

Weekly economic update

30 May – 5 June 2005

This week financial markets will live in the aftermath of the French NO in the constitutional referendum. As such a result was already anticipated, euro is only slightly weaker against the dollar today in the morning. We see a potential impact on the Polish zloty *only* via possible influence of cross exchange rate EURUSD, as higher political uncertainty may increase pressure on the euro (Dutch polls also suggest strong NO in the referendum on Wednesday).

In Poland, only two data releases will take place in the coming days, both on Tuesday. Data on GDP should confirm that despite slowdown in 1Q05, economic prospects remain quite positive and the second half of this year should see much better results. Balance of payments data should be positive for Polish currency. Abroad, the Friday's US non-farm payroll report will be crucial for investors.

The MPC kept interest rates on hold in May because it agreed that balance of risks for inflation "has not changed enough to warrant a change of the monetary policy parameters". New *Inflation report* shows inflation close to the 2.5% target in the medium run, and GDP growth rate at 5.0-5.5% in the next two years. These are not conditions particularly supportive for decisive monetary easing, however one should note that the NBP deputy president Krzysztof Rybiński said on Wednesday that if rates were changed in a scale priced-in by the market the inflation projection would not change much. Therefore, we do not change our view that the next MPC's move would be a 25 bp rate cut in July.

Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD	FORECAST			LAST VALUE
				MARKET	BZWBK		
MONDAY (30 May)							
09:00	POL	Auction for 52-weeks treasury bills – PLN500m (M)					
TUESDAY (31 May)							
08:00	EMU	Money supply (H)	Apr	%YoY	6.4	-	6.5
09:00	EMU	Business climate (M)	May	-	-	-	-0.28
09:00	EMU	Preliminary HICP (H)	May	%YoY	2.0	-	2.1
14:00	POL	GDP (H)	1Q	%YoY	3.0	3.0	3.9
14:00	POL	C/A (M)	Mar	€m	200	-158	132
WEDNESDAY (1 June)							
09:00	POL	Auction for 2y bond (OK0807) – PLN2.5bn (H)					
09:00	EMU	GDP (H)	1Q	%YoY	1.4	-	1.6
14:00	USA	ISM manufacturing (H)	May	-	52.1	-	53.3
THURSDAY (2 June)							
09:00	EMU	PPI (M)	Apr	%MoM	0.5	-	0.6
11:45	EMU	ECB meeting – decision (H)	-	%	2.0	-	2.0
14:00	USA	Durable goods orders (H)	Apr	%	-	-	1.9
14:00	USA	Factory orders (H)	Apr	%	1.0	-	0.1
FRIDAY (3 June)							
12:30	USA	Change in non-farm payrolls (H)	May	000	185	-	274
14:00	USA	ISM non-manufacturing	May	-	60.0	-	61.7

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

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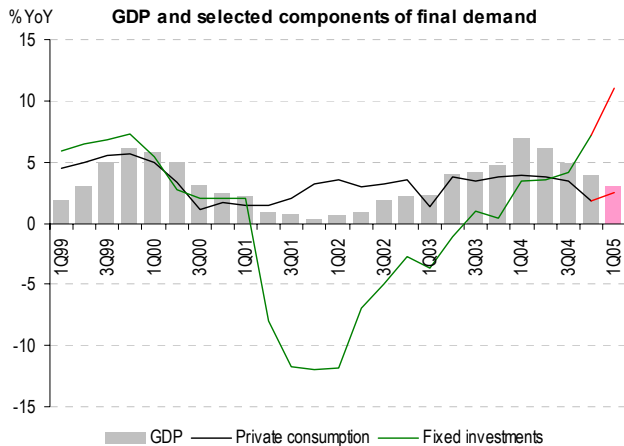
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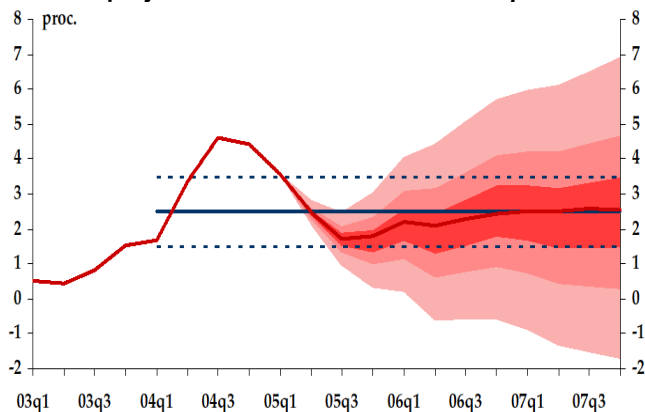
What's hot this week – Anticipated GDP slowdown in the first quarter



- GDP growth in 1Q05 probably decelerated to 3%YoY, amid 2.5% rise in private consumption and acceleration in investment growth to 11%. Slowdown resulted from the effect of high base, and thus should be temporary.
- The CSO will publish detailed quarterly GDP figures for 2004, which have been revised up. New estimates could impact our GDP forecasts for 2005.
- Balance of payments data will show small current account deficit, amid weaker export and import growth due to strong statistical base. Cumulated 12-month deficit in relation to GDP should keep declining – to 1.1% in 1Q05.
- US non-farm payroll report will be crucial for international markets. After exceptionally strong rise in April, May should see less impressive result. However, in the case of another positive surprise, the dollar could gain more against the euro.

