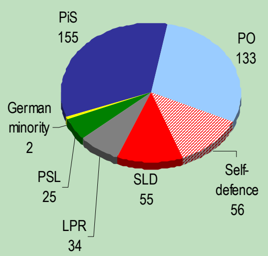
Bank Zachodni WBK

MACROscope

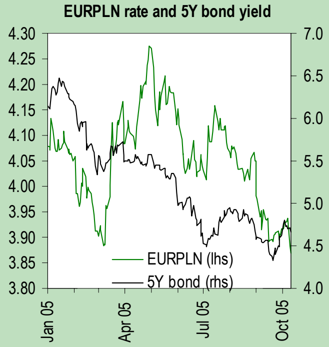
Polish Economy and Financial Markets

October 2005

Distribution of seats in the Sejm after election



EURPLN rate and 5Y bond yield



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Right turn!

- **Polish zloty remains in unexpectedly good shape despite a protracted political uncertainty caused by the presidential election and forming of a coalition government.** An announcement of the finance minister about a currency swap on the market also helped the Polish zloty to appreciate against the euro reaching the highest level for the last three years. In *Special focus* section we outline the situation after the parliamentary election and try to assess its impact on macroeconomic policy as well as on the financial markets. In the coming weeks we do not expect to receive any information that would substantially reshape the picture of fiscal policy from the viewpoint of financial markets. We assume that a government coalition of the Civic Platform and Law and Justice will be formed and will deftly adopt a budget for 2006 with a slightly lowered deficit while the convergence programme will be dispatched in a version prepared by the finance minister still in office, however the content of the programme will be subject to further modifications. All in all, we don't expect any major changes in the mood of the Polish financial market over the next 6-9 months, especially that the economic outlook is good. A test of credibility in the fiscal policy as well as co-operation between the government and the Parliament will be the 2007 budget that will cast more light on such issues as how to reduce deficit, taxes and fulfil the election promises of social spending that Law and Justice have made. Because of large uncertainty veiling medium-term fiscal plans and unwillingness of Law and Justice to join the euro zone quickly, we expect that in the second half of 2006, our currency will be slightly weaker while the yield curve will grow steeper.

- **What we wrote last month came true as subsequent information reaching the market and the Council's decision effected another adjustment to the interest rates.** We also believe that the interest rate market has reacted too nervously to certain statements contained in a communiqué after the meeting and in *Monetary Policy Guidelines for the year 2006*. According to the Monetary Policy Council the main risk factor which can affect the future inflation rate movements are high petrol prices that if resulting in the second round effect, the Council will not hesitate to raise the interest rates. We need to remember though that the Council perceives that scenario as very unlikely (many reasons provided in the *Guidelines…* reinforce that stance), as they maintain a mild attitude in this respect. Inasmuch as we are close to the end of cyclical interest rate cuts, the economy may still witness a 50bp. reduction over the coming months. There is only a question when the Council will change their stance to neutral.

- **Another risk factor on the Polish currency and bonds market are developments on the international markets.** Higher interest rates in the US may drain other regions out of equity (as it happened in March). We are also expecting a better profitability of bonds worldwide both in the euro zone and the US. In terms of our next year forecast we quote 10-year bonds at 3.8% and treasuries at 4.7% respectively.

Financial market on 31 August 2005:

NBP deposit rate	3.25	WIBOR 3M	4.61	USDPLN	3.3140
NBP reference rate	4.75	Yield on 52-week T-bills	4.23	EURPLN	4.0495
NBP lombard rate	6.25	Yield on 5-year T-bonds	4.61	EURUSD	1.2219

This report is based on information available until 13.10.2005

Special focus

The new coalition to demonstrate their real skills

Swerve to the right

As expected after four years of the left-wing parties in power, the right-wing opponents are now about to form a new government. This is not a smooth transition though with a presidential campaign gathering speed in the background. However, there are clear indications that Law and Justice and Civic Platform will form a coalition government and the only question can be about the strength of each of the coalition partners and their impact on real politics (especially economy). Undoubtedly, the final political layout of the new government will be affected by the upcoming presidential elections. For this reason financial markets are watching for further developments knowing that the outcome of presidential elections can impact the country's economy and not only by the president's entitlement to veto.

Despite the fact that the results of this year's parliamentary elections were not commensurate with earlier opinion polls (Civic Platform ahead of Law and Justice with a constitutional majority of these two parties) the financial markets do not show any nervousness. We need to remember though that with a marginal majority in the Sejm, the coalition will need to muster up all of its resources to pass budget-related acts. As far as creation of the government coalition is concerned there are not many doubts around this issue though the parliamentary majority cannot be expected equally stable. We just need to recollect how Law and Justice voted in the case of acts which not necessarily appeared beneficial for the public finance or promoted entrepreneurship. Besides, we do not know whether all the Law & Justice MPs will be against costly but populist acts which the opposition (Self-Defence, The Polish Families League, The Polish Peasants' Party) may advocate. We hope that such initiatives will be of incidental nature though it is noteworthy that quite recently Law and Justice have voted for a 50% PIT rate to change their mind shortly and they now support tax rate reductions. The Civic Platform presidential candidate assures the public that he will veto all the acts that can prove harmful for the economy, hence his leading position in the polls allows the financial markets to believe in a political stability. However, should the bad scenario materialise, even the liberal president's veto can be outvoted.

First budget and the convergence programme

It appears that the first test for the new government will be budget appropriations in the upcoming year. But the overall framework of the next year's budget has already been created by the finance minister now in office and there will not be much time to modify it substantially, therefore this will not be a big challenge for the coalition of Civic Platform and Law and Justice. In the first place, the new government could draw up a critical overview of the situation 'as is' in terms of the public finance and for this reason even marginal modifications to the budget assumptions might be perceived as a positive move. Secondly, some minor changes might be done, for example higher GDP forecast translating into stronger budget revenue streams. At the same time cuts in administrative expenditure might alleviate the budget deficit and bring it down to PLN30bn. as announced before the elections. An increased GDP forecast is likely, inasmuch as a candidate for the prime minister, Kazimierz Marcinkiewicz has already announced it. We still need to remember that the Public Finance Act imposes on the government an obligation to maintain a deficit to revenues ratio at a level not higher than in the previous year due to an excess over the 50% threshold of public debt to GDP in 2004. It seems that at the outset of its term of office, the government may want to focus on earning trust with the financial markets, so we should not expect any major problems around accepting or changing the next year budget.

The other document that will serve this purpose will be a new convergence programme which needs to be sent to Brussels by the end of November (perhaps EU officials won't mind a minor delay). The document should cover the plan of public finance including projected revenue and expenditure. So, the new government's assumptions of the basic budget indicators for the next year may come up to surface in this very document before we learn about the amended budget draft. In the first place though, the convergence programme ought to reiterate our commitment set out in the previous document and relating to a reduction of the budget deficit down to 2.2% of GDP. Here, another crucial issue resurfaces – can Open Pension Funds be treated as part of the public finance ? Eurostat's decision on that matter seemed final, nevertheless the candidate for prime minister assures that it will be changed. It is curious what sort of rationale the new government will provide for a change to that decision. Would it be resistance to undertake major changes in the public finance framework ?

In terms of economy plans Law and Justice treats open pension funds as one of the fundamental matters. Let us remind our readers that Eurostat's decision of March 2004 clearly indicated that the open pension funds must be treated as an element of private financial sector though EU agreed to a gradual transition towards that solution with 20% of pension contributions to be allocated to the OPF in 2006, 40% in 2007 and 100% in 2010. If Eurostat does not change its decision (very likely), then the budget deficit that Law and Justice plans at PLN30bn. will actually be higher over the next four years because each year amounts arising out of the open pension funds would have to be factored in (these will increase gradually to represent ca. 2% of GDP in 2010). Be also mindful of the fact that even if in the optimistic scenario of Law and Justice Eurostat agreed to changing the decision, the deficit of PLN30bn. would not necessarily reflect the deficit to GDP ratio as set out in the previous convergence programme, though this would obviously depend on the performance of other public finance sectors (apart from the central budget) and GDP growth rate.

The convergence programme will then be the first forerunner of a prospective fiscal policy through the years to come although we cannot rule out a possibility that the new government will simply dispatch the already complied documentation to Brussels advising the EU officials that it will be updated later. We can then assume that in the upcoming months (even until the next year's half) the new coalition will not take any important decisions about the shape of the fiscal policy in the coming years. With unmade decisions, there will not be stark contrasts in views.

Budget 2007 – the real test

Budgetary problems may manifest themselves later while the real test of fiscal credibility that the new government will have to sit will be the 2007 budget whose assumptions will be a subject of talks and arrangements commencing in June 2006. In all likelihood this budget draft will be accompanied by numerous budget-related acts as and this stage it will be necessary to reconcile the promises of tax cuts (difficult as it may seem, a compromise in this case is reachable) with a subsequent deficit reduction and preservation of the public social spending. We still need to remember that Law and Justice outlined in their economic programme, also advocated by the candidate for prime minister, proposed changes to the revaluation rate of personal pensions and sickness benefits, extension of maternity leaves, family tax relieves, re-establishment of the alimony fund, special housing schemes etc. It is difficult to figure out whether all the above proposals are to be effected or it is just an element of the election campaign. Still, these are expenditure lines which are difficult to match with a deficit reduction to the level assumed in the convergence programme. A growing pace of GDP growth gives hopes that the Polish economy is getting stronger, which can translate into higher budget revenues thus pushing it out of deficit. Notwithstanding a bullish economy that is capable of generating more jobs, we need to bear in mind that the recent economic updates have proved rather disappointing, the question is then if the government will be prepared to bite the bullet in this respect.

When will we join the Euro zone ? Law and Justice is not in a hurry

The financial markets are closely watching differing viewpoints of *the* Civic Platform and Law and Justice in relation to Poland's entry to the euro zone. It is a common knowledge that *the* Civic Platform would like to introduce the common currency as soon as possible while Law and Justice is sceptical to say the least. At the same time Law and Justice claims that during this parliamentary term of office the convergence criteria should be met (budget deficit below 3% of GDP), though in the light of the above mentioned fiscal plans of Law and Justice, this commitment is easier said than done. If we then assume that the economic programme to be pursued will borrow from Law and Justice proposals in terms of fiscal alignment, then Poland's accession to the Euro zone will have to be postponed for several years thus making the year 2009 as the target term of the current administration look absolutely unrealistic. Undoubtedly, this scenario might adversely affect the market of long-term government bonds. So far though this is not taken into consideration and despite political uncertainty yield from the bonds remain stable with the Polish zloty getting stronger. Perhaps investors are aware that no major turmoil should be expected in the government coalition in the upcoming months (honeymoon). Still, we would rather expect the coalition of *the* Civic Platform and Law and Justice to formulate plans of Poland's conformity to the convergence criteria and a prospective entry to the Euro zone. However, this being a component of the government programme will be known only after the presidential election.

Conflict with the NBP ?

