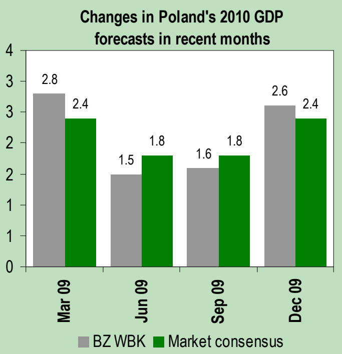
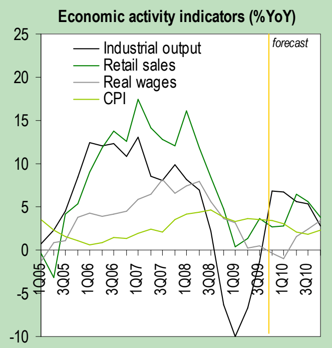
Bank Zachodni WBK

MACROscope

Polish Economy and Financial Markets

January 2010





In this issue:

Maciej Reluga
Chief economist
+48 22 586 8363

Piotr Bielski
+48 22 586 8333

Piotr Bujak
+48 22 586 8341

Cezary Chrapek
+48 22 586 8342

Email: ekonomia@bzwbk.pl

So far so good

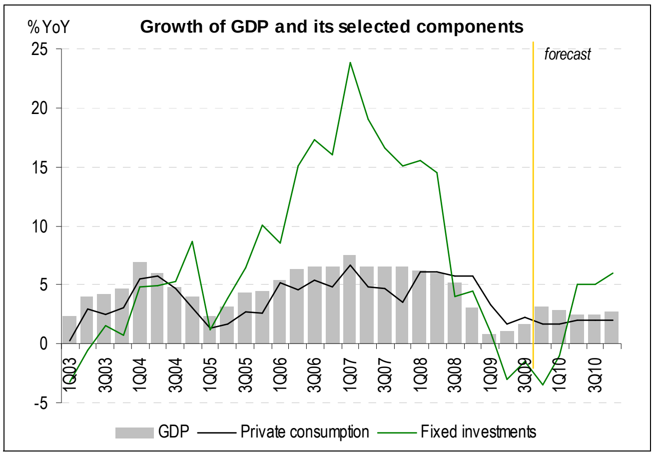
- **Last year, in the January report *"2010 to be better"* we referred to 2009 as a year we would wish to forget quickly.** Actually, the economic slowdown was quite evident. Despite the fact that H1 2009 witnessed a continued deterioration of the sentiment, we did not follow the pattern of pessimistic projections envisaging a potential recession in Poland. Concurrently, we expected lower investments, exports and employment. Overall, our forecast produced a year ago and providing for the GDP growth of 2% proves to be quite close to the economic reality, though, we need to admit that it was revised a number of times (first downwards and later upwards). The scale of the Polish zloty depreciation seen at the beginning of the last year and driven by a rapid deterioration of investors' sentiment towards our region came as the biggest surprise. During the year, however, it proved obvious to everyone that the Polish economy would get through the crisis much less affected than the Baltic states or Ukraine, which consequently led to the Polish zloty strengthening.
- **The Polish economy enters 2010 with quite an upside momentum given that the GDP growth topped up ca. 3% in Q4 2009 and will stay at that level in Q1 2010.** There is, however, a big question mark over further developments in H2 2010. The continuation of a high growth rate recorded by the Polish economy at the turn of the year will be determined, primarily, by the situation overseas. Much as the processes undergoing in the domestic economy may stir up some optimist, we may still feel concerned about the second wave of the global slowdown. Therefore, in our view the risk of our Polish GDP forecast for 2010 (of 2.6%) is asymmetric downwards.
- **We expect most of the factors which in 2009 drove inflation up to work in the opposite direction in 2010, i.e. the Polish zloty will strengthen, while the scale of rises in energy prices and excise duty will be lower.** Furthermore, despite some revival, the pace of economic growth will still be below its potential level with a similar situation seen globally, thus curbing the inflationary pressures. However, given that the recovery may continue in the following years and that the monetary policy should take into account future economic processes, we envisage two interest rate rises in H2 2010. That will be supported by the expected launch of the monetary policy tightening cycle by the EBC and Fed. For obvious reasons (very late appointment of the new MPC), forecasting the next year's monetary policy is hampered.
- **We envisage that the global economic recovery and the interest rates kept low throughout much of 2010 will stimulate a higher global risk appetite.** That will support steady appreciation of the Polish zloty, though, we should also expect high fx fluctuations during the year being the consequence of volatile sentiment worldwide.

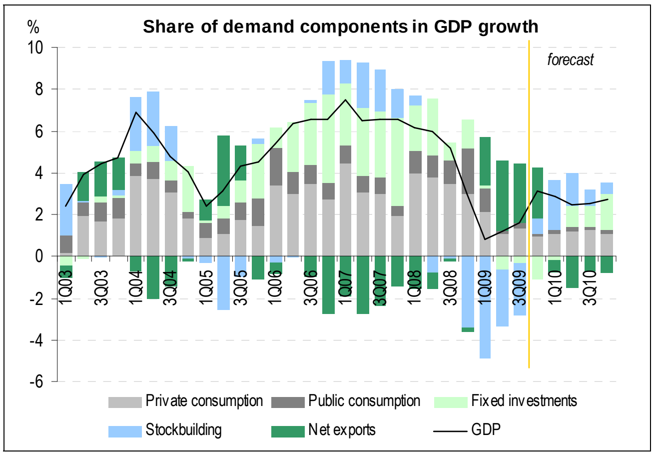
See the following pages for our 2010 forecast, including basic assumptions underlying the GDP growth projections, inflation rate, property market, financial markets as well as the monetary and fiscal policy (table at the end of the report).

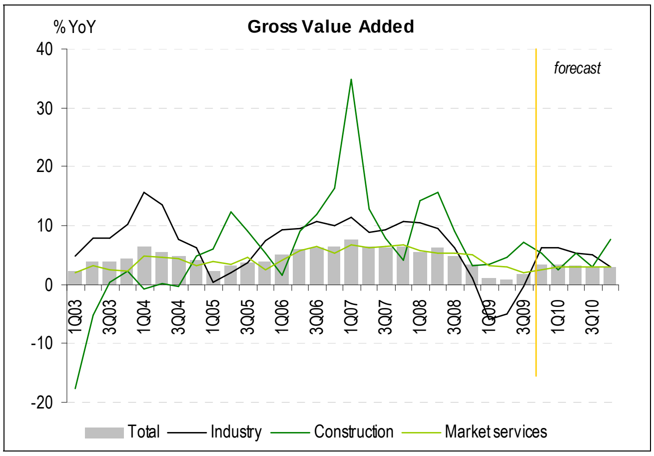
Financial market on 31 December 2009:					
NBP deposit rate	2.00	WIBOR 3M	4.27	USDPLN	2,8503
NBP reference rate	3.50	Yield on 2-year T-bonds	4.92	EURPLN	4,1082
NBP lombard rate	5.00	Yield on 5-year T-bonds	5.68	EURUSD	1,4413

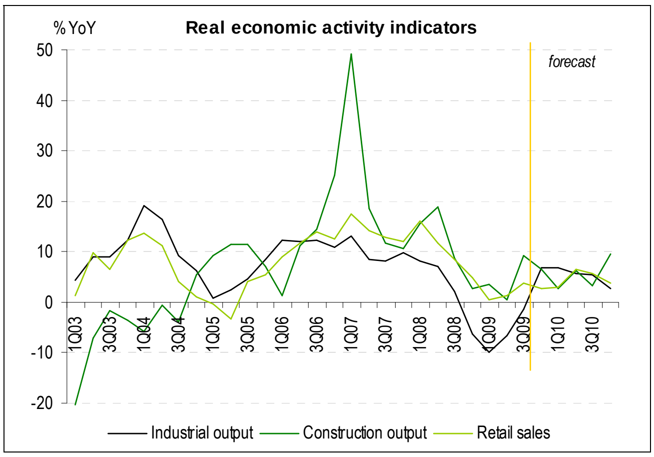
This report is based on information available until 6.01.2010

Economic update









Source: CSO, Reuters, own calculations

Forecasts for 2010 – demand side of the economy

▪ Situation in the labour market in 2009 proved very similar to our forecasts presented a year ago – the registered unemployment rate rose to ca. 12%, employment dropped by over 1.5% and average wage growth decelerated. The latter was more significant than we expected and private consumption growth considerably weakened. At the same time, one should be glad that both deterioration in labour market conditions and strength of consumption demand did not prove as pessimistic as it was indicated by forecasts presented during the year.

▪ We predict that pace of private consumption growth will remain at ca. 2% and situation in the labour market will be improving with employment growth likely in the H2 2010. However, strict cost control in enterprises should constrain wage growth in 2010 (although H2 may be better).

▪ As to fixed investments, we expect they will start growing in annual terms during 2010, mainly thanks to positive impact on inflow of EU funds on public investments neutralising negative tendencies in private investments. At the same time, along with improving economic situation globally, there should be some rise in FDIs inflow (although not to level seen in 2006-2008).

▪ Exports results will depend on pace of GDP growth at Poland's main trading partners. We assume the euro zone's GDP will grow ca. 1% in 2010 and thus Polish exports should rise amid favourable exchange rate (mild, gradual appreciation). However, as fixed investments and restocking process (the latter with ca. 1.5pp positive contribution to GDP growth in 2010) are strongly driving imports, the net exports contribution to GDP growth will be negative (ca. -1pp).

