Bank Zachodni WBK

Weekly economic update

13 - 19 February 2006

Next week we will get to know a number of information important for financial markets participants as well as for the MPC, although it has to be noticed that despite no important news scheduled for last week situation on the market was quite interesting – zloty strengthening at the end of the week and yields fall amid situation on core markets, budget surplus in January and statements of one of MPC members. Professor Andrzej Sławiński, who seems to represent the view of the majority of Council, identified his view on inflation perspective with the one presented in the optimistic NBP's inflation projection. This allows us maintaining expectations on another interest rate cut already this month, although the final support for such view will be possible after the upcoming releases of economic data. The most important publication will take place on Wednesday, when the statistical office will publish January's inflation as well as labour market figures, which were mentioned as crucial by the so-called hawkish faction, being in the minority in the MPC. However, the business climate report published by the central bank showed that despite expected continuation of employment creation (and positive assessment of economic situation, in general), inflation pressure (from both wage growth and high prices of commodities) is limited.

Economic calendar

TIME GMT	REGION	INDICATOR (importance level*)	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
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15:00	**POL**	**Trade deficit (CSO) (M)**	**Dec**	**EUR m**	**-535**	**-700**	**-539**
		TUESDAY (14 February)					
15:00	**POL**	**Money supply (M)**	**Jan**	**%YoY**	**10.7**	**10.4**	**10.3**
10:00	GER	ZEW index (H)	Feb	%YoY	71.0	-	71.0
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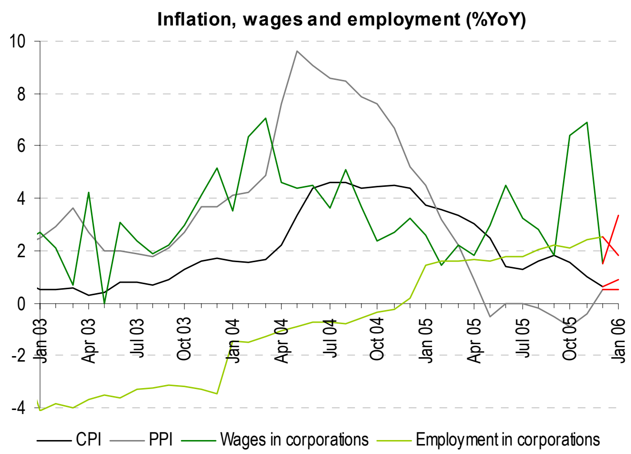
What's hot this week – Publication of data crucial for MPC decision

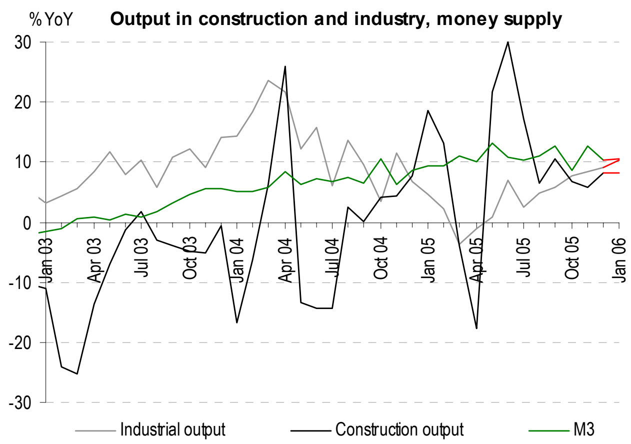


▪ In the next couple of days we will see economic data releases, after which market participants will assess with higher probability the next move of the MPC.

▪ The most important figures will be published on Wednesday and while we expect the same rise in CPI inflation as market participants (to 0.9%YoY from 0.7%), we are below market consensus as regards labour market data.

▪ Although there is indeed a chance for higher employment growth (especially as stat office will probably annually revise big firms' database), we maintain our opinion that there is high chance for another rate cut already this month.

