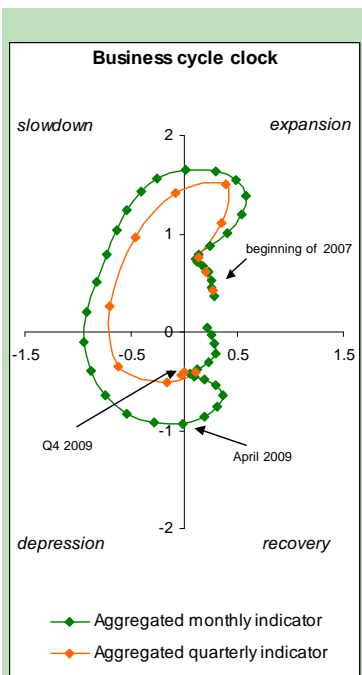


# MACROscope

## Polish Economy and Financial Markets

July-August 2010

### Hot summer ahead



Note: construction of business cycle clock, including concepts and methodology used for its creation was presented in November's MACROscope [http://english.bzwbk.pl/items/english/doc/m\\_eng\\_2009\\_11.pdf](http://english.bzwbk.pl/items/english/doc/m_eng_2009_11.pdf)

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Just like last year, this MACROscope is a bimonthly issue. Actually, we do not delude ourselves that the summer season will be peaceful for financial markets. Quite the opposite, the summer is going to be rather hot and high volatility will surely continue. We can expect major developments both at home and abroad (let's take the Polish budget deficit planning or publication of the European bank stress-tests results) that will be touched upon in the September issue of our report. Then, once 2Q 2010 GDP figure is released, we would decide to what extent (if any) to revise the forecasts for the rest of the year. Those interested in our economic and market comments are invited to read our weekly and daily reports.

Economic data published in recent weeks have been optimistic about the revival of the Polish economy. Industrial output grew by 14%, construction production has clearly started to make up for the losses recorded at the beginning of the year, more and more jobs have been created and increases in salaries and retail sales have been higher than expected. This has been accompanied by exports and imports boosting and advance PMI clearly rising further in June. This suggests that in the second quarter the economic growth rate was similar to that recorded in the first three months of 2010 and makes us believe that the Polish economy will grow by more than 3% in 2010. Our monthly business climate clock has even turned into expansion phase. Despite this, we have been moderately optimistic about the Polish economy moving forward in 2011 (3.5% GDP growth) due to a high risk of an economic slowdown in the euro zone. Especially given that the major drive for industrial recovery is a significant increase in export orders.

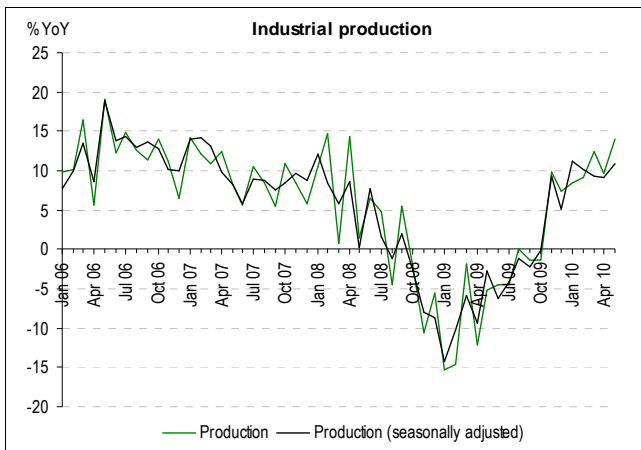
The Monetary Policy Council has taken a holiday break and will not meet in July to decide about interest rates. At its first meeting chaired by the new head, MPC dropped the informal monetary policy bias, though the overtone of both statement and press conference shifted to a more restrictive one - many inflation risks emerge in the medium-term perspective with the economic revival and financial markets turbulence (weak Polish zloty). The MPC has made us to keep expectations for the interest rate hikes to start later this year.

As far as fiscal policy is concerned, we have not yet known the size of the 2011 budget deficit. The macroeconomic assumptions of the Finance Ministry are more or less the same as our forecasts but it is hard to assess whether the proposed sector-wide fiscal policy tightening will be greater than in the convergence programme update published in February (5.9% GDP in 2011 compared to 6.9% in 2010, assuming a faster economic growth rate). In our view, even with Bronisław Komorowski elected the president of Poland, we should not expect major fiscal reforms in the near future given the approaching local government elections (in autumn) and parliamentary elections (in 2011).

Financial market on 30 June 2010:					
NBP deposit rate	2.00	WIBOR 3M	3.87	USDPLN	3.3946
NBP reference rate	3.50	Yield on 2-year T-bonds	4.81	EURPLN	4.1458
NBP lombard rate	5.00	Yield on 5-year T-bonds	5.38	EURUSD	1.2213

This report is based on information available until 08.07.2010

## Economic update



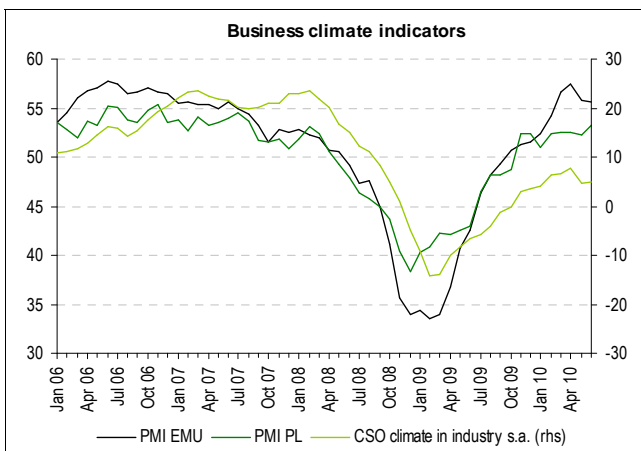
### Excellent May for industry, and probably also June

▪ The industrial production in May rose by 14.0%YoY, which was well above expectations (market consensus at 8.4%YoY, our forecast at 8.9%YoY). After seasonal adjustment annual growth reached 10.9%YoY – the best result since January 2010 and second-best since January 2008.

▪ The production increased in 25 out of 34 sectors, similarly as in recent months, mainly in export-oriented branches. It seems that foreign demand and exports remain core drivers that fuel recovery in industry and economy as a whole, which is supported by improving economic climate in neighbouring economies (mainly Germany) and dampening of the zloty appreciation.

▪ It seems that also in June industrial production recorded significant growth, as the leading indicator PMI showed increase above the most optimistic expectations. It rose by more than one percentage point to 53.3 (as compared to our forecast of 52.6, which was above market consensus of 52.3). It is worth to notice that strong PMI resulted from rise in manufacturing orders (the growth well above the long-term average), mainly export orders (the most significant increase since December 2005).

▪ According to the PMI index, the growth rate of industrial production in June was the highest for three months and industry capacity utilisation increased again. This supports our forecast, according to which industrial production in June, adjusted for seasonal factors, was at this year's high. Before the publication of PMI data our forecast was at 11.3% (slightly above the market consensus). The re-estimation of the production model after PMI release suggests that the growth may climb to some 12%.

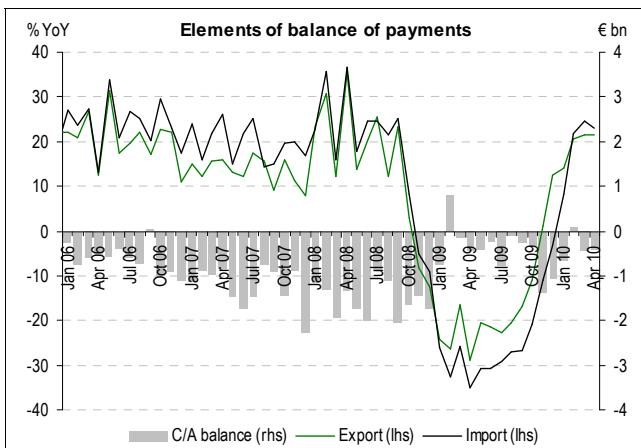


### Strong growth in foreign trade maintains

▪ In line with our forecasts, both imports and exports rose considerably in April – in euro terms by 21.5% and 23%YoY, respectively. It is worth noticing that trade turnover in zloty has also shown acceleration in the last two months. In April, exports and imports in PLN advanced by 6.5% and 7.7%YoY, respectively. The data confirmed recovery in both external and domestic demand.

▪ The current account deficit reached €424m versus market consensus of above €600m. The trade deficit was at €370m and balances of services and transfers were roughly in line with expectations. The only surprise in data, which was the reason behind lower than expected C/A deficit, was the income balance.

▪ We forecast current account surplus in May due to significant inflow of EU transfers.

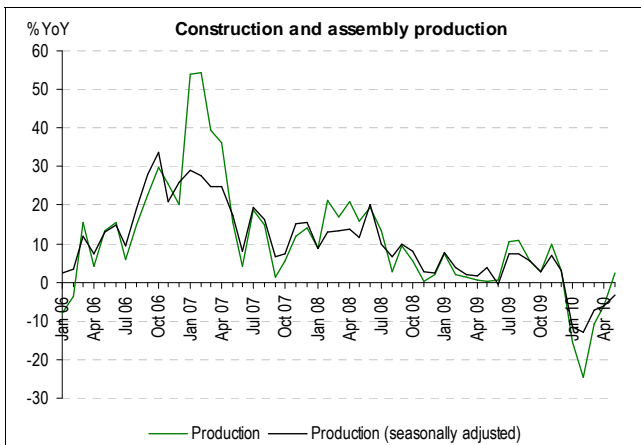


### Improvement in construction output

▪ Production in construction sector also positively surprised and showed growth of 2.3%YoY in May, after four-month period of decreases in annual terms (caused by very bad weather conditions at the start of the year).

