

# Weekly economic update

28 May – 3 June 2007

After publication of set of April's data that showed slightly weaker than forecasted economic activity at the start of the second quarter, we do not change our expectations regarding interest rate prospects in the following months. The nearest MPC meeting that will conclude on Wednesday will most likely end up with no change in main interest rates, as the majority of Council members will prefer to wait with next rate hikes until some more convincing signs of building inflationary pressure appear. GDP data for 1Q07 that will be released one day after the MPC meeting are likely to confirm that the start of the year was an exceptionally good period in Poland's economy when economic growth rate reached at least 7%YoY. For the financial market, the most important information during the week could be Ministry of Finance's inflation forecast for May that may be announced on Friday. The forecast could affect market analysts' inflation estimates and expectations re timing of the next rate hike. Our current prediction for May is at 2.2%YoY, down from 2.3% in April.

Economic calendar abroad is thick with very important data releases in major world economies. Most of them will be concentrated in the second part of the week, and they could have important impact on the core financial markets and expectations regarding future decisions of major central banks. Particularly important will be data about GDP and inflation in the US and the euro zone, Fed's minutes, and labour market report from the US.

## Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
<b>MONDAY (28 May)</b>							
-	US, GER, UK	Market holiday					
<b>TUESDAY (29 May)</b>							
14:00	US	Consumer confidence	May	pts	104.5	-	104.0
<b>WEDNESDAY (30 May)</b>							
-	<b>PL</b>	<b>MPC meeting – decision</b>	-	%	<b>4.25</b>	<b>4.25</b>	<b>4.25</b>
08:00	EMU	Money supply M3	Apr	%YoY	10.5	-	
12:15	US	ADP Report	May	'000	115	-	64
18:00	US	Minutes of FOMC meeting in May					
<b>THURSDAY (31 May)</b>							
<b>08:00</b>	<b>PL</b>	<b>GDP</b>	<b>1Q07</b>	<b>%YoY</b>	<b>7.2</b>	<b>7.0</b>	<b>6.7</b>
09:00	EMU	Economic sentiment	May	pts	110.7	-	111.0
09:00	EMU	Flash HICP	May	%YoY	1.9	-	1.9
12:30	US	Preliminary GDP	1Q07	%YoY	1.6	-	1.6
12:30	US	Core PCE	1Q07	%YoY	2.2	-	2.2
12:30	US	GDP Deflator	1Q07	%YoY	4.0	-	4.0
13:45	US	Chicago PMI	May	pts	53.8	-	52.9
<b>FRIDAY (1 June)</b>							
08:00	EMU	PMI manufacturing	May	pts	55.5	-	55.4
09:00	EMU	GDP	1Q07	%YoY	3.1	-	3.3
12:30	US	Core PCE	Apr	%MoM	0.2	-	0.0
12:30	US	Non-farm payrolls	May	'000	125	-	88
14:00	US	ISM manufacturing	May	pts	54.5	-	54.7
14:00	US	Final Michigan index	May	pts	88.4	-	87.1

Source: Reuters, BZ WBK

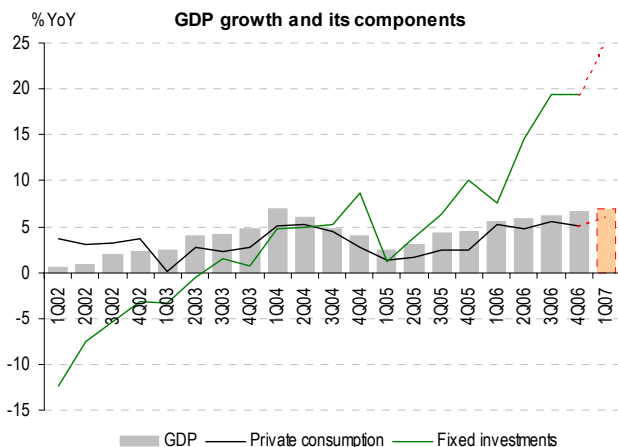
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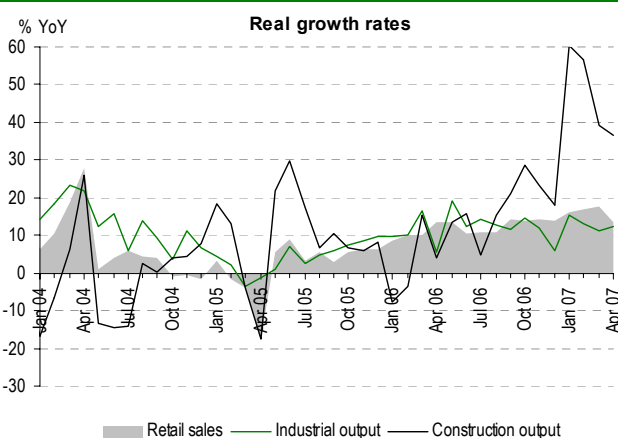
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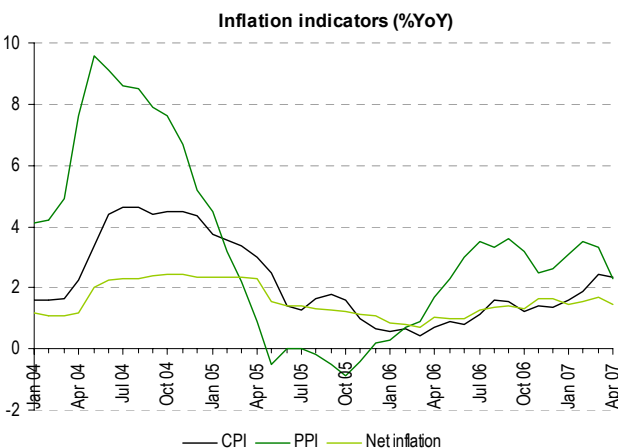
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**What's hot this week – MPC, GDP, and lots of data releases abroad**

