Bank Zachodni WBK

Weekly economic update

11 July – 17 July 2005

While crucial data for the perspective of the Polish economy in 2H05 (on industrial output and retail sales) will be released only next week, some information will be published in the following days. Data from the labour market should support hopes for improvement in economic situation, however the most important from the market perspective will be June's inflation figure, to be released on Thursday. It seems that another strong fall in inflation is almost certain, however analysts' opinions differ as regards precise scale of this decline. While very optimistic forecast of the Ministry of Finance (1.3%) seemed to influence market expectations, we think that CPI inflation may be slightly higher (though still much lower than May's 2.5%) amid assumption of not so sharp fall in food prices and higher fuel prices.

In the face of lack of domestic data releases, last week the zloty was following moves in the euro/dollar market. During the week the zloty declined by 1.8% against the dollar and 1.1% to the euro. In the coming days, a test for the zloty will be Wednesday's bond auction and CPI inflation number release one day later. Magnitude of demand for an auction will have substantial consequences for investors in foreign exchange market and inflation data will show if capital flow into the Polish market is continued.

Economic calendar

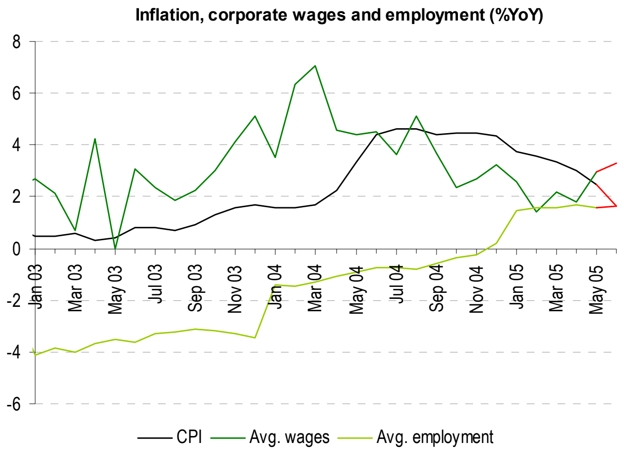
Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (11 July)					
09:00	**POL**	**Auction for 52-weeks and 13-weeks treasury bills – PLN400m and PLN100m (M)**					
		TUESDAY (12 July)					
14:00	**POL**	**C/A (M)**	**May**	**€m**	**90**	**80**	**537**
		WEDNESDAY (13 July)					
09:00	**POL**	**Auction for 10y bonds (DS1015) – PLN1.5-2.5bn (H)**					
12:30	USA	Import prices (H)	Jun	%MoM	1.0	-	-1.3
12:30	USA	International trade (H)	May	$bn	-57.5	-	-57.0
18:00	USA	Monthly budget statement (M)	Jun	$bn	25.0	-	19.12
		THURSDAY (14 July)					
09:00	EMU	GDP – revision (H)	1Q	%YoY	-	-	1.5
12:30	USA	CPI (H)	Jun	%MoM	0.3	-	-0.1
12:30	USA	Retail sales (H)	Jun	%MoM	0.7	-	-0.5
14:00	**POL**	**CPI (H)**	**Jun**	**%YoY**	**1.4**	**1.6**	**2.5**
14:00	**POL**	**Money supply (M)**	**Jun**	**%YoY**	**12.0**	**12.0**	**13.0**
		FRIDAY (15 July)					
12:30	USA	Business inventories (M)	Jun	%MoM	0.4	-	0.3
12:30	USA	PPI (H)	Jun	%MoM	0.4	-	-0.6
13:15	USA	Industrial production (H)	May	%MoM	0.3	-	0.4
13:15	USA	Capacity utilisation (M)	Jun	%	79.6	-	79.4
13:45	USA	Preliminary Michigan index (H)	Jun	-	94.0	-	96.0
14:00	**POL**	**Corporate employment (M)**	**Jun**	**%YoY**	**1.6**	**1.7**	**1.6**
14:00	**POL**	**Employment wages (H)**	**Jul**	**%YoY**	**2.8**	**3.3**	**3.0**

* 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 – First set of statistics for June

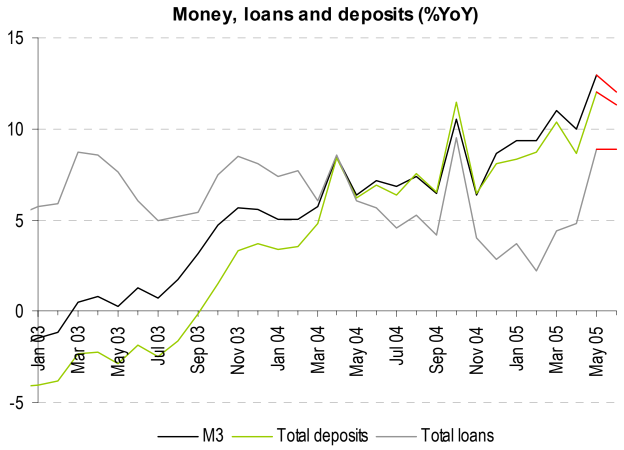


▪ In June, another deep fall in inflation rate is expected, by almost 1 pct. point from May's 2.5%. Our forecast is at 1.6%YoY, although majority of market analysts predict CPI in 1.4-1.5% range, while FinMin foresees 1.3% growth. Scale of drop in food prices will be crucial for inflation level in June.