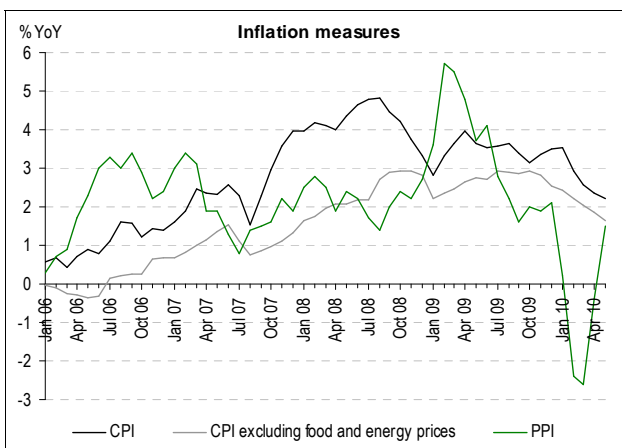
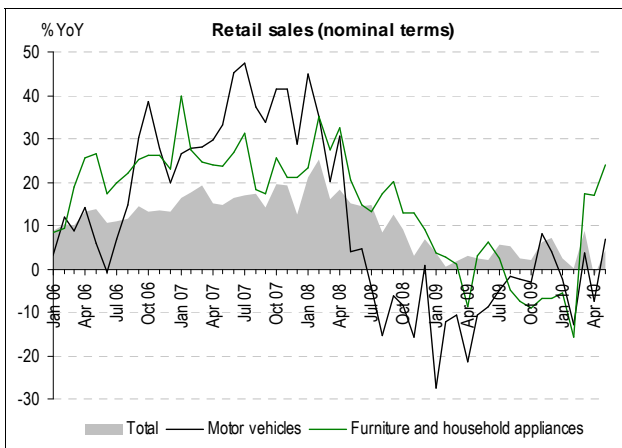
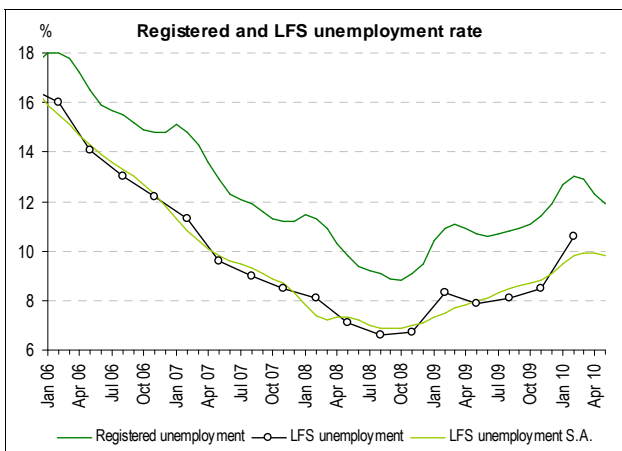
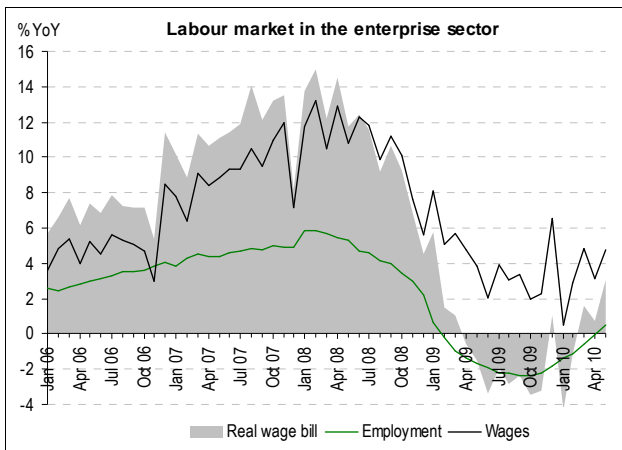
▪ Construction output in seasonally adjusted terms rose by 3.4%YoY in May. The data suggested that companies continue to make up for earlier backlogs and a negative influence of some one-off factors in May (heavy rain, flood) was limited and did not stop the recovery process.

▪ In the remainder of the year a reconstruction connected with flood damage will be additional supporting factor. At the same time this will be connected with recovery in fixed investments in the following quarters after a significant fall recorded in 1Q10.



Source: CSO, NBP, Reuters, own calculations

## Economic update



Source: CSO, NBP, Eurostat, own calculations

### Further improvement in the labour market...

- The data on domestic labour market for May were roughly in line with our expectations. Employment in the corporate sector advanced 0.2%MoM in May (third monthly gain in a row which allows to perceive it as durable trend), driving the annual growth rate up from 0.0% in April to 0.5% (first rise in annual terms since January 2009). The annual growth of wages also improved, to 4.8% in May from 3.2%.

- The data confirmed that surprising slowdown in wage growth in April was rather temporary and one off phenomenon, did not indicate changes in the upward trend in wage growth. Improving employment and wage growth has translated into acceleration of the wage bill growth in the corporate sector, which constitutes an important component of total household disposable income.

- The registered unemployment rate at the end of May fell to 11.9%, while the tentative estimates of the Ministry of Labour and the market consensus indicated a decline to 12.0% from 12.3% at the end of April. The result confirmed that the peak of the unemployment rate in the current business cycle is already behind us. Though on an annual basis the jobless rate and the number of the unemployed continue rising, but each month a rise is getting smaller.

- We forecast that by the end of the year the unemployment will start falling in annual terms and at the end of December the registered unemployment rate will reach ca. 11.5% versus 11.9% at the end of 2009. Continuation of positive trends on the labour market was confirmed by detailed unemployment statistics. The number of newly registered unemployed was smaller than a year ago. At the same time, more people than in the corresponding period of 2009 have been registered out of the labour offices.

### ... supports consumption demand

- Retail sales figures for May proved also better than expected. Annual growth rate in nominal terms improved to 4.3% from -1.6% in April and versus average rise of 3.8% in 1Q10. Annual real rise in retail sales reached 2.0% after a decline by 4% in April and average rise by 0.6% in 1Q10.

- What is important, the improvement in annual growth rate was seen in all categories of retail sales, supporting the view that the demand recovery is spread across different sectors.

- The already observed improvement and the expected further positive developments in the labour market later in the year are positive for the outlook of consumer demand. We predict that after a temporary slowdown to ca. 2%YoY, in the second half of the year private consumption growth will accelerate to ca. 2.5%.

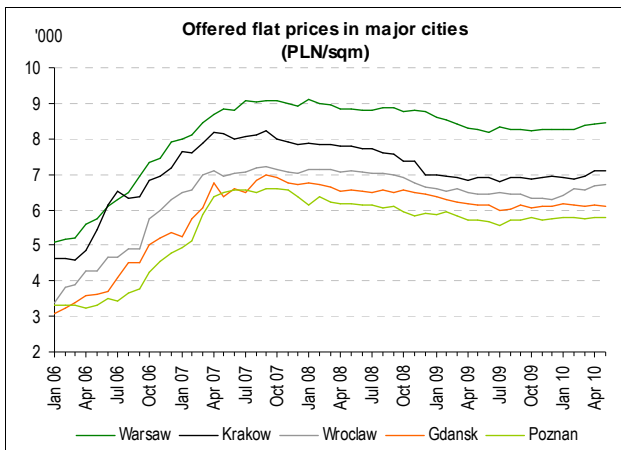
### Inflation in the downward trend, as for now

- CPI inflation in May reached 2.2%YoY (down from 2.4% in April), which was exactly between the projections of the Ministry of Finance (2.1%) and ours (2.3%). Median of market expectations was at 2.4%. The core inflation (CPI less food and energy prices) dropped to 1.6%YoY in May from 1.9%.

- As a result of floods there is large uncertainty regarding performance of food prices, i.e. scale of their possible drop in summer months. According to the Ministry of Finance, the inflation rate in June declined to 2.1% YoY (with flat food prices), which is in line with our and market expectations. The ministry forecasts the CPI at 0.2%MoM versus our expectations at 0.1%.

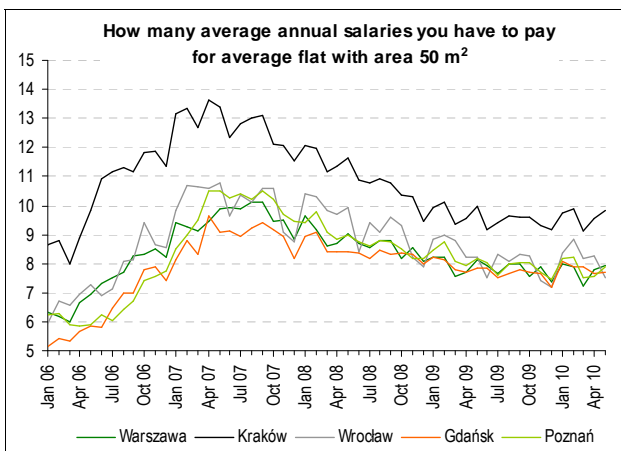
- In the next months we predict drop in the CPI inflation to below 2%, followed by a rise to ca. 2.5% at the year-end.

## Housing market update



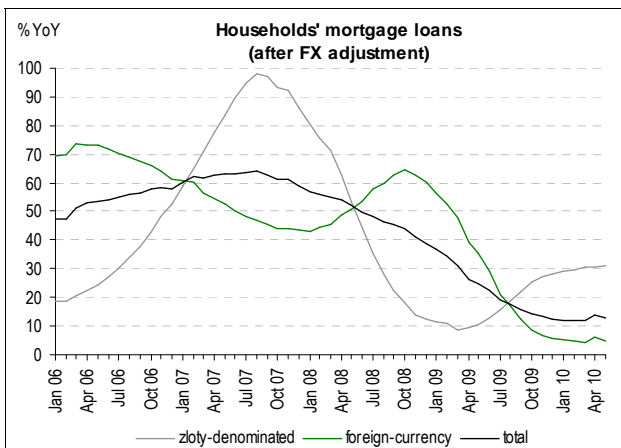
### House prices stand still

- Offered house prices in the secondary market have been quite stable in recent months. In May, slight increases in prices were recorded in some cities, while in others the prices remained stable or decreased slightly. Reports from various sources give ambiguous conclusions.
- During the holiday months activity in the housing market is generally lower and prices are more stable. Therefore, in the next few months, analysts do not expect any significant change in the situation.
- Offered prices are still significantly higher than the prices at which customers are willing to make purchases. Nevertheless, the sellers are resistant to lowering price offers.
- Rental prices of apartments in major cities still remain under pressure of quite high supply.



