

Weekly economic update

2 July – 8 July 2007

Contrary to expectations of most market analysts, the MPC raised main interest rates by 25 bp at its meeting in June. The decision was to some extent anticipated by the financial market, but the market rates increased due to expectations that scale of monetary tightening in the whole cycle will be larger than earlier predicted. FRA rates currently take into account to some extent a chance for another rate hike in July. Unfortunately, the MPC statement failed to deliver clear hints on timing of next moves, but the fact that the Council decided to act faster than expected resulted in a change of our forecasts. Now we predict that the reference rate could reach 5% at the end of this year (with next rate hike in August and another one in Q4), and 5.5% at the end of 2008. As regards MPC decisions in the near term, the key factors will be developments on the labour market, the scale of domestic demand growth (including degree to which fiscal policy is expansionary) and performance of the zloty exchange rate. As regards the latter, the larger scale of expected monetary tightening in Poland is positive for the local currency. Therefore, we revise our FX forecasts and predict that the EURPLN rate will fall below 3.70 at the end of this year. This in turn should constrain a need for more aggressive rate hikes.

This week, financial market's attention will be focused on information abroad. The first half of the week may be rather dull due to less important data releases and US Independence Day on Wednesday. The most important for investors will be US non-farm payroll numbers to be released on Friday and the result of the ECB meeting plus its statement on Thursday. The most significant information in Poland will be announcement of the Ministry of Finance's inflation forecast for June, which will be as usual a valuable hint for the market. In case it differs substantially from market predictions (median forecast is currently at 2.7%), it may have impact on the debt market and investors' expectations regarding the result of MPC meeting in July.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
MONDAY (2 July)							
8:00	EMU	Manufacturing PMI	Jun	pts	55.4	-	55.0
14:00	USA	Manufacturing ISM	Jun	pts	55.0	-	55.0
TUESDAY (3 July)							
9:00	EMU	PPI	May	%YoY	2.4	-	2.4
14:00	USA	Factory orders	May	%	-1.0	-	0.3
WEDNESDAY (4 July)							
9:00	POL	Auction of PLN0.5-1.5bn OK0709 2Y bonds					
	USA	Independence Day – market holiday					
8:00	EMU	Services PMI	Jun	pts	58.3	-	57.3
9:00	EMU	Retail sales	May	%YoY	1.6	-	1.6
THURSDAY (5 July)							
11:00	GB	BoE meeting		%	5.75	-	5.50
11:45	EMU	ECB meeting		%		-	4.0
12:15	USA	ADP report	Jun	'000	100	-	97
14:00	USA	Non-manufacturing ISM	Jun	pts	58	-	99.7
FRIDAY (6 July)							
12:30	USA	Non-farm payrolls	Jun	'000	118	-	157
12:30	USA	Unemployment rate	Jun	%	4.5	-	4.5

Source: Reuters, BZ WBK

Maciej Reluga Chief economist (+48 22) 586 8363

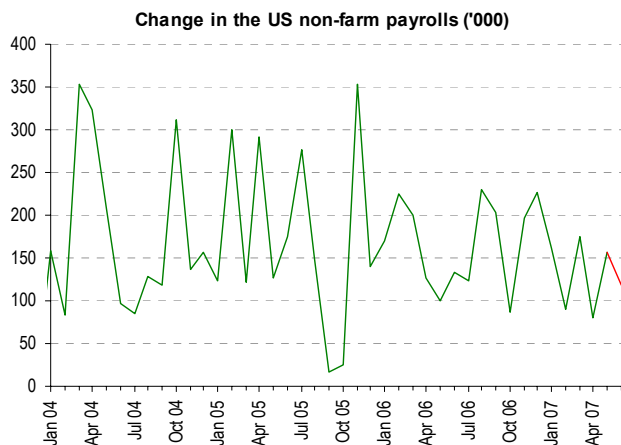
Piotr Bielski (+48 22) 586 8333

Piotr Bujak (+48 22) 586 8341

Cezary Chrapek (+48 22) 586 8342

e-mail: ekonomia@bzwbk.pl

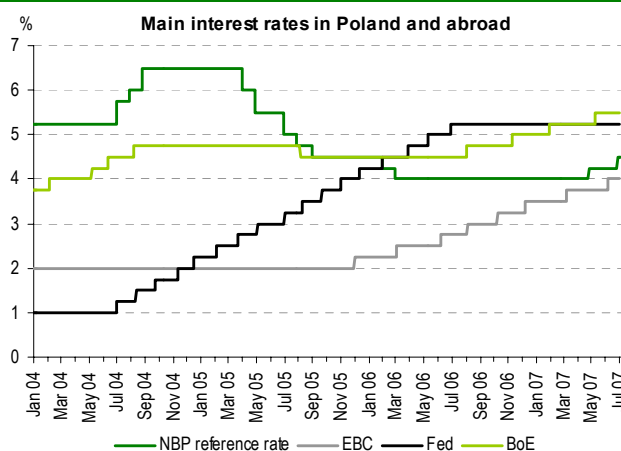
What's hot this week – Foreign data most important



- The economic calendar this week will be filled with data releases abroad. The end of the week will be crucial, with the European Central Bank's (expected to leave interest rate on hold) and Bank of England's (likely 25 bp rate hike) decisions on Thursday and June's US employment report on Friday.

