



TOP NEWS FROM THE POLISH MARKET

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MACROECONOMICS

Budget schedule published – 10.4% deficit execution after February expected

The MF published the official monthly schedule for the budget execution. The most important figure of the report is the February deficit forecast – 10.4% of the annual limit, below earlier estimates (14-15%). This would indicate a monthly deficit of 6.2 b PLN, below the one executed last year. This should be regarded as an excellent execution as February spending is usually higher (due to higher EU membership fee and educational subsidy). In February 2006 the deficit amounted to 7.5 b PLN. The schedule already includes the plans to reduce disability insurance rates from July (spending in H2 is higher), and in our opinion the risk of overshooting the deficit even after such a cut is marginal.

The government however presented yet another proposal to worsen the budget balance next year. The government plans to implement new “pro-family rules” (e.g. PIT discounts for families with children). The forecasted cost could reach 1 b PLN next year. The new rules themselves should not pose a threat, but when combined with the 2nd stage of disability rates cuts, the accumulation of changes in next year’s budget can be considered a risk factor.

Is the MPC really behind the curve?

With the exception of the preliminary budget deficit estimates there were no data releases last week. We witnessed, however, some interesting comments from the MPC members and Polish central bankers.

To start with, in Professor Noga’s opinion the Council should tighten the monetary policy now in order to prevent the inflation rate breaching the 2.5% target and topping 3.5% in the future. Noga also reiterated that the economic expansion over the last 8 quarters must finally result in higher inflationary pressure. Thus, if the MPC postpones its reaction the rate hikes will have to be more aggressive in the future. Hence Professor Noga stipulated that the Council is behind the curve now. A very similar opinion was also expressed by Mrs Wasilewska-Trenkner, who in addition pointed to a particularly high contribution of the domestic demand in the GDP growth structure and its pro-inflationary implications.

Turning back to Professor Noga, he noticed that the MPC, by not raising the rates, may harm its credibility. At this point we reiterate that hiking the rates unnecessarily may bring about the same damage to the MPC’s image.

Finally, Professor Noga made some astonishing references to the latest MPC communiqué by noting that it has been falsely interpreted by the market participants as dovish. In our opinion the communiqué was indeed more hawkish compared to the January one but the market had expected the council to comment on the record GDP and other figures in a more aggressive manner. According to Noga the March inflation rate will rise to 2.2-2.4%. Our forecast is 2.1%.

Globalization has potential to explain the low inflation puzzle in Poland

Another interesting comment was made by Dr Rybinski, an influential deputy president of the central bank. He reiterated that low inflation in Poland is attributed to globalization and to the conservative stance on the monetary policy in the past. In his opinion “globalization” may have some pro-inflationary effects, which are mainly attributable to the commodity prices, in the short term, but in the long run increased international competition will offset inflationary pressure. We think that this argument has some potential to, at least partially, explain the low inflation puzzle in Poland. The view of Dr Rybinski also finds, in our opinion, broader support among the moderate MPC members.

Unemployment rate dropped to 15.0% in February

The Labour Ministry stated that its preliminary estimates point to a drop in the unemployment rate to 15.0% in February (15.1%). This is in line with expectations – after a seasonal rise in December and January, the unemployment rate usually stabilizes or drops slightly in February. The pace of the unemployment drop remains strong, we expect an even sharper drop in March – to 14.7% and to ca. 13.2% in December

FIXED INCOME**Very quiet week on the market**

Last week curve stayed in very tight range, total volatility has not exceeded more than 3-4 bp on the whole curve. The only event on the market was 2y bond auction, which drew limited attention, as size offered was very small. We see good chances for curve to stay in very tight range this week also.

RECOMMENDATION:

Pay curve on dips

MONEY MARKET**Stable carry**

Stable carry all over the week plus again open market operation above the expectations (21,5 billion pln vs 21.6 billion pln – 20,5 billion pln expected). Moreover, CB's liquidity projection shows slight lack of the cash next week, so no chances for cheaper carry. Market is calm because it is the beginning of the reserve, however if they carry on like this we can not exclude another squeeze.

