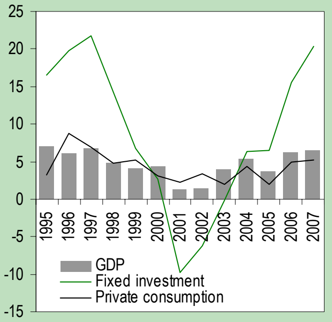
Bank Zachodni WBK

MACROscope

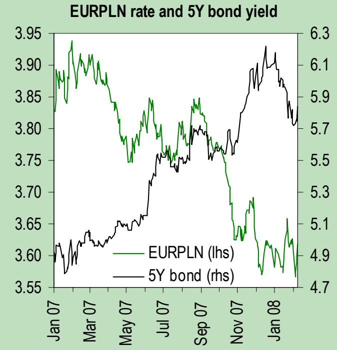
Polish Economy and Financial Markets

February 2008

Economic growth in Poland (%YoY)



EURPLN rate and 5Y bond yield



In this issue:

Resistant to recession

- **Many of monthly macroeconomic indicators for December proved weaker than predicted.** Industrial output, retail sales and average wage in the enterprise sector increased much slower than forecast. Employment growth was also lower than expected. However, the biggest disappointment was estimate of private consumption growth in 4Q07, based on preliminary GDP data for 2007 as a whole. On the other hand, solid rise was noted in construction output and favourable weather conditions this winter suggest that economic activity in this sector should remain strong at the beginning of 2008. All in all, the recently published data increased uncertainty regarding further development of the economic situation, but as for now it seems the Polish economy remains on the path of solid growth.

- **Meanwhile, prospects for economic growth in the US and euro zone are much worse**, as recently released data indicated a growing risk of severe economic slowdown (or even a recession in the United States) at the start of this year.

- **The Monetary Policy Council has raised interest rates once again by 25 bp in January,** in reaction to a risk of further build-up of wage pressure, particularly in the public sector, and a rise in core inflation that accelerated in December due to price hikes in other areas than just food and fuels. At the same time, the Council emphasised a rise in uncertainty concerning world economic situation as a deceleration of economic growth may decrease inflationary pressure. Also, an increasing disparity between interest rates in Poland and abroad that may lead to zloty appreciation will be of high importance for the Council. In such situation, we maintain a view assuming that interest rates will go up no more than once again by 25 bp, probably in March. A rate hike could be delayed or become less likely if the next data releases confirm a slowdown in economic activity in Poland and the ECB decides to cut interest rates already in Q1.

- **Despite a significant deterioration of sentiment in the world markets and increase of fears over global economy the zloty was relatively stable fluctuating in narrow ranges against the major currencies.** On the other hand the fixed income market experienced a significant strengthening due to weaker data from the domestic economy, some change of the tone in the comments of the MPC members, expected moves of the major central banks as well as sell-off in the Polish stock market. Overall, during the last month participants of the domestic interest rate market verified their expectations regarding the scale of further monetary policy tightening by the MPC, and the market consensus moved toward a scenario presumed by us for several months.

Financial market on 31 January 2008:

NBP deposit rate	3.75	WIBOR 3M	5.65	USDPLN	2.4438
NBP reference rate	5.25	Yield on 2-year T-bonds	5.63	EURPLN	3.6260
NBP lombard rate	6.75	Yield on 5-year T-bonds	5.73	EURUSD	1.4838

This report is based on information available until 08.02.2008

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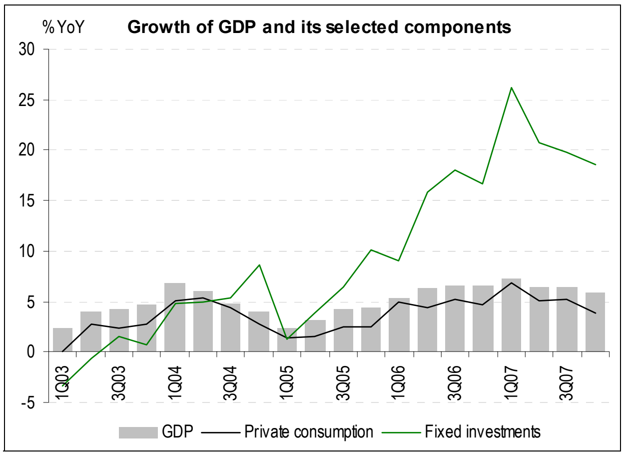
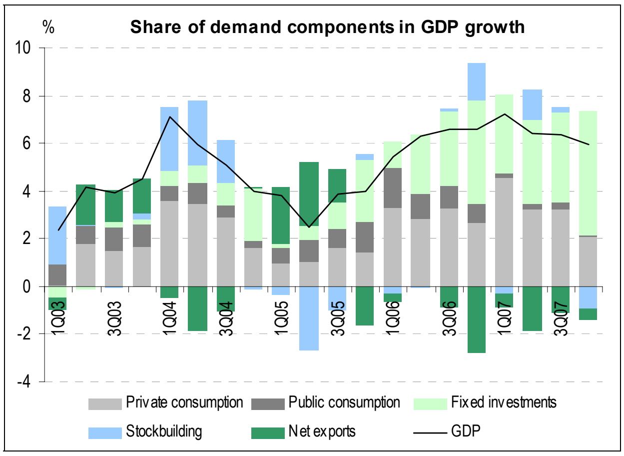
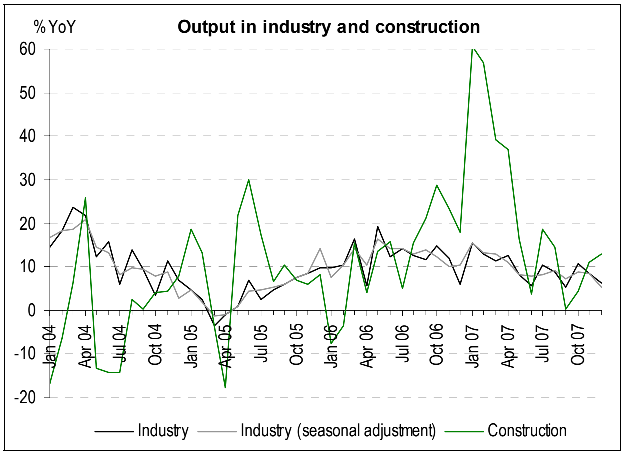
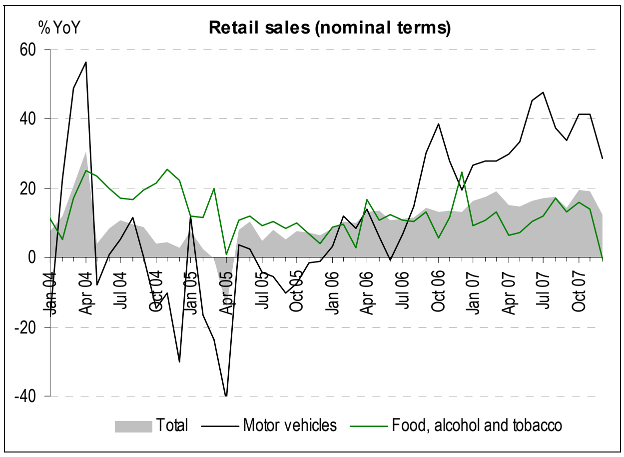
Economic update









Source: CSO, own calculations

Surprising breakdown of GDP growth in 4Q07

- According to preliminary estimates of the CSO, Poland's GDP growth reached 6.5% in 2007 as a whole against 6.2% in 2006. The growth of fixed investment outlays amounted to 20.4%, much above result from 2006 (15.6%), while the private consumption growth was 5.2% against 4.8% in the previous year.
- On the basis of preliminary annual data and available quarterly statistics for the first three quarters, we estimate that GDP growth in Q4 alone amounted to 5.9-6.0%, as we expected.
- However, the breakdown of GDP growth in 4Q07 appeared surprising – our estimates point to investment growth by as much as 18.5%YoY, which is above our forecast (15.5%), while the private consumption growth clearly decelerated in the last quarter of the past year to 3.8%YoY against our forecast at 5.2%. The contribution of the net exports significantly improved, reaching -0.4 pp (against an average of -1.2 pp in the first three quarters of 2007). The inventories change reduced GDP growth rate in Q4 2007 by ca. 1 pp.
- It is hard to explicitly point a reason of trimming consumption growth in the environment of quickly improving personal income. Perhaps, high food prices may have had an effect as in our opinion it is unlikely that households reacted to situation on the financial markets and became less optimistic as regards economic growth prospects. What is important, the value added growth in market services accelerated to ca. 7%YoY in Q4, which seem to confirm the former thesis (the retail sales data for December also showed that apart from the food sales demand for other goods remained robust). Further data will be needed to answer the question to what extent the weaker consumption growth is not just a short-lived disruption. Possibly, the revised GDP numbers will show higher consumption rise in 4Q07 and weaker in the previous quarters of last year.

