

(Bi)weekly economic update

21 March – 4 April 2005

Due to upcoming Easter, this time we have prepared a report for the nearest two weeks. Despite holiday moods, this period may see interesting developments on the financial markets, as the calendar envisages many important events, both in Poland and abroad. For the Polish market, the key will be MPC meeting on 29-30 March. Macro data for February published so far strongly supported expectations for the first rate cut in the cycle to be delivered already this month. The data to be published throughout the nearest week, before the MPC meeting, should have a similar effect. We think that a cycle of interest rate reductions will start with 50bp cut.

Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
MONDAY (21 March)							
10:00	POL	Auction for 52-week T-bills – PLN800m (M)					
TUESDAY (22 March)							
13:30	USA	PPI (H)	Feb	%MoM	0.3	-	0.3
15:00	POL	Core inflation (H)	Feb	%YoY	2.3	2.3	2.4
15:00	POL	Business climate (M)	Mar	-	-	-	-
19:15	USA	FOMC decision (H)	-	%	2.75	-	2.5
WEDNESDAY (23 March)							
09:00	POL	Retail sales (H)	Feb	%YoY	4.1	4.9	7.5
09:00	POL	Unemployment rate (M)	Feb	%	19.5	19.5	19.5
09:00	GER	IFO index (H)	Mar	-	95.60	-	95.50
10:00	POL	Switching auction (H)					
13:30	USA	CPI (H)	Feb	%MoM	0.4	-	0.1
THURSDAY (24 March)							
10:00	POL	Auction for 52-week T-bills (M)					
13:30	USA	Durable goods orders (H)	Feb	%	1.0	-	-1.3
TUESDAY (29 March)							
15:00	USA	Consumer confidence (M)	Mar	-	104.0	-	104.0
WEDNESDAY (30 March)							
-	POL	MPC meeting – decision (H)	-	%	6.00	6.00	6.50
08:00	EMU	Money supply (H)	Feb	%YoY	-	-	6.60
13:30	USA	Final GDP (H)	4Q	%QoQ	4.0	-	3.8
THURSDAY (31 March)							
15:00	POL	C/A (M)	Jan	€bn	-	-200	-275
15:00	USA	Factory orders (M)	Mar	%	-	-	0.2
FRIDAY (1 April)							
13:30	USA	Change in non-farm payrolls (H)	Mar	000	223	-	262
14:45	USA	Final index Michigan (H)	Mar	-	93.00	-	94.10
15:00	USA	ISM manufacturing (H)	Mar	-	55.00	-	55.30

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

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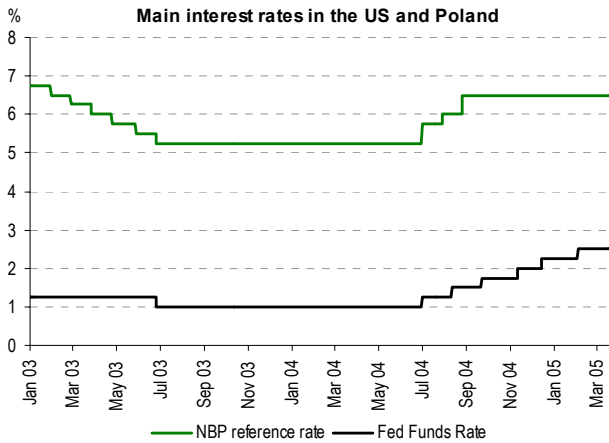
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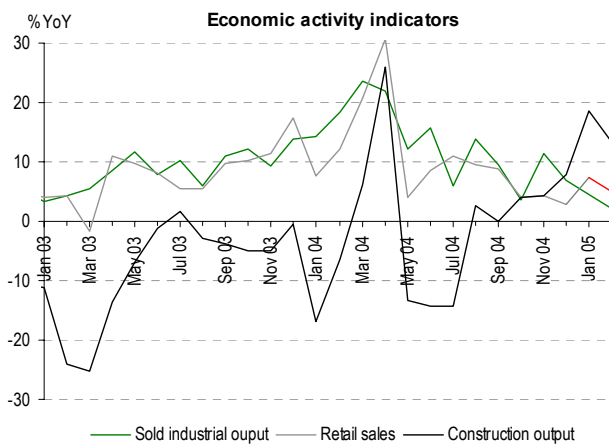
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What's hot this week – First cut in Poland, another hike in the US

