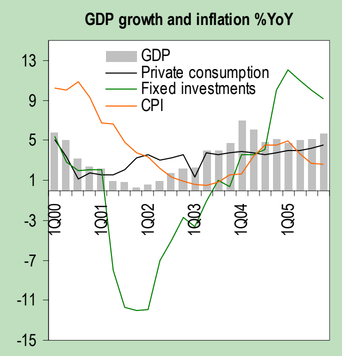
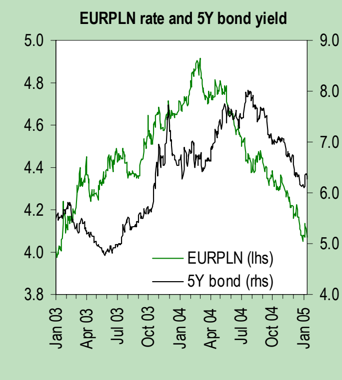
Bank Zachodni WBK

MACROscope

Polish Economy and Financial Markets

January 2005





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Welcome to 2005

- **In the first issue of MACROscope last year, we described 2004 as *Year of ups in economy*. It turned out that it was a year of growth beyond the initial expectations observed across the majority of economic indicators, among others GDP, inflation and interest rates. What then will the next year bring?** We present the expected economic scenario for 2005 in the Special focus called *Economy storming ahead! What about politics?* Financial market trends and statistics published at the end of 2004 led us to adjust macroeconomic forecasts for 2005. We now expect GDP growth of 5.2% this year, which is still one of the most optimistic ones on the market. We expect acceleration in fixed investments growth and stabilisation in private consumption increase. At the beginning of the year growth in disposable income in real terms will be strongly exposed to negative effects of high inflation, while the second year half should bring a slight acceleration. Also, the beginning of 2005 will be marked with growing inflation, which will be influenced by some one-off factors (higher administrative prices and indirect taxes increases). During the year the inflation will probably fall as a result of statistical base effect. We expect year-end inflation at 2.6%, while the average annual inflation should amount to 3.5%.

- **We still believe that it is still to early to cut interest rates, however the MPC may decide to switch its policy to neutral (possibly as early as in February).** However, taking a neutral stance in the monetary policy would not mean in our opinion, but against expectations of some of the financial market players, preparation towards a speedy interest rate cut and would allow for interest rate movements either way depending on how the situation unfolds. It is worth to remember that inflation will probably have to be below the current NBP target to be in line with the Maastricht inflation requirement. If we consider the government's plans (quite optimistic, but also feasible) to reduce the budget deficit below 3% in 2007 and delays in monetary policy transmission mechanisms (up to 6-8 quarters), we might conclude that there is not much room slicing the current interest rate at 6.5% even with inflation reaching 2.5% towards the year end.

- **We expect higher yields and some zloty depreciation as the time of parliamentary elections is approaching**. Sentiment worsening will be probably used by foreign investors to resume the so-called convergence play. Therefore, we expect that the average zloty exchange rate towards euro in the last quarter of the year will reach ca. 4.1 (it would be lower if the elections were held in spring), and there is a chance to cross the barrier of 4 zloty for 1 euro at the year close. As regards the US dollar, the psychological barrier of below 3 zloty will probably be approached again, and possibly as soon as in the second quarter when the US currency may hit another record low on the international markets (1.4 against euro).

Financial market on 31 December 2004:

NBP deposit rate	5.00	WIBOR 3M	6.64	PLN/USD	2.9904
NBP reference rate	6.50	Yield on 52-week T-bills	6.34	PLN/EUR	4.0790
NBP lombard rate	8.00	Yield on 5-year T-bonds	6.16	EUR/USD	1.3640

This report is based on information available until 10.01.2005

Special focus

Economy storming ahead! What about politics?

2004 – the year of wishes that came true

In the first issue of MACROscope last year, our editorial Special focus described 2004 as *The year of growth in economy.* It turned out that it was a year of growth beyond the initial expectations observed across the majority of economic indicators, among others GDP, inflation and interest rates.

As for the GDP growth rate, even the most optimistic economic pundits did not assume that the first year of Poland's membership in the European Union would prove so much beneficial to our economy. The economic growth gathered substantial speed up to 5.7% p.a. – according to our estimates against the previous year's expectations of having GDP at 4.5%. It is worth mentioning that we were one of the most optimistic market players (the average expected rate of growth was at 4.3%). A visibly greater consumer spending shortly before the accession when the total of capital expenditure was disappointing fuelled this faster growth. One of the underlying reasons for a greater consumers' appetite was their fear of price hikes shortly after Poland's merger with the EU economy. The fears appeared justified (as a matter of fact those were self-fulfilling forecasts) and the inflation hike reported in the second quarter took all the market players by surprise including the central bank. However, it was not really the very effect of growing prices that surprised them, but rather the pace powered by a very big demand for Polish food products in the wealthiest EU countries. This did not leave the central bank's interest rate policy untouched and in consequence the interest rates grew by 125 basis points between June and August. Let's just recollect that merely a year ago the monetary policy was a big question mark mainly due to the fact that new members of the Monetary Policy Council, whose stance was expected to be overly 'dovish', were being appointed. Let's hope that their anti-inflation attitude will remain a distinguishing mark of the new Monetary Policy Council throughout the whole term of office.

The average global economic growth appeared slightly below expectations (US economy grew by 4.4% against our forecast of 4.8% while the EU economy grew by 1.8% against the expected growth of 2%), which was affected, inter alia, by high commodity prices. As initially projected, interest rates began to grow, however (despite high inflation) the euro zone remained intact. But even the policy of pushing interest rates higher as pursued by the US Federal Reserve did not manage to prevent the dollar from further depreciation.

Despite a fast pace of economic growth, the last year also posed a number of questions relating both to domestic and global political developments. We can say that nothing has changed in the United States in spite of the presidential elections, the American economy is still facing a necessity to sort out twin deficits; i.e. budget and trade and there are not many signs of a quick change in this respect. In Poland, for a change, although parliamentary and presidential elections will take place in several months' time, the influence of politics on financial markets (we are not talking about economy here as our GDP growth can hardly be attributed to the government's actions) could already be felt last year. Surprisingly enough, the cabinet reshuffle shortly after Poland's accession to EU had a positive outcome. The new finance minister managed to convince the financial markets to a positive assessment of the 2005 budget assumptions (though to a large extent the assumptions are simply based on a fast economic growth) and the new Treasury Minister has given much stronger impetus to privatisation. This has translated into PLN appreciation and lower yield on treasury securities. Foreign investors must have also appreciated a tumbling support for the populist Self-Defence Party (down to ca. 10% at the close of 2004 from the initial 30% in March), which reduced risk premium for investment in Poland. Although, we were not among the economists who forecasted that zloty would tumble above the level of 5 zloty for 1 euro when at the beginning of 2004 it continued to weaken (our forecasts for the close of 2004 were 0,1 PLN below the average market expectation), but we admit that appreciation of that magnitude came to us as a big surprise. First of all, the zloty did not depreciate in September, which was related to the above mentioned very effective information policy of the finance minister (fiscal policy did not change that much).

In the first 2004 MACROscope issue, we came up with New Year's greetings to the Finance Minister whom we wished a possibly cheap deficit funding and a better information policy towards financial markets. We might say at this stage that those wishes came true despite the lagging performance of the Hausner plan. We wished the central bank to start publishing inflation forecasts (this wish finally materialised although initially it was difficult) and to enjoy a stable exchange rate as well as low inflation without any interest rate hikes (unfortunately, it happened otherwise). Entrepreneurs received our wishes of good trading performance and lower labour costs. Undoubtedly, the previous year boasted a good business climate. What then will the next year bring ?

2005 – bullish growth in the world with rate hikes

We expect that the global economic climate will remain favourable although OECD countries may slacken their pace of growth from 3.6% to 2.9%. The US economy remains robust whilst the EU lags behind. This disproportion is likely to continue through 2005. We expect that US will report a 3.5% GDP growth and the UE economy will grow by 1.8%.

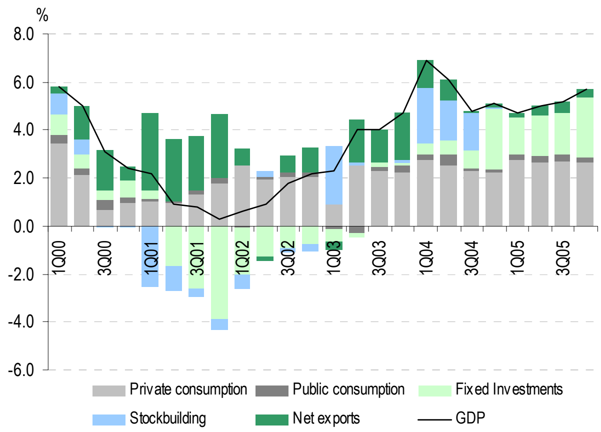
Assuming that the oil market will quote 40 $ a barrel (comparing to the previous year's average at 38 $), the average annual US inflation will continue the previous year's trend at 2.6% while the EU will have a drop down to 1.9% (from 2.2% in 2004). Despite the interest rate hikes to date, the US monetary policy is still relatively accommodative and we are expecting further moves this year forecasting the official Federal interest rate at 3.5% in December 2005. Bearish economic performance in the euro zone allows us to believe that the interest rate on this side of Atlantic will not change at least until mid 2005. We expect though that the interest rate will increase by 50 basis points by the end of 2005, however a divergence from this scenario might rather be downward than upward. There inasmuch as the strong euro creates additional risk for economic growth and contributes to lower inflation.

Economic expansion – to be continued…

Recently published statistics and financial market trends that took shape in Poland at the close of 2004 persuaded us to adjust macroeconomic forecasts for 2005. Comparing to our earlier forecasts, the final months of 2004 showed a slower pace of salary growth across enterprises (although remuneration measured across the whole economy has been growing faster than inflation), slightly lower employment and stronger zloty appreciation. Weaker than expected was also GDP and capital expenditure growth in Q3 of 2004. Having viewed the latest information about the economy, we trimmed our growth forecasts from 5.8% to 5.2%. It is worth noticing that other market analysts also reviewed their projections – according to *Gazeta Bankowa,* the average GDP forecast receded from 5.3% to 4.8%, which makes our projections one of the most optimistic ones on the market.

Like most of the market players we are expecting to see a more robust capital expenditure at ca. 10% against the previous year. Consumer spending should remain at ca. 4%, though at the beginning of the year growth in disposable income in real terms will be strongly exposed to negative effects of high inflation (this will be discussed at length in the further part of this article), while the second year half should bring a slight acceleration. Total domestic demand is forecasted to increase by nearly 5% additionally fuelled by the net export. Inasmuch as we expect that the trade deficit denominated in the euro will deteriorate, its zloty denominated value should stay close to what we had last year (ca. 2% GDP) in consequence of a substantial annualised average appreciation of the Polish zloty (from 4.53 to 4.13). A possibility of yet faster zloty appreciation (which we do not assume in our base-case scenario) creates certain risk for economic growth, however in our view a slowdown would come in the wake of a decreasing profitability of export trade combined with shrinking domestic demand rather than as an aftermath of a grossly reduced volume of export trade. It seems to us that the risk of weakening economic growth hampered by the current zloty appreciation will be higher in the coming years. For this reason we believe that the budget forecast of a 5% GDP growth for 2005 is relatively safe.

Quarterly structure of GDP growth



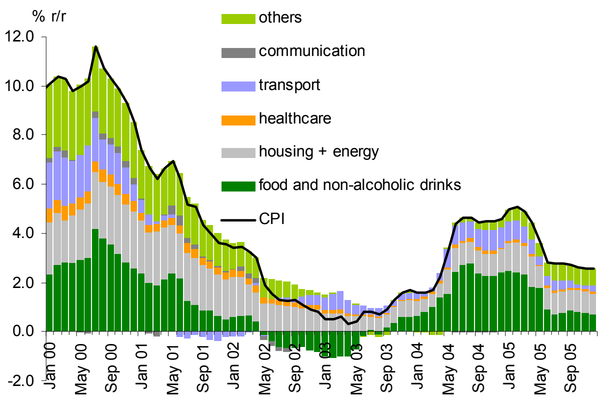
Source: CSO, own estimates

Inflation - controlled increase and fall towards target

Annual inflation rate closed 2004 at 2 pp above the inflation target set by the central bank (2.5%). The existing circumstances bode even better for reaching the target in 2005, but it is still too early to be absolutely positive about it. A lot depends on the f/x movements (discussed in further detail below) and on a potential manifestation of demand pressure on prices, especially in the second half of 2005. Obviously, food prices will also contribute as they account for over a quarter of the shopping basket priced to measure inflation. Good harvest last year might suggest that food prices will increase less. On that basis we assume that the annual 12M food price index will rise in 2005 by 2.5% as compared to 8.1% reported in December 2004. Of course, we need to remember that such a sizable reduction will be possible owing to expiry of the EU accession effect. In our opinion, a specific risk element should also be factored in; namely the process of levelling off prices between Poland and the EU in respect of certain products has not been completed yet (this is so in the case of beef and dairy products).

