Bank Zachodni WBK

Weekly economic update

6 – 12 February 2006

Last week saw many important events. On Monday preliminary GDP data for 2005 were released, on Tuesday the MPC renewed rate cut cycle and on Thursday the ruling PiS signed the so-called stabilisation pact with populist Self-defence and LPR.

According to preliminary CSO data, GDP growth in 2005 as a whole and in 4Q05 alone was weaker than expected but was achieved amid much stronger domestic demand, especially investment. In our opinion strong rebound in investment growth should not necessarily create significant pressure on prices, as investment demand increases not only actual GDP, but also potential GDP. As long as private consumption demand does not accelerate rapidly, improvement in domestic demand does not create big risk for medium-term inflation prospects. Such interpretation of GDP data was probably shared by majority of MPC members, as GDP figures did not prevent them from making decision to cut interest rates. Fully in line with market expectations, the reference rate was trimmed by 25bps and now stands at 4.25%. The Polish official interest rate is currently lower than the main rate in the US, as FOMC decided to hike Fed funds rate by another 25bps to 4.5%. The ECB did not change rate last week, but a hike was considered. Decision of the Polish MPC was justified by favourable inflation outlook, reflected in lower inflation projection (and weaker GDP projections) presented in the new *Inflation Report*. While the MPC was expected to show a new way of communication this year, after dropping monetary policy bias, we did not notice it, unfortunately. This does not make predicting monetary policy prospects easier and worsens its transparency. However, although official statement after MPC meeting and the new *Inflation Report* did not gave clear hints on future monetary policy decisions and central bankers' judgement on inflation outlook, the documents were rather of dove-ish tone. If next economic data and developments on financial markets show no increase in inflationary risks, another 25bps rate cut cannot be excluded, even in February.

Within the nearest week no important events are scheduled, although one cannot exclude that there will appear more details regarding bills which form a part of the "stabilisation pact". One of the hot topics will be planned changes to the NBP Act.

Economic calendar

TIME GMT	REGION	INDICATOR (importance level*)	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		WEDNESDAY (6 January)					
10:00	**POL**	**Auction of PLN1.0bn 52-week T-bills (M)**					
		WEDNESDAY (8 February)					
10:00	**POL**	**Auction of PLN500m 12Y CPI linked IZ0816 bonds**					
10:00	**POL**	**PLN1.0-2.0bn 7Y floating rate bonds**					
		THURSDAY (9 February)					
15:00	USA	Wholesale inventories (H)	Dec	%	0.5	-	0.4
		FRIDAY (10 February)					
7:00	GER	CPI (M)	Jan	%	2.1	-	2.1
7:00	GER	HCPI (M)	Jan	%	2.2	-	2.1
13:30	US	Foreign trade (H)	Dec	mld $	-63.5	-	-64.21
29:00	US	Budget deficit (M)	Jan	mld $	8.0	-	8.58

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

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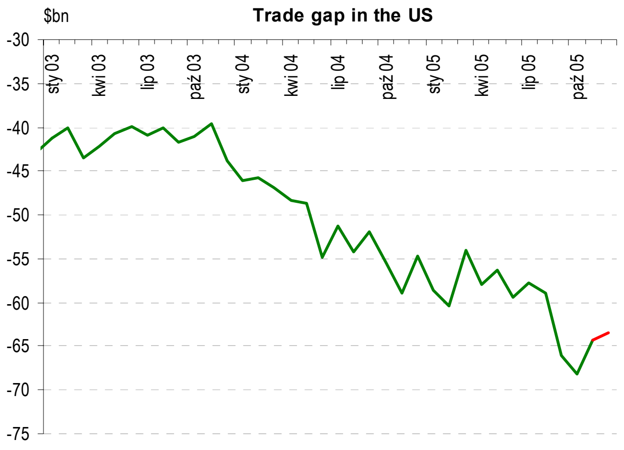
What's hot this week – A few calm days



- The nearest week will see no data releases in Poland and there are also no other domestic events scheduled.
- Thus, participants of the Polish financial market will watch developments on the major markets abroad.
- However, for the better part of the week, there will be also no important drivers for the markets abroad. Only a few major data releases are due for this week, all of them concentrated on the last two days of the week. The key focus of attention will be data on US trade deficit to be published on Friday.
- Apart from tendencies on the markets abroad, participants of the Polish market are likely to closely watch developments on the domestic political scene. After signing of the so-called "stabilisation pact" by PiS with populists, the market will wait what the parliamentary majority will propose as regards economic policy and planned changed in the NBP Act.

