Bank Zachodni WBK

Weekly economic update

26 December 2005 – 1 January 2006

Although a week before Christmas was full of news significant for the financial market, e.g. publications of macroeconomic data and meeting of Monetary Policy Council, there were in fact no substantial surprises and our opinion about economic situation has not changed. On one hand, indices of economic activity recorded robust rates of growth – industrial output grew much above expectations, construction output and retail sales below forecasts but still not bad – confirming that the last quarter of this year will be a period of notable acceleration in economic growth rate (in our view, GDP growth in 4Q05 will be ca. 4.5%). On the other hand, indices of producer prices and core inflation confirmed one more time that as for now faster economic expansion does not translate to intensification of pressure on prices, and inflation is still well below central bank's inflation target. Taking into account multi-directional signals from the economy and awaiting for the new NBP inflation projections that will be ready by the end of January, the Monetary Policy Council decided to keep interest rates on hold for the fourth consecutive month. Official communiqué was more "dovish" than recently, and for the financial market the most important thing is that majority of Council members still see threats for inflation as rather limited, which was reflected in maintaining easing bias in monetary policy. MPC decision in January will depend on the new *Inflation Report*, which will be published unfortunately only after the MPC meeting. As for now, we maintain a scenario of interest rates remaining unchanged until the end of 2006.

The last week of the year will be as usually a period of muted activity and low liquidity on international financial markets. Investors in Poland will receive only one macroeconomic data release – balance of payments data for Q3 2005. The figures will be published on Friday afternoon, and thus their impact on financial market behaviour should be very little. Especially that monthly data on balance of payments published before were an important hint on what could be expected from quarterly figures. Of course as usually, one cannot rule out that quarterly data will introduce significant corrections to previous balance of payments results, however the changes should not be revolutionary. On foreign markets, market attention will be turned on indices of consumer confidence, as well as Chicago PMI activity index in the US.

❄ **Merry Christmas on behalf of Economic Analysis Unit BZ WBK** ❄

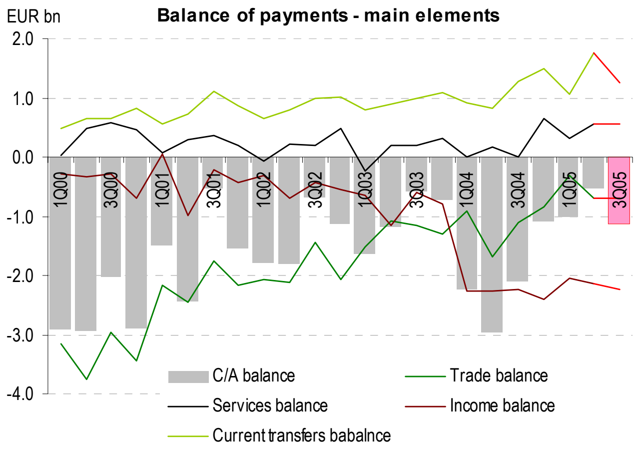
Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (26 December)					
	INT	Christmas Day					
		TUESDAY (27 December)					
	UK	Holiday					
15:00	US	Consumer Confidence (H)	Dec	pts	101.8	-	98.9
		THURDAY (29 December)					
9:00	EMU	Money supply (H)	Nov	%	8.0	-	8.0
15:00	US	Chicago PMI (H)	Dec	pts	60.1	-	61.7
15:00	US	Home sales (H)	Nov	m	7.0	-	7.09
		FRIDAY (30 December)					
15:00	**POL**	**Current account (M)**	**Q3**	**€bn**	-	-1130	-528

* 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 – Merry Christmas

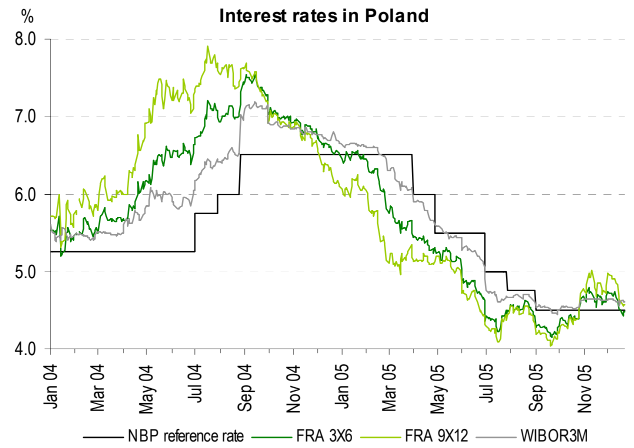


▪ Before the end of 2005 we will get to know only one more data release in Poland – balance of payments statistics for Q3 2005.

▪ Monthly BoP data published before suggested that Q3 was a period of highly positive trends in Polish foreign trade. Export growth accelerated to almost 14%YoY, import rose almost 10%YoY, C/A deficit was higher than in Q2 but in relation to GDP it fell to 1.6% from 2.1% after a year-half. One should bear in mind however, that publication of quarterly data could show a revision of previous figures (thanks to more precise and complete data set).

