

Weekly economic update

27 February – 5 March 2006

Statistical data published by the CSO last week confirmed the Polish economy is on a path of accelerating economic growth. January's retail sales rose a stronger than forecasted 8.6%YoY (the consensus was 6.7%) and the unemployment rate posted weaker than expected seasonal rise in the first month of the year. However, the discrepancy between predictions and actual data was not as significant so that change expected scenario of economic situation and negatively affect favourable inflation outlook.

The key feature of the nearest week on the Polish financial market will be MPC meeting. Although market analysts are strongly divided in their expectations regarding timing of a rate cut (February or March), hardly anyone has doubts rates will be trimmed again soon. In our opinion a majority of rate-setters will recognise that there is no use delaying monetary policy action (one can even argue that January's rate cut was too late by a few months), if they actually think that inflation return to the target should be quickened.

Economic calendar

TIME GMT	REGION	INDICATOR (importance level*)	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
MONDAY (27 February)							
9:00	EMU	Money supply M3	Jan	%	7.3	-	7.3
15:00	USA	New home sales	Jan	m	1.26	-	1.269
TUESDAY (28 February)							
	POL	MPC meeting - decision	Feb	%	4.25	4.0	4.25
10:00	EMU	Consumer sentiment	Feb	pts	-10.0	-	-11.0
10:00	EMU	Final HICP	Feb	%YoY	2.4	-	2.2
13:30	USA	Preliminary GDP	Q4	%	1.5	-	1.1
15:00	USA	Chicago PMI	Feb	pts	59.0	-	58.5
15:00	USA	Consumer confidence	Feb	pts		-	106.3
15:00	USA	New home sales	Jan	m	6.6	-	6.6
WEDNESDAY (1 March)							
10:00	POL	Auction of 2 year bonds					
	POL	GDP	Q4	%YoY	4.1	3.9	3.7
	POL	Private consumption	Q4	%YoY	3.2	3.3	2.7
	POL	Fixed investments	Q4	%YoY	9.9	9.8	5.7
9:00	EMU	Manufacturing PMI	Feb	pts	54.0	-	53.5
10:00	EMU	Flash HICP	Feb	%YoY	2.3	-	1.4
15:00	USA	Manufacturing ISM	Feb	pts	55.5	-	54.8
THURSDAY (2 March)							
10:00	EMU	Revised GDP	Q4	%	1.7	-	-
12:45	EMU	ECB meeting – decision	Mar	%	2.5	-	2.25
FRIDAY (3 March)							
9:00	EMU	PMI services	Feb	pts	57.3	-	57.0
14:45	USA	Final Michigan index	Feb	pts	88.5	-	91.2
15:00	USA	ISM services	Feb	pts	58.0	-	56.8

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

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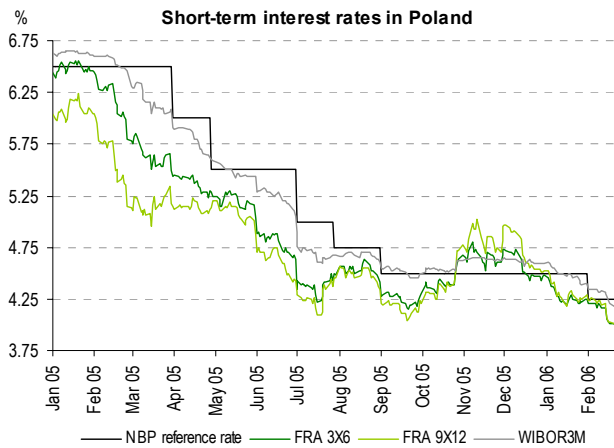
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What's hot this week – Central banks to decide on rates

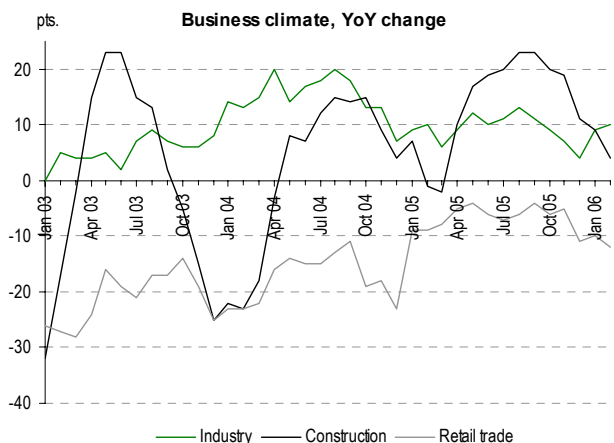


- MPC decision on rates will be the key focus of attention on the Polish market in the nearest week.
- FRA quotations indicate that market participants expect as much as two rate cuts of 25 bps until April, with the first move already in February. However, results of polls among market analysts show that predictions regarding timing of the nearest cut are divided fifty-fifty (between February and March).
- There are much more unanimous expectations as regards ECB decision on rates that will be announced on Thursday. A rate hike of 25 bps seems sure to the market.
- Apart from decision on interest rates, there will be many data releases during the week, mainly abroad, as in Poland only GDP data for 4Q05 will be revealed. However, they should not be much different than estimates for that period based on preliminary data for 2005 as a whole.

