Bank Zachodni WBK

MACROscope

Polish Economy and Financial Markets

January 2006

Welcome to 2006

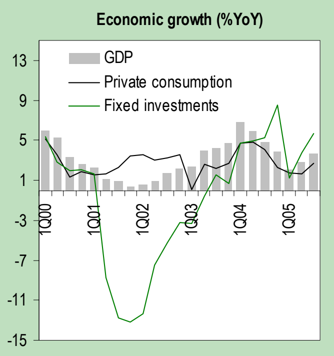
- **While last weeks of 2005 brought relative stabilisation on Polish political scene that allowed investors to stop worrying about different from expected result of general election, at the start of new year politics has entered the centre of attention again.** Approaching budget debate became a pretext for a serious crisis in the parliament, that could be an impulse for major reshuffle in political configuration. It is more and more apparent that current situation, when minority PiS government must rely on support of opposition deputies in every important voting, is a highly unstable arrangement that makes efficient ruling next to impossible. Thus, a question returns whether premature election is indeed a real option, or is there a chance for PiS coalition with some opposition parties (which ones?). Scenario of election in the spring cannot be ruled out, although for sure all minor parties will do their best to avoid such scenario amid very unfavourable opinion polls for them. A first talk between PO and PiS leaders gave hope for return to centre-right coalition, which would be of course the best solution and excellent news for the market. However, it seems that chances for closer PO-PiS cooperation should not be overrated, and a deal with populist parties is at least equally likely.

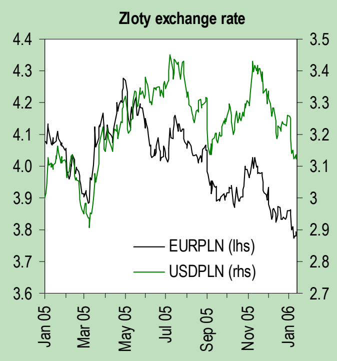
- **Amid political storm the economy pushes ahead.** Macroeconomic data for November showed that ending of 2005 was good for the Polish economy. There was acceleration in industrial output growth, solid rise in retail sales, excellent results in foreign trade. Expansion of the economy is coupled with clear improvement in the labour market. Labour demand steadily gains strength, once again we saw robust growth in wages. As a result, very strong increase in wage bill took place in the enterprise sector. However, this does not exert pressure on price growth. One of factors constraining wage pressure on prices is strong rise in labour productivity. Inflation in November reached only 1%YoY. What is important, this is not only an effect of temporary developments on food and fuel market. Drop in all inflation measures indicates that there is complete lack of inflationary pressure at the moment.

- **A question arises, what trends will dominate Polish economy over the starting 2006.** While developments on political scene seem to be next to impossible to predict (there were as many sharp and surprising turns of plot in politics recently that politician's behaviour seems to have almost random walk characteristics), this month we are trying to outline a scenario of changes in the economy and on the financial market predicted by us. This analysis is presented in the Special focus section.

Financial market on 30 December 2005:					
NBP deposit rate	3.00	WIBOR 3M	4.60	USDPLN	3.2613
NBP reference rate	4.50	Yield on 52-week T-bills	4.32	EURPLN	3.8598
NBP lombard rate	6.00	Yield on 5-year T-bonds	5.95	EURUSD	1.1835

This report is based on information available until 12.01.2006





In this issue:

Maciej Reluga
Chief economist
+48 022 586 8363

Piotr Bielski
+48 022 586 8333

Piotr Bujak
+48 022 586 8341

Cezary Chrapek
+48 022 586 8342

Email: ekonomia@bzwbk.pl

Special focus

Economy stronger than politics

2005 – quite positive outcome

In spite of the unexpected, in particular in terms of its scale, economic slowdown in H1 2005, the last year is considered favourable for the Polish economy. The second half of the year saw acceleration in the growth in economic activity indicators accompanied by balanced economic growth – very low inflation and good balance of payments. Obviously, this balance was partially driven by worse economic results early in the year as low internal demand was reflected in low (if existent at all) pressure on growth in prices and prompted companies to grow their exports in spite of the strong zloty. Despite projections produced in early 2005, investment growth slowed down, but the respective results of Q1 turned out to have had a considerable impact on the whole year's results. In the later part of the year, things could only get better, however the expectations to achieve a two-digit GDP growth in the last years have not come true yet and there is still a question whether they will materialise this year.

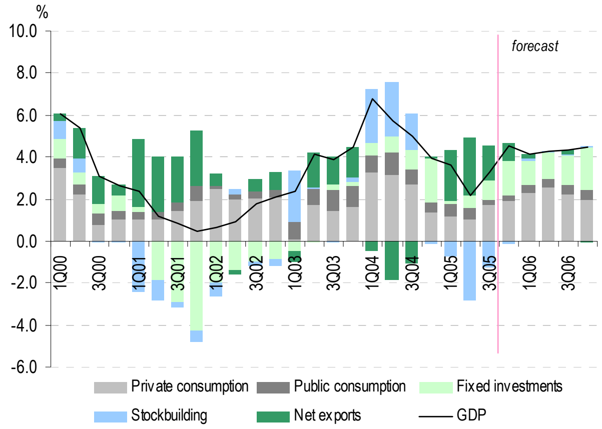
It should be noted that the first half of the year was worse than expected in view of more stormy than projected recovery from the effect of the 2004 EU accession. While in 2004, a great deal of economic indicators was higher than projected (GDP growth, growth in domestic demand, inflation), in 2005, the trend was the opposite. However, it was the beginning of the period which was not impacted by the so-called base effect associated with Poland's EU accession, so it can be stated that the year-end statistics, and more importantly the 2006 statistics, will show the actual economic conditions in Poland. From this point of view, it is favourable that we are back on track of long-term economic growth, although we do not expect growth rate in excess of 5% in 2006.

In the year of election the situation on the political scene was cleared up in a way unexpected to the majority of financial market participants and probably also to political circles. The new political landscape has not brought any implications (positive of negative) to the economic policy to date, especially that the 2006 budget was, to a great extent, drafted by the previous government. We maintain our opinion that the real test for the government and the parliament will be the 2007 budget (although it is not certain now whether it will be a test for this or the next administration). For the time being, the fiscal situation is favourable and thanks to considerable tax flows (it should be noted that the flows are high in spite of the fact that the GDP growth was slower than expected) the 2005 budget was delivered without problems. However, because of that we cannot forget about the public debt level which is oscillating close to the security level defined in the Act on Public Finance, but everything indicates that the limit will not be exceeded in the subsequent year especially as the definition of public debt changed. Also, there is still a problem with public finance in the medium run as the so-called Mech's anchor is too little ambitious a plan, and what is more, you may be left with an impression that the government is not ready for a scenario more negative that this (very) optimistic core scenario which is based on the assumption of a substantial acceleration of the GDP growth and the change of the definition of Open Pension Funds by the EU.

2006 – faster growth and domestic demand

In 2006 we expect an acceleration of the GDP growth up to 4.3% as compared to the ca 3.5% projected for 2005. At the same time, the growth is likely to be fuelled by substantially increased domestic demand, both in terms of investments and private consumption. Arguments in favour of investment acceleration are commonly known (excellent performance from businesses reflected in, among other things, funds accumulated in banking accounts, faster growth in the domestic demand, lower interest rates, utilisation of EU funds etc.), however, part of them were in place, to a greater or lesser extent, also in the last year, and the investment performance was rather disappointing. It is fair to say that economists are tired with projecting acceleration of investment on a great scale. Maybe it is worth, in spite of a number of positive signals, being more conservative in terms of projection of the acceleration ratio for this year? This is our assumption for the slightly over 8% growth for 2006, while many market participants are predicting a two-digit growth. Consumption will be another key driver of the faster growth in the domestic demand. Firstly, such expectations are warranted by continuation of the improvement on the labour market, which is gradual yet evident in salary acceleration in the business sector (in spite of the once-off effects at the end of 2005 there is a change for better) and by employment growth (paralleled by the continued drop in unemployment rate). Secondly, a factor which promotes the growth in private consumption will be a significant once-off factor, i.e. pension revaluation – additional over PLN 6bn addressed to a group who tends to consume rather than to save. As a result, according to our estimates, the domestic demand can accelerate to ca ok. 4%, which should be associated, to some extent, with import acceleration and the reduction of the net export contribution to the GDP growth. However, we expect that the export growth rate will still be high and the net export contribution to the GDP growth will not be much negative (if negative at all). In general, this is the better export performance that, in our opinion, offers a chance for the 2006 growth rate to exceed our forecast. We do realise, however, that this will much depend on the zloty exchange rate – if the zloty continues to be (too) strong, which will be paralleled by the increasingly faster growth in domestic demand, we may see the reorientation to the domestic market. Obviously, this may apply to the part of exports only (part of the exports, maybe quite small now, is insensitive to changes in the domestic demand and F/X rates), however, it should be noted that one of the likely export drivers in 2005 was insufficient domestic demand.

Contribution of components to GDP growth



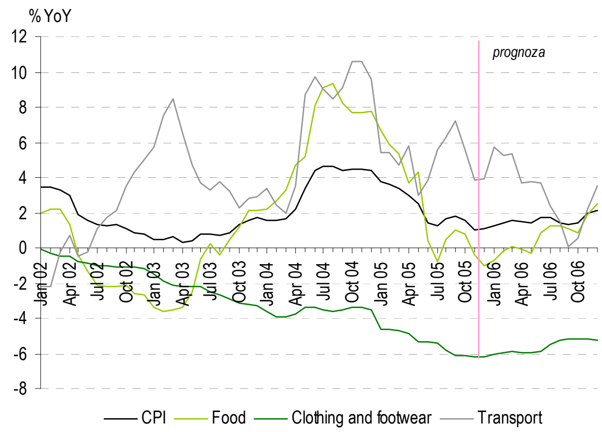
Source: CSO, own estimates

… but the risk of price growth rather moderate

The 2005 inflation was lower than expected in spite of the further substantial growth in oil prices which was somehow offset by the zloty strength against dollar. This was surely impacted by favourable trends on the food market (there are grounds to expect relatively good performance also in 2006), however, even if we exclude fuel and food from the inflation basket, the net inflation shows an absolute lack of pressure on price growth. Evidently, there is a chance that as at the end of 2005 all inflation measures (PPI, CPI, base inflation and maybe also inflation expectations of households) will be below the inflation target and in addition, below the permissible target band. With this astonishing inflation scenario, the interest rate cuts made by the Monetary Policy Council do not come as a surprise. The decisions about interest rate cuts and continuation of the easing bias was the reflection of the change in the expected economic conditions rather than of the Council's 'dovish nature.'

Start of a new year with the very low inflation gives a lot of comfort to the Monetary Policy Council, in a situation where the inflation target is not at risk in terms of the influence of the monetary policy. Even accelerating domestic demand does not pose a threat to the inflation. As a matter of fact, we will see quite a high number of increases of regulated prices which was also the case last year so this will have no major impact on the annual CPI. As usual, food and fuel prices will be key and, to a great extent, unpredictable factors to influence the CPI. The former, at least in the first part of the year, should be favourable for inflation, which may be driven by the continuation of the so-called Putin's effect (blockade of food exports to Russia which contributes to the growth in domestic demand and price reduction), but it may also impact prices across the region (the so-called swine bottom). Later in the year, the situation will largely depend on the crops. We assume a scenario which can be called neutral for inflation, as it envisages that food prices will grow on average by 1% yoy in 2006. The growth in transport prices is in turn projected at ca. 3% yoy, based on expectations around oil prices in the world's markets, PLN forecast, and assessment of the likelihood of the possible impact of price growth on the world's markets on the Polish retail market (this impact can be stronger than in 2005 because of a higher demand but yet this demand is unlikely to be as high as to fuel the growth in prices). As a consequence, our projection of the net inflation (the measure of inflation pressure independent of supply factors) indicates that the situation will be favourable from the point of view of the Central Bank. This is so as the inflation can be below 2% throughout 2006.

