

Zloty on the crossroads

▪ **New macroeconomic data from abroad and locally cooled down optimism regarding pace and durability of economic recovery.** Vast majority of domestic macro figures proved disappointing, including data on industrial output, retail sales, average wages for August and PMI manufacturing for September. Negative changes were also seen in domestic consumer confidence indicators for September. This suggests that improvement in economic situation seen in previous months has been halted. This increases uncertainty regarding further development of economic situation. However, the baseline scenario is still the gradual and slow recovery rather than renewed clear deterioration in economic situation.

▪ **CPI inflation rose to 3.7%YoY in August, stronger than expected, and may be even higher at the year-end.** However, it is still widely expected that consumer inflation will ease considerably the next year, although pace of its fall depends largely on uncertainty regarding timing and size of changes in administered prices.

▪ **Monetary policy prospects have not changed over the past month.** The current inflation stubbornly remaining above the upper end of the allowed fluctuations margin and signs of economic recovery have lowered central bankers' willingness to reduce interest rates already a few months ago. What is more, the MPC clearly suggested in its post-meeting statement in September that one should expect a change in informal policy bias from easing to neutral in the near time. In our opinion this will take place in October, if next macro data and new NBP projection for inflation and GDP confirm that the economy remains on the path of gradual recovery and inflation will be returning to the target of 2.5% after expected temporary drop to even below 2% in the course of 2010. Decisions on first rate hikes will depend on the new MPC while we still do not know much about its personal composition apart from candidacies indicated by anonymous sources, which makes it difficult to assess monetary policy prospects. We assume that next year the new MPC will raise interest rates twice by 25bps.

▪ **The past month was not favourable for the zloty and in the short-term the domestic currency may remain under pressure.** One cannot exclude that due to regional factors (concerns about currency devaluation in Latvia, intensified expectations of rate cuts in the Czech Republic and Hungary) the EURPLN may reach or even break the 4.30 level in the near time. However, the potential for the zloty correction, which we have been writing about for some time, seems to diminish. If the recently started season of earnings reports for Q3 does not bring major negative surprises and new macro data from the US and the euro zone confirm that the global economy is on a path of recovery, the zloty should begin a march towards 4.00 to the euro, but in our view breaking this level is a longer perspective than a month. Performance of the zloty in the medium-term will continue to depend mainly on global factors, which we indicate in the *Special focus* section of the report.

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Financial market on 30 September 2009:

NBP deposit rate	2.00	WIBOR 3M	4.18	USDPLN	2.8852
NBP reference rate	3.50	Yield on 2-year T-bonds	5.10	EURPLN	4.2226
NBP lombard rate	5.00	Yield on 5-year T-bonds	5.70	EURUSD	1.4635

This report is based on information available until 08.10.2009

Special focus

Zloty during financial turmoil

Global players in financial markets apply various investment strategies to speculate in financial markets. Among the most popular in the financial markets are fundamental valuation strategies, "momentum" strategies (based on technical analysis) as well as "carry trade" strategies. The latter consist of holding a long position in a high interest rate currency, which is financed by a short position in a low interest rate currency. The positive rate of return on these positions contradicts the theory of interest rate parity and has been widely discussed in the literature.

In the case of carry trade transactions, there is a growing role of the differences between short-term O/N interest rates in the countries which determine the changes in the foreign investors' balance sheets¹. Hence, as a result of applying this strategy, the importance of short-term interest rates in shaping monetary policy is bigger than it is commonly thought.² In the recent years, the carry trade process of international investors has also been "supported" by Polish borrowers who raise loans in foreign currencies, primarily in Swiss francs, as well as by private individuals in Japan who borrowed money in the domestic currency to invest in the emerging markets' funds looking for high rates of return.³

Speculative players' activity boosts liquidity in currency markets, but it may also add to the volatility of exchange rates by contributing to large deviations of the market exchange rates from the equilibrium rates. Speculation in the international markets by global players may make running monetary policy by central banks more difficult.

Zloty impacted by global factors

Given a significant increase in risk aversion in global markets recorded towards the end of last year, international investors limited their positions in risky assets as well as closed their carry trade positions as interest rates went down (details - page 5). The deleveraging process, i.e. downsizing balance sheets – assets and liabilities in global markets – resulted in a strong depreciation of the zloty which, despite relatively better fundamentals, was one of the region's most weakening currencies.

One of the reasons was zloty's strong appreciation in the past (e.g. in H1 2008 – details - Table 1 on page 6), which was driven by a number of factors. In H1 2008, GDP

growth stayed at a high level, while interest rates continued to rise. The Polish currency's appreciation in H1 2008 was also a consequence of international investors' search for alternative investments, which were not correlated with the majority of other assets and offered a possibility to achieve a positive rate of return when the global equity markets witnessed declines (see Table 2 on page 6). The zloty and currencies in our region were selected together with commodity markets (e.g. oil) as based on the market opinion prevailing back then, the impact of the crisis on the countries of this region could be relatively small. Moreover, zloty's appreciation was also driven by draw-downs of subsequent instalments of fx loans denominated in Swiss francs.

As the crisis became more and more severe and volatility exploded, investors started to perceive all data and ratios in a negative way. The volatility pushed up correlation ratios of all the asset groups (see Table 2 on page 6). Carry trade positions were limited. Currencies perceived as risky started to show a depreciation trend and most probably the "momentum" strategy started to be used with increasing frequency which fuelled the downward trend of currencies and helped global players make profit.

Regional and domestic factors

Zloty's depreciation was driven by concerns about financing foreign liabilities by Central and East European countries as well as the problem of FX options issued by Polish companies. Moreover, foreign investors were able to borrow zloty (and other currencies in the region) very cheaply in FX swap transactions, while selling it speculating for the domestic currency's depreciation. Though Poland's and zloty's fundamental situation seemed to be relatively the best in the region, zloty depreciated most. It was most likely because the domestic currency is considered the key representative of the region, while the Polish currency market is relatively "the deepest", hence, it is easiest to open a speculative position here and close it later with a relatively lowest liquidity risk. Moreover, according to investors, zloty offered a robust exposure in the financial market to the region of Baltic States, which pursue a policy of fixed currency rate against euro.

Analyses show that carry trade strategies brought about high return rates in the past years before the growth of global risk aversion⁴. Possibility to generate an average positive rate of return over a few years stemmed from volatility risk premium reflected in the exchange rate changes. The devil (potential cost) was in the specifics of the leptokurtic distribution of exchange rates, in its left "tail"

¹ M. Hattori, H.S. Shin, *The broad yen carry trade*, Bank of Japan, 2007

² Ibidem

³ G. Galati, A. Heath, P. McGuire, *Evidence of carry trade activity*, BIS Quarterly review, September 2007

⁴ L. Menkhoff, L. Sarno, M. Schmelming, A. Schrimpf, *Carry trades and global FX volatility*, MPRA, April 2009

to be more precise⁵. As volatility (risk aversion) grows, low interest-rate currencies, which are a synonym of a “safe haven”, appreciate.⁶ This is a consequence of repayments of liabilities denominated in financing currencies, including mainly the Japanese yen, made by international players (details - page 5). Investors sold high interest rate bearing currencies subject to carry trade or a measure of risk appetite (i.e. the Australian dollar, the New Zealand dollar, British pound, Euro) as global volatility was enhancing. Falling interest rates disparities were conducive to it. In return, they bought Japanese yen and Swiss francs thus triggering their strong appreciation (details – pages 5 and 6). The zloty being part of the emerging economies’ basket followed the trend. Even though it is difficult to visualize well the scale of carry trade in the banks’ balance sheets, data of the Bank for International Settlements (BIS) may be helpful. Deleveraging and closing carry trade positions was reflected in the reduction of the banks’ receivables from the non-banking sector entities in offshore financial centres, among others, hedge funds (details – page 5) and in the reduced foreign assets and liabilities of the banking sector, denominated in the Japanese Yen.

Zloty strengthens as volatility lessens

The peak of the global volatility, which is well demonstrated by the level of VIX index (index of the implied volatility of S&500 index quoted on the CBOE stock exchange), materialized at the end of October 2008. Another local peak was recorded in the second half of February this year (detail – page 6). A few days earlier, the zloty hit the weakest rate in a few years. It was accompanied by verbal interventions by the central bank and currency exchange done by the Ministry of Finance through BGK in the market rather than in the NBP. As a principle, currency or verbal interventions have a limited power to resist global relocations of capital. However, when effectuated at the right moment, they may decrease investors’ propensity for speculating against a given currency. In the situation when zloty had already much depreciated, interventions increased the potential cost of the game against the Polish currency. As it turned out, it coincided with the local peak of risk aversion in global markets (local peak of VIX and Itraxx – credit risk index built up of credit swaps for selected European companies), which determined the effectiveness of the said interventions.

March marked the beginning of the downward trend in global volatility. At the same time, zloty started to

appreciate, which was tightly correlated with the resurfacing risk appetite.

As the global volatility subsided, investors started to attach increasing weight to the local conditions. Currencies of emerging economies are becoming increasingly diversified in relative terms (as part of the percentage shares set out in the international funds portfolios for the sector of EM currencies), which is evidenced by the smaller correlation between currency pairs and asset classes (details - Table 2 on page 6).

Outlook for the domestic currency

A decrease in indices VIX and Itraxx to the levels from before the crisis intensification, i.e. before the collapse of Lehman Brothers, and a good liquidity situation in the global markets reflected, among others, in the reduction of TED spread (difference between the money market rate and the yield of T-bills in the US) to the levels from early 2007, i.e. before the downturn in equity markets, creates a positive environment for further gradual recovery of the appetite for risky assets and for the domestic currency’s appreciation.

Along with the reduction in the global aversion to risk and the more diversified assessments of individual economies, their currencies and interest rates, also the carry trade position will be rebuilt, especially as the period of monetary policy being loosened up has come to an end in most countries and markets focus on the moment of first interest rate hikes in the next cycle. The first step to this end has been taken by the Australian central bank.⁷ The scale of carry trade positions may increase gradually. However, carry trade positions may reach the level recorded before the crisis only after a long period, when the economic boom stage develops during the next cycle. We believe, this may be driven by restrictions imposed on global investors, including the hedge funds, in relation to the pending discussion on the regulations in the financial sector, to increase transparency and supervision in the sector, which intensified during and because of the global crisis.

Even though speculative transactions of the players added to the liquidity on the domestic FX market, their lower scale, which included a limited number of carry trade transactions, may lead to a slower appreciation and smaller deviation of the market PLN rate from the equilibrium exchange rate. PLN rate should become less volatile along with the lower global volatility, which will be one of the

⁵ Extreme rates of return of financial assets occur more often than it is assumed in models used in the financial markets, thus the probability of large loss is higher.

⁶ L. Menkhoff, L. Sarno, M. Schmeling, A. Schrimpf, Op. cit.

⁷ It should be noted that Australia is the producer of raw materials and in the view of the rebound on the raw materials markets, the monetary policy actions may be taken sooner than in other countries. It does not, however, change the fact that RBA intends to increase interest rates, which may accelerate speculation on Australian dollar.

factors driving the selection of an appropriate moment to join the ERM2 system (details - page 6).

Another factor that positively influences the PLN rate is the fact that problem with options has become less important than before as the majority of options sold by the Polish companies either matured or were restructured. Moreover, the PLN price in FX swap transactions has significantly increased. In the long term, the growth in labour productivity will fundamentally stay at a higher level in comparison to the euro zone.

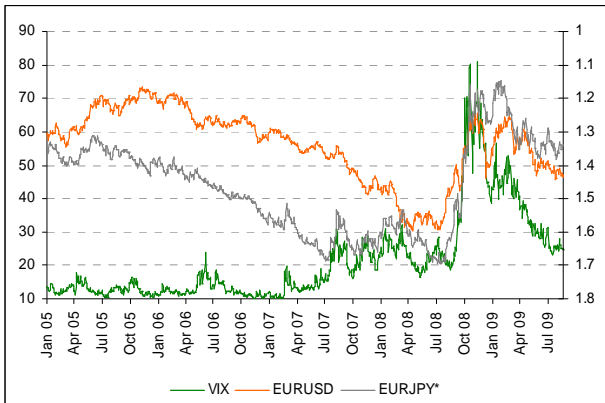
On the other hand, fiscal issues got in the front line. In the forthcoming quarters and years, investors will pay attention to the scale of increased borrowing needs, to the success of the privatization program and to the public debt relation to GDP. Should the public debt/GDP ratio exceed prudential thresholds stipulated by the Public Finance Act, it would lead to substantial fiscal adjustments. Moreover, in the short term the regional factor may negatively affect the zloty. In the recent days the market concerns increased about devaluation of the Latvian lat and budget problems in Latvia, which may make more difficulties in receiving next tranches from IMF loan. In Czech Republic the representatives of the central bank are not satisfied with appreciation of Czech crown and do not rule out intervention in the market and another interest rate cut.