So, all the reasons indicated tell us that the beginning of 2005 will be marked with growing inflation. A number of one-off factors will contribute to that. Unlike in the previous year, January has witnessed gas and electricity price increases. Besides, this year will also bring higher excise taxes whose average rate set out in the Budget Act will be as follows: 3.4% charged on the price of diesel fuel, 10% charged on the price of LPG, 3.4% charged on the price of spirits and 14.7% charged on the price of tobacco. It is not known whether those higher rates will be charged from the beginning of the year thereafter or whether they will be spread in time over the coming year. At any rate the second scenario of the price hike would have to be higher to gain the same effect on the year average. In view of the factors discussed above and with the assumption of food prices growing by 0.7% on a month to month basis (comparing against the average of 0.9% measured in Q4 of 2004), we expect that the January inflation will reach ca. 5%. This rate of inflation may continue through the first quarter and then decline in reaction to the effect of statistics (Poland's accession to the EU will no longer be reflected in the 12-month index).

Structure of CPI growth



Source: CSO, own estimates

We expect the year to close with inflation at 2.6% while the average yearly inflation should stand at 3.5% (0.5 pp above the budget).

Assuming that the oil prices will fluctuate around ca. 40 $ a barrel and the Polish zloty will appreciate on an annualised average by some 0,5 against EUR and USD, we think that the net inflation (CPI less food and oil prices) will stay close to the inflation rate target of 2.5% set by the NBP.

Interest rates – too early for easing stance

A bit different scenario of further macroeconomic developments and tendencies on the currency market from the earlier expectations will surely affect decisions of the Monetary Policy Council. We still believe that it is still to early to cut interest rates, however the MPC may decide to switch its policy to neutral bias when it decides that the likelihood of keeping inflation above the target for 4-6 quarters is no longer 'much above 50%'. The next inflation projection will be presented in February and if the zloty remains relatively strong until that time, it may show that inflation is directing towards the target set for 2006 and 2007. Moreover, if this scenario is to unfold, taking a neutral stance in the monetary policy will be possible as early as in February or March. However, taking a neutral stance in the monetary policy would not mean in our opinion, but against expectations of some of the financial market players, preparation towards a speedy interest rate cut. This would simply reflect the fact that inflation projections are again close to the target and would allow for interest rate movements either way depending on how the situation unfolds. It is also worth noticing that as Dariusz Filar, one of the MPC members, says a neutral interest rate in Poland stands at ca. 4%. This implies that the nominal reference interest rate should not be lower than 6% if inflation remains at 2.5% and the MPC wishes to keep the inflation target in a longer perspective.

Moreover, another MPC member, Halina Wasilewska-Trenker has recently reminded that inflation will have to be below the current target to be in line with the Maastricht inflation requirement. If we consider the government's plans (quite optimistic, but also feasible) to reduce the budget deficit below 3% in 2007 and delays in monetary policy transmission mechanisms (up to 6-8 quarters), we might conclude that there is not much room slicing the current interest rate at 6.5% even with inflation reaching 2.5% towards the year end. Obviously enough, it is not easy to assess perspectives of the fiscal policy going forward just before the oncoming parliamentary elections. Still, it is difficult to imagine that the National Bank of Poland fails to fulfil its mission aimed at flattening the inflation rate to a level at which Poland will be able to enter the euro zone as scheduled by the government (i.e. if the government manages to sort out the budget deficit). It is then quite unreasonable to expect substantial interest rate cuts in the forthcoming months. We expect that the NBP will not change the interest rates this year. However, the central bank may adopt an easing bias towards the monetary policy if the market outlook in terms of inflation movements will be favourable, though in this scenario we would expect a slight interest rate reduction only in the next year.

World markets – dollar and yields under pressure

Before we move on to expectations towards the Polish financial market, let's take a look at what may happen on international markets. The Polish market will remain under a big influence of developments on international markets concerning both interest and currency rates. The second half of last year showed that the zloty is more and more bound with the euro currency. Luckily this happened when the euro appreciated against the dollar which was beneficial to our economy. We can expect that as we are advancing through the year towards accession of the Polish currency to ERM2 system, this bond will grow yet stronger. Therefore the exchange rate of the euro to the dollar will affect mainly the performance of the zloty to the dollar. Still, we need to remember that some of the market players continue to rate the zloty against both currencies (a so-called deviation from the old parity rate).

International markets are expected to trade in the weak dollar owing to factors similar to those which we have observed over the previous months. Financial markets seem to disbelieve that the US economy will be able to remedy the problem of twin deficits (budget deficit and trade deficit) shortly. Growing savings or external demand for American products might mitigate the structural problems. However, financial markets are convinced that a substantial reduction of the trade deficit will not be possible without appreciation of the trading partners' currencies against the US dollar. Since, at least in early 2005 the Asian currencies are likely to demonstrate quasi fixed exchange rates, the weakening of the dollar will be the euro task. Hence, we do not rule out record highs of EUR to USD (even 1.4) in the first year half. It will also be a test of EBC intentions that on seeing next record high rates may be more willing to intervene in the currency market if f/x movements appear to rapid. On the other hand, we can expect that in the second half of the year, China will decide to perform a controlled yuan revaluation which will ease pressure on euro. This will be stimulated by a more bullish economic growth in the US accompanied by consecutive interest rate hikes. In view of the pending structural problems, we would rather expect that the above factors will allow the US dollar to level off rather than appreciate significantly, e.g. below 1.3 for 1 euro.

In 2004 the world market interest rates increased less than expected. This was effected by lower interest rate hikes in the US and speculations about potential interest rate cuts in the Euro zone (quite unjustified considering the fact that during the December session, the ECB Council was thinking about raising interest rates). However, as official interest rates are growing, both US and Euro zone treasury securities should demonstrate higher yields. Inasmuch as the US monetary policy is likely to be more restrictive, interest rate hikes in Europe are still under a question mark. The basic scenario envisages yields increases by ca. 50 bp on both markets. In US a larger portion of that increase should take place in the first year half while Europe may postpone it until the second year half.

In Poland, sluggish beginning followed by recovery

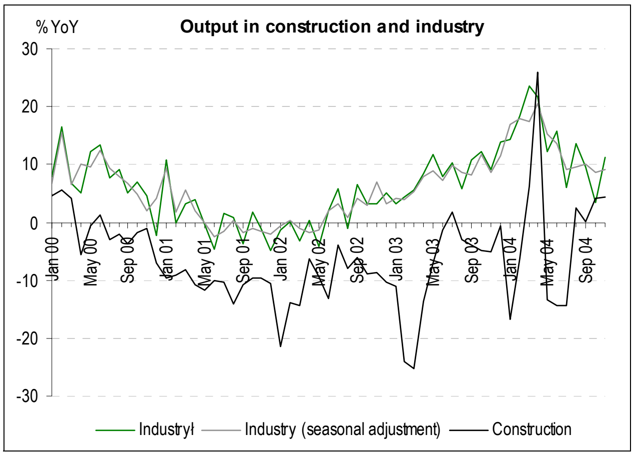
2005 will also be under substantial influence of political developments. Parliamentary elections will surely affect the perception of risk premium for investing into securities. Especially that the recent poll results do not give a clear picture as to what coalition will be formed after the election. Will it be a coalition of two or three parties? Besides, economy and business related programmes of potential winners vary quite a lot and a climate for budget deficit reductions over the coming years may not be as good as expected. A date of the parliament elections represents another uncertainty. While senior representatives of the ruling parties and the government sustain the decision to shorten the Sejm's term of office (mentioning that quite often recently), we need to bear in mind that a majority of two third of all MPs may pass such a decision. For that reason our basic scenario envisages the elections to be held in autumn. Our forecasts reflect it in a higher average rate of zloty against euro and dollar in the third quarter. Likewise yields on treasury securities – these should be higher as the time of parliamentary elections is approaching. We also expect that equity risk premium expressed as difference of the Polish interest rates forward in five years' time in relation to relevant euro denominated assets (spread 5X5) will grow before the elections. At the close of the previous year equity risk premium measured in the same manner dropped substantially (our reports read that it was too sharp) to 85 bp., however at the beginning of 2005 it climbed again to over 100 base points. We believe that a temporary growth of the equity premium risk up to 150 bp before the elections is possible.

Like in previous years, higher yields on treasury securities and lower zloty value will most likely be used by foreign investors to resume the so-called convergence play. Therefore, we expect a positive sentiment to appear towards the end of the year and accompanied by zloty appreciation and higher yields on stocks and securities. As we expect that the average zloty exchange rate towards euro in the last quarter of the year will reach ca. 4.1 (it would be lower if the elections were held in spring), there is a chance to cross the barrier of 4 zloty for 1 euro at the year close. As regards the US dollar, the psychological barrier of below 3 zloty will probably be approached in the second quarter (with the elections in spring, this would occur closer to the year end) when the US currency may be at its lowest on the international markets. Market interest rates should also decline towards the year end below 6% on five-year bonds and risk premium may even be slightly lower than at the end of the previous year (in the scenario of having a relatively stable government coalition after the elections). The convergence play may grow intense at the close of the year if it appears that the Polish government decides to enter the ERM2 system in 2006. Negotiations on that issue may also help to determine the scope of zloty movements against euro. Now that we do not expect changes to the official interest rate (slight reductions only in 2006), the short end of the yield curve should be relatively stable this year.

Summing up, the parliamentary elections should bring further correction to the Polish financial market which foreign players may use again to rebuild their position in the Polish securities. Therefore, exporters might take advantage of a temporary zloty depreciation to hedge payments with forward transactions while importers can be concerned about this depreciation near the elections time (though it is difficult to say exactly when it would occur).

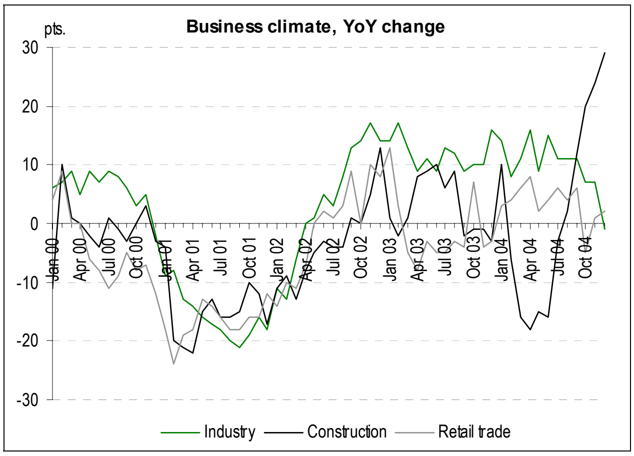
Tables containing forecasts of macroeconomic variables can be found at the end of the report.

Economic update



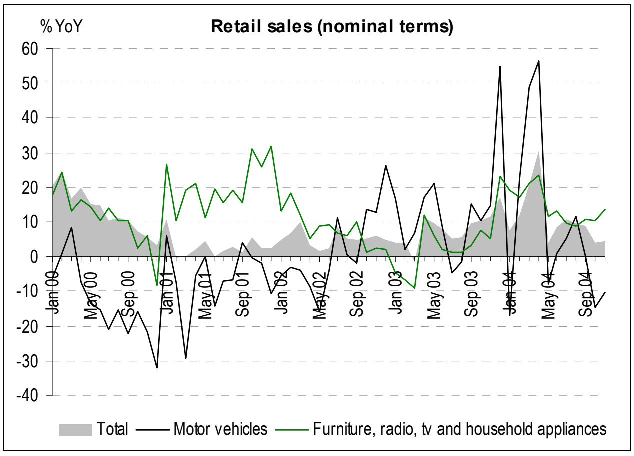
Stable growth in industry, better and better in construction

- Industrial output growth was higher than expected in November, reaching 11.3%YoY. This stemmed partly from higher number of working days, but even without this effect (and seasonal factors) industrial output grew a healthy 9.2%YoY.
- This means that strong expansion of the Polish industry was continued in the final quarter in 2004 and the zloty's strength has not harmed the economy yet.
- November saw rise in construction output again (of 4.3%YoY), but it was slightly weaker than expected, especially that seasonally adjusted growth rate was still in red (-1.2%YoY).
- Construction sector gradually recovers from a slump lasting over 4 years. We think that months to come will bring stronger rebound in construction output growth, following bigger investment activity.



