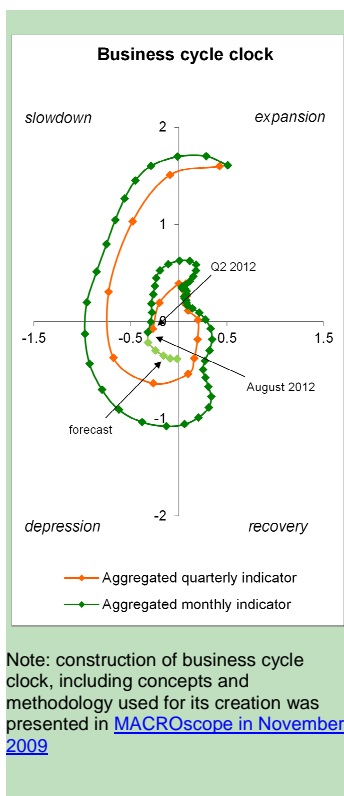


MACROscope

Polish Economy and Financial Markets

October 2012



All is not lost...

▪ **The slowness of the Monetary Policy Council we described in the previous edition of the report has been continued. The MPC kept interest rates on hold in October, but all is not lost that is delayed** – the MPC signalled that if new data and NPB projection confirm economic slowdown and lack of inflation risk, then a cut can be implemented in November. We are expecting that this will be the case, given weak macro data and results of the new projection. We maintain our forecast that the NBP reference rate will be cut to 4.0% until the end of 1Q2013.

▪ **Monetary policy guidelines for 2013 are not very different as compared to the documents from the previous years.** In our view they are well shaped and make it possible to conduct a flexible monetary policy. However, we are under impression that some MPC members tend to forget the strategy set by themselves and we try to justify our point in *Special topic*. We also show the estimation of optimal inflation rate for Poland, which, according to our estimates based on Phillips curve model, amounts to ca. 4%. At the same time, we argue why the inflation target should remain at current level of 2.5%.

▪ **CPI inflation rate is still running above NBP inflation target, but we maintain our opinion that the risk that it will persist on elevated level is limited.** Inflation will probably increase in September due to statistical base effects, but this will be probably the last “jump” before the downward trend is outlined more pronouncedly. Core inflation is declining considerably. Strong deceleration of economic growth and weak labour market situation do not bring any threats of second round effects and it seems very probable that the CPI will descend to inflation target as early as in Q1 2013.

▪ **In spite of some positive surprises delivered by indicators released abroad recently, the global economic prospects remain far from being optimistic.** The IMF in its newest report cut forecasts of economic growth worldwide, with most considerable downward correction in case of developed economies. The euro zone has probably ended Q3 2012 with a marked drop of GDP, while situation in its strongest economies seem to be more and more similar to peripheries. Weak economic outlook of the US economy encouraged the Fed to launch the third round of quantitative easing. Slowdown in Asia is also continued. Most forecasts are assuming that some rebound in global growth can be visible in 2013, but the scale and pace of expected improvement are waning.

▪ **The economic slowdown is deepening also in Poland.** Data for September, which are due for release in the upcoming days, will complete the picture of situation in Q3, probably confirming that the GDP growth slowed below 2%YoY and may decelerate even more in the upcoming quarters. We are predicting that the business cycle will bottom out at the turn of 2012 and 2013 and the economic activity should recover after reaching trough at ca. 1%YoY of GDP growth. Still, improvement will be a lengthy process, similarly as worldwide.

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Financial market on 9 October 2012:

NBP deposit rate	3.25	WIBOR 3M	4.91	EURPLN	4.0721
NBP reference rate	4.75	Yield on 2-year T-bond	4.02	USDPLN	3.1501
NBP lombard rate	6.25	Yield on 5-year T-bond	4.20	CHFPLN	3.3616

This report is based on information available until 9.10.2012

Special topic

Flexible guidelines difficult to implement?

In September, the MPC released *The Monetary Policy Guidelines for 2013*. They have changed only slightly as compared to the previous year, but we would like to draw attention to several key features of this document and want to comment on the implementation of the policy guidelines by the Monetary Policy Council. Also, one of the MPC members has voiced a need for adjusting the inflation target, i.e. the foundation of the policy guidelines. We know that the issue was not addressed at the Council's meetings and the target remains unchanged. Still, the adjustment of the inflation target was hinted and became an interesting topic for discussion. This is why the text below also makes references to that problem. Overall, we believe that the Council disposes of well-shaped monetary policy guidelines which will allow it to respond flexibly to economic developments. But we are also of opinion that the Council members sometimes seem to forget about the strategy they have set themselves and tend to pursue their personal beliefs. As far as the level of the inflation target is concerned, we think that it is adequate taking into account low anchoring of Polish consumers' inflation expectations.

The strategy remains unchanged

The MPC's strategy has remained unchanged. Since June 2004 the MPC is following a permanent inflation target of 2.5% with a symmetrical tolerance band for deviations of ± 1 percentage point. Similarly as in 2012, the primary objective of the monetary policy in 2013 is to stabilise inflation at the level of 2.5% in the medium term.

Although the monthly CPI is the primary inflation indicator, the *Guidelines* call for the application of other indicators, for example quarterly and annual CPI readings, HICP inflation and core inflation indicators, which can make it easier to distinguish between temporary and persistent inflationary pressure as well as between supply and demand shocks. The paper also points out to the fact that distinguishing among various types of shocks is important in the context of the economic policy because output and prices are moving in the same direction when demand shocks occur, but when supply shocks kick in, they are moving in opposite directions. Different shock types demand different responses, then.

This year, the Council has also indicated for the first time that supply shocks accompanying the global crisis developments (exchange rate volatility, changes of commodity prices, indirect tax hikes) are indeed conducive to higher inflation in the short term, but they also limit the risk of a persistently heightened inflation in the medium term. Also, if the inflationary factors are accompanied by a deteriorating

medium-term growth outlook, then the risk of stronger wage pressure and the second-round effects is limited.

The Council have also stressed that due to the delayed response of output and inflation to the monetary policy, they have little influence on the current inflation rate, whilst the policy's timescale and impact on the economic processes is uncertain. This is why the *Guidelines* call for a possibly broad array of information to be factored in when examining the inflation related processes.

The paper also highlights inflation expectations, and their role in the persistence of shock impact on inflation. According to the MPC, the inflation expectations in Poland are not anchored deep enough, which may provide rationale for the policy's reaction even when shocks are temporary.

The take on Poland's accession to ERM II and the currency union in the latest *Guidelines* is quite different from what was voiced in the previous editions. At that time, the Council was opting for a possibly quick adoption of those mechanisms, but now its members suggest that the move should be considered only when the euro crisis has been overcome.

The Council is also reminding that it is necessary to take real interest rates and real exchange rate into consideration when assessing the restrictiveness of monetary policy.

Similarly as in previous years, the Council did not rule out an intervention on the currency market should they turn out necessary to ensure domestic macroeconomic and financial stability.

The paper also stresses the role of the macroprudential policy in containing the risk of economic imbalances, the necessity of existence of institutions responsible for its implementation and ensuring that the central bank plays a leading role in pursuing this policy.

The implementation of guidelines

The *Guidelines* provide an apt and comprehensive account of determinants and limitations in conducting the monetary policy. In our view, the framework set out in the *Guidelines* is making it possible to conduct flexible monetary policy and to effectively reduce inflation and output volatility. However, we are getting an impression that the Council sometimes behaves differently from what it has set out.

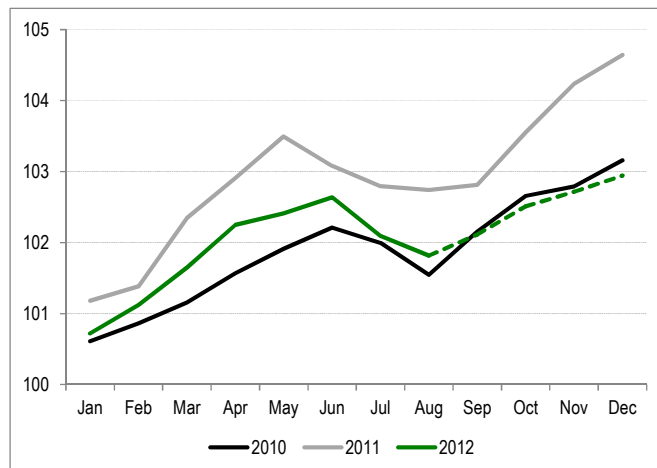
The CPI inflation has been heightened since the beginning of the year and has been hovering around 4%. This is largely attributable to the crisis-driven supply shocks. Concurrently, the core inflation readings dropped significantly in January 2012, and this trend has continued since then (the core inflation excluding food and energy prices in August was at 2.1%YoY). On the other hand, the labour market outlook has been deteriorating gradually since August 2011. This implies

a low demand and wage pressure on prices, so even with high inflation expectations, there is no risk of the second-round effects. Poor performance has also been reported by the manufacturing, construction and assembly output for several months already. The euro zone is in recession, which has an adverse effect on the domestic economy. Basically, the economic forecasts have consistently been revised downwards. In a word, all signs have shown that the economy is slowing down, which facilitates inflation decrease towards target in the medium term. Many market analysts forecast that trend as early as in autumn 2011, when even suggestions could be heard that the Council should lower the interest rate. Interestingly enough, the official NBP projections also showed a major deceleration of industrial output and inflation in 2013.

Although the above mentioned circumstances are discussed and analysed in the *Guidelines*, one can get an impression that the Council did not pay much attention to them and between January and August 2012 continued to maintain restrictive bias (and raised the interest rate by 25bps in May), arguing that the prospects of inflation's return to target are still distant. As mentioned in the previous paragraph, we find it hard to subscribe to that rationale. We have a feeling that the decisive argument for maintaining the restrictive bias was the elevated current CPI inflation rate. For example, one of the Council members said in July: "We cannot start monetary policy easing just because we have lower inflation forecast on paper. The deceleration of price increases must occur." This comment proves that some of the MPC members focus only on the current inflation reading (which as a matter of fact is showing inflation from two months ago), rather than on the expected changes in the medium term, let alone taking into consideration "all available information relevant for inflation developments". Besides, even the current CPI indicator shows that inflation pressure in 2012 is much weaker than in 2011 (see graph 1). Even though the YoY reading is still around 4%, this is caused statistical effects to a large extent. This means that the Council acted in a pro-cyclical fashion most likely strengthening the volatility of the business cycle instead of weakening that effect.

