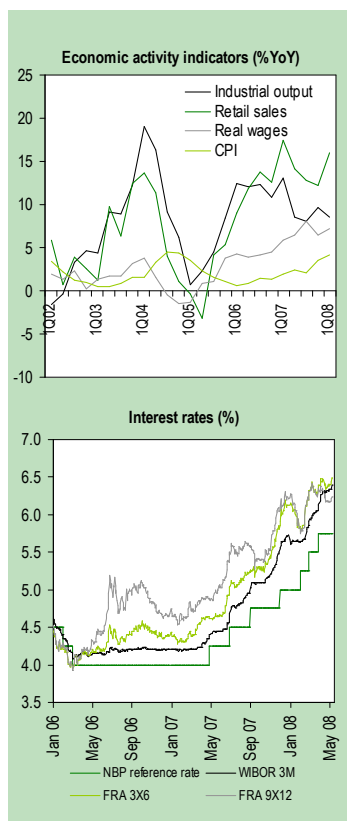


MACROscope

Polish Economy and Financial Markets

May 2008



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Break. And what next?

- In the last report titled "Time for a Break", we wrote that in April the Monetary Policy Council would withhold its decision on raising interest rates, there would be a correction of the zloty rate after a substantial appreciation and macroeconomic figures would indicate a slowdown in the national economy. Our forecasts proved correct, however new questions are coming up. Will subsequent data releases confirm that an economic slowdown is a fact? Will a break in interest rate hikes last one or two months?
- Following worse than expected data about production and sales in March, we will uphold our overall assessment of the Polish economy. Our forecast continues to show that GDP will drop below 5% in the second half of the year due to a weaker dynamics of industrial output, export sales and investment, still the tone of forthcoming business updates will be consolatory. Polish economy is not as robust as suggested by the January-February statistics (and the April update), but it isn't as ailing as might be inferred from the March figures, either.
- Except for a rebound seen in the industrial output and sales statistics, our forecast for the forthcoming period is below market consensus, both in relation to inflation (CPI and PPI) and to salaries in the industrial sector. If inflation does not fall and salaries accelerate visibly, the likelihood of having another interest rate hike passed during the May meeting will increase substantially. So far, however, it seems to us that the June hike (on the back of an inflation projection and GDP figures for the first quarter) is still very likely. In its communiqué, the Monetary Council pointed out that the zloty rate was important, hence the decision would also depend on developments in FX market.
- Although markets are preoccupied mainly with predictions about the monetary policy, this time in our Special focus section, a special attention is paid to the fiscal policy which is discussed against the backdrop of the Convergence Program. At the end of March, the government adopted the updated version of the Convergence Program and sent it off to Brussels. Joaquin Almunia, EU Commissioner responsible for Monetary and Economic Affairs, announced that the document will form a basis for his recommendation to the European Commission on discontinuing the excessive deficit procedure towards Poland. Are then the government's plans as much realistic as ambitious? The results of our analysis show that to reach the government's deficit target an additional fiscal adjustment of PLN18.5bn or 1.35% of GDP will have to be exercised. This is related, among other things, to a higher than adopted in the Programme growth of rigid spending. Assuming that the government does not want to reduce capital expenditure on EU subsidised infrastructure projects, other spending in 2009 would have to drop by over 10% against 2008. Reaching such a large scale of spending reductions appears hardly realistic, which may give rise to a need to at least a partial reversal of the fiscal burden reductions.

Financial market on 30 April 2008:					
NBP deposit rate	4.25	WIBOR 3M	6.14	USDPLN	2.2267
NBP reference rate	5.75	Yield on 2-year T-bonds	6.14	EURPLN	3.4604
NBP lombard rate	7.25	Yield on 5-year T-bonds	6.07	EURUSD	1.5540

This report is based on information available until 09.05.2008

Special focus

Program of goodwill

Towards the end of March, the government adopted the updated version of the Convergence Programme and sent it off to Brussels. Joaquin Almunia, EU Commissioner for Monetary and Economic Affairs, announced that the document will form a basis for his recommendation to the European Commission on discontinuing the excessive deficit procedure against Poland. The presented path of fiscal consolidation envisage that following 2008 the general government deficit will be lowered by 0.5% of GDP very year. Does the government's plans as much realistic as ambitious ?

A good starting point, very ambitious plans

The previous year was favourable for Poland's public finance. The central budget's deficit closed slightly below PLN17bn versus a forecast of PLN30bn and the general government deficit in relation to GDP fell to 2% from 3.8% in 2006 against the updated Convergence Programme of 2006 which assumed the deficit to reach 3.4%. These better than expected developments resulted from a sound macroeconomic situation.

Benefiting from a good starting point, the Ministry of Finance has come up with a very ambitious path of reduction in the public finance imbalance in the coming years. The updated version of the 2007 Convergence Programme, adopted by the new government in a slightly modified version at the end of March, assumes that after 2008 the general government deficit will be lowered by 0.5% of GDP every year (see table 1). According to the government, such a major squeeze will be possible notwithstanding a sizeable cost of reducing the tax wedge. A considerable charge on that account is supposed to cause a temporary hike in deficit to GDP ratio this year. Next year though a reverse trend should be observed. Were it not for the cost of reducing the tax wedge, the general government finance would be balanced.

Table 1. Balance of the general government and sub-sectors (% of GDP)

	2006	2007	2008	2009	2010
Central government	-4.2	-3.2	-3.2	-2.5	-2.0
Local government	-0.3	0.2	0.6	0.3	0.3
Social security funds	0.7	1.0	0.1	0.2	0.2
General government balance	-3.8	-2.0	-2.5	-2.0	-1.5

Source: Convergence Program

As regards the public debt, the government assumes that a consistent reduction of the deficit and a favourable economic environment will cause the ratio of public debt to GDP to fall from 47.6% in 2006 to 42.3% in 2010 (the convergence threshold is 60%).

Table 2. General government debt (% of GDP)

	2006	2007	2008	2009	2010
Gross debt	47.6	44.9	44.2	43.3	42.3
Change in debt-to-GDP ratio	0.6	-2.7	-0.7	-0.9	-1.0

Source: Convergence Program

Except for a deficit and debt of the general government sector, the Convergence Programme also presents revenues and spending across the sector (see table 3). According to the Programme's authors, its content is meant to be an anchor for politicians. Assumptions underlying the rate of growth in revenues and spending are quite ambitious. Thus, a question arises whether to treat them as a real anchor and whether the whole document deserves to be regarded as a reliable plan of reduction in the country's public finance imbalance on the way to the euro zone.

Table 3. Revenues and spending of the general government sector

	2007	2008	2009	2010
Revenues (% of GDP)	40.0	40.0	39.2	38.7
Spending (% of GDP)	42.0	42.5	41.2	40.1
Revenues (PLNbn)	466.1	508.9	539.7	573.3
Spending (PLNbn)	489.4	540.8	567.2	594.0
Revenues (%YoY)	9.9	9.2	6.0	6.2
Spending (%YoY)	5.4	10.5	4.9	4.7

Source: Convergence Program, own calculations

The table above shows that the revenues of the general government sector, following this year's growth by over 9%, are expected to climb by a mere 6% in the next year. Spending are planned to increase by less than 5% in 2009, following a year of two-digit growth. The former deputy finance minister, Stanisław Gomułka, indicated in his statements that the spending of the central budget only would grow by 6% next year, while spending excluding projects subsidised by EU would be higher by a mere 3%. Given the inflation forecast in the Programme (see below), spending of the general government (excluding projects subsidised by EU) sector would remain unchanged in real terms. At the first glance, it seems to be an unrealistic target, at least in light of the declarations to curb public spending that have been made so far. Likewise, the assumption about local authorities being able to maintain a budget surplus

in the coming years appears unfeasible. A surplus recorded in 2007 came in the wake of a good economic situation and concurrent delay in the launch of EU programmes co-financed by local authorities. Subsequent years in a less robust economy, lower PIT rates and expected advancement of EU programmes will put a much greater strain on the budgets of local authorities.

Hardly conservative macroeconomic assumptions

Doubts about the government's ambitious plan of deficit reduction arise already around macroeconomic assumptions (see table 4).

Table 4. Basic macroeconomic assumptions of the Convergence Program versus the BZ WBK forecasts

	2008		2009		2010	
	CP	BZ WBK	CP	BZ WBK	CP	BZ WBK
GDP growth	5.5	5.1	5.0	4.5	5.0	4.5
Private consumption	6.0	5.6	5.4	5.2	4.5	5.4
Fixed investments	14.5	12.6	10.0	12.0	10.0	10
Exports	6.0	12.8	6.2	9.0	6.2	12.0
Imports	9.6	16.9	7.8	15.5	7.0	15.0
Inflation	3.5	4.1	2.9	3.3	2.5	2.7
Short-term interest rates	5.5	5.75	5.8	6.0	5.5	6.0

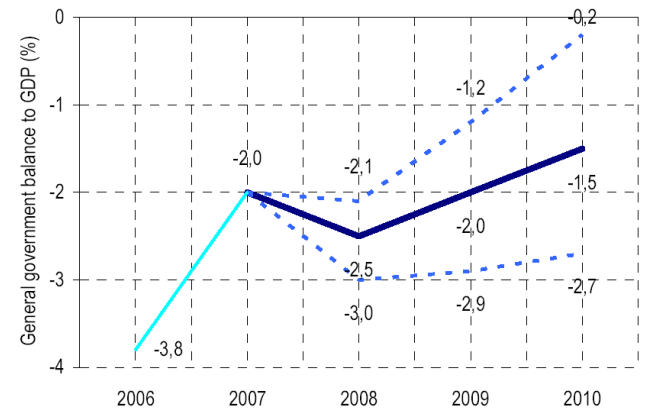
Source: Convergence Program (CP), own forecasts

The Programme assumes that the pace of economic growth in 2008 will slacken to 5.5% from 6.6% (posted in 2007) and will continue at a stable level of 5% in 2009-2010. Concurrently, the steady revival of the Polish labour market is expected with the unemployment rate declining further. The main risks in this are adverse developments in the global economy. In terms of domestic factors, some risk is perceived in inflation that began to grow at the beginning of 2008. Subsequent years, however, are expected to see inflation falling down to the target. It is assumed that external imbalance will be gradually mounting, but not on a scale that would put a stable economic growth at risk.

The adopted assumptions regarding the economic growth, although attainable, cannot be seen as conservative. According to our forecast, GDP growth this year will be closer to 5% rather than 5.5% with a decline to 4.5% over the coming years. Consequently, revenues of the general government sector may grow slower than envisaged in the Programme. In light of a sensitivity analysis presented in the Programme (see chart 1), the delivery of our GDP forecast would mean

that revenues this year would be below the assumption by ca. 0.2%, in 2009 by 0.45% and in 2010 by 0.6% of GDP. If the anticipated economic slowdown were rapid (GDP growth at 4% or less in 2009), then the achievement of the government's fiscal targets would be even harder.

Chart 1. Sensitivity of the general government balance to changes in GDP growth



Source: Convergence Program

The risk relating to an unsatisfactory GDP growth in Poland is caused, among other things, by overly optimistic expectations as to the economic growth in the external environment of the Polish economy (see table below).

Table 5. Forecasted GDP growth in the EU

GDP growth in the EU according to	2008	2009	2010
Convergence Program	2.0	2.0	2.0
International Monetary Fund	1.8	1.7	2.6
European Commission	2.0	1.8	b.d.

Source: CP, IFM, EC

As the table above shows, the Programme relies on economic assumptions for EU (the EU markets are key importers of Polish exports), covering the years 2008 and 2009, which are much more optimistic than the spring forecast of the International Monetary Fund and the EU Commission.

Also, the inflation path assumed by the government seems questionable. An average inflation in this year will most likely grow above the assumed 3.5%, given that it is a HICP inflation rate which consistently remains several percentage points above the CPI inflation rate. Meanwhile, in light of our inflation forecasts and projections by the EU Commission (see table 6), the expected rate of decline in inflation over subsequent years seems realistic.