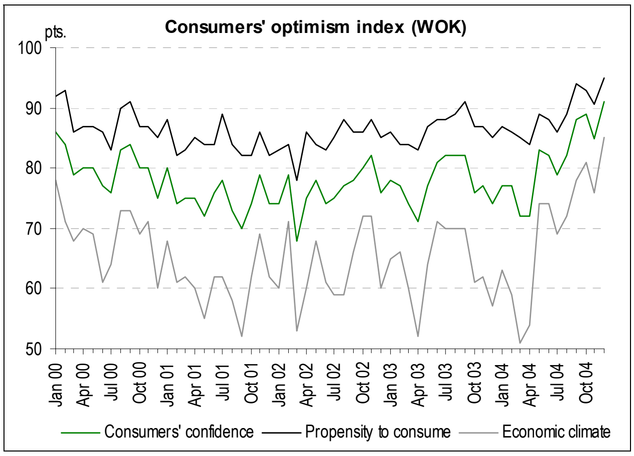
Good omen for construction

- December's results of business climate showed a continuation of strong rise in construction sector, while indices for industry and retail trade were almost unchanged in annual terms.
- Index for construction recorded two-digit growth for a fourth month running. Limited demand was still seen as a major impediment for development, but in December 2004 it was reported by only 51% of firms against 71% a year earlier. It seems that strong improvement begins in construction sector.
- Retailers' moods were relatively the weakest as usual, but we still think this reflects tight competition (faced mostly by small firms), and not indicate weaker demand.
- Indicator of business climate in industry was negative for the first time since 1Q02 amid lower orders (chiefly domestic ones, so it should not be perceived as the effect of the strong zloty).



Retail sales not as bad as it looks like

- At first glance, retail sales figures for November were disappointing, because the nominal growth rate was a mere 4.4%YoY. In real terms, retail sales dropped 0.4%YoY following real fall in the previous month and 4.7%YoY real rise in 3Q04.
- November's result was negatively affected by slump in new car sales, but other components saw solid sale increases. Thus, taking into account that retail sales figures do not reflect increased purchases of imported used cars, one cannot claim that consumption demand weakens.
- On the contrary, we expect that individual consumption growth in 4Q04 was slightly higher than 3.5% posted in 3Q04 and will accelerate moderately in 2005. The latter will be possible thanks to improvement of the labour market conditions and better moods of consumers.

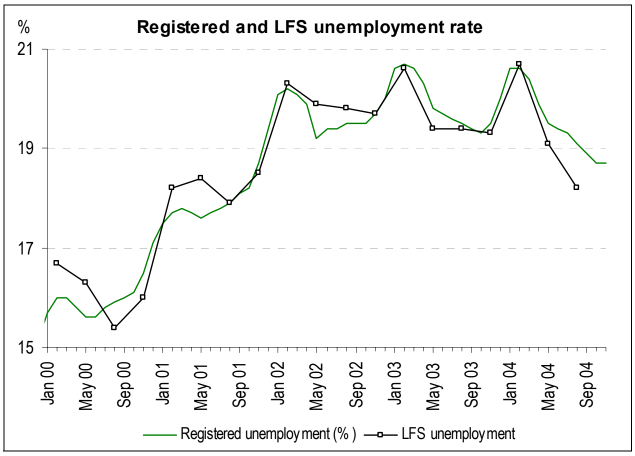


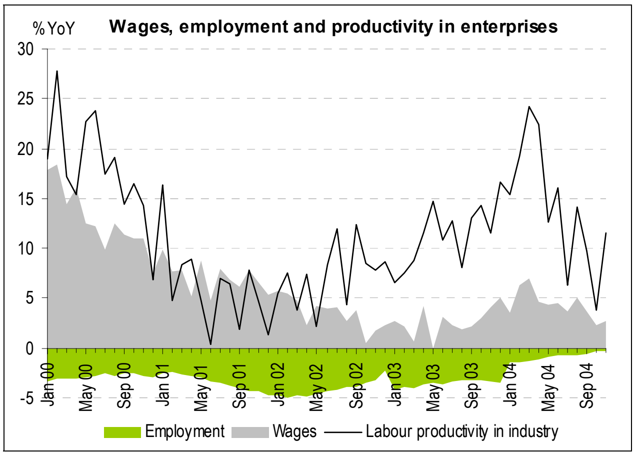
Source: CSO, Ipsos, BZWBK own estimates

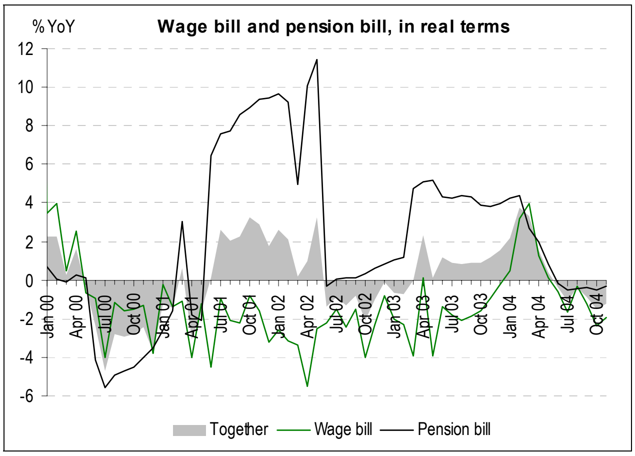
Consumers more and more confident

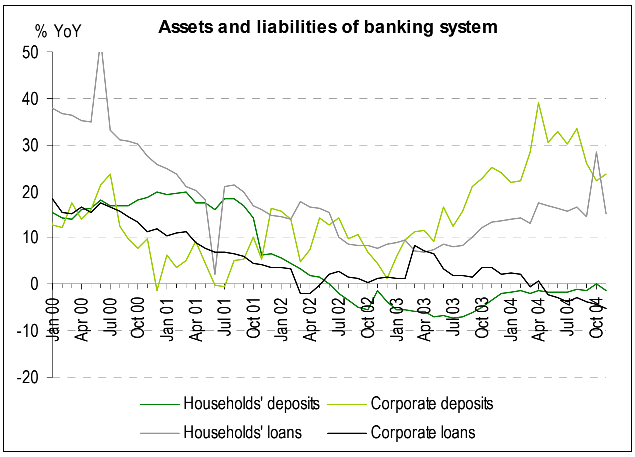
- Consumer confidence index published by the CSO showed that households' assessment of their own financial stance and general economic situation keeps improving.
- This tendency has been observed since July 2004. For the first time since July, there was significant improvement in consumers' assessment of "current possibility of substantial purchases".
- Households also declared increase in their ability to savings and maintain expectations for unemployment reduction.
- For the fourth month in a row „leading indicator of consumer confidence" saw record high level since 1999, and all sub-indices increased.
- Apart from CSO indices, considerable improvement in consumers' moods was also seen in December's results the survey carried out by Ipsos institute.

Economic update









Source: CSO, NBP, BZWBK own estimates

Unemployment reduction gains momentum

- The registered unemployment rate amounted to 18.7% in November (0.8pp decline on the year). This was the fastest annual pace of unemployment fall since September 1998. We expect that the unemployment rate will keep falling in annual terms, although the nearest months will see a seasonal jump to 19% in December and ca. 19.5% in 1Q05.
- LFS unemployment rate totaled 18.2% in 3Q04 (1.2pp drop in annual terms), reaching the lowest level in three years.
- Moreover, the number of employed rose 1.7%YoY in 3Q04 after 0.9%YoY and 0.2%YoY increases in 1Q04 and 2Q04, respectively. We think that labour market conditions will keep improving (possibly even faster than up to date), which bodes well for individual consumption growth in future and at the same time constitutes potential source of inflationary pressure.

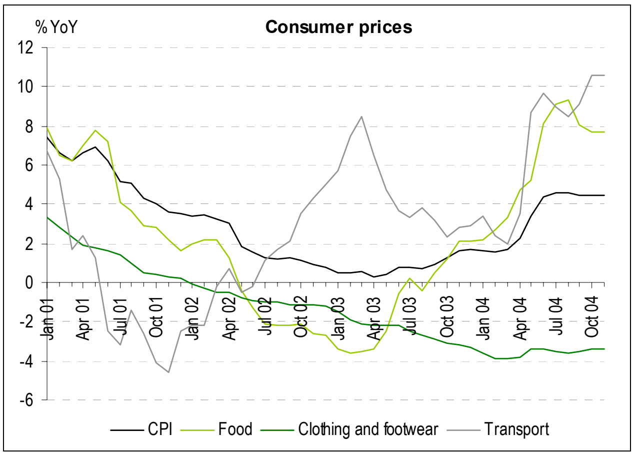
Employment and wages statistics disappointed again, but...

- The above mentioned LFS data on labour demand has not been confirmed in the CSO data on employment in the whole economy (1.2%YoY decline in 3Q04).
- Besides, numbers from the enterprise sector disappointed again, showing weaker than expected wage growth and lower than predicted employment.
- Average employment in enterprises edged down by 0.1%MoM and 0.3%YoY. However, the same as in a few previous months, this stemmed from labour shedding in mining and construction, while employment in industry and trade has been rising at growing pace.
- Average wage in the enterprise sector increased 2.7%YoY in November after 2.4%YoY rise a month earlier and 4.5%YoY increase on average in January-October 2004.
- This was not an impressive acceleration in wage growth taking into account inflation at 4.5%YoY (which implies that wages fell in real terms) and GDP growth of around 5%.
- Wage bill in the enterprise sector increased by a mere 2.4%YoY in nominal terms, which means drop of 2%YoY in real terms.
- Thus, one has hardly grounds for claiming that there is strong wage pressure in the Polish economy. Wage growth in enterprises stays below productivity growth, which reduces risk for inflation outlook.
- However, one should take note of the fact that wages in the whole economy grows faster than in the enterprise sector.
- In 3Q04, it rose by 5.1%YoY (against 4.1%YoY rise in enterprises in the same period) after 4.4%YoY rise in 1H04 and 3.2%YoY in 2003. Thus, growth rate of wage in the whole economy all the time remains above inflation.

Return to normality in monetary statistics

- After distortions in monetary statistics for October, connected with IPO of PKO BP, November brought growth rate of money supply as well as of deposits and credits to the earlier observed trend.
- M3 aggregate increased 6.4%YoY and total deposits rose 6.5%YoY. Total credits' growth decelerated to 4.1%YoY.
- Monetary statistics did not indicate anything that could be perceived as risky in terms of the inflation outlook. Credit growth is under control and one can even say that it is very low given strong economic growth in recent quarters.
- Continued slump in corporate borrowing (-5.1%YoY against -4.2%YoY in October and -3.9%YoY in September) seems to be a threat to the economy prospects (assuming it indicates low investment demand); on the other hand, low money creation is good news for inflation outlook.

Economic update



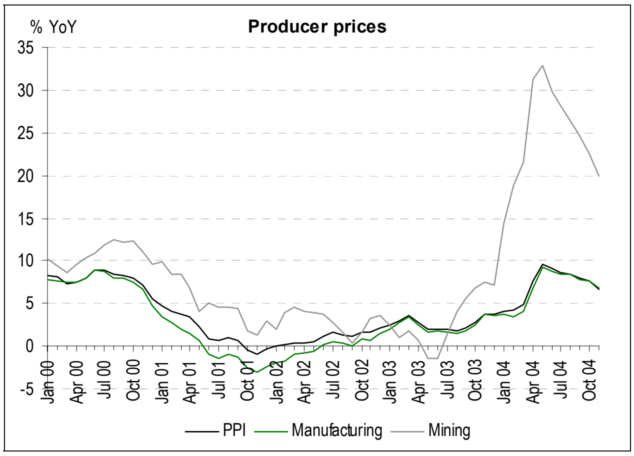
Consumer inflation persistently high

▪ November's annual CPI remained at October's level of 4.5%, in line with our forecast, but above market consensus of 4.3-4.4%.

▪ The two most important factors preventing inflation from a fall were high food prices (7.7%YoY) and fuel prices (19.1%YoY). The latter was particularly surprising, as November saw substantial fall in oil prices.

▪ It seems that contrary to finance minister's expectations, appreciation of the zloty had not fast and strong effect on inflation. Minister Gronicki's belief in CPI fall to ca. 4%YoY at year-end seems to be overly optimistic.

▪ In our opinion, December's CPI stayed at ca. 4.5%YoY or even slightly increased. Price increases and tax hikes at the start of the year may push inflation up to around 5%YoY in 1Q05.



