

Weekly economic update

23 – 29 July 2007

This week, we will learn another set of quite important economic data in Poland and abroad. However, the most significant event for the local market will be a decisive meeting of the Monetary Policy Council. This time, the MPC members will have at their disposal, apart from standard data set, the new *Inflation report* including, among others, current projections of inflation and GDP. New inflation path predicted in the report is likely to confirm a risk of CPI rise to the upper end of tolerance band around target at the end of 2008. However, the MPC decisions about rate hikes in April and June took this risk into account. One could suspect that a motion to raise rates again will be probably discussed at the nearest MPC meeting, however we believe it will not find enough support (as even one of the most hawkish MPC members suggested recently there was a greater “decisional freedom”), and the more likely timing of the decision is August. For the financial market it may be interesting to look at voting results over the motions that were rejected at the MPC meetings in March and May. They may hint a new light on the distribution of votes in the Council.

Among foreign data releases, the focus will be on the preliminary estimates of US GDP growth in Q2. They should confirm that after a significant slowdown in the first quarter, the American economy started returning on a path of robust growth, which may improve international investors’ sentiment towards emerging markets. Home sales data will be also important due to concerns that problems on the housing market may get stronger. In the European Union, the most important will be data about German Ifo index and euro zone’s money supply that may affect expectations regarding pace of rate hikes to be delivered by the ECB.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
MONDAY (23 July)							
	PL	Business climate	Jul				
12:00	PL	Net inflation	Jun	%YoY	1.7	1.8	1.6
TUESDAY (24 July)							
8:00	PL	Retail sales	Jun	%YoY	15.0	13.9	14.8
8:00	PL	Unemployment rate	Jun	%	12.5	12.4	13.0
	PL	MPC meeting					
WEDNESDAY (25 July)							
	PL	MPC meeting – decision		%	4.50	4.50	4.50
14:00	US	Home sales	Jun	m	5.92	-	5.99
THURSDAY (26 July)							
8:00	GER	Ifo index	Jul	pts	106.5	-	107.0
8:00	EMU	M3 money supply	Jun	%YoY	10.7	-	10.7
12:30	US	Durable goods orders	Jun	%	1.4	-	-2.4
14:00	US	New home sales	Jun	m	0.901	-	0.915
FRIDAY (27 July)							
12:30	US	Advance GDP	Q2	%	3.2	-	0.7
12:30	US	Advance core PCE	Q2	%	2.3	-	2.4
12:30	US	Advance GDP deflator	Q2	%	3.2	-	4.2
14:00	US	Final Michigan index	Jul	pts	86.0	-	85.3

Source: Parkiet daily, Reuters, BZ WBK

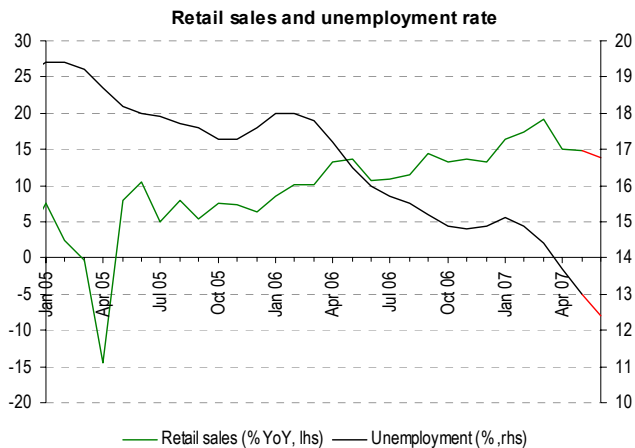
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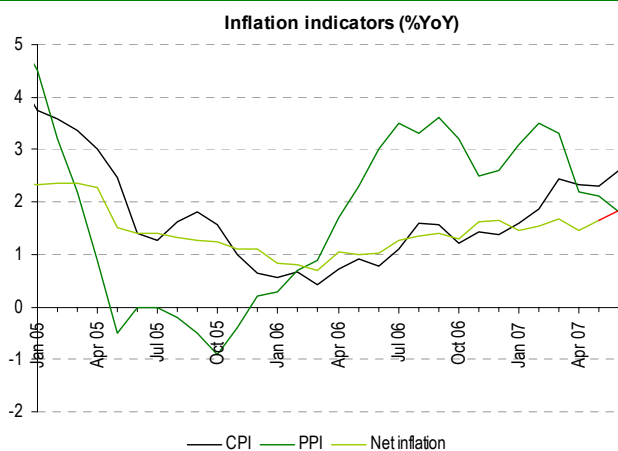
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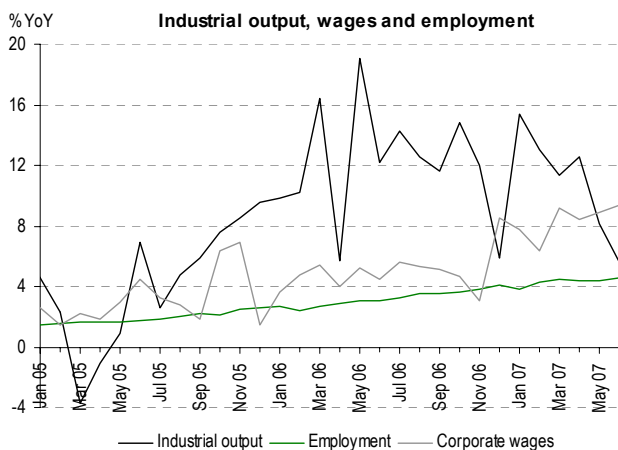
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What's hot this week – Lots of data, MPC decision and Inflation report

