Bank Zachodni WBK

Weekly economic update

12 – 18 March 2007

After another wave of weakening in stock markets and merging markets currencies, which took place on Monday, the remainder of the week brought a considerable improvement in moods on financial markets. The zloty strengthened against major currencies, remaining within the ranges we had indicated a week ago. We continue to believe that in the longer perspective it is more likely that the zloty rate against the euro will fall below 3.85 rather than rise above 3.95, though we are still far from end of temporary correction driven by higher global risk aversion. The zloty is still being supported by strong economic fundamentals and this week we will see another confirmation – low current account deficit at ca. 2% of GDP with another acceleration in exports.

The data to be published in the next couple of days will be crucial for the fixed income market – inflation (for February and revision for January), as well as labour market statistics. These data are of great importance, especially after the Monetary Policy Council intended to sent more hawkish signals to market participants in recent months. While this was not entirely successful, we think one should expect more hawkish comments by MPC members in the media, and not only from members who supported rate hikes already in the fourth quarter 2006. This will be even more likely if the data, to be released in the upcoming week, surprise on the upside as regards current and future inflation. Therefore, inflation increase as well as higher wage growth may negatively affect the bond market.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (12 March)					
18:00	US	Federal budget	Feb	$bn	-119.5	-	-119.2
		TUESDAY (13 March)					
10:00	GER	ZEW index	Mar	pts	3.3	-	2.9
12:30	EMU	Retail sales	Feb	%MoM	0.3	-	0.0
		WEDNESDAY (14 March)					
10:00	**POL**	**Auction of PLN 1.0-2.0bn 20Y bonds WS0922**					
13:00	**POL**	**CPI**	**Feb**	**%YoY**	**1.9**	**1.9**	**1.7**
13:00	**POL**	**Money supply**	**Feb**	**%YoY**	**18.7**	**17.5**	**19.4**
13:00	**POL**	**Current account balance**	**Jan**	**€m**	**-305**	**-196**	**-915**
12:30	USA	Import prices	Feb	%	0.8	-	-1.2
		THURSDAY (15 March)					
13:00	**POL**	**Average wage in the enterprise sector**	**Feb**	**%YoY**	**6.7**	**6.5**	**7.8**
13:00	**POL**	**Employment in the enterprise sector**	**Feb**	**%YoY**	**3.9**	**3.8**	**3.8**
10:00	EMU	Final HICP	Feb	%YoY	1.8	-	1.8
12:30	US	PPI	Feb	%MoM	0.5	-	-0.6
13:00	US	TICS	Jan	$bn	-	-	-11.0
16:00	US	Philadelphia Fed index	Mar	pts	4.0	-	0.6
		FRIDAY (16 March)					
13:30	US	CPI	Feb	%MoM	0.3	-	0.2
13:30	US	Capacity utilisation	Feb	%	81.3	-	81.2
13:30	US	Industrial output	Feb	%MoM	0.2	-	-0.5
15:00	US	Preliminary Michigan index	Mar	pts	90.0	-	91.3

Source: Reuters, BZ WBK

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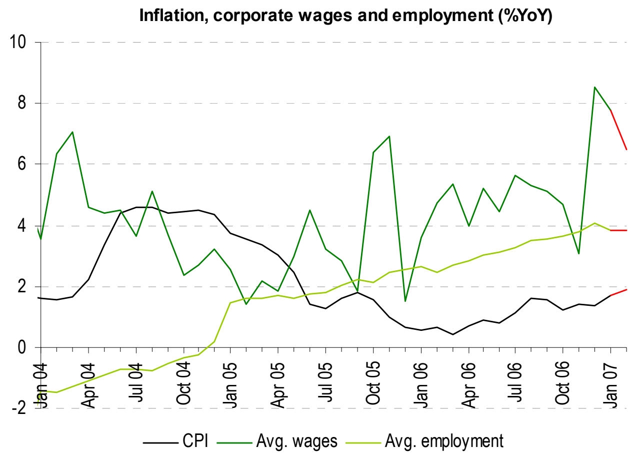
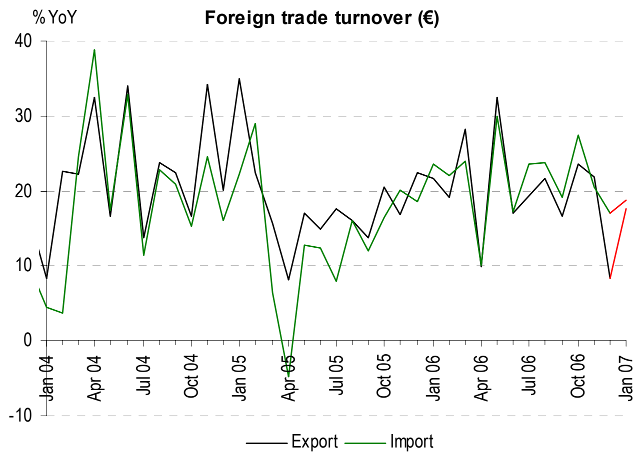
What's hot this week – Data set important for the MPC and markets



▪ This week the key information for the bond market, and thus also for the zloty, will be released on Wednesday, as the CSO will publish CPI inflation data for February and the revised figure for January. However, taking into account that the MPC has recently emphasised many times the importance of the labour market statistics for their future decisions, Thursday's data on wages and employment should be also watched very closely.

