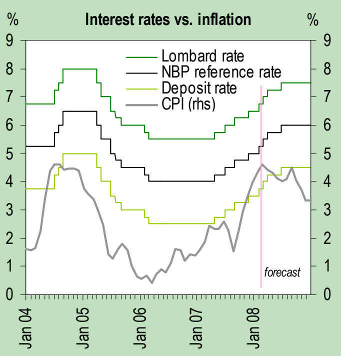
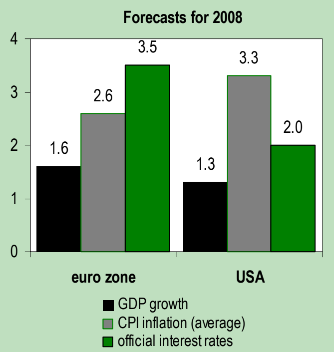
Bank Zachodni WBK

MACROscope

Polish Economy and Financial Markets

March 2008





In this issue:

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Oops! They did it again

- **Interest rate hikes time after time. After the January increase, the MPC decided on another hike a month later.** The key argument for the hike must have been the January inflation surprise and the wish to curb inflation expectations in the wake of further quick-paced growth in wages. Given the further expected growth of inflation in February, it seems likely that the March MPC meeting will see another rate hike. At the same time we hope that the reduction of intervals between the rate hikes this year by the MPC stems from the belief that the earlier moves will allow to lessen the overall scale of the monetary policy tightening. As the inflation is likely to stay above 4% until autumn, there is a high risk that there will be another rate increase during the year and that the reference rate will grow up to 6%. In our opinion, the situation on the foreign currency market (we are changing our in-house outlook for PLN towards a bigger appreciation), further developments in the world economy and global markets will be the elements scaling down the monetary policy tightening. Moreover, let us not forget that the MPC tightened the policy by 150 bp already, with the effects of this decision to surface in the near future.

- **The upward revision of the inflation path this year is accompanied by a projected changed pace of GDP growth in upcoming quarters.** After weaker December data, we wrote last month that the uncertainty as to the developments in the economy increased. It still seems to us that the Polish economy stays on the quick growth track, yet the pace of this growth will be lower than expected earlier as a result of revisited global growth outlook. Nonetheless, we increase our GDP growth outlook even a bit upwards for H1 this year, yet in H2 we expect the growth under 5%. This is driven mainly by reduced expectations as regards growth in exports and investments stemming from the changed GDP outlook for the US and euro zone (by half a percentage point). At the same time we sustain the forecast of quick private consumption growth, which will be fuelled by speedy increase of wages and employment rate, revaluation of social benefits and reduction of the pension contribution which will offset the effect of higher inflation driving down real income.

- **The changed inflation path and scale of expected interest rate hikes caused the major uplift in yields which went beyond 6%.** In February, the yields increased by over 40 bp and the trend continued at the beginning of March – as compared to January-end, the yields were higher by approx. 60 bp (in the case of 10Y bonds by 45 bp). What is interesting this change was accompanied by PLN appreciation - by more than 2% against euro and more than 4% against US dollar in February. Even though the beginning of March saw a slight correction and it is possible that the 3.60 rate against euro will be temporarily topped, our expectation is that at the end of the year the zloty will be still stronger against euro than now.

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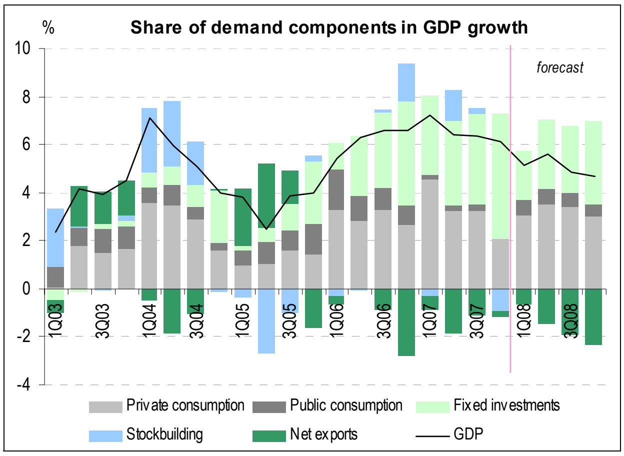
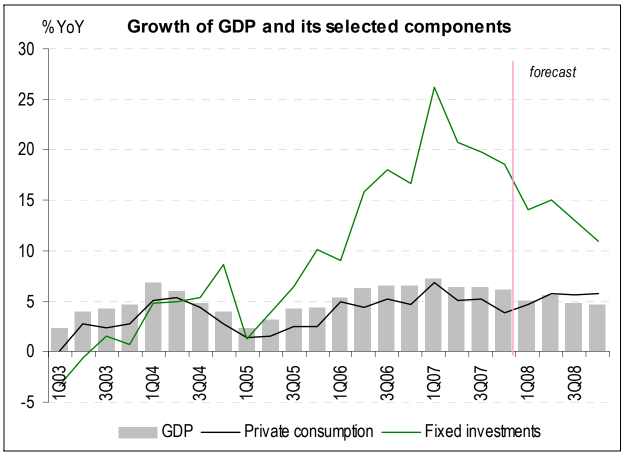
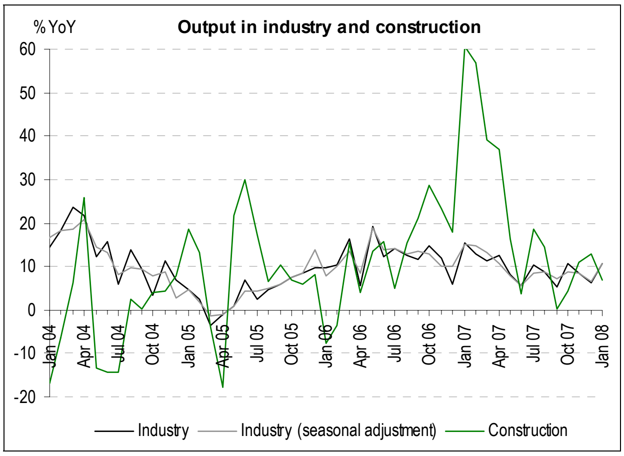
Financial market on 29 February 2008:					
NBP deposit rate	4.00	WIBOR 3M	5.94	USDPLN	2.3155
NBP reference rate	5.50	Yield on 2-year T-bonds	6.09	EURPLN	3.5204
NBP lombard rate	7.00	Yield on 5-year T-bonds	6.14	EURUSD	1.5204

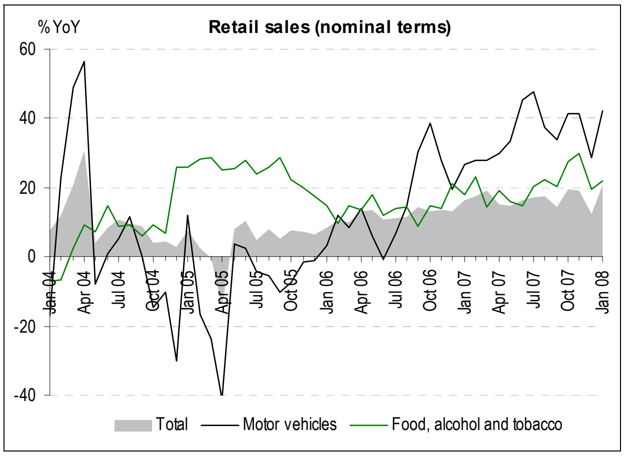
This report is based on information available until 11.03.2008

Economic update









Source: CSO, own calculations

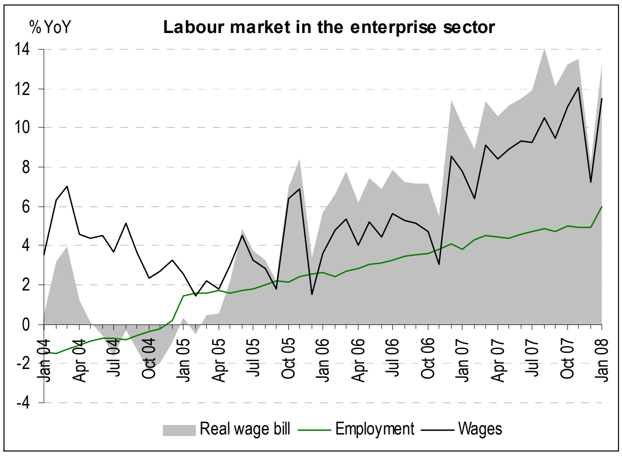
Very good beginning of 2008, then GDP deceleration

