

Weekly economic update

4 – 10 June 2007

MPC meeting in May did not bring any surprises. Interest rates remained unchanged and the official statement of the Council was neutral for expectations regarding monetary policy prospects. The MPC maintained informal restrictive bias in monetary policy, but the assessment of balance of risks for future inflation did not change.

GDP data for 1Q07 revealed one day after the MPC meeting were stronger than expected. Thus, hawks from the MPC received an argument for a rate hike, but we do not change our expectations regarding next moves of the Council. We think that the next step of 25bp is possible in July at the earliest. From the market's point of view, one can say that better-than-expected GDP data for 1Q07 neutralised an effect of data for April, which were mostly weaker than predicted.

From the MPC's point of view, GDP data for 1Q07 are historical and expected acceleration of GDP growth in 1Q07 to above 7% was taken into account by the Council when it decided to hike rates in April. In the forthcoming quarters the MPC expects some deceleration of GDP growth. Much will depend on the scale of the expected deceleration (we predict GDP growth of 5.5% in 4Q07 and above 6% in the whole year) and at the same time on relation between wage growth and productivity gains. In this context, economic activity indicators and labour market statistics for May and June will be of crucial importance for the market.

This week there will no domestic data releases. Given a holiday on Thursday and the long weekend, activity in the Polish market should be low in the forthcoming days. Performance of the domestic market will depend on moods in global markets and data releases abroad. A crucial factor will be ECB meeting on Wednesday.

An element which again begin to attract more attention of the market are development on the domestic political scene. The ruling parties started talks regarding changes in the coalition agreement, including economic issues. Minor coalition partners make some populist demands, but the Prime Minister try to defend the planned reforms. In the forthcoming weeks the government will have to accept macroeconomic assumption for the 2008 budget and final decisions on a reduction in disability pensions contribution will be made, so it is worth to watch domestic politics.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
MONDAY (4 June)							
9:00	POL	Auction of PLN500m 52-week Treasury Bills					
14:00	US	Factory orders	Apr	%	0.6	-	3.1
TUESDAY (5 June)							
9:00	EMU	Retails sales	Apr	%YoY	2.0	-	2.6
14:00	US	ISM non-manufacturing	May	pct	55.7	-	56.0
WEDNESDAY (6 June)							
11:45	EMU	ECB – interest rates decision		%	4.00	4.00	3.75
12:30	US	Unit labour costs	Q1	%	0.8	-	0.6
THURSDAY (7 June)							
-	PL	Holiday – Corpus Christi					
11:00	UK	Bank of England - interest rates decision			5.50	5.50	5.50
14:00	US	Wholesale inventories	Apr	%	0.3	-	0.3
FRIDAY (8 June)							
12:30	US	Trade balance	Apr	US\$bn	-63.3	-	-63.9

Source: Reuters, BZ WBK

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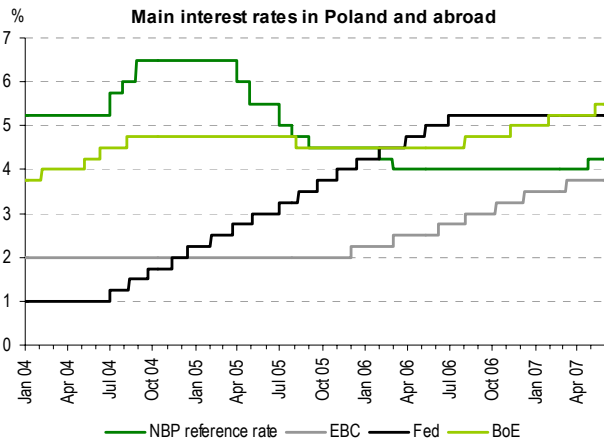
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What's hot this week – Rate hike by the ECB and data abroad



- There are no data releases scheduled in Poland for this week. The only important news may come from the political scene, as ruling parties conduct talks on update of the coalition agreement.
- It is possible, however, that a prospect of the long weekend (holiday on Thursday) will cause that nothing important will happen this week also in domestic politics.
- Abroad, the economic calendar is not as heavy as in the previous week, but every day of the week the markets will get a piece of information important for expectations regarding monetary policy of the world's major central banks and thus for sentiment in emerging markets.
- It is widely expected that the EBC will raise interest rates by 25bp at its meeting on Wednesday. The markets will focus on the official statement in search for hint on next moves of the bank.

