Bank Zachodni WBK

Weekly economic update

17 January – 23 January 2005

This week will see the first important data releases in Poland in 2005. Market players will surely focus on CPI inflation figures. If inflation in December stabilised at the level of 4.5%YoY seen in the two previous months or grew to 4.6%YoY predicted by us, one may expect further rise in yields on the short end of the curve. For 5-year segment, a key factor will be the auction of the new benchmark PS0310. Last week, the zloty performed slightly better than we expected and it should stabilise at relatively strong levels this week. The domestic currency may be supported by relatively high inflation numbers and expected good output numbers.

Economic calendar

TIME GMT	COUNTRY	INDICATOR (importance level*)	PERIOD		FORECASTS		LAST VALUE
					MARKET	BZWBK	
		MONDAY (17 January)					
10:00	**POL**	**Auction 52- and 13-weeks Treasury Bills – PLN600m and PLN100m (M)**					
15:00	**POL**	**Corporate employment (M)**	**XII**	**%YoY**	**-0.2**	**-0.1**	**-0.3**
15:00	**POL**	**Corporate wages (H)**	**XII**	**%YoY**	**3.0**	**3.5**	**2.7**
15:00	**POL**	**CPI (H)**	**XII**	**%YoY**	**4.5**	**4.6**	**4.5**
		TUESDAY (18 January)					
10:00	EMU	Industrial production (M)	XI	%MoM	-0.5	-	-0.5
14:00	USA	Net capital flows (H)	XI	$bn	-	-	48.10
14:00	USA	Foreign Treasury buying (H)	XI	$bn	-	-	18.30
13:30	USA	New York Fed (M)	I	-	27.0	-	29.9
		WEDNESDAY (19 January)					
10:00	**POL**	**Auction for 5y bond (PS0310) – PLN2.5bn (H)**					
13:30	USA	CPI (H)	XII	%MoM	0.0	-	0.2
13:30	USA	Housing Starts (M)	XII	$m	1.90	-	1.77
20:00	USA	Fed Beige Book published (H)					
		THURSDAY (20 January)					
15:00	**POL**	**PPI (H)**	**XII**	**%YoY**	**6.3**	**6.3**	**6.7**
15:00	**POL**	**Industrial production (H)**	**XII**	**%YoY**	**12.5**	**10.2**	**11.3**
09:00	EMU	Eurostat trade balance (M)	XI	€bn	-	-	5.5
10:00	EMU	Final HICP (H)	XII	%MoM	0.4	-	-0.1
15:00	USA	Leading Indicators (M)	XII	%	0.1	-	0.2
17:00	USA	Philadelphia Fed (M)	I	-	27.0	-	25.4
		FRIDAY (21 January)					
15:00	**POL**	**Business climate (M)**	**XII**	**-**	**-**	**-**	**-**
15:45	USA	Preliminary Michigan Index (H)	I	-	97.10	-	98.00
		DURING A WEEK					
	POL	**Budget performance (M)**	**I-XII**	**PLNbn**	**40.8**	**40.8**	**33.8**

* Importance level: (H)igh, (M)oderate; Source: Reuters, BZ WBK, Gazeta Bankowa

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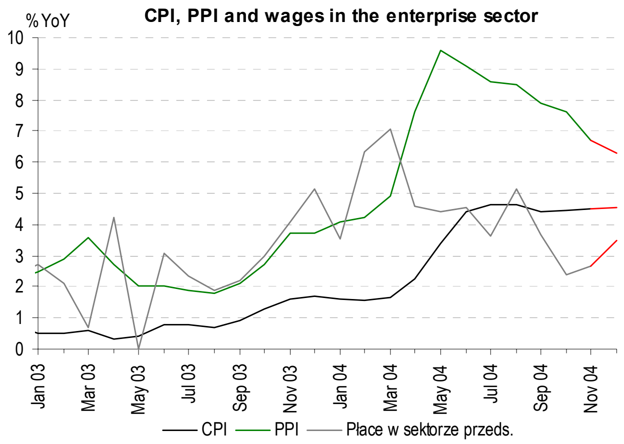
What's hot this week – A bunch of important data this week



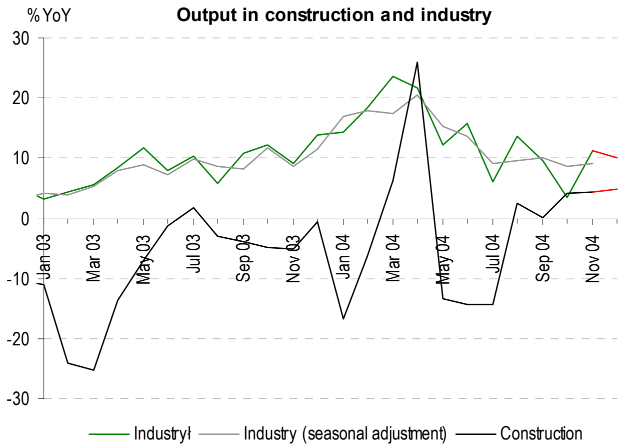
▪ A few important data releases are due this week. The key one for the market will be CPI inflation for December.

