Bank Zachodni WBK

Weekly economic update

20 March – 26 March 2006

Key statistical data for February released last week gave mixed signals for the MPC and financial market. On one hand, CPI inflation in January and February was slightly lower than expected, but on the other hand, corporate wages posted much stronger rise in February than expected, suggesting that upturn on the labour market observed recently was something more than just a short-lived effect. At the same time, industrial output growth confirmed that a pace of economic expansion gets stronger. Those information suggest that even though current CPI numbers stay low, factors that could push prices up in future are intensifying. This is recognised by the MPC members, as their last comments show clearly that the Council will keep interest rates on hold for some time as it needs more information to assess whether further reductions are necessary and adequate.

All publications of domestic economic data this week will take place on Thursday. We expect that, similarly as last week's figures, they will show fast economic expansion amid low inflation. Retail sales rising almost 9% will confirm strengthening domestic demand, which should not be surprising in the face of accelerating wage bill and booming households' credit. Shopping spree is also being supported by steadily descending unemployment – 18% in February, i.e. 1.4 pts below last year's level. Data should be neutral for expectations regarding next MPC decisions.

Week in politics will be turbulent again, as on Wednesday the Sejm will start setting up investigation committee for surveying NBP chief and bank supervision. PiS leaders could intensify threats of snap election at this occasion. However the market should be watching those declarations with big aloofness.

Foreign data are thin on the ground this week, with Friday's durable goods report in the US likely to dominate.

Economic calendar

TIME GMT	REGION	INDICATOR (importance level*)	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (20 March)					
10:00	**POL**	**Auction of PLN1.3bn of 52-week T-bills**					
		TUESDAY (21 March)					
13:30	USA	PPI	Feb	%	-0.1	-	0.3
		WEDNESDAY (22 March)					
10:00	**POL**	**Switch auction**					
10:00	EMU	Current account	Jan	EUR bn		-	
		THURSDAY (23 March)					
13:00	**POL**	**Business climate**	**Mar**	**pts**			
13:00	**POL**	**Net inflation**	**Feb**	**%YoY**	**0.9**	**0.8**	**0.8**
13:00	**POL**	**Retail sales**	**Feb**	**%YoY**	**9.3**	**8.9**	**8.6**
13:00	**POL**	**Unemployment**	**Feb**	**%**	**18.0**	**18.0**	**18.0**
15:00	USA	Home sales	II	m	6.5	-	
		FRIDAY (24 March)					
13:30	USA	Durable goods orders	II	%	1.0	-	-0.9
15:00	USA	New home sales	II	m	1.21	-	1.233

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

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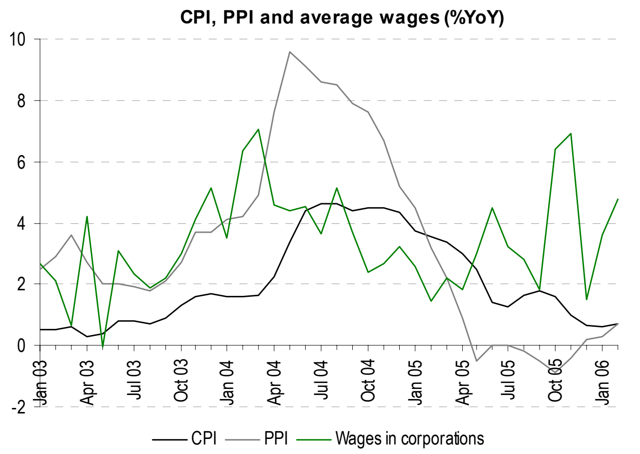
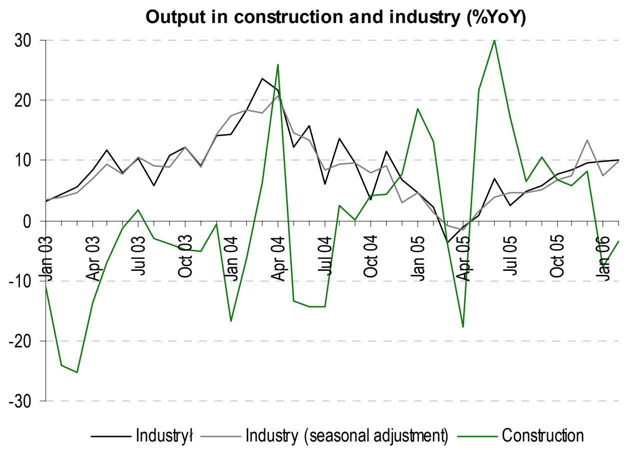
What's hot this week – More data releases with politics in the background

