

Weekly economic update

25 April – 1 May 2005

Recently published macroeconomic data indicated lower economic growth in the first quarter of this year (substantial fall in industrial and construction output) and reinforced expectations for favourable perspective of inflation (low CPI and PPI as well as core inflation measures). Obviously this supported expectations for reduction in official interest rates during the next meeting of the Monetary Policy Council, scheduled for Wednesday. The only remaining question concerns the scale of rate cut. As for now, financial market does not price-in 50 bp cut, although this may easily change after Monday's publication of retail sales (we expect a fall in annual terms). However, we still believe that a reduction of 25 bp is slightly more likely, as a compromise solution acceptable for the majority of MPC members. If the Council adopts such scenario of cautious changes in monetary policy parameters, the next move should be expected already in May, when the next inflation projection of the central bank will be published. That is why, a possible increase in market rates after reduction of 25 bp should not be very significant and long lasting. On the other hand, if the MPC decides to act more aggressively (cut of 50 bp), we would see a sharp reduction in yields on the fixed income market, especially at the short-end of the curve. On the international market, ahead of important events at the beginning of May - FOMC decision (May, 3) and non-farm payroll data (May, 6) - a heavy economic calendar provides plenty for the dollar which is see-sawing on signs of slowing economic activity or inflationary pressures.

Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
MONDAY (25 April)							
08:00	POL	Retail sales (H)	Mar	%YoY	-1.5	-7.0	2.4
08:00	POL	Unemployment rate (M)	Mar	%	19.2	19.2	19.4
08:00	GER	IFO index (H)	Apr	pts	93.6	-	94.0
09:00	POL	Auction for 52-weeks T-bills – PLN800m (M)					
TUESDAY (26 April)							
14:00	USA	Consumer confidence (M)	Apr	pts	98.8	-	102.4
WEDNESDAY (27 April)							
-	POL	MPC meeting – decision (H)	-	%	5.75	5.75	6.00
08:00	EMU	Money supply (H)	Mar	%YoY	6.4	-	6.4
12:30	USA	Durable goods orders (H)	Mar	%	0.1	-	0.5
THURSDAY (28 April)							
09:00	POL	Switching auction (H)					
12:30	USA	GDP (H)	1Q05	%	3.5	-	3.8
12:30	USA	PCE (H)	1Q05	%	-	-	1.7
FRIDAY (29 April)							
14:00	USA	Chicago PMI (H)	IV	pts	63.5	-	69.2
14:00	POL	Current account (M)	Feb	€bn	-95	-264	-72
14:00	POL	Trade balance (M)	Feb	€bn	5	-114	158

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

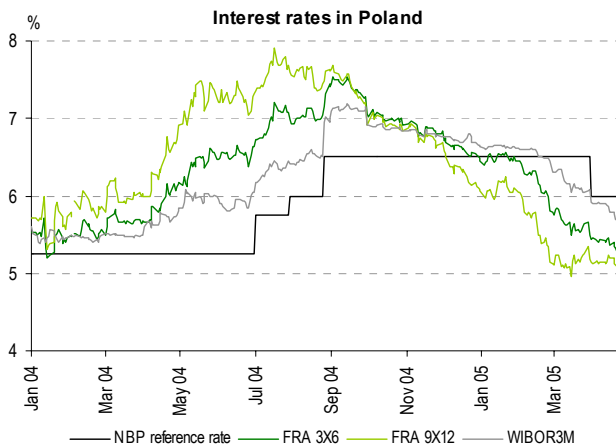
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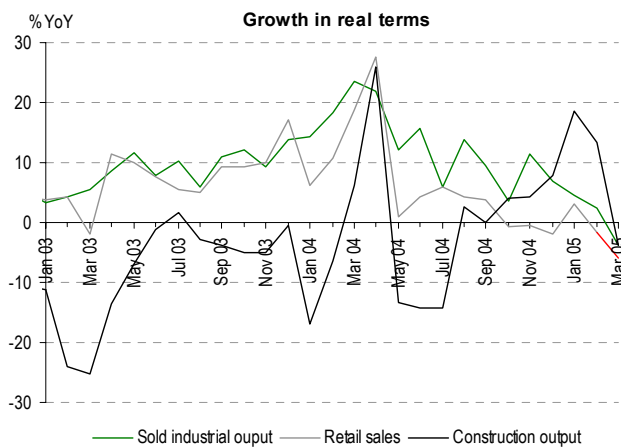
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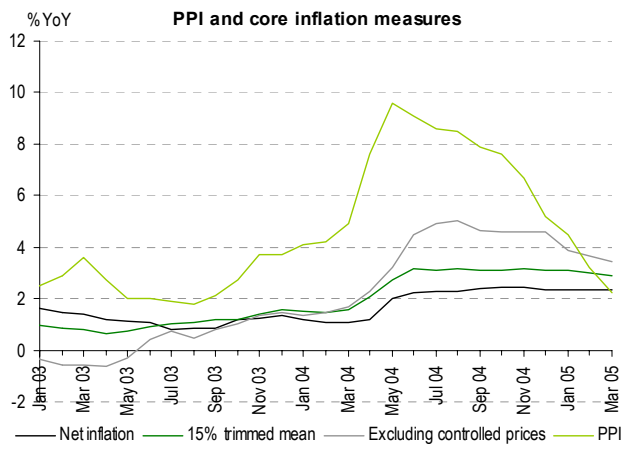
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What's hot this week – Lower economic activity, lower interest rates

