



POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

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PREVIEW: The week of May 15th to May 21st

Indicator	Date of release	Pe-riod	BRE forecast	Consen-sus	Last	Comment
C/A balance (EUR)	May 15	Mar	-460 mln	-460 mln	515 mln	11% fall in exports (higher business activity) accompanied by 20% drop in imports (softer consumer demand). C/A to improve further in coming months.
Wages y/y	May 19	Apr	4.6%	4.6%	5.7%	Mid-term downward trend. Temporary jumps governed by swifts in monthly economic activity.
Employment y/y	May 19	Apr	-1.4%	-1.3%	-0.9%	Ongoing process of job destruction. Seasonal factors drive the growth rate of employment higher (note the official unemployment rate estimate at last month's level).
Industrial output y/y	May 20	Apr	-11.0%	-10.8%	-2.0%	One working day less on annual basis. Pretty strong base effects (towards lower reading). Stagnation of PMI.
PPI y/y	May 20	Apr	5.4%	5.9%	5.7%	Cheaper commodities. Sharp PLN appreciation. Data confirms ongoing disinflation with lower prices (level) in manufacturing.
Core inflation y/y	May 21	Apr	2.5%	2.5%	2.5%	Only moderate growth of core categories. Trend to be sustained in current cycle.

In Focus / Macroeconomics

No ERM2 entry in sight

The European Commission warned Poland and three more EU countries that they run too extensive budget deficits, which almost automatically makes excessive deficit procedure opened. Even though imposing the EDP on Poland will not automatically translate into any substantial sanctions, as the old EU countries are running the extensive deficits too, it will practically block the Poland's plans of ERM-2 entry in 1H 09 and euro adoption in 2012.

It seems that even the overly optimistic government is now getting more and more skeptical as far as the euro adoption is concerned. Although Polish deputy finance minister Kotecki still believes that the ERM2 entry could happen in 2H, he admitted that Poland would not be able to enter the ERM-2 in 1H 2009.

We see the Polish government credibility being severely damaged since it hid the true deficit numbers for 2008. Any comments then, related to the euro adoption and ambitious fiscal spending cuts, should not be treated seriously. On the one hand, the political calendar (elections in 2009, 2010 and 2011) makes any drastic fiscal tightening very unlikely. On the other hand, weakening domestic demand will be working towards further shortages of budget revenues. All in all, the general government deficit is to top 5% of GDP this year and remain well above 3% mark in the coming years, making euro adoption plans really unrealistic.

CPI way above the target

CPI in April reached 4.0% after 3.6% a month ago (market consensus 3.8%). Among the benign behavior of most categories there are two striking exceptions: food prices (+1.6% m/m) and transport (+1.4% on higher transport fares); the latter driving the core inflation to 2.6% after 2.5% in March. It seems food prices entered the period of seasonal growth with additional boost from import prices and behavior of Polish food exporters who make use of cross boarder arbitrage, along with some structural deficiencies resulting from CAP.

April's CPI reading is going to be the highest in current cycle, although inflation is likely to remain on elevated level for several months. Reasoning along the lines of current MPC rhetoric, 4.0% CPI reading seems to be an ultimate argument against lowering rates in May. There is still some room to ease, though, with faulty credit supply (M3 slowed to 14.4% in April after 17.6% in March) and ongoing real sphere contraction. We think the MPC underestimated the risks to growth (domestic demand in particular) in 2009 and neglected a strong signal from awful business activity indicators (ironically, prepared by the central bank).

The data lifted the curve by some bps. Although MPC members speak in favor of another pause in May, we expect the repo rates to fall ultimately to 3.0-3.25% in current cycle and short forward rates seem to be a bargain at current levels.

MID-TERM FORECASTS

Indicator	2006	2007	2008	2009	2010
GDP y/y (%)	6.1	6.5	4.8	0.0	2.0
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	-1.0	-1.5	0.4
Inflation rate (% , average)	4.7	3.8	3.2	3.1	2.5	2.4
NBP repo rate (end-of-quarter)	6.00	5.00	3.75	3.50	3.25	3.25

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

Fixed Income

Yield keep climbing. Opportunity to receive?

