Bank Zachodni WBK

Weekly economic update

2 May – 8 May 2005

Last week, the most important event was the MPC decision to cut interest rate by 50pb and change monetary policy bias from easing to neutral. In this way, the Council was simultaneously more dove-ish than expected, because most of market analysts predicted 25bp cut and the market did not fully priced-in 50pb move, and more hawkish than expected, as no one supposed a bias change to take place already in April. As a result, the market reaction to 50bp cut and a change in bias to neutral was in line with our expectations for a scenario of 25bp cut coupled with maintaining easing bias – yield curve moved upwards moderately.

The official statement after the meeting and rate-setters' comments imply that inflation outlook perceived by the MPC is optimistic. What is important, views presented by numerous MPC members indicate that they expect sharp decline in inflation indicators in 2H05, which drives us to the conclusion that inflation staying well below the inflation target from 3Q05 onwards has been already taken into account by the MPC is its decisions until now (100bp cuts in the last two months). Possibly, majority of MPC members see room for further rate cuts, but they are kept from doing it by political uncertainty. This was reflected in adoption of neutral bias. However, one cannot exclude some additional fine-tuning moves of 25bp, if political scene clears up and inflationary pressures remain subdued.

This week, the key event for the Polish market will be the Sejm's vote over a motion to dissolve parliament. An outcome of the vote will most likely have an influence on next steps of the MPC. If the parliaments dissolves itself, one should not expect the MPC to do anything until the new cabinets is formed, which is not likely to take place before late July. However, in the scenario of early elections the MPC may resume monetary easing in 2H05, if economic program of the new government is reasonable and inflationary pressures remain subdued. In the other scenario, assuming the current parliament and government stay until autumn elections, one cannot exclude some fine-tuning moves (single move not larger than 25pb) in summer.

Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (2 May)					
14:00	USA	ISM manufacturing (H)	Apr	-	55.0	-	55.2
		TUESDAY (3 May) – Constitution Day					
14:00	USA	Factory orders (M)	Mar	%	0.4	-	0.2
18:15	USA	FOMC meeting (H)	-	%	3.0	-	2.75
		WEDNESDAY (4 May)					
09:00	**POL**	**Auction for 2y bonds (OK0807) – PLN2.6bn (H)**					
09:00	EMU	Retail sales (M)	Mar	%MoM	-	-	-
11:45	EMU	ECB meeting – decision (H)	-	%	2.0	-	2.0
14:00	USA	ISM non-manufacturing (H)	Apr	-	61.0	-	63.1
		THURSDAY (5 May)					
-	**POL**	**Voting in Sejm self-dissolution (H)**					
12:30	USA	Productivity (H)	1Q	%	2.0	-	2.1
		FRIDAY (6 May)					
12:30	USA	Change in non-farm payrolls (H)	Apr	000	173	-	110

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

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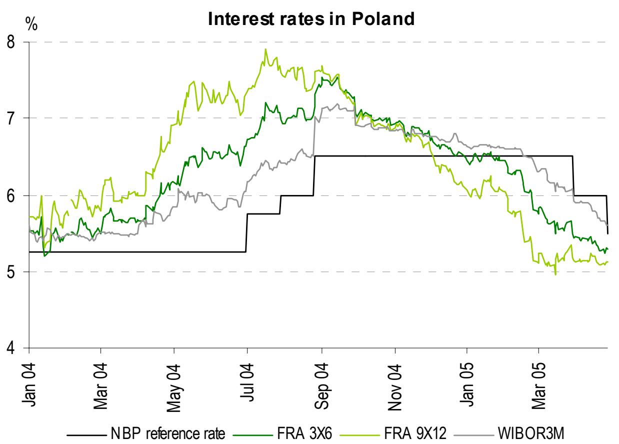
What's hot this week – Crucial vote in the Sejm

Likely outcome of the vote over a motion to dissolve parliament

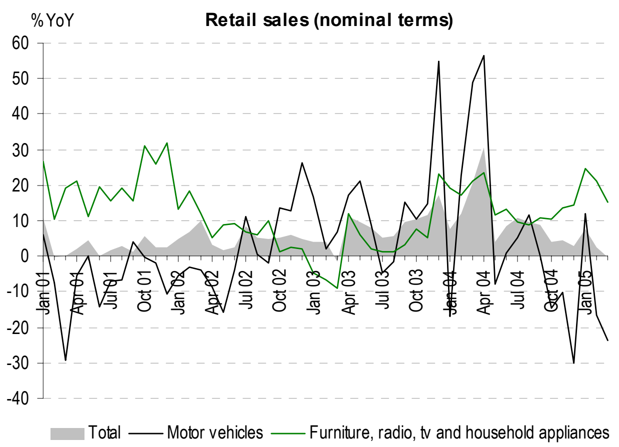
Party	For	Against and abstain
SLD	-	150
UP	-	12
PSL	-	40
Minor parties and independent MPs	24	46
PO	56	-
PiS	46	-
SdPl	31	-
Samoobrona	30	-
LPR	25	-
Total	212	248

