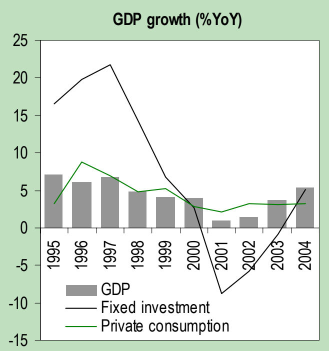
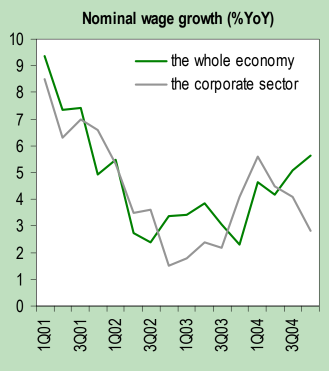
Bank Zachodni WBK

MACROscope

Polish Economy and Financial Markets

February 2005





In this issue:

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Growth on credit

- **The Polish economy is continuing the expansion, however regardless of this, data from monetary sector do not show increase in demand for loans.** Are the current events in the monetary area a portent of imminent slow-down in the Polish economy? Since the topic has not been examined thoroughly enough, this month we decided to take a closer look at the loan market to try to understand and identify the reasons and nature of the credit growth deceleration. Closer look at the data suggests that the observed aggregate changes are a product of a range of overlapping phenomena which slightly blur the fact that the demand for new loans has risen sharply recently which is mostly justified with intensifying investment boom.

- **Economic data published recently were disappointing.** Industrial output and retail sales recorded a notable slowdown, while GDP data for 2004 suggested merely 4.1% GDP rise in the fourth quarter. Undoubtedly, very high economic growth in the first half of 2004 was a bit on credit (due to EU accession), and this will be reflected in slowdown this year (statistical base effect). Nevertheless, it is hard to judge to what extent recent statistical figures were an accident, and to what extent it was a beginning of more distinct economic slowdown and a significant risk factor for realisation of budgeted GDP growth forecast (as well as our forecast) of 5% this year. In the last quarter of 2004 private consumption was growing really slowly (a mere 1.6% rise), however data on investment were indeed optimistic, as they showed continuing acceleration of growth (to over 7%). We forecast investment to grow in double digits this year, which is suggested e.g. by very high ratio of capacity utilisation, presented in NBP's survey of business climate. We perceive low growth of private consumption in 4Q04 as a temporary phenomenon. One should notice that contrary to what is shown by data from corporate sector, wages in entire economy rose faster than inflation in the last quarter of 2004 (and in the preceding quarter as well).

- **We uphold our forecast of change in monetary policy bias in February and maintaining interest rates unchanged until the end of this year.** Shift into neutral bias, which has been signalled by the MPC members, should not be interpreted as a step towards swift interest rate reductions, but rather it would reflect a favourable change in balance of risks for future inflation (which will be probably shown by February's inflation projection). Such point of view was confirmed by comments of the MPC members, suggesting that there was no room for monetary easing as long as there exists risk of zloty depreciation due to significant political uncertainty (details in *Central bank watch* section). In other words, the recent rise in zloty value could be a bit on credit and this trend could reverse before the election, which result (and timing) is still uncertain.

Financial market on 31 January 2005:					
NBP deposit rate	5.00	WIBOR 3M	6.61	PLN/USD	3.1200
NBP reference rate	6.50	Yield on 52-week T-bills	6.23	PLN/EUR	4.0503
NBP lombard rate	8.00	Yield on 5-year T-bonds	6.20	EUR/USD	1.2982

This report is based on information available until 11.02.2005

Special focus

There is something about loans

All is well but the loan

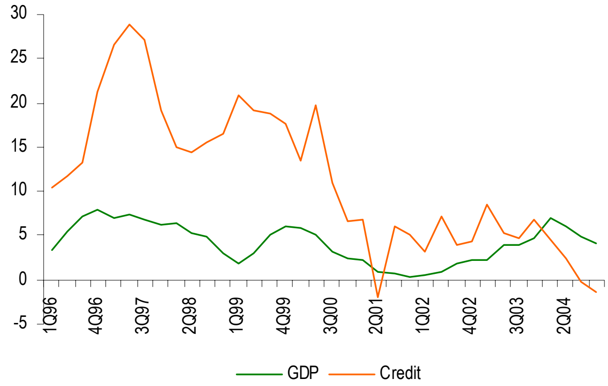
For many months we have been informing that the Polish economy is continuing its expansion. 2004 was closed with a GDP growth by 5.4% while this year the expected growth pace is ca. 5%. Even though the statistical data for December and preliminary 2004 GDP data revealed a certain weakening in the GDP growth in the last quarter of last year, which can continue in the beginning of this year, the general economic condition of Poland is still relatively good and the economy is undoubtedly in its upwards cycle. The evidence of this are, for example, signals, increasingly strong each month, of distinct growth in investments which starting with early 2005 should be increasing on a two-digit figure base.

Interestingly enough, expansion of most real economy sectors is not accompanied yet by a growth in activity in the monetary area, and in particular in the loan market. Or at least that is the first glance impression. So far, this phenomenon has not been given too much attention in macroeconomic analyses; even the Monetary Council Policy seems to take this as a matter of fact. But in fact this is not fully justified. Quite frequently, it is the very changes in the credit market which allow to envisage acceleration or deceleration of the GDP growth in advance. The tendencies observed at present in the credit area seem to be in sharp contrast with the progressing expansion in economic activity reported from other economic areas, particularly, in terms of investments. Are the current events in the monetary area a portent of imminent slow-down in the Polish economy? Since the topic has not been examined thoroughly enough, this month we decided to take a closer look at the loan market to try to understand and identify the reasons and nature of the credit dynamics deceleration to be able to answer to what extent these phenomena can prove permanent and threaten continuation of growth trends of the whole economy. The text below is also a preface to a more in-depth analysis of demand for the Polish non-financial sector's loan. We will try to present it in early Q2 this year.

Slow-down despite revival

For a start, let's take a look at the tendencies that have been observed in the banking loans market in Poland. Throughout the better part of the economic transformation period, total credit in the banking system grew at a real pace much exceeding the GDP growth dynamics (see the chart). This trend decelerated distinctly in the period of economic slow-down in the years 2001-2002, yet even then, the credit market development (after adjustment by the inflation rate) was much ahead of the GDP growth.

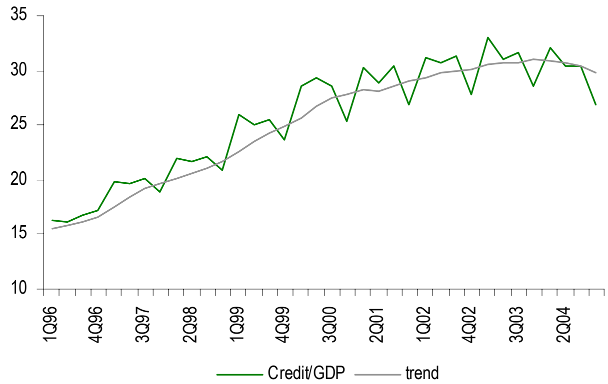
Annual growth of the GDP and total credit in the banking system (in real terms, %YoY)



Source: GUS, NBP, own estimates

A consequence of this was a regular growth in the relation between the total loan and GDP throughout most of the economic transformation. The ratio nearly doubled over the past decade – from ca. 15% in the mid 90s to over 30% at the peak point of 2003[1].

Total loans and borrowings to GDP (%)



Source: GUS, NBP, own estimates

Interestingly enough, a distinct shift in the credit market took place in parallel with a robust speed up of economic growth in early 2004. The real loans growth entered a downward phase to drop below 0 in the second half of last year despite maintaining the GDP growth at a decent level and strengthening upwards tendencies as regards investment growth. We will try to ponder a bit on what could possibly happen to trigger a

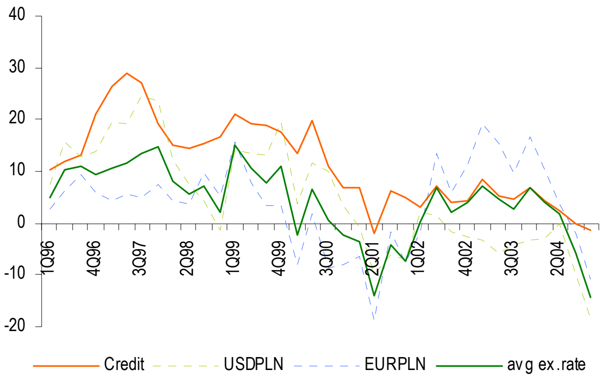
[1] It is worth emphasizing, however, that despite the growth in the credit/GDP ratio, it is still much lower in Poland than in developed market economies. The average ratio for the EU 15 member states (from before enlargement in 2004) was ca. 120%.

sudden and relatively permanent (sustained for a over a year now) reversal in the relation between economic activity growth and the loan.

First: exchange rate

The first factor suspected of driving down credit growth in the Polish banking system is the f/x exchange rate which since May 2004, has been incessantly appreciating as a result of which the zloty strengthened in H2 2004 by ca. 20% against the US dollar and by 10% against the Euro. Even a cursory look at the real loan dynamics and nominal zloty exchange rate changes suggests that these variables are closely correlated (see the chart below).

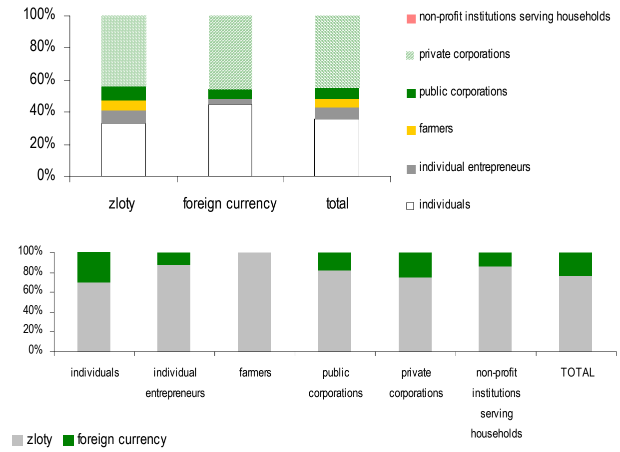
Real credit and exchange rate growth (%YoY)



Source: NBP, own estimates

This is not happening for no reason as detailed NBP data re. monetary receivables of financial institutions[2] (MIF) from the non-financial sector[3] (as at the end of December 2004) indicate that foreign currency credit represents quite a high percentage, i.e. nearly 25% of the total receivables. The highest concentration of f/x credit has been recorded in the case of private individuals (30%) as well as private companies (25%). It is worth noticing at this point that receivables from those two groups: private individuals and businesses clearly dominate in the sectoral breakdown of MIF receivables from the non-financial sector (their respective share is 36% and 44%, i.e. in total 80% of total receivables, as at December 2004).

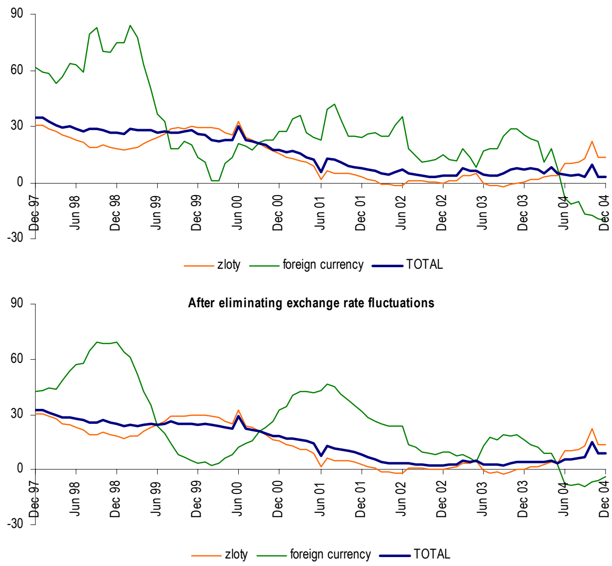
Structure of credit due to monetary financial institutions from the non-financial sector



Source: NBP, own estimates

Impact of exchange rate fluctuations can actually be easily eradicated, yet only roughly of course[4]. Our estimates imply that following such an adjustment, annual total credit growth for the non-financial sector as at the end of 2004 was slightly higher than 9%YoY rather than 3.2%YoY reported officially (see below).

