Bank Zachodni WBK

Weekly economic update

16 – 22 July 2007

In line with our expectations, the zloty fluctuations in the first part of the last week were quite limited, as there were few important events for the market, both locally and abroad. Event political jitters were not sufficient to significantly affect the zloty. The EURPLN rate was remaining in the range of 3.75-3.78 observed for the whole previous week. Only towards the end of last week, when appetite for risk considerably rose in the global markets, the zloty managed to appreciate clearly below the level of 3.75 against the euro. However, on Friday there was slight correction on the domestic FX market after publication of data which showed wider than predicted C/A deficit in May and lower than expected CPI inflation in June (it exactly matched our forecasts of 2.6%YoY against the market consensus and FinMin's estimate of 2.7%YoY). The latter information cooled down market expectations of further swift rate hikes by the MPC.

In our opinion, data that are due for release this week may have similar effect. Our forecasts for growth rates of average wage, industrial production and producer prices are lower than the market consensus. A weakening in expectations of continuation of decisive steps by the rate-setting panel could weaken the zloty and at the same time positively affect the fixed income market. However, much will depend on last comments from MPC members before their July's meeting (some interviews with rate-setters should be expected in the first part of this week, not later than a week before the decision meeting) and on information included in minutes of the Council's meeting in June that are due on Thursday.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (16 July)					
12:00	**PL**	**Wages**	**Jun**	**%YoY**	**9.0**	**8.2**	**8.9**
12:00	**PL**	**Employment**	**Jun**	**%YoY**	**4.3**	**4.3**	**4.4**
	JP	Market holiday					
9:00	EMU	Final HICP	Jun	%YoY	1.9	-	1.9
12:30	US	NY Fed index	Jul	pts		-	25.75
		TUESDAY (17 July)					
9:00	GER	ZEW index	Jul	pts	20.0	-	20.3
12:30	US	PPI	Jun	%YoY	0.4	-	0.9
13:00	US	Net capital flows	May	$ bn		-	111.8
13:15	US	Industrial output	Jun	%MoM	0.4	-	0.0
13:15	US	Capacity use	Jun	%	8.4	-	8.3
		WEDNESDAY (18 July)					
9:00	**PL**	**Switch auction**					
12:30	US	CPI	Jun	%MoM	0.2	-	0.1
12:30	US	House starts	Jun	m	1.46	-	1.474
		THURSDAY (19 July)					
12:00	**PL**	**MPC minutes**	**Jun**				
12:00	**PL**	**PPI**	**Jun**	**%YoY**	**1.8**	**1.7**	**2.2**
12:00	**PL**	**Industrial production**	**Jun**	**%YoY**	**7.9**	**6.2**	**8.1**
16:00	US	Philadelphia Fed index	Jul	pts	14.5	-	18.0
18:00	US	FOMC minutes					

Source: Parkiet daily, Reuters, BZ WBK

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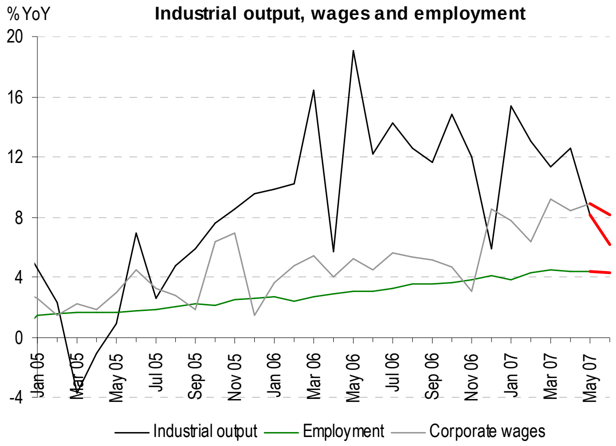
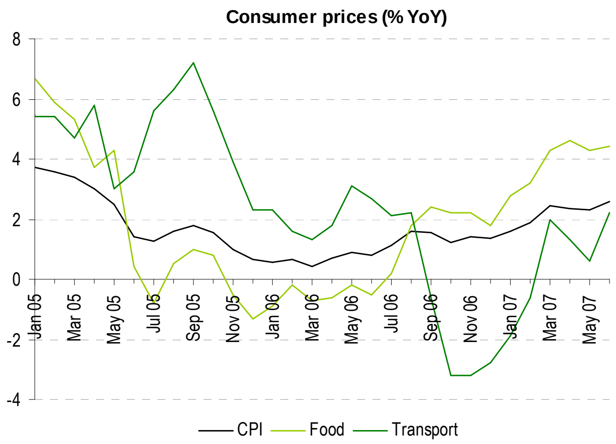
What's hot this week – Next data and minutes of MPC meeting in June

