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MONTHLY MACROECONOMIC REVIEW

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- Slowdown in employment growth in the enterprise sector and a decline in the number of employees in manufacturing signal a significant change of the situation in the labour market and herald the possibility of a gradual return to a state of long-term equilibrium. We expect further changes in this direction to be mainly driven by weakening demand for labour due to declining investment growth and the gradually progressing overall decline in economic activity. At the same time, we are rather sceptical about the prospects for a major increase of the labour supply owing to a mass return of emigrants and/or thanks to the implementation of the government programme aimed at increasing labour activity of persons above 50.
- The materialisation of the scenario envisaging a gradual moderation of tensions in the labour market could significantly affect further decisions of the MPC. However, what may become an obstacle to a possible loosening of monetary policy is the still very fast wage growth. There is a risk that wage growth rate will react with a rather considerable delay to the ongoing change in the business cycle, all the more so as in the face of high inflation employees will try to protect their real wages.
- The decision taken by Monetary Policy Council (MPC) in July to keep interest rates unchanged was fully in line with market expectations. We still believe that rising inflation and inflationary expectations, combined with concerns about the second-round effects, may prompt the Council to opt for yet another interest rate hike, but increasing symptoms of an economic slowdown in Poland as well as decisions taken by other central banks substantially reduce the probability of such a hike. It cannot be excluded the tightening cycle in Poland has already ended.
- The implementation this year's budget has been proceeding without any major difficulties, but definitely less successfully than in the same period of 2007. Most disturbing is that the much lower than planned growth in revenue, although this mainly results from delays in the inflow of EU funds. We expect that for the whole year revenue will be lower than assumed in the budget bill, which means that the deficit level will be determined by the scale of actual savings in budgetary expenditure.

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KEY MACROECONOMIC INDICATORS

