

Weekly economic update

28 August – 3 September 2006

The week ahead will be filled with events and data releases with great significance for the financial market in Poland and abroad. On the domestic market, Wednesday will be crucial, when the CSO will release GDP growth figures for Q2 2006, and the MPC will announce its decision. High GDP growth based largely on strong domestic demand could have negative impact on the debt market, although it could be alleviated to some extent by the MPC statement, assuming the Council will suggest that long-run inflation prospects are not that bad. There will be numerous data releases abroad and almost every publication will be significant for the market. Top of a busy agenda will be Friday's non-farm payrolls report for August, revised Q2 GDP, core PCE in the US, and HICP inflation in the euro zone. The ECB meeting is not expected to bring any rate change, but markets will be looking to the press conference for evidence of a "vigilant" ECB to support expectations of an October increase.

Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD	FORECAST		LAST VALUE
				MARKET	BZWBK	
MONDAY (28 August)						
	GB	Market holiday				
8:00		M3 money supply (H)	Jun	%	8.2	- 8.5
TUESDAY (29 August)						
14:00	US	Consumer confidence (H)	Jul		104.0	- 106.5
	US	Fed minutes (H)				
WEDNESDAY (30 August)						
8:00	POL	GDP (H)	Q2	%YoY	5.4	5.5 5.2
	POL	MPC meeting (H)	Aug	%	4.0	4.0 4.0
12:30	US	Preliminary GDP (H)	Q2	%	2.2	- 2.5
12:30	US	GDP deflator (M)	Q2	%	3.3	- 3.3
12:30	US	PCE (H)	Q2	%	4.1	- 4.1
THURSDAY (31 August)						
9:00	EMU	Preliminary HICP (H)	Aug	%	2.3	- 2.4
9:00	EMU	Economic sentiment (H)	Aug		107.4	- 107.7
11:45	EMU	ECB meeting (H)		%	3.0	- 3.0
12:30	US	Core PCE (H)	Jul	%	0.2	- 0.2
14:00	US	Factory orders (H)	Jul	%	0.4	- 1.2
14:00	US	Chicago PMI (H)	Aug		57.0	- 57.9
Friday (1 September)						
8:00	EMU	Manufacturing PMI (H)	Aug		57	- 57.4
9:00	EMU	GDP revised (H)	Q2	%YoY	2.4	- 2.0
12:30	EMU	Non-farm payrolls (H)	Aug	'000	12.5	- 11.3
12:30	US	Unemployment (H)	Aug	%	4.7	- 4.8
13:45	US	Final Michigan index (H)	Aug		81.5	- 84.7
14:00	US	Manufacturing ISM (H)	Aug		55.0	- 54.7

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

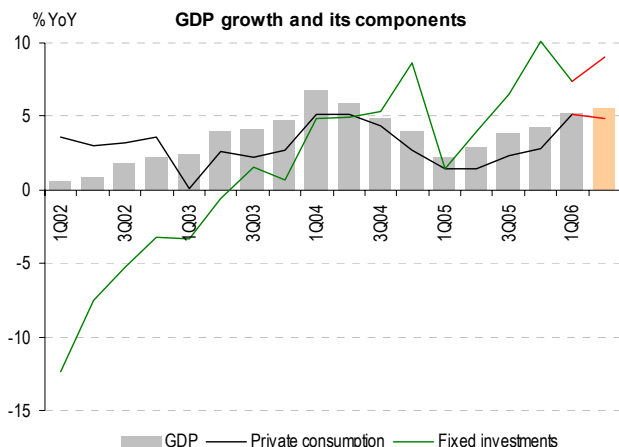
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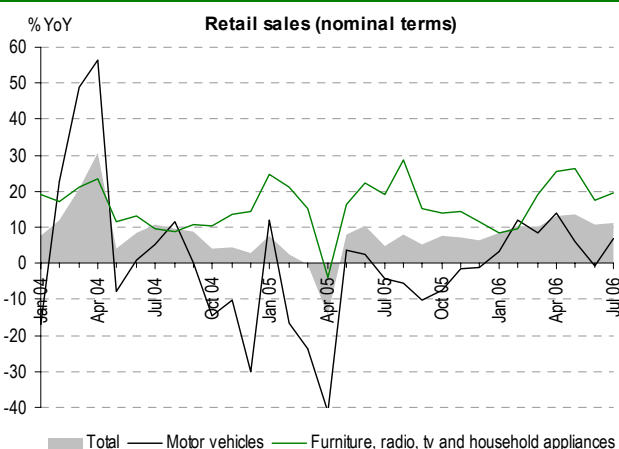
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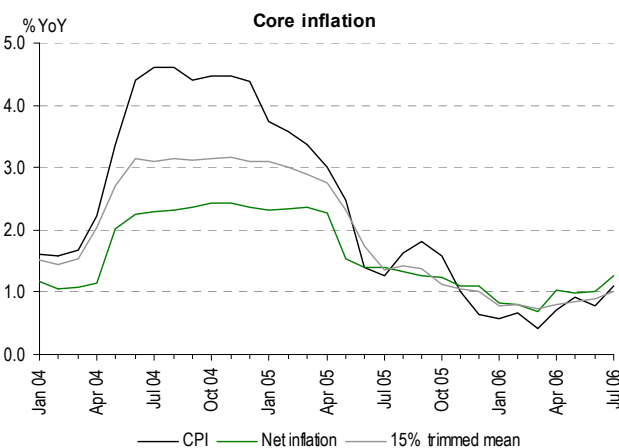
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What's hot this week – Week full of data significant for the market

