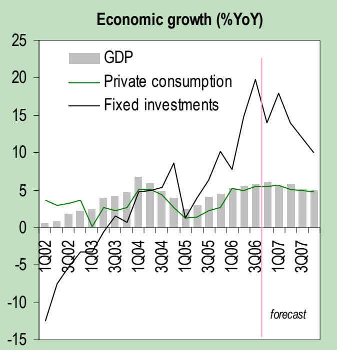
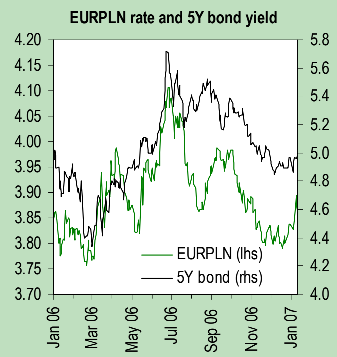
Bank Zachodni WBK

MACROscope

Polish Economy and Financial Markets

January 2007





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Another good year

- **Is it really possible to repeat the year of 2006 which was so good in terms of economy?** It will be difficult given less favourable external conditions. Should the relatively high-paced GDP growth continue, won't the inflation start to pose a threat to the central bank's medium term target? Or perhaps, the excessively strong zloty will be a sufficient factor increasing the restrictiveness of the monetary policy and we do not have to be afraid of interest rate hikes? Either way, there is no reason for now to count on a more restrictive fiscal policy. In the first topic of the month this year, we will try to answer the above (and other) questions by presenting our scenario of the economic situation development in 2007.

- **The Polish economy was in excellent shape at the end of 2006.** This was indicated by data published during the last month. Economic activity indicators for November confirmed our estimates showing that GDP might have again accelerated in 4Q06 (from 5.8% in 3Q06) and slightly exceeded 6%. Strong economic activity translates into further tightening of labour market conditions. However, record high employment growth has not caused higher wage growth so far. This allows to keep an optimistic view on inflation prospects. In November CPI inflation was again lower than expected, rising to only 1.4%YoY from 1.2%YoY in October. This was possible to a large extent thanks to exogenous factors such as food and fuel prices. However, it is noteworthy that all core inflation measures, showing underlying inflationary pressure, are also still much below the central bank's inflation target of 2.5%.

- **At the first meeting in the new year, the Sejm approved Sławomir Skrzypek for the post of NBP president.** The decision came as no surprise so it was also not surprising that it had no big impact on the Polish market. Investors will now keep watching public comments and decisions of Sławomir Skrzypek in the new position. His first comments were cautious and rather general, and one can expect that it will remain the same in the near time, at least until Skrzypek familiarizes a little with the new set of responsibilities and new working environment. One should keep in mind that the replacement of NBP chief is a risk factor for the MPC decisions on interest rates in the near term. If his first decisions and statements create impression that his views on the monetary policy perspectives are strongly dovish, the Council could decide to deliver a signalling rate hike in order to protect anti-inflationary reputation and credibility. Still, it is too early to make this judgement right now.

- **Zloty weakened with regards to the sell-off in the emerging markets, that together with higher yields in the core markets negatively influenced the Polsih bonds.** The short end of the yield curve was supported by the lowered CPI forecasts of the Ministry of Finance. Zloty should stabilize as well as bonds, though the most important will be for the investors sentiment toward the emerging markets, while the short end of the yield curve is still going to be supported by the low inflation.

Financial market on 29 December 2006:

NBP deposit rate	2.50	WIBOR 3M	4.20	USDPLN	2.9105
NBP reference rate	4.00	Yield on 52-week T-bills	4.20	EURPLN	3.8312
NBP lombard rate	5.50	Yield on 5-year T-bonds	4.97	EURUSD	1.3163

This report is based on information available until 11.01.2007

Special focus

Play it again Sam?

Is it really possible to repeat the year of 2006 which was so good in terms of economy? It will be difficult given less favourable external conditions. Should the relatively high-paced GDP growth continue, won't the inflation start to pose a threat to the central bank's medium term target? Or perhaps, the excessively strong zloty will be a sufficient factor increasing the restrictiveness of the monetary policy and we do not have to be afraid of interest rate hikes? Either way, there is no reason for now to count on a more restrictive fiscal policy. In the first topic of the month this year, we will try to answer the above (and other) questions by presenting our scenario of the economic situation development in 2007.

Excellent 2006

Last year's economy came as a good surprise to virtually all the analysts. GDP growth totalled 5.5-6.0% and it was much higher than the majority of projections which quoted it at the 1 pp. lower level. The same applied to us. Underestimation of projections applied to all the GDP elements, however, it is worth pointing to the fact that their proportional contribution to GDP (growth structure) was more or less as expected. Much as last year we wrote in a similar analysis contained in the MAKROscope that the risk for our (relatively optimistic) investment and exports projections was definitely on the upside, it must be admitted that we did not expect an acceleration of the GDP growth to over 5% in 2006 while the economic activity data have surprised us since as early as the beginning of the year.

Interestingly enough, however, with a much higher GDP growth and a significant improvement in the labour market (record high employment growth and a slight acceleration of salary growth) - driven mainly by the domestic demand - inflation continued to be very low, lower than expected. Our last year's projection for December 2006 was 1.9% and was short of the average market expectations and everything seems to be indicating that in reality inflation will be even lower.

The improvement in the economy, i.e. a significant acceleration of the GDP growth, witnessed in 2006 was not only a substantial one but also balanced, based on a few concurrent factors (consumption, investments and exports). The trading balance deteriorated slightly while inflation remained, throughout the year, below not only the central bank's target (2.5%) but also below the lower end of the acceptable variance from the target (1.5%). This, of course, allows us to ask about the costs of pursuing such a monetary policy (what could be the growth of the GDP if the inflation continued to be in line with the target all the time?). The problem is important as the low inflation was not triggered by once-off effects (demand factors), the evidence of which is the net base inflation staying below the target for a few years now. Such a situation was one of the reasons for keeping the central bank's interest rates at the historic low of 4%, after two cuts in early 2006.

Certainly, a very favourable economic situation last year was primarily driven by good economic climate abroad where we also saw (another year in a row) a quick GDP growth with a relatively low inflation. Thinking then, about the prospects for the Polish economy for the upcoming twelve months, it is worth asking if the situation witnessed last year can be witnessed in the world again in 2007?

Global slow down, but slowly

We would have to step a few decades back to see a few consecutive years of such a high-paced GDP growth in the world as the one we have seen recently. What is more, projections prepared by some institutions (e.g. IMF) indicate continuation of this trend also this year. It seems, however, that risk factors that have been visible for a few quarters, especially in the American property market, caution against excessive optimism about the global growth. We project that the GDP growth in the US will reduce in 2007 (to 2.3% from 3.4%), as deterioration of the situation in the property market will impact other economic sectors. Impact on consumer expenses will represent a particular risk. It will not, however, be a deceleration substantial enough to worry about the American economy in medium term perspective, as over the next 2 years, it will come back to a 3% growth track (due to, among others, forthcoming interest rate cuts and the weaker dollar). In the meantime, the slower growth rate will allow to keep inflation in check. Next year, it will be, according to our projections, 1.5% on average.

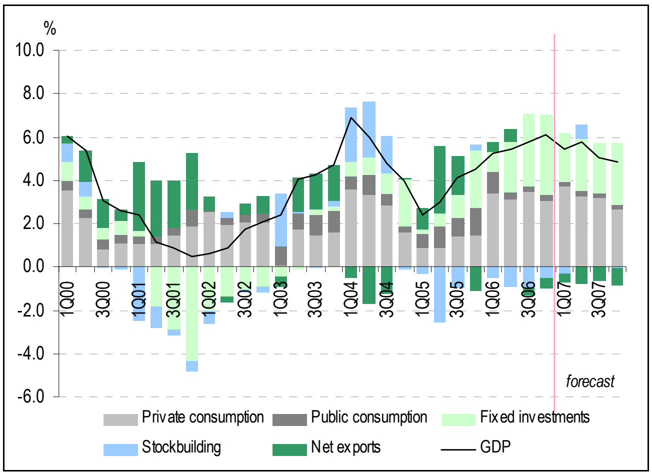
According to our estimates, last year the European economy was subject to the fastest growth in many years (2.6%). We forecast, however, that in the upcoming three years, the GDP growth pace will fall to 2% which will be a result of a more restrictive macroeconomic policy, both in fiscal terms (mainly in Germany) and in terms of monetary policy (higher interest rates stifling domestic demand and the strong euro affecting exports). At the same time, however, the negative impact exerted by this situation on the Polish economy (condition of the Polish exports) should not be overly negative as the prospects for the economic situation in the euro zone in the following years are not that bad – companies' financial performance is quite good, the monetary policy can be described as accommodative, export is structurally strong while the situation in the labour market has improved. Though the inflation in the euro zone may stay below 2% on average in 2007, its temporary growth at the beginning of the year (e.g. due to VAT increase in Germany) will bring about, in our view, another interest rates hike by ECB in the first quarter. Economic deceleration worldwide will be a crucial argument in favour of halting the cycle of interest rate hikes, however, it is difficult to state conclusively that 3.75% will be a target level and we cannot rule out another move upwards at the turn of 2007.

High-paced growth in Poland should continue

We expect a certain deceleration in the GDP growth this year, though it should continue, in our view, in excess of 5%. Its structure will remain similar to the one recorded in 2006. The key growth driver will still be the domestic demand as a result of which import will grow faster comparing the export growth. Export deceleration and the impact of deficit in cross-border trade on the GDP, more negative than in 2006, stems from a lower-paced GDP growth worldwide. It is worth emphasizing, however, that we expect an export growth at a two-digit level. A risk factor for this scenario is excessive appreciation of the zloty which, when paralleled by a lower demand abroad, could cause the shift of export to the domestic market which will continue to display high dynamics.

We expect a quick growth in consumption (though slower than the GDP growth pace), which will result from the continued improvement in the labour market. Employment increase will, however, be slower in our view than in the record year of 2006. At the same time, increase in the wage bill should be subject to further acceleration, especially that we will deal with inflation growth (referred to below). In real terms, wages should not grow much quicker than in the past year though, of course, we are aware that the risk scenario for this forecast is more upwards than downwards. Yet, it seems to us that the year of 2007 will be another year when we will record a concurrent, dynamic investment growth (influx of direct foreign investments, bigger use of EU grants), sizable growth in employment and an increase in labour productivity. According to our projections, labour productivity growth will be 3.2% p.a. on average (3.7% in 2006 and 1.7% in 2005) and it will not fully compensate the envisaged wage bill increase. This means another year of increased pressure on companies coming from unit labour costs (their growth can even oscillate around 3%). Obviously, the question is still valid of when, to what extent and in which economic sectors, companies will be able to transfer these costs onto the prices of retail goods in view of the strong competition. It seems, however, that the growth in labour costs will trigger increase in the pressure on the price hike this year. The basic question will be about the scale of this growth.

Share of demand components in GDP growth



Source: CSO, own estimates

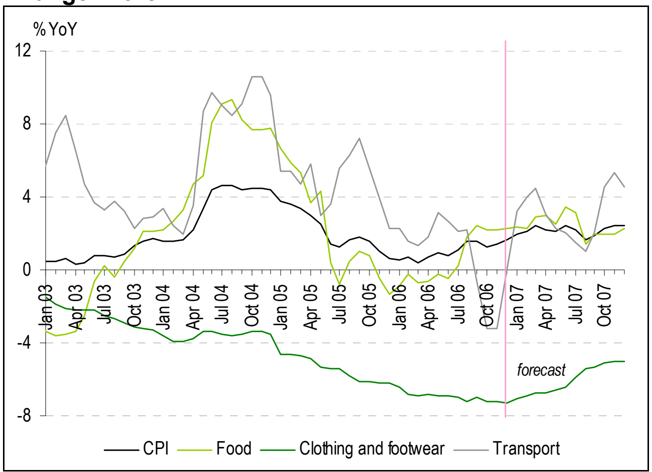
Inflation at the targeted level at last?