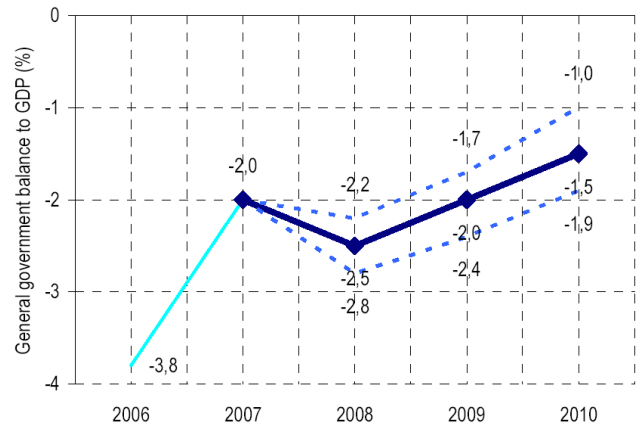
Table 6. Alternative inflation forecasts

Prognozy inflacji wg	2008	2009	2010
European Commission	4.3	3.4	b.d.
Bank Zachodni WBK	4.1	3.3	2.7

Source: EC, own forecasts

The higher than assumed inflation this year will add to the central budget's revenue (higher VAT and excise duty receipts). Nevertheless, higher than assumed inflation will also mean higher indexation of social benefits the next year. Also, a higher inflation this year may add to a growing wage pressure in the public sector. Meanwhile, spending on social benefits and wages in the public sector represents 60% of total spending of the general government sector. Consequently, this year's higher inflation puts the assumed rate of growth in the next year's expenditures at risk. One should remember that social benefits need to be adjusted by an inflation rate and at least 20% of real growth in wages in the previous year, while wage demands in the public sector vary across different jobs and may go up from several to a few dozen percent in real terms. In light of the above, the assumption of no real growth in the central government spending (excluding projects co-financed by the EU) in 2009 strikes as overly optimistic. Assuming that both social benefits and wages in the public sector need to be raised by the inflation rate forecast by us (4.1% instead of 3.5% assumed in the Programme), these two main public spending items (adding up to a total of PLN327bn in 2008) will exceed the programme assumption by PLN1.9bn, i.e. by 0.14% of GDP. On the other hand, higher than assumed inflation in 2008-2009 will positively influence tax revenues the next year. We estimate the scale of this positive influence at 0.05% of GDP.

Another macroeconomic assumption which cannot be seen as conservative relates to interest rates. The assumed path of annual average NBP reference rate for the years 2008–2009 seems little realistic, given decisions made to date by the Monetary Policy Council (the reference rate at 5.75% at the end of March) and a widely anticipated at least one more hike by 25bps before the end of mid-year. Meanwhile, the sensitivity analysis included in the convergence programme shows that an interest rate change by 1pp worsens the general government balance in 2008-2009 by 0.3% and 0.4% of GDP, respectively (see chart below).

Chart 2. Sensitivity of the general government balance to changes in interest rates

Source: Convergence Program

Taking into account our predictions for the domestic monetary policy (the reference rate at 5.8% on average in 2008 and 6% in 2009), we expect that on account of interest hikes only, the general government balance in 2008 and 2009 will be 0.08% of GDP lower than assumed in the Program.

Fiscal consequences of the reforms

The Program provides for the already adopted legislature, affecting revenue, expenditure and balance of the general government sector. The most important factors influencing revenues are as follows:

- net costs of the pension reform,
- net costs of tax wedge reduction (lower social security contributions, lower PIT rates, family tax relief schemes).

Estimates of the above mentioned costs, presented in the Program (see table 7), seem feasible and are neutral for assessment of the credibility of assumed deficit reduction path.

Table 7. net costs of the pension reform and net costs of tax wedge reduction (% of GDP)

	2007	2008	2009	2010
Net costs of pension reform	2.7	2.8	3.0	3.2
Net costs of tax wedge reduction	0.3	1.3	2.0	2.1
Total	3.0	4.1	5.0	5.3

Source: Reuters

On the spending side, among factors which will impact the general government balance are primarily higher spending on development programs. The most important of these are infrastructure improvement schemes. The allocations to this purpose appear realistic. Another factor is a restructuring of social spending which includes extension of paid maternity leaves and increase in pension/disability benefit

contributions paid for persons on maternity leaves. A cost of these rearrangements is estimated at 0.02% of GDP in 2009 and up to 0.05% of GDP in 2011, and the estimates seem realistic.

List of risks

The updated version of the Convergence Programme covers the list of risks which might shape the path of fiscal variables differently than assumed. It is worth to notice that the finance ministry clearly points out that risks are do the downside that is in direction of larger fiscal deficit. The first and foremost one is macroeconomic risk discussed above. Among other risk factors, reprivatisation is high on the agenda. In April, Prime Minister Donald Tusk announced that within a few months relevant laws would be enacted and mentioned that compensations paid to those who lost their property under the communist regime would represent 15-20% of claims. According to the Program, total value of reprivatisation claims are estimated at ca. PLN100bn. Assuming that the release of compensations would be spread evenly over 15 years, a fiscal result would deteriorate by GDP 0.07% - 0.1% annually.

An important risk factor mentioned in the Program is a claim brought by Eureka in response to the pronouncement of the Arbitrary Tribunal on the privatisation of PZU (the Poland's largest insurance company). A preliminary amount of compensation demanded by that Dutch company is PLN35bn, representing as much as 2.5% of GDP.

Another risk discussed in the programme is of legislative and political nature. Over a relatively short time since the issue of the updated Programme, the Parliament has already adopted solutions that will backfire on the performance of the general government sector in 2008-2009. Namely, on 25 April, a new bill was passed, whereby a state owned rail company specialising in regional passenger train service (PKP Przewozy Regionalne) was discharged of its debts. This measure necessitates an additional allocation of PLN1.4bn from the state budget this year and nearly PLN0.8bn in 2009 (0.06% of GDP). On top of that goes the cost of tax abolition for emigrants, estimated by the finance ministry at PLN0.6bn this year, attributable to tax reliefs and refunds for the last two years and PLN0.2bn annually on account of maintaining the relief over subsequent years (0.01% of GDP). There may be more surprises of this kind. For example, a likely debt relief scheme for hospitals (estimated cost of PLN2.7-4.5bn, i.e. 0.2-0.33% of GDP) and proposed by the ruling party's coalition partner, the Peasants' Party, a family benefits (equal to family tax allowances) for people who do not

pay PIT (these are mainly farmers), which may cost PLN3-3.5bn, i.e. 0.22-0.25% of GDP.

Although by principle, the Program authors relied only on laws that had been in place before completion of the document, it was optimistically assumed that early pension eligibility would be curbed, in anticipation of still absent solutions. According to the former deputy finance minister, Stanisław Gomułka, bridging pension regulations, not adopted yet, should bring PLN3bn worth of savings in 2009 (0.22% of GDP). It is not certain, though, what final solutions for the early pensions will come into effect and consequently whether the assumed savings will materialise. Nevertheless, in the ambitious scenario, which creates the basis for negotiations with social partners, the Ministry of Labour and Social Policy assumed that net savings in this line will yield merely PLN0.35bn in 2009 and PLN0.7bn in 2010.

This would mean that savings on adoption of bridging pensions, as compared with the programme version, would be lower by at least PLN2.65bn (0.19% of GDP) in 2009. The cancellation of "pension privileges" in the course of negotiations with social partners will necessitate their "redemption" through pay increases. Teachers seem to be enjoying the strongest position owing to guarantees set out in the Teacher's Charter. As a result, pay rises by approximately 30% in this group seem realistic. This in turn would necessitate a additional spending representing 0.4% of GDP in form of the educational subsidy to local government.

Waning optimism of rating agencies

Despite no decisive actions of the current government in the fiscal policy area so far, in March the S&P agency improved outlook for Poland's rating from stable to positive. The change was justified with "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 comments to the decision we wrote that arguments for the change in outlook for Poland's rating had not changed since the parliamentary election, which means that it should have taken place already a few months earlier. At the same time we said that taking into account a deterioration in prospects for economic growth, inflation and lack of details on reforms from the government after 100 days in power, one can conclude that timing of the S&P decision was unfortunate. At the beginning of May, the S&P analyst said that lack of reform may delay a decision on rating upgrade and

theoretically it could even lead to return of the rating outlook from positive to stable.

Table 8. Rating for long-term debt in foreign currency

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 (stabilna)
Fitch Ratings	A- (stable)	A+ (stable)	A (positive)	BBB+ (stable)

Source: Reuters

Critical year 2009

Although there are many question marks over the assumed reduction in fiscal deficit, the European Commission announced abrogation of the excessive deficit policy against Poland. However, the Commission's forecast as to the pace of deficit reduction in Poland are less optimistic than the one presented by the Polish government. The year of 2009 will be a critical one as it will witness the adoption of lower PIT rates and higher inflation this year will increase the planned scale of social benefits indexation. Consequently, Brussels expects that this year's deficit of the general government sector will reach 2.5% of GDP, in line with the Program's assumptions, but 2009 will witness not a reduction to 2%, as anticipated by the government, but an increase to 2.6%. Our estimates show that the balance of the general government sector may be even worse (see the table below).

Table 9. The general government balance in 2009 according to BZ WBK estimates

	% of GDP
Deficit assumed in the Convergence Program	-2.0
Lower GDP growth	-0.45
Negative effect on higher inflation in 2008	-0.14
Positive effect of higher inflation in 2008-2009	0.05
Higher interest rates	-0.08
Overall macroeconomic risk	-0.62
Redemption of "Teacher's Chart"	-0.40
Overestimated savings related to bridging pensions	-0.19
Reprivatisation	-0.07
Debt relief scheme for railways	-0.06
Tax abolition	-0.01
Overall other risk factors	-0.73
Overall general government balance	-3.35

Source: own estimates

Factoring in a macroeconomic risk by taking on board our GDP, inflation and interest rates forecast instead of the figures found in the Program, the general government deficit would grow to 2.62% of GDP. Taking into account other risk factors, i.e. the cost of redeeming the Teacher's Charter, lower than expected savings from the adoption of bridging pensions, cost of reprivatisation and debt relief scheme for the railway company, the general government deficit would increase by additional 0.73% of GDP.

