

Eyeopener – daily update

Prime Minister replacement

10 July 2006

Today PM Marcinkiewicz will step down from the post and the President Lech Kaczyński will designate his twin brother Jarosław Kaczyński for the new government head. The government line-up will remain almost unchanged, with the exception of finance minister Paweł Wojciechowski who will be replaced by Stanisław Kluza, present deputy finmin. Candidates for new Prime Minister and new finance minister declared strong commitment to stick to PLN30bn budget deficit anchor and pledged continuation of Gilowska's economic reforms, which calmed down market nerves, so now the investors will be watching first steps of the new government to have idea about its true intentions as regards economic policy in future.

As regards economic data, this week the most important release will be the CPI inflation for June on Friday. If the forecast of the Ministry of Finance materialises (as it was the case in the last couple of months) this would be positive news for the yield curve, especially its short-end. Assuming CPI inflation would reach the level of 1.5% by year-end, it is hard to expect, in our opinion, interest rates hikes this year, which are currently priced-in by the market. Remaining data this week (balance of payments for May and money supply for June) should be quite neutral for the market, although they will confirm fast economic growth – high trade balance turnover and higher activity on the credit market. As regards data abroad the most important seem to be Friday's figures in the U.S.

*PM Marcinkiewicz to be replaced by
Jarosław Kaczyński*

*Stanisław Kluza to be the new
finance minister*

*Kluza declared policy continuation
and keeping PLN30bn deficit anchor*

What's hot this week

No longer than two weeks after dismissal of finance minister Zyta Gilowska, Poland faces even more significant political changes. On Friday evening, PM Kazimierz Marcinkiewicz declared he was going to resign from the post, and the political council of ruling PiS recommended the party leader Jarosław Kaczyński to take over the chair of the Prime Minister. Formal dismissal of Marcinkiewicz is expected today and probably the same day the president Lech Kaczyński will designate his twin-brother to take control over the government. According to Jarosław Kaczyński's declarations, there will be only one major change in the government line-up apart from the Prime Minister's chair. Namely, recently appointed finance minister Paweł Wojciechowski will be released after only two weeks in the office, and he will be replaced by Stanisław Kluza, present deputy finance minister, ex chief-economist at BGŻ bank, and economist specialising in statistics and macroeconomic policy at Warsaw School of Economy. In the interviews during the weekend Kluza pledged a continuation of policies initiated by ex-minister Zyta Gilowska, including further work on public finance reform, and keeping PLN30bn budget deficit anchor as a main priority of the government. Kluza's candidature for the finance minister's post, and his commitment to stick to earlier announced budgetary rules could be stabilising factors for the market. Thus, market reaction to the change in the government will be probably less significant than to the Gilowska's dismissal. Nevertheless, the beginning of the week could be still quite nervous for investors as they will try to evaluate the true impact of the Prime Minister replacement on the

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economic prospects of Poland. However, in this regard the market will probably have to wait for get more reliable hints until seeing the first results of the government's activity (e.g. at the occasion of finishing 2007 budget draft).

From a formal point of view, new prime minister Jarosław Kaczyński and the entire cabinet will have to win a confidence vote in the parliament. This is possible at the nearest Sejm's session starting this Wednesday, or at the last meeting before parliament's summer break, next week. The motion success requires a majority of at least 231 votes (absolute majority) with the presence of at least 50% of all deputies. This implies that the new government should have no problems with surviving the vote, assuming that it will be supported by all the coalition allies. Although Samoobrona leader Andrzej Lepper have started moaning during the weekend he would require an amendment to coalition deal before backing the cabinet reshuffle, it seems likely that eventually the vote will be successful, even at the cost of minor concessions to small allies.

Apart from political news, this week also a couple of economic data releases will take place. The most closely watched will be Friday's release of CPI inflation for June. Expectations as regards inflation were defined by the forecast of the Ministry of Finance (0.9% YoY). Our estimation is slightly higher (1%), but it is worth to mention this was lowered after the ministry presented its assumptions, especially as regards food prices. Please recall that forecasts of the Ministry of Finance were accurate in the last couple of months and if the situation repeats also this time, this would be positive news for the yield curve, especially its short-end. Assuming CPI inflation would reach the level of 1.5% by year-end, it is hard to expect, in our opinion, interest rates hikes this year.

