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FINANCIAL MARKETS DEPARTMENT

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POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

PREVIEW: The week of June 12ve to June 18th

Indicator	Date of release	Pe-riod	BRE forecast	Consen-sus	Last	Comment
CPI Inflation y/y	Jun 15	May	**3.5-3.6%**	3.7%	4.0%	Moderate growth of food prices. Core inflation excluding food and energy unchanged at 2.6% y/y (to be published June 22). MinFin's forecast at 3.8% on higher food prices.
C/A balance	Jun 17	Apr	**+246 mln EUR**	+69 mln EUR	+ 70 mln EUR	Drop of exports by 28.5% y/y – a high basis from 2008, Easter effect and lower output in April. Decrease in imports by 34.5% y/y reflecting decreases in retail and wholesale trade. Trade deficit totaling 183 mln EUR. C/A balance higher on substantial EU flows.
Wages y/y	Jun 18	May	**5.0%**	5.0%	4.8%	Annual indicator still inflated by wage rises in a Q3 2008. Fallout from higher economic activity in May.
Employment y/y	Jun 18	May	**-1.7%**	-1.7%	-1.4%	Improvement of business tendency indicators concerning employment (almost all sections).

In Focus / Macroeconomics

Some notes on European parliamentary elections

Not surprisingly, European Elections' results showed that the two biggest parties in the Polish Parliament had won most of the votes. The pro-business Civic Platform party had 44.4% support. Ranked second, conservative opposition Law and Justice party won 27.4% of the votes. The politicians from a coalition Democratic Left Alliance and Labor Union received 12.3% support. The Polish People's Party, which entered into a coalition after a parliamentary election in 2007 placed fourth, with 7% of the votes.

The Civic Platform party and the Polish People's Party (Polish Peasants Party), which belong to the Group of European People's Party, received 25 and 3 seats in the Parliament respectively. The Law and Justice from Union for Europe of the Nations group received 15 seats in the Parliament and a coalition Democratic Left Alliance and Labor Union from Socialist Group in the European Parliament – 7. The turnout amounted to 24.5%, almost twice as much as during the former European event of this sort.

In comparison with elections to the Polish Parliament in 2007 only the Civic Platform party drew more votes, but only 3pp. more. The rest three parties lost from 1pp. to 5pp. The results reflect exactly the public opinion polls (proving them quite reliable). Although the ruling coalition is going through a hard period, opposition does not seem to be better footed. Ruling party preserved still enough social capital to navigate through delicate issues concerning the amendment of the budget bill. But still, having presidential elections in 2010 on the horizon it would be unreasonable to scoop on it. The strategy of positive surprises is still on then.

What to expect next week

There are some crucial publications next week concerning the real and nominal sphere of the economy. There is a good chance that CPI inflation fell more than expected. This fact combined with rather sluggish recovery of manufacturing, falling wages and low domestic demand is likely to be reflected in new inflation projection, a good reason for another rate cut to 3.50%.

The parade of readings begins with CPI inflation (May 15) which we expect to come out lower than market consensus (+3.7%) and the forecast of the Ministry of Finance (+3.8%) as well. We think both forecasts base on higher food prices (MinFin announced they rose in May by 1.4-1.5% m/m) and rising costs of fuels (with regard to this item we agree that the monthly growth rate rather fell short of 3%). The evidence against another spike in food prices seems promising: lower prices in the wholesale market, drop of business tendency indicators concerning food prices in retail which breaks usual seasonal pattern of rises in May, drop of food prices in the Czech Republic (it is highly significant variable in our food prices model), also divergent from seasonal norm. That is why we still expect CPI inflation at 3.5-3.6% with core inflation intact at 2.6%.

Two day later (May 17) C/A data see the light. We expect nothing but a confirmation of the recent trends: falling exports and imports but improving trade balance (that is why we think net exports will be significant contributor to GDP growth rate throughout 2009). Our C/A forecast at +246 mln EUR is slightly above the consensus (+70 mln EUR).

Thursday (May 18) will be dominated by the labor market data. Our wage and employment forecasts reflect market consensus (+5.0% y/y and -1.7% y/y respectively). Wage data are still influenced by solid growth experienced in Q3 2008; monthly variation is also affected by the level of economic activity. The trend remains negative, though, closely following the yawning output gap. As for employment figures, there are some signs in the data that the number of lay-offs has stabilized. However, business activity indicators are still under water (although improving) and anecdotal evidence suggests further cost-cutting.

Friday's data concentrate on manufacturing. Industrial output is likely to have ameliorated to -5.2% on annual basis (market consensus -6.9%). We witnessed some improvement in the underlying trend (reflected in better PMI), there is no difference in working days and quite substantial base effect (a dip in industrial output in May 2008). Also the hard data concerning auto production (they give some indication as to how large is the aforementioned base effect from previous year) confirm that industrial output growth rate improved in May. On the other hand, producer prices fell further in May to 4.5% y/y (exact market consensus) reflecting spare capacities. However, owing to the renewed upward trend in commodity markets, strong disinflationary influence of local factors may be partially offset for some time.

