Bank Zachodni WBK

Weekly economic update

24 – 30 April 2006

This week we will see a number of information important for the market. Data on core inflation, unemployment rate and retail sales are unlikely to change a general assessment of economic situation, although the latter figure will undoubtedly surprise at least part of market analysts, as forecasts of sales growth are heavily dispersed this time. We do not expect a surprise from the Monetary Policy Council, which is likely to leave interest rates on hold. An important hint regarding MPC's future decisions could be an official communiqué and new Inflation Report, likely to be published on Thursday or Friday. Judging by latest comments of MPC members (that have already seen draft version of the Report), a pace of CPI return to the inflation target should not differ substantially from the one presented in January's version of prediction. Nevertheless, as Andrzej Wojtyna suggested, if inflation data in next months keep surprising on the downside, the MPC could agree that some factors limiting inflationary pressure work stronger than predicted by the models. On top of economic data, market will eye news from politics. A coalition of PiS with small parties is likely to be formed finally, but its impact on the financial market will be limited as long as populists' influence on government's economic programme seems to be constrained.

Economic calendar

TIME GMT	REGION	INDICATOR (importance level*)	PERIOD		FORECAST MAREKT	FORECAST BZWBK	LAST VALUE
		MONDAY (24 April)					
9:00	**POL**	**Auction of PLN1.0bn 52-week and PLN300m of 26-weekT-bills**					
12:00	**POL**	**Net inflation (H)**	**Mar**	**%YoY**	**0.7**	**0.7**	**0.8**
	POL	**Business climate**	**Mar**				
		TUESDAY (25 April)					
	POL	**MPC meeting**					
8:00	GER	Ifo index (H)	Apr	pts	105.0	-	105.4
9:00	EMU	Current account (M)	Feb	€ bn	-4.0	-	-10.8
14:00	US	Home sales (H)	Mar	M	6.7	-	6.91
14:00	US	Consumer confidence (H)	Apr	pts	106.0	-	107.2
		WEDNESDAY (26 April)					
	POL	**MPC meeting – decision (H)**	**Apr**	**%**	**4.0**	**4.0**	**4.0**
8:00	**POL**	**Retail sales (H)**	**Mar**	**%YoY**	**9.2**	**3.7**	**10.2**
8:00	**POL**	**Unemployment rate (H)**	**Mar**	**%**	**17.8**	**17.8**	**18.0**
9:00	EMU	Industrial production (M)	Feb	%YoY	1.6	-	2.7
12:30	US	Durable goods orders (H)	Mar	%	1.1	-	1.08
14:00	US	New home sales (H)	Mar	m	3.1	-	2.5
		FRIDAY (28 April)					
8:00	EMU	M3 money supply (H)	Mar	%		-	8.0
9:00	EMU	Consumer sentiment (H)	Apr	pts	109.5	-	109.1
12:30	US	GDP advance deflator (H)	Q1	%	2.5	-	3.5
12:30	US	GDP advance (H)	Q1	%	4.9	-	1.7
13:45	US	Final Michigan index (H)	Apr	pts	89.4	-	88.9
14:00	US	Chicago PMI (H)	Apr	pts	59.0	-	60.4

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

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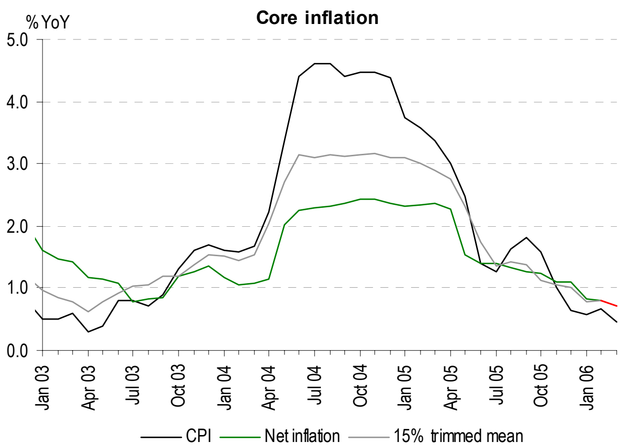
What's hot this week – Lots of new information, interest rates unchanged

▪ The nearest week will be full of events – we will see a number of new economic data, MPC decision on interest rates and possibly some conclusions from coalition talks.

▪ Core inflation data are likely to show slight decrease. We estimate net inflation at 0.7%YoY in March, down 0.1 pp from February, which is in line with market consensus.

▪ Analysts' forecasts of retail sales growth are extremely dispersed and range from –1.9% to 11.5% (with median at 9.2%). In our view, sales rose 3.7%YoY due to different cycle of seasonal shopping (later Easter this year).

