

# Weekly economic update

4 July – 10 July 2005

The Monetary Policy Council meeting was the event of last week. Expectations ahead of the meeting were very diversified and while the decision of rate cut by as much as 50 bps with accompanied change in monetary policy bias into easing was taken into account by financial markets participants, it was regarded as the less likely option. Therefore, the announcement of the decision led to quite significant fall in market interest rates across the yield curve (both money market and fixed income). Currently, the market prices-in 25 bps rates reduction within a month and some 50 bps during three months. What will be the next steps in monetary policy? Future moves of the MPC will simply depend on forthcoming economic data. As the MPC wrote in the statement: “the data to be released in the coming months should allow a better assessment of the scale of the expected improvement in economic activity and, in consequence, should determine the scale and period of the adjustment in monetary policy”. In our opinion, next interest rate cut of 50 bps will take place during three months, but not necessarily in July, as indicators of economic activity for June should be much better than in previous month. Additionally, only in August the MPC will get to know important data on investments (in big enterprises for H1), as well as the central bank will prepare new inflation report including medium-term projections of inflation and GDP growth.

Both in the US and in the euro zone several data releases are due for this week with the US non-farm payrolls data as the most important. They should confirm gradual improvement in labour market conditions in the US economy and thus support expectations for further rise in Fed Funds rate. Meanwhile, on Thursday the ECB and the Bank of England will decide on interest rates. It is expected rates will be kept on hold, but it will be important how the central banks will assess outlook for inflation and economic activity.

## Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD	UNIT	FORECAST		LAST VALUE
					MARKET	BZWBK	
<b>MONDAY (4 July)</b>							
09:00	POL	Auction for treasury bills- 52-weeks of PLN600m and 13-weeks of PLN100m (M)					
-	US	Market holiday	-		93.3		92.9
09:00	EMU	PPI (M)	May	%MoM %YoY	-0.1 3.6	- -	0.4 4.2
<b>TUESDAY (5 July)</b>							
09:00	EMU	Retail sales (H)	May	%MoM %YoY	- 0.8	- -	-1.2 -0.9
14:00	US	Factory orders (H)	May	%MoM	3.0	-	0.9
<b>WEDNESDAY (6 July)</b>							
14:00	US	ISM manufacturing (H)	Jun	pts	59.0		58.5
<b>THURSDAY (7 July)</b>							
11:00	UK	Bank of England meeting – decision on rates (M)		%	-	-	4.75
11:45	EMU	ECB meeting – decision on rates (H)		%	-	-	2.0
<b>FRIDAY (8 July)</b>							
12:30	US	Non-farm payrolls (H)	Jun	'000	175.0		78.0

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

**Maciej Reluga** Chief economist (+48 22) 586 8363

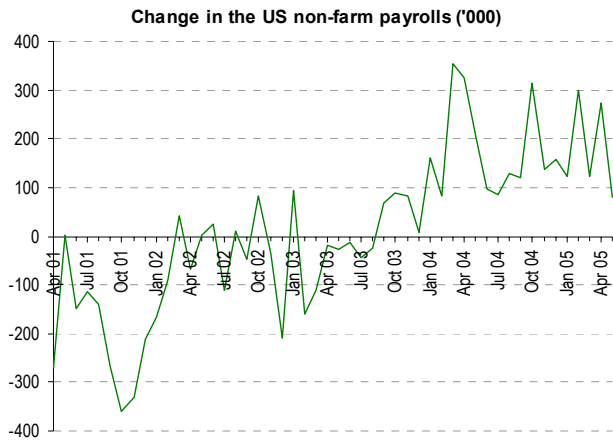
**Piotr Bielski** (+48 22) 586 8333

**Piotr Bujak** (+48 22) 586 8341

**Tomasz Terelak** (+48 22) 586 8342

e-mail: ekonomia@bzwbk.pl

## What's hot this week – No data in Poland, focus on international markets

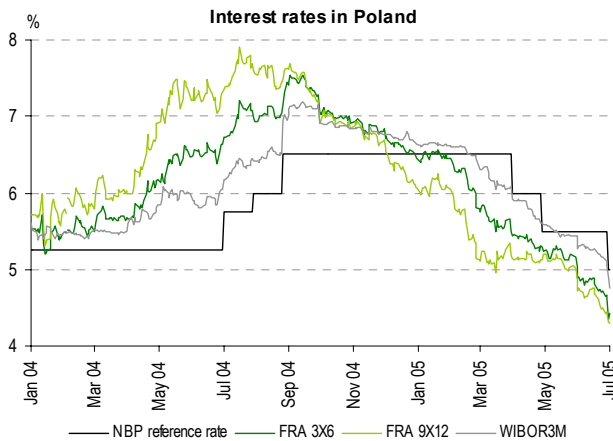


- There are no important data releases scheduled in Poland for this week. Recently deputy finance minister Grzegorz Stanislawski announced that in the first week of July the ministry would present "technical strategy" of the road to the euro zone. However, we think the presentation will take place with some delay.

