

Eyeopener – daily update

Wages surprised on the upside

18 November 2005

The CSO said yesterday that October saw 6.4%YoY rise in average wage in the enterprise sector. Although the superb upturn in wages could have resulted from one-off effects, likewise a slowdown in September, and is unlikely to persist, the data suggest systematic improvement on labour market and call for more caution regarding next monetary policy decisions. It reinforces our prediction that the MPC will leave interest rates unchanged at the meeting in November. Another important factor for the MPC decision later this month will be data on output and PPI due for release today at 16:00 local time (we forecast a decent 5.7%YoY rise in industrial output and 0.5%YoY drop in producer prices against market consensus of 6%YoY and –0.4%YoY, respectively), but one should remember the key meaning will be of GDP data for 3Q05. Yesterday comments from three MPC members confirmed a view that interest rate cut would be possible in November, if GDP data disappoint badly. On the other hand, scope for cuts in Poland is limited by a rise in interest rates abroad, in opinion of some central bankers. Also, budget proposals of the new government will be of high importance for the central bank.

The European Commission said yesterday, presenting its autumn economic forecasts, that Poland's fiscal deficit in relation to GDP would be declining slower than assumed in the last convergence program and would reach 3.6% in 2006 and 3.4% in 2007 against the program's targets of 3.2% and 2.2%, respectively. The reason for that is both the downward revision of Commission forecasts of Poland's GDP growth and, to a greater extent, concerns about negative effect of costly legislation passed towards the end of previous parliament's term (the forecasts are based on no-policy change assumption).

What's hot today

Output and PPI figures today

Today at 16:00 local time the CSO will publish PPI and output figures for October. Industrial production should continue its upward drift, showing 5.7%YoY rise after 5.5%YoY in September (market forecasts are a bit higher, averaging at ca. 6%). Also construction output is likely to show another strong growth, probably in double-digits. The data would confirm that both industry and construction are experiencing healthy expansion in economic activity in the final quarter of this year. This could be one of arguments calling for caution in further monetary policy decisions, especially after yesterday's data on wages. On the other hand, producer prices are unlikely to show any sign of rising inflationary pressure. We estimate PPI fell 0.5%YoY in October (market consensus points to 0.4% decline), on the back of lower fuel prices after a cut in excise tax and scant tendency to pass higher energy costs to other prices among entrepreneurs. This should keep constraining central bank's worries about possible second-round effects of high oil prices, at least to some extent. However, the fact is also that producer prices would probably start growing faster in the following months.

Bottom line: *Output figures for October will be important hint on the strength of economic activity at the beginning of 4Q05, but the nearest MPC decision is likely to depend mostly on GDP figures for 3Q05.*

We expect October saw 5.7%YoY rise in industrial output

...and 0.5%YoY fall in producer prices

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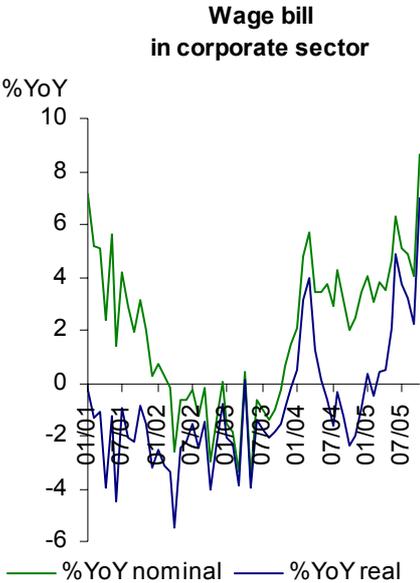
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Wage growth in October reached 6.4% YoY, beating all forecasts

Wages soared in October

After disappointing slowdown in average wage growth in corporate sector in September to 1.8%YoY, October saw a remarkable rebound to 6.4%YoY. The reading beat all market forecasts ranging between 2.0% and 3.7%, and was the highest since March 2004. Bearing in mind that September's deceleration resulted to a large extent from a one-off disturbance in post and communication sector, also the latest surge in wage growth should be interpreted with caution as it has been probably biased by a shift between payoff in September and October (probably, a regular bonus payment in post and communication has been postponed by one month). Anyway, even if we average pay rise recorded in September and October, it shows a decent 4.1%YoY, suggesting some improvement in relation to previous months. While in subsequent months a rate of wage increase will most likely come down from elevated 6.4%, it will probably remain at a fair level of 3-4%YoY, which together with continuing rise in employment should secure a stable and robust growth in wage bill in enterprises sector and thus fuel consumption revival.



Average employment in enterprises rose 2.1%YoY in October, in line with market consensus and slightly below our 2.2% prediction. It seems that a rate of improvement in labour demand has stabilised at around 2% for some time at one of the highest levels in Poland's post-transition history. We believe this rate of growth will be maintained in subsequent months amid continuing improvement in economic situation.

Because of a strong upturn in salaries, total wage bill in enterprises sector soared 8.6%YoY in October in nominal terms and 7.0%YoY in constant prices, which was the highest levels since late nineties. But considering that October's result could be biased, it is better to look at average for the last two months, which also shows a good result, i.e. 4.6%YoY improvement in real terms. This confirms our predictions of gradually recovering private consumption in subsequent quarters that will be assisted in 2006 by an improvement in social transfers (due to pension indexation and higher social benefits vowed by the government).

Bottom line: October's superb upturn in wages could have resulted from one-off effects, likewise a slowdown in September, and is unlikely to persist. Nevertheless, data suggest systematic improvement on labour market and call for more caution regarding next monetary policy decisions. It reinforces our prediction that the MPC will leave interest rates unchanged at the meeting in November.

