



## POLAND WEEKLY REVIEW

### MACROECONOMICS AND FINANCIAL MARKETS

**IN FOCUS /  
MACROECONOMICS**

- *Unilateral euroization as a doubtful remedy for polish economic distress* • page 2

**FIXED INCOME**

- *Big auction, very good auction!!!* • page 3

**FI  
RECOMMENDATION**

- *Hold short 3x6, hold 2y bonds, for more aggressive investors add duration preferably with bonds.*

**MONEY MARKET**

- *Not too much action last week*
- *Two T-bills tenders due to Easter.* • pages 3-4

**MM  
RECOMMENDATION**

- *Offer 1-3M polonia at current levels.*

**FOREIGN EXCHANGE**

- *Zloty in range*
- *Implied volatility lower* • pages 4-5

**FX  
RECOMMENDATION**

- *Short EURPLN*
- *Short gamma*

**MARKET PRICES  
CONTACT LIST  
DISCLAIMER**

- page 6
- page 7
- page 8

### PREVIEW: The week of April 10<sup>th</sup> to April 16<sup>th</sup>

Indicator	Date of release	Period	BRE forecast	Consensus	Last	Comment
C/A balance bn EUR	Apr 14	Feb	-0.3	-0.65	-1.1	Exports and imports falling by 30 and 35% respectively. Substantial inflow of EU funds (including Common Agricultural Policy). Income and service account stable; narrowing trade deficit.
M3 Supply y/y	Apr 14	Mar	17.1%	17.4%	17.4%	Better flows with mutual funds. Observed zloty depreciation rises the PLN value of deposits.
CPI Inflation y/y	Apr 15	Mar	3.5%	3.2%	3.3%	The MinFin forecast at 3.5% y/y. Relatively high growth of food prices (1.2-1.5% m/m). Core inflation excluding food and energy at 2.3% y/y (to be published Apr 22).
Employment y/y	Apr 17	Mar	-0.8%	-0.8%	-0.2%	Business tendency indicators show the labor demand is falling further (anywhere besides

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						manufacturing, where there are on record low levels). Group lay-offs continue.
<b>Wages y/y</b>	<b>Apr 17</b>	Mar	<b>3.2%</b>	4.2%	5.1%	Falling trend extended. Lower bonuses.

## In Focus / Macroeconomics

### Unilateral euroization as a doubtful remedy for polish economic distress

Last week the Financial Times cited the main conclusions from a one month old IMF report on CEE economies. The IMF suggested that the best way to break the financial crisis in CEE would be to unilaterally and immediately introduce the common currency. Despite rather strong dementi issued by European Commission and ECB Governing Board members who decided to unconditionally support the criteria imposed by the Stability and Growth Pact, Polish Ministry of Finance seems to fully back the main thesis of the IMF's report. Although it is unlikely that the market will price it as one of the more likely scenarios, we cannot rule out that discussion on the euroisation will escalate as the Finance Minister Rostowski (in its joint paper with A. Bratkowski) promulgated the idea already few years ago.

Many academic (and also empirical) results suggest the elevated exchange rate volatility decreases the welfare of consumers (defined as in typical general equilibrium economic models as total lifetime utility derived from consumption and leisure). Thus, a quick adoption of the common currency would clearly elevate the nation's welfare. Such a view neglects potential threats to emerge on the longer horizon though, including also the mid-term benefits from depreciated currency on the expected turnaround of the real sphere of the economy. There may be also technical obstacles and explicit veto from ECB (as in case of Montenegro, which owing to its relative tiny size, did not pose such threats to the euro zone stability). That is why there may be some discussion on the euroization topic but this scenario is rather unlikely to really come back on the agenda.

The government may switch to the passive strategy instead. If the nation decides to go for the euro currency in a usual way, the prerequisite is to enter the ERM2 first. But then the period of stricter fiscal and monetary policy accompanied with an ongoing risk of breaching the nominal convergence criteria may work towards decreasing the welfare. Given the fragile nature of current financial markets equilibrium (waves of risk aversion) the short-term costs of entering the ERM2 may completely offset the long-term benefits, especially in case when violating Maastricht criteria triggers abrupt market reactions. We think that the government and leading intellectuals (including Leszek Balcerowicz himself) are more and more aware of the risks attached to such a scenario. That is why we think the ERM2 and euro entry agenda is now losing its importance for the government (and markets fortunately) and one should not expect any shocking declaration as far as the acceleration of the process is concerned any time soon.