▪ Additionally, one should remember that that inflation data will be preliminary and will be revised in March, after changing the CPI basket, which will include prices of mobile services for the first time. This may lower inflation rate by as much as 0.2-0.3 percentage point.



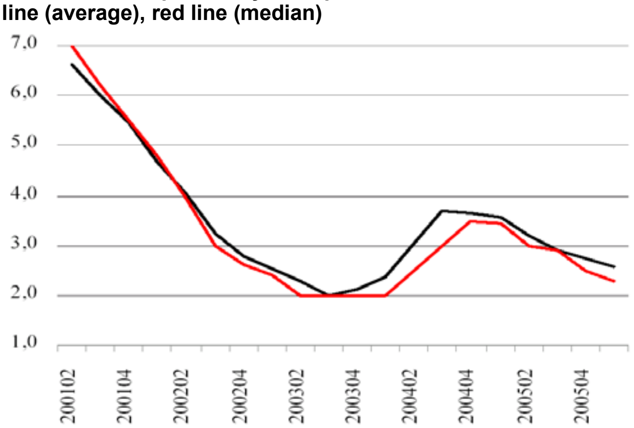
▪ Additional information this week will be data on money supply (at the beginning of the week) and data from industrial sector (just before the weekend).

▪ While M3 figures should be neutral for the market, production data will indicate the pace of economic recovery at the beginning of this year. We expect two-digit growth in industrial output (a bit above market forecast), although it has to be noticed that there is a risk on the downside given frosty weather in January. However, this factor will influence more significantly production in construction sector.

▪ Also on Friday we will get know producer prices, which will complete the picture of the expanding Polish economy without a significant risk for substantial price growth. We expect that annual PPI inflation maintained at the low December's level of 0.5%.

Economy last week – Expansion with limited price pressure

CPI inflation expected by enterprises within 12 months – black line (average), red line (median)



▪ The NBP business climate survey for 4Q05 indicates a continuation of fast economic expansion, but with inflationary pressures staying under control.

▪ Improvement in the assessment of economic situation as well financial stance of enterprises was observed and firms indicated expectations of higher demand.

▪ Despite expected employment creation, lower percentage of enterprises is planning to raise wages and the scale of the planned wage hikes is lower than a year ago. This may suggest limited inflationary pressure even with continued employment increase.

▪ What is more, forecasted price growth rate is estimated to be lower than in the analogous period of last year and high oil prices have limited effect on retail prices.

▪ Exporters perform quite well in spite of strong zloty.

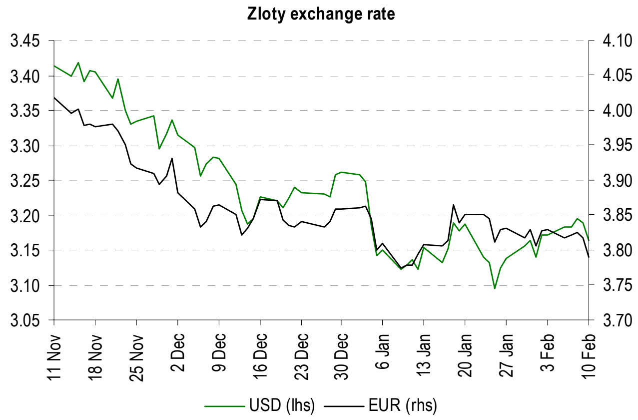
Quote of the week – Projection shows the most likely scenario

Andrzej Sławiński, MPC member; PAP, Reuters, 10 February

Most likely we are entering the period, which was awaited for some time, i.e. quite strong growth with low inflation. Fro the point of view of central bank the situation is favourable, After January rate cut the inflation projection still shows the most likely inflation perspective. Monetary policy consists in adjusting interest rates level to the most likely scenario.

In two interviews one of MPC members presented the view, which was missing in the official MCP communiqué. Namely, he referred to the inflation projection, which showed optimistic inflation path and he said that this is the most likely scenario, to which MPC should adjust rates. This could mean that according to Sławiński uncertainty factors mentioned by the MPC neutralise themselves and do not change inflation path presented in projection.

