Bank Zachodni WBK

Weekly economic update

29 January – 4 February 2007

Economic data published last week did not surprise and Polish financial market remained under influence of events on the international markets. Thursday's weakening in the US bond market and stock exchange caused further sell-off of assets in emerging markets. As a result, the EURPLN rate rose to the level of 3.95. We think that the weakening may be close to the end, though it will of course depend on another set of data describing the economic situation in the US. That is why US data releases this week may be even more important than preliminary data on GDP growth in 2006 (which should support the zloty confirming strong fundamentals) and the MPC meeting.

This will be the first MPC meeting chaired by the new NBP President, Sławomir Skrzypek. Therefore, not only the MPC decision on interest rates will be crucial for financial markets, but also the first press conference of the new governor. This will be even more important because the MPC will refer to the new projection of the central bank, prepared by central bank's analysts still under supervision of the previous NBP governor, Leszek Balcerowicz. We will see whether there is a chance for improvement in MPC's communication (statement, press conference, Inflation report).

The parliament approved the 2007 budget with minor amendments, which did not change its assessment. Taking into account economic expansion the budget deficit is too high, though it cannot be excluded that budget realisation will surprise positively during the year (similarly as in 2006), as macroeconomic assumptions were conservative.

Economic Calendar

Time GMT	COUNTRY	INDICATOR (importance level)	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (29 January)					
9:00	**POL**	**Preliminary GDP (H)**	**2006**	**%YoY**	**5.7**	**5.7**	**3.5**
		TUESDAY (30 January)					
15:00	USA	Consumer confidence (H)	Jan			-	8.0
		WEDNESDAY (31 January)					
	POL	**MPC meeting - decision (H)**			**4.0**	**4.0**	**4.0**
10:00	EMU	Economic sentiment (H)	Jan		109.5	-	110.0
10:00	EMU	Preliminary HICP (H)	Jan	%YoY	2.1	-	1.9
13:15	USA	ADP report (H)	Jan	'000	122.0	-	-40.0
13:30	USA	Preliminary GDP (H)	Q4	%YoY	2.9	-	2.0
13:30	USA	Core PCE (H)	Q4	%YY	2.3	-	2.2
14:45	USA	Chicago PMI (H)	Jan		52.0	-	51.6
19:15	USA	Fed meeting – decision (H)		%	5.25	-	5.25
		THURSDAY (1 February)					
9:00	EMU	Manufacturing PMI (H)	Jan		56.3	-	56.5
13:30	USA	Core PCE (H)	Dec	%YoY	0.2	-	0.0
13:30	USA	New jobless claims (H)		'000		-	325
15:00	USA	Manufacturing ISM (H)	Dec		52.0	-	51.4
		FRIDAY (2 February)					
13:30	USA	Non-farm payrolls (H)	Jan	'000	140	-	167
13:30	USA	Unemployment (M)	Jan	%	4.5	-	4.5
15:00	USA	Factory orders (H)	Dec	%	0.9	-	0.9
15:00	USA	Final Michigan index (H)	Jan		94.0	-	91.7

Importance level: (H)igh, (M)oderate; Source: Reuters, BZ WBK   * publication time not confirmed officially

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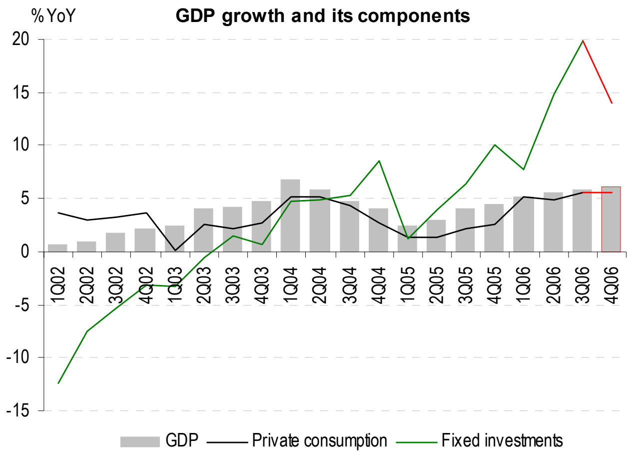
What's hot this week – Rates unchanged with high economic growth