One of the members of the Monetary Policy Council declared before the parliamentary elections that the NBP representatives would meet with members of the newly composed cabinet to discuss macroeconomic policies. In view of what we have written above, we can expect NBP officials to be disappointed about the proposed date of adopting the euro currency. From the perspective of

FX policy, several opinions voiced by the winning politicians are worth reminding now. Firstly, Kazimierz Marcinkiewicz pointed out that an exchange rate of PLN 4.1/4.3 to euro would suit the Polish economy best. Secondly, Stefan Kawalec, an economic expert of the Civic Platform said that the case of fast PLN appreciation coming in the wake of the new government's reforms one of the options would be to introduce a fixed exchange rate. In earnest, as we wrote above, we do not expect in the existing political configuration that the economic reforms get full go-ahead, but let us try to imagine a positive (negative for the export traders) scenario. If the Polish zloty appreciated against euro to 3.7, Law and Justice would change its stance towards the common currency. If not, why the option of the Civic Platform shouldn't be adopted to fix the exchange rate and avoid excessive appreciation? We need to remember though that according to the NBP act, it is the Council of Ministers that decides about a currency policy in liaison with the Monetary Policy Council. Should the new government wish to change the currency policy, they have to either convince the Monetary Council or change the NBP act. The former will not be easy to handle. Although the Monetary Council would on that issue present varying opinions (like in many other cases) a general opinion will prevail that Poland should not deprive itself of currency fluctuations (assuming accession to ERM2), even if we enjoy a reliable fiscal plan and stable, low inflation expectations. Obviously, if these conditions were not met, there is no point in discussing a fixed exchange rate which is the central bank's weapon in fight against inflation. Neither does it seem likely that the government would like to mark the onset of its term with a fight against the central bank though the leaders of Law and Justice are known to have recently advocated interest rate cuts so that they correspond to the EU standard (well, it is enough to enter the euro zone to reach that level). One of their postulates also envisages dissolution of the Monetary Policy Council, which is quite unfeasible.

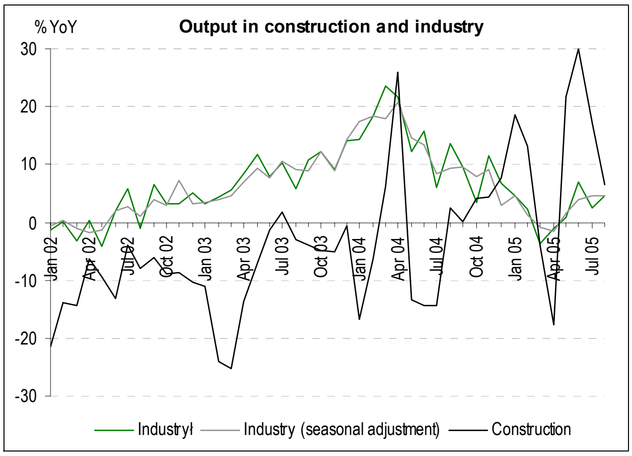
Wrap up: honeymoon for how long ?

In the coming weeks we do not expect to receive any information that would substantially reshape the picture of fiscal policy from the viewpoint of financial markets. We assume that following the presidential elections, a government coalition of the Civic Platform and *Law*and *Justice* will be formed which will deftly adopt budget assumptions with a lower deficit than Mr. Gronicki's proposal. A medium-term fiscal policy plan will be presented under the convergence programme, however it is possible to dispatch Mr. Gronicki's version to be later amended accordingly. This policy accompanied by announcements of lower deficit and taxes will enable the government in the short term to win credibility in the eyes of financial markets or gain some time before it comes to taking difficult decisions next year. Perhaps it will also be possible to receive support from rating agencies, especially as the rating of Poland is worse than of other countries in this regions. We don't expect any major changes in the mood of the Polish financial market over the next 6-9 months as the economic outlook is good. Inasmuch as developments on the global market may contribute to higher risk (higher interest rates in US, outflow of equity from regional markets), a temporary depreciation of the Polish zloty may foster purchases of our currency.

A test of credibility will be the 2007 budget with its accompanying acts that will cast more light on such issues as how to reduce deficit, taxes and fulfil the election promises of social spending that Law and Justice have made. It will also be a test of collaboration between the government and the Parliament. It is relatively easy to imagine a compromise among the Council of Ministers, unlike in the case of coalition MPs who may not vote unanimously on certain solutions. Voting results in the previous Sejm raise concerns about discipline of the coalition MPs. Because of large uncertainty veiling medium-term fiscal plans and unwillingness of Law and Justice to joint the euro zone quickly, we expect that in the second half of 2006, our currency will be slightly weaker.

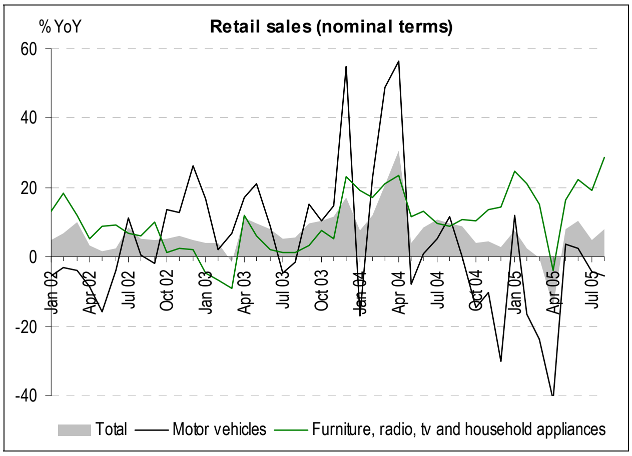
The profitability curve may then grow steeper. Inasmuch as we are close to the end of cyclical interest rate cuts, the economy may still witness a 50bps reduction over the next six months, and we are also expecting higher yields worldwide (both in the euro zone and US although the former is likely to demonstrate that next year).

Economic update



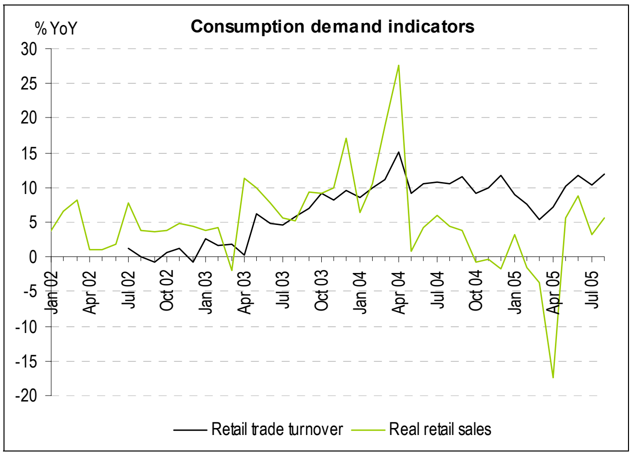
Output growth below expectations… still not too bad

- Sold industrial output rose 4.6%YoY In August. It was above 2.6%YoY growth in July, however below market consensus predicting ca. 5% increase.
- Seasonally adjusted data showed 4.6%YoY rise as well, which was the highest result since the beginning of this year. It conforms that two last quarters will be a period of much faster growth in industry than the first year-half.
- Output in construction and assembly increased 6.5%YoY, much below July's 17.3%YoY. A slowdown (although not as significant) could be expected, taking into account fading of low statistical base effect that used to take place in May-July. August's increase in construction was a decent result and one could expect a gradual acceleration, likewise in the case of output in industry.



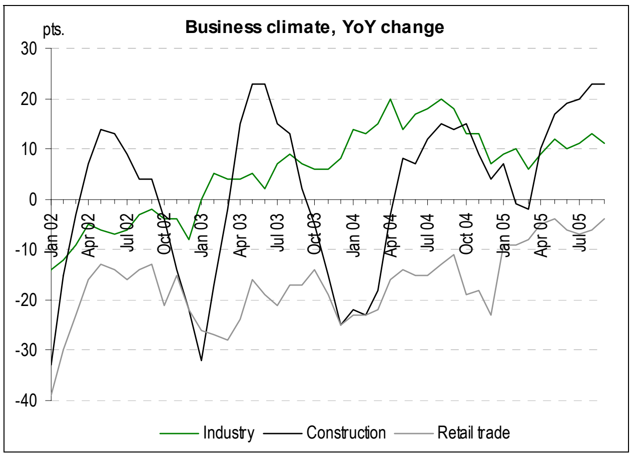
... but retail sales growth better than expected

- Unlike production, retail sales rose more than expected In August. Nominal worth of sales soared 7.9%YoY against 5.6%YoY in July, while market consensus was 6.2%YoY.
- Real sales growth accelerated to 5.6%YoY against 3.2%YoY in the previous month, which was the second best result this year.
- Apart from sales of motor vehicles, still experiencing a downturn (-5.5%YoY), other kinds of sales maintained quite high rates of growth, suggesting that consumption demand has been gradually strengthening. In particular, one should notice fast rise in sales of durable goods (furniture, household appliances – almost 30%YoY in nominal terms, which could represent similar growth in real terms amid slowly growing or even declining prices in this group of products).



Any chances for private consumption rebound?

- In 2Q05 a significant deceleration in domestic demand growth was observed, e.g. due to low growth in private consumption – a mere 1.5%YoY, which was the lowest rise since early 2003.
- Recent signals from the economy suggest however that the second part of the year should bring a significant improvement in consumption demand growth. Retail sales growth (in constant prices) has improved considerably already in 3Q05, according to our estimates to 5.5%YoY from -3.2% in 2Q05. In the final quarter of the year it could be above 8%YoY. Rising consumption has been supported by higher households' disposable income (see the next page), falling unemployment and low interest rates.
- It will be one of factors accelerating GDP growth in the nearest quarters.

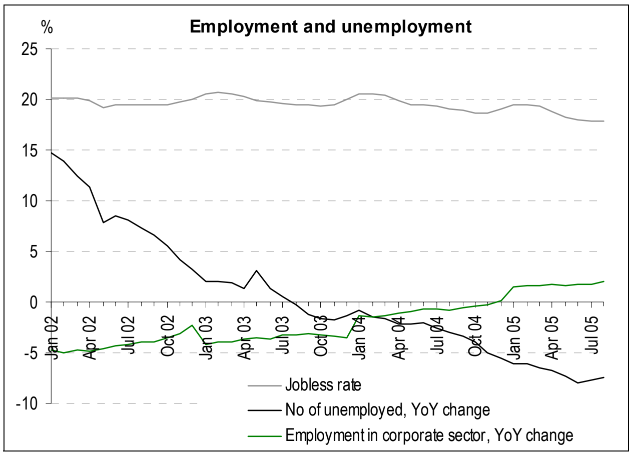


Source: CSO, NBP, own calculations

Optimisic business climate results

- Business climate index in retail trade has been below zero for a number of months, however it has been steadily improving and in September it was at the highest level for six years. Entrepreneurs reported smaller constraints of current sales and improvement in still unsatisfactory financial situation.
- The most optimistic were construction companies (higher orders and production, good and improving financial standing), which suggests further dynamic growth in this sector.
- In manufacturing, both current and expected orders and production were reviewed positively. However, moods worsened slightly due to weaker financial situation. It could confirm that zloty appreciation starts being a problem for Polish enterprises, hampering their financial standing but not the level of activity.

Economic update

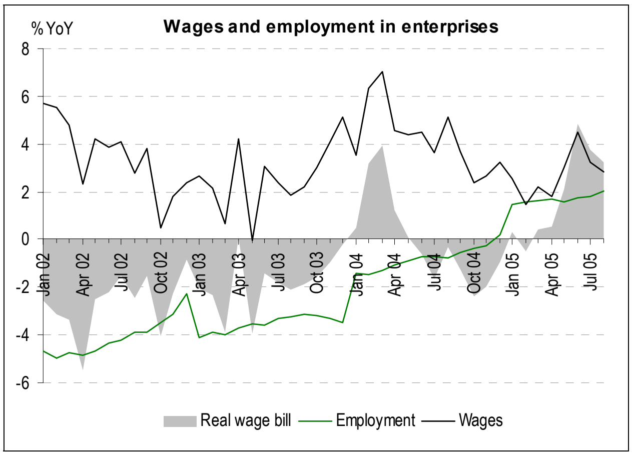


Unemployment down, new jobs up

▪ Registered unemployment rate decreased in August to 17.8% from 17.9% in July and 19.1% one year before, maintaining a trend of slow but systematic reduction, connected with building demand for labour.

