

Weekly economic update

14 November – 20 November 2005

Minority government led by Prime Minister Kazimierz Marcinkiewicz received a confidence vote on Thursday backed by PiS, Self-Defence, LPR and PSL. Now the question arises who will support the new cabinet when it comes to passing the consecutive budgets and other legislation. PiS will probably want to balance between populist parties and pro-market Civic Platform, however even in optimistic scenario it seems apparent that in such political configuration one should forget about serious reforms of public finances and labour market.

This week will be very busy in terms of economic data releases. We think they should confirm faster economic growth in 4Q05 yet without significant risks for inflation prospects. Most of analysts do not expect rate cut in November and we share this opinion given high uncertainty regarding economic programme of the new cabinet that could potentially have negative impact on inflation projections e.g. through significant rise in exchange rate risk. A cut in interest rates would be possible only if GDP data for Q3 surprise significantly on the downside offsetting potential inflation threats stemming from political risk.

Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
MONDAY (14 November)							
16:00	POL	Consumer prices (H)	Oct	%YoY	1.5	1.5	1.8
16:00	POL	Money supply (H)	Oct	%YoY	8.1	8.4	12.7
TUESDAY (15 November)							
16:00	POL	Current account (H)	Sep	EUR m	-390.0	-520.0	-380.0
10:00	GER	ZEW index (H)	Nov		45.0	-	39.4
13:30	USA	Producer prices (H)	Oct	%MoM	0.2	-	0.3
13:30	USA	Retail sales (M)	Oct	%MoM	-0.7	-	0.2
WEDNESDAY (16 November)							
16:00	POL	Auction of 5-year DS1110 PLN1.0-2.5bn (H)					
10:00	EMU	Final HICP (H)	Oct	%YoY	2.5	-	2.6
13:30	USA	Consumer prices (H)	Oct	%MoM	0.0	-	1.2
14:00	USA	Net capital flows (H)	Sep	USD bn		-	91.3
THURSDAY (17 November)							
16:00	POL	Wages (H)	Oct	%YoY	2.9	2.5	1.8
16:00	POL	Employment (H)	Oct	%YoY	2.1	2.2	2.2
10:00	EMU	Industrial output (H)	Sep	%MoM		-	0.8
14:15	USA	Capacity utilization (M)	Oct	%	79.1	-	79.0
14:15	USA	Industrial output (H)	Oct	%MoM	0.8	-	-1.5
PIĄTEK (18 November)							
16:00	POL	Producer prices (H)	Oct	%YoY	-0.4	-0.5	-0.2
16:00	POL	Output in industry and construction (H)	Oct	%YoY	5.8	5.7	5.5