Nominal credit growth before and after eliminating exchange rate fluctuations (%YoY)



Source: NBP, own estimates

Second: more than just the exchange rate

Still the exchange rate changes alone cannot fully account for the mystery which is the disappointing growth in the volume of loans over the past quarters. Or at least not only the direct exchange rate effect can be an explanation. The NBP statistics point to a very interesting phenomenon – drop in debt arising from f/x loans in a degree which significantly exceeds the pace

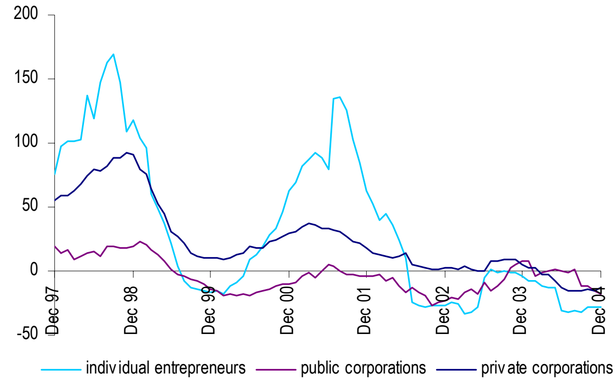
[2] Since March 2002, the National Bank of Poland has been gradually introducing the European Central Bank's standards in monetary statistics. According to this methodology until end-2004 , the notion "other monetary financial institutions" meant banks and "monetary financial institutions" (MIF) covered banks + NBP. Since January 2005, "other MIFs" has also included SKOKs (cooperative savings and credit union).

[3] Liabilities towards the non-financial sector represent vast majority (90% in December 2004) of total liabilities towards MIF. Other liabilities towards: non-monetary financial institutions (4%), local governments (4%), social insurance funds (2%).

[4] Only a rough estimate is possible as the NBP does not quote what is the share of individual currencies in f/x credit. For our calculations we have adopted the following split: 50% USD and 50% EUR.

of changes in the exchange rates in the currency market. What is more, this drop has been witnessed for a few months in the majority of loan categories related to business entities, regardless of which data cross-section we look at (sectors, loan purpose, or primary maturity). The scale of this drop often reaches a value of a few dozen percent per annum. This trend is observed in the case of all groups of businesses regardless of their size or ownership status. Theoretically, this can mean – at least in some cases – that the companies' preferences as regards the currency structure of the debt has changed and f/x loans are converted into the zloty. Especially that most often – except for the state-owned companies sector – reduction of the f/x debt is accompanied by an increase in PLN exposure. It is difficult, however, to find an economic justification for that taking into account the market conditions that emerged in mid 2004 – upwards trend in interest rates in Poland and a strong zloty appreciation tendency, which provides more economic case for raising debts in foreign currencies.

Growth of foreign currency credit for businesses after elimination of f/x fluctuations (%YoY)

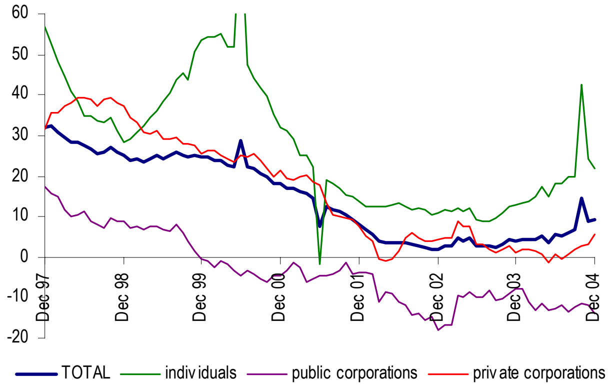


Source: NBP, own estimates

Third: repayment (what about execution?) of debts

If we look at the loan and borrowing dynamics with a breakdown into individual sectors and eliminate the effects of f/x fluctuations, the following picture emerges. For quite long now, the personal loan has displayed the highest rate of growth while the "weakest link" are undoubtedly loans sanctioned to businesses. To be specific, the biggest drop is recorded in the case of state companies which for over 5 years have consistently been reducing their bank debts. This very aspect may primarily stem from a regular decrease in the number of state enterprises (liquidation, privatization), or perhaps also from the shrinking of operations in the companies which still exist. However, hardly impressive are also debt growths in private partnerships or with single traders (employing up to 9 people). They are unsatisfactory at least taking into account long awaited, and recently more and more frequently signalled, accelerated increase in fixed investment outlays at the turn of 2004.

Growth of credit in the key sectors after elimination of f/x fluctuations (%YoY)

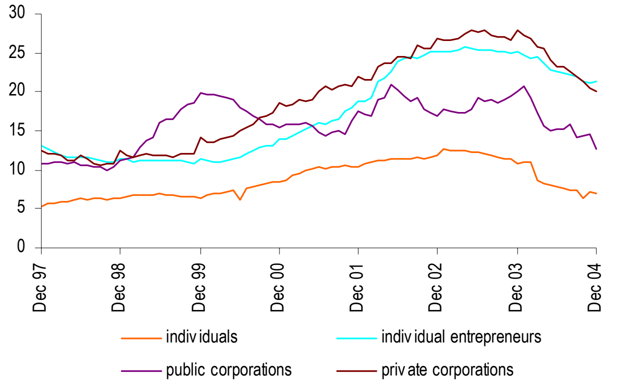


Source: NBP, own estimates

Outcome of the surveys run by the National Bank of Poland, to examine the situation in the loan market and the standing of companies indicate that in the business sector two parallel phenomena can be observed for quite long. On the one hand, growth in the companies' appetite for loans has been seen lately, particularly for SME loans, towards financing investments, stock and W/C requirements, and – which is a new phenomenon in Q1 2005 – loans for financing investments subsidized with EU funds. On the other hand, there is a large stable group of companies which have been cutting down on their liabilities towards banks for a long period of time. It seems then that the changes in the balance of the companies' debt are a product of two concurrent processes: growth in the portfolio of new loans for investments and development of more active companies and repayment of liabilities raised earlier by these entities which do not display investment activity (not necessarily is it voluntary repayment, but, for example, execution of the old non-repaid debt which has become feasible subsequent to the improvement in the company's financial standing).

The theory whereby the old debts are repaid on a massive scale seems to be confirmed by the NBP data on irregular loans – since the end of 2003 the share of bad loans in all the key categories has been decreasing, particularly in the case of receivables from private businesses and state enterprises. Distinct downward tendency in the percentage of bad loans, in the context of small or even negative total credit dynamics (when the denominator of this relation does not grow quickly) seems to be evidence that total debts not repaid on a regular basis ARE decreasing, so the overdue amounts are now being repaid to the banks by the debtors.

Share of non-performing credit (%)

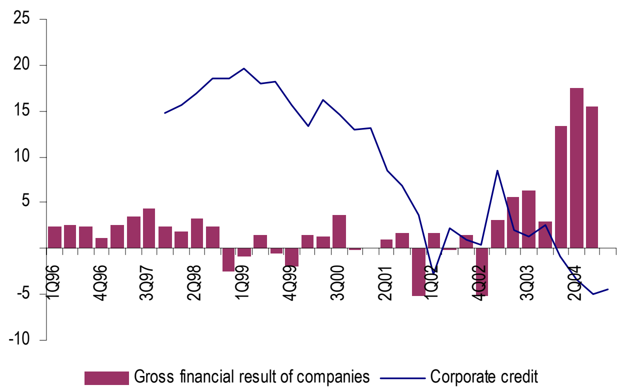


Source: NBP

Fourth: high profits generated by businesses

What has given the companies ability to repay debt raised earlier in the banking system is certainly quick, unprecedented on such a scale since the early 90s, improvement in the companies' financial performance (see the chart below), which is a consequence of economic revival in H1 of 2004. As a result, since the beginning of 2004, there has been a quick growth in stream of liquid financial assets which companies had (the surplus stayed, among others, in the businesses' banking accounts). Not only did it enable some companies to repay some "old" debts, but to some extent, it was a natural blockage in the increase in borrowing appetite in companies undertaking new investments.

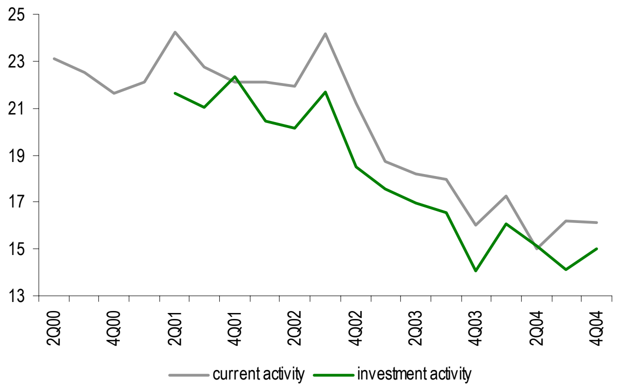
Growth in credit (YoY, PLN bn) vs. companies' gross financial result (PLN bn)



Source: NBP, GUS, own estimates

It is worth remembering that Polish enterprises' utilisation of the banking loan for financing investments is traditionally relatively low and according to the NBP research, towards the end of 2004 it was at ca. 15%. On the other hand, the utilisation of own funds for financing investments grew concurrently reaching one of the highest levels in the NBP research history (since beginning of 2001), ca. 75%. This seems to be consistent with the proposed theory whereby the companies' interest in the banking loan has weakened while the own funds are abundant as a result of improved financial standing.

Average share of bank credit in financing companies' activity (%)



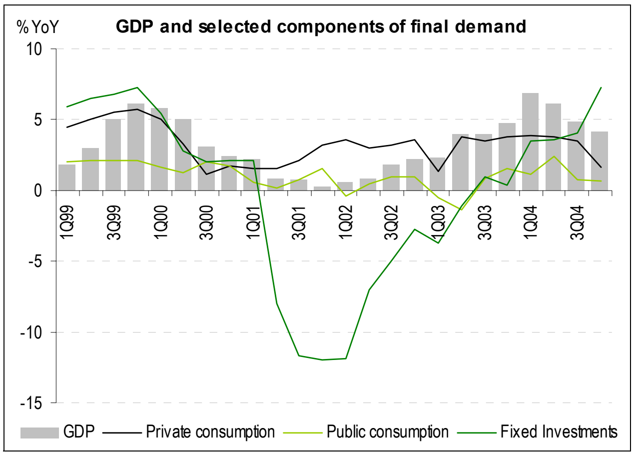
Source: NBP

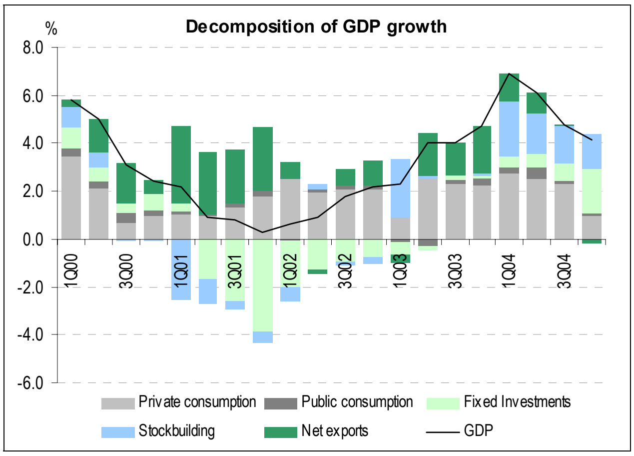
Conclusion: do not be misled by the low ratio

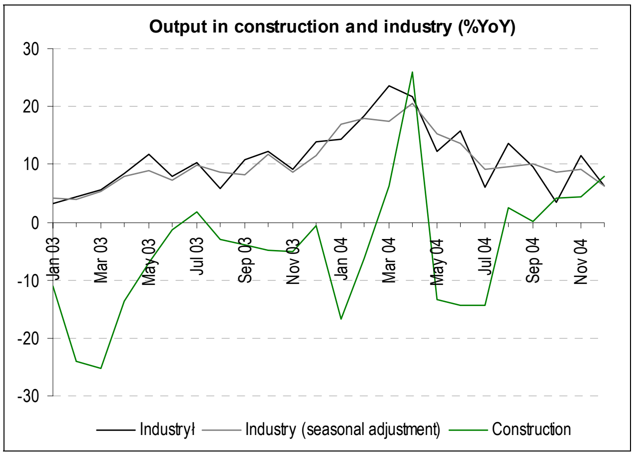
It seems that based on the observations made in the text, concerns about a surprisingly low credit growth (especially for businesses) in the Polish economy can be alleviated. It appears that the observed aggregate changes are a product of a range of overlapping phenomena which slightly blur the fact that the demand for new loans has risen sharply recently which is mostly justified with intensifying investment boom.

