



POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

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PREVIEW: The week of April 2nd 2010 to April 8th 2010

Indicator	Date of release	Pe-riod	BRE forecast	Consensus	Last	Comment
NO SIGNIFICANT RELEASES						

In Focus / Macroeconomics

Rates on hold. NBP reserves in focus.

As expected, Polish MPC did not change the rates at the March meeting (repo rate at 3.5%) and uphold its unofficial neutral bias. In its statement MPC elaborates on the uncertainty of global economic outlook and risks related to expansive fiscal policies. It seems to sound more optimistic on local growth perspectives (it links the series of worse domestic data to unfavorable weather conditions) and labor market. Turning to inflation, MPC continuously points to statistical base effects lowering inflation rates in the short-term. In the mid-term possible state controlled price increases pose some risks to consumer price stability.

It has to be acknowledged that falling annual inflation rate, although it reflects mainly base effects, has potential to further dampen expectations for quick rate hikes. In our opinion, ongoing economic recovery, along with quite risky MPC policy of focusing on exchange rate stabilization, will result in postponed but quite aggressive monetary tightening. As for now the low interest rate environment and impressive carry will support the short end of the Polish sovereign curve.

It was the NBP profit/reserves issue that attracted the most media attention, though. On its March meeting the MPC voted on change of the NBP reserves calculation methodology (with the outcome being the adjustment to the resolution from 2006). This adjustment was openly discredited by NBP governor and NBP board. The confrontation within the NBP (with 6 members of MPC supporting the adjustment, and 4 – including president Skrzypek – voting against) attracted wide live coverage by the media.

From the comments and quite thick atmosphere during the meeting, we presume that NBP governor wants to transfer no more than PLN 4.1bn NBP profit to the state budget. We think it may be possible that the new methodology would, on the other hand, result in much higher transfer. As some MPC members openly criticized Skrzypek's refusal to accept new methodology that would increase the NBP's profit, the conflict may damage the central bank's credibility. Additionally, FinMin's involvement (it initiated the discussion on NBP profit in Summer 2009, now it expressed its satisfaction with the new rules), though it pushes for higher transparency of NBP rules, may be interpreted ambiguously. Higher than expected deficit figures for Q1 (see lower retail sales and consequently VAT revenues) may even propel speculations on how severe the fiscal situation really is (and how it contrasts with more positive market assessments). This factor clearly poses some risk to Polish bonds (longer end of the curve in particular). However, we cannot really quantify it and assess whether it would outweigh general positive sentiment towards Polish assets.

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	-1.6↓	-2.7↓	-3.7
Unemployment rate (end-of-year)	11.4	9.5	11.9	12.1	10.9
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	3.1	2.6-2.8	3.3
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

Quite a busy week behind us.

Another week with a strong receiving interest and quite substantial volumes traded. The RPP meeting held on March 30th didn't bring any breakthrough in an attitude to the future policy. The Council confirmed its scenario of lower base-effect CPI numbers within the next couple of months combined with a balanced risks on both sides of a target band. That may suggest again

No hikes this year, but....

that the rate hikes are likely to be postponed till Q4 2010.

The downside trend was continued with nearly 20bp drop in yields along the curve. The most indicative monetary policy target period, 2y swap, was dealt down at 4.53% from 4.73% last week, slightly over 30 points above 1Y. Surprisingly the bull's market has pushed down the end-year FRA contracts to the levels that reflect only "a chance" of a hike. As a result, if we look at the FRA curve, the spread between end-of-December's 2010 9x12s contract and end-of-December's 2011 21x24s contract has narrowed to 55-60 points. Considering we can see 100+ bp move in rates in the next cycle, and it seems at odds now with current market pricing.

