Bank Zachodni WBK

Weekly economic update

21 – 27 July 2008

Among data released last week in fact only acceleration in wage growth in enterprises sector to 12%YoY was a "hawkish" surprise, while other publications were either neutral (CPI) or lower than forecast (employment, industrial output, export, PPI), fitting well in a picture of Polish economy undergoing a gradual slowdown. Those data will be arguments for the Monetary Policy Council for several months of observation of situation and no interest rate hikes in the summer period. Nevertheless, the Council will remain vigilant, as definitely accelerating wage growth could be a worrying signal.

This week will bring about lower number of publications either local and on international markets. The most important domestic data will be those about retail sales growth. They may be slightly negative for bonds, as we predict higher sales growth than the market (thanks to solid rise in revenues). Core inflation data, that are likely to show slight increase in most of measures, should be quite neutral for market sentiment, as well as business climate indicators and minutes of June MPC meeting. Abroad, the housing market should be the focus of attention in the US. Other data of note in a relatively quiet week include durable goods for June and the final reading for July's Michigan Sentiment survey. Amid a light data schedule, markets will be keeping a close eye on half year corporate earnings reports/trading statements and the performance of stock markets, as well as developments on oil prices.

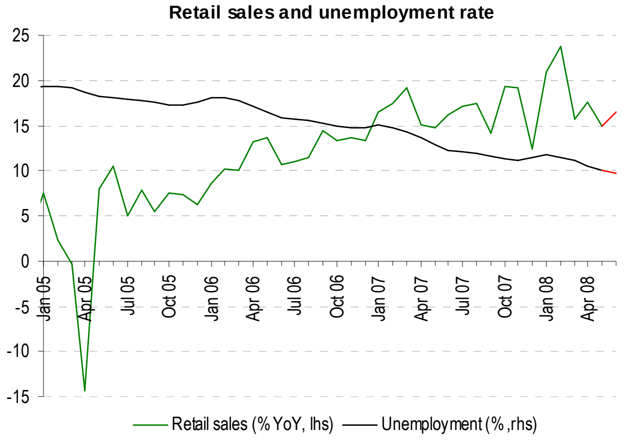
Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (21 July)					
9:00	**PL**	**T-bill auction: 13-week worth PLN0.5bn and 52-week worth PLN1.2bn**					
	JP	Market holiday					
		TUESDAY (22 July)					
12:00	**PL**	**Net inflation**	**Jun**	**%YoY**	**3.3**	**3.3**	**3.2**
		WEDNESDAY (23 July)					
9:00	**PL**	**Switch auction**					
9:00	EZ	Industrial orders	May	%YoY	2.6	-	11.7
12:00	**PL**	**Business climate survey**	**Jul**	**pts.**	**-**	**-**	**-**
		THURSDAY (24 July)					
8:00	DE	Ifo index	Jul	pts.	100.2	-	101.3
8:00	EZ	PMI flash - manufacturing	Jul	pts.	48.7	-	49.2
8:00	EZ	PMI flash - services	Jul	pts.	48.8	-	49.1
12:00	**PL**	**MPC minutes**	**Jul**	**-**	**-**	**-**	**-**
12:30	US	New jobless claims	w/k	k	375.0	-	366.0
14:00	US	Home sales	Jun	m	4.93		4.99
		FRIDAY (25 July)					
8:00	EZ	M3 money supply	Jun	%YoY	10.3	-	10.5
12:00	**PL**	**Retail sales**	**Jun**	**%YoY**	**16.0**	**16.5**	**14.9**
12:00	**PL**	**Unemployment rate**	**Jun**	**%**		**9.7**	**10.0**
12:30	US	Durable goods orders	Jun	%MoM	0.2	-	0.0
13:55	US	Michigan index final	Jul	pts.	56.0	-	56.4
14:00	US	New home sales	Jun	m	0.51	-	0.512

Source: BZ WBK, Parkiet, Reuters

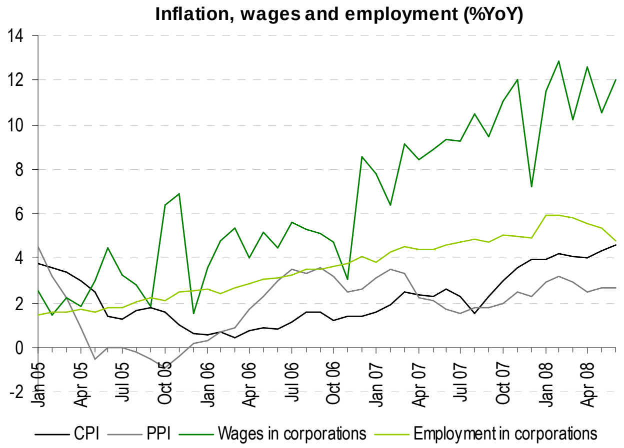
Maciej Reluga Chief economist (+48 22) 586 8363
Piotr Bielski (+48 22) 586 8333
Piotr Bujak (+48 22) 586 8341
Cezary Chrapek (+48 22) 586 8342
e-mail: ekonomia@bzwbk.pl

