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FINANCIAL MARKETS DEPARTMENT

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POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

PREVIEW: The week of December 12th to December 18th

Indicator	Date of release	Period	BRE forecast	Consensus	Last	Comment
C/A Balance (EUR)	**12 Dec**	Oct	**-2.3 bn**	-2.0 bn	-2.0 bn	Deteriorating trade balance and income account (substantial coupon payments on debt service). Negative balance of transfers due to negative balance of settlements with the EU. C/A to GDP ratio at 5.3%.
M3 Supply (y/y)	**12 Dec**	Nov	**16.9%**	16.8%	17.6%	Lower growth rate of household deposits, firms' deposits growth comparable to the last month's one. Net inflow to investment funds.
CPI Inflation (y/y)	**15 Dec**	Nov	**3.7-3.8%**	3.8%	4.2%	Negligible growth of food prices (the tendency confirmed by business tendency indicators and lower regional readings of CPI inflation). Gas and electricity hikes effective since November. Core inflation excluding food and fuels at 4.8%, excluding food and energy at 2.9%.
Employment (y/y)	**15 Dec**	Nov	**3.2%**	3.3%	3.6%	Gloomier employment forecasts in majority of sections. Drop of employment on monthly basis; signals on group lay-offs.
Wages (y/y)	**15 Dec**	Nov	**8.5%**	8.6%	9.8%	Gradual fall in wage dynamics. Regular extra payments in mining and some other (discretional) premiums.
Industrial output (y/y)	**18 Dec**	Nov	**-7.0%**	-5.3%	0.2%	2 working days less on annual basis, 4 days missing on monthly basis. Massive falls of business tendency indicators concerning current production and new orders.

Producer prices (y/y)	**18 Dec**	Nov	**2.3%**	2.4%	2.4%	Monthly fall of prices in manufacturing and mining. Another month of diving price expectations. Rise of utilities prices partially offsetting the falls in other sections.

In Focus / Macroeconomics

MPC ready for 50 pb. cuts

The statement issued after the last MPC meeting suggested rate-setters entered the monetary easing. From then on we have been seeing another wave of interest rate cuts delivered by leading monetary institutions (ECB including). The arguments for aggressive cuts are common: deteriorating growth outlook (conditional on present information) which enables inflation to settle within central bank's targets (or in some cases, even undershoot them). It seems the MPC has already started to take such risks seriously – fresh comments suggest the consensus has drifted not only to breaking December tradition (no change in rates this month), but to do it substantially: 50 bp. cut is the most likely scenario.

Taking into consideration only the latest comments of the MPC members, it seems there are only two members strictly opposing the December cut – Filar and Wasilewska-Trenkner. Both suggest the decisions on monetary easing should be postponed till the beginning of 2009 as December is not supposed to carry any changes in the "rules of the game". Filar cites mainly the behavior of core inflation – he is unwilling to ease monetary policy further until he sees a fall in this measure of inflation (which, by the way, he expects to see in…January). As for Wasilewska-Trenkner arguments, she seems overly optimistic on the forthcoming GDP growth figures. Moreover, much attention she devotes to the stability of the zloty, postponing the decision on rates till the publication of the new inflation projection.

The doves seem to be in majority now, including Skrzypek (with decisive vote additionally), Slawinski, Czekaj, Nieckarz, Pietrewicz and Owsiak. Their arguments rely mainly upon disinflationary forces flowing from decelerating GDP growth. They have been recently backed by the Polish regulatory watchdog: not only the large scale of energy price hikes is going to be substantially limited, but also the time of implementation postponed at least until February 2009. It translates into inflation falling to approximately 3.0-3.2% y/y – within the target range of the MPC.

From risk management perspective, waiting for the new projection seems to be a step backwards. Up to now, the MPC should have processed many factors pointing towards lower inflation path including further deterioration of growth perspectives, further fall of commodity prices or recently halted price deregulation in energy sector. In the fast changing economic environment, the projection should be treated as a checkpoint to verify policy changes already delivered. Such a view may be tacitly present in arguments of the doves – some of them urge to act quickly (Czekaj) citing the lags in monetary transmission mechanism. We regard 50 bp. cut as a baseline scenario for now. It may find further confirmation in the forthcoming high frequency data as the level of market expectations is too optimistic. Furthermore, even depreciating zloty is not an obstacle to deeper cuts – the majority of members have realized that they will not exaggerate currency movements (as they are for long locked in FI yield curves).