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	4/12/2010	-	3.929%	4/1/2010
2Y T-bond OK0712	4/7/2010	-	4.895%	3/10/2010
5Y T-bond PS0415	4/21/2010	-	5.736%	12/2/2009
10Y T-bond DS1019	4/14/2010	-	6.103%	2/19/2010
20Y T-bond WS0429	6/16/2010	-	6.170%	9/23/2009

Money Market

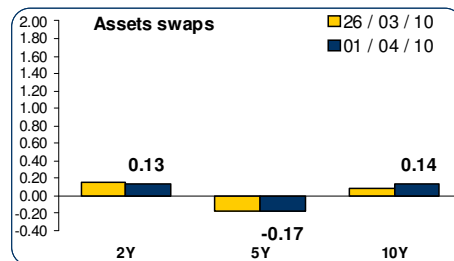
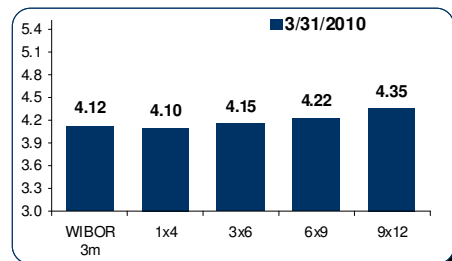
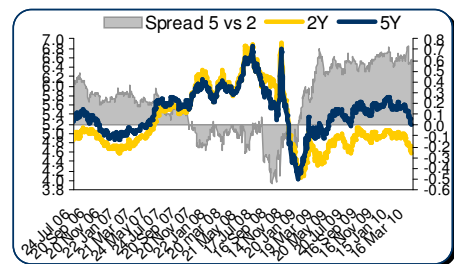
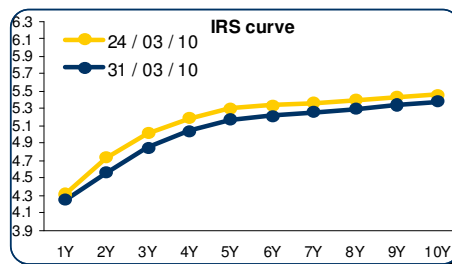
The new reserve started relatively high

Bullish sentiment still dominates the market

Nothing interesting happened during the last week. Very cheap end of the reserve must have been taken for granted (the new record was beaten though as far as the purchase of the money bills is concerned – PLN 77bn), therefore no surprise. No release of important figures. The MPC meeting and their decision was also fully discounted. To make the long story short the week was boring.

The new reserve started relatively high. However, tomorrow's OMO will correct it almost with certainty. Bullish sentiment is mostly visible by watching the currency (another important resistance level was breached today) or/and the decreasing debt yields (today benchmark T-bills auction ended with the average yield of 3.88%).

FIXED INCOME & MONEY MARKET CHARTS



Foreign Exchange

Better global investment climate and most of all, the local privatizations deals looming on the

Zloty stronger

horizon are the main reasons behind the Zloty strength. Tauron, PZU and eventually Polkomtel (it is not decided yet) are the main public offers that may and will influence the Zloty market in the coming months. Today (Thursday), EUR/PLN rate has broken the previous double bottom level at 3.8550, marking the fresh low of this year at 3.8380. We expect the zloty uptrend to continue, unless any external shock materializes on the market.

Implied volatility lower

The implied volatility of two major zloty crosses have been offered the whole week, due to low historical volatility and stronger zloty. Not only the ATMs were sold last week, the risk reversals and flies have applied to the same pattern. The dismissing risk reversals are logical consequence of the lower ATMs curve, but we also have a feeling that the same market participants were purchasing the downside gamma expecting the another leg down in EUR/PLN.

