

# Weekly economic update

20 June – 26 June 2005

The calendar for upcoming week will be less heavy as compared to recent days. However, there will be still a couple of important information, which will be important hint for the markets before the MPC meeting, scheduled for the end of June. On Tuesday, CSO will publish data on retail sales and registered unemployment rate in May, which will be the last piece of information as regards economic activity last month. We expect that retail sales grew quite substantially (by 9%YoY), as unfavourable statistical base effect connected with EU accession disappeared. The unemployment rate should continue the path of gradual improvement and we expect it fell to 18.3% in May, a bit more than suggested by seasonal factors. These will be pieces of information giving some hope that economic slowdown should not be significant. The same day, the CSO will publish monthly bulletin, which will include some important information e.g. sector breakdown of industrial production in May including production of investment goods. On Wednesday, NBP will publish core inflation indicators, which should confirm positive inflation perspectives, showing a substantial fall. We expect that one of the most important measures, net inflation, fell to some 1.6%YoY from 2.3% in April. Also, business climate indicators will be published and we expect entrepreneurs to be quite optimistic about future economic situation, though this will have no importance for the market.

In the following days, investors' moods on the Polish financial market will be driven by data published on Friday. Both PPI inflation and industrial production were lower than market expected, which may reinforce market expectations for rate cuts. Market is very likely to price-in 50 bps in June, though we think that uncertainty as regards future economic situation supports 25 bps. Possibly, the MPC will decide to move to easing bias again.

## Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD	FORECAST		LAST VALUE
				MARKET	BZWBK	
<b>MONDAY (20 June)</b>						
09:00	POL	Auction for 52-weeks treasury bills – PLN600-900m (M)				
14:00	USA	Leading indicators	May		-0.3	-0.2
<b>TUESDAY (21 June)</b>						
08:00	POL	Retail sales (H)	May	%YoY	7.5	9.0
08:00	POL	Unemployment rate (M)	May	%	18.3	18.3
08:00	GER	ZEW index (H)	May		16.0	13.9
<b>WEDNESDAY (22 June)</b>						
09:00	EMU	Trade balance (M)	Apr	€bn		4.2
09:00	EMU	Industrial orders (H)	Apr	%MoM		-0.5
14:00	POL	Business climate (M)	Jun			
14:00	POL	Net inflation (H)	May	%YoY	1.6	1.6
<b>FRIDAY (24 June)</b>						
12:30	USA	Finished goods orders (H)	May	%	0.6	1.9

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

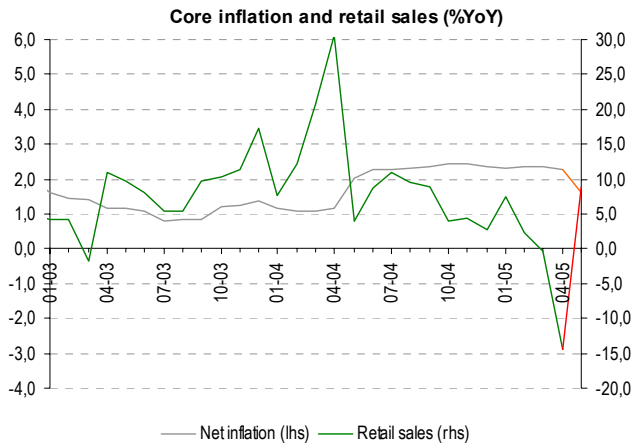
**Maciej Reluga** Chief economist (+48 22) 586 8363

**Piotr Bielski** (+48 22) 586 8333

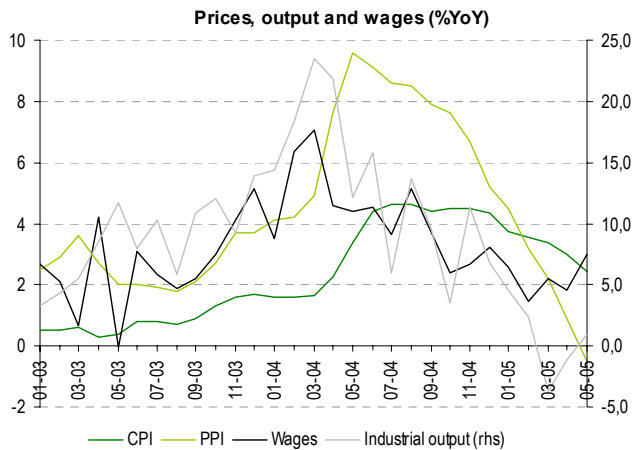
**Piotr Bujak** (+48 22) 586 8341

**Tomasz Terelak** (+48 22) 586 8342

e-mail: ekonomia@bzwbk.pl

**What's hot this week** – Strong retail sales, lower core inflation

- As the statistical base effect has died off, growth in retail sales in May should show a significant rebound to 9%YoY, showing that private consumption growth is not so low.
- We expect the rate of unemployment to show a drop to 18.3%, slightly stronger as suggested by seasonal factors, which would confirm a gradual improvement on the labour market.
- Core inflation measures dropped again in May - net inflation to 1.6%YoY from 2.3% in April – showing no underlying inflationary pressure and positive prospects for CPI.
- June's result of CSO business climate indices should not disappoint. Entrepreneurs' expectations as regards economic situation in future should be quite optimistic, confirming that economic indicators will improve in H2 2005.

