Bank Zachodni WBK

Weekly economic update

21 – 27 May 2007

We are in the middle of the cycle of publication of monthly economic data for Poland. The last week's statistics did not change the picture of the Polish economy and its prospects – inflation is still relatively low, situation in the labour market quite difficult yet not getting out of control, balance of payments results showing rising current account and trade deficits, but still at low level with both exports and imports rising strongly. Next week the data will confirm that the demand-side pressure on prices remains rather limited and the economy started the second quarter with a momentum not observed in the first quarter. The next two months (May and June) are likely to show some slowdown, but still GDP growth will remain above 6% (close to 7%), which will remain a kind of puzzle for the MPC. In our opinion, as for now data are an indication for the MPC that despite strong economic expansion, inflation processes are still under control. That's why we think that the April's statistics will confirm the view of majority within the MPC that swift tightening of monetary policy is not necessary. We maintain our view that rate hikes will be continued, but we think that the Council will make a pause and next move will take place only in 3Q07.

On global markets, apart from the economic data publications, which may influence expectations as regards next moves in monetary policy by the ECB and Fed, changing at the same risk appetite on financial markets, we will see other important events. This will be G8 meeting and talks between the U.S. and China, which may endd with some comments as regards situation on foreign exchange markets.

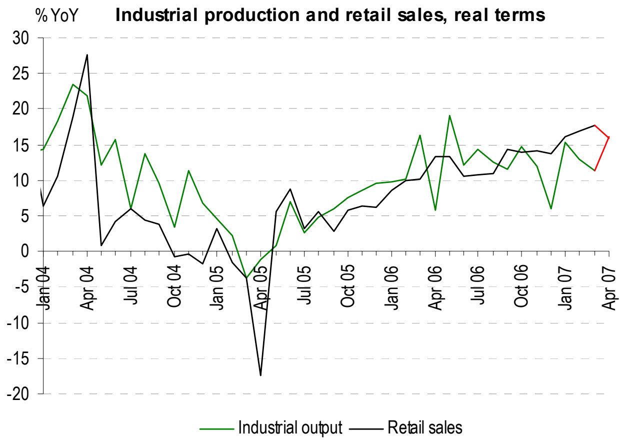
Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (21 May)					
12:00	**POL**	**Industrial output**	**Apr**	**%YoY**	**15.3**	**16.1**	**11.3**
12:00	**POL**	**PPI**	**Apr**	**%YoY**	**2.4**	**2.5**	**3.3**
12:30	USA	Chicago Fed index	Apr	-	-	-	0.01
		TUESDAY (22 May)					
9:00	GER	ZEW	May	-	23.0	-	16.5
9:00	EMU	Trade balance	Mar	€ bn	-	-	-1.7
		WEDNSESDAY (23 May)					
12:00	**POL**	**Core inflation**	**Apr**	**%YoY**	**1.4**	**1.4**	**1.7**
12:00	**POL**	**Business climate**	**May**				
		THURSDAY (24 May)					
12:00	**POL**	**MPC minutes**	**Apr**	**-**	**-**	**-**	**-**
8:00	GER	Ifo index	May	-	108.8	-	108.6
12:30	USA	Durable goods orders	**Apr**	%	1.0	-	3.7
14:00	USA	New home sales	**Apr**	m	0.87	-	0.858
		FRIDAY (25 May)					
12:00	**POL**	**Retail sales**	**Apr**	**%YoY**	**20.0**	**16.4**	**19.2**
12:00	**POL**	**Unemployment rate**	**Apr**	**%**	**13,9**	**13.7**	**14.4**
14:00	USA	Existing home sales	Apr	m	6.1	-	6.12

Source: Reuters, BZ WBK

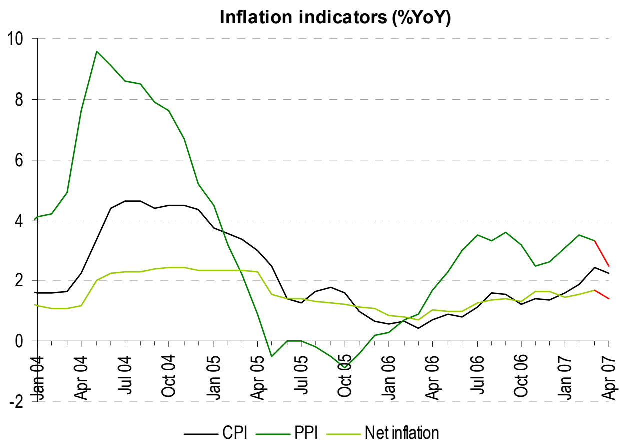
Maciej Reluga Chief economist (+48 22) 586 8363
Piotr Bielski (+48 22) 586 8333
Piotr Bujak (+48 22) 586 8341
Cezary Chrapek (+48 22) 586 8342
e-mail: ekonomia@bzwbk.pl

