



POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

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PREVIEW: The week of April 24th to April 31st

Indicator	Date of release	Period	BRE fore-cast	Consensus	Last	Comment
MPC Decision	Apr 30	-	6.0%	5.75%	5.75%	The discussion during the meeting is going to be extremely fierce. We still think the meeting result is not set and the hawks are likely to infect the other members with their views.

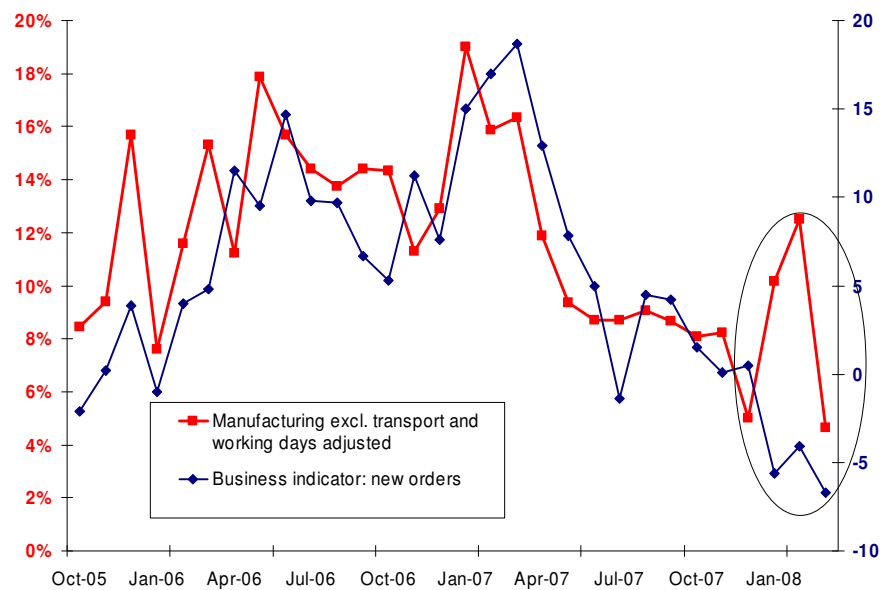
In Focus / Macroeconomics

Distorted monthly data on retail sales and industrial output - a prophet of a looming slowdown or return to the trend?

Data on industrial output and retail sales have brought much confusion to the market participants and the MPC as well. Both figures substantially diverged from expectations, putting the April's decision on rates into question (see the separate section below). In our opinion, the chances for a hike are still tilted to the upside, however, growing concerns regarding the real sphere of the economy weigh substantially on the projected length of the tightening cycle. It is high time then to scrutinize the data.

Industrial output expanded in March at 0.9% annual pace which in comparison with recent growth rates seemed abysmal. The data looks less gloomy in seasonally adjusted terms (6.1% y/y) but still stays below recent surges. Falls in growth rates were substantially widespread – only 11 out of 29 sections recorded a rise in real output. A closer look at business indicators (namely: new orders) reveals some striking features: it seems that the newest reading is consistent with the trend which began in autumn last year. Adjusting to this line of reasoning we assess that January and February production figures can be regarded as outliers and what we observe now is a return to the long marked trend. We expect this tendency to continue in the coming months: seasonally adjusted figures are likely to hover around 5-8%. The symptoms of a more pronounced slowdown may appear no sooner than in the H2 2008.

Manufacturing output (% y/y change) vs. business indicators (pts.)



Retail sales data surprised also on the downside reaching 15.7% y/y after growing by 23.8% in February. Part of the deceleration can be attributed to the new state regulation which came into force in late 2007. According to the law, only gas stations and pharmacies are allowed to operate during the national holidays; other stores (including large department ones and supermarkets) must be closed unless it is the owner who acts in his capacity of a clerk (which is possible only in case of small, local stores). The effects of the regulation are visible in the data: the sales in non-specialized stores surged to 38.1% y/y and the turnover in pharmacies remained almost stable. It is also worth to note, that the durable goods sales (excluding autos, probably being hit hard by the end of seasonal sales) remained relatively unscathed suggesting still bright consumption outlook. Other retail categories recorded substantial deceleration, with the press and books sales being under the heaviest pressure.

The data brought an avalanche of comments from the MPC members, raising important questions about the real sphere of the economy but sometimes a little bit too hasty in conclusions.

All four declared hawks confirmed their assessments of inflationary processes implicitly pushing

for one more hike to come in April. Wojtyna reiterated his opinions regarding the risks stemming from elevated inflationary expectations and rising wages. Suppressed industrial output figures were for him rather a sign of deteriorating wage-productivity tradeoff than a symptom of an outright economic slowdown.

Much more dovish opinions have been expressed by a moderate member J. Czekaj. He focused almost entirely on the downside risks to economic growth, trifling thereby with an elevated headline and core inflation. The Committee should not overreact, although Czekaj admits he might have lost the thread on assessments of both the momentum of the economy and the persistency of inflation.

