Bank Zachodni WBK

Weekly economic update

12 – 18 May 2008

Finance Ministry's inflation forecast for April was consistent with market consensus and showed stabilisation of inflation at March level. Our forecast is more optimistic, which implies in our opinion lower risk of interest rate hike at the MPC meeting in May. According to the European Commission's Convergence Report, Poland still did not adjust some legal regulation in accordance with euro zone's requirements and did not fulfil most of the convergence criteria. Nevertheless, the Commission said that Poland's convergence programme is still under review and the excessive deficit procedure may be lifted after the appraisal is done. The Commission recommended abrogation of the EDP in case of Slovakia and positively assessed the readiness of Slovakia to euro zone entry, which delivered a support for currencies in the region, including the zloty. The domestic currency strengthened during the week and breached 3.40 level on Friday. On the bond market there was a slight correction. In the nearest days, apart from inflation data that may slightly support the debt market and weaken the zloty, we will also see less important data about money supply (we predict a small slowdown in money growth in April) as well as balance of payments figures for March, where we predict to see a slight increase in trade deficit and no significant change in current account gap as compared to February. Global moods and local market may be also affected by a series of important data releases scheduled abroad.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		TUESDAY (13 May)					
12:30	US	Import prices	Apr	%	1.6	-	1.5
12:30	US	Retail sales	Apr	%MoM	0.0	-	0.2
		WEDNESDAY (14 May)					
9:00	**PL**	**Auction of 20Y bonds**					
12:00	**PL**	**CPI**	**Apr**	**%YoY**	**4.1**	**4.0**	**4.1**
12:00	**PL**	**Money supply**	**Apr**	**%YoY**	**13.6**	**13.3**	**13.5**
9:00	EZ	Industrial output	Mar	%YoY	2.3	-	3.1
12:30	US	CPI	Apr	%MoM	0.3	-	0.3
		THURSDAY (15 May)					
12:00	**PL**	**Current account**	**Mar**	**€ m**	**-1355**	**-1331**	**-1324**
12:00	**PL**	**Trade balance**	**Mar**	**€ m**	**-**	**-1131**	**-933**
9:00	EZ	Preliminary GDP	1Q	%YoY	1.9	-	2.2
9:00	EZ	Final HICP	Apr	%YoY	3.3	-	3.6
12:30	US	NY Fed index	May	pts	0.6	-	0.63
12:30	US	New jobless claims		'000	400	-	365
13:00	US	Capital flows report			-	-	-
13:15	US	Capacity utilisation	Apr	%	80.6	-	80.5
13:15	US	Industrial production	Apr	%YoY	-0.1	-	0.3
14:00	US	Philadelphia Fed index	May	pts	-20.0	-	-24.9
		FRIDAY (16 May)					
12:30	US	House starts	Apr	m	0.94	-	0.947
13:55	US	Preliminary Michigan index	May	pts	63.0	-	62.6

Source: BZ WBK, Parkiet, Reuters

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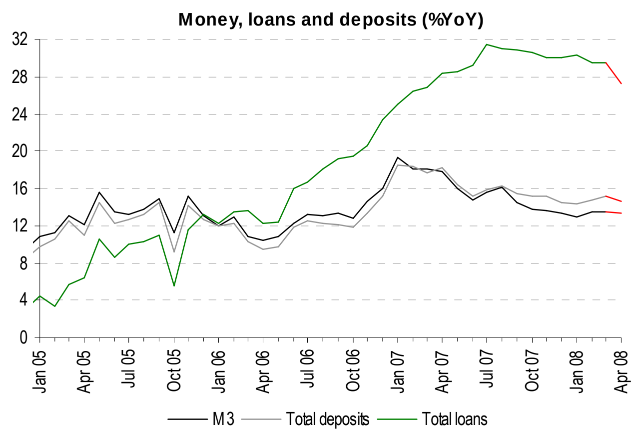
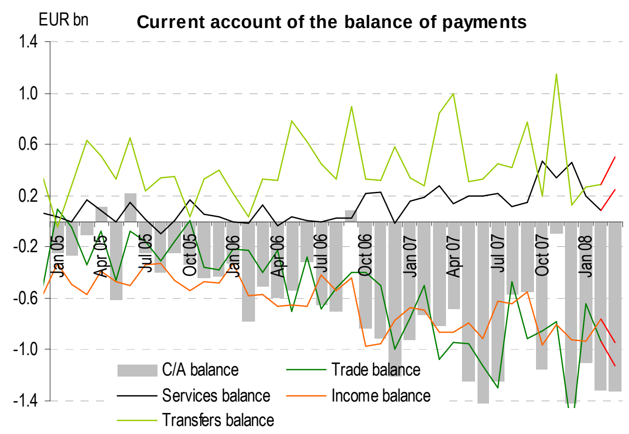
What's hot this week – New data from the economy

