

# Weekly economic update

27 June – 3 July 2005

All economic data releases for May has been already announced, thus both financial market and the Monetary Policy Council can now adjust to the new situation. Although at the beginning of last week there was some correction taking place on the fixed income market, since Tuesday the yields have entered a downward trend, and hit historical lows levels on Friday. It seems that weak data about industrial output and GDP released earlier were much more important for the market than reasonably strong rise in retail sales. Positive moods on foreign markets had undoubtedly high importance in determining sentiment in Poland. The zloty appreciated to below 4.0 against euro only for a while, however this level could be tested again pretty soon.

What will be the MPC's response to such situation? Market analysts take into account four scenarios. The most hawkish one assumes 25 bps rate cut without change in policy bias, while the most dovish envisages 50 bps cut and simultaneous shift to easing bias. While the former seems to not be very likely, taking into account recent comments of MPC members, the latter seems too aggressive considering how much medium-term economic forecasts could change under influence of single economic data (about GDP). We believe that there are two most likely scenarios – a 25 bps rate cut with change of policy bias to easing, suggesting chance for additional 25-50 bps cut before the election, or 50 bps cut with no change in neutral bias, showing that the scale of policy adjustment is adequate to change in assessment of economic situation after latest data releases. We bet the MPC will pass the first of these options, although we realise that working out a common stance by the 10-members panel with different (sometimes extremely different) views could be exceptionally difficult this time. Apart from the MPC decision, this week data on balance of payments will be released (with low impact on the market), and abroad the attention will focus on FOMC decision about interest rates (25 bps rate hike is commonly expected).

## Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD	UNIT	FORECAST		LAST VALUE
					MARKET	BZWBK	
<b>MONDAY (27 June)</b>							
09:00	POL	Auction for treasury bills- 52-weeks of PLN400m and 13-weeks of PLN100m (M)					
08:00	GER	IFO Index (H)	Jun		93.3		92.9
<b>TUESDAY (28 June)</b>							
10:00	EMU	Money supply (H)	May	% r/r	6.9		6.7
16:00	USA	Consumer confidence (H)	Jun		103.0		102.2
<b>WEDNESDAY (29 June)</b>							
	POL	MPC meeting - decision (reference rate)		%	5.25	5.25	5.50
	POL	MPC meeting – decision (monetary policy bias)			easing	easing	neutral
12:30	USA	GDP (H)	1Q	%	3.6		3.5
<b>THURSDAY (30 June)</b>							
14:00	POL	Current account balance (M)	Apr	€bn	16	-59	67
18:15	USA	FOMC meeting – decision (H)		%	3.25		3.00
<b>FRIDAY (1 July)</b>							
13:45	USA	Michigan sentiment index (H)	Jun		93.5		86.9
14:00	USA	Manufacturing ISM (H)	Jun		51.0		51.4

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

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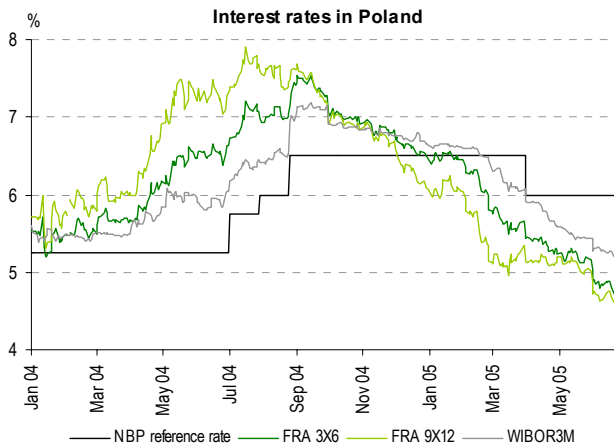
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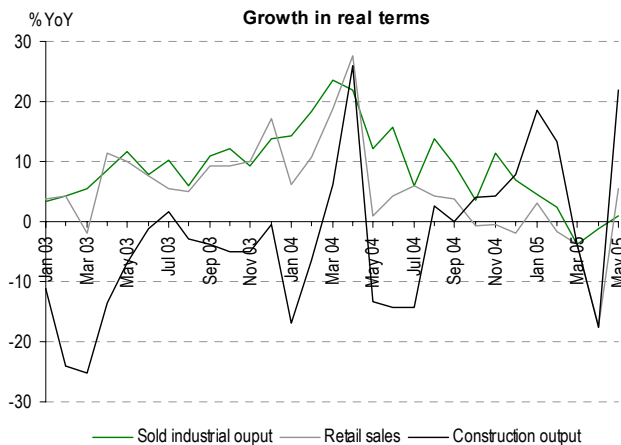
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## What's hot this week – MPC faces a tough choice

