Bank Zachodni WBK

Weekly economic update

22 August – 28 August 2005

Last week brought about publication of data, which were expected to settle what will be the MPC decision on interest rates in August. CPI inflation in July proved worse than predicted and weakened expectations for a possible rate cut of 25bp. At the same time, however, inflation is still low and does not indicate any sign of substantial threat to the inflation target. Quite favourable picture of inflation prospects was also confirmed by PPI, which was lower than expected in July, suggesting that record high oil prices has not influenced significantly overall inflation so far. All in all, data on CPI and PPI for July has not gave clear hint as regards desirable steps in monetary policy. Output figures were also inconclusive. Growth in industrial output in July was slightly higher than we forecasted, but much lower than market expectations, which are a basis for assessment of the situation by some of MPC members. Thus, although output figures were objectively good and confirmed that the economic growth in Poland gains momentum at the beginning of 2H05, for some of central bankers the figures may be an argument for a rate cut. Meanwhile, hawks from the Council has started to talk about a need to stop rate cuts and change policy bias into neutral from easing in the nearest time. For the moment, duel between advocates of rate cuts and supporters of conservative monetary policy seem to be unsettled. Therefore, another economic data will be of crucial importance. The key focus of attention will be GDP figures for 2Q05 (due for release shortly before MPC meeting), but much attention is also likely to be paid to retail sales data for July that will be revealed on Tuesday.

Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (22 August)					
8:00	EMU	Current account balance (M)	Jun	€ bn	-	-	0.9
9:00	EMU	Trade balance (M)	Jun	€ bn	-	-	2.2
9:00	**POL**	**Auction for 52-week treasury bills – PLN500m (M)**					
14:00	**POL**	**Business climate indices (M)**	**Aug**	**pt**	**-**	**-**	**-**
14:00	**POL**	**Financial results of enterprises (H)**	**Q2**	**PLN bn**	**-**	**-**	**-**
		TUESDAY (23 August)					
8:00	**POL**	**Retail sales (H)**	**Jul**	**% YoY**	**-**	**7.4**	**10.5**
8:00	**POL**	**Unemployment rate (M)**	**Jul**	**%**	**-**	**17.9**	**18.0**
9:00	GER	ZEW index	Aug	pt	38.5	-	37.0
		WEDNESDAY (24 August)					
9:00	**POL**	**Switching auction (M)**					
9:00	EMU	Industrial new orders	Jun	% MoM	-	-	-1.5
12:30	USA	Durable goods (H)	Jul	%	0.2	-	2.0
14:00	**POL**	**Core inflation (H)**	**Jul**	**% YoY**	**-**	**1.4**	**1.4**
		THURSDAY (25 August)					
8:00	GER	IFO index (H)	Aug	pt	95.2	-	95.0
		FRIDAY (26 August)					
8:00	EMU	M3 money supply (H)	Jul	%	7.3	-	7.5
13:45	USA	Michigan index – final (H)	Aug	pt	92.7		96.5

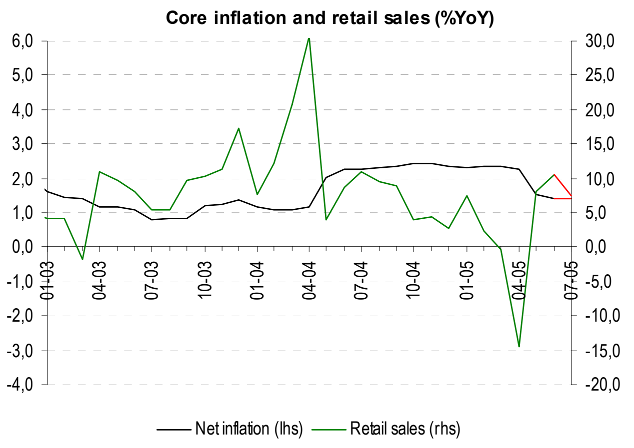
* Importance level: (H)igh, (M)oderate; Source: Reuters, BZ WBK,