Components of the Consumer Price Index



Source: CSO, own estimates

NBP rates with potential to fall

The Monetary Policy Council starts the new year with an easing bias which in our opinion reflects well the actual and expected economic conditions. Nonetheless, over the last four months of 2005, the Council decided to keep interest rates at an unchanged level of 4.5%. Although a scope for further monetary easing does not seem to be big any more, it cannot be ruled out that as early as in Q1 this year, there will be further interest rate cuts if it turns out that inflation is very low (under 1% in December 2005), and the salary acceleration turns out to be a once-off effect. Later in the year, the monetary policy will be influenced, to some extent, by the government's fiscal plans and their impact on financial markets. In extreme scenario, interest rate hikes in the second half of the year cannot be ruled out. In our opinion, the hikes that not that long ago financial markets expected to see within 6-9 months, are not really warranted in view of the existing inflation prospects. The first decisions of the Council in 2006 will also depend on the new inflation and GDP growth projections, that will be outlined in the January *Inflation Report,* the first report supervised directly by the central bank's governor. The conclusions about the medium-term inflation prospects arising from this report will help the Council assess what level of interest rates is enough to keep the inflation within the inflation target bands while minimising the economic growth fluctuations. In view of the existing majority of the Council members, interest rate cuts within the upcoming months cannot be ruled out which is best evidenced in the communication issued after the December meeting. For some of the Council's members, the argument against the cuts is the fact that interest rates abroad will go up (we expect that the official interest rates in the USA and euro zone will grow to 4.75% and 2.75%, respectively, in December 2006). However, in our opinion, if it had impact on inflation in Poland in view of lower attractiveness of making portfolio investments in Poland, the possible zloty depreciation related to this, from the Council's point of view, would mean the return to the level assumed in the projection which does not pose a threat to exceeding the NBP inflation target for good (if at all). The situation in Poland is different as the European Central Bank increases interest rates as the inflation is above the target and Fed increases the rates from a very low level, in a very natural process of returning to the level which is more fundamentally justified by the GDP growth and inflation that also exceeds the level considered comfortable. It should be remembered that while in the world the rates were very low and hence the room for increasing them, you cannot say that in Poland interest rates are low relative to other countries in the region.

In our opinion, additional challenge for the Council will be the change in communication with financial markets, following the decision not to define the monetary policy with the bias. This means that the Council's communications should include more detailed information about risk factors (or lack of risk factors) around the inflation and economic growth. To date, it has not been the Council's strength, especially that some communications were 'hawkish' enough and if the easing bias had not been announced you could have thought that the Council was ready to hike interest rates (although nobody really knew why). In addition, at the end of the year, we will see an institutional change, i.e. change in the position of the NBP governor and the Council's chairman at the same time. This prompts a question which remains unanswered – to what extent can the prospect of the change alter the structure of powers in the Council which, as everybody knows is divided, and where one vote can tip the scales in favour of one party?

Financial markets – growth in profitability, strong zloty

As the Polish financial markets, both the bond and currency ones, are much impacted by the situation on international markets, so let us have a look at what may happen there. We expect that throughout a better part of the year, the dollar will range from 1.20 to 1.25 against euro, as a result of weakening expectations around subsequent interest rate hikes by Fed on the one hand and the interest rate hikes in the euro zone on the other. However, the euro should not bounce back (above 1.25) as the concerns related to a significant external imbalance of the American market reduced following the big flow of capital to the American market which easily finances the trade deficit.

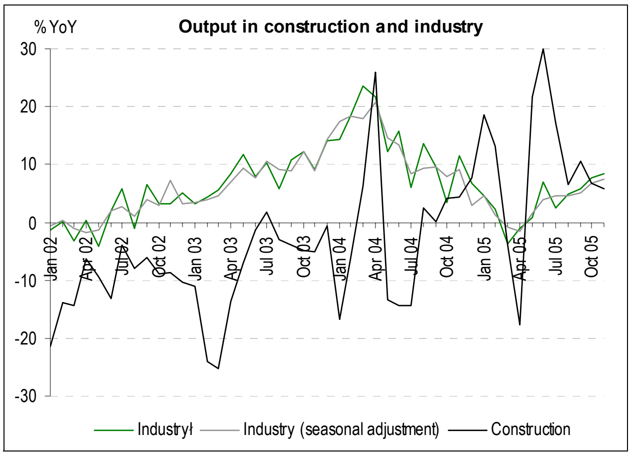
The major force driving the changes in yields abroad recently were the expectations of interest rate hikes by Fed. As the majority of further hikes are likely to be made in the first half of the year (the scale of which is not being estimated by the market at present), they are likely to trigger a growth in yield on American bonds (up to ca 4.8% for 5-10-year bonds and up to as much as 5% for 30-year long-term bonds). It is quite likely as the American economy should not show any signs of weakness while growing at the pace similar to 2005 (ca 3.5%). Economic growth should accelerate in the euro zone (from ca 1.5% to ca 2%) which, coupled with interest rates hikes, should contribute to the growth in yields just like in the case of American bonds. As this is the case, the situation on international markets will not support the Polish yield curve, and the EURUSD rate will be neutral for the Polish currency market, however, indications are that the dollar will be weak relative to the euro which would be favourable for the Polish economy.

In 2005, the scale of the zloty appreciation exceeded majority of expectations, especially at the end of the year, when first election-related correction and then zloty depreciation were expected as a result of the unforeseen political situation. Average-yearly EURPLN rate projected by us for the past year was 4.13 and it does not depart much from the actual rate (4,02) in view of the fact that the zloty really strengthened (from the level of over 4.5). The end of the year had a particular impact on this difference when the Minister of Finance, led to a significant (unnecessary) Polish currency appreciation through the currency exchange transactions. Although recently Prime Minister Kazimierz Marcinkiewicz and new finance minister Zyta Gilowska declared that Finance Ministry will undertake actions aimed at curbing zloty strength (i.e. most likely the ministry will stop selling currencies on the market), however this is still not certain, so there is a risk for our forecast of average EURPLN rate in 2006 (3.97) on the side of stronger zloty, especially at the start of 2006. At the same time, we are of the opinion, that the higher political risk should be taken into account from the point of view of the Polish financial markets, either in the context of early election (problems with the Sejm majority supporting governmental acts), or because of the willingness of some parties to limit the independence of the central bank.

Last year, the official interest rate cuts were paralleled by the drop in the yield on bonds. As the NBP rate cuts were, to a large extent, unexpected, the scale of the debt market strengthening was also surprising. Having reached their minimum values at the end of Q3, yields started to move upwards, which was partially a reflection of the situation on the world's markets and partially arose from taking account of higher fiscal risk in the medium-term perspective (spread 5X5 increased by 44 bps in Q4). In 2006 the Polish bond market should be quite interesting as already in the first half of the year international markets can exert pressure on yield growth, while it is likely that Polish financial markets will take account of probable NBP interest rates cuts. As a result, the only thing we can do is to maintain the opinion that the yield curve should be more steep with the general growing trend next year. While early in the year yields will be similar to those recorded in December 2005, their growth will be promoted later by: official interest rate hikes, growth in yields on world's markets end of the cut cycle in Poland, uncertainty about the fiscal policy in the medium-run and political risk.

See the last pages of the report for tables showing projections for macroeconomic variables.

Economic update



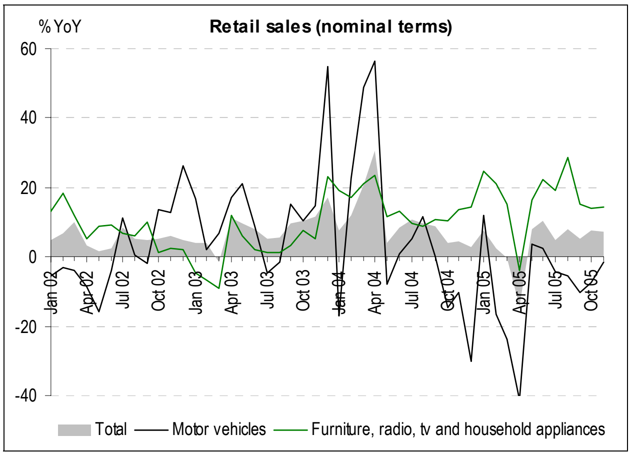
Strong output growth

▪ Rise in industrial output in November was stronger than expected by the market and matched our forecast at 8.5%YoY.

▪ November's result was the best this year, which concerns also seasonally adjusted data (output rise of 7.4%YoY).

▪ Let us remind that growth in industrial output averaged 4.4%YoY in 3Q05 (4.98%YoY in seasonally adjusted terms), which means that the first two months of 4Q05 saw significant strengthening of economic activity.

▪ Construction output growth decelerated in November (to 5.9%YoY from 6.8%YoY in October and 11.4%YoY on average in 3Q05), which was related to some extent to high base effect (strong revival in construction in late 2004). Seasonally adjusted growth reached 8.6%YoY, which is a good news.

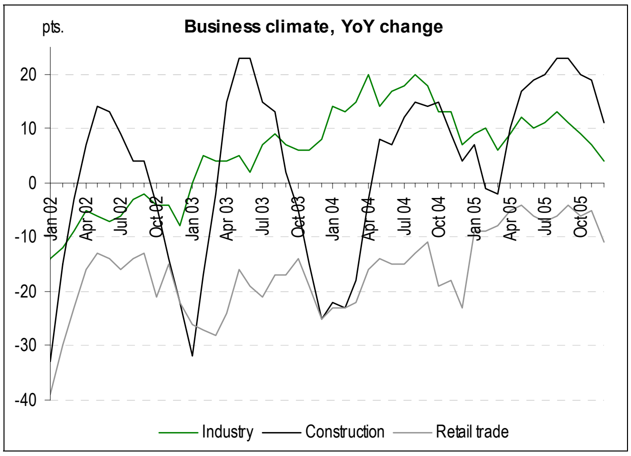


Solid rise in retails sales, though lower than expected

▪ Retail sales in November increased 7.3%YoY in nominal terms. The results was weaker than the least upbeat forecast, but it was not bad and it did not change assessment of overall economic situation in 4Q05.

▪ The breakdown of retail sales growth did not change much from previous months, vast majority of components increased.

▪ Despite retail sales figures looked worse than output figures, the scale of sales growth bodes well for estimates of consumption demand growth in 4Q05. Real retail sales growth was 6.4%YoY against rise of 5.7%YoY in October and 3.9%YoY on average in 3Q05. This resulted partly from reduction in the inflation rate in recent months. All in all, the data (both output and retail sales) supported for acceleration of GDP growth to around 4.5% in the final quarter of last year.

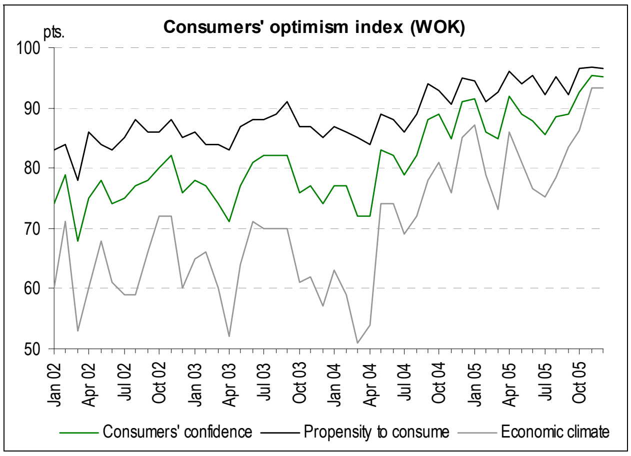


Mixed results of business climate survey

▪ December's results of business climate survey carried out by the Central Statistical Office showed some deterioration in manufacturing (both on annual and monthly basis), and annual improvement in construction and retail trade (despite seasonal deterioration on the month).

▪ Deterioration in manufacturing (although index is still in the positive territory) is surprising given outstanding output figures, but enterprises has reported drop in orders, lower current production and worse financial stance.

▪ Possibly, very strong zloty began to affect evaluation of current and future economic condition of firms, especially that drop in orders was attributed mainly to portfolio of domestic orders. Let us hope that this will not be reflected in investment decisions of enterprises.