Yields continued to push up last week, however market is apparently losing momentum. Most important event was the CPI data release; came out at 4.0%, slightly above market consensus and our expectations. However we don't think this reading would have any significant impact on the rates from this point. It's almost certain, we've already seen highest level of inflation this year, from now on we should see it decline towards the 2.5% target, which is achievable by the end of year. Easing inflation and positive projection to be published in June should be enough for the MPC to cut rates again. We're getting more and more positive for the front end of the curve, we consider 1Y1Y forward above 5% as really high, also short FRA prices seem somehow elevated. However, situation on Wibors is still far from being normal which makes receive positions in derivatives somehow tricky. But bond yields, currently 200bp above main rate on 2y bond are quite attractive in our opinion and we recommend long position in 0711. We also still like steeper curve, so stay pay steepeners.

RECOMMENDATION:

Buy OK0711, pay 10Y.

AUCTIONS

	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	6.142%	12/9/2008
26 Week T-bills	-	-	4.456%	5/4/2009
52 Week T-bills	5/18/2009	-	5.055%	5/11/2009
2Y T-bond OK0711	6/3/2009	-	5.669%	5/13/2009
5Y T-bond PS0414	6/3/2009	-	6.039%	4/1/2009
10Y T-bond DS1019	5/20/2009	-	6.224%	4/8/2009
20Y T-bond WS0429	5/20/2009	-	5.369%	1/14/2009

Money Market

Liquidity stable

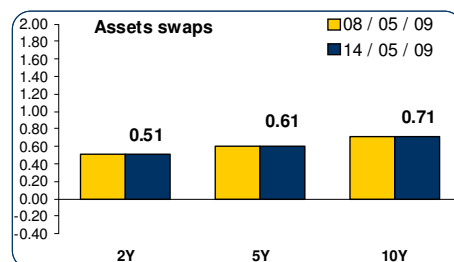
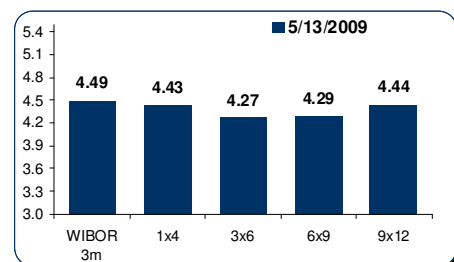
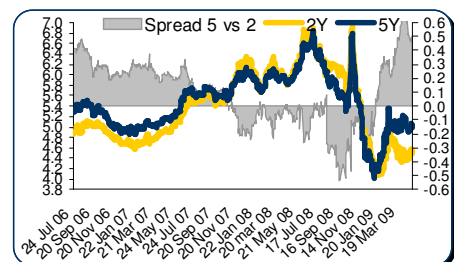
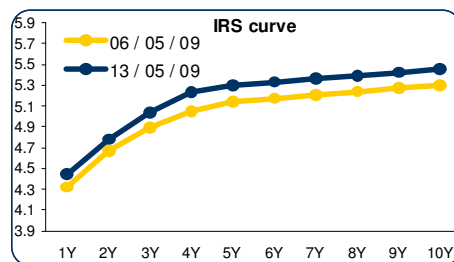
Benchmark T-bill average yield 5.055%

Nothing new as far as liquidity is concerned. Cost of carry still nearby the main market rate. Repo operation amounted only to 3.2 billion pln (almost 9 billion maturing). However, it is mainly due to the next week's 6M repo, which is a new facility and probably will attract much bigger demand. Benchmark T-bill average yield also stable at 5.055 during last tender. As for trading also nothing new. Although the ECB cut its rates last Thursday, our MPC seems to be resistant to loosen the monetary policy this month, focusing on real economy current data. We bet on two more hikes in June and July. Both 25 bps.

RECOMMENDATION:

Sell 9,12M polonia at current level.

FIXED INCOME & MONEY MARKET CHARTS



Foreign Exchange

Zloty weaker

This week zloty has opened at 4.3400 and weakened toward 4.5100 top. Driver was once again global sentiment, worsening of it took all CE3 currencies on weaker side.

Implied volatility untouched

Zloty is weaker but volatility curve stays at same levels. Looks like market do not believe weakening trend will last long.