Maciej Reluga Chief economist (+48 22) 586 8363

Piotr Bielski (+48 22) 586 8333

Piotr Bujak (+48 22) 586 8341 e-mail: ekonomia@bzwbk.pl

What's hot this week – Another portion of important data



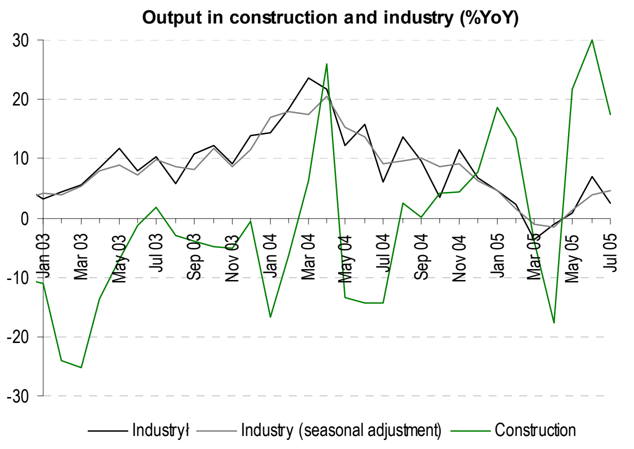
▪ The week will bring continuation of data releases.

▪ The most important will be data on retail sales for July, because the financial market still focus on economic activity indicators, which are currently seen as more important argument for the MPC than different inflation indicators. As regards the latter, this week we will see core inflation measures for July.

▪ Before release of retail sales data and core inflation measures, the CSO will publish business climate indices for August and financial results of enterprises (employing over 49 persons) for 1H05. These figures should confirm that the economy is in good shape and on the right track to reach faster growth in 2H05.

▪ Apart from data, market participants will watch for possible comments from MPC members, especially those who has not taken the floor recently.

Economy last week – Inflation and output figures did not settle about MPC decision



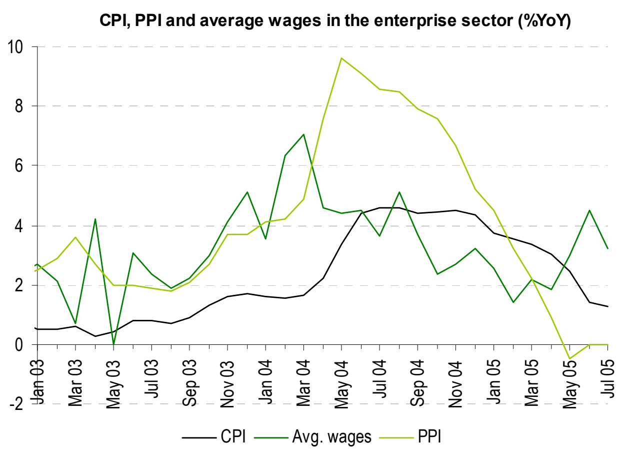
▪ Our expectations regarding rise in industrial output in July were much modest than average market forecast, but these were our predictions that proved closer to reality.

▪ In our opinion industrial output growth of 2.6%YoY is quite a good result (seasonally adjusted growth was 4.7YoY, the strongest this year), confirming that the Polish economy vigorously accelerated in 2H05.

▪ However, for the market and for those MPC members for whose market consensus is a basis for assessment of the situation, the data were weak.

▪ The fact is that the data were not strong enough to indicate that economic activity is so strong that it will bring about significant inflationary pressure.

▪ A good signal on investment activity was growth in construction in July, which was again strong, although slightly weaker than expected.



▪ CPI inflation in July was higher than expected (it fell a mere 0.1pp to 1.3%YoY instead of forecasted 1.1%YoY), which weakened expectations for another rate hike in August.

▪ CPI was higher than our forecast as food prices growth proved smaller than we had assumed. Rise in fuel prices was in line with our estimates.

▪ On the other hand, PPI in July was lower than predicted, which suggests that record high oil prices has not affected overall inflation as strong as one could have expected.

