

Weekly economic update

16 May – 22 May 2005

Last week was under influence of US dollar strengthening on the international market, which was connected with much better than expected data, weakening speculations about soft patch in the US economy. Week in the Polish economy was quite calm. Somewhat larger was activity on the political scene, on which discussion on the next year's budget intensifies. Finance minister confirmed his plans to continue fiscal tightening in 2006 and to propose budget deficit at ca. PLN30bn with conservative macroeconomic assumptions as regards GDP growth (4%) and CPI inflation (average at 1.5%). While SLD and SdPI are supporting PLN30bn deficit, both Civic Platform (PO) and Law and Justice (PiS), which are two parties likely to form a coalition government after election, would like to see it lower (at PLN15-20bn and PLN26bn, respectively). Details of their proposals are not known, though PiS plans to concentrate on cuts in administrative spending. We still think 2006 budget draft should be assessed positively by the market.

Next week will see plenty of important macroeconomic data releases for April. Already on Monday the CSO will release consumer inflation data, which will most likely show another substantial fall, helpful for the Ministry of Finance, given the auction of five-year bonds scheduled on Wednesday. Also on Wednesday, data from the labour market will be published, which will confirm a gradual improvement, though not on a scale creating a risk of inflationary pressure. On Friday, we will see data on industrial output and PPI, which should be positive for yields.

Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
MONDAY (16 May)							
09:00	POL	Auction for 52-weeks treasury bills – PLN600m (M)					
13:00	USA	Net capital flows (H)	Mar	\$bn	-	-	84.5
14:00	POL	CPI (H)	Apr	%YoY	2.9	3.0	3.4
TUESDAY (17 May)							
12:30	USA	PPI	Apr	%MoM	0.3	-	0.7
13:15	USA	Industrial production	Apr	%MoM	0.2	-	0.3
13:15	USA	Capacity utilisation	Apr	%	79.5	-	79.4
WEDNESDAY (18 May)							
09:00	POL	Auction for 5y bonds (PS0310) – PLN2.5-3.0bn (H)					
12:30	USA	CPI	Apr	%MoM	0.4	-	0.6
14:00	POL	Corporate gross wages	Apr	%YoY	2.4	2.6	2.2
14:00	POL	Corporate employment	Apr	%YoY	1.6	1.7	1.6
THURSDAY (19 May)							
09:00	EMU	Final HICP	Apr	%YoY	0.4	-	0.7
09:00	EMU	Industrial production	Mar	%MoM	-	-	-0.5
14:00	USA	Leading indicators	Apr	%	-0.2	-	-
FRIDAY (20 May)							
14:00	POL	PPI	Apr	%YoY	0.7	0.4	2.2
14:00	POL	Industrial production	Apr	%YoY	-4.7	-3.9	-3.7
14:00	POL	Business climate	May	-			

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

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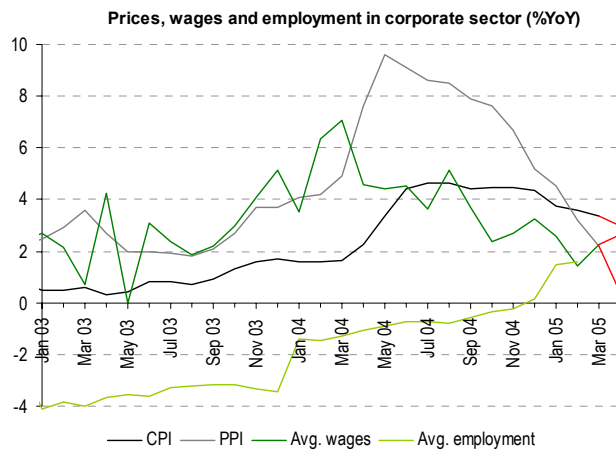
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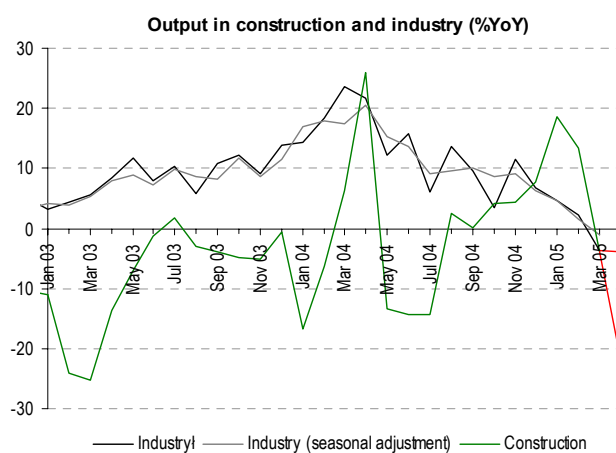
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What's hot this week – A bunch of important data

