

# Weekly economic update

1 August – 7 August 2005

This week will be calm in terms of domestic events. There will be no macro data releases, and stabilisation on the political scene is also likely. Therefore, the only domestic factors that could impact the results of auction of 2-year bonds scheduled on Wednesday may be comments of MPC members suggesting further moves in monetary policy (but only if they appear this week). The most important information abroad in the coming week will be US non-farm payrolls report for July, to be released on Friday.

In line with expectations, the Monetary Policy Council cut interest rates by 25bp and maintained easing bias in its policy in July. The justification of the decision was also consistent with expectations. The Council said that despite recent upbeat data from real economy, the medium-term inflation outlook remained favourable, leaving room for downward adjustment in interest rates. However, a lower scale of rate cut in comparison with earlier moves shows that rate-setters to a growing extent take into account risk factors. Apart from possible revival in the economy, the main risk factors mentioned by the MPC are high oil prices and uncertainty regarding future fiscal policy. The latter will depend on the outcome of September's parliamentary elections, which means that after very likely, another 25bp rate cut in August, the central bankers will refrain from changing rates for a while.

Retail sales and unemployment figures in June came in stronger than expected. Retail sales grew over 10%YoY, beating the most optimistic market forecasts and the unemployment dropped to 18%, the lowest level in four years. This confirms hopes for faster consumption rise in the second half of the year. Thus, although the data for a single month do not change the medium-term inflation outlook significantly, they call for caution in monetary policy, as higher private consumption may change the expected balance of factors affecting future inflation.

## Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD	FORECAST			LAST VALUE
					MARKET	BZWBK	
<b>MONDAY (1 August)</b>							
14:00	USA	ISM manufacturing (H)	Jul	-	54.0	-	53.8
<b>TUESDAY (2 August)</b>							
09:00	EMU	PPI (M)	Jun	%MoM	0.4	-	-0.2
14:00	USA	Factory orders (H)	Jun	%MoM	0.0	-	2.9
<b>WEDNESDAY (3 August)</b>							
<b>09:00</b>	<b>POL</b>	<b>Auction for 2y bonds OK0807 – PLN2.5-3.0bn (H)</b>					
09:00	EMU	Retail sales (M)	Jun	%MoM	-	-	1.1
14:00	USA	ISM non-manufacturing (H)	Jul	-	61.0	-	62.2
<b>THURSDAY (4 August)</b>							
11:00	GB	BoE meeting – decision (H)	-	%	4.5	-	4.75
11:45	EMU	EBC meeting – decision (H)	-	%	2.0	-	2.0
<b>FRIDAY (5 August)</b>							
12:30	USA	Payrolls (H)	Jul	000	180	-	146

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

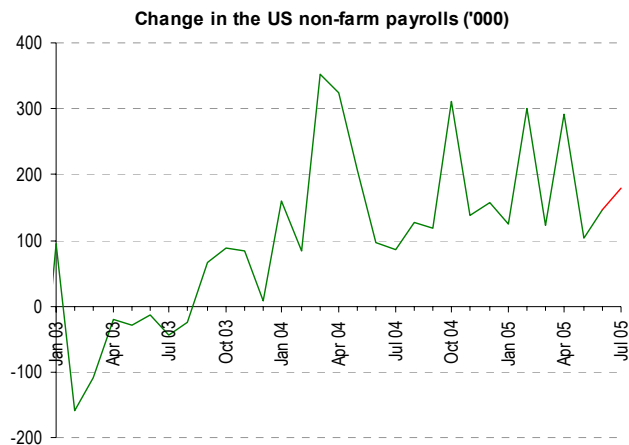
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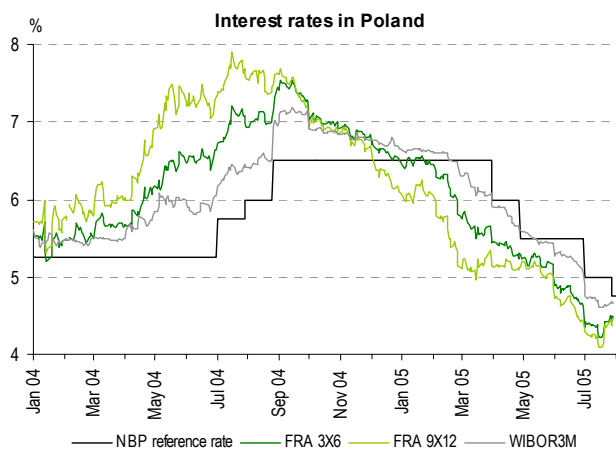
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**What's hot this week** – No events in Poland, watch for US data

