



POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

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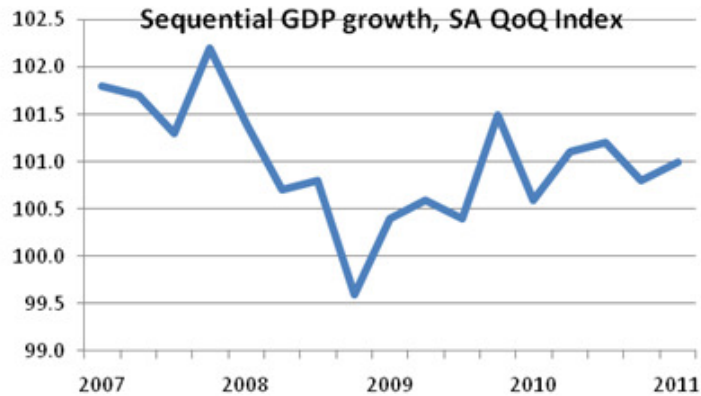
PREVIEW: The week of June 3rd 2011 to June 9th 2011

Indicator	Date of release	Pe- riod	BRE forecast	Consen- sus	Last	Comment
MPC decision	Jun 8	-	4.50%	4.50%	4.25%	The MPC is willing to accelerate rate hikes to safely enter a wait-and-see phase.

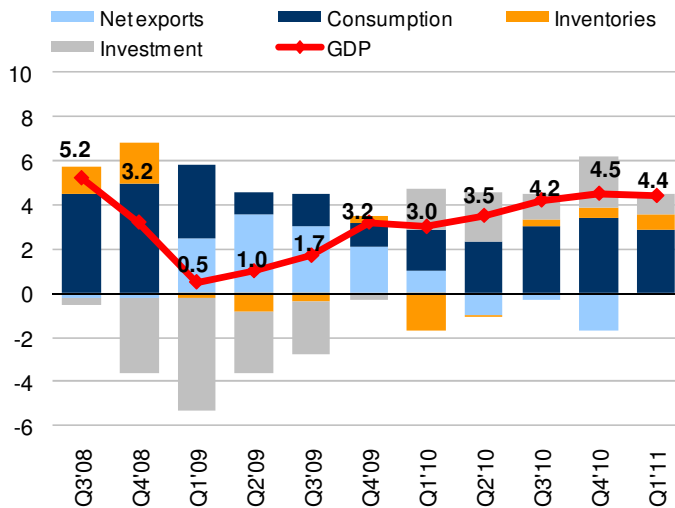
In Focus / Macroeconomics

4.4% GDP growth in Q1 2011. Strong momentum.

GDP growth in Q1 reached 4.4% (exactly the market consensus), close to Q4 2010 level. Domestic demand increased by 4.5% y/y (previously 6.3% y/y – mainly due to change in inventories and elevated public consumption). Seasonally adjusted data suggest that economic momentum remains strong – 1.0% q/q is even more than in the former quarter (0.8% q/q).



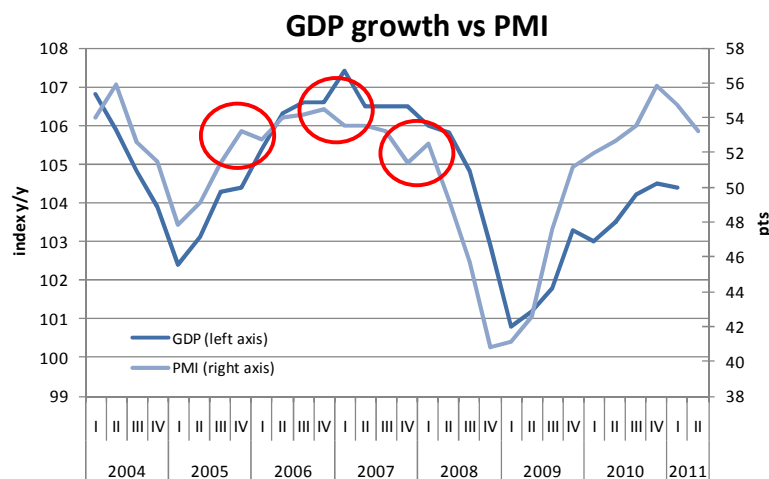
Decomposition is not at all a surprise – cyclical tendencies continue with a substantial regularity. Private consumption slowed only slightly compared to the previous quarter (3.9% after 4.0%), noticeable acceleration was recorded in investment (6.0% after 1.6% in the previous quarter). Public consumption gained only (consolidation + expenditure limits) 1.5% (compared to almost 4% growth in 2010). Contribution of inventories changes amounted to 0.9 pp. (after 2.3 pp. in Q4 2010) while contribution of net exports to GDP growth stood at -0.1pp. (after -1.7pp.).



