

Weekly economic update

7 – 13 July 2008

In the first part of last week, with rise in EURUSD, the zloty was stable against the euro and reached the strongest level to the dollar since 1993. Later in the week, EURPLN fell below historical low of 3.3407 from June 2001. However, it did not happen as a consequence of strengthening expectations for more interest rate hikes by the ECB, which could have increased room for monetary tightening in Poland. Actually, the comment after the ECB meeting was less hawkish than expected by the market, and the US data were better than some market participants feared, and in effect there was a significant weakening of the euro against the dollar in the international markets. This led to zloty appreciation against the euro and simultaneous weakening versus the dollar. Numerous comments from MPC members last week had neutral impact on the Polish market. They have not changed our view on monetary policy prospects. We still believe there is substantial risk of further rise in the reference rate to 6.25-6.5%. Likely months for further rate hikes will be September (after Q2 GDP data and August inflation at ca. 5%) and/or October (next inflation projection).

After falling below the historical low level, EURPLN may go into direction of 3.30 (on Friday it fell below 3.32). The zloty may be positively influenced by the Eurogroup's final decision on Slovakia's entry to the euro zone and the Slovak crown conversion rate to the euro. We lower expected range for EURPLN to 3.28-3.38 and for USDPLN to 2.08-2.18. Among data from the euro zone and US due for release this week, the most important will be preliminary Michigan index for July. Changes in risk aversion and moods on stock markets will be also important for the local financial market. The meeting of the Bank of England will be important for the British pound. In our view, amid expected rise in inflation in the nearest months and at simultaneously strengthening signs of deep economic slowdown the BoE will not decide to lift main interest rates this year.

Economic calendar

Time GMT	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
MONDAY (7 July)							
09:00	PL	Tender of 13-week Treasury bills worth PLN0.5bn					
09:00	PL	Tender of 52-week Treasury bills worth PLN1.2bn					
TUESDAY (8 July)							
14:00	US	Pending home sales	May	%MoM	-2.5	-	6.3
14:00	US	Wholesale inventories	May	%MoM	0.8	-	1.3
WEDNESDAY (9 July)							
09:00	PL	Auction of 10Y bonds DS1017 worth PLN0.5-1.5bn					
09:00	EZ	Revised GDP	Q1	%YoY	2.2	-	2.2
THURSDAY (10 July)							
11:00	GB	Bank of England decision announcement	Jul	%	5.0	5.0	5.0
12:30	US	Initial jobless claims	w/e	'000	390.0	-	404.0
FRIDAY (11 July)							
12:30	US	Import prices	Jun	%MoM	2.0	-	2.3
12:30	US	Trade balance	May	\$bn	-62.3	-	-60.9
13:55	US	Michigan preliminary	Jul	pts	55.5	-	56.4
18:00	US	Federal budget	Jun	\$bn	33.0	-	27.48

Source: BZ WBK, Parkiet, Reuters

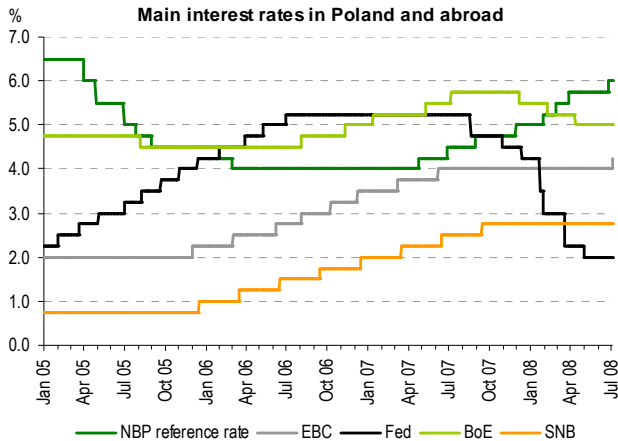
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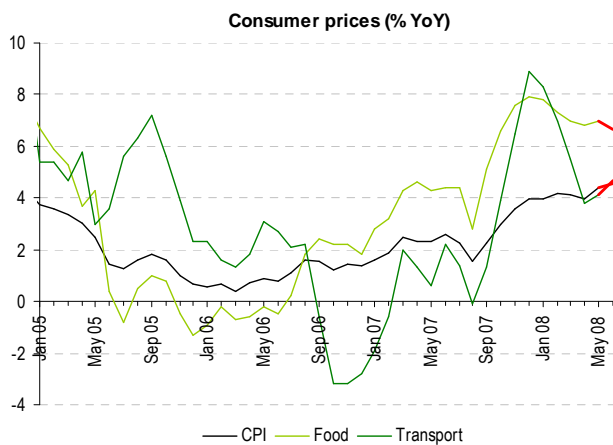
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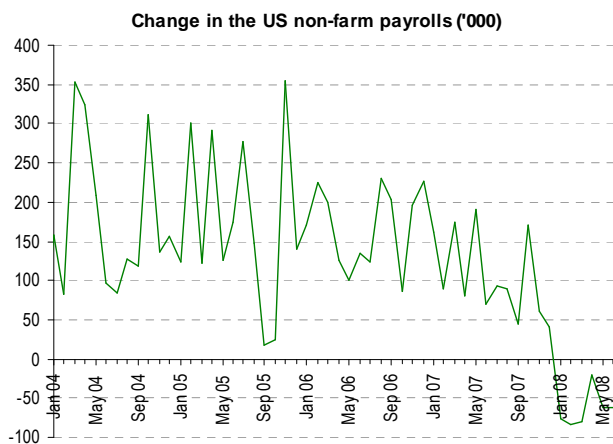
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What's hot this week – No local events, focus on events abroad