All in all, to reach the government's deficit target, an additional fiscal adjustment of 1.35% of GDP (i.e. PLN18.5bn) will have to be exercised. An adoption of the debt relief scheme for hospitals and the family benefits advocated by the Peasants' Party would wreak extra havoc in the state budget, pushing the deficit by additional 0.4% of GDP. Not to mention that staggering amount of damages sought by Eureko. Over the first May weekend, the Prime Minister began to track down savings in the next year's budget, and managed to identify a figure of PLN2.5bn. Well, it can now be much more difficult to winkle out any extra large savings. Primarily, it is because of a substantial rigidity of budget spending. According to the Program, the main rigid spending items (social benefits, wages in the public sector and spending on national defence) as well as spending on fixed assets (this is a top ranking priority over the coming years and relates to projects subsidised by the EU), are expected to reach PLN432.3bn, rising 5.5%. Thus, with the assumed limit of total spending, other spending could reach PLN134.9bn, rising by 2.9%. According to our estimates, taking into account macroeconomic risks and other risk factors, rigid spending and spending on fixed assets will reach PLN439.7bn, growing by 7.3%. If we account for additional deterioration in fiscal balance, not related to rigid spending and spending on fixed assets, other spending could reach PLN116.4bn in 2009, which means it should drop by 11.2% as compared to 2008. In such case one could not even consider the family benefits proposed by the Peasant's Party of the repayment of hospitals' debts. Because such a large scale of spending cut seems hardly possible, it then may appear necessary to levy higher taxes. It should be pointed out here that former deputy finance minister Stanisław Gomułka mentioned a possibility of giving up on lower pension contributions. Also, an increase in healthcare contribution was considered. The general government's stance could be improved by better than planned performance of public finance this year as this would make achievement of revenue targets next year easier. However, one should remember that this has

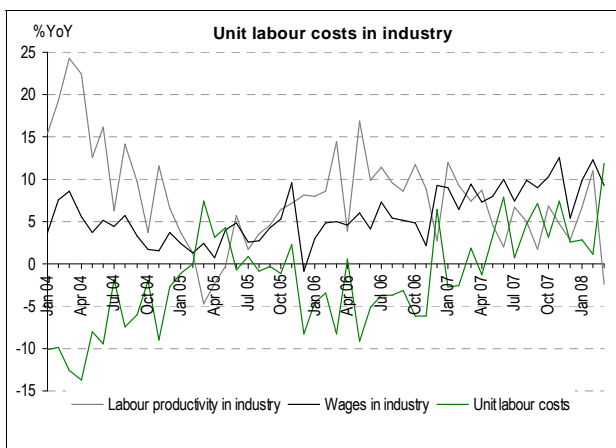
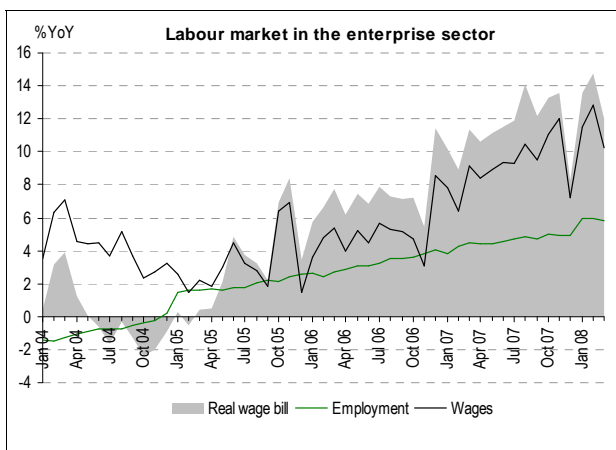
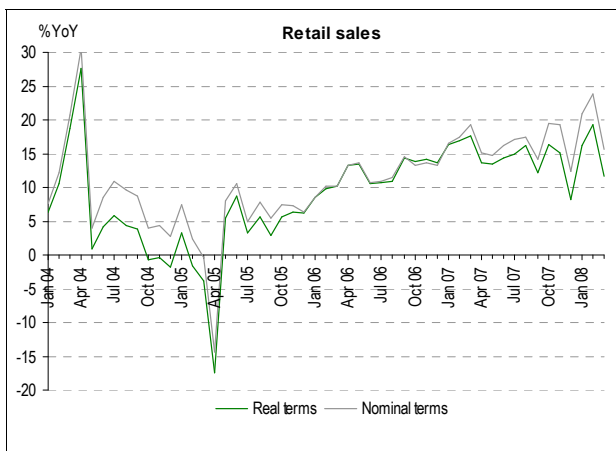
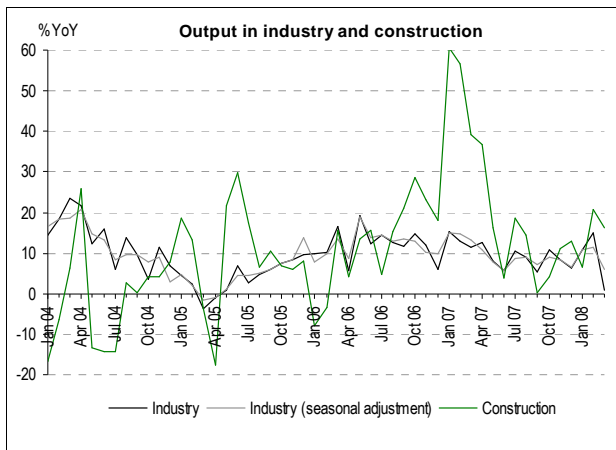
been taken into account in the Program in the form of revision of macroeconomic assumptions as compared to the 2008 budget. While in the budget it was assumed that average inflation this year will reach 2.3%, the Program assumed 3.5%. At the same time, the assumption of GDP growth at 5.5% was not lowered.

Summary

In the coming years there is a chance for reduction in the general government deficit, but this would depend heavily on the pace of economic growth. This in turn would depend on global economic growth and uncertain effects of the already carried out and planned reforms. Summing up, the path of deficit reduction assumed by the government does not seem very realistic and one should expect serious problems with its realisation. This was even reflected in the list of risk factors indicated in the Program. However, if the economic growth abroad and in Poland remains strong (at least consistent with the Program assumptions) the government is likely to keep the general government deficit below the threshold of 3% of GDP. Thus, Poland has a chance (but a certainty) to continuously meet fiscal criteria of nominal

convergence in the next years. This was reflected in the announcement by the European Commission that excessive deficit procedure against Poland will be abrogated. What is more, the positive recommendation of the European Commission for Slovakia to adopt the euro, despite reservations regarding sustainability of meeting the Maastricht criteria (including the fiscal one) by that country suggests that it could be similar in case of Poland. As a result, despite all the reservations regarding the Poland's Convergence Program, with continuation of strong economic growth, sufficient political will and some fiscal adjustment, Poland could join the euro zone in 2012 or 2013, depending on the timing of the ERM2 entry and successful presence in the mechanism for at least two years. The very recent comments from finance minister Jacek Rostowski indicate that entry to the ERM2 could take place after the situation in the global financial markets have stabilised. Similar view was presented by NBP governor Sławomir Skrzypek. Of course, one should not forget that additional condition for the euro zone entry is inflation criterion, but this is completely different story...

Economic update



Was it only a temporary slowdown?

- In March industrial output increased a mere 0.9%YoY against 15%YoY rise in February while the market consensus pointed to 8.3%YoY growth and our forecast of 5.1%YoY was the lowest in the market. Although the data for March were under negative influence of the lower number of working days in March this year (2 days fewer as compared to March 2007), the seasonally adjusted output growth also significantly slowed down, to 6.1%YoY from 11.4% in February. Growth in construction output was slightly stronger than expected as it rose in March by 16.3%YoY (seasonally adjusted by 11%YoY)

- Nominal growth in retail sales reached 15.7%YoY in March against market expectations of 21%, our forecast of 19% and almost 24%YoY rise posted in February.

- Some slowdown in sales growth was recorded in all categories, although to a different extent. Real growth in retail sales in March was 11.7%YoY versus 19.2% the previous month. We had predicted a slowdown in retail sales growth in March, among others due to an effect of earlier Easter this year, but the magnitude proved larger than we had expected. It is hard to assess whether this is already an indication of a weakening in consumption demand, especially that influence of Easter on retail sales was ambiguous (on the one hand, pre-holiday shopping earlier than last year, but on the other hand the new regulation forced large retail chains to close shops during holidays).

- We maintain our expectations for economic slowdown later during the year (lower growth in production, exports and investments), but at the same time we think that upcoming economic data will be a kind of tranquiliser. Namely, the picture of the economy is not as positive as it was suggested by January-February statistics (and forecasts for April), but it is neither as negative as one might conclude from statistics for March.

Some stabilisation in the labour market

- While data from the real sphere of the economy brought more uncertainty into the assessment of the prospects for the Polish economy, labour market statistics were only a moderate surprise, though in the same direction. Both employment and wages in the enterprise sector were below expectations. The former rose by 10.2%YoY (3.7%MoM) in March, while a less significant slowdown was forecasted – to 11.1% from 12.8% in February. At the same time the annual growth rate of employment was down to 5.8% from 5.9% in February.

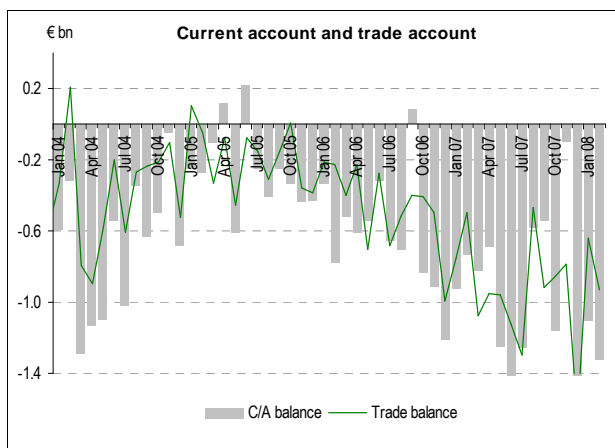
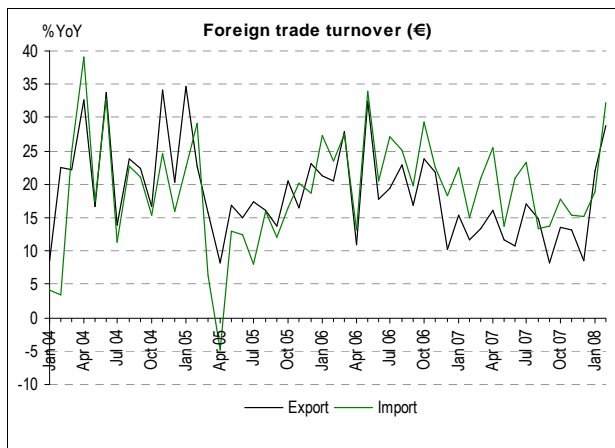
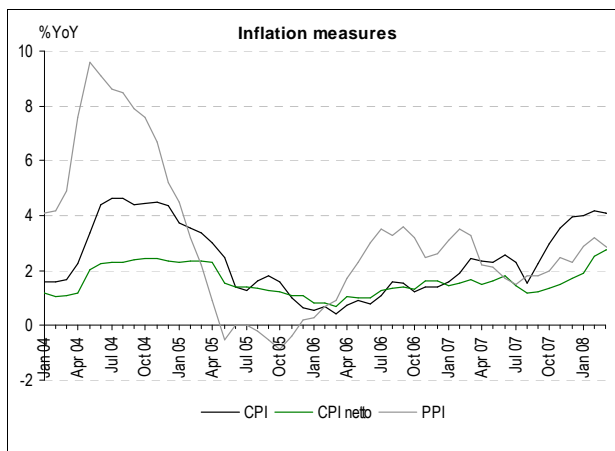
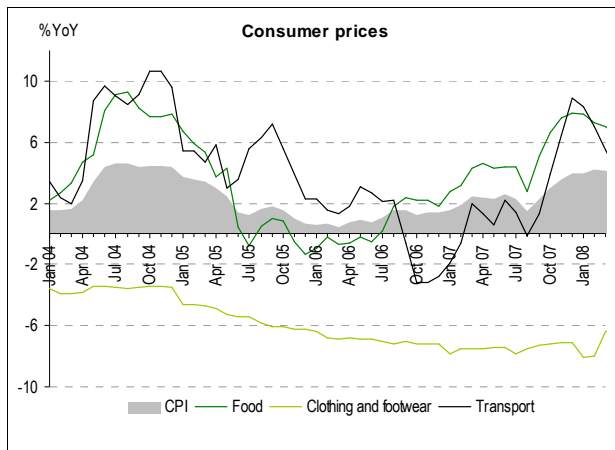
- As a result, the wage bill growth in the corporate sector decelerated in March to 16.6%YoY in nominal terms and to 12%YoY in real terms from record high levels at 19.5% and 14.7%, respectively, in February.

- The detailed data on wages in the corporate sector showed that in March slowdown in wage growth in the manufacturing sector and in trade was deeper than in other categories (the growth at one-digit level again). In the manufacturing sector the weakening of employment was also more significant (to 4.1%). This suggests that in sectors, in which market competition is stronger, the wage pressure is more limited than in the corporate sector as a whole.

