Bank Zachodni WBK

Weekly economic update

5 March – 11 March 2007

The last week passed under the sign of significant correction on world stock markets and outflow of capital from risky to save assets amid strengthening fears about prospects of US economy. Interestingly, correction was only slight on the zloty market that appeared quite immune to changes in moods in international markets, as compared to other emerging markets. Nevertheless, trends of foreign financial markets will remain a key driver of situation on Polish FX market, especially in the face of lack of publications at home and quite busy calendar abroad this week.

American data will be crucial this week, particularly a report on non-farm payrolls due on Friday, and before that non-manufacturing ISM and factory orders, that may help in assessment of scale of economic slowdown this year. The most important event in the euro zone will be the meeting of the European Central Bank and expected rate hike by 25 bp, to 3.75%. As always, analysts will focus on the statements from the central bank after the meeting as they may include suggestions regarding a pace of further monetary tightening. The same day, the Bank of England will also hold a meeting. In January, the BoE surprised the market with a rate hike, but this time it is likely to wait until April before delivering the next increase, probably the last one in the tightening cycle. Earlier during the week the data about services PMI, retail sale and GDP in the euro zone will be released, showing more hints regarding current economic situation in Europe.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (5 March)					
10:00	**POL**	**Auction of PLN1.0bn 52-week Treasury Bills**					
9:00	EMU	Non-manufacturing PMI	Feb		57.7	-	57.9
15:00	USA	Non-manufacturing ISM	Feb		57.5	-	59.0
		TUESDAY (6 March)					
10:00	EMU	GDP	Q4	%YoY	3.3	-	2.7
10:00	EMU	Retail sales	Jan	%YoY	1.2	-	2.1
13:30	USA	Unit labour costs	Q4	%	3.0	-	1.7
13:30	USA	Labour productivity	Q4	%	1.7	-	3.0
15:00	USA	Factory orders	Jan	%	-4.0	-	2.4
		WEDNESDAY (7 March)					
10:00	**POL**	**Auction of PLN 1.0-2.0bn 2Y bonds PS0412**					
13:15	USA	ADP report	Mar	'000		-	152
		THURSDAY (8 March)					
12:00	GB	BoE meeting – decision		%	5.25	**-**	**5.25**
12:45	EMU	EBC meeting – decision		%	3.75	-	3.5
		FRIDAY (9 March)					
13:30	USA	Trade balance	Jan	$ bn	-60.5	-	-61.18
13:30	USA	Non-farm payrolls	Feb	'000	105	-	111
13:30	USA	Unemployment	Feb	%	4.6	-	4.6
15:00	USA	Wholesale inventories	Jan	%	0.0	-	-0.5

Source: Reuters, BZ WBK

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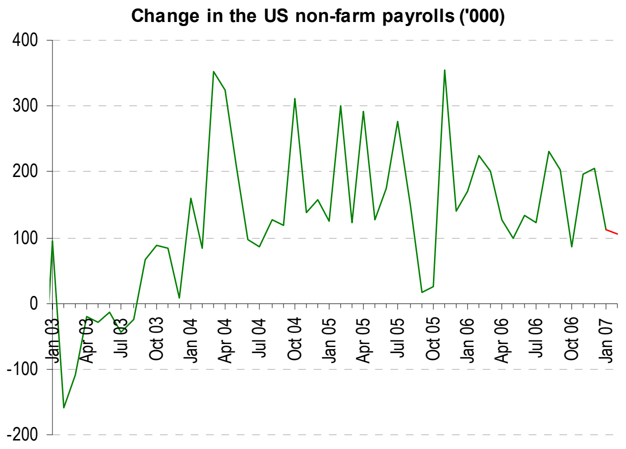
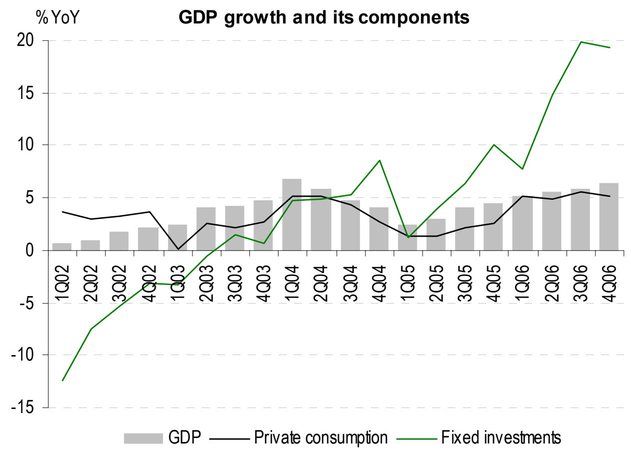
What's hot this week – No domestic data, busy calendar abroad

