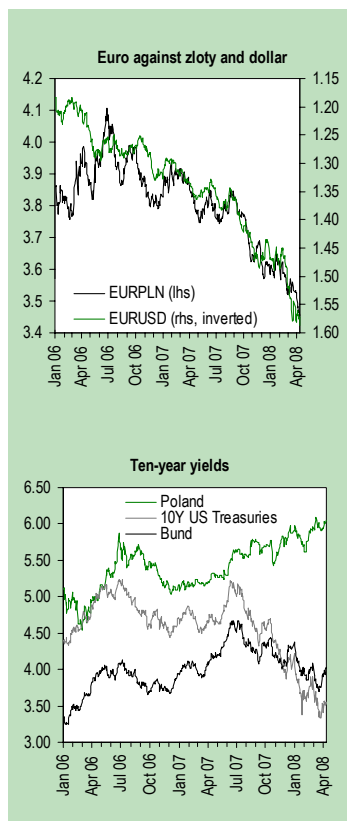


# MACROscope

## Polish Economy and Financial Markets

April 2008



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## Time for a break

▪ **March saw interest rate hike by another 25bps, which was third hike this year and seventh over the last 12 months.** A question should be posed whether the Council decides to take a break before increasing interest rates again. One will find no such suggestions in the official statement and the Council does not explicitly specify the moment when the next interest rates hike is to be delivered. The only exceptions are interviews with some of the MPC members who can be perceived as strong supporters of subsequent hikes anyway. In our opinion subsequent hike may take place as soon as in April but only if the relevant economic data, especially the ones on wage pressure, are below expectations again. Our projections indicate a slowdown both in terms of the wage growth and other economic indicators. In addition, the zloty is under the appreciation pressure and inflation may decrease a bit. This is why we are of the opinion that there is a chance that there will be a 1-2 month break before the subsequent hike.

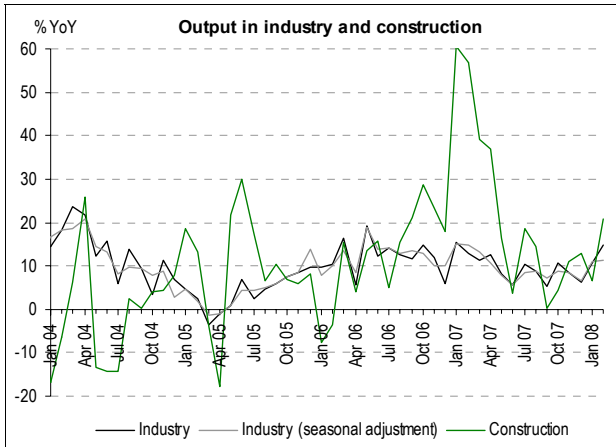
▪ **After the evident appreciation of the domestic currency in the recent weeks, we expect the zloty exchange rate correction to happen soon and the above mentioned break before subsequent hikes may be conducive to this scenario.** The break in the appreciation trend that accelerated over the recent weeks would be a relief for exporters who would surely use this moment to hedge future transactions as further zloty appreciation can be expected in the longer run. As early as in March, zloty showed strong resistance against the sustainable concerns of investors about the condition of the US economy and negative information about problems of financial institutions. Although as at the end of March the EURPLN exchange rate was 3.52, it dropped by 10 groszy over the following 10 days to reach the lowest level in nearly 8 years. Zloty appreciation against the dollar was even stronger and the rise in EURUSD exchange rate was conducive to this.

▪ **Similarly as the information for the first month of the year, the February data on output, sales and the labour market came as a positive surprise. It seems, however, that there is a time for a break.** We expect to see a slowdown for the majority of economic indicators in March although the good performance in the first two months prompts us to revisit the GDP growth forecast for Q1. Nonetheless, we still expect the GDP growth to slow down in the second half of 2008 to reach the level below 5% as a result of lower growth in fixed investments (as a result of interest rate hikes, global slowdown, tightened lending conditions) and lower exports (following the likely slowdown for our key trading partners, significant zloty appreciation, and cost-related problems of Polish enterprises). Consumption will remain the key growth driver although given the appreciation of the Polish currency on the scale observed in the recent weeks, consumption may focus on the imported goods. Accordingly, the current account deficit would grow substantially.

Financial market on 31 March 2008:					
NBP deposit rate	4.25	WIBOR 3M	6.15	USDPLN	2.2305
NBP reference rate	5.75	Yield on 2-year T-bonds	6.13	EURPLN	3.5258
NBP lombard rate	7.25	Yield on 5-year T-bonds	6.12	EURUSD	1.5807

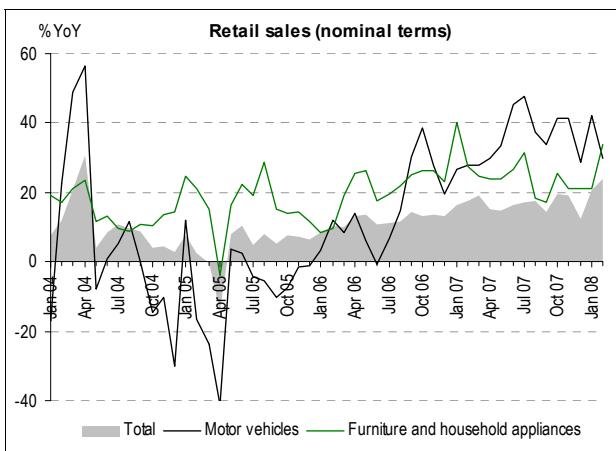
This report is based on information available until 10.04.2008

# Economic update



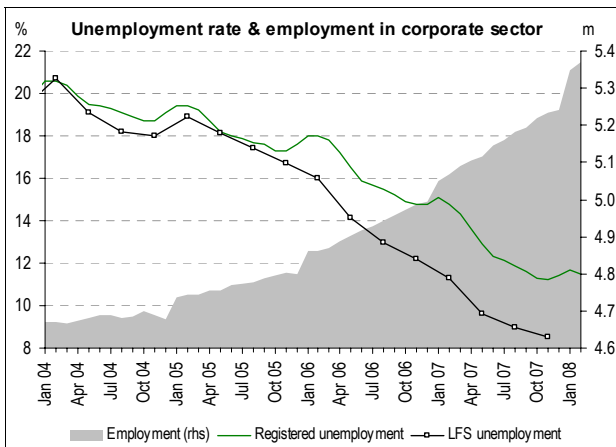
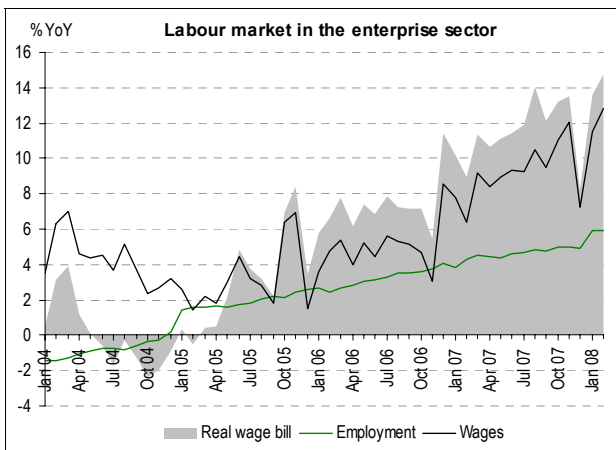
## Strong economic activity indicators

- February saw acceleration in output growth both industry and construction (to 14.9%YoY and 20.7%YoY, respectively).
- Significant acceleration in industrial output growth was visible in majority of sections, on the highest scale in manufacturing, including the branches with large share of exports.
- Strong rise in construction output, after a surge in February 2007, was an effect of favourable weather conditions, even better than a year ago. In March the effect of weather conditions on construction output growth may not be as favourable.
- Nominal growth in retail sales was 23.8%YoY in February. It was the strongest growth in 8 years, except for the one-off spike in April 2004 before the EU accession. The real growth in retail sales was 19.2%YoY against 16.1% in January.
- Similar as in previous months, a very strong growth of sales was recorded in almost all components. The strongest growth was recorded in sales of furniture, radio, TV, and household appliances (34%YoY), clothing and footwear (33%YoY) and motor vehicles (29.8%YoY). Such structure of retail sales growth is consistent with high optimism of consumers. It seems that the fast private consumption growth may be maintained until the end of this year being an important driver of GDP growth.
- Economic activity indicators for the first two months of the year bode well for GDP growth in Q1. If there is no significant slowdown in output growth in March and retail sales growth remains at two-digit level (which seems very likely given situation in the labour market), the slowdown of GDP growth at the beginning of this year may be only slight. Therefore, we revised up our forecast of GDP growth in Q1 to 5.6% from 5.3%, with stronger rise in private consumption. Forecasts for the remainder of the year remain unchanged.



