Bank Zachodni WBK

Weekly economic update

5 – 11 February 2007

Last week in Poland brought two important sets of information for the market: GDP data and MPC meeting coupled with publication of the new Inflation Report that included the new inflation projection. GDP numbers confirmed positive picture of the country's economic situation. GDP growth in 2006 amounted to 5.8%, beating market expectations, which means that GDP growth in 4Q06 clearly exceeded 6%. The breakdown of the GDP growth looks quite favourably, because the main driver of the economic growth is fixed investment, rising by over 19%YoY in 4Q06. This suggests gradual increase in potential GDP and thus it may limit inflationary pressure in the medium run.

As was widely expected, the MPC maintained interest rates unchanged and the statement released after the meeting did suggest that our assessment of monetary policy prospects still holds. In the Council's opinion, current interest rates level is appropriate for stabilisation of inflation close to the target and rate hike would be needed only if the forthcoming data suggests worsening of inflation environment. We do not predict realisation of a negative scenario and we stick to our view that interest rates will only be raised at the beginning of 2008. The MPC announced changes in the way of communication, including regular publication of minutes, which should increase transparency of monetary policy in Poland.

According to PAP agency and *Gazeta Wyborcza* daily, the European Commission will approve a document on Wednesday, calling Poland to undertake adequate steps in order to reduce the excessive general government deficit below 3% of GDP already in 2007, and not until 2009 as the Polish government declared in the latest version of the country's Convergence Program. Besides, there will be no data releases this week, so the key focus of attention will be auction of 2-year bonds and crucial events abroad. The most important will be ECB meeting on Thursday and G7 meeting starting on Friday. As regards the latter it will be important in the context of the Japan's monetary policy and the yen exchange rate and their influence on global liquidity and investors' attitudes towards emerging markets.

Economic Calendar

Time GMT	COUNTRY	INDICATOR (importance level)	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (5 February)					
10:00	**POL**	**Auction of PLN0.9-1.1bn 52-week T-bills (M)**					
9:00	EMU	Non-manufacturing PMI (H)	Jan		56.9	-	57.2
15:00	USA	Non-manufacturing ISM (H)	Jan		57.0	-	56.7
		TUESDAY (6 February)					
10:00	EMU	Retail sales	Dec	%YoY	2.3	-	1.3
		WEDNESDAY (7 February)					
10:00	**POL**	**Auction of PLN1.0-1.5 bn of 2Y OK0709 bonds (H)**					
13:30	USA	Unit labour costs (H)	Q4	%	2.3	-	2.3
13:30	USA	Labour productivity (H)	Q4	%	1.7	-	0.2
		THURSDAY (8 February)					
12:00	GB	BOE meeting - decision (M)		%	5.25	-	5.25
12:45	EMU	EBC meeting – decision (H)		%	3.5	-	3.5
13:30	USA	Jobless claims (H)		K	3.0		
15:00	USA	Wholesale inventories (H)	Dec	%	0.5	-	1.3
		FRIDAY (9 February)					
		G7 meeting					

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

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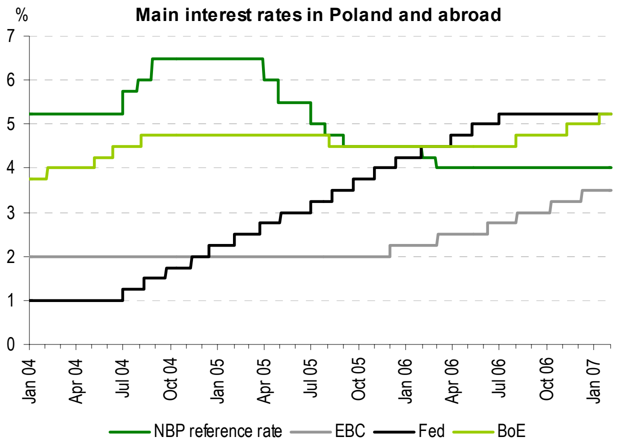
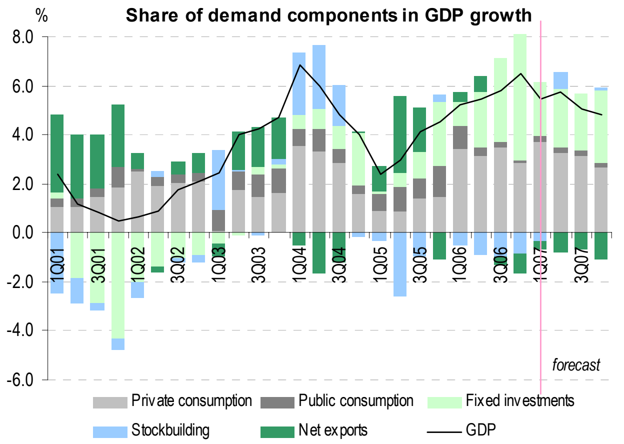
What's hot this week – Calm week?