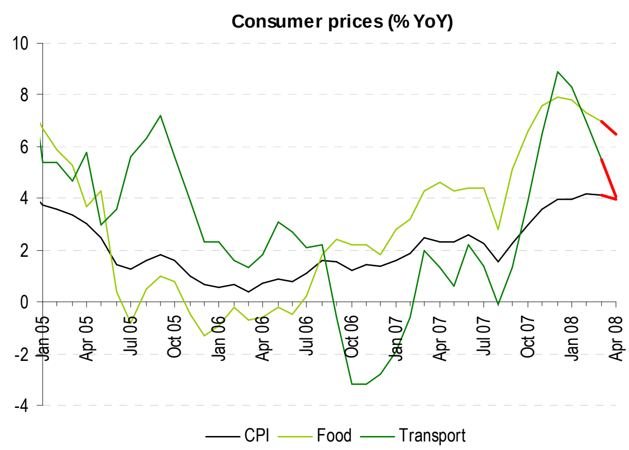


- In contrast to the FinMin's forecast and market consensus that assume inflation stabilisation at 4.1%YoY level in April, we predict a slight decrease to 4.0%YoY amid 0.3%MoM increase in prices. We assume food price growth at 0.8%MoM. The data may have significant impact on market expectations concerning the result of MPC meeting in May.
- In our view, money supply growth decelerated in April to 13.3%YoY from 13.5% in March. Loan growth also slowed down to 27.3%YoY.
- On Wednesday, the Ministry of Finance will hold auction of 20Y bonds, which will be important for the debt market.
- Large number of important data releases will appear abroad, with potentially big impact on global market sentiment.



- Balance of payments data for March should present the current account gap in March close to February's level, i.e. €1.3bn, as well as a rise in trade deficit to €1.1bn.
- At the same time we predict a slowdown in export and import growth (connected with low growth in industrial output and lower number of working days as compared to previous years) with export growth (17.5%YoY) exceeding imports (16.2%).
- We expect a slight increase in surpluses on services and current transfers accounts as compared to February, outpacing a deterioration in income account.
- According to the CSO, publication of data about wages and employment in enterprises sector for April was postponed until the next week.

Economy last week – FinMin's inflation estimate in line with consensus



- The Ministry of Finance published its inflation forecast for April, which showed CPI rose 0.4%MoM and 4.1%YoY.
- The European Commission and the ECB released their assessment of convergence reports of the euro zone candidates. According to the report, the EC will propose lifting the excessive deficit procedure against Poland. At the same time, the EC positively assessed readiness of Slovakia to adopt the euro. The ECB expressed some reservations on that issue.
- The ECB kept interest rates unchanged with the refinance rate at 4%. Jean Claude Trichet once again stressed that the primary goal of the bank is price stability and the ECB has to ensure, even despite risk for the economic growth, that inflation increase will be temporary. The Bank of England also kept interest rates unchanged last week with the main rate at 5%.

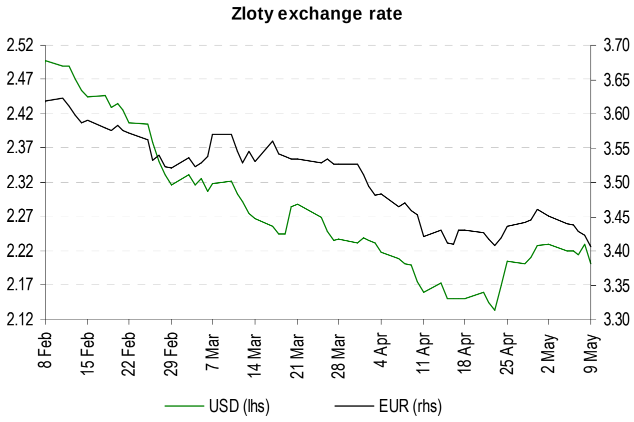
Quote of the week – We have to wait for data for April and May

Jan Czekaj, MPC member, Gazeta Prawna, 8 May

We have to wait for data for April and May. I think that having information for two, three months we will be able to assess more precisely to the question [whether data for March were a sign of economic wakening of just a one-off]. I think that if economic data for April are also weaker, there will be no rate hike in May. (…) If the ECB starts to lower rates, we would have to follow the same way in order to not maintain excessive disparity, which would put further appreciation pressure on the zloty. (…) Situation in the labour market suggests that the economy is still above its potential, which may increase inflation.

Recent comments from Jan Czekaj had mixed tone. On the one hand, he said one should wait for data for a few next months and pointed out that signals from the world economy are against rate hikes in Poland. Prof. Czekaj would even be ready to cut rates in case of rate cuts by the ECB in order to avoid excessive appreciation of the zloty. On the other hand, however, he does not exclude a rate hike in May, if monthly economic data are not weak and believes that it is not sure whether the reference rate level of 6% will be enough. Meanwhile, Marian Noga from the hawkish camp said that the Council decided to wait for GDP data for Q1 due after the MPC meeting in May. All in all, the comments seem to confirm our view that the next rate hike is more likely in June than in May.