Economy last week – The economy gains strength



- Retail sales rose a faster than expected 8.6%YoY in January. Market consensus was 6.7%, our forecast stood at 7.3%. In real terms, retail sales grew 8.5%YoY. Both nominal and real growth was the highest since June 2005.
- The data confirmed predictions pointing to further acceleration in GDP growth in 1Q06 to above 4%.
- Consumption demand is supported by continued improvement of labour market conditions. Although the unemployment rate grew to 18% in January, this is solely a seasonal effect. In annual terms, the jobless rate dropped by 1.5pp, the same as in December and the strongest since 1998.
- Detailed data from the labour market showed continuation of strong rise in labour productivity and fall in unit labour costs, which is supportive for maintaining low inflation.



- Business climate indicators for February also indicated that expansionary tendencies in the economy has been maintained. Indices for manufacturing and construction were again in positive territory. Although index for retail trade remained in the red, lower than in any months of 2005, it was significantly higher than in the analogous period of 2001-2004 when competition among retailers was much weaker.
- Apart from data releases, the market received some news from the political scene last week. They were negative, showing some flaws on the stabilisation pact. The news started to appear when the government rejected Self-Defence's draft bill regarding costly rebate in excise tax on fuel for farmers. However, we do not expect so that Self-Defence or LPR decided to break the pact as long as public opinion polls show dominating position of PiS.

Quote of the week – In the mood for cuts

Andrzej Sławiński, MPC member; ISB, 21 February

January's inflation projection reflects the most likely scenario of future developments in the economy and related to that future inflation which should approach the target [of 2.5%] in 2008.

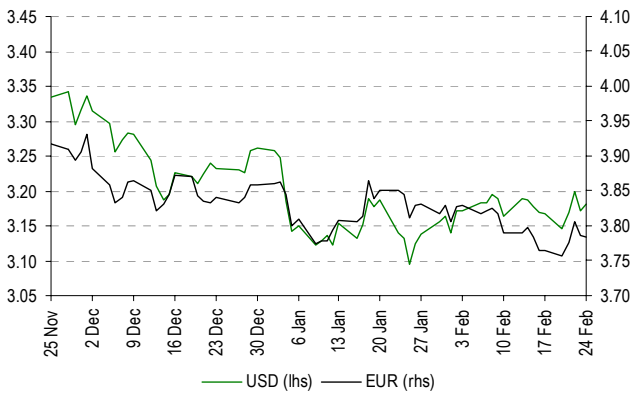
Andrzej Wojtyna, MPC member; Reuters, 21 February

Inflation was a positive surprise and if it undershoots lower end [of inflation target range] for longer period, this would not be comfortable situation from the point of view of the strategy [of the MPC].

Comments from Sławiński and Wojtyna support market expectations for continuation of rate cut cycle. Since future inflation undershoots the target, the central bank should not delay reducing rate. The question is how many cuts will be delivered (currently the market prices in two cuts until April), but the answer will be possible only after February's MPC meeting. We do hope it will be possible, but one has to bear in mind communication problems of the Council.