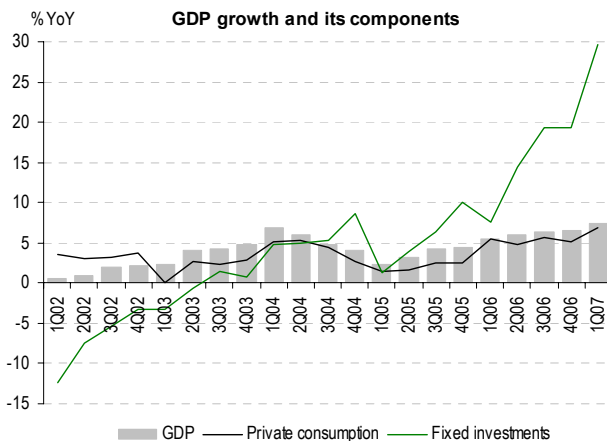
Economy last week – MPC did not surprise, GDP data stronger than expected

Selected fragment of the MPC statement from 30 May

In the Council's assessment the high growth of domestic demand, which most probably exceeds the growth of potential GDP, will be sustained in the next quarters. The latest data on labour market developments point to a further build-up in wage pressure, which may lead to an increase in inflation. The Council assesses, however, that in the medium term inflation increase will be constrained primarily by a probable continuation of high productivity growth supported by high investment growth, very good financial results of enterprises and low growth of external prices, related to globalisation and the ensuing intensified competition in the market of internationally traded goods and services.

In the Council's assessment in 2007 Q3 CPI inflation may temporarily fall below its present level.

- The MPC left interest rates on hold, in line with market expectations. In the statement released after the meeting the MPC said that the risk of inflation running above the target in the medium term had decreased, although was still higher than probability of inflation running below the target. This means that an informal restrictive bias is still bidding.
- At the same time, both the official statement and comments from rate-setters indicated that the Council as a whole is not in hurry with next rate hikes and possible moves will depend on incoming data.
- We maintain our view that a rate hike could take place in 3Q07 (possibly in July). The MPC stressed in the statement that recent labour market statistics indicate that wage pressure keeps mounting. Labour market conditions will surely remain the key focus of the MPC's attention.



- GDP growth amounted to 7.4%YoY in the first quarter, which was the best result since 1997.
- The main factors responsible for acceleration of GDP growth from 6.6% recorded in 4Q06 were private consumption (increase of close to 7%YoY) and fixed investments (a surge of nearly 30%YoY).
- The two factors translated into strong growth of domestic demand. It was 8.6%YoY, the same as in 4Q07.
- Negative net export contribution was slightly lower than recorded in 4Q06 and reached 1.2pp.
- The data may be probably another argument for the hawkish faction within the MPC, though one should remember these were historical figures and the MPC already reacted to them in April (at least partly).

Quote of the week – MPC never sleeps, MPC keeps watching

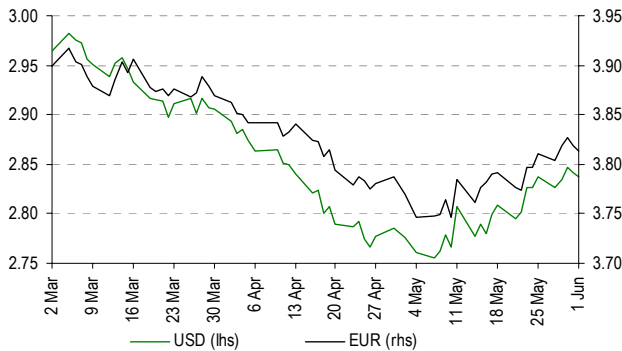
Halina Wasilewska-Trenkner, MPC member; Radio PiN, 31 May
I would say – paraphrasing a well-known saying – the Council never sleeps, the Council keeps watching. No, we are not unconcerned. We have many questions regarding developments in the first quarter and its implications for future. We discuss about it, but as for now we think that we still have leeway, we do not have to raise rate aggressively.

Mirosław Pietrewicz, MPC member; PAP, 31 May
If GDP growth in Q2 was equally strong as in Q1, this would probably require a reaction of the central bank. However, I think that such strong growth in Q2 is not very likely and assessment whether there is a hike is needed will be possible after GDP data for 2Q07.

MPC comments, which appeared after the last week's meeting, confirmed our opinion that the Council will not hurry with next rate hikes. The hawkish camp, among others Halina Wasilewska-Trenkner, still believe further tightening is necessary, but even they admitted that there was no need to hike rates aggressively. At the same time, doves admitted (it was stated by Jan Czekaj and Mirosław Pietrewicz) that if GDP growth remains at same level as in Q1, more rate hikes could be required. Yet, current forecasts show that GDP growth will decelerate in next quarters and inflation pressure will remain moderate.

