

Weekly economic update

23 - 29 October 2006

This week's most important events will be MPC's and Fed's meeting. Because in both cases, market expectations indicate no interest rate change and it is hard to imagine things would go in another way, market's attention will focus on the communiqués released after the meetings. Concerning Poland the new inflation projection will be an additional element, of which main results will be published on Wednesday, while we will get to know the whole *Inflation report* (hopefully) in the next part of the week. Though October's Council's meeting is very awaited, especially that some of its members suggested a possible rate hike already by now, we don't believe it is going to change moods fundamentally on the market. The market is pricing slight rate hikes next year, which makes sense taking into account that the economic situation is changing towards growing risks concerning inflation. In our view, however, these risks are not that fundamental so they can represent a danger for inflation targeting the medium term, while breaking it because of supply factors is not a valuable argument for increasing restrictiveness in monetary policy. By the way, it is already more restrictive given recent zloty strengthening and increase in market interest rates (as well as world interest rates). According to professors Sławiński's and Wojtyna's declarations, it appears that rate hikes are not certain at all and it is worth remembering that their votes were crucial in the past.

Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD	UNIT	FORECAST		LAST VALUE
					MARKET	BZWBK	
MONDAY (23 October)							
09:00	POL	Auction of 800m of 52-week of T-bills (M)					
12:00	POL	Business climate (M)	Oct				
TUESDAY (24 October)							
12:00	POL	Net inflation (H)	Sep	%YoY	1.4	1.5	1.4
12:00	POL	Retail sales (H)	Sep	%YoY	12.7	13.4	11.5
12:00	POL	Unemployment rate (M)	Sep	%	15.4	15.3	15.5
08:00	EMU	Current account (M)	Aug	€ bn	-4.0	-	-4.8
18:15	USA	Fed meeting – decision (H)	Oct	%	5.25	-	5.25
WEDNESDAY (25 October)							
9:00	POL	MPC meeting – decision (H)	Oct	%	4.0	4.0	4.0
08:00	GER	Ifo Index (H)	Oct		104.5	-	104.9
14:00	USA	House sales (H)	Sep	mln	6.23	-	6.3
THURSDAY (26 October)							
09:00	POL	Switch auction (M)					
12:30	USA	Durable good orders (H)	Sep	%MoM	0.9	-	0.0
14:00	USA	New home sales (H)	Sep	mln	1.048	-	1.05
FRIDAY (27 October)							
08:00	EMU	M3 money supply (H)	Sep	% YoY	8.0	-	8.2
12:30	USA	Core PCE (H)	Q3	%	2.7	-	2.7
12:30	USA	GDP deflator (H)	Q3	%	2.8	-	3.3
12:30	USA	Advanced GDP (H)	Q3	%	2.2	-	2.6
14:00	USA	Final Michigan (H)	Oct		88.0	-	85.4

