Bank Zachodni WBK

Weekly economic update

16 – 22 January 2006

First of this month's data releases, i.e. monetary statistics for December and balance of payments statistics for November did not have any impact on the market. It is not surprising given the data did not bring much new to he picture of economic situation (maybe except for strong acceleration in imports' growth) while market participants were looked up to events on the political scene. Everything because of a storm in the Sejm related to budget debate. Finally, politicians reached a compromise on a schedule of work over budget, but the question how to stabilise the political situation remained in place. PiS leader Jarosław Kaczyński stated that the situation cannot be continued and either "solid coalition" will be established or "premature election" should take place. After w few days of consultations between different political forces, all scenarios (PiS coalition with populists, PiS coalition with PO, early elections) are still possible. However, the best scenario from market's point of view, i.e. PiS coalition with PO seems to be relatively the least probably option. Strong position of PiS in public opinion polls (one of the latest polls showed the party could count on majority of seats in the Sejm, if election was held in January) may increase willingness of PiS towards early elections.

Apart from budget debate, also a presentation of the new Convergence Programme has been delayed. The official reason for that was a change on the post of finance minister (nomination of Zyta Gilowska in place of Teresa Lubińska). Her nomination caused strengthening on the Polish financial market at the end of last week, but later developments on the political scene swiftly chilled moods on the market. This week the program should be finally published. There will be also publication of a few major macroeconomic indicators (CPI, PPI, wage, output). They may help to properly asses probability whether the MPC will actually cut rates in January as the market expects.

Economic calendar

TIME GMT	REGION	INDICATOR (importance level*)	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (16 January)					
10:00	**POL**	**Auction of T-bills PLN100m 13-week and PLN 1.0bn of 52-week (M)**					
15:00	**POL**	**CPI (H)**	**Dec**	**%YoY**	**0.8**	**0.9**	**1.0**
15:00	**POL**	**Wages (H)**	**Dec**	**%YoY**	**3.8**	**4.5**	**6.9**
15:00	**POL**	**Employment (M)**	**Dec**	**%YoY**	**2.5**	**2.5**	**2.4**
		TUESDAY (17 January)					
14:15	USA	Capacity use (M)	Dec	%	80.5	-	80.2
14:15	USA	Industrial output (H)	Dec	%MoM	0.5	-	0.7
		WEDNESDAY (18 January)					
10:00	**POL**	**Auction of PLN3.0bn of 5Y bonds DS1110 (H)**					
10:00	EMU	Industrial output (H)	Nov	%YoY	1.9	-	0.1
13:30	USA	CPI (H)	Dec	%MoM	0.2	-	-0.6
14:00	USA	Net capital flows (H)	Nov	USD bn	87.5	-	106.8
		THURSDAY (19 January)					
15:00	**POL**	**PPI (H)**	**Dec**	**%YoY**	**0.8**	**0.9**	**1.0**
15:00	**POL**	**Industrial output (H)**	**Dec**	**%YoY**	**7.9**	**8.4**	**8.5**
10:00	EMU	Final HICP (H)	Dec	%YoY	2.2	-	2.3
		FRIDAY (20 January)					
14:45	USA	Preliminary Michigan index (H)	Jan	pts	92.5	-	91.5

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

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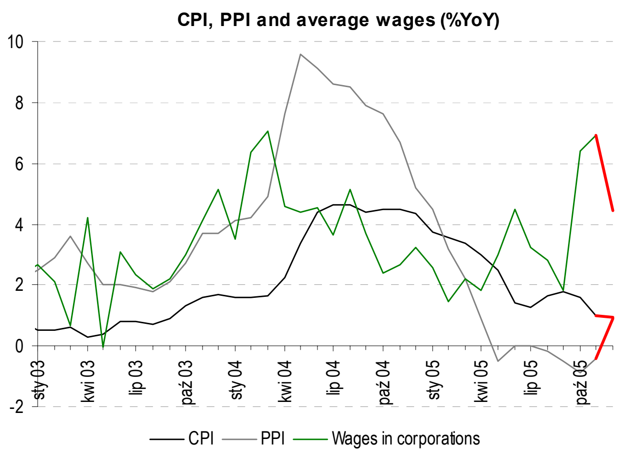
What's hot this week – Important data against the background of political chaos

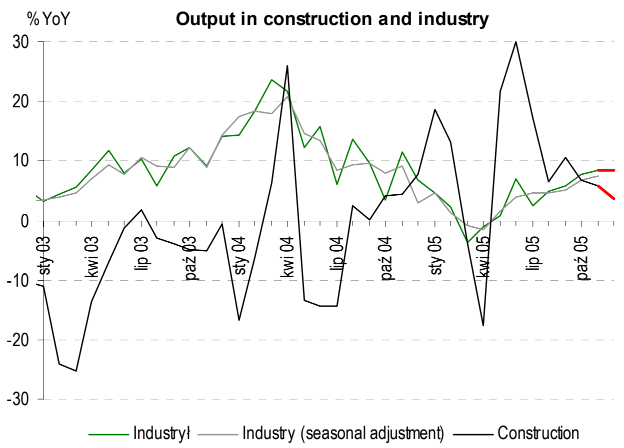


▪ The nearest week will bring many important news, both data releases and other events.