▪ There will be also a small number of data releases abroad, and they should have limited impact on markets amid small activity and liquidity just before year-end. The most important will be data on consumer confidence and Chicago PMI activity index in the US.

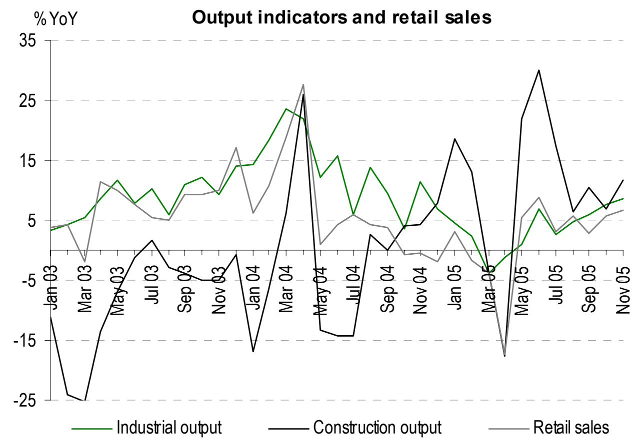
Economy last week – Activity higher, inflation lower, interest rates unchanged



▪ For the fourth consecutive month the MPC kept interest rates unchanged. Policy bias remained at easing stance, so according to the MPC there are bigger chances for rate cuts than for rate hikes in future. Since 2006, the term "bias" will be no longer used by the MPC.

▪ There was an important change in MPC statement – while for the past three months the Council has been warning that inflation could return to the target faster than predicted in August *Inflation Report*, in December they agreed that the return could be slower than previously assumed. It suggests that for most of the MPC members a view on inflation outlook has improved.

▪ In January, the MPC could consider a rate cut, especially if inflation stays around 1% and pay rise decelerates in December; however, the decision will depend very much on conclusions from new *Inflation Report*.



▪ Industrial production in November rose 8.5%YoY, and after taking out seasonal effects it increased 7.4%YoY. Growth in construction was 5.9%YoY and after seasonal adjustment 8.6%. Retail sales increased 7.3%YoY in nominal terms and 6.4%YoY in real terms. The data confirmed ongoing economic recovery at the end of the year; GDP growth in 4Q05 could reach ca. 4.5%.

▪ Situation on labour market is also improving, which is reflected by decreasing unemployment and growing number of people in the job.

▪ However, notwithstanding fast expansion of the economy, no signs of building inflationary pressure could be seen. PPI declined 0.4%YoY in November and all core inflation measures dropped significantly. Net inflation reached 1.1%, 15% trimmed mean 1.0% and remaining measures were between –0.1% and 0.7%YoY.

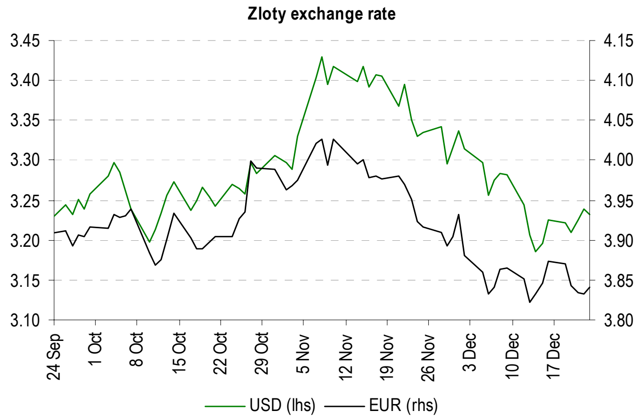
Quote of the week – The Ministry of Finance supports the zloty

Cezary Mech, deputy finance minister; Reuters, 23 December

Funds from the next eurobond issue will be used for current budget financing. One cannot rule out that part of those funds will be exchanged on the market. We hope that reduction of deficit, presentation of long-term, conservative fiscal plan in the convergence programme and obtaining sizeable UE transfers in the next fiscal perspective will result in significant foreign investors' interest in our placements.

It seems that FinMin decided to make a Christmas gift for all those who borrow in foreign currencies and buy imported goods for presents (but surely not for exporters), by contributing significantly to sizeable zloty appreciation via operations on FX market and also comments of ministry officials. If currencies exchange will be continued as suggested by Cezary Mech, one should expect that pressure on zloty appreciation will last also in Q1 2006.

