

# Weekly economic update

27 March – 2 April 2006

Macroeconomic data published last week brought good news on the economic situation. Retail sales growth in February reached 10.2%YoY in nominal terms (real growth was 10.1%YoY), beating market expectations at around 9%. This confirms strengthening in consumption demand at the beginning of 2006 and bodes well for GDP growth in 1Q06 and the whole 2006. What is important, data on labour market showed upward trend in consumption demand should last for a considerable period. According to results of Labour Force Survey for 4Q05, the unemployment rate reached the lowest level since end-2000 and the number of unemployed fell below 3 million for the first time in five years. The number of working people grew 2.4%YoY in the final quarter of 2005. Firmer labour market conditions and resulting upside move in consumption demand are likely to deter the MPC from further rate cuts, even though current inflationary pressure is very weak, as reflected in core inflation fall in January and February. NBP data showed net inflation reached 0.8%YoY in that period versus 1.1%YoY in December. However, this situation seems to have been already taken into account by the MPC members (which is confirmed by recent comments from central bankers), who already think about CPI prospects in 2007-2008 rather than in a very short run.

On the political scene, a deadlock continues. Although PiS offered a change in election law (aimed at strengthening position of strong parties) in order to convince the PO that premature election in May is a good idea, the latter party sticks to its view that possible early election should not take place earlier than in autumn. In face of that, a motion to dissolve parliament is not likely to be accepted by MPs in a vote planned for the next session of Sejm on 4-7 April.

## Economic calendar

TIME GMT	REGION	INDICATOR (importance level*)	PERIOD	FORECAST		LAST VALUE	
				MAREKT	BZWBK		
<b>TUESDAY (28 March)</b>							
	<b>POL</b>	<b>MPC meeting</b>					
8:00	GER	Ifo index (H)	Mar	pts	102.8	-	103.3
8:00	EMU	M3 money supply (H)	Feb	%YoY	7.7	-	7.6
15:00	US	Consumer confidence (M)	Mar	pts	102.3	-	101.7
19:15	US	Fed meeting - rate decision (H)	Mar	%	4.75	-	4.5
<b>WEDNESDAY (29 March)</b>							
	<b>POL</b>	<b>MPC meeting – decision (H)</b>	<b>Mar</b>	<b>%</b>	<b>4.0</b>	<b>4.0</b>	<b>4.0</b>
<b>THURSDAY (30 March)</b>							
13:30	US	Final GDP (M)	<b>Q4</b>	<b>%</b>	1.7	-	1.6
<b>FRIDAY (31 March)</b>							
9:00	EMU	Consumer sentiment (M)	Q4	pts	-10.0	-	-10.0
9:00	EMU	Economic sentiment (M)	Mar	pts	102.8	-	102.7
9:00	EMU	Preliminary HICP (H)	Mar	%YoY	2.2	-	0
<b>13:00</b>	<b>POL</b>	<b>Current account (M)</b>	<b>Q4</b>	<b>EUR bn</b>	-	<b>-1.5</b>	<b>-0.9</b>
14:45	US	Chicago PMI (H)	Mar	pts	88.0	-	86.7
15:00	US	Factory orders (H)	Feb	%	56.3	-	54.9
15:00	US	Final Michigan index (H)	Mar	%	1.0	-	-4.5

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

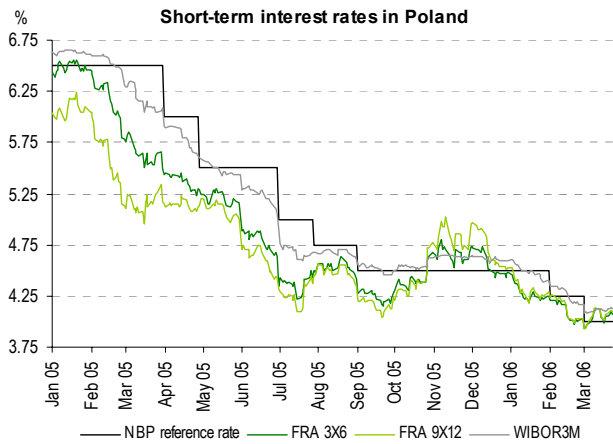
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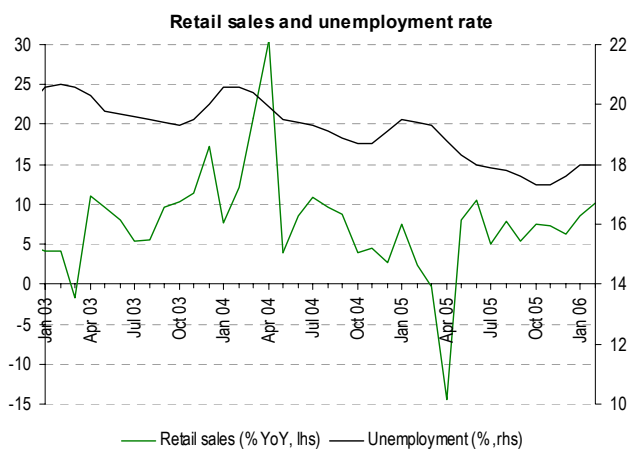
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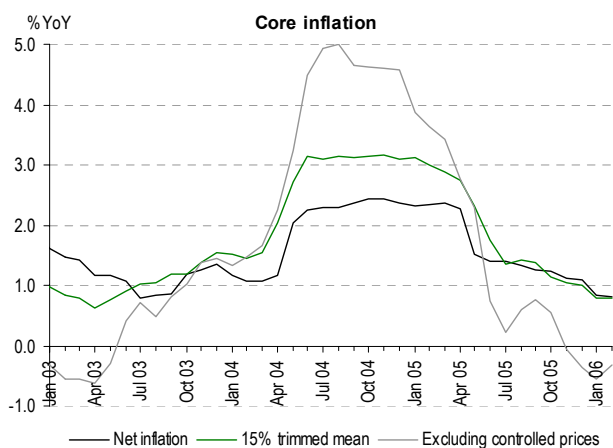
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**What's hot this week** – Unanimous expectations regarding MPC decision

