



POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

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PREVIEW: The week of February 7th to March 13th

Indicator	Date of release	Period	BRE fore-cast	Consensus	Last	Comment
Inflation	Mar 13	Feb	4.5%	4.6%	4.3%	Substantial dynamics of imports end exports (23.8% y/y and 20.8% y/y respectively) on the back of booming economic activity. Trade deficit to reach 0.9 bln EUR under the pressure of seasonal factors. January saw a worsening balance of transfers (Poland's EU member's fee to have reached about 400 mln EUR, the inflow of cash mainly in structural funds, excluded from current account.
C/A balance	Mar 13	Jan	-1.39 bn EUR	-1.3 bn EUR	-1.9 bn EUR	Higher energy prices will lead core inflation towards 3% y/y in February. However, February saw also diminish-

						ing food prices (-0.5% m/m) and fuels (-2.0% m/m). Watch revision of consumption basket; CSO will quote also the revised data for January (net inflation above 2.0% y/y).
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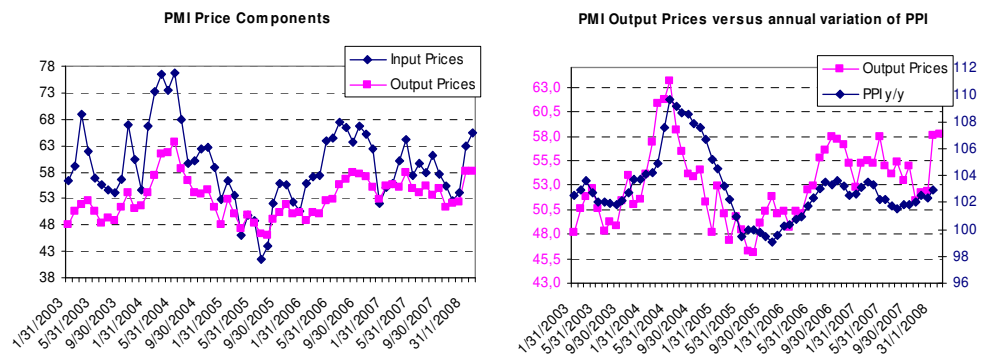
In Focus / Macroeconomics

Now it's producers' turn

We have recently focused much on inflation perspectives for the ultimate consumer. It seems it is high time now to move down the production chain and scrutinize the producer prices as well. Recent releases of PPI have shown considerable acceleration of prices quoted in wholesale trade. Much of the MPC rhetoric stems from the fact that good financial standing of companies allows them to accommodate rising cost and leave the prices intact. It is likely now though that advances in producer prices may start to feed through the production chain and leave their mark on the CPI. That is why we envisage the rising market impact of the PPI data releases with the next release due on March 19.

The analysis of the PMI price components (Input and Output Prices) shows a considerable level of co-movement between them (the linear correlation coefficient totals nearly 0.9). It is worth to note, however, that the latter indicator is more smooth; not all short-run fluctuations of input prices reflect themselves in the PMI Output Price index (later PMlop) – the bumper effects of ultimate producer prices quoted is visible (see the figure below). That is why regard this component as the one reflecting advances in producer prices best.

Comparison of the PMlop and the annual variation of PPI reveals that in most cases the PMlop leads the PPI or at least reflect contemporary changes (taking in consideration the earlier date of publication of PMlop it means it leads the PPI as well). Basing on this observation alone we may see there is still some place for further acceleration of producer prices, the level near to 4% may be achieved in Q1.



The above analysis may be somehow augmented by the thorough investigation of economic background. January saw an immense increase of prices in mining, a result of altered coal tariffs. Another rise is on its way – effective from March – this time stemming from a correction of recently granted rebates. It is not the end of the story. We welcomed January with higher costs of energy (reflected in a jump in prices of utilities), supported by additional increase of transmission costs (to be reflected in February reading). Additional hikes are to be announced unless the rising trend in the wholesale energy market halts.

Among the other factors which may eat through the companies' profits there are also regulatory devices levied by the European Union, namely the carbon dioxide emission limits. The granted limits fall short of power station's demands. Thus they're forced to bridge the gap by trading the lacking limits in the market for emissions – it poses additional cost that may encourage to increase prices quoted for recipients.

As for the additional cost pressure stemming from tight labour market, we covered this field ex-

tensively in many past issues of Poland Weekly Review. We advise the interested reader to turn to appropriate sources.

