Bank Zachodni WBK

Weekly economic update

17 – 23 July 2006

During last week, Polish financial market was affected by factors working in different directions. On one hand, resurgence in global risk aversion and rising geopolitical tension were not supporting for emerging markets, including Poland. On the other hand, stabilisation of political situation and good macroeconomic data (low current account gap, very low inflation) delivered support for the zloty and Polish debt market. In particular, CPI data confirmed opinion of MPC's Andrzej Wojtyna, that we share, that talking about rate hikes in Poland is premature.

The week ahead will be full of macroeconomic data releases in Poland and abroad that could have significant impact on expectations regarding future decisions of the central banks. As regards domestic data, in our view they should go in line with Friday's CPI figure, showing growth rates slightly below market consensus, which will be supportive for domestic bonds. At the same time, they will be still consistent with predicted continuation of strong economic growth in the remaining part of the year. Top of the busy agenda abroad will be Bernanke who delivers his semi annual testimony to the Senate Banking Committee. Also, inflation measures and news from housing market will be key for investors' expectations. We expect to see signals that would confirm predictions that interest rate hikes in the US will be paused.

Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (17 July)					
12:00	**POL**	**Wages (H)**	**Jun**	**%YoY**	**4.5**	**4.5**	**5.2**
12:00	**POL**	**Employment (H)**	**Jun**	**%YoY**	**3.1**	**3.0**	**3.0**
9:00	EMU	Final HICP (H)	May	%YoY	2.5	-	2.5
13:15	US	Capacity utilisation (H)	Jun	%	81.9	-	81.7
13:15	US	Industrial production (H)	Jun	%MoM	0.4	-	-0.1
		TUESDAY (18 July)					
9:00	GER	ZEW Index (H)	Jul	pts	35.0	-	37.8
12:30	US	PPI (H)	Jun	%MoM	0.3	-	0.2
13:00	US	Net capital flows (H)	May	$ bn	60.0	-	46.7
		WEDNESDAY (19 July)					
12:00	**POL**	**PPI (H)**	**Jun**	**%YoY**	**2.3**	**2.2**	**2.3**
12:00	**POL**	**Industrial production (H)**	**Jun**	**%YoY**	**10.3**	**8.2**	**19.1**
12:30	US	Core CPI (H)	Jun	%MoM	0.2	-	0.3
12:30	US	CPI (H)	Jun	m	0.2	-	0.4
12:30	US	Build permits (H)	Jun	m	1.92	-	1.946
12:30	US	House starts (H)	Jun	m	1.91	-	1.957
	US	Ben Bernanke testifies to Senate Banking Committee (H)					
		THURSDAY (20 July)					
12:30	US	Jobless claims (H)		'000			332
16:00	US	Philadelphia Fed index (H)	Jul	pts	12.3		13.1
19:15	US	FOMC minutes (H)	May				
	US	Ben Bernanke testifies to House (H)					

