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MONTHLY MACROECONOMIC REVIEW

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- The recent figures released by CSO, showing unemployment rate increased to 10.5% in January 2009, confirm yet again that the situation in the labour market is deteriorating much faster than expected. By the end of this year, the number of the unemployed may rise by about 500,000, and the unemployment rate may exceed 13%. Combined with the expected steep decline in wage growth, this will have highly adverse repercussions both for consumption and for the state budget.
- Reasons for the significant weakening of the zloty should be sought both in the dynamics of market processes and in factors of a more fundamental nature leading to a deteriorating relation between supply and demand in the FX market. What have also played a major role are the processes involved in resolving the currency option problem. We do not believe, however, that interest rate cuts made by the Monetary Policy Council should also be considered an important trigger accelerating the depreciation of the zloty. It is not the changes in interest rate disparity, but a growing risk aversion and deteriorating prospects for the Polish economy that seem to be the main driver behind the capital outflow from Poland. The supply of currencies in the FX market is limited, among other things, by falling export revenue, decreasing foreign investment, and a negative balance of EU transfers in the last quarter of the past year.
- The surplus of PLN 2.9 billion generated in January does not really provide grounds for optimism about this year's state budget performance, as it was mainly a one-off effect, attributable especially to a very high increase in excise duty revenue, and to the fact that some PIT payments were shifted from last December. On the other hand, the CIT and VAT revenue performance was very low, which can be viewed as the first sign confirming that the tax revenue growth rate adopted in this year's budget is overestimated by far. The weakening of the zloty will probably also make it necessary to earmark additional funds for servicing the foreign debt.

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KEY MACROECONOMIC INDICATORS

