Bank Zachodni WBK

Weekly economic update

8 – 14 May 2006

Last week the Polish market was under strong influence of international events – higher yields and pressure on weaker dollar. During the long weekend activity of domestic players were limited and when they were on holidays on Wednesday the zloty strengthened to some 3.80 against the euro and ca. 3.00 against the dollar. While in the remainder of the week the zloty weakened against the euro, a continuation of rise in EURUSD rate (to 1.27) brought the USDPLN rate down below 3.00. Other currencies in the region also appreciated last week, which could have been connected with proposals of fiscal deficit lowering in Hungary.

It seems market participants do not really care about political issues and cabinet reshuffle. Politicians of Law and Justice (PiS) managed to from majority parliamentary coalition with populist Samoobrona and LPR. Finance minister Zyta Gilowska will stay in the cabinet "as long as economic policy will be responsible", while Samoobrona's chief Andrzej Lepper assured that budget deficit anchor of PLN30bn will be maintained.

Next week we will see only one data release in Poland (money supply) and thus international events will be of key importance again as regards Polish zloty and yields levels. Fed meeting will be crucial and while another rate hike of 25 bp is expected, market will focus on statement, which could include suggestions as regards further moves in monetary policy in the U.S. Recently published data on non-manufacturing ISM as well as comments by Fed's chief Ben Bernanke increased chances that there would be no pause in interest rates hikes by Fed in June. On the other hand, non-farm payrolls figure published at the end of the week was disappointing. Last week, hawkish comments by ECB's President Jean-Claude Trichet led to negative reaction on the fixed income markets and weakened the dollar.

Economic calendar

TIME GMT	REGION	INDICATOR (importance level*)	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (8 May)					
9:00	**POL**	**T-bills auction 52-week, 1.0 PLN bn**					
		TUESDAY (9 May)					
14:00	US	Wholesale inventories (M)	Mar	%	0.5		0.8
		WEDNESDAY (10 May)					
9:00	**POL**	**Auction of 7y floating rate bonds and 12y CPI linked bonds**					
18:15	US	Fed decision (H)	%	5.00			4.75
		THURSDAY (11 May)					
9:00	EMU	GDP flash (H)	Q1	%YoY	2.0		1.8
12:30	US	Retail sales (M)	Apr	%	0.5		0.6
		FRIDAY (12 May)					
12:00	**POL**	**M3 money supply (M)**	**Apr**	**%YoY**	**n/a**	**9.7**	**9.7**
12:30	US	Export prices (M)	Apr	%	0.1		0.2
12:30	US	Import prices (M)	Apr	%	1.0		-0.4
12:30	US	International trade balance (H)	Mar	$ bn	-67.23		-65.74
13:45	US	Michigan index preliminary (H)	Mar	pts	87.0		87.4

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

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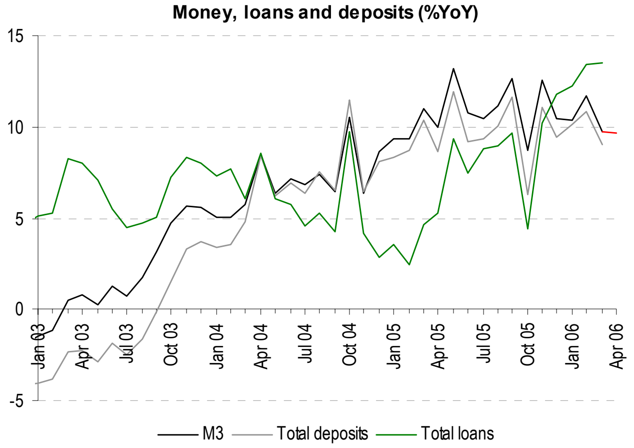
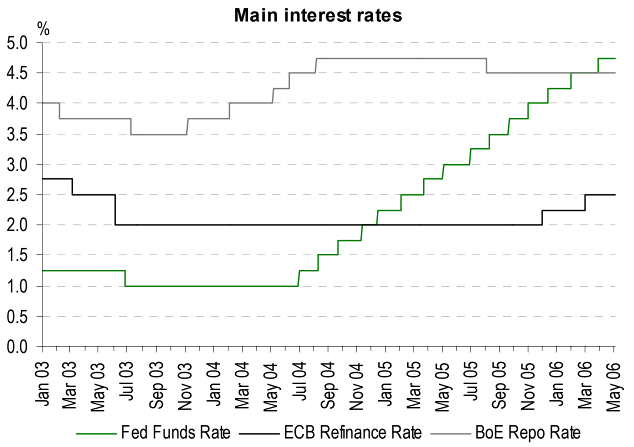
What's hot this week – Money supply in Poland, Fed meeting abroad