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

Maciej Reluga Chief economist (+48 22) 586 8363

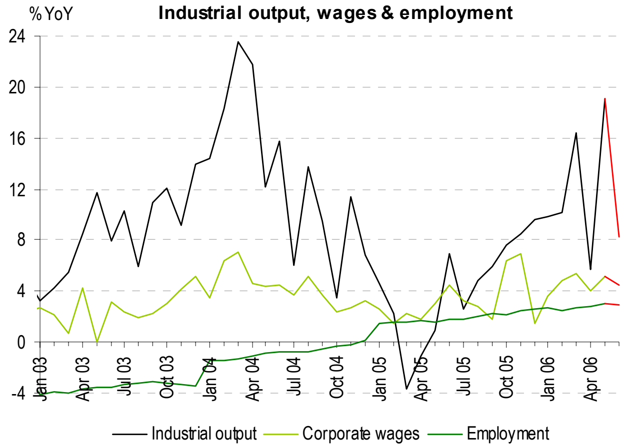
Piotr Bielski (+48 22) 586 8333

Piotr Bujak (+48 22) 586 8341

Cezary Chrapek (+48 22) 586 8342

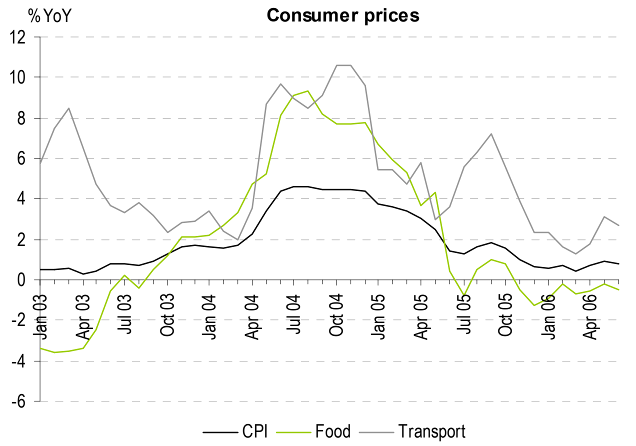
e-mail: ekonomia@bzwbk.pl

What's hot this week – Lots of data releases in the calendar

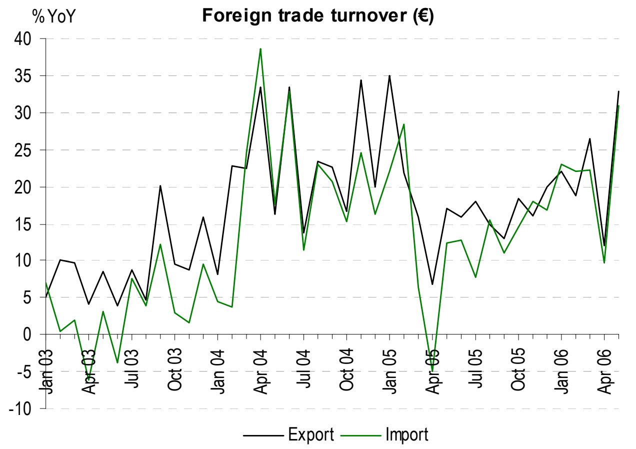


- Labour market data due on Monday, which are important for the MPC, are likely to show continuously strong rise in employment and not so bad growth in wages, which would support expectations for further rise in consumption, without spurring fears of soon rate hike.
- June's growth in industrial output was weaker than in May, e.g. due to lower number of working days. Our forecast suggests it was also below market consensus, co the release could be supportive for the bond market. PPI data will probably have little importance for the market.
- There is heavy calendar of data releases abroad. Inflation measures, housing data and Fed minutes could be crucial for investors' attitude towards emerging market through affecting expectations for policy prospects in the US. We expect to see signals confirming pause in Fed's rate hikes.

Economy last week – Low inflation, strong foreign trade



- Inflation in June was lower than expected by the market and the Ministry of Finance, falling to 0.8%YoY. In relation to May there was a drop in food prices (-1.1%MoM) and fuel prices (-0.3%MoM), but in other segments of CPI basket there was also no sign of price hikes. According to our estimates net inflation remained stable at 1%YoY, which shows that inflationary pressure is still negligible. In the next months inflation should remain below 1%, rising to ca. 1.5% in December.
- June saw growth of credit to 16%YoY, the highest rate for 4.5 years. Households' loans soared almost 29%YoY, which was probably fuelled by individuals' rush to take mortgage loan in foreign currency before banks tighten conditions for granting FX loans. The data confirmed one could expect fast economic expansion in the coming months.



