Bank Zachodni WBK

# Weekly economic update

9 – 15 January 2006

**First week of the new year passed under the sign of zloty appreciation, and zloty rate against the euro set new 3.5 year high. Inflow of foreign capital is being supported e.g. by very good condition of economy that has been quickly expanding amid still low inflation, and also by very good foreign investors' sentiment towards markets in our region. Although a political situation and fiscal policy have recently receded to the background in investors' considerations, they might become the focus of attention again in the coming days. An opportunity for this will be the final stage of debate over 2006 budget in the parliament, and also a publication of updated *Convergence programme*. Votes on the budget bill will be also an important test of political support for the government in the parliament and a hint on possibility of premature election in the spring (in case the budget is not accepted, the president can, but is not obliged to, dissolve the parliament). While it seems that the budget should not be rejected by the Sejm, as minor caucuses are afraid of early election because of opinion polls unfavourable for them, one cannot rule out that – likewise in the case of child benefit motion – the opposition will manage to push through series of amendments, changing the shape of the bill. The Sejm cannot increase the size of budget deficit, however it can decide about higher spending if it shows sources of their financing; the problem is that those sources could be hardly reliable. Additional problem is finding resources for financing higher spending raised by child benefit bill approved recently. In general, a debate in the parliament over 2006 budget could cause a rise political risk in perceived by the financial market.**

**At the end of the week we will get to know data on money supply in December and balance of payments in November. While the former should have little impact on the market, confirming known upward trends in loans and deposits, figures on balance of payments and foreign trade should be positive for the zloty. Most likely, they will show small deficit on current account balance, and continuation of fast expansion in both exports and imports, being positive for GDP prospects.**

## Economic calendar

| TIME GMT | REGION | INDICATOR (importance level*) | PERIOD | | FORECAST MARKET | FORECAST BZWBK | LAST VALUE |
|---|---|---|---|---|---|---|---|
| | | **TUESDAY (10 January)** | | | | | |
| 10:00 | GER | ZEW index | Jan | pts | 65.0 | - | 61.6 |
| 15:00 | US | Wholesale inventories | Nov | % | 0.5 | - | 0.2 |
| | | **WEDNESDAY (11 January)** | | | | | |
| **10:00** | **POL** | **Auction of 10Y bonds DS1015 PLN1.8-2.8bn** | | | | | |
| | | **THURSDAY (12 January)** | | | | | |
| 10:00 | EMU | GDP revised | Q3 | %YoY | 1.6 | - | 1.2 |
| 12:45 | EMU | ECB meeting – decision | Jan | % | 2.25 | - | 2.25 |
| 13:30 | US | International trade | Oct | USD bn | -65.9 | - | -68.89 |
| 13:30 | US | Import prices | Nov | % | 0.0 | - | -1.7 |
| 19:00 | US | Fed budget | Dec | USD bn | -10.0 | - | -2.85 |
| | | **FRIDAY (13 January)** | | | | | |
| **15:00** | **POL** | **Money supply** | **Dec** | **%YoY** | **10.7** | **10.6** | **12.5** |
| **15:00** | **POL** | **Current account** | **Nov** | **EUR m** | **-210.0** | **-250.0** | **-253.0** |
| 13:30 | US | PPI | Dec | %MoM | 0.2 | - | -0.7 |
| 13:30 | US | Retail sales | Dec | %MoM | 0.9 | - | 0.3 |

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


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## **What's hot this week –** Budget debate in focus of attention

**Selected assumptions of *Convergence programme***

**General government balance* (% of GDP)**

| | 2005 | 2006 | 2007 | 2008 |
|---|---|---|---|---|
| Updated version | n/a | -2.6 | -2.2 | -1.9 |
| November 2004 version | -3.9 | -3.2 | -2.2 | - |
| 2006 budget draft ** | -3.4 | -2.8 | -2.0 | -0.8 |

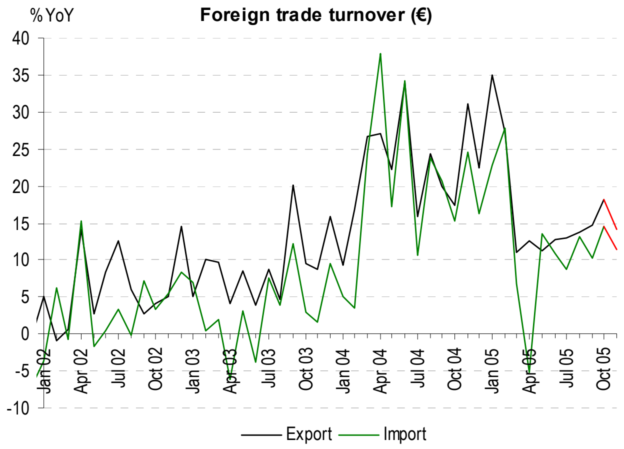
**Average inflation (%YoY)**

| | 2005 | 2006 | 2007 | 2008 |
|---|---|---|---|---|
| Updated version | n/a | 1.5 | 2.2 | 2.5 |
| November 2004 version | 3.0 | 2.7 | 2.5 | - |

*** OFE included in public finance sector**
**** estimates from 2006 budget draft prepared by Marek Belka's government**

▪ This week a work over 2006 budget enters the final stage. Third reading of budget bill is planned for 14 January (Saturday), and until then deputies will be working over amendments. Progress of work in Sejm's committees is a bit worrying, as deputies proposed increased spending. Sejm cannot increase the deficit, so lifting expenditure deputies have to specify additional revenues; the problem is that assumed sources of revenues are unreliable.