▪ We forecast higher rise in imports than exports, which will lead to widening of C/A gap, but with improved structure of its financing.

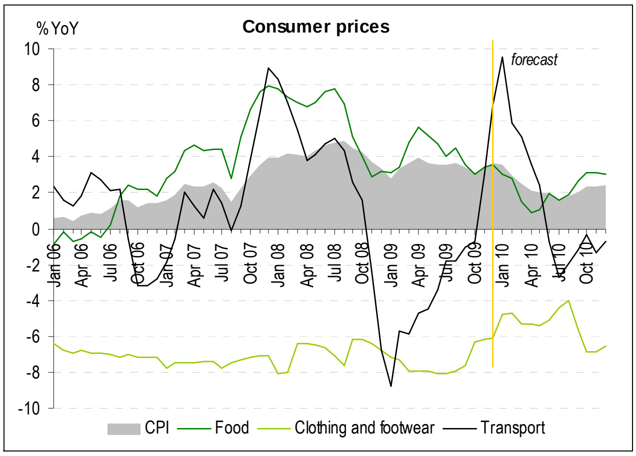
Forecasts for 2010 – supply side of the economy

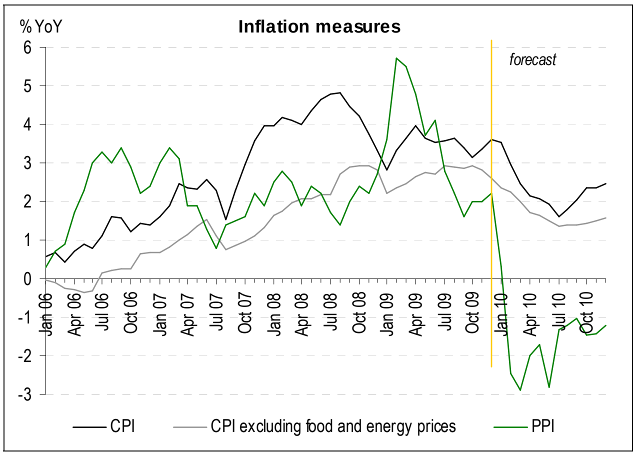
▪ Contrary to our expectations, situation in construction notably improved in 2009. Increased scale of infrastructural projects co-financed by the EU proved not only a stabilising factor for the construction sector (what we expected), but led to clear rise in construction output and some rise in employment in this sector.

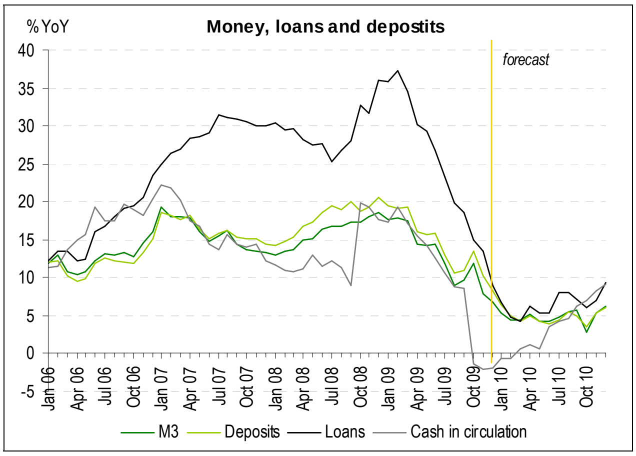
▪ For 2010 we assume slight acceleration in construction output growth. At the same time, we expect the improvement in industrial output growth will be stronger. After a fall in 2009, we should see rise in industrial output by a few percent in 2010, which will be driven by exports rebound and restocking process. The latter element began probably already towards the end of 2009, underlying strong rise in industrial output growth in November-December period. However, the restocking process will gradually wane and the so-called low base effect seen in late 2009 related to slump in economic activity in last months of 2008 will not repeat. Thus, one should not expect so that industrial output will keep two-digit pace of annual growth during 2010.

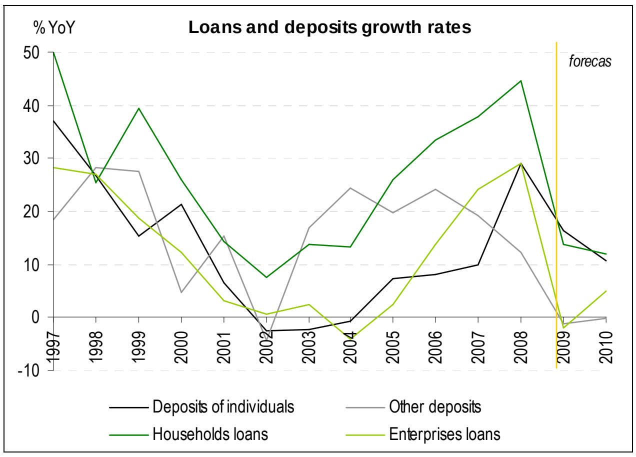
▪ For value added in market services (element of GDP from the supply side related to consumption demand) and retail sales we also forecast improvement of annual growth rates. However, this will be constrained by difficult labour market conditions. In 2009 a rise in retail sales was seen mostly in case of basic goods while demand for durable goods was subdued. An exception was sale of motor vehicles, which experienced a recovery, but it could be related to demand from neighbouring countries (with special programs stimulating demand for new cars). We expect similar structure of retail sales in 2010, although one should remember that a part of demand for motor vehicles was borrowed from the future.

Economic update









Source: CSO, NBP, own calculations

Forecasts for 2010 – inflationary process

▪ Our forecast of average annual inflation in 2009 has proved to be overly optimistic (lower than actual inflation by almost 1 percentage point), which resulted largely from a significant shock in the form of a zloty weakening. This factor has also affected food and fuel prices, which were therefore slightly higher than our assumptions. Prices of housing and energy use were in line with our predictions.

▪ We expect that the factors that were responsible for higher inflation in 2009 will work in the opposite direction in 2010. First of all, we forecast strengthening of the zloty, while we believe that even maintaining current level of the exchange rate would be a disinflationary factor. Secondly, the scale of price hikes in indirect taxes will be smaller. Thirdly, we expect smaller rise in prices of energy, heating and gas than last year.

▪ In addition, we assume that food prices will grow slightly less than in 2009 (around 3%), which will be due to, inter alia, high harvest of cereals in Poland and relatively good crop abroad in 2009, fairly high global inventories, and predicted appreciation of the zloty. Furthermore, our inflation forecast assumes that the average price of crude oil in 2010 will be at a similar level as at the end of 2009 (a dozen or so dollars per barrel more than the average price recorded in 2009).

▪ In total, while maintaining the pace of economic growth below potential and the relatively low growth in private consumption, we expect a decrease in annual average inflation to around 2.5% (below the target). The lowest level of inflation (below 2%) is predicted in the summer, although this will depend on the scale of decline in food prices. We forecast that core inflation (CPI excluding food and energy prices) on average in 2010 will be below 2%.

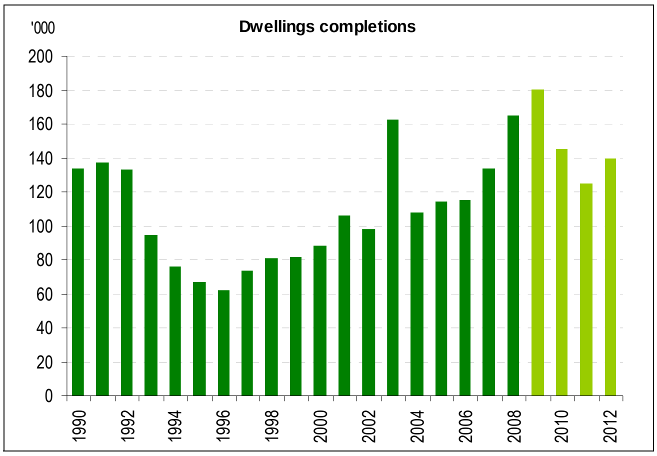
Forecasts for 2010 – loans and deposits

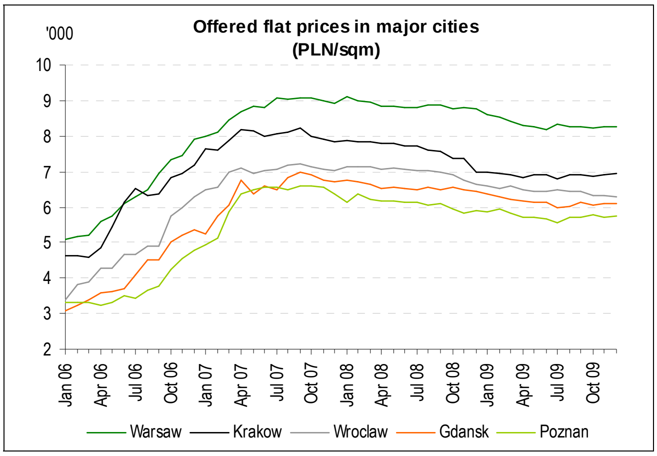
▪ We forecast that in 2010 lending will revive slightly. On the one hand, this will be triggered by increased money demand associated with economic recovery and improving sentiment of consumers and business. On the other hand, credit growth will be promoted by more relaxed policy of commercial banks amid improvement in prospects of firms' financial situation and better labour market outlook, improvement in the capital base observed in 2009, and a moderate scale (thus far) of deterioration in the quality of loan portfolio of banks.