	Jul 08	Aug 08	Sep 08	Oct 08	Nov 08	Dec 08	Jan 09
GDP and Output							
GDP			4.8%				
Domestic demand			4.3%				
Private consumption			5.1%				
Investment in fixed assets, gross			3.5%				
Value added			4.7%				
in industry			3.1%				
in the construction sector			11.0%				
in the market services sector			5.4%				
Industrial production growth YoY	5.6%	-3.7%	6.8%	0.2%	-8.9%	-4.4%	-14.9%
Industrial production growth MoM	-3.4%	-8.1%	17.2%	2.9%	-13.1%	-3.7%	-5.8%
Retail sales YoY	14.3%	7.7%	11.6%	7.9%	2.7%	2.5%	1.3%
Retail sales MoM	1.8%	-3.9%	1.8%	0.1%	-9.0%	11.2%	-22.9%
Labour Market							
Average wage in the enterprise sector (PLN)	3228.98	3165.14	3171.65	3241.81	3320.94	3419.82	3215.75
Wage growth in the enterprise sector YoY	11.6%	9.7%	10.9%	9.8%	7.4%	5.4%	8.1%
Wage growth in the enterprise sector MoM	0.4%	-2.0%	0.2%	2.2%	2.4%	3.0%	-6.2%
Employment in the enterprise sector YoY	4.7%	4.2%	4.1%	3.6%	3.1%	2.3%	0.7%
Employment in the enterprise sector MoM	0.2%	0.0%	0.1%	0.1%	-0.2%	-0.6%	0.4%
Unemployment rate	9.4%	9.3%	8.9%	8.8%	9.1%	9.5%	10.5%
Foreign trade							
Current account (EUR)	-879	-1 300	-1 881	-2 012	-1 637	-1920	
Trade balance, transaction-based (EUR)	-1 635	-1 329	-1 249	-1 526	-1 519	-1 688	
Exports, transaction-based YoY (EUR)	22.8%	9.4%	20.9%	0.5%	-11.3%	-16.4%	
Imports, transaction-based YoY (EUR)	22.5%	17.8%	21.0%	4.8%	-8.3%	-13.5%	
Current account (% GDP)	-4.9%	-5.0%	-5.2%	-5.3%	-5.5%	-5.4%	
Prices							
CPI MoM	0.0%	-0.4%	0.3%	0.4%	0.2%	-0.1%	0.5%
CPI YoY	4.8%	4.8%	4.5%	4.2%	3.7%	3.3%	3.1%
Net inflation YoY	2.2%	2.7%	2.9%	2.9%	2.9%	2.8%	2.6%
PPI MoM	0.0%	0.2%	0.2%	-0.3%	-0.5%	-0.5%	1.7%
PPI YoY	2.3%	2.0%	2.1%	2.4%	2.2%	2.6%	3.0%
Money aggregates							
Money supply M3 (PLN B)	616.1	628.6	630.5	637.4	648.3	666.3	669.0
Money supply YoY	16.8%	16.8%	17.3%	17.6%	18.1%	18.6%	17.7%
Household loans YoY	30.5%	31.5%	33.5%	40.4%	37.9%	44.6%	45.3%
Corporate loans YoY	23.5%	25.2%	24.5%	26.8%	26.9%	28.9%	27.9%
Household deposits YoY	24.7%	23.8%	24.1%	24.4%	25.0%	26.4%	24.2%
Corporate deposits YoY	7.0%	3.1%	7.1%	4.3%	2.6%	4.0%	4.3%
Forex Rates							
EUR/PLN rate (end of month)	3.20	3.35	3.41	3.63	3.76	4.17	4.44
USD/PLN rate (end of month)	2.05	2.27	2.37	2.85	2.92	2.97	3.46
Interest Rates							
NBP reference rate	6.00%	6.00%	6.00%	6.00%	5.75%	5.00%	4.25%
Lombard rate	7.50%	7.50%	7.50%	7.50%	7.25%	6.50%	5.75%
Deposit rate	4.50%	4.50%	4.50%	4.50%	4.25%	3.50%	2.75%
WIBOR 3M	6.56%	6.50%	6.63%	6.85%	6.56%	5.88%	4.86%
2Y bond yield	6.53%	6.35%	6.23%	6.86%	5.87%	5.23%	4.81%
5Y bond yield	6.31%	6.17%	5.99%	6.82%	5.75%	5.25%	5.08%
10Y bond yield	6.25%	6.05%	5.82%	6.60%	5.89%	5.37%	5.49%
Global Economy							
Eurozone inflation (YoY)	4.1%	3.8%	3.6%	3.2%	2.1%	1.6%	1.1%
Eurozone GDP (YoY)			0.8%			-1.2%	
ECB basic rate	4.25%	4.25%	4.25%	3.75%	3.25%	2.50%	2.50%
US inflation (YoY)	5.6%	5.4%	4.9%	3.7%	1.1%	0.1%	0.0%
US GDP (QoQ ann.)			-0.3%			-3.8%	
Fed Funds target rate	2.00%	2.00%	2.00%	1.00%	1.00%	0.00-0.25%	0.00-0.25%

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

POLISH ECONOMY

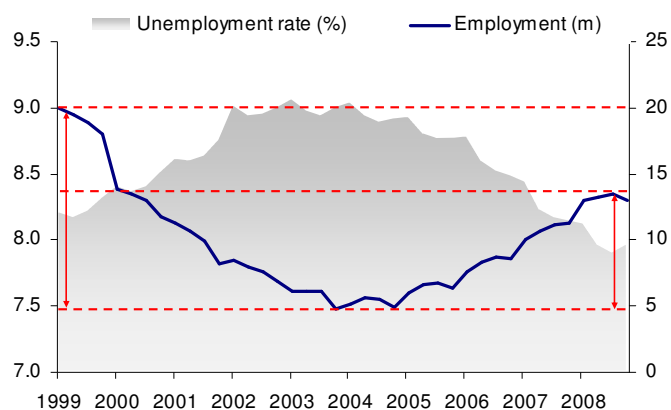
Labour market faces a slowdown

Official CSO figures have confirmed prior estimates of the Ministry of Labour and Social Policy indicating that the unemployment rate increased from 9.5% at the end of 2008 to 10.5% in January this year. This pessimistic sign is also confirmed by data on employment in the enterprise sector. In the analysis below, we are trying to present a potential scale of the deterioration in the labour market and its consequences for the macroeconomic situation and the state budget.

