

# Weekly economic update

7 – 13 May 2007

In the first week of May the activity on Polish financial market was very little because of holiday period and lack of important events in the agenda. While most of investors and domestic market players were on the leave, enjoying the long weekend, those who stayed at work were in quite optimistic moods, which was reflected in significant zloty strengthening and gains on the stock exchange. It was largely possible thanks to a set of positive data from the US economy that weakened fears about possible recession and at the same time reduced global risk aversion. Even weaker than forecasted Friday's data about non-farm payrolls were unable to spoil optimistic sentiment at the end of the week. However, one cannot rule out that their effect will appear only at the beginning of the new week, after liquidity and investors return to the market.

Monetary policy is in the limelight this week with the three major central banks due to meet. The Federal Reserve kicks off proceedings with its US rate announcement on Wednesday evening. Monetary policy is widely expected to be left on hold at 5.25%, leaving the focus on the FOMC's statement. Given recent suggestions that inflationary pressures are easing, there may be some softening in tone. Any such change in their view is likely to be negative for the dollar, which remains on the back foot versus other majors, despite last week's better performance. Like the Fed, the ECB is expected to leave eurozone interest rates on hold when it meets on Thursday. However, markets will be looking to the press conference for confirmation of a June rate hike (use of the word "vigilance" should do it) and any suggestion of further tightening beyond that. Given the strength evident in recent activity and monetary aggregates data, as well as the further improvement in the labour market, a hawkish tone is likely to prevail. Following March's inflation surprise, which required Mervin King to write a letter of explanation to the Chancellor, an interest rate hike from the Bank of England on Thursday seems like a done deal. We expect a rise of 0.25 bp.

## Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE
				MARKET	BZWBK	
<b>MONDAY (7 May)</b>						
	GB	Market holiday				
9:00	POL	Auction of PLN900m 52-week Treasury Bills				
<b>TUESDAY (8 May)</b>						
14:00	US	Wholesale inventories	Mar	%	0.3	- 0.5
<b>WEDNESDAY (9 May)</b>						
9:00	POL	Auction of PLN2-3bn 10Y floating rate WZ0118 and PLN0-0.5bn 12Y CPI linked bonds IZ0816				
18:15	US	Fed meeting – decision		%	5.25	- 5.25
<b>THURSDAY (10 May)</b>						
11:00	GB	BoE meeting – decision		%	5.5	- 5.25
11:45	EMU	ECB meeting – decision		%	3.75	- 3.75
12:30	US	Import prices	Apr	%	1.0	- 1.7
12:30	US	Trade balance	Mar	\$ bn	-59.9	- 58.44
12:30	US	New jobless claims		'000		- 305.0
18:00	US	Fed budget	Mar	\$ bn	130.0	- 118.84
<b>FRIDAY (11 May)</b>						
12:30	US	PPI	Apr	%MoM	0.6	- 1.0
12:30	US	Retail sales	Apr	%MoM	0.4	- 0.7

Source: Reuters, BZ WBK

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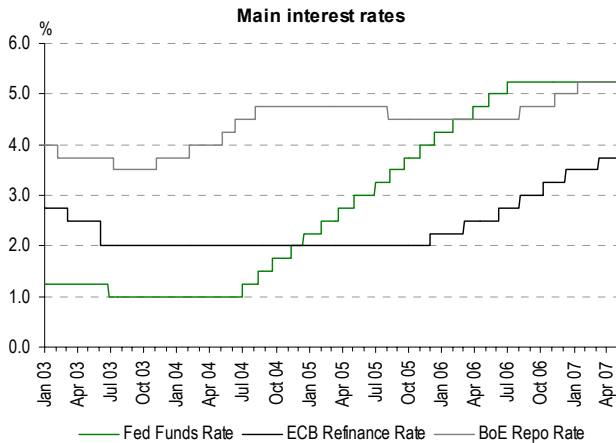
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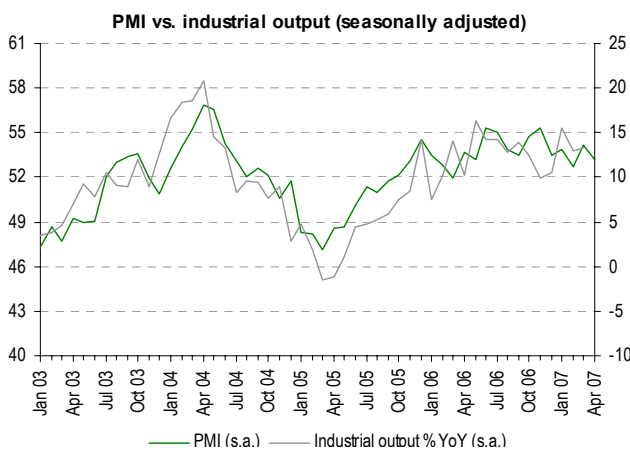
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## What's hot this week – Major central banks in focus of attention

