Bank Zachodni WBK

Weekly economic update

13 – 19 August 2007

The past week was another one dominated by fears over problems in the housing market in the United States. Financial markets were only temporarily supported by calming tone of Fed's communiqué. There was more news in the market on next financial institutions, which may be hurt on investment in the US mortgage markets, while rising rates in the money markets contributed to liquidity interventions by the ECB, Fed and other central banks. Despite holing risk aversion, zloty remained relatively stable against the major currencies, though there was significant sell-off in the Warsaw stock exchange and slight prices decline in the fixed income market. Data on wages for Q2 in the whole economy, which were released last Thursday are negative factor for the debt market, as they are another argument in favour of interest rate hike in August. The probability of realisation of such scenario may rise after the release of the wages and employment data for July. On the other hand, inflation data for July may be of some support for bonds, as we forecast slightly deeper deceleration as compared with market consensus and the forecast of the Ministry of Finance. The development of events in the political stage is going still to be less important that news related to the US mortgage market, however first decisions on potential early elections may be made already on Saturday. We keep our expectations of zloty weakening for this week.

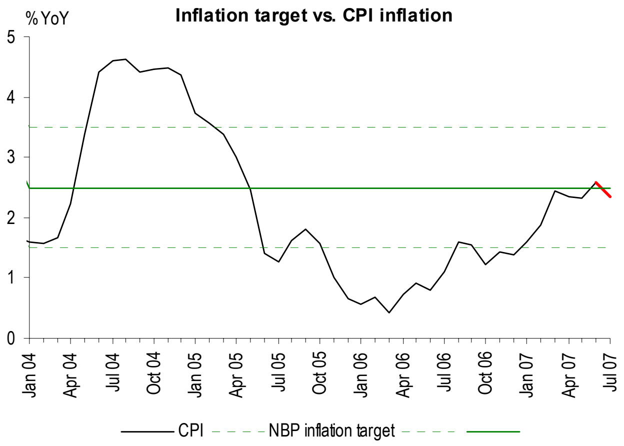
Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (13 August)					
12:00	**PL**	**Trade balance**	**Jun**	**€ m**	**-491**	**-817**	**-734**
12:00	**PL**	**Current account balance**	**Jun**	**€ m**	**-829**	**-917**	**-1202**
12:30	US	Retail sales	Jul	%MoM	0.2	-	-0.9
		TUESDAY (14 August)					
12:00	**PL**	**CPI**	**Jul**	**%YoY**	**2.4**	**2.3**	**2.6**
12:00	**PL**	**Money supply**	**Jul**	**%YoY**	**14.8**	**15.5**	**14.9**
9:00	EMU	Preliminary GDP	Q2	%YoY	2.7	-	3.1
12:30	US	Trade balance	Jun	$ bn	-61.0	-	-60.04
12:30	US	PPI	Jul	%MoM	0.2	-	-0.2
		WEDNESDAY (15 August)					
	PL	**Market holiday**					
12:30	US	CPI	Jul	%MoM	0.2	-	0.2
12:30	US	New York Fed index	Aug	pts	20.0	-	26.46
13:00	US	Net capital flows	Jun	$ bn			105.9
13:15	US	Industrial production	Jul	%MoM	0.3	-	0.5
		THURSDAY (16 August)					
12:00	**PL**	**Wages**	**Jul**	**%YoY**	**9.3**	**9.5**	**9.3**
12:00	**PL**	**Employment**	**Jul**	**%YoY**	**4.6**	**4.6**	**4.6**
9:00	EMU	Final HICP	Jul	%YoY	18	-	1.9
12:30	US	House starts	Jul	m	1.42	-	
16:00	US	Philadelphia Fed index	Aug	pts	9.5	-	9.2
		FRIDAY (17 August)					
14:00	US	Preliminary Michigan index	Aug	pts	88.5	-	90.4

Source: Reuters

Maciej Reluga Chief economist (+48 22) 586 8363
Piotr Bielski (+48 22) 586 8333
Piotr Bujak (+48 22) 586 8341
Cezary Chrapek (+48 22) 586 8342
e-mail: ekonomia@bzwbk.pl

What's hot this week – Ample data on CPI inflation, labour market, C/A and money supply



- At the start of the week the balance of payments for June is going to be released. According to our expectations C/A declined (amid fall of exports growth and increase of imports growth and trade deficit). In our view this may have resulted from improvement in current transfers, as the decline in transfers in May might have been a one-off event.
- This week the CSO is going to release inflation data for July. We estimate that the CPI index rose by 2.3%YoY, presuming that the food prices dropped by 1.5%MoM, and transport prices slightly rose. The market consensus is set at 2.4%YoY, which is in line the MinFin's forecast.
- At the same time as the CPI release the NBP is going to publish monetary statistics, which may show a slight acceleration of money supply growth (to 15.5%YoY) in July after a surprisingly weak June figure and keeping growth rates of loans for businesses and households at high levels.