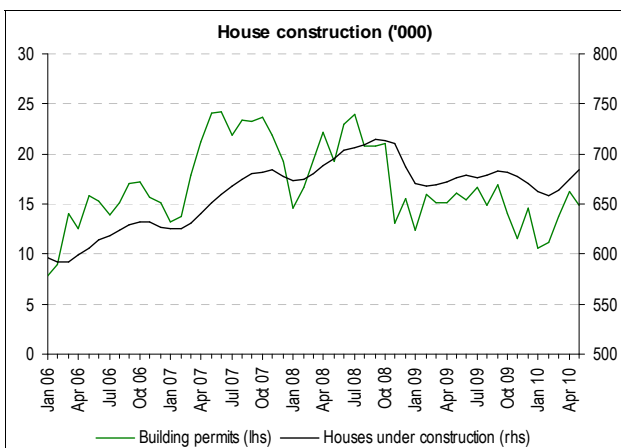
### Labour market rebound supports the demand

- Improvement of situation in the labour market and growing households' income mean that housing prices are becoming increasingly affordable for the average family. The pace of this process is still relatively slow, but should accelerate in the second half of the year, with more pronounced recovery in the labour market.
- Increasing affordability of housing also stems from the improving offer of housing loans.
- In May the average price of a 50-meter apartment in Warsaw corresponded to the equivalent of nearly eight annual average salaries (only 2% less than last year). It turns, using a zloty-denominated mortgage loan, average citizen of Warsaw could have purchased apartment with an area of ca. 53 m<sup>2</sup>, nearly 10% larger than one year ago.



### Further easing of credit conditions by banks

- In May and June banks continued easing conditions of granting mortgage loans. As a result of promotional policies of banks, and the customers' fear that credit conditions may be worse since August (after implementation of the T recommendation of the banking supervision, prohibiting the 100% loan-to-value ratio for FX loans), a demand for housing loans has increased.
- Available NBP data on housing loans show a gradual increase in demand - according to our estimates, households' mortgage loans adjusted for exchange rate fluctuations increased in May by PLN2.4bn. According to unofficial estimates, in June there was a significant growth in sales of housing loans (of around PLN4bn).



### House supply bottoming out

- CSO data confirms a gradual recovery on the supply side in the housing market, which has been signalled for some time by developers. There is a growing number of housing projects started and the number of dwellings under construction. After a clear stagnation in the first quarter of the year, new building permits have also bottomed out recently.
- Experts point to the fact that a large part of developers still have a stockpile of investment projects with valid construction permits, which will allow them to increase the supply of new housing investments, so that the supply will flexibly adjust to increasing customer demand. This will be the factor limiting potential for growth in property prices in the near future.

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

## Central bank watch

### Selected fragments of the MPC statement in June

Further signals of recovery can be seen in the world economy. However, the rate of economic growth varies across regions.

The short-term growth outlook for the euro area is negatively affected by the uncertainty regarding the pace of reducing public finance imbalance in the region, including the uncertainty connected with the fiscal crisis in Greece. At the same time, fast economic growth is continuing in the largest emerging economies. The ensuing risk of a significant deepening of economic imbalance as a result of the economic boom leads to a gradual tightening of macroeconomic policy in these countries.

Disruptions in the international financial markets, connected with the uncertainty as to the reduction of fiscal imbalances in some of euro-area countries, continued. The scale of those disruptions has nevertheless decreased recently, which has contributed to halting the fall in prices of some financial assets.

The data on the Polish economy indicate a stabilisation of the rate of economic growth. Robust increase in industrial output continued. Rise in employment in the corporate sector (for the first time since January 2009 also in year-on-year terms), stabilisation in unemployment rate (in seasonally adjusted terms) observed in May 2010 are signs of a gradual improvement in the labour market situation. The investment activity of enterprises is still limited and will probably remain so in the quarters to come, especially because the production capacity utilisation in enterprises – though rising – remains low.

This decline in CPI inflation was mainly connected with a decrease in core inflation. In the coming period, inflation will be further lowered by negative base effects stemming from a strong increase in the prices of excise goods in 2009.

The Council has discussed factors that may fuel inflationary pressures in the medium term.

An important factor affecting monetary policy is the situation of public finance, especially in the face of changing attitude in many European countries to high budget deficits and growing public debts. Introducing decisive measures aimed at permanently reducing the deficit of the general government sector and at curbing the increase of the public debt is necessary for macroeconomic stability and will allow the meeting of euro adoption criteria.

### MPC more hawkish, though with no bias

▪ The first decision of the Monetary Policy Council after the appointment of the new NBP President Marek Belka was not surprising. Main interest rates were left unchanged with the reference rate at 3.5%.

▪ However, together with appointment of the new President we saw a change in the communication policy. Quite surprisingly, the official communiqué of the Council lacked the important sentence summarising the MPC's opinion regarding balance of risks for future inflation. Market participants treated this sentence as an informal bias in monetary policy. Also, as compared to the previous month the statement lacked a few factors which may limit inflationary pressure such as low demand pressure or moderate increase in labour costs (only the so-called base effect were left). Belka emphasised that the Council discussed factors that may fuel inflationary pressures in the medium term, which "indicates direction of interests of the MPC".

▪ Overall, the overtone of the MPC communiqué and the press conference in June were clearly more hawkish than at the previous meeting. Despite this, there was no significant reaction of the debt market and in our view it was justified, since the increase in market expectations for interest rate hikes had already occurred before (after some comments of MPC members – details on next page) June's meeting confirmed the Council is ready to start the tightening cycle when risks for inflation in the medium-term are clear enough. The risks might be connected with economic recovery and observed turmoil in financial markets (weaker zloty). In our opinion, first hike will take place in 4Q10.

▪ Marek Belka said that projection results did not worry the Council too much and one should not exaggerate with its importance, though they are one of elements in decision-making process.

### Many changes in the projection of GDP and CPI

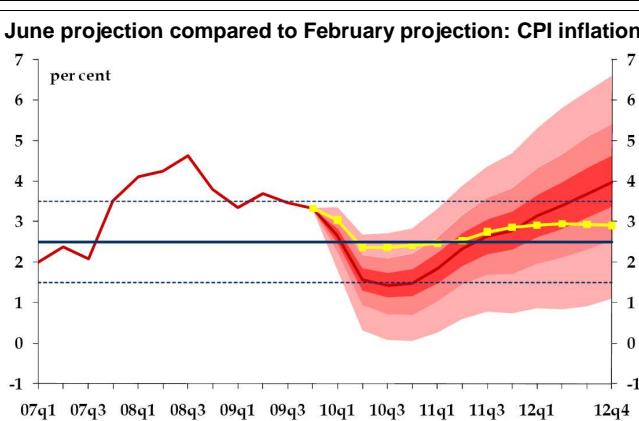
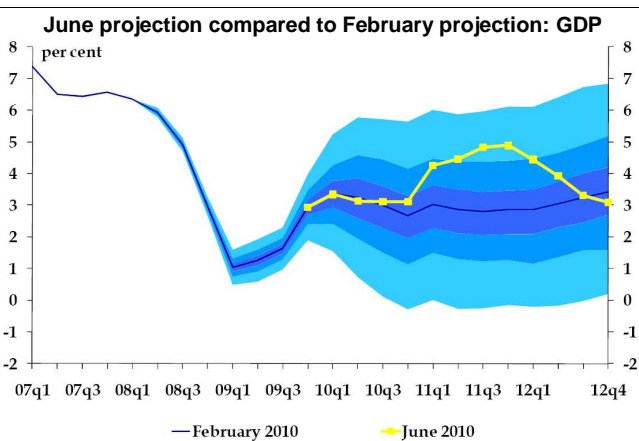
▪ NBP projection showed higher GDP path as compared to February *Inflation Report*. According to the NBP economic growth will significantly accelerate in 2011 – the central projection path assumes GDP growth at 4.6%, which is driven by accumulation of investments projects before EURO2012 tournament, as well as higher private consumption. Then, it is forecasted that GDP growth decelerates in 2012 with fixed investment growth rate going down to 4.7% from 8.1%, and private consumption slowdown to 2.9% from 3.3% in 2011. As a result, the central path of the projection for 2012 shows GDP growth of 3.7% in 2012.

▪ At the same time, authors of the projection emphasise the asymmetric risk for GDP projection to the downside. This is mainly connected with uncertainty as regards global economic recovery. It is worth to notice that estimates regarding potential GDP growth rate was lowered to ca. 3% in 2011-12.

▪ As regards CPI inflation the new projection showed higher path as compared to the February's results for 2010-11 (not significantly above the target) and lower for 2012 (2.9% as compared to 3.5% previously). Currently the projection assumes moderate rise in CPI, while previously inflation was below the target in 2010-11 and a sharp rise in 2012.