**Economy last week** – May statistics send different signals

- CPI inflation fell to 2.5%, which was slightly higher as compared to market expectations. However, except food market, all inflation components showed quite stable prices suggesting no demand-side pressure on prices. CPI inflation is expected to fall to around 1.5-1.6% in summer.
- Average wage in enterprise sector rose in May by 3%YoY, which was above market consensus; employment growth was slightly weaker and amounted to 1.6%. As a result, wage bill in this sector of the economy increased by 4.6%YoY in nominal terms and by 2.1% in real terms – the fastest since Q1 2004. This confirms forecasts for gradual improvement in households' disposable incomes in 2H05.
- Friday's data surprised in the other direction. Industrial production amounted to only 0.9%YoY and producer prices fell by 0.5%YoY. The data supported market expectations for the rate cut.

**Budget parameters and macroeconomic indicators**

	2005 E	2006 P
Revenues (PLNbn)	176.25	184-189
Expenditures (PLNbn)	209.7	216-222
Budget deficit (PLNbn)	33.45	28-34
Budget deficit (% of GDP)	3.4	2.8-3.4
GDP (%YoY)	3.7	4.0
Domestic demand	3.1	4.6
Investment (%YoY)	7.0	10.0
Unemployment rate (% end-year)	18.0	17.0
Inflation (% annual average)	2.1	1.5
EURPLN	4.16	4.07
USDPLN	3.2	3.16
EURUSD	1.3	1.29

Note: E – estimated execution, P – plan; Source: Ministry of Finance

- The government approved the 2006 budget guidelines prepared by the finance minister. Macroeconomic assumptions seems very reasonable. However, planned ranges of revenues, spending and deficit are disappointing.
- The planned deficit range is unfavourably asymmetric in comparison with the earlier declared PLN30bn, which suggests that final deficit target in the budget act (that will be sent to the Sejm in September) may be higher than finance minister pledged initially.
- The planned indexation of pensions in 2006 does not explain the increase in deficit target, as it was taken into account by minister when he promised PLN30bn target.
- The upper end of planned spending means their growth of 6% in nominal terms, which coupled with the assumed inflation of 1.5% means strong real rise in spending and it cannot be seen as a good news for the financial market.

**Quote of the week** – Faster or later euro adoption?

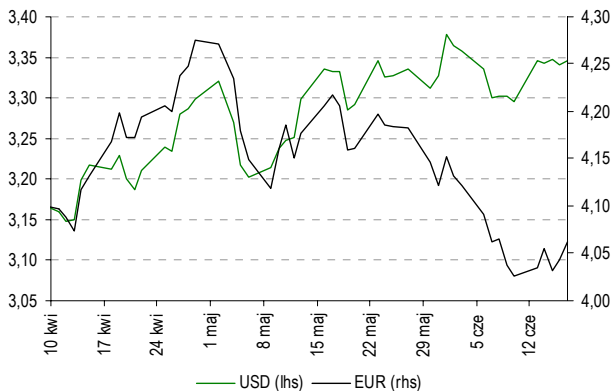
**Stanisław Owsiak, MPC member;** Reuters, PAP 15 June  
*Poland's priority should be the real convergence, not nominal convergence (...) In my opinion, euro adoption in 2009 was impossible from the beginning.*

**Andrzej Sławiński, MPC member;** Reuters, 16 June  
*Poland should quickly enter the ERM2 and adopt the euro, which would eliminate foreign exchange risk*

Thus far central bankers have not presented explicitly discrepancies of their personal views as regards euro adoption. Hence, Owsiak's statement could have raised some doubts whether the Council as a whole is still an advocate of fast entry to the euro zone. In this context, comments from MPC member Andrzej Sławiński seem to be a tranquilliser, confirming that the central bank's stance is unchanged.

