



POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

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PREVIEW: The week of January 15th 2010 to January 21st 2010

Indicator	Date of release	Pe-riod	BRE forecast	Consensus	Last	Comment
C/A mln EUR	Jan 15	Nov	-1400	-1625	-991	On the back of the data on trade balance (as published by the Central Stat. Office) we decided to revise our forecast upwards. From now on we anticipate trade surplus at ca. PLN +450 mln. Euroko dividend payment weighs negatively on the whole figure.
Wages y/y	Jan 19	Dec	4.9%	3.2%	2.3%	Higher economic activity, low base effect from the last year. Bonuses paid in mining. Manufacturing wages running yet at 6.0% y/y.
Employment y/y	Jan 19	Dec	-1.8%	-1.9%	-2.2%	Solid upward trend in business tendency indicators. Monthly fall of employment induced by seasonal factors. Positive momentum stays in.
Industrial output y/y	Jan 21	Dec	15.3%	11.8%	9.8%	One working day more on annual basis. Re-stocking continues. Seemingly large base effect from 2008 (production breaks owing to empty order books in many companies).
Producer prices y/y	Jan 21	Dec	2.2%	2.2%	2.0%	Prices falling still on a monthly basis. Higher prices of base metals offset by lower valuation of oil prices. Stable EURPLN. Firms continue to expect falling prices.
Core inflation y/y	Jan 21	Dec	2.6%	2.8%	2.8%	Substantial downward surprise in core categories (telecommunications and recreation and culture).

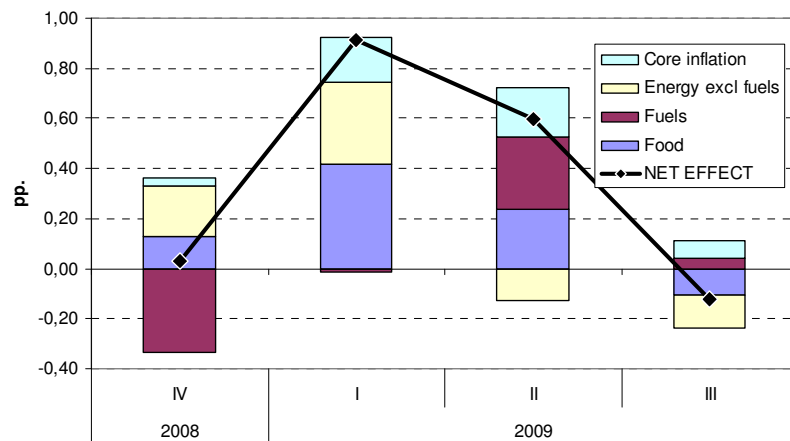
In Focus / Macroeconomics

December inflation, a positive surprise

December's inflation surprised not only positively in terms of headline but also the core. Although it rose in December (mirroring mostly the base effects in fuels), the growth of 3.5% y/y was lower than commonly expected (3.6% y/y). With moderate increases of food prices (0.5% m/m), the reading was dominated by the falls in recreation and culture (-1.0% m/m) and communications (-1.3% m/m), accompanied by almost flat prices in lodging. This makes us revise the core inflation forecast towards 2.6% (from previously reported range 2.8-2.9%).

It seems the upward pressure from the zloty depreciation recorded at the beginning of the year has petered out, seemingly corroborating the falling quarterly trend we pictured in some of our latest research notes (it seems the impulse response function to of the core inflation to EURPLN spikes is simply monotonic and going to zero in the domain of quarterly readings...). Falling core also reflects lagged effects of decelerating domestic demand. Although the factors we mention seem to be economically fully justified, we cannot exclude, however, that some extraordinary ingredients also added to the lower reading (taking into account the unpredicted and unseasonal pattern reflected in major contributors to the core) – yet it is December, prompting various one-off price actions.

Extraordinary effects and their impact on different CPI categories (pctg points in quarterly growth rate)



As for the perspectives in coming months, January reading may come marginally higher than 3.0%. Next months will bring substantial drop of inflation, connected with massive statistical base effects from the start of the year. The minimum of inflation path (slightly below 2.0% y/y) is to be reached mid-year and from then on, inflationary pressures may gradually mount along with ongoing real sphere recovery and conformation of labor market stability.

Systematic fall of inflation (both headline and core) may potentially reduce monetary tightening expectations. However, the fall may be limited due to hawkish comments from single MPC members (Rzonca, Winięcki). Moreover, the potential of yields to fall at the short-end of the curve may be limited by MPC "Minutes" after the January meeting (whether or not there are any indications on the change of monetary policy bias towards restrictive) and the release of inflation projection in February (indicating temporary fall of inflation and accelerating prices in 2011 and 2012). For now, lower inflation (regardless of its nature) may support the long-end of the yield curve (expectations of non-inflationary growth scenario and lower risk of unmooring inflation expectations).

