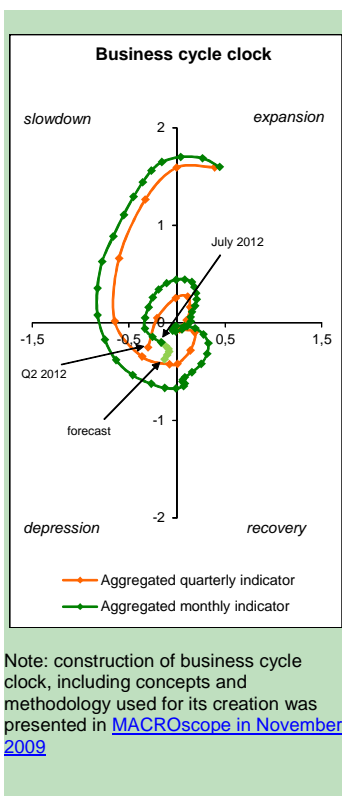


# MACROscope

## Polish Economy and Financial Markets

September 2012



## ECB on the go, MPC very slow

▪ **The European Central Bank did not waste time since its last meeting and prepared a solution to support the euro zone countries. On the other hand, the Polish MPC is still waiting, though in our opinion the economic situation clearly suggests an action (of course not to the extent as the ECB).**

▪ The ECB's plan of sovereign bond purchases – unlimited in scale, focused on short-end of the bond curve, conditional, fully sterilised – was welcomed by the markets. However, further development of this optimism is dependent on the ruling of the German Constitutional Court about the ESM and on the conditions necessary for the central bank to start bond purchases. Fed decision about another round of quantitative easing will also be of importance, especially given weak data from the US economy. Taking into account considerable scale of political uncertainty in the euro zone in the upcoming time, we decided to maintain our exchange rate forecasts (EURPLN at ca. 4.20 at the end of 2012, 4.15 on average in 2013).

▪ **The MPC has done the necessary minimum – adjusted its tone to the changing economic environment, making it more dovish, as maintaining the statement about a possibility of further hikes would be rather ridiculous.** We think the MPC cannot escape from the economic reality any longer so we expect three interest rate cuts by 25 basis points in the upcoming months. The nearest move should be made already in October, as upcoming data will confirm slowdown and low inflationary pressure (see pages 7-8 for a more detailed comment on monetary policy).

▪ **Our forecast of economic growth in the second quarter (2.6%) was the lowest among the market forecasts, while the reality proved to be even more pessimistic (2.4%).** Quite positive July's data will be, in our view, only a temporary revival of the economic activity and the upcoming data from the economy will reflect the continued slowdown. In general, we expect the Polish economy to grow by less than 2% in the third quarter and the growth rate may slide towards 1% at the year-end. Our quarterly business cycle clock (see graph beside) shows that the domestic economy has entered a depression phase (monthly data have been showing it for some time already). Surely, a less favourable economic situation is a challenge for the government and its fiscal adjustment path needs a revision. However, we do not think that change of planned deficit for 2013 will discourage foreign investors from investing in the Polish debt market and cause capital outflow. A further decline of short-maturity yields is quite possible, at least in the short term, due to weak macro data and declining inflation, as the market will probably overreact in terms of pricing-in the scale of MPC's interest rate cuts.

▪ **This month we would like to suggest putting short-term economic and market issues down and focusing on some aspects of long-term economic developments in Poland.** Our *Special focus* shows basic trends in demographics as well as challenges for the economic policy regarding these issues.

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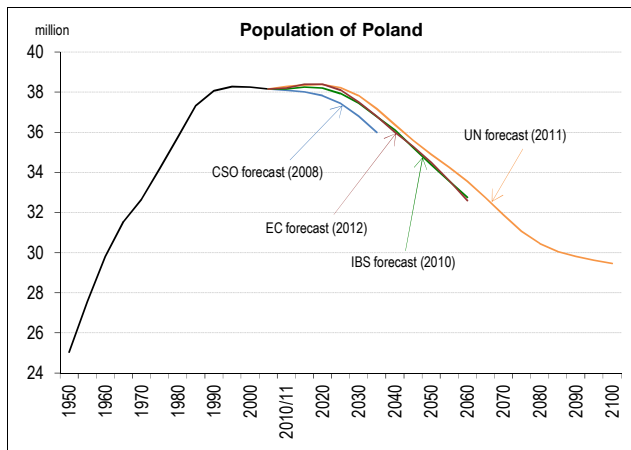
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### Financial market on 7 September 2012:

|                    |      |                        |      |        |        |
|--------------------|------|------------------------|------|--------|--------|
| NBP deposit rate   | 3.25 | WIBOR 3M               | 4.96 | EURPLN | 4.1275 |
| NBP reference rate | 4.75 | Yield on 2-year T-bond | 4.05 | USDPLN | 3.2578 |
| NBP lombard rate   | 6.25 | Yield on 5-year T-bond | 4.24 | CHFPLN | 3.2670 |

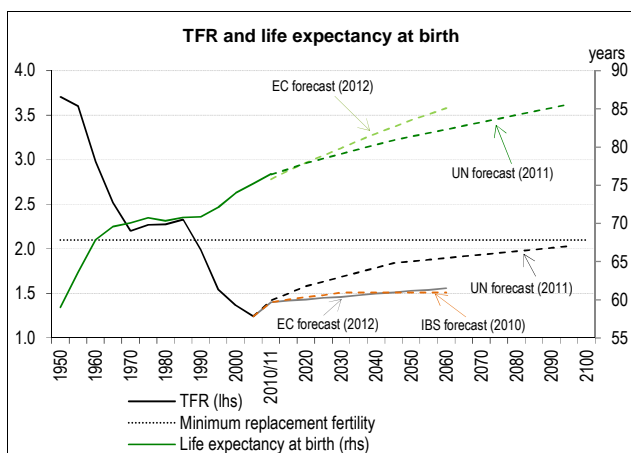
\* Special focus was prepared in cooperation with Marcin Chrostowski from Warsaw School of Economics (SGH) during his summer training in BZWBK.

# Special focus: Demographic challenges\*



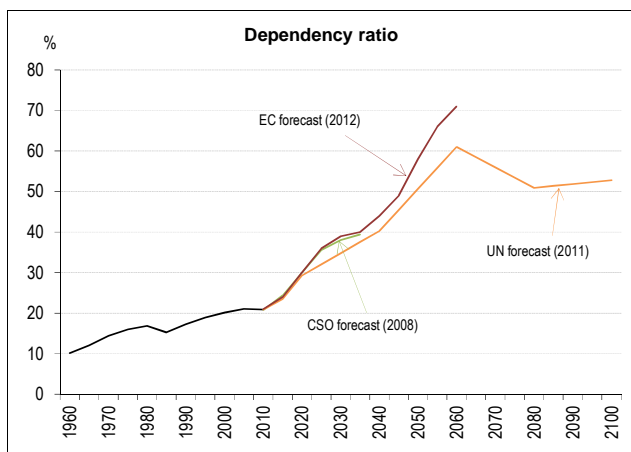
## Population shrinkage is unavoidable

- Over the horizon of the next several dozen years, population shrinkage in Poland seems to be unavoidable. The number of Polish citizens may continue to grow for a few years, to start decreasing to 32-34 million people in 2060. Towards the end of the 21<sup>st</sup> century, the number may start to stabilize at ca. 29 million.
- Population shrinkage is related to the so-called second demographic transition triggered, among others, by the improving standard of living and cultural changes. It means, among others, a drop in total fertility rate, extension of life expectancy, migration pick up.
- Fertility drop and higher life expectancy lead to society's aging, i.e. the growing percentage of elderly people in the population.
- It is important for the economy given the dependence of the value of taxes and premiums paid by an individual to the state's treasury as well as the value of benefits the individual collects at the particular age.



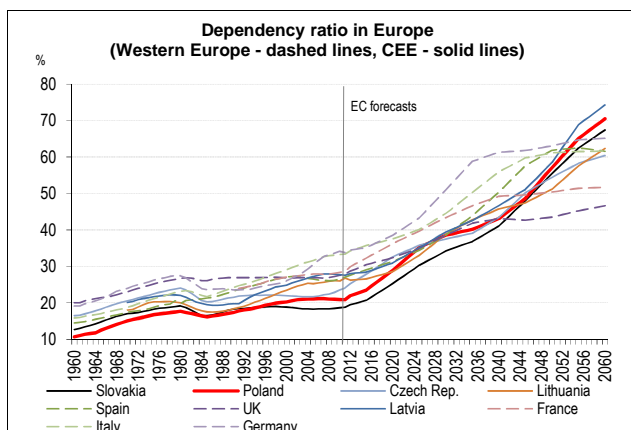
## Moderate increase in the total fertility rate and extension of life expectancy

- Since the 80s, Poland's TFR (total fertility rate), the ratio which defines the number of children born per woman of reproductive age (15-49 years of age) stays below the minimum replacement level (2.1). In 2010, it was merely 1.4 which was one of Europe's lowest records. Decrease in the fertility rate in Poland has primarily been driven by the evolution of the family model. The TFR is projected to increase to 1.51-1.56 in 2060. However, even the most optimistic forecast (United Nations) does not envisage that TFR will go beyond 2.1 by 2100.
- Average life expectancy at birth has increased from 59 years in 1950 to ca. 76 years in 2010. This figure is expected to grow further from 71.7 to 82.4 for men and from 80.1 to 87.9 for women in the years 2010-60.



## Increase in the age dependency ratio

- In view of the said trends, the society will age. It is predicted that in the years 2007-2035, the percentage of people aged over 65 will increase from 13.4% to 23.2% which will affect, e.g., public spending on health as unit costs of healthcare peak in the last years of life.
- Increase in the number of elderly people will trigger growth of the age dependency ratio (the ratio of older dependents – people older than 65 – to the working-age population – aged 20-64) from ca. 25% to 46% in 2035 and 71% in 2060. It is crucial primarily from the point of view of the pension system as this ratio roughly reflects the ratio of individuals collecting pension benefits to the number of people who pay premiums.

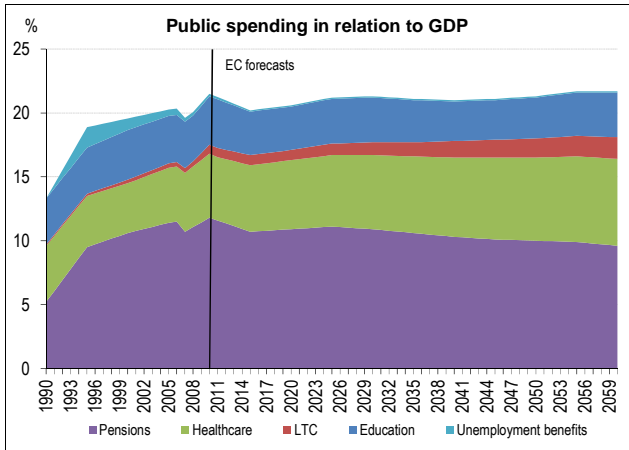


## The Polish society will age quicker than in the West

- The pace of society's aging (measured with the age dependency ratio) in Western Europe will slow down in the 30s of the 21st century. In the EU states of the Central and Eastern Europe, on the other hand, the rate will be still high. At the same time, the ratio of the post-working age population to the working age population will exceed, among others in Poland, the level recorded for the largest economies of Western Europe in the middle of the 21st century.
- Provided there are no major changes driven, among others, by new governmental policies, the Polish society will age quicker than in Western Europe due to, e.g. differences in the net balance of migrants and less spending on actions intended to counteract the society's aging in Poland than in Western Europe.

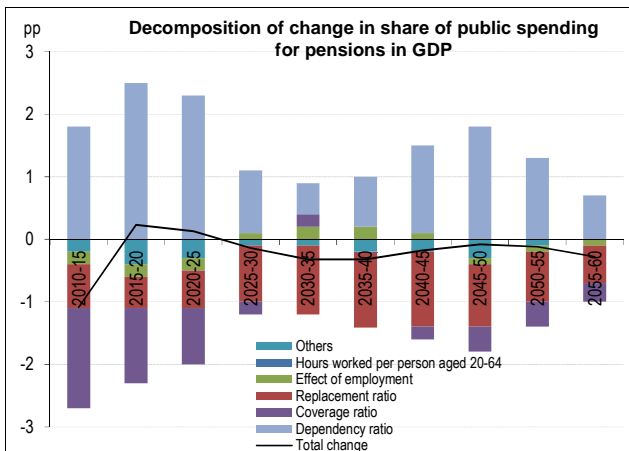
Source: CSO, Eurostat, EC, IBS, UN \* Marcin Chrostowski from Warsaw School of Economics (SGH) contributed to this research.