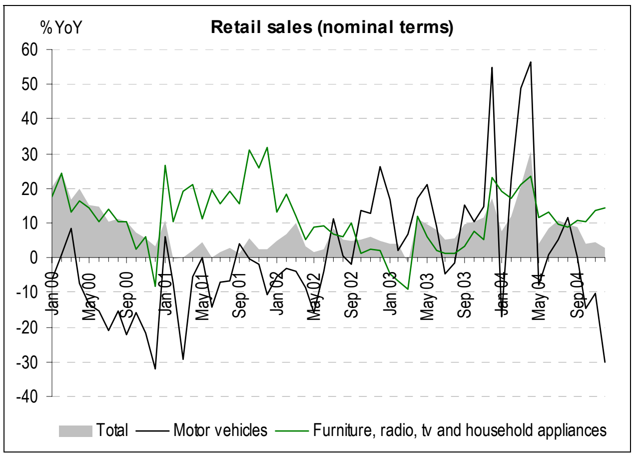
Please, notice that the analysis above was based solely on a simple list of observations made by means of generally available NBP data on Monetary Financial Institutions' credit. A much more in-depth analysis of the demand for loans in Polish economy will be our task in one of the following months.

Economic update









Source: CSO, BZWBK own estimates

GDP growth amounted to 5.4% in 2004

- According to tentative data, GDP growth in 2004 was 5.4% with private consumption rising by 3.2% and fixed investment by 5.1%.
- Estimates for the 4Q04, based on data for the entire year, show that GDP increased 4.1%, fixed investment jumped 7.3% and individual consumption grew a mere 1.6%. Although very low growth in consumption suggested weakening of domestic demand, we think this was a transitory phenomenon, caused by high base effect and high CPI. 2H05 should see consumption growth of above 4% again thanks to fall in inflation and better conditions on the labour market.
- From a point of view of prospect for GDP growth and monetary policy, much more important is an acceleration in investment growth. We think this will gather momentum further in next quarters, which was suggested by (apart from reasons observed so far such as high profitability of enterprises, good demand prospects record high capacity utilisation) the results of latest survey on firms' investment plans carried out by the NBP.
- Along with sharper rise in investment, there will be a change in the role of main driver of economic growth. Net export will be replaced with domestic demand. Actually, it already happened in 4Q04, as contribution of net export to GDP growth at that period was negative for the first time since 1Q03. It is still possible that in the whole 2005 contribution of net export may be positive, but on the lower scale that in the two previous years.
- GDP growth in 2004 was slightly lower than expected recently (market consensus was 5.6%), but 2004 was a good year for the Polish economy. It is worth noticing that the growth of 5.4% is stronger than forecasted 12 months ago.
- We predict that GDP growth will be slightly below 4% in 1Q05 and slightly above 4% in 2Q05 (we lowered forecast of private consumption), but in the second half of the year it should rebound to above 5% again. In the whole 2005 it should reach ca. 5%.

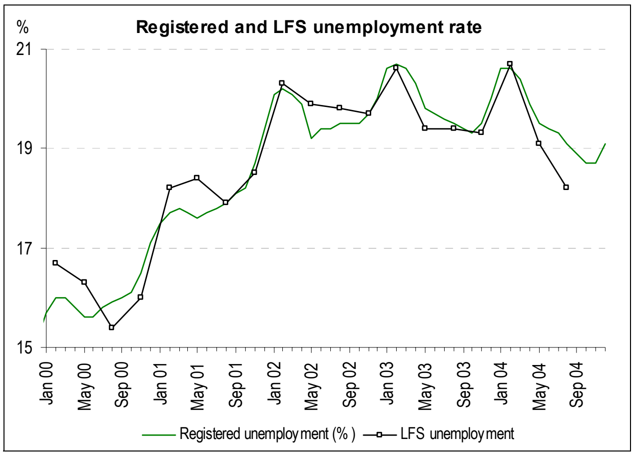
Weaker growth in industry, stronger in construction

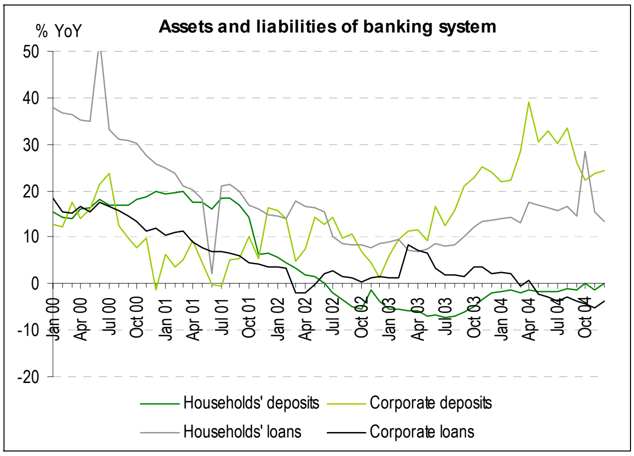
- Industrial output growth in December was disappointing. It was a mere 6.4%YoY, a half of what the market had expected.
- Seasonally adjusted growth amounted to 6.2%YoY, which is much lower than 9.2%YoY rise in November and average growth of 13.5%YoY in January-November 2004.
- The reason for slowdown in industrial output growth was mainly a high statistical base effect – it will be even more evident in months to come. Taking this into account, December's growth in industrial output should be regarded as a solid pace of industry expansion.
- There was further acceleration in construction output (to 7.9%YoY), which confirms that this sector has finally recovered from the slump. Possible boom in construction may offset "statistical" slowdown in industry to some extent.

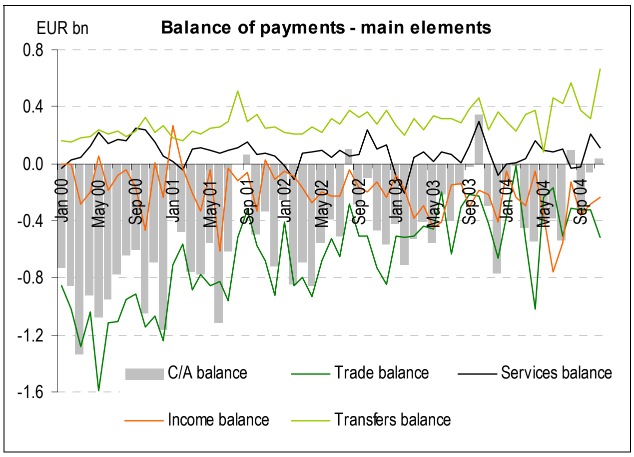
Slump in new car sales affects the overall retail sales

- Consumer grew 2.8%YoY in nominal term in December. In real terms, retail sales dropped for the third month in a row, this time by 1.8%YoY.
- The main reason for weaker growth in retail sales was deep annual decline in new car sales – on the one hand, there was surge in new car sales in December 2003 (ahead of introduction of new tax rules) and on the other hand there was slump in new car sales after EU entry (due to sharp increase in import of used care).
- Meanwhile, sales in all other groups of consumer goods grew at very fast pace again, in some cases at two-digit level, which does not seem to indicate permanent weakening of consumption demand.

Economic update







Source: CSO, NBP, BZWBK own estimates

More and more notable improvement on the labour market

- The registered unemployment rate rose to 19.1% in December from 18.7% in November.
- Monthly rise results from seasonal effect, while in annual terms the unemployment fell 0.9pp, deeper than a month earlier.
- Data on registered unemployment confirmed that situation on the labour market improves slowly, but steadily. More evident drop in the unemployment rate will be possible only in the second half of the year, when it should fall to below 18%.
- This will be possible due to intensification of currently observed rise in labour demand. Seasonal decline in employment was only 0.2%MoM and in annual terms labour demand grew 0.2%. This was the first annual increase in employment at least since the beginning of 2001, when comparable time series begins. Rising labour demand may soon translate into stronger wage growth.
- As for now, there are no signs of wage pressure in the enterprise sector, where average wage grew only 3.2%YoY in December and real wage bill fell 1.0%YoY. However, it is worth noticing that data for the whole economy for 4Q04 showed faster rise in wages than in the enterprise sector (see chart). It stood at 5.6%YoY, i.e. one percentage point above inflation level, up from 5.1%YoY seen in 3Q04. For sure, this will be not overlooked by the MPC before it makes any decision on monetary policy parameters.
- Because the central bank closely watch any signs of possible wage pressure in the economy, labour market statistics will surely remain the focus of attention. Monthly data for the first months of 2005 will be very important, as some MPC members pointed out that the first quarter of a year is a traditional period of wage negotiations in the Polish economy.

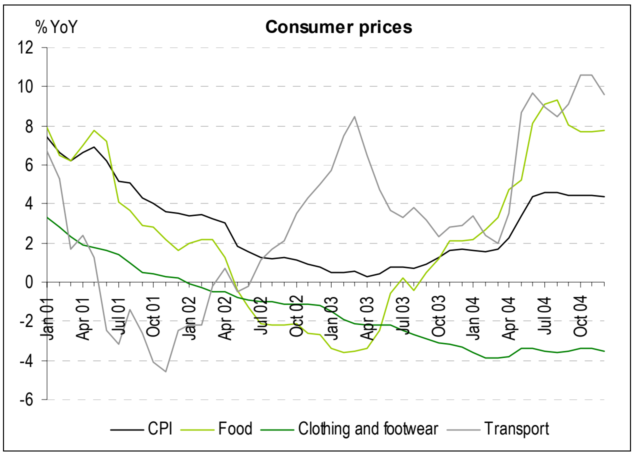
Stronger growth in money

- December 2004 saw acceleration in money supply growth to 8.7%YoY from 6.4%YoY in November and 6.9%YoY on average in January-November period.
- Rise in total deposits in 2004 was mainly a result of rising corporate deposits (as enterprises did not spent all record high profits for investment), while households deposits were stagnant (although one should notice some improvement with this regard in comparison with decreases observed in 2003).
- As regards counterparts of money supply elements, there was a surge again in households' borrowing (chiefly mortgages), while corporate borrowing contracted again.
- We expect money supply growth to accelerate in 2005, which will be a consequence of continued economic expansion (we forecast nominal GDP growth of close to 9% this year).

Surge in foreign trade turnover, C/A surplus

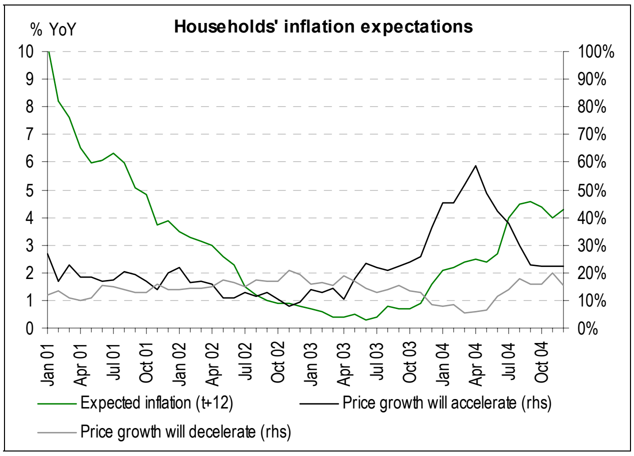
- December saw €31m C/A surplus, while the market expected the deficit of €160m.
- This resulted from high surplus on transfers account (€666m), which was related to inflow if EU aid funds.
- Surplus on transfers account offset high trade gap, which amounted to €512m. This was very close to our forecast at €534m, but much above market expectations of €350m.
- Exports surged 25.7%YoY and imports jumped 25.4%YoY, which confirmed the earlier observed tendencies, indicating a robust rise in both foreign and domestic demand.
- 12-month cumulative C/A deficit in relation to GDP stood at 1.9% after November, which means that scale of external imbalance of the Polish economy remains very small and does not represent any threat.

