Bank Zachodni WBK

Weekly economic update

19 – 25 March 2007

Last week brought important domestic data, but they did not change assessment of current and expected economic situation. Inflation in February proved consistent with market consensus forecast. There was also no surprise as regards price growth of particular components of CPI and changes made by the CSO to system of weights in CPI basket. Therefore, the data did not affect significantly inflation path forecasted by us for the remainder of the year. Particularly that other data published last week also did not introduce much new to the assessment of factors influencing inflationary processes. Labour market statistics were mixed. While employment growth proved much stronger than expected, but average wage growth was lower than expected, so overall the data were interpreted by the market as neutral. Monetary statistics for February also did not change assessment of economic situation and inflation prospects, because on the one had they showed slowdown in money supply growth, but on the other hand further acceleration in loans growth was noted.

With neutral impact of domestic data, performance of the Polish market last week reflected changes in moods on the global market and attitude towards emerging markets. As fears of the condition of the US economy re-emerged, which was followed by rise in risk aversion, the better part of the last week was marked by zloty weakening. However, there was a rebound on Friday and prospects for the domestic currency for the next week seem quite good. Much will depend on next crucial data from the US and results of FOMC meeting. Of course, participants of the domestic market will also pay much attention to another set of domestic data due for release this week.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (19 March)					
10:00	**POL**	**Auction of PLN1.0bn of 52-week T-bills**					
13:00	**POL**	**PPI**	**Feb**	**%YoY**	**3.2**	**3.2**	**2.9**
13:00	**POL**	**Industrial production**	**Feb**	**%YoY**	**13.5**	**12.7**	**15.6**
14:00	USA	Home sales	Jan	m	6.33	-	6.46
		TUESDAY (20 March)					
6:00	JP	BOJ meeting – decision – report					
12:30	USA	House starts	Feb	m	1.462	-	1.408
		WEDNESDAY (21 March)					
10:00	**POL**	**Auction of PLN1.0-2.0bn 5Y PS0412 bonds**					
	JP	Market holiday					
11:00	USA	Mortgage index				-	690.5
18:15	USA	Fed meeting – decision		%	5.25	-	5.25
		THURSDAY (22 March)					
	POL	**Business climate**	**Mar**				
12:30	USA	Jobless claims		'000		-	318
		FRIDAY (23 March)					
9:00	**POL**	**Retail sales**	**Feb**	**%YoY**	**16.2**	**15.9**	**16.5**
9:00	**POL**	**Unemployment rate**	**Feb**	**%**	**15.0**	**15.0**	**15.1**
13:00	**POL**	**Net inflation**	**Feb**	**%YoY**	**1.7**	**1.5**	**1.6**
14:00	USA	Home sales	Feb	%YoY		-	

Source: Reuters, BZ WBK

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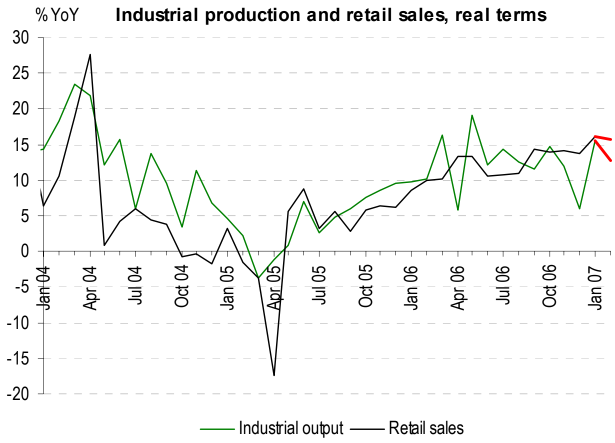
What's hot this week – Data releases due at beginning and end of the week

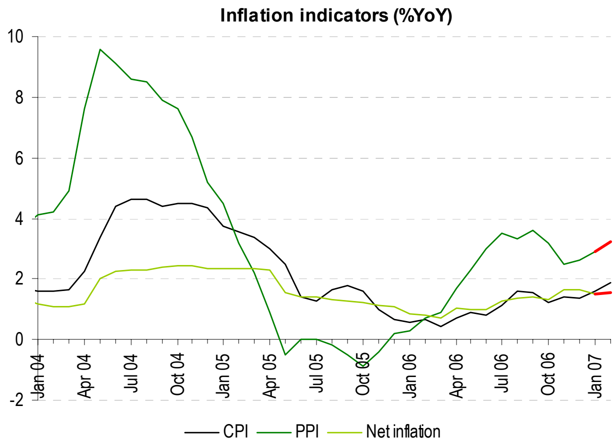


▪ Macroeconomic data that are due for release on the first day of this week should confirm strengthening economic expansion (output growth expected to remain in strong upward trend) with moderate intensification of inflationary pressure (predicted higher PPI inflation).

▪ As regards data on producer prices, apart from looking at growth rate of the overall PPI one should pay attention to changes in price growth in manufacturing, as price changes in this sector take place in environment of competitive markets.