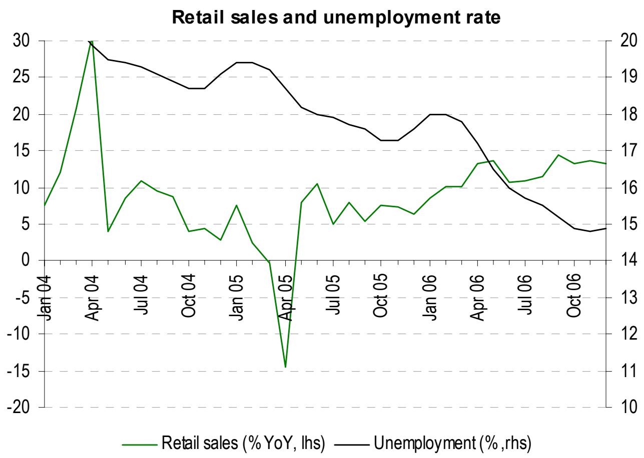
▪ The CSO will release preliminary data on GDP growth in 2006. We expect it to amount to 5.7%, which would imply growth in 4Q06 of above 6%YoY – high increase in investments (14%) and private consumption (5.5%) and slightly negative contribution of net exports (0.6 pp).

▪ GDP data should be neutral for the Monetary Policy Council, as well as for the bond market, though it has to be stressed that the risk is on the upside (as it is also suggested by the forecasts of the Ministry of Economy).

▪ First MPC meeting chaired by the new NBP President will not bring, in our opinion, interest rates change, while January inflation projection should not bring new elements to the assessment of inflationary processes.

▪ What is important, for the first time projections for 2009 will be included and we will see whether CPI increase expected by the projection's authors in 2008, is temporary.

Economy last week – … which was suggested by monthly data

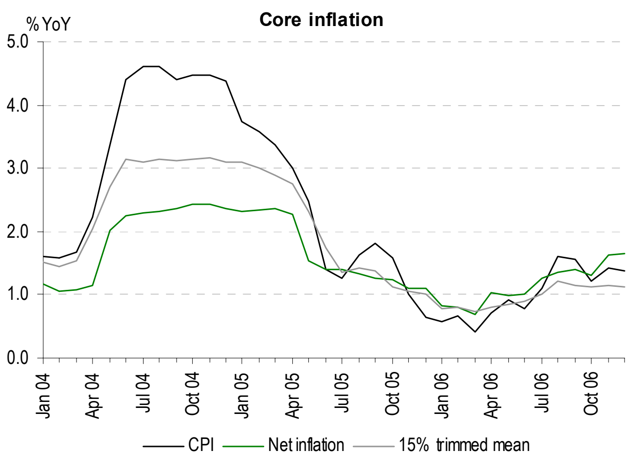


▪ Nominal rise in retail sales reached 13.3%YoY in December, which was more or less consistent with market expectations. Though this rate of growth was slightly below our forecast, it is hard to perceive it as disappointing result.

▪ In the entire year sales increased by 12%, which was almost three times as high as in 2005. What is important, growth in December and in other months of the year was in double digits (some months saw ca. 20%YoY rise), which shows broad-based expansion in consumption demand.

▪ It is worth recognising that real sales growth was even higher than nominal increase and reached 13.7%YoY, and in the entire 2006 both rates were equal. It shows no pressure on price growth in retail trade sector.

▪ In December unemployment rate rose seasonally to 14.9%, which was another record-high drop YoY (by 2.7 pp).



▪ In December majority of core inflation measures stabilised at November's levels. This concerned, among others, two measures the most closely watched by the market and by the Monetary Policy Council i.e. net inflation (CPI excluding food and fuel prices) that amounted to 1.6%YoY and 15%-trimmed mean, which was at 1.1%YoY.

