Bank Zachodni WBK

Eyeopener – daily update

Short week, heavy calendar

23 May 2005

This week will be very busy despite Thursday's public holiday in Poland. We will see release of more statistical data – core inflation on Tuesday, retail sales and unemployment on Wednesday. The same day the central bank will publish *Inflation Report* for Q1 2005, which includes MPC assessment of economic situation, inflation projection for 2005-07 and voting pattern. Upcoming news could significantly impact Polish financial market, especially that they are followed by two days of very little market liquidity (long weekend in Poland).

Friday's data on output should bring a correction on the interest rate market after last week's gains connected with low inflation and low wages growth. We maintain our view that MPC will keep rates on hold on Wednesday. On Friday, the government's monitor published information that only Dariusz Filar was against rate cut by 50bps in March.

On Friday, the Polish parliament approved the bill, which increases budgetary spending by PLN1.3bn as a result of higher payments for the poorest pensioners. This was against the government's view, however was approved with vast majority of votes. On the other hand, the Lower House speaker announced he would not allow to change electoral law this year. Such idea was proposed by parties having small support in opinion polls, but numerous representation in today's parliament.

What's hot this week

Very busy week ahead

This week, despite shorter than usually due to public holiday on Thursday (Corpus Christi), will see quite a lot of new data, events and information important for the financial market in Poland. The hottest day of the week will be undoubtedly Wednesday, when accumulation of crucial releases and events will take place: press conference of the CSO presenting data on retail sales and unemployment (10:00), decision of the Monetary Policy Council (around mid-day), and its press conference (16:00), publication of *Inflation report* for 1Q05, including new inflation projection of the central bank (also 16:00) followed by press conference of NBP deputy chief Krzysztof Rybiński (17:00).

Core inflation, to be released on Tuesday, should show quite positive results

Before that, on Tuesday at 16:00 core inflation measures will be released by the central bank. We predict net inflation to inch down a little bit in April, reaching 2.3%YoY, against 2.4% in March (market consensus forecast is the same). In fact, net inflation measure has been oscillating around 2.3% since June 2004, which shows that significant rise in CPI growth in 2H04 and its sharp decrease in recent months was caused chiefly by changing trends on markets of food and fuels. Other measures of core inflation should display similar pattern, declining slightly in comparison with previous month, and confirming still quite positive inflation perspectives. The data should be slightly positive for the fixed income market, supporting expectations of those who predict interest rate cut already this week (see below).

Maciej Reluga Chief Economist (22) 586 8363

Piotr Bielski (22) 586 8333
Piotr Bujak (22) 586 8341
Tomasz Terelak (22) 586 8342

Email: ekonomia@bzwbk.pl

Retail sales probably fell in April amid strong base effect

Data published by the CSO on Wednesday, just before announcement of the MPC decision, will probably have smaller impact on investors' behaviour, especially that we expect them to follow trends observed recently. Retail sales growth will be undoubtedly negative, as there is no way to repeat unbelievably strong rise in consumers' spending observed in the eve of EU accession (18.8%MoM, 30.6%YoY). Thus, we foresee sales to fall 9.3%YoY after 0.3%YoY drop in March. However, in fact such result – if confirmed by the data – would be quite optimistic for economic growth perspectives, showing that private consumption is not that weak as it seems. Most of other analysts are more pessimistic, as median market forecast points to over 15%YoY slump in nominal sales, but please note that April's output in industry was better than market had expected (see below). Registered unemployment rate is predicted to have fallen in April to 18.8% from 19.3% in March (market consensus is 18.9%). Mainly, this would correspond to a typical seasonal improvement on the labour market in the spring period.