The number of the unemployed increased in January by 160,000, much more that could be attributed to seasonal factors (by comparison, in January 2008 unemployment increased by 60,000). In December last year, employment in the enterprise sector dropped by over 30,000, which also deviates from the seasonal pattern. A small increase in employment reported in January (by about 21,000) must not be compared with the results for the previous month, as the figures are distorted by the change of the sample enterprises included in the survey, which always takes place at the beginning of the year. It can be estimated that disregarding this factor the number of jobs in the enterprise sector dropped by about 50,000 in January. In fact, layoffs affect nearly all sectors: industrial manufacturing, trade and services. In manufacturing, all sections reported employment reductions already in December 2008, and in the case of as many as 13 sections they exceeded 1% MoM, reaching 4% MoM in extreme cases. The decline in employment is particularly visible in export-oriented enterprises, including the electromechanical, automotive, metal and furniture industries.

As exporters have a significant share in total employment, layoffs in those enterprises will be particularly painful for the entire labour market. As already mentioned, similar tendencies are also observed in trade and services. In the former sector, the decline in employment affected wholesale, and it had been partly offset by an increase of employment in retail. Yet the buffer effect will weaken with a slowdown in retail sales. In services (the part for which monthly CSO figures are available, which do not include e.g. financial services) employment drops were reported in business and property services. Given the growing number of enterprises forced to seek dramatic savings, the tendency may aggravate. The figures on group layoffs notified to labour offices and various press reports indicate that the layoff problem also affects the financial sector.

Changes in the labour market become disturbingly reminiscent of the 1999-2001 period. At that time, employment in the national economy dropped by about 1 million. Despite the fact that almost 400,000 people retired at the same time on account of age or disability, the increase in the number of the unemployed exceeded 1 million. This was also due to demographic factors – as the baby-boomers of the late 1970s and early 80s were entering the labour market. The impact of demographic tendencies was even stronger in the years 2002-2004, when signs of economic recovery were already visible – the unemployment rate increased to 20%.



2001 with the present situation, it should be borne in mind that they were accompanied by a deep restructuring of employment in enterprises, leading to an increase in unemployment which was not related directly to the business cycle. What may directly confirm the restructuring changes is the fact that the decline in employment continued in 2002-2003, when the Polish economy already started to recover. In total, during 1999-2003 the number of the working population (in entities employing more than 9 people, excluding agriculture and the uniformed services) dropped by about 1.5 million, reaching a low of about 7.5 million. By comparison, at the end of 2008 the number could be estimated at 8.3 million (the last figures are available for Q3 2008).

In this case, a comparison of employment levels may provide no less information than a comparison of growth rates. If the scenario for 2000, the first year of the slowdown, when the negative employment growth rate reached 7.5%, were to be repeated in 2009, this would mean a decline in employment to 7.7 million people. This level is very close to the 2003 low, at which the four-year employment decline period ended, with nearly 40% of the overall job reduction in 2000. Such a rapid decline in employment seems unlikely in 2009 for two reasons: a higher potential

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product of the Polish economy and restructuring changes in enterprises. Taking those factors into account, the drop in the number of jobs this year can be estimated at about 300,000-350,000, which still means a negative employment growth rate of about 3.5-4.0%. A conservative correction of the figure by entities employing fewer than 9 persons (about 40% of the total working population, including also farmers and uniformed services) shows that about 400-500,000 people face the threat of unemployment.

The retirement of older employees in 2009 will not be capable of cushioning those changes. According to the CSO's latest demographic forecast, the size of the population of productive age will actually not change in 2009, whereas as a result of statutory amendments the number of persons eligible for early retirement has decreased. The impact of migration remains an open question. Recession in the Western European countries will probably result in a decline in the negative migration balance, but the fact that the situation in Poland is not much better and the persisting differences in wage levels (recently aggravated by a steep decline of the zloty exchange rate) may prevent striking a positive balance. What is more, people with more years abroad may be eligible for higher unemployment benefits if they stay at the existing places of residence instead of returning to Poland.