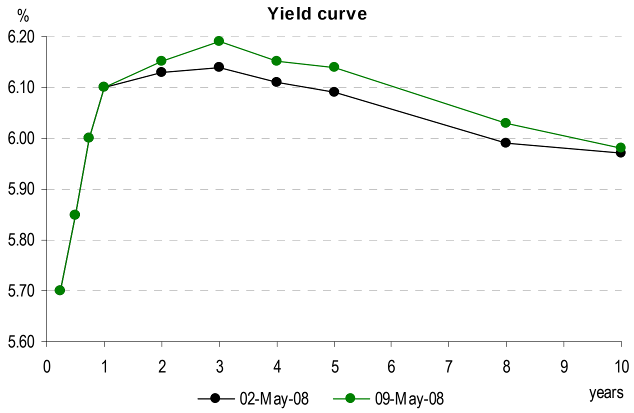
Market monitor



Significant recovery of the zloty

▪ In the first part of the week the zloty was quite stable. However, later on the domestic currency appreciated against the euro, which resulted from improved risk appetite in the region after the release of the assessment of convergence programmes of countries applying for the euro zone, which gave the green light to Slovakia for the joining the EMU. This event supported the currencies in the region. After a slight correction the zloty strengthened again the end of the week.

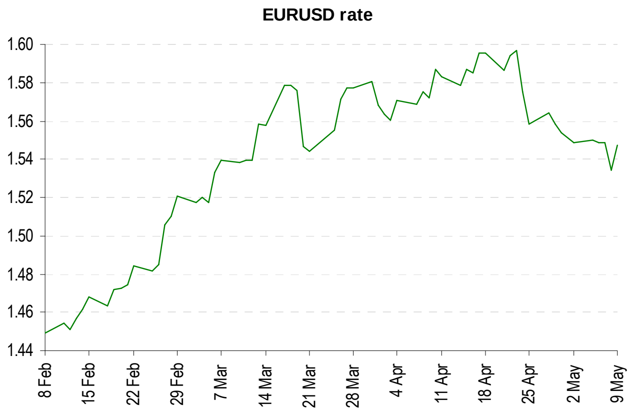
▪ After dropping below 3.40, the zloty may strengthen further (due to stop-losses), with risk of approaching 7-year low of ca. 3.35. However, taking into account our low inflation forecast we see a scope for a correction. All in all, we lower the trading range for this week for the EURPLN rate to 3.35-3.45, and for USDPLN rate to 2.14-2.24 amid expected EURUSD rate rise.



Small changes in the fixed income market

▪ At the start of the week the activity in the fixed income market was limited, as not all investors returned to market after the long May weekend and there was small number of important events. The market was not affected by the release of April inflation forecast of the Ministry of Finance. In the 5Y bond auction day the moods in the debt market were not positive and despite quite significant zloty strengthening investors were selling bonds. Later bond prices remained quite stable till the week end. The yield curve slightly rose since previous Friday.

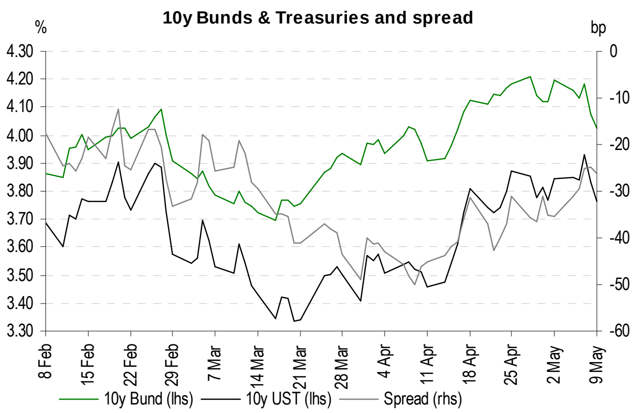
▪ Our CPI forecast is more optimistic than FinMin's and market consensus, which implies in our opinion lower risk of interest rate hike at the MPC meeting in May.



Dollar appreciating against the euro again

▪ In the last days the dollar continued the appreciation trend against the euro. The hawkish comments of the Fed representative and expectations the ECB will focus to larger extent on risks to economic growth contributed to the EURUSD rate decline below 1.53. However the comments of the ECB president after the interest rate meeting emphasised concerns of inflation, which resulted in the euro recovery to above 1.54.

▪ We expect the dollar to weaken in the nearest time, though the recovery of the US currency may be a start of the EURUSD rate falling trend. This week the activity indicators and CPI data will be important for the dollar, while euro may be sensitive to data from the EMU as they may affect the willingness of the ECB to cut rates.



Debt markets strengthen at the end of the week

▪ A weakening was recorded at the start of the week in the core debt markets after better activity indicators in services in the US and the EMU. Information on losses of Fannie May and negative news from the financial sector (job cuts in the UBS) temporarily strengthened the markets. However, soft retail sales in the EMU, „hawkish" Trichet, falls in the stock markets and high interest in the US bonds offer at auctions resulted in market strengthening. At the end of the week the respective yields were at 3.75% and 4.02% vs. 3.84% and 4.19% on previous Friday.

▪ Inflation data as well as retail sales and activity figures in the US as well as production and GDP data from the euro zone will be essential for the core markets. We expect 25 bp rate cut in 2Q and another 50 bp in 2H08, while in the EMU a total easing of 50 bp in 4Q.

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