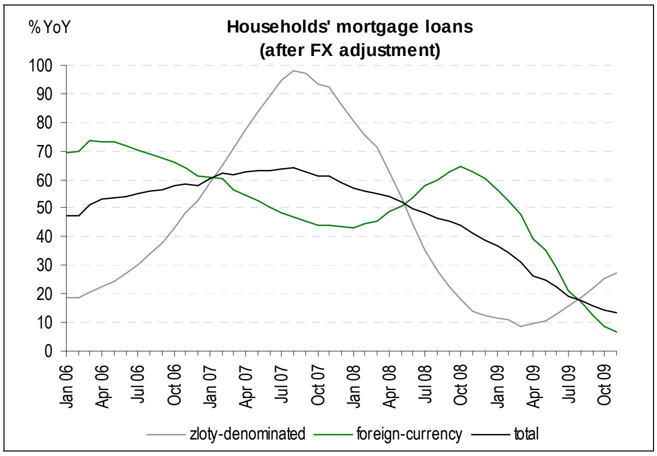
▪ The annual growth rate of total loans at the end of 2010 will increase slightly to 9.4%YoY from the expected ca. 9% at the end of 2009. After eliminating the impact of exchange rate, the improvement will be more clear - to 11.8% from 9.5%. In the case of loans for companies we expect a rise by almost 5% against over 2% drop in 2009 (after eliminating the FX effect a rise of less than 7% after a drop of 1.7% in 2009). Quite clear revival of credit to companies may take place in the segment of current and operational loans through the reconstruction of inventories and rise in production in firms. We expect only a slight improvement in investment loans, and in real estate loans we assume further deterioration in the annual growth. Loans for households are expected to decelerate annual growth to 12% from 13.8% at the end of 2009, but after eliminating the FX effect it yields an improvement to 15.0% from 14.3%. It will result from expected acceleration in housing loans (after eliminating FX effect) to 19.2% from 16% in 2009 (risk factor is possible implementation of T recommendation of the banking supervision).

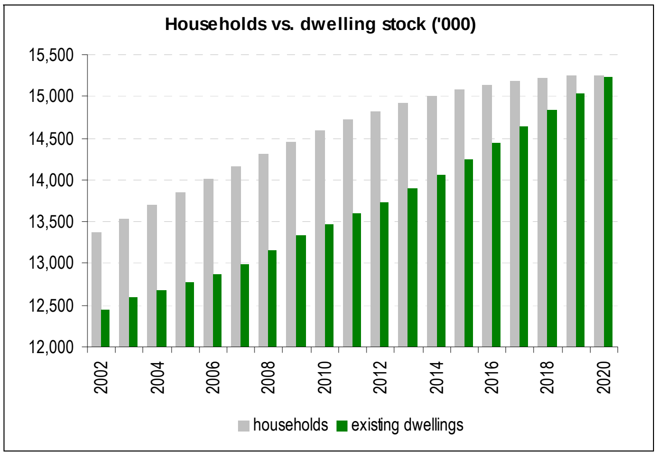
▪ For deposits we assume a slight deterioration in the annual growth due to continued low increase in wage bill, amid a greater propensity to consume, and some increase in share of more risky assets in the portfolio of the population.

Housing market update









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

Forecast for 2010 – housing market

▪ Situation in the property market in 2009 was in many respects close to the scenario, which we expected one year ago. Despite a sharp slowdown in investment activity by developers, which took place in response to the global crisis, the number of house completions during the year broke another record, rising to ca. 180,000 according to our current estimates (compared to 156,000 in 2008). This resulted from finishing construction of investments launched before the end of the housing boom. At the same time, in line with expectations, demand for houses diminished under the influence of the overall economic uncertainty, a deteriorating situation on the labour market and a significant deterioration in the supply of credit by banks and lower availability of housing loans.

▪ Despite the large supply in primary and secondary markets and stagnant demand, changes in housing prices in the Polish market were surprisingly mild. According to the Szybko.pl report, average offered prices of flats in twelve major Polish cities in 2009 fell by about 5%, twice less than we had feared one year ago. The AMRON-SARFiN report confirms a similar scale of transactional price drop in the third quarter of 2009.

▪ From the mid-2009 a stabilisation of property prices in major cities is observed. At the same time, agencies and developers see the gradual growth of the market activity and rising number of transactions, which suggests that the period of collapse in the market comes to an end.

▪ Projected further acceleration of economic growth under conditions of extremely low interest rates should encourage the reconstruction of the demand for real estate. But this will probably be a rather slow process. It must be remembered that improvement of situation in the labour market and thus the financial situation of households will be delayed as compared to the overall business cycle.

▪ Much also depends on the lending policies of banks, which remain more restrictive than before the outbreak of the crisis in financial markets. Factor of major importance to the market was a significant reduction of banks' offer of housing loans denominated in Swiss francs.

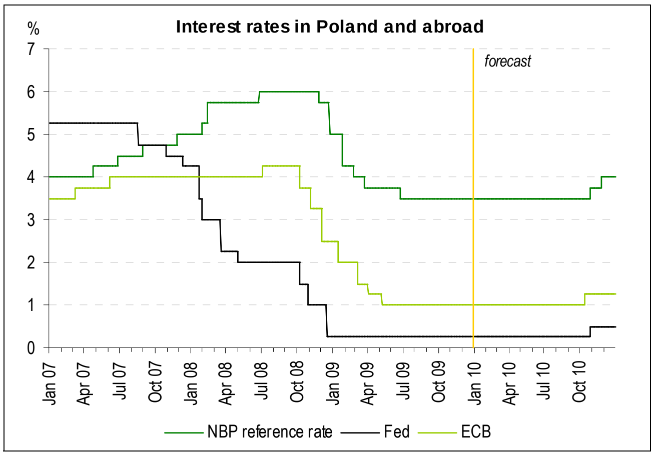
▪ At the end of 2009, the first signals of credit policy easing by commercial banks have appeared, as manifested in a slight decrease in margins and an increase in the maximum credit for the average customer. Recent quarters also saw a growth in popularity of housing loans denominated in euro. Growth of zloty-denominated mortgage loans also started accelerating.

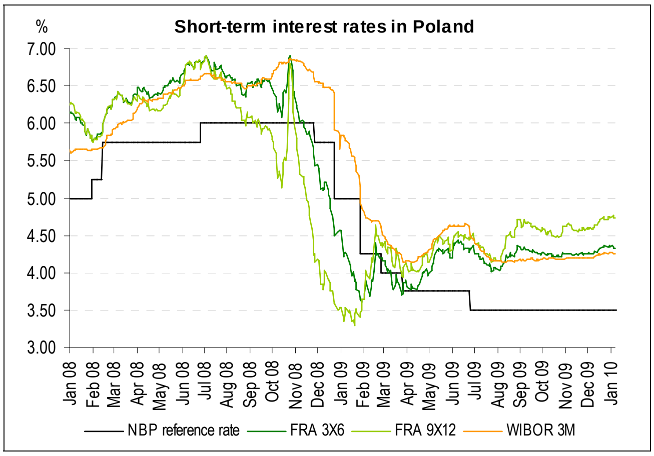
▪ Next two years will probably see a clear reduction in the supply of new housing, as evidenced by a drop in the number of new building permits and the number of house starts, which took place in recent quarters. Nevertheless, the scale of collapse after a record supply of 2009 will probably be much smaller than we feared before. There are already emerging signals from largest developers of planned new investments and possible relatively flexible response to rising demand.

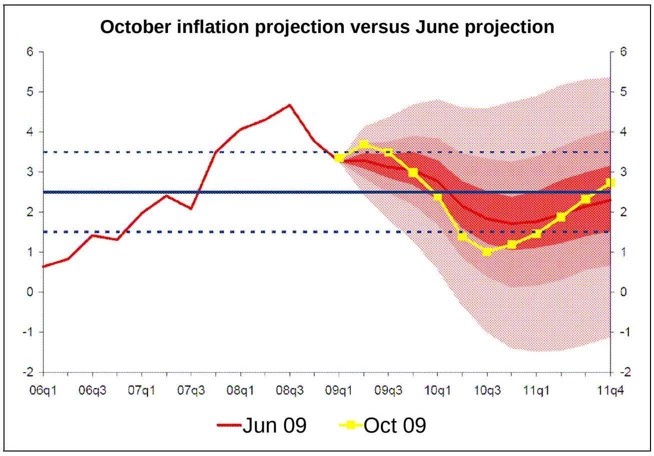
▪ In total, we expect that average house prices in 2010 will be stable because, despite a slow recovery in demand, the market will remain under the influence of a record supply of the last year.

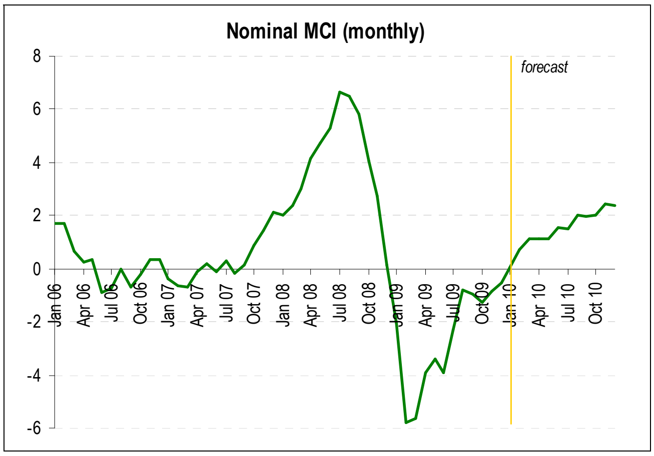
▪ In the longer term we expect the return of the upward trend in prices. It will be fostered, in addition to stronger demand, by the structural shortage of dwellings in Poland in relation to the number of households, which still remains above 1 million units and decreased only slightly in 2009. This is due to, inter alia, the growing number of households whose source is baby boomer generation coming into adulthood.

