

# Weekly economic update

9 - 15 April 2007

We would like to wish all our readers Happy Easter!

Last week, as usual at the beginning of the month, there were no macroeconomic data releases in Poland. The only important event was the press conference of the Prime Minister and finance minister, during which they presented the idea of the so-called public finance reform. However, it did not affect the Polish financial market. First of all, this was only another announcement of the plan, which was not much different from previous projects and one should wait with a positive assessment until the plan is realised. Secondly, no details about the planned scale of fiscal savings (PLN10bn within two years 2008-09) were presented and still the figure was not exceptionally high given other plans of the government in terms of increasing spending and lowering revenues. Nevertheless, in pre-Easter mood the Polish currency performed very well with a clear zloty appreciation. While the EURPLN rate did not break the lower end of the fluctuation band we outlined (3.82), we think it is possible in the later part of the month. On the other hand we remain rather negative as regards the bond market. Although yields of Polish bonds has recently risen quite significantly, especially at the lower-end of the curve, this trend may be continued amid expectations for CPI inflation rise (data for March on Friday) and the next MPC meeting. Recent comments of MPC members leave no doubt that a possibility of a rate hike will be seriously considered in the near future.

Another rate hike is bringing closer also in the euro zone. Therefore, the main news event in the international markets should be Thursday's ECB meeting and press conference. Policy is expected to be left on hold at 3.75% but the tone of the press conference should indicate that the ECB still has more to do, which would not support bond markets. The highlight in the US should be Wednesday's minutes from the March FOMC meeting.

## Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
<b>EASTER MONDAY</b>							
Market holiday on many international markets (excl. US and Japan)							
<b>TUESDAY (10 April)</b>							
6:00	JP	BOJ meeting – report after decision					
<b>WEDNESDAY (11 April)</b>							
9:00	POL	Auction of PLN1.8bn of 10Y DS1017					
18:00	USA	FOMC minutes					
<b>THURSDAY (12 April)</b>							
9:00	EMU	GDP	Q4	3.3	-	2.7	
11:45	EMU	ECB meeting – decision		3.75	-	3.75	
12:30	USA	Foreign trade prices (import)	Mar	0.9	-	0.2	
<b>FRIDAY (13 April)</b>							
12:00	POL	CPI	Mar	%YoY	2.4	2.4	1.9
12:00	POL	Current account	Feb	€ m	-873	-956	-678
12:00	POL	Trade balance	Feb	€ m	-475	-736	-387
12:00	POL	Money supply	Mar	%YoY	18.1	18.5	17.9
12:30	USA	Trade balance	Feb	\$ bn	-60.0	-	-59.12
12:30	USA	PPI	Mar	%MoM	0.7	-	1.3
14:00	USA	Preliminary Michigan	Apr		87.5	-	88.4

Source: Reuters, BZ WBK

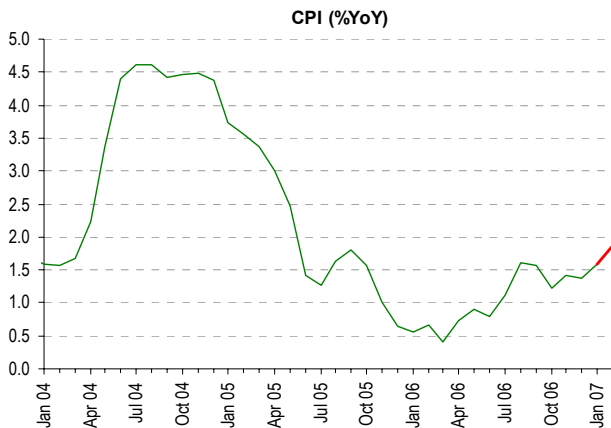
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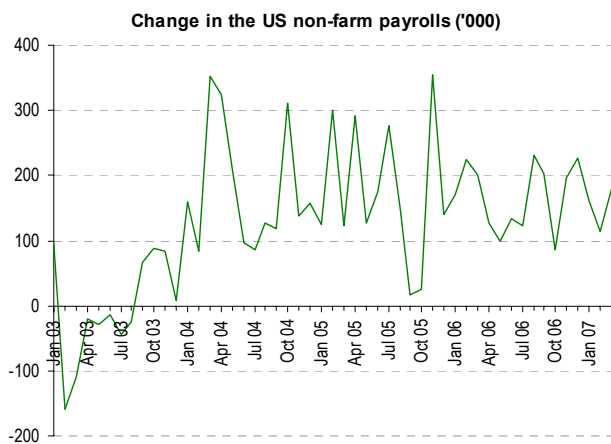
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**What's hot this week – Focus on CPI for March**

- The key event for the domestic market this week will be CPI data release on Friday.
- An estimate published by the Ministry of Finance last week indicate that inflation rose to 2.4%YoY in March from 1.9%YoY in February.
- Assuming that food prices rose on a scale predicted by the ministry, i.e. 0.7%MoM, our forecast also points to 2.4%YoY increase in consumer prices in March.
- Such clear increase in inflation in March, even though it is partly related to exogenous factors (apart from food prices, inflation in March was driven by fast rise in fuel prices), would probably be perceived by the market as an argument for rate hike in April. However, paradoxically, the MPC may want to avoid an impression that it hikes rates under influence of increase in current inflation.



