

Weekly economic update

29 August – 4 September 2005

Next week will bring many information of key importance for the Polish financial market and two of them will be revealed already on Monday at 1600 local time. First of all, deputies will most likely decide to overturn the presidential veto on the bill allowing for rebate of VAT on construction materials (already decision on calling a special session of the parliament brought negative market reaction). Second, the CSO will publish data on GDP for the second quarter, which may disappoint again, especially as regards domestic demand and thus will most likely strengthen market expectation that the MPC will deliver interest rate reduction on Wednesday. In our opinion, the MPC will cut rates by 25 bp and will also keep easing bias in monetary policy amid low inflationary pressure (as shown by core inflation measures for July) and weaker than expected economic activity (shown by retail sales figure). As a result, market interest rates at the short-end of the curve may decrease, but at the same time negative fiscal news may keep yields at the long-end from falling and steepening of the yield curve, which was observed last week, may be continued. As regards the foreign exchange market, it is possible that the EURPLN rate will break the range we indicated for a couple of weeks (4.0-4.1). Negative information from the parliament may lead to zloty depreciation to above 4.1 against the euro, although it is worth to notice that a possibility of selling foreign exchange currency on the market by the Ministry of Finance, as well as positive (from market perspective) results of opinion polls ahead of elections, limit a room for zloty weakening.

Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
MONDAY (29 August)							
14:00	POL	GDP (H)	2Q05	%YoY	2.7	2.8	2.1
14:00	POL	Fixed investments (H)	2Q05	%YoY	4.0	5.0	1.0
14:00	POL	Private consumption (H)	2Q05	%YoY	1.6	1.5	1.7
TUESDAY (30 August)							
14:00	US	Consumer confidence (H)	Aug	pts.	102.0	-	103.2
14:00	GER	Factory orders (H)	Jul	%MoM	-0.1	-	1.4
WEDNESDAY (31 August)							
-	POL	MPC meeting – decision on interest rates (H)	-	%	4.5	4.5	4.75
09:00	EMU	GDP – final (M)	2Q05	%YoY	-	-	1.4
09:00	EMU	HICP – flash (H)	Aug	%YoY	-	-	2.2
12:30	US	PCE (H)	2Q05	%	-	-	3.3
12:30	US	GDP – preliminary (H)	2Q05	%	3.4	-	3.4
14:00	US	Chicago PMI (H)	Aug	pts.	62.0	-	63.5
THURSDAY (1 September)							
11:45	EMU	ECB meeting – decision on interest rates (H)	-	%	2.0	-	2.0
14:00	US	ISM manufacturing (H)	Aug	pts.	57.0	-	56.6
FRIDAY (2 September)							
09:00	EMU	Producer prices (M)	Jul	%YoY	-	-	4.0
12:30	US	Non-farm payrolls (H)	Aug	'000	188.0	-	207.0

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

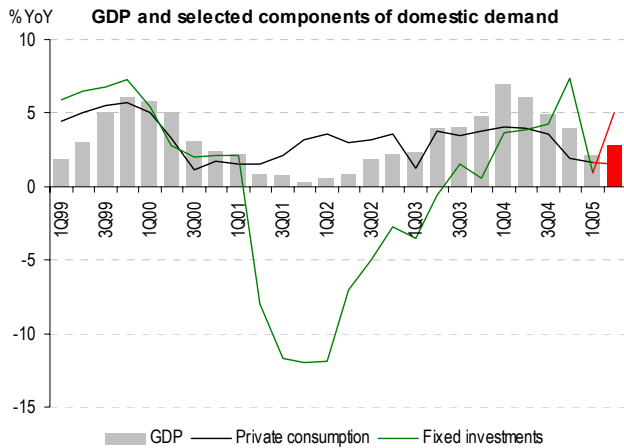
Maciej Reluga Chief economist (+48 22) 586 8363