- First half of the week will be full of events and data releases in Poland, while in the second one information from foreign markets will dominate.
- Core inflation data will probably show slight increase (net inflation to 1.8%) although from low levels, showing that inflationary pressure is rising but very moderately.
- Retail sales growth may surprise on the upside taking into account June's strong labour market data, showing continuation in very fast consumption rise.
- Unemployment data should be optimistic as well, likely to decrease significantly in June amid continuation of strong demand for labour in enterprises.
- CSO business climate survey for July will be a hint regarding sentiment in Polish enterprises at the start of Q3.



- A key event on the local market will be the Monetary Policy Council's decision to be announced on Wednesday.
- Minutes of the previous MPC meeting released last week were not very helpful in predicting monetary policy perspectives. But majority of market players (including us) expect that after a hike made in June, the next change in rates will wait until August.
- At the nearest meeting, the MPC members will have the new Inflation report (it will be released in public on Thursday). The new inflation projection may be more pessimistic than the previous one, but one should keep in mind that the MPC does not fully agree with its results.
- As regards data abroad, the most important will be estimates of US GDP growth in Q2 and home sales data, as well as German Ifo index for July.

Economy last week – Set of mixed data for June

- Wages and employment growth rates in June were much above forecasts, accelerating to 9.3%YoY and 4.6%YoY correspondingly. In effect, wage bill rose 14.4%YoY in nominal terms and 11.5% in real terms.
- Industrial output growth decelerated to 5.6%YoY and in construction to 3.7%YoY (after seasonal correction, 8% and 9.9%YoY correspondingly). But in our opinion this was only a transitory slowdown rather than a change in trend.
- Thus, relation between wage growth and productivity gains that strongly deteriorated in June, should not be as bad in the subsequent months.
- PPI growth declined to 1.8%YoY in June from 2.3% in May mainly due to high base effect. Producer prices increased 0.6%MoM, which was triggered mostly by higher prices in tobacco industry and processing of fuels.

Quote of the week – Rate hikes coming, but not yet in July**Dariusz Filar, MPC member; PAP, 17 July**

I take into account that a set of data available in July may be argument in favour of continuation of monetary tightening, but making decision in June the Council had a choice to do it in June or in July. It made a decision in June, and so widened a margin of decisional freedom somehow.

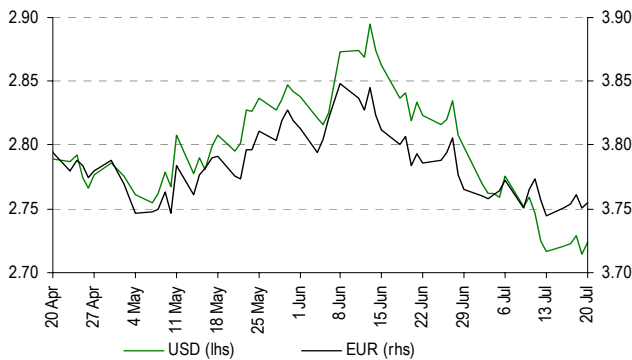
Stanisław Owskiak, MPC member; PAP, 17 July

As long as inflation does not reach 3% and wage growth does not exceed 10%, we do not have to make any moves. Two rate hikes were enough to send a warning signal and confirm that MPC members have situation under control. I see no risk at all of faster price growth in the medium run.

The latest comments of the MPC members were clearly preparing the market for the next rate hike. The main question is whether it will happen in July or in August. One should notice that even one of the most hawkish MPC members Dariusz Filar did not declare a strong need for next move already in July. Interestingly, a tone of his comments got close to words of Mirosław Pietrewicz who said that more rate hikes are likely though not necessarily in July. Extreme views in the Council started converging towards the consensus although there are still members (e.g. Stanisław Owskiak) who are against any further hikes. In our view, the most likely timing of the decision is August.

