Bank Zachodni WBK

Weekly economic update

9 – 15 July 2007

Last week there were no important economic events domestically and the only one worth mentioning was the confirmation of the unemployment rate forecast by the Ministry of Labour and Social Policy. It is estimated that the jobless rate fell to 12.4% in June from 13% in the previous month. At the same time, the ministry did not confirm very optimistic predictions presented earlier by one of ministry's officials, who said that a decrease to below 10% was possible until year-end. Amid no local factors, the Polish market was mainly under the influence of the situation on international market. Also, further consequences of unexpected rate hike by the MPC in June were visible. At the beginning of the week the zloty continued appreciation trend and though some correction took place in the following days, the trading range remained narrow and was around the middle of the range we indicated a week ago. We perceive a rise in EURPLN rate to above 3.77 rather as a correction of longer-term trend for zloty appreciation, though no interest rate increase expected by us this month may lead to strengthening of this correction, temporarily even to the level of 3.80.

Recent comments of MPC members, who used to vote in the past in favour of interest rate hikes, may limit expectations as regards future swift moves in monetary policy, though the upcoming data should be more important for the market. Next week the most important figure to watch will be inflation rate for June, though it is widely expected that it will remain close to the inflation target. While the Ministry of Finance and market consensus forecast 12M CPI to increase to 2.7%, we expect that with moderate food price deflation on monthly basis and a rise in fuel prices (lower than in the ministry's projection of 3%MoM), inflation rose to 2.6%. Even if inflation data surprise on the upside, in our opinion the following data (labour market, economic activity) will be more important for the MPC.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (9 July)					
09:00	**POL**	**Tender of 52-week T-bills worth PLN0.5bn**					
		TUESDAY (10 July)					
14:00	US	Wholesale inventories	May	%MoM	0.4	-	0.3
		WEDNESDAY (11 July)					
09:00	**POL**	**Auction of 10Y bonds DS1017 worth PLN1.5-2.5bn**					
		THURSDAY (12 July)					
09:00	EMU	GDP	Q1	%YoY	3.0	-	3.3
09:00	EMU	Industrial output	May	%YoY	2.3	-	2.8
12:30	USA	Trade balance	May	$bn	-60.0	-	-58.5
18:00	USA	Federal budget	Jun	$bn	34.0	-	20.52
		FRIDAY (13 July)					
12:00	**POL**	**CPI**	**Jun**	**%YoY**	**2.7**	**2.6**	**2.3**
12:00	**POL**	**Money supply M3**	**Jun**	**%YoY**	**16.0**	**16.3**	**16.1**
12:00	**POL**	**Trade balance**	**May**	**€m**	**-797**	**-716**	**-779**
12:00	**POL**	**Current account balance**	**May**	**€m**	**-829**	**-716**	**-678**
12:30	USA	Import prices	Jun	%MoM	0.7	-	0.9
12:30	USA	Retail sales	Jun	%MoM	0.4	-	1.4
12:30	USA	Preliminary Michigan index	Jul	pts	85.5	-	85.3

Source: Parkiet daily, Reuters, BZ WBK

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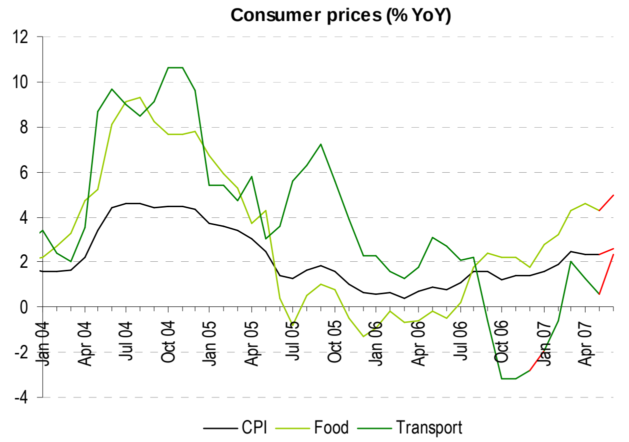
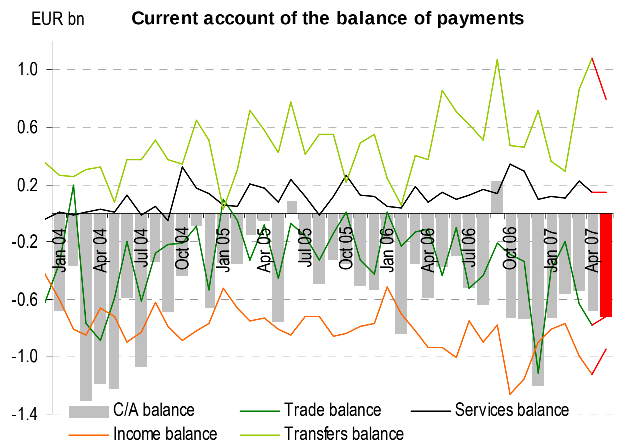
What's hot this week – A lot of data on Friday the 13th