# Special focus: Demographic challenges



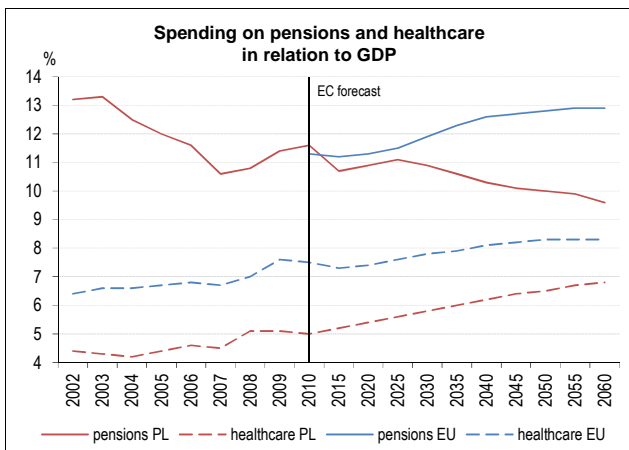
## Public spending on pensions to decrease

- The age dependency ratio affects the volume of the state's spending on public pensions. The European Commission (EC) projects that the state's spending on pensions relative to the GDP in Poland will decline to reach 9.6% in 2060 versus 11.8% in 2010. The decrease of the spending is driven, among others, by the fact that the pension system in Poland is based on a defined contribution rather than a defined benefit and by the gradual transition to the private pension system.
- The projection does not take into account lifting the retirement age up to 67 years by 2020 (men) and 2040 (women), as well as changes limiting uniformed services' state pension entitlements (both acts were signed by the president in June 2012) which deliver an additional cut to pension spending (analysis of the impact of the reform on the next page).



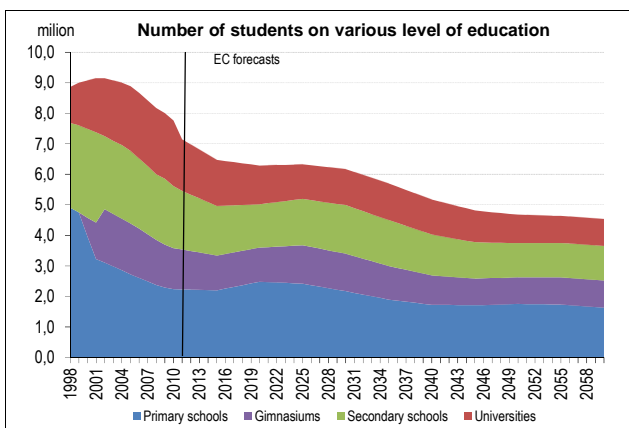
## Drivers of decreasing pension spending

- Spending on public pension relative to the GDP in Poland is to decline in most periods. The expenditure is positively stimulated by the expected rise in age dependency ratio, while the negative impact is exerted by the so-called coverage ratio (the ratio of the number of pension benefits paid to the number of people aged 65+) and the income replacement ratio (relation of average retirement benefit to average salary).
- Poland is in a relatively good position as regards the pension system as it is an emerging economy which is related to a more favourable stage of economic development and a relatively low ratio of public pension expenditure to the GDP. It is worth emphasising, however, that in the case of Poland there is a risk of expenditure growing beyond forecast in view of the risk driven by the lack of political approval of major shrinkage in the income replacement ratio.



## Increase in public spending on healthcare

- The progressing aging of the society implies growth in expenditure on healthcare relative to the GDP. According to the EC, healthcare expenditure will increase by 1.9 percentage points of the GDP by 2060. It is related to the growing percentage of elderly people in the population which leads to growth in the old age-related disease incidence ratio.
- It is worth stressing the fact that the issue of healthcare related expenditure is often played down. Accordingly, politicians dedicate more time to reforming pension systems and less to modifying healthcare systems.

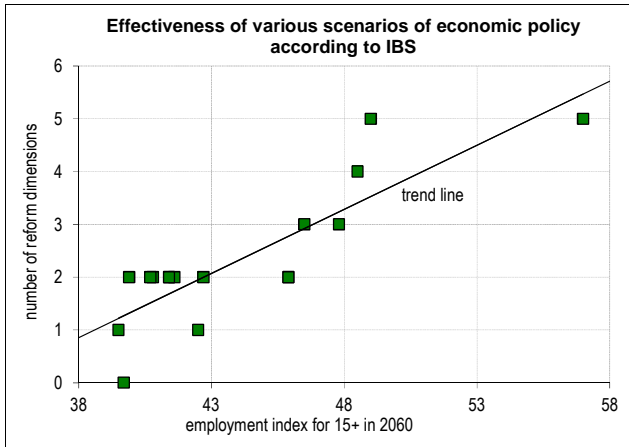


## Public expenditure on LTC will grow and spending on education will decrease

- The growing percentage of elderly people in the population will also affect the LTC sector (long-term care, care over chronically ill and disabled people) which, for now, is primarily financed in Poland with private funds where informal care dominates. However, the it seems very likely that demand for state-funded benefits will grow. Public expenditure is expected to grow in the LTC sector from 0.7% of the GDP in 2010 to 1.7% of the GDP in 2060.
- Moreover, demographic changes will be reflected in public spending on education. The expenditure is forecast to decrease relative to the GDP in the years 2010-2060 from 3.9% to 3.5% of GDP. It will result from the decreasing number of pupils and students of all types of schools in the forecast period.

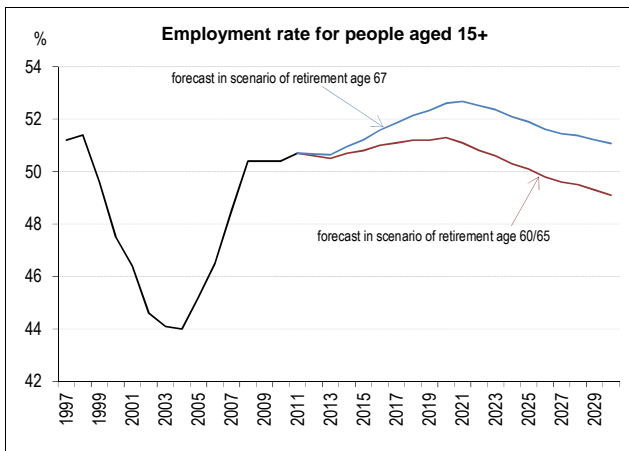
Source: CSO, Eurostat, EC

# Special focus: Demographic challenges



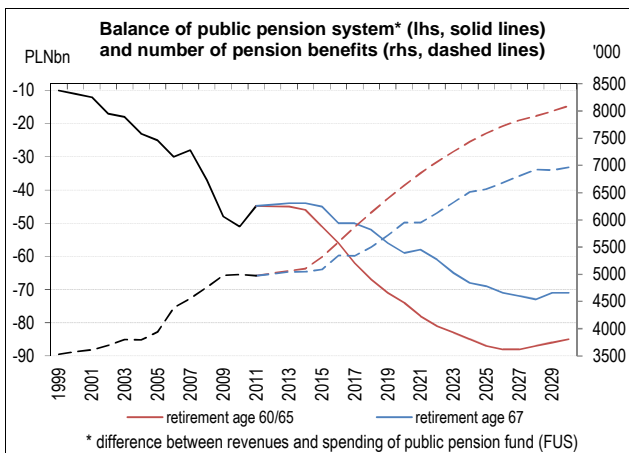
### Reforms should be multi-dimensional

- The government's economic policy should respond to demographic changes in a comprehensive way. Only multi-dimensional, coordinated, and implemented as early as possible reforms will allow sustaining potential GDP growth at a level similar to the current one. The chart on the left hand side illustrates the relation between the number of dimensions of the reform in line with the individual scenarios of the economic policy (selected by the Institute for Structural Research - IBS) and the 15+ employment ratio in 2060.
- Reforms should cover the following areas: increase of retirement age, activating people in all age groups, initiatives aimed at increasing the TFR among women, stimulating an additional net migration to Poland.



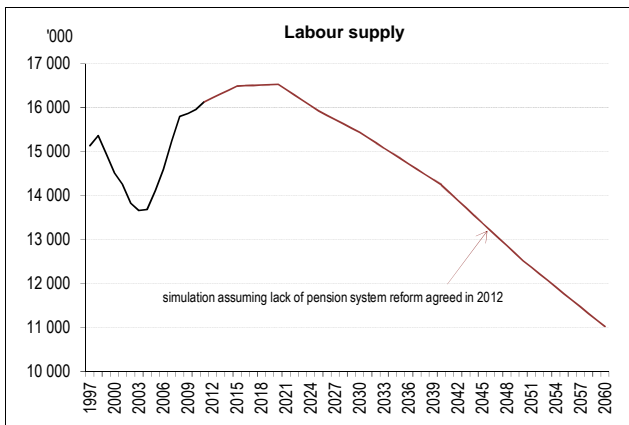
### Higher retirement age = more activity and bigger employment

- The IBS analysis shows that the pension age increase (that has been passed this year) will trigger a pick-up in working activity relative to the scenario of 60/65 retirement age. The vast majority of additional professionally active individuals will find employment (the working population will increase by ca. 0.5m people over a dozen years). The number of the unemployed will increase only marginally (by 0.1m people). Employment growth in response to growing professional activity is common in the case of countries, which increase their retirement age with a view to extending the period of professional activity and decreasing the risk of the labour market being left by individuals aged 50+.
- The jobless rate will pick up only marginally (max. by 0.06 pp.). As a result of the pension reform, the professional activity will increase by 2.2 pp. by 2030, while the employment ratio will hike by 2.0 pp.



### Better balance of the pension system

- According to IBS, due to approved increase in retirement age, within 10 years the number of pension benefits paid may decrease by 1m and the pension system's balance may improve (reasons: less retirement benefits paid, more income from premiums) by nearly PLN 20bn (in constant prices) in 2021-22. Beyond that time horizon, the advantage may be smaller – the difference will be a dozen billion zloty. Decrease in positive effect is caused by the fact that the higher the retirement age the retirement benefits paid will be bigger.
- Higher tax income is expected, driven by the higher employment rate and consequently bigger consumption and higher GDP (PLN3.1bn more income in 2020 and PLN14.4bn more in 2030).
- To summarize: changes in the pension system will improve the situation without arresting the trends sparked by demographic changes (number of pensioners and the pension system's deficit will grow).

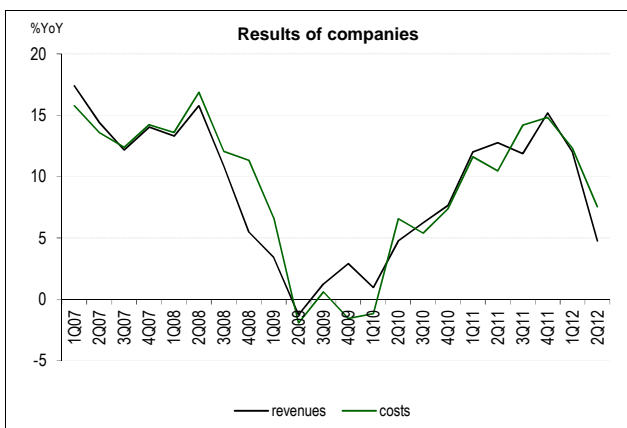
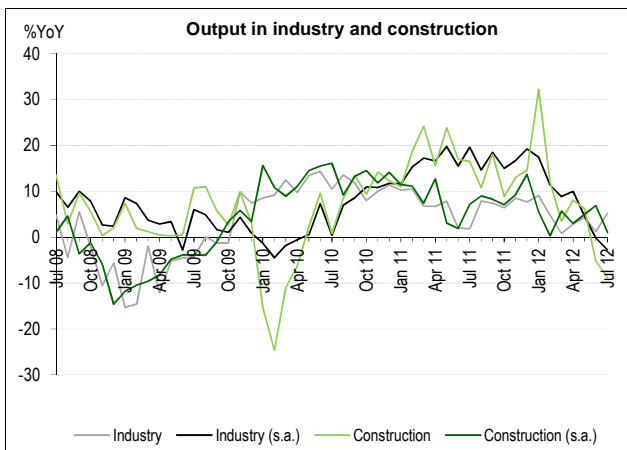
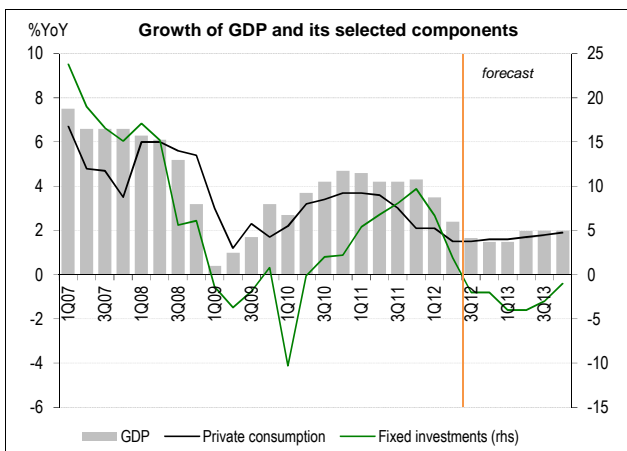
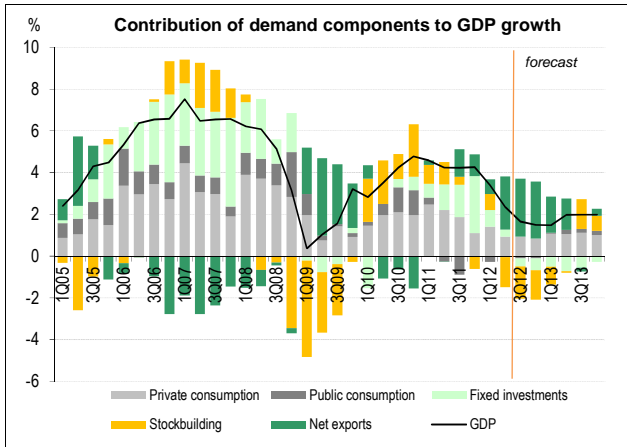