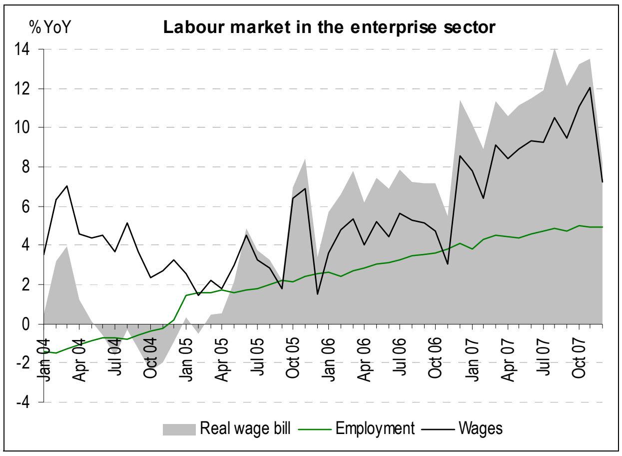
Mixed output figures for December

- Despite a low base effect, industrial output growth in December 2007 was a mere 6.2%YoY, much below forecasts. It seems that negative effect of timing of Christmas holiday (Christmas's Eve on Monday) was more important than positive effect of the low base, especially in manufacturing, where output growth slowed down to 5.7%YoY (i.e. the lowest level in 2 years).
- On the other hand, It is hard to say whether holiday timing actually played a role, as construction output increased by 13%YoY, in line with our expectations the strongest in 5 months. Despite high base effect related to extraordinary high construction output in January 2007, very favourable weather conditions this winter should allow to achieve high growth rates in construction output in the first months of 2008. This would be positive estimates of GDP growth in 1Q08.

Retail sales much below expectations

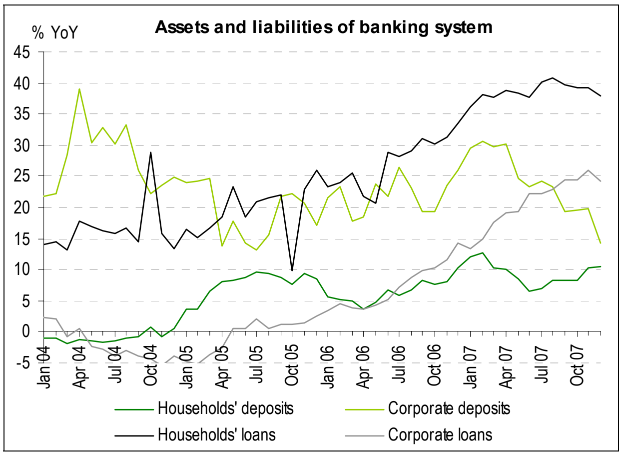
- Retail sales in December grew a mere 12.4%YoY in nominal terms, much weaker than expected, the weakest since August 2006. In real terms, retail sales growth was 8.1%YoY, down from 15.1%YoY in November, reaching the weakest result in 2 years.
- What is interesting, December saw nominal drop in sales of food and beverages (after 14%YoY rise in November). To some extent this was caused by high base effect. Meanwhile, it is hard to determine at the moment whether high food prices induced Poles to constrain consumption during Christmas and whether this will be long-lasting phenomenon.
- Anyway, one should not talk of general weakening in consumption demand looking at other components of retail sales, which posted two-digit growth in December (although some deceleration was seen in case of motor vehicles).

Economic update



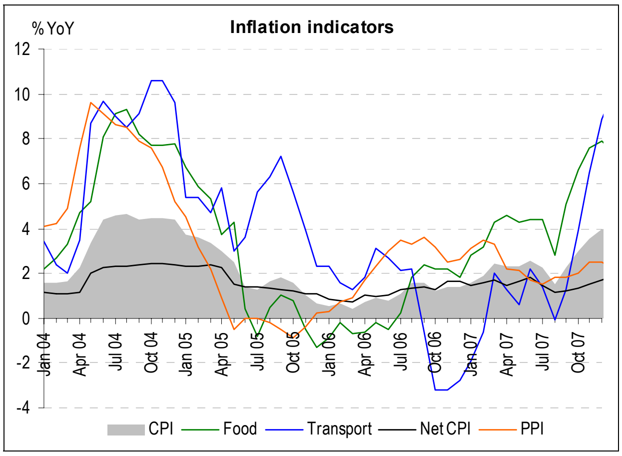
Much weaker than predicted wage growth

- In December, the average wage in enterprises increased 7.2%YoY and average employment rose 4.9%YoY while market forecasts were at 11%YoY and 5%YoY, respectively.
- Detailed data on wages in enterprises sector in December showed that much stronger than predicted slowdown (below trend) resulted not only from earlier bonuses payments in mining (although this factor played an important role – average wage in mining fell in December by 0.8%YoY after rising 28%YoY in November). The deceleration in annual wage growth was also observed in other sectors: in manufacturing from 10.5% to 8.8%, in construction from almost 17% to 12.4%, in trade and services from 12.1% to 10.6%. This suggests that wage growth in months tom some may not be as strong as earlier expected, although it should rebound in January, returning to the trend of ca. 10%.



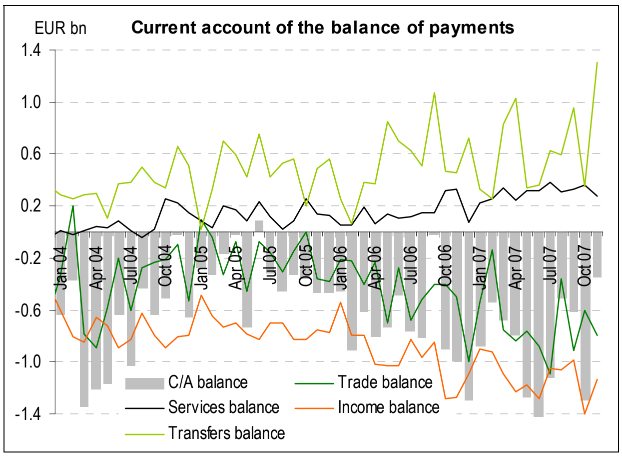
Significant rise in households deposits

- Annual rise in money supply growth decelerated to 13.1 in December from 13.6% in November, with a slowdown in total deposits growth to 14.3% from 15.1%. However, households' deposits growth accelerated to 10.6% from 10.2%, which is related to substantial outflow of funds from mutual funds. At the same time, corporate deposits growth slowed down to 14.3% from 19.8%, which is likely to be a result of strong investment activity.
- In line with our forecast, December saw another deceleration in credits growth, to 29.9% from 30.1%. This was related to weaker rise in both households' and corporate borrowing.
- We predict that in months to come we should see continuation of gradual deceleration in money supply growth, including deposits, and credits.



CPI and core inflation up, PPI inflation stable

- The CPI inflation reached 4.0%YoY in December. Prices of food and non-alcoholic beverages increased only by 0.3%MoM (as compared to an average rise of nearly 2% in the previous three months), which drove annual growth rate up to 7.9%, weaker than forecast. Fuel prices rose again (by 0.2%MoM and 18.1%YoY).
- What is important, December saw an increase in prices of other goods and services, which resulted in stronger than expected rise in net inflation (CPI excluding food and fuel prices). Although it was still at low level of 1.7%, we predict it will be gradually accelerating in the course of 2008, reaching 2.2-2.3% on average.
- While increase in core inflation suggests strengthening of inflationary pressures, producer prices growth in December proved weaker than expected and stayed at 2.5%YoY seen in November, which is a positive sign for inflation prospects.

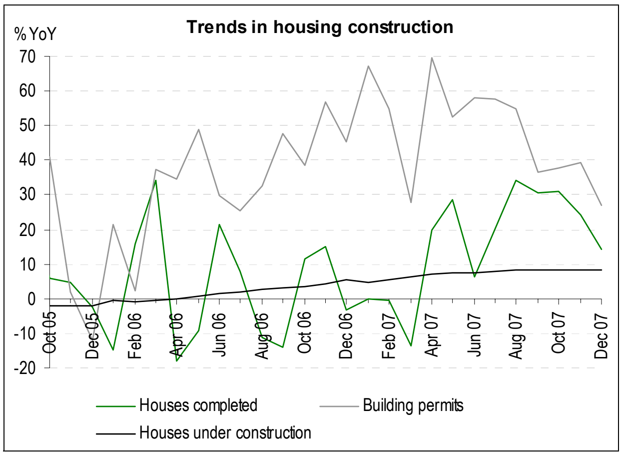


External position still strong

- C/A deficit in November reached €350m against market expectations of around €1bn gap. Growth in foreign trade turnover was weaker than market forecasts (especially in case of imports), although remained at two-digit levels.
- The main factor which positively affected the current account was a €1.3bn surplus in current transfers. This resulted from both substantial inflow of EU funds (€635bn in transfers and additional €421m on the capital side of the balance of payments) and also from remuneration transfers from emigrants.
- As regards FDIs, their inflow was still high and reached €1.2bn in November, more than on average in first ten months of the year. 12-month cumulated C/A gap in relation to GDP fell to 3.6% after November from 3.8% after October.

