

Eyeopener – daily update

Strong labour market data

18 July 2005

After sharp inflation fall, which influenced positively fixed income market, Friday's labour market data for June showed a considerable improvement. Corporate wages rose by 4.5%YoY, which was much higher than forecasts (market 2.8%, BZ WBK 3.3%) and the highest since one year. At the same time employment continued to rise by 0.3%MoM and 1.7%YoY, which was in line with our forecast but higher than market consensus. As a result wage bill in real terms rose by as much as 4.8%YoY (amid lower inflation), the fastest growth for years. While hawks in the Council obtained an argument to be cautious in monetary policy, there is no doubt that the most important will be the publication of industrial production figure. MPC members stressed many times in their statements, as well as in the official communiqué, that data from the labour market and data showing the performance of the economic activity will be crucial for future decisions. Data on investments will be released only in August, but tomorrow we will see June's output figure. Next week we will get to know whether the MPC will do what they say.

Last week's CPI inflation influenced market positively, which was important ahead of Wednesday's 5Y bond auction

... but after Friday's strong labour market data, tomorrow's industrial output figure will be crucial

Out forecast of production is above market consensus

... and we expect strong construction output and positive business climate

What's hot this week

Publication of CPI inflation for June was the most important event in the previous week. Thanks to very deep monthly fall in food prices the annual inflation rate fell to 1.4% from 2.5%, which gave some hope for the market that recent weakening of the zloty may be stopped amid capital inflow on the fixed income market. This is particularly important ahead of Wednesday's five-year bonds auction, after unsuccessful tender of ten-year papers last week. However, this week sentiment will be set by data on industrial output, which will be released on Tuesday, as this will be one of the most important pieces of information from the point of view of monetary policy. After disappointing figure for May, some revival is commonly expected, but given that it was partly influenced by higher number of working days, scale of acceleration will be the key. While market consensus points to output growth of around 5%YoY, out forecast is higher (by close to 8%),. Growth of ca. 8% would show that the Polish economy get out of slowdown relatively quickly. On the other hand, another disappointment would be possibly an argument for the MPC to deliver interest rates cut (possibly by as much as 50 bp) already this month. One of MPC members was very precise by saying "if industrial output growth in June reached 3-5%, the MPC should cut rates by 50 bps in July".

The CSO will also release construction output figure and we expect it reached above 20% growth in June for the second consecutive month. Also, CSO business climate data for July, which will be released on Friday, should show quite positive picture of the Polish economy at the beginning of the third quarter.

This week will see a couple of inflation data – core inflation (Friday) and PPI (Tuesday). MPC's Sławiński said recently that one should not concentrate on

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

Net inflation should be roughly stable

Law and Justice will present economic programme on June 21

... but will not give target date for euro entry

On international markets hints on monetary policy will be crucial

CPI inflation, but on net inflation (CPI excluding food and fuel prices). According to our estimation, net inflation, inched down to 1.4% from 1.5% in May. This slight fall would show that both measures (net inflation and CPI inflation) are very close to each other, as large adjustment of net inflation (from 2.3% to 1.5%) took place already in May. 12M PPI inflation should remain below zero (actually quite close to zero) even despite higher fuel prices and weaker zloty against US\$.

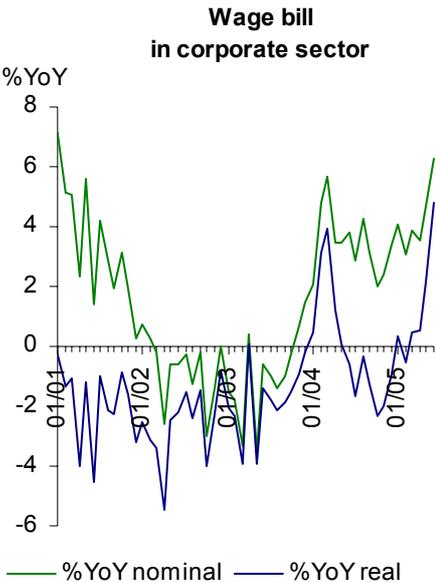
One additional important event will be publication of the economic programme of the Law and Justice (PiS), planned for June 21. PiS is the leader of opinion polls with public support of above 20% and a possible coalition partner of the Civic Platform (PO). According to Kazimierz Marcinkiewicz, one of PiS leaders responsible for economic programme, the party plans to lower budget deficit to PLN30bn in 2006 and to maintain this level in nominal terms during four consecutive years, which would represent a fall in budget deficit as a % of GDP (given accelerating economy). While this would allow to meet budget deficit criterion to join the euro zone as soon as in 2007, PiS is sceptical on fast euro zone entry. The economic programme will not include the target date of euro adoption, which shows this issue is not of top priority for PiS.