▪ The key focus of attention will be Monday's data on inflation and average wages growth in December. If inflation actually fell again in the last month of 2005, this would support expectations for another rate cut. If the figure is lower than consensus, the expectations may be fuelled even further than so far.

▪ As regards wage growth, if it does not decelerate significantly, at least to the market consensus, effect of current low inflation may be offset to some extent and expectations for another rate cut may be somewhat chilled.

▪ If growth rate of employment will be maintained or accelerates as compared to previous months, this will bode well for prospects of consumption demand, even if wage growth proves slightly lower than expected.

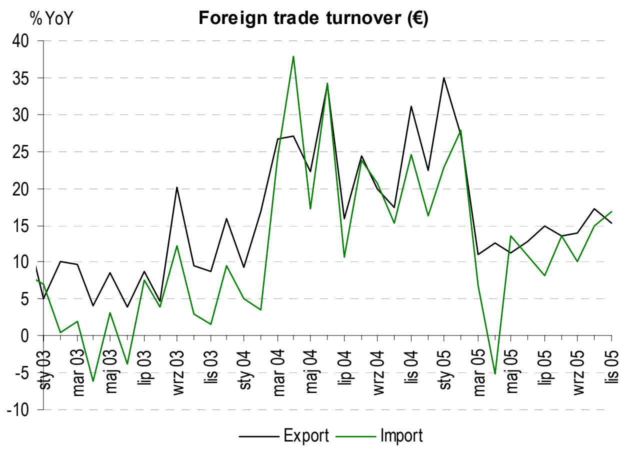


▪ Another portion of data will appear on Thursday. If output and PPI figures are not substantially higher than market consensus, they should strengthened market players in expectations for another cut in borrowing costs.

▪ This week we should finally see the new Convergence Programme. New finance minister Zyta Gilowska said the government had not counted anymore on a change in EU institutions' stance on classification of Poland's open pension funds. Let us recall, that without such a change, the path of fiscal deficit reduction envisaged in the new Convergence Programme is unlikely to secure meeting of Maastricht criterion of 3% fiscal gap in relation to GDP.

▪ Chaos on the political scene continues. Likelihood of different scenarios changes from day to day, but chances for the best scenario (from market's perspective) seems relatively the lowest.

Economy last week – Export still strong, import even stronger



▪ Balance of payments data for November confirmed that despite strong zloty appreciation exporters still perform very well. Exports growth rata decelerated, but weaker than we expected. On the other hand, imports grew stronger than we predicted, which may signal strengthening of domestic demand in late 2005.

▪ For some time ahead, imports growth rate should not exceed exports, so we predict net exports' contribution to GDP growth will remain positive until mid-2006.

▪ A healthy rise in money supply, with improvement in total deposits and total loans, suggests expansion of the economy. However, this should not bother the MPC, as up-to-date and expected scale of revival in money (especially in case of corporate borrowing) does not seem to be dangerous for future inflation .

Quote of the week – Politics and chances for another rate cut

Jan Czekaj, MPC member; PAP, 12 Jan

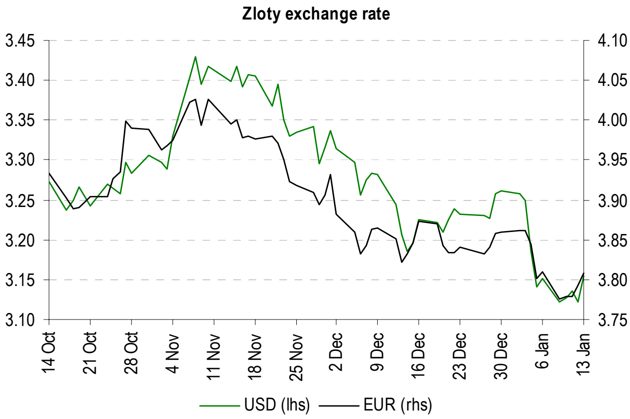
So far, one could not seen any reasons for zloty weakening. (…) One cannot see now any demand-side pressure on prices. (…) Therefore, monetary policy should be adjusted to the actual situation.

Halina Wasilewska-Trenkner, MPC member; Reuters, 12 Jan

The current political confusion is destabilising, it makes markets volatile. (…) The current political situation will be an important aspect for the council this month.