- This week there will be no data releases in Poland, and the parliament has just concluded its last working session in its tenure. Thus, the coming days should be a period of relative tranquillity on the Polish financial market. Although, one could not rule out that some comments from the MPC members would appear, influencing market expectations.
- Amid lack of important domestic information, investors' eyes would be turned to events abroad. The most important will be the report on non-farm payrolls in the US, that could impact EURUSD rate, as usually. A solid increase of the number of jobs of 180,000 is expected, which could help in strengthening of the dollar.
- Bank of England is expected to cut borrowing costs by 25 bps this week, while the ECB meeting should conclude with no changes in monetary policy.

**Economy last week** – The MPC did not surprise, the economy did

- MPC reduced interest rates by 25 bps, in line with predictions of majority of analysts and market players.
- In the official communiqué the MPC wrote that “in spite of the fact that data on economic activity in June 2005 proved better than expected and despite higher forecast prices of fuels, the probability of inflation running below the inflation target in the monetary policy transmission horizon still exceeds the probability of its moving above the target”.
- On the next meeting in August, the Council will know not only new projections of GDP and inflation, but also the CSO data about GDP in 2Q05. If GDP growth is consistent with our prediction of slightly below 3%, the next 25bps rate cut in August will be very likely, amid good inflation outlook.
- Subsequent decisions will depend not only on economic data but also on the result of parliamentary election in September.



- Retail sales growth in June topped even the most optimistic market expectations, reaching 10.5%YoY in nominal terms and 8.8%YoY in real terms.
- In most of major branches, sales rose in double digits, i.e. by 22.4% in sales of household appliances, and 27.7%YoY in drugs and cosmetics.
- Unemployment rate was lower than expected and reached 18% in June, the lowest level in four years. The number of unemployed fell almost 8%YoY, while the number of new job offers soared 32%YoY.
- On the other hand, data from CSO's statistical bulletin showed that June's strong rise in wages in enterprises was largely an effect of one-off payments in mining, where average salary upsurged 35%MoM.

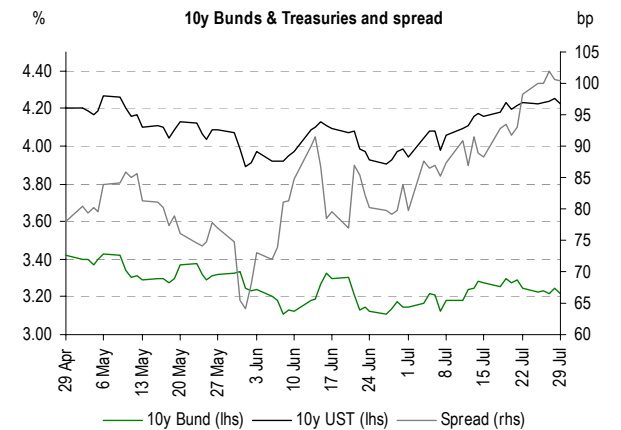
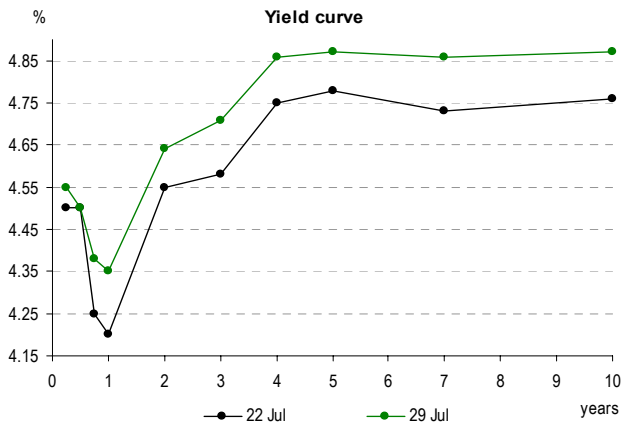
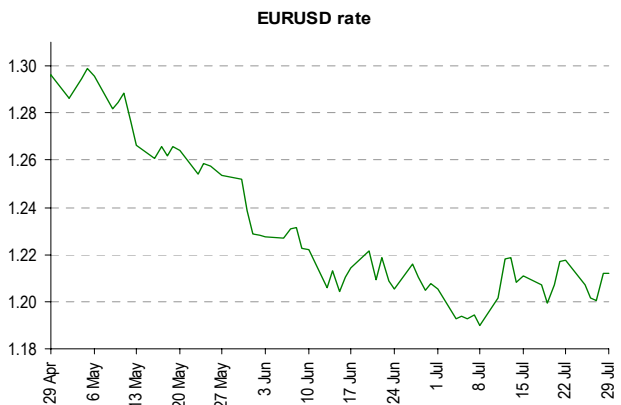
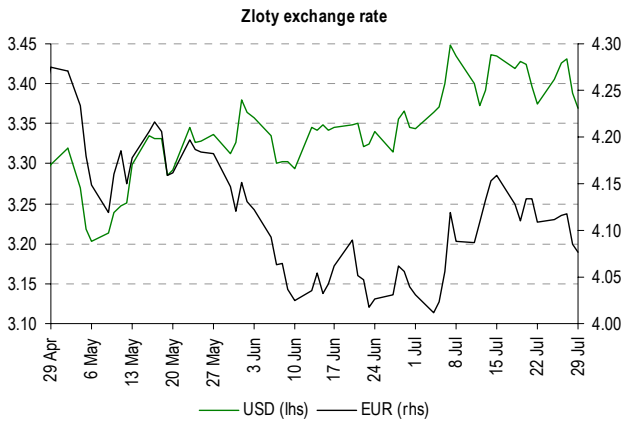
**Quote of the week** – More optimism from economy, but inflation still low