- The most important events of the week on the local market will be MPC meeting and GDP data release for 1Q07.
- We predict the MPC to leave rates on hold, awaiting for more data that would help in assessment of inflation prospects. The MPC comment on recent labour market data from LFS may be critical for expectations regarding timing of next moves.
- GDP growth in Q1 reached at least 7%YoY amid strong growth in private consumption (6%) and investment. Next quarters may show some slowdown in growth, yet moderate.
- Although the week will start with holiday in the core markets, its second part will be crammed with publications of key economic data from the USA and the euro zone, including inflation numbers, GDP, employment and business climate. They may affect expectations regarding central banks' future decisions.

**Economy last week – Weaker economic activity growth at the start of Q2**

- Data about economic activity in April were slightly weaker than forecasted, confirming that the second quarter may see some slowdown in economic growth rate.
- Industrial output increased 12.4%YoY, construction output rose 36.7%YoY, while retail sales rose 15.1%YoY.
- On the other hand, labour market data confirmed that a scale of tightening in this area has been strengthening and pace of unemployment decline has been accelerating.
- Registered unemployment rate fell in April to 13.7%YoY, but results of Labour Force Survey showed even stronger signal. LFS jobless rate dropped in Q1 to 11.3% and number of employed advanced by 5.3%YoY. Unit labour costs calculated using those data increased 5%YoY in Q1. This could be a warning signal for the MPC but please recall that the central bank used to have doubts in the past regarding credibility of such estimates.



- Thus far, inflation data did not give reasons for serious concerns as it is difficult to find signs of strong fundamental pressure on prices.
- PPI growth decelerated in April to 2.3%YoY, more than expected, and net inflation fell to 1.5%YoY, in line with forecasts. Data confirmed that despite strengthening in domestic demand inflationary pressure is not clearly visible, which should allow the MPC to wait until Q3 with next interest rate hikes.
- Minutes of the MPC meeting in April released by the central bank confirmed our assessment of the distribution of views among the MPC members that was established after analysis of their previous comments and decisions. April's rate hike was a signalling move and the MPC is likely to wait with the next decision until it gets more certain that risks for inflation will materialise.

**Quote of the week – There is time to think this over**

**Jerzy Owsiak, MPC member; PAP, 21 May**

*Current economic growth around 7% is close to the potential. (...) In many areas of the country this growth does not translate into reduction of unemployment, which is still very high.*

**Andrzej Sławiński, MPC member; Gazeta Prawna, 23 May**

*Rate of economic growth is higher than potential, which creates a risk of inflation increase. (...) Labour market tensions get stronger.*

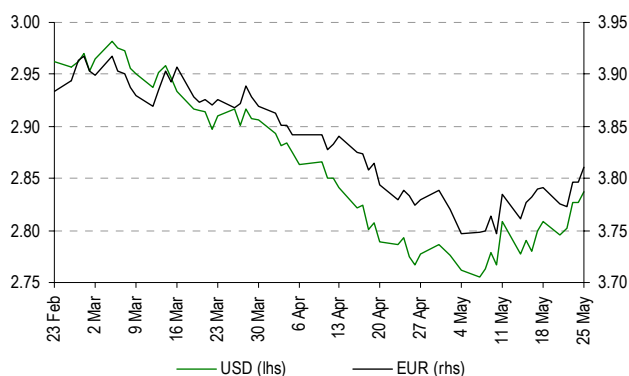
**Dariusz Filar, MPC member; PAP, 22 May**

*Since June, until July and August the Council may be receiving very important information leading to a need for another rate hike.*

Recent comments of MPC members and minutes of the last MPC meeting signalled that the Council is divided into three groups with different views on inflationary and economic perspectives. While representatives of dovish faction are quite predictable and it seems very little likely they will be ready to vote for rate hike in the nearest months, two other groups deserve more attention. First of all, one should notice that even the most hawkish MPC members were recently mentioning longer pauses between rate decisions and small scale of the hikes. Secondly, MPC members with moderate views could find it difficult to find arguments in favour of further rate hikes among set of economic data for April that were released recently and were weaker than predicted.

