

# Weekly economic update

14 – 20 May 2007

Last week was marked by meeting of major central banks. Their decisions on interest rates were in line with market expectations. FOMC and the ECB kept rates on hold at 5.25% and 3.75%, respectively, while the Bank of England lift rates by 25bp to 5.5%. Tone of official statement of US central bank was not softened as expected, but next data raising concerns about condition of the world's largest economy suggest a possibility of rate cuts in the US later this year. Meanwhile, the tone of ECB statement underpinned market expectations of a rate hike in June, but did not delivered any hint on further steps of rate-setters in the euro zone.

This week we will get crucial domestic macro data for April – CPI inflation and labour market statistics from the enterprise sector. Besides, monetary statistics and budget results for April as well as balance of payments for March will be published. All of them are expected to confirm very good condition of the Polish economy with slight increase in macroeconomic imbalance as regards tendencies in inflation and foreign trade, but reduction in fiscal imbalance, as the Ministry of Finance said the budget gap after March reached a mere 7-8% of the full year plan.

Strong domestic macro data are positive of the zloty in the medium and long term, but we think that the forthcoming days may see a continuation of correction in the domestic FX market. We maintain the forecasted range of EURPLN rate at 3.72-3.82 and for the USDPLN rate at 2.74-2.84.

## Kalendarz wydarzeń i publikacji

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
<b>MONDAY (14 May)</b>							
12:00	PL	Money supply	Apr	%YoY	17.5	17.1	18.0
<b>TUESDAY (15 May)</b>							
12:00	PL	CPI	Apr	%YoY	2.3	2.3	2.5
	PL	Budget deficit	Apr				
9:00	EMU	Preliminary GDP	Q1	%YoY	2.9	-	3.3
12:30	US	CPI	Apr	%MoM	0.5	-	0.6
13:00	US	Net capital flows	Mar	\$ bn		-	94.5
<b>WEDNESDAY (16 May)</b>							
9:00	PL	Auction PLN1.5-2.5bn of 5Y PS0412 bonds					
9:00	EMU	Final HICP	Apr	%YoY	1.8	-	1.9
12:30	US	Houses starts	Apr	m	1.5	-	1.518
13:15	US	Industrial output	Apr	%MoM	0.3	-	-0.2
13:15	US	Capacity utilization	Apr	%	81.5	-	81.4
<b>THURSDAY (17 May)</b>							
12:00	PL	Wages	Apr	%YoY	8.8	7.9	9.1
12:00	PL	Employment	Apr	%YoY	4.6	4.4	4.5
6:00	JP	BOJ report after decision				-	
16:00	US	Philadelphia Fed index	May		3.0	-	0.2
<b>FRIDAY (18 May)</b>							
12:00	PL	Trade balance	Mar	€ m	-391	-489	-60
12:00	PL	Current account balance	Mar	€ m	-489	-489	-424
14:00	US	Preliminary Michigan index	May		87.3	-	87.1