	Jan 08	Feb 08	Mar 08	Apr 08	May 08	Jun 08	Jul 07
GDP and Output							
GDP			6.1%				
Domestic demand			6.3%				
Private consumption			5.6%				
Investment in fixed assets, gross			15.7%				
Value added			5.5%				
in industry			6.9%				
in the construction sector			16.7%				
in the market services sector			6.7%				
Industrial production growth YoY	10.6%	14.9%	0.9%	14.9%	2.3%	7.2%	5.6%
Industrial production growth MoM	3.0%	1.6%	0.7%	4.0%	-8.5%	5.0%	-3.4%
Retail sales YoY	20.9%	23.8%	15.7%	17.6%	14.9%	14.2%	14.3%
Retail sales MoM	-18.7%	0.3%	11.8%	2.9%	-1.9%	2.4%	1.8%
Labour Market							
Average wage in the enterprise sector (PLN)	2969.65	3032.70	3144.41	3137.74	3069.43	3215.32	3228.98
Wage growth in the enterprise sector YoY	11.5%	12.8%	10.2%	12.6%	10.5%	12.0%	11.6%
Wage growth in the enterprise sector MoM	-8.5%	2.1%	3.7%	-0.2%	-2.2%	4.8%	0.4%
Employment in the enterprise sector YoY	5.9%	5.9%	5.8%	5.6%	5.4%	4.8%	4.7%
Employment in the enterprise sector MoM	2.0%	0.4%	0.2%	0.1%	0.0%	0.0%	0.2%
Unemployment rate	11.7%	11.5%	11.1%	10.5%	10.0%	9.6%	9.4%
Foreign trade							
Current account (EUR)	-1 105	-1 324	-1 605	-1550	-1 602	-2292	
Trade balance, transaction-based (EUR)	-644	-933	-1 480	-1260	-1 240	-1706	
Exports, transaction-based YoY (EUR)	21.9%	28.7%	19.1%	31.1%	12.2%	16.1%	
Imports, transaction-based YoY (EUR)	18.8%	32.3%	21.1%	31.3%	14.0%	20.2%	
Current account (% GDP)	-3.7%	-3.8%	-4.1%	-4.2%	-4.3%	-4.4%	
Prices							
CPI MoM	0.7%	0.2%	0.4%	0.4%	0.8%	0.2%	0.0%
CPI YoY	4.0%	4.2%	4.1%	4.0%	4.4%	4.6%	4.8%
Net inflation YoY	1.9%	2.5%	2.7%	2.8%	3.2%	3.3%	3.5%
PPI MoM	1.2%	0.9%	0.6%	-0.1%	0.7%	0.3%	0.1%
PPI YoY	2.9%	3.2%	2.9%	2.5%	2.7%	2.7%	2.3%
Money aggregates							
Money supply M3 (PLN B)	568.6	579.0	581.0	593.9	599.6	605.7	614.9
Money supply YoY	12.9%	13.5%	13.6%	14.9%	15.0%	16.2%	16.5%
Household loans YoY	37.9%	37.8%	37.3%	36.2%	33.8%	34.2%	30.3%
Corporate loans YoY	26.2%	24.8%	25.2%	24.9%	26.0%	24.6%	23.5%
Household deposits YoY	14.2%	15.3%	17.5%	19.0%	21.2%	22.6%	24.6%
Corporate deposits YoY	11.7%	8.2%	6.1%	7.8%	6.1%	6.8%	7.0%
Forex Rates							
EUR/PLN rate (end of month)	3.61	3.52	3.53	3.46	3.38	3.35	3.20
USD/PLN rate (end of month)	2.42	2.32	2.23	2.23	2.18	2.12	2.05
Interest Rates							
NBP reference rate	5.25%	5.50%	5.75%	5.75%	5.75%	6.00%	6.00%
Lombard rate	6.75%	7.00%	7.25%	7.25%	7.25%	7.50%	7.50%
Deposit rate	3.75%	4.00%	4.25%	4.25%	4.25%	4.50%	4.50%
WIBOR 3M	5.68%	5.94%	6.15%	6.34%	6.48%	6.65%	6.56%
2Y bond yield	5.71%	6.18%	6.29%	6.21%	6.48%	6.89%	6.53%
5Y bond yield	5.75%	6.17%	6.12%	6.08%	6.38%	6.78%	6.31%
10Y bond yield	5.66%	5.97%	5.96%	5.97%	6.27%	6.61%	6.25%
Global Economy							
Eurozone inflation (YoY)	3.1%	3.5%	3.6%	3.3%	3.6%	4.0%	4.0%
Eurozone GDP (YoY)			2.1%			1.5%	
ECB basic rate	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.25%
US inflation (YoY)	4.3%	4.0%	4.0%	3.9%	4.2%	5.0%	5.6%
US GDP (QoQ ann.)			0.9%			1.9%	
Fed Funds target rate	3.00%	3.00%	2.25%	2.00%	2.00%	2.00%	2.00%

Source: CSO, NBP, Eurostat, Reuters, ECB, Federal Reserve, BRE Bank S.A. Forecasts are marked in italics.

POLISH ECONOMY

Labour market

The falling rate of growth of employment in the enterprise sector observed in recent months is coherent with a scenario envisaging the return of the labour market to a state of equilibrium as outlined in the NBP's latest inflation projection. Even the prospect of this scenario materialising in the medium-term, irrespective of a still extended period of high wage growth, may significantly alter the direction of monetary policy.

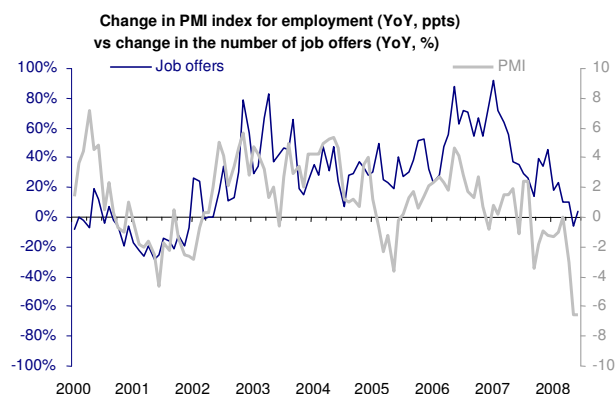
Beginning of a return to equilibrium?

