Bank Zachodni WBK

Weekly economic update

26 September – 2 October 2005

According to results from 60% of districts already counted, the Law and Justice (PiS) won the general election in Poland receiving 26.6%of votes, with a slight lead over the Civic Platform (PO) that obtained 24.1% support. The results are a negative surprise for the financial market. Not only the PiS rather than the PO that will have predominant position in the new government, but also the entire coalition will probably have smaller majority in the Sejm than was suggested by pre-election polls (below 2/3 of seats that is required to change the Constitution). Thus, the week started with a correction on the Polish financial market. Uncertainty is likely to stay for at least few weeks, however it seems further weakening should not be excessively strong.

Although at the beginning of the week market sentiment will be driven by election result, the Monetary Policy Council's decision on interest rates will be crucial in the middle of the week. Similarly to majority of expectations, we do not expect rate cut, as in our opinion the economic situation did not change much since the previous MPC meeting. Last week's data showed mixed signals (retail sales higher than expected, while industrial output lower), although it has to be stressed that inflation measures still did not show demand-side pressure on prices. In our opinion, the MPC may take the liberty of not cutting rates (and keeping easing bias), which would allow not only for better assessment of economic situation, but also for better understanding of economic programme of new cabinet and adjusting monetary policy to this strategy. The recent zloty fluctuations should not be critical for the MPC decision, as two members of the Council (whose votes are the key for MPC decisions) said: „up-to-date the scale of appreciation did not pose a threat to stabilisation of inflation" (Sławiński) and "short-term zloty movements should not be a key factor influencing MPC decisions" (Wojtyna).

Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (19 September)					
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**
		TUESDAY (20 September)					
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
		WEDNESDAY (21 September)					
09:00	**POL**	**Auction of 5-year bonds of PLN1.8-2.8bn (H)**					
08:00	EMU	Current account (M)	Jul	€ bn	-	-	-2,5
		THURSDAY (22 September)					
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)igh, (M)oderate; Source: Parkiet Reuters, BZ WBK

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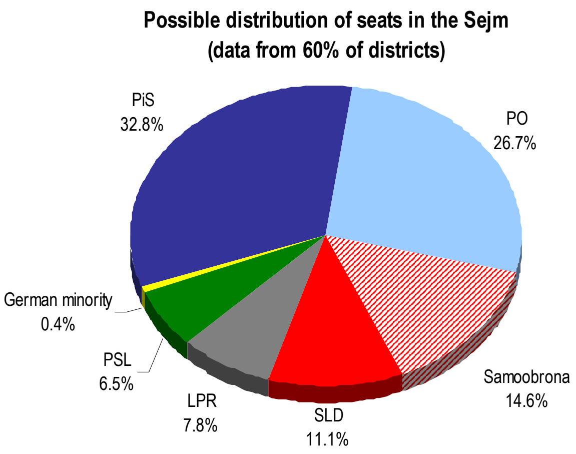
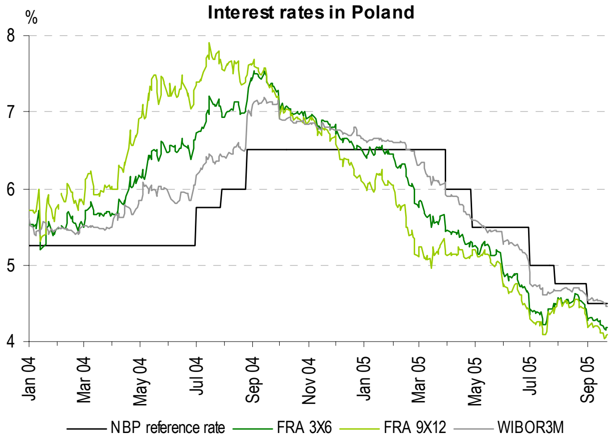
What's hot this week – Markets to be influenced by election result and MPC decision

