Bank Zachodni WBK

Weekly economic update

17 October – 23 October 2005

This week will be marked by final stage of presidential race and publication of another important data for September. The data will be released in two doses. Labour market statistics from the enterprise sector and data on budget performance will be delivered already today, while output and PPI figures on Wednesday. In our opinion, the data should not change the picture of the Polish economy, and thus should not affect market expectations as regards the outcome of October MPC meeting – no change in monetary policy parameters forecasted. Such view was confirmed by recent MPC members' comments that suggested the Council will prefer to wait for full 3Q05 data. Given inflation staying under control (CPI at 1.8%YoY in September), we think the MPC will trim rate again, especially if economic growth (domestic demand) does not show signs of notable acceleration.

As election campaign continues it is quite difficult to distinguish elements of economic programme from pre-election talks. Negotiations on economic programme between PiS and PO will be continued, but key decisions are expected only after presidential election scheduled for October 23. It is quite interesting that candidate for Prime Minister post focused on monetary policy recently. Fro financial market point of view, important information may concern the strategy of public debt management, as PiS would like to change completely. No foreign issues could mean that in contrary to current minister's plans of selling foreign currencies, finance ministry would exchange zlotys into currencies, needed to repay foreign debt. Maybe this is a way to achieve the level of the zloty (4,1-4,3) desired by candidate for PM post.

Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (17 October)					
9:00	**POL**	**Auction of T-bills 52-week of PLN400m and 13-week of PLN100m (M)**					
14:00	**POL**	**Wages (H)**	**Sep**	**%YoY**	**3.2**	**3.1**	**2.8**
14:00	**POL**	**Employment (H)**	**Sep**	**%YoY**	**2.0**	**2.1**	**2.0**
	POL	**Budget deficit (H)**	**Sep**	**PLN bn**	**17.9**	**17.7**	**18.5**
		TUESDAY (18 October)					
9:00	GER	ZEW index (H)	Oct	Pts	42.0	-	38.6
9:00	EMU	HICP final (M)	Sep	%YoY	2.5	-	2.2
12:30	USA	PPI (H)	Sep	%YoY	-	-	2.4
13:00	USA	Capital net flows (M)	Aug	USD bn	54.0	-	87.4
		WEDNESDAY (19 October)					
9:00	**POL**	**Auction of 5-year bonds of PLN2.1bn (H)**					
14:00	**POL**	**Industrial and building production (H)**	**Sep**	**%YoY**	**5.0**	**5.6**	**4.6**
14:00	**POL**	**PPI (H)**	**Sep**	**%YoY**	**0.1**	**0.3**	**-0.1**
9:00	EMU	Industrial production (H)	Aug	%YoY	1.0	-	0.5
		THURSDAY (20 October)					
9:00	EMU	Trade deficit (H)	Aug	EUR bn	2	-	7.2
		FRIDAY (21 October)					
14:00	**POL**	**Business climate indicators (M)**	**Oct**	**pts**	-	-	-

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

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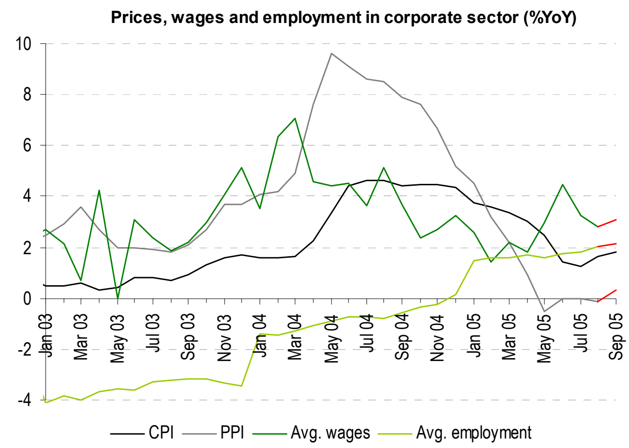
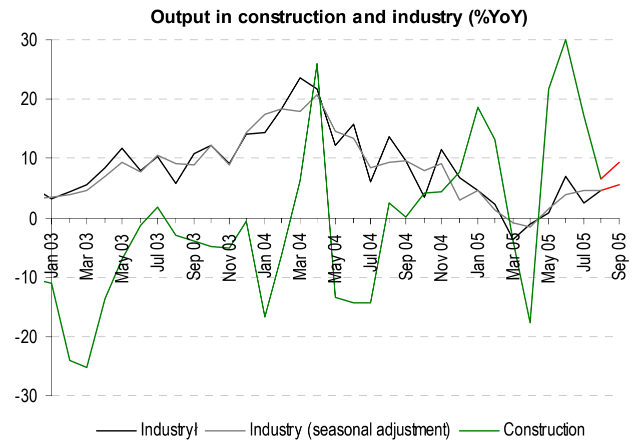
What's hot this week – Labour market data, production and PPI