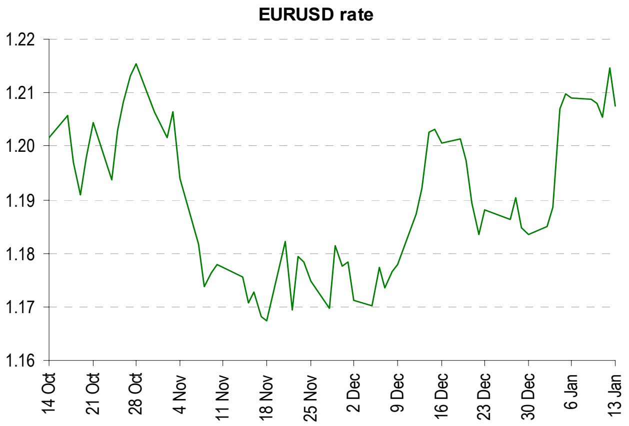
MPC members are as always divided in their opinions. Probably a set of important data expected this week and possible comments from other rate-setters will help to guess what an outcome of the next MPC meeting will be. Currently, we see predict the Council may actually cut rates, but only if majority of MPC will think political instability will not trigger strong correction of the zloty rate.

Market monitor



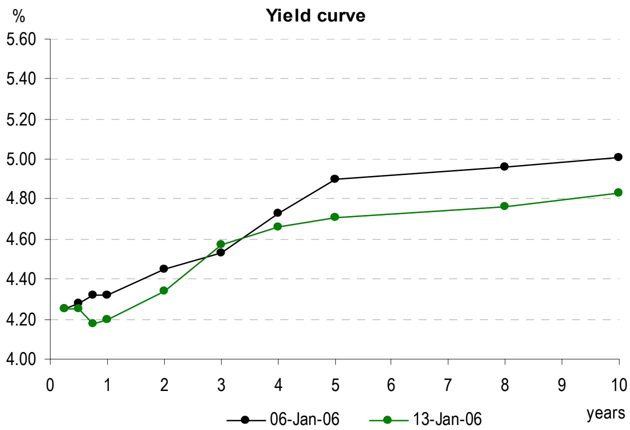
Zloty stronger and stronger

- Last week zloty strengthened to the highest level for 3.5 year (3,757), after Zyta Gilowska was nominated for the post of finance minister and deputy PM, which went along with new records on WSE. In the second part of the week a political crisis occurred in Sejm with regards to budget debate, which effected in a correction back to levels seen at the end of the previous week. Zloty did not change against the euro and lost ca. 0.1% vs. the dollar.
- Weaker macroeconomic data supporting the rate cut (mainly CPI) as well as unstable political situation , which may result in coalition with populists or early election may act against the zloty. EURPLN rate should fluctuate in range 3.79-3.89, with resistance at 3.83-3.84, while USDPLN between 3.10-3.20.



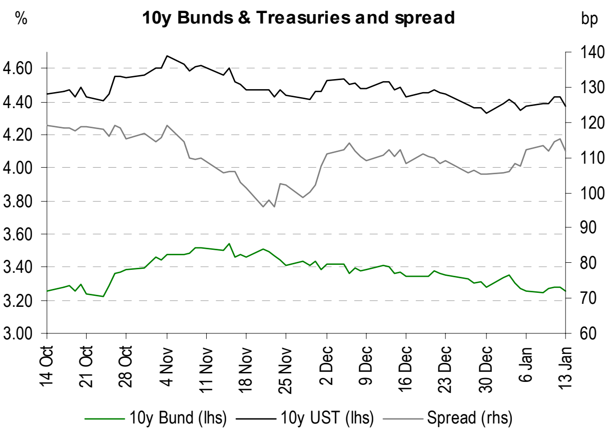
Dollar still weaker

- In the past week the dollar strengthened slightly against the single currency. A correction followed the higher than expected ZEW index and awaiting higher trade deficit. As the deficit appeared lower than the consensus and ECB's chairman Trichet's statement was not hawkish enough dollar strengthened again. Another greenback depreciation followed after softer PPI and retail sales figures in U.S.
- The market will focus on several important data from U.S., such as low CPI, preliminary Michigan index, housing market figures as well as expected net capital flow drop. In the EMU the most important will be industrial output as well as HICP inflation. Till then euro will be supported by Friday's Trichet's comment, which was more hawkish than the one after Thursday's conference.



Debt still supported by rate cut expectations

- Yield curve lowered on promises and willingness of new finance minister to look after public spending and lower tax burdens as well as on positive results of T-bill and bonds tenders, with high interest and demand of foreign investors speculating on rate cut. Fixed income market weakened after MPC's H. Wasilewska-Trenkner statement on negative influence of political turmoil on running monetary policy and possibility of populists entering the government coalition.
- We predict inflation in December was low and wage growth decelerated. If our predictions materialize, market expectations for rate cut in January should be cemented. Output figures will also be very important. Chaos on the political scene may influence the debt market negatively.



No change in yields

- Yields of both 10-year Treasuries and Bunds did not change over the last week and remained at 4.37% and 3.25%, respectively. However, during the week they rose to 4.45% and 3.29%, respectively, in a reaction to higher than expected trade deficit in the US and large supply of bonds at auctions. Subsequent drop in yields was related to low PPI and retail sales in the US.
- This week the key factor for US Treasuries will be major data releases, especially CPI, industrial output, preliminary Michigan index and figures from housing market. In face of accelerating output growth from one side and falling inflation from the other side, yields in the euro zone may be driven by development in the US market.

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