

Weekly economic update

31 October – 6 November 2005

The first week after presidential election was supposed to revive coalition talks between PiS and PO. The talks have actually revived, but started to head towards previously unexpected direction. The issue of economic program receded into the background. Meanwhile, a rough dispute over several posts began. Refusal of PiS to give the ministry of interior to PO and additionally the rejection of PO candidates for speaker of Sejm and deputy speaker of Senate by PiS supported by Self-Defence, LPR and PSL, brought about a collapse in negotiations. Although both parties may still return to coalitions talks, it seems very unlikely at the current stage of constitutional procedure of forming the new government. Although PM designate Kazimierz Marcinkiewicz still tries to convince PO to resume negotiations he also prepares simultaneously a minority government. On Monday he is going to present the line-up of his cabinet, which will then receive nominations from the President. During the next two weeks the Council of Ministers will have to receive a confidence vote from the Sejm. The question arises which parties will support PiS and for what price. If PiS will be supported by populist parties (Self-Defence, LPR and PSL), this may happen at the expense of deterioration in economic program.

MPC decision to leave rates on hold and maintain easing bias in monetary policy was fully in line with expectations. Before making a possible decision on another rate cut, the Council want to wait for quarterly economic data (on GDP and wages in the whole economy in 3Q05)

Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
MONDAY (31 October)							
15:00	USA	Chicago PMI (H)	Oct		57.5	-	60.5
TUESDAY (1 November)							
9:00	EMU	Manufacturing PMI (H)	Oct		52.6	-	51.7
15:00	USA	Manufacturing ISM (H)	Oct		56.5	-	59.4
19:15	USA	Fed meeting – decision (H)	Oct	%	4.0	-	3.75
	POL	Market holiday					
WEDNESDAY (2 November)							
11:00	POL	Auction of 2-year bonds OK1207 of PLN1.5bn (H)					
THURSDAY (3 November)							
9:00	EMU	PMI non-manufacturing (H)	Oct		55.0	-	54.7
12:45	EMU	ECB rate – decision (H)	Nov	%	2.0	-	2.0
13:30	USA	Labor productivity (H)	3Q	%	1.9	-	2.5
13:30	USA	Unit labor costs (H)	3Q	%	2.4	-	1.8
15:00	USA	ISM non-manufacturing (H)	Oct		56.8	-	53.3
15:00	USA	Factory orders (H)	Sep	%	-0.3	-	2.5
FRIDAY (4 November)							
10:00	EMU	Unemployment rate (M)	Sep	%YoY	8.6	-	8.6
10:00	EMU	PPI (M)	Sep	%YoY	4.3	-	4.0
13:30	USA	Unemployment rate (H)	Oct	%	5.1	-	5.1
13:30	USA	Non-farm payrolls (H)	Oct		75.0	-	-35.0

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

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What's hot this week – What coalition?

Support for candidates for Sejm's speaker

Party*	Marek Jurek (PiS)	Bronisław Komorowski (PO)
PiS (154)	152	0
PO (132)	0	130
Self-Defence (56)	54	0
SLD (55)	0	0
LPR (33)	33	0
PSL (25)	25	0
Independent (5)	1	3
Total (460)	265	133

Source: Sejm * in brackets total numbers of deputies for a given party

- PM designate Kazimierz Marcinkiewicz will present makeup of his cabinet. PM together with his ministers will receive nominations from the President and from that moment the cabinet will have to weeks to receive a confidence vote from the Sejm.
- The question arises who will support minority government of PiS with PM Marcinkiewicz. The confidence vote requires majority in the Sejm. Will this be the same majority which rejected PO candidates for Sejm's speaker and deputy speaker of Senate?
- PiS government with a support from Self-Defence, LPR and PSL would be a negative scenario from the point of view of economic policy. On the other hand, one still cannot exclude that PO will return to coalition talks, if Marcinkiewicz's cabinet fails to get confidence vote. However, even if PO-PiS coalition is formed, it would most likely be unstable and vulnerable to internal tensions.

Economy last week – The MPC waits for more data

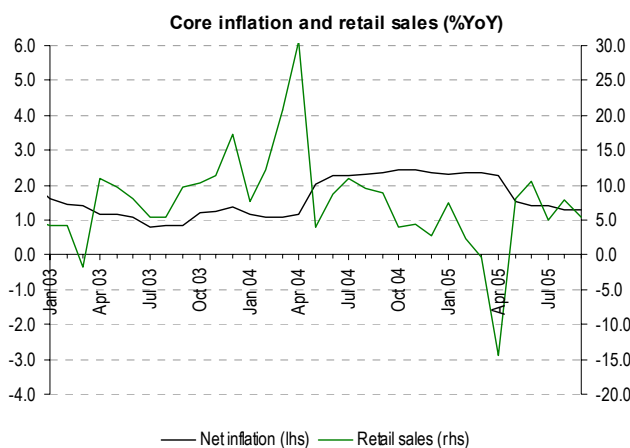
Selected fragments of MPC statement from 26 October

The September data do not suffice to assess if economic growth acceleration was actually as large as expected in the August Inflation Report. The more complete assessment will be possible once GUS data on Q3 have been released.