**Jan Czekaj, MPC member; TVN 24, 28 July**

*With big probability we could say that until year-end inflation rate will be below inflation target. Next year inflation also should not exceed the middle of target range (2.5%). On the other hand, several information appeared acting in the opposite direction. We have to wait for confirmation of this trend until data about 2Q05.*

The MPC noticed that strong June's data “may confirm that the economic growth deceleration in 1Q05, signalled by the CSO, is temporary in nature”, although better assessment of a scale of improvement in economic activity will be possible only after publication of data to be released in the coming months. On the other hand, despite higher optimism regarding GDP growth, inflation perspectives will remain very good, which is likely to allow for slight interest rate cut in August.

Market monitor



The market may stay volatile

At the outset of the last week the zloty lost due to sell-off in the bond market after retail sales data that confirmed positive tendencies in the economy. Additionally the decline was compounded by weakening of the euro in core market. Following MPC decision foreign investors returned to the market that finally supported the zloty. During a week the zloty gained almost 1% to the euro, staying virtually unchanged to the dollar.

Next week the zloty will remain under influence of the cross market due to abundance of reports in US. 2y bond tender may have a positive impact owing to the prospect of another interest rate cut. However one should not forget about the volatility that prevails in the market. We expect that the zloty will fluctuate in the range of 4.04-4.14 to the euro and 3.32-3.42 against the dollar.

Breaking from current range looks unlikely

The cross through the majority of the last week fluctuated within a range of 1.20-1.22, not counting short-term falls below lower band. The dollar tended to advance ahead of economic data that however, though pointing to the power of US economy, as a consequence were bringing about a increase of the euro. Strong 2Q05 US GDP data also failed to support the dollar lastingly.

Next week EURUSD market may fluctuate strongly owing to large number of reports from the US and ECB meeting. However it should not break out from recent range of fluctuations 1.20-1.22 ahead of release of crucial data from US labour market due to be published only on Friday.

Bonds should rise

Last week 5y benchmark bond hit two times a level of 4.94%, the first as a result of retail sales data and later owing to switching auction and MPC member comments. Finally at the end of the week were by 8-13 pb higher as compared to previous Friday. The slope of the yield curve did not alter. FRA curve move a bit upwards that means the market till the year-end has priced in slightly more than 50 bp yet.

The outset of the next week will go by with awaiting 2y bond auction. The Ministry may without any difficulty offer the supply close to PLN3bn. Taking into account current attractive levels, the Polish bonds should gain this week. Due to reports in US our papers performance may hinge on bonds abroad.

It will be difficult for foreign yields to rise

Throughout the whole previous week core bond markets awaited a release of 2Q US GDP data actually with no major fluctuations. US economic releases introduced a bit of volatility to the markets, but yields were quickly reverting to original levels. Strong GDP data had a minor impact, as actual growth rate did not differ from analysts' predictions. 5/5y spread between the Polish and euro curves widened from 60 bp to 70 bp owing to yield rises in Poland.

Releases next week will probably confirm favourable conditions of the American economy, but it may not suffice yields to rise, as meaningful part of impact of previous reports is already reflected in prices. However very volatile US employment data may trigger fluctuations at the end of week.

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