### Absence of changes will slow down the GDP growth

- The outcome of IBS study indicates that in the scenario of no reforms in 2012, the nominal value of the GDP will be lower than in the hypothetical scenario of fixed population and employment over the entire projected period by over 7% in 2060 (consumption will be over 9% smaller). This means reduction in the GDP growth rate (in the 40s and 50s of the 21<sup>st</sup> century by ca. 0.25 pp.). It is indicative of the necessity to implement adequate reforms to counteract decline in the GDP growth.
- The said negative trends will be triggered by the decline in the labour supply, which, according to the IBS's calculations, will be 5m people until 2060, which will cause the economic activity and employment among people aged 15+ to decrease.

Source: Eurostat, IBS, MF, OECD, Government's Economic Council, ZUS

# Economic update



## Further slowdown ahead – change in forecasts

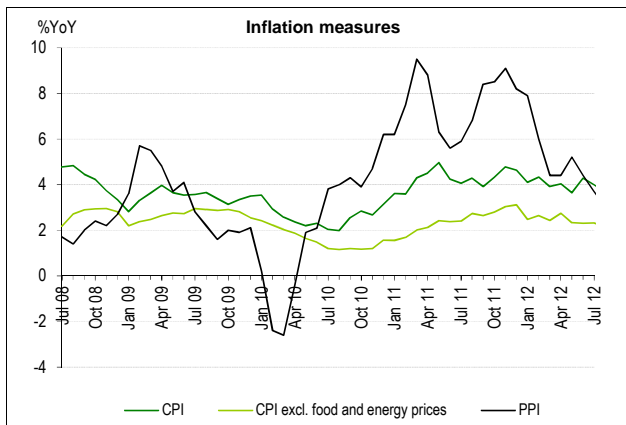
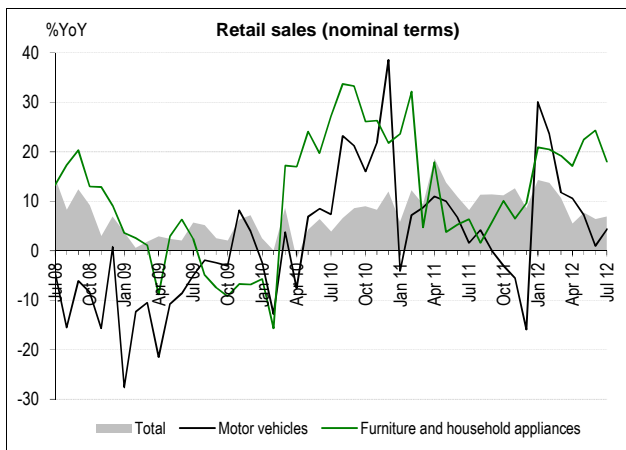
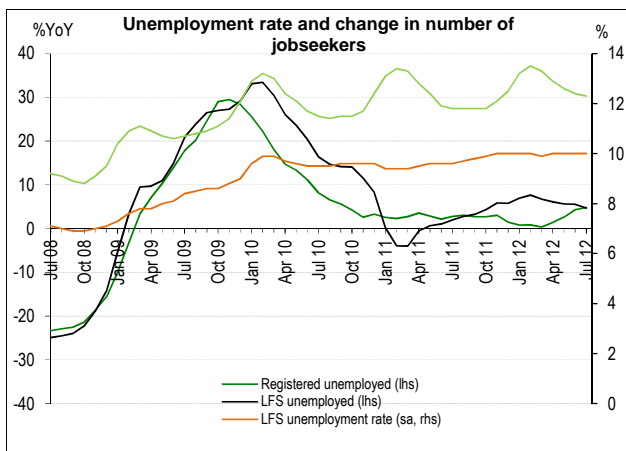
- GDP growth decelerated in 2012Q2 to 2.4%YoY which was the lowest reading since 2009Q3. Data proved to be weaker even than our forecast at 2.6%, which was actually the most pessimistic on the market.
- Domestic demand slowed markedly, showing a decline by 0.2%YoY in Q2 (after an increase by 2.7% in Q1). Growth of individual consumption weakened to 1.5%YoY (from 2.1%YoY in Q1). At the same time, pace of growth of fixed investments plunged to 1.9%YoY from 6.7%YoY in Q1. It is worth noting that this deceleration took place during period of preparations to EURO2012, when – as we can suppose – dynamics of infrastructural investments financed from public funds was high. This means that investment activity of private sector may have been limited strongly in Q2.
- Net exports had significant positive contribution to pace of GDP growth in Q2 (2.6pp versus 0.7pp in Q1). Despite slowing exports, the trade balance clearly improved amid weaker imports. In Q2 there was even a surplus in foreign trade. Economic slowdown is also affecting stockbuilding (contribution to GDP growth: -1.5pp), which is connected with lower imports and output in face of weak orders.
- The Q2 2012 GDP data and other information from real economy received recently suggested that the situation in H2 2012 could be worse than we assumed earlier. In our view, investments will show a negative growth rate (-2%YoY) in the upcoming quarters, which will be due to reduction of public projects and lower private investment activity. This will mean further slowdown of domestic demand. Scale of GDP slowdown will be slightly mitigated by positive contribution of net exports.
- We expect the GDP growth to slow down to 1.7%YoY in Q3 and to 1.5% in Q4. In 2012 as a whole the economy will grow by 2.2% and in 2013 by 1.9%.

## Polish companies' situation deteriorates

- Industrial output increased in July by 5.2%YoY (1.2%YoY in June). This positive outcome was partly due to one more working day in comparison with July 2011. It is worth noting that seasonally adjusted output growth rate was also stable and amounted almost to 5% (in comparison with 3.5% in Q2).
- We do not expect that July's outcome will be repeated in the upcoming months and we still maintain our expectations for further deceleration of the economy. This forecast is supported by weak data on PMI index for Polish manufacturing, which recorded a drop in August to 48.3pts from 49.7pts in July. Indices for output and new orders are in a visible downward trend and will probably stay below neutral mark of 50pts for the upcoming months.
- In contrast with pretty good industrial output, information about construction and assembly output clearly disappointed. A fall by 8.8% in annual terms was recorded after drop by 5.2% in June. The decrease occurred also in case of seasonally adjusted measure (by 2.8%YoY) and in all branches of construction sector. The bleak situation in construction will probably maintain for a couple of nearest quarters, as the sector will be undermined by financial problems of construction companies and declining number of orders.
- Our expectations about the production sector are supported by weak data on results of non-financial companies in Q2. Annual drop of net profit amounted to almost 34% (the deeper contraction since 2009Q1) as compared to growth by 7.3% in Q1. Pace of growth of revenues decelerated considerably (to 4.8%YoY from 12%YoY in Q1).
- In environment of declining orders and deteriorating financial situation, enterprises are likely to limit their investment activity and cut their plans of wage rises and hiring.

Source: CSO, Reuters, BZ WBK

# Economic update



Source: CSO, NBP, Reuters, BZ WBK

## Miserable labour market situation

- July's data on wages and employment in the corporate sector proved to be the weakest in more than two years. Employment growth was unchanged on annual basis (0.1%YoY in June). Since January 22k jobs were already shed, and since last employment peak in July 2011: 47k (if we omit January, when the CSO is adjusting the sample). A falling employment in construction, which recorded its worst July in 10 years, was the main culprit behind weakening growth of employment in the whole enterprise sector.
- Wage growth in the enterprise sector slowed to 2.4%YoY, down from 4.3%YoY in June. Distortions in pace of growth of wages (a strong acceleration in June and a deceleration in July) were mainly due to shifts of bonus payments in mining. In our view wage growth will return to ca. 3%YoY in the upcoming months.
- The registered unemployment rate declined in July in line with our expectations to 12.3% from 12.4% in June. Lower rate is coherent with seasonal pattern, but it is worth to emphasize that this year the number of unemployed declined on monthly basis only by 11.2k, which is the weakest result since 2002 (when omitting crisis year of 2009) – usually the number declines by 20-40k in July versus June.
- Data on unemployment rate according to LFS released also today showed that in Q2 the rate declined to 9.9% from 10.5% in Q1. On the annual basis the number of unemployed increased by 4.1% in total. Still, it is worth to notice that the ratios of economic activity and employment are higher than a year ago. That indicates that higher unemployment in Q2 in annual terms was partly triggered by activation of those inactive.
- We expect the demand for labour to remain weak in the upcoming quarters, as companies will not decide to hire new employees in face of economic slowdown. Wage pressure will also be limited.

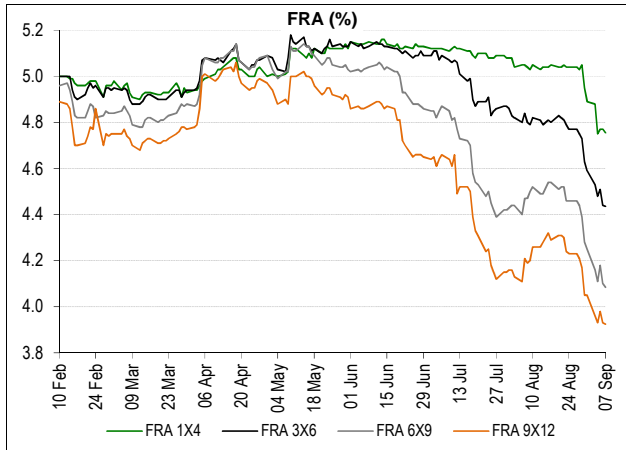
## Consumption growth will remain moderate

- Retail sales accelerated in July by 6.9%YoY (from 6.4% in June). In real terms sales advanced by 3.4%YoY vs. an increase by 2.6%YoY in June. One should notice that the third quarter has begun with slightly stronger increase as compared with the second quarter, which could be a positive signal for private consumption.
- However, wage bill in corporate sector fell by 1.5%YoY in real terms in July, while NBP's report on financial situation of households, which showed that real gross disposable income fell in Q1 by 1.9%YoY. Moreover, saving rate of households was below zero. It means that households were "consuming" their savings, thus helping the consumption growth to maintain above 2% in Q1. However, households have already begun to rein in their consumption and will be more cautious while planning their expenses in the upcoming quarters.

## Inflationary pressure will continue to ease

- CPI inflation rate decreased in July to 4.0%YoY, down from 4.3% in June. Main factor responsible for the decline was the deeper than expected fall in food prices. They plunged by 2%MoM, what is the strongest price drop in July in the last decade. In comparison with June also prices of clothing and fuel decreased significantly (in both categories -2.4%MoM).
- We expect the CPI inflation to record a further decline in August, to ca. 3.7%YoY mainly on the back of declining food prices. Until the year-end CPI will decline towards 3% and will reach inflation target (2.5%) in 2013.
- Core inflation excluding food and energy prices remained stable in July at 2.3%YoY, while PPI inflation declined to 3.7%YoY. Both measures will remain in downward trends.

