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FINANCIAL MARKETS DEPARTMENT

PAGES: 8

WARSAW, NOVEMBER 26, 2010

POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

PREVIEW: The week of November 29th 2010 to December 2nd 2010

Indicator	Date of release	Period	BRE forecast	Consensus	Last	Comment
GDP growth	Nov 30	Q3	**3.9%**	3.6%	3.5%	We expect some softening in private consumption (2.6%) accompanied by the boost in public consumption, Investment accelerates to 5.5%, change of inventories contribution at 1.0pp. offset by net exports at -0.9pp.
FinMin's inflation forecast	Dec 1	Nov	**2.9%**	-	2.8%	Food prices following classic hump-shaped pattern after the shock. Minor rises of fuel prices. Core inflation 1.3%.
PMI	Dec 1	Nov	**56.1pts**	-	55.6pts	Strong rises of Ifo index and stable domestic indicators suggest another possibility of PMI rise.

In Focus / Macroeconomics

Idle MPC – trading rate hikes for EURPLN appreciation

Another month MPC stayed idle. The statement does not differ at all in its crucial part outlining the decisive factors for monetary policy. Specifically, muted wage and inflationary pressure, along with the risk of worldwide growth flattening, speak in favor of stable rates, especially in environment of increased capital inflows towards emerging markets which may positively affect the more direct disinflationary channel through import prices. Other parts of the statement were subject only to updates (Ireland case, QE in the US, sort of credit rationing resulting from Recommendation T), which increase the ruling uncertainty.

More eventful than the statement itself were governor Belka's comments. Although he thinks there may be a risk of a second round effects (a process in which wage pressures increase in response to higher inflation), he also acknowledges high potential for zloty appreciation (at least 10%). The governor mentioned also some technicalities. Specifically, next year's MPC meeting are going be rescheduled for the first decade of each month (January meeting will be held extraordinarily on January 18-19). Besides difficulties posed for interest rate hedgers, such a decision de facto lags the information set standing for MPC disposal at the beginning of 2011.

We think the MPC will stay idle till the end of Q1 2011. First of all, MPC believes that CPI increases are of supply nature and it seems the baseline scenario within MPC is that price rises are going to fade out in the course of 2011. Secondly, uncertainty regarding the economy is high. There are periphery problems and the risks of re-emergence of debt crisis (heavily influencing the ECB behavior in terms of withdrawing liquidity). MCP seems also aware that the same factors which are propelling Polish retail sales right now will transform into a brake at the very beginning of 2011. Thirdly, the Belka's statement of EURPLN appreciation seems of utmost importance. We think it indicates the willingness of MPC to trade current rate hikes for EURPLN appreciation, which stems more from an exploitation of current disparity of rates in cheap money-abundant environment rather than follows a rise of rate hike expectations (somehow in retreat right now).

We see earlier rate hikes only possible as an emergency scenario, reflected by the adverse EURPLN movements (depreciation) in case of intensification of European debt woes or domestic fiscal problems (so far the fiddling with the pension fund seems neutral for investors, but it may be soon regarded as a substitute of solid reform everybody is awaiting within the next years).

MID-TERM FORECATS

Indicator	2007	2008	2009	2010	2011
GDP y/y (%)	6.5	4.8	1.7	3.6	4.2
Inflation rate (%, average)	2.4	4.3	3.5	2.8	3.5
Current account (% of GDP, average)	-4.5	-5.3	-1.6	**-2.8**↓	**-3.8**↓
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	3.50	4.50

Indicator	2009		2010			
	Q3	Q4	Q1	Q2	Q3	Q4
GDP y/y (%)	1.7	3.1	3.0	3.5	3.9	4.0
Inflation rate (%, average)	3.5	3.3	3.0	2.1	2.6	2.8
NBP repo rate (end-of-quarter)	3.50	3.50	3.50	3.5	3.5	3.50