▪ Assuming no change in January's figure (1.7%) after changes in CPI weighting system, we expect inflation to rise in February to 1.9%. this will be mainly driven by higher food and fuel prices, though net inflation is also expected to increase from 1.6% to 1.7%.

▪ Will such increase in inflationary pressure be enough to trigger interest rate hike by the MPC?

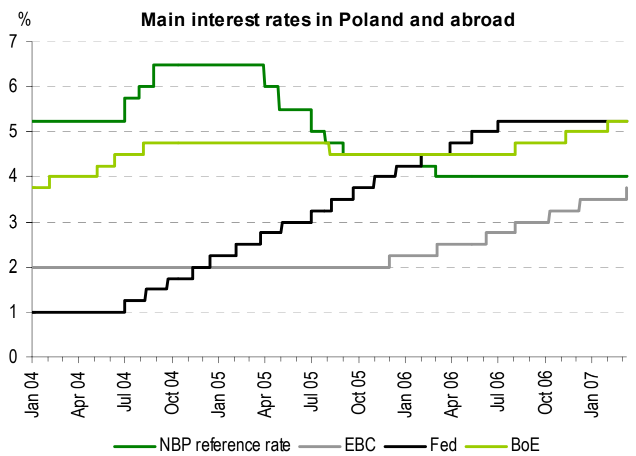


▪ This will depend, to a large extent, on other elements of the economic puzzle, and especially on the labour market figures. After the unit labour costs showed some deceleration in 4Q06, we expect this indicator to accelerate again this year. The question is to what extent.

▪ Response will be partly delivered by monthly data from the enterprise sector. In the last few months, statistics as regards salaries were affected by one-off payments (mainly in mining), but if these factors were excluded, there was a visible acceleration (from 5.2% in October to 6.5% in January). That is why, while we expect February's increase by 6.5%, we think the risk is on the upside. On the other hand, employment rise by ca. 4% guarantees strong productivity gains (with GDP up by ca. 7% in Q1).

▪ Export growth should accelerate substantially again.

Economy last week – ECB hikes rates again, more to come



▪ In line with expectations the European Central Bank raised main interest rates by 25 bp to 3.75%. According to European central bankers' view, which was reflected in the statement, the level of official rates is "moderate".

▪ For comparison, in the previous statements and comments by Jean Claude Trichet, the level of interest rates was described as "low". Such change in wording may suggest that the ECB considers further monetary tightening in the euro zone, though the cycle may be close to the end.

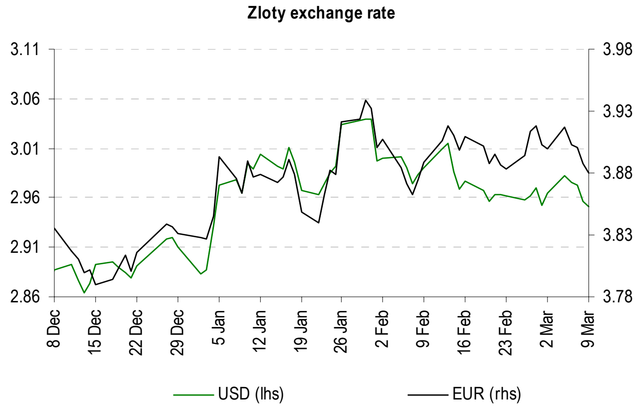
▪ In our opinion, the next hike in rates by the European Central Bank will take place in June and then a pause in monetary tightening will take place until 4Q07. It is too early to suggest that 4% would represent the peak for official rates in the eurozone.

Quote of the week – And some people would like to hike in Poland now

Marian Noga, MPC member; Reuters, 7 March
The Council sees risks and in my opinion should tighten its policy already now to prevent inflation topping not only 2.5%, but 3.5%. There is such risk and this is why we must act now. As time passes, the risk rises that the Council will be too late with monetary tightening. (…)In my opinion the financial markets did not interpret our last message too well.
Halina Wasilewska-Trenkner, MPC member; 6 March
If the MPC waits too long with a rise in interest rates if it delays until the second half of 2007, this may be too late and sharp monetary tightening might have to be needed.