Market monitor

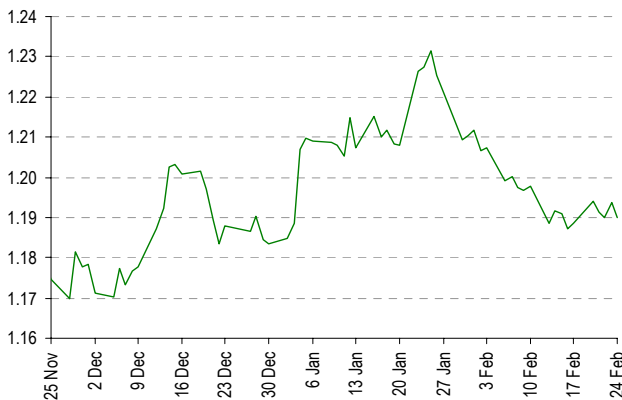
Zloty exchange rate



Slight correction of zloty exchange rate

- The beginning of the previous week was quite calm on the FX market, and zloty fluctuated in a quite narrow range. After downgrading the credit ratings outlooks of Iceland and Hungary emerging markets currencies were loosing against main currencies, which affected zloty as well. Later on the Polish currency recovered some losses though it has depreciated ca. 0.4% against the euro and ca. 0.5% vs. the dollar since last Friday.
- In the coming week quite essential with regards to the zloty rate will be the decision of the MPC. We forecast that the Council will cut the main repo rate by 25bp. If the communiqué suggests lower room for further cuts, this may weaken the demand for Polish bonds and negatively affect zloty. We think EURPLN rate is going to fluctuate in range 3.74-3.84, while USDPLN rate between 3.10-3.20.

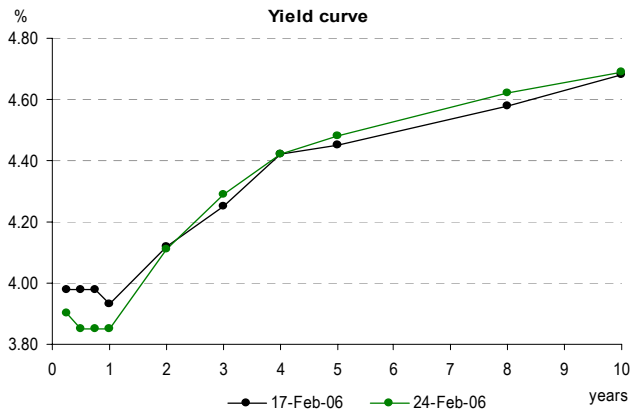
EURUSD rate



EURUSD in narrow range

- In the past week EURUSD rate was hardly changed and the dollar slightly strengthened against the single currency. Inflation data from U.S. were in line with expectations an similarly to January FOMC minutes did not significantly influence the relation between main currencies, while the highest in 14 years German Ifo index as well as weaker than expected durable goods orders data in U.S. supported euro.
- The most important for the EURUSD relation will be inflation data in the euro zone, expected rate hike in the EMU as well as ECB's communiqué. In the U.S. positive data from the housing market may confirm lower negative influence of high interest rates on this market. Activity indices and Q4 GDP data will be essential as well.

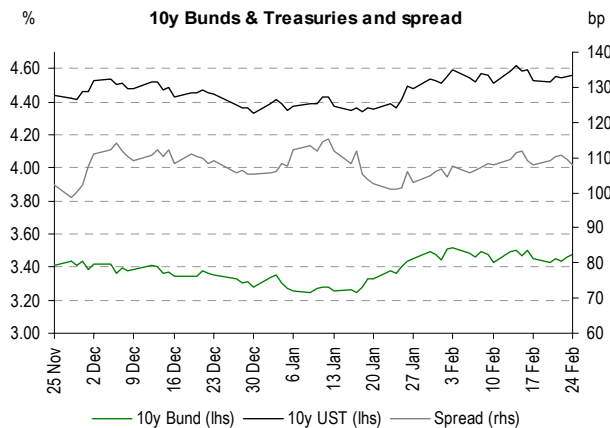
Yield curve



Yields hardly changed

- The long end of the yield curve slightly weakened while the short end moderately strengthened. Yields of longer term bonds rose in reaction to negative information on Hungary's rating and sell-off on the emerging markets. Bonds prices fell also after stronger than expected retail sales data as well as German Bunds weakening.
- We expect that MPC will cut interest rates next week. As important as the decision itself will be the Council's communiqué, which will show, whether the MPC's members see room for further cuts. They seem to depend on further macroeconomic data and April inflation projection. A rate cut together with more neutral statement may appear more negative for the interest rate market than no interest rate cut.

10y Bunds & Treasuries and spread



FOMC minutes and Ifo weaken core bond markets

- January meeting FOMC minutes contributed to a slight rise of Treasuries yields. The opposing effect had core CPI inflation in U.S., which was in line with market consensus. The Ifo index at the strongest level since 1991 resulted in yields rise of Bunds, though unexpected drop of durable goods orders in United States contributed to strengthening on the core bond markets.
- The communiqué of European Central Bank and inflation data are going to be crucial for the euro zone core markets with regards to further tightening of monetary policy. ECB is expected to raise main interest rate in the EMU by 25 bp. Q4 GDP and housing market data as well as activity indices may confirm sound outlook of U.S. economy and will be the most important for Treasuries.

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