



POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

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MACROECONOMICS**

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- Sell on upticks
- Stay aside/Short EURPLN gamma

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PREVIEW: The week of May 8th to May 15th

Indicator	Date of release	Period	BRE forecast	Consensus	Last	Comment
M3 Supply y/y	May 14	April	13.5%	13.6%	13.5%	Unfavorable conditions in the stock exchange and further withdrawals from investment funds fuel elevated growth rate of household deposits (19-20% y/y). Expansion of firm deposits still at annual 6%.
CPI Inflation y/y	May 14	April	4.0%	4.1%	4.1%	Sustained deceleration of food prices (0.4% m/m). Net inflation still in upward tendency: 2.9% in April (vs. 2.7% in March). Only 1/6 of announced gas hike will be counted in April's reading, the rest goes to May.
C/A Balance	May 15	March	-1.5 bn EUR	-1.35 bn EUR	-1.3 bn EUR	Trade balance at 1.7 bn EUR. The growth of exports decelerated to 12.6% y/y while imports sustained the momentum expanding at 18.2%. The forecast under revision after the data on foreign trade, published by the Central Statistical Office in mid-May. C/A deficit to GDP ratio at

						4.1% in the end of March.
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In Focus / Macroeconomics

EMU enlargement has gained momentum, high time for Poland? Not really.

This week has brought some positive data for the convergence spreads. The European Central Bank has published its Convergence Report, giving green light for Slovakia's entering and arousing speculation that Poland will follow suit.

The publication of the Report made J. Vincent-Rostowski, usually quietly hidden in the offices of the Ministry of Finance, comment on the convergence criteria. The case of Slovakia shows that fulfilling the requirements of Maastricht Treaty has become more explicit either the country meets the necessary arrangements or simply not (much less room for qualitative assessment of the convergence). Entering the euro zone is thus slightly easier than in previous years, devoid of political games. It seems the EMU enlargement has gained a necessary momentum to drive onwards (we still think Slovakia is going to face problems with excessive inflation soon, thereby not all criteria are to be met permanently).

The assessment of Poland was quite favourable...but inflation and public finance are still top concerns (despite the fact that Poland is going to be exempted from EDP in coming months). Traditionally, European Central Bank advocates the consolidation of public finance, a remedy for inflation and a boost to fiscal flexibility during the business cycle as well. The Report also suggests dealing with labor market issues – namely the low participation rate, which apparently takes up a prominent place in the proposed government reform agenda. Solving the problems with labor force will help to revamp the situation of the pension system and limit inflation pressures flowing from tightening job market. Making the long story short, quite misty convergence programme sent by the government seems to be convincing for the EU's decision bodies; but still we see problems with meeting the inflation goals in the future.

Minister Vincent-Rostowski was rather unwilling to reveal the date for entering the ERM II; at least he suggested 2009 as a possible term. It is still a good news that the euro-adopting strategy insist on meeting the criteria in a sustainable manner (cases of Spain and Portugal show that loosing the control of monetary policy limits the set of tools in case of idiosyncratic shocks occurring in times of shallow and - to some extent unsustainable - structural reforms). As for the entering ERM II, it was once again stressed that it is reasonable to postpone the decision until the financial turbulence ends.

The date of entering the euro zone remains an open question. Favorable assessment of convergence criteria fulfillment plays into the hands of euro-enthusiasts; however, it is the assessment just before trading the zloty for the common currency which is decisive for exact accession. Looking more in to the future, inflation is to remain a worry for a while. The issues of public finance are also to be dealt in line with a strategic vision. The government is probably going to put forward 2009 date – we are more skeptical though. It will be much harder though. The government is to deal with elevated inflation and budget deficit issues in times of softening GDP growth and cumulated problems of social policy. It seems more reasonable then to bet on 2010.

Rate hike expectations split between May and June

The Ministry of Finance announced its forecast for April inflation of 4.1% y/y, pretty in line with market expectations. This notwithstanding, we expect the actual figure, to be announced on May 14th, to drop to 3.9-4.0% on the back of lower food prices (mainly vegetables). The net core inflation is though very likely to accelerate to 2.9% from 2.7% recorded in April.

MinFin's inflation forecast triggered some MPC comments. The doves, as usual, found confirmation of their view and announced the end of tightening. The hawks, on the other hand, stuck to a view of one more hike. Quite volatile and contradictory comments made by moderate Czekaj (in his comments he points interchangeably to a May rate hike and rate cuts to align with ECB monetary policy), led us to some weird conclusions. So, the Council agreed to one more hike and is only testing for the best possible timing. New NBP staff projection and release of the GDP data for the first quarter support the hypothesis of June rate hike. Some MPC members admitted, however, that the monthly data releases would be much more hawkish already in May (positive

working day effects). So, suddenly the May meeting gets more attractive. Turning to the mid-term perspectives, the MPC may keep the rates on hold, trying at the same time to calm the markets ahead of expected inflation peak in August/September. The rate hike expectations are very unlikely to subside at that time, however.

