

Weekly economic update

26 May – 1 June 2008

Data released last week did not give a clear hint whether the Monetary Policy Council will decide to hike interest rates one more time in May or if it waits until June to have broader set of information. Wage growth in April was higher than expected, but job growth slowed down, which may herald weaker wage pressure in future. Output growth in industry and construction was high, but the results were biased by higher number of working days. Financial results of companies improved, however progress was weaker than in previous quarters and showed a risk of fall in profitability. Core inflation increased, however it was lower than predicted. Meanwhile, PPI growth slowed down in April, particularly in manufacturing sector.

This week will go by in expectation for the MPC decision. Just before its announcement, there will be release of data about retail sales and unemployment rate. However, the market will pay more attention to the Council's communiqué than to the data. On Friday, GDP data for Q1 will be released, and may show to what extent a slowdown in world economy is passing through the economic activity in Poland. After market holiday in the US and UK on Monday, the next days will see a number of data releases with potentially high importance for the international financial markets.

Economic calendar

| Time GMT | COUNTRY | INDICATOR | PERIOD | | FORECAST | | LAST VALUE |
|---------------------------|---------|-------------------------------|--------|------|----------|-------|------------|
| | | | | | MARKET | BZWBK | |
| MONDAY (26 May) | | | | | | | |
| | PL | T-bills auction | | | | | |
| | US, GB | Market holiday | | | | | |
| TUESDAY (27 May) | | | | | | | |
| 13:00 | US | Case/Shiller home price index | Mar | %YoY | -14.0 | - | -12.7 |
| 14:00 | US | Consumer confidence | May | pts. | 61.0 | - | 62.3 |
| 14:00 | US | New home sales | Apr | m | 0.52 | - | 0.526 |
| WEDNESDAY (28 May) | | | | | | | |
| 8:00 | PL | Retail sales | Apr | %YoY | 18.8 | 19.8 | 15.7 |
| 8:00 | PL | Unemployment rate | Apr | % | 10.5* | 10.4 | 11.1 |
| | PL | MPC meeting – decision | May | % | 5.75 | 5.75 | 5.75 |
| 12:30 | US | Durable goods | Apr | %MoM | -0.4 | - | 0.1 |
| THURSDAY (29 May) | | | | | | | |
| 8:00 | EZ | M3 money supply | May | %YoY | 10.3 | - | 10.3 |
| 12:30 | US | Jobless claims | w/k | k | 370.0 | - | 365.0 |
| 12:30 | US | Preliminary GDP | Q1 | % | 1.0 | - | 0.6 |
| 12:30 | US | GDP deflator | Q1 | % | 2.6 | - | 2.6 |
| 12:30 | US | Core PCE | Q1 | % | 2.2 | - | 2.2 |
| FRIDAY (30 May) | | | | | | | |
| 12:00 | PL | GDP | Q1 | %YoY | 5.7 | 5.6 | 6.3 |
| 9:00 | EZ | Business climate | May | pts. | 0.4 | - | 0.44 |
| 9:00 | EZ | HICP flash | May | %YoY | 3.5 | - | 3.3 |
| 12:30 | US | Core PCE | Apr | %MoM | 0.1 | - | 0.2 |
| 13:45 | US | Chicago PMI | May | pts. | 48.8 | - | 48.3 |
| 13:55 | US | Michigan index final | May | pts. | 59.5 | - | 62.6 |

Source: BZ WBK, Parkiet, Reuters, PAP; * estimate of the Labour Ministry

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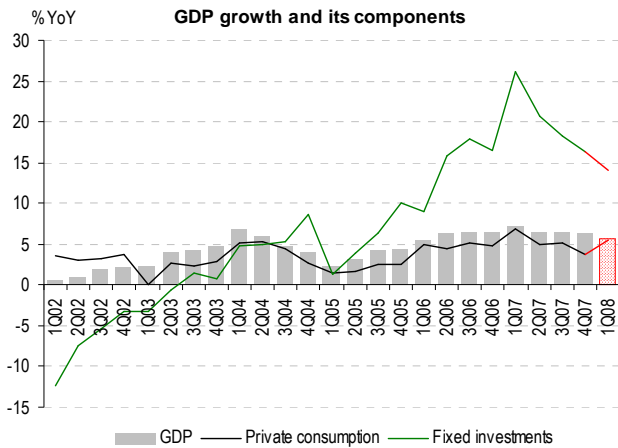
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What's hot this week – MPC decision and GDP data

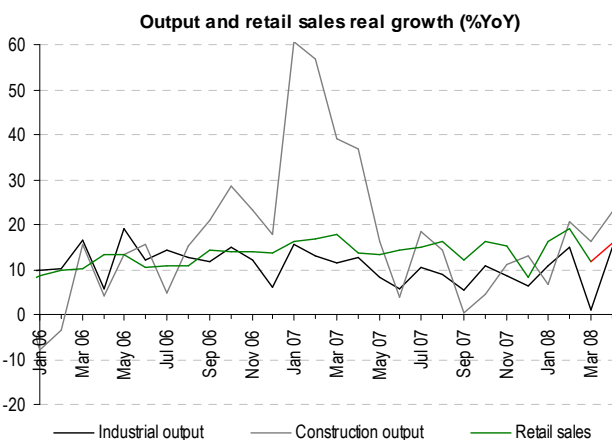


- On Wednesday we will find out whether the MPC will decide to pause monetary tightening until June or will deliver a hike this month. Last data releases gave no clear suggestion, however the MPC members' comments signalled that gaining majority of votes for a rate hike motion could be problematic.

