

Weekly economic update

10 October – 16 October 2005

In line with expectations, a second turn will be needed to settle the presidential election. PO candidate Donald Tusk won with slight advantage over PiS candidate Lech Kaczyński. Thus, we are likely to face a continuation of tough campaign between the candidates and delayed formation of the new government. Political uncertainty will stay with us and affect the market for the nearest two weeks.

The better part of this week will be probably similar to last one – market participants will be awaiting publication of new economic data, final conclusion of presidential election and more precise information about functioning and policy of the new government. Kazimierz Marcinkiewicz, candidate for prime minister, promised to present today major points of the programme of the cabinet he wants to head. However, it is hard to say to that extent his ideas would be binding, considering that serious talks with the PO about coalition programme have not taken place yet. Still, this could be some hint regarding economic plans of the future prime minister.

The most important data release this week will be inflation figure, expected to show modest rise to 1.7%YoY (Ministry of Finance foresees even 1.9%!) amid high prices of fuel and food. We do not expect to see signals of building demand-side pressure on prices in the data. Money supply figure is likely to show continuing acceleration in M3 growth to 11.6% in September amid improving growth in loans – mostly for households – and deposits, which reflects expanding economic activity in the second year-half. Balance of payments data for August could be hard to predict this time, due to substantial revision made by the NBP last week, after taking into account information about foreign investors' reinvested profits. We estimate that August saw slight surplus on the current account (€190m), after €302m (revised) deficit in July. It was achieved thanks to surpluses in current transfers and services account, while income balance and trade account recorded deficits. Both exports and imports should retain fairly high growth rates, at 12.5%YoY and 10.4%YoY correspondingly.

Economic calendar

| Time GMT | COUNTRY | INDICATOR (importance level*) | PERIOD | | FORECAST | | LAST VALUE |
|-------------------------------|---------|---|--------|------|----------|-------|------------|
| | | | | | MARKET | BZWBK | |
| WEDNESDAY (12 October) | | | | | | | |
| 09:00 | POL | Auction of 10-year bonds DS1015: PLN1.5-2.5bn (H) | | | | | |
| THURSDAY (13 October) | | | | | | | |
| 12:30 | US | Export prices (M) | Sep | %MoM | - | - | - |
| 12:30 | US | Import prices (H) | Sep | %MoM | 1.0 | - | - |
| 12:30 | US | Trade balance (H) | Aug | \$bn | -59.0 | - | -57.94 |
| 14:00 | POL | Current account balance (H) | Aug | PLNm | 12 | 190 | -302 |
| 18:00 | US | Federal budget (H) | Sep | \$bn | - | - | 24.61 |
| FRIDAY (14 October) | | | | | | | |
| 12:30 | US | CPI (H) | Sep | %YoY | - | - | 3.6 |
| 12:30 | US | Retail sales (H) | Sep | %MoM | 0.3 | - | -2.1 |
| 13:15 | US | Capacity utilization (H) | Sep | % | 79.6 | - | 79.8 |
| 13:15 | US | Industrial output (H) | Sep | %MoM | -0.4 | - | 0.1 |
| 13:45 | US | Michigan sentiment index – preliminary (H) | Oct | pts | 79.0 | - | 76.9 |
| 14:00 | POL | CPI (H) | Sep | %YoY | 1.8 | 1.7 | 1.6 |
| 14:00 | POL | Money supply (M) | Sep | %YoY | 11.7 | 11.6 | 11.2 |

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

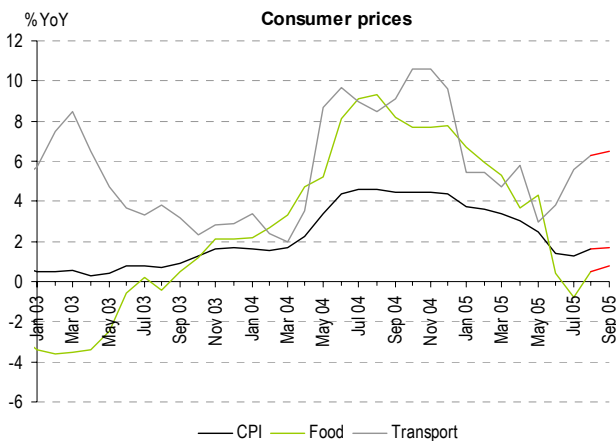
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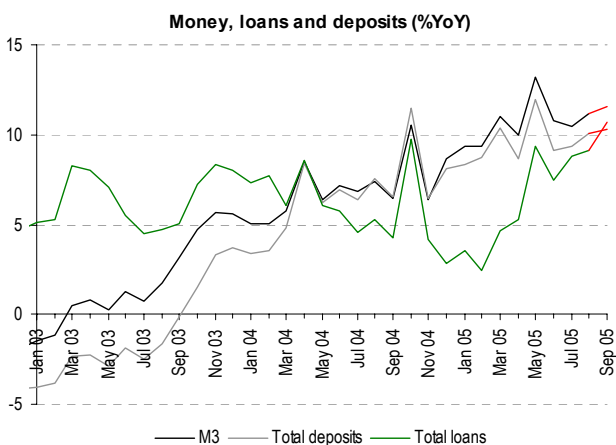
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What's hot this week – First new data at the end of week