▪ Another dose of domestic data will be released on Friday and the should also confirm strong economic activity (expected strong rise in retail sales and fall in unemployment) with moderate inflationary pressure (according to our estimates net inflation fell to 1.5%YoY in January and February from 1.6%YoY in December.

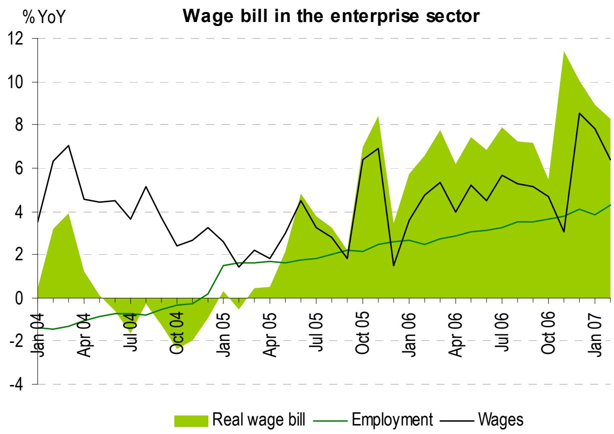
Economy last week – No change in assessment of the situation



▪ February inflation was in line with expectations, rising to 1.9%YoY, though the figure for January was downwardly revised to 1.6% as a result of the revision of weights system. It seems that the weights changes should be slightly positive for inflation this year, mainly with regards to lower contribution of "food" and higher of "clothing and footwear".

▪ All in all, CPI data for February did not change assessment of current inflationary pressure and inflation prospects – we still predict inflation rise to 2.2%YoY in March and then fall in 2Q07 and 3Q07 before a rise to 2.5%YoY in December.

▪ The current account was higher than expected in January, which resulted among others from fast rise in imports. As for now, the relation of the deficit to GDP stays low, and export prospects seem quite positive, taking into consideration good business climate of Poland's main trading partners and expected effects of FDIs inflow.



▪ February's labour market statistics from the enterprise sector showed lower than predicted wage growth (6.4%YoY) and higher than forecasted employment growth (record high 4.3%YoY). Growth rate of wage bill in enterprises declined, but only slightly and still remains at high level (11%YoY in nominal terms and 8.9%YoY in real terms) confirming forecasts of private consumption rise in 1Q07 at nearly 6%.

▪ We predict gradual acceleration in unit labour costs, but thanks to lower than expected wage growth labour market statistics for February are not likely to bring about an immediate rate hike by the MPC. As for now, wage growth does not seem excessive.

▪ All in all, the data published last week did not change assessment of the economic situation and inflation prospects.

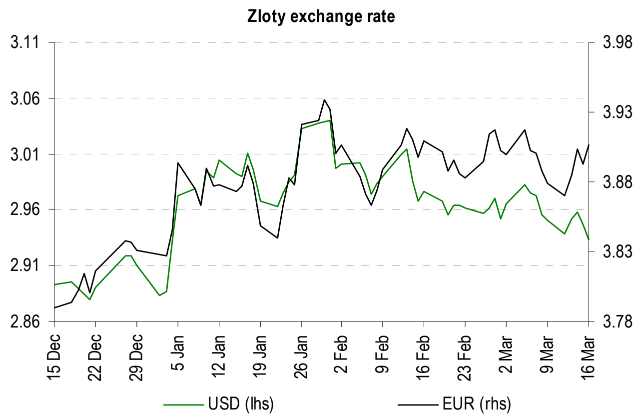
Quote of the week – Rising probability of rate hikes

Andrzej Wojtyna, MPC member; PAP, 14 March

In my opinion a horizon of decision on rate hike is clearly shortening, because there is intensification of such processes in the economy which may lead to price growth. There is rising probability of rate hikes in 1H07. (…) Such signal was sent by us in the last statement, but reaction of many analysts shows that it was not unambiguous and was interpreted as less and not more hawkish. This was not consistent with our intentions. (…) One should remember that our goal is not preventing the economy from overheating, which would take place with inflation above 3.5%, but our goal is stabilisation of inflation close to 2.5%.

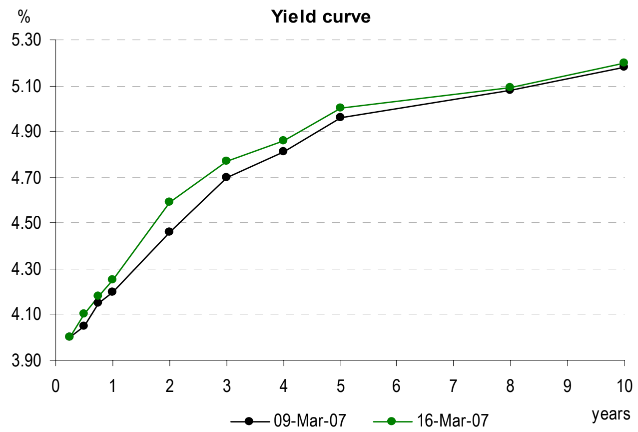
Comments of Andrzej Wojtyna confirm our impressions after the last MPC meeting. Official statement of the MPC was improperly interpreted by the market, because it was not noticed that the message is more hawkish than earlier. Wojtyna's comments show that stronger than earlier expected pace of GDP growth (including stronger growth in domestic demand) increased his propensity to apply the economy a rate hike in the forthcoming months. Especially that Wojtyna stressed the central bank's goal is stabilisation of inflation close to the target of 2.5%. However, we think that a rate hike is not determined and the MPC will wait for next data, particularly from the labour market.