Taking into consideration our expectations of the global and domestic economic growth, the anticipated further reduction in the global volatility and the lack of domestic shocks should support our PLN rate forecasts. The current correction in the FX market may lead the zloty even above 4.30. However, after it is finished in the next weeks we believe, PLN is likely to strengthen by the end of the year to ca. 4.00 and 3.80 at the end of the next year. However, PLN appreciation up to the before-the-crisis level is not very likely in the forthcoming quarters and it may take several years as Poland along with approaching date of joining the euro zone and interest rate hikes.

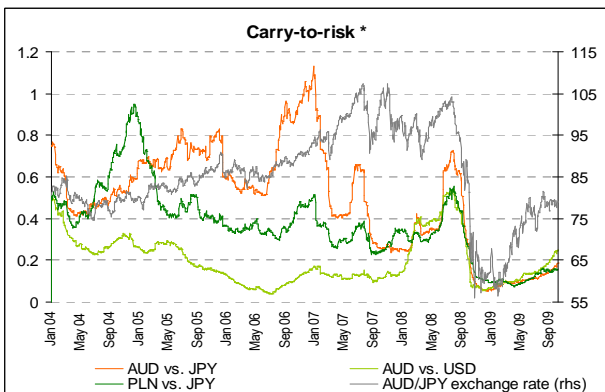
What if zloty strengthens too much?

Just a few months ago according to majority of analysis the alternative scenario for gradual appreciation of the zloty was further weakening (there were forecasts of the EURPLN rate at 5.0). Currently, although we see risk of short term depreciation (we write about this in the report), the medium term prospects point to strengthening, and the main question is in what scale. It seems to us that an important risk scenario against our baseline scenario would be excessive strengthening of the zloty in the coming years (not months). It would happen in case of sooner return of global speculation on large scale than it is currently expected, which may occur if the implemented regulation is not globally efficient. Especially, amid over-liquidity in the financial markets connected with using extraordinary monetary policy easing by foreign central banks and depending on taken „exit strategies”. If additionally there were prospects of quite fast recovery of the global economy, which would lead to increase in risk appetite and emerging market currencies (including the zloty) could appreciate much more or much faster return to levels recorded before the crisis intensification, in the middle of the previous year. In case of excessive appreciation of the zloty, the competitiveness of the Polish economy versus the euro zone economy would deteriorate again, which would hurt the economic growth. This may raise a question about running an optimal exchange rate policy with inflation targeting strategy on the way to entering the euro zone. In current situation just after the crisis culmination this problem may seem to be remote, though one may not rule out that it will be one of the interesting subjects of discussions during the meetings of new Monetary Policy Council.

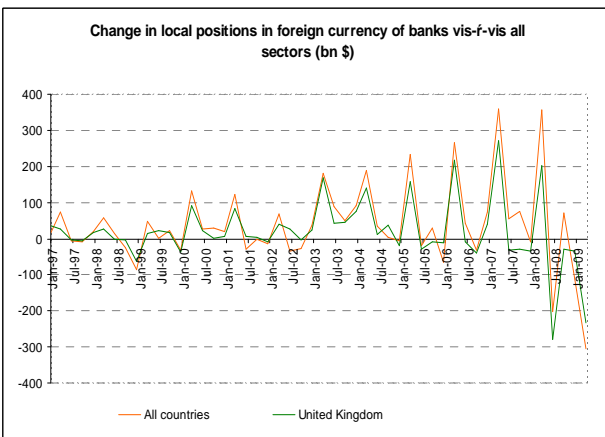
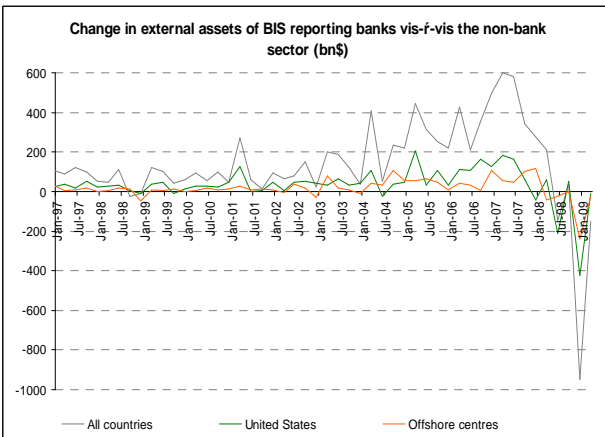
Special focus: Zloty during financial turmoil



* EURJPY/100



* relation of the difference between 3M money market rates of target and funding currency and the 3M standard deviation of exchange rate returns



VIX affects the high yielders

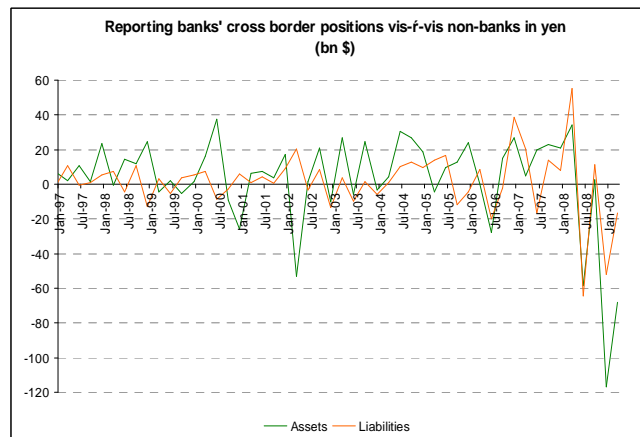
- In years of decreased volatility (low levels of VIX) there was an increasing interest of investors in carry-trade strategy, which favoured high yielding currencies (AUD, NZD, GBP, EUR) vs. the low yielding ones (JPY, CHF, and since the US rates fell almost to zero also the \$). The scale of the carry trade increased in conditions of monetary policy tightening and rising interest rates.
- Euro stayed at strong levels against yen despite falls in the equity markets also in 2008 till the bankruptcy of Lehman Brothers, which increased the global volatility and contributed to unwinding carry trades.
- In carry trade transactions the scale of potential benefits against costs may be represented by carry-to-risk ratio.

Decline of carry-to-risk ratio

- Carry-to-risk ratio for zloty versus yen was at stable level for a few years and was slightly lower than for Australian dollar, which is considered as one of main currencies used in carry trade.
- In period of increased volatility the carry-to-risk ratio declines, which contributes to closing risky positions and weakening of target currencies used in this strategy.
- Last year the jump in market volatility was accompanied by falling interest rates, which significantly lowered the premium for investors compensating for the risk.
- Since March 2009 carry-to-risk ratio started rising along with decline of global volatility. The influence of interest rate disparity on FX rate should gradually increase amid the end of monetary policy easing and falling global volatility.

Deleveraging

- BIS locational data show that in Q2 and Q4 2008 and Q1 2009 there was a significant fall of domestic positions denominated in foreign currencies globally, and mainly in banks in United Kingdom (figure below).
- There was also decline in bank assets against the non-banking sector, which includes among others hedge funds. This took place mainly against non-banking sector in the US and in the offshore financial centres (Cayman etc. - figures to the left).
- At the same time there was a decline of yen denominated assets and liabilities of the banking sector against the non-banking sector, which were rising for a few previous years.
- Positions in derivative contracts were also closed, though this is not visible in the bank balances.



Source: BIS, Reuters, own calculations

Special focus: Zloty during financial turmoil

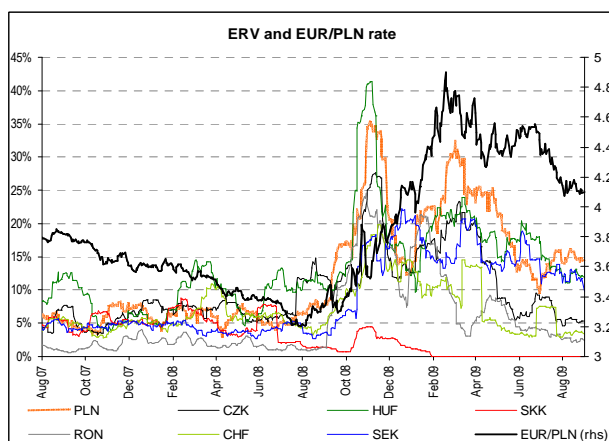
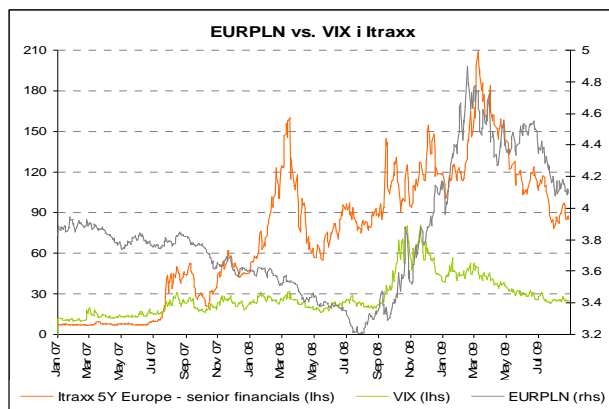
Table 1. FX exchange rate changes (%)

	2002 - 2003*	2004 - 2007*	Jan 08 - Jul 08**	Aug 08 - Feb 09**	Feb 09 - Aug 09**
EUR/PLN	9.6	-3.6	-10.7	52.4	-16.4
EUR/HUF	-0.4	-0.1	-7.5	32.0	-11.9
EUR/CZK	-3.1	-3.3	-9.7	23.5	-14.1
EUR/RON	20.2	-2.6	0.8	20.5	-1.4
EUR/TRY	28.6	1.4	6.0	18.7	0.2
EUR/SEK	-0.7	0.3	0.1	18.0	-8.4
EUR/USD	12.7	5.0	6.9	-19.3	13.8
USD/BRL	14.6	-10.6	-12.0	49.5	-19.9
USD/MXN	7.6	0.3	-7.9	46.5	-9.4
EUR/JPY	9.8	5.4	3.5	-30.9	14.7
AUD/JPY	9.6	7.0	4.1	-42.2	33.2
GBP/JPY	4.1	5.7	-3.3	-38.5	15.2
JPY/PLN	-0.2	-8.4	-12.7	119.2	-26.7

* annual average changes ** changes EoP/EoP

Table 2. EUR/PLN correlation coefficients

	2004-2007	Sep 07 - Jul 08	Aug 08 - Feb 09	Feb 09 - Aug 09
EUR/HUF	-0.03	0.83	0.94	0.83
EUR/CZK	0.94	0.93	0.97	0.85
EUR/TRY	-0.05	-0.65	0.87	0.61
EUR/SEK	-0.33	-0.22	0.89	0.81
EUR/USD	-0.49	-0.83	-0.62	-0.7
USD/BRL	0.9	0.93	0.75	0.78
USD/MXN	0.56	0.96	0.89	0.76
AUD/JPY	-0.72	-0.50	-0.81	-0.76
EUR/JPY	-0.71	-0.62	-0.83	-0.64
USD/JPY	-0.58	0.36	-0.90	0.34
S&P500	-0.79	0.64	-0.82	-0.84
VIX	0.02	0.37	0.36	0.79
5Y Eur Itraxx	0.07	-0.34	0.70	0.78
Oil (Brent)	-0.85	-0.9	-0.84	-0.69



Source: Reuters, own calculations

CEE3 currencies temporarily stand out

▪ The zloty was one of the emerging market currencies, which were hurt the most in the phase of limiting positions in risky assets, which started in July 2008 (at this time there was a decline of world oil prices and the exchange rates including EURJPY, GBPJPY, EURUSD, and EURCHF).

▪ It is worth to notice that in 2004-2007 the annual average rate of zloty appreciation was the highest in the region CEE4 (mainly in 2004, partly due to earlier heavy depreciation). It was similar in 2007 and 1H 2008, when the view of developing economies decoupling from the developed ones was dominating, and CEE3 currencies were preferred by investors.