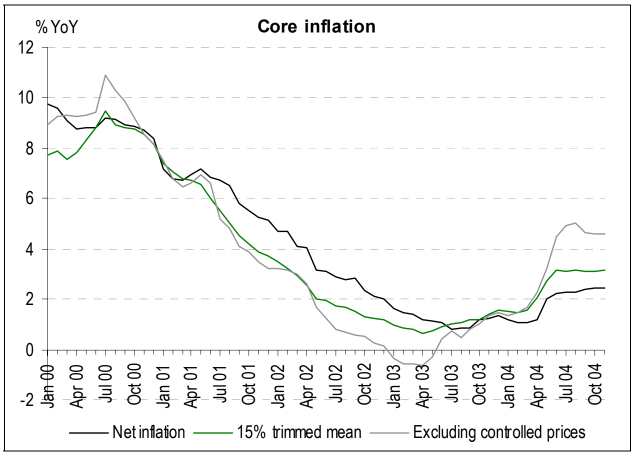
Producer inflation declines quickly, but still very high

▪ Contrary to consumer prices, producer prices rose slower than expected in November. Annual PPI dropped to 6.7% from 7.6% a month earlier after 0.3%MoM decrease in prices.

▪ It seems that the PPI fall stemmed mainly from the decline in oil prices and energy costs, because the deepest price drop was observed in refinery produce (-4.8%MoM).

▪ Taking into account that there was adverse situation in consumer inflation, where fuel prices contributed to November's rise, one may assume that reduction in fuel prices in PPI in November will be seen in CPI with some lag.

▪ Despite producer price index was better than expected, one should take note of the fact that PPI remains very high, which does not create supportive environment for fast reduction in the headline inflation rate.



Stabilisation of core inflation

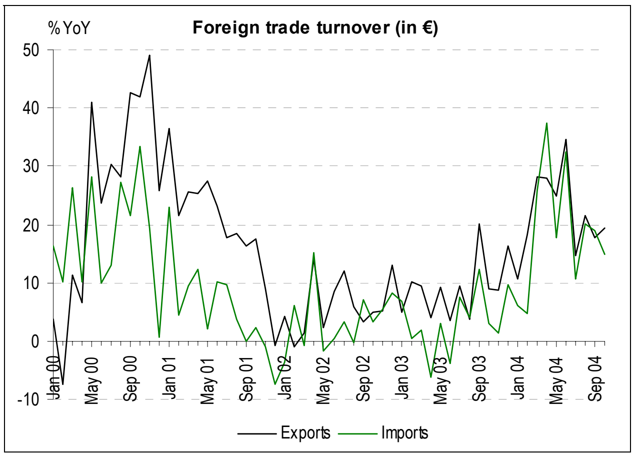
▪ November's data on core inflation showed almost all measures unchanged against October's levels.

▪ Only one out of five measures (15% trimmed mean) increased slightly by 0.1pp to 3.2%YoY.

▪ The most important measure – net inflation – amounted to 2.4%YoY, which was in line with expectations.

▪ The remaining three measures were still above the upper end of a tolerance band for inflation deviations from the target. They range from 4.6%YoY in case of CPI excluding controlled prices to 5.7%YoY in case of CPI excluding the most volatile prices.

▪ All in all, core inflation figures suggested that even excluding exogenous factors (such as food and fuel prices), inflationary pressure remains at the level, which does not allow for inflation drop below the central bank target of 2.5%.



Source: CSO, NBP, BZWBK own estimates

External position of the economy remains safe

▪ According to NBP data, October 2004 saw €234m surplus on the current account, but figures for April-September period were revised downward.

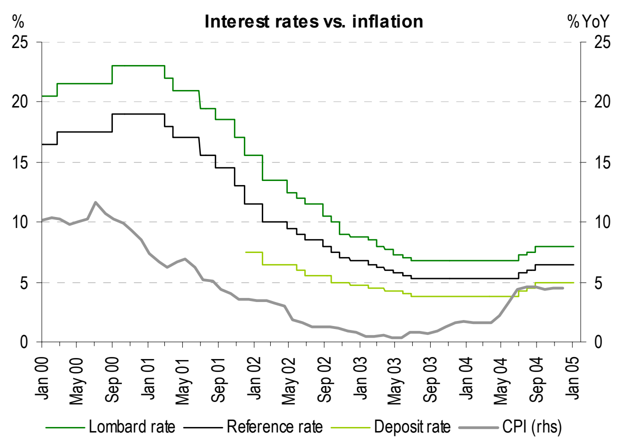
▪ 12-month cumulative C/A deficit in relation to GDP inched up to 1.9% after October from 1.8% after September. This is very safe level. Despite fast pace of the economic growth, external imbalance of the Polish economy is very small. This supports the zloty exchange rate in the medium-term.

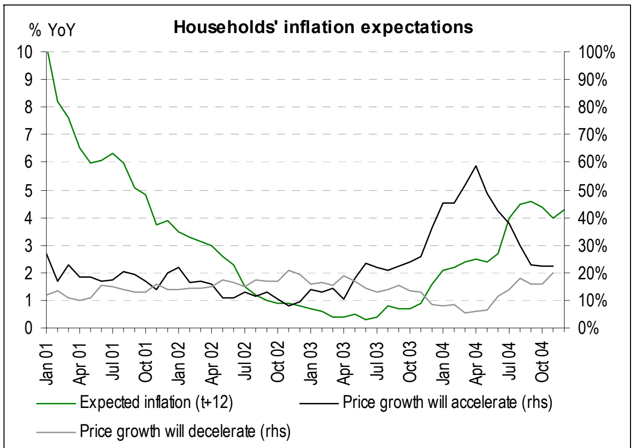
▪ Exports and imports rose at two-digit pace in October, confirming good condition of both external and domestic demand.

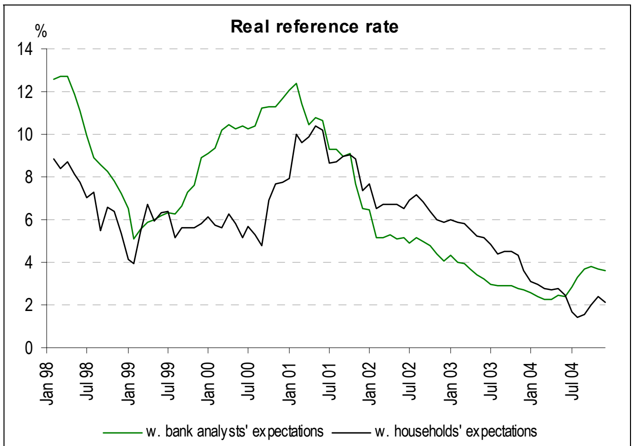
▪ October saw FDIs inflow of €2.16bn This was much above the levels seen in the previous months of this year. According to the NBP, almost the whole amount reflected one-off transaction of individual investor.

Central bank watch

Crucial fragments of the MPC statement from 15 December 2004
High share of inventories growth in GDP growth together with accompanying lower than expected investment dynamics make the assessment of the outlook for economic growth difficult. (…) Overall, it is difficult to assess the extent to which GDP data for 3Q04 change the balance of risks presented in the November *Inflation Report.*
Available data do not, as yet, indicate that the positive tendencies in the labour market will be sustained. (…) Inflation expectations, which have been higher since July, still have not translated into wage dynamics (no second-round effects observed).
NBP estimates (…) indicate that as a result of these changes [VAT reform proposed by the FinMin] the consumer price index may show a one-off increase, which may extend the process of lowering inflation in 2005-2006.
Should the information on the low investment dynamics be confirmed, the probability of economic growth dynamics in 2005-2006 running lower than expected in the Report would increase.
In the Council's opinion the balance of risks for future inflation has not changed significantly since the previous meeting. The probability of inflation staying above the target of 2.5% in 2006 is still higher than the probability of inflation falling below target. Thus the Council maintained its tightening monetary policy bias.







Source: NBP, CSO, own estimates

Interest rates and bias unchanged in December

▪ In line with expectations, the MPC left interest rates unchanged in December and maintained tightening bias. It also agreed the balance of risks for future inflation had not changed much since the previous meeting.

▪ According to the MPC it was hard to tell to what extent GDP data for 3Q04 affected balance of risks for inflation. It seems the MPC shares our concerns regarding tremendous surge in inventories change. Leszek Balcerowicz said the true puzzle was not why there was no revival in investment activity (because actually it was taking place), but why official data suggested drop in investment outlays among the smallest companies. MPC member Marian Noga pointed out that the Council believed in strong investment revival, which would be the main driving force of GDP growth in 2005.

▪ The MPC noticed that strong zloty appreciation in 2004 would act to lower inflation in 2005. However, according to NBP chief future exchange rate fluctuations are uncertain, thus future impact of the zloty on inflation is hard to determine.

▪ The MPC passed a resolution to shorten maturity of basic open market operations from 14 to 7 days since January 2005 (it was announced earlier in *Monetary policy guidelines 2005*).

Change into neutral bias possible in H1 2005

▪ Recent comments of MPC and NBP officials (see next page) suggested that change of policy bias into neutral is possible already in Q1 2005.

▪ However, in our opinion it does not imply fast interest rate reductions – until end of 2005 the main NBP interest rates should remain unchanged, because of mounting demand pressure, which could make keeping inflation in target more difficult in the medium run.

Inflation expectations up, following high CPI

▪ Index of households' inflation expectations rose to 4.3% in December from 4.0% in the previous month.

▪ Most likely, it reflected worsening structure of answers in the poll, because currently observed inflation rate inched up only slightly from 4.4%YoY to 4.5%YoY.

▪ It seems likely that expectations index will remain at high level (well above inflation target) for the next several months, because CPI is forecasted to rise to ca. 5% in Q1 2005.

▪ In Dariusz Filar's opinion, it will be very important for the MPC whether high inflation rate at the beginning of 2005 strengthens high inflation expectations, which could consequently translate into faster rise in wages.

Not much room for interest rate cuts

▪ Dariusz Filar also underscored that real neutral interest rate in Poland amounts to ca. 4% (which probably results from the NBP analysis).

▪ Problems with proper measurement of inflation expectations in the economy imply that it is difficult to specify actual level of real interest rate – it is different for different group of economic agents.

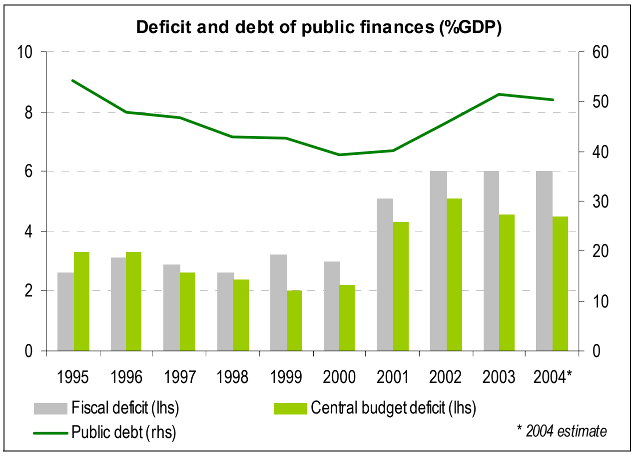
▪ However, regardless of how we measure expectations, real interest rate remains below 4% recently. Taking into account that expectations of households (and probably part of entrepreneurs) are to large extent adaptive, real interest rate for them is (and will be in the nearest months) almost twice lower than neutral.

▪ Even if expectations stabilise around 2.5% in the long run, it implies little room for interest rate cuts from present levels.