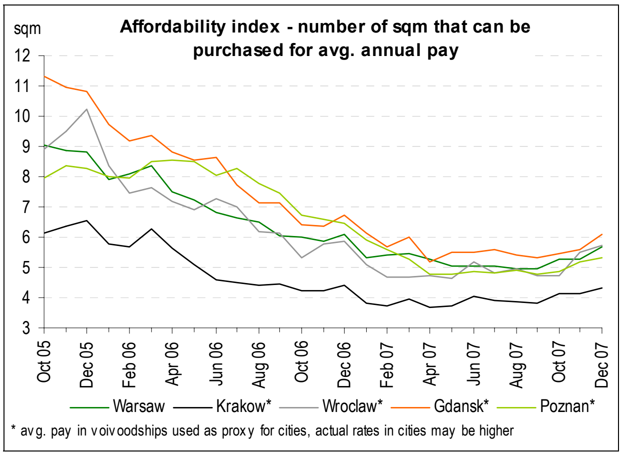
Source: CSO, NBP, own calculations

Housing market update



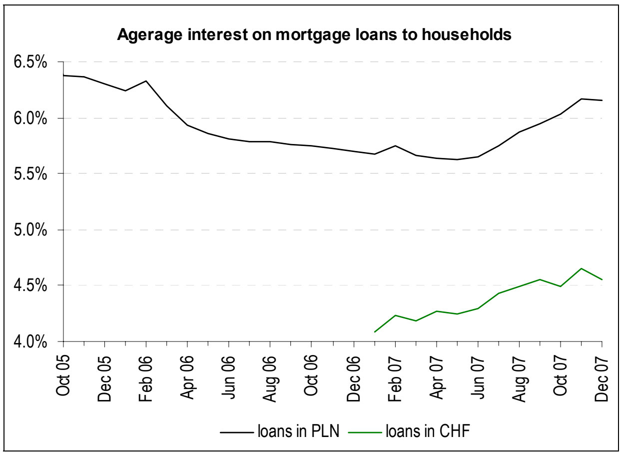
Weaker growth in house supply at the end of year

- A revival in house supply that was observed in the better part of 2007, clearly lost momentum at the end of the year. In December the number of house completions was 14.4% higher than last year, which implies more than halved growth rate as compared to previous months. December also saw a slowdown in building permits growth.
- In the entire 2007, there were almost 134,000 house completed, 16% more than in the previous year.
- Continuing growth in new house starts suggests that house supply will be gradually increasing, however a rate of this growth does not imply a reduction of structural deficit of dwellings in Poland, as the annual increase in the number of households is still bigger, estimated at ca. 150,000 p.a.



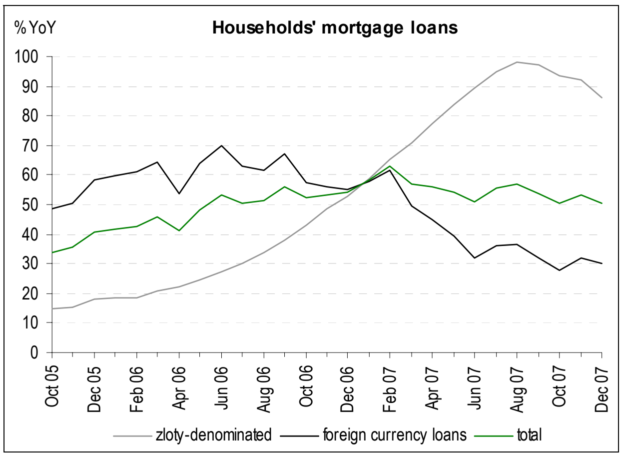
... while the start of new year saw slight rebound in demand

- According to signals from real estate agents, a start of the year saw some increase in demand for flats from individuals and slightly higher turnover on the housing market as compared to final months of 2007. However, big investors' demand for flats remained dormant.
- Partly, this could have reflected a deterioration in moods on the stock market and predicted further slump in stock prices.
- In our opinion, a more important factor was a continuing rise in households' revenues, as – amid stabilizing prices – it resulted in gradual rebound in house affordability. In December, a relation between average wages and average flat prices in Poland's biggest cities returned to levels seen at the start of last year, and it seems that more recovery in this relation is possible in the next months.



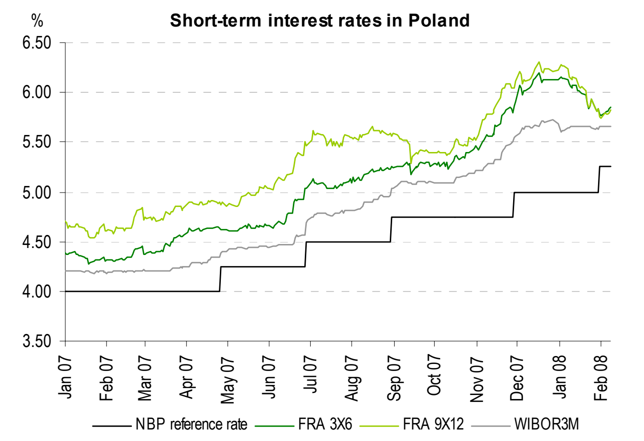
Mortgage loans getting more expensive

- A rise in house affordability resulting from wage growth was constrained by tighter credit conditions.
- In 2007 interest rates on mortgage loans increased, both as regards credit in zloty and in Swiss franc. A scale of average interest growth in the entire year was similar in both currencies, however in the case of loans in CHF a rise was taking place gradually during the year, while in PLN-denominated loans almost entire hike took place in the second half of the year.
- If interest rates in Poland continue climbing, widening disparity between loans in zloty and Swiss franc (where economic slowdown should prevent further monetary tightening), it is likely that the demand will start switching back to loans in foreign currencies.
- However, an increase in PLN-denominated loans' interest this year should not be significant, as market interest rates are already anticipating possible scale of further monetary tightening. But on the other hand, banks started tightening their lending practices and according to NBP survey, in Q4 2007 one fourth of banks decided to raise credit margins.
- In effect, in Q4 2007 banks recorded a clear decline in demand for mortgage loans. Among main reasons of such situation, apart from a rise in cost of credit and tightened lending conditions, banks indicated forecasts of decline in house prices, persuading households to wait with home purchases.
- Although annual growth rate of mortgage loans is gradually slowing down, a nominal rise in households' mortgage debt is still high, and in Q4 it was still higher than in the final quarter of 2006, exceeding PLN1bn.
- Interestingly, mortgage loans for enterprises are booming and in December their growth accelerated to 45%YoY.



Source: CSO, NBP, szybko.pl, own calculations

Central bank watch



Selected fragments of the January's MPC communiqué

Since the last meeting of the Council the risk of a substantial slowdown in the world economy increased, though it is currently difficult to assess this risk or its impact on economic growth in Poland. An additional factor increasing the uncertainty as to the prospects of the global and consequently Polish economy growth is the increased volatility in the financial markets that has been observed over the recent period.

In the Council's assessment, in the near future inflation will remain above the upper limit for deviations from the inflation target, which may also, to a large extent, be the result of the expected increased growth of regulated prices.

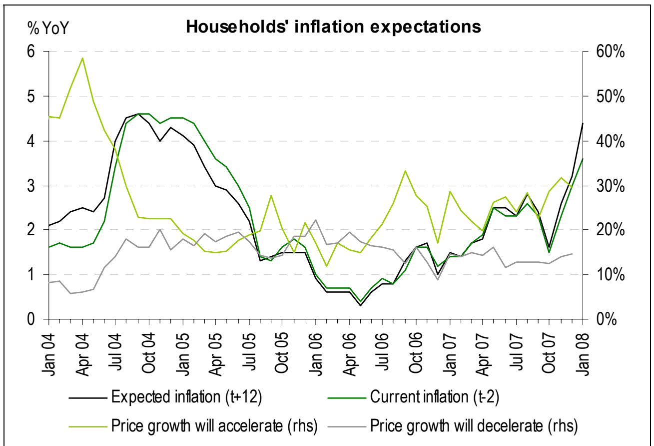
The information on labour market developments in December 2007 points to a decline in the strong wage growth and an improvement in unfavourable relation between wage and labour productivity growth. However, a further build-up in wage pressure, particularly in the public finance sector and, consequently, inflationary pressure is quite probable. (...) Moreover, in line with the 2008 Budget Act passed by the Parliament, a procyclical impact of fiscal policy on the economy can be expected this year

Fragments of minutes of MPC meeting in December

Some discussants assessed that the forecasted rise in net core inflation and the continuing high growth of food and fuel prices might result in CPI inflation remaining above the inflation target at the end of 2008. (...)Other members of the Council argued that future inflation might be lower than in the October projection due to higher level of zloty exchange rate than accounted for in the projection.

Some members of the Council indicated that the rise in current CPI inflation was likely to boost inflation expectations. They emphasised that the risk of rising inflation expectations is particularly high when inflation increase is driven by a strong growth in the prices of food, i.e. frequently purchased goods having high share in the CPI basket. (...) Other Council members, however, believed that the risk of second-round effects was moderate due to institutional changes that had taken place in the labour markets in Poland and in other countries.

The majority of the Council members argued that high level of current inflation and the ensuing risk of rising inflation expectations, as well as tight labour market, constituted a major risk to price stability.



Source: NBP, Reuters

First rate hike in the new year

- In line with expectations, the Monetary Policy Council raised main interest rates in January by 25 bp. The reference rate increased in effect to 5.25%.
- The statement released after the meeting included many changes as compared to December's version, but it is hard to say that they were a surprise, taking into account vulnerable macroeconomic environment recently.
- A new argument among factors increasing risk of inflation rise was a wage growth in the public sector.
- On the other hand, the MPC drew attention in the communiqué to increasing uncertainty concerning world economic situation and possible restraint to inflationary pressure because of slowdown in economic growth.
- Exchange rate developments will probably remain important for the Council. The MPC kept the sentence in the statement about importance of "relative stability of the zloty" (which in our view should be interpreted as "strength of the zloty") for curbing inflation. It will be particularly interesting in the context of rising interest rate disparity between Poland and other economies, in a situation of already made and predicted further Fed's rate cuts in the US and also likely rate cuts in the euro zone.
- We keep a view that main interest rates in Poland will rise by 25 bp in March and it will be probably the last move this year.
- A rate hike could be delayed or completely abandoned in case of confirmation of severe economic slowdown in Poland in next statistical data and the ECB's decision to cut interest rates in the euro zone already in Q1.