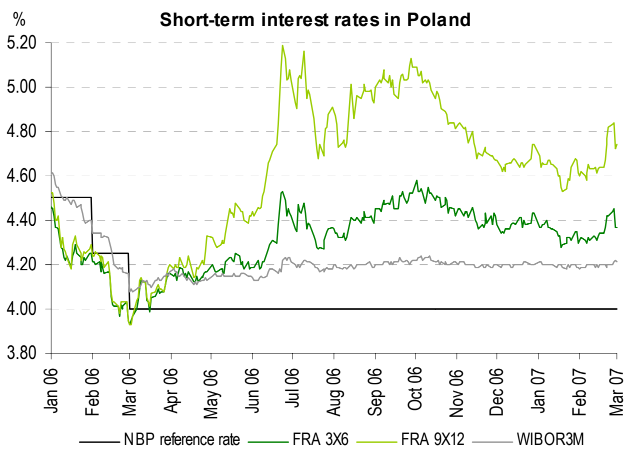


- There will be no releases of domestic economic data this week, while the calendar of events abroad will be quite thick.
- Data from the United States will be particularly important, as they may deliver new hints regarding the scale of economic slowdown this year. The key figure to watch will be Friday's non-farm payrolls report, while earlier one should pay attention to non-manufacturing ISM, factory orders, labour productivity.
- The most important event in Europe will be the ECB decision (expected 25 bp rate hike) and its statement, that will suggest a pace of next rate changes. Bank of England holds a meeting in the same day, but it is likely to wait until April with the last rate hike in the tightening cycle.
- Even before the ECB decision, data on services PMI, retail sales and Q4 GDP in the euro zone may deliver new hints on economic perspectives in the continent.

Economy last week – Economy growing, MPC getting more hawkish



- GDP growth in Q4 2004 reached 6.4%, slightly below our prediction (6.5%). Private consumption increased 5.2% and fixed investment soared 19.3%, roughly in line with expectations.
- Domestic demand increased as much as 7.7%YoY, so the contribution of net exports proved to be more negative than we had anticipated and reached -1.2 pp.
- All in all, the data confirmed the picture of economic situation known before and did not change our expectations regarding future economic developments. We predict GDP growth to accelerate to ca. 6.7% in 1Q07, which is consistent with estimates of the Ministry of Finance that are in range of 6.5-7%. Subsequently, growth is likely to slow down a little in the next quarters, averaging 5.7% in the entire year 2007.



- The MPC kept main interest rates unchanged, in line with expectations. The statement released after the meeting included little changes as compared to previous month, however in our opinion they were important and amplified hawkish tone of the communiqué.
- The interest rate market interpreted it quite differently and strengthened after the MPC decision, statement and soft comments of NBP president at the press conference.
- The MPC statement suggested a maintenance of informal tightening bias in monetary policy and in our view it suggested that a chance for a rate hike has recently increased.
- Next MPC decisions will depend on future data about the labour market and economic growth ("whether rising economic activity proves more permanent").

Quote of the week – Market underestimating hawkish signals from the MPC?

Jan Czekaj, MPC member; Interfax, 28 February

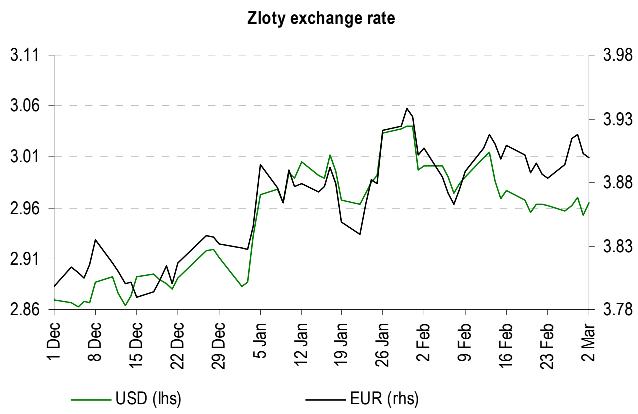
You are not reading it [the statement] right. There is the sentence about economic activity. Growth appears to be very strong, much stronger than anyone expected. [...] If you have growth of 6.5-7.0%, then that probably means the gap is closing. [...] If GDP accelerates, then we will act.

Sławomir Skrzypek, NBP president; 28 February

[The data released since the January sitting] have not generally changed the picture of inflation. It seems that, if inflation expectations are revised, then it will be downwards, in the next [NBP] Report on Inflation in April.

We think the financial market is misinterpreting recent MPC communiqués, overlooking hawkish statements and focusing only on soft (dovish) comments of NBP president and some of MPC members. Meanwhile, the MPC has been signalling straight in the last few months that a likelihood of rate hike has been rising and if relations between labour productivity and wages get worse and the Council gets more certainty about persistence of economic revival, then the rates may go up. Possibly, next MPC communiqués will be even more straightforward if the Council realises it needs to impact market expectations more efficiently.