▪ However, for the MPC much more important than inflation level (which is expected to fall anyway) will be data from real economy. First portion of information of this kind will be data about employment and wages in enterprises sector.

▪ We predict slightly faster rise in employment in June (1.7%YoY) and acceleration in pay rise to 3.3%YoY. In effect, total wage bill in firms should grow by 5%YoY – at fastest pace since March 2004.

▪ Market consensus is a bit weaker, pointing to 2.9%YoY rise in employment and 1.6-1.7%YoY growth in wages.

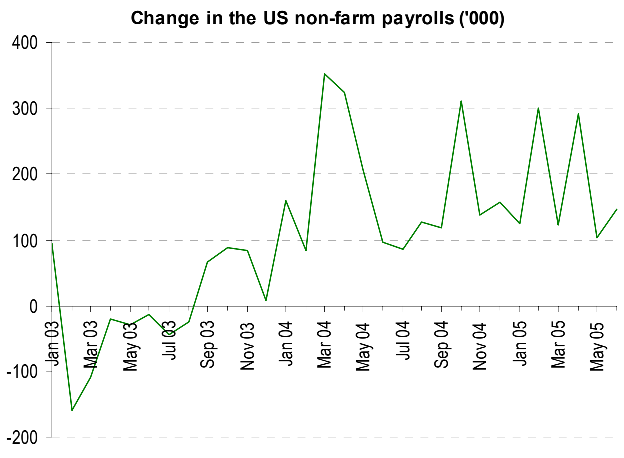


▪ Money supply growth will slow down in June, but will remain high anyway (our forecast at 12%YoY, consistent with market consensus). We expect continuation of improvement in loans for companies, confirming recovery in investment.

▪ Data about budget realisation after six months should be quite optimistic. Thanks to transfer of NBP profit and quite good tax performance declared by FinMin's officials, the deficit should be at ca. 50% of annual plan, which is well below average level in the corresponding period of previous years. It would confirm lack of major threats for budget realisation this year.

▪ NBP hastened publication of balance of payments data, so May's figures will be released only a few days after April's numbers. We forecast €80m surplus in current account amid strong rise in exports and imports (both ca. 11%YoY).

Economy last week – US non-farm payrolls weaker than expected



▪ Employers in the US created 146,000 new jobs outside the agriculture sector in June. The result was a bit weaker than expected by market analysts, however on the other hand increase in new jobs in April and May have been revised upwards by 44,000, boosting count up to 292,000 and 104,000.

▪ Unemployment rate fell to 5.0% against expected level 5.1%. It was the lowest unemployment reading since September 2001. The drop was mostly due to a slight increase in the workforce.

▪ Although data on non-farm payrolls slightly disappointed, it seems that trends on the US labour market will not stop the Fed from continuation of gradual interest rate hikes in the coming months.

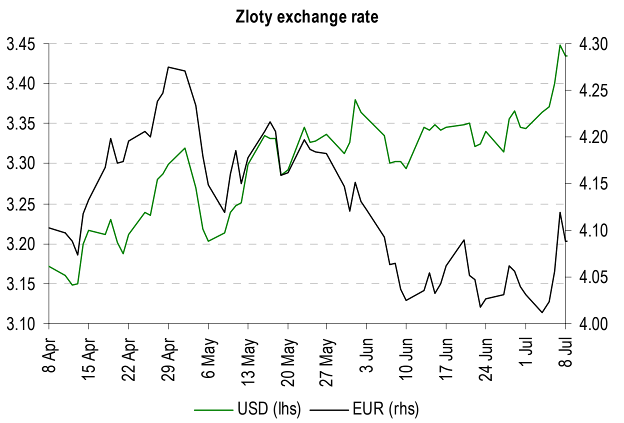
Quote of the week – Next rate cuts will depend on economic data

Dariusz Filar, MPC member; Reuters, 5 July

The easing stance opened the door to interest rate reductions. But the scale of future cuts is not yet clear and will depend on information that we will get about the state of the economy. The data to watch concern perspectives of economic growth, i.e. industrial output, employment and wage bill. Next three months will be see crucial data.