Economic update



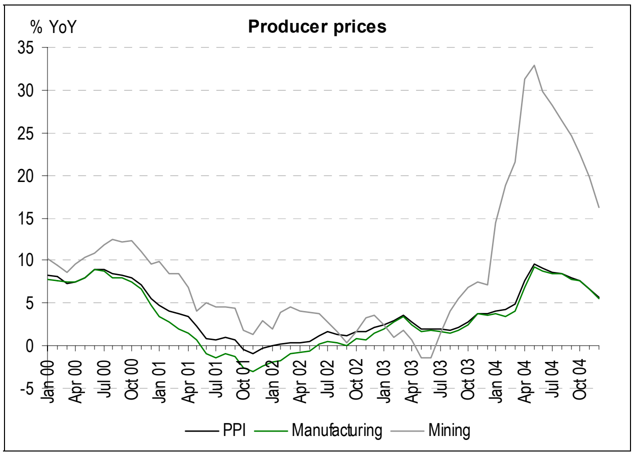
Year-end CPI slightly below expectations

- Consumer prices in December were lower than predicted and rose 0.1%MoM and 4.4%YoY against the widely expected growth of 4.5%YoY.
- The key factor for fall in annual CPI was weaker than assumed rise in food prices.
- Besides, fuel prices declined by 2.2%MoM and their annual growth decelerated to 17% from over 19% a month earlier. This shows that drop in oil prices and zloty appreciation has finally translated into reduction of fuel prices on the domestic market.
- Price trends in other components of consumer basket did not change much in December, except for recreation and culture that saw unexpected drop of 0.8%MoM and 1.6%YoY.



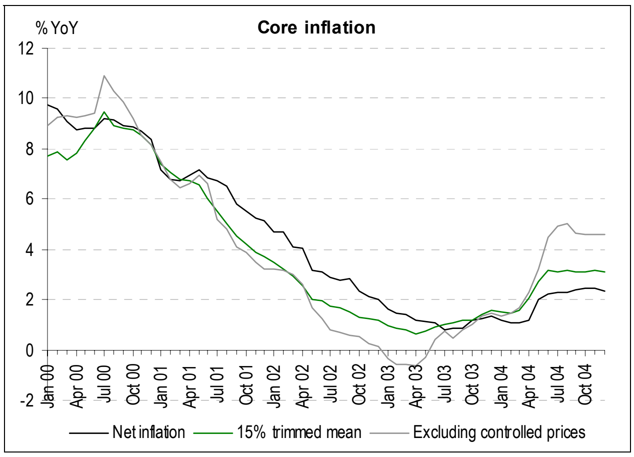
… makes us to change inflation forecasts for 2005

- Lower than expected inflation at the end of 2004 caused revision in our inflation forecasts for this year.
- Currently, we forecast that 12M CPI will accelerate to 4.7-4.8%YoY in Q1, but will not approach 5%YoY, as we predicted earlier.
- In mid-2005, CPI should slow down to 2.5%YoY (earlier we predicted 2.8%YoY) and stabilise at that level until the year-end.
- However, one should remember that revision of our forecasts takes place under influence of such volatile factors as food and fuel prices (as well as zloty exchange rate) and thus inflation outlook may easily change in future (in both directions), for instance in a reaction to intensification of wage pressure in the economy.
- Despite improvement in market forecasts, households' inflation expectations remain relatively high (see chart).



Weaker pressure from producer prices

- PPI figures also surprised on the positive side. Annual rise in producer prices decelerated to 5.6% from 6.7% a month earlier.
- This stemmed from a gradual termination of price shock on the commodities market. The effect of falling oil prices was probably strengthened by appreciation of the zloty.
- If commodities do not become more expensive and the zloty remains relatively strong, annual PPI should fall to below 1% in May and total 2.5% on average in the whole 2005.
- This calms down fears of a potential influence of high producer prices on consumer prices. Lower than expected PPI supports expectations for a change in monetary policy bias to neutral from tightening in the nearest time.

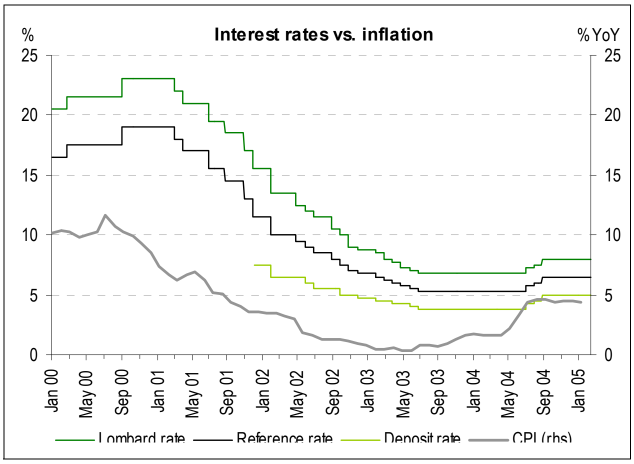


Core inflation in a horizontal trend

- All core inflation measures decreased slightly in December, following slight drop in the CPI inflation.
- In case of three measures (net inflation, 15% trimmed mean and CPI less controlled prices) the drop did not exceed 0.1pp, while the two other indices declined by 0.14pp and 0.24pp.
- In general, the most of core inflation measures remained in a horizontal trend in December.
- One may expect that after inflation rise in the first months of the year, core inflation will also increase moderately. In the second half of the year, core inflation will most likely ease, but at slower pace than the headline inflation rate, which should be one of arguments preventing the MPC from monetary easing.

Source: CSO, NBP, BZWBK own estimates

Central bank watch



Crucial fragments of the MPC statement from 26 January 2005

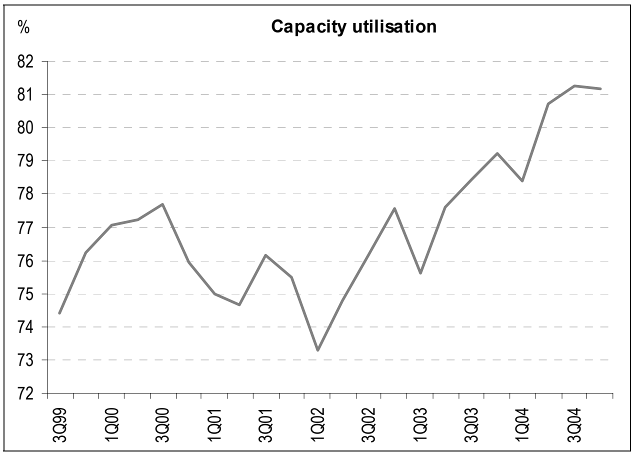
In the Council's opinion the balance of risks for future inflation has not changed significantly since the previous meeting.

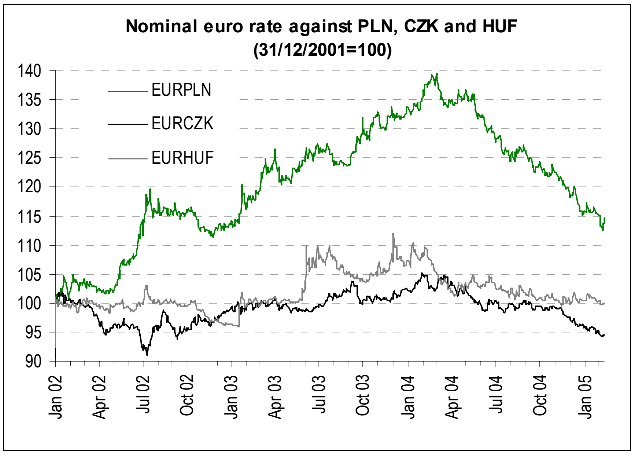
Since the last meeting of the Council the FX market has witnessed fluctuations in the zloty rate and the appreciation trend, observed in previous months, has been halted.

In view of available data it is difficult to assess whether in the next two years there may occur a slight drop in the rate of economic growth in relation to the expectations presented in November Inflation Report. Still, it is expected that in 2005 the contribution of net exports in economic growth will decrease, while the role of investment as a growth factor will increase.

Inflation expectations, which have been higher since July, still have not translated into wage dynamics (no second-round effects observed). At the same time, the NBP surveyed enterprises have reported moderate plans of pay rises in 2005.

The enterprises surveyed by the NBP have signalled a decrease in new orders as well as a possible slide in production dynamics. These data, however, are not consistent with optimistic plans the surveyed enterprises declared for new investments and also with the sustained high level of production capacity utilisation. Thus, it is hard to include on the degree to which the short-term signals of a deteriorating economic climate will be reflected in the actual economic situation in the longer run.





Source: NBP, CSO, own estimates

No change in rates, bias still tightening

▪ Since October 2004, MPC decisions has become predictable. In January, similarly as in the four previous month, all monetary policy parameters remained unchanged.

▪ Decision of the Council and the official statement released afterwards (details below) confirmed that the MPC still faces huge uncertainty regarding further developments in the Polish economy.

▪ The MPC recognised that the available economic data give contradictory signals as regards economic activity and inflation prospects.

...because balance of risks for inflation has not changed

▪ While the decision to keep rates on hold and maintain tightening bias was in line with expectations, a tone of the MPC statement could be a bit surprising for market participants.

▪ Namely, the MPC said that there had been no change in balance of risks to inflation since its previous meeting.

▪ This was not consistent with market expectations, that were based on macroeconomic data for December, which pointed to weaker economic activity and indicated lower than predicted inflation at the end of 2004.

▪ Possibly, the halted trend of zloty appreciation and rising risk of zloty depreciation in future were more important for the MPC than temporary weaker economic indicators.

▪ It is worth noticing that even without a change in balance of risks in January, but taking into account assessments made in November and December, the inflation outlook in the MPC opinion is currently more favourable than indicated by November's inflation projection. The new February's projection will most likely be more optimistic and we still see policy bias to be changed to neutral from tightening already this month.

Firms want to invest despite concerns over zloty's strength

▪ Results of the NBP business climate survey showed that 1Q05 saw rise in enterprises' fears of possible influence of the zloty appreciation on their competitiveness. However, the reported range of EURPLN profitability threshold between 3.8 and 4.2 against on average 4.1 in 4Q04 and 4.2 in 3Q04, which shows that at least to some extent they are able to adjust to appreciation of the zloty.

▪ Results of the survey also showed that the zloty's strength does not prevent enterprises from undertaking new investment projects. The indicator of investment activity, calculated by the NBP, has reached the highest level since the beginning of 1999.

▪ One of the reasons for starting new investments is a high level of capacity utilisation. According to the NBP, it has exceeded NAICU (i.e. non-accelerating inflation level of capacity utilisation).

The zloty rate remains the focus of attention

▪ The zloty exchange rate remains key in a debate on the monetary policy prospects.

▪ The MPC has stressed for some time that strong appreciation of the zloty in 2004 will act towards inflation reduction in 2005.

▪ However, more and more often central bankers warn against a possibility of zloty weakening in future due to political uncertainty connected with elections and formation of the new government (see central bankers' comments in the section below).

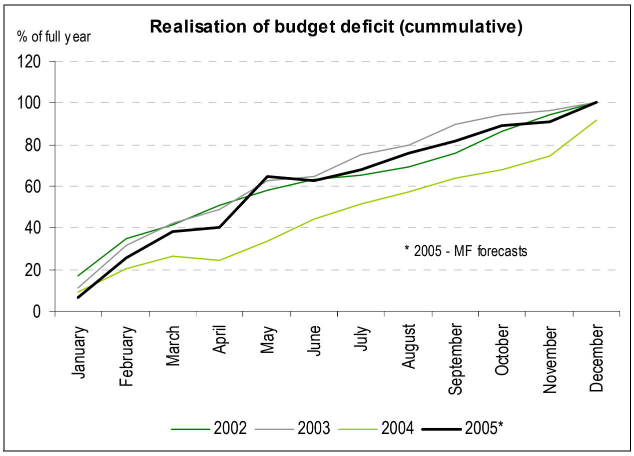
▪ The scenario of zloty depreciation seems likely due to a character of the capital, which currently flows to Poland and other countries in the region, leading to strengthening of their currencies.

