

Eyeopener – daily update

Output figures to drive the market

18 August 2005

Today, the Polish market will wait for another set of important figures, including key data on industrial output. Our forecast is much below market consensus and if it materialises, one may expect strengthening on the interest rate market. In the opposite scenario, if the consensus is right, another rate cut at the MPC meeting later this month will become doubtful. Of course, much will depend on GDP data for 2Q05 to be released shortly before MPC meeting and on new projection of inflation and GDP prepared by the NBP.

President Aleksander Kwaśniewski signed controversial pension bill entitling miners to early retirement. The bill will be very expensive for the state budget, although the nearest years (2007-2008) will not see significant burden on public finance. Later on, however, the cost will rise rapidly and reach cumulatively above PLN90bn until 2020.

The latest public opinion polls published recently do not change a picture ahead of parliamentary election – Civic Platform and Law and Justice are in the lead with majority in the parliament.

Yesterday, Treasury Minister Jacek Socha announced that the government approved his decision on listing PGNiG (Polish Oil & Gas company) before the autumn elections.

What's hot today

Key economic data today

Today the statistical office will publish output figures for July. While CPI inflation published earlier this week was much higher than expected, it triggered only a moderate market reaction (though reinforced by MPC member comment on possibility of neutral bias introduction) because data on production seems to be more important for prospects of monetary policy. We expect growth of 1.1%YoY, while market consensus is much higher pointing to 4-5% increase (with quite wide range of forecasts). It should be highlighted that our forecast represents a pretty decent growth of 5% in seasonally adjusted terms (one working day less last month than in July 2004), which would be the fastest growth this year, confirming acceleration in GDP growth in 2H05. Market forecast of ca. 5% means very high (two-digit) seasonally adjusted growth and it would show very strong beginning of the third quarter, which could even cause the MPC to refrain from a rate cut in August (depending on other information, which will be available ahead of the meeting).

Also today data on construction output, as well as producer prices will be released. We expect production in construction sector to maintain high growth level of around 30%YoY. Annual growth rate of PPI is forecasted to stabilise around zero, although the risk is on the upside given record-high oil prices.

Bottom line: *If our forecast of industrial output materialises, interest rate market should strengthen. On the other hand, if the consensus is right, the MPC may postpone rate cut decision (though GDP data and new Inflation Report will be also very important).*

We forecast industrial output grew 1.1%YoY in July

...while market consensus stands at ca. 5%YoY

Construction output and PPI figures also due for release today

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The President signed costly pension bill

The decision should not affect the central bank's decisions

President signed the bill negative for economy

A couple of weeks ago we wrote that at the end of its term of office, the Polish parliament approved a few bills harmful for the economy, among others granting special pension privileges for miners. Well, the President's Aleksander Kwaśniewski tenure is also coming to an end and yesterday he decided to sign into law this controversial bill, which (if not changed by the next parliament) will be very costly for public finances in the upcoming years. While in 2007 financial effect of the bill is negligible, the costs are rising gradually to reach cumulatively above PLN90bn within the nearest 15 years and some PLN5-6bn annually in a few years time. Of course, such an additional burden would make bringing general government below 3% of GDP much more difficult.

Leszek Balcerowicz, NBP President commented Kwaśniewski's decision by saying that "for anyone not looking at the short term this is bad news (...) it places a greater burden exactly where it is most harmful - on (pension) contributions, (which) make reducing unemployment harder". While it is well possible that the Monetary Policy Council will criticise the bill in the next official statement, we do not think it will influence its decision on interest rates. Kwasniewski's decision was also criticised by government's representatives. Let's recall that Prime Minister Marek Belka (who used to be a chief of economic advisors to the President) asked the President to reject the bill.

Let's also remind that at the beginning of May the President Aleksander Kwaśniewski said: "I call on parliament not to pass laws that are bad for the Polish economy (and) aimed only at having an electoral effect. I see no reasons to sign any laws that I believe are harmful or linked to the election campaign". Well, already last week he signed also controversial bills approved earlier by the parliament, and also harmful for the economy: bill raising minimal wage in the economy and the one putting a cap on interest rate on loans.

Bottom line: Bills signed by the President may be harmful for the economy, but the short-term impact on financial markets should not be excessive.

Market monitor

The zloty was weakening yesterday erasing gains from the previous day, after morning comment from the MPC hawk Dariusz Filar dampened market hopes for further interest rate cuts. Until early afternoon, Polish currency lost ca. 0.7% against both dollar and euro. After that, the rates pulled back again a bit amid renewed demand from foreign investors, and until the end of session the zloty made up for part of the losses, mostly against the euro. During the day, the dollar firmed to 2-week highs against euro after stronger than expected PPI rise in the US, supporting hopes for further rate hikes from Fed.

Hawkish comment of the MPC member and disappointing president's decision to sign harmful pension bill spoiled sentiment on the fixed income market and triggered substantial rise in yields. This trend was also assisted by deterioration on core debt markets after high US PPI reading, however later during the day international bonds erased earlier losses, while Polish

The zloty trading ranges (17.08.2005)

	Min	Max	Fixing
EUR	4.0055	4.0370	4.0252
USD	3.2630	3.2845	3.2765

F/X rates (today's opening)

EURUSD	1.2278	CADPLN	2.6964
USDPLN	3.2700	DKKPLN	0.5382
EURPLN	4.0142	NOKPLN	0.5064
CHFPLN	2.5916	SEKPLN	0.4305
JPYPLN*	2.9696	CZKPLN	0.1365
GBPPLN	5.9013	HUFPLN*	1.6456

*per 100 units

Treasury yield curve (17.08.2005)

T-bills	Yield	Change (bp)
3M	4.40	5
6M	4.38	5
9M	4.36	5
12M	4.36	5
Bonds		
2Y	4.67	11
3Y	4.71	9
4Y	4.88	12
5Y	4.93	11
8Y	4.94	10
10Y	4.91	8

WIBOR rates (17.08.2005)

Term	Rates	Change (pb)
O/N	5.39	39
T/N	5.41	42
SW	4.91	5
2W	4.88	3
1M	4.82	3
3M	4.70	5
6M	4.67	5
9M	4.64	4
1Y	4.63	3

interest rate market remained weak, with bond yields ca. 10 bps above Tuesday's close levels.

Bottom line: After yesterday's deterioration of moods on the Polish market, market players will be awaiting publication of crucial output figure due today that could impact expectations regarding outcome of the MPC meeting.

International update

US producer prices soared 1%MoM in July, which was twice as much as expected by market consensus. Strong upturn resulted largely from 4.4%MoM hike in energy prices, boosted by rising oil costs. What is more, also prices of production excluding food and energy rose stronger than predicted (0.4% against forecasted 0.1%), which was taken as a possible sign of inflationary pressure in the American economy. The data sparked correction on international debt markets amid reinforcing investors' expectations that the Fed will keep steadily raising interest rates.

Today, a couple of important indicators will be released in the US and the euro zone. Please find details in the table below.

TIME GMT	COUNTRY	INDICATOR	PERIOD	FORECASTS	LAST VALUE
09:00	EMU	Industrial output	Jun %YoY	0.5	0.1
09:00	EMU	Final HICP	Jul %YoY	2.2	2.1
14:00	US	Leading indicators	Jul %MoM	0.2	0.9

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