After years of high unemployment and stagnant wages, a rapid improvement of the situation in the labour market started to unfold at the turn of 2006 and 2007. Two-digit wage growth rates observed since autumn of 2007 and the results of business tendency surveys seem to even lend credence to the claim that the actual unemployment rate has recently dropped below its natural level. However, deviation from long-term equilibrium may not be considered a lasting state. Therefore the drop in the growth rate of employment in the enterprise sector recorded in recent months (from 5.8% YoY in March to 4.7% YoY in July) may herald a return of the labour market to equilibrium. In absolute terms, the number of employees in that sector remained unchanged in June and increased only marginally in July. In manufacturing alone, even a small drop in employment was reported in June, which may be considered yet another signal pointing to a growing risk of an economic slowdown.

However, the claim that the labour market is gradually returning to its equilibrium can hardly be reconciled with wages continuing to grow at a two-digit rate. In Q2 2008, such growth rates could be observed not only the enterprise sector, but also in the whole economy. According to the latest inflation projection of the NBP, this situation is to change already in the latter part of 2008. The growth in average wage in the whole of 2008 is to reach 8.7%, while in 2009 it is expected to drop to 6.3%. The decline in the wage growth rate is to be a response to a feeble growth of employment as forecast by the NBP experts (a mere 1.1% in 2008 and 0.5% in 2009), which would not be high enough to prevent a renewed increase of the unemployment rate. The forecast for the labour market (and in particular the expected increase in unemployment) is based on the assumption that labour activity rates of older people will significantly change in the coming years (i.a. due to the introduction of new rules on early retirement). Another factor that could contribute to a prompt normalisation of the

situation in the labour market is the often indicated (and rather overplayed by the media) prospect of large-scale returns of Polish migrant workers. If the envisaged changes in the labour market were to materialise, this would mean a significant shift of risks to future inflation, a change in the MPC rhetoric, and finally a prospect of interest rate cuts. It is also worth keeping in mind that the high level of inflation implied by the NBP model is partly the result of the assumed significant nominal depreciation of the zloty.

The key issue, on which we would like to focus our analysis, are the changes in demand and supply conditions in the labour market and their relation to the NBP forecasts and to market consensus. Most forecasts implicitly assume now that labour demand growth will decline, which is expressed by expected decrease of the employment growth rate. This assumption is coherent with the picture emerging from business tendency surveys. The recent NBP analyses show a drop in the percentage of industries planning to increase employment (only construction still resists this tendency) and an increase in the share of companies planning layoffs (this mainly concerns manufacturing). The PMI index for employment dropped in July to the lowest level since 2003 (46.3 pts.). By looking at the changes in business tendency indexes, and not at their absolute levels, one can conclude the strong growth in employment that accompanied the earlier recovery in investment is about to fade out.



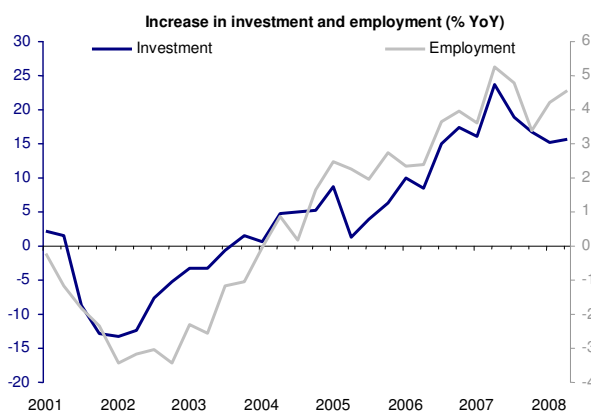
Demand for labour and the cyclical slowdown

While the enterprises surveyed by the NBP still point to a high level of investment activity, this mainly concerns projects that are nearing completion rather than new project starts. However, a rapid decrease in investment, and consequently a rapid drop in employment, can be avoided thanks investments in infrastructure and the inflow of EU funds. What also

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lends stability to the labour market is the continued growth of employment in services. It is largely owing to that factor that Q1 2008 witnessed an acceleration in the employment growth rate despite a decline in investment growth.

