



## POLAND WEEKLY REVIEW

### MACROECONOMICS AND FINANCIAL MARKETS

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### PREVIEW: The week of February 13<sup>th</sup> to March 20<sup>th</sup>

Indicator	Date of release	Period	BRE fore-cast	Consensus	Last	Comment
Wages y/y	Mar 17	Feb	12.5%	11.2%	11.5%	Reading distorted by extra payment of 14th wage in Kompania Weglowa, an employer for 65 thou. workers (the total employment in relevant mining section totals 130 thou.)
Employment y/y	Mar 17	Feb	6.0%	5.8%	5.9%	Leading indicators point to a faster expansion of employment on monthly basis than the one recorded a year ago. Elevated annual dynamics stems from recent adjustment of statistical base on which the data is collected.
Industrial Output y/y	Mar 19	Feb	9.4%	10.3%	10.7%	Data in December and January may have been distorted by the way the data is collected (the settlement of payments reflected in invoices). We expect the industrial output to return to the trend we saw in Autumn. One working day more compared with February 2007. Strong car production reported by Samar.
PPI y/y	Mar 19	Feb	3.6%	3.2%	2.8%	Surging prices of copper and relatively slowly rising prices of oil (measured on a monthly basis). High level of price expectations, higher level of production costs assessment. High risk associated with utilities – hard to judge whether the elevated costs of energy transmission are going to find confirmation in producer prices

## In Focus / Macroeconomics

### Inflation surprised on the downside owing to basket revision

*The surprise does not affect the overall picture of inflationary processes*

Annual inflation figures published in February wreak havoc with the market. Revision of inflation basket caused the growth of prices to calm down to 4.0% in January, vs. preliminary 4.3%, and to 4.2%, vs. 4.6 expected in February. To make the long story short, the weights of food and housing have gone down, while the ones attached to so-called "demand" categories have been revised upwards. The weight reshuffling reflects, to some extent, the rising disposable income of households recorded in 2007 (the stream of money flew to such categories as hotels and restaurants and audiovisual appliances etc.).

Although the annual figure is the one closely monitored by the market, the most important and most actual insights have been offered by monthly variation. Strikingly, the m/m price growth appeared to be in line with expectations with regard to its scale (0.4% versus our forecast of 0.4%) as well as the structure; inflation is currently driven by higher state-controlled prices and prices of services. Consequently we continuously see the net core inflation to have sharply gone up to 2.8-2.9% in February up from 1.7 and about 2.1% recorded in December and February respectively.

As the rising prices have been mainly recorded in such categories as food and household maintenance (including electricity) the inflation rate perceived by households may be currently closer to, say, 6% than the official rate of 4.2%. This may clearly affect the households' inflation expectations and stimulate the wage demand ultimately leading to the so-called second round effects. All in all, we do not see the February data as changing the overall picture of inflationary processes in Poland.

Inflation figure triggered some new comments from the MPC members. Pietrewicz, seen as extremely dovish, explained there is a threat the inflation will hover around 4% in H1. Noga sees another two 25 bps hikes needed regardless of the downward revision of CPI inflation. Wasilewska-Trenkner expects 1 to 3 more hikes to come. Filar, an extreme hawk, underlined that the date imply neither the inflation trend change nor the shift in MPC rate path. Czekaj, a sort of swing voter, sees the main reasoning for increasing the reference rate stemming from the labor market and fast rising wages.

Temporary lower inflation is not going to discourage the MPC from hiking in March (inflation is a gradually process and it is worth to stress again that monthly price growth remained intact despite the revision of the consumption basket). This month figures including wages, industrial output and producer prices may show that either the supply side of the economy is shielded from global turbulences and the basis for the demand pulled and cost push inflation still widens as well.

#### MEDIUM-TERM FORECATS

Indicator	2006	2007	2008
GDP y/y (%)	6.1	6.5	5.6
Inflation rate (%)	1.0	2.4	4.0
Current account (% of GDP)	-2.1	-4.5	-5.3
Unemployment rate (end-of-year)	14.9	11.4	9.8
NBP repo rate (end-of-year)	4.00	5.00	<b>&gt;6.0</b>

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

## Fixed Income

*Volatile week on the FI market.*

Last week was rather volatile on the FI market. Massive unwind of ASW positions, EURUSD highs, economic releases made market very vulnerable and volatile. The high on the 2y IRS was 6.48 and week later 2y traded at 6.24. We see market positions as rather heavy especially in bonds, and ASW, we still favor higher yields. Next week we have wages, PPI and production, all figures we believe will print higher. With recent drop in yields after CPI basket revision we see it as opportunity to pay, we recommend paying 1y3s. We think that there is a change in RPP rhetoric, we heard from all members that Council is currently in tightening mode and in our opin-

**RECOMMENDATION:**

ion this is due to high risk of second round effects, and rising core CPI.

