



## POLAND WEEKLY REVIEW

### MACROECONOMICS AND FINANCIAL MARKETS

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#### PREVIEW: The week of November 9<sup>th</sup> to November 15<sup>th</sup>

Indicator	Date of release	Period	BRE fore-cast	Con-sensus	Last	Comment
C/A Balance	Nov 13	Sep	-1,59 bn	-754 mn	-637 mn	Lower industrial output in September underlies weaker exports (11.1% y/y) and high internal demand stimulates imports (18.5% y/y). We see C/A at 4.5-5.0% GDP in the end of the year.
CPI y/y	Nov 14	Oct	2.6-2.7%	2.9%	2.3%	The forecast stems from lower (than widely expected) food price growth. Strong zloty neutralizes the adverse effect of surging oil prices. We see net inflation barely unchanged at 1.3%.

M3 Supply y/y	Nov 14	Oct	14.4%	-	14.4%	Lower dynamics recorded in previous month resulted form decelerating growth of category labeled as "others". The annual trend is slowly flattening.
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## In Focus / Macroeconomics

### Budget 2008 – no room for serious deficit reduction

*The 2008 budget is becoming increasingly tight*

This week we witnessed some explicit comments about the next year's budget, made by Z. Chlebowski, an economic expert and vice president of the Civic Platform (PO). Though he envisaged a possibility of minor adjustments of the budget bill, so that the official deficit figure would drop by 1-2 PLN billion vs. that accepted by the outgoing government, he ruled out any serious amendments to the budget bill. His official motivation was the timing (the budget has to be put forward by the end of January). In our opinion, however, the outstanding victory in the snap elections and currently a very broad social support of the Civic Platform, strikingly, makes it more difficult for the party to implement truly liberal solutions. Moreover, as the PO voted for the fiscal stimuli (tax deductions for families, tax wedge cuts and indexation of pensions) proposed by the outgoing coalition in pre-election fever, they are now unlikely to cancel them without damaging the party's new image. The situation also worsened as the outgoing government put forward some new fiscal stimuli (wage rises for the police: cost of 1 PLN billion, and fuel subsidies for farmers: cost of 0.65 PLN billion for the 2008 budget), which are as well very unlikely to be rejected by the new coalition – the Peasant's Party is likely to oppose any decision disadvantageous of farmers.

As for now the implementation of the 2007 budget is very smooth – the Ministry of Finance announced this week that after October the accumulated deficit amounted to only 17-18% of the 30 PLN billion plan. We expect the whole figure for the year not to exceed 20 PLN billion. However, the economic conditions, though not bad at all, may not raise the budget revenues next year to such an extent as they have in 2007. Thus, the 2008 budget is becoming increasingly tight. So the fiscal policy is likely to be an important factor to watch.

### Meaningful inflation forecast by the Ministry of Finance

On Monday the Ministry of Finance released its estimate of inflation in October at 3.0% beating market consensus situated then at 2.6%. The publication triggered further comments from MPC members.

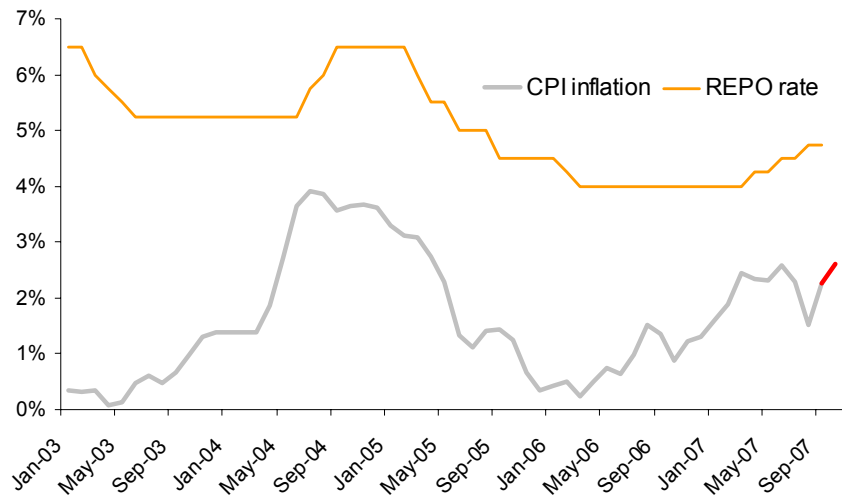
*The forecast was considerably higher than our estimate of 2.6-2.7%. The divergence stems from food prices.*

The forecast was considerably higher than our estimate of 2.6-2.7%. The divergence stems from food prices – in order to reach annual growth of CPI posted by the Ministry (3.0%) food prices should have risen in October by about 2% m/m, close to the figure recorded in September. In our opinion, such a growth does not find confirmation in the data from the agriculture market.