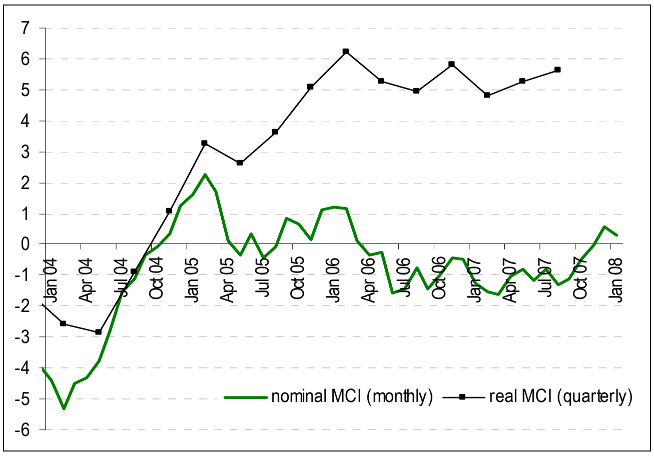
MPC voted on rate hike motion in December

- Minutes of the MPC meeting in December did not change the assessment of monetary policy perspectives and had no impact on the interest rate market.
- According to the report, a motion to raise interest rates was submitted in December, however it found no majority in the voting, even despite a majority of the MPC members agreed that a risk of rise in inflationary expectations and labour market tightening create a substantial threat for price stability.
- Nevertheless, those risk factors were not significant enough to persuade the MPC to increase a frequency of interest rate hikes, which was not a surprise for market players, as earlier comments of the MPC members suggested what is the consensus view in the Council.

Inflation expectations sharply up

- Index of households' inflationary expectations computed for the NBP increased in January to 4.4%, by 1.2 pct. point as compared to December.
- Method of index calculation implies that it is vulnerable to changes in current inflation, however this time growth in expectations was twice as strong as increase in observed CPI.
- Apparently, it reflected a rise in proportion of households that expected acceleration in price growth. This could have been strengthened by numerous publications and articles heralding substantial increase in the cost of living in the new year.
- Bank analysts' expectations are much more stable – average forecast of inflation in December 2008 (according to PAP) slightly decreased in January to 3.3% from 3.4% in the previous month.

Restrictiveness of the Monetary Policy (Council)



January slightly easier

- Although the MPC raised official interest rates by 25 bps at the January meeting, the first month of 2008 saw a decrease in restrictiveness of overall monetary conditions measured with our nominal MCI.
- The drop of the nominal MCI resulted from slight fall in average level of nominal interest rates in the interbank market and some weakening of the nominal exchange rate of the zloty against the euro, both in absolute terms. What is important, the fall in short-term interest rates in the interbank market and in EURPLN was even stronger relative to the long-term trend of the two variables.
- Calculation of the real MCI for 4Q07 is still not possible, as not all the necessary data are already available.

6.0% **Filar 1.38 (1.61)**

Wasilewska-Trenkner 1.38 (1.45)

Noga 1.38 (1.51)

Wojtyna 1.38 (0.95)

Sławiński 1.13 (0.95)

5.5% **Czekaj 1.00 (0.88)**

Owsiak 0.75 (0.91)

5.25% **Pietrewicz 0.75 (0.68)**

Nieckarz 0.75 (0.77)

Skrzypek 0.63 (N/A)

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. Average of points for all votes is the value of the index for a given MPC member.

Numbers directly by the name are values of the index for period since the beginning of Sławomir Skrzypek's term as NBP governor and numbers in parentheses are values of the index for 2004-2006.

Direction of the arrow reflects our expectations regarding direction of interest rate changes within the nearest 12 months. Values in percent indicate **our subjective** assumption as regards a preferred level of the reference rate in 12 months by a particular MPC member.

In November the MPC was unanimous

Official information about results of MPC vote at November meeting showed that the hike of 25 bp was decided unanimously. Taking into account central bankers' comments from that period, one could have expected such result of the vote. However, recently rate-setters have again become more diversified in views on monetary policy actions.

Hawks still call for monetary tightening

Despite quite significant change in situation abroad and release of many weaker than expected domestic data, representatives of the hawkish faction in the Council still stress a need for further rate hikes. Dariusz Filar said that "we face significant risk of inflation increase". At the same time he pointed out that in situation when the FinMin declares permanent fulfilment of fiscal criteria, there is a need to meet criteria regarding inflation and long-term interest rates, so the MPC should hike rates. According to Filar, "decision climate" is worsening and the last good moment for affecting future inflation, with relatively low cost, is the first quarter of this year. Filar mentioned a weakening of the global economy, but in his opinion "this is quite distant from the Polish perspective". Marian Noga reiterated his view that in order to bring inflation back to the inflation target and stabilise it around that level the reference rate should be increased to 5.75%. Halina Wasilewska-Trenkner said directly after the rate hike in January that in her opinion at least one more rate hike is needed, stressing inflation risks.

...Wojtyna and Sławiński have doubts about scale of further hikes…

Substantial doubts regarding scale of further monetary policy tightening in Poland were expressed by Andrzej Wojtyna. While he suggested that next hikes are still needed, now Wojtyna believes that the minimum scale of further tightening may be just one move by 25 bp, although he did not exclude 2 or 3 moves of the same scale. Wojtyna is afraid that turmoil in the financial markets may negatively affect domestic fixed investments and on top of the that there is a threat that widening interest rate disparity (rate cuts abroad and hikes in Poland) may cause excessive appreciation of the zloty. According to Wojtyna, it would likely take months before the bank had a clearer view as to what degree European and emerging market economies are insulated from US trends. In Andrzej Sławiński's view, in face of persisting threats to the medium-term inflation prospects, the MPC should act decisively (i.e. raise rates further), but also judiciously, so that not harm the economic growth too much.

...and Czekaj thinks next hikes may not be needed

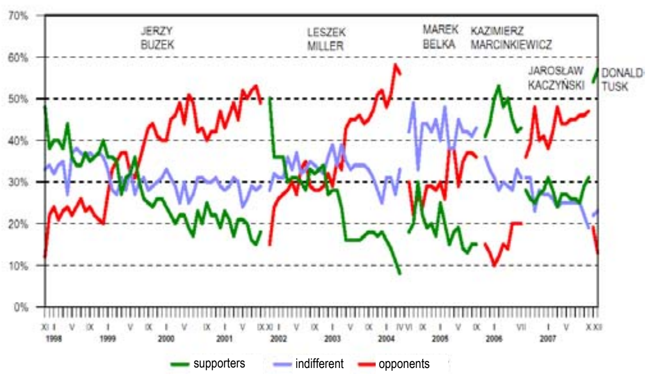
Jan Czekaj, whose vote determined outcome of a few MPC meetings in 2007, does not exclude that further rate hikes may not be needed. This is because the Fed aggressively cut rates and other central banks may also cut rates, including the ECB, which could strengthen the zloty. Moreover, Czekaj pointed out that domestic data for December were weaker than forecasted and one has to wait for the next data to assess whether we face new tendency or this was just a one-off. Asked what should happen to prevent the MPC from further hikes, Czekaj answered that "we would have to see more signs that the Polish economy is weakening, as direct effect of the downturn in the US on the domestic economy is large". In his view, the MPC has to assess to what extent rate hikes may counteract inflation rise that is driven by external factors.

Source: CSO, Eurostat, NBP, Reuters, own calculations

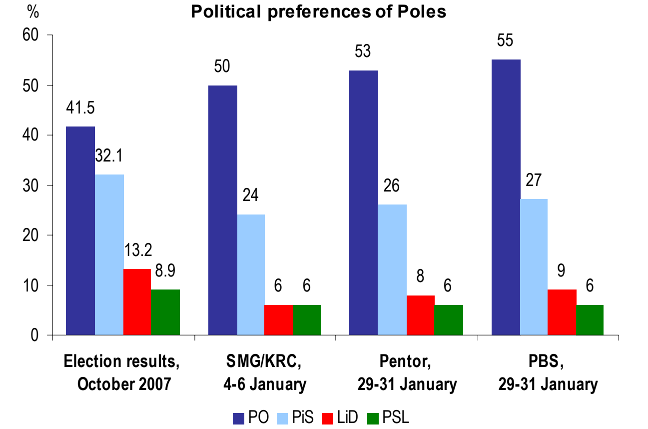
Government and politics

Fragments of Donald Tusk's exposé	What about realisation?
The first task of our government will be releasing a positive energy of Poles.	hard to gauge but... consumer sentiment slightly down
A march only in one direction (...) towards lower taxes and abandoning excessive, often unnecessary fees.	no details, little progress likely as compared to previous government
At the same time, we have to secure wage growth for workers in the public sector.	no details (to be presented on 13 February)
Curbing growth in public debt is necessary. In few years time budget must be nearly balanced.	positive declarations, no details or solutions
We will support entrepreneurship, at last we will change laws – and this is a strong pledge – that are unsupportive for entrepreneurs.	work in progress with chance for quick move forward

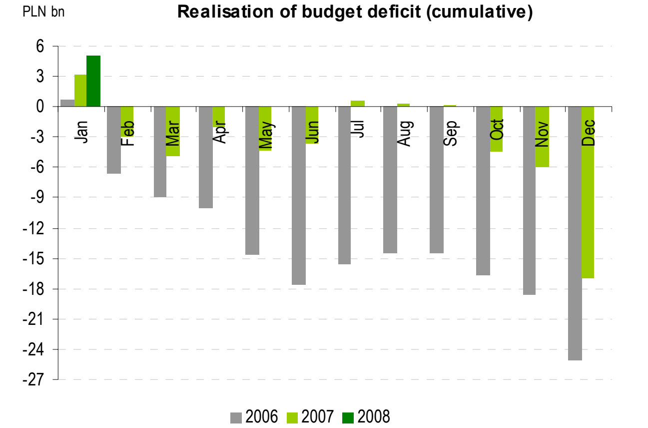
CBOS survey of support for the government headed by PM:



Political preferences of Poles



Realisation of budget deficit (cumulative)



Source: Ministry of Finance, polling institutes, own calculations

First 100 days of new government – nothing spectacular

▪ Summing up the first 100 days of the government formed by PO-PSL coalition, it is hard to point out any spectacular achievements. Hopes for speeding up economic reforms so far found no clear confirmation in government's action.

