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FINANCIAL MARKETS DEPARTMENT

PAGES: 8

WARSAW, JULY 16, 2009

POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

PREVIEW: The week of July 17th to July 23rd

Indicator	Date of release	Period	BRE forecast	Consensus	Last	Comment
Industrial output y/y	Jul 17	Jun	**-6.3%**	-5.9%	-5.2%	Data under strong influence of base effects from 2008 which drive the total index down despite no difference in working days and warmer business conditions.
PPI y/y	Jul 17	Jun	**3.3%**	3.4%	3.7%	Enterprises expect prices to stay within falling trend. Support to this tendency is given by falling gas prices whereas headwind comes from fuels rising more than 7% in terms of CPI and PLN depreciation.
Core inflation y/y	Jul 21	Jun	**2.7%**	2.7%	2.8%	Core inflation lower than in previous month but woing to base effects alone; prices may stay elevated for some months.
Retail sales y/y	Jul 23	Jun	**1.5%**	0.4%	1.1%	Nominal growth inflated by fuel prices. Real growth rate still negative although some one-off factors contributing positively e. g. auto sales.

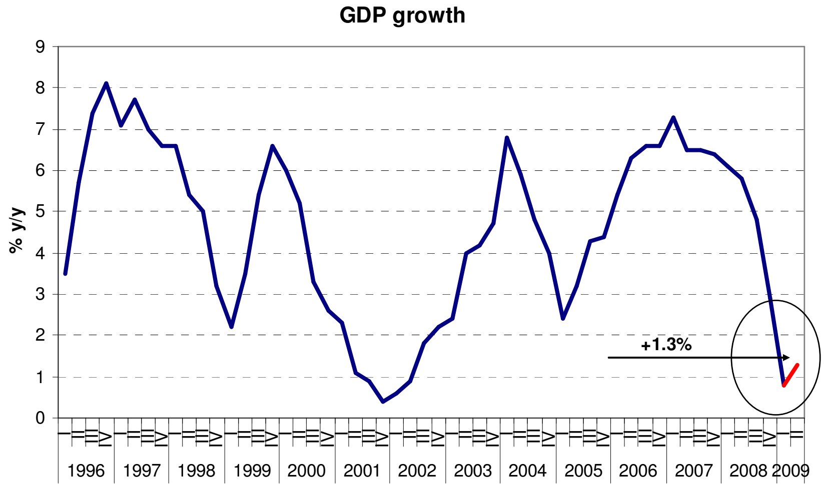
In Focus / Macroeconomics

C/A surplus climbing higher, 2009 GDP growth yells for revision

May enjoyed another C/A surplus amounting to PLN 207 million (compared to 147mln EUR a month ago). Credit on the account was generated mainly by current transfers (+467 million) and services (+235 million resulting from softer demand on services rendered abroad) accompanied by less negative income account (-437 million) and trade balance slightly under water (-58 million versus -4 million a month ago). It is worth to take a look at trade and services balance together which add up now to PLN 714 million after five months of 2009 compared with a substantial deficit of almost 5 billion in the corresponding period of the previous year.

Much weaker zloty encouraged consumers to substitute foreign goods for the domestic ones, putting thereby a solid brake on imports. The divergence between growth rate of imports and exports (with the latter behaving relatively better) allowed for a trade balance improvement . It is important to note that the balance improves primarily owing to soft consumer spending (and to some extent to one-off factors concerning auto exports) which is unlikely to rebound this year. On the other hand, we see some room for improvement in exports, along with better hard data in western economies. Both mechanisms speak in favor of better net exports. It is possible for net exports to end the whole 2009 close to zero – in our opinion, the only factor preventing the balance to tip positive is high elasticity of imports with respect to exports (but this relation may be somehow relaxed in times of the slowdown and high spare domestic capacities).

