Bank Zachodni WBK

# Eyeopener – daily update

## Talks on 2006 budget intensify

12 May 2005

**Finance minister confirmed his plans to continue fiscal tightening in 2006 and to propose budget deficit at PLN30bn. Such figure should be assessed relatively positively by the market. Additionally, today *Rzeczpospolita* presented also plans of other political parties as regards next year's budget deficit. While SLD and SdPl are supporting PLN30bn deficit, both Civic Platform (PO) and Law and Justice (PiS), which are two parties likely to form a coalition government after election, would like to see it lower (at PLN15-20bn and PLN26bn, respectively). Details of their proposals are not known, though PiS plans to concentrate on cuts in administrative spending.**

**MPC's Dariusz Filar said that the new inflation projection (to be published at the end of May) would show that with today's rate at 5.5% CPI inflation would be close to the NBP target of 2.5% over the next two years. He said the projection would show inflation near 1.5% this year, but close to 2.5% in 2006. Filar perceived preliminary budget assumptions of the Ministry of Finance (GDP at 4% and average CPI of 1.5% in 2006) as conservative.**

## What's hot today

### Gronicki (and others) about 2006 budget

*FinMin plans budget deficit at PLN30bn in 2006*

Yesterday, finance minister Mirosław Gronicki made some more comments regarding next year's fiscal policy. He said he would like the general government deficit in 2006 to reach ca. 3% of GDP against 3.6% in 2005 and 4.6% in 2004, and confirmed that PLN30bn budget deficit next year is a realistic target. However, he noticed it was only a tentative assumption. In his opinion, total debt of the public sector – calculated according to the Polish methodology – will not exceed 53% of GDP this year, and should be at ca. 53.5% in 2006; since 2007 the debt/GDP ratio should start falling. Gronicki said that level of public debt in ESA95 terms would be lower than above-mentioned values by ca. 6.5% of GDP.

*… which includes PLN5-6bn of pensions indexation*

*… and in case of very strong positive inflation surprise (CPI below 1% in 2H05), budget deficit might be lower by this amount*

Minister confirmed also that next year's GDP growth has been assumed to reach at least 4%, against 4-4.5% forecasted at the moment for 2005, and said this is a conservative and cautious approach, in order to prepare a secure budget. In his opinion, investment growth should exceed 10% in both 2005 and 2006. In turn, inflationary pressure should remain benign in those two years in his opinion. Level of inflation in the nearest months is quite crucial for the budget not only because of its potential impact on budget revenues, but because it could trigger or not pension indexation in 2006 (if cumulated growth in CPI since 2004 exceeds 5%). Gronicki said yesterday that if this happens, net subsidy to the pension fund would have to be higher by ca. PLN4.5-5.0bn in 2006. However, his advisor Przemysław Kwiecień explained that this amount has already been included in ministry's plans to cut budget deficit to ca. PLN30bn. Therefore, in the case of very strong positive inflation surprise this year, planned budget deficit for 2006 could be even lower by almost PLN5bn. While this is not a central-case scenario

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*FinMin considers higher tax free amount for pensioners to replace indexation*

predicted by us (it would require inflation rate to be below 1%YoY in H2 2005), one cannot rule out such situation completely if for example food prices surprise on the downside in the summer period. Also, according to *Gazeta Wyborcza* daily a senior Ministry of Finance's official said the ministry considered a proposal to replace pensions indexation by higher tax free amount for pensioners. If this is the case, budgetary effect would be visible on the revenues rather than spending side.

*PO and PiS would like to see lower budget deficit*

Today *Rzeczpospolita* presented also plans as regards next year's budget deficit of other political parties. While SLD and SdPl are supporting PLN30bn deficit proposed by the Ministry of Finance, both Civic Platform (PO) and Law and Justice (PiS) would like to see it lower. The former would like to cut the deficit by as much PLN10-20bn as compared to this year's PLN35bn, the latter targets the level of PLN26bn next year. PiS would like to concentrate on administrative spending only. However, this is positive news that both parties, which are likely to form a coalition government after election focus on lowering budget deficit in 2006. What is interesting, more populist parties such as League of Polish Families (LPR) and Samoobrona see budget deficit in 2006 at this year's level, while one could have expected their will to increase it by dozens of billions zloty.

*… while populist parties are not even so eager to increase it*

***Bottom line*: Finance minister confirmed his plans to continue fiscal tightening in 2006 budget draft, which is likely to be positively assessed by the market. PO and PiS politicians declare lowering 2006 budget deficit below PLN30bn.**

## Market monitor

The zloty continued to decline in the morning on Wednesday. It tested technical support at 4.2 several times, but finally failed to breach that psychological barrier and went up to 4.17 ahead of US trade data release. Temporary increase was recorded also in case of USDPLN rate, which reached levels close to 3.26, but similarly to EURPLN rate, it rebounded after struggling to break and fell to 3.235. After US data publication zloty maintained its gains against the euro, but lost over 1% to 3.27 in relation to the dollar on move following trade deficit data. Just before the close the zloty strengthened to 4.156 and 3.251 against the euro and dollar, respectively.

