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FINANCIAL MARKETS DEPARTMENT

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POLAND WEEKLY REVIEW
MACROECONOMICS AND FINANCIAL MARKETS

PREVIEW: The week of January 21st 2010 to January 28th 2010

Indicator	Date of release	Period	BRE forecast	Consensus	Last	Comment
MPC decision	Jan 26	-	**3.5%**	3.5%	3.5%	The first meeting with partially changed MPC composition (5 new members). We expect the decision itself to be rather uneventful. High variation in I/O data postpones the decision on bias rather towards February with new inflation projection.
Retail sales y/y	Jan 28	Dec	**6.7%**	6.7%	6.3%	One working day more on annual basis. Solid business confidence in food sales, upswing in durable goods. The results on car sales seem to be promising and confirm the possibility of higher reading than in November.

In Focus / Macroeconomics

Real sphere overall still solid…but output slightly disappointing

Substantial growth rate of wages suggested that also the dynamics of industrial output is unlikely to disappoint. The reality unveiled the brutal truth and rather soft manufacturing figures. However, there may be a lot o high frequency noise in the output data which distorts somehow the big picture of ongoing recovery.

December corporate wages dynamics hit 6.5% y/y up from 2.3% recorded in November. The market consensus stood at 3.0%. December reading has been boosted by the following factors: 1) statistical base effects from December 2008 (temporary shutdowns of many factories, lower bonuses and shifting of salaries to January due to tax related issues), 2) bonus payments in mining industry, 3) underlying positive trend in manufacturing (we see this sector as exhibiting most stable tendency and have some leading properties). We expect wages to growth by 4-5% in the months to come and accelerate further in H2 2010.

December's growth of employment surpassed expectations and reached -1.8% y/y matching our more optimistic forecast. As for the closely monitored monthly variation, enterprise sector shed 9k jobs, following seasonal pattern. Despite monthly, seasonal contraction, the underlying trends in employment are upward sloping and labor market reaps now the benefits of fast adjustment at the very beginning of the slowdown. Such a picture of the economy is confirmed by business tendency indicators which – also sectoral-wise, with manufacturing taking the lead – are showing unabated upward tendency. On the back of firming economic recovery and shrinking capacity underutilization we expect the enterprise sector to be able to add workers as soon as in H1. Till then it is wise to closely watch seasonal patterns of the published employment statistics. January is usually linked to massive revisions on the back of the annual change of the number of enterprises in the sample – after the period of economic contraction and slower growth, the direction of revision is negative. But again, this is not a change in the underlying trend, but rather a one-off statistical operation bringing the statistics closer to the actual picture of the economy, unaffecting actual consumer behavior.

As for the disappointing industrial output, its growth rate reached 7.4% in December (below last month's 9.9% and expected 11.8%). However, increases in manufacturing were still very broad based and recorded in 24 out of 34 sections. After seasonal adjustment, industrial output grew by 6.2% (softer than 6.8% recorded a month ago) but still far beyond the average from the last months.

Monthly, seasonally adjusted variation amounted to -2.8% which seems an odd one out case in the rising trend. Accompanied by quite soft construction output in December, it makes us think of one-off factors which drive the production down in December with relation to expectations. One of the potential culprits are seasonal holidays, recently very eagerly prolonged by manufacturers (owing to still low capacity utilization). This fact may have made our working-days count inappropriate and skew it upwards. The other potential culprit are low temperatures (another fairly strong winter) feeding through manufacturing by lower construction output; this factor may be still in place in January.

Perspectives for industrial output stay as they have been. The most fundamental supporter for Polish output is the recovery in German manufacturing (mind the upward trend in orders, which – excluding car production – is almost intact). There are also statistical base effect which are likely to drive the annual growth rate upwards. We expect the true positive trend in manufacturing to be revealed in January/February, as soon as one-off factors dissipate.