MEDIUM-TERM FORECASTS

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	>6.0

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

Fixed Income

Rate hike and hawkish comment did damage to PLN rates.

Last week was rather volatile on the FI market. After February hike and hawkish statement market moved sharply in yields pricing now 6% rate as the top of the cycle. The biggest event though was widening of asset swaps on Polish bonds, which have moved to levels not seen in past few years. With the coming set of figures the most of risk we see on the CPI figure which is to be released on Wednesday, and we recommend reducing positions ahead of this figure. We still are bearish on rates, especially front end of the curve, we like paying FRAs on dips. We don't quite understand the reason why 9x12 should be lower than 6x9, and 9x12 have also this advantage that it fixes in December, month in which Wibor rates tend to be elevated due to liquidity reasons. Other opportunity is extremely inverted curve past 1y. With 2y getting so much pressure we observe that difference between 6x9 and 21x24 FRA tend to reach 75 points, which is virtually pricing cutting cycle sometime next year. While this cannot be excluded, we see this spread to pay as opportunity. With closing positions we think of using bonds, as they got very cheap to curve and we see some players running short positions on asset swaps, which at current rates are very expensive.

RECOMMENDATION:

Stay pay 9x12, add 6x9 ag 21x24 spread at dips, reduce pay positions with bonds.

AUCTIONS

	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	4.208%	1/16/2006
26 Week T-bills	-	-	3.943%	4/24/2006
52 Week T-bills	3/10/2008	-	5.652%	2/11/2008
2Y T-bond OK0709	4/4/2008	-	6.189%	1/2/2008
5Y T-bond PS0413	5/7/2008	-	6.167%	3/5/2008
10Y T-bond DS1017	4/9/2008	-	5.785%	2/13/2008
20Y T-bond WS0922	5/14/2008	-	5.794%	1/9/2008

Money Market

Easy beginning of the new reserve

Another 25 bps hike expected in March

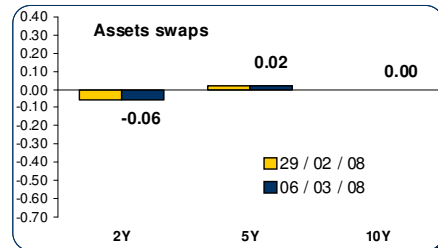
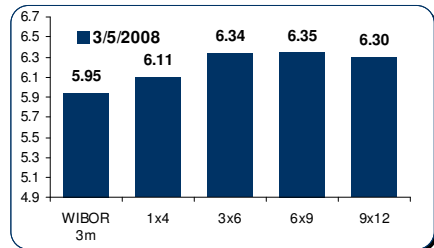
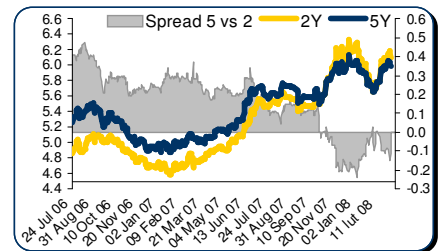
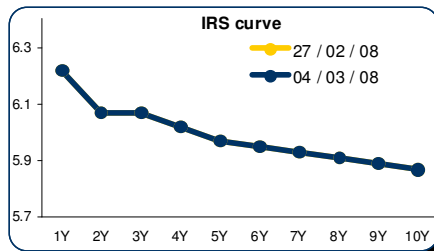
Easy beginning of the new reserve with the cost of carry slightly above the main market rate. Open market operation was quite substantial comparing to the real needs (15.7 billion pln vs 13.5 billion pln), nonetheless all the money bills were succumb into the system, supporting higher deposit rates. This scenario will probably repeat itself the following week.

As for longer terms not too much action. Waiting for figures will probably trigger a little bit further positive sentiment. However, we consider it as a great opportunity to take pay position. 25 bps hike in March has already been fully discounted.

RECOMMENDATION:

Pay on dips.

FIXED INCOME & MONEY MARKET CHARTS



Foreign Exchange

Zloty in range

This week the zloty was traded between 3.5135 and 3.5450. Polish currency is relatively strong, and as all good local/region news were priced in last week, fluctuations of global sentiment are responsible for trading range bounds.

Volatility curve slightly higher

Recently braking of downside barriers still leaves market on demand side of both, gamma and vega. Curve is traded a bit higher on all tenors, with respectively 7.3 and 6.3 for 1M and 1Y.

