



## POLAND WEEKLY REVIEW

### MACROECONOMICS AND FINANCIAL MARKETS

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#### PREVIEW: The week of May 23<sup>rd</sup> to May 29<sup>th</sup>

Indicator	Date of release	Period	BRE fore-cast	Consensus	Last	Comment
MPC Decision	May 28	-	5.75%	5.75%	5.75%	Latest press comments of the MPC members suggest the rate-setters are split on the timing of the hike. More moderate members are likely to wait for the new inflation projection; widely anticipated rebound of industrial output gives also more room for maneuver. We expect the MPC to hike in June.
Retail Sales	May 28	Apr	19.0%	18.8%	15.7%	Last month's surprise stemmed mainly from working days effect and Easter effect (for the first time large stores remained closed). Large drops of business indicators in home appliances (structural change?); the rest of indicators on a fairly similar level pointing to a slight deceleration. The car sales estimated by Samar at 20% y/y (the final reading for March was at 8.7% y/y).

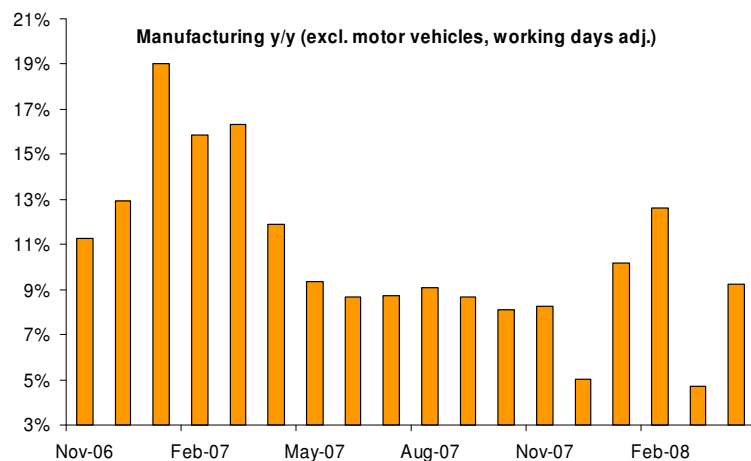
## In Focus / Macroeconomics

### Strong real sphere but no surprise

This week was abundant with key macroeconomic data: wages continued to grow at substantial rate whereas industrial production dispelled concerns on rapidly decelerating real sphere. All the figures were widely anticipated though, leaving thereby the MPC with slightly more space to discuss essential issues in appropriate perspective during the next meeting. It is in our opinion more and more likely that the tightening decision will be put through in June: till then the rate-setters will digest the new inflation projection and the Q1 GDP data.

Average paid employment in enterprise sector grew in April by 5.6% y/y, after 5.8% recorded in March. At the same time average corporate wage soared by 12.6% y/y - a way above market consensus and the previous reading (10.2%). It is worth to note that wage figures are unlikely to have been distorted by bonuses as the period of extra payments is generally over (we will seek for the confirmation of this thesis in a detailed breakdown of the data). Wage and employment figures confirm the labor market is still tightening. Although some business indicators have recently started to project a gradual softening in the labor market, the theory - in contrast - suggests that at least wages are likely to thrive for some time as they respond with a lag to softer economic growth. Coming months are likely to bring a lower growth rate of employment but the purchasing power is going to be fuelled by decent dynamics of average wage.

After soft March data (0.9% y/y increase) industrial output rebounded by 14.9% y/y in April, which was in line with market expectations. A positive annual growth rates have been recorded in 25 out of 29 sections. Note, however, that higher dynamics has been partially induced by working days effect (+2 working days on an annual basis). These effects are to be blamed for the lower production figure in March. Strikingly, seasonally adjusted annualized figure was up to 11.9% as compared to 6.1% recorded in March. Such a volatility may be seen as an indication of deteriorating statistical quality of the data. In the months to come we expect the industrial output dynamics to ease to 5-8% y/y, in line with the business survey outcomes. Moreover, the next month's reading is to be affected by working days effect (double may holiday), therefore it may drop significantly on a yearly basis.



As for the data from nominal sphere, we witnessed two releases in the past week: producer prices and core inflation.

Producer prices decelerated to 2.5% y/y on the back of stable fuel prices and strong gains in EUR/PLN and USD/PLN rates. PPI fell for the third time in a row but we expect this tendency to be reversed in May – the adverse shock in the oil market (hitting primarily industries connected with transport and then eating through the distribution chain) seems to be enough to make firms alter their prices despite further gains of the zloty.