- Labour market data may be more important for the Monetary Policy Council members, as they will confirm tightening conditions and rising difficulties on the labour costs side.
- Our forecast points to acceleration of wage growth in July to 9.5%YoY (1%MoM) against 9.3%YoY in June.
- We expect the employment growth rate to stay at the record high level, which was recorded in June, i.e. 4.6%YoY after an increase of 0.2% in monthly terms.
- According to our estimates, this would result in acceleration of wage bill growth to the highest level in history of 14.5%YoY and 11.9%YoY (in real terms), and keeping the strong consumption demand and would be yet another circumstance in favour of an interest rate hike in August.

Economy last week – High wage growth in 2Q07

- According to the CSO data the average wage in the whole economy amounted in Q2 to PLN2644.34, which means a rise by 8.9%YoY (the same as in the corporate sector), i.e. the highest level in 6 years, against 7.1% in Q1.
- Taking into consideration the forecasted employment growth and slowdown of the value added growth this means acceleration of the unit labour costs in the economy to 6%YoY from 2.9%YoY in Q1.
- With regards to the importance of these data, which was emphasized many times by the MPC members, they support our view for an interest rate hike by 25 bp in August.
- In Friday's interview for Reuters Dariusz Filar, the most hawkish member of the MPC, confirmed in the necessity of the MPC to act already now in order to prevent rise of inflation in 2008, as the Q2 wages data shows mounting inflation pressure in his opinion.

Quote of the week – Preliminary elections more and more probable

Donald Tusk, PO president, PAP, 9 August

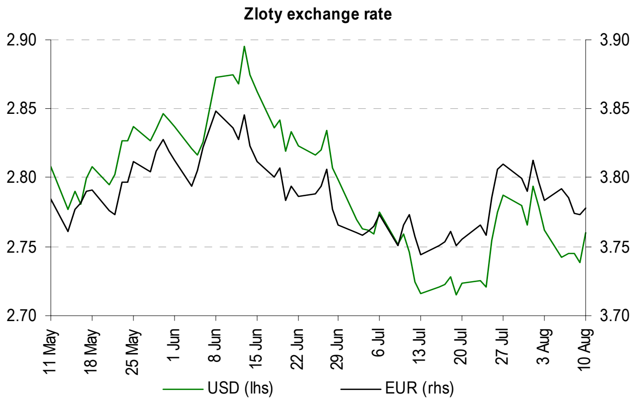
We both [with President] agreed that, this progressive mess and destabilisations of Polish politics should be ended as soon as possible (...) that it would be a good idea to pursue with preliminary elections already in Autumn this year. (...) October is the most realistic date. (...) I am convinced, that this decision was already made and we have elections in October.

Marek Suski, PiS representative, Reuters, 10 August

The Council is going to deal with the current political situation. (...) The motion on early elections will be debated for sure.

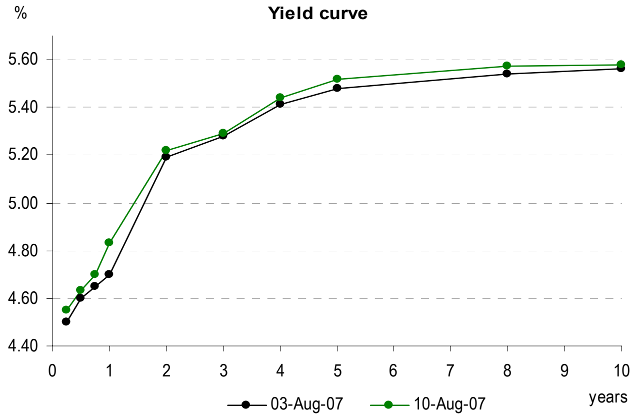
The turmoil in the political stage and comments from different parties point of rising probability of early elections. Statements of Donald Tusk show that he counts on soon meeting with Sejm's speaker, so as to clarify the package of bills, which are necessary to be passed before the self-dissolving of the parliament, which may be voted at the start of September. According to PO president, the President's stance is an "enough guarantee", that there are early elections. First decisions may be made already on Saturday at the meeting of Political Council of ruling PiS.