▪ All indicators remained considerably below the target of the central bank of 2.5% and all except the net inflation were below the tolerance band around the target (1.5%).

▪ Core inflation measures still indicate lack of strong inflationary pressure, especially on such a scale that could pose a threat of inflation running persistently above the inflation target of 2.5%. In our opinion the core inflation, excluding the food and fuel prices is going to rise this year, though the growth pace will be very moderate thus the core CPI should stay below 2.5%YoY level till the end of year.

Quote of the week – No room for rate hike

Zyta Gilowska, finance minister; Radio PiN 25 January

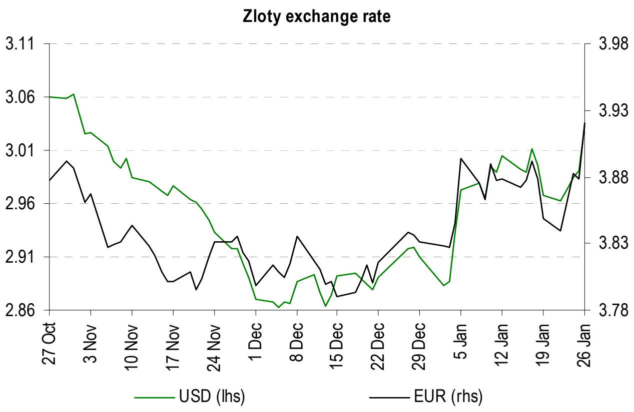
Q: If you are not able to conduct these reforms, which you would like to introduce again? A: I will leave (…) I am not interested in being finance minister only for the fact of being the minister.

I do not see – as it was usually stated – a room for rate hikes. Simply, I do not see justification in the nearest future. We have very low inflation rate in terms of both year-end and annual average. Talking about pre-emptive increase in rates or some warning signals, which should be sent to market participants, is unjustified, in my opinion. This may be even negative for the country.

This is not the case as regards many issues, but we tend to agree with the finance minister in terms of assessment of monetary policy perspectives. While we do expect inflation to increase in the following months (higher demand, higher labour costs etc.), we do not see significant risk for inflation target.

Gilowska mentioned again the risk that she might quit if her plan of reforms is not accepted, but we perceive such comments neutrally. Firstly, we do not know what plan is considered (labour costs were planned to be lower in 2007). Secondly, in our opinion her resignation would not affect markets in the scale as it was the case previously, of course assuming smooth change.

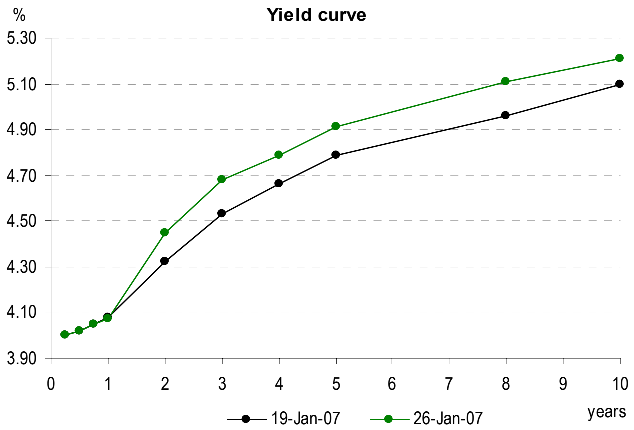
Market monitor



Zloty weaker on emerging markets sell-off

▪ Despite previous week rating upgrade, zloty strengthening and new record levels at the WSE, there were still some signals showing possible zloty depreciation. This scenario was materialized at the end of the week, when the EURPLN broke important technical levels (topped at ca. 3.95). During the whole week the EURPLN rate rose by 1,9%, while USDPLN o 1,7%.

