

Weekly economic update

19 December – 25 December 2005

After much lower than expected CPI inflation for November, which led to significant strengthening on the fixed income market amid renewed hopes for interest rate cut, yesterday saw the release of very strong labour market data, which caused an adverse effect. Both wages and employment were significantly higher than forecasted by market participants rising in November by 6.9%YoY and 2.4%, respectively. One explanation of stronger-than-expected wage growth (which was confirmed in *Gazeta Wyborcza* daily) is that we experienced a shift of December's bonus payments in mining companies. Anyway, the data will be probably perceived as hawkish argument and the MPC will wait to see more information. As after CPI data release we did not change our view that interest rates will be kept unchanged at next week's meeting, all the more we maintain this opinion after labour market figures were published. Nevertheless, we still think that easing bias in monetary policy is appropriate as interest rate cut is more likely than interest rate hike within next 3-6 months. Financial markets will now impatiently wait for other signs of economic situation in Poland – a lot of data will be released in the upcoming week, including PPI inflation, industrial production, retail sales, core inflation. However, not all data will be available for the MPC meeting scheduled for Tuesday-Wednesday.

Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD	FORECAST		LAST VALUE	
				MARKET	BZWBK		
MONDAY (19 December)							
10:00	POL	Auction of PLN100m 13-week and PLN0.9bn 52-week T-bills (M)					
15:00	POL	PPI (H)	Nov	%YoY	-0.5	-0.5	-0.9
15:00	POL	Industrial production (H)	Nov	%YoY	7.3	8.5	7.6
10:00	EMU	Industrial production (H)	Oct	%YoY	1.1	-	1.0
TUESDAY (20 December)							
10:00	EMU	Eurostat trade (M)	Oct	€ bn	1.6	-	-
13:30	USA	Building permits (M)	Nov	M	2088	-	2103
13:30	USA	House starts (M)	Nov	M	2017	-	2014
13:30	USA	PPI (H)	Nov	%MoM	-0.4	-	0.7
WEDNESDAY (21 December)							
	POL	MPC meeting – decision (H)	Dec	%	4.5	4.5	4.5
13:30	USA	Final GDP (H)	Q3	%	4.3	-	4.3
THURSDAY (22 December)							
9:00	POL	Retail sales (H)	Nov	%YoY	8.5	8.4	7.5
9:00	POL	Unemployment rate (M)	Nov	%	17.4	17.4	17.3
15:00	POL	Core inflation (H)	Nov	%YoY	1.1	1.1	1.6
15:00	POL	Business climate (M)	Dec				
13:30	USA	Personal income	Nov	%	0.3	-	0.4
FRIDAY (23 December)							
13:30	USA	Durable goods orders (H)	Nov	%	0.8	-	3.7
14:45	USA	Michigan index (H)	Dec	pts	89.0	-	81.6

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

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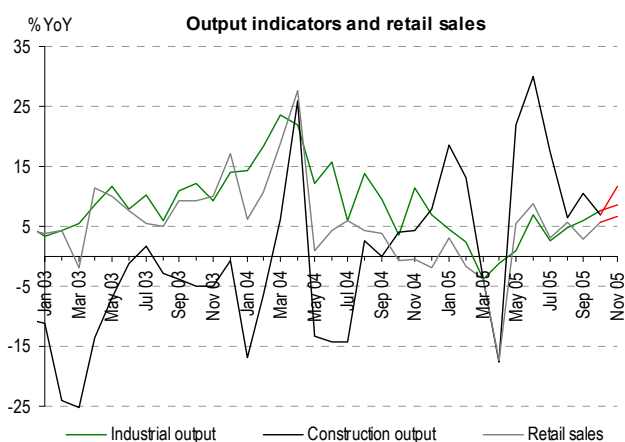
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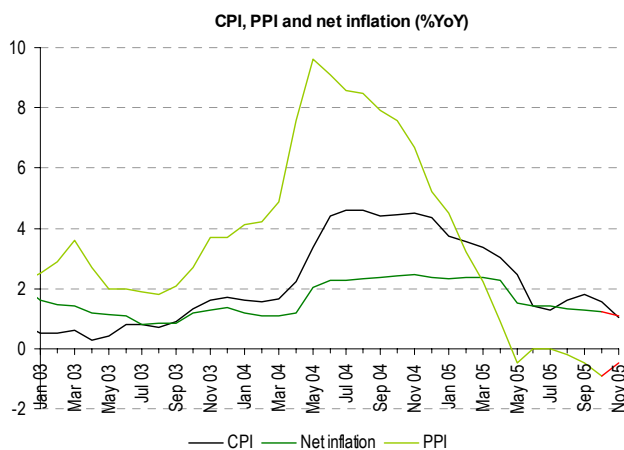
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What's hot this week – A couple of data on economic activity and prices