Source: Reuters, BZ WBK

**Maciej Reluga** Chief economist (+48 22) 586 8363

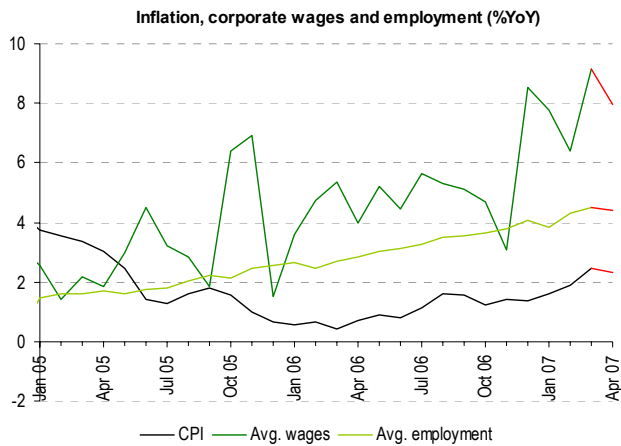
**Piotr Bielski** (+48 22) 586 8333

**Piotr Bujak** (+48 22) 586 8341

**Cezary Chrapek** (+48 22) 586 8342

e-mail: ekonomia@bzwbk.pl

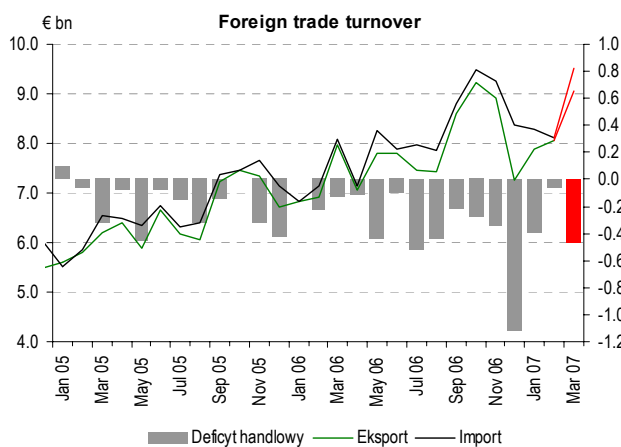
## What's hot this week – Fresh domestic macro data



▪ The forthcoming week will bring next set of monthly macro data, including the market-sensitive data on CPI inflation and labour market statistics.

▪ We forecast that CPI inflation in April have fallen to 2.3%YoY from 2.5%YoY in March. Inflation remains above 2% mainly because of food and fuel prices as well as a result of high growth in housing and energy costs. Price changes in other categories of consumption basket were not large (some prices drop and other increase) which is reflected in net inflation staying below 2%.

▪ However, central bankers are concerned that underlying inflationary pressure may mount in future due to tightening labour market conditions. Therefore, labour market data will be in focus of market's attention. We predict wage growth has slowed down slightly, but remained in upward trend, calling for cautiousness in monetary policy.

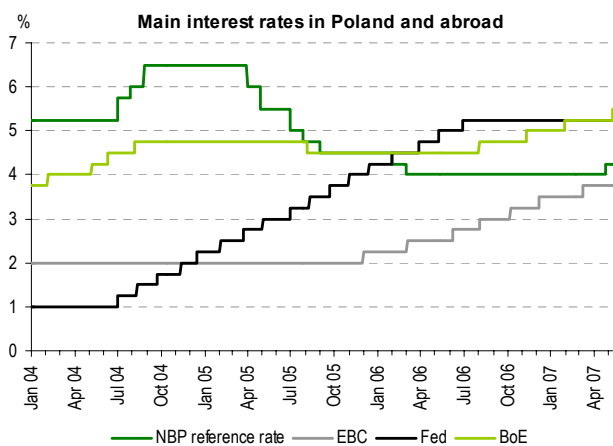


▪ Before we will get data on inflation on Tuesday and labour market statistics on Thursday, on Monday the NBP will publish monetary statistics for April and on Friday balance of payments for March will be released.

▪ We predict that money supply growth in April has decelerated somewhat, but remained in strong upward trend. This would reflect robust economic activity and the fact that some part of investment and consumption demand is financed to a growing extent by loans.

▪ After some improvement of balance of payments results in February, we predict trade gap in March widened again, as there was increase in difference between growth of imports and exports. Amid strong domestic demand, we expect some widening of external imbalance of the economy, but this should not be significant thanks to continued relatively strong performance of export sector.

## Economy last week – Decisions of major central banks in line with expectations



▪ Last week's series of major central banks' meetings brought decisions that were in line with market expectations. FOMC and the ECB left rates on hold and the Bank of England raised rates by 25bp to 5.5%.

▪ As decisions were consistent with expectations, the markets focused on official statements of the central banks in search for hints on future monetary policy decisions.

▪ The official statement released by the Fed was less hawkish than expected (the market expected some softening of its tone), but we still assume rate cuts will take place in the US later this year. A tone of ECB statement underpinned market expectations of rate hike in June, but lacked hints on the euro zone's interest rate prospects in longer time horizon. Thus, the statement was interpreted as a less hawkish than expected.