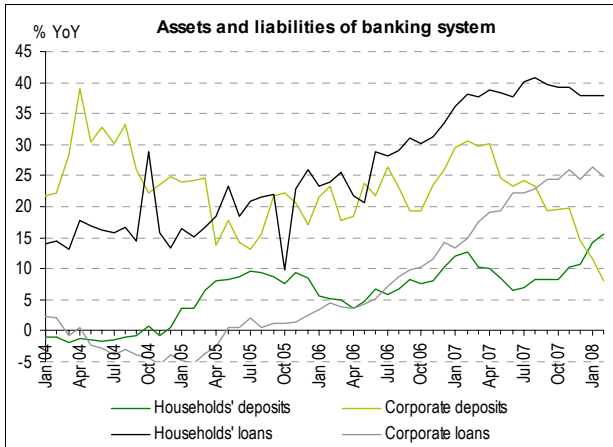
## Better than expected labour market statistics

- Strong economic expansion at the beginning of this year has been reflected in the labour market. Statistics for February proved much better than forecasts.
- Instead of expected slowdown in annual wage growth to 11% from 11.5% in January, there was an acceleration to nearly 13%.
- Detailed data on wage growth in the enterprise sector in February showed that acceleration in wage growth was the effect of wage increases in the industry sector, while the construction and trade sectors showed a moderate deceleration. The manufacturing sector saw wage growth by 12.7%YoY against 12.8%YoY in the enterprise sector as a whole.
- Employment growth in the enterprise sector remained at record high level of 5.9%YoY against expectations of a slight slowdown to 5.8%.
- Wage bill in enterprises in February increased by 19.6%YoY in nominal terms and by 14.7%YoY in real terms, which was the record high growth rate in history. However, one should remember that wage bill growth this year is not fully comparable to the growth rate of the variable in the previous years due to a change of enterprises sample (the population of companies hiring more than 9 people) surveyed by the CSO.
- Nevertheless, labour market data for January and February confirm that private consumption growth in Q1 returned to ca. 5% after a temporary slowdown to 3.8% in Q4 last year.
- The registered unemployment rate fell to 11.5% in February from 11.8% in the previous month. This year, similarly as in 2007, the fall in the registered unemployment rate already in February, following seasonal increase in December-January, was brought about by the effect of good weather conditions.



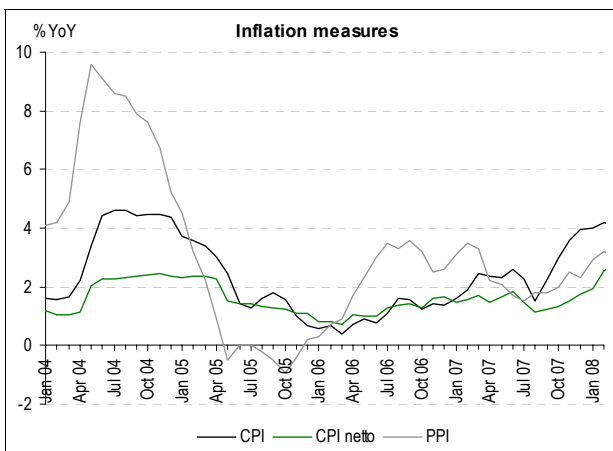
Source: CSO, own calculations

# Economic update



## Weaker monetary expansion

- Monetary statistics for February confirmed recently observed tendencies.
- First, February saw another acceleration in households deposits growth (among others due to net outflow of funds from mutual funds), which translated into faster rise in total deposits, despite continued slowdown in corporate deposits growth.
- Second, pace of credit expansion slowed down again. This was an effect of a slight deceleration in households borrowing growth (continuation of the tendency seen since mid-2007) and weaker growth in corporate borrowing. In our opinion, the remainder of the year should see further deceleration in credit growth due to increase in interest rates, weaker economic expansion and tighter credit policy.

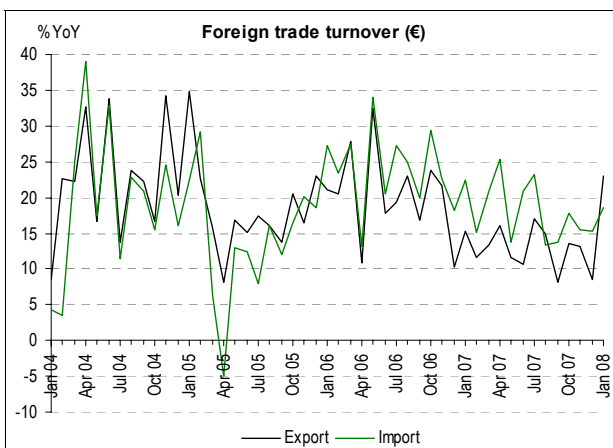


## Surprising inflation figures

- In February, the headline inflation rate increased to 4.2% from 4.0% in the previous month. Figure for January was substantially revised down from earlier reported 4.3% while the figure for February was much lower than market consensus of 4.6%.
- It should be noticed that the main reason for lowering of inflation path in the two first months of the year (but also for the remainder of the year) was a change in weights system (see table). In particular, weights of food and housing decreased, while these two factors have been responsible for inflation growth in recent months. The main factors responsible for inflation rise in February were other components of CPI basket, chiefly prices of services. As a result, net inflation increased to 2.6%YoY in February from 1.9% in January, stronger than predicted. Thus, while CPI inflation path for the entire year will be more optimistic than it seemed last month, a path of net inflation is less favourable due to rise in controlled prices.
- After publication of inflation data for January and February, it seems unlikely that pessimistic forecasts indicating that CPI inflation may top the level of 5% could materialise this year. In our opinion, at the end of the year CPI inflation will probably be lower than earlier predicted. On the other hand, one should stress that breakdown of CPI growth will be less favourable from the central bank's point of view as the net inflation is likely to exceed 3% in the course of the year.
- PPI inflation reached 3.2%YoY in February. Manufacturing prices rose by 0.4%MoM (the highest growth rate was recorded in the industry sectors processing commodities, metals and chemical goods), and 2.3%YoY. Overall, data showed the rising prices of commodities and energy remain the main reason for PPI growth, while the secondary effects of those hikes in other sectors in the industry have been limited so far.

## Weights of main CPI components

CPI components	2007	2008
Food and non-alcoholic beverages	26.2	25.7
Alcoholic beverages and tobacco	5.7	5.7
Clothing and footwear	5.4	5.6
Housing and energy	20.4	19.0
Furnishings, household equipment and maintenance	4.9	5.3
Health	5.1	5.1
Transport	8.4	8.9
Communication	5.4	5.2
Recreation and culture	7	7.3
Education	1.4	1.3
Restaurants and hotels	4.9	5.5
Other goods and services	5.2	5.4

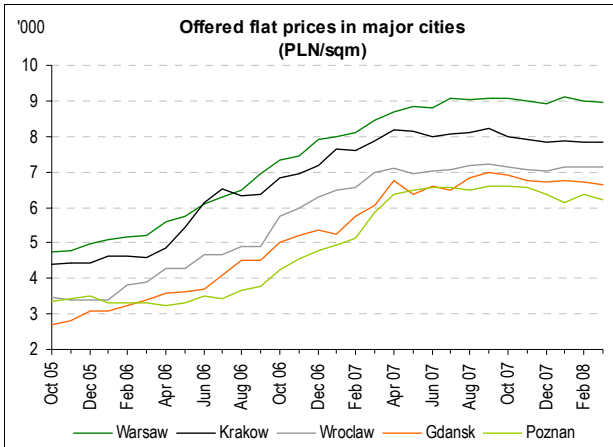


## Still positive picture of external economic relations

- C/A deficit in January was €1.04bn. The trade gap was a mere €544m thanks to a strong exports growth (22.9%YoY - the highest growth rate in 16 months) and weaker than forecasted imports rise (21.5%, similarly as in December).
- Data showed that despite strong zloty the domestic producers are still coping quite well in the international markets. However, appreciation of the zloty, weakening of economic activity abroad will negatively affect exports in the remainder of the year.
- The cumulated 12-month C/A gap rose after January to 3.9% of GDP from 3.7% after December. The relation may gradually rise, though it is still at safe level, especially that there is a large inflow of foreign direct investments (€1.1bn in January). The cumulated inflow of the FDIs for the last 12 months exceeded the cumulated current account deficit by almost 20%.