RECOMMENDATION:

Spot:
Main supports / resistances:
EUR/PLN: 3.5100 / 3.5570
USD/PLN: 2.2800 / 2.3700

Sell on upticks

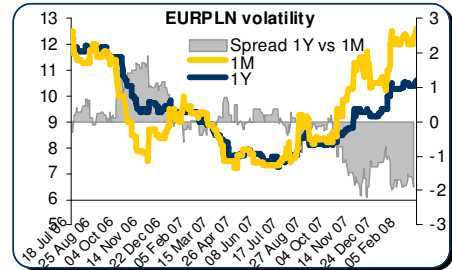
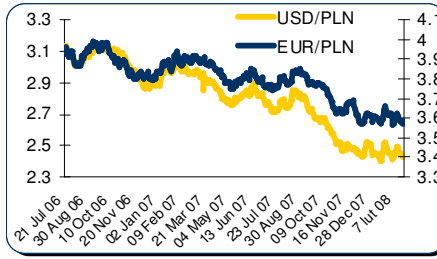
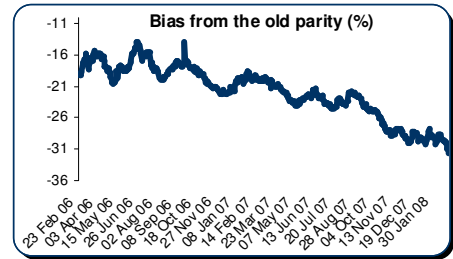
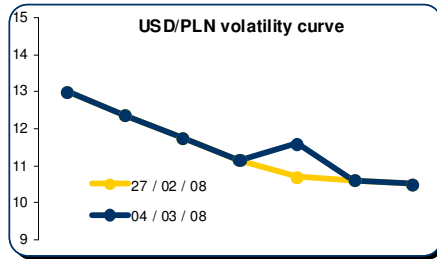
We believe 3.5500 is good entry level in short EURPLN position with 3.5100 as P/T and 3.5750 as potential S/L.

Short EURPLN gamma

Options:

We advice to trade small amounts of short EURPLN gamma with both 7.3 for 1M and 6.8 for 3M priced well above historical average.

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
27/02/08	5.80%	5.75%	6.05%	5.98%	6.20%	6.16%
28/02/08	5.80%	5.82%	6.05%	6.08%	6.30%	6.23%
29/02/08	5.85%	5.84%	6.11%	6.09%	6.29%	6.27%
03/03/08	5.86%	5.83%	6.10%	6.12%	6.29%	6.29%
04/03/08	5.85%	5.85%	6.10%	6.11%	6.29%	6.29%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
27/02/08	6.03%	6.24%	6.29%	6.25%	6.31%
28/02/08	6.06%	6.30%	6.33%	6.29%	6.33%
29/02/08	6.09%	6.34%	6.36%	6.30%	6.37%
03/03/08	6.11%	6.34%	6.36%	6.34%	6.38%
04/03/08	6.11%	6.34%	6.36%	6.31%	6.38%

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
27/02/08	6.16%	5.08%	5.57%	5.29%	5.72%	5.69%	5.73%	5.76%
28/02/08	6.23%	5.05%	5.57%	5.29%	5.71%	5.68%	5.72%	5.76%
29/02/08	6.27%	5.05%	5.57%	5.34%	5.71%	5.67%	5.71%	5.76%
03/03/08	6.29%	5.05%	5.56%	5.30%	5.71%	5.65%	5.72%	5.75%
04/03/08	6.29%	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
27/02/08	12.30	11.00	10.60	10.40	0.75	0.90	0.30	0.35
28/02/08	12.30	11.00	10.65	10.40	0.75	0.90	0.30	0.35
29/02/08	12.40	11.20	10.65	10.50	0.75	0.90	0.30	0.35
03/03/08	12.40	11.20	10.90	10.50	0.75	0.90	0.30	0.35
04/03/08	12.60	11.40	11.05	10.60	0.75	0.90	0.30	0.35

PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
27/02/08	2.3155	3.5204	-31.86%
28/02/08	2.3305	3.5356	-31.50%
29/02/08	2.3171	3.5221	-31.82%
03/03/08	2.3255	3.5290	-31.64%
04/03/08	2.3075	3.5379	-31.74%

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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