▪ Plans of fiscal deficit reduction still exist only as declarations and reduction and simplification of taxes in the next years will probably go no further than proposed and accepted by the previous government. A big question mark is how fiscal consolidation and tax cuts will be matched with a pledge to deliver a substantial wage hike in the public sector, particularly in the environment of slowing down economy.

▪ A positive issue is a good understanding of problems on the labour market and high priority attached to actions aimed at solving those problems. Increase in labour supply and its efficiency will be one of the main goals of fiscal reform package being prepared by the Ministry of Finance. However, at the moment those are still only declared changes, and there is no specific bills ready (according to deputy finance minister some draft bills should be ready in the first half of the year).

▪ The government approved the first package of measures aimed at increasing economic freedom. The Ministry of Economy and special parliament's commission is working on further changes that should be ready in the nearest months.

▪ Apparently in the key areas (reform of public finances, labour market or healthcare sector) the government has no ready solutions and is still working on relevant programmes and bills. It cannot be excluded that results of this work will prove positive, however thus far the time is passing by, the economic climate is deteriorating, and investors that used to have big hopes for swift economic changes after PO's victory in election

... but public opinion still favours PO

▪ Nevertheless, the public opinion surveys show that the support for the Civic Platform (PO) remains at elevated level after the election, far distance ahead of the remaining political parties.

▪ The Law and Justice that is second most popular party in the surveys, enjoys a support of 25% of Poles, which is half of the leader's result.

▪ A test for government's popularity may be a way (and speed) of tackling a crisis in the healthcare sector and quickly accumulating wage claims of various professions in the public sector. Fulfilling promises from the election campaign and meeting building demands of workers may be costly and hard to match with prudent fiscal policy.

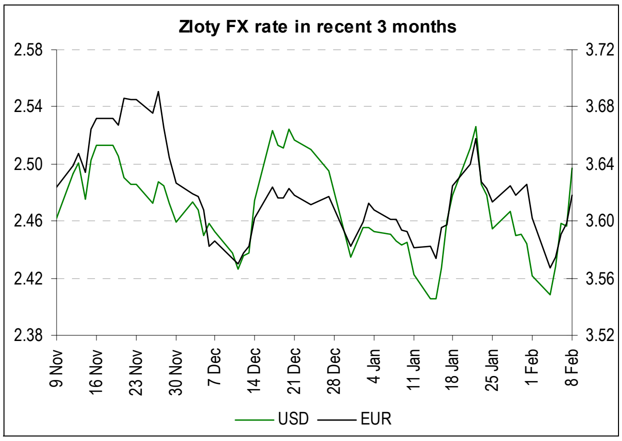
Big surplus in the budget in January

▪ According to preliminary estimates from the Ministry of Finance the state budget reached a surplus of PLN5.0-5.5bn in January. This is a very good result, much above a record-high surplus achieved in January 2007, when it reached PLN3.1bn.

▪ Although in part it could be effect of delaying some inflows from the end of 2007. one could assume that tax revenue is continuing a rapid growth, which is a very good sign for the assessment of business climate at the start of the new year.

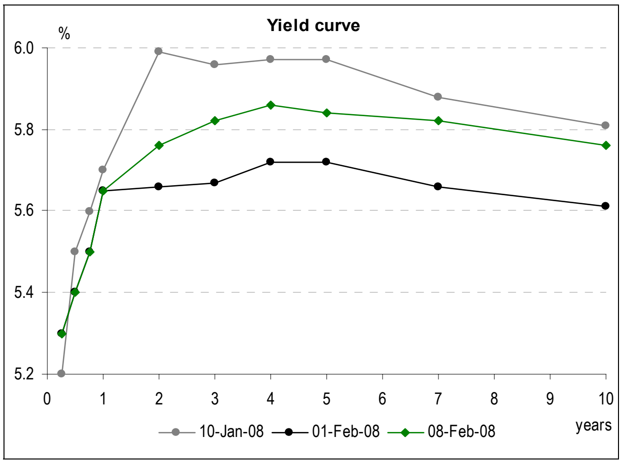
▪ According to the MinFin, the general government deficit in 2007 reached ca. 2.5% of GDP. After a rise to 2.6-2.7% of GDP in 2008, the Ministry plans a steady reduction in the fiscal gap – to 2.0-2.5% of GDP in 2009, 1.5% of GDP in 2010 and 1% of GDP in 2011. Such path of fiscal consolidation will be probably presented in the new update of Convergence programme.

Market monitor



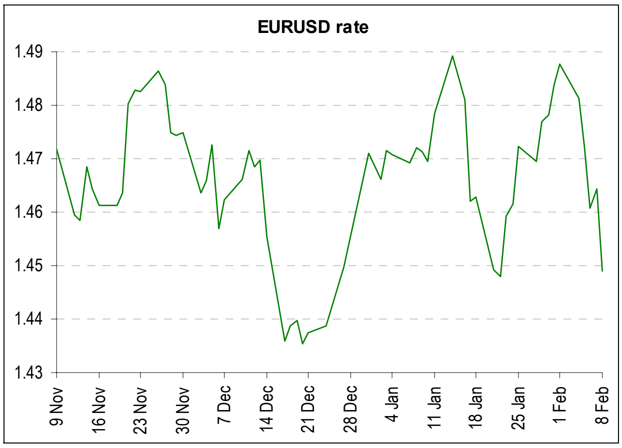
Zloty in a narrow range despite poor moods

- Zloty fluctuated in a quite narrow range in the last few weeks especially against the euro (3.56-3.63). Despite not too positive moods in the international markets the zloty weakening in moments of higher risk aversion was not smaller as compared to other emerging market currencies. The fluctuations of the USDPLN rate were larger due to large changes of the dollar against the euro.
- The zloty rate is still going to stay under influence of the investors' moods and fears over influence of possible recession in the US on the world economy. This zloty negative factor is going to be balanced among others by large interest rate disparity in the context of expected monetary policy easing by the ECB. Moreover the will still be supported by very strong fundamentals, relatively low current account deficit to GDP and further inflow of the EU funds.



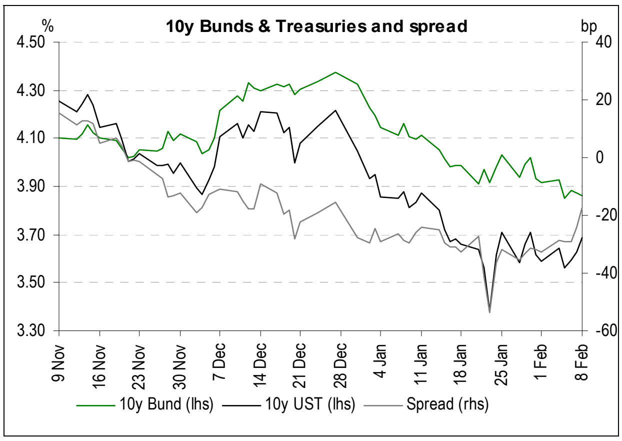
Significant yields fall

- At the start of the year there was a significant strengthening in the Polish bond market. At the end of 2007 the fixed income market was heavily sold-off, and the December data from the Polish economy appeared surprisingly weak. Moreover the tone of the MPC comments changed to less hawkish among others due to the uncertainty toward further moves of the major central banks. Falling yields in the core markets and drops in the WSE were additional arguments supporting bond prices. After significant rise of prices some investors were taking profits in last days.
- We expect that the correction after such significant strengthening may be continued. On the other hand the main data for January, i.e. CPI and wages may support the Polish debt market, similar as the expected further decline of yields in the euro zone ahead of rate cuts by ECB in Q2. This may also contribute to limiting the interest rate hikes in Poland.



Significant fluctuations of EURUSD, stronger dollar

- In the last few weeks the EURUSD rate has experienced strong fluctuations. Since the release of the previous report the dollar depreciated against the euro due to weak data from the US economy, fears over the growth expressed by the Fed members, and interest rate cuts in the US. This contributed to an increase of the EURUSD rate to over 1.49. Dollar slightly recovered after quite high ISM index. Further decline of the EURUSD rate below 1.45 in the last days was connected with fears over the business activity in the EMU and expectations of interest rate cuts also by the ECB.
- We expect the euro appreciation against the dollar in the coming weeks. However in the next months of this year the dollar should gradually recover amid expected revival of the US economy.