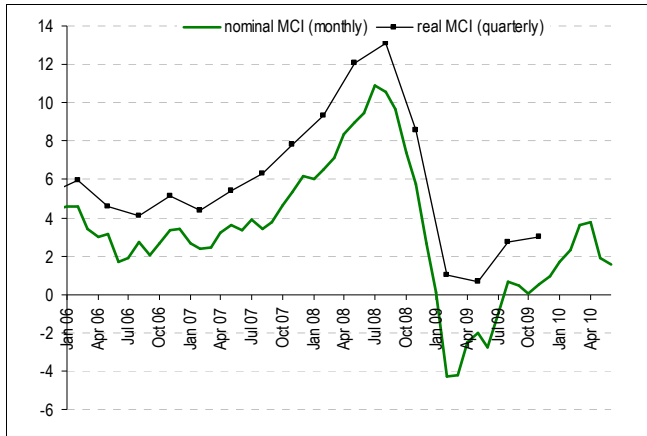
▪ These changes in the inflation path in both directions were connected with different path of core inflation, as well as for food and energy prices.

▪ Projection of stronger zloty (as compared to February's projection) was also favourable for inflation scenario. Currently, the NBP assumes lower importance of fiscal deficit and interest rate disparity for the exchange rate.



Source: NBP, PAP, Reuters

# Restrictiveness of the Monetary Policy (Council)



## Weaker zloty lowers monetary policy restrictiveness

- Real MCI rose slightly in the final quarter of 2009, confirming the growth of monetary policy restrictiveness during this period, indicated earlier by the nominal MCI index.
- After more than a year of growth in monetary policy restrictiveness, the last two months have seen the reversal, triggered by a drop in money market rates and the weakening of the zloty.
- Monthly nominal MCI index fell slightly in June, mainly due to further increase in EURPLN rate, amid stabilization of average WIBOR 3M rate.
- If there is no another wave of sudden zloty weakness in the second half of July, we may assume the stability of the nominal MCI index this month.

## Changes in communication, however of no revolutionary nature

Following his appointment to the position of President of the National Bank of Poland, Marek Belka said that this role required restraint from giving comments at large. We hoped that he would be able to convince other MPC members to follow suit. After the first meeting of the Council, he appears to have succeeded, at least to some extent. A few days after the meeting it was hard to find comments of MPC members across the Polish media. Even during the press conference, only Belka was active, while other two members took only one question about the atmosphere at the meeting. Let's hope this was the first signal of a better communication between the central bankers and the media, as some of the comments by some members in the last weeks should not have really taken place.

At the same time, we were taken by surprise by the fact that the Belka's restraint meant no bias in monetary policy already after the first meeting he had chaired. At the press conference, when asked for justifying his stance, Belka said explicitly that the change was connected with the appointment of the new NBP President. He added that this element of the statement was not indispensable. Still, Belka managed to get the other members' buy-in on that approach without more ado. If they did not like it, they should have got rid of the bias a few months ago... Possibly they had no idea how to replace it? And the new President seems to have one. He said he preferred communicating with the market in a different way. In what way, then? He pointed out to one sentence in the communiqué, which "indicates direction of interests of the MPC". This reads as follows: "the Council has discussed factors that may fuel inflationary pressures in the medium term".

Will it be more difficult to forecast next steps of the MPC without bias in monetary policy (even the informal one)? Not necessarily. But only under condition that good communication is maintained. Just like after the June meeting. Besides, we have to remember that the central bank may want to surprise the markets sometimes. At the same time, it has to be emphasised that if further modifications in communication take place, the new members of the Council have to remember that a lot of improvement has been made on this front in recent years and NBP's documents are in line with best international standards. Therefore, any changes cannot move us backward. Fortunately, Marek Belka said in the Parliament that "he would not like to suggest that the new person makes a revolution, when it is not needed".

## Hawkish comments by MPC members before June's meeting

One week before the MPC meeting, MPC member, Anna Zielińska-Głębocka, who is perceived as a hawkish member of the Council, said that she opts for "one rate hike by 50 bp in the autumn, which will anchor inflation expectations, with simultaneous signal that monetary policy will remain unchanged after the hike for several months". She also added that there were opinions to hike interest rates already in June. Such comments (Adam Glapiński also mentioned the idea of hike by 50bp) led to increase in market expectations for scale and timing of monetary policy tightening in Poland (FRA rates up). What was interesting, Zielińska-Głębocka said also there was no reason to change the monetary policy bias. Well, it seems she did not take into account that one week later the bias would not exist anymore.

- Filar 1.63 (1.61)
- Wasilewska-Trenkner 1.59 (1.48)
- Noga 1.53 (1.52)
- Wojtyła 1.50 (0.91)
- Sławiński 1.25 (0.91)
- Czekaj 1.00 (0.86)
- Owsiak 0.88 (0.91)
- Nieckarz 0.88 (0.83)
- Skrzypek** 0.81 (b.d.)
- Pietrewicz 0.80 (0.74)

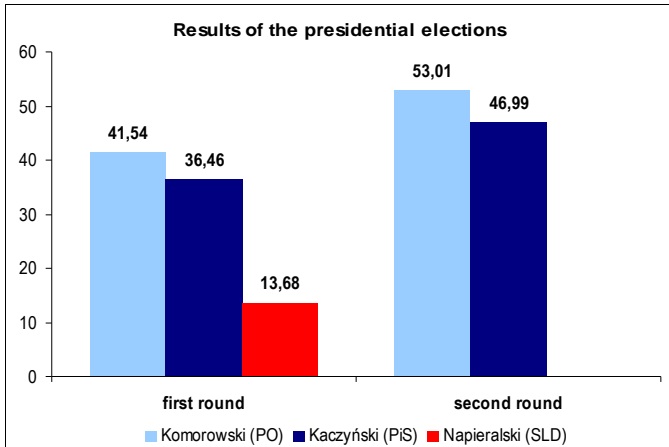
- Winiecki
- Rzońca
- Zielińska-Głębocka
- Bratkowski
- Belka
- Hausner
- Chojna-Duch
- Gilowska
- Glapiński
- Każmierczak

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 of the previous MPC are values of the index for period of Sławomir Skrzypek's term as NBP governor and numbers in parentheses are values of the index for 2004-2006.

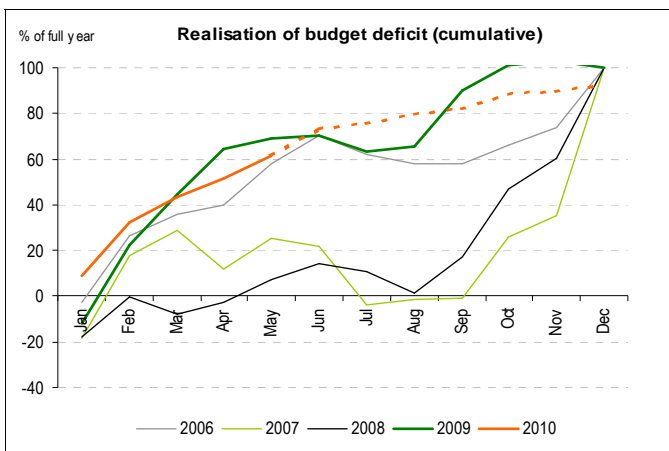
Direction of the restrictiveness axis reflects our expectations regarding direction of interest rate changes in the next 12 months.

# Government and politics



## Bronisław Komorowski wins presidential race

- In the second round of presidential elections PO's Bronisław Komorowski reached 53,01% of votes, defeating Jarosław Kaczyński from PiS, who gained the support of 46.99% of the citizens. The turnout was 55.31%.
- During the election campaign one could have an impression that both candidates did not really realise the importance of situation in the Polish public finance sector.
- The victory by Komorowski can be treated as a chance for fiscal reforms, as he represents the same party as major coalition partner in the government. However, one has to remember the upcoming local government election (autumn) and parliamentary election (2011) and thus it is hard to expect unpopular decisions. Nevertheless, the fact is that with no risk of presidential veto the cabinet has no excuse to reform.



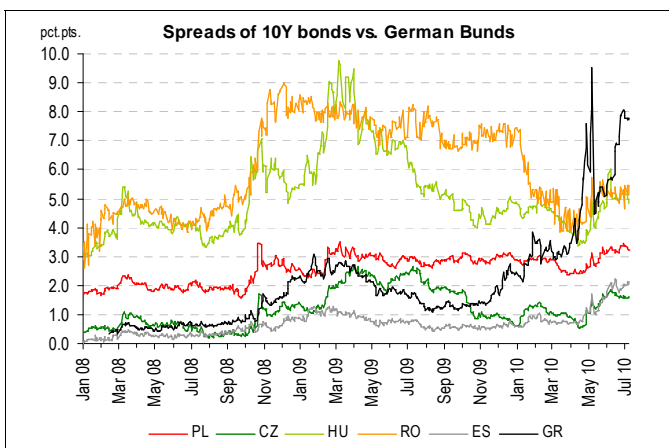
## No major tensions in this year's budget

- According to the Ministry of Finance's data the budget deficit after five months reached PLN32.1bn, i.e. 61.6% of the full-year plan. The reading was in line with the earlier estimates. This year's revenues were realised in 38.9%, while spending in 41.4%.
- The indirect tax revenues rose considerably suggesting continuation of improvement in domestic economic activity. In May alone the increase was above 6%YoY.
- Fall in revenues in annual terms was continued in the case of corporate and personal taxes, but they represent much smaller portion of total revenues.
- In the following months the budget will be supported by the profit of the central bank. We still expect deficit this year a few billions zloty below the plan.