- Just before the MPC decision, the data about retail sales and unemployment rate will be released. We expect to see high growth in sales, supported by rapid wage growth and a rebound after a March slowdown. Unemployment rate is estimated by the Labour Ministry to reach 10.5%, however we expect it may be even slightly lower.

- On Friday, GDP data for Q1 will be released. One should pay attention not only to headline growth figure (slowdown below 6% expected) but also to its structure, i.e. growth rate of private consumption and investment.

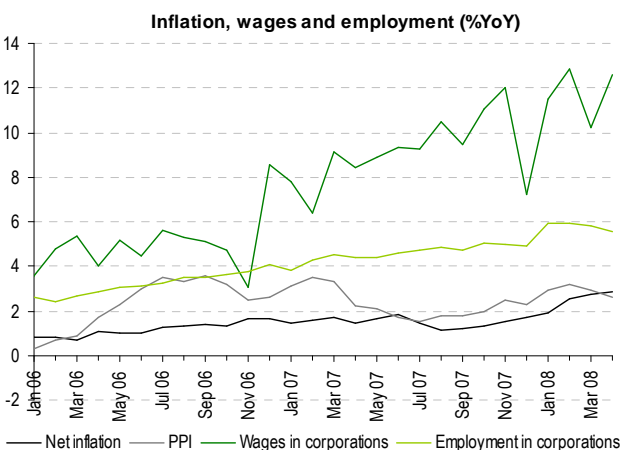
Economy last week – Last data did not give a clear hint



- Industrial output growth in April reached 14/8%YoY and was above market consensus but lower than our forecast. After seasonal adjustment, output growth reached 11.9%YoY and was the highest for over a year. Output in construction rose 23%YoY (also one year high), and 15%YoY after seasonal adjustment.

- Output growth in April was affected by higher number of working days. We predict a gradual slowdown in production growth in the next months.

- Average wage growth in April was higher than predicted and reached 12.6%YoY. However, employment growth was below forecasts and slowed down to 5.6%YoY. Wage bill in enterprises sector increased 18.9%YoY in nominal terms and 14.3%YoY in real terms, which was the second best result in the last nine years.



- In turn, inflationary data were below forecasts. Even though three out of five measures of core inflation increased in April, however net inflation was lower than predicted and reached 2.8% versus 2.7% in March. 15% trimmed mean decreased slightly from 4.2% to 4.1%.

- PPI growth decelerated in April to 2.5% from 2.9% in March, and price growth in manufacturing slowed down to 1.6%YoY, which shows that in highly competitive sectors producers are reluctant to pass growing costs to prices.

- Financial results of companies in Q1 2008 were better than last year, however improvement was not as impressive as in previous quarters. Indicators of profitability have decreased and growth in costs outpaced growth in revenues, which may signal weakening of expansionary trends in the economy.

Quote of the week – Will there be a majority in May?

Andrzej Wojtyna, MPC member, Reuters, 20 May

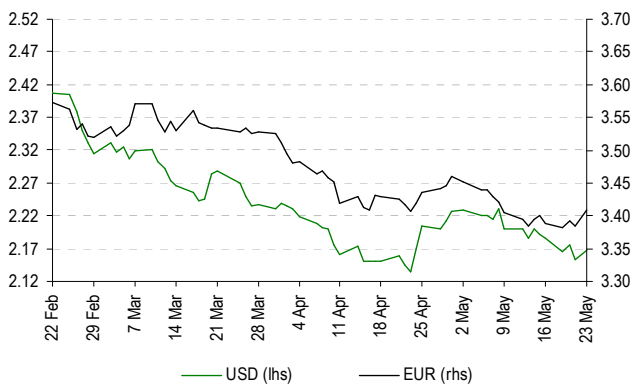
Because our main problem is based on how to show that the council is determined to act against a permanent trend of inflation above the target, I believe that we should raise rates once more as quickly as possible. (...) If we...raised rates more and faster, then adjusting inflation and its fall to target would be faster. But this is a dilemma of all central banks how fast to push inflation back down. The belief dominates that it should be a gradual process that does not cause a slowdown of growth. (...) Recent wage data would only be good in a situation in which productivity was rising faster. In the current situation they fuel inflationary pressures. The pace of wage growth worries us.

Taking into account recent comments of the MPC members, it seems very likely that four of them will vote in favour of a hike already next week (Wasilewska-Trenkner, Filar, Noga, Wojtyna). Therefore, they will need the casting vote of the NBP President, which is not likely, or the support of two other members. We still have some doubts whether six members will vote to hike rates. Unfortunately, the recently released data did not make it easier to answer this question.

One should notice that even among the MPC hawks there is an idea that monetary tightening cannot go too far from current level (possibly one more rate hike would do), because stronger MPC reaction would create a risk of excessive economic slowdown.

