Bank Zachodni WBK

Eyeopener – daily update

Higher output, lower prices

20 October 2005

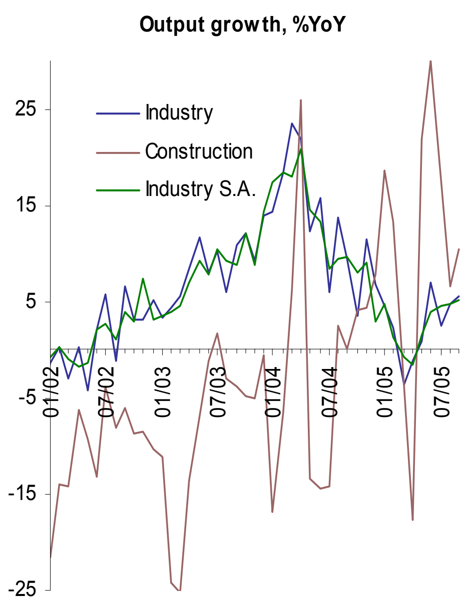
Industrial output growth in September beat market forecasts rising 5.5%YoY, while PPI eased 0.2%YoY, signalling the economy was gaining steam without stoking inflation. This is a good news in terms of inflation perspectives. However, the data should not change the outlook for next week's interest rate decision, as MPC members have made it clear they wanted to wait for GDP figures for 3Q05.

PiS and PO continue arguing, and this time a row concerned the post of Lower House speaker. The Sejm's proceedings were paused yesterday until next Wednesday with a support of votes from PiS, Samoobrona and PSL. It will be interesting to see how the result of Sunday's presidential election will influence the behaviour of the two major parties as regards forming a coalition government.

Recent opinion polls show mixed results as regards support for presidential hopefuls. PO's Donald Tusk is still in the lead, however while GfK Polonia reported he could still count on 56% of votes, OBOP's survey showed a decline in his support to 53%.

What's hot today

Output grew at a healthy pace, producer prices fell



The CSO said yesterday that industrial output in September grew by 9.8%MoM and 5.5%YoY, almost exactly matching our forecast and being higher than market consensus of around 5%YoY. Seasonally adjusted data showed industrial output expanded by 1.5%MoM and 5.1%YoY. The unadjusted data indicated an increase in output was recorded in 16 out of 29 branches, the highest in those with large share of exports. Thus, while acceleration in industrial output growth suggests that pace of GDP growth improved in 3Q05 as compared to the previous period, this could again be driven to a large extent by net exports and not domestic demand (consumption plus investment). If this is confirmed in GDP data for 3Q05 due for release in late November, one may expect many MPC members will still see some room for rate cuts. A positive thing from the perspective of forecasted strength of investment activity is further expansion of construction output – it grew by 13.3%MoM and 10.5%YoY in September.

Output figures and GDP, %YoY

Date	Industrial output	Industrial output seasonally adjusted	Construction output
1Q05	0.7	1.7	9.3
2Q05	2.3	1.3	11.3
3Q05	4.3	4.8	11.4

*Source: CSO, own calculations * BZ WBK estimates*

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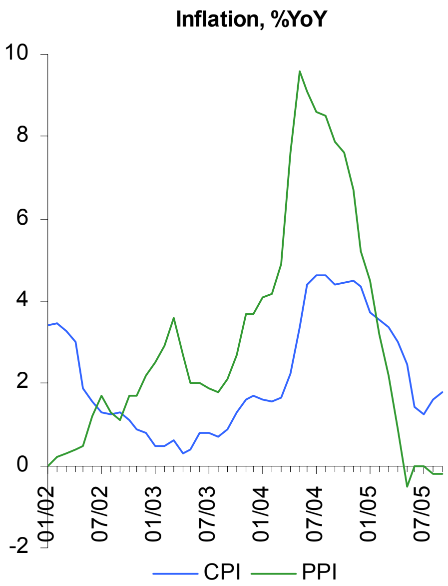

As we have written above, even relatively strong acceleration of economic growth in 3Q05 may not prevent the MPC from another rate cut. Apart from a structure of the growth (still relatively weak domestic demand), a reason for that may be the fact there are continuously no signs of negative inflationary effects of high oil prices. According to the CSO, producer prices in September were flat on a monthly basis, driving annual growth rate to -0.2% while an increase of the same scale was expected by the market. While prices of refinery products grew by as much as 2.7%MoM, most of other prices in manufacturing recorded decreases (probably largely due to zloty appreciation). In manufacturing as a whole, September saw 1.1%YoY fall in prices. This shows that one can hardly talk about direct effects of high oil prices on other prices, not to mention a risk of second-round effects. This is a good news for the MPC.

MPC member Dariusz Filar, regarded as one of hawks within the rate-setting panel, said after the data release that the rise in industrial production in September confirmed that economic growth in the third quarter had been above 3%. In two separate interviews with PAP and Reuters, carried out before and published after the data release, Filar repeated his earlier opinion that current level of interest rates is close to the level allowing for stabilisation of inflation close to the inflation target and it enables the economic growth to accelerate steadily without price pressures. "Growth is strengthening from quarter to quarter, but is not breeding inflation pressure, hence our current base rate of 4.5% is close to an appropriate level to stabilise inflation over 5-7 quarters," Filar said. He stressed that further monetary policy decisions (both on interest rates and policy bias) will heavily depend on GDP data for 3Q05. In his opinion, economic growth for 3Q05 would have to slow or fail expectations reflected in August inflation report to make monetary easing necessary (he also mentioned a rate cut could be needed in case of strong zloty appreciation). Filar added that some wage pressure may appear only in the second half of 2006 and the MPC has to take it into consideration, but he did not state it could pose a threat to the inflation target. Apart from opinions on current economic situation, MPC member also hinted yesterday that a change in frequency and date of inflation report publication is considered. The decision on this issue may be announced in the communiqué after October's meeting of the Council.