Lower industrial output data has short-term implications, though. On the basis of our supply-side model we expect Q4 GDP to have reached 3.0% (down from 3.2% we suggested earlier). It may also influence nearest MPC decisions in terms of changing the bias. After the wage data we expected that discussion on this may pop up during the January meeting. After today's data MPC members may be quite confused with the current publications and likely to wait until February, when the new inflation projection is published. (Additionally, the "Minutes" of the December MPC meeting revealed that the Board is rather reluctant to raise interest rates – or even signal this at the moment - as it fears of excessive zloty appreciation which may hamper economic recovery). Uncertainty regarding the GDP outlook (often referred to by various MPC members) and actual fall of inflation in the coming months are going to put off the moment of monetary tightening. We expect first hikes in H2 2010.

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	3.0	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 chages from the last release with arrows showing the direction of chages

Fixed Income

The Plan.

"Stupid man with the plan is wiser than a genius without a one". Last week showed that market is trading without any pattern, strong view or … plan. We had some steepening, some flattening, 2y IRS touching low but just to climb to the almost this year high. Some expensive bonds got very squeezed but in one day time there are no buyers of them. Supply scared market so much that ahead of the auction bonds traded very heavy, but eventually Ministry of Finance sold them at the market top for this year. Market activity is very high, last year the ratio of quotes for notional 100 mio + bonds to regular queries (10-25 mio) was 1 to 20, now it is more like 1 to 1 … Kind of easy to get lost. That is why we would like to outline 3 point plan. 1) We expect the yield curve to get flatter (already happening 18 bp tighter from beginning of the year), and in the first half of 2010 most likely with outright yields lower than currently observed. 2) Long end 10+ area bonds are likely to fall in yield owing to convergence and rebalancing of the economy (this segment seems also the least overcrowded). 3) We expect quite high volatility; this may offer plenty of tactical opportunities (bonds-wise), although mind 1) and 2). Risks to our scenario we mainly see on the external side. Greece spillovers, or fiscal risk adjustments should be of a temporary mater to the local market. The differentiating between good and poor credit should be supportive for bonds, especially longer tenors. However they can trigger sharp corrective moves. Next week we will have RPP meeting in partly new squad, we should also get details of the fiscal consolidation announced earlier by Ministry of Finance and Minister Boni. Fingers crossed our plan will work.

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.

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	1/25/2010	-	3.932%	1/18/2010
2Y T-bond OK0712	2/10/2010	-	5.052%	1/13/2010
5Y T-bond PS0415	2/10/2010	-	5.736%	12/2/2009
10Y T-bond DS1019	2/19/2010	-	6.046%	5/20/2009
20Y T-bond WS0429	2/19/2010	-	6.170%	9/23/2009

Money Market

Again market short PLN 1.5 bln

It was another short of cash week for money market. On Friday NBP offered PLN 65 bln bills and banks bought all papers from the offer with the reduction rate 3.3%. After the OMO system was short PLN 1.5 bln and the rates were around 3% almost all week. Next week is the last one in this reserve requirements period therefore demand on tomorrow's tender should be lower. Short term depo rates should be lower as well next week.

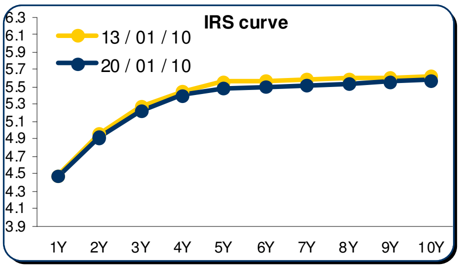
Significant demand on 6M repo

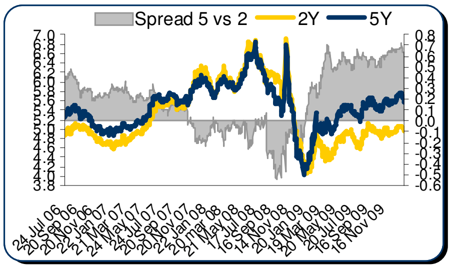
On Tuesday NBP offered 6M repo collateralized in PLN and EUR. Demand for repo collateralized in PLN was 2.2 bln PLN (against 1 bln PLN maturing) and NBP accepted all offers at an av. rate 3.86%. There was no demand for repo collateralized in EUR.