Piotr Bielski (+48 22) 586 8333

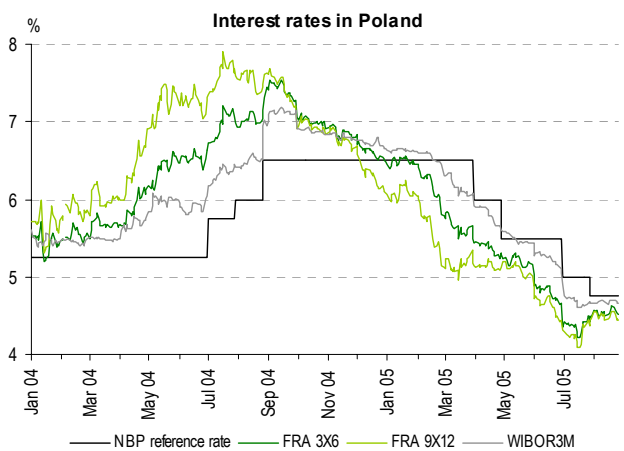
Piotr Bujak (+48 22) 586 8341

e-mail: ekonomia@bzwbk.pl

What's hot this week – Rate cut expected after GDP release

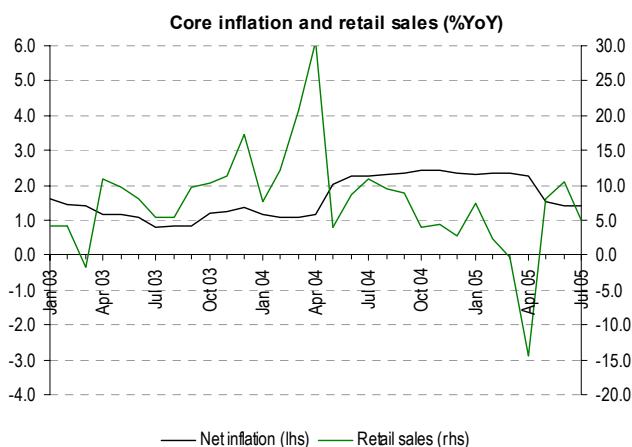


- The last piece of information important for the MPC ahead of the Tue-Wed meeting will be 2Q data on GDP.
- While we expect GDP growth to accelerate to 2.8%, this does not change our view of rate cut by 25bp in August, especially as recent comments of CSO representatives and finance minister suggested some risk on the downside.
- The most important, in our opinion, will be data concerning domestic demand. Despite expected acceleration (from 1.1% to 1.6%YoY), it is hard to call such growth a hawkish argument. We expect stronger investments, but weaker private consumption.
- We forecast positive net exports' contribution to be higher as compared to 1Q result (above 1 percentage point).
- We still expect economic growth of above 4% in the second half of the year.



- Market analysts are not unanimous as regards MPC decisions, both on rates and monetary policy bias.
- Important information for the MPC (besides economic data, which in our opinion support a cautious rate cut) will be inflation and GDP projection of the NBP staff. This will be published only after MPC decision, which makes forecasting decision more difficult. However, we do not expect a significant increase in projected inflation, and expected GDP growth may be even lower than forecasted a quarter ago.
- We expect the MPC to maintain easing bias in monetary policy, although we do not expect another rate cut in the following months (September-October).
- We think that the MPC will not risk a premature change in bias into neutral, after a mistake they made in April. Still, it will be interesting to see voting results of the MPC in 2Q, which will be also published in the *Inflation report*.

Economy last week – Low growth in sales, low core inflation



- In July retail sales increased by 5%YoY nominally, (3.2% in real terms), which was below market consensus of 7.4%.
- July's retail sales data (as well as output figures released last week) confirmed that the Polish economy started the 3Q with accelerating growth as compared to H1, although the pace of improvement was weaker than expected.
- Net inflation was stable at 1.4% in July. All core inflation measures are not only below the NBP target (2.5%), but below the tolerance band around the target (1.5%). This is undoubtedly one of arguments supporting rate cut at the next MPC meeting.
- In July unemployment rate fell below 18% (by 0.1 pp to 17.9%) for the first time since August 2001. For the second consecutive month, the unemployment rate fell in annual terms by 1.4 pp. The number of unemployed was at 2.8 millions in July, which was 7.7% lower than a year ago.

Quote of the week – A room for small rate cut

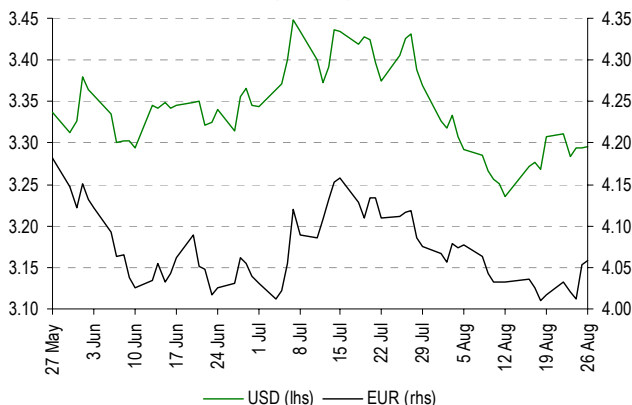
Andrzej Wojtyna, MPC member; Reuters, 23 August

As long as gross domestic product in the second quarter was not clearly above expectations of around 2.8-2.9 percent, I would not rule out a small, single cut in rates in the next two months. (...) A recession gap was not closed and we have a safety cushion as regards non-inflationary growth (...) The inflation projection may show somewhat higher inflation, but over its duration, the rise of CPI rather should not exceed the middle of the (1.5-3.5 percent) range.

Last week we saw three interviews with MPC members (Czekaj, Filar, Wojtyna). Views of the two first of them were easily predictable, but it was important what moderate MPC members, such as Andrzej Wojtyna, think. He said that the economy was growing below its potential (non-inflationary) pace, which leaved room for the central bank to cut rates again. This statement reinforced market expectations for rate reduction next week.