Good performance of net exports lead us to revise our GDP forecasts. Basing on the supply side alone (once again we used our fairly good performing econometric model), it is possible for Q2 GDP growth to outperform Q1 with growth rate amounting to more than 1% on annual basis (see the graph below). It fully conforms to the back-of-the-envelope calculations concerning the demand composition. The risks concerning domestic demand are straightforward in case of consumption and investment (although we would like to remind the reader the recent robustness of the latter aggregate corroborating somehow the risk towards higher reading). It is possible that Q2 saw less destocking (slightly better sales, better sold industrial production) and another spike in net exports contribution (close to +3pp.). The same mechanism is viable for the whole year what may result in statistical GDP window dressing (huge contribution of net exports on low turnover) despite falling domestic demand. It poses some downside risks to 2010 when domestic demand fails to fully recover (weak labor market) and negative net export contribution sets in (due to pure statistical effect). At the moment we cannot rule out 2010 to be statistically worse than 2009 (we need more data to be more specific, thus we leave our official forecast intact for now).



CPI inflation a notch lower in June

CPI inflation decelerated in June to 3.5% y/y from 3.6% recorded in May. The huge discrepancy between our forecast of 3.8-3.9% and the final figure is to be blamed on food prices. According to official estimates, June saw a significant price decline in vegetables (-7.5%) and fruit (-11.3%) in contrast to more benign behavior of those prices observed in wholesale and on marketplaces.

Strikingly, there is no sign of price easing in the core inflation categories. For the consecutive month we saw higher prices in tourism (effect of weaker zloty), restaurants and "other services". We estimate that core inflation excluding food and energy remained at an uncomfortable high level of 2.7% y/y (an insignificant y/y drop is to be attributed solely to a high base effect). We preliminary estimate the CPI inflation to fall to 3.0-3.2%y/y in July and to remain elevated at the levels above 3% in the months to come. The Autumn may see, however, a bit higher inflation due to low base effect attributed to a huge oil price decline realized in 2008. On the other hand, 2010 statistical base effects will be probably working in the opposite direction leading to a pronounced decline of headline inflation. For 2010 we also expect some disinflationary effect originating from weaker labor market (June saw a sharp decline of wage dynamics to 2.0% y/y) to take its toll.

June inflation data do not change our assessment of Polish rate outlook. It seems that the MPC is getting increasingly worried about the real interest level and does not welcome the de-synchronization of the monetary policy with the ECB. The MPC members' comments that followed the data release suggest the Committee is to cease fire at least for a few months. The resumption of rate cuts is still possible in Autumn but we do not necessarily see such a scenario as a baseline.

MID-TERM FORECATS

Indicator	2006	2007	2008	2009	2010
GDP y/y (%)	6.1	6.5	4.8	**1.1↑**	2.0
Inflation rate (%, average)	1.0	2.4	4.3	3.4	1.8
Current account (% of GDP, average)	-2.1	-4.5	-5.3	0.2	-2.9
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	3.75

Indicator	2008		2009			
	Q3	Q4	Q1	Q2	Q3	Q4
GDP y/y (%)	4.7	2.9	0.8	**1.3↑**	**0.8↑**	**1.6↑**
Inflation rate (%, average)	4.7	3.8	3.2	3.7	3.4	3.5
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

We were wrong.

Most important issue in the passing week was the CPI data. Although 3.5% y/y was quite in line with market consensus, it caused another wave of strenghtening across the curve, forcing us to close our pay 2Y position. Sentiment remains positive, PLN strength also supports the FI market, bond auctions attract decent demand. However we think that further potential is quite limited, especially in the front end. As we don't expect rate cuts, at least not in the next few month, further move down on Wibors seems unlikely. Also asset-swap spreads have narrowed, both in nominal term, also spread between cash and Wibor makes them less attractive, therefore we're becoming more neutral there. We recommend reducing OK0711 ASW position at current levels and pay front end (preferably 1M gaps) on dips.

