Bank Zachodni WBK

Weekly economic update

19 – 25 February 2007

Inflation did not surprise in January, rising moderately to 1.7%YoY and it seems this trend will maintain in subsequent months. We maintain our forecast that the inflation rate is going to rise further gradually in February and March, (up to 2.2%YoY), to stabilise or even slightly decline in Q2 and Q3 and to rise again to some 2.5% by year-end. What is more, the net inflation should stay at low level (according to our estimates in January it remained unchanged at 1.6%, and may stay below 2.5% till the year-end). Such situation creates no pressure on the MPC to tighten monetary policy swiftly. On the other hand, wage growth keeps accelerating and it will be surely carefully monitored by the MPC. However, it is worth to remember about low statistical base effect. In February 2006 the MPC wrote in the statement that low wage growth in January last year was significantly affected by a shift in bonus payments in the mining sector. Also, the key issue for the MPC is the relation between growth in wages and labour productivity, and the latter – taking into account weaker job growth in January and the expected fast rise in economic activity at the start of the year, which will be confirmed this week by industrial production and retail sales data – should be still quite favourable.

Moods in emerging markets are still affected by mixed signals from international markets. Last week yields in core market fell, which caused a moderate strengthening in the Polish fixed income market. As regards the foreign exchange market, the zloty was positively influenced by Ben Bernanke's comments, while stronger-than-expected GDP growth data in Japan worked in the opposite direction. As these effects were cancelling each other out, the zloty remained in very narrow trading range. Next week will probably be similar. Investors' assessment as regards U.S. monetary policy will be under influence of Fed minutes. Besides, the Bank of Japan will decide on interest rates and while GDP data gives the excuse to hike rates (which would probably negatively affect the zloty), it remains hard to justify on economic grounds alone.

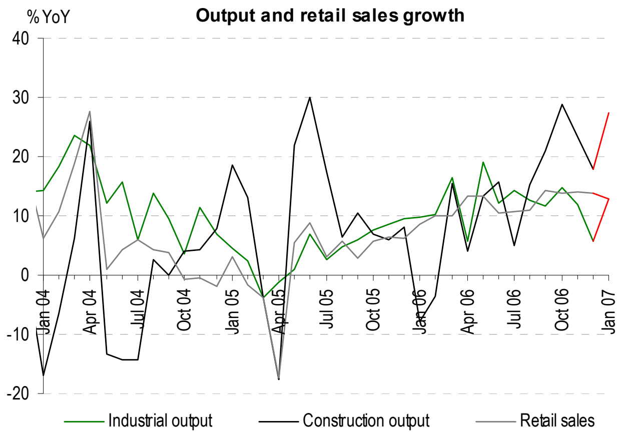
Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level)	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (19 February)					
10:00	**POL**	**Auction 52-week Treasury bills**					
13:00	**POL**	**Industrial production**	**Jan**	**%YoY**	**11.7**	**12.9**	**5.7**
13:00	**POL**	**PPI**	**Jan**	**%YoY**	**2.8**	**2.8**	**2.8**
	USA	Market holiday					
		WEDNESDAY (21 February)					
10:00	**POL**	**Auction 1.0-2.0bn of 5Y bonds**					
13:30	USA	CPI	Jan	%MoM	0.1	-	0.4
6:00	JP	BOJ meeting – decision - report					
19:15	USA	FOMC minutes					
		THURSDAY (22 February)					
	POL	**Business climate**	**Feb**				
		FRIDAY (23 February)					
9:00	**POL**	**Retail sales**	**Jan**	**%YoY**	**14.0**	**13.0**	**13.3**
9:00	**POL**	**Unemployment rate**	**Jan**	**%**	**15.1**	**15.1**	**14.9**
9:00	GER	Ifo index	Feb		107.5	-	107.9

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

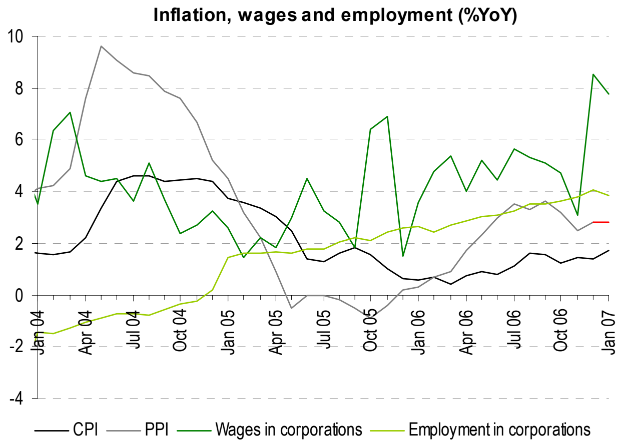
Maciej Reluga Chief economist (+48 22) 586 8363
Piotr Bielski (+48 22) 586 8333
Piotr Bujak (+48 22) 586 8341
Cezary Chrapek (+48 22) 586 8342
e-mail: ekonomia@bzwbk.pl

