



POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

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PREVIEW: The week of February 29th to March 6th

Indicator	Date of release	Period	BRE fore-cast	Consen-sus	Last	Comment
GDP	Feb 29	Q4	6.2%	6.0%	6.4%	Investment was the main engine of growth in 2007 whereas consumption might slightly fall behind the growth rate of the aggregate.
MinFin's inflation forecast (y/y)	Mar 3	Feb	4.5%	4.4%	4.3%	Rise of inflation stems mainly from core measures whereas the prices of food are driving the aggregate to the downside.

In Focus / Macroeconomics

Polish MPC hiked the rates, no end of tightening cycle in sight

In line with our and market's expectations the MPC raised the rates by 0.25 bps to 5.5% this week. This second in a row rate hike may be probably seen as a sort of substitute for a more aggressive 50 bps steps postulated by hawkish MPC members in January. The latter has not been implemented, however, as the Council panicked about the allergic reaction of the financial markets.

The reasoning behind the February rate decision, as outlined in the statement, was pretty the same as in January; the Council anticipated rising wages and controlled prices as well as threat of second round effects. The only new argument was a 2008 budget deficit overshoot.

Inflation projection

It is also quite likely that the rate hike has been prompted by less favorable outcome of the newest inflation projection. Forecasted inflation hit 4.15% in 2008, much above the level in the October projection. In 2009 the Central Bank envisages the CPI inflation to ease only slightly to 3.75%. Given the already implemented rate hikes and the appreciation of the zloty, the 2010 may also disappoint the dovish camp in the Council – according to the projection, inflation is set to drop only insignificantly below a 3.5% mark. The picture painted by the Central Bank stuff is thus very pessimistic for inflation perspectives and clearly push for more active monetary policy in the coming months.

Press conference and comments

The press conference held traditionally after the meeting was chaired by S. Skrzypek accompanied by A. Sławiński and J. Czekaj – two swing voters of the MPC. The mood of the conference can be summarized as predominantly hawkish. It may be regarded as further indication that attitudes within the body have become more aggressively anti-inflation biased.

Sławiński opted for more active monetary policy focused on restraining the ULC growth which presses down the competitiveness of Polish goods. It is likely that this channel is far more important for exporters than appreciating zloty. This argument stands in contrast with earlier comments delivered by this MPC member. What is more, in his opinion Polish economic growth seems to be highly vulnerable to global turbulences – the MPC has not bothered to consider economic growth as much as it did during the January meeting.

Czekaj seemed to be hawkish as well and he confirmed his stance in Thursday's interview. He cannot rule out taking 50 bps steps or another consecutive hike already in March. As for the main reasons behind the decision he enumerates January data (a month earlier the member was not convinced of a necessity to hike at all; the data released this month proved to be extremely hawkish) and inflation projection. Czekaj stressed that it was February data which was crucial for the timing of another hikes. At the same time Czekaj mentioned that the MPC will carefully watch actions taken by other central banks – in case when they cease fire citing prevailing risks to economic growth, the MPC will not stay idle.

It seems the MPC behavior starts to resemble the scenario sketched earlier by D. Filar and recently repeated in an interview given after the MPC meeting. In his opinion, fast rise of reference rate to 6% will give the MPC more space to watch the developments in the economy.

Some conclusions

Contrary to the comments of other analysts, the period of tightening is far from being over. The view is backed by the macro data (we see rising core inflation and two-digit wage growth as likely to be maintained this month) and the moods within the MPC as well. We expect the reference rate to rise at least to 6%. The timing of the nearest hike is much more subtle though. It has become apparent that the MPC has again entered the period of data dependence. Our short-term forecasts suggest it is likely that rate expectations will gain power and the hike timing will stuck to the coming month.

**MEDIUM-TERM
FORECATS**

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

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

Fixed Income

Rates higher. Further hikes to come.

