



## POLAND WEEKLY REVIEW

### MACROECONOMICS AND FINANCIAL MARKETS

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### PREVIEW: The week of April 3<sup>rd</sup> to April 9<sup>th</sup>

Indicator	Date of release	Pe- riod	BRE forecast	Consen- sus	Last	Comment
NO SIGNIFICANT RELEASES						

## In Focus / Macroeconomics

### Will positive surprises continue?

All the data published in the last few days surprised to the upside. In each case we would see the ongoing higher publications as temporary. The trend in the real sphere remains negative and speaks in favor of continuing disinflation in mid-term. As for the budget data we do not expect they to reflect and change in fundamentals – sooner or later the deficit would have to be raised (or expenditures severely cut); the strategy the Ministry of Finance is pursuing now is aimed at buying more time and confidence before unpopular announcements would have to be made.

Monthly inflation forecast of the Ministry of Finance surprised to the upside, posting a 3.5% annual gain in CPI. We fully agree with the estimated price level. The breakdown was not revealed, but the bulk of the rise can be attached to fast-rising food prices (a break in seasonal pattern is visible in the real data and the business activity indicators as well) accompanied by (this time) negligible growth of automotive fuel prices. The fallout of higher EURPLN valuation is likely to fuel upward pressure on prices in coming months; it translates into a stabilization of annual inflation. In the horizon closer to mid-term we expect disinflation process to continue at full throttle (in particular we do not expect the pass through mechanism from currently higher producer prices to be significant as GDP growth will be short of the potential for some time).

As for the real sphere data, we witnessed some signs of warming this week. PMI extended upward trend and shot up to 42.1pts. The commentary accompanying the publication shows further signs of improvement in current production, supported by the record pace of inventory reduction, further lay-offs and slightly lower pressure on producer prices. The PMI data conforms with lower fall in industrial output in March which we estimate at 9.9% y/y. We are far from seeing this specific reading as a sign of trend reversal, though. We would rather bet on a technical correction stimulated by earlier overshooting of orders reduction and current depletion of supplies. The trend remains negative: we expect steep fall of consumer demand in coming months (likely to find confirmation in the fresh retail sales data which we expect to post a 3.0% annual fall in March) accompanied by still gloomy situation abroad, mainly the euro zone which has already started bearing the problems of cyclical deterioration in labor market. Potential signs of improvement in the Polish economy will be seen in H2 as soon as GDP growth in German economy makes a u-turn (this scenario is still highly conditional).

Also the public finance added to the warmer economic climate. The fresh estimates of the Q1 budget deficit fall short of 12 bn PLN presented in the revamped schedule. The Ministry estimates the deficit to have reached 10.1 bn PLN after March on higher income and some successful trimming of expenditures. We still believe the most severe problems with public finance are still ahead (the most sharp fall of consumption and wages is to be seen in coming months). One has to admit, though, the publication of quite pessimistic deficit schedule and information on higher revenues announced just a few days after start to look like a brisk PR strategy of the Ministry of Finance. It also fully explains the contemporary unwillingness of the government to apply for IMF's FCL (Flexible Credit Line). As soon as some of the risk aversion fades, and the demand for T-bills revives, it would be much easier to finance a higher budget deficit; the possibility to draw 10 bn USD from IMF any time (and unconditionally) looks like another insurance in case anything goes wrong (we remind the reader the eligibility for FCL is almost equal to already opened additional credit line and may be regarded as a positive piece of news itself).

The MPC decision is going to be another close call. However, taking into consideration the stable dovish camp (with dovish governor Skrzypek having the right for casting vote) we bet at 25bp. cut in the coming meeting. It is hard to expect more from the MPC as there are more and more concerns on the zloty volatility (to which the rate-setting body is unwilling to add). There is some room for maneuver on the systemic liquidity, though. The discussions on lowering the deposit rate asymmetrically are going on; there are some plans to cut the reserve requirement ratio as well but we would not regard such a move as a possible one at the moment as the MPC seems to be pleased with short term liquidity and focuses on encouraging the banks to lend each other instead of depositing cash reserves with the central bank. We expect the MPC to cut further 2-3 times in small amounts during this cycle.

**MID-TERM  
FORECATS**

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	-3	-2.5
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	3.25	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	3.25	3.25	3.25

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

**Fixed Income***Following EURPLN again*

Apparently EURPLN had become main driver of the FI market again. Currency weakness towards 4.75 pushed the curve higher by some 25-30bp. However as this turned to be only temporary, move up was followed by quite a sharp rally. It seems that such events are quite unsustainable and just create some receiving opportunity. After recent closing of our long PS0414 position, we've decided to open new position in 2Y sector - there is still room for rates to be cut, cash market remains overliquid, asset swap spreads stay wide. Ministry of Finance inflation prediction sets expectations at high enough level, for the actual outcome to be either neutral or slightly positive. We still like shorting 3x6 FRA and would rather add to that position on upticks than reduce it.