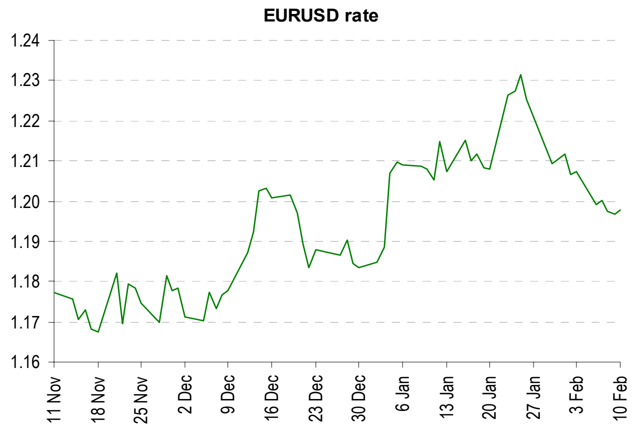
Market monitor



Zloty again below 3.80

▪ Polish currency traded in a narrow range almost throughout the whole past week, as there were no essential information released on the market, which would more significantly influence decisions of investors. However at the end of the week zloty substantially appreciated and broke key technical level 3.80 against the single currency. Within the whole week zloty strengthened ca. 1% vs. the euro and ca. 0.3% vs. the dollar.

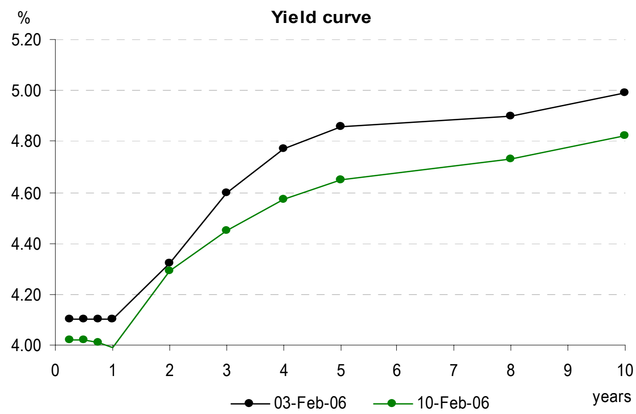
▪ Ample crucial data are going to be released next week. The most important for the FX market will be figures increasing expectations on further monetary policy easing, which may boost demand for Polish bonds and support Polish currency as well. We estimate that zloty will fluctuate in range 3.74-3.84 against the euro and 3.10-3.20 versus the greenback.



Dollar strongest for 5-weeks

▪ U.S. currency appreciated ca. 0.8% against the single currency up to the highest levels for 5 weeks with regards to higher expectations on further monetary policy tightening in the U.S. amid positive situation on the labour market. Alan Greenspan's statement on the sound outlook of U.S. economy also helped the dollar. However, despite the trade deficit was in line with expectations it triggered correction of the EURUSD rate.

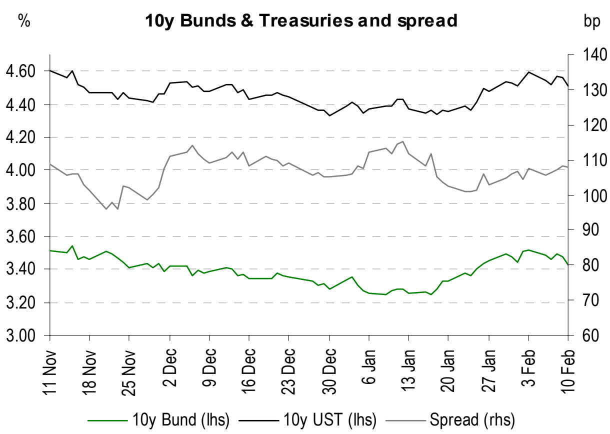
▪ After stabilization of U.S. trade deficit at the high level net capital flows data due next week as well as the figures influencing views on the future level of interest rates and monetary policy tightening such as utilisation capacity, industrial production and housing market data will be important for the greenback.