- There are no important local events in this week's agenda. However, an important factor for the Polish market will be the Eurogroup's final decision (due on July 7) on Slovakia's entry to the euro zone and the Slovak crown's conversion rate to the euro. Besides, investors' attention will focus on foreign markets.
- Among data from the euro zone and US due for release this week, the most important will be preliminary Michigan index for July.
- Changes in risk aversion and moods on stock markets will be also important for the local financial market.
- The meeting of the Bank of England will be important for the British pound. In our view, amid expected rise in inflation in the nearest months and at simultaneously strengthening signs of deep economic slowdown the BoE will not decide to lift main interest rates this year.

Economy last week – Under the influence of the ECB

- CPI forecast released by the Ministry of Finance was in line with market consensus previously determined in Parkiet daily's poll.
- According to the FinMin, inflation rate accelerated to 4.5% in June from 4.4% in May (our forecast is 4.6%).
- The ministry estimates that inflation acceleration was mainly caused by rise in alcohol and tobacco prices by 0.9%MoM (our forecast 0.3%) and rise in fuel prices by 4.2%MoM (our forecast 4%). Meanwhile, prices of food and non-alcoholic beverages fell according to their estimate by 1.2%MoM (our forecast -0.8%).
- FinMin maintained forecast of average inflation in 2008 at 4.1% (we think it will be ca. 4.4%).
- The official CPI for June data will be released by the statistical office on Tuesday, 15 July.



- As the FinMin's inflation forecast was consistent with expectations, a factor that had the biggest impact on the Polish market last week was the ECB meeting and US labour market data. The comment after the ECB meeting were less hawkish than expected and American labour market data were stronger than market had feared.
- ECB president Jean Claude Trichet said that inflation in the euro zone may remain elevated longer than previously predicted, however the central bank's action made so far will help in reaching price stability. He also said that after a rate hike in July he had no bias concerning future decisions.
- We still predict that expected worsening of economic situation in the euro zone will restrain the ECB from further hikes in interest rates.

Quote of the week – The MPC does not have hands tied

Dariusz Filar, MPC member, Puls Biznesu, 4 July

One has to take into account that interest rates will have to be raised this year and next year.

Marian Noga, MPC member, Dziennik, Rzeczpospolita, 4 July

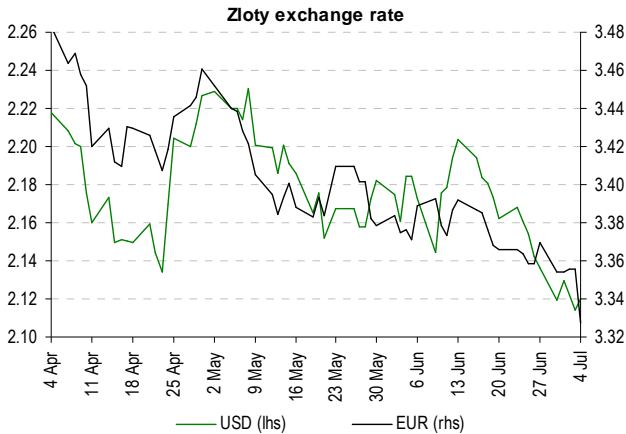
If it appears that against expectations inflation does not drop in September, and the new inflation projection will not assume moderation of price growth, then it will be a good time for reaction. (...) I think that one cannot rapidly raise rates and lower inflation by force.

Sławomir Skrzypek, MPC member, PAP, 3 July

The MPC does not have hands tied until October. Apart from the inflation projection we also analyse currently appearing data. If the MPC agrees that further monetary adjustment is necessary, it may hike rates earlier than in October.

The most hawkish MPC member Dariusz Filar thinks that further interest rate hikes are still possible in 2008 and 2009. In Marian Noga's opinion, one cannot hike rates suddenly and the next hike may take place in October if inflation does not start falling after August peak. However, NBP president, considered as a dove, said that rate hike before October cannot be ruled out if it's necessary. All in all, recent comments from MPC members do not change our view on monetary policy prospects. We still think that at the end of this year the reference rate may reach 6.25-6.5%. Likely months for further rate hikes will be September (after Q2 GDP data and August inflation at ca. 5%) and/or October (next inflation projection).

