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FINANCIAL MARKETS DEPARTMENT

PAGES: 8

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POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

PREVIEW: The week of June 6th to June 12th

Indicator	Date of release	Period	BRE fore-cast	Consen-sus	Last	Comment
CPI Inflation	**Jun 13**	May	**4.4%**	4.3%	4.0%	The reading distorted upwards by recent gas and electricity hikes. Also fuel prices exerted upward pressure on the figure whereas food prices resemble usual seasonality. We see net inflation reaching 3.3% y/y.

In Focus / Macroeconomics

Highly uncertain economic background leaves the question regarding the hikes after June opened

Solid GDP growth recorded in the first quarter of the year has given the MPC the desired space to concentrate on nominal processes at the moment. And the need to focus on inflation is gaining on importance: expected acceleration of CPI has found confirmation in the forecast of the Ministry of Finance. But it is OECD and its fresh projections that set the ceiling for CPI inflation in 2009 – 5.5%, a way above the early budget assumptions and the market consensus.

Q1 GDP growth amounted to 6.1% y/y, close to our estimate at 6.0%. Private consumption rebounded to 5.6% y/y and fixed capital investment dynamics amounted to 15.7%. More than a half of the growth (3.7 pp) can be attributed directly to private consumption, 2.2 pp. to fixed capital investment. It is striking that public consumption recorded an outright decline in Q1 reaching the growth rate of -1.1% y/y. At first sight it can be easily reconciled with exceptional budget performance in the first three months. It is likely then that the bulk of expenditures is postponed forward into the year. The figures are consistent with our medium-term view: we expect the growth of consumption to be maintained and fixed capital investment to soften gradually during the year.

As for the Ministry's forecast, it came a notch lower than our expectations for the final CPI figure (4.4% y/y) at 4.3%. According to the statement released just after the publication, accelerating growth of prices can be attributed to the food prices, gas and electricity price hikes and elevated costs of fuels. We see an asymmetric upward risk concerning the two latter components, hence a higher forecast for the final CPI.

OECD forecast has set the ceiling for inflation expectations at 5.5% in 2009. According to the Ministry of Finance, such a level seems implausible. However, the view presented by the OECD is consistent with their recent research concerning the impact of price shocks on the growth of potential GDP. Given the adverse effects for the potential, the GDP gap may widen amplifying inflationary pressures. The consumer demand will be able to keep up: rising costs of materials and capital may force optimally behaving firms to increase demand for relatively cheaper labor force, leading straight to further wage increases in the tight job market. Analysis relies on partial equilibrium model, thereby it neglects serious feedback effects among various variables (e.g. anti-inflationary effects stemming from the firming zloty). Owing to the mentioned shortcomings, the forecast may be regarded as a warning, but not as a serious threat.

After the releases of GDP and Ministry's inflation forecast we witnessed quite hawkish comments from the MPC members. Declared hawks including M. Noga, H. Wasilewska-Trenkner and D. Filar were unexpectedly backed by S. Owsiak who regards the GDP figures as the ones increasing the probability of the nearest hike. The outlook for longer term monetary policy will be determined by the fresh inflation projection. We do expect a wait-and-see stance just after the June hike: despite stronger than expected growth in Q1, there are numerous signs that the GDP expansion will be softer in coming quarters, playing into the cards of more moderate MPC members. What is more, fresh comments given by A. Wojtyna suggest that bringing the CPI to the target may be in current circumstances more prolonged than in the case of accession shock of 2004 and, what is more important, lingering return may be optimal for the economy. We still think the June's hike is done deal; given the uncertainty concerning global market's, the MPC is unlikely to communicate the end of cycle, leaving the doors open for unexpected events later in the year.

MEDIUM-TERM FORECATS

Indicator	2006	2007	2008
GDP y/y (%)	6.1	6.5	5.3
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

Low liquidity in the market

Last week showed how little liquidity is in PLN market, both in bonds and IRS. Relatively small but consistent selling pressure made most of locals full of bonds and it was only a matter of time when eventually market collapsed. Looking at fundamental side nothing has happened, our economic forecast for this month show that figures will point for lower wages, production, PPI and retail sales. We also think that NBP forecast which will be presented to MPC on the coming meeting will show lower CPI path especially in the 2010. Looking at the market dynamics and positioning we decided to close all our pay positions, we are neutral at this levels. We like to hold 5y5y pln ag eur convergence spread at current levels.