- All economic data releases this week will appear on Thursday. Likewise last week's figures, they should show fast economic expansion amid low inflation.
- Retail sales rising almost 9% will confirm strengthening domestic demand, which should not be surprising in the face of accelerating wage bill and booming households' credit. Shopping spree is also being supported by steadily descending unemployment – 18% in February, i.e. 1.4 pts below last year's level.
- Data should be neutral for the MPC that will most likely hold rates unchanged in March, awaiting new Inflation report.
- Week in politics will be turbulent again, as on Wednesday the Sejm will start setting up investigation committee for surveying NBP. PiS leaders could intensify threats of snap election at this occasion. However the market should be watching those declarations with big

Economy last week – Low inflation, higher wages, even higher output





- Inflation rate in February reached 0.7%YoY, while January's figure was revised down from 0.7% to 0.6%YoY, after a change in CPI weight system. Changes in weights were not substantial, however one should notice a rise in share of food (0.3 pts) and communication (0.6 pts) that could potentially reduce inflation rate.
- PPI growth rate in February equalled CPI, reaching 0.7% as well, after a downward revised 0.3%YoY rise in January. In this case, higher growth rate resulted entirely from low base effect, as in relation to previous month price level declined slightly.
- The data showed no significant inflationary pressure in the short run and it seems very likely that CPI rate will remain low in nearest months – clearly below 1% until October-November. However, medium-term perspectives should be more important for the MPC.
- Unlike CPI, wage rise in February was much higher than expected, reaching 4.8%YoY. Employment saw a robust growth of 2.5%YoY, so in sum, total wage bill in corporate sector soared 7.3%YoY (6.6% in real terms), which was the third best result in last five years. Revival on the labour market is clearly something more than just a temporary phenomenon, which is one of the factors changing balance of risks of future inflation towards less favourable.
- Industrial output in February rose 10.1%YoY, and 9.8%YoY after elimination of seasonal fluctuations. Number for January was revised up to 9.8%. It shows continuation of expansionary trends in the economy and confirms that GDP growth in 1Q06 could be higher than 4.2% recorded in 4Q05. Output in construction disappointed, falling 3.5%YoY, however it was probably affected once again by unfavourable weather conditions.

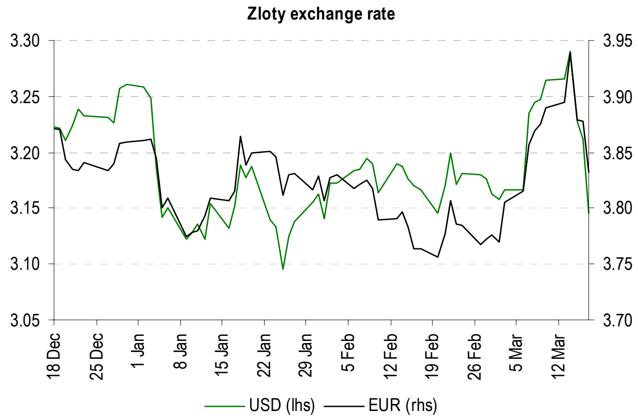
Quote of the week – Next rate cut not so soon

Jan Czekaj, MPC member; PAP, 15 March

We have significant rate cuts behind and one should wait to see whether they are sufficient or not. Definitely, changes in the economy can be seen in the last quarters. More data is needed to assess situation more precisely. Inflation is in line with expectations, slight downward revision in January has been expected. We will have to wait until projection with the full review of future situation, then we will be smarter.

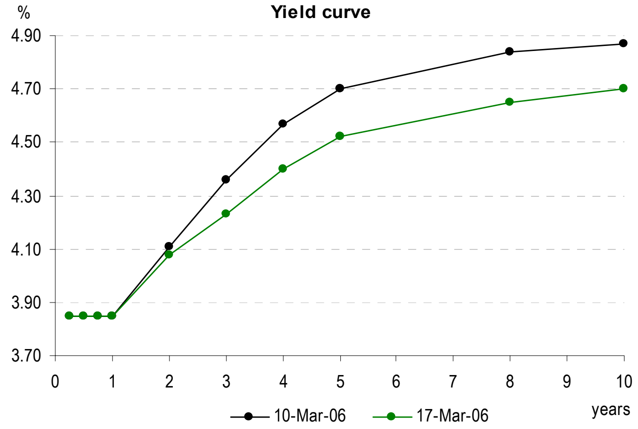
On Friday, two more MPC members – Stanisław Nieckarz and Mirosław Pietrewicz – spoke in a very similar tone than Jan Czekaj. All those are members who used to support continuation of monetary easing so far. It confirms our view that the MPC will not cut interest rates in March, awaiting more complete set of information, and most of all for new *Inflation Report* that will show how latest economic data incorporated into NBP models affect medium-term inflation prospects.