Remaining data this week (balance of payments for May to be release on Wednesday and money supply for June to be release on Friday) should be quite neutral for the market, although they will confirm fast economic growth – high trade balance turnover and higher activity on the credit market. Balance of payments data did not bring much attention of financial markets in the last couple of months, as there were no major changes in external balance trends. Current account deficit maintains at the very low level (below 2% of GDP), especially if we take into account strong acceleration in domestic demand. On the other hand, Polish exports still continues to rise robustly. Such situation was most likely also maintained in May. Though trade and current account deficits were, in our opinion, higher than monthly average year-to-date, the similar situation was observed last year. Our forecast of current account and trade deficits are higher than market consensus - €740m vs. €340m and €550m vs. ca €200m, respectively. We expect two-digit growth in both exports and imports (actually, of even above 20%YoY), while market sees lower rate of growth of imports. Monetary statistics should show a continuation of acceleration in deposits and credits. We expect broad money M3 to rise by 11.7% (market consensus 11.3%).

As regards data abroad the most important seem to be Friday's figures in the U.S. (trade balance, Michigan index, retail sales).

Bottom line: Replacement of the Prime Minister weakened Polish market, however negative reaction was moderated due to strong commitment to

continuation of economic policies. Crucial data, which may be positive for market interest rates, will be released only on Friday, while during the better part of the week the Polish market should be driven by global markets' sentiment.

What's hot today

Unemployment rate dips again

According to the Ministry of Labour, tentative data from labour offices showed that the registered unemployment rate at the end of June fell to 16% from 16.5% in May. In annual terms, this would mean 2 percentage point drop in the unemployment rate, the strongest for 8 years. This suggests continuation of very positive tendencies in the economy, i.e. strong economic activity and rapidly rising demand for labour. It is noteworthy, however, that sharp reduction in the unemployment rate may lead to emergence of inflationary pressure. According to various estimates, level of NAIRU (not accelerating inflation rate of unemployment) is relatively high in Poland and stands at least at 10%. Thus, even quite high observed unemployment may have proinflationary consequences. On the other hand, one has to remember that there are other factors (such as tight competition on goods' market) which counteract potential inflation increase. The actual data on registered unemployment will be published in the last decade of this month.

Bottom line: Fast reduction of unemployment confirms very strong economic activity, and at the same time creates a potential risk factor for future inflation.

Market monitor

On Friday session zloty fluctuated in a tight range losing against the euro and appreciating versus the dollar. The weakening of Polish zloty was connected with rumours of PM Kazimierz Marcinkiewicz's dismissal, though as this was denied by the Prime Minister zloty regained some strength. The EURPLN rate rose from 4.019 at the opening to 4.0222, while the USDPLN rate declined from 3.142 to 3.178. After the session's close Kazimierz Marcinkiewicz informed he was in fact going to resign, which took the EURPLN rate to 4.08. The low liquidity environment during the weekend suggests that the actual impact of the cabinet change to the zloty rate will be known today.

The dollar lost versus the single currency mainly after the long awaited non-farm payrolls data, which appeared to be much below expectations. In the result the EURUSD rate rose from 1.277 to 1.282.

The activity in the Polish market was quite moderate in the first part of the session. The fixed income market strengthened after non-farm payrolls data in United States, which contributed to the drop of yields in the US market. However further speculation on the stepping down of the Prime Minister effected in a strong correction. Thus Polish bonds yields remained almost unchanged as compared to Thursday's closing. US Treasuries strengthened on Friday in first reaction to the labour market data though later on a

correction came. Finally 10Y yields fell from 5.19% to 5.14%, while yields of 10Y Bunds declined from 4.11% to 4.06%.

At today's tender the Ministry of Finance is going to offer PLN1.0bn of 52-week T-bills, which the lower end of the previously given range PLN1.0-1.2bn.

Bottom line: During the Friday's session the zloty slightly depreciated against the euro, while bonds yields remained almost unchanged as the weaker than expected non-farm payrolls and yields drop in US were balanced by the rumours on the PM's dismissal. After the information on PM's dismissal in the evening the zloty slumped to weaker levels though the actual impact will be known today with increased liquidity in the market.

International update

The non-farm payrolls in the United States amounted to 121,000 in June as compared to market consensus of 185,000 and from upwardly revised 92,000 (75,000 before revision) in the previous month. Hourly average earnings in US rose by 0.5%MoM, which was higher than the analysts' forecasts at 0.3%. The unemployment rate remained at 4.6% level.