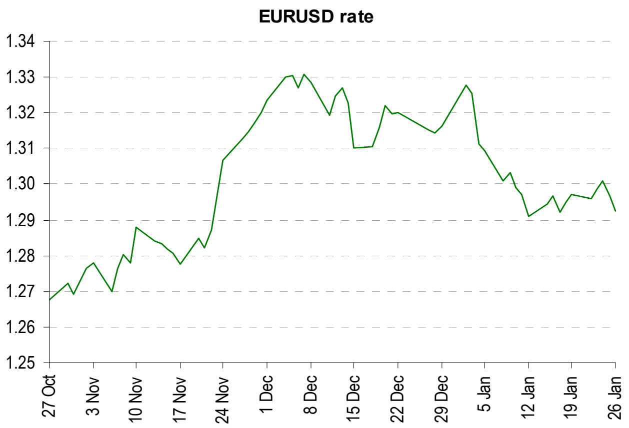
▪ It seems to us, that the sell-off in the emerging markets may be close to an end thought the sentiment toward the region amid further data from Unites States as well as expectations on rates in Japan is still going to be essential. The 3.96 level will be the next strong resistance of the EURPLN rate. In our view this week the EURPLN rate will fluctuate in range of 3.87-3.97 (3.9 - resistance, 3.96 - support), and the USDPLN rate of 2.97-3.07.



The region and core markets weakened debt

▪ Bonds weakened in the last days and yields rose by ca. 11-15 bp. Data on core inflation and retail sales had only temporary effect on the debt prices. Auction slightly strengthened bonds though yields rose on weakening in the region and falling prices of long-term bonds in the core markets.

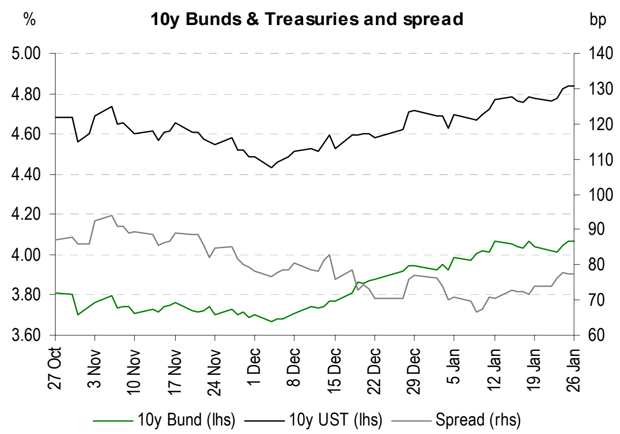
▪ Central bankers' comments, especially of the moderate ones, support our scenario of lack of rate hikes in the coming months. The released data also show lack of significant inflation pressure. In the coming days debt may be negatively affected by the GDP, if it is above the forecasts. The new inflation projection should be rather neutral. Later the situation in the core markets will be the most essential amid large number of data releases.



Dollar is still stable

▪ In the past week the EURUSD rate was traded in quite narrow range. After the statements of ECB's representatives on possible further rate hikes in the euro zone the single currency strengthened above 1.30 versus the dollar. However later the greenback recovered and appreciated to 1.29 against the euro.

▪ Ample crucial data for the EURUSD rate were scheduled for this week. Fed's communiqué after the decision, Q4 GDP data (especially Fed's favourite PCE) and labour market data, which may show still limited influence of the slowdown in the housing market on other sectors of the economy. The activity indices for the manufacturing sector (PMI, ISM) are going to be essential as well. The risk for the EURUSD rate is upward.



Core bond yields rise

▪ Core bond markets significantly weakened since the last Friday. US bonds prices were falling on expectations of quite high supply at the auctions, and this influenced also German Bunds. After breaking the key technical levels yield of 10Y US and German bonds rose to 4.88% and 4.09% from 4.75% and 4.04% respectively.

▪ The ADP report may give some hints on the non-farm payrolls (recently data might have been misleading, quite significant difference). Data on US economy may show a level of US economic slowdown. If they are positive and this is confirmed by the Fed communiqué still with the hawkish bias, the core markets may stay at weaker levels.

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