RECOMMENDATION:

Receive 5y5y pln ag eur, close all pay positions

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	6/9/2008	-	6.664%	6/2/2008
2Y T-bond OK0709	7/2/2008	-	6.193%	4/2/2008
5Y T-bond PS0413	9/3/2008	-	6.155%	5/7/2008
10Y T-bond DS1017	7/9/2008	-	6.054%	4/9/2008
20Y T-bond WS0922	9/12/2008	-	6.080%	5/14/2008

Money Market

Very cheap end of the reserve

Last days of the reserve were very cheap. At the end of the last reserve day the market placed in the CB over 7.7 billion PLN, which best visualizes the scale of surplus. Open market operation was 10.0 billion PLN (8.5 during the previous auction) which was fair enough to push the carry up at the beginning of the new reserve.

The rates went up due to bearish sentiment on the bond market

No signs of recovery in the nearest future

On Wednesday FRA and swap rates went up due to bearish sentiment on the bond market. It made rates go up 10-15 bps at the long end of the curve at the end of week. It was caused by the OECD report, which says substantial rate hikes will be needed to bring price growth back towards the central bank's target.

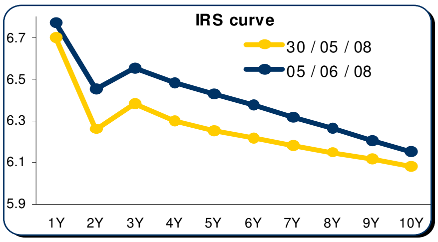
T-bills yields up at tender, continuation of the movement expected

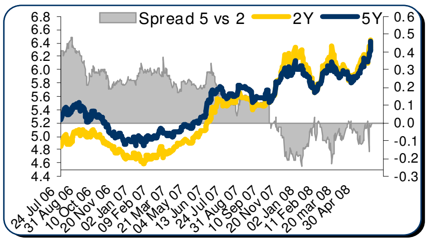
The average yield on the Polish benchmark 52-week Treasury bill edged up to 6.644% at Monday's auction, from 6.504% at the previous tender May 26. The offer attracted bids worth 3.31 billion PLN plus additional 1,47 billion PLN in 13-week papers. Average yield of 13-weeks papers was 6.342%. The ministry will offer another 1-2 billion PLN of 52-week paper next week, along with 1-2 billion of shorter 13-week bills. We expect average yields to go up again.

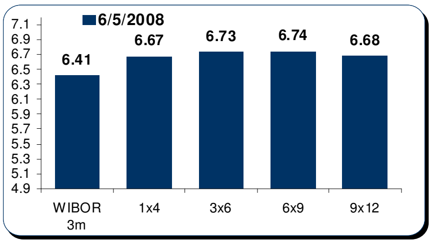
RECOMMENDATION:

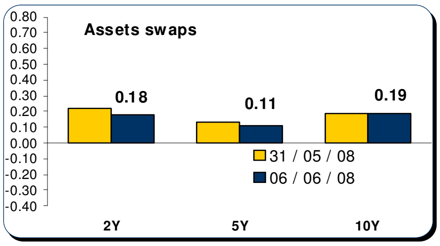
Sell 12 month Polonia OIS around 6.50%.

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty stronger

Zloty is consolidating in a well defined range 3.3600-3.3950. It is the very good performance taking in the consideration the global equities performance plus the sharp reversal in the dollar value. If the sentiment became sour again we probably will face a small correction towards 3.40/6.41 area. But we view it as a correction only, and think, the EUR/PLN is targeting 3.32/35 in the weeks to come.

Volatility curve slightly lower

Not much to report. The short end of the curve slightly higher with surprising bids for o/n and 1 week volatility. The rest of the run was unchanged for the whole week.