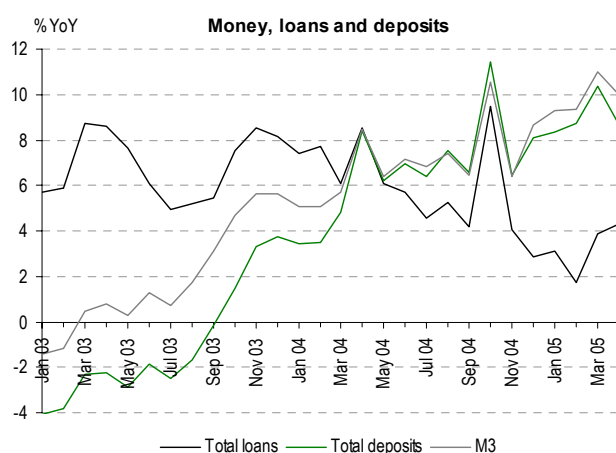


- In April 2004 monthly inflation amounted to 0.8% amid prices increase ahead of EU accession. As a result of such high statistical base effect, annual inflation surely fell last month. The only question is by how much.
- We expect that CPI inflation rose by 0.3%MoM in April, mainly as a result of higher food prices (by 0.6%). While it is possible that food prices show slower rise (they used to surprise on the downside in previous months), fuel prices might be higher.
- We expect a fall in 12M CPI to 3.0% from 3.4% in March.
- High fuel prices will be also important factor for PPI inflation – average Brent price maintained above 50\$ per barrel last month, but USDPLN rate rose significantly.
- As in April last year producer prices rose by as much as 2.1%MoM, PPI inflation is doomed to fall significantly on annual basis – to some 0.5%.



- Corporate wages should show relatively low rate of growth, again below inflation. As we also expect a continuation of job creation in the enterprise sector (by 0.3%MoM and 1.7%YoY), wage bill should rise in real terms in April - by close to 1.5%YoY.
- Still, this is a level not creating a threat for inflation and from monetary policy point of view. Especially that wage growth in the economy as a whole amounted to only 3.6%YoY in the first quarter of 2005 – it was above growth in the enterprise sector, but still relatively mild.
- April data on production will indicate deceleration again. While the number of weekend days was the same as last year, the statistical base effect (the so-called EU accession effect) unfavourable affected the rate of growth in annual terms. Additionally, the day of John Paul II funeral (April 8) was a day off in many enterprises in Poland.

Economy last week – Foreign data much more important



- US macroeconomic data were crucial for financial markets last week.
- Both US trade deficit and retail sales proved to be better than expected, which boosted dollar exchange rate.
- April's retail sales figure showed growth by 1.4%MoM, while 0.7% was expected. Trade deficit narrowed to US\$55.0bn in March against forecast of 61.5bn.
- CSO foreign trade data for the first quarter of 2005 confirmed that external demand for Polish exports remains strong. However appreciation of the zloty could hurt exporters' results, if continued.
- In line with expectation money supply M3 rose by 10%YoY. Total credits accelerated to 4.3YoY (3.9% in March). Improvement was visible in both enterprises and households sector.

Quote of the week – The end of easing cycle?

Halina Wasilewska-Trenkner, MPC member

Reuters, 9 May

The cycle of interest rate cuts has come to an end.

Dariusz Filar, MPC member

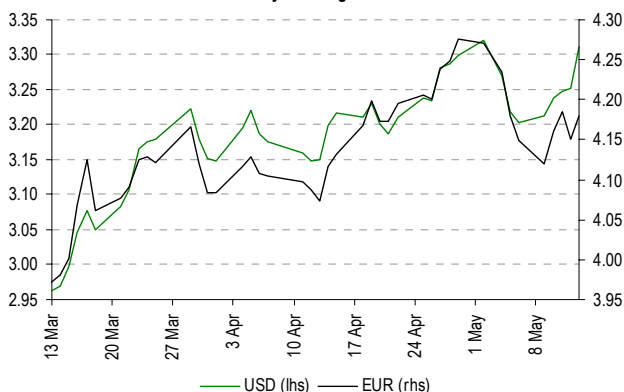
Reuters, 12 May

We are at such a rate level that guarantees, keeping inflation near the 2.5%.