We do not expect the hawks to retreat from their positions during the next MPC meeting. Arguments of the dovish side are still at most uncertain and it seems that they, as a group, still lack a sort of intellectual leader to overrun the hawks. That is why we assess the likelihood of the rate hike as slightly higher than anticipated by the market.

MEDIUM-TERM FORECATS

Indicator	2006	2007	2008
GDP y/y (%)	6.1	6.5	5.5
Inflation rate (%)	1.0	2.4	4.5
Current account (% of GDP)	-2.1	-4.5	-4.6
Unemployment rate (end-of-year)	14.9	11.4	9.8
NBP repo rate (end-of-year)	4.00	5.00	>6.25

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

Fixed Income

Wait and see...

It seems that we're approaching period of limited volatility on the market. Even the MPC decision shouldn't have much impact on rates. As currently market hardly prices in another hike, if it is delivered on Wednesday it could push up short rates by few bp, otherwise, there will be expectations for such a move in June. We think it's hard to find any particular value in polish yield curve at the moment. We can easily see it move in either direction by some 15bp, but without any new information, any mid term trend on rates is hard to imagine. Two four-day weekends in May won't increase willingness to take risks either. However we remain bearish on rates; FRAs trading below spot Wibor rates make no sense to us, rate cuts priced in already early next year seems to optimistic. Also hardly any risks to the convergence process are priced in the 5y5y forward spread to EUR, currently below 70bp. From that perspective we think paying short rates is still a safe bet, but as we are generally expecting low activity and volatility ahead, we'd rather wait for nice opportunities to enter the position.

RECOMMENDATION:

Pay rates on dips

AUCTIONS

	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	6.061%	4/14/2008
26 Week T-bills	-	-	6.220%	4/14/2008
52 Week T-bills	4/14/2008	-	6.380%	4/14/2008
2Y T-bond OK0709	7/2/2008	-	6.193%	4/2/2008
5Y T-bond PS0413	5/7/2008	-	6.167%	3/5/2008
10Y T-bond DS1017	7/9/2008	-	6.054%	4/9/2008
20Y T-bond WS0922	5/14/2008	-	5.794%	1/9/2008

Money Market

Cost of carry slightly above the main rate

Stable carry all over the week plus again open market operation above the expectations (12.0 billion PLN against 14.6 billion pln maturing papers – 11.0 billion PLN expected). The reduction

Easy end of the reserve ahead

rate remained very low (9.80%).

Weaker than expected IO, retail sale and PPI figures

Tomorrow's open market operation will be crucial as far as liquidity at the end of the reserve is concerned. More signs are for the cheap scenario.

Positive sentiment for longer terms

As for longer terms everyone was waiting for economic figures. Industrial output, retail sales and PPI was substantially below the market expectations. This figures temporary shifted down yield curve about 10 basis points.

Next T-bill auction on May 12th.

In our scenario probability of hike in April is now 50:50.

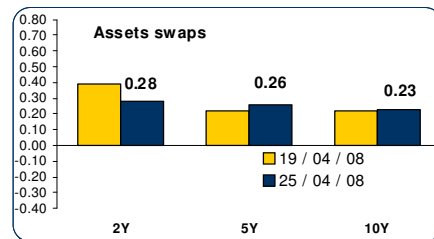
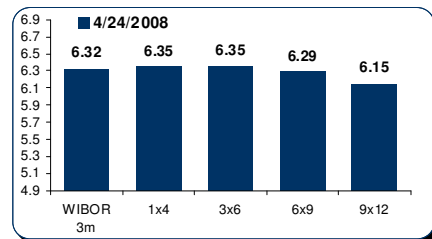
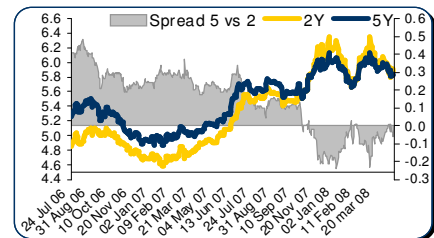
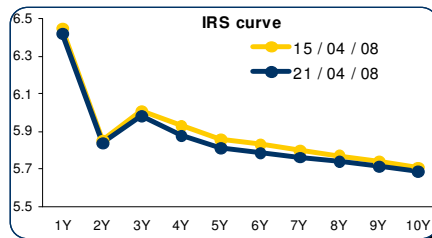
Derivatives discount 25 bps cut within a year.

No T-bills auction. Next one is on Monday, May the 12th.

RECOMMENDATION:

Stay neutral before the MPC decision.

FIXED INCOME & MONEY MARKET CHARTS



Foreign Exchange

Zloty in tight range

Since Friday the zloty was traded between 3.4050 and 3.4280. Such calm trading is strictly related to situations on global markets – It's all quiet on the Western Front.

Volatility curve untouched

Narrow trading made volatility curve untouched with small pressure on down side, 1M was traded at 6.35 with 1Y staying still around 6.1.