- The Polish financial market will track developments on the foreign markets. Both in the US and in the euro zone several data releases are due for this week. As usual in the first week of a month the focus will turn to the US non-farm payrolls data. They should confirm gradual improvement in labour market condition in the US economy and thus support expectations for further rise in Fed Funds rate.

- The attention will be also attracted by the ECB decision on rates and the way economic prospects of the euro zone will be evaluated.

## Economy last week – Strong adjustment in monetary policy



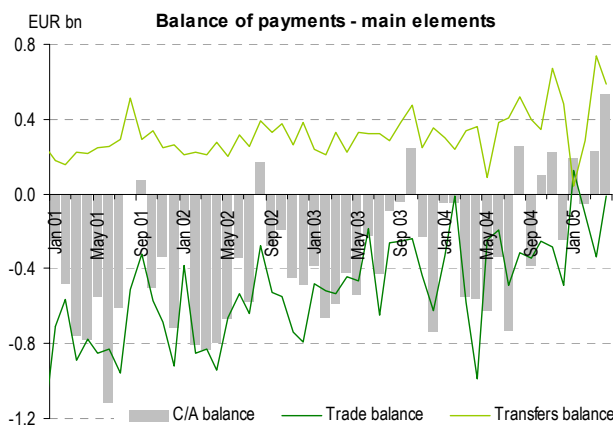
- The MPC has chosen the most "dovish" option (and the least expected as well) among several scenarios considered by the market players.

- In effect, market expectations for more rate cuts have deepened. FRA rates imply that the market expects currently over 50 bps rate cut until year-end.

- Main reason of policy adjustment in June was weak GDP data for 1Q05 (in particular low investment growth).

- Explanation of MPC decision and comments of MPC members at the press conference suggested however, that next cuts are not given and the upcoming data will be important hint to assess how much medium-term scenario of economic situation has changed.

- Subsequent decisions in monetary policy will depend on trends in economic activity, because inflation environment will be very positive anyway.



- Balance of payments figures for April showed much better than expected situation. Current account balance was in surplus, exceeding €0.5bn, while trade deficit reached merely €7m.

- Apart from very low trade deficit, improvement in current account balance resulted also from high net transfers.

- Growth rates of both export and import saw strong slowdown in April (in the case of import, it fell below zero), which resulted from very high base effect. We predict that in subsequent months growth of import and export will be higher, confirming high level of economic activity.

- Almost balanced trade account in April suggested that in the second quarter of 2005 contribution of net export to GDP growth should be significantly positive again.

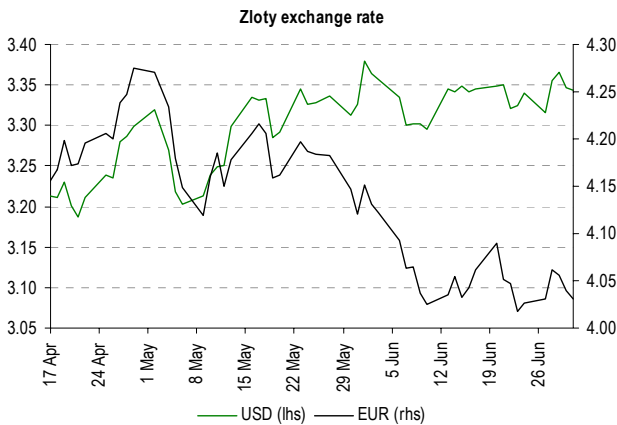
## Quote of the week – No threats for the inflation target

**Halina Wasilewska-Trenkner, MPC member;**  
Radio PiN , 1 July

*There is no threat, neither now nor in the future, that inflation in 2006 and even in 2007 will be much higher than inflation target. [Rate cuts] cannot be ruled out; as the bias in monetary policy suggests, if there are any changes [in policy] they will be rather towards further decline.*

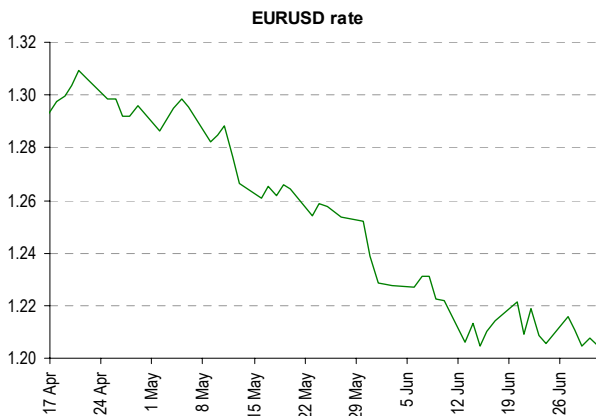
Perspectives of inflation target realisation in the horizon of monetary policy transmission are not threatened in the MPC's view. In such situation, exact level of inflation in the coming months will not be crucial for the Council, and the situation in real sphere of the economy will be more important, as it may affect medium-term economic forecasts. Thus, in our opinion next steps in monetary policy will depend heavily on indicators of economic activity in Poland.