MEDIUM-TERM FORECATS

Indicator	2006	2007	2008	2009
GDP y/y (%)	6.1	6.5	5.0	1.8
Inflation rate (%, average)	1.0	2.4	4.3	**2.9↓**
Current account (% of GDP, average)	-2.1	-4.5	-5.3	-5.7
Unemployment rate (end-of-year)	14.9	11.4	9.5	11.2
NBP repo rate (end-of-year)	4.00	5.00	5.50	3.75

Indicator	2008			2009	
	Q2	Q3	Q4	Q1	Q2
GDP y/y (%)	5.8	4.7	3.0	2.1	1.6
Inflation rate (%, average)	4.3	4.7	3.8	**3.2↓**	**2.8↓**
NBP repo rate (end-of-quarter)	6.00	6.00	**5.25↓**	4.50	4.00

Bold denotes chages from the last release with arrows showing the direction of chages

Fixed Income

Rally is losing momentum

Last week hasn't brought much change on the market. Yields stayed at low levels pushed down by good interest to buy bonds. However it seems that the rally is getting a bit overdone and correction seems more and more likely. Even though next week's data will be very supportive for rates, and will probably result in 50bp easing this month, such optimistic scenario is almost fully priced in; moreover Wibors would have to move lower significantly in order to reach current forward rates. From that perspective, there is hard to find much value in FRAs trading below 4%. Only the very front end of the curve can still perform, if policy rate moves down significantly in few consecutive 50bp cuts. We start to look to pay on dips, we like 6x9 and 9x12 most, especially if data and rate cut expectations push the rates much lower, we'll be at levels where upside potential is big, and downside risk quite limited.

RECOMMENDATION:

Pay FRAs on dips.

AUCTIONS

	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	6.142%	12/9/2008
26 Week T-bills	-	-	6.197%	12/9/2008
52 Week T-bills	-	-	6.211%	12/9/2008
2Y T-bond OK0711	?	-	5.470%	12/10/2008
5Y T-bond PS0413	2/6/2009	-	5.926%	10/1/2008
10Y T-bond DS1019	2/13/2009	-	6.054%	4/9/2008
20Y T-bond WS0429	1/9/2008	-	5.992%	9/10/2008

Money Market

Cheap December is a fact

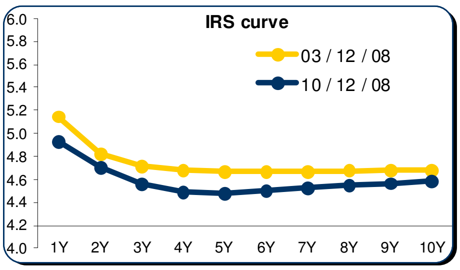
Cut in December 50 bps or more?

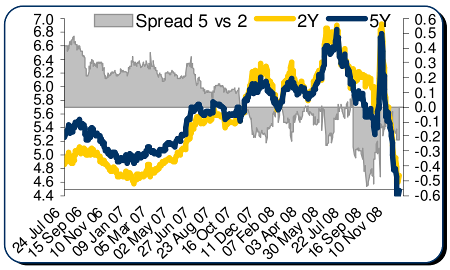
Cheap December became a fact. The market is loaded with excess cash and looking on remaining cash flows leaves no doubt that only something extremely strange could change the cheap carry this month. The central bank is very active on both repo and reverse repo transactions, which additionally regulate the market, and taking into consideration safety reasons before the end of the year, all the odds are on the cheap side. For longer terms figures lost in value. The only question is by how much the MPC will cut the rates in December and January.

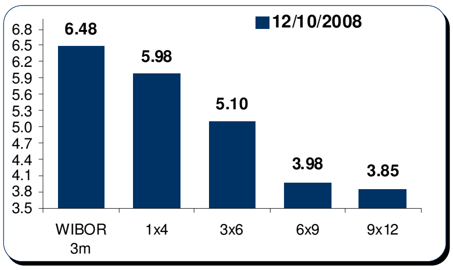
RECOMMENDATION:

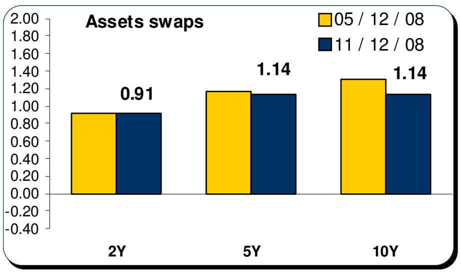
Start thinking about buying longer contracts. There is a lot built in.

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty weaker

This week zloty opened at 3.8550 and weakened toward 4.0000, where paid level triggered profit taking on pretty currency long market.

Volatility stable

Volatility market had priced in such PLN moves, so 1M is still staying around 28-30 and 1Y is traded at 18-19.

