Bank Zachodni WBK

Weekly economic update

26 March – 1 April 2007

After getting familiar with a set of monthly economic data for February we can say that with high probability the GDP growth rate in Q1 2007 will reach 7%YoY. At the same time, the data showed that fast expansion, based simultaneously on three pillars: private consumption, investments and exports, is still relatively well balanced, and pressure on inflation is not growing without control. In effect, although a risk of interest rate hikes has increased recently quite a lot, monetary tightening still does not seem to be the most likely scenario for the nearest months.

Perspectives of monetary policy will be undoubtedly a subject of particular attention this week, as the monthly meeting of the Monetary Policy Council starts on Tuesday. While a change in interest rates does not seem to be likely this time, one should pay attention to the MPC's official communiqué that will be probably written in effort to steer market and analysts' expectations regarding interest rate prospects more effectively than in the previous month. After a series of hawkish comments from MPC members (even those representing moderate views) that had appeared in the last weeks, one should expect that the Council's communiqué will also include stronger wording than before, suggesting a rise in probability of interest rate hikes, which can have negative impact on debt market.

Foreign exchange market will remain under the influence of foreign data. After last week's Fed statement that triggered strengthening on emerging markets, this week new information from American economy will be crucial that will allow to assess a scale of economic slowdown in the first quarter. It seems that a series of good data may be continued and as a result we lowered a predicted band of zloty fluctuations against euro to 3.82-3.92.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (26 March)					
14:00	USA	New home sales		m	0.99	-	0.937
		TUESDAY (27 March)					
8:00	GER	Ifo index	Mar		106.5	-	107.0
14:00	USA	Consumer confidence	Mar		109.0	-	112.5
		WEDNESDAY (28 March)					
	POL	**MPC meeting – decision**		**%**	**4.0**	**4.0**	**4.0**
8:00	EMU	M3 money supply	Feb	%YoY	9.8	-	9.8
12:30	USA	Durable goods orders	Feb	%		-	
		THURSDAY (29 March)					
9:00	**POL**	**Switch auction**					
12:30	USA	Final GDP	Q4	%	2.2	-	2.2
12:30	USA	Final PCE	Q4	%	1.7	-	1.9
		FRIDAY (30 March)					1.6
12:00	**POL**	**Current account**	**Q4**	**€ m**		**- 2 033**	**-907**
12:00	EMU	Economic sentiment	Mar		109.5	-	109.7
9:00	EMU	Preliminary HICP	Mar	%YoY	1.9	-	1.8
12:30	USA	Core PCE	Feb	%		-	2.3
13:45	USA	Chicago PMI	Mar		49.6	-	47.9
14:00	USA	Final Michigan	Mar		89.0	-	91.3

Source: Reuters, BZ WBK

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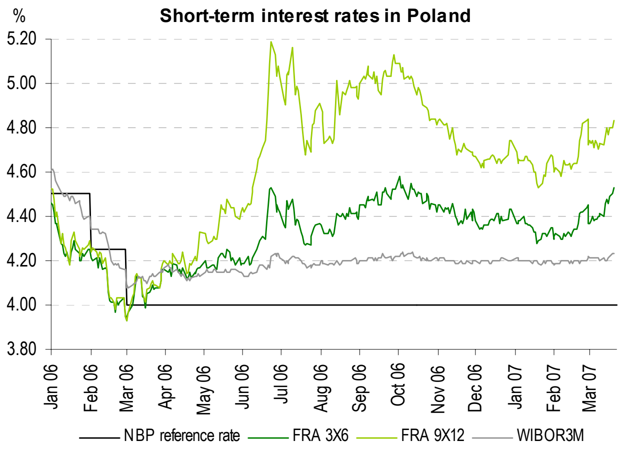
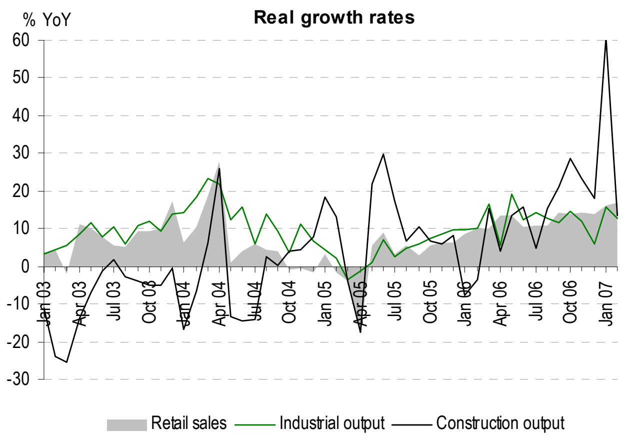
What's hot this week – The MPC may tighten its wording

