Bank Zachodni WBK

Eyeopener – daily update

Bad news ignored

3 February 2005

As expected, the European Commission presented its critical stance regarding Poland's medium-term fiscal adjustment programme, signalling doubts whether the country would be able to cut fiscal deficit below 3% of GDP by 2007. However, the news did not seem to upset Polish financial market, which saw significant strengthening in both foreign exchange and fixed income segment yesterday.

Also, top government officials did not seem to be overly concerned about EC's critique. Finance minister Mirosław Gronicki suggested there was a contingency plan to achieve fiscal targets, more painful for the society (probably rise in tax burden), while economy minister Jerzy Hausner said the EC was too pessimistic, as always. At present, Hausner is much more concerned about zloty strength than failure of his reform programme. Yesterday he repeated once again that he would discuss ways to stop appreciation pressure during the talks with the central bank on Monday.

US Fed raised main interest rates by 25 bps, and said they could keep raising rates at a "measured" pace.

What's hot today

EC scolds Poland, economy minister blames the zloty for everything

European Commission has doubts regarding Poland's ability to meet fiscal targets

In line with expectations, the European Commission released an opinion yesterday, in which it criticised Poland's convergence program. The Commission said that Poland's fiscal austerity program might be insufficient to cut the budget gap below 3% in 2007 that would allow the country to adopt the euro in 2009. "In the absence of additional savings measures, the fulfilment of the Council recommendation to bring the deficit below 3% of GDP in the end year of the programme is not ensured, based on the new 2007 deficit target of 2.2%" the Commission said, adding that Poland should fully implement the Hausner plan and strengthen fiscal adjustment by taking additional austerity measures. The Commission stated that Poland needs more fiscal savings to make up for a change ordered by the EU in how it books transfers to pension funds that will inflate budget deficit after 2007. Besides, the Commission said Poland's projection of economic growth assuming 5.6% GDP rise in 2007 could prove too optimistic.

Finance minister saw little political will to deepen fiscal reform

Poland has plan B if final decision on pension funds' booking proves unfavourable

Finance minister Mirosław Gronicki said he saw little political will for more spending cuts in the years ahead and vowed to keep contest the pension ruling. Gronicki said the failure to implement Hausner's reforms in full showed the lack of political appetite for the unpopular cutbacks and bodes ill for the future. "I don't think we will see significant fiscal changes in coming years" he said. However, he said Poland would have a contingency plan to protect its euro adoption targets in case the EU rejects Warsaw's view on how to book its pension funds, and added it would be more painful for the society. He did not give any details, but we think the plan B would mean increase in tax burden on the economy (for instance rise in effective VAT rate).

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Hausner not concerned too much about EC's critique

Deputy PM and economy minister Jerzy Hausner also assured yesterday that euro adoption targets are still valid. He said the government was doing its job and the European Commission should not worry excessively. According to Hausner, the Commission's opinion about Poland's convergence program is as overly pessimistic as it was in the case of the country's preparations for EU entry and use of EU aid funds. Hausner seems to have more serious concerns than insufficient fiscal reforms and again he complained about the zloty strength yesterday. He said appreciation of the zloty might harm exports and economic growth and this will be one of subjects of talks between top government officials and the central bankers on Monday. Hausner said there were not many ways to influence the exchange rate under free floating regime, but he stressed there were some measures and they should be used. This confirms our view, presented earlier, that Hausner will strongly insist on the MPC to cut rates in order to weaken the zloty.

... as in his opinion strong zloty is a more serious problem

Deputy PM likely to press on rate cuts

***Bottom line**: Optimistic view on Poland's fiscal prospects for the nearest years begins to erode, which might be negative for Polish financial market in the medium run (even despite there was no short-term reaction). Deputy PM does not seem to be concerned about his failure to carry out public finance reform but rather keeps concentrating on the zloty strength.*

Market monitor

The zloty was stable throughout the better part of the day, and activity on Polish FX market was rather limited. However, the afternoon brought dramatic change of situation, as the currency saw abrupt and deep appreciation, gaining ca. 0.9% against basket of two currencies. Exchange rate against the euro dropped the most, by more than PLN0.04. This sudden appreciation took place shortly after deputy PM Hausner's comments regarding excessive zloty strength. Nevertheless, the reason was probably not the comment itself, but execution of large order on the FX market. After the move has been made, the zloty stabilised at those new, lower levels.