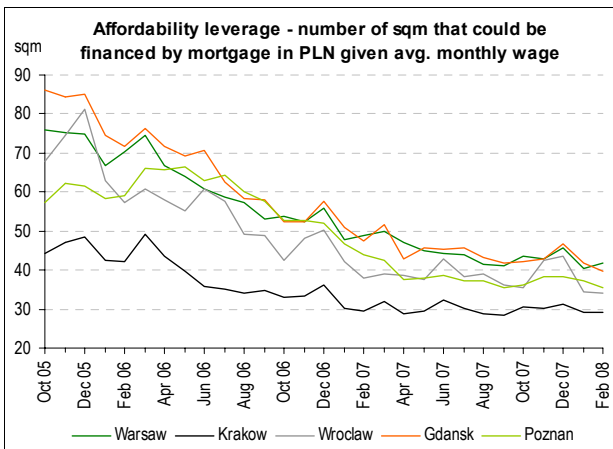
Source: CSO, NBP, own calculations

# Housing market update



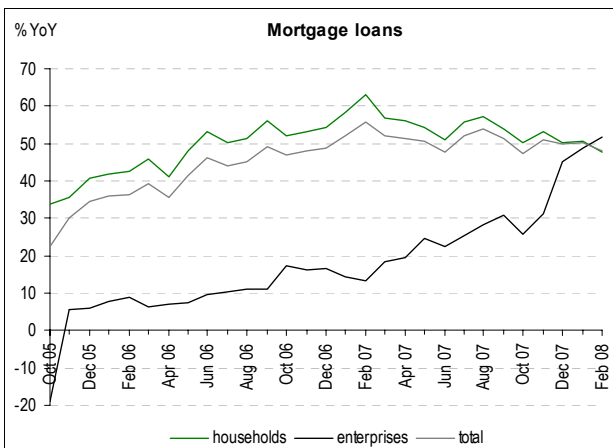
## House prices stagnating, land prices up

- There were little changes in the first months of the year as regards general price trends on the housing market.
- Since Q3 2007, average prices of flats in the Poland's biggest cities has stabilised, and in some cases even declined a little. According to the report by szybko.pl and Expander, average price for 1 sqm of flat in Warsaw in March was 5.5% higher than one year before, in Wrocław it increased 2.3% in the last 12 months, in Poznań 5.9%, while in Kraków prices fell 0.4%YoY.
- Home brokers are signalling growing diversity of prices, depending on the location and quality segment. Prices of the low-end apartments seem to be more susceptible to fall.
- There was a continuation of growth of land prices in the Poland's biggest cities in the first quarter.



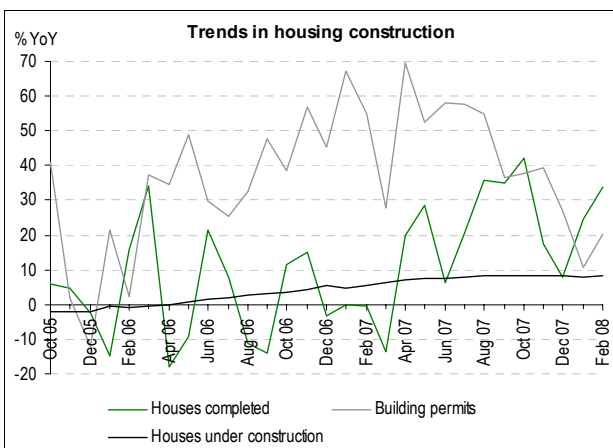
## House affordability rising, but loan costs getting higher

- Strong rise in wages and employment amid simultaneous stabilisation of house prices resulted in a gradual rise in house affordability index in recent months. However, those changes are much slower than earlier affordability decline caused by rapid price growth.
- Nevertheless, due to rise in domestic interest rates, affordability of houses financed by zloty-denominated loans is practically stagnant. In February, loan-leveraged house affordability was approx. the same as six months before, and several percent lower than one year ago. The situation was better in the case of houses financed by loans denominated in Swiss francs, where an increase in interest rate was much smaller.



## ... but mortgage loans keep growing fast

- In February, annual growth of mortgage loans for households declined to 47.9%YoY, the lowest level in almost two years. However, this is still a solid increase, and lower rate of growth results largely from very high statistical base. A sum of loans granted in January-February this year was higher by PLN0.9bn than in corresponding period of 2007.
- After a clear rise in interest in foreign currency loans in January, in February a growth in zloty-denominated loans was again higher. However, in medium run clients' demand will be gradually shifting to loans in CHF due to much lower scale of interest rate increase.
- Housing loans for companies keep accelerating. In February their growth reached a record-high 52%YoY.

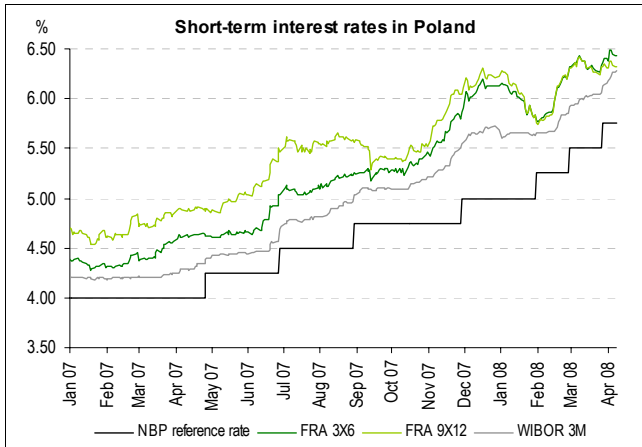


## Growing number of new houses entering the market

- After a clear deceleration in house completions growth at the end of last year, there was a revival in supply in January and February. The number of houses completed in February was 27.5% higher than one year before, while the number of new house starts has risen 47.6%YoY.
- In the last 12 months, a total sum of 139,000 was completed, construction of 190,000 houses has been started, and 252,000 new building permits have been granted.
- In the next several quarters, a growing house supply will support further price stagnation amid limited demand. However in the medium run, a potential demand is still much higher than a supply due to high structural deficit of housing units and a constantly growing number of households in Poland.

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

## Central bank watch



### Fragments of statement after MPC meeting in March

Increased year-on-year inflation was largely sustained due to the still strong annual growth of food and fuel prices. The Council maintains its assessment that in the near future inflation will remain above the upper limit for deviations from the inflation target, which will be, to a large extent, the result of a considerable rise of regulated prices. In the Council's assessment the latest macroeconomic data signal that in the first half of 2008 economic growth will most probably continue to exceed the growth of potential GDP.

It is quite probable that the wage pressure and, consequently, inflationary pressure will persist. Increased inflation in the months to come will, to a large extent, result from increased growth of regulated prices and may also be a result of the food and fuel price growth observed in the world economy and affecting the Polish market. This creates a risk of inflation expectations staying high and, consequently, feeds the risk of the so-called second-round effects.

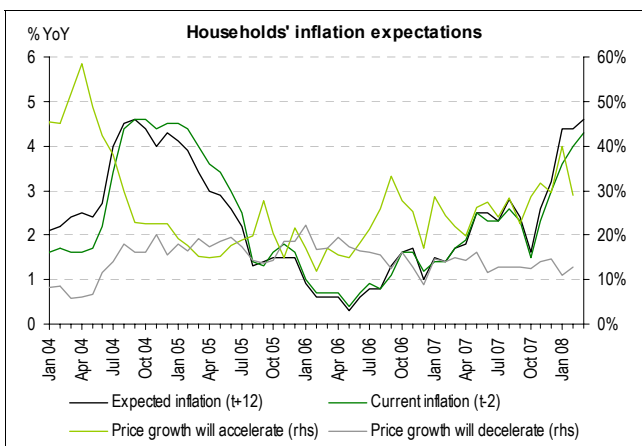
The previous increases of the NBP's interest rates should also be conducive to lowering inflation.

### Fragments of minutes of the MPC meeting in February

It was pointed out that in the months to come a further acceleration in net core inflation should be expected, among other things, due to the rise in regulated prices, particularly prices of energy and natural gas. It was emphasised that a one-off increase of those prices would be pushing up the annual CPI level for the next twelve months. (...) At the same time, it was underlined that the expected continuation of CPI inflation above the inflation target in the time to come would largely result from factors that are independent from monetary policy.

While discussing the interest rates decision, the majority of the Council members believed that it was necessary to contain the risk of sustained increased CPI inflation and curb the expected growth in net core inflation and a possible boost in inflation expectations.

In the opinion of some Council members, the outlook for inflation outlined in the February projection justified a significant interest rate increase at the current meeting. In the assessment of the majority of the Council, monetary policy tightening should be measured and proceed gradually due to, among other things, the uncertainty about the potential impact of interest rate increases on zloty exchange rate and about the outlook for global economic growth.



Source: NBP, Reuters

### Third rate hike this year... Time for a break?

▪ The MPC raised interest rates in March for the third time in a row and seventh time in the last 12 months. The main interest rate increased to 5.75%.

▪ In the communiqué, the Council maintained an opinion that maintenance of wage pressure and consequently inflationary pressure is likely. Additionally, elevated inflation creates a risk of persisting high inflationary expectations that could trigger the so-called second round effects. On the other hand, the Council underscored once again that factors responsible for inflation increase are in large part beyond the central bank's control and it listed a number of factors that may limit inflation in future, including a slowdown of world economic growth.

▪ There is an interesting sentence in the communiqué saying that interest rate hikes made so far should act towards limiting inflation. It may suggest that the Council would prefer to wait some time with further actions to assess effects of its earlier decisions.

▪ A timing of the MPC's next decisions will be surely heavily dependent on the upcoming data. The fourth hike in April cannot be completely ruled out, however only in a situation when new data releases, particularly concerning wage pressure, will be again much above the consensus forecast.

▪ Taking into account that our forecasts concerning most of monthly economic indicators for March (average wages, production, retail sales, as well as inflation) are below market consensus, it seems that a one- or two-month pause in monetary tightening seems to be more likely at the moment.

### Most MPC members support gradual tightening

▪ At the meeting in February the Council discussed issues that were already debated in the previous months, i.e. the level of current inflation that is high in large part due to factors independent of the central bank, perspectives of food prices, signals coming from reports about inflation expectations, possibility of exceeding the level of Maastricht inflation criteria.

▪ There was a motion about 50 bp rate hike submitted in February, however the majority of MPC members agreed that monetary tightening should be gradual. Those arguments were also raised in a discussion about future interest rates perspectives.