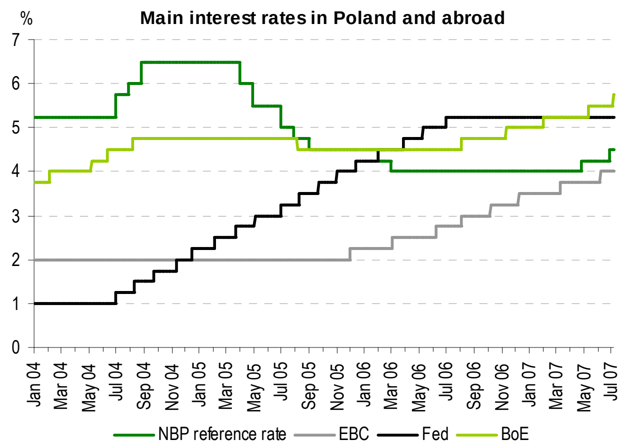


- The key events for the Polish financial market will be concentrated during just one day – three data publications on Friday afternoon.
- The most important will be the inflation data release for June, which is expected at the level of 2.7%YoY, which is consistent with the estimates of the Ministry of Finance.
- In our opinion, there is a chance for positive surprise, as with the assumption of moderate fall in food prices on monthly basis and lower growth in fuel prices as compared to the ministry's forecast, we predict that inflation rate rose to 2.6% in June from 2.3% in the previous month.
- Nevertheless, we do no think that June's CPI level will be crucial for monetary policy perspective. In line with previous declaration of the MPC, even if inflation amounts to 2.7% this should be interpreted as keeping inflation close to the target.



- From the point of view of next MPC decisions, information regarding the pace of economic activity together with labour market statistics will be more important, but they will be release only in the following week.
- On Friday two other figures will be published. The National Bank of Poland will release monetary statistics for June and balance of payments for May.
- Data concerning money supply and credit growth should confirm continuation of economic expansion.
- We expect that strong domestic demand will be one of factors responsible for higher imports than exports growth, which will be reflected in keeping trade deficit at the level of ca. €700m. At the same time, high surplus in net transfers together with positive balance in services should neutralise the negative effect of net income.

Economy last week – The Bank of England hiked rates, the ECB pauses



- In line with expectations, the Bank of England raised main interest rate by 25 bp to 5.75% and the European Central Bank kept the refinance rate on hold at 4%.
- Based on Mr Trichet's comments at the ECB press conference, it seems clear that rates have not yet peaked in the euro zone. The ECB still regards monetary policy as on the accommodative side.
- It is unclear whether the next hike in rates will come in September or October and, indeed, the ECB Council may not yet have made up its mind on the precise timing. Beyond that, given the continuing strength of activity, buoyant growth of monetary aggregates and likely rise in inflation to well over 2% later in the year, the ECB can be expected at some stage to move policy to a somewhat restrictive stance. Thus, we see rates being increased by another 0.25% in early 2008, bringing them up to 4.5%.

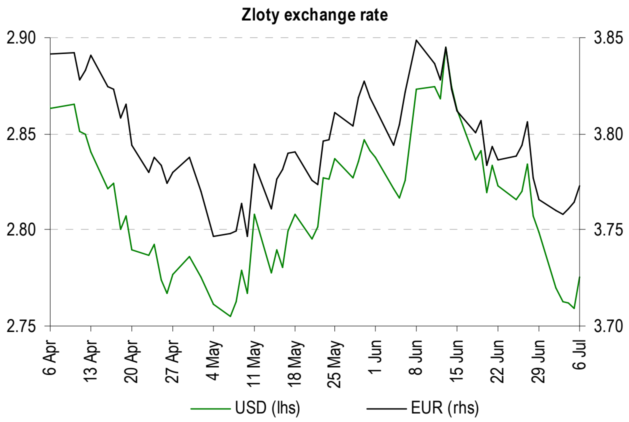
Quote of the week – Another hawk speaks in dovish manner

Marian Noga, MPC member; PAP, 4 July

This year probably only one decision to tighten monetary policy will be needed, because I would expect some positive effects of decisions from April and June, through the foreign exchange changes, which is fastest monetary transmission mechanism channel. Timing as regards future moves in monetary policy will depend on relation between wage growth and productivity, as well as on the inflation path in August-September i.e. how much the effect of high statistical base, food prices and fiscal stimulus will be responsible for inflation decrease in this period. (…) Currently, I think that in 2008 we will se more than just one hike in rates.

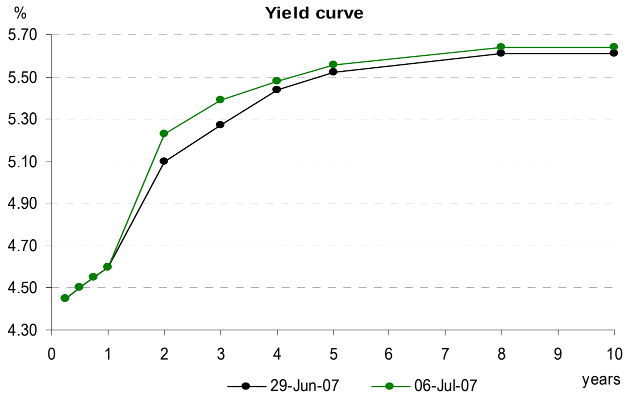
After comments by Halina Wasilewska-Trenkner, which might lead to lowering expectations as regards swift interest rate hikes, last week the similar effect on the market might have had statements by other MPC member. Marian Noga, perceived by the market as a hawk, said that only one more hike might be needed in 2007. however, it is worth to notice that at the same time he suggested a necessity to tighten monetary policy further next year and most likely in a few steps. The scale of additional tightening would depend on, among others, situation on global markets, which is one of factors influencing the Polish foreign exchange market and thus the influence of the zloty on inflation. Latest comments of MPC members confirm our scenario of no rate hike in July.

