



POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

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PREVIEW: The week of May 6th 2011 to May 12^{ve} 2011

Indicator	Date of release	Pe- riod	BRE forecast	Consen- sus	Last	Comment
MPC decision	May 11	-	4.00%	4.00%	4.00%	The MPC embarked on another exchange rate experiment, this time with the support of MF. So far they seems happy with that, the evaluation time will come in June. So far the zloty is successfully capped.

In Focus / Macroeconomics

2012 budget draft

The draft assumes 2012 deficit 2012 at PLN 35.0 bn vs. 35.7 bn projected for this year (the original figure of 40.2bn has been revised downwards due to pension syetm reform). The EU part of the budget (counted as a separate entity) is projected at 4.5 bn versus 15.4 bn in 2011. As for trajectories of revenues and spending, the former is set to rise towards 292.7bn (7% over 2011) and the latter towards 327 bn (4.3% over 2011).

Macroeconomic assumptions are – as usual – conservative. GDP growth is expected at 4% whereas CPI inflation at 2.8% (both relatively low). However, the revenue side seems to be drawing form high pro-cyclicality of the underlying tax inflows as indirect taxes (VAT and excise) are expected to grow by 7.0% over 2011 and CIT by 19% (the period of loss deduction will be over in 2012). State-owned companies dividend injections are planned at 2.0bn whereas expected NBP profit is set at null (vs record high 6.2bn in 2011). As for the expenditure side, capital expenditures and outlays for UE co-financed projects are set to fall by 5.0% and 13.0% respectively. However, they both comprise only 9% of total expenditures. Solid gains are expected in subventions and subsidies (47% of total expenditures, channeled mainly into local communities), set to grow at 5.4% over 2011, and social transfers (+4.8% y/y). Relatively mild growth will be posted by current expenditures of budget entities (+2.8%) what is closely tied with planned zero wage growth there.

Net financing needs are set to be lifted higher to 46.8bn vs 45.7bn this year (earlier it was planned at 56.3bn although the calculation excluded the effect of pension reform i. e. lowering the part of social contribution diverted to open pension funds; moreover the financing needs have been brought substantially down by aggressive privatization plans and consolidation within public sector financial flows – this one alone is responsible for slightly less than 20bn improvement). 2012 privatization flows are set at 10bn. On the other hand, gross financing needs are set to be substantial (185bn vs 154bn this year) on the basis of debt maturity structure (the effect of issuing short-dated papers in 2009). Expected solid acceleration of debt issuing suggest the government will be trying to pre-finance at least part of it in 2011 which would translate into a jump in debt origination in H2. In order to eliminate the risks of huge roll-overs in the next year the government is also very likely to buy back the 1-2 year papers in the months to come.

The draft is set to be accepted by the parliament in July. Such an early date is dictated by the timing of parliamentary elections. It would be warmly welcome by the financial markets, the more so Polish fiscal policy is appraised by the Commission (no negative comments on the Convergence Program update). However, one has to bear in mind that the current shape of the budget bill does not include any systemic changes on the expenditure side, seems over-reliant on optimistic revenue projections and may be regarded as less precise due to its earlier publication. Some of the flaws are likely to change after general elections: primarily we expect to see a change in some pension schemes, higher tax rate for self-employed, minor KRUS reform. Much will depend on the shape of the ruling coalition, though.

MID-TERM FORECATS

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	4.1
Current account (% of GDP, average)	-4.5	-5.3	-1.6	-3.1	-4.8
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	4.4	4.4	4.4
Inflation rate (% , average)	3.0	2.1	2.6	2.9	3.7	4.3
NBP repo rate (end-of-quarter)	3.50	3.5	3.5	3.50	4.00	4.00

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

Fixed Income

Rally continues

With only three real trading sessions this week, activity on the market was quite limited and turnover remained low. Bullish trend from previous week continued and rates drifted lower by some 7-8 bp across the curve. Wednesday's switch auction attracted decent demand as it was first 10y bond tender since January. ECB turned to be not as hawkish as market had anticipated, which obviously created some support as well. In the short term most important event will be the MPC meeting next week. Outlook for decision have changed quite a lot recently, and possibility of a hike is actually close to zero. Probably most important thing influencing the decision will be latest inflation expectations, which fell to 4.0% from 4.6% previously. Even though that seems only a temporary effect (expectations tend to follow headline figure, that fell by 0.2% from previous poll), still can be used as a good reason not to tighten policy. Also lack of 'vigilance wording' in Trichet's comments and therefore Euro rates probably staying on hold for another month could ease in Council opinion the pressure to react promptly. In case Wednesday's statement is kept in a dovish tone, it may turn out that we won't see another move in rates until July, when next inflation projection will be published. Of course this month economic data pose biggest risk to the development on the market, but should CPI not jump up again, positive sentiment can remain intact even for another month. From longer perspective of course there are still a lot of risks that shouldn't be ignored and should be reflected in yield levels or curve shape (we prefer steepening). We also think if current trend continues, selling into the rally would be a very good idea.