## Quote of the week – Spring frosts and inflation

**Katarzyna Zajdel-Kurowska, deputy FinMin; PAP, 8 May**

*If information about damages to fruit-growing are confirmed, we may have higher inflation in 2H07, but not significantly. According to our estimates, impact on annual average inflation will not be larger than 0.1pp.*

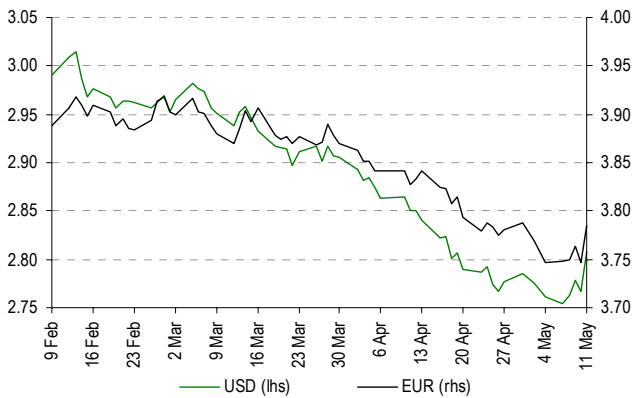
**Mirosław Pietrewicz, MPC member, PAP, 7 May**

*If information about disaster in fruit-growing are confirmed, this will have negative impact on inflation, but I think it will not be significant, as the weight of fruits in consumption basket is not too large. As for now we have to wait for more complete information about possible damages from different regions of the country.*

If damages to fruit-growing are confirmed, inflation path for the next 12 months may move upward by a few decimals of percentage point (FinMin estimates it will be maximum 0.1pp). However, one should remember that in case of such supply shocks, their direct impact on the headline inflation rate is visible only for 12 months (net inflation is not affected at all). Thus, the news about spring frosts are not a serious argument for a rate hike. In our opinion the MPC is focused on labour market developments and other factors affecting medium-term inflation outlook while growth rate of food prices is less important information for central bankers.

**Market monitor**

**Zloty exchange rate**

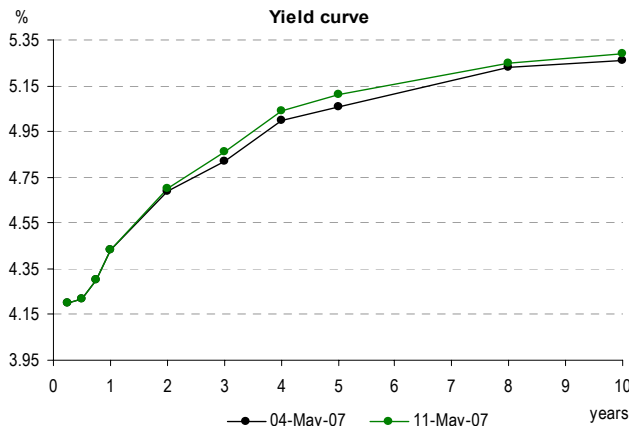


**A slight correction in the FX market**

At the start of the past week zloty fluctuated in a quite narrow ranges against the major currencies and held at very strong levels. In the last days there was a significant correction, which was connected with worsening of sentiment toward the emerging markets, among others after downgrading of the Turkey's credit rating and dollar strengthening as well as Hungarian forint depreciation. The EURPLN rate declined in the last week by ca. 0.6%, and USDPLN by ca. 1.2%.

This week there is going to be a series of domestic data releases in the domestic market, which are going to confirm a good economic situation. This may support the zloty. However we assume the correction in the FX market may be slightly deeper than till now. We kept the range of 3.72-3.82 for the EURPLN rate and increase for USDPLN to 2.74-2.84.

**Yield curve**

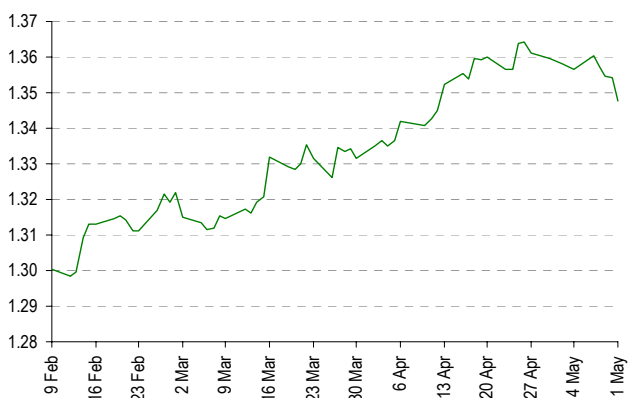


**Debt market slightly weaker**

In the last days the activity in the debt market increased after domestic investors returned after May holidays, and the market slightly weakened and return to the levels before the May holidays. The worsening of moods in the emerging markets with regards to situation in Turkey, higher CPI in Czech, was the most important factor that negatively affected the debt market.