▪ Average employment growth in enterprises sector accelerated to 2%YoY in August from 1.8%YoY in July. It was the fastest rise for more than seven years. In subsequent months we foresee further improvement.

▪ Positive trends on the labour market have been confirmed by LFS (Labour Force Survey) data, which showed that according to commonly used in EU definition, unemployment rate in Poland dropped to 18.1% in 2Q05 from 18.9% in 1Q05. The number of employed people rose 1.9%YoY to almost 14 million.

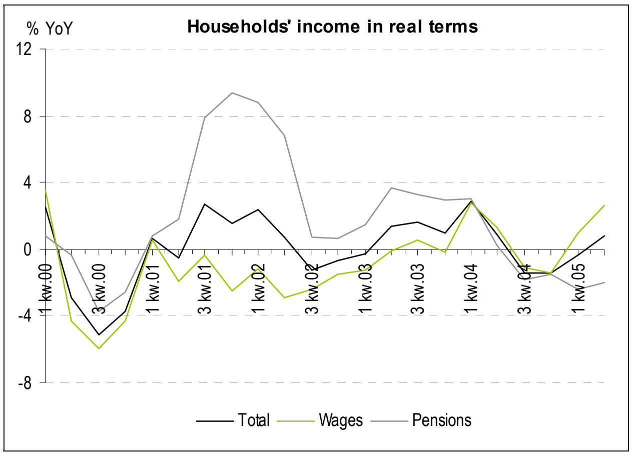


Moderate pay rise, no wage pressure

▪ Despite growing number of jobs, rise in salaries remains restrained. Average wage in enterprises sector rose 2.8%YoY in August, lower than 3.2%YoY in July and below market consensus of 3.5%.

▪ However, already after data from two first months of 3Q05 it is apparent that average pay rise in this quarter will be much above the one in 2Q05 (in real terms over two times higher).

▪ Wage growth in the entire economy is probably – likewise in previous quarters – slightly faster than in the enterprises sector (in 2Q05 wages in economy rose 3.9%YoY in nominal terms, while in enterprises 3.0%YoY), however still this rate of growth should be seen as moderate. Thus far, no signs of building wage pressure could be seen, probably due to low inflation expectations and still high unemployment.

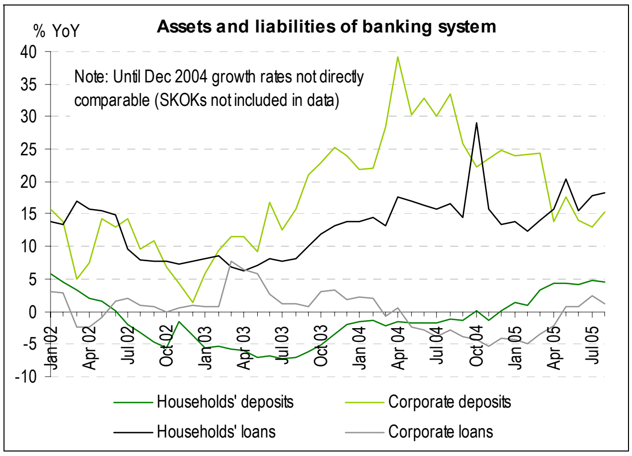


...yet households' income is growing

▪ Wage bill in enterprises sector, being a hint for households' disposable income, rose in August 4.9%YoY in nominal terms and 3.3%YoY in real terms. Even though real growth was lower than 3.8%YoY recorded in July, it was above average level 1.3% observed in the first year-half.

▪ Much lower is growth in pension bill (decreasing number of beneficiaries, lack of pension indexation this year) – in 2Q05 it was a mere 0.3%YoY in nominal terms and -2%YoY in real terms. Until pension indexation in March 2006, this element will constraint private consumption growth in Poland.

▪ A constraint for consumption could be also maintaining pessimism regarding future households' financial situation, reported in opinion polls. On the other hand, significant drop in fears of unemployment could be a positive factor.



Households' loans growth on the rise

▪ Since the beginning of this year, money supply has been expanding much faster than nominal GDP. In August the rate of M3 growth accelerated to 11.2%YoY from 10.4% in July.

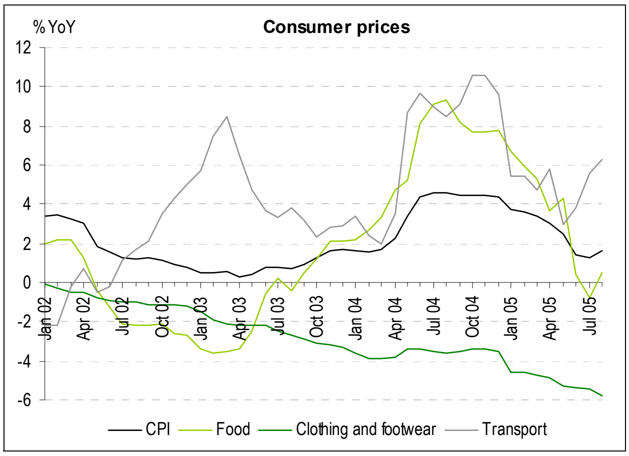
▪ Rise in households' deposits decelerated to 4.5%YoY from 4.7% in July, while companies' savings increased 15.2%YoY against 12.9% in the previous month.

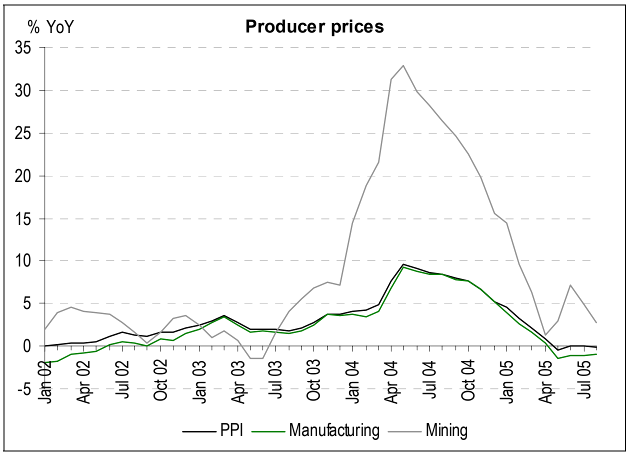
▪ Fast rise in households' loans was maintained (acceleration to 18.3%YoY). A significant part of this increase (ca. 50%) represents mortgages; however the other half is probably financing households' consumption spending.

▪ Growth in corporate loans is still low (1.2%YoY). However, it could result largely from the fact that very good financial results allow some companies to pay back old debt, and thus a demand for new loans is less clearly visible in the data.

Source: CSO, NBP, own calculations

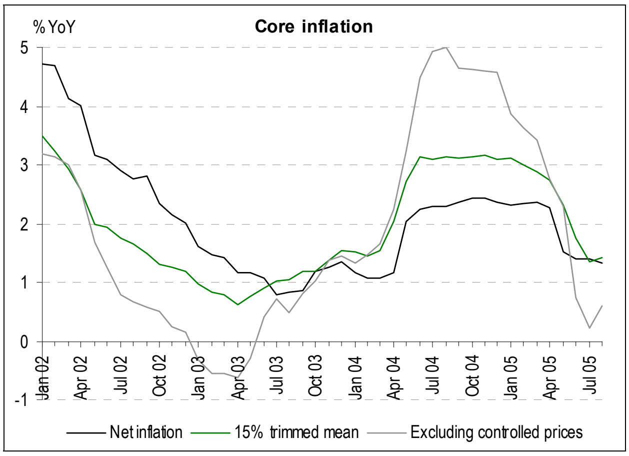
Economic update





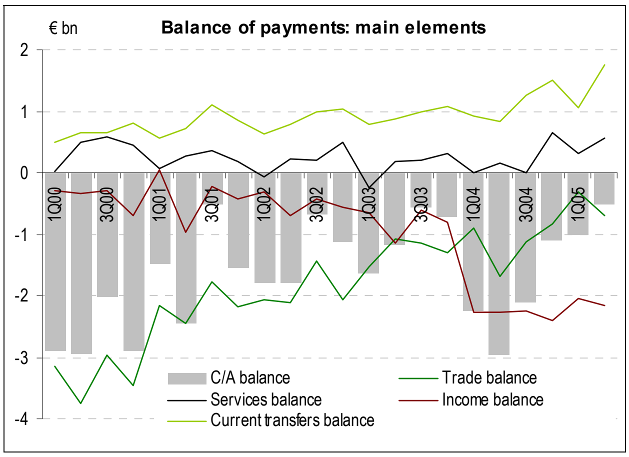
Inflation rate falling no more

- In line with our forecast, inflation rate rose in August (it was the first inflation rise since October 2004) to 1.6%YoY from 1.3%YoY in July.
- Two main sources of inflation growth were high fuel prices (+2.3%MoM) and weaker than last year seasonal drop in food prices (-0.6%YoY).
- Apart from those two factors, prices in other goods and services were characterised by great stability (monthly changes between 0.0% and 0.1%), except for prices of clothing and footwear descending 1.2%MoM; it confirmed that for now one could hardly speak about signals of demand pressure on prices.
- Impact of fuel prices on prices of other goods and services usually takes some time and thus one should not expect it to reveal in the same month that fuel price hikes took place. Thus, for the MPC it would be crucial to watch inflation development in the next few months.
- Fortunately, there is a number of factors that could help in constraining impact of high oil prices in Polish economy: strong zloty, high unemployment, low inflation expectations, reduction (temporary) in excise tax for fuel.
- In September, inflation rate is likely to rise again to 1.7%YoY (the Ministry of Finace predicts even 1.9%). Main factors of growth will be high prices of fuels and possibly food, however we do not expect to see any signs of demand pressure again. In October, after effects of fuel excise cut appear, inflation rate should come down again to ca. 1.5%YoY.



Stabilisation of core inflation

- In August two measures of core inflation declined slightly, while three others increased. In line with expectations, net inflation dropped to 1.3%YoY from 1.4% in July. Second important measure, 15% trimmed mean inched up to 1.4% from 1.3%.
- In sum, taking into account behaviour of all core inflation measures it seems that a significant drop in core inflation observed since the beginning of year has stopped for now, however in the nearest months we foresee stabilisation of net inflation close to (below) 1.5% (inflation rise in September due to prices of fuels and food).
- The fact that the most important measures of core inflation will stay close to (possibly even below) the lower end of allowed margin of inflation fluctuation around the target will support further adjustment in rates, if other data also allow for that.