Given that the impact of re-emigration on unemployment growth will remain limited, and the total increase in the number of the unemployed will not be significantly greater than 500,000, it can be estimated

that the unemployment rate will rise to about 13% at the end of 2009. While the level does not seem very high when benchmarked against the 1999-2004 experience, a rapid growth in the number of people without permanent jobs leads to the risk of a significant increase of burden on public finance. It can be estimated that the increase in the number of the unemployed by 500,000 will lead to higher spending by about PLN 2-3 billion on allowances alone. Other costs include about PLN 3-4 billion in health and pension contributions financed from the state budget. At the same time, budgetary revenue from direct taxes will shrink substantially.

The prospect of a strong growth in unemployment makes the thesis on a stabilising effect of consumption on economic growth (which we have already noted in an analysis provided in the previous issue of the Macroeconomic Review) highly questionable. In the face of a growing number of layoffs, there is no doubt any more that this year will see a considerable decline in the wage growth rate. With an anaemic growth in wages and possible employment reduction by 3.5-4.0%, the wage growth rate may even fall below zero, additionally limiting an increase in consumer spending (which will have an unfavourable effect on budgetary revenue from indirect taxes). We believe the expected developments in the labour market and its adverse impact on the consumption level are a major factor indicating that the real GDP growth rate in Poland may be significantly lower this year than 1.7%, the level provided for in the government's "pessimistic" scenario.

MONETARY POLICY

Mysterious slump of the zloty

The primary sources of the depreciation of the zloty witnessed since August 2008 and rapidly accelerated over the recent weeks should be sought mainly in the economic downturn in Poland, in the region, and around the globe. The zloty has distinct features of a cyclic currency, which strengthens as prospects of economic growth improve in Poland (and in the region) and as rates of return on investment in Polish assets (including equity securities and bonds) increase, and it loses value as the growth prospects of our economy deteriorate.

Many economists have recently been trying to superimpose additional factors on that basic mechanism to account for the suddenness itself of the zloty depreciation. It is worth noting that the zloty weakening scale over the past 12 months is comparable only with the loss of value by currencies such as the Russian Rouble or the Icelandic Crown. One of the rather common hypotheses focuses on adverse effects of a narrowing interest rate disparity between Poland and the Eurozone. In this context, opinions are even voiced that the NBP interest rate cuts initiated last November were too deep and/or implemented too fast (total reduction reached 200 bps).

Those holding such opinions probably do not make them on the basis of an analysis of the mechanisms underlying the financial markets and the development taking place in those markets. Firstly, already in the last months of the past year the markets themselves accepted the interest rate cuts as a natural way of balancing the Polish economy and a measure conducive to its return onto a faster growth track. Secondly, the recent weakening of the zloty should be considered in the context of the situation throughout the region. Hence events such as the devaluation of the Russian Rouble or the fire-sale of the Forint dictated by concern about the stability of the Hungarian financial system might have been of key importance. For most foreign investors, risk assessment is based on regional baskets. A rapid loss of value by one currency in such a basket and capital losses incurred in a country are signals prompting the reduction of commitment in the whole region (in the case of popular dynamic strategies, basket re-weighting is almost automatic). Owing to high liquidity of the Polish market, foreign investors find it easiest to withdraw capital from Poland (which is virtually impossible to do e.g. in the Baltic States). We believe this mechanism can largely explain the recent weakening of the zloty.

Certainly, in looking for the reasons behind the weakness of the Polish currency, one should not

disregard factors of a more local nature, such as fast-growing decline in economic activity in Poland, uncertainty about further developments in public finance, and the emerging questions about the stability of the Polish banking system. As the zloty sets new records against the euro (and the Swiss franc), the probability of negative scenarios for the banking sector increases. The issues of particular significance here are currency loans and currency options, and their potential impact on an increase of credit risk. Especially the issue of option contracts made on a large scale with companies could have significantly contributed to active speculation aimed at the weakening of the zloty, additionally augmented by analysts' recommendations that were increasingly negative for the Polish currency. The game was about piercing successive technical levels at which customer stop loss orders are triggered (forced foreign currency buy orders). The speculators were sure of their success owing to the shallowness of the market (i.e. low liquidity) and decreasing supply of foreign currency from export, direct investment, and even EU funds (three of the last four months of the past year saw a negative balance of EU transfers). Hence they managed to sell the euros bought at lower prices to customers forced to close/secure option contracts issued earlier.