# Monetary policy watch

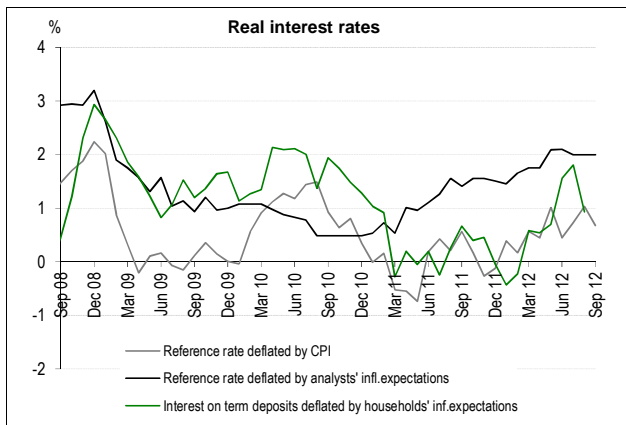
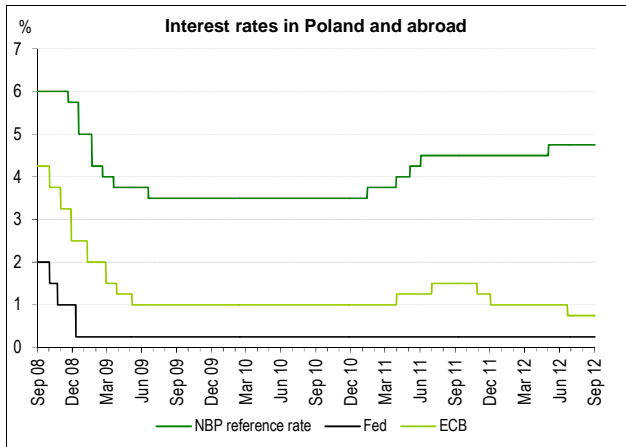


### Fragments of MPC communiqué in September:

The data on GDP in Poland point to slower than expected economic growth in 2012 Q2. Growth of consumption and investment expenditures, including corporate investment, decreased. Change in inventories made a significantly negative contribution to GDP growth. Exports growth also slowed down. However, due to a simultaneous decline in imports, net exports were a major contributor to GDP growth. Weaker output growth was accompanied by deteriorating corporate financial results.

In the opinion of the Council, inflation will decrease gradually over the coming months, as the statistical base effect wanes amidst slowing demand in the economy. The recently observed increase in global commodity prices poses an upward risk to the expected decrease in inflation. In the medium term, economic slowdown will be conducive to inflation returning to the target.

Should the incoming data confirm further weakening of economic conditions, and should the risk of increase in inflationary pressure be limited, the Council will consider adjustment of monetary policy.



Source: NBP, Reuters, BZ WBK

### Door to interest rate cuts is open

- The Monetary Policy Council kept interest rates on hold, with reference rate still at 4.75%. The decision was in line with expectations of economists (no one was forecasting a cut in Parkiet and Reuters surveys), but the financial market was pricing-in a possibility of cut already in September.

- The Council eased tone of its communiqué. Well, maintaining July's statement about a possibility of further hikes would be rather ridiculous. As the NBP President Marek Belka said, last sentence in the communiqué "opened possibility of interest rate cuts". However, the tone of the statement did not suggest nor pre-announce a cut in October (at least not as clearly as May's rate hike was heralded in April).

- Next meeting's decision will probably depend on the upcoming data. In our view these data will be rather weak and will confirm slowdown, so we find a cut more probable at the upcoming meeting in October. However, the first cut cannot be ruled out in November, when the MPC will see the new GDP and CPI projection. Figures for September to be released in October will be so miserable that the Council will have no other option but to cut (maybe even by 50bps).

- In our view, a rate cut already in September would have been fully accepted and justified by current and expected GDP and CPI developments. Apparently, for the majority of the MPC current inflation is vital obstacle in voting for a rate cut. The MPC again proved they are following a backward-looking rule even though majority of forecasts (including the NBP projection) point to lower CPI in the medium term.

- It seems the MPC prefers gradual changes of parameters regardless considerable change of economic outlook since July's meeting (and that was confirmed by the NBP Governor during the press conference).

- The MPC cannot escape from economic reality any longer so thus we maintain our forecast that the reference rate will fall by 50bps in the fourth quarter and by further 25bps in 2013Q1.

- Overall, the MPC has done what was a necessary minimum – adjusted its tone to changing economic environment. It seems that contracting domestic demand is still not enough to ease monetary policy and the Council needs more information. In our view, data due for release in the upcoming month may encourage the Council to cut rates in October, but in September (unless until releases of important macro data from the real economy) we can see a continuation of correction of aggressive cuts priced-in by the market, as the statement was less dovish than most market participants (especially those pricing-in cuts) were expecting.

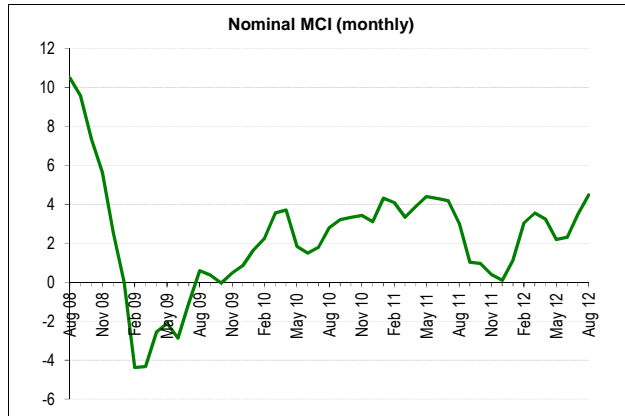
### Real interest rates are positive

- NBP President Marek Belka stressed during the press conference that the Council would like to see positive real interest rates in Poland. However, it is difficult to say that this argument is limiting manoeuvre for MPC's action.

- Taking into account a considerable drop of inflation expected in one year's horizon – both by market analysts (median of CPI forecasts for September 2013: 2.7%) and by the NBP projection – real interest rates are well above zero and they are climbing.

- Also from the point of view of households, whose inflation expectations are highly adaptive (rose to 4.4% in August), real interest rates are strongly positive since the early months of the year. Average weighted interest on private persons' deposits has been recently close to 5% and visibly higher for term deposits.

## Restrictiveness of the Monetary Policy (Council)



### MCI the highest since the start of the crisis

- In July and August the index of monetary policy conditions (MCI) recorded solid increase, reaching the highest level since November 2008.
- Such strong change was triggered mainly by appreciation of the zloty, which gained on average 5% in the last two months, amid maintenance of money market rates at stable levels - more significant drop of WIBOR took place at the end of August in reaction to weak GDP data and bigger expectations for interest rate cuts, but it did not have significant impact on the monthly average.
- In the near term the MPC index will decrease due to drop of money market rates, strengthened by monetary policy easing and depreciation of the zloty.



**Rzońca (1.10)**

**Kaźmierczak (1.10)**

**Gilowska (1.09)**

**Hausner (1.08)**

**Winiecki (1.07)**

**Zielińska-Głębocka (1.07)**

**Glapiński (1.07)**

**Belka (1.00)**

**Chojna-Duch (0.53)**

**Bratkowski (0.36)**



Index is between 0 and 2. A vote for the majority view is given a score of 1. A vote for a more hawkish (less dovish) decision than the majority view has a score of 2 and a vote for a less hawkish (more dovish) decision than the majority view has a score of 0. Value of the index for a given MPC member is a weighted average of points for all votes. Recent votes have higher weights, more distant – lower.

Numbers directly by the name are values of the index for period since the beginning of current term of office of the current MPC and NBP governor.

Direction of the restrictiveness axis reflects our expectations regarding direction of interest rate changes in the nearest 12 months.

### Virtues of monetary policy

At the press conference after September's MPC meeting the NBP Governor Marek Belka said that among the virtues of monetary policy are: its stability, predictability, and lack of sudden turns. This means that the MPC sees some virtue in keeping interest rates unchanged. But perhaps this is all because it has increased main interest rates only four months ago? Well, the MPC may find itself in hot water over the rate hike decision taken in May and finally will have to cut rates. Any postponing of this move will not make it more pleasant, rather quite the opposite. We do not think it is necessary to prepare observers of monetary policy for decision that is broadly anticipated. Or maybe the MPC wants to prepare itself for such move. We would like to stress the "most important feature" of the monetary policy mentioned by the NBP Governor at the press conference in September – "taking decisions relying on medium-term outlook". We cannot resist an impression that there has been a lack of this element lately.

### Who will be ready to back interest rate cut?

Among MPC members there are people ready to cut interest rates. Already at the July's meeting, after which the Council has officially not excluded further monetary tightening, there were two motions put under voting to cut interest rates. This shows how much the Monetary Policy Council is divided in their opinions. It would have been really interesting to see motions to cut and to hike rates at the same meeting. In July the motion to cut rates by 50 bp was supported by Andrzej Bratkowski, while motion to cut by 25 bp was backed by Andrzej Bratkowski and Elżbieta Chojna-Duch. We decided to include some methodological changes in the index of restrictiveness of MPC members visualised on the chart to the left – the most recent votes now have the highest weights, which are diminishing in time. The index shows that it is really hard to say who – apart from the mentioned two MPC members (and possibly the NBP President) – would be ready to back interest rate cut. Although Andrzej Kaźmierczak admitted recently that outlook for economic growth has deteriorated substantially, he did not mention any possibility of cutting rates, while his earlier comments emphasised the importance of current inflation figure. While a number of MPC members recently have been very active in media (even in a blackout period one week before the meeting), the remaining part – whose votes may be important for the change of balance of power – is very silent, and this it is hard to say what they are thinking. We assume that the majority of MPC members will not remain blind to quite clear-cut signals coming from the Polish economy.

### No discussion about change of inflation target

At the press conference in September the NBP Governor said also that the MPC has discussed the Monetary Policy Guidelines for 2013, however the change of the inflation target has not been debated. Belka said that none of the MPC members has raised such issue. It is surprising, as at the end of August Elżbieta Chojna-Duch has mentioned that at the September's meeting she would like to discuss a change in inflation target. In her opinion, current target is too restrictive and it should be altered to make it "more fitted to changing environment". Apparently it is easier to express such theories in media than at the MPC meeting. We do not think that changing inflation target would be a good idea. We do not think that – contrary to Chojna-Duch's opinion – it would improve monetary policy credibility. We agree with prof. Andrzej Sławiński, head of NBP's Economic Institute, that "inflation targeting strategy allows for elasticity".



## Fiscal policy watch

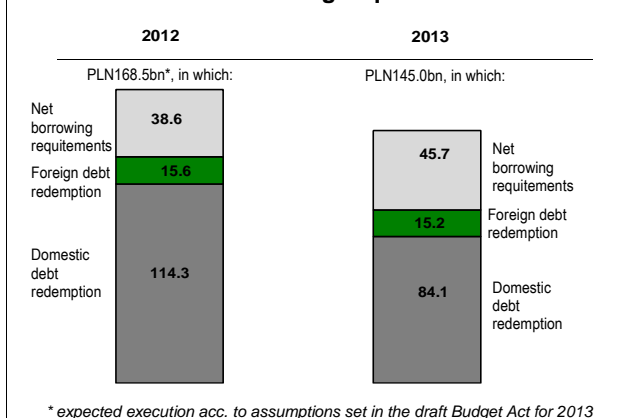
### Macro assumptions for the 2013 budget draft

|                                      | 2011   | 2012PW | 2013   | 2014   | 2015   |
|--------------------------------------|--------|--------|--------|--------|--------|
| GDP (in PLN bn)                      | 1524.7 | 1612.7 | 1688.3 | 1769.5 | 1875.7 |
| GDP (% YoY)                          | 4.3    | 2.5    | 2.2    | 2.5    | 3.5    |
| CPI inflation (% avg.)               | 4.3    | 4.0    | 2.7    | 2.3    | 2.5    |
| Employment (% avg.)                  | 0.9    | 0.1    | 0.2    | 0.4    | 0.7    |
| Wages (% avg.)                       | 5.4    | 4.4    | 4.6    | 4.6    | 5.2    |
| Registered unemployment rate (% eop) | 12.5   | 13.0   | 13.0   | 12.6   | 12.0   |
| EURPLN (avg.)                        | 4.12   | 4.21   | 4.05   | 3.87   | 3.72   |
| Reference rate (% avg.)              | 4.22   | 4.66   | 4.36   | 4.25   | 4.25   |

### Revenues and expenses of state budget in 2012-2013

| (in PLN bn)                | 2012PW<br>/1/ | 2013<br>/2/   | Change<br>/2/ / 1/ |
|----------------------------|---------------|---------------|--------------------|
| <b>Revenues, in which:</b> | <b>292.44</b> | <b>299.39</b> | <b>102.4</b>       |
| Tax income                 | 253.92        | 266.98        | 105.1              |
| VAT                        | 121.50        | 126.41        | 104.0              |
| CIT                        | 26.64         | 29.64         | 111.3              |
| PIT                        | 40.43         | 42.94         | 106.2              |
| Non-tax income             | 37.00         | 30.81         | 83.3               |
| <b>Expenses, in which:</b> | <b>324.1</b>  | <b>334.95</b> | <b>103.3</b>       |
| subsidies                  | -             | 157.54        | -                  |
| public debt servicing      | -             | 43.42         | -                  |
| <b>Budget balance</b>      | <b>-31.7</b>  | <b>-35.56</b> | <b>-</b>           |

### Gross borrowing requirements



### The 2013 budget draft in a new version

- Poland's government has preliminarily adopted the 2013 budget draft with new macro assumptions. Currently, macro forecasts are more realistic and adjusted to the current situation and economic outlook (see table beside). GDP forecasts are realistic to achieve, however our predictions for 2012-2013 are slightly lower.
- In face of the economic slowdown, adjusting the fiscal consolidation plan should not be a surprise (to below 3.5% of GDP this year and slightly lower next year). It is possible that such figures could be low enough for the European Commission to abolish the excessive deficit procedure next year.
- Deterioration of economic activity prospects might result in further worsening situation of labour market (decline in employment, slower growth of wages). This may result in higher unemployment rate as compared to government's forecast.