**AUCTIONS**

Pay 1y3s

	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	4.208%	1/16/2006
26 Week T-bills	-	-	3.943%	4/24/2006
52 Week T-bills	4/14/2008	-	6.230%	3/10/2008
2Y T-bond OK0709	4/4/2008	-	6.189%	1/2/2008
5Y T-bond PS0413	5/7/2008	-	6.167%	3/5/2008
10Y T-bond DS1017	4/9/2008	-	5.785%	2/13/2008
20Y T-bond WS0922	5/14/2008	-	5.794%	1/9/2008

**Money Market**

*Carry above the main rate*

Carry 3-5 bp above the main rate, just as we were forecasting last week, with no prospects to bigger changes in the nearest future. Open market operation 14.6 billion PLN, however market bought only 13.55 billion PLN.

*Waiting for figures*

As for longer terms, waiting for Thursday's CPI figure. 4.7% and above will surprise the market (4.6% expected) and will bring the bearish sentiment.

*Fast rate hikes expected, March scenario fully priced in*

Another comments from the MPC member prof. Noga sustained and even intensified fast rates hike expectations. The OIS curve has already priced in March hike in 100%. For longer terms there is practically no doubt, and potential tightening of the monetary policy next months will surprise no one.

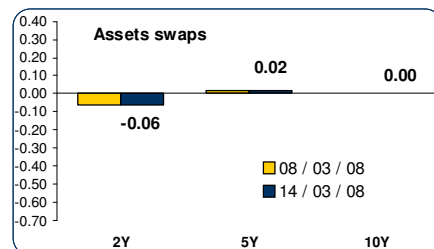
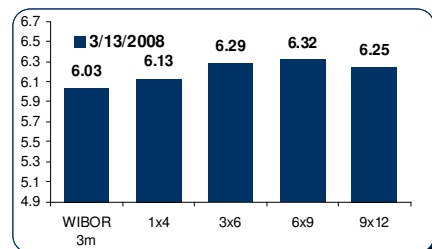
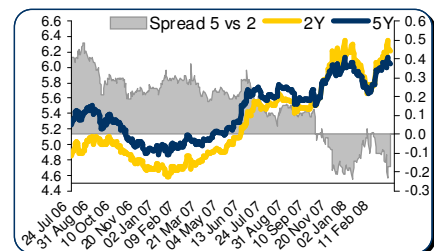
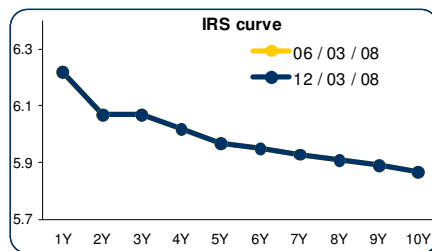
*T-bills yields up*

The average yield on Poland's 52 week T-bills rose to 6.23% at auction Monday, from 5.62% at the previous auction. The ministry sold its entire 1 billion zloty offer of 52-week paper. The ministry also sold five-week T-bills (PLN 737 mm) at average yield of 5.60%.

**RECOMMENDATION:**

Pay on dips.

**FIXED INCOME & MONEY MARKET CHARTS**



## Foreign Exchange

*Zloty volatile*

Since Friday the zloty was traded between 3.5880 and 3.5260. Such volatile trading was provoked by outer impact. Problems of hedge funds and central banks intervention were few, strongest, of them.

*Volatility curve slightly higher*

Despite of volatile zloty, only short end of curve was affected with long end being well supplied by local exporters.

**RECOMMENDATION:**

Spot:  
 Main supports / resistances:  
 EUR/PLN: 3.5200 / 3.5700  
 USD/PLN: 2.2400 / 2.3000