RECOMMENDATION:

Reduce OK0711 ASW, pay 1y1s 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	-	-	4.456%	5/4/2009
52 Week T-bills	7/20/2009	-	4.387%	7/13/2009
2Y T-bond OK0112	8/5/2009	-	5.410%	6/3/2009
5Y T-bond PS0414	9/2/2009	-	5.549%	7/15/2009
10Y T-bond DS1019	9/9/2009	-	6.340%	5/20/2009
20Y T-bond WS0429	9/9/2009	-	6.340%	5/20/2009

Money Market

Cost of carry remained low

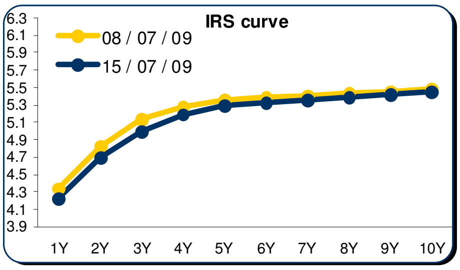
Bullish sentiment strengthened by the figures and currency

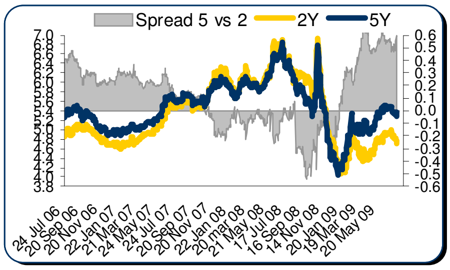
The central bank offered 41.5 billion pln in money bills on Friday. This time all the papers were bought. Despite of the fact that the surplus of the cash was successfully sterilized, the shortest rates remained low and the short polonia oiss were still well offered below 3%. This shows quite a strong believe in a cheap carry at least till the end of the month.
Slightly lower CPI and wages figures then expected (3.5% vs 3.6% and 2% vs 2.6%) has strengthened bullish sentiment; stronger currency was also very helpful. If we add cheap financing, falling wibor rates are not a surprise. It seems that this movement will be also visible in the coming days.
T-bills average yield has dropped by 15 bps during the weekly tender to 4.3%.

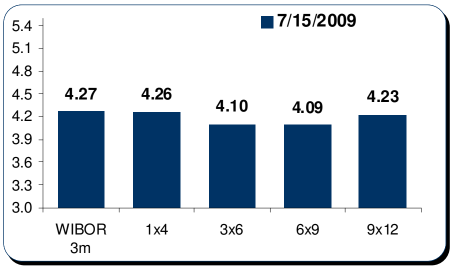
RECOMMENDATION:

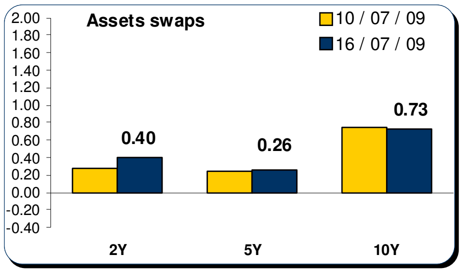
Stay receive on polonia.

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty stronger

This week zloty has opened at 4.4100 and strenghtened to 4.2700 low. We still see good sentiment all around us so risk appetite is growing.

Implied volatility lower

Stronger zloty on quiet trading pushed EURPLN curve lower with 1M traded at 15.5 and 1Y at 14.5.

RECOMMENDATION:

Sell upticks

SPOT

Main supports / resistances:
EUR/PLN: 4.2600 / 4.5200
USD/PLN: 3.9600 / 3.3000

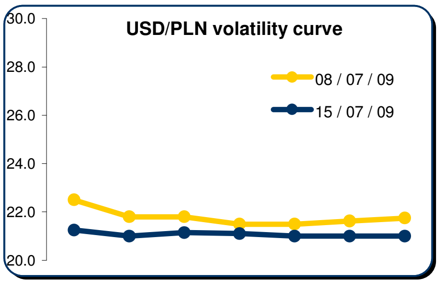
Good sentiment lasts, summer months are quiet, this is perfect environment for stronger PLN. Just lack of inflows makes move slow. Level like 4.45 is desired for PLN long entry. If 4.26 broken, next is 4.06.