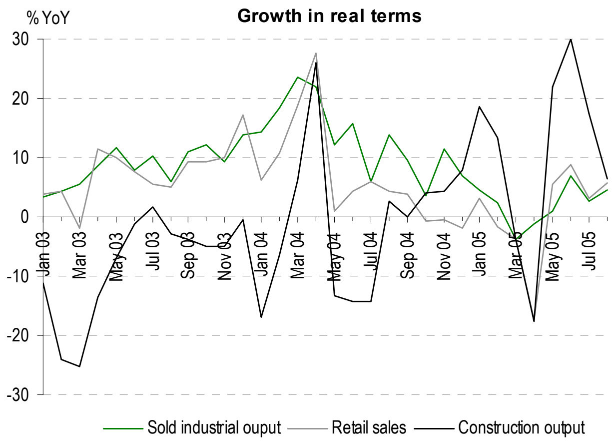


- Election results from 60% of districts showed PiS in the lead with 26.6% of votes, just before PO (24.1%), which suggests the coalition of the two parties should get ca. 274 seats in the Lower House of the parliament.
- This week, financial markets will await signals from politicians as regards details on forming a new cabinet, new ministers responsible for economic policy and the shape of economic programme.
- Last week, PO leader Jan Rokita said that decisions as regards the next year budget will be announced 2-3 weeks after formation of the new cabinet. However, there is a risk that the government may be formed only a few weeks after election, especially as we are in the middle of presidential electoral campaign.
- Extending period of uncertainty would not be favourable for the Polish market.



- Although at the beginning of the week market sentiment will be driven by election result (weakening and a period of uncertainty), the MPC decision on interest rates will be crucial in the middle of the week.
- Similarly to majority of expectations, we do not expect rate cut, as in our opinion the economic situation did not change much since the previous MPC meeting.
- Last week's data (details below) showed mixed signals, although it is worth to remind that corporate wages growth published earlier was weaker than expected.
- In our opinion, the MPC may take the liberty of not cutting rates (and keeping easing bias), which would allow not only for better assessment of economic situation, but also for better understanding of economic programme of new cabinet and adjusting monetary policy to this strategy.

Economy last week – Balance of risks did not change much



- While industrial output growth of 4.6%YoY was lower than market forecast, retail sales increase of 7.9%YoY was above expectations. Therefore, economic activity data should be rather neutral from monetary policy point of view.
- Data on unemployment (both monthly and quarterly) showed continuation of improvement, which was expected.
- Rapid fall in underlying inflation observed for several months to has been brought to a stop, which may be an argument in favour of keeping rates on hold.
- The only important surprise from economic data was PPI inflation, which showed prices' fall of 0.1%YoY (while a growth of the same scale was expected), which demonstrated that high fuel prices did not influence prices of other goods, as for now. Will this be enough to cut rates this week given a continued growth in oil prices?

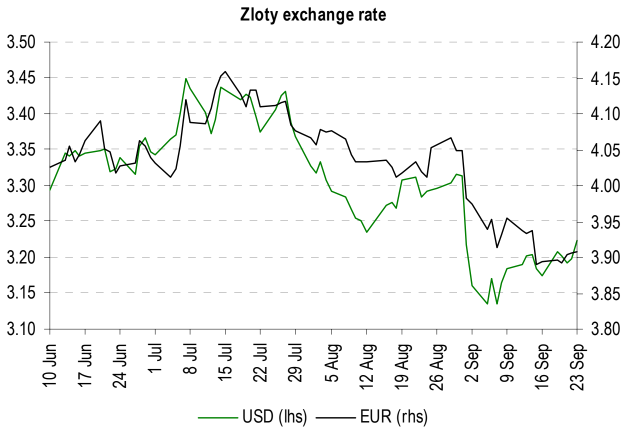
Quote of the week – Up-to-date appreciation not a threat

Andrzej Sławiński, MPC member; PAP, Reuters 21 Sep.

Despite economic recovery is still disappointing, the situation is developing in a way consistent with our latest forecast. (…) If strong zloty appreciation takes place, this could influence the output gap and thus inflation. However, up-to-date the scale of appreciation did not pose a threat to stabilisation of inflation. (…) The easing bias still appropriately reflects the situation of the economy and prospects for inflation.

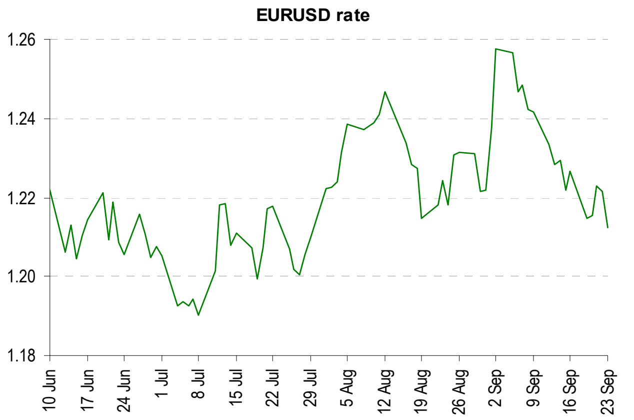
The factor, which could have potentially improved the balance of risks for future inflation perceived by the MPC was zloty appreciation. However, as professor Sławiński stated, a scale of strengthening did not create a threat for inflation stabilisation and therefore – even if it continues – should not tip the scales in favour of a cut already this month. At the same time, easing bias is appropriate amid a possible further zloty appreciation in case of deep economic reforms of new cabinet.