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

Maciej Reluga Chief economist (+48 22) 586 8363

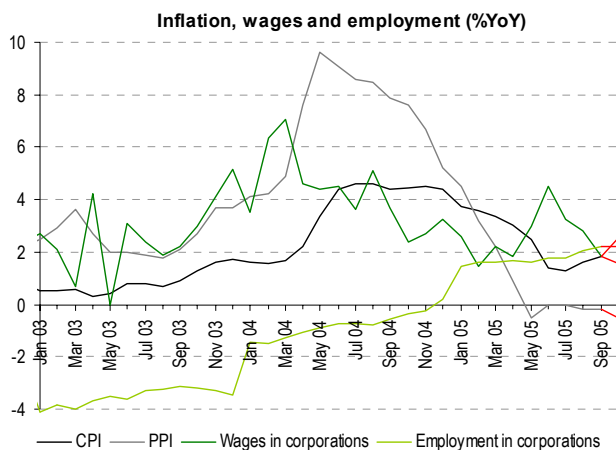
Piotr Bielski (+48 22) 586 8333

Piotr Bujak (+48 22) 586 8341

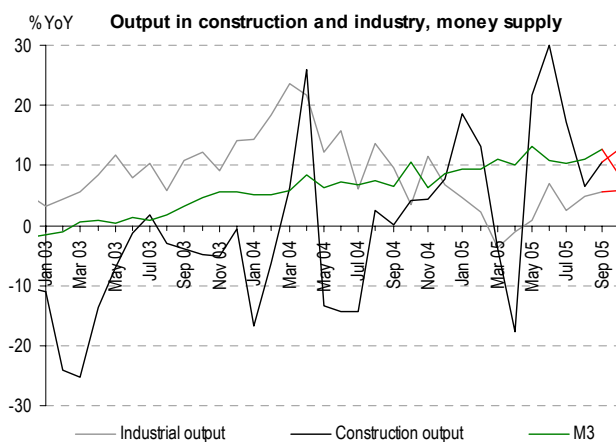
Cezary Chrapek (+48 22) 586 8342

e-mail: ekonomia@bzwbk.pl

What's hot this week – A week full of new economic figures



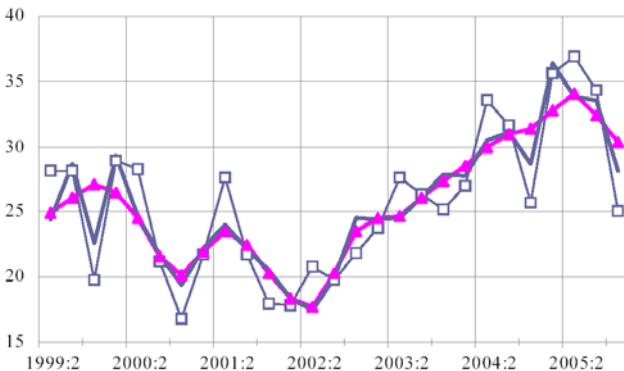
- Inflation rate temporarily down in October to 1.5% from 1.8%, amid a cut in excise tax for petrol. However, it would start picking up in December, going to ca. 2% in 1Q06.
- Although it is still difficult to find signs of demand-side pressure on prices, but poor fiscal perspectives and their possible impact on exchange rate market have been deteriorating inflation outlook.
- In turn, growth of salaries should accelerate in October after disappearance of high base effect in one sector. Still, a rate of pay rise would be only moderate (2.5%YoY).
- Employment growth unchanged at 2.2%YoY, which is a good result as for Polish situation.
- Wage bill in corporate sector rose 4.8%YoY in nominal terms and 3.2%YoY in real terms, suggesting that improvement in private consumption growth in 4Q05 would not be too rapid.



- One-off slowdown in growth of money, loans and deposits due to high base in October 2004. However, money is still on the upward path.
- Output growth in industry by 5.7% and in construction by over 10%YoY confirm acceleration in GDP growth in 4Q05.
- However, higher economic activity still fails to pass through into faster rise in producer prices. In October, PPI is predicted to fall 0.5%YoY, mostly thanks to less expensive fuels after a cut in excise tax. Subsequent months could bring a pickup in producer prices though, which will be additionally boosted by zloty depreciation.
- Still fast rise in exports and imports – both up ca. 12%YoY in September. Current account deficit quite high, although lower than last year. Relation of deficit to GDP has been descending.

Economy last week – Better business climate, but limited inflation risk

Investment activity indicator i.e. share of firms planning new investments within a quarter - trend (pink line), SA (solid line)



- According to NBP survey, at the end of Q3 enterprises showed more optimism as regards economic situation and some improvement is possible in Q4. Expectations for higher demand were mostly driven by seasonal factors and there was no strong permanent trend.
- Lower investment activity was observed, which was partly seasonal, but more significant downward trend was visible in new investments. The most important barrier for investments was connected with availability of EU funds.
- There was no risk of excessive wage growth.
- Banks expect that demand for consumer loans will increase in Q4. Banks probably also count on increase in corporate lending, as they plan to ease credit standards as well as loan terms and conditions for enterprises, particularly with regard to the large enterprise sector.

Quote of the week – How much money for government's promises?

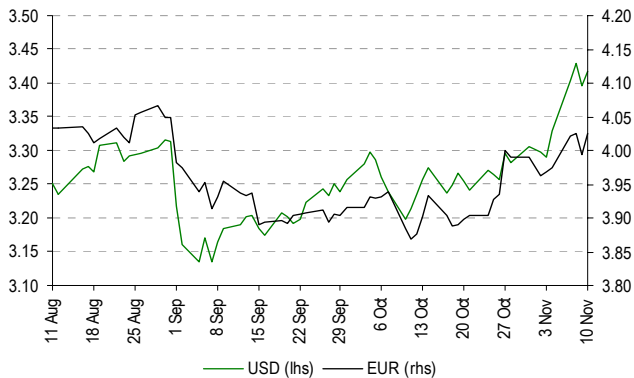
Kazimierz Marcinkiewicz, Prime Minister; PAP, 9 November

Social policy will cost a little. This means additional money that we will have to spend already in 2006. At the same time we maintain budget anchor by keeping budget deficit at PLN30bn for all four years of our tenure, starting with 2006. This deficit is not sufficient for healing public finances, but with proper negotiation with EU on OFE classification it seems Poland will meet all Maastricht criteria.

New government's fiscal plans (although still unknown in details) raise serious concerns. First of all, there is a risk that 2006 budget will close with PLN30bn deficit only because of too optimistic macro assumptions and buoyant planned revenues. Secondly, medium-term fiscal perspective is based on two assumptions – sharp growth acceleration and change in Eurostat's opinion as regards OFE (treating them as a part of public sector) – which may also turn out illusive.