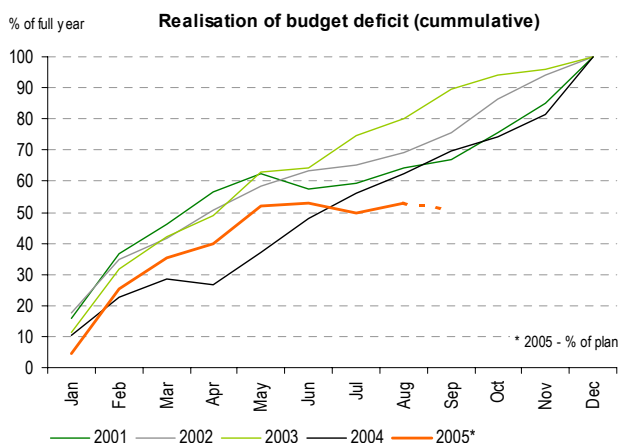


- Result of the first turn of presidential election did not bring final settlement. Uncertainty will last 2 more weeks.
- Candidate for prime minister Kazimierz Marcinkiewicz declared that on Monday he will present major points of new government's programme. It is hard to judge how binding whose proposals will be, taking into account that serious talks with the PO regarding coalition's programme have not taken place yet. Still, this could be a hint regarding future prime minister's economic plans.
- The most important data release this week will be CPI in September. We predict slight increase to 1.7%, while the Ministry of Finance foresees 1.9%YoY rise. Most important reasons for increase will be high fuel prices (but they will turn lower in October after cut in excise tax) and possibly fuel prices, however we do not expect to see signals of demand-side pressure on prices.



- Money supply growth is forecasted to accelerate to 11.6%YoY in September. Also, growth in loans (mostly for households) and deposits has been improving, reflecting expanding economic activity.
- The NBP made substantial revisions in balance of payment statistics for 2004 and 2005, taking into account data on foreign investors' reinvested profits. In effect, current account balance deteriorated sharply. This revision should be taken into account when forecasting C/A figures for August.
- We estimate that August saw slight surplus on the current account of €190m amid positive balance in current transfers and on services account, and deficit in income balance and trade balance. Both exports and imports retained high rates of growth – correspondingly 12.5%YoY and 10.4%YoY.

Economy last week – Excellent budget performance in 2005



- According to FinMin's estimates, budget deficit after 9 months reached 51% of plan, which implies September alone saw a PLN750m surplus. Good result is an effect of quickly growing tax revenues, confirming high economic activity in the second year-half. Deputy finance minister estimated budget gap could reach PLN30.5-31bn at the end of year, i.e. 4-4.5 lower than planned in the budget bill.
- New *Strategy for public debt management for 2006-2008* assumes rise in foreign borrowing by €5bn, out of which ca. 1/4 will be used for foreign debt servicing, while the rest could be exchanged into zlotys – half of it in the central bank, and half on the FX market.
- In September, US non-farm payrolls decreased by 35,000, while market analysts predicted 143,000 drop. Despite positive news from the labour market, US dollar gained only moderately on Friday afternoon.

Quote of the week – Will MPC wait for 3Q05 data?

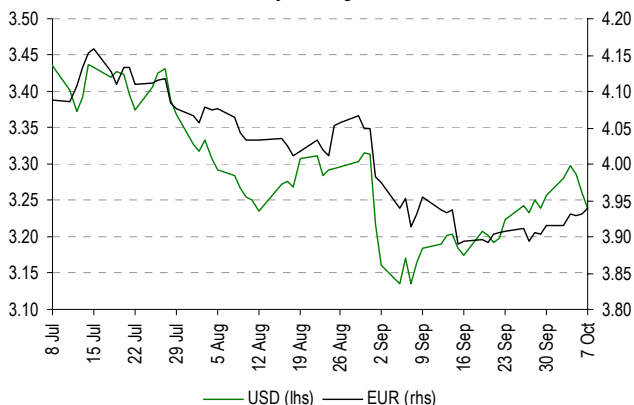
Stanislaw Nieckarz, MPC member; Reuters, 4 October

The Council recognized that one has to wait for CSO data for 3Q05, mainly for key figures on investment. (...) The economic recovery is stalled, domestic demand is also not too much impressive. There is room for gradual reduction in rates, but it is too early to talk about the timing. (...) There is no treat that inflation will exceed the target within the nearest two years.

Nieckarz's comments are a confirmation of our opinion that a further monetary easing is possible in a few nearest months. However, the MPC will probably wait with another cut until the end of November, when GDP data for 3Q05 and the new inflation report will be published.

