



POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

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PREVIEW: The week of March 4th 2011 to March 10th 2011

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

In Focus / Macroeconomics

GDP accelerated in Q4

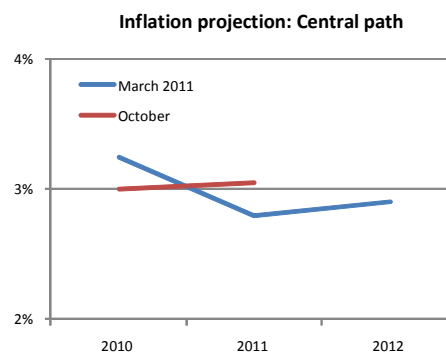
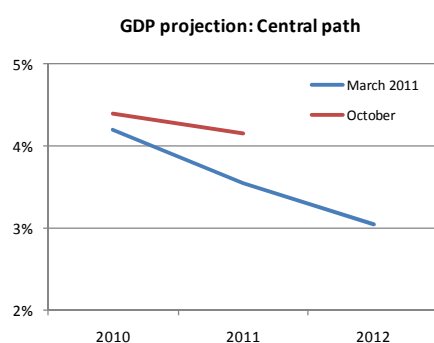
As expected, Polish GDP accelerated to 4.4% yoy in Q4. Decomposition is not at all a surprise – it is more or less the same as one could have calculated using annual data (published in January).

Composition with respect to expenditures points to a strong momentum in individual consumption: 4.1% (from 3.5% in the third quarter) as well as in public consumption (5.4% from 4.3%); minor acceleration was also recorded in investment demand (to 0.9% from 0.4%). The contribution of net exports to GDP growth stood at -1.2 pp (this is a result of higher imports corresponding to substitution effects in consumption), and was easily compensated by the contribution of change in inventories (2.1 pp). Domestic demand became even stronger and stood at 5.6% yoy. Expenditures decomposition showed weaker industry growth (6.2% compared to 10.2% in Q3), steady construction momentum (6.6% compared to 6.1% in the previous quarter) and stronger market services (3.3% versus 2.2% previously, showing a steady growth path for several quarters).

High individual consumption growth is not a surprise due to substitution effects which occurred last year. Currently, we expect weaker individual consumption in the first quarter, but it should get back to a growth path in the quarters to come. Investment has been showing relatively tepid growth. Nevertheless, we think that we will see an acceleration in investment, due to several factors: 1) growing capacity utilization, 2) growing labor productivity – considerable utilization of labor generates a need to expand capital base as well, 3) high liquidity of enterprises and a beginning of expansion in corporate loans (excluding currency exchange effects). Moreover, delay in the investment demand does not prove that the cycle will end. Basing on the American economy (the so called “stylized facts”), such delay in investment process occurred in 20% of upswing phases and was not followed by any break in the cycle. Therefore, we expect continuing recovery of the Polish economy. In 2011 the GDP growth should amount to about 4.2% (as we noted, a slowdown in GDP expansion will be noticeable only in Q1, corresponding to a reversion of substitution effects – we think this tendency is already noticeable in the PMI). Annual investment growth is set to be strong.

Interest rates unchanged. ECB supposed to indicate direction...

As expected MPC did not decide to change interest rates. The statement after the meeting was relatively mild, just as chairman opinions during the conference. March meeting brought the results of the fresh inflation projection (see charts below).



MPC highlights that global economy is on the rise, but risk factors are still in place: fiscal imbalances and results of unconventional monetary policy. In the context of Middle East and North Africa events, two-fold results of oil prices growth were mentioned: pro-inflationary and anti-growth ones.

After the very optimistic January “Minutes”, MPC became again more cautious in its assessment of the Polish economy, mentioning solid GDP growth in IV quarter although fuelled by consumption, not investment. The statement refers to stronger production, weaker sales, growing em-

ployment and wages (although still only “moderately”), but also increasing unemployment rate. Traditionally, MPC has mentioned slow growth of corporate credit and ongoing fast growth of mortgage (MPC, as usual, highlights the need for restricting expansion of mortgage in foreign currencies). As far as prices are concerned, MPC stressed that inflation rate breached the upper target range, however, owing to exogenous factors. Exchange rate hasn’t even been mentioned, which may be interpreted as willingness of MPC to focus more on inflationary target, at least in the medium-term.