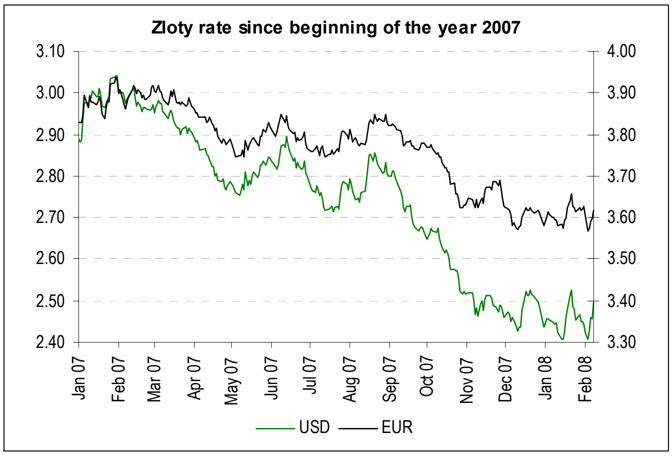


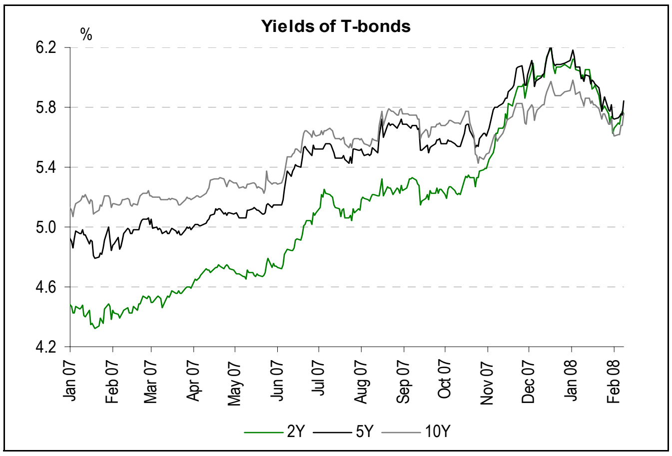
Increased interest in safe have assets

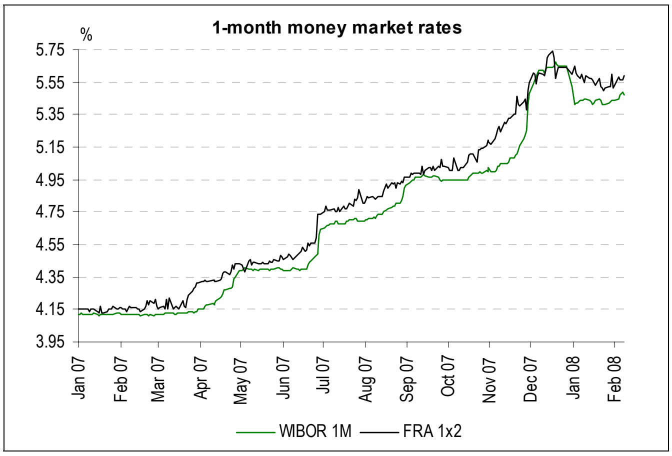
- An increase of risk aversion, which was recorded in January due to fears of recession in the US, contributed to falls in the stock markets, which increased demand for safe-haven bonds. Further interest rate cuts by Fed (in January by 1.25%) boosted the strengthening. The spread between the US Treasuries and Bunds gradually fell due to repeating hawkish comments of the ECB. However in the last days after poor PMI index for services the comments of the President J.C. Trichet at the ECB conference were less hawkish, and the spread increased afterwards. Yields of 10Y Treasuries fell since the mid-January from 3.83% to 3.67%, while Bunds from 4.09% to 3.86%.
- We expect further monetary policy easing in the US by 50 bp in March and further 25 bp in Q2. In our view the ECB will also decide to cut rates by 25 bp in Q2 and one more time in Q3.

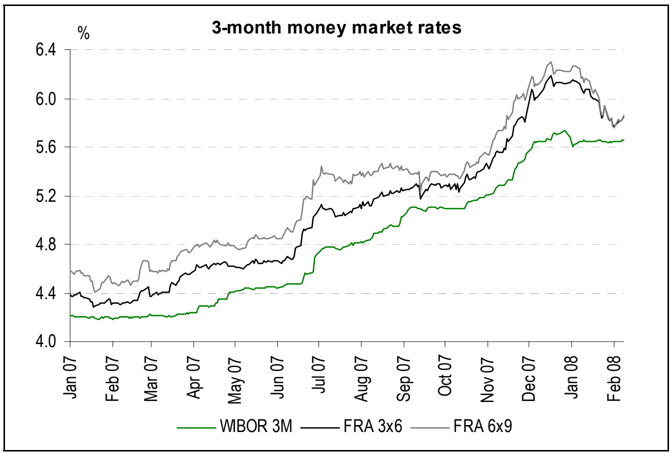
Source: Reuters, BZ WBK

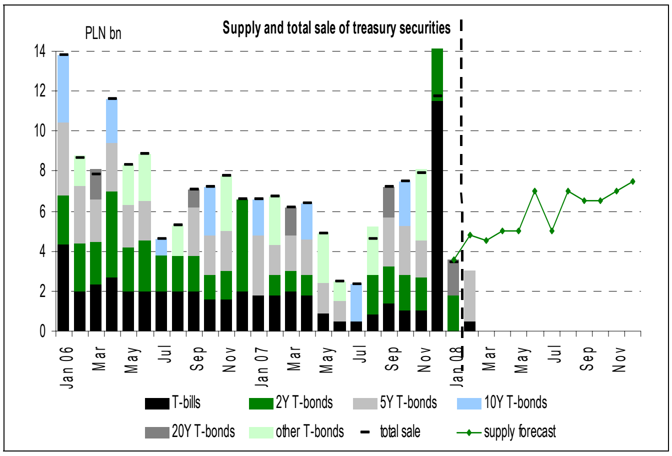
Market monitor











Treasury bill auctions (PLN m)

Date of auction	52-week	Date of auction	52-week
	OFFER / SALE		
14.01.2008	2 000 / 2 000	**11.08.2008**	-
11.02.2008	500*	**08.09.2008**	-
10.03.2008	-	**22.09.2008**	-
14.04.2008	-	**13.10.2008**	-
12.05.2008	-	**27.10.2008**	-
09.06.2008	-	**17.11.2008**	-
14.07.2008	-	**18.12.2008**	-

* estimations based on Ministry of Finance preliminary information

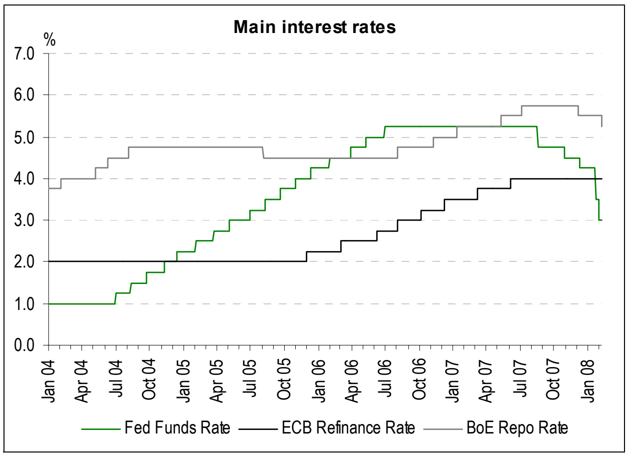
Treasury bond auctions in 2008 (PLN m)

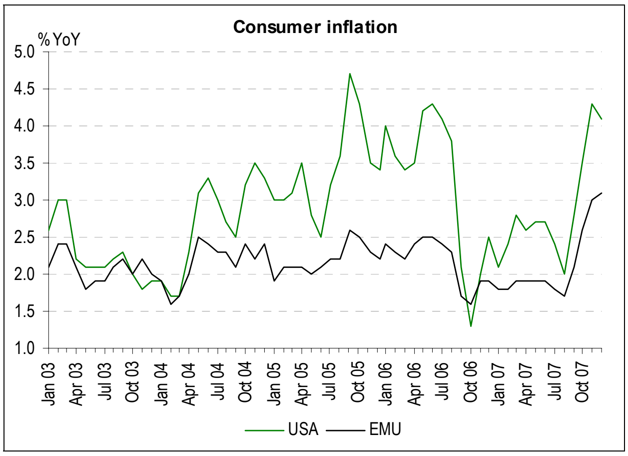
month	First auction				Second auction				Switch auction		
	date	T-bonds	offer	sale	date	T-bonds	offer	sale	date	T-bonds	sale
January	02.01	OK0710	1 800	1 655	09.01	WS0922	1 800	1 800	16.01	PS0413 / IZ0816 / WS0922	524 / 766 / 431
February	06.02	PS0413	2500	2500	13.02	DS1017	2 000	-	20.02	-	-
March	05.03	5Y	-	-	12.03	30Y	-	-	19.03	-	-
April	02.04	2Y	-	-	09.04	10Y	-	-	-	-	-
May	07.05	5Y	-	-	14.05	20Y	-	-	-	-	-
June	04.06	5Y	-	-	11.06	12Y CPI | 10Y float	-	-	-	-	-
July	02.07	2Y	-	-	09.07	10Y	-	-	-	-	-
August	06.08	2Y	-	-	13.08	12Y CPI | 10L float	-	-	-	-	-
September	03.09	5Y	-	-	10.09	20Y	-	-	-	-	-
October	01.10	5Y	-	-	08.10	10Y	-	-	-	-	-
November	05.11	5Y	-	-	12.11	12Y CPI | 10Y float	-	-	-	-	-
December	03.12	2Y	-	-	-	-	-	-	-	-	-

