

# Weekly economic update

1 – 7 May 2006

The first week of May will be short on the Polish market and without important economic events and thus should remain under influence of international markets (possible further yields' rise and stronger euro).

It seems that current level of interest rates is seen by the Monetary Policy Council as neutral and appropriate for present and expected economic situation, which confirms our view that policy parameters are likely to remain unchanged for a prolonged time unless new economic data bring more significant surprises. The new *Inflation Report* shows higher GDP growth projection (especially in 2007-08), while CPI path expected for this year is lower than before, although it goes higher than previously forecasted in 2008. According to the authors of projection, inflation may be higher than presented in the projection, but such a view does not seem to be shared by majority of the MPC.

Last week the coalition agreement has been signed between PiS, Samoobrona, and a group of rebel deputies from LPR. The alliance of 218 deputies does not give majority in 460-seats Sejm, but PiS politicians declared they will keep seeking support of other deputies or factions, that would guarantee a stable majority. A cabinet reshuffle including nomination of new ministers will take place most likely on May 5 and the leader of Samoobrona Andrzej Lepper will be most likely deputy Prime Minister and Minister of Agriculture.

## Economic calendar

TIME GMT	REGION	INDICATOR (importance level*)	PERIOD	FORECAST		LAST VALUE
				MARKET	BZWBK	
<b>MONDAY (1 May)</b>						
	<b>POL</b>	<b>Public holiday</b>				
	<b>INT</b>	<b>Market holiday</b>				
12:30	US	PCE (M)	Mar	%	0.2	- 0.1
14:00	US	Manufacturing ISM (H)	Apr	pts	55.0	- 55.2
<b>TUESDAY (2 May)</b>						
7:00	EMU	Manufacturing PMI (H)	Apr			
<b>WEDNESDAY (3 May)</b>						
	<b>POL</b>	<b>Public holiday</b>	<b>Mar</b>			
9:00	EMU	PPI (M)	Mar	%YoY	5.1	- 5.4
14:00	US	Factory orders (H)	Apr	%	1.3	- 0.2
14:00	US	Non-manufacturing ISM (H)	Apr	pts	59.5	- 60.5
<b>THURSDAY (4 May)</b>						
<b>9:00</b>	<b>POL</b>	<b>Auction of PLN1.8bn 2Y OK0408 bonds (H)</b>				
7:00	EMU	Non-manufacturing PMI (H)	Apr	pts	58.5	- 58.2
9:00	EMU	Retail sales (M)	Mar	%YoY	0.1	- -0.2
11:00	GB	BoE meeting – decision (M)	Apr	%		- 4.5
11:45	EMU	ECB meeting – decision (H)	Apr	%	2.5	- 2.5
12:30	US	Average unit labour costs (H)	Q1	%	1.0	- 3.3
12:30	US	Labour productivity (H)	Q1	%	3.0	- -0.5
<b>FRIDAY (5 May)</b>						
12:30	US	Non-farm payrolls (H)	Apr	'000	200.0	- 211.0
12:30	US	Unemployment (H)	Apr	%	4.7	- 4.7

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

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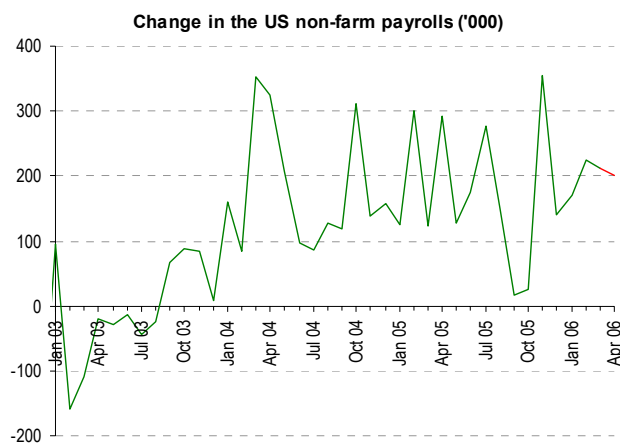
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## What's hot this week – Data releases only abroad



- In the nearest days the Polish financial market will be dominated by the long weekend (public holiday on May 1 and Constitution Day on May 3) and there will be only one important event – auction of new two-year benchmark.
- The President will nominate new ministers in the government, but this should not influence the market, although of course there is a risk as regards economic policy of new parliamentary coalition.
- On the international markets, the key events will be the meeting of the European Central Bank and data from the U.S. labour market. As rate hike in the euro zone is expected only in June, the statement of the ECB will be important and it may influence positively the common currency. On the other hand, Friday's data on non-farm payroll may be supportive for the dollar.