Source: CSO, Ipsos, own calculations

Good predictions for future

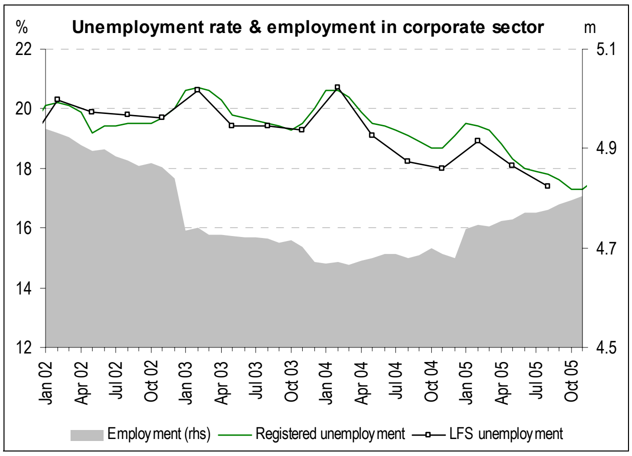
▪ Other surveys of business climate and consumer confidence brought optimistic signs on prospects of the Polish economy.

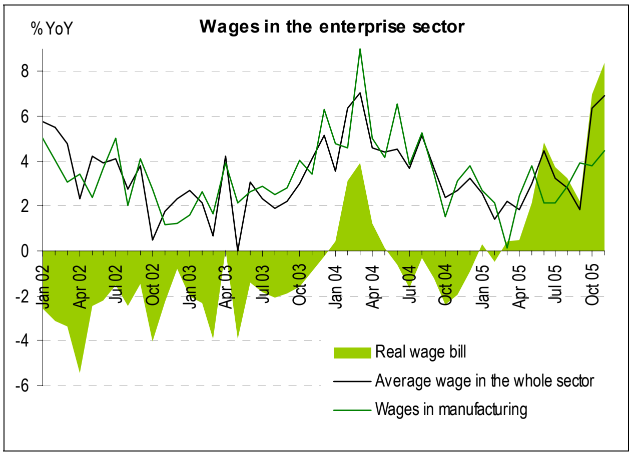
▪ PMI index rose for the seventh straight month in December, reaching 54.5 pts, the highest level for 19 months. The survey pointed to growing role of external demand (with export orders rising faster than domestic ones).

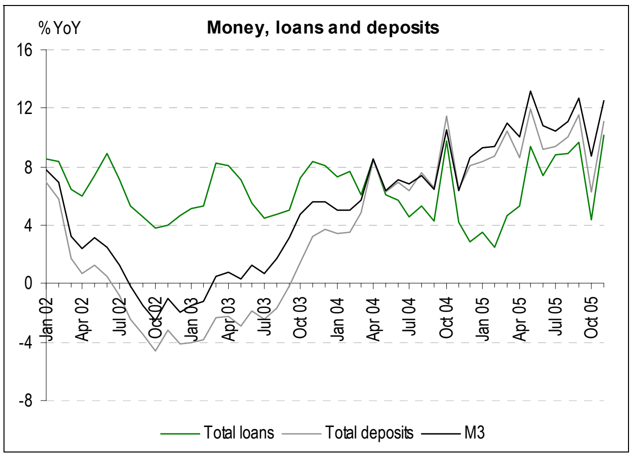
▪ Leading indicator for the Polish economy prepared by Bureau for Investments and Economic Cycles soared significantly (1.5 pct. point) for the second consecutive month.

▪ Consumer moods in December were almost unchanged as compared to November and again rose in annual terms. Undoubtedly, one of reasons for consumers' optimism is steady improvement of situation on the labour market.

Economic update







Source: CSO, NBP, own calculations

Steady increase in labour demand

- Registered unemployment rate was flat in November at 17.3% (down 1.4 pp in annual terms), and the number of unemployed was 7.5% lower than a year earlier. Even if the unemployment rate rises to 17.7% in December, annual pace of its reduction will increase to 1.5pp.
- Reduction in the unemployment rate was also evident in quarterly LFS data (to 17.4% in Q3 from 18.2% a year earlier). The number of unemployed in the LFS survey dropped by 890,000 people, i.e. 2.9%YoY in 3Q05, while the number of people in a job grew 385,000 (2.8%YoY, the strongest ever).
- Increase in average employment in the enterprise sector was stronger than expected and totalled 0.1%MoM and 2.4%YoY. This means that labour demand rises faster and faster. We maintain employment will keep growing in 2006.

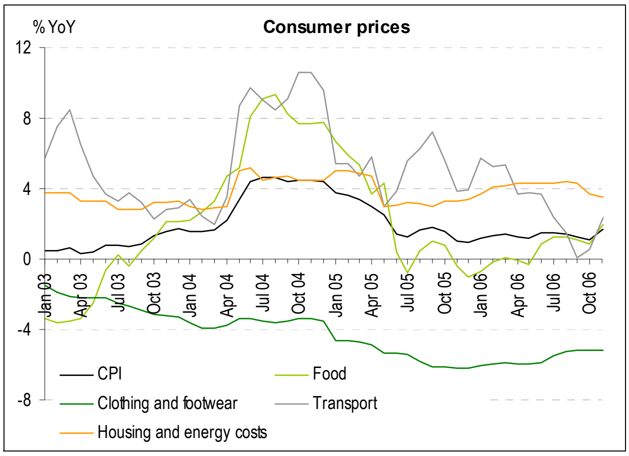
Very high wage growth, but partly incidentally

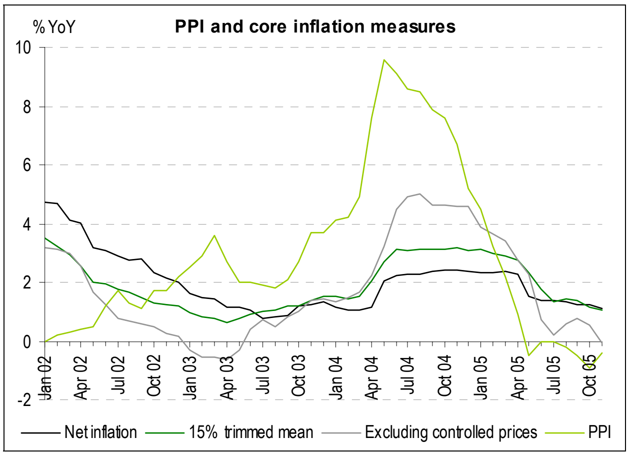
- Average wage in the enterprise sector rise 5.5%MoM and 6.9%YoY in November. As a result, given the scale of employment growth, wage bill in enterprises increased by 9.5%YoY in nominal terms and 8.4%YoY in real terms, reaching the highest growth rate from the start of comparable time series (January 2001).
- November's wage increase beat market expectations for a modest 3.8%YoY rise. The explanation for that was included in detailed data on breakdown of wage growth among several sections and branches in the enterprise sector.
- The data showed that strong wage growth in enterprises in November was related to situation in mining sector (surge of 41.2%YoY). Meanwhile, wage growth in manufacturing amounted to 4.5%YoY versus 3.8%YoY in October and 2.6%YoY on average in January-October period, which should be seen as a good sign as regards prospects for private consumption growth, but at the same time it should not be perceived, in our opinion, as an alarming signal for inflation outlook.
- As far as wage growth in the nearest future is concerned, we predict the most likely scenario is some slowdown from high levels in October and November and December probably saw a growth rate of 4.5%YoY. However, the fact is that we have been observing continuous firming of labour market conditions (its pace was gaining strength with every month), which is related to significantly improved financial stance of enterprises and rising economic activity.
- One should take note of the fact that fast wage growth in industry is not notably stronger than growth in labour productivity, which also accelerated recently. This means that accelerating wage growth should not fuel inflationary pressure.

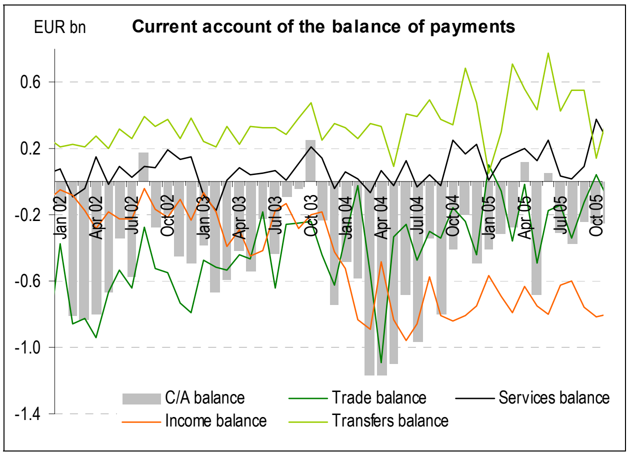
Monetary statistics returned to upward trend

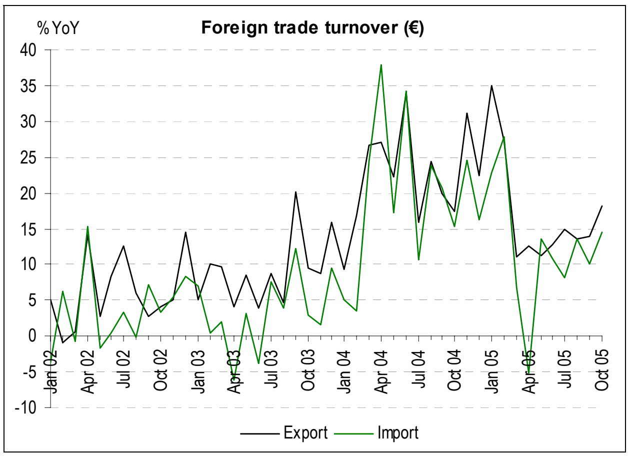
- Annual pace of money supply growth accelerated to 12.5% in November from 8.7% a month earlier. This means a return to previous trend, disturbed in October by high base effect.
- Total deposits growth accelerated to 11.0%YoY against average growth of 9.5%YoY in January-October period. Total deposits grew to a large extent thanks to surge in corporate deposits (up 20.4%YoY) while households' deposits growth was still moderate at 4.5%YoY.
- Total loans growth accelerated to 10.1%YoY. The main driver of loans growth was household borrowing (up 19.7%YoY) while tendency in corporate borrowing remained broadly intact (1.6%YoY increase) All in all, the data confirmed strong economic expansion of the economy, but delivered no sing of overheating demand (weak growth of corporate borrowing).

Economic update









Source: CSO, NBP, own calculations

Unexpectedly deep drop of inflation

- CPI inflation dropped to 1.0%YoY in November from 1.6% in October. The result was much below market expectations and our predictions below 1.3%YoY.
- The most important reason for that was much lower than predicted prices of foodstuffs and fuels.
- We expect that as long as Russian ban on export of Polish foodstuffs is binding and the strong zloty constrains increase in fuel prices, inflation will stay at very low level.
- Changes in prices of other goods and services show one cannot talk of any inflationary pressure at the moment and there are no reasons to think it may appear on a significant scale in foreseeable future. Economic activity gains strength and at the same time price growth slows down. We forecast CPI inflation in December will reach only 0.9%YoY.