The MPC members justified the May interest hike with a need to bring the real interest rate to the positive territory. We do not really know what interest rate it is about, but to our minds the real interest rate in Poland had recently been negative in 2011, and only temporarily, so this year's hike in May could not bring a tangible effect. The *Guidelines* also indicate that the hike was meant to prevent the inflation expectations from anchoring at a relatively high level. We do not believe, though, that the period of economic slowdown, when the second-round effect risk is marginal, is the right time for inflation expectations anchoring.

Graph 1. Consumer price index (December of the previous year=100)



The mindset of some of the Council members changed only when GDP figures confirmed a significant deceleration of economic growth in the second quarter, and the domestic demand turned out to be negative on an annual basis. But even these weak figures did not convince some of the Council members to ease the monetary policy as they believe that the risk of persistently elevated inflation is still considerable, even though this belief is contrary to the NBP's projection, and a majority of market forecasts.

What level of the inflation target?

At the end of August Elżbieta Chojna-Duch, one of the MPC members, suggested that the inflation target should be changed, i.e. raised or replaced with a band target (it is a point target now). In our view, currently such a change would certainly not add to the credibility of the monetary policy (the actual inflation is above the target, so let's raise it). Here, we fully subscribe to the view presented by Andrzej Sławiński, the head of Economic Institute at the National Bank of Poland, who said that there was no reason for raising the target as it allows the MPC to respond flexibly to the changing economic environment. Still, in our view it is worth looking at this problem closer because choosing the inflation target value is not a light issue. Inflation should not be too high as it will be too costly for the economy. First, transaction costs go high – people begin to "steer clear of the money", exchange it for other currencies or commodities (the shoe leather costs) because they are afraid of currency depreciation. Also, frequent price increases necessitate price list and catalogue updates (the menu costs). Second, inflation causes income redistribution, as it lowers the real interest on loans, which is of benefit to borrowers, but not of lenders. Third, inflation adds to the risk of business planning through the uncertainty about future price trends and eats away at productivity.

On the other hand, inflation should not be too low. First, a too low inflation target may increase the risk of deflation which is deemed to be more dangerous than inflation.

Second, low inflation couples with low nominal interest rates, which limits the room for manoeuvre of the central banks and adds to the risk of falling into the liquidity trap. This issue was brought up to the surface by for example Olivier Blanchard, the chief economist of IMF, who suggested that the inflation targets set by the central banks ought to be higher. It needs to be stressed, though, that Poland's probability of falling into the liquidity trap amid the current economic environment is purely theoretical. Also, the study of deflationary risk proves that it is low in Poland¹.

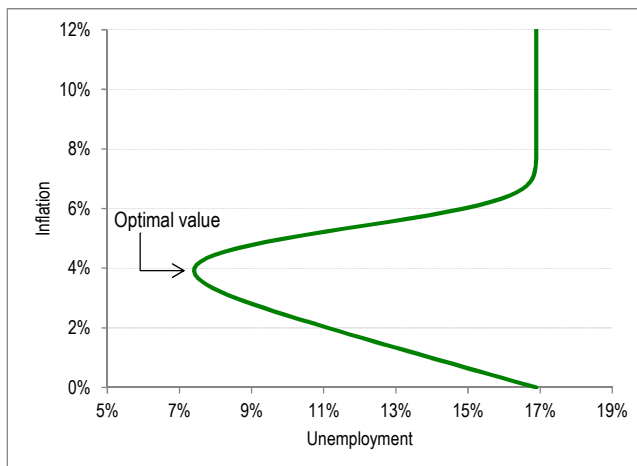
From the perspective of the Polish economy, the most important is the third factor of too low inflation, i.e. the downward wage rigidity. The decline of nominal wages is something that employees find hard to accept. This is why enterprises have only limited room for responding to negative demand shocks with wage cost reductions. The labour market has to adjust via changes of real wages, i.e. changes of the overall price level in the economy. This phenomenon is also known as the *grease effect* - inflation makes the labour market and wages more flexible. The significance of this effect grows bigger as the wages get more rigid (they often comprise elements that depend on the current economic climate, for example bonuses that soften rigidity). On the other hand, inflation may have an adverse impact on the change of relative prices and distort an efficient market allocation. This phenomenon is known as the *sand effect*. The optimal inflation rate maximises the grease effect and minimises the sand effect.

The relationship between inflation and labour market (unemployment rate) has been of great interest to economists for many years, and its best known emanation is the Phillips' curve. According to the economic theory, in short term unemployment can be lowered at the expense of higher inflation (the falling curve), but in the long term unemployment will return to its natural level (the vertical curve). The more modern Phillips' curve models rely on the assumption that low inflation is neglected by economic agents in decision making and inflation awareness begins to grow when its rate is on the increase. Thanks to that, Phillips' curve falls when inflation is very low (the grease effect prevails), grows when inflation is moderate (the sand effect prevails), and gets vertical when inflation is high. Such a shape allows for finding the optimal inflation rate at which employment is highest.

We have estimated a Phillips' curve model for the Polish economy based on the above assumptions (details can be found in the technical annex). Our estimates show that the optimal inflation rate from the perspective of unemployment would be at ca. 4% (see graph 2.) with the corresponding

unemployment rate of ca. 7.4% (LFS) or ca. 10.2% (registered unemployment). Inflation growth above 4% will cause unemployment to grow on account of the greater impact of the sand effect; decline below 4% will also add to unemployment but due to a weaker grease effect.

Graph 2. Long-run Phillips curve



Given such results, would we be willing to recommend raising the inflation target to 4%? Save for the fact that estimations received from an econometric model always carry some uncertainty, our simulation shows that inflation exceeding 4% and rising to 5-6% would bring about a strong growth of unemployment. When the inflation expectations are not deeply anchored, the risk of exceeding the target may be high. Hence, it seems reasonable to set the target below the estimated value. And that is the case in Poland. NBP studies² show that the inflation target is well anchored in the expectations of the financial and business sectors, quite contrary to the consumers' expectations. As regards the financial sector, 70-75% of financial sector's forecasts is driven by the inflation target, and 25-30% by the current inflation rate. As for business enterprises, 55-65% of their expectations is driven by the inflation target, while only 10-15% of consumers account for that factor. In our view, this low level of anchoring is a strong argument for leaving the inflation target unchanged.

¹ Błaszczak P., Stabilność cen – sposoby definicji oraz wyzwania dla polityki pieniężnej, Materiały i Studia zeszyt nr 249, Warszawa 2010

² Łyziak T., Oczekiwania inflacyjne w Polsce, Materiały i Studia zeszyt nr 271, Warszawa 2012

Technical annex

Our model aiming at estimation of optimal inflation rate for Poland was designed based on proposal of Akerlof, Dickens and Perry for the US economy³. These three researchers have made an assumption that economic agents can ignore price changes, provided that they are small enough so that the inflation costs can be neglected (i.e. firms will carry no important costs of ignoring inflation). However, as the inflationary changes are amplifying, more and more agents will take inflation into consideration and correct their products' prices based on their inflation expectations. This assumption is inconsistent with traditional rational expectations theory, but can be explained by modern theories, e.g. rational inattention theory. This theory assumes that neglecting some information while solving optimization problem is rational, as information gathering and processing is costly. Such a model makes it possible to explain developments observed in empirical research: trade-off between inflation and unemployment and increasing importance of inflation expectations during high-inflation periods.

Model estimated by us is of following form:

$$cpi_t = A + \Phi(B + C * cpi_climate_t^2) * cpi_exp_t + D * u_t + E * x_t + \varepsilon_t,$$

Where *cpi* is CPI inflation rate, *cpi_climate* is inflationary climate, calculated as weighted average of inflationary climate in previous period and CPI inflation rate in previous period (initial observation is assumed to be equal to inflation rate), *cpi_exp* is companies' expectations about changes of their products' prices in the upcoming quarter, *u* is LFS unemployment rate and *x* are dummies. Structural parameters are given by letters A-E and error terms is reflected by ε . Letter Φ stands for cumulative distribution function of standard normal distribution. Thanks to such a construction, parameter reflecting influence of inflation expectations is rising from 0 to 1 as inflationary climate rises. This means that the higher the inflation rate in the past was, the more focused on the inflation expectations the companies are. Inflationary climate variable is squared so that deflation also causes rising impact of expectations.

Results of estimation are presented in the table below:

Parameter	Estimated value	P-value
A	0.057425	0.0000
B	-2.511776	0.0027
C	1031.126	0.0193
D	-0.339865	0.0000

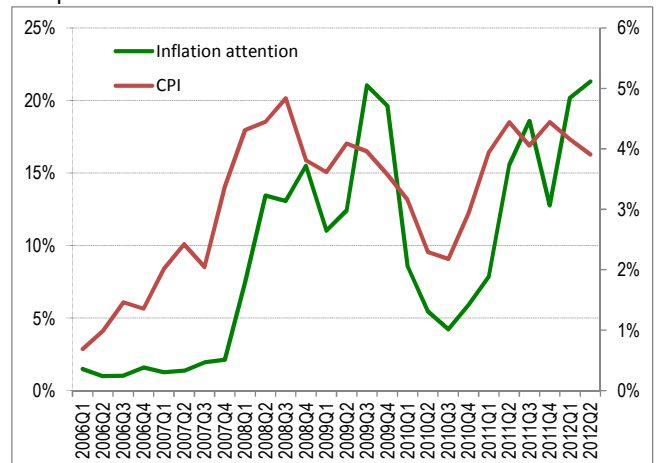
R-squared: 0.909250
DW: 2.237913
Sample: 2006Q1-2012Q2 (26 observations)

Our model was estimated also using other measures of inflation (private consumption deflator, annualized seasonally adjusted CPI rate), unemployment (registered unemployment) and inflation expectations and results were quite robust to specification changes. However, there were some problems with statistical significance of unemployment in larger samples, but other parameters did not lose their characteristics.

The table below shows the degree of inflation attention (i.e. the share of economic agents who are taking inflation into account when making decisions) as a function of actual inflation (inflationary climate). It shows that inflation running above 5% becomes a very important factor when making economic decisions.