Bond yields lower

▪ This week the interest rate market remained to much higher extent under influence of core bond markets. Polish debt strengthened at the beginning of the week and despite a temporary correction yields fell by 8-15 bp, while the yields curve flattened at 2-5 years period and slightly steepened at 5-10 years. Additional strengthening came in after statement of Monetary Policy Council member Andrzej Sławiński.

▪ The most crucial for the fixed income market will be CPI inflation, data from the labour market as well as industrial production in later course. If figures appear to be in line with our forecasts, than provided the stability in politics holds, the expectations on a rate cut yet in February may rise, and bond yields may fall further.



Slight strengthening on the core bond markets

▪ U.S. government bonds weakened this week mainly before auction with regards to high supply of bonds. In the result 10-year yields were lower by 4 bps at 4.51% as compared to the previous Friday.

▪ Amid lack of release of important data as well as essential events in the euro zone Bunds followed the American market and 10Y yields fell by 5 pts to 3.43%.

▪ Next week the most important for the Federal Reserve as well as the U.S. interest rate market will be capacity utilisation, industrial production and data from the housing market, which may confirm a solid growth of American economy. ZEW index and Q4 GDP data will be key for the ECB and the euro zone bonds.

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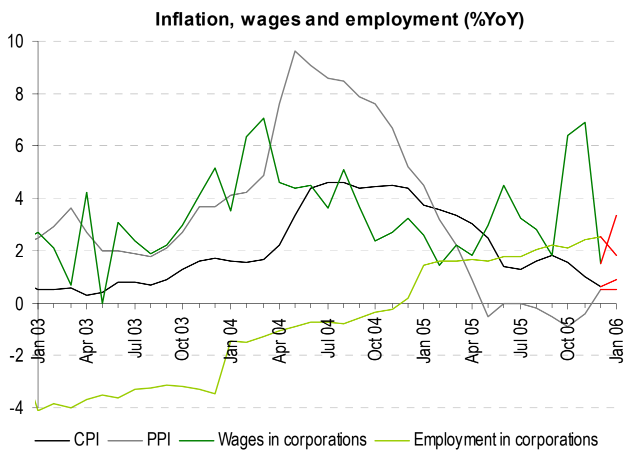

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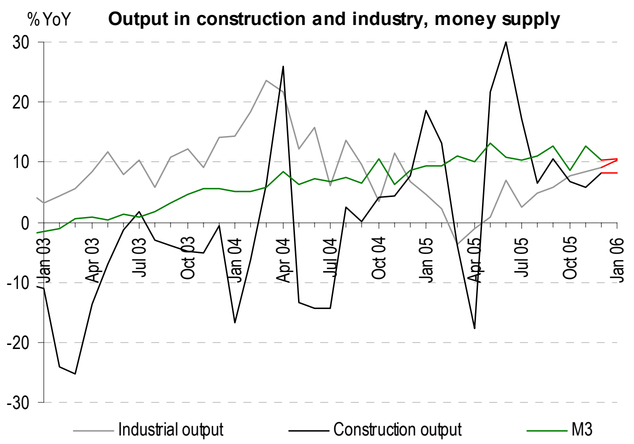

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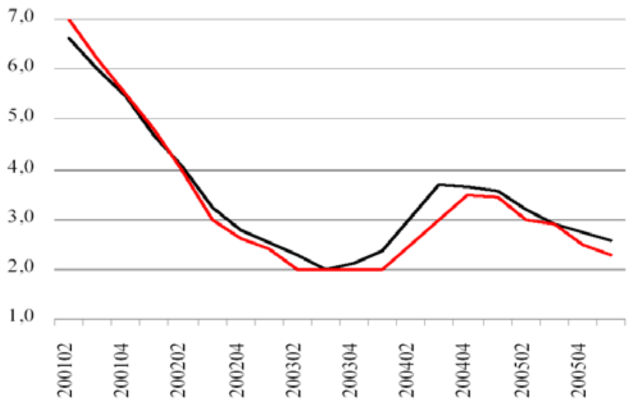