▪ Moreover, there are still not indications of excessive wage pressure. As expected, wage growth in firms decelerated in July. However, it was quite decent, which together with stronger rise in employment and falling inflation translated into acceleration in real wage bill growth. This bodes well for consumption growth in 2H05.

Quote of the week – Diversified views within the MPC

Statement of MPC members from 18 August (Reuters)

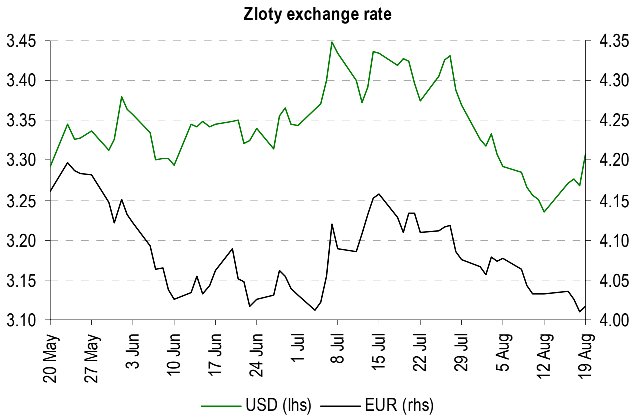
Marian Noga: *There is minimal scope to cut rates this year, but it will probably not take place this month or next, but around the end of the year.*

Mirosław Pietrewicz: *We have rather unfavourable growth data and zloty appreciation. This shows that there is scope to cut rates.*

Stanisław Owsiak: *These data are not enough to anticipate the council's decision at the upcoming meeting.*

Given comments of Prof. Noga there are 4 MPC members (also Balcerowicz, Filar and Wasilewska-Trenkner), who are going to vote against a rate cut in August. On the other hand, the doveish faction within the MPC still want to trim rates. Thus, hawks will need one more vote to keep rates on hold. The possible supporters are Owsiak, Sławiński and Wojtyna. The latter two of them has not presented their views last week, while Owsiak seems to be undecided.

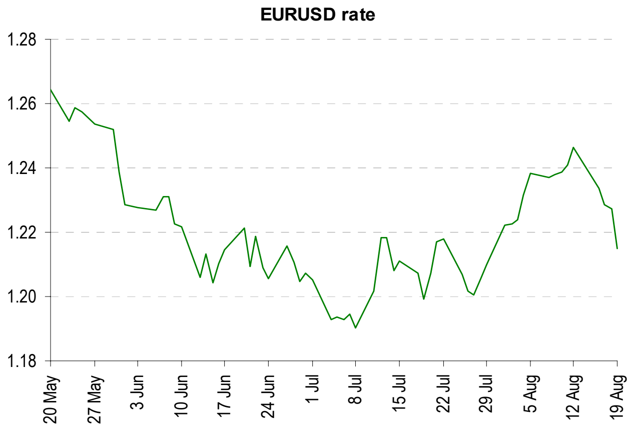
Market monitor



Zloty resistant to ambiguous data

▪ A bit shorter business week was quite peaceful on the Polish fx market, and the zloty was relatively immune to releases of domestic data about inflation and production. In turn, strong impact came from global appreciation of US dollar on international markets. In effect, EURPLN rate rubbed against lower end of the band we had indicated last week, while USDPLN reached the upper end of the bank, breaking it on Friday afternoon.

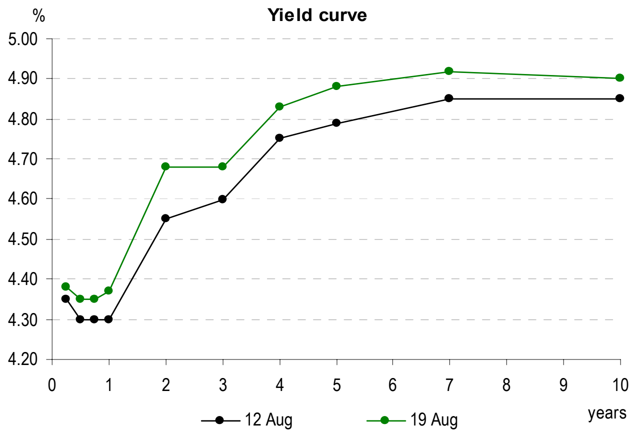
▪ This week domestic data releases will not be as important, so the zloty is likely to react mainly to euro./dollar swings, and possible comments of MPC members. We predict that the EURPLN will range between 3.98 and 4.08, and USDPLN will be in 3.26-3.36 range.



