

# Eyeopener – daily update

## Rates at appropriate level

27 April 2006

It seems that current level of interest rates is seen by the Monetary Policy Council as neutral and appropriate for present economic situation, which confirms our view that policy parameters are likely to remain unchanged for a prolonged time unless new economic data bring more significant surprises. *New Inflation Report* will be published only today in the afternoon and according to the MPC statement it will show higher GDP growth projection (especially in 2007-08), while CPI path expected for this year is lower than before, although it goes higher than previously forecasted in 2008. According to the NBP staff, inflation may be even higher than presented in the projection, but in our opinion financial markets should ignore such statements as long as such view is not shared by majority of the Council.

Yesterday strong data on retail sales (above 10%YoY growth) confirmed that private consumption demand has been strengthening and it seems that GDP growth may be above 5% in Q1 as well as in 2006 as a whole.

On the international market the focus of attention today will be also on central bank, as Fed Chair Ben Bernanke will speak today at 14:00 GMT. The key question for the market concerns the timing of the final rate hike, but comments on the housing market and recent oil price increase will be also very important.

According to chief of PiS' parliamentary caucus, it is possible that coalition agreement with Samoobrona and PSL will be signed today. This will depend on the outcome of PSL's General Council meeting.

## What's hot today

### Reference rate stable at 4%

### No surprise in monetary policy again

As expected, the Monetary Policy Council held interest rates unchanged yesterday, maintaining the main reference rate at 4.0%. In the statement justifying the decision, the Council listed a number of factors and information that had appeared since the previous meeting, showing that while current inflation remains very low and inflationary pressure is very little, a notable acceleration in economic growth has been recorded, as well as strong revival on the labour market, and upward tendencies in oil prices. As we have suggested before, an important argument in discussion about interest rate decision in April was the new *Inflation Report*, including updated projections of GDP and inflation. Full text of the report will be published today at 14:00 local time at NBP's website (and it will be followed by a more detailed presentation during special press conference Friday morning). However, some basic results of the projections were revealed in yesterday's MPC communiqué. According to those figures, new projections show stronger economic growth rate within forecast horizon, especially in 2007-08, in relation to January's prediction. As regards inflation, situation is more complicated, as CPI path expected for this year is lower than before, while it goes higher than previously forecasted only in 2008 – please see the table below for details.

### Inflation Report will be published only today in the afternoon

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**April NBP’s projections (January projections in parentheses)**

	<b>GDP*</b>	<b>CPI**</b>
2006	3.9-5.0 (3.8-5.1)	0.5-2.0 (0.5-2.3)
2007	3.4-5.8 (3.4-5.2)	1.3-3.4 (1.1-3.6)
2008	3.5-6.2 (3.6-5.5)	1.2-3.9 (0.8-3.9)

\* all year; \*\* fourth quarter

*It seems that medium-term outlook presented by the new projection is the most likely scenario of events according to the majority of the Council*

*... which suggests that current level of interest rates is appropriate or neutral*

*According to the NBP staff inflation may be higher than presented in the projection*

*... but financial market should ignore such statements as long as such view is not shared by majority of the Council*

Of course, one should keep in mind that inflation projection included in the *Inflation Report* represents estimates made by the NBP staff, and the key question for those who want to predict future monetary policy moves is what is the MPC’s opinion about prediction’s results. Is predicted path likely to materialise or is it biased upwards/downwards? The MPC underscored yesterday that inflation prediction did not take into account all sources of uncertainty and had been prepared before publication of latest data on economic activity and inflation. It suggested also that it could happen that some factors could make inflation return to the targeted level sooner or later than predicted by the model. Nevertheless, there was no clear hint, which option seems to be more likely for majority of the Council members. Perhaps this stems from the fact that for the time being the MPC treats the projection as the most likely scenario, and risk factors as almost equally balanced. This was suggested by the sentence in yesterday’s statement: “If developments in the economy go in line with April NBP’s inflation projection, current level of reference rate would be supportive for gradual return of inflation to the target in the horizon of projection and maintaining economic growth close to potential” (our translation as the Polish central bank did not manage to publish the English version of the statement until Thursday morning). Such formula shows that current level of interest rates is seen as neutral and appropriate for present economic situation, and it confirms our view that policy parameters are likely to remain unchanged for a prolonged time unless new economic data bring more significant surprises (e.g. negative CPI inflation in annual terms, which would be also argument for improved medium-term inflation prospects). Interestingly, during the press conference NBP president Leszek Balcerowicz suggested that according to authors of the prediction (NBP staff), actual inflation will be higher than outlined in the report (because of factors not included in computations). One could expect that such opinion will be repeated by head of NBP research during press conference presenting *Inflation Report* in details on Friday. However, the market should not react to such declarations as long as MPC’s opinion seems to be quite different. It still seems that there is higher risk on the downside than on the upside to inflation scenario for the coming months, and thus a possibility of slight monetary easing in the remainder of the year cannot be completely ruled out, although we don’t treat it as a base-case scenario.