At first glance CPI figures released in the Czech Republic confirm the forecast of the Ministry – the growth in food and alcoholic beverages reached monthly 2.1% in October. However, inflation of that category in September amounted to only 0.1% m/m whereas in Poland it reached 2.4%. It seems that the impact of dearer food revealed itself faster in Poland and was already reflected in September CPI.

The MPC members' comments suggest they were quite surprised by the released estimate. S. Skrzypek began to wonder whether the jump was caused by a one-off factor or it marks a new trend. M. Pietrewicz said he would not exclude a rate increase in November if the growth prospects would not weaken considerably. M. Noga changed his view on the possibility of a policy easing in late 2008 and replaced it with a more hawkish stance on a necessity for the interest rate to reach 5.75 next year. These comments might somehow explain the lack of a rise in October if only H. Wasilewska-Trenkner did not mention that "the figure projected by the Ministry of Finance was known by the MPC at the decision-making meeting". So, given the October rate decision, we do not fully understand the reactions of the particular members. It seems that the outcome of October's voting was prejudiced in a sense that the MPC had planned to increase exactly in November and October had not even been the cause. In the context of expectations, such a movement has some sense: the MPC may have been frightened that a faster hike would

make the zloty appreciate further on a wave of expectations concerning the depth of monetary tightening, hurting thereby export possibilities and economic growth.



**MEDIUM-TERM FORECASTS**

Indicator	2006	2007	2008
GDP y/y (%)	6,1	6,5	5,4
Inflation rate (%)	1,0	2,4	3,2
Current account (% of GDP)	-2,1	-4,5	-5,3
Unemployment rate (end-of-year)	14,9	11,0	9,8
NBP repo rate (end-of-year)	4,00	5,00	5,50

Source: GUS, NBP, BRE Bank, **bold** change on last week

**Fixed Income**

*Panic on the market after MinFin announces CPI fore-cast*

After quiet end of last week the main event on the market was publishing Ministry of Finance CPI forecast for October. Preliminary consensus stood at 2.6-2.7% y/y basis, so when the announcement came showing 3% we had some panic reaction on the market. The flame was fanned by statements from MPC members highlighting the fact that they don't have the comfort to watch the situation without reacting (we don't know still why MPC had not decided to hike rates in October). 9x12 on Wednesday after MPC left rates unchanged were trading at 5.50 level. Today they are 25 bp higher. The consensus on rate hikes is now 25 in November, 25 in January and 25 in March - all priced in 100%. Curve is very negatively sloped. 1y1y IRS is trading at 6% while 1y9y IRS is at roughly about 5.20% level. We are neutral on the curve now and we will be receivers of 5y on the up tic if anything. We see bonds quite cheap in 5y sector unlike in 10y sector, and additionally we see financing on bonds very favorable, they got also very cheap to the curve.

**RECOMMENDATION:**

Buy 0412 on dips

**AUCTIONS**

	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	4,208%	2006-01-16
26 Week T-bills	-	-	3,943%	2006-04-24
52 Week T-bills	05-11-07	-	5,144%	2007-10-22
2Y T-bond OK1209	07-11-07	-	5,284%	2007-10-03
5Y T-bond PS0412	21/11/2007	-	5,718%	2007-10-17
10Y T-bond DS1017	14/11/2007	-	5,658%	2007-10-10
20Y T-bond WS0922	-	-	5,796%	2007-09-12

**Money Market**

*Squeeze left its mark*

After almost one week of liquidity squeeze market had to take a break. Best way to do this was not buying money bills in the amount offered by the CB. The gap reached 4 billion pln (15.7 vs 19.9 billion pln), providing very easy beginning of the new reserve. Tomorrow the scenario has a good chance to repeat itself, however in a more moderate scale. Hence, another week should be also quite stable as far as cost of carry is concerned.