Market monitor

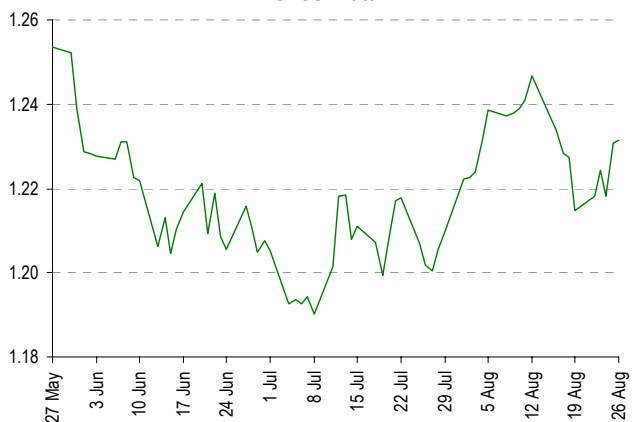
Zloty exchange rate



Zloty lost on worries about next budgets

- Last week, the zloty exchange rate was moving inside ranges indicated by us a week ago. A positive factor was improvement in sentiment towards the region with simultaneous outflow of funds from Hungary (the beginning of the week) while a negative factor was bad fiscal news at the end of the week. All in all, the zloty fell throughout the week, mostly to euro as the EURUSD rate rose abroad.
- We predict that this week the EURPLN will range between 4.02 and 4.12, and USDPLN will be in 3.26-3.36 range. A pressure on the zloty weakening will stem from fears of fiscal outlook worsening. On the other hand, the zloty will be supported by a possible continuation of foreign currency sales by the FinMin and positive results of public opinion polls.

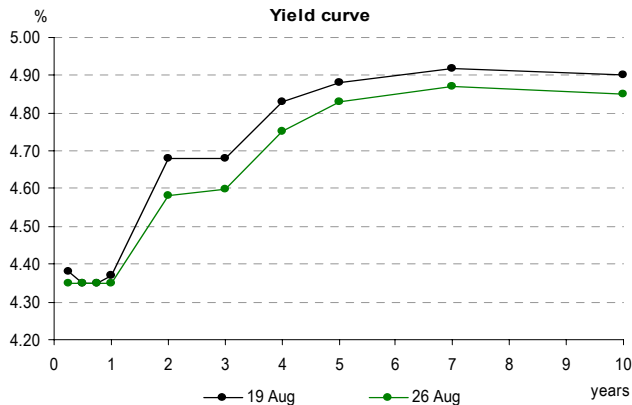
EURUSD rate



Dollar lost on worries about the economy's strength

- Last week was good for the euro. Initially it gained on much higher than expected ZEW index and then on dollar's weakness following the release of weaker than expected durable goods figures. On Wednesday, the EURUSD exceeded 1.23 and stayed above this level until the end of the week.
- In the upcoming week the EURUSD rate may be very volatile due to a large number of important events abroad. The key focus of attention will be data indicating prospects for interest rates in the US and euro zone. The former will be indicated by a series of crucial data, including GDP figures for 2Q05 and monthly non-farm payrolls numbers. ECB is widely expected to leave rates on hold, so the decision would not affect the market.

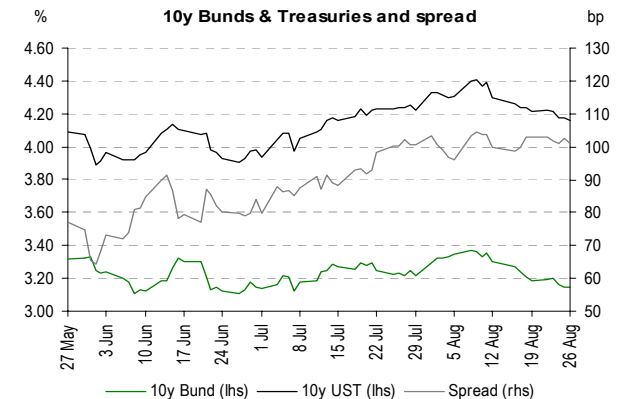
Yield curve



Mixed feelings on the domestic debt market

- The domestic debt market, likewise the zloty, reacted to negative fiscal news. Thus, while in the first part of the week the yield curve was moving downwards thanks to rising hopes for rate cut in August (after weaker than expected data on retail sales in July) and comments from MPC's Wojtyna, the last two days of the week brought a rise in yields, particularly at the longer end of the curve.
- This week, participants of the domestic interest rate market will wait for the MPC decision and the new projection of inflation and GDP. Before decision on rate, the market may be affected by GDP figures for 2Q05, which will be important hint as regards next moves of the MPC.

10y Bunds & Treasuries and spread



Rise in bond prices abroad

- Last week, bond prices in the euro zone reached the highest level in 7 weeks after Ifo index for August fell behind expectations. However, at the end of the week a correction took place due to data on much higher rise in euro zone's money supply in July. Prices of US Treasuries were also rising last week, particularly after weaker than predicted data on durable goods.
- This week will bring many important data publications in the US. There will be also ECB meeting. As regards the latter, there is no doubt that rates will be kept unchanged, but market participants will analyse wording of the ECB in search of hints regarding possible moves in rates in future.

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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, <http://www.bzwbk.pl>



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