Bank Zachodni WBK

Weekly economic update

5 December – 11 December 2005

Last week investors were awaiting data on GDP, decision of Monetary Policy Council, and government's amendment to 2006 budget. It turned out that all the information was roughly consistent with expectations. GDP growth in 3Q05 reached 3.7%, confirming a gradual economic recovery based to a growing extent on domestic demand (although net exports still plays very important role). Taking into account improvement in economic situation and predicted return of inflation to the target, the Monetary Policy Council maintained interest rates unchanged but at the same time it preserved easing bias in policy, which implies that most of its members believe that chances for rate cuts are still higher than for rate increases. It seems that indeed a threat of excessive inflationary pressure is not too big at the moment, especially that excess supply of food products caused by Russian ban on Polish exports improved short-term inflation outlook. Amendment to 2006 accepted by the government assumes PLN30.55bn budget gap, i.e. slightly above PLN30bn "anchor" but PLN2bn below level planned by previous administration. Budget revenues were boosted by PLN3bn, which will be accomplished e.g. by shifting some of this year's elevated proceeds. In sum, we see no reasons for major concerns on budget realisation in 2006 in the shape presented by the government.

This week there will be no publication of domestic economic data, and thus the market will be observing trends on core markets, and paying attention to news from the government and the parliament. On Wednesday the Sejm begins a debate on 2006 budget, which will be probably quite stormy as usually. It is worth keeping in mind that according to Polish law the parliament cannot lift the level of budget deficit above ceiling proposed by the government, which should limit investors' fragility on news from the Sejm. Finance minister Teresa Lubińska said last week that updated convergence programme should be ready by 10 December. The document will show a path of fiscal deficit reduction envisaged by the government in the medium-term horizon. Still, it is not certain whether the report will be published before the end of this week.

Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
		MONDAY (5 December)					
10:00	**POL**	**Auction of 13-week PLN100m and 52-week PLN1.2bn T-bills**					
9:00	EMU	Non-manufacturing PMI	Nov	pts	55.0	-	54.9
10:00	EMU	Retail sales	Oct	%YoY	1.0	-	0.9
15:00	USA	ISM services	Nov	pts	59.0	-	60.0
		TUESDAY (6 December)					
13:30	USA	Unit labor costs	Q3	%	-0.5	-	-0.5
13:30	USA	Labor productivity	Q3	%	4.2	-	4.1
15:00	USA	Factory orders	Oct	%	1.3	-	-1.7
		WEDNESDAY (7 December)					
10:00	**POL**	**Auction of PLN2.5-3.5bn WZ0911 bonds**					
		FRIDAY (9 December)					
14:45	USA	Preliminary Michigan Michigan	Dec	pts	83.5	-	81.6
15:00	USA	Wholesale inventories	Oct	%	0.4	-	0.6

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

Maciej Reluga Chief economist (+48 22) 586 8363

Piotr Bielski (+48 22) 586 8333

Piotr Bujak (+48 22) 586 8341

Cezary Chrapek (+48 22) 586 8342

e-mail: ekonomia@bzwbk.pl

What's hot this week – Budget debate commencing in the parliament

Main assumptions to 2006 budget

	Amendment	Gronicki's draft
GDP growth (% r/r)	4.3	4.3
CPI avg. (% r/r)	1.5	1.5
Budget revenue (PLN bn)	194.2	191.30
Budget spending (PLN bn)	224.7	223.87
Budget deficit (PLN bn)	30.55	32.58

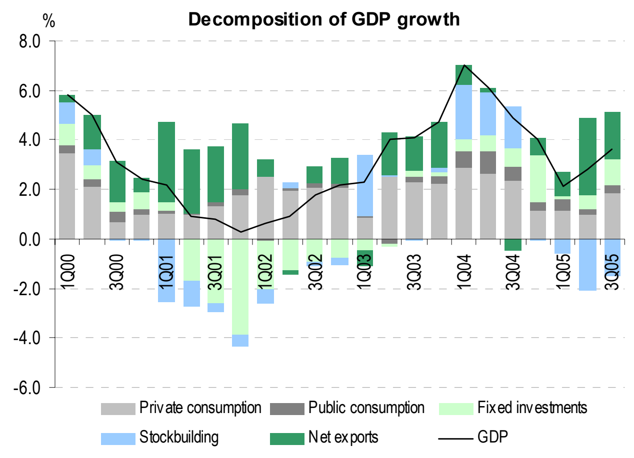
Source: Reuters, Finance Ministry

▪ Calendar of important events for the nearest week is almost empty, especially that there will be no publications of domestic economic data until mid-December. In such situation, financial market will observe trends on core markets and will be paying attention to news from the government and the parliament.

▪ On Wednesday Sejm begins a debate over 2006 budget, which will be probably quite stormy as usually. However, one should remember that according to Polish law the size of the deficit cannot be increased by the parliament.