Central bank watch

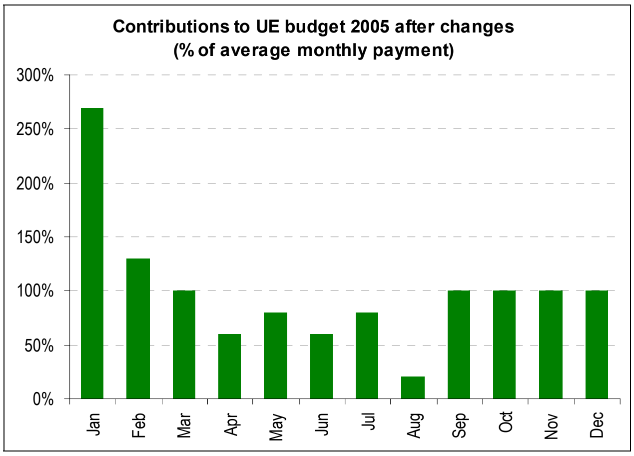
Comments of the central bank representatives	Remarks
Krzysztof Rybiński, NBP deputy governor Radio PiN, 27 December If this trend [of zloty appreciation] becomes persistent, then [...] it could turn out that our inflation projection, reaching out two years ahead, will show inflation below 2.5%. 2005 is already less important. More important becomes 2006 and it seems that inflation target in 2006 is within reach now.	NBP vice-president's comment suggested that no more monetary tightening could be necessary in order to bring inflation rate back to 2.5% target. It was the first such clear suggestion from the central bank that at the end of Q1 2005 a powerful argument could emerge, calling for change in monetary policy bias into neutral – inflation projection to be published in February will show inflation rate at the level of inflation target, or even below.
Dariusz Filar, MPC member PAP, 5 January One cannot rule out that inflation projection in February will show more favourable inflation path than in November. From this point of view, I would not ignore the projection, as it could hasten decision on changing monetary policy bias. [...] Move into neutral bias reduces probability that the next step would be a rate hike, but it does not exclude it. […] Shift into easing bias would be possible once inflation returns to the target, and inflation projection would show that it is a persistent return. It is still a distant perspective. Reference rate at slightly above 6% is closely corresponding to neutral interest rate, amid inflation reaching target 2.5%. […] Assuming inflation drop to 2.5%, the room for interest rate reductions is not big. I see only one threat for inflation. We managed to avoid second round effects so far, but traditionally, the first quarter is a period of wage negotiations in Poland. I am not sure that wage claims will not show up in this period, despite difficult situation on the labour market.	Filar suggested that adoption of neutral bias in policy is possible already in February or March, after publication of new inflation projection of the NBP, because strong zloty appreciation would improve inflation perspectives. However, one should note that adoption of neutral bias does not mean preparation for rate cuts. It would just reflect the fact that inflation predictions returned close to the target, but it would allow for interest rate moves in both directions, depending on the situation. We share Filar's view that it is still quite a long way until the MPC adopts easing bias, signalling a clear tendency to cut rates. Filar hinted that in the central bank's view a real neutral interest rate in Poland is at ca. 4%. It implies that nominal reference rate should not be lower than 6% if inflation is at targeted 2.5%, so there is not much room for rate cuts from present 6.5% if the MPC wants to reach inflation target in the longer run. We definitely agree. Filar attached high importance to wage pressure. Please note that wages in the national economy are rising much faster than in corporate sector. Even in 3Q04 their wage growth was much above inflation rate. We expect reinforcement of pay growth in 2005, which could be argument for MPC hawks.
Stanisław Nieckarz, MPC member Reuters, 17 December If there is a change of bias, it will be after the first quarter of next year. It will also depend on how the budget situation looks in the first quarter of next year. [...] If fiscal policy is tightened and the budget deficit shrinks, then there must be some relaxing of restrictive monetary policy. This would signal a necessity to move to a neutral bias.	Stanisław Nieckarz has been repeating for a long time already that if 2005 budget assumes lower deficit, then it implies tightening in fiscal policy, which should be compensated by relaxing monetary conditions. Thus, even stranger is that he mentioned that change of policy bias into neutral is possible after Q1 2005 at the earliest. Probably for Nieckarz – similarly as for the previous MPC – neutral bias in monetary policy is the one, which is applied during monetary easing cycle.
Andrzej Sławiński, MPC member Reuters, 20 December The balance of inflation risks is improving, mainly because of zloty appreciation. It is hard to see any serious threats on the demand side. [...] But the appreciation, if it continues at the same pace, can become a potential threat to growth. One should assume that importance of inflation projection will be rising. Inflation projection helpful in conducting in forward-looking monetary policy. One should not expect, however, that MPC decisions will be mechanical reactions to projection results.	Another voice from the MPC confirmed that fast zloty appreciation improved inflation perspectives and thus could impact monetary policy decisions. Lack of clear demand-side pressure on inflation backs this argumentation. At the same time, Andrzej Sławiński pointed out that NBP's inflation projection will be gaining importance for the MPC. One should remember that inflation projection that will be presented in February will include 2007 for the first time ever. In 2007 Poland aims at meeting Maastricht criteria, and in our opinion MPC members could start taking it into account. Meanwhile, it is still not sure what level of inflation would be sufficient to fulfil convergence criterion in 2007 (see comment below).
Halina Wasilewska-Trenkner, MPC member PAP, 22 December Present tightening bias is a kind of shield in case something [unpredictable] happens, and situation is still shaky from the perspective of inflation, economy, exchange rate. If situation stabilises after inflation upturn in Q1 and we will be certain about maintaining trends, this shield will be no longer needed. I don't know whether it will be in Q2. [...] Interest rate cuts will be preannounced by the Council by a change in bias. In order to cut rates, we have to make sure that there are no major threats in economy and we can move around in different conditions. If we are sure that at the end of 2005 and at the beginning of 2006 inflation will be exactly at target level or below, then we can withdraw from actions suppressing inflation, i.e. [we can] reduce rates. Achieving such certainty would require data from at least early 2005. In future it might show up that inflation criterion could come below 2.5%. It is not that once we arrive at 2.5%, we will have nothing more to do and we will be only taking care for maintaining 2.5% inflation.	Wasilewska-Trenkner, like their colleagues, suggested that change in monetary policy bias is possible no earlier than after Q1 2005. And it is possible only in a situation if there are no unfavourable effects of transitory inflation surge at the beginning of the year (e.g. rise in inflation expectations or wage pressure). Moreover, MPC member clearly signalled that before start of rate cuts cycle, there should be one more change in bias, into easing one. One should note that Halina Wasilewska-Trenkner is already thinking about perspectives of fulfilling Maastricht convergence criteria, needed for euro zone eligibility. She rightly noticed that it is not certain at what level will be inflation in EU member states, and thus what will be the level of inflation criterion. One cannot be sure that attaining 2.5% average inflation in 2007 will guarantee access to the euro zone. It might turn out that in order to fulfil Maastricht criteria, Poland will have to achieve lower average inflation, and one should remember that it this average inflation in 2007 would be affected by monetary policy decisions in the nearest quarters (due to substantial lags in monetary transmission mechanism).

Government and politics



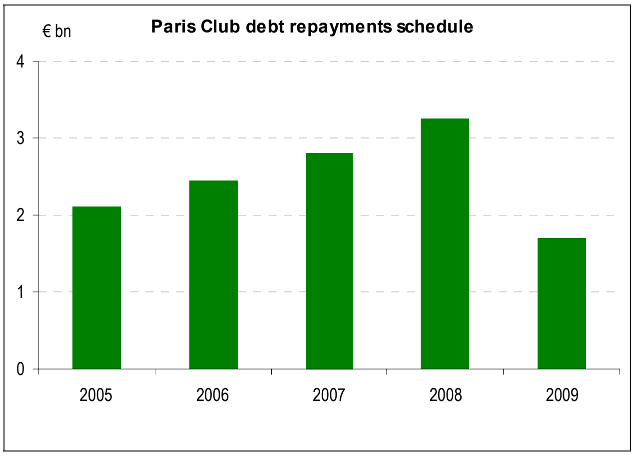
Fiscal deficit and debt in 2004 lower than expected

- After 11 months of 2004 budget deficit reached PLN38.8bn, i.e. 74.6% of the annual plan. In November alone deficit topped PLN3bn, which was quite high level as for this month. It resulted from significant rise in budget expenditure, only partly compensated by acceleration in revenue growth.
- However, entire 2004 closed with very positive result – according to finance minister, budget gap reached ca. PLN40bn (4.5% of GDP) at the end of December, against planned PLN45.3bn.
- Public debt was also much lower than predicted, as it reached ca. 50% of GDP. It was possible thanks to: faster GDP growth, faster privatisation, and zloty appreciation. However, it is worth to mention that even if the zloty did not strengthen in 2004, the debt would be below 55% of GDP!



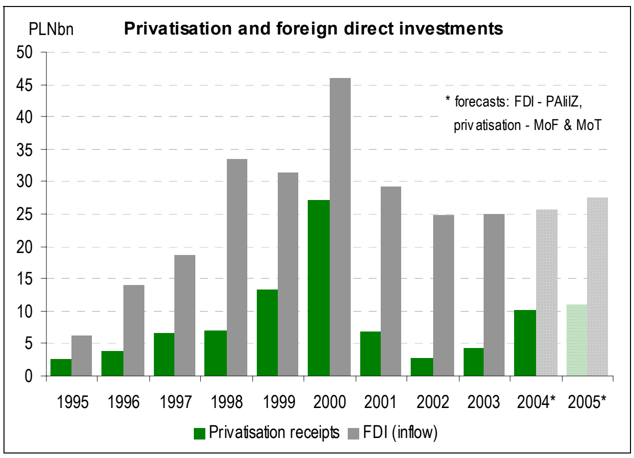
... however early 2005 will be tough for the budget

- In the first two months of 2005, Polish budget will be weighed down by higher than planned contributions to the EU; in total, EU payments will be increased by ca. €1.5bn in the first quarter.
- Accordingly, budget deficit will rise more at the beginning of the year – up to ca. 18% of annual plan in January and ca. 40% in March. However, it might be beneficial for the state budget in the whole year perspective, as payments in 1Q05 will be made under still favourable exchange rate (strong zloty), while in the second part of the year some depreciation of Polish currency is possible (implying higher zloty value of EU contributions).
- Budget liquidity could reduce substantially in 1Q05 from PLN13.4bn level at the end of December, especially that the government will restart direct payments for farmers, suspended at the end of 2004 (PLN5bn overdue payments from 2004).



Poland wants to repay Paris Club debt

- Poland plans premature repayment of Paris Club debt in 2005. Total outstanding amount is €12.3bn, and its maturity is concentrated in 2005-09, in 2010-14 only €70m is to be repaid.
- Paris Club will examine this issue in the following weeks, and "discussions are already very advanced".
- Operation will be financed by eurobonds issuance, but the open question is whether the ministry would buy FX currencies on the market in the scenario of further strong zloty appreciation (which we do not expect, by the way).
- Against the Ministry of Finance's expectations, it is unlikely that the Polish rating will be changed as a result of buy back Poland's debt in the Paris Club.
- … and it is hard to expect changes in rating agencies' assessments ahead of parliamentary elections.



Source: Ministry of Finance, PAIiIZ, PAP, own estimates

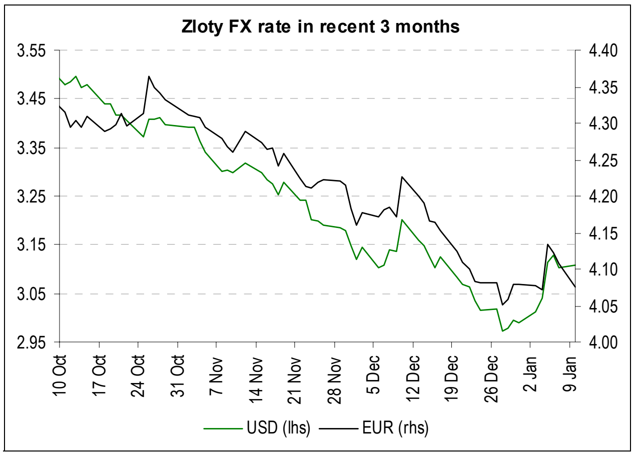
Higher foreign investments, faster privatisation

- According to the Polish Foreign Investment Agency, direct investment in Poland in 2004 topped $6.4bn level from 2003. Number of planned investment projects suggests that 2005 will be even better, and in the following years inflow of $10bn per year is expected.
- Privatisation revenues in 2004 reached PLN10.25bn against PLN8.8bn planned in the budget act. Surplus came mainly from privatisation of PKO BP, which raised PLN7.6bn.
- 2005 budget assumes privatisation receipts of PLN5.7bn, out of which PLN4.4bn is directed for deficit financing. It is possible that actual inflows will be almost twice higher than planned for the second consecutive time, if public offering of PZU S.A. will take place. However, it is still uncertain whether the parliament will agree for a compromise between government and Eureko.

