Bank Zachodni WBK

Weekly economic update

18 – 24 February 2008

Data released last week showed that January hikes in prices and corporate wages were much stronger than expected. Inflation increased to 4.3%YoY, wages rose by 11.5%YoY and employment growth reached a new record high of 5.9%YoY. Data will certainly not calm the MPC concerns, signalling an increase in risk of building wage and price pressures in the economy. At the same time it is worth to remember, the Council also pays attention to a risk of economic downturn under the influence of weaker growth perspectives abroad. This is why next data on economic activity (industrial output, retail sales) will be important for the next decisions on interest rates. So far, we leave expectations regarding MPC decisions unchanged and we think there will be one more interest rate hike of 25 bp in March. However, a risk of further monetary tightening is growing.

This week, we will get output figures for January. We predict that industrial output data will show higher growth in industry and construction. The latter sector benefited in January from good weather, which at least partly offset high base effect from the previous year. MPC's minutes is unlikely to introduce many new elements to the assessment of monetary policy prospects, as since the last MPC meeting rate-setters made several comments on the most important factors influencing monetary policy actions. Apart from local data on Tuesday, the situation on domestic market this week will be dependent on sentiment on global markets, determined by crucial events in the US on Wednesday and Thursday and by data from the euro zone on Friday.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (18 February)					
-	US	Market holiday	-	-	-	-	-
		TUESDAY (19 February)					
13:00	**PL**	**Industrial output**	**Jan**	**%YoY**	**6.8**	**7.1**	**6.2**
13:00	**PL**	**Construction output**	**Jan**	**%YoY**	**12.1**	**15.7**	**13.0**
13:00	**PL**	**PPI**	**Jan**	**%YoY**	**2.1**	**2.1**	**2.5**
23:50	JP	Bank of Japan minutes	Jan	-			
		WEDNESDAY (20 February)			-	-	-
10:00	**PL**	**Switching auction**	**-**	**-**	**-**	**-**	**-**
13:30	US	CPI	Jan	%	0.2	-	0.3
13:30	US	House starts	Jan	m	1.0	-	1.006
13:30	US	Permits	Jan	m	1.03	-	1.08
19:00	US	FOMC minutes	Jan	-	-	-	-
		THURSDAY (21 February)					
13:00	**PL**	**MPC minutes**	**Jan**	**-**	**-**	**-**	**-**
13:30	US	Initial jobless claims	w/e	'000	350	-	348
15:00	US	Philadelphia Fed index	Feb	pts	-10.5	-	-20.9
		FRIDAY (22 February)					
09:00	EZ	Preliminary PMI manufacturing	Feb	pts	52.3	-	52.8
09:00	EZ	Preliminary PMI services	Feb	pts	50.7	-	50.6
13:00	**PL**	**Business climate indicators**	**Feb**	**-**	**-**	**-**	**-**

Source: BZ WBK, Parkiet, Reuters

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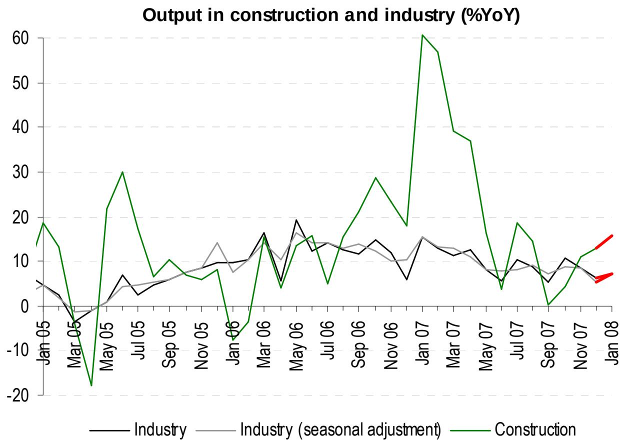
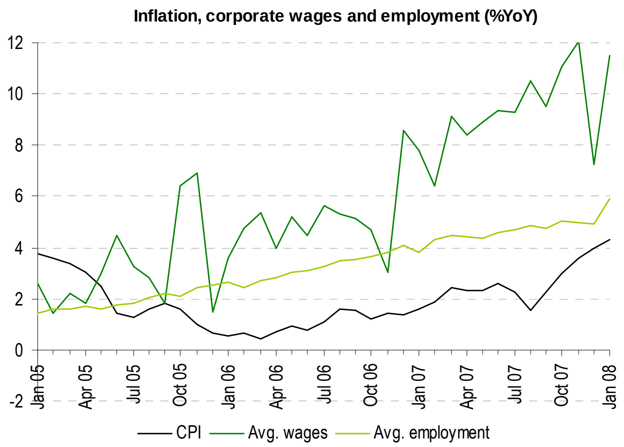
What's hot this week – Next crucial news locally and abroad