Correction on the market hasn't lasted long. Some 10bp rally ahead of MPC's rate decision created nice opportunity to add to pay position. 25bp tightening, followed by relatively hawkish comments from Council members pushed the rates even higher. What is interesting in some comments is that previously popular theory of CPI peaking in Q1 and then falling in second half of the year is not so obvious any more (vide Filar's statement that inflation might peak either in Q1 or in Q3 as well). In addition we cannot find any hint about when and at what level the tightening would end, yet the market currently prices in another 50bp of hikes soon and then some easing in 2009. We think inflationary pressures that has been built for some time will keep showing impact on both headline and core figures, with the latter very likely to exceed 4%. Along with still high wages growth, it could prompt the Council to take more action in order to keep CPI contained. Our call is for main rate to exceed 6%, we also think rates will stay on higher levels for longer time. From that perspective we still consider short end of the curve as cheap and we see most value in 9x12. We are quite neutral for the long end of the curve - wide spreads to the core limit potential weakening.

RECOMMENDATION:

Pay 1y3s and 9x12FRA

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	2008-03-10	-	5,652%	2008-02-11
2Y T-bond OK0709	2008-04-04	-	6,189%	2008-01-02
5Y T-bond PS0413	2008-03-05	-	5,729%	2008-02-06
10Y T-bond DS1017	2008-04-09	-	5,785%	2008-02-13
20Y T-bond WS0922	2008-05-14	-	5,794%	2008-01-09

Money Market

Cheap end of the reserve

Liquidity was not the main issue this week as far as money market is concerned. Low cost of carry allowed market participants to focus strictly on trading.

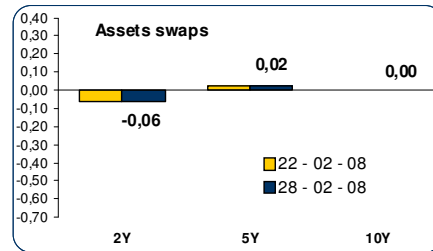
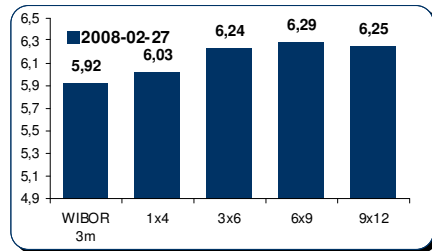
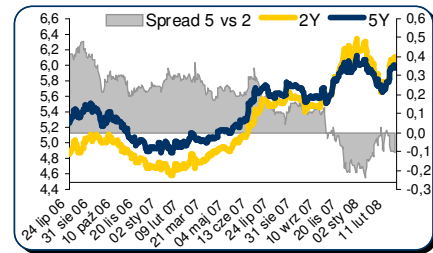
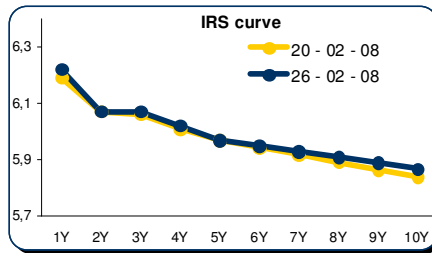
All the rates up by 25 bps

Retail sales confirmed expectations for fast further tightening of the monetary policy (21% vs 15% expected). Hike in February was completely discounted; hence the decision itself did not change much. The Central Bank decided to raise all the rates by 25 bps. The main rate now is 5.5%, deposit rate is 4%, and last resort Lombard rate 7%. Although we can say this decision was expected (some dose of uncertainty was there till the end), the statement made by the MPC seemed to be more hawkish then we had got used to. Hence, the market again time concentrated its expectations building into the curve another 25 bps hike in March plus one more next quarter. All this moved MM curves significantly up, and in the nearest future we see no incentives to change this situation.

RECOMMENDATION:

Pay 6 and 9M Polonia.

FIXED INCOME & MONEY MARKET CHARTS



Foreign Exchange

Zloty stronger

This week the zloty was traded between 3.5735 and 3.5140. There were a few reasons: positive global investment sentiment, higher expectations for further rate hikes and National Bank of Hungary abandoning of peg, and as lack of bad news means good news we see no reasons for PLN to weaken at the moment.

Volatility curve slightly higher

During the deep strengthening, zloty moved and broke easily through supporting option barriers levels. Evaporating of long vega and gamma made market demand of those what caused some buying through the whole curve, with 1M was traded 0.2 vol above Monday's opening, and 1Y around 0.1.