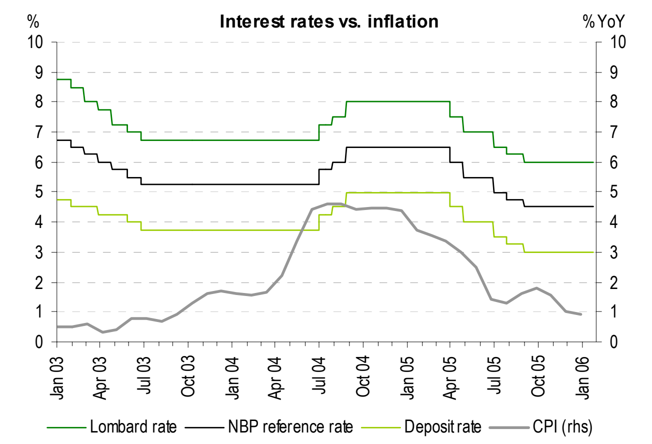
PPI and core inflation confirms lack of inflationary pressure

- PPI in November was very close to our expectations, rising a mere 0.1%MoM due to price growth of 2.4%MoM in mining. Meanwhile, prices in manufacturing fell again (0.1%MoM). In annual terms producer prices dropped for the fourth consecutive month (this time by 0.4%). Although annual growth in PPI will most likely return into black in the nearest months, PPI inflation of around 1.5%YoY in 1Q06 should not be perceived as risky phenomenon for future inflation.
- Favourable inflation outlook was confirmed by core inflation measures. Net inflation fell to 1.1%YoY, while 15% trimmed mean (the second most closely watched measure) dropped to 1%YoY. The other three measures ranged between –0.1%YoY and 0.7%YoY. Such low level of core inflation (excluding exogenous factors) points to lack of inflationary pressure.

Low core inflation confirms lack of inflationary pressure

- October's data on balance of payments, published by the National Bank of Poland, showed that current account deficit slightly increased to €253m in October from €245m in September, but fell from €407m a year earlier.
- 12-month cumulative C/A deficit in relation to GDP fell to 1.4% after October from 1.5% after September, confirming that Poland's external position is well and keeps improving.
- Low level of current account in October was possible to achieve mainly thanks to trade surplus of €44m, the second trade surplus since January 2000, i.e. since the starting date of fully comparable time series published by the NBP. This in turn was possible due to surprisingly excellent exports performance.
- While we expected exports growth to remain high despite zloty strengthening observed for some time to date, it unexpectedly accelerated even further to 18.2%YoY (reaching record high level of €7.38bn). Imports growth was very close to our prediction and reached 14.6%YoY (level at €7.34bn).
- What is more, October saw not only record high exports of goods, but also record high exports of services (€1.28bn). As a result, services account posted €372m surplus (the highest ever).
- Income account was in deficit of €814m (due to continuously high dividend payments to foreign shareholders) and transfer account was in surplus of €145m.
- All in all, the data signaled quite strong expansion of the economy (driven both by external and domestic demand). However, the question arises whether we will not see some lagged effects of zloty strengthening. They may take form of much weaker growth in exports volume and/or weaker exports profitability and thus weaker investment activity.

Central bank watch



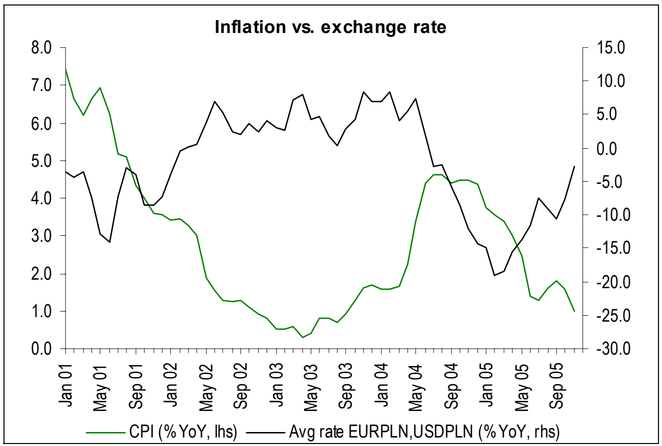
Fragments of the MPC statement from 21 December 2005

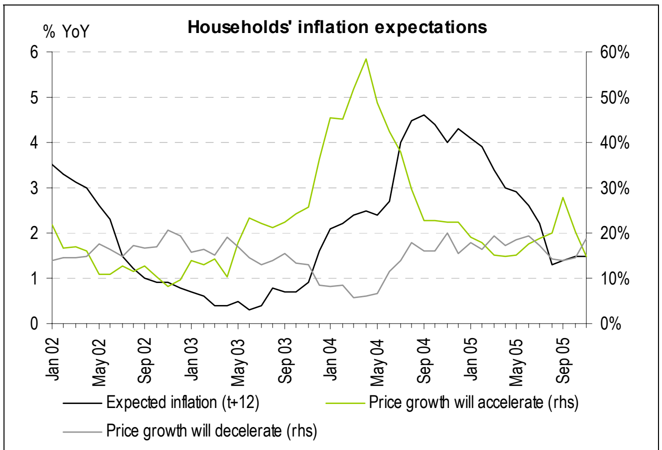
The data published since the last meeting of the Council point to a strengthening of the economic recovery in Poland observed since 2005 Q2.

The November inflation was consistent with the expectations for 2005 Q4 presented in the August Inflation Report.

Since the Council's last meeting, zloty exchange rate has not changed significantly and has remained stronger than forecasted in the August Inflation Projection.

In the Council's assessment low inflation in November may indicate that inflation will return to the target later that it was assessed in the previous meetings. It is expected that – assuming no shocks occur - having achieved the target, inflation will remain at a level close to it. Broader assessment of the inflation outlook will be possible in January 2006 once the Inflation Projection is published.





Source: NBP, CSO, Reuters, own calculations

No changes in monetary policy at the year-end

- One more time, the Monetary Policy Council's decision has not surprised the financial market. Monetary policy parameters remained unchanged in December, and reference rate was maintained at 4.5%, without changes since September 2005.
- Also, easing bias in monetary policy was preserved, implying higher chances for rate cuts than for rate hikes in future. One should keep in mind however, that it was the last month of using bias as a tool of communication with market, as since January this term will be dropped from MPC statements' language. It is interesting what other tools the Council would adopt to steer financial market's expectations.
- In the official MPC statement there was a substantial change. While in previous three months the Council has been repeating that "inflation could return to the target faster than assumed in August inflation projection", this time there was a statement that "low inflation in November could imply that inflation's return to the target will take place later than assumed at previous meetings".
- Apparently, inflation perspectives are now perceived as more optimistic by most of MPC members than in the last three months. Although probably this view is not shared by all (NBP head Leszek Balcerowicz is probably not among them, judging by his comments).
- The official communiqué suggests the MPC is impatiently waiting for publication of new Inflation report. Unfortunately, this document will be unknown for market players before the MPC meeting, which lowers predictability of MPC decision.
- Clearly lower than previously forecasted inflation in December (below 1%) and strong zloty appreciation in the last period expanded set of arguments calling for a cautious rate cut and could persuade the MPC to make such decision in January.

Will zloty strength determine MPC decision?

- Undoubtedly, zloty movements, if persistent, could have significant impact on inflation development, not only directly by affecting prices of imported goods and components, but also via their potential impact on economic growth. Exchange rate channel is perhaps one of the fastest acting channels of monetary policy's transmission.
- One could guess that significant zloty appreciation observed in recent weeks will have an important impact on the MPC's decision in January, amid already favourable forecasts regarding demand-side sources of inflationary pressure.
- A potential risk factor is possibility of deepening of crisis in the parliament, that in the least optimistic scenario could lead to stronger correction on the FX market (though we do not expect such scenario).

Low households' inflation expectations

- In December, households' inflation expectations have not changed substantially and remained low. A synthetic index of inflation anticipated within next 12 months maintained at 1.5% level for the third consecutive month.
- Available data about structure of households' answers for November show that a significant rise in ratio of those predicting acceleration in price growth, that took place in September, was a transitory phenomenon and has been dying off in the next two months. Interestingly, a share of households predicting that in 12 months time prices will be lower than currently, has been rising.
- Development of inflation expectations does not foretell a possible strengthening in inflationary pressure in Polish economy and a rise in risk of so-called second round effects.

Central bank watch

Comments of the central bank representatives	**Our remarks**
Leszek Balcerowicz, NBP president **Reuters, 11 January** Over the past few months the finance ministry has added to the forces driving the zloty's strength and despite warnings from the central bank began selling foreign currencies on the market, strengthening the zloty. I hope that after various warnings the finance ministry will revise its position. This is not just my opinion. It's the official position of the Monetary Policy Council. The current deputy finance minister Cezary Mech criticised the former cabinet's debt strategy but after his appointment he continued it on an even larger scale. If Mech believes the zloty is too strong, he should first of all revise the strategy and refrain from actions pushing the zloty stronger, i.e. stop issuing debt abroad.	NBP governor and other MPC members share the opinion (and we also subscribe to this view) that Finance Ministry's activity on the exchange rate market was an important factor stimulating zloty appreciation in recent period. It does not seem likely that the central bank could decide to contribute to reversing trends on currency market by undertaking currency interventions. Since the moment of floating zloty exchange rate in April 2000, the NBP consistently sticks to its strategy of non-intervening on the market unless there are indeed very special circumstances, and nothing suggests that this approach could be changed in near future. Especially, that stopping FinMin's currency sales and a rise in political risk will be factors weakening upward pressure on the zloty anyway. A separate issue is that a significant zloty appreciation that took place recently could be a strong argument for the MPC, moving a balance of factors in favour of cautious interest reduction in January.
Jan Czekaj, MPC member **PAP, 12 January** If current inflation maintains at very low level, if a return to target will move away in time, then the MPC will have to consider a possibility of rate cuts. In such situation, i.e. amid low inflation, strong zloty, lack of wage pressure, I believe that monetary policy easing would be possible. After data for October and November, when CPI proved to be more favourable than expected, we agreed that earlier alarm was not justified and a path of inflation return towards target will probably not accelerate. What seemed to be dangerous, proved not dangerous. In the last two-three months situation changed for better. The only factor that could raise some concerns is acceleration in wage growth in recent months. We do not know however if this is persistent. Anyway, wage growth accompanied by rise in labour productivity does not create a threat for inflation. For the moment, there are no visible reasons why the zloty could start weakening. And strong zloty is an ally of low inflation. Today it is apparent that there is no demand-side inflationary pressure. There could be some supply-side shocks, but they always could act in both directions. Therefore, monetary policy must be adjusted to situation.	Czekaj's comments clearly suggest that last macroeconomic data and trends on foreign exchange rate market will be – at least for some MPC members – arguments supporting view that further relaxation of monetary policy is possible without major risk for inflation. One cannot rule out that the next decision on cautious rate cut will take place already in January. On the other hand, one has to be remember that Czekaj belongs to the faction in the MPC with views favouring more relaxed monetary policy, and also in previous months he was not ruling out option of interest rate cut, while such decision was not made since September. High importance that MPC members attach to data on wages suggests that this publication for December could have important impact on financial market's expectations regarding outcome of the nearest MPC meeting. It is not without reason, as the data will show to what extent a strong upsurge in wages in October-November was a one-off event.
Dariusz Filar, MPC member **Radio PiN, 10 January** Please remember that January is a month of another inflation projection and it will be really extremely important, because it will appear after long delay, since August. August projection used to suggest that in the first quarter of this year average inflation would be within the target, i.e. above 1.5% or close. Now the first quarter 2006 will be a starting point of the new projection. It is crucial whether it will show the same inflation level, as was seen half a year ago, or lower or higher, as entire future path of inflation will depend on it and it is a critical issue for us. [What will happen with rates in January] it will depend on what inflation projection shows. I always presented a view that when currency rate is determined by mechanism of floating exchange rate, then exporters are doing well with it, and it was visible in data until very last months of previous year. Nevertheless, in a situation when additional factors enter, strengthening the exchange rate, then undoubtedly it could start raising problems, at least for some exporters. [...] NBP many times surveyed level of exchange rate that exporters perceived as satisfactory for them in a sense that it was not a barrier for profitability. And of course this exchange rate keeps getting stronger and stronger, it results from the fact that productivity in our economy has been rising, and if for 1,5 year exporters used to survive with 4.10 or 4.15 rate, then after some time it turned out that they can also survive with 4.0 rate, because they are simply more competitive in a productivity sense. So from this point of view indeed a threshold acceptable for exporters is now close to the one we mentioned [3.95 to 4.0 against euro].	Before a meeting in January the Monetary Policy Council will receive new *Inflation report*, including updated projections of inflation and GDP prepared by NBP staff. It will be important set of information, as because of change in publication schedule, it will be the first update of projections since August 2005, while many important and surprising data and information appeared since then. It is not surprising then that in Dariusz Filar's opinion new projections will be extremely important factors affecting MPC decision in January. In this situation, it is particularly a shame that financial market participants will have no occasion to find out what's inside the *Inflation report* before the MPC meeting. It surely reduces predictability of Council's decision. However, taking into account information and data from last few months (faster than expected economic growth, lower inflation, strong zloty appreciation) and their possible impact on estimation results, it seems likely that a path of inflation outlined in the new report will not be more pessimistic than the one presented in August. It could be a reason for interest rate reduction in January.