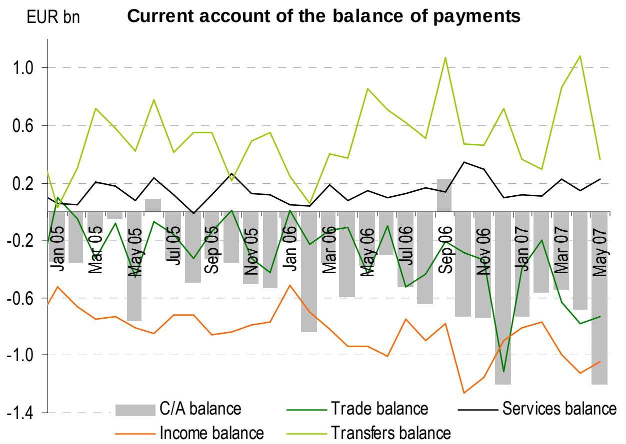


- After CPI data revealed last Friday, this week will start with a publication of next important data, as on Monday we will get labour market statistics.
- Our forecast of average wage growth is below the market consensus and realisation of our forecast could cool down market expectations regarding the timing and scale of rate hikes by the MPC.
- According to our forecasts, output and PPI figures that are due for release on Thursday, should have similar effect, as in this case we are also below the consensus.
- Also on Thursday, minutes of the June MPC meeting will be published. It would be positive, if the document showed what arguments induced the Council to deliver a rate hike last month.
- Besides, there will be many important events abroad.

Economy last week – CPI below expectations, C/A deficit wider than predicted



- CPI inflation data for June exactly matched our expectations, rising to 2.6%YoY from 2.3%YoY posted in May. The result was lower than market expectations and FinMin's estimates at 2.7%YoY.
- Lower than predicted CPI was probably mainly a result deeper than expected seasonal fall in food prices, which suggests that concerns about an effect of spring frosts on overall food prices were exaggerated.
- Excluding food and fuel prices (the latter increased stronger than we assumed), price growth of other categories of consumption goods and services were somewhat higher than we predicted. Therefore, we revised upward our estimate of net inflation in June to 1.8%YoY from 1.7%YoY. However, last month we revised the path of inflation on the same scale, so now it returned to the earlier estimates. We predict that until the end of the year it will not exceed 2%.



- Growth of money supply were also lower than expected, showing rise in M3 of 14.9%YoY instead of the expected increase of around 16%YoY.
- However, loans growth accelerated again, as expected, which supports expectations for continuation of robust demand growth in the economy.
- Stronger domestic demand negatively affects the balance of payments. In line with our forecasts, trade gap slightly exceeded €700m in May. Deficit of the whole current account was much wider that predicted. This resulted mainly from unexpectedly low surplus in transfers due to weak inflow of EU funds. We think that this is a one-off and thus an increase in 12-month cumulated C/A deficit to 2.8% of GDP after May from 2.4% after April does not mean a similarly large scale of widening of external imbalance in subsequent months.

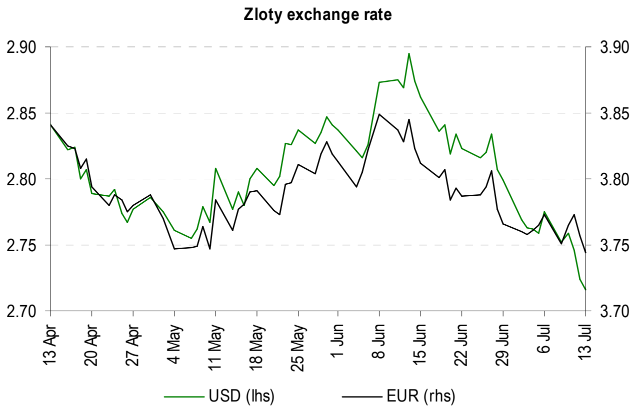
Quote of the week – Moderate comments from a hawk

Halina Wasilewska-Trenkner, MPC member; Reuters, 11 July

I doubt that this year we will be able to stop at the current interest rate level. (…) In one-year time it can just as well be at 4.5%, which does not mean it will be stable until then, or one percentage point higher at 5.5%. Possibly, one more rate hike this year would be enough. Much will depend on what will be decisions in fiscal policy. If there is actually an increase in public spending, the Council would not be in difficult position, as central bankers know what to do in such situation. We would need an unpleasant measure, but a inevitable one – further rate hikes.

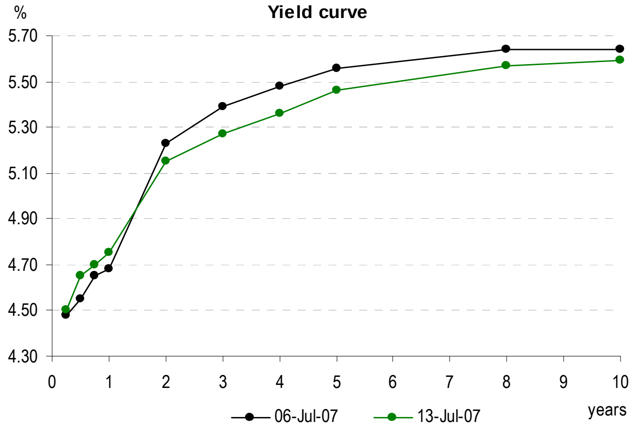
Comments by MPC's Halina Wasilewska-Trenkner have recently been more moderate than one could expect from a member of the hawkish camp in the rate-setting panel and they seem to represent a consensus within the Council. The comments were one of the reasons supporting local debt market amid a correction in the core debt markets. However, Wasilewska-Trenkner pointed out fiscal policy as a risk factor for inflation. It seems that this is a kind of a warning for the government against the submission to growing pressure on rise in public spending amid rapidly growing revenues thanks to strong economic expansion.