Central bank watch









Source: NBP, Reuters, own calculations

Interest rates in 2010 – rate hikes ahead

▪ Our forecast made a year ago assuming a reduction in the reference rate in Poland to 3.50% in the second quarter proved to be correct. This followed the deterioration in the economic environment in the world and improvement in the inflation outlook, which triggered reaction of the major central banks. As we expected, in those countries where there was still a room for monetary easing (the euro area and UK) the rate cuts were continued. Central banks were also applying other non-standard measures to stimulate economies (the so-called quantitative monetary easing).

▪ 2010 will likely see a reversal of these trends. As written in the section on the economy, the inflation outlook for 2010 is quite favourable, but the Monetary Policy Council will probably take into account possible developments in the medium-term horizon. Continuation of economic recovery and risk of the emergence of inflationary pressure may trigger the start of the rate hikes cycle from the lowest level in history.

▪ It will be supported by normalisation of interest rate levels abroad, which will probably be preceded by the withdrawal of quantitative easing measures in monetary policy. We forecast that the first rate hikes in both the euro zone and the US will take place at the end of 2010, but there will be a follow-up in 2011 (to nearly 3%). For the moment, an interesting question is whether the Polish MPC will decide to act faster than the ECB. We assume two rate hikes in Poland, 25 bp each, in the second half of the year.

▪ At the end of 2009 money market rates were pricing in a bit faster hikes in reference rate as compared to our expectations (we assume the first two rate hikes by 25 bp in the last quarter of the year).

What will show new MPC and new inflation projection?

▪ A factor, which makes predicting monetary policy difficult is (very late) change of MPC makeup. First, we still do not knows names (we write about candidates on the next page). Second, we do not know their views on monetary policy and thus it is hard to assess potential balance of strengths in the Council.

▪ It seems that the new MPC will be at least as divided as the current one. However, apart from personal preferences, a key role will be played by information from the economy and analyses and forecasts prepared by the NBP.

▪ Already at the first meeting with all the nine new members in February they will get the new NBP projection. The previous one pointed to inflation rise above the target in late 2011. However, we do not think that at one of its first meetings the new Council could change policy bias to tightening.

Rise in monetary policy restrictiveness in 2010

▪ The graph on the left shows our forecast of the monetary policy conditions index for 2010. It is clear that, based on our forecasts of interest rates and exchange rates, one may expect a gradual increase in monetary policy restrictiveness this year. This growth, however, will loose a bit of strength in comparison with large part of 2009 (which saw a significant appreciation of the zloty as a rebound from earlier weakness).

▪ We expect that both the appreciation of nominal exchange rate of the zloty and the performance of 3-month WIBOR rate will be above the long-term trend. We expect a gradual reduction in the difference between the WIBOR rate and the reference rate. However, it will remain elevated at a level not much lower than in 2009.

What will be the new Monetary Policy Council like?

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.

Source: NBP, PAP, Reuters, own calculations

What will be the new Council like: dovish, hawkish or ... owlish?

In the past one of the instruments used in assessing the level of restrictiveness of the Council was the index, which we present on the left side. Based on the published results of the voting there is a division on “hawks”, “doves” and swing voters, who determined the results of the votes. As we know, in the middle there used to be Jan Czekaj (with index value at 1, i.e. his votes were always in line with the Council decision) and Andrzej Sławiński (value close to 1). Vote of the president Skrzypek was also important, as when Mr. Czekaj voted in line with the doves, the NBP president's vote was determining the results.

Unfortunately we still do not know all candidacies to the new Monetary Policy Council and what is more we will get acquainted with the opinions of the new members regarding the interest rates only within a few months. However, we tried to guess already now, where to place the names of particular candidates – both the six official candidates, as well as three potential from the President Kaczyński.

Four “hawks” vs. four “doves”?

Based on comments regarding the economy and the interest rate policy of a few official candidates, we may only guess what kind of monetary policy they will prefer. It seems to be quite easy to see through some of them also based on their achievements and past experience. Jan Winiecki seems to be an “extreme hawk” in the Council and may be even more radical than the most hawkish members of the past term. Similarly, Andrzej Rzońca, who is close associate of the previous NBP president, Leszek Balcerowicz, will probably be in the hawkish wing, though it is tough to assess, as he dealt mainly with fiscal policy in the past. Among the candidates it is Andrzej Bratkowski, who seems to have the biggest experience in monetary policy issues (former deputy president of the NBP responsible for economic research). We assess him also as a moderate hawk, though his last comments were not so explicit. We do not know a lot about views on monetary policy of Anna Zielińska-Głębocka, a current PO member of Parliament. However, she called herself in one of the interviews as “quite hawkish”.

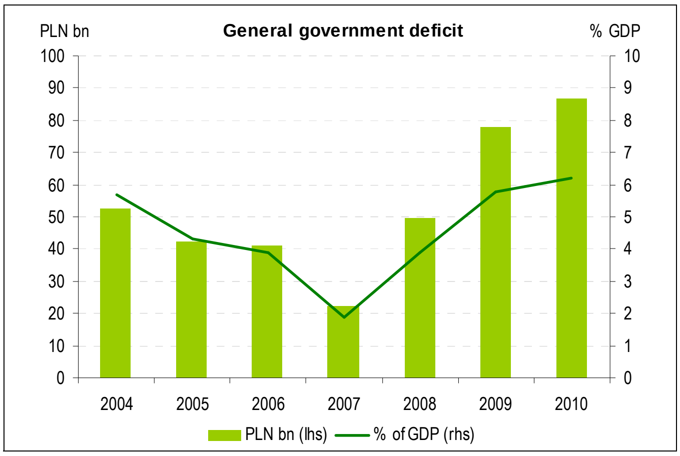
Consequently, we would have then four “hawks” in the new Council. However, the fact that they would be even more hawkish than the predecessors does not mean a lot for the shape of the monetary policy. We assume, that three candidates from the President (which may include Zyta Gilowska, Adam Glapiński, Andrzej Kaźmierczak, Wojciech Roszkowski, or Małgorzata Iwonicz-Drozdowska being a candidate of PiS from Senate) will represent a dovish wing. As there is also president Skrzypek on this side of the axis (based on voting results), this faction will need only one more vote for majority.

The key votes for decision regarding interest rates will belong to two remaining candidates – Elżbieta Chojna-Duch and Jerzy Hausner. In the past PSL candidates usually were “doves” in the Council (Pietrewicz, earlier Ziółkowska). It is hard to say, whether Chojna-Duch will adhere to this tradition. Similar, it is not easy to assess whether Hausner (deputy Prime Minister in SLD-PSL government) will be a hawk. Nevertheless, it seems to us that it is too early for the statements, repeated sometimes, that the new Council will be clearly more hawkish than the previous one.

New MPC members opinions on FX policy will be important

It seems that an important criteria for the parliamentary coalition of choosing new Council members was their opinion regarding the euro zone entry. In this issue most probably all six of the MPC candidates nominated by PO-PSL will be unanimous. For obvious reasons (not fulfilling fiscal criteria in the nearest years), this will be of minor importance for some time (perhaps even until the nomination of new NBP president in three years). It is essential, in our view, what will be the view of new MPC members on FX policy, not only in the context of euro zone entry. In this regard we know even less than in case of opinions on interest rates. We positively assess comment of Andrzej Bratkowski: “it should be acted so as the zloty strengthening, which will accompany the rising interest rate disparity between Poland and euro zone, use as a factor stabilising inflation and not something which will curb economic growth”.

Government and politics



Significant widening of fiscal gap

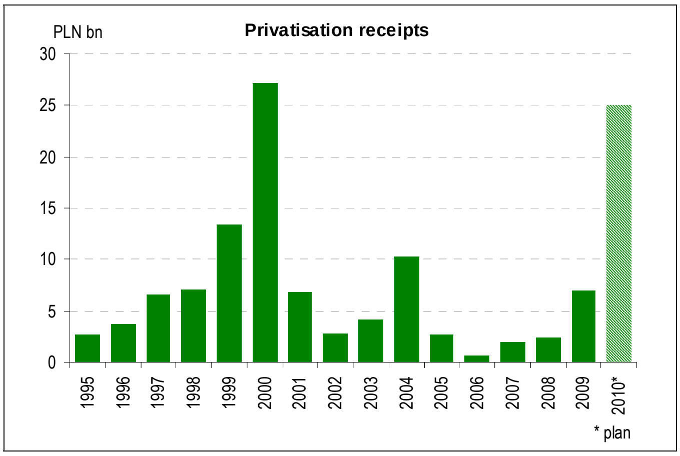
- The state's budget deficit for this year was planned at PLN52.2bn, but in terms comparable with 2009 one should add PLN14.4bn gap in the budget of EU funds.
- However, the budget deficit may prove lower than planned due to higher than assumed GDP growth and inflation (which may give additional PLN10bn revenues). Especially that realisation of domestic income for 2009 was higher than planned by over PLN10bn, which should facilitate realisation of ambitious income targets for 2010. Besides, NBP governor announced there will be transfer of NBP profit to the budget (PLN3-4bn) and there is a chance that dividend income will be a few billion zlotys higher than planned PLN4bn.
- However, even with positive risks, our estimate for general government deficit is around 6% of GDP.