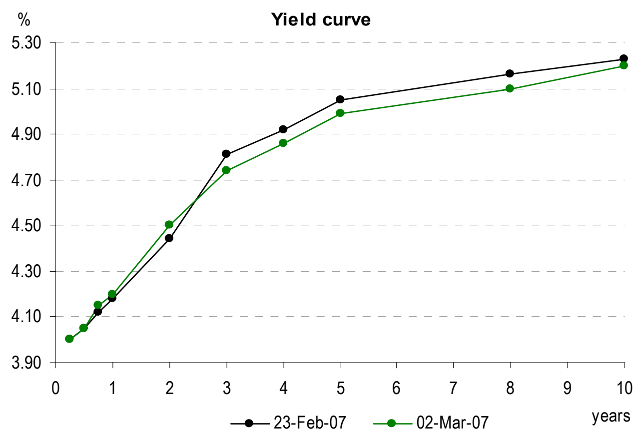
Market monitor



Zloty was stable despite emerging market sell-off

▪ There was significant sell-off in equity markets last week. This influenced also the Polish stocks. However the currency moves were limited. After moderate weakening zloty recovered at the end of the week and since the previous Friday the EURPLN and USDPLN rate both slightly rose by 0.5%.

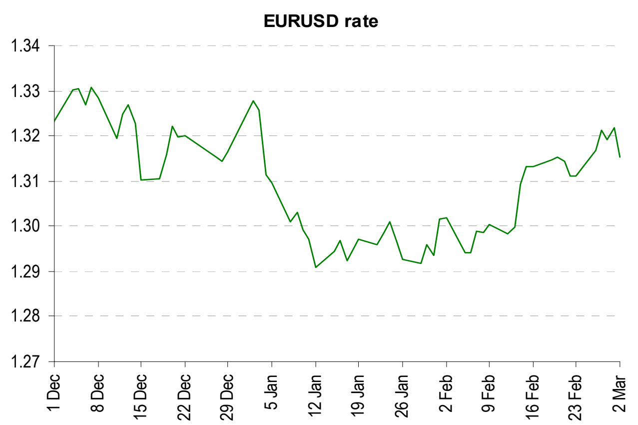
▪ Good economic data support zloty, and its fluctuations against major currencies are limited as compared to other currencies of emerging market economies. In our view such situation will hold though present rise of nervousness in the global markets may result in a further slight weakening of the zloty. It seems that the 3.95 resistance level is rather not yet at serious risk. We maintain our view for EURPLN rate to fluctuate in range of 3.85-3.95 (3.885-support, 3.92-resistance) and USDPLN in range of 2.9-3.0.



Slight yields fluctuations

▪ Despite the sell-offs in the equity markets the domestic bond market reaction to the turmoil in the international markets and emerging markets weakening was limited. After MPC's statement, which was perceived as less hawkish than expected, FRA rates fell in longer term. This slightly strengthened also bonds, which were additionally supported by the substantial gains in the core bond markets. Lower than expected Q4 GDP data also had some positive impact.

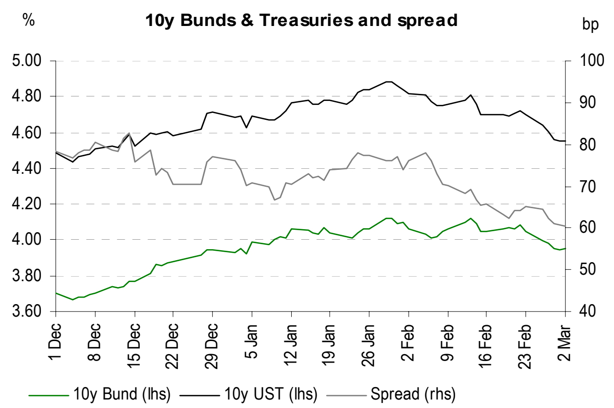
▪ Amid lack of significant data in the domestic market core bond markets behaviour (possible correction) will be crucial as well as 2Y bonds auction (high demand expected again). In their next comments the MPC members may want to sharpen their rhetoric to more hawkish. The bond market may weaken next week.



EURUSD rate stabilisation

▪ In the first part of the week there was a significant weakening of the US dollar (EURUSD rate rose to 1.326) among others in reaction to weaker than expected durable goods orders, revised Q4 GDP and housing market data. The EURUSD rate fell to the levels recorded at the start of the week after better-than-expected manufacturing ISM and Bernanke's comments reassuring moderate growth in US.

▪ The influence of PMI and ISM activity indices may be balanced. The GDP data in the euro zone may support the single currency, while the dollar may negatively react to the factory orders data. The ECB will most probably raise the interest rates by 25 bp and the market will focus on the communiqué. The labour market data may support the dollar at the end of the week.



Fears of US recession strengthen debt markets

▪ Last week there was significant strengthening in the core bond markets, which was connected with rising risk aversion amid fear of possible recession in US. International investors were selling stocks, closing *carry trade* positions and purchasing US and German government bonds. 10Y Treasuries fell from 4.71% to 4.54% (weekly minimum at 4.45%), and 10Y Bunds from 4.05% to 3.94%.

▪ The ECB's communiqué may include some expressions regarding the influence of slowdown in US on the European economy. In our opinion the ECB rates are going to rise at least to 4.0% in the middle of the year. The figures from the US labour market and activity indices may negatively affect the core bond markets and contribute to some correction.

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