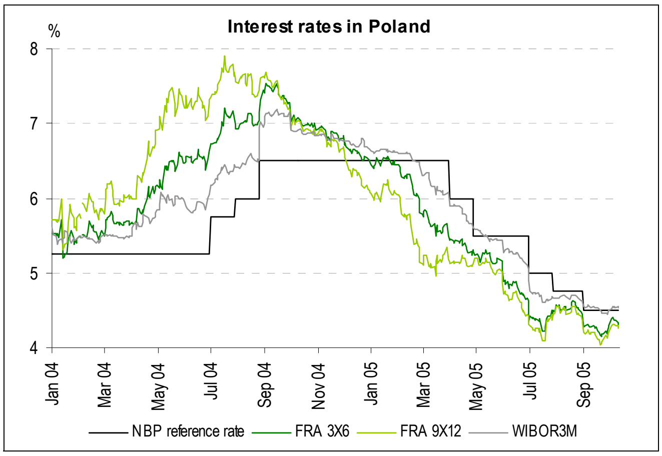


Source: CSO, NBP, own calculations

Current account gap higher than it appeared

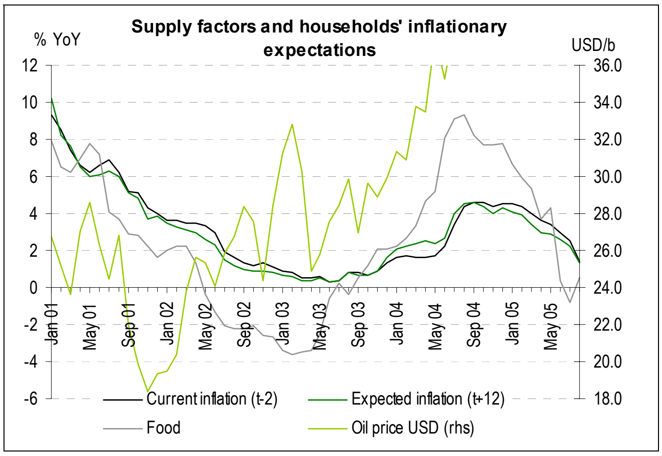
- Like every year, the NBP has revised balance of payments data basing on companies' reports about direct investment.
- After taking into account reinvested profits, income balance (and consequently also current account balance) has deteriorated significantly – in 2004 current account deficit reached 4.3% of GDP rather than 1.5% of GDP previously reported. In two first quarters of 2005, C/A balance reached deficits €1bn and €0.53bn correspondingly, instead of surpluses €0.38bn and €0.18bn.
- However, general trend of improvement in current account balance in recent quarters has been maintained, while exports and imports retained high rates of growth.
- Next monthly data will take into account estimates of reinvested profits made by the central bank for compatibility.

Central bank watch



Fragments of the MPC statement from 28 September 2005
According to current forecasts, in the medium term oil prices may increase or persist on an elevated level. There persists a large uncertainty about the influence of considerable accumulated oil price increase on economic growth and inflation.
On the whole, the above data point to higher economic growth rate in Q3 05 than in Q4 05.
As a result of recently increased forecasts of oil and gas prices inflation may move back to the target faster than presented in August projection. It needs to be emphasised that increased oil prices may also weaken economic growth.
The zloty exchange rate developments in September 2005 have not deviated significantly from the exchange rate path accounted for in the August Inflation Report.
The Council emphasises that maintaining the easing monetary policy bias does not have to imply a change in interest rates over the coming meetings.

Fragments of Monetary Policy Guidelines for 2006
Such factors as increase in flexibility of labour market, enterprises' restructuring and international competition may act towards weakening of inflationary pressures.
The Council will aim at keeping inflation expectations at low level. From this point of view the year of 2006 will be of particular importance. (...) The main factor complicating a process of inflation stabilisation around the target may by further, significant rise in oil prices.
The Council will very carefully analyse the situation from a point of view of the risk of second-round effects related to both up-to-date and possible future hikes in oil prices. If probability of such effects is considerable, the Council will take necessary actions that would counteract increase in inflation expectations. One should notice that the risk of occurrence of the second-round effects may be constrained by still high unemployment rate and slow pace of its reduction.
The MPC will also take into consideration evolution of balance of factors affecting probabilities of future inflation going above or below the target level. The Council will also take into account deviations of actual inflation path from the earlier forecasts. Such deviations indicates that future developments in the economy may differ from the earlier predictions.



Source: NBP

Easing bias does not mean cuts automatically

- In line with market consensus MPC kept reference rate on hold at 4.5% and maintained easing bias.
- Easing bias means the MPC still assesses the probability of inflation falling below the target (2.5%) as significantly higher than that of inflation moving above 2.5%. This signals also higher probability of lowering interest rates than increasing them.
- We do not change our view that official rates may be lowered by 50 bp within six-months period. We do not expect change in monetary policy parameters this month, but we see quite high probability of 25 bp rate reduction in November, especially if private consumption and fixed investments or 3Q05 surprise on the downside. Our view is similar to market consensus.

MPC statement leaves a lot to be desired

- The MPC statement gave very limited (if any) indications as regards future monetary policy decisions and we perceive it as a deterioration in communication of the MPC with the market.
- In practice, the only indication about future monetary policy direction was the easing bias, but the bias instrument will be abandoned starting 2006. Whether the MPC wanted or not, it seems that official statement in September actually justified using bias as a tool in communication. In current situation, we can only hope that statements will be much better in 2006.
- The MPC pointed to higher economic growth rate in 3Q05 than in 2Q05. Well, this is obvious that Q3 saw higher GDP growth figure (e.g. amid statistical base effect), but the MPC did not say whether the expected acceleration is faster or slower as compared to the forecast presented a month ago.

Guidelines 2006 – not as hawkish as it seems

- Monetary policy guidelines put much attention to high oil prices and potential effects on economy and possible central bank's reaction.
- It was also reflected in September MPC's statement. But did oil prices forecasts increase since previous meeting? Let's remind that last month the MPC expected CPI inflation to be below projection presented in the August report despite high oil prices. There is no doubt that such inconsistencies in communication do not make predicting MPC decisions easier.
- No major changes in understanding of the inflation target and the way of its implementation.
- The MPC maintained the view that Poland should adopt the euro as soon as possible.

Second-round effects dangerous… if they appear

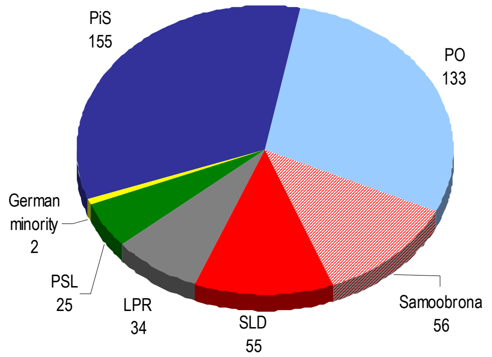
- The MPC mentioned several factors, which may change inflation path in future, out of which the most important were high oil prices, which may maintain at high level in the medium-term, according to the Council.
- If high oil prices lead to second-round effects, (high inflationary expectations acceleration in wages), the MPC would be ready to increase interest rates.
- This should not be surprising given the MPC constitutional aim. However, it is worth to remember that the MPC today's assessment of probability of such event is quite low.
- The MPC stressed that situation on the labour market makes the risk of second-round effects limited, not to mention other structural factors, which speak in favour of low inflation in future.

Central bank watch

Comments of the central bank representatives	Our remarks
Leszek Balcerowicz, NBP governor, MPC chairman **PAP, 11 October** The strategy adopted by MPC to reject bias in monetary policy since 2006 was a result of NBP experts proposal, which was based on analysis of experiences of other central banks. I will remind, it is a way of signalling, which is called bias and not bias in general sense (...) The overwhelming majority of central banks has not used this instrument and we have made conclusions. PAP, press conference, 28 September MPC is guided only by economic factors analysis and forecast of economic situation and inflation and it does not analyse political situation.	The Monetary Policy Guidelines did not even include an explanation why the bias instrument was abandoned. This appeared only in statements of MPC members. It is interesting that international experience with this regard did not really change during the last 12 months and a year ago the MPC decided to keep this instrument as a communication tool. In our opinion the bias was very useful in assessing a real balance of power within the MPC, especially as monthly statements were insufficient. Possibly different MPC members understood the bias differently and thus preferred to abandon it than using in a wrong way. Also, as voting pattern regarding bias change shows (MPC chairman outvoted a couple of times), that the currently binding easing bias was against view of a few MPC members, which could have been one of reasons behind abandoning the bias as a communication tool in monetary policy.
Dariusz Filar **Radio PiN, 11 October** I believe we have our task to accomplish and this task is to ensure low and stable inflation in Poland, closest to the inflation target. I would like to emphasize one thing, that when we ended increasing the rates in August last year, we have declared in adopted Monetary Policy Guidelines for 2005, that we will go back to inflation target within 5 to 7 quarters. 5 quarters have passed since our decision and 6th commences and inflation is in target range, in its lower part, though in range. In September, inflation will be close to 2 percent, nearing the central bank's target, and in the first quarter of next year it will top 2 percent due to a high base effect,	Expectations of inflation jump to above 2%YoY in first months of 2006 may become important point of reference for MPC members (NBP president also talked about rising CPI in 1Q06). Namely, if these expectations do not materialise (we forecast inflation to rise gradually from 1.5% in December 2005 to 2.0% in March 2006), an impression may arise that inflation performance is better than earlier expected. Thus, it may be easier to convince Filar and other hawkish rate-setters to another rate cut in 1Q05, following expected by us 25bps move in November. Even if inflation tops 2%YoY at the beginning of next year, this would be mainly a result of relatively low statistical base of 1Q05. Thus, possible materialisation of Filar's relatively pessimistic inflation predictions for early 2006 is not likely to provoke serious hawkish rhetoric. During the interview, Filar also referred to economic plans of candidate for Prime Minister. MPC member pointed out that some of Kazimierz Marcinkiewicz's proposals are inconsistent.
Stanisław Nieckarz, MPC member **PAP, 30 September** With low inflation there is no need to use the bias as an instrument of policy, (since) with low inflation, moves in interest rates are minimal. This will hold till 2006. All central banks in Europe that pursue direct inflation target retracted from bias usage. We will give more attention to presentation of balance of risks, the pro- and anti- inflation factors.	It is worth to notice that at the beginning of MPC's tenure (beginning 2004) inflation was similarly low as today (1.6% in 1Q04 and below 1% on average in 2003) and bias was used as an instrument in monetary policy. Additionally, even if moves in monetary policy are minimal, it is good to know in which direction the change may be expected. It is worth to remind that in mid-September Nieckarz (and a number of other Council members) was against abandoning the bias.
Halina Wasilewska-Trenkner, MPC member **PAP, 30 September** We have found, that bias, in the form we have published it, could lead to ambiguous interpretation, whether we speak on circumstances influencing inflation or the inflation itself. We are going to exchange it for new set of information on balance of risks. This will be the same, though more communicative. We are working on this, as we stil have a few months left and we hope, we will work out a canon which will be clear for everyone.	In 2006 communication of the MPC will be based on such instruments as inflation reports, statements and press conferences. One can only hope that the quality of statements will be better as compared to last communiqué. In other words, let's hope the MPC will deliver the goods, as in the guidelines they wrote: "the MPC will make an effort to make these instruments transparent and unambiguous" (our translation, as until mid-October the central bank did not release this important document in English). From this point of view, statements of MPC's Halina Wasilewska-Trenkner were very promising. We are looking forward to see substantial improvement in MPC statement in January 2006 and we really hope the new strategy will be successful.
Andrzej Wojtyna, MPC member **PAP, press conference after MPC meeting, 28 September** The strategy is based on the idea that central banks should not react on supply shocks. The most important for us are and may be in the future signals, which may be evidence of something happening with second round effects. Higher oil prices may result in higher inflation expectations, which would lead to higher wages and wages negotiations and then the Council will be ready to act and make adequate decisions, as it happened lat year with three rates raises as reaction. Reforms will be important for the MPB, if they are pursued. It is important how they will influence on potential GDP and effectiveness of production factors usage. They may lead to higher GDP growth rate with low inflation and lower interest rates. Strong zloty does not have to negatively affect the economy. There are countries, that achieved balance of payments surplus with permanent currency appreciation. The key factor is, whether local currency appreciation goes along with positive relation of labour productivity and wages change. There are many reasons against fast interest rates drop in Poland to the level in EU.	Statement of professor Wojtyna was one of factors sending yields higher after MPC meeting. However, in our opinion (we attended the press conference), rate hikes were presented by the MPC member as a "what if" scenario, which should not be treated as the most likely scenario expected by the Council. We have no doubts that if second-round effects appear the monetary policy tightening may be needed. But the most important issue is whether the Council expects it to happen. September's statement, monetary policy guidelines and August inflation report showed that this is not very likely, according to the MPC, amid low wages growth, high productivity growth, microeconomic changes in Polish enterprises, which together with high international competition limits the influence of high commodity prices on prices of other products. Some of those factors were mentioned by Wojtyna, but his statements were quoted partially, which caused market reaction. While political uncertainty was probably one of factors behind keeping rates on hold (though MPC members did not agree with that), as regards future monetary policy in reaction to an optimistic scenario after election there was one important quote of Wojtyna.

