Bank Zachodni WBK

Eyeopener – daily update

It's not over till it's over

23 January 2006

Political uncertainty is not over yet, and in the coming days we will see more events that could affect market sentiment (vote on 2006 budget in the Sejm, talks between political parties). Neither of political solutions cannot be ruled so either early election or some sort of agreement with opposition could be equally expected, and it seems it will take some time until the situation clears out. Economic data releases are concentrated on Tuesday, however they should not alter economic picture and market's expectations for a rate cut. Sejm's vote on 2006 budget bill will also take place on Tuesday and the same day the MPC will discuss on new *Inflation Report* (however its publication will not take place before interest rate decision).

The survey of consumers' optimism published in today's *Rzeczpospolita* showed continuing improvement of moods, and for the first time since 1998 the index was above 100, which reflected higher number of optimists than pessimists in the surveyed panel. The results are supportive for expectations of revival in consumption demand in the coming quarters.

What's hot this week

Early election still possible

... as well as a signature of "stabilisation pact" with minor opposition parties

... or coalition with PO

The situation on the Polish political scene is still highly uncertain. This week work on budget 2006 will be continued but this is unlikely that until the end of this month deputies will be able to accept all amendments, then send the document for further work in the Senate and then discuss Senate's proposal again. In such situation, the President will have a possibility of dissolving the parliament during the first two weeks of February. He will probably wait and see whether it is possible that minority government will get support from other political parties. If this is the case and LPR, PSL and Samoobrona will back the idea of the so-called "stabilisation pact", we can indeed see some stabilisation on the Polish political scene. Thus, one can conclude that despite the political mess lasting within recent weeks nothing has really changed – we still have Marcinkiewicz's minority government supported by populist parties. The problem is, however, that those parties are not likely to back the cabinet for free and they have already proposed a number of bills, which could significantly increase social spending and lower independence of the central bank. What is more, PiS chief said it was possible to include these bills in the pact. Therefore, even if we see a "stabilisation", this may be connected with worse shape of economic policy, which could be negative news for financial markets. On the other hand, one still cannot rule out early election or a coalition with the Civic Platform, and it is hard to assess which solution is more likely at the moment.

The second element vital for the markets will be expectations regarding Monetary Policy Council's decision. Economic data published last week showed that acceleration of economic growth is continued, but with no threat for inflation target in the medium-term, especially as inflation data were below expectations again (and much below the tolerance band around the target).

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Risk factors for inflation include political uncertainty, which may lead to sharp zloty depreciation in the extreme scenario, as well as recently observed rise in oil prices. These two arguments may be important for some members of the Monetary Policy Council. Indeed, political risk creates a problem for the MPC. However, in our opinion, even if the zloty depreciates sharply (let's say to 4 against euro) as a result of political situation, this would not pose a considerable threat for the inflation target, which is very distant at the moment, as economic factors make inflation outlook favourable and justify interest rate cut by 25 bp. Additional problem with forecasting MPC decision is connected with the date of publication of the new Inflation Report, as the new inflation projection will be important benchmark for the Council's point of view. The Report will be discussed by the Council on Tuesday but will be published only after the decision (most likely on 31st January).

Economic releases due this week should not change picture of economic situation

This week we will also see another portion of data on economic activity – retail sales for December and business climate for January. They should not change the economic picture considerably given that data on production confirmed higher rate of GDP growth in Q4. We expect retail sales to rise by 8.1%YoY, while market consensus is only slightly higher. Unemployment rate figure will be published the same day (Tuesday) and it will probably show a seasonal rise to 17.6%. The same day the NBP will publish core inflation data for December. Although CPI inflation was lowered mainly by the same factors as in previous months (food and fuel prices), price changes in other categories of goods and services do not point to any sings of inflationary pressure. According to our estimates, net inflation (CPI excluding food and fuel prices) remained at 1.1%YoY in December 2005 and it is likely to stay below 1.5% i.e. below the lower end of allowed fluctuation band around the inflation target until the end of 2006. Other measures of core inflation will probably also maintain at very low levels.

On the international market, apart from the first estimate of Q4 GDP (growth is expected to slip back to 3.1% from 4.1%), this week's US data releases are largely second tier, though markets will be keeping a close eye on new and existing home sales for any signs of slowdown in the housing market. Meanwhile, growth in durable goods orders is expected to slow from November's strong rate. In the eurozone, the latest German Ifo survey and eurozone M3 should dominate. Following a strong rebound in December, the Ifo index is expected to make further modest gains, which should underpin hopes for a recovery in the eurozone's largest economy.

