Bank Zachodni WBK

Weekly economic update

18 – 24 September 2006

In the next week information important for the market can come as much from the economy as the politics. Concerning economic data releases, information about production and prices in industry will be of a major importance. We expect an acceleration in industrial output growth (almost 18%YoY) as much as in PPI (3.8%YoY), both above market consensus, which – after a round of unfavourable data for the bond market in the last week – won't be of a great use concerning mood improvement. On the other hand, in our view waiting for quick interest rate hikes is not justified, which was confirmed by latest MPC members' declarations. Other statements of the Council's representatives could help in the softening of the fear of monetary policy tightening and in the yields fall (if they do appear). Figures concerning net inflation (unchanged at 1.3%) should also confirm our view, assuming no quick rate hikes, although their influence can be limited because of the figure release only on Friday afternoon.

Events on the political scene can also have an influence on moods on the market. The harshening of the relations in the coalition in the last days increased the uncertainty concerning further development of the situation. According to the plan, the government should have a working meeting on the 20th September concerning the budget. Investors will surely be interested how the PM will resolve the issue of remaining claims of minor coalition parties, which demand a rise in spending and maybe even higher budget deficit. During the weekend Zyta Gilowska should inform about her decision concerning a comeback (or not) to the government. PM has repeated a number of times that her comeback is certain, so if this doesn't get confirmed, the market can understand this as a signal that bad things are going on in public finance.

Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (18 September)					
09:00	**POL**	**Auction of PLN1-1.2bn 52W Treasury bills (M)**					
09:00	EMU	Industrial production (H)	Jul	%YoY	4.1	-	4.3
11:00	USA	Net capital flow (H)	Jul	$ bn	70.0	-	75.1
		TUESDAY (19 September)					
12:00	**POL**	**Industrial production (H)**	**Aug**	**%YoY**	**14.8**	**17.8**	**14.3**
12:00	**POL**	**PPI (H)**	**Aug**	**%YoY**	**3.6**	**3.8**	**3.5**
09:00	GER	ZEW index (H)	Sep	pts	- 6.4	-	-5.6
12:30	USA	Build permits (H)	Aug	m	1.74	-	1.763
12:30	USA	House starts (H)	Aug	m	1.76	-	1.795
12:30	USA	PPI (H)	Aug	%MoM	0.2	-	0.1
		WEDNESDAY (20 September)					
09:00	**POL**	**Auction of 7y floating rate and 12y CPI linked bonds**					
18:15	USA	Fed meeting – decision (H)		%	5.25	-	5.25
		THURSDAY (21 September)					
08:00	EMU	Current account (M)	Jul	€ bn	-1.2		4.0
16:00	USA	Philadelphia Fed index (H)	Sep		15.0	-	18.5
		FRIDAY (22 September)					
12:00	**POL**	**Net inflation (H)**	**Aug**	**% YoY**	**1.3**	**1.3**	**1.3**

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

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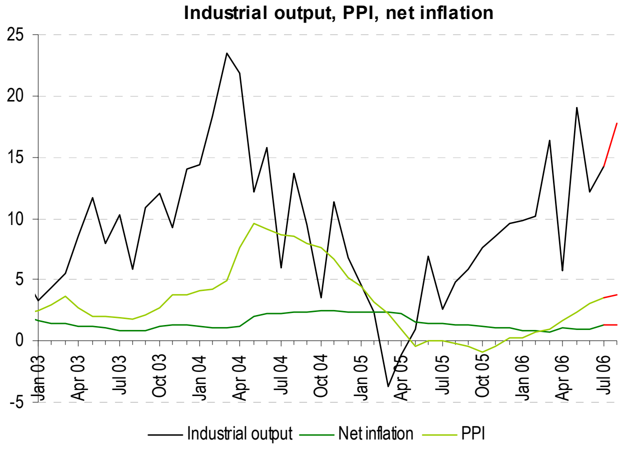
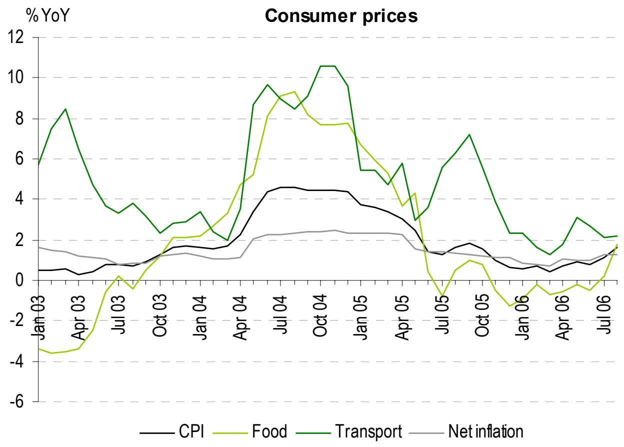
What's hot this week – Some more data and political news