Government and politics

Distribution of seats in the newly elected Sejm



And the winner is… PiS!

▪ PiS took the first place in parliamentary election, slightly ahead of PO. Total result of the two parties proved weaker than expected. They will have majority of seats in the Sejm, but not large enough to amend the Constitution.

▪ Taking into account that except for PO all other parties in the Sejm have many “social” elements in their economic programmes, there is a risk MPs will adopt some costly bills. From this point of view, effects of possible break-up of the ruling coalition could be disastrous.

▪ Meanwhile, Fitch Ratings maintained positive outlook for Poland’s ratings. Fitch said it hoped the new government would be determined in efforts aimed at fiscal consolidation and would maintain reasonable macroeconomic policy.

Results of first presidential polls after the first turn

Poll	Donald Tusk	Lech Kaczyński
By OBOP carried out on 11 October for Fakt daily	54	46
By OBOP carried out on 11 October for Polityka weekly	54	46
By OBOP carried out on 10 October for Fakt daily	55	45
By PBS carried out on 10 October for Gazeta Wyborcza daily	56	44
By OBOP carried out on 9 October for Fakt daily	51	49

Note: Only PBS poll was not carried out through telephone, which means that the group

Election marathon continues

▪ In line with expectations, the first turn of presidential election did not bring the final settlement – exhausted candidates of PO and PiS will continue fight the election fiercely. This is surely not a good news from the point of view of coalition talks which so far has not proceeded successfully, especially as regards economic program. Both sides of the possible coalition admits that an agreement on makeup of the government and its detailed program could be reached only after the presidential election.

▪ One day after the first of presidential election PiS candidate for Prime Minister Kazimierz Marcinkiewicz presented an outline of his economic program. The outline proved to be a repeat of earlier announced watchwords and general ideas. Among other, a concept of “budget anchor” – nominal budget deficit at PLN30bn in the nearest four years - was repeated.

Main parameters of 2006 budget, PLNm

	2005 P	2005 E	2006 P
Total revenue	174 703.7	178 870.0	189 228.0
- tax revenue	155 285.9	156 950.0	171 996.0
- indirect taxes	116 980.7	115 650.0	126 220.0
- CIT	14 690.6	17 300.0	20 126.0
- PIT	23 614.6	24 000.0	25 650.0
- non-tax revenue	16 641.5	19 085.6	15 083.0
- foreign revenue	71.1	336.9	105.7
- payments from EU	2 705.2	2 498.4	2 043.3
Total spending	209 704.0	209 704.0	221 803.0
Deficit	-35 000.0	-30 833.7	-32 575.0

P – planned in the budget bill/draft; E – estimated execution

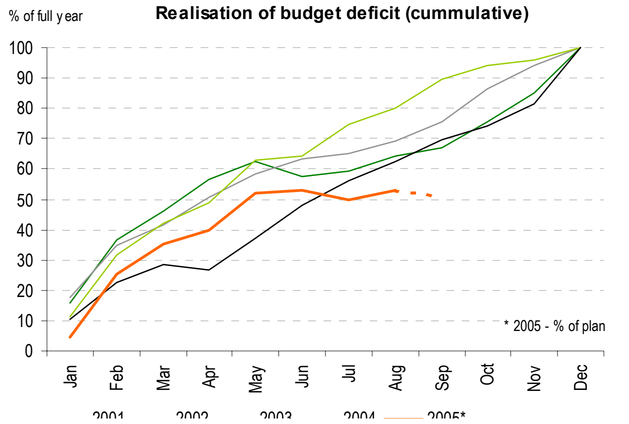
2006 budget officially approved, but will be amended

▪ On September 27 the outgoing government approved the final version of the 2006 budget draft.

▪ We have already written about the main budget parameters (see table) and there is no use discussing them once again. The budget prepared by outgoing finance minister Mirosław Gronicki is not of particular importance for the market, because election winners announced they would like to amend the 200 budget. Besides, what really matters for the market are fiscal plans for the subsequent years.

▪ As far as 2006 is concerned, PiS plans to lower the deficit to PLN30bn, mostly through cuts in administrative spending. Taking into account that all administrative spending do not exceed PLN9bn, its reduction by over PLN2bn may be very difficult. There would be no major changes in taxes for 2006.

Realisation of budget deficit (cummulative)



Source: Ministry of Finance, State Election Commission

2005 budget performs smoothly

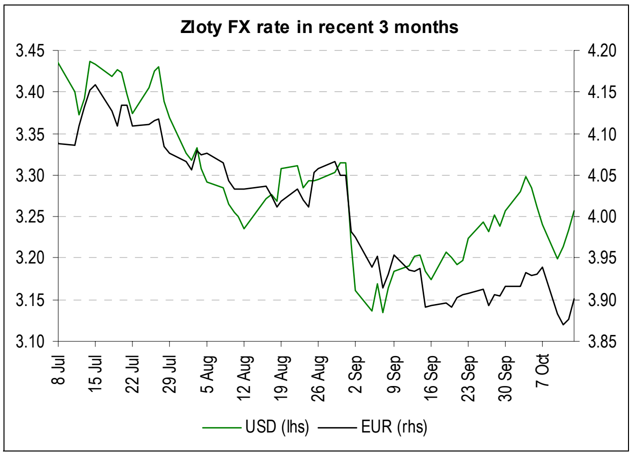
▪ This year’s budget still performs very well. The deficit after August amounted to only PLN18.5bn or 52.8% of the full-year plan. According to hints from FinMin, the budget gap after September would reach only 51% of the annual plan (which means a surplus in September alone). This was possible thanks to tight control over spending side and fast rise in revenues. There is strong inflows growth both in case of direct and indirect taxes. The latter suggests strong economic activity.

▪ All in all, one may optimistically think about execution of this year’s budget. It seems almost sure that declarations of finance minister that this year’s budget gap would be around PLN4bn lower than planned are likely to materialise. However, one cannot exclude the new cabinet will increase spending towards the end of this year (e.g. on elimination of children’s malnutrition).

Government and politics

Comments of government representatives and politicians	**Our remarks**
Kazimierz Marcinkiewicz, kandydat PiS na premiera **Reuters, 5 October** I treat Rokita's letter as a first signal to reach consensus. On a deep analysis of the letter and proposals included I can say that there is agreement between two parties as far as willingness to introduce high standards of ruling is concerned. I am 100% positive I will succeed to form a government. **Reuters, 3 October** Changes we propose, are less costly changes, which net is around PLN12-14bn. It is not possible to introduce everything since 1 January 2006. (...) As a consequence, these costs, spread over 2 years, will be covered with no obstacles. We will not change taxes since 2006 in order to maintain tax system stability. We would like changes in taxes to be adopted in half of next year, so as they could be introduced since the beginning of 2007. It refers to directs as well as indirect taxes. I assume, that during 2005-2009 term of office the government will not have to make a decision on common currency adoption, our aim is to fulfil all convergence criteria, however we will not decide on euro adoption. I have to watch out, because now there will be something about monetary and fiscal policy and all markets will shiver. Attention: sound monetary and fiscal policy is a policy for growth and not only for lower inflation. Interest rates must be lower. Today inflation is not a problem in Poland. (...) To follow – proper zloty value. Zloty should be on the level, which makes export profitable. It is, what all exporters are awaiting. I base solely on analysts opinions and analysis. Many of them thinks 4.1-4.3 for euro is best level for growth of Polish economy.	Civic Platform has not presented its negotiations statement in coalition talks with PiS as far as economic policy is concerned. PO deputy prime minister candidate Jan Rokita described only a „grid of ruling", these are proposals on way of ruling government . It was a good will gesture, which enabled deadlock break, that started right after parliamentary elections. PO may have decide not to release their programme ideas for new government as liberal elements could weaken Donald Tusk chances in presidential elections. One could expect, that as the coming elections shine fades away, PO will disclose its concepts and coalition talks will move on. However consensus will be hard to achieve. Starting point on economic policy will be ideas declared by PiS prime minister candidate Kazimierz Marcinkiewicz issues. Some of them will meet disapproval of coalition fellowmen from PO, the same as they did not gain favour of the markets. As example, bond prices fell when Marcinkiewicz announced net cost of planned changes at PLN12-14bn, instead of social cuts proposal. For now the markets feel PiS is only talking about the costs of the reforms, but nothing about necessary cuts. The negative side of what was proposed by Marcinkiewicz is that given numbers and figures are formed very superficial way and with no connection between each other(as commented by MPC member Dariusz Filar). PiS wants the taxes to be lower and lower budget deficit than in Minister of Finance Mirosław Gronicki's budget draft (quite tight now), but what we may here is only additional expenditures. PiS's ideas on euro zone entrance pace are very controversial (although declaration of strive towards meeting the convergence criteria is positive), as well as views on the role of central bank in the economy and weakening of zloty. PO opinion on this matter is different.
Jan Rokita, PO **PAP, 22 September** [Strategy of entering the euro zone] This will be the case, of how much the deficit can be limited. However there is another A key issue, which not to be solved within next 100 days. It needs adoption of long-term strategy and consultation with the European Commission. This is a question about the method of currency stabilization, especially when it comes to high zloty appreciation pressure after ambitious economic growth programme and fiscal adjustments introduction. This makes currency stabilization even more neuralgic problem, which may be coped with by reasonable mechanisms negotiated with EC on ERM2 range, or by zloty fixing. As it is known all countries, that entered the path to euro operate in the latter model.	In the key issues with regards to markets concerning zloty value, there is some space to reach agreement between coalition parties. Both parties agree that potential strong zloty strong appreciation, which might result as the effect of introduction of ambitious and deep reforms, should be stopped. Abstracting from the fact, whether PO together with PiS manage to pursue such reforms, both parties think, that in the scenario of significant zloty appreciation adoption of fixed/pegged/ stiffer currency may be necessary. PO leader said, that this issue would not be solved in the first period of new government operating/ruling, as it requires consultation with EU. Rokita forgot to mention that it will be determined as well by the agreement of independent central bank. We think NBP will be more inclined to take on standard ERM2 mechanism course rather than zloty fixing.
Donald Tusk, PO **PAP, 15 September** Actual and positive effects may be achieved through euro convergence criteria. Entering the euro zone will be a result and not the aim of our efforts. I do not reject the idea of referendum on this matter, especially when main political forces will not be able to reach consensus. If the euro zone entrance date was the only dissenting problem I would be highly optimistic. **Lech Kaczyński, PiS** **Reuters, 15 September** Issue of euro adoption will not dissent us with PO, because entering euro zone is not possible during the cadence of this Parliament. We do not oppose euro adoption, however this will require improvement of position of Polish economy and fulfilling economic criteria. We will observe, how euro case will develop in Europe. We believe, referendum as to the euro adoption is required. It is absolutely necessary, as it is a matter of sovereignty. We thing that such referendum could take place at the end of Parliament cadence.	Although Donald Tusk, PO leader and candidate in presidential elections, claims, that Poland should adopt common currency as soon as possible, he will not insist as principle. According to Tusk the most important task is meeting the convergence criteria, whereas the euro adoption will not be an aim of this process but its result. Lech Kaczyński, the second candidate for president post believes, that it will not be possible to adopt common currency during the cadence of this parliament, which does not make euro case a cause of potential dissention. Tusk seems to agree it is not the most important difference in their programme. Both candidates for president agreed that when it comes to euro adoption referendum should be called. According to Tusk it is possible, whereas for Kaczyński it is necessary and should take place at the end of the cadence of the parliament (probably not before 2009). As a result the date of euro zone entrance may be postponed after the previously planned 2009-2010 – lets remind, that according to the Ministry of Finance document 3 years have to pass since making the decision of euro adoption to actual euro zone entry.