**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	-1.3	-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*World record!*

Last week we saw good volatility on the FI market. Rates pushed lower with 2y trading at 2.93 and 5y at 5.53 as the low. PS0415 made impressive 100 cents gain and WS0922 traded as high as 96.90. Activity on the market was very high with volumes being close to record. Generally we had quite a few records and quite a few still to come. Ministry of Finance placed record 3 bio of 15 year EUR issue. 2y bond auction drew record of 16 bio demand, with record sale of PLN 7 bio. It looks like another record of monthly sale of treasury bonds will be set in January bringing the total close to PLN 30 bio. Having said that, all of the record supply made yields on the curve go lower and ASW have even compressed. Our view is that record supply will not hurt FI market at all, and we expect further compression of credit spreads with outright yields on the bonds going lower into 1st and 2nd quarters of 2010 (we see borrowing needs much lower than expected by the market, especially on the domestic market). As far as the economy we see it re-balancing nicely and we tend to lean towards tighter monetary policy, probably sooner than market is expecting. On the other hand, we start to think that the volume of hikes can be reduced on the back of strengthening EURPLN (especially due to strong GDP growth, privatization flows and green flows, higher cash rate), though it is too soon to make that call. Overall, we think the environment is still supportive for long end of the curve, especially bond curve. E.g. 2y2y should drop even if hikes are delivered in the 2nd quarter this year. Having RPP ahead of the curve should support this tendency. However, next week may also see a bit lower prices at coming auction. All in all we still see longer bonds to fall in yields and 2y2y IRS continue to fall.

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

After the OMO market short 1,5 bln PLN

Lower demand on 3M repo

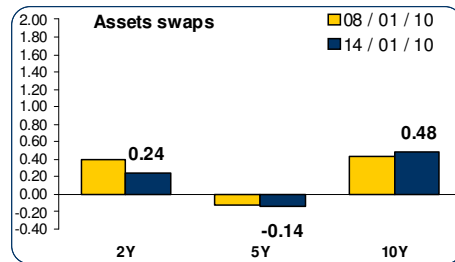
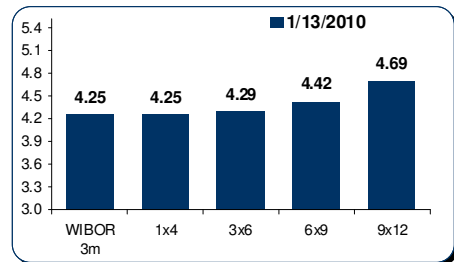
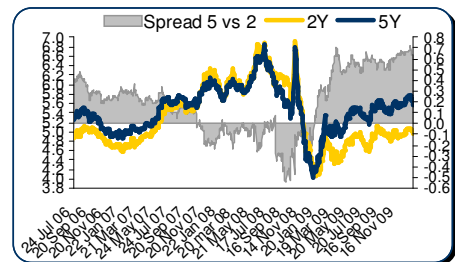
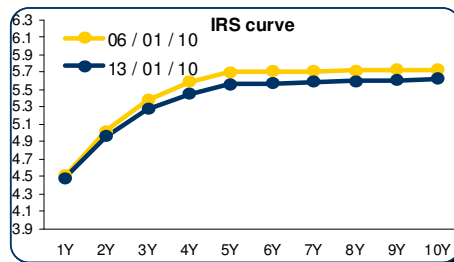
First in this year t-bills tender

After very low beginning of this month NBP offered PLN 68 bln NBP bills last Friday. Banks demand was 72 bln PLN and the reduction rate almost 6%. Central Bank forecast indicated that the market will be square but in fact it was short 1,5 bln. That is why short term depo increased this week and was around 2.5-2.8%. We expect demand on Tomorrow's OMO to be lower and short term depo rates to be lower as well next week.

At 3M repo NBP accepted offers worth PLN 770 million in comparison to 2.7 bln maturing.

After two months of break time MinFin offered 52-week t-bills on Monday. Banks demand was almost PLN 2.9 bln and MinFin sold 700 million PLN bills at an av. rate 3.976%.

FIXED INCOME & MONEY MARKET CHARTS



Foreign Exchange

Zloty traded in range

New Year's optimism lasts, EURPLN deepen its move down to 4.0350. If global environment will stay at same levels, despite short EURPLN market positioning, we target it 4.00 and 3.85 then (61.8 Fibonacci and weekly 200MA). We like the fact market participants are so unanimous about direction, what we do not like is turnover. It's simply running out of ammunition, as we barely see fresh EURPLN shorts. But like we said until risk is well bid direction is only one.

