Bank Zachodni WBK

Weekly economic update

24 January – 30 January 2005

The week will start with publication of remaining statistical data for December – retail sales and unemployment rate on Monday, and core inflation on Tuesday. However, financial market will be looking forward to Wednesday, when the outcome of the first MPC meeting this year will be announced. We do not expect any changes in monetary policy parameters, although the Council is likely to notice that the balance of risks for future inflation has improved. This could result in short-lived strengthening on the fixed income market. Nevertheless, recent comments from MPC members clearly showed that they would start pondering adoption of neutral bias only after receiving new inflation projection from the NBP staff, and a way to interest rate cuts is still quite long. Additional factor determining trend on the bond market would be switching tender on Thursday. Foreign markets would await US GDP data and German IFO. We predict that in anticipation of Fed's rate hike in early February, the dollar will remain strong against euro, and exchange rate could even temporarily drop below 1.29 in the case of strong data in the US.

Economic calendar

TIME GMT	COUNTRY	INDICATOR (importance level*)	PERIOD		FORECASTS MARKET	FORECASTS BZWBK	LAST VALUE
		MONDAY (24 January)					
10:00	**POL**	**Auction 52-weeks Treasury Bills – PLN600m (M)**					
09:00	**POL**	**Unemployment rate (M)**	**XII**	**%**	**19.0**	**19.0**	**18.7**
09:00	**POL**	**Retail sales (H)**	**XII**	**%YoY**	**3.6**	**6.0**	**4.4**
		TUESDAY (25 January)					
15:00	**POL**	**Net inflation (M)**	**XII**	**%YoY**	**2.4**	**2.4**	**2.4**
15:00	USA	Home sales (M)	XII	M	6.80	-	6.94
15:00	USA	Consumer confidence (H)	I	-	102.20	-	102.30
		WEDNESDAY (26 January)					
	POL	**MPC meeting – decision (H)**	**-**	**%**	**6.50**	**6.50**	**6.50**
09:00	GER	IFO Index (H)	I	-	96.35	-	96.20
		THURSDAY (27 January)					
	POL	**Switching auction (H)**					
13:30	USA	Durable Goods Orders (H)	XII	%	0.5	-	1.4
		FRIDAY (28 January)					
09:00	EMU	Money Supply (M)	XI	%YoY	-	-	6.0
13:30	USA	GDP (H)	4Q	%	3.5	-	4.0
13:30	USA	Personal Consumption Expenditure (H)	4Q	%	-	-	1.3
13:30	USA	Final Michigan Sentiment (M)	I	-	-	-	-

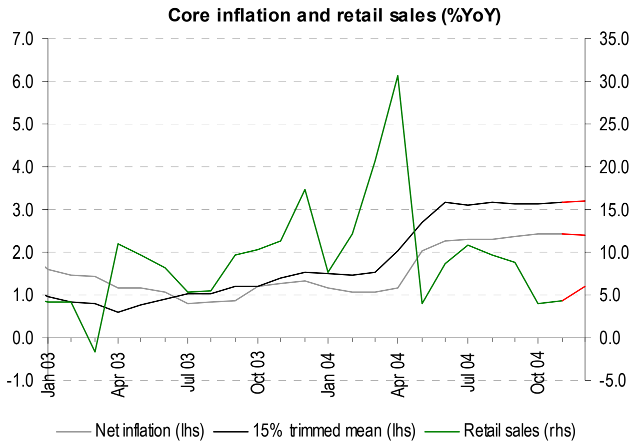
* Importance level: (H)igh, (M)oderate; Source: Reuters, BZ WBK, Gazeta Bankowa

Maciej Reluga Chief economist (+48 22) 586 8363

Piotr Bielski (+48 22) 586 8333
Piotr Bujak (+48 22) 586 8341
Tomasz Terelak (+48 22) 586 8342

Email: firstname.secondname@bzwbk.pl

What's hot this week – No changes in monetary policy expected, as for now



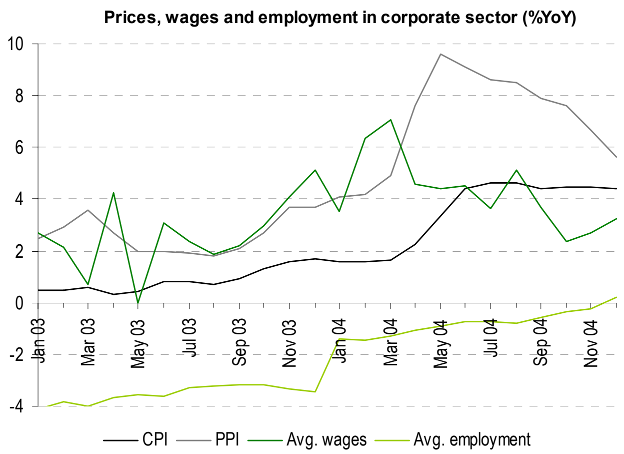
▪ New week will start with publication of CSO's statistical bulletin, containing e.g. data on retail sales and unemployment rate for December. We expect 6%YoY nominal rise in sales and unemployment at 19%.