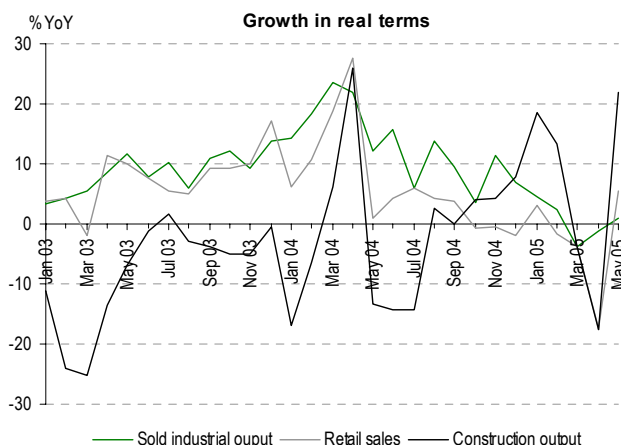


- It is almost sure that the MPC will deliver a monetary easing already this month.
- The Council will have to settle whether it is proper to trim rates with a neutral bias adopted in April. A decision on policy bias will be equally (or even more) important than a scale of rate cut.
- We think that the MPC will choose between a rate cut of 25bp with shift in bias to easing and a rate cut of 50bp with leaving the neutral bias. We predict the Council will decide for the first option, although we would choose the second one.
- A rate cut of 50bp with a bias change to easing (the scenario priced in by the market) seems to aggressive to us, given that expectations for the next 12-18 months has not changed that dramatically.

## Economy last week – Slightly more optimism after weak data



- Retail sales rose in May by 8%YoY in nominal terms, while its real growth reached 5.5%YoY, and was the highest since July 2004.
- The data suggested that private consumption demand was in quite a good shape in the middle of the year, confirming hopes for improvement in consumption growth in the second half of this year (2Q05 is likely to be quite weak again, biased heavily by very weak April's results), which will fuel GDP rise in the corresponding period.
- The uncertainty still remains with respect to pace of investment growth in the remainder of the year. The monthly bulletin of the CSO included sector breakdown of industrial production in May, which showed a fall in output of investment goods by 1%YoY. Deputy president of the CSO still believes (like we do) that investment revival will come in the second half of the year



- Registered unemployment rate fell in May to 18.3% from 18.8%. In comparison with May 2004, it dropped by 1.2 pct. point, which was the fastest annual rate of decline for about seven years.
- The improvement on the labour market was clearly stronger than implied by regular seasonal pattern. The number of registered unemployed fell below 2,9 million for the first time since August 2001, and was over 7% lower than last year.
- LFS survey for 1Q05 also showed improvement of situation – fall in unemployment rate by almost 2 pp, lower number of unemployed by 310,000 people (8.8%YoY), number of people in a job higher by 302,000 (2.2%YoY).
- Strengthening improvement on the labour market should be supportive for private consumption growth in the second half of the year.

## Quote of the week – There is a need for adjustment in monetary policy

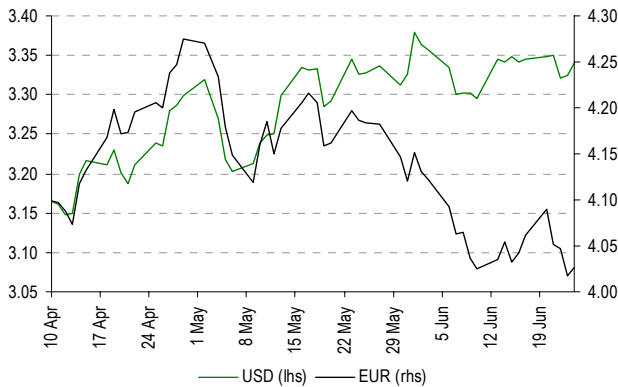
**Dariusz Filar, MPC member;** Bloomberg, 21 June  
*GDP growth outlook has changed, which heightened a need for adjustments in monetary policy. Currently, a threat of inflationary pressures diminished to a considerable extent.*

**Andrzej Sławiński, MPC member;** PAP, 21 June  
*The current GDP growth is lower than the potential one, which indicates a need for adjustment in monetary policy.*

MPC members stressed in their public speeches that the situation requires “adjustment in monetary policy”. It is difficult, however, to draw a conclusion from their statements on a scale of the adjustment. Therefore, it is not easy to guess the outcome of the nearest MPC meeting. While Prof. Sławiński said that low pace of GDP growth is supportive for rate cuts, MPC decisions should depend on predictions of inflation and GDP growth, and not on their current levels.