▪ In general, minutes of the February MPC meeting did not introduce many new information that would significantly change the assessment of monetary policy prospects.

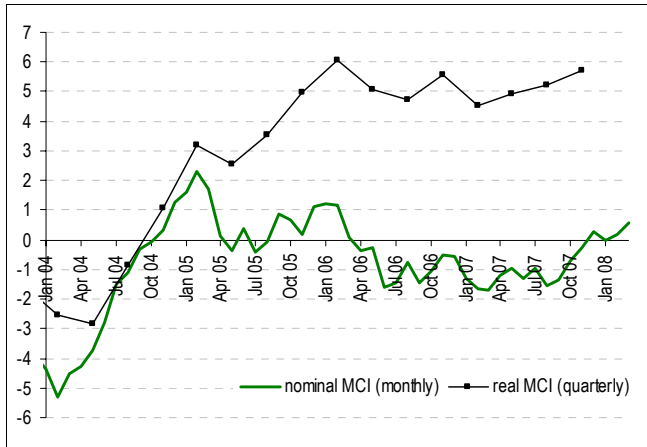
### Inflation expectations up again

▪ Index of households' inflation expectations has increased once again in March, reaching 4.6%, i.e. the same level as at the peak of the EU accession-related inflationary fever in 2004.

▪ Nevertheless, a ratio of people expecting that prices will be increasing at faster pace than at present is currently much lower than in 2004, and its sharp increase in January was reversed in the very next month. A rise in expectations index results in large part from an increase in observed inflation, because of the construction of the index.

▪ Nevertheless, predicted stabilisation of CPI growth at around 4% for more than six months may result in anchoring high inflation expectations and creates a risk of second round effects that the MPC must take into account.

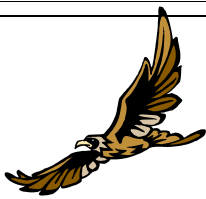
# Restrictiveness of the Monetary Policy (Council)



## Monetary policy restrictiveness increases again

- March saw another increase in nominal monetary conditions index calculated by us. This resulted from both market interest rates rise, following rate hikes by the MPC, and appreciation of the zloty.
- First, the scale of the zloty appreciation last month was as large that deviation of nominal EURPLN rate from its long-term trend estimated by us increased. Second, rise in market interest rates was as significant that difference between monthly average of WIBOR3M and its long-term trend widened.
- Taking into account performance of the zloty and market interest rates since the beginning of this year, one should expect increase in real MCI in Q1 and nominal MCI in April event without a rate hike by the MPC this month.

6.5%



Filar 1.45 (1.61)

Wasilewska-Trenkner 1.45 (1.48)

Noga 1.45 (1.52)

Wojtyna 1.45 (0.91)

Sławiński 1.09 (0.91)

Czekaj 1.00 (0.86)

5.75%

Owsiak 0.82 (0.91)

Nieckarz 0.82 (0.83)

5.50%

Skrzypek 0.73 (N/A)

Pietrewicz 0.73 (0.74)



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.

## Lonely dove in January

The results of MPC vote on 25bp hike in January showed Miroslaw Pietrewicz was lonely in his opposition to the decision. As a result, prof. Pietrewicz moved at the end of our measure of central bankers' restrictiveness. Meanwhile, NBP governor Sławomir Skrzypek escaped from the position of the most radical dove on the rate-setting panel after he was the only MPC member opposing the 25bp rate hike in August 2007. Currently he tries to avoid the label of the extreme dove, which is positive for the credibility of the central bank.

## Czekaj does not want to harm the economy

Jan Czekaj, i.e. the MPC member whose vote has significant meaning for results of MPC meetings, said on April 9 in an interview with *Rzeczpospolita* daily that one should wait and see "whether there will be confirmation of forecasts that inflation in March fell and whether this is a beginning of the trend or a one-off". Besides, he said that "for the Council the decisive will be current data from the economy, which will allow to assess whether GDP will still grow at pace of above 6% or will weaken". In his opinion, if the economy grows at such strong pace and inflationary pressure strengthens, further rate hikes would be very likely. At the same time, however, he stressed that "if it proves that although inflation is higher than the target, but the economy slows down, then hikes does not seem obvious or even needed". Czekaj is afraid that the strong zloty may soon start negatively affecting the next export and lower GDP growth. Such comments suggest that with our macroeconomic scenario, the monetary tightening cycle should end soon and the reference rate should not exceed 6%. On the other hand, one should remember that a few weeks earlier prof. Czekaj said that the MPC "cannot base its decision on expectations and hopes, which may not fulfil" and therefore "it is better to hike rates now, even tighten monetary policy too much, than underestimate inflation threats". Meanwhile, "if expectations that inflation next year will start falling quickly proves right, we can cut rates also very quickly". The comments suggest that Czekaj is ready to deliver more rate hikes, even risking excessive policy tightening (that could be reversed quickly), as long as the economy is expanding faster than potential. It implies a risk that rates may go up higher than 6% this year (even if it would be followed by swift cuts).

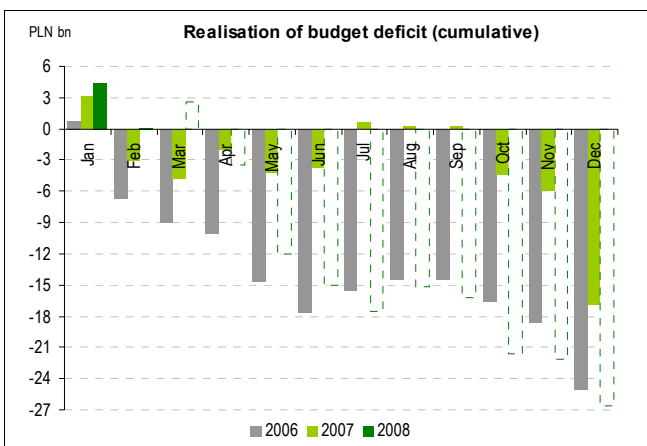
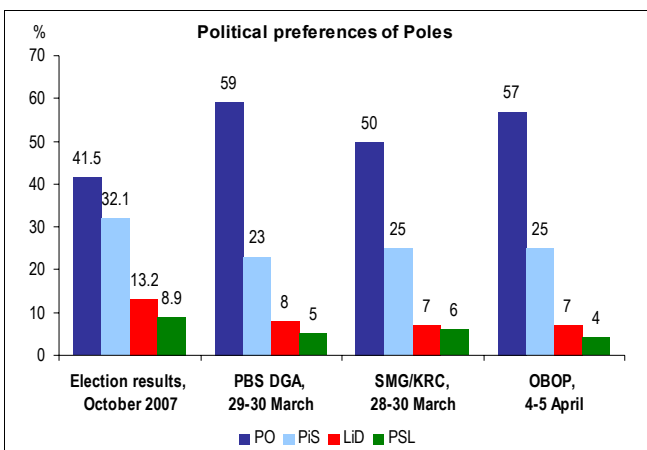
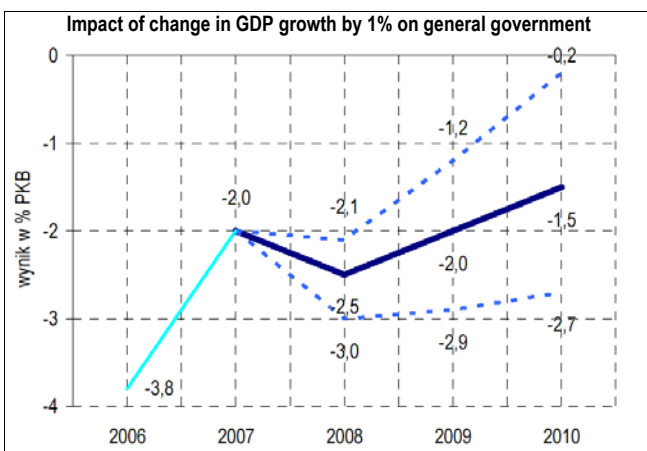
## Hawks does not want to pause hikes

The fresh comments from the hawkish camp in the Council imply that the faction is insisting on a rate hike in April. Andrzej Wojtyna said that there had been no major changes since the previous meeting that could allow for a pause in rate hikes. Although the incoming data are important for him, he said that long-term relations are more important. At the same time Wojtyna stated that further rate hikes will depend among others on the zloty exchange rate. Other hawk from the MPC, Dariusz Filar, said that a rate hike in April is very likely, but the final decision will be made based on new data. He also expressed hope that possible rate cuts could take place, but in late 2009 at the earliest. However, earlier he stated that the real interest rate in Poland should stand at 2%, which assuming market inflation forecasts would mean a possibility of a rate cut already towards the end of 2008.

## Government and politics

### Assumptions of updated convergence programme

(% GDP)	2008	2009	2010
General government balance	-2.5	-2.0	-1.5
Structural balance	-2.7	-2.1	-1.4
Structural balance without costs of tax wedge reduction	-1.4	-0.1	0.7
General government debt	44.2	43.3	42.3



Source: Ministry of Finance, polling institutes, own calculations

### Government's economic plans

- At the end of March, the government approved the update of convergence programme, which main parameters were consistent with earlier information, described by us in the previous months.