	Spread vs Bunds (10 years) bp			CDS		
	08.07	change since 31.05	change since 31.12.09	08.07	change since 31.05	change since 31.12.09
Poland	322	10	33	151	10.9	17.2
Czech Republic	155	-6	91	99	4.7	5.8
Hungary	483	11	-2	341	91.9	95.9
Romania	513	4	-231	396	134.0	108.5
Spain	205	41	142	251	36.0	138.2
Greece	775	63	-53	903	205.9	620.5
Portugal	283	67	213	297	-19.5	207.4
Italy	143	-6	66	175	-30.9	66.9

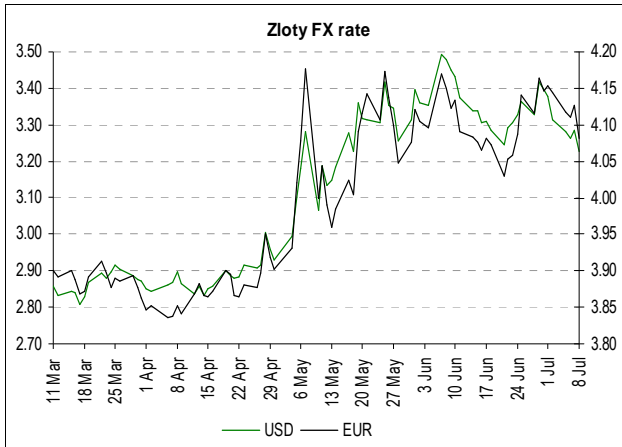
## How do investors perceive the fiscal risk?

- While awaiting the details of the budget for next year, this month we begin monitoring the fiscal risk priced-in by the financial markets. Two simple market indicators will be used: the spread in bond yields against the German Bunds and the rates of credit default swaps (CDS) for different countries (see table).
- 10-year bond spread also depends on short-term rates and the shape of the yield curve, so we focus on the change of this difference in recent months. Since the end of May the only country in the region that saw a drop in spread was the Czech Republic. In Romania, albeit the CDS rates have clearly increased, but the spread for bonds remained largely unchanged (though very high). In the south of Europe markets still see the greatest fiscal risk in Greece.
- Polish bonds spread in the past month has been relatively stable, although reached the highest level for many months (344pb) at the end of June. Compared to other countries, growth in spread and CDS rates since the start of the year has been quite moderate, but points out that investors are pricing-in considerable fiscal risk.
- Undoubtedly, the budget deficit and borrowing needs in 2011 will be among the most important factors influencing the perception of fiscal risk in Poland. By now, we know only the macroeconomic assumptions of the budget, which are rather moderately optimistic than overly conservative. It is worth recalling that in the update of convergence program in February a deficit reduction of 1 percentage point was assumed amid higher GDP growth forecast (4.5% vs. 3.5% currently). Elasticity provided by the Ministry of Finance suggests that this change in GDP could result in fiscal deficit higher by ca. 0.5% of GDP, assuming no additional actions.



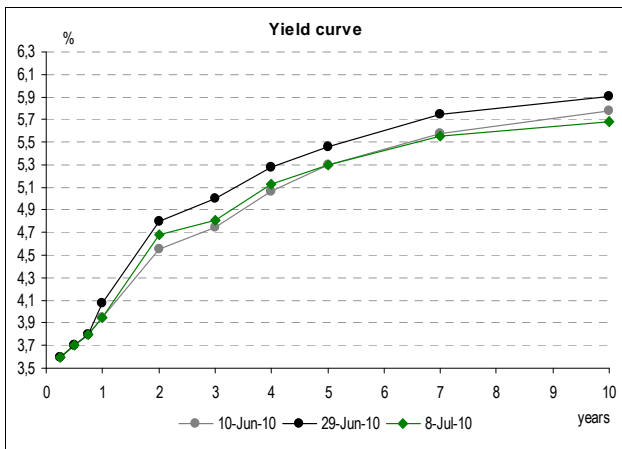
Source: Ministry of Finance, National Electoral Committee, Reuters, own calculations

# Market monitor



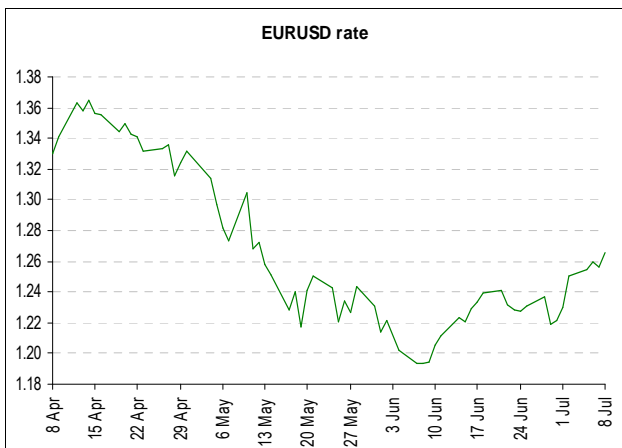
### Zloty as the gauge of market mood

- Since the beginning of June till early July the EURPLN was traded in a broad horizontal trend ranging 4.04-4.18, only temporarily reaching 4.20. Apart from the global risk aversion, fiscal problems in Romania and Hungary put some negative pressure on the zloty. The improvement of the situation in the CEE region increased the potential for the zloty appreciation.
- High volatility that prevailed on the market in recent weeks bears the possibility of higher than usual error for short-term forecasts. We expect the zloty to appreciate gradually in July, and the EURPLN shall not permanently break 4.16. First area of support, which has been tested at the beginning of July, is 4.06-4.08. In case of further zloty appreciation, next levels of support for the EURPLN are 4.04 and 4.00.



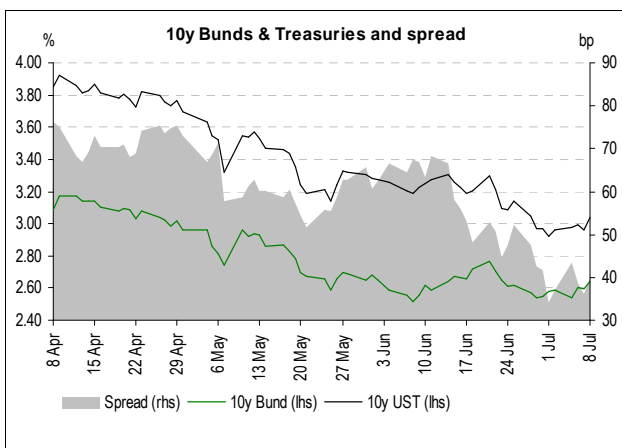
### Rise in the short-end of the yield curve

- During the past month the domestic fixed income market priced in sooner than previously anticipated interest rates hike. Hawkish MPC members' comments even before the June's meeting and the following MPC communiqué were reflected in surge in the market interest rates.
- We assume that some decline of the global risk aversion (that still depends on European banks' stress-tests results) might lead to further decline in yields. The domestic factor that may influence the market in coming weeks are assumptions to budget and financing needs of the government for 2011. Relatively high supply of bonds may counter the positive impulse from abroad, while lower borrowing needs might support bond market. Till the publication of the stress-tests' results and the budget assumptions we expect horizontal trend on the domestic fixed income market.



### Considerable surge of the EURUSD

- The euro managed to pare losses after major decline at the beginning of the June as the global market sentiment improved at the beginning of July. Common worries of growth prospects of the European countries fuelled by the fiscal stimulus programs withdrawal and fears of European banks' liquidity triggered the surge of risk aversion in the mid June, that constrained the EURUSD gains. At the turn of the month some negative data from the US were published, that further supported the euro, that regained momentum.
- At the beginning of July the EURUSD broke the first level of support at 1.26. That gives the potential for further euro's appreciation towards 1.28, and then 1.30. However, some correctional decline to 1.24-1.25 shall not be a surprise. The area of 1.22-1.23 and the upward trend line that crosses that range shall support the euro.



