

Weekly economic update

11 – 17 June 2007

Last week the situation on Polish financial market was under influence of changing moods abroad. Clear deterioration in market sentiment connected with building international investors' concerns over rising interest rates in core markets triggered, among others, declines on the Warsaw stock exchange, zloty weakening and substantial increase in bond yields last week. The coming week will bring more information that may be crucial for trends on international financial markets, as we will learn new data regarding inflation and economic activity indicators in the US and euro zone. For emerging markets, the statement after Bank of Japan's meeting could be also important.

Apart from information from core markets, there are important domestic data releases in the agenda this week. The key publication will concern inflation rate for May. The estimates shown by the Ministry of Finance assume that CPI growth decelerated to 2.1%YoY from 2.3% in April (median of market forecasts is the same). If this prediction gets confirmed, it will be quite a good news for the central bank, suggesting that negative impact of frosty weaker in early May on food prices may be not strong enough to trigger substantial variation in inflation rate. Money supply data will be less important, as usually, especially that they will probably show slight deceleration in M3 growth. Balance of payments data are likely to confirm continuation of fast, double-digit increase in exports coupled with even faster import expansion. Still, the current account deficit should remain moderate, below 2.5% of GDP, which should have no negative impact on the zloty.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
TUESDAY (12 June)							
9:00	EMU	Industrial production		%YoY	4.5	-	3.7
18:00	USA	Federal budget		\$ bn	-61.0	-	-42.91
WEDNESDAY (13 June)							
12:00	POL	CPI	May	%YoY	2.1	2.2	2.3
12:30	USA	Import prices	May	%	0.4	-	-1.3
12:30	USA	Retail sales	May	%MoM	0.5	-	-0.2
THURSDAY (14 June)							
12:00	POL	Money supply	May	%YoY	16.9	17.6	17.8
9:00	EMU	Final HICP	May	%YoY	1.9	-	1.9
12:30	USA	PPI	May	%MoM	0.5	-	0.7
FRIDAY (15 June)							
12:00	POL	Trade balance	Apr	€ m	-405	-404	-627
12:00	POL	Current account	Apr	€ m	-500	-414	-539
6:00	JP	BOJ report after decision					
12:30	USA	CPI	May	%MoM	0.5	-	0.4
12:30	USA	New York Fed index	Jun		10.0	-	8.03
13:00	USA	Net capital flows	Apr	\$ bn		-	45
13:15	USA	Industrial production	May	%MoM	0.2	-	0.7
13:15	USA	Capacity utilisation	May	%	81.5	-	81.6
14:00	USA	Preliminary Michigan index	Jun		88.4	-	88.3

Source: Reuters, BZ WBK

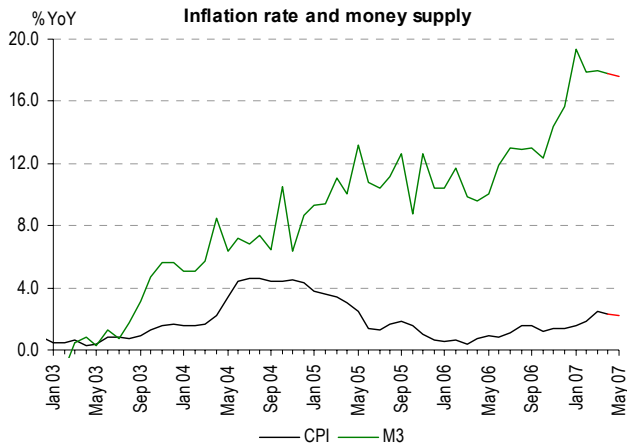
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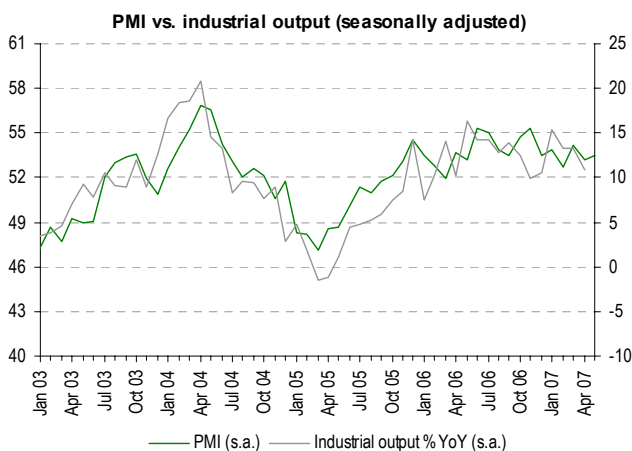
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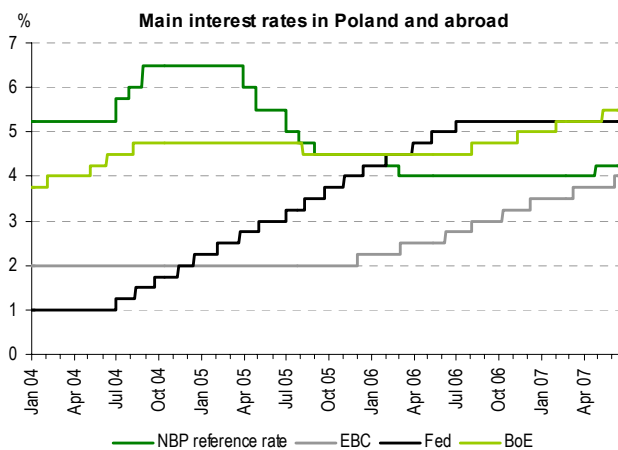
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What's hot this week – First macroeconomic data for May