- For realisation of programme's objectives, it will be essential to curb spending growth in the next years. According to PO officials, work on introduction of spending anchor is under way. The anchor would limit spending growth to 1-2% above inflation. It is also planned to prepare four-year budget perspective and audit of expenditures in various sectors. The government also wants to introduce income tax for farmers. The changes seem to go in right direction, however there is still no detailed information whether this would be enough to finance a tax reduction and promised wage hikes in the public sector.

- Especially that the PO also mulls introduction of flat rate tax with large tax-free amount, perhaps even since 2009. Final decisions on this matter will be made in July-August. However, there are serious doubts whether such ideas are realistic given very likely president's veto, which the coalition will be unable to reject. Even deputy PM Waldemar Pawlak from PSL said that introduction of flat rate tax in 2009 is unrealistic.

- Interestingly, the PO also announced an increase in healthcare contribution in 2010 from 9% to 10%. Such move is completely against declared reduction in tax burden, and additional reservation derives from the fact that it will be introduced instead – not as initially promised – after a reform of healthcare system. In effect, there is absolutely no guarantee that the money would be used effectively.

### PO leads in opinion polls, government's score falling

- PO is still the unquestionable leader of public opinion polls, far ahead of other parties, while the PSL is slowly losing supporters. Thus, perhaps the PSL's resistance against budgetary and tax reforms would not be too strong.

- Even though most of Poles would vote for the PO in parliamentary election, they were increasingly displeased with the government's activities (of their lack?). According to SMG/KRC poll, 51% of Poles had negative opinion about the government's work at the start of April, which was 17 pp higher than in March. Also, 67% of Poles had negative opinion about Sejm's activity.

- Proposals of new reforms are unlikely to improve government's score in opinion polls, as most of citizens are against flat rate tax, not to mention hikes in healthcare premium.

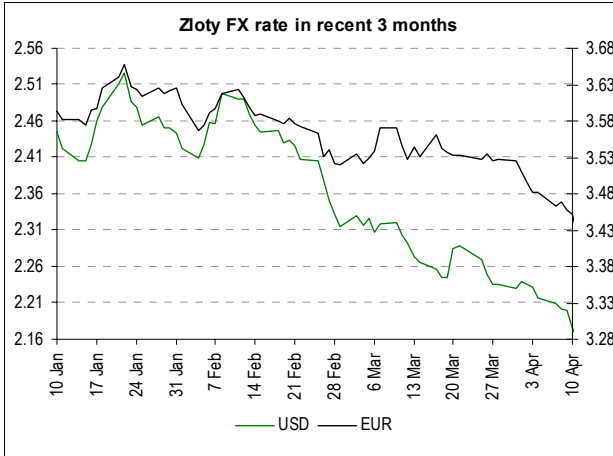
### Budget realisation still much ahead of plan

- In February, the result of the state budget was again much better than expected. After two months of the year, there was a small surplus of PLN21m, against deficit of PLN1.3bn previously predicted by the Ministry of Finance. Moreover, according to FinMin's tentative estimates, at the end of Q1 the budget recorded surplus of PLN2.5-3bn, which resulted from higher than planned CIT revenues and delays in spending.

- In the previous years, there was a deficit of ca. 30-40% of annual plan in the corresponding period of the year.

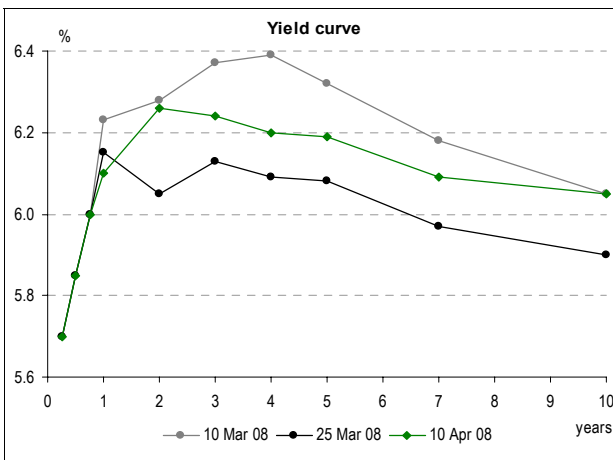
- Realisation of spending will probably accelerate in the next months, and weakening of economic growth may slow down growth of budget revenues in the second half of the year. Nevertheless, realisation of budget deficit planned for this year still does not seem to be endangered.

# Market monitor



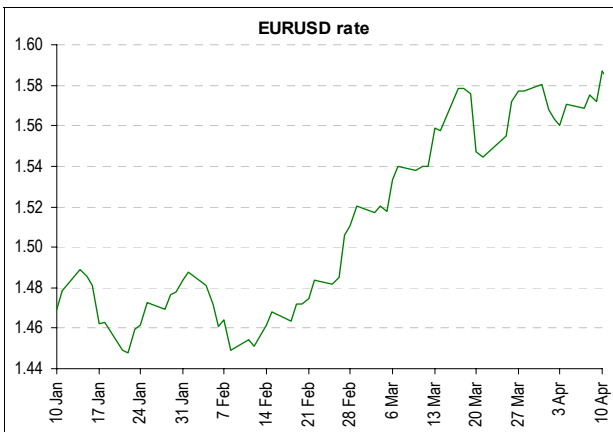
### EURPLN rate down 10 figures in 10 days. Time for a break?

- Despite maintaining fears of investors regarding the condition of the US economy and further negative information from financial institutions the zloty was relatively resistant. Moreover after a slight and temporary weakening in the mid-March the zloty started strengthening again, which was boosted at the start of April. The EURPLN rate was at 3.52 yet in March and after 10 days it fell by 10 figures to the lowest level in almost 8 years. The USDPLN rate also fell additionally influenced by the EURUSD rate increase.
- After a clear appreciation of the domestic currency in the last weeks we expect a zloty exchange rate correction amid assumed no interest rate hike in April. In the longer term we forecast zloty appreciation again.



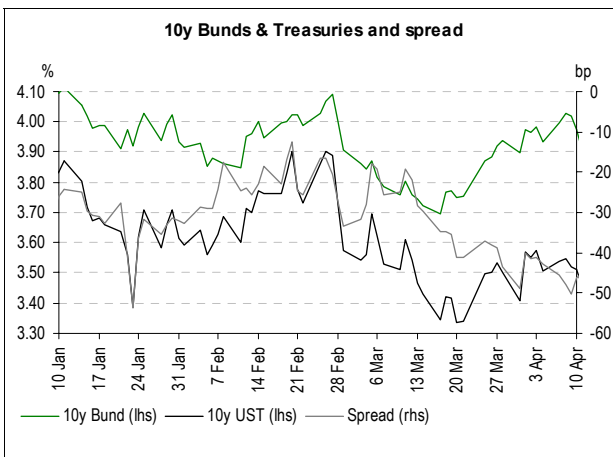
### Yields rise again after a temporary debt strengthening

- After a significant sell-off in the bond market, which occurred at the start of March, among others due to flight-to-cash in the international markets (spread increase in the asset swaps) later on in the past month the debt market recovered. The yields fall was continued until the MPC decision on rates despite the fact that the data from the economy were higher than expected. The Council raised the interest rates and the communiqué was interpreted by the market as hawkish one. This event started a falling trend of bond prices, amid strengthening of market expectations for a rate hike already in April. Yields returned to the levels recorded a month ago.
- Taking into account our macroeconomic forecasts there is some room for strengthening in the bond market. In our view the Monetary Policy Council will put off the decision to raise interest rates this month, which should also support the debt market.



### Record high EURUSD

- The dollar depreciated against the euro to the weakest level in the history approaching 1.60 on the wave of risk aversion, which was accompanied by the acquisition of the Bear Stearns by JP Morgan, the Fed taking decisive steps, and postponement of the expected interest rate cuts in the EMU. In April there was a slight recovery of the dollar due to declining expectations of deep interest rate cuts in the US, though the EURUSD rate remained near record high levels.
- After a stabilisation of the EURUSD rate at currently recorded levels in the nearest time we expect further dollar weakening. However it seems that reaching 1.60 level will rise a risk of intervention supporting the dollar will significantly rise. In the next months we forecast the dollar recovery to 1.52 at the year-end.



