Bank Zachodni WBK

Weekly economic update

17 – 24 March 2008

This week we will see a bulk of important information both domestic and international. Possibly already on Monday the energy market regulatory office will decide about gas price hikes, which will be important for inflation path in the nearest months. If decision is delayed, new tariffs will not be applied since 1 April, which will reduce inflation in April and increase in May. Data from the labour market, and about output growth in industry and construction should be rather strong, confirming continuation of relatively fast economic expansion in the first quarter of this year. Our forecasts are below market consensus, however not to the extent that would persuade the MPC to delay the next rate hike. Minutes of the MPC meeting in February may show reasons that convinced the Council to act quickly.

The most important event abroad will be the meeting of American central bank. Amid increasingly pessimistic news from the US economy, another Fed's rate cut is a deal done, and the question concerns a scale of easing. Currently part of the market players do not exclude even a 75 bp rate reduction. Before the decision, there will be several important data from the US, so the first part of the week may be again a test period for the dollar. The end of the week may be more peaceful, due to market holiday in many countries abroad.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (17 March)					
13:00	**PL**	**Wages**	**Feb**	**%YoY**	**11.2**	**10.9**	**11.5**
13:00	**PL**	**Employment**	**Feb**	**%YoY**	**5.8**	**5.8**	**5.9**
12:30	US	New York Fed index	Mar	pts	-8.0	-	-11.72
13:00	US	Capital flows report	Jan	$ bn	-	-	60.4
13:15	US	Capacity utilization	Feb	%	81.2	-	81.5
13:15	US	Industrial production	Feb	%MoM	-0.2	-	0.1
		TUESDAY (18 March)					
12:30	US	PPI	Feb	%MoM	0.4	-	1.0
12:30	US	House starts	Feb	m	0.995	-	1.012
18:15	US	Fed meeting – decision	-	%	2.5	-	3.0
		WEDNESDAY (19 March)					
10:00	**PL**	**Switch auction**					
13:00	**PL**	**Industrial production**	**Feb**	**%YoY**	**10.3**	**9.9**	**10.8**
13:00	**PL**	**PPI**	**Feb**	**%YoY**	**3.2**	**3.0**	**2.8**
		THURSDAY (20 March)					
13:00	**PL**	**MPC minutes**	**Feb**	**-**	**-**	**-**	**-**
9:00	EZ	Flash manufacturing PMI	Mar	pts	51.9	-	52.3
9:00	EZ	Flash services PMI	Mar	pts	52.0	-	52.3
12:30	US	New jobless claims		'000	360.0	-	353.0
14:00	US	Philadelphia Fed index	Mar	pts	-20.0	-	-24.0
		FRIDAY (21 March)					
13:00	**PL**	**Net inflation**	**Feb**	**%YoY**	**-**	**2.5****	**1.73***
13:00	**PL**	**Business climate**	**Mar**	**pts**	**-**	**-**	**-**
	US, DE, GB	Market holiday					

Source: BZ WBK, Parkiet, Reuters ** data for December ** forecast for February, forecast for January at 1.8%YoY.*

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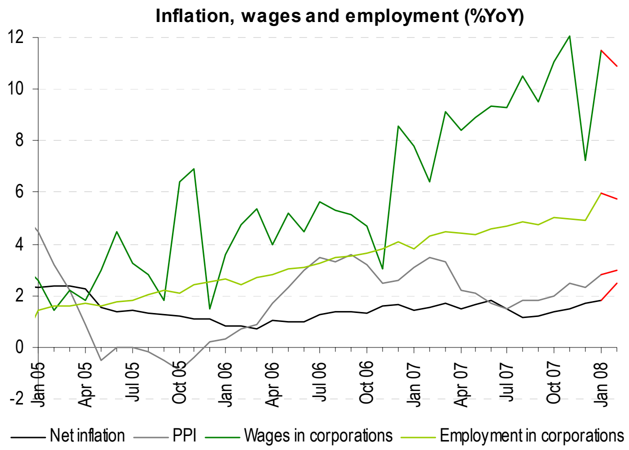
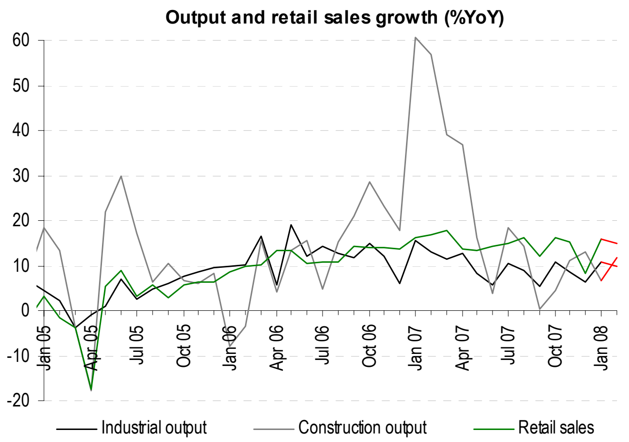
What's hot this week – Many important events and data releases