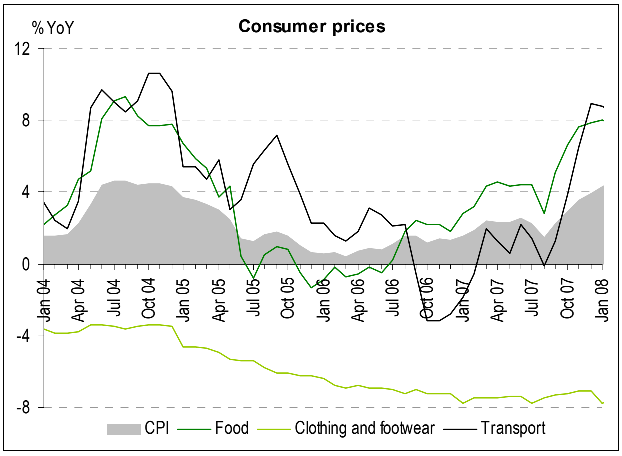
- Data on GDP growth for 4Q07 proved broadly in line with expectations. Although overall GDP growth was 6.1%, slightly above our estimate at 5.9%, main components of domestic demand, i.e. private consumption and fixed investment, grew exactly as we estimated, by 3.8% and 18.5%, respectively. Net export contribution to GDP growth in the final quarter of last year was slightly better that we assumed and this factor is responsible for higher than expected overall GDP growth.
- First monthly data for 2008 (details below) have show that the first quarter would not be as bad as one could have expected a few months ago. The so-called statistical base effect will be important, but to the lower extent and therefore we change the GDP growth forecasts for the first half of the year slightly upwards (from 5.0% and 5.4% in Q1 and Q2, respectively). At the same time, however, we see economic growth deceleration to below 5% in the second half of the year.
- This is connected with deterioration in economic activity in both US and the euro zone (lower GDP growth forecast by 0.5 pp). According to our estimations, lower global growth will negatively influence the Polish exports, which will decelerate to single-digit growth rates in the second half of the year, especially given the zloty appreciation. Also, we expect that the annual dynamics of fixed investments will be lowered as compared to the previous forecasts.
- We still GDP growth forecast for the whole year at slightly above 5%, which is connected with high growth in private consumption. Though higher annual average inflation will lower disposable income growth in real terms, this will be offset by strong growth in nominal wages and employment. Additionally, one should remember about lower disability pension contribution as well as indexation of social spending.

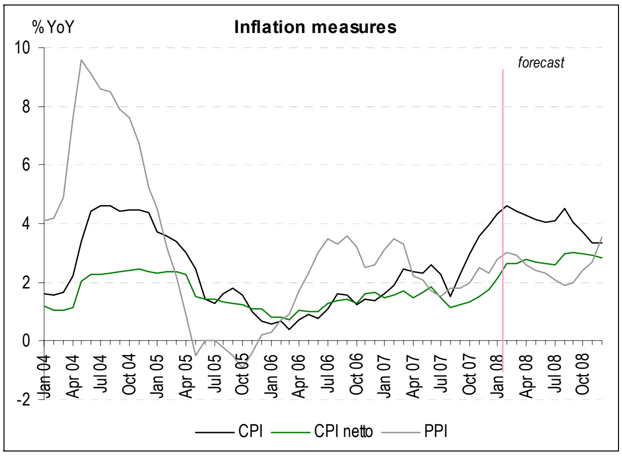
Weak December followed by excellent January

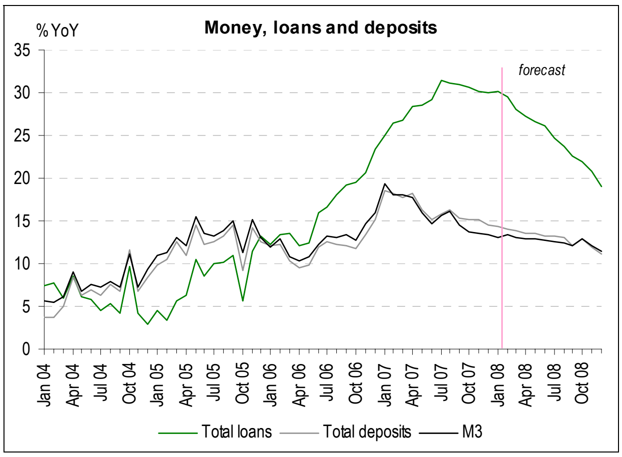
- While macroeconomic data for December were weaker than predicted, suggesting a beginning of gradual economic slowdown, the data released in the last month have shown that the economy maintains a rapid expansion at the start of the year.
- Industrial output growth in January reached 10.8%YoY against the market consensus of 6.8% and 6.2% increase in December. Construction output growth was 6.8% versus the median of market forecasts at 12.1% and 13% rise in December. The seasonally adjusted output growth was 10.6% in industry and 5.6% in construction.
- The acceleration in the industrial output growth was connected mainly with an increase in the growth rate of manufacturing output, to 11.1%YoY. This fact, together with information on output growth across different industrial branches (strong growth in branches with high share of exports, e.g. in production of motor vehicles) suggests that the export sector continued strong expansion of at the beginning of this year. However, it is hard to expect this trend to maintain in the remainder of the year. In construction, despite good weather in January, the result was partly biased by the high-base effect from January 2007. Nevertheless, construction output growth should return to the two-digit level in the following months.
- January's retail sales growth was also above forecasts - 20.9% in nominal terms and 15.9%YoY in real terms. Sales of food and beverages, which dragged December's figure down, returned to a two-digit growth rate. On the other hand, in January the largest increase was recorded in the category of motor vehicles. Sales data confirmed that consumption demand will be driving force of economic growth this year, supported by developments observed in the labour market.

Economic update









Source: CSO, NBP, own calculations

Labour figures slowdown also one-off in December?

- Significant slowdown in wage growth in December was not an indication of trend reversal.
- Average wage grew in January 11.5%YoY and employment increased 5.9%YoY (new all time high). As a result, wage bill in the enterprise sector increased 18.1%YoY in nominal terms and 13.3%YoY in real terms.
- One has to be aware that employment growth was positively affected by a change in a group of enterprises surveyed by the stats office caused by an increase in the number of firms employing more than nine people. Nevertheless, the data clearly confirm that labour market conditions in Poland are getting tighter. We expect further drop in unemployment rate, which rose seasonally to 11.7% in January (in annual terms a strong improvement has been maintained).

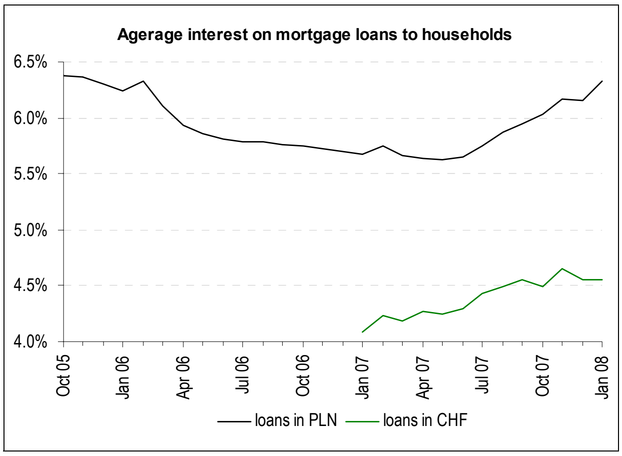
Surprise in January has changed inflation path for 2008

- Preliminary CPI inflation figure for January was significantly higher than expectations, showing a rise by 4.3%Yo against t4.0% in December and 3.6% in November.
- The main factor, which pushed the CPI higher at the start of the year was the price hike in housing, which amounted to almost 2%MoM. This occurred despite majority of electricity plants postponed price hikes of electricity till February. Also, food prices increased slightly more than we had expected (1.2%MoM against 0.9% forecast). On the other hand, clothing and footwear prices as well as transport prices were lower than we expected (decline by 3.1%MoM and 0.8%, respectively).
- In the near future the key event in the Polish financial market will be release of the inflation data for February. Our forecast points to further rise to 4.6%, which is in line with the market consensus and the Finance Ministry's estimate. There is an uncertainty regarding the forecasts due to annual change of weights in the consumption basket. Together with the new weights for the CPI components and data for February, the CSO will also release revised data for January. The risk for the February forecast connected with the effect of basket change seems symmetrical to us. The change of weights means also the uncertainty regarding the net inflation. Our estimates based on old weights shows net inflation up to 2.6% from 2.1% in January.
- Higher CPI inflation at the beginning of the year means that the average for 2008 as a whole will amount to at least 4%. What is more, net inflation will be also higher than previous estimates amid higher administrative prices (energy prices up in February, gas prices up in April). Nevertheless, though net CPI is likely to exceed 3% during the year, we still expect CPI inflation to decrease in the fourth quarter amid food prices deceleration.

What next with deposits and credits growth?

- Lower GDP growth forecasts amid deterioration in economic sentiment globally (mainly on the credit market), together with higher expected scale of interest rate hikes by the Monetary Policy Council means also some changes for the prospects of the Polish credit market. It seems that the annual rate of growth in banking credit may be below 20%, though in January it was still above 30% (38% for households and 26% for firms).
- On the other hand, turmoil and higher uncertainty as regards equity markets performance, as well as higher interest rates, create a possibility of higher increase in deposits of households. This was already visible in monetary statistics in recent months, as the growth rate of total deposits has been maintained at relatively high level driven by inflow of money from investment funds.

Housing market update



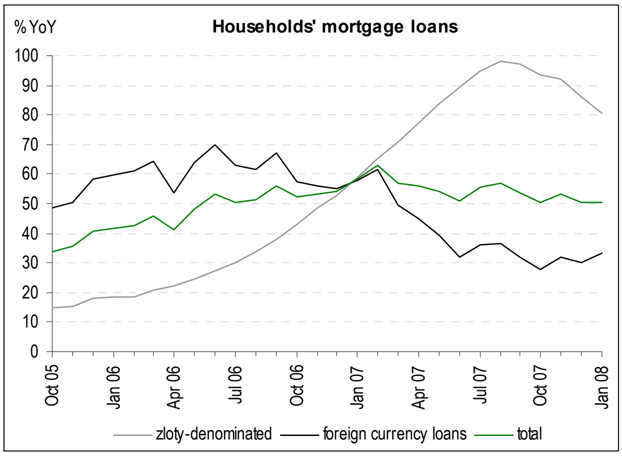
Higher rates in PLN, stable in CHF

▪ Continued rate hikes by the Monetary Policy Council and expectations for more policy tightening, reflected in rising interest rates in the money market, are translating into a rise in interest rates for loans in PLN.