Turning to gross value added: significant acceleration in construction is noticeable (14.1% compared to 6.8% last quarter), reflecting partly base effects from last year and cyclical behavior of construction, supported by public investment. Gross value added in industry accelerated to 7.8% (6.5% previously). The same gross value added in services as last quarter was reported (3.3%); non-market services reported near zero growth (similarly as in the last quarter).

Fresh GDP data – even though no spectacular surprises were reported – should be assessed as positive, supporting the scenario of continuing cyclical recovery in the Polish

economy. More specifically, we look for a continuation of investment cycle and elevated individual consumption growth (see labor market: growing employment and easing unemployment rate). Our targets (whole 2011) are the following: 4.1% growth in consumption, 7-9% growth in investment. Whole year GDP is set to top 4.3%. Recent PMI reading suggest slight moderation in the latter part of the year. However, 4% mark in GDP should be successfully defended – and this would feel exactly like 4.4% recorded at the start of the year, as far as monetary policy is concerned. On the other hand, the more positive news is that not once there was such an aberration between PMI and GDP (in both directions) but actual GDP growth did not react at all (see the graph).



Although we do not think the headline can be a shocker for MPC, the composition (strong consumption, solid rebound in fixed capital formation) speaks clearly that above potential GDP will be sustained, and endogenous inflationary pressures seem still on their way (i.e. the change of inflation composition towards higher core). Therefore we sustain our view that the MPC may decide to lift interest rates further in June and after that enter a wait-and-see mode. The risk to our call is poised by recent free fall of indicators of global business activity. However, given the Poland's endogenous ability to generate inflationary pressure (mind the strong domestic demand, partly self-sustaining on rising wages, employment, and improving labor market) the postponement of a rate hike (if there is any in MPCs plan...) beyond June would not make much sense, as projection is unlikely to properly factor in any of the ongoing global risks. Going beyond the nearest decision, we expect some dovish comments after the inflection point in headline CPI is reached (as always was the case in such circumstances). However, at the same time we acknowledge the possibility that MPC will resume hikes in the late Summer (early Autumn) when core inflation stays stubbornly at elevated levels and growth momentum remains relatively solid.

MID-TERM FORECASTS

Indicator	2007	2008	2009	2010	2011
GDP y/y (%)	6.5	4.8	1.7	3.8	4.4
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	-4.9
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	4.75

Indicator	2010			2011		
	Q2	Q3	Q4	Q1	Q2	Q3
GDP y/y (%)	3.5	4.2	4.5	4.4	4.3	4.4
Inflation rate (% , average)	2.1	2.6	2.9	3.7	4.3	4.3
NBP repo rate (end-of-quarter)	3.5	3.5	3.50	4.00	4.50	4.50

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

Fixed Income

Near end

Last week the FI market drifted down in yields by some 5bp with a limited turnover. The curve has flattened further trading 2y5y spread at 28 points with a downside pressure and seemed to stay quite resistant to the possible Greece default. Without any important news and economic data the market was likely to await the next Wednesday's MPC meeting which might become a trigger to greater activity. Assuming the latest MPC rhetoric the probability of a June rate hike is around 50%. If it's materialize the market would play the next hike in July for sure but it would be very likely to start pricing the near end of a tightening cycle for sure. If the MPC restrains from raising rates in June the short end of a curve would seem to be under downside pressure but the July move would still be played as a done deal this time.

