Bank Zachodni WBK

Weekly economic update

6 June – 12 June 2005

Last week saw relatively strong zloty and sharp decline in yields. The former was accompanied by quite significant weakening of the euro against the dollar (to below 1.22 level), as it remained under pressure, with the resounding No votes in France and the Netherlands, talk of a collapse of EMU and weak eurozone data. On the fixed income market positive sentiment was driven by the rally abroad (weak data and comments from the Fed's Fischer that the FOMC could be nearing the end of its tightening cycle) and by poor Polish economic growth data (especially fixed investments) for Q1 2005. After GDP growth data the Polish curve prices-in some 75 bps until year-end with 50 bps already at the meeting at the end of June. We think, however, that 25 bps cut is more likely in June given difficulties in interpreting CSO's data.

There is one important unresolved political issue in Poland – fate of finance minister. Opposition parties had threatened to call a motion of no confidence in Mirosław Gronicki if he did not back off from a hike of excise tax on heating oil. The question is, however, whether the finance minister would wait until deputies decide on his future and would not resign before. During the weekend PM Marek Belka decided to postpone the introduction of higher excise tax (from June 15 to August 1) and additionally the parliamentary committee prepared a bill to cancel this tax hike. This would lower the pressure on finance minister to an extent. A possible dismissal (or resignation) of finance minister will be on the agenda for the upcoming weeks rather than days.

This week no major data releases are scheduled in Poland. There is also very light calendar abroad. The key event for international markets, especially for the FX markets, will be Friday's release of US trade data. For the core fixed income markets, a plenty of attention will be paid to Greenspan's testimony on Thursday.

Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (6 June)					
09:00	**POL**	**Auction for 52-weeks treasury bills – PLN600m (M)**					
		WEDNESDAY (8 June)					
09:00	**POL**	**Auction for floaters (WZ) – PLN0.5-2.0bn (H)**					
14:00	US	Wholesale inventories (M)	Apr	%	0.4	-	0.4
		THURSDAY (9 June)					
11:00	GB	BoE meeting – decision (H)	-	%	4.75	-	4.75
15:00	US	Greenspan's testimony to Congress' Joint Economic Committee (H)					
		FRIDAY (10 June)					
12:30	US	Import prices (H)	May	%	-0.1	-	0.8
12:30	US	International trade (H)	Apr	$bn	-58.00	-	-54.99
18:00	US	Budget statement (M)	May	$bn	-57.15	-	-62.46

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

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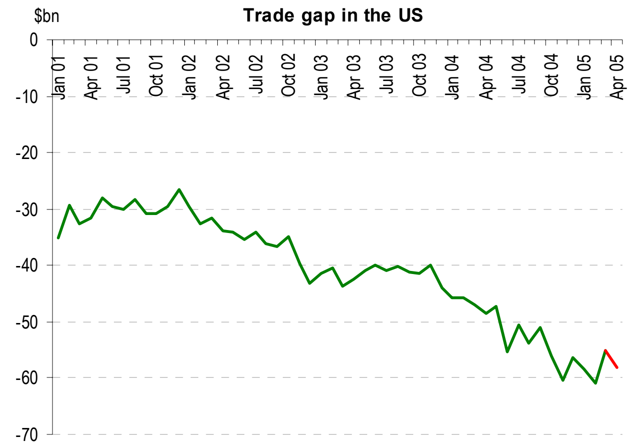
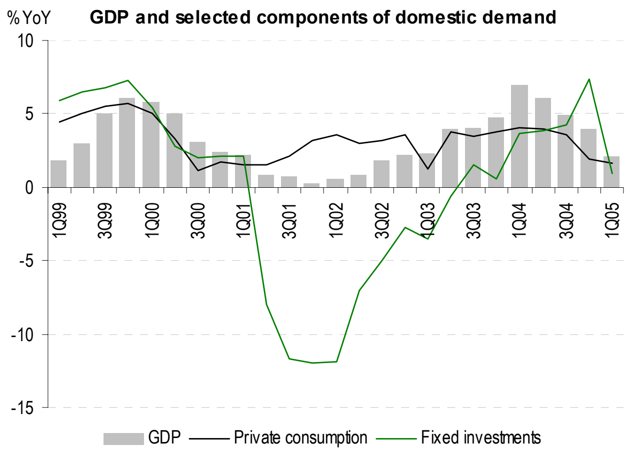
What's hot this week – Important US data on Friday