- Current account deficit rose €209m in May, while 12-month cumulated gap decreased to 1.4% of GDP from 1.6% in April. The result was better than forecasted, mainly due to surplus in current transfers, boosted by inflow of EU funds, mainly to agriculture. At the same time, trade deficit reached €483m, and was at the highest level for 1,5 year.
- Growth rates in both exports and imports accelerated to 33% and 31%YoY correspondingly in euro terms (above 20%YoY in PLN), confirming high economic activity.
- On Friday, the new government headed by PM Jarosław Kaczyński has been sworn in. The vote of confidence in the government is planned on Wednesday and we do not expect any problems the support of the motion.

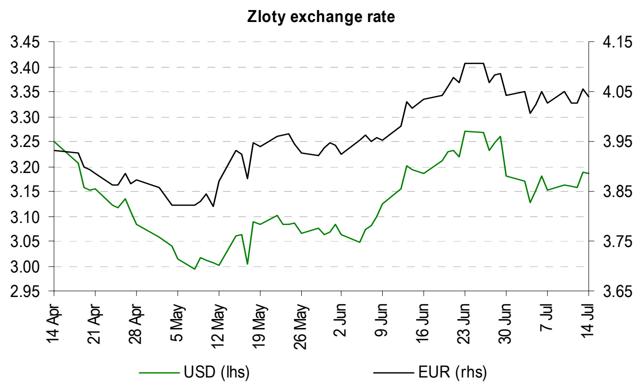
Quote of the week – Talk about rate hikes in Poland premature

Andrzej Wojtyna, MPC member; PAP, 12 July

There is a chance for several months of stable interest rates if there is no significant change in inflationary pressure stemming from worse relation between labour productivity growth and wage growth or from external environment. (...)I do not feel comfortable if inflation is so long not only below 2.5% but below 1.5% and if inflation return to the target could be faster, then nothing bad happens. (...) Potential slowdown in world economy would make room for some slight rate cut. One cannot forget that there could be slowdown in economic climate and I don't believe in allegories about rushing train that is hard to brake.

While the money market in Poland is currently pricing-in quite soon interest rate hikes, yesterday's interview with the mainstream member of the MPC Andrzej Wojtyna confirmed our view that the central bank will not rush with policy tightening, and the official rates should remain flat at least until end-2006. We agree that talking about interest rate hikes is premature, even if summer drought will lift food prices up in the autumn, and July's inflation prediction will show faster inflation convergence towards (but not beyond) 2.5% target.

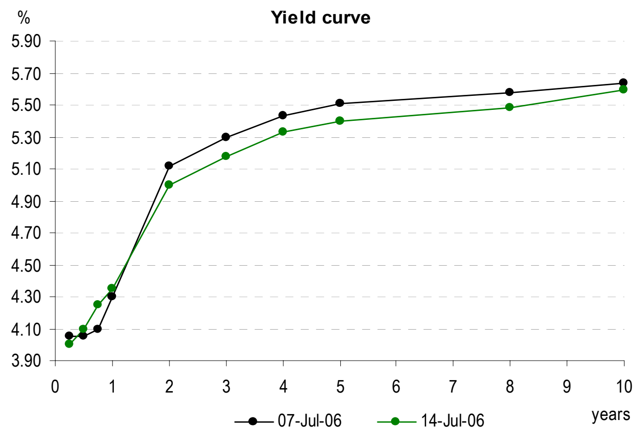
Market monitor



Zloty recovered after PM's dismissal

▪ After presentation of new finance minister candidate and declarations of continuation of reasonable fiscal policy zloty recovered losses that effected after PM Marcinkiewicz's resignation. Afterwards zloty depreciated with regards to worsening of moods toward the emerging markets amid rising global geopolitical turmoil, though the balance of payments data gave some support.

▪ Next week series of US data will be of crucial importance for the developing markets, while the prolonging international conflicts may still have some negative impact. The domestic data may be essential as well. We assume that in the coming week the EURPLN and USDPLN rates will trade in ranges of 3.98-4.08 and 3.13-3.23.