**RECOMMENDATION:**

Stay short 3x6, buy 2Y bonds 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	-	-	4.242%	3/30/2009
52 Week T-bills	4/6/2009	-	4.857%	3/30/2009
2Y T-bond OK0711	5/6/2009	-	5.615%	4/1/2009
5Y T-bond PS0414	5/6/2009	-	6.039%	4/1/2009
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***Cheap end of reserve settlement period*

At the end of reserve settlement period the rates were close to deposit rate. Beginning of new one coincide with end of the first quarter. That day no one wanted to lend cash that is why short term interbank rates were 60 bps higher than previous couple of days and the volume was very low.

*Central Bank published new OMO schedule*

Central Bank decided to launch 6 month repo operations starting in May and broaden the array of collateral for banks. New list of collateral will include for example other than government – issued papers placed in KDPW, government-issued papers denominated in EUR, mortgage bonds. NBP will also accept as a collateral securities with coupon payment during repo duration. There will be also opportunity to use collateral from maturing operation as a collateral for new one.

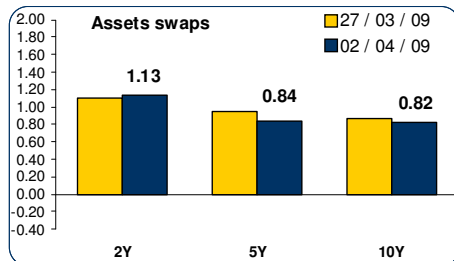
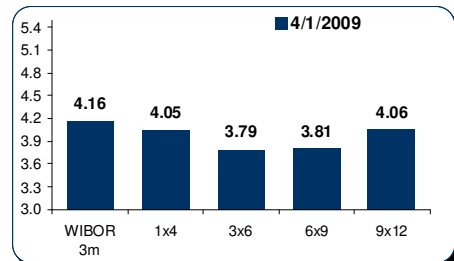
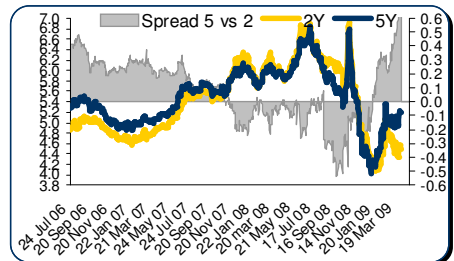
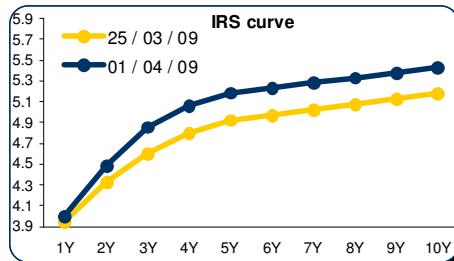
*T-bill's yields up at the tender.*

The average yield on Polish 52-week T-bill at primary tender went up to 4.857% from 4.827%. Demand was 2.4 billion PLN and the Ministry sold all 1 billion papers from the offer.

**RECOMMENDATION:**

Sell 3M OIS at current price

**FIXED INCOME & MONEY MARKET CHARTS**



**Foreign Exchange**

*Zloty stronger*

This week zloty has opened at 4.7400ish and performed very well. Strengthening toward recent lows at 4.44 was caused by good global sentiment plus some good local info .

*Implied volatility lower*

Despite quite volatile PLN, recent sell-off on vols, keeps curve low. Stronger zloty pushed it even for new local lows with 1M traded at 24 and 1Y at 19.