The moderate wage growth, if sustained, would contribute to a further growth in employment and – with labour productivity growth still considerably higher than wage growth – to limiting inflationary pressure. Due to a lack of data on wages outside the corporate sector in Q3 2005, it is difficult to assess the future wage developments in the whole economy.

The Council maintains its opinion that inflation may return to the target sooner than it was forecasted in the August inflation projection. It is expected that having achieved the target, inflation will remain at a level close to the target. The moderate wage growth is an indication that no second round effects have materialised so far. Should there appear signals of increased probability that these effects should occur, the balance of risks might change, which would then affect the future decisions of the Council.

- Official statement after MPC meeting confirmed a view that central bankers want to wait for data on GDP in 3Q05 (due for release on November 29) before making possible decision on another interest rate cut. We think GDP data will show there is a room for cautious rate cut.
- The Council did not make any comment on current political situation, but possible further weakening of the zloty (lower risk of rapid appreciation after elections that some MPC members were afraid of) could lower penchant of some MPC members for further rate cuts.
- The MPC also made a decision on a change in the schedule of publication of *Inflation reports*. The decision is aimed at allowing the NBP staff to take into account fresh GDP data in inflation and GDP projections. As a result of the decision, the next *Inflation report* will be published only in January rather than in November.



- Retail sales data for September disappointed, showing 5.4%YoY rise in nominal terms and 2.4%YoY rise in real terms against market consensus at 7%YoY and our forecast at above 9%. The registered unemployment rate fell to 17.6% at the end of September.
- The data showed that although one may expect some acceleration in consumption growth in 3Q05, the scale of expected improvement is likely to be lower than forecasted.
- In September, all five measures of core inflation calculated by the NBP remained below level of 1.5%YoY (net inflation stabilised at 1.3%YoY), i.e. below the lower end of allowed fluctuation band around the inflation target. This confirms that underlying inflationary pressure in the economy is subdued. The data suggests that cautious monetary easing is still possible without creating a serious risk of higher inflation.

Quote of the week – Crisis of confidence

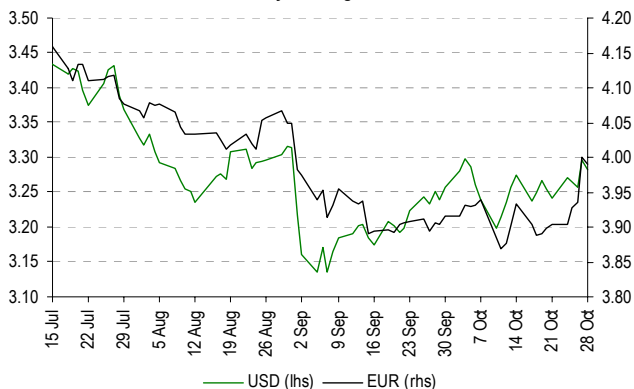
Jan Rokita, one of PO leaders; PAP, 28 October

The problem is not how many words - let be honest - without meaning will be said by Kazimierz Marcinkiewicz. The problem is whether Jarosław Kaczyński is ready to stand in public and say: I made a mistake trying to create coalition with Lepper [leader of Self-Defence], I withdraw from that, the last week was a series of my mistakes, we have to do something new.

Jan Rokita's statement suggests that theoretically PO could return to the negotiation table. We believe that it could happen in practice, if Marcinkiewicz's cabinet fails to get confidence vote. Additionally, PiS would have to distance itself from co-operation with Self-Defence. However, it is hard to expect that Jarosław Kaczyński publicly admitted that his actions so far has been a mistake.