▪ Saturday's vote on budget bill will be also an important test of support for the government and a hint on premature election. It seems that the budget will not be rejected (minor parties afraid of election), however one cannot rule out that, likewise in child benefit voting, opposition will manage to introduce many changes to the bill that will change its shape significantly. It could imply a rise in political risk perceived by the financial market.

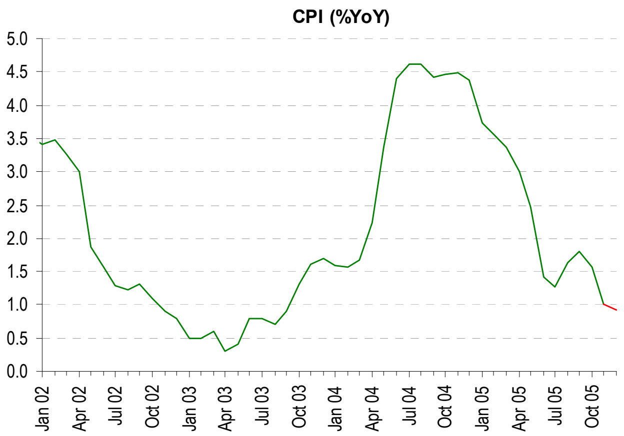



▪ On 10 January the government is expected to present updated Convergence programme, showing a path of fiscal consolidation in the medium run. According to unofficial information, the document will assume reduction in general government deficit to 2.2% of GDP in 2007 (the same as in previous version) and to 1.9% of GDP in 2008. Such scenario implies Poland will meet Maastricht fiscal criteria in 2008 only if EU agrees to treat OFEs as a part of public finances sector.

▪ Data on money supply should show ca. 10.5%YoY rise in M3 and ca. 11% credit growth, confirming good environment for fast economic growth in 2006.

▪ Current account deficit in November should be similarly low as in November (ca. €250m). Export and import growth, although a bit lower than in October, are likely to stay high. Data should be positive for the zloty.

## **Economy last week –** Optimistic inflation forecasts




▪ According to Ministry of Finance, budget deficit after January should reach 8-10% of this year's plan. Although a suggested outcome would be worse than in corresponding period of 2005, it would be better than multi-year average and thus should be positively received by the market. In the later part of the year, fast GDP growth will be supporting budget revenues, however exceeding planned revenues will be hard because they were assumed at very ambitious level.

▪ Start of the year should be also good for inflation. FinMin predicts CPI fall to 0.8%YoY in December and average inflation at 1.0-1.1%YoY in 1Q06. Our forecasts are slightly higher, but also below 1.5%YoY in 1Q06.

▪ At the start of new year, treasury minister Andrzej Mikosz was dismissed after accusations in press article. The decision had no impact on financial market.

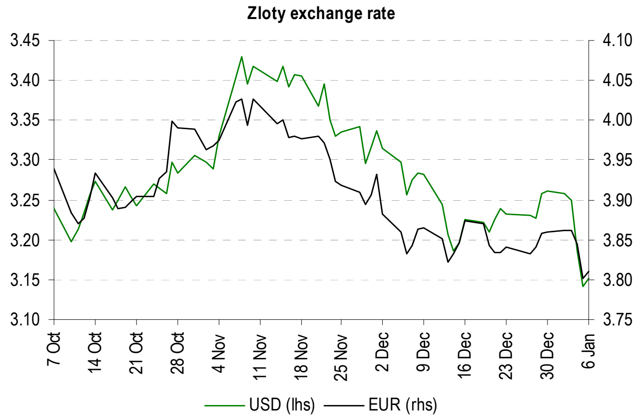
## **Quote of the week –** Poland mulling repayment of Paris Club debt

**Piotr Marczak, head of FinMin's debt dept.**; Reuters, 5 January

*We are considering further early payments of our Paris Club debt. As long as we have this debt, the issue remains open. Our debt duration is currently even better (longer) than that of some countries in the euro zone. It's important to present rating agencies with arguments pointing out continued improvement of the fiscal situation, which will enable better evaluations of not just the current position, but the near future.*

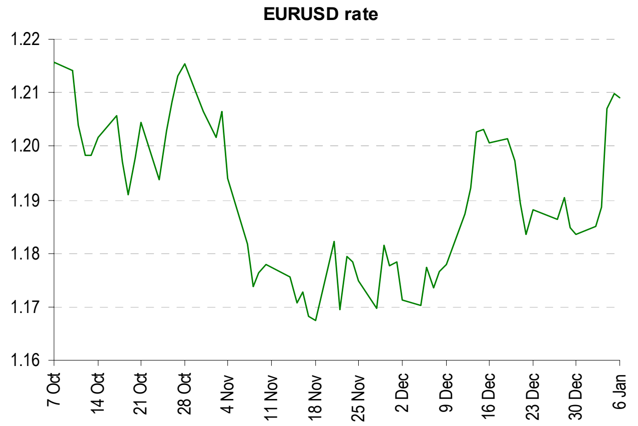
While the operation of early debt repayment could be beneficial for public finances, because it enables lowering debt servicing costs, extending debt's average duration and improving prospects for a rating upgrade, it is not necessarily supportive for the zloty. Namely, plans of early payments of foreign debt may mean that the ministry will sell less foreign currencies, from current eurobond issues, on the FX market.