Financing of the budget deficit according to the Budget Act

Item	2009 PLNbn	2010 PLNbn	2010 %YoY
Domestic financing	**34.504**	**60.941**	**76.6**
Market treasury papers	33.783	59.333	75.6
T-bills	-2.952	8.939	-
market bonds	36.735	50.395	37.2
Savings bonds	1.522	1.670	9.7
Non-market bonds (for BGŻ bank)	-0.103	-0.106	2.8
Foreign financing	**9.332**	**20.797**	**122.9**
Treasury bonds	11.577	13.267	14.6
Received loans	6.424	7.979	24.2
Other	-8.670	-0.449	-94.8

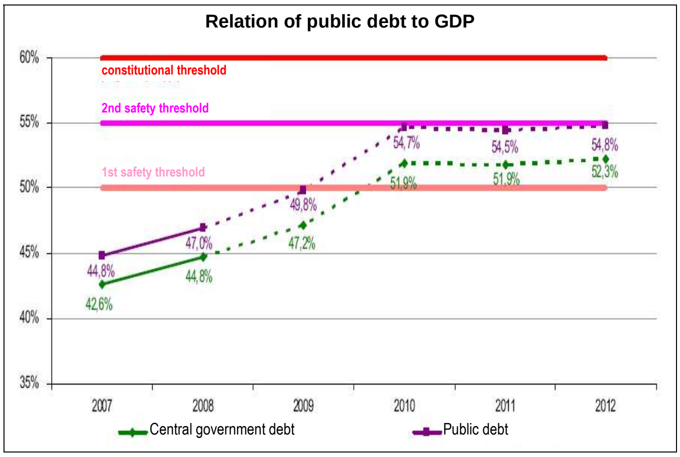
…and rise in borrowing needs

- According to the Budget Act, net borrowing needs will rise from PLN52bn in 2009 to PLN82bn in 2010. Gross borrowing needs in 2010 were assumed at ca. PLN203bn against PLN163bn last year. Important for the market value of domestic issue of market treasury bills and bonds was set at PLN169bn vs. PLN137bn in 2009, which means average monthly issuance of ca. PLN14bn.
- According to new estimates of the FinMin, gross borrowing needs may be less than PLN197bn thanks to buy-back of T-bills and switch auctions of bonds in Q4 2009.
- Lower than planned deficit may translate into further lowering of borrowing needs and issue of treasury papers in the domestic market (by a dozen or so billion zlotys). However, this would be still a rise from high level in 2009.



Risks for ambitious privatisation plan

- Possibly lower than planned budget deficit gives a chance for lower than assumed borrowing needs, but on the other hand there is risk connected with privatisation plan.
- The government's target for privatisation revenues this year is ca. PLN25bn (plus additional PLN5bn of delayed projects from 2009), but after deductions for special funds effectively for the budget financing would be less than PLN10bn.
- While interest in IPO of PZU insurer should be large and there should be no problems with sale of share packages of KGHM, PGE and other companies at WSE, one may expect some problems with repeated attempt to sell Enea. Failure of such a one big project (ca. PLN7bn) would make it impossible to reach nearly record privatisation revenues (more than PLN25bn was only once, in 2000).

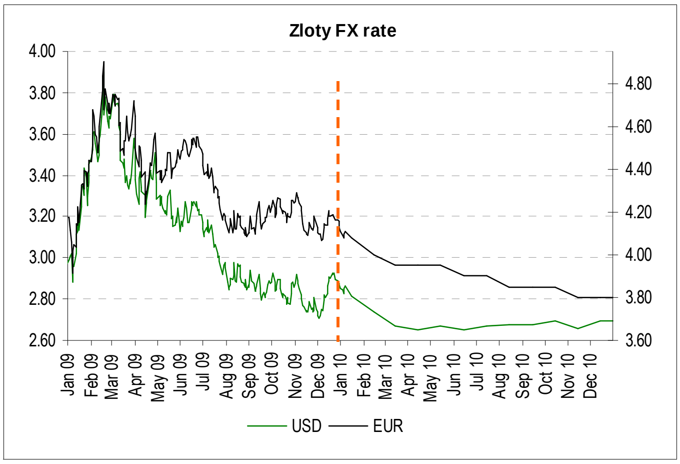


Public debt at the edge of safety threshold at 55% of GDP

- Rise in borrowing needs (and additionally at least partial failure of privatisation plan) means significant rise in public debt. The government's strategy of public debt management assumes growth of public debt to GDP ratio to 49.8% in 2009, 54.75% 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 (with average EURPLN in 2010 assumed quote conservatively at 4.0776), additionally supported by accelerating economic growth. In our view the stronger appreciation of the zloty, faster economic growth and a likely lower deficit suggest the government will avoid to break the threshold of 55% of GDP.

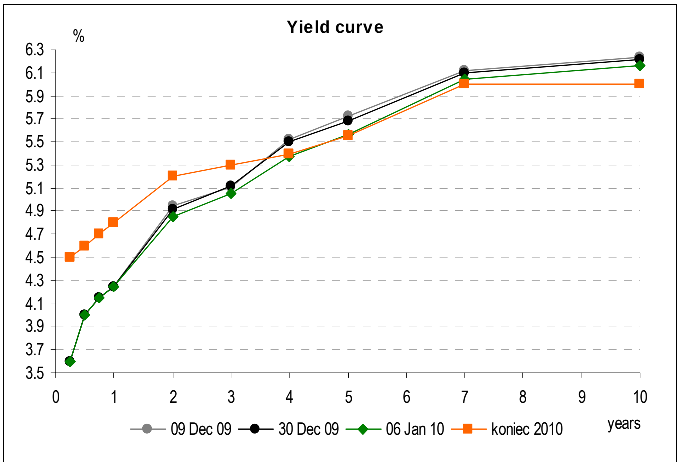
Source: Ministry of Finance, Ministry of State Treasury, own calculations

Market monitor



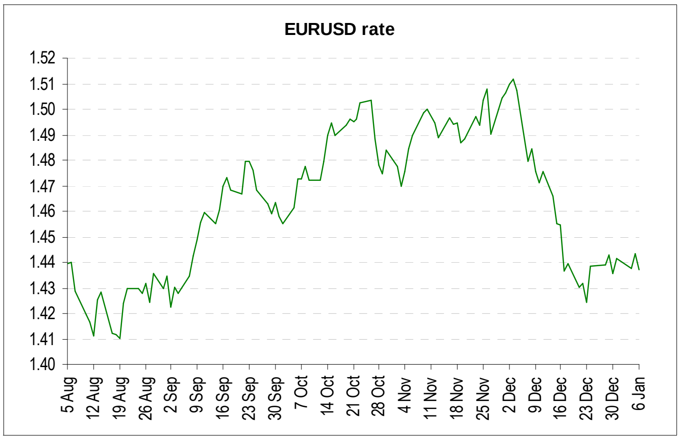
Further zloty appreciation with slightly less volatility

- We expect gradual zloty strengthening this year. In our view the EURPLN rate should soon break 4.00 and at the year-end should reach ca. 3.80. In periods of increased risk aversion the zloty may gradually weaken, though these should not be significant corrections. In our view the EURPLN rate will not break 4.30. The exchange rate volatility will be still high, though it will decline as compared to 2009.
- The domestic currency should be supported by recovery in the world economy, gradual increase of risk appetite, acceleration of economic growth in Poland, privatisation, which should increase demand of foreign investors for the zloty. Moreover a series of recommendations recently released by foreign institutional investors should also be positive for the zloty. Zloty appreciation may be limited by any dollar appreciation moves in the global markets.



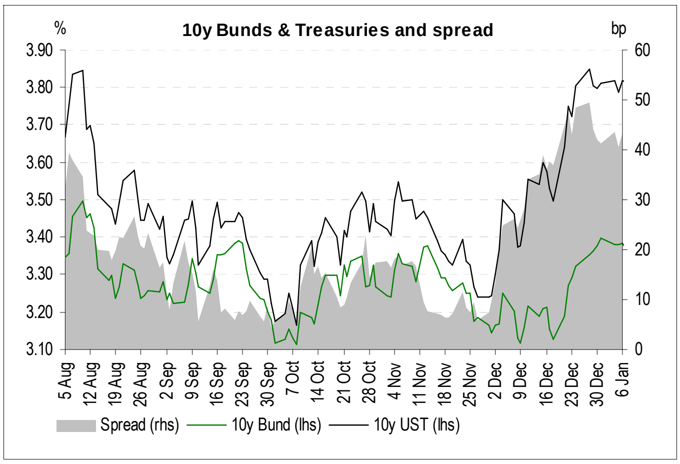
Yield curve slightly less steep

- This year the MPC will start a series of interest rate increases, which should act toward increase of short-term interest rates. On the other hand, higher risk appetite and zloty strengthening should positively affect debt prices. Budget situation may appear better than assumed by the government, and the bonds supply may be lower than scheduled. Consequently, there may be some strengthening at the longer end of the curve. Spreads between the reference rate and the 2Y bond yield (ca. 150 bp) and 2-10 spread (ca. 130 bp) are quite high and in our view they should decline. Realisation of privatisation process will be a risk factor for the debt market.
- EU/PL 5x5 spreads (currently at ca. 130 bp) and 10Y spreads against Bunds (currently at ca. 280 bp) should also gradually decline due to decline of fiscal and credit risk.



