

Bi-weekly economic update

24 December 2007 – 6 January 2008

We would like to wish all our readers a Merry Christmas and a prosperous New Year. The next issue of the weekly economic update will be released on Friday, 4th January 2008.

The Monetary Policy Council left rates unchanged in December, which positively influenced the interest rate market, offsetting to a large extent the negative impact of higher-than-expected data on November's inflation and corporate wages. This was also justified by the fact that the stat office confirmed that strong wage growth was affected by early payment of bonuses in the mining sector. Also, the industrial production and PPI inflation figures were below market consensus, while on the other hand the construction output was a positive surprise. The above-mentioned data did not affect financial market, similarly as high growth in retail sales. At the beginning of the New Year the Polish interest rate market will be again under pressure of the release of inflation forecast by the Ministry of Finance. Also, in the first week of January, US data from the labour market will be released.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
TUESDAY - WEDNESDAY (25 – 26 December)							
Christmas Holiday							
THURSDAY (27 December)							
13:30	US	Durable goods orders	Nov	%	0.7	-	-0.2
15:00	US	Consumer confidence	Dec	pts	87.0	-	87.3
FRIDAY (28 December)							
14:45	US	Chicago PMI	Dec	pts	52.0	-	52.9
15:00	US	New home sales	Nov	m	0.72	-	0.728
MONDAY (31 December)							
15:00	US	Home sales	Nov	m	5.0	-	4.97
TUESDAY (1 January)							
New Year's Day							
WEDNESDAY (2 January)							
	PL	Auction of 2Y bonds					
11:00	EZ	Manufacturing PMI	Dec	pts	52.5	-	52.8
15:00	US	Manufacturing ISM	Dec	pts	51.0	-	50.8
19:00	US	FOMC minutes					
THURSDAY (3 January)							
9:00	EZ	M3 money supply	Nov	%YoY	12.2	-	12.3
13:15	US	ADP report	Dec	'000	80.0	-	189.4
15:00	US	Factory orders	Nov		0.8	-	0.5
FRIDAY (4 January)							
9:00	EZ	Non-manufacturing PMI	Dec	pts	53.2	-	54.1
10:00	EZ	Flash HICP	Dec	%YoY	3.1	-	3.1
13:30	US	Non-farm payrolls	Dec	'000	84.0	-	94.0
15:00	US	Non-manufacturing ISM	Dec	pts	54.0	-	54.1

Source: BZ WBK, Parkiet, Reuters

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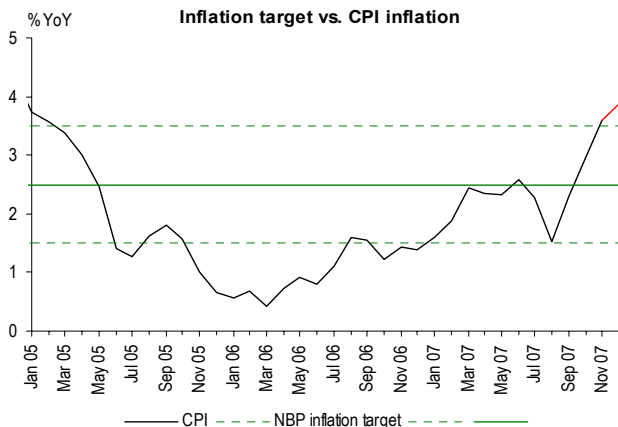
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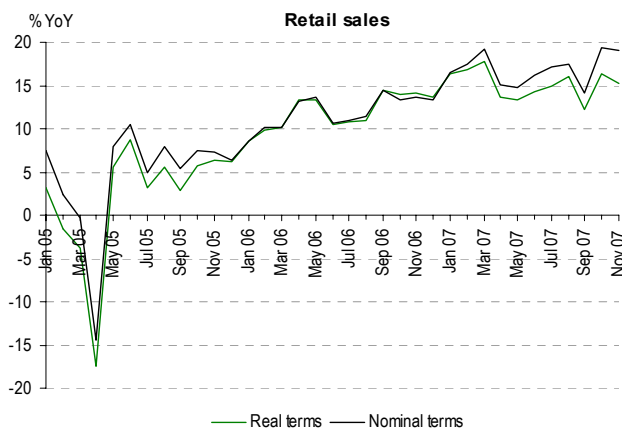
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What's hot this week – US data and inflation forecast of the FinMin