## Market monitor



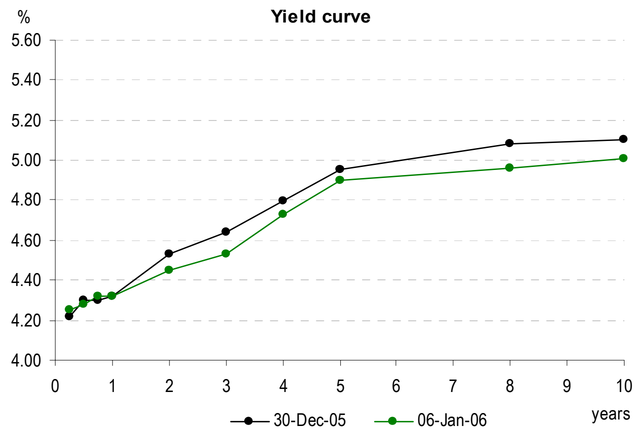

### Zloty at the strongest level since June 2002

- At the beginning of the week the activity on the market was quite low mainly due to absence of the foreign investors and zloty depreciated. However later on there was a strong appreciation of Polish currency to the highest level against the euro since 3.5 years (3.79), which was connected with substantial foreign capital inflow on the markets of our region. This went in line with January effect and new records on the WSE. Zloty gained 1.3% against the euro and 3.4% versus the dollar.
- In the incoming week quite important will be November current account data, as well as dispute on the budget with regards to its second parliamentary reading. If these events do not bring any negative surprising information we believe zloty remains strong with EURPLN rate on range between 3.76-3.86 and USDPLN rate between 3.14-3.24.



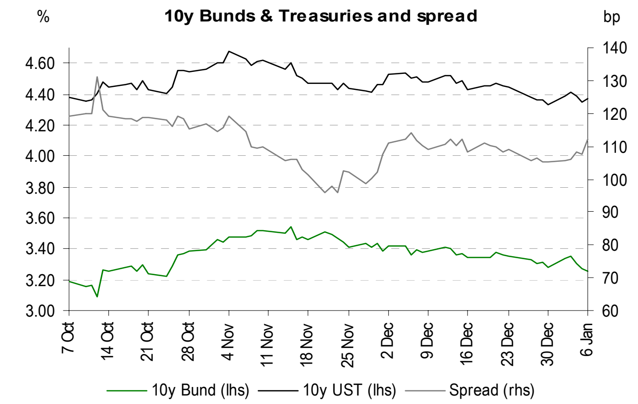

### Dollar falls amid the end of rate tightening cycle in U.S.

- The first day after New Year's Day was quite calm on the eurodollar market due to market holiday on many international markets. In reaction to weaker than expected manufacturing ISM figure as well as Fed minutes from December meeting, which included signals suggesting earlier end of rate hikes in U.S. as well as weaker than expected non-farm payrolls the dollar lost versus the single currency 2.5% up to 1.215.
- The market does not await interest rate changes in EMU, thus the decision should not have influence. As China indicated that it may diversify its growing dollar foreign exchange reserves away from the greenback and U.S. Treasuries, this may work against the dollar. The key figures for the EURUSD rate will be ZEW index, current account deficit and PPI in Unites States.




### Debt strengthens moderately– speculation on rate cut in January

- In the past week Polish debt strengthened by 6-13 bps amid foreign capital inflows, which was connected with speculation on rate cut in January and information on lower than market expectations of MF inflation forecast. The positive outlook of the interest rate market was influenced by successful T-bills and 2Y bonds auctions, whereas temporary correction resulted from a situation on the core bond markets.
- Next week convergence program is going to be presented and a date of euro zone entry may be announced, which may support bonds further on. Yields of Polish bonds will be influenced by 10Y bonds tender and situation on the core bond markets, where quite important figures are scheduled to be released.




### Yields drop in EMU; spread rise

- Yields of German and American government bonds rose at the beginning of the week though later on foreign debt recovered part of the losses after weaker than expected ISM figure as well as amid FOMC minutes from December meeting. The bond market strengthened slightly on weaker than expected non-farm payrolls data with highest for 33 months rise YoY of average hourly earnings. At the end 10Y Treasuries weakened from 4.33% to 4.35%, whereas Bunds gained up from 3.28% to 3.25% last Friday.
- The crucial factors for bond yields and rates will have ZEW index in EMU as well as producer prices and current account data in USA. EBC will probably not change the parameters of monetary policy in the euro zone.

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