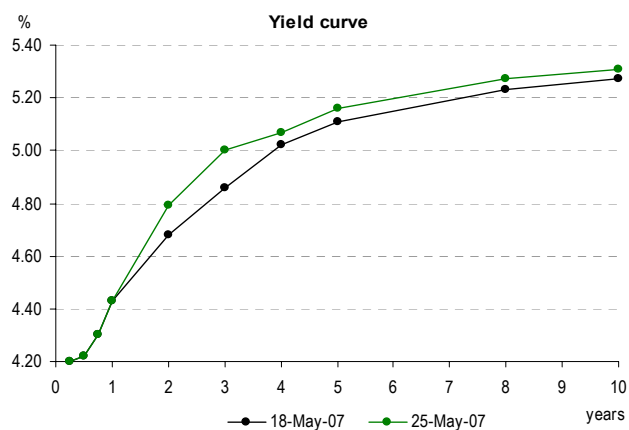
## Market monitor

Zloty exchange rate



### Zloty harmed by worse sentiment on global markets

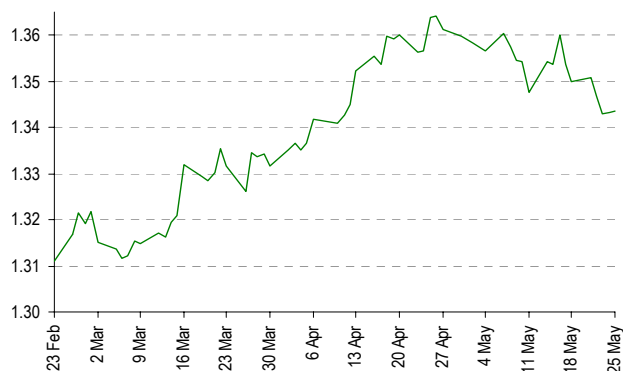
- Despite strengthening at the beginning of the week, later on the zloty was harmed by increase in risk aversion in the global markets, among others due to deep fall at Chinese stock exchange. The EURPLN rate broke not only the 3.80 level, with which it was struggling in vain for the whole previous week, but also topped 3.82. This confirmed our predictions from the previous report were right. Only on Friday some stabilisation took place before the long weekend in the major foreign markets.
- This week the domestic FX market will be large dose of crucial data from the US and performance of stock markets in Asia and at Wall Street. For the EURPLN rate we maintain the range of 3.75-3.85 and for the USDPLN we move the range up to 2.78-2.88.



### Domestic yield curve moves up

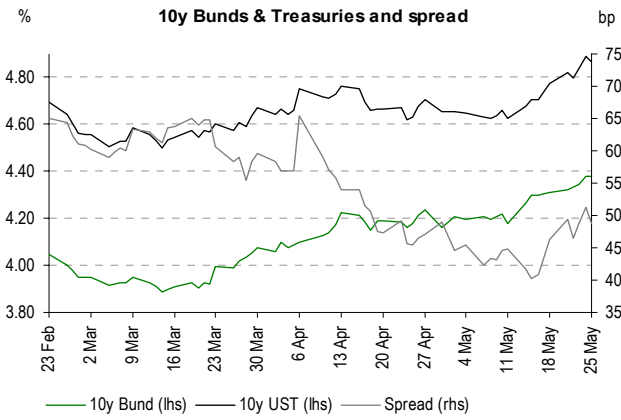
- At the beginning of the week the domestic debt market was stable. Despite rising yields in core markets, domestic bonds were not weakening, being supported by lower than expected output figures and dovish comments from the MPC. However, later on domestic bonds began to gradually weaken, especially strong on Thursday after sharp rise in yields on core markets following much stronger than expected figures in the US. Publication of minutes of the MPC meeting in April, as well as retail sales and unemployment figures for April, did not affect the market.
- This week the domestic market will wait for conclusions from the MPC meeting (the key focus will be on official statement), domestic GDP data for 1Q07 and for very important data abroad in the second half of the week.

EURUSD rate



### Dollar gains thanks to strong data

- Last week the dollar continued strengthening started during the previous week. Appreciation of the greenback was driven by much stronger than predicted data on the condition of the US economy (showing, among others, the strongest rise in new home sales in 14 years), which weakened expectations of swift rate cuts by the FOMC. Strengthening of the dollar against the euro was also a consequence of revaluation of the Chinese yuan against the US currency, which potentially improves the US balance of payments.
- At the beginning of this week the EURUSD market should be stable due to the long weekend (market holiday on Monday) of the main markets. Later during the week the EURUSD rate will depend on numerous publications of crucial data both in the euro zone and in the US.



**Strong rise in yields on core markets**

- Bond yields on core markets went up last week, especially in the US. Treasuries gained temporarily on Tuesday after signals of a possibility of swift rate hikes in Japan. Later on, however, a series of stronger than expected data releases weakened expectations of swift rate cuts by the FOMC and 10-year Treasuries weakened reaching the maximum level during the week at 4.88%.
- This week there will be next releases of very important data from the euro zone and in the US. The figures will be of high important for expectations regarding next moves of major central banks. The accumulation of crucial data publications will take place on Thursday and Friday. Before the data releases the core debt market should be quite stable.

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