Dollar gaining strength again

▪ After two weeks of declines, the dollar started to recover last week, making up for most of the losses it took earlier. Although we did not rule out possible reversion of trend, its strength exceeded expectations. A support for the dollar comes from macroeconomic data that confirm strong economic expansion and possible inflationary pressure (confirming that Fed will continue rate hikes), while data for the euro zone are still not convincingly powerful, suggesting that dollar-positive interest rate differential should persist.

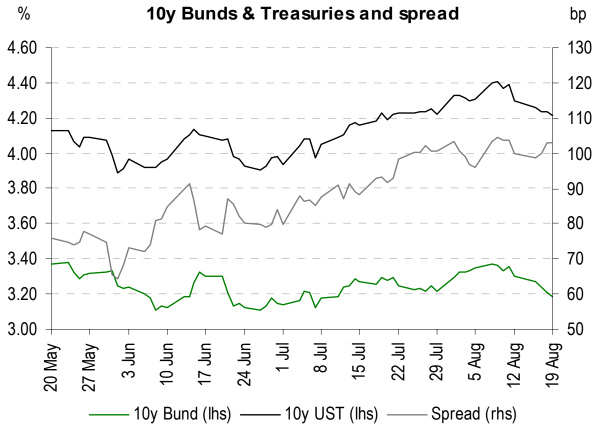
▪ The dollar is now at its best level for two weeks and we could see a test of the $1.2150 level going into the weekend. However, a move outside the five cent range that has prevailed for much of the last month seems unlikely.



Swinging moods amid inconclusive figures

▪ After quite good start of the week on Polish debt market, a significant deterioration of moods took place and yield curve moved up ca. 10 bp. Weakening (despite clear fall in yields abroad) was triggered by higher than expected inflation, hawkish comments from MPC members and president's signature of harmful pension bill. Only output figures much below consensus forecasts caused the market to strengthen– in line with our prediction, yet not for long.

▪ This week yields are likely to fluctuate again under influence of contradictory data on (high) retail sales and (low) core inflation. Even bigger impact could have potential comments of those MPC members who have not expressed their views recently (Sławiński and Wojtyna).



Correction of bond yields abroad continued

▪ Correction of upward trend in bond yields that has started already in the previous week, was maintained in last couple of days. In effect, Bund yields came down 12 bps during the week, while yields on Treasuries fell 9 bps.

▪ While in the euro zone, reduction in yield curve is supported by macroeconomic data confirming still weak demand growth, limited rise in production and benign inflationary pressure, then in the US data confirmed strength of economy and expectations for further rate hikes from Fed. Thus, one should suppose that strengthening on the US debt market is only temporary. This week data released in the euro zone and US will be crucial for interest rate markets.

This publication has been prepared by Bank Zachodni WBK S.A. (a member of AIB Group) for information purposes only. It is not an offer or solicitation for the purchase or sale of any financial instrument. All reasonable care has been taken to ensure that the information contained herein is not untrue or misleading. But no representation is made as to its accuracy or completeness. No reliance should be placed on it and no liability is accepted for any loss arising from reliance on it. Bank Zachodni WBK S.A., its affiliates and any of its or their officers may be interested in any transactions, securities or commodities referred to herein. Bank Zachodni WBK S.A. or its affiliates may perform services for or solicit business from any company referred to herein. This publication is not intended for the use of private investors. Clients should contact analysts at and execute transactions through a Bank Zachodni WBK S.A. entity or an AIB Group entity in their home jurisdiction unless governing law permits otherwise. Copyright and database rights protection exists in this publication.

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

Bank Zachodni WBK is a member of Allied Irish Banks Group