## Market monitor

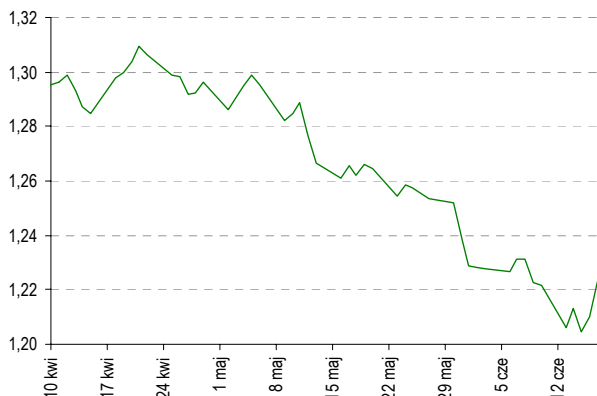
Zloty exchange rate



## Zloty under pressure of budget and macro data

- Last week the zloty was under influence of higher than expected data on CPI inflation and wages, quite unfortunate statement of one of MPC members as regards euro entry, as well disappointing macroeconomic assumptions for budget 2006. However, the market reaction to above-mentioned information was quite limited. The zloty rate was changing mainly as a result of large fluctuation on international foreign exchange market.
- In the upcoming days the market will be awaiting another economic data (retail sales, core inflation), however changes on EURUSD market may be of higher importance again. We expect the zloty to fluctuate in range 4.00-4.10 to the euro and 3.25-3.35 against the dollar.

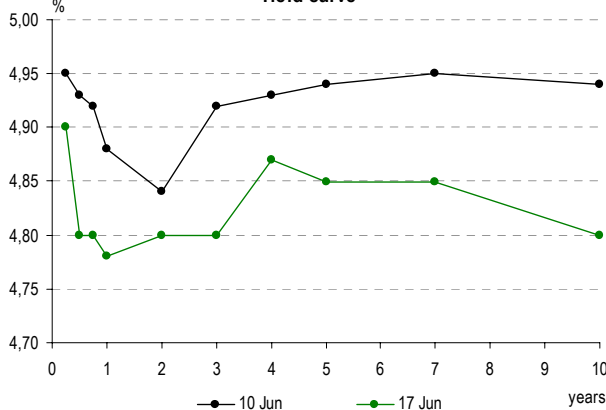
EURUSD rate



## Unclear situation in EU weakens the euro

- Last week EURUSD rate was very volatile. Investors' mood was under strong influence of a possible political crisis in the European Union and uncertainty as regards the EU budget for the next financial perspective of 2007-13. That is why, even weaker than expected data from the US economy did not manage to weaken the American currency during the last couple of days. During last week the EURUSD rate was approaching a barrier of 1,20 a couple of times.
- Only at the end of the week, on Friday a clear strengthening of the euro was observed on the market, after the data on US current account in Q1 2005 were published. EURUSD rate rose as much as to above 1.22 (above 1% in during just few hours).

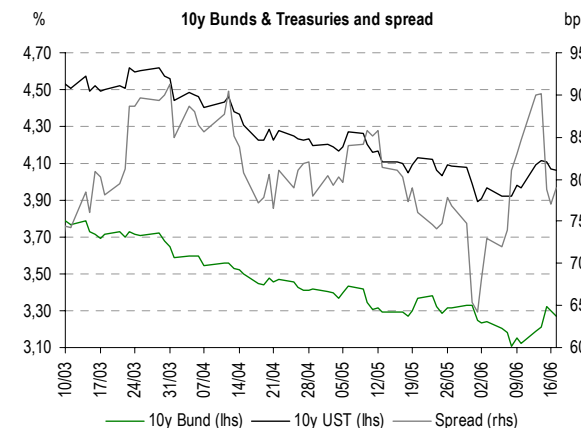
Yield curve



## Fixed income market strong only at the end of week

- For the better part of last week, the domestic fixed income market was dominated by a correction following the clear strengthening a week earlier. Weakening on the core markets, weaker than expected results of bonds auction and higher than forecasted inflation data sent bond yields higher. The reversal of this tendency took place only on Thursday due to rebound on the German market and weaker than expected local data on industrial output. As a result, on Friday, yields curve fell below the level seen a week earlier.
- The beginning of the next week should be good for the market, following lower than predicted output and PPI figures. Assuming lack of significant correction abroad, a positive sentiment should prevail on the domestic market.

10y Bunds &amp; Treasuries and spread



## Slight improvement after wave of sale-offs

- After several days of strong sale-offs on the core markets, some improvement in moods took place at the end of the week. It was grounded more on technical reasons than on reaction to economic data.
- Calendar of economic data releases and events for the coming week shows that there should be no crucial information that could significantly impact investors' sentiment. The biggest attention would probably attract publication of ZEW index, describing economic activity in Germany.

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Additional information is available on request. Please contact Bank Zachodni WBK S.A. Treasury Division, Economic Analysis Unit, ul. Marszałkowska 142, 00-061 Warsaw, Poland, phone (+48 22) 586 83 63, email [ekonomia@bzwbk.pl](mailto:ekonomia@bzwbk.pl), <http://www.bzwbk.pl>



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