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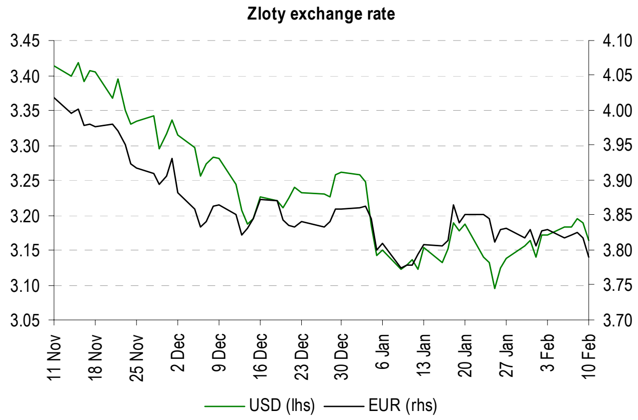

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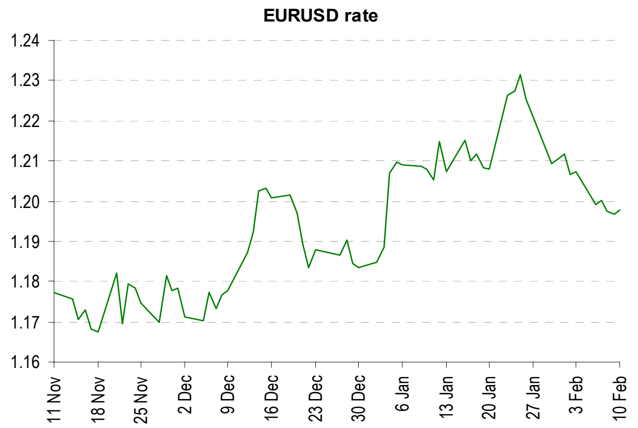

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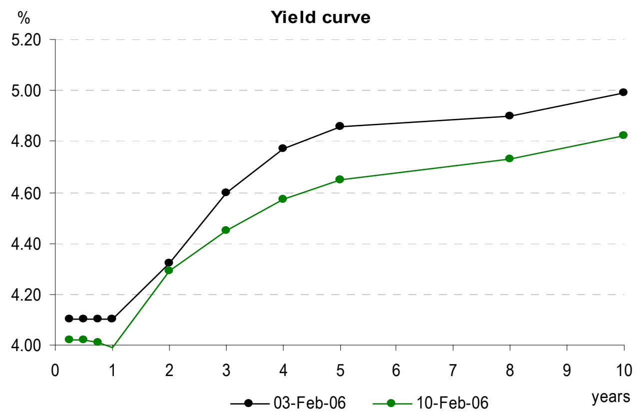

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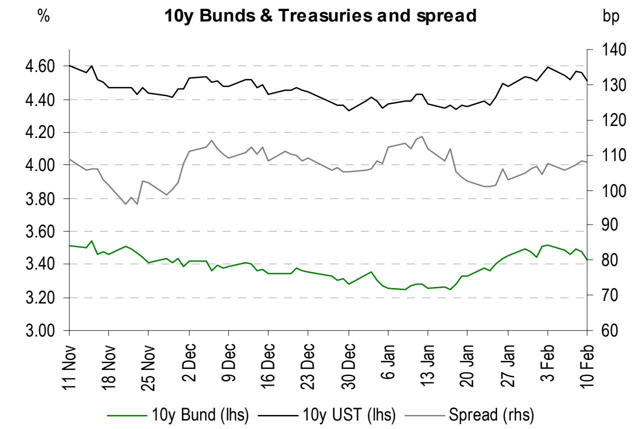