TIME GMT	REGION	INDICATOR	PERIOD		MARKET	LAST VALUE
14:00	US	Wholesale inventories (H)	May	%	0.5	0.9

Source: Reuters

The zloty trading ranges (07.07.2006)

	Min	Max	Open*	Close**	Fixing
EUR	4.0110	4.0360	4.0193	4.0222	4.0263
USD	3.1290	3.1520	3.1419	3.1379	3.1520

* 6:30 GMT. ** 15:00 GMT

The EUR/USD trading range (07.07.2006)

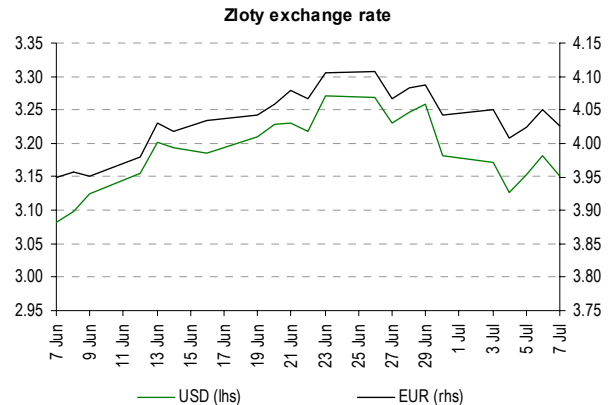
	Min	Max	Open*	Close**
EUR/USD	1.2770	1.2845	1.2772	1.2821

* 6:30 GMT. ** 15:00 GMT

F/X rates (today's opening)

EURUSD	1.2805	CADPLN	2.8638
USDPLN	3.1888	DKKPLN	0.5473
EURPLN	4.0830	NOKPLN	0.5118
CHFPLN	2.6064	SEKPLN	0.4464
JPYPLN*	2.8064	CZKPLN	0.1435
GBPPLN	5.9015	HUFPLN*	1.4462

*per 100 units



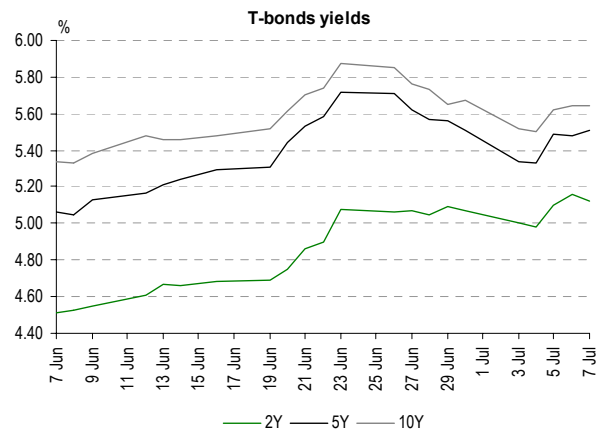
Fixed income markets (07.07.2006)

Term	PL		US		DE	
	Yield	Change (bp)	Yield	Change (bp)	Yield	Change (bp)
2Y	5.12	-4	5.17	-4	3.60	1
3Y	5.30	0	5.14	-4	3.75	7
4Y	5.43	-1			3.81	4
5Y	5.51	3	5.10	-5	3.86	0
8Y	5.58	0			4.02	0
10Y	5.64	0	5.13	-6	4.08	0

T-bond auction

Date	Offer	Bid	Sale	Avg. Yield	Prev. Avg. Yield	Change
		PLN m		%		bp
06.07	2Y	1 800	4 089	5.025	4.517	51
21.06	5Y	2 000	3 530	5.525	5.031	49
12.04	10Y*	2 160	5 685	4.978	4.936	4

* with a supplementary auction

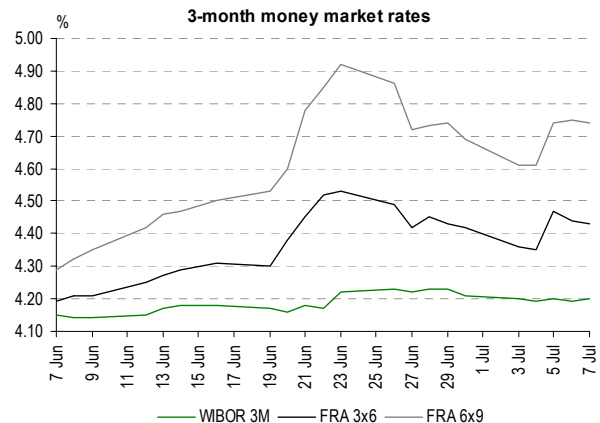


WIBOR rates (07.07.2006)

Term	Rates	Change (bp)
O/N	4.09	8
T/N	4.10	1
SW	4.11	1
2W	4.11	1
1M	4.11	0
3M	4.20	1
6M	4.34	1
9M	4.51	0
1Y	4.65	0

Forward Rate Agreements (07.07.2006)

Term	Mid	Change (bp)
1x2	4.16	4
3x6	4.41	0
6x9	4.72	0
9x12	5.02	0
3x9	4.60	2
6x12	4.91	1



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