RECOMMENDATION:

Spot:
 Main supports / resistances:
 EUR/PLN: 3.5000 / 3.5550
 USD/PLN: 2.3800 / 2.4700

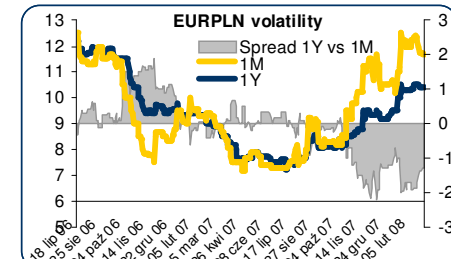
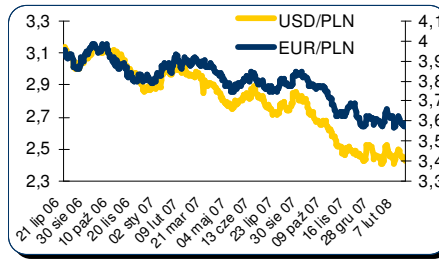
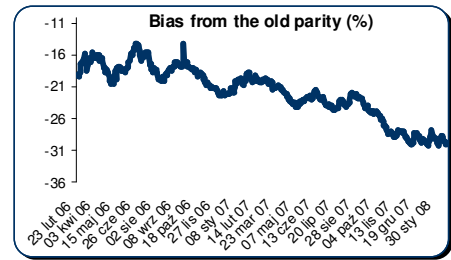
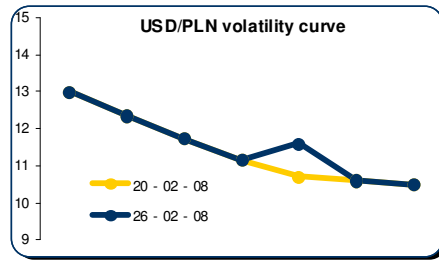
Sell on upticks

With improving both global and local sentiment we see selling EURPLN on upticks as most profitable idea these days.

Short EURPLN gamma

Options:
 We advice to trade small amounts of short EURPLN 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
20-02-08	5,73%	5,70%	5,99%	5,90%	6,25%	6,10%
21-02-08	5,70%	5,74%	5,94%	5,91%	6,13%	6,11%
24-02-08	5,73%	5,73%	5,95%	5,92%	6,13%	6,11%
25-02-08	5,71%	5,73%	5,91%	5,92%	6,11%	6,12%
26-02-08	5,77%	5,75%	5,98%	5,96%	6,37%	6,16%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
20-02-08	5,98%	6,12%	6,17%	6,13%	6,18%
21-02-08	5,99%	6,15%	6,19%	6,16%	6,21%
24-02-08	6,01%	6,19%	6,22%	6,20%	6,26%
25-02-08	5,99%	6,22%	6,24%	6,21%	6,27%
26-02-08	6,01%	6,19%	6,22%	6,18%	6,22%

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
20-02-08	6,10%	5,08%	5,57%	5,29%	5,72%	5,69%	5,73%	5,76%
21-02-08	6,11%	5,05%	5,57%	5,29%	5,71%	5,68%	5,72%	5,76%
24-02-08	6,11%	5,05%	5,57%	5,34%	5,71%	5,67%	5,71%	5,76%
25-02-08	6,12%	5,05%	5,56%	5,30%	5,71%	5,65%	5,72%	5,75%
26-02-08	6,16%	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	07-12-03	08-12-03	95,415	5,74%	2000	33116	2000
OK0710	08-01-02	09-07-25	85,730	6,19%	1800	2047	1654
PS0413	08-02-06	13-04-25	97,852	5,73%	2500	4206	2500
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
20-02-08	11,75	11,00	10,60	10,40	0,75	0,85	0,30	0,35
21-02-08	11,75	11,00	10,60	10,40	0,75	0,85	0,30	0,35
24-02-08	11,75	11,00	10,60	10,40	0,75	0,85	0,30	0,35
25-02-08	11,75	11,00	10,60	10,40	0,75	0,85	0,30	0,35
26-02-08	11,70	10,90	10,60	10,40	0,75	0,90	0,30	0,35

PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
20-02-08	2,4074	3,5725	-30,19%
21-02-08	4,4049	3,5630	-7,50%
24-02-08	2,3785	3,5318	-31,00%
25-02-08	2,3507	3,5395	-31,23%
26-02-08	2,3320	3,5219	-31,65%

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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