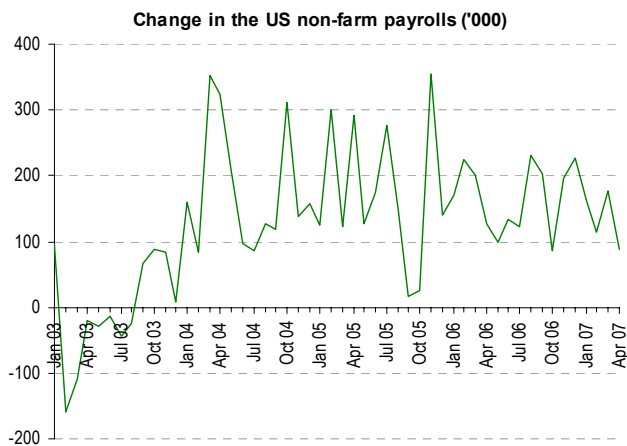


- The second week of May, likewise the first one, will pass under the sign of information from foreign markets, amid lack of important events scheduled in the local market.
- Meetings of central banks in the US, UK, and the euro zone will be in focus of attention. While the Bank of England may hike the main repo rate by 25 bp to 5.5%, interest rates in the United States and euro zone should remain unchanged. As always, investors will be seeking hints regarding future decisions in the statements following central banks' meetings. Particularly important for the emerging markets will be signals from the American Fed.
- Possibly, first voices in the debate on 2008 budget may appear as the Ministry of Finance is supposed to show tentative assumptions to the new budget draft regarding GDP and inflation by 10 May. This may be occasion for minor coalition parties to demand more social spending.

## Economy last week – Optimistic moods at the start of May



- May holiday period passed in optimistic moods on Polish financial market, largely thanks to positive macroeconomic data from the US that eased fears about severe economic slowdown, at the same time reducing global investors' risk aversion.
- The only economic data that appeared in Poland during the week concerned PMI manufacturing index that increased to 57 in April, confirming continuation of very good business climate. The data had no impact on the financial market.
- The NBP released quarterly survey about situation on credit market. The report showed continuation of strong rise in demand for loans from enterprises in the first quarter, as well as slight decrease in households' demand for mortgages and consumer loans.



- Much more important information for the market appeared abroad, especially in the United States.
- The macroeconomic data released in the US were mixed. On one hand, ISM activity indices in manufacturing and in services were significantly higher than forecasted.
- On the other hand, ADP labour market report and Friday's key non-farm payrolls report were weaker than predicted, which offset positive message sent by ISM figures.
- In such situation, the market will pay special attention to Fed's suggestions regarding perspectives of American economy and possible changes in monetary policy.

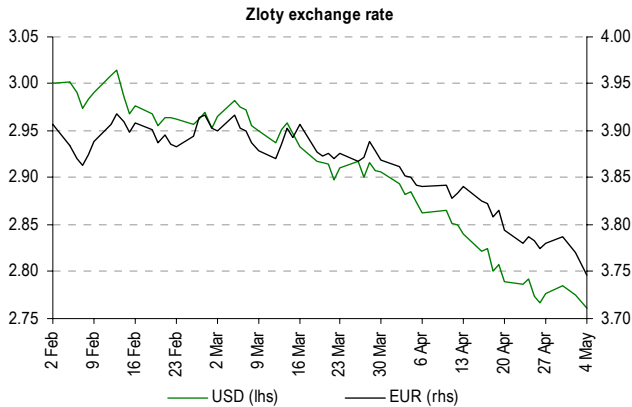
## Quote of the week – Inflation down in the nearest months

**Katarzyna Zajdel-Kurowska, deputy finance min.; PAP, 2 May**  
*Inflation forecast at 2.3%YoY and 0.5%MoM in April results mostly from supply-side factors. Situation from two previous months has been repeating: prices of food and fuels are on the rise. Food went up in prices by 0.8% in April, while fuels by over 6%. (...) Other elements of the basket were little changed.*

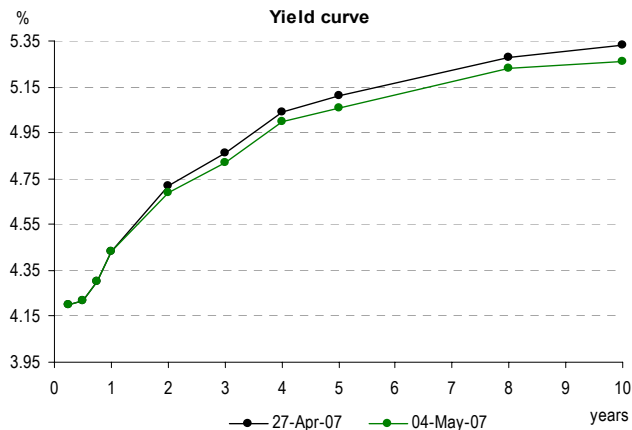
*This is already a month of inflation decline, we have lower growth than in March. This trend will be continued, to even below 2% in the summer holiday period. As regards the second half of the year, there is still high uncertainty concerning food prices in the summer. Our forecast for December is still at 2.5%YoY.*

Although the Ministry of Finance's estimates of inflation in April seem to be slightly higher than expected, mainly because of high prices of food and fuels, but forecasts for the next months are still optimistic and assume CPI below 2% in the summer months. In the second year-half another CPI rise is likely, although its scale will be largely dependent on the situation on food market, which is still very uncertain. On the one hand, forecasted crops of cereals should be very high, but on the other hand recent information suggests that fruit harvest could suffer from very cold nights at the start of May.