## Market monitor

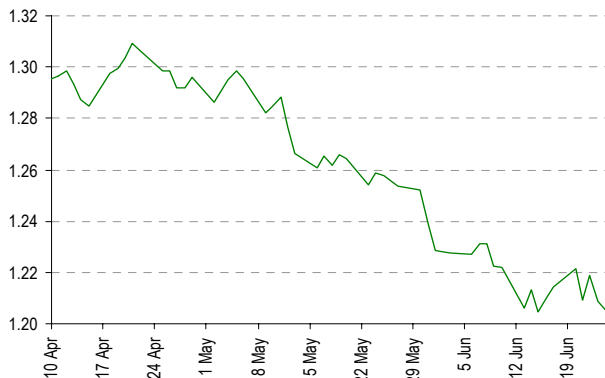
Zloty exchange rate



## Zloty gaining strength against the euro

- Last week the zloty has been appreciating since Tuesday, mainly against the euro (by almost 1%), however it stemmed mostly from change in EURUSD rate.
- Awaiting the MPC decision, the zloty should remain quite stable. However, we believe that depending on EURUSD moves, next week the zloty could again test 4.0 level (possibly with more persistent effect). We predict the zloty to vary in 3.27-3.37 band against the dollar and 3.97-4.07 against the euro.
- It is consistent with our forecasts presented in the past, pointing to zloty appreciation in June-July. We think that average EURPLN rate in July is likely to be lower than in June (up-to-date at 4.06).

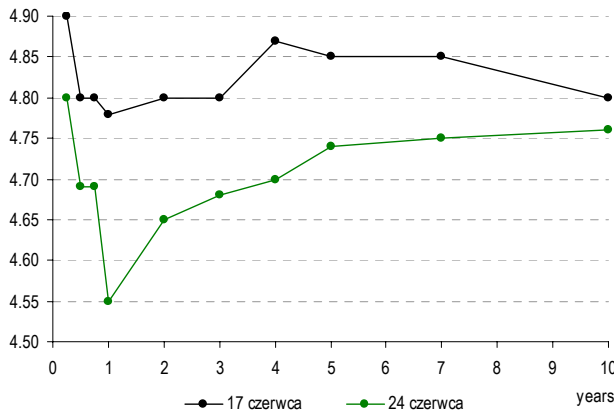
EURUSD rate



## ... similar to the US dollar

- Last week saw further gains of the dollar on international markets. Despite a weakening to above 1.22 at the beginning of the week (which took place again after hawkish comments from Fed officials), throughout the remainder of the week the EURUSD rate was steadily falling to 1.2. On Friday, the level was even breached.
- In the nearest days, the key driver for major markets will be the Thursday's FOMC decision on interest rates. A rate cut of 25bp is expected and then another one in August. Moreover, the main international FX and debt markets will be affected by data on the real economy that are expected to shed more light on the strength of the European and US economy.

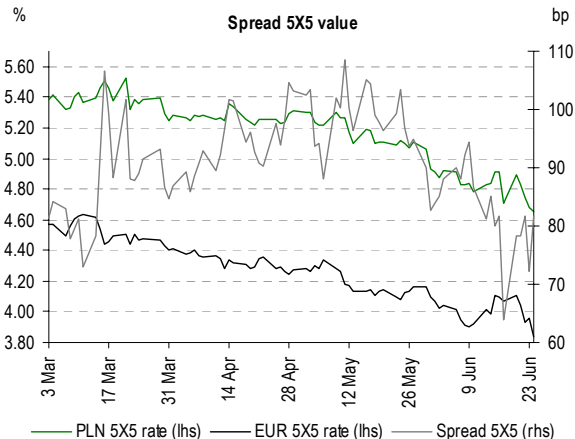
Yield curve



## New records on the fixed income market

- At the beginning of week there was some correction taking place on the fixed income market, however since Tuesday the yields entered a downward trend.
- Short end of the yield curve is pricing-in interest rate cuts very aggressively, while long end is under influence of positive sentiment for bonds abroad (see below).
- At the end of week, yields on Polish bonds hit record-low levels – 4.65% for 2y and 4.75% for 5y.
- Now, the MPC decision will be crucial for the market. One should notice that rate cut by 25bps with change of policy bias should be more positive for the market than cut by 50 bps wit bias unchanged.

Spread 5X5 value



## Positive sentiment on the core markets

- Sentiment on the core debt markets has been very positive, which resulted among others from unexpected scale of rate cut by the Riksbank and dove-ish minutes from the last meeting of the Bank of England (two MPC members voted for a rate cut).
- Yields of 10Y Treasuries and Bunds reached 3.92% and 3.14%, respectively.
- 5X5 spread between the Polish and the European curve fell to 72bp last week and although it was slightly higher than the previous week's level (64bp seen after output figures), it is worth noting that this was the lowest levels since 3Q03 when the average spread was below 70bp. On Friday, the spread widened to above 80bp, i.e. to the level that was observed for the better part of June.

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