Domestic factors related to a quick growth in the domestic demand and the continued improvement on the labour market causing the unit labour costs to grow, will go towards the increase in the pressure on the price growth. On the other hand, foreign factors (global demand gap) will go in the opposite direction in view of the economic slow-down (and drop in inflation). It should be noted that even according to the research of the National Bank of Poland, inflation in Poland is more and more dependant on global factors rather than only domestic ones. Obviously, as usual the global political situation is a risk factor as it influences prices of raw materials, crude oil prices in particular, which according to our assumptions will be stable this year. Their potential growth should be neutralised by the weaker dollar. As the dollar is weaker against euro, the zloty should strengthen against the dollar more than against the euro. We expect the average EURPLN rate in 2007 to be lower than in 2006 (see details below) which will also limit the inflation pressure.

In addition, the factor that limits the pressure is the growth in investments which has been evident for a few years (and for a few quarters on a large scale) which in a longer run will lead to a potential GDP growth. It also seems that while the emigration of the labour power will increase the pressure on the growth in salaries in some sectors of the economy, the average growth in salaries (the median in particular) should not be rapid as we can see a gradual growth in the Polish labour market flexibility.

However, in general, we are of the opinion that with the clear growth in the unit labour costs (by ca 3% on average and above 3% in the second part of the year), the net effect of all factors impacting the inflation will be negative. This is why we expect inflation to grow this year. We do not think, however, that this will be a problem for the central bank. This arises from the fact that inflation was too low for some time (below the target for a number of months, and passing over the effect of the UE entry, it was below the target, sometimes much below it, for a number of years). As a result, the inflation risk emerged when the inflation starting point is low. So this year, eventually, the central bank will be able to say that it has achieved its target. We also expect the growth in net inflation although for a substantial part of the year it will be, just like the CPI, below 2.5% (and even below 2%), reaching the targeted level in Q4.

Change in the CPI



Source: CSO, own estimates

Risk of interest rate hikes

With this inflation scenario, and it should be noted that 2008 is expected to see inflation stabilise with a little lower GDP growth, we do not think that the increase in NBP interest rates is necessary. This is why we uphold the opinion that interest rate will remain stable this year and some slight increases are more likely in early 2008. Then, the Monetary Policy Council will have an opportunity to harmonise the cycle of rate changes with the changes in the world (Fed starting its increase cycle again and the growth in the ECB rates to 4%). It seems that this scenario is more and more seriously being considered by analysts as the projected moment of the first interest rate hike is being deferred in 2007 (not to mention the hikes projected in 2006).

Another key factor for our official rates forecast this year is the nomination of a new NBP governor. As we mentioned in the last month, paradoxically, the more dovish the statements made by the new governor, the more likely the decision of the MPC about a slight increase in interest rates with a view to sustaining their anti-inflation credibility. First public comments of the just appointed NBP chief Sławomir Skrzypek were cautious and general, which could decrease a need for such action by the Monetary Policy Council.

Even if such an increase had happened, we would have interpreted it as a signal movement that does not represent the beginning of the interest rate increase cycle. However, financial markets which tend to overreact would have perceived it in a different way estimating a few subsequent movements at 25 bp. It seems to us that the MPC members will actually sustain the market expectations about the interest rate hikes. Even if our scenario of keeping the official interest rates unchanged was to materialise, we would expect the MPC members to point to the inflation growth risks in their public statements. The reason for this is quite simple – if the communication with the market is good, the maintenance of the risk of increasing interest rates can be a good instrument for restricting inflation expectations (maybe even better than the hikes themselves), and the steep and favourably bent down yield curve does this part of the job for the Council. This is why the risk of hikes will be in the air on the market all year long and the estimations of the scale of the increases will range from 25 to 75 bp.

Dollar still weak in the world

We expect 2007 to be the second in a row rather unfavourable year for the USD quotations. The signals indicating economic slowdown on the one hand and the continued increases of interest rates in the other, will be, in our opinion, sufficient arguments to make EURUSD exchange rate reach the level of 1.35. As voices can be heard that it may reach as much as 1.40, in our opinion, further euro appreciation is not very likely. We expect to see lower pressure on the USD during the year and we project the average exchange rate at the level of 1.32, while it is possible that it will drop below 1.30 in the H2 of 2007.

The changes in the yield on foreign markets will be impacted by the assessment of the economic conditions in the United States and the euro zone that will be dependant on policies pursued by central banks. As we expect Fed to reduce rates by 75 bp with the first drop to happen in Q2, the middle of the year may see low yields (under 4.5% for a 10-year bond). In the H2 of the year, the slump in the American economy will slowly come to an end, so if the market takes account of the increases in interest rates again, in our opinion, the yield will grow, and the yield curve in the USA will be steep. In the euro zone, we expect another increase in official interest rates (to 3.75%) in Q1 and flat yield curve in this period that will get steeper towards the end of the year. This will be a result of the growth in yield in the US and possible return to the option of increasing rates in early 2008 also in the euro zone. Towards the end of 2007, we expect the yield of 10-year Bunds at the level of ca 4%.

Markets in Poland – growth in profitability, strong zloty

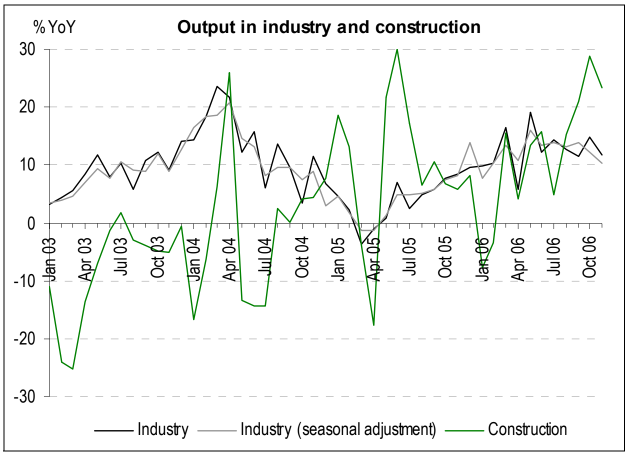
It turned out that the nearly accurate PLNEUR exchange rate for the end of 2006 was simply the fixing of the last day of the previous year (a difference is mere PLN 0.03). Will it be similar this year? In our opinion we will see more evident zloty appreciation and we project the level of 3.75 for the end of the year. In relation to the dollar, while during the year the USDPLN rate will surely be lower than at the end of 2006 (in view of the continued dollar depreciation on the world's markets), towards the end of the year it should not differ much from the recent level of 2.90. Zloty appreciation next year will, in our opinion, be a result of the sustainable good condition of the Polish economy, inflow of direct foreign investments, EU funds, portfolio capital and monies of the Poles working abroad. On the other hand, we do not expect any sudden appreciation as the conditions on global markets will not necessarily encourage to have a higher risk appetite in emerging economies.

For 2006 we projected an average EURPLN rate at 3.97 and USDPLN at 3.23. The actual rates were slightly lower while the difference against the forecast was bigger for the USD rate (PLN 0.07 for euro, PLN 0.13 for dollar), which was driven by higher than the expected USD depreciation against euro.

Although the difference between our projection and the actual EURPLN rate was not big, our yield curve projection was even more accurate. In 2006, we expected average yield on 5- and 2-year bonds at the level of 5.06 and 4.55 respectively, against the actual levels of 5.03 and 4.57. The difference for a 10-year bond was slightly higher (the forecast was 5.14 against the actual yield of 5.22). Our expectations anticipating positive moods on the bond market and their deterioration in Q2 & Q3 were met, however, we did not project the repeated improvement at the end of the year. This was caused by improvement on foreign markets (10-year Treasuries temporarily even below 4.50%) and improvement in short-term inflation outlook. The two factors will also influence investor behaviour on the bond market this year. Early in the year, the inflation will grow to exceed 2% which will strengthen the market expectations as regards the interest rate hikes and then this may change especially that the recent economic data published in 2006 in the United States caused the yield to grow there. At the same time, we expect interest rate cuts in the US starting from Q2 which will strengthen the US market. This in turn will have an impact on the Polish bonds especially if the Monetary Policy Council stands the pressure and will keep the interest rates unchanged when the inflation reaches its local high (ca 2.5% in March). In addition, inflation will drop significantly (to ca 1.5%) in Q3 in view of the statistical base effect (the effect of the 2006 drought). Towards the end of the year another approaching interest rate hike in the euro zone and the fact that the market is taking account of the possible change in the Fed's policy may cause the yield to grow one more time. In summary, the above considerations indicate that 2007 can be opposite to 2006 for Polish bonds – higher yields in Q1 and Q4 and lower in Q2, opposite to 2006.

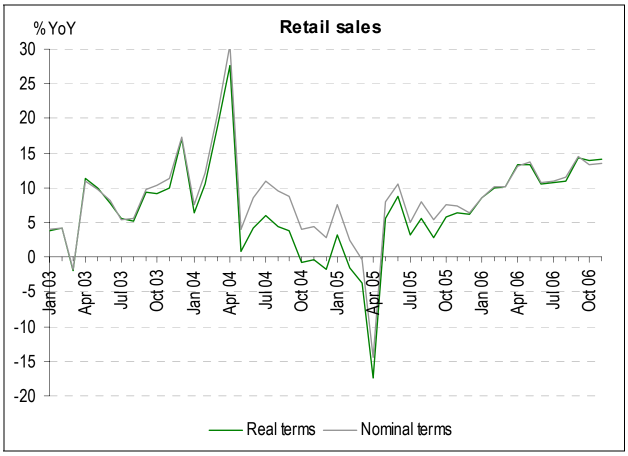
See the last pages of the report for tables showing projections for macroeconomic variables.

Economic update



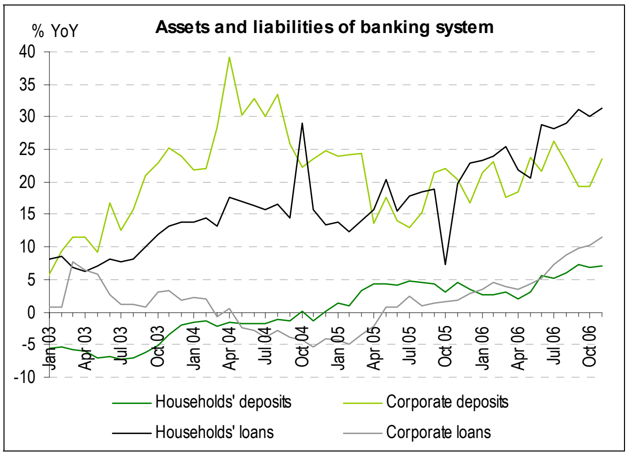
Output still in strong upward trend

- Industrial output grew less than expected in November (11.7%YoY rise against market consensus of 14-15%), but the figure was still solid and confirmed our optimistic estimates regarding GDP growth in the final quarter of the year.
- Growth in the manufacturing sector cooled from 17%YoY in October to 13.9%YoY and output in mining sector shrank by 3.8%YoY versus 1.1%YoY drop a month earlier.
- In the construction sector, output growth decelerated from 28.7%YoY to 23.4%YoY, but this is still very rapid pace of expansion, suggesting that investment activity remains strong.
- Despite output figures for November were somewhat weaker than expected, they are still consistent with our estimates assuming GDP growth again accelerated in 4Q06 and reached slightly above 6%. This is also indicated by other data.



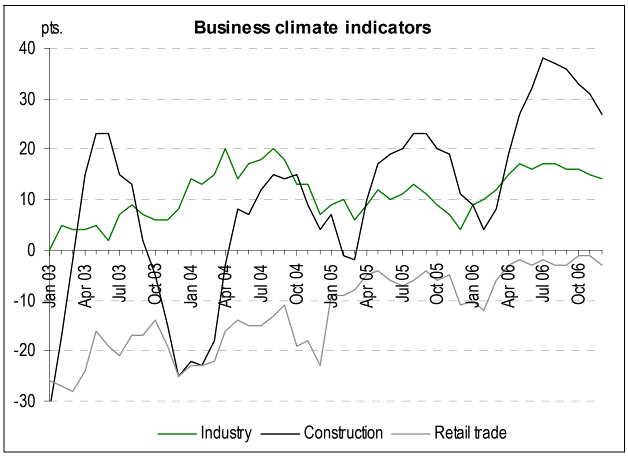
…the same as retail sales

- In November retail sales in nominal terms fell 4.2%MoM and grew 13.6%YoY against 13.3%YoY rise in October.
- In real terms retail sales growth accelerated to 14.1%YoY from 13.9%YoY in October. What is interesting, real growth is still higher than the nominal one, which means deflator of retail sales is still negative. This indicates that a pressure on price growth in retail market is virtually non-existent.
- Meanwhile, expansion of consumption demand is continuously strong and widespread. Solid, two-digit growth was recorded in majority of sales components.
- All in all, the data supported expectations that GDP growth in the final quarter of the year probably again accelerated from already high level of 5.8% noted in the third quarter.



