

Weekly economic update

23 May – 29 May 2005

First macro data for April, which were released last week, were broadly in line with market expectations. An exception were output figures that showed much weaker than expected decline in industrial production. Other data confirmed downward trend in inflation with hardly any sign of inflationary pressure from the labour market – mostly thanks to very low growth in corporate wages. With low wage growth, gradual acceleration in employment growth is not strong enough to create a threat of excessive demand pressure.

Already before MPC meeting, another bunch of macro data will be published: core inflation measures on Tuesday as well as retail sales figures and registered unemployment statistics on Wednesday. In our opinion, retail sales numbers may prove a positive surprise, similarly as output figures last week. Thus, we do not see why the MPC should trim interest rates already at this week's meeting. Especially that political risk (uncertainty regarding economic program, including fiscal policy of the next government) persists and this factor was the main reason for shifting monetary policy to neutral from easing at April's meeting of the Council.

President Aleksander Kwaśniewski and the Sejm's speaker Włodzimierz Cimoszewicz officially announced that parliamentary election will take place on 25 September, while presidential election will be held on 9 October (second turn, if necessary, will be 2 weeks later). The president also said that a referendum on EU constitutional treaty (if ordered by the parliament) could take place on 9 October, together with presidential election.

Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD	FORECAST			LAST VALUE
				MARKET	BZWBK		
MONDAY (23 May)							
09:00	POL	Auction for 52-weeks treasury bills – PLN400m (M)					
TUESDAY (24 May)							
09:00	GER	ZEW index (H)	May	-	22.0	-	20.1
09:00	EMU	Trade balance (M)	Mar	€bn	4.5	-	3.0
14:00	POL	Core inflation (H)	Apr	%YoY	2.3	2.3	2.4
-	USA	FOMC Minutes (H)					
WEDNESDAY (25 May)							
-	POL	MPC meeting – decision (H)	-	%	5.5	5.5	5.5
08:00	POL	Retail sales (H)	Apr	%YoY	-15.7	-9.3	-0.3
08:00	POL	Unemployment rate (M)	Apr	%	18.9	18.8	19.3
08:00	GER	IFO index (H)	May	-	93.5	-	93.3
12:30	USA	Durable goods orders (H)	Apr	%	1.0	-	-2.3
14:00	POL	Inflation report for 1Q05 – inflation projection (H)	1Q	-	-	-	-
THURSDAY (26 May) – CORPUS CHRISTI							
12:30	USA	Preliminary GDP (H)	1Q	%QoQ	3.6	-	3.1
FRIDAY (27 May)							
08:00	EMU	Balance of payments (M)	Mar	€bn	5.8	-	8.0
12:30	USA	Net PCE (H)	Apr	%MoM	0.1	-	0.3
13:45	USA	Final Michigan index (H)	May	-	86.0	-	87.7

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

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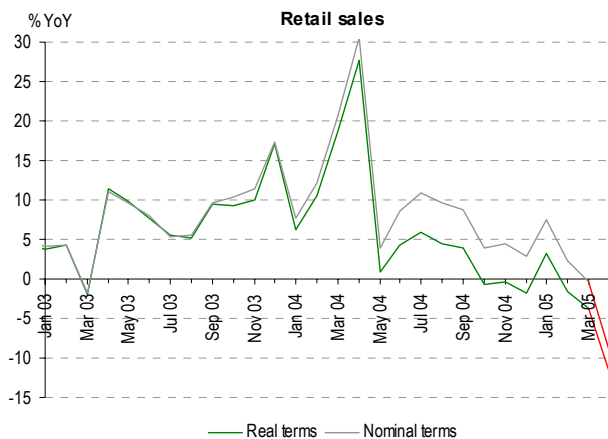
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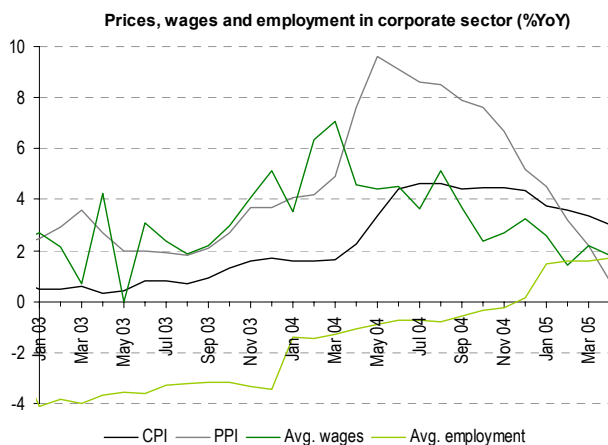
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What's hot this week – Eyes on the central bank