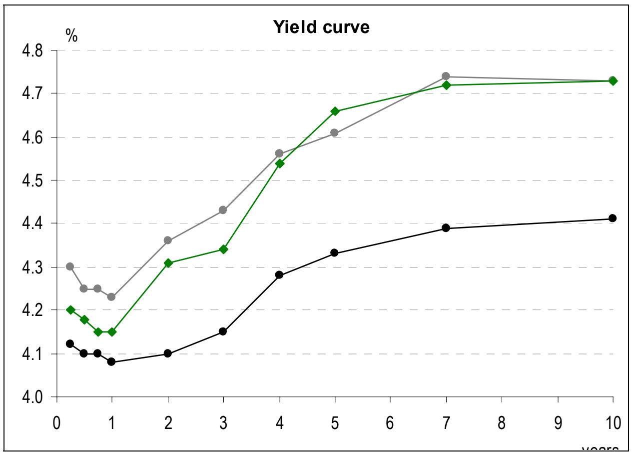
Market monitor



Zloty not troubled with election results

▪ On strong and unexpected appreciation in the beginning of September zloty has started to slightly weaken in the second half of September. One reason for this could be parliamentary elections polls, which showed lower advantage of PO over PiS. The result of elections, i.e. PiS victory, did not weaken zloty further, although investors counted on PO new government lead. Despite difficult coalition talks, zloty sharply strengthened and EURPLN hit 3 year low.

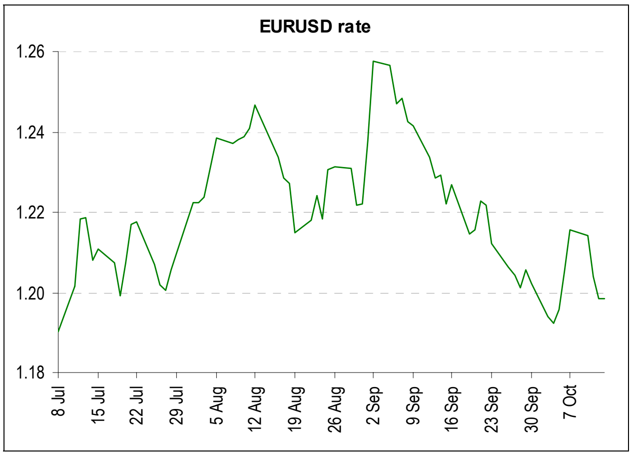
▪ Apart from long-term factors such as strong balance of payment position the zloty is supported by declaration of MinFin it will sell part of the dollar proceeds received from foreign debt issue. We believe, that if PiS and PO form government with sensible programme zloty will remain strong.



... however fixed income market significantly weakened

▪ In the first half of October the yield curve is more or less at the same level as compared with the end of August, though it is steeper between 2-5 years, as a result of long-term bonds yield rise and 2Y bonds yield drop. Throughout 2 decades of September yields were going down hitting record low level on 20th September. However, on distressing parliamentary elections polls and on PiS victory over PO debt market weakened. Long end of the curve was influenced by yields rise in the foreign debt markets, whereas more hawkish than expected MPC statement as well as Monetary Policy Guidelines for 2006 had negative effect on short end of the curve.

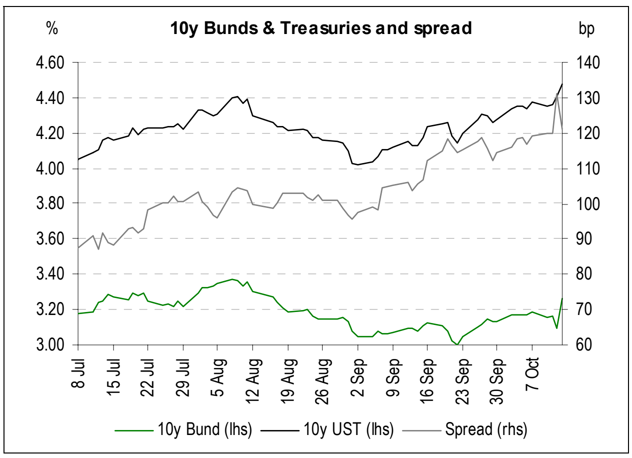
▪ In the nearest future fixed income market will be influenced by political situation.



Dollar appreciates thanks to positive data and higher interest rates

▪ In contrast to the beginning of September dollar appreciated in the following weeks against euro. The negative consequences of Katrina hurricane had lower influence on U.S. economy than expected, and next Rita hurricane did not cause substantial damage. Majority of recently published activity ratios and data on labour markets in USA were better than expected, which strengthened dollar. EURUSD dropped down to 1.19, however weak ISM ratio for services sector and positive data from euro zone resulted in temporary correction.

▪ At the beginning of October dollar appreciated once more thanks to hawkish Fed information. Expectations on further interest rates rise supports dollar. In the nearest perspective EURUSD should fluctuate around 1.20.



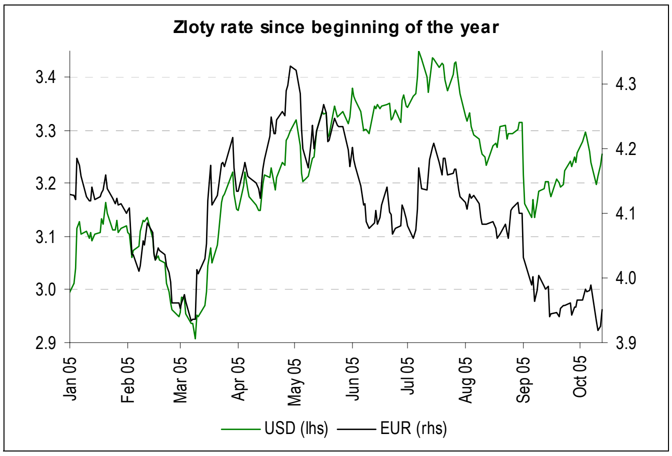
Source: Reuters, BZ WBK

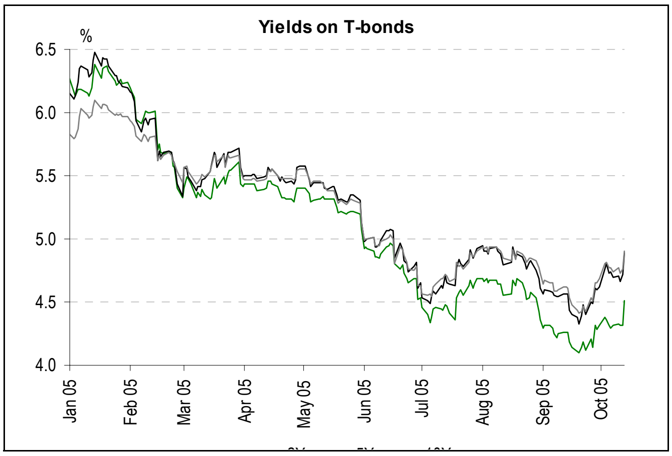
Yields soar on the foreign fixed income markets

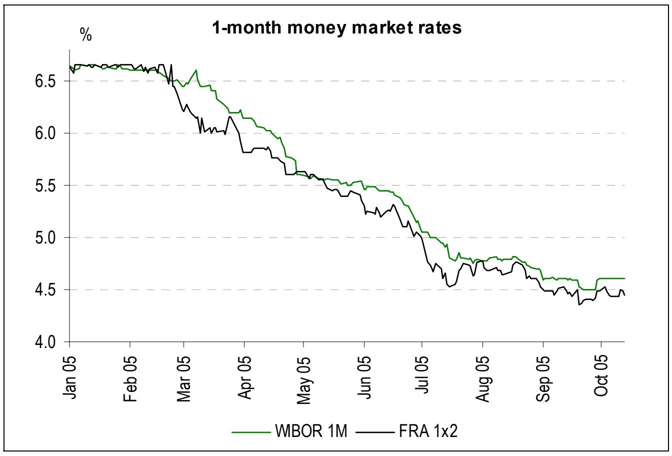
▪ After August, which was positive for all main debt markets, there came a period of explicit yields increases. This was the consequence of positive activity data in USA and euro zone as well as the fact the situation on the oil market calmed down, when it appeared hurricane effects in USA are not so painful for American economy as expected. In comparison to beginning of August markets have stronger belief of gradual rates increases in U.S. and started considering ECB rates rises in nearest future as well.

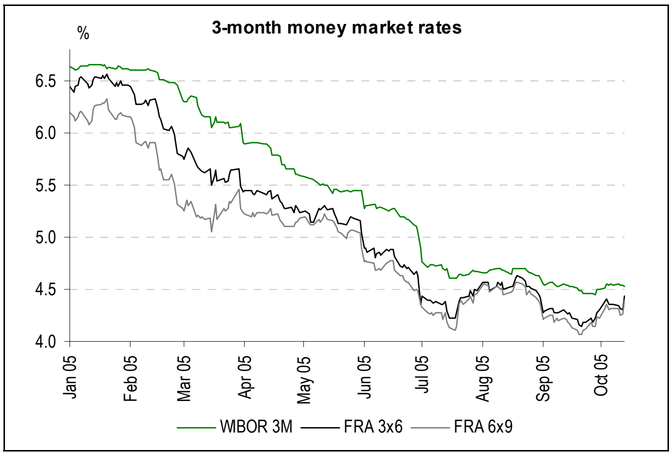
▪ Faith in strength of economy and interest rates rise as its consequence is still higher in U.S. than in euro zone. As a result spread between 10Y Treasuries and Bunds rose up to 120bp.