Accelerating growth in money supply and loans

- A reflection of very strong economic activity is also monetary statistics. Money supply growth accelerated sharply in November – to 14.4%YoY from 12.3% in the previous month.
- Deposits growth accelerated in both households and enterprises sector, reaching 7.2%YoY and 23%YoY, respectively.
- The same was observed on the credit side – total loans rose by 20.7%YoY (19.5% in October) with households' credit up by 31.4%YoY (30.1% in October) and firms' credit higher by 11.6%YoY (10.3% in October).
- In our opinion it should not imply significant risk for inflation prospects, but at the same time it is an optimistic hint on economic activity in the fourth quarter of 2006 and it heralds well for economic activity in 2007.

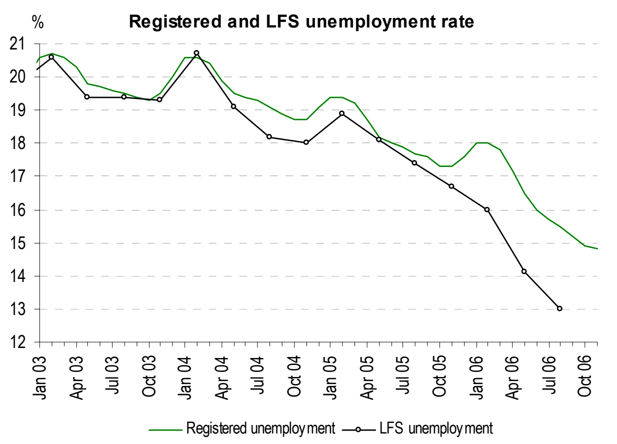


Source: CSO, NBP, own calculations

Very warm business climate

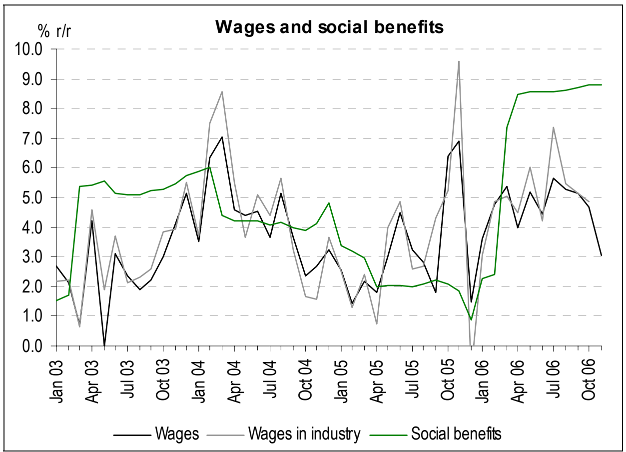
- Business climate indicators for December, released by the Central Statistical Office, showed that positive moods among enterprises keeps improving in annual terms, although on a monthly basis we saw a seasonal deterioration in all the analysed sectors.
- Index for manufacturing fell 1pt to 14pts (10pts up on the year), index for construction dropped 4pts to 27pts (16pts up on annual basis) and index for retail trade dipped 2pts to -3pts (8pts up as compared to December 2005).
- The numbers are yet another indication that economic expansion kept gaining momentum in the last month of 2006 and are another evidence supporting the view that GDP growth again accelerated in the fourth quarter and topped 6%.

Economic update



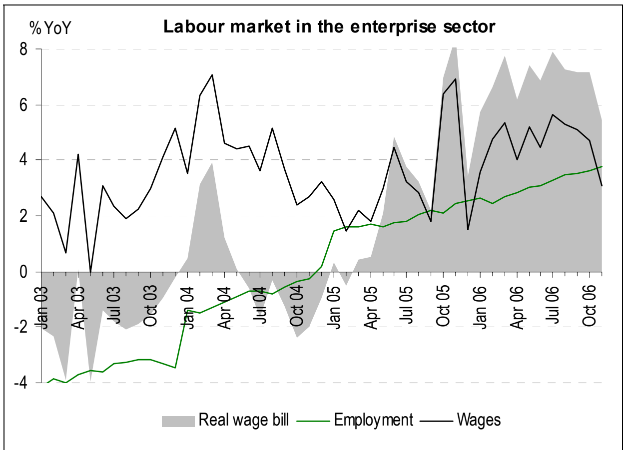
Unemployment continuously down

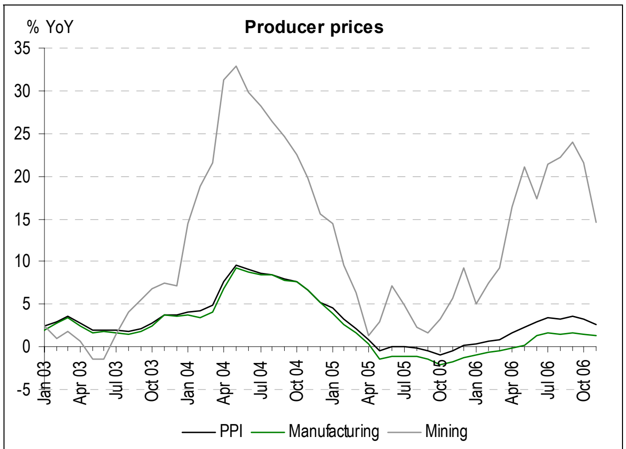
- The registered unemployment rate reached 14.8% at the end of November, falling from 14.9% in October. The number of unemployed dropped to 2287.3 thousand which was 435.6 thousand (16%) fewer than a year earlier.
- This happened despite negative seasonal effect, usually lifting the unemployment level in November-March period.
- The CSO also released official results of Labour Force Survey for 3Q06. The numbers confirmed tentative data revealed earlier and showed rapid fall in the unemployment rate (to 13% from 14.1 in 2Q06 and 17.4% a year earlier) and strong rise in employment (3.9%YoY).
- At the same time, the figures indicated that labour activity indicator deteriorated in annual terms (a fall of 1.2pp), which may maintain concerns about shrinking workforce.



Wage growth still under control

- Despite very strong employment growth and shrinking labour force, pressure on wage growth in the economy seems to remain under control.
- Average wage growth in enterprises sector amounted to a mere 3.1%YoY in November, decelerating from 4.7% in October and 4.8%YoY on average in the first ten months of 2006.
- Nevertheless, one should take into account that November's data on wages were under strong influence of one-off base effect, as in November 2005 there was a bonus payment for mining sector that usually takes place in December.
- Therefore, deceleration in wage growth in November 2006 was probably temporary and pay rise will resurge above the trend in December so that average growth rate in the last two months of 2006 will probably correspond to the previously observed range of 4.5-5.5%.
- While average wage growth temporarily decelerated in November, average jobs number soared by 3.8%YoY (new record-high growth), signalling that the demand for labour in companies kept strengthening in the fourth quarter in response to robust economic activity.
- Given record high employment growth on the one hand and clearly lowered average wage growth on the other hand, wage bill in enterprise sector increased 7%YoY in November against 8.5%YoY rise in October. Real wage bill growth decelerated to 5.5%YoY, the lowest pace since the start of 2006.
- All in all, the data were quite optimistic for inflation prospects, showing that a pressure on wage growth has not been gaining strength despite tightening labour market conditions.



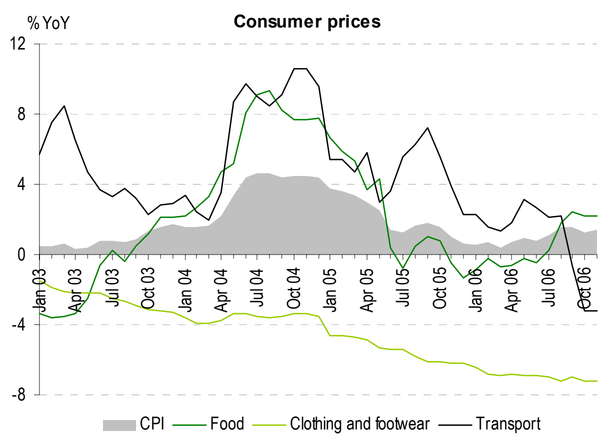


Source: CSO, own calculations

Deeper than expected drop in PPI inflation

- The CSO also said that producer prices in November rose 2.6%YoY, below a market forecast of 3.1%. While the risk to forecasts was on the dovish side, the result was better than expected also because of downward revision of October's data. PPI inflation in October was revised to 3.2%YoY from earlier reported 3.4%YoY.
- Annual growth in prices in mining fell from 21.5%YoY in October to 14.6%YoY while price growth in other categories was little changed. It seems that fall in commodities prices (e.g. cooper prices) and strong zloty played a substantial role in that.
- What is important, however, is that price growth in manufacturing eased again (-0.3%MoM and 1.3%YoY), which shows that inflationary pressure is still not visible at the producer level, not to mention retail prices.

Economic update

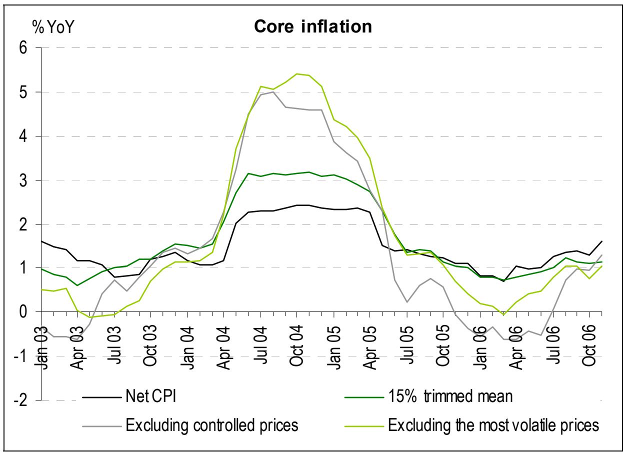


CPI again lower than expected

▪ CPI inflation was below expectations again. In November, prices were flat as compared to previous month, while the annual price growth accelerated to 1.4% from 1.2% in October. At the first glance the result seems positive, as it shows that the risk of inflation increase above the target has lowered.

▪ However, it is worth to notice what kind of factors were responsible for only moderate inflation increase. It was driven to large extent by lower fuel prices (-2.5%MoM and -7.1%YoY) amid oil prices decrease in recent months combined with zloty appreciation, especially against the dollar. Besides, food prices, which is another supply-side component in CPI basket, rose moderately by 0.2%MoM due to untypical fall in meat prices accompanied by a seasonal rise in vegetable and fruit prices.

▪ We still see CPI below 2% in Dec. and below 2.5% in 1Q07.

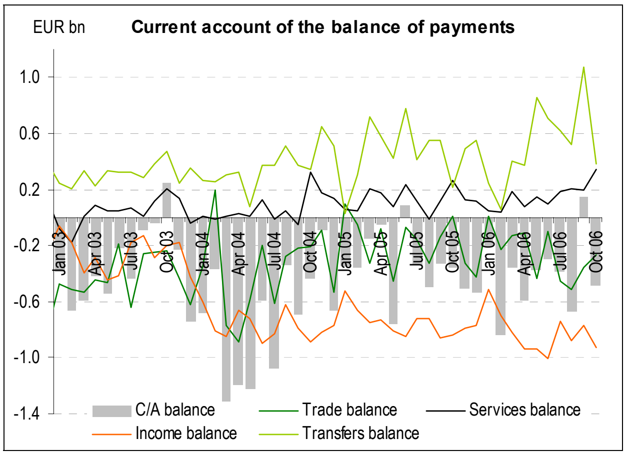


Core inflation slightly up, as expected

▪ In a period when prices of exogenous components of inflation are volatile, better assessment of inflation prospects is possible on the basis on core inflation measures.