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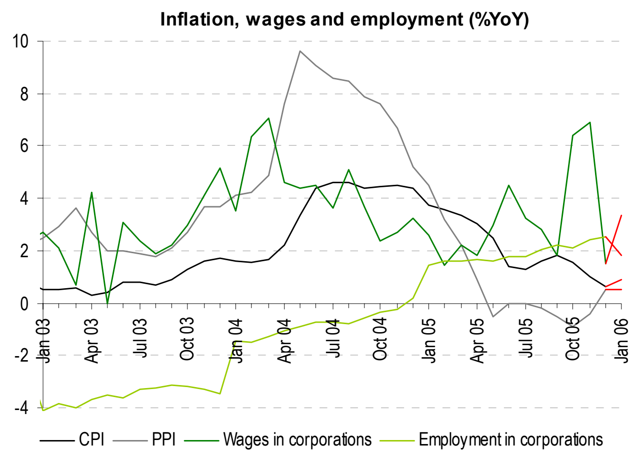
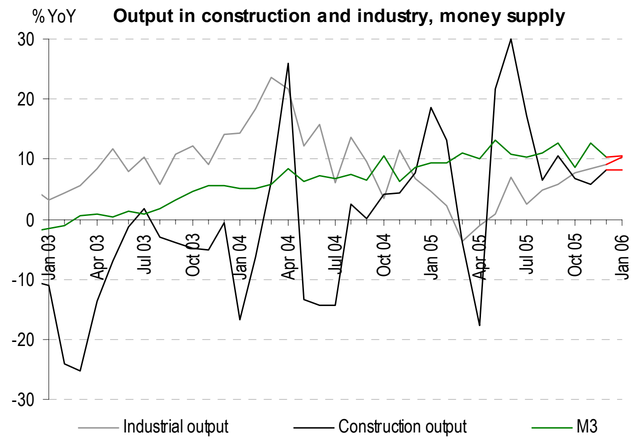


▪ In the next couple of days we will see economic data releases, after which market participants will assess with higher probability the next move of the MPC.

▪ The most important figures will be published on Wednesday and while we expect the same rise in CPI inflation as market participants (to 0.9%YoY from 0.7%), we are below market consensus as regards labour market data.

▪ Although there is indeed a chance for higher employment growth (especially as stat office will probably annually revise big firms' database), we maintain our opinion that there is high chance for another rate cut already this month.

▪ Additionally, one should remember that that inflation data will be preliminary and will be revised in March, after changing the CPI basket, which will include prices of mobile services for the first time. This may lower inflation rate by as much as 0.2-0.3 percentage point.



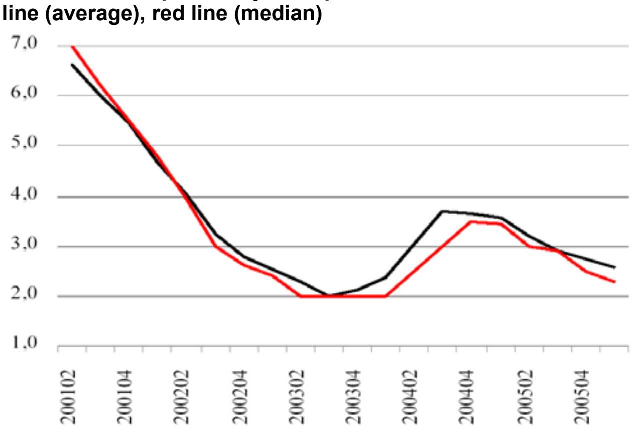
▪ Additional information this week will be data on money supply (at the beginning of the week) and data from industrial sector (just before the weekend).

▪ While M3 figures should be neutral for the market, production data will indicate the pace of economic recovery at the beginning of this year. We expect two-digit growth in industrial output (a bit above market forecast), although it has to be noticed that there is a risk on the downside given frosty weather in January. However, this factor will influence more significantly production in construction sector.

