



## POLAND WEEKLY REVIEW

### MACROECONOMICS AND FINANCIAL MARKETS

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**MM  
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### PREVIEW: The week of September 7<sup>th</sup> to September 13<sup>th</sup>

Indicator	Date of release	Period	BRE forecast	Con-sensus	Last	Comment
C/A	Sep 12	Jul	-1253 EUR mn	-	-1182	We expect the trade gap to widen in the mid-term.
CPI inflation	Sep 13	Aug	1.8% y/y	1.9%	2.3%	Drop of inflation owing to high base effect on food prices. We expect the net core inflation to edge up to 1.6% y/y.

## In Focus / Macroeconomics

*Fiscal policy will extensively stimulate consumption demand in 2008*

### An explosive mixture – snap elections and budgeting for 2008

On the political front, we will most likely see the dissolution vote take place on 7 September. Thus, early elections could be called for as soon as late October. The market will favour the PO as the ruling party, though some of the latest polls indicate that PiS has overtaken PO to as the leader. Early elections coinciding with budgeting for the next year have already proven to be a quite explosive mixture – the Parliament may accept social spending proposals which, in more normal circumstances, would have no chance of even being voted on. Thus, on Wednesday, Parliament accepted a controversial proposal concerning extensive pro-family tax exemptions put forward by the right wing Prawica RP. These exemptions will lower the budget revenues by total of 6.5 PLN bn in 2008. Note that early this week the government proposed other tax exemptions which may cost the central budget more than 28 PLN bn over the next seven years. All this will clearly lead to a higher budget deficit in 2008, though, for the moment, we maintain our view that the nominal limit of 30 bn PLN will be not breached. Significantly, the tax rate cuts already implemented (cost of 18 PLN bn in 2008) and the scheduled indexation of pension benefits (cost of 5.7 PLN bn) will extensively stimulate consumption demand, eventually exerting more pressure on prices and, consequently, on the interest rate policy. In our opinion, the increasingly expansive fiscal policy in 2008 may also limit the chances of lowering the tax rates scheduled for 2009.

While the expenditure side of the budget has yet to be fully determined, as far as the revenue side is concerned, the Ministry of Finance has already taken steps and obtained the first estimates. These estimates, though still undisclosed, will not - judging by remarks made by the Finance Minister - be affected by a minor change in the budget macro assumptions; the FinMin has recently downgraded GDP growth from 5.7 to 5.5% next year. The high base from this year – revenues are expected to be 25% higher than in 2006 – will leverage the next year revenues leaving much space for increased spending. However, we foresee little chance of any fiscal reform in the midterm and, consequently, permanent, long-term improvement in the budget deficit ahead of adoption of the euro.

#### MEDIUM-TERM FORECATS

Indicator	2006	2007	2008
GDP y/y (%)	6,1	<b>6,4</b>	5,7
Inflation rate (%)	1,0	2,4	3,2
Current account (% of GDP)	-2,1	-4,0	-4,8
Unemployment rate (end-of-year)	14,9	10,3	9,8
NBP repo rate (end-of-year)	4,00	5,00	5,50

Source: GUS, NBP, BRE Bank, **bold** change on last week

## Fixed Income

*Time to pay*

Last week was rather uneventful on the PLN market. Rates stayed in very tight range, and activity was very low. We think that neither current rates level or shape of the curve make any sense at all. Curve is virtually pricing in one hike by RPP within 3 months time and then staying on hold for the rest of the cycle with small probability of getting to 5.25 in more distant future. Well ... we disagree and disagree heavily. We see CPI pressure building much bigger than expected and having much bigger influence next year than anticipated. We see imbalances growing in especially on the supply side, where shortages are more than visible. Demand side will be stimulated next year by enormous fiscal spending: lowering pension fee, additional money on wages for all the budget sector and the early retirement bill. Additionally this week parliament voted extra 2.3 billion \$ tax relief for families with kids. With fuels staying and food prices climbing as it happens to poultry and grains, plus fruits and compulsory hikes of gas prices and excise tax for cigarettes,

car insurance ect the effect on the CPI can be surprisingly big. Till now, RPP was hiking on the fear of inflation rising in the future, till now CPI is still stable in RPP comfort range, imaging what will happen when cpi goes towards 3.5%. There is only one strategy now, and timing is indifferent as curve virtually cannot get any lower. We think it is time to pay rates in Poland.