Market monitor

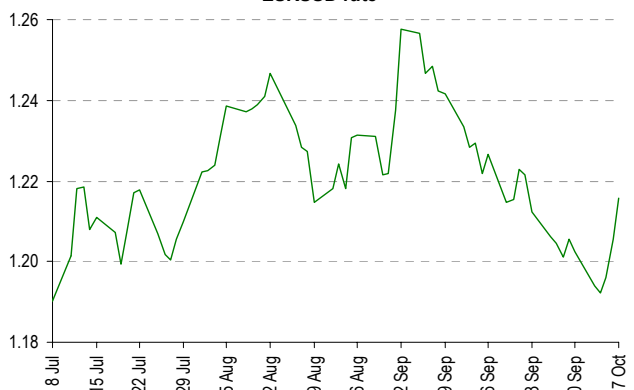
Zloty exchange rate



The zloty waits for the new cabinet

- Last week the zloty exchange rate fluctuated within the ranges indicated by us in the previous weekly report. With a lack of important events and information in Poland, the domestic currency against the majors reflected fluctuations of the EURUSD rate on the global markets. Thus, the EURPLN went up by ca. 0.5% and the USDPLN lost also ca. 0.5%. Activity of market participants was relatively low, as they are probably waiting for a result of presidential election, which will pave the way for formation of the new government and agreement on its program.
- Given the result of the first turn of presidential election (Tusk wins by a few percentage points, but the second turn is needed), we still predict that EURPLN will range between 3.88 and 3.98 while the USDPLN should fluctuate within 3.20-3.30 range.

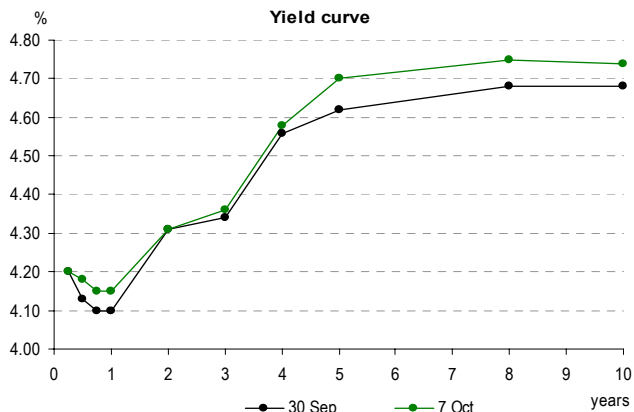
EURUSD rate



Swinging moods in the EURUSD market

- The beginning of last week was quite good for the dollar due to a release of better-than-expected ISM manufacturing in the US. As a result, the EURUSD rate fell below 1.20 and approached 1.19. In the middle of the week the situation reversed. ISM non-manufacturing was much weaker than predicted while data from the euro zone (PMI non-manufacturing and retail sales) were stronger than forecasted. Thus, the EURUSD started to climb and its upward march was stopped only on Friday. Then the dollar slightly rebounded thanks to better than expected non-farm payrolls.
- In the nearest week, participants of the EURUSD market will wait for Thursday and Friday when data major data will be released. Until then the EURUSD rate should be stable.

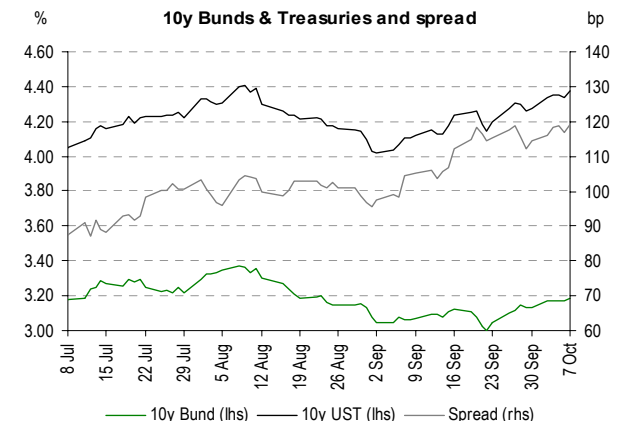
Yield curve



Polish curve steeper

- Last week was not good for longer dated bonds. Their yields went up already on Monday due to comments from candidate for PM about costs of planned reforms, pessimistic inflation forecasts of FinMin as well as on the back of yields rise in the core markets. Meanwhile, short end of the yield curve was supported by comments from MPC's Nieckarz, which renewed hopes for another rate cut before the end of this year. As a result, the Polish yield curve become steeper during the last week.
- In the nearest week the Polish interest rate market will wait for inflation figures. The market may also be affected by results of the first turn of presidential election and Wednesday's auction of 10-year bonds.

10y Bunds & Treasuries and spread



Upward march continued

- Last week brought continuation of a rise in bond yields both in the US and in the euro zone. It resulted from the fact that most of economic activity indicators for both of these economic areas was better than expected. The euro zone market was also negatively affected by quite hawkish statement of the ECB, following its Thursday's decision to leave rates on hold. As a key non-farm payrolls proved much better than forecasted, Treasuries recorded loss at the end of the week.
- In the nearest week, the markets will wait for Friday, when inflation figures and important economic activity indicators will be published in the US. Until then, one should expect some stabilisation in yields after their rises in recent weeks.

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