Bank Zachodni WBK

Eyeopener – daily update

Inflation keeps going down

17 May 2005

Inflation rate fell to 3% in April, as we expected. The data confirmed predictions of fast CPI reduction to 1.5%YoY in mid-year, however was rather neutral for interest rates outlook. Despite the doves in the MPC would surely prefer to continue monetary easing already in May, in our view the 10-members panel will decide about slight fine-tuning reduction in borrowing costs in the summer period (probably in July).

According to anonymous source quoted by PAP yesterday, one MPC member (out of ten) was against rate cut of 50 bps in March. Official information about voting results will be released on Friday.

Budget deficit reached close to 40% of annual plan after four months of the year. Annual growth in revenues was quite poor, but this was affected by high base effect (tax inflows boosted ahead of EU entry in April 2004). We believe budget revenues will accelerate in H2 2005 together with growth revival.

What's hot today

Inflation in line with our expectation

In April, CPI inflation fell to 3.0%YoY from 3.4% in March, exactly as we had predicted and above market consensus of 2.9%. On monthly basis, prices rose by 0.4% driven by fuel prices growth of 4.5%MoM (high oil prices and weaker zloty), and food and tobacco prices increase by 0.5%MoM. As last year consumer prices grew by as much as 0.8% (as a result of EU accession), 12M CPI fell substantially. This effect was the most significant in food inflation, which fell to 3.7%YoY from 5.3%. The same should be expected in the following months and that is why we forecast CPI inflation's fall to 2.4% in May and 1.7% in June (and to maintain at ca. 1.5% till year-end). Therefore, within next two months inflation will reach the lower end of the allowed fluctuation band around the target of 2.5%. We continue to expect that the Monetary Policy Council will then decide on some fine-tuning in rates (cut by 25 bps) and we do not change our view that the MPC will keep rates on hold during May's (and possibly also June's) monthly meeting keeping neutral bias. This is at odds with MPC Mirosław Pietrewicz's view, who said once again yesterday that in his opinion "slight interest rate cut could be necessary until June". He argued that such decision would be justified not only by lack of inflationary pressure, but also by concerns about economic growth, which could not exceed 4% this year.

***Bottom line**: Inflation data confirmed expectations for fast inflation reduction to 1.5%YoY in mid-year. Our outlook on interest rates remains unchanged.*

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High base effect affected budget revenues

Budget deficit at ca. 40% of annual plan after four months

After one-third of the year budget deficit amounted to PLN13.9bn or close to 40% of the annual plan. This was slightly above market expectations. However, the most important element to watch was figure concerning indirect tax revenues, as their performance disappointed in March and one could have expected further difficulties amid slightly slower economic growth. While at the first glance those revenues were quite poor again (drop of above 4%YoY), one should remember that annual growth rate was affected by high statistical base effect (high revenues amid higher economic activity ahead of EU accession). In nominal terms, indirect tax revenues amounted to PLN9.4bn, which cannot be perceived as a bad result. Total revenues fell by 4.2%YoY and amounted to PLN55.8bn or 32% of the annual plan, while spending rose by 12.4%YoY to PLN69.6bn or 33.2% of the plan amid high subsidy to Social Security Fund (almost 50% of the plan after April). Money on governmental accounts showed that liquidity in the central budget was still above PLN7bn in April.

Revenues from indirect taxes fell 4%YoY, but this resulted largely from high base effect

Budget still has liquidity cushion of more than PLN7bn

***Bottom line**: Annual growth in revenues quite poor in April, but this was affected by high base effect (growth boosted ahead of EU entry in April 2004). We believe budget revenues will accelerate in H2 2005 together with growth revival.*

Market monitor

The zloty opened weaker on Monday on continued dollar strength and hit 4.216 against the euro and 3.348 to the dollar. As it was below significant technical support for both currencies, the Polish currency bounced back paring some of its losses to 4.204 and 3.332 respectively. Yet in early afternoon the zloty resumed downward tendency and set new high (since mid-November) for USDPLN rate at 3.352 and reached 4.225 against the euro. Before inflation figures the zloty gained sharply to 4.2 against the euro and 3.322 to the dollar and declined only a shade towards the session-end.

