



## POLAND WEEKLY REVIEW

### MACROECONOMICS AND FINANCIAL MARKETS

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#### PREVIEW: The week of March 11<sup>th</sup> 2011 to March 17<sup>th</sup> 2011

Indicator	Date of release	Pe- riod	BRE forecast	Consen- sus	Last	Comment
Current account mln EUR	Mar 14	Jan	-1709	-1380	-1573	Narrowing of trade balance may be solid. Recent data published by GUS shows that import volume may have fallen below EUR 10000mln. Therefore there is a risk C/A balance will be even lower than EUR 1000mln.
M3 Supply y/y	Mar 14	Feb	8.5%	8.5%	8.1%	Recent trend continues.
CPI inflation y/y	Mar 15	Feb	3.9%	3.9%	3.8%	Revision of consumption basket -0.1-0.2pp. Food prices close to 1.0% m/m (confirmed regionally). Core inflation at 2.1%.
Employment y/y	Mar 16	Feb	4.0%	4.0%	3.8%	Zero growth on monthly basis. Business tendency indicators slightly more positive.
Wages y/y	Mar 16	Feb	4.9%	4.9%	5.0%	No surprises in mining. Wages in solid, upward trend (a tendency to be vividly seen in manufacturing).
Industrial output y/y	Mar 17	Feb	11.1%	9.9%	10.3%	No difference in working days. Lower PMI poses down-side risk.
Producer prices y/y	Mar 17	Feb	7.1%	6.7%	6.2%	Higher prices of oil (+6.5% in PLN) and copper (+2.5%). Producer price expectations sky high.

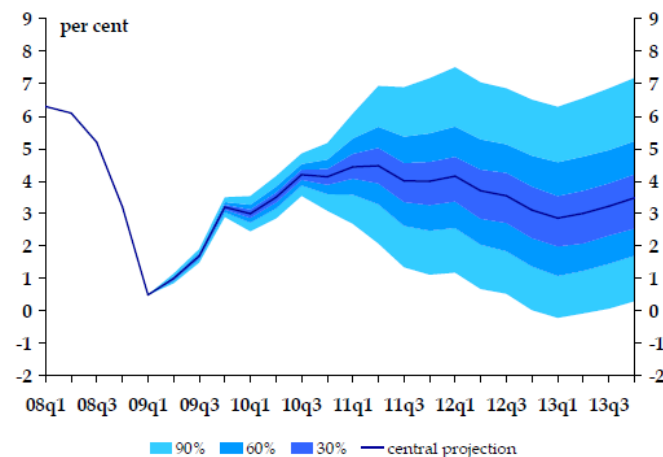
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## In Focus / Macroeconomics

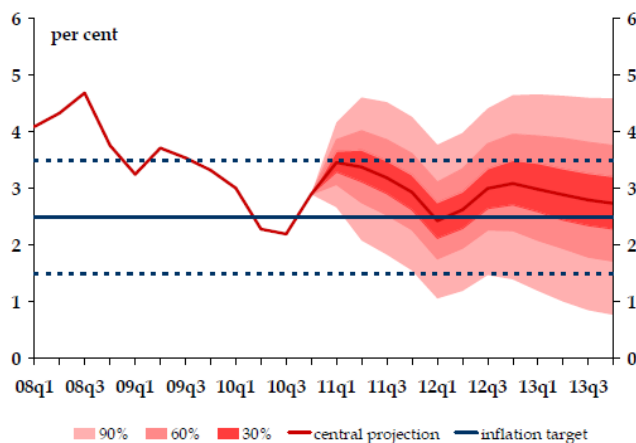
### March 2011 "Inflation Report". More pessimistic forecasts of the real economy and only temporary inflation increase.