**RECOMMENDATION:**

Pay 6x9, Pay 2y, Pay 5y

**AUCTIONS**

	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	4,208%	16-01-06
26 Week T-bills	-	-	3,943%	24-04-06
52 Week T-bills	17-09-07	-	5,084%	03-09-07
2Y T-bond OK1209	03-10-07	-	5,327%	05-09-07
5Y T-bond PS0412	19-09-07	-	5,480%	20-06-07
10Y T-bond DS1017	10-10-07	-	5,658%	11-07-07
20Y T-bond WS0922	12-09-07	-	5,309%	14-03-07

**Money Market**

*Cheap end of the reserve*

*Positive GDP figure and CPI forecast without any echo*

*T-bills yields up during the tender*

Extremely cheap end of the reserve. During last two days one could observe deposit in the central bank of 2 and 4 billion pln. But watching our forecast gave enough time to hedge any long cash positions. The new reserve started quite as usual. Open market operation amounted to 21 billion pln, which was just enough to square the market. Cost of carry stabilized around 4.8% and similar levels should also be seen next week.

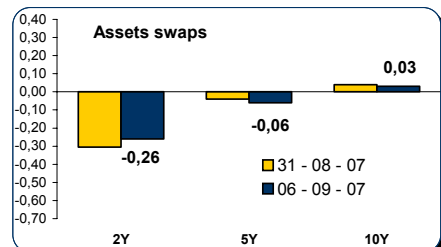
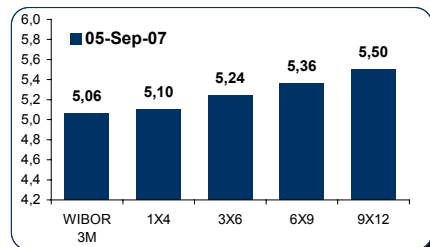
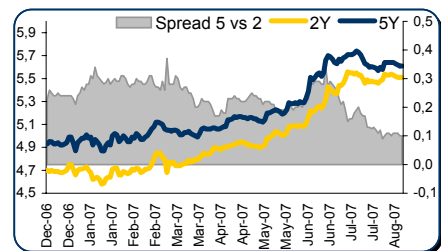
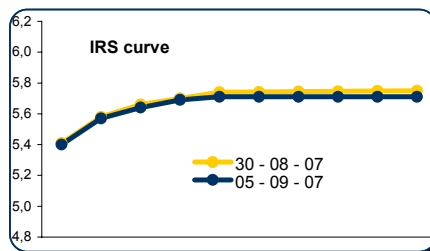
As for longer terms not too much action. Very sound GDP figure (lower then expected consumption plus high investments) was a positive signal but hardly noticed by the market participants. Another positive figure was the CPI forecast by the FinMin, which showed 1.9%. Again it seems that everyone was prepared for this. To sum up, despite of the quite bullish figures market is frozen; hence our best guess is that any bad figure or event may push the curves significantly up.

T-bills average yield finally up during the tender. The new level of the 52-week benchmark is 5.08% up from 4.82%. It does not change much. Those papers are still expensive.

**RECOMMENDATION:**

Pay 9M, sell 3M.

**FIXED INCOME & MONEY MARKET CHARTS**



## Foreign Exchange

*Zloty consolidating*

Zloty was moving in the very narrow range since next week. We are boxed between 3, 8050 /3, 8100 support zone and 3, 8350/3, 8400 resistance. The reason behind that was of course related to improving global sentiment, and decreasing realized volatility on the major crosses, especially EUR/JPY.

*Volatility lower*

The EUR/PLN volatility was sold off the highs 6,3% on 1 year to 5,8 % given 1 year and 6 months sold at 5,75 % on the wave of fresh optimism. And the EUR/PLN run stabilized at 5,7/6,1 the curve ( 1month till 1 year)

**RECOMMENDATION:**

:

*Zloty in side trend*

Spot:  
Main supports / resistances:  
EUR/PLN: 3.7950, 3.8100 / 3.8400, 3.8550  
USD/PLN: 2.7750, 2.7900 / 2.8250, 2.8500

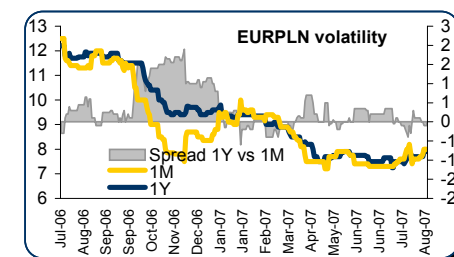
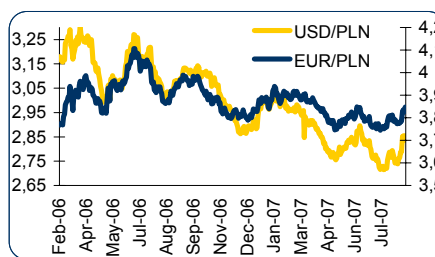
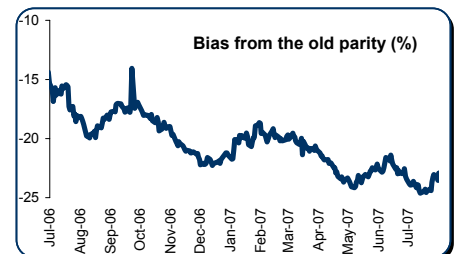
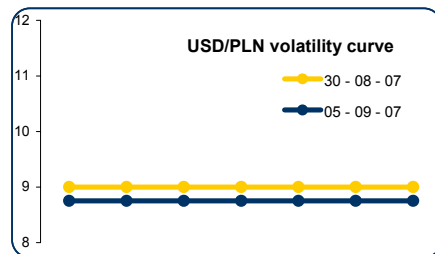
EUR/PLN is in the side trend, the last days price action is really discouraging us from any directional view. The USD/PLN cross is being much more interesting and one can try to play the range 2,7800/2,8250 but is advisable to remember that USD/PLN is very strongly negatively correlated to EUR/USD.