- Much lower than predicted CPI inflation and output will probably convince some MPC members to demand deeper rate cut than 25 bps.
- In our opinion, rate cut of 25 bps would confirm the MPC's desire to relax monetary conditions, and at the same time it would reflect Council's caution.
- ...especially as even quite dovish MPC members indicated risk factors connected with food and fuel prices as well as foreign exchange market.
- We think that the MPC will pay more attention to medium-term tendencies rather than to very volatile monthly economic data.
- We also believe that the central bank's GDP growth forecast for 2005 (of 4.0-4.5%) will not change, which will be another argument for more cautious monetary policy.



- On Monday, data on retail sales will be published, which will be another argument for lower interest rates
- ... but gradual improvement on the labour market, which will be indicated by unemployment rate, should not be an important element for financial markets.
- Balance of payments data will be released just before the long weekend in Poland (May 3 is the Constitution Day) and should have limited impact on the market.
- Industrial production and construction output fell in March by almost 4%YoY. Seasonal factors and base effect did not explain such deep decrease.
- It seems likely now that GDP growth rate in the first quarter of 2005 was lower than earlier assumed and it might even not exceed 3%. Still, GDP growth in the entire year should be above 4%, but budgetary assumption of GDP growth at 5% will be very difficult to achieve.

Economy last week – Inflation indicators are also favourable

- After the release of CPI inflation and corporate wages data, last week we saw other figures on prices in March, which confirmed favourable perspective of inflation.
- Although monthly PPI increase (0.5%) was much higher than expected, annual growth rate (2.2%) was close to expectations amid downward revision of February's results.
- The biggest rise in prices took place in production of oil and its derivatives and tobacco, which may have some effect on consumer prices' growth in the nearest months.
- However, trend in PPI inflation should be quite favourable – in May and June it should fall slightly below zero.
- Net inflation inched up to 2.4%YoY from 2.3% last month, confirming that supply-side factors were responsible for CPI fall in March. Other measures lowered in a scale similar to CPI reduction, indicating that pressure on price growth is not excessive.

Quote of the week – The question is “by how much”, not “if”**Dariusz Filar, MPC member**

Radio PiN, 18 April

For me it [a gradual step] is a reduction of 25 bps and such cautious cuts should allow us to stabilise inflation in the environment of relatively high GDP growth.

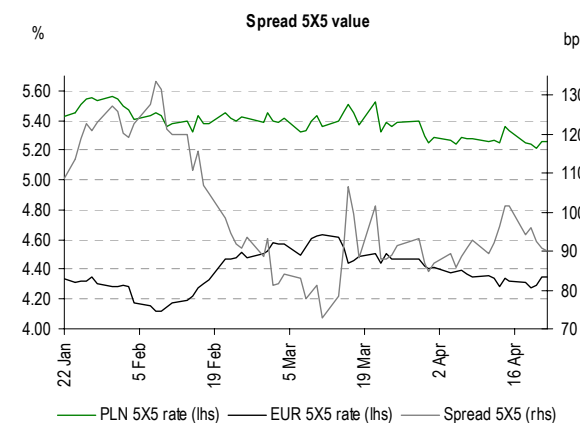
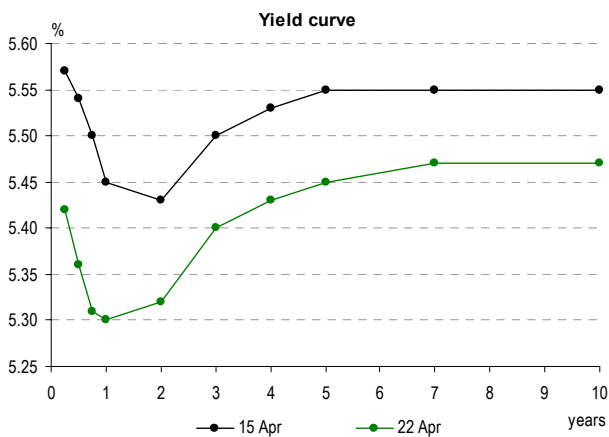
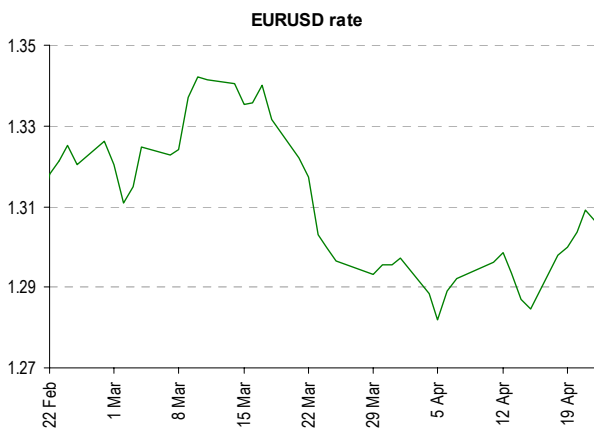
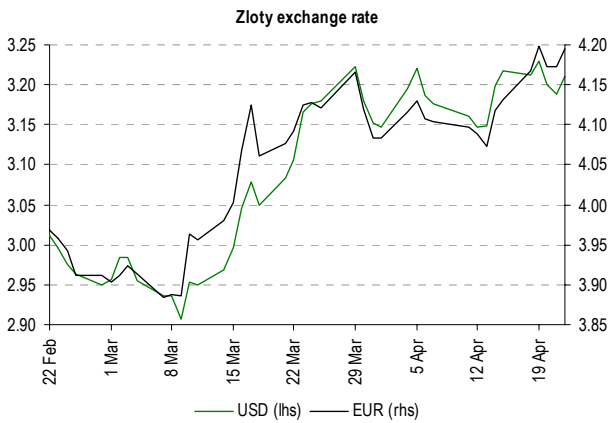
Mirosław Pietrewicz, MPC member