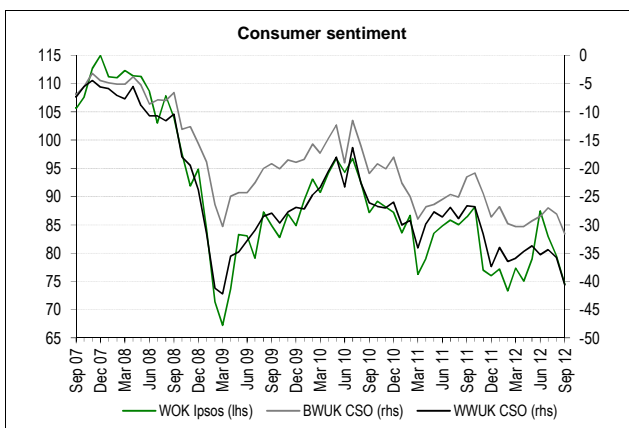
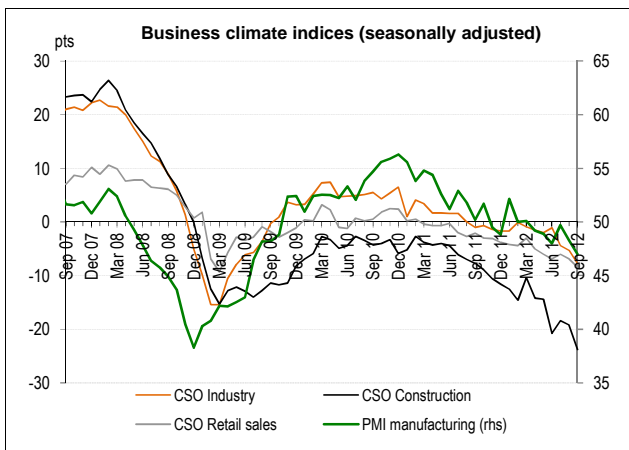
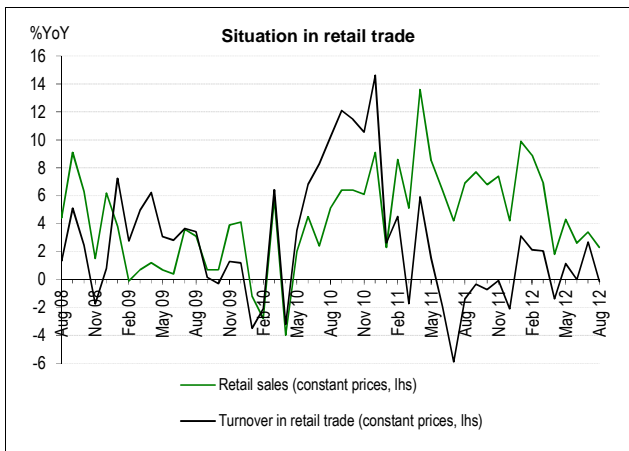
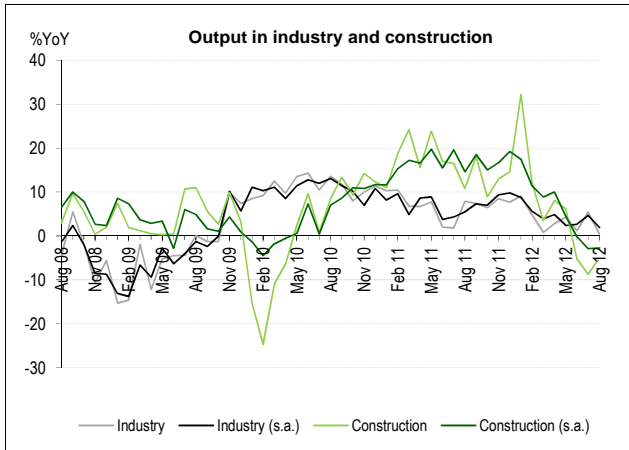
Inflation rate	Inflation attention
2.9%	5%
4.0%	20%
4.9%	50%
5.7%	80%
6.3%	95%

The graph below is showing estimated inflation attention as compared with inflation rate.



³ Akerlof G.A., Dickens W.T., Perry G. L., Near-Rational Wage and Price Setting and the Long-Run Phillips Curve, Brookings Papers on Economic Activity, 1: 2000.

Economic update



Activity in industry, construction and trade is weakening

▪ The August's data from domestic industry have confirmed that the July's rebound was only a one-off distortion in downward trend. Industrial output growth decelerated in August to 0.5%YoY, while construction again showed a deep contraction (-5%YoY). This time, contrary to previous months, the outcome was not distorted by differences in number of working days as compared to previous year.

▪ One should expect a continuation of negative tendencies in the upcoming months. Data on industrial output for September will be especially bleak, as, apart from general tendency of slowing activity, they will be strongly affected by a lower number of working days than one year before (this time difference amounts to two days). Our forecast of September's output (both industrial and construction) are considerably below market consensus.

▪ Retail sales growth decelerated in August to 5.8%YoY in nominal terms and to 2.3%YoY in real terms. Biggest constrain on sales was put by poor demand for autos and parts of automobiles (-9.5%MoM, -2%YoY). Still, even after excluding this part of sales, the deceleration of consumption demand growth is visible – according to our estimates, retail sales excluding autos and fuels rose 3.8%YoY (the same as in July, less than in previous two months). Additionally, data on turnover in retail trade (which in contrast to retail sales data include also units hiring less than 9 employees and do not cover data, among other, on sales of autos) showed that consumer demand stagnated – annual growth rate is close to zero.

▪ A considerable deterioration of consumer confidence (see below), decline of real incomes and uncertainty about employment prospects will be putting a cap of consumer demand in the upcoming months and quarters.

Leading indicators are heralding further slowdown

▪ Surveys covering current and expected economic climate are indicating a further deterioration of domestic economy situation.

▪ PMI for Polish manufacturing declined in September to 47.0, markedly below market expectations and to the lowest level since July 2009. Apart from categories, which have been moving in a downward trend for a long time (subindexes for output and new orders plunged in September to lowest levels since June 2009) it is worth to notice that employment declined for the first time since March (subindex for this category reached the lowest level since the beginning of the year and second lowest in last 32 months).

▪ Rather worrying tendencies were also shown by the CSO economic climate indices, which recorded another month of drops across the board. The most considerable deterioration of moods is visible in construction (seasonally adjusted index reached the lowest value ever). Let us remind that a strong drop of this index in June has predicted a contraction in construction output. Strong drops were also posted by indicators for industry and retail sales (index for the latter sector is close to trough from 2009).

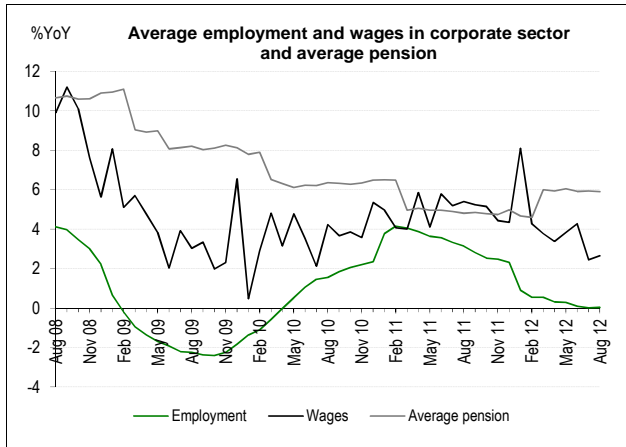
▪ Consumer confidence is also deteriorating quickly, approaching minimums from 2009.

▪ In spite of some improvement of PMI for euro zone and German manufacturing, the general picture drawn by the economic climate indicators for the euro zone is heralding a strong quarterly drop of GDP in Q3. What is even worse, economic climate in core euro zone countries is deteriorating and becoming similar to peripheries' situation.

▪ According to deputy head of statistical office Halina Dmochowska, Poland's Q3 GDP growth will likely be slightly lower than 2.4% recorded in Q2. Our forecasts are less optimistic, showing Q3 GDP slowdown even below 2%YoY and to ca. 1%YoY at the turn of 2012 and 2013.

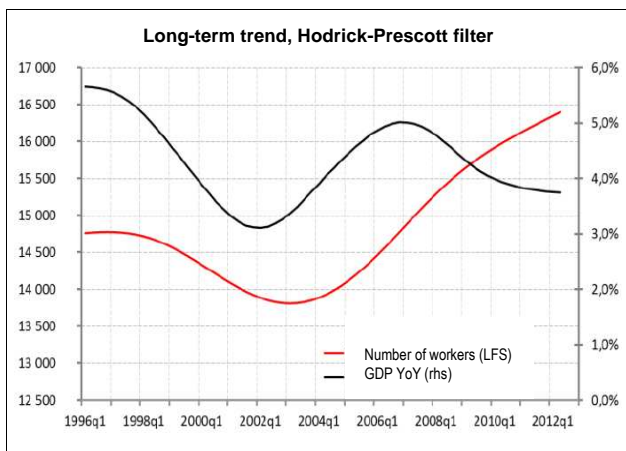
Source: CSO, Reuters, BZ WBK

Economic update



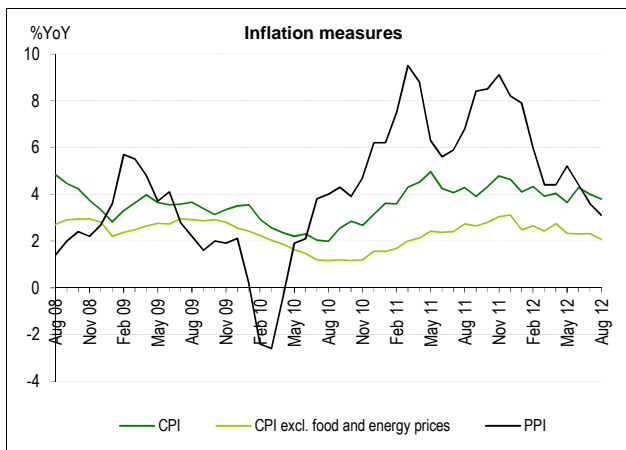
Labour market still in stagnation

- Wage growth in corporate sector slightly accelerated in August (to 2.7%YoY), but data after eliminating dividend payments show significant slowdown in the last couple of months (from 3.6%YoY in June to 2.6% in August).
- Average employment once again dropped in monthly terms, and its annual growth rate stabilised at zero. Since the start of the year the number of jobs fell by ca. 30k, while there was an increase of 20k in the corresponding period of 2011.
- Registered unemployment rate increased in August to 12.4%, which is untypical for this month (when usually a seasonal drop applies). Seasonally adjusted LFS unemployment rate rose to 10.1% from 10% in the previous months.
- The data show that upward unemployment trend amid stagnation in labour demand results mainly from fast rise in economic activity among people just before retirement age. This is the effect of decreasing number of early retirements. Fall in chances of finding job affects mainly young people and is one of factors discouraging them from labour activity.