The actual impact of the above-mentioned factors cushioning the decline in employment is hard to estimate. Based on historic relationships between increases in employment and investment, the 1.1% increase forecast by the NBP for 2009 can be considered rather conservative. With our investment growth forecast of about 6-8% for the next year (NBP has a similar estimate), we would expect the rate of growth in employment to be closer to 2% than 1%. However, we believe that in view of the cyclical and global character of the coming slowdown, a bigger risk to the implementation of the scenario drawn by the NBP may be posed by the overly optimistic estimates of investment growth rather than by the assumed relations between employment and investment growth.



The intriguing question of labour supply

More unknowns seem to exist with regard to supply of labour. After the opening of labour markets in other EU countries it ceased to be strictly correlated with the increase in working age population. While it is true (as indicated by NBP analysts in the description of their assumptions for the inflation projection) that the next few years will see favourable changes in the age structure of the Polish population, it remains an open issue what part of that potential increase in labour force will actually remain within Poland. Unfortunately, the population estimates do not take into account temporary migration. Estimates quoted by various sources mention 1-2 million people who have left the country in the last four years to seek employment abroad. This means that the working age population could have been depleted by some 4 to 8%.

First: return of migrant workers

The long-heralded mass return of emigrants, to be spurred by adverse (for them) changes in the exchange rate of the zloty and the approaching economic slowdown in Europe, actually falls within the terms of a sociological rather than economic analysis. The consequences of the appreciation of the zloty may turn out to be not as strong as often believed. The emigrants' current consumption is financed in the same currency in which they receive income, and therefore the effects of weakness of the euro or the pound are not so clearly visible to them (although they may also experience the effects of rising inflation in countries where they reside). While it is true that the value of savings accumulated by emigrants is diminishing when expressed in zloty, it is still hard to assess to what extent this may be reflected in a much increased number of returning workers. After all, a decision to go home does not directly compensate (at least in economic terms) for the depreciation of the currencies in which savings are allocated.

In our view, the stronger zloty will rather tend to discourage the new labour market entrants from emigrating and will have less impact on those who have already left Poland. More important for the decisions to return can be the deterioration of labour markets conditions in countries such as the UK or Ireland. It is true that layoffs usually affect immigrants stronger than local employees, and this development will probably be witnessed e.g. in construction. Nevertheless, not all sectors will be equally affected by the reduction of employment. Given the fact that a significant number of Polish emigrants perform rather simple jobs in food services, hotels and public utility companies (where employment changes are less cycle-dependent), we would not expect a massive wave of returns due to layoffs.

Instead, we would attach greater significance to sociological or even cultural aspects as far as decisions to return from emigration are concerned. Four years after Poland's accession to the EU is a sufficiently long period for such factors to start working. As each year the generations entering the labour market will be less numerous, the number of returning workers - at least in some job categories - may prove to be higher than the number of new emigrants. Taking also into account the effects of exchange rate changes, strong wage increases in Poland and deteriorating conditions in West European labour markets, we can expect the migration balance to improve but not to such an extent as to substantially change the situation in the Polish labour market. The consequences of returns will probably be more visible in sectors which are still affected by labour shortages (like construction).

Second: the 50+ programme

For a few months now, the medium-term forecasts of the situation in the labour market have tried to incorporate, to a lesser or greater extent, the effects of the governments' programme to promote labour market participation of people over 50. This programme assumes, among other things, partial financing from the state budget of social insurance contributions for such employees. What is also of great significance is the planned adoption of new regulations dealing with the issue of early retirement issue and the introduction of bridging pensions. However, the detailed proposals are yet to be proposed: the list of jobs that would give right to early retirement keeps expanding as various pressure groups try to secure best deals for professions they represent. The uncertainty about the government's programme can be indirectly confirmed by the fact that in preparing this report we have not managed to come across any official document presenting government's specific plans in that area.

