



POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

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PREVIEW: The week of January 7th 2010 to January 14th 2010

Indicator	Date of release	Pe-riod	BRE forecast	Consensus	Last	Comment
CPI inflation	Jan 14	Dec	3.7%	3.6%	3.3%	Low base effect on fuels. Food prices on the rise by 0,7-0,8% m/m. Core inflation at 2,8-2,9%. We stick to our forecast despite lower MoF estimate (in our opinion they assumed too low food inflation).
M3 Supply	Jan 14	Dec	5.3%	6.8%	7.9%	No further deposit effect connected with Eureka dividend payment. Lower growth rate of household deposits than in Dec'08.

In Focus / Macroeconomics

Good start into 2010: a series of positive fiscal surprises

At Wednesday's press conference, FinMin Rostowski announced that 2009 budget deficit will be lower than previously estimated PLN 27.2bn. By far, the most probable outcome lies somewhere between PLN 24 and 25bn. Better than expected results stem from higher tax income (by 11bn total), mostly indirect taxes (7bn) and PIT (1bn). At the same time, the Ministry announced the EU inflows will be lower by 8-9bn. As for the tax income, it should not be regarded as a surprise. For some months, we have been signaling positive trends observed in VAT and excise, which we used to connect with improving domestic demand – and the hard data proved us finally right.

So far the Ministry speaks about the public sector deficit with cautious reservation (quoting the need to wait for exact GDP data for 2009). The only firm statement we got so far is that the deficit-GDP ratio may be lower than previously estimated 6.3%. Our calculations basing on 1.7% annual real GDP growth suggests the 50% threshold has not been breached (but there is still a slight margin of error, as local authorities have not handed over the complete set of financial operations).

The bunch of positive current fiscal news was accompanied by further announcements of the fiscal reform and consolidation plan with long-awaited expenditures anchor (to be issued within 10-15 days) and very encouraging news on the profits of the National Bank of Poland (at the day of the conference it was described by Skrzypek as substantial, day after substantial turned into 4-5 bn). 95% of the NBP profit is to be transferred to government accounts reducing thereby by the full amount the assumed level of budget deficit (we remind the reader that current budget plan for 2010 expects NBP profit to be null).

Although the announcements were complementary to the more and more popular scenario assuming further revival of the Polish economy, fixed income market was surprised (yield drops amounted to a dozen of bp, we saw some curve flattening). In our opinion, Wednesday's statements constitute only a tip of the iceberg of to-be-announced good fiscal news (by the way it is a scenario we support for some months). The government pulls its socks up: unexpected plan to sell 10% stake in KGHM till the end of the week is another example how determined it is to overhaul public finance.

We expect the 2010 to be a year of good fiscal news. Taking account the very conservative budget assumptions, accelerating GDP growth is likely to push tax income higher and we may expect systematically lower deficit figures in the course of the year. At the end of 2010 we may end up with a substantially lower deficit (NBP profit payment brings it down to approx. 40bn, and there is a long way down on higher tax income). As for the borrowing needs we expect substantial boost from privatization, what – along with lower deficit – helps to end up 25-30bn lower (at a level of PLN 170-180bn). As a consequence we expect lower risk premium build-up in Polish papers and further flattening of the yield curve.

MID-TERM FORECATS

Indicator	2007	2008	2009	2010	2011
GDP y/y (%)	6.5	4.8	1.7	3+	4.5
Inflation rate (% , average)	2.4	4.3	3.5	2.3	2.9
Current account (% of GDP, average)	-4.5	-5.3	-1.2	-2.3	-3.7
Unemployment rate (end-of-year)	11.4	9.5	11.9↓	11.7↓	10.5
NBP repo rate (end-of-year)	5.00	5.00	3.50	4.00	5.50

Indicator	2009			2010		
	Q1	Q2	Q3	Q4	Q1	Q2
GDP y/y (%)	0.8	1.1	1.7	3.2	3.2	2.9
Inflation rate (% , average)	3.2	3.7	3.5	3.5	3.3	2.1
NBP repo rate (end-of-quarter)	3.75	3.50	3.50	3.50	3.50	3.50

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

Fixed Income

Where are my bonds ?

