

Weekly economic update

23 – 29 April 2007

This week the key event for the Polish financial market will be MPC meeting coupled with the publication of the new Inflation Report including new inflation projection. 20 out of 21 analysts surveyed by Reuters predict a rate hike of 25bp. Such scenario is supported by recently published data, especially labour market statistics. Output and PPI data showed that rapid rise in economic activity does not cause significant acceleration in producer prices, which mitigates fears of the inflation target. The tone of data due for publication this week should be similar (on the one hand robust rise in retail sales and on the other hand continuously low core inflation). However, a rate hike in April seems to be determined given stronger than expected wage growth in March. Worsening in relation between wage growth and labour productivity gains, signalled by the data, negatively affects central bankers' perception of medium-term inflation outlook (while the new inflation projection will be more optimistic than the previous one, according to hints from the NBP governor). However, one should remember that there are still factors counteracting inflation rise. Therefore, we maintain our view that the rate hike of 25bp in April will be a pre-emptive move and we will see at least a few months break before another move of the central bank, as rate-setters will want to reassess the economic situation and medium-term inflation prospects under influence of new data. We think that in case of a rate hike in April the Council will suggest in its official statement that possible another move will take place no sooner than in a few months.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
MONDAY (23 April)							
9:00	POL	Auction of PLN0.9bn 52-week Treasury Bills					
12:00	POL	Net inflation	Mar	%YoY	1.7	1.7	1.6
	POL	Business climate indices	Apr				
TUESDAY (24 April)							
14:00	USA	Consumer confidence	Apr		106.0	-	107.2
14:00	USA	Home sales	Mar	m	6.5	-	6.69
WEDNESDAY (25 April)							
8:00	POL	Retail sales	Mar	%YoY	18.0	16.5	17.5
8:00	POL	Unemployment rate	Mar	%YoY	14.4	14.4	14.9
	POL	MPC meeting – decision		%	4.25	4.25	4.00
8:00	USA	Ifo index	Apr		107.9	-	107.7
12:30	USA	Durable goods orders	Mar	%	1.1	-	1.2
14:00	USA	New home sales	Mar	m	0.88	-	0.848
THURSDAY (26 April)							
9:00	POL	Switch auction					
12:30	USA	New jobless claims	Mar	'000		-	338
FRIDAY (27 April)							
12:30	USA	Preliminary GDP	Q1	%	2.0	-	2.5
12:30	USA	Core PCE	Q1	%	2.1	-	1.8
12:30	USA	GDP deflator	Q1	%	2.6	-	1.6
14:00	USA	Final Michigan	Apr		85.4	-	88.4

Source: Reuters, BZ WBK

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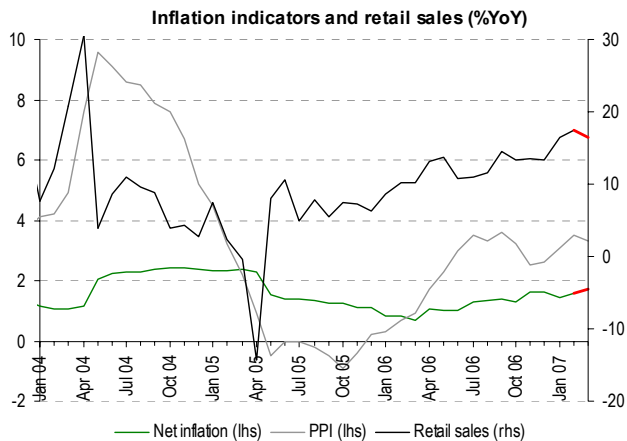
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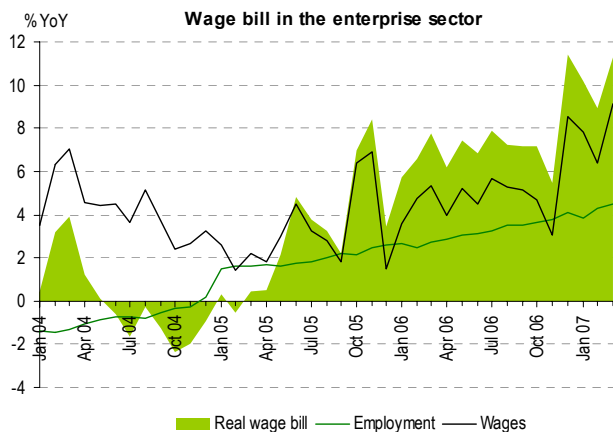
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What's hot this week – Another data and rate hike