***Bottom line: No surprise in monetary policy in April. MPC statement suggests that most of the Council member see interest rates at adequate level right now that should not be changed unless some significant surprises appear.***

**Upbeat data on retail sales and unemployment**

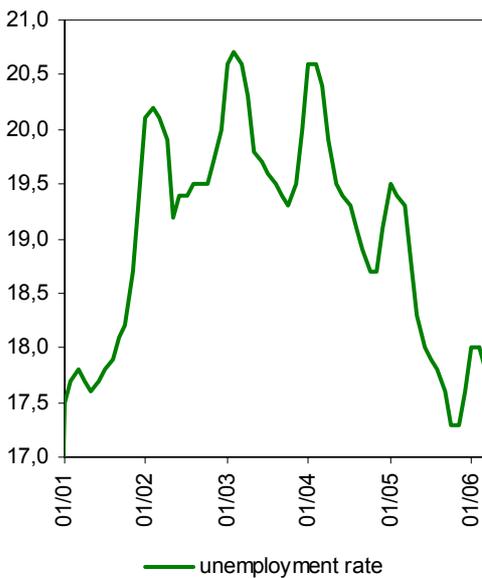
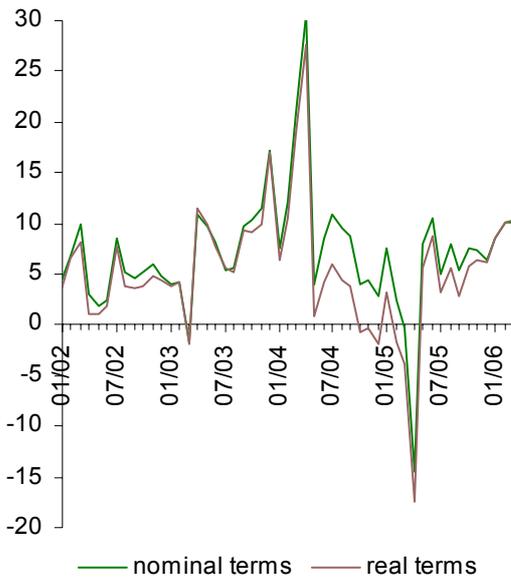
Retail sales data delivered another positive surprise, showing that Polish economy expanded faster than expected at the start of this year. Nominal sales growth reached 10.1%YoY in March, i.e. almost as much as in February, while growth in real terms was even faster coming up to 10.4%YoY, the highest level for two years. In the entire first quarter, retail sales soared 9.4%YoY in real terms, which is much above 5.4%YoY rise seen in Q4 2005, and the fastest rate of growth since EU-accession-related revival in activity in mid-2004. High sales growth in March was achieved despite later Easter, that shifted some food purchases from March to April this year (food sales saw deceleration to 2.7%YoY rise in March from 9.8%YoY in February). This was possible, because sales in other branches performed very well, for example furniture and household appliances went up by nearly 20%YoY, showing that consumers spend increasing portion of their money on goods other than necessities.

On one hand, the data on retail sales confirmed that private consumption demand has been strengthening, which bodes well for GDP growth forecasts for this year. After this release and earlier upbeat results of production and better than expected data from the labour market, we expect GDP growth in the first quarter approached 5.3%, and could be even above 5% in 2006 as a whole. On the other hand, the relation between nominal and real growth in sales shows clearly that upsurge in activity on retail trade market did not translate into pressure on prices, which could moderate fears about inflationary consequences of consumption boom.