EURUSD influenced by risk appetite

- At the start of the year there may another weakening of the dollar due to increase of risk appetite and rebuilding of portfolios using low yielding US currency to finance purchases of risky assets. The EURUSD rate may increase toward 1.48.
- The euro appreciation may be temporarily stopped by negative news on ratings (e.g. Greece) or financial stability of some financial institutions in the euro zone. Moreover, the news weakening the faith in the durability of world economic recovery may negatively affect the euro.
- At the year-end the dollar may recover on economic recovery and expectations for interest rate hikes in the US. Balance of payments data in the US will be another factor positively influencing the dollar.

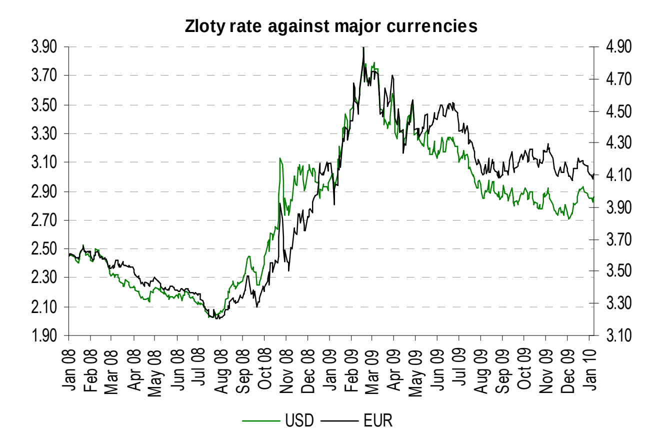


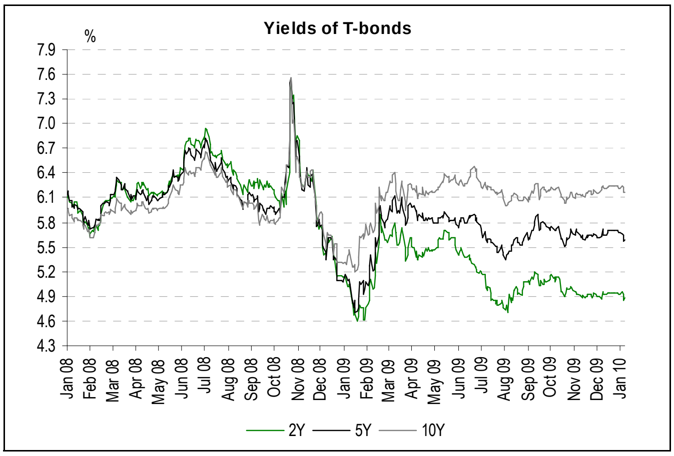
No change in rates by ECB and Fed long into 2010

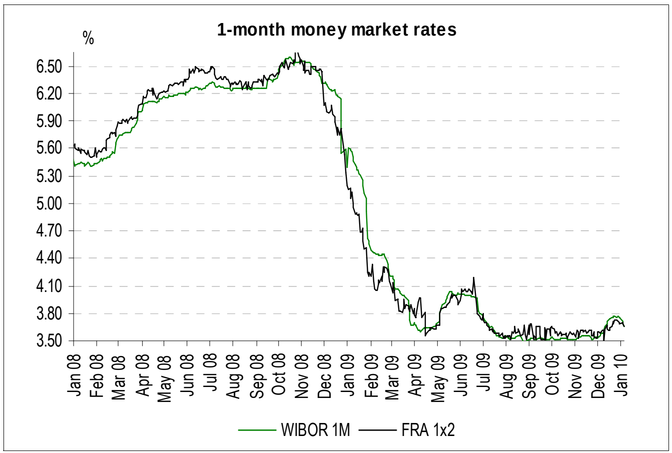
- The unemployment rate in the US reached 10% and the economic recovery is still below potential and the long-term trend, while inflation remains clearly low. Consequently, the interest rates will remain low for the most of 2010 or perhaps even in 2011. ECB said that the refinance rate is at appropriate level, despite the recession ended and we do not think the bank raises interest rates only at the start of 2H 2010 taking into account the concerns over the durability of recovery.
- The core bond market will be under pressure from high fiscal spending made in order to support the economies and from expectations on interest rate hikes, when the business climate starts to improve. Market rates at the short end of the curve start to gradually increase in the US (2Y swap rates up to 1.50%, and 5Y to 3.0%) and in the euro zone (2Y swap rates to 2.15%, and 5Y to 3.15%) especially at the end of the year.

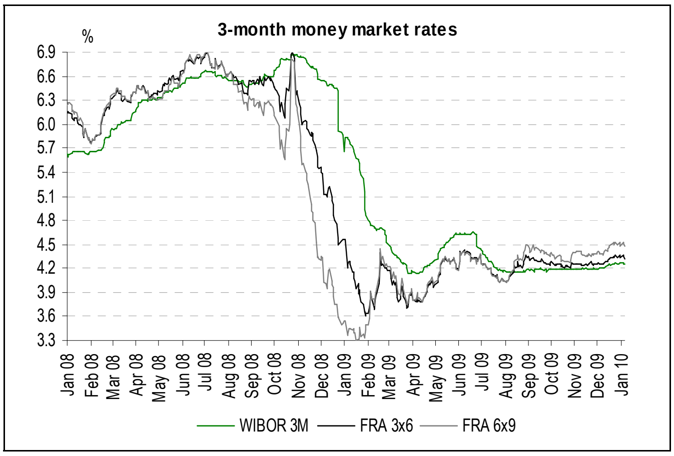
Source: Reuters, BZ WBK

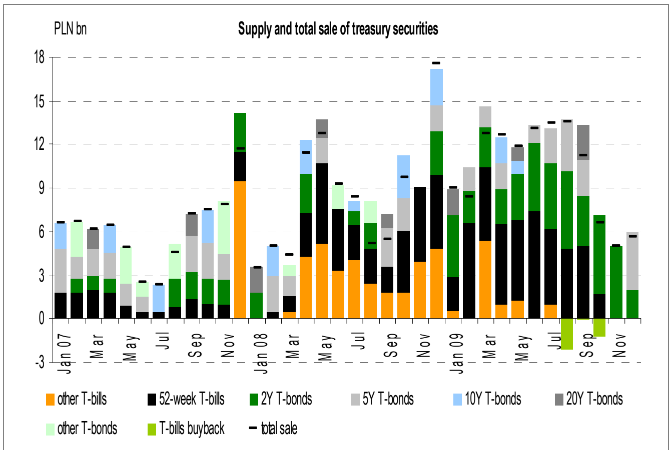
Market monitor











Treasury bills auctions (PLN m)

Auction date	
11.01.2010	52-week
18.01.2010	52-week
25.01.2010	52-week
1.02.2010	-
8.02.2010	-
15.02.2010	-
22.02.2010	-
1.03.2010	-
8.03.2010	-
15.03.2010	-
22.03.2010	-
29.03.2010	-
1.04.2010	-

** based on data of the Ministry of Finance*

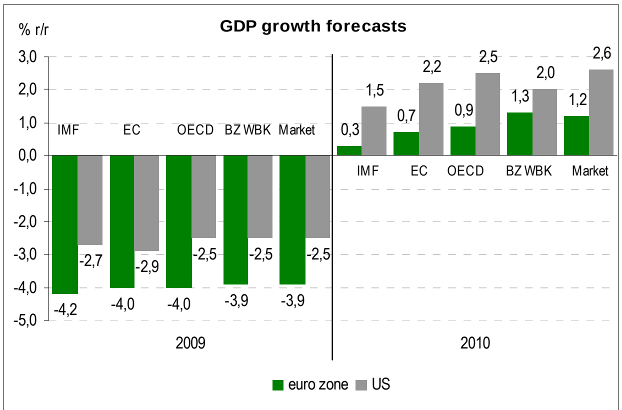
Treasury bond auctions in 2009/2010 (PLNm)

month	First auction				Second auction				Switch auction		
	date	T-bonds	offer	sale	date	T-bonds	Offer	sale	date	T-bonds	sale
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	PS0413/PS0414/DS1019	1573/1753/1290
November	10.11	OK0712	3500-5000	5000	-	-	-	-	26.11	OK0712/P0414	1121/2243
December	2.12	OK0712/PS0415	3000-6000	5651	-	-	-	-	16.12	-	-
January	13.01	OK0712	-	-	20.01	DS/WS	-	-	6.01	PS0415/WZ0118	2494/2383
February	10.02	OK/PS			17.02	DS/WS/WZ/IZ	-	-	3.02		-
March	10.03	OK/PS			17.03	DS/WS/WZ/IZ	-	-	3.03		-

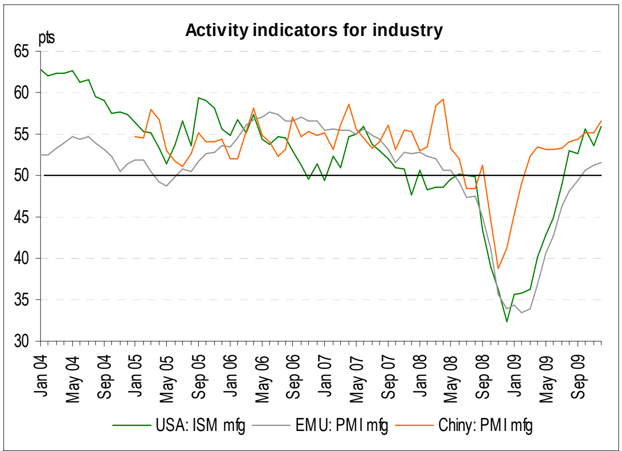
* with supplementary auction, ** primary auction

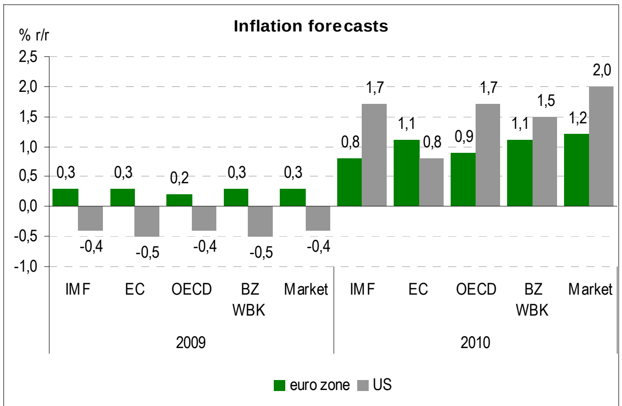
Source: Ministry of Finance, Reuters, BZ WBK

International review



Date of forecast preparation: IMF - 1.10.09, European Commission - 22.10.09, OECD - 19.11.09, Market (Reuters consensus) – 9.12.09, BZ WBK - 7.01.10.