- The first week of May will begin with the long weekend, but shortly after return from holidays, on Thursday, May 5, market players will face the Sejm's vote over a motion to dissolve parliament.
- We think the more likely option is that opposition will not gather 307 votes out of 460, which is a necessary majority to approve the parliament's dissolution. It is not sure whether PM will resign in such situation. President wants him to stay in office.
- President announces that if PM resigns, he will not accept the dismissal and the current cabinet will remain in power until autumn elections (most likely towards the end of Sep.)
- Apart from vote in the Sejm, the Polish market will be under influence of FOMC decision and US data.
- Both FOMC decision and outcome of the Sejm's vote will affect result of Wednesday's auction of 2-year bonds.

Economy last week – Hawkish rate cut



- Most of analysts predicted 25bp rate cut in April, but the MPC trimmed rates by 50bp. Such scenario was seriously taken into account, but no one expected a shift in policy bias from easing to neutral.
- The reason for bolder reduction was a fact that the MPC optimistically assesses inflation outlook (this was reflected in the tone of official statement after the meeting), while the reason for bias change was uncertainty regarding political situation and economic policy of the new government.
- Apart from political risk, the only risk factor for inflation mentioned by the MPC were oil prices.
- If inflationary pressures remain subdued, political uncertainty decreases and risk for GDP perceived by the Council persists, one may expect additional fine-tuning moves (with single move not larger than 25bp).



- After weaker than forecasted data on industrial output, retail sales figures proved to be a nice surprise.
- While retail sales dropped 0.3%YoY in nominal terms and declined as much as 3.8%YoY in real terms (the strongest fall in four years), the results were better than predicted.
- If not the high base effect, visible particularly in case of motor vehicles, retails sales would record a healthy rise.
- Therefore, our view on consumption demand growth in the second half of the year is quite upbeat (although April will see slump in retail sales due to culmination of high base effect). Our optimism also stems from continued unemployment decline (in March by 1.1pp to 19.3%).
- Balance of payments data showed C/A surplus (€132m) and trade surplus (€57m) with strong rise in both export and imports. However, zloty-denominated value of export grew very slowly due to strength of the zloty.

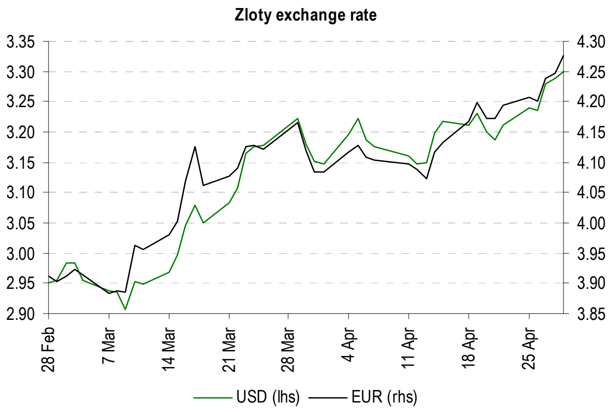
Quote of the week – Cuts with neutral bias not excluded, although less likely

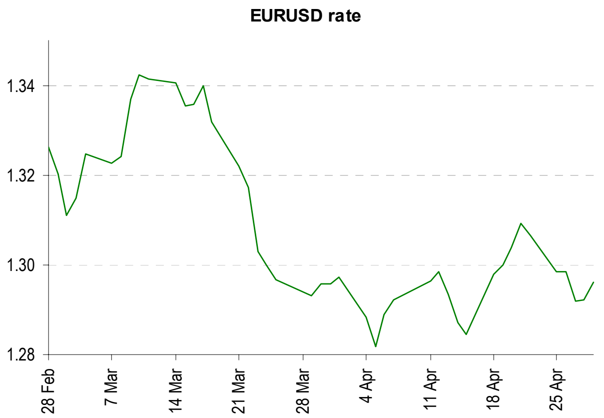
Andrzej Sławiński, MPC member
Radio PiN, 28 April