- The nearest week will be scant as regards important events in Poland. There will be no major data releases and the only crucial event will be auction of 2-year bonds.
- Besides, an important factor for the domestic market will be another data abroad and meeting of the ECB and the Bank of England.
- According to our expectations, this time interest rates in the euro zone will remain on hold, but the tone of ECB statement after the meeting is likely to confirm market expectations of a rate hike in March.
- Interest rates in the UK, after the unexpected hike in January, should remain unchanged this time.
- Also, this week international investors will wait for G7 meeting, particularly in the context of the yen exchange rate which affects sentiment on the emerging markets.

Economy last week – Rates still on hold



- GDP growth in 2006 amounted to 5.8%, beating market expectations, which means that GDP growth in the 4Q06 alone reached ca. 6.5%.
- The data confirmed that economic growth in Poland is not only very fast, but also well-balanced.
- Domestic demand remains an important driver of the growth, but this stems mostly from fixed investment, and not consumption. Investments grew 16.7% in 2006 (the strongest growth in a decade) suggesting an increase in potential output which should moderate inflationary pressure in future.
- At the same time, the negative contribution of net exports does not increase too strongly thanks to persistently excellent results of Polish exports.
- We predict that in 2007 GDP growth will reach 5.3%.

Inflation projections (% YoY)

	Jan 06	Apr 06	Jul 06	Oct 06	Jan 07
Q4 2007	1.1-3.6	1.3-3.4	1.5-3.5	1.9-3.8	2.1-3.8
Q4 2008	0.8-3.9	1.2-3.9	1.7-4.3	2.2-4.6	2.2-4.5
Q4 2009	-	-	-	-	2.4-5.2

GDP growth projections (%)

	Jan 06	Apr 06	Jul 06	Oct 06	Jan 07
2007	3.4-5.2	3.4-5.8	3.6-5.9	4.1-6.2	4.9-6.7
2008	3.6-5.5	3.5-6.2	4.0-6.6	4.5-7.0	3.6-6.4
2009	-	-	-	-	3.5-6.5

Source: NBP, Inflation Report - January 2007

Note: Projection shows that there is a 50-percent probability that inflation and GDP growth will stay within the ranges indicated in the table.

- GDP data and the new inflation projection were the most important pieces of information received by the MPC before its January meeting. As was widely expected, the Council kept rates on hold.
- The new inflation projection is quite hawkish (inflation path for 2008 unchanged, but further inflation growth in 2009), although one should note that for the first time in a long time a risk for the projection, according to authors of the projection, is on the downside.
- It seems that according to the Council the balance of risks for future inflation is even more on the downside. Keeping a "restrictive bias", introduced informally in December, means existence of a risk of rate hikes, but we still believe that this will not happen this year.
- We positively perceive introduced and planned changes in MPC communication, especially publication of minutes.

Quote of the week – …and are not likely to rise soon

Andrzej Wojtyna, MPC member; PAP, 31 January

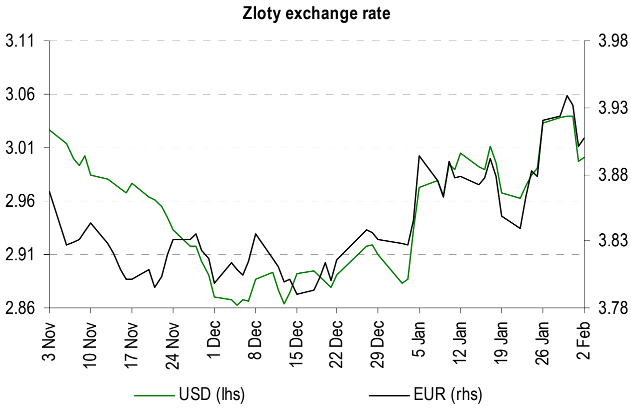
Balance of risks described in today's statement may be identified, with some restrictions, to a restrictive bias. The restriction is that there is no automatism as regards decision on rates.

Stanisław Owsiak, MPC member; PAP, 1 February

One could think about rate hike only when inflation exceeds 2.5% and there is risk of exceeding 3.5%. Thus, I am convinced that if there is a rate hike this year, it will only take place towards the end of the year and 25-50bps will be enough as a signal that the MPC is vigilant and cares about future inflation.

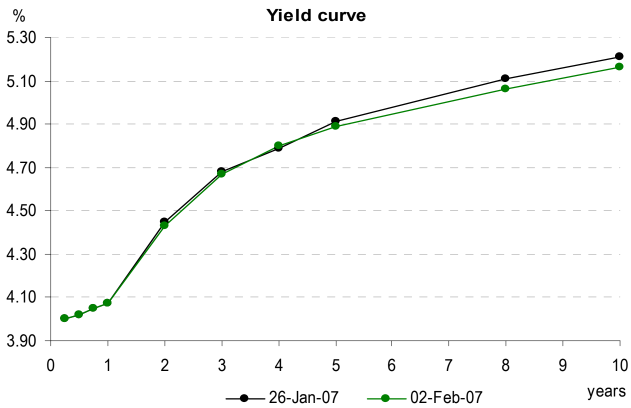
Results of MPC votes in October and November showed that the motions to hike rates by 25bps did not win a majority. Four rate-setters voted for a rate hike: Balcerowicz, Filar, Noga and Wasilewska-Trenkner. The other six MPC members constituted a majority opposing rate hikes and their comments in the media should be in key focus of attention. Thus, one should note Wojtyna's comments that talking about restrictive bias in monetary policy was not equal to admitting that a rate hikes is needed in the forthcoming months. One should also note a comment from Stanisław Owsiak who said that if there was a need for rate hike, it would be only towards the end of this year.