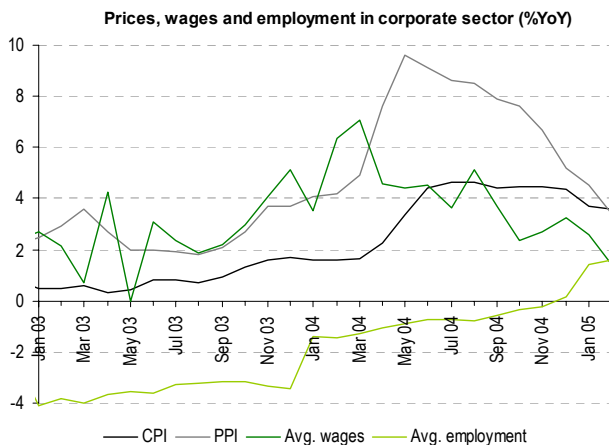


- The key event on Polish financial market in the next two weeks will be MPC meeting.
- Considering signals from the economy that had appeared since the previous MPC meeting (see below), 50bps rate cut in March is widely anticipated (we share this view).
- Only doubts regarding fast start of monetary easing cycle were raised by recent zloty depreciation.
- However, comments of MPC members made after zloty slump showed that despite risk from FX rate they are not afraid of inflation outlook.
- The American Fed will decide about interest rates a bit earlier than the Polish MPC. Another interest rate rise of 25bps in the US is widely expected, however the market is not certain what will be Fed's directions for future.



- Before the MPC decides about interest rates, the last set of data will be released in Poland.
- According to our forecasts, their overtone should be similar to that from earlier information.
- Slowdown in retail sales growth, even though caused mainly by high base effect, is likely to reinforce concerns about strength of the economy and will confirm expectations for rate cuts (likewise weak production figures did last week).
- Core inflation data are likely to show that current drop in CPI is originated mostly in supply side. At the same time, they should suggest inflation pressure is under control.
- After MPC meeting current account data for January will be released. We foresee robust performance of exports and very low external imbalance – good news for the zloty.

Economy last week – Inflation surprised even the biggest optimists



- Among many important data released last week, the most important and the most surprising were CPI figures for January (revised) and February.
- Annual growth in CPI fell to 3.6% from 3.7% in January. The lowest forecast was 3.8% and consensus stood at 4.0%. Annual PPI rise (3.4%YoY) also surprised on the downside.
- Much lower than expected CPI in the two first months of the year improved expected inflation path for subsequent months. Average inflation in 1Q05 will be lower than assumed in the inflation projection by as much as ca. 1pp.
- Surprisingly fast inflation fall supports expectations for early beginning of interest rate reduction cycle.
- Labour market statistics for February supported such view. Average wage in the enterprise sector rose a mere 1.4%YoY and even accelerating growth in employment (1,6%YoY) did not prevent wage bill from another fall in real terms.

Quote of the week – Growing penchant for large rate cuts

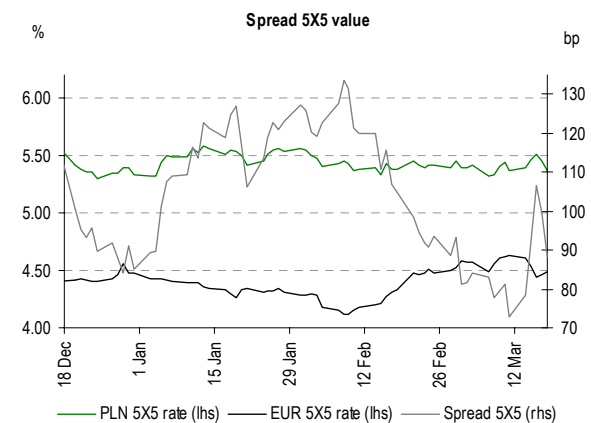
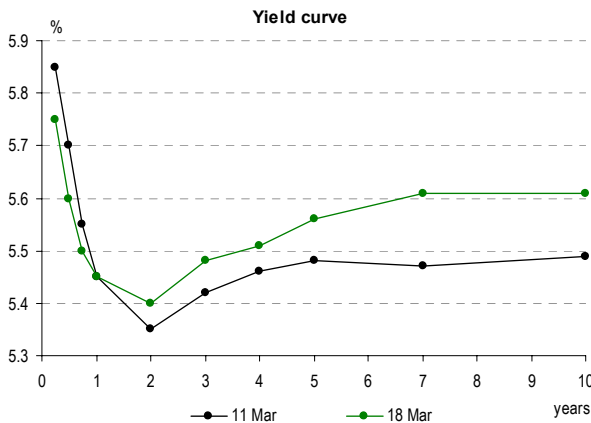
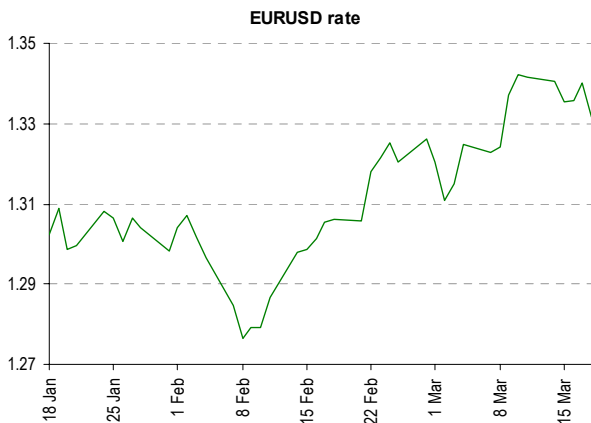
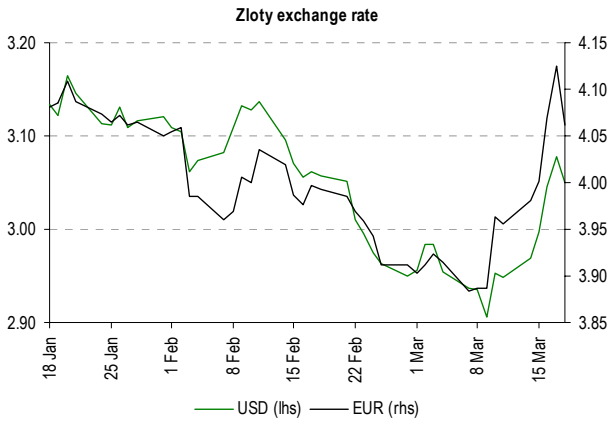
Halina Wasilewska-Trenkner, MPC member