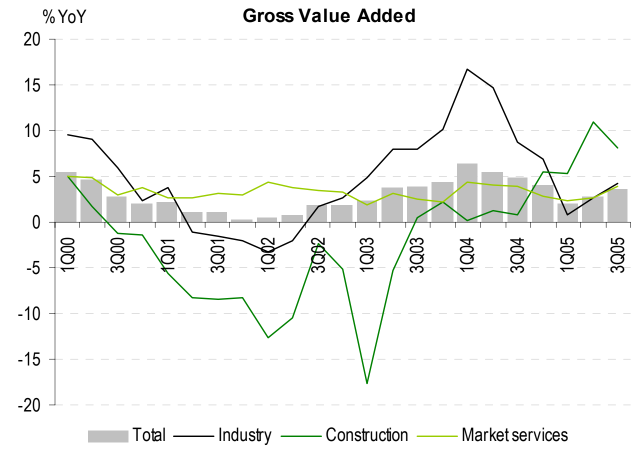
▪ Finance minister Teresa Lubińska said last week that Poland's updated convergence programme should be ready by 10 December. The document will show a path of fiscal deficit reduction planned by the government in the medium run. Still, it is not certain whether the report will be shown before the end of this week.

Economy last week – GDP, rates and budget in line with expectations



▪ GDP rose 3.7% in 3Q05, private consumption growth accelerated to 2.7%, and investment growth to 5.7%. Despite improvement in domestic demand, net exports still plays important role, being responsible for ca. 2 pp GDP rise in third quarter. Expectations for gradual economic recovery are materialising, however the situation is still not particularly dangerous for inflation perspectives.

▪ In line with expectations, the Monetary Policy Council left interest rates unchanged, using similar argumentation as in previous months. MPC maintained view that inflation rate will return to 2.5% target faster than predicted in August Inflation report. At the same time, easing bias in policy was upheld, suggesting that majority of Council members still believe that chances for rate cuts are higher than for rate hikes.



▪ 2006 budget amendment approved by the government assumes PLN30.55bn deficit (PLN2bn lower than planned by previous administration) and a rise in revenue and spending by correspondingly PLN3bn and PLN0.8bn.

▪ Although a notable increase in revenue could raise some doubts (it is justified by higher use of EU funds and faster construction of roads and houses, effecting in higher spending the first turn), it seems that it will be achieved e.g. through shifting some of this year's elevated revenue to 2006 (this year's budget realisation will be ca. PLN3bn higher than suggested by previous finance minister).

▪ In general, we find no serious reasons to worry about realisation of the budget 2006 in the shape presented by the cabinet, and the bill was a neutral news for the market.

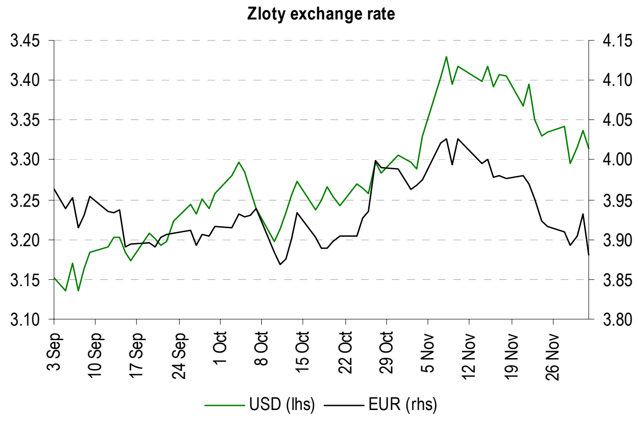
Quote of the week – Ban on export to Russia could depress inflation

Jacek Krzyślak, head of the FinMin's analysis and statistics department; Reuters, 1 December

We expect inflation in November to fall to 1.2%. Prices did not increase since October, and maybe even dropped a little. Data that we collected show that food prices rose only 0.1%MoM and fuels got cheaper by 3.1%MoM. [...] Changes observed until now show there is no reason for an inflationary upturn in January or February.

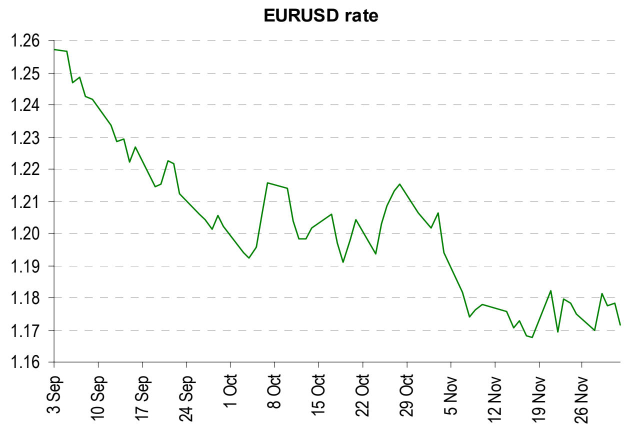
While we previously expected CPI fall to 1.5% in November, this was based on assumption of much higher food prices. A substantial risk on the downside in this area arose after Russia had blocked exports of Polish food, which created excess supply on the domestic food market and could have led to reductions in prices. This improves short-term inflation outlook, which should be positive for debt market.