As the latest MPC actions have been quite random, both scenarios have an equal probability but tend to the same result. THE NEAR END OF A TIGHTENING CYCLE. Regardless the level of an official rates in the very beginning of July, it's quite obvious the end of a cycle should favor the longer bonds and the curve to be flatter.

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	6/27/2011	-	4.577%	5/30/2011
2Y T-bond OK1013	6/9/2011	-	5.112%	5/12/2011
5Y T-bond PS0416	6/9/2011	-	5.614%	18/5/2011
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

Waiting for the MPC

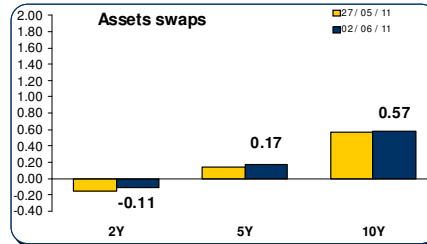
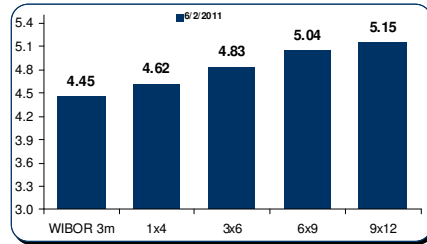
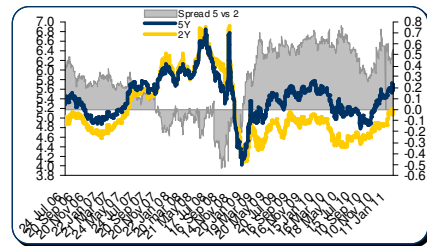
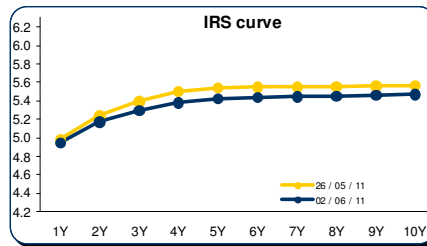
Very cheap end of the reserve and significant growth in the cost of carry cost at the beginning of the new one. Since the public finance consolidation had its main impact in May, we think that June will be more expensive on average. Thus we should also expect shortest polonia overnight index swaps rates to go up.

Successful new T-bill benchmark auction

Trading up 1 year is in a stand-by mode. Market is waiting for the MPC next week, and their decision will determine the new trend. For longer terms we faced quite a nice bullish sentiment this week.

Good auction for the new benchmark 52 week T-bill. The average yield was 4.58%, and the MinFin sold all from the very small supply of pln 500 mln pln. The supply of the new papers will also be small during the only two auctions in June. The papers are quite expensive and without any probability of the hike this month discounted in the prices. Our estimation of this probability is 65/35 for the hike.

FIXED INCOME & MONEY MARKET CHARTS



Foreign Exchange

Zloty has stuck

Initial agreement on Greece has made PIGS problems being swept under the rug. With Improved sentiment 3.99 top has not been retested and EURPLN has stuck in narrow 3 big figs range (3.9450-3.9750). So far nothing to add on local side.

Implied curve lower

Narrow range, low turnover. Underlying realized volatility again values about 6%. If we would take those facts into consideration natural pressure for lower implied is simple output. As a result tenors were traded as specified below: 1M 7.5% (8.0% week ago), 3M 8.3 (8.6), 1Y 10.15 (10.3). Smile was traded at very same levels. EURPLN vs USDPLN currency spread was traded slightly (0.15%) higher due to mayors strong buying interest.