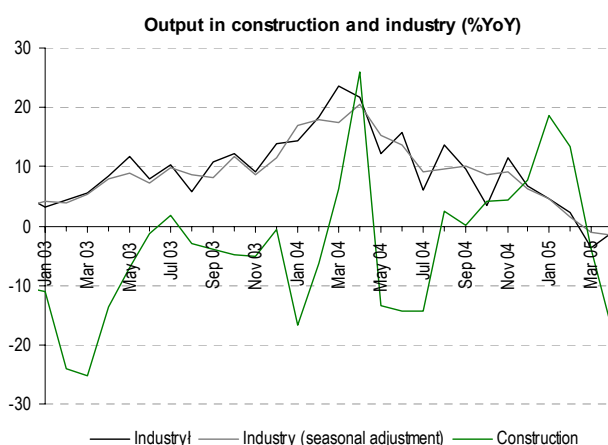


- Data on core inflation for April, to be published by the NBP on Tuesday, should show slight fall in all five measures. This may induce some market participants to speculate for a rate cut already on Wednesday.
- Similar effect may be brought about by data on retail sales and registered unemployment which are to be published by the CSO on Wednesday. Retail sales most likely fell in annual terms due to the effect of very high base. Unemployment continued downward trend, which was strengthened by seasonal factors in April.
- On Wednesday, apart from the MPC decision itself, it will be very interesting to see the new *Inflation report*, including inflation projection of the central bank. Given hints from MPC members it should indicate stabilisation of CPI inflation around the inflation target of 2.5% in 2006-2007.

Economy last week – Confirmation of favourable inflation outlook



- CPI inflation fell to 3%YoY from 3.4%YoY in March, in line with our forecast. A healthy rise was recorded in fuel (4.5%MoM), and food and tobacco prices (0.5%MoM), but a year ago prices in these categories were growing even faster, thus the annual inflation decelerated. In May, it may fell to 2.4%YoY and in April CPI is likely to reach only 1.7%YoY.
- Wage growth was a mere 1.8%YoY in April, but together with employment rise of 1.7%YoY it translated into real growth in wage bill of 0.5%YoY, the same as in March. We expect wage bill growth will gradually accelerate.
- PPI inflation dropped to 0.8%YoY, weaker than we anticipated, but very deep anyway (from 2.2% in March). This resulted mainly from high base effect, which may turn annual PPI growth into red in May. However, PPI inflation should return above 2% towards the end of the year.



- After four months of the year, budget deficit reached almost 40% of the full-year plan. Growth rate of tax revenues clearly worsened (to -4%YoY), but it stemmed to a large extent from very high statistical base. Liquidity of the central budget remained above the level of PLN7bn.
- The high base effect acts also in the case of production. However, industrial output fell by a mere 1%YoY (the market expected 5% drop), which means that without base effect one would see very solid growth. Construction output declined by 17.7%YoY. It is important that output figures were better than expectations, as it bodes well for estimates of GDP growth in 1Q05.
- Financial results of enterprises slightly worsened in 1Q05 – possibly firms started to invest strongly, there could also be some negative impact from the zloty's strength – but remained many times better than before 2004.

Quote of the week – Even hawk does not exclude a fine-tuning cut

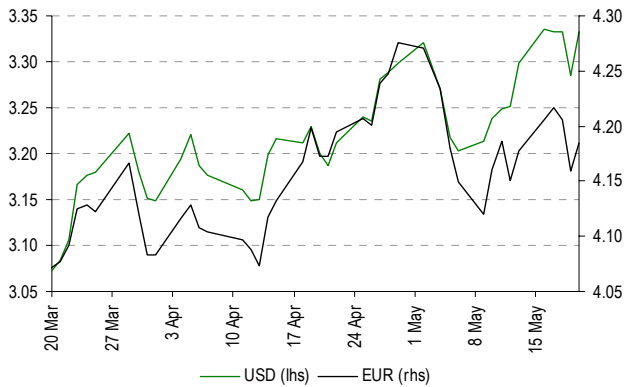
Dariusz Filar, MPC member
PAP, 17 May

Being convinced that interest rate is at appropriate level, but noticing new developments in the economy that could induce some probability that desired inflation path will deviate in one or the other direction, we could decide on a proper fine-tuning move.

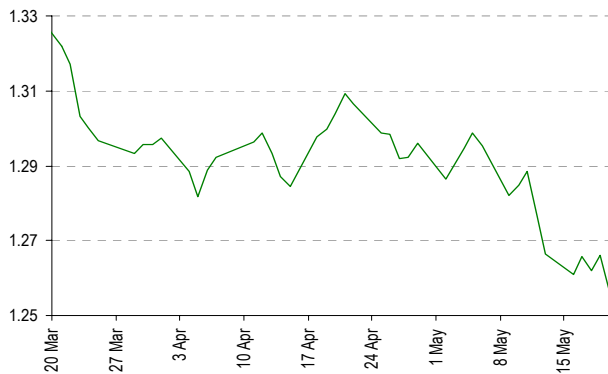
According to information in Government's Monitor, Prof. Filar was the only MPC member who voted against 50bps rate cut in March. However, his statements shows he sees a possibility of a fine-tuning cut, although it is not likely in the nearest months (until more new information appears). This supports our expectations for additional fine-tuning cut in rates until summer months (most likely in July).