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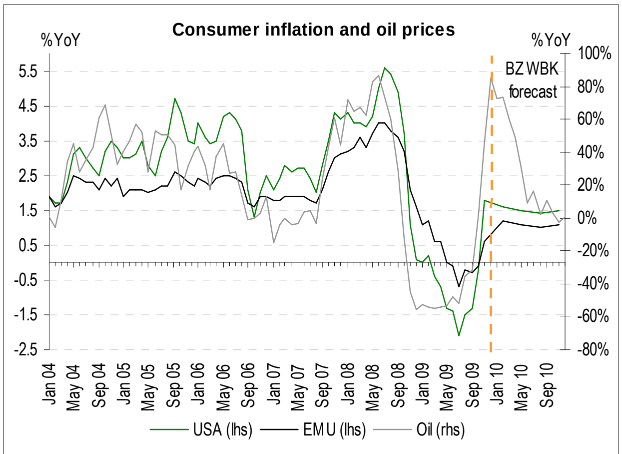

Source: Reuters, ECB, Federal Reserve

How durable is the recovery in 2010?

- The forecasts of key institutions point to economic growth acceleration in 2010, though the GDP growth will remain below the long-term average.
- According to the recent official forecasts of the IMF from October 2009 the world GDP will rise in 2010 by 3.1% after a decline by 1.1% in 2009. For the emerging economies IMF predicts GDP growth of 5.1%, though for the CEE countries by merely 1.8%. After very good data from the world economy recently the IMF informed about plans to upwardly revise its forecasts.
- The current market consensus points to stronger recovery of the GDP in the US than in the euro zone. According to our estimates the GDP growth in the US will be at 2.0%YoY, and in the euro zone at 1.3%. ECB's forecast for the euro zone at 0.8% is rather pessimistic as compared to the market consensus.
- The most recent economic activity indicators in the world (PMI, ISM, etc.) signal improvement of economic situation. The Chinese contribution is especially important for the world economy. There are some concerns regarding the durability of the recovery along with the finishing of government fiscal packages in the developed economies. Additional negative factor is also economic policy tightening planned by China aiming at avoiding overheating the economy and increase of inflation.
- In the major economies the consumer demand was revived by temporary factors such as car purchases refunds, tax allowances for house purchases (US). The consumer spending may hurt again this year on further increase of unemployment. In the US the households' budgets will be under pressure of high debt and pressure on disposable incomes from rising need for raising savings and despite some labour market improvement. The availability of credit will be limited, which will negatively affect the recovery of the economic activity.

Inflation still under control

- Euro zone and US inflation rose above zero for the first time in a few months. Deflation resulted from low commodity and food prices.
- We assume that with gradual economic recovery in the world oil prices should be quite stable and on average will reach ca. 75$. We do not expect any large increase of food prices as last year crops were quite high.
- We expect the annual average inflation in the euro zone in 2010 slightly below ECB estimate (1.3%). Inflation pressure will be limited also in the US.
- Recession and rising unemployment puts downward pressure on core inflation in the major economies. This year it should remain under control and may continue to decline.
- There emerge some concerns about possible breakout of inflation in case when the economic recovery was durable and much faster than expected, while banks would be too late with exit strategies limiting over-liquidity from the financial markets in respective time. However, in our view this scenario is little probable, especially within next few quarters.
- Central banks will carefully and gradually exit form quantitative monetary policy easing.
- Fed announced closing majority of its liquidity supporting programmes in the market starting from February, due to improvement of the situation in the financial markets.
- After withdrawal of 12-month refinancing operations the ECB will keep the most of the remaining operations as long as necessary and according to ECB president's comments this will be not sooner than in mid April.

Economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
11 January ***PL: Auction of Treasury Bills***	**12** US: Trade balance (Nov)	**13** ***PL: Auction of 2Y bonds*** EZ: Industrial production (Nov)	**14** ***PL: CPI (Dec)*** ***PL: Money supply (Dec)*** EZ: ECB decision US: Import prices (Dec) US: Retail sales (Dec)	**15** ***PL: Balance of payments (Nov)*** EZ: Final HICP (Dec) US: CPI (XII) US: NY Fed index (Jan) US: Industrial production (Dec) US: Capacity utilisation (Dec) US: Preliminary Michigan (Jan)
18 ***PL: Auction of Treasury Bills*** US: Market holiday	**19** ***PL: Wages and employment (Dec)*** DE: ZEW index (Jan) US: Capital flows (Nov)	**20** ***PL: Bond auction*** US: New home sales (Jan) US: PPI (Dec)	**21** ***PL: Industrial output (Dec)*** ***PL: PPI (Dec)*** ***PL: Core inflation (Dec)*** US: Leading indicators (Dec)	**22** ***PL: MPC minutes*** ***PL: Business climate indicators (Jan)***
25 ***PL: Auction of Treasury Bills*** US: Home sales (Dec)	**26** ***PL: MPC meeting-decision*** DE: Ifo index (Jan) US: Case/Shiller (Nov) US: Consumer confidence (Jan) JP: BOJ decision	**27** US: New home sales (Dec) US: Fed decision	**28** ***PL: GDP (2009)*** ***PL: Retail sales (Dec)*** ***PL: Unemployment rate (Dec)*** EZ: Economic sentiment (Jan) US: Durable goods orders (Dec)	**29** EZ: M3 money supply (Dec) EZ: Flash HICP (Jan) US: Advance GDP (Q4) US: Final Michigan (Jan)
1 February ***PL: Auction of Treasury Bills*** ***PL: PMI (Jan)*** EZ: Manufacturing PMI (Jan) US: Core PCE (Dec) US: Manufacturing PMI (Jan)	**2** EZ: PPI (Dec) US: Pending home sales (Dec)	**3** ***PL: Bond switch auction*** EZ: Non-manufacturing PMI (Jan) US: Retail sales (Dec) US: ADP report (Jan) US: Non-manufacturing PMI (Jan)	**4** EZ: ECB decision US: Labour productivity & unit labour costs (Q4) US: Factory orders (Dec)	**5** US: Non-farm payrolls (Jan) US: Unemployment rate (Jan)
8 ***PL: Auction of Treasury Bills***	**9** US: Wholesale inventories (Dec)	**10** ***PL: Bond auction*** US: Trade balance (Dec)	**11** JP Market holiday US: Retail sales (Jan)	**12** EZ: Flash GDP (Q4) EZ: Industrial production (Dec) US: Preliminary Michigan (Feb)

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

MPC meetings and data release calendar for 2010

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

* quarterly data, [a] preliminary data for January, [b] January and February, [c] November
Source: CSO, NBP