We are far from attaching too much importance to the role of the difference in interest rates between Poland and the eurozone, which periodically narrows down, while standing at an average of 225 bps. Given the present volatility of the zloty and prospects for hefty return on capital, the costs of financing long positions in a foreign currency (investors must speculatively borrow the Polish currency at a higher rate to buy the euro) are almost negligible. While the difference in interest rates is a factor that affects the development of exchange rates in a longer term, given the present exceptional situation in the global markets (strong risk aversion and outflow of capital to developed countries), this factor is not dominant at the moment. It is worth noting that the carry trade transactions, which used to be very popular until recently, are usually made on a larger scale with a lower volatility of exchange rates and a clearer trend of their development. It can be expected that only a short-term rate level close to (or exceeding) 10% would provide a strong incentive for investors to buy the Zloty.

ERM2 – the government's declarations and uncertainty about the NBP's stance

At a point when numerous economic commentators had already lost all hope for the Zloty to reverse its depreciation trend, the Polish government and repre-

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representatives of the main coalition party unexpectedly came to rescue. First prime minister Donald Tusk announced an exchange of EU funds on the FX market when the rate overshoots the magic borderline of 5 zlotys per euro. Yet the declaration did not impress the market much, as the potential supply of the euro from that source appeared rather poor compared with demand arising for instance from currency options. But when the chairman of the Civic Platform parliamentary club Zbigniew Chlebowski advised (a bit prematurely, as it later turned out) that the government had already started negotiations with the European Commission on Poland's accession to ERM2, the market started to interpret those apparently unconnected pieces of information as something of a well-thought-out strategy in defence of the zloty. Speculative investors were probably alarmed by the possibility of measures taken jointly with the ECB in a not-too-distant future, aimed to constrain changes in the exchange rate of the zloty, which would not arise from fundamentals. In such a situation, the exchange of even a small amount of euros on the market by the state-owned BGK bank proved to be a highly effective step, which helped to strengthen the Polish currency by almost 3%.

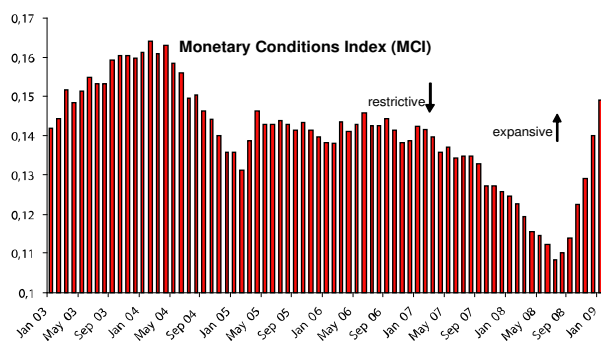
It seems that at this point a fundamental debate on whether the cost of staying in ERM2 under conditions of economic slowdown and highly unstable markets will not be too high, recedes slightly into the background, while the effectiveness of possible currency interventions becomes a key issue.

While there is still a chance to adopt the Euro within the timeline set by the government, the road to that target seems very bumpy. Apart from doubts about the possibility of meeting the criterion of exchange rate stability, what seems to be the main risk factor is the situation in public finance and a high probability that the fiscal deficit will again exceed 3% of the GDP by the end of this year. Given the expected possibility of deflation in a large part of the eurozone, meeting the price stability criterion may also prove to be a problem. Admittedly, there are opinions that owing to concern about the stability of the banking systems in the CEE countries and a negative impact of possible difficulties in the area on the situation of the banking sector in the eurozone, the EU and ECB authorities will look more favourably on efforts made by the new member states to join the common currency area. In our opinion, however, one should have no great expectations in this respect, as for the time being nobody is announcing amendments to the Maastricht Treaty, and the last decision of the European Commission announcing the initiation of the excessive deficit procedure against six member states makes it quite clear that the EU authorities still attach significant weight to respecting the rules of fiscal discipline.