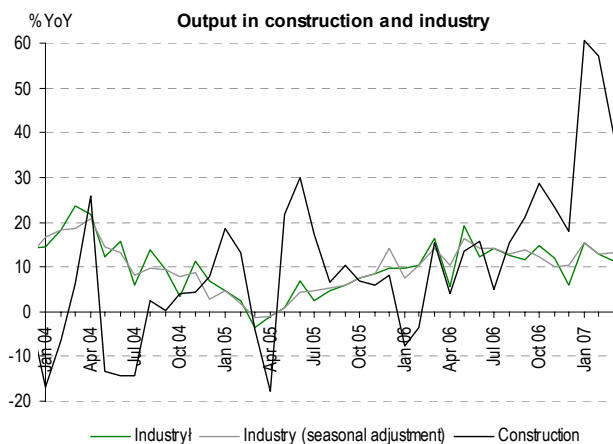


- In the forthcoming week, the key focus of attention on the Polish market will be MPC meeting. 20 out of 21 analysts surveyed by Reuters predict 25bp rate cut.
- Before the decision we will get another set of macro data for March: core inflation measures on Monday and retail sales and unemployment figures on Wednesday.
- We estimate that in March net inflation (i.e. CPI excluding food and fuel prices) increased only slightly to 1.7%YoY from 1.6%YoY in February, showing that significant rise in CPI inflation was mostly an effect of exogenous factors and did not reflect intensification of underlying inflationary pressure.
- Robust increase in retail sales and deep fall in unemployment, predicted by us, would confirm strong firming of labour market conditions and strengthening in consumption demand at the beginning of this year.

Economy last week – Fast rise in output, wages and employment



- As a result of simultaneous acceleration of annual growth in wages (to 9.1% from 6.4%) and employment (to 4.5% from 4.3%), the annual growth of wage bill in companies significantly accelerated to 14% in nominal terms and to 11.3% in real terms.
- On average in 1Q07 the real growth of wage bill amounted to 10.1%YoY and was the highest in history of comparable data. This points to a strong growth of consumption in 1Q07 and confirms forecasts that GDP grew by at least 7% in the first three months of the year.
- At the same time, the data suggested that the relation between wage growth and labour productivity gains, which is a key indicator of future inflationary pressure for the MPC, deteriorates. Thus, the numbers does not leave much doubts that the MPC will deliver interest rate hike already in April.



- An argument for a rate hike in April will be also output data for March. Industrial output growth in March was stronger than expected and reached 11.3%YoY versus 13%YoY in February. The deceleration resulted from an effect of lower number of working days. Seasonally adjusted growth in industrial output accelerated to 13.3%YoY from 13%YoY in February.
- At the same time, construction output surged 39.1%YoY, following record strong increases of around 60%YoY in January and February.
- All in all, output figures confirmed our opinion about strength and persistence of economic expansion. In 1Q07 as a whole industrial output rose 13.2%YoY and construction output grew 52%YoY.
- We still estimate that GDP growth in 1Q07 was 7% and in the whole year will exceed 6%.

Quote of the week – Ready for a pre-emptive hike

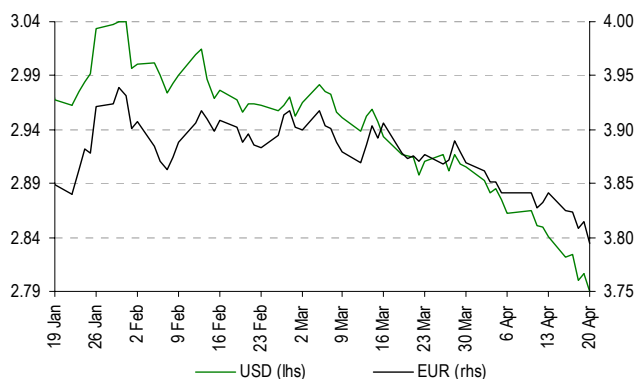
Andrzej Wojtyna, MPC member; PAP, 18 April

If we hike rates, we will show that we control inflation and take into account a possibility of its acceleration. A small rate hike may be desirable so that keep inflation under control. We have to catch the moment when wage pressure will start to pose a threat to price stability. Therefore, uncertainty regarding wage growth leads to fears of inflation prospects. Currently, inflation risk is relatively low due to sizeable corporate profits. Consumers' behaviour also is not a reason for worry. This should be treated as a pre-emptive move against the fundamental risk, which may be materialised through higher than potential economic growth.

Comments of Andrzej Wojtyna suggested that majority of MPC members are ready for a rate hike. At the same time, his words confirmed our opinion that the rate hike would be a pre-emptive move and it would be aimed at causing a psychological effect (the central bank is vigilant), while it should not be treated as a start of series of rate hikes. After publication of new data and taking into account recent comments from MPC members we maintain our view that after April's rate hike another one will take place after a few months and then after one more hike at the turn of the year the reference rate will stabilise at 4.75%.