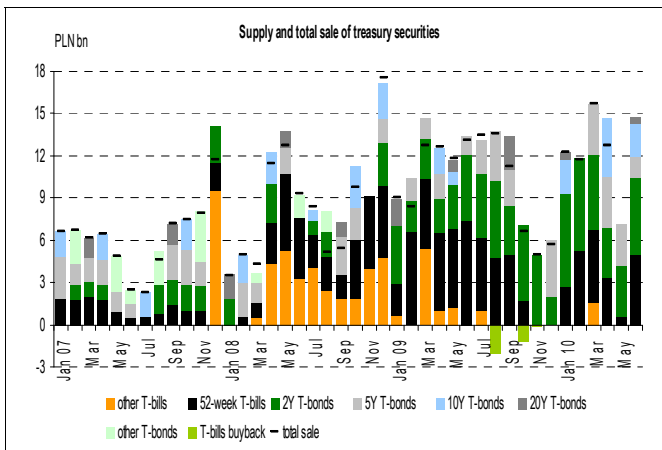
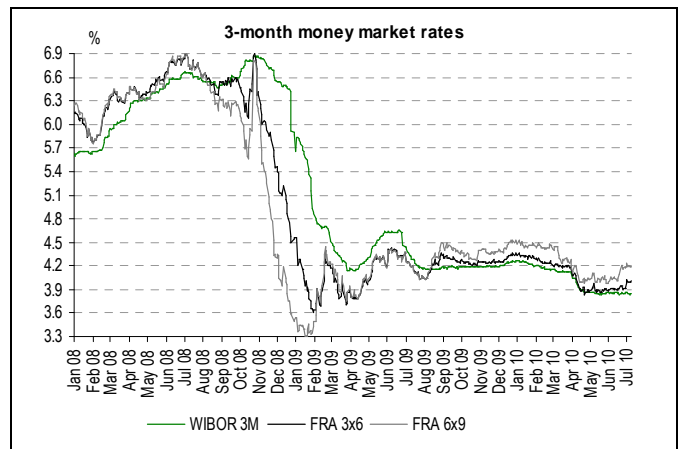
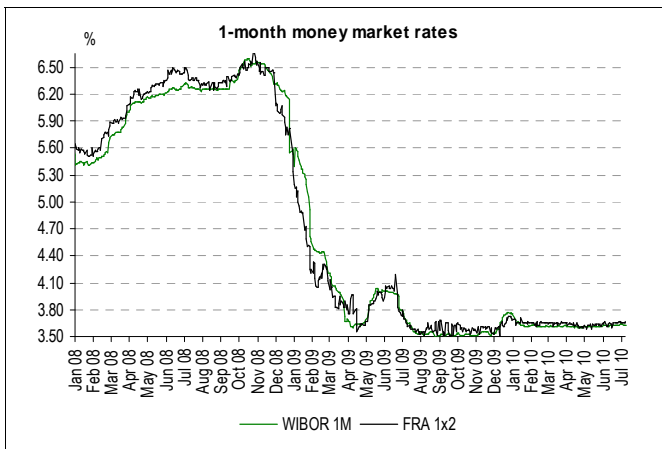
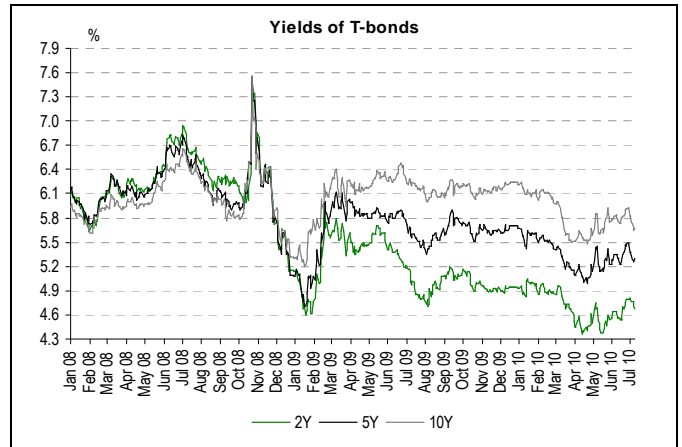
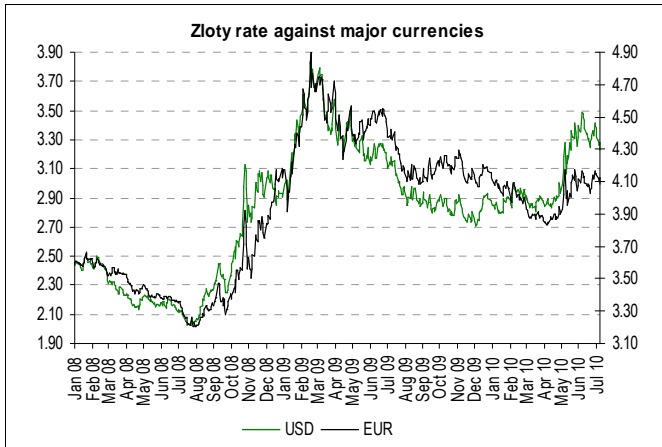
### Core market yields keep falling

- The yields of Bunds and Treasuries clearly reacted to the deterioration of global economy growth outlook. The prospect of fiscal stimulus withdrawal and introduction of saving programmes was perceived as a main threat. According to Ben Bernanke, that actions may have a negative impact on the US economy's pace of growth. Regardless the source of the negative impulse - US or the euro zone - the yields of Bunds and Treasuries were declining and consequently again reached record low levels established at the beginning of June.
- Lack of any prospect for interest rates' hikes in the US and the euro zone implies that the global market sentiment will be a decisive factor that would influence the core debt markets. Assuming the scenario of stabilisation with some slight positive tendency in risk appetite, the yields are expected to rise.

Source: Reuters, BZ WBK



# Market monitor



**Treasury bills auctions (PLN m)**

Auction date	OFFER	DEMAND/SALE
7.06.2010	52-week: 1100-1600	4096/1458
14.06.2010	52-week: 800-1200	3058/1176
21.06.2010	52-week: 600-1000	1872/945
28.06.2010	52-week: 1300-1800	2788/1442
5.07.2010	52-week: 700-1100	4151/1100
12.07.2010		
26.07.2010		
2.08.2010		
9.08.2010		
16.08.2010		
23.08.2010		
30.08.2010		
6.09.2010		

*\* based on data of the Ministry of Finance*

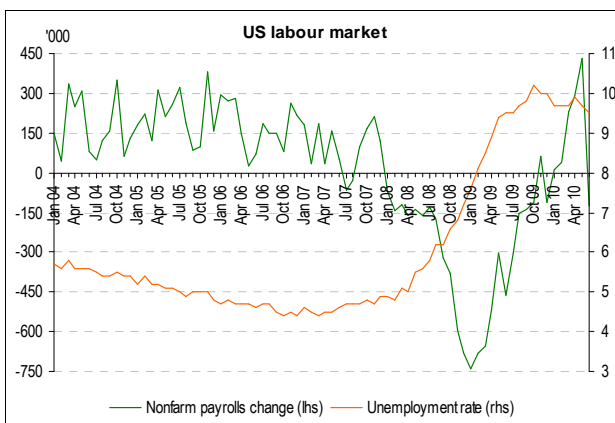
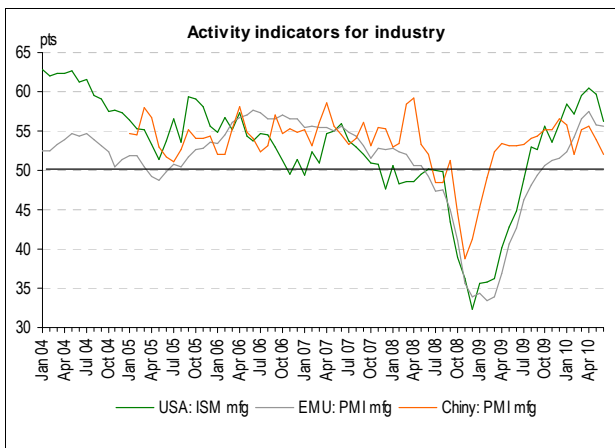
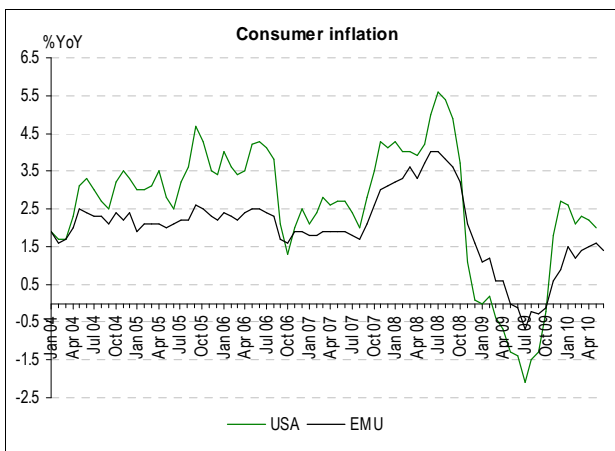
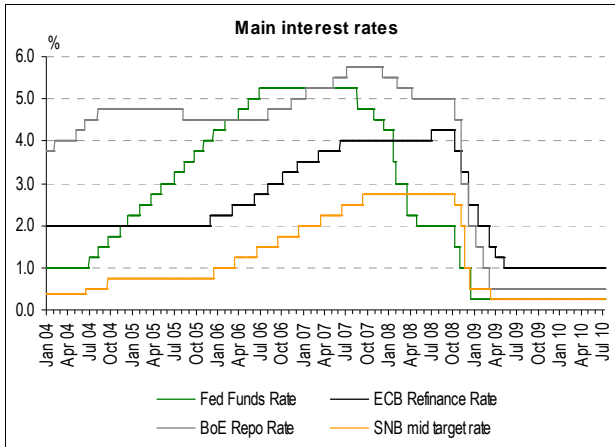
**Treasury bond auctions in 2009/2010 (PLNm)**

month	First auction			Second auction			Switch auction				
	date	T-bonds	offer	sale	date	T-bonds	Offer	sale	date	T-bonds	sale
September	2.09	OK0112	2500-3500	3500	9.09	PS0414	1000-2500	1109	23.09*	WS0922	1000-2400/2400
October	7.10*	OK0112	3000-5400	5400	-	-	-	-	29.10	PS0413/PS0414/DS1019	1573/1753/1290
November	10.11	OK0712	3500-5000	5000	-	-	-	-	26.11	OK0712/P0414	1121/2243
December	2.12	OK0712/PS0415	3000-6000	5651	-	-	-	-	16.12	-	-
January	13.01*	OK0712	6600	6600	20.01*	DS1019/WS0429	2400/600	2409/591	6.01	PS0415/WZ0118	2494/2383
February	10.02*	OK/PS	6600	6600	17.02	DS/WS/WZ/IZ	-	-	3.02	-	-
March	10.03	OK0712	3500-5400	5448	17.03	WZ0121	2000-3600	3600	3.03	PS0415/DS1019/WS0429	1784/2662/315
April	7.04	OK0712	2500-3600	3219	14.04	DS1020	2000-4200	3600	21.04**	PS0415	3600/3000***
May	5.05	OK0712	2500-4500	3700	12.05	PS0415	1500-3000	2989	27.05	WZ0121	422
June	2.06	OK0712	3000-5400	5400	16.06	DS/WS/WZ/IZ	1500-3000	2430	23.06	PS0415/WS0429	1549/54
July	7.07	OK1012	3000-5000	4971	14.06	PS0415	-	-	21.07	-	-
August	4.08	OK1012	-	-	11.08	-	-	-	18.08	-	-

*\* with supplementary auction, \*\* primary auction, \*\*\* demand/sale*

Source: Ministry of Finance, Reuters, BZ WBK

# International review



Source: Reuters, ECB, Federal Reserve

## Liquidity of the European banks at the focus

▪ Main event of the month was a payback of €442bn liquidity loan that the European banks have borrowed a year ago from the ECB. European banks sought cash on short-term liquidity actions conducted by the ECB, gathering around a half of funds that had to be returned to the central bank. After the July meeting, during which the official rate was kept at 1%, ECB officials said that short-term liquidity operations (one-week, one-month and three-months) will be continued. High demand for cash was reflected in the surge of the 3-month EURIBOR, that reached 0.79% at the end of June (highest since September 2009) versus 0.70% at the beginning of the previous month.