An interesting MPC meeting

The sharp weakening of the zloty must have affected sentiment among the Monetary Policy Council members. It seems that the number of the MPC members truly concerned about the developments in the FX market may have increased. The situation is additionally aggravated by a rather inconsistent approach to the issue of currency options – the central bank head seemed to rule out such interventions (at least until recently), while some of the Council members take a more open position on the matter, and the head of government announces an exchange of EU funds on the market, stating that the borderline of 5 zlotys per euro is the level the government would like to defend.

In our opinion, all that confusion and uncertainty about the nature of the weakening of the zloty (while most of the MPC members do not attribute this to interest rate cuts, the Council finds it rather difficult to identify the reasons for the latest developments in the FX market) significantly narrows down the scope for action by the MPC. Some of the MPC members are already openly speaking about the risk of interrupting the disinflation process and an excessively expansive monetary policy (referring to a step increase in the MCI Index). In fact, the rapid weakening of the zloty will leave its mark on the forthcoming inflation readings (first of all, fuel prices will increase, while the weaker zloty will have a lesser effect on demand side of the basket). Yet we are not expecting core inflation decline to stop with energy and food prices excluded.



In the face of highly unfavourable prospects of the Polish economy (the new NBP projection also indicates a further decline in the GDP growth rate), the dovish wing of the MPC may become even more convinced about the need of further easing of monetary policy. It also seems that further reduction of interest rates, owing to the fact that household and corporate loans are linked to the Warsaw interbank rate, may soon reduce credit servicing costs. It is but obvious that borrowers are looking forward to such support and that it would also contribute to increased consumption, which is usually credited with a key role in maintaining the GDP growth rate.

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Recent strengthening of the zloty, combined with deteriorating macroeconomic figures and the development of the new inflation projection still prompted the MPC to reduce the prime rate by 25 bps on the February meeting. It should be stressed, however, that the situation is highly dynamic and changes in

the zloty exchange rate may have a strong impact on the MPC decision in March as well.

FISCAL POLICY

Surplus in January, deficit in February

The surplus of PLN 2.9 billion reported in January provides no particular ground for optimism about this year's state budget performance. The main source of the surplus was a rapid increase of excise duty revenue (by over 90% YoY), which seems to have resulted primarily from decisions taken by tobacco companies. This situation can hardly be hoped to arise again in the months to come, as over the entire year excise duty revenue is to increase only by 15% (which may still be too optimistic assumption). What may also prove impossible to achieve again in the following months is a decent growth rate of PIT revenue reported in January, as the result was probably distorted by the fact that some of wage and bonus payments were moved from December to January in anticipation of the tax rate reduction. The good performance of the budget in January was also attributable to some extent to a rather small amount remitted to the Social Insurance Fund, but as the surpluses held by the SIF in bank accounts are depleted, and due to the expected decline in the growth rate of social security contributions, the amount of transfers

to the SIF will have to be increased gradually. What seems to indirectly confirm the strong influence of one-off factors on the budget performance in January is both the emergence of a negative balance of the state budget in February, already preliminarily announced by the Ministry of Finance, and the efforts made by the government to reduce fiscal expenditure. While a single month's performance is hardly enough to provide a basis for any solid judgment, both the miserable volume of CIT revenue (-46% YoY in January, while an over-optimistic growth of nearly 22% was planned for the whole year), and a poor VAT revenue growth rate, are disturbing signs. The latter increased in January by less than 2% YoY, compared with a 13% growth YoY in January 2007 and the planned increase of proceeds from the tax by as much as 16%. As far as expenditure is concerned, what is worth noting is a very strong (more than 33% YoY) growth in the cost of public debt service. In the case of foreign debt, it arose solely from the weakening of the zloty. If the exchange rate of the Polish currency remains low, even the increase of expenditure on foreign debt service by more than 20%, planned for this year, will prove by far insufficient.