▪ To a large extent, this is a speculative portfolio capital, which may outflow as fast as it inflow.

Central bank watch

Comments of the central bank representatives	Remarks
Leszek Balcerowicz, NBP governor, MPC chairman Reuters, 4 February The zloty rate has shown large volatility in the past, while structural problems of public finances, which were an important source of this volatility, did not vanish. It would be risky to assume the zloty's appreciation will be a lasting trend.	Balcerowicz's statement took place after deputy PM Hausner's appeal to the MPC for a change in monetary policy. Reaction of the NBP governor to Hausner's woes shows that he is against undertaking any actions, including rate cuts, aimed at weakening of the zloty.
Dariusz Filar, MPC member Radio TOK FM, 8 February The fact that the zloty is strong today is not a guarantee that it will be strong in a few months. We do not know how investors will evaluate risk connected with election period. Taking into account possible fluctuations of the zloty we have to draw conclusions for our policy. [Q: Do I correctly conclude that one should not expect a bias change or any radical decisions from the MPC in the nearest time?] I would not say that. This will depend on how future inflation path will look like. (…) If the path looks favourable from our point of view, one should not exclude a bias change to neutral. Radio PiN, 27 January In *Monetary Policy Guidelines for 2005* the Council said very clearly that it would like to use all three kind of approaches sin monetary policy bias. (…) Thus, before rates were trimmed, we would have to change biases. I think that a reasonable approach is to look at a possible moment of a bias change as situated in some timeframe. (…) Let say, between February and May or June.	Filar's comments suggest that despite widely expected the inflation-dampening effect of the stronger currency, the MPC is not likely to trim rates soon. Similarly as NBP governor, Filar warned against potential sharp depreciation of the zloty in future on the back of political upheaval. According to Filar, reasons for zloty lies to a large extent abroad and are associated with high liquidity on the global markets, causing high flows of portfolio capital (in this context, Filar pointed out that recent rate cut in Czech Republic did not weaken the koruna). We think that instead of cutting rates in reaction to the zloty's strength, the central bank will become more cautious in its monetary policy, as the zloty's strengthening driven to a large extent by inflow of short-term capital may lead to a rapid depreciation in future. However, Filar reiterated there was a possibility that the MPC would change its bias from tightening to neutral soon. He suggested it would take place between February and June, depending on the new inflation projections and indications of wage pressure in the economy in 1Q05. Filar clearly stated that rate should not be changed with neutral bias. Many market participants probably does not realize this fact and market expectations for rate cuts in the nearest months are too optimistic.
Stanisław Nieckarz, MPC member PAP, 31 January A bias change to neutral, with current knowledge about different factors, will be possible even already in 1Q05. The next change in bias to easing may take place when it is sure that inflation will fall in next months and the inflation target will be reached in December. And the bias change to easing could mean higher probability of rate cuts. [Asked explicitly about possibility of rate cuts this year answered] Possibly. Not everything is dependent on domestic factors.	One of the most dove-ish MPC members had suggested that change of policy bias into neutral could take place already in 1Q05. However, indirectly he also suggested that interest rate cuts will be more likely only under easing bias in monetary policy. Nieckarz did not rule out adoption of the latter under some circumstances, but at the same time he was quite cautious as regards chances for interest rate reductions this year. He underscored that the MPC must take into account exogenous factors that are unpredictable right now. In Nieckarz's view rate cuts in 2005 are not so certain, which seems to be quite a hawkish stance as for the most dove-ish MPC member.
Mirosław Pietrewicz, MPC member Rzeczpospolita, 17 January If inflation falls and pace of output growth strongly decreases, the meaning of arguments for monetary easing will increase in the Council. One should not wait with rate cuts longer than it is necessary. This should also be conducive to weakening of the zloty and investment growth. If the zloty were to strengthen further, the central bank should consider not only verbal intervention, but also more decisive action.	Apart from Nieckarz, Pietrewicz is one of the most dove-ish MPC member. Therefore, one should not be surprised with his opinion that monetary policy should be relaxed as soon as possible. In his opinion, such move is justified by reduction in economic activity later this year. Pietrewicz believes that interest rate cut would be good for zloty depreciation and strengthening economic activity. Appreciation of the zloty worries him to the extent, that he proposed undertaking actions by the central bank that would reach further than just verbal interventions. We believe his views are not representative for the majority of MPC members.
Halina Wasilewska-Trenkner, MPC member Bloomberg, PAP, 13 January An interest rate reduction in 2005 doesn't seem probable. (…) It could happen only as an emergency reaction to a global recession. As long as there is no proof the inflation rate is falling permanently, the Monetary Policy Council won't hurry with cuts.	Wasilewska-Trenkner's statement had very strong influence on the market, significantly cooling expectations for rate cuts (though temporarily). The tone of her interview with Bloomberg was in line with her earlier speech, in which she suggested that the central bank had to be very cautious, because meeting Maastricht criteria on inflation might be much more demanding than reaching the domestic inflation target.
Andrzej Wojtyna, MPC member Reuters, 11 February I believe rates should be changed only while holding an easing or tightening bias and not a neutral stance. The neutral bias is the most comfortable situation for the central bank, because it shows balanced risks and stable macroeconomic situation. The balance of risks goes in such direction that it creates a room for changing the bias to neutral. But if political risk and uncertainty grow before the election, the possibility of keeping a neutral stance for a longer period will be limited. If the risk for inflation rose, return to a tightening bias would be necessary. If we tried to influence [the zloty] and offset every change in exchange rate with interest rate change, we would have to raise rate again, when political factors would cause depreciation of the zloty in two-three months.	While Nieckarz and Pietrewicz on one side, and Balcerowicz and Filar on the other side, could be regarded as representatives of extreme viewpoints within the Council, Andrzej Wojtyna, together with Halina Wasilewska-Trenkner and Andrzej Sławiński, belongs to the group of those MPC members, whose voices could decide about the Council's moves. Therefore, his views are crucial for shaping market expectations. In our view, Wojtyna's comments suggest that he does not see room for monetary easing as long as there is a risk of zloty depreciation due to significant political uncertainty. Improvement in inflation outlook justifies shift in policy bias to neutral, in Wojtyna's opinion, however, this should not be treated as a signal of soon rate cuts. Except for special cases, e.g. currency crisis, rate cuts should be made under easing bias, in his opinion.

Government and politics



No budgetary problems in 2004. We'll see in 2005…

- In 2004 the budget gap undershot the government's target of PLN45.3bn and reached PLN41.5bn (or 91.6% of the plan).
- In the whole year, total revenues were 1.1% (or PLN1.74bn) higher than targeted (as a result of higher CIT inflows and higher budget entities' revenues) and spending were 1% lower.
- Liquidity of the state budget drastically fell to PLN3.3bn at the year-end from PLN21.5bn in November.
- Higher transparency of budget policy in 2005 – the Ministry of Finance presented forecasts of budget deficit for each month. In comparison with our predictions presented in December's issue of MACROscope, the ministry's plan assumes higher budget realisation after the first half of this year .

Fragments of the statement after MPC meeting with cabinet members

In order to meet these criteria [Maastricht], it is necessary to fully implement the Convergence Programme [CP], the update of which was passed by the Government on 24 November 2004. Attaining this objective should be supported by proper fiscal-monetary policy mix.

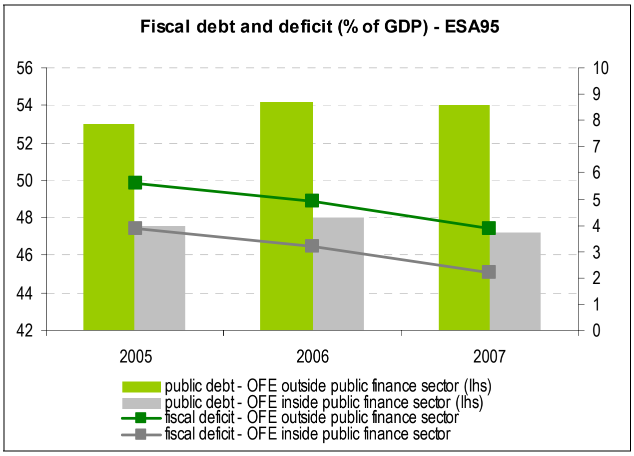
A key element in the implementation of the Convergence Programme is to bring fiscal deficit below 3% of GDP and to keep it at this level. (…) A high and sustainable economic growth rate reconcilable with the inflation target would facilitate the implementation of the CP. While assessing the compliance with the convergence criteria it would also be desirable to correctly account for the short-term costs following from the introduction of retirement pension reform, which will limit the level of public debt in the long run.

The period of Poland's participation in ERM II before its entry to the euro area should not be longer than the required minimum. Thus, the decision to join the mechanism should be taken when it is possible to conclude with a high degree of probability that the reforms being implemented as well as the macroeconomic situation would ensure the compliance with the remaining criteria within this period.

The Government and the MPC also agree that it would be most desirable if the institutions of the European Union interpreted the exchange rate criterion in a way that would eliminate unnecessary macroeconomic risk.

Meeting government-MPC: much cry and little wool

- Conclusions from the meeting could have been disappointing for market participants speculating on whether some actions could be taken to weaken the zloty.
- Statements included in the joint communiqué (see box on the left) had to be very general.
- Even if short-term measures are planned in the case of further zloty appreciation (MinFin buying foreign currency on the market or NBP intervening on the market), discussion on such subjects should be confidential to be effective.
- As regards longer perspective, it is difficult to expect that any decisions can be taken by current government. Reduction of the fiscal deficit will be the task for new cabinet after election. That is why the market will probably disregard the communiqué.



Gronicki to present plan B. What will EU say?

- On 16 February finance minister will present a contingency plan is case of unfavourable EU ruling on Polish open pension funds (which is expected in March).
- If Gronicki's plan consisted of spending cuts, the parliament would reject it ahead of election, if the plan means higher indirect taxes the NBP would not be enthusiastic about it.
- Anyway, budget deficit reduction will be the task for new cabinet, and the problem is not connected with the classification of OFE only, but with other elements of the Convergence Programme.
- The European Commission criticised the Convergence Programme for slower deficit reduction by 2007 (revision to 2.2% GDP from 1.5%) and keeping fast GDP growth forecast for 2007 (5.6%). Additionally a large part of the Hausner plan was rejected.

Support for main political parties

	OBOP support (%)	OBOP Number of seats	PBS support (%)	PBS Number of seats
PO	20 (28)	108	27 (25)	162
PiS	16 (14)	94	14 (14)	81
LPR	14 (13)	79	10 (12)	57
Samoobrona	11 (13)	60	16 (14)	88
SLD	9 (6)	49	8 (8)	48
SdPl	7 (7)	41	4	0
PSL	6 (4)	27	6	24

Note: OBOP poll 6-10 January, PBS poll 5-6 February; previous results in parenthesis.

Source: Ministry of Finance, OBOP, PBS, own estimates

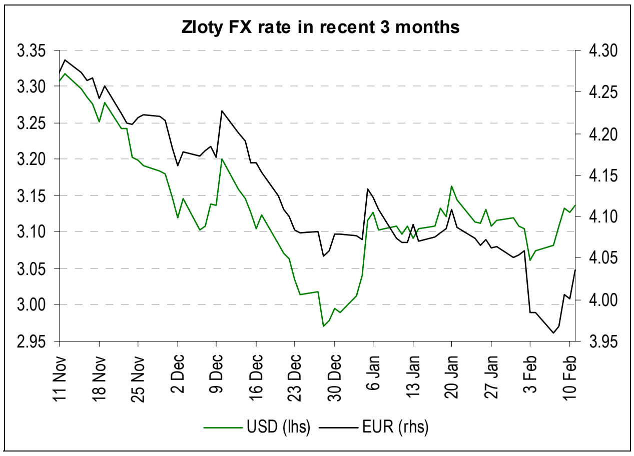
Medium-term fiscal plans will be the task for new cabinet

- EcoFin Council will refer to the Convergence Programme. The next programme will have to show credible plans to lower fiscal deficit to below 3% of GDP. And the plan will have to be accepted as in the other case the excessive deficit procedure might cause stopping cohesion funds from the EU.
- That is why, for financial market (and for the EC) programmes of political parties, which are likely to form new cabinet should be much more important. PO programme will be known in June.
- Recent opinion polls gave no response as regards chances for new cabinet formation after parliamentary election. The joint support for Civic Platform (PO) and Law and Justice (PiS) might be too low to assure simple majority in 460-seats Lower House.
- … and the euro entry is not a priority for Law and Justice.

