

Weekly economic update

7 March – 13 March 2005

The most important event of the past week was supposed to be publication of the *Inflation report*, including new inflation projection of the NBP. Undoubtedly, this was a significant event, which among others induced the market to price in even deeper and sooner rate cuts. We also changed out interest rate predictions and currently we foresee rate cuts of a total 100bps until year-end. However, next days brought information that shattered positive market trend, that formed after surprising MPC decision on bias change. It was Marek Belka's speech that proved to be crucial for the market, suggesting possibility of Prime Minister's dismissal after 5 May and increasing chances that parliamentary election would be held before autumn. Thus, the market had weakened from the levels recorded at the start of the week, however one cannot rule out that economic data expected in the coming weeks (likely to support soon rate cuts) will create opportunity for return to appreciation pressure.

Crucial event in the coming days will be meeting of EU member states' finance ministers scheduled for 8 March. One of the subjects under discussion will be reform of Growth and Stability Pact determining e.g. whether (and how) costs of pension system reform would impact procedure of excessive deficit. This decision would be crucial for Poland, as it might impact ability of the country to meet Maastricht criteria by 2007. Finance minister Miroslaw Gronicki announced that he prepared a plan (details expected after EcoFin meeting), which would allow Poland for deeper deficit reduction and accession to the euro zone in schedule even amid unfavourable EU decision on pension reform costs.

On Friday, the CSO will present GDP data for 4Q04 that would allow for verifying estimates based on whole year data. We predict GDP growth of 4.2%, amid 1.8% rise in private consumption and 7.0% in fixed investment.

Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
MODNAY (7 March)							
10:00	POL	Auction for 52-weeks T-bills – PLN800m (M)					
15:00	POL	Reserve assets (M)	II	€bn	-	-	-
TUESDAY (8 March)							
	EU	ECOFIN Council Meeting					
WEDNESDAY (9 March)							
09:00	POL	Auction for 20y bonds WS0922 PLN0.5-2.0bn (H)					
19:00	USA	Beige book (H)	II				
THURSDAY (10 March)							
07:00	GER	Trade balance (M)	I	€bn	-	-	12.40
12:00	GB	BoE meeting – decision (H)		%	4.75	4.75	4.75
15:00	USA	Wholesale inventories (M)	I	%	0.5	-	0.4
19:00	USA	Monthly budget statement (M)	II	\$bn	-91.05	-	-96.70
FRIDAY (11 March)							
09:00	POL	GDP (H)	4Q	%YoY			
13:30	USA	International trade (H)	I	\$bn	-56.00	-	-56.40

* Importance level: (H)igh, (M)oderate; Source: Parkiet, Reuters, BZ WBK

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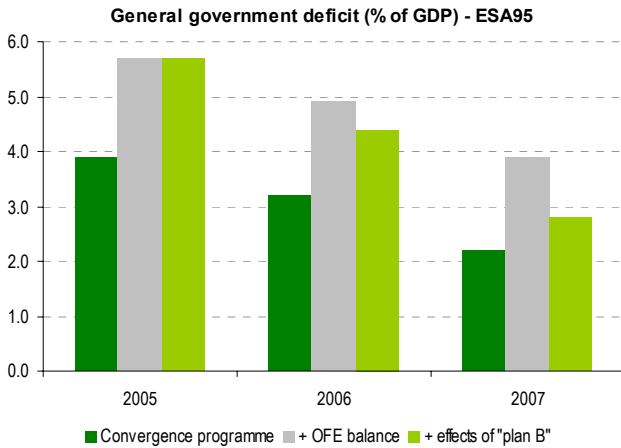
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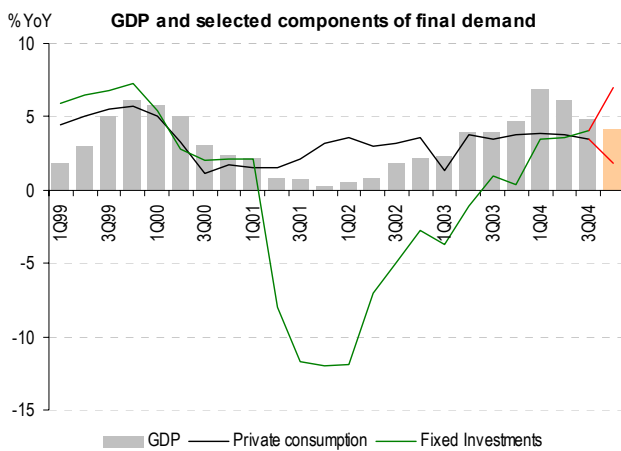
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What's hot this week – EcoFin ruling more important than GDP data