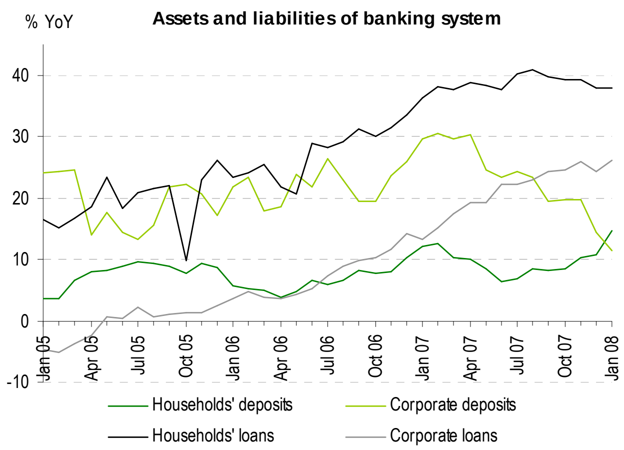


- We expect that output figures for January, due on Tuesday, will show that economic activity at the start of 2008 remained strong. At the same time PPI numbers should show a slowdown of producer prices growth.
- Materialisation of our forecasts regarding output and PPI data would be consistent with our expectations assuming one more interest rate hike of 25 bp in March.
- The minutes of the MPC meeting in January is unlikely to change assessment of monetary policy prospects.
- The business climate indicators for February, due for release on Friday, should not bring a change in earlier observed tendencies, showing that assessment of the situation in the surveyed sectors remains close to historical maximum levels for February.
- The number of important events abroad will be smaller this week as compared to the past two weeks.

Economy last week – Higher than expected rise in wages and prices



- CPI inflation in January rose to 4.3%YoY against market consensus at 4.0-4.1%YoY. The data are tentative and the CSO did not release the complete detailed numbers. Thus, it is not possible to indicate precisely reasons for stronger than expected inflation rise and estimate the net inflation. However, the data increase the forecasted inflation path.
- Average wage and employment growth in the corporate sector was also stronger than predicted. Average wage growth was 11.5%YoY versus market consensus of 10% and employment growth was 5.9%YoY, at all time high. Wage bill grew 18.1%YoY in nominal terms and 13.3%YoY in real terms. All in all, the data confirmed that labour market conditions in Poland are very tight and pose a significant threat to the medium-term inflation outlook. At the same time, the data support our expectations assuming private consumption will be strong in 2008.



- Money supply data for January had no impact on the market, but one should notice a clear acceleration in households' deposit growth (effect of withdrawals from mutual funds) and at the same time a slower growth in companies' deposits and faster growth in corporate borrowing, suggesting that investment activity remains strong despite turmoil on financial markets and concerns about global economic growth.
- C/A gap in December proved much wider than predicted. The reason was much lower than expected surplus in current transfers. Other elements of current account balance, i.e. balances of trade, services and income were close to expectations. Cumulated 12-month C/A deficit in relation to GDP rose to 3.7% at the end of 2007, which is still a rather low level, especially that 12-month cumulated FDIs inflows remain higher than C/A deficit.

Quote of the week – We like the floating FX regime

Jacek Rostowski, minister of finance, Rzeczpospolita, 13 Feb

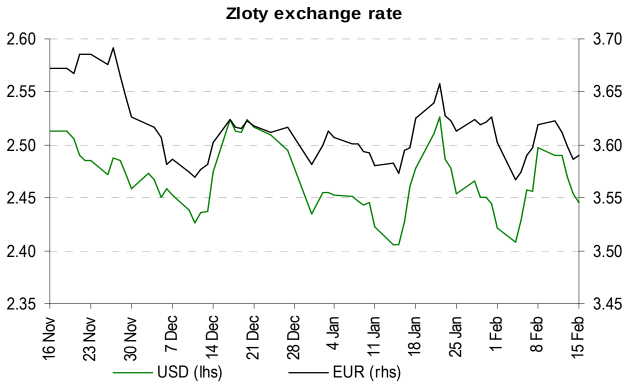
Exchange rate policy is a government's domain. It is conducted in accord with the central bank. We like the floating exchange rate regime.

Sławomir Skrzypek, NBP president, Gazeta Wyborcza, 14 Feb

I am sceptical as regards use of foreign exchange interventions. Mr. Koziński's competences in this field are invaluable for us, but in a perspective of ERM2 participation.

In the last week we saw a wave of comments following NBP deputy president hopeful Witold Koziński's statements regarding FX interventions aimed at a zloty weakening. Finance minister stressed the role of the government in determining the FX regime, showing disapproval for interventions. Also the NBP governor was quite sceptical about FX interventions and even though he said that Koziński's competences in this field are precious, he suggested that they should be used only after joining the ERM2. Comments of MPC members suggested that even though the monetary policy guidelines do not exclude a use of interventions, this instrument should be employed only in the case of a threat for the inflation target.