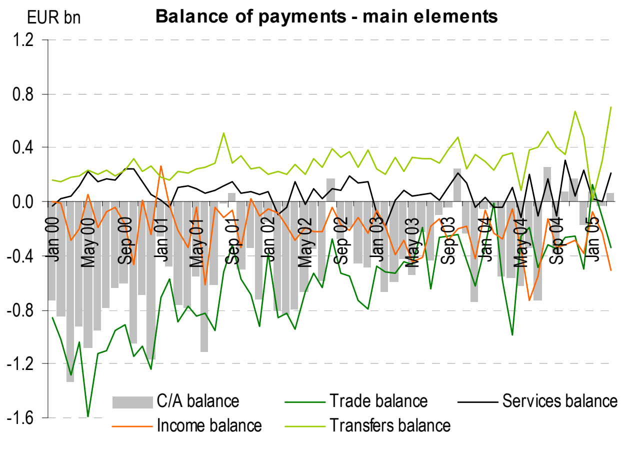


- This week the Polish market will see no major data releases and economic events and should be driven mostly by sentiment on international markets.
- A possible dismissal (resignation) of finance minister will hang over the market, though no further development in this regard should be expected this week.
- On the international market the euro is likely to remain under pressure. Data important for the dollar rate include the US trade and federal budget balances (on Friday).
- As regards fixed income markets, there is light calendar this week but Greenspan's testimony on Thursday, as well as comments from other Fed speakers, should attract plenty of attention.

Economy last week – Poor GDP data mean lower interest rates



- Slowdown in economic growth rate was commonly anticipated, but its scale exceeded expectations as GDP growth reached 2.1%, against 3% predicted on average by the market (this was also our forecast).
- The biggest disappointment concerned investment growth, which decelerated sharply to a mere 1% from 7.4% reached in the final quarter of 2004. It is very difficult to find a plausible explanation for such investment slowdown.
- Private consumption was also relatively weak, rising 1.7% after 1.9% growth in 4Q04.
- Domestic demand as a whole rose only 1.1%YoY, which was the weakest result since 3Q02 when the economy was in the middle of economic stagnation phase.
- Strong positive contribution of net exports – it was responsible once again for ca. 1 pct. point of GDP rise.



- In seasonally adjusted terms, GDP rose 1.2%QoQ in 1Q05, which was the highest rise since 1Q04 (1.7%) and shows the economy continues expanding.
- However, investment fell even after seasonal adjustment (by 0.4%QoQ), after seven quarters of steady rise.
- GDP growth rate should improve in the subsequent quarters, but it would be difficult to reach average GDP growth of above 4% in 2005 with such low starting point.
- NBP also stressed the importance of starting point for projections of growth and inflation for subsequent quarters.
- In March, Poland's current account balance was in surplus of €67m, while trade balance was in deficit of €334m.
- Exports (expressed in euro terms) rose 10.1%YoY, while imports increased 5.3%YoY.

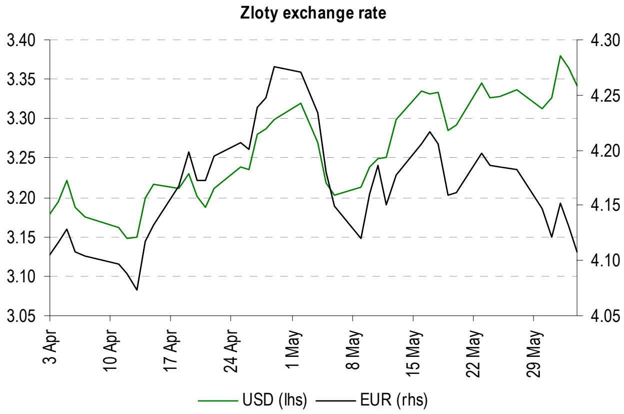
Quote of the week – GDP data surprised also the NBP

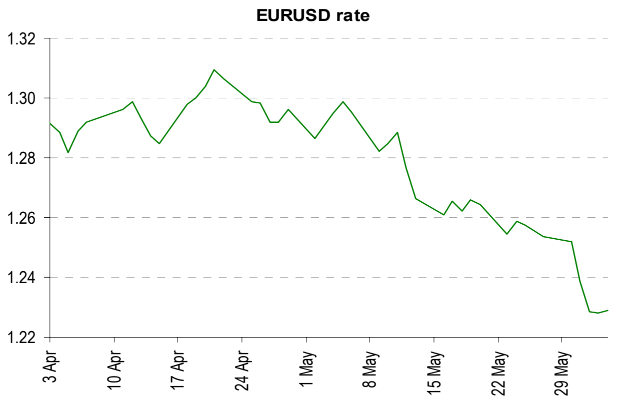
Krzysztof Rybiński, deputy NBP president
Reuters, 2 June