- Nevertheless, we expect the two-digit growth in wages to be maintained in the nearest months and in 2008 as a whole, though it should not be much higher than 10%. This would mean still quite high growth in unit labour costs, which will be one of arguments behind further monetary policy tightening. As regards April's data, our forecast as regards wage growth is below the market consensus (11.2%YoY vs. 11.5%), which together with lower inflation reading may persuade the MPC to wait with the next rate hike until more data and the new inflation projection will be available in June.

Source: CSO, own calculations

Economic update



Source: CSO, NBP, own calculations

Inflation has stabilised close to 4%, as for now

- CPI inflation rate fell to 4.1%YoY in March from 4.2% in the previous month, after a price increase of 0.4%MoM. The data matched our forecasts and estimate of the Ministry of Finance and were lower than the market consensus of 4.2%YoY.

- The annual growth in food and fuel prices appeared higher than we predicted, reaching 7% and 10.1%, respectively. The annual growth in other price categories was lower than expected. As a result, the net inflation acceleration was slightly weaker than we had assumed and reached 2.7%YoY against 2.5%YoY in February. Rise in core inflation measures above the central bank's inflation target, reflects strength of underlying inflationary pressure, but it is also a result of higher regulated prices. This will lead to its further rise - net inflation to above 3% already in the next months and to ca. 4% in 2H08.

- In April we expect a slight fall in CPI inflation to 4%, while in May we may see its acceleration to 4.2-4.3% due to another hikes in regulated prices. In the following months, until October, the consumer inflation should stabilise at the level of slightly above 4%. Figure for August will be the exception, as the 12M CPI index will rise then to 4.6%-4.7% on the low statistical base effect. In the final months of the year we expect inflation to fall down to the upper limit of fluctuation range around the central bank's inflation target (3.5%).

- In March producer prices rose by 0.2%MoM and 2.9%YoY against our forecast of 3%YoY and market expectations for stabilization of PPI inflation at 3.2%YoY seen in February. Price growth in manufacturing decelerated to 1.9%YoY from 2.1%YoY in February after a monthly increase in prices of 0.2%MoM. A slight slowdown of prices growth in mining and in utilities was also recorded. PPI figures suggested that significant rise in commodity prices has not translated into other prices.

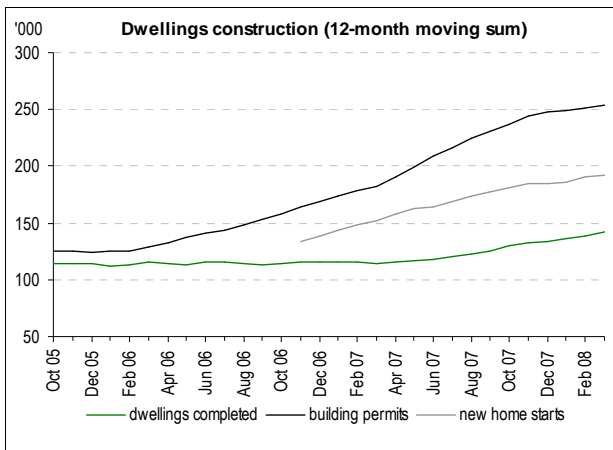
Higher trade volumes and higher deficit

- In February the current account deficit rose to €1.32bn from €1.1bn in January, against a median of market forecasts at €1bn and our estimate of ca. €1.2bn. As we expected both exports and imports growth accelerated sharply in February, significantly exceeding market forecasts, which was a result of very rapid growth in industrial output and retail sales in that period.

- Exports (in euro terms) rose by almost 29%YoY, which was the best result since May 2006, while imports increased even more, by almost 32%YoY. In our opinion, such good results of exports will not be maintained during the year due to significant zloty appreciation and economic weakening abroad. At the same time, imports growth is likely to remain high amid expected continuation of domestic demand expansion. This will lead to a gradual rise in trade deficit and deterioration in current account deficit in relation to GDP. After February, a cumulated 12-month current account deficit was at 4% of GDP, against 3.9% after January. At the end of the year the relation could exceed 5%.

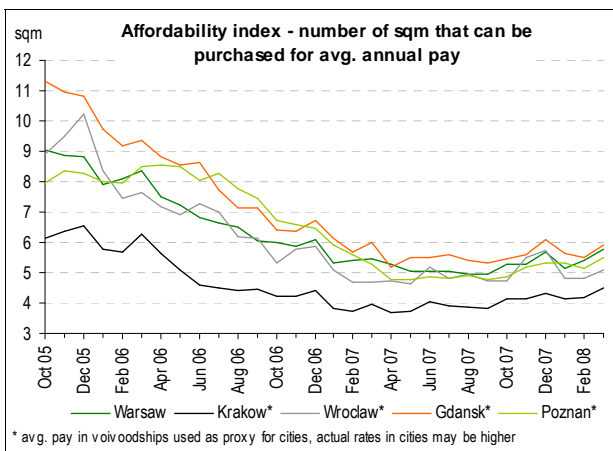
- In February, apart from higher trade gap (€933m), there was a deterioration in income balance (surplus of only €90m), while some improvement in income balance was observed (-€767m), which have resulted among others from higher income of Poles working abroad. Once again, there was a high inflow of foreign direct investment in February (€1.3bn), which in terms of cumulative 12-months flows exceeds the deficit in current account. However, it is worth to notice that this relation has worsened in the last couple of months.

Housing market update



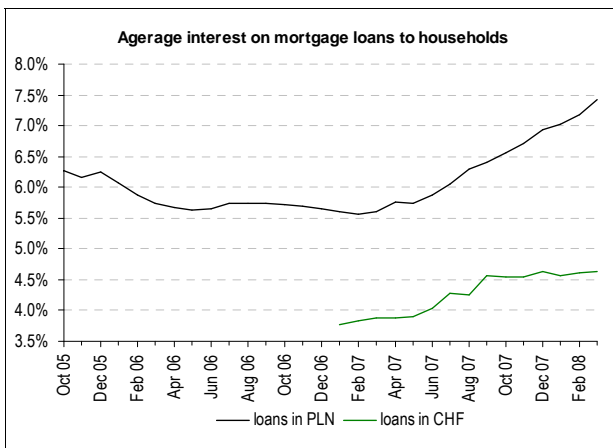
House supply steadily growing

- The number of house completions has been growing, which is a yield of real estate investments launched in the last two years. In March, house completions increased 28%YoY, and the sum of completed buildings in the last 12 months amounted to 142,000 units.
- It seems realistic that in the next two-three years the annual house supply may increase to ca. 200,000 units. Stronger gains seem not very likely, especially that a pace of growth in building permits and new home starts started decelerating in recent months.
- One should remember that even amid such scale of rebound on the supply side, the shortage of the number of flats in relation to number of households will persist for at least the next ten years.



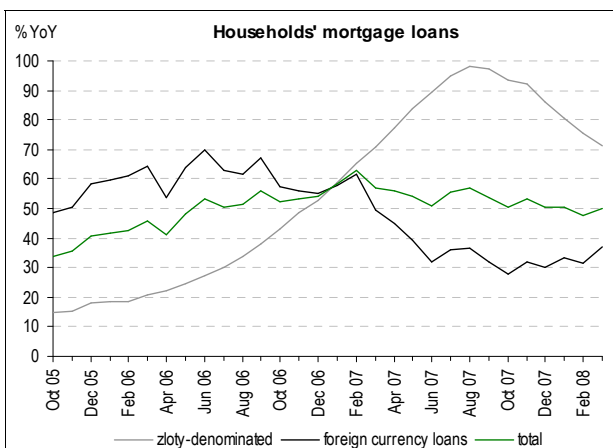
Price-to-income ratio slowly improving

- Thanks to stabilisation or even a slight decline in house prices amid simultaneous improvement of situation on the labour market and rising households' revenues, flats' affordability started bottoming out. In March, for an equivalent of 12 average salaries in Warsaw, Kraków or Poznań, one could afford to buy 15-17% bigger living space than six months earlier, while in Wrocław the improvement was 7%.
- Demand for flats still remains subdued as potential clients are postponing purchases, hoping for a deeper price correction. However, it is likely that delayed demand is likely to show up eventually, and thus a scope for price drop is limited. Especially that rents in big cities have been growing, which implies that delaying house purchase is getting increasingly costly.



Rising gap between interest rates in PLN and CHF

- Households' purchasing power is being constrained by a rise in domestic interest rates, which compensates in large part for an increase in labour income. In March, average interest on new zloty-denominated mortgage loans was 1.8 pp higher than one year before, which implies that monthly instalment for 50 sqm flat financed with a loan in Warsaw rose by ca. PLN850, while in Kraków, Poznań and Wrocław was higher by ca. PLN600.
- In effect, using zloty-denominated mortgage loan, in Warsaw one could afford 8% bigger flat than six months earlier, but 11% smaller than one year before.
- A disparity between interest on loans in PLN and CHF has been growing. The latter remained stable in the last six months, and in the last year increased only half as much as interest on zloty-denominated loans.

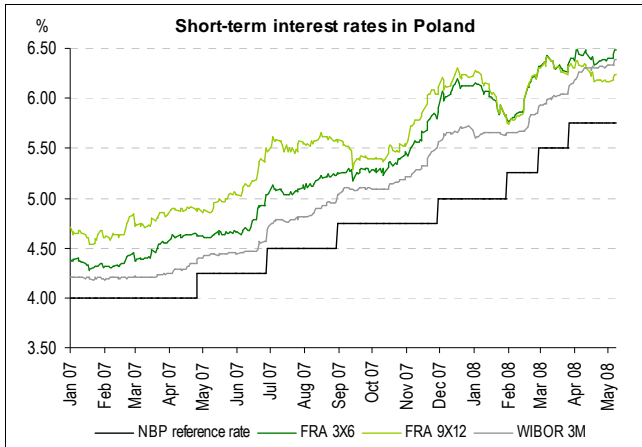


... boosting demand for foreign currency loans

- As an effect of relative changes in interest rates, the clients' demand has clearly moved to CHF-linked loans. In Q1 2008 individuals' mortgage loans increased by PLN13bn, out of which 70% represented foreign currency loans (the disproportion would have been even bigger if not the zloty appreciation). In Q4 2007 the relation was opposite: 70% of debt increase was in zloty-denominated loans.
- According to the NBP report, banks recorded a decline in demand for mortgage loans in Q1. At the same time, despite planned tightening of credit conditions, banks expected the strongest increase in mortgage demand for a year, probably in effect of realisation of delayed housing market transactions. More and more banks are relaxing conditions for granting foreign currency loans.

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

Central bank watch



Fragments of statement after MPC meeting in April

In the medium term inflationary pressure may be curbed by still good financial results of enterprises and high investment growth conducive to productivity growth. Inflationary pressure may also be constrained by globalisation and the ensuing increased competition in the market of internationally traded goods and services, as well as the slowdown in the global and, consequently, also in the Polish economy. The previous increases of the NBP's interest rates and the zloty appreciation observed over the past few quarters should also be conducive to lowering inflation.

The Council assessed the probability of inflation overshooting the inflation target in the medium term to be higher than the probability of inflation running below the target. The Council does not rule out that bringing inflation down to the target in the medium term would require further monetary policy tightening. In view of the increased uncertainty as to the global growth outlook and the prospects of the Polish economy, the Council assessed that a more comprehensive assessment of inflation outlook will be possible after analysing the data released in the near future.

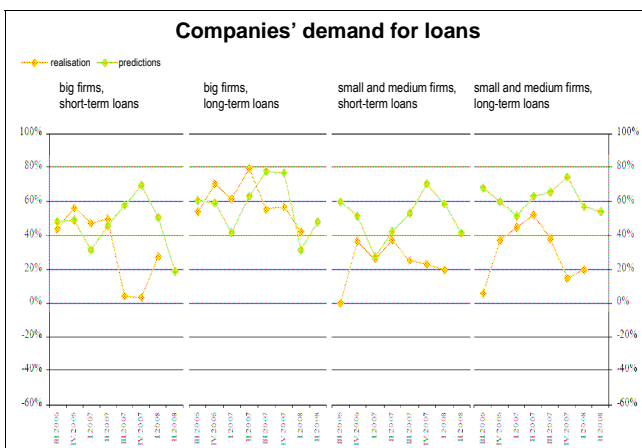
Fragments of minutes of the MPC meeting in March

It was pointed out that the rise in the annual inflation in February 2008 in relation to January 2008 was primarily driven by a strong growth in regulated prices. It was underlined that the CPI excluding regulated prices fell in February 2008 as compared to January 2008.