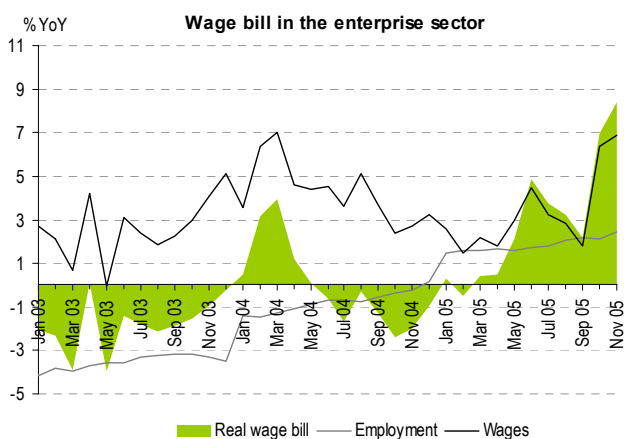


- In the upcoming week the CSO will publish a lot of macroeconomic data, which will be crucial for market sentiment, especially as recent indicators sent mixed signals for the fixed income market.
- Strong growth in industrial production, construction output and retail sales is expected, which would confirm that economic growth continues to accelerate in the last quarter of the year (to some 4.5%)
- Some information about prices will be also released with producer inflation and core inflation. They should confirm that higher economic activity is not accompanied (at least as for now) by higher pressure on price rise, which could make central bankers' headache. Quite contrary, all core inflation measure should maintain below 1.5% (some of them even below 1%), while annual PPI inflation will probably show a deflation again.

Economy last week – Low inflation, but wages and employment (and exports) rise faster



- In November CPI inflation fell to 1.0%YoY from 1.6% in October after 0.2%MoM drop in prices. This was much lower than expectations.
- The main reason for that were low prices of foodstuff and fuels, which fell 0.3%MoM and 2.2%MoM, respectively. Nevertheless, our estimates indicate that net inflation (CPI excluding food and fuel prices) fell to 1.1%YoY in November (official data on Thursday).
- Price growth in other categories of consumer prices showed no signs of increase in inflationary pressure. We expect that as long as Russian ban on Polish foodstuff is binding and the zloty rate constrains fuel prices, inflation will remain very low.
- We forecast CPI inflation will slightly rise in the following months, but will not exceed 1.2%YoY in December and will be around 1.5% in 1Q06.



- Average wage in the enterprise sector rose by as much as 6.9%YoY, beating market consensus and our forecast at 3.8%YoY.
- Employment growth rate was also higher than expected and reached 0.1%MoM and 2.4%YoY. As a result, increase in wage bill in the enterprise sector was 9.5%YoY in nominal terms and 8.4%YoY in real terms.
- One explanation of strong wage growth was that we experienced a shift of December's bonus payments in some of branches (mining). Therefore, the most likely scenario is that wage growth will decelerate in December again.
- October saw trade surplus with sharply rising exports and accelerating imports, which was very positive information.

Quote of the week – Inflation created room for cut. What about wages?

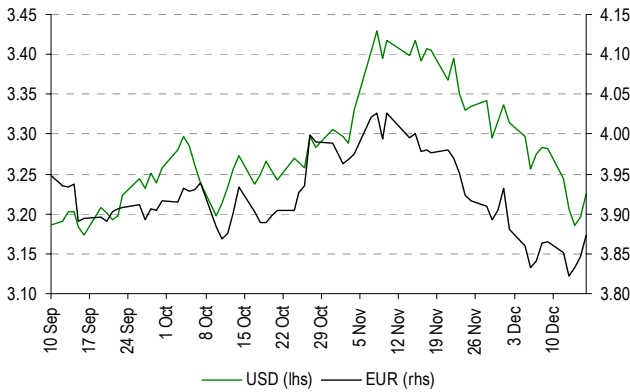
Marian Noga, MPC member; PAP, 14 December

The level of 1% is below analysts' expectations. While after previous data one could have stated that room for monetary easing narrowed, today we can say it narrowed but still exists. (...) this is only one piece of information for the MPC. We take into account the whole balance of factors. But this factor influences the development of other elements.

Some MPC members may become less opposing against rate cut after CPI data. Before the release further monetary easing was possible, according to Noga, only in case of a "shock", while after the data a room for cut has widened. It is interesting whether wage data narrowed it again. Well, it would be better not to see MPC members' comments on monetary policy perspectives before the full set of monthly data is published.

