Bank Zachodni WBK

Eyeopener – daily update

Coalition talks collapsed

27 October 2005

After PiS supported by Self-defence, LPR and PSL elected PiS candidate for the post of Sejm's speaker yesterday, many investors started to seriously think that PO-PiS coalition may actually not come into being. This resulted in significant weakening on the Polish financial market. The fact is that yesterday's events in the Sejm brought about suspension of coalition talks. Although PM designate declared he would try to bring PO back to the negotiation table and PO leader Donald Tusk does not exclude completely such possibility, chances for PO-PiS coalition considerably decreased. The nearest weeks ahead looks like very uncertain period and this is likely to significantly affect financial market's sentiment.

MPC decision to leave interest rate on hold and maintain easing bias in monetary policy was fully in line with expectations. Official statement after the meeting was similar as a month ago and confirmed in our opinion that slight monetary easing is still possible at November's meeting, if GDP data do not show strong upturn in domestic demand.

What's hot today

Step back in coalition talks

Yesterday's events in Sejm lowered chances for formation of PO-PiS coalition

Yesterday, an impasse in coalition talks between PiS and PO turned into a big clash, after the Lower House of parliament elected PiS candidate Marek Jurek for the Sejm's speaker (with the support of deputies from PiS, Samoobrona, PSL and LPR), while PO nominee Bronisław Komorowski was rejected. Before the vote, PiS had tried to overcome a crisis by proposing new share of competences in a new government, but the proposals were rejected by the PO. Appointment of PiS candidate for the post of Lower House speaker drastically narrows chances for agreement between the two parties. PO leaders said after the vote that they did not see an option of further talks at the moment and the negotiations have been suspended.

Return to talks between PiS and PO is still possible, but the more likely option now is minority government of PiS

Now, several options are still likely. One could not completely rule out a scenario that PiS will convince PO to come back to negotiation table. However, probability of such scenario seems very low at the moment. More likely is creation of minority government controlled by PiS, and then the biggest question mark for the market is on support of which parties this cabinet will count? Will they still hope for backing of PO deputies in realisation of badly needed reforms, or will it be an informal coalition with Samoobrona, PSL and LPR – more populist caucuses, which have similar pro-social economic programmes as PiS. Kazimierz Marcinkiewicz should present a line-up of the government and receive a vote of confidence by Wednesday, November 2. However, even if he fails there are still several steps more to appoint a government. The nearest weeks ahead looks like very uncertain period and this is likely to significantly affect financial market's sentiment. It seems that part of investors are still hoping that yesterday's clash was not the ultimate end

Maciej Reluga Chief Economist (22) 586 8363

Piotr Bielski (22) 586 8333
Piotr Bujak (22) 586 8341
Cezary Chrapek (22) 586 8342 Email: ekonomia@bzwbk.pl

of PiS-PO coalition. Thus, confirmation of negative scenario (no PO in the government) could trigger further falls on Polish market.

***Bottom line*: Polish market falls as chances for coalition agreement diminish. Further correction is likely, if investors get certainty PO will not enter the government.**

Interest rates unchanged, as expected

MPC decision was fully in line with expectations

In line with expectations, the Monetary Policy Council left interest rates unchanged and maintained easing bias in monetary policy at the meeting that concluded yesterday. The decision, consistent with our expectations and market consensus, was announced shortly before crucial vote on the Sejm's speaker, so it was hardly noticed by investors whose attention was focused on political events. The MPC confirmed in a statement that recently published monthly economic data gave no clear answer on strength of economic revival and the Council expected that more accurate assessment of situation would be possible after publication of GDP data for 3Q05. The MPC noticed that moderate rise in wages was positive for continuation in employment growth and would constraint inflationary pressure. However, NBP president Leszek Balcerowicz said during the press conference that one should be cautious with interpreting data on 1.8%YoY rise in salaries, as according to NBP's analysis the figure was biased down by a high base effect in one of the sectors, while after eliminating this effect a rate of growth should be at ca. 2.8%YoY. Also, a lack of data on pay rise outside enterprise sector, made it difficult to predict future wage growth in entire economy.

In a conclusion of its statement, the MPC said it still expected inflation rate to come back to the inflation target faster than was predicted in August Inflation report, and then inflation should stabilise around the target. The Council said that moderate rise in wages showed no second-round effects have already appeared, but if they show up it could affect a balance of risks for inflation and thus also the MPC's decisions.