Although headline CPI softened a bit in April, core “net” measure expanded further to 2.8% y/y. The core rate excluding the most volatile components of the basket reached 4.3% and it's

monthly variation was close to the one attributed to the full-basket CPI. It seems that the first round CPI trigger (mainly food prices) which occurred in late summer of 2007 has somewhat faded and from now on CPI inflation is going to be more persistent.

### MEDIUM-TERM FORECATS

Indicator	2006	2007	2008
GDP y/y (%)	6.1	6.5	5.3
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	>6.0

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

## Fixed Income

*Sell, sell, sell...*

Apparently it was a little to early to switch more towards more neutral attitude as we did last week. Strong selling on bonds across the curve pushed the yields to new year-tops and caused significant widening of asset swap spreads. Switch auction, on which the Ministry of Finance surprisingly rejected all the bids, improved the sentiment a bit, and the curve moved back by some 10bp. Another bad auction isn't definitely a good news for the market in the medium term. It's quite a dangerous game to keep rejecting bids at market levels, as at some point they might be forced to accept even worse price levels. It seems that we have to come back to our 'pay dips' strategy. Next week's rate decision probably won't change much on the market - no hike shouldn't result in strengthening, as everyone would expect such a move in June. Policy tightening on the other hand would push short rates even higher, causing bond positions even more expensive to fund and therefore increasing pressure to sell papers.

### **RECOMMENDATION:**

Pay 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	5/26/2008	-	6.340%	5/5/2008
2Y T-bond OK0709	7/2/2008	-	6.193%	4/2/2008
5Y T-bond PS0413	6/4/2008	-	6.155%	5/7/2008
10Y T-bond DS1017	7/9/2008	-	6.054%	4/9/2008
20Y T-bond WS0922	9/12/2008	-	6.080%	5/14/2008

## Money Market

*Cheap end of the reserve ahead*

Liquidity was quite balanced for the whole week; however we can assume that the end of the reserve will be very cheap this month. Last OMO amounted to 9.5 billion pln, and Central Bank's liquidity projection for coming days shows substantial surplus of cash in the system. If only credit lines allow for its redistribution it will be lower and lower.

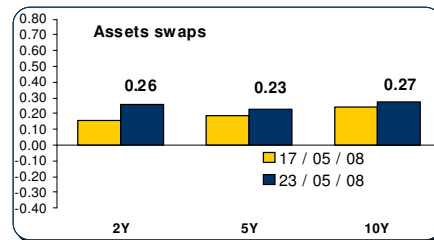
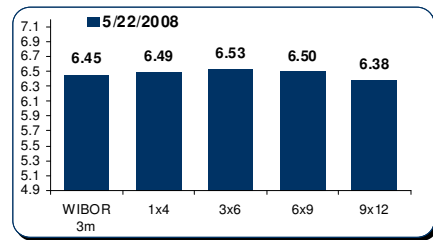
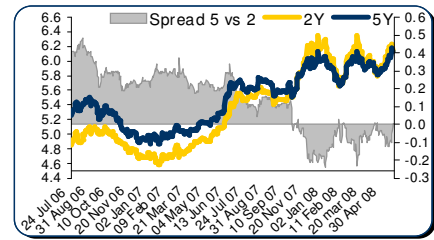
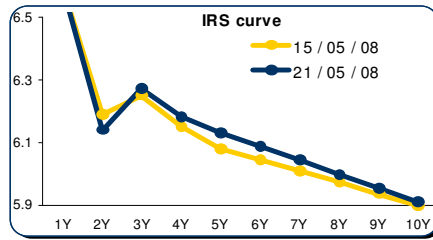
*Mixed figures, poor switch tender, bullish*

Wages much above expectations (12.6 vs 11.5%) and quite bearish beginning of the week. Then mixed and in our opinion rather neutral core inflation, PPI and IO (2.8, 2.5 and 14.9% respectively). However just before the figures were released as poor as one can get switch bond auction was held, and neutral figures triggered a nice bullish movement. To sum up, no substantial changes, although the probability for may rates hike slightly deteriorated.

### **RECOMMENDATION:**

Pay 9m polonia on dips.

**FIXED INCOME & MONEY MARKET CHARTS**



**Foreign Exchange**

*Zloty slightly weaker*

Since Friday the zloty was traded between 3.3801 and 3.4220. Once again 3.8000 was protected what resulted with buying back short EURPLN positions. Though CPI/PPI/production data were in focus it hadn't affect zloty so far.

*Volatility curve untouched*

Until the zloty stays in medium term strengthening trend volatility curve becomes relatively steady.