Monitor rynku

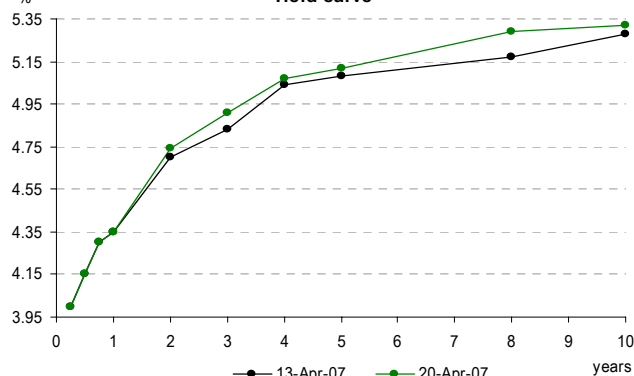
Zloty exchange rate



Zloty broke important technical levels, for how long?

- In the past week zloty's strengthening against the main currencies was continued. Initially, very good data from the labour market had positive impact on the domestic currency. Later amid weakening in the emerging markets there was news that Poland and Ukraine will host the European Football Championships in 2012, which supported the zloty. This event also contributed to further zloty strengthening and breaking ranges we forecasted a week ago.
- Strong fundamentals of the Polish economy and increased optimism will support the zloty, however the technical analysis suggests, the zloty is overbought. Soon one may expect a correction. When it materialises, we think this is going to be a good moment to buy zloty. We decide to lower our forecasted ranges of EURPLN to 3.75-3.85, and for the USDPLN rate to 2.75-2.85.

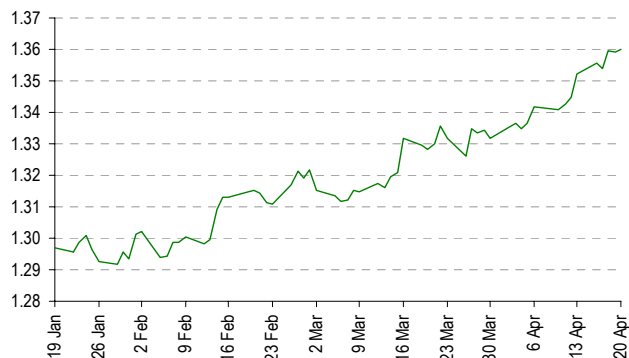
Yield curve



MPC's statement key for the market

- Despite significant weakening, which lasted for a few weeks, last days also brought some slight rise in yields, despite strengthening in the core bond markets. This was a result of much higher than expected data on wages and employment, which increased the probability of monetary policy tightening already in April.
- This week the chances for an interest rate hike by 25 bp are high, however the communiqué is going to be more important. The market may be also influenced by data releases. The possibility of less hawkish tone of the MPC's statement may contribute to yield curve stabilisation (and may even lead to some rates decline at shorter end of the curve). Next week situation in the core markets may be still important amid ample data releases in US and in the EMU.

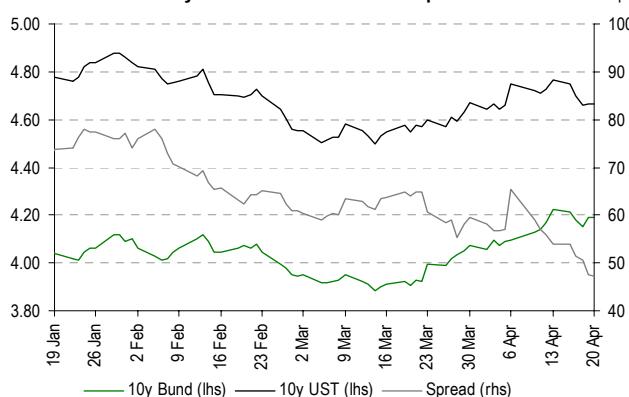
EURUSD rate



EURUSD rate at the highest level in 2.5 years

- Last week the dollar continued weakening against the single currency. Data on retail sales did not support the US currency and there was further depreciation after lower than expected core CPI, which diminished fears of elevated inflation in US. Additional factor that positively influenced the euro was higher than expected ZEW index. Apart from that weaker Philly Fed index also did not give support to the greenback.
- Further dollar's weakening is possible, however the potential to additional rise of the EURUSD rate declined. Next week investors are going to focus most of all on US data from the housing market and Ifo index (in the context of stronger ZEW) in the euro zone. At the end of the week the market is going to concentrate on key US Q1 GDP data.

10y Bunds & Treasuries and spread



Another weakening after solid firming

- After significant weakening, in the first part of the previous week there was some recovery in the core bond markets, among others with regards to the fall of inflation fears in US (after low core CPI). However, at the end of the week the investors' demand declined and there was another weakening. Yields of 10Y US Treasuries and German Bunds dropped from 4.74% and 4.2% to 4.68% and 4.19%.
- We hold our view that in the second half of this year there may be some monetary policy easing in US and further rate hikes may follow in the EMU, (in June and at the end of 2007). Data from the US housing market will show whether the market situation stabilises. GDP data are going to be very important with regards to concerns over economic growth, which tend to surprise. Fed's favourite inflation measure, which is the core PCE index, is going to be also essential.

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