Bank Zachodni WBK

Weekly economic update

4 April – 10 April 2005

During around-Easter period financial markets were under influence of central banks' decisions on interest rates. In line with expectations the US FOMC increased interest rates by 25 bp, though it was accompanied by rather a hawkish statement, which upbeat positive mood for the dollar. However, US dollar depreciated again after weak US labour market report. In our region interest rates cuts were observed – by 25 bp in Czech Republic and by 50 bp in Hungary. In Poland, The MPC cut main interest rate by 50 bp to 6%. After surprisingly low inflation the change was expected, but it triggered some positive reaction on the fixed income and foreign exchange markets. The market is likely to price-in next cut (possibly of 50 bps) in April and 100 bp more in 2005. Such expectations will be reinforced by MPC member, Andrzej Sławiński, Friday's statement that "something very extraordinary would have to happen NOT to cut rates in April". This shows that next interest rate cut is very likely already this month. We think 25 bp cut in April is more likely than 50bp, but financial market is likely to price in deeper reduction.

In the upcoming week two more central bank meetings are scheduled, but neither the Bank of England nor the European Central Bank are expected to change interest rates. There are no important economic events on the Polish market, except the auction of two-year bonds with relatively high supply. On Monday the European Commission will release spring economic forecasts.

Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (4 April)					
09:00	**POL**	**Auction for 13- and 52-weeks T-bills – PLN0.1bn and PLN1bn (M)**					
09:00	EMU	PPI (M)	Feb	%MoM	0.4	-	0.6
		TUESDAY (5 April)					
09:00	EMU	Retail sales (M)	Feb	%MoM	-	-	0.3
		WEDNESDAY (6 April)					
09:00	POL	**Auction for 2y bonds OK0407 PLN3-4bn (H)**					
		THURSDAY (7 April)					
11:00	GB	BoE meeting – decision (H)		%	4.75	-	4.75
11:45	EMU	ECB meeting – decision (H)		%	2.0	-	2.0
14:00	**POL**	**Reserve assets (M)**	**Mar**	**€bn**	**-**	**-**	**-**
15:00	USA	Wholesale inventories (M)	Feb	%	0.7	-	1.0

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

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What's hot this week – Calm week ahead, European Commission's forecasts on Monday

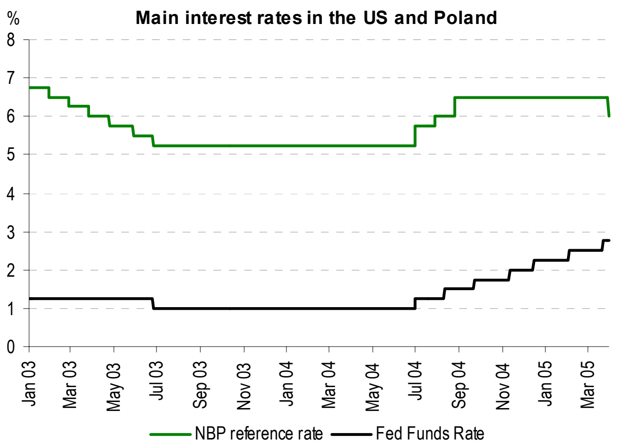
Main features of economic forecast for Poland (% YoY)

	2004	2005	2006
GDP	5.8	4.9	4.5
Private consumption	4.0	4.2	4.4
Gross fixed capital formation	6.5	10.0	12.0
Exports	13.3	11.9	10.4
Imports	11.6	12.6	12.6
Unemployment rate	19.0	18.7	18.1
HICP Inflation	3.5	3.3	3.0
General government balance (% GDP)	5.6	4.1	3.1
General government gross debt (% GDP)	47.7	49.8	49.3

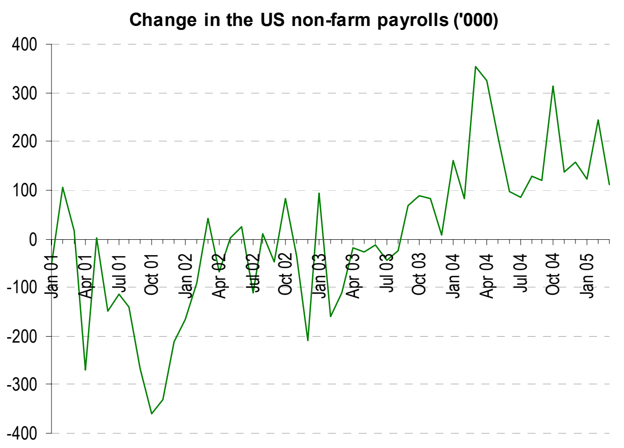
Source: European Commission; Economic Forecasts. Autumn 2004

