Bank Zachodni WBK

Weekly economic update

20 – 26 February 2006

First economic data in the new year confirmed fast rate of economic expansion and improving situation on the labour market, with persistently low inflation at the same time. While GDP growth and domestic demand are likely to be strong in the coming months and quarters, some pressure on prices may well appear, but this won't be necessarily substantial and at this stage there are no signs of substantial risk of inflation going above the central bank's target of 2.5%. It allows for predicting that Monetary Policy Council will go for another cautious rate cut already at the end of this month.

Before this happens, this week we will receive another portion of data that could be helpul in MPC decision making. In practice, all important indices will be released on Thursday, during CSO press conference on economic situation. The most important will be relail sales growth in January, forecasted at ca. 7%YoY. Such rate of growth would be consistent with predicted path of gradual revival in private consumption. Registered unemployment rate in January should rise to 18.1%, however this will not signal reversal of positive trends on labour market, but rather a typical seasonal effect of growing number of jobless rate in winter. In relation to analogous period of previous year, unemployment is still falling at reasonable pace. Possibly, detailed data included in monthly statistical bulletin released on Thursday will be also of high importance for the MPC. They will consist of e.g. more complete information on labour market situation in Q4 2005 – total employment and wages in entire economy and specific sectors.

As regards data and information abroad, the minutes of the January FOMC meeting are likely to be the main focus of attention in the US, with markets looking for confirmation that further rates hikes are in the pipeline. There will be limited number of economic data in the US, while in the eurozone a number of leading business surveys are due for release including the Ifo and INSEE.

Economic calendar

TIME GMT	REGION	INDICATOR (importance level*)	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (20 February)					
10:00	**POL**	**Auction of PLN1.0bn 52-week Treasury bills (M)**					
		TUESDAY (21 February)					
10:00	EMU	Eurostat trade (M)	Dec	EUR bn	-0.1	-	-2.3
		WEDNESDAY (22 February)					
9:00	EMU	Current account (H)	Dec	EUR bn	-8.0	-	-
13:30	US	CPI (H)	Jan	%MoM	0.5	-	-0.1
19:00	US	FOMC minutes (H)	Jan				
		THURSDAY (23 February)					
10:00	**POL**	**Switch auction (H)**					
9:00	**POL**	**Retail sales (H)**	**Jan**	**%YoY**	**6.7**	**7.3**	**6.3**
9:00	**POL**	**Unemployment (M)**	**Jan**	**%**	**18.1**	**18.1**	**17.6**
9:00	**POL**	**Business climate (M)**	**Feb**				
9:00	GER	IFO index (H)	Feb	pts	101.5	-	102.0
		FRIDAY (24 February)					
13:30	US	Durable goods (H)	Jan	%	-1.0	-	1.8

* Importance level: (H)igh, (M)oderate; Source: Parkiet Reuters, BZ WBK

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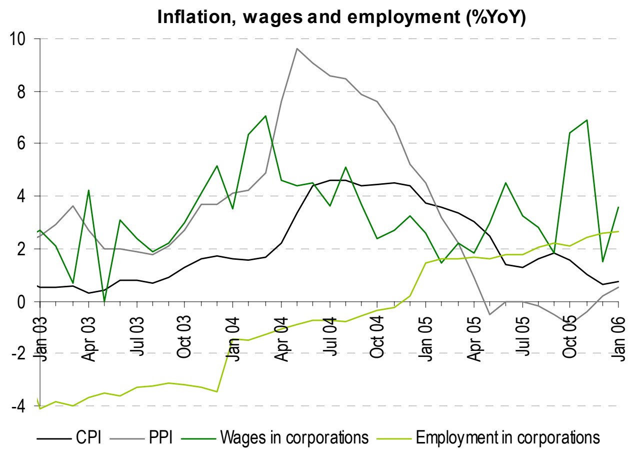
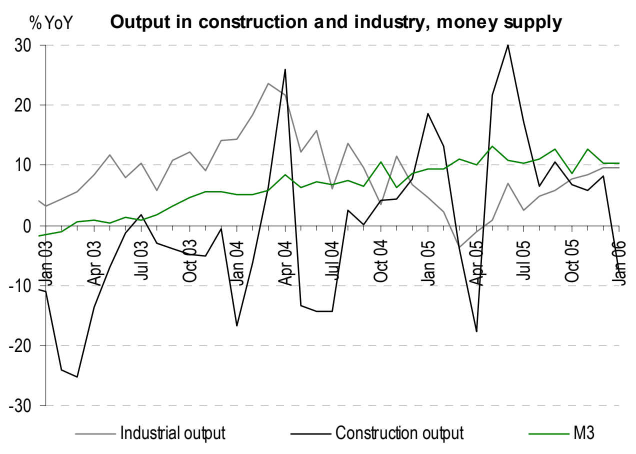
What's hot this week – Last set of data before MPC meeting