Coming week is likely to bring some news on public finance, namely: macroeconomic assumptions for 2010 budget bill. At the beginning of May, the Ministry of Finance announced it expected GDP growth in 2010 at 0.5-1.3% and CPI inflation at 1.5-1.9%. Point forecasts are to be published on Monday. According to unofficial comments from anonymous MinFin officials (as quoted by the press) they are likely to hit the more pessimistic bounds of intervals: 0.5% GDP growth and 1.5% rise of prices. There is no surprise the government wants to be as conservative as it can in order to generate upside surprises, not the other way round. Pessimistic GDP growth rate accompanied by relatively stable prices constitute a good base for meager income growth which, in turn, should discourage excessive expenditures. A way to upside surprise on deficit figures remains then opened should actual GDP growth and inflation actually increase by more than expected.

MID-TERM FORECATS

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	12.8	13.5
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	0.8	-0.7	-1.1	0.5
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 chages from the last release with arrows showing the direction of chages

Fixed Income

CPI to support the market

Very good results of Monday t-bills auction (1y yield at 4.75%, more than 10bp lower than a week earlier) and cancelling Wednesday bond auction had some positive impact on the sentiment on the FI market. Yields moved down by some 10-15bp, with 10y sector gaining the most. Due to holiday on Thursday rest of the week was very quiet, however market lost bit of previous gains. Asset swap spreads remain tight, especially in the 4y-5y sector, shorter maturities remain relatively cheap - we still like OK0711 and recommend holding that position. Next week will bring large set of macroeconomic data, with probably most important CPI on Monday. So far the Ministry of Finance prediction has set market expectation at relatively high level (3.8% y/y). As our forecast is significantly lower (3.5-3.6% y/y), we expect yields moving lower, as such reading would definitely reinforce rate cut expectation. We recommend receiving 2y on upticks or adding some OK0711 outright.

RECOMMENDATION:

Stay long OK0711 outright or in ASW. Receive 2Y

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	6/15/2009	-	4.749%	6/1/2009
2Y T-bond OK0112	7/1/2009	-	5.456%	6/3/2009
5Y T-bond PS0414	7/1/2009	-	5.783%	6/3/2009
10Y T-bond DS1019	7/8/2009	-	6.340%	5/20/2009
20Y T-bond WS0429	7/8/2009	-	6.340%	5/20/2009

Money Market

Cheap week may turn into cheap month

T-bill yields down

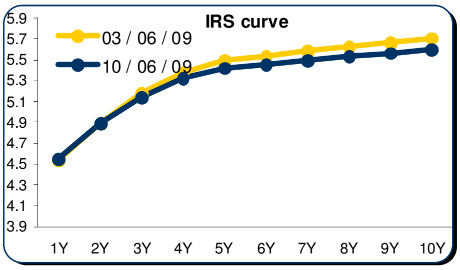
Shortest rates well below the main market rate. Polonia fixings below 3%. Today's open market operation again without meeting the supply (29.7 billion demand against 31,5 billion on the offer), therefore next week should also be cheap. If this scenario happens, the probability of the cheap month significantly rises.

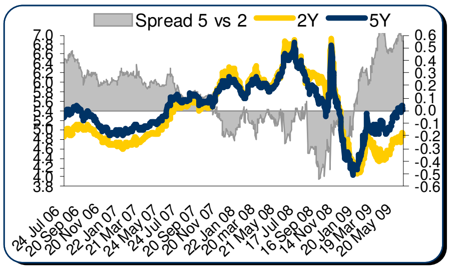
T-bills auction bought by one buyer with the 4.74% yield. Market still lacks liquidity; hence main activity for trading is waiting for new data. 25 bps cut is built in the curve and this view is common. Next week's CPI will be crucial for further outlook.

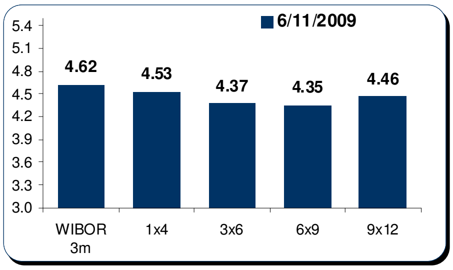
RECOMMENDATION:

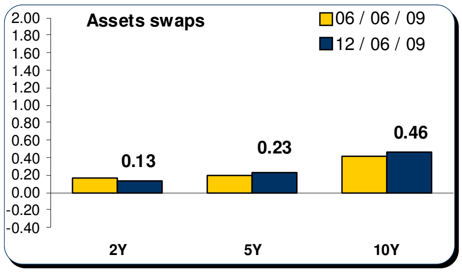
Sell short polonia.

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty stronger

This week zloty has opened at 4.5400 – the last weakness was as a result of Latvia's troubles. In the second part of week we observed a bigger wave of retracement. The zloty closed at 4.47

Implied volatility lower

Stronger zloty, better global sentiment, so volatility has moved down a little. The 3M EUR/PLN was at 18.5, 1Y traded at 17.0.