Government and politics

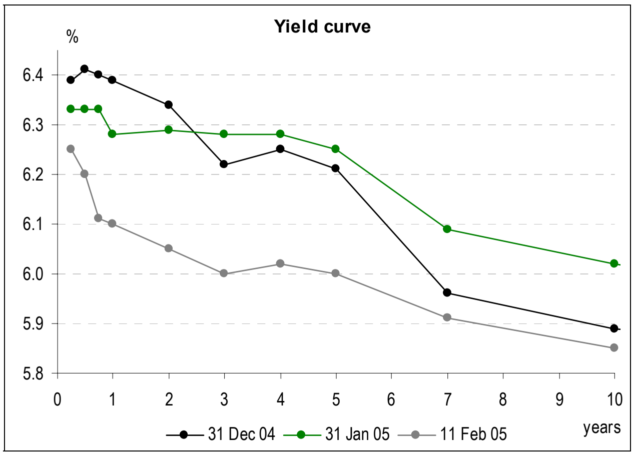
Comments of government representatives and politicians	Remarks
Włodzimierz Cimoszewicz, Lower House speaker Reuters, 10 February There is such a possibility because the political situation is changing dynamically. The vote [on parliament's dissolution] will take place on May 5. Many deputies in the SLD may vote to dissolve parliament.	Ending parliament's term requires the support of 307 deputies (two-thirds of lower house deputies). Although we still think the election is more likely to take place in autumn, one should be aware the vote in May is going to be a close call. Therefore, as we have argued earlier, market players may become nervous before the voter, particularly that there is still high uncertainty regarding result of the election.
Jerzy Hausner, deputy PM, economy and labour minister Radio TOK FM, 7 February My path and the path of the SLD have been going apart and finally went apart. I consider this chapter to be closed. I am no longer a member of the SLD. There is still a chance for a new political initiative. Otherwise I wouldn't engage myself in anything like that.	This statement led to some zloty weakening, although its importance was relatively low, in our opinion. What is more, even Hausner's dismissal from the cabinet should be neutral for the market, although PM Belka is not planning such scenario. What is interesting is that Hausner is establishing a new formation in the centre of the Polish political scene (together with Freedom Union and Centre Party politicians). We will see what kind of electorate the party will attract and whether it will be easier or more difficult to form cabinet after election.
Jerzy Hausner, deputy PM, economy and labour minister PAP, 3 February We have to talk to the MPC, and make them to see, what is happening and what may be economic consequences of continuation of conducting policy, which leads to such sharp zloty strengthening. I expect them to understand the situation, which from the point of view of public finance sector is very favourable temporarily, but from the point of view of economic growth becomes more and more dangerous. My worries are higher than previously. Radio TOK FM, 7 February I don't see any cause for alarm. This is good news, even very good news, but there are certain side effects and I must speak as the economy minister.	The zloty appreciation to over two-year high against the euro triggered an alarming comment of deputy PM. It is difficult to say whether his worries were expressed during the meeting with the MPC (they were surely visible in Polish media) , as official statements suggest that no specific zloty exchange rate levels were discussed and talks had not been focused on current zloty performance. However, even if the government's representatives could have been insisted on the central bank during the meeting to change monetary policy direction, the NBP maintained its stance of fully float exchange rate regime (unless the NBP would like to surprise the market to increase chance of successful intervention). Quite interestingly, just before the meeting Hausner moderated his stance in the radio interview as he said that zloty level of below four against euro was not a cause for alarm.
Jerzy Hausner, deputy PM, economy and labour minister PAP, 3 February The government's Convergence Programme is still valid. I do not know any cabinet, stance on this issue and that is why my answer to the European Commission will be the following: "your concern is correct but the government is doing its job and you should not worry excessively". **Mirosław Gronicki, finance minister** Reuters, 2 February A failure, or a limited success of Hausner's reforms in full showed the political appetite for such decisions. I don't think we will see significant fiscal changes in coming years. We still think there is higher probability that a favourable decision [including pension funds in the public finance sector] will be taken. In other case we have a contingency plan to protect the euro adoption targets.	Optimistic view on Poland's fiscal prospects presented in the Convergence Programme begins to erode, which might be negative for the Polish financial market in the medium run (even despite there was no short-term reaction). In our opinion, and against Hausner's view, the European Commission is not really worrying excessively, but rather is doing its job connected with the excessive deficit procedure, which started against Poland in the middle of May 2004. The next step will be the opinion of the EcoFin Council and then we will wait for the new convergence programme of the new government. Therefore, we really do not know what does minister Hausner means by "government is doing its job", especially as he confirmed recently that the remaining bills from the so-called Hausner plan would not be accepted by the parliament. The most important is, however, that a revision of medium-term fiscal perspective will be the task for the new government. And this applies not only to a basic plan, but also to a contingency plan, mentioned by finance minister Gronicki.
Józef Oleksy, SLD chief Reuters, 31 January In my opinion, the first possible date for parliamentary elections is September 25.	The SLD National Council decided to back out of its early election promise and delay election date until September or October. However, as mentioned above, the timing of election is still very uncertain given other politicians' statements, which creates a risk factor for the Polish financial market.
Zbigniew Chlebowski, PO deputy chief Reuters, 9 February We will want to talk to the central bank on how to finally improve the policy mix, and set Poland's strategy and timeframe for ERM-2 and eurozone entry. Our coalition government will not focus on day-to-day issues like zloty levels at the meeting, because that's the central bank's job and it knows what it's doing. Everything else will be up for sale. We plan to liquidate the Treasury Ministry by the time our term in office is over. Reuters, 1 February Everything indicates that because of the timing of the election our most crucial reforms - such as tax and public finance reforms - will be launched in January 2007, not in 2006 as we earlier planned. PO's strategic goal is euro adoption by 2008 or 2009. In our view Poland's convergence programme is realistic and we would very much like to stick to it, but we do not think that more significant deficit reduction is possible, especially in 2006.	Chlebowski said the PO would want to talk to the central bank on how to improve the policy mix. Well, the problem may be to find a common line with the PO's potential coalition partner – Law and Justice (PiS). PiS leaders said recently that adopting euro should not be a priority of economic policy and this may be delayed even much beyond 2010. While faster privatisation process is favourable for the economy, this may be another controversial aspect of common economic programme. What is more, even Chlebowski's statements do not seem fully coherent. Firstly, if euro is to be adopted in 2008, budget deficit has to be lowered to below 3% of GDP in 2006… and Chlebowski agreed it is rather impossible. Secondly, if euro is to be adopted in 2009, budget deficit has to be lowered to below 3% of GDP in 2007 and one should note implementing tax reform at the same time might not necessarily bring immediate revenues boost. Although we believe the lower taxes (flat tax rate) would be positive for future economic development of Poland, the first year after its introduction might be quite risky for budgetary revenues and thus for budget deficit. PO is expected to present its program in June.

Market monitor



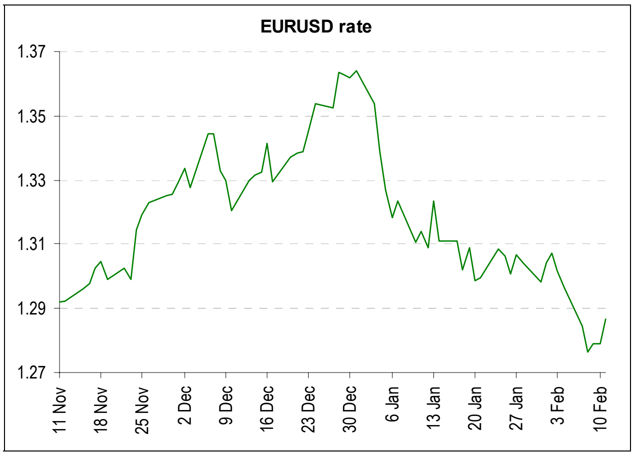
Zloty's volatility may be retained

- In January the zloty advanced to the euro by 0.97%, however weakened to the dollar by 0.87%. It means that against the basket of currencies it preserved its relative value, but individual rates reflect changes in EURUSD performance.
- It was however seen amid elevated volatility caused by initially substantial euro deterioration, then due to foreign capital inflow into bond market following weaker data and finally because of renewed confusion regarding parliamentary election date.
- Zloty's performance to a large extent hangs on solution of political problems. If it turns out that the likelihood of Sejm's dissolution in the spring has increased, one should consider zloty depreciation. After latest zloty's advancement amid simultaneous euro pullback against the dollar, relationship between those two currencies is not so clear.



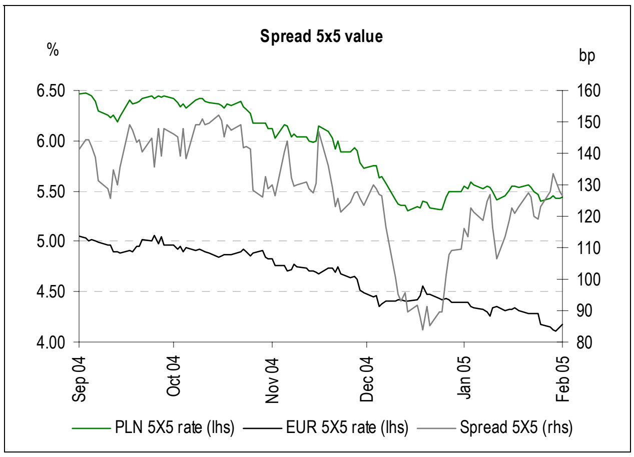
New yield lows

- Yield curve moved sharply downwards, especially in 5y sector where yield fell during last month by 44 bp. Curve slope in 2/5y sectors from positive (+19 bp) transformed into negative (-10 bp). FRA 6x9 decreased by 23 bp that discounts a cut by 75 bp in 3Q.
- Upward tendency in yield owing to unsuccessful auctions of longer dated papers rapidly reversed due to weaker data from real economy. The market crossed December's yield lows amid decent turnover that means technically significant levels.
- Reception of 5y bond tender will depend on CPI release. We think that inflation will rise distinctly, so bond yields ought to increase as well. Change in policy bias to neutral on the MPC meeting will be neutral for the market. Political risks from f/x market may spill over into debt market.



Greenspan and Bush support the dollar

- Euro rate to the dollar lost during last month 1.82% (the lowest 1.2730). It was seen as result of substantial moves at the beginning and at the end of the month, but in the meantime it fluctuated in relatively narrow range of 1.2960 –1.31.
- As record high US trade deficit is still covered by capital inflow in the US, the rate was responsive to positive (for the dollar) announcements from Fed's chief and Bush administration on deficits reduction. G7 meeting did not altered currency regimes in Asian countries, so for some time that risk factor will have a limited impact on the market.
- Fundamentally US balance of payment data will still stay important, but technically due to short position accumulation the market has an upward potential. We consider that dollar's upward tendency has been stopped.