▪ At the same time, interest rates for loans in CHF remain slightly above the level of 4.5%.

▪ What is more, prospects for monetary policy in Poland (rates up) and in Switzerland (no rate hikes expected) indicate that the difference between mortgage rates in zlotys and Swiss francs may widen further in months to come.

▪ In such situation, one may expect substitution of loans in zlotys with loans in foreign currencies. As a result, effect of rate hikes by the MPC on demand for properties financed with loans should be weaker.



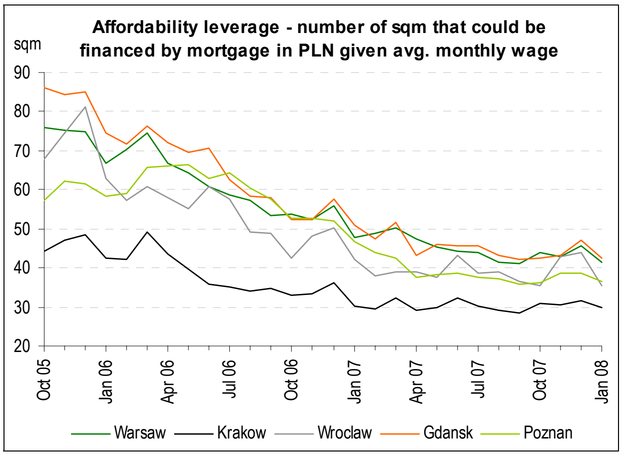
Substitution effect works

▪ An effect of substitution of more expensive loans in zlotys with loans in foreign currencies is clearly visible in the central bank's monetary statistics for January.

▪ In the first month of this year mortgages in zlotys increased by a mere PLN927m against the average monthly increase by over PLN2bn during 2007.

▪ Meanwhile, mortgages in foreign currencies increased by as much as PLN4.8bn in January, which is much higher value than the average monthly increase of PLN1.2bn over the previous year.

▪ While in December share of outstanding mortgages in foreign currency in total value of mortgage debt fell to 55%, the lowest level since April 2002, in January the relation rose to 57%.



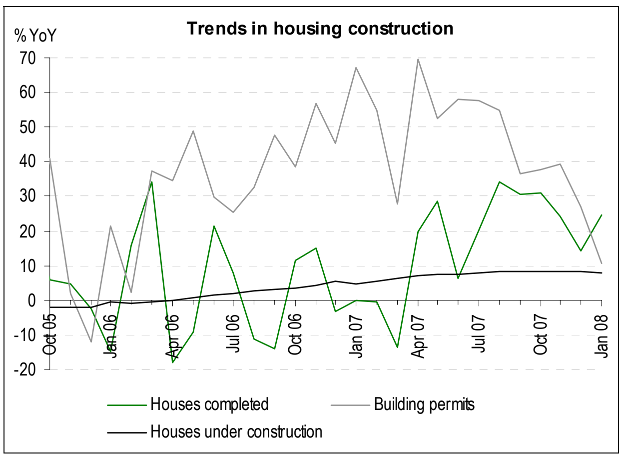
Seasonal drop in the loans affordability index

▪ Information from the real estate agencies indicate that there was a stabilisation of house prices in the majority of local markets in Poland.

▪ However, assuming that in all cities for which we calculate the affordability index there were stable house prices in January (official data from the source we use are not available yet), the index fell across the board, the deepest in Wrocław.

▪ The decline in the affordability index is an effect of an increase in interest rates on zloty-denominated loans (see above) and of a seasonal drop in average monthly wage in all the regions of the country taken into account.

▪ Strong increase in average wage later in the year should bring the fall in the index to a stop, even despite further increase in interest rates on loans in zlotys.



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

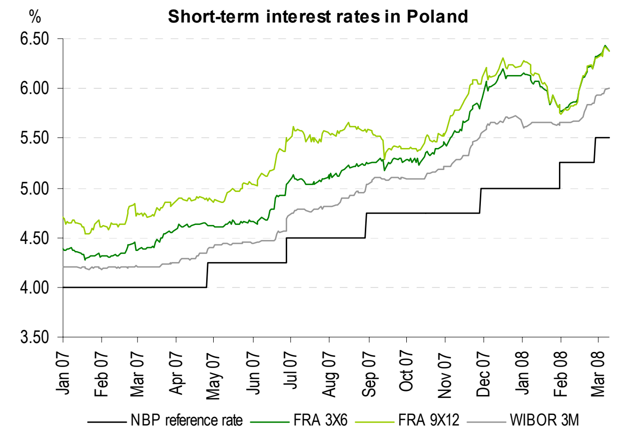
Adjustment on the supply side of the market

▪ January was another month during which there was clear slowdown of building permits growth rate. Fundamental demand, related to hosing deficit, is still strong, but buyers refrain from transaction awaiting further price drops following correction in the second half of 2007. As a result, there is simultaneous adjustment on the supply side of the market.

▪ Meanwhile, in the first month of this year there was acceleration in growth rate of dwellings completed, which reflects increase in supply stemming from strong rise in new investment projects in 2006-2007. Continuation of this tendency in months to come, assuming some stabilisation of demand, should lead to stabilisation of house prices.

▪ Growth rate of dwellings under construction has been on stable level of around 8% for more than a half year.

Central bank watch



Selected fragments of the February's MPC communiqué

Macroeconomic data released since the last meeting of the Council point at the continuation of strong economic growth in Poland at the beginning of 2008. Uncertainty persists as to the prospects of growth of the global and consequently Polish economy.

This rise in inflation was largely driven by growing prices of services connected with house maintenance and energy. As in many other countries, increased inflation has been largely sustained by strong annual growth of food and fuel prices. Another factor increasing inflation was the growth in the prices of some services. In the Council's assessment, in the near future inflation will remain above the upper limit for deviations from the inflation target, which may also, to a large extent, be the result of the expected further rise of regulated prices.

It is quite probable that the wage pressure and, consequently, inflationary pressure will persist. (...) This creates a risk of inflation expectations staying high and, consequently, feeds the risk of the so-called second-round effects.

Inflation projections (%YoY)

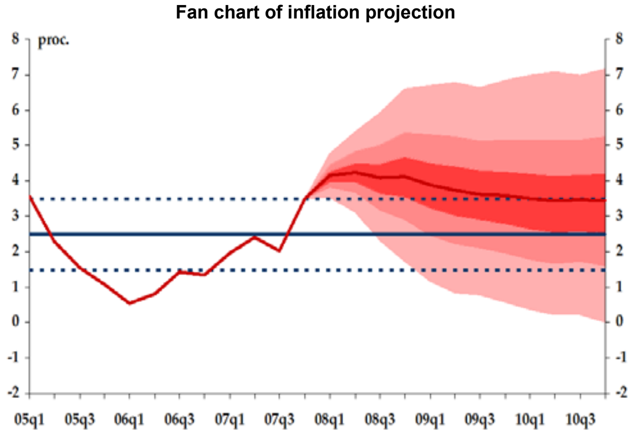
	Jan 07*	Apr 07*	Jul 07	Oct 07	Feb 08
2008	2.2-4.5	1.6-3.8	2.1-3.8	2.2-3.5	3.6-4.7
2009	2.4-5.2	2.1-4.6	2.1-4.3	2.5-4.6	2.6-4.9
2010	-	-	-	-	2.1-4.8

GDP growth projections (%YoY)

	Jan 07	Apr 07	Jul 07	Oct 07	Feb 08
2008	3.6-6.4	4.0-6.3	4.3-6.7	4.4-6.2	4.4-5.8
2009	3.5-6.5	4.0-7.0	4.0-7.2	3.8-6.7	3.5-6.1
2010	-	-	-	-	3.6-6.9

* concerns average inflation in the fourth quarter of a given year
Note: there is a 50% probability that the annual growth of GDP and inflation will be within the indicated ranges.