▪ On June 30 the ECB fulfilled the program of buying covered bonds issued by the European banks. The ECB bought bonds worth just over €60bn and intends to hold them till the maturity.

▪ In line with expectations, the Fed maintained interest rates unchanged at record low level. Just alike in recent comments, it stressed that interest rates will be held at current level for "extended period" as not to damp the US economic recovery. Some pessimistic element of the Fed' comment was a remark, that the withdrawal of fiscal stimulus and the introduction of saving plans in the Europe may have a negative impact the US growth.

▪ In May the US CPI declined to 2.0% YoY from 2.2% in April. The monthly dynamics showed a decline by 0.2% versus April. Core inflation (CPI less energy and food prices) reached 0.1% MoM in May (versus 0.0% in April) and 1.0% YoY (alike in April). The data show no inflationary pressure, that will support present expansionary monetary policy.

▪ In the euro zone preliminary estimate showed HICP twelve month inflation falling to 1.4% from 1.6% in May

## Global recovery losing momentum

▪ June was a second consecutive month of a decline in leading economic indicators in global industry. The indicators for the US, euro zone and China dropped below the levels recorded in May.

▪ Final data on PMI for euro zone's industry showed a slight decline to 55.6 versus 55.8 in may (market consensus at 55.3). The index for Germany stabilised at 58.4. The data indicate some deceleration of the euro zone's growth.

▪ The ISM for US industry declined in June to 56.2 from 59.7 in May. Additionally, the Conference Board consumer confidence index showed a slope to 52.9 versus 62.8 expected by the market. Such major drops reflect market's worries of the pace of growth of the US economy in coming months.

▪ The PMI for Chinese industry reached 52.1 in June versus 53.9 in May. That was a great disappointment for world investors.

▪ Retail sales in the euro zone advanced in May by 0.2% MoM (market consensus at 0.4%) and 0.3% YoY (market expectations at -0.3%) versus April (after revision: -0.9% MoM and -0.5% YoY).

▪ Final data on the US GDP growth in Q1 showed that the economy expanded by 2.7% QoQ versus 3.0% published previously. The rise of personal consumption was a positive factor, while the contraction of government spending.

▪ In June there was a decline of 125k of payrolls versus the rise of 433k in May (after the revision). The market expected a drop by 110k. On the other hand, the unemployment rate decreased to 9.5% (versus 9.7% in May and 9.8% expected by the market), the lowest level since July 2009.

## Economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
<b>12 July</b> <i>PL: Auction of Treasury bills</i>	<b>13</b> <i>PL: CPI (Jun)</i> <i>PL: Balance of payment (May)</i> DE: ZEW index (Jul) US: Trade balance (May)	<b>14</b> <i>PL: 5Y bond auction</i> <i>PL: Money supply (Jun)</i> EZ: Industrial production (May) EZ: Final HICP (Jun) US: Import prices (Jun) US: Retail sales (Jun)	<b>15</b> US: NY Fed Index (Jul) US: PPI (Jun) US: Capacity utilization (Jul) US: Industrial production (Jun) US: Philadelphia Fed (Jul)	<b>16</b> <i>PL: Wages and employment (Jun)</i> EZ: Trade balance (V) US: CPI (Jun) US: Capital flow (May) US: Preliminary Michigan (Jul)
<b>19</b> <i>PL: PPI (Jun)</i> <i>PL: Industrial production (Jun)</i> EZ: Balance of payments (May)	<b>20</b> <i>PL: Core inflation (Jun)</i> US: Building permits (Jun) US: House starts (Jun)	<b>21</b> <i>PL: Bond switching auction</i>	<b>22</b> <i>PL: Business tendency (Jul)</i> EZ: Flash PMI – industry (Jul) EZ: Flash PMI – services (Jul) EZ: Consumer confidence (Jul) US: Existing home sales (Jun) US: Leading indicators (Jun)	<b>23</b> <i>PL: Unemployment rate (Jun)</i> <i>PL: Retail sales (Jun)</i> DE: Ifo index (Jul)
<b>26</b> <i>PL: Auction of Treasury bills</i> US: New home sales (Jun)	<b>27</b> DE: GfK index (Aug) EZ: Money supply (Jun) US: S&P/Case-Shiller home price index (May) US: Consumer confidence (Jul)	<b>28</b> <i>PL: Consumer confidence (Jul)</i> US: Beige book (Jul) US: Durable goods orders (Jun)	<b>29</b> DE: Unemployment rate (Jul) EZ: Economic sentiment (Jul)	<b>30</b> EZ: Flash HICP (Jul) EZ: Unemployment rate (Jun) US: Advance GDP (Q2) US: Chicago PMI (Jul) US: Final Michigan (Jul)
<b>2 August</b> <i>PL Auction of Treasury bills</i> <i>PL: PMI (Jul)</i> EZ: PMI - industry (Jun) EZ Retail sales (May) US: ISM – industry (Jul)	<b>3</b> EZ: PPI (Jun) US: Core PCE (Jun) US: Personal income (Jun) US: Personal spending (Jun) US: Factory orders (Jun) US: Pending home sales (Jun)	<b>4</b> <i>PL: 2Y bond auction</i> EZ: Retail sales (Jun) EZ: PMI – services (Jul) US: ADP report (Jul) US: ISM – services (Jul)	<b>5</b> DE: Factory orders (Jun) EZ: ECB decision	<b>6</b> DE: Industrial production (Jun) US: Non-farm payrolls (Jul) US: Unemployment rate (Jul)
<b>9</b> <i>PL Auction of Treasury bills</i>	<b>10</b> US: Wholesale inventories (Jun) US: Fed decision JP: BoJ decision	<b>11</b> <i>PL: 5Y bond auction</i> <i>PL: Balance of payment (Jun)</i> US: Trade balance (Jun)	<b>12</b> EZ: Industrial production (Jun) US: Import prices (Jul)	<b>13</b> <i>PL: CPI (Jul)</i> <i>PL: Money supply (Jul)</i> DE: Preliminary GDP (Q2) EZ: Preliminary GDP (Q2) US: CPI (Jul) US: Retail sales (Jul) US: Preliminary Michigan (Aug)
<b>16</b> <i>PL: Auction of Treasury bills</i> EZ: Final HICP (Jul) US: NY Fed index (Aug)	<b>17</b> <i>PL: Wages and employment (Jul)</i> EZ: Current account (Jun) DE: ZEW index (Aug) US: Building permits (Jul) US: House starts (Jul) US: PPI (Jul) US: Industrial production (Jul)	<b>18</b> <i>PL: Bond switching auction</i> <i>PL: PPI (Jul)</i> <i>PL: Industrial production (Jul)</i>	<b>19</b> US: Leading indicators (Jul) US: Philadelphia Fed (Aug)	<b>20</b> <i>PL: Core inflation (Jul)</i> <i>PL: Business climate (Aug)</i>
<b>23</b> <i>PL: Auction of Treasury bills</i> EZ: Flash PMI - services (Aug) EZ: Flash PMI - industry (Aug) EZ: Consumer confidence (Aug)	<b>24</b> <i>PL: MPC meeting</i> EZ: Industrial orders (Jun) US: Existing home sales (Jul)	<b>25</b> DE: Ifo index (Aug) US: Durable goods orders (Jul) US: New home sales (Jul) US: Home prices (Jul)	<b>26</b> DE: GfK index EZ: Money supply (Jul)	<b>27</b> <i>PL: Consumer confidence (Aug)</i> US: Core PCE (Q2) US: Preliminary GDP (Q2) US: Final Michigan (Aug)
<b>30</b> <i>PL: Auction of Treasury bills</i> <i>PL: GDP (Q2)</i> EZ: Business climate (Aug) US: Personal income (Jul) US: Personal spending (Jul) US: Core PCE (Jul)	<b>31</b> EZ: Unemployment rate (Jul) EZ: Flash HICP (Aug) US: S&P/Case-Shiller home price index (Jun) US: Chicago PMI (Aug)	<b>1 September</b> <i>PL: 2Y bond auction</i> <i>PL: PMI (Aug)</i> EZ: PMI – industry (Aug) US: ADP report (Aug) US: ISM – industry (Aug)	<b>2</b> EZ: GDP (Q2) EZ: PPI (Jul) EZ: ECB decision US: Factory orders (Jul) US: Pending home sales (Jul)	<b>3</b> EZ: PMI – services (Aug) EZ: Retail sales (Jul) US: Non-farm payrolls (Aug) US: Unemployment rate (Aug) US: ISM – services (Aug)
<b>6</b> <i>PL: Auction of Treasury bills</i> US: Market holiday	<b>7</b> DE: Factory orders (Jul)	<b>8</b> <i>PL: bond auction</i> DE: Trade balance (Jul) US: Beige book	<b>9</b> US: Trade balance (Jul)	<b>10</b> US: Wholesale inventories (Jul)

