Bank Zachodni WBK

Weekly economic update

15 August – 21 August 2005

Though the upcoming week will be shorter, we will see a few pieces of information crucial for the Polish financial market. The statistical office will publish CPI inflation and production data for July. In both cases our forecasts are lower than market consensus, which means that the realisation of our scenario may trigger a strengthening in the interest rate market ahead of the Monetary Policy Council meeting. MPC members continue to emphasise that next decisions will depend on upcoming economic data (and new *Inflation Report*). We think that data on economic activity will be more important than inflation figures (inflation fall was expected to fall for quite a long time). PAP and Reuters published monthly opinion polls among market analysts, which showed quite interesting results as regards July's industrial production. Average expected growth in output amounts to 4-5%YoY, while our forecasts points to ca. 1%. Majority of market analysts see a chance for 25 bp cut in August and this is also our view. However, in our opinion, production growth of ca. 5% could even lead to no rate cut scenario.

Last week June's balance of payments data were very important as they showed surpluses in current account and trade account accompanied by high growth of exports and imports. This led to a substantial zloty strengthening and the zloty rate fell below ranges we indicated a week ago. In the case of euro it was only temporary and moderate, but the zloty gained much more against the US dollar amid rising EURUSD rate to almost 1.25. In the upcoming week we will see next bunch of US data, which will set sentiment towards the American currency, as well as fixed income market, as rising trend in yields has recently stopped.

Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (15 August)					
	POL	**Public holiday – Assumption Day**					
13:00	US	Net capital flows (H)	Jun	$bn	-	-	60.0
		TUESDAY (16 August)					
12:30	US	CPI (H)	Jul	%YoY	-	-	2.5
13:15	US	Capacity utilisation (H)	Jul	%	80.3	-	80.0
13:15	US	Industrial production (H)	Jul	%MoM	0.6	-	0.9
14:00	**POL**	**CPI (H)**	**Jul**	**%YoY**	**1.1**	**1.0**	**1.4**
14:00	**POL**	**Average wage in the enterprise sector (H)**	**Jul**	**%YoY**	**3.1**	**3.9**	**4.5**
14:00	**POL**	**Average employment in the enterprise sector (M)**	**Jul**	**%YoY**	**1.8**	**1.9**	**1.7**
		WEDNESDAY (17 August)					
12:30	US	Producer prices (H)	Jul	%MoM	0.5	-	0.0
		THURSDAY (18 August)					
09:00	EMU	Industrial output (H)	Jun	%YoY	0.5	-	0.1
09:00	EMU	Final HICP (H)	Jul	%YoY	2.2	-	2.1
14:00	US	Leading indicators (H)	Jul	%MoM	0.2	-	0.9
14:00	**POL**	**Industrial output (H)**	**Jul**	**%YoY**	**5.0**	**1.1**	**6.8**
14:00	**POL**	**Producer prices (H)**	**Jul**	**%YoY**	**0.3**	**0.2**	**0.1**

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

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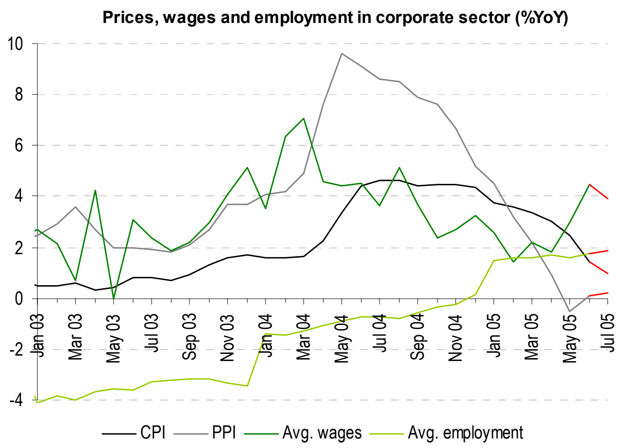
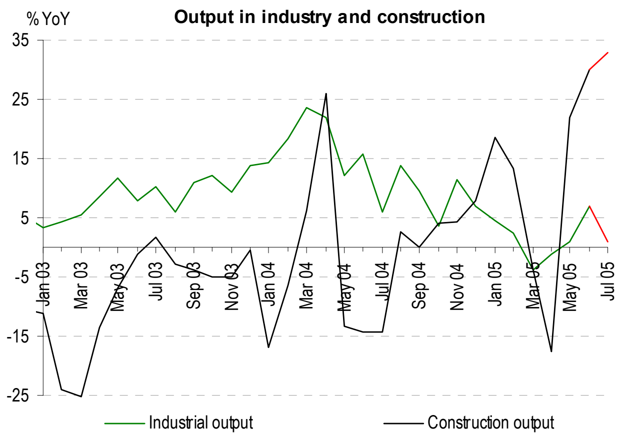
What's hot this week – Key data for financial market