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

Fixed Income

Panic sell-off continues

The main event this week was presumed to be the Polish MPC meeting. The Council restrained finally from hiking rates once again this year and released quite a moderate comment on the monetary policy standing and CPI pressure in coming months. One could have believed that such an outcome would definitely trigger some pullback on a yield curve but unfortunately the global mood forced the bearish market again. The sudden military crisis on Korean Peninsula and EU fiscal contagion fears hit hard the European currency and drove the long term yields sky-high. The Polish debt suffered a lot for the last few days with DS1020 10y benchmark traded down at 94.00 (6.07% YTM), lowest since the end of June. As a result the yield curve steepened another 10-15 points pushing 2y10y spread up to nearly 70 points.

The end of a year is coming very fast. We don't believe there is any reason to pay the short end of a curve at the moment as the first possible interest rate hike has been postponed to the next CPI projection in February and it's no use to suffer from a very expensive carry for the next few months, especially when the FRA market still prices too much. On the other hand the 2y10y spread topped 114 points in the first half of a year on a Greek Crisis so we might have a long way ahead of us to go as we believe there should be some more upside pressure in the longer end of a curve when the debt crisis in EU and some more instability in the Far East persist

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	12/20/2010	-	4.056%	10/25/2010
2Y T-bond OK1013	12/1/2010	-	4.595%	10/6/2010
5Y T-bond PS0416	12/3/2010	-	5.137%	10/13/2010
10Y T-bond DS1020	-	-	5.772%	11/17/2010
20Y T-bond WS0429	-	-	6.170%	9/15/2010

Money Market

Falling rates before reserve end

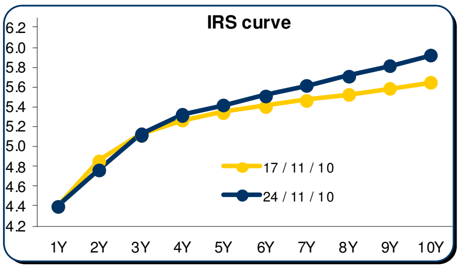
Deteriorating cost of carry due to smaller demand during the OMO last Friday and maturity of DS1110 bond. Shortest rates were falling parallel to growing surplus and we do not expect that tomorrow's auction will change a thing for this reserve settlement period. Therefore, we can expect growing rates no sooner than on Tuesday.

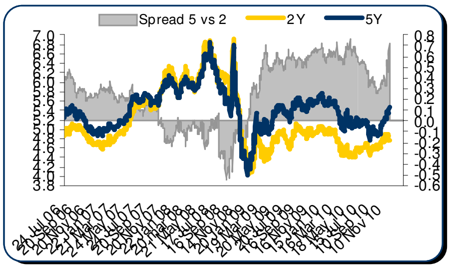
Change of rules during the game by the MPC

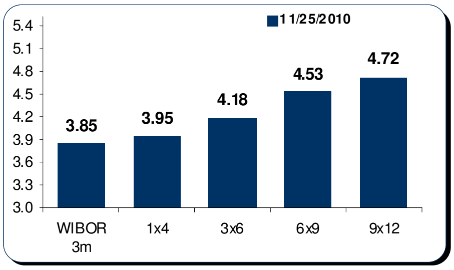
The MPC did not change any of the monetary policy parameters, however they intend to change the term of their regular meetings (first decade of the month starting February). This by all appearances innocent change, have in fact huge impact on the polish derivatives markets with a special attention to FRAs. Curves calibrated before the change were giving false output considering the change announced on Tuesday. This may be a source of serious trouble for those making trades based on the assumption of the end of month meetings. Moreover, the phrase first decade is not a precise one and makes traders guess what can it be. Timing for financial markets is crucial as much as impossible without the trust and schedule. Unfortunately, both were violated. To make the long story short the MPC changed the rules during the game and it never does any good.