When analysing the situation in the labour market, it was pointed out that the data on wages in the enterprise sector in February were higher than expected, and the growth of employment remained at a high level.

While discussing external factors affecting the Polish economy, it was pointed out that uncertainty persisted as to the growth outlook for the global economy.

When discussing the monetary policy it was pointed out that too strong policy tightening, combined with interest rates cuts by the US Federal Reserve and the ECB interest rates kept unchanged, may be conducive to the inflow of speculative capital to Poland and to an excessive exchange rate appreciation. In turn, such an excessive strengthening of the zloty may lead to deteriorating the competitiveness of the Polish foreign trade, which amid a slowdown in the world economy may result in a decline in the growth of Polish exports and GDP.



Source: NBP, Reuters

No rate hike in April

■ In line with our expectations, the Monetary Policy Council has kept main interest on hold in April, after a series of three straight hikes in the previous months. The reference rate remained at 5.75%.

■ In the MPC statement, there were two new important elements that justified a break in hikes: a slowdown in economic growth in the world with possible consequences for Polish economy, and strong zloty.

■ On the other hand, the Council maintained an informal restrictive bias and listed a number of "hawkish" arguments (rapid wage growth, risk of second round effects, risk of persistence of elevated inflation and inflationary expectations).

■ We still believe that this year there will be one more interest rate hike, but most likely in June. In our view, the Council will want to postpone a decision until receiving more data and more information, to have better assessment of situation as regards both inflation path and prospects of economic slowdown. Only in June, the MPC will have access to quarterly GDP data for Q1 and to the next NBP's inflation projection. Also in June, the MPC will be able to assess a scale of inflation increase in effect of the second round of spike in controlled prices (natural gas, electricity).

■ Also, our forecasts of inflation and wage growth in April call for a delay in interest rate hike, as they are below market consensus. However, if data about CPI and wages appear to be higher than we predict, it would imply higher chances for a rate hike already this month. Especially that we predict a clear rebound in industrial output and retail sales growth.

Tightening in March despite growing uncertainty

■ A description of the discussion at the MPC meeting in March suggested that the Council made the third hike in a row due to persisting economic expansion, probably faster than potential GDP growth, substantial rise in wages and employment and a risk of growth in inflation expectations.

■ Nevertheless, during the discussion a number of dovish arguments appeared and the MPC members were underscoring a persisting uncertainty concerning economic prospects and possible pass-through of economic slowdown abroad on the local business climate. For MPC members, a significant factor was also a relation between interest rates in Poland and abroad and its potential impact on the exchange rate and exports' competitiveness.

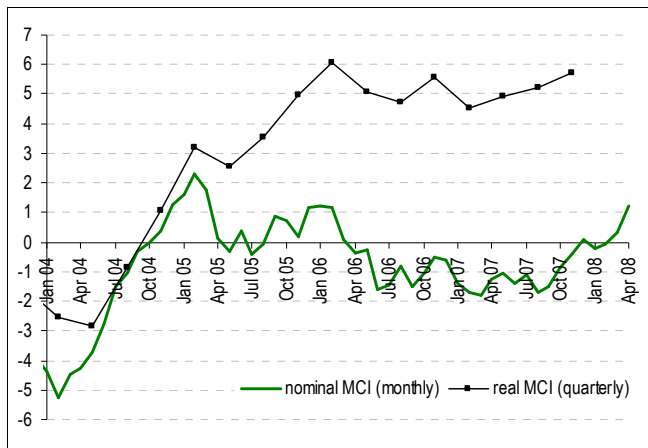
Banks tightening lending criteria, yet demand growing

■ According to the NBP quarterly report, in Q1 banks slightly tightened loan criteria for companies and maintained policies unchanged for individuals. Margins on all credits were raised (which implies additional tightening of monetary policy).

■ Banks recorded a rise in enterprises' demand for loans, mainly due to higher needs for financing investment and turnover capital. There was further rise in demand for consumption loans resulting from an improvement in households' situation and growing demand for durable goods. At the same time, demand for mortgage loans continued a downward trend.

■ Banks are expecting a rise in demand for loans in Q2, both for companies and for households.

Restrictiveness of the Monetary Policy (Council)



MCI sharply up in April, despite no hike by the MPC

- In line with our expectations, presented in the previous monthly report, significant zloty strengthening and an increase in market short-term interest rates led to a sharp rise in nominal MCI in April.
- Both in case of average EURPLN and average WIBOR3M in April, increase in divergence from the estimated long-term trend was substantial.
- In the first week of May the zloty exchange rate was slightly stronger than on average on April and market short-term interest rates were higher than on average in April, but in both cases the scale of change was not large enough to increase divergence from long-term trend. As a result, nominal MCI probably stabilised and in light of our forecasts may even slightly decline in the whole month.

6.25%

Filar 1.45 (1.61)
Wasilewska-Trenkner 1.45 (1.48)

Noga 1.45 (1.52)

Wojtyna 1.45 (0.91)

Sławiński 1.09 (0.91)

Czekaj 1.00 (0.86)

5.75%

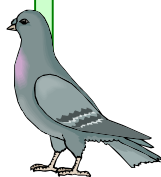
Skrzypek 0.73 (N/A)

Owsiak 0.82 (0.91)

5.50%

Nieckarz 0.82 (0.83)

Pietrewicz 0.73 (0.74)



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

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

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

Growing resistance to rate hikes among doves

In an interview with ISB, representative of the dovish faction in the Council, Stanisław Nieckarz, said that in face of weakening economic growth in the euro zone, the ECB will cut rates once or twice in the second half of this year. In his view, for Poland this would mean further widening of already substantial interest rate disparity and stronger pressure on the zloty appreciation with all its negative consequences for export and GDP growth. Nieckarz expressed hope that this would lead to further widening of external imbalance. He stressed that this would make monetary policy more difficult in future.

NBP governor against doves

Last month we wrote that NBP governor Sławomir Skrzypek tries to avoid a label of radical dove which has been attached to him since MPC meeting in August 2007 when he lonely opposed a 25bp rate hike. This caused a change in Mr. Skrzypek's position on our axis of central bankers' restrictiveness. Recently published results of MPC vote on a 25bp rate hike in April again moved NBP governor up in restrictiveness ranking. At February meeting, Skrzypek voted against declared doves (Pietrewicz, Nieckarz, Owsiak), setting the vote result at 7 to 3 for a hike.

Czekaj waits for next data

MPC member Jan Czekaj (whose surname means „wait” in English) said in an interview with TVN-CNBC on May 7 that it is not determined whether the Council will raise rates in June (or in other month) and whether the reference rate at the level 6% will be sufficient, as everything depends on incoming data. It is not clear whether the comment means higher probability of a rate hike already in May or rather a possibility of its delay beyond June. Another interview with Czekaj published in Gazeta Prawna daily on May 8 shed more light on his view. He said that the MPC should wait for data from April and May to draw conclusions on the economic situation. What is more, in his opinion „signals coming from the world economy do not induce to hike rates”. Czekaj explicitly said that “if the data will show that the economic slowdown is taking place, then (...) there would not be a need for more rate hikes”, and if inflation starts to decelerate, “we would do the same what other central banks” that is lower rates. All in all, his comments seem to support our view that another rate hike is more likely in May than in June, even taking into account our quite high forecasts of output and retail sales growth in April.

Hawks still see a need for hikes

The most recent comments from hawks indicate that they still see a need for further monetary policy tightening, but admit that it is likely there will be no rate hike also in May. Marian Noga said in an interview with PAP on May 5 that in his opinion one more rate hike is needed and answering when it could take place said that “the MPC decided that there should be data for Q1 and they will be at the end of May”. This suggests that more likely timing of next rate hike is June than May. By then the Council will have had not only GDP figures for Q1 (due for release on May 30), but also the new inflation projection of the NBP.

Government and politics

Fragments of ECB's Convergence Programme 2008

There are upside risks to inflation in Slovakia. [...] In sum, there are considerable concerns regarding the sustainability of inflation convergence in Slovakia.

Further fiscal consolidation is required for Slovakia to comply with the medium-term objective specified in the Stability and Growth Pact, which in the convergence programme is quantified as a cyclically adjusted deficit net of temporary measures of 0.8% of GDP by 2010.

The trend appreciation of the currency in recent years makes it more difficult to analyse how the Slovak economy might operate under conditions of irrevocably fixed exchange rates.

Achieving an environment conducive to sustainable convergence in Slovakia requires, inter alia, the implementation of a sustainable and credible fiscal consolidation path. [...] As regards structural policies, it will be crucial to improve the functioning of the labour market, which is characterised by persistently high structural unemployment, mismatches and insufficient labour mobility. [...] Slovakia will also need to resume its liberalisation of the economy and further enhance competition in product markets, particularly in the energy sector.

Fragments of European Commission's Convergence Programme

In the case of Poland, the moderating influence of the appreciating exchange rate on inflation represents an important temporary factor, and average annual inflation is expected to soon rise above the reference value.

At the time of preparing this report, the Commission is assessing this [convergence] programme. In the light of this assessment and the Commission services' Spring 2008 Forecast, the Commission could recommend the abrogation of the excessive deficit procedure.

Fragments of ECB's Convergence Programme 2008

Achieving an environment conducive to sustainable convergence in Poland requires, inter alia, the implementation of a sustainable and credible fiscal consolidation path. [...] It will be equally important for Poland to continue its restructuring of the economy, to speed up the privatisation process and to further enhance competition in product markets. Moreover, measures to improve the functioning of labour markets and to increase the low participation rate are crucial for solid growth performance and price stability. In particular, labour market reforms should aim to increase wage differentiation, lower tax wedges, reduce skill mismatches and better target social benefits.

Polish law does not comply with the requirements of central bank independence and legal integration into the Eurosystem.

Comments of the Finance Ministry's officials

Stanisław Gomułka: (TVP Info, 4 May) I was supposed to be nominated a proxy for public finance reform [...] but this project was unsuccessful, and the Prime Minister's determination to go in this direction was in my opinion insufficient. There was an interest in reforms, but no determination. [...] Moreover, there were some suggestions that in fact it is not a good time for serious reforms in Poland, as although we have the majority in the parliament, the majority is not big enough to reject the President's veto, which was likely to appear in case of more controversial government's proposals.

(Gazeta Wyborcza, 17 April) There is a huge pressure from politicians to talk a lot about issues that they consider as politically "good", catchy for electorate, e.g. about reducing taxes. There was no interest at all among ministers and politicians in discussion about control over spending, about reforms necessary to curb spending growth.

Jacek Rostowski: (Rzeczpospolita, 21 April) Minister Gomułka was supervising amendment to public finance bill, rather than the entire public finance reform. [...] As a deputy minister, Gomułka did not decide about the policy in any means, he had no 'plans' of his own. [...] The convergence programme is our anchor. The public finance deficit in 2009 must be 2% of GDP, i.e. half percentage points lower than in 2008.

Green (blinking?) light for euro in Slovakia

▪ In the *Convergence Report* released at the start of May, the European Commission assessed that Slovakia met all necessary criteria and is ready to join the euro zone.

▪ However, a parallel report prepared by the ECB was much more sceptical in assessment of Slovakian economy's readiness to adopt the single currency (see table on left), even though according to unofficial information its tone has been softened just before the publication.

▪ The decision on Slovakia's euro zone entry will depend on politicians. The key will be EU summit in June when heads of European states will share their opinions. We expect there will be no surprise and Slovakia will be allowed to join the EMU, and a sceptical report of the ECB will not be an excuse for changing light to red in the very last moment.