▪ Along with the stabilisation of market moods and decline of global risk aversion the zloty belonged to the group of currencies, which recovered the fastest.

Stronger correlations during the crisis

▪ In 2004-2007 the EURPLN had strongest positive correlation with the currencies in the CEE4 (mainly the Czech crown and Slovak crown) and Brazilian real, and negative correlation with oil prices and equity indices (S&P500 and WIG 20).

▪ Since the moment of downtrend in the equity markets at the end of 2007 the correlation of stock indices and some EM currencies (excluding BRL, MXN) including the zloty was disturbed. There was a negative correlation close to -1 with oil and the correlation with the EURUSD rate strengthened.

▪ Since the intensification of the crisis in 2H 2008 the EURPLN rate had a strong positive correlation with CEE3 currencies, other EM FX rates, but also EURSEK, EURAUD and the credit risk index Itraxx. At the same time it showed negative correlation with equity markets, oil, USD/JPY, GBP/JPY and EUR/JPY.

Volatility „outbreak” started the zloty weakening

▪ Despite increase in credit risk in Europe since mid 2007, which was fuelled by concerns over condition of the financial sector, the zloty was appreciating amid equity markets volatility staying at relatively low level.

▪ Jump in global volatility last year affected also the volatility of the zloty and of most of currencies and assets triggering the zloty weakening.

▪ After an increase in risk aversion investors started to notice all fundamental relations negatively. Along with falling interest rates the momentum strategy became more important than carry trades.

▪ As the global volatility declines the importance of local factors increases. The interest rate disparities will be more and more important.

The zloty volatility is still high

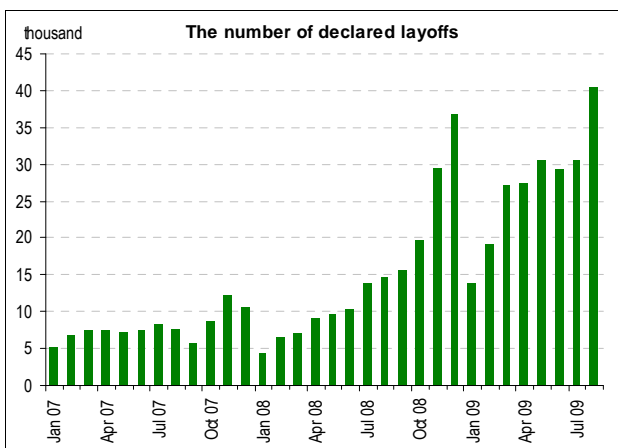
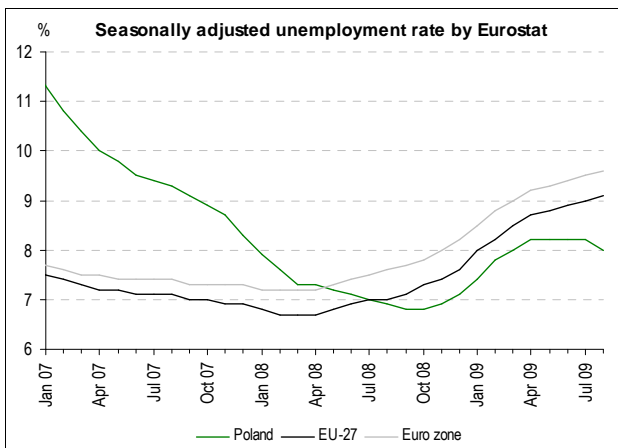
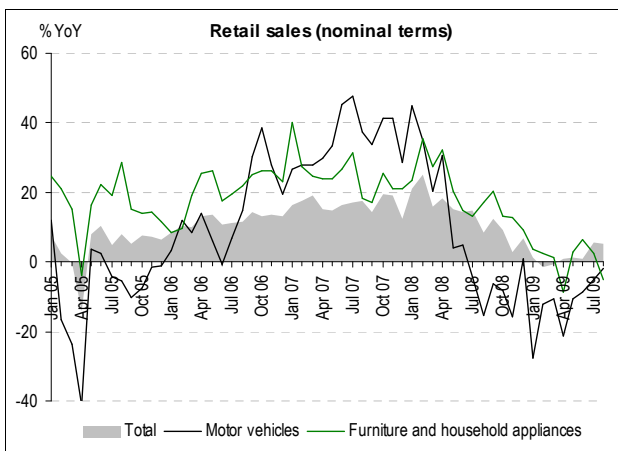
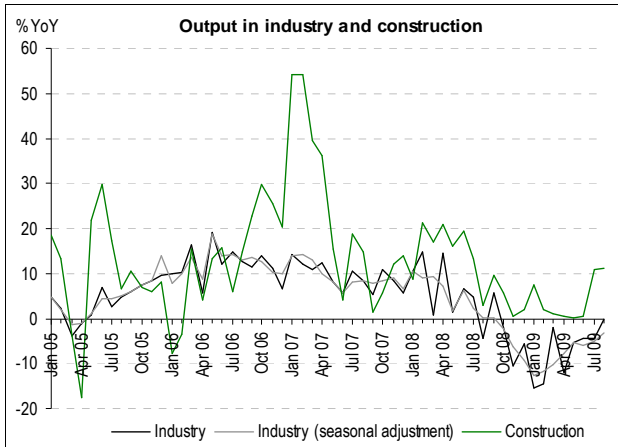
▪ Since end of 2006 till the moment of global crisis intensification there was a clear fall of zloty volatility against the euro. Periodically it approached the volatility level of CHF or SEK and was below CZK volatility.

▪ Since August last year the EURPLN rate volatility started to rise, and after the intensification of the turmoil in the financial markets it jumped above the volatility levels of other currencies of countries in the EU outside the euro zone. In the last months the volatility of the EURPLN declined to the level from the turn of the year, when the zloty was in 3.95-4.20 range.

▪ The ERV volatility measure analysed by the ECB points that currently the conditions to adopt euro are not favourable.

▪ High zloty volatility makes setting central parity more difficult and lowers the effectiveness of FX equilibrium models.

Economic update



Source: Eurostat, CSO, own calculations

Mixed economic activity indicators

- Industrial output fell 0.2%YoY in August (a slight rise was expected). Smaller fall than -4.4%YoY in July resulted to some extent from a larger number of working days effect. Seasonally adjusted growth rate improved to a lesser extent, to -3.1%YoY from -5.3%YoY in July. However, the data confirmed that negative trends in industry gradually subside. Looking at data broken down into sections, it is noteworthy that the first time since September 2008, the growth rate of manufacturing output was above zero (0.6%YoY), although to a some extent it was an effect of larger number of working days.

- Once again, a positive surprise shown up in construction, with an annual growth in output accelerating to 11.0% in August from 10.7%. What is important, this may prove a persistent tendency given the growing scale of the realisation of major infrastructure projects. The importance of this factor is indicated by a rise in output in units engaged mainly in works related to the construction of buildings and civil engineering by 41.4%YoY.

- Retail sales growth in August slightly slowed down to 5.2%YoY from 5.7% in July. Growth in most of sales categories decelerated, though only moderately. The exception was sales of furniture, radio, TV and household appliances where a drop by almost 5% was recorded after a rise of 2.4% in July.

- It is still hard to explicitly state how persistent will be the retail sales growth recovery, which occurred during holidays, and to what extent it was a temporary effect (much less Poles decided to spend holidays abroad this year). Taking into account further deterioration of situation in the labour market one should expect rather poor results of retail sales in the following months.

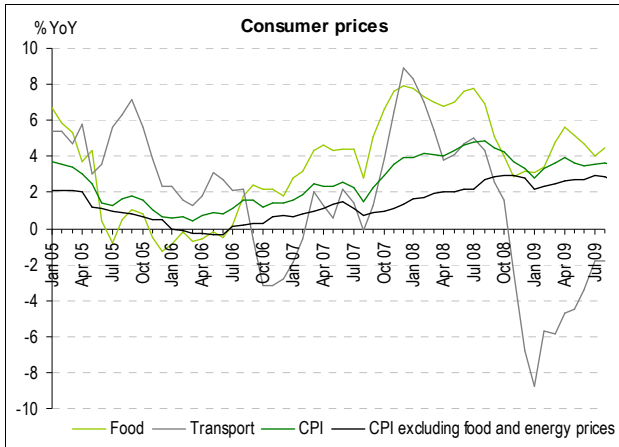
Negative trends in the labour market continued

- Average wage in the enterprise sector fell 2.8%MoM in August, driving the annual growth rate down to 3% from 3.9% in July. The deceleration was expected as the wage growth in July was related mainly to bonus payments in petroleum industry. Excluding this one-off effect, the wage pressure weakens, which is a natural process amid high unemployment.

- Average employment in the enterprise sector in August fell 0.1%MoM and 2.2%YoY (the same as in July). The pace of employment reduction stopped accelerating, but this does not change the fact that situation in the labour market remains difficult and negatively affects consumption demand. Wage bill in the enterprise sector grew a mere 0.7%YoY in nominal terms in August while in real terms it fell nearly 3%YoY.

- The registered unemployment rate reached 10.8% at the end of August, the same as a month earlier. This could seem a seasonal effect as in annual terms the registered unemployment rate and the number of unemployed is still on the rise and its pace even accelerates. However, the LFS unemployment rate reported by the Eurostat in seasonally adjusted terms (a measure showing real tendency in the labour market better than register statistics) showed that after stabilisation at 8.2% in April-July period, the unemployment rate in Poland fell to 8.0% in August, despite its further rise in the euro zone and EU-27. Such a result suggests that the worst in Polish labour market is over. However, the improvement in August may prove temporary, when looking at the stats office data indicating a strong rise in declared layoffs at the end of August, above the peak in December 2008. This heralds deterioration in labour market conditions with negative consequences for households' financial stance and consumption demand.

Economic update



Inflation still elevated

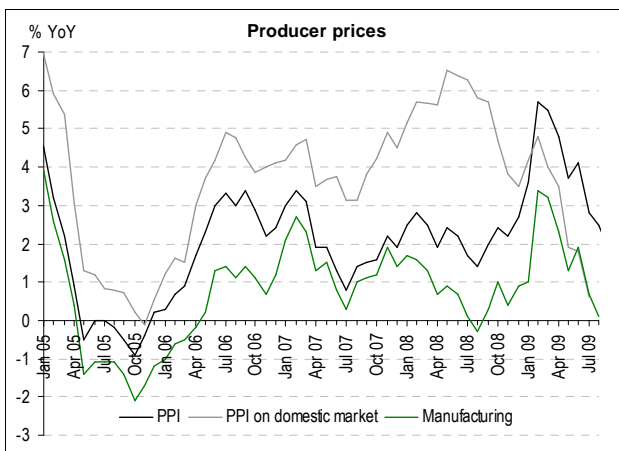
- The CPI inflation in August proved higher than the market consensus pointing to stabilisation at 3.6%YoY posted in July, rising to 3.7%YoY with seasonal fall in prices of 0.4%MoM.

- Prices of food and fuel fell by 1.3%MoM and 1.9%MoM, respectively. Looking at other components of CPI, price changes in August were not significant. One should notice there was no further rise in tobacco prices after they went up sharply in July due to a hike in excise tax. In most of other CPI components once again there was a rise in prices, for example in recreation and culture by 0.1%MoM, in hotels and restaurants by 0.2%MoM. It shows that weakening of consumption demand is still not strong enough to trigger a fall in prices of services.

- Although the headline inflation rate in August was a bit higher than expected, it has not changed the assessment of the medium-term inflation outlook.

- In August there was stabilisation of core inflation measures - CPI excluding food and energy prices remained at 2.9%YoY posted in July and there was slight changes in other three core inflation measures (one of them down, two of them up). In our view core inflation peaked in August and in the next months it should gradually fall to below 2%YoY during 2010.

- The PPI inflation fell to 2.5%YoY in August from a revised 2.8%YoY in July. For the second straight month there was monthly fall in manufacturing prices (-0.5%) and deceleration in its annual growth to a mere 0.1%, which should be attributed to zloty appreciation and weak demand. Fall in manufacturing could have been larger, if not the oil price growth reflected in significant rise in prices of refinery products (3.5%MoM).