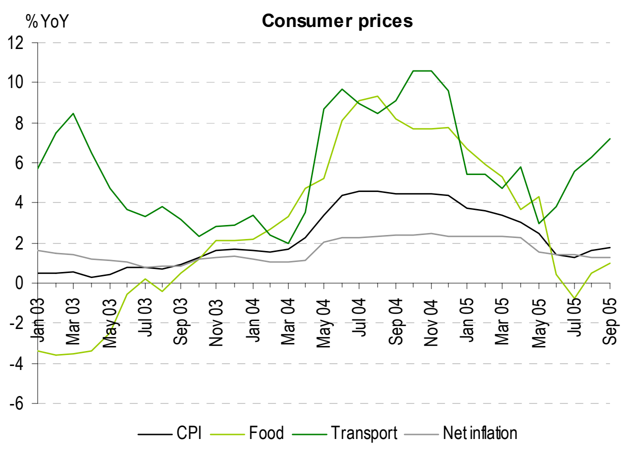


- Data form the labour market will be important for the MPC, but we expect rather moderate wages growth, which would show no second-round effects.
- Continuation of employment growth would mean wage bill in the enterprise sector advances at a healthy pace (also in real terms given low inflation), boding quite well for consumption strength in the third quarter.
- On Monday the Ministry of Finance will release budget performance data after September. FinMin representatives has already hinted that budget deficit reached only 51% of the full-year plan (implying around PLN750m surplus in September alone).
- Such outcome would confirm that execution of this year's budget would be outstandingly good – actual gap by a few billion zlotys lower than targeted PLN35bn.



- With inflation being low, data o economic activity become yet more important.
- As usual, market forecasts of annual growth in industrial output are dispersed (they range from 2.7% to 9.0%YoY). The realisation of our forecast would point to a continuation of economic expansion.
- Relatively optimistic predictions of September's industrial output are supported by information on increase in car production (growth in September by 5.9%YoY versus a fall in January-August period).
- We expect that construction output probably also advanced at a solid pace.
- The expected increase in producer prices reflects hikes in fuel prices. However, we think it has not spilled over prices of other products.

Economy last week – Inflation increased, but net inflation still low



- Consumer inflation picked to 1.8%YoY in September from 1.6%YoY in August after a monthly price growth of 0.4%.
- Te reason for inflation jump in September was mainly a hike in fuel prices (3.4%MoM and 16.5%YoY). Additionally, September saw relatively high rise in food prices (0.6%MoM and 1.0%YoY).
- We did not see again any impact of high fuel prices on the remaining categories of prices. Demand-side pressure on prices remains idle. We estimate net inflation for September could even fall to 1.2% from 1.3% in August.
- Money supply grew stronger than expected in September, suggesting economic activity improves, but weak corporate borrowing does not allow for strong optimism on investment activity.

Quote of the week – Significant change in public debt management strategy

Kazimierz Marcinkiewicz, candidate for PM; Radio PiN, 07.10

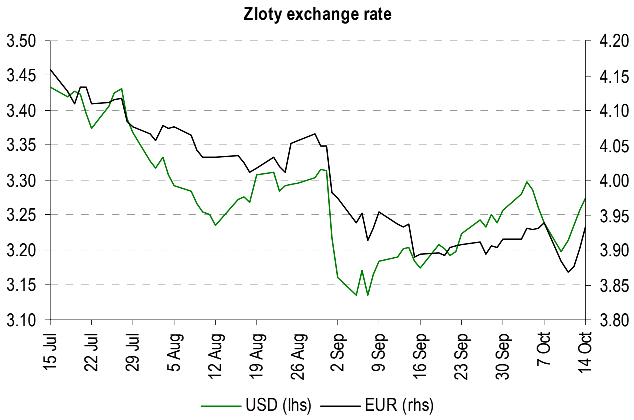
With this inflation, with financial stability and our planned budget anchor, rates could be reduced almost every month... and maybe not only by 25 bp. (…) A safe level for today is 2.5-3.0%

Cezary Mech, candidate for finance minister; PAP 07.10

As regards strategy of public debt management, we will see a U-turn in policy.

Likely members of future government focus on monetary policy in their statements. From market point of view, comment on public debt management strategy was quite important. The policy of no foreign issues in public debt was announced (not to mention exchanging foreign currencies on the market), which might be negative for the market, as this would mean higher supply of treasury papers and some depreciation pressure on the zloty.