This week National Bank of Poland published "Inflation Report". In the March projection inflation forecasts were increased by 0.5-0.6 pp. for the first two quarters of 2011. The difference itself looks impressive, however, decomposition suggests higher inflation will be a result of global factors: higher prices of energy and food. Core inflation projection for this year is only slightly higher than in the October issue of "Inflation Report" while forecasts for 2012 is even lower. Lower inflation forecasts in Q3 and Q4 and in 2012 will be a result of lower prices of food. Inflation will remain above the target at about 3% y/y all over the projection horizon (except from Q1 2012).

Central GDP projection and fan chart.



Central inflation projection, fan chart of inflation and NBP inflation target.



NBP expects that high GDP growth will be sustained this year. This will be a result of growing domestic demand with decreasing contribution of inventories. In short term GDP growth will be weaker as a result of lower forecasts of gross fixed capital formation. This corresponds to less optimistic forecasts of public gross fixed capital formation (new Plan of Roads and Highways Construction and lower EU funds transfer). Forecasts of private gross fixed capital formation are almost unchanged – contribution to GDP growth will be higher in Q3 and Q4. In 2013 private gross fixed capital formation will be a pillar of overall investment growth easing, excluding public investment. Lower GDP growth forecasts resulted in slightly less optimistic perspectives for the labor market. Higher unemployment rate should correspond to weaker bargaining power of employees and lower wage pressure.

**MID-TERM  
FORECASTS**

The most important risk factor in the March projection is external environment – European Central Bank revised its forecasts while NBP report stays pessimistic... According to NBP it is difficult to tell exactly whether withdrawal of stimulatory policy mix, growing indebtedness together with food and fuel prices uncertainty will result in higher or lower inflation; inflation risks are skewed to the upside, though.

Current inflation projection certainly supports dovish members of MPC (including the MPC head) and should reduce the scale of monetary tightening in the coming months. MPC may follow ECB and increase interest rates in April, but this may be the only hike in the first half of 2011.

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**

*Still bullish on rates.*

Without any important economic releases the market traded in a tight range near its year highs. As we expected the curve steepened by few points especially in 2y5y sector reaching 47 points local month's high. The front end of a curve stayed under receiving pressure especially between 6x9s and 9x12s FRAs that resulted in flattening the curve in 1y sector. The longer end of a curve became better paid as the global sentiment worsened due to the turmoil in Northern Africa and still existing threats of a Euro zone peripherals' crisis.

The regular 2Y benchmark treasury bond auction attracted a huge demand of over 10bln PLN and the Ministry Of Finance easily sold 4.5bln notional at 5.15% average YTM. We don't change our view on a short end of a curve. We still believe there is a huge opportunity to take advantage from receiving rates up to 2Y as the market has priced 50bp hike till June and 100bp till the end of a year. Our main scenario presented from the very beginning of a year assumed the CPI would reach its top in April-May. On the other hand we believed the MPC finally would realize the tightening policy might have limited impact in curbing inflation resulted mainly from external factors. Moreover, the higher interest rates might adversely affect the economic growth and spark the new crisis.

The lack of a hike in March, and the latest dovish comments from the Council members suggest we may face up to two 25bp moves till June and our main scenario is likely to materialize. Taking into account that the Ministry of Economy estimate the March CPI figure at 3.7%, below the previous reading, we may reach the main rate at 4% in June. Concluding, we still sell FRAs at local tops and stay received.

**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	3/28/2011	-	4.291%	1/31/2011
2Y T-bond OK1013	4/13/2011	-	5.113%	3/9/2011
5Y T-bond PS0416	4/20/2011	-	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