MPC members on rates and euro

After a prolonged period of silence and scarcity of comments from central bank officials in recent couple of weeks, yesterday three MPC members took the floor during the day presenting their views (although in three different interviews). All three policymakers – Jan Czekaj, Andrzej Sławiński and Andrzej Wojtyna – expressed quite similar opinions as regards monetary policy prospects and euro zone entry.

Wojtyna and Sławiński confirmed that in their opinion quick euro zone entry would be the best solution for Poland, contributing to faster economic

MPC's Wojtyna call on government to carry out debate on euro adoption

development and reduction in macroeconomic risk. Also, they both shared concerns that lack of clear government's declaration about targeted date of euro adoption could contribute to a rise in long-term interest rates in Poland, which is negative for economy. Wojtyna said that Poland needs a serious public debate on the preferred road to euro zone, based on economic arguments, and that the central bank should initiate such discussion with the government before the latter finally decides about its stance towards the euro. While the two MPC members mentioned above warned against negative consequences of delaying euro entry or making no decision at all, Jan Czekaj was more relaxed and said that delaying euro adoption by the government should not affect investors' moods significantly, as prospects of entering EMU in 2009 had been hazy anyway.

There is still room for rate cuts

As regards monetary policy prospects, all three central bankers admitted there was still some room for manoeuvre in monetary policy, although next decisions would heavily depend on upcoming GDP data for 3Q05 and on government's economic programme and its credibility. Wojtyna said that 2006 budget will be particularly important, as it would be a test of government's credibility and ability to keep public finances in curbs. In turn, in Czekaj's opinion, government's budget anchor assuming constant PLN30bn deficit would be neutral for monetary policy neither calling for a hike in interest rates nor creating better conditions for monetary easing. MPC members agreed that weaker than expected GDP numbers in 3Q05 could increase scope for more interest rate reductions. In Wojtyna's view GDP growth rate not much higher than 3% and no decent rebound in investment would increase room for rate cuts. Czekaj seemed to be of similar opinion, as he said that 3.5% GDP rise would be neutral for monetary policy. All three members noticed however that a room for interest rate reductions in Poland was constrained by upward move in official rates worldwide, especially in the US.

Bottom line: MPC members' comments show that interest rate cut would be possible in November, if GDP data disappoint badly. On the other hand, a rise in interest rates abroad limits scope for cuts in Poland. Also, budget proposals of the new government will be of high importance for the central bank.

Market monitor

Yesterday the zloty was quite stable throughout the whole day and closed slightly stronger than the day before. The Polish currency gained against main currencies on MPC's Sławiński statement that keeping PLN30bn anchor may rise chances of euro adoption. Later on markets awaited wages and employment figures which did not significantly affect the zloty and it eventually dropped from 3.9825 to 3.9670 against euro and from 3.3990 to 3.3880. The euro partly recovered against the dollar on mixed data from US market to 1.172.

Yesterday, Polish fixed income market was weaker than the day before. At the beginning of yesterday's session Polish bonds strengthened on central bankers statements on need of talks with government on euro adoption and setting euro zone entry date, which could lower long term interest rates. MPC's Wojtyna comment that there is still a room to cut rates also played some role. However, towards the end of the session yields rose considerably,

The zloty trading ranges (17.11.2005)

	Min	Max	Fixing
EUR	3.9670	3.9875	3.9804
USD	3.3750	3.4090	3.4075

F/X rates (today's opening)

EURUSD	1.1716	CADPLN	2.8493
USDPLN	3.3831	DKKPLN	0.5337
EURPLN	3.9638	NOKPLN	0.5141
CHFPLN	2.5865	SEKPLN	0.4144
JPYPLN*	2.8743	CZKPLN	0.1355
GBPPLN	5.9154	HUFPLN*	1.5843

*per 100 units

Treasury yield curve (17.11.2005)

T-bills	Yield	Change (bp)
3M	4.24	-7
6M	4.29	-5
9M	4.31	-3
12M	4.40	6
Bonds	Yield	Change (bp)
2Y	4.72	4
3Y	4.77	1
4Y	5.03	4
5Y	5.19	5
8Y	5.32	2
10Y	5.32	2

WIBOR rates (17.11.2005)

Term	Rates	Change (pb)
O/N	4.60	-2
T/N	4.62	-1
SW	4.62	-1
2W	4.62	-1
1M	4.63	-1
3M	4.64	-1
6M	4.67	-2
9M	4.71	-3
1Y	4.73	-4

as much higher than forecasted wage figures were revealed, which weakened expectations for potential rate cut. As regards situation on core markets, US Treasuries stabilized above 4.45% support level on some data showing signs of growth slowdown and curbing inflation, which weakened expectations for further swift rate hikes.

Bottom line: Zloty keeps on strengthening and bonds got weaker on high wages data.

International update

According to Eurostat industrial output in euro zone dropped by 0.4%MoM and rose 1%YoY in September, which was much below market expectations at 0.5%MoM and 1.9%YoY.

Fed announced yesterday that industrial production in the US in October rose at expected 0.9%MoM rate, the highest since May 2004. It was manufacturing output that contributed the most to the industrial production rise soaring by 1.4%MoM, the strongest since October 1999. Industrial capacity usage increased from 78.9% to 79.5% and was slightly higher than market consensus at 79.4%. The number of house starts in US had balancing negative overtone as it fell in October by 5.6%MoM and amounted to 2 014 with market forecast at 2 070 and revised 2 134 in September and might be a first symptom of economic growth cooling down. However positive factor appeared on the labor market as jobless claims fell from revised 328 000 to 303 000 in the last week as compared to expected drop from 326 000 to 322 000. This figure could signal good non-farm payrolls number. The further firming of labour market conditions may contribute to rise in consumer spending, as it was supported by Philadelphia Fed's manufacturing activity, which was weaker than expected though showed highest employment subindex since September 2004.

Today no important data are scheduled abroad.

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