Bank Zachodni WBK

Weekly economic update

31 March – 6 April 2008

After a series of surprisingly strong macroeconomic data for February, the Monetary Policy Council has raised main interest rates by 25 bp third time in a row. A tone of the MPC statement and comments of the Council members leave little doubts that interest rates will go up again quite shortly. The main question now is whether after three straight hikes the MPC will now take some rest to observe effects of already taken actions (which seems to be suggested by one of the sentences in the communiqué). In our view such scenario is quite likely, taking into account our forecasts of monthly economic indicators for March. However, if the data will surprise once again showing stronger results than expected, the MPC members will probably not hesitate too much before delivering another hike.

This week, amid lack of key data releases on the local market, the focus of attention will be on the Ministry of Finance's forecast of inflation in March that will be released on Tuesday, 1 April. Even though recently the Ministry failed to predict accurately the effect of change in CPI weights, the prediction will be not an April Fool's Day joke and may have significant effect on the debt market performance and analysts' expectations. According to our forecast, CPI growth should stabilise in March at 4.2%YoY, amid moderate growth in prices of food and fuels. However, a risk for this forecast is asymmetric on the downside.

Among numerous data publications abroad, the most important will be the US non-farm payrolls figures, to be released on Friday. Before that, the market players will focus on Ben Bernanke's speech in Congress and numerous data releases, among others activity indices ISM and PMI.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (31 March)					
8:00	EZ	Money supply (M3)	Feb	%YoY	11.4	-	11.5
9:00	EZ	Economic sentiment	Mar		100.0	-	100.1
9:00	EZ	HICP flash	Mar	%YoY	3.3	-	3.3
13:45	US	Chicago PMI	Mar		46.0	-	44.5
		TUESDAY (1 April)					
8:00	EZ	PMI – manufacturing	Mar		52.0	-	52.3
14:00	US	ISM – manufacturing	Mar		48.0	-	48.3
		WEDNESDAY (2 April)					
	PL	**Auction of 2Y bonds**					
9:00	EZ	PPI	Feb	%YoY	5.2	-	4.9
12:15	US	ADP employment	Mar	'000	-38.0	-	-23.0
14:00	US	Factory orders	Feb	%	0.6	-	-2.5
	US	Ben Bernanke's speech in Congress					
		THURSDAY (3 Alril)					
8:00	EZ	PMI – services	Mar		51.7	-	52.3
12:30	US	Jobless claims	week	'000		-	366.0
14:00	US	ISM – non-manufacturing	Mar		49.0	-	49.3
		FRIDAY (4 April)					
12:30	US	Non-farm payrolls	Mar	'000	-40.0	-	-63.0
12:30	US	Unemployment rate	Mar	%	5.0	-	4.8

Source: BZ WBK, Parkiet, Reuters

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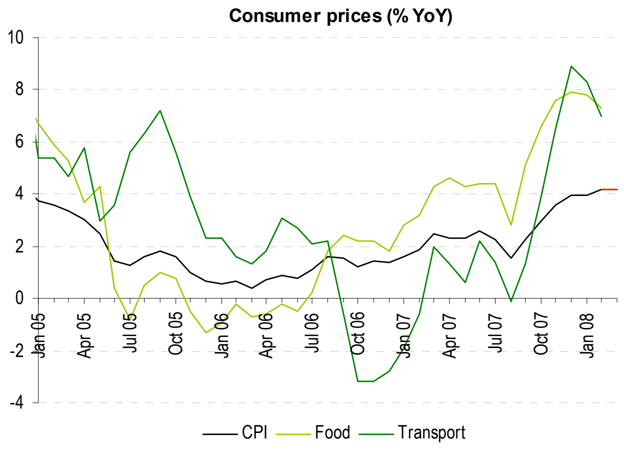
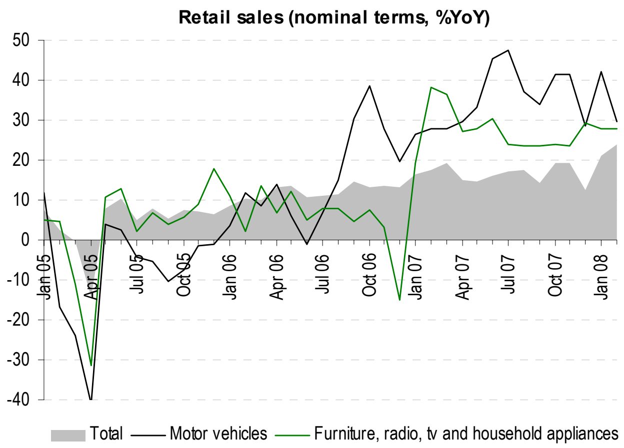
What's hot this week – FinMin's inflation forecast and new data releases abroad