Market monitor



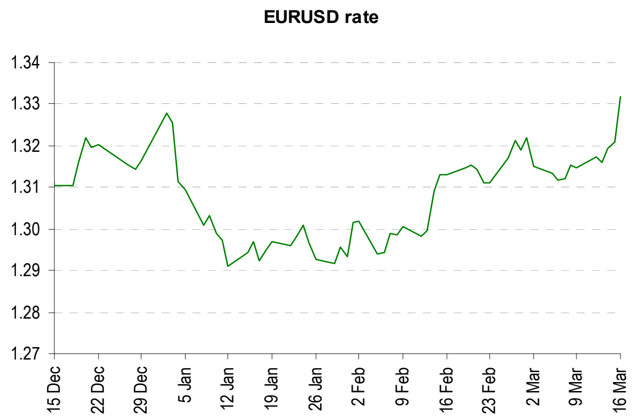
Zloty slightly weaker, still in narrow ranges

- Zloty was slightly weakening throughout most part of the week against the euro and strengthening vs. dollar. The main reason of depreciations was the weakening in the emerging markets amid fears about economic situation in US. At the end of the week there was a slight recovery in the FX market. The EURPLN rate rose since last Friday by 0.4%, while USDPLN rate fell by 1.1% on dollar weakening in the global markets.
- Sentiment of foreign investors to emerging markets and yen movements seem still to be crucial for zloty rate moves. We maintain our view that Polish currency is going to be supported by very good situation of Polish economy, and fluctuations in Polish FX market should be limited. We forecast that EURPLN will trade in rage of 3.85-3.95, and USDPLN in range of 2.87-2.97.



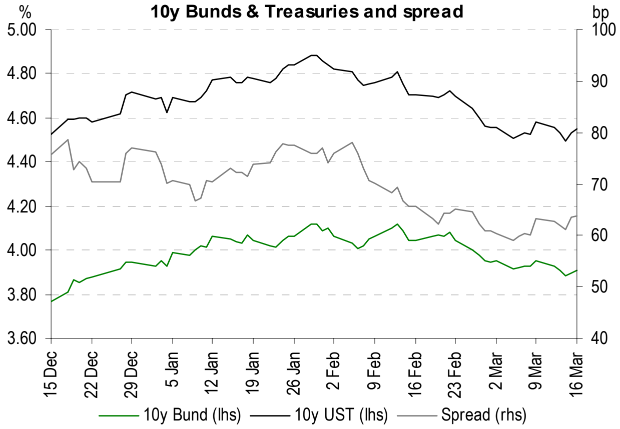
Higher yields at the short end of the curve

- Last week yields of Polish government bonds did not change significantly. Slight weakening occurred at the short end of the yield curve in reaction among others to hawkish comments of MPC members, which was in line with our expectations (mainly of Andrzej Wojtyna). CPI index as well as labour market data were rather neutral for the market.
- In our opinion if wages accelerate and labour productivity growth slows down interest rates may rise sooner than expected. However such situation has not yet occurred. In the nearest days the market is going to focus on the retail sales data, which are to going to show a high two-digit growth and may influence the short end of the curve. The longer end will mainly depend on situation in the core bond markets.



EURUSD above 1.33

- The greenback continued the weakening trend last week against the euro with regards to fears of housing market performance and economic growth in United States amid weaker than expected retail sales data and activity indices from the manufacturing sector (NY Empire State & Philly Fed). The euro was also strengthened comments form ECB on inflation risks in the euro zone. Higher than expected PPI and CPI did not help the US currency.
- In our view fears of situation as well as next data from United States will contribute to the EURUSD rate staying at high levels. This week several important statistics form the US housing market are going to be released, though Fed statement after the decision meeting seems to be crucial.



Another strengthening in the core bond markets

- After weaker end of the previous week on good non-farm payrolls in United States there was another strengthening in the core bond markets in last days. Prices of US bonds rose in reaction to growing uncertainty of US economy (after a series of weaker than expected data). Yields of 10Y Treasuries fell from 4.59% to 4.55%, and of 10Y Bunds from 3.96% to 3.91%.
- Fed's statement and any reference to expected scale of economic slowdown, situation in the housing market and inflation will be crucial for the core bond markets. US statistics on home sales and house starts may signal whether a correction in the housing market is close to the end or continues.

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