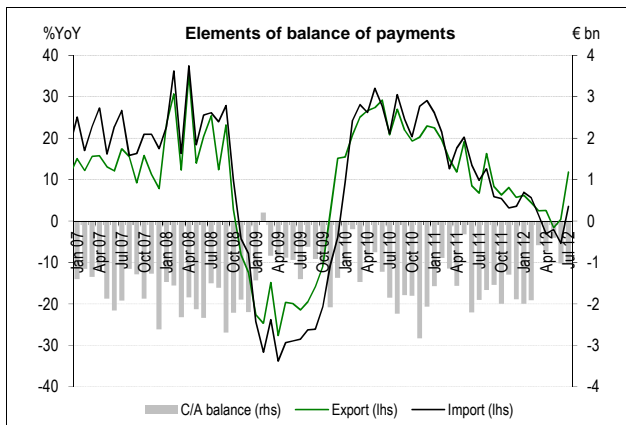
Lower GDP growth needed for spurring job creation

- According to the NBP report about situation on the labour market, since 2007 there is a growing discrepancy between long-term GDP growth and long-term employment growth in Poland. As a result, the level of GDP growth needed to produce rise in employment currently seems to be lower than in the past. According to the report, it is mainly services sector that is responsible for growing employment even despite decreasing economic activity.
- On the other hand, it suggests that restoring high productivity growth in the future may be difficult.



No threat of inflationary pressure

- CPI inflation fell in August to 3.8%YoY, roughly in line with expectations. This was possible, among others, due to effect of high statistical base (hike in communication prices in August 2011). We predict a rise in inflation in September, back to 4%, and in subsequent months a more persistent downward trend should be established, bringing CPI to ca. 3% in December and to the inflation target at the end of 1Q 2013.
- In August all measures of core inflation dropped. Inflation excluding prices of food and energy reached 2.1%YoY (vs. 2.3% in previous three months). PPI growth slowed third month in a row, to 3.1%YoY, the lowest level for more than two years; since May the PPI growth fell by over 2 percentage points.
- Recent data releases confirmed that there is hardly any threat of inflationary pressure.

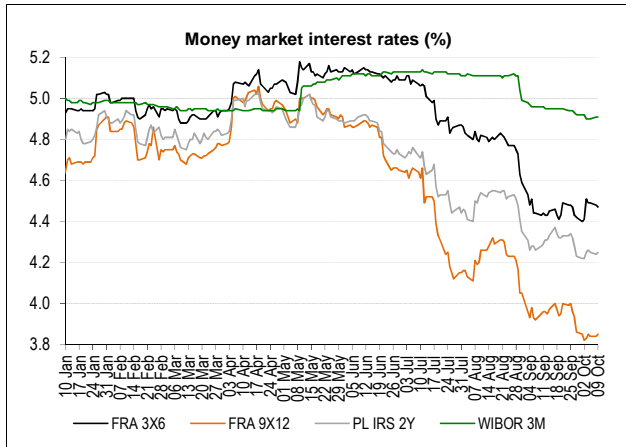


Only temporary rebound in external trade

- Annual growth of exports and imports soared in July (to 12.7% and 4.2%, respectively). This was caused – likewise a rebound in industrial output – by transitory factors (including low base effect). In next months we expect a return of downward trend in foreign trade. This is suggested by August's data about industrial output, and September's PMI report, showing continuing fall in export orders.
- Poland's external debt increased in 2Q 2012 to the all-time high, i.e. €264bn or 72% of GDP (driven mainly by a rise in public sector's foreign debt). At the same time, short-term foreign debt decreased slightly, and its coverage by reserve assets increased (to 144%). Poland's international investment position improved slightly in Q2, although it remains largely negative (-€238bn, i.e. 65% of GDP).

Source: CSO, NBP, Reuters, BZ WBK

Monetary policy watch



Interest rates unchanged, signalled rate cut in November

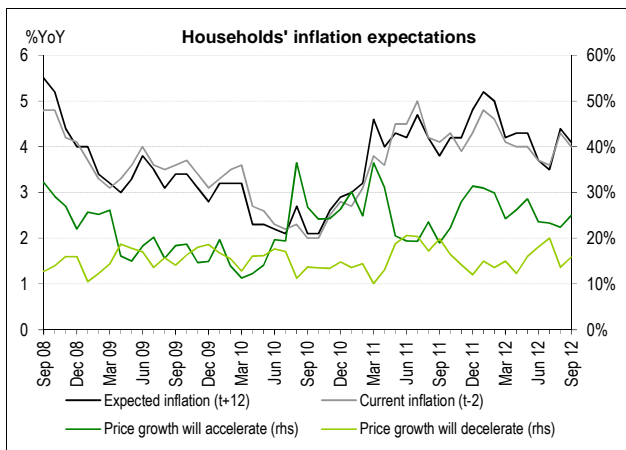
- Monetary Policy Council kept main interest rates on hold in October, surprising analysts and market participants, which were betting on 25bp rate cut.
- The tone of the post-meeting statement has been softened further (already in September it was more dovish than before the summer holidays). The Council recognised signals of deteriorating business climate in Poland and abroad, and factors favouring inflation reduction.
- There was a modification of the last, most important sentence of the statement, where the MPC stated that “should incoming data, including the November inflation projection of the NBP, confirm that economic slowdown would become protracted, while the risk of increase in inflationary pressure be limited, the Council will ease monetary policy”. In our view, this change is a very clear hint that interest rates may be trimmed at the next MPC meeting. Especially that according to our forecasts the data to be released before the next meeting will confirm the scenario, which according to the Council is a condition for rate cut. Importance of this part of the statement was confirmed by the NBP President, who said the aim of changing this fragment was to strengthen the signal of possible easing of monetary policy. Comments of MPC members after the meeting also indicated that it might be now easier to gather majority to support a motion for a rate cut.
- We predict that the MPC will cut main interest rates by 25bps in November (and probably again in December), and we also stick to the view that until the end of 1Q 2013 the NBP reference rate will be reduced in total by 75bps, to 4.0%. This is a lower scale of monetary easing than this priced-in by the financial market (at least 100bps).

Fragments of MPC communiqué in October:

The data on economic activity in Poland in July and August, including ongoing deceleration of industrial production, persisting decline in construction output and further decrease in retail sales growth, point to a continued downturn in economic conditions in 2012 Q3.

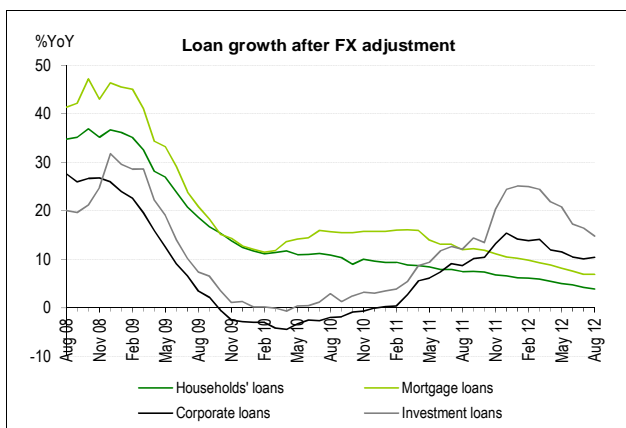
In the opinion of the Council, inflation will decrease gradually over the coming months, as the statistical base effect wanes amidst slowing demand in the economy. However, it will remain above the inflation target of 2.5% until the end of 2012. In the medium term, the slowdown in economic growth will contribute to inflation returning to the target while high commodity prices in the global markets remain an upward risk to inflation decline.

Should the incoming data, including the November inflation projection of the NBP, confirm that economic slowdown would become protracted, while the risk of increase in inflationary pressure be limited, the Council will ease monetary policy.



Inflation expectations with no major changes

- Households' inflation expectations declined slightly in September to 4.1% (from 4.4% in August), which was mainly due to a decrease of current inflation figure, serving as a base for calculation of this gauge.
- Breakdown of respondents' answers was similar to the previous one. Share of respondents expecting an acceleration of price growth increased slightly (to 25% from 22.4%), while share of respondents expecting the pace of growth of prices to remain the same dropped (from 55.1% to 51.4%). This means that the total share of respondents anticipating that price growth will not decelerate declined from 77.5% to 76.4%.
- In our view, the breakdown of answers can improve in the upcoming months, as deepening economic slowdown will put a cap on price growth.

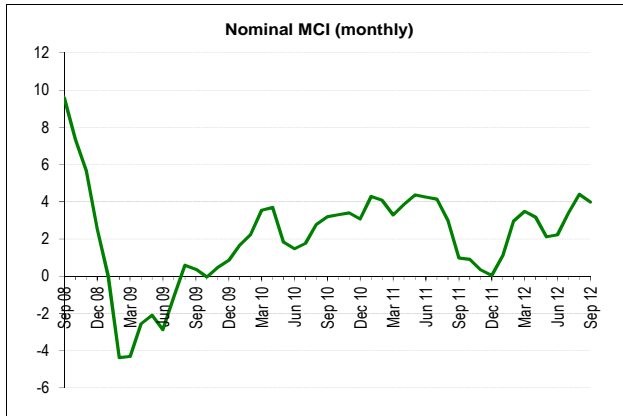


Loan growth slowing down

- Total loan growth slowed down again in August to 5.7%YoY, and after eliminating effect of exchange rate fluctuations to 5.9%YoY.
- The sharpest slowdown concerns households' credit – total loans grew 3.5%YoY (3.9% after FX adjustment), which is the weakest result since 2003. This is caused mainly by deepening fall in consumption loans (-4.6%YoY in August). Slowdown in mortgage market stopped for a while – in August their growth (FX adjusted) stabilised at 6.9%YoY.
- Loans for companies (after elimination of FX effect) rebounded slightly, to 10.4%YoY in August from 10.1% in July. However, growth in investment loans keeps slowing down.