- In the first part of the week, investors' attention will focus on activity indices in the euro zone and US (PMI and ISM).
- There will be no important data releases in Poland, but an important news for the market could be announcement of Ministry of Finance's CPI forecast for June. Usually, this information has strong influence on expectations of analysts and market players, which could be also important for market predictions regarding the Monetary Policy Council's decision in July.

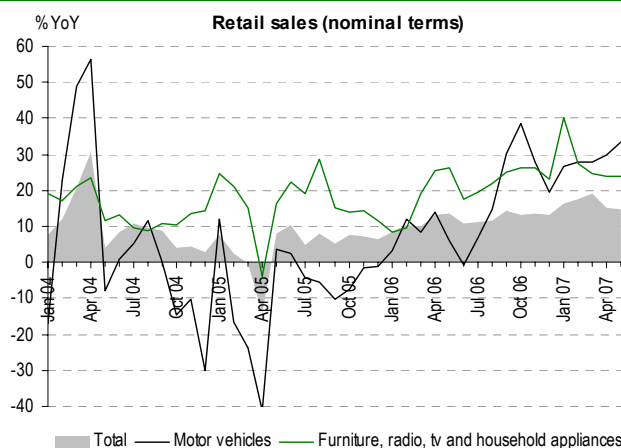
Economy last week – Faster monetary tightening



- The MPC raised main interest rates by 25 bp in June.
- The statement does not indicate clearly a future path of interest rates, however faster MPC's action than expected mad us revise our forecasts. The reference rate is likely to reach 5% at the end of this year (next hike in August, another in Q4), and could go up to 5.5% at the end of 2008.

- In the nearest months, the most important factors for the MPC will be, apart from trends on the labour market, a pace of domestic demand growth (including scale of fiscal policy expansion) as well as zloty exchange rate.

- US Fed left interest rates on hold as expected. In the statement, the bank underscored that its main concern is still that inflation rate may not decelerate, which confirmed expectations that interest rate cut in the US is not very likely in the near term.



- Retail sales increased 14.8%YoY in May, which was close to April's result (15.1%) and our prediction (15%). In real terms, retail sales grew 13.4% against 13.6% in April.

- Retail sales data confirmed our opinion that we had presented after output figures that there is an asymmetric downward risk to our forecast of GDP growth in the second quarter (6.5%).

- Registered unemployment rate declined to 13% in May, which was consistent with our forecast. It implies another month of unemployment falling at very fast pace 3.5 pct. points per annum.

- Quarterly data about balance of payments showed slightly higher current account deficit in Q1 than resulted from monthly data (2.5% of GDP instead of 2.4% of GDP).

Quote of the week – Hawk not so hawkish

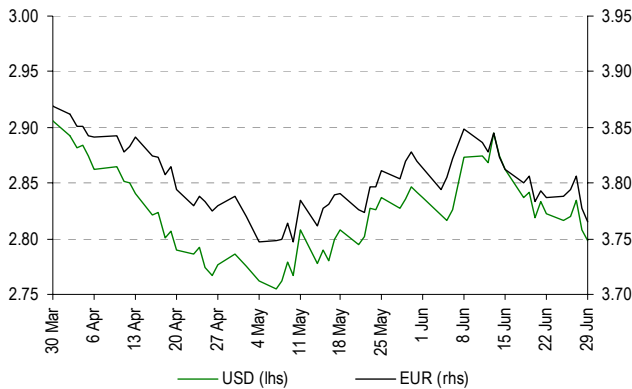
Halina Wasilewska-Trenkner, MPC member; Radio PiN, 28 June

If we do not face further unpleasant surprises, for example sudden rise in wages and at the same time drop in production, which was the case in May, i.e. if there is no deterioration in relations between production and salaries, if nothing worse happens to food prices than what we already know and anticipate, if world oil prices remain at predictable levels, if the zloty will continue performing as it was until now, then the rate hike (in June) was sufficient. But I tell you, this is possible, but it is not certain. I cannot tell right now whether we will have to use this arsenal (...). It cannot be ruled out.

Halina Wasilewska-Trenkner's comment was a big surprise. Its overtone was much less hawkish than the MPC statement and comments of other central bankers, considered to have more moderate views. This could have caused some confusion on the market. In our view, with such comment the MPC member perhaps wanted to calm down the market's emotions regarding pace of further rate hikes and reduce expectations that next hike could take place already in July. A scale and a timing of subsequent monetary tightening decisions will depend on the economic data to be released. Nevertheless, the fact that the Council started to act sooner than we expected makes us believe that a total scale of tightening could be higher than we had assumed before.