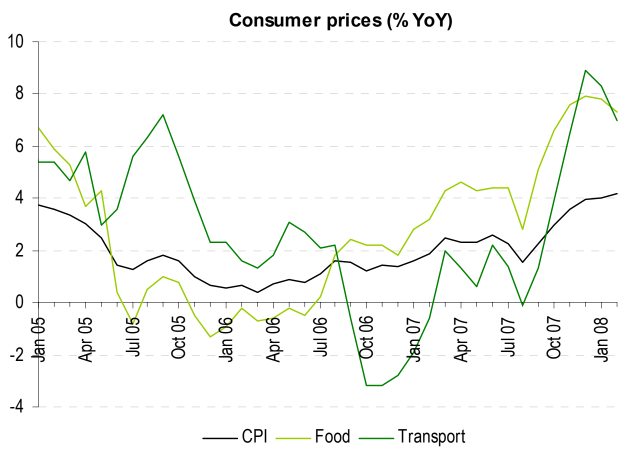


- After strong surprise from CPI data, the market will be awaiting the next data releases that may help to better assess a possible timing of future rate hikes.
- Wages and employment in enterprises sector that will be releases on Monday should confirm continuation of rapid growth although slightly below January's levels. Realisation of market forecasts (wages ca. 11%, employment 5.8%) will allow predicting another strong rise in retail sales, to be released next week. However, if data are clearly below forecasts, a change for delaying the next MPC's rate hike would increase.
- Production growth should remain quite fast in industry and is likely to accelerate in construction (above 11%), confirming moderately fast pace of economic expansion in the first quarter of the year.



- PPI growth accelerated according to forecasts to 3%YoY or even more, but more important for the market will be core inflation. Its level in February was probably slightly lower than expected before CPI data release, however an increase from January was higher.
- Decision of energy market watchdog about gas tariffs hike will be important for short-term inflation forecasts.
- Minutes of the February's MPC meeting, even though their impact on the market will be moderate, may include more hints why the Council decided to hike interest rates faster and whether sooner hikes imply lower scale of total monetary tightening.
- Apart from local data releases, information from abroad will be important. Fed meeting is crucial, and even before it there will be several key data releases in the US.

Economy last week – Nice inflation surprise



- Inflation rate in January has been revised down from 4.3% to 4.0%, while in February it increased to 4.2%, i.e. which was much below forecasts. To large extent, it resulted from a change in CPI weights, which implies also a reduction in inflation path for the next months. Another local peak of inflation may take place in August (low base effect). We do not change expectations regarding monetary policy.
- Current account deficit in January was consistent with forecasts. Export growth was a positive surprise, accelerating to almost 23%YoY and exceeding import growth (which may have been affected more by blockages on Eastern frontiers). Cumulated 12m deficit increased in January to 3.9% of GDP.
- Money supply growth accelerated in February to 13.8%YoY, boosted by rapid rise in households' deposits (due to high redemptions in mutual funds). Credit growth decelerated slightly to 29.5YoY.

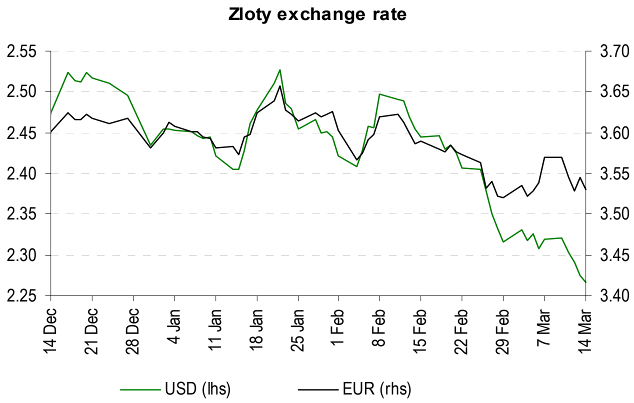
Quote of the week – Upcoming data important for timing of the next rate cut

Jan Czekaj, MPC member, Rzeczpospolita, 13 March
Is a rate hike in March possible? Everything is possible. (...) We will have to look at data about wages, productivity, production, retail sales.

Halina Wasilewska-Trenkner, MPC member, Thomson, 14 March
In my opinion more than one rise in interest rates is needed to counteract the rise in inflation. A rise in March is not, however, guaranteed, as we must have more data which allows us to more fully evaluate the situation, particularly here I mean the labour market, industrial production and retail sales.

Despite lower than predicted CPI data, the most hawkish MPC members (Filar, Noga) still see a need of fastest possible rate hike to 6.0%. Nevertheless, Halina Wasilewska-Trenkner tends to link a timing of the next rate hike with the remaining data for February due for release this week. Similar view is shared by Jan Czekaj who used to tip the balance of votes many times recently. One should notice that while a rate hike in March is less certain now, a general MPC opinion about direction and scale of monetary policy changes has not changed. Even dovish Pietrewicz said that inflation in February "is rather high". Thus, our opinion that interest rates will climb to 6% this year remains unchanged.