Fan chart of inflation projection



Source: NBP, Reuters

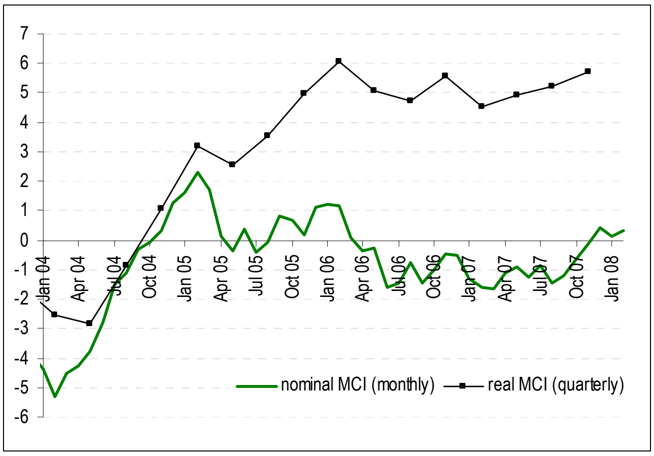
MPC shortens lag between hikes

- Just one month after January's rate hike, the Monetary Policy Council decided to raise interest rates again by 25 bp, so in effect the main reference rate arrived at 5.5%, which is 1.5 pct. point higher than one year ago.
- The official communiqué and comments of MPC members suggested that the Council realises that it has no control over main factors that will keep inflation at high levels in the nearest months – hikes of controlled prices, elevated prices of food and commodities.
- The decision about next rate hike was motivated by an effort to counteract a risk of the so-called second round effects that may arise in effect of "temporarily elevated inflation" and at the same time high inflationary expectations and tight labour market situation. Shortening lag between rate hikes to just one month suggests that the Council intended to send a stronger signal than before to the economic agents. Probably, the MPC also judged that thanks to faster monetary tightening, a total scale of necessary policy adjustment may appear to be smaller.
- Taking into account expected further strong rise in inflation in February and forecasted strong monthly data about economic activity and labour market, it seems very likely that main interest rates will be lifted again in March by 25 bp, third time in a row.
- Moreover, most likely it will not be the last hike this year. Because of higher inflation forecast, we predict a rise in main reference rate to 6.0% in the middle of the year. The exact timing of the decision will depend on the data about price rise and economic activity.

Higher inflation projection in the short run

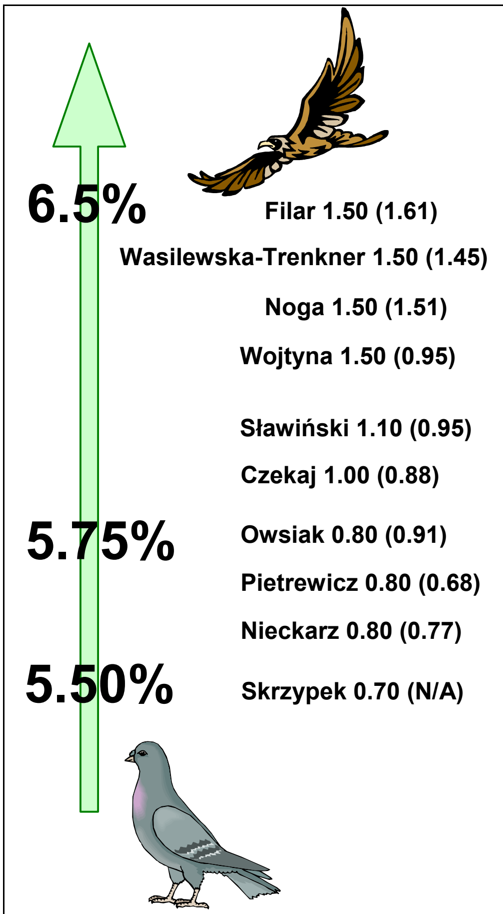
- The new inflation projection included in the new Inflation *report* presented a significant rise in short-term inflation path.
- Predicted pace of CPI growth is much higher than in October's report until mid-2009, mainly because of hikes in controlled prices. Central projection is above the upper end of fluctuations band around NBP target, and the range in which inflation will be with 50% probability moved up by almost 1.5 pct. points.
- In H2 2009, currently predicted inflation is close to previous October's path, and in 2010 (which appeared for the first time in the projection) inflation goes down but only slightly as compared to 2009.
- According to central path in prediction, net inflation will rise to 3.8% in 2009, even faster than CPI, and in 2010 it will decline in smaller scale than headline inflation, to 3.6%.
- Predicted GDP growth in 2008-2009 is slightly lower than in the October's report, but still moderately fast, around 5%.
- While according to the NBP staff in the short run a risk for projection is symmetrical, in the long run it is asymmetric on the downside, among others due to situation on the food market (possible smaller price growth) and economic slowdown in the world economy.
- As regards risk in the short run, the projection does not take into account a big hike in gas prices in the nearest months and also a higher starting point (January's CPI was not known at the report cut-off date). In the long horizon, an important factor causing a downward asymmetry in risk is the assumption about nominal zloty depreciation embedded in the NBP model.

Restrictiveness of the Monetary Policy (Council)



Monetary policy slightly tightening

- In February our monthly nominal MPC index showed a slight increase in monetary policy restrictiveness, due to a minor rise in money market WIBOR rates and appreciation of average EURPLN rate. Although the increase has not fully offset a drop seen in the previous month, but taking into account behaviour of the zloty and WIBOR rates at the start of March one could assume that this month will see further rise in MCI.
- Real MPC index increased again in Q4 2007, third time in a row. It was caused most of all by significant appreciation of the real effective exchange rate of the zloty at the end of the year, and to smaller degree also from a rise in real interest rate.



Index is between 0 and 2. A vote for the majority view is given a score of 1. A vote for a more hawkish (less dovish) decision than the majority view has a score of 2 and a vote for a less hawkish (more dovish) decision than the majority view has a score of 0. Average of points for all votes is the value of the index for a given MPC member.

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

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

December's distribution of votes same as in October

The results of MPC voting published in the *Inflation report* showed that after an unanimous hike in November, in December the motion to raise rates again was backed by the same four Council members than in October. In sum, it did not affect the order of MPC members' arrangement according to our index of monetary restrictiveness. Probably, the scores in the hawkish group will get more diversified after the release of full voting results from January and February, as according to comments of some members (e.g. Andrzej Wojtyna) not all of them supported rate hike by 50 bp, while such motion was submitted in January and perhaps also in February. Besides, it will be interesting to see how big was the majority of votes that supported rate hikes made in the last two months.

Voices about necessary further tightening still present

Definitely, the monetary tightening delivered so far was not enough to satisfy the most hawkish members of the Monetary Policy Council. Halina Wasilewska-Trenkner said that the tightening cycle is not over yet and "one cannot rule out 1-3 rate additional rate hikes", although she added also that the steps should not be increased to 50 bp. According to Dariusz Filar, the reference rate should increase to 6.0% "in relatively short time", and then the MPC may take some time to analyse the situation. In turn, in Marian Noga's view the interest rate that would allow to bring inflation back to the target is around 6.2%, although he also said that after the MPC delivers another rate hike in March it could wait 3-4 months to observe the new data. In sum, opinions of the above-mentioned MPC members concerning a scale of necessary tightening seem to be similar, although they differ in opinions regarding a pace of reaching target interest rate levels. The position the most hawkish MPC member still belongs to Dariusz Filar, as he was the only one who openly admitted a need to increase a scale of tightening steps to 50 bp.

... although criticised by the NBP president

Comments of MPC members regarding a scale of necessary rate hikes were criticised by the NBP president. Referring to the interview with Halina Wasilewska-Trenkner, Sławomir Skrzypek said that he does not like a way of several MPC members' communication and presenting their own opinions about future path of interest rates, as "opinions of this kind concerning rate hikes are not appropriate". It is worth noticing that the NBP president did not criticise statements of those MPC members who predicted smaller scale of rate hikes (although their comments also described future rate path). At this occasion, Skrzypek said that he is thinking about introduction of path of future interest rates in a form of fan-chart, however preparation for this will take ca. 2 years.

Even Pietrewicz does not rule out the next rate hike in March

Meanwhile, the last decisions and comments of the MPC signalled that even the moderate members of the Council are currently attaching higher weight to inflation risk and are keen to act faster than before. A rate hike in March was not ruled out not only by hawkish MPC members but also by Jan Czekaj and even Mirosław Pietrewicz. The decision about next increase in borrowing costs should be helped by, apart from high inflation, next set of data about strong economic activity in February.

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

Government and politics

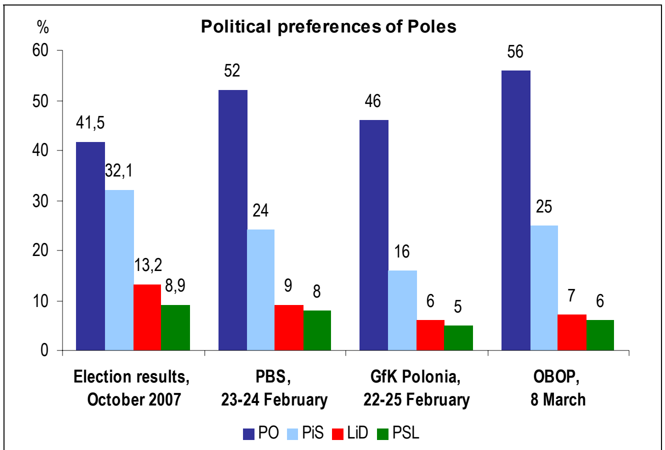
Planned macroeconomic assumptions in the updated Convergence Program

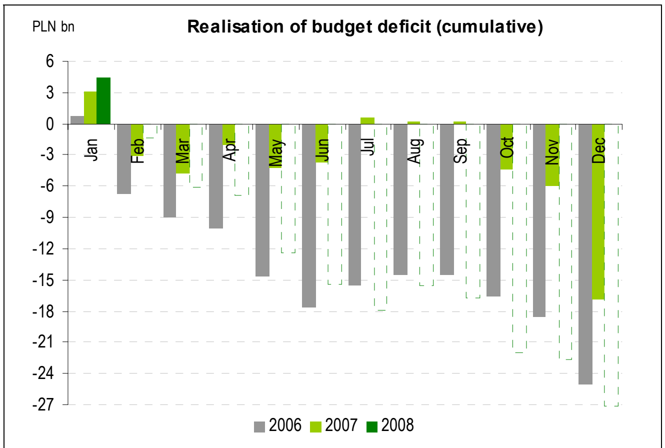
	2008	2009	2010
GDP growth, %	5.5 (5.5)	5.0 (5.2)	5.0 (5.0)
Annual average inflation, %	3.5 (2.4)	2.9 (2.5)	2.5 (2.5)
General government balance, % PKB	-2.5 (-3.0)	-2.0 (-2.8)	-1.5 (-2.5)

Note: in brackets assumptions from the previous update of the Convergence Program published in October 2007

Rating for long term debt in foreign currency (in brackets rating outlooks)

Rating agency	Poland	Czech Republic	Slovakia	Hungary
Standard and Poor's	A- (positive)	A (stable)	A (positive)	BBB+ (stable)
Moody's	A2 (stable)	A1 (positive)	A1 (stable)	A2 (stable)
Fitch Ratings	A- (stable)	A+ (stable)	A (positive)	BBB+ (stable)





Source: Ministry of Finance, polling institutes, own calculations

The updated Convergence Program due for release soon

▪ The Ministry of Finance is finishing works on the updated version of the Convergence Program, which is going to be sent to Brussels until the end of March.