First week of 2010 was rather intensive one on the FI market. Monday and Tuesday we saw market climbing in yields with 5y trading as high at 5.78, bonds were under big pressure as new 5y benchmark traded at 98.00 as the low (making 75 cents decline from the first auction). Additionally, curve was steepening, at certain point of time 2y5y spread was 73bp bid. The total change in the sentiment happened after Wednesday switch auction, which brought very good demand for fixed as well as floater bonds. Big news came latter during the day, when NBP governor Skrzypek announced dividend payment from NBP profit (not included in budget). With previous news about lowering borrowing needs from 203 to 198 already it seems to us that market expectations towards difficulties with financing 2010 budget are a little bit exaggerated. Our view is that final sale of bonds/bills on all markets will not be higher than 180 bio, with risk they may come even lower. Not all will come in fixed bonds, and definitely not all will come in PLN, so the supply of domestic bonds will be significant, but maybe less than market is currently expecting. On the macro side, we still expect rebalancing of economy with solid growth and falling CPI (definitely well below 2.5% NBP target). With favorable (yes, favorable) fiscal side, and very limited political risk the convergence game may be launched once again.

We expect long off-the-run 20y bonds a notch higher in price. The 2y2y fwd IRS rates are expected to fall further.

AUCTIONS

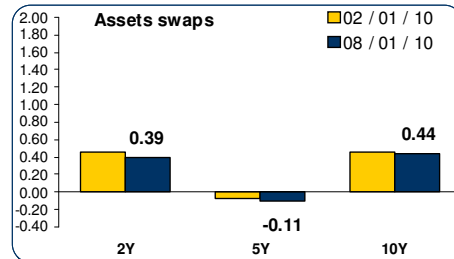
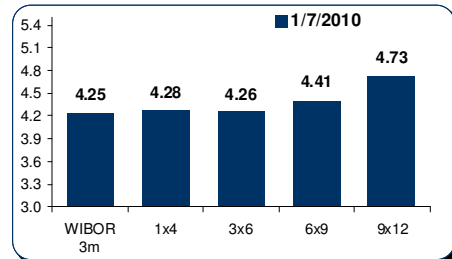
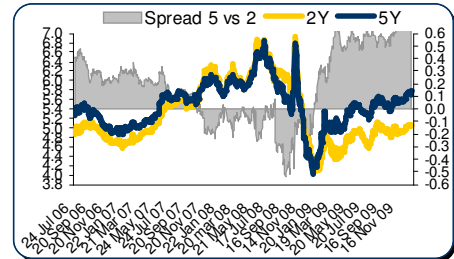
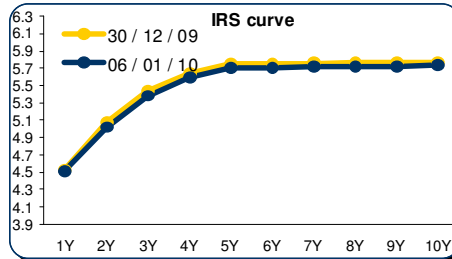
	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	6.142%	12/9/2008
26 Week T-bills	-	-	4.456%	5/4/2009
52 Week T-bills	1/11/2010	-	4.223%	10/26/2009
2Y T-bond OK0712	1/13/2010	-	5.099%	12/2/2009
5Y T-bond PS0415	2/10/2010	-	5.736%	12/2/2009
10Y T-bond DS1019	2/19/2010	-	6.340%	5/20/2009
20Y T-bond WS0429	2/19/2010	-	6.300%	9/23/2009

Money Market

Low cost of carry at the beginning of reserve requirements period

Due to year end and banks aversion for lending cash at this day POLONIA increased by 148 bps to 3.56% on 31 December 2009. Last Central Bank bills caused cheap beginning of reserve requirements period. From PLN 57 bln offer bank bought only PLN 41 bln money market bills. Therefore there is over PLN 20 bln cash surpluses in the system, reserve requirements are overbuilding and the deposit with Central Bank is growing. (PLN 10 bln for Thursday). On Today's tender demand should be higher than on previous one but probably this will be low month.

FIXED INCOME & MONEY MARKET CHARTS



Foreign Exchange

Zloty optimistic start

In the first trading week of the year, the liquidity was slowly coming back to the market. The Zloty was fluctuating in the tight range 4.0650-4.1350, just above the crucial 4.0650 support level. The supports at 4.0650 and 4.000 are marking a very important pivotal levels. The market close below the 4.0000, would spark in our opinion the swift move to 3.9000 and then 3.8500 (the stop loss scenario). On the upside it is the 4.22250 resistance, which we have to clear out, to consider the EUR/PLN heading higher. Everything in this range 4.0650/4.22250 is just a pure noise.

Implied volatility lower

The option market from the start was trading really vigorously. In the first day the gamma was in demand as traders who were short gamma for holiday's period, rushed to close their shorts and lock in profit. As a result the 1 month of EUR/PLN was trading at 14.1. Later in the week, the sellers of Vega (due to low historic volatility) have prevailed, and 1 month has dropped to 12.5 mid, 3 month traded in good amount at 12.45 %. In general, both volatility curves EUR/PLN and USD/PLN ended the week lower in comparison to their year close. 6 month USD/PLN ATM was traded at 18.80% in 350 mio \$!.