▪ Also on Friday we will get know producer prices, which will complete the picture of the expanding Polish economy without a significant risk for substantial price growth. We expect that annual PPI inflation maintained at the low December's level of 0.5%.

Economy last week – Expansion with limited price pressure

CPI inflation expected by enterprises within 12 months – black line (average), red line (median)



▪ The NBP business climate survey for 4Q05 indicates a continuation of fast economic expansion, but with inflationary pressures staying under control.

▪ Improvement in the assessment of economic situation as well financial stance of enterprises was observed and firms indicated expectations of higher demand.

▪ Despite expected employment creation, lower percentage of enterprises is planning to raise wages and the scale of the planned wage hikes is lower than a year ago. This may suggest limited inflationary pressure even with continued employment increase.

▪ What is more, forecasted price growth rate is estimated to be lower than in the analogous period of last year and high oil prices have limited effect on retail prices.

▪ Exporters perform quite well in spite of strong zloty.

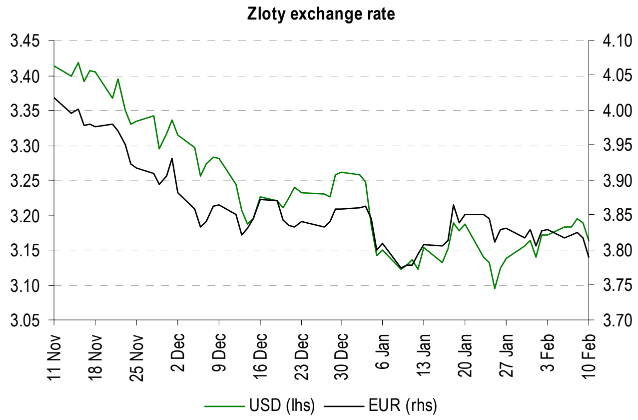
Quote of the week – Projection shows the most likely scenario

Andrzej Sławiński, MPC member; PAP, Reuters, 10 February

Most likely we are entering the period, which was awaited for some time, i.e. quite strong growth with low inflation. Fro the point of view of central bank the situation is favourable, After January rate cut the inflation projection still shows the most likely inflation perspective. Monetary policy consists in adjusting interest rates level to the most likely scenario.

In two interviews one of MPC members presented the view, which was missing in the official MCP communiqué. Namely, he referred to the inflation projection, which showed optimistic inflation path and he said that this is the most likely scenario, to which MPC should adjust rates. This could mean that according to Sławiński uncertainty factors mentioned by the MPC neutralise themselves and do not change inflation path presented in projection.

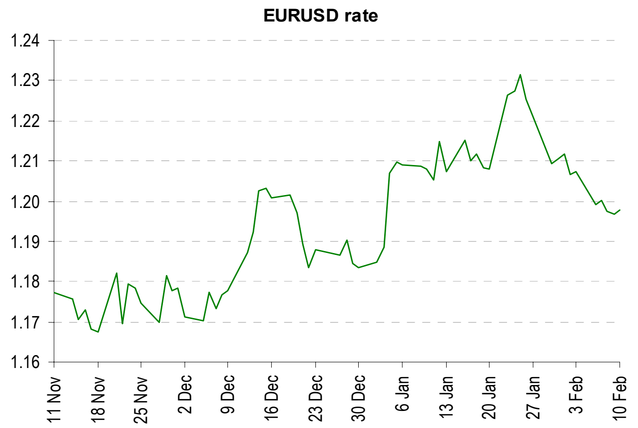
Market monitor



Zloty again below 3.80

▪ Polish currency traded in a narrow range almost throughout the whole past week, as there were no essential information released on the market, which would more significantly influence decisions of investors. However at the end of the week zloty substantially appreciated and broke key technical level 3.80 against the single currency. Within the whole week zloty strengthened ca. 1% vs. the euro and ca. 0.3% vs. the dollar.