Source: NBP, Reuters, BZ WBK

Restrictiveness of the Monetary Policy (Council)



Slight drop of the MCI

- As we expected, in September the nominal index of monetary policy restrictiveness MCI dropped slightly due to declining money market interest rates (three-month average WIBOR picked down from 5.10% to 4.95%) and depreciation of the zloty (EURPLN climbed to 4.14 from 4.09). In spite of a slight drop, the value of the index is still running at relatively high level.
- We expect that the index may pick up slightly in October, thanks to a stronger zloty and unchanged NBP's interest rates. However, but already in November the index may record another drop due to monetary policy easing.



Rzońca (1.10)

Każmierczak (1.10)

Gilowska (1.09)

Hausner (1.08)

Winiński (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.

MPC waiting for the next inflation projection

NBP President and MPC chairman Marek Belka said at the press conference after October's MPC meeting that one of the reasons to wait with interest rate cut was the Council's willingness to become sure of tendencies regarding the economic growth and inflation by, among others, receiving new NBP projection. It is interesting that the MPC started putting so much emphasis on the results of the NBP projections and they are now necessary to make decision about monetary easing, while the results of previous two updates of those forecasts seemed not so relevant in the decision-making process. If the Council would follow conclusions from the NBP projections in the previous months, it should have reduced interest rates already after July's projection; moreover, there should be no rate hike at all after the results of NBP projection in March. Apparently, in the last six months or so the results of the projections were not the key arguments for the MPC. The NBP President repeated several times in the past that there are other analyses and forecasts (perhaps better), which are taken into account. So why the importance of this document is growing currently? Marek Belka, asked during the press conference whether the hike in May was a mistake, answered: no. But possibly, according to some MPC members, a short distance between the hike in May and a rate cut would be too open admission of such a mistake. Therefore, there was a need for arguments to postpone unwinding the controversial rate hike.

Glapiński not ruling out rate cut, Zielińska not committing

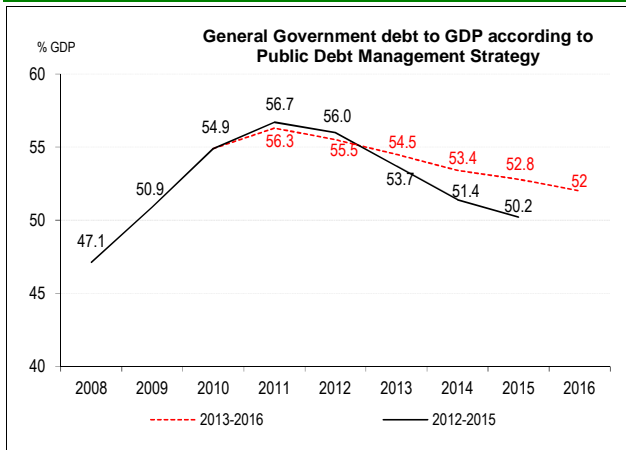
Adam Glapiński until very recently was seen as strong opponent of interest rate cuts in current environment. Only one week before the last MPC meeting he was arguing that "there is no reason at all to start monetary easing cycle", as inflation – after stabilising at high level – may rise in 2013. Meanwhile, in the interview after the last MPC meeting Glapiński did not rule out supporting a motion to cut interest rates in November, should the new NBP projection confirm decent economic slowdown and lack of threat for NBP inflation target in 2013. He also added that monetary policy easing should be made in few steps in order to be effective, and total scale of cuts could reach 75bps (consistent with our forecast).

In turn, Anna Zielińska-Głębocka, who suggested at the end of September that she was ready to back interest rate cut in October or November, warned recently that interest rate cut in November is not predetermined. In her view, the Council has to be sure how strong is the "anti-inflationary impulse", in which the results of new NBP projections will help. It is worth recalling that quite recently the NBP president Marek Belka said in the press interview that majority of forecasts that the central bank has at its disposal clearly show that inflation rate is going to drop to the target next year.

Real interest rates show scope for monetary easing

Marek Belka said at the press conference that room for interest rates reductions can be deducted from the Council's intention to leave real interest rates on the positive level. It is consistent with the scope of interest rates cuts assumed by us – currently real interest rates are at ca. 1% (however, one should notice that real rates might increase as a result of the drop in inflation and inflation expectations).

Fiscal policy watch



Higher path of debt to GDP in 2013-2016 period

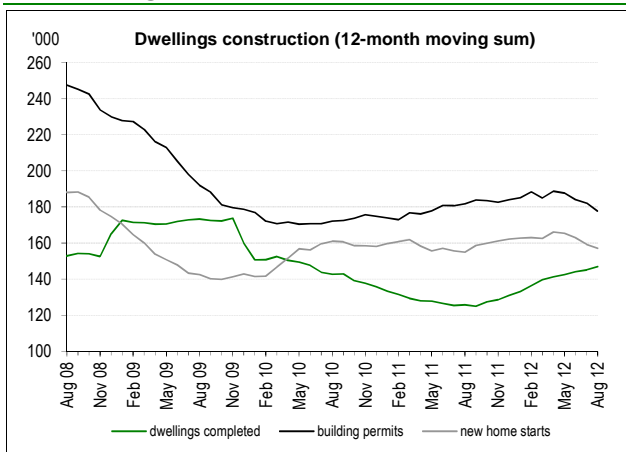
- In September Poland's government approved the 2013 budget draft and „The Public Finance Sector Debt Management Strategy in the years 2013-2016”. According to the “Strategy”, the trajectory of public debt to GDP ratio has been revised upward in comparison with the previous one (see chart beside). It results from not only less optimistic macroeconomic assumptions, but also from expected worsening of budget conditions.
- The government also approved prospective changes in legal procedures regarding limits on public debt in relation to GDP. It assumes that: (1) public debt denominated in foreign currency is calculated using average exchange rate, (2) debt amount is reduced by the value of means collected in order to finance borrowing needs in the following budget year, (3) if the ratio does not exceed the 50% or 55% threshold, prudential and remedial procedures and also increases in VAT rates are not applied.

	Spread vs Bunds (10Y) in bps			CDS (5Y USD)		
	09.10	change since 10.09.12	change since 30.12.11	09.10	change since 10.09.12	change since 30.12.11
Poland	317	-12	-87	103	-27	-176
Czech	86	-13	-90	85	-17	-88
Hungary	580	-16	-228	344	-41	-266
Greece	1682	-351	-1684	37030	0	26799
Spain	435	15	108	352	-16	-24
Ireland	355	-62	-311	289	-51	-446
Portugal	701	21	-471	461	-65	-708
Italy	361	-5	-157	308	-28	-177
Germany	-	-	-	50	-3	-50

Peripheral debt has strengthened thanks to central banks

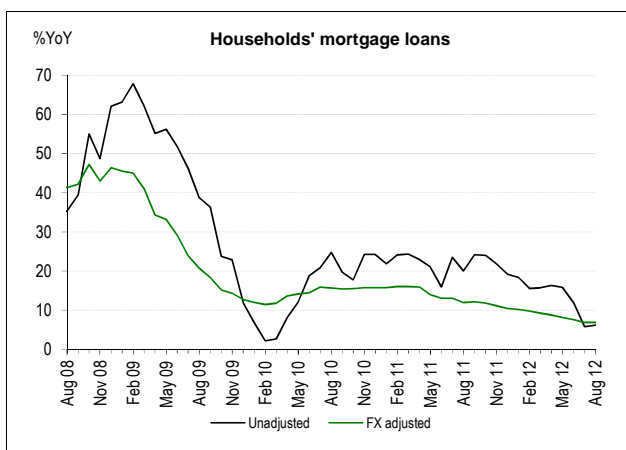
- Debt of peripheral countries strengthened significantly in September due to decisions of central banks (ECB, Fed, BoJ). Rising fears about the situation in Spain supported demand for safe-haven assets. Notwithstanding, the beginning of October brought further decline in yields of both the Spanish and Italian debt. We noted also spread narrowing vs Bunds in 10Y sector and further decline in CDS.
- The possibility of a targeted ECB intervention at the front-end of the Spanish and Italian curves should continue to favour short-term instruments in these markets and keep the steepening trend in place. Investors focus on Spain. It is widely expected that Spanish government will ask for international financial aid possibly during the EU summit (18-19.10). Spanish request for assistance will be a supporting factor for the euro zone peripheries.