▪ On Tuesday the NBP will show core inflation indices, which should remain stable, at quite low level.

▪ On Wednesday the outcome of the MPC meeting will be announced. We do not expect any changes in monetary policy, although the Council is likely to agree that balance of risks for inflation has somewhat improved since the former meeting.

▪ Recent comments from the MPC members had suggested that they would be pondering change of bias into neutral only after reading new inflation projection (February), and road until rate cuts is still distant – in our opinion rates would remain unchanged until end-2005.

Economy last week – December of weaker increases

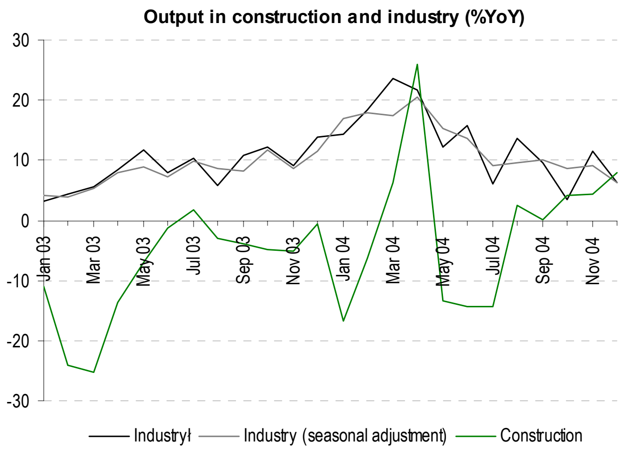


▪ Inflation rate in December fell to 4.4%YoY, against average forecasts at 4.5%. Biggest surprise came from food prices, which were lower in H2 of the month. Decrease was also see in prices of fuel (-2.2%MoM), and clothing (-0.1%).

▪ Lower CPI at the end of 2004 implies lower inflation in early 2005 – in 1Q05 it should rise to 4.7-4.8%YoY. In mid-2005 CPI growth is likely to come down to 2.5%YoY (earlier we predicted 2.8%), and should stabilise at this level until end 2005.

▪ Wages in corporate sector rose 3.2%YoY, which does not show threat for inflation. One should keep in mind, however, that outside corporate sector salaries are rising faster, above inflation rate.

▪ Employment in companies was higher than forecasted and rose 0.2%YoY – it was the first growth for more than 4 years. Rebuilding demand for labour might stimulate wage growth.



▪ Improvement on labour market is good for consumers' moods – in January consumer optimism index improved again, which could herald consumption boom in future.

▪ Industrial output growth in December reached 6.4%YoY, twice lower than expected. Slowdown resulted chiefly from high base effect from 2003. However, such rate of growth should be perceived as solid. In turn, construction sector recorded upturn in output to nearly 8%YoY, which bodes well for investment recovery in 2005.

▪ We maintain forecast of GDP growth at ca. 5% in 4Q04. In 2005 average 5% growth is also expected, although first half should be weaker due to adverse effect of high base.

▪ PPI growth decelerated to 5.6% from 6.7%YoY month earlier, mostly owing to lower prices of refinery products and metals. By mid-2005 PPI growth could drop below 1%YoY, which is good for CPI prospects.

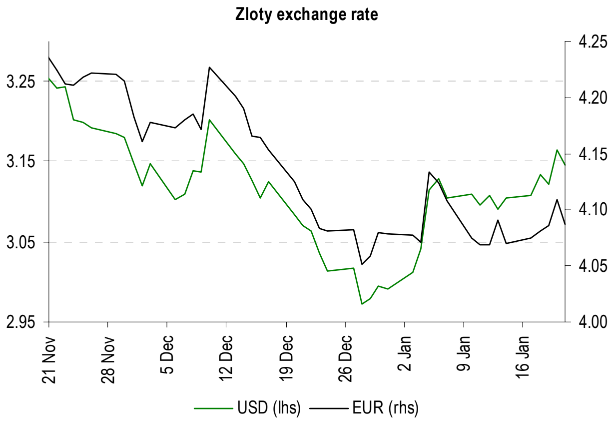
Quote of the week – Bumpier road to the euro zone?

Anonymous EU diplomat
(Reuters, 17 Jan)

I see little possibility of simply writing off the costs of pension reforms from the budget deficit. [...] What may be considered is treating spending on pension reform in a special way. A country might not be punished if it breaches the deficit due to the costs of the pension system overhaul.

Comment of the EU official suggested it was unlikely that Poland could succeed in its fight for favourable ruling on classification of its pension system in the ESA95 accounting rules. This would undermine Poland's plan to meet fiscal convergence criteria by 2007 and would probably extend our road to the euro zone. Meanwhile, Polish finance minister Mirosław Gronicki remained optimistic on this issue, and in his opinion "even now we have high chance to have pension system reform treated as an exception". Final decision on this issue is to be made in March.