RECOMMENDATION:

SPOT

Main supports / resistances:
EUR/PLN: 4.3800 / 4.6000
USD/PLN: 3.0000 / 3.3500

Stay away/Buy dips

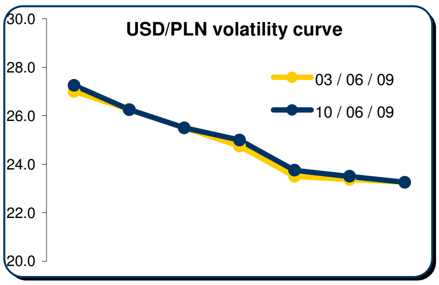
After Latvia's issue we are probably back to the global equity and EUR/USD correlation game. No big levels in the vicinity, 4,45-4,55 still the narrow range.

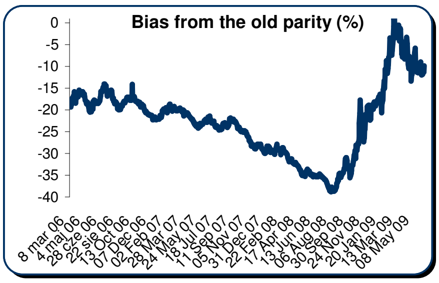
OPTIONS

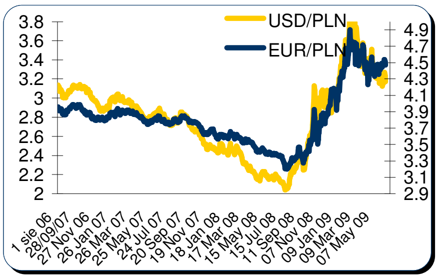
Sell vega on upticks

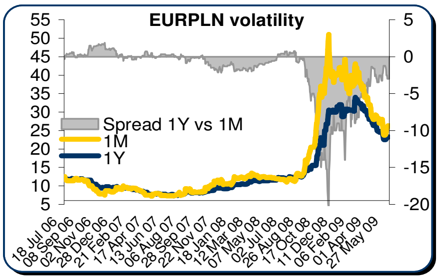
Vols looks a bit offered here, so we suggest wait for higher levels to entry short vega (20 vol for 1Y).
For hedging we suggest buying KO options as it is cheaper due to barrier pricing on high volatility market.
Exporters may have some benefits from selling Risk Reversals as it is nearly highs (4.5 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
04/06/09	4.55%	4.64%	4.60%	4.64%	4.89%	4.95%
05/06/09	4.52%	4.63%	4.70%	4.65%	5.09%	6.59%
08/06/09	4.49%	4.63%	4.63%	6.49%	4.90%	4.94%
09/06/09	4.50%	4.64%	4.61%	4.64%	4.89%	4.94%
10/06/09	4.50%	4.62%	4.60%	4.66%	4.90%	4.94%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
04/06/09	4.50%	4.27%	4.27%	4.37%	4.43%
05/06/09	4.56%	4.38%	4.36%	4.47%	4.51%
08/06/09	4.56%	4.36%	4.35%	4.46%	4.52%
09/06/09	4.55%	4.37%	4.37%	4.47%	4.53%
10/06/09	4.55%	4.41%	4.40%	4.52%	4.55%

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
04/06/09	4.95%	5.08%	4.91%	5.07%	5.51%	5.66%	5.72%	6.09%
05/06/09	6.59%	5.10%	4.93%	5.10%	5.51%	5.70%	5.70%	6.12%
08/06/09	4.94%	5.05%	4.94%	5.08%	5.49%	5.70%	5.66%	6.10%
09/06/09	4.94%	5.01%	4.89%	5.04%	5.44%	5.66%	5.61%	6.06%
10/06/09	4.94%	5.01%	4.89%	5.02%	5.42%	5.65%	5.60%	6.06%

PRIMARY MARKET RATES

Last Primary Market Rates

	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	09/06/01	10/06/01	95.305	4.87%	2000	9419	2125
OK0112	09/06/03	12/01/25	86.909	5.46%	4000	6658	4018
PS0414	09/06/03	14/04/26	99.835	5.78%	1000	1614	971
DS1017	09/04/08	19/10/25	94.460	6.22%	2500	4846	1820

FX VOLATILITY

	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
date	1M	3M	6M	1Y	1M	1Y	1M	1Y
04/06/09	26.25	25.00	23.75	23.25	4.00	5.25	1.25	1.25
05/06/09	26.25	25.00	23.75	23.25	4.00	5.25	1.25	1.25
08/06/09	26.25	25.00	23.75	23.25	4.00	5.25	1.25	1.25
09/06/09	26.25	25.00	23.75	23.25	4.00	5.25	1.25	1.25
10/06/09	26.25	25.00	23.75	23.25	4.00	5.25	1.25	1.25

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
04/06/09	3.1685	4.5048	-11.84%
05/06/09	3.1983	4.5365	-11.66%
08/06/09	3.2706	4.5353	-10.94%
09/06/09	3.2385	4.5118	-11.29%
10/06/09	3.1698	4.4729	-9.82%

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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