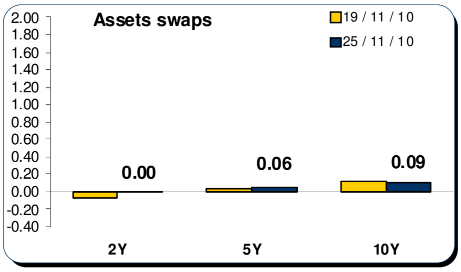
The other components of the MPC statement make us believe that the rate hike can occur in February in its most strict scenario and in March or even later (depending on currency value) in other variations.

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty weaker

Old debt nightmares have come back. Most watched residents are at the moment: Ireland, Portugal and Spain. And despite Ireland bailout, sentiment has worsened for more than while. Zloty has lost to EUR 1.5 percent. One may say: not much (EUR has lost to USD about 3.6%). So say we, light positioning in last months plus relatively good fundamentals have limited number of buyers and reaction was also limited. Range for this week was 3.9250-3.9850.

Curve bit higher

Implied curve bit higher or, to be more precise, short end bit higher. Weaker Zloty and uncertain future has attracted volatility buyers. While catching weakening spot 1M tenor has moved from 9.9 to 10.5 and 3M benchmark is still traded about 11%. How was realized doing during that – 6.5%. Market reaction for weaker Zloty well describes the fact that RRs run has stayed untouched and EURPLN vs USDPLN currency spread was traded even bit lower – from 7.85 to 7.5.

Short-term forecasts:

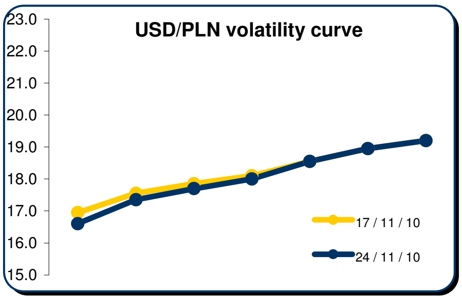
SPOT

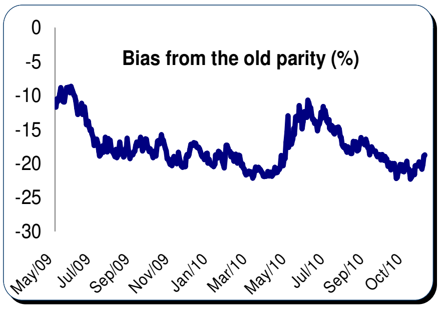
Main supports / resistances:
EUR/PLN: 3.8800 / 4.0050
USD/PLN: 2.8750 / 3.0000

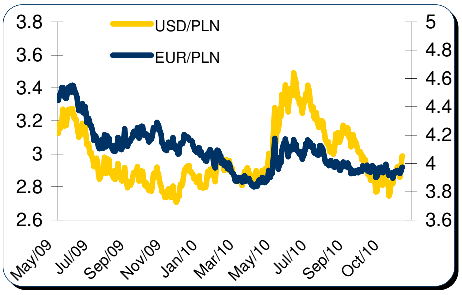
We stick to the last week's idea and one may to try to sell at 3.98, add around 4.00. S/L at 4.03, P/T at 3.88.

OPTIONS
Despite global turbulences gamma sellers can still feel very comfortable and this state is going to be extended. The same idea applies to those neutral/ slightly short Vega.

FX CHARTS


USD/PLN volatility curve
23.0
22.0
21.0
20.0
19.0
18.0
17.0
16.0
15.0
17 / 11 / 10
24 / 11 / 10


Bias from the old parity (%)
0
-5
-10
-15
-20
-25
-30
May/09
Jul/09
Sep/09
Nov/09
Jan/10
Mar/10
May/10
Jul/10
Sep/10
Oct/10