Short-term forecasts

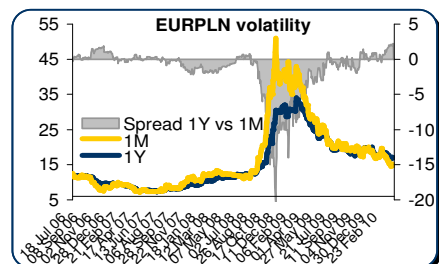
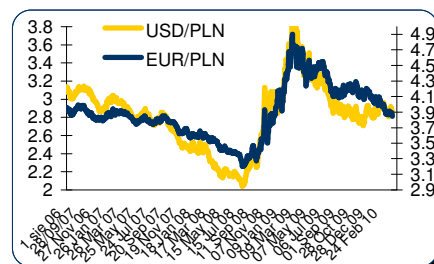
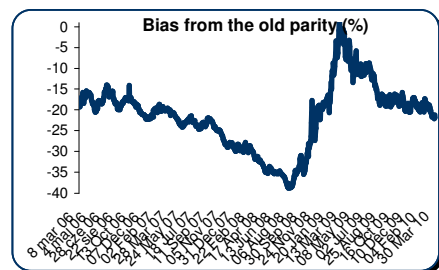
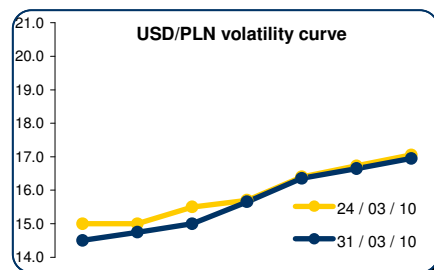
SPOT
 Main supports / resistances:
 EUR/PLN: 3.8000 / 3.9500
 USD/PLN: 2.8000 / 3.9500

Potential flow scenario is supporting our base fundamental pro-zloty scenario. Important technical levels 3.95 from the upside and 3.70 from the downside.

OPTIONS

The implied volatility is well above the historical average, plus the stronger zloty is typically strongly correlated with lower volatility levels (6% mid of 1 year ATM for the fist half of 2008, with spot at 3.20/3.40 level).

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
25/03/10	4.03%	4.12%	4.13%	4.13%	4.33%	4.34%
26/03/10	4.09%	4.12%	4.10%	4.13%	4.30%	6.59%
29/03/10	4.04%	4.13%	4.10%	6.49%	4.29%	4.33%
30/03/10	3.90%	4.13%	4.15%	4.13%	4.34%	4.34%
31/03/10	4.05%	4.12%	4.10%	4.14%	4.33%	4.34%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
	25/03/10	4.13%	4.18%	4.28%	4.54%
26/03/10	4.14%	4.17%	4.28%	4.53%	4.46%
29/03/10	4.14%	4.16%	4.24%	4.49%	4.44%
30/03/10	4.15%	4.17%	4.25%	4.49%	4.44%
31/03/10	4.13%	4.18%	4.24%	4.48%	4.42%

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
25/03/10	4.34%	3.87%	4.74%	4.49%	5.31%	5.13%	5.46%	5.52%
26/03/10	6.59%	3.87%	4.70%	4.46%	5.27%	5.10%	5.44%	5.52%
29/03/10	4.33%	3.87%	4.69%	4.46%	5.26%	5.07%	5.46%	5.51%
30/03/10	4.34%	3.85%	4.63%	4.41%	5.21%	5.05%	5.42%	5.51%
31/03/10	4.34%	3.78%	4.56%	4.38%	5.17%	5.00%	5.38%	5.52%

PRIMARY MARKET RATES

Last Primary Market Rates

	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	10/03/15	11/03/15	96.184	3.92%	1000	2610	1000
OK0712	10/03/10	12/07/25	89.280	4.90%	5400	17000	5448
PS0415	09/12/02	15/04/25	98.691	5.78%	5000	5614	3629
DS1019	10/02/19	19/04/25	95.629	6.10%	2000	5570	2000

FX VOLATILITY

date	USD/PLN 0-delta straddle				25-delta RR		25-delta FLY	
	1M	3M	6M	1Y	1M	1Y	1M	1Y
25/03/10	14.75	15.65	16.35	16.95	2.50	3.70	0.70	0.85
26/03/10	14.75	15.65	16.35	16.95	2.50	3.70	0.70	0.85
29/03/10	14.75	15.65	16.35	16.95	2.50	3.70	0.70	0.85
30/03/10	14.75	15.65	16.35	16.95	2.50	3.70	0.70	0.85
31/03/10	14.75	15.65	16.35	16.95	2.50	3.70	0.70	0.85

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
25/03/10	2.9163	3.8902	-21.56%
26/03/10	2.9062	3.8856	-21.30%
29/03/10	2.8864	3.8929	-21.53%
30/03/10	2.8748	3.8765	-22.11%
31/03/10	2.8720	3.8622	-21.83%

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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