

Weekly economic update

31 January – 6 February 2005

Already on Monday we will get to know GDP data for 2004, which will allow for assessment of Poland's economic performance in the fourth quarter. Also, the NBP will release balance of payments figures for November, which should not impact the financial market anyway. Moreover, the SLD is expected to decide on Monday about date of parliamentary election. As we expect rise in risk premium before the election, its delay until autumn could allow financial market to take some breather. Nevertheless, voting over Sejm's self-dismissal most likely will be held anyway (probably in May), creating additional uncertainty, thus we do not foresee return of positive market sentiment in the coming months. On Wednesday, the government meets the central bank to discuss exchange rate policy in the coming years. The cabinet might insist on fast interest rate cuts aimed at weakening of the zloty, however we do not believe the MPC would lean to such pressure. Thus, in the case of reappearing strong zloty appreciation, it is still possible the government would buy foreign currencies on the market.

The MPC held main interest rates unchanged in January. The ECB is expected to do the same, while the US Fed is widely anticipated to deliver 25bps rate hike this week (main rate to 2.5%). Besides, US market will eye releases of number of significant economic data this week.

Economic calendar

TIME GMT	COUNTRY	INDICATOR (importance level*)	PERIOD	FORECASTS		LAST VALUE	
				MARKET	BZWBK		
MONDAY (31 January)							
10:00	POL	Auction for 52-weeks Treasury bills – PLN600m (M)					
15:00	POL	C/A balance (M)	Nov	€m	-150	-324	234
09:00	POL	GDP (H)	2004	%YoY	5.5	5.6	3.8
15:00	USA	Chicago PMI (H)	Jan	-	59.00	-	61.20
TUESDAY (1 February)							
09:00	EMU	Reuters PMI (U)	Jan	-	-	-	51.40
15:00	USA	ISM Manufacturing (H)	Jan	-	57.50	-	58.50
15:00	USA	Consumer spending (M)	Dec	%	0.5	-	-0.4
WEDNESDAY (2 February)							
10:00	POL	Auction for 2y bonds (OK0407) – PLN1.5-2.5bn (H)					
19:15	USA	FOMC Decision (H)		%	2.50	-	2.25
THURSDAY (3 February)							
12:45	EMU	ECB Decision (H)	-	%	2.0	-	2.0
15:00	USA	ISM non-Manufacturing (H)	Jan	-	61.00	-	63.10
15:00	USA	Factory orders (H)	-	%	0.5	-	1.2
15:00	USA	Durable goods orders (H)	Dec	%	-	-	0.6
FRIDAY (4 February)							
13:30	USA	Change in non-farm payrolls (H)	Jan	K	180	-	157
13:30	USA	Unemployment rate (M)	Jan	%	5.4	-	5.4
14:45	USA	Final Michigan index (H)	Jan	-	96.00	-	97.10

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

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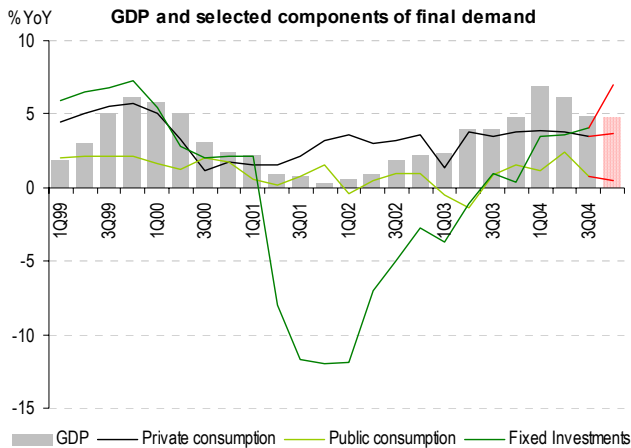
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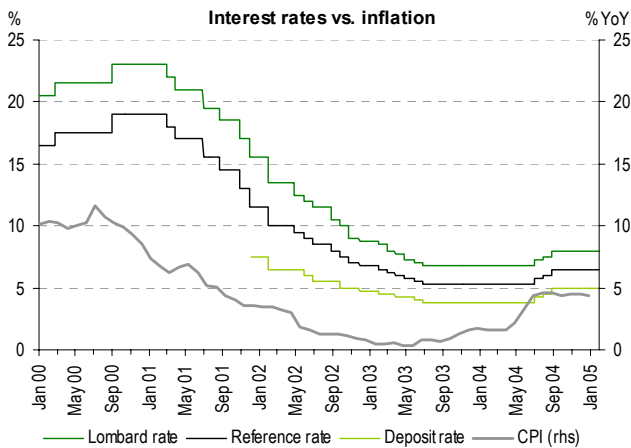
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What's hot this week – What GDP growth in fourth quarter?