#### 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

*Big auction, very good auction!!!*

The main event of last week was auction of DS1019, first time in almost 3 months the Ministry of Finance decided to sell longer maturity bonds on primary auction and with splendid result. After auction with low price above secondary market offer, DS1019 continued to climb to make 100 cents within 24 hours. As far as the shape of the curve is concerned we saw some flattening especially in the 5y10y sector, as investors decided to go for more risk. However, there are many reasons to be rather optimistic about that part of the curve in particular. Firstly, the 5y5y forward which trades at record high levels, secondly the ASW which yields almost 85 bp for 10 years and additionally relatively attractive forward curve with rates approaching 5.75% 5y forward. With slight change in risk perception we see this curve as rather attractive place to receive especially through bonds. The main risks to this strategy are obvious: expected budget amendment and ongoing threat of risk aversion coming back. Because of that we will stick to our defensive strategy, for the time being we prefer to hold 2y bonds outright, which are providing nice capital increase as well as they yield very well compared to the cash, we are keen however to increase duration. We also like short 3x6 as we don't think MPC is close to finishing with cutting rates and cash market put nice cap on where Wibor rates can go. We wish everybody Happy Easter.

### **RECOMMENDATION:**

Hold short 3x6, hold 2y bonds, for more aggressive investors add duration preferably with bonds.

### **AUCTIONS**

	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	6.142%	09/12/2008
26 Week T-bills	-	-	4.242%	30/03/2009
52 Week T-bills	06/04/2009	-	4.822%	09/04/2009
2Y T-bond OK0711	06/05/2009	-	5.615%	01/04/2009
5Y T-bond PS0414	06/05/2009	-	6.039%	01/04/2009
10Y T-bond DS1019	13/05/2009	-	6.224%	08/04/2009
20Y T-bond WS0429	13/05/2009	-	5.369%	14/01/2009

## Money Market

*Not too much action last week*

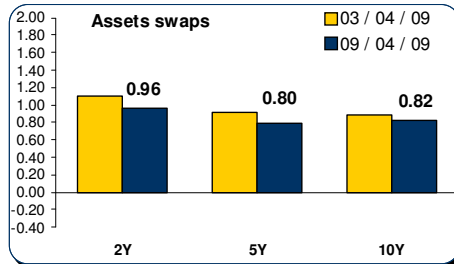
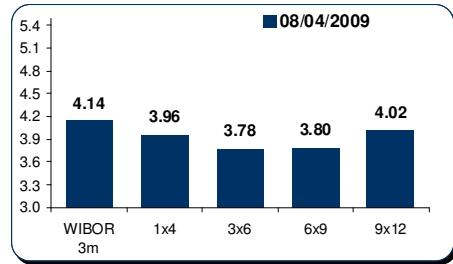
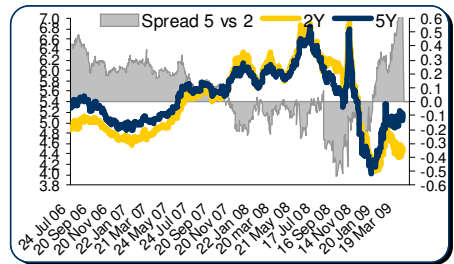
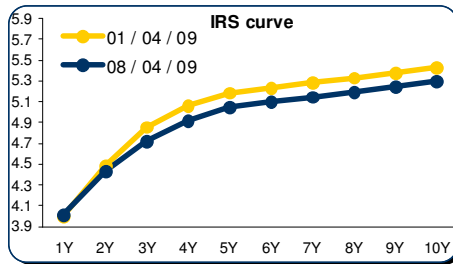
*Two T-bills tenders due to Easter.*

Lazy week for both trading and liquidity as far as the money market is concerned. The central bank is still limiting the amount of money bills, and for the beginning of the new reserve this figure dropped to 12 billion pln with almost 70% reduction rate. Substantial surplus of the short cash in the system keeps the carry slightly above the deposit rate in the central bank. Longer terms are affected by lack of the current economic figures and now we have awaiting period. Hence, no real trading is present. Two T-bills auctions this week (Monday and Thursday) due to Easter Monday next week. During the first auction benchmark average yield stayed almost unchanged at 4.83%, during the second one quite similar at 4.82%.

### **RECOMMENDATION:**

Offer 1-3M polonia at current levels.

**FIXED INCOME & MONEY MARKET CHARTS**



**Foreign Exchange**

*Zloty in range*

This week zloty has opened at 4.40, weakened toward 4.5250 just to get back to Monday's levels. Global sentiment remains quite good so even weaker Hungarian data did not affected PLN.

*Implied volatility lower*

EURPLN volatility is decreasing, lower number of 10 delta observations translated to lower run (1M 22, 1Y 19), lower RR (1Y 25D 5.75) and lower flies (1Y 25D 1.35). Vols are well offered at the moment.