*Keep short vega*

Options:

We stick to our last recommendation, keeping short vega in EUR/PLN. With the better global risk appetite conditions we may see the test of the downside, targeting 5,5 % mid vol on 1 year. We also recommend buying same short gamma on USD/PLN as a bet for Friday's payrolls (the usual market mover).

**FX CHARTS**



**MARKET PRICES UPDATE****MONEY MARKET RATES**

Money market rates (Closing mid-market levels)						
date	3M		6M		1Y	
	FXSW	WIBOR	FXSW	WIBOR	FXSW	WIBOR
30-08-07	5,01%	5,03%	5,10%	5,18%	5,32%	5,46%
02-09-07	4,96%	5,03%	5,05%	5,19%	5,27%	5,47%
03-09-07	4,95%	5,03%	5,05%	5,19%	5,26%	5,47%
04-09-07	4,95%	5,03%	5,05%	5,19%	5,26%	5,47%
05-09-07	4,90%	5,06%	5,01%	5,19%	5,25%	5,48%

**FRA MARKET RATES**

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
30-08-07	5,07%	5,23%	5,40%	5,57%	5,52%
02-09-07	5,07%	5,22%	5,40%	5,55%	5,51%
03-09-07	5,07%	5,23%	5,39%	5,55%	5,51%
04-09-07	5,07%	5,23%	5,39%	5,55%	5,51%
05-09-07	5,10%	5,24%	5,36%	5,50%	5,47%

**FIXED INCOME MARKET RATES**

Fixed Income Market Rates (Closing mid-market levels)								
date	1Y		2Y		5Y		10Y	
	WIBOR	TB	IRS	OK1208	IRS	PS0511	IRS	DS1017
30-08-07	5,46%	4,90%	5,58%	5,31%	5,74%	5,70%	5,75%	5,80%
02-09-07	5,47%	4,90%	5,58%	5,27%	5,73%	5,69%	5,73%	5,77%
03-09-07	5,47%	5,08%	5,57%	5,29%	5,72%	5,69%	5,73%	5,76%
04-09-07	5,47%	5,05%	5,57%	5,29%	5,71%	5,68%	5,72%	5,76%
05-09-07	5,48%	5,05%	5,57%	5,34%	5,71%	5,67%	5,71%	5,76%

**PRIMARY MARKET RATES**

Last Primary Market Rates							
	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	07-09-03	08-09-03	1,000	5,08%	900	1295	900
OK0709	07-09-05	09-07-25	90,694	5,33%	1800	4232	1800
PS0412	07-06-22	12-04-25	96,925	5,48%	1000	2673	1000
DS1017	07-07-11	17-10-25	96,817	5,66%	1800	2997	1800

**FX VOLATILITY**

date	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
	1M	3M	6M	1Y	1M	1Y	1M	1Y
30-08-07	9,10	8,75	8,75	8,50	1,30	1,30	0,30	0,35
02-09-07	9,10	8,75	8,75	8,50	1,30	1,30	0,30	0,35
03-09-07	8,30	8,20	8,20	8,10	1,30	1,30	0,30	0,35
04-09-07	8,30	8,20	8,20	8,10	1,30	1,30	0,30	0,35
05-09-07	8,30	8,20	8,20	8,10	1,30	1,30	0,30	0,35

**PLN SPOT PERFORMANCE**

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
30-08-07	2,8072	3,8278	-22,60%
02-09-07	2,7990	3,8230	-22,75%
03-09-07	2,7995	3,8209	-22,77%
04-09-07	2,8131	3,8255	-22,56%
05-09-07	2,8105	3,8208	-22,65%

Note: parity on 11/04/00 – USD= 4.3806, EUR=4.2196, basket share 50:50  
Mid-market volatility of vanilla option strategies

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