▪ Likewise in a few previous months, our inflation forecast (4.6%YoY in December) is the most pessimistic in the market (other predictions range from 4.3%YoY to 4.5%YoY).

▪ If inflation stabilised at the level of 4.5%YoY seen in the two previous months or grew slightly, one may expect further rise in yields on the short end of the curve.

▪ In the context of inflation pressure, one should pay attention to labour market statistics from the enterprise sector. We expect wage growth remained benign (3.5%YoY versus market consensus of 3%YoY), and employment growth rate remained in red (-0.1%YoY and the market consensus is –0.2%YoY).

▪ Annual PPI probably dropped in December, but is still very high, creating risk for consumer inflation.



▪ This week, data on budget performance in the last month of 2004 will be revealed. One should not expect any surprises – optimistic hints from FinMin's officials will most likely be confirmed.

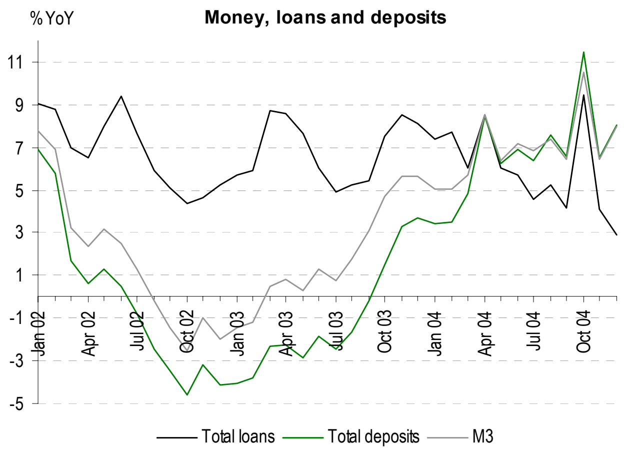
▪ December's data on industrial and construction output should confirm that the Polish economy stays on the path of strong expansion.

▪ We predict that industrial output remained in stable trend observed in a few previous months, pointing to growth of around 10% in annual terms.

▪ Data on construction output growth will be important indication of domestic (investment) demand prospects. We expects December saw further acceleration.

▪ January's results of business climate survey should confirm upbeat perspectives for the construction sector.

Economy last week – More money than expected



▪ Money supply measured by M3 aggregate growth in December was higher than expected and amounted to 8%YoY against the market consensus of 6.5% and our prediction at 6.8%YoY.

▪ Total deposits grew at the same pace as broad money. This resulted mainly from continued robust growth in corporate deposits, which suggests firms still refrained from stronger investment activity. Annual growth rate of households' deposits was close to zero, but one should take note of almost PLN4.6bn monthly increase.

▪ Households' borrowing was still growing fast (mostly mortgages), while corporate borrowing were still falling, confirming that investment activity was weaker than one could have expected.

▪ All in all, December's monetary statistics hardly bring any indication of serious threat to medium-term inflation outlook.

Quote of the week – Rate cuts? It doesn't seem probable

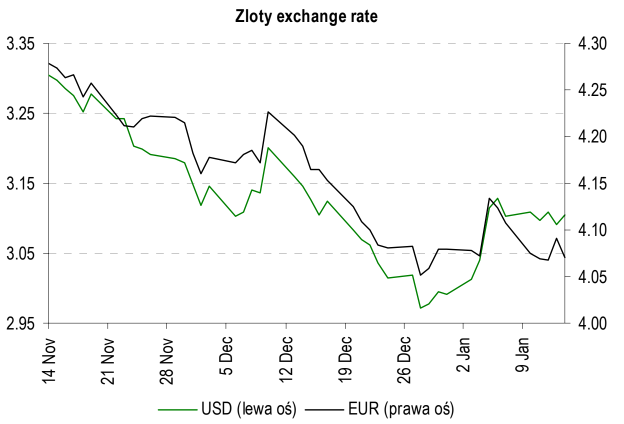
Halina Wasilewska-Trenkner, MPC member

(Bloomberg , PAP, 13 Jan)

An interest rate reduction in 2005 doesn't seem probable. (…) It could happen only as an emergency reaction to a global recession. As long as there is no proof the inflation rate is falling permanently, the Monetary Policy Council won't hurry with cuts.

Comment from Wasilewska-Trenkner significantly affected the market last week – recently growing expectations for swift rate cuts were strongly cooled down. The statement goes in line with her earlier comment, in which she stressed the central bank had to be cautious in monetary policy, as meeting inflation criterion of nominal convergence might be more difficult than hitting the inflation target (the criterion is likely to be below the current target of the MPC at 2.5%).