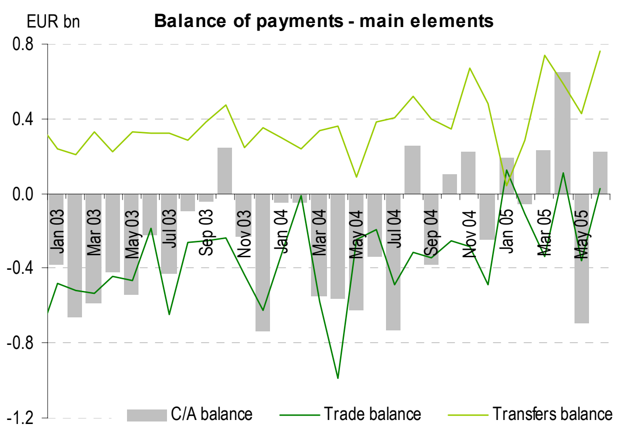


- The first business day of the next week will bring important information for financial markets – CPI inflation and labour market statistics.
- Market expectations show inflation decrease to 1.0-1.2%YoY in July, while our forecast is at the lower end of this range. We assume deep fall in food prices of 2.5%MoM and transport prices higher by 1.5%MoM (high oil prices, high USDPLN rate in July).
- Wages growth in corporate sector surprised in previous month amid high payment in mining sector. Therefore, it is expected that wages decelerated in July. As the rate of growth of employment continues to accelerate, the wage bill will show quite substantial growth.
- Another information on inflation will relate to producer prices. 12M PPI is forecasted to stabilise around zero.



- Together with PPI publication, the CSO will release industrial production figure, which will be crucial for market sentiment, especially on the interest rate market.
- Stronger-than-expected June's reading was probably perceived by market participants as a trend change and they adjusted forecasts upwards. Consensus view (4-5%YoY) is achieved amid high dispersion of forecasts (in PAP's survey they range between -7% and 8.8%).
- Since the data for June were more or less in line with our projection, we did not change the growth forecast for July which was ca. 1%. It should be highlighted that this would represent a pretty decent growth of 5% in seasonally adjusted terms – the fastest growth this year.
- We also expect output in construction sector to maintain high growth level of around 30%YoY.

Economy last week – Yet another surplus(es)



- After negative surprise in data for May, balance of payments statistics for June were much better than expected, showing strong import rise (good signal as regards strength of domestic demand) and even faster growth in exports. As a results, a trade surplus was recorded. We estimate that in the second quarter net exports contribution to GDP growth was positive again.
- Balances of services and transfers were also very positive in June, while income balance showed substantial deficit for the second month in a row amid dividends payments.
- Just before the long weekend, the NBP published money supply statistics for July. Broad money supply growth was below expectations (10.4%YoY against consensus of 11.1%). However, acceleration in credits (8.8%YoY from 7.5%) observed in households and firms bodes well for economic activity.

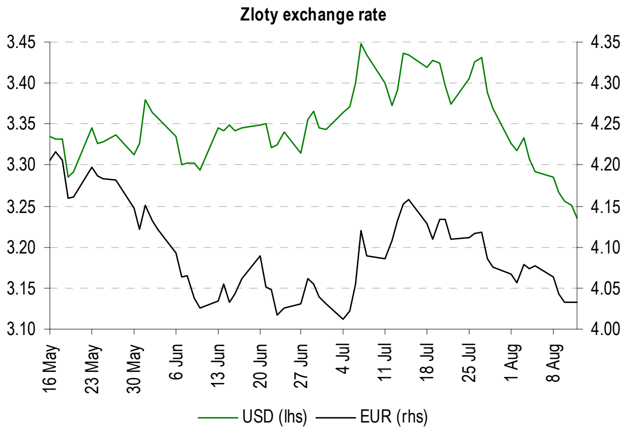
Quote of the week – Rate cut possible, but not certain

Halina Wasilewska-Trenkner, MPC; Reuters, 8 August

The easing bias shows that a possibility to reduce interest rates this year still exists, but when it will happen, whether it will happen and its scale will depend on further information and what the projection will show.(…) Inflation will remain near the target (…) now there's risk that it can be a little more than 2.5 percent.