State budget performance in January 2009

	PLN m	% of plan	YoY growth rate
Revenue, of which:	27670.4	9.1%	22.4%
Indirect taxes	22293.1	12.5%	25.8%
Excise duty	9043.2	15.6%	93.0%
CIT	303.5	0.9%	-46.3%
PIT	3016.9	7.5%	10.9%
EU funds	215.8	0.6%	-34.7%
Expenditure	24756.0	7.7%	36.2%
Domestic debt service	1326.5	5.0%	53.4%
Foreign debt service	1222.6	19.8%	15.4%
Social Insurance Fund subsidy	1250.0	4.0%	247.2%
Local government subvention	6073.3	13.4%	16.1%
Deficit/Surplus	2914.4	---	-34.3%

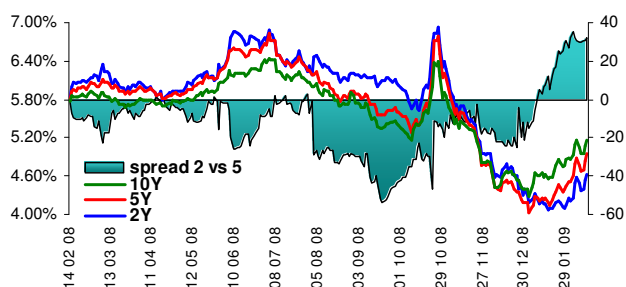
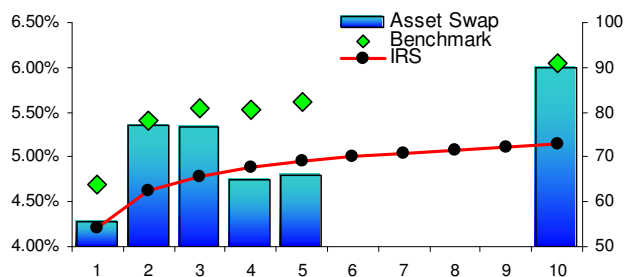
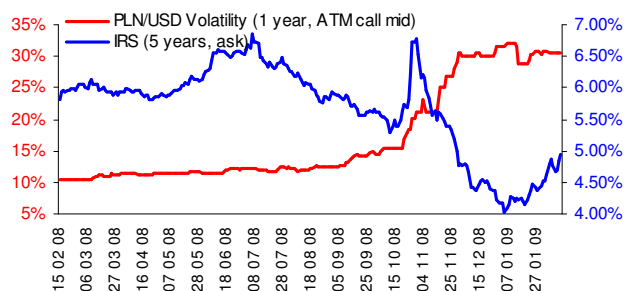
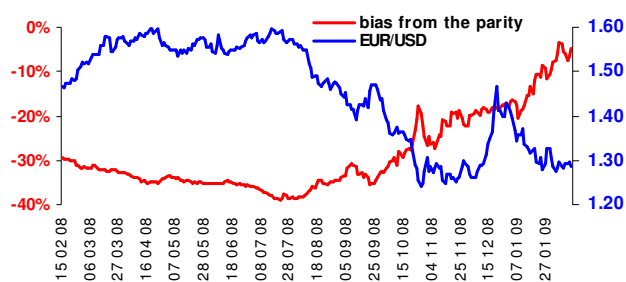
Source: Ministry of Finance

EUROMONITOR

		Convergence criteria *	Exchange rate and the 2.5% and 15% fluctuation bands around the ERM2 central parity over the last 2 years (in the case of states outside the ERM2 – around the rate as of the beginning of the observation period)
Poland		<ul style="list-style-type: none"> • HICP inflation (12-month average): 3.9% (January 2009) • Long-term interest rates (12-month average): 6.21% (January 2009) • Budget deficit: <3.0% of GDP • Public debt: < 60.0% of GDP • ERM2 membership: 2 years 	
		<ul style="list-style-type: none"> • HICP inflation (12-month average): 4.1% (January 2009) • Long-term interest rates (12-month average): 6.01% (January 2009) • Budget deficit: 2.5% of GDP (2008) • Public debt: 45.5% of GDP (2008) • ERM2 membership: no 	
		<ul style="list-style-type: none"> • HICP inflation (12-month average): 5.7% (January 2009) • Long-term interest rates (12-month average): 4.60% (January 2009) • Budget deficit: 1.2% PKB (2008) • Public debt: 27.9% of GDP (2008) • ERM2 membership: no 	