The market consensus fro CPI slightly rose on the release inflation forecast by the Ministry of Finance, however it seems that inflation data may not influence the bond prices. Labour market data may be more important, and may slightly weaken bonds. The auction of 5Y bonds is going to show moods in the market. The data from abroad that will influence the moods in the emerging markets will be also essential.

**EURUSD rate**

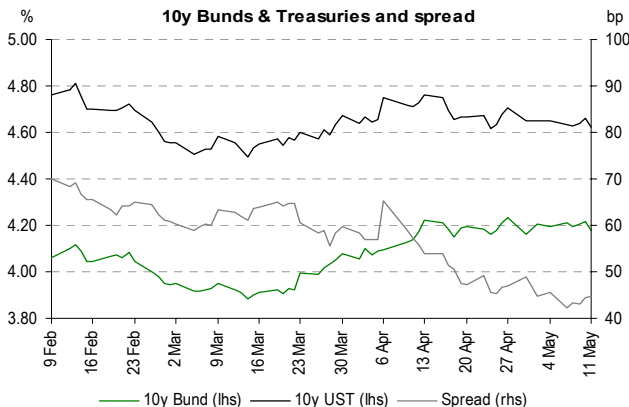


**Significant dollar's strengthening**

After heavy appreciation of the dollar in the previous week the greenback's strengthening was continued in the last days. This resulted from more hawkish than expected Fed's statement, that declined the market expectations for interest rate cuts in the United States less hawkish comments of the EBC's president. After limiting of short dollar positions the EURUSD rate fell at the end of the week to 1.35.

There are quite significant data scheduled for this week that may be important for Fed's decisions and the most important will be the CPI inflation and the US housing market data. Philadelphia Fed is going to be also important. In the euro zone the preliminary GDP data for Q1 are going to be also essential as well as final HICP inflation. We assume that in the short term the dollar may weaken again, however later this year it may appreciate.

**10y Bunds & Treasuries and spread**



**Slight changes in the core markets**

The US bonds slightly strengthened ahead of Fed meeting. However Fed's statement was more hawkish than some analysts expected. The negative influence on the German markets was limited by not too much hawkish comments of Jean Claude-Trichet. At the end of the week weaker than expected retail sales strengthened the debt. Yields of 10Y Treasuries and Bunds fell by ca. 2 bp to 4.62% and 4.17%.

If the inflationary data in US show a drop in core CPI the expectation of interest rate cuts may return to the market. The Philadelphia Fed index and housing market data will also be important for the US debt market. After the ECB's meeting and expected hike in June with do not exclude another one later this year.

---

This publication has been prepared by Bank Zachodni WBK S.A. (a member of AIB Group) for information purposes only. It is not an offer or solicitation for the purchase or sale of any financial instrument. All reasonable care has been taken to ensure that the information contained herein is not untrue or misleading. But no representation is made as to its accuracy or completeness. No reliance should be placed on it and no liability is accepted for any loss arising from reliance on it. Bank Zachodni WBK S.A., its affiliates and any of its or their officers may be interested in any transactions, securities or commodities referred to herein. Bank Zachodni WBK S.A. or its affiliates may perform services for or solicit business from any company referred to herein. This publication is not intended for the use of private investors. Clients should contact analysts at and execute transactions through a Bank Zachodni WBK S.A. entity or an AIB Group entity in their home jurisdiction unless governing law permits otherwise. Copyright and database rights protection exists in this publication.

Additional information is available on request. Please contact Bank Zachodni WBK S.A. Treasury Division, Economic Analysis Unit, ul. Marszałkowska 142, 00-061 Warsaw, Poland, phone (+48 22) 586 83 63, email [ekonomia@bzwbk.pl](mailto:ekonomia@bzwbk.pl), <http://www.bzwbk.pl>



Bank Zachodni WBK is a member of Allied Irish Banks Group