MEDIUM-TERM FORECATS

Indicator	2006	2007	2008
GDP y/y (%)	6.1	6.5	5.5
Inflation rate (%)	1.0	2.4	4.5
Current account (% of GDP)	-2.1	-4.5	-4.6
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

Rather calm week

Last week was rather calm on the FI. One thing that has changed was Wibor rates which pushed another 6-7 bp. higher, and they are currently standing 65 bp above official repo rate. We still don't think there is much hikes priced, but it is liquidity premium that is pushing money market rates higher. All in all even given the fact that RPP may not be willing to rise rates it is hard to expect money market rates will ease off and so will not Wibors. We still recommend paying short curve up to 2y. As far as the bond market we are rather neutral, and looking at range in 5y5y forward PLN to EUR, we see it closed in range 60-80 currently trading at upper band of the range which make us receivers of this spread especially after up beat comments from Ministry of Finance about our possible ERM2 entry.

RECOMMENDATION:

Pay short curve, play 5y5y fwd PLN EUR range.

AUCTIONS

	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	6.061%	4/14/2008
26 Week T-bills	-	-	6.220%	4/14/2008
52 Week T-bills	5/26/2008	-	6.340%	5/5/2008
2Y T-bond OK0709	7/2/2008	-	6.193%	4/2/2008
5Y T-bond PS0413	6/4/2008	-	6.155%	5/7/2008
10Y T-bond DS1017	7/9/2008	-	6.054%	4/9/2008
20Y T-bond WS0922	5/14/2008	-	5.794%	1/9/2008

Money Market

Main interest rates stayed unchanged

May scenario strongly dependent on current data

Growing liquidity premium

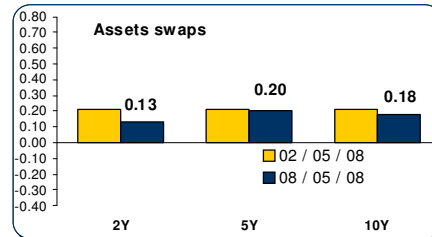
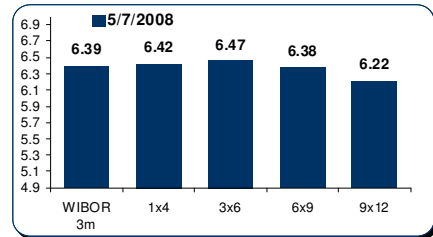
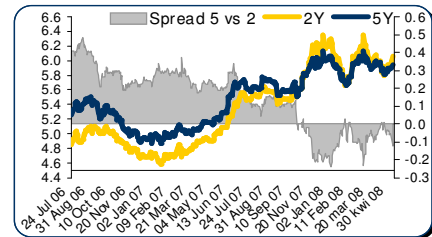
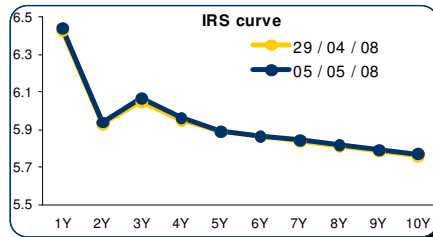
The MPC did not change any monetary policy parameters. Biggest probability is for June, however May scenario strongly depends on current data. So far so good, since the MinFin's CPI projection was in line with expectations. As of now, waiting for figures and range trading slightly skewed to the bearish, just to give some credit for uncertainty.

Growing liquidity premium is lifting the cost of carry higher and higher. 20-30 bps over the main rate becomes the standard. Main problem stays of course with credit limits. Their insufficiency makes redistribution of bigger surpluses impossible. Hence, smaller OMO's (only 10 billion pln last week, probably similar amount tomorrow) have only negligible impact for the system's liquidity. The MinFin itself is also not too helpful issuing strange short maturity papers (over 2 billion pln in 3W papers on Monday), just to finance its current coupon obligations. Those papers absorb short cash mainly from the clients, and additionally squeeze the cash market, since it is not really an alternative for money bills. To sum up we do not think that carry will fall down soon.

RECOMMENDATION:

Pay shortest polonia below 6%

FIXED INCOME & MONEY MARKET CHARTS



Foreign Exchange

Zloty recovered

Since Friday the zloty was traded between 3.4470 and 3.4080. Look-for-correction trading, with 3.4650 top, was exchanged for CE4 optimism as Slovakia's EUR adopting date was shown.

Volatility curve flattened/lower

As wave of omnipresent optimism spilled over region volatility curve flattened and lowered with 1M traded at 6.3 and 1Y at 5.9.