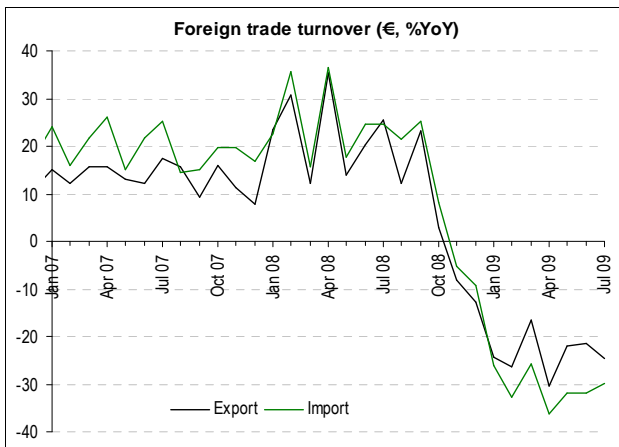
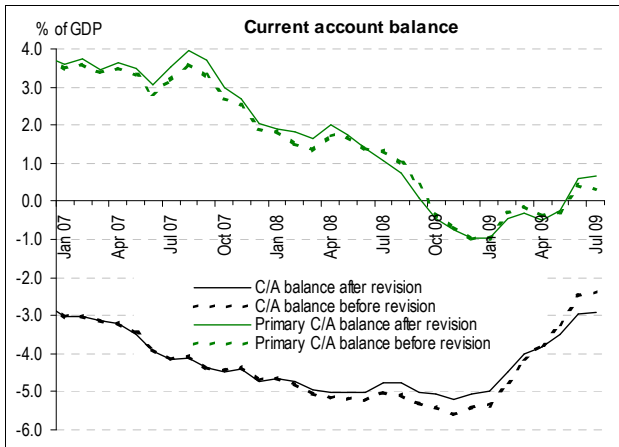
Large revision in balance of payments data

- NBP data on balance of payments for Q2 were much different than estimates based on earlier published monthly data. Now the data show that there was C/A gap of €875m in Q2 against earlier reported surplus of €890m. The considerable revision resulted mainly from update of estimates regarding reinvested profits in enterprises – deterioration in the income account due to larger than earlier estimated dividend payments and at the same time upward revision in FDIs inflow. Foreign trade deficit was revised up slightly, while services balance improved a little. Such a shape of the revision means that the primary C/A balance (C/A plus FDIs and EU funds inflow) did not change much (even slightly improved) and thus positive assessment of external stability of the Polish economy has not changed.

- The latest data for July showed a C/A gap of over €0.5bn. The trade deficit reached €551m, which resulted from the lower than in earlier months scale of imports drop (less than 30%YoY vs. average fall of 33.4% in Q2 and 30.8% in H1 2009). We do not think that higher import level than in previous months indicates any clear revival of the consumption and/or investment demand. This was most likely import of intermediate goods, needed for restocking. Exports fell by 24.5%YoY in July, on a similar pace as on average in the first half of 2009.

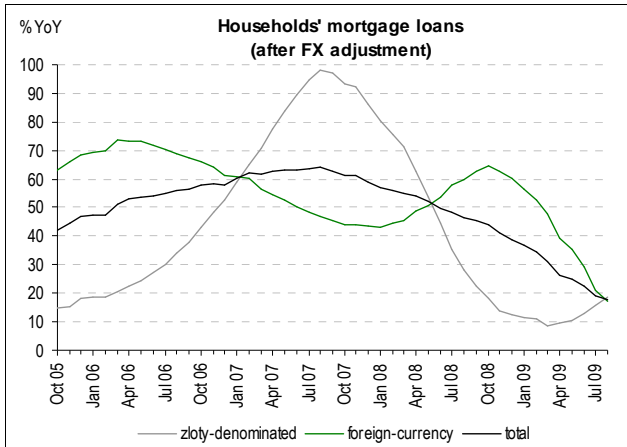
- Deficit in the income account reached as much as €661m, mainly due to dividend payments of €897m. Surplus in the current transfers reached €275m, out of which EU funds inflow in the current transfers was a mere €163m.

- On the capital account the striking factor is clear inflow of funds to debt instruments (€3.6bn), but this was related mainly to issuance of bonds denominated in the US dollar abroad and not to inflow of funds to the domestic bond market (€176m).



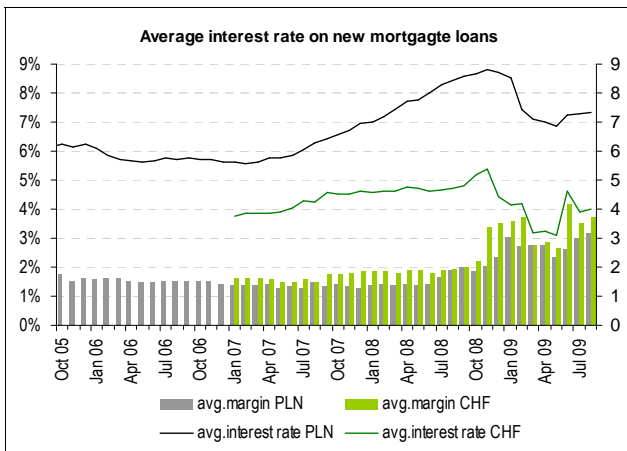
Source: CSO, NBP, own calculations

Housing market update



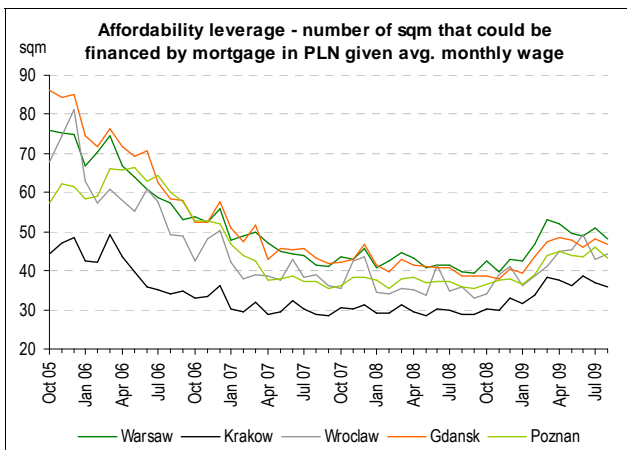
Demand for housing loans inched up

- The growth rate of housing loans to households weakened in recent months, but in August we saw a slight recovery.
- The value of housing loans rose by PLN1.6bn since July, but after taking into account correction for the zloty appreciation it was PLN3.1bn rise, while a year ago a similar increase amounted to PLN3.8bn, and the average monthly increase in January-July 2009 (FX-adjusted) amounted to PLN1.6bn.
- Increase of customer interest in housing loans in Q3 was recorded by banks and is reflected in the results of a recent NBP survey on the situation in the credit market.
- A share of new housing loans in foreign currencies is decreasing, which results from the reduction of banks' offer in this segment of the market.



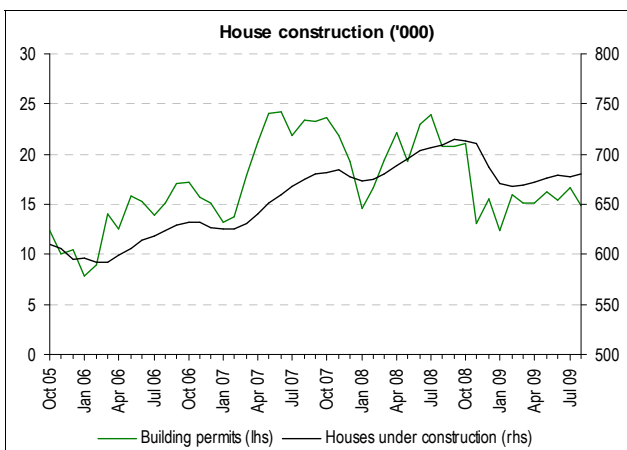
... but banks restrict the supply and sharpen the criteria

- While there are signs of revival in demand from customers, banks continue tightening credit policy because of the high macroeconomic risks.
- After a period of relative stability in the first half of the year, the average margins in the banking sector for new loan agreements again started to rise. As a result, despite the domestic money market rates declined during the summer holidays, the average interest rate on zloty-denominated housing loans has increased in recent months (although it is still clearly below the level before the outbreak of the crisis in the autumn of last year). An analogous situation took place in the case of foreign currency loans.



Households' purchasing power has ceased to grow

- After a slight rebound from the bottom at the start of this year, purchasing power of households in the property market stopped growing, at least in major cities, for which we have data available.
- This was triggered by several factors: stabilization in house prices, wage growth slowdown and the aforementioned increase in costs of housing loans.
- As a result, the index of leveraged house affordability that we estimate (house purchase financed by mortgage loan with 100% LTV) declined in August. If there is no deepening of price decreases in the property market, the index in the coming months may decrease further (further slowdown in wages, end of interest rate cuts cycle). The index does not take into account other loan criteria than interest rate cost and customer's income, while those criteria are tightening as well.



Stable supply at a reduced level

- In August, there were 11,000 flats completed in Poland, 1% less than the year before, and the number of building permits issued was about one-third less than in August 2009. Building permits for homes for sale or rent are declining particularly rapidly (about -50%YoY). The number of newly started investments in the housing market in January-August was 25% lower than in the corresponding period of last year.
- These data confirm the stagnation of the supply-side of housing market, which impact will be visible in the horizon of several quarters, especially when the economy starts to bottom out more rapidly. For now, however, a large pool of available homes on the market built in the last two years is, amid limited demand, a factor exerting downward pressure on property prices.

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

Central bank watch

Main elements of the MPC statement after its meeting in September

The recently released data – including those on GDP in 2009 Q2 – indicate easing of recessionary tendencies in the United States and in most EU countries. Recently released data point to further improvement in economic activity in the United States and in the euro area, though the activity remains low. Both economies have recorded further improvement in most economic sentiment indicators and the forecasts of GDP growth in 2010 have been slightly revised upwards. The global economic activity, however, is still low and at present, it is difficult to assess the scale and sustainability of the expected recovery, especially given the persistent problems in the financial sector and gradual restraint of stimulus packages.

In major economies the decline in the general price level continued – driven by the slowdown in the world economic growth and the previously observed drop in food and other commodity prices, has deepened – though its scale was smaller than in the preceding month. In turn, the prices of energy commodities in the world markets have begun to rise again.

In the Council's assessment, inflation is likely to remain at an elevated level in the coming months, mainly due to the relatively high annual growth of food prices and regulated prices, including, above all, energy prices. The recently observed rise in crude oil prices, mitigated to a certain extent by the recent zloty appreciation, may also be conducive to inflation remaining at an increased level. In the medium term, however, low demand pressure and a slower growth of labour costs should be conducive to inflation decrease.

In the Council's assessment, the probability of inflation running below the inflation target in the medium term is higher than the probability of its running above the target. At the same time, in the Council's assessment, the probability of inflation running below the inflation target in the medium term has decreased in recent months. In the Council's view, the expected improvement in the global economic activity and the implemented cuts in the NBP interest rates together with the lowering of the required reserve rate will support the return of the economy to the potential growth path. The Council's decisions in the coming months will take account of the incoming information on the outlook for economic growth and inflation, the situation in the financial markets in Poland and abroad, information on the public finance sector and the zloty exchange rate developments.

Fragments of Monetary policy guidelines for 2010

In 2010, the primary objective of monetary policy will be pursued to maintain inflation in the medium run at 2.5%. At the same time, monetary policy will continue to be conducted in such a way as to encourage the maintenance of sustainable economic growth. (...) In its decisions the Council will take into account the situation of the financial sector, which stability is a prerequisite for maintaining price stability over the longer term.

In the case of a binding decision on the date of the planned Poland's accession to the euro area, the Council will adjust the monetary policy strategy on the need of meeting the Maastricht criteria, and then will conduct monetary policy to enable the fulfilment of these criteria, thereby enabling the adoption of the euro by Poland within the prescribed period.

Discount credit is intended to finance new loans to businesses by banks. Under this facility the NBP will accept for discount promissory notes issued by the enterprises at the banks.

Comments regarding new monetary policy instruments

Stawomir Skrzypek, NBP president, MPC press conference, 30 Sep

We will propose the Council to publish a path of future interest rates. But if there is no agreement on such a radical change in communication, then we can discuss a return to formal policy bias. Soon will present concrete proposals on this [introduction of discount credit], including the rate for such loans. And therefore, the NBP may be publishing information about additional rate, i.e. discount rate.