PAP, 18 March

Revision of inflation data for January weakens the view presented by deputy governor [of the NBP] Krzysztof Rybiński that interest rate cut of 150bps in 12 months time, as expected by the market, would significantly increase a risk of inflation staying above the target.

Statement of Wasilewska-Trenkner shows that she is not afraid of possible inflationary effects of large rate cuts. Other rate-setters spoke in similar tone (e.g. Andrzej Wojtyna, who said the MPC will not wonder whether to cut rate, but how much). What's interesting, central bankers are willing to trim rates having quite cautious expectations regarding inflation outlook (e.g. Stanisław Owsiak thinks CPI may drop to below 2.5% only towards the end of the year). Our predictions are more optimistic (CPI below 2% from June until year-end).

Market monitor



Sell-off gains momentum

- The zloty likewise the other emerging markets currencies fell exceptionally sharply. Capital outflow caused by major yield rise of US papers from early March and political risks laid behind. Only macro data and investors' return on the bond market boosted the zloty. Last week closed weaker respectively by 3.10% and 2.30% to the dollar and the euro.
- The zloty performance within next two weeks will depend on central banks. On the Fed, which statement will indicate the direction of EURUSD rate and MPC that lowering interest rates, may give a signal it is not concerned about the impact of zloty weakening on inflation what will induce capital to revert to interest rate market. Thus, we expect the zloty to fluctuate within the ranges: 4.04-4.14 to the euro and 3.04-3.14 to the dollar.

Capital inflow stronger than needed

- EURUSD rate last week recorded meaningful volatility due to high capital inflow into US first and confirmation of record high US external deficit in 4Q04. At the end of the week was focused on positioning ahead of Tuesday's Fed meeting, on which a share of participants anticipates hawkish statement. Finally EURUSD declined by 0.71%.
- Next two weeks are embraced by important market events with less active Easter period inside. If the Fed changes an overtone of the statement into hawkish one, then the dollar may break below strong support 1.32. Otherwise, owing to many short positions in the euro EURUSD rate will revert to 1.34. Fed decision will set a trend in the market till the next labour market data, which should be positive for the dollar.

Data offset zloty impact

- Zloty sell-off, enhanced by bond auction, triggered major volatility in the interest rate market. Players being concerned about weaker currency influence on MPC decision got rid of papers, ignoring very low February CPI. But on the back of data prices reduced the majority of losses. Eventually, yields were higher by 5-12 bp and FRA reverted actually to initially priced in rate cuts.
- Taking into account only domestic factors, investors should support the bonds, especially 2y ones. Switching auction will probably bring favourable results, once the market following data expects reduction by 50 bp. But one should keep in mind the Fed which may spoil sentiment in the Polish market if it alters statement overtone.

Spread back to the norm

- Spread 5/5y between PLN and EUR curves widened to 95 bp due to deterioration in Polish bonds amid stronger Bunds. Only renewed capital inflow into Polish bonds may be able to lower spread to 80 bp.
- US 10y bonds managed to retain levels around 4.50% owing to technical factors and funds outflow from emerging markets. 10y Bunds advanced to 3.72% on Treasuries and due to declines in European exchanges.
- Likewise EURUSD rate the situation depends on Fed meeting and inflation indicators in US and IFO. Bond prices should be strongly correlated with dollar performance. After Easter period turnover will gradually increase ahead of US labour market data, which may be negative for papers.

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