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Eyeopener – daily update

Few more figures before the MPC

24 January 2005

The week will start with publication of remaining statistical data for December – retail sales and unemployment rate on Monday, and core inflation on Tuesday. However, financial market will be looking forward to Wednesday, when the outcome of the first MPC meeting this year will be announced. We do not expect any changes in monetary policy parameters, although the Council is likely to notice that the balance of risks for future inflation has improved. This could result in short-lived strengthening on the fixed income market. Nevertheless, recent comments from MPC members clearly showed that they would start pondering adoption of neutral bias only after receiving new inflation projection from the NBP staff, and a way to interest rate cuts is still quite long. This should weaken expectations for soon monetary easing.

As expected, budget gap in 2004 was much lower than planned reaching PLN41.5bn. Performance of this year's budget may not be equally painless, however we do not expect target deficit to be overshoot.

Positive results of business climate survey in January indicated continuation of fast economic growth at the beginning of 2005. However, the structure of the growth may be different than to date – the role of industry (driven by export) may decrease, while that of construction (investment) and retail trade (consumption) may become more important. This can be negative for the medium-term inflation outlook.

What's hot today

Retail sales and unemployment figures due today

We predict higher sales growth than market consensus

Core inflation measures should show stabilisation on Tuesday

The week will start with publication of remaining statistical data for December. On Monday, the Central Statistical Office will release monthly statistical bulletin, containing e.g. data on retail sales and unemployment rate for December (unfortunately, no precise time of the release has been given). We expect 6%YoY nominal rise in sales and slight rise in unemployment rate to 19% from 18.7% in November. However, market consensus is much more pessimistic as regards growth in retail sales, and median forecast stands at a mere 3.6%YoY. Moreover, one could suppose those weak expectations even reinforced after lower than expected data on industrial output. Thus, materialisation of our prediction could act negatively for fixed income market, signalling that private consumption demand was not all dead at the end of 2004. Slight rise in unemployment to 19% is a typical seasonal phenomenon at the end of the year, and was announced earlier by EconMin officials, therefore it should be no surprise for the financial market players.

On Tuesday at 16:00 the National Bank of Poland will show core inflation indices for December. Most of the measures are expected to remain stable, including two the most important – net inflation and 15% trimmed mean (at the levels 2.4% and 3.2%YoY, respectively). This publication should be also quite irrelevant for Polish financial market, bringing no change to the already known picture of economic situation.

In fact, market participants will be already looking forward to Wednesday, when the outcome of the first MPC meeting this year will be announced. We

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The MPC unlikely to alter monetary policy in January

... but may signal improved balance of risks for inflation

do not expect any changes in monetary policy parameters, although the Council is likely to notice that the balance of risks for future inflation has improved, due to zloty appreciation and lower than expected growth in output and prices at the end of 2004. This could result in short-lived strengthening on the fixed income market. Nevertheless, recent comments from MPC members clearly signalled that they would start pondering adoption of neutral bias only after receiving new inflation projection from the NBP staff, and a way to interest rate cuts is still quite long. This line of reasoning could be also reiterated by central bankers after the MPC meeting, and should inhibit too optimistic expectations regarding rate cuts perspectives.

Bottom line: *The event of the week will be MPC meeting. No change in monetary policy parameters is expected, however the Council could guide market expectations regarding future steps. Hint on improvement of risks for inflation could temporarily strengthen fixed income market.*

What's hot today

Budget deficit PLN3.8bn lower than planned in 2004

Budget gap in 2004 was much lower than planned, as expected

... due to higher tax revenues

... as well as lower spending

Budget liquidity dropped dramatically in December

On Friday, the Ministry of Finance released tentative data on budget execution in 2004. The budget gap undershot the government's target of PLN45.3bn, but was slightly higher than market consensus of PLN40.8bn and reached PLN41.5bn (or 91.6% of the plan). In the whole year, total revenues were 1.1% (or PLN1.74bn) higher than targeted and spending were 1% lower than planned. Higher revenues were a consequence of better than expected performance of two items: CIT inflows (by PLN3.3bn) and budget entities' revenues (by PLN3.5bn). Despite reduction in tax rate from 27% to 19%, higher CIT inflows stemmed from strong economic growth and rapid increase in enterprises' profitability. On the other hand, indirect taxes were PLN2.5bn lower than targeted.

On the spending side, savings were possible due to lower than envisaged debt servicing costs (PLN2.5bn in case of domestic debt and PLN1.5bn in case of foreign debt). There was also PLN2bn saving in subsidy to the Labour Fund but this was offset by PLN2.1bn higher subsidy to the Social Security Fund (among others, due to some shift in tasks from the former to the latter fund).

Financing of the deficit was more favourable than the planned, as privatisation revenues turned higher than targeted PLN8.8bn and reached PLN10.2bn. Liquidity of the state budget drastically fell to PLN3.3bn at the year-end from PLN21.5bn in November.