- After a usual pause in data publications at the start of new month and the long weekend, this week we will learn first new macroeconomic data for May – inflation rate and money supply.
- Ministry of Finance's optimistic CPI forecast, assuming inflation decline to 2.1% in May from 2.3% in April, has influenced market expectations as usually.
- Money supply growth in May should decelerate slightly, while staying at level high enough to support further economic expansion (market consensus almost 17%, our forecast 17.6%YoY).
- Balance of payments data should represent continuation of fast export growth in April and even faster import expansion, while current account deficit should remain at moderate level.

Economy last week – Little new data, deterioration of moods on financial markets

- PMI for Poland increased in May to 53.5 from 53.2 in April. The data had no significant impact on the market but were an optimistic hint before next week's publication of data on industrial production.
- According to deputy finance minister Elzbieta Suchocka-Roguska the tentative estimates of the Ministry of Finance suggested that budget deficit in January-May period reached 14.5-15% of the annual plan against earlier predictions 16-17%. This is a very good result, confirming still very high flow of revenues to the central budget thanks to fast economic growth.
- In turn, the Ministry of Labour and Social Policy informed that the registered unemployment rate declined to 13% in May from 13.7% in April. It is in line with our own forecast and confirms still very good situation on the labour market and continuing fast rise in employment.



- The European Central Bank decided to raise main interest rates by 25 bp to 4.0%. We believe the next rate hike in the euro zone by 25 bp will take place in the second half of the year, possibly in September, and the next tightening could take place early next year.
- Bank of England decided to keep interest rates unchanged at 5.5%, in line with expectations.
- Building concerns about interest rate hikes in the euro zone and USA contributed to rise in anxiety on world financial markets, significant weakening on core debt markets and falls in stock markets. It also translated to weakening of currencies in the emerging markets, including the zloty, amid rising tide of global risk aversion.

Quote of the week – MPC members split in opinions**Marian Noga, MPC member; Reuters, 8 June**

New estimates of the central bank experts show that the inflation path over the upcoming months will be higher than the April projection showed. [...] In order to fulfil our mission [...] monetary policy requires further tightening in two steps. Further steps, beyond all doubt, should take place this year.

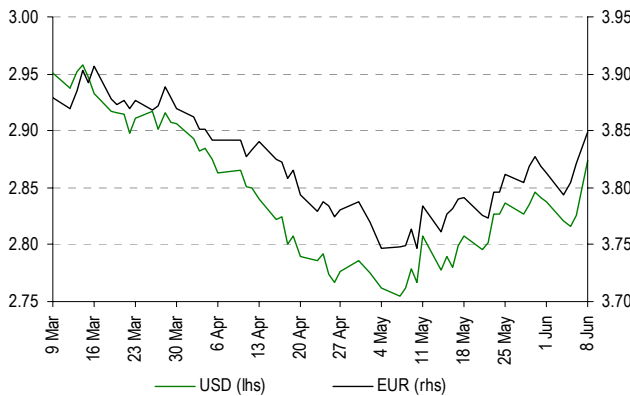
Mirosław Pietrewicz, MPC member; Gazeta Prawna, 6 June

I would prefer this [rate hike] does not happen. But if fast rise in wages and employment i.e. wage bill continues, if credit and retail sales keep growing fast, and zloty weakens, then there could be a need to tighten monetary policy. At this moment there is no ground for changing monetary policy.

New comments of MPC members confirmed differences of opinions within the Council regarding inflation perspectives and required actions in monetary policy. The faction calling for further monetary tightening remains active and will surely keep proposing rate hikes at the nearest MPC meeting. But the success of the motion will depend on the support of "moderate" members. Will they become convinced by the fact that new NBP estimates show higher inflation predictions? The key issue for future MPC decisions should be medium-term inflation perspectives rather than inflation path "over the upcoming months". And the former will be dependent among others on the new data from the labour market. We maintain opinion that the next rate hike will take place in Q3, possibly in July.