Unemployment in downward trend

MPC should not change interest rates this week

As regards MPC meeting, we expect that despite several economic figures signalling abating economic activity and little threats for inflation, the Monetary Policy Council will not decide to trim main interest rates this time. Data on industrial output in April and firms' financial results in 1Q05 have shown that economic activity is not that bad at all and confirmed expectations for decent improvement in situation in the second part of the year. Thus, the economy does not seem to need urgently a stimulus from further monetary easing (as suggested recently by MPC Nieckarz and Pietrewicz). Moreover, political risks listed last month by the Council as main reasons behind changing policy bias to neutral still persist, and the zloty does seem to be vulnerable to development on Polish political scene and on international FX markets. Finally, the main reason for changing monetary policy parameters should be inflation perspectives. This month, when making decision about interest rates, the MPC will have at its disposal results of new inflation projection prepared by the NBP (*Inflation report*, including inflation projection, MPC's assessment of economic situation, and detailed results of MPC voting in the first quarter will be released the same day, at 16:00). And recent hints given by several MPC members, who have already seen preliminary results of projection, suggested that the report would predict inflation rate to fluctuate around the MPC's inflation target in 2006-2007. This might allow for some minor adjustment in interest rate level if more risks for economic growth appears (that's why we do not rule out 25bps rate cut in July), however should not prompt an MPC's action at this time.

Inflation Report with new inflation projection to be released just after MPC decision

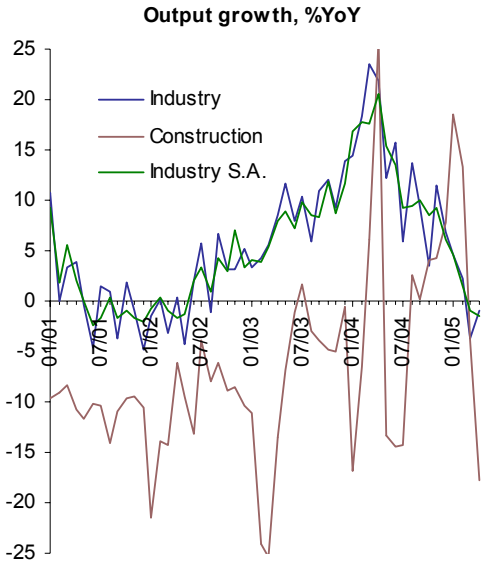
MPC's press conference at 16:00 and contents of the new *Inflation report* released concurrently could be very helpful in assessment of future monetary policy perspectives. However, the problem is that those information will come up just before Thursday's holiday in Poland, after which domestic market activity would be very limited on Friday. As a result, if the news from the report and press conference contain significant signals for expectations, market adjustment forced by foreign players in two following days could be quite abrupt amid very limited liquidity.

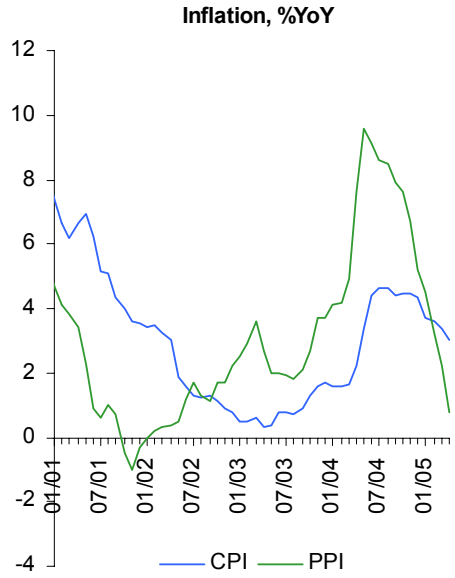
***Bottom line*: Wednesday's news could significantly impact Polish financial market, especially that they are followed by two days of very little market liquidity (long weekend in Poland). Lack of interest rate cut and strong**

signal that rates are currently at right level, while inflation forecast is in target could restrain investors' expectations regarding monetary easing perspectives and result in yields' rise in fixed income market.

What's hot today

Output and PPI higher than expected





After CPI inflation and corporate wages data, which might have increased expectations for interest rate reduction already in May, Friday brought a slightly different picture. Data released by the CSO showed both industrial production and producer prices higher than expectations. The data may bring a correction on the interest rate market after last week's gains.

Industrial production fell by 1%YoY, which seems to be a poor result at the first glance. However, one should remember that this was affected by high growth in April 2004 and the same applies to construction output, which fell 17.7%YoY but last year it showed growth as high as 26%YoY amid pre-accession spree (see peak in April 2004 on the margin chart). Therefore, we do not perceive low figure in construction as a risk factor for further investment revival. Especially as we expect two-digit growth in construction in May-June period (amid very favourable base effect).