▪ The measure of inflation excluding fuel and food prices, i.e. net inflation, rose to 1.6%YoY in November from 1.3%YoY in October. This neutralises somehow the positive effect of lower-than-expected CPI figure.

▪ Still, such level of core inflation was widely expected. What is more, it is widely expected to increase further in the following months (to around 2.2% on average in 2007), but this does not change the prospects of monetary policy as all core inflation measures (see chart) are still much below the central bank's target of 2.5%.



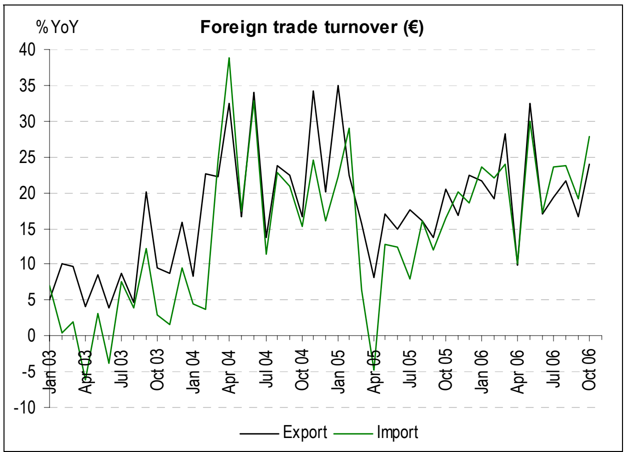
Picture of external relations still positive

▪ In October, the current account deficit of €482m was recorded after €195m surplus recorded in September. Quite interestingly, both trade and services accounts improved in comparison with the previous month: trade deficit reached €269m against €299m in September, while services surplus grew to record-high €340m from €151m. Thus, deterioration in current account balance was a consequence of slump in income balance and current transfers. The former was in deficit of €931m against September's €638m gap (high dividend payments), while the transfers surplus shrank to €378m from elevated €981m in the previous month (low inflow of EU support funds in October).

▪ An important feature was outstanding performance of Polish exports that soared 24%YoY. This confirms that export sector remains a very vital driver of currently observed economic expansion. At the same time, import growth was even higher than exports growth and reached almost 28%YoY (the second best reading this year), which was driven by strong domestic demand.

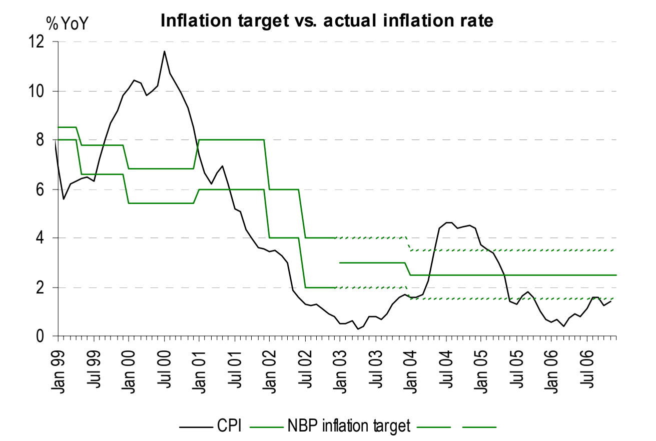
▪ It seems likely that export-oriented production will continue to serve as an important driver of economic growth in Poland in future. This is indicated by the balance of payments data for October which showed strong inflow of foreign direct investment (the second straight month above €1bn).

▪ At the same time, we expect that imports will also expand rapidly in the coming quarters due to strengthening consumption and investment demand, additionally supported by strong zloty. Nevertheless, it seems that a pace of trade deficit deterioration should be rather moderate and should not pose significant threat to external balance of the economy.



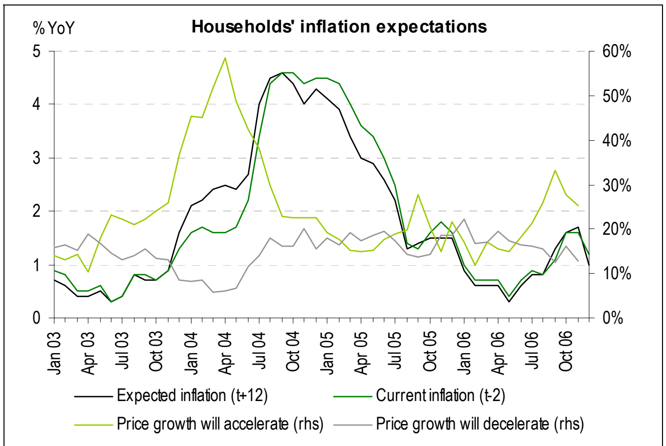
Source: CSO, NBP, own calculations

Central bank watch



Fragments of MPC statement, 20 December 2006
The latest data on GDP in Q3, combined with data on the nominal wage growth in the economy (5.0% y/y in Q3) and the growth of the number of working persons outside private farming (6.9% y/y in Q3), confirm preliminary assessments formulated in November that the growth of unit labour costs (outside private farming) stepped up significantly in Q3 (to 6.1% y/y against 4.5% y/y in Q2 and 2.7% in 2006 Q1). This growth was slightly higher than estimated in the October projection.
The latest data suggest that annual CPI inflation in 2006 Q4 will be lower than indicated in the October projection. 'Net' core inflation will run close to the path expected in the projection. Some factors may arise in 2007 which can be temporarily pulling (CPI) inflation down in some periods.
The analysis of inflation outlook indicates that maintaining inflation close to the target of 2.5% in the medium term may require monetary policy tightening.

Biographical note of Sławomir Skrzypek
42-year-old Sławomir Skrzypek graduated from Silesian University of Technology in Gliwice and also holds M.A. in economics from Warsaw School of Economics. He holds an MBA from University of Wisconsin - La Crosse and diploma in Business Management from Georgetown University. Also, he was trained in asset and liability management in Polish banking system at Silesian University in Katowice. In 1993-1997 he was working in the Supreme Chamber of Control, being responsible for financial control of central and local administrations and of the banking sector. In 1997-2000 he was deputy president of the National Fund for Environmental Protection and Water Management. Since November 2002 he was deputy mayor of Warsaw, right-hand of president Lech Kaczyński, being responsible e.g. for financial policy, investments and proprietary supervision. Recently he was acting president of the state-owned PKO Bank Polski savings bank.



Source: NBP, Reuters

Monetary policy perspectives unchanged

▪ At the last meeting in 2006 and also the last one chaired by the NBP president Leszek Balcerowicz, the Monetary Policy Council kept interest rates unchanged at 4%.

▪ However, for the first time the official communiqué included the sentence that "the analysis of inflation outlook indicates that maintaining inflation close to the target of 2.5% in the medium term may require monetary policy tightening". This may be interpreted as an introduction of the restrictive bias in monetary policy, but at the same time the majority of the Council did not seem to be overly concerned about inflation perspectives as rates were kept on hold.

▪ The MPC acknowledged that in 2006 Q4 and also in 2007 the inflation rate could be temporarily lower than indicated in the October projection, which implies that the Council is quite comfortable with inflation prospects for the next 12 months.

▪ We think that similar assessment should be maintained in the coming months and lowered inflation forecasts for 2006-07 give the MPC some comfort in the adopted wait-and-see approach.

▪ In our opinion, the sentence "monetary policy tightening may be required" should be interpreted as "there are some risks for inflation in 2008, but probability of inflation exceeding the target persistently is still much below 50%". As the MPC should react to the most likely scenario of economic developments, rates remained stable.

▪ Also, one should remember about additional risk factor connected with the appointment of the new governor of the central bank. The paradox is that the more dovish comments of the new NBP President will be, the more likely becomes interest rate hike, in order to uphold the anti-inflationary reputation and credibility of the MPC.

Sławomir Skrzypek appointed as the new NBP governor

▪ After unexpected and sudden withdrawal of professor Jan Sulmicki's candidacy, little known Sławomir Skrzypek has been appointed for the post of the NBP governor.

▪ Lack of solid economic background, no scientific output, and little orientation in the area of monetary policymaking and central banking will offer little help to the new governor in fulfilling his mission.

▪ On the other hand, Skrzypek's first comments suggested he did not plan any sudden actions in monetary policy and he intended to nurse independence, credibility, and transparency of the central bank. The new NBP head will find it very hard to control the panel of MPC members and one could guess that two influential members with well balanced views – Andrzej Wojtyna i Andrzej Sławiński – will now take the lead.

Inflation expectations fell again

▪ In December households' inflation expectations descended again, after several months of moderate upward trend.

▪ Average inflation expected in the horizon of the nearest 12 months reached 1.0% against 1.7% in November.

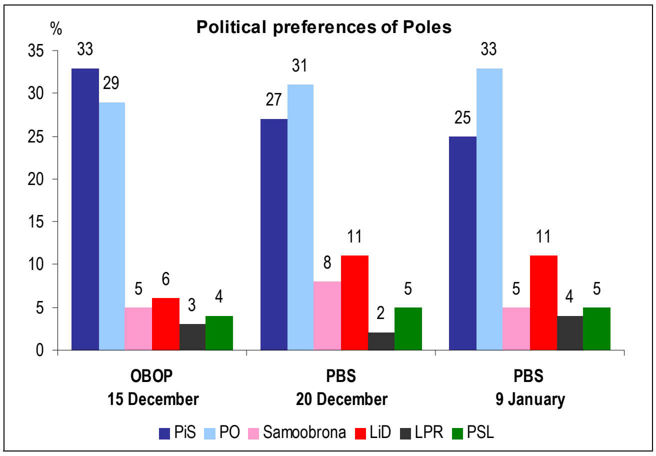
▪ One should remember that variations in expectations measure used by the NBP are closely connected with changes in actual inflation (CPI delayed by 2 months). In effect, after CPI starts rising again in the following months, the expectations measure will follow it up.

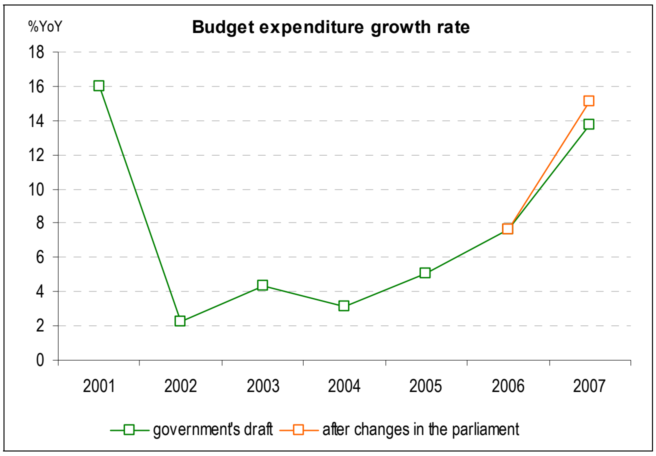
▪ Still, the positive fact is that according to the survey the structure of households' expectations has been improving, i.e. the ratio of households predicting acceleration of price growth has been diminishing.