▪ New macroeconomic assumptions were prepared taking into account the fresh data for January. Although the assumptions may be regarded as quite realistic (in the light of our new forecasts only predicted pace of GDP growth this year seems too optimistic), credibility of indicated path of fiscal deficit reduction is hard to assess at the moment due to lack of details on how the fiscal targets are to be achieved.

▪ As for now, we only know that the program aimed at increasing labour participation rate among people at age of over 50 is expected to bring PLN20-30bn savings in 2-3years, which seems to be an overly optimistic assumption.

Improved outlook for Poland's rating

▪ Despite no decisive actions of the current government in the fiscal policy area so far, the S&P agency improved outlook for Poland's rating from stable to positive. The change took place due to improved climate for reforms under the new government. According to the agency, upgrade of the rating may take place, when the planned reform bring results, which could be expected rather the next year than this year.

▪ In our opinion arguments for the change in outlook for Poland's rating has not changed since the parliamentary election, which means that it should have taken place already a few months ago. Taking into account a deterioration in prospects for economic growth, inflation and lack details on reforms from the government after 100 days in power, one can conclude that timing of the S&P decision is unfortunate.

Civic Platform maintains high popularity

▪ Results of public opinion polls still give the Civic Platform (PO) a comfort as regards proposing brave reforms. Leader of the ruling coalition has still very a large advantage over other political parties.

▪ It is noteworthy that while the PO does not have to worry about a possibility of early elections, its junior coalition partner PSL is balancing on the verge of parliamentary threshold. Such a situation should make it easier for the Platform to push brave reform ideas within the ruling coalition.

▪ However, one cannot exclude that support for particular political parties will change, if proposals of unpopular reform will eventually appear. This could take place especially, if some weakening of economic growth actually took place, which seems more and more likely.

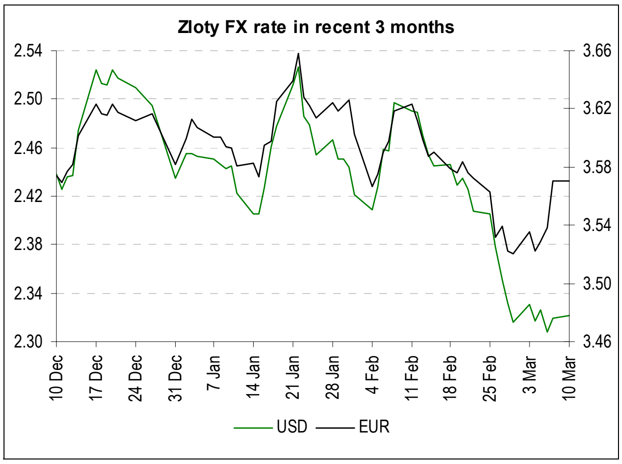
The 2008 budget performance very well so far

▪ According to the schedule of the 2008 budget execution this year presented by the Ministry of Finance, the central budget gap after February reached nearly PLN1.33bn (but could be lower). This means that path of this year's budget performance remains better than in the two previous year.

▪ The ministry assumed in the schedule that from March on results of this year's budget will be weaker than in 2007 and in the second half of the year will be even weaker than in 2006.

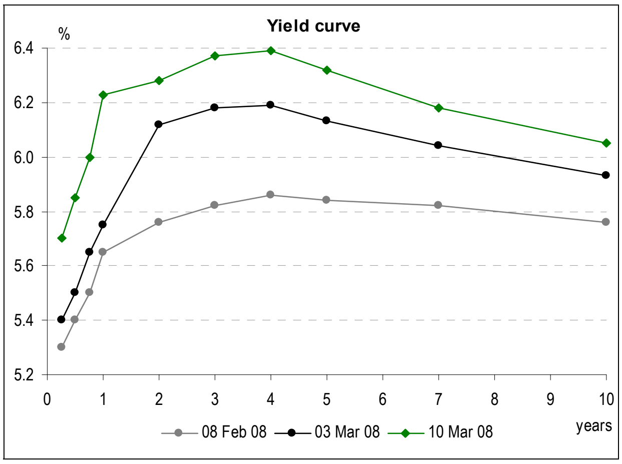
▪ Some slowdown in economic growth predicted by us in the second half of the year may actually negatively affect the budget, but on the other hand budget revenues this year will be positively influenced by higher than assumed inflation (it is noteworthy at the same time that higher inflation this year will increase spending indexation the next year).

Market monitor



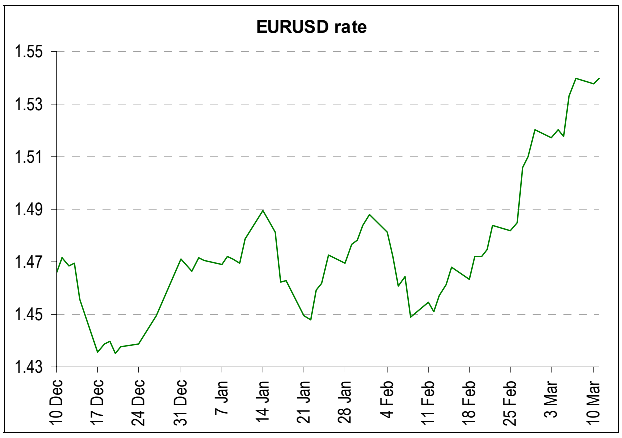
Market moods swing the zloty

- At the end of February there was a significant zloty appreciation against the major currencies due to monetary policy tightening by the MPC and strengthening of currencies in the region (especially of Hungarian forint on lifting its central parity). The zloty rate approached the 3.50 level against the euro and 2.30 versus the dollar. However, in the last days there was a temporary correction connected with a significant jump in risk aversion and wave of asset sell-off, which was not avoided in the region and affected the Polish bonds, equities and the zloty. The USDPLN rate correction was smaller due to large increase of the EURUSD rate.
- After reduction in risk aversion and stabilisation of situation in the international markets the zloty should strengthen again especially against the euro due to strong fundamentals and expectations of rate hikes. Appreciation vs. the dollar may be smaller due to possible EURUSD rate decline.



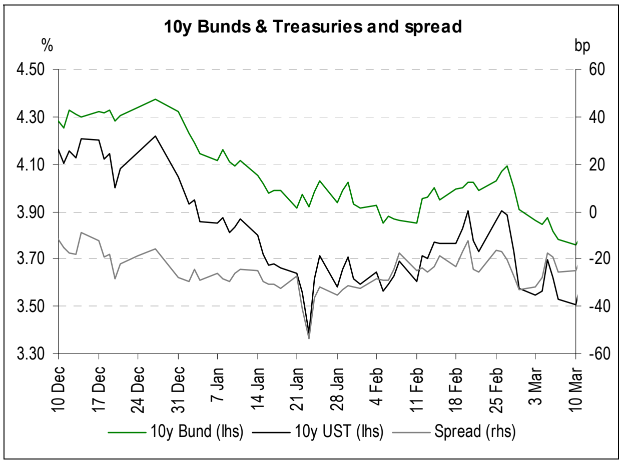
Debt influenced by risk aversion and rate hikes expectations

- For the better part of February bonds were in a weakening mode, which was connected with higher than expected data, among others CPI, production, wages, employment, and sales. An additional factor, which resulted in the bond prices decline, was the MPC decision to raise rates in February, and the market was further depressed by the sell-off of risky assets in the international markets. Bonds yields rose by 30-55 bp during a month, and the yield curve flattened.
- Amid current tight market situation the debt market may weaken only slightly after the CPI data for February. The release of other data from the economy may have a slightly positive effect on the interest rate market, though it is worth to remember that it will be burdened by the expected rate hike in March. The debt market should recover if the situation in the international markets stabilises and appetite for risk increases.



Record weak dollar

- The dollar weakened against the euro in the last few weeks, which was in line with our assumptions though the depreciation scale was larger than we forecasted. The EURUSD rate increased to record high level above 1.54 from 1.45 in mid-February. The main reason for this was an increase of fears over the prospects of the US economy (on weaker than expected data from the US) and better than forecasted figures from the euro zone. Moreover the euro was supported by quite „hawkish" comments from the ECB President, while Bernanke comments had a negative influence on the dollar and they strengthened expectations of larger rate cuts by the Fed.
- The euro is going to be still supported by the little „dovish" ECB bias on interest rates and further interest rate cuts in the United States. After a temporary stabilisation of the EURUSD rate near current levels it should decline below 1.50 in the coming months.