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

Maciej Reluga Chief economist (+48 22) 586 8363

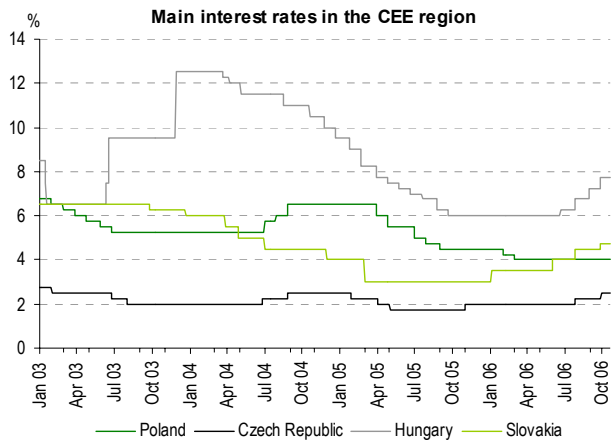
Piotr Bielski (+48 22) 586 8333

Piotr Bujak (+48 22) 586 8341

Cezary Chrapek (+48 22) 586 8342

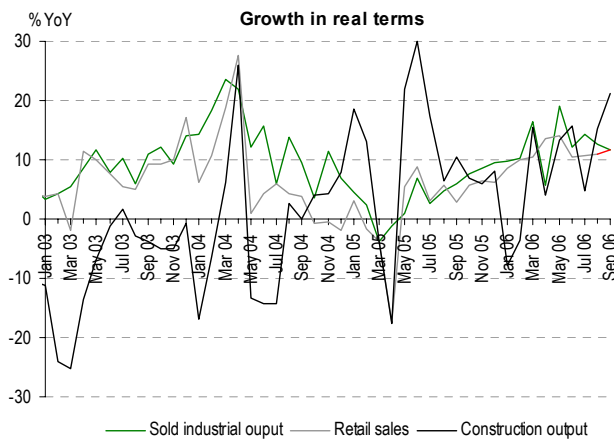
e-mail: ekonomia@bzwbk.pl

What's hot this week – All eyes on central banks

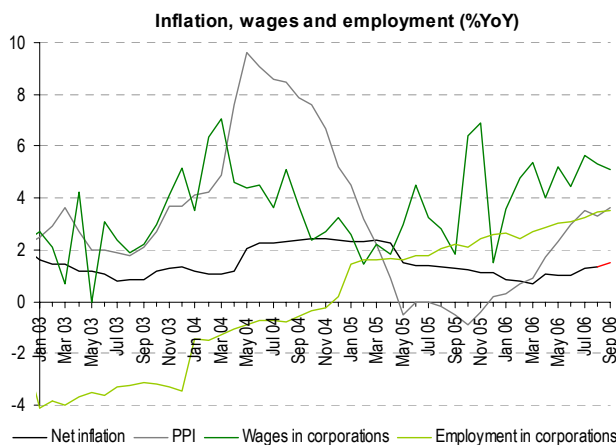


- The Monetary Policy Council will not change interest rates, but most of all we hope it will relate directly to the projection results, especially for 2008.
- The projection can show slightly higher inflation, though it will be mainly due to food prices increase, which will affect 12M CPI inflation until mid 2007.
- Other banks in the region are likely to hike rates.
- The communiqué after Fed's meeting can be fundamental as it can influence risk appetite and this has been the main factor behind recent currencies strengthening in developing markets, including the zloty.
- Before the Council's meeting we will see retail sales and net inflation data. The first indicator should show the continuation of the economic expansion, while the second should rise moderately (if any), indicating a small pressure on prices' growth.

Economy last week – Fast growth, but not necessarily in wages or prices



- In September sold industrial output rose by 11.7% YoY, despite fewer working days. Average output growth in 3Q06 was even slightly faster than in the first half of the year.
- We keep our forecast that economic growth will be around 5% in Q3, slightly below Q2's level at 5.5%. Optimistic growth expectations in Q3 are also due to the fact that construction growth has jumped by 21.3% YoY.
- Producer prices fell by 0.1% MoM in September and rose by 3.6% YoY. Meanwhile, PPI indicator for August has been revised downward to 3.3% YoY from 3.4% YoY.
- A fall in manufacturing prices by 0.2% MoM occurred in September (1.7% YoY), showing no pressure on prices. High PPI inflation was a consequence of high rise in oil and commodities prices.



- Average wage in companies' sector did not change in September as compared to August and grew by 5.1% YoY. This figure was below expectation, though above year average (4.8%) which is a good sign for housing revenues and consumption demand.
- Especially that employment rise remained at a record level (3.5% YoY) in September just as in August, overgrowing January-August average employment rise by 2.9% YoY.
- It does not seem that wage rise was excessive from the prices processes point of view. Especially if we take into account the fact that even if we assume that wages will continue rising, then it is not certain that the companies will afford justifying these costs in retail prices because of increased competition.

Quote of the week – Rates unchanged for a while

Andrzej Sławiński; MPC member, PAP, 17 October

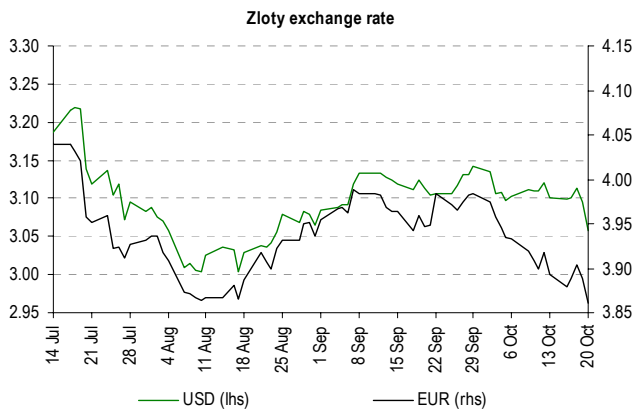
We gradually enter into a period when central bank is taking more and more into account that at a certain moment it will be necessary to adapt monetary policy to the new situation in economic cycle.

Andrzej Wojtyła, MPC member; PAP, 17 October

I hope that the elements of the macroeconomic puzzle will not change that much so we have to make decisions about interest rates changes in the nearest months. Of course, MPC could react earlier but for the moment there are more arguments that stability of macroeconomic conditions will stay with us for the next few months.

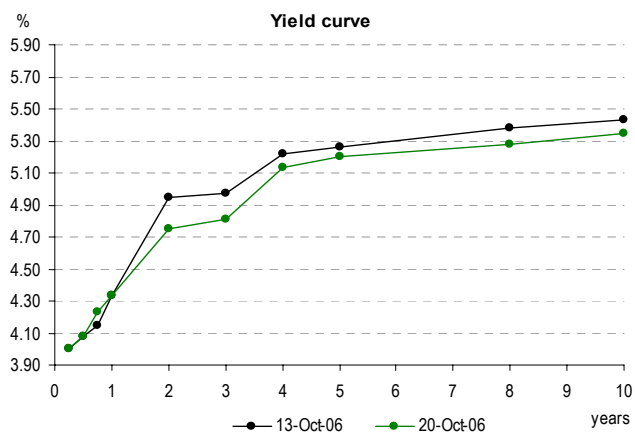
MPC members who usually tip the balance in votes on monetary policy actions signalled they saw little need for interest rate hikes in the nearest few months. Despite the mounting up inflationary pressure, it does not seem that the inflation target could be endangered in the medium-term, especially that some monetary tightening effectively took place due to rise in market interest rates or rate hikes abroad. If the economic scenario predicted by us materialises (net inflation below 2.5% in 2007), then rates can remain unchanged for the nearest 12 months.