Poland has a long way to go

▪ According to the European Commission, Poland met only one of five convergence criteria (long term interest rates).

▪ The Commission wrote however that it may recommend lifting the excessive deficit procedure for Poland after finishing review of the country's updated convergence programme. According to Joaquin Almunia, it may take place on 11 June.

▪ Finance minister Jacek Rostowski said Poland may enter the ERM-2 system in 2009 (possibly in the middle of year), but not before the world financial markets stabilise. The minister hopes that in 4 years time Poland will be in the euro zone. We think it is possible if the government implements "sustainable and credible fiscal consolidation path", as advised by the ECB. The problem is we still don't know solutions that would allow achieving this target.

Slower reforms without Gomułka?

▪ Stanisław Gomułka's resignation from the post of deputy finance minister and his comments suggesting that a reason for a dismissal was low government's determination to carry fiscal reforms, deepened our concerns that realisation of fiscal consolidation plan outlined in the convergence programme is under big question mark.

▪ Even the S&P that has recently upgraded outlook of Poland's rating to positive seems to be increasingly uncertain and recently its analysts said that lack of economic reforms in the medium run could result in reducing outlook back to neutral.

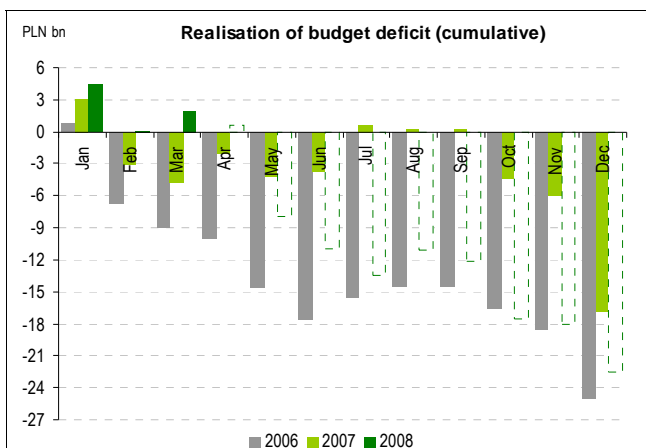
▪ An important test for government's consistency in realisation of planned fiscal consolidation will be 2009 budget, which preliminary assumptions will be known in June.

Very strong rise budget revenues

▪ The state budget recorded a surplus of PLN1.8bn after the first quarters (rather than PLN3.1bn tentatively estimated by the FinMin). Still, it was again much better result than planned initially. It was possible thanks to strong rise in budget revenues and a delay in some spending.

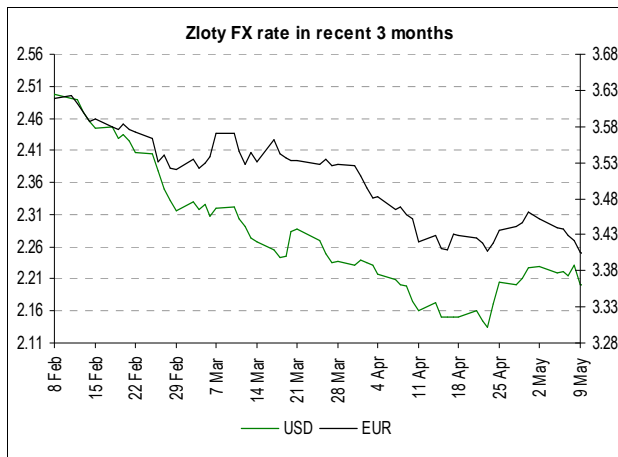
▪ CIT revenues increased almost 110%YoY in March, which was probably a one-off effect related to taxation of 2007 profits. A fast growth was also recorded in the case of direct taxes (12%YoY) and personal income tax (8%YoY), which suggests that economic activity is still rising pretty quickly.

▪ According to the FinMin's estimates, after April the budget recorded a surplus of PLN600m. Revenues were again higher than initially planned, while spending was short of agenda. The Ministry expects that full-year deficit will be PLN3bn below plan.



Source: Ministry of Finance, polling institutes, own calculations

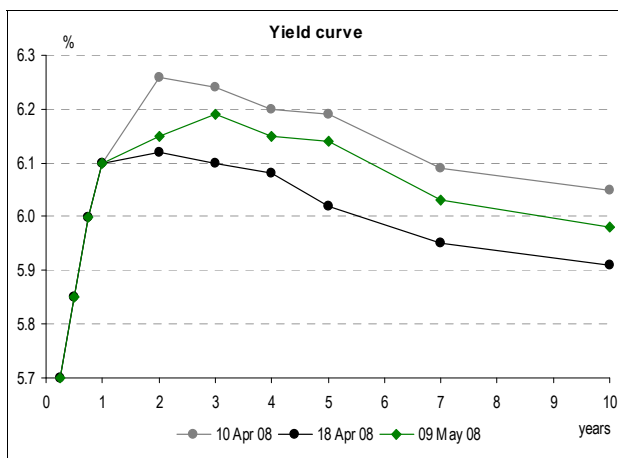
Market monitor



Zloty below 3.40 against euro

▪ After the release of the April report there was a correction of the zloty rate versus the euro in the domestic FX market, which was in line with our expectations. This move was accompanied by weaker than expected data from the economy for March, no interest rate hike at the April meeting of the Monetary Policy Council and the dollar's recovery in the world markets. At the start of May the domestic currency appreciated again, which was connected with positive recommendation of the European Commission for Slovakia joining the euro area, which strengthened the currencies in the region.

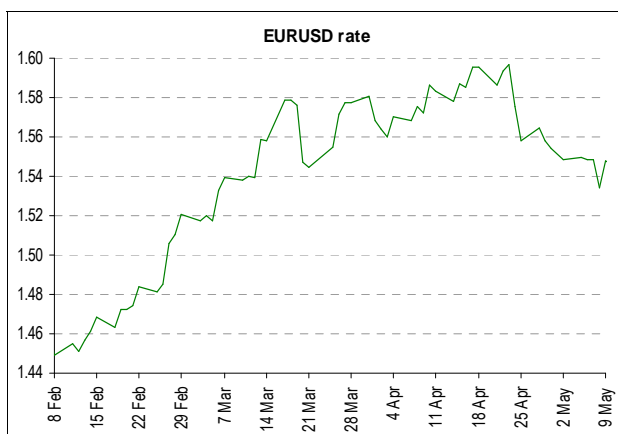
▪ After a decline to below 3.40, the zloty may strengthen further against euro, with a risk of approaching the historical minimum of ca. 3.35. Nevertheless, taking into consideration our forecast of inflation and the assumed lack of interest rate hike in May we see room for a correction.



Yields rise again after some strengthening

▪ In April there was a series of data releases from the economy (inflation, wages, production, sales), which appeared below expectations and weakened expectations of an interest rate hike at the April meeting. As we forecasted the Council decided to pause with a change of monetary policy parameters. In the first days of May the bond prices declined again. During the last month the yield curve slightly steepened.

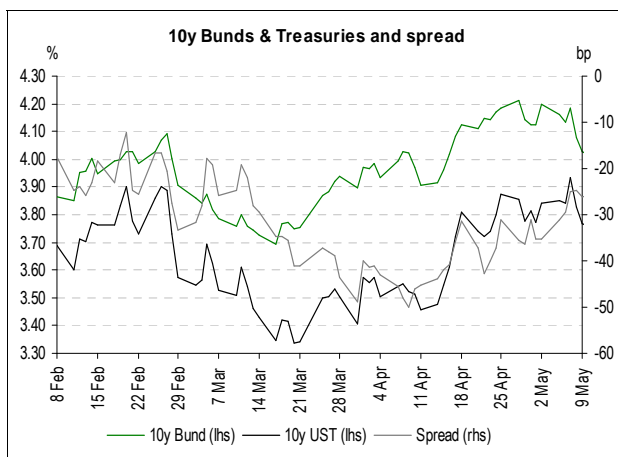
▪ In our view, the inflation data and figures from the labour market may slightly support the interest rate market. The industrial production and retail sales data will act the other way. If our scenario assuming no interest rate hike in May fulfils, this may positively affect the interest rate market. However, the Council communiqué is going to be rather „hawkish” signalling monetary tightening in June, which will halt the rates from decline.



A clear dollar recovery after reaching 1.60

▪ In the last weeks after the EURUSD rate exceeded 1.60 there was a significant recovery of the dollar against the euro. The main reason for this was a gradual weakening of expectations of further monetary policy easing in the US amid some increase of fears over inflation. Apart from this some of the data from the US was better than expected while in the euro zone some figures were weaker than forecasted, showing signs of economic slowdown in the EMU and rising expectations of interest rate cuts and changing the tone of the ECB comments. The hawkish tone of the J.C. Trichet comments after the last ECB decision meeting helped the euro to recover.

▪ We expect the dollar to weaken again against the euro in the nearest time, though 1.60 may be difficult to reach. However, the dollar recovery may be a start of the EURUSD falling trend.



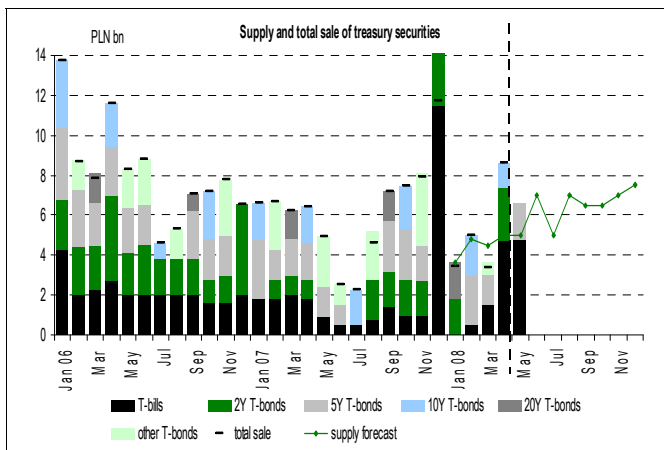
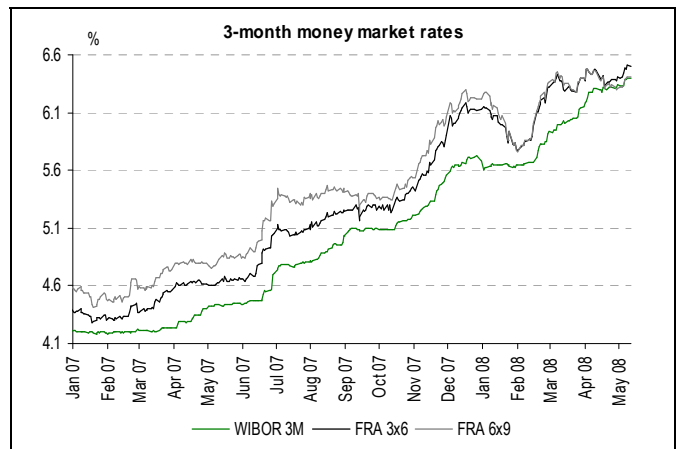
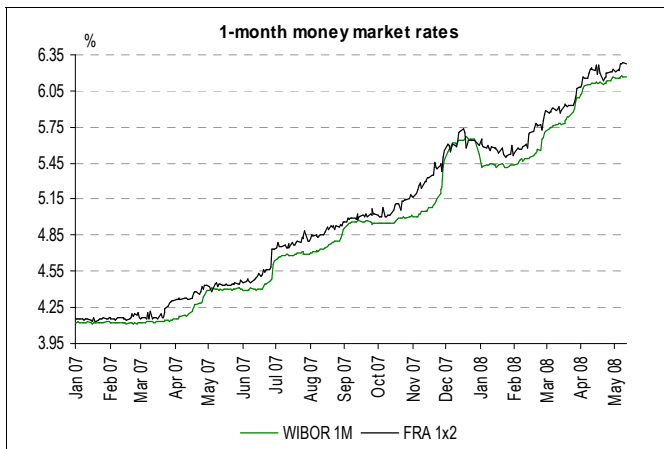
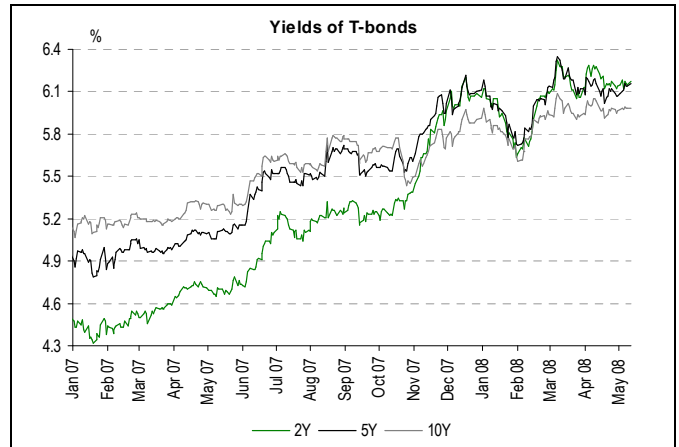
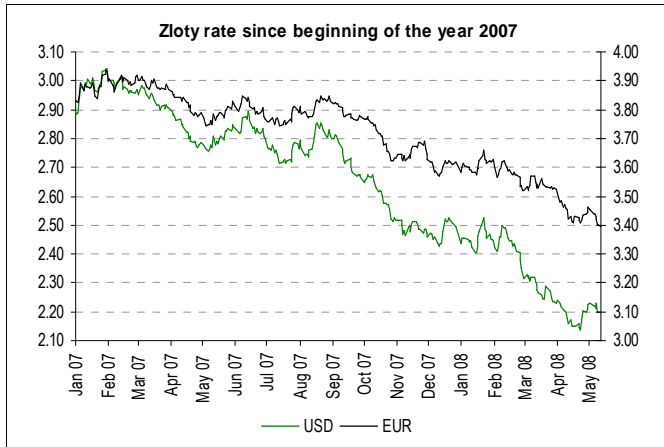
Smaller scale of rate cuts weakens Treasuries