Waiting for figures

Bad sentiment for emerging markets was not so visible in Poland. It seems that everyone is waiting for coming figures. The week ahead we have CPI and wages.

T-bills average yield sharply up

The average yield on Polish benchmark 52-week T-bill sharply up to 4.2 from 4.1%. This movement was fully expected by us; since the 4.1% yield did not fit any other MM curve (we were writing about this a few weeks ago). The Ministry sold all 1 billion pln of 52-week papers giving the bid-to-cover ratio of 1.33 (down from 2.88).

RECOMMENDATION:

Sell 1y OISs.

FOREIGN EXCHANGE**Zloty stronger**

Last week, the EUR/PLN, as well as most of the regional crosses, strengthened as a result of – what seems to be – an end of a worldwide risk-reduction period. On Friday we saw EUR/PLN trading below 3.8700 (almost at the same time EUR/SKK broke the 34.000 and EUR/HUF the 250.00)

Volatility lower

As a result of Zloty appreciation, the volatilities have been heavily sold in all tenors. The 1m EURPLN traded at 6.9 (versus 7.5 the week earlier), whereas 1m USD/PLN at 8.9. 1y ATM traded respectively at 7.0 and 9.0.

RECOMMENDATION:**Zloty stable**

Spot:
Main supports / resistances:
EUR/USD: 1.3070 / 1.3250
EUR/PLN: 3.8500 / 3.9000
USD/PLN: 2.9300 / 2.9500

In the following week we may see Zloty trade within a range. That is why we do not recommend any directional positions.

Square Vega

Options:

Given the increased selling interest of longer term volatilities, we do no longer recommend long Vega positions. We recommend square the Vega and wait for the spot to trade outside the range.

MARKET PRICES UPDATE

MONEY MARKET RATES

Money market rates (Closing mid-market levels)						
date	3M		6M		1Y	
	FXSW	WIBOR	FXSW	WIBOR	FXSW	WIBOR
05-03-07	4.13%	4.21%	4.25%	4.35%	4.48%	4.55%
06-03-07	4.13%	4.21%	4.25%	4.35%	4.48%	4.55%
07-03-07	4.13%	4.21%	4.22%	4.35%	4.42%	4.54%
08-03-07	4.12%	4.21%	4.25%	4.34%	4.47%	4.54%
09-03-07	4.12%	4.21%	4.25%	4.34%	4.47%	4.54%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
05-03-07	4.25%	4.37%	4.55%	4.71%	4.69%
06-03-07	4.25%	4.35%	4.53%	4.70%	4.64%
07-03-07	4.24%	4.35%	4.53%	4.69%	4.63%
08-03-07	4.24%	4.35%	4.55%	4.69%	4.65%
09-03-07	4.26%	4.37%	4.57%	4.70%	4.65%

FIXED INCOME MARKET RATES

Fixed Income Market Rates (Closing mid-market levels)								
date	1Y		2Y		5Y		10Y	
	WIBOR	TB	IRS	OK1208	IRS	PS0511	IRS	DS1017
05-03-07	4.55%	4.20%	4.77%	4.51%	5.05%	5.00%	5.13%	5.21%
06-03-07	4.55%	4.20%	4.76%	4.48%	5.04%	5.00%	5.11%	5.20%
07-03-07	4.54%	4.21%	4.77%	4.50%	5.05%	5.00%	5.13%	5.21%
08-03-07	4.54%	4.20%	4.74%	4.51%	5.05%	4.97%	5.09%	5.19%
09-03-07	4.54%	4.20%	4.74%	4.48%	5.04%	4.97%	5.09%	5.19%

PRIMARY MARKET RATES

Last Primary Market Rates							
	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	07-03-05	08-03-07	95.926	4.20%	900	1329	900
OK0709	07-03-07	09-07-25	89.923	4.56%	1000	3819	1000
PS0412	07-02-21	12-04-25	98.899	4.99%	1500	5205	1500
DS1017	07-01-10	17-10-25	100.070	5.24%	1800	4148	1800