### Budget income targets are burdened with risk

- The 2013 budget draft assumes revenues at ca. PLN300bn (increase by 2.4%YoY), while budget spending at ca. PLN335bn. As a result the budget deficit is set at PLN35.6bn, i.e. PLN3.6bn higher than previously expected and higher than this year's realisation (PLN31.7bn).
- The ministry assumed the increase in tax revenues by 5.1%YoY due to CIT growth by more than 11%, PIT increase by ca. 6% and VAT growth by 4.0%. Recent financial results of companies and expected economic slowdown means that expected CIT income is burdened with risk of lower realisation. Assuming lower scope of VAT (below nominal GDP growth) the MF has tried to adjust it to current economic environment. However, we see some risk for lower VAT income, depending on GDP breakdown.
- The 2013 budget draft with the higher deficit shows that the government tries to find a balance between a continued consolidation and an adjustment to slower economic growth.

### Lower redemptions reduce the 2013 borrowing requirements

- In 2013 the MF plans the gross borrowing requirements at ca. PLN145bn, down from PLN168bn planned for this year (decline by 14%). It comes from lower domestic debt redemptions next year (by ca. 26%). In 2013 net borrowing needs are slightly higher than this year (PLN45.7bn vs. PLN38.6bn), which partly resulted from assumed loans for social security fund (FUS) at PLN4.8bn.
- The net borrowing requirements (similarly as in 2012) will be financed mainly on the domestic market (PLN25.5bn). The Treasury Securities' offer on the markets will remain flexible (including switch auctions), adopted to market conditions. Additionally, we think that part of borrowing needs for 2013 will be already financed this year. Currently, we find the risk of significant foreign investors outflows (due to extending the fiscal consolidation) as a relatively low.

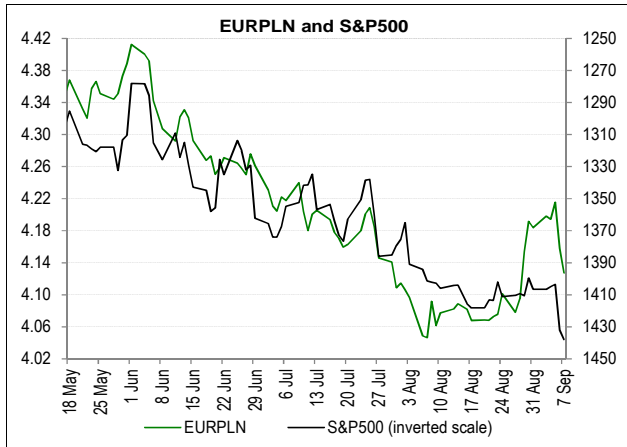
### The ECB supports debt of euro zone peripheries

- Last weeks brought significant decline in yields of peripheries debt, especially on the front end. Market mood's changes strongly depended on news flows and the euro zone leaders' wording. Notwithstanding, at the end August yields of peripheries debt were lower as compared with July's level and spreads vs. Bunds narrowed.
- The ECB at its September's meeting presented technical details regards debt purchasing programme, which will be associated with many conditions which must be to fill by countries. Important information for the market was that the ECB resigned from the seniority status, which increase the comfort of purchasing sovereign debt by private investors.
- We expect spread between peripheries' debt and Germany bonds to continue to narrow in coming weeks.

|          | Spread vs Bunds (10Y) in bps |                       |                       | CDS (5Y. USD) |                       |                       |
|----------|------------------------------|-----------------------|-----------------------|---------------|-----------------------|-----------------------|
|          | 7.09                         | change since 10.07.12 | change since 30.12.11 | 7.09          | change since 10.07.12 | change since 30.12.11 |
| Poland   | 329                          | -50                   | -76                   | 136           | -69                   | -142                  |
| Czech    | 97                           | -49                   | -79                   | 104           | -30                   | -68                   |
| Hangary  | 606                          | -62                   | -201                  | 393           | -108                  | -217                  |
| Grece    | 2011                         | -445                  | -1355                 | 37030         | 0                     | 26799                 |
| Spain    | 425                          | -121                  | 98                    | 369           | -198                  | -7                    |
| Ireland  | 418                          | -81                   | -248                  | 390           | -145                  | -344                  |
| Portugal | 666                          | -253                  | -506                  | 533           | -312                  | -636                  |
| Italy    | 361                          | -97                   | -157                  | 332           | -170                  | -153                  |
| Germany  | -                            | -                     | -                     | 55            | -40                   | -45                   |

Source: Finance Ministry, CSO, NBP, Reuters, BZ WBK

# Foreign exchange market

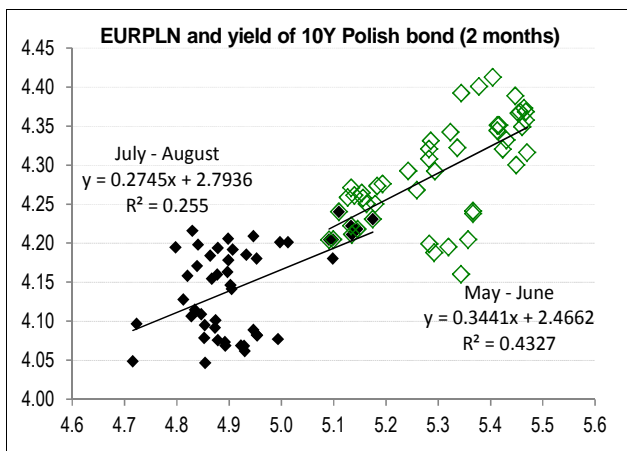


## EURPLN highly volatile during summer holiday

▪ Summer months were characterised by large fluctuation of EURPLN. At the end of July EURPLN rose to 4.22 due to worries that Greece may exit the euro zone and Spain may ask for external financial assistance. In the subsequent weeks domestic currency was gaining and at the start of August the EURPLN reached 4.026 (this year's low). In the following few weeks it has fluctuated in range 4.05-4.10.

▪ At the end of August EURPLN successfully tested resistance at 4.10 due to strengthening concerns about world economic growth. Dovish comment of NBP Governor about change of MPC's bias and disappointing data about Polish GDP in Q2 have resulted in additional negative pressure on the domestic currency. As a result, the EURPLN was testing 4.20 and ended August slightly above this level. In turn, at the start of September the zloty equally quickly was trimming earlier losses. This was triggered by MPC's decision to leave main interest rates on hold, positive reception of ECB's plan, and rising hopes for QE3 after weak labour market data from the US.

▪ Strength of relationship of the EURPLN with the EURUSD was changing during the past two months, while correlation of domestic currency with S&P500 remained stable at high level (temporary drop occurred after dovish statement of NBP governor). It seems that it was thanks to hopes for QE3 that the zloty was gaining versus euro and dollar. US stock indices soared to the highest levels since April, which allowed the EURPLN to stay close to local minimum for the better part of August. Additional – though smaller than before summer – support for domestic currency was provided by solid inflow of foreign capital on the domestic debt market. Zloty was gaining along with decreasing yield of 10Y bond.



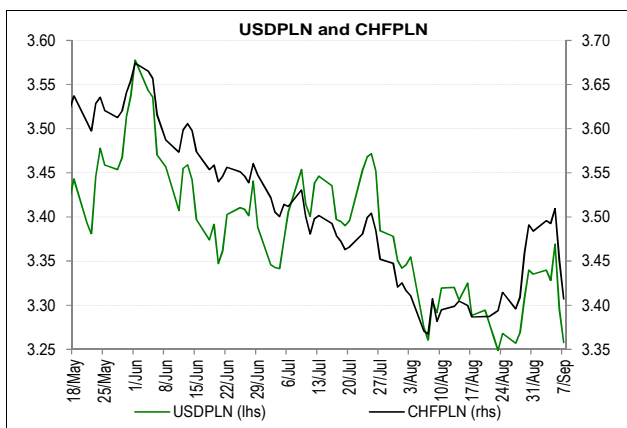
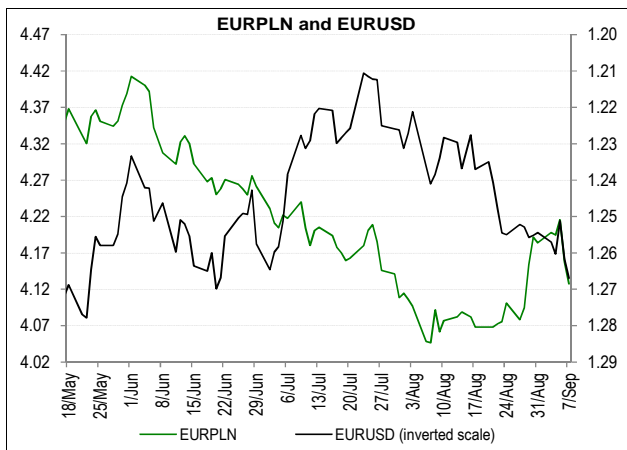
## Lots of events important for the zloty in September

▪ September is likely to be a very busy month in the FX market, as the agenda is full of events important for the euro zone future. Last days of August seem to be a good hint that high volatility is going to stay with us for longer. On 12 September the German Constitutional Court will announce the decision regarding the ESM. Launching this fund is an important prerequisite for the ECB plan (central bank's purchases are conditional on using the ESM). One day after Court's decision the US Fed will hold a meeting and after recent disappointing data from the US labour market the expectations for announcing QE3 are very high.

▪ The crisis in the euro zone will continue playing important role, also due to Greece. At the end of month the Troika will publish the report about progress in reforming Greek economy, and in the middle of September the Ecofin meeting will be held.