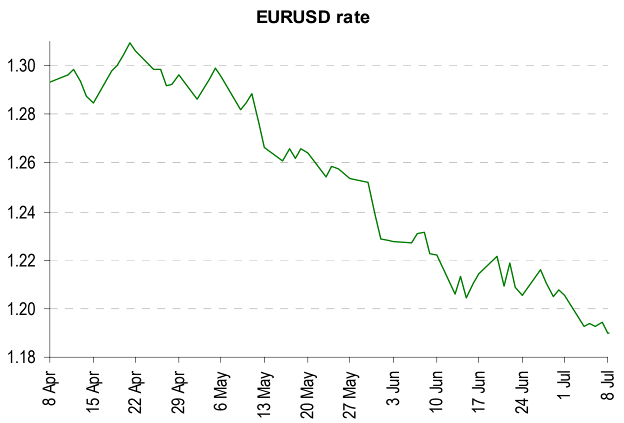
Filar's comment confirmed our view on the perspectives of next monetary policy decisions – they will depend on forthcoming statistical data, especially those describing economic activity. The Council could wait until August for the data on investment in big companies and new Inflation report with NBP projections. Nevertheless, if output and retail sales growth in June are very low, the next interest rate cut could take place already this month.

Market monitor



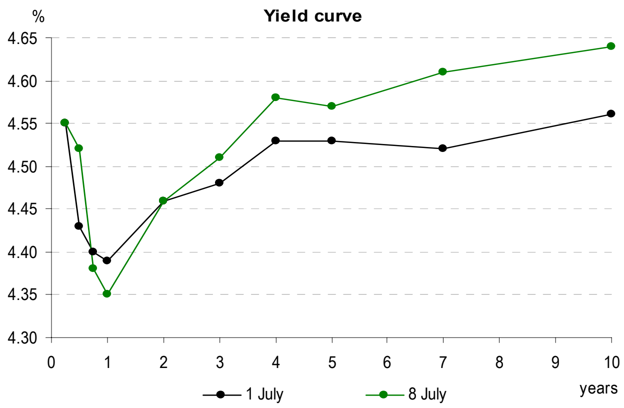
Will capital inflow be continued?

- Last week after a strong outset the zloty started to lose first due to significant strengthening of the dollar following EBC representative's comments and then as a result of low demand at 2y bond auction. Movements in core market after attacks in London did not translate into the zloty performance. Only the euro gains after US labour market data caused the zloty to increase. During a week the zloty declined by 1.8% against the dollar and 1.1% to the euro.
- Test for the zloty will be bond auction and inflation release a day after the former event. Magnitude of demand for an auction will have substantial consequences for investors in FX market and an inflation data will show if capital flow into the Polish market will be continued. We expect the zloty to trade in the range of 4.04-4.14 to the euro and 3.34-3.44 against the dollar.



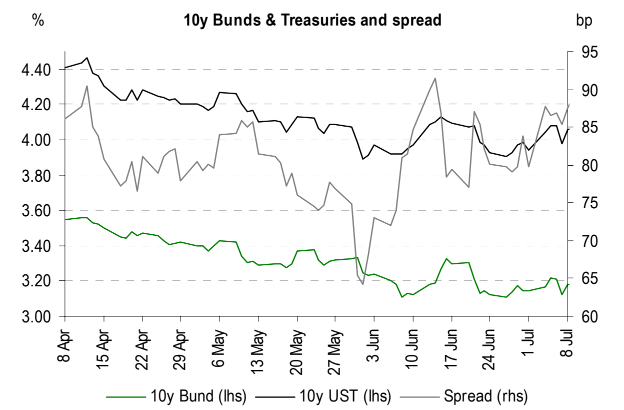
Environment becomes conducive to the euro

- The beginning of the last week brought a meaningful rise of the dollar's value on comments from ECB member and favourable data from US economy (ISM indices and durable goods orders). Strengthening of the euro on the back of London events proved to be a short-lived one. Only US employment data became a stimulus for the euro to rise to 1.196. During a week the dollar gained by 0.7%.
- Next week the EURUSD rate will be under influence of foreign trade and inflation data in US. Both the former and the latter may have positive impact on the euro, as following last month release of high C/A deficit in US the market will be sensitive to trade deficit performance. Low inflation may fuel expectations for the end of tightening cycle in US.



Demand rather moderate ahead of inflation

- Positive sentiment maintaining after MPC decision, low supply of papers for 2y bond auction and comments from MPC's Filar translated into a fall of yields at the beginning of the week. Low demand at the auction induced investors to take profits. But a rise in yields was restrained by still strong core markets after attacks in London. Finally yields rose at the long end of the curve by 6 bp.
- After a correction investors will probably be more inclined to purchase bonds at the auction, but it seems that ahead of CPI release they will adopt a cautious stance regarding risk taking. If Ministry of Finance optimistic forecast would be fulfilled, it may bring about a fall in yields to below 4.5% in the 5y sector.



The end of the week fully packed with data

- Barring Thursday core markets remained quite stable and US 10y bonds yield maintained at the level of 4.05% and in Germany – 3.2%. Typical market reaction to terrorists attacks triggered them to decline to 3.93% and 3.1% respectively. At the end of the week the situation normalised and prices reverted to pre-attack levels.
- Next week core markets only in the later part of the week will obtain strong impulses, when reports on inflation indices (CPI and PPI) and real economy situation (production and sales) are published. It seems that those data will not alter market conviction on economic stance and may still keep yields in 10y sector on core curves at relatively low level.

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, http://www.bzwbk.pl