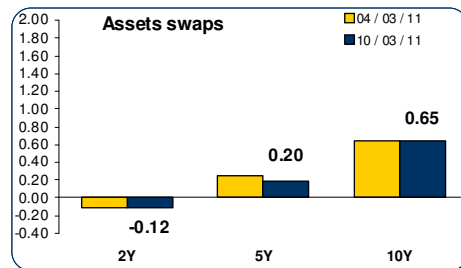
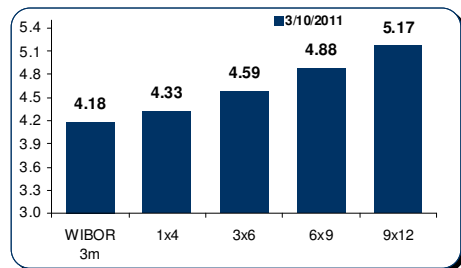
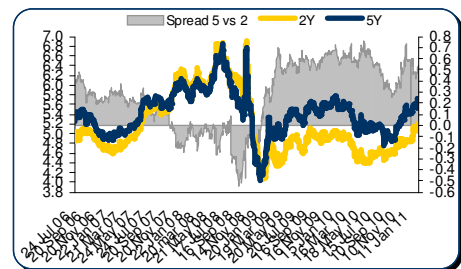
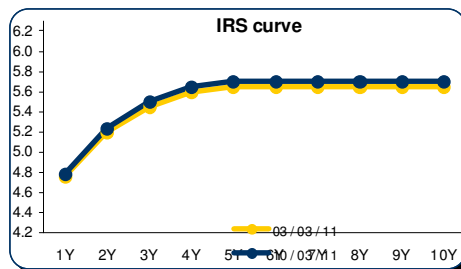
**Money Market**

*Amazing demand for T-bills.*

Since the beginning of the new month ON cash went quite higher, around 3.55 which can be quite surprising as last month average was 3.17. Looks like people are getting used to new reference rate at 3.75. Next week should be around 3.55 too as its still few OMOs till the end of reserve requirement period.

Finally the Ministry of Finance offered a bit less t-bills on Monday's auction (900 mln ag. 1.5 bn previously) and this encouraged investors to show their needs, the demand was around 5 bn and max yield fell by 4bp to 4.50%. There will be 2 more auctions of 29-02-12 t-bills and this will prevent prices from rising dramatically as Ministry of Finance can show huge offer again.

**FIXED INCOME & MONEY MARKET CHARTS**



**Foreign Exchange**

*Zloty in range*

Range, defined by 3.95/4.02 numbers, has held till Friday. This week's bottom/top were marked by 3.9620/3.9950 rates and more or less we may end this story...But to honestly develop subject: i) 3.9950 has provoked some strong selling so 3.9620 took place (a P/T?), ii) market positioning seems light/slightly skewed for short PLN, iii) end of week weakening towards 4.00 (Spain downgrade) has printed 6.50% realized volatility, iv) still very low number of new interests.

*Implied vols traded at low levels*

EURPLN trade range on low realized volatility (6% weekly) records. Result: 1M 8.5 (9.2 last week), 3M 9.3 (9.75) and 1Y 10.5 (10.8). Same decent offers we see on USDPLN run, where 3M USDPLN vs. EURPLN currency spread is traded at 4.75% level (5.25 % week ago) Smile is priced at very same levels -3M 25D RR benchmark has stuck at 1.8%.

