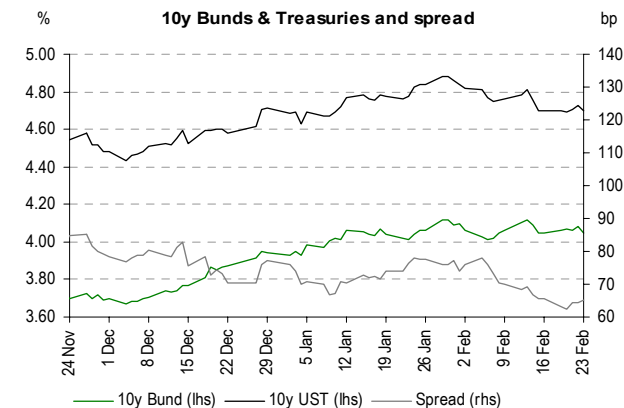
**Series of factors weaken debt**

- In the fixed income market there was a quite significant weakening due to a series of events. First of all industrial production and PPI as well as retail sales data significantly exceeded expectations. Additionally comments of central bankers could have had negative impact on debt together with rising yields in the core markets.
- In our view, this week as well as in several next months the Monetary Policy Council does not decide to raise interest rate, unless slowdown of labour productivity against rising wages growth occurs. The GDP data may positively surprise, which may weaken the fixed income market. On the other hand weaker data from abroad (US) may support the bond core markets, which may affect also the domestic market.



**EURUSD rate stabilisation**

- The start of the week in the international markets was rather calm due to the Presidents' Day in US. Later on the inflation data released in US appeared to be above expectations, which together with Fed's statement that expressed uncertainty of US central bankers toward the fall of inflation and with weaker Ifo contributed to a slight dollar gains.
- The GDP data for the Q4 2006 will certainly be downwardly revised, which may negatively affect the dollar, similar to the housing market data, which confirm the weakening. Investors are going to focus as well on activity indices such as US Chicago PMI and ISM (recently below 50), and PMI index in the euro zone. M3 money supply and economic sentiment figures will be also essential for the single currency.



**Core markets weaker after CPI and FOMC minutes**

- Higher than expected CPI inflation as well as FOMC minutes from the January meeting negatively affected the expectations of fast rate cuts in US. The sentiment in the US market was hardly improved by good results of some auctions. After weaker than expected Ifo index there was a slight strengthening though within the whole week yields of 10Y Treasuries rose to 4.71% from 4.67% and of 10Y Bunds from 4.02% to 4.05%.
- US GDP data as well as housing market figures and activity indices will stay in focus as far as core bonds markets are concerned and they may support the US debt market. On the other hand the data from the euro zone may show stable inflation and signal maintaining positive moods in the economy.

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