Government and politics

Second government's amendment to 2006 budget

	Amount (PLNm)
Higher revenues	**553.4**
- higher NBP profit	486.5
- unused so-called EFSAL loan	20.0
- increase in other non-tax revenue	46.9
Lower spending	**746.6**
- lower contribution to the European Union	521.0
- guarantees for Agricultural Market Agency and shipyards	127.0
- lower spending on public administration	98.6

Budget debate soon, possibly stormy

- The government approved second self-amendment to 2006 budget, securing funds for financing higher spending on baby bonus and social subsidies for farmers (in sum PLN1.3bn).
- Level of budget deficit remained unchanged (PLN30.55bn), which is a good news, thanks to PLN747m cut in other spending and PLN553m rise in planned revenue. However, some of the changes raise concerns, e.g. hopes for higher non-tax revenue could prove futile (why it was impossible before?), and higher proceeds from NBP profit have been already exploited by deputies in the amendments approved in Sejm's public finance committee.
- A row on timing of budget debate turned into a serious crisis in the Sejm between PiS and entire opposition. According to latest news, third budget reading will take place on 24 January.

Selected assumptions of *Convergence programme*

General government balance* (% of GDP)

	2005	2006	2007	2008
Updated version	n/a	-2.6	-2.2	-1.9
November 2004 version	-3.9	-3.2	-2.2	-
2006 budget draft **	-3.4	-2.8	-2.0	-0.8

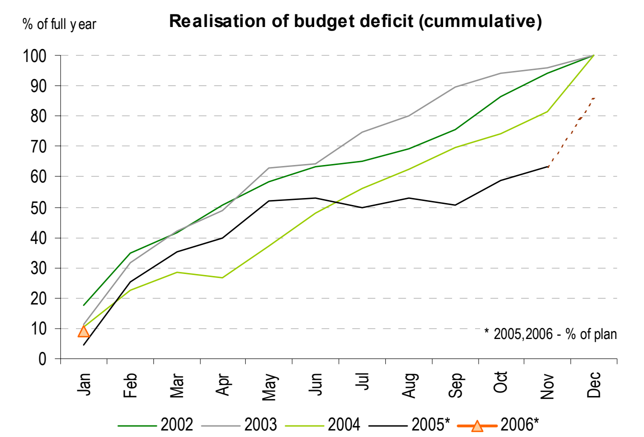
Average inflation (%YoY)

	2005	2006	2007	2008
Updated version	n/a	1.5	2.2	2.5
November 2004 version	3.0	2.7	2.5	-

* OFE included in public finance sector
** estimates from 2006 budget draft prepared by Marek Belka's government

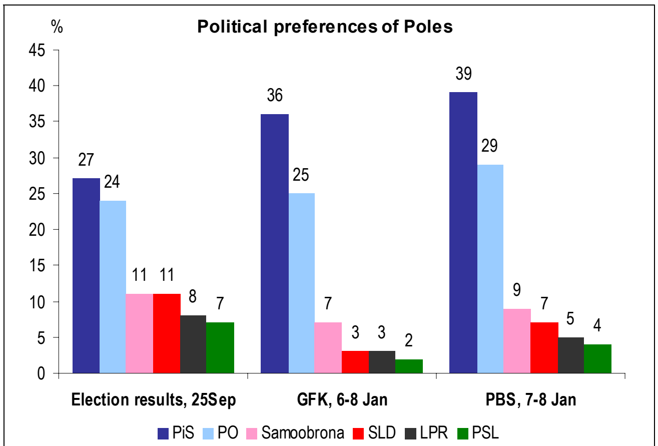
Convergence programme a bit later than planned

- Until 10 January the government was supposed to present updated *Convergence programme* including a path of fiscal consolidation in the medium term. After a change on finance minister's post, the publication was delayed by one week.
- According to earlier unofficial information, the document will assume a reduction in general government deficit to 2.2% of GDP in 2007 (the same as in previous version) and to 1.9% of GDP in 2008 – assuming OFEs in public finance sector.
- The plan raises several reservations. First of all, assumed path seems to be inconsistent with a strategy of keeping budget gap stable at PLN30bn (deficit underestimated by ca. 0.5% of GDP). Secondly, fiscal deficit computed according to EU's rules (enlarged by part of OFE sector) will not get below 3% of GDP until 2008.



Will budget realisation In 2006 will be as good as in 2005?

- Preliminary estimates of Finance Ministry show that 2005 ended up with a deficit of PLN29-30bn (against planned PLN35bn), i.e. was consistent with MF's and our predictions.
- In FinMin's view, after January the deficit should reach 8-10% of the plan (still being under discussion in parliament). Although this result was worse than in January 2005, it was much better than a multi-year average, which shows that good economic situation keeps supporting budget revenues.
- However, this year exceeding planned revenue level will be much harder than in 2005, as it is much more ambitious than previously. Moreover, during work in the Sejm there could appear new amendments lifting revenue even higher.



Strong coalition or earlier election?

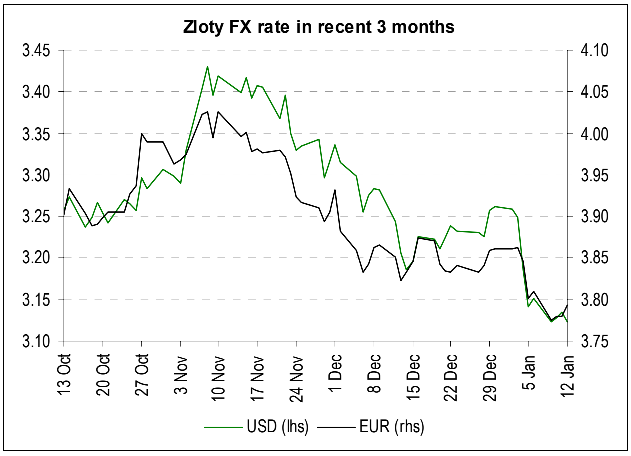
- A row on a date of budget debate triggered a major crisis in the parliament, that could be an impulse for change in political configuration. It is becoming more and more apparent that a minority PiS government cannot trust in stable support in the Lower House, which is a major obstacle in ruling the country.
- Therefore, a question arises whether a real option is premature election, or perhaps a coalition with some opposition parties (and which ones?). Election scenario cannot be ruled out, although it seems that minor parties will do their best to avoid such scenario given unsupportive for them opinion polls.
- Latest news suggest that deal with PO is in practice out of option, and PiS is negotiating a coalition with Samoobrona and PSL.

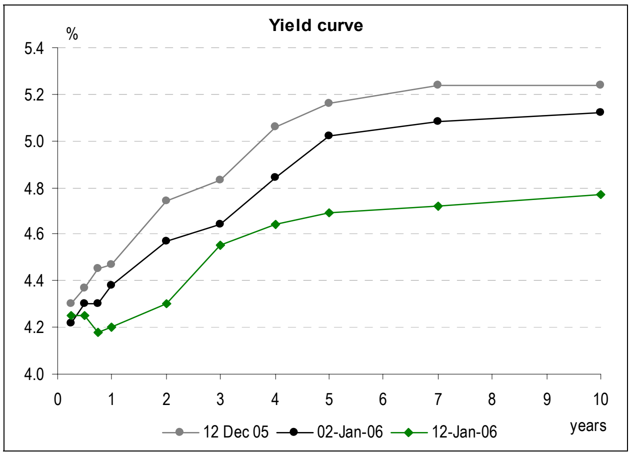
Source: Ministry of Finance, PAP, Reuters, opinion polls

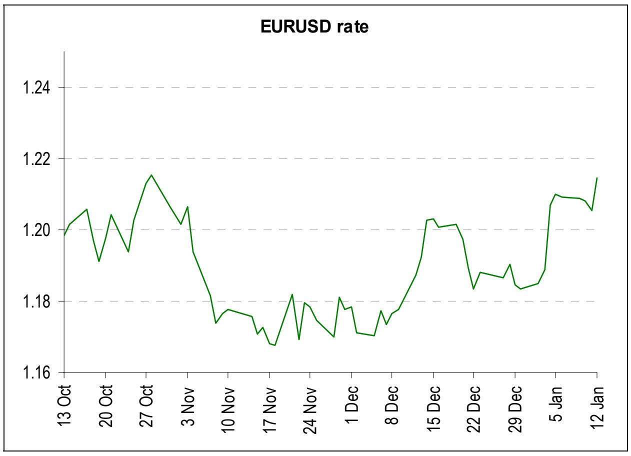
Government and politics

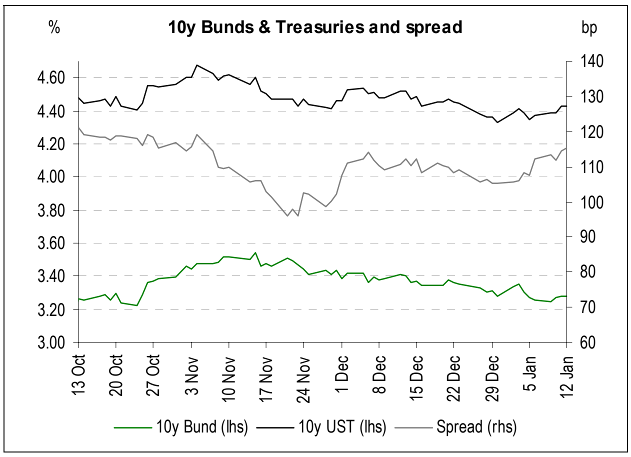
Comments of government representatives and politicians	Our remarks
Kazimierz Marcinkiewicz, Prime Minister **PAP, Reuters, 10 January** I talked to the deputy ministers of finance and I am convinced that, in so much as it is possible, steps to ensure the zloty is not too expensive will be taken. [...] There will be no radical steps though. Last time currencies were sold on 6 December. It's not the case that the ministry is the main reason for such a strong zloty. It's the good shape of the economy and an excellent government that make the zloty so strong.	In practice, apart from halting FinMin's currency transactions, there are indeed very little things the government could do to weaken domestic currency (assuming it will not resort to irresponsible economic policy). Prime Minister pledged to make efforts to counteract zloty appreciation, but he also said "there should be no radical steps … as it is in fact the central bank that is responsible for monetary policy in the country". Perhaps this means that in the near term he would renew calls for the central bank to reduce interest rates in the coming months. And in the medium run, especially if those calls prove ineffective, it seems likely that the parliament will return to a debate on the change in the NBP charter.
PAP, 6 January Soon I will meet with the central bank's council and governor, and will argue for a cut in interest rates already in January to improve our growth rate. Only in this way can we reduce unemployment and create new jobs.	We think the best way to accelerate economic growth and create more jobs in Poland would actually be a cut, but not that of interest rates, yet taxes. Unfortunately, PM has not done anything in this direction so far and this may be very difficult in future as long as PiS look for political support in the parliament among such parties like LPR and Samoobrona. Instead, one may expect rising pressure on the central bank to substitute for the government in creating favourable conditions for fast economic growth.
Zyta Gilowska, deputy PM, finance minister **Reuters, PAP, 9 January** This is my pet project -- watching over public finances [...] I will put intensive work into simplifying the tax system and lowering at least some of our tax burden. [...] All actions should be focused on reducing unemployment rate. [...] I am a Christian liberal and I always was. There's economy and there are its margins. I was always in the economic mainstream. I was always denying to specify a date of euro zone entry. It is not the question of date, but of preparations. We should enter as soon as possible [....] when we are ready.	Replacement of Teresa Lubińska by professor Zyta Gilowska on the post of finance minister met with very positive market reaction. It was not without reason, as Gilowska, contrary to her predecessor, is regarded as expert in macroeconomic policy and advocate of discipline in public finances. Thus, one could hope that new minister with liberal views and strong personality will try to improve government's economic policy. At the same time one should realise that despite Gilowska took a chair of deputy PM it is hard to expect that her presence in the cabinet alone will cause a U-turn in stance of the government and PiS as regards euro zone entry and fiscal consolidation. A significant barrier is also doubtful support for fiscal reforms in the parliament.
Jarosław Kaczyński, PiS leader **PAP, 12 January** This talk [with Tusk] allowed to understand many things and it was quite a lot as for the first step. We will se what will be further. I believe that some perspective clears out that several months ago was obvious and natural. Later on, it was covered by thick rainy clouds, but now sunshine appears again. [...] If there is reasonable approach to budget, no amendments breaking budget apart, there will be no grounds for making [premature] election. **Donald Tusk, PO president** **PAP, 12 January** We cannot say where this talk will lead us, however it will facilitate stabilising situation that is not good for Poland. After this meeting I can look forward in future with bigger hope. I believe this is an opening.	A row on delaying budget debate triggered a serious crisis in the parliament, that could be an impulse for major reshuffle in political configuration. It is more and more apparent that current situation, when minority PiS government must rely on support of opposition deputies in every important voting, is a highly unstable arrangement that makes efficient ruling next to impossible. Thus, a question returns whether premature election is indeed a real option, or is there a chance for PiS coalition with some opposition parties (which ones?). Scenario of election in the spring cannot be ruled out, although for sure all minor parties will do their best to avoid such scenario amid very unfavourable opinion polls for them. A first talk between PO and PiS leaders gave hope for return to centre-right coalition, which would be of course the best solution and excellent news for the market. However, it seems that chances for closer PO-PiS cooperation should not be overrated, and a deal with populist parties is at least equally likely.
Piotr Marczak, FinMin's debt department **Reuters, 5 January** We are considering further early payments of our Paris Club debt. As long as we have this debt, the issue remains open. Our debt duration is currently even better (longer) than that of some countries in the euro zone. It's important to present rating agencies with arguments pointing out continued improvement of the fiscal situation, which will enable better evaluations of not just the current position, but the near future.	While the operation of early Paris Club debt repayment could be beneficial for public finances, because it enables lowering debt servicing costs, extending debt's average duration and improving prospects for a rating upgrade, it is not necessarily supportive for the zloty. Perhaps, such operations will be part of set of actions promised by the Prime Minister, aimed at curbing zloty appreciation. Plans of early payments of foreign debt may mean that the ministry will use part of proceeds from current eurobond issues for this purpose (or at least part of it).