- On Friday we will also get balance of payments for February and monetary statistics for March.
- Although the number will be overshadowed by CPI figures, in face of clear weakening of exports growth as compared to imports growth in recent months, balance of payments statistics may be important for the zloty.
- We predict that exports growth in February remained much lower than imports growth, but the cumulated current account deficit for last 12 months remained 2.5% of GDP. This is still quite low level, but we expect C/A deficit to widen this year along with strong expansion of domestic demand.
- Monetary statistics for March should confirm earlier observed tendencies, i.e. gradual acceleration in growth of money supply, deposits and loans. This would be another indication of strong economic expansion in Poland at the beginning of this year.

**Economy last week – No domestic data, mixed signals from abroad**

- Last week, there were no domestic data releases. A plan of changes in public finance presented by finance minister Zyta Gilowska did not affect the market. The planned measures are positive and desirable from the point of view of public finance transparency, but they do not bring necessary savings and do not change structure of budget spending. Thus, Poland's public finance remain significantly vulnerable to a possible economic slowdown in some time.
- Amid lack of important domestic events, market participants focused on information from abroad. A positive news was a release of British soldiers seized earlier by Iran. Most of US economic data were below expectations, but labour market data, which were released at the very end of the week, were much above consensus (non-farm payrolls at 180 thousands and unemployment rate down to 4.4%), improving perception of the condition of the US economy.

**Quote of the week – When the MPC will buy insurance against inflation rise?**

**Jan Czekaj, MPC member; Gazeta Prawna, 2 April**

*Time to a rate hike should be counted in months, and not quarters. However, I do not know whether this will happen already in a month or in five months. (...) Today it is hard to talk about a scale [of monetary tightening]. We will watch development of the situation and make adequate decisions.*

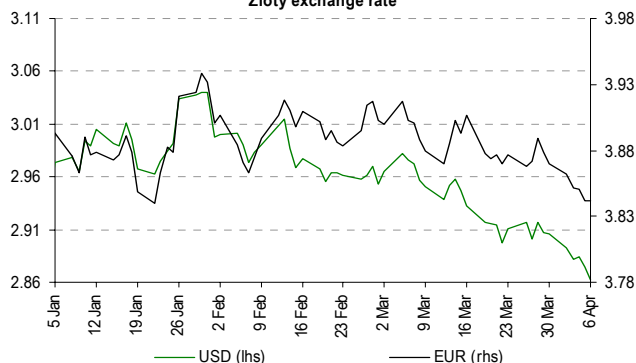
**Andrzej Sławiński, MPC member; PAP, 3 April**

*The incoming data confirm that the situation is still favourable, as high economic growth is accompanied by low inflation, but the data do not leave doubts that actual GDP growth exceeds potential growth. In such situation central banks buy insurance against a risk of inflation increase, through tightening monetary policy.*

Latest comments of moderate MPC members confirmed conclusions drawn from the official MPC statement after its meeting in March. We will most likely see rate hike in the near term aimed at counteracting future inflationary pressure related to robust expansion of domestic demand and tightening labour market conditions. In April, the new NBP's inflation projection will be important piece of information, though for the MPC projection of GDP growth may be equally important if one notices the importance of this factor emphasised in their recent interviews. On the other hand, data on GDP growth (and LFS statistics) for 1Q07 will be available only in May.

## Market monitor

Zloty exchange rate

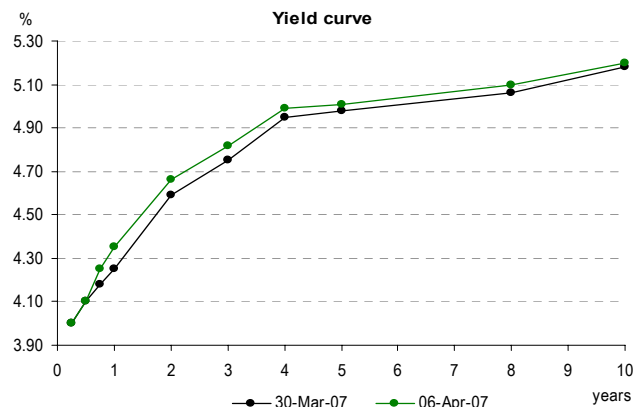


## Zloty stronger and stronger

■ In the last days zloty was appreciating against the major currencies with regards to positive moods in the Polish financial markets after Poland's rating upgrade by S&P's agency in the previous week. Since last Friday the EURPLN rate fell by 0.9% and broke important technical support levels, while the USDPLN rate declined by 1.1%.