Even if a large part of the proposed changes indeed came into force in 2009, the question would remain about their impact on the actual labour force. Reference to the experience of other countries, such as Germany, does not yield particularly optimistic results. Even if such programmes, predominantly based on "soft solutions", led to some statistical increase in the level of economic activity, this was often accompanied by an increase in the scale of unemployment. The increase in the number of jobs occupied by older workers was usually marginal. This suggests that the NBP analysts may be right when assuming that implementation of government's plans could lead to an increase in the unemployment rate next year. However, such a purely statistical increase would not reduce wage pressure. The German experience shows that only direct economic incentives (like a substantial reduction of social benefits or forcing the unemployed to accept lower-paid jobs offered by labour offices under the threat of the loss of unemployment allowance) result in a lasting improvement of the supply side of the labour market.

With the existing unemployment rate (9.6% according to the CSO data or 7.3% according to Eurostat), the pool of people ready to take up employment is virtually non-existent. This is indicated e.g. by NBP busi-

ness tendency survey – about 60% of enterprises still have difficulties in finding employees (in a large majority of cases – qualified ones), although only 7% mention the shortage of personnel as the main barrier to their activity (it has dropped from number one to number four on the list of such barriers). The problem is most acute in construction (it affects more than 80% of firms). The promotion of labour market activity of people over 50 years of age can solve such problems only to a small extent.

Hence, we are in a situation where the implementation of the government programme to promote the activity of people over 50 may paradoxically become one of the main causes of an increase in unemployment. The labour supply growth related to the return of migrant workers may prove to be a factor of only secondary importance to the mitigation of tensions in the labour market. What is more, the re-emigrants will probably come back with higher pay expectations than those without an experience of working abroad. If such expectations will not be satisfied, the returning workers, being more mobile by their very nature (at this point, sociological analysis elements should again be taken into account), may find it easier to take a decision to emigrate again. They may show a similar reaction in case of a significant increase in unemployment in Poland.

In our view, factors that will have strongest impact on changing the labour market situation (and, in particular, in determining inflection points) are of a cyclical nature. As such they are related rather to the demand side of the labour market. The forthcoming economic slowdown will naturally constrain employee fluctuation and hence reduce their bargaining power. In such a situation, pay rise demands can be justified mainly by a rising inflation. It cannot be ruled out that a deteriorating position of businesses operating under global competition will halt the fulfilment of even such limited demands. However, what we find to be a more probable scenario is that in the next several quarters wages will continue to respond with a delay to the ongoing change in the phase of the business cycle. Yet in a longer term, it seems inevitable that even after taking into account the important effects of wage levels convergence with other EU countries the growth in wages will be negatively affected by the economic slowdown.

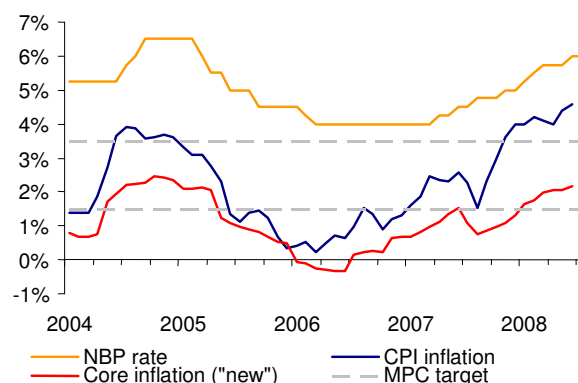
MONETARY POLICY

MPC decision as expected

As expected, the MPC did not change interest rates at its July meeting, leaving the reference rate at 6%. We also expect the NBP rates to remain unchanged in August. The statement released after the July meeting reiterated the main components of the risk balance from the previous MPC communique. The MPC still expects both a somewhat lower economic growth and the continuation of an unfavourable relation between wages and labour productivity. The MPC also pointed to the possibility of a further increase in supply-driven inflation and stressed the risk that inflationary expectations could become entrenched at an elevated level. However, the overall tone of the statement and its medium-term implications for monetary policy seem to be somewhat milder than in the previous month. The MPC expects that a weaker economic growth may contribute to reducing the wage pressure, which is now one of the key factors justifying a restrictive bias of the monetary policy. In a situation where the CPI index remains much above the upper bound of the range around the NBP inflation target (and keeps rising), the Council evidently felt obligated to emphasise the need to bring inflation in the medium-term back to target. However, the simultaneous reference to the persistence of inflationary processes and to the need of allowing more time for inflation returning to the target may suggest that in the coming months the MPC will adopt a somewhat less restrictive stance of monetary policy. A new feature that appeared in the Council's July statement is the clause that the fast rate of zloty appreciation observed over many quarters "in the recent period has most probably outpaced the appreciation of the equilibrium exchange rate". Putting emphasis on this fact may suggest that the MPC is either afraid of a correction of the zloty exchange rate (which would complicate its task to reduce inflation), or it believes that in view of the concerns about an economic slowdown some weakening of the Polish currency would be advisable.