Bloomberg, 20 April

A reduction of half a percentage point to 5.5% is an appropriate reduction and should be expected this month.

There is no doubt that the MPC is divided as regards the scale of interest rate reduction in April. We think there will be at least three MPC members (Jan Czekaj, Stanisław Nieckarz and Mirosław Pietrewicz) insisting on 50 bp rate cut in April. They will need three allies more to trim rates aggressively. The key will be stance of Andrzej Sławiński and Andrzej Wojtyna, as Leszek Balcerowicz, Dariusz Filar and Halina Wasilewska-Trenkner are rather unlikely to support larger than 25bp rate cut this month.

Market monitor



Voting in the Council and parliament ahead

- The zloty set out last week from decline triggered by a change on finance minister post in Hungary. Circumstances worsened due to capital outflow from emerging markets after sell-off in stock exchanges. A rise in EURUSD rate and technical support strengthened the zloty leaned against foreign supply last week. Finally, the zloty stayed unchanged to the dollar, but weakened by 1,53% to the euro.
- MPC decision and upcoming voting in parliament will generate market movements next week. Possible pressure on zloty's weakening owing to political issues should be compensated by MPC decision. Thus, we expect the zloty to fluctuate between 4.14-4.24 to the euro and 3.15-3.25 against the dollar.

Outflow in stock exchanges

- Last week the dollar ignored majority of positive signals. Distinct rise in US core inflation and Beige Book pointing to price pressure in the economy were offset by declines in stock exchanges and funds outflow from US. Only after release of high activity indicator on Thursday confidence to American currency picked up. During a week the dollar fell to the euro by 1,70%.
- Next week will be the last one before Fed meeting on May 3rd. Dollar's performance will depend on confidence index, which will indicate if in fact one should be concerned about deceleration in US economy and further declines in stock exchanges. The important hint will be a publication of 1Q05 GDP on Thursday.

Possible reaction in both directions

- Despite initial sentiment deterioration due to events in Hungary, thanks to weak data on industrial production Polish yield curve moved downwards by 7-10 bp. Positive slope in the sector 2/5y systematically increases and presently it amounts to 13 bp. FRA contracts also gained a bit, but they still price in cumulative cut of 150 pb.
- The outset of the next week will go by in the expectations for MPC decision. Monday's data should not have major impact on the market. Owing to recently increased expectations for 50 bp cut, reduction by both 25 and 50 bp may trigger a market reaction (negative one should be shallower). Switching auction may attract fewer number of investors in the case of 50 bp reduction in NBP rates.

Bonds as safe haven

- Due to strengthening of the Polish curve 5/5y spread between Poland and euro zone narrowed again to ca. 90 bp. Upcoming voting in parliament may cause its widening.
- The factor that supported prices in core curves last week were developments in equity markets, from which capital was flowing out for fear of economic deceleration in US. The power of influence from stock indices weakened at the end of the week following activity indicator release.
- The core bond market performance will be conditioned by data on consumer confidence and developments in equity market. Positioning ahead of the Fed meeting will depend on that. Amid poor forecasts for economic growth in euro zone importance of IFO index due on Monday will be higher.

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