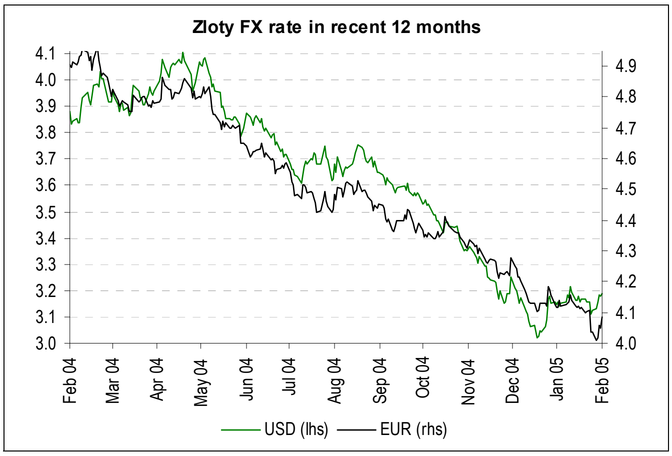


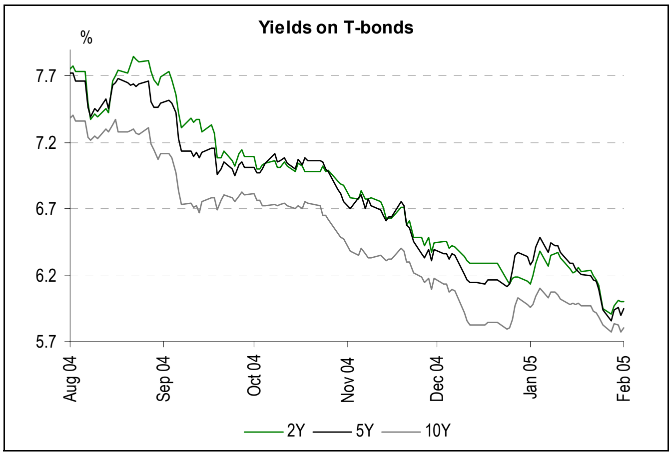
Stronger abroad

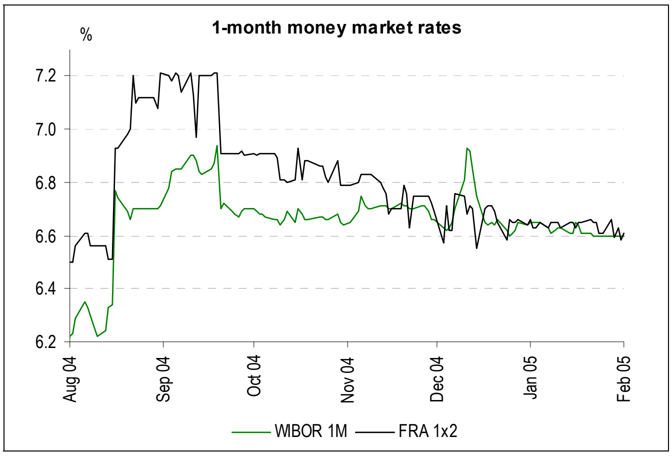
- Spread 5/5y through the majority of previous month fluctuated in the bracket of 110-120 bp amid meaningful curves movements. Only latest political confusion backed it up to 130 bp. Though that level takes into account a large chunk of risks, earlier election may send it even to 150 bp.
- Bonds in Germany and US recorded yield decline to 3.45% and 4.08% owing to change in ECB chief's rhetoric, lower real data in US and warmly received auctions in January. As a consequence of positive comments on US twin deficits reduction spread between them narrowed to 62 bp.
- As short term US interest rates rise, profitability of US bonds will decrease. So amid simultaneous keeping of ECB rates unchanged in foreseeable future, spread between Bunds and Treasuries may start to widen.

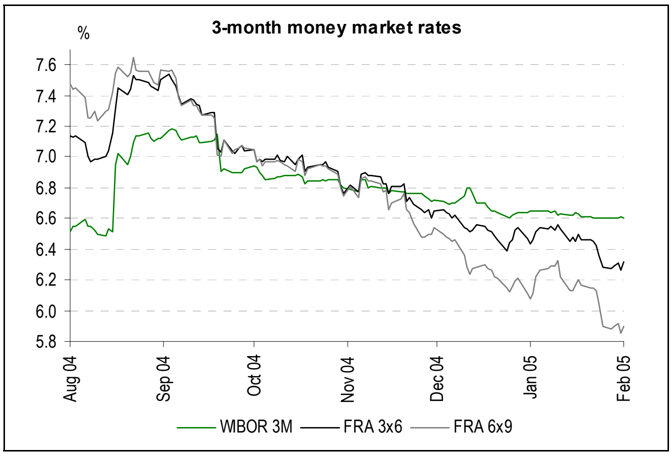
Source: Reuters, BZ WBK

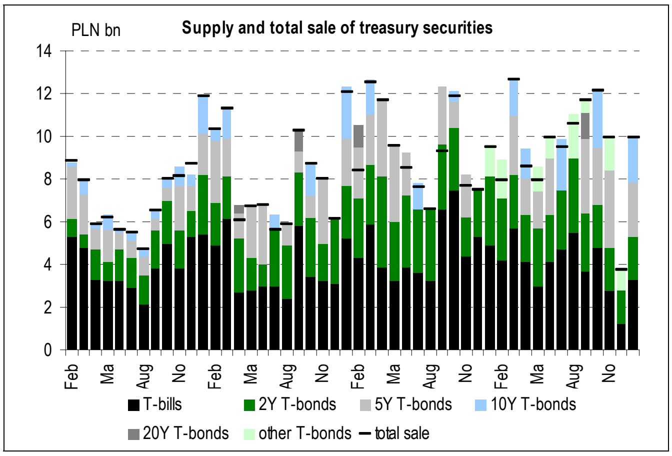
Market monitor











Treasury bill auctions (PLN m)

Date of auction	OFFER / SALE 13-week	52-week	Total
03.01.2005	100 / 100	700 / 700	800 / 800
10.01.2005	100 / 64	600 / 600	700 / 664
17.01.2005	100 / 63	600 / 600	700 / 663
24.01.2005	-	600 / 600	600 / 600
31.01.2005	-	600 / 600	600 / 600
Total January	**300 / 227**	**3 100 / 3 100**	**3 400 / 3 327**
07.02.2005	-	900 / 900	900 / 900
14.02.2005	-	900	900
21.02.2005	-	600 – 1 000	600 – 1 000
28.02.2005	-	600 – 1 000	600 – 1 000
Total February*	**-**	**3 000/-3 800/ 900**	**3 000-3 800/ 900**

* estimations based on Ministry of Finance preliminary information

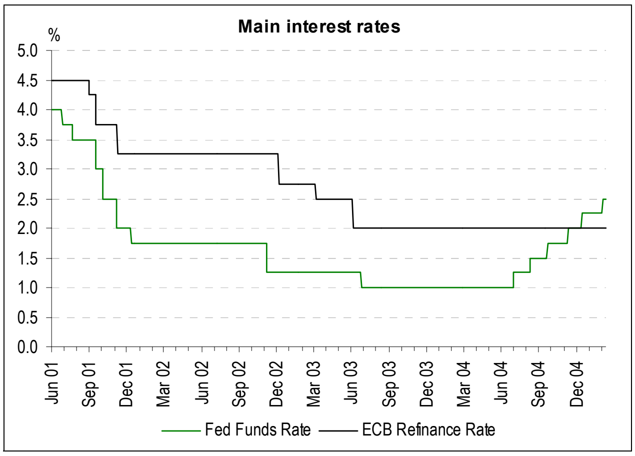
Treasury bond auctions in 2005(PLN m)

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	2 130	19.01	PS0310	2 500	2 500
February	02.02	OK0407	2 760	2 760	09.02	IZ0816	960	960	16.02	PS0310	2 500-3 500	-
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

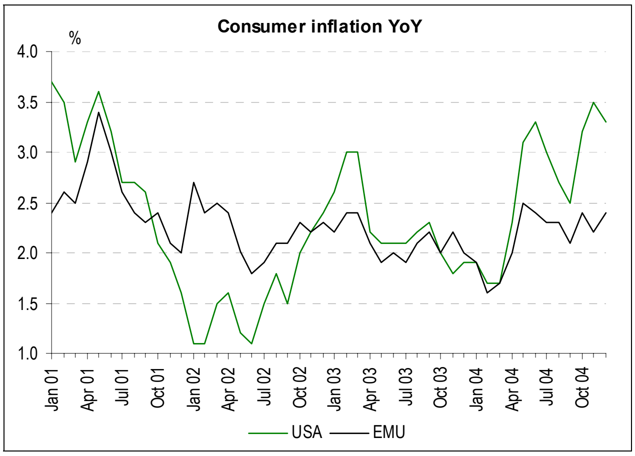
International review



Rates in US will be hiked. The pace is the question

▪ ECB kept rates unchanged at its last meeting on Feb 3rd at 2%. But governor Trichet's comments from Jan 13th on the lack of evidence of price pressure were deemed as dovish, especially against the background of its previous statements. ECB chief stressed the need to make Asian countries currency regimes more flexible.

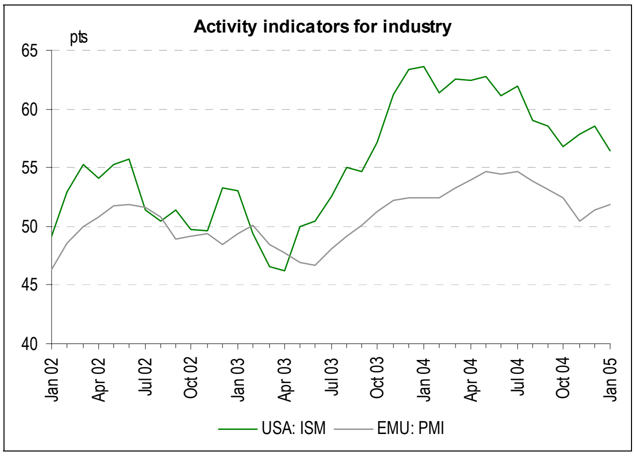
▪ In line with expectations Fed hiked rates on Feb 2nd by 25 bp. It was a sixth consecutive rate hike, after which Fed funds rate amounts to 2.5%. In the statement following the meeting Fed maintained the assessment that balance of risks for future inflation is balanced and further hikes ought to be seen at measured pace. However American central bank representatives suggested not long ago that the phrase "at measured pace" may disappear from a statement.



Oil prices reduce US inflation

▪ CPI index in US fell in December by 0.1%MoM due to further strong declines in oil prices. Core inflation that excludes volatile prices of food and energy still rose at steady pace of 0.2%MoM. In annual terms net inflation retained its levels from previous month and recorded growth of 2.2%. In the whole 2004 CPI advanced by 3.3%.

▪ December HICP index for euro zone was revised upwardly to 2.4%YoY from initially reported 2.3%YoY owing to higher prices of healthcare services, tobacco and several foodstuff. In monthly terms inflation rose by 0.4%. Inflation in the euro zone another month in a row retains above ECB target of 2%. Excluding food and energy costs inflation index amounts to 1.9%YoY, but that is not the reference indicator for ECB.

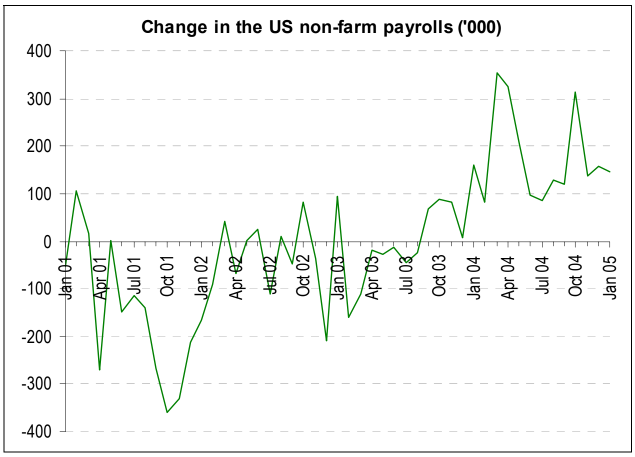


Optimism is not borne out

▪ US economy developed slower than expected at 3.1%QoQ in the final quarter last year, the weakest since the outset of 2003, because deterioration in foreign trade and inflation increase were recorded. Despite weaker 4Q GDP in the whole 2004 grew by 4.4%YoY as compared to 3% in 2003.

▪ January manufacturing activity in euro zone grew, as global demand and domestic expenditures increased. Euro zone PMI improved the second consecutive month to 51.9 from 51.4 in December. Stronger global economy supported export orders, while higher domestic spending shored up the production.

▪ The growth in manufacturing sector slowed in January, because demand for new products fell, though enterprises declared renewed willingness to hire new workers. ISM manufacturing index fell to 56.4 in January from 57.3 in December.



