

# Weekly economic update

19 September – 25 September 2005

The last and the nearest week will bring together almost the whole set of monthly data and will set market expectations regarding an outcome of the nearest MPC meeting scheduled on 27-28 September. Last week, the most important for the market were data on inflation and average wage in the enterprise sector. While the former were some disappointment for the market (although the structure of price growth did not bring alarming signals as regards inflation outlook), weaker than predicted data on wages in firms were very warmly welcomed by the interest market and brought about intensification of expectations for another reductions in official rates and drove market interest rates significantly down to new lows. Poland attracted actually large amount of capital flows last week, both on the fixed income market and on the equity market, where every day of the week saw new records. The zloty benefited from that tendency and reached the strongest level to the euro in three years. The question arises how the market will be affected by the data which will be revealed this week. According to our forecasts, economic activity indicators for August (industrial and construction output as well as retail sales) will be pretty good which may be a reason for a correction on the interest rate market or it will at least prevent market rates from further falls. If the data are not worse than expected, market participants may recall words of MPC members from last week (mostly of Andrzej Wojtyna, but also of Jan Czekaj). They stressed in their comments that maintaining easing bias in monetary policy does not mean automatically the next rate cut at the next policy meeting. We do not expect a rate cut this month.

An indirect impact on the Polish market may be expected this week from important events abroad. The most important will be market's reaction to an outcome of general election in Germany and interpretation of Tuesday's Fed decision on rates and its justification.

## Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
<b>MONDAY (19 September)</b>							
09:00	POL	Auction of T-bills 52-week of PLN400m and 13-week of PLN100m (M)					
14:00	POL	Industrial production (H)	Aug	% YoY	4.8	7.5	2.6
14:00	POL	PPI inflation (H)	Aug	% YoY	0.1	0.1	0.0
<b>TUESDAY (20 September)</b>							
09:00	US	ZEW index (H)	Sep	pts	45	-	50
18:15	US	FOMC decision on Fed fund rate (H)		%	3.75	3,75	3,50
<b>WEDNESDAY (21 September)</b>							
09:00	POL	Auction of 5-year bonds of PLN1.8-2.8bn (H)					
08:00	EMU	Current account (M)	Jul	€ bn	-	-	-2,5
<b>THURSDAY (22 September)</b>							
08:00	POL	Retail sales (H)	Aug	%YoY	6.2	6.9	5.0
08:00	POL	Unemployment rate (H)	Aug	%	17.8	17.7	17.9
14:00	POL	Net inflation (H)	Aug	%YoY	1.3	1.3	1.4
14:00	POL	Business climate indices (M)	Sep	pts	-	-	-
09:00	EMU	Industrial orders (M)	Jul	% YoY	-	-	4.9
14:00	US	Leading indicators (H)	Aug	%MoM	-0.3	-	0.1

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

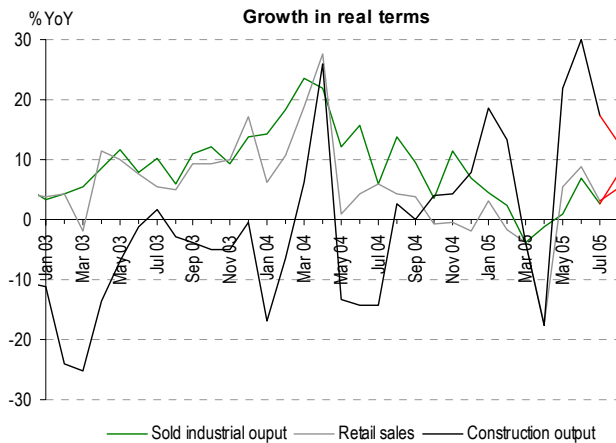
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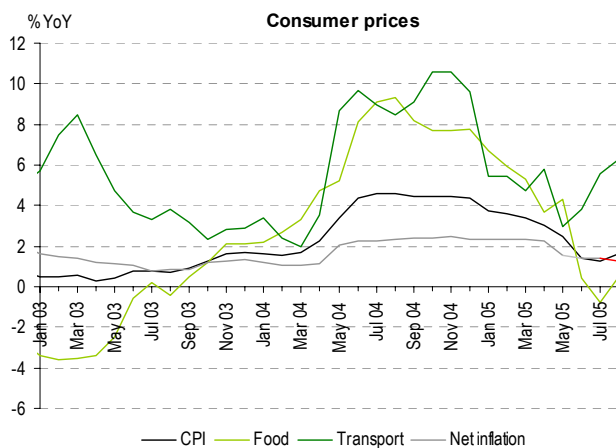
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## What's hot this week – Focus on economic activity indicators