In line with an established practice, some of the MPC members tried to explain, and expand on, the content of the official communiqué in a series of public statements. Prof. Czekaj, widely viewed as often holding the tie-breaking vote in the highly polarised Council, stated in a rather straightforward manner that further interest rate hikes will largely depend on the growth in wages and that he was expecting this growth to decline in the coming months. Czekaj also emphasised that some of the MPC members are very sensitive to the signals pointing to an economic slowdown, which makes them wait for

new data that would provide a more complete picture of the prospects of the Polish economy.



Lower oil prices, strong zloty and cyclical slowdown, and their possible impact on monetary policy

The CPI increase to 4.8% in July, the forecasts pointing to an even higher inflation in August, and the strong rise in households' inflationary expectations suggest that the MPC may consider introducing in the coming months (though rather not in August) yet another interest rate hike. These factors may become an important argument for the hawkish fraction of the MPC that is in favour of such a move in order to stabilise inflationary expectations and to strengthen the credibility of monetary policy.

However, the medium-term prospects of the Polish monetary policy seem to be increasingly influenced by the expected cyclical economic slowdown (mainly resulting from the significant deterioration in external conditions), the recent fall in oil prices (from 147 dollars per barrel to less than 120 dollars) and the expected decline (owing mainly to a good harvest in most European countries) in the growth rate of food prices. It is also quite evident that the MPC prefers to avoid excessively rapid interest rate changes. We believe that these factors, combined with what we expect to be a rather moderate pass-through of energy prices to other consumer prices, will lead to more optimistic assessments of the inflation prospects than those presented in the recent inflation report. We believe that after the third quarter, which its many uncertainties and the forecast peak in CPI inflation, the fourth quarter of this year may see much more favourable tendencies in the development of prices of the Polish bonds.

FISCAL POLICY

State budget performance: still not bad, but not as good as last year.

The preliminary results of the state budget after the first seven months of 2008 confirm our opinion that the implementation of this year's budget has been proceeding fairly well, albeit definitely worse than in the same period of last year. Instead of a surplus in excess of PLN 0.6 bn reached during January – July 2007, a deficit estimated at close to PLN 2.7 bn has been recorded this year. This difference results entirely from the July outcome being by about PLN 3.5 bn worse than in 2007. The poor results achieved last month can mainly be attributed to the lack of the NBP profit transfer (which amounted to nearly PLN 2.5 bn in July last year) and probably also to slightly lower dividend payments (about PLN 1 bn in July 2007). PIT refunds might also have been somewhat higher than in July last year. The performance of the state budget in July can be seen as a continuation of some disturbing tendencies that were already visible in the results for the first six months of this year. While the deficit level was almost the same during that period as in the first half of 2007, the balance recorded in each of the two quarters turned out to be completely different. This year, the Q2 outcome was by about PLN 7 bn worse than in the first quarter, whilst Q2 of 2007 saw an improvement of the balance by a similar amount.

The level of the state budget deficit in the first half of this year must have come as a rather unpleasant surprise to the Ministry of Finance. At the end of June, the Ministry signalled that it would be close to PLN 1.5 bn, but by mid-July this figure was revised up to PLN 3.4 bn. One of the reasons explaining this unusually large discrepancy could be a delay in recording the inflow of some funds from the European Union. The most disturbing feature in the implementation of this year's budget is the relatively low rate of growth in revenue. In the first seven months it was slightly lower than 11% (YoY), whereas the 2008 budget bill provides that that revenue in the whole year should increase by nearly 20%. The main "culprit" is the low degree of utilisation of EU funds (with less than one third of inflows planned for this year recorded as state budget revenue till the end of July), but the growth rate of indirect tax and customs duty revenues was also significantly lower than planned. The total budget revenue over the January-July period represented only 53.5% of the whole amount planned for this year, while in the corresponding period of 2007 the respective ratio exceeded 60%. Al-

though the revenue shortfall at the end of July amounted to less than PLN 3 bn, when compared with the schedule announced by the Ministry of Finance, we still believe that it may come close to PLN 10 bn for the whole year. In such a situation, the entire burden of ensuring an appropriate level of the deficit will rest on the expenditure side of the budget.