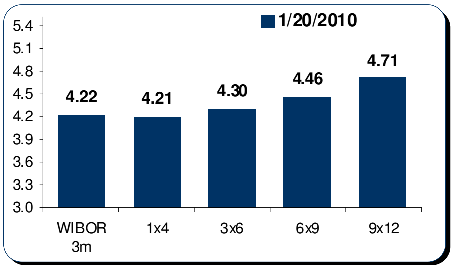
T-bills yields down at the tender

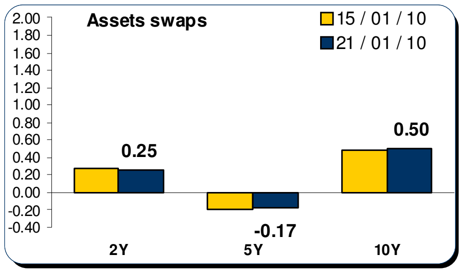
On Monday MinFin offered 52-week t-bill. Banks demand was almost PLN 3.9 bln and MinFin sold PLN 638 million bills at an av. yield 3.932% (against 3.976% last week).

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty just above 4.00

The big 4.0000 support (pivotal level for zloty) is acting like a magnet. But once we get closer to that level, the market is lacking the energy to break it. Fresh zloty long positions are too crowded, and the whole idea of falling straight to 3l9000/3l8500 is a little bit too obvious. The scenario has repeated itself this week till the Greece and global sentiment deterioration has triggered the wave of stop loss zloty selling. 4.00/4.08 weekly range …

Implied volatility lower

The historical volatility is really low, and that has encouraged the implied volatility selling. The 1 month mid has bottomed at 10.75%, 1 year is at 12%. As the consequence of the sell off in the ATMs, the Skew was also offered (1 year RR 25D was given at 2.5 % via 2.85% mid a week ago). Today (Thursday) the trend reversed, but we really need to break out of 4.00/4.20 multi week range to change the bigger picture, and stop the implied volatility slide.

Short-term outlook

SPOT

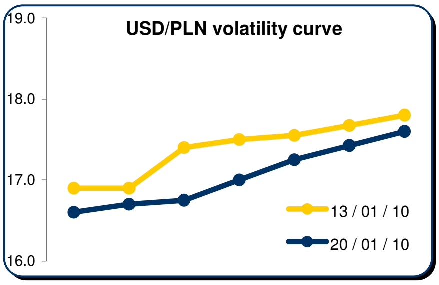
Main supports / resistances:
EUR/PLN: 4,0000 / 4.2000
USD/PLN: 2.8000 / 3.9500

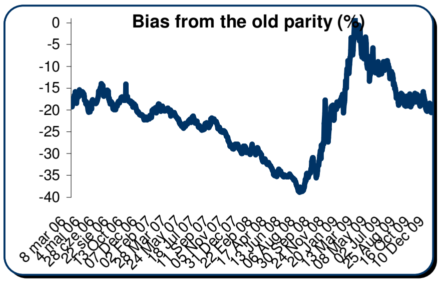
The Zloty is still in the well defined range 4.0000/4.2000 and the market gives plenty of opportunities to ride on volatility. We have to remember though, that only 4.2000 is the real resistance level, everything bellow are just the minor ones. Falling EUR/PLN is consistent with macro foundations of the Polish economy.