Polish bonds started the session stable ignoring pressure from zloty decline. Announcement of the offer for Wednesday's auction did not induce any response, as the market awaited crucial CPI numbers. As they came a bit higher than expected PS0310 yield rose to 5.41%.

Ministry of Finance will offer PLN2.8bn of 5y benchmark at a tender on Wednesday. The average yield on the Polish 52-week treasury bill fell to 5.138% at the auction on Monday. The ministry sold all PLN600m, while investors submitted bids totaled PLN1.77bn.

Supply for 5y bond auction was unlikely to surprise the market, as initially Ministry of Finance had set quite narrow range for the offer of PLN2.5-3.0bn. Apart from weaker data, negative bond market reaction stems also form the fact that 5y bond auction approaches. Minor scale of movement however results from lack of strong market positioning ahead of data, so "fresh" long positions do not weigh upon the market. It seems that until French and Dutch referendum the zloty, even if the cross improves, will remain volatile. Though USDPLN rate broke yesterday intraday above highs from April, yet from

The zloty trading ranges (16.05.2005)

	Min	Max	Fixing
USD	3.3220	3.3520	3.3355
EUR	4.1900	4.2250	4.2055

F/X rates (today's opening)

EURUSD	1.2628	CADPLN	2.6294
USDPLN	3.3350	DKKPLN	0.5659
EURPLN	4.2120	NOKPLN	0.5203
CHFPLN	2.7263	SEKPLN	0.4570
JPYPLN*	3.1135	CZKPLN	0.1396
GBPPLN	6.1292	HUFPLN*	1.6668

*per 100 units

T-bills auction (16.05.2005)

T-bills	Bid	Sale	Average Yields	Change (bp)
	PLN m			
52-week	1 770	600	5.14	-9

Treasury yield curve (16.05.2005)

T-bills	Yield	Change (bp)
3M	5.20	-15
6M	5.17	-16
9M	5.15	-15
12M	5.15	-10
Bonds		
2Y	5.32	2
3Y	5.35	1
4Y	5.40	1
5Y	5.41	2
8Y	5.39	1
10Y	5.38	0

WIBOR rates (16.05.2005)

Term	Rates	Change (pb)
O/N	5.60	-8
T/N	5.61	-6
SW	5.58	-2
2W	5.58	-2
1M	5.55	-1
3M	5.42	-8
6M	5.40	-3
9M	5.39	-1
1Y	5.37	-2

technical point of view the most important is market close, which value again fell below 3.335.

Much lower US net capital flows number and negative value of New York Fed index failed to weaken the dollar, but they undoubtedly caused its upward move to stop. It seems that before today's releases on production and, or even above all, PPI one should not expect major moves, as US prices growth rate will be crucial for expectations for interest rate cuts in US.

***Bottom line**: The zloty amid increased volatility declined again. Bonds reacted only slightly, but Wednesday's auction will weigh on the market. Today core market will be in the public eye with meaningful data out of US.*

International update

Net inflows of capital into US assets in March fell more than expected to $45.7bn, short of the amount needed to cover the US trade deficit of $55.0bn in March. Analysts had expected inflows of ca. $65bn. New York Fed index against expectations for growth slipped to -11.11. Negative reading in this particular survey means activity contraction.

Today US real economy numbers will be revealed and first if inflation data, namely PPI.

TIME GMT	COUNTRY	INDICATOR	PERIOD		FORECASTS	LAST VALUE
12:30	USA	PPI (H)	Apr	%MoM	0.3	0.7
13:15	USA	Industrial production (H)	Apr	%MoM	0.2	0.3
13:15	USA	Capacity utlisation (M)	Apr	%	79.5	79.4

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