What's hot this week – Last data releases before the MPC meeting

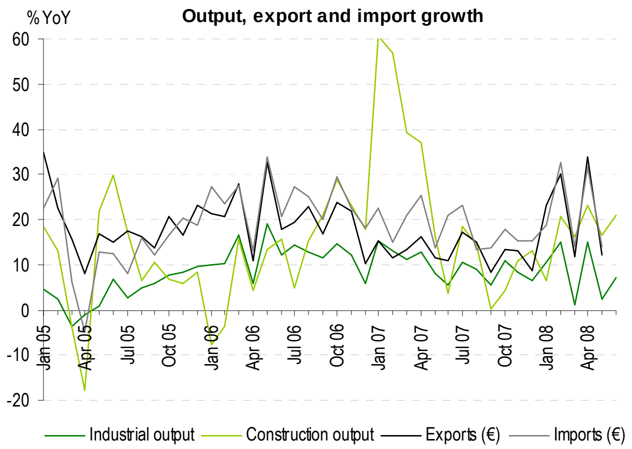


- This week will see smaller number of important data releases and events than the last one.
- Slight increase in net core inflation should not surprise the market, neither will the release of the MPC minutes from June meeting. However, possibly there will be some hint in the document about reasons why the Council abandoned the sentence representing informal restrictive bias in monetary policy.
- Forecasts of retail sales growth in June are widely spread (from 12 to over 20%YoY). Our forecast is slightly above consensus and we feel that the risk is on the upside, due to strong increase in wages.
- There will be smaller number of data releases abroad and they will be concentrated at the end of the week. Markets will be still watching quarterly results of US companies.

Economy last week – Dovish data, except for wages



- The only "hawkish" surprise in recently released data was acceleration of wage growth in enterprises sector to 12%YoY. To some extent it could have been affected by higher number of hours worked and semi-annual bonuses in mining.
- In turn, employment growth was a negative surprise as it slowed down to 4.8%YoY. On monthly basis, job creation remained stagnant for the second straight month, which may herald weakening of wage pressure in the near future.
- CPI inflation increased in June to 4.6%YoY, in line with our forecast. Fuel costs increased 7.5%YoY and 3.3%MoM and food prices fell 0.6% since May, slightly less than we predicted. There was a clear acceleration in growth of services prices and stable (or falling) prices of many goods.



- Producer price growth was lower than predicted. PPI growth in manufacturing remained at merely 1.5%YoY, which shows that in competitive markets enterprises are reluctant to pass growing costs to final prices.
- Output growth in industry (7.2%YoY) was also below forecasts, supporting our view that the economy started decelerating.
- In some exporting sectors output growth was still high, while in some cases a slump in production was recorded.
- Already in May export growth decelerated clearly and in H2 further slowdown in possible due to worse external demand and strong zloty. Current account deficit reached €1.6bn in May and may exceed 5% of GDP this year.
- Situation in investments looks better, which was reflected by construction production growth by almost 21%YoY.

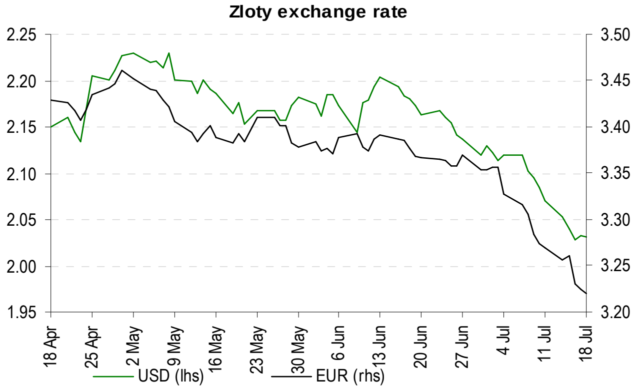
Quote of the week – Strong zloty and possible slowdown worrying MPC

Marian Noga, MPC member, PAP, 18 July
After 6.1% GDP growth in Q1, it looks like we are facing first symptoms of slowdown, I didn't think it would be so fast. (...) The data reinforced my belief that we have to change with changes in monetary policy parameters until October.

Andrzej Sławiński, MPC member, TVN CNBC, 18 July
Thus far, zloty was appreciating roughly in line with the equilibrium exchange rate, which was a brake for inflationary pressure "for free". (...) However if the zloty rate starts appreciating against the equilibrium rate, then appreciation would still help in curbing inflation but it would be at expense of trade balance. (...) What would happen with interest rates will depend largely on the exchange rate developments.

Comments of MPC members confirmed that the Council will not hurry with next interest rate movements, at least not in the summer period. Even the most hawkish Dariusz Filar admitted recently that the MPC has some time for "observation" now (even in his opinion it is a short period). For future MPC decisions very important will be inflation behaviour in the summer period, but also a pace of economic slowdown in H2. We still think this is not the end of interest rate hikes this year.