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

## Economic data and forecasts

### Monthly economic indicators

		Jun 09	Jul 09	Aug 09	Sep 09	Oct 09	Nov 09	Dec 09	Jan 10	Feb 10	Mar 10	Apr 10	May 10	Jun 10	Jul 10
PMI	pts	43.0	46.5	48.2	48.2	48.8	52.4	52.4	51.0	52.4	52.5	52.5	52.2	53.3	53.6
Industrial production	%YoY	-4.5	-4.4	0.1	-1.3	-1.3	9.9	7.4	8.5	9.2	12.5	9.7	14.0	11.7	8.5
Construction production	%YoY	0.5	10.7	11.0	5.7	2.7	9.9	3.2	-15.3	-24.7	-10.9	-6.3	2.3	3.2	-0.2
Retail sales <sup>a</sup>	%YoY	2.1	5.7	5.2	2.5	2.1	6.3	7.2	2.5	0.1	8.7	-1.6	4.3	4.5	1.8
Unemployment rate	%	10.6	10.7	10.8	10.9	11.1	11.4	11.9	12.7	13.0	12.9	12.3	11.9	11.6	11.6
Gross wages in enterprises sector <sup>a</sup>	%YoY	2.0	3.9	3.0	3.3	2.0	2.3	6.5	0.5	2.9	4.8	3.2	4.8	4.4	3.6
Employment in enterprises sector	%YoY	-1.9	-2.2	-2.2	-2.4	-2.4	-2.2	-1.8	-1.4	-1.1	-0.6	0.0	0.5	1.0	1.2
Export (€)	%YoY	-21.3	-22.8	-20.6	-17.0	-10.9	1.0	12.6	14.0	20.5	21.5	21.5	24.6	22.8	17.5
Import (€)	%YoY	-30.6	-29.3	-27.0	-26.8	-20.8	-11.0	-3.3	8.3	21.7	24.6	23.0	25.3	21.1	16.2
Trade balance	EURm	-279	-445	-420	59	-200	-291	-627	-104	-177	-526	-368	-90	-194	-402
Current account balance	EURm	-232	-776	-116	-250	-330	-1 376	-1 070	-672	67	-458	-424	60	-294	-402
Current account balance	% GDP	-3.0	-3.0	-2.8	-2.3	-1.9	-1.8	-1.6	-1.6	-1.8	-1.9	-1.9	-1.8	-1.8	-1.7
Budget deficit (cumulative)	PLNbn	-16.7	-15.0	-15.6	-21.5	-24.0	-24.4	-23.8	-4.8	-16.7	-22.7	-27.0	-32.1	-37.3	-39.3
Budget deficit (cumulative)	% of FY plan	70.0	63.2	65.8	90.3	101.1	102.6	100.0	9.3	32.1	43.5	51.8	61.6	71.4	75.2
CPI	%YoY	3.5	3.6	3.7	3.4	3.1	3.3	3.5	3.5	2.9	2.6	2.4	2.2	2.1	1.8
CPI excluding prices of food and energy	%YoY	2.7	2.9	2.9	2.9	2.9	2.8	2.6	2.4	2.2	2.0	1.9	1.6	1.5	1.3
PPI	%YoY	4.1	2.8	2.2	1.6	2.0	1.9	2.1	0.2	-2.4	-2.6	-0.4	1.5	1.2	2.4
Broad money (M3)	%YoY	14.4	11.9	9.0	9.6	11.9	8.0	8.1	6.3	5.1	5.5	6.0	7.6	6.5	6.2
Deposits	%YoY	15.9	13.0	10.7	10.9	13.5	10.3	9.8	7.5	6.8	6.2	6.9	8.4	7.2	7.1
Loans	%YoY	26.8	23.3	19.8	18.6	14.9	13.4	8.6	5.4	3.0	2.2	3.8	5.0	5.1	7.9
USD/PLN	PLN	3.22	3.05	2.90	2.86	2.85	2.79	2.83	2.85	2.93	2.87	2.89	3.24	3.36	3.24
EUR/PLN	PLN	4.51	4.30	4.13	4.16	4.21	4.17	4.14	4.07	4.01	3.89	3.87	4.06	4.10	4.07
Reference rate <sup>b</sup>	%	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50
Lombard rate <sup>b</sup>	%	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00
WIBOR 3M	%	4.60	4.26	4.16	4.18	4.18	4.19	4.23	4.24	4.17	4.13	3.92	3.85	3.86	3.85
Yield on 52-week T-bills	%	4.73	4.43	4.23	4.33	4.35	4.26	4.25	4.01	3.90	3.92	3.84	3.71	3.93	3.95
Yield on 2-year T-bonds	%	5.34	4.93	4.92	5.10	5.03	4.92	4.92	4.95	4.90	4.76	4.47	4.52	4.66	4.70
Yield on 5-year T-bonds	%	5.83	5.55	5.53	5.74	5.65	5.64	5.67	5.58	5.51	5.27	5.10	5.26	5.35	5.30
Yield on 10-year T-bonds	%	6.34	6.19	6.08	6.18	6.15	6.14	6.21	6.12	6.09	5.71	5.56	5.74	5.83	5.70

Source: CSO, NBP, Finance Ministry, BZ WBK own estimates; <sup>a</sup> in nominal terms, <sup>b</sup> at the end of period

## Quarterly and annual economic indicators

		2007	2008	2009	2010	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10	4Q10
GDP	PLNbn	1 176.7	1 272.8	1 342.6	1 415.9	313.7	327.0	331.9	371.4	327.4	344.2	349.4	394.9
GDP	%YoY	6.8	5.1	1.8	3.2	0.7	1.1	1.8	3.3	3.0	3.0	3.4	3.4
Domestic demand	%YoY	8.7	5.6	-1.0	3.6	-1.6	-2.3	-1.3	0.9	2.2	3.4	3.7	4.8
Private consumption	%YoY	4.9	5.7	2.3	2.4	3.3	1.6	2.3	1.7	2.2	2.2	2.5	2.8
Fixed investments	%YoY	17.6	9.6	-0.8	2.1	-0.8	-3.3	-1.4	1.1	-12.4	1.0	6.0	6.5
Industrial production	%YoY	10.7	3.6	-3.2	9.2	-10.0	-6.7	-1.3	5.5	9.4	11.8	10.1	5.2
Construction production	%YoY	16.5	10.0	4.6	3.1	3.1	0.5	9.0	4.8	-16.7	0.1	6.0	12.9
Retail sales <sup>a</sup>	%YoY	16.4	13.1	3.5	5.5	2.0	2.3	4.3	5.1	4.0	2.5	5.5	9.4
Unemployment rate <sup>b</sup>	%	11.2	9.5	11.9	11.5	11.1	10.6	10.9	11.9	12.9	11.6	11.1	11.5
Gross wages in enterprise sector <sup>a</sup>	%YoY	9.3	10.3	4.4	4.1	6.3	3.7	3.9	3.8	2.8	3.5	4.3	6.0
Employment in enterprise sector	%YoY	4.6	4.8	-1.2	0.7	0.1	-1.0	-1.8	-2.0	-1.3	0.5	1.5	1.9
Export (€)	%YoY	13.4	14.2	-17.1	20.1	-22.2	-23.8	-20.1	0.1	18.3	22.9	19.3	19.9
Import (€)	%YoY	19.5	17.2	-25.4	21.4	-28.2	-32.2	-27.8	-12.1	18.0	23.0	20.6	23.6
Trade balance	EURm	-12 369	-17 724	-3 183	-5 123	-744	-513	-812	-1 114	-796	-652	-1 318	-2 358
Current account balance	EURm	-14 696	-18 302	-5 039	-5 447	-30	-1 088	-1 159	-2 762	-1 064	-658	-1 418	-2 308
Current account balance	% GDP	-4.7	-5.1	-1.6	-1.5	-4.0	-3.0	-2.2	-1.6	-1.9	-1.7	-1.7	-1.5
General government balance	% GDP	-1.9	-3.7	-7.1	-6.7	-	-	-	-	-	-	-	-
CPI	%YoY	2.5	4.2	3.5	2.4	3.3	3.7	3.5	3.3	3.0	2.2	2.0	2.5
CPI <sup>b</sup>	%YoY	4.0	3.3	3.5	2.6	3.6	3.5	3.4	3.5	2.6	2.1	2.3	2.6
CPI excluding food and energy prices	%YoY	1.0	2.3	2.7	1.7	2.3	2.7	2.9	2.8	2.2	1.7	1.4	1.6
PPI	%YoY	2.0	2.2	3.3	0.8	4.9	4.2	2.2	2.0	-1.6	0.8	2.3	1.6
Broad money (M3) <sup>b</sup>	%YoY	13.4	18.6	8.1	6.2	17.5	14.4	9.6	8.1	5.5	6.5	6.6	6.2
Deposits <sup>b</sup>	%YoY	14.5	20.6	9.8	6.1	19.4	15.9	10.9	9.8	6.2	7.2	6.8	6.1
Loans <sup>b</sup>	%YoY	29.9	36.0	8.6	8.2	34.5	26.8	18.6	8.6	2.2	5.1	6.9	8.2
USD/PLN	PLN	2.77	2.41	3.12	3.08	3.45	3.27	2.94	2.83	2.88	3.15	3.16	3.07
EUR/PLN	PLN	3.78	3.52	4.33	3.95	4.50	4.45	4.20	4.17	3.99	4.01	3.98	3.81
Reference rate <sup>b</sup>	%	5.00	5.00	3.50	3.75	3.75	3.50	3.50	3.50	3.50	3.50	3.50	3.75
Lombard rate <sup>b</sup>	%	6.50	6.50	5.00	5.25	5.25	5.00	5.00	5.00	5.00	5.00	5.00	5.25
WIBOR 3M	%	4.73	6.36	4.42	3.98	4.83	4.44	4.20	4.20	4.18	3.88	3.85	4.03
Yield on 52-week T-bills	%	4.69	6.26	4.54	3.99	4.75	4.81	4.33	4.29	3.94	3.83	4.00	4.20
Yield on 2-year T-bonds	%	5.23	6.22	5.17	4.72	5.26	5.46	4.98	4.96	4.87	4.55	4.65	4.80
Yield on 5-year T-bonds	%	5.52	6.15	5.65	5.34	5.50	5.85	5.61	5.66	5.46	5.24	5.30	5.35
Yield on 10-year T-bonds	%	5.56	6.06	6.11	5.76	5.86	6.27	6.15	6.17	5.97	5.71	5.65	5.70

Source: CSO, NBP, Finance Ministry, BZ WBK own estimates; <sup>a</sup> in nominal terms, <sup>b</sup> at the end of period

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