What's hot this week – Positive beginning of the year in the economy

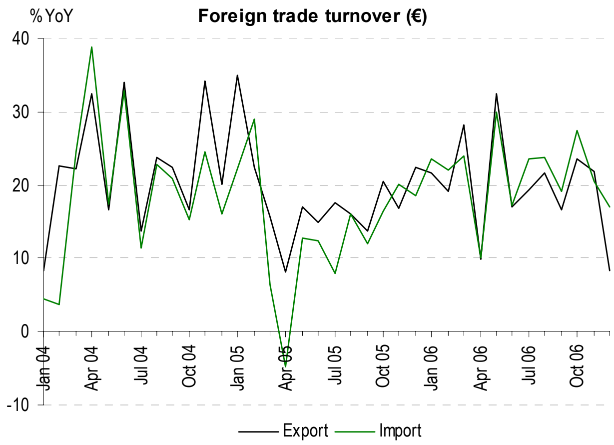


- The beginning of the year should be very good in terms of economic conditions in Poland and this should be confirmed this week by January's data on industrial production and retail sales (two-digit growth expected).
- Data on producer price index should be neutral for the MPC, showing a stabilisation in 12M inflation index.
- The increase in the unemployment rate in January was a seasonal phenomenon and it did not change positive picture in the labour market – sharp reduction on annual basis.
- It is worth to notice that monthly bulletin of the stat office will be published and this will include Q4 data on employment in the economy as a whole. Thus, calculation of unit labour costs figure will be possible. Also, the detailed data on wages will show to what extent sharp rise in January was affected by low statistical base effect in mining.

Economy last week – Inflation and labour market data neutral for the MPC



- In January CPI inflation rose by 1.7%YoY from 1.4% in the previous month, which was consistent with market consensus and our forecast.
- On monthly basis prices rose by 0.5%, which was driven to a large extent by food prices rise by 1.3% as well as housing and energy prices by 1.2%. However, as regards the latter, it should be noted their growth was substantially lower than in January 2006.
- What is interesting, the influence of excise tax increases (tobacco, alcohol and fuels) was not visible at the beginning of the year.
- One should remember that January's provisional data will be revised next month after the CSO recalculates the CPI basket, though we do not expect major changes in that respect.



- Labour market data for January brought two surprises - higher-than-expected wage growth (7.8% against 6.6%) and below-forecast employment increase (3.8% vs. 4.2%). Wage bill in the enterprise sector increased by 11.9%YoY in January, which was the highest growth rate since late 1990s, excepting December 2006. But we should remember that January 2007 was also exceptionally high.
- Trade and current account deficits were much above expectations as a result of sharp deceleration in exports. In our opinion, this is not a change in positive tendency in Polish export, but rather just a one-off phenomenon.
- Money supply increased by as much as 19.4%YoY to PLN485.5bn, which was significantly above market expectations at 15.6%. Further acceleration in both deposits and credits of households and enterprises was observed.

Quote of the week – … though the risk of rate hike has recently increased

Jan Czekaj; Reuters, 15 February

I do not exclude a possibility that some factors will appear, which will force the MPC to hike rates.

Stanisław Nieckarz; Reuters, 15 February

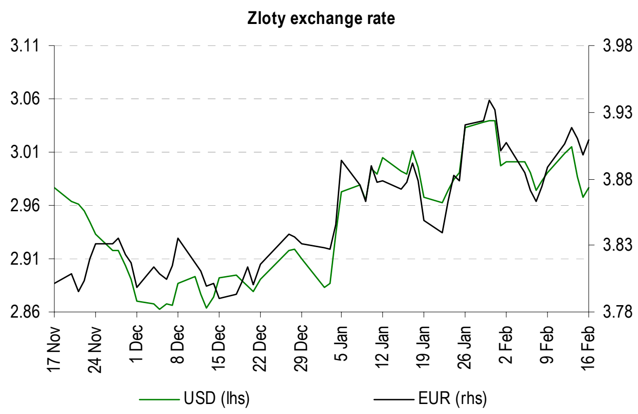
If the balance of risks for inflation in the medium term moves towards higher than today's inflationary pressure as a result of higher labour costs or weaker zloty, a rate hike may be necessary at the beginning of 2008.

Andrzej Wojtyna; Rzeczpospolita, 10 February

For me the key factor is relation between rates of growth in wages and productivity. (…) This [rate hike in 1H07] may happen.

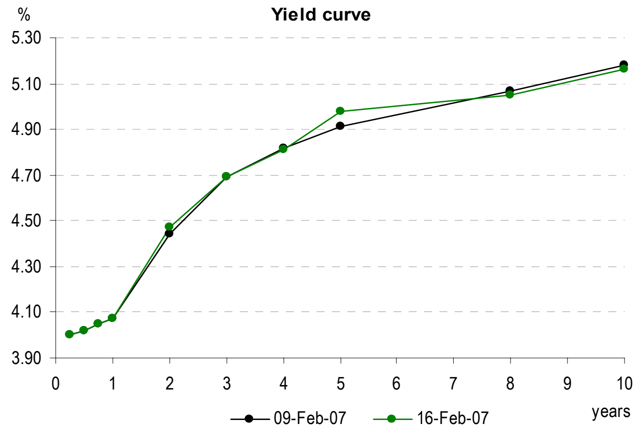
Investors should not pay much attention to comments of MPC members, who used to vote in favour of rate hikes for many months. However, one cannot help noticing that other members changed wording. Focusing on importance of the labour market data, they emphasise a possibility of rate hikes, which is well in line with the restrictive bias they informally adopted. While we maintain our view on flat interest rates through 2007, in our opinion the risk of a hike has recently increase. Thus, we are taken by surprise that market consensus is changing towards later start of monetary tightening.