*CPI forecast way from expectations*

As for longer terms the highlight of the week was much higher than expected CPI forecast by the MinFin. 3% vs 2.3% does make a difference and the market reacted in one and only proper way. MM curves moved up 10-20 bps depending on term (the longer the higher).

*T-bills yields up*

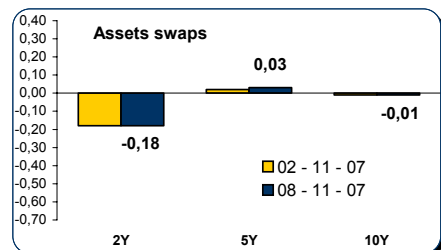
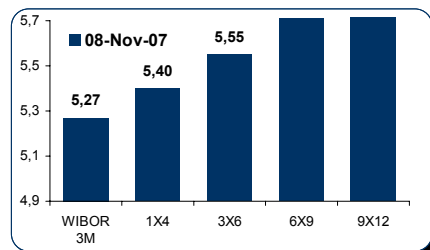
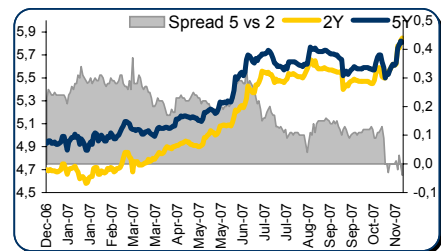
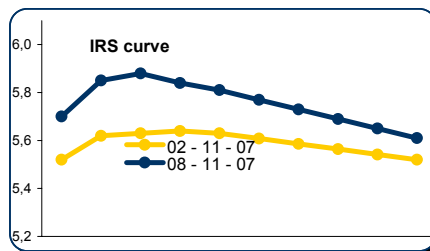
T-bills traditionally behind the curve, nonetheless some yield hike occurred. Average yield grew up to 5.31% comparing to 5.14% on the last tender.

**RECOMMENDATION:**

We recommend offering 3M polonia at current levels.

**RECOMMENDATION:**

**FIXED INCOME & MONEY MARKET CHARTS**



**Foreign Exchange**

*Zloty in side trend*

This week zloty was traded between 3.6120 and 3.6575. Despite outlook for PLN is still positive, Wednesday's fall on EURJPY cross weakened PLN more than 1% what precisely shows market is long/square in PLN and short timed positions are main players at the moment. Because of that we see it as vanishing, but still volatility providing effect.

*Volatility curve still steep*

Nevertheless, we had some quiet trading days, recently broken EURPLN barriers made market hungry for gamma and vega, and any move toward those (3.57-3.60) makes curve pricing in more demand.

**RECOMMENDATION:**

Look for upticks to sell EURPLN

Sell mid-curve vega if barrier hit

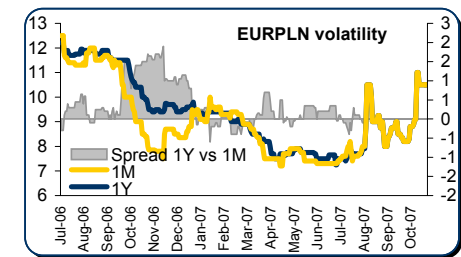
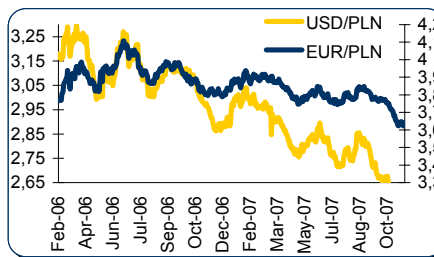
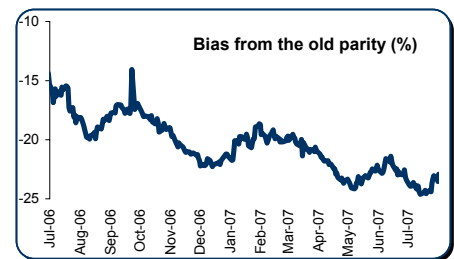
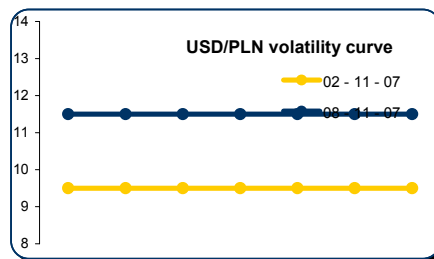
**FX CHARTS**