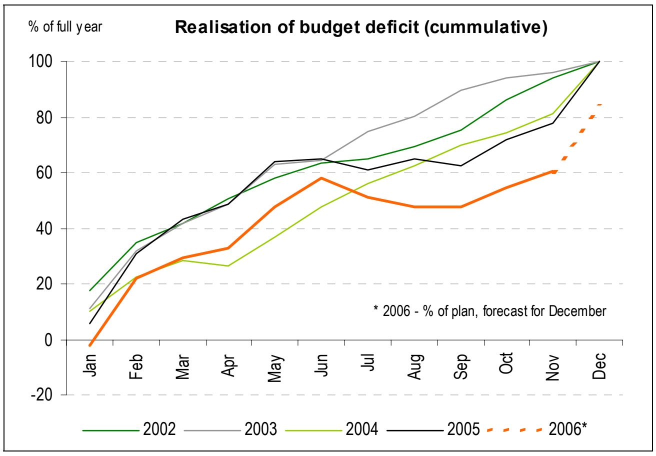
Central bank watch

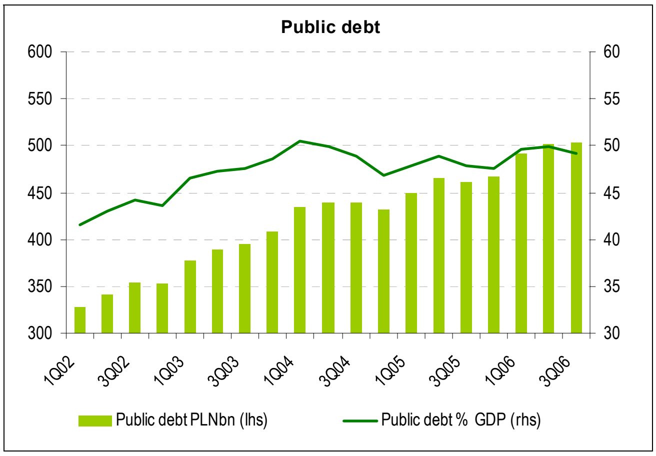
Comments of the central bank representatives	Our remarks
Sławomir Skrzypek, candidate for NBP governor **press statement, 4 January** If the parliament decides to appoint me as the governor of the National Bank of Poland, I will safeguard the stability of the Polish currency. I support stable and credible monetary policy. I am against sudden changes (in policy). **comments in the parliament, 8-9 January** There are four basic pillars that I want to base on. It is independence, transparency, credibility and competence. I will safeguard the value of the Polish currency. The constitutionally-guaranteed pillar of the National Bank of Poland is its independence. I will safeguard that pillar. My primary task will be to take care of stability of the Polish zloty and to take care of economic growth, as long as it won't threaten price stability. I do not plan any radical changes in the monetary policy, we will make content-related decisions based on solid data from the NBP analysts at the MPC meetings that must be held at least once a month according to the law. Euro is not the most important economic subject. (...) Poland should join the euro area when it will be most beneficial for it. (...) Give me 100 days to take a position on this matter. Market (FX) intervention is a very unique instrument, very rarely used. It should be used with great caution. The decisions will be made in adequate constitutional framework. I follow other examples (than Mr. Leszek Balcerowicz's) and I would like to keep following them. I do not see reasons for fast and radical changes in the inflation target. (...) There will be no nervous movements, the decisions will be made along with the MPC, please do not take it as an announcement of any specific plans.	Although vote on the appointment of Sławomir Skrzypek was delayed and accompanied with political bargains in the parliament between coalition parties, in general the decision was not surprising so it was also no surprise that it had no big impact on the Polish market, which was much more preoccupied with trends on international financial markets. Nevertheless, investors will keep watching first public comments and first decisions of Sławomir Skrzypek in the new position. His comments made so far were cautious (which is good) and rather general, and one can expect that it will remain the same in the near time, at least until Skrzypek familiarizes a little with the new set of responsibilities and new working environment. However, according to *Rzeczpospolita* daily, even before the vote in the parliament Skrzypek had promised Samoobrona deputies to think about using a part of FX reserves for economic growth promotion (he did not promise to free the reserves but to review the allocation policy) and had ensured the LPR deputies that the euro zone entry was not beneficial for Poland. This may cast some shade on expectations regarding his future actions in the central bank. In our view the most important disadvantage of Sławomir Skrzypek at the NBP president's post is the lack of solid macroeconomic background, no scientific output and no experience in the area of monetary policy, macroeconomics or central banking. During the questioning in the parliamentary public finance committee, when asked to enumerate the presidents of the most important central banks, Sławomir Skrzypek named Wim Duisenberg, who died in 2005 and used to be the ECB's president until 2003. This indicates his lack of orientation in the world of central banking.
Dariusz Filar, MPC member **Rzeczpospolita, 4 January** One should never forget that the MPC is a ten-member panel. (...) Obviously the new person may affect the internal balance of votes to some extent. But it does not imply that monetary policy will weigh on the new governor only. (...) I will keep insisting that a rate hike is necessary. **Marian Noga, MPC member** **PAP, 4 January** The balance within the MPC is likely to remain unchanged – with camp opting against monetary policy tightening still prevailing. But it is still hard to judge without doubts, as we still do not know the opinions of the new NBP president. **Mirosław Pietrewicz, MPC member** **Rzeczpospolita, 4 January** NBP governor is only one of the Council members and its chairman. I doubt whether the change will affect the MPC's policy. (...) Thus far, there is no threat of inflation going persistently above the target. Therefore, as long as we do not have grounds for being afraid of such scenario in the medium run, there is no need to raise rates.	MPC members correctly pointed out that the new NBP president will be only one out of ten interest rate setters, co one should not expect he will manage to set the tone of the Council's policy. Especially that even his predecessor was not able to do it despite very strong personality, while the new governor is definitely not as good as other MPC members as regards both theoretical macroeconomic skills and experience in central banking and policymaking. Let's repeat one more time that if the new NBP chief starts pushing too strongly for monetary easing or if his comments or actions create impression that the confidence in the central bank could be undermined, it could yield opposite results, i.e. it could convince majority of MPC members to vote for a preventive rate hike in order to strengthen MPC credibility. Much more important from the financial market's point of view will be NBP president's views on F/X policy (e.g. as regards foreign exchange interventions). Nevertheless, even in this regard the NBP president is not able to make decisions on his own, but only together with the NBP board, while most of the board's members (except two) cannot be replaced until the end of their term of office (2010-2011).
Andrzej Sławiński, MPC member **Gazeta Prawna, 8 January** In the face of strong economic revival it could be necessary to tighten monetary policy at some point of time, in order to promote realisation of our goal, which is medium-term inflation stabilisation around 2.5% target. **PAP, 21 December** We have entered a phase of swift economic growth. (...) At a given moment the council may decide that it needs an insurance policy, in the shape of tightening of monetary policy, which would insure the economy against an unwanted rise in inflation.	Recent comments of professor Sławiński confirmed that a risk of rate hike exists, which was also reflected in the last communiqué released by the Monetary Policy Council in December. Changes occurring in the economy (foreign direct investment inflow, productivity growth, higher market openness which allows bigger competition) are increasing potential GDP growth in the long term, nevertheless inflation increase will take place in the meantime. In our view, the level, to which inflation will grow is the key, and according to our forecasts, inflation target is not threatened, which should not push the MPC to fast monetary tightening.

Government and politics









Source: BZWBK, Ministry of Finance, opinion polls

Ruling coalition holds despite scratches

- Recent public opinion polls showed little changes in political preferences. The Civic Platform is in the lead, only slightly ahead of the ruling Law and Justice, while minor coalition partners LRP and Samoobrona are oscillating around minimum 5% threshold. The latter factor is effectively cooling down tempers of minor coalition partners that are afraid of election.
- The ruling coalition frequently faces new conflicts and internal tensions. The nomination of new NBP chief and Zyta Gilowska's decision on excise tax on bio-fuels were in the roots of the latest conflict. Nevertheless, likewise in all previous cases, the clash did not ruin the coalition also this time.
- The next excuse for a row in the coalition could be the final vote on 2007 budget at the end of January.

Budget for 2007 almost ready

- Work on the 2007 budget is slowly coming to an end. The Senate has introduced over 100 amendments to the version accepted by the Sejm.
- Deputies and senators jointly boosted revenues and expenditure of the budget by over PLN1.5bn in comparison with the version originally submitted by the government. The deficit could not have been raised, and remained at PLN30bn.
- Persistence of fast GDP growth will help in budget realisation, but even under optimistic assumptions planned increase in budget revenues by ca. 15% seems careless.
- Now the budget does back to the Sejm that will approve or reject Senate's amendments on 24 January. Two days later the bill goes to the President who is expected to sign it into the law within the next 7 days.

Deficit in 2006 much below the plan

- Government budget deficit reached PLN18.5bn in November, i.e. 60.7% of plan for the entire year.
- Tax rise remained at high level, confirming that economic expansion was being maintained. At the same time, there was still no signs of accelerating spending growth that was anticipated at the end of the year due to postponement of some expenditures in the previous months.
- According to tentative estimates of the Ministry of Finance, December's result was also much better than expected. The budget deficit at the end of the year is estimated to reach PLN25-26bn, which corresponds to 82-85% of the plan written down in the budget law for 2006. This was an exceptionally good result accomplished mainly thanks to very face economic growth in the last year.

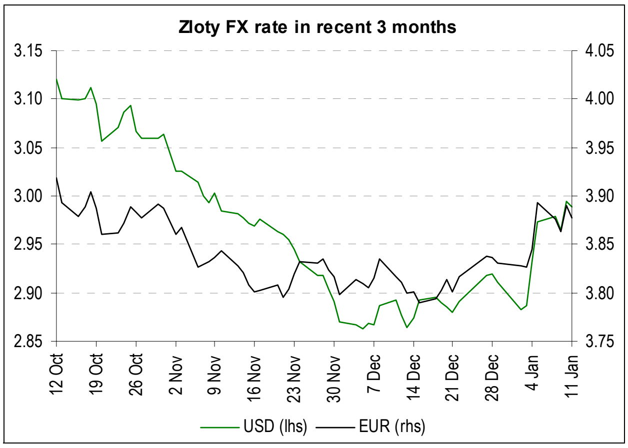
Public debt close to 50% of GDP

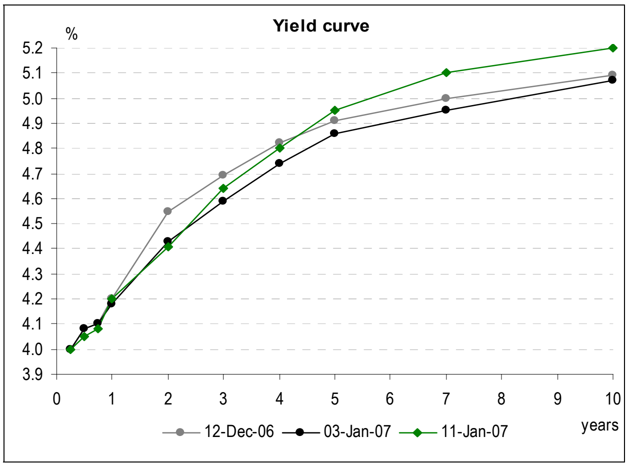
- According to the Ministry of Finance, the debt of the public sector in 3Q06 reached PLN503.7, which implies that in the course of four quarter it increased by over PLN42bn.
- It implies that the relation of public debt (calculated according to Polish method) to GDP declined slightly to 49.1% in Q3.
- The official data about the entire year will be released only after several months. However, one could deduce right now that in the fourth quarter the debt remained slightly below 50% of GDP. It was favoured by better than planned performance of the central government budget and fast GDP rise that according to our estimates exceeded 6%YoY in this period.

