Bank Zachodni WBK

Weekly economic update

18 – 24 June 2007

Data released last week did not change the economic situation much, though both CPI inflation and current account deficit were higher than expected. Rather than expected by the market fall to 2.1%YoY, the headline inflation rate in May remained unchanged at 2.3%YoY posted in April. However, according to our estimates, underlying inflationary pressure did not strengthened – on the contrary, net inflation increased weaker than we estimated (to only 1.6%). Current account deficit in April was higher than predicted due to strong upsurge in imports boosting trade deficit. Relation between current account deficit and GDP is still low (2.4%), so the situation in balance of payments does not seem to be a big threat for macroeconomic stability.

We think that from the point of view of expectations regarding monetary policy, information in the upcoming week will be more important – labour market statistics, production, PPI and the release of minutes of the May's MPC meeting. Our forecasts point to deceleration in all economic indicators as compared to the levels recorded in April, and thus they should not increase risk of interest rate hike already in June. However, if the data surprise on the upside, the market may start to price-in higher probability of swift rate increase. And this would be the case especially, as the minutes would have rather hawkish overtone, showing that the motion to increase rates was proposed already in May and the next one should be expected in June. As for now, we do not change our scenario of the next step in the cycle of monetary policy tightening in July.

At the end of the week the Sejm accepted the government's proposal to cut disability pension contribution by 7 percentage points. Starting from July the contribution will be lowered by 3 pp on the employee's side and starting next year by 2 pp on both employee's and employer's side. This decision should be positive from the point of view of the situation in the labour market and limits the risk of substantial budget spending increase next year.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		TUESDAY (19 June)					
12:00	**POL**	**Wages**	**May**	**%YoY**	**8.3**	**8.0**	**8.4**
12:00	**POL**	**Employment**	**Jun**	**%YoY**	**4.5**	**4.4**	**4.4**
9:00	GER	ZEW index	May		29	-	24
12:30	USA	House starts		m	1.489	-	1.528
		WEDNESDAY (20 June)					
9:00	**POL**	**Auction of PLN1.0-2.0bn of 5Y PS0412 bonds**					
12:00	**POL**	**PPI**	**May**	**%YoY**	**2.1**	**2.1**	**2.3**
12:00	**POL**	**Industrial output**	**May**	**%YoY**	**9.6**	**11.4**	**12.4**
		THURSDAY (21 June)					
12:00	**POL**	**MPC minutes**	**May**				
12:30	USA	Jobless claims	Jun			-	311
16:00	USA	Philadelphia index	Jun		5.5	-	4.2
		FRIDAY (22 June)					
12:00	**POL**	**Net inflation**	**May**	**%YoY**	**1.6**	**1.6**	**1.5**
	POL	**Business climate**	**Jun**				
8:00	GER	Ifo index	Jun		108.4	-	108.6

Source: Reuters, BZ WBK

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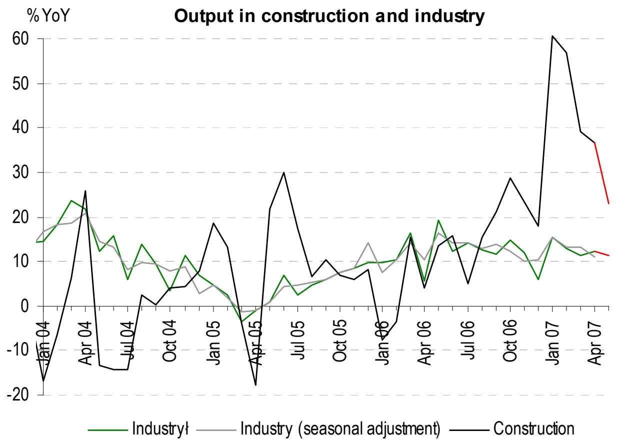
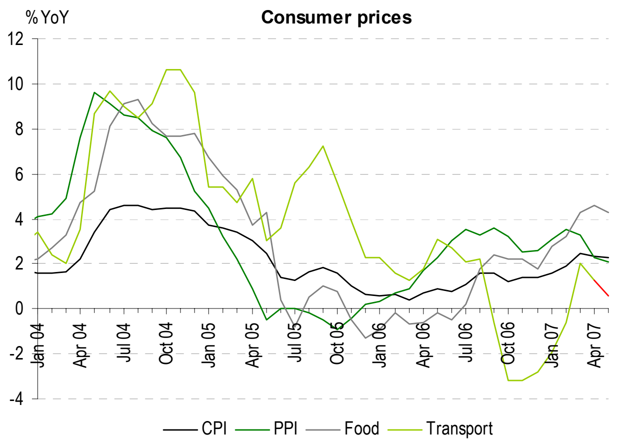
What's hot this week – A lot of data and MPC minutes