Government and politics

Comments of government representatives and politicians	Remarks
Jerzy Hausner, deputy PM, economy and labour minister PAP, 30 December We have already exceeded 50% realisation of [Hausner] plan, but being realistic [...] I believe that maximum 75% could be achieved. I have no intention to make any artificial steps to weaken the zloty. [...] If the Polish economy has strong fundamentals, and conducted policy is rational, then the zloty would be appreciating. One should accept it. Now we have to [...] seek cooperation between economic policy and monetary policy. I do not want to be the MPC's prompter, but talk with the central bank should be aimed at considering pros and cons, e.g. of interest rate cut. I don't say that they should cut rates now, but perhaps it is worth considering if monetary policy bias should be changed.	Deputy PM Jerzy Hausner is satisfied with the government's economic policy and realisation of his own reform package in public finances. He is also quite an optimist as regards amount of savings still possible to achieve. Let us recall that deputy NBP governor Krzysztof Rybiński said the central bank assumed the plan would be implemented in 50% at most. Deputy Prime Minister believes the economy needs relaxation of monetary policy. He is likely to insist on the change in policy bias and rate cuts during the talks with the central bank scheduled for January. Hausner probably believes this would help to weaken the zloty, although he does not admit explicitly that the zloty's strength is a serious problem.
Mirosław Gronicki, finance minister ISB, 4 January In January annual inflation will not reach 5% [...] I believe we will have 4.5% in Q1, and in Q3 it will be already below 2.5%. Public debt at the end of 2004 reached, carefully speaking, below 51%, i.e. 50.6%. There is a chance that it was below 50%. [...] All suggests that realisation of budget deficit at ca. PLN40bn would be realistic. We expect that economic growth rate in the second half of 2005 will be higher than in the first half. We predict that in H1 it could be below 5% due to base effect. [...] Second half would be better, because of investment kick-off. Export should be growing fast and one should expect rather strong zloty. GDP growth could top 5% [in 2H05], which will produce ca. 5% in the entire year.	Finance minister is very optimistic as regards inflation forecasts. He justified such view with strong zloty and lower oil prices that would drag prices of imported goods down quite rapidly. But in our opinion his optimism in this regard is excessive, and inflation rate should be close to 5% in entire Q1 2005. Let us remind that quite recently Gronicki predicted inflation rate at ca. 4% in December 2004 (while most likely it topped 4.5%), which perhaps helps to understand his upbeat forecasts for early 2005. Preliminary estimates of budget deficit and public debt for 2004 presented by finance minister show that both figures came much lower than planned. It was possible thanks to faster GDP growth, higher inflation, higher privatisation receipts, and strong zloty. Those are good pieces of news for the fixed income market, however they were priced-in already.
Elżbieta Suchocka-Roguska, deputy finance minister Reuters, 29 December The deficit will be better than previously envisaged as a result of very good revenue figures. Budget gap is likely to be 4-5 billion zlotys lower. [...] Liquidity deposit will reach ca. 2 billion zlotys at the year-end. Reuters, 28 December The deficit will come in 3.5 billion zlotys lower [than planned] and this estimate should not change much more. It can be treated as a final forecast.	Comments of deputy finance minister create some confusion on the market from time to time. At the end of last year it turned out that her "final estimate" of 2004 budget gap was not so much final. Following days brought information that the deficit was lower than planned by over PLN4bn rather than PLN3.5bn, and later comments of minister Gronicki suggested it was more than PLN5bn. Additional muddle was introduced by deputy minister's statement that budget liquidity deposit dropped to PLN2bn in December from almost PLN21bn in November. At the start of January, however, there was new information that budget liquidity at the end of 2004 was at ca. PLN10bn.
Reuters, 27 December Acceleration of EU contribution payment in the first months of next year implies increase in deficit in the first quarter. In January budget gap will reach ca. 20% [of annual plan], and after Q1 it could reach 40%.	High deficit at the beginning of the year is connected with higher payments to the EU budget. Additionally, payments of education subsidies and higher transfer to the Social Security Fund are scheduled for January.
Jacek Socha, treasury minister Radio PiN, 31 December [Privatisation revenues of] PLN5.7bn are written down in the budget act and we maintain this level. [...] However, this amount could be topped. In the case of PZU sale, then it would be several billion zlotys more. If there is a row [with Eureko], then there is no IPO. I do not imagine approving public offering during a row [...]. In the case of agreement, then we have very stringent agenda and offering in Warsaw is at the beginning of June.	If the agreement between the Polish government and Eureko takes place, PZU public offering is very likely in June. Thanks to inflows from this IPO and also sale of part PGNiG gas company, privatisation receipts might exceed planned levels (almost twice!) in the second consecutive year. It would allow for reduction of budget borrowing needs. However, it is still uncertain whether PZU offering will take place. Treasury minister said it is conditional on the parliament's approval for agreement with Eureko. Meanwhile, the Sejm started investigation on irregularities during PZU privatisation in 1999-2001. Deputies might be hesitant to back the agreement during the investigation.
Marek Dyduch, SLD secretary general Reuters, 10 January June 19 is the date [of parliamentary elections] agreed by the party leadership and the president at a meeting late last month. [...] SLD parliamentary caucus will decide about election date in voting, in March at the latest. However, I am convinced it will agree on date in spring. June 19th is the most convenient date because of holidays calendar.	Although senior management of the SLD have agreed with the President Aleksander Kwaśniewski that parliamentary elections should be held on 19 June 2005, one should remember that election date depends in fact on deputies, rather than party leaders. In order to have election in spring, motion on parliament's self-dissolution must be backed by two-thirds of deputies in the Sejm (307 votes). Success of this motion is very uncertain, taking into account low public support for the left-wing parties, shown in opinion polls.

Market monitor

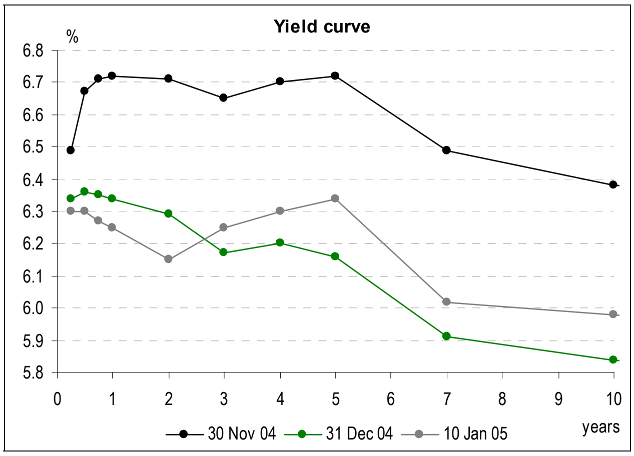


Considerable demand amid low liquidity

▪ In December the zloty gained 2.20% to dollar and 3.33% to the euro. While within last three weeks the euro rate was being retained at average level of 4.10, that is around our forecast of average rate for 1Q, then dollar fluctuated substantially recording levels even below PLN3.

▪ Before year-end the zloty appreciation occurred, which was connected with meaningful demand from foreign investors amid low liquidity. Moreover, strong increases of euro against dollar had an impact. The tendency was supported also by comments from government's and central bank's representatives.

▪ The zloty as a peripheral currency will be closely related to the euro. Until non-market risks begin to loom, the zloty will remain strong and persistence of euro above 1.30 may cause renewed testing the barrier of PLN3 to the dollar.

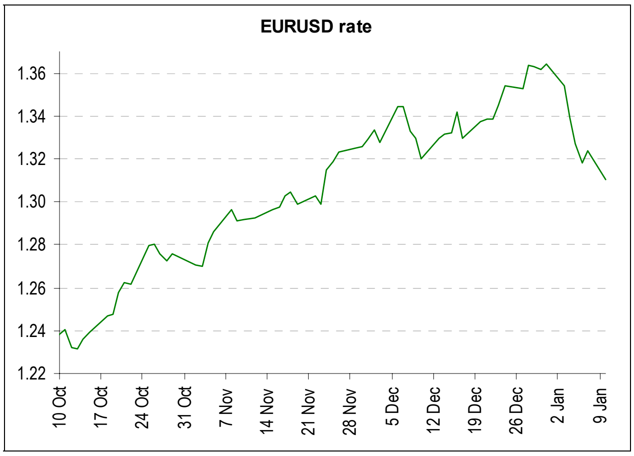


Delayed supply

▪ Last month yield curve moved downwards, changing its shape into positive in the first week of January. 2y paper yield declined by 52 bp to 6.19%, however 5y by 35 bp to 6.37%.

▪ Usual supply shortfall in December in the presence of large demand from investors was the main driving force in the market. But announcement of substantial tenders in 1Q05 enabled market rates to revert to pre-Christmas levels.

▪ The market currently awaits the auction of longer dated papers, first 10-year, then 5-year. Bonds offers (details are in the table overleaf) will probably meet some reception from investors, but release only in February of important data concerning January CPI and new updated inflation projection may trigger further yields increase.

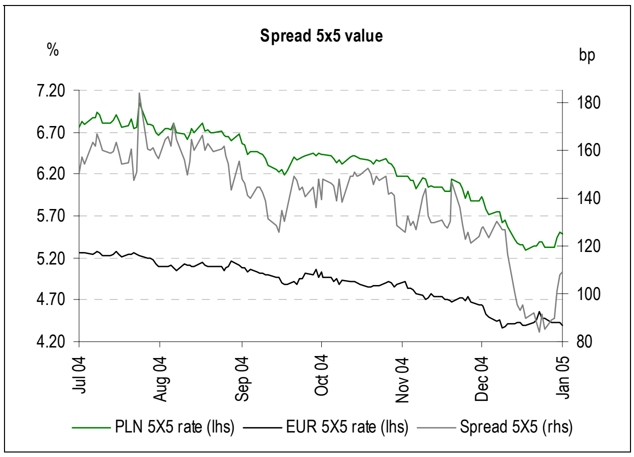


High volatility

▪ December brought distinct euro strengthening that gained during this period 2.88%. However, taking into account the New Year's correction the euro recorded decline of its value by 1.15%.

▪ It took place owing to strong technical movement that was seen after crossing of 1.30 mark, series of data pointing to record high C/A deficit and dwindling inflow of capital financing twin deficits in USA. The slump was induced by hawkish comments from the Fed and US government declaration about the need to cut deficits.

▪ Though short-term euro prospects seem not to be supportive, yet we still believe that it is to early to think about the trend change. Fed's interest rate hikes and government actions might only refrain further EUR/USD gains.



Source: Reuters, BZ WBK

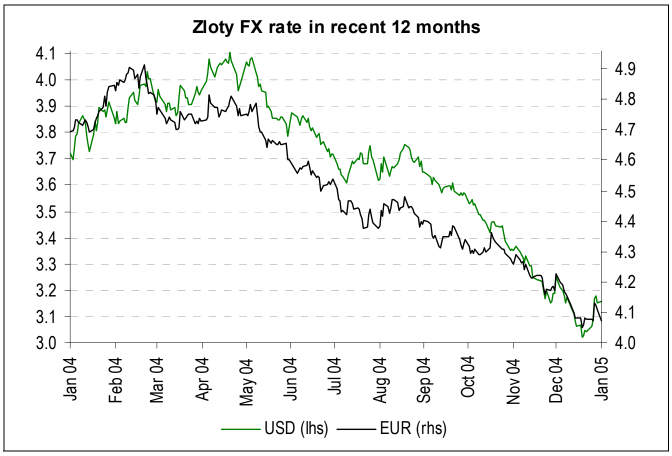
Spread stable, unless election

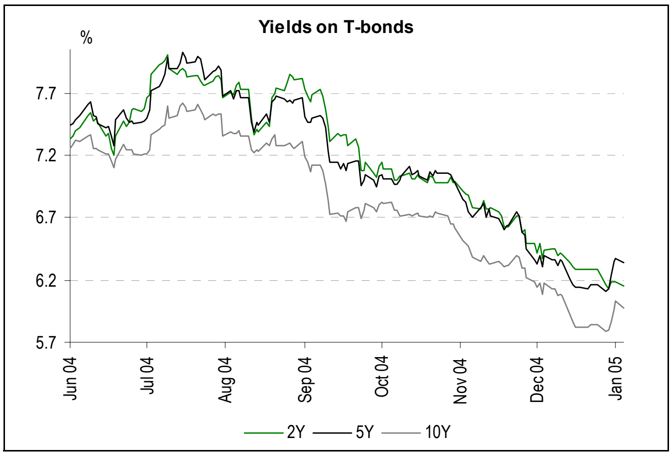
▪ The difference between rates 5x5 systematically diminished from 130 bp along with decline of market rates in Poland. But its narrowing, that took place amid the lowest liquidity in the market from 115 to 85 bp, was actually entirely erased yield rise along the Polish curve.

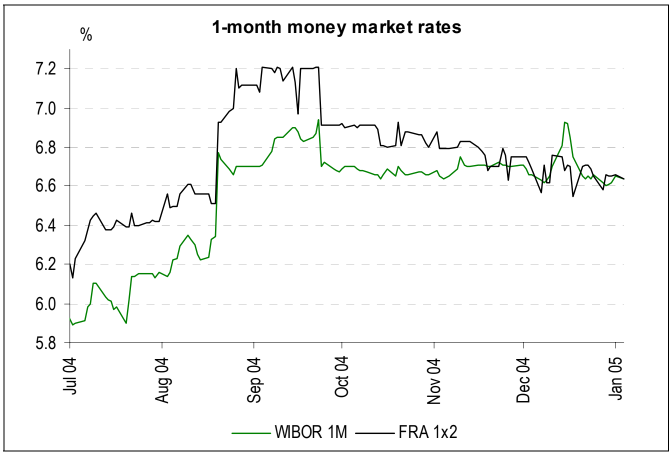
▪ Spread between 10y papers in Germany and USA widened from 52 bp to current 67 (respectively 3.60% and 4.27%). That shows the premium for investing into American bonds still rises amid record high budget deficit.