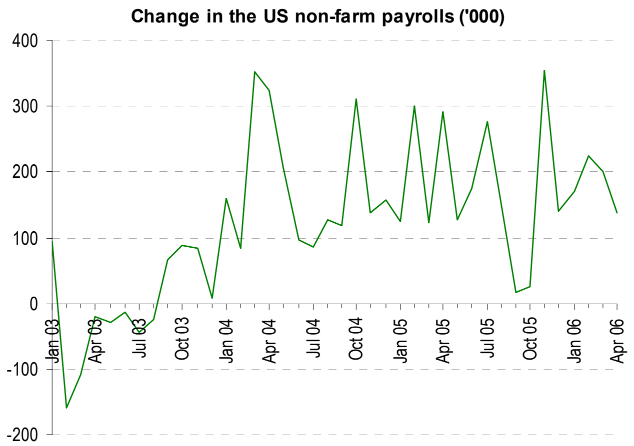


- The next week will bring only one piece of information concerning the Polish economy – April money supply data. Usually, this figure has limited influence on the market and additionally it will be released on Friday in the afternoon when the market will already start to think about inflation.
- We expect that money supply rose by 9.7%YoY, which would be the same pace of growth as in March.
- Taking into account the NBP's "Senior loan officer opinion survey on bank lending practices and credit conditions", which showed a continuation of expansionary tendencies on the credit market, one can expect that both households' and firms' credits continued expansion in April.
- Majority coalition of Law and Justice with populist Samoobrona and LPR should not have major influence on the market given their withdrew from costly proposals.

Economy last week – Hawkish Trichet and mixed U.S. data



- Next week the key event abroad will Fed meeting. Rate hike of 25 basis points is widely expected. However, similarly as it was in the case of the European Central Bank, the statement will be most important, as it will probably show some hints as regards future moves of American interest rates. It will be especially interesting given mixed US data published recently.
- As it was widely expected the European Central Bank and the Bank of England maintained official rates unchanged. However, comments made by ECB's President Trichet were more hawkish than expected, which negatively influenced bond market and the dollar. A rate hike of 50 basis points in June cannot be completely ruled out by market participants, although 25 bp per quarter still seems to be the most likely outcome.



- Last week brought a couple of interesting data release in the United States, which significantly influenced market sentiment.
- Better than expected economic data, especially as regards non-manufacturing ISM (increase to 63 pts as compared to market expectations of 59.5) increased in market's opinion probability that there would be no pause in interest rates hikes by Fed in June, especially given high price of oil.
- On the other hand, labour market report published at the end of the week showed very low non-farm payroll figure for April of 138 thousands (market consensus of 200 thousands) and additionally March data were revised downwards. The unemployment rate remained stable st 4.7%.

Quote of the week – What inflation level in April?

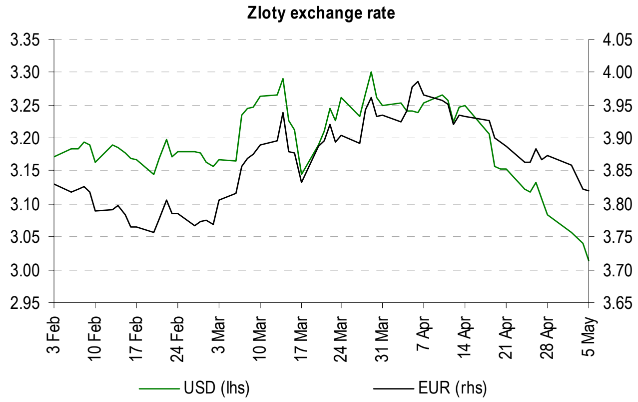
Jacek Krzyslak, head of research department in the Ministry of Finance

Reuters, 5 May

According to our estimates inflation in April was 0.6 percent month-on-month. It amounted to 0.6 percent year-on-year as well due to rising fuel, gas, vegetables and fruit prices. It will stay at a similar level in May.

Expectations as regards April's inflation level (publication on May 15) will be the only domestic event influencing investors' sentiment on the fixed income market. Higher inflation forecast of the Ministry of Finance cannot be ignored, as their estimation was the only accurate on the market in the previous month. We also assume higher prices of food gas and oil, although it seems that at slower pace, as our forecasts point to roughly stable annual inflation in both April and May as compared to March level.