**RECOMMENDATION:**

Spot:  
Main supports / resistances:  
EUR/PLN: 3.3800 / 3.4200  
USD/PLN: 2.1300 / 2.2200

*Stay aside/Buy on dips*

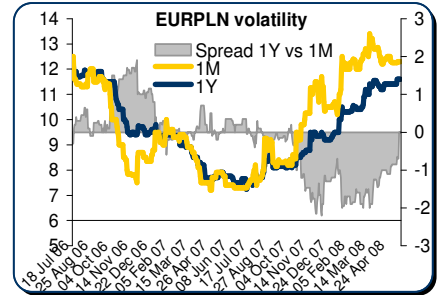
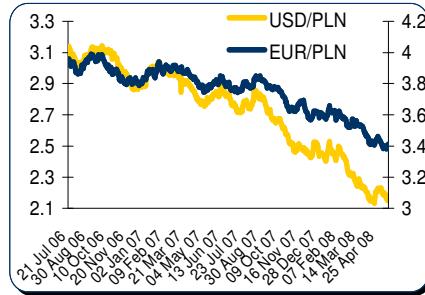
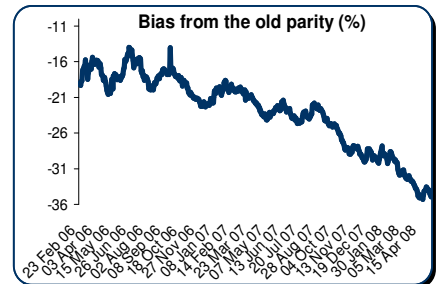
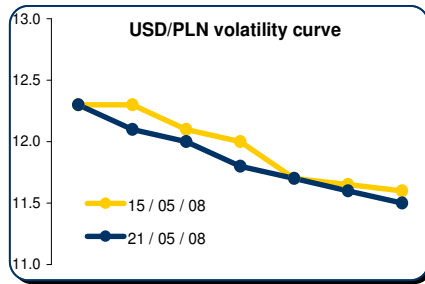
As 3.3800 level increased its significance with next rescuing, we believe it uncovered 3.4200 as potential breaking level with targeting for 3.4700.

Options:

*Stay aside/Short EURPLN gamma*

Till PLN, started on January, strengthening trend last, we see keeping small amounts of short EURPLN gamma as best idea, but our second-best thought is to buy strikes above 3.4200.

**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
15/05/08	6.29%	6.32%	6.52%	6.45%	6.68%	6.56%
16/05/08	6.32%	6.31%	6.51%	6.45%	6.62%	6.56%
19/05/08	6.38%	6.31%	6.44%	6.46%	6.54%	6.56%
20/05/08	6.37%	6.33%	6.52%	6.48%	6.55%	6.58%
21/05/08	6.37%	6.35%	6.51%	6.49%	6.67%	6.58%

**FRA MARKET RATES**

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
15/05/08	6.48%	6.55%	6.47%	6.35%	6.46%
16/05/08	6.48%	6.52%	6.47%	6.32%	6.45%
19/05/08	6.51%	6.58%	6.56%	6.41%	6.55%
20/05/08	6.50%	6.59%	6.56%	6.41%	6.53%
21/05/08	6.50%	6.53%	6.49%	6.38%	6.49%

**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
15/05/08	6.56%	5.08%	5.57%	5.29%	5.72%	5.69%	5.73%	5.76%
16/05/08	6.56%	5.05%	5.57%	5.29%	5.71%	5.68%	5.72%	5.76%
19/05/08	6.56%	5.05%	5.57%	5.34%	5.71%	5.67%	5.71%	5.76%
20/05/08	6.58%	5.05%	5.56%	5.30%	5.71%	5.65%	5.72%	5.75%
21/05/08	6.58%	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	08/05/05	09/05/05	93.941	6.34%	2500	4123	2787
OK0710	08/01/02	09/07/25	85.730	6.19%	1800	2047	1654
PS0413	08/04/07	13/04/25	96.211	6.16%	1800	3129	1800
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
15/05/08	12.30	12.00	11.70	11.60	0.70	0.85	0.30	0.35
16/05/08	12.30	12.00	11.70	11.60	0.70	0.85	0.30	0.35
19/05/08	12.30	12.00	11.70	11.60	0.70	0.85	0.30	0.35
20/05/08	12.30	12.00	11.70	11.60	0.70	0.85	0.30	0.35
21/05/08	12.10	11.80	11.70	11.50	0.70	0.85	0.30	0.35

**PLN SPOT PERFORMANCE**

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
15/05/08	2.1861	3.3884	-34.90%
16/05/08	2.1650	3.3827	-35.21%
19/05/08	2.1758	3.3930	-34.96%
20/05/08	2.1522	3.3836	-35.34%
21/05/08	2.1675	3.4095	-34.86%

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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