- This week economic data releases will take place only on Thursday.
- The most important will be retail sales, that should maintain quite rapid rise (we forecast over 7%, market consensus is 6.7%), confirming recovery taking place in consumption demand. Unemployment rate probably rose to 18.1%, but it was a seasonal effect, while in annual terms situation on the labour market is constantly improving. Business climate indices will be a hint what could be expected in industry and trade in February.
- The CSO will also release monthly statistical bulletin, including e.g. complete labour market data for 4Q05.
- Slightly more information will appear abroad. The main focus will be on FOMC minutes from January. In US also CPI data will be important, while in the euro zone IFO business sentiment index will be released.

Economy last week – January data should not deter a rate cut



- Inflation data surprised again – CPI growth in January remained at December's level 0.7%YoY, against 0.9% forecasts. One should remember that this figure will be revised in March after a change in consumption basket, which could reduce inflation even more. Data showed that even after exclusion of food and fuel prices from CPI, inflationary pressure is low, which supports expectations for further rate cuts. Especially that PPI grew a mere 0.5%YoY in January.
- Average pay in firms rose 3.6%YoY, and employment grew 2.6%YoY. In effect, wage bill in enterprises sector rose 6.3%YoY in nominal terms and 5.5% in real terms. It confirms expectations for faster rise in private consumption in subsequent quarters, although rate of wage growth does not exceed pace of productivity growth and thus does not seem to endanger inflation outlook.



- Output figures for January confirmed expansionary tendencies in the Polish economy. Industrial output rose 9.5%YoY in January, slightly stronger than expected, while construction output dropped 7.8%YoY, probably due to severe weather conditions in the first month of the year.
- In January state budget was in surplus of PLN704m thanks to very high tax revenues, partly moved from December 2005, and partly boosted by high economic activity at the start of the year.
- Money supply increased 10.2%YoY in January. Revival in credit for households continues (23.2%YoY), supporting forecasted rise in consumption. Credit for companies also improved a little, growing 3.4%YoY after 2.8% in December. Low growth in households' deposits (2.5%YoY) is probably connected with rising popularity of mutual funds.

Quote of the week – Will MPC need more information to make decision?

Mirosław Pietrewicz, MPC member; PAP, 15 February

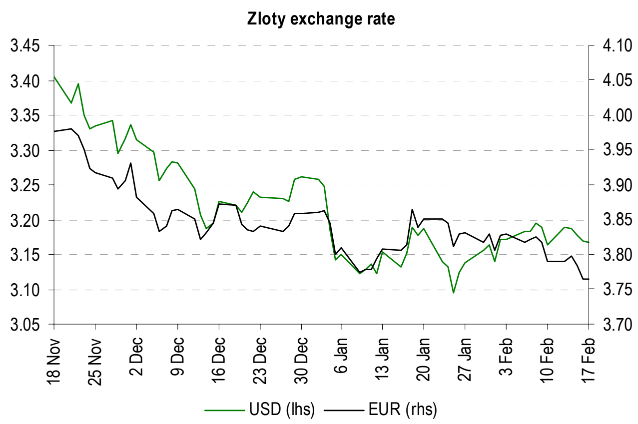
The data give our greater comfort as regards the future, but as far as interest rate decisions are concerned, one should wait for the next data and compare them with the projection.

Andrzej Wojtyna, MPC member; PAP, 15 February

I cannot exclude a possibility of further rate reductions, if structural changes related to globalisation will be maintained. This also depends on the shape of the 2007 budget. Much also depends on FX developments.

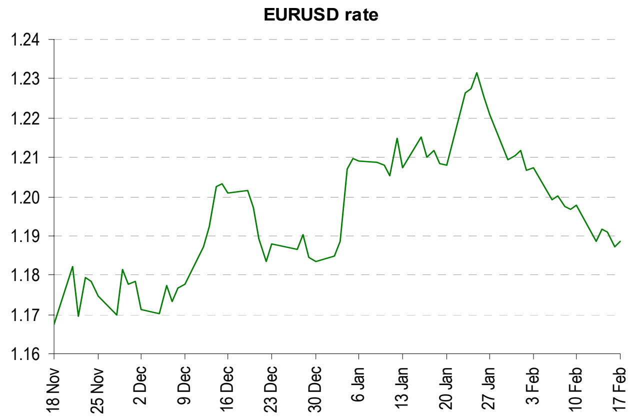
Although the recent data confirmed expectations that another rate cut is possible already in February, one should take note of the fact that a few comments from MPC members suggest further monetary easing is not obvious. However, it seems to us that there will be enough arguments in February to convince majority of rate-setters to deliver another cautious cut of 25bps, while information in next months (e.g. the new inflation projection and 2007 budget) will show whether more cuts are possible.