What's hot this week – Another data did not change picture of the economy

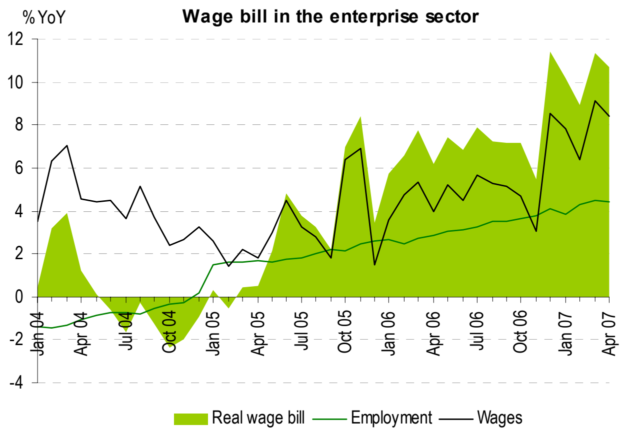


- Next week we will see next portion of macroeconomic data releases, which will again show the continuation of economic expansion. We expect that annual rate of growth for both industrial production and retail sales was faster in April as compared to the results for Q1. However, the next two months are likely to show some slowdown.
- Nevertheless, GDP rate of growth in the second quarter will probably remain above the potential growth rate, which will make the central bank vigilant. Data on inflation for April will not show strong pressure on price growth – we expect net inflation and PPI inflation to decrease - which may the a neutralising signal for the Council.
- On international markets the market will focus on data on economic activity in Germany, as well as information from the American housing market.

Economy last week – CPI with no surprises, favourable labour market



- In line with expectations CPI inflation amounted to 0.5%MoM or 2.3%YoY in April. What is important, the factors responsible for keeping consumer inflation indicator close to the central bank target of 2.5% were food and fuel prices. The prices in these categories increased by 0.9%MoM and 4.6YoY for the former and by 3.8%MoM and 2.6%YoY in case of fuels. Prices of the remaining goods and services were quite stable.
- Strong economic expansion with high consumption demand in crease the risk of price pressure to mount. We forecast, however, this will be a gradual process and net inflation will reach maximum of 2.0% until the end of the year. We assume also that food prices are going to rise in May at similar scale as in April (among others due to damages in the fruit-growing), though the annual CPI should slightly fall in May. In June it should rise again to close to around 2.5%.



- Average wage in the corporate sector grew 8.4%YoY in April against market consensus at 8.8%YoY and our prediction at 7.9%YoY. As compared to March when average wage jumped 9.1%YoY, April saw some deceleration but underlying wage growth remains high and indicates there is some wage pressure in the economy.
- Average employment in the corporate sector increased 4.4%YoY in April, exactly matching our forecast while market consensus pointed to an acceleration in wage growth to 4.6%YoY from a record strong 4.5% rise posted in March. All in all, wage bill in enterprises in April increased 13.2%YoY in nominal terms and 10.6%YoY in real terms. Such strong growth of households' income will support private consumption growth in 2Q07 and subsequent quarters. This will be also the key factor for the MPC in making future decisions as regards interest rates.

Quote of the week – There is time to think this over

Andrzej Wojtyna, MPC member; Reuters, 17 May

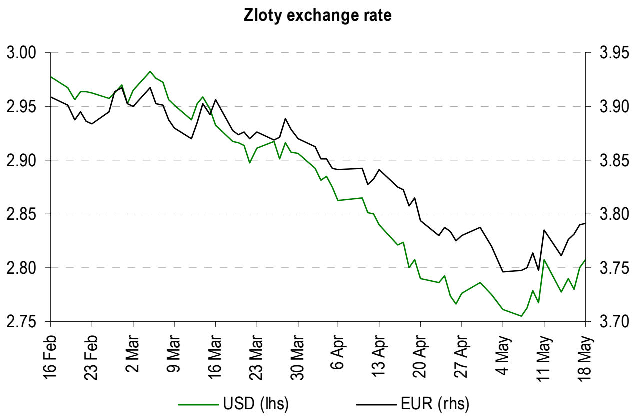
The balance of risks shows that further monetary policy tightening could take place. (…)One cannot easily say that the Council can now afford a pause, a two to three months-long breather. It is difficult to talk about comfort at such high economic growth, which is surely exceeding the potential growth rate level. Even if almost double-digit wage growth recorded in March maintained next month, this would not yet pose a significant threat.

Jan Czekaj, MPC member; PAP 18 May

Rate hike in April was the pre-emptive reaction and I think this will be sufficient for the next couple of months.