*Sell on upticks*

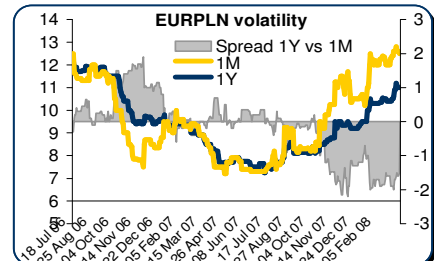
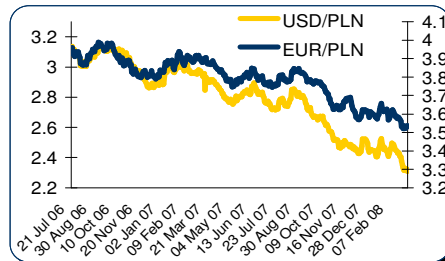
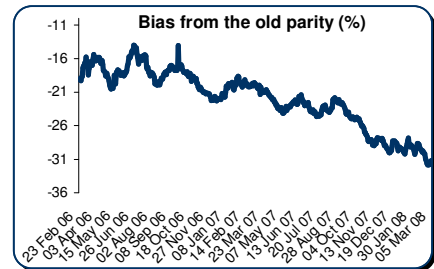
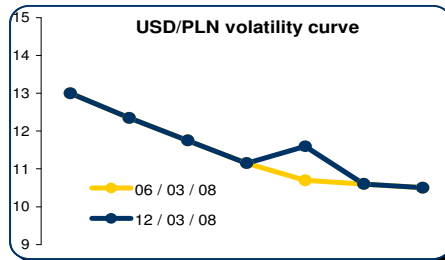
Despite of nervous reaction on global sentiment fluctuations we believe PLN is still worth buying and 3.5700 provides good level for entry short EURPLN with 3.5950 as S/L and 3.5200 as P/T.

Options:

*Short USDPLN vega*

We advice to trade short 1Y USDPLN vega above 11.00. Reasons are 10.00 % of historical volatility and lowering correlation between EURPLN and EURUSD.

**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
06/03/08	5.87%	5.86%	5.90%	6.13%	6.15%	6.30%
07/03/08	5.92%	5.89%	6.16%	6.17%	6.34%	6.33%
10/03/08	5.89%	5.90%	6.18%	6.18%	6.33%	6.33%
11/03/08	5.92%	5.90%	6.15%	6.19%	6.32%	6.34%
12/03/08	5.95%	5.91%	6.25%	6.20%	6.49%	6.35%

**FRA MARKET RATES**

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
06/03/08	6.13%	6.37%	6.40%	6.37%	6.43%
07/03/08	6.15%	6.38%	6.40%	6.38%	6.42%
10/03/08	6.11%	6.35%	6.38%	6.34%	6.41%
11/03/08	6.12%	6.35%	6.39%	6.35%	6.43%
12/03/08	6.15%	6.35%	6.38%	6.34%	6.39%

**FIXED INCOME MARKET RATES**

Fixed Income Market Rates (Closing mid-market levels)								
date	1Y		2Y		5Y		10Y	
	WIBOR	TB	IRS	OK0709	IRS	PS0511	IRS	DS1017
06/03/08	6.30%	5.08%	5.57%	5.29%	5.72%	5.69%	5.73%	5.76%
07/03/08	6.33%	5.05%	5.57%	5.29%	5.71%	5.68%	5.72%	5.76%
10/03/08	6.33%	5.05%	5.57%	5.34%	5.71%	5.67%	5.71%	5.76%
11/03/08	6.34%	5.05%	5.56%	5.30%	5.71%	5.65%	5.72%	5.75%
12/03/08	6.35%	5.03%	5.56%	5.34%	5.70%	5.68%	5.70%	5.75%

**PRIMARY MARKET RATES**

Last Primary Market Rates							
	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	08/03/10	09/03/10	94.074	6.23%	1000	296132	10000
OK0710	08/01/02	09/07/25	85.730	6.19%	1800	2047	1654
PS0413	08/03/05	13/04/25	95.950	6.17%	1500	2019	1500
DS1017	08/02/13	17/10/25	96.048	5.79%	2000	2785	2000

**FX VOLATILITY**

date	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
	1M	3M	6M	1Y	1M	1Y	1M	1Y
06/03/08	12.60	11.50	11.20	10.90	0.75	0.90	0.30	0.35
07/03/08	12.80	12.00	11.30	11.20	0.75	0.90	0.30	0.35
10/03/08	12.60	12.00	11.30	11.10	0.75	0.90	0.30	0.35
11/03/08	12.60	12.00	11.20	11.00	0.75	0.90	0.30	0.35
12/03/08	12.60	12.00	11.20	11.00	0.75	0.90	0.30	0.35

**PLN SPOT PERFORMANCE**

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
06/03/08	2.3213	3.5700	-31.20%
07/03/08	2.3028	3.5458	-31.70%
10/03/08	2.2915	3.5280	-32.04%
11/03/08	2.2741	3.5445	-32.04%
12/03/08	2.2741	3.5445	-32.04%

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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