■ We assume that positive sentiment toward the domestic currency should hold for some time. Although after quite significant firming, a correction may follow with regards to e.g. rising risk aversion, we decided to lower again the expected trading range for EURPLN rate down to 3.8-3.9 (3.85 - resistance, 3.87 - second resistance), and for the USDPLN rate to 2.82-2.92.

Yield curve

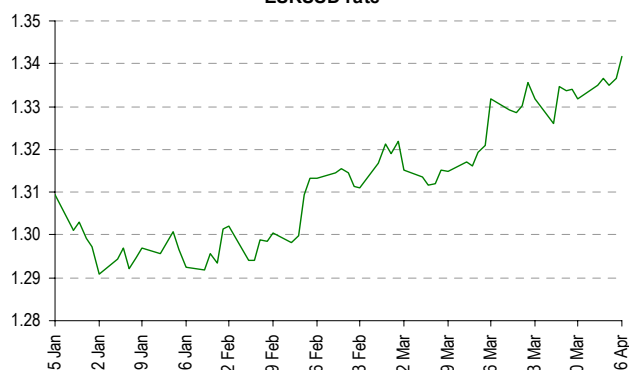


## Further curve flattening

■ After rating upgrade by S&P's in the previous week, further hawkish comments of Monetary Policy Council's members and high inflation forecast of the Ministry of Finance that was released at the start of the week, yield curve has flattened during the week.

■ After recent central bankers' comments we presume that interest rates may be raised already in April. At the bond auction the Ministry of Finance is going to offer more 10Y bonds than 2Y bonds at the last tender. The market will focus on the Friday CPI inflation data and if the finance ministry's forecast confirms further bonds weakening is probable. Situation in the core markets amid rather hawkish comments at the conference after ECB meeting may be also important.

EURUSD rate

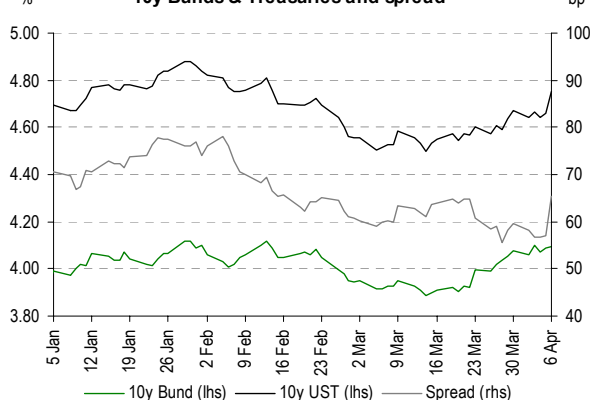


## EURUSD rate above 1.34

■ In the past week US currency significantly weakened. The dollar fluctuated against the euro near 1.336. Weaker than expected data from US economy (ISM indices, ADP report) as well as temporary rise of tensions with Iran had some negative effect on the dollar. The EURUSD rate jumped at the end of the week above 1.34, though after very strong payrolls dipped back to 1.339

■ The start of this week should be relatively calm in many markets with regards to market holiday and few data releases. FOMC minutes will be essential for the dollar as well as the PPI index and trade balance data. The statement of the European Central Bank after the meeting may be crucial for the euro. It may be rather hawkish amid expectations of good prospects of economic situation in the euro zone.

10y Bunds &amp; Treasuries and spread



## Slight weakening in the core markets

■ In the core bond markets there was further slight weakening among others due to quite good data from the euro zone (PMI indices), hawkish comments of ECB's central bankers as well as very strong non-farm payrolls. Initially prices of US bonds fell slightly less with regards to weaker than expected US economic figures released during the week. Yield of 10Y Treasuries and Bunds rose from 4.65% to 4.74%, and from 4.05% to 4.09% respectively.

■ This week ECB's communiqué is going to be crucial for the euro zone bond markets. If it is hawkish the expectations for next rate hikes may increase. In our opinion rates in the euro zone may rise in June by 25 bp. In the US FOMC minutes are going to be the most important for the US market. Investors will focus also on producer prices inflation especially in the context of concern that inflation will stay above the level accepted by Fed.

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