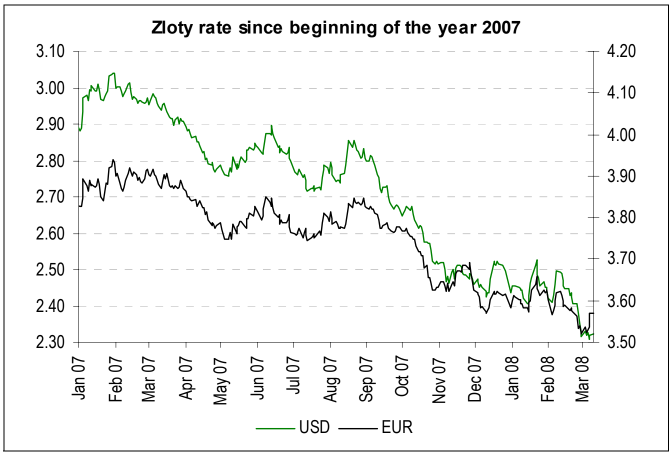


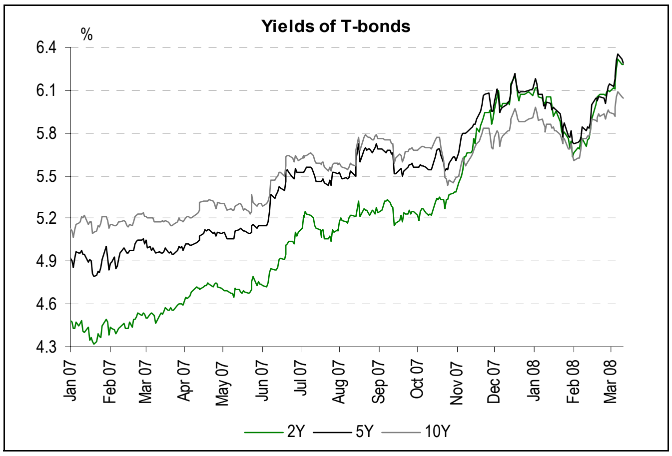
Flight to quality prevailed

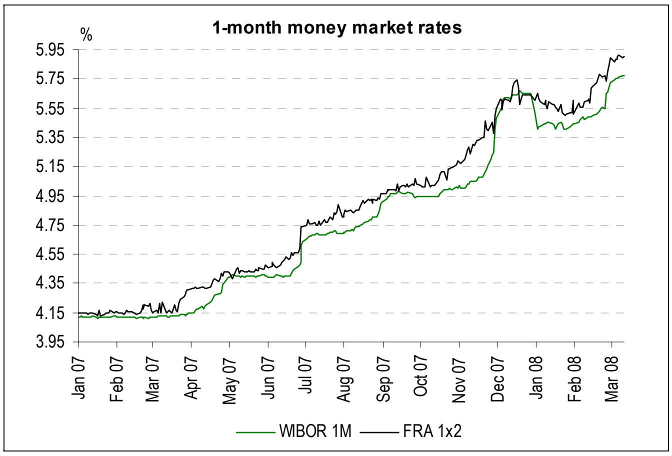
- In February the long term bonds in the core markets weakened amid lower risk aversion, higher fears over inflation and slightly better than expected data from the EMU. At the end of February weaker data from the US and declines in the stock markets contributed to a fall of risk appetite and increase of interest in safe assets, which substantially strengthened the core debt markets. News on financial institutions problems and poor US labour market data added to risk aversion sentiment. Yields of 10Y Treasuries declined since mid-February from 3.68% to 3.50%, while Bunds from 3.86% to 3.76%.
- We expect a slightly lower scale of interest rate cuts in the US as compared to the market view, i.e. by 50 bp in March and next 50 bp in Q2, while further downward move for yields of 10Y Treasuries may be limited. After the recent ECB comments we postponed forecasted two 25 bp rate cuts in the EMU for Q3 and Q4.

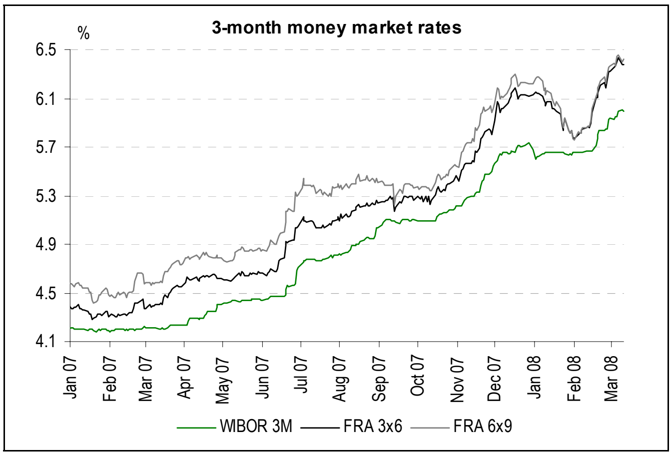
Source: Reuters, BZ WBK

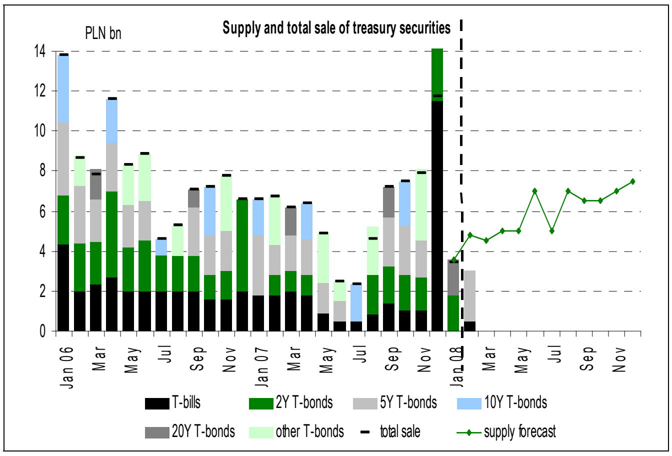
Market monitor











Treasury bill auctions (PLN m)

	OFFER / SALE			
Date of auction	**52-week**	**5-week**	**Date of auction**	**52-week**
14.01.2008	2 000 / 2 000		**11.08.2008**	-
11.02.2008	500 / 500		**08.09.2008**	-
10.03.2008	1 000 / 1 417	500 / 737	**22.09.2008**	-
14.04.2008	-		**13.10.2008**	-
12.05.2008	-		**27.10.2008**	-
09.06.2008	-		**17.11.2008**	-
14.07.2008	-		**18.12.2008**	-

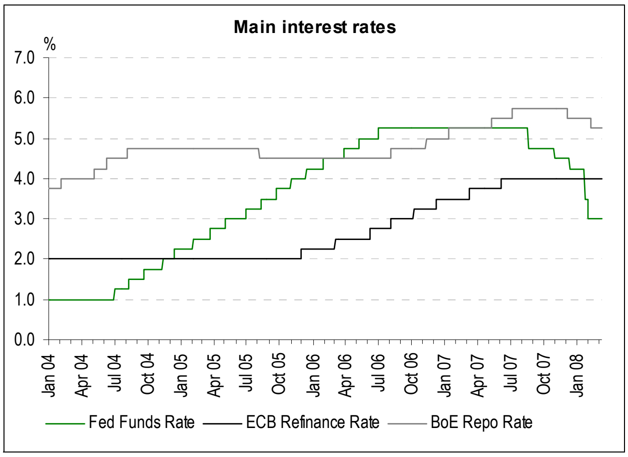
Treasury bond auctions in 2008 (PLN m)

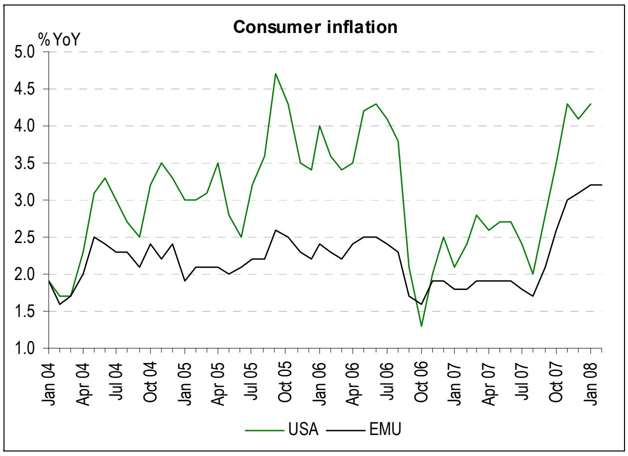
month	First auction				Second auction				Switch auction		
	date	T-bonds	offer	sale	date	T-bonds	offer	sale	date	T-bonds	sale
January	02.01	OK0710	1 800	1 655	09.01	WS0922	1 800	1 800	16.01	PS0413 / IZ0816 / WS0922	524 / 766 / 431
February	06.02	PS0413	2 500	2 500	13.02	DS1017	2 000	2 000	20.02	WZ0816 / WZ1118	855 / 914
March	05.03	PS0413	1 500	1 500	12.03	WS0437	700	700	19.03	-	-
April	02.04	2Y	-	-	09.04	10Y	-	-	-	-	-
May	07.05	5Y	-	-	14.05	20Y	-	-	-	-	-
June	04.06	5Y	-	-	11.06	12Y CPI | 10Y float	-	-	-	-	-
July	02.07	2Y	-	-	09.07	10Y	-	-	-	-	-
August	06.08	2Y	-	-	13.08	12Y CPI | 10L float	-	-	-	-	-
September	03.09	5Y	-	-	10.09	20Y	-	-	-	-	-
October	01.10	5Y	-	-	08.10	10Y	-	-	-	-	-
November	05.11	5Y	-	-	12.11	12Y CPI | 10Y float	-	-	-	-	-
December	03.12	2Y	-	-	-	-	-	-	-	-	-