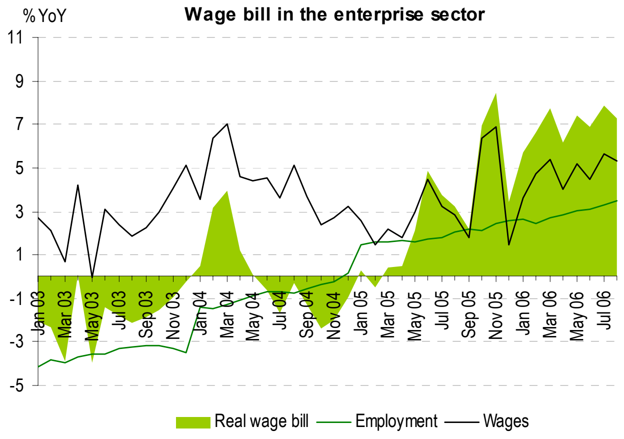


- During the week, we will get to know some more important figures concerning August.
- Industrial output growth should be strong (our forecast 17.8% YoY, market 14.8%), affirming persistence of economic growth in the third quarter.
- Growth in producer prices is likely to accelerate as well, however only due to low base effect and high commodity prices, which will not emphasize pessimism concerning inflation perspectives.
- Core inflation indicators, key for the MPC, should remain low (net inflation 1.3%YoY, the same as in July), showing the lack of a fundamental pressure on prices.
- News from the politics may have an impact on the market – among other things, tensions between coalition parties, discussion on 2007 budget, the comeback (or not) of Zyta Gilowska to the government.

Economy last week – Expensive foodstuffs boost inflation



- Inflation in August rose more than expected, from 1.1% to 1.6%YoY, as a result of higher food and fuel prices.
- However, if we skip those two factors, other prices rise was not big – according to our estimation net inflation remained at 1.3% YoY.
- The influence of the drought on the food market will show up in the next months and together with the effect of low base at the end of the year will provoke further inflation rise to 2% (or a bit higher) in December. In Q1 2007, inflation will be still rising and is likely to breach the 2.5% inflation goal (and will even be close to 3%).
- Nevertheless, CPI rise due to food prices doesn't have to trigger rate hike, if it doesn't provoke second round effects. The lack of excessive tensions on the labour market and low net inflation cause that we expect NBP rates to remain with no changes in the next months.



- Wages in the enterprises sector rose in August by 5.3% YoY, roughly in line with the market consensus, while the employment rise accelerated to a record high 3.5% YoY. Thus, wage bill rose nominally by 9% YoY and 7.3% YoY in real terms, a little slower than in the previous month.
- Although improvement speed in the labour market is still high, according to our estimates this won't lead to excessive tensions because labour productivity is also growing quickly. As a consequence, data were neutral for the MPC.
- Current account deficit in July reached almost 800 mln € and, like the trade deficit, was higher than the forecasts, mainly due to high import rise (27.7% YoY). Export rise remained quite high (17.3%). Those figures do not change the assessment of the situation in foreign trade, especially that trade deficit has been very volatile lately.

Quote of the week – Interest rate hikes not so soon

Halina Wasilewska-Trenkner, MPC member; PAP, 15 September

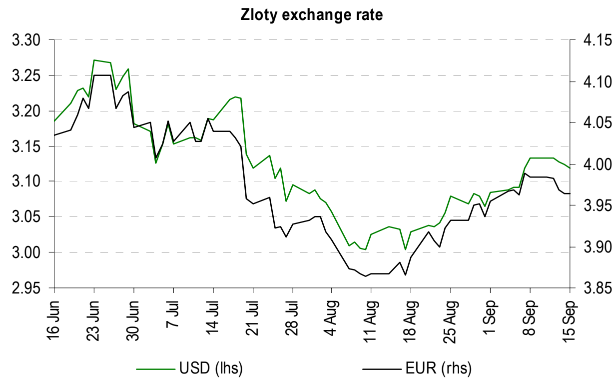
Currently the main factor that could cause our reaction is a relation between wages and labour productivity. This could spoil favourable picture of economy in 2007. But I doubt it. (...)The time for a risk (of higher inflation) to appear may vary from a few months to half a year.

Andrzej Wojtyna, MPC member; Reuters, 13 September

It may be the case that inflation exceeds the target next year, although breaching the target of itself is not a reason to increase interest rates. (...)The current balance of pro- and anti-inflation factors is fairly advantageous. That allows us several months for more consideration.

The last MPC members' declarations confirm our view, that a transitory overpass of the inflation goal at 2.5% is not a sufficient argument for rate hikes. For the Council, trends on the labour market will have a key meaning (risk of a second round effect), as well as consumption demand and the fiscal policy shape. Economic growth structure is lately seen as favourable for medium term inflation perspectives, an so are developments on the labour market, which means rate hikes should not happen too quickly.