We still think further, slight, downward adjustment in interest rate it possible

It seems that the MPC decision and its statement confirmed our expectations regarding future monetary policy decisions. Lack of signals about building inflationary pressure and no second-round effects of fuel price hikes make inflation outlook still quite favourable, especially that long-expected revival in domestic demand in 2H05 could prove weaker than forecasted. In such situation, it seems likely that slight downward adjustment in interest rates is still likely, and a cautious cut (of 25 bps) could take place already in November after publication of GDP data, assuming that consumption and investment will show no rapid increase and events on political scene does not pose threat to medium-term economic prospects.

Additionally, the MPC informed about a change in a schedule of publication of Inflation reports. The change was made to allow the central bank to take into account the newest available data on national accounts in preparation of inflation and GDP predictions. The next Inflation report will be released after the MPC meeting in January 2006, and next documents will be released quarterly, i.e. in April, July and October.

***Bottom line*: No surprise in monetary policy, slight monetary easing still possible next month if GDP data do not show strong upturn and political situation stabilises.**

The zloty trading ranges (26.10.2005)

	Min	Max	Fixing
EUR	3.9240	3.9840	3.9360
USD	3.2445	3.2960	3.2573

F/X rates (today's opening)

EURUSD	1.2093	**CADPLN**	2.7874
USDPLN	3.2990	**DKKPLN**	0.5327
EURPLN	3.9902	**NOKPLN**	0.5072
CHFPLN	2.5730	**SEKPLN**	0.4187
JPYPLN*	2.8605	**CZKPLN**	0.1340
GBPPLN	5.8660	**HUFPLN***	1.5693

*per 100 units

Treasury yield curve (26.10.2005)

T-bills	Yield	Change (bp)
3M	4.20	-1
6M	4.20	-1
9M	4.23	2
12M	4.23	3
Bonds	**Yield**	**Change (bp)**
2Y	4.51	8
3Y	4.59	11
4Y	4.95	26
5Y	5.05	21
8Y	5.06	19
10Y	5.08	20

WIBOR rates (26.10.2005)

Term	Rates	Change (pb)
O/N	4.43	-1
T/N	4.53	-2
SW	4.60	0
2W	4.60	0
1M	4.60	0
3M	4.53	0
6M	4.50	0
9M	4.46	1
1Y	4.45	1

Market monitor

Yesterday, the zloty depreciated significantly against main currencies in reaction to political events. At the opening Polish currency gained slightly against euro to 3.9240 as PM designate Kazimierz Marcinkiewicz said he was convinced of coalition talks' success. However, when Law and Justice (PiS) supported among others by Self-defence elected PiS member Marek Jurek for Sejm's speaker, and PO candidate Bronislaw Komorowski declared this meant there would be no coalition, the zloty fell sharply against common currency to above 3.96 and to 3.26 against dollar. As Jurek was chosen presidential elections runner-up Donald Tusk confirmed that he saw no possibilities to continue coalition talks and EURPLN rose to 3.9840 and USDPLN to 3.2965. In the end, the zloty depreciated by 1.5% against majors. After yesterday's events coalition creation is less probable than before and this may result in further zloty depreciation. After Tuesday's strengthening, yesterday the euro opened flat to dollar around 1.21 and was quite stable to finally weaken and fluctuate around 1.208.

Fixed income markets experienced significant weakening, which was a result of both political jitters and yields rise in core bond markets. At the longer end of the curve yields rose by 19-26bps, which significantly steepened the curve. It was a consequence of sell-off of U.S. Treasuries and Bunds as well as government coalition talks and events, that effected in suspending talks between conservative Law and Justice (PiS) and Civic Platform (PO).

On Wednesday meeting MPC decided to keep the reference rate unchanged at 4.5% with easing bias, which was consistent with market expectations.

***Bottom line*: Zloty plummeted against euro and the greenback, bond yields rocketed by 20bp. at longer end and curve steepened. Coalition government creation stays under question.**

International update

There were no important international figures scheduled for yesterday.

Today at 9:00 data on durables orders in September will be published, with market expectations at USD-1.0bn and USD3.4bn in August.

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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

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