Market monitor

Zloty exchange rate

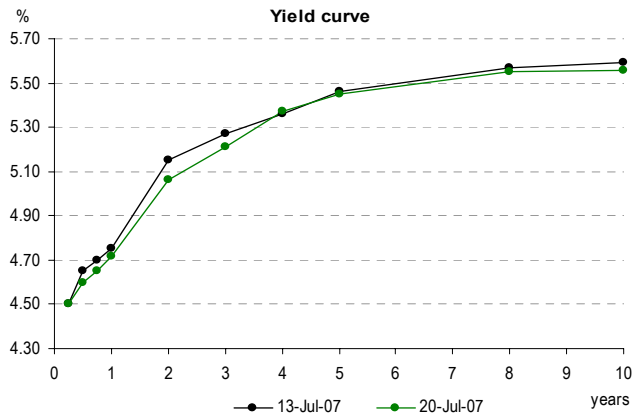


Stable FX market

During the past week zloty fluctuated in a tight range, despite ample macroeconomic data were released. The continuation of the turmoil in the political stage did not influence the zloty. Slight changes in the major international markets also supported the stabilisation in the domestic FX market. The EURPLN rate traded near 3.75 level and USDPLN rate near 2.72.

We maintain our view that FX market may experience a correction, among others in reaction to weakening expectations of rate hike in July and possible rise of risk aversion globally. Such move is suggested by the technical analysis. We keep the forecasted trading ranges for the EURPLN at 3.72-3.82 and 2.69-2.79 for USDPLN for this week.

Yield curve

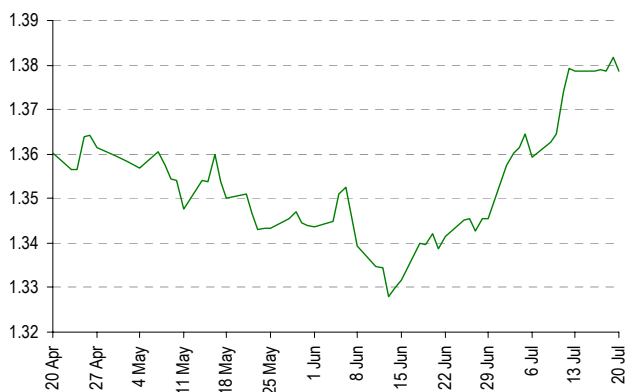


Stabilisation also in the debt market

In the domestic debt market the situation was similar as in the FX market. Its reaction to labour market and production data was muted. Yields were almost unchanged as compared to the previous Friday, though one should notice an increase of spread over core markets. FRA rates slightly rose at the shorter terms. The market reaction to Council's members' comments and MPC minutes was limited.

We hold our view that another rate hike may follow in August, which may be suggested in July's communiqué. We see potential for weakening in the bond market. Yields may be also slightly affected by retail sales data. Apart from that domestic market will be under influence of core debt markets.

EURUSD rate

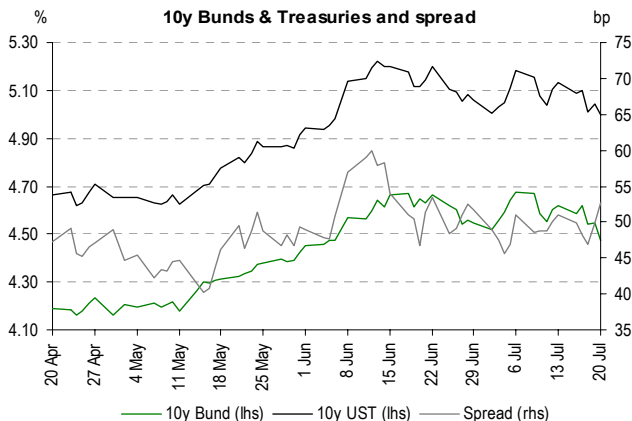


EURUSD highest in history

In the last days the dollar reached the weakest level against the euro in the history again, as fears over problems of two US hedge funds operating in the subprime mortgage market returned to the foreground. Lower ZEW did not significantly support the dollar, while Ben Bernanke's comments before US Congress on the housing market contributed to it's weakening.

The start of the week in the major markets should be quite calm with regards to lack of crucial data releases. Later investors are going to focus on the data from the US housing market and the US Q2 GDP figures, which should show some recovery after weak Q1. The Ifo index may be important for the euro. The EURUSD rate may stabilise near 1.37, and if market belief in rate cuts in the US is stronger it may reach 1.40.

10y Bunds & Treasuries and spread



Core market stronger again

The core debt markets strengthened again. Despite the fact that US CPI and core PPI were above expectations the US debt prices rose with reference to new information on Bear Stearns hedge funds and comments of Ben Bernanke on the housing market. Later there was some profit taking followed by another wave of strengthening (weak Philly Fed). Yields of 10Y Treasuries and Bunds amounted at the end of the week to 5.00% and 4.50%, respectively.

In the nearest days investors will concentrate on the home sales data, which should confirm the weakening in the housing sector as well as on advance data on Q2 GDP in the US. German Ifo index and euro zone monetary statistics are going to be the most important for the euro zone bond market.

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