Source: Reuters, ECB, Federal Reserve

Labour market data still too low

▪ German business sentiment index IFO grew in January to 96.4 from 96.2 as compared to previous month, as stronger domestic demand shored up firms' future expectations. That indicator recorded an improvement though current conditions component fell slightly, because German economy had failed to cope with all the problems yet. Earlier index of investors' confidence ZEW, that reached 26.9 comparing with expectations at 20.0. The market perceives that index as leading indicator for headline IFO value.

▪ Change in US non-farm payrolls grew in January by 146'000 against market expectations at the level of 190'000. Previous months data were revised downwardly. Unemployment rate fell to 5.2% because some recently professionally active people has left workforce.

What's hot this month

Monday	Tuesday	Wednesday	Thursday	Friday
31 January ***POL: T-Bills auction*** ***POL: C/A (XI)*** ***POL: GDP (2004)*** USA: Chicago PMI (I)	**1 February** EMU: PMI (I) USA: ISM manufacturing (I) USA: Consumer spending (XII)	**2** ***POL: 2y bonds auction (OK0407)*** USA: FOMC decision	**3** EMU: ECB decision USA: ISM non-manufacturing (I) USA: Factory orders (XII) USA: Durable goods orders (XII)	**4** USA: Non-farm payrolls (I) USA: Unemployment rate (I) USA: Final Michigan (I)
7 ***POL: T-Bills auction*** USA: Consumer Credit (XII)	**8** GER: Industrial production (XII)	**9** ***POL: 12y inflation linked bonds auction (IZ0816)*** USA: Wholesale inventories (XII)	**10** UK: BoE decision USA: Trade balance (XII) USA: Budget statement(I)	**11** FRA: Flash GDP (4Q)
14 ***POL: T-Bills auction*** ***POL: Money supply (I)***	**15** ***POL: Employment (I)*** ***POL: Gross wages (I)*** ***POL: CPI (I)*** EMU: Flash GDP (4Q) GER: ZEW index (II) USA: Capital inflow (XII)	**16** ***POL: 5y bonds auction (PS0310)*** USA: Industrial production (I) USA: Capacity utilisation (I) USA: Greenspan's testimony	**17** ***POL: PPI (I)*** ***POL: Industrial production (I)*** USA: Import prices (I)	**18** USA: PPI (I) USA: Preliminary Michigan (II)
21 ***POL: T-Bills auction*** ***POL: Business climate (II)***	**22** GER: GDP (4Q) EMU: ECB C/A (XII) USA: Consumer confidence (II)	**23** ***POL: Retail sales (I)*** ***POL: Unemployment (I)*** GER: IFO Index (II) USA: CPI (I) USA: Fed Minutes	**24** ***POL: Switching auction*** USA: Durable goods orders (I)	**25** ***POL: MPC meeting (decision)*** EMU: Money supply (I) USA: Home sales (I)
28 ***POL: T-Bills auction*** ***POL: C/A (XII)*** EMU: CPI (I) EMU: Business climate (II) USA: Chicago PMI (II)	**1 March** GER: Unemployment (II) EMU: PMI (II) EMU: Unemployment (I) USA: ISM manufacturing (II)	**2** ***POL: 2y bonds auction (OK0407)*** EMU: PPI (I) EMU: GDP (4Q)	**3** EMU: ECB decision USA: Productivity (IV kw.) USA: ISM non-manufacturing (II)	**4** EMU: Retail sales (I) USA: Non-farm payrolls (II) USA: Final Michigan (II) USA: Factory orders (I)

Source: CSO, NBP, Finance Ministry, Reuters

MPC meetings and data release calendar 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*	-	-	21	-	-	21	-	-	21	-	-	21
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	21	23	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	21	23	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	31	-	-	-	-	-	-	-
Money supply	14	14	14	14	13	-	-	-	-	-	-	-
NBP balance sheet	7	7	7	7	6	-	-	-	-	-	-	-
Business climate indices	21	21	22	22	20	22	22	19	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

		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	Feb 05
Industrial production	%YoY	14.4	18.3	23.5	21.8	12.2	15.8	6.0	13.7	9.5	3.5	11.4	6.4	5.6	3.4
Retail sales [c]	%YoY	7.6	12.1	20.7	30.6	4.0	8.6	10.9	9.6	8.8	4.0	4.4	2.8	7.4	4.8
Unemployment rate	%	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	19.6
Gross wages [b c]	%YoY	3.5	6.3	7.0	4.6	4.4	4.5	3.6	5.1	3.7	2.4	2.7	3.2	4.8	5.1
Employment [b]	%YoY	-1.4	-1.5	-1.3	-1.1	-0.9	-0.7	-0.7	-0.8	-0.6	-0.4	-0.3	0.2	0.2	0.4
Export [d]	%YoY	10.6	18.3	28.2	27.9	24.9	34.5	14.6	21.5	17.7	13.0	25.7	19.1	16.3	14.8
Import [d]	%YoY	6.1	4.6	25.8	37.4	17.8	32.4	10.5	20.2	19.0	14.2	25.4	17.5	17.9	20.0
Trade balance [d]	EURm	-369	-9	-535	-1 021	-232	-172	-509	-312	-326	-320	-512	-700	-500	-250
Current account balance [d]	EURm	-130	-14	-447	-541	-416	-379	-532	97	-334	-66	31	-570	-300	-150
Current account balance [d]	% GDP	-2.1	-1.7	-1.7	-1.7	-1.7	-1.8	-1.8	-1.7	-1.8	-2.0	-1.8	-1.7	-1.8	-1.8
Budget deficit (cumulative)	PLNbn	-4.2	-9.4	-11.8	-11.0	-15.3	-19.9	-23.2	-25.9	-29.0	-30.8	-33.8	-41.5	-6.3	-45.3
Budget deficit (cumulative)	% realisation	9.3	20.7	26.1	24.3	33.8	43.9	51.3	57.1	63.9	67.9	74.6	91.6	0.0	0.0
CPI	%YoY	1.6	1.6	1.7	2.2	3.4	4.4	4.6	4.6	4.4	4.5	4.5	4.4	4.7	4.8
PPI	%YoY	4.1	4.2	4.9	7.6	9.6	9.1	8.6	8.5	7.9	7.6	6.7	5.6	5.2	4.9
Broad money (M3)	%YoY	5.1	5.1	5.7	8.5	6.4	7.2	6.8	7.4	6.5	10.5	6.4	8.0	7.8	6.7
Deposits	%YoY	3.4	3.5	4.8	8.4	6.2	6.9	6.4	7.6	6.6	11.5	6.5	8.0	7.8	6.8
Credits	%YoY	7.4	7.7	6.1	8.5	6.1	5.7	4.6	5.2	4.2	9.5	4.0	2.9	3.4	3.3
USD/PLN	PLN	3.74	3.84	3.89	3.97	3.93	3.78	3.64	3.64	3.58	3.46	3.28	3.09	3.11	3.11
EUR/PLN	PLN	4.71	4.85	4.77	4.76	4.72	4.59	4.47	4.43	4.37	4.32	4.26	4.14	4.08	4.04
Reference rate [a]	%	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	6.50
WIBOR 3M	%	5.46	5.46	5.49	5.69	5.99	5.91	6.34	6.58	7.12	6.89	6.81	6.72	6.44	6.60
Lombard rate [a]	%	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	8.00
Yield on 52-week T-bills	%	5.59	5.78	5.87	6.20	6.65	6.79	7.15	7.24	7.38	7.00	6.81	6.44	6.28	6.10
Yield on 2-year T-bonds	%	6.17	6.34	6.34	6.83	7.41	7.44	7.80	7.66	7.51	7.04	6.81	6.39	6.24	6.05
Yield on 5-year T-bonds	%	6.65	6.76	6.60	7.13	7.57	7.50	7.79	7.65	7.33	7.03	6.78	6.29	6.31	6.05
Yield on 10-year T-bonds	%	6.65	6.81	6.65	7.02	7.32	7.27	7.44	7.36	6.96	6.75	6.43	6.02	5.98	5.95

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	884.2	958.6	203.8	216.1	218.8	245.6	221.8	233.4	236.7	266.2
GDP	%YoY	1.4	3.8	5.4	5.0	6.9	6.1	4.8	4.1	3.9	4.4	5.5	5.8
Domestic demand	%YoY	0.9	2.5	4.9	4.7	5.5	5.1	4.6	4.3	4.0	4.3	5.0	5.3
Total consumption	%YoY	2.8	2.5	2.8	3.1	3.3	3.5	2.9	1.4	2.7	2.8	3.4	3.5
- Private consumption	%YoY	3.3	3.1	3.2	3.6	3.9	3.8	3.5	1.6	3.0	3.2	3.9	4.1
Fixed investments	%YoY	-5.8	-0.9	5.1	10.7	3.5	3.6	4.1	7.3	12.0	11.0	12.0	9.2
Industrial production	%YoY	1.1	8.4	12.3	7.1	19.0	16.4	9.2	6.1	3.2	6.4	9.1	9.7
Retail sales (real terms)	%YoY	1.9	3.6	7.9	1.8	13.6	11.3	4.0	-1.0	-2.5	-2.7	5.9	6.3
Unemployment rate [a]	%	20.0	20.0	19.1	17.7	20.4	19.4	18.9	19.1	19.4	18.3	17.8	17.7
Gross wages (real terms)	%YoY	1.5	2.0	0.8	1.7	3.8	1.6	-0.5	-1.5	0.3	1.9	2.9	3.3
Export [b]	%YoY	6.0	9.1	21.2	11.0	19.3	29.1	17.6	19.0	14.0	11.0	10.0	10.0
Import [b]	%YoY	3.5	3.3	19.3	13.0	12.6	29.3	16.3	18.9	17.0	10.0	12.0	12.0
Trade balance [b]	EURm	-7 701	-5 077	-5 027	-6 588	-909	-1 438	-1 148	-1 532	-1497	-1413	-1616	-2 062
Current account balance [b]	EURm	-5 404	-4 109	-3 302	-4 282	-592	-1 338	-767	-605	-973	-989	-1212	-1 547
Current account balance [b]	% GDP	-2.7	-2.2	-1.7	-1.8	-1.7	-1.8	-1.8	-1.7	-1.8	-1.5	-1.7	-2.0
Budget deficit (cumulative) [a]	PLNbn	-39.4	-37.0	-41.5	-35.0	-11.8	-19.9	-29.0	-41.5	14.0	22.8	29.8	35.0
Budget deficit (cumulative) [a]	% GDP	-5.0	-4.5	-4.7	-3.7	-5.8	-3.7	-4.1	-5.1	6.3	3.7	3.0	2.0
CPI	%YoY	1.9	0.8	3.5	3.3	1.6	3.3	4.5	4.4	4.8	3.4	2.5	2.4
CPI [a]	%YoY	0.8	1.7	4.4	2.5	1.7	4.4	4.4	4.4	4.7	2.6	2.5	2.5
PPI	%YoY	1.0	2.6	7.0	2.6	4.4	8.8	8.3	6.6	4.6	1.4	1.7	2.8
Broad money (M3) [a]	%YoY	-2.0	5.6	8.0	8.9	5.7	7.2	6.5	8.0	6.5	6.6	9.9	8.9
Deposits [a]	%YoY	-4.1	3.7	8.0	8.3	4.8	6.9	6.6	8.0	6.2	6.9	10.2	8.3
Credits [a]	%YoY	5.2	8.1	2.9	10.1	6.1	5.7	4.2	2.9	4.0	4.4	6.7	10.1
USD/PLN	PLN	4.08	3.89	3.65	3.07	3.82	3.89	3.62	3.27	3.09	3.02	3.12	3.03
EUR/PLN	PLN	3.85	4.40	4.53	4.13	4.78	4.69	4.43	4.24	4.06	4.14	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	6.19	5.75	6.24	7.26	6.75	6.18	6.20	6.30	6.10
Yield on 2-year T-bonds	%	7.94	5.38	6.89	6.21	6.28	6.86	7.66	6.75	6.13	6.20	6.40	6.10
Yield on 5-year T-bonds	%	7.86	5.61	7.02	6.26	6.67	7.10	7.59	6.70	6.15	6.40	6.50	6.00
Yield on 10-year T-bonds	%	7.34	5.77	6.84	5.97	6.70	7.00	7.25	6.40	5.98	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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