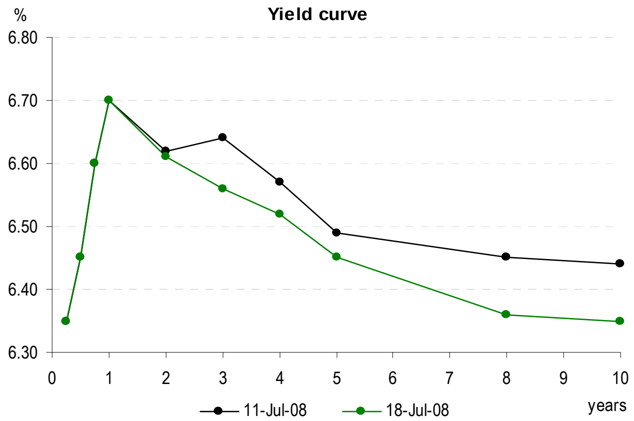
Market monitor



The zloty stronger than ever

▪ The second week of significant appreciation of the zloty behind us. Almost every day the zloty was reaching new highs, breaking consecutive psychological levels. EURPLN fell below 3.21 and USDPLN below 2.03.

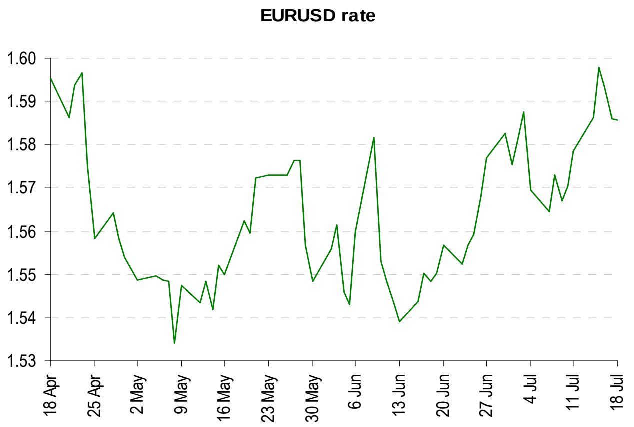
▪ Calendar of events for this week includes no events which could significantly weaken the zloty. Changes in risk aversion are possible under influence of events abroad, but recently their influence on the Polish market was limited. On the other hand, pace of the zloty appreciation slowed down in recent days. We think chances for breaking 3.20 against the euro this week are low. Therefore, we set expected range for EURPLN at 3.20-3.30 and for USDPLN at 2.00-2.10.



Better moods in the local debt market

▪ Although higher that expected data on wage growth temporarily weakened the debt market, next days saw clear fall in bond yields (though not as significant as a week earlier). This was driven by the zloty appreciation and weakening expectations for hikes by the MPC.

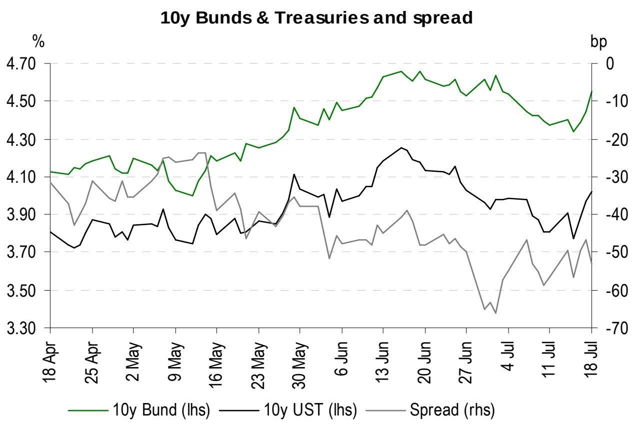
▪ Data indicating stronger rise in retail sales and acceleration in core inflation may cause some increase in yields, but moods in the Polish market this week will probably be driven mainly by developments in the core debt markets. If moods abroad are bullish for bonds (among others due to weaker economic activity indicators), the Polish interest rate market may experience further strengthening.



Dollar keeps weakening

▪ Last week, the US currency weakened against other majors and EURUSD temporarily rose above 1.60 reaching fresh low versus the euro, among others due to concerns about condition of the financial sector in the US and less hawkish than expected comments from Fed chairman. In the second part of the week the dollar recovered thanks to improved sentiment in the US stock market and fall in crude oil prices.

▪ In the near term the key factor for the EURUSD will be changes in moods on the global market driven by next publications of earnings reports for Q2 by US companies. Data from the US housing market and economic activity indicators from the euro zone will also be important.



Volatile moods in the core debt markets

▪ Yields in the debt markets in the US and the euro zone increased over the last week, although there were significant changes in yields in both directions during the week amid changes in risk aversion.

▪ The key focus of attention this week will be on quarterly earnings reports and performance of the global stock markets. Economic activity indicators from the euro zone and data on home sales in the US will affect expectations regarding monetary policy of the world's major central banks and thus they will be important for the core debt markets. The Fed's Beige Book will also be noteworthy.

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