Market monitor



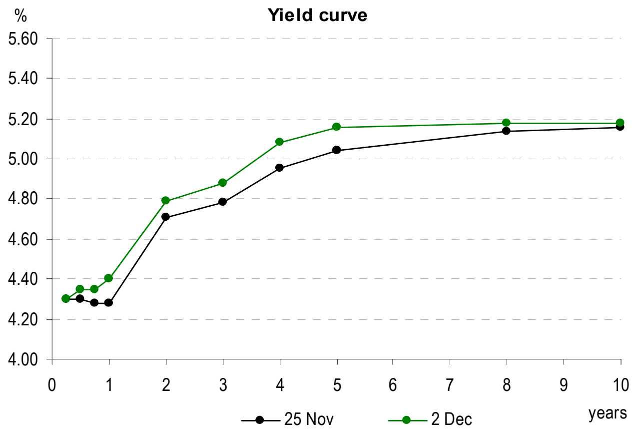
Good moods in the region supporting the zloty

- Zloty strengthened on Slovakia entry to ERM-2 and improved sentiment of investors towards our region. Later on there was a correction supported by the perspective of ending the rate cuts cycle, good GDP data and controversial proposals of Samoobrona on changing NBP's goals. Polish currency appreciated on PM's statement rejecting any interference in central bank's policy and controversial ideas of the populists as well as on low MF's November inflation forecast. Zloty strengthened by 0.9% against the euro and 0.6% against the dollar last week.
- Polish currency will be stable with potential to strengthen amid positive investor moods towards the region. We forecast next week EURPLN between 3.84-3.94, and USDPLN 3.25-3.36



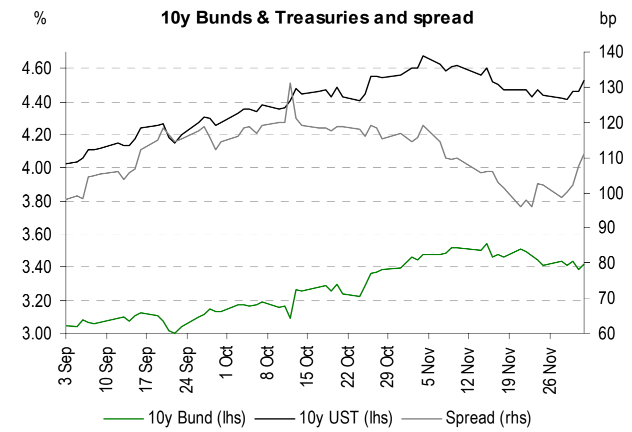
EURUSD volatile in narrow range

- At the beginning of the week the euro strengthened to the dollar from 1.169 to 1.19 on weak secondary market home sales in U.S., in perspective of rate hike in EMU and dollar positions reduction. Higher durable goods orders, new homes sales, consumer confidence, Q3 GDP figure resulted in another dollar appreciation. On rate increase in the euro zone and slightly dovish statement of ECB's chairman Jean-Claude Trichet as well good data from the U.S. labor market EURUSD dropped to below 1.17.
- Slightly dovish overtone of Trichet's comments as well as better than expected data from U.S. economy will support dollar appreciation and EURUSD will probably stay between 1.164-1.19.



Yields rise, higher Q3 GDP and no rate cut

- Yields fell at the beginning of the week thanks to better moods in the region as well as on strengthening on the core bond markets. Later on debt weakened significantly awaiting and on release of GDP data and on prices drops on the American and German markets. Bond prices fell on information on higher supply of bonds on December auctions as well amid MPC's decision, which left main repo rate at 4.5% and easing bias. Yields rose by 2-13 bps throughout the week.
- MPC's decision and statement minimized the expectations of rate cuts in a next few months and large supply of T-bills and bond auction may weaken fixed income market though situation on the core bond markets is going to be more important



Good data in U.S. and rate hike in EMU

- Last week 10-year U.S. Treasuries rose by 10 bps, and Bunds remained at the same level. Yields of U.S. bonds strengthened at the beginning of the week to 4,39 on poor figures, however bounced back higher to 4.50 (3.45 – Bunds) on good data (Q3 GDP, Chicago PMI). On a correction to 4.40 10Y Treasuries yields rose again to 4.53 on relatively strong ISM figure and data from the labour market. 10Y Bunds strengthened to 3.41 hitting 3.38 on first for 5 year time rate hike from 2.0 to 2.25% and dovish Trichet's comments.
- Expectations on speedier rate hikes and its size in EMU declined, whereas U.S. data was much better than market forecasts. This week the most important will be U.S. figures: ISM services, factory orders and preliminary Michigan index.

Additional information is available on request. Please contact Bank Zachodni WBK S.A. Treasury Division, Economic Analysis Unit, ul. Marszałkowska 142, 00-061 Warsaw, Poland, phone (+48 22) 586 83 63, email ekonomia@bzwbk.pl, http://www.bzwbk.pl