Market monitor

Zloty exchange rate

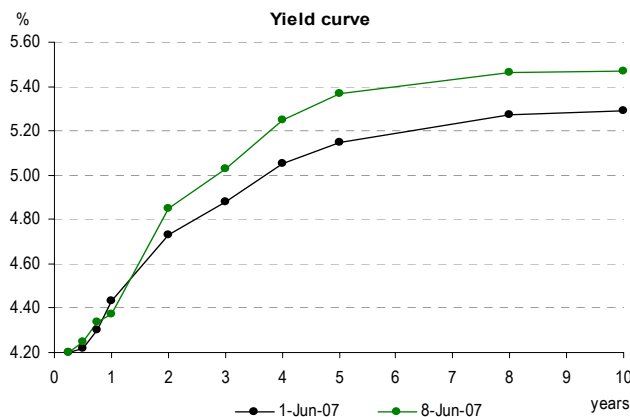


Correction on the zloty continued

▪ After significant weakening of the Polish currency in the last weeks there was a slight recovery at the start of the past week, though it was relatively short-lived. In reaction to dollar's strengthening and an increase of expectations on interest rate hike globally zloty depreciated. At the end of the week it was close to 3,86 against the euro and 2.89 versus the dollar.

▪ In our view, after the correction in the FX market, which we have experienced since the beginning of May there may be some stabilization. In the mid term we expect zloty strengthening. 3.86 and 3.88-3.9 are important technical resistance levels and ranges. The communiqué of Bank of Japan may be essential for the emerging market currencies. We increase the ranges for the EURPLN rate to 3.77-3.87 and for the USDPLN rate to 2.82-2.92.

Yield curve

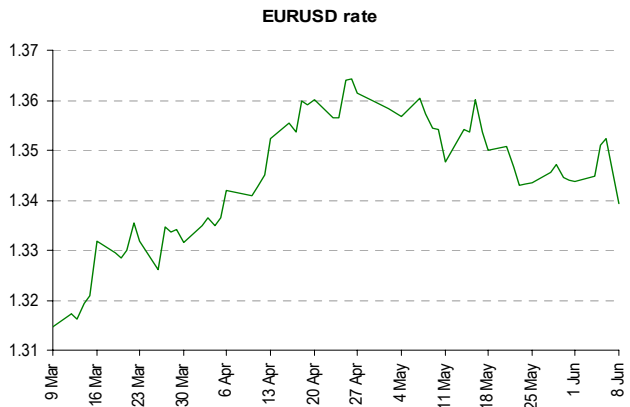


Bonds weaker on core bond yields rise

▪ In the last days there was significant weakening in the domestic bond market. Since the previous Friday yields of the domestic bonds rose by ca. 19-22 bp. Despite significant rise in yields in the core bond market, which was observed in the last few weeks, the domestic debt reaction was limited until substantial weakening in the core markets in the past week.

▪ In the nearest days the market players are going to focus most of all on inflation data especially in the context of quite low inflation forecast of the Ministry of Finance (2.1%YoY). Further moves in the core bond markets will also be important as they will reflect changes in expectations of international interest rate moves amid a lot of data releases (e.g. CPI in the US).

EURUSD rate

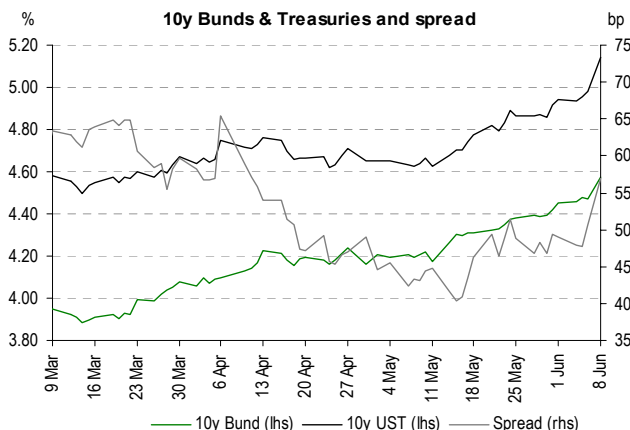


Significant dollar's appreciation

▪ In the first part of the week the EURUSD rate rose significantly above 1.35 ahead of ECB's decision to raise interest rates in the euro zone and with regards to comments of Fed's Governor on US economy. Later on the dollar recovered after the release of high ISM index for services sector as well as with regards to strengthening expectations of globally higher rates. The EURUSD rate fell at the end of the week to 1.335.

▪ In the longer term we expect greenback's further appreciation. This week retail sales and inflation (CPI and PPI) data are going to be the most important for the relation of euro against the dollar. US production data and Michigan consumer sentiment index may be also essential.

10y Bunds & Treasuries and spread



Another jump in yields

▪ After substantial weakening in the last weeks at the start of the week there was some fall in yields among others with regards to correction in the stock markets. However after Bernanke's comments and ISM index expectations of rate cuts in the US declined. Moreover expectations of interest rate hikes in the euro zone increased, though the monetary tightening cycle may be close to end.

▪ We presume the ECB may raise rates to 4.25% in September and yet another hike may follow at the start of next year. This week core CPI and PPI data on inflation figures will be crucial for interest rates expectations. US retail sales figure will also be important as they may show consumer moods and may give hint on the prospects of US economy. Activity NY Fed index may be also interesting.

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