MPC embarked on a classic wait-and-see mode. However, this idyllic (and comfortable) picture may have been destroyed by the hawkish ECB stance. It is hard to neglect that risk factors are more or less the same in Poland and euro zone (with a tilt towards the latter, owing to the debt problems). Moreover, it is even harder to pick factors which may spoil cyclical recovery in Poland without any disruptions in Germany (with this respect the assessment of ECB is clear). Therefore rate hikes in Poland should be regarded as warranted, the more so inflation expectations may soar in March and anchoring them seems of utmost importance right now (especially for MPC which does not have strong credibility, even comparable to the one of ECB). We think that MPC may raise rates in April, unwilling to be divergent with the ECB. One has to note, however, that MPC stays very data dependent and large swings of mood are recently nothing unusual within this body. Mid-term wise and taking into account inflation projection, earlier rate hikes (frontloaded) may deliver price stability and the total scale of tightening does not have to be considerable (75-100bp. total) if only inflation expectations stay properly anchored. The same applies to ECB. Crucial is the timing and prevention of second-round effects. This way, at the end of the day the cycle may be shortened, without compromising price stability.

MID-TERM FORECASTS

Indicator	2007	2008	2009	2010	2011
GDP y/y (%)	6.5	4.8	1.7	3.8	4.2
Inflation rate (% , average)	2.4	4.3	3.5	2.8	3.7
Current account (% of GDP, average)	-4.5	-5.3	-1.6	-3.1	-3.8
Unemployment rate (end-of-year)	11.4	9.5	11.9	12.3	11.9
NBP repo rate (end-of-year)	5.00	5.00	3.50	3.50	4.25

Indicator	2010				2011	
	Q1	Q2	Q3	Q4	Q1	Q2
GDP y/y (%)	3.0	3.5	4.2	4.5	4.4	3.8
Inflation rate (% , average)	3.0	2.1	2.6	2.9	3.7	3.7
NBP repo rate (end-of-quarter)	3.50	3.5	3.5	3.50	3.75	4.25

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

Fixed Income

Moving steeper

Most important event of the passing week was the MPC rate decision announced on Wednesday. As recent comments from Council members suggested that rates would be left unchanged, rates in the front end drifted lower already ahead of the decision, and afterwards the move continued, all together by some 8bp. Positive sentiment didn't last long though, as hawkish ECB comments pushed the rates back up to the levels from the beginning of the week. Potential rate increases in the eurozone, if they actually materialize, could surely have some impact on rate path in Poland. But that would only mean that we would only get a bit closer to what is already priced in the curve. Now, that April's hike is already fully priced in, and there is still almost whole month till the decision, and two weeks before this month economic data releases, it looks that current yields are around some equilibrium level and will most likely fluctuate in a range, following EUR curve and currency moves. We think curve is likely to steepen further in 2y-10y and 5y-10y. We think bonds are quite cheap, especially in 10y sector - with no supply from FinMin, and probably quite limited in coming month, asset swaps should tighten. In the front end, we still don't change our opinion - rate hike expectations are exaggerated, especially what's priced in 1y1y forward, and we tend to receive tops there.

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	2/28/2011	-	4.291%	1/31/2011
2Y T-bond OK1013	3/9/2011	-	5.031%	2/9/2011
5Y T-bond PS0416	3/9/2011	-	5.642%	1/5/2011
10Y T-bond DS1020	3/16/2011	-	6.210%	1/12/2011
20Y T-bond WS0429	3/16/2011	-	6.246%	1/12/2011