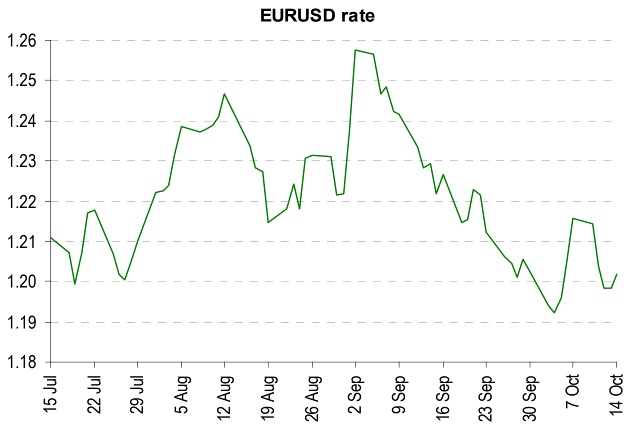
Market monitor



No clear trend before government formation

▪ PO candidate's lead in the first turn of presidential election and speculations about FinMin's currency sales on the market had helped the zloty at the beginning of last week, pushing the EURUSD rate to the strongest level for 40 months. Next days were not that positive though and the zloty lost in reaction to economic data releases, worrisome PiS officials' declarations and foreign players' tendency to cash profits in the region. At the end of week, the zloty lost ca. 1% against the dollar and was almost unchanged to the euro, as compared to preceding Friday.

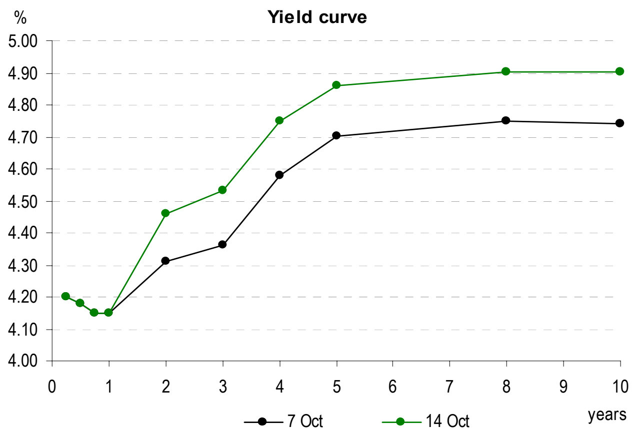
▪ Until establishment of new government, one should not count that a clear trend will form on the market. We predict that EURPLN will range between 3.88 and 3.98 while the USDPLN should fluctuate within 3.22-3.32 range.



Euro/dollar following interest rate expectations

▪ The dollar started the week rather poorly, with EURUSD above 1.21. However, the situation changed quite rapidly together with rising belief in further rate hikes in the US. It was aided e.g. by inflation data and signals bout Fed members' resolve for further hikes. Only at the end of week the euro erased part of losses, returning above 1.20, however during the week it lost over 1%.

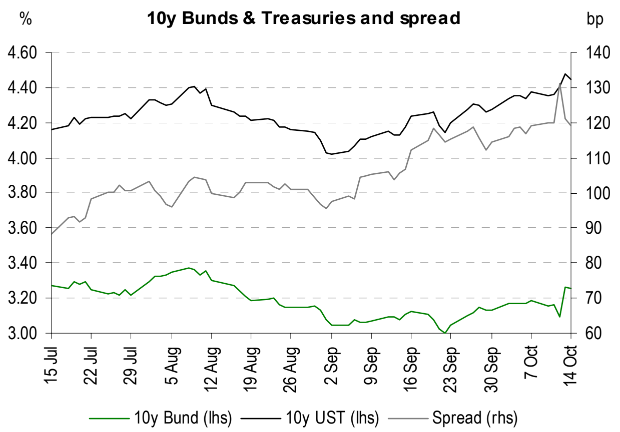
▪ In the days to come markets will be closely watching statements of central bankers, looking for hints regarding interest rate perspectives, being main determinant foe euro/dollar exchange rate. Interest rate differentials should continue to lend underlying support to the dollar, though upside may be limited by any further hawkish ECB comments.



Polish curve steeper

▪ Likewise the zloty, Polish bonds kept strengthening in the first part of the week, however next days brought about notable rise in yields. In effect, the week ended with yield curve at the highest level for 2 weeks. A rise in yields was also supported by analogous trend in core debt markets (see below).

▪ In the nearest days, moods on Polish debt market will be affected by publication of next economic data (in particular about industrial output), that could influence expectations regarding next interest rate changes. PiS officials' declarations about resignation from foreign debt issues could negatively affect Polish treasuries' yields.



Yields up, following inflation concerns

▪ US Treasury yields rose from mid-week following the publication of the September FOMC minutes, showing that Fed officials were keen to continue raising rates to subdue inflationary pressures. Only after data at the end of week, expectations for further rate hikes eased a bit. Eurozone data were thin on the ground but yields still tracked the US higher. Hawkish ECB comments about possible inflationary pressures also weighed.

▪ The extent of the rebound in US October business surveys will be important for Treasuries, along with the tone of the Fed Beige Book. Also, statements of central bank officials will be crucial - Fed and ECB speakers are likely to continue to reiterate their inflation concerns, which will be supportive for yields rise.

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