*The Eurozone convergence criteria were set in the Treaty of Maastricht of 1992 and encompass five areas: price stability (HICP inflation in the 12 months before the qualification period cannot exceed the average of the three best-performing EU member states by more than 1.5 percentage points), long-term interest rates (the yield on 10-year fixed-rate treasury bonds cannot exceed the average for the three EU states with the lowest inflation rates), public finance stability (no excessive deficit procedure, which requires the general government deficit to be maintained below 3% of GDP and public debt below 60% of GDP), exchange rate stability (at least two years in the ERM2 system without any serious tension, i.e. within the +/-15% fluctuation band) and legislation compliance (legal adjustment to the EU requirements). **In our summary**, we are monitoring, on an ongoing basis (as data is released by Eurostat), the extent to which the first four criteria are satisfied by Poland, the Czech Republic and Hungary. The European Central Bank and the European Commission prepare convergence reports at least once every two years, assessing the extent to which the convergence criteria, which constitute grounds for the EU Council decision giving consent to a state's accession to the Eurozone, are satisfied.

MARKETS



F/X

The recent weeks have seen an intensive depreciation of the zloty against the main currencies. From the beginning of February, when the EUR/PLN rate stood at about 4.40 and the USD/PLN rate at 3.45, the Zloty has weakened relative to the Euro and the Dollar by more than 10%. At a peak moment, the EUR/PLN rate reached 4.92 and it came close to the historical high of 2004 at 4.94. The government's suggestion to proceed with a currency intervention at PLN 5.00 per euro, the announced accession to ERM2 without amending the Constitution, and initiating an exchange of EU funds into zlotys on the interbank market prevented a test of that boundary level and helped to strengthen the zloty to some extent. However, such measures may prove insufficient to ensure a sustainable change in the mid-term declining trend of the zloty. A coordinated action by the central banks of Poland, the Czech Republic and Hungary has become a new feature, but is yet too early to assess to what extent it will affect the situation in the currency market. It should still be taken into account that the exchange rate of the zloty will fluctuate strongly.

The weakness of the zloty has contributed to a significant correction of expectation concerning further reduction of the NBP interest rates. However, the probable limitation of the scale and pace of those reductions may contribute to stopping the depreciation of the zloty only to a limited extent. In addition, our currency is not helped by the weakness of the euro against the dollar (the rate dropped from 1.30 at the beginning of February to about 1.25 in the middle of the month).

Fixed Income

The outflow of foreign capital from Poland has led to a significant increase of yields on domestic debt securities along the entire yield curve. Yields on short-maturity securities increased the most – in the case of the 2-year bond temporarily by more than 100 bps, to about 5.90%. It is the highest level since the end of last November. To a lesser extent the yield growth concerned securities at the long end, which had previously already stood relatively high. Consequently, 10-year bond yields reached 6.00%, and the yield curve temporarily flattened.

The yield levels, especially at the short end of the curve, seem to us to be high even with the present level of the NBP intervention rate, hence we find their correction and return to a steeper curve pattern probable.

February 2009

ECONOMIC AGENDA

	February 2009	March 2009	April 2009	May 2009
CPI	13	13	15	14
Industrial production and PPI	19	18	20	20
Wages and employment in the enterprise sector	17	17	17	19
GDP estimates	–	2	–	–
Business tendency survey (CSO)	20	20	22	22
Money supply M3	13	13	14	14
Polish balance of payments	12	13	14	15
Core inflation	–	20	22	21
Official reserve assets	6	6	7	7
MPC meetings	24-25	24-25	28-29	26-27
ECB meetings	5	5, 19	2	7
Fed meetings	–	17	28-29	–

Source: CSO, NBP, ECB, Federal Reserve

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