FX VOLATILITY

date	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
	1M	3M	6M	1Y	1M	1Y	1M	1Y
05-03-07	9.30	9.30	9.20	9.10	1.30	1.35	0.40	0.65
06-03-07	9.30	9.20	9.10	9.00	1.30	1.35	0.40	0.65
07-03-07	9.30	9.20	9.10	8.90	1.30	1.35	0.40	0.65
08-03-07	9.10	9.00	9.00	8.90	1.30	1.35	0.40	0.65
09-03-07	8.90	8.90	8.90	8.90	1.30	1.35	0.40	0.65

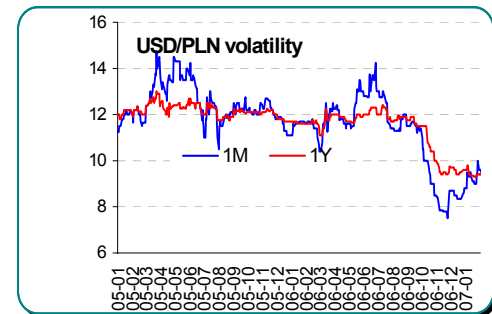
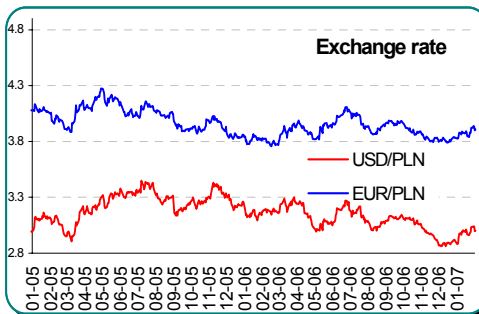
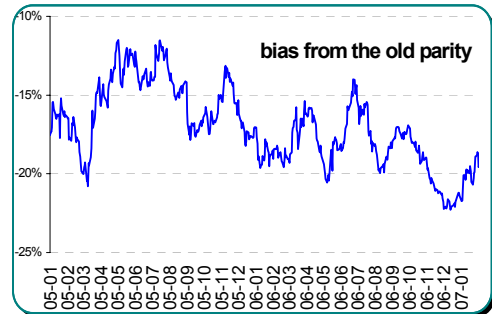
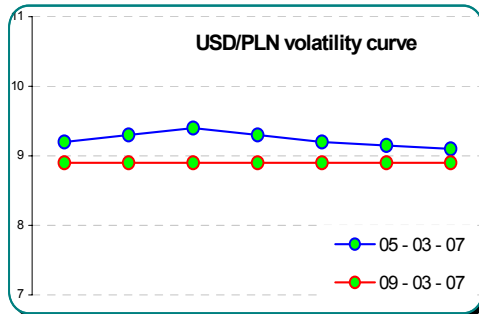
PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
05-03-07	2.9821	3.9170	-19.55%
06-03-07	2.9758	3.9030	-19.79%
07-03-07	2.9729	3.9007	-19.85%
08-03-07	2.9561	3.8880	-20.19%
09-03-07	2.9507	3.8795	-20.35%