Market monitor

Zloty exchange rate

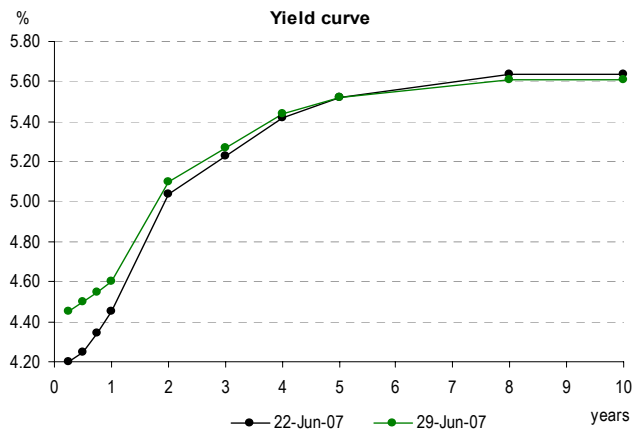


Zloty strengthens on the MPC

At the start of the week the zloty weakened against the major currencies, which was connected among others with appreciation of low yielding currencies (Yen and Swiss franc). However after interest rate hike by the MPC, which to some extent was surprising, there was significant appreciation of the domestic currency. The EURPLN rate broke important technical support level and declined to 3.76, while the USDPLN rate declined to 2.781.

After the MPC move we changed our zloty exchange rate forecasts. We do not expect significant weakening in the nearest time amid forecasted higher pace and scale of monetary policy tightening. We expect that after slight corrections the zloty should strengthen in the medium and long term. We lower the forecasted range for EURPLN rate to 3.72-3.82 and for USDPLN to 2.74-2.84.

Yield curve

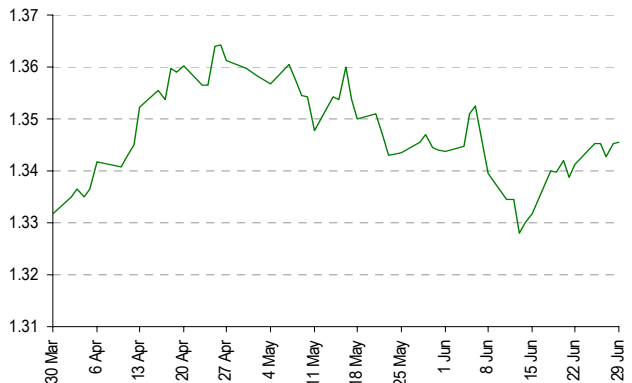


MPC weakens the interest rate market

Despite the fact analysts were surprised the market partly discounted the June's rate hike, as some central bankers comments to some extent prepared for this hike. However after the decision, the rising trend of rates in the money market and bond market was continued. After comments of Halina Wasilewska-Trenkner the bearish moods slightly cooled down, though the FRA rates still to large extent price in hike in July.

We change our baseline scenario presuming higher number of interest rate hikes. Next move may follow in August, another in Q4, while in 2008 the reference rate may rise to 5.50%. This week amid lack of data release in the domestic market and high number of the figures scheduled abroad bonds will be under influence of the core debt markets behaviour.

EURUSD rate

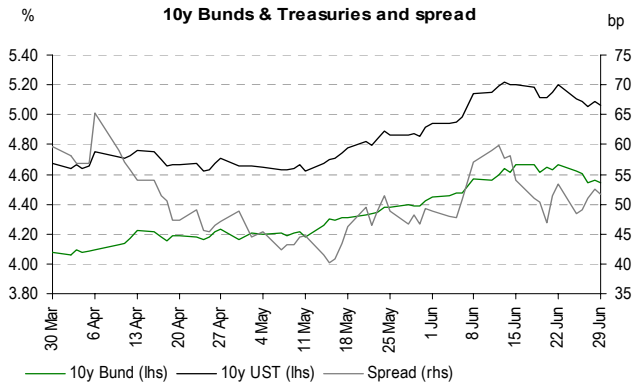


Dollar still strong

Despite higher number of releases abroad than in the previous week the EURUSD rate remained stable near 1.346. Final US Q1 GDP data were upwardly revised, though they were below expectations. The core PCE index exceeded forecasts. These data similar to US housing market data and Fed's communiqué did not affect the dollar. At the end of the week EURUSD rose above 1.35.

We expect the dollar to remain relatively stable against the single currency in the medium term and in a slightly longer term, till the year's end we forecast a dollar weakening. This week the figures from the labour market in the US will be crucial for the markets as well as the activity indices from the euro zone and the US. The decision and the communiqué of the ECB will be also important.

10y Bunds & Treasuries and spread



Slight recovery in the core debt markets

In reaction to slightly weaker US housing market data and news on problems of two US hedge funds investing in this market, the moods deteriorated on rising fears that the slowdown in this sector could negatively affect the whole US economy. The Fed's communiqué did not significantly affect the market. US Core PCE added to bond gains. Yields of 10Y Treasuries declined to 5.09% and Bunds to 4.55%.

This week the foreign investors will focus on the non-farm payrolls data in the United States. The ECB's and BoE's communiqués may signal the pace of further monetary policy tightening and are going to be important for euro zone bonds. Economic activity indices will be also essential and they may confirm good situation in the EMU and recovery in the US.

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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>



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