- The upcoming week should be relatively calm on the Polish financial market amid light economic calendar.
- On Monday the European Commission will publish its spring economic forecasts of main economic indicators of the European Union countries (autumn forecasts for Poland are presented in the table on the left).
- We expect lowering GDP growth and inflation forecasts for 2005. However, Commission's view on fiscal position will be much more important for market participants. Given recent assessment of the convergence programme, one may expect higher forecast of general government deficit for 2005-06, though one should remember it was lower in 2004.
- However, the problem is that forecasts only until 2006 will be presented and it will be difficult to assess the Commission's view on possibility of meeting Maastricht fiscal criterion by Poland in 2007.

Economy last week – Central bankers did not surprise; strong data in Poland and weak in the US



- This time the Monetary Policy Council's decision did not surprise a majority of financial market participants – main interest rate was cut by 50 bp to 6.00%.
- The MPC statement was quite dovish leaving no doubt that more interest rates cuts will come soon.
- Almost all domestic factors (low inflation measures, better food prices outlook, no wage pressure) pointed to lower inflation in future, some risk factors were mentioned, including oil prices as the most important.
- NBP expects CPI inflation below 2% in 2H05, but medium-term forecasts will be more important for decisions.
- Other central banks did not surprise as well – US FOMC raised rates by 25 bps (with a hawkish statement as regards inflation prospects), interest rates fell in Hungary (by 50 bp to 7.75%) and in Czech Republic (by 25 bp to 2%).



- January balance of payments data showed very low current account deficit and trade surplus.
- Imports maintained high growth rate suggesting quite robust domestic demand. Zloty appreciation observed in 2H04 did not contribute to weakening of export performance (growth by 30%YoY), which is positive for the zloty.
- Though preliminary January data may be revised, quite similar picture was presented by quarterly statistics – high exports and imports growth.
- March US labour market data was an additional factor supporting the zloty (via rising EURUSD rate). They showed growth in non-farm payroll by a mere 110,000 as compared to expectations of 220,000. what is more, data for January and February were revised down by 27,000 in total.
- This was the lowest result in July 2004, though the rate of unemployment fell to 5.2% from 5.4% in February.

Quote of the week – Zloty level is not the most important

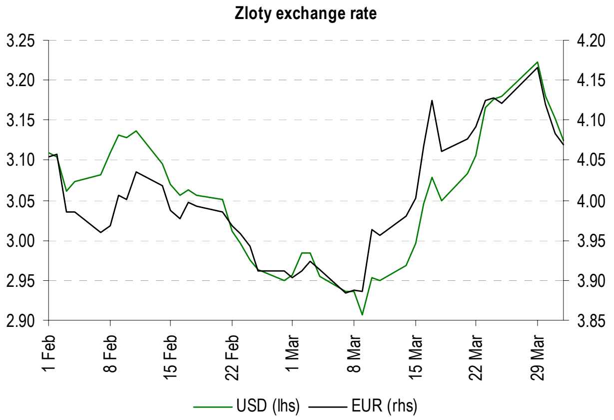
Leszek Balcerowicz, NBP governor
(MPC press conference, 30 March)

Recent zloty weakness justifies the MPC's assessment that it is extremely difficult to forecast FX movements.

[from MPC statement] The Council acknowledges the rise in uncertainty surrounding the future course of the exchange rate in view of the situation in international financial markets and the uncertainty related to the preelection period".

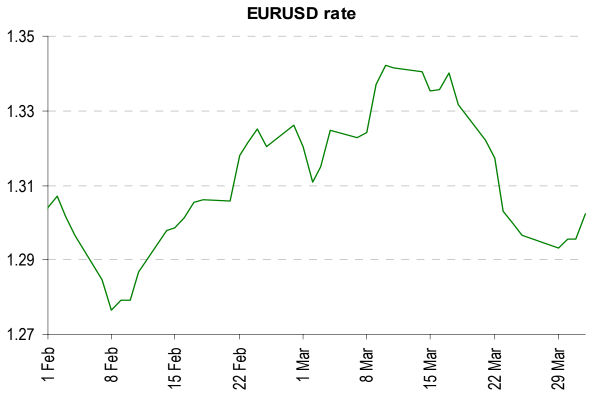
It does not seem FX market developments will be crucial for interest rates changes in the coming months. Recent weakening of the zloty may give additional argument to hawks in the MPC - even if the zloty appreciates to say 3.8 against euro, why this should lead to a sharp NBP reaction if PLN may depreciate back to 4.2 within a couple of weeks? We think that even if the zloty get stronger this would not be an important argument for faster and deeper rate cuts.