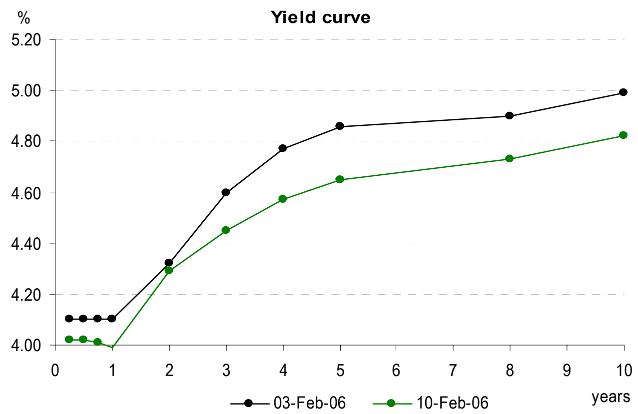
▪ Ample crucial data are going to be released next week. The most important for the FX market will be figures increasing expectations on further monetary policy easing, which may boost demand for Polish bonds and support Polish currency as well. We estimate that zloty will fluctuate in range 3.74-3.84 against the euro and 3.10-3.20 versus the greenback.



Dollar strongest for 5-weeks

▪ U.S. currency appreciated ca. 0.8% against the single currency up to the highest levels for 5 weeks with regards to higher expectations on further monetary policy tightening in the U.S. amid positive situation on the labour market. Alan Greenspan's statement on the sound outlook of U.S. economy also helped the dollar. However, despite the trade deficit was in line with expectations it triggered correction of the EURUSD rate.

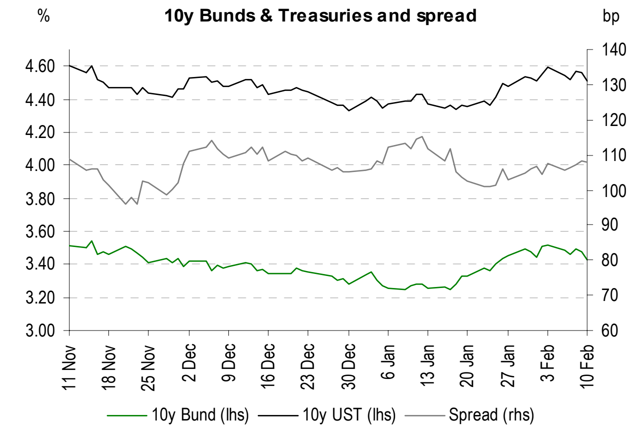
▪ After stabilization of U.S. trade deficit at the high level net capital flows data due next week as well as the figures influencing views on the future level of interest rates and monetary policy tightening such as utilisation capacity, industrial production and housing market data will be important for the greenback.



Bond yields lower

▪ This week the interest rate market remained to much higher extent under influence of core bond markets. Polish debt strengthened at the beginning of the week and despite a temporary correction yields fell by 8-15 bp, while the yields curve flattened at 2-5 years period and slightly steepened at 5-10 years. Additional strengthening came in after statement of Monetary Policy Council member Andrzej Sławiński.

▪ The most crucial for the fixed income market will be CPI inflation, data from the labour market as well as industrial production in later course. If figures appear to be in line with our forecasts, than provided the stability in politics holds, the expectations on a rate cut yet in February may rise, and bond yields may fall further.



Slight strengthening on the core bond markets

▪ U.S. government bonds weakened this week mainly before auction with regards to high supply of bonds. In the result 10-year yields were lower by 4 bps at 4.51% as compared to the previous Friday.

▪ Amid lack of release of important data as well as essential events in the euro zone Bunds followed the American market and 10Y yields fell by 5 pts to 3.43%.

▪ Next week the most important for the Federal Reserve as well as the U.S. interest rate market will be capacity utilisation, industrial production and data from the housing market, which may confirm a solid growth of American economy. ZEW index and Q4 GDP data will be key for the ECB and the euro zone bonds.

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