Short-term forecasts:

SPOT

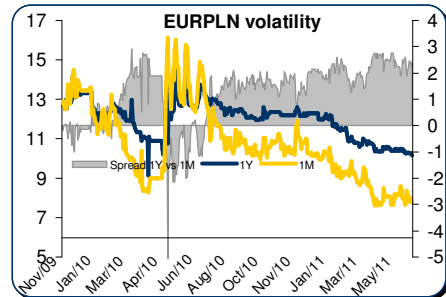
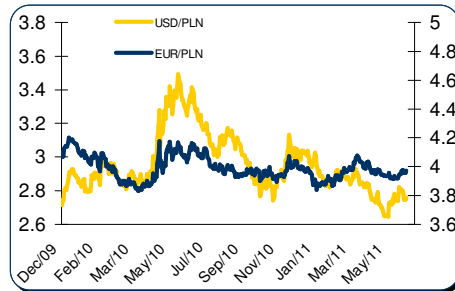
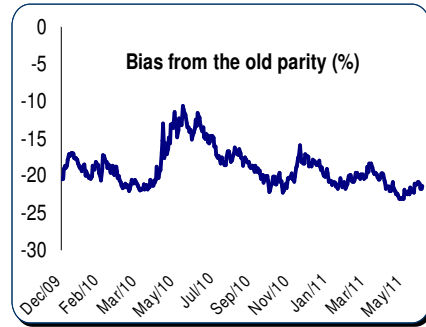
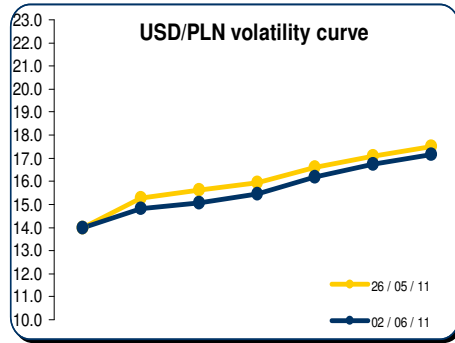
Main supports / resistances:
 EUR/PLN: 3.9400 / 4.0050
 USD/PLN: 2.7000 / 2.9000

As week before we see 3.94-4.01 range trading as most likely. Bottom of it was well defended this week. Zloty is (just) tracking global sentiment development. Trade range.

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. Although cheap in numbers hard to see it profitable - we have squared long gamma.

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
27/05/11	4.35%	4.45%	4.51%	4.52%	4.67%	4.66%
30/05/11	4.35%	4.45%	4.51%	4.52%	4.67%	6.59%
31/05/11	4.35%	4.45%	4.51%	6.49%	4.65%	4.66%
01/06/11	4.35%	4.45%	4.52%	4.51%	4.67%	4.66%
02/06/11	4.35%	4.45%	4.50%	4.51%	4.64%	4.66%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
27/05/11	4.55%	4.72%	4.99%	5.16%	5.12%
30/05/11	4.62%	4.75%	5.05%	5.20%	5.17%
31/05/11	4.63%	4.83%	5.15%	5.23%	5.19%
01/06/11	4.63%	4.83%	5.15%	5.21%	5.18%
02/06/11	4.61%	4.79%	5.05%	5.21%	5.18%

FIXED INCOME MARKET RATES

Fixed Income Market Rates (Closing mid-market levels)						
date	1Y		2Y		5Y	
	WIBOR	TB	IRS	OK0112	IRS	PS0511
27/05/11	4.66%	4.60%	5.21%	5.04%	5.51%	5.64%
30/05/11	6.59%	4.62%	5.21%	5.04%	5.51%	5.63%
31/05/11	4.66%	4.60%	5.19%	5.01%	5.49%	5.58%
01/06/11	4.66%	4.64%	5.17%	5.04%	5.45%	5.60%
02/06/11	4.66%	4.63%	5.17%	5.06%	5.43%	5.60%

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	11/01/05	16/04/25	97.078	5.64%	6500	2795
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
27/05/11	15.43	15.95	16.60	17.50	2.15	4.00
30/05/11	15.43	15.95	16.60	17.50	2.15	4.00
31/05/11	15.28	15.65	16.35	17.25	2.50	4.00
01/06/11	15.03	15.50	16.20	17.15	2.50	4.00
02/06/11	14.83	15.45	16.20	17.15	2.50	4.00

PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
27/05/11	2.8003	3.9785	-20.9%
30/05/11	2.7810	3.9726	-21.2%
31/05/11	2.7468	3.9569	-21.8%
01/06/11	2.7479	3.9595	-21.7%
02/06/11	2.7578	3.9740	-21.4%

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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