Bank Zachodni WBK

Weekly economic update

2 - 8 April 2007

Interest rates remained unchanged in March, but the Monetary Policy Council's statement clearly suggested that a rate hike could take place in one of the nearest months, possibly in April. It is worth to notice that the important sentence was missing in the communiqué, as in the previous months the MPC wrote that "current level of interest rates enables keeping inflation close to the target of 2.5% in the medium-term". This means that higher level of rates is required. Thus, why we did not see a hike in March? It seems the central bankers preferred to wait with the decision so that confront their concerns about inflation with the new inflation projection that will be estimated on the basis of updated and somewhat modified econometric model next month. Additionally, the perspective of inflation increase above the target is not so obvious and in such environment the MCP did not want to surprise the market.

The communiqué said that the scale of tightening would depend on the new economic data. After the first rate hike, the MPC should wait with next moves for more complete picture of economic situation in the second quarter. It seems that a total scale of monetary tightening predicted by us, i.e. 75 bp until end of 2008, is still valid, although the cycle will apparently begin earlier than we had assumed.

Next week, ahead of Easter, will see a number of economic data releases abroad, including the key US non-farm payrolls to be published on Good Friday. Of course, the Polish currency will remain under influence of global factors and risk appetite, though the Polish economy fundamentals are positive enough (S&P confirmed this by upgrading Poland's rating last week) and we do not expect zloty depreciation. The situation on the FX market last week confirmed we were right in revising down the expected range for EURPLN fluctuations (we keep 3.82-3.92 range for the next week as well).

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (2 April)					
9:00	**POL**	**Auction of PLN0.9bn of 52 week Treasury bills**					
8:00	EMU	Manufacturing PMI	Mar		55.7	-	55.6
14:00	US	Manufacturing ISM	Mar		51.5	-	52.3
		TUESDAY (3 April)					
14:00	US	Pending home sales	Feb		107.0	-	108.7
		WEDNESDAY (4 April)					
9:00	**POL**	**Auction of PLN1.0-2.0 2Y bonds**					
8:00	EMU	Services PMI	Feb		57.6	-	57.5
12:15	US	ADP report	Mar	m	122.0	-	57.0
14:00	US	Non-manufacturing PMI	Mar		55.0	-	54.3
14:00	US	Factory orders	Feb	%	2.1	-	-5.6
		THURSDAY (5 April)					
11:00	EMU	Bank of England meeting – decision		%	5.25	-	5.25
12:30	US	New jobless claims		'000		-	308.0
		FRIDAY (6 April)					
	INT	Market holiday					
12:30	US	Non-farm payrolls	Mar	'000	135.0	-	97.0
14:00	US	Wholesale inventories	Feb	%	0.4	-	0.7

Source: Reuters, BZ WBK

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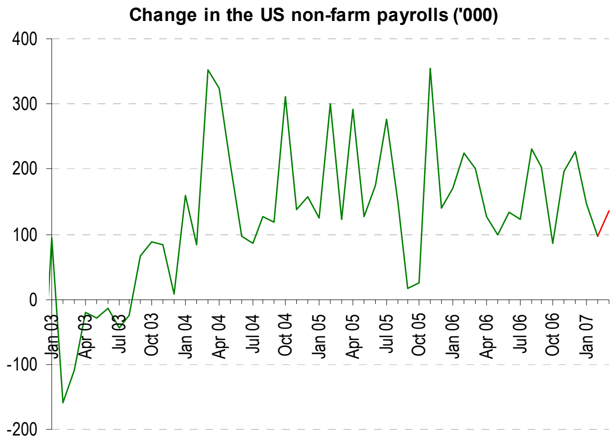
What's hot this week – Data abroad crucial again

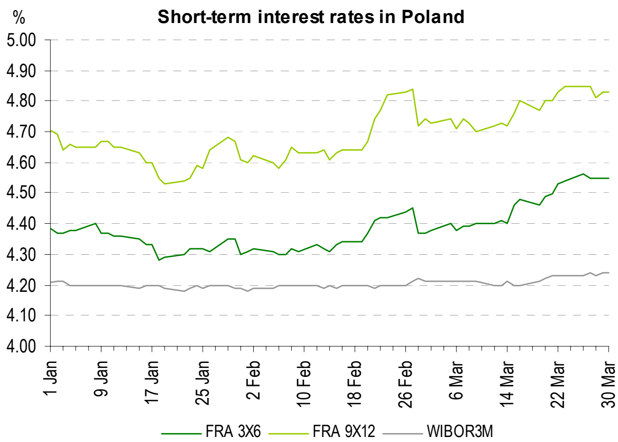


- No publication of important economic information is scheduled before Easter in Poland, similarly as last week.
- Last week, most of economic data in the US were below expectations. The exception was the revised figure as regards economic growth in the fourth quarter. Still, there is high uncertainty concerning the prospects of the American economy.
- Next economic figures will shed more light, especially as next week the closely watched labour market data will be published (non-farm payrolls, unemployment).
- Also, we will get some economic indicators for the euro zone and the American economies (PMI, ISM), while given problem in the US housing market the figure on pending home sales may be important (the release is scheduled for Tuesday).