▪ In the last month the expectations regarding the scale of monetary policy easing in the United States significantly diminished, which was reflected in the recent moderate Fed's move. High inflation in the euro zone had some influence on the rates increase as well as higher risk appetite in global markets. A recovery came after the Fed's meeting and after an increase of the risk aversion and fears over situation in the credit markets (declines in the equity markets), as well as after ECB meeting and weaker EMU data. Yields of the 10Y Treasuries and Bunds rose to 3.75% and 4.06% from 3.51% and 4.03%, respectively.

▪ We still maintain our expectations for interest rate cuts in the US by 25 bp at the next meeting and further 25 bp in the second half of the year. On the other hand, the two expected interest rate cuts in the euro zone by 25 bp each may be postponed till Q4.

Source: Reuters, BZ WBK

Market monitor



Date of auction	(OFFER)*SALE				
	52-week	26-week	13-week	5-week	3-week 2-days
14.01.2008	2000	-	-	-	-
11.02.2008	500	-	-	-	-
10.03.2008	1417	-	-	737	-
10.04.2008	-	-	-	-	2837
14.04.2008	3134	1005	573	-	-
05.05.2008	2787	-	-	-	2007
26.05.2008	(2000-3000)	(0-1500)	(0-1500)	-	-
09.06.2008	-	-	-	-	-
14.07.2008	-	-	-	-	-
11.08.2008	-	-	-	-	-
08.09.2008	-	-	-	-	-
22.09.2008	-	-	-	-	-
13.10.2008	-	-	-	-	-

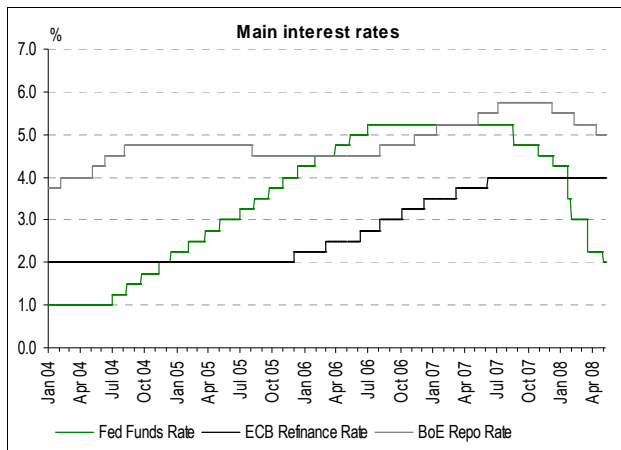
* based on data of the Ministry of Finance

month	First auction				Second auction				Switch auction		
	date	T-bonds	offer	sale	date	T-bonds	offer	sale	date	T-bonds	sale
January	02.01	OK0710	1 800	1 655	09.01	WS0922	1 800	1 800	16.01	PS0413 / IZ0816 / WS0922	524 / 766 / 431
February	06.02	PS0413	2 500	2 500	13.02	DS1017	2 000	2 000	20.02	WZ0816 / WZ1118	855 / 914
March	05.03	PS0413	1 500	1 500	12.03	WS0437	700	700	19.03	PS0413/WZ0118/WS0922	1632/ 340 /369
April	02.04	OK0710	2 700	2 700	09.04	DS1017	2 300	1 208	16.04	PS0413/DS1017	3399/2804
May	07.05	PS0413	1 800	1 800	14.05	WS0922	1 000 - 2 500	-	21.05	-	-
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

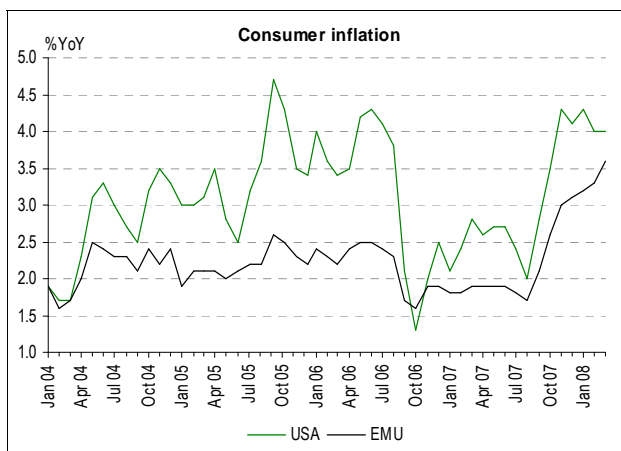
Source: Ministry of Finance, Reuters, BZ WBK

International review



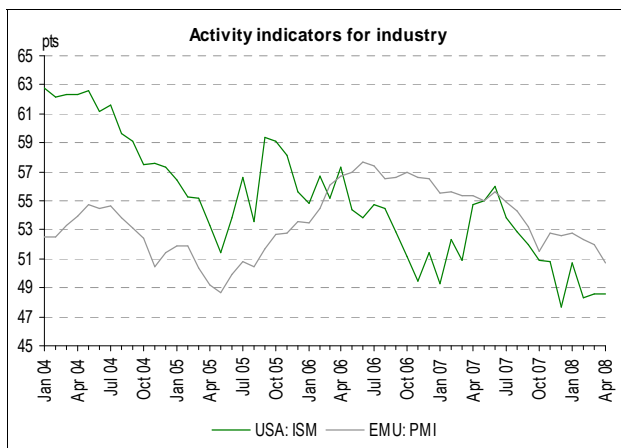
Weaker expectations for rate cuts by Fed

- At the end of April Fed lowered the interest rates by 25 bp (the Fed Funds rate fell to 2%). According to expectations the tone of the Fed communiqué pointed to a pause in interest rate cuts, though it left some room open for more rate cuts. This means the market is still going to very closely examine the incoming data. Overall, the decision and the Fed's communiqué were interpreted relatively dovish.
- The European Central Bank left rates on hold in May. Jean Claude Trichet stressed once again that the primary goal of the bank is price stability and that ECB actions are aimed at counteracting the second round effects, which could appear due to long period of increased inflation. The ECB President said the bank has to assure that inflation increase is temporary, even if there are still risks for the economic growth.



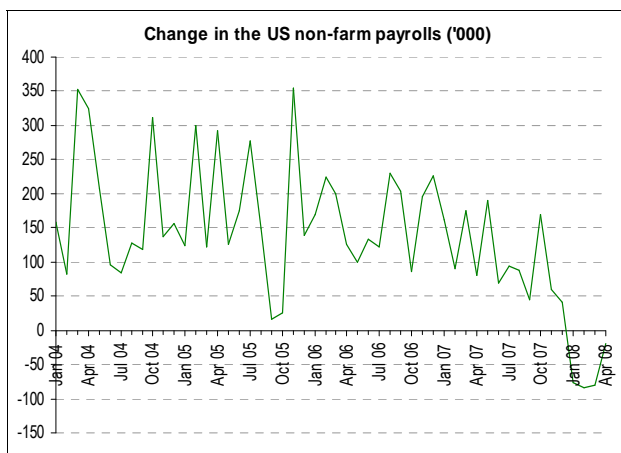
US inflation still elevated, HICP above below forecasts

- Data on inflation in the US showed an increase of the CPI by 0.3%MoM (4.0%YoY) against the market consensus of 0.4%. On the other hand, the core inflation was at 0.2%MoM (2.4%YoY) as compared to the market expectations. The producer prices growth in the United States in March doubled the expectations and was at 1.1%MoM (6.9%YoY) amid strong rise of food and energy prices. The core PPI increased in March as expected by 0.2%MoM and 2.7%YoY.
- According to preliminary Eurostat estimates, inflation for March in the euro zone, measured by the HICP index, amounted to 3.6% against 3.3% in February and market expectations at 3.5%YoY and. Preliminary estimates for April showed faster inflation decline to 3.3% against expectations of 3.4%. Producer prices rose by 0.7%MoM and 5.7%YoY against expectations of 5.6%YoY.



Activity indices still weak

- The ISM manufacturing index for April was at 48.6 pts versus forecasted decline to 48 pts. Data improved moods in the stock markets and supported the dollar. The ISM index for services sector rose in April to 52.0 pts from 49.6 pts, while analysts expected a drop to 49.0 pts. A fall of business activity index and rise of employment and prices paid indices were recorded.
- The PMI index describing the activity in the manufacturing sector in the euro area was at 50,7 pts level against 52.0 pts in March. Analysts expected a marginally softer decline to 50.8 pts. The value of the PMI index above 50 pts means expansion in the sector. The PMI index for the services sector appeared better than expected and amounted to 52 pts. In April the market forecasts pointed to an increase to 51.8 pts from 51.6 in March.
- The US economy grew in 1Q08 by 0.6% against expectations of 0.2%. However the detailed statistics were less optimistic. The GDP growth resulted mainly from the change in inventories, while a drop in sales was recorded (first decline in domestic sales in 16 years), the PCE consumption expenditures growth lowered to 1% and residential and business investments fell further.



US payrolls still poor, though better than expected

- In April the non-farm payrolls fell by 20k against forecasted decline by 80k. Data for the previous two months were downwardly revised by 8k. Although the headline figure was better than expected this was another month of negative jobs growth in the private and production sector. The situation in the labour market did not significantly improve.
- The rate of unemployment fell to 5.0% instead of expected increase to 5.2% from 5.1% in March.