RECOMMENDATION:

Sell on uptics

Spot:
Main supports / resistances:
EUR/PLN: 3.4000 / 3.4650
USD/PLN: 2.1800 / 2.2700

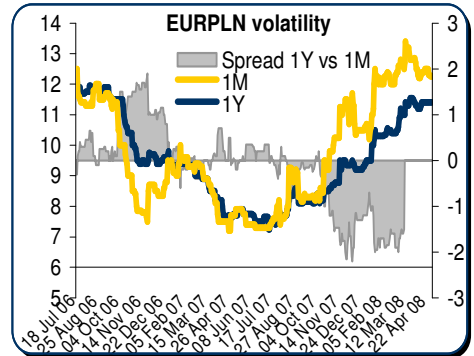
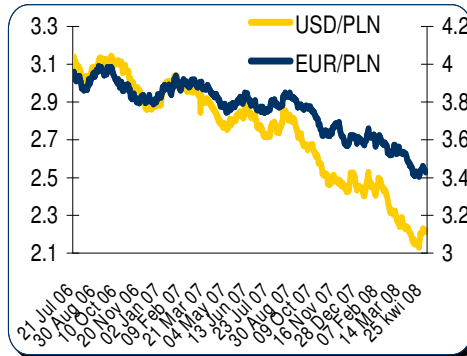
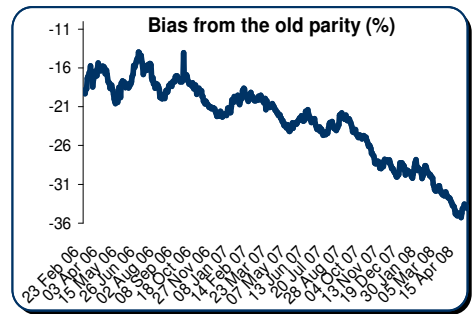
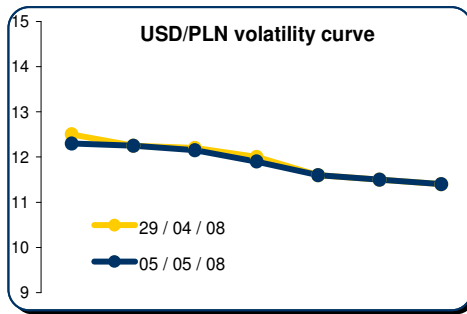
Although 3.4000 was not broken and still provides support, we suggest to look for selling opportunities toward 3.4600. Breaking of 3.4000 opens way for 3.3600.

Stay aside/Short EURPLN gamma

Options:

We advice to stay aside EURPLN market as present volatility levels do not offer much room to continue move, although present market sentiment still decline to keep short EURPLN gamma position to maintain theta gains.

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
29/04/08	6.26%	6.22%	6.46%	6.41%	6.66%	6.54%
30/04/08	6.20%	6.24%	6.40%	6.40%	6.65%	6.54%
02/05/08	6.22%	6.23%	6.39%	6.39%	6.55%	6.53%
05/05/08	6.25%	6.24%	6.40%	6.39%	6.53%	6.52%
06/05/08	6.23%	6.24%	6.40%	6.40%	6.53%	6.53%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
29/04/08	6.34%	6.35%	6.29%	6.15%	6.26%
30/04/08	6.37%	6.38%	6.28%	6.14%	6.28%
02/05/08	6.36%	6.38%	6.30%	6.15%	6.27%
05/05/08	6.36%	6.38%	6.30%	6.15%	6.27%
06/05/08	6.39%	6.42%	6.32%	6.19%	6.34%

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
29/04/08	6.54%	5.08%	5.57%	5.29%	5.72%	5.69%	5.73%	5.76%
30/04/08	6.54%	5.05%	5.57%	5.29%	5.71%	5.68%	5.72%	5.76%
02/05/08	6.53%	5.05%	5.57%	5.34%	5.71%	5.67%	5.71%	5.76%
05/05/08	6.52%	5.05%	5.56%	5.30%	5.71%	5.65%	5.72%	5.75%
06/05/08	6.53%	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	08/05/05	09/05/05	93.941	6.34%	2500	4123	2787
OK0710	08/01/02	09/07/25	85.730	6.19%	1800	2047	1654
PS0413	08/04/07	13/04/25	96.211	6.16%	1800	3129	1800
DS1017	08/02/13	17/10/25	96.048	5.79%	2000	2785	2000

FX VOLATILITY

date	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
	1M	3M	6M	1Y	1M	1Y	1M	1Y
29/04/08	12.30	12.10	11.60	11.40	0.65	0.70	0.30	0.35
30/04/08	12.30	12.10	11.60	11.40	0.70	0.85	0.30	0.35
02/05/08	12.25	12.00	11.60	11.40	0.70	0.85	0.30	0.35
05/05/08	12.25	12.00	11.60	11.40	0.70	0.85	0.30	0.35
06/05/08	12.25	11.90	11.60	11.40	0.70	0.85	0.30	0.35

PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
29/04/08	2.2267	3.4604	-33.58%
30/04/08	2.2291	3.4518	-33.66%
02/05/08	2.2199	3.4400	-33.90%
05/05/08	2.2203	3.4385	-33.91%
06/05/08	2.2142	3.4285	-34.10%

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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