Market monitor









Source: Reuters, BZ WBK

Zloty at the strongest level since June 2002

▪ For the most part of the past month the market featured low activity amid Christmas and the end of the year and zloty gradually appreciated with low liquidity on the market. In the first days of new year Polish currency strengthened against the euro to the highest level since June 2002 (3.7755) with positive sentiment of investors toward the region, new records on WSE, and nomination of Zyta Gilowska for the post of finance minister. Since similar period last month zloty appreciated ca. 2% against the euro, and 3.3% vs dollar.

▪ With regards to finance minister statements on taking actions toward stabilization of the situation on the FX market, the exchange of the proceeds of foreign currency denominated debt issues may be limited. This may act against the Polish currency, together with clashes in budget debate, parliamentary disputes and potential interest rate cut in January.

Substantial drop of yields - awaiting price cut

▪ Within last month the fixed income market strengthened by 42-52 bps. The drop of yields resulted after less hawkish Fed's communiqué, surprisingly low inflation in November and slightly dovish Polish MPC statement. Interest rate market strengthened in new year as investors speculated on rate cut on January meeting of the MPC amid low MF's inflation forecast, which went along positive results and high demand at T-bills and T-bonds auctions, and new pro-market finance minister.

▪ MPC's decision may be influenced first of all by the inflation projection, and macroeconomic data as well. If MF's inflation forecast at 0.8%YoY fulfils and zloty rate stays stable and strong posing a threat for exports and growth, MPC will probably cut rates in January. The long end of the curve may negatively react on signal of populists in the government coalition.

Dollar weakening amid the end of rate hikes in U.S.

▪ In the analyzed period the greenback lost ca. 2.5% vs. the euro from 1.18 to 1.22 mainly due to change in the Fed's communiqué, which suggested sooner end of arte hikes in U.S. what was confirmed in FOMC minutes. Record high trade deficit was balanced once again with record high net capital flows. The dollar strengthened after stronger data from housing market and Q3 PCE inflation and fell on weaker ISM and non-farm payrolls. The greenback recovered some losses on lower than expected trade deficit and not enough hawkish ECB's chairman statement

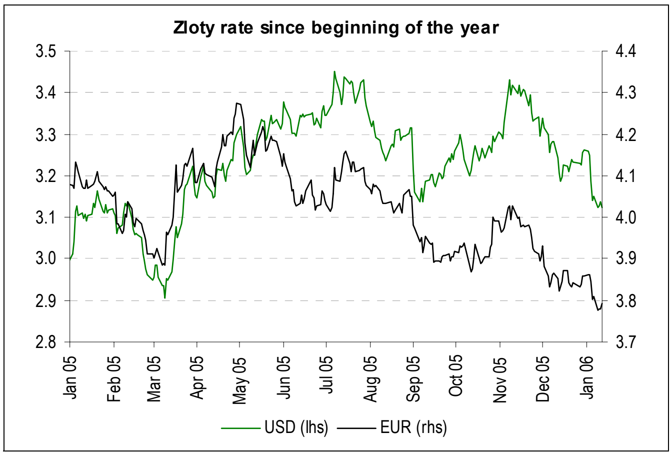
▪ Taking into consideration the earlier end of aggressive monetary policy tightening campaign in U.S. and faster growth and higher economic activity as well as rate rise in EMU, the growing importance will be put to U.S. trade deficits. At it seems appreciation potential for the dollar is limited.

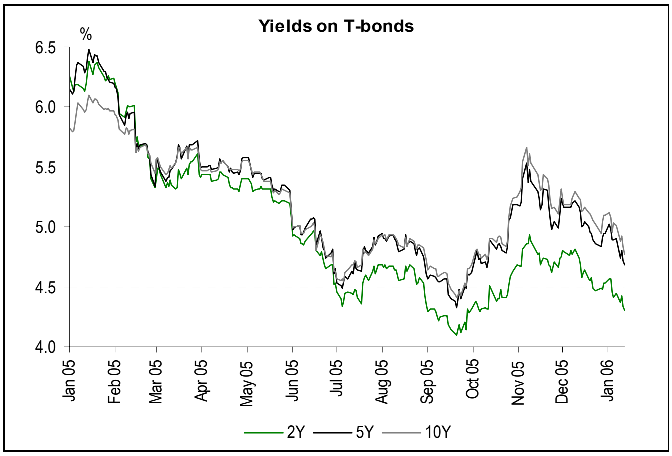
Yields drop on dovish change in Fed's communiqué

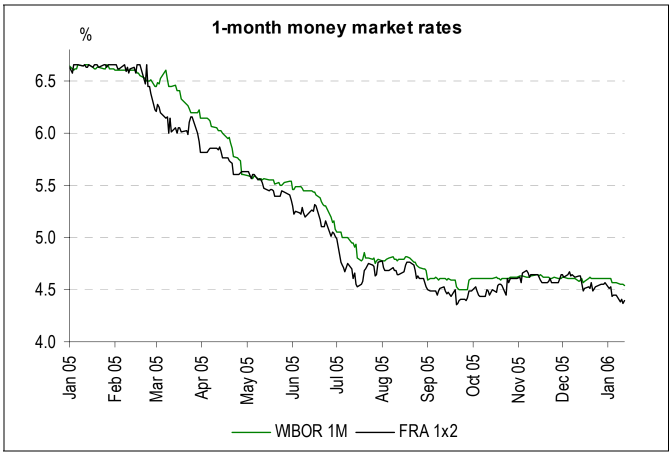
▪ Yields of 10Y Treasuries fell from 4.52% (12.XII) to 4.43% (12.I), while 10Y Bunds from 3.40% to 3.28%, with lower activity amid the end of 2005. U.S. bonds strengthened after change in Fed's communiqué on expectations of sooner end of rate hikes, weaker ISM and worse non-farm payrolls. Temporary weakening occurred on good industrial production data, housing market as well as U.S. PCE inflation in Q3. Lower than expected inflation forecast in EMU supported Bunds.

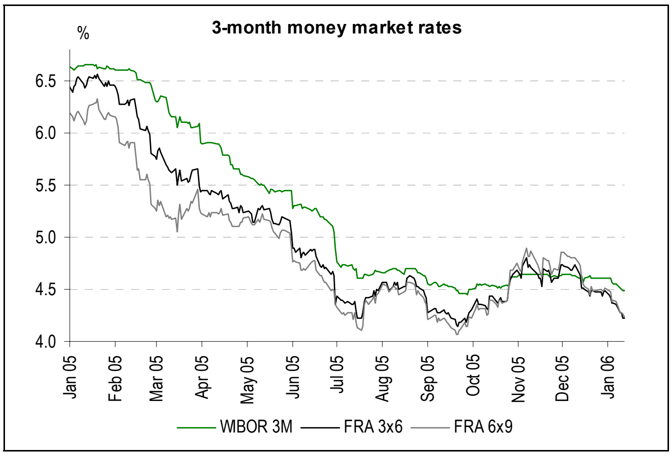
▪ Yields of U.S. government bonds may stay under pressure amid highest bonds supply since similar period 1996. Slightly less hawkish statement than expected did not influence the yields. Thus yields of U.S. Treasuries as well as Bunds should react on released macroeconomic data.

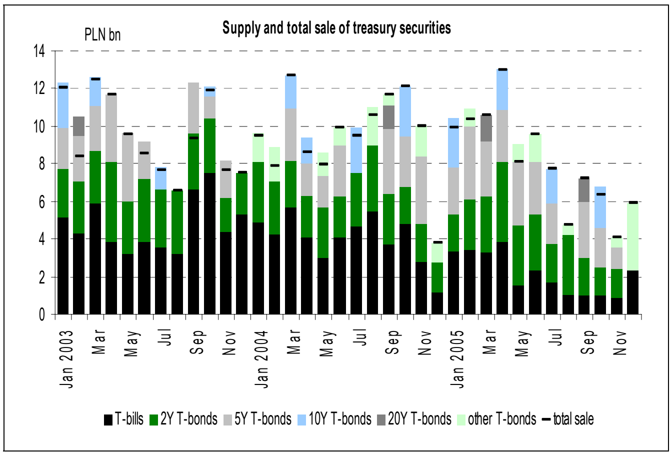
Market monitor











Treasury bill auctions (PLN m)

	OFFER / SALE			
Date of auction	3-week	13-week	52-week	Total
07.11.2005	-	-	400 / 400	400 / 400
21.11.2005	-	-	500 / 500	500 / 500
Total November	**-**	**-**	**900 / 900**	**900 / 900**
05.12.2005	-	100 / 100	1 200 / 1 200	1 300 / 1 300
19.12.2005	-	100 / 100	900 / 900	1 000 / 1 000
Total December*	**-**	**200 / 200**	**2 100 / 2 100**	**2 300 / 2 300**
02.01.2006	2 000 / 2 000	100 / 100	1 100 / 1 100	3 200 / 3 200
16.01.2006	-	100	1 000	1 100
Total January*	**2 000 / 2 000**	**100 - 200**	**1 100 - 2 100**	**3 200 - 4 300**