Short-term outlook

SPOT

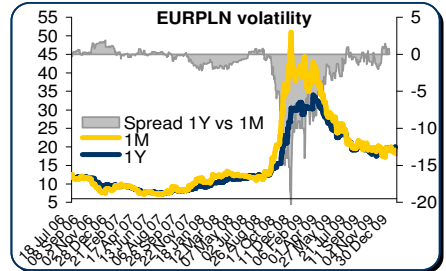
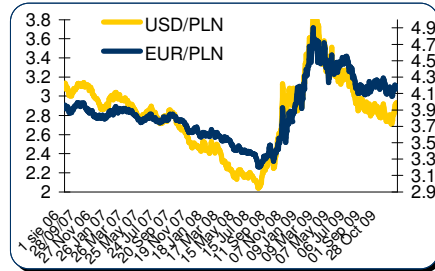
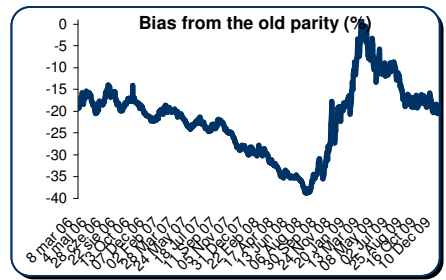
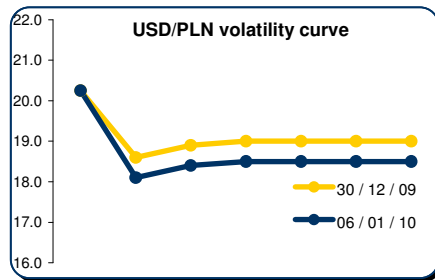
Main supports / resistances:
 EUR/PLN: 4.0650 / 4.2250
 USD/PLN: 2.7500 / 2.9500

The market is lacking a clear direction, liquidity is slowly recovering and customers are coming back from holidays.

OPTIONS

The magnitude of the slide of the implied volatility and the skew (1 year 25d RR was trading at 3.1 vs 3.75 year close), makes us think it is happening too quickly. Long Vanna i.e via long end R/R looks promising for the coming months..

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
30/12/09	3.90%	4.27%	4.30%	4.27%	4.44%	4.42%
31/12/09	4.05%	4.27%	4.30%	4.28%	4.44%	6.59%
04/01/10	4.00%	4.27%	4.28%	6.49%	4.42%	4.42%
05/01/10	4.10%	4.26%	4.20%	#ARG!	4.40%	4.42%
06/01/10	4.15%	4.25%	4.25%	4.28%	4.40%	4.42%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
30/12/09	4.29%	4.33%	4.49%	4.73%	4.68%
31/12/09	4.27%	4.32%	4.46%	4.74%	4.70%
04/01/10	4.29%	4.33%	4.47%	4.73%	4.69%
05/01/10	4.30%	4.32%	4.47%	4.73%	4.69%
06/01/10	4.29%	4.33%	4.48%	4.72%	4.69%

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
30/12/09	4.42%	4.13%	5.07%	4.90%	5.75%	5.59%	5.77%	6.17%
31/12/09	6.59%	4.13%	5.07%	4.98%	5.75%	5.67%	5.78%	6.23%
04/01/10	4.42%	4.10%	5.05%	4.98%	5.77%	5.67%	5.81%	6.24%
05/01/10	4.42%	4.10%	5.07%	4.95%	5.77%	5.66%	5.78%	6.24%
06/01/10	4.42%	4.10%	5.02%	4.90%	5.70%	5.59%	5.73%	6.17%

PRIMARY MARKET RATES

Last Primary Market Rates

	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	09/10/26	10/10/26	95.905	4.22%	500	1758	431
OK0712	09/12/02	12/07/25	87.692	5.10%	5000	5472	1440
PS0414	09/12/02	15/04/25	98.691	5.78%	5000	5614	3629
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
30/12/09	19.10	19.50	19.00	19.00	3.25	4.50	0.80	0.85
31/12/09	19.10	19.50	19.00	19.00	3.25	4.50	0.80	0.85
04/01/10	19.10	19.50	19.00	19.00	3.25	4.50	0.80	0.85
05/01/10	19.10	19.50	19.00	19.00	3.25	4.50	0.80	0.85
06/01/10	19.10	19.50	19.00	19.00	3.25	4.50	0.80	0.85

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
30/12/09	2.8725	4.1244	-17.22%
31/12/09	2.8503	4.1082	-17.23%
04/01/10	2.8465	4.0924	-17.32%
05/01/10	2.8264	4.0794	-16.99%
06/01/10	2.8493	4.0950	-17.04%

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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