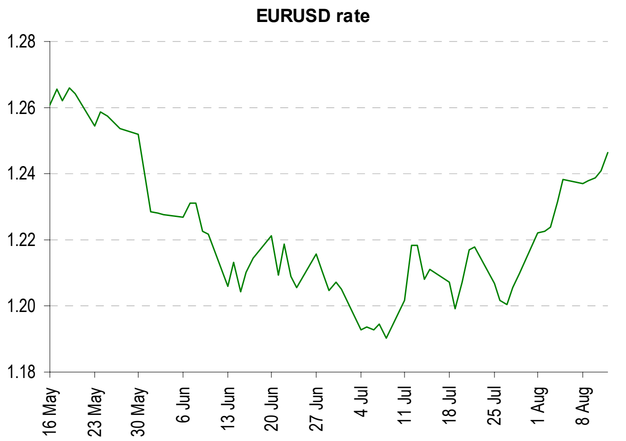
MPC members comments confirmed that next MPC decisions will depend on upcoming information. She was also quite optimistic as regards perspectives of economic activity, emphasising at the same time that high oil prices create inflationary risk, which may lead to inflation acceleration to above 2.5%. This is against earlier predictions of the MPC, indicating low inflation, around the lower end of the target tolerance band (1.5-3.5%).

Market monitor



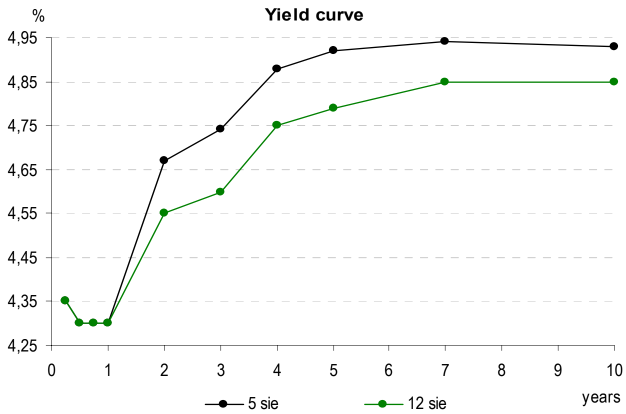
Zloty gains on good sentiment in the region and data

- Last week was good for the zloty. With low activity on the market, the exchange rate of domestic currency was gradually strengthening. It resulted from positive attitude towards currencies in the region and additional support for the zloty was delivered by better-than-expected balance of payments statistics for June (details above). Zloty gains were stronger versus the dollar, as the EURUSD went up.
- This week the zloty exchange rate will be affected by publication of crucial domestic data. The figures will shape expectations regarding next moves of the MPC, which may indirectly impact the zloty. We predict that during this week the EURPLN will range between 4.00 and 4.10, and USDPLN will fluctuate within 3.20-3.30 range.



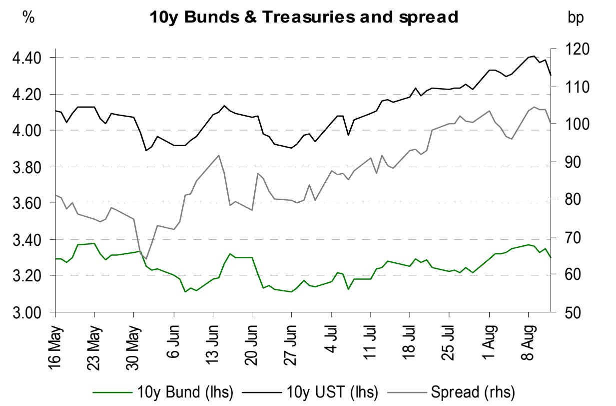
Weak sentiment towards the American currency

- Last week dollar continued to depreciate against the euro However, the greenback's losses were not as dynamic as in the previous weeks.
- The reason for rise in EURUSD were good data from the euro zone and weak data from the US as well as a disappointment of market players as regards a possibility of more aggressive rate hikes by Fed, which was indicated by a tone of statement released after the 10th straight rise in rates by 25bp. US foreign trade data were weaker than expected, but the dollar strengthened after they had been released, as a profit taking on other currencies started.
- This week, the EURUSD rate will be under influence of numerous publications of important data in the US. The key release will be Monday's data on net capital flows.



Polish debt market gains on better moods abroad

- The domestic interest rate market was positively affected last week by fall in market rates abroad. As a result, a moderate fall in yield curve and lowering of FRA rates was observed. This week the Polish interest rate market will be influenced by releases of crucial economic data.
- As we predict that both inflation and output figures will prove lower than market expectations, one may expect some decline in market interest rates. However, the reaction is not likely to be very strong, as market players will wait with formulation of final expectations regarding MPC steps for the next data, including GDP numbers for 2Q05.



Interrupted rise in yields abroad

- Since the beginning of July, yields of US bonds, as well as yields of European bonds to some extent, were almost relentlessly increasing. On the day of FOMC meeting the trend was interrupted. As Fed statement was not as hawkish as market had expected and economic data were weaker than predicted, Treasuries' yields fell by some 10bp on Friday as compared to the beginning of the week.
- This week bond yields abroad should return to the earlier upward trend, as the data to be published this week should confirm that the US economy expands at a solid pace, and Fed is going to continue rate hikes. Bonds prices in the euro zone are also likely to increase due to expected strong macro data.

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