The presented MPC members' quotes might dispel hopes of those market participants who counted on continuation of rate cut on large scale. Wasilewska-Trenkner suggested even that one cannot exclude rate hikes. However, we think that favourable inflation path may lead to some fine-tuning cut by 25 bps. Besides, one should remember that other MPC members seem to have more dove-ish views than presented by Filar and Wasilewska-Trenkner.

Market monitor

Zloty exchange rate



After strong rally – strong correction

- Last week saw a correction of the zloty performance. It stemmed from getting over previous substantial increases and sizeable advancement of the dollar in international markets. Good proposals from minister Gronicki regarding 2006 budget failed to offset the impact of those factors. During a week the zloty weakened by almost 3% to the dollar and 0.8% against the euro.
- Due to a series of publication that may fuel expectations for interest rate cuts, the zloty may gain owing to capital flow into bond market. Against the euro the zloty should find again a support at the level of 4.2. Additionally the Polish currency may gain due to relief rally on EURUSD rate. Thus we expect the zloty to trade in the range of 4.1-4.2 to the euro and 3.23-3.33 to the dollar.

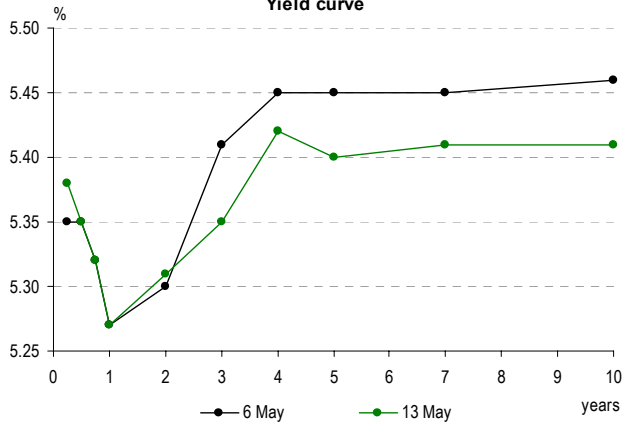
EURUSD rate



The dollar at six months high

- Not counting a positioning at the outset of the week ahead of US trade data which strengthened the euro, last week went by with strong dollar. It was supported by data on lower trade deficit and higher growth rate of retail sales in US. Additionally EURUSD rate broke key support level at 1.276, reaching the lowest level for six months.
- Once record high US external deficit has been finding foreign financing, this time there should not be any problems with covering lower gap with capital inflow either. Still the market may additionally fluctuate due to unsolved issue of Chinese yuan revaluation. Dramatic declines may be stopped this week, but 1.276 may prove to be strong resistance.

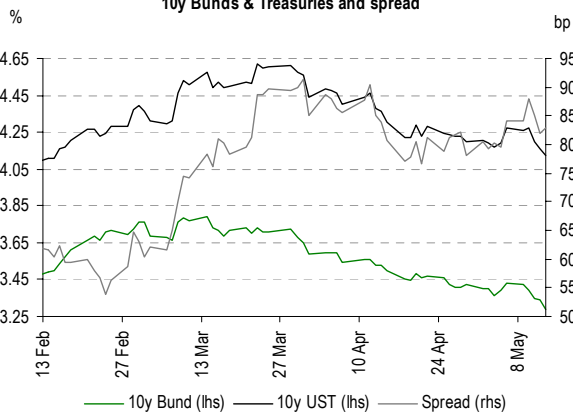
Yield curve



The data favourable for market rates

- The absence of domestic macro data and fixed coupon papers auction exposed the Polish curve to the influence of core markets. Bonds advanced mainly at the long end of the curve on the back of strong Bunds' performance. Short end and FRA contracts did not recorded major changes, as the perspective of next week data was compensated by comments from MPC members.
- The data to be published next week undoubtedly will support the performance of Polish bonds along the whole curve (data on production may prove to be more important than those on inflation). Good mood in the market enables finance minister to offer PLN3bn (upper band of the range) of 5y papers at Wednesday's auction. Developments in Bunds' market will still have an impact on Polish market.

10y Bunds & Treasuries and spread



The market will focus on inflation

- In core markets bonds remained strong, as pressure resulting from high retail sales was offset by demand related to mood deterioration in credit markets (after substantial rating reduction for GM and Ford players "fly" to safe investment). Moreover bonds in US again attracted meaningful interest (mainly from foreign investors) at auctions last week.
- Core bond markets will await data on inflation both in US and euro zone. As oil prices in April were already falling the markets will focus more on net inflation. Moreover the market will look confirmation of the end to soft patch period in the data on US industrial production.

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