**RECOMMENDATION:**

SPOT

Main supports / resistances:  
 EUR/PLN: 4.4000 / 4.8000  
 USD/PLN: 3.1000 / 3.5500

*Short EURPLN*

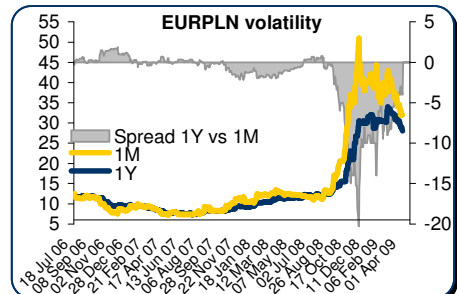
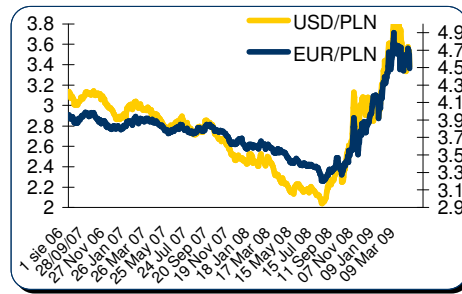
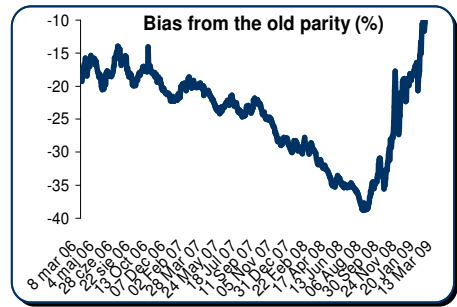
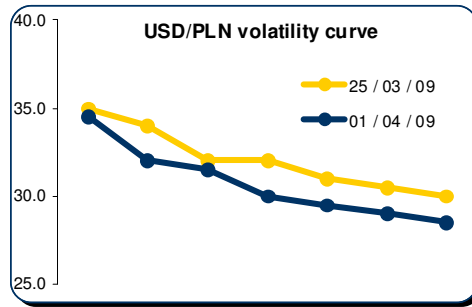
We are far away from our best and 2nd best EURPLN short entry level. Anyway probability of trading on upside is lower, so we would sell at 4.60 for testing 4.40.

OPTIONS

*Short vega*

Vols looks a bit offered here, so we suggest wait for higher levels to entry short vega. Selling gamma, however, looks as good idea. For hedging we suggest buying KO options as it is cheaper due to barrier pricing on high volatility market. Exporters may have some benefits from selling Risk Reversals as it is nearly highs (6 vols favour call).

**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
26/03/09	4.00%	4.14%	4.18%	6.49%	4.21%	6.59%
29/03/09	4.03%	4.14%	4.16%	4.17%	4.17%	4.19%
30/03/09	4.02%	4.14%	4.15%	4.15%	4.17%	4.19%
31/03/09	4.04%	4.17%	4.16%	4.16%	4.17%	4.21%
01/04/09	4.05%	4.16%	4.15%	4.16%	4.18%	4.20%

**FRA MARKET RATES**

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
26/03/09	4.06%	3.78%	3.80%	4.03%	3.95%
29/03/09	3.95%	3.72%	3.77%	3.97%	3.90%
30/03/09	3.93%	3.68%	3.73%	3.93%	3.86%
31/03/09	3.96%	3.70%	3.75%	3.91%	3.87%
01/04/09	4.01%	3.83%	3.84%	4.04%	4.00%

**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
26/03/09	6.59%	4.67%	4.34%	5.42%	4.97%	5.89%	5.23%	6.10%
29/03/09	4.19%	4.77%	4.45%	5.55%	5.08%	6.02%	5.35%	6.22%
30/03/09	4.19%	4.77%	4.58%	5.65%	5.21%	6.08%	5.46%	6.31%
31/03/09	4.21%	4.85%	4.56%	5.61%	5.19%	6.00%	5.43%	6.27%
01/04/09	4.20%	4.85%	4.48%	5.56%	5.19%	6.02%	5.43%	6.25%

**PRIMARY MARKET RATES**

Last Primary Market Rates							
	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	09/03/30	10/03/30	95.319	4.86%	800	2382	1012
OK0711	09/04/01	11/07/26	88.147	5.62%	2000	4384	2144
PS0414	09/04/01	14/04/26	98.748	6.04%	1500	2427	1514
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
26/03/09	33.00	31.50	30.50	29.50	0.00	0.00	0.00	0.00
29/03/09	32.00	31.00	30.00	29.00	0.00	0.00	0.00	0.00
30/03/09	33.00	31.50	30.00	29.00	0.00	0.00	0.00	0.00
31/03/09	32.00	30.50	30.00	29.00	0.00	0.00	0.00	0.00
01/04/09	32.00	30.00	29.50	28.50	0.00	0.00	0.00	0.00

**PLN SPOT PERFORMANCE**

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
26/03/09	3.3605	4.5593	-7.24%
29/03/09	3.5054	4.5883	-7.23%
30/03/09	3.5779	4.7191	-7.86%
31/03/09	3.5416	4.7013	-6.62%
01/04/09	3.5222	4.6462	-7.84%

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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