Spot:  
Main supports / resistances:  
EUR/PLN: 3.6000 / 3.6700  
USD/PLN: 2.4100 / 2.5000

End of year is closing and turnover is likely to decrease what lower probability of breaking trend, 3.6700 provides good resistance with short sell opportunity.

Options:

We see breaking of barriers (probably last big sized) as both, a decent move on curve and opportunity to sell vega on the other hand



**MARKET PRICES UPDATE****MONEY MARKET RATES**

Money market rates (Closing mid-market levels)						
date	3M		6M		1Y	
	FXSW	WIBOR	FXSW	WIBOR	FXSW	WIBOR
02-11-07	5,25%	5,21%	5,25%	5,38%	5,42%	5,57%
05-11-07	5,23%	5,22%	5,32%	5,41%	5,52%	5,59%
06-11-07	5,25%	5,24%	5,32%	5,42%	5,55%	5,62%
07-11-07	5,23%	5,26%	5,32%	5,46%	5,57%	5,63%
08-11-07	5,24%	5,27%	5,33%	5,50%	5,58%	5,66%

**FRA MARKET RATES**

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
02-11-07	5,31%	5,41%	5,50%	5,55%	5,57%
05-11-07	5,34%	5,50%	5,67%	5,72%	5,73%
06-11-07	5,36%	5,49%	5,66%	5,71%	5,71%
07-11-07	5,37%	5,51%	5,70%	5,75%	5,75%
08-11-07	5,40%	5,55%	5,71%	5,76%	5,77%

**FIXED INCOME MARKET RATES**

Fixed Income Market Rates (Closing mid-market levels)								
date	1Y		2Y		5Y		10Y	
	WIBOR	TB	IRS	OK0709	IRS	PS0511	IRS	DS1017
02-11-07	5,57%	5,08%	5,57%	5,29%	5,72%	5,69%	5,73%	5,76%
05-11-07	5,59%	5,05%	5,57%	5,29%	5,71%	5,68%	5,72%	5,76%
06-11-07	5,62%	5,05%	5,57%	5,34%	5,71%	5,67%	5,71%	5,76%
07-11-07	5,63%	5,05%	5,56%	5,30%	5,71%	5,65%	5,72%	5,75%
08-11-07	5,66%	5,03%	5,56%	5,34%	5,70%	5,68%	5,70%	5,75%

**PRIMARY MARKET RATES**

Last Primary Market Rates							
	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	07-10-22	08-10-22	95,056	5,14%	500	1177	500
OK0709	07-10-03	09-07-25	91,123	5,28%	1800	3571	1800
PS0412	07-10-17	12-04-25	96,188	5,72%	2300	38750	2300
DS1017	07-10-10	17-10-25	96,607	5,70%	1800	5061	1800

**FX VOLATILITY**

date	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
	1M	3M	6M	1Y	1M	1Y	1M	1Y
02-11-07	9,80	9,00	9,00	8,70	0,50	0,55	0,30	0,35
05-11-07	9,80	9,00	9,00	8,70	0,50	0,55	0,30	0,35
06-11-07	10,00	9,20	9,00	8,70	0,50	0,55	0,30	0,35
07-11-07	10,25	9,30	8,90	8,70	0,50	0,55	0,30	0,35
08-11-07	10,25	9,30	8,90	8,78	0,50	0,55	0,30	0,35

**PLN SPOT PERFORMANCE**

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
02-11-07	2,5184	3,6467	-28,04%
05-11-07	2,5181	3,6446	-28,07%
06-11-07	2,5018	3,6339	-28,38%
07-11-07	2,4672	3,6238	-28,90%
08-11-07	2,4829	3,6419	-28,51%

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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