Market monitor

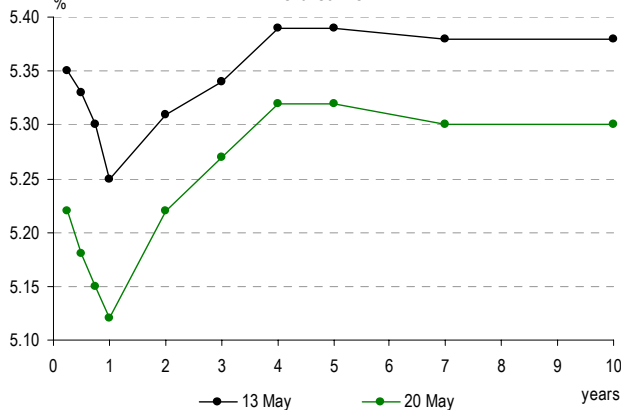
Zloty exchange rate



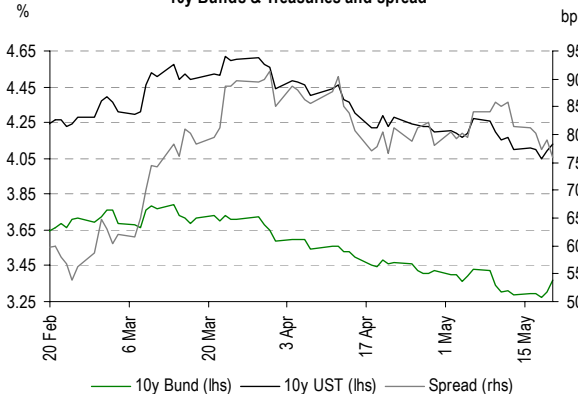
EURUSD rate



Yield curve



10y Bunds & Treasuries and spread



The zloty under dollar's pressure

During a majority of last week the zloty remained under pressure of strong dollar. Only on Wed and Thu the Polish currency's performance improved on the back of EURUSD rate increase after decline in core inflation in US and capital flow into bond market ahead of data from real economy. During a week the zloty weakened to the dollar by 1% and to the euro it virtually did not change.

Next week the Polish FX market will probably be dominated by expectations for MPC meeting. Moreover it will be a shorter week due to a market holiday on Thu, though activity of foreign players cannot be ruled out. An impact on the market will have upcoming referendum in France. Thus we expect the zloty to fluctuate in the range of 4.12-4.22 to the euro and 3.25-3.35 against the dollar.

The dollar indifferent to negative signals

Weak data on net capital flows into US assets failed to impair dollar's performance. Only decline in net inflation in US caused a correction of strong upward tendency, when EURUSD rate reached 1.268. At the end of the week however French referendum issue signalled its presence in the form of another unfavourable opinion polls. During last week EURUSD fell by 0.7%.

Next week French voting, slated for Sunday will weigh on the EURUSD market. In Tuesday's Minutes the Fed will reveal the reasons behind dovish statement. US GDP data will be released only on Thursday and taking into account anticipation of meaningful upward revision the dollar will probably remain strong. At 1.25 strong technical resistance for the dollar is located.

Yields at this year's low

CPI inflation a bit higher than median forecast caused a correction in bonds performance boosted by 5y benchmark auction. High demand and release of low US net inflation triggered yields' fall along the whole curve (PS0310 reached a new low of 5.29%). Reversal of situation in core markets did not have an impact on the Polish market, as it was kept by speculations for Friday's data. During a week yields declined by ca. 10 bp.

Trading in bond markets will become less active ahead of MPC meeting. If the news from *Inflation Report* and press conference contain significant signals for expectations, market adjustment forced by foreign players in two following days could be quite abrupt amid very limited liquidity. Moreover switching auction will not take place this week.

Core inflation good for economy

US core inflation forced bond prices to go up, though that increase was erased, when markets perceived those data as positive signal for the economy what resulted in strong gains in stock exchanges. Larger sell-off in German bonds as compared to US ones was caused by upcoming French referendum. At the end of the week 10y Bunds yielded 3.38% and US papers – 4.12%.

At the outset of the week the market will turn attention to confidence indices from Germany (ZEW, IFO) and Fed Minutes. However the most important release will be US GDP data, which will show how larger will be the revision against preliminary estimates. Bonds performance will hinge also to a larger extent on durability of stocks' rally, which did not "allow" them to advance last week.

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