Marian Noga, MPC member, PAP, 30 Sep

In the Monetary Policy Guidelines for 2010 we have included discount credit, previously presented by the president Skrzypek. But nothing in that case had been done. Its launch will require presentation of details by the Management Board for discussion and approval of the Council.

Zdzisław Sokal, member of NBP Management Board, PAP, 5 October

The Board is working on preparation of full documentation [regarding discount credit] and it will be presented to the Council. At this moment there is not situation that would require using this instrument and it may happen there will be no need to use it at all.

Neutral bias getting closer and closer

- As expected, in September the MPC has left interest rates unchanged (the reference rate is still 3.5%).
- In addition, the Council agreed that it is still justified to maintain the informal easing bias in monetary policy, while at the same time pointed out that the moment of changing bias to neutral is getting close, saying in a statement that "the probability of inflation running below the inflation target in the medium term has decreased in recent months".
- Most likely, a change in bias to neutral will take place in October, if only the assessment of outlook for inflation and economic growth do not change significantly under the influence of new data and results of the new NBP projection.
- The remaining part of the Council's communiqué has not changed significantly. It stressed that economic activity in the US and the euro zone has continued improving, but found it difficult to assess a scale and durability of the improvement. Central bankers noticed that most domestic indicators of economic activity and business climate signals further improvement of the Poland's economic situation, but highlighted the continuing deterioration in the labour market and weakening credit activity, particularly in the corporate sector.
- The MPC's assessment regarding inflation outlook has not changed significantly - the elevated level of inflation may persist in the short term, but in the medium term, low demand pressure and reduction of labour costs growth should lead to lower inflation.
- It seems clear that after a change in bias to neutral in October, the main interest rates will remain unchanged until the end of the current MPC's term of office.

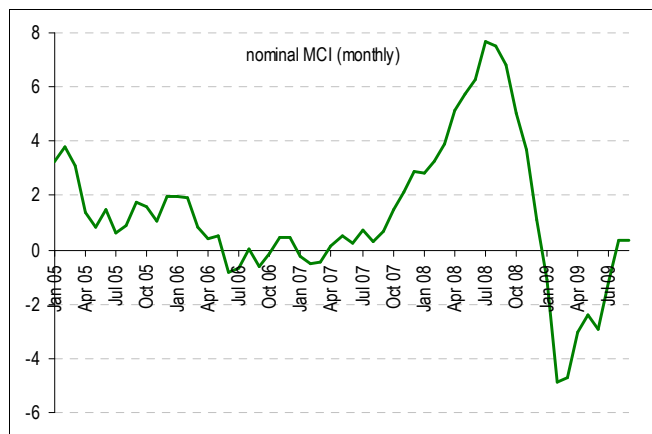
Monetary policy tools largely unchanged

- In the *Monetary Policy Guidelines for 2010* adopted in September, the Council introduced additional instrument of monetary policy, i.e. discount credit. It is to be used to refinance new loans to businesses by banks. Launch of the instrument may take place after the development of rules by the NBP Management Board and their approval by the MPC.
- The MPC predicts an increase in short-term liquidity of the banking sector in 2010 to PLN33.4bn, by ca. PLN15.2bn higher versus this year, through the influx of EU funds and their conversion at the NBP.
- The MPC wrote, as before, that the strategy of monetary policy and exchange rate system will be adapted to the need of meeting the Maastricht criteria after making a binding decision on the proposed date of entry into the euro area.

... but NBP Board offering new solutions

- NBP management proposed changes in monetary policy instruments. A few weeks ago the NBP President announced the extension of repo maturity to 12M and announced plans to introduce new monetary policy instruments: the discount credit and the purchase of bonds of banks by the NBP. Only discount credit has gained (conditional) approval of the MPC, which is reflected in the *Monetary Policy Guidelines for 2010*.
- Recently the head of the NBP announced he will propose to the new Council to change the way of communication – publication of the path of future interest rates, or at least a return to the formal bias of the monetary policy. Among these solutions, which according to us would have positive impact on the transparency of monetary policy, it is more likely that the formal policy bias will be restored.

Restrictiveness of the Monetary Policy (Council)



Stabilisation of MCI

- After a few months of a rise, the nominal MCI stabilised in September amid two opposing factors. On the one hand, the moderate zloty weakening observed in September slightly increased the difference between the monthly average EURPLN level and its long-term trend. This acted towards fall in MCI.
- On the other hand, there was a slight rise in WIBOR 3M in September and this narrowed the difference between the actual WIBOR 3M and its long term trend. This factor was pushing the MCI up.
- Given our expectations of slight zloty appreciation and WIBOR stabilisation until the end of this year, the nominal MCI should slightly rise in the next months, indicating that monetary policy becomes effectively more restrictive without hikes in NBP rates.

3.50%



Filar 1.62 (1.61)

Wasilewska-Trenkner 1.59 (1.48)

Noga 1.52 (1.52)

Wojtyna 1.48 (0.91)

Sławiński 1.21 (0.91)

Czekaj 1.00 (0.86)

Owsiak 0.90 (0.91)

Nieckarz 0.86 (0.83)

Skrzypek 0.83 (N/A)

Pietrewicz 0.79 (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 restrictiveness axis reflects our expectations regarding direction of interest rate changes in the nearest months – till the end of the MPC's term of office. Values in percent indicate our subjective assumption as regards a preferred level of the reference rate in 12 months by current MPC members.

When the change in bias?

Extremely hawkish MPC member, Dariusz Filar, said on October 6 in an interview with Bloomberg that the change of informal monetary policy bias from easing to neutral may be influenced by the October NBP's projection and the November data. This suggested that the most hawkish member of the Council allows a delay in changing bias until the next month, which is quite surprising, given that he belonged to a group of members of the MPC that have been advocating for a move to a neutral bias for a few months. Perhaps the most recent, weaker than expected macroeconomic data, slightly changed the point of view of central bankers and their assessment of the economy's prospects. Prof. Filar stresses importance of data due for release in November, while in our view timing of a change in policy bias may depend already on figures to be released in October. If they strengthen central bankers' belief in economic recovery, the change in policy bias to neutral should not be delayed.

Still not much known about new MPC members

Anonymous source from the Civic Platform told PAP agency that candidates of this party to the new MPC will probably be prof. Elżbieta Adamowicz, prof. Jan Winięcki i prof. Janusz Beksiak. All the mentioned economists have a strong academic and research background. One should expect that the issue of appointing new MPC members will become one of the main topics on the agenda for the Polish financial markets (the current MPC ends its term in January). Two months ago an anonymous source cited by PAP mentioned also Andrzej Bratkowski (former deputy NBP governor and chief economist of a large bank) as the Civic Platform's candidate to the MPC. As candidates of the President an anonymous source listed Adam Glapiński, prof. Wojciech Roszkowski and (possibly) prof. Zyta Gilowska. In turn, an anonymous source said that candidates to the MPC from the minor partner in the ruling coalition will be prof. Józef Kozioł, prog. Władysław Szymański and Elżbieta Chojna-Duch (the flatter confirmed she was ready to candidate), although it is not certain whether the PSL party could pick one or more seats in the Council.

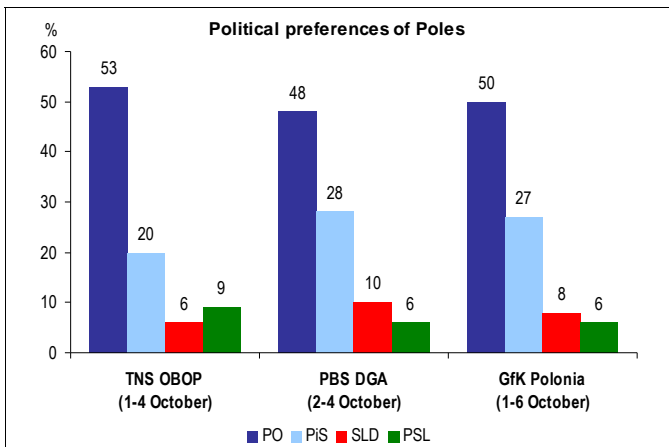
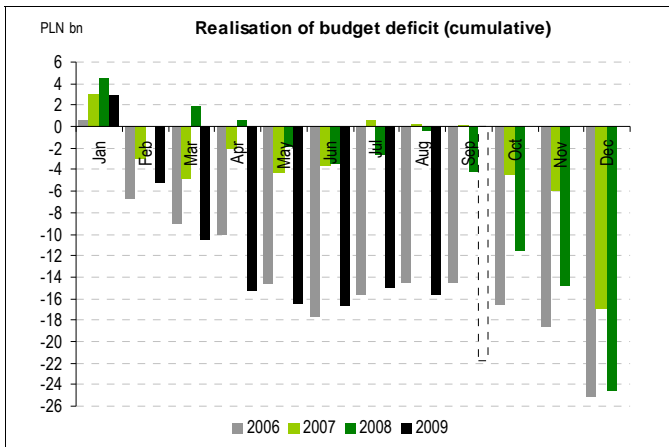
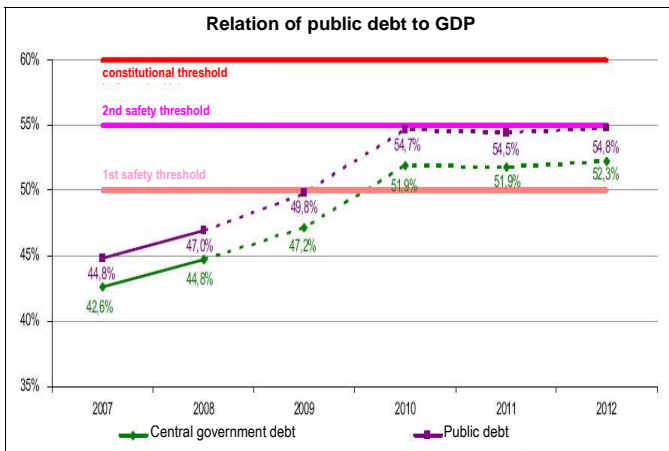
Current MPC members sceptical about NBP ideas

After the NBP Management Board announced an idea of implementation new instruments of monetary policy (details at the previous page), some members of the MPC explicitly expressed serious reservations regarding this issue. Prof. Andrzej Sławiński said that the discount credit may become useful, but only on a limited scale – in period when Polish banks will be in a difficult situation for some time. This instrument was included in the *Monetary Policy Guidelines for 2010*. Meanwhile, as regards purchase of banks' bonds by the NBP, Sławiński had serious doubts. In his opinion, a source for fixed investments in the economy and increase in capital banks should not be printing money, yet savings. The central bank should also not decide indirectly about direction of fixed investments, which took place to some extent in Asia before the crisis in 1997 and led to low effectiveness of the fixed investments. Besides, Sławiński thinks that the central bank should not take risk on behalf of taxpayers. The Fed and ECB acted in such a way, but only because there were really dramatic events in the US and the euro zone's financial systems. In turn, according to prof. Andrzej Wojtyna both the discount credit and purchase of banks' bonds are controversial. He stressed that currently there is a debate how central banks should exit from extraordinary tools of monetary easing while in Poland there were no serious problems, which could justify use of non-standards measures.

Government and politics

Main parameters of fiscal policy in 2010			
(PLN bn)	2008	2009	2010
Revenues of state budget	254.1	272.9	249.0
Expenditure of state budget	278.7	300.1	301.2
Balance of domestic budget	-24.6	-27.2	-52.2
Balance of EU funds budget	-	-	-14.4
Public debt	597.8	658.8	739.1
- central government	566.9	616.2	690.5
- local governments	28.1	36.7	43.7
- social security	2.8	5.9	4.9
(% of GDP)	2008	2009	2010
General government balance	-3.9	-6.0*	-6.9*
Public debt	47.0	49.8	54.7

* BZ WBK estimates



The government approved draft budget for 2010

- The final shape of the draft budget adopted by the government is not much different from the previous version.
- Deficit of the state budget will increase in line with the earlier announcement to PLN52.2bn and the deficit in the budget of the European funds will be PLN14.4bn, slightly less than previously stated.
- Budget revenue and spending are higher than previously indicated about PLN3.3bn, which, according to FinMin, results from the fact that some of the funds originally included in the EU budget, have been moved to domestic budget.
- The government also adopted the *Strategy of public debt management for 2010-2012*, envisaging, inter alia, higher issue of foreign bonds, especially in the euro and further increase in maturity of Treasury debt.