Market monitor

Zloty exchange rate

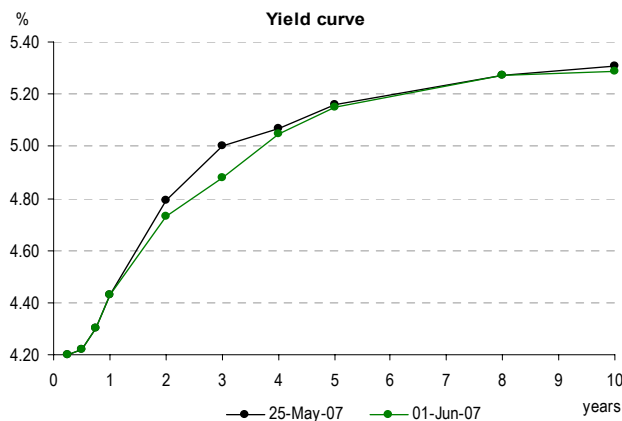


Correction in the foreign exchange market

▪ After calm beginning of the week, which was connected with the long weekend in main core markets, the following days brought quite significant weakening of the zloty. This was driven by deep falls on Chinese stock market following a decision by the Chinese authorities to triple tax on securities transactions to cool the market's rally. As a result of moods deterioration in emerging markets the zloty reached the levels of 3.837 and 2.86 against the euro and the dollar, respectively.

▪ At the end of the week sentiment towards the Polish currency proved again and it seems that this week information from abroad will be again the key. We maintain the range of 3.75-3.85 for the EURPLN rate and 2.78-2.88 for the USDPLN.

Yield curve

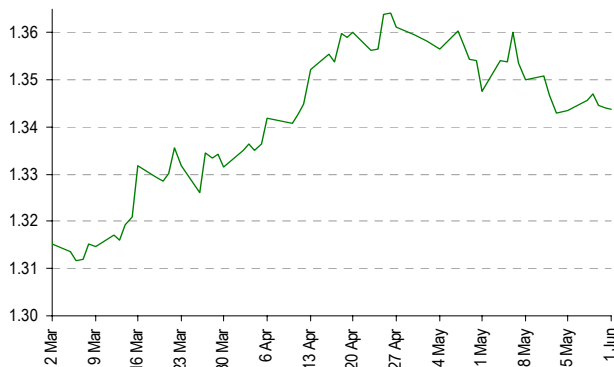


Domestic yields did not follow core markets

▪ Despite further weakening in core bond markets, the Polish yield curve was relatively stable last week. As regards domestic factors, a moderate decrease in yields was visible in reaction to MPC members' comments, which were perceived by the market as rather dovish. The market could have been positively influenced also by information from the Ministry of Finance on lower supply of Treasury papers in June (e.g. no auction of two-year papers next week) as well as on inflation projection for May (2.1%YoY). Higher than expected GDP data and MPC decision were market neutral.

▪ We expect that stabilisation of the Polish curve will be continued and the key factors this week will be meetings of the central banks – the ECB and the Bank of England.

EURUSD rate

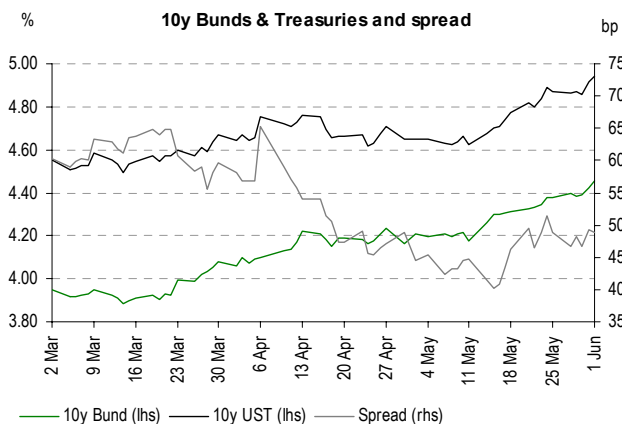


Stabilisation of the EURUSD rate

▪ Situation in the international foreign exchange market was quite stable with the EURUSD rate trading in a narrow range. A temporary weakening of the dollar (rate above 1.35) resulted from, among others, an activity of Far East central banks, which have been selling the greenback in order to diversify the structure of FX reserves. Also, strengthening of expectations for monetary tightening in the euro zone, after ECB's Axel Weber suggested further rate hikes, could have played a role. However, after better than expected data on US economy the EURUSD went back to the levels observed at the end of the previous week (slightly above 1.34).

▪ In the upcoming week ECB meeting as well US data on ISM non-manufacturing and trade balance will be important.

10y Bunds & Treasuries and spread



Further rise in yields abroad

▪ Last week showed further continuation of the trend observed in the last couple of weeks on yields increase in the core bond markets. Although some strengthening in the fixed income market took place during the week in reaction to deterioration in moods in equity markets and higher appetite for safe assets, but this should be perceived rather as a temporary correction.

▪ In consequence of US economic data releases (consumer confidence, Chicago PMI, labour market data), yield of ten-year Treasuries rose significantly, exceeding the level of 4.90% by a few basis points. Yields of German Bunds followed the same pattern and this additionally reinforced by strong expectations for further rate hike by the ECB. Thursday's decision will be the key in the upcoming week.

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