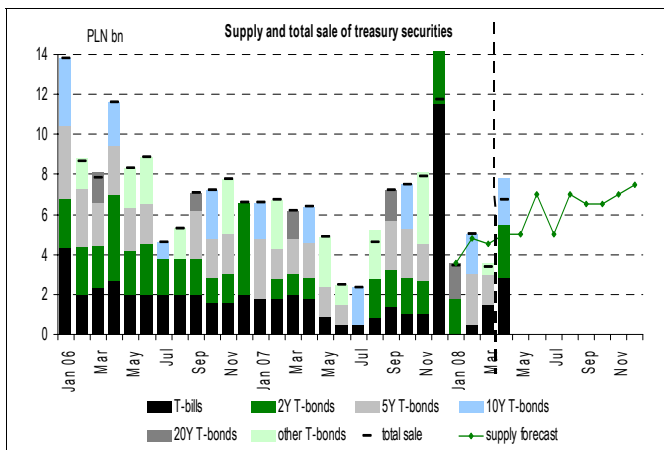
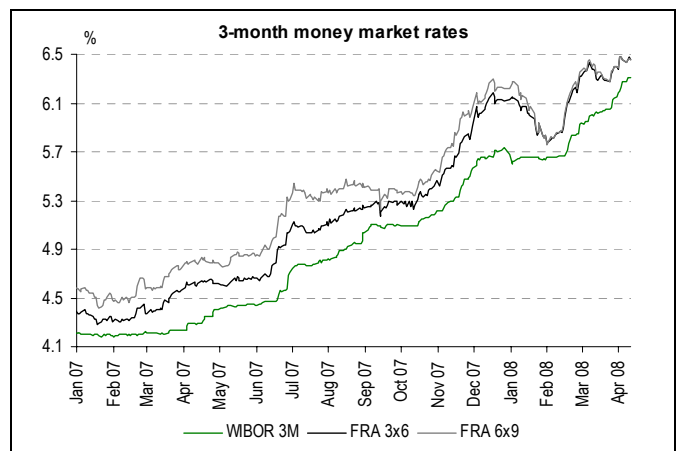
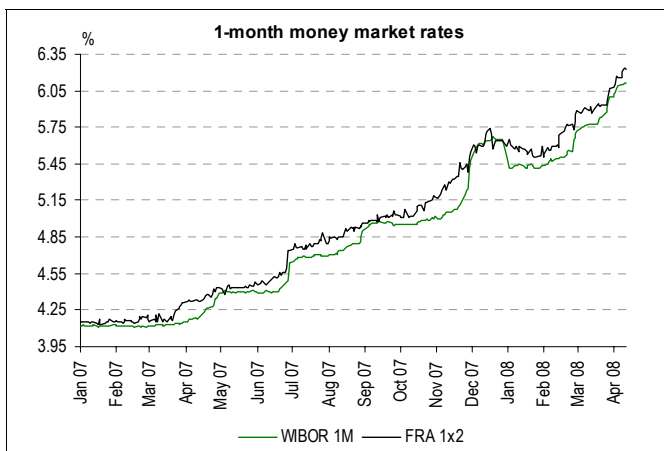
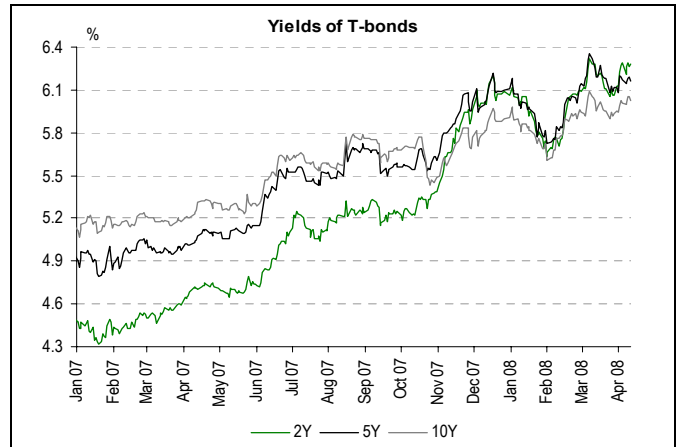
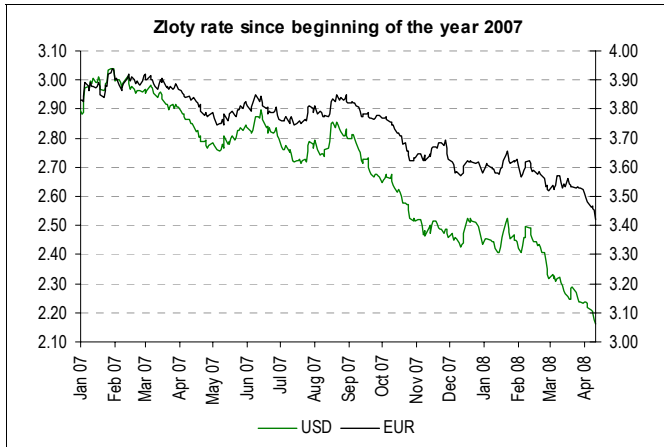
### Significant Bunds weakening

- Risk aversion in the mid-March contributed to clear strengthening in the debt markets. Yields of 10Y Treasuries fell to 3.34%, though actions taken by the Fed resulted in a correction. At the end of March the market moods were volatile on concerns over stability of the financial system in the US, though later on the risk appetite rose again. In the end yield of 10Y Treasuries remained at levels recorded a month ago while of Bunds rose by ca. 30 bp to 4.03%. Bunds weakened on delayed prospects of monetary policy tightening, among others after inflation data.
- We keep our view that downward move of 10Y Treasuries yields is going to be limited amid 50 bp rate cut by the Fed in April and another 25 bp at the next meeting. We also expect two interest rate cuts by 25 bp in 3Q and 4Q.

Source: Reuters, BZ WBK



# Market monitor



**Treasury bill auctions (PLN m)**

Date of auction	OFFER / SALE		Date of auction	
	52-week	other		
14.01.2008	2 000 / 2 000		11.08.2008	-
11.02.2008	500 / 500		08.09.2008	-
10.03.2008	1 000 / 1 417	500 / 737*	22.09.2008	-
10.04.2008	-	2 800 / 2 837**	13.10.2008	-
14.04.2008	2 000 - 3 000	-	27.10.2008	-
12.05.2008	-	-	17.11.2008	-
09.06.2008	-	-	18.12.2008	-
14.07.2008	-	-	-	-

\* 5-week; \*\*

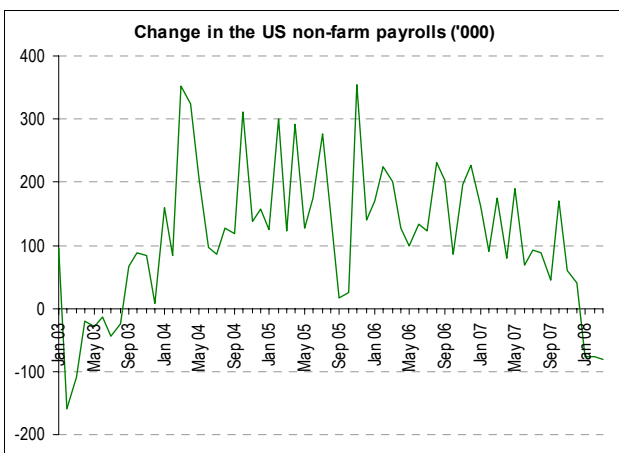
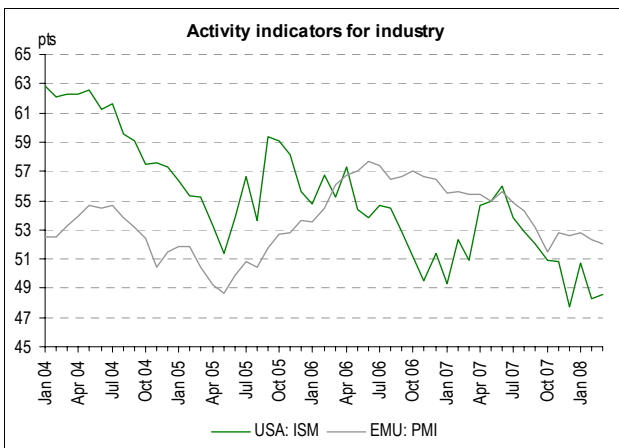
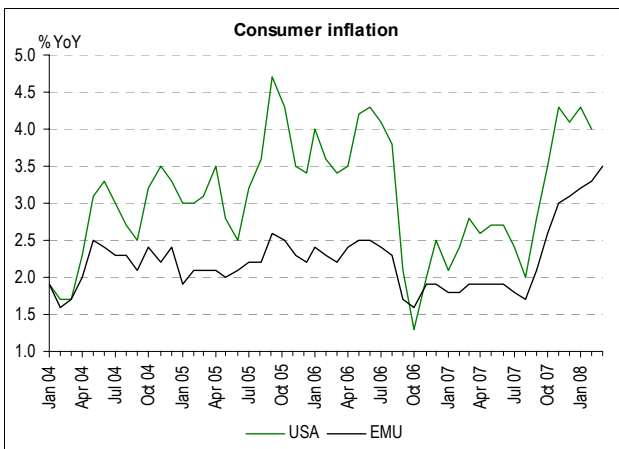
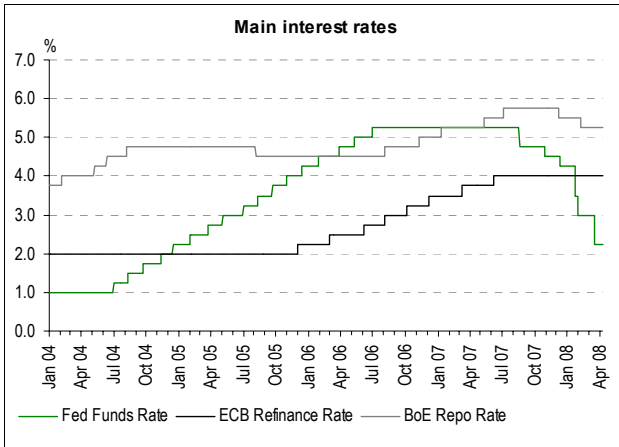
**Treasury bond auctions in 2008 (PLN m)**

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	2 500	2 500	13.02	DS1017	2 000	2 000	20.02	WZ0816 / WZ1118	855 / 914
March	05.03	PS0413	1 500	1 500	12.03	WS0437	700	700	19.03	PS0413/WZ0118/WS0922	1632/ 340 /369
April	02.04	OK0710	2 700	2 700	09.04	DS1017	2 300	1 208	16.04	-	-
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

### More rate cuts in the US, delayed cuts in the EMU

- Yet before the official meeting the US central bank cut discount rate by 25 bp. At the official meeting the interest rates were cut by 75 bp, and the main interest rate declined to 2.25%. Fed said in its statement that prospects of the US economy deteriorated. However, in the bank's view the taken actions should support the economic growth. After the last appearance of Ben Bernanke before the Congress the scale of the expected monetary easing declined, though Fed minutes reinforced the dovish market view.
- In April the ECB left the interest rates unchanged. The comments of the ECB president did not bring much new information. The ECB president underlined the uncertainty resulting from turmoil in the financial markets, which may last longer than was previously expected. However maintaining price stability and anchoring inflation expectations remains the main goal of the ECB.