- Though the Polish financial market has been recently mainly under the influence of global factors (revisions in expectations as regards official rates abroad), this week a number of important information will be released as regards expectations for next moves in Polish monetary policy.
- The key factor will be labour market data, which are very closely watched by the Monetary Policy Council's members. We expect that corporate wage growth in May amounted to 8%YoY, which would be a result slightly below market expectations and could support the fixed income market.
- We forecast employment growth in the enterprise sector at 0.3%MoM, which would be the same as in the previous month, but higher than result recorded in each of months in the first quarter. This would mean the annual rate of growth at the level of 4.4%, which should be neutral for the market



- Also, data on production, PPI inflation and core inflation will be released this week.
- We forecast industrial production growth at ca. 11%, which is close to the market consensus and consistent with the scenario of moderate economic growth deceleration in the second quarter.
- At the same time, 12M PPI indicator is likely to decrease again – to 2.1% according to our forecast.
- Taking above factors into consideration, we do not think that monthly data releases for May should increase fears of market participants about swift interest rate hike already in June. Although, it is worth to remember that the MPC minutes from the May's meeting will be released this week. They may show that some members of the Council would like to hike rates as soon as possible, which could have some hawkish overtone.

Economy last week – Inflation data rather neutral



- In May the headline inflation rate remained unchanged as compared to April at 2.3%YoY while the market analysts and the FinMin predicted a decline to 2.1% and our forecast was at 2.2%.
- Food prices (rise by 1.2%MoM and 4.3%YoY) were mainly responsible for higher than forecasted inflation. Transport prices (due to higher fuel prices) rose by 0.8%MoM and 0.6%YoY, while prices of other components of CPI basket were rising slightly slower than we had expected.
- In effect, according to our estimates May saw a slight increase in net inflation to 1.6%YoY from 1.5% in April.
- The path of future inflation did not change much - inflation will rise again in June near to the target, should fall even below 2% in summer months and to increase and slightly exceed the inflation target at the end of this year.

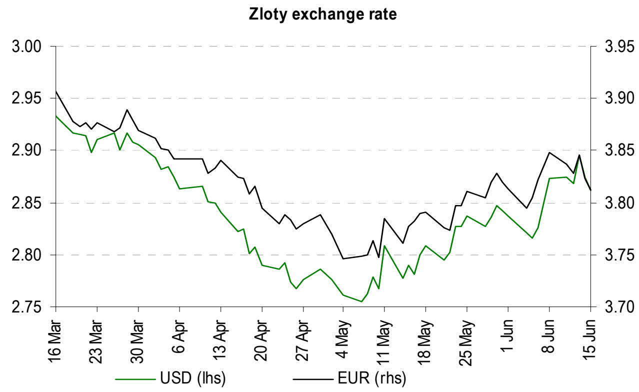
Quote of the week – We should count on necessity of raising rates

Jan Czekaj, MPC member; Reuters, 14 June

The labour market is key, although all the data is important now. Wages grew fast in recent months, but it's not an alarming growth, especially in light of high productivity. (…) Taking into account the entire picture of the economy, we should count on the necessity of raising interest rates this year and next. (…) But when the hikes could happen or what their scale could be will depend on data from the economy. If wages did not grow as fast in May as they did in April and March, then in the context of slightly slower industrial output and retail sales, the prospect of monetary tightening may be delayed. We will know this in a few days.

Financial markets participants are convinced for some time already that, contrary to what was said during April's press conference of the MPC, the hike in April was a beginning of the tightening cycle rather than just a one-off move. The uncertainty factor is the timing of the next step. Jan Czekaj, who seems to be the key member of the Council to form majority favouring hike, did not answer to this question, suggesting everything will be data-dependent. What is interesting, however, he indicated that wage growth of 8-9% is not alarming from the point of view of future inflation. We continue to expect rate hike in July. It is worth to notice that Czekaj mentioned that rate hike may be delayed by deceleration in wages, production and sales in May, which we expect.