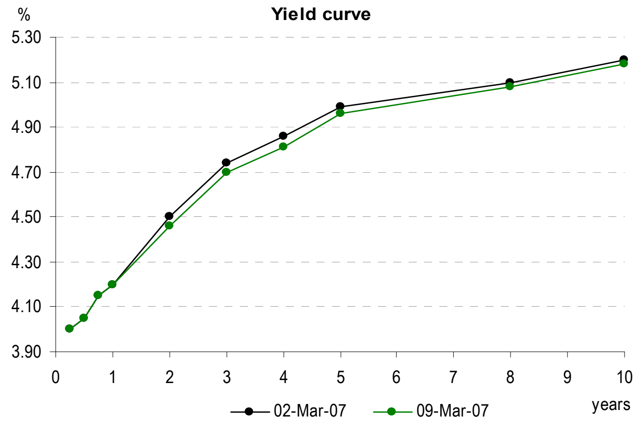
A few members of the MPC would like to hike rates already now. We should remember, however, that these are opinions of members, who vote in favour of hikes already in the fourth quarter, using the same line of reasoning. As the time showed, the argumentation was not entirely convincing. Nevertheless, taking this factor into account, we emphasise again that risk of rate hike has recently increased and the MPC wanted to stress this in the communiqué, which was perceived by the market as too dovish. Marian Noga confirmed this. In our opinion, one should expect more hawkish wording in MPC's members comments, not only those who favoured hikes in 4Q06.

Market monitor



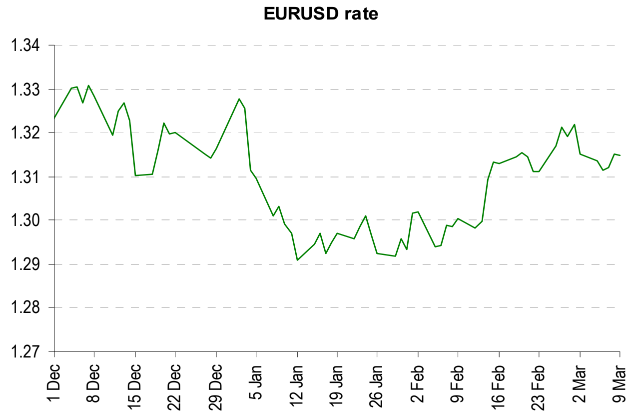
Better moods globally positive for the zloty

- After the period of higher nervousness on the world markets, last week brought some stabilisation with lowering risk aversion, positive mood in equity markets and weaker Japanese yen. In result, after a temporary weakening on Monday, the zloty has been strengthening against the major currencies. During the week the EURPLN fell by 0.7%, while USDPLN by 0.5%.
- Similarly to previous weeks, situation on global markets will be important for the zloty. We maintain our opinion that even if moods towards emerging markets deteriorate, the zloty should be relatively stable, as it will be supported by strong economic fundamentals. We still expect EURPLN to be traded in the range 3.85-3.95, while USDPLN in 2.90-3.00.



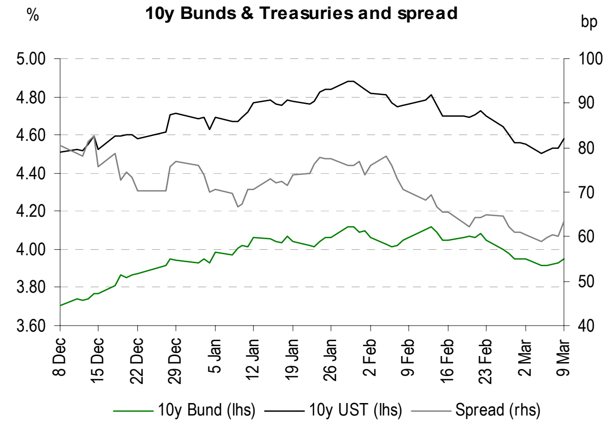
Debt market still stable

- Amid no domestic data releases the Polish debt market remained under influence of situation in the core markets. An atmosphere there was quite calm, which together with lower nervousness on emerging markets translated into low volatility on the Polish market. Only on Friday there was visible decline in yields of domestic bonds after US non-farm payrolls which lowered general risk aversion.
- In the first days of this week, market participants will take positions ahead of CPI figures. Inflation increase may cause a strengthening in expectations of a swift rate hike. However, labour market statistics may be at least equally important as wage growth and employment rise are seen as major risk factors for inflation. With many data releases scheduled abroad, an important factor will be also performance of core markets.



Dollar strengthened again

- At the beginning of last week the dollar strengthened against the euro from 1.32 to 1.31 amid higher risk aversion on global markets. During the latter part of the week the EURUSD rate was again in the upward trend as a result of weaker ADP report on the US labour market. However, at the end of the week, after positive non-farm payrolls figure and lower-than-expected US trade deficit, the dollar appreciated again to ca. 1.31.
- This week a number of important data for the EURUSD rate will be released. The German index ZEW may lead to euro strengthening, though retail sales data and PPI and CPI inflation figures (as well as Philadelphia index) later during the week may be more important. US data on capital flows will be also interesting.



Higher yields of Treasuries after non-farm payrolls

- With lower nervousness on global markets as regards yen trading and equity markets, yields of long-term bonds in US and in the euro zone stabilised. While the yield of 10-year Treasuries fell as much as to 4.49% after ADP report, better moods towards equities and quite strong non-farm payrolls reading led to sell-off in the bond. As a result, yield of 10-year Treasuries increased from 4.54% to 4.59%, while as regards Bunds the increase was from 3.94% to 3.96%.
- Data on retail sales for February will show whether weak January was only temporary phenomenon. However, data on core CPI (and PPI) will be equally important, as they will show whether core inflation maintains at elevated levels, especially as Fed remains concerned about inflationary pressure.

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