▪ Unemployment rate probably started declining in the spring, especially that number of jobs in firms rose strongly. We expect a fall in unemployment rate in March to 17.8%, the lowest level in five years, which is consistent with market consensus forecast.

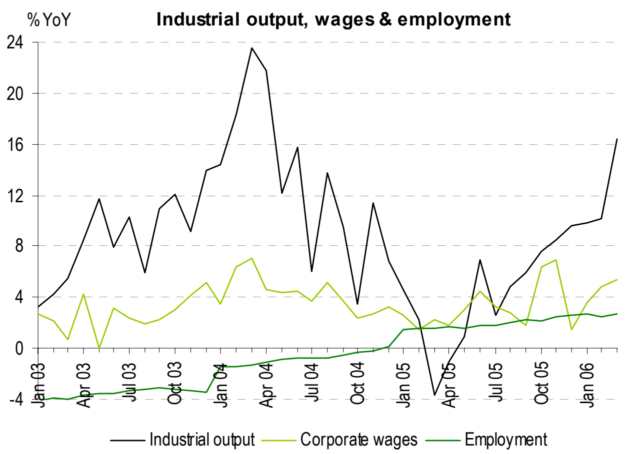


▪ At this month's meeting the MPC will have at its disposal not only a regular set of macro data, but also new *Inflation Report*, including updated projections of inflation and GDP. We will get to know the report only after the MPC meeting, however taking into account latest comments of Council members one could assume that a pace of inflation return to the target will not differ a lot from the one presented in the projection in January.

▪ We stick to the opinion that the MPC will leave interest rates unchanged. As regards next months, the new *Inflation Report* and Council's communiqué could deliver new important hints, although a scenario of no more cuts until year-end seems to be the most likely right now.

▪ Establishment of coalition government with small parties will have little effect on the market as long as populists' influence on government's policy will seem to be limited.

Economy last week – Economy expanding at full steam



▪ Wages in corporate sector rose 5.4%YoY in March, while employment increased 2.7%YoY. Both figures were above expectations and confirmed persistence of recovery on the labour market. Real wage bill in companies soared 7.7%YoY in March and 6.7%YoY in the first quarter, which heralds strengthening in consumption demand in 2006, probably stronger than we had anticipated so far.

▪ Output figures were also better than predicted. Industrial production surged 16.4%YoY, and 16.6%YoY after seasonal adjustment. Growth in manufacturing was as high as 18.7%. Construction output increased 15.5%YoY. Such good results suggest that GDP growth in 1Q06 reached ca. 5%.

▪ PPI growth accelerated to 0.9%YoY in March, due to strong rise of prices in mining. However, there is no inflationary pressure seen in manufacturing where prices declined by 0.5%YoY.

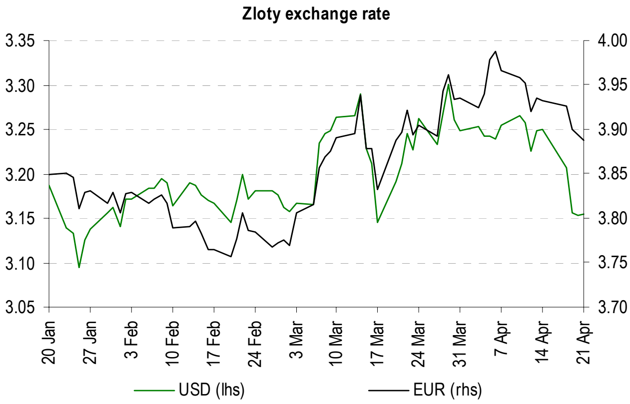
Quote of the week – Interest rates appropriate, but for how long?

Andrzej Wojtyna, MPC member
Reuters, 19 April

I agree with my colleagues' comments that interest rates are at an appropriate level. But (this) is not a given. These structural factors may work more against inflation pressure than the model suggests. That would change the expected path of inflation and I do not rule out that room for fine-tuning will appear, even this year.

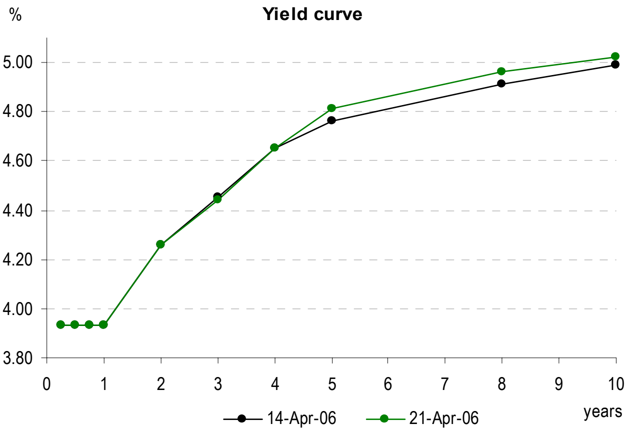
Last comments of MPC members confirmed our view that interest rate cuts are quite unlikely in nearest months. However, a risk for our base case scenario is more towards slight additional easing than rate hikes. Small fine-tuning cut in the second half of the year could be possible even despite faster than expected economic growth if new inflation data keep surprising on the downside and the MPC will reckon that structural changes that work against inflationary pressure are strong enough to considerably lengthen a process of inflation's return to the target.