Economy last week – Renewed rate cut hopes

NBP inflation projections (%YoY)

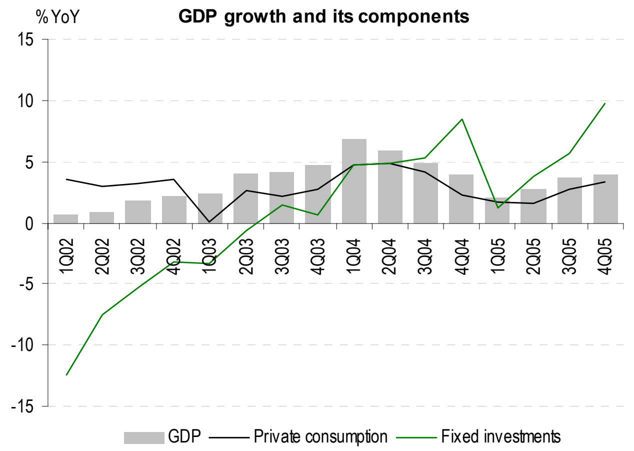
	May 2004	Aug 2004	Nov 2004	Feb 2005
4Q05	0.4-4.2	1.2-3.8	1.0-3.1	0.5-2.3
4Q06	0.5-4.6	0.7-4.3	1.2-4.1	1.1-3.6
4Q07	-	-	-	0.8-3.9

NBP projections of GDP growth (%)

	August 2005	January 2006
2006	3.9-5.3	3.8-5.1
2007	3.8-5.6	3.4-5.2
2008	-	3.6-5.5

Source: Inflation Report – January 2006

- In line with broad market consensus, the MPC reduced main interest rates by 25bps at its January's meeting. The basis for such decision was new Inflation Report, which included the new inflation projection, more optimistic than the previous one. New, lower GDP projections were also an argument in favour of another rate cut.
- Although the official statement after MPC meeting and the new Inflation Report were rather dove-ish, they did not gave clear hints on future monetary policy decisions and central bankers' judgement on inflation outlook.
- Both documents strongly stressed existence of many uncertainty factors. These factors are twofold. Some of them could improve inflation outlook (price effects of globalisation, zloty appreciation), while others could act in the opposite direction (uncertainty regarding public finances, firming labour market conditions).



- According to preliminary CSO data, GDP growth in 2005 reached 3.2% against widely expected 3.4%.
- In 4Q05 alone, GDP growth amounted to only 3.9%YoY while the broad market consensus was 4.5%YoY.
- However, the breakdown of GDP growth bodes well for the future. Finally, there was strong revival in investment demand. In the whole year, investment demand grew 6.2% and in 4Q05 alone it expended by almost 10%YoY, the strongest since 1Q98. Individual consumption grew 2.3% in the whole year and 3.3% in 4Q05, as expected.
- All in all, domestic demand grew by 5.1%YoY in 4Q05 and overall GDP growth disappointed due to negative contribution of net exports (which also confirmed rebound in domestic demand). The point is that investment demand finally revived, which bodes well for future GDP growth, especially that there are good prospects for consumption.

Quote of the week – "Stabilisation pact" complicated the situation

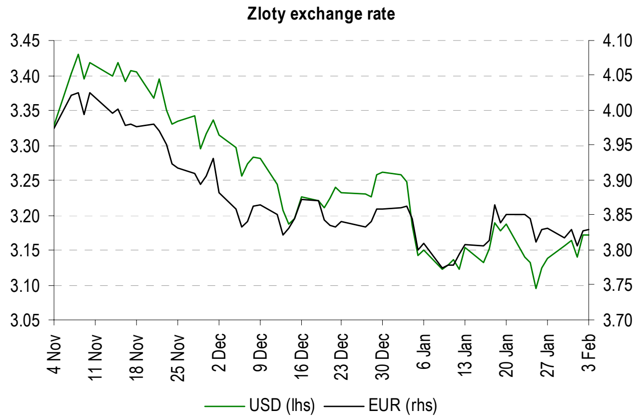
Halina Wasilewska-Trenkner, MPC member; Reuters, 2 January

The position is difficult, it has become much more complicated. We need time to analyze the details. Everything will depend on what happens with the budget and economic policy.

It gives us something to think about. But we need to analyse the situation. For now these are only words.

Wasilewska-Trenkner's reaction to the fact that PiS reached an agreement with populist parties suggests that one should not count on another rate cut already in February. However, it is not sure whether majority of MPC members, which decided to cut rates in January, shares her opinion. An argument against another cut at February's meeting may be an early date of the meeting (21-22 February) and thus the lack of some of important data.