On the international markets focus will be on US net capital flow data (on Monday), which will show whether lower US trade deficit gets financing abroad. In the second part of the week (Wednesday) Alan Greenspan's testimony and a report from the latest FOMC meeting will give hints regarding monetary policy.

Bottom line: Tuesday's industrial production crucial for monetary policy perspective and for development of situation on financial markets, especially given five-year bonds auction on Wednesday. Our forecast is ca. 3pp higher than market consensus.

Strengthening revival on the labour market

Data from the labour market surprised on the upside on Friday, showing clear acceleration in average pay growth and continuing improvement in employment. Wage in the enterprises rose 4.5%YoY in June, after 3.0%YoY in May and 1.8%YoY in April. It was much higher result than forecasted (market consensus 2.8%, our forecast 3.3%) and the highest for one year. Although it should be noted that June is particular month of the year when some companies pay bonuses or extra money, so high pay could be to some extent a one-off event, however acceleration in average wage growth has been observed for a couple of months already so it seems likely that it simply reflects a phenomenon of more long-term nature. At the same time, employment has been continuing upward trend, rising 1.7%YoY in June. In the first half of the year Polish enterprises created 90 thousands of new jobs, whereas in 2004 almost no new jobs were created in the corresponding period. Combination of those two factors – faster wage increase and growing number of jobs – results in fast improvement in total wage bill in corporate sector. In June it soared 6.3%YoY, which was the best result since the end of 2001. What is more, quickly falling inflation considerably improved real



disposable income of households. Real wage bill in enterprises sector rose 4.8%YoY in June, which was the fastest growth for many years.

Bottom line: *Clear improvement in situation on the labour market will support growth in private consumption in the second half of this year, in line with our expectations.*

Deficit realisation at 52.9% of annual plan after June (ca. 50% was expected)

Indirect taxes flow of above PLN9bn in June was quite positive result

June's budget gap worse than declared, yet under control

Budget deficit after six months of the year reached 52.9% of the annual plan, i.e. PLN18.5bn. The result was considerably worse than declared recently by the FinMin's officials (who had claimed it should be close to 50%, thanks to e.g. transfer of NBP profit). Still, the figures were not very bad, confirming the budget is under control, and weaker performance of the economy should not cause major problems with its realisation this year. Budget gap in June alone was very small and reached only PLN225m, which was the best result since 2001 and the second best for ten years. After six months, both revenue and spending reached ca. 50% of the plan for entire year. Apart from transfer from the central bank (PLN4.2bn), total revenues were also helped by quite good performance of tax receipts. Total revenues rose 34.6%YoY after six months and 49.5%YoY in June alone, however one should be careful with interpretation of this growth rates because of very low base in June 2004. Inflow from indirect taxes reached almost PLN9.2bn in June, showing that despite weakening in statistical data observed recently, the economic activity is not in a bad condition (it was one of the best results observed in June in last couple of years). After six months they reached almost 48% of level planned for 2005. Direct taxes from both corporations and individuals were also performing quite well (correspondingly, 51% and 44% of annual plan after June). If we take into account that the second half of the year should be a period of much better economic activity, there should be no major risk for realisation of this year's budget deficit at planned level or even slightly below.

Bottom line: *Budget realisation after June was worse than expected, but not very bad, especially if we take into account revenues from indirect taxes, which did not show signs of lower economic activity.*

Market monitor

After uncertain opening the zloty advanced to 3.42 against the dollar and below 4.14 to the euro on the flow into the Polish interest rate market. Losses in EURUSD market forced the zloty to adjust to them, while keeping the value against the basket. EURPLN fell to 4.13 and USDPLN rose to 3.43.