Market monitor



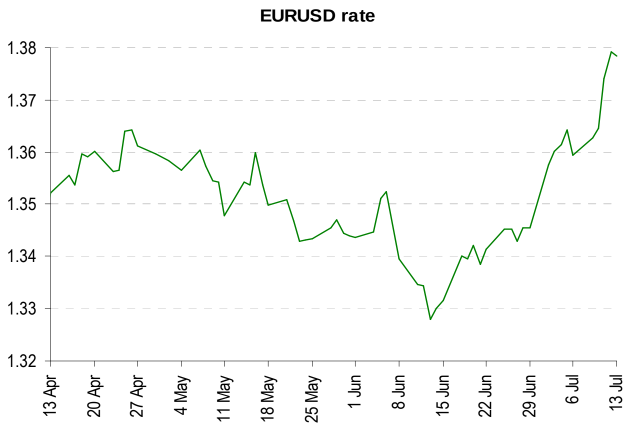
Temporary weakening

- At the start of the past week there was insignificant zloty weakening in reaction to fluctuations at the political stage. However these events had temporary influence on the market, which was in line with our view and afterwards the zloty regained strength in the second part of the week on higher risk appetite. Since the previous week the EURPLN rate declined by o 0.3% and USDPLN rate by 1.4%.
- We presume that there may be a correction in the FX market, and weaker data from the economy lowering expectations for interest rate hikes may contribute to this scenario. We do not exclude the possibility, however, that zloty may slightly strengthen before this correction. We hold the range for the EURPLN rate at 3.72-3.82, and lower for the USDPLN rate to 2.69-2.79.



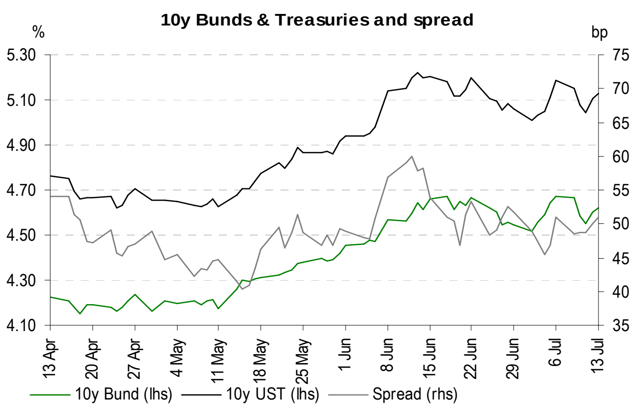
Recovery in the fixed income market

- In the last days there was some recovery in the fixed income market, which to some extent might have been connected with little hawkish comment of Halina Wasilewska-Trenkner and CPI data, which was below the consensus. During the week yields fell by 3-8 bp, and yield curve steepened.
- This week several important are going to be released, among others PPI, industrial production and labour market data, which are crucial for the MPC and the market as they determined the rate hike in June. Taking into consideration our forecast we do not assume that another rate hike may follow in July. However, if data negatively surprise to the upside they may slightly weaken the interest rate market. The MPC minutes scheduled for Thursday will be also important. The situation in the core debt market is going to be essential with regards to ample data releases.



Record weak dollar against the euro

- Since the start of the week the dollar depreciation against the single currency was continued. Rating agencies warning reports on sub-prime mortgage bond as well as prospects for stable rates in the US amid rising expectations of rate hikes abroad, negatively affected the dollar. The EURUSD rate increased to the highest level in history above 1.38 after weaker retail sales data.
- In the nearest days inflation data from the United States will be crucial for the EURUSD rate. The market is going to focus on next data from the housing market. What is more, regional US activity indices are going to be released as well as minutes from the last Fed's meeting. In the short term the dollar may slightly weaken, though in the longer term we expect recovery.



Large moves in the core debt markets

- After significant rise of yields in the core debt markets at the end of the past week at the start of the last week there was significant strengthening in reaction to negative news from the US housing market. After yields of 10Y US Treasuries did not manage to break important technical level 4.98% there was another weakening wave. Yields of 10Y Treasuries and Bunds reached 5.10% and 4.60% at the end of the week.
- This week the market is going to focus on the US headline and core CPI and PPI figures, as inflation remains the main concern for Fed and is important as well as the housing market data for expectations of potential interest rate cuts in the Unites States.

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