



## POLAND WEEKLY REVIEW

### MACROECONOMICS AND FINANCIAL MARKETS

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**PREVIEW: The week of March 27<sup>th</sup> to April 2<sup>nd</sup>**

Indicator	Date of release	Pe-riod	BRE forecast	Consen-sus	Last	Comment
MinFin's inflation forecast y/y	Apr 1	Mar	3.3-3.4%	-	3.3%	Food prices may be affected upwards by the exchange rate movements and some seasonal factors. Moderate rise of fuel prices. Core categories relatively stable.
PMI	Apr 1	Mar	41.5 pts	-	40.8 pts	A slight warming in business activity indicators worldwide and in Poland. Relatively good results in February production may work towards higher reading. There is some anecdotal evidence suggesting a better conditions in transport.

## In Focus / Macroeconomics

### Monetary easing set to continue ...

In line with analysts and market expectations Polish MPC cut the rates by 25bps to 3.75% in March. The statement highlights ongoing economic slump, deteriorating credit conditions and falling consumer optimism. As one should have expected, the Committee linked the higher inflation and producer prices in February to rises of controlled prices and rapid zloty depreciation. Elevated prices are however, in MPC's opinion, to last for a limited period of time, as widening output gap and deteriorating labor market conditions will support the disinflation in the medium term.

Strikingly, the MPC stated that actions it had implemented so far have started to show some positive effects on the economy. Note that the previous statement put emphasis on the future not current effects! It seems the MPC is somehow content with its recent policy decisions.

The MPC stated that, apart from macroeconomic data, it would monitor the situation in the financial markets and the zloty exchange rate developments in particular. It seems now that the Committee shifted in an implicit way from inflation targeting to zloty exchange rate targeting. Turning to the short-term perspectives, we expect the monetary easing to continue with the REPO rate falling to 3.0-3.5%. We are not sure about the exact timing however, as it hinges on zloty stability. The next rate cut may well be delivered as soon as in April but there are some rationales for postponing the rate cuts till, say, May. As far as the asymmetric lowering of compulsory reserve rate is concerned, the MPC probably needs more time to analyze the effects of such a move on financial markets and banking sector. However, the plans to asymmetrically cut the deposit rate become more specific – hawkish Filar expect this rate to be lowered asymmetrically 25-50bp below the reference rate in the coming meeting.

### Weak consumption and gloomy outlook for state budget

Retail sales growth slowed in February to -1.6% y/y, slightly below market expectations and close to our forecast. The breakdown confirms the durable goods are no longer supporting the growth rate of retail. Moreover, excluding price-inflated fuel sales and export driven sales of new autos (which may be temporary and fade in coming months as soon as initial effects of car-subsidies in Germany burst), the deteriorating retail trade is quite rapid and puts into question the support of private consumption the government is still counting on.

The latest estimates of the Finance Ministry showed that the budget deficit had grown to 12 bln PLN after March. It means that over 66% of the annual deficit was realized in only 3 months of the year. At the same time the Ministry issued an upgraded plan for revenues and expenditures in which the deficit rises towards 16 bln in mid-year, then jump downwards for some months and reach the target of 18.2 bln in the year end. The recalculation of budget deficit in the second part of the year includes the earlier announced savings in expenditures. We are still sceptical over the presented scenario which is still sketched under the assumption of 1.7% GDP growth. As the Ministry explicitly admits, the growth falling short of that figure poses some serious threats to the budget. We are inclined to say that falling retail sales confirms our scenario of relatively modest growth of consumption which may translate in 20 bln PLN revenue shortfall and budget amendment in the middle of the year.

**MID-TERM  
FORECASTS**

Indicator	2006	2007	2008	2009	2010
GDP y/y (%)	6.1	6.5	4.8	0.0	3.0
Inflation rate (% average)	1.0	2.4	4.3	3.0	2.0
Current account (% of GDP, average)	-2.1	-4.5	-5.3	<b>-3↑</b>	<b>-2.5↑</b>
Unemployment rate (end-of-year)	14.9	11.4	9.5	13.5	13.9
NBP repo rate (end-of-year)	4.00	5.00	5.00	<b>3.25↓</b>	4.00

Indicator	2008		2009			
	Q3	Q4	Q1	Q2	Q3	Q4
GDP y/y (%)	4.7	2.9	1.0	-0.5	-1.0	0.7
Inflation rate (% average)	4.7	3.8	3.3	2.8	2.5	2.4
NBP repo rate (end-of-quarter)	6.00	5.00	3.75	<b>3.25↓</b>	<b>3.25↓</b>	<b>3.25↓</b>

*Bold denotes changes from the last release with arrows showing the direction of changes*

**Fixed Income**

*Optimistic end of quarter.*

Last week we saw moderate improvement in sentiment. Consolidation in EURPLN helped market to regain some strength. Curve pushed down some 20-35 bp. with front end leading the way, best performer on the market were yet again long position in short maturity bonds. Curve is rather steep and we see further possibility of that trend to continue, as front end will be capped by possibility of rate cuts, while longer end is pressured from rising yields in core markets and expected negative news from fiscal side. RPP cut rates as expected leaving doors open for further easing in the pipeline in not so distant future. For this week we would like to take again sidelines and we recommend scaling back risk position, waiting for better entry levels. We think that current "optimism" on the market can be linked to end of quarter "window dressing" and we don't exclude sell off in bonds ahead of auction coming due in April.