Market monitor

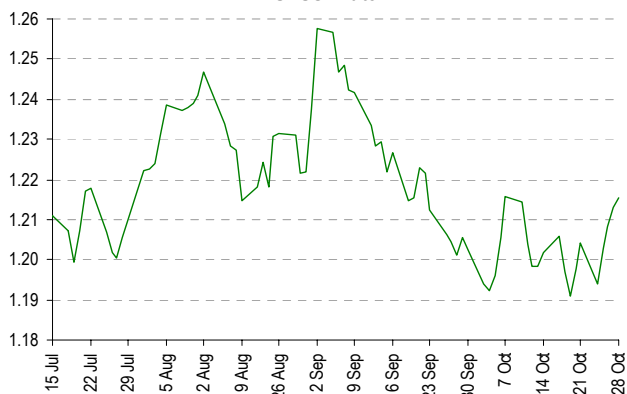
Zloty exchange rate



Zloty plummets on coalition talk crisis

- At the beginning of the week zloty depreciated 1% in reaction on Lech Kaczynski's victory in presidential elections. Later on zloty weakened slightly as markets awaited PO and PiS government coalition creation. In the middle of the week crisis in coalition talks arose and as a result zloty depreciated against main values to break 4.00 against euro. In the end EURPLN stabilized around 3.99 and USDPLN around 3.29. Polish currency lost 1.3% against the greenback and 2.2% against euro as compared to previous week.
- Facing uncertain political situation and lower liquidity during the long weekend we hold wider currency trading range 3.95-4.10 for EURPLN and 3.25-3.39 for USDPLN.

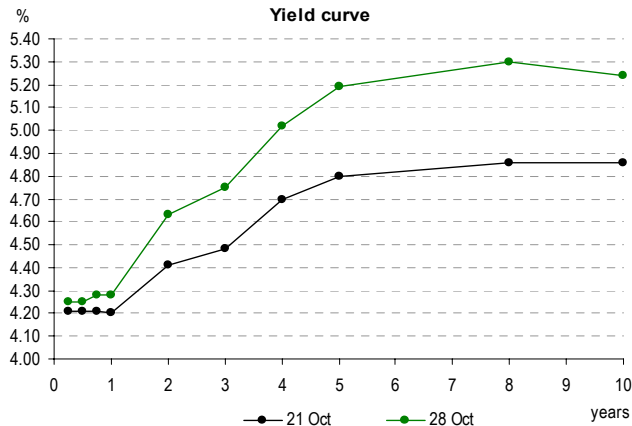
EURUSD rate



Euro gaining strength

- Dollar strengthened against euro to 1.194 on dovish statement from ECB member and Ben Bernanke nomination for Fed chairman. However high ZEW index and worse macro data (consumer confidence) in U.S. weakened dollar to 1.2115 against euro and further to 1.217 on hawkish statement of ECB member Erkki Liikanen on SEC investigation on GM accounting practices. Dollar strengthened at the end of the week to 1.207 on better than expected GDP data in U.S.
- On 1st November Fed will probably raise interest rate by 25bp. to 4%. Market expects, that EBC will leave main interest rate unchanged at 2%, which should further support dollar.

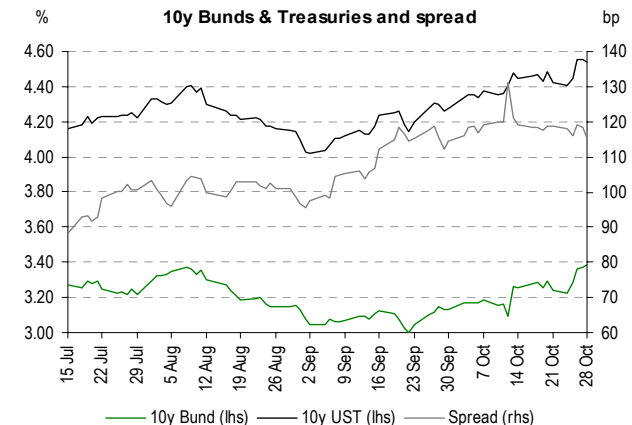
Yield curve



Political risk harms Polish bonds

- Despite a victory of less preferred by investors Lech Kaczyński in presidential election, bond market gained at the beginning of last week amid decreasing yields on international markets. However, after coalition talks were broken and chances for PO in the government fell, Polish yield curve has steepened and yields went up by 20-40bps.
- The latest Kazimierz Marcinkiewicz's proposal on more pro-market economic programme was a step towards deal with PO and aimed at markets stabilisation. However, uncertainty regarding government's future still remains very high, so the support for the market will not be too significant.

10y Bunds & Treasuries and spread



Yields up awaiting interest rate hikes

- At the beginning of week, foreign debt markets were strengthening due to better investors' sentiment. Higher than forecasted IFO index in Germany boosted expectations for interest rate hikes in the euro zone. In the middle of week, a sale-off started on core debt markets. On Friday, American Treasuries gained in a reaction to weaker data on wages in 3Q05.
- This week, the FOMC statement and ECB's press conference should set the tone at fixed income markets, but a busy data schedule, testimony by Greenspan and the quarterly US refunding announcement could also impact.

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