Bottom line: *In line with expectations the budget gap in 2004 was much lower than planned. Performance of this year's budget may not be equally painless. The first problem is relatively low liquidity of the state budget at the start of 2005, particularly that first months of the year will bring increased spending (among others, higher contribution to the EU budget).*

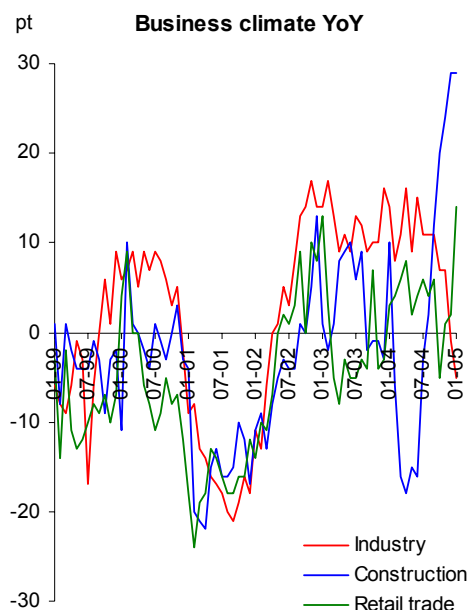
Business climate shows warming up domestic demand

Business climate indices for industry, construction and retail trade improved in January from the previous month, the CSO said on Friday. Retail sector remained in red at -9pts, but this was the best result since April 2001 (up 14pts in annual terms – the strongest improvement since June 1998). Forecasts of future sale were still negative, but to a lesser degree than in the previous month. Moreover, business climate in retail trade warmed up thanks to less pessimistic evaluation of current sales and enterprises' financial stance. If maintained in the nearest months, better moods of retailers may be an indication of an upcoming consumption boom signalled by recent results of consumer confidence surveys. Retailers reported rise in both current and future prices of goods, which suggested that rising domestic demand may be followed by price hikes. Enterprises from this sector still envisaged staff reduction, but its scale was planned to be lower than expected earlier.

The index in construction was 7pts (up 29pts on the year, the best result in nine years), as firms reported better order book expectations and upbeat forecasts of future production. Predictions regarding future financial situation were still negative, but better than a month earlier. Construction enterprises declared increase in prices of construction works, at faster pace than it was expected a month ago. Employment was predicted to fall, but to a lesser degree than in December, which seems optimistic given a unfavourable seasonal pattern. What's interesting, similarly as in previous month, among all barriers to construction firms, the fastest decline in annual terms was seen in case of insufficient demand. At the same time, there was growing share of firms declaring that their capacity was too low as compared to expected demand. Meanwhile, there was decreasing share of firms reporting their capacity as too high in comparison with predicted order portfolio. Such results indicated the output gap in the construction sector was closing.

The index for industry was 9pts, down 5pts against January 2004. Likewise in the case of industrial output, colder business climate in the sector as compared to the analogous period of last year was a result of high base effect – moods of manufacturers began to significantly improve at the start of 2004. However, one should keep in mind that moods of enterprises in industry were the best among all the three sectors. Expectations regarding future orders' portfolio were better than a month ago. Current production was also slightly expanded; in months to come it was expected to grow on a larger scale. Financial stance was predicted to slightly improve in the nearest months. Prices of produced goods may slightly increase in near future.

Bottom line: Positive results of business climate survey indicate continuation of fast economic growth at the beginning of 2005. However, the structure of the growth may be different than to date – the role of industry (driven by export) may decrease, while that of construction (investment) and retail trade (consumption) may become more important. This can be negative for the medium-term inflation outlook.



Market monitor

The zloty trading ranges (21.01.2005)

	Min	Max	Fixing
USD	3.1240	3.1620	3.1449
EUR	4.0874	4.0680	4.1000

F/X rates (today's opening)

EURUSD	1.3057	CADPLN	2.5542
USDPLN	3.1239	DKKPLN	0.5479
EURPLN	4.0893	NOKPLN	0.4963
CHFPLN	2.6356	SEKPLN	0.4502
JPYPLN*	3.0360	CZKPLN	0.1346
GBPPLN	5.8665	HUFPLN*	1.6515

*per 100 units

Treasury yield curve (21.01.2005)

T-bills	Yield	Change (bp)
3M	6.35	0
6M	6.35	0
9M	6.32	-3
12M	6.32	-3
Bonds		
2Y	6.33	-4
3Y	6.33	-5
4Y	6.37	-6
5Y	6.37	-5
8Y	6.10	-4
10Y	6.02	-3
20Y	5.87	-3

WIBOR rates (21.01.2005)

Term	Rates	Change (pb)
O/N	6.23	1
T/N	6.38	7
SW	6.59	2
2W	6.60	0
1M	6.63	0
3M	6.63	1
6M	6.60	-2
9M	6.59	-1
1Y	6.56	-1

On Friday, the zloty initially hovered around closing levels, but in the afternoon both against the euro and the dollar it increased noticeably by 0.5% hitting 4.07 and 3.13 respectively amid relatively low liquidity.

Bonds kept gaining at opening on the optimism wave following Thursday weak production figures. That factor pushed DS0509 to 6.37% which, as technically significant price level, induced many players to take profits after previous day hefty gains. Finding support at 6.40% the market stayed between those two marks till the end of the session.

Ministry of Finance announced the offer worth PLN600m of 1y bills for regular Monday's tender.

As we anticipated, bond market showed increased activity only at the outset of the session, when players adjusted their portfolios to altered conditions. In the aftermath of poorer production data investors probably have modified expectations regarding Monday's release of December retail sales figure. If it also proves to be weaker than market consensus, then market response would be yet relatively negligible. Polish currency was supported by increasing euro and technical signal of reversion to recent trading range, that is below 3.15 to the dollar and 4.10 to the euro. Lack of data in international markets may make zloty exchange rate not fluctuate too much unless retail sales takes by surprise strongly.

Bottom line: Interest rate market displayed activity mainly at opening. Zloty advanced meaningfully after the euro climbed above 1.30 mark. It looks like we will have a calm session on Monday ahead of MPC decision and US data portion later within the week.

International update

January preliminary reading of University of Michigan index came at 95.8 down from final December number of 97.1. Market analysts anticipated higher reading of 98.0. As the markets eye portion of data due later within the week, that number only slightly pushed up the euro.

On Monday, no market moving figures are scheduled.

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