Economy last week – Statement signalled rate hike "in the near future"

Key changes in the MPC's statement in March
In the medium term, ~~the growth of wages may gradually increase~~, **the gradual increase in wage growth is likely to be sustained**, ~~leading to higher inflation~~ **which may lead to higher inflation**.
~~The Council judged that the current level of NBP interest rates makes it possible for inflation to be kept close to the target of 2.5% in the medium term. However,~~ Maintaining inflation close to target and thus creating conditions for sustainable long-term economic growth may require monetary policy tightening **in the near future**. ~~Future decisions of the Council~~ **The scale of the tightening** will depend, to a large extent, on whether ~~rising economic activity proves more permanent~~. **the incoming data confirm the expectations that the high growth of domestic demand, which most probably outpaces the growth of potential GDP, will be sustained in the next few quarters.** ~~It~~ **Future decisions** will also depend on other economic developments in Poland and in the world and also on their impact on the inflation outlook in Poland.

- The Monetary Policy Council kept interest rates unchanged again (the reference rate still at 4%), which was consistent with market expectations. At the same time, in line with our expectations, the Council considerably strengthened the signal that a tightening in monetary tightening may be needed in the forthcoming months in order to keep inflation under control.
- The changes in the statement suggested that interest rate hike in 1-2 months horizon is almost certain while a scale of overall monetary tightening in future (a number of hikes) will be determined by upcoming economic data, depending on whether they will indicate further inflation acceleration or suggest a possibility of inflation stabilisation near to the target.



- According to our forecasts, data due for publication in April will be quite strong (high retail sales growth, solid increase in output, employment, and inflation increase), confirming continuation of rapid economic expansion and rising risks for inflation.
- A delay in monetary tightening could take place, if the upcoming data are weaker than expected, which could induce the Council to wait with a hike until May when important data for 1Q07 will be released: GDP numbers and results of the Labour Force Survey.
- The money market and bonds did not react to the MPC statement release, but this was connected with the fact that market rates adjustment upwards took place much earlier, in reaction to interviews of MPC members, especially the one with Andrzej Wojtyna.

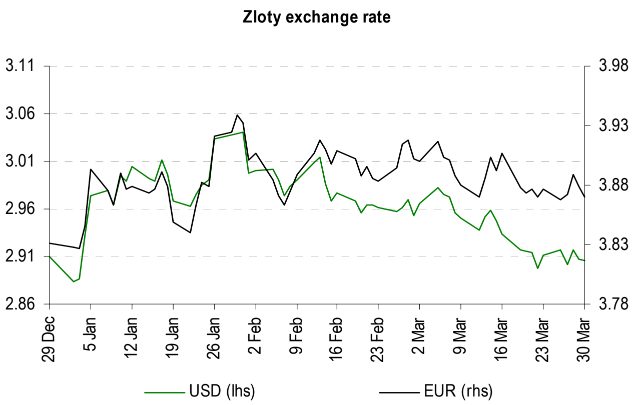
Quote of the week – … and comments of MPC members confirmed this

Jan Czekaj, MPC member; PAP, 29 March
In the last statement the MPC signalled a possibility of rate hikes, this is not a settled, but developments of economic situation has recently shown a rising probability of monetary tightening. The timing for such monetary tightening is a question of months rather than quarters.

Halina Wasilewska-Trenkner, MPC member; Radio PiN, 29 March
The MPC did change rates in March as on the one hand we have excellent picture of the Polish economy, and on the other hand inflation threats (though we are aware they exist) are not significant enough and they suggest inflation may remain low. However, we have to act, anyway.

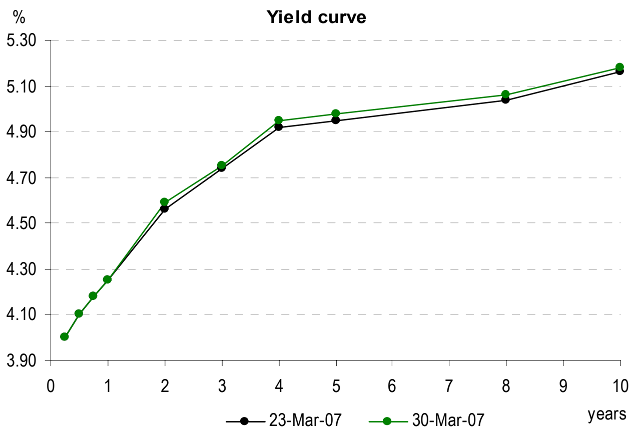
The comments of the MPC's Halina Wasilewska-Trenkner, who is considered as one of more hawkish members, were perceived by the market as rather soft and dovish. Later, Jan Czekaj, who used to vote against rate hikes, spoke in slightly more hawkish manner, in line with the statement. In his opinion, with regards to the fact that current inflation is low and economic situation stabilised, the monetary policy tightening should be gradual. His comments neutralised somehow earlier soft tone of the interview with Wasilewska-Trenkner, suggesting almost certain interest rate hike within next two months.