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	5/30/2011	-	4.458%	3/28/2011
2Y T-bond OK1013	5/12/2011	-	5.163%	4/13/2011
5Y T-bond PS0416	5/12/2011	-	5.642%	1/5/2011
10Y T-bond DS1020	7/20/2011	-	6.210%	1/12/2011
20Y T-bond WS0429	7/20/2011	-	6.246%	1/12/2011

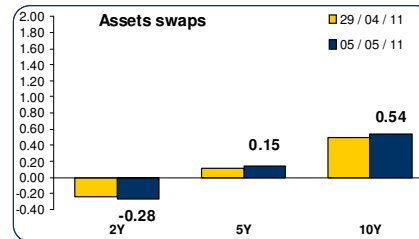
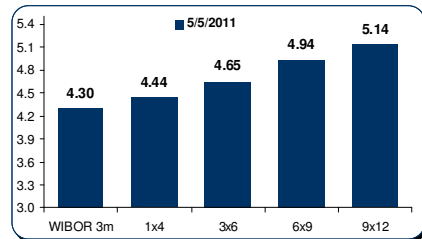
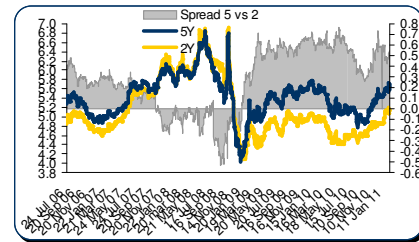
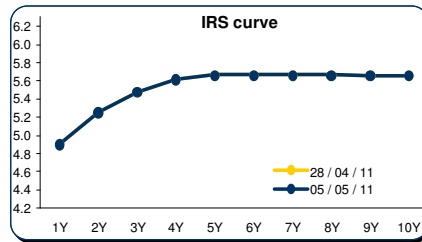
Money Market

Cheap end of the reserve

Very cheap end of the reserve settlement period with the deposit in the central bank amounting to pln 7 bln. The market entered the new reserve period with the surplus of 3 bln, which kept the cost of carry 25 bps below the main market rate. Tomorrow's OMO is very likely to square the market and lift the carry 15-ish bps for the coming week.

The soft ECB statement triggered rally

Market did not reacted for the weaker PMI figure, however, rally was triggered by the quite soft ECB statement after no hike decision. PLN curve dropped by 5-10 bps since the probability of no hike next week deteriorated further. The timing question now is whether June or July will be in play.

FIXED INCOME & MONEY MARKET CHARTS**Foreign Exchange***Zloty in range/bit weaker*

Short week, short story... Driven by weaker global commodities and equities Zloty has started trading weaker side. Not much, about 1% (3,92 to 3,96 move), but despite MinFin statement confirming that swapping EUR on market has been started. We feel like some foreign long PLN positions were closed as turnover looked decent.

Vols untouched

Despite low realized volatility record (6.6% weekly), short end was traded slightly higher this week (1W 8.5%). But as same has happened all across European markets we should exclude local factors. In number terms curve has formed into: 1M 8% (7.7 last week), 3M 8.7 (unchanged), 1Y 10.45 (also untouched). EURPLN smile and EURPLN vs USDPLN currency spread has been traded at very same levels. We have observed some buying interest on USDPLN smile.

Short-term forecasts:

SPOT

Main supports / resistances:

EUR/PLN: 3.9000 / 3.9800

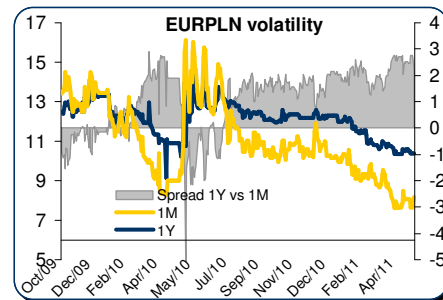
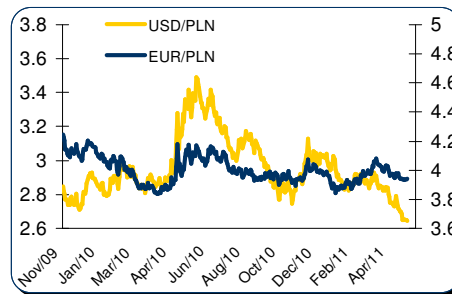
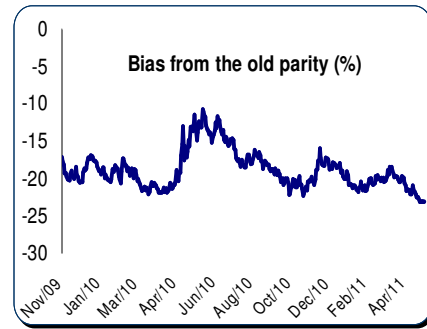
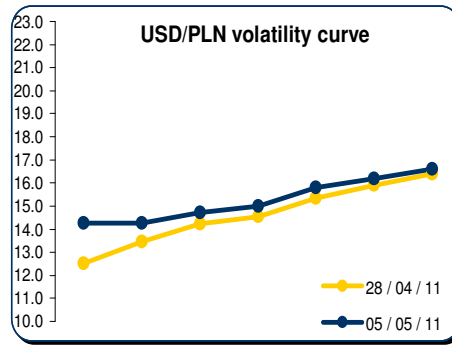
USD/PLN: 2.6800 / 2.7800

We are still waiting for 3.96 and 3.98 to enter short EURPLN position, S/L at 4.01, P/T at 3.90.

OPTIONS

We think the back end of the curve is well supported, taking into account the lowest levels since 2008 and the fact that due to expected rate hikes the forward delta gamma offers additional value. The possible "market interventions" should limit the upside potential in the short term but on the other way it should add to the realized volatility as markets will start to "play that tune". In our opinion being long in 35 delta EURPLN puts against short 15/20 delta calls, provides the cheap gamma profile.

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
29/04/11	4.20%	4.30%	4.39%	4.41%	4.56%	4.56%
02/05/11	4.19%	4.30%	4.42%	4.41%	4.57%	6.59%
03/05/11	4.20%	#ARG!	4.39%	6.49%	4.57%	#ARG!
04/05/11	4.19%	4.30%	4.25%	4.41%	4.58%	4.57%
05/05/11	4.21%	4.30%	4.39%	#ARG!	4.57%	4.57%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
29/04/11	4.45%	4.66%	4.93%	5.17%	5.21%
02/05/11	4.47%	4.71%	5.01%	5.21%	5.18%
03/05/11	4.46%	4.70%	5.00%	5.20%	5.17%
04/05/11	4.46%	4.70%	5.00%	5.20%	5.17%
05/05/11	4.46%	4.68%	4.98%	5.20%	5.15%

FIXED INCOME MARKET RATES

Fixed Income Market Rates (Closing mid-market levels)						
date	1Y		2Y		5Y	
	WIBOR	TB	IRS	OK0112	IRS	PS0511
29/04/11	4.56%	4.66%	5.25%	5.00%	5.66%	5.77%
02/05/11	6.59%	4.63%	5.25%	5.00%	5.66%	5.76%
03/05/11	#ARG!	4.63%	5.25%	5.00%	5.66%	5.76%
04/05/11	4.57%	4.64%	5.23%	4.95%	5.64%	5.73%
05/05/11	4.57%	4.63%	5.18%	4.90%	5.57%	5.71%

PRIMARY MARKET RATES

Last Primary Market Rates						
	au. date	maturity	avg price	avg yield	supply	demand
52W TB	11/01/31	12/01/31	95.841	4.35%	2000	2968
OK0113	11/04/13	13/01/26	89.159	5.16%	5500	7385
PS0416	10/10/13	16/04/25	99.300	5.14%	3000	3414
DS1020	11/01/12	19/04/25	93.022	6.21%	2250	4252

FX VOLATILITY

date	USD/PLN 0-delta stradle				25-delta RR	
	1M	3M	6M	1Y	1M	1Y
29/04/11	13.48	14.55	15.35	16.40	1.85	3.65
02/05/11	13.48	14.55	15.35	16.40	1.85	3.65
03/05/11	13.83	14.70	15.50	16.40	1.85	3.65
04/05/11	14.18	15.00	15.80	16.60	1.85	3.65
05/05/11	14.28	15.00	15.80	16.60	1.85	3.65

PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
29/04/11	2.6501	3.9376	-23.1%
02/05/11	2.6541	3.9322	-23.1%
03/05/11	2.6541	3.9322	-23.1%
04/05/11	2.6499	3.9366	-23.1%
05/05/11	2.6458	3.9406	-23.1%

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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