Market monitor



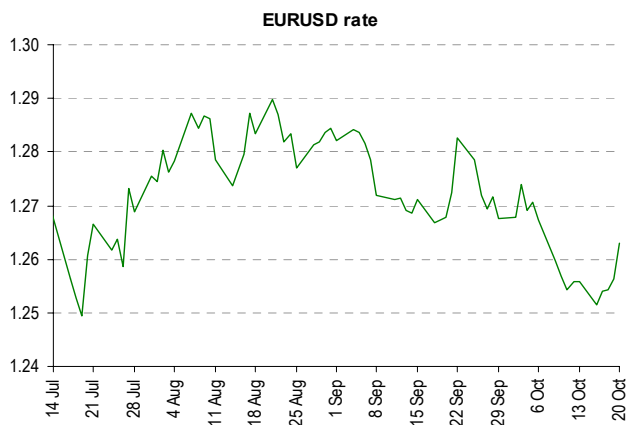
Region still strengthens the zloty ...

- Improvement of the moods toward the emerging markets amid expected „soft landing” of US economy contributed to a significant strengthening in the region. The neighbouring countries currencies were supported by expectations of further rate hikes and positive 2007 budget of Slovakia, what supported the zloty, that appreciated after a few days of stabilisation. The EURPLN rate declined during the week by 1.2%, USDPLN by 0.4%.
- The sentiment toward the emerging markets and the region amid expectations of the US growth scenario may be still the most important for the Polish currency. In our view after breaking important technical level vs. euro, it may further slightly appreciate. We decided to decrease the EURPLN range to 3.82-3.92, and USDPLN to 3.02-3.12, with support level of 3.845 and resistance of 3.88-3.9.



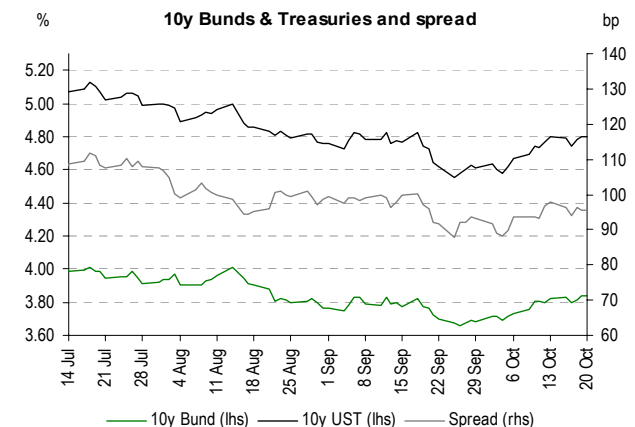
... as well as fixed income market

- The situation in the emerging markets also affected the rising bonds prices. Initially the debt was under higher influence of the core markets behaviour and amid quite poor results of five-year bonds auction and good production data there was some weakening. At the end of the week yields plummeted with regards to better moods in the region and realisation of stop-loss transactions.
- In the coming days the MPC’s communiqué, inflation projection, as well as retail sales data will be the most influential on the Polish government papers. The interest of the foreign investors in the region will also be important. We assume that the bonds prices are relatively high, let alone in the context of the expectations of monetary policy tightening.



Slight EURUSD correction

- The dollar oscillated in a very narrow range slightly above 1.25 but by the end of the week it weakened to more than 1.26. EURUSD slightly fell after a weaker ZEW index however the industrial output data provoked a light correction. Further dollar strengthening occurred after good housing market data, though by the end of the week, the dollar depreciated again mainly due to poor Philly Fed index.
- After growing expectations concerning lighter slowdown in the US, the dollar can weaken at a slightly slower pace than assessed previously. In the next week, the market will focus on Fed’s communiqué, Ifo Index real estate market figures and American GDP figures. We believe that the EURUSD rate will fluctuate in the 1.25-1.30 range till the end of this year and will keep weakening further next year.



Little change in yields in the core markets

- Mixed CPI and PPI inflation data had a measured influence on debt prices in the US. Weaker production data were more essential and they were balanced by better housing market statistics, while better labour market by weaker Philadelphia Fed economic conditions indicator. Treasuries and Bunds Yields remained nearly unchanged respectively at 4.8% and 3.84%.
- Fed’s communiqué and GDP data will be key events of the next week. Home sales data in the US and important high bonds auctions’ offer will also be essential. Money supply will be important from the ECB’s point of view as much as the Ifo index. We think that the debt market in the US will remain relatively strong in the next few quarters.

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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>



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