RECOMMENDATION:

SPOT

Main supports / resistances:
 EUR/PLN: 4.2200 / 4.6000
 USD/PLN: 3.1000 / 3.5000

Play range

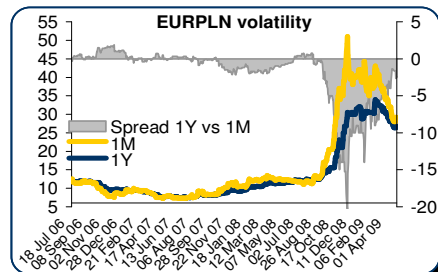
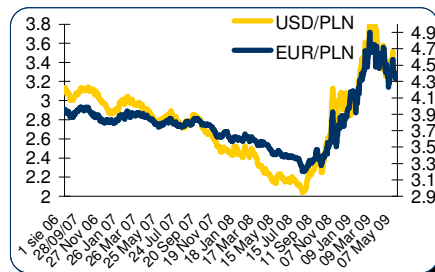
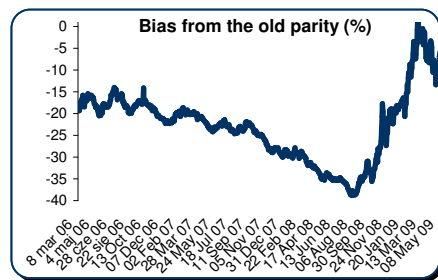
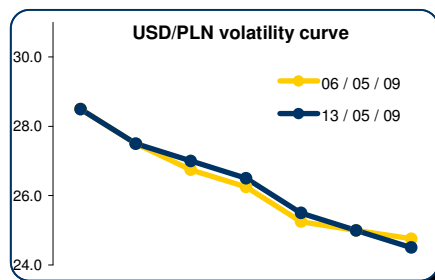
Seems like outer problems took PLN in 4.50 area. We still see 4.55 as good resistance and level for long PLN position, but...
 But local problems with budget deficit, ERM entry are still out of play. It increases probability of breaking 4.55 and range play 4.30-4.65. And that's range we would like to play.

Short gamma

OPTIONS

Vols looks a bit offered here, so we suggest wait for higher levels to entry short vega (20 vol for 1Y). 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 (4.5 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
07/05/09	4.28%	4.42%	4.35%	4.41%	4.59%	4.63%
08/05/09	4.30%	4.43%	4.41%	6.49%	4.61%	6.59%
11/05/09	4.31%	4.46%	4.42%	4.47%	4.62%	4.70%
12/05/09	4.32%	4.47%	4.45%	4.48%	4.65%	4.70%
13/05/09	4.34%	4.49%	4.45%	4.50%	4.65%	4.73%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
07/05/09	4.22%	4.02%	4.05%	4.22%	4.19%
08/05/09	4.28%	4.05%	4.07%	4.23%	4.29%
11/05/09	4.34%	4.12%	4.12%	4.28%	4.32%
12/05/09	4.33%	4.13%	4.16%	4.33%	4.29%
13/05/09	4.39%	4.23%	4.26%	4.43%	4.37%

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
07/05/09	4.63%	4.98%	4.69%	5.20%	5.16%	5.77%	5.32%	6.03%
08/05/09	6.59%	5.00%	4.76%	5.23%	5.24%	5.80%	5.38%	6.08%
11/05/09	4.70%	5.00%	4.80%	5.30%	5.29%	5.84%	5.44%	6.13%
12/05/09	4.70%	5.02%	4.76%	5.30%	5.26%	5.80%	5.40%	6.12%
13/05/09	4.73%	5.03%	4.78%	5.30%	5.30%	5.88%	5.45%	6.18%

PRIMARY MARKET RATES

Last Primary Market Rates

	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	09/05/11	10/05/11	95.138	5.06%	800	1563	758
OK0711	09/05/13	11/07/25	88.602	5.67%	3150	5320	3313
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**PLN SPOT PERFORMANCE**

date	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
	1M	3M	6M	1Y	1M	1Y	1M	1Y
07/05/09	27.00	26.25	25.50	24.50	3.75	5.25	1.25	1.25
08/05/09	27.00	26.25	25.50	24.50	3.75	5.25	1.25	1.25
11/05/09	27.00	26.25	25.50	24.50	3.75	5.25	1.25	1.25
12/05/09	27.00	26.25	25.50	24.50	3.75	5.25	1.25	1.25
13/05/09	27.50	26.50	25.50	24.50	3.75	5.25	1.25	1.25

PLN spot performance

date	USD/PLN	EUR/PLN	bias
07/05/09	3.2632	4.3362	-9.04%
08/05/09	3.2419	4.3511	-8.37%
11/05/09	3.2145	4.3724	-6.90%
12/05/09	3.2250	4.3998	-5.80%
13/05/09	3.2078	4.3943	-8.83%

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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