Market monitor



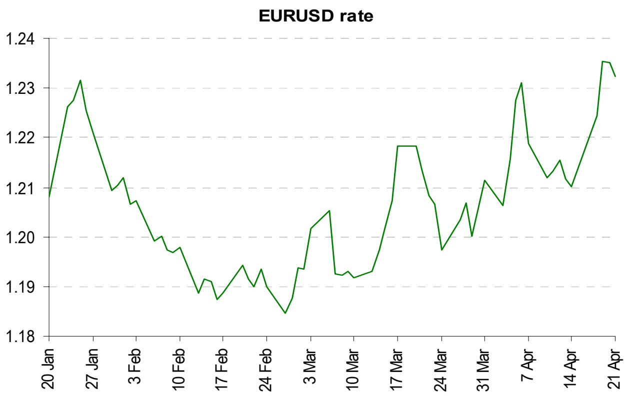
Zloty gradually strengthens

- At the beginning of the week zloty strengthened with regards to the dollar weakening and improved sentiment toward the region among others after FOMC's minutes. Another yields rise in United States caused short-term correction, while later on zloty appreciated again supported by good production data, which went in line with record high levels of indices on the Warsaw bourse. Since last Friday zloty strengthened ca. 1.3% against the euro and 3% vs. the dollar.
- Diminishing expectations to the next rate hikes in the U.S. may be a positive factor for the emerging markets currencies. The events in politics such as concluding government coalition deal will have rather neutral effect.
- In our opinion EURPLN is going to trade in range 3.86-3.96 against the euro and 3.12-3.22 versus the dollar.



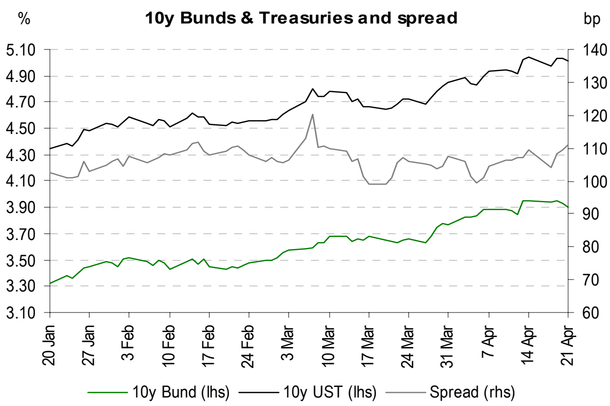
Slight steepening of the curve after CPI and production

- As we suggested in our last report the full reaction to CPI data effected after the Easter holiday, and the market significantly strengthened. Additional yields drop came in after strengthening on the core markets and statements of the MPC members about possible rate cuts later this year. Afterwards bonds lost all gains in reaction to positive production data and another yields rise on U.S. and German government bonds.
- In the coming week we expect that the Council will leave rates unchanged and the communiqué will not include any changes of expected inflation path, which will be rather neutral for the market. Situation on the core bonds markets will be also important, however this time Treasuries and Bunds may give some support to the Polish market.



Rate expectations in U.S. weaken the dollar

- The expectations of faster end of rate hikes in U.S. resulted in the greenbacks weakening at the start of the week though the capital inflow data trimmed EURUSD rise. Another weakening occurred after PPI index and housing market data, as well as less hawkish FOMC minutes, while a slight correction came in after CPI was released. The dollar lost against the euro ca. 2% in the last week.
- Ifo index will be a key factor for the euro next week after it reached the highest level for 15 years last month. Confirmation of falling trend of the home sales on the U.S. market may negatively affect the dollar's value. M3 money supply in the euro zone, durable goods orders as well as GDP data for the first quarter in U.S. will be important as well.



Slight strengthening on the core markets

- Initially low PPI index, housing market data together with FOMC minutes contributed to a significant weakening of U.S. government bonds, with 10Y yields falling below 5% again. However, after higher than expected core consumer prices inflation Treasuries prices fell substantially. During the week yields of 10-year Treasuries declined from 5.05% to 5.01%, while yields of 10Y Bunds decreased from 3.95% to 3.90%.
- At the start of the next week Ifo index will be essential for Bunds, after ZEW index declined in the previous month. Treasuries will be influenced mainly by home sales on the primary and secondary market data, which may show continuation of weakening of the U.S. housing market. This together with Q1 GDP figure may support U.S government bonds.

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