**Short-term forecasts:**

**SPOT**

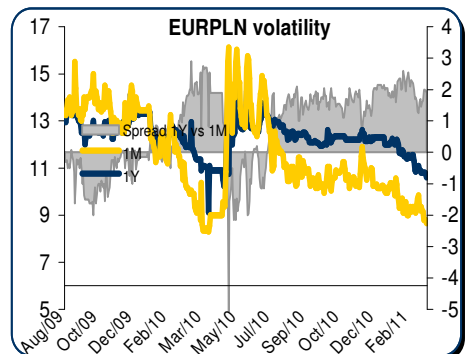
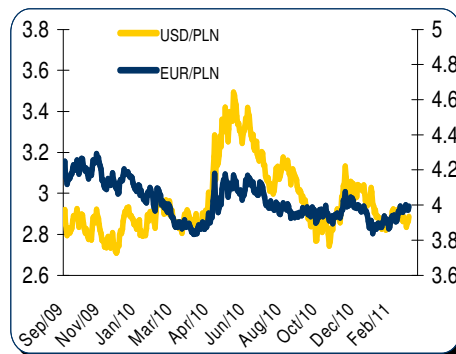
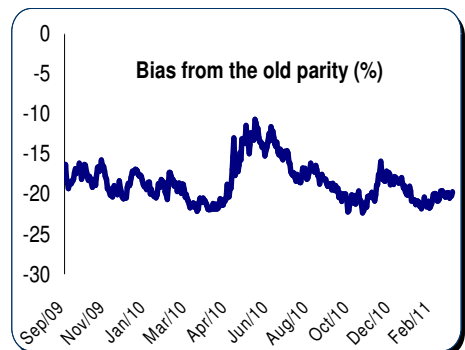
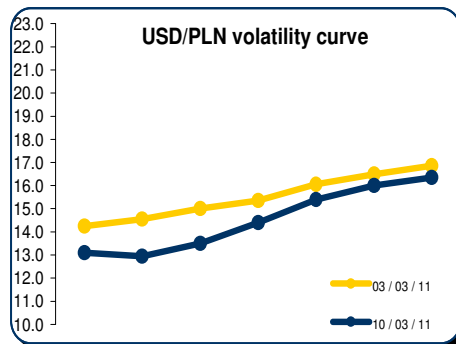
Main supports / resistances:  
 EUR/PLN: 3.9500 / 4.0200  
 USD/PLN: 2.8400 / 2.9700

Range holds. Positioning is counter-PLN. Spain downgrade may provoke further PLN selloff and take PLN to 4.0150 level – our desired sell level, S/L 4.04. On the other hand lack of natural PLN demand place P/T and buyers opportunity at close 3.96 level.

**OPTIONS**

Vega is priced lower (1Y tenor 12.3 to 10.5 since 1st of Jan!) and its 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 – 8.5% implied, 6.0 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
04/03/11	4.06%	4.17%	4.25%	4.28%	4.45%	4.45%
07/03/11	4.09%	4.17%	4.30%	4.28%	4.45%	6.59%
08/03/11	4.06%	4.17%	4.27%	6.49%	4.45%	4.46%
09/03/11	4.06%	4.18%	4.30%	4.30%	4.45%	4.47%
10/03/11	4.10%	4.18%	4.28%	4.30%	4.45%	4.47%

**FRA MARKET RATES**

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
04/03/11	4.29%	4.59%	4.90%	5.17%	5.10%
07/03/11	4.24%	4.51%	4.81%	5.10%	5.04%
08/03/11	4.26%	4.55%	4.85%	5.15%	5.09%
09/03/11	4.34%	4.57%	4.87%	5.17%	5.09%
10/03/11	4.33%	4.56%	4.89%	5.20%	5.09%

**FIXED INCOME MARKET RATES**

Fixed Income Market Rates (Closing mid-market levels)							
date	1Y		2Y		5Y		
	WIBOR	TB	IRS	OK0112	IRS	PS0511	IF
04/03/11	4.45%	4.56%	5.20%	5.08%	5.64%	5.90%	5.6
07/03/11	6.59%	4.55%	5.22%	5.09%	5.68%	5.89%	5.6
08/03/11	4.46%	4.55%	5.26%	5.21%	5.73%	5.95%	5.7
09/03/11	4.47%	4.56%	5.25%	5.12%	5.73%	5.92%	5.7
10/03/11	4.47%	4.56%	5.24%	5.12%	5.71%	5.90%	5.7

**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	11/03/09	13/01/26	91.054	5.11%	4500	10808	45
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	
04/03/11	14.40	15.30	16.00	16.70	1.60	3.70	0.
07/03/11	13.70	14.65	15.55	16.40	1.60	3.70	0.
08/03/11	13.55	14.55	15.50	16.40	1.60	3.70	0.
09/03/11	13.10	14.45	15.50	16.40	1.60	3.70	0.
10/03/11	12.95	14.40	15.40	16.35	1.60	3.70	0.