The state budget expenditures in the first seven months of this year were by nearly PLN 18 bn lower than planned for that period by the Ministry of Finance. The detailed data for July are not yet available but it is very likely that the largest spending shortfalls (relative to amounts planned for the whole year) continued to be recorded in capital expenditure (only 17.2% of the budgeted amount were spent in the first half of this year) and in spending on projects co-financed by the EU (less than 29% of the budgeted amounts was released by the end of June). It can be assumed, however, that the specific distribution over time of spending on those purposes has been taken into account by the MoF when it prepared its budget implementation schedule. This suggests that a significant part of the expenditure shortfall can be attributed to the substantial "savings" in spending on Social Insurance Fund subsidies and on the domestic debt service. Some part of the lower than planned spending on public debt service may turn at the end of the year into actual savings, but we do not believe it could amount to more than PLN 1bn. The level of such savings will be influenced by the increase in costs resulting from changes in the supply composition of treasury securities (increased supply of T-bills) and from higher interest rates as well as by the scale of benefits from bond conversion transactions. The largest impact on the implementation of state budget spending plans for the whole year will have the progress in releasing funds on projects co-financed by the EU funds. If the final ratio of actual to planned spending on this purpose proved to be close to the one achieved last year (which we find possible), the resulting "savings" could be as high as PLN 12 bn. As it was the case at the end of 2007, the Ministry of Finance will also be able to directly influence the final level of deficit by deciding (or not) on additional transfers to social security funds. The intention to transfer such funds has already been preliminarily signalled by MoF representatives, which suggests that no particular savings in subsidies to the social security fund should be expected (in 2007, they proved to be by nearly PLN 2.5 bn higher than planned in the budget).

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State budget results January - July 2008

	PLN m	% of plan 01-07.2008	% of plan 01-07.2007	YoY growth rate
Revenue, of which:	150943.8	53.5%	60.1%	109.6%
Indirect taxes	91597.6	55.6%	60.5%	109.3%
Excise duty	28381.6	54.4%	59.9%	104.8%
CIT	16406.8	60.4%	63.1%	117.9%
PIT	20655.4	57.1%	61.9%	105.6%
EU funds	11272.7	32.0%	38.0%	201.9%
Expenditure	153622.5	49.7%	52.9%	112.1%
Domestic debt service	9226.9	42.2%	48.9%	86.7%
Foreign debt service	4066.7	68.6%	65.3%	99.3%
Social Insurance Fund subsidy	15723.8	47.3%	52.9%	144.9%
Local government subvention	27109.4	66.6%	66.5%	110.8%
Deficit/Surplus	-2678.7	9.9%	---¹	----