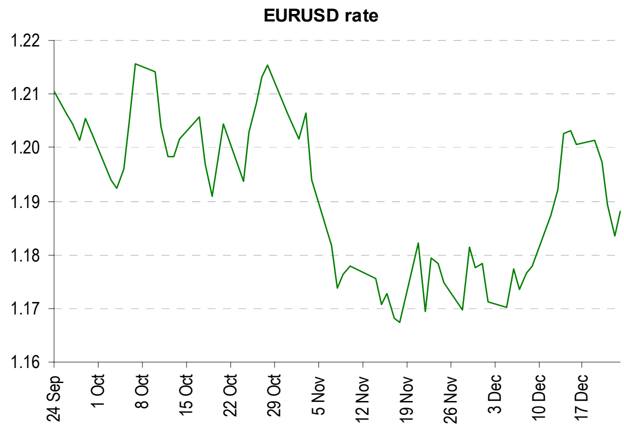
Market monitor



Zloty got stronger before Christmas Day

▪ In the past week there was a pre-holiday atmosphere on the market which effected in low activity of the investors. Zloty strengthened versus the euro as well as versus the greenback. This went along with gains of currencies in the region as well as good moods and new records on the Warsaw Stock Exchange. Polish currency appreciated by 0.84% against the single currency and depreciated by 0.2% versus the dollar.

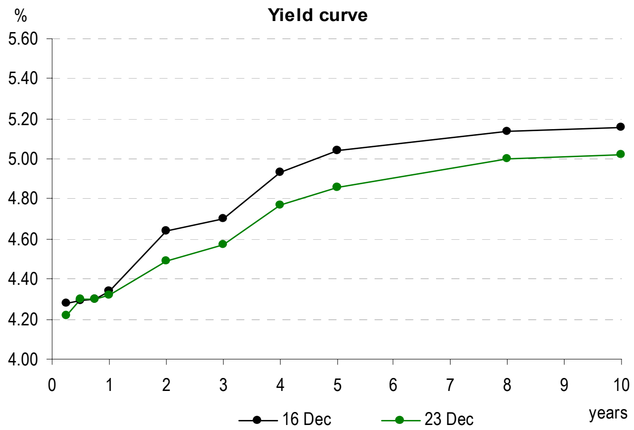
▪ The next week should feature even lower activity amid calm period between Christmas Day and New Year's Day, as well as few publications of essential domestic data (only Q3 2005 balance of payments). We forecast EURPLN rate will stay in range 3.80-3.90, while USDPLN rate between 3.17-3.27.



...like the dollar

▪ After a period of lingering around 1.20 the, EURUSD fell 1.3% to 1.185. The strengthening of the dollar took place after a publication of better-than-expected data from the US housing market (higher number of build's permits and house starts) and upwardly revised PCE index for 3Q05. Stronger than predicted fall in PPI index for November and downwardly revised GDP data for 3Q05 proved less important, while a slight correction was caused by lower than predicted PCE inflation for November.

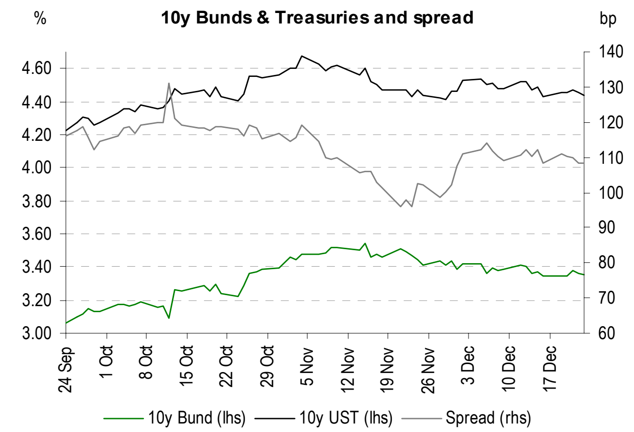
▪ Next week will see publication of a few important indicators such as Chicago PMI, home sales and consumer confidence in the US and money supply in the EMU. However, as a result of low activity in financial markets towards the end of the year, one should not expect significant moves of the EURUSD.



Yields drop while MPC statement slightly dovish

▪ Polish debt strengthened last week before Christmas and bond market featured low activity, the same as FX market. Higher than expected industrial production did not significantly affect the curve. MPC did not change the parameters of monetary policy, though its statement was more dovish than before. This with lower than forecasted retail sales and drop of net inflation which was in line with market consensus resulted in yields drop.

▪ The next week on the fixed income market should be calm. Low activity and lack of major events and data should be conducive to stabilization of the yield curve. One cannot exclude temporary correction, though we believe investors may speculate on rate cut in January.



Yields abroad unchanged

▪ Yields of 10Y Treasuries and Bunds ended the week at the same level as a week ago - 4.43% and 3.33%, respectively. A weakening, which took place after positive data from housing market and after revised data on Q3 PCE, was offset by lower than forecasted PCE figure for November. As regards bunds, an additional temporary rise in yields took place after hawkish comment from an anonymous source connected with the ECB.

▪ The end of the year should see some stabilization of the yield curves, although if the data from US housing market are stronger than previously the fixed income market may be affected negatively.

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