Market monitor



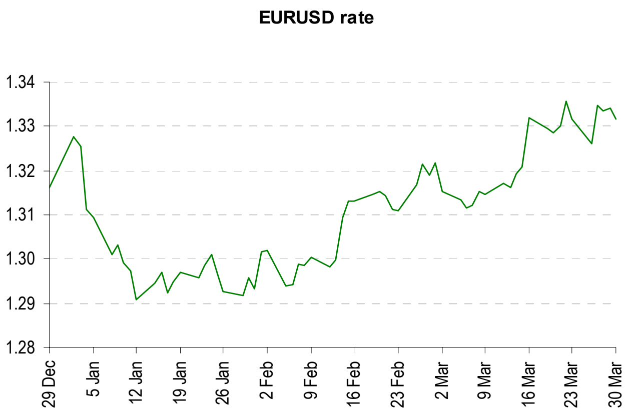
Rating upgrade supports the zloty

- In the first part of the last week zloty was quite stable. Later it slightly depreciated along the weakening other currencies in the region. However after S&P agency upgraded Polish rating there was significant strengthening in the Polish FX market. Since the last Friday the EURPLN rate fell by ca. 0.3% similar to the USDPLN rate move.
- Change of rating by S&P followed a series of positive news regarding the Polish economy and was a result of very good fundamentals. This should still support the zloty and limit the influence of negative factors from abroad. We maintain our view for the EURUSD rate to fluctuate in range of 3.82-3.92 (3.85-support, 3,89-resistance), and the USDPLN rate in range of 2.87-2.97.



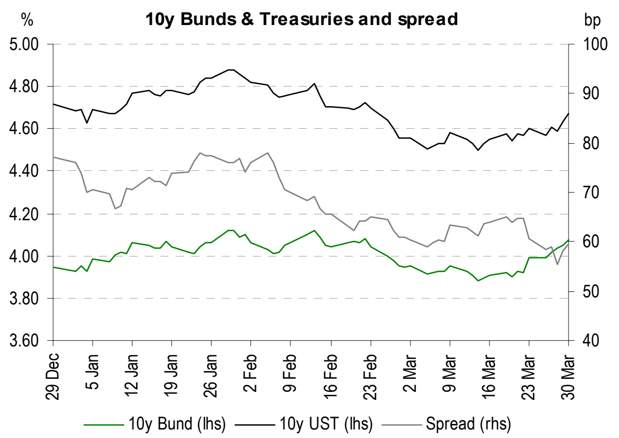
Bonds weaken across the yield curve

- Bonds weakened during the week across the curve. Bonds prices fell at the short end of the curve ahead of MPC's decision and statement. The latter appeared to be much more hawkish than in February. The longer end of the yield curve followed the weakening in the core markets. The positive effect of S&P rating upgrade was temporary.
- After the release of hawkish statement by the MPC, in our view rates will rise within next two months by 25 bp. Further tightening may follow in a few months and near the turn of this year depending on persistence of fast economic growth and relation between labour productivity and wages growth. Next week 2Y auction and core bond market behaviour amid plenty of data releases are going to be most important for Polish debt market.



EURUSD rate almost unchanged

- In the past week after weaker data from the US housing market and durable goods orders and high Ifo index the EURUSD rate rose to 1.34. However after Ben Bernanke's comments, who emphasised concern over inflation and after upward revision of US Q4 GDP the dollar recovered against the single currency, and the EURUSD fell to 1.33.
- In the coming week PMI index (should confirm good situation in the euro zone) and ISM (especially in the context of high Chicago PMI) as well as non-farm payrolls are going to be crucial for the EURUSD relation. On Friday, despite the data publications, the activity during the session should be moderate due to a market holiday in many international markets and shorter session in the US.



Continuation of weakening in the core markets

- Weaker-than-expected data on new home sales and worse than forecasted figure of durable goods orders slightly strengthened the US bonds market. High Ifo index had negative impact on the European market, which also affected US bonds. Comments of Fed's president on inflation and GDP data lowered expectations on faster rate cuts in the US. Yields of 10Y Treasuries rose from 4.6% to 4.65%, and of Bunds from 3.99% to 4.05%.
- ISM and PMI indices will be the key for bond markets this week. It is still important whether slowdown in manufacturing sector affects the services sector (it seems this influence should be moderate). Data from the labour market may be better than in the previous month (ADP and non-farm payrolls), though at the end of the week activity should be limited before Easter.

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