Market monitor



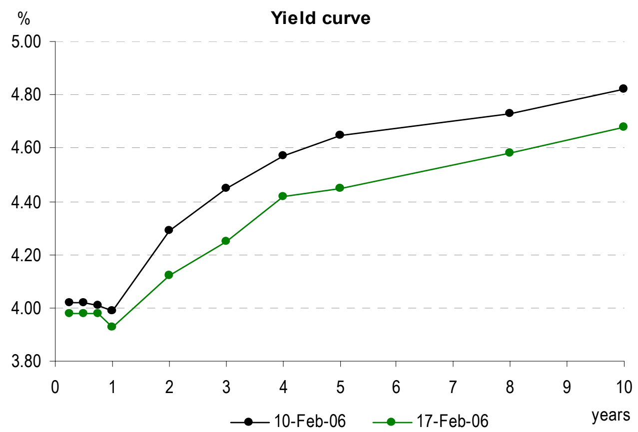
Zloty at the strongest level for 3.5 years

- The beginning of the week brought significant depreciation of the zloty, which was connected with increased uncertainty with regards to early elections. When the risk of parliament dissolving diminished, and demand for bonds jumped thanks to weak macroeconomic data Polish currency appreciated substantially to the highest levels for 3.5 years (3.75). Zloty gained ca. 0.7% against the single currency and ca. 0.1% versus the dollar.
- We believe that in spite of the fact that negative influence of political risk still exists and durability of "stabilisation pact" is doubtful zloty still has some appreciation potential with regards to high interest of foreign investors in Polish assets. We forecast the EURPLN rate to fluctuate in range 3.72-3.82 against the euro an 3.10-3.20 versus the dollar.



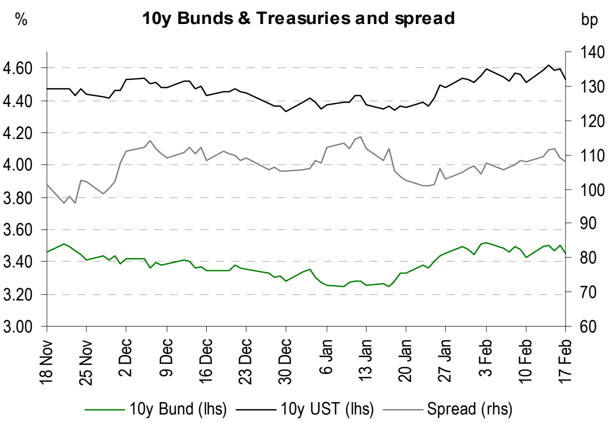
Dollar the strongest for 5 weeks

- The dollar strengthened against the single currency by 0.8% to the highest level for 5 weeks. Initially it was a consequence of higher retail sales data in United States. Net capital flows were lower than the trade deficit, which contributed to a slight correction. Bernanke's testimony in U.S. Congress strengthened market view for further rate raise, which strengthened the dollar, however quite soft PPI and Michigan index contributed to EURUSD rate rise.
- In the coming week the most important for the EURUSD rate will still be data influencing expectations on the future level of interest rates. The FOMC minutes from the January meeting will be essential though more important seems to be CPI inflation and durable goods orders figure.



Yields near all time lows

- The political turmoil connected with possibility of dissolving of the parliament resulted in bonds prices slump. This appeared to be a good moment to buy Polish debt. After political situation calmed down and low CPI inflation and labour market data were released bond yields fell strongly (by ca. 14-20 bps within a week). Industrial production and PPI figures were quite neutral for the market.
- Retail sales data as well as unemployment figures will be a next signal with regards to further shape of monetary policy. If data is weak expectations on further rat cuts may be strengthened. With positive sentiment of investors toward the region and Poland bond prices may still rise. In our opinion MPC will cut interest rate in February, while the demand for bonds in March will depend on the Council's communiqué.



Strengthening at the end of the week

- Treasuries yields remained at the end of the last week was near the previous Friday level. Initially yields rose amid expectations on Bernanke's speech, which suggested further monetary policy tightening as well as retail sales data in U.S. Lower PPI than in the previous month and weak Michigan index contributed to bonds strengthening. Bund yields followed the U.S. market.
- Next week the most important the FOMC minutes may be of slightly less importance than formerly, as the next Fed meeting will be chaired by new president. CPI inflation data as well as durable goods orders data will be essential for interest rate market this week. In the euro zone Ifo index will be of key importance.

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