Market monitor

Zloty exchange rate

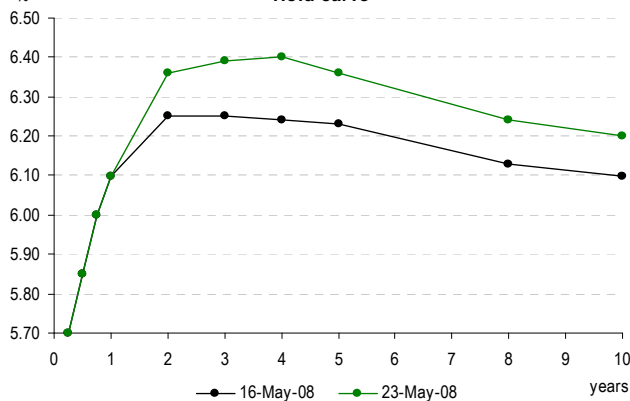


Zloty marginally weaker, deeper correction ahead?

During the week the zloty remained in a narrow range against the major currencies, apart from holiday Thursday, when the zloty exceeded 3.42 amid closed domestic market. In the whole week the zloty moderately weakened against the euro and strengthened versus the dollar. At the end of the week the EURPLN rate was slightly above 3.40.

Although the zloty remained strong in the last days there was some weakening pattern, which may also appear in the nearest time, especially taking into consideration no interest rate hike at the May meeting of the MPC and/or increase of risk aversion in the international markets. We predict trading ranges for this week at 3.35-3.45 for the EURPLN rate and 2.10-2.20 for the USDPLN rate.

Yield curve

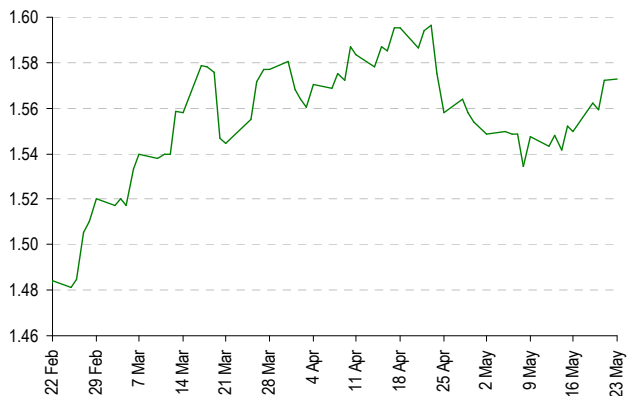


Clear deterioration of moods in the debt market

In the debt market negative moods were mounting throughout the week, which was influenced among others by higher than expected data on wages, comments of the MPC members, as well as expectations for a switch tender. On Wednesday after the FinMin turned down all offers at the switch auction the market recovered, though overall during the week yields significantly increased.

This week the MPC decision as well as the official communiqué of the Council are going to be the key events. However, lack of interest rate hike will rather not result in significant recovery of the market, as it will already discount the MPC move in June, especially amid our forecast for strong retail sales growth.

EURUSD rate

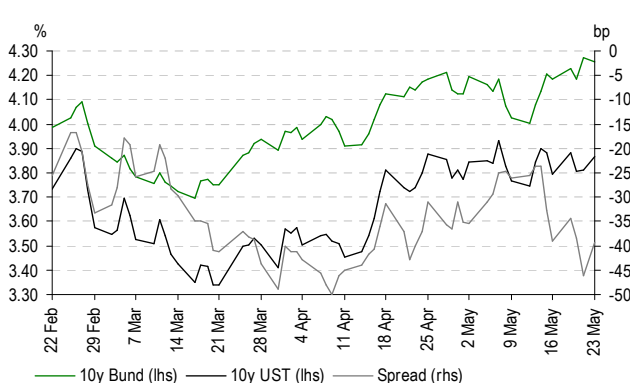


Dollar under pressure again

The dollar returned to the weakening trend in the international markets, which was influenced among others by disturbing inflation figures from the US (higher PPI index) and German Ifo index above expectations, which together with rise of oil prices to new record high level 135\$ per barrel increased concerns on interest rate hike in the euro zone. The dollar was not supported by the Fed's minutes, which emphasised bank's fears over inflation and suggested no more rate cuts in the United States.

Data scheduled to be released this week may give mixed signals for the market – the second estimate of the GDP in the US will most probably show an upward revision, though the other data may be relatively weak. Data from the euro zone will be rather pessimistic for inflation prospects. In the result, the EURUSD rate may test 1.60 again.

10y Bunds & Treasuries and spread



Inflationary concerns weigh on debt markets

Bond yields on core markets recorded a significant rise last week, among others due to worrying inflation news (high core PPI in the US and in Germany, record-high oil prices) which moved up expectations concerning future interest rates of main central banks. In the euro zone, speculation about interest rate hike has appeared.

As far as the start of the week abroad will be rather calm due to market holidays in the United States and Great Britain, next days will bring many important data releases. Data on HICP and M3 from the euro zone may increase concerns of interest rate hike by the ECB. In the US much will depend on the monthly activity statistics.

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