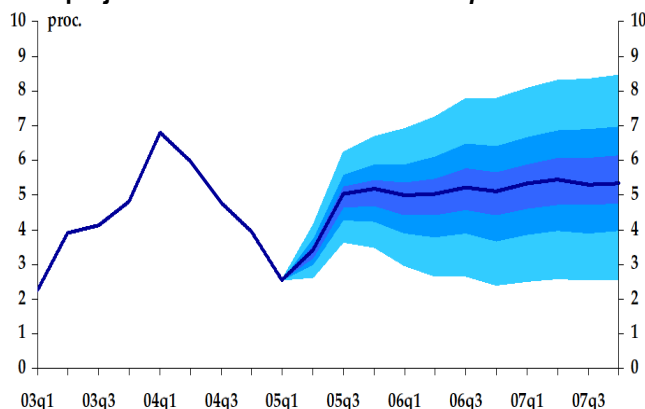
Economy last week – No surprise in monetary policy this time

Inflation projection in NBP's new *Inflation report*



- In line with expectations, the MPC has left interest rates on hold in May, and maintained neutral bias in policy.
- Despite favourable inflation outlook, the Council recognised persisting political risk and uncertainty regarding strength of Polish economy. Considering all aspects, the MPC agreed that balance of risks for inflation “has not changed enough” to warrant changes in rates.
- President Balcerowicz's comments and contents of the *Inflation report* (see below) suggested that room for monetary easing was not sizeable. However, Stanisław Niecekz signalled during the press conference that there are advocates of more relaxed monetary policy in the Monetary Policy Council.
- We still believe the next MPC move will be a 25 bp rate cut in July, however decision in June cannot be ruled out if the upcoming macro data support such decision.

GDP projection in NBP's new *Inflation report*



- According to the new inflation projection, until mid-2006 a likelihood of inflation staying above the inflation target is much greater than probability of inflation falling below the 2.5% target, but for longer time-horizon both probabilities are similar.
- GDP projection, published for the first time, predicts economic growth should reach 4% in 2005, and in 2006-07 should accelerate to 5.0-5.5%. NBP's estimates for 1Q05 show 3% GDP growth, but slowdown is justified mainly by high base effect.
- President Balcerowicz stressed that the MPC did not distance itself from GDP growth projection.
- Voting results in the *Inflation report* showed that adoption of easing bias in February was possible due to sudden change in Stanisław Owsiak's view, who was against any change in bias in January.

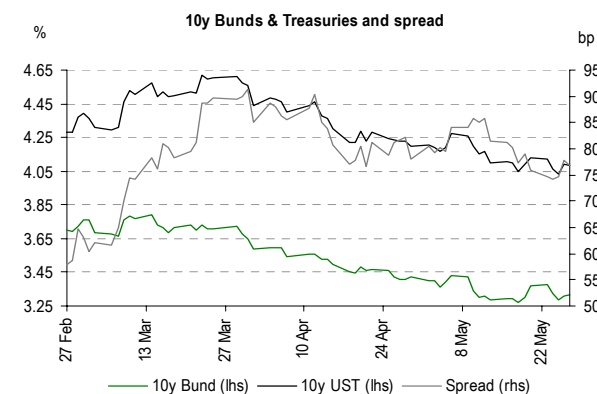
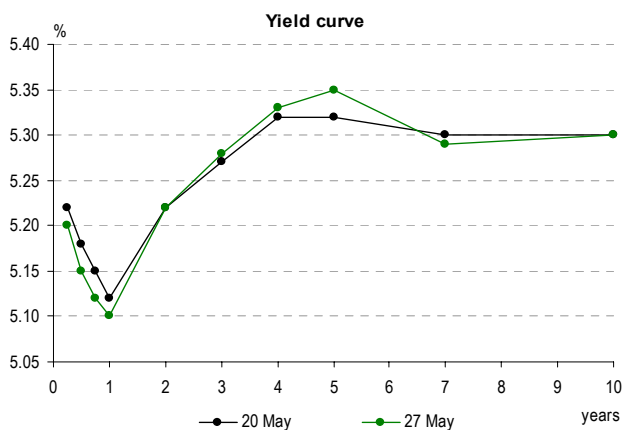
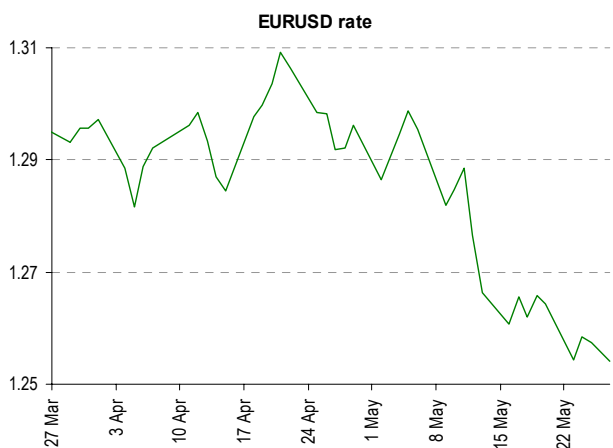
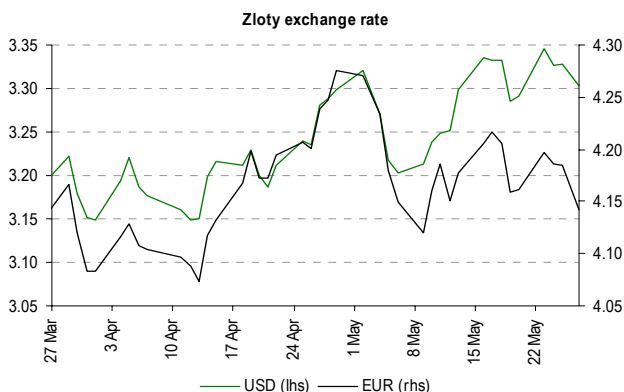
Quote of the week – French NO to EU constitution will not delay our road to euro