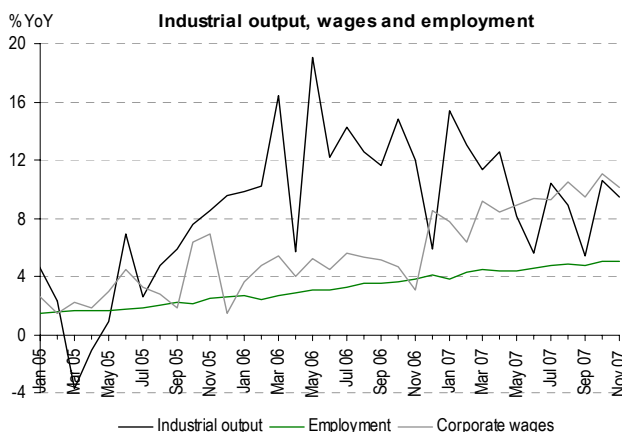


- Due to low number of data releases and other events this week will be dominated by holiday moods with limited market activity and lowered liquidity. Next data releases are scheduled after Christmas.
- The beginning of the next week should also be calm. However, after the New Year's Day activity of investors may increase along with a large number of major data releases abroad. The key focus of attention will be the US non-farm payrolls report.
- Among domestic events scheduled on the first days of the 2008, an auction of 2-year bonds will attract some attention. However, the key event in the local market will be, as usual at the beginning of a month, release of the FinMin's inflation forecast. We predict that the CPI inflation accelerated to 3.9%YoY in December, although the FinMin's estimate may be higher.

Economy last week – Rates unchanged, high wages, lower output



- The MPC left interest rates unchanged at its December meeting, despite the ongoing rise in the headline inflation rate. The Council suggested that given nature of factors pulling inflation up (i.e. food and fuel prices), it is not going to change the strategy of gradual and cautious actions. The statement suggests that next rate hikes are possible and their timing as well as overall scale of monetary tightening will depend on upcoming data. Contrary to the previous month, the Council stressed the importance of the zloty exchange rate for next monetary policy actions. All in all, we maintain our scenario assuming the next rate hike of 25bps in January and another one in March 2008.
- Retail sales data proved very close to forecasts, showing 19.2%YoY rise. The registered unemployment rate at the end of November was lower than indicated by tentative estimates, falling to 11.2%.



- The average wage in the enterprise sector grew 12%YoY in November (stronger than expected, due to bonus payments in mining earlier than a year ago) and employment growth remained at record high level of 5%YoY. The data are positive for estimates of individual consumption in Q4 (the same as retail sales data), offsetting the negative influence of higher inflation on real income of households. At the same time, the data are negative for the medium-term inflation prospects.
- Despite industrial output growth in November was lower than forecasted (8.3%YoY), it was offset by higher than expected rise in construction output and we do not change our estimate of GDP growth in Q4. PPI was flat on a monthly basis and lower than predicted in annual terms (2.6%). The main reason for price growth in manufacturing was rise in commodities prices.

Quote of the week – Rates up, though with deliberation

Jan Czekaj, MPC member, Dziennik, 20 December

Very high wages growth has been maintained, however enterprises may still cope with it (...) without the necessity to significantly raise prices. The situation in the world and Polish economy substantially complicated. Decisions have to be made with deliberation, so as the fight against inflation did not negatively affect the economic growth.

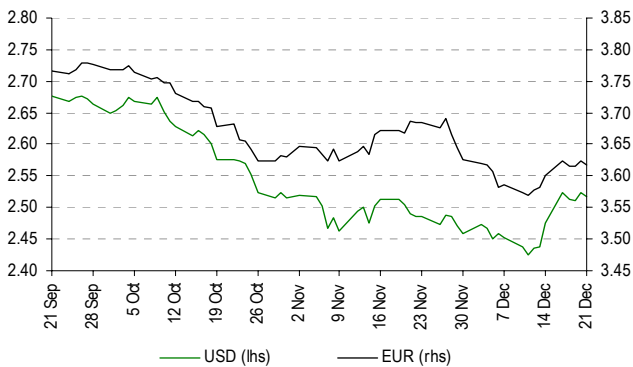
Dariusz Filar, MPC member, TVN CNBC, 20 December

MPC may still have impact on the inflation level at the start of 2009, there is some space to manoeuvre. There are some significant risks of inflation acceleration; I am a proponent of more substantial actions of the MPC. Analysts' expectations assuming there will be 4 more interest rate hikes in 2008 are justified.

Dariusz Filar, one of the most "hawkish" members in the Council explicitly declares in favour of more significant moves by the MPC. The tone of Halina Wasilewska-Trenkner comments was similar. In our view, their opinions are not representative for the whole Council. On the other hand, one may conclude from the comments of Jan Czekaj, who is considered as one of the moderate MPC members determining the interest rate decision this year, that he is not willing to accelerate the process of monetary policy tightening nor to increase its scale. Apart from the fact that Jan Czekaj pointed to complicated situation in the world markets, he also questioned one of the core arguments, which was mentioned by the Council at the time it was raising rates. In the opinion of Jan Czekaj the wage pressure does not have to contribute to inflation acceleration.