Bonds kept gaining from the very beginning of the session on short covering induced by good inflation number. After reaching 4.6% on PS0310 the market halted awaiting US and the Polish figures. 2y benchmark was the biggest mover in the market that shifted by 8 bp to 4.39%. Yield rise in core markets following strong US figures and higher than expected data on domestic wages prompted the Polish papers to lose to 4.64% in 5y sector.

Ministry of Finance will offer on Monday 1y bills worth PLN400m and 13-weeks bills worth PLN100m.

The zloty trading ranges (15.07.2005)

	Min	Max	Fixing
EUR	4.1390	4.1575	4.1523
USD	3.4250	3.4400	3.4371

F/X rates (today's opening)

EURUSD	1.2100	CADPLN	2.8399
USDPLN	3.4407	DKKPLN	0.5580
EURPLN	4.1626	NOKPLN	0.5243
CHFPLN	2.6709	SEKPLN	0.4458
JPYPLN*	3.0684	CZKPLN	0.1374
GBPPLN	6.0572	HUFPLN*	1.6863

*per 100 units

Treasury yield curve (15.07.2005)

T-bills	Yield	Change (bp)
3M	4.47	0
6M	4.43	0
9M	4.37	0
12M	4.35	0
Bonds		
2Y	4.47	-1
3Y	4.50	-6
4Y	4.63	-6
5Y	4.65	-6
8Y	4.67	-3
10Y	4.71	-1

WIBOR rates (15.07.2005)

Term	Rates	Change (pb)
O/N	5.17	2
T/N	5.17	0
SW	5.09	1
2W	5.05	1
1M	4.93	2
3M	4.70	1
6M	4.54	1
9M	4.49	2
1Y	4.42	-2

During Friday's session the buyers of bond were mainly domestic players that caused the gains in the market only to 4.6% as compared to 4.48% reached before 2y bond tender. It suggests that the market will remain above yield low at least until production data release, the more because after labour market data. Today the Ministry will present a supply for 5y bond tender, which should also be closer to lower band of initially proposed range. As regards to the zloty, which movements were rather induced by EURUSD market than bond prices increase, investors will surely refrain from decision till Tuesday.

Bottom line: Bonds continued increases initiated on Thursday, though slightly pulled back due to wages data, but the zloty actually adjusted only to EURUSD moves. Bonds supply for Wednesday's auction should be relatively low.

International update

US producer prices held steady last month despite a big rise in energy costs. Energy prices went up 2% in June, while food prices dropped 1.1%. Outside of those volatile areas, core PPI fell 0.1%, the first decline in four months.

New York Fed index in July showed activity increasing to 23.91 from a revised +10.49 in June and -11.06 in May. July is the second month in a row of expansion in the survey. US business inventories grew by 0.1% in May, while sales shrank by 0.1%. Analysts had forecasted a 0.3% rise in inventories. US industrial production rose more than expected by 0.9% against expectations of 0.4%. Capacity utilisation also reported a increase from 79.4 to 80.0.

In today's euro zone HICP release there will probably be visible an impact of high oil prices and that's why last month reading is expected to print higher. Besides net capital flows will show if even lower US trade deficit gets financing abroad.

TIME GMT	COUNTRY	INDICATOR	PERIOD	FORECASTS	LAST VALUE	
09:00	EMU	Final HICP (H)	Jun	%YoY	2.1	1.9
13:00	USA	Net capital flow (H)	May	\$bn	-	47.4

This publication has been prepared by Bank Zachodni WBK S.A. (a member of AIB Group) for information purposes only. It is not an offer or solicitation for the purchase or sale of any financial instrument. All reasonable care has been taken to ensure that the information contained herein is not untrue or misleading. But no representation is made as to its accuracy or completeness. No reliance should be placed on it and no liability is accepted for any loss arising from reliance on it. Bank Zachodni WBK S.A., its affiliates and any of its or their officers may be interested in any transactions, securities or commodities referred to herein. Bank Zachodni WBK S.A. or its affiliates may perform services for or solicit business from any company referred to herein. This publication is not intended for the use of private investors. Clients should contact analysts at and execute transactions through a Bank Zachodni WBK S.A. entity or an AIB Group entity in their home jurisdiction unless governing law permits otherwise. Copyright and database rights protection exists in this publication.

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>



Bank Zachodni WBK is a member of Allied Irish Banks Group