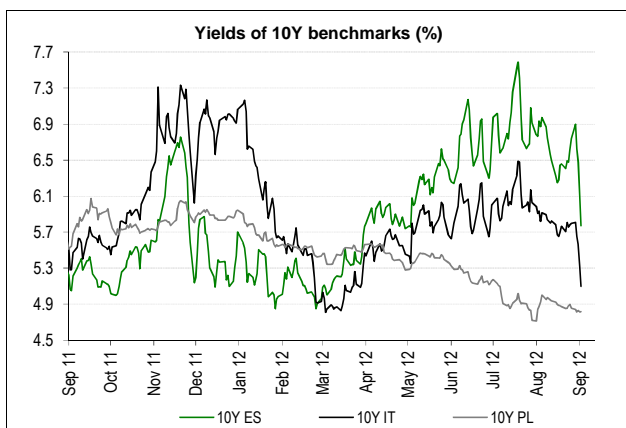
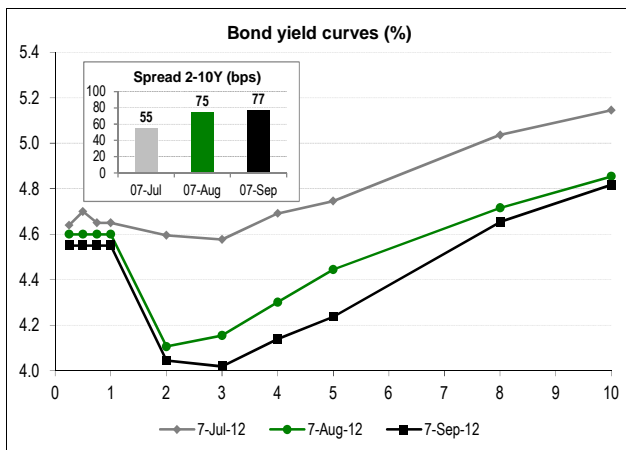
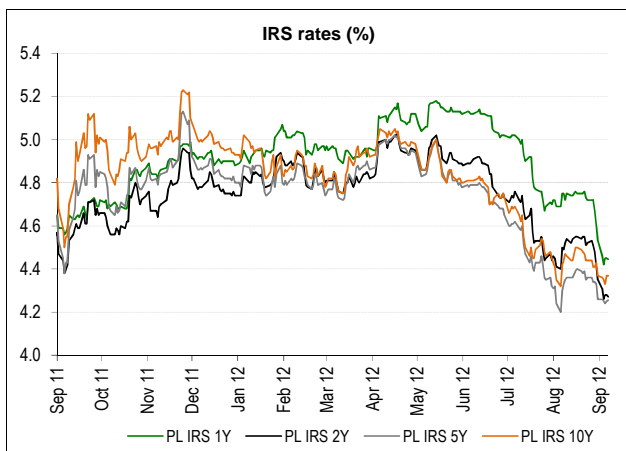
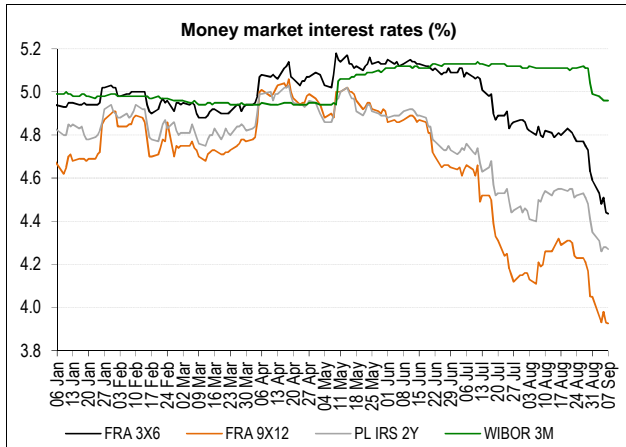
▪ Taking into account recent words of NBP President that the door for interest rate cuts is open, and the unexpected September's interest rate cut in Hungary, one should notice that the relation between EURPLN and EURHUF has increased significantly in August. The interest rate cut by the MNB had negative impact on the forint, as well as on the zloty. At the start of September, forint has not benefited from good sentiment that appeared after ECB decision, as the Hungarian government has rejected terms of assistance proposed by the IMF. Lack of reaction of the zloty on this event may indicate that this time the domestic currency remains relatively resilient to a turmoil on the Hungarian market.

▪ Summing up, the month ahead may be characterised by large volatility due to numerous global factors. Meanwhile, at the turn of September and October expectations for MPC decision may be important. We predict that average EURPLN will reach 4.14, but due to high uncertainty about how the mentioned events will affect the market, there is quite high risk for this forecast.



Source: Reuters, BZ WBK

# Interest rate market



Source: Reuters, BZ WBK

## GDP supported the short end

- August's release of the GDP data for Q2 proved to be the most important summer event for the interest rate market. The lower-than-expected reading supported hopes that the MPC might begin monetary policy easing earlier than previously thought.
- Release of this figure caused a strong drop of WIBOR3M+ rates by 5-7bps in one day (these rates were stable earlier during summer months) and this was a most considerable scale of decrease since 2009. The downward trend strengthened also on the FRA market (these rates fell by 10-50bps in period between early July and release of the data). Sanguine moods maintained also at the beginning of September. MPC's decision to keep rates on hold has stabilised WIBOR rates, while FRA rates fell after a temporary upward correction, with 9x12 rate reaching 3.90% at the end of the first week of September.
- Macroeconomic data for August should be supportive for the shorter end of the curve. Still, potential for declines seems limited – currently the market is already pricing-in rates reductions by 100bps in one year's horizon.
- Drops were also present on bond and IRS markets. Still, they remained strong even despite lower activity of investors. Since early July to end of August IRS rates moved down by 29-48bps and bond curve by 32-53bps, with the most considerable drops at the short end. These decreases continued also in the first week of September. It is worth noting that yields of 2Y and 5Y bonds reached all-time lows at 3.98% and 4.18%, respectively.

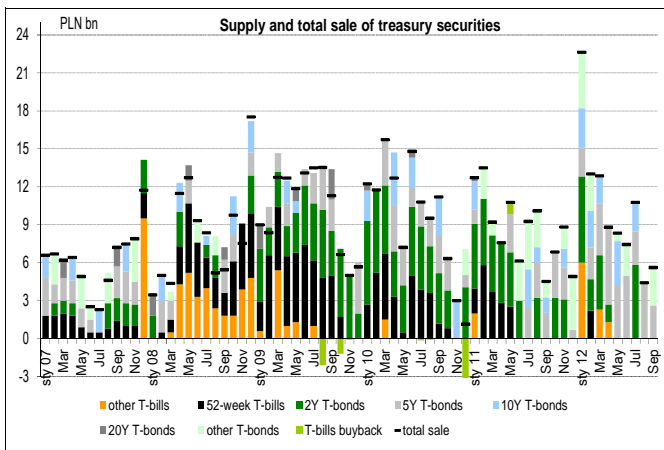
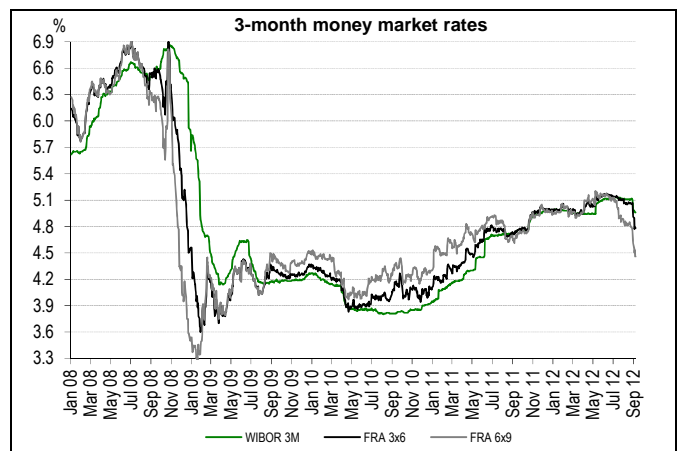
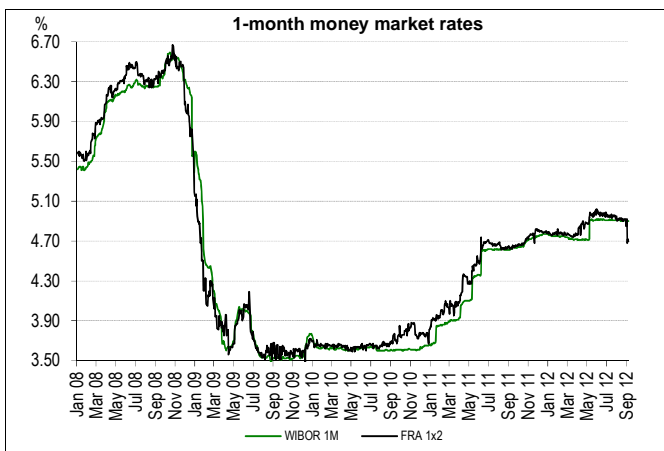
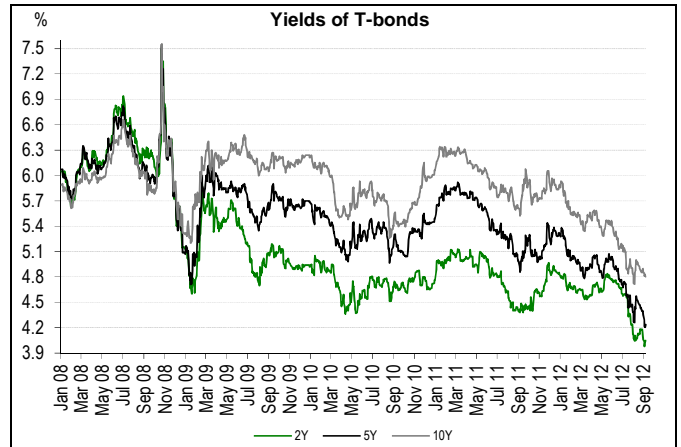
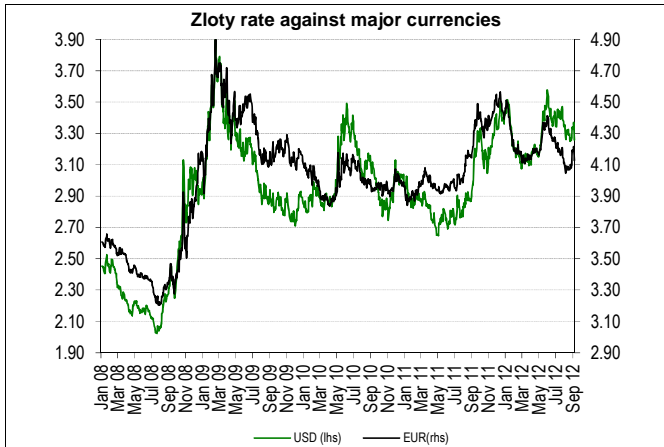
## Bull steepener is still valid

- Changes on the bond and IRS markets caused curve steepening. Realisation of our interest rate scenario (we expect reductions by 50bps in 2012) will be supportive for the shorter end, which means a further widening of 2-10Y spread, with more visible changes more probable on the IRS market. In our view, 2Y bond yield will stay in 4.0-4.1% range with possible tests of both lower and upper bounds of this range.
- Lack of 2Y bonds in September's offer of the Finance Ministry is underpinning 5Y bonds, which now stand for the shortest sovereign paper available on the primary market. This can cause a narrowing of 2-5Y spread in the upcoming weeks.
- Longer end of the curve will stay under influence of global events. Uncertainty is still there and risk factors will be generating higher volatility in this sector. We expect that yields of 10Y bond will stay in 4.75-4.95% range.

## MF's activity on the primary market rose slightly

- In September the Finance Ministry is enhancing its activity on the primary market, after its reduction in August. Supply plans for September are quite similar to these presented for the whole second quarter. Still, the offer is relatively low, which is due to the fact that coverage of borrowing needs was nearly at 90% at the end of August.
- Announcing the September's issuance plan the Ministry also mentioned that it has planned to redeem before maturity all of the Brady's RSTA and PAR bonds worth US\$297m. Piotr Marczak, the head of Debt Department in the Ministry, explained that "yields on these bonds are currently higher than the cost of financing on the American market, and the prices of Brady's bonds on the secondary market are above their nominal value (...)".
- The September's plan makes it more probable that this year's borrowing needs will be covered in October at the latest. The Ministry of Finance, similarly as in 2011, began pre-financing borrowing needs for 2013 already in September via switch auctions.