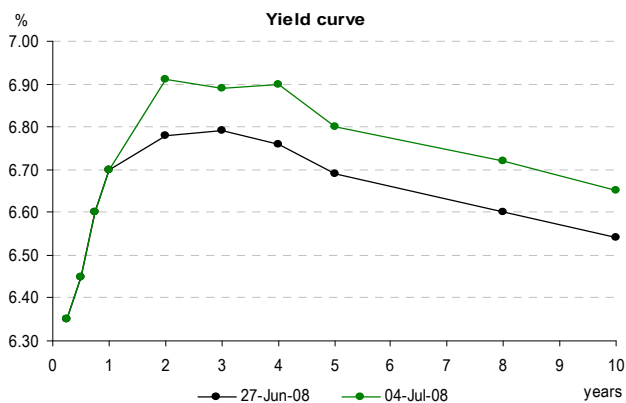
Market monitor



Zloty reaches new highs

▪ In the first part of the last week, EURPLN was stable while USDPLN was falling (to the lowest level since 1993), with gradual rise in EURUSD. Later in the week, following less hawkish than expected comments after the ECB meeting and data from the US which proved better than many had feared, EURUSD significantly fell and EURPLN dropped below the historical low of 3.3407, at the same time breaking the lower end of range indicated in our previous report. USDPLN rebounded.

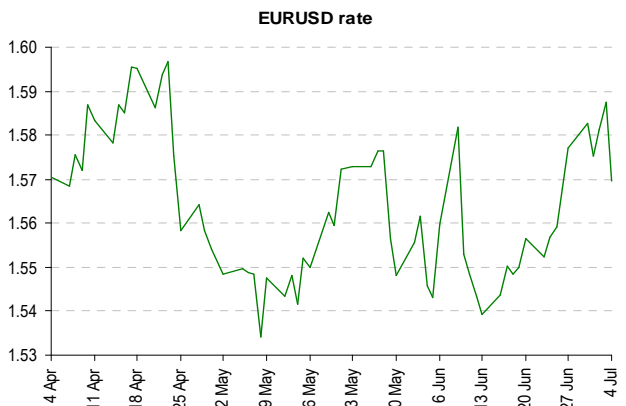
▪ After falling below the historical low level, EURPLN may go into direction of 3.30 (on Friday it fell below 3.32). The zloty may be positively influenced by the Eurogroup's final decision on Slovakia's entry to the euro zone and the Slovak crown conversion rate to the euro. We lower expected range for EURPLN to 3.28-3.38 and for USDPLN to 2.08-2.18.



Domestic debt considerably weaker

▪ Last week brought significant weakening in the domestic debt market. The FinMin's inflation forecast for June did not affect the market, but the Polish yields curve moved clearly up due to rise in yields on the core debt markets. Some recovery took place after less hawkish than expected comments at the ECB post-meeting press conference. Numerous comments from MPC members last week altogether had neutral impact on the domestic interest rate market.

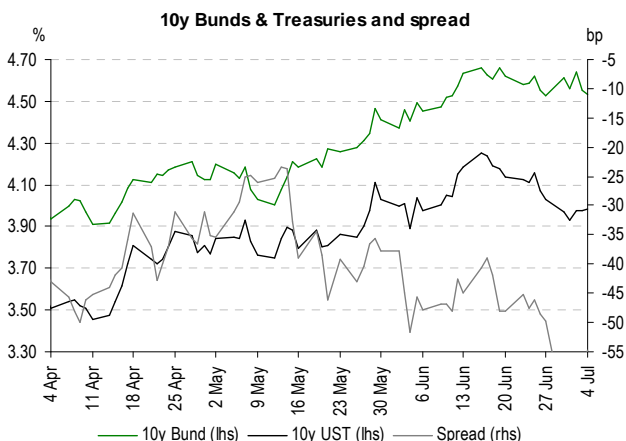
▪ This week there will be no domestic data releases. Performance of the Polish debt market will depend mostly on developments in the core debt markets. However, one should also pay attention to possible next comments from Polish rate-setters. An important factor for the local debt market will be also auction of 10Y bonds scheduled on Wednesday.



EURUSD down after the ECB and US non-farm payrolls

▪ The dollar gained versus the euro last week, although the first part week brought weakening of the greenback. Under influence of higher than expected HICP and PPI figures from the euro zone and hawkish comments from the ECB President before the meeting, EURUSD was gradually rising and reached ca. 1.59. However, less hawkish than expected tone of comments at the ECB post-meeting and the US labour market data which proved better than the market feared led to significant depreciation of the euro to the dollar. At the end of last week, EURUSD was traded below 1.57 against 1.58 a week earlier.

▪ There are fewer events important for the FX markets scheduled this week and we predict that EURUSD should stabilise.



High volatility in the core debt markets

▪ Last week there was high volatility in the core debt markets, but weekly change in yields was not significant. The beginning of last week brought weakening after release of higher than expected HICP inflation in the euro zone and Chicago PMI in the US, but it was limited by positive influence on the core debt markets by increase in risk aversion. However, later on, high ISM in the US, PPI in the euro zone and hawkish comments of the ECB President before the decision meeting led to a weakening again. Then, a clear rebound took place after the ECB press conference. At the end of the week, yields of 10Y Treasuries and Bunds reached 3.99% (4bps lower than a week ago) and 4.54% (unchanged).

▪ This week the core debt markets should stabilise due to fewer important events that could affect expectations regarding monetary policy of major central banks.

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