Housing market update



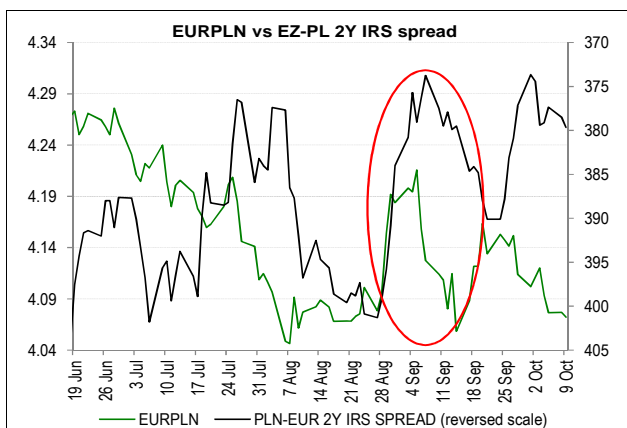
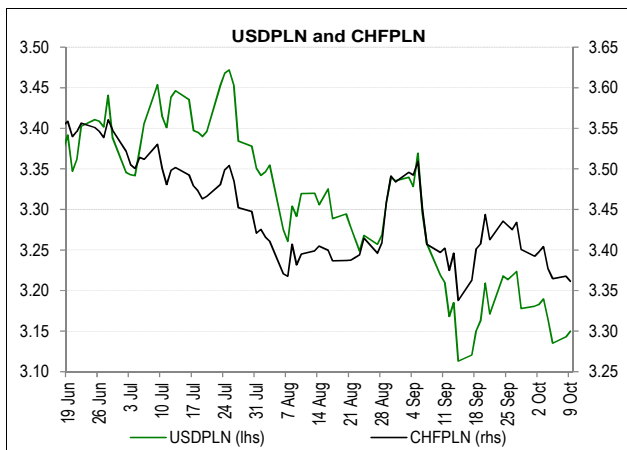
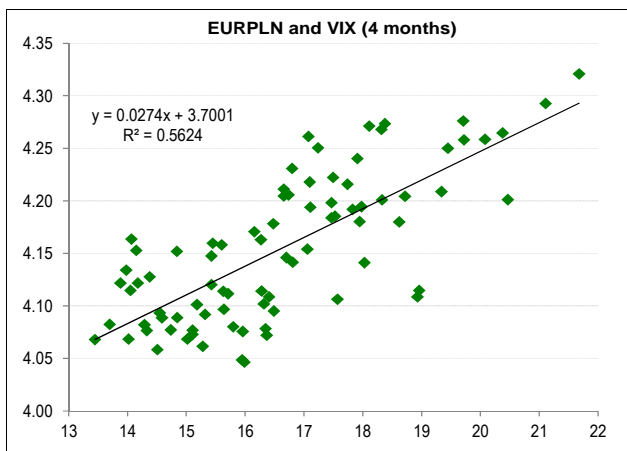
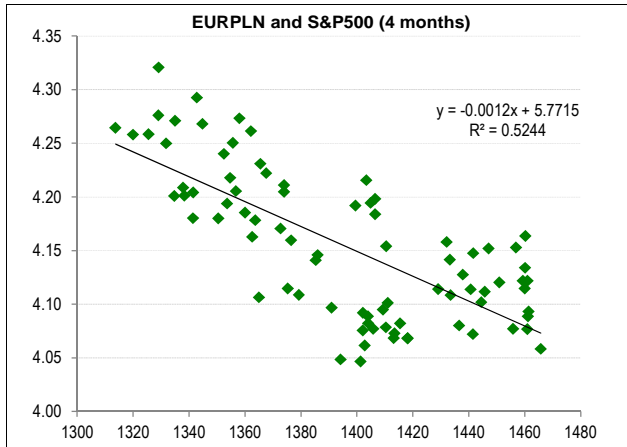
Tough times for the housing sector

- Over the course of recent months home prices continued their downward trend visible since early 2011. In September 2012, as compared to September 2011, average offered prices were lower by 7.4% in Gdańsk, 6.8% in Warsaw, 6.8% in Wrocław, 5.8% in Poznań and 3.7% in Kraków. Thanks to declining prices and still positive growth of wages (which is however decelerating), affordability of flats in Poland's biggest cities improved considerably – by ca. 10%YoY.
- A support for the decline of prices is provided by still growing supply: in September 2011 – August 2012 period 147k dwellings were completed, which is the highest number since mid-2010. However, trends observed on the market currently are likely to reverse in a couple of quarters' horizon, which is suggested by numbers of begun constructions and building permits. These figures are on a decline since mid-2012.
- Declining home prices are also due to weakening demand. In spite of increasing affordability, a drag on demand is put by stricter lending criteria (as a result of introduction of recommendation S and exhaustion of family-supporting government programme), especially as regards currency loans (in Q2 as much as 95% of new mortgage loans were granted in domestic currency). According to the AMRON-SARFiN report, the second quarter of the year saw a decline of worth of new loans by 1.53%QoQ for the first time in more than a decade.
- Demand for dwellings is also undermined by uncertainty about economic situation, which is invigorating to postpone long-term investments. The upcoming months may be difficult for the housing sector construction companies, as – in our view – demand will be still falling and accompanied by rising supply, resulting in further declines of prices. Upward trend of home supply may reverse in a couple quarters' horizon.



Source: CSO, NBP, MF, Reuters, szybko.pl, AMRON-SARFiN, BZ WBK

Foreign exchange market



Source: Reuters, BZ WBK

Zloty stronger thanks to ECB and MPC

▪ The zloty clearly appreciated during the first half of the past month. Main driver of the downward move of the EURPLN was the decision taken by the ECB in early September to introduce the Outright Market Transaction programme aimed at lowering short term bond yields on the peripheral debt market. Disappointing payrolls data fuelled hopes for Fed's QE3 which also contributed to zloty's appreciation. The EURPLN plunged temporarily to just below 4.05 (lowest level since early August) and the USDPLN tested 3.09 (lowest since early April).

▪ After the Fed announced its decision, risky assets – including emerging currencies – were hit by profit-taking. The EURPLN surged to nearly 4.18 and the USDPLN approached 3.24.

▪ Considerable impact on the depreciation of domestic currency was also put by expectations for a rate cut in October. That was clearly seen after the MPC – contrary to market consensus – left the NBP interest rates unchanged this month. Doubts whether the MPC will deliver aggressive easing of monetary policy provided support for the zloty. EURPLN returned in early October to lows seen in September among others thanks to the MPC decision.

Volatility of the EURPLN may increase in October

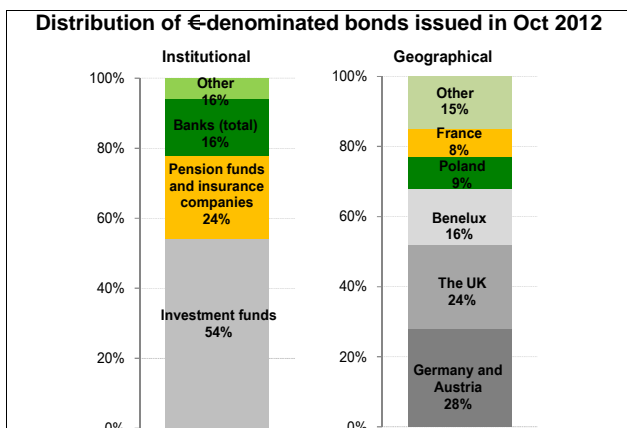
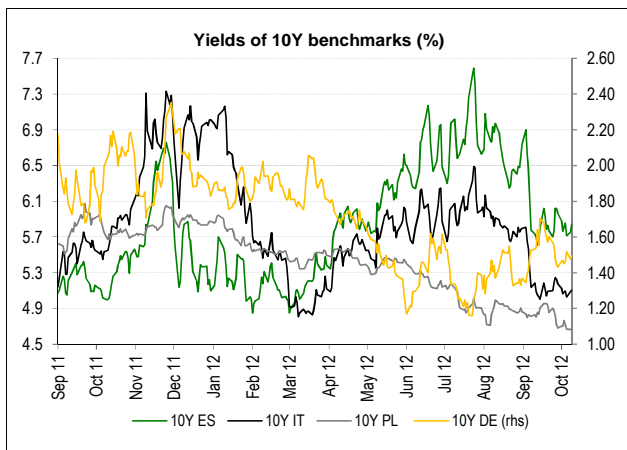
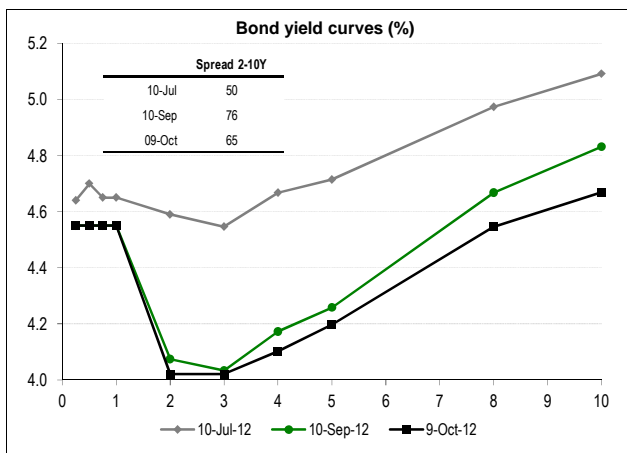
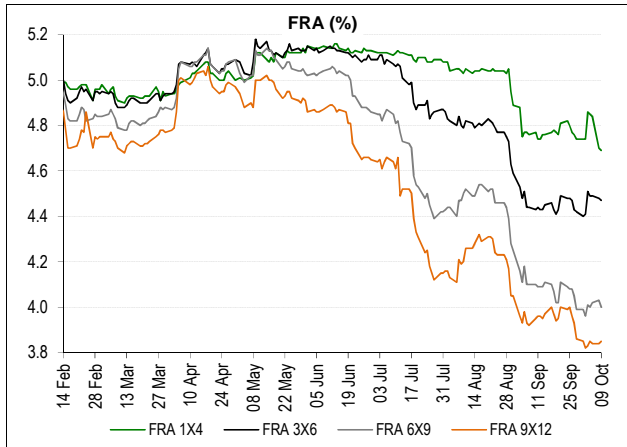
▪ The zloty continued to be supported by the situation on the US stock market. The 4-month correlation of the EURPLN with the S&P500 eased somewhat during September (from -0.89 to -0.72), but situation on the US stock exchange remains an important driver of the EURPLN. Profit-taking that emerged after the Fed was only marginal (so far) and this may indicate that currently there is no additional factor that could encourage investors to reduce the engagement in capital market. Market still hopes QE3 will work and that, despite a positive surprise from the US labour market, (data for September were better than expected and August's number was revised clearly upwards) the stimulation will not be terminated soon. Apparently, investors do not want to sell stocks in order not to miss any future upward move in prices. Consequently, unless there is an increase in risk aversion due to euro zone's problems, there should be no negative sentiment in the stock market. As a result, the zloty is likely to be driven by situation on the S&P500 (if the correlation does not decline significantly).

▪ On the other hand, we expect the domestic factors to put some negative pressure on the zloty. We forecast really poor macro data for September and we assume that market participants are not fully pricing-in further slowdown of economic growth to ca. 1%YoY (or even below). Additionally, after the expected rate cut in November, forecasts for further (more aggressive) easing of monetary policy will likely be maintained. It is worth to notice that market expectations regarding further decisions of the MPC were vital factor that generated high volatility of the EURPLN. Chart shows that strong increase of rate cuts expectations after disappointing Q2 GDP data pushed the EURPLN to ca. 4.22 and the MPC decision on leaving rates unchanged in September supported the zloty in the following days (the EURPLN declined to 4.05).