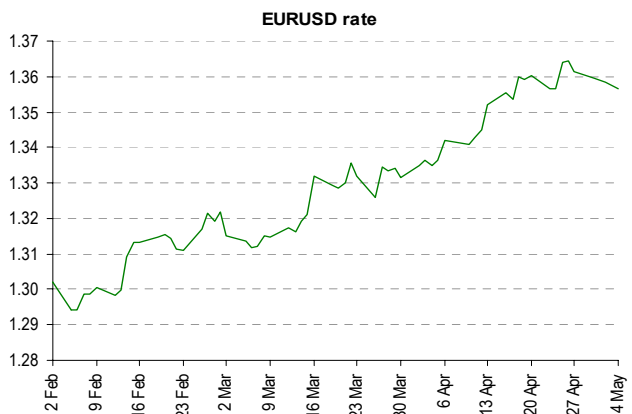
## Market monitor

**Zloty at the strongest levels in 5 years vs. the euro**

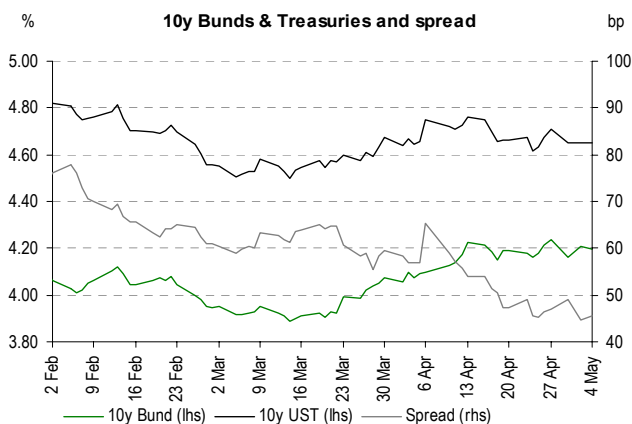
- The start of the week brought some zloty depreciation due to the weakening in the emerging markets on events in Turkey. However later that week zloty recovered losses and amid low liquidity and stabilisation of political situation in Turkey and appreciated to below 3.75 vs. euro and to 2.76 vs. the dollar. The EURPLN rate declined during the week by 0.7%, and USDPLN rate by 0.2%.
- Sentiment of investors toward the emerging markets remains very good, which helps the zloty. However the technical analysis suggests the zloty is rather overbought and a correction may be expected though it may need a strong negative impulse. In our view the zloty may trade in range of 3.72-3.82 against the euro and 2.72-2.82 vs. the dollar.

**Stable in the debt market**

- Amid week-long holiday period connected with May national holidays the activity in the debt market was limited. Bond yields were almost unchanged against levels from previous Friday, despite significant changes in the core markets, though at the end of the week there was some strengthening. Rates were not affected by the estimates of inflation of the Ministry of Finance, which might have been slightly above the market forecasts.
- Similar as in the past few days no important data for the domestic market were scheduled for this week. After domestic players return from holidays the market may react on changes that occurred in the core bonds markets in the last days. Situation in the core markets will be also essential with regards to ample data releases abroad. After some stabilisation the market rates may slightly fall.

**Dollar recovers after strong ISM indices**

- As we expected the EURUSD rate experienced a correction. After lower than expected core PCE index for March in US the dollar slightly depreciated again. However after much better than expected ISM indices for the US manufacturing and services sectors the US currency significantly appreciated. Non-farm payrolls resulted in dollar's weakening to 1.358.
- The recently released data were a bit more optimistic and they support the dollar's stabilisation. Such situation may be continued. This week Fed's and ECB's (may strengthen market view for interest rate hike in June) communiqués are going to be the most important as well as data on US retail sales and producer prices.

**Slightly stronger in the core markets**

- After weaker than expected PCE index there was a substantial strengthening in the core debt markets. However better than expected ISM indices contributed to sell-off in the US market, which negatively affected also the German market. On Friday prices rose after weaker data from the US labour market. In the result yields of 10Y Bunds and Treasuries slightly declined against the previous week (4.23% and 4.70%) to 4.19% and 4.64% respectively.
- Fed is going to leave interest rates unchanged this month, similar as the ECB. The statements to be released after the meetings are going to be more essential. The picture of US economy may be influenced by the retail sales figure, while the PPI index is going to be important with regards to inflation concerns. Expected interest rate hike by the Bank of England may have slightly negative effect on European markets.

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