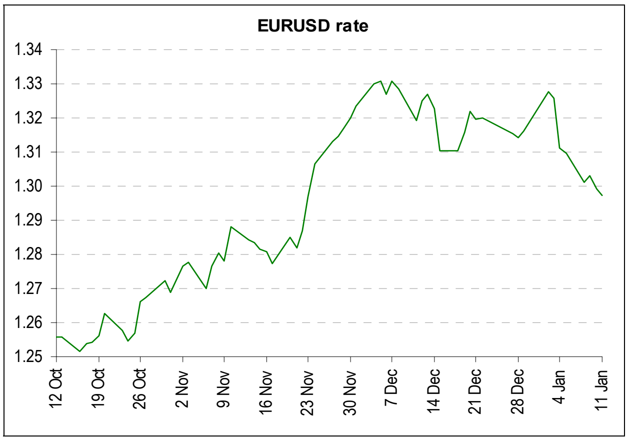
Government and politics

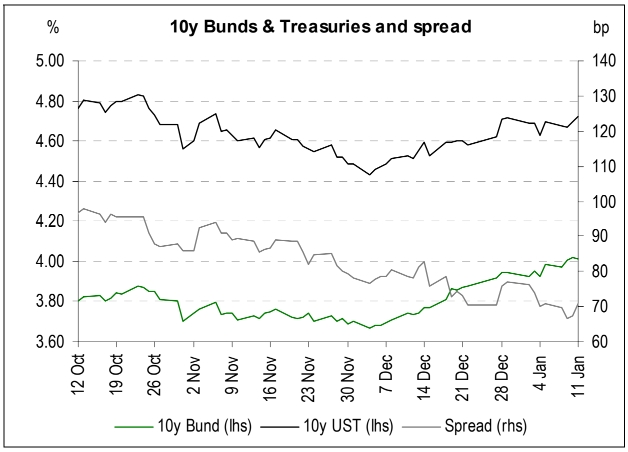
Comments of government representatives and politicians	Our remarks
Lech Kaczyński, President **PAP, 5 January** Mr. Skrzypek has such a biography that he was told: congratulations for such a biography. NBP president is totally independent, he is doomed for independence because the Polish constitution says so. There is no reason for concern. We are in the period of fast economic expansion. If something is slightly upsetting me, it's excessive consumption optimism in the society, very rapid rise in sales, very high rise in loans, especially in mortgages. Monetary policy should be adjusted to the specific situation. (...) Perhaps it will be necessary to take control over this excessive optimism.	After the appointment for NBP governor, Sławomir Skrzypek will be in fact able to prove his independence that should be guaranteed by the fact that he cannot be dismissed until the end of the six-years tenure, as well as his competence. In this context, the fact that in his first statements Skrzypek was underscoring a need to respect statutory goals of the NBP and its legal framework was a positive factor. On the other hand, it should be noted that in those comments there was always present a remark about his care for economic growth. In this context, it is interesting that in president Lech Kaczyński's opinion the rapid growth in private consumption observed recently could be a reason for concern and could require some monetary policy action.
Jarosław Kaczyński, Prime Minister **PAP, 10 January** I am glad that we got someone who is qualified, honest and hard-working. Even if he got the names wrong it does not change the conclusion that he is well qualified. Skrzypek's appointment is a good news also for those who are criticising him today, but are wishing good luck for Poland. (...) I am very happy as I know the troubles with picking this candidate.	Currently the market patiently awaits for decisions of the new NBP governor. Undoubtedly, on of the first and most visible effects of his first actions could be staff reshuffle in the central bank. While there is quite limited field for manoeuvre as regards the NBP board (only two out of current seven board members could be replaced), the question mark concerns crucial departments dealing with macroeconomic research and forecasts, which produce analysis taken into account by the MPC in the process of making decisions on interest rates. Those changes could be the first tests of the competence of the new NBP head.
Elżbieta Suchocka-Roguska, deputy finance minister **PAP, 9 January** Inflationary pressure in 2007 should be limited. PLN should be appreciating due to strong economic fundamentals. Nevertheless, appreciation will be smaller due to diminishing interest rate parity. According to CSO data, GDP growth reached 5.8% in Q3 and we predict that it will reach ca. 6% in Q4 2006.	Ministry of Finance's opinions regarding inflationary pressure are consistent with our view. Inflation rate will be probably rising at the start of 2007, although the growth with start from lower level than was predicted lately, and additionally its strength should be limited. According to our prediction, GDP growth in the final quarter of 2006 slightly exceeded 6%.
PAP, 3 January Budget deficit in 2006 will reach probably around PLN25-26bn. PLN2.5bn is from higher revenues and PLN2.8bn is this (part of spending) which was not used. This is information from 29 December and could be still changed later on.	Excellent budget result in 2006 is mainly a product of very fast economic growth in Poland, and partly also an effect of Finance Ministry's self-restraint in spending money. As long as good economic climate maintains, realisation of the next budget seems to be without major threat, even though the target is ambitious.
Janusz Maksymiuk, Samoobrona deputy **PAP, 9 January** Despite the candidate's (for NBP president) declarations that he wants to care for the economy and for unemployment reduction, we believe it would be much better that he can do this with a support of the relevant bill. **Artur Zawisza, PiS deputy** **PAP, 9 January** In this matter (amendment to NBP charter), we have always had clear opinion. We do not support those changes that are constraining the independence of the central bank, e.g. possibility to dismiss the NBP president during his tenure. We support those changes that expand the responsibilities of the central bank by adding care for economic growth as a primary target, together with inflation target. **Wojciech Szarama, head of parliament's legislative committee** **Reuters, 11 January** The committee regarded the proposed change as legally unacceptable. It implies that the work on this amendment concludes. The biggest legal reservations were connected with inconsistence with European Union's law.	After the success in central bank president nomination, the coalition members were planning to proceed with the NBP charter amendment. Those changes could be much less neutral for the financial market than the governor's nomination, as they could potentially infringe solid legal framework that is currently in place. Among the proposals included in the Samoobrona's draft amendment, large part was inconsistent wit the Poland's constitution, with the European Union's regulations, not to mentioned well-established world standards. It was e.g. a possibility to dismiss NBP president and MPC members before the end of their term of office or setting the second primary goal for monetary policy – care for economic growth equally important as care for stable prices. Fortunately, this has been recognised by the Sejm's Legislative Committee that decided that the Samoobrona's draft amendment was unacceptable, ending further work on this document. The question is whether this implies that the deputies will loose their interest in changing central bank regulations or will return to the proposals in somewhat modified shape. Among the Samoobrona's proposals that did not seem to be inconsistent with the law there was e.g. an idea to reduce the number of MPC members from 10 to 6. The idea on its own is not completely unjustified, however if it is implied in current situation, it will shed an entirely new light on the just-made nomination of Sławomir Skrzypek for the NBP governor (as his importance in the rate-setting panel would rise significantly).

Market monitor









Source: Reuters, BZ WBK

The sell-off in the emerging markets weakens zloty

- In the last days of 2006 zloty slightly weakened and at the start of this year Polish currency continued drops following the currency moves emerging markets. After significant strengthening at the end of the previous year investors started to take profit amid significant sell-off in commodities markets as well as drops of stock indices and possible narrowing of global liquidity with regards to monetary tightening in Japan.
- In our view presently the most important factor influencing the value of zloty is the sentiment of foreign investors toward the emerging markets. If the correction in these markets continues zloty may weaken slightly further. Comments of new NBP's president may also have some negative effect. However in the longer term it will be supported by strong fundamentals and may return to appreciation trend.

Yield curve steepened

- Bonds were strengthening since the mid-December though at the end of year there was a slight correction with reference to the weakening in the core markets. The start of this year featured strengthening again though on lowered CPI forecasts by the Ministry of Finance and budget deficit data. Further sell-off in the emerging markets negatively influenced Polish bonds. Since the last report was released the yield curve steepened (shorter end – lower thanks to CPI, longer end – higher).
- If the correction in the emerging markets continues this may affect Polish bonds as well as some statements of the new chief of NBP (especially the loner end of the curve). Hawkish comments of some MPC' members to some extent may also contribute to rising yields together with good data in the labour market. The short term of the curve is going to be supported by the inflation data.

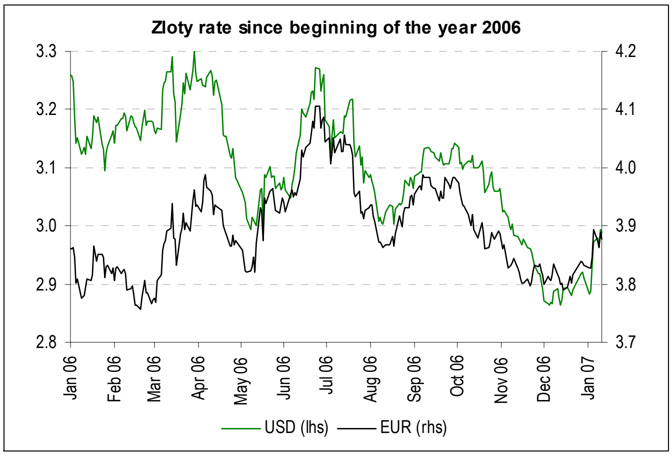
Dollar recovers on stronger US data

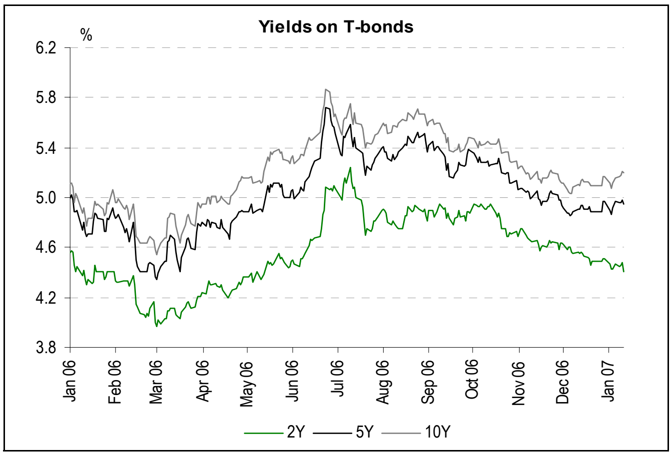
- Since the release of our December report there was a significant correction of the EURUSD rate among others thanks to better US labour market data, retail sales. Euro slightly regained some strength after high Ifo index, however later on the US greenback strengthened again, with regards to good data from the US economy, i.e. data from the housing market and manufacturing ISM activity index and non-farm payrolls.
- We hold our view that the dollar is going to weaken in the next months until the Q3, with reference to the economic slowdown in US. After the expected rate cuts at the end of the year we may see some dollar's rebound. Statistics from the manufacturing sector and housing market sector in United States as well as signals on further rate moves of European Central Bank will be of key importance.

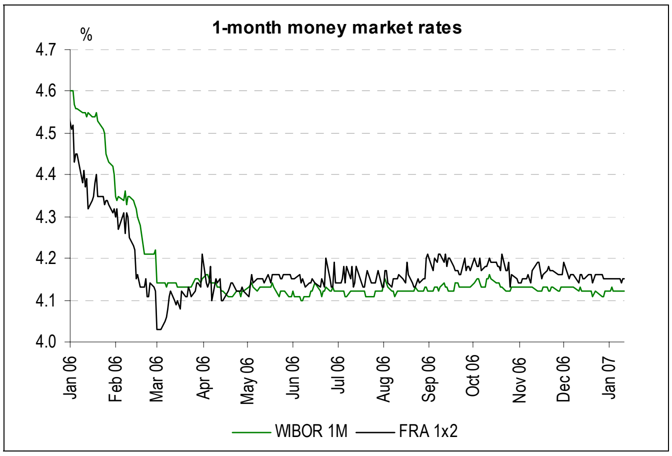
Weakening on good data

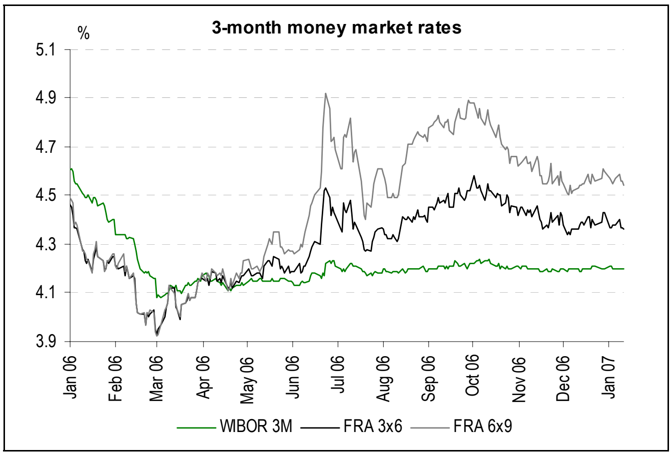
- Yields of 10Y US Treasuries rose by ca. 17 bp since the middle of December after better than expected figures from US economy (labour market, manufacturing ISM and to some extent also the housing market). Bunds prices followed the US market and dropped to much broader extent (ca. 30 bp rise of 10Y yields to 4.02%) after better data from euro zone's economies (e.g. Ifo). Spread between US and German 10Y bonds fell below 70 bp.
- Despite slightly better that expected data from US economy we assume the slowdown accelerates in the first half of 2007, what will lead to rate cuts to 4.5%. With regards to ECB statement and euro zone data we assume that with good performance of euro zone's economy rates will be raised in EU-12 to 4.0% by mid-year and even to 4.25% at the end of 2007. Spread between Bunds and Treasuries would diminish further.