Market monitor



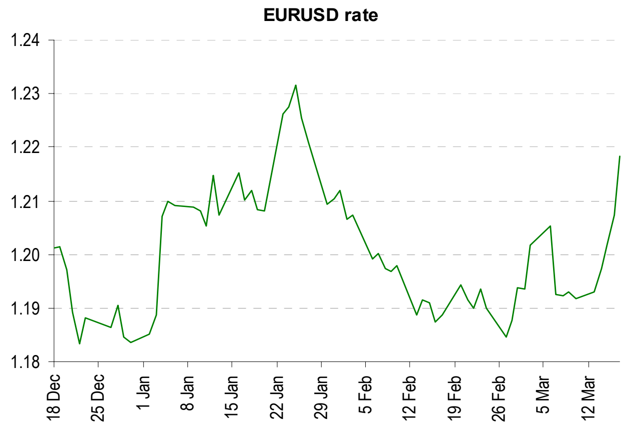
Improved sentiment on the emerging markets

- At the start of the previous week zloty kept on weakening and reached the lowest level since November 2005 (3.95). Since Wednesday Polish currency started to recover losses incurred against the main currencies thanks to positive macroeconomic domestic data and improvement of sentiment towards the emerging markets due to lowered Treasuries yields. Zloty gained ca. 1.4% against the euro and 3% vs. the dollar since last Friday.
- Amid lack of important data release abroad the sentiment towards the region should not change significantly. It seems that the domestic data will have limited influence on the zloty rate. In our view EURPLN rate will fluctuate around the current levels in range of 3.81-3.91, while the USDPLN rate between 3.15 and 3.25.



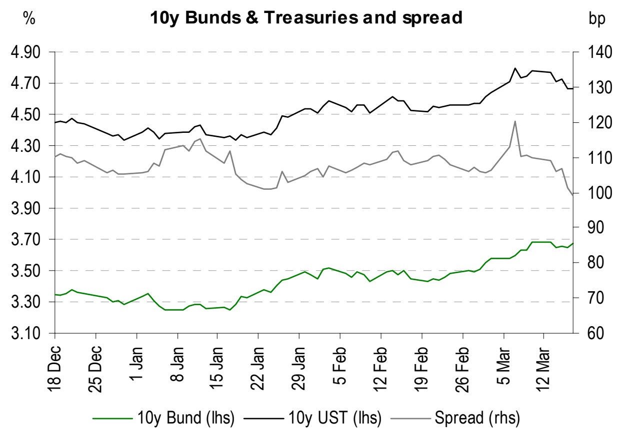
Core markets and CPI strengthen bonds

- Last week bonds strengthened by 3-19 bp, and the yield curve flattened after significant weakening and steepening in the previous week. The debt market was supported by the situation on the core markets, the revision of January inflation as well as lower than expected February CPI index. At the end of the week industrial production and MPC members statements contributed to a slight correction.
- In the coming week the fixed income market may be affected by the retail sales data, although this should not influence the March rate decision of the Monetary Policy Council. In our opinion the Council will leave the interest rates unchanged till the end of 2006. The core markets may slightly weaken amid Fed's decision which may also affect the Polish treasuries.



U.S. rate expectations change weakens the dollar

- Since the last weekly report was published the dollar has weakened against the euro by 2.5% mainly as a result of decrease of expectations on stronger interest rates hikes by the Fed, which effected after the U.S. inflation release. Net capital flows in the U.S. did not cover the record high trade deficit for the second month in a row, which also worked against the dollar.
- Despite the lack of crucial economic data for the relation of euro against the greenback, the EURUSD rate may be influenced by the durable goods orders figure as well as Fed and ECB comments. The housing market data may show further drop, although this may have lower impact than previously.



U.S. yields drop; spread below 100

- After reaching the weakest levels since 21 months by 10-year Treasuries (4.81%) in the previous week the 10Y yields plummeted to do 4.65% mainly in reaction to low headline and core CPI figures in U.S., as well as weaker retails sales data, which increased speculation on softer pth of monetary policy tightening in United States. The 10Y yields of German government bonds rose to 3.65%, despite weaker ZEW index.
- No essential figures, which could significantly influence the target level of official rates expectations in U.S, are scheduled for the coming week. The yields rise may by supported by Fed's and ECB's representatives comments amid next week's rate decision meeting of the FOMC.

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