Market monitor



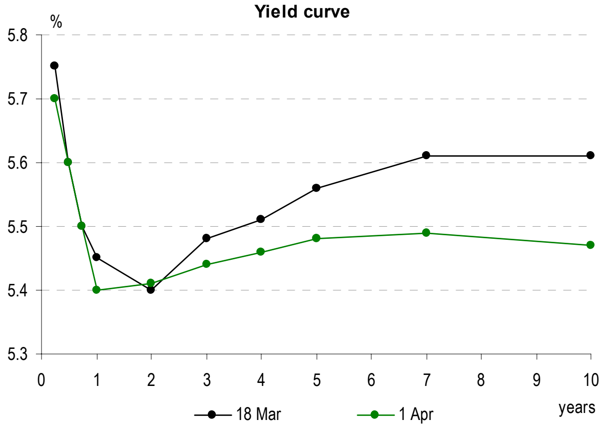
The Council solves the zloty problems

- Within last two weeks the zloty at the beginning continued declines triggered this time by the Fed and strong dollar. But decreasing euro sell-off and MPC decision on interest rate cut supported the zloty. Eventually, after reaction to weak US labour market data, Polish currency was weaker to the dollar by 2.2%, but its performance against the euro virtually did not change.
- In the upcoming week, the zloty may gradually appreciate amid support from the international market - higher EUR USD rate and lower yields of Treasuries. An additional factor keeping the zloty upbeat might be the auction of two-year bonds. Therefore, we expect the zloty to fluctuate within the ranges: 4.03-4.12 to the euro and 3.08-3.16 to the dollar.



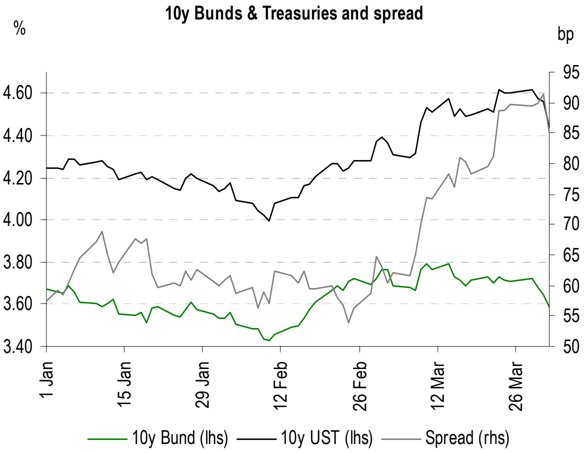
Employment disappoints strongly

- During last two weeks EURUSD rate remained under pressure of hawkish Fed statement. The dollar strength was additionally boosted by expectations of strong data from US labour market. But due to technical overbought position and signals about too good situation flowing from the labour report, the euro rebounded steeply reaching the 1,305.
- As economic calendar for the upcoming week is quite light, with the exception of the ECB meeting, we expect that EURUSD rate will be in the upward trend as an aftermath of weak non-farm payrolls data, as well as amid expectations for the publication of next US trade balance data, which are usually negative for the dollar



MPC offsets supply

- Yield curve movements were highly correlated with zloty stance, but their magnitude was limited by interest rate cuts expectations. MPC decision on 50 bp reduction and weak data from US caused the bonds to get dearer finally than two weeks earlier. Papers supply in 2Q05 limited gains of 2y bonds owing to substantial offer for Wednesday's auction. FRA contracts gained only on the short end that suggests cuts won't exceed 150 bp, in market view.
- The auction of two-year bonds is likely to attract quite high interest of investors expecting interest rates reductions. As no important economic information are expected on the domestic market, we expect core markets to positively influence the fixed income market. FRA curve will await the next inflation data release (in mid-month).



Labour market versus the Fed

- Spread 5/5y between the euro and Polish curve did not change maintaining in the vicinity of 90 bp. It points to high correlation between those markets, despite weakening of the zloty. Due to hawkish Fed statement spread between 10y bonds in US and Germany widened to 90 bp, but it narrowed again to 84 bp because of payrolls data. Bond yields at the end of the week amounted to 4.42% and 3.58% respectively.
- Low growth in US non-farm payrolls decreased a concern of investors as regards possible sharp rise in inflation and faster and more significant interest rates hikes by Fed. However, as the American economy develops quite fast, high oil prices should be the factor limiting further decrease in yields of Treasuries. When short positions reversal materialises, the market will concentrate on the ECB meeting.

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