Market monitor



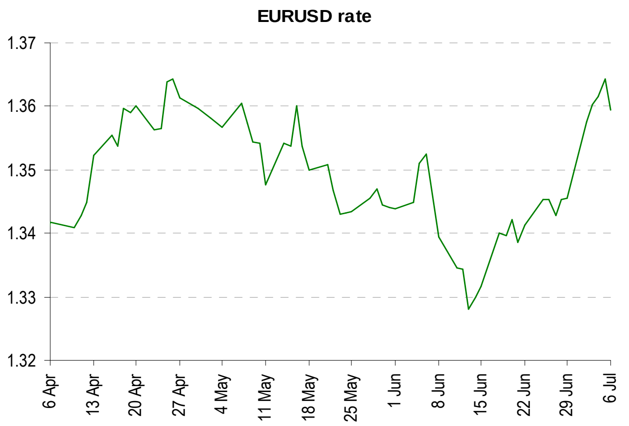
Zloty traded in narrow range

- Although at the opening of the first session of the last week the zloty weakened, during the day it rebounded and the EURPLN dropped again to 3.75. On Tuesday in the morning it was even below 3.75, but later in the day a correction took place ahead of the US Independence Day. On Wednesday the zloty gained but higher yields on core markets on Thursday lowered risk appetite and the local currency lost. On Friday the situation reversed once again.
- All in all, the EURPLN rate was traded in quite a narrow range last week (3.75-3.78). Movements of the USDPLN rate were also limited. We think that this week the domestic FX market will also be relatively stable and we maintain expected range for the EURPLN at 3.72-3.82 and for the USDPLN at 2.74-2.84.



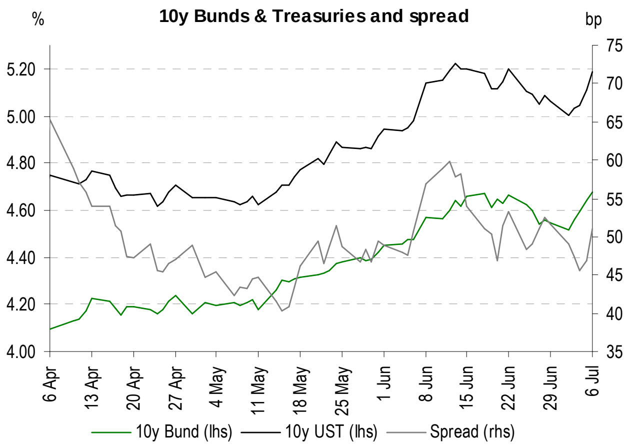
The fixed income market keeps weakening

- News on cancellation of auction of 2-year bonds did not prevent the Polish debt market from weakening. The whole fixed income market lost due to release of quite high forecast of June CPI inflation by the FinMin. The local debt market was also negatively affected by weakening in the core debt markets. Some recovery took place thanks to comments of MPC's Marian Noga, but at the end of the week the market was weaker than a week earlier. There was more evident weakening at the short end of the yield curve, so it flattened during the week.
- This week the domestic fixed income market will wait for CPI figures due on Friday. Key events for the core markets are also scheduled for the last days of this week.



The dollar weaker again

- The euro was gaining to the dollar ahead of the ECB meeting. Comments from its governor Jean Claude Trichet confirmed expectations of another rate hikes in the euro zone in the remainder of the year, as policy stance remains accommodative in the central bankers' opinion. The euro was also positively affected by data releases which pointed to continuation of revival in the euro zone's economy. On the other hand, data from the US were also strong (including the key data on US non-farm payrolls) which limited scale of the greenback's losses.
- Current expectations regarding future rates in the euro zone and in the US are not favourable for the dollar. At least for the first part of this week, the EURUSD market should be quite calm amid no major data releases.



Weaker week in the core markets

- On Monday, yields of 10-year Treasuries were slightly below 5% and of 10-year Bunds was 4.50%, as investors were buying safe assets after attempts of terrorists attacks in the UK. However, later on there was a clear weakening the core debt markets due to releases of stronger than expected data. After lower activity on Wednesday (holiday in the US), Thursday and Friday saw further weakening in the core markets following outcomes of the meetings of the Bank of England and the ECB. On Friday, after higher than expected US non-farm payrolls, yields of 10-year Treasuries transitory topped 5.20% and 10-year Bunds reached nearly 4.70%, but later on a slight rebound took place.
- In the first part of this week the core debt markets should stabilise amid lack of major data releases. Important data releases will be cumulated towards the end of the week.

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