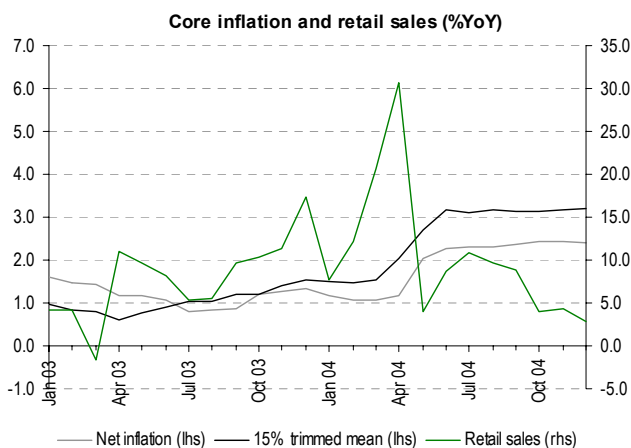


- Relying on GDP data for entire 2004 it will be possible to estimate results for 4Q04 (slowdown is widely anticipated after weaker than expected data for December).
- We still maintain that despite slight deceleration in H2, GDP growth in 2004 was quite robust, reaching 5.6%.
- It was stimulated by almost 5-percent growth in domestic demand, fuelled in turn by 5% growth in investment outlays in entire year (even faster in fourth quarter), and stable growth in private consumption (3.7%).
- NBP's data regarding balance of payments in November should not affect the market significantly. Current account deficit should remain below 2% of GDP, and high pace of export and import growth is expected.

Economy last week – Quite hawkish statement, despite weak data



- Interest rates unchanged, tightening bias maintained – it means that chances for rate hikes are still higher than for rate cuts.
- According to the MPC the balance of risks for future inflation remained unchanged since previous meeting. This statement was more hawkish than expected.
- In our opinion, shift to neutral bias is still possible in February, but it will not signal soon interest rate cuts (see: Quote of the week below).
- February's inflation projection will be crucial, which will include 2007 for the first time. It will be published only after the next MPC meeting.
- It is very hard to guess what inflation path will be generated by NBP models for 2007. One could guess it will show there is not much room for monetary easing if Poland wants to meet Maastricht criteria in 2007.



- MPC said that available data give contradicting signals regarding economic activity and price growth.
- ... disregarding the fact that data on retail sales released last week joined set of disappointing news about economy.
- However, one should notice that detailed structure of retail sales growth showed that main reason of severe slowdown in sales growth (to 2.8%YoY from 4.4% in Nov) was downturn on car market after EU accession.
- In remaining categories high, mostly two-digit pace of growth was maintained, which does not seem to confirm significant slowdown in private consumption growth.
- Core inflation measures, released last week, declined slightly in December, but in general they introduced little new information to the already known picture of economic situation.

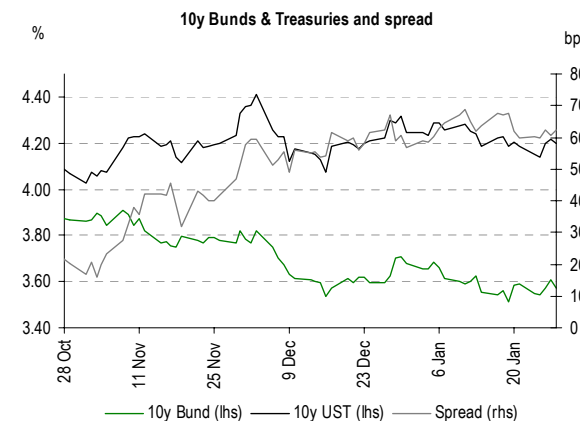
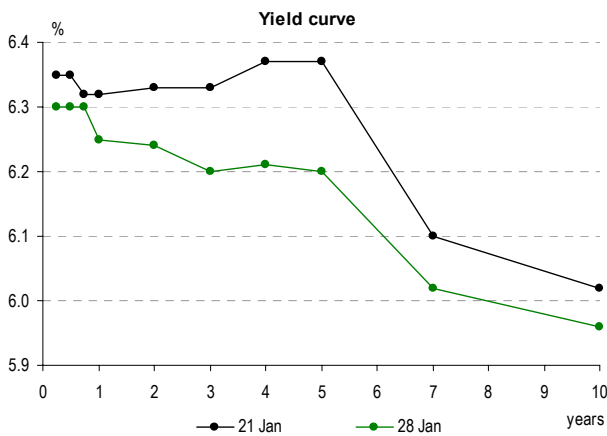
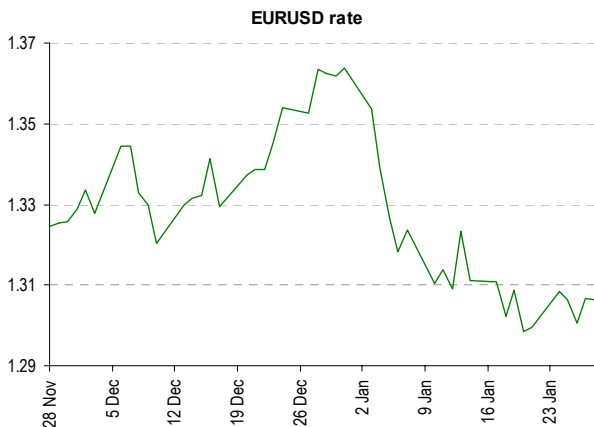
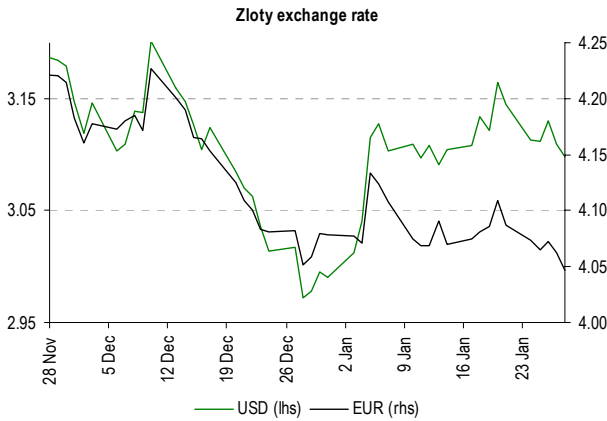
Quote of the week – Still a long way to rate reductions