Market monitor

Zloty exchange rate

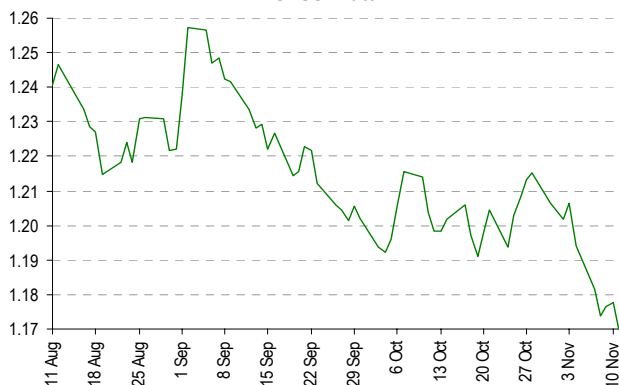


Further falls of the zloty

During the last week, the zloty dropped to the weakest level since late August in case of the euro (4.0445) and the weakest level since July in case of the dollar (3.4375), following controversial interview of finance minister with Financial Times (suggesting delay in euro adoption and a will to increase budget deficit) and expectations of some concessions for populists parties. The zloty gained on Thursday after PM's exposé and today the strengthening was continued to the level of 3.99 following successful confidence vote. However, during last week, the zloty lost 2.6% to the dollar and 1.3% to the euro.

As political decisions on economy remain uncertain we forecast the EURPLN rate to range between 3.97 and 4.07 and the USDPLN should fluctuate within 3.36-3.46 range.

EURUSD rate

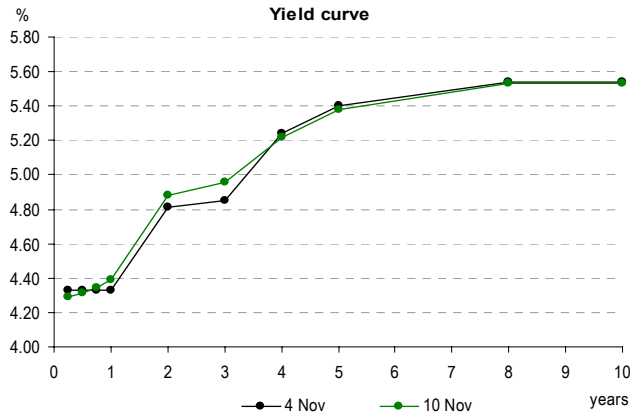


Dollar upside remains intact

At the end of the week, EURUSD rate reached 1.1677, the lowest level in two years. The dollar's strength resulted from expectations of further rate hikes in the US and better prospects of the US economy than the euro zone. The euro was also negatively affected by EU finance ministers' appeal to ECB to not hike rates. Riots in France also played some role. Even record wide trade deficit in the US did not weaken the greenback and only at the beginning of the new week the euro regained some ground, driving EURUSD back above 1.17.

This week the most important news for the FX market will be inflation data, output figures, ZEW index for Germany and data on net capital flows in the US.

Yield curve

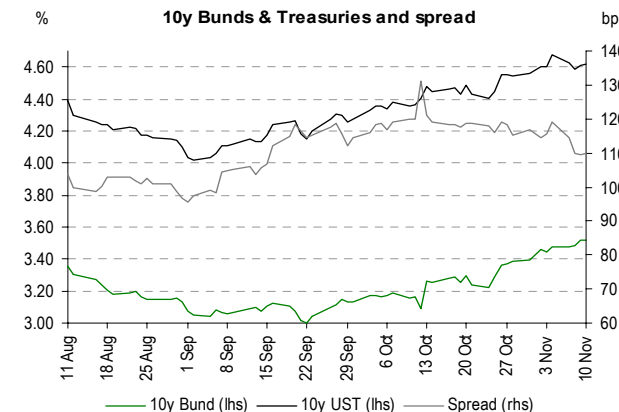


Fixed income market stable ahead of voting

Bond market ended last week at the level similar as compared to the previous week, however large volatility was observed in the last couple of days. Yields rose after the interview with the new finance minister, unclear statements of Prime Minister, in the perspective of costly proposals of new cabinet, as well as a result of increased overall political uncertainty. They have been falling were non negative information appeared and after a temporary strengthening on the core markets.

After the cabinet won the vote of confidence, market sentiment slightly improved, however one should remember that risk connected with fiscal policy remains high and yields abroad may rise again.

10y Bunds & Treasuries and spread



Bunds weaker, contrary to Treasuries

At the beginning of last week 10-year US Treasuries recorded a correction after recent falls. Then, temporary rise in yields to above 4.6% was connected with unsuccessful bond auction. Yields of Bunds were relatively stable at the beginning of last week at around 3.46%, but weakened to above 3.5% after hawkish comments of ECB's Axel Weber on higher inflation risk. Data on record-high US trade deficit and export fall were quite dovish and Treasuries' yields fell to around 4.5% at the beginning of this week.

This week a lot of important data will be published, with market focus on inflation, industrial production and central bankers' comments.

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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, <http://www.bzwbk.pl>



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