Market monitor



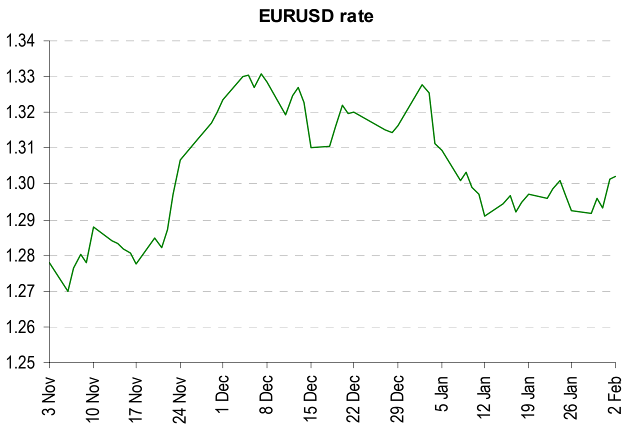
The moods in the emerging markets strengthen zloty

- After the weakening in the previous week in the last day zloty appreciated. Initially it fluctuated in a quite narrow range against the euro and the dollar. US data (GDP, PCE) and Fed's statement improved the sentiment toward the emerging markets. Polish currency was supported also by the 2006 GDP data and new record high stock levels. EURPLN rate fell by 1.6% to 3.9, and USDPLN by 0.7%.
- With lack of key domestic data and events the market players are going to focus on the international markets behaviour. The ECB and G7 countries meeting may be important. The latter one will be eyed as investors will looking for comments on yen weakness and this may influence the emerging markets currencies. We assume the EURPLN stays in range 3.85-3.95 (3.9 – support, 3.95 - resistance), while USDPLN in range of 2.95-3.05.



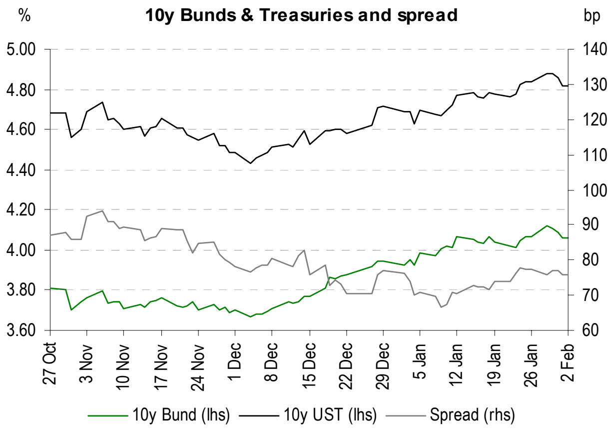
... and bonds; core markets strengthen the longer end

- During the past week the yield curve flattened (yields fell in the longer end). Initially the shorter end of the curve was negatively affected by the higher 2007 GDP forecasts and better than expected 2006 GDP. Later on there was a significant strengthening in the market (especially the at the longer end of the curve) among others in reaction to the falling yields in the core market, MPC's communiqué, MPC members' comments.
- The inflation report and projection were rather neutral and MPC members' comments still support our scenario of lack of rate hikes in 2007. This week the core market moves will be key for Polish bonds. What is more, the overall sentiment toward the emerging markets amid US and G7 meeting.



Activity indices & non-farm payrolls weaken the dollar

- Since previous Friday the dollar weakened against the single currency by ca.1.2% to 1.302. The rise of EURUSD rate resulted despite better than expected US Q4 GDP data and the main reasons were lower than expected inflation PCE data and Chicago PMI index. Fed's statement slightly softened its wording on inflation and improved on economic growth. Lower ISM and non-farm payrolls in US also did not help the greenback.
- We reiterate our view, that the influence of slowdown in the US housing market will be visible also in the other sectors of the economy (ISM), what may weaken the dollar. If the PMI index stays at high level and confirms the economic situation picture in the euro zone this may support the euro. The risk of EURUSD rate is still to the upside.



US data strengthen debt

- There was a heavy weakening of US and German government bonds (10Y yields topped at 4.93% and 4.13%, respectively) after the US GDP data and ECB's comments on threat of rising inflation pressure in the euro zone. However, after the release of Chicago PMI and ISM (both above 50) and lower PCE and data from the labour market yield of 10Y Treasuries and Bunds fell to 4.82% and 4.08%.
- US ISM will be all the more interesting that it may bring some hints to answer the question whether there was already a reaction of services sector to the manufacturing sector slowdown. At the end of the week ECB will leave rates unchanged (3.5%), and next rate hike amid positive situation in the euro zone was probably scheduled for March. The statement after the meeting will be important for this scenario.

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