Economic data and forecasts

Monthly economic indicators

		Dec 08	Jan 09	Feb 09	Mar 09	Apr 09	May 09	Jun 09	Jul 09	Aug 09	Sep 09	Oct 09	Nov 09	Dec 09	Jan 10
PMI	pts	38.3	40.3	40.8	42.2	42.1	42.5	43.0	46.5	48.2	48.2	48.8	52.4	52.4	52.7
Industrial production	%YoY	-5.6	-15.3	-14.6	-1.9	-12.2	-5.2	-4.5	-4.4	0.1	-1.3	-1.3	9.8	12.1	2.3
Construction production	%YoY	2.0	7.4	1.9	1.2	0.5	0.3	0.5	10.7	11.0	5.7	2.7	9.9	6.9	5.8
Retail sales [a]	%YoY	6.9	3.8	0.6	1.8	2.9	2.4	2.1	5.7	5.2	2.5	2.1	6.3	6.1	4.8
Unemployment rate	%	9.5	10.4	10.9	11.1	10.9	10.7	10.6	10.7	10.8	10.9	11.1	11.4	11.9	12.2
Gross wages in enterprises sector [a]	%YoY	5.6	8.1	5.1	5.7	4.8	3.8	2.0	3.9	3.0	3.3	2.0	2.3	4.7	1.6
Employment in enterprises sector	%YoY	2.2	0.7	-0.2	-0.9	-1.4	-1.7	-1.9	-2.2	-2.2	-2.4	-2.4	-2.2	-1.9	-2.5
Export (€)	%YoY	-12.6	-24.3	-26.3	-16.6	-28.9	-20.6	-21.3	-23.5	-21.3	-18.4	-17.6	-1.4	12.6	11.0
Import (€)	%YoY	-9.2	-26.2	-32.7	-25.9	-35.1	-30.7	-30.6	-29.1	-27.2	-27.4	-21.7	-9.2	-2.5	9.3
Trade balance	EURm	-1819	-483	-67	-214	-205	-26	-279	-539	-470	-25	-819	-700	-700	-400
Current account balance	EURm	-1740	-754	790	-131	-451	-405	-232	-833	-107	-308	-991	-2359	-800	-200
Current account balance	% GDP	-5.0	-5.0	-4.5	-4.0	-3.8	-3.5	-3.0	-3.1	-2.8	-2.3	-2.1	-2.4	-2.1	-1.9
Budget deficit (cumulative)	PLNbn	-24.6	2.9	-5.3	-10.6	-15.3	-16.4	-16.7	-15.0	-15.6	-21.5	-24.0	-24.4	-24.7	-0.5
Budget deficit (cumulative)	% of FY plan	100.0	-10.7	19.4	39.0	56.4	60.3	61.3	55.3	57.5	79.0	88.4	89.8	91.0	1.0
CPI	%YoY	3.3	2.8	3.3	3.6	4.0	3.6	3.5	3.6	3.7	3.4	3.1	3.3	3.6	3.5
Core inflation excluding prices of food and energy	%YoY	2.8	2.2	2.4	2.5	2.6	2.8	2.7	2.9	2.9	2.9	2.9	2.8	2.6	2.3
PPI	%YoY	2.7	3.6	5.7	5.5	4.8	3.7	4.1	2.8	2.2	1.6	2.0	2.0	2.2	0.3
Broad money (M3)	%YoY	18.6	17.6	17.8	17.5	14.4	14.2	14.4	11.9	9.0	9.6	11.9	7.9	6.8	5.3
Deposits	%YoY	20.6	19.5	19.2	19.4	16.1	15.7	15.9	13.0	10.7	10.9	13.5	10.3	8.2	6.3
Loans	%YoY	36.0	35.8	37.2	34.5	30.3	29.3	26.8	23.3	19.8	18.6	14.9	13.4	9.1	6.8
USD/PLN	PLN	2.98	3.18	3.63	3.55	3.36	3.23	3.22	3.05	2.90	2.86	2.85	2.79	2.83	2.81
EUR/PLN	PLN	4.01	4.22	4.65	4.62	4.43	4.41	4.51	4.30	4.13	4.16	4.21	4.17	4.14	4.08
Reference rate [b]	%	5.00	4.25	4.00	3.75	3.75	3.75	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50
Lombard rate [b]	%	6.50	5.75	5.50	5.25	5.25	5.25	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00
WIBOR 3M	%	6.40	5.51	4.69	4.30	4.20	4.52	4.60	4.26	4.16	4.18	4.18	4.19	4.23	4.20
Yield on 52-week T-bills	%	6.10	4.85	4.62	4.78	4.80	4.91	4.73	4.43	4.23	4.33	4.35	4.26	4.25	4.25
Yield on 2-year T-bonds	%	5.43	4.81	5.37	5.60	5.44	5.60	5.34	4.93	4.92	5.10	5.03	4.92	4.92	4.90
Yield on 5-year T-bonds	%	5.42	4.96	5.57	5.97	5.88	5.85	5.83	5.55	5.53	5.74	5.65	5.64	5.67	5.65
Yield on 10-year T-bonds	%	5.57	5.43	5.94	6.21	6.17	6.30	6.34	6.19	6.08	6.18	6.15	6.14	6.21	6.20

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

Quarterly and annual economic indicators

		2007	2008	2009	2010	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10	4Q10
GDP	PLNbn	1 175.3	1 272.8	1 345.3	1 399.3	314.1	326.3	331.5	373.4	330.4	336.9	342.0	389.9
GDP	%YoY	6.7	4.9	1.7	2.6	0.8	1.1	1.7	3.1	2.8	2.5	2.5	2.8
Domestic demand	%YoY	8.6	5.5	-0.9	3.5	-1.5	-2.1	-1.2	0.7	3.5	4.0	3.2	3.5
Private consumption	%YoY	5.0	5.4	2.2	1.9	3.3	1.7	2.2	1.7	1.6	2.0	2.0	2.0
Fixed investments	%YoY	17.6	8.1	-2.2	4.4	1.0	-3.0	-1.5	-3.5	-1.0	5.0	5.0	6.0
Industrial production	%YoY	9.7	3.5	-2.8	5.1	-10.0	-6.7	-1.3	6.9	6.7	5.6	5.3	2.8
Construction production	%YoY	22.5	11.4	4.9	5.4	3.5	0.4	9.1	6.5	2.3	6.4	3.3	9.6
Retail sales (real terms)	%YoY	14.0	9.6	2.0	4.7	0.4	1.4	3.7	2.7	2.8	6.5	5.6	3.8
Unemployment rate [a]	%	11.2	9.5	11.9	12.1	11.1	10.6	10.9	11.9	12.2	11.2	11.2	12.1
Gross wages in enterprise sector (real terms)	%YoY	6.7	5.9	0.7	1.6	3.2	0.2	0.5	-0.3	-0.9	1.6	2.5	3.3
Employment in enterprise sector	%YoY	4.6	4.8	-1.2	-1.1	0.1	-1.0	-1.8	-2.2	-2.2	-1.2	-0.6	-0.5
Export (€)	%YoY	13.4	14.2	-18.1	8.1	-22.2	-23.8	-21.1	-3.4	12.0	10.0	6.0	5.0
Import (€)	%YoY	19.5	17.2	-25.4	13.8	-28.2	-32.2	-28.0	-11.6	16.0	18.0	12.0	10.0
Trade balance	EURm	-12 369	-17 724	-4 515	-10 765	-744	-513	-1 039	-2 219	-1 805	-2 545	-2 676	-3 739
Current account balance	EURm	-14 696	-18 302	-6 532	-10 665	-30	-1 088	-1 264	-4 150	-1 705	-3 245	-2 376	-3 339
Current account balance	% GDP	-4.7	-5.1	-2.1	-3.0	-4.0	-3.0	-2.3	-2.1	-2.5	-3.1	-3.3	-3.0
General government balance	% GDP	-1.9	-3.6	-5.8	-6.2	-	-	-	-	-	-	-	-
CPI	%YoY	2.5	4.2	3.5	2.3	3.3	3.7	3.5	3.4	3.0	2.0	1.8	2.4
CPI [a]	%YoY	4.0	3.3	3.6	2.4	3.6	3.5	3.4	3.6	2.5	1.9	2.0	2.4
PPI	%YoY	2.0	2.2	3.4	-1.6	4.9	4.2	2.2	2.1	-1.7	-2.2	-1.2	-1.4
Broad money (M3) [a]	%YoY	13.4	18.6	6.8	6.2	17.5	14.4	9.6	6.8	4.4	4.2	5.7	6.2
Deposits [a]	%YoY	14.5	20.6	8.2	6.1	19.4	15.9	10.9	8.2	4.2	4.0	5.0	6.1
Loans [a]	%YoY	29.9	36.0	9.1	9.4	34.5	26.8	18.6	9.1	4.3	5.3	7.2	9.4
USD/PLN	PLN	2.77	2.41	3.12	2.69	3.45	3.27	2.94	2.83	2.74	2.66	2.67	2.68
EUR/PLN	PLN	3.78	3.52	4.33	3.91	4.50	4.45	4.20	4.17	4.01	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	3.50	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	5.00	5.50
WIBOR 3M	%	4.73	6.36	4.42	4.17	4.83	4.44	4.20	4.20	4.17	4.15	4.10	4.27
Yield on 52-week T-bills	%	4.69	6.26	4.54	4.33	4.75	4.81	4.33	4.29	4.25	4.25	4.30	4.50
Yield on 2-year T-bonds	%	5.23	6.22	5.17	5.09	5.26	5.46	4.98	4.96	4.90	5.05	5.20	5.20
Yield on 5-year T-bonds	%	5.52	6.15	5.65	5.59	5.50	5.85	5.61	5.66	5.65	5.60	5.55	5.55
Yield on 10-year T-bonds	%	5.56	6.06	6.11	6.08	5.86	6.27	6.15	6.17	6.20	6.10	6.00	6.00

Source: CSO, NBP, Finance Ministry, BZ WBK own estimates [a] at the end of period

This analysis is based on information available until 6.01.2010 has been prepared by:

ECONOMIC ANALYSIS UNIT

TREASURY DIVISION

ul. Marszałkowska 142, 00-061 Warszawa, fax +48 022 586 83 40

Email: ekonomia@bzwbk.pl Web site (including Economic Service page): http://www.bzwbk.pl

Maciej Reluga – Chief Economist

tel. +48 022 586 83 63, Email: maciej.reluga@bzwbk.pl

Piotr Bielski	+48 022 586 83 33
Piotr Bujak	+48 022 586 83 41
Cezary Chrapek	+48 022 586 83 42

TREASURY SERVICES DEPARTMENT

Gdańsk

Długie Ogrody 10
80-765 Gdańsk
tel. +48 058 326 26 40
fax +48 058 326 26 42

Kraków

Rynek Główny 30/8
31-010 Kraków
tel. +48 012 424 95 01
fax +48 012 424 21 41

Poznań

pl. Gen. W. Andersa 5
61-894 Poznań
tel. +48 061 856 58 14
fax +48 061 856 55 65

Warszawa

ul. Marszałkowska 142
00-061 Warszawa
tel. +48 022 586 83 20
fax +48 022 586 83 40

Wrocław

ul. Rynek 9/11
50-950 Wrocław
tel. +48 071 370 25 87
fax +48 071 370 26 22