- The week ahead will be full of information very important for both domestic and foreign markets.
- GDP data should post solid growth in Q2 amid strong domestic demand and slightly positive contribution of net exports. The risk for our forecast 5.5% and market consensus is more on the upside than on the downside.
- The MPC will keep interest rates on hold one more time, and in the statement we expect to see at last reference to the July's inflation projection and possibly a suggestion that in the long run inflation path could be slightly lower.
- There will be plenty of key data releases and events abroad this week. Top of a busy agenda will be Friday's non-farm payrolls report. Other data to watch include revised Q2 GDP, core PCE and Fed minutes. The ECB is expected to keep rates unchanged, but markets will be looking to the press conference for further guidance.

Economy last week – Statistical data confirmed good economic situation

- Polish companies' financial results were very good in Q2. Net profit reached PLN18.9bn (+36%YoY), which was the best result in a decade. Revenues and costs were both rising in double digits, but for the first time since end-2004 the former increased faster.
- Retail sales increased 11%YoY in July. Although it was slightly below forecasts, such result – combined with strong output growth in July – heralds quite promising beginning of Q3 2006 in terms of economic growth.
- Unemployment rate in July dropped to 15.7%, in line with earlier estimates of Labour Ministry, from 16% in June. The number of unemployed declined by 13%YoY. This trend supports increase in private consumption in the subsequent months.



- Investment outlays in big companies increased 14.3%YoY in H1 2006. It confirms expectations that investment growth accelerated in Q2, although one should be careful as the data for entire economy and big companies used to differ substantially in the past.
- Four out of five measures of core inflation increased in July by average 0.4 pp, under influence of the same factors as CPI, namely unexpected hike in "recreation and culture" and "communications". In turn, 15% trimmed mean, that excludes significant, mostly one-off, price increases, inched up by merely 0.1 pp to 1%, which shows that fundamental inflationary pressure is still muted.
- Besides, one should note that average level of all core inflation measures was at ca. 0.8%YoY, much below inflation target 2.5% +/-1.5 pp.

Quote of the week – Strong inflation growth needed for rate hike

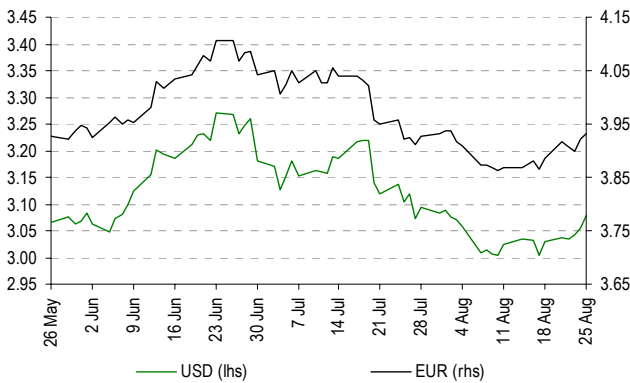
Halina Wasilewska-Trenkner, MPC member; Reuters, 22 August

Trend of interest rate hikes observed in the region could speed up hikes in Poland. Until the projection shows that in the projected horizon inflation breaches upper end of the range (3.5%), if such probability seems big enough, the MPC will have to make adequate decisions, although I cannot rule out MPC's action even earlier. It is not bad when inflation stays in the lower end of the range. Only its persistent rise above 2.5% is an alarm bell.

Although in Wasilewska-Trenkner's opinion the rise in interest rates abroad could translate into faster policy tightening in Poland, but at the same time the MPC member presented a number of conditions necessary for such rate hike. First of all, there has to be high risk of inflation breaching 3.5%. Meanwhile, even in Wasilewska-Trenkner's opinion inflationary pressure caused by rise in economic activity is rather subdued. It confirms that the perspective of interest rate hikes in Poland is still quite distant.