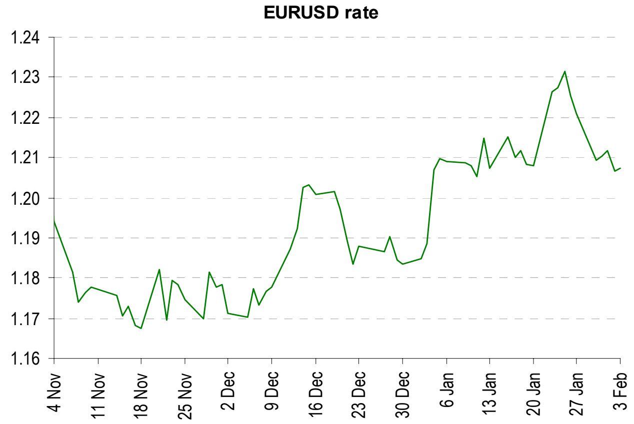
Market monitor



Zloty in a narrow range

▪ Last week the FX market was quite calm. At the beginning zloty slightly strengthened, however slightly worse sentiment of investors towards Poland as well as heavy declines of indices at the WSE resulted in zloty depreciation. Another strengthening came in after MPC cut interest rate, which was followed by a temporary weakening after signing of so called „stabilisation pact". In the past week Polish currency remained flat against the euro and depreciated versus the dollar by 1.1%.

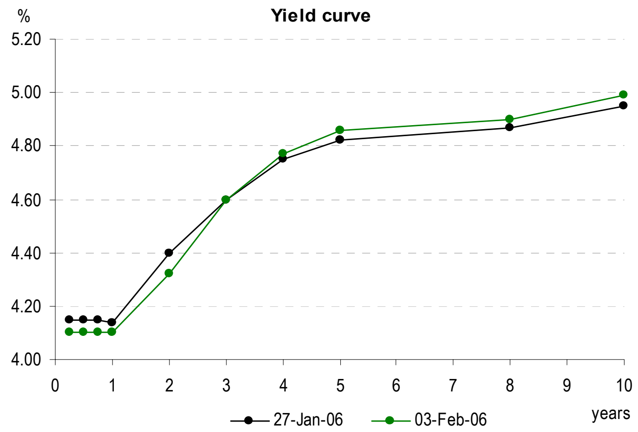
▪ The political situation should be more calm and stable, despite the negative aspects of the „stabilisation pact". It seems that the most valuable bills are not going to be approved. We believe, that next week the EURPLN rate will fluctuate in range 3.77-3.87, while USDPLN 3.12-3.22.



Dollar strengthened

▪ This week the dollar strengthened by ca. 1% as compared to the single currency to the highest levels for 4 weeks. After the weaker Chicago PMI index EURUSD rate soared to 1.215, however suggestions on possibility of further rate hikes by Fed strengthened the greenback to 1.208. ECB communiqué, which was more hawkish than before as well as new on planned attacks on United States by terrorists from al Qaeda contributed to a temporary correction to 1.21. However as data from the labour market appeared to be positive the dollar strengthened to 1.197.

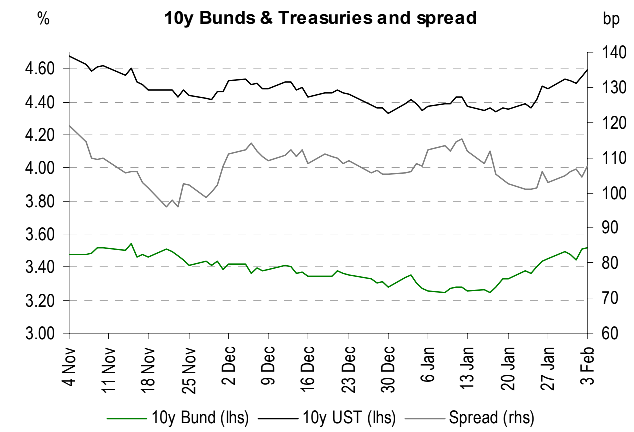
▪ Next week will feature few events and the market will focus on figures from U.S., mainly on wholesale inventories and trade deficit. If the drop of the deficit becomes a firmer trend this may result in dollar appreciation.



Slight steepening of the curve

▪ The bonds strengthened in the passed week by 5-8 pb. at the short term, which resulted in a steepening of the curve. Initially a yields soared as amid little events on the domestic market the bonds prices were down in reaction to situation on the core bond markets. However the interest rate cut as well as dovish MPC statement and new inflation projection suggesting inflation will converge to the target at 2.5% later than previously assumed contributed to Polish debt strengthening and gave it some firm support.

▪ In the coming week the situation on the fixed income market should be quite stable amid lack of data release on the Polish market and temporary stabilisation at the political scene. Yields will be determined by the situation on the core bonds markets and next weeks tenders.



Yields rise on expectations of a rate hike

▪ As it was expected Federal Reserve raised the main Fed Funds rate by 25 bps and European Central Bank left the interest rate at the unchanged level, issuing a more hawkish statement than previously. 10Y U.S. Treasuries weakened to 4.61% awaiting positive non-farm payrolls and unemployment data, after the data were released and after information on next weeks bond supply. Bunds followed the U.S. market, and 10Y yields followed jumped from 3.45% to 3.52%.

▪ Next week the most important will be wholesale inventories and trade deficit data. Amid figures from U.S. market as well as statements issued after Fed and ECB meetings, investors expect further monetary policy tightening in both regions.

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