**RECOMMENDATION:**

SPOT

Main supports / resistances:  
 EUR/PLN: 4.4000 / 4.6000  
 USD/PLN: 3.1000 / 3.5000

*Short EURPLN*

Our idea is to sell upticks from 4.40 (4.60 desired level) or wait for breaking of 4.40 and sell then.

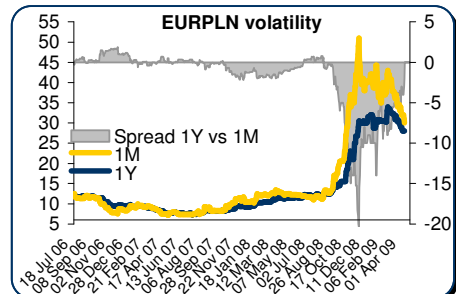
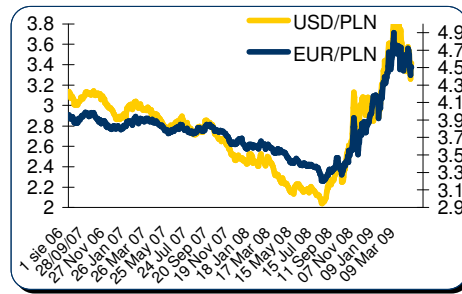
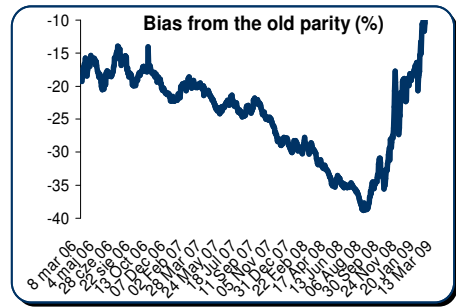
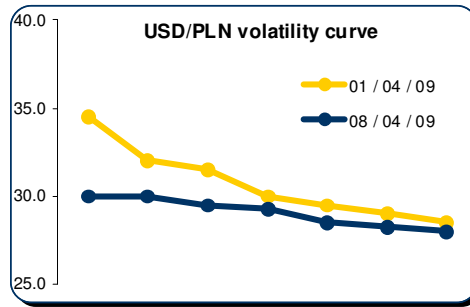
*Short gamma*

OPTIONS

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
02/04/09	4.05%	4.16%	4.16%	6.49%	4.20%	6.59%
03/04/09	4.05%	4.16%	4.15%	4.18%	4.19%	4.21%
06/04/09	4.11%	4.14%	4.20%	4.16%	4.20%	4.20%
07/04/09	4.00%	4.14%	4.23%	4.16%	4.25%	4.20%
08/04/09	4.00%	4.14%	4.13%	4.16%	4.17%	4.20%

**FRA MARKET RATES**

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
02/04/09	4.07%	3.85%	3.90%	4.10%	4.03%
03/04/09	4.03%	3.89%	3.92%	4.13%	4.04%
06/04/09	4.05%	3.79%	3.81%	4.06%	3.96%
07/04/09	3.99%	3.75%	3.77%	3.95%	3.92%
08/04/09	3.97%	3.78%	3.81%	4.01%	3.92%

**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
02/04/09	6.59%	4.85%	4.56%	5.61%	5.19%	6.00%	5.43%	6.27%
03/04/09	4.21%	4.85%	4.48%	5.56%	5.19%	6.02%	5.43%	6.25%
06/04/09	4.20%	4.85%	4.35%	5.50%	5.04%	5.99%	5.30%	6.22%
07/04/09	4.20%	4.85%	4.43%	5.54%	5.08%	6.00%	5.34%	6.23%
08/04/09	4.20%	4.85%	4.46%	5.43%	5.08%	5.94%	5.34%	6.20%

**PRIMARY MARKET RATES**

Last Primary Market Rates							
	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	09/04/09	10/04/09	95.351	4.82%	1500	5065	1961
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	09/04/08	19/10/25	94.460	6.22%	2500	4846	1820

**FX VOLATILITY**

date	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
	1M	3M	6M	1Y	1M	1Y	1M	1Y
02/04/09	32.00	29.75	29.00	28.00	5.50	6.75	1.40	1.40
03/04/09	32.00	29.75	29.00	28.00	5.50	6.75	1.40	1.40
06/04/09	32.00	29.75	29.00	28.00	5.50	6.75	1.40	1.40
07/04/09	31.00	29.50	29.00	28.00	5.50	6.75	1.40	1.40
08/04/09	30.00	29.25	28.50	28.00	5.50	6.75	1.40	1.40

**PLN SPOT PERFORMANCE**

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
02/04/09	3.3805	4.4895	-6.22%
03/04/09	3.3078	4.4523	-7.52%
06/04/09	3.2615	4.4135	-8.27%
07/04/09	3.3828	4.5101	-7.46%
08/04/09	3.4140	4.5039	-7.62%

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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