# Market monitor



**Treasury bill auctions in 2011/2012 (PLNm)**

| Auction date | OFFER              | DEMAND/SALE   |
|--------------|--------------------|---------------|
| 26.05.2011   | Repurchase tender  | 1444/940      |
| 30.05.2011   | 52-week: 500-600   | 2667/505      |
| 20.06.2011   | Repurchase tender  | 356/256       |
| 11.07.2011   | Repurchase tender  | 2498/724      |
| 19.12.2011   | Repurchase tender  | 4331/2247     |
| 27.12.2011   | Repurchase tender  | 2939/2486     |
| 09.01.2012   | 49-week: 1000-2000 | 5402/2223     |
| 30.01.2012   | 30-week: 1000-2000 | 3249/1997     |
| 30.01.2012   | 51-week: 1000-2000 | 4225/1592     |
| 27.02.2012   | 52-week: 1000-2000 | 6711/2190     |
| 26.03.2012   | 52-week: 1000-3000 | 5402/2223     |
| 23.04.2012   | 31-week            | 3116,5/1332,1 |

\* based on data of the Ministry of Finance

**Treasury bond auctions in 2011/2012 (PLNm)**

| month       | date  | First auction |           |        | Second auction |               |           | Switch auction |          |                   |               |
|-------------|-------|---------------|-----------|--------|----------------|---------------|-----------|----------------|----------|-------------------|---------------|
|             |       | T-bonds       | offer     |        | date           | T-bonds       | offer     | date           | T-bonds  | offer             |               |
| Sep'11      | 22.09 | WZ0115/WZ0121 | 1000-3000 | 1273,5 | -              | -             | -         | 08.09          | WZ/DZ/OK | PS0416/DS1021     |               |
| October     | 19.10 | PS1016        | 1000-3500 | 3638   | -              | -             | -         | 02.10          | OK/PS/DZ | OK0114            |               |
| November    | 16.11 | PS1016        | 1000-2500 | 2500   | -              | -             | -         | 10.11          | DZ/OK/PS | OK/WZ/DS/WS       |               |
| December    | -     | -             | -         | -      | -              | -             | -         | 14.12          | OK/PS    | WZ/IZ/PS          |               |
| January '12 | 12.01 | IZ/PS/WS      | 1000-4000 | 4067   | 19.01          | OK0114        | 3000-6000 | 6753           | 04.01    | OK/PS/OK          | WZ/WZ/DS      |
| February    | 09.02 | OK0114/PS1016 | 3500-5500 | 5049   | 16.02          | WZ0117        | 1000-3000 | 3518           | 01.02    | DS1021: 1000-3000 | 2937          |
| March       | 14.03 | OK0114        | 1500-3500 | -      | 21.03          | DS1021/WS0429 | 1000-2500 | -              | 08.03    | PS1016: 1500-3000 | 4080          |
| April       | 19.04 | OK0714/PS1016 | 5000-9000 | -      | -              | -             | -         | -              | 05.04    | PS/OK             | WZ            |
| May         | 10.05 | DS1021/WS0429 | 2000-4000 | 4092.3 | 16.05          | PS0417        | 2000-4000 | -              | -        | -                 | -             |
| June        | 20.06 | PS0417        | 2000-4000 | -      | -              | -             | -         | -              | 14.06    | OK0712/OK1012     | WZ/IZ         |
| July        | 19.07 | OK0714        | 2000-5000 | -      | -              | -             | -         | -              | 05.07    | OK0712/OK1012     | PS0417/DS1021 |
| August      | 01.08 | PS0417        | 2000-4000 | -      | -              | -             | -         | -              | -        | -                 | -             |
| September   | 19.09 | WZ/ DS/ IZ    | 2000-4000 | -      | -              | -             | -         | -              | 05.09    | OK1012/OK0113     | WZ0117/PS0417 |

\* with supplementary auction, \*\* primary auction, \*\*\* demand/sale, \*\*\*\* in February and March 2012 the MF refrained from switch tenders

Source: MF, Reuters, BZ WBK

## Economic calendar

| MONDAY   | TUESDAY   | WEDNESDAY   | THURSDAY   | FRIDAY   |
|--|---|---|--|--|
| <b>10 September</b><br>EZ: Sentix index (Sep)  | <b>11</b><br><b>PL: Balance of payments (Jul)</b><br>US: Trade balance (Jul)  | <b>12</b><br>EZ: Industrial output (Jul)<br>US: Import prices (Aug)<br>US: Wholesale inventories (Aug)  | <b>13</b><br><b>PL: CPI (Aug)</b><br>US: Fed decision  | <b>14</b><br><b>PL: Money supply (Jul)</b><br>EZ: HICP (Aug)<br>US: Core CPI (Aug)<br>US: Retail sales (Aug)<br>US: Industrial output (Aug)<br>US: Flash Michigan index (Sep)  |
| <b>17</b>  | <b>18</b><br><b>PL: Wages and employment (Aug)</b><br>DE: ZEW index (Sep)   | <b>19</b><br><b>PL: Industrial output (Aug)</b><br><b>PL: PPI (Aug)</b><br>US: House starts (Aug)<br>US: Building permits (Aug)<br>US: Home sales (Aug) | <b>20</b><br><b>PL: Core inflation (Aug)</b><br><b>PL: MPC minutes</b><br>CN: Flash PMI-mfg (Sep)<br>DE: Flash PMI-mfg (Sep)<br>EZ: Flash PMI-mfg (Sep)<br>EZ: Consumer confidence index (Sep)<br>US: Leading indicators (Aug) | <b>21</b>  |
| <b>24</b><br>DE: Ifo index (Sep)   | <b>25</b><br><b>PL: Retail sales and the unemployment rate (Aug)</b><br>DE: GfK index (Oct)<br>US: S&P/Case-Shiller home price index (Jul)<br>US: Consumer confidence index (Sep) | <b>26</b><br>US: New home sales (Aug)   | <b>27</b><br>GB: GDP (Q2)<br>US: Durable goods orders (Aug)<br>US: Final GDP (Q2)<br>US: Pending home sales (Aug)  | <b>28</b><br><b>PL: Inflation expectations (Sep)</b><br><b>PL: Balance of payments (Q2)</b><br>EZ: Flash HICP (Sep)<br>US: Personal income (Aug)<br>US: Consumer spending (Aug)<br>US: Core PCE (Aug)<br>US: Chicago PMI index (Nov)<br>US: Michigan index (Sep) |
| <b>1 October</b><br><b>PL: PMI-manufacturing (Sep)</b><br>DE: PMI-manufacturing (Sep)<br>EZ: PMI-manufacturing (Sep)<br>CN: PMI-manufacturing (Sep)<br>US: ISM-manufacturing (Sep) | <b>2</b>  | <b>3</b><br><b>PL: MPC decision</b><br>DE: PMI-services (Sep)<br>EZ: PMI-services (Sep)<br>EZ: Retail sales (Aug)<br>US: ADP report (Sep)               | <b>4</b><br>GB: BoE decision<br>EZ: ECB decision<br>US: Industrial orders (Aug)  | <b>5</b><br>DE: Industrial orders (Aug)<br>US: Non-farm payrolls (Sep)<br>US: Unemployment rate (Sep)  |
| <b>8</b><br>EZ: Sentix index (Oct)<br>DE: Industrial output (Aug)  | <b>9</b>  | <b>10</b><br>US: Wholesale inventories (Sep)  | <b>11</b><br>US: Import prices (Sep)<br>US: Trade balance (Aug)  | <b>12</b><br><b>PL: Money supply (Aug)</b><br>EZ: Industrial output (Aug)<br>US: Flash Michigan index (Oct)  |
| <b>15</b><br><b>PL: CPI (Sep)</b><br><b>PL: Balance of payments (Aug)</b><br>US: Retail sales (Sep)  | <b>16</b><br>EZ: HICP (Sep)<br>DE: ZEW index (Oct)<br>US: Core CPI (Aug)<br>US: Industrial output (Sep)   | <b>17</b><br>US: House starts (Sep)<br>US: Building permits (Sep)   | <b>18</b><br><b>PL: MPC minutes</b><br>US: Leading indicators (Sep)<br>US: Philly Fed index (Oct)  | <b>19</b>  |

## MPC meetings and data release calendar for 2012

|                          | I   | II              | III             | IV  | V   | VI  | VII | VIII | IX  | X   | XI  | XII |
|--------------------------|---|-----------------|-----------------|-----|-----|-----|-----|------|-----|-----|-----|-----|
| ECB meeting              | 12  | 9               | 8               | 4   | 3   | 6   | 5   | 2    | 6   | 4   | 8   | 6   |
| MPC meeting              | 10-11                                       | 7-8             | 6-7             | 3-4 | 8-9 | 5-6 | 3-4 | 21   | 4-5 | 2-3 | 6-7 | 4-5 |
| MPC minutes              | 26  | 23              | 22              | 26  | 24  | 21  | -   | 23   | 20  | 18  | 22  | 20  |
| GDP*                     | -   | -               | 1               | -   | 31  | -   | -   | 30   | -   | -   | 30  | -   |
| CPI                      | 13  | 15 <sup>a</sup> | 13 <sup>b</sup> | 13  | 15  | 13  | 13  | 14   | 13  | 15  | 14  | 13  |
| Core inflation           | 20  | -               | 20              | 20  | 22  | 20  | 20  | 21   | 20  | 22  | 21  | 20  |
| PPI                      | 19  | 17              | 19              | 19  | 21  | 20  | 18  | 20   | 19  | 17  | 20  | 19  |
| Industrial output        | 19  | 17              | 19              | 19  | 21  | 20  | 18  | 20   | 19  | 17  | 20  | 19  |
| Retail sales             | 27  | 23              | 26              | 25  | 31  | 26  | 26  | 30   | 25  | -   | -   | -   |
| Gross wages. employment  | 18  | 16              | 16              | 18  | 18  | 19  | 17  | 17   | 18  | 16  | 19  | 18  |
| Foreign trade            | about 50 working days after reported period |                 |                 |     |     |     |     |      |     |     |     |     |
| Balance of payments*     | -   | -               | 30              | -   | -   | 29  | -   | -    | -   | -   | -   | -   |
| Balance of payments      | 13  | 13              | 13              | 12  | 16  | 15  | -   | -    | -   | -   | -   | -   |
| Money supply             | 13  | 14              | 13              | 13  | 14  | 14  | -   | -    | -   | -   | -   | -   |
| Business climate indices | 20  | 22              | 22              | 20  | 20  | 22  | 20  | 22   | 21  | 22  | 22  | 20  |

\* quarterly data. <sup>a</sup> preliminary data for January. <sup>b</sup> January and February