¹ Surplus of PLN 615.6 m

Source: Ministry of Finance

MARKETS

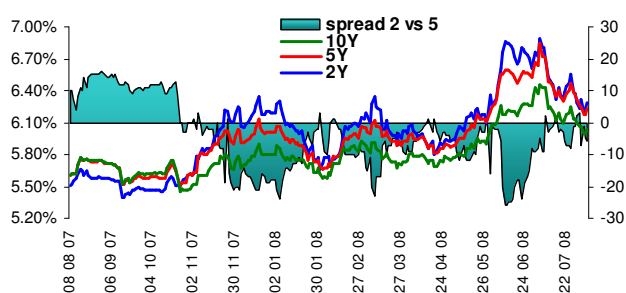
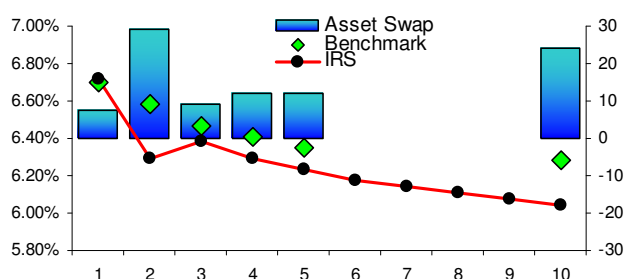
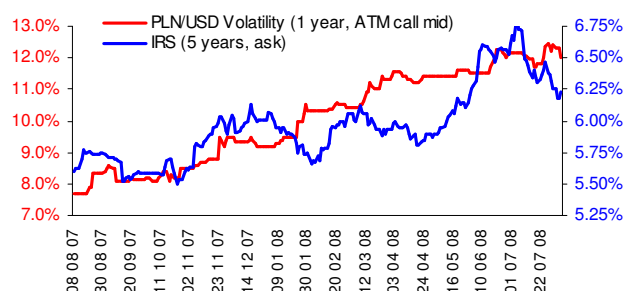
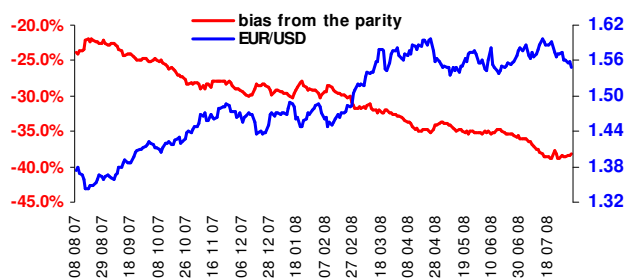
F/X

Strengthening of the zloty against the major currencies has taken a clear pause since mid-July, and at the beginning of August the zloty started to depreciate. In early July the EUR/PLN rate moved below 3.30, whereas the USD/PLN rate crossed the 2.10 barrier. The zloty was then supported by expectations of further interest rate hikes, boosted by the publication of June inflation figures. This pushed the zloty exchange rate to the levels of around 3.20 per euro and close to 2.00 per dollar, were the zloty found strong resistance.

The release of weaker data on real economy developments in June (mainly concerning industrial production) considerably mitigated expectations for further rate hikes, and contributed to a correction in the exchange rate correction. For the euro, it turned out to be slightly less pronounced (in the last week of August the EUR/PLN exchange rate stood at around 3.30), while the USD/PLN exchange rate moved to the 2.22-2.23 range. The weakening of the zloty against the dollar was also the result of the significant strengthening of the US currency against the euro after the recent series of central bank meetings and in view of rising recession risks in the euro zone (in the first half of August, the EUR/USD rate moved from 1.55 to 1.49).

Fixed Income

The weaker than expected growth in industrial production and the retail sales data for June, combined with dovish statements by some of the MPC members and the release of minutes from the previous MPC meeting, (having a similar tone) contributed to a decline in bond yields and IRS rates. That was reinforced by the Czech central bank's decision to cut interest rates, which altered the investors' sentiment for the entire CEE region. Consequently, the yield curve moved downward significantly. Compared with the beginning of July, yields in a 2-5 years tenor dropped by as much as 60-70 bps, and rates at the long end of the yield curve dropped by about 50 bps. The yield curve was steepening for yet another month in a row, which could be seen especially in the case of bonds. The IRS curve remained flatter, which was largely attributable to asset swaps exceeding 20 bps for a 10-year tenor.



August 2008

ECONOMIC AGENDA

	August 2008	September 2008	October 2008	November 2008	December 2008
CPI	13	15	14	13	15
Industrial production and PPI	20	18	17	20	18
Wages and employment in the enterprise sector	18	15	15	18	15
GDP estimates	29	-	-	28	-
Business tendency survey (CSO)	22	23	23	21	22
Money supply M3	14	12	14		
Balance of payments	12	12	13		
Core inflation	21	22	21	20	22
Official reserve assets	7	5	7		
MPC meetings	26-27	23-24	28-29	25-26	22-23
ECB meetings	7	4	2	6	4
Fed meetings	5	16	29	-	16

Source: CSO, NBP, ECB, Federal Reserve

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