Market monitor



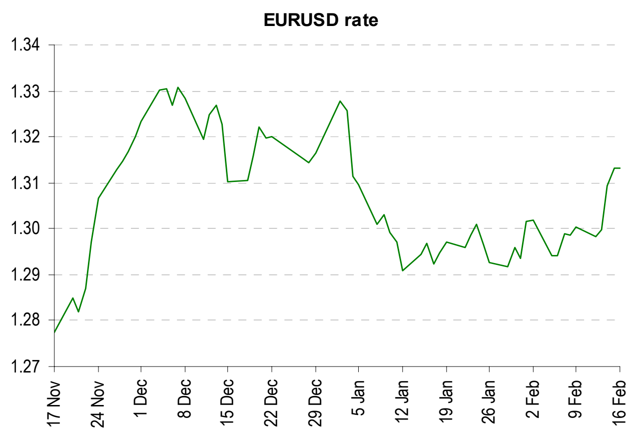
Zloty in a narrow range

- Last week zloty fluctuated in a very narrow range (3.89-3.93 against the euro). Initially weakened above 3.9 (negative influence of G7 meeting fall in WSE). Afterwards Polish currency was strengthening (among others after Ben Bernanke's statement) so as to weaken again at the end of the week. Eventually the EURPLN rate rose 0,2%, and USDPLN fell by 0,3%.
- The data released on the Polish economy to be released in the next days should be good and positive for zloty. It seems that most important will be the events abroad (decision of Bank of Japan on rates, US CPI and Fed minutes), which will influence the sentiment to the emerging markets. The EURPLN rate is going to stay in range of 3.85-3.95, while USDPLN rate of 2.94-3.04.



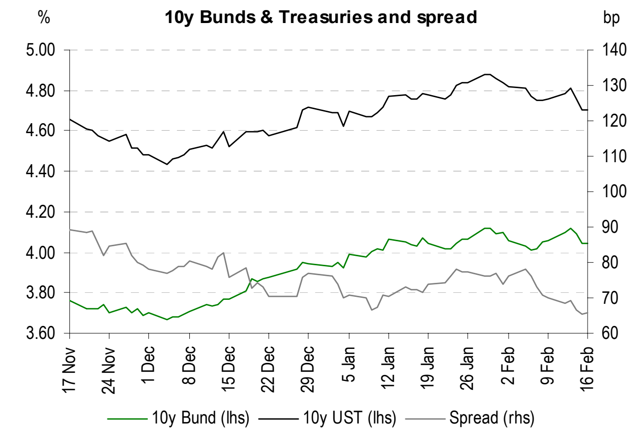
Stabilisation also in the bond market

- Bond prices remained at stable levels and some strengthening resulted in the long end of the curve mainly due to long-term yield falls in the core markets. Domestic CPI and labour market data were rather neutral and MPC members' comments were rather in line with consensus. Since previous Friday yields fell by 1-2 bp.
- The statements of the Council members point ot higher risks for inflation and probability of interest rate hike. We hold our view that monetary policy may be tightened not until the start of 2008. The debt market may weaken after good figures on industrial production and retail sales. Polsih market will be to high extent under influence of the core markets.



The EURUSD rate is above 1.3

- In the last week the EURUSD rate finally left the very tight range, in which traded since the start of this year. Ben Bernanke's comments in easing inflation and weak economic data (retail sales, industrial production, labour market and housing market) were negative for the dollar. At the end the EURUSD rate rose since last Friday by 1% above 1.31.
- We hold our view that in the first part of the year weak US economic figures and monetary tightening in the euro zone will negative affect the greenback. Next week US inflation data and FOMC minutes, which will probably be similar to Fed's communiqué and Ben Bernanke's comments, is going to be crucial for the EURUSD relation. Ifo index will be also essential (euro may strengthen).



Stronger core bond markets

- Weak data from United States such as retail sales, industrial production, labour and housing market figures as well as producer prices were positive for US debt. It was additionally boosted by Fed 's president comments in front of US Senate banking Committee. 10Y yields of US Treasuries fell during the weak from 4.76% to 4.67% while of German Bunds from 4.8% to 4.02%.
- The start of the week may be rather calm due to market holiday in United States. US inflation may fall with regards to expectations of Federal Reserve, which may support US government bonds. On the other hand good Ifo figure may contribute to further narrowing 10Y spread between US Treasuries German Bunds (last week it fell by 5 bp to 65 bp).

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