**RECOMMENDATION:**

Close long PS0414, hold 3x6 PLN FRA

**AUCTIONS**

	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	6.142%	12/9/2008
26 Week T-bills	-	-	4.319%	3/23/2009
52 Week T-bills	3/30/2009	-	4.827%	3/16/2009
2Y T-bond OK0711	4/1/2009	-	5.804%	3/4/2009
5Y T-bond PS0413	4/1/2009	-	6.053%	3/4/2009
10Y T-bond DS1019	4/8/2009	-	5.724%	12/17/2008
20Y T-bond WS0429	4/8/2009	-	5.369%	1/14/2009

**Money Market**

*Liquidity still boosted*

*All the rates down by 25 bps*

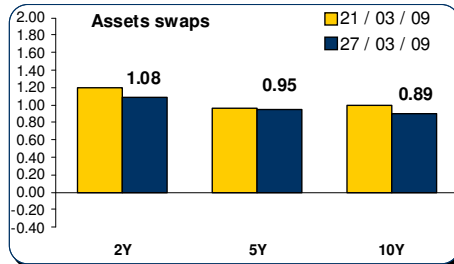
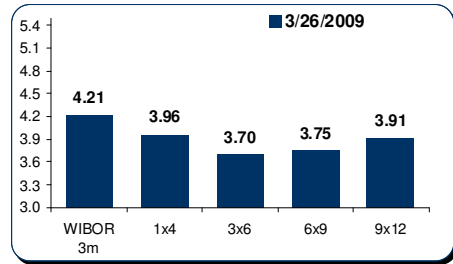
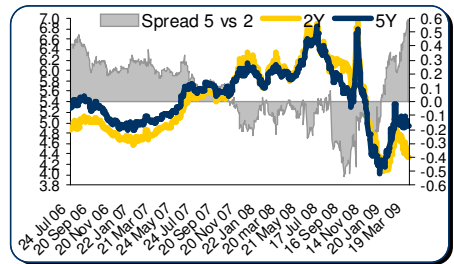
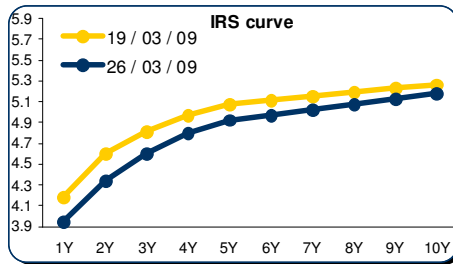
Liquidity still nearby the deposit rate in the central bank. End of the reserve and coming new one will probably not change the current situation.

The MPC cut all interest rates by 25 bps, setting the main rate at 3.75%, the deposit rate at 2.25%, the Lombard rate at 5.25% and the rarely used rediscount rate at 4%. There is still high probability of another 25-50 bps cut in the next 3M. Therefore Wibor rates went aggressively down, setting 1M rate below current main rate.

**RECOMMENDATION:**

Stay received.

**FIXED INCOME & MONEY MARKET CHARTS**



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

Money market rates (Closing mid-market levels)						
date	3M		6M		1Y	
	FXSW	WIBOR	FXSW	WIBOR	FXSW	WIBOR
20/03/09	4.15%	4.26%	4.21%	6.49%	4.22%	6.59%
23/03/09	4.12%	4.27%	4.23%	4.25%	4.25%	4.28%
24/03/09	4.10%	4.26%	4.22%	4.24%	4.24%	4.28%
25/03/09	4.06%	4.23%	4.20%	4.23%	4.23%	4.27%
26/03/09	4.00%	4.21%	4.18%	4.22%	4.21%	4.26%

**FRA MARKET RATES**

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
20/03/09	4.00%	3.84%	3.91%	4.18%	4.08%
23/03/09	4.10%	3.95%	4.05%	4.30%	4.20%
24/03/09	4.08%	3.87%	4.01%	4.23%	4.19%
25/03/09	4.03%	3.82%	3.92%	4.15%	4.13%
26/03/09	4.06%	3.78%	3.80%	4.03%	3.95%

**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
20/03/09	6.59%	4.70%	4.50%	5.69%	5.04%	5.99%	5.24%	6.23%
23/03/09	4.28%	4.77%	4.40%	5.69%	4.97%	5.99%	5.20%	6.23%
24/03/09	4.28%	4.76%	4.35%	5.38%	4.92%	5.80%	5.17%	6.00%
25/03/09	4.27%	4.70%	4.33%	5.42%	4.92%	5.87%	5.18%	6.07%
26/03/09	4.26%	4.70%	4.34%	5.42%	4.92%	5.87%	5.18%	6.07%

**PRIMARY MARKET RATES**

Last Primary Market Rates							
	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	09/03/16	10/03/16	95.354	4.83%	1200	3200	1181
OK0711	09/03/04	11/07/25	87.404	5.80%	3800	3199	2090
PS0414	09/03/04	14/04/25	98.663	6.05%	2500	1305	640
DS1017	08/12/17	19/10/25	98.186	5.72%	4500	3521	2340

**FX VOLATILITY**

date	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
	1M	3M	6M	1Y	1M	1Y	1M	1Y
20/03/09	34.50	32.25	31.25	30.50	8.00	8.25	2.40	2.40
23/03/09	34.50	32.25	31.25	30.50	0.00	0.00	0.00	0.00
24/03/09	34.50	32.25	31.25	30.50	0.00	0.00	0.00	0.00
25/03/09	34.00	32.00	31.00	30.00	0.00	0.00	0.00	0.00
26/03/09	33.00	31.50	30.50	29.50	0.00	0.00	0.00	0.00

**PLN SPOT PERFORMANCE**

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
20/03/09	3.3942	4.6446	-1.24%
23/03/09	3.3533	4.5748	-1.41%
24/03/09	3.3330	4.5308	-3.95%
25/03/09	3.3784	4.5555	-4.05%
26/03/09	3.3605	4.5593	-7.24%

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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