### EMU inflation surprised to the upside

- US inflation decelerated in February to 4.0%YoY, against expected stabilisation at January level of 4.3%. The CPI index did not change on monthly basis, while the market expected a 0.3% increase. The core inflation, excluding the food and energy prices, declined to 2.3% from 2.5% January. The PPI data did not surprise, as the producer prices rose in February by 0.3%MoM in line with expectations, though the core PPI index rose in monthly terms by 0.5% clearly exceeding the expectations.
- Inflation in the euro zone reached in February 3.3%YoY, which is the highest level in 14 years, against expected stabilisation at January level of 3.2%. According to the flash estimates of the Eurostat the HICP inflation rose in March to 3.5%YoY, the highest level in 16 years, as compared to market forecasts and February level at 3.3%.

### Economic activity data still poor

- The ISM index for manufacturing sector in the US fell in March to 48.6 pts from 48.3 pts in February. The ISM index for services rose moderately to 49.6 pts from 49.3 pts. The employment index in services sector remained unchanged at low level, i.e. 46.9 pts, while the new orders index rose slightly above 50 pts.
- The PMI data for manufacturing in the euro zone showed an index fall in March to 52 pts from 52.3 pts. The PMI index for services declined to 51.6 pts from 52.3 pts. The economic expectations index was the lowest since November 2002. The input price index was at the highest level since July 2006, while the production index was the highest since April 2007.
- The US final data on economic growth in Q4 showed unchanged GDP growth as compared to the previous estimates at 0.6%. The effect of upward revision of consumption and downward of the trade deficit was balanced by lower investments, change in inventories and public spending. The GDP deflator was revised down to 2.4% from 2.7% and core PCE index to 2.5% from 2.7%.
- According to the final data on GDP from the euro zone economic growth in Q4 was at 0.4%QoQ and 2.2%YoY in line with previous estimates and expectations.

### US labour market continues to weaken

- A report from the US labour market for March showed a fall of non-farm payrolls by 80k against downwardly revised decline by 76k in February and 76k in January. The previous data releases pointed to a decline of jobs in January by 22k, and in February by 63k. The market expected a decline by 60k in March.
- Moreover, an increase of the rate of unemployment jumped to 5.1% from 4.8% in February, while the market expected an increase only to 5%.

## Economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
<b>14 April</b> <b>PL: Auction of Treasury Bills</b> <b>PL: Money supply (Mar)</b> EZ: Industrial production (Feb) US: Retail sales (Mar)	<b>15</b> <b>PL: CPI (Mar)</b> <b>PL: Wages and employment (Mar)</b> <b>PL: Balance of payments (Feb)</b> DE: ZEW index (Apr) US: NY Fed index (Apr) US: PPI (Mar) US: Capital flows (Feb)	<b>16</b> <b>PL: Switch auction</b> EZ: Final HICP (Mar) US: CPI (Mar) US: House starts (Mar) US: Capacity use (Mar) US: Industrial output (Mar)	<b>17</b> US: New jobless claims US: Philadelphia Fed index (Apr)	<b>18</b> <b>PL: Industrial output (Mar)</b> <b>PL: PPI (Mar)</b>
<b>21</b>	<b>22</b> <b>PL: Net inflation (Mar)</b> <b>PL: Retail sales (Mar)</b> <b>PL: Unemployment (Mar)</b> US: Home sales (Mar)	<b>23</b> <b>PL: Business climate (Mar)</b> EZ: Flash manufacturing PMI (Apr) EZ: Flash services PMI (Apr) US: Mortgage index	<b>24</b> <b>PL: Minutes RPP (Feb)</b> DE: Ifo index (Apr) US: Durable goods orders (Mar) US: New home sales (Mar)	<b>25</b> EZ: M3 money supply (Mar) US: Final Michigan (Apr)
<b>28</b> <b>PL: Easter Monday</b> DE, GB: Market holiday	<b>29</b> <b>PL: MPC meeting</b> US: Case/Shiller index (Feb) US: Consumer confidence (Apr)	<b>30</b> <b>PL: MPC meeting – decision</b> EZ: Economic sentiment (Apr) US: Mortgage index US: ADP report (Apr) US: Preliminary GDP (Q1) US: Chicago PMI (Apr) US: Fed meeting – decision	<b>1 May</b> JP: BoJ meeting – decision DE: Market holiday US: Core PCE (Mar) US: New jobless claims US: Manufacturing ISM (Apr)	<b>2</b> EZ: PMI – manufacturing PMI (Apr) US: Non-farm payrolls (Apr) US: Unemployment (Apr) US: Factory orders (Mar)
<b>5</b> GB, JP: Market holiday US: Non-manufacturing ISM (Apr)	<b>6</b> EZ: Services PMI (Apr) EZ: PPI (Mar)	<b>7</b> US: Retail sales (Apr) US: Labour productivity & unit labour costs (Q1) US: Mortgage index	<b>8</b> GB: BoE meeting – decision EZ: ECB meeting - decision US: New jobless claims US: Wholesale inventories (Mar)	<b>9</b> US: Trade balance (Mar)
<b>12</b>	<b>13</b> US: Import prices (Apr) EZ: Retail sales (Apr)	<b>14</b> <b>PL: CPI (Apr)</b> <b>PL: Money supply (Apr)</b> <b>PL: Auction of 5Y bonds</b> EZ: Industrial production (Mar) US: Mortgage index US: CPI (Apr)	<b>15</b> <b>PL: Balance of payments (Mar)</b> EZ: Preliminary GDP (Q1) EZ: Final HICP (Apr) US: NY Fed index (May) US: Capital flows (Mar) US: Capacity use (Apr) US: Industrial output (Apr) US: Philadelphia Fed index (May)	<b>16</b> <b>PL: Wages and employment (Apr)</b> US: Home sales (Apr) US: Preliminary Michigan (May)

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 <sup>a</sup>	13 <sup>b</sup>	15	14	13	15	13	15	14	13	15
Core inflation	22	-	21 <sup>b</sup>	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	26	22	-	-	-	-	-	-	-	-
Gross wages, employment	16	15	17	15	16	16	15	18	15	15	18	15
Unemployment	24	25	26	22	-	-	-	-	-	-	-	-
Foreign trade	about 50 working days after reported period											
Balance of payments*	2	-	31	-	-	30	-	-	-	-	-	-
Balance of payments	18 <sup>c</sup>	12	13	15	15	17	-	-	-	-	-	-
Money supply	14	14	14	14	14	13	-	-	-	-	-	-
NBP balance sheet	7	7	7	7	7	6						
Business climate indices	23	22	21	23	23	23	23	22	23	23	21	22

\* quarterly data, <sup>a</sup> preliminary data for January, <sup>b</sup> January and February, <sup>c</sup> November 2007