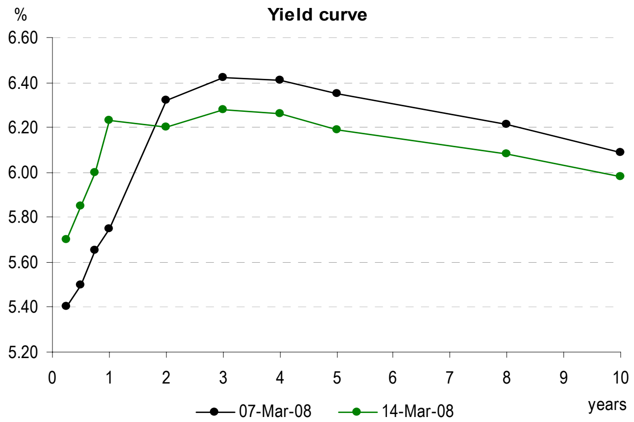
Market monitor



Polish currency resistant to risk factors

▪ A week ago the zloty was in the short-term depreciation trend, which was connected with higher risk aversion on global markets. The EURPLN rate almost reached the level of 3.59. However, the zloty made up for the losses quite quickly, driven by sentiment improvement abroad after Fed rescue action to provide liquidity. What is more, despite global confidence weakened, the zloty remained stable later during the week.

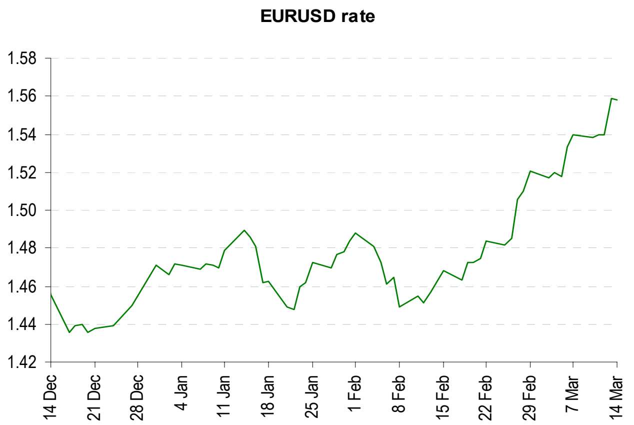
▪ A number of US data releases will again cause volatility in risk aversion this week. The zloty should not, however, react much to external factors, especially if expectations for rate hike by the MPC in March maintains. We stick to the zloty range from previous week of 3.50-3.60 for EURPLN and lower it to 2.23-2.33 for USDPLN.



Yields down in reaction to inflation data

▪ In the first part of the week the activity in the fixed income market was limited as investors were awaiting the inflationary data. After the announcement of the figures much below forecasts the fall in yields was quite substantial.

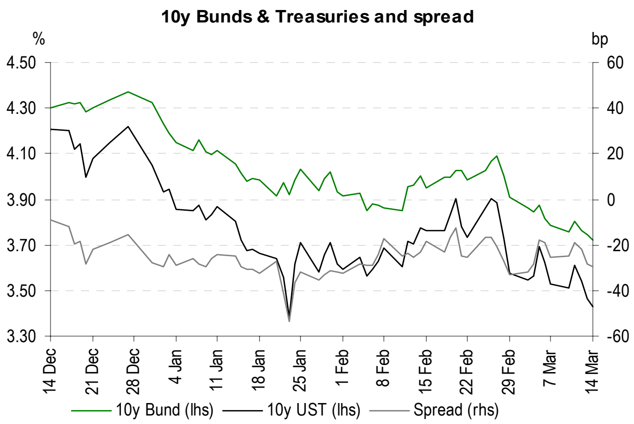
▪ As the next macroeconomic data releases (labour market report, production and sales) will be of high importance for the Monetary Policy Council, their publication will be the main factor influencing the bond market. Our forecasts are moderately lower than market consensus, which means a potential for some strengthening on the market. We do not think, however, that the data will be weak enough to postpone the hike. As usual in recent months, global sentiment will be important for moods on the fixed income market.



Dollar reaching new lows

▪ The beginning of the week was stable for the American currency on foreign exchange markets thanks to Fed rescue action. However, starting Thursday the dollar continued to hit new lows (1.565) amid ongoing evidence of weak economic activity in the US and credit/ hedge fund related developments. On Friday, news about financial problems of Bear Sterns was another negative factor for the greenback.

▪ The days ahead are unlikely to bring any relief for the beleaguered currency as we continue to expect a negative newsflow from the US. Data release and Fed decision will be the key for the market.



Risk aversion means stronger bonds

▪ Another wave of risk aversion caused a substantial increase in demand for safe assets and as a result the yields of bonds fell very substantially. The only short-term correction in this trend was caused by the rescue action by Fed. However, investors' belief in its efficiency did not last for long.

▪ The next rate cut by Fed, weak US economic data as well as liquidity problems of American financial institutions will keep the yields in the downward trend. Especially, as Friday's data on inflation proved to be lower than the market consensus. Decline in euro zone's yields may by limited by hawkish tone of ECB officials' comments.

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