Money Market

No rates hike in March

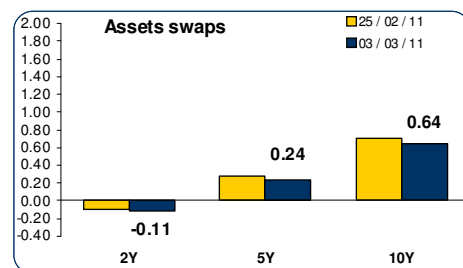
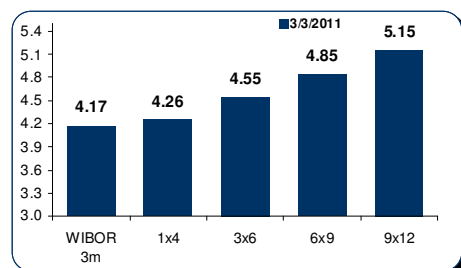
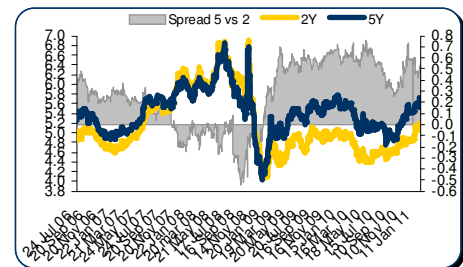
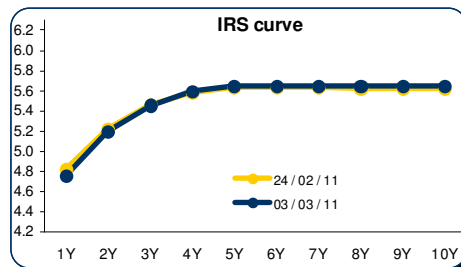
Benchmark T-bill quite cheap during the tender

The end of the reserve was very cheap as expected plus pln 3 bln of cash surplus left for the beginning of the new settlement period. Despite the fact of the surplus shortest rates are relatively high just below 3.5%. If the market is square after OMO, we can move further north.

The MPC did not change any of the monetary policy parameters which can be perceived as expected, however drop in the derivatives rates by 5-10 bps proves that some probability was built in till the very end. CPI, wages and retail sales will determine the timing of the next hikes. April is still in prices but the bet may be similar as in March. New benchmark T-bill was very cheap during the tender with an average yield of 4.51%. Those papers should be more expensive on Monday.

Since longest ois contracts lost least after MPC, we still see much value in receiving them.

FIXED INCOME & MONEY MARKET CHARTS



Foreign Exchange

Zloty in range

After trading 4.0030 top, EURPLN has traded stronger side reaching quickly 50% retracement of last upside move placed at 3.95. Long Zloty positions, threaten by global worries and high oil prices, were washed out of market leaving EURPLN's rate at no man's land. Although without those positions Zloty has become less vulnerable for upside pressure (barely no reaction for lack of March rate hike) trading sub 3.95 levels is also unlikely. Simply Zloty is not most popular asset these days.

Implied vols traded at low levels

Well, weaker PLN do not exclude new implied low. While short end is traded relatively steady: 1M is traded in 9.0-9.5 range (slightly above realized – 8.5% realized in weekly terms), 3M about 9.75, 1Y has touched new low - 10.8 was traded (11.0 last week's low). Smile is priced at very same levels -3M 25D RR benchmark has stuck at 1.8%. Low EURPLN vs EURUSD correlation readings has translated into slightly lower USDPLN run – about 0.3-0.5 lower (3M ATM 15.25).

SPOT

Main supports / resistances:
 EUR/PLN: 3.9500 / 4.0200
 USD/PLN: 2.8400 / 2.9700

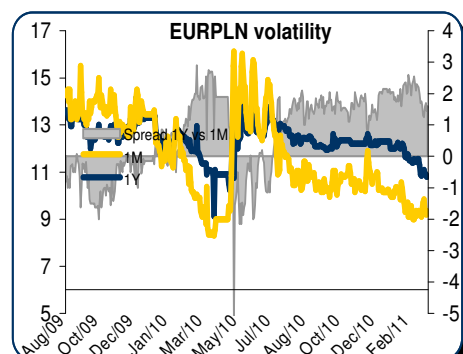
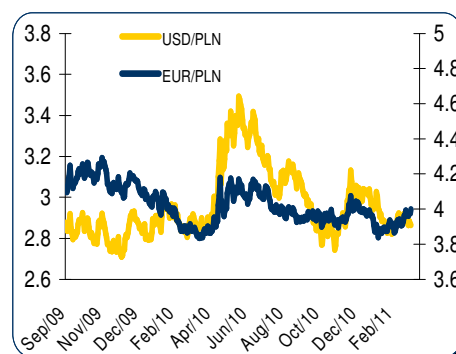
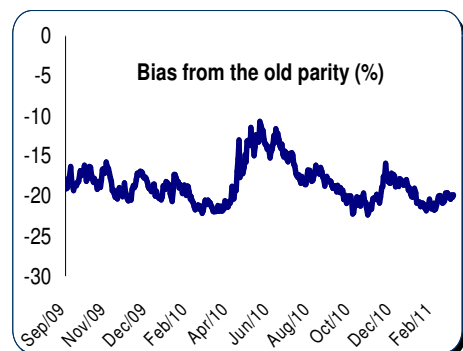
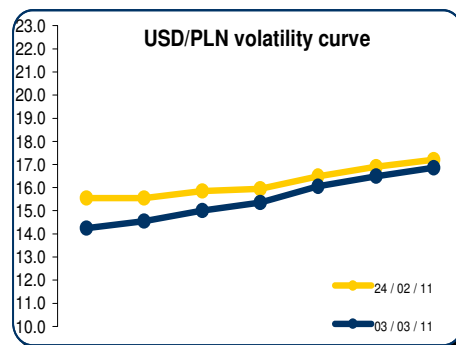
Short-term forecasts:

Neither 4.01 sell (4.0030 top) nor 3.94 buy levels were drawn (3.95 low). Sentiment remains poor but positioning don't help here anymore. We see 3.95/3,96 as buy level, 4.00/4.02 as sell one. Play range.

OPTIONS

Vega is priced lower (1Y tenor 12.3 to 10.8 since 1st of Jan!) and it is hard to convince us to catch running train. We would be a buyer of it if PLN weakness will extend, 10.0-10.2 desired level. Gamma is still priced above realized – 9.8% implied, 9.0 realized but this is the price of anxious times.

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
25/02/11	3.99%	4.13%	4.23%	4.26%	4.40%	4.42%
28/02/11	4.04%	4.13%	4.26%	4.26%	4.41%	6.59%
01/03/11	4.06%	4.15%	4.27%	6.49%	4.43%	4.44%
02/03/11	4.09%	4.17%	4.24%	4.27%	4.43%	4.45%
03/03/11	4.07%	4.17%	4.26%	4.28%	4.43%	4.45%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
25/02/11	4.31%	4.61%	4.94%	5.19%	5.14%
28/02/11	4.29%	4.58%	4.91%	5.18%	5.11%
01/03/11	4.30%	4.62%	4.96%	5.22%	5.16%
02/03/11	4.29%	4.60%	4.93%	5.19%	5.12%
03/03/11	4.28%	4.59%	4.91%	5.18%	5.10%

FIXED INCOME MARKET RATES

Fixed Income Market Rates (Closing mid-market levels)							
date	1Y		2Y		5Y		
	WIBOR	TB	IRS	OK0112	IRS	PS0511	IF
25/02/11	4.42%	4.52%	5.20%	5.09%	5.61%	5.88%	5.6
28/02/11	6.59%	4.52%	5.18%	5.07%	5.61%	5.84%	5.6
01/03/11	4.44%	4.53%	5.19%	5.09%	5.61%	5.83%	5.6
02/03/11	4.45%	4.55%	5.14%	5.06%	5.58%	5.83%	5.6
03/03/11	4.45%	4.54%	5.20%	5.09%	5.65%	5.89%	5.6

PRIMARY MARKET RATES

Last Primary Market Rates							
	au. date	maturity	avg price	avg yield	supply	demand	sc
52W TB	11/01/31	12/01/31	95.841	4.35%	2000	2968	19
OK0113	10/12/01	13/01/26	90.550	4.80%	4000	9322	40
PS0416	10/10/13	16/04/25	99.300	5.14%	3000	3414	24
DS1020	11/01/12	19/04/25	93.022	6.21%	2250	4252	22

FX VOLATILITY

date	USD/PLN 0-delta stradle				25-delta RR		2
	1M	3M	6M	1Y	1M	1Y	
25/02/11	15.40	16.00	16.50	17.20	2.10	3.80	0.
28/02/11	15.05	15.75	16.45	17.10	1.60	3.70	0.
01/03/11	15.05	15.70	16.40	17.00	1.60	3.70	0.
02/03/11	15.00	15.55	16.15	16.85	1.60	3.70	0.
03/03/11	14.55	15.35	16.05	16.85	1.60	3.70	0.

PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
25/02/11	2.8770	3.9757	-20.1%
28/02/11	2.8765	3.9763	-20.1%
01/03/11	2.8643	3.9612	-20.4%
02/03/11	2.8843	3.9776	-19.9%
03/03/11	2.8704	3.9773	-20.1%

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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