- On Tuesday, the EcoFin will issue recommendation for the EU Council regarding the Growth and Stability Pact. The most important issue for Poland will be whether (and how) costs of pension system reform would impact procedure of excessive deficit.
- This decision might impact Poland's ability to meet Maastricht criteria in line with the schedule, i.e. by 2007. Balance of Polish private pension funds sector is ca. 1.8% of GDP per year.
- Finance minister announced that he had prepared "plan B" that would allow for meeting criteria even in the case of EU decision negative for Poland. Details of the plan could be revealed later this week, after EcoFin meeting. Tentative hints suggested it could give reduction of budget deficit by ca. 0.5% of GDP in 2006 and over 1% of GDP in 2007.



- Official CSO data on GDP growth in 4Q04 will verify analysts' estimates made based on tentative figures for entire 2004.
- We expect the CSO will show 4.2% GDP growth amid 1.8% rise in private consumption and 7.0% increase in investment. Market consensus points to 4.1% GDP growth, 1.8% consumption and 7.3% investment.
- In general, the data should not reduce market expectations for soon rate cuts, especially that much more important for investors would be CPI release due next week.
- On Saturday, the SLD will reconsider the best timing of parliamentary election. Party leader Józef Oleksy said they could mull supporting early election (even earlier than in June), as the SLD was losing control over the government.

Economy last week – No threats for inflation in the medium run

NBP inflation projections (YoY)

	May 2004	Aug 2004	Nov 2004	Feb 2005
4Q05	2.1-5.4%	2.8-5.5%	2.5-5.2%	1.2-4.0%
4Q06	1.1-4.4%	1.6-5.1%	1.3-4.8%	0.4-4.2%
4Q07	-	-	-	0.5-4.6%

Probability of CPI falling in a given range in 4Q 2006

CPI	Aug'04 projection	Nov'04 projection	Feb'05 projection
below 1.5%	23%	27%	39%
1.5-2.5%	13%	14%	14%
2.5-3.5%	15%	16%	13%
above 3.5%	49%	43%	34%

- New Inflation report showed significant improvement in inflation outlook. According to NBP there should be no problems with achieving 2.5% target over the next three years horizon (assuming no rate cuts). Distribution of probabilities attached to inflation projection improved substantially (see table).
- Conclusions of the Report justified introduction of neutral rather than easing bias (likelihood of inflation below target close to the likelihood of inflation above). However, in MPC's own view the balance of risks was more favourable than presented by the NBP.
- New inflation projection and subjective MPC's judgement of risks made us change interest rate forecasts – now we foresee a total rate cut by 100bps until end-2005: 50bps in Q2 and 50bps in Q3.

Quote of the week – Earlier elections getting more and more likely

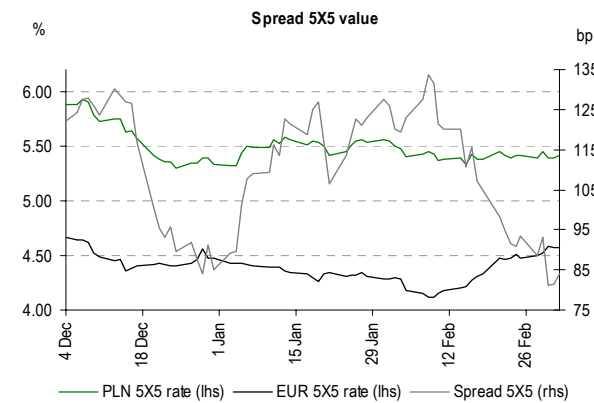
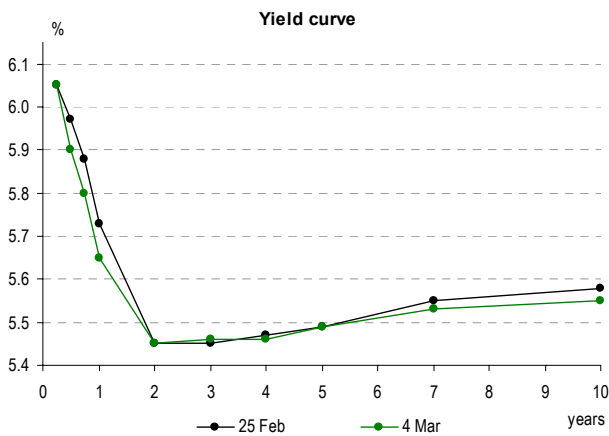
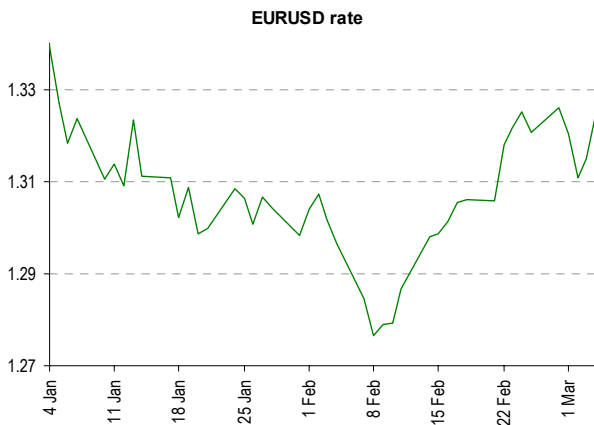
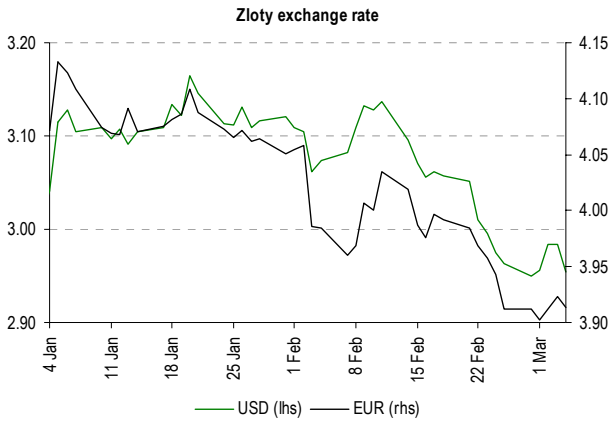
Marek Belka, prime minister