***Bottom line**: Political uncertainty will continue for some time (vote on 2006 budget on Tuesday) and may be important factor influencing markets. Economic data releases (which should not change economic picture and expectations for rate cut), as well as first day of parliamentary session, are scheduled for Tuesday.*

What's hot today

Poland may continue eurobonds issues

Head of FinMin's debt department Piotr Marczak said on Friday that one cannot exclude further foreign issues in 2006. "For now we are carrying out the plan for the first quarter, which provides for one large issue. Possible further issues will be decided on an ongoing basis in further plans for further quarters", Marczak said. The more eurobonds issue is planned for this year, the stronger market expectations will be that part of proceeds from the issues will be swapped on the market. The expectations are one of important factors behind appreciation pressure on the zloty.

***Bottom line:* If the finance ministry maintains plans of another eurobond issues, the market will expect the ministry will sell some foreign currencies on the market, which will exert appreciation pressure on the zloty.**

Market monitor

Polish currency appreciated at the Friday's session against the main currencies as the perspective of early elections was put away. EURPLN rate fell from 3.859 at the opening back to Thursday's early afternoon levels and stabilized near 3.83-3.84, while USDPLN fell from 3.193 to 3.174 as Civic Platform leader Donald Tusk said after the meeting with president Lech Kaczynski that probability of early elections declined. Thus atmosphere at the Polish political stage slightly improved and contributed to currencies rise in the whole region. The U.S. currency lost against the euro from 1.208 to 1.2095 on news that Iran is going to transfer its assets from foreign banks to the domestic market, where most of them may be dollar denominated proceeds from oil sales and might put pressure on the greenback. The dollar fell as well after a bit dovish comments of Richmond Fed's President Jeffrey Lacker as it appeared to be more important than higher than expected preliminary Michigan index. The greenback fell to the lowest level versus the euro for 4 months to 1.225 at today's opening.

The interest rate market strengthened and recovered most of Thursday losses. Yields of 2-5Y bonds fell by 1-4 and 10Y yields rose by 1 bp as PPI figure confirmed there is still room for rate cuts and investors speculate on monetary policy easing in January despite the political turmoil. Yields of 10Y U.S. Treasuries fell from 4.37% to 4.35% as market awaited Michigan index and next weeks auctions.

Fitch rating agency ascribed BBB+ rating to Polish euro denominated bonds worth EUR3.0bn with price around 13-16 bps over mid swap rate.

Strong data reflecting positive outlook of Polish economy should support the zloty, however budget debate and voting may still bring some nervousness.

***Bottom line*: Zloty recovered part of weekly losses against the euro and bonds strengthened as speculation on rate cut in January offset political turmoil and as probability of snap elections seemed to lower on positive results of PO leader Tusk meeting with the president.**

The zloty trading ranges (20.01.2006)

	Min	Max	Fixing
EUR	3.9330	3.8610	3.8500
USD	3.1750	3.1950	3.1868

F/X rates (today's opening)

EURUSD	1.2248	**CADPLN**	2.6812
USDPLN	3.1412	**DKKPLN**	0.5093
EURPLN	3.8481	**NOKPLN**	0.4676
CHFPLN	2.4544	**SEKPLN**	0.4079
JPYPLN*	2.7276	**CZKPLN**	0.1318
GBPPLN	5.5422	**HUFPLN***	1.5082

*per 100 units

Treasury yield curve (20.01.2006)

T-bills	Yield	Change (bp)
3M	4.2	0
6M	4.2	0
9M	4.2	0
12M	4.22	0
Bonds	**Yield**	**Change (bp)**
2Y	4.4	0
3Y*	4.62	-1
4Y	4.8	-1
5Y**	4.83	-3
8Y	4.93	4
10Y	4.95	1

*DS0509, **DS1110

WIBOR rates (20.01.2006)

Term	Rates	Change (bp)
O/N	4.45	-10
T/N	4.52	-5
SW	4.59	2
2W	4.58	1
1M	4.53	-2
3M	4.46	-2
6M	4.45	-1
9M	4.45	0
1Y	4.44	-1

International update

Swedish central bank raised main interest rate for the first time since May 2002 from 1.50% to 1.75% on expectation of faster pace of economic growth.

Preliminary Michigan consumer sentiment index for January rose from 91.5 pts in December to 93.4 pts and was stronger than the forecast at 92.5 pts.

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