USD/PLN
EUR/PLN
3.8
3.6
3.4
3.2
3
2.8
2.6
5
4.8
4.6
4.4
4.2
4
3.8
3.6
May/09
Jul/09
Sep/09
Nov/09
Jan/10
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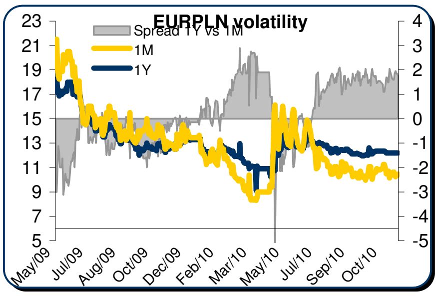
May/10
Jul/10
Sep/10
Oct/10


EURPLN volatility
Spread 1Y vs 1M
1M
1Y
23
21
19
17
15
13
11
9
7
5
4
3
2
1
0
-1
-2
-3
-4
-5
May/09
Jul/09
Aug/09
Oct/09
Dec/09
Feb/10
Mar/10
May/10
Jul/10
Sep/10
Oct/10

MARKET PRICES UPDATE

MONEY MARKET RATES

Money market rates (Closing mid-market levels)

date	3M		6M		1Y	
	FXSW	WIBOR	FXSW	WIBOR	FXSW	WIBOR
18/11/10	3.75%	3.86%	3.94%	3.95%	4.18%	4.17%
19/11/10	3.72%	3.86%	3.92%	3.95%	4.12%	6.59%
22/11/10	3.75%	3.86%	3.92%	6.49%	4.12%	4.17%
23/11/10	3.75%	3.85%	3.95%	6.49%	4.15%	4.17%
24/11/10	3.75%	3.85%	3.95%	3.95%	4.18%	4.17%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
18/11/10	4.03%	4.24%	4.57%	4.78%	4.72%
19/11/10	3.98%	4.20%	4.53%	4.74%	4.72%
22/11/10	3.98%	4.20%	4.53%	4.74%	4.71%
23/11/10	3.97%	4.18%	4.53%	4.74%	4.68%
24/11/10	3.97%	4.18%	4.52%	4.73%	4.68%

FIXED INCOME MARKET RATES

Fixed Income Market Rates (Closing mid-market levels)

date	1Y		2Y		5Y		10Y	
	WIBOR	TB	IRS	OK0112	IRS	PS0511	IRS	DS1017
18/11/10	4.17%	4.03%	4.86%	4.83%	5.34%	5.38%	5.66%	5.81%
19/11/10	6.59%	4.03%	4.89%	4.83%	5.35%	5.38%	5.70%	5.81%
22/11/10	4.17%	4.06%	4.76%	4.78%	5.39%	5.39%	5.89%	5.89%
23/11/10	4.17%	4.08%	4.78%	4.77%	5.39%	5.42%	5.89%	5.92%
24/11/10	4.17%	4.08%	4.77%	4.77%	5.42%	5.49%	5.92%	5.97%

PRIMARY MARKET RATES

Last Primary Market Rates

	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	10/09/27	11/09/27	96.189	3.92%	600	1150	580
OK0113	10/10/06	13/01/26	90.178	4.60%	3000	7568	3000
PS0416	10/10/13	16/04/25	99.300	5.14%	3000	3414	2491
DS1020	10/09/15	19/04/25	98.383	5.46%	3000	8953	3000

FX VOLATILITY

	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
date	1M	3M	6M	1Y	1M	1Y	1M	1Y
18/11/10	17.45	18.15	18.55	19.20	2.65	4.20	0.65	0.88
19/11/10	17.50	18.05	18.60	19.20	2.65	4.20	0.65	0.88
22/11/10	17.30	17.90	18.55	19.20	2.65	4.20	0.65	0.88
23/11/10	17.20	17.90	18.55	19.20	2.65	4.20	0.65	0.88
24/11/10	17.35	18.00	18.55	19.20	2.65	4.20	0.65	0.88

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
18/11/10	2.8871	3.9386	-20.4%
19/11/10	2.8749	3.9381	-20.5%
22/11/10	2.8591	3.9292	-20.8%
23/11/10	2.9020	3.9443	-20.1%
24/11/10	2.9808	3.9695	-18.9%

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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