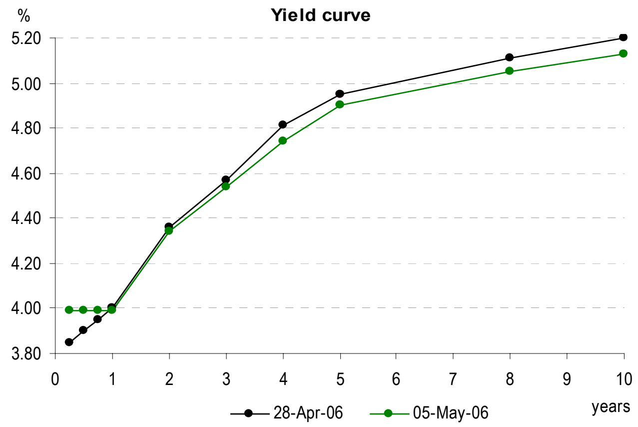
Market monitor



Strong zloty amid limited market activity

▪ While activity on the Polish market was muted because of long holiday break, foreign investors pushed the zloty much stronger last week. Similar effect took place on other markets in the region and derived e.g. from poor sentiment towards American dollar. Despite slight correction in the second part of the week, the zloty remained very strong and since previous Friday it gained ca. 1.4% against euro and over 2.3% versus dollar.

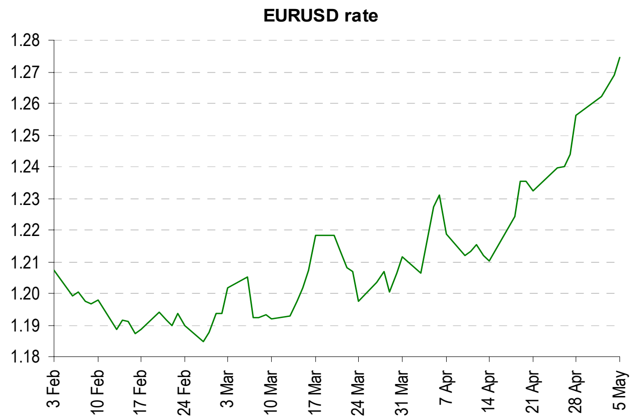
▪ The week ahead will see no key domestic data releases again, and changes in the government are already priced in, so the zloty will still remain vulnerable to news from abroad, especially re Fed decision and its impact on euro-dollar rate. In our view, EURPLN will fluctuate in 3.78-3.88 range while USDPLN will be in 2.95-3.05 band.



Polish debt under pressure of core markets

▪ May long weekend caused Polish bond market to stay idle. Meanwhile, there were quite significant movements abroad where yields soared to record-high levels. In effect, Polish market followed this trend, with particularly strong weakening in 5y segment (to almost 5%). The week ended with significant drop in yields (5y to 4.9%) after US payroll figures that strengthened core debt markets.

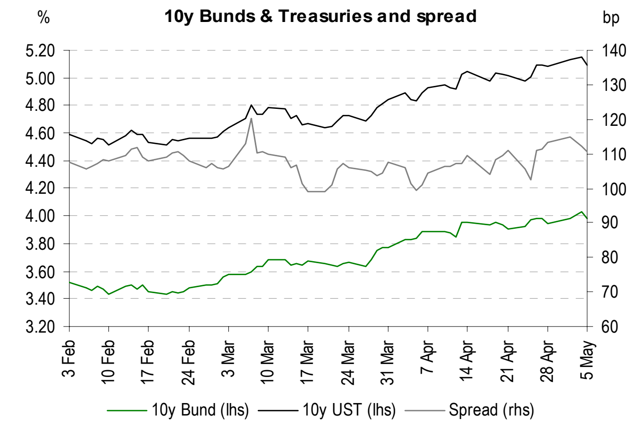
▪ Awaiting first key domestic data, Polish market will keep following trends from abroad this week. Fed meeting will be the most important event to watch and could result in rise in yields again if the bank does not soften a tone of its wording regarding interest rate prospects.



Dollar loosing the ground

▪ It was one more week of dollar depreciation versus euro. Despite quite good activity data from US economy and hawkish comment of Fed's Ben Bernanke, EURUSD managed to dip below 1.26 only for short moments. On Thursday and Friday a retreat from the dollar was spurred by hawkish ECB statement and weak payrolls data. In effect, the week ended with EURUSD close to 1.275 – ca. 1.5% higher than on last Friday.

▪ This week, a key factor for the dollar could be the Fed statement. A key factor for the market will be whether the Fed will end its cycle of monetary tightening at 5% (which could hurt the dollar even stronger), or if it suggests that more rate hikes are still possible, delivering some support for the US currency. It is likely though that this support will be only temporary.



Strong end of the week after significant weakening

▪ Last week, sentiment on core bond markets was deteriorating amid strong data from US and the euro zone (high activity indices ISM and PMI, labour market recovery in Europe) and statement of ECB president heralding more rate hikes in the euro area. In effect, in the middle of the week yields of 10y Bunds topped 4%, and yields of 10y Treasuries rose to 5.17%, the highest level in four years. After weaker non-farm payroll figures a sharp correction took place on Friday, to below 5.10% in case of 5y American bonds.

▪ Among this week's events, the most important will be Fed's statement, including clues on perspectives for interest rates in the American economy.

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