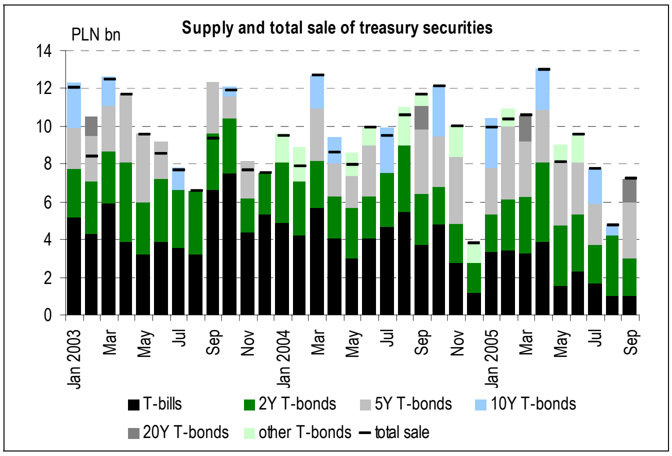
Market monitor











Treasury bill auctions (PLN m)

Date of auction	13-week	52-week	Total
	OFFER / SALE		
08.08.2005	-	500/500	500/500
22.08.2005	-	500/500	500/500
Total August	**-**	**1 000 / 1 000**	**1 000 / 1 000**
05.09.2005	100/100	400/400	500/500
19.09.2005	100/100	400/400	500/500
Total September	**200 / 200**	**800 / 800**	**1 000 / 1 000**
03.10.2005	100/100	400/400	500/500
17.10.2005	100	400	500
Total October*	**200**	**800**	**1 000**

* estimations based on Ministry of Finance preliminary information

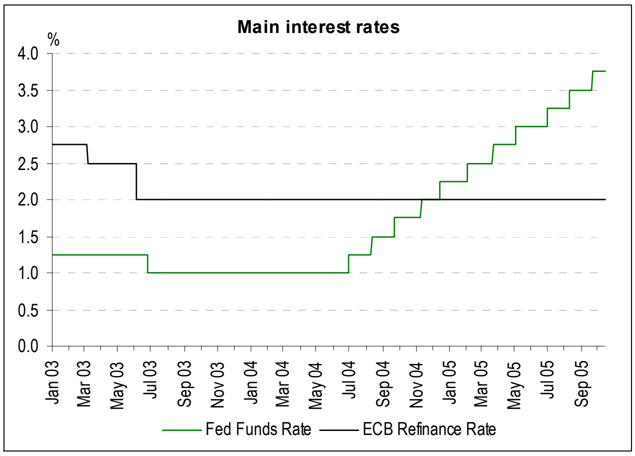
Treasury bond auctions in 2005 (PLN m)

month	First auction				Second auction				Third auction			
	date	T-bonds	offer	sale	date	T-bonds	offer	sale	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	3 840	3 200
March	02.03*	OK0407	3 000	3 000	09.03	WS0922	1 400	1 400	16.03	PS0310	2 900	2 900
April	06.04	OK0407	3 500	3 500	13.04	DS1015	2 200	2 130	20.04*	PS0310	2 750	2 750
May	04.05*	OK0807	3 120	3 120	11.05	IZ0816	1 000	0	18.05*	PS0310	3 360	3 360
June	01.06*	OK0807	3 000	3 000	08.06*	WZ0911	1 440	1 440	15.06	PS0310	2 800	2 800
July	06.07	OK0807	2 000	2 000	13.07	DS1015	1 800	1 800	20.07	PS0310	2 200	2 200
August	03.08*	OK0807	3 240	3 240	10.08	IZ0816	500	500	-	-	-	-
September	07.09	OK1207	2 000	2 000	14.09*	WS0922	1 200	1 200	21.09*	PS0310	3 000	3 000
October	05.10	OK1207	1 500	1 500	12.10*	DS1015	2 025	2 025	19.10	PS0310	-	-
November	02.11	OK1207	-	-	09.11	12Y CPI	-	-	16.11	5Y	-	-
December	07.12	3&7Y float	-	-	-	-	-	-	-	-	-	-

* with supplementary auction

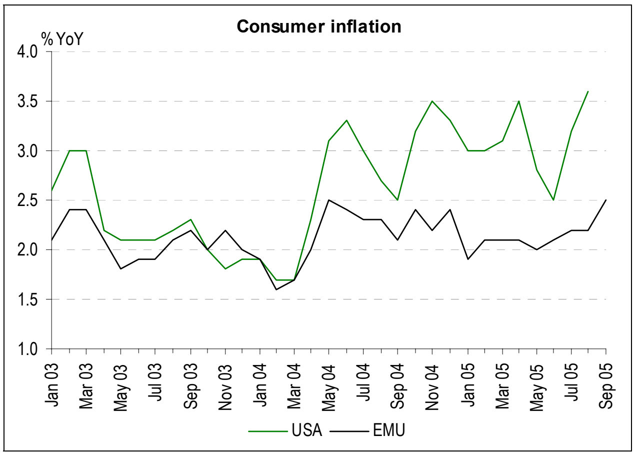
Source: Ministry of Finance, Reuters, BZ WBK

International review



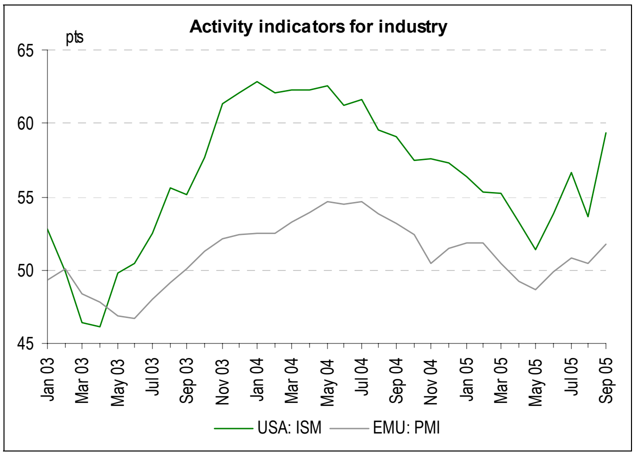
Interest rate rise in US, growing expectations Euro Zone will soon follow

- Fed increased interest rates by 25 b.p. claiming Kathrina hurricane will have shortterm effect on economy. In contrast to previous months, decision was not unanimous, as one Fed member voted against rate increase. Official interest rate in USA amounts 3,75% and is on the highest level since June 2001. Next increases are expected.
- ECB decided to leave rates on current 2% level. However on press conference called after the decision the market was surprised by ECB president Jean-Claude Trichet words, which were more hawkish than expected. He gave more attention to inflation rise risks, which strengthened expectations, of soon rates rise in euro zone.



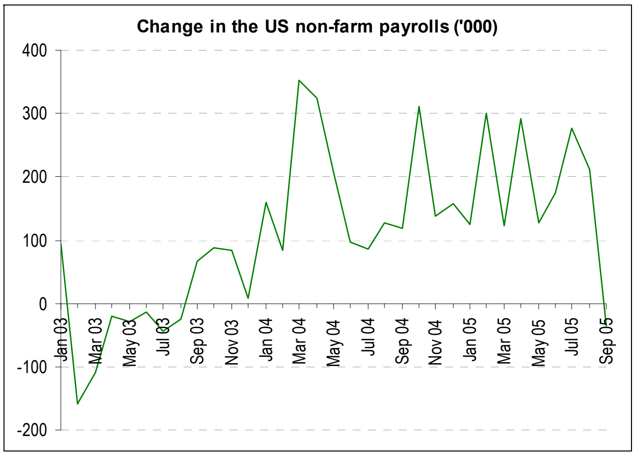
High fuel prices cause higher inflation

- CPI index in USA rose in August by 0,5% MoM and basis inflation index, which excludes food and energy prices, increased by 0,1% MoM. Data was better than market expectations which amounted respectively 0,6% and 0,2%. Energy prices increased in August by 5% MoM and food prices remained on the previous level. Annual CPI growth rate (inflation rate) increased to 3,6%, which is the highest level since beginning of 2001.
- According to preliminary estimates of Eurostat, inflation in euro zone jumped from 2,2% in August to 2,5%. It is the highest level since May 2004. Production prices increased by 0,4% MoM and 4% YoY, as record high oil prices contributed to energy prices rise by 1,6% MoM and 15,1 YoY. On energy prices exclusion, production prices increased only by 0,1 MoM 1,3% YoY.



Industrial activity indices rise.

- ISM ratio in production sector experienced unexpected rise in August from 53.4pp to 59.4pp, whereas analysts forecasted drop to 52pp. Employment ratio increased moderately from 52.6pp to 53.1pp. and new orders ratio jumped significantly from 56.4pp to 63.8pp. In contrast ISM ratio for services sector decreased in September from 65.0pp in August to 53.3pp, which was much below market expectations of 61.0pp.
- PMI index for industry in euro zone was higher than predicted and amounted 51.7p.p. against the expected 50.8p.p. PMI for services sector rose in September to 54.7p.p., as compared with August ratio revised upwards to 53.4p.p. and expectations at 53.5p.p. It means, that service sector activity experienced in September the highest level since 14 months, thanks to among other things better shape of German economy.



Jobs drop lower than expected

- September was first month since May 2003, when American economy lost jobs. However, employment drop in USA was smaller than expected (35k as compared with 143k predicted), as negative effect of Katrina hurricane was diminished by jobs increase in other regions. The effects of Rita hurricane may be noticed in the following moth data.
- According to US Labour Department of Labor, the increase of jobs might have amounted 194k, which is close to previous year average, but for the hurricane effect. Simultaneously data for the next two months was revised. Unemployment rate rose from 4.9% in August to 5.1% (the highest level since May). Positive data limited doubts as to next interest rate increases on the next Fed meeting, which resulted in dollar appreciation and Treasuries' yields rise.

Source: Reuters, ECB, Federal Reserve

Economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
10 October	**11**	**12** ***POL: 10Y bond auction***	**13** ***POL: Balance of payments (Aug)*** USA: Foreign trade (Aug)	**14** ***POL: CPI (Sep)*** ***POL: Money supply (Sep)*** USA: CPI (Sep) USA: Retail sales (Sep) USA: Industrial output (Sep) USA: Michigan index (Oct) USA: Capacity utilisation (Sep)
17 ***POL: Treasury bills auction*** ***POL: Wages (Sep)*** ***POL: Employment (Sep)***	**18** GER: ZEW index (Oct) EMU: Final HICP (Sep) USA: PPI (Sep) USA: Net capital flows (Aug)	**19** ***POL: 5Y bond auction*** ***POL: Output in industry and construction (Sep)*** ***POL: PPI (Sep)*** EMU: Industrial output (Aug)	**20** EMU: Trade balance (Aug)	**21** ***POL: Business climate (Oct)***
24 ***POL: Core inflation (Sep)***	**25** ***POL: MPC meeting*** ***POL: Retail sales (Sep)*** ***POL: Unemployment rate (Sep)*** GER: IFO index (Oct) USA: Consumers' confidence (Oct)	**26** ***POL: MPC meeting – decision***	**27** USA: Durable goods (Sep)	**28** EMU: Money supply (Sep) EMU: HICP flash (Oct) USA: GDP final (Q3) USA: Michigan Index final (Oct)
31 USA: Chicago PMI (Oct)	**1 November** ***POL: Holiday*** USA: Fed meeting – decision EMU: PMI manufacturing (Oct) USA: ISM manufacturing (Oct)	**2** ***POL: 2Y bond auction***	**3** EMU: PMI non-manufacturing (Oct) EMU: ECB meeting – decision USA: Unit labour costs, productivity (Q3) – final USA: Factory orders (Sep) USA: ISM non-manufacturing (Oct)	**4** EMU: PPI (Sep) EMU: Unemployment (Sep) USA: Non-farm payrolls (Oct) USA: Unemployment (Oct)
7 ***POL: Treasury bills auction*** EMU: Retail sales (Sep)	**8**	**9** ***POL: 12Y CPI-indexed bond auction*** USA: Wholesale inventories (Sep)	**10** USA: Foreign trade (Sep) USA: Foreign trade prices (Oct) USA: Michigan index (Nov) USA: Budget deficit (Oct)	**11** ***POL: Independence day***