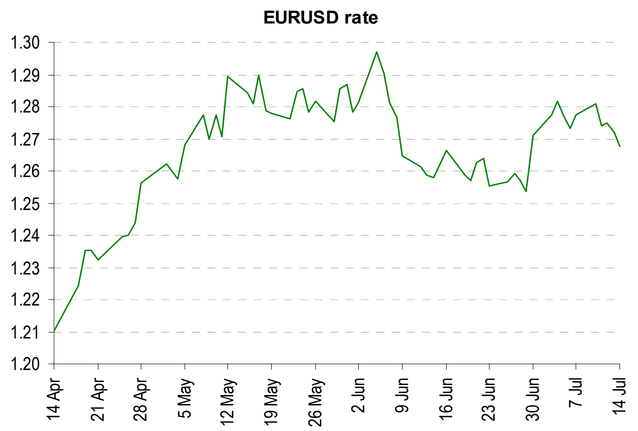


Yields slightly lower after CPI and MPC comments

▪ After initial sell-off in reaction to PM Marcinkiewicz's resignation there came some strengthening similar to the FX market. The global rise of risk aversion connected with

▪ International conflicts contributed to the weakening in the international markets. MPC members comments, lower than expected CPI inflation figure and lower retail sales in US supported the debt and during the weekend the week yields fell by 5-12 bp.

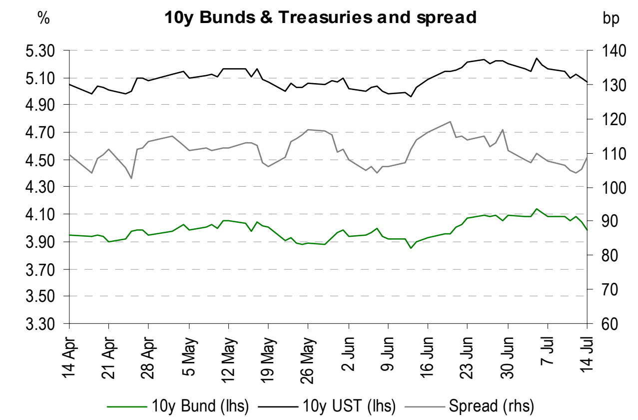
▪ Next week the situation abroad is going to be probably the most essential for the domestic bonds. Quite important will be also the domestic data from the labour market and production figures, which may result in a slight strengthening. Amid good economic figures we see rather no substantial risks to inflation we see no essential reasons to pursue rate hikes till the year's end.



Dollar strengthens again

▪ The greenback gradually strengthened against the euro since the start of the previous week ahead of US data. Narrower than expected trade deficit data gave some support to the US market, while the additional factor that worked in favour to the US currency was the rise of geopolitical risk (bomb attacks in India, Israel's attack on Lebanon, Nigeria).

▪ In the following week some crucial data are going to be released that will have strong influence on the August Fed' decision on the interest rates. We expect that weaker US data may work against the monetary tightening and against the dollar. FOMC minutes as well as net capital flows may be of high importance as well. In EMU the HICP inflation and German ZEW may gave some effect on the single currency.



Flight to safety and quality strengthens the core markets

▪ US and German bonds significantly strengthened first of all due to rising tensions and conflicts in the international ground as well to record high oil prices, which resulted in flight to safety. Lower than expected US retail sales and Michigan also gave some support. 10-Y yields of Treasuries fell during the week from 5.19% to 5.04%, while of Bunds from 4.08% to 3.98%.

▪ Core CPI and other inflation data from US, the FOMC minutes from the June meeting as well as housing market figure that may confirm falling trend are going to be key factors for Fed. Production figures and activity Philadelphia index may be also important. Bunds will be more dependent on the German sentiment ZEW index.

Additional information is available on request. Please contact Bank Zachodni WBK S.A. Treasury Division, Economic Analysis Unit, ul. Marszałkowska 142, 00-061 Warsaw, Poland, phone (+48 22) 586 83 63, email ekonomia@bzwbk.pl, http://www.bzwbk.pl