Market monitor

Zloty exchange rate

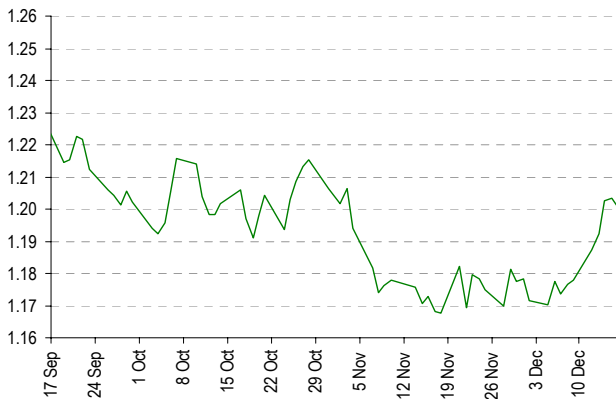


Zloty still strong

At the beginning of the week zloty appreciated against the euro to the strongest level for 3.5 years (3.809) and 3.178 versus the dollar on stabilization in Hungary as well as amid changed Fed's statement, which suggested sooner end of rate hikes in U.S. This could increase inflows to the emerging markets. On a slight correction zloty fluctuated around 3.83 to fall to 3.88 and 3.22. Polish currency lost 0.2% versus the single currency and gained 1.7% against the greenback

We estimate that USDPLN rate will trade in range 3.15-3.25, whereas EURPLN will stay strong between 3.82-3.92. 3.88-3.89 is going to be a strong support level for the Polish currency and if it is broken zloty may weaken to 3.92.

EURUSD rate

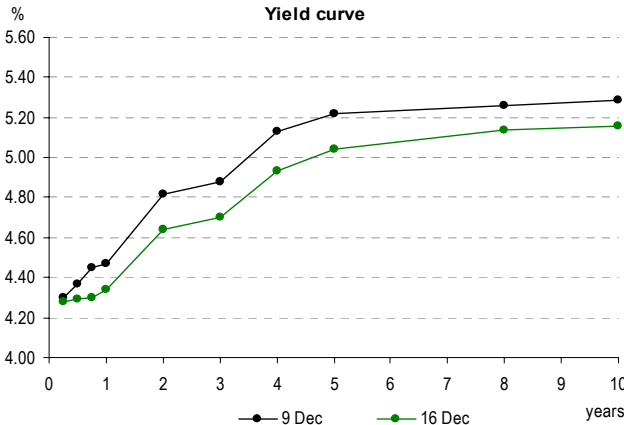


The end of dollar rally?

The dollar lost 2% against the euro within the passing week from 1.18 to 1.2, which was mainly a result of change in Fed's communiqué. Part of the greenback's depreciation was determined by record high trade deficit as well as the highest for 5,5 years lfo index tough record capital inflow in U.S. as well as lower than expected HICP inflation in the euro zone calmed down the market.

Despite the change in Fed's statement wording and inflation plunged (mainly on energy and gasoline prices drop), good figures from manufacturing sector may effect in higher inflation pressure. Next week quite important will be data on durable goods orders, housing market and Michigan index. It appears the room for greenback appreciation has narrowed and we expect EURUSD rate to stay in range 1,195-1,21.

Yield curve

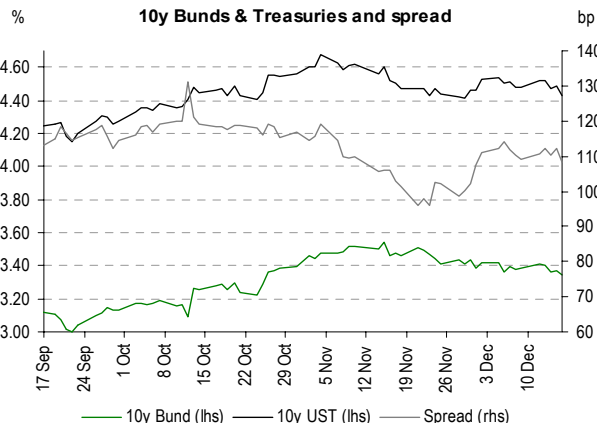


Fed and mixed data strengthen bonds

Polish debt strengthened with regards to change in Fed's communiqué, yields drop on the core bond markets and dovish statement of MPC member Pietrewicz on room for 50 bps cut. Another strengthening occurred on low CPI inflation figure, which increased expectations on rate cut. (yield of 5Y bond dropped to 4.93%). Although strong wages effected in a correction the yield curve declined by 12-20 bps below previous Friday levels.

Industrial production and PPI figure will be crucial as well as core inflation, retail sales later on may be decisive. However even if data is positive for the rate cut MPC will hold with its decision to January until new NBP's inflation forecast is released.

10y Bunds & Treasuries and spread



Yields drop amid Fed's communiqué

Yields of 10Y Treasuries fell from 4.53% at the beginning of the week to 4,42%, 10Y Bunds from 3.41% to 3.34%. U.S. bonds strengthened on change in overtone of Fed's statement and expectations on less aggressive tightening in monetary policy. Temporary weakening occurred on strong data on industrial production from manufacturing sector in U.S. Lower than expected HICP inflation in the euro zone supported Bunds.

Next week the most essential figures will be U.S. PPI, durable goods orders and Michigan index. On strong industrial production and good data in manufacturing sector as well as high lfo index, stronger data from U.S. and EMU may slightly weaken debt.

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