Source: CSO, NBP, Ministry of Finance, Reuters, Bloomberg

## Economic data and forecasts

### Monthly economic indicators

|  |              | Aug 11 | Sep 11 | Oct 11 | Nov 11 | Dec 11 | Jan 12 | Feb 12 | Mar 12 | Apr 12 | May 12 | Jun 12 | Jul 12 | Aug 12 | Sep 12 |
|--|--------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| PMI  | pts          | 51.8   | 50.2   | 51.7   | 49.5   | 48.8   | 52.2   | 50.0   | 50.1   | 49.2   | 48.9   | 48.0   | 49.7   | 48.3   | 47.1   |
| Industrial production                          | %YoY         | 7.9    | 7.4    | 6.4    | 8.5    | 7.7    | 9.1    | 4.8    | 0.8    | 2.8    | 4.3    | 1.2    | 5.2    | 1.9    | -5.9   |
| Construction production                        | %YoY         | 10.8   | 18.1   | 8.9    | 13.0   | 14.6   | 32.2   | 12.0   | 3.5    | 8.1    | 6.2    | -5.2   | -8.8   | -5.6   | -17.8  |
| Retail sales <sup>a</sup>                      | %YoY         | 11.3   | 11.4   | 11.2   | 12.6   | 8.6    | 14.3   | 13.7   | 10.7   | 5.5    | 7.7    | 6.4    | 6.9    | 5.9    | 4.7    |
| Unemployment rate                              | %            | 11.8   | 11.8   | 11.8   | 12.1   | 12.5   | 13.2   | 13.5   | 13.3   | 12.9   | 12.6   | 12.4   | 12.3   | 12.3   | 12.5   |
| Gross wages in enterprises sector <sup>a</sup> | %YoY         | 5.4    | 5.2    | 5.1    | 4.4    | 4.4    | 8.1    | 4.3    | 3.8    | 3.4    | 3.8    | 4.3    | 2.4    | 2.9    | 3.2    |
| Employment in enterprises sector               | %YoY         | 3.1    | 2.8    | 2.5    | 2.5    | 2.3    | 0.9    | 0.6    | 0.6    | 0.3    | 0.3    | 0.1    | 0.0    | 0.0    | 0.1    |
| Export (€)                                     | %YoY         | 15.9   | 7.5    | 8.6    | 8.4    | 4.7    | 7.7    | 6.4    | 3.8    | 1.2    | -0.1   | 0.5    | 4.5    | -1.5   | -2.2   |
| Import (€)                                     | %YoY         | 12.0   | 4.5    | 7.8    | 5.0    | 2.4    | 9.5    | 7.1    | 3.0    | -3.7   | -0.1   | -5.7   | -1.1   | -9.0   | -7.8   |
| Trade balance                                  | EURm         | -903   | -211   | -722   | -964   | -1 122 | -734   | -823   | -607   | -398   | -933   | -412   | -563   | 42     | 497    |
| Current account balance                        | EURm         | -1 382 | -1 241 | -1 861 | -1 473 | -1 685 | -1 979 | -1 668 | -670   | -713   | -749   | -1 240 | -1 247 | -393   | -514   |
| Current account balance                        | % GDP        | -4.7   | -4.6   | -4.7   | -4.4   | -4.3   | -4.5   | -4.8   | -4.7   | -4.5   | -4.7   | -4.5   | -4.3   | -4.0   | -3.8   |
| Budget deficit (cumulative)                    | PLNbn        | -20.7  | -21.9  | -22.5  | -21.6  | -25.1  | -5.3   | -16.5  | -23.0  | -24.8  | -27.0  | -21.1  | -24.3  | -25.2  | -25.4  |
| Budget deficit (cumulative)                    | % of FY plan | 51.4   | 54.4   | 55.9   | 53.7   | 62.5   | 15.1   | 47.2   | 65.6   | 70.9   | 77.1   | 60.2   | 69.6   | 72.1   | 72.4   |
| CPI  | %YoY         | 4.3    | 3.9    | 4.3    | 4.8    | 4.6    | 4.1    | 4.3    | 3.9    | 4.0    | 3.6    | 4.3    | 4.0    | 3.7    | 4.0    |
| CPI excluding prices of food and energy        | %YoY         | 2.7    | 2.6    | 2.8    | 3.0    | 3.1    | 2.5    | 2.6    | 2.4    | 2.7    | 2.3    | 2.3    | 2.3    | 2.2    | 2.3    |
| PPI  | %YoY         | 6.8    | 8.4    | 8.5    | 9.1    | 8.2    | 7.9    | 6.0    | 4.4    | 4.4    | 5.2    | 4.4    | 3.7    | 3.0    | 1.5    |
| Broad money (M3)                               | %YoY         | 8.8    | 10.2   | 10.5   | 11.8   | 12.5   | 13.7   | 12.5   | 9.3    | 10.3   | 11.3   | 11.1   | 11.1   | 9.9    | 8.6    |
| Deposits                                       | %YoY         | 8.8    | 9.5    | 9.4    | 11.2   | 11.7   | 12.8   | 12.5   | 8.5    | 10.0   | 10.8   | 10.4   | 10.8   | 10.3   | 8.9    |
| Loans  | %YoY         | 13.2   | 14.7   | 14.8   | 14.6   | 14.4   | 14.5   | 13.0   | 12.8   | 13.4   | 13.1   | 10.7   | 7.5    | 7.1    | 5.7    |
| EUR/PLN  | PLN          | 4.12   | 4.33   | 4.35   | 4.43   | 4.48   | 4.37   | 4.18   | 4.14   | 4.18   | 4.30   | 4.30   | 4.19   | 4.09   | 4.14   |
| USD/PLN  | PLN          | 2.87   | 3.15   | 3.18   | 3.27   | 3.40   | 3.39   | 3.16   | 3.13   | 3.17   | 3.36   | 3.43   | 3.41   | 3.30   | 3.29   |
| CHF/PLN  | PLN          | 3.68   | 3.61   | 3.54   | 3.60   | 3.65   | 3.61   | 3.47   | 3.43   | 3.47   | 3.58   | 3.58   | 3.49   | 3.41   | 3.45   |
| Reference rate <sup>b</sup>                    | %            | 4.50   | 4.50   | 4.50   | 4.50   | 4.50   | 4.50   | 4.50   | 4.50   | 4.50   | 4.75   | 4.75   | 4.75   | 4.75   | 4.75   |
| WIBOR 3M                                       | %            | 4.72   | 4.75   | 4.80   | 4.94   | 4.98   | 4.99   | 4.97   | 4.95   | 4.94   | 5.05   | 5.12   | 5.13   | 5.10   | 5.02   |
| Yield on 52-week T-bills                       | %            | 4.53   | 4.48   | 4.48   | 4.48   | 4.55   | 4.51   | 4.50   | 4.48   | 4.58   | 4.75   | 4.75   | 4.64   | 4.58   | 4.45   |
| Yield on 2-year T-bonds                        | %            | 4.47   | 4.43   | 4.54   | 4.73   | 4.86   | 4.75   | 4.66   | 4.58   | 4.67   | 4.77   | 4.71   | 4.46   | 4.12   | 4.05   |
| Yield on 5-year T-bonds                        | %            | 5.14   | 5.08   | 5.09   | 5.19   | 5.30   | 5.20   | 5.00   | 4.88   | 4.97   | 4.97   | 4.85   | 4.58   | 4.43   | 4.25   |
| Yield on 10-year T-bonds                       | %            | 5.71   | 5.80   | 5.76   | 5.85   | 5.88   | 5.74   | 5.53   | 5.45   | 5.50   | 5.41   | 5.24   | 4.99   | 4.88   | 4.83   |

Source: CSO. NBP. Finance Ministry. BZ WBK own estimates; <sup>a</sup> in nominal terms. <sup>b</sup> at the end of period

## Quarterly and annual economic indicators

|   |       | 2010    | 2011    | 2012    | 2013    | 1Q12   | 2Q12   | 3Q12   | 4Q12   | 1Q13   | 2Q13  | 3Q13   | 4Q13   |
|---|-------|---------|---------|---------|---------|--------|--------|--------|--------|--------|-------|--------|--------|
| GDP   | PLNbn | 1 416.4 | 1 524.7 | 1 597.9 | 1 667.0 | 370.5  | 388.4  | 394.4  | 444.7  | 386.4  | 404.3 | 411.3  | 464.9  |
| GDP   | %YoY  | 3.9     | 4.3     | 2.2     | 1.9     | 3.5    | 2.4    | 1.7    | 1.5    | 1.5    | 2.0   | 2.0    | 2.0    |
| Domestic demand                               | %YoY  | 4.6     | 3.6     | -0.1    | 1.1     | 2.7    | -0.2   | -1.1   | -1.2   | -0.2   | 0.5   | 2.2    | 1.6    |
| Private consumption                           | %YoY  | 3.2     | 3.1     | 1.7     | 1.7     | 2.1    | 1.5    | 1.5    | 1.6    | 1.6    | 1.7   | 1.8    | 1.9    |
| Fixed investments                             | %YoY  | -0.4    | 8.1     | 0.0     | -2.6    | 6.7    | 1.9    | -2.0   | -2.0   | -4.0   | -4.0  | -3.0   | -1.0   |
| Industrial production                         | %YoY  | 9.0     | 7.7     | 2.5     | 2.7     | 4.9    | 2.8    | 0.1    | 2.7    | 1.1    | 3.8   | 3.5    | 2.5    |
| Construction production                       | %YoY  | 4.6     | 16.3    | -3.8    | -7.3    | 13.8   | 2.2    | -11.1  | -8.8   | -10.4  | -7.2  | -5.0   | -7.7   |
| Retail sales <sup>a</sup>                     | %YoY  | 6.1     | 11.2    | 7.2     | 4.5     | 12.6   | 6.5    | 5.9    | 4.9    | 4.6    | 3.7   | 5.2    | 4.4    |
| Unemployment rate <sup>b</sup>                | %     | 12.4    | 12.5    | 13.6    | 13.9    | 13.3   | 12.4   | 12.5   | 13.6   | 14.0   | 13.2  | 13.3   | 13.9   |
| Gross wages in enterprise sector <sup>a</sup> | %YoY  | 3.3     | 5.0     | 3.7     | 1.7     | 5.3    | 3.0    | 2.9    | 3.0    | 1.7    | 2.1   | 1.7    | 1.4    |
| Employment in enterprise sector               | %YoY  | 0.8     | 3.2     | 0.3     | 0.0     | 0.6    | 0.3    | 0.1    | 0.1    | 0.0    | 0.0   | 0.1    | 0.1    |
| Export (€)                                    | %YoY  | 22.8    | 11.4    | 2.0     | 4.2     | 5.7    | 0.5    | -0.1   | 2.0    | 2.0    | 4.0   | 5.0    | 6.0    |
| Import (€)                                    | %YoY  | 24.9    | 11.5    | -1.6    | 1.9     | 6.2    | -3.2   | -6.1   | -3.0   | -2.0   | 0.5   | 5.5    | 4.0    |
| Trade balance                                 | EURm  | -8 893  | -10 112 | -4 904  | -1 697  | -2 165 | -1 743 | -24    | -972   | -692   | -511  | -200   | -293   |
| Current account balance                       | EURm  | -16 493 | -15 974 | -12 216 | -7 219  | -4 344 | -2 702 | -2 153 | -3 017 | -2 243 | -947  | -1 816 | -2 212 |
| Current account balance                       | % GDP | -4.7    | -4.3    | -3.2    | -1.8    | -4.7   | -4.5   | -3.8   | -3.2   | -2.6   | -2.1  | -2.0   | -1.8   |
| General government balance                    | % GDP | -7.8    | -5.1    | -3.4    | -3.0    | -      | -      | -      | -      | -      | -     | -      | -      |
| CPI   | %YoY  | 2.6     | 4.3     | 3.8     | 2.5     | 4.1    | 4.0    | 3.9    | 3.3    | 2.7    | 2.1   | 2.5    | 2.5    |
| CPI <sup>b</sup>                              | %YoY  | 3.1     | 4.6     | 3.0     | 2.5     | 3.9    | 4.3    | 4.0    | 3.0    | 2.5    | 2.1   | 2.5    | 2.5    |
| CPI excluding food and energy prices          | %YoY  | 1.6     | 2.4     | 2.3     | 2.1     | 2.5    | 2.5    | 2.2    | 2.1    | 2.2    | 2.0   | 2.2    | 2.2    |
| PPI   | %YoY  | 2.1     | 7.6     | 3.5     | 1.7     | 6.1    | 4.7    | 2.7    | 0.7    | 0.9    | 1.1   | 2.1    | 2.6    |
| Broad money (M3) <sup>b</sup>                 | %YoY  | 8.8     | 12.5    | 6.4     | 4.9     | 9.3    | 11.1   | 8.6    | 6.4    | 7.3    | 7.6   | 6.6    | 4.9    |
| Deposits <sup>b</sup>                         | %YoY  | 9.1     | 11.7    | 6.5     | 5.2     | 8.5    | 10.4   | 8.9    | 6.5    | 6.7    | 7.7   | 6.8    | 5.2    |
| Loans <sup>b</sup>                            | %YoY  | 9.2     | 14.4    | 3.1     | 3.6     | 12.8   | 10.7   | 5.7    | 3.1    | 4.3    | 5.2   | 5.9    | 3.1    |
| EUR/PLN                                       | PLN   | 3.99    | 4.12    | 4.20    | 4.15    | 4.23   | 4.26   | 4.14   | 4.17   | 4.21   | 4.15  | 4.15   | 4.10   |
| USD/PLN                                       | PLN   | 3.02    | 2.96    | 3.31    | 3.37    | 3.23   | 3.32   | 3.33   | 3.36   | 3.45   | 3.39  | 3.35   | 3.29   |
| CHF/PLN                                       | PLN   | 2.90    | 3.34    | 3.49    | 3.37    | 3.50   | 3.55   | 3.45   | 3.47   | 3.51   | 3.39  | 3.32   | 3.28   |
| Reference rate <sup>b</sup>                   | %     | 3.50    | 4.50    | 4.25    | 4.00    | 4.50   | 4.75   | 4.75   | 4.25   | 4.00   | 4.00  | 4.00   | 4.00   |
| WIBOR 3M                                      | %     | 3.94    | 4.54    | 4.94    | 4.26    | 4.97   | 5.04   | 5.08   | 4.66   | 4.33   | 4.23  | 4.25   | 4.22   |
| Yield on 52-week T-bills                      | %     | 3.96    | 4.51    | 4.49    | 4.17    | 4.50   | 4.69   | 4.56   | 4.22   | 4.13   | 4.10  | 4.18   | 4.27   |
| Yield on 2-year T-bonds                       | %     | 4.72    | 4.81    | 4.40    | 3.97    | 4.66   | 4.71   | 4.21   | 4.00   | 3.93   | 3.90  | 3.98   | 4.07   |
| Yield on 5-year T-bonds                       | %     | 5.31    | 5.44    | 4.63    | 4.15    | 5.02   | 4.93   | 4.42   | 4.13   | 4.07   | 4.08  | 4.18   | 4.27   |
| Yield on 10-year T-bonds                      | %     | 5.74    | 5.98    | 5.17    | 4.85    | 5.58   | 5.38   | 4.90   | 4.80   | 4.80   | 4.86  | 4.88   | 4.87   |

Source: CSO, NBP, Finance Ministry, BZ WBK own estimates; <sup>a</sup> in nominal terms. <sup>b</sup> at the end of period

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