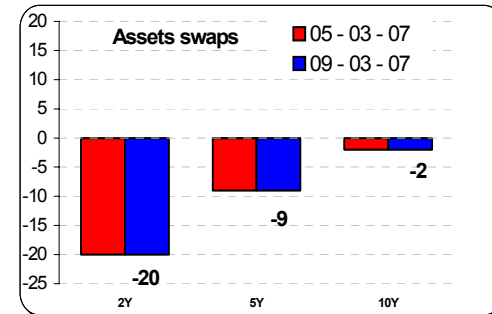
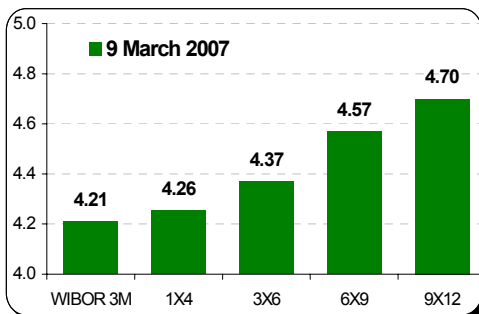
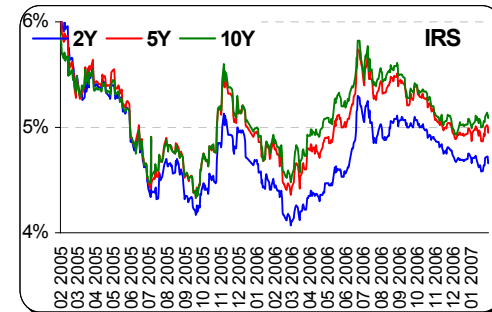
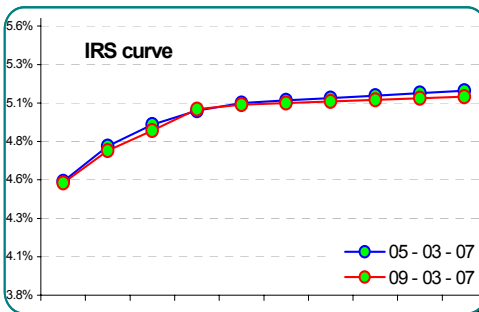
Note: parity on 11/04/00 – USD= 4.3806, EUR=4.2196, basket share 50:50
Mid-market volatility of vanilla option strategies

CHARTS

Foreign Exchange



Fixed Income



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CALENDAR

Macro

	December	January	February	Data Release	BRE Bank forecast
CPI m/m	-0.2%	0.5%		14-03-07	0.2%
CPI y/y	1.4%	1.7%		14-03-07	1.9%
PPI m/m	-0.5%	0.5%		19-03-07	0.2%
PPI y/y	2.6%	2.9%		19-03-07	3.4%
Industrial production growth m/m	-6.7%	0.4%		19-03-07	-0.3%
Industrial production growth y/y	5.9%	15.6%		19-03-07	13.9%
Average wages in enterprise sector [PLN]	3027.5	2663.6		15-03-07	2648.3
Average wages in enterprise sector y/y	8.5%	7.8%		15-03-07	4.8%
Unemployment	14.9%	15.1%		23-03-07	15.1%
Budget realisation (%)	82.3%	-10.3%	10.4%	15-04-07	
Current account [EUR mn]	-915			14-03-07	-281
Balance of foreign trade in goods (transaction basis) [EUR mn]	-1080			14-03-07	-191
Exports growth y/y (transaction basis)	8.3%			14-03-07	20.5%
Imports growth y/y (transaction basis)	17.0%			14-03-07	21.2%
Current account [% of GDP]	2.2%			14-03-07	2.1%
Money supply (M3)	477.0	485.5		14-03-07	496.6
Money supply growth y/y	15.7%	19.3%		14-03-07	19.3%
Total PLN loans [PLN bn]	367.3	376.5		14-03-07	
Households PLN loans	188.5	193.9		14-03-07	
Corporate PLN loans	143.3	144.6		14-03-07	
Total PLN deposits [PLN bn]	397.2	404.8		14-03-07	
Households PLN deposits	223.1	226.6		14-03-07	
Corporate PLN deposits	125.2	123.8		14-03-07	
NBP intervention rate	4.00%	4.00%	4.00%	28-03-07	4.00%

Auctions

	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	4.208%	16-01-06
26 Week T-bills	-	-	3.943%	24-04-06
52 Week T-bills	19-03-07	-	4.201%	19-02-07
2Y T-bond OK1208	04-04-07	-	4.562%	07-02-07
5Y T-bond PS0412	21-03-07	-	4.988%	21-02-07
10Y T-bond DS1017	11-04-07	-	5.240%	11-10-06
20Y T-bond WS0922	14-03-07	-	5.707%	13-09-06

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