Market monitor



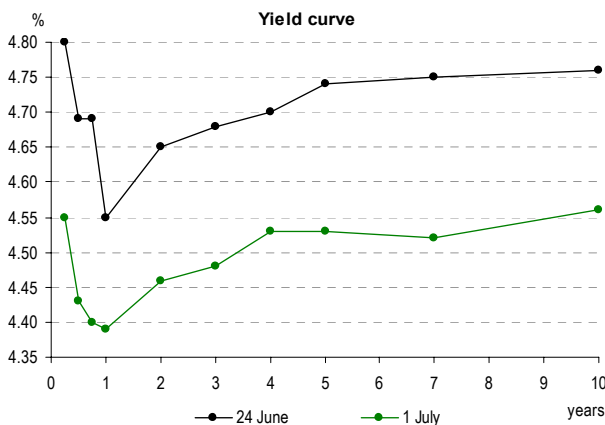
**Deep rate cut, but zloty relatively strong**

- At the beginning of last week, the zloty lost ca. 1% against major currencies, amid closing positions in Polish assets before vote of no confidence in finance minister and MPC’s decision on interest rates.
- Result of voting in Sejm over minister Gronicki’s fate had no impact on the FX market. MPC decision, boosting hopes for scale of rate cuts in the cycle did not harm the zloty, because negative impact of lower interest rate differential was compensated by inflow of capital on the debt market.
- In the coming week the zloty should remain quite stable. Like in the previous week, we foresee it will fluctuate in 3.30-3.40 band against the dollar and 3.97-4.07 against the euro.



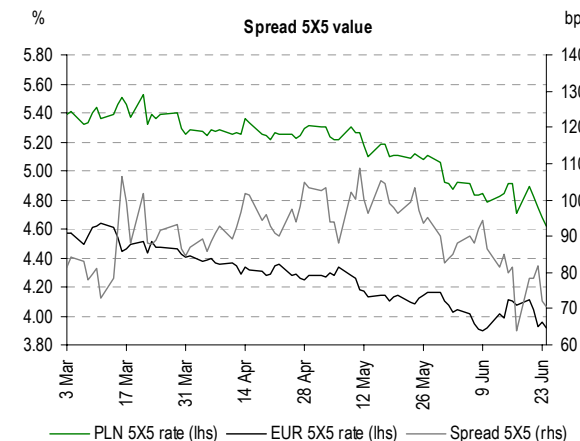
**Dollar continuously pricey**

- Stability of the zloty exchange rate was aided last week by relatively narrow fluctuations of EURUSD.
- The euro started the week with slight strengthening against the dollar, however for bigger change we had to wait until Friday’s afternoon.
- As both the ISM indices and consumer confidence were much better than forecasted, their release triggered sharp dollar appreciation against the euro. EURUSD broke through 1.20 level and fell to 1.192.
- In the coming days, good data about US economy (services ISM and non-farm payrolls) could positively impact the dollar again.



**Yields at new record-lows thanks to the MPC**

- Debt market saw correction at the beginning of last week, connected with profit taking after yields fell to record low levels last Friday and on position closing ahead of MPC meeting.
- MPC decision surprised the market, and pushed yields to new record low levels. Two-year bond concluded week at 4.46%, and five-year paper at 4.53%.
- This week should provide some relief for the market, because first economic data for June that would impact MPC next steps will appear only next week. Market players will thus focus on debt markets in the euro zone (ECB decision) and in the US.



**Foreign debt markets still relatively strong**

- Strengthening on the Polish market was also supported by positive situation on the international markets, as positive sentiment towards debt market was still visible.
- Yields increased abroad only on Friday, after much better than expected data on US economy. Yields of 10-year treasury rose to above 4% , which could have been also driven by closing positions before the long weekend in the US.
- Last week 5X5 spread between the Polish and the European curve fell again. After the MPC decision it decreased below 60bp (the lowest level this year) and Friday’s close was at similar level, though some correction was observed on Thursday.

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Additional information is available on request. Please contact Bank Zachodni WBK S.A. Treasury Division, Economic Analysis Unit, ul. Marszałkowska 142, 00-061 Warsaw, Poland, phone (+48 22) 586 83 63, email [ekonomia@bzwbk.pl](mailto:ekonomia@bzwbk.pl), <http://www.bzwbk.pl>



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