Polish fixed income market opened strong, despite Reuters' news on forthcoming EU's critique of Poland's fiscal adjustment programme. Just before the auction, there was some short-lived sell-off, pushing yields up. Nevertheless, the tender of 2y bonds went surprisingly well, which improved market sentiment a lot, and resulted in continuing buying of Polish treasuries after the auction. As a result, bond prices rose notably in the second part of the day, even despite some correction seen on the Bunds market, and Polish market remained immune to any negative news regarding Polish economy (e.g. publication of critical EU stance). The day ended with the yield curve slightly below Tuesday's close levels.

Ministry of Finance sold the entire offer PLN2.3bn of 2y bonds OK0407 on Wednesday auction, amid bulky demand from investors that reached PLN7.876bn. This translated into higher than expected bid cover ratio of over 3.4 and average yield amounted to 6.196%. Large demand induced the ministry to hold supplementary tender with an offer of PLN460m, which was absorbed as well.

***Bottom line**: After sharp zloty appreciation resulting from big order, the currency is likely to stabilise at new levels for a while. Fixed income market also seems predominated by positive moods.*

The zloty trading ranges (02.02.2005)

	Min	Max	Fixing
USD	3.0800	3.1120	3.1046
EUR	4.0125	4.0630	4.0583

F/X rates (today's opening)

EURUSD	1.3024	CADPLN	2.4891
USDPLN	3.0827	DKKPLN	0.5394
EURPLN	4.0118	NOKPLN	0.4862
CHFPLN	2.5800	SEKPLN	0.4425
JPYPLN*	2.9593	CZKPLN	0.1339
GBPPLN	5.8066	HUFPLN*	1.6421

*per 100 units

T-bond auction (02.02.2005)

	Offer	Bid PLN m	Sale	Average Yield
2Y*	2 760	8 436	2 760	6.196%

* with supplementary auction

Treasury yield curve (02.02.2005)

T-bills	Yield	Change (bp)
3M	6.30	0
6M	6.28	-2
9M	6.28	+1
12M	6.24	+1
Bonds		
2Y	6.16	-4
3Y	6.14	-1
4Y	6.17	0
5Y	6.15	-1
8Y	6.01	1
10Y	5.92	-1
20Y	5.74	-1

WIBOR rates (02.02.2005)

Term	Rates	Change (pb)
O/N	6.42	-4
T/N	6.46	-2
SW	6.58	2
2W	6.60	0
1M	6.60	0
3M	6.60	0
6M	6.60	0
9M	6.54	0
1Y	6.49	-1

International update

In line with expectations, the US Federal Reserve raised interest rates by 25 bps on Wednesday. It was the sixth hike in a row, which brought the federal funds rate to the level of 2.5%. In a statement issued after a meeting, Fed officials retained an assessment that economic risks were balanced between slower growth and rising prices and said they thought they could keep raising rates at a "measured" pace. The decision was fully consistent with broad market expectations, therefore it did not trigger any significant reaction.

Today, the ECB will announce its decision regarding monetary policy. It is expected that the bank will hold interest rates unchanged amid still not very convincing performance of European economy (e.g. in Germany, see below). ECB's main refinance rate has been staying at 2.0% since June 2003.

German labour office informed on Wednesday that unemployment rate in the EU's biggest economy rose in December to 11.4% (after seasonal adjustment), the highest level since October 1997, and the number of unemployed topped 5 million, the level last seen in 1933, during the great depression. Even though some of the increase comes from methodological changes in computation of unemployment statistics, deputy head of German labour office said yesterday that the country needed GDP growth of more than targeted 1.6% in order to have dynamic growth creation. Therefore, one should not expect that German unemployment rate drops significantly over the next few quarters.

Today, a few important figures released in the US will hint on real economic activity of American economy. Details are given in table below.

TIME GMT	COUNTRY	INDICATOR	PERIOD		FORECASTS	LAST VALUE
12:45	EMU	ECB Decision		%	2.0	2.0
15:00	USA	ISM non-Manufacturing	Jan		61.3	63.9
15:00	USA	Factory orders		%	0.5	1.2
15:00	USA	Durable goods orders	Dec	%	-	0.6

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