▪ Furthermore, as the time of the release of Troika's report on the progress Greece has (not) made on implementing reforms is getting closer, the uncertainty regarding further developments in the euro zone is likely to continue to play important role.

▪ As mentioned above there will be many important factors driving the FX market in October and thus the exchange rate may temporarily test lower (4.046-4.059) and upper (currently 4.12) band of range in which EURPLN stays since early September. To sup up, we see asymmetric risk for higher EURPLN and we expect the average exchange rate to reach 4.12 this month.

Interest rate market



Source: Reuters, BZ WBK

Short-lived correction move after the MPC's decision

- Macroeconomic data readings for August and words of the NBP's Governor Marek Belka, who clearly announced monetary easing cycle, renewed expectations for monetary easing as soon as possible. It backed not only FRA rates, but also the front end of curves (bond, IRS). Consequently, just before the October's MPC decision FRA rates reached this year's minimum (at 4.40% for FRA3x6, 3.96% for FRA6x9 and 3.82% for FRA9x12), while yield of 2Y benchmark tested the level of 3.98%.
- The medium and long-term bonds were more vulnerable to investors' mood changes during September. Yields increase towards 4.40% for 5Y and near 5.0% for 10Y activated the demand side. Significant strengthening was noted especially at the end of September, with information about the issuance plan for Q4 as an additional factor. Ahead of October's MPC meeting downward trend of yields was continued, with both 5Y and 10Y benchmarks reaching the multi-year lows.
- The MPC's decision to keep interest rates unchanged disappointed market players. The tone of statement was very soft and suggestion that the Council would cut rates in November caused that the correction on the debt market after strong rally was only short-lived.

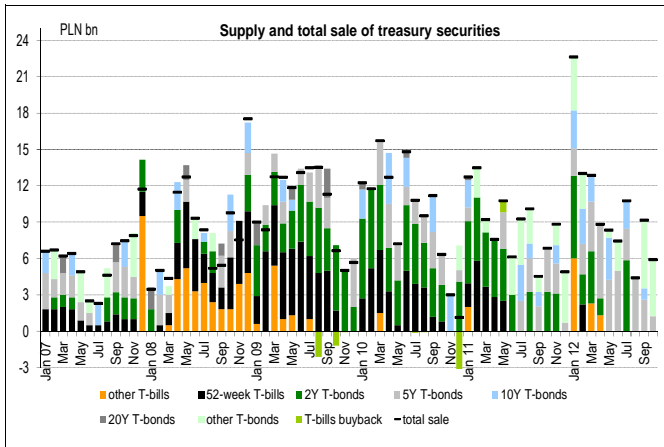
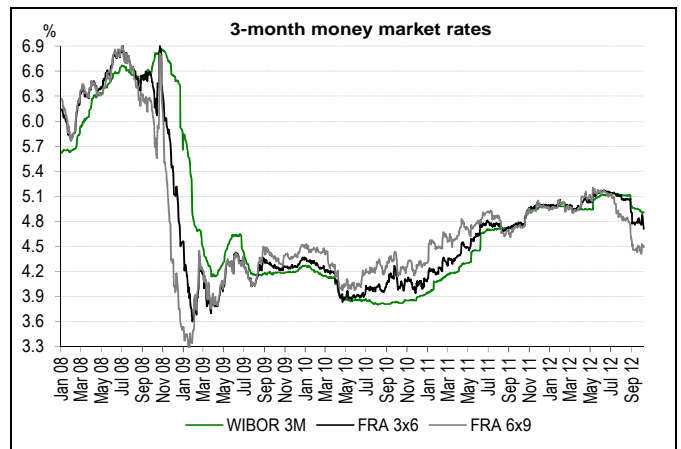
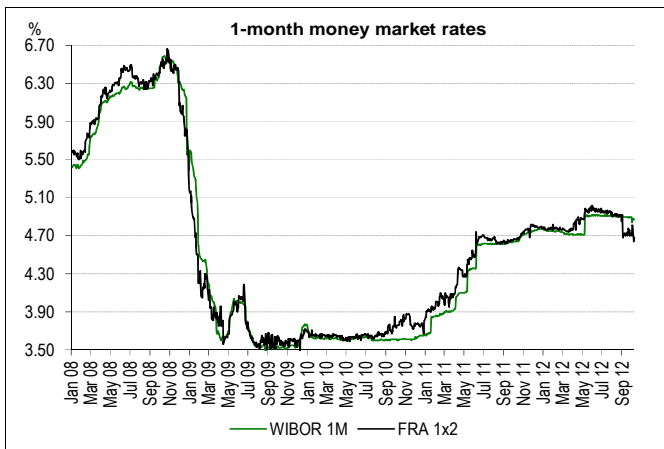
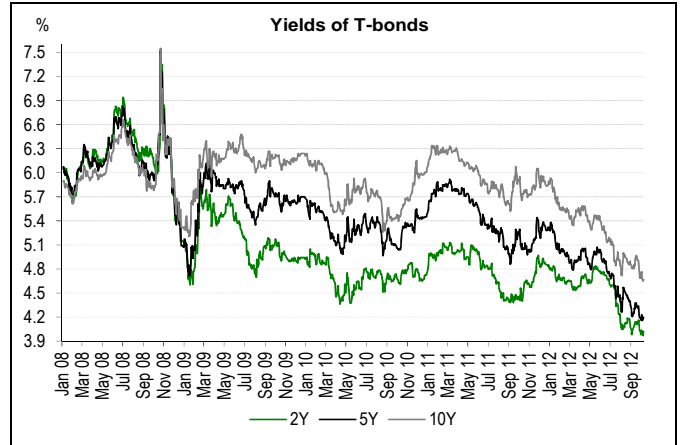
Market still aggressively prices-in interest rate cuts

- Lack of the MPC's decision about interest rates cut in October has caused market players to revise downward their expectations about monetary easing this year. Currently market prices-in one cut by 25bps till year-end, but it maintains aggressive scenario of total easing in the upcoming cycle (by 100bps or even a bit more in 9 months' horizon). In our opinion the scale of reduction will be lower, but we do not exclude that market will overshoot even more.
- At the beginning of October (after the MPC's decision) bond yields have been near their important support levels at 3.95% for 2Y, 4.15% for 5Y and 4.65% for 10Y. The front end of the curve will remain under influence of strong interest rate cuts expectations in November, underpinned by weak data from real economy for September. Consequently, we foresee yield of 2Y to decline towards 3.90% in upcoming weeks.
- Medium and long-term bonds will significantly depend on external factors, including the shape of core yield curves. Expected by us increase in Bund yields in medium terms might limit strengthening on the long end. On the other hand, still low supply on the long end should support 10Y sector.
- We still do not exclude yield curve to become more steep ahead of November's rate cut. We foresee spread 2-10Y to widen towards 80bps, while in case of IRS the first target is at 20bps.

Supply side is still supportive for the debt market

- Issuance plans for Q4 2012 were more or less in line with expectations. In October-December period the Ministry wants to raise funds worth PLN10-18bn in total, in which the October's offer accounts for nearly 80% of total supply. It results from willingness to absorb funds from redemption of OK1012 (PLN16.4bn) and coupon payments (PLN9.3bn in total).
- The Ministry of Finance, tapping bonds denominated in euro, has finished financing borrowing needs for 2012. The Ministry's aim is to prefund at least 20% of next year's requirements. Taking into account the high demand for Polish government bonds from non-residents, we think that the Ministry's goal is realistic to achieve.
- Flexible issuance policy and high activity on the foreign market should support domestic debt market. We think that the Ministry should not have any problem to tap bonds at 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	
October '11	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	3458.8	-	-	-	-	05.09	OK1012/OK0113	WZ0117/PS0417
October	4.10	WZ /PS	3000-5000	5900.9	23.10	OK0714/DS1023	5000-9000	-	-	-	-

* 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
15 October <i>PL: CPI (Sep)</i> <i>PL: Balance of payments (Aug)</i> CN: CPI (Sep) US: Retail sales (Sep)	16 <i>PL: Wages and employment (Sep)</i> EZ: HICP (Sep) DE: ZEW index (Oct) US: Core CPI (Sep) US: Industrial output (Sep)	17 <i>PL: Industrial output (Sep)</i> <i>PL: PPI (Sep)</i> US: House starts (Sep) US: Building permits (Sep)	18 <i>PL: MPC minutes</i> CN: GDP (Q3) US: Leading indicators (Sep) US: Philly Fed index (Oct)	19 US: Home sales (Sep)
22 <i>PL: Core inflation (Sep)</i>	23 <i>PL: Retail sales and unemployment rate (Sep)</i> EZ: Consumer confidence index (Oct)	24 CN: Flash PMI-mfg (Oct) DE: Flash PMI-mfg (Oct) DE: Ifo index (Oct) EZ: Flash PMI-mfg (Oct) US: New home sales (Sep) US: Fed decision	25 GB: Flash GDP (Q3) US: Durable goods orders (Sep) US: Pending home sales (Sep)	26 DE: GfK index (Nov) US: Advance GDP (Q3) US: Michigan index (Oct)
29 US: Personal income (Sep) US: Consumer spending (Sep) US: Core PCE (Sep)	30 US: S&P/Case-Shiller home price index (Aug) US: Consumer confidence index (Oct)	31 <i>PL: Inflation expectations (Oct)</i> EZ: Flash HICP (Oct) US: ADP report (Oct) US: Chicago PMI index (Oct)	1 November <i>PL: Market holiday</i> CN: PMI-manufacturing (Oct) US: ISM-manufacturing (Oct)	2 <i>PL: PMI-manufacturing (Oct)</i> DE: PMI-manufacturing (Oct) EZ: PMI-manufacturing (Oct) US: Non-farm payrolls (Oct) US: Unemployment rate (Oct) US: Industrial orders (Sep)
5 DE: PMI-services (Oct) EZ: PMI-services (Oct) EZ: Sentix index (Nov)	6 DE: Industrial orders (Sep)	7 <i>PL: MPC decision</i> EZ: Retail sales (Sep) DE: Industrial output (Sep)	8 CN: CPI (Oct) CN: Industrial output (Oct) DE: Exports (Sep) GB: BoE decision EZ: ECB decision US: Trade balance (Sep)	9 US: Import prices (Oct) US: Flash Michigan index (Nov) US: Wholesale inventories (Sep)
12 <i>PL: Balance of payments (Sep)</i>	13 DE: ZEW index (Nov)	14 <i>PL: CPI (Oct)</i> <i>PL: Money supply (Oct)</i> EZ: Industrial output (Sep) US: Retail sales (Oct)	15 DE: Flash GDP (Q3) EZ: Flash GDP (Q3) EZ: HICP (Oct) US: Core CPI (Oct) US: Philly Fed index (Nov)	16 US: Industrial output (Oct)