**PLN SPOT PERFORMANCE**

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
04/03/11	2.8646	3.9988	-19.9%
07/03/11	2.8372	3.9795	-20.5%
08/03/11	2.8549	3.9756	-20.3%
09/03/11	2.8644	3.9758	-20.2%
10/03/11	2.8849	3.9915	-19.8%

Note: parity on 11/04/00 – USD= 4.3806, EUR=4.2196, basket share 50:50  
Mid-market volatility of vanilla option strategies

## Contact Details

### BRE BANK SA

Ul. Senatorska  
18  
00-950 Warszawa  
P.O. Box 728  
Poland

Reuters Pages:  
BREX, BREY,  
and BRET

Bloomberg: BRE

SWIFT:  
BREXPLPW

[www.brebank.pl](http://www.brebank.pl)

### Forex (BREX) - FX Spot & Options

Marcin Turkiewicz (+48 22 829 01 84) [marcin.turkiewicz@brebank.pl](mailto:marcin.turkiewicz@brebank.pl)  
Jakub Wiraszka (+48 22 829 01 73) [jakub.wiraszka@brebank.pl](mailto:jakub.wiraszka@brebank.pl)  
Tomasz Chmielarski (+48 22 829 01 78) [tomasz.chmielarski@brebank.pl](mailto:tomasz.chmielarski@brebank.pl)

### Fixed Income (BREP) - FRA, IRS, T-Bonds, T-Bills

Lukasz Barwicki (+48 22 829 01 93) [lukasz.barwicki@brebank.pl](mailto:lukasz.barwicki@brebank.pl)  
Paweł Białczyński (+48 22 829 01 86) [pawel.bialczynski@brebank.pl](mailto:pawel.bialczynski@brebank.pl)

### MM (BREP) - MM

Bartłomiej Małocha, CFA (+48 22 829 01 77) [bartlomiej.malocha@brebank.pl](mailto:bartlomiej.malocha@brebank.pl)  
Bogumił Modzelewski [bogumil.modzelewski@brebank.pl](mailto:bogumil.modzelewski@brebank.pl)

### Structured Products (BREX)

Jarosław Stolarczyk (+48 22 829 01 67) [jaroslaw.stolarczyk@brebank.pl](mailto:jaroslaw.stolarczyk@brebank.pl)  
Jacek Dereziński (+48 22 829 01 69) [jacek.derezinski@brebank.pl](mailto:jacek.derezinski@brebank.pl)

### Institutional Sales (BRES)

Inga Gaszkowska-Gębska (+48 22 829 12 05) [inga.gaszkowska-gebska@brebank.pl](mailto:inga.gaszkowska-gebska@brebank.pl)

### Research

Ernest Pytlarczyk, PhD, CFA (+48 22 829 01 66) [ernest.pytlarczyk@brebank.pl](mailto:ernest.pytlarczyk@brebank.pl)  
Marcin Mazurek, PhD (+48 22 829 0183) [marcin.mazurek@brebank.pl](mailto:marcin.mazurek@brebank.pl)  
Paulina Ziemińska (+48 22 829 02 56) [paulina.ziembinska@brebank.pl](mailto:paulina.ziembinska@brebank.pl)  
Maciej Pielaszkiewicz (+48 22 829 90 34) [maciej.pielaszkiewicz@brebank.pl](mailto:maciej.pielaszkiewicz@brebank.pl)

### Financial Markets Department

Phone (+48 22 829 02 03)  
Fax (+48 22 829 02 45)

### Treasury Department

Phone (+48 22 829 02 02)  
Fax (+48 22 829 02 01)

### Financial Institutions Department

Phone (+48 22 829 01 20)  
Fax (+48 22 829 01 21)

### Back Office

Phone (+48 22 829 04 02)  
Fax (+48 22 829 04 03)

### Custody Services

Phone (+48 22 829 13 50)  
Fax

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