The Polish bonds weakened a bit at the outset of Wednesday's session on zloty weakness, ignoring buoyant Bunds trading close to historical low at 3.33%. PS0310 yield rose to 5.47%. Though all the bids at the auction of 12y CPI paper were rejected, bond actually did not respond. Sudden zloty weakness on US data pushed 5y benchmark yield higher to 5.48%. At the end of the session an impulse from rising Bunds set the close back at 5.45%.

Yesterday at the auction for inflation linked bonds (so called real) investors claimed from issuer a premium, which could not be accepted, that resulted in rejection of all offers. It occurred because foreign investors did not take part in the auction who had constituted so far a hard core of demand in the auctions for that kind of papers. In the environment of stable nominal rates and falling inflation real interest rates start to rise diminishing the attractiveness of real bonds for portfolio investors. Moreover finance minister

**The zloty trading ranges (11.05.2005)**

| | Min | Max | Fixing |
|---|---|---|---|
| USD | 2.2345 | 3.2710 | 3.2483 |
| EUR | 4.1540 | 4.1980 | 4.1856 |

**F/X rates (today's opening)**

| | | | |
|---|---|---|---|
| EURUSD | 1.2792 | CADPLN | 2.6015 |
| USDPLN | 3.2461 | DKKPLN | 0.5579 |
| EURPLN | 4.1512 | NOKPLN | 0.5137 |
| CHFPLN | 2.6889 | SEKPLN | 0.4502 |
| JPYPLN* | 3.0585 | CZKPLN | 0.1388 |
| GBPPLN | 6.0738 | HUFPLN* | 1.6616 |

*per 100 units

**Treasury yield curve (11.05.2005)**

| T-bills | Yield | Change (bp) |
|---|---|---|
| 3M | 5.39 | 0 |
| 6M | 5.37 | 0 |
| 9M | 5.34 | 0 |
| 12M | 5.30 | 0 |
| **Bonds** | | |
| 2Y | 5.34 | 2 |
| 3Y | 5.39 | -2 |
| 4Y | 5.45 | 0 |
| 5Y | 5.45 | 0 |
| 8Y | 5.44 | -3 |
| 10Y | 5.44 | -2 |

**WIBOR rates (11.05.2005)**

| Term | Rates | Change (pb) |
|---|---|---|
| O/N | 5.83 | 11 |
| T/N | 5.83 | 8 |
| SW | 5.65 | 1 |
| 2W | 5.62 | 1 |
| 1M | 5.56 | 1 |
| 3M | 5.51 | 1 |
| 6M | 5.42 | 1 |
| 9M | 5.40 | 3 |
| 1Y | 5.39 | 4 |

did not want to spoil market sentiment by accepting low prices ahead of 5y bond auction slated for next Wednesday.

Zloty's rebound from 4.2 to the euro confirmed that its weakening lasting from the beginning of the week was a correction after dramatic gains and not a initial part of return to the levels from the end of April. Concurrently, behaviour of Polish currency points that political risk was not eliminated, but only reduced until the start of election campaign. US trade data caused sudden short position covering in the dollar against the euro formed earlier. Presently EURUSD rate may be under further pressure ahead of today's US retail sales data. However, if they prove to be low, that is point to prolonged slowdown, the euro may again return to 1.29.

***Bottom line*: Despite weak opening, the zloty closed stronger than on Tuesday that should encourage investors to buy the Polish currency. Unsuccessful auction for real bonds actually did not have any impact on the bond market, which again enjoyed a calm session. Today another portion of US data will be presented amid lack of them domestically.**

# International update

Germany's economy recorded its strongest growth rate in four years in the 1Q05 thanks to buoyant exports, and despite domestic demand declined according to preliminary data. GDP expanded 1.0%QoQ, adjusted for seasonal factors.

US trade deficit narrowed unexpectedly to US$55.0bn in March, as exports rose to a new record and imports from China declined. Analysts had expected the trade gap to extend to US$61.5bn on high oil prices and vast quantity of textile imports from China. The sharp decline in imports constituted an evidence that the economy recorded a period of slowdown at the beginning of the year. The immediate reaction sent the cross to 1.282, as an impact of largely lower number than consensus was boosted by dollar-supportive positioning in the EURUSD market.

Today investors will convince themselves if last month's sharp decline in US retail sales dynamics was only one-off event.

| TIME GMT | COUNTRY | INDICATOR | PERIOD | | FORECASTS | LAST VALUE |
|---|---|---|---|---|---|---|
| 12:30 | USA | Retail sales (H) | Apr | % | 0.4 | 0.3 |



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