Market monitor

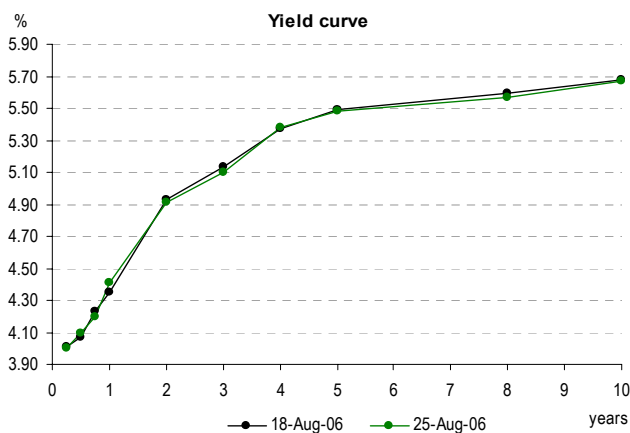
Zloty exchange rate



Continuation of zloty depreciation

- In line with our expectations depreciation of zloty was also continued last week and was accompanied with low trading activity. Hungary's convergence programme was in line with analysts' forecasts and supported both forint and zloty, though later on the zloty saw wave of depreciation with regards to the falling trend started half of August. Zloty got through the resistance of 3.94 to euro and weakened above 3.07 to dollar.
- Positive GDP for the second quarter data can be support to the Polish currency. However in our opinion zloty's downward trend is not over due to hot period incoming connected with parliamentary budget discussion. We expect EUR/PLN fluctuating between 3.88-3.98 and USD/PLN between 3.03 and 3.13.

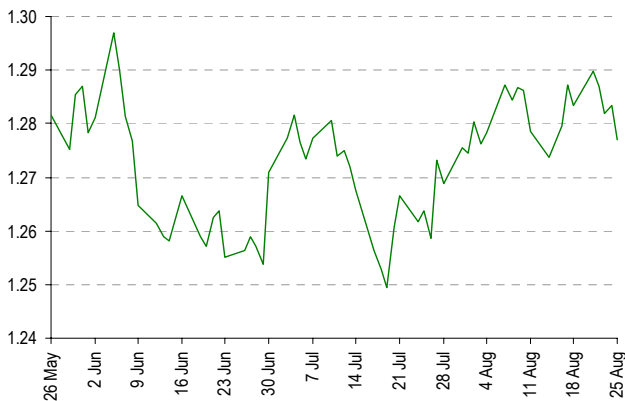
Yield curve



Yields almost unchanged

- During the week yields of Polish bonds stayed almost unchanged as compared to the previous Friday's levels. At the beginning of the week bond market strengthened after a sharp weakening last Friday, which was accompanied with falling yields in the core markets. Further correction in US and deteriorating investors' sentiment towards region added to negative tone.
- In the following week key factors influencing the market will be GDP data for second quarter (bond market weakening possible), MPC meeting and its members' comments. We reiterate our view that rates will not change for a few following quarters. Market key factors will also be foreign markets trends facing quite a lot important publications and events abroad.

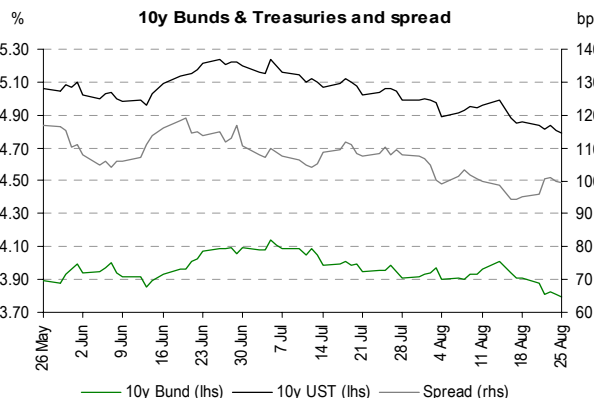
EURUSD rate



Dollar recovers vs. the euro

- At the beginning of the week dollar depreciated against the euro due to economic slowdown expectations in US and lower inflation figures from previous week, though after weak ZEW it regained some strength. Despite the depreciation after data from the housing market and quite high IFO figure the US currency was managed to recover. During the week dollar appreciated to euro by 0.5%.
- The following week will be full of publications on foreign markets. Dollar can sharply react to Fed's minutes from August meeting and preliminary GDP data for second quarter. Important factors for euro will also be ECB meeting and activity figures. The EUR/USD rate can still fluctuate in range of 1.27-1.29 with upward risk.

10y Bunds & Treasuries and spread



Up trend in the core markets due to weaker data

- Expectations of US economic slowdown and weaker than expected euro zone data (ZEW) were factors positively influencing bonds in the core markets. After a temporary correction the markets strengthened further after new home sales data and ahead of Fed's chairman Ben Bernanke's speech.
- Second quarter GDP data and economic activity figures in US may confirm slowdown in US and support Treasuries. FOMC minutes and non-farm payrolls data can be important factors for another Fed decision on interest rates due in September. Bunds and the expectations on the pace of euro zone rates hikes can be influenced by the communiqué after the European Central Bank meeting and activity figures.

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