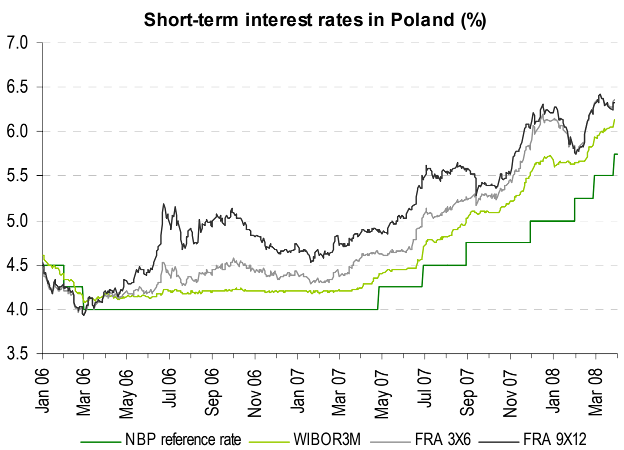


- This week, investors will take a rest from domestic data releases. The only crucial information on the local market will be the Ministry of Finance's inflation forecast for March that may affect expectations concerning MPC decision. We predict a stabilisation of CPI growth at 4.2%YoY.
- The release of quarterly NBP data about balance of payments for Q4, initially planned for Monday, has been rescheduled for the next week.
- As regards news from international markets, the Fed's Bernanke address to Congress on Wednesday will be a key feature this week. The highlight of the week on the data front will undoubtedly be Friday's non-farm payrolls report for March. Ahead of Friday, markets will have plenty to focus on with the March manufacturing and services ISM due for release along with the Chicago PMI, construction spending, car sales and factory goods orders.

Economy last week – February shopping spree, another rate hike in March



- Retail sales increased in February by 23.8%YoY in nominal terms and 19%YoY in real terms, much faster than predicted. It was the highest growth in eight years if we skip a one-off surge just before the EU accession.
- The fastest rise was recorded in sales of non-essentials and non-food products, which probably reflects a strong rise in households' income. Consumption demand will continue rapid growth throughout the end of this year, being a major driving force of economic growth.
- Registered unemployment rate declined in February to 11.5% from 11.7% in January, in line with our forecast.
- Detailed data about wages in enterprises sector showed that acceleration in pay growth in February resulted mainly from wage hikes in industry, while in construction and trade there was slight slowdown in remuneration growth.



- The MPC raised main interest rates by 25 bp, for the third time this year and seventh time in the last twelve months. The reference rate is now at 5.75%.
- A new sentence in the MPC communiqué is worth attention, saying that the previous increases of the NBP's interest rates should be conducive to lowering inflation. It may be a suggestion that the Council would like to wait for some time now with further moves to assess the effects of its earlier actions. Nevertheless, a timing of next decisions will be surely dependent on the upcoming economic data.
- Next interest rate hike in April cannot be ruled out, however we think it may take place only if new data releases, particularly those concerning wage pressure, will be again much above expectations. At this moment a one or two months delay in hikes seems to be more likely.

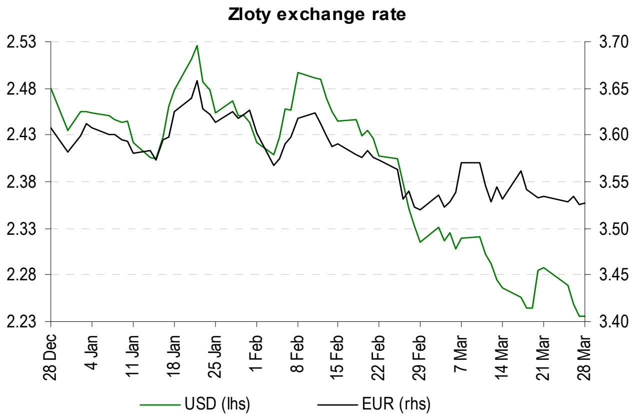
Quote of the week – Czekaj ready to continue tightening

Jan Czekaj, MPC member, ISB, 28 March

The MPC cannot base its decisions on expectations and hopes that may not fulfil. Therefore, it is better to apply preventive interest rate hikes now, even to tighten policy excessively than underestimate threats. (...) If it turns out that inflation next year starts falling quickly, then we may cut rates equally quickly. It is much easier, is less costly, and brings faster effect for the economy than rate hikes. Therefore, amid symptoms of economic slowdown I see no problem with fast rate reductions by 50 bp or even, like the Fed did recently, cutting rates at the special meeting on Sunday and then once again after a few days.

While there are no doubts that the MPC hawks will vote in favour of next rate hike in April, key for the decision are opinions of the Council's moderate members. In this context, Czekaj's comments seem relevant, as it suggests that he is ready to deliver more rate hikes, even risking excessive policy tightening (that could be reversed quickly), as long as the economy is expanding faster than potential. It implies a risk that rates may go up higher than 6% this year (even if it would be followed by swift cuts). Will Czekaj back a motion to hike rates in April? It will definitely depend on monthly statistical data that will appear before the meeting.