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 ^a	13 ^b	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	-	-	28	-	-	-
Balance of payments	13	13	13	12	16	15	13	13	11	15	12	13
Money supply	13	14	13	13	14	14	13	14	14	12	14	14
Business climate indices	20	22	22	20	20	22	20	22	21	22	22	20

* quarterly data. ^a preliminary data for January. ^b January and February

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

Economic data and forecasts

Monthly economic indicators

		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	Oct 12
PMI	pts	50.2	51.7	49.5	48.8	52.2	50.0	50.1	49.2	48.9	48.0	49.7	48.3	47.0	46.8
Industrial production	%YoY	7.4	6.4	8.5	7.7	9.1	4.8	0.8	2.8	4.3	1.2	5.4	0.5	-7.1	6.6
Construction production	%YoY	18.1	8.9	13.0	14.6	32.2	12.0	3.5	8.1	6.2	-5.2	-8.7	-5.0	-18.0	-4.1
Retail sales ^a	%YoY	11.4	11.2	12.6	8.6	14.3	13.7	10.7	5.5	7.7	6.4	6.9	5.8	4.5	3.4
Unemployment rate	%	11.8	11.8	12.1	12.5	13.2	13.5	13.3	12.9	12.6	12.4	12.3	12.4	12.5	12.7
Gross wages in enterprises sector ^a	%YoY	5.2	5.1	4.4	4.4	8.1	4.3	3.8	3.4	3.8	4.3	2.4	2.7	2.7	2.7
Employment in enterprises sector	%YoY	2.8	2.5	2.5	2.3	0.9	0.6	0.6	0.3	0.3	0.1	0.0	0.0	0.0	0.0
Export (€)	%YoY	8.4	6.3	8.1	5.7	6.2	4.4	2.5	2.6	-1.6	0.4	11.9	1.5	0.2	5.3
Import (€)	%YoY	5.9	5.4	3.2	3.5	6.9	5.6	1.5	-3.1	-2.1	-5.4	3.5	-3.6	-2.2	-1.7
Trade balance	EURm	-268	-695	-772	-1,139	-687	-883	-544	-421	-842	-376	-314	-298	45	172
Current account balance	EURm	-1,539	-1,999	-1,294	-1,890	-1,994	-1,909	-585	-734	-403	-1,025	-1,027	-919	-995	-680
Current account balance	% GDP	-5.2	-5.3	-4.9	-4.9	-5.0	-5.3	-5.1	-4.9	-4.9	-4.6	-4.4	-4.1	-4.0	-3.6
Budget deficit (cumulative)	PLNbn	-21.9	-22.5	-21.6	-25.1	-5.3	-16.5	-23.0	-24.8	-27.0	-21.1	-24.3	-22.9	-20.8	-32.7
Budget deficit (cumulative)	% of FY plan	54.4	55.9	53.7	62.5	15.1	47.2	65.6	70.9	77.1	60.2	69.6	65.5	59.5	93.4
CPI	%YoY	3.9	4.3	4.8	4.6	4.1	4.3	3.9	4.0	3.6	4.3	4.0	3.8	4.0	3.6
CPI excluding prices of food and energy	%YoY	2.6	2.8	3.0	3.1	2.5	2.6	2.4	2.7	2.3	2.3	2.3	2.1	2.1	2.0
PPI	%YoY	8.4	8.5	9.1	8.2	7.9	6.0	4.4	4.4	5.2	4.4	3.6	3.1	1.7	1.6
Broad money (M3)	%YoY	10.2	10.5	11.8	12.5	13.7	12.5	9.3	10.3	11.3	11.1	11.1	9.5	7.9	8.3
Deposits	%YoY	9.5	9.4	11.2	11.7	12.8	12.5	8.5	10.0	10.8	10.4	10.9	9.5	7.8	8.7
Loans	%YoY	14.7	14.8	14.6	14.4	14.5	13.0	12.8	13.4	13.1	10.7	7.5	7.0	6.2	6.2
EUR/PLN	PLN	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	4.12
USD/PLN	PLN	3.15	3.18	3.27	3.40	3.39	3.16	3.13	3.17	3.36	3.43	3.41	3.30	3.22	3.19
CHF/PLN	PLN	3.61	3.54	3.60	3.65	3.61	3.47	3.43	3.47	3.58	3.58	3.49	3.41	3.42	3.41
Reference rate ^b	%	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	4.75
WIBOR 3M	%	4.75	4.80	4.94	4.98	4.99	4.97	4.95	4.94	5.05	5.12	5.13	5.10	4.95	4.88
Yield on 52-week T-bills	%	4.48	4.48	4.48	4.55	4.51	4.50	4.48	4.58	4.75	4.75	4.64	4.58	4.53	4.25
Yield on 2-year T-bonds	%	4.43	4.54	4.73	4.86	4.75	4.66	4.58	4.67	4.77	4.71	4.46	4.12	4.09	4.03
Yield on 5-year T-bonds	%	5.08	5.09	5.19	5.30	5.20	5.00	4.88	4.97	4.97	4.85	4.58	4.43	4.28	4.16
Yield on 10-year T-bonds	%	5.80	5.76	5.85	5.88	5.74	5.53	5.45	5.50	5.41	5.24	4.99	4.88	4.85	4.70

Source: CSO. NBP. Finance Ministry. BZ WBK own estimates; ^a in nominal terms. ^b 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	1,597.5	1,665.7	370.5	388.4	392.9	445.7	385.4	404.1	409.2	467.0
GDP	%YoY	3.9	4.3	2.2	1.9	3.5	2.4	1.7	1.5	1.3	2.0	2.0	2.2
Domestic demand	%YoY	4.6	3.6	-0.1	1.1	2.7	-0.2	-1.1	-1.2	-0.4	0.5	2.2	1.9
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	-2.7	6.7	1.9	-2.0	-2.0	-5.0	-4.0	-3.0	-1.0
Industrial production	%YoY	9.0	7.7	1.9	1.9	4.9	2.8	-0.8	1.3	-0.3	2.4	2.9	2.5
Construction production	%YoY	4.6	16.3	-3.9	-7.5	13.8	2.2	-11.0	-9.0	-10.7	-7.4	-5.4	-7.7
Retail sales ^a	%YoY	6.1	11.2	7.2	4.4	12.6	6.5	5.8	4.7	4.5	3.6	5.1	4.4
Unemployment rate ^b	%	12.4	12.5	13.5	13.9	13.3	12.4	12.5	13.5	14.0	13.2	13.3	13.9
Gross wages in enterprise sector ^a	%YoY	3.3	5.0	3.5	1.4	5.3	3.0	2.6	2.5	1.2	1.6	1.4	1.4
Employment in enterprise sector	%YoY	0.8	3.2	0.2	-0.1	0.6	0.3	0.0	0.0	-0.2	-0.2	-0.1	0.1
Export (€)	%YoY	22.8	12.1	2.6	4.3	4.1	0.4	4.0	2.0	2.0	4.0	5.0	6.0
Import (€)	%YoY	24.9	12.2	-0.8	2.3	4.3	-3.5	-0.9	-3.0	-1.2	1.1	5.5	4.0
Trade balance	EURm	-8,893	-10,059	-5,107	-2,451	-2,115	-1,641	-567	-784	-945	-623	-781	-102
Current account balance	EURm	-18,129	-17,977	-12,195	-6,836	-4,515	-2,164	-2,941	-2,575	-2,182	-804	-2,145	-1,705
Current account balance	% GDP	-5.1	-4.9	-3.2	-1.7	-5.1	-4.6	-4.0	-3.2	-2.6	-2.2	-2.0	-1.7
General government balance	% GDP	-7.8	-5.1	-3.5	-3.0	-	-	-	-	-	-	-	-
CPI	%YoY	2.6	4.3	3.8	2.4	4.1	4.0	3.9	3.2	2.6	2.0	2.4	2.5
CPI ^b	%YoY	3.1	4.6	2.9	2.5	3.9	4.3	4.0	2.9	2.4	2.0	2.5	2.5
CPI excluding food and energy prices	%YoY	1.6	2.4	2.3	2.0	2.5	2.5	2.2	1.9	2.0	1.8	2.1	2.1
PPI	%YoY	2.1	7.6	3.6	1.9	6.1	4.7	2.8	0.9	1.2	1.3	2.4	2.7
Broad money (M3) ^b	%YoY	8.8	12.5	6.4	4.8	9.3	11.1	7.9	6.4	7.3	7.6	7.3	4.8
Deposits ^b	%YoY	9.1	11.7	6.5	5.2	8.5	10.4	7.8	6.5	6.7	7.6	7.8	5.2
Loans ^b	%YoY	9.2	14.4	3.3	3.6	12.8	10.7	6.2	3.3	4.5	5.4	5.6	3.3
EUR/PLN	PLN	3.99	4.12	4.20	4.15	4.23	4.26	4.14	4.16	4.21	4.15	4.15	4.10
USD/PLN	PLN	3.02	2.96	3.27	3.21	3.23	3.32	3.31	3.23	3.33	3.26	3.17	3.08
CHF/PLN	PLN	2.90	3.34	3.48	3.37	3.50	3.55	3.44	3.44	3.51	3.39	3.32	3.28
Reference rate ^b	%	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	5.06	4.69	4.32	4.23	4.25	4.22
Yield on 52-week T-bills	%	3.96	4.51	4.50	4.17	4.50	4.69	4.58	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	4.22	3.99	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	4.43	4.13	4.07	4.08	4.18	4.27
Yield on 10-year T-bonds	%	5.74	5.98	5.14	4.85	5.58	5.38	4.91	4.69	4.80	4.86	4.88	4.87

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

This analysis is based on information available until 9.10.2012 has been prepared by:

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