RECOMMENDATION:

Spot:
Main supports / resistances:
EUR/PLN: 3.3800 / 3.4700
USD/PLN: 2.1100 / 2.1900

Stay aside / look for correction signs

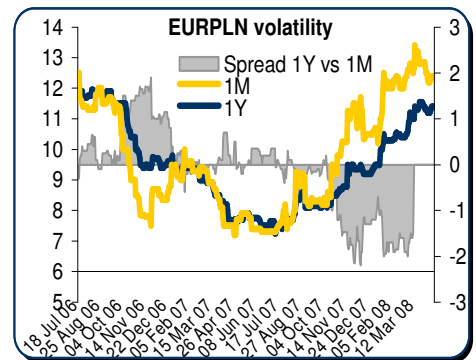
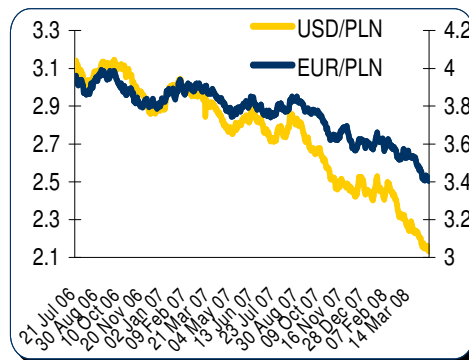
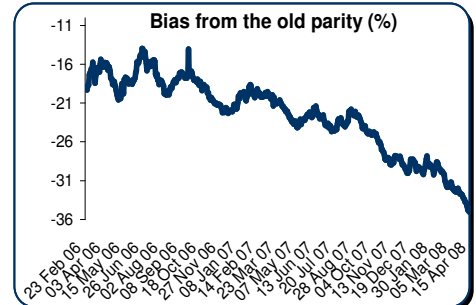
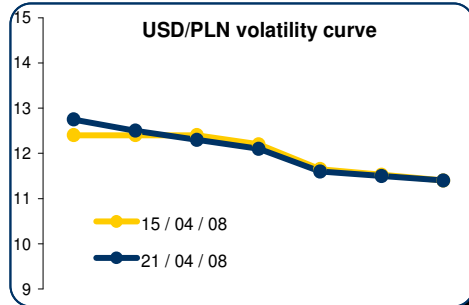
Consolidation above 3.4000 lasts but downward trend was not broken. We see 3.3800 as next support and 3.4700 as resistance. Therefore our idea is to buy at 3.4000 with P/T at 3.3900 and P/T 3.4700.

Stay aside/Short EURPLN gamma

Options:

We advice to stay aside EURPLN market as present volatility levels do not offer much room to continue move, although present market sentiment still decline to keep short EURPLN gamma position to maintain theta gains.

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
17/04/08	6.23%	6.22%	6.37%	6.41%	6.64%	6.57%
18/04/08	6.14%	6.21%	6.35%	6.42%	6.62%	6.58%
21/04/08	6.24%	6.21%	6.43%	6.41%	6.60%	6.55%
22/04/08	6.23%	6.22%	6.42%	6.41%	6.58%	6.55%
23/04/08	6.20%	6.22%	6.39%	6.41%	6.59%	6.55%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
17/04/08	6.33%	6.33%	6.29%	6.15%	6.32%
18/04/08	6.33%	6.33%	6.31%	6.17%	6.31%
21/04/08	6.32%	6.34%	6.32%	6.16%	6.29%
22/04/08	6.36%	6.35%	6.33%	6.16%	6.28%
23/04/08	6.35%	6.35%	6.29%	6.15%	6.31%

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
17/04/08	6.57%	5.08%	5.57%	5.29%	5.72%	5.69%	5.73%	5.76%
18/04/08	6.58%	5.05%	5.57%	5.29%	5.71%	5.68%	5.72%	5.76%
21/04/08	6.55%	5.05%	5.57%	5.34%	5.71%	5.67%	5.71%	5.76%
22/04/08	6.55%	5.05%	5.56%	5.30%	5.71%	5.65%	5.72%	5.75%
23/04/08	6.55%	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	08/04/14	08/04/14	93.909	6.38%	3000	6053	3134
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
17/04/08	12.40	12.20	11.65	11.40	0.65	0.70	0.30	0.35
18/04/08	12.40	12.20	11.65	11.40	0.65	0.70	0.30	0.35
21/04/08	12.40	12.20	11.65	11.40	0.65	0.70	0.30	0.35
22/04/08	12.50	12.20	11.65	11.40	0.65	0.70	0.30	0.35
23/04/08	12.50	12.10	11.60	11.40	0.65	0.70	0.30	0.35

PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
17/04/08	2.1499	3.4295	-34.82%
18/04/08	2.1596	3.4258	-34.76%
21/04/08	2.1444	3.4178	-35.02%
22/04/08	2.1340	3.4074	-35.27%
23/04/08	2.1700	3.4182	-34.73%

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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