Will public debt exceed 55% of GDP?

- Strategy of public debt management predicts growth of public debt to 49.8% of GDP this year, 54.75% of GDP in 2010 and then stabilisation in the next two years, slightly below 55% of GDP.
- The strategy is based on the assumption of a gradual appreciation of the zloty in the coming years (average EURPLN 4.0776 in 2010, 3.8526 in 2011 and 3.6143 in 2012), which is supported by accelerating economic growth.
- Realisation of scenario of weaker zloty and/or slower growth than planned by the government would mean, in the absence of action to repair the public finances, high risk of exceeding the safety threshold of 55% of GDP. According to the NBP's analysis, there is a serious risk that the debt in 2010 may exceed 60% of GDP.

Realisation of the 2009 budget

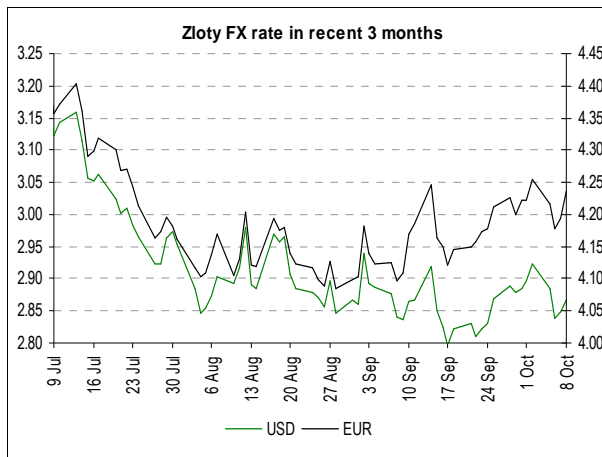
- After eight months of this year, the budget deficit amounted to PLN15.6bn, or 57.5% of the plan for the entire year after the amendment.
- Tax revenues again were at pretty good level, mainly through income taxes, while indirect taxes (which may be an indication of economic activity) were slightly worse than in July.
- The new timetable for implementation of the budget released after the budget amendment provides for the increase in the deficit in September to PLN21.8bn (80% of plan), an rise of over PLN6bn as compared to August. According to FinMin, this results from much lower than expected revenues from the EU.
- While earlier the Ministry of Finance predicted that the deficit in 2009 will amount to PLN22.5bn, in the final draft it is assumed that this year's deficit will be at PLN27.2bn.

Changes in the government, changes in the polls?

- PM Tusk accepted resignation of seven ministers in connection with the so-called "gambling scandal", the abuse at work to regulate the gambling industry. The dismissals included the ministers of the interior and justice departments, sports minister, and deputy minister of economy. The names of the alternates have not been given yet.
- Political turmoil may affect the public support for the government and the PO, although recent surveys, carried out immediately after the disclosure of the scandal, yet not show significant changes in support for the ruling party.
- The question is whether it will not reduce the government's will to undertake economic reforms. Finance Minister Rostowski has just announced that by the end of the year the government will show a 2-year plan to repair public finances.

Source: Ministry of Finance, Reuters, own calculations

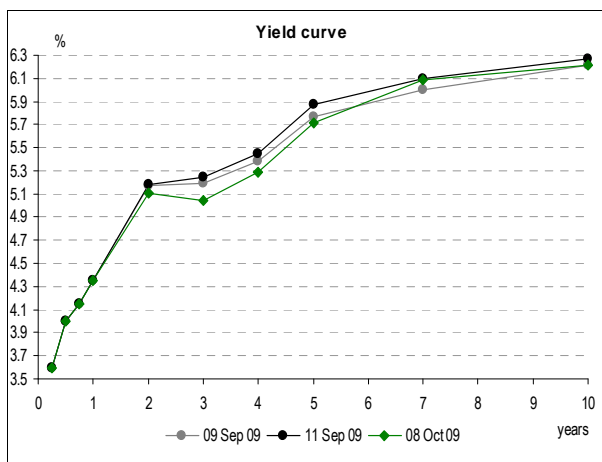
Market monitor



Correction of the zloty

■ As we expected in the past few weeks the zloty depreciated. The EURPLN rate fluctuated in range of 4.08-4.22 for a long time. At the turn of the month the zloty depreciated to ca. 4.30 vs. the euro, which was connected among others with expectations of dividend payment for Eureko from PZU. The final resolution of the conflict with the Eureko, the rating outlook upgrade of Hungary and increase of risk appetite led to zloty recovery to ca. 4.20.

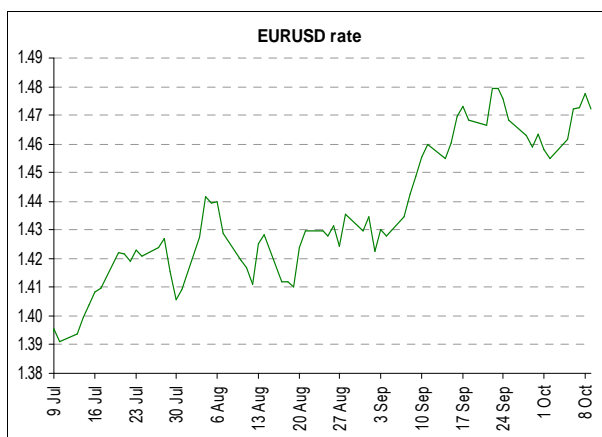
■ One may not rule out that due to regional factors the zloty reaches 4.30, or even slightly exceeds it, though the potential for correction gradually diminishes. If the started season of earnings releases in the US in Q3 does not disappoint and new macroeconomic data confirm that the global economy is on the recovery path, the zloty should move toward 4.00 vs. the euro, though breaking this level is a longer perspective than one month in our view.



Bonds recover despite high 2010 deficit

■ The 2010 budget bill released in September led to weakening of the bond market. The declines of prices appeared temporary and the market recovered. Bonds were supported by comments from the FinMin about the limiting the long term bond issue and strengthening of bonds in Hungary amid expectations for interest rate cuts. The concerns over the bonds sale by the PZU for dividend payment to Eureko led to temporary correction in the debt market, which recovered after final resolution of the issue. In the last month the IRS curve flattened (decline in long term rates).

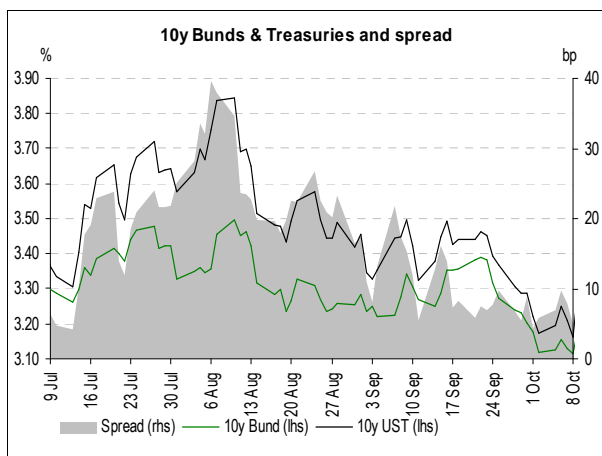
■ Decline of inflation to 3.5% in September may slightly strengthen the interest rate market, similar as the expected by us strengthening of the zloty and improvement in global sentiment. Low bond supply at primary auctions and buy back of T-bills may also support the market.



Euro gains vs. dollar continued

■ In September the euro continued to strengthen against the dollar as a result of increasing risk appetite amid rising expectations for global recovery. The EURUSD rate rose to the highest level this year, i.e. over 1.48. At the end of September investors took profit and dollar rebound was fuelled by a series of poor US data. This was supported by increased interest in US bonds. The euro recovered in October on press speculation about resignation from the dollar as a currency for settlement of oil trade as well as on interest rate hike in Australia.

■ Positive earnings reports of enterprises in the coming weeks may support the risk appetite leading to further increase of the EURUSD rate. Stronger dollar recovery may take place only next year along with rising expectations for rate hikes.

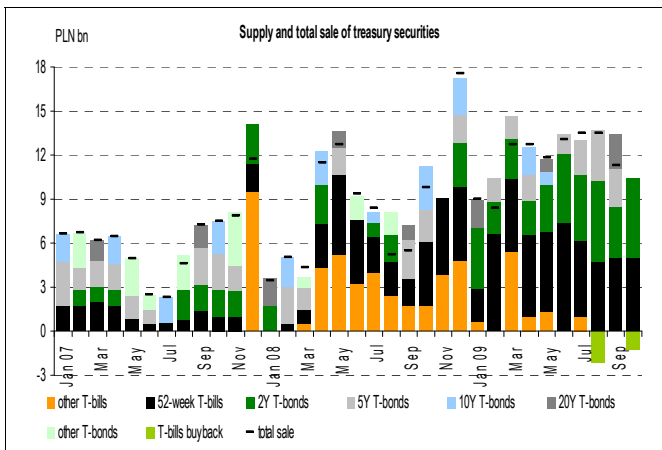
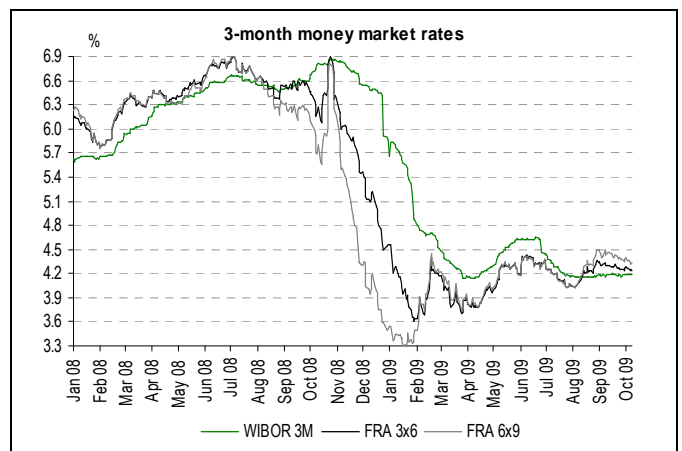
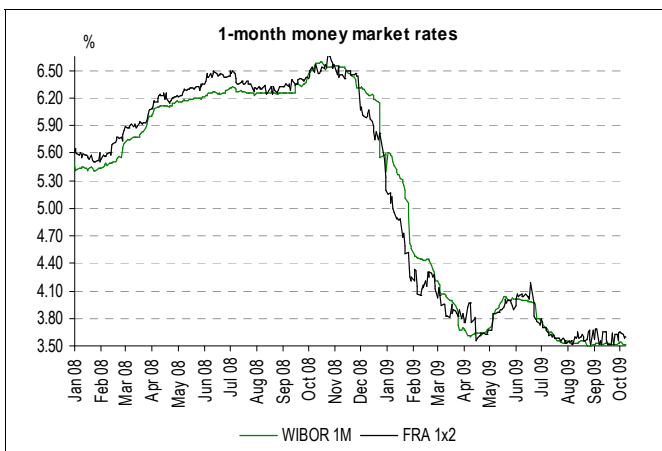
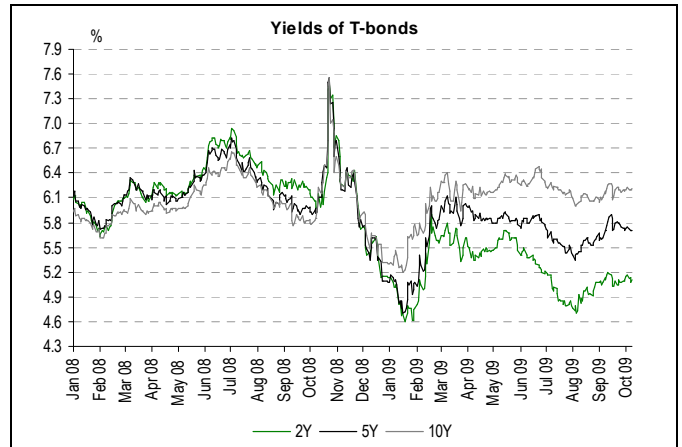
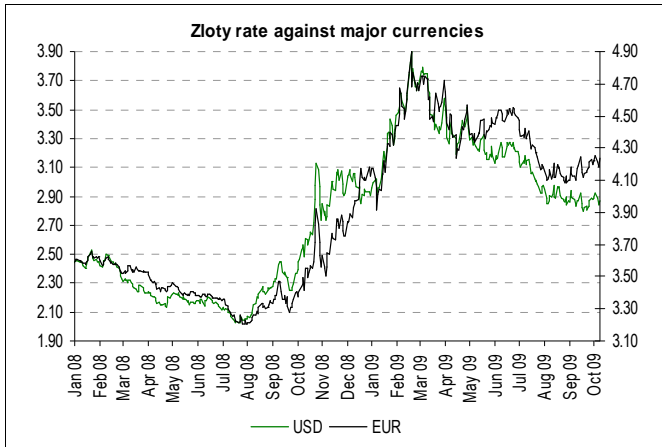


Still high demand for bonds

■ In the core debt markets in 1H of September the yields were rising, which was connected with limiting investors' positions in safe haven assets. This was accompanied by stock indices increases. The correction in the equity markets led to recovery of the government bond prices in the US and Germany. During last month the 10Y Bunds and Treasuries yields fell to 3.13% and 3.21% from 3.34%, 3.50% and there was a decrease in spread between these yields to ca. 8 bp.