Data on registered unemployment confirmed optimistic predictions and showed a decline in jobless rate to 17.8% in March, down 0.2 pp from previous month and 1.5 pp from corresponding period of last year. The number of unemployed fell to 2.8m, which was ca. 7.6% lower than last year, and a number of new job offers rose considerably by 36%YoY. Improving situation on the labour market will be one of the factors supporting further fast expansion in domestic demand in the remainder of this year.

***Bottom line: All statistics concerning economic activity in March were much stronger than predicted, and retail sales data was no exception rising 10.4%YoY in real terms. This justifies upward revision of GDP forecasts for the first quarter and the entire year, and we believe its growth is likely to be above 5% in both cases.***

**Retail sales, %YoY**



**The zloty trading ranges (26.04.2006)**

	Min	Max	Fixing
EUR	3.8550	3.8965	3.8848
USD	3.1200	3.1355	3.1334

**F/X rates (today's opening)**

EURUSD	1.2419	CADPLN	2.7477
USDPLN	3.1293	DKKPLN	0.5180
EURPLN	3.8864	NOKPLN	0.4924
CHFPLN	2.4670	SEKPLN	0.4157
JPYPLN*	2.6742	CZKPLN	0.1355
GBPPLN	5.5786	HUFPLN*	1.4594

\*per 100 units

**Market monitor**

On Wednesday's session zloty was almost unchanged against the main currencies. Initially Polish currency lost against the euro from 3.882 to 3.892 though later on it appreciated to 3.874 and closed near the opening level 3.885. The USDPLN rate rose from 3.127 to 3.134 and at the end of the session declined back to 3.121. Zloty was hardly influenced by released data or the MPC communiqué. The EURUSD rate fluctuated in a tight range and eventually marginally rose from 1.242 to 1.244 as the dollar was supported by positive macroeconomic data and rising yields of U.S. government bonds.

**Polish Treasuries (26.04.2006)**

Term	Yield	Change (bp)
2Y	4.40	8
3Y	4.50	1
4Y	4.72	0
5Y*	4.89	0
8Y	5.04	-2
10Y	5.14	1

\* PS0511

**WIBOR rates (26.04.2006)**

Term	Rates	Change (bp)
O/N	4.07	2
T/N	4.10	0
SW	4.11	-1
2W	4.11	-1
1M	4.11	0
3M	4.13	0
6M	4.16	0
9M	4.18	0
1Y	4.18	0

**Forward Rate Agreements (26.04.2006)**

Term	Mid	Change (bp)
1x2	4.10	0
3x6	4.13	2
6x9	4.16	2
9x12	4.18	0
3x9	4.16	3
6x12	4.19	3

Yesterday the fixed income market weakened at the opening at the short end of the curve as market awaited the MPC's statement and higher yields were supported by high retail sales data as well as by U.S. Treasuries yields rise in the afternoon. The MPC decision to leave the main interest rate unchanged was widely expected and the communiqué was rather neutral for the market. Yields of 10Y U.S. Treasuries increased from 5.07% to 5.10%, reaching 5.12% in the meantime in reaction to very good and higher than expected data from the housing market as well as durable goods orders. German Bunds yields changed little and remained near the Tuesday's levels near 3.99%.

***Bottom line: Zloty remained flat against the main currencies and the yields increased at the short end of the yield curve mainly as a result of strong retail sales, while MPC's decision was in line with expectations. Today market may focus on Bernanke's speech.***

## International update

In reference to Eurostat data in February factory orders increased in the euro zone by 2.7%MoM and by 13.3%YoY as compared to a 5.7%MoM fall and 10.2%YoY increase in January. The analysts expected orders will rise by 1.0%MoM and 10.8%YoY with 5.9%MoM fall and 9.7%MoM rise before the revision.

According to the Department of Commerce new home sales in United States increased in March by 13.8% to 1.213 from 1.066m units while the market expected 1.1m units. In March U.S. durable goods orders soared in March by 6.1% against the forecasted 1.6% rise.

No essential data are going to be released today, however Fed's chairman Ben Bernanke is going to speak today at 14:00 GMT.

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