RECOMMENDATION:

SPOT

Main supports / resistances:
EUR/PLN: 3.8000 / 4.0500
USD/PLN: 2.8000 / 3.1800

Buy on dips

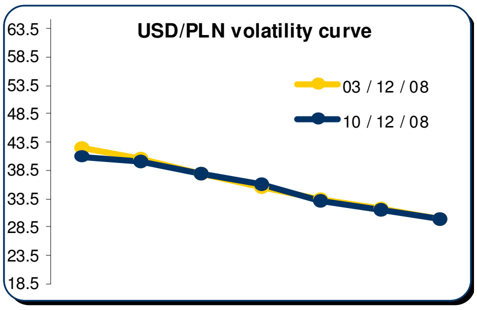
With 4.00 level touched as market target price we see possibility of correction, although still high demand in EUR against PLN convincing us to keep buy dips as FX strategy.

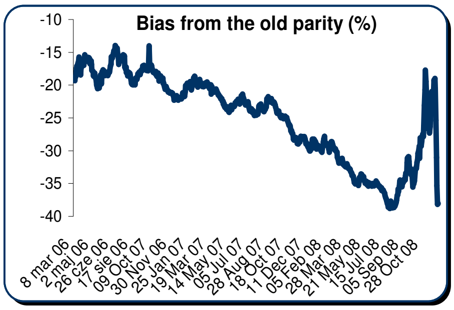
Short gamma/vega

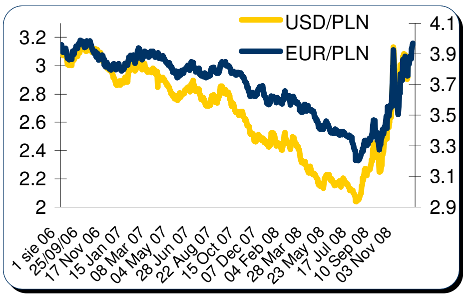
OPTIONS

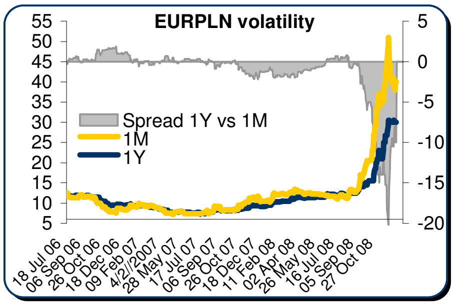
We believe in receiving some benefits from short gamma and vega. Both priced in bad enough scenario.

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
04/12/08	6.40%	6.54%	6.47%	6.49%	6.48%	6.59%
05/12/08	6.44%	6.54%	6.51%	6.51%	6.51%	6.51%
08/12/08	6.41%	6.53%	6.46%	6.48%	6.46%	6.50%
09/12/08	6.45%	6.48%	6.47%	6.43%	6.49%	6.47%
10/12/08	6.36%	6.48%	6.41%	6.42%	6.46%	6.46%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
04/12/08	5.98%	5.13%	4.03%	3.88%	4.17%
05/12/08	5.98%	5.11%	3.99%	3.79%	4.15%
08/12/08	5.89%	5.10%	3.98%	3.82%	4.15%
09/12/08	5.93%	5.08%	3.93%	3.75%	4.12%
10/12/08	5.98%	5.10%	3.98%	3.85%	4.24%

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
04/12/08	6.59%	5.08%	5.57%	5.29%	5.72%	5.69%	5.73%	5.76%
05/12/08	6.51%	5.05%	5.57%	5.29%	5.71%	5.68%	5.72%	5.76%
08/12/08	6.50%	5.05%	5.57%	5.34%	5.71%	5.67%	5.71%	5.76%
09/12/08	6.47%	5.05%	5.56%	5.30%	5.71%	5.65%	5.72%	5.75%
10/12/08	6.46%	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	08/12/09	09/12/09	94.091	6.21%	1800	6800	1910
OK0711	08/12/09	11/07/25	86.996	5.47%	2500	8037	2930
PS0413	08/10/01	13/04/25	99.132	5.93%	1800	4924	1856
DS1017	08/10/08	19/10/26	97.121	5.86%	2500	4472	2500

FX VOLATILITY

	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
date	1M	3M	6M	1Y	1M	1Y	1M	1Y
04/12/08	41.00	36.00	34.00	30.50	8.50	8.50	1.40	1.40
05/12/08	40.00	36.00	34.00	30.50	8.50	8.50	1.40	1.40
08/12/08	38.00	36.00	33.00	30.00	8.50	8.50	1.40	1.40
09/12/08	38.00	36.00	33.00	30.00	8.50	8.50	1.40	1.40
10/12/08	40.00	36.00	33.00	30.00	8.50	8.50	1.40	1.40

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
04/12/08	3.0805	3.8824	-20.58%
05/12/08	3.0476	3.8881	-25.41%
08/12/08	3.0035	3.8686	-31.06%
09/12/08	3.0548	3.9323	-35.33%
10/12/08	3.0610	3.9589	-38.14%

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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