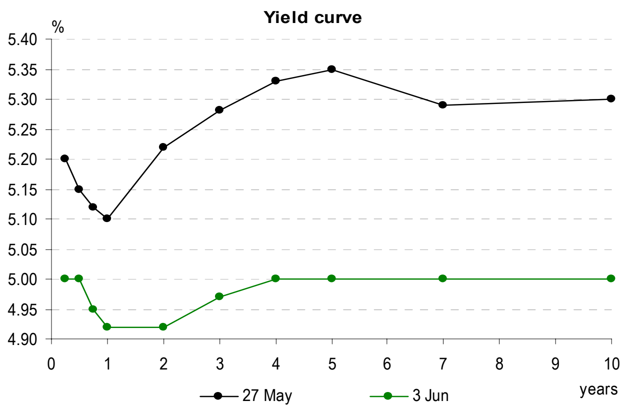
We are thoroughly analysing the [GDP] data, trying to understand whether we deal with a temporary deviation form the expected path or with a structural change influencing the predicted path of economic development.(…) It is too early to settle this question.

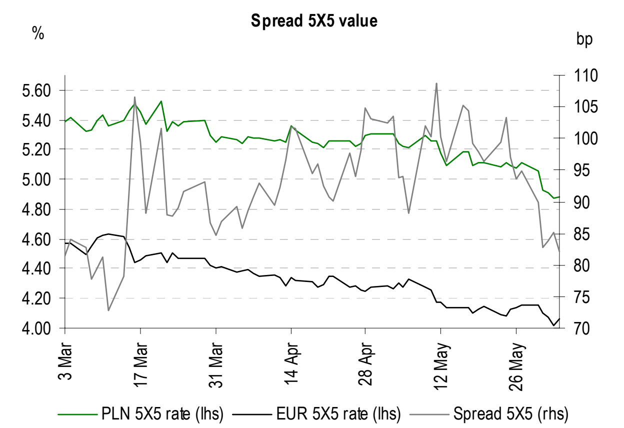
The data on GDP growth in 1Q05 surprised also the central bank's analysts. As for now the NBP maintains its GDP prediction for this year at 4%, which assumes that each subsequent quarter will see faster economic growth, and the second year-half will be definitely better than the first one. NBP vice-president added that a more credible assessment of processes going on in the economy should be available in 2-3 weeks time.

Market monitor









Return of politics?

- Last week the zloty gained to the euro 1.7% and to the dollar its performance virtually did not change. Initial weakening of the Polish currency induced by weak GDP data was exceeded by its substantial advancement owing to poor data from US labour market. Failure of referenda in France and Netherlands brought about only rates' fluctuations within a basket without meaningful impact on overall zloty conditions.
- This week on the back of potential calming down the situation in EURUSD market and scarcity of domestic data, FX market may attach larger importance to domestic events, mainly to a possibility of finance ministry's dismissal. Thus we expect the zloty to fluctuate with a range of 4.06-4.16 to the euro and 3.28-3.38 to the dollar.

New hope for the euro

- During the majority of last week the cross was declining owing to unsuccessful French and Dutch referenda. Though the market got ready to such outcome, the euro broke out from key technical support zone 1.245-1.25. The strength of downward tendency was so strong that weaker than expected ISM indices and especially US employment data were able only to constrain the dollar from further increases. The euro during last week lost above 2%.
- At the outset of the week amid lack of data EURUSD rate will have chances to stabilise between 1.22-1.23. Later within the week approaching US foreign trade data, which "traditionally" are negative for the dollar, EURUSD may gradually strengthen supported by technical factors.

Consolidation ahead

- Substantial rally in the Polish bonds prices was an outcome of low GDP data coupled with moderate supply of Treasury papers for June. Favourable mood was boosted by further increases in foreign bonds. Yields fell by ca. 30 bp along the whole curve reaching level of 5%. FRA contracts 6x9 hit a level of ca. 4,7%, pricing in another 75 bp cuts within half a year.
- Softer outset of the week after bonds prices decline in core markets in conjunction with empty calendar of events will allow players to take a breather following nervous last week and to adjust positions ahead of large portion of data next week (consolidation phase). A risk factor may be possible change on the finance minister's post.

Then support, now resistance

- Weak ISM indicators and low change in payrolls in US brought about a substantial fall in yields on core curves. However due to strong overbought conditions in the market a dramatic yield increase took place in Friday evening - from 3.81% to 3.98% in US and from 3.16% to 3.25% in Germany for 10y sector.
- Amid lack of data till Friday the market will focus on technical indications and Greenspan's testimony. It seems that level of 4% for 10y US bond will be now a strong resistance (earlier it was a technical support), at which players will eagerly build long positions.
- As a result of deeper decline in the Polish yields than on euro curve 5/5y spread lowered from almost 90 bp to 80 bp. Owing to political risk this spread may widen.

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