Market monitor

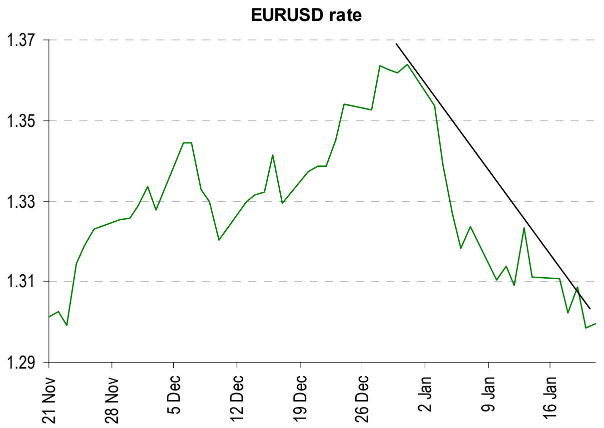


The dollar will weigh again

▪ In the past week the zloty was under pressure of strong dollar, MPC members' comments and volatile sentiment in bond market.

▪ Ultimately it weakened mainly to the dollar, against which it lost 1.31%, however retained similar levels against the euro hovering around 4.10 mark (our average forecast for 1Q05). The zloty breached upper bands of ranges, which we indicated a week ago. However, high levels were used to purchase the Polish currency and the zloty reverted into the brackets.

▪ Next week due to expected euro dollar rate movements and MPC meeting we believe that euro will fluctuate within the range of 4.06-4.12 and dollar - 3.10-3.18.

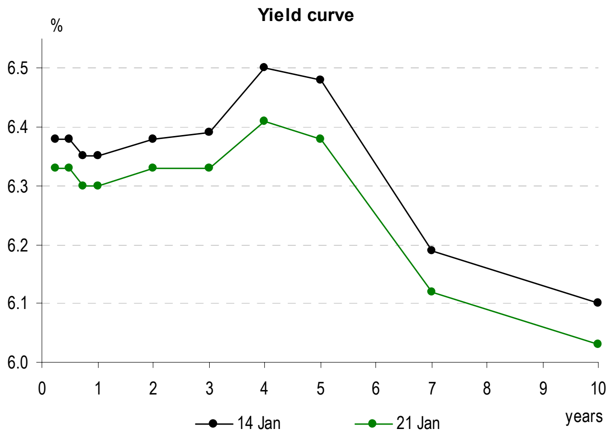


Break through

▪ The euro weakened to the dollar by 0.88% owing to data on healthy capital inflow into US in November ($81.1bn) and optimistic signals included in Fed Beige Book.

▪ Exchange rate crossed psychological barrier of 1.30, to which we turned the attention, but in our opinion its technical importance is only moderate.

▪ Next week dollar's upward tendency ought to be retained with possibility of euro rate slide even below 1.29, if the data take by surprise positively. Upcoming Fed meeting will probably be supportive factor, on which we expect another interest rate hike by 25 basis points.

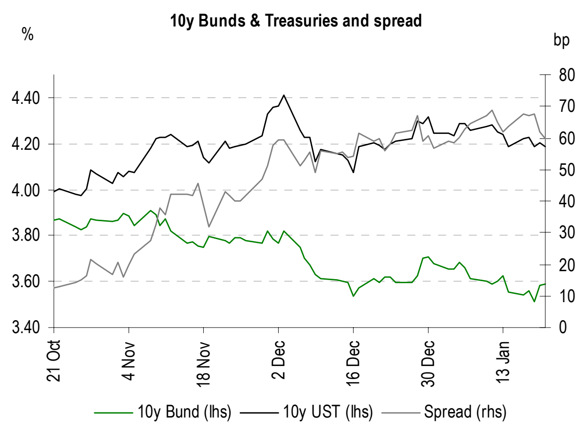


Macro data against foreign players

▪ Amid exceptionally huge fluctuations the curve moved slightly downwards, flattening a bit in the 2/5y sector. FRA 6x9 prices in currently a cut by 43 bp against 40 bp last week. We still perceive it as excessively aggressive.

▪ Bond positive data from the economy and tender success failed to strengthen the market substantially facing large supply from foreign players.

▪ Next week may bring short-term market advancement, especially at the short end of the curve due to expected by us the MPC statement on more favourable balance of risks for future inflation. But in the long run we think that bond yields will rise above current levels. Besides MPC investors will await switching tender.



Strong Bunds' resistance

▪ 10y Bunds again rebounded from 3.50% barrier and reached 3.58%. Their spread to 10y Treasuries, which retained levels around 4.20%, narrowed to 62 bp due to dollar's strength. If US data prove to be solid spread may widen again.

▪ Spread 5x5 between Poland and euro zone fell slightly below 120 bp because of yields rise in Europe. We think that next week will bring spread fluctuations within the range of 110-120 bp, as relatively good sentiment in the Polish market may maintain till the end of the month.

▪ Core bond markets will await next week the release of preliminary US GDP data for 4Q04 and IFO index (ZEW bodes well for it), but its impact in the face of recent dovish ECB chief's comments will be limited.

Additional information is available on request. Please contact Bank Zachodni WBK S.A. Treasury Division, Economic Analysis Unit, ul. Marszałkowska 142, 00-061 Warsaw, Poland, phone (+48 22) 586 8363, email ekonomia@bzwbk.pl, http://www.bzwbk.pl

Bank Zachodni WBK
is a member of
Allied Irish Banks Group