Market monitor



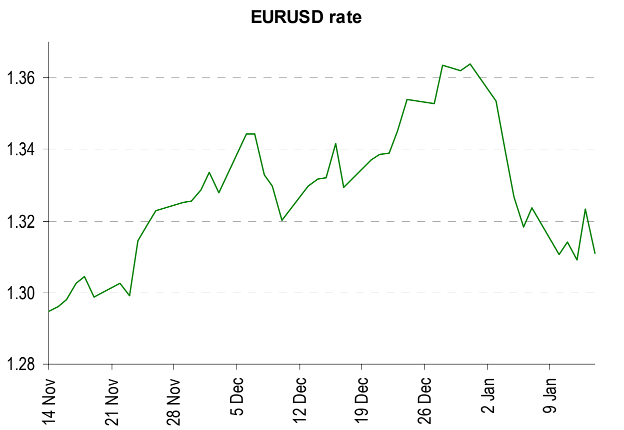
Eurobonds in the leading role

▪ Last week the zloty amid elevated volatility strengthened by 0,92% to the euro staying actually unchanged to the dollar.

▪ Exchange rates fell out of the ranges indicated last week owing to exceptionally good reception of new eurobonds issue and MPC members' comments.

▪ In our opinion current zloty strength will be retained, thus expected by us range of fluctuations is lower than last week – 4.03-4.10 to the euro. We set range for the dollar between 3.07 and 3.15 owing to its present volatility.

▪ Unexpected euro rate movements are the risks to that scenario.

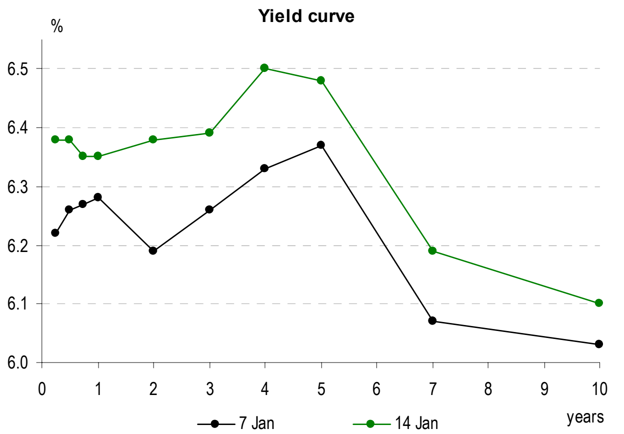


Everybody supports the dollar

▪ Amid meaningful rate volatility the euro boosted to the dollar only by 0.4%. Record high trade deficit failed to retain exchange rate above 1.32 for longer.

▪ Significant factors that will influence the rate are the shift in ECB's Trichet's rhetoric and firm statements on tightening of both monetary and fiscal policies.

▪ We still maintain the outlook that euro will retain high levels, as any binding decisions regarding US budget deficit are expected as for now. The market currently seems to attach less importance to the historical data, relying mostly on expectation. EURUSD market will eye this week Tuesday's data on US net capital inflow.

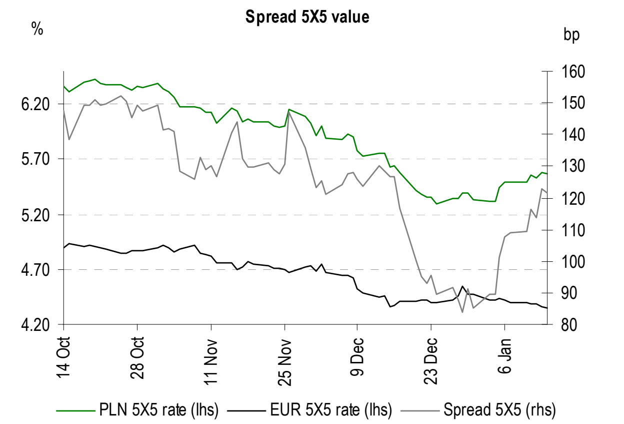


The week full of surprises

▪ The curve moved upwards, reducing positive slope between 2/5y sectors to 10 bp. FRA 6x9 contracts price in presently 40 bp cut versus 54 bp a week ago.

▪ Low demand for 10y bonds stemmed to a large extent from substantial eurobonds interest. Shift in market players reception of MPC members' point of view triggered curve move ahead of key inflation data publication.

▪ If consumer prices retain the rate of growth of at least 4.5%, we expect further yield increase at the short end of the curve. Even in the presence of lower supply of PS0310 (PLN2.5bn) the market will remain under pressure till the auction. Possible rebound may occur only after the tender.



Trichet's wording

▪ Spread 5x5 between the zloty and euro fell out last week outside the bracket 100-110 bp and hit 122 bp. It happened owing to 10y Bunds strengthening (3.57%) following Trichet's comments despite substantial offer on the auctions and unsuccessful 10y Polish bond tender.

▪ Both positive impact for Bunds of Trichet's wording and negative sentiment in Polish bond market are expected to last this week what suggests the spread will retain levels above 120 bp.

▪ American bond market (10y 4.23%) will await December inflation data release and publication of Fed's Beige Book.

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