Marek Belka, Prime Minister
PAP, 24 May

Undoubtedly, rejection of EU constitutional treaty would weaken France's position within the EU, but I find it hard to imagine that it could impact our plans regarding euro adoption. [...] I believe that black scenarios of sharp market reaction are not very likely.

In line with Marek Belka's prediction, Polish financial market has not reacted abruptly to French NO in the referendum, which was widely anticipated. We agree also with a view that the result of the referendum will not affect perspectives of Poland's accession to the euro zone. In this regard, much more significant will be domestic economic policy, and Poland's ability to meet Maastricht convergence criteria.

Market monitor



Impulses both foreign and domestic

- Due to awaiting MPC decision on rates, that did not cause any pronounced reaction in the market, the zloty fluctuated under positive technical factors and negative signals from abroad. Finally, however, the zloty gained during a whole week by 0.5% to the euro, but lost 0.4% against the dollar despite Friday's increase induced by the euro rebound in highly illiquid market.
- Next week will rather not bring events that may directly affect the zloty, though one cannot rule out movements in case of data on GDP. Though there will be plenty of important data abroad, that will influence the zloty through the EURUSD rate. Thus we expect the zloty to fluctuate in the range of 4.1-4.2 to the euro and 3.23-3.33 against the dollar.

Labour market will again rivet the attention

- Last week the dollar was gradually losing momentum, though positive signals from US economy was flowing in (US GDP upward revision) and poor data for the euro "supported" by worse and worse opinion polls ahead of referendum. On Friday EURUSD rate bounced back from strong technical support (62% Fibonacci retracement and falling channel support) at 1.25. During a week that dollar managed to advance to the euro by 0.8%.
- Following minor impact from French "No" on EURUSD rate, US releases, i.e. ISM indicators and labour market data (Wed and Fri) will gain importance. Technical picture of the market is euro supportive, though fundamentals might point further dollar's rally. Regardless of that the market will wait for Wednesday's Dutch voting, which given last opinions polls, may worsen the euro performance.

Moderate supply

- Zloty's weakness and unfavourable signals from Hungary even before MPC decision induced many players to take profits mainly in 5y sector. As rates were left unchanged and because of lack of further significant increases in core markets enabled to retain yields at levels slightly higher than a week ago.
- Supply of papers for June should not constitute an important factor affecting the market this week. Value of 2y bond offer is moderate and amid current favourable mood will be probably easily absorbed by the market. Under these circumstances core markets will have substantial impact on long end of the curve, though the short one will rather be constantly supported by conducive inflation prospects.

Volatility is likely to go up

- 10y papers in core markets gained reaching levels close to 4% for US bonds and 3.25% for Bunds. Relative stabilisation in stock exchanges and London based banks' recommendations laid behind it, which exceeded potentially negative impact of sizeable GDP revision in US and relatively hawkish FOMC Minutes from last meeting.
- In the upcoming week bond core markets will wait, likewise FX market, for key data on activity in US manufacturing and services (ISM) and labour market report. Capital markets performance will still affect prices, which, however, following substantial gains may "give up" a driving force to bond markets.

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