## Economy last week – Rates at appropriate level

### Important elements of Monetary Policy Council's statements (26 April)

The Council maintains its assessment that with large probability inflation will in 2006 Q2 and maybe Q3 remain below the inflation target mainly due to short-term factors. If the developments in the economy were consistent with the April NBP inflation projection, then the current level of the reference rate of the central bank would support a gradual return of inflation to the target over the projection horizon and would also be conducive to keeping economic growth at a pace, which is consistent with the potential output growth, determined by the structural features of the Polish economy.

The fact that inflation and core inflation has stayed below the previous forecasts for a relatively long period may be an indication that the impact of the factors which may slow down the returning of inflation to the target in relation to that accounted for in the projection is stronger than previously assumed. Factors which could potentially accelerate the return of inflation back to the target include a higher wage growth than assumed in the projection, provided it would not be accompanied by sufficiently fast increase of productivity, further oil price hikes or a deterioration of the public finance situation in relation to that envisaged in the Convergence Programme.

- As expected, the Monetary Policy Council kept official interest rates unchanged maintaining the main reference rate at 4.0%.
- In the statement justifying the decision, the Council listed a number of factors and information that had appeared since the previous meeting, showing that while current inflation remains very low and inflationary pressure is very little, a notable acceleration in economic growth has been recorded, as well as strong revival on the labour market, and upward tendencies in oil prices.
- In our opinion, the MPC communiqué suggested that inflation path showed by the inflation projection seems to be the most likely scenario right now. Therefore, we do not change our view that interest rates will remain stable for some time unless some significant surprises appear (e.g. deflation in mid-year).

### Inflation projections NBP (% YoY)

	May 2005	August 2005	January 2006	April 2006
Q4 2006	1.2-3.8	1.0-3.1	0.5-2.3	0.5-2.0
Q4 2007	0.7-4.3	1.2-4.1	1.1-3.6	1.3-3.4
Q4 2008	-	-	0.8-3.9	1.2-3.9

### GDP growth projections (%)

	August 2005	January 2006	April 2006
2006	3.9-5.3	3.8-5.1	3.9-5.0
2007	3.8-5.6	3.4-5.2	3.4-5.8
2008	-	3.6-5.5	3.5-6.2

Source: NBP, Inflation Report - April 2006

Note: Projection shows that there is a 50-percent probability that inflation and GDP growth will stay within the ranges indicated in the table.

- As it is widely known, important argument in discussion about interest rate decision in April was the new *Inflation Report*, including updated projections of GDP and inflation.
- New projections show stronger economic growth rate within forecast horizon, especially in 2007-08, in relation to January's prediction. As regards inflation, situation is more complicated, as CPI path expected for this year is lower than before, while it goes higher than previously forecasted only in 2008.
- Although according to the authors of projection, inflation may be even higher than projection amid several risk factors, it seems that financial markets should not take such opinion into account to a large extent as long as this is not shared by the majority of the Monetary Policy Council.

## Quote of the week – Is really rate hike more likely than a cut?

### Halina Wasilewska-Trankner, MPC member

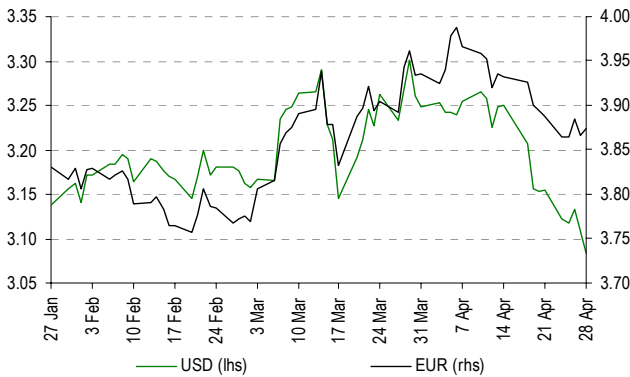
PAP, 28 April

*We have such level of interest rates that we should be very careful not to undermine good situation in the economy by a rash decision as regards both a rate cut and a rate hike. Rate cut by 25 bp would be a risky step in current situation. From international markets point of view (high prices of commodities, high growth) we should take into account rather hike than cut in rates in following years.*

Comments made by Halina Wasilewska-Trankner confirmed our view that interest rates should remain stable (at least) until year-end. In our view, however, the alternative scenario should assume a possibility of rate cut during this year if it turns out that inflation is lower than predicted and economic growth decelerates. Of course, one should notice that a perspective of a rate hike presented by the MPC member is a question of quite distant future and today such a decision would be equally "rash" as a rate cut, in her opinion.