* estimations based on Ministry of Finance preliminary information

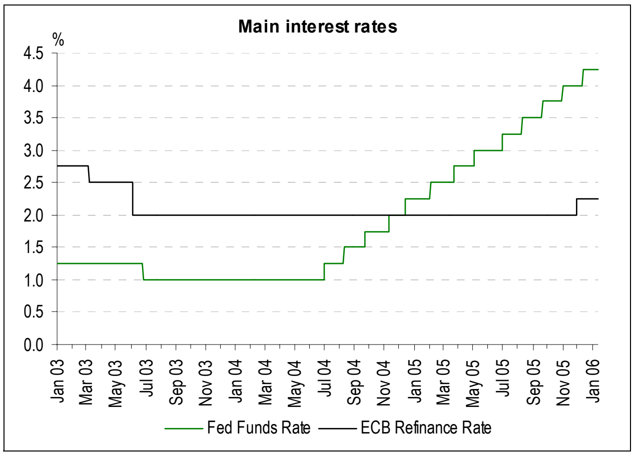
Treasury bond auctions in 2006 (PLN m)

month	First auction				Second auction				Third auction			
	date	T-bonds	offer	sale	date	T-bonds	offer	sale	date	T-bonds	offer	sale
January	04.01	OK0408	2 500	2 500	11.01*	DS1015	3 360	3 360	18.01	DS1110	2 000 - 3 000	-
February	01.02	2Y	-	-	08.02	7Y WIBOR | 12Y CPI	-	-	15.02	5Y	-	-
March	01.03	2Y	-	-	08.03	20Y	-	-	15.03	5Y	-	-
April	05.04	2Y	-	-	12.04	10Y	-	-	19.04	5Y	-	-
May	04.05	2Y	-	-	10.05	7Y WIBOR | 12Y CPI	-	-	17.05	5Y	-	-
June	07.06	2Y	-	-	14.06	20Y	-	-	21.06	5Y	-	-
July	05.07	2Y	-	-	12.07	10Y	-	-	-	-	-	-
August	02.08	2Y	-	-	09.08	7Y WIBOR | 12Y CPI	-	-	-	-	-	-
September	06.09	2Y	-	-	13.09	20Y	-	-	20.09	5Y	-	-
October	04.10	2Y	-	-	11.10	10Y	-	-	18.10	5Y	-	-
November	02.11	2Y	-	-	08.11	7Y WIBOR | 12Y CPI	-	-	15.11	5Y	-	-
December	06.12	2Y	-	-	-	-	-	-	-	-	-	-

* with supplementary auction

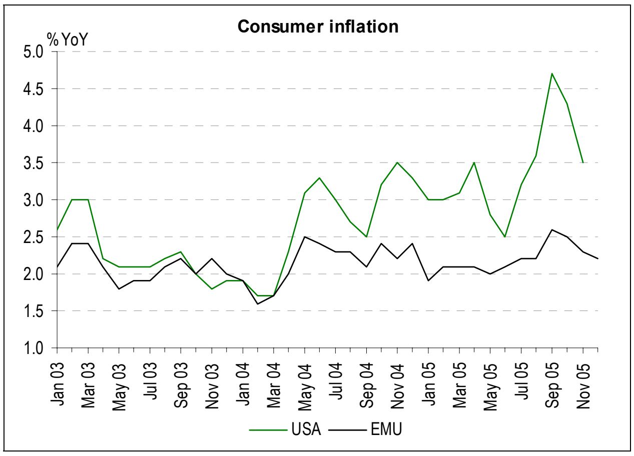
Source: Ministry of Finance, Reuters, BZ WBK

International review



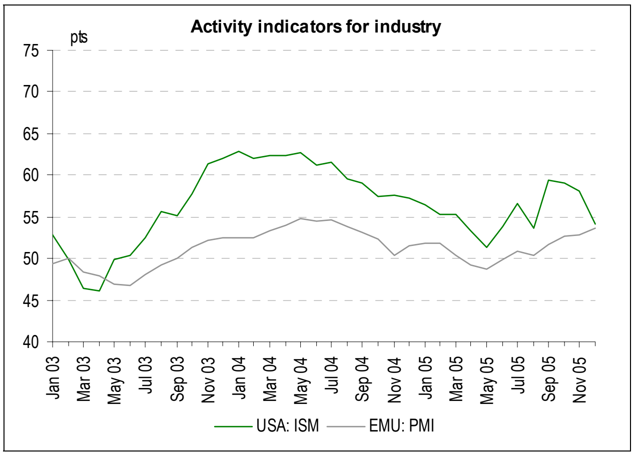
Rising expectations on sooner end of rate hikes in U.S.

- On December meeting Fed increased main Fed Funds rate for the 13th consecutive month from 4% to 4.25%, although Fed's statement suggested in line with expectations that aggressive monetary policy tightening may be going to the end. FOMC minutes confirmed those signals and suggested sooner end of rate hikes. In the current situation the automatism of rate hikes will disappear and released figures will be of crucial importance to rate decisions.
- ECB left the main repo rate in the EMU unchanged at 2.25%. ECB's chairman J. C. Trichet's comments were slightly more hawkish than after previous meeting though less than expected. Trichet stated, that there are threats for price stability as well as growth, and monetary policy in EMU is still accommodative Interest rate hikes in EMU are expected the earliest in March.



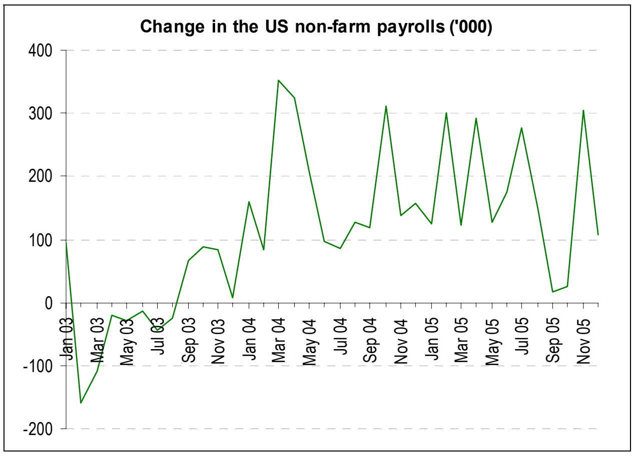
Falling inflation due to energy prices drop

- Consumer prices index in United States fell in November by 0.6%MoM, which was the deepest drop month-on-month for 56 years, to 3.5%YoY, as a result of record drop of energy and gasoline prices. Core inflation measure rose in line with expectations by 0.2%MoM to 2.1%YoY. Producer prices fell by 0.7%MoM after 0.7%MoM rise in October. Core producer prices inched up by o 0.1%MoM, with high drops of gasoline and heating oil.
- Consumer inflation in the euro zone fell in November to 2.3%YoY from 2.5%YoY in October. Producer prices index fell in the same month by 0.2%MoM mainly due to decline of energy prices and rose 4.2%YoY. According to preliminary estimates of EU statistical office Eurostat in December CPI inflation in the euro zone amounted 2.2%YoY.



Mixed activity data in U.S. and rise in EMU

- December ISM index, which measures economic activity in manufacturing sector in U.S. fell from 58.1 pts to 54.2 pts. Prices component decreased from 74.0 pts to 63.0 pts, and employment index fell from 56.6 pts to 52.7 pts. ISM index showing activity in the services sector soared from 58.5 pts in November to 59.8 pts. Employment sub-index rose slightly from 57.0 to 57.1 pts, while new-orders index increased from 59.5 pts to 61.9 pts.
- PMI index in the euro zone rose in December to 53.6 pts from 52.8 pts in the previous month and similarly to new orders component at 56.0 pts was at the highest level since July 2004. Employment index rose to 50.3 pts and showed first rise of new jobs in manufacturing sector since May 2001. PMI services sector index increased from 55.2 to 56.8 pts, while employment index rose for the first time since July 2001.



Source: Reuters, ECB, Federal Reserve

Unemployment rate drops in the U.S.

- The number of new jobs outside the agricultural sector rose in December by 108,000, which surprised the analysts as the market consensus amounted 200,000. Data for the previous month was revised from 215,000 to 305,000 (as an effect of post-hurricanes revival), the highest level since April 2004 and showed, that situation on the labor market is not as negative as the headline figure could suggest. One should notice as well that employment component of the ISM fell.
- Unemployment rate in the United States fell in December from 5.0% to 4.9%, while the market did not expect any change. In the same month the average hourly earnings rose by 5 cents to USD16.34, which is a 0.3%MoM rise as compared to 0.1%MoM increase in November and market expectations at 0.2%MoM.

Economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
9 January	**10** USA: Wholesale inventories (Nov) GER: ZEW index (Jan)	**11** ***POL: Auction of 10Y bonds***	**12** EMU: GDP revised (Q3) EMU: ECB meeting – decision USA: Foreign trade (Nov) USA: Foreign trade prices (Dec) USA: Fed budget (Dec)	**13** ***POL: Money supply (Dec)*** ***POL: Balance of payments (Nov)*** USA: PPI (Dec) USA: Retail sales (Dec)
16 ***POL: Treasury bills auction*** ***POL: CPI (Dec)*** ***POL: Wages (Dec)*** ***POL: Employment (Dec)*** USA: Holiday	**17** USA: Net capital flows (Nov) USA: Capacity utilisation (Dec) USA: Industrial output (Dec)	**18** ***POL: Auction of 5Y bonds*** EMU: Industrial output (Nov) USA: CPI (Dec)	**19** ***POL: PPI (Dec)*** ***POL: Output in industry and construction (Dec)*** EMU: Final HICP (Dec) EMU: Trade balance (Nov) USA: House starts (Dec)	**20**
23 ***POL: Business climate (Jan)***	**24** ***POL: Core inflation (Dec)*** ***POL: MPC meeting*** EMU: Current account (Nov)	**25** GER: IFO index (I) USA: Home sales (Dec)	**26** USA: Durable goods (Dec)	**27** USA: Flash GDP (Q4)
30 ***POL: MPC meeting*** ***POL: Retail sales (Dec)*** ***POL: Unemployment rate (Dec)*** USA: PCE (Dec) USA: Personal income (Dec)	**31** ***POL: MPC meeting – decision*** EMU: HICP flash (Jan) EMU: Business climate (Jan) USA: Chicago PMI (Jan) USA: Consumer confidence (Jan) USA: Fed meeting – decision (Jan)	**1 February** ***POL: Auction of 2Y bonds*** EMU: Unemployment (Dec) EMU: PMI manufacturing (Jan) USA: ISM manufacturing (Jan)	**2** EMU: PPI (Dec) EMU: ECB meeting – decision USA: Unit labor costs, productivity – preliminary data (Q4)	**3** EMU: PMI non-manufacturing (Jan) EMU: Retail sales (Dec) USA: Non-farm payrolls (Jan) USA: Unemployment (Jan) USA: Factory orders (Dec) USA: Michigan index (Jan) USA: ISM non-manufacturing (Jan)
6	**7**	**8** ***POL: Auction of bonds***	**9** USA: Wholesale inventories (Dec)	**10** USA: Budget deficit (Jan) USA: Foreign trade (Dec)
13 ***POL: Balance of payments (Dec)***	**14** ***POL: Money supply (Dec)*** GER: ZEW index (Feb) EMU: Preliminary GDP (Q4) USA: Retail sales (Jan)	**15** ***POL: Auction of 5Y bonds*** ***POL: CPI (Jan)*** ***POL: Wages (Jan)*** ***POL: Employment (Jan)*** USA: Net capital flows (Dec) USA: Industrial output (Jan)	**16** USA: Building permits (Jan) USA: Foreign trade prices (Jan)	**17** ***POL: PPI (Jan)*** ***POL: Output in industry and construction (Jan)*** EMU: Industrial output (Dec) USA: PPI (Dec)