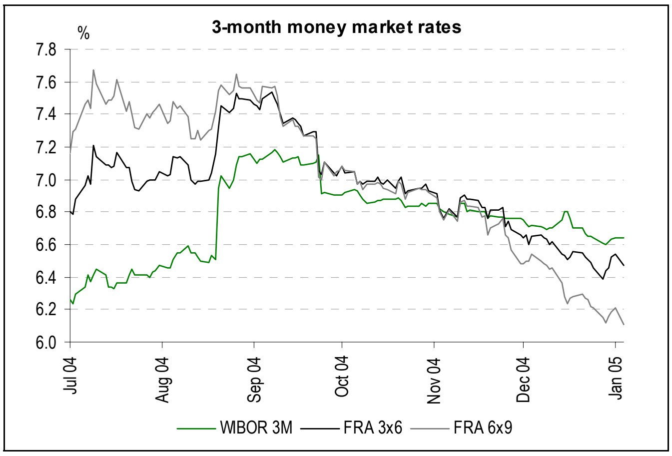
▪ In the near future spread 5x5 is expected to stabilise between 105-115bp., as both Polish and European market will face this month elevated bonds supply. But we expect that it will experience a widening, as parliamentary elections date approaches.

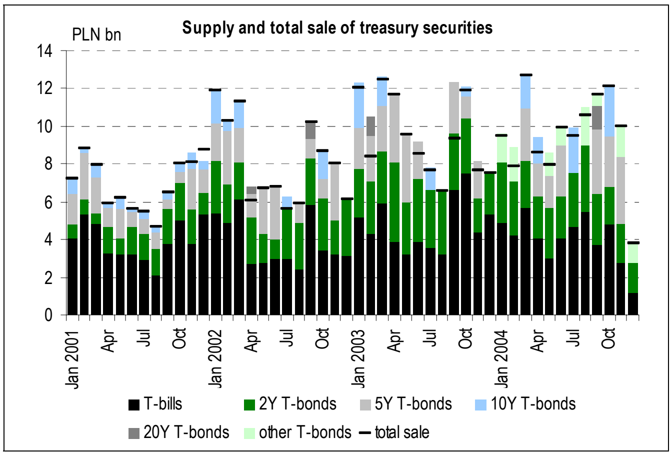
Market monitor











Treasury bill auctions (PLN m)

Date of auction	OFFER / SALE 13-week	52-week	Total
6.12.2004	-	400 / 400	400 / 400
13.12.2004	-	300 / 300	300 / 300
20.12.2004	100	400 / 400	500 / 500
total December	**100**	**1 100 / 1 100**	**1 200 /1 200**
03.01.2005	100 / 100	700 / 700	800 / 800
10.01.2005	100 / 64	600 / 600	700 / 664
17.01.2005	100	600-900	700-1000
24.01.2005	-	600-900	600-900
31.01.2005	-	600-900	600-900
total January*	**300 / 164**	**3100-4300 / 1 300**	**3400-4600 / 1464**

* estimations based on Ministry of Finance preliminary information

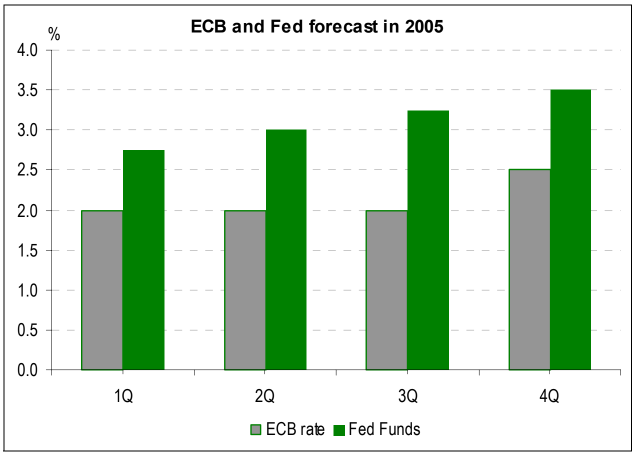
Treasury bond auctions in 2005(PLN m)

month	First auction date	T-bonds	offer	sale	Second auction date	T-bonds	offer	sale	Third auction date	T-bonds	offer	sale
January	05.01	OK0407	2 000	2 000	12.01	DS1015	2 600	-	19.01	PS0310	2 500-3 500	-
February	02.02	OK0407	-	-	09.02	IZ0816	500-2 000	-	16.02	PS0310	-	-
March	02.03	OK0407	-	-	09.03	WS0922	1 000-2 000	-	16.03	PS0310	-	-
April	06.04	2Y	-	-	13.04	10Y	-	-	20.04	5Y	-	-
May	04.05	2Y	-	-	11.05	12Y CPI	-	-	18.05	5Y	-	-
June	01.06	2Y	-	-	08.06	3&7Y Float	-	-	15.06	5Y	-	-
July	06.07	2Y	-	-	13.07	10Y	-	-	20.07	5Y	-	-
August	03.08	2Y	-	-	10.08	12Y CPI	-	-	-	-	-	-
September	07.09	2Y	-	-	14.09	20Y	-	-	21.09	5Y	-	-
October	05.10	2Y	-	-	12.10	10Y	-	-	19.10	5Y	-	-
November	02.11	2Y	-	-	09.11	12Y CPI	-	-	16.11	5Y	-	-
December	07.12	3&7Y Float	-	-	-	-	-	-	-	-	-	-

* with supplementary auction

Source: Ministry of Finance, Reuters, BZ WBK

International review

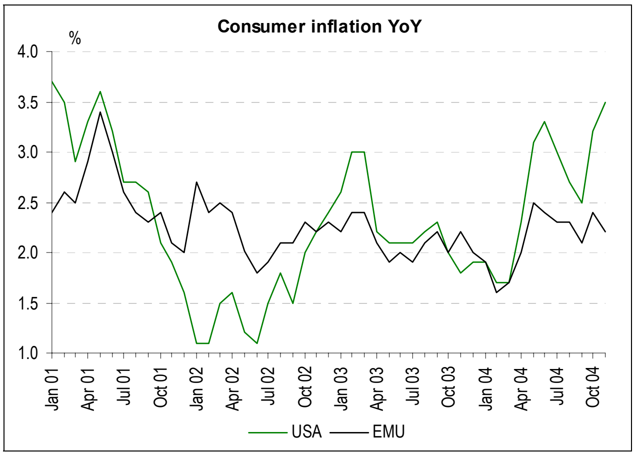


Consistent Fed decision

▪ On its last meting on December 14th FOMC hiked interest rates in line with expectations by another 25 bp to 2.25%. US central bank retained the same rhetoric about gradual normalisation of interest rates.

▪ This year the lag in publication of minutes from FOMC meeting was shortened from six to three weeks what is intended to make Fed decisions more transparent for financial markets. Minutes published on January 4th (concerning the latest meeting) brought decisive FOMC statement that current level of interest rates is too low to curb inflation, which increased again. Thus on the next meeting on February 1-2nd another hike by 25bp is expected.

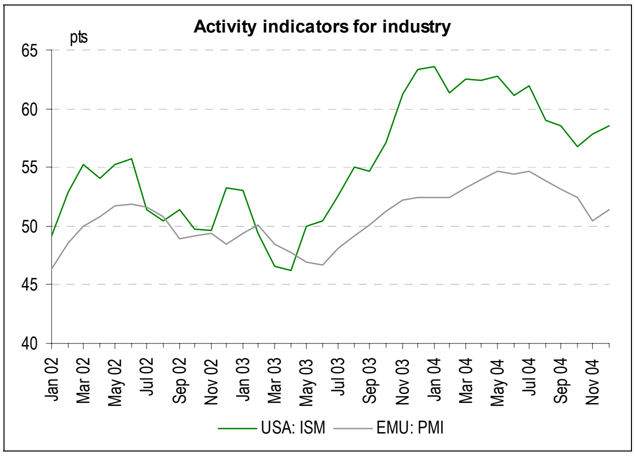
▪ Next ECB meeting is scheduled for January 13th, but owing to inflation ease and strong euro, interest rates change seems to be unlikely.



US inflation up, down in euro zone

▪ November HICP for euro zone eased by 0.1% and rose in annual terms by 2.2%. Decline in oil prices in various markets slowly begins to signal its presence, which caused inflation surge in recent months. But ECB still remains concerned by inflation level, as index persistently retains above the bank's inflation target.

▪ Positive factor of lower fuel prices had an impact on US inflation. US CPI rose only by 0.2%MoM against 0.6% a month earlier. However, in annual terms inflation still rises recording in growth of 3.5% in November. Also core inflation increased to 2.2%YoY. In the foreseeable future US inflation may be even higher, but not fast enough so as to force the Fed to hike rates more aggressively.

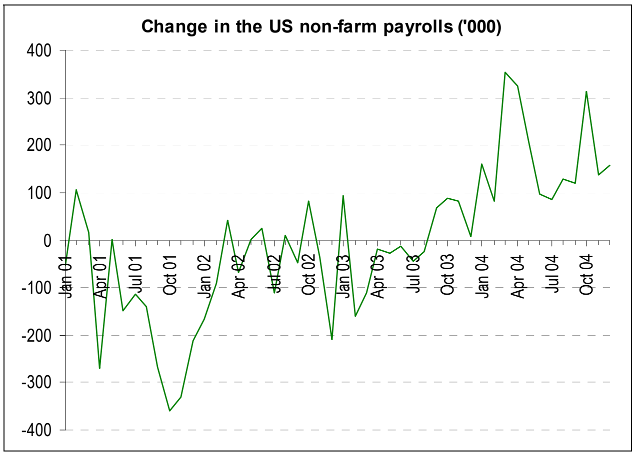


Activity indicators rise but doubts stay in place

▪ The most important activity indicator in manufacturing sector of the American economy rose to 58.6 in December. New orders recorded decent growth what confirmed investment demand recovery. But employment index suffered a decline casting doubts about labour market conditions.

▪ In December euro zone PMI index experienced, for the first time for five months, increase to 51.4. The biggest growth was observed in Germany - from 49.9 (contraction) to 51.7 (expansion). Despite such optimistic data there are no grounds to announce the end of euro zone economic problems, especially strong euro negatively influences export orders performance.

▪ US GDP growth in 3Q04 was revised to 4.0%QoQ from 3.9%.



Source: Reuters, ECB, Federal Reserve

No surprise this time

▪ December employment data showed the change in on-farm payrolls of 157,000 against expectations of 175,000. However the correction was made to previous results by altogether 34,000 of new jobs. The unemployment rate remained unchanged at 5.4%. These data showed that US labour market still lags the other sectors of the American economy, but not to the extent that would hold off the Fed from further interest rate hikes.

▪ December Index IFO recorded an increase to 96.2, from 94.1 in November. It was heralded by higher reading of ZEW index published in 1H of December. In the statement, the Institute said that the firms not only noticeably improved their assessment of current business conditions, but also future outlook for the coming 6 months.