(Reuters, 3 March)

Regardless of what happens on May 5, if parliament decides one way or another, I will regard the mission of my government to have ended with success. I will then make a decision on where I belong politically.

Chances for premature election have clearly risen, which could increase potentially market's fragility to political news. However, simultaneously PM Belka ruled out immediate dismissal before May, which might encourage some investors for more buying in the short term and does not exclude that nearest data releases (likely to support rate cuts) will create an opportunity to continue rally on the Polish market.

Market monitor



You can't do anything with politics

- During last week the zloty virtually did not change against the euro. In relation to the dollar it gained by mere 0.28%. Though it occurred amid elevated volatility.
- Polish currency advanced first on capital inflow after MPC decision, then lost significantly due to politics. Soothing statement from PM Belka supported the market only for a few hours that ultimately declined below the levels from the beginning of the week. Euro advancement on US labour market data brought about complete reduction of declines of Polish currency.
- Next week the market to a large extent will depend on EURUSD performance. We expect the zloty to fluctuate in the following brackets: 3.85-3.95 to the euro and 2.90-2.98 to the dollar.

Employment long awaited

- Last week either sentiment indicators or Greenspan's testimony did not trigger any major movements in the market. The dollar strengthened suddenly only on large Australian trade deficit. High non-farm payrolls number failed the EURUSD rate to break downward from a range 1.31-1.33, in which it stayed awaiting them.
- US labour market data, though significantly higher than expectation, triggered decline in the dollar value to above 1.32 due to preponderance of long positions in the dollar. Additionally pressure may be boosted by still high US trade deficit, which magnitude will be known for the market on Friday. We expect that till that time EURUSD rate will be traded above 1.31.

Demand temporarily halted

- Bond yields moved during last week actually did not alter, but likewise the zloty high volatility caused significant price fluctuations. 2y bond auction came amid turmoil around Belka's issue that in the face of future rate cuts constituted an opportunity to buy for many players. On Friday afternoon market reaction for US data caused a return of the prices to week-old levels.
- 20y bond auction is not a breaking event in Polish market, but it may boost positive sentiment in case of favourable outcome. Tuesday's ECOFIN Council decision on Polish pension funds will be important for the market. Optimism coming from core markets may support Polish papers next week.

Employment rises, and yields... fall

- Owing to political jittery spread 5/5y widened to 93 bp last week, but after PM's statement in reverted to ca. 80 bp, on which it should stay, as the zloty probably will stay supported.
- 10y Bunds strengthened, and 10y US Treasuries lost by 2 bp. The spread between them owing to that widened slightly to 62 bp. But its volatility rises constantly, as correlation diminishes.
- Increased demand for bonds in core markets, induced by employment data creates positive sentiment, especially ahead of papers auctions in USA. Interest rate markets will await also Fed Beige Book publication (scheduled for Wednesday).

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