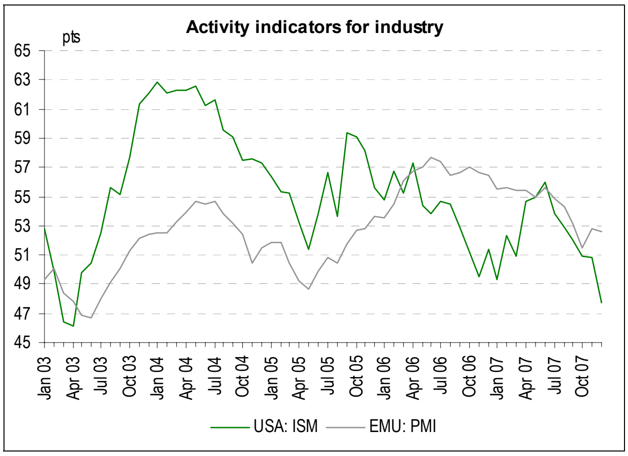
* with supplementary auction

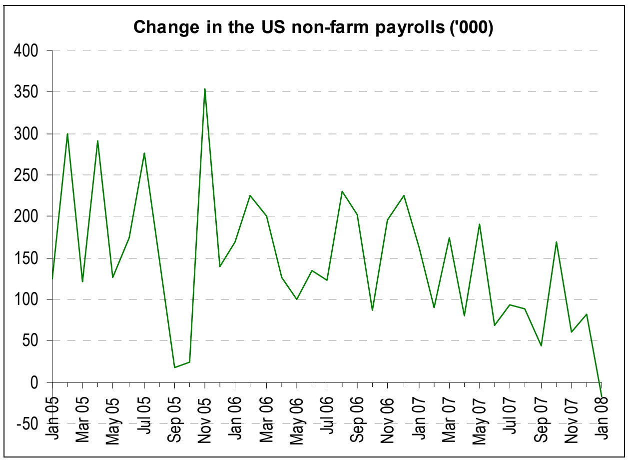
Source: Ministry of Finance, Reuters, BZ WBK

International review









Source: Reuters, ECB, Federal Reserve

Fed's intervention, expected rate cuts in the EMU

- In January amid very poor performance of the US stock market and rising fears of recession in the US the Federal Reserve decided to cut interest rates twice, firstly by 75 bp to 3.50% at an extraordinary meeting and secondly by 50 bp to 3.00% at the officially scheduled meeting. According to Fed the decisions to cut rates were aimed at supporting the economic growth. Despite this downside risks to growth remained, which suggests further monetary easing.
- In February the ECB left rates unchanged. J.C. Trichet said that there are upside risks for inflation and downside risks for growth in the euro zone. The ECB President underlined the risks for the prices stability prospects remain the most important concern for the ECB. However, on the other hand Trichet did not describe the monetary policy as accommodative. The tone of ECB President's comments was less hawkish as compared to his previous comments and strengthened expectation of interest rate cuts.

Inflation still at elevated level

- The headline CPI inflation index In the US rose in December by 0.3%, slightly above the expectations of 0.2%, while the core inflation was in line with the consensus and amounted to 0.2%. The annual growth of the CPI was at 4.1%, and the core inflation amounted to 2.4%. The US PPI fell In December by 0.1%MoM against expected growth of 0.2%, while the core producer prices index rose in line with market forecasts of 0.2%MoM. The favourite Fed's measure of inflation the core PCE index rose in December in line with expectations by 0.2%Mom and 2.2%YoY.
- According to the earlier estimates in December the HICP index rose by 3.1%YoY. On the other hand in January according to flash estimates of the Eurostat it exceeded expectations, which assumed no change as compared to December and rose to 3.2%YoY. On the other hand the PPI index increased in December by 0.1%MoM and 4.3%YoY.

Poor activity indices, soft Q4 US growth

- The ISM index for the manufacturing sector in the US significantly increased in January to 50.7 pts from 48.4 pts, clearly exceeding expectations (47.8 pts). Employment index declined and stayed below 50 pts, similar as the new orders index. The output index rose above 50 pts and prices paid index reached 76 pts level against 68 pts in December. Data positively influenced the market moods. The non-manufacturing index had an opposite effect, as it sharply declined to 41.9 pts (the lowest level since October 2001) from 54.4 pts in December, which means a clear decline in activity.
- The manufacturing PMI index for the euro zone rose in January to 52.8 pts from 52.6 pts and was close to expectations. However, the services sector index surprisingly declined to 50.6 pts from 53.1 pts in December, clearly below market expectations of 52.0. Weaker data from the euro zone significantly increased fears over economic prospects and the influence of the US economic slowdown. EMU figures may become much more important for the EURUSD rate and result in larger changes in the euro zone bond market.
- The US Q4 GDP growth rate also negatively surprised as it amounted only to 0.6% against 4.9% in Q3, amid slowdown of private consumption to 2.0% from 2.8%, further fall of residential investment and significant fall of inventories. The forecasts pointed to a slowdown of the economic growth only to 1.2%YoY. Core PCE index, rose by 2.7% and was slightly above forecasts.

The downtrend in the labour market continued

- Data from the US labour market showed a decline of non-farm payrolls In January by 17k, while the market expected their increase by 80k. Despite the December figure was revised from 18k to 82k, the November data was also revised to 60k from 115k. The unemployment rate declined in January to 4.9% from 5.0% in December. Despite revisions this is still a falling trend.

Economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
11 February ***PL: Auction of Treasury Bills*** JP: Market holiday	**12** ***PL: Balance of payments (Dec)*** DE: ZEW index (Feb)	**13** ***PL: Auction of 10Y bonds*** EZ: Industrial production (Dec) US: Retail sales (Jan)	**14** ***PL: Money supply (Jan)*** EZ: Preliminary GDP (Q4) US: Trade balance (Dec)	**15** ***PL: Wages and employment (Jan)*** ***PL: CPI (Jan)*** US: Import prices (Jan) US: NY Fed index (Feb) US: Capital floks (Dec) US: Capacity use (Jan) US: Industrial output (Jan) US: Preliminary Michigan (Feb) JP: Report after interest rate decision
18 ***PL: Money supply (Dec)*** US: Market holiday	**19** ***PL: Industrial output (Jan)*** ***PL: PPI (Jan)***	**20** ***PL: Switch auction*** US: CPI (Jan) US: Mouse starts (Jan) US: FOMC minutes	**21** ***PL: Minutes RPP (Jan)*** US: New jobless claims US: Philadelphia Fed index (Feb)	**22** ***PL: Business climate (Jan)*** EZ: Flash manufacturing PMI (Feb) EZ: Flash services PMI (Feb)
25 ***PL: Retail sales (Jan)*** ***PL: Unemployment (Jan)*** US: Home sales (Jan)	**26** ***PL: MPC meeting*** DE: Ifo index (Feb) US: PPI (Jan) US: Case/Schiller home prices index (Dec) US: Consumer confidence (Feb)	**27** ***PL: MPC meeting – decision*** EZ: M3 money supply (I) US: Durable goods orders (Jan) US: New home sales (Jan)	**28** US: Preliminary GDP (Q4) US: Core PCE (Q4) US: GDP deflator (Q4) US: New jobless claims	**29** ***PL: GDP (Q4)*** EZ: Economic sentiment (Feb) EZ: Final HICP (Jan) US: Core PCE (Jan) US: Chicago PMI (Feb) US: Final Michigan (Feb)
3 March EZ: PMI – manufacturing PMI (Feb) EZ: Flash HICP (Jan) US: Manufacturing ISM (Feb)	**4** EZ: GDP (Q4)	**5** ***PL: Auction of 5Y bonds*** EZ: Services PMI (Feb) EZ: Retail sales (Jan) US: ADP report (Feb) US: Unit labour costs, labour productivity (Q4) US: Factory orders (Jan) US: Services ISM (Feb)	**6** GB: BoE meeting – decision EZ: ECB meeting - decision US: New jobless claims US: Pending home sales (Jan)	**7** JP: Report after interest rate decision US: Non-farm payrolls (Feb) US: Unemployment (Feb)
10 ***PL: Auction of Treasury Bills*** US: Wholesale inventories (Jan)	**11** DE: ZEW index (Mar) US: Trade balance (Jan)	**12** ***PL: Auction of 30Y bonds*** EZ: Industrial production (Jan)	**13** ***PL: CPI (Jan & Feb)*** ***PL: Balance of payments (Dec)*** US: Import prices (Feb) US: Retail sales (Feb)	**14** ***PL: Money supply (Feb)*** EZ: Final HICP (Feb) US: CPI (Feb) US: Preliminary Michigan (Mar)

Source: CSO, NBP, Finance Ministry, Reuters

MPC meetings and data release calendar for 2008

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

* quarterly data, [a] preliminary data, January, [b] January and February, [c] November 2007