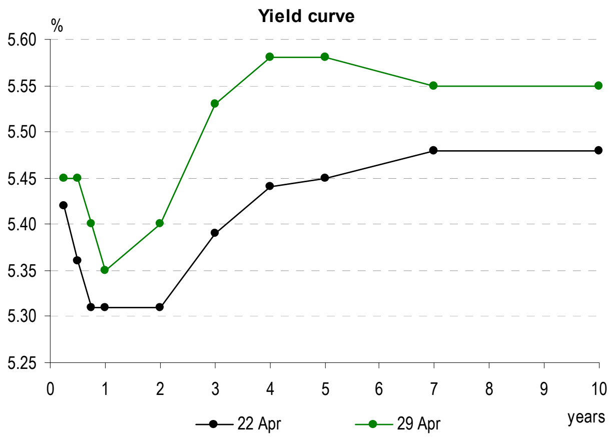
Please not that during recent months we have created very comfortable situation for the market that is we change the bias first and then we made decisions on rates. We cannot exclude that if there will be rate changes, they will be preceded with a change in bias, but one cannot exclude, although it is less probable, that rate changes will take place with the bias we have now.

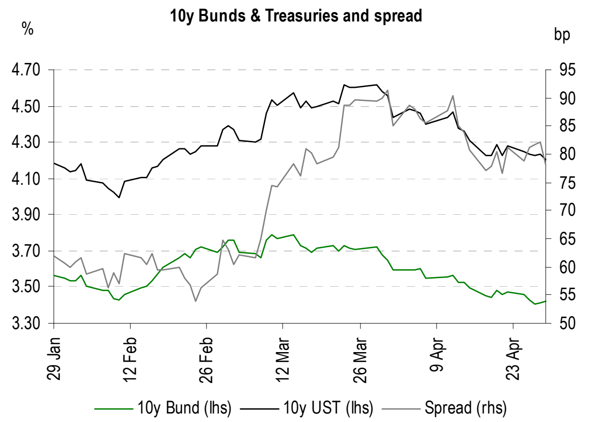
Comment from Prof. Sławiński suggests that possible further rate cuts are more likely after bias change to easing again than with neutral bias. In our opinion, this also means that another rate cut in May is very unlikely. However, May meeting of the MPC bring some uncertainty, because the new inflation projection will alter rate-setters' knowledge on inflation outlook for 2007, which is a key period from the perspective of Poland's road to the euro zone.

Market monitor









Sell-off ahead of voting

▪ The outset of the week went by calmly in the expectation for MPC decision. Later, despite zloty supportive decision on change in bias, the zloty significantly fell due to political risk ahead of voting in parliament and worse moods in the region. Polish currency against the euro reached first technical support levels. The zloty during a week lost 2.72% to the dollar and 1.92% to the dollar.

▪ Next week actually will start only on Wednesday before a crucial voting in Sejm, which in our opinion will not be dissolved that should have a positive impact on FX market. Thus we expect the zloty to fluctuate in the range 4.2-4.3 to the euro and 3.24-3.34 to the dollar. But one could not exclude a brief breaking from those ranges due to the nervousness in the market.

Possible yuan revaluation

▪ Despite weak data the dollar amid elevated volatility was constantly gaining to the euro last week. It was related to the markets' conviction that economic deceleration regards also to, maybe even to a larger extent, the euro zone. Moreover further interest rate hikes are still expected in US owing to quickly growing inflation. During a week the dollar gained to the euro 0.79%.

▪ Economic calendar abroad next week is exceptionally fully packed. Though the outcome of the Fed and ECB meetings is not hard to predict (hike by 25 bp and no change in rates), then ISM indices and labour market data may provide conflicting signals. Possibility of Chinese yuan revaluation joins the barrage of data, which is hard to judge the impact on the market.

The week short, but distinct

▪ Ahead of MPC meeting yields along the whole curve were inching down when another players were becoming convinced that a cut by 50 bp is possible. But change in bias triggered a move upwards boosted by the zloty decline and switching auction. Strong Bunds were still a counterweight for domestic factors. During a week yields rose by 6-12 bp. A slope of the curve in 2/5y sector remained actually unchanged.

▪ Just after a long weekend 2y bonds auction will take place, which may not attract a sizeable demand on the back of voting in the Sejm. The result of that event will have an impact on the bond market, though not so big as on the zloty. In turn, Friday will bring US labour market data, so domestic papers performance will depend on conditions in international markets.

Barrage of important data

▪ Weak real data and sentiment indicators in US and in Europe moved core curves downwards. Both Bunds and US Treasuries set new yield lows at the level of 3.38% and 4.14% respectively.

▪ Spread 5/5y between euro and Polish curve widened from ca. 90 bp to above 100 bp due to advancement of Bunds and Polish papers declines.

▪ Next week will be important also for performance of world bonds. Bad economic data cause that more crucial than the Fed statement (though significant as usual) will be ISM releases and their components and, or maybe above all, US labour market data. There will be the first indicators for April and thus market will convince itself if deceleration took place at the outset of 2Q05.

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