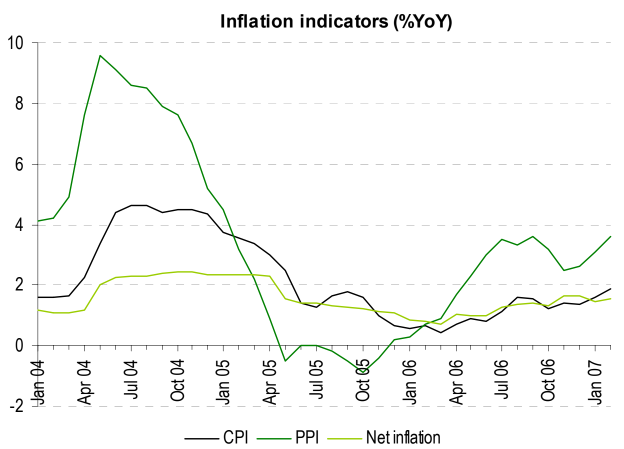


- In the last week of March the domestic market will focus on the MPC meeting. After a series of hawkish statements, also from MPC members with moderate views, the tone of the official communiqué will be crucial and its assessment of risks for future inflation. One could suspect that the statement will be more hawkish than the previous one in order to impact market expectations more efficiently this time. The MPC's decision on rates will depend on new data (especially labour market statistics).
- On Friday, quarterly balance of payments figures will be released for 4Q06. They should be not much different from results of monthly figures and neutral for the market.
- Abroad, important data releases will include Ifo index in Germany and data from US: new home sales, consumer sentiment, durable goods orders.

Economy last week – Strong economy, inflation still not so scary



- Industrial output rose 12.7%YoY in February, roughly in line with our forecast. Manufacturing remains the main driving force with 15.8%YoY growth. Construction output soared almost 60%YoY for the second straight month.
- Retail sales rose more than expected, by 17.5%YoY (16.9%YoY in real terms) and the biggest gains were recorded in sales of durable goods.
- Consumption strengthening is being supported by fast improvement on the labour market: registered unemployment rate fell to 14.9% in February, more than expected.
- Data about sales and output suggested that GDP growth in Q1 will reach ca. 7%YoY. The growth remains well balanced, being supported by three pillars: exports, consumption and fixed investment, which does not raise concerns about economic stability.



- Producer prices growth in February was higher than forecasted, reaching 3.6%YoY, while January result have been revised up from 2.9% to 3.2%YoY. Prices went up mainly in manufacturing sector, to large extent due to more expensive fuel prices. Accelerating PPI growth could be a warning signal for the MPC, however is unlikely to trigger interest rate hike on its own.
- In line with expectations, core inflation measures remained at low levels in the first two months of the year, although most of them increased. However, the closely watched net inflation was lower than in December.
- Last week's Fed meeting was an important event for the financial markets, together with its statement, in which the central bank eased tone and abandoned warning against possible further policy firming, at the same time calming down fears of possible recession in US, which boosted

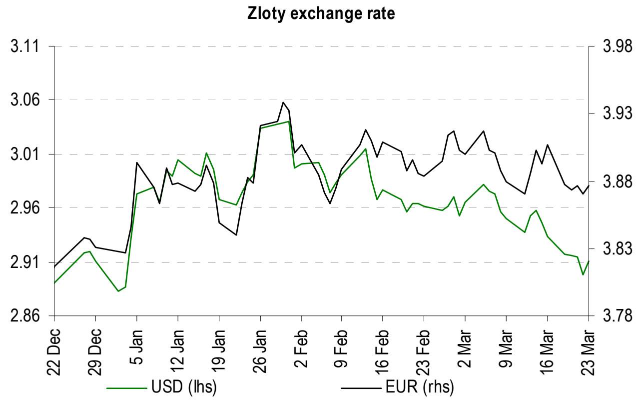
Quote of the week – Rising probability of rate hikes

Andrzej Wojtyna, MPC member; Gazeta Prawna, 20 March

Signals coming from the economy make me believe the situation has changed and in comparison to previous month, a likelihood of interest rate hikes has increased. The perspective of making such decision comes closer with slightly bigger steps. The horizon has shortened to the extent that it could be possible considering rate hikes already in the fist half of the year. (...) After a signalling move we can wait and see whether next data will confirm rightness of the decision, whether there will be more signals about economic overheating. This need not to be entire cycle of rate hikes, as we are not facing a strong shock, and additionally we did not have negative interest rate hikes in the past.

Andrzej Wojtyna is one of the moderate MPC members and his opinion is often crucial in determining the results of MPC votes. Thus, a change in his rhetoric towards more hawkish raises a probability of rate hikes perceived by the market. By the way, probably this was his intention after the market misperceived the last MPC official statement. However, we think that any changes in monetary policy before publication of next inflation projection are not very likely, and serious consideration on rate change could take place only after publication of complete economic data for Q1, including particularly LFS data from the labour market that will be available in May.