Dariusz Filar, MPC member
(Radio PiN, 27 Jan)

In 2005 monetary policy guidelines the Council clearly said it would like to use all three biases [...]. Accordingly, before we turn into interest rate reductions we have to adjust the bias. I believe that reasonable would be to look at possible time of bias change as some time bracket [...] To sort it out: between February and May, June.

Our point of view is consistent with Dariusz Filar's comment. It seems that rise in MPC's inclination to cut rates will be signalled by change of monetary policy bias to "easing". Beforehand, the bias must be changed to "neutral", and according to Filar it is not sure it will take place at the nearest MPC meeting. Taking this into account, we do not change the view that financial market's expectations for rate cuts in the coming months are overly optimistic (FRA 3x6 – 6.42%, 6x9 – 6.12%).

Market monitor



MPC's balance of risks favourable to the zloty

- Last week the zloty gained 1.49% to the dollar and 0.99% to the euro. Throughout most of the week, exchange rate was located close to the bottoms of the brackets indicated by us last week, as the balance of risks for future inflation did not change in the MPC opinion and scenario of substantial weakening of the euro rate did not realize.
- We think that MPC statement constitutes positive factor to the zloty in short term. Additionally, it may be supported by Monday's release of investment in 2004. Therefore for next week we set fluctuation ranges of zloty 4.03-4.09 to the euro and 3.07-3.15 to the dollar. We expect meaningful impact of EURUSD rate on Polish currency owing to economic calendar full of events.

Hot week ahead

- Last week despite the majority of data was supportive, the dollar failed to go down below 1.29. That was hindered by comments from Chinese government on possibility of change in yuan's regime during G7 meeting. Under those circumstances the rate stayed rangebound within 1.2920-1.31.
- As G7 meeting takes place only at the end of the next week the market probably won't show any clear direction until then. Till the Fed's decision announcement and president Bush's State of the Union speech, EURUSD rate will fluctuate within recent trading range. Afterwards, one could expect volatility increase ahead of US Labour Report release.

Excessive reaction

- Yield curve declined last week altering the slope from normal (+4 bp) into inverted one (-4 bp). FRA 6x9 still prices in rate cut close to 50 bp.
- Throughout the week, the market continued strengthening triggered by weak economic data, ignoring relatively hawkish MPC statement and supply from switching auction.
- We believe that bonds excessively responded to weak data. Moreover we deem that GDP data may stop further prices' gains, rendering the market vulnerable to correction. But in the face of two main central banks meetings and release of Labour Report in US it is possible only in the second part of the week.
- Reception of Wednesday's 2y bond auction to the large extent will depend on investment data.

Fed's statement in the public eye

- Core markets weakened under pressure of data and unsuccessful 2y bond auction in US, but reverted after weak GDP data. Yield curves moved to the same extent, so spread between Bunds (3.55%) and Treasuries (4.17%) didn't change (ca. 62 bp). Next week in the public eye will be meeting of the Fed (particularly statement) and ECB and employment data from US. We still expect spread's widening.
- 5/5y spread between Polish and euro curve, as we expected, fluctuated within 110-120 bp range. We think that it will be preserved, as ECB probably will retain recent statement rhetoric, and Polish parliamentary elections will be held in autumn, which will be decided by SLD on Monday.

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