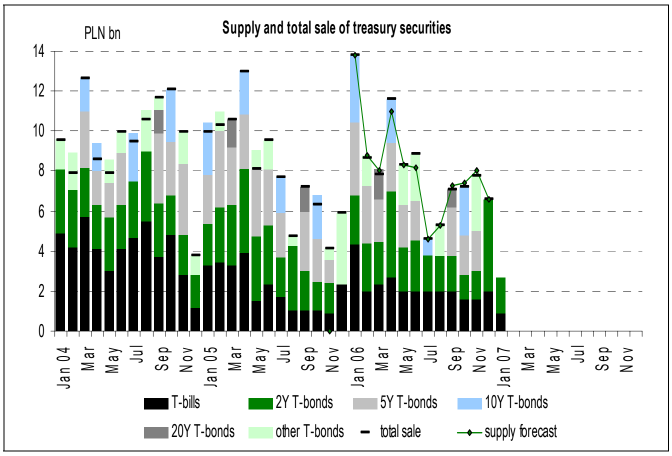
Market monitor











Treasury bill auctions (PLN m)

	OFFER / SALE	
Date of auction	52-week	Total
06.11.2006	800 / 800	800 / 800
20.11.2006	800 / 800	800 / 800
Total November	**1 600 / 1 600**	**1 600 / 1 600**
04.12.2006	1 000 / 1 000	1 000 / 1 000
18.12.2006	1 000 / 1 000	1 000 / 1 000
Total December	**2 000 / 2 000**	**2 000 / 2 000**
08.01.2007	900 / 900	900 / 900
22.01.2007	900 - 1 100	900 – 1 100
Total January*	**1 800 - 2 000**	**1 800 - 2 000**

* estimations based on Ministry of Finance preliminary information

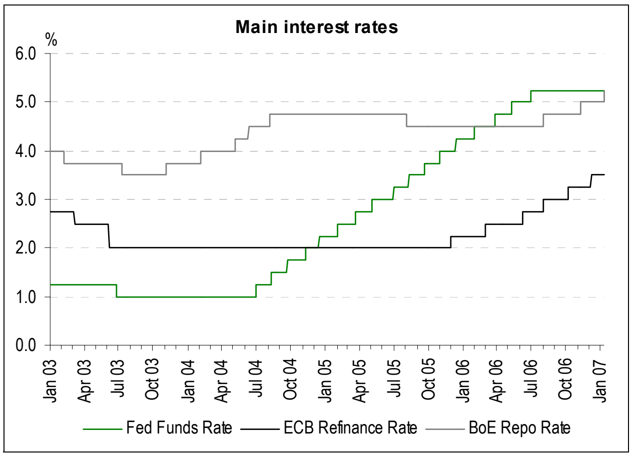
Treasury bond auctions in 2007 (PLN m)

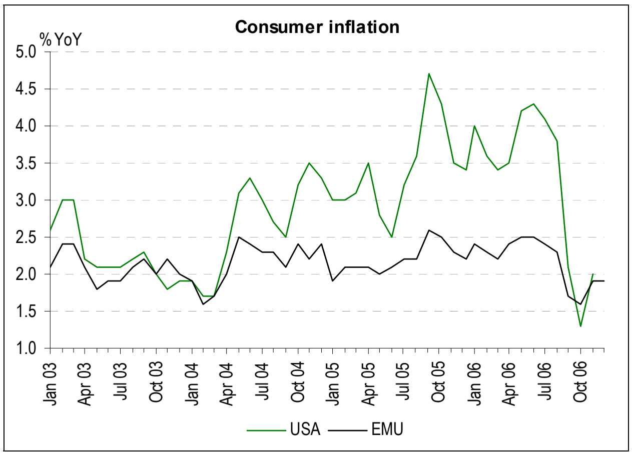
month	First auction				Second auction				Third auction			
	date	T-bonds	offer	sale	date	T-bonds	offer	sale	date	T-bonds	offer	sale
January					10.01	DS1017	1 800	1 800	17.01	PS0412	1 800 – 2 800	
February	07.02	2Y	-	-	14.02	10Y WIBOR | 12Y CPI	-	-	21.02	5Y	-	-
March	07.03	2Y	-	-	14.03	20Y	-	-	21.03	5Y	-	-
April	04.04	2Y	-	-	11.04	10Y	-	-	18.04	5Y	-	-
May	-	-	-	-	09.05	10Y WIBOR | 12Y CPI	-	-	16.05	5Y	-	-
June	06.06	2Y	-	-	-	-	-	-	20.06	5Y	-	-
July	04.07	2Y	-	-	11.07	10Y	-	-	-	-	-	-
August	01.08	2Y	-	-	08.08	10Y WIBOR | 12Y CPI	-	-	-	-	-	-
September	05.09	2Y	-	-	12.09	20Y	-	-	19.09	5Y	-	-
October	03.10	2Y	-	-	10.10	10Y	-	-	17.10	5Y	-	-
November	07.11	2Y	-	-	14.11	10Y WIBOR | 12Y CPI	-	-	21.11	5Y	-	-
December	05.12	2Y	-	-	-	-	-	-	-	-	-	-

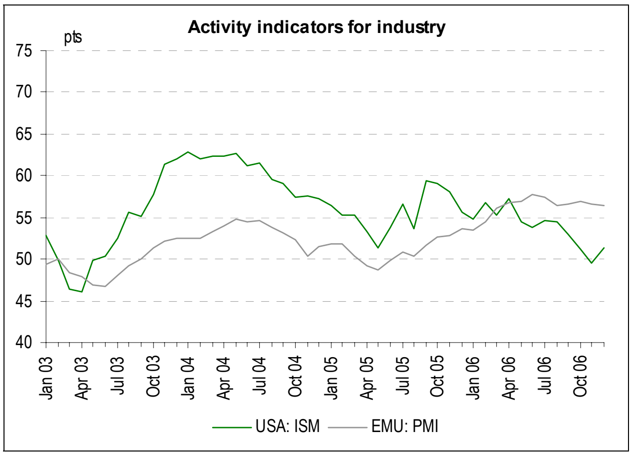
* with supplementary auction

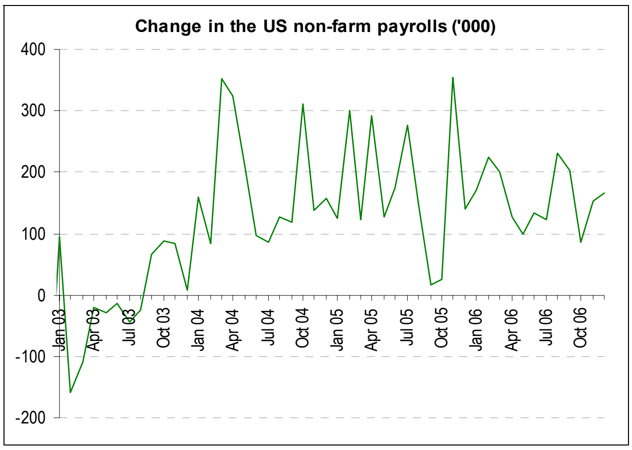
Source: Ministry of Finance, Reuters, BZ WBK

International review









Source: Reuters, ECB, Federal Reserve

More rate hikes expected in the euro zone

- In December US central bank left the Fed Funds rate unchanged at 5.25% level. The communiqué emphasized the economic weakening in US especially with regards to the weakening in the housing market. The minutes from December minutes underlined higher risks for economic growth signalling that inflation still is the most important issue.
- On January meeting the European Central Bank left the main interest rate unchanged at 3.5%. The ECB's statement said the official rates are still low and monetary policy accommodative, though it did not include the expected expression of "strong vigilance" against inflation. Instead the communiqué said ECB will "act in a firm and timely manner" to ensure prices stability. This moved the rate hike expectation for March at earliest. ECB signalled the downside risk for growth and upside for inflation.

US CPI in the downward trend

- US CPI in November remained unchanged on monthly basis (+2,0%YoY) as compared to a drop by 0.5%MoM in October. Core CPI also stayed flat and fell to 2.6%YoY from 2.7%YoY. PPI rose in November by 2%, which resulted from rise of truck prices. 12-month PPI amounted to 0.9%. The energy, fuel and heating oil prices component amounted to 6.1%, 17.9% and 7.7%MoM respectively. The core PPI amounted to 1.3%MoM and 1.8%YoY.
- Final HICP inflation in the euro zone in November amounted to 1.9%YoY and was above the market consensus, that indicated no change from 1.8%YoY level. The core figures remained at 1.5%YoY. The preliminary data on HICP for December show the index unchanged at 1.9%.

Surprisingly high ISM

- Ism index for the manufacturing sector in US significantly rose to 51.4 from 49.5 (expectations: 49.9). The prices paid index fell to 47.5 from 53.5, while the new orders index increased to 52.1 from 48.7. ISM index in the manufacturing sector in US fell in December to 57.1 from 58.9 in November. The prices paid index rose to 59.1 against 55,6 in the previous month, while employment component rose to 53.3 from 51.6.
- PMI index for the manufacturing index in the euro zone fell to 56.5 (the lowest level since August) from 56.6. In the services sector the index fell slightly from 57.6 to 57.2. The business expectations index rose to the highest level since May, i.e. 65.3 from 64.1.
- Final data on US GDP in Q3 was revised downwardly to 2.0%QoQ. This was below expectations of 2.2%QoQ, while Wall Street analysts expected no change as compared to the previous estimates. The core PCE prices index stayed at 2.2%QoQ.

Better than expected non-farm payrolls

- ADP report showed a decline of jobs outside the farming in the private sector in Unites States in December by 40k, while the Wall Street analysts forecasted a rise by 128k against 158k in November.
- In December the non-farm payrolls in Unites States amounted to 167k (rise by 178k in the services sector, fall by 11k in the manufacturing sector) while the analysts expected 100k. What is more the data for the previous two months was upwardly by total 29k (i.e. 22k in November and 7k in October). The unemployment rate remained at 4.5%. The average hourly earnings increased by 0.5%MoM (the strongest rise since April 2006) and 4.2%YoY.

Economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
8 January ***POL: Treasury bills auction***	**9**	**10** ***POL: Auction of 10Y bonds*** US: Trade balance (Oct) US: Wholesale inventories (Nov)	**11** EMU: EBC meeting – decision US: Federal Budget (Dec)	**12** ***POL: Money supply (Dec)*** US: Foreign trade prices (Dec) US: Retail Sales (Dec)
15 ***POL: Preliminary CPI (Dec)*** EMU: Industrial production(Nov)	**16** ***POL: Wages and employment (Dec)*** ***POL: Balance of payments (Nov)*** GER: ZEW Index (Jan)	**17** ***POL: Auction of 5Y bonds*** EMU: Final HICP (Dec) US: PPI (Dec) US: Net capital flow (Nov) US: Capacity use (Dec) US: Industrial output (Dec)	**18** JP: BOJ – decision US: CPI (Dec) US: House starts (Dec) US: Philadelphia Fed index (Jan)	**19** ***POL: Industrial Output (Dec)*** ***POL: PPI (Dec)*** US: Preliminary Michigan (Dec)
22 ***POL: Treasury bills auction*** ***POL: Core inflation (Dec)***	**23** ***POL: Business climate (Jan)*** JP: BOJ minutes USA: Richmond Fed services index (Jan)	**24** ***POL: Switch auction***	**25** GER: Ifo Index (Jan) US: Home sales (Dec)	**26** EMU: M3 money supply (Dec) US: Durable goods orders (Dec) US: New homes sales (Dec)
29 ***POL: Retail sales (Dec)*** ***POL: Unemployment (Dec)***	**30** ***POL: MPC meeting***	**31** ***POL: MPC meeting – decision*** EMU: Business climate (Nov) EMU: Preliminary HICP (Jan) USA: ADP report (Jan) US: Flash GDP (Q4) US: Core PCE (Q4) US: Fed meeting - decision	**1 February** EMU: Manufacturing PMI (Jan) USA: Core PCE (Dec) US: Manufacturing ISM (Jan)	**2** EMU: PPI (Dec) US: Non-farm payrolls (Jan) US: Unemployment (Jan) US: Factory orders (Dec) US: Final Michigan (Jan)
5 ***POL: Treasury bills auction*** EMU: Non-manufacturing PMI (Jan) US: Non-manufacturing ISM (Jan)	**6** EMU: Retail sales (Dec)	**7** ***POL: Auction of 2Y bonds*** US: Unit labour costs & labour productivity (Q4)	**8** EMU: EBC meeting - decision US: Wholesale inventories (Dec)	**9**