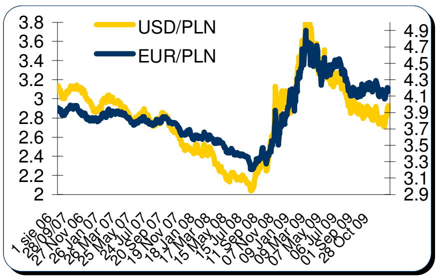
OPTIONS

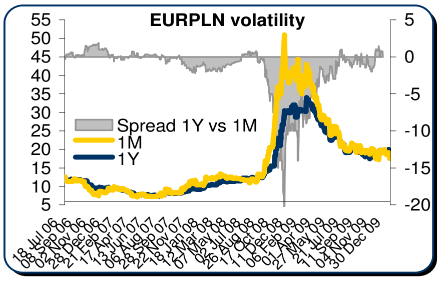
The falling historical volatility is a dominant factor behind the implied volatility curves slide in both, EUR/PLN and USD/PLN. But that is a case as long as 4.00/4.20 range holds, in other words it may change dramatically especially if the upper side of the range will be broken.

FX CHARTS









MARKET PRICES UPDATE

MONEY MARKET RATES

Money market rates (Closing mid-market levels)

date	3M FXSW	3M WIBOR	6M FXSW	6M WIBOR	1Y FXSW	1Y WIBOR
14/01/10	4.15%	4.25%	4.35%	4.29%	4.50%	4.43%
15/01/10	4.15%	4.26%	4.26%	4.29%	4.39%	6.59%
18/01/10	4.20%	4.24%	4.25%	6.49%	4.40%	4.43%
19/01/10	4.10%	4.23%	4.33%	4.28%	4.50%	4.42%
20/01/10	4.14%	4.22%	4.24%	4.27%	4.38%	4.41%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
14/01/10	4.27%	4.31%	4.44%	4.70%	4.64%
15/01/10	4.27%	4.30%	4.43%	4.70%	4.64%
18/01/10	4.25%	4.29%	4.42%	4.69%	4.62%
19/01/10	4.26%	4.30%	4.43%	4.69%	4.64%
20/01/10	4.26%	4.30%	4.43%	4.67%	4.61%

FIXED INCOME MARKET RATES

Fixed Income Market Rates (Closing mid-market levels)

date	1Y WIBOR	1Y TB	2Y IRS	2Y OK0709	5Y IRS	5Y PS0511	10Y IRS	10Y DS1017
14/01/10	4.43%	3.85%	4.98%	4.74%	5.60%	5.43%	5.67%	6.16%
15/01/10	6.59%	3.85%	4.94%	4.73%	5.55%	5.36%	5.64%	6.13%
18/01/10	4.43%	3.85%	4.89%	4.69%	5.49%	5.31%	5.59%	6.10%
19/01/10	4.42%	3.76%	4.94%	4.69%	5.51%	5.30%	5.60%	6.10%
20/01/10	4.41%	3.76%	4.92%	4.72%	5.48%	5.31%	5.58%	6.08%

PRIMARY MARKET RATES

Last Primary Market Rates

	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	10/01/28	11/01/28	96.176	3.93%	700	3935	638
OK0712	10/01/13	12/07/25	88.260	5.05%	6600	23000	6600
PS0415	09/12/02	15/04/25	98.691	5.78%	5000	5614	3629
DS1019	10/01/20	19/04/25	96.009	6.05%	2000	6596	2409

FX VOLATILITY

date	USD/PLN 0-delta stradle 1M	3M	6M	1Y	25-delta RR 1M	25-delta RR 1Y	25-delta FLY 1M	25-delta FLY 1Y
14/01/10	16.90	17.25	17.35	17.60	1.50	2.75	0.80	0.85
15/01/10	16.70	17.00	17.25	17.60	1.50	2.75	0.80	0.85
18/01/10	16.70	17.00	17.25	17.60	1.25	2.75	0.80	0.85
19/01/10	16.70	17.00	17.25	17.60	1.25	2.75	0.80	0.85
20/01/10	16.70	17.00	17.25	17.60	1.25	2.75	0.80	0.85

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
14/01/10	2.7930	4.0534	-18.79%
15/01/10	2.7973	4.0339	-19.02%
18/01/10	2.8042	4.0312	-19.40%
19/01/10	2.7974	4.0190	-18.95%
20/01/10	2.8296	4.0143	-18.61%

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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