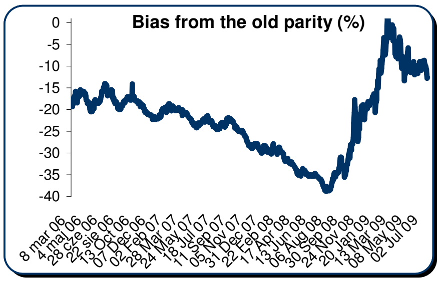
Sell gamma

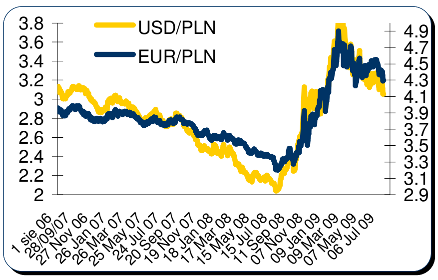
OPTIONS

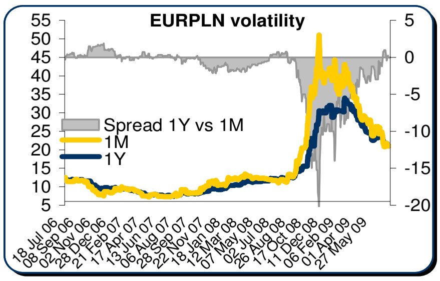
Curve is much lower but we still see chance for short gamma trade to be profitable
For hedging we suggest buying KO options as it is cheaper due to barrier pricing on high volatility market.

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
09/07/09	4.23%	4.33%	4.44%	4.45%	4.63%	4.62%
10/07/09	4.23%	4.31%	4.45%	4.44%	4.60%	6.59%
13/07/09	4.23%	4.29%	4.35%	6.49%	4.58%	4.56%
14/07/09	4.18%	4.29%	4.43%	4.40%	4.57%	4.55%
15/07/09	4.20%	4.27%	4.36%	4.39%	4.55%	4.53%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
09/07/09	4.33%	4.23%	4.23%	4.39%	4.51%
10/07/09	4.29%	4.21%	4.21%	4.36%	4.46%
13/07/09	4.27%	4.19%	4.18%	4.35%	4.44%
14/07/09	4.25%	4.17%	4.17%	4.32%	4.42%
15/07/09	4.24%	4.17%	4.17%	4.32%	4.41%

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
09/07/09	4.62%	4.25%	4.80%	5.28%	5.31%	5.60%	5.44%	6.22%
10/07/09	6.59%	4.44%	4.83%	5.10%	5.31%	5.55%	5.44%	6.18%
13/07/09	4.56%	4.44%	4.81%	5.27%	5.36%	5.63%	5.48%	6.23%
14/07/09	4.55%	4.30%	4.76%	5.19%	5.36%	5.61%	5.51%	6.22%
15/07/09	4.53%	4.45%	4.70%	5.10%	5.29%	5.55%	5.45%	6.18%

PRIMARY MARKET RATES

Last Primary Market Rates

	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	09/07/06	09/07/06	95.691	4.46%	1200	3254	1200
OK0112	09/07/01	12/01/25	87.362	5.41%	4500	4431	4006
PS0414	09/07/15	14/04/26	100.782	5.55%	2000	6347	2011
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
09/07/09	21.60	21.25	21.35	21.15	2.75	4.75	1.25	1.25
10/07/09	21.50	21.50	21.40	21.50	0.00	0.00	0.00	0.00
13/07/09	21.10	21.25	21.10	21.25	0.00	0.00	0.00	0.00
14/07/09	21.00	21.25	21.10	21.25	0.00	0.00	0.00	0.00
15/07/09	21.00	21.10	21.00	21.00	0.00	0.00	0.00	0.00

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
09/07/09	3.1222	4.3577	-9.94%
10/07/09	3.1425	4.3711	-10.17%
13/07/09	3.1600	4.4045	-10.82%
14/07/09	3.1158	4.3613	-11.87%
15/07/09	3.0557	4.2906	-12.80%

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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