While market consensus forecast pointed to a fall in industrial output of 5%YoY (we expected -3.9%), it turned out to be much less significant boding well for GDP growth in the second half of the year. According to our estimations, the first quarter showed GDP growth of only 3%, but we still expect economic growth to accelerate in the consecutive quarters – to some 3.5% in Q2 and around 5% in the second half of the year. Business climate indicators released on Friday confirmed a continuation of improvement in economic situation in May. Friday's data were hardly an argument for the MPC to cut rates this week and we still expect the MPC to keep rates on hold, especially as producer prices also surprised on the upside.

PPI inflation amounted to 0.6%MoM and 0.8%YoY in April. It was another month of significant fall in annual terms (from close to 10% in May 2004). The decrease from 2.2% in March was connected (similarly as in the case of output figures) with very high statistical base effect, as prices rose by above 2%MoM in April 2004. Therefore, it is not surprising that even with relatively high growth in prices on monthly basis (affected by high commodity prices and weaker zloty), the 12M index showed quite substantial fall. The same phenomenon will be observed in May and it is possible that PPI inflation will be below zero this month. However, we still expect that in the second half of the year PPI inflation will be in the upward trend.

<u>Bottom line</u>: Friday's data should bring a correction on the interest rate market after last week's gains connected with low inflation and low wages growth. We maintain our view that MPC will keep rates on hold this week. Output data showed that the Polish economy started the second quarter in better shape than the previous quarter when GDP rose by a mere 3%.

The zloty trading ranges (20.05.2005)

	Min	Max	Fixing
USD	3.2905	3.3485	3.2915
EUR	4.1550	4.1870	4.1615

F/X rates (today's opening)

EURUSD	1.2564	**CADPLN**	2.6390
USDPLN	3.3339	**DKKPLN**	0.5624
EURPLN	4.1869	**NOKPLN**	0.5156
CHFPLN	2.7039	**SEKPLN**	0.4560
JPYPLN*	3.0868	**CZKPLN**	0.1383
GBPPLN	6.0920	**HUFPLN***	1.6606

*per 100 units

Treasury yield curve (20.05.2005)

T-bills	Yield	Change (bp)
3M	5.22	2
6M	5.18	3
9M	5.15	3
12M	5.12	2
Bonds		
2Y	5.22	1
3Y	5.27	3
4Y	5.32	2
5Y	5.32	2
8Y	5.30	3
10Y	5.30	2

WIBOR rates (20.05.2005)

Term	Rates	Change (pb)
O/N	5.58	-1
T/N	5.63	1
SW	5.57	-2
2W	5.55	0
1M	5.51	-4
3M	5.43	-1
6M	5.37	-2
9M	5.32	-2
1Y	5.30	-1

Market monitor

On Friday, the zloty has stabilised in the first half of the day. However, in the afternoon it depreciated sharply in reaction to abrupt US dollar strengthening against the euro. The dollar appreciated to the strongest level since last October, party due to information about growing number of EU Constitution opponents in France. As a results, investors were selling Polish currency and buying the dollar. This trend even reinforced today in the morning amid continuing dollar surge.

Fixed income market settled down on Friday after previous day's strengthening, and yields rose a bit along the yield curve. Reaction on better than expected output figures was not significant, however the day ended with yields 2-3 bps higher than on Thursday.

The market was surprised with Ministry of Finance's very low supply of treasury bills on today's tender. Only PLN400m worth of 52-week bills will be offered today, despite earlier announcement that minimum supply will be PLN800m.

International update

There were no market-sensitive data releases abroad on Friday, and no important publications are scheduled also for today.

Additional information is available on request. Please contact Bank Zachodni WBK S.A. Treasury Division, Economic Analysis Unit, ul. Marszałkowska 142, 00-061 Warsaw, Poland, phone (+48 22) 586 83 63, email ekonomia@bzwbk.pl, http://www.bzwbk.pl