Source: CSO, NBP, Finance Ministry, Reuters

MPC meetings and data release calendar for 2006

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
MPC meeting	30-31	21-22	28-29	25-26	30-31	27-28	25-26	29-30	26-27	24-25	28-29	19-20
GDP*	-	-	1	-	30	-	-	29	-	-	29	-
CPI	16	15[a]	15[b]	14	15	14	14	14	14	16	15	14
Core inflation	24		23[b]	24	23	23	24	23	22	24	23	22
PPI	19	17	17	20	19	20	19	18	19	18	20	19
Industrial output	19	17	17	20	19	20	19	18	19	18	20	19
Retail sales	30	-	-	-	-	-	-	-	-	-	-	-
Gross wages, employment	16	15	15	18	17	16	17	16	15	16	16	15
Unemployment	30	-	-	-	-	-	-	-	-	-	-	-
Foreign trade	about 50 working days after reported period											
Balance of payments*	-	-	31	-	-	-	-	-	-	-	-	-
Balance of payments	13[c]	13	14	-	-	-	-	-	-	-	-	-
Money supply	13	14	14	-	-	-	-	-	-	-	-	-
NBP balance sheet	6	7	7	-	-	-	-	-	-	-	-	-
Business climate indices	23	23	23	24	23	23	24	23	25	23	23	22

* quarterly data, [a] preliminary data, January, [b] January and February, [c] November 2005, [d] January, [e] February

Source: CSO, NBP

Economic data and forecasts

Monthly economic indicators

		Dec 04	Jan 05	Feb 05	Mar 05	Apr 05	May 05	Jun 05	Jul 05	Aug 05	Sep 05	Oct 05	Nov 05	Dec 05	Jan 06
Industrial production	%YoY	6.8	4.6	2.3	-3.7	-1.1	0.9	6.9	2.6	4.8	5.9	7.6	8.5	8.4	9.9
Retail sales [c]	%YoY	2.8	7.5	2.4	-0.3	-14.4	8.0	10.5	5.0	7.9	5.4	7.5	7.3	8.1	7.9
Unemployment rate	%	19.1	19.5	19.4	19.3	18.8	18.3	18.0	17.9	17.8	17.6	17.3	17.3	17.6	18.1
Gross wages [b c]	%YoY	3.2	2.6	1.4	2.2	1.8	3.0	4.5	3.2	2.8	1.8	6.4	6.9	4.5	4.3
Employment [b]	%YoY	0.2	1.5	1.6	1.6	1.7	1.6	1.7	1.8	2.0	2.2	2.1	2.4	2.5	1.7
Export [d]	%YoY	22.5	35.0	27.3	11.0	12.6	11.3	12.9	15.0	13.5	14.0	18.2	14.2	16.2	12.1
Import [d]	%YoY	16.3	22.7	27.9	6.8	-5.2	13.5	10.8	8.1	13.5	10.0	14.6	11.5	14.3	11.5
Trade balance [d]	EURm	-442	100	-60	-359	-19	-495	-172	-143	-341	-127	44	-100	-400	150
Current account balance [d]	EURm	-489	-408	-317	-275	114	-685	53	-308	-376	-245	-253	-250	-540	-70
Current account balance [d]	% GDP	-4.1	-4.0	-3.8	-3.4	-2.7	-2.5	-2.1	-1.8	-1.8	-1.5	-1.4	-1.4	-1.4	-1.3
Budget deficit (cumulative)	PLNbn	-41.5	-1.6	-8.8	-12.3	-13.9	-18.3	-18.5	-17.5	-18.5	-17.8	-20.6	-22.2	-30.0	-3.0
Budget deficit (cumulative)	% realisation	100.0	4.5	25.2	35.2	39.6	52.3	52.9	49.9	52.8	50.8	58.8	63.4	85.7	9.0
CPI	%YoY	4.4	3.7	3.6	3.4	3.0	2.5	1.4	1.3	1.6	1.8	1.6	1.0	0.9	1.2
PPI	%YoY	5.2	4.5	3.2	2.2	0.9	-0.5	0.0	0.0	-0.2	-0.5	-0.9	-0.4	0.9	0.9
Broad money (M3)*	%YoY	8.7	9.3	9.4	11.0	10.0	13.2	10.8	10.4	11.1	12.7	8.7	12.5	10.6	10.8
Deposits*	%YoY	8.1	8.4	8.7	10.4	8.7	11.9	9.2	9.4	10.1	11.6	6.3	11.0	9.0	9.7
Credits*	%YoY	2.9	3.5	2.4	4.6	5.3	9.4	7.4	8.8	9.0	9.6	4.4	10.1	11.3	12.0
USD/PLN	PLN	3.09	3.11	3.06	3.04	3.21	3.29	3.34	3.40	3.29	3.20	3.26	3.37	3.25	3.18
EUR/PLN	PLN	4.14	4.08	3.99	4.02	4.16	4.18	4.06	4.10	4.05	3.92	3.92	3.97	3.85	3.82
Reference rate [a]	%	6.50	6.50	6.50	6.00	5.50	5.50	5.00	4.75	4.75	4.50	4.50	4.50	4.50	4.25
WIBOR 3M	%	6.72	6.63	6.54	6.15	5.78	5.48	5.22	4.66	4.67	4.57	4.50	4.64	4.62	4.50
Lombard rate [a]	%	8.00	8.00	8.00	7.50	7.00	7.00	6.50	6.25	6.25	6.00	6.00	6.00	6.00	5.75
Yield on 52-week T-bills	%	6.44	6.28	5.95	5.51	5.36	5.19	5.09	4.30	4.33	4.15	4.19	4.35	4.38	4.24
Yield on 2-year T-bonds	%	6.39	6.24	5.82	5.43	5.39	5.27	5.14	4.50	4.60	4.22	4.42	4.75	4.64	4.40
Yield on 5-year T-bonds	%	6.29	6.31	5.80	5.56	5.50	5.38	5.25	4.70	4.84	4.51	4.85	5.23	5.04	4.80
Yield on 10-year T-bonds	%	6.02	5.98	5.72	5.57	5.49	5.36	5.24	4.72	4.87	4.57	4.90	5.36	5.14	4.90

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

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

* 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

		2003	2004	2005	2006	1Q05	2Q05	3Q05	4Q05	1Q06	2Q06	3Q06	4Q06
GDP	PLNbn	842.1	922.2	970.5	1 027.7	226.2	235.7	237.2	271.3	239.1	249.4	251.2	288.0
GDP	%YoY	3.8	5.3	3.4	4.3	2.1	2.8	3.7	4.5	4.1	4.3	4.3	4.4
Domestic demand	%YoY	2.7	5.9	1.5	4.2	1.1	-0.5	1.6	3.7	3.9	4.2	4.1	4.5
Private consumption	%YoY	1.9	4.0	2.3	3.6	1.7	1.6	2.7	3.3	3.5	4.0	3.5	3.5
Fixed investments	%YoY	-0.1	6.3	4.9	8.2	1.2	3.8	5.7	6.5	9.0	8.0	8.0	8.0
Industrial production	%YoY	8.4	12.3	3.9	5.8	0.7	2.3	4.5	8.2	9.5	3.5	4.8	5.4
Retail sales (real terms)	%YoY	3.6	7.1	1.7	6.9	-0.4	-3.2	4.1	6.4	4.3	6.4	8.2	8.7
Unemployment rate [a]	%	20.0	19.1	17.6	16.6	19.3	18.0	17.6	17.6	17.9	16.8	16.3	16.6
Gross wages (real terms)	%YoY	2.0	0.8	1.3	3.2	-1.3	0.8	1.1	4.7	3.5	3.1	4.7	1.3
Export [b]	%YoY	9.1	22.3	16.1	8.4	23.1	12.2	14.1	16.1	10.0	10.0	7.0	7.0
Import [b]	%YoY	3.3	19.5	11.6	12.3	17.8	5.7	10.4	13.4	10.0	17.0	11.0	11.0
Trade balance [b]	EURm	-5 077	-4 552	-2 074	-5 260	-316	-690	-612	-456	-348	-2 124	-1 447	-1 341
Current account balance [b]	EURm	-4 108	-8 401	-3 499	-5 260	-1 001	-529	-926	-1 043	-348	-2 124	-1 447	-1 341
Current account balance [b]	% GDP	-2.1	-4.1	-1.5	-2.0	-3.3	-2.1	-1.5	-1.4	-1.2	-1.8	-1.9	-2.0
Budget deficit (cumulative) [a]	PLNbn	-37.0	-41.5	-30.0	-30.5	-12.3	-18.5	-17.8	-30.0	-12.2	-18.3	-24.4	-30.5
Budget deficit (cumulative) [a]	% GDP	-4.4	-4.5	-3.1	-3.0	-	-	-	-	-	-	-	-
CPI	%YoY	0.8	3.5	2.1	1.4	3.6	2.3	1.6	1.2	1.3	1.3	1.4	1.5
CPI [a]	%YoY	1.7	4.4	0.9	1.9	3.4	1.4	1.8	0.9	1.4	1.5	1.2	1.9
PPI	%YoY	2.6	7.0	0.8	1.3	3.3	0.1	-0.2	-0.1	1.2	0.9	1.4	1.7
Broad money (M3)* [a]	%YoY	5.6	8.7	10.6	11.4	11.0	10.8	12.7	10.6	10.5	10.6	9.3	11.4
Deposits* [a]	%YoY	3.7	8.1	9.0	11.7	10.4	9.2	11.6	9.0	9.4	11.1	9.2	11.7
Credits* [a]	%YoY	8.1	2.9	11.3	15.0	4.6	7.4	9.6	11.3	12.9	14.6	16.7	15.0
USD/PLN	PLN	3.89	3.65	3.23	3.23	3.07	3.28	3.30	3.29	3.22	3.24	3.28	3.18
EUR/PLN	PLN	4.40	4.53	4.02	3.97	4.03	4.13	4.02	3.91	3.88	3.98	4.03	3.98
Reference rate [a]	%	5.25	6.50	4.50	4.25	6.00	5.00	4.50	4.50	4.25	4.25	4.25	4.25
WIBOR 3M	%	5.69	6.21	5.29	4.45	6.44	5.49	4.63	4.59	4.43	4.45	4.45	4.45
Lombard rate [a]	%	6.75	8.00	6.00	5.75	7.50	6.50	6.00	6.00	5.75	5.75	5.75	5.75
Yield on 52-week T-bills	%	5.33	6.50	4.92	4.43	5.91	5.21	4.26	4.31	4.30	4.40	4.50	4.50
Yield on 2-year T-bonds	%	5.38	6.89	5.04	4.55	5.83	5.27	4.44	4.60	4.40	4.50	4.60	4.70
Yield on 5-year T-bonds	%	5.61	7.02	5.25	5.06	5.89	5.38	4.68	5.04	4.90	5.00	5.15	5.20
Yield on 10-year T-bonds	%	5.77	6.84	5.24	5.14	5.76	5.37	4.72	5.13	5.00	5.10	5.20	5.25

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.

Bank Zachodni WBK

TREASURY DIVISION

Pl. Władysława Andersa 5, 61-894 Poznań
secretary tel. +48 061 856 58 35, fax +48 061 856 55 65

This analysis is based on information available until 12.01.2006 has been prepared by:

ECONOMIC ANALYSIS UNIT

ul. Marszałkowska 142, 00-061 Warszawa, fax +48 022 586 83 40
Email: ekonomia@bzwbk.pl Web site (including Economic Service page): http://www.bzwbk.pl

Maciej Reluga – Chief Economist
tel. +48 022 586 83 63, Email: maciej.reluga@bzwbk.pl

Piotr Bielski +48 022 586 83 33
Piotr Bujak +48 022 586 83 41
Cezary Chrapek +48 022 586 83 42

TREASURY SERVICES DEPARTMENT

Gdańsk
Długie Ogrody 10
80-765 Gdańsk
tel. +48 058 326 26 40
fax +48 058 326 26 42

Kraków
Rynek Główny 30/8
31-010 Kraków
tel. +48 012 424 95 01
fax +48 012 424 21 41

Poznań
pl. Gen. W. Andersa 5
61-894 Poznań
tel. +48 061 856 58 14
fax +48 061 856 55 65

Warszawa
ul. Marszałkowska 142
00-061 Warszawa
tel. +48 022 586 83 20
fax +48 022 586 83 40

Wrocław
ul. Rynek 9/11
50-950 Wrocław
tel. +48 071 370 25 87
fax +48 071 370 26 22