■ The economic recovery in the US will be slow, and inflation is going to remain low, which suggests interest rates in the US remain unchanged at very low level at least till 2H 2010, if not longer. The situation looks similar, when it comes to prospects for interest rates in the euro zone. In our view further improvement in market moods will support fall in bond yields. Risk factor may be market concerns about inflation.

Market monitor



Treasury bills auctions (PLN m)

Auction date	(OFFER)*SALE	BUYBACK
19.08.2009	-	-2104
24.08.2009	800-1000/860	-
1.09.2009	800-1000/812	-
7.09.2009	800-1000/807	-
14.09.2009	800-1000/803	-
16.09.2009	-	-44
21.09.2009	800-1000/1000	-
28.09.2009	800-1000/848	-
5.10.2009	-	-1210
12.10.2009	400-600	-
19.10.2009	400-600	-
26.10.2009	400-600	-
2.11.2009	-	-

* based on data of the Ministry of Finance

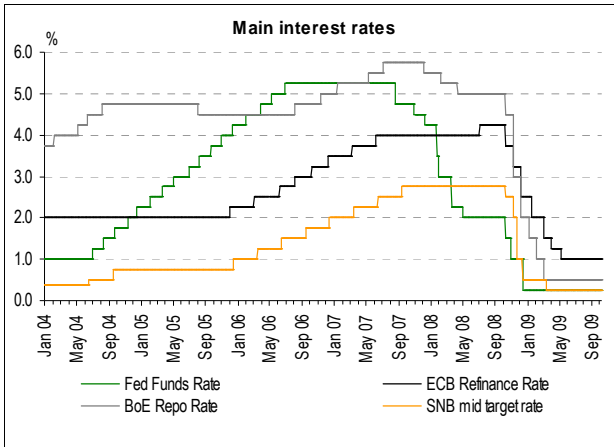
Treasury bond auctions in 2009 (PLNm)

month	First auction			Second auction			Switch auction				
	date	T-bonds	offer	sale	date	T-bonds	Offer	sale	date	T-bonds	sale
January	7.01*	OK0711	4200	4296	14.01	WS0429	1500	1500	21.01	PS0414/DS1019	2800/1300
February	4.02	OK0711/PS0414	2200/1600	722/1186	-	-	-	-	18.02	-	-
March	4.03	OK0711/PS0414	2760/1500	2550/640	-	-	-	-	11.03	OK0711/PS0414	2759/1809
April	1.04	OK0711/PS0414	2400/1800	2544/1814	8.04	DS1019	1000-1800	2120	15.04	PS0414/DS1019/WS0922	1437/3129/1158
May	13.05*	OK0711	3150	3286	20.05	DS1019/WS0429	1000-1800	1835	6.05	DS1013/DS1015	765/2505
June	3.06*	OK0112/PS0414	4000-6000	4359/1122	10.06	DS1019/WS0429	0-2000	cancelled	17.06	OK0112/PS0414	1739/2108
July	1.07	OK0112	3000-4500	4006	15.07*	PS0414	1000-2000	-	8.07	PS0414/ DS1019	0/1982
August	5.08*	OK0112	3900-5400	5402	12.08	PS0414	2000-3500	3500	-	-	-
September	2.09	OK0112	2500-3500	3500	9.09	PS0414	1000-2500	1109	23.09**	WS0922	1000-2400/2400
October	7.10*	OK0112	3000-5400	5400	-	-	-	-	29.10	-	-
November	10.11	OK0712	-	-	-	-	-	-	26.11	-	-
December	2.12	OK0712/PS0415	-	-	-	-	-	-	16.12	-	-

* with supplementary auction, ** primary auction

Source: Ministry of Finance, Reuters, BZ WBK

International review



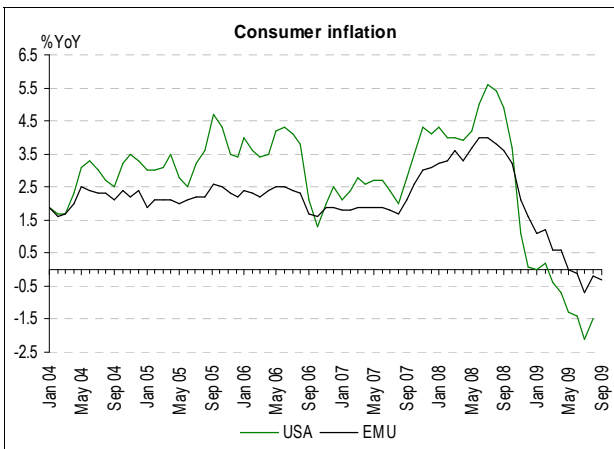
First rate hike in G20

▪ In line with expectations, the Fed kept rates on hold in September, saying that they will remain very low for a considerable period. In the central bank's view economic recovery is still too weak to withdraw from various forms of monetary easing. The end of securities purchase programme, including mortgage securities, has been delayed from December until March 2010.

▪ ECB decided in October to leave interest rates unchanged, with main interest rate at 1.0%. ECB President J.C. Trichet said at the news conference that the economy is showing signs of improvement, but the recovery would be "uneven", and stated once again that the ECB interest rates are currently at an appropriate level, which suggests that one should not expect their rapid changes. There were also no signs of a possible bank considering an exit strategy from quantitative policy easing. In our view first interest rate hikes may occur in 2H 2010, though if the more pessimistic than our forecasts on GDP of the ECB came true there is a risk that interest rates could remain unchanged till the end of next year.

▪ At the start of October Bank of Australia, as the first central bank among G20 countries, unexpectedly raised interest rates interest rates by 25 bp from the lowest level in 49 years, to 3.25%, indicating the possibility of further increases, in response to signs of economic recovery.

▪ Although, in major economies the inflation rate remained below zero (US CPI: 0.4%MoM and -1.5%YoY in August, euro zone HICP down from -0.2%YoY to -0.3%YoY) there are rising concern in the market over the rise in inflation along with the economic recovery among others on significant easing in monetary policy.



Increase of activity indices decelerated

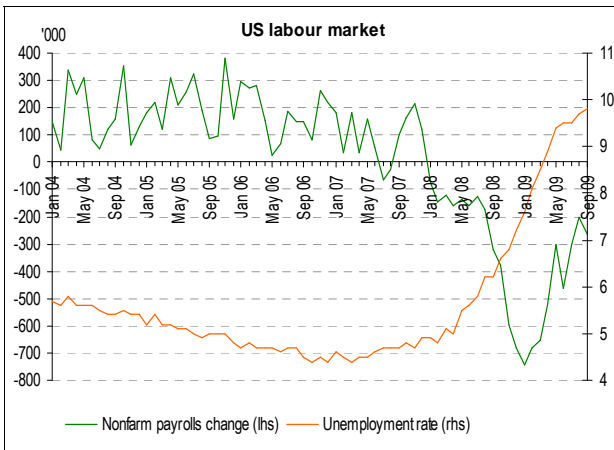
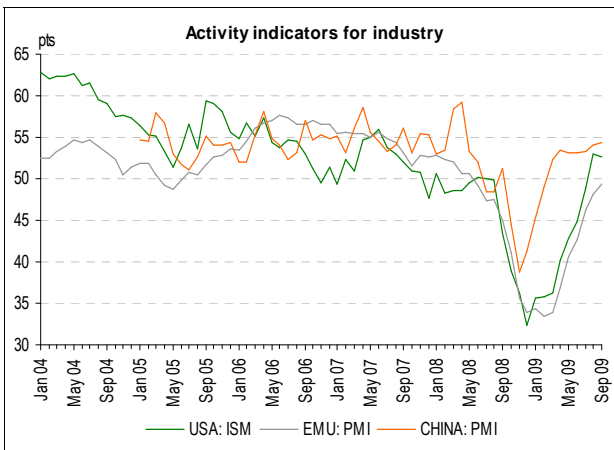
▪ Global investors still look with hope at Asia seeking for source of economic recovery. In September the activity in Chinese manufacturing improved more than a month before, as the PMI index rose to 54.3 pts from 54.0.

▪ In the euro zone the manufacturing PMI index rose, though it stayed slightly below 50 pts (49.3). In the services sector there was another increase in activity (PMI rose to 50.9). Data from the US manufacturing disappointed as the ISM index fell to 52.6 pts from 52.9 pts (below expected 54), though the activity increase is still recorded. On the other hand the ISM in services was much better than expected as it rose to 50.9, for the first time in a year breaking 50. Moreover, the final consumer sentiment Michigan index rose in September to 73.5 pts from 65.7.

▪ Quite optimistic outlook from activity data was disturbed by deterioration of consumer confidence in the US (Conference Board fell to 53.1 pts) and housing market (first drop in 4 months of existing home sales in August to 5.10m and smaller than expected increase in new home sales in August to 429k).

▪ Labour market data were slightly worse than expected. According to the US Department of Labour the decline of non-farm payrolls in September by 263k was larger than forecasted (-175k). The unemployment rate in the US rose to 9.8%, the highest level in 26 years from 9.7% in August.

▪ Final Q2 GDP data from the US were upwardly revised to -0.7% from -1% on better than expected result in investments in non-residential building investments. GDP data in the euro zone were downwardly revised to -4.8%YoY from -4.7%YoY.



Source: Reuters, ECB, Federal Reserve

Economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
12 October <i>PL: Auction of Treasury Bills</i> US: Market holiday	13 <i>PL: Balance of payments (Aug)</i> DE: ZEW index (Oct)	14 <i>PL: Money supply (Sep)</i> <i>PL: CPI (Sep)</i> EZ: Industrial output (Aug) US: Import prices (Sep) US: Retail sales (Sep) JP: BoJ decision US: Fed minutes	15 EZ: Final HICP (Sep) US: CPI (Sep) US: Philadelphia Fed index (Oct) US: NY Fed index (Oct)	16 <i>PL: Wages and employment (Sep)</i> US: Capacity utilisation (Sep) US: Industrial production (Sep) US: Capital flows (Aug) US: Preliminary Michigan (Oct)
19 <i>PL: Treasury Bills auction</i> <i>PL: Industrial output (Sep)</i> <i>PL: PPI (Sep)</i> JP: BoJ minutes	20 US: New home sales (Sep) US: Building permits (Sep) US: PPI (Sep)	21 <i>PL: Core inflation (Sep)</i>	22 <i>PL: Business climate indicators (Oct)</i> <i>PL: MPC minutes (Sep)</i> US: House prices (Aug) US: Leading indicators (Sep)	23 <i>PL: Retail sales (Sep)</i> <i>PL: Unemployment rate (Sep)</i> EZ: Flash manufacturing PMI (Oct) EZ: Flash services PMI (Oct) DE: Ifo index (Oct) GB: GDP (Q3.) US: Home sales (Sep)
26 <i>PL: Treasury Bills auction</i> DE: Gfk index (Nov)	27 <i>PL: MPC meeting</i> EZ: M3 money supply (Sep) US: Case/Shiller (Aug) US: Consumer confidence (Oct)	28 <i>PL: MPC meeting decision</i> US: Durable goods orders (Sep) US: New home sales (Sep)	29 <i>PL: Switch auction</i> EZ: Economic sentiment index (Oct) US: Preliminary GDP (Q2)	30 EZ: Flash HICP (Oct) US: Core PCE (Sep) US: Chicago PMI (Oct) US: Final Michigan (Oct) JP: BoJ decision
2 November <i>PL: Treasury Bills auction</i> EZ: Manufacturing PMI (Oct) US: Manufacturing ISM (Oct) US: Pending home sales (Sep)	3 US: Factory orders (Sep)	4 EZ: Services PMI (Oct) EZ: PPI (Sep) US: Services ISM (Oct) US: ADP report (Oct) US: Fed decision JP: BoJ minutes	5 <i>PL: PMI (Sep)</i> GB: Industrial output (Sep) EZ: Retail sales (Sep) GB: BoE decision EZ: ECB decision US: Labour productivity & unit labour costs (Q3)	6 US: Non-farm payrolls (Oct) US: Unemployment rate (Oct) US: Wholesale inventories (Sep)
9 DE: Export (Sep)	10 <i>PL: Balance of payments (Sep)</i> <i>PL: Bonds auction</i> DE: ZEW index (Nov)	11 <i>PL: Independence Day</i>	12 EZ: Industrial production (Sep)	13 <i>PL: CPI (Oct)</i> <i>PL: Money supply (Oct)</i> DE: Preliminary GDP (Q3) EZ: Preliminary GDP (Q3) US: Trade balance (Sep) US: Preliminary Michigan (Nov)