Implied volatility lower

Underlying is traded in a narrow range. Realized volatility lowered values down to 9.9% for last 5 trading days. It made the whole curve, short end especially, traded lower – 1M at 11.4 and 1Y 11.8. We have seen tenors between 1W-1M well offered, i.e. 2W 4.10 traded in 150 millions, whilst down gamma was higher priced.

Short-term outlook

SPOT

Main supports / resistances:
 EUR/PLN: 4.0000 / 4.2000
 USD/PLN: 2.7000 / 2.9500

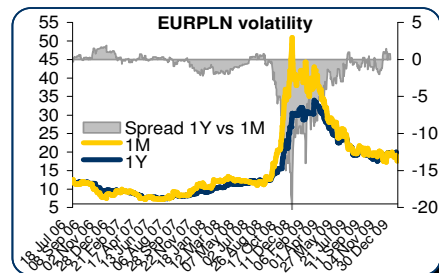
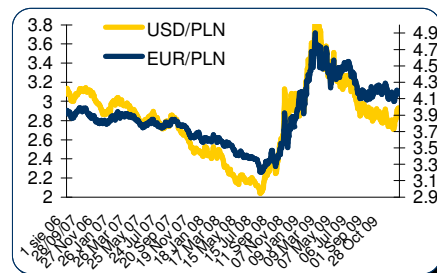
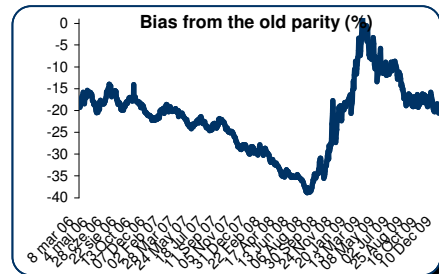
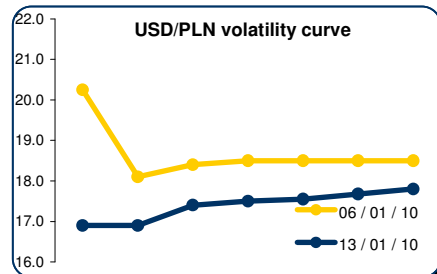
Blurred picture

The market believes in one direction, and so is positioned. We see it as bit out of steam but fresh money could change picture. Breaking of 4.00 is needed to accelerate move, otherwise likelihood of correction will increase.

OPTIONS

We believe only breaking down through 4.00 may push lower curve significantly. This environment is vega neutral and supports the idea of being long Vanna i.e via being long end R/R for the months to come.

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
07/01/10	4.15%	4.25%	4.25%	4.28%	4.40%	4.42%
08/01/10	3.95%	4.25%	4.25%	4.28%	4.42%	6.59%
11/01/10	4.15%	4.27%	4.25%	6.49%	4.40%	4.43%
12/01/10	4.20%	4.26%	4.26%	4.29%	4.41%	4.43%
13/01/10	4.20%	4.25%	4.33%	4.29%	4.50%	4.43%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
07/01/10	4.29%	4.33%	4.48%	4.72%	4.69%
08/01/10	4.29%	4.26%	4.51%	4.75%	4.71%
11/01/10	4.27%	4.31%	4.47%	4.72%	4.69%
12/01/10	4.28%	4.26%	4.41%	4.73%	4.69%
13/01/10	4.27%	4.32%	4.47%	4.71%	4.68%

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
07/01/10	4.42%	4.08%	5.02%	4.89%	5.70%	5.53%	5.73%	6.14%
08/01/10	6.59%	3.95%	5.02%	4.89%	5.66%	5.53%	5.70%	6.14%
11/01/10	4.43%	3.83%	4.99%	4.84%	5.63%	5.46%	5.68%	6.09%
12/01/10	4.43%	3.85%	4.98%	4.83%	5.58%	5.46%	5.64%	6.08%
13/01/10	4.43%	3.85%	4.96%	4.72%	5.56%	5.42%	5.62%	6.10%

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 straddle				25-delta RR		25-delta FLY	
	1M	3M	6M	1Y	1M	1Y	1M	1Y
07/01/10	17.60	18.00	18.50	18.50	1.75	3.25	0.80	0.85
08/01/10	17.60	18.00	18.25	18.50	1.75	3.25	0.80	0.85
11/01/10	17.60	18.00	18.00	18.25	1.75	3.25	0.80	0.85
12/01/10	17.35	17.75	17.75	18.00	1.75	3.25	0.80	0.85
13/01/10	16.90	17.50	17.55	17.80	1.50	3.00	0.80	0.85

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
07/01/10	2.8631	4.1109	-17.12%
08/01/10	2.8683	4.1084	-17.59%
11/01/10	2.7983	4.0595	-17.70%
12/01/10	2.8167	4.0814	-17.90%
13/01/10	2.8009	4.0615	-18.34%

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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