Market monitor

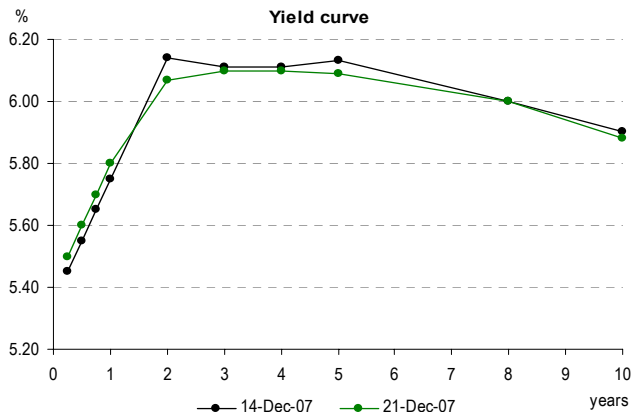
Zloty exchange rate



The zloty quite stable

- The pre-Christmas week showed some stabilisation on the Polish foreign exchange market. While in the first days of the week the zloty strengthened moderately against both the euro and the dollar, correction took place later on. However, this was not an effect of no rate hike by the MPC, but was rather connected with sentiment on the international markets. During the week the zloty rate did not change against the euro, while the USDPLN rate rose by 0.6%.
- In our opinion the end of the year should be calm as well with stable Polish currency. As usual in this season it is worth notice lower liquidity and activity of investors. The zloty ranges for the next weeks remain unchanged at 3.58-3.68 for EURPLN and 2.46-2.56 for USDPLN.

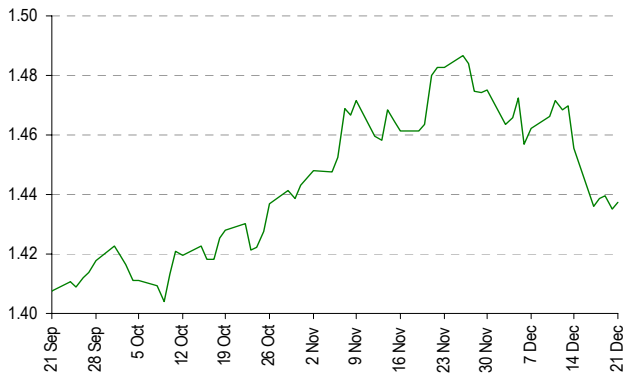
Yield curve



Bonds stronger after earlier weakening

- Polish bond market weakened significantly at the beginning of the week driven by strong labour market data and acceleration in wages in the enterprise sector. High levels in yields were perceived by investors as attractive and the market strengthened, additionally driven by the MPC decision to keep rates on hold. The weaker-than-expected data on industrial production and PPI inflation did not affect the market, similarly as the data released on Friday.
- In our opinion, the bond market should be quite calm until the year-end, though the prospects of another inflation increase in December's data and the publication of the Ministry of Finance's forecast will probably put another upward pressure on yields.

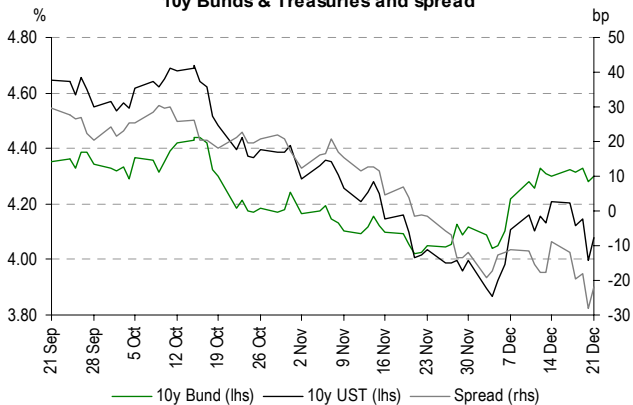
EURUSD rate



Dollar stronger at the end of the year

- Appreciation of the dollar against the single European currency was continued before Christmas. The influence of the data releases in the previous week (inflation and retail sales) could have still had some effect. Also, investors seemed to limit short dollar positions and took profit before the year-end. Additionally, the greenback was supported by information on financial flows from China to Morgan Stanley as well as central banks' liquidity intervention on the money market. Despite a small correction the EURUSD rate maintained below the level of 1.44.
- We expect that at the beginning of 2008 the dollar may return to the weakening trend, given possible renewed expectations for more interest rate cuts by Fed.

10y Bunds & Treasuries and spread



US Treasuries stronger

- After a significant increase in yields of US Treasuries after CPI and PPI, as well as retail sales data, the last days of the week showed the reversal of the trend. This was connected with information on losses in financial institutions and negative assessment of S&P's as regards bond insurers. Also, the results of central banks actions to improve liquidity were published, which had a mixed impact on the market. At the end of the week yields of ten-year Treasuries amounted to 4.07% against 4.20% a week ago. Ten-year Bunds were roughly stable at ca. 4.30% despite temporary decreases in yields and they were supported by hawkish comments of the ECB President.
- After Christmas the US labour market report as well as another information from the housing sector will be the key for the market.

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