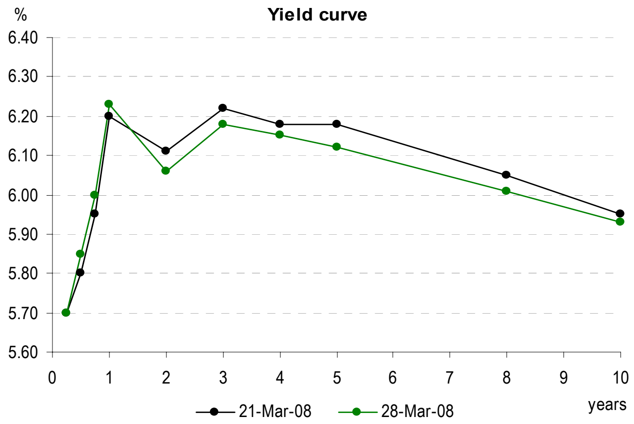
Market monitor



Zloty remains strong and stable

▪ The zloty exchange rate has been relatively stable last week and has been traded in the narrow fluctuations band against the euro. On the other hand, it appreciated 2% against the dollar amid movements in EURUSD rate. Moods in global markets and a moderate improvement in terms of risk appetite favoured stabilisation in emerging markets. Additionally, the zloty was supported by strong economic data and the MPC decision to hike rates.

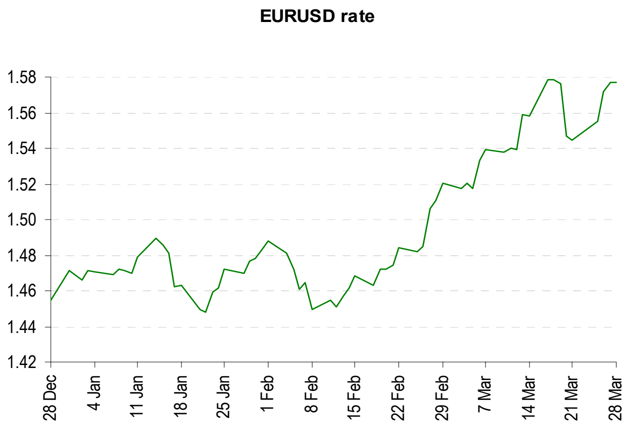
▪ This week will bring no major pieces of economic news for the market and thus the Polish currency should be driven to a large extent by international events. We assume that the zloty will remain strong but will not break the level of 3.50. Therefore, we maintain trading ranges for the euro and the dollar at 3.50-3.60 and 2.20-2.30.



Stable moods abroad positive for Polish bonds

▪ For the most of the previous week yields of Polish government bonds were below levels recorded before Easter, which was connected with lower risk aversion on global markets. The strengthening of the fixed income market was not even interrupted by high growth in retail sales, the MPC decision and statement nor quite significant rise in yields on the core bond markets. At the end of the week, a slight correction took place.

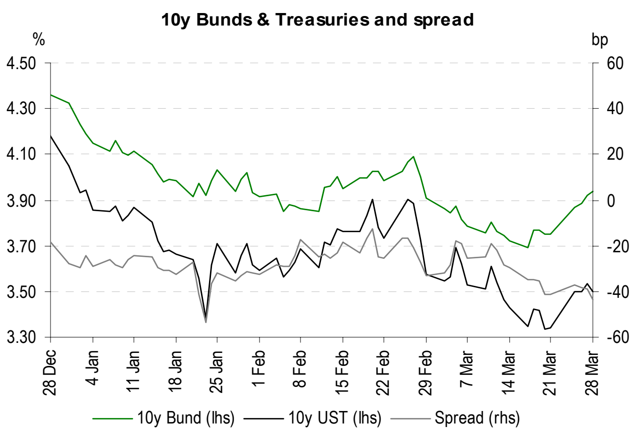
▪ The first part of this week on the bond market will be under influence of the publication of inflation forecast by the Ministry of Finance. However, during the week international moods and risk appetite will be at least equally important. Assuming no another wave of pessimism as regards the assessment of the shape of US economy, we think there is room for the Polish bond to strengthen in the short-term.



Dollar loosing ground again

▪ Dollar strengthening was short-lived and in the last week, the EURUSD rate increased again, approaching record high levels, among others in reaction to new quite weak data from the US economy, better than expected news about economic situation in the euro zone and comments of ECB officials dispelling hopes for soon rate cuts in the common currency area.

▪ The non-farm payrolls figure due on Friday will be key for the EURUSD and pose a risk of further dollar decline, as the number of jobs is predicted to continue falling. Earlier, the EURUSD will be influenced by a number of economic indicators, including ISM and PMI indices and comments of Ben Bernanke in the US congress than may include remarks about financial market turmoil.



Bond yields in upward trend on core markets

▪ The week after the Easter holiday passed under the sign of deterioration in core debt markets, which was caused by a fall in general risk aversion and gains on the international stock markets. As an effect of capital outflow from safe assets, yields of 10Y Treasuries and Bunds increased during the week by 18 bp and 16 bp respectively.

▪ Economic data due for release in the US and the euro zone will have significant impact on investors' appetite for risky assets. If the data do not renew fears about recession in the US, a rise in yields may be maintained. A tone of Fed president's speech in the Congress will be also important with markets looking to see what he has to say about financial market turmoil and the US economy in general.

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