Source: CSO, NBP, Finance Ministry, Reuters

MPC meetings and data release calendar for 2007

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
MPC meeting	30-31	27-28	27-28	24-25	29-30	26-27	24-25	28-29	25-26	30-31	27-28	18-19
GDP*	-	-	2	-	31	-	-	30	-	-	30	-
CPI	15	15[a]	14[b]	13	15	13	13	14	13	15	14	13
Core inflation	22		23[b]	23	23	22	23	23	24	22	23	21
PPI	19	19	19	20	21	20	19	20	19	18	20	19
Industrial output	19	19	19	20	21	20	19	20	19	18	20	19
Retail sales	29	-	-	-	-	-	-	-	-	-	-	-
Gross wages, employment	16	15	15	18	17	19	17	16	15	16	16	15
Unemployment	29	-	-	-	-	-	-	-	-	-	-	-
Foreign trade	about 50 working days after reported period											
Balance of payments*	2	-	30	-	-	-	-	-	-	-	-	-
Balance of payments	16[c]	12	14	13	-	-	-	-	-	-	-	-
Money supply	12	14	14	13	-	-	-	-	-	-	-	-
NBP balance sheet	5	7	7	6	-	-	-	-	-	-	-	-
Business climate indices	23	22	22	23	23	22	23	23	24	23	23	21

* quarterly data, [a] preliminary data, January, [b] January and February, [c] November 2006, [d] January, [e] February

Source: CSO, NBP

Economic data and forecasts

Monthly economic indicators

		Dec 05	Jan 06	Feb 06	Mar 06	Apr 06	May 06	Jun 06	Jul 06	Aug 06	Sep 06	Oct 06	Nov 06	Dec 06	Jan 07
Industrial production	%YoY	9.6	9.8	10.2	16.4	5.7	19.1	12.2	14.3	12.6	11.6	14.8	11.7	6.4	10.1
Retail sales [c]	%YoY	6.3	8.6	10.2	10.1	13.2	13.7	10.7	11.0	11.5	14.5	13.3	13.6	14.2	13.8
Unemployment rate	%	17.6	18.0	18.0	17.8	17.2	16.5	16.0	15.7	15.5	15.2	14.9	14.8	14.9	15.3
Gross wages [b c]	%YoY	1.5	3.6	4.8	5.4	4.0	5.2	4.5	5.6	5.3	5.1	4.7	3.1	5.9	6.2
Employment [b]	%YoY	2.6	2.6	2.4	2.7	2.8	3.0	3.1	3.3	3.5	3.5	3.6	3.8	3.8	3.9
Export (€) [d]	%YoY	22.5	21.7	19.2	28.2	9.8	32.5	16.9	19.4	21.8	16.6	24.0	18.7	18.9	16.0
Import (€) [d]	%YoY	18.6	23.7	22.0	23.9	10.1	29.9	17.2	23.6	23.7	19.2	27.8	17.6	19.5	19.1
Trade balance [d]	EURm	-425	6	-229	-130	-108	-439	-103	-450	-518	-356	-269	-300	-550	-203
Current account balance [d]	EURm	-530	-211	-839	-356	-597	-374	-300	-387	-668	143	-482	-380	-590	-308
Current account balance [d]	% GDP	-1.7	-1.6	-1.8	-1.9	-2.1	-1.9	-2.0	-2.0	-2.1	-1.9	-1.9	-1.9	-1.9	-1.9
Budget deficit (cumulative)	PLNbn	-28.6	0.7	-6.7	-9.0	-10.0	-14.6	-17.7	-15.6	-14.5	-14.5	-16.6	-18.5	-25.5	-1.5
Budget deficit (cumulative) [e]	% realisation	100.0	-2.3	21.9	29.4	32.8	47.8	57.8	51.1	47.5	47.4	54.4	60.7	83.5	5.0
CPI	%YoY	0.7	0.6	0.7	0.4	0.7	0.9	0.8	1.1	1.6	1.6	1.2	1.4	1.7	2.0
PPI	%YoY	0.2	0.3	0.7	0.9	1.7	2.3	3.0	3.5	3.3	3.6	3.2	2.6	3.0	3.0
Broad money (M3)	%YoY	10.5	10.4	11.7	9.8	9.6	10.1	11.9	13.0	12.9	13.0	12.3	14.4	14.1	14.8
Deposits	%YoY	9.4	10.2	10.8	9.1	8.6	8.9	11.4	12.3	12.0	11.6	11.4	13.1	13.1	13.2
Loans	%YoY	11.8	12.3	13.5	13.6	12.2	12.4	16.0	16.7	18.0	19.2	19.5	20.7	22.3	23.2
USD/PLN	PLN	3.25	3.16	3.18	3.23	3.20	3.05	3.17	3.15	3.05	3.12	3.09	2.97	2.88	2.98
EUR/PLN	PLN	3.85	3.82	3.79	3.88	3.92	3.90	4.02	4.00	3.90	3.97	3.90	3.82	3.81	3.87
Reference rate [a]	%	4.50	4.50	4.25	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00
Lombard rate [a]	%	6.00	6.00	5.75	5.50	5.50	5.50	5.50	5.50	5.50	5.50	5.50	5.50	5.50	5.50
WIBOR 3M	%	4.62	4.49	4.26	4.12	4.14	4.15	4.17	4.19	4.19	4.21	4.22	4.20	4.20	4.20
Yield on 52-week T-bills	%	4.38	4.22	3.97	3.87	3.95	4.02	4.20	4.30	4.35	4.44	4.35	4.29	4.20	4.20
Yield on 2-year T-bonds	%	4.64	4.40	4.20	4.10	4.28	4.44	4.75	4.95	4.85	4.87	4.84	4.65	4.54	4.50
Yield on 5-year T-bonds	%	5.04	4.82	4.60	4.59	4.80	5.00	5.33	5.37	5.41	5.31	5.24	5.01	4.91	4.95
Yield on 10-year T-bonds	%	5.14	4.94	4.78	4.78	5.02	5.26	5.54	5.55	5.61	5.48	5.39	5.18	5.10	5.20

Source: CSO, NBP, Finance Ministry, BZ WBK own estimates

[a] at the end of period [b] in corporate sector [c] in nominal terms [d] balance of payments data on transaction basis [e] 2005 - % of Dec, 2006 - % of plan

Quarterly and annual economic indicators

		2004	2005	2006	2007	1Q06	2Q06	3Q06	4Q06	1Q07	2Q07	3Q07	4Q07
GDP	PLNbn	923.2	980.7	1 045.7	1 124.7	240.9	251.7	258.6	294.5	259.5	272.2	276.8	316.2
GDP	%YoY	5.3	3.5	5.7	5.3	5.2	5.5	5.8	6.1	5.5	5.7	5.0	4.9
Domestic demand	%YoY	5.9	2.4	5.6	5.9	4.8	4.8	6.1	6.5	5.8	6.5	5.6	5.6
Private consumption	%YoY	4.0	1.9	5.3	5.1	5.2	4.9	5.5	5.5	5.6	5.1	5.0	4.8
Fixed investments	%YoY	6.3	6.5	14.5	12.5	7.7	14.8	19.8	14.0	18.0	14.0	12.0	10.0
Industrial production	%YoY	12.3	4.0	11.9	8.2	12.4	12.1	12.3	11.0	8.4	9.5	7.8	7.2
Retail sales (real terms)	%YoY	7.1	1.5	12.0	12.4	9.0	11.8	13.8	13.4	14.4	14.0	11.4	9.7
Unemployment rate [a]	%	19.1	17.6	14.9	13.0	17.8	16.0	15.2	14.9	15.4	13.7	13.0	13.0
Gross wages (real terms) [c]	%YoY	0.8	1.2	3.7	3.9	4.3	3.9	4.1	3.1	3.7	4.0	4.3	3.8
Employment [c]	%YoY	-0.8	1.9	3.2	3.6	2.6	3.0	3.4	3.7	3.9	3.7	3.5	3.2
Export (€) [b]	%YoY	22.3	17.8	20.6	14.8	23.3	19.5	19.3	20.5	16.0	15.5	14.5	13.5
Import (€) [b]	%YoY	19.5	13.4	21.5	16.6	23.3	19.0	22.2	21.6	17.8	17.5	15.5	16.0
Trade balance [b]	EURm	-4 552	-2 242	-3 439	-5 724	-352	-646	-1 322	-1 119	-806	-1 212	-1 759	-1 947
Current account balance [b]	EURm	-8 670	-4 130	-5 021	-6 086	-1 396	-1 266	-907	-1 452	-1 545	-1 527	-1 039	-1 975
Current account balance [b]	% GDP	-4.3	-1.7	-1.9	-2.1	-1.9	-2.0	-1.9	-1.9	-1.9	-1.9	-2.0	-2.1
Budget deficit (cumulative) [a]	PLNbn	-41.5	-28.6	-25.5	-30.0	-9.0	-17.7	-14.5	-25.5	-11.1	-18.0	-21.0	-30.0
Budget deficit (cumulative) [a]	% GDP	-4.5	-2.9	-2.4	-2.7	-	-	-	-	-	-	-	-
CPI	%YoY	3.5	2.1	1.1	2.2	0.6	0.8	1.4	1.4	2.2	2.2	1.9	2.4
CPI [a]	%YoY	4.4	0.7	1.7	2.5	0.4	0.8	1.6	1.7	2.5	2.4	1.9	2.5
PPI	%YoY	7.0	0.7	2.6	2.5	0.9	3.0	3.6	3.0	3.2	2.2	1.8	2.8
Broad money (M3) [a]	%YoY	8.7	10.5	14.1	10.7	9.8	11.9	13.0	14.1	14.4	13.7	13.2	11.1
Deposits [a]	%YoY	8.1	9.4	13.1	10.7	9.1	11.4	11.6	13.1	12.9	12.4	12.0	11.8
Loans [a]	%YoY	2.9	11.8	22.3	15.5	13.6	16.0	19.2	22.3	22.6	21.4	20.2	19.2
USD/PLN	PLN	3.65	3.23	3.10	2.95	3.19	3.14	3.10	2.98	2.96	2.93	2.96	2.94
EUR/PLN	PLN	4.53	4.02	3.90	3.86	3.83	3.95	3.96	3.85	3.87	3.89	3.88	3.80
Reference rate [a]	%	6.50	4.50	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00
Lombard rate [a]	%	8.00	6.00	5.50	5.50	5.50	5.50	5.50	5.50	5.50	5.50	5.50	5.50
WIBOR 3M	%	6.21	5.29	4.21	4.30	4.29	4.15	4.20	4.20	4.20	4.20	4.20	4.20
Yield on 52-week T-bills	%	6.50	4.92	4.18	4.30	4.02	4.06	4.37	4.28	4.30	4.30	4.30	4.30
Yield on 2-year T-bonds	%	6.89	5.04	4.57	4.73	4.23	4.49	4.89	4.67	4.75	4.70	4.60	4.85
Yield on 5-year T-bonds	%	7.02	5.25	5.03	5.14	4.67	5.04	5.36	5.05	5.15	5.10	5.00	5.30
Yield on 10-year T-bonds	%	6.84	5.24	5.22	5.34	4.83	5.27	5.55	5.22	5.35	5.30	5.20	5.50

Source: CSO, NBP, Finance Ministry, BZ WBK own estimates

[a] at the end of period; [b] balance of payments data on transaction basis [c] in corporate sector

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This analysis is based on information available until 11.01.2007 has been prepared by:

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