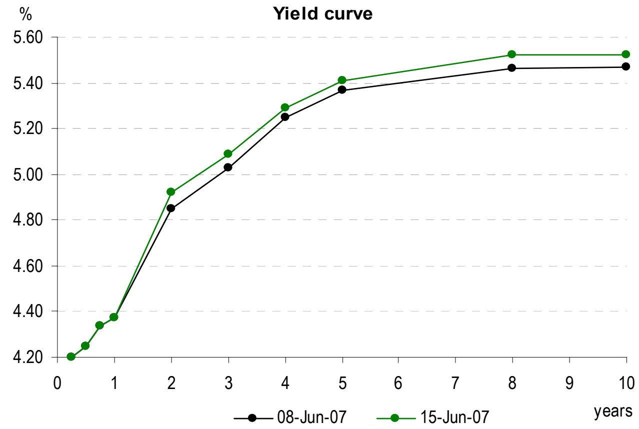
Market monitor



Slight zloty's recovery

▪ After significant weakening of the Polish currency, which occurred recently in the last few days the FX market experienced some recovery. Strengthening of the domestic currency went in line with increases in the Warsaw Stock Exchange, some dollar depreciation at the end of the week and despite some weakening of the domestic bonds.

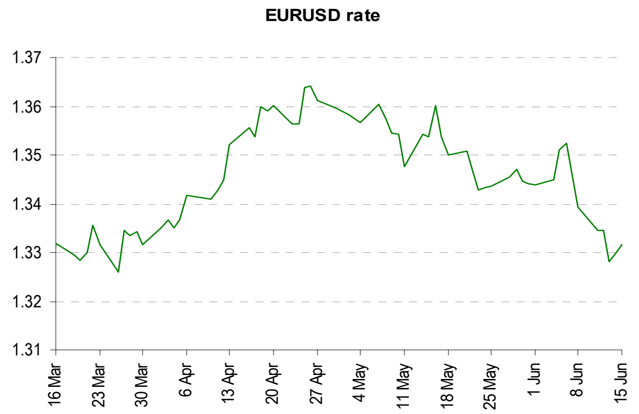
▪ At the end of the week there was some strengthening of the zloty and other emerging market currencies amid rise of risk appetite (EURPLN rate below 3.80). As far as we expect zloty's appreciation in the medium term we lower our forecasted ranges for the EURPLN rate to 3.76-3.86 and for the USDPLN rate to 2.81-2.91, i.e. with slight upward asymmetry.



Weakening continued

▪ The negative moods in the world major markets influenced also the domestic debt market again. Yields rose during the week by ca. 5-6 bp across the yield curve. Data on inflation negatively surprised the market and contributed to slight weakening, while comments of the MPC members were not of key importance for the markets.

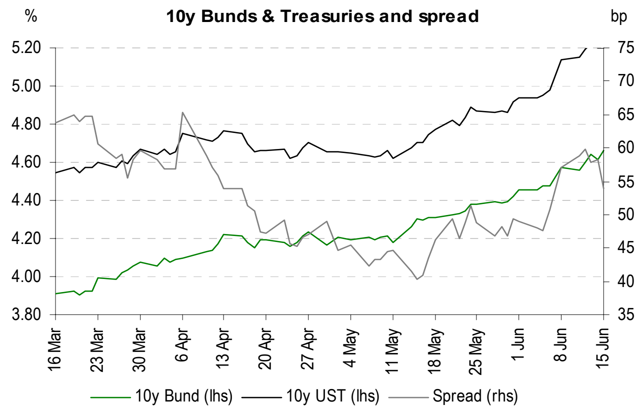
▪ Despite higher May CPI its structure was quite positive in the context of net inflation, which is going to be released at the end of the week. We expect some wages growth rate decline, which may weaken expectations for swift rate hikes. MPC minutes from the May meeting may be crucial. Production data will be also important. We expect some rates stabilisation, though core debt markets influence may be still decisive.



EURUSD the lowest in 3 months

▪ Dollar appreciation against the single currency was continued last week, which was connected among others with rise of US bond yields relatively versus the European rates. The EURUSD rate declined to the lowest level in three months, which was supported by good US retail sales data. US CPI released at the end of the week slightly negatively affected the greenback.

▪ This week, the number of data releases is going to be quite low and investors will focus mainly on the economic activity figures in Germany (ZEW and Ifo) as well as on Philadelphia Fed index in the United States. What is more, data from the housing market in the United States are going to be released as well.



Strong fluctuations in the core debt markets

▪ Rise of yields in the core debt market was experienced also in the last days, which was connected with fears over US inflation, more monetary tightening by the major central banks and occurred ahead of data releases. Yields of 10Y US bonds rose to 5.3%, and of 10Y Bunds to 4.69%. At the end of the week there was slight recovery to below 5.2% and 4.65% respectively.

▪ This week house starts data from the US, which may confirm slowdown in this sector of the US economy, may be quite essential. Activity indices in the euro zone and the US may be also important and they may signal whether the recovery in the US and the EMU is sustained. It is worth to focus also on the central bankers' comments.

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