- In the nearest week, the focus of attention on the domestic financial market will be MPC meeting. This time there should not be so much emotions as a month ago when the MPC surprised many market participants with a decision to trim rates made after record long discussion.
- Market analysts are unanimous in their expectations regarding the nearest MPC meeting. No one expect a change in rates. What is important, recent comments from rate setters suggest that they actually do not have an intention to change monetary policy parameters.
- Apart from MPC meeting, this week will see a release of balance of payments statistics for 4Q05. They should show tendencies in foreign trade in a more reliable way than monthly data that are often significantly revised.
- Besides, one should pay attention to Fed decision and many important data in the US and euro zone.

**Economy last week** – Consumption grows, inflation falls

- Retail sales growth in February reached 10.2%YoY, topping market expectations around 9% and confirming gradual revival in consumption demand.
- Good sales performance is being supported by improving situation on the labour market. In February, the registered unemployment rate reached 18%, the same as in January, but 1.4pp lower than a year earlier. The number of unemployed fell by 7.4%YoY. Positive trends found confirmation in quarterly Labour Force Survey report. The LFS unemployment rate fell to 16.7% in 4Q05 from 17.4% in the previous quarter, reaching the lowest level since end-2000. The number of unemployed fell below 3 million for the first time in five years. The survey results validated persistence of upward trend in employment, as 4Q05 saw 2.4%YoY rise in number of working people.



- CSO's report on business climate in March gave quite optimistic results, showing upturn in entrepreneurs' sentiment in all surveyed areas – in manufacturing, construction, and retail trade.
- Despite stronger and stronger economic expansion, inflationary pressure remains very weak, which was reflected in the latest NBP data. Four out of five core inflation measures fell in February versus December 2005. In line with our forecast, net inflation reached 0.8%YoY in January and February, down from 1.1%YoY in December, which was the lowest result since August 2003. The second important measure, 15% trimmed mean was also at 0.8%YoY in January-February against 1.0% in December. Such situation means there is no threat of significant inflation rebound in the near term. However, this situation seems to have been already taken into account by the MPC members who already think about CPI prospects in 2007-2008 rather than in a very short run.

**Quote of the week** – Lack of strong reasons for change in interest rates

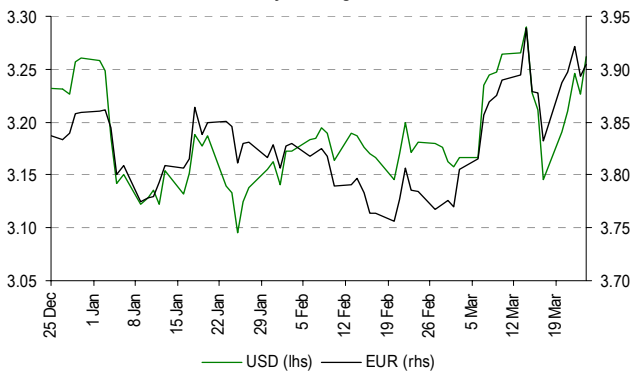
**Andrzej Wojtyna, MPC member; PAP, 21 March**

*Although reviving consumption demand will push inflation up, it will be gently returning to 2.5%, so there are no strong reasons for any change in interest rates. (...) We are currently close to hypothetical neutral rate. (...) April inflation projection should not bring significant changes in future inflation path, although some corrections will obviously take place.*

Wojtyna's comments are yet another voice from the MPC, following similar statements from some of MPC's doves that appeared last week, suggesting that further interest rate cuts are undesired in the near term. This confirms our view that official interest rates will most likely stay flat not only at the MPC meeting in March, but at least until year-end. What is important, Wojtyna is of the opinion that April's inflation projection will not bring much new to the picture of economic situation and inflation prospects.