Source: CSO, NBP

# Economic data and forecasts

## Monthly economic indicators

		Mar 07	Apr 07	May 07	Jun 07	Jul 07	Aug 07	Sep 07	Oct 07	Nov 07	Dec 07	Jan 08	Feb 08	Mar 08	Apr 08
Industrial production	%YoY	11.3	12.6	8.1	5.6	10.4	8.9	5.4	10.8	8.5	6.4	10.7	14.9	5.1	16.6
Retail sales <sup>c</sup>	%YoY	19.2	15.1	14.8	16.2	17.1	17.4	14.2	19.4	19.2	12.4	20.9	23.8	19.0	22.3
Unemployment rate	%	14.3	13.6	12.9	12.3	12.1	11.9	11.6	11.3	11.2	11.4	11.7	11.5	11.0	10.2
Gross wages <sup>b,c</sup>	%YoY	9.1	8.4	8.9	9.3	9.3	10.5	9.5	11.0	12.0	7.2	11.5	12.8	11.1	11.9
Employment <sup>b</sup>	%YoY	4.5	4.4	4.4	4.6	4.7	4.8	4.7	5.0	5.0	4.9	5.9	5.9	5.9	5.8
Export (€) <sup>d</sup>	%YoY	13.4	16.1	11.6	10.7	17.0	14.9	8.2	13.6	13.1	8.6	23.0	27.7	16.5	20.6
Import (€) <sup>d</sup>	%YoY	20.8	25.4	13.7	20.8	23.3	13.4	13.7	17.7	15.4	15.3	18.6	27.2	16.2	24.6
Trade balance <sup>d</sup>	EURm	-1076	-949	-957	-1123	-1299	-472	-917	-858	-785	-1644	-544	-594	-1219	-1510
Current account balance <sup>d</sup>	EURm	-818	-687	-1246	-1506	-1252	-576	-546	-1158	-95	-1976	-1035	-1194	-1289	-1510
Current account balance <sup>d</sup>	% GDP	-2.9	-2.9	-3.2	-3.5	-3.7	-3.6	-3.8	-3.9	-3.5	-3.7	-3.9	-4.0	-4.1	-4.5
Budget deficit (cumulative)	PLNbn	-4.8	-2.1	-4.3	-3.7	0.6	0.3	0.2	-4.4	-6.0	-16.9	4.4	0.0	2.5	-3.5
Budget deficit (cumulative) <sup>e</sup>	% of FY plan	28.6	12.2	25.2	21.7	-3.6	-1.6	-1.2	26.2	35.5	100.0	-16.4	-0.1	-9.3	12.8
CPI	%YoY	2.5	2.3	2.3	2.6	2.3	1.5	2.3	3.0	3.6	4.0	4.0	4.2	4.1	4.0
PPI	%YoY	3.3	2.2	2.1	1.7	1.5	1.8	1.8	2.0	2.5	2.3	2.9	3.2	3.0	2.7
Broad money (M3)	%YoY	18.0	17.8	16.0	14.7	15.6	16.1	14.4	13.8	13.6	13.4	12.9	13.8	13.8	13.3
Deposits	%YoY	17.7	18.2	16.4	15.2	15.9	16.3	15.4	15.2	15.1	14.5	14.3	14.8	14.9	14.6
Loans	%YoY	26.8	28.4	28.6	29.2	31.4	31.1	31.0	30.6	30.1	30.0	30.3	29.4	28.0	27.3
USD/PLN	PLN	2.94	2.83	2.80	2.84	2.75	2.80	2.73	2.61	2.49	2.47	2.46	2.43	2.28	2.19
EUR/PLN	PLN	3.89	3.82	3.78	3.81	3.77	3.81	3.79	3.71	3.66	3.60	3.61	3.58	3.54	3.47
Reference rate <sup>a</sup>	%	4.00	4.25	4.25	4.50	4.50	4.75	4.75	4.75	5.00	5.00	5.25	5.50	5.75	5.75
Lombard rate <sup>a</sup>	%	5.50	5.75	5.75	6.00	6.00	6.25	6.25	6.25	6.50	6.50	6.75	7.00	7.25	7.25
WIBOR 3M	%	4.22	4.32	4.44	4.52	4.78	4.80	5.09	5.13	5.36	5.67	5.64	5.74	6.03	6.10
Yield on 52-week T-bills	%	4.23	4.36	4.43	4.42	4.70	4.80	5.01	5.04	5.30	5.78	5.75	5.66	6.09	6.10
Yield on 2-year T-bonds	%	4.55	4.71	4.70	4.93	5.14	5.23	5.25	5.30	5.77	6.06	5.92	5.90	6.17	6.20
Yield on 5-year T-bonds	%	4.98	5.07	5.11	5.40	5.50	5.61	5.60	5.59	5.90	6.07	5.94	5.93	6.20	6.15
Yield on 10-year T-bonds	%	5.18	5.27	5.28	5.52	5.60	5.68	5.69	5.64	5.70	5.85	5.81	5.82	5.98	6.00

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

<sup>a</sup> at the end of period <sup>b</sup> in corporate sector <sup>c</sup> in nominal terms <sup>d</sup> balance of payments data on transaction basis <sup>e</sup> 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	1 162.9	1 269.4	266.7	280.2	286.8	329.2	293.1	307.5	312.8	356.1
GDP	%YoY	3.6	6.2	6.5	5.1	7.2	6.4	6.4	6.1	5.6	5.6	4.9	4.7
Domestic demand	%YoY	2.4	7.3	7.3	6.7	7.7	8.2	7.4	6.2	6.1	6.9	6.6	6.9
Private consumption	%YoY	2.0	4.9	5.2	5.6	6.9	5.1	5.2	3.8	5.4	5.7	5.6	5.7
Fixed investments	%YoY	6.5	15.6	20.4	12.8	26.2	20.8	19.8	18.5	14.0	15.0	13.0	11.0
Industrial production	%YoY	4.0	12.5	9.7	6.8	13.0	8.5	8.1	9.6	10.2	9.7	3.8	3.2
Retail sales (real terms)	%YoY	1.5	11.9	14.0	16.0	17.4	14.1	12.8	12.2	16.6	16.3	15.3	15.7
Unemployment rate <sup>a</sup>	%	17.6	14.8	11.4	8.5	14.3	12.3	11.6	11.4	11.0	9.0	8.3	8.5
Gross wages (real terms) <sup>c</sup>	%YoY	1.2	4.2	6.7	6.5	5.9	6.5	8.1	6.5	7.4	7.1	6.2	5.4
Employment <sup>c</sup>	%YoY	1.9	3.2	4.6	5.3	4.2	4.5	4.8	5.0	5.9	5.6	5.2	4.6
Export (€) <sup>b</sup>	%YoY	17.8	20.4	12.8	12.5	13.4	12.7	13.1	12.0	22.1	15.7	8.0	5.5
Import (€) <sup>b</sup>	%YoY	13.4	24.0	17.9	16.5	19.5	19.7	16.6	16.2	20.3	19.9	14.0	12.5
Trade balance <sup>b</sup>	EURm	-2 242	-5 539	-11 311	-17 418	-2 322	-3 029	-2 684	-3 276	-2 357	-4 728	-4 640	-5 693
Current account balance <sup>b</sup>	EURm	-3 008	-7 283	-11 499	-18 521	-2 468	-3 434	-2 376	-3 221	-3 518	-5 133	-4 232	-5 638
Current account balance <sup>b</sup>	% GDP	-1.2	-2.7	-3.7	-5.1	-2.9	-3.5	-3.8	-3.7	-3.9	-4.2	-4.6	-5.1
Budget deficit (cumulative) <sup>a</sup>	PLNbn	-28.6	-25.1	-16.9	-26.6	-4.8	-3.7	0.2	-16.9	2.5	-15.0	-16.3	-26.6
Budget deficit (cumulative) <sup>a</sup>	% GDP	-2.9	-2.4	-1.5	-2.1	-	-	-	-	-	-	-	-
CPI	%YoY	2.1	1.0	2.5	3.9	2.0	2.4	2.0	3.5	4.1	4.0	4.0	3.5
CPI <sup>a</sup>	%YoY	0.7	1.4	4.0	3.4	2.5	2.6	2.3	4.0	4.1	3.9	4.0	3.4
PPI	%YoY	0.7	2.5	2.3	2.6	3.3	2.0	1.7	2.3	3.0	2.5	2.1	3.0
Broad money (M3) <sup>a</sup>	%YoY	13.1	16.0	13.4	11.5	18.0	14.7	14.4	13.4	13.8	12.8	12.1	11.5
Deposits <sup>a</sup>	%YoY	12.6	15.2	14.5	11.1	17.7	15.2	15.4	14.5	14.9	13.2	12.2	11.1
Loans <sup>a</sup>	%YoY	13.3	23.4	30.0	19.0	26.8	29.2	31.0	30.0	28.0	26.0	22.6	19.0
USD/PLN	PLN	3.23	3.10	2.77	2.27	2.97	2.82	2.76	2.52	2.39	2.20	2.25	2.26
EUR/PLN	PLN	4.02	3.90	3.78	3.51	3.89	3.80	3.79	3.65	3.58	3.49	3.52	3.47
Reference rate <sup>a</sup>	%	4.50	4.00	5.00	6.00	4.00	4.50	4.75	5.00	5.75	6.00	6.00	6.00
Lombard rate <sup>a</sup>	%	6.00	5.50	6.50	7.50	5.50	6.00	6.25	6.50	7.25	7.50	7.50	7.50
WIBOR 3M	%	5.29	4.21	4.73	6.12	4.20	4.42	4.89	5.39	5.80	6.11	6.30	6.25
Yield on 52-week T-bills	%	4.92	4.18	4.69	5.98	4.14	4.40	4.84	5.37	5.84	6.10	6.00	6.00
Yield on 2-year T-bonds	%	5.04	4.57	5.23	6.10	4.47	4.78	5.21	5.71	5.99	6.20	6.15	6.05
Yield on 5-year T-bonds	%	5.25	5.03	5.52	6.11	4.95	5.19	5.57	5.85	6.02	6.20	6.15	6.05
Yield on 10-year T-bonds	%	5.24	5.22	5.56	5.90	5.17	5.36	5.66	5.73	5.87	6.00	5.90	5.85

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

<sup>a</sup> at the end of period; <sup>b</sup> balance of payments data on transaction basis <sup>c</sup> in corporate sector

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