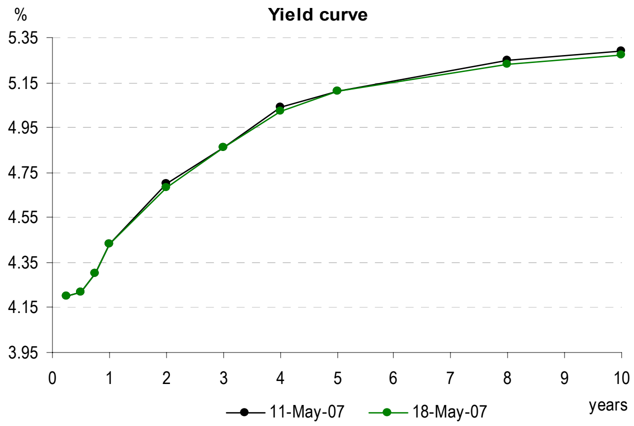
Comments by MPC members suggest that as for now wage growth acceleration is not perceived as extremely dangerous for inflation outlook. Andrzej Wojtyna emphasised the informal restrictive bias is still binding and there is no comfort in monetary policy conducting amid strong economic growth. On the other hand, Jan Czekaj suggested the MPC has at least a couple of months of time for further analyses. What is interesting, the two members voted most likely in favour of rate hike in April and their interviews were quite different in overtone.

Market monitor



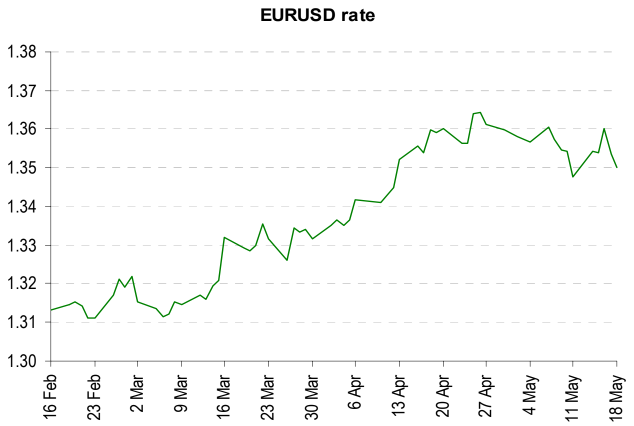
Zloty under pressure

- Last week we had predicted a deepening of correction on the FX market and indeed the better part of the week passed under the sign of weaker zloty, that reached even 3.80 against euro for a moment. It was caused among others by dollar appreciation that dragged down currencies in the region. Domestic economic data had no significant impact on the market.
- This week output and sales data should support the zloty, confirming excellent shape of the economy at the start of Q2. But foreign events could be crucial again, including G8 meeting and talks between the USA and China on trade policies. They could spur yen appreciation being negative for the zloty. We increase band of zloty fluctuations to 3.75-3.85 against euro and 2.75-2.85 against dollar.



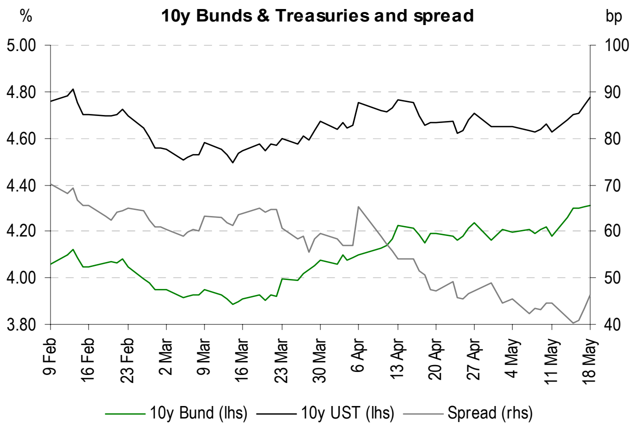
Stabilisation on the debt market

- Polish debt market remained stable throughout the week. Yields did not show significant reaction to local data about CPI inflation that was in line with forecasts nor to wages and employment that increased less than predicted. On the other hand, significant weakening of Treasuries took place that could have offset influence of data from Polish labour market.
- Production and sales data are expected to be strong but should not affect market expectations regarding future MPC decisions. On the other hand, next set of positive data together with high yields abroad could eventually weaken bond market, especially if yen appreciates in reaction to events abroad, leading to an increase in global risk aversion.



Faltering moods on euro-dollar market

- After clear dollar strengthening against euro in the previous few weeks, last week initially saw a correction, yet later on the dollar regained again in reaction to economic data that weakened expectations for soon rate hikes in the U.S. At the end of the week, EURUSD fell to ca. 1.348.
- This week, apart from next important data from the US (e.g. from housing market) and the euro zone (ZEW, Ifo), world FX markets could be also affected by the results of G8 meeting and next round of talks between the U.S. and China on trade policies. Both events, and especially a risk of undertaking some protectionist measures against China by the U.S., create a risk of dollar weakening, particularly with regards to yen.



Bonds weaker amid smaller chances for Fed's cuts

- Yields of treasury bonds on core debt markets were gradually increasing throughout the week, which was affected e.g. by publications of macroeconomic data in the U.S. that showed better than expected situation on the labour market and revival in economic activity, suggesting that Fed does not have to hurry up with rate cuts.
- In the nearest days, international debt markets will focus on the next set of economic activity indicators. German ZEW and Ifo indices are likely to confirm continuation of booming business confidence, validating expectations for rate hikes in June. Bigger uncertainty concerns U.S. housing market data that will affect expectations regarding future Fed decisions.

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