Market monitor

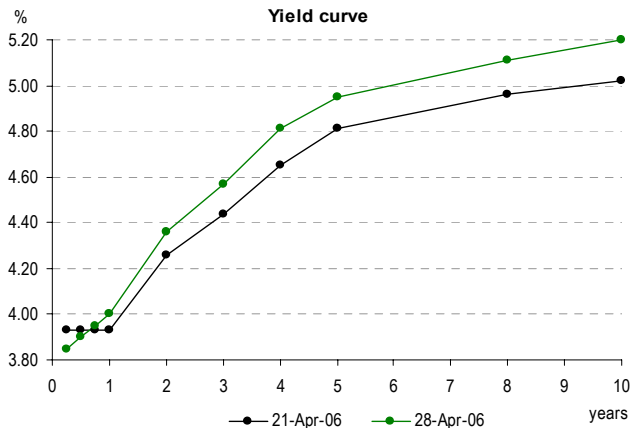
Zloty exchange rate



Quite strong zloty in a tight range

- During the whole previous week the zloty rate fluctuated in a narrow range against the main currencies. High Q1 GDP estimates worked in favour of Polish currency, while downgrading of Poland's credit rating by the S&P and bonds sell-off had a negative effect. The rise of USDPLN rate resulted from substantial weakening of the dollar against the single currency. Since the previous Friday zloty gained 0.1% against the euro and 1.7% vs. the greenback.
- The nearest week should be quite calm for the FX market with regards to holiday season, which may contribute to low liquidity on the market. In our opinion EURPLN rate will fluctuate in range 3.85-3.95, while the USDPLN rate is going to be traded between 3.05-3.15.

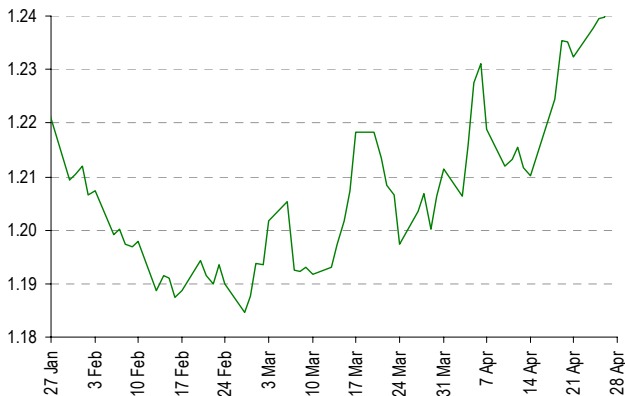
Yield curve



Higher yields abroad weakened Polish debt

- Lack of rate cut and MPC's communiqué were neutral for the market. However, last week yields increased in reaction to weakening on the core bonds markets as well as strong rise of retail sales and deterioration of Poland's credit rating outlook by the S&P. Ben Bernake's statements before JEC gave some support to core markets and Polish bonds as well. During a week yields rose by 10-18 bp, while the 5Y yield approached 5% level.
- In reference with the long weekend at the beginning of May, the investors' activity may be limited, due to lack of any data release yields of Polish bonds may be under influence of core debt markets, which may still weaken. The establishing of government coalition will have rather neutral effect on the market.

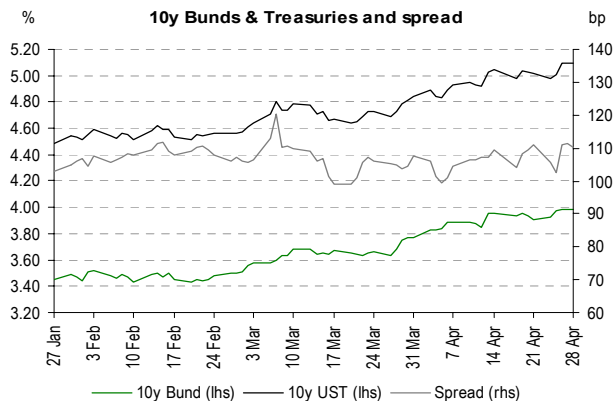
EURUSD rate



The highest EURPLN in 7 months

- Ifo index reached the highest level for 15 years again, which effected in substantial strengthening of the single currency. The dollar lost also after the news that some central banks increase the share of the euro in their reserves. Good economic data gave some support to the greenback, but less hawkish than expected comments of Fed's president resulted in further weakening of the U.S. currency, which lost 1.7% vs the euro in the last week .
- Next week ample essential figures are going to be published. The most important will be activity indices and ECB's communiqué, which may positively affect the single currency. On the other hand, good labour market data may support the dollar.

10y Bunds & Treasuries and spread



Core bond yield higher and higher

- Greater than expected Ifo index resulted in a deep Bunds' weakening, and U.S. Treasuries also followed. Yields of the latter soared further (to 5.13%) after the publication of consumer confidence index, home sales data and durable orders. Ben Bernanke's statement supported U.S. debt and in the result 10Y Treasuries yields increased from 5.01% to 5.10%, while yields of 10Y Bunds rose from 3.90% to 3.99%.
- After labour market data and especially non-farm payrolls bond yields in United States may rise again, whereas the communiqué of the ECB will be crucial for the euro zone. Activity indices may weaken bonds on the core bonds markets as well.

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