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

MPC meetings and data release calendar for 2009

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
MPC meeting	27	24-25	24-25	28-29	26-27	23-24	28-29	25-26	29-30	27-28	24-25	22-23
MPC minutes	22	19	19	23	21	18	23	20	24	22	19	17
GDP*	-	-	2	-	29	-	-	28	-	-	30	-
CPI	14	13 ^a	13 ^b	15	14	15	14	13	15	14	13	15
Core inflation	21	20	22	21	22	22	20	20	22	21	20	22
PPI	20	19	18	20	20	19	17	19	17	19	19	17
Industrial output	20	19	18	20	20	19	17	19	17	19	19	17
Retail sales	29	24	24	27	26	25	23	25	23	23	-	-
Gross wages, employment	19	17	17	17	19	18	16	18	16	16	18	16
Unemployment	29	24	24	27	26	25	23	25	23	23	-	-
Foreign trade	about 50 working days after reported period											
Balance of payments*	-	-	31	-	-	30	-	-	30	-	-	30
Balance of payments	15	12	13	14	15	17	14	11	11	13	10	11
Money supply	14	13	13	14	14	12	14	13	14	14	13	14
NBP balance sheet	7	6	6	7	7	5	7	7	7	7	6	7
Business climate indices	22	20	20	22	22	22	22	21	22	22	20	22

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

Source: CSO, NBP

Economic data and forecasts

Monthly economic indicators

		Sep 08	Oct 08	Nov 08	Dec 08	Jan 09	Feb 09	Mar 09	Apr 09	May 09	Jun 09	Jul 09	Aug 09	Sep 09	Oct 09
Industrial production	%YoY	5.5	-2.0	-10.6	-5.6	-15.3	-14.6	-1.9	-12.2	-5.2	-4.5	-4.4	-0.2	-1.1	-7.8
Retail sales ^c	%YoY	12.4	9.2	3.0	6.9	1.3	-1.6	-0.8	1.0	1.1	0.9	5.7	5.2	3.5	-0.4
Unemployment rate	%	8.9	8.8	9.1	9.5	10.5	10.9	11.2	11.0	10.8	10.7	10.8	10.8	11.0	11.2
Gross wages ^{b,c}	%YoY	11.2	10.1	7.6	5.6	8.1	5.1	5.7	4.8	3.8	2.0	3.9	3.0	3.2	1.0
Employment ^b	%YoY	4.0	3.5	3.0	2.2	0.7	-0.2	-0.9	-1.4	-1.7	-1.9	-2.2	-2.2	-2.4	-2.6
Export (€) ^d	%YoY	23.3	3.0	-8.1	-12.6	-24.3	-26.3	-16.6	-30.3	-22.1	-21.4	-24.5	-15.3	-14.6	-12.6
Import (€) ^d	%YoY	25.3	8.0	-5.2	-9.2	-26.2	-32.7	-25.9	-36.3	-31.9	-32.0	-30.0	-21.6	-20.3	-18.3
Trade balance ^d	EURm	-1450	-1611	-1553	-1819	-483	-67	-214	-207	-44	-109	-551	-498	-498	-692
Current account balance ^d	EURm	-2045	-1640	-1432	-1740	-754	790	-131	-428	-420	-11	-565	-248	-468	-442
Current account balance ^d	% GDP	-5.0	-5.1	-5.2	-5.1	-5.0	-4.5	-4.0	-3.8	-3.5	-3.0	-2.9	-2.7	-2.2	-1.9
Budget deficit (cumulative)	PLNbn	-4.2	-11.6	-14.8	-24.6	2.9	-5.3	-10.6	-15.3	-16.4	-16.7	-15.0	-15.6	-21.8	-24.2
Budget deficit (cumulative) ^e	% of FY plan	17.0	47.1	60.3	100.0	-10.7	19.4	39.0	56.4	60.3	61.3	55.3	57.5	80.2	89.1
CPI	%YoY	4.5	4.2	3.7	3.3	2.8	3.3	3.6	4.0	3.6	3.5	3.6	3.7	3.5	3.4
PPI	%YoY	2.0	2.4	2.2	2.7	3.6	5.7	5.5	4.8	3.7	4.1	2.8	2.5	2.1	2.2
Broad money (M3)	%YoY	17.3	17.3	18.1	18.6	17.6	17.8	17.5	14.4	14.2	14.4	11.9	9.2	9.0	8.9
Deposits	%YoY	20.0	18.7	19.4	20.6	19.5	19.2	19.4	16.1	15.7	15.9	13.0	10.8	9.9	10.6
Loans	%YoY	28.0	32.8	31.7	36.0	35.8	37.2	34.5	30.3	29.3	26.8	23.3	19.8	16.9	10.6
USD/PLN	PLN	2.34	2.69	2.93	2.98	3.18	3.63	3.55	3.36	3.23	3.22	3.05	2.90	2.86	2.86
EUR/PLN	PLN	3.37	3.57	3.73	4.01	4.22	4.65	4.62	4.43	4.41	4.51	4.30	4.13	4.16	4.18
Reference rate ^a	%	6.00	6.00	5.75	5.00	4.25	4.00	3.75	3.75	3.75	3.50	3.50	3.50	3.50	3.50
Lombard rate ^a	%	7.50	7.50	7.25	6.50	5.75	5.50	5.25	5.25	5.25	5.00	5.00	5.00	5.00	5.00
WIBOR 3M	%	6.56	6.80	6.74	6.40	5.51	4.69	4.30	4.20	4.52	4.60	4.26	4.16	4.18	4.15
Yield on 52-week T-bills	%	6.46	6.45	6.52	6.10	4.85	4.62	4.78	4.80	4.91	4.73	4.43	4.23	4.33	4.25
Yield on 2-year T-bonds	%	6.25	6.46	6.26	5.43	4.81	5.37	5.60	5.44	5.60	5.34	4.93	4.92	5.10	5.05
Yield on 5-year T-bonds	%	6.01	6.48	6.21	5.42	4.96	5.57	5.97	5.88	5.85	5.83	5.55	5.53	5.74	5.65
Yield on 10-year T-bonds	%	5.89	6.39	6.25	5.57	5.43	5.94	6.21	6.17	6.30	6.34	6.19	6.08	6.18	6.15

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 2008 - % of Dec, 2009 - % of plan

Quarterly and annual economic indicators

		2007	2008	2009	2010	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10	4Q10
GDP	PLNbn	1 175.3	1 271.7	1 338.5	1 381.1	314.5	326.6	329.2	368.2	325.4	335.0	337.0	383.7
GDP	%YoY	6.7	4.9	1.2	1.6	0.8	1.1	1.3	1.3	1.3	1.4	1.5	2.2
Domestic demand	%YoY	8.6	5.5	-1.4	2.2	-1.0	-2.0	-1.7	-1.1	2.4	2.8	1.6	2.1
Private consumption	%YoY	5.0	5.4	1.9	1.2	3.3	1.9	1.5	1.0	1.0	1.1	1.3	1.5
Fixed investments	%YoY	17.6	8.1	-4.4	1.5	1.2	-2.9	-4.0	-8.0	-3.0	2.0	2.0	3.0
Industrial production	%YoY	9.7	3.5	-5.1	-2.6	-10.0	-6.7	-1.9	-1.8	-4.7	-3.3	-5.3	2.9
Retail sales (real terms)	%YoY	14.0	9.6	0.3	0.2	-1.4	-0.1	2.7	-0.2	-0.7	0.0	-0.6	1.9
Unemployment rate ^a	%	11.2	9.5	12.5	13.7	11.2	10.7	11.0	12.5	13.5	12.7	12.8	13.7
Gross wages (real terms) ^c	%YoY	6.7	5.9	0.2	-0.4	3.2	0.2	-0.2	-2.1	-3.0	-0.5	0.0	2.1
Employment ^c	%YoY	4.6	4.8	-1.5	-2.3	0.1	-1.0	-2.3	-2.6	-3.0	-2.4	-2.1	-1.7
Export (€) ^b	%YoY	13.4	14.2	-20.0	3.1	-22.2	-24.8	-18.3	-14.0	-2.0	1.0	2.5	11.0
Import (€) ^b	%YoY	19.5	17.2	-26.8	6.5	-28.2	-33.4	-24.1	-21.0	3.0	7.0	6.0	10.0
Trade balance ^b	EURm	-12 369	-17 724	-4 715	-8 358	-744	-360	-1 547	-2 064	-1 944	-1 821	-2 553	-2 039
Current account balance ^b	EURm	-14 696	-18 302	-3 520	-5 658	-30	-845	-1 281	-1 364	-1 344	-1 121	-1 653	-1 539
Current account balance ^b	% GDP	-4.7	-5.1	-1.1	-1.6	-4.0	-2.9	-2.2	-1.1	-1.5	-1.5	-1.6	-1.6
General government balance	% GDP	-2.0	-3.9	-6.0	-6.9	-	-	-	-	-	-	-	-
CPI	%YoY	2.5	4.2	3.5	2.4	3.3	3.7	3.6	3.6	3.1	2.2	2.0	2.4
CPI ^a	%YoY	4.0	3.3	3.8	2.4	3.6	3.5	3.5	3.8	2.6	2.1	2.2	2.4
PPI	%YoY	2.0	2.2	3.4	-1.3	4.9	4.2	2.5	2.0	-1.6	-1.8	-1.0	-0.8
Broad money (M3) ^a	%YoY	13.4	18.6	5.2	4.0	17.5	14.4	9.0	5.2	4.0	3.7	5.3	4.0
Deposits ^a	%YoY	14.5	20.6	5.1	3.3	19.4	15.9	9.9	5.1	2.6	2.3	3.8	3.3
Loans ^a	%YoY	29.9	36.0	3.9	4.0	34.5	26.8	16.9	3.9	-0.1	0.3	1.7	4.0
USD/PLN	PLN	2.77	2.41	3.12	2.72	3.45	3.27	2.94	2.81	2.72	2.73	2.72	2.72
EUR/PLN	PLN	3.78	3.52	4.31	3.90	4.50	4.45	4.20	4.11	3.98	3.93	3.87	3.82
Reference rate ^a	%	5.00	5.00	3.50	4.00	3.75	3.50	3.50	3.50	3.50	3.50	4.00	4.00
Lombard rate ^a	%	6.50	6.50	5.00	5.50	5.25	5.00	5.00	5.00	5.00	5.00	5.50	5.50
WIBOR 3M	%	4.73	6.36	4.40	4.19	4.83	4.44	4.20	4.15	4.08	4.05	4.19	4.43
Yield on 52-week T-bills	%	4.69	6.26	4.54	4.29	4.75	4.81	4.33	4.25	4.25	4.10	4.30	4.50
Yield on 2-year T-bonds	%	5.23	6.22	5.20	5.21	5.26	5.46	4.98	5.10	5.23	5.05	5.20	5.35
Yield on 5-year T-bonds	%	5.52	6.15	5.67	5.72	5.50	5.85	5.61	5.70	5.78	5.65	5.70	5.75
Yield on 10-year T-bonds	%	5.56	6.06	6.11	6.03	5.86	6.27	6.15	6.15	6.13	6.00	6.00	6.00

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 08.10.2009 has been prepared by:

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