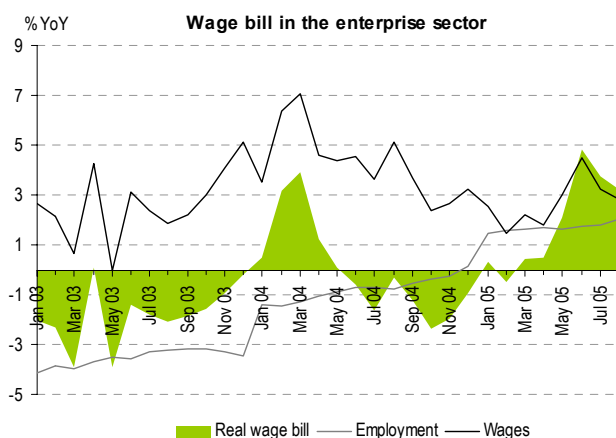


- The feature of this week will be publication of economic activity indicators for August.
- As inflationary pressure seems to be subdued, which should be confirmed by PPI data on Monday and core inflation measures on Thursday, the market has paid more attention to the condition of the real economy for some time.
- We predict that results of the Polish economy in August (industrial and construction output as well as retail sales) were pretty good, which together with higher than expected CPI for August may cool down expectations of another rate cut already in September.
- Meanwhile, unemployment data and results of business climate survey (Thursday) should not affect the market, although they are set to confirm the Polish economy is in better and better shape.

## Economy last week – Higher inflation, but weaker wage growth



- CPI inflation in August reached 1.6%YoY, matching our forecast and exceeding market expectations by 0.1pp.
- While the scale of inflation acceleration was some disappointment for the market, the structure of price growth seems quite favourable. Apart from expected strong rise in transport prices (an effect of record high fuel prices) and lower than last year drop in food prices, prices of other components of consumer basket showed stability or even declines (in case of clothes and footwear).
- This indicates that there are no substantial sources of inflationary pressure currently, including indirect effect of very high fuel prices.
- Monetary statistics for August were also not alarming in terms of inflation outlook. Although money supply growth was decent, weak growth in corporate borrowing suggests one can still hardly talk about strong investment rebound.



- While a slight acceleration in wage growth in the enterprise sector in August was expected, the data showed slowdown and this was positively perceived by the market in terms of future inflation.
- At the same time, a stronger than expected acceleration in employment growth was noted, which allowed for a solid rise in wage bill in the enterprise sector. Thus, one may still optimistically look at prospects for consumption demand growth in 3Q05.
- Besides, last week we received again good news on this year's budget (it seems sure that budget gap in 2005 will be a few billion zlotys lower than planned) and balance of payments. After July, Poland recorded a surplus in cumulative 12-month C/A balance, for the first time since 1995. It amounted to 0.1% of GDP and we expect it may rise further in future due to excellent export performance.

## Quote of the week – Trying to cool down expectations of another cut in September

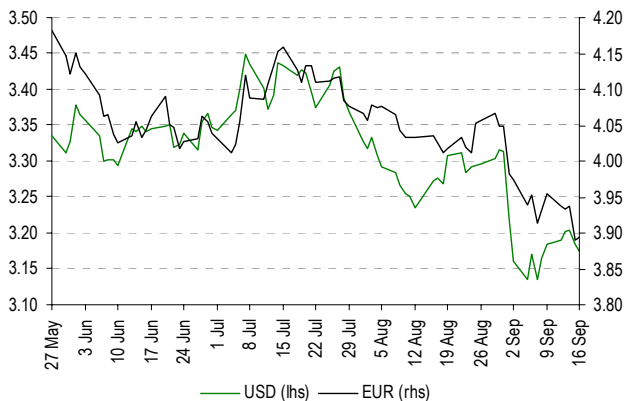
**Andrzej Wojtyna, MPC member; PAP, 14 Sep**

*Maintaining of easing bias does not mean that there will be rate cuts for sure, and there is certainly no such automatism as regards the next meeting. (...) If consumption demand is still weak, and the pace of investment growth is still around 5%, it will mean that the process of closing output gap delays. Then, the balance of risks will change and there will be a reason for lowering interest rates. .*

Despite easing bias, the nearest months may not see another rate cuts, unless upcoming macro data significantly change balance of risks for future inflation. Until now, the Council has been always reducing interest rates with easing bias in place. Therefore, the lack of rate cut in September would be a new situation for the market and it would teach market participants that easing bias does not mean automatically a rate cut at every policy meeting.