Market monitor



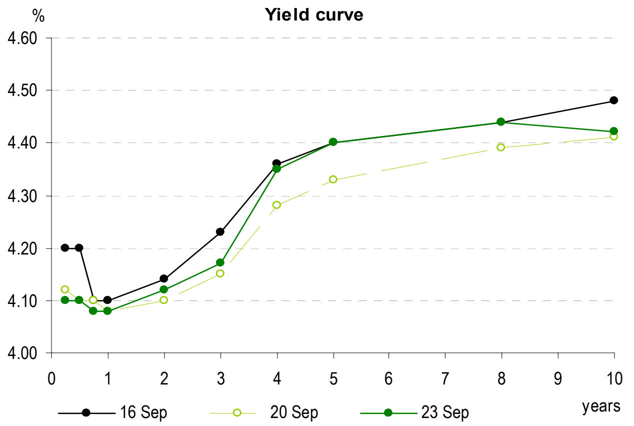
Great optimism followed by caution

- Last week started very well for the zloty, being supported by rising investors' optimism re election results and strengthening hopes (especially after weak output and PPI data) for rate cut in September. In the second half of the week a temporary correction took place, however in the end the zloty reached slightly above 3.88 to the euro and 3.21 to the dollar on Friday evening, returning to previous week's close levels.
- Disappointing for the market election results and uncertainty regarding shape and policy of new government will hurt the zloty this week. Currency fluctuations could be significant amid politicians' comments and proposals about future economic strategy. We predict the zloty to trade within 3.85-3.95 range against euro and 3.18-3.28 against dollar.



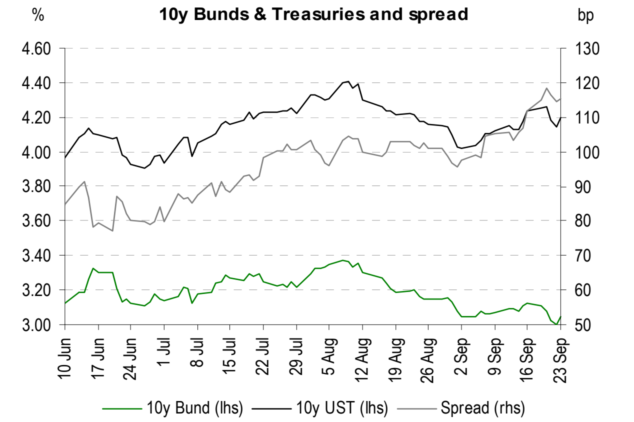
German election and hurricane crucial for market

- . At the beginning of last week the most significant for EURUSD exchange rate were German election results. Lack of clear winner and concerns about possible problems with government establishment pushed the euro below 1.22. In the next days this move was pared partly amid rising fears about impact of Hurricane Rita approaching the USA, however at the end of week the dollar gained again, going to 1.21 – the strongest level in two months.
- After the effects of Hurricane Rita proved to be weaker than feared indeed, the dollar strengthened on Monday morning to 1.2010. Markets will be looking to see if the euro can hold the 1.20 level over the coming days.



Correction after record gains

- Optimistic polls and weaker than expected data about production and PPI clearly strengthened Polish debt market, where yields plummeted to the record low levels. Next days brought significant correction amid profit taking, a bit worse poll results and higher than predicted growth in retail sales; still, the market remained relatively firm.
- Political uncertainty after election will be negative for Polish debt market this week. However, equally important will be the MPC's meeting. We do not expect interest rate cut this week, however the content of the Council's official statement could be an important hint for the fixed income market.



… in spite of rising yields abroad

- Another 25 bps interest rate hike in the US was not a surprise for the financial market. However, directly after Tuesday's Fed decision yields of American Treasuries rose to 4.29%. Still, the reaction was short-lasting and in the following days yields saw drop by ca. 10 bps amid wave of fears about possible impact of Hurricane Rita. At the same time, Bund's yields fell even deeper (reaching the historical lows close to 3%) and in effect the spread between German and American papers rose to 115 bps.
- This week started with rise in yields on global markets after weaker than expected impact of hurricane and resulting drop in oil prices.

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