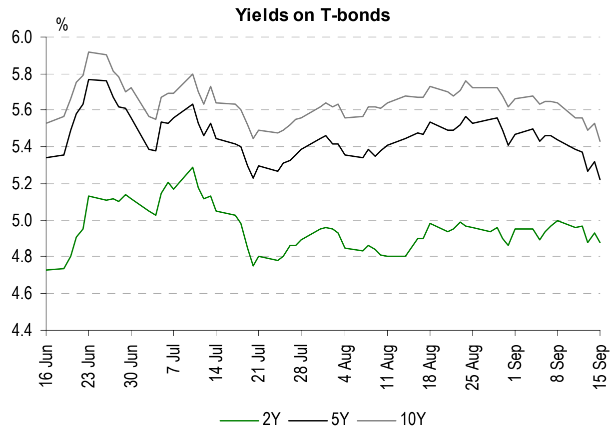
Market monitor



Zloty in counterattack

▪ After a few weeks of weakening, last week has seen a reaction of the zloty rate. The EURPLN rate could not force the crucial technical barrier at 3.99 and even does not tried to test the 4.0 level. Capital flow on the debt market helped the domestic currency. Sentiment improvement was strong enough to break the 3.95 level (after Friday's fixing), which was an important technical level.

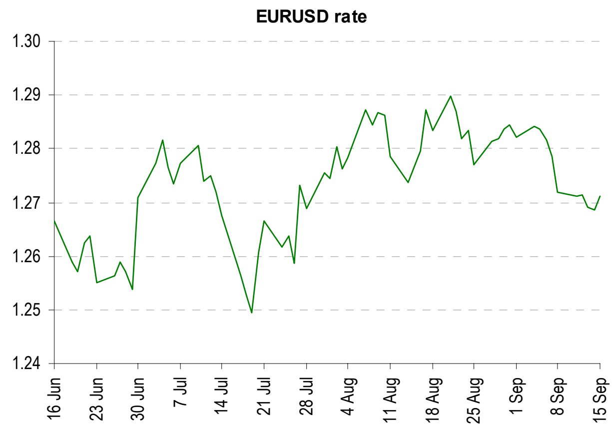
▪ Getting better of this level open the way to 3.9. On the other hand, uneasiness remains due to tohepolitical situation and the 2007 budget's fate. From this point stems the zloty weakening risk. All in all, we predict the EURPLN rate will range between 3.9 and 4.0 and the USDPLN rate between 3.06 and 3.16.



Good moods on the debt market

▪ Last week a mood improvement took place on the debt market. It was favoured, among other things, by the MPC representatives comments, which calming down the medium term fear about inflation perspectives although higher than predicted inflation in the previous months. Thursday publication about surprisingly high inflation rise in August weakened the debt market, but it was considered as an occasion to buy cheaper bonds and on Friday market strengthened again, especially that labour market figures didn't exceed market expectations.

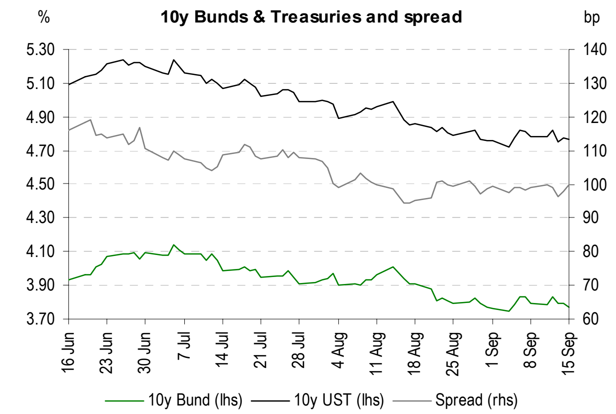
▪ In the next week a key event for the domestic debt market will be the publication of output figure. We expect a higher level than the one forecasted by the market, which may trigger some correction in bonds prices.



Dollar keeps a firm tone

▪ The last week was not bad for the US currency. The EURUSD rate broke the 1.27 level and ended the week clearly under that level. The dollar strengthened on firmer positions occupied the previous week. The greenback wasn't harmed by much higher than expected trade deficit. Meanwhile, retail sales data above expectations favoured the dollar. Friday's date portion from the US concerning inflation, capacity use, industrial production and Michigan index allowed the dollar to remain strong.

▪ In the next week, net capital flow, figures concerning real estate PPI but above all the content of the statement after Fed's meeting will be of a crucial concern to the greenback performance. Concerning the decision, the market agrees that rates will remain without change.



Further yields fall on core markets

▪ During the last week, yields on the core markets kept in a falling trend. It was mainly due to fall in prices of fuel and other commodities, which decreased market expectations for further rate hikes by the world's main central banks. In line with expectations, US inflation figures confirmed the scenario of a progressive cooling of the inflation pressure expected by the Fed and allowed the 10Y Treasuries yields reach week minimum at 4.75%, and 10Y bonds at 3.76%.

▪ In the nearest week, likewise in case of dollar performance, the key factor for the core debt markets will be the content of FOMC statement after its meeting. One may expect the statement will confirm a pause in monetary tightening in the US.

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