Market monitor



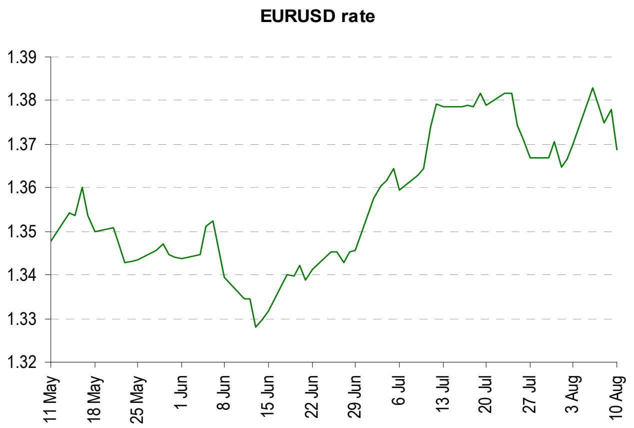
Relatively stable złoty despite moves abroad

- During the past week zloty slightly appreciated against the euro and weakened versus the dollar. After the Fed's communiqué the moods in the international financial markets slightly improved, which resulted in temporary zloty appreciation. At the end of the week the domestic currency weakened on the wave of rising risk aversion.
- News on US housing market is going to remain the major factor influencing the investors' appetite for risk. We still presume that the sentiment toward the emerging markets currencies may lead to zloty depreciation. However, despite that we decided to lower our forecasted ranges of zloty exchange rates this week to 3.75-3.85 for the EURPLN rate and 2.71-2.81 for the USDPLN rate.



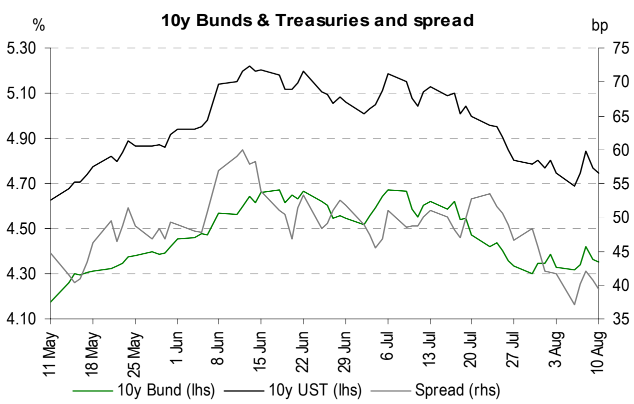
Slightly weaker fixed income markets

- In the last days the domestic market was relatively stable. After slight strengthening in the first days of the week, which occurred among others after significant falls of yields in the core markets, the situation in the US and Germany reversed and there was some weakening experienced. At the end of the week falling risk appetite contributed to further rise of market rates.
- The data on Q2 wages that were released last week were negative for the debt market. In our opinion the CPI figure may support bonds, however strong data on wages and employment may determine the rate hike in August and may contribute to slight bonds weakening. Prices may fall further on risk aversion theme.



The dollar appreciated on retreat from risky assets

- At the beginning of the week investors in the financial markets awaited US central bank meeting, which tried to calm down markets in its communiqué, and the dollar slightly strengthened versus euro. Later the EURUSD slightly rose with regards to moderate fall of risk aversion, however new information on problems of financial institutions investing in the US mortgage loans market resulted in substantial dollar appreciation to 1.368 against the euro on jump of risk aversion.
- The dollar is still going to be under strong influence of more news incoming from the US subprime mortgage market. This week one should concentrate on US data on CPI and PPI, houses starts and regional activity indices in the US manufacturing sector.



Volatility in the core bond markets

- In the past week we noticed quite significant prices moves in the core debt markets. Fed's communiqué temporarily improved moods leading to bonds weakening (10Y Treasuries: 4.87%). However at the end of the week there was more negative news in the market regarding the US mortgage market and intervention of ECB and Fed, which supported markets liquidity. Despite fluctuations yields of 10Y Bunds and Treasuries remained at 4.74% 4.33%.
- In the coming days the market will focus on retail sales, inflation and housing market data from the US. Information on problems of more financial institutions, may keep yields low in the relatively safer core debt markets.

Additional information is available on request. Please contact Bank Zachodni WBK S.A. Treasury Division, Economic Analysis Unit, ul. Marszałkowska 142, 00-061 Warsaw, Poland, phone (+48 22) 586 83 63, email ekonomia@bzwbk.pl, http://www.bzwbk.pl