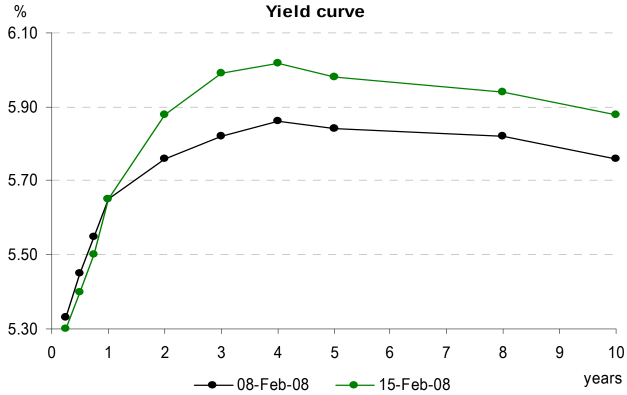
Market monitor



Zloty gains on lower risk aversion and higher data

▪ Start of the last week was unsuccessful for the zloty amid weakening of currencies in the region and negative market reaction to news from G7 summit. Later on, the zloty was gradually gaining due to improvement in moods on global markets and rise in risk appetite. At the end of week, zloty breached through 3.58 against euro, being supported by good sentiment on the markets and higher than predicted CPI and wages that strengthened expectations for continuation of rate hikes amid persisting expectations for cuts abroad.

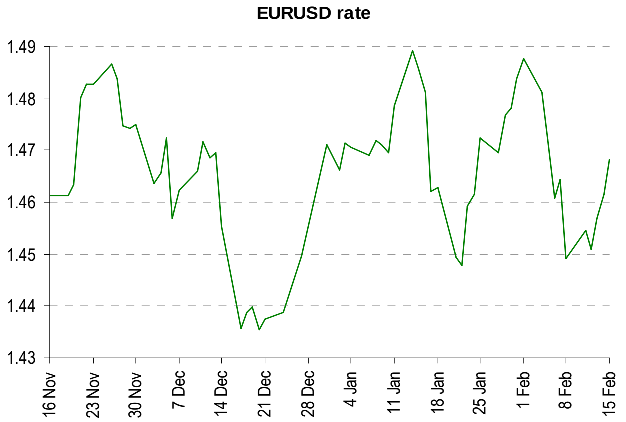
▪ This week, zloty may strengthen. We reduce ranges of predicted zloty fluctuations for EURPLN to 3.53-3.63 and for USDPLN to 2.39-2.49.



Local bonds again weaker

▪ Local bonds were performing conversely to the zloty. Higher risk aversion at the start of the week triggered a strengthening on the market. Later during the week, Polish bonds were weakening amid falling interest in safe assets and rising yields abroad. It was also affected by gradual strengthening of expectations for more interest rate hikes by the MPC, particularly at the end of the week after the release of much higher than predicted data on CPI, wages and employment. In sum, the yield curve was on Friday clearly higher than in the previous week.

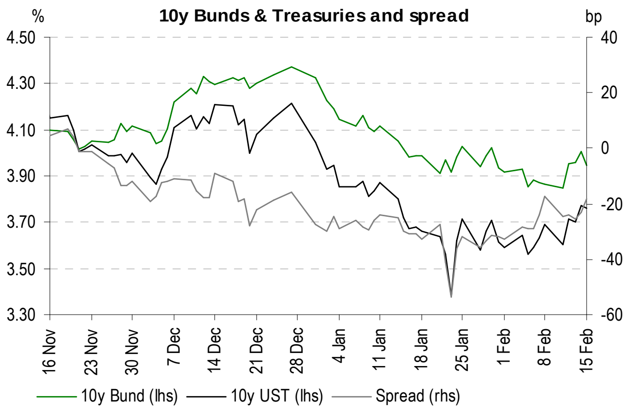
▪ This week, the domestic bond market will be still under influence of core markets, but local data about industrial output and PPI will be also important.



Euro erasing losses against the dollar

▪ During last week, the euro pared some losses against dollar. While dollar strengthened at the start of the week after information from G7 summit, but later on a fall in risk aversion caused a gradual weakening of American currency. Euro strength was positively affected also by slightly better than predicted data about GDP in the euro zone and clearly stronger German ZEW index. Ben Bernanke's speech at the end of week did not have permanent effect on the dollar. At the end of week, the EURUSD was above 1.47 against slightly below 1.45 one week before.

▪ At the start of the week, EURUSD may stabilise due to market holiday in the US and lack of data on Tuesday, but later during the week it will be under influence of important data from US and euro zone.



Weakening in the core debt markets

▪ The core debt markets experiences a weakening last week, as reduction in risk aversion lowered interest in safe-haven assets. Yields of 10Y Treasuries and Bunds rose also due to increased concerns about inflation outlook amid lowered official interest rates. Over the week, Bunds weakened to a larger extent than Treasuries due to stronger than predicted data from the euro zone. At the end of the week, 10Y Treasuries and Bunds were at 3.77% and 3.95%, respectively, vs. 3.69% and 3.86% a week earlier.

▪ The beginning of this week in the core debt markets should be calm, but the next days will bring important events, among which they key ones will be CPI and housing data from the US as well as minutes of FOMC meeting in January, all due for release on Wednesday.

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