## Market monitor

Zloty exchange rate

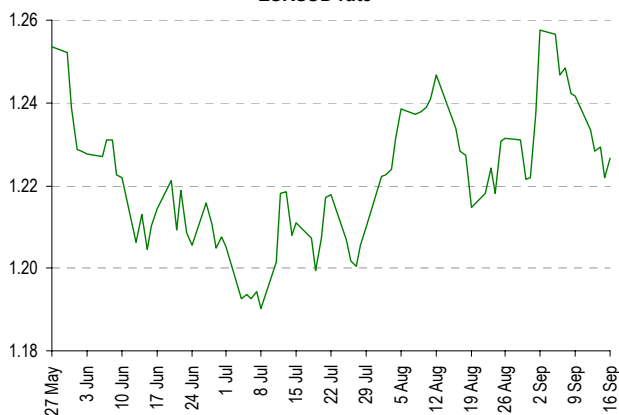


## Huge capital inflow at the end of the week

At the beginning of the week the zloty weakened and it was even worse than expected data on current account. However, after some stabilisation, a sharp appreciation of the zloty started on Thursday. It was connected with large inflow of foreign capital on the fixed income and equity (inter alia IPO of PGNiG) markets. Breaking psychological barrier at 3.90 against the euro caused a further move to below 3.88.

While the USDPLN rate was above the range we indicate last week only for a while, we did not expect such significant EURPLN move. For this week we maintain fluctuation band for USDPLN at 3.10-3.20 and we lower the range for EURPLN to 3.85-3.95. As opinion polls are not likely to change, market won't price-in higher election risk.

EURUSD rate

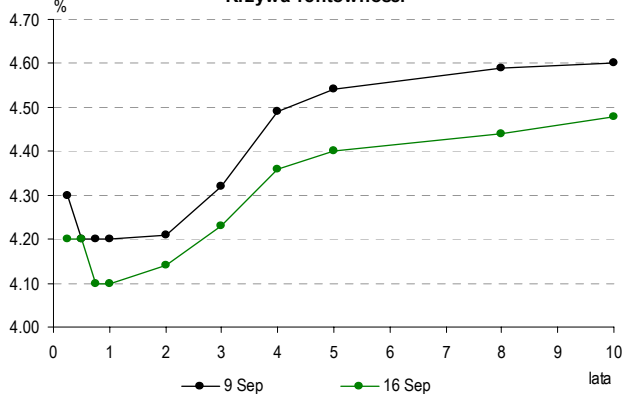


## EURUSD roughly stable

At the beginning of the week the dollar strengthened (to above 1.23), which was connected with the fact that Japan's PM Koizumi won a landslide victory in general election and the yen has hit a two-week high versus the euro. As the euro has been subject to a bout of jitters, with increasing uncertainty about the outcome of the German elections, the slide in the euro helped to lift the dollar, leaving it little changed against the yen.

During the rest of the week the euro appreciated again (even to below 1.22). In the following days EURUSD market will be driven by the outcome of German elections as well as a result of FOMC meeting on Tuesday (continuation of hikes forecasted expected). We still expect EURUSD to be traded in 1.20-1.25 range.

Krzywa rentowności

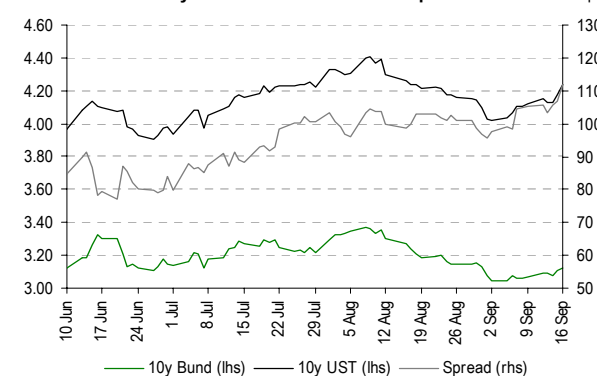


## Market rates substantially down

At the beginning of the week interest rate market players were awaiting inflation data, while it turned out higher than expected, the market strengthened significantly. It was driven by the fact that net inflation probably fell in August, while corporate wages data were weaker than expected. Polish yields reached record-low levels of 4.14% for two-year bond and 4.40% for five-year bond. FRA market moved down by 10-15 bp during the week.

Quiet hawkish statements of MPC members were ignored by the market and it seems that the only factor, which may bring a correction are releases of economic data this week, as we expect both production and retail sales to be above market consensus.

10y Bunds &amp; Treasuries and spread



## ... in spite of rising yields abroad

Strengthening on the Polish interest rate market was observed despite rising yields on the international markets. Yield of ten-year bund reached 3.12%, while ten-year Treasuries were traded at around 4.25%. During the week rise in Treasuries' yields (of some 12 bp) was more significant than that of Bunds, which brought the spread between the two papers rose to above 110 bp.

As a result of changes on the Polish and international markets, spread 5X5 between the Polish and euro curve fell considerably and reached the lowest level for many months of only slightly above 50bp. It seems that fiscal policy risk after election is perceived by investors as very moderate.

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