Other MPC member Marian Noga, similarly to Filar seen as a supporter of cautious monetary policy, said yesterday that inflation might still rise in the nearest months (he sees CPI at 2%YoY in December; we forecast only 1.5%YoY), which could fuel inflation expectations and constrain room for rate cuts. In his opinion, the balance of risks for future inflation has changed to such extent that probability of inflation acceleration becomes higher.

***Bottom line**: Industrial output growth beat market forecasts while PPI eased, signalling the economy was gaining steam without stoking inflation. The data should not change the outlook for next week's rate decision, as MPC members have made it clear they want to wait for GDP figures for 3Q05.*

Who will be the Sejm speaker? Doubts about coalition

The first session of the new parliament brought no conclusions and ended with a break in proceedings. Lower House speaker has not been selected and the candidature of Civic Platform's (PO) Komorowski was not even discussed and voted, as the Law and Justice (PiS) proposed to continue the debate on Wednesday, after presidential election. This motion reached majority as PiS was supported by Samoobrona and PSL. This shows the difference in opinions between the two (still most likely) coalition partners in the new government. It is worth reminding that PiS, after winning parliamentary election, proposed for PO positions of both deputy PM and Lower House speaker. Perhaps PiS has changed its mind given still high support for Tusk in presidential race? Or maybe the candidature of Komorowski is unacceptable for PiS? Anyway, the latest opinion polls show higher support for PO's Tusk (53-56%) and if such result is confirmed in the Sunday's vote it will be interesting to see the strategy of PiS as regards the second most important person in the country (Sejm speaker). PO officials have already announced that if PiS is against PO's candidate, a coalition agreement would not be possible. Does it mean that Tusk's victory would not be necessarily positive for the market?

***Bottom line*: PiS and PO continue to quarrel, this time it concerns the post of Lower House speaker. It will be interesting to see how the result of Sunday's election will influence the behaviour of the two parties as regards forming the coalition government.**

Market monitor

Yesterday the zloty weakened against European currency and strengthened against dollar, as a result of euro zone figures, political risk and sale on the stock exchange. EURPLN rose from 3.8880 to above 3.90 and USDPLN increased from 3.2545 to 3.2820, especially as euro was weakening against dollar to bottom at 1.1876 on Tuesday data on PPI, net capital flows in U.S and Wednesday statement of Fed vice president Roger Ferguson, who said that Katrina and Rita hurricanes worsened price stability perspectives in the U.S. Later on, much better than expected data on EU-12 industrial production resulted in stronger expectations for faster rates rise in euro zone. This information helped euro which recovered all its earlier losses to appreciate against dollar to 1.20, whereas EURPLN rose higher to 3.9115 and USDPLN dropped to 3.2520.

Fixed income market weakened at the opening as investors were waiting for the bonds tender and industrial production data. Ministry of Finance issued PLN2.1bn of 5Y treasury bonds with PLN7.55bn bid. Average yield amounted to 4.891% and minimum price 1032.60 as compared to 4.412 and 4.412 in and 1052.52 in on 21st September. Yields went down after the auction but stayed close to yesterday values. Bonds prices increased slightly on industrial production data for August, which was along market expectations and producer prices, which dropped by 0.2%YoY and remained at same level as in July. This could mean, that inflation pressure is under control and there will be room for rate cuts, though not in this month.

The zloty trading ranges (19.10.2005)

	Min	Max	Fixing
EUR	3.8855	3.9115	3.8899
USD	3.2500	3.2820	3.2661

F/X rates (today's opening)

EURUSD	1.1968	CADPLN	2.7697
USDPLN	3.2608	DKKPLN	0.5224
EURPLN	3.9025	NOKPLN	0.4983
CHFPLN	2.5189	SEKPLN	0.4175
JPYPLN*	2.8434	CZKPLN	0.1321
GBPPLN	5.6766	HUFPLN*	1.5605

*per 100 units

T-bond auction (19.10.2005)

	Offer	Bid PLN bn	Sale	Average Yield
5Y	2.100	7.546	2.100	4.891

Treasury yield curve (19.10.2005)

T-bills	Yield	Change (bp)
3M	4.21	0
6M	4.21	0
9M	4.21	0
12M	4.20	0
Bonds		
2Y	4.40	0
3Y	4.48	-3
4Y	4.75	4
5Y	4.86	1
8Y	4.90	-3
10Y	4.92	1

WIBOR rates (19.10.2005)

Term	Rates	Change (pb)
O/N	4.60	0
T/N	4.61	0
SW	4.61	1
2W	4.60	0
1M	4.60	0
3M	4.52	1
6M	4.48	1
9M	4.46	0
1Y	4.45	0

Bottom line: Emerging markets still volatile as political risk (Poland), economic risk (Hungary) as well as perspective of lowering spreads against Treasuries and euro zone bonds stay under question.

International update

On Wednesday industrial production figures for euro zone were published. According to Eurostat industrial output rose 0.8%MoM and 2.6%YoY, which was much higher than market expectations at 0.1%MoM and 1%YoY and together with Tuesday higher than forecasted HICP inflation contributed to higher chance of speeding up rates raises in euro zone. This information affected common currency as it started recovering its losses against dollar.

Today at 9:00 a.m. figures on trade deficit in EMU will be published.

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