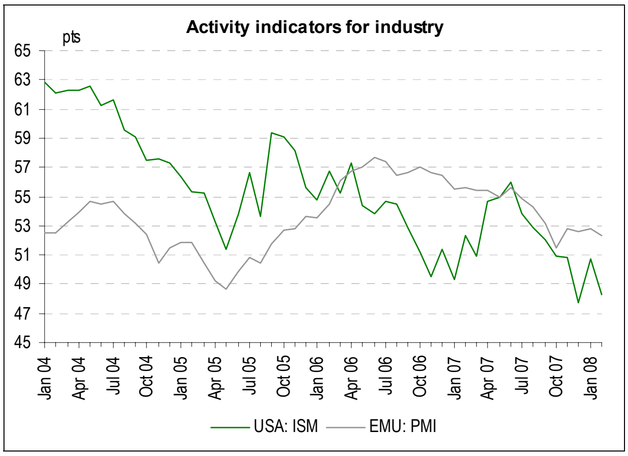
* with supplementary auction

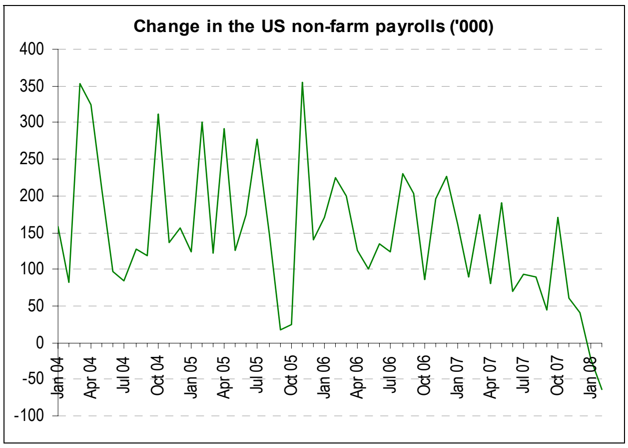
Source: Ministry of Finance, Reuters, BZ WBK

International review









Source: Reuters, ECB, Federal Reserve

Dovish Fed, hawkish ECB

▪ The minutes of the FOMC meeting in January included a GDP growth forecast for 2008, which was lowered to 1.3-2.0% from 1.8-2.5% previously and it did not include wording, which could weaken expectations of another interest rate cut by 50 bp in March, though there was a suggestion in this report that the recent deep rate cuts may be soon reversed, if the economy begins to recover. The recent comments of Ben Bernanke suggested significant moves by the Fed supporting the economic growth.

▪ After the ECB left interest rates unchanged in March the bank's president reiterated that maintaining prices stability and anchoring inflation expectations are the main priorities for the central bank. The ECB expects inflation will remain at elevated levels through longer period amid upside risk for inflation and lower GDP growth forecast. In spite of this Trichet said that the fundamentals of the European economy are solid.

Inconvenient inflation

▪ The US inflation January reached 0.4%MoM (expected 0.3%), and in annual terms rose to 4.3% from 4.1% in December. Core inflation was 0.3%MoM and 2.5%YoY against a forecast of 0.2%MoM and 2.5%YoY. PPI rose 1%MoM against expected increase by 0.4% and 7.4%YoY. Core PPI grew 0.4%MoM (expected 0.2%) and 2.3%YoY. Core PCE index rose 0.3%MoM and 2.2%YoY.

▪ According to the final Eurostat data, the HICP inflation in the euro zone was remained flat in February at the level of 3.2%YoY posted in January.

▪ The elevated inflation makes the running of monetary policy difficult for central banks. Quite disturbing from the Fed's point of view may be the acceleration of the core inflation, which may be a signal rise in energy and food prices are spreading to other goods and services categories.

Lower economic activity in the US

▪ The ISM manufacturing in February fell to the lowest level since April 2003 and reached 48.3 pts against 50.7 pts in January (expected 48.0 pts), while the market feared that the result may be even below forecasts. The fall of the employment index to 46.0 pts was recorded (the lowest level since June 2003). The ISM index for services rose to 49.3 pts from 41.9 in January against expected increased to 47.0 pts. The prices paid components for both indices stayed at elevated levels.

▪ The PMI index for the euro zone in February fell to 52.3 pts, in line with market expectations and earlier estimate. As expected, the PMI index for services rose from 50.6 pts in January to 52.3 pts in February.

▪ The preliminary estimate of US GDP growth rate in Q4 was not revised from 0.6% against expected 0.7%. The private consumption and investments were downwardly revised. If not the better foreign trade results, the US economy would experience a contraction amid decline of domestic demand. The core PCE was not revised and reached 2.7% in Q4. In our view the US economy is balancing on the verge of recession amid lower activity indices.

▪ The economic growth in the EMU in Q4 2007 was 0.4%QoQ and 2.2%YoY against expectations of 2.3%YoY.

Non-farm payrolls decline second month in a row

▪ The US labour market data for February showed a decline of employment outside farming by 63k after a fall by 22k in January, while market analysts expected an increase by 25k against a 17k decline in January before revision. Moreover, the December data were revised from 82k increase to 41k rise.

▪ The rate of unemployment fell to 4.8% from 4.9%, against expected increase to 5%, which resulted from a fall in labour force.

Economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
10 March ***PL: Auction of Treasury Bills*** US: Wholesale inventories (Jan)	**11** DE: ZEW index (Mar) US: Trade balance (Jan)	**12** ***PL: Auction of 30Y bonds*** EZ: Industrial production (Jan)	**13** ***PL: CPI (Jan & Feb)*** ***PL: Balance of payments (Jan)*** US: Import prices (Feb) US: Retail sales (Feb)	**14** ***PL: Money supply (Feb)*** EZ: Final HICP (Feb) US: CPI (Feb) US: Preliminary Michigan (Mar)
17 ***PL: Wages and employment (Feb)*** US: NY Fed index (Mar) US: Capacity use (Feb) US: Industrial output (Feb) US: Capital flows (Jan)	**18** US: PPI (Feb) US: House starts (Feb) US: Fed meeting - decision	**19** ***PL: Switch auction*** ***PL: Industrial output (Feb)*** ***PL: PPI (Feb)***	**20** ***PL: Minutes RPP (Feb)*** EZ: Flash manufacturing PMI (Mar) EZ: Flash services PMI (Mar) US: New jobless claims US: Philadelphia Fed index (Mar)	**21** ***PL: Net inflation (Jan & Feb)*** ***PL: Business climate (Feb)*** US, DE, GB: Market holiday
24 ***PL: Easter Monday*** DE, GB: Market holiday US: Home sales (Feb)	**25** ***PL: MPC meeting*** US: Consumer confidence (Mar)	**26** ***PL: Retail sales (Feb)*** ***PL: Unemployment (Feb)*** ***PL: MPC meeting – decision*** DE: Ifo index (Mar) US: Durable goods orders (Feb) US: New home sales (Feb)	**27** US: Final GDP (Q4) US: Core PCE (Q4) US: GDP deflator (Q4) US: New jobless claims	**28** US: Core PCE (Feb) US: Final Michigan (Mar)
31 ***PL: Balance of payments (Q4)*** EZ: M3 money supply (Feb) EZ: Economic sentiment (Mar) EZ: Flash HICP (Feb) US: Chicago PMI (Mar)	**1 April** EZ: PMI – manufacturing PMI (Mar) US: Manufacturing ISM (Mar)	**2** ***PL: Auction of 2Y bonds*** EZ: PPI (Feb) US: ADP report (Mar) US: Factory orders (Feb)	**3** EZ: Services PMI (Mar) US: New jobless claims US: Non-manufacturing ISM (Mar)	**4** US: Non-farm payrolls (Mar) US: Unemployment (Mar)
7	**8** US: Pending home sales (Feb) US: FOMC minutes	**9** ***PL: Auction of 10Y bonds*** JP: Report after interest rate decision EZ: GDP (Q4) US: Wholesale inventories (Feb)	**10** GB: BoE meeting – decision EZ: ECB meeting - decision US: New jobless claims	**11** US: Import prices (Mar) US: Preliminary Michigan (Apr)