## Market monitor

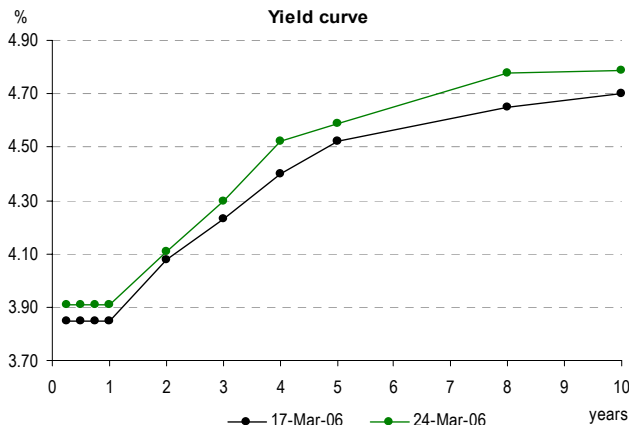
Zloty exchange rate



## Further outflows from the region

- Previous week's strengthening appeared to be only temporary. Straight since Monday zloty started to weaken after news that the ruling party PiS was willing to dissolve the parliament. Polish currency gradually depreciated and at the end of the week there was a slight correction. Zloty eventually lost against the euro ca. 1.3% and 3.3% versus the dollar during the last week.
- With no release of domestic data the decision as well as Fed's communiqué after Tuesday's meeting will be of crucial importance for Poland and the region. If it is more hawkish than expected, than further outflow of capital may affect the emerging markets. We expect that the EURPLN rate will trade in range of 3.85-3.95, and the USDPLN rate will fluctuate between 3.21 and 3.31.

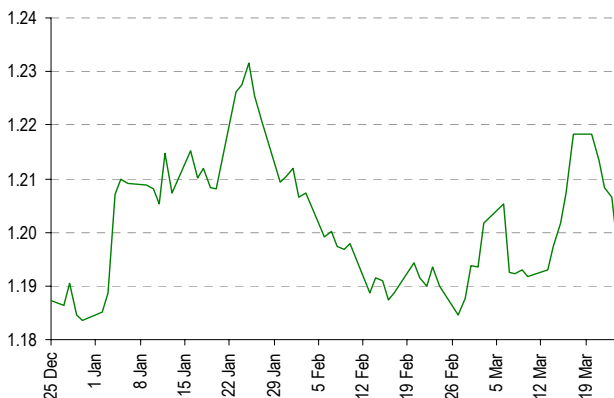
Yield curve



## Bonds weaken following the core bond markets

- The fixed income market experienced a similar situation as on the FX market. In the past week bonds weakened again, which was an effect of the situation on the core bond markets as well as further speculation on possibility of dissolving of the parliament. Retail sales and net inflation data were quite neutral for the market. Bond yields rose in the past week by ca. 3 - 12 bp.
- In the coming week the MPC will make decision with regards to the interest rate level. We believe that the rates will old unchanged, and the communiqué's tone will be quite neutral. The members of the Council will expect further inflation projections (nearest in April) taking into consideration faster GDP growth as well as target level of official interest rates on the core markets. Fed's decision and the communiqué may affect the Polish market as well.

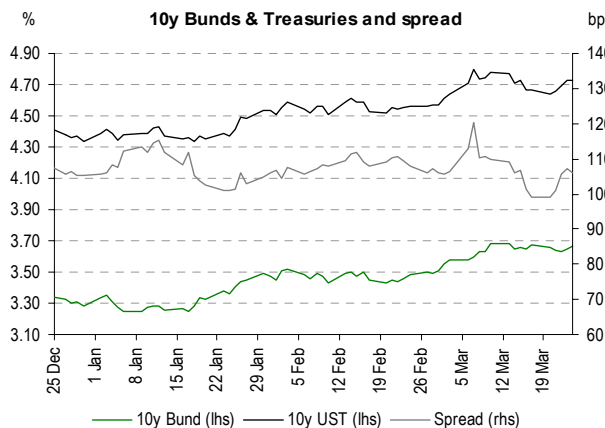
EURUSD rate



## Macroeconomic data and Bernanke weaken the dollar

- After quite significant weakening due to low core CPI the greenback strengthened again against the euro mainly in reaction to higher than expected core producer prices, optimistic statements of Ben Bernanke Fed's president toward the outlook of the U.S. economy as well as home sales data. The dollar strengthened since the last Friday by ca. 1.7% against the single currency.
- Next week the EURUSD rate will be influenced by data affecting the expectations toward the target interest rate levels on the core markets and Fed's statement after the decision. After weaker ZEW index quite essential may be the value of Ifo index as well as economic indicators in the euro zone.

10y Bunds &amp; Treasuries and spread



## U.S. yields rise after PPI and Bernanke

- U.S. government bonds weakened in the previous week amid higher than expected core PPI as well as Fed's president statements. Yields of 10Y Treasuries rose from 4.65% to 4.74%, and of 10Y Bunds followed the U.S. market from 3.65% to 3.67% respectively.
- On Tuesday the Federal Open Market Committee will most probably raise the main Fed Funds interest rate by another 25 bp. Fed's communiqué after the first Fed meeting chaired by Ben Bernanke will be quite essential. Durable goods orders and final Q4 GDP (with focus on inflation) will be important as well. In the euro zone investors will focus on the money supply and Ifo index, which a month ago was at the highest level since 15 years.

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