Source: Reuters, ECB, Federal Reserve

Economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
12 May PL: Wages in the whole economy (Q1)	13 US: Import prices (Apr) US: Retail sales (Apr)	14 PL: CPI (Apr) PL: Money supply (Apr) PL: Auction of 20Y bonds EZ: Industrial production (Mar) US: Mortgage index US: CPI (Apr)	15 PL: Balance of payments (Mar) EZ: Preliminary GDP (Q1) EZ: Final HICP (Apr) US: NY Fed index (May) US: Capital flows (Mar) US: Capacity use (Apr) US: Industrial output (Apr) US: Philadelphia Fed index (May)	16 US: House starts (Apr) US: Preliminary Michigan (May)
19 PL: Wages and employment (Apr)	20 DE: ZEW index (May) US: PPI (Apr)	21 PL: Industrial output (Apr) PL: PPI (Apr) PL: Net inflation (Apr) PL: Switch auction DE: Ifo index (May) US: Mortgage index US: FOMC minutes	22 PL: Market holiday – Corpus Christi US: New jobless claims	23 PL: MPC minutes (Apr) PL: Business climate (May) EZ: Flash manufacturing PMI (May) EZ: Flash services PMI (Apr) US: Home sales (Apr)
26 PL: Auction of Treasury Bills US, GB: Market holiday	27 PL: MPC meeting US: Consumer confidence (May) US: New home sales (Apr) US: Case/Shiller index (Mar)	28 PL: MPC meeting – decision PL: Retail sales (Apr) PL: Unemployment (Apr) US: Durable goods orders (Apr) US: Mortgage index	29 EZ: M3 money supply (Apr) US: New jobless claims US: Preliminary GDP (Q1)	30 PL: GDP (Q1) EZ: Economic sentiment (May) US: Core PCE (Apr) US: Chicago PMI (May) US: Final Michigan (May)
2 June EZ: PMI – manufacturing PMI (May) US: Manufacturing ISM (May)	3 EZ: revised GDP (Q1) EZ: PPI (Apr) US: Factory orders (Apr)	4 PL: Auction of 5Y bonds EZ: Services PMI (May) EZ: Retail sales (Apr) US: Mortgage index US: ADP report (May) US: Labour productivity & unit labour costs (Q1) US: Non-manufacturing ISM (May)	5 GB: BoE meeting – decision EZ: ECB meeting - decision US: New jobless claims	6 US: Non-farm payrolls (May) US: Unemployment (May) US: Wholesale inventories (Apr)
9 PL: Auction of Treasury Bills US: Pending home sales (Apr)	10 US: Trade balance (Apr)	11 PL: Auction of 12Y CPI linked and 10Y floating rate bonds	12 EZ: Industrial production (Apr) US: New jobless claims US: Import prices (May) US: Retail sales (May)	13 PL: CPI (May) PL: Money supply (May) US: CPI (May) US: Preliminary Michigan (Jun)

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	22	28	-	-	-	-	-	-	-
Gross wages, employment	16	15	17	15	19	16	15	18	15	15	18	15
Unemployment	24	25	26	22	28	-	-	-	-	-	-	-
Foreign trade	about 50 working days after reported period											
Balance of payments*	2	-	31	-	-	30	-	-	-	-	-	-
Balance of payments	18 ^c	12	13	15	15	17	15	12	-	-	-	-
Money supply	14	14	14	14	14	13	14	14	-	-	-	-
NBP balance sheet	7	7	7	7	7	6	7	7				
Business climate indices	23	22	21	23	23	23	23	22	23	23	21	22

* quarterly data, ^a preliminary data for January, ^b January and February, ^c November 2007

Source: CSO, NBP

Economic data and forecasts

Monthly economic indicators

		Apr 07	May 07	Jun 07	Jul 07	Aug 07	Sep 07	Oct 07	Nov 07	Dec 07	Jan 08	Feb 08	Mar 08	Apr 08	May 08
Industrial production	%YoY	12.6	8.1	5.6	10.4	8.9	5.4	10.8	8.5	6.4	10.7	15.0	0.9	18.0	5.6
Retail sales ^c	%YoY	15.1	14.8	16.2	17.1	17.4	14.2	19.4	19.2	12.4	20.9	23.8	15.7	19.8	17.1
Unemployment rate	%	13.6	12.9	12.3	12.1	11.9	11.6	11.3	11.2	11.4	11.7	11.5	11.1	10.2	9.5
Gross wages ^{b,c}	%YoY	8.4	8.9	9.3	9.3	10.5	9.5	11.0	12.0	7.2	11.5	12.8	10.2	11.2	10.8
Employment ^b	%YoY	4.4	4.4	4.6	4.7	4.8	4.7	5.0	5.0	4.9	5.9	5.9	5.8	5.8	5.7
Export (€) ^d	%YoY	16.1	11.6	10.7	17.0	14.9	8.2	13.6	13.1	8.6	21.9	28.7	17.5	21.6	14.1
Import (€) ^d	%YoY	25.4	13.7	20.8	23.3	13.4	13.7	17.7	15.4	15.3	18.8	32.3	16.2	24.6	18.6
Trade balance ^d	EURm	-949	-957	-1123	-1299	-472	-917	-858	-785	-1644	-644	-933	-1131	-1425	-1526
Current account balance ^d	EURm	-687	-1246	-1506	-1252	-576	-546	-1158	-95	-1976	-1105	-1324	-1331	-1425	-1826
Current account balance ^d	% GDP	-2.9	-3.2	-3.5	-3.7	-3.6	-3.8	-3.8	-3.5	-3.7	-3.9	-4.0	-4.1	-4.5	-4.6
Budget deficit (cumulative)	PLNbn	-2.1	-4.3	-3.7	0.6	0.3	0.2	-4.4	-6.0	-16.9	4.4	0.0	1.9	0.6	-7.9
Budget deficit (cumulative) ^e	% of FY plan	12.2	25.2	21.7	-3.6	-1.6	-1.2	26.2	35.5	100.0	-16.4	-0.1	-6.9	-2.2	29.1
CPI	%YoY	2.3	2.3	2.6	2.3	1.5	2.3	3.0	3.6	4.0	4.0	4.2	4.1	4.0	4.2
PPI	%YoY	2.2	2.1	1.7	1.5	1.8	1.8	2.0	2.5	2.3	2.9	3.2	2.9	2.6	2.4
Broad money (M3)	%YoY	17.8	16.0	14.7	15.6	16.1	14.4	13.8	13.6	13.4	12.9	13.5	13.5	13.3	12.7
Deposits	%YoY	18.2	16.4	15.2	15.9	16.3	15.4	15.2	15.1	14.5	14.3	14.7	15.1	14.6	14.1
Loans	%YoY	28.4	28.6	29.2	31.4	31.1	31.0	30.6	30.1	30.0	30.3	29.5	29.5	27.3	26.7
USD/PLN	PLN	2.83	2.80	2.84	2.75	2.80	2.73	2.61	2.49	2.47	2.46	2.43	2.28	2.19	2.19
EUR/PLN	PLN	3.82	3.78	3.81	3.77	3.81	3.79	3.71	3.66	3.60	3.61	3.58	3.54	3.45	3.42
Reference rate ^a	%	4.25	4.25	4.50	4.50	4.75	4.75	4.75	5.00	5.00	5.25	5.50	5.75	5.75	5.75
Lombard rate ^a	%	5.75	5.75	6.00	6.00	6.25	6.25	6.25	6.50	6.50	6.75	7.00	7.25	7.25	7.25
WIBOR 3M	%	4.32	4.44	4.52	4.78	4.80	5.09	5.13	5.36	5.67	5.64	5.74	6.03	6.29	6.29
Yield on 52-week T-bills	%	4.36	4.43	4.42	4.70	4.80	5.01	5.04	5.30	5.78	5.75	5.66	6.09	6.10	6.10
Yield on 2-year T-bonds	%	4.71	4.70	4.93	5.14	5.23	5.25	5.30	5.77	6.06	5.92	5.90	6.17	6.20	6.18
Yield on 5-year T-bonds	%	5.07	5.11	5.40	5.50	5.61	5.60	5.59	5.90	6.07	5.94	5.93	6.20	6.12	6.16
Yield on 10-year T-bonds	%	5.27	5.28	5.52	5.60	5.68	5.69	5.64	5.70	5.85	5.81	5.82	5.98	5.98	5.98

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	1 166,7	1 275,9	267,6	281,2	288,2	329,7	294,1	309,0	314,9	357,9
GDP	%YoY	3,6	6,2	6,6	5,1	7,3	6,5	6,5	6,3	5,6	5,6	4,7	4,6
Domestic demand	%YoY	2,4	7,3	8,3	6,5	9,4	9,3	8,6	6,4	5,8	6,7	6,6	6,8
Private consumption	%YoY	2,0	4,8	5,2	5,6	6,9	5,0	5,1	3,7	5,4	5,7	5,7	5,7
Fixed investments	%YoY	6,5	15,6	19,2	12,6	26,2	20,8	18,3	16,4	14,0	14,0	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	10,3	4,1	3,5
Retail sales (real terms)	%YoY	1,5	11,9	14,0	14,3	17,4	14,1	12,8	12,2	16,0	13,7	13,3	14,3
Unemployment rate ^a	%	17,6	14,8	11,4	8,5	14,3	12,3	11,6	11,4	11,1	9,0	8,4	8,5
Gross wages (real terms) ^c	%YoY	1,2	4,2	6,7	5,9	5,9	6,5	8,1	6,5	7,2	6,3	5,4	4,8
Employment ^c	%YoY	1,9	3,2	4,6	5,4	4,2	4,5	4,8	5,0	5,9	5,6	5,2	4,6
Export (€) ^b	%YoY	17,8	20,4	12,8	12,8	13,4	12,7	13,1	12,0	22,5	16,7	8,0	5,5
Import (€) ^b	%YoY	13,4	24,0	17,9	16,9	19,5	19,7	16,6	16,2	22,0	19,9	14,0	12,5
Trade balance ^b	EURm	-2 242	-5 539	-11 311	-17 519	-2 322	-3 029	-2 684	-3 276	-2 708	-4 477	-4 640	-5 693
Current account balance ^b	EURm	-3 008	-7 283	-11 499	-18 708	-2 468	-3 434	-2 376	-3 221	-3 760	-5 077	-4 232	-5 638
Current account balance ^b	% GDP	-1,2	-2,7	-3,7	-5,1	-2,9	-3,5	-3,8	-3,7	-4,0	-4,3	-4,6	-5,1
Budget deficit (cumulative) ^a	PLNbn	-28,6	-25,1	-16,9	-23,8	-4,8	-3,7	0,2	-16,9	1,9	-12,1	-13,4	-23,8
Budget deficit (cumulative) ^a	% GDP	-2,9	-2,4	-1,5	-1,9	-	-	-	-	-	-	-	-
CPI	%YoY	2,1	1,0	2,5	4,1	2,0	2,4	2,0	3,5	4,1	4,1	4,3	3,7
CPI ^a	%YoY	0,7	1,4	4,0	3,6	2,5	2,6	2,3	4,0	4,1	4,1	4,3	3,6
PPI	%YoY	0,7	2,5	2,3	2,6	3,3	2,0	1,7	2,3	3,0	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	13,5	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	15,1	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	29,5	26,0	22,6	19,0
USD/PLN	PLN	3,23	3,10	2,77	2,27	2,97	2,82	2,76	2,52	2,39	2,20	2,25	2,23
EUR/PLN	PLN	4,02	3,90	3,78	3,50	3,89	3,80	3,79	3,65	3,58	3,45	3,52	3,47
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	6,16	4,20	4,42	4,89	5,39	5,80	6,30	6,30	6,25
Yield on 52-week T-bills	%	4,92	4,18	4,69	5,98	4,14	4,40	4,84	5,37	5,84	6,10	6,00	6,00
Yield on 2-year T-bonds	%	5,04	4,57	5,23	6,10	4,47	4,78	5,21	5,71	5,99	6,20	6,15	6,05
Yield on 5-year T-bonds	%	5,25	5,03	5,52	6,10	4,95	5,19	5,57	5,85	6,02	6,16	6,15	6,05
Yield on 10-year T-bonds	%	5,24	5,22	5,56	5,90	5,17	5,36	5,66	5,73	5,87	5,99	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 09.05.2008 has been prepared by:

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