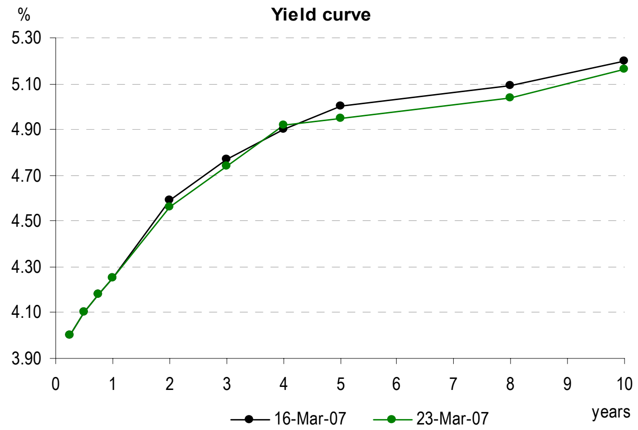
Market monitor



Region strengthens thanks to SKK revaluation

▪ At the start of the previous week the zloty strengthened against the euro, due to appreciation of the Slovak crown after its revaluation within ERM2 system, which affected other currencies in the region. Later the Slovak central bank intervention had opposite, though smaller influence. Till the end of the week Polish currency fluctuated in narrow range. The EURPLN rate fell during the week by 0.7% and USDPLN by 0.4%.

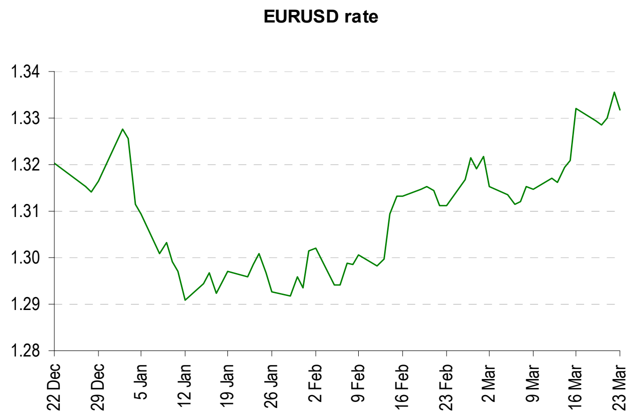
▪ Slightly better moods in the emerging markets and higher risk appetite on calming Fed's communiqué as well as still very good data from the Polish economy will positively influence the zloty. After 7 weeks of maintaining stable range of EURPLN we decide to lower it to 3.82-3.92 (3.85 - support; 3.9 – resistance). In our opinion the USDPLN rate is going to stay in range of 2.87-2.97.



Further curve flattening

▪ In the last few days the yield curve continued to flatten. After a rise of yields at the short end in the previous week this time there was a fall at the longer end of the curve. This was connected with, among others, moderately stronger zloty, and moods improvement after Fed's statement. Released data (especially PPI) negatively affected the debt market, while more hawkish comments of MPC members contributed to a rise of FRA rates.

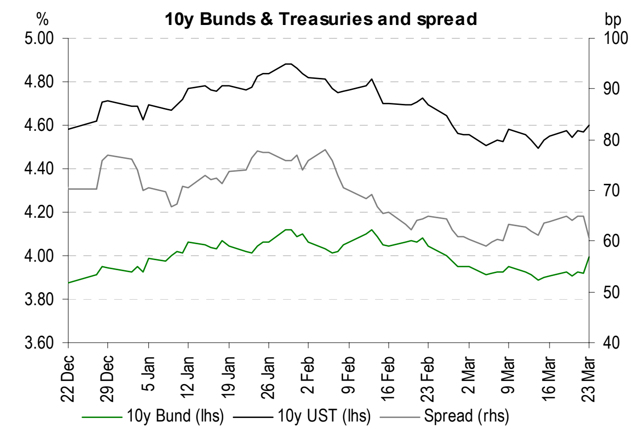
▪ The released data confirm strong economic expansion, which till now has not resulted in the perspective of significant rise of inflation. However in our view the expectations of faster rate hikes may rise and bonds may weaken. The longer end of the curve will be also influenced by further reaction of Fed's communiqué and published data.



Dollar recovers after sell-off on Fed

▪ In the first part of the week ahead of Fed meeting the EURUSD fluctuated in a narrow range. The US central bank dropped expression on possible tightening of monetary policy, which resulted in sudden weakening of the dollar. The market slightly overreacted and at the end of the week it regained strength against the euro and EURUSD fell below 1.33.

▪ Despite the recovery of US currency after some stabilization further weakening may follow, among others amid expectations of lower interest rates in the United States. This week the Ifo index is going to confirm good climate in the German economy, which may support the euro. Durable goods orders data, Chicago PMI index and final GDP data will be also important.



Core markets slightly weaken

▪ The core markets slightly weakened ahead of Fed decision on rates, as the market feared wording putting more significance on inflation. After the release of the statement initially market players perceived it as changing Fed's bias from hawkish to neutral, and core markets substantially strengthened. In the second reaction the market weakened, as players reassessed the statement and focused more on expressions emphasizing inflation. Yields of 10Y Treasuries rose from 4.55% to 4.6%, and Bunds from 3.91% to 3.99%.

▪ This week several important data are going to be released. European markets may be influenced mainly by Ifo and monetary statistics. Chicago PMI will be important and may give some signals on ISM. Final GDP and PCE index will be also essential.

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