What's hot this month

Monday	Tuesday	Wednesday	Thursday	Friday
3 January 2005 ***POL: Treasury bills auction*** USA: ISM Manufacturing (XII)	**4** FRA: GDP (3Q04) GER: Unemployment rate (XII) USA: Factory orders (XI) USA: Durable goods orders - R (XI)	**5** ***POL: 2y bond auction (OK0407)*** GER: Retail sales (XI)	**6** FRA: Consumer confidence (XII) EMU: PPI (XI) EMU: Business climate (XII)	**7** ***POL: Reserve assets (XII)*** EMU: Unemployment rate (XI) EMU: Retail sales (XI) GER: Industrial orders (XI) USA: Non-farm payrolls (XII) USA: Unemployment rate (XII)
10 ***POL: Treasury bills auction*** USA: Wholesale inventories (XI)	**11** FRA: Trade balance (XI) FRA: Industrial production (XI) GER: ZEW index (I) GER: Industrial production (XI)	**12** ***POL: 10y bond auction (DS1015)*** USA: International trade (XI) USA: Fed budget (XII)	**13** EMU: ECB Meeting USA: Retail sales (XII) USA: Import prices (XII)	**14** ***POL: Money supply (XII)*** USA: PPI (XII) USA: Business inventories (XI) USA: Industrial production (XII) USA: Capacity utilization (XII)
17 ***POL: Treasury bills auction*** ***POL: Employment (XII)*** ***POL: Gross wages (XII)*** ***POL: CPI (XII)*** ITA: Final HICP (XII)	**18** EMU: Industrial production (XI) USA: New York Fed (I)	**19** ***POL: 5y bond auction (PS0310)*** USA: CPI (XII) USA: Housing Starts (XII)	**20** ***POL: PPI (XII)*** ***POL: Industrial production (XII)*** EMU: ECB C/A balance EMU: Final HICP (XII) USA: Leading Indicators (XII) USA: Philadelphia Fed (I)	**21** ***POL: Business climate (XII)*** FRA: Consumer spending (XII) FRA: Final HICP (XII)
24 ***POL: Treasury bills auction*** ***POL: Unemployment rate (XII)*** ***POL: Retail sales (XII)***	**25** USA: Home sales (XII) USA: Consumer confidence (I)	**26** ***POL: MPC meeting (decision)*** GER: IFO Index (I)	**27** ***POL: Switching auction*** USA: Durable Goods Orders (XII)	**28** FRA: PPI (XII) EMU: Money Supply (XI) GER: Final HICP (XII) USA: GDP (4Q) USA: PCE (4Q) USA: Michgan Sentiment (I)
31 ***POL: Treasury bills auction*** ***POL: C/A balance (XI)*** ***POL: GDP for 2004*** FRA: Consumer confidence (I) EMU: Business climate (I)	**1 February** EMU: Unemployment rate (XII)	**2** ***POL: 2y bond auction (OK0407)*** EMU: PPI (XII)	**3**	**4** EMU: Retail sales (XII)

Source: CSO, NBP, Finance Ministry, Reuters

Data release calendar MPC meetings schedule for 2005

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
MPC meeting	25-26	24-25	29-30	26-27	24-25	28-29	26-27	30-31	27-28	25-26	29-30	20-21
GDP*	-	-	11	-	-	9	-	-	8	-	-	9
CPI	17	15[a]	14[b]	14	16	14	14	16	14	14	14	14
Core inflation	25	-	22[b]	22	24	22	22	24	22	24	22	22
PPI	20	17	17	19	20	17	19	18	19	19	18	19
Industrial output	20	17	17	19	20	17	19	18	19	19	18	19
Retail sales	24	21	21	21	23	21	21	22	21	21	23	21
Gross wages, employment	17	15	15	15	18	15	15	16	15	17	17	15
Unemployment	24	21	21	21	23	21	21	22	21	21	23	21
Foreign trade	about 50 working days after reported period											
Balance of payments*	-	-	31	-	-	-	-	-	-	-	-	-
Balance of payments	31[c]	28	31	29	-	-	-	-	-	-	-	-
Money supply	14	14	14	14	-	-	-	-	-	-	-	-
NBP balance sheet	7	7	7	7	-	-	-	-	-	-	-	-
Business climate indices	21	21	22	22	20	22	22	22	22	21	22	22

* quarterly data, [a] preliminary data, January, [b] January and February, [c] November 2004, [d] January [e] February , *Source: CSO, NBP*

Economic data and forecasts

Monthly economic indicators

		Dec 03	Jan 04	Feb 04	Mar 04	Apr 04	May 04	Jun 04	Jul 04	Aug 04	Sep 04	Oct 04	Nov 04	Dec 04	Jan 05
Industrial production	%YoY	13.9	14.4	18.3	23.5	21.8	12.2	15.8	6.0	13.7	9.5	3.5	11.3	10.2	7.1
Retail sales [c]	%YoY	17.3	7.6	12.1	20.7	30.6	4.0	8.6	10.9	9.6	8.8	4.0	4.4	6.0	16.9
Unemployment rate	%	20.0	20.6	20.6	20.4	19.9	19.5	19.4	19.3	19.1	18.9	18.7	18.7	19.1	19.6
Gross wages [b c]	%YoY	5.1	3.5	6.3	7.0	4.6	4.4	4.5	3.6	5.1	3.7	2.4	2.7	3.5	4.9
Employment [b]	%YoY	-3.5	-1.4	-1.5	-1.3	-1.1	-0.9	-0.7	-0.7	-0.8	-0.6	-0.4	-0.3	-0.1	-0.1
Export [d]	%YoY	16.4	10.6	18.3	28.2	27.9	24.9	34.5	14.6	21.5	17.7	19.4	18.0	14.7	16.3
Import [d]	%YoY	9.6	6.1	4.6	25.8	37.4	17.8	32.4	10.5	20.2	19.0	14.9	18.6	17.5	17.9
Trade balance [d]	EURm	-658	-369	-9	-535	-1 021	-232	-172	-509	-312	-326	-15	-524	-900	-500
Current account balance [d]	EURm	-770	-130	-14	-447	-541	-416	-379	-532	97	-334	234	-324	-720	-300
Current account balance [d]	% GDP	-2.2	-2.1	-1.7	-1.7	-1.7	-1.7	-1.8	-1.8	-1.7	-1.8	-1.9	-1.8	-1.8	-1.7
Budget deficit (cumulative)	PLNbn	-37.0	-4.2	-9.4	-11.8	-11.0	-15.3	-19.9	-23.2	-25.9	-29.0	-30.8	-33.8	-40.8	-6.3
Budget deficit (cumulative)	% realisation	100.0	9.3	20.7	26.1	24.3	33.8	43.9	51.3	57.1	63.9	67.9	74.6	90.1	18.0
CPI	%YoY	1.7	1.6	1.6	1.7	2.2	3.4	4.4	4.6	4.6	4.4	4.5	4.5	4.6	5.0
PPI	%YoY	3.7	4.1	4.2	4.9	7.6	9.6	9.1	8.6	8.5	7.9	7.6	6.7	6.3	5.9
Broad money (M3)	%YoY	5.6	5.1	5.1	5.7	8.5	6.4	7.2	6.8	7.4	6.5	10.5	6.4	6.8	6.6
Deposits	%YoY	3.7	3.4	3.5	4.8	8.4	6.2	6.9	6.4	7.6	6.6	11.5	6.5	6.4	6.5
Credits	%YoY	8.1	7.4	7.7	6.1	8.5	6.1	5.7	4.6	5.2	4.2	9.5	4.1	4.8	5.2
USD/PLN	PLN	3.79	3.74	3.84	3.89	3.97	3.93	3.78	3.64	3.64	3.58	3.46	3.28	3.09	3.08
EUR/PLN	PLN	4.66	4.71	4.85	4.77	4.76	4.72	4.59	4.47	4.43	4.37	4.32	4.26	4.14	4.10
Reference rate [a]	%	5.25	5.25	5.25	5.25	5.25	5.25	5.25	6.00	6.50	6.50	6.50	6.50	6.50	6.50
WIBOR 3M	%	5.69	5.46	5.46	5.49	5.69	5.99	5.91	6.34	6.58	7.12	6.89	6.81	6.72	6.60
Lombard rate [a]	%	6.75	6.75	6.75	6.75	6.75	6.75	6.75	7.50	8.00	8.00	8.00	8.00	8.00	8.00
Yield on 52-week T-bills	%	6.02	5.59	5.78	5.87	6.20	6.65	6.79	7.15	7.24	7.38	7.00	6.81	6.44	6.25
Yield on 2-year T-bonds	%	6.49	6.17	6.34	6.34	6.83	7.41	7.44	7.80	7.66	7.51	7.04	6.81	6.39	6.20
Yield on 5-year T-bonds	%	6.82	6.65	6.76	6.60	7.13	7.57	7.50	7.79	7.65	7.33	7.03	6.78	6.29	6.30
Yield on 10-year T-bonds	%	6.75	6.65	6.81	6.65	7.02	7.32	7.27	7.44	7.36	6.96	6.75	6.43	6.02	5.90

Source: CSO, NBP, Finance Ministry, BZ WBK own estimates

[a] at the end of period [b] in corporate sector [c] in nominal terms [d] balance of payments data on transaction basis

Quarterly and annual economic indicators

		2002	2003	2004	2005	1Q04	2Q04	3Q04	4Q04	1Q05	2Q05	3Q05	4Q05
GDP	PLNbn	781.1	814.7	887.1	965.4	203.8	216.1	218.8	248.4	224.0	235.5	237.4	270.9
GDP	%YoY	1.4	3.8	5.7	5.2	6.9	6.1	4.8	5.1	4.7	5.0	5.2	5.7
Total consumption	%YoY	2.8	2.5	3.2	3.6	3.3	3.5	2.9	3.1	3.5	3.4	3.6	3.9
- Private consumption	%YoY	3.3	3.1	3.8	4.2	3.9	3.8	3.5	3.8	4.0	4.0	4.2	4.5
Fixed investments	%YoY	-5.8	-0.9	6.2	10.2	3.5	3.6	4.1	10.0	12.0	11.0	10.0	9.2
Industrial production	%YoY	1.1	8.7	13.3	8.5	19.0	16.4	9.7	8.3	4.7	7.1	10.2	11.9
Retail sales (real terms)	%YoY	1.9	7.9	7.4	8.4	13.6	11.3	4.7	-0.1	7.4	4.6	11.2	10.4
Unemployment rate [a]	%	20.0	20.0	19.1	17.9	20.4	19.4	18.9	19.1	19.4	18.3	17.8	17.9
Gross wages (real terms)	%YoY	1.5	2.0	0.8	1.5	3.8	1.6	-0.7	-1.6	0.1	1.8	2.7	3.1
Export [b]	%YoY	6.0	9.1	20.8	11.0	19.3	29.1	17.6	17.5	14.0	11.0	10.0	10.0
Import [b]	%YoY	3.5	3.3	18.7	13.0	12.6	29.3	16.3	16.9	17.0	10.0	12.0	12.0
Trade balance [b]	EURm	-7 701	-5 077	-4 934	-6 479	-909	-1 438	-1 148	-1 439	-1497	-1412	-1616	-1 953
Current account balance [b]	EURm	-5 404	-4 109	-3 507	-4 212	-592	-1 338	-767	-810	-973	-988	-1 212	-1 465
Current account balance [b]	% GDP	-2.7	-2.2	-1.8	-1.8	-1.7	-1.8	-1.8	-1.8	-1.9	-1.6	-1.8	-2.0
Budget deficit (cumulative) [a]	PLNbn	-39.4	-37.0	-39.4	-35.0	-11.8	-19.9	-29.0	-39.4	14.0	22.8	29.8	35.0
Budget deficit (cumulative) [a]	% GDP	-5.0	-4.5	-4.4	-3.6	-5.8	-3.7	-4.1	-4.2	6.3	3.0	2.9	1.9
CPI	%YoY	1.9	0.8	3.5	3.5	1.6	3.3	4.5	4.5	5.0	3.6	2.7	2.6
CPI [a]	%YoY	0.8	1.7	4.6	2.6	1.7	4.4	4.4	4.6	4.9	2.8	2.7	2.6
PPI	%YoY	1.0	2.6	7.1	3.2	4.4	8.8	8.3	6.9	5.3	2.0	2.3	3.2
Broad money (M3) [a]	%YoY	-2.0	5.6	6.8	5.6	5.7	7.2	6.5	6.8	6.5	6.6	9.9	10.1
Deposits [a]	%YoY	-4.1	3.7	6.4	3.8	4.8	6.9	6.6	6.4	6.2	6.9	10.2	10.0
Credits [a]	%YoY	5.2	8.1	4.8	11.0	6.1	5.7	4.2	4.8	5.9	6.3	8.6	10.1
USD/PLN	PLN	4.08	3.89	3.65	3.06	3.82	3.89	3.62	3.27	3.06	3.03	3.13	3.04
EUR/PLN	PLN	3.85	4.40	4.53	4.14	4.78	4.69	4.43	4.24	4.10	4.15	4.22	4.10
Reference rate [a]	%	6.75	5.25	6.50	6.50	5.25	5.25	6.50	6.50	6.50	6.50	6.50	6.50
WIBOR 3M	%	9.09	5.69	6.21	6.55	5.47	5.87	6.68	6.81	6.60	6.60	6.50	6.50
Lombard rate [a]	%	8.75	6.75	8.00	8.00	6.75	6.75	8.00	8.00	8.00	8.00	8.00	8.00
Yield on 52-week T-bills	%	8.18	5.33	6.50	6.20	5.75	6.24	7.26	6.75	6.22	6.20	6.30	6.10
Yield on 2-year T-bonds	%	7.94	5.38	6.89	6.23	6.28	6.86	7.66	6.75	6.20	6.20	6.40	6.10
Yield on 5-year T-bonds	%	7.86	5.61	7.02	6.30	6.67	7.10	7.59	6.70	6.30	6.40	6.50	6.00
Yield on 10-year T-bonds	%	7.34	5.77	6.84	5.95	6.70	7.00	7.25	6.40	5.90	6.00	6.10	5.80

Source: CSO, NBP, Finance Ministry, BZ WBK own estimates

[a] at the end of period [b] balance of payments data on transaction basis

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