Source: CSO, NBP

Economic data and forecasts

Monthly economic indicators

		Jan 07	Feb 07	Mar 07	Apr 07	May 07	Jun 07	Jul 07	Aug 07	Sep 07	Oct 07	Nov 07	Dec 07	Jan 08	Feb 08
Industrial production	%YoY	15.4	13.0	11.3	12.6	8.1	5.6	10.4	8.9	5.4	10.8	8.5	6.2	7.1	5.8
Retail sales [c]	%YoY	16.5	17.5	19.2	15.1	14.8	16.2	17.1	17.4	14.2	19.4	19.2	12.4	14.3	14.8
Unemployment rate	%	15.1	14.8	14.3	13.6	12.9	12.3	12.1	11.9	11.6	11.3	11.2	11.4	11.7	11.5
Gross wages [b c]	%YoY	7.8	6.4	9.1	8.4	8.9	9.3	9.3	10.5	9.5	11.0	12.0	7.2	9.6	9.5
Employment [b]	%YoY	3.8	4.3	4.5	4.4	4.4	4.6	4.7	4.8	4.7	5.0	5.0	4.9	4.9	4.8
Export (€) [d]	%YoY	15.4	13.8	15.0	17.1	13.1	11.5	19.1	16.0	9.0	15.8	12.3	14.2	12.3	10.5
Import (€) [d]	%YoY	19.6	12.2	18.5	24.9	12.7	18.6	22.6	13.0	14.4	17.2	14.8	15.6	13.1	16.0
Trade balance [d]	EURm	-542	-141	-757	-836	-762	-882	-1090	-362	-917	-604	-793	-1251	-672	-601
Current account balance [d]	EURm	-881	-545	-681	-798	-1274	-1488	-1127	-513	-620	-1289	-351	-1301	-1022	-901
Current account balance [d]	% GDP	-3.4	-3.2	-3.2	-3.2	-3.3	-3.6	-3.7	-3.6	-3.8	-3.8	-3.6	-3.5	-3.7	-3.7
Budget deficit (cumulative)	PLNbn	3.1	-3.0	-4.8	-2.1	-4.3	-3.7	0.6	0.3	0.2	-4.4	-6.0	-16.9	5.0	-2.0
Budget deficit (cumulative) [e]	% of FY plan	-18.3	17.9	28.6	12.2	25.2	21.7	-3.6	-1.6	-1.2	26.2	35.5	100.0	-18.5	7.4
CPI	%YoY	1.6	1.9	2.5	2.3	2.3	2.6	2.3	1.5	2.3	3.0	3.6	4.0	4.0	4.3
PPI	%YoY	3.1	3.5	3.3	2.2	2.1	1.7	1.5	1.8	1.8	2.0	2.5	2.5	2.2	2.5
Broad money (M3)	%YoY	19.3	18.0	18.0	17.8	16.0	14.7	15.6	16.1	14.4	13.8	13.6	13.1	13.3	12.8
Deposits	%YoY	18.5	18.3	17.7	18.2	16.4	15.2	15.9	16.3	15.4	15.2	15.1	14.3	14.4	13.4
Loans	%YoY	25.0	26.5	26.8	28.4	28.6	29.2	31.4	31.1	31.0	30.6	30.1	29.9	29.2	28.7
USD/PLN	PLN	2.98	2.98	2.94	2.83	2.80	2.84	2.75	2.80	2.73	2.61	2.49	2.47	2.46	2.45
EUR/PLN	PLN	3.88	3.90	3.89	3.82	3.78	3.81	3.77	3.81	3.79	3.71	3.66	3.60	3.61	3.60
Reference rate [a]	%	4.00	4.00	4.00	4.25	4.25	4.50	4.50	4.75	4.75	4.75	5.00	5.00	5.25	5.25
Lombard rate [a]	%	5.50	5.50	5.50	5.75	5.75	6.00	6.00	6.25	6.25	6.25	6.50	6.50	6.75	6.75
WIBOR 3M	%	4.20	4.20	4.22	4.32	4.44	4.52	4.78	4.80	5.09	5.13	5.36	5.67	5.64	5.65
Yield on 52-week T-bills	%	4.14	4.07	4.23	4.36	4.43	4.42	4.70	4.80	5.01	5.04	5.30	5.78	5.75	5.65
Yield on 2-year T-bonds	%	4.41	4.46	4.55	4.71	4.70	4.93	5.14	5.23	5.25	5.30	5.77	6.06	5.92	5.77
Yield on 5-year T-bonds	%	4.90	4.97	4.98	5.07	5.11	5.40	5.50	5.61	5.60	5.59	5.90	6.07	5.94	5.80
Yield on 10-year T-bonds	%	5.16	5.18	5.18	5.27	5.28	5.52	5.60	5.68	5.69	5.64	5.70	5.85	5.81	5.75

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] 2006 - % of Dec, 2007 - % of plan

Quarterly and annual economic indicators

		2005	2006	2007	2008	1Q07	2Q07	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08
GDP	PLNbn	983.3	1 060.2	1 163.6	1 272.3	266.7	280.2	286.8	329.9	291.7	306.5	314.7	359.4
GDP	%YoY	3.6	6.2	6.5	5.5	7.2	6.4	6.4	5.9	5.0	5.4	5.8	5.8
Domestic demand	%YoY	2.4	7.3	7.3	6.9	7.7	8.2	7.4	6.3	5.9	6.9	7.3	7.4
Private consumption	%YoY	2.0	4.9	5.2	5.4	6.9	5.1	5.2	3.8	5.0	5.5	6.0	5.0
Fixed investments	%YoY	6.5	15.6	20.4	14.0	26.2	20.8	19.8	18.5	12.0	15.0	14.5	14.0
Industrial production	%YoY	4.0	12.5	9.7	7.1	13.0	8.5	8.1	9.6	4.9	7.5	8.1	8.0
Retail sales (real terms)	%YoY	1.5	11.9	14.0	15.4	17.4	14.1	12.8	12.2	10.4	14.8	16.7	19.8
Unemployment rate [a]	%	17.6	14.8	11.4	8.6	14.3	12.3	11.6	11.4	10.9	8.9	8.3	8.6
Gross wages (real terms) [c]	%YoY	1.2	4.2	6.7	5.2	5.9	6.5	8.1	6.5	4.8	5.1	5.2	5.6
Employment [c]	%YoY	1.9	3.2	4.6	4.3	4.2	4.5	4.8	5.0	4.8	4.5	4.3	3.7
Export (€) [b]	%YoY	17.8	20.4	14.2	12.2	14.7	13.8	14.4	14.1	9.5	13.0	13.0	13.0
Import (€) [b]	%YoY	13.4	24.0	16.9	16.1	16.8	18.4	16.6	15.8	11.7	17.0	17.0	18.0
Trade balance [b]	EURm	-2 242	-5 536	-8 935	-14 528	-1 440	-2 481	-2 366	-2 648	-2 171	-3 939	-3 834	-4 584
Current account balance [b]	EURm	-3 866	-8 787	-10 864	-16 543	-2 104	-3 559	-2 260	-2 941	-2 921	-5 017	-3 728	-4 877
Current account balance [b]	% GDP	-1.6	-3.2	-3.5	-4.7	-3.2	-3.6	-3.8	-3.5	-3.6	-4.0	-4.3	-4.7
Budget deficit (cumulative) [a]	PLNbn	-28.6	-25.1	-16.9	-28.0	-4.8	-3.7	0.2	-16.9	-	-	-	-28.0
Budget deficit (cumulative) [a]	% GDP	-2.9	-2.4	-1.5	-2.2	-	-	-	-	-	-	-	-
CPI	%YoY	2.1	1.0	2.5	3.7	2.0	2.4	2.0	3.5	4.1	3.8	3.8	3.0
CPI [a]	%YoY	0.7	1.4	4.0	2.8	2.5	2.6	2.3	4.0	4.1	3.6	3.6	2.8
PPI	%YoY	0.7	2.5	2.3	1.8	3.3	2.0	1.7	2.3	2.3	1.7	1.2	2.1
Broad money (M3) [a]	%YoY	13.1	16.0	13.1	11.5	18.0	14.7	14.4	13.1	13.1	12.8	12.1	11.5
Deposits [a]	%YoY	12.6	15.2	14.3	10.4	17.7	15.2	15.4	14.3	13.1	12.9	12.2	10.4
Loans [a]	%YoY	13.3	23.4	29.9	22.8	26.8	29.2	31.0	29.9	28.0	26.0	23.8	22.8
USD/PLN	PLN	3.23	3.10	2.77	2.49	2.97	2.82	2.76	2.52	2.44	2.47	2.53	2.53
EUR/PLN	PLN	4.02	3.90	3.78	3.63	3.89	3.80	3.79	3.65	3.60	3.64	3.67	3.63
Reference rate [a]	%	4.50	4.00	5.00	5.50	4.00	4.50	4.75	5.00	5.50	5.50	5.50	5.50
Lombard rate [a]	%	6.00	5.50	6.50	7.00	5.50	6.00	6.25	6.50	7.00	7.00	7.00	7.00
WIBOR 3M	%	5.29	4.21	4.73	5.69	4.20	4.42	4.89	5.39	5.66	5.70	5.70	5.70
Yield on 52-week T-bills	%	4.92	4.18	4.69	5.60	4.14	4.40	4.84	5.37	5.70	5.65	5.55	5.50
Yield on 2-year T-bonds	%	5.04	4.57	5.21	5.82	4.47	4.78	5.21	5.71	5.86	5.90	5.80	5.70
Yield on 5-year T-bonds	%	5.25	5.03	5.49	5.82	4.95	5.19	5.57	5.85	5.88	5.90	5.80	5.70
Yield on 10-year T-bonds	%	5.24	5.22	5.54	5.73	5.17	5.36	5.66	5.73	5.79	5.80	5.70	5.65

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

This analysis is based on information available until 08.02.2007 has been prepared by:

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