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*	31	-	11	-	31	-	-	29	-	-	29[f]	-
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	23	23	25	25	23	25	23	21	25	23	21
Gross wages, employment	17	15	15	15	18	15	15	16	15	17	17	15
Unemployment	24	23	23	25	25	23	25	23	21	25	23	21
Foreign trade	about 50 working days after reported period											
Balance of payments*	-	-	31	-	-	30	-	-	30	-	-	-
Balance of payments	31[c]	28	31	29	31	30	12	11	12	13	15	-
Money supply	14	14	14	14	13	14	14	12	14	14	14	-
NBP balance sheet	7	7	7	7	6	7	7	5	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 , [f] not officially confirmed

Source: CSO, NBP

Economic data and forecasts

Monthly economic indicators

		Sep 04	Oct 04	Nov 04	Dec 04	Jan 05	Feb 05	Mar 05	Apr 05	May 05	Jun 05	Jul 05	Aug 05	Sep 05	Oct 05
Industrial production	%YoY	9,5	3,5	11,4	6,8	4,6	2,3	-3,7	-1,1	0,9	6,9	2,6	4,6	5,6	5,9
Retail sales [c]	%YoY	8,8	4,0	4,4	2,8	7,5	2,4	-0,3	-14,4	8,0	10,5	5,0	7,9	9,6	9,9
Unemployment rate	%	18,9	18,7	18,7	19,1	19,5	19,4	19,3	18,8	18,3	18,0	17,9	17,8	17,6	17,4
Gross wages [b c]	%YoY	3,7	2,4	2,7	3,2	2,6	1,4	2,2	1,8	3,0	4,5	3,2	2,8	3,1	3,3
Employment [b]	%YoY	-0,6	-0,4	-0,3	0,2	1,5	1,6	1,6	1,7	1,6	1,7	1,8	2,0	2,1	2,2
Export [d]	%YoY	20,0	17,5	31,0	22,5	35,0	27,3	11,0	12,6	11,3	12,9	12,9	15,1	11,9	10,6
Import [d]	%YoY	20,7	15,3	24,5	16,3	22,7	27,9	6,8	-5,2	13,5	10,8	8,7	15,5	12,4	15,3
Trade balance [d]	EURm	-344	-160	-238	-442	100	-60	-359	-19	-495	-172	-286	-368	-420	-480
Current account balance [d]	EURm	-797	-407	-199	-489	-408	-317	-275	157	-754	77	-438	-380	-420	-510
Current account balance [d]	% GDP	-4,3	-4,6	-4,5	-4,3	-4,2	-3,9	-3,5	-2,8	-2,6	-2,2	-1,9	-1,9	-1,7	-1,7
Budget deficit (cumulative)	PLNbn	-29,0	-30,8	-33,8	-41,5	-1,6	-8,8	-12,3	-13,9	-18,3	-18,5	-17,5	-18,5	-17,7	-20,8
Budget deficit (cumulative)	% realisation	69,8	74,1	81,4	100,0	4,5	25,2	35,2	39,6	52,3	52,9	49,9	52,8	50,7	59,5
CPI	%YoY	4,4	4,5	4,5	4,4	3,7	3,6	3,4	3,0	2,5	1,4	1,3	1,6	1,7	1,5
PPI	%YoY	7,9	7,6	6,7	5,2	4,5	3,2	2,2	0,9	-0,5	0,0	0,0	-0,1	0,3	0,2
Broad money (M3)*	%YoY	6,5	10,5	6,4	8,7	9,3	9,4	11,0	10,0	13,2	10,8	10,4	11,2	11,6	7,7
Deposits*	%YoY	6,6	11,5	6,5	8,1	8,4	8,7	10,4	8,7	11,9	9,2	9,4	10,1	10,3	5,6
Credits*	%YoY	4,3	9,7	4,2	2,9	3,5	2,4	4,6	5,3	9,4	7,5	8,8	9,1	10,7	5,0
USD/PLN	PLN	3,58	3,46	3,28	3,09	3,11	3,06	3,04	3,21	3,29	3,34	3,40	3,29	3,20	3,26
EUR/PLN	PLN	4,37	4,32	4,26	4,14	4,08	3,99	4,02	4,16	4,18	4,06	4,10	4,05	3,92	3,95
Reference rate [a]	%	6,50	6,50	6,50	6,50	6,50	6,50	6,00	5,50	5,50	5,00	4,75	4,75	4,50	4,50
WIBOR 3M	%	7,12	6,89	6,81	6,72	6,63	6,54	6,15	5,78	5,48	5,22	4,66	4,67	4,57	4,50
Lombard rate [a]	%	8,00	8,00	8,00	8,00	8,00	8,00	7,50	7,00	7,00	6,50	6,25	6,25	6,00	6,00
Yield on 52-week T-bills	%	7,38	7,00	6,81	6,44	6,28	5,95	5,51	5,36	5,19	5,09	4,30	4,33	4,15	4,15
Yield on 2-year T-bonds	%	7,51	7,04	6,81	6,39	6,24	5,82	5,43	5,39	5,27	5,14	4,50	4,60	4,22	4,30
Yield on 5-year T-bonds	%	7,33	7,03	6,78	6,29	6,31	5,80	5,56	5,50	5,38	5,25	4,70	4,84	4,51	4,70
Yield on 10-year T-bonds	%	6,96	6,75	6,43	6,02	5,98	5,72	5,57	5,49	5,36	5,24	4,72	4,87	4,57	4,80

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

* Since January 2005 the NBP changed methodology of monetary statistics (definition of Monetary Financial Institutions has been extended with cooperative savings and credit unions (SKOK)). Before January 2005 the table presents growth rates in old methodology, not fully comparable with recent data.

Quarterly and annual economic indicators

		2002	2003	2004	2005	1Q04	2Q04	3Q04	4Q04	1Q05	2Q05	3Q05	4Q05
GDP	PLNbn	781,1	816,1	885,3	936,7	204,1	216,3	219,2	245,7	218,5	226,1	230,8	261,3
GDP	%YoY	1,4	3,8	5,4	3,5	7,0	6,1	4,9	4,0	2,1	2,8	3,7	4,9
Domestic demand	%YoY	0,9	2,6	5,0	2,0	6,0	5,8	5,2	3,3	1,1	-0,3	1,8	4,9
Private consumption	%YoY	3,3	3,1	3,4	2,5	4,1	4,0	3,6	1,9	1,7	1,5	3,0	4,0
Fixed investments	%YoY	-5,8	-0,9	5,3	5,5	3,7	3,9	4,3	7,4	1,0	3,8	6,0	8,0
Industrial production	%YoY	1,1	8,4	12,3	3,5	19,0	16,4	9,2	6,2	0,7	2,3	4,3	6,7
Retail sales (real terms)	%YoY	1,9	3,6	7,1	2,6	13,6	11,3	4,0	1,1	-0,4	-3,2	5,5	8,5
Unemployment rate [a]	%	20,0	20,0	19,1	17,7	20,4	19,4	18,9	19,1	19,3	18,0	17,6	17,7
Gross wages (real terms)	%YoY	1,5	2,0	0,8	0,6	3,8	1,6	-0,5	-1,5	-1,3	0,8	1,5	1,6
Export [b]	%YoY	6,0	9,1	22,3	14,2	17,9	27,7	19,7	23,6	23,1	12,2	13,3	10,0
Import [b]	%YoY	3,5	3,3	19,5	11,7	11,4	29,9	18,0	18,7	17,8	5,7	12,2	12,0
Trade balance [b]	EURm	-7 701	-5 077	-4 552	-3 374	-910	-1 693	-1 115	-834	-316	-690	-1 074	-1 294
Current account balance [b]	EURm	-5 399	-4 108	-8 401	-3 284	-2 245	-2 962	-2 102	-1 092	-1 001	-528	-1 238	-517
Current account balance [b]	% GDP	-2,7	-2,2	-4,3	-1,4	-2,6	-3,5	-4,3	-4,3	-3,4	-2,2	-1,7	-1,4
Budget deficit (cumulative) [a]	PLNbn	-39,4	-37,0	-41,5	-30,8	-11,8	-19,9	-29,0	-41,5	-12,3	-18,5	-17,7	-30,8
Budget deficit (cumulative) [a]	% GDP	-5,0	-4,5	-4,7	-3,3	-5,8	-3,7	-4,1	-5,1	-5,6	-2,7	0,3	-5,0
CPI	%YoY	1,9	0,8	3,5	2,2	1,6	3,3	4,5	4,4	3,6	2,3	1,5	1,5
CPI [a]	%YoY	0,8	1,7	4,4	1,5	1,7	4,4	4,4	4,4	3,4	1,4	1,7	1,5
PPI	%YoY	1,0	2,6	7,0	1,1	4,4	8,8	8,3	6,5	3,3	0,1	0,1	1,1
Broad money (M3)* [a]	%YoY	-2,0	5,6	8,7	10,0	5,7	7,2	6,5	8,7	11,0	10,8	11,6	10,0
Deposits* [a]	%YoY	-4,1	3,7	8,1	8,5	4,8	6,9	6,6	8,1	10,4	9,2	10,3	8,5
Credits* [a]	%YoY	4,7	8,1	2,9	10,0	6,0	5,7	4,3	2,9	4,6	7,5	10,7	10,0
USD/PLN	PLN	4,08	3,89	3,65	3,22	3,82	3,89	3,62	3,27	3,07	3,28	3,30	3,22
EUR/PLN	PLN	3,85	4,40	4,53	4,03	4,78	4,69	4,43	4,24	4,03	4,13	4,02	3,94
Reference rate [a]	%	6,75	5,25	6,50	4,25	5,25	5,25	6,50	6,50	6,00	5,00	4,50	4,25
WIBOR 3M	%	9,09	5,69	6,21	5,25	5,47	5,87	6,68	6,81	6,44	5,49	4,63	4,43
Lombard rate [a]	%	8,75	6,75	8,00	5,75	6,75	6,75	8,00	8,00	7,50	6,50	6,00	5,75
Yield on 52-week T-bills	%	8,18	5,33	6,50	4,88	5,75	6,24	7,26	6,75	5,91	5,21	4,26	4,15
Yield on 2-year T-bonds	%	7,94	5,38	6,89	4,96	6,28	6,86	7,66	6,75	5,83	5,27	4,44	4,30
Yield on 5-year T-bonds	%	7,86	5,61	7,02	5,16	6,67	7,10	7,59	6,70	5,89	5,38	4,68	4,70
Yield on 10-year T-bonds	%	7,34	5,77	6,84	5,16	6,70	7,00	7,25	6,40	5,76	5,37	4,72	4,80

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

[a] at the end of period; [b] balance of payments data on transaction basis
* Since January 2005 the NBP changed methodology of monetary statistics. Before January 2005 the table presents growth rates in old methodology, not fully comparable with recent data.

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