Source: CSO, NBP, Finance Ministry, Reuters

MPC meetings and data release calendar for 2008

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

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

Source: CSO, NBP

Economic data and forecasts

Monthly economic indicators

		Feb 07	Mar 07	Apr 07	May 07	Jun 07	Jul 07	Aug 07	Sep 07	Oct 07	Nov 07	Dec 07	Jan 08	Feb 08	Mar 08
Industrial production	%YoY	13.0	11.3	12.6	8.1	5.6	10.4	8.9	5.4	10.8	8.5	6.4	10.8	9.9	4.9
Retail sales [c]	%YoY	17.5	19.2	15.1	14.8	16.2	17.1	17.4	14.2	19.4	19.2	12.4	20.9	19.9	20.3
Unemployment rate	%	14.8	14.3	13.6	12.9	12.3	12.1	11.9	11.6	11.3	11.2	11.4	11.7	11.5	11.0
Gross wages [b c]	%YoY	6.4	9.1	8.4	8.9	9.3	9.3	10.5	9.5	11.0	12.0	7.2	11.5	10.9	9.6
Employment [b]	%YoY	4.3	4.5	4.4	4.4	4.6	4.7	4.8	4.7	5.0	5.0	4.9	5.9	5.8	5.6
Export (€) [d]	%YoY	13.8	15.0	17.1	13.1	11.5	19.1	16.0	9.0	15.8	14.6	20.0	20.2	18.6	14.0
Import (€) [d]	%YoY	12.2	18.5	24.9	12.7	18.6	22.6	13.0	14.4	17.2	14.5	21.2	23.2	23.7	15.1
Trade balance [d]	EURm	-141	-757	-836	-762	-882	-1090	-362	-917	-604	-562	-1294	-905	-578	-966
Current account balance [d]	EURm	-545	-681	-798	-1274	-1488	-1127	-513	-620	-1289	-120	-1944	-1225	-888	-886
Current account balance [d]	% GDP	-3.2	-3.2	-3.2	-3.3	-3.6	-3.7	-3.6	-3.8	-3.8	-3.5	-3.7	-3.9	-3.9	-4.0
Budget deficit (cumulative)	PLNbn	-3.0	-4.8	-2.1	-4.3	-3.7	0.6	0.3	0.2	-4.4	-6.0	-16.9	4.4	0.0	-4.7
Budget deficit (cumulative) [e]	% of FY plan	17.9	28.6	12.2	25.2	21.7	-3.6	-1.6	-1.2	26.2	35.5	100.0	-16.4	0.1	17.5
CPI	%YoY	1.9	2.5	2.3	2.3	2.6	2.3	1.5	2.3	3.0	3.6	4.0	4.3	4.6	4.4
PPI	%YoY	3.5	3.3	2.2	2.1	1.7	1.5	1.8	1.8	2.0	2.5	2.3	2.8	3.0	2.9
Broad money (M3)	%YoY	18.0	18.0	17.8	16.0	14.7	15.6	16.1	14.4	13.8	13.6	13.4	13.1	13.4	13.1
Deposits	%YoY	18.3	17.7	18.2	16.4	15.2	15.9	16.3	15.4	15.2	15.1	14.5	14.4	14.1	13.8
Loans	%YoY	26.5	26.8	28.4	28.6	29.2	31.4	31.1	31.0	30.6	30.1	30.0	30.1	29.5	28.0
USD/PLN	PLN	2.98	2.94	2.83	2.80	2.84	2.75	2.80	2.73	2.61	2.49	2.47	2.46	2.43	2.36
EUR/PLN	PLN	3.90	3.89	3.82	3.78	3.81	3.77	3.81	3.79	3.71	3.66	3.60	3.61	3.58	3.54
Reference rate [a]	%	4.00	4.00	4.25	4.25	4.50	4.50	4.75	4.75	4.75	5.00	5.00	5.25	5.50	5.75
Lombard rate [a]	%	5.50	5.50	5.75	5.75	6.00	6.00	6.25	6.25	6.25	6.50	6.50	6.75	7.00	7.25
WIBOR 3M	%	4.20	4.22	4.32	4.44	4.52	4.78	4.80	5.09	5.13	5.36	5.67	5.64	5.74	5.95
Yield on 52-week T-bills	%	4.07	4.23	4.36	4.43	4.42	4.70	4.80	5.01	5.04	5.30	5.78	5.75	5.66	6.10
Yield on 2-year T-bonds	%	4.46	4.55	4.71	4.70	4.93	5.14	5.23	5.25	5.30	5.77	6.06	5.92	5.90	6.25
Yield on 5-year T-bonds	%	4.97	4.98	5.07	5.11	5.40	5.50	5.61	5.60	5.59	5.90	6.07	5.94	5.93	6.25
Yield on 10-year T-bonds	%	5.18	5.18	5.27	5.28	5.52	5.60	5.68	5.69	5.64	5.70	5.85	5.81	5.82	6.00

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

[a] at the end of period [b] in corporate sector [c] in nominal terms [d] balance of payments data on transaction basis [e] 2006 - % of Dec, 2007 - % of plan

Quarterly and annual economic indicators

		2005	2006	2007	2008	1Q07	2Q07	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08
GDP	PLNbn	983.3	1 060.2	1 162.9	1 271.4	266.7	280.2	286.8	329.2	293.4	308.2	313.4	356.4
GDP	%YoY	3.6	6.2	6.5	5.1	7.2	6.4	6.4	6.1	5.3	5.6	4.9	4.7
Domestic demand	%YoY	2.4	7.3	7.3	6.6	7.7	8.2	7.4	6.2	5.9	6.9	6.6	6.9
Private consumption	%YoY	2.0	4.9	5.2	5.5	6.9	5.1	5.2	3.8	5.0	5.7	5.6	5.7
Fixed investments	%YoY	6.5	15.6	20.4	12.8	26.2	20.8	19.8	18.5	14.0	15.0	13.0	11.0
Industrial production	%YoY	4.0	12.5	9.7	6.6	13.0	8.5	8.1	9.6	8.5	7.9	5.2	5.0
Retail sales (real terms)	%YoY	1.5	11.9	14.0	16.1	17.4	14.1	12.8	12.2	15.4	15.9	16.2	16.7
Unemployment rate [a]	%	17.6	14.8	11.4	8.5	14.3	12.3	11.6	11.4	11.0	8.9	8.3	8.5
Gross wages (real terms) [c]	%YoY	1.2	4.2	6.7	5.9	5.9	6.5	8.1	6.5	6.0	6.0	6.0	5.5
Employment [c]	%YoY	1.9	3.2	4.6	5.3	4.2	4.5	4.8	5.0	5.8	5.5	5.2	4.6
Export (€) [b]	%YoY	17.8	20.4	14.9	10.5	14.7	13.8	14.4	16.5	17.4	12.0	8.0	5.5
Import (€) [b]	%YoY	13.4	24.0	17.3	15.7	16.8	18.4	16.6	17.5	20.3	17.0	14.0	12.5
Trade balance [b]	EURm	-2 242	-5 536	-8 747	-15 798	-1 440	-2 481	-2 366	-2 460	-2 449	-4 198	-4 296	-4 856
Current account balance [b]	EURm	-3 866	-8 787	-11 276	-18 113	-2 104	-3 559	-2 260	-3 353	-2 999	-5 276	-4 090	-5 749
Current account balance [b]	% GDP	-1.6	-3.2	-3.7	-5.1	-3.2	-3.6	-3.8	-3.7	-3.8	-4.1	-4.5	-5.1
Budget deficit (cumulative) [a]	PLNbn	-28.6	-25.1	-16.9	-25.8	-4.8	-3.7	0.2	-16.9	-4.7	-14.2	-15.4	-25.8
Budget deficit (cumulative) [a]	% GDP	-2.9	-2.4	-1.5	-2.0	-	-	-	-	-	-	-	-
CPI	%YoY	2.1	1.0	2.5	4.1	2.0	2.4	2.0	3.5	4.4	4.2	4.2	3.5
CPI [a]	%YoY	0.7	1.4	4.0	3.4	2.5	2.6	2.3	4.0	4.4	4.0	4.0	3.4
PPI	%YoY	0.7	2.5	2.3	2.5	3.3	2.0	1.7	2.3	2.9	2.4	2.0	2.9
Broad money (M3) [a]	%YoY	13.1	16.0	13.4	11.5	18.0	14.7	14.4	13.4	13.1	12.8	12.1	11.5
Deposits [a]	%YoY	12.6	15.2	14.5	11.1	17.7	15.2	15.4	14.5	13.8	13.2	12.2	11.1
Loans [a]	%YoY	13.3	23.4	30.0	19.0	26.8	29.2	31.0	30.0	28.0	26.0	22.6	19.0
USD/PLN	PLN	3.23	3.10	2.77	2.43	2.97	2.82	2.76	2.52	2.41	2.38	2.46	2.47
EUR/PLN	PLN	4.02	3.90	3.78	3.55	3.89	3.80	3.79	3.65	3.58	3.51	3.57	3.53
Reference rate [a]	%	4.50	4.00	5.00	6.00	4.00	4.50	4.75	5.00	5.75	6.00	6.00	6.00
Lombard rate [a]	%	6.00	5.50	6.50	7.50	5.50	6.00	6.25	6.50	7.25	7.50	7.50	7.50
WIBOR 3M	%	5.29	4.21	4.73	6.11	4.20	4.42	4.89	5.39	5.77	6.11	6.30	6.25
Yield on 52-week T-bills	%	4.92	4.18	4.69	5.98	4.14	4.40	4.84	5.37	5.84	6.10	6.00	6.00
Yield on 2-year T-bonds	%	5.04	4.57	5.22	6.11	4.47	4.78	5.21	5.71	6.02	6.20	6.15	6.05
Yield on 5-year T-bonds	%	5.25	5.03	5.51	6.11	4.95	5.19	5.57	5.85	6.04	6.20	6.15	6.05
Yield on 10-year T-bonds	%	5.24	5.22	5.55	5.91	5.17	5.36	5.66	5.73	5.88	6.00	5.90	5.85

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 11.03.2008 has been prepared by:

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