RECOMMENDATION:

Spot:
Main supports / resistances:
EUR/PLN: 3.3500 / 3.4000
USD/PLN: 2.1500 / 2.2200

Sell spikes

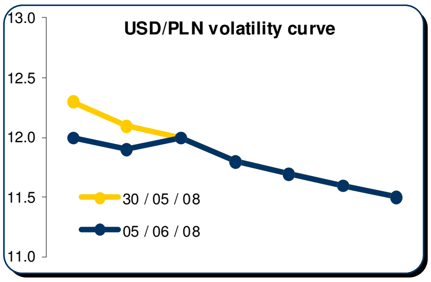
Already short EUR/PLN at current market levels, looking to add to this position on spikes to 3.3950/3.4050 with the s/l above 3.42. Hoping for move to 3.35 and next to 3.33.

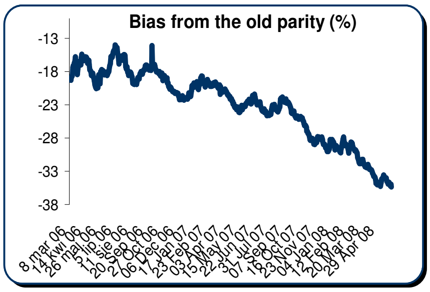
Options:

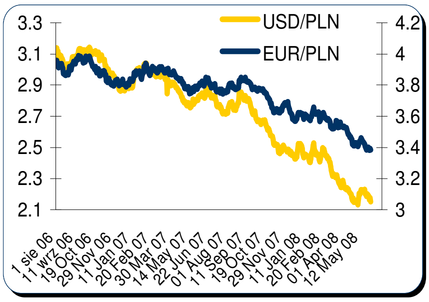
Stay aside/Short EURPLN gamma

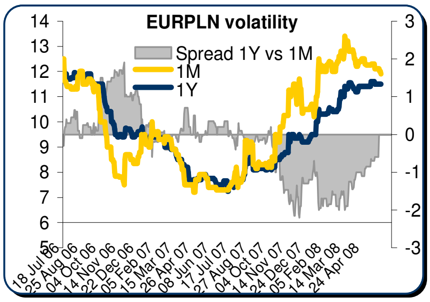
EUR/PLN volatility is being almost constant this year. We favour being slightly theta positive, waiting for the clearer signal to take same directional position.

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
29/05/08	6.28%	6.36%	6.48%	6.49%	6.60%	6.59%
30/05/08	6.31%	6.38%	6.46%	6.52%	6.56%	6.60%
03/06/08	6.25%	6.41%	6.30%	6.52%	6.35%	6.60%
04/06/08	6.40%	6.41%	6.51%	6.53%	6.63%	6.62%
05/06/08	6.40%	6.41%	6.51%	6.53%	6.58%	6.62%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
29/05/08	6.56%	6.60%	6.54%	6.42%	6.55%
30/05/08	6.59%	6.63%	6.59%	6.44%	6.59%
03/06/08	6.60%	6.65%	6.62%	6.50%	6.65%
04/06/08	6.61%	6.64%	6.62%	6.53%	6.66%
05/06/08	6.63%	6.68%	6.68%	6.58%	6.72%

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
29/05/08	6.59%	5.08%	5.57%	5.29%	5.72%	5.69%	5.73%	5.76%
30/05/08	6.60%	5.05%	5.57%	5.29%	5.71%	5.68%	5.72%	5.76%
03/06/08	6.60%	5.05%	5.57%	5.34%	5.71%	5.67%	5.71%	5.76%
04/06/08	6.62%	5.05%	5.56%	5.30%	5.71%	5.65%	5.72%	5.75%
05/06/08	6.62%	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	08/06/02	09/06/02	93.705	6.64%	1500	3310	1496
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

	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
date	1M	3M	6M	1Y	1M	1Y	1M	1Y
29/05/08	12.10	11.80	11.70	11.50	0.70	0.85	0.30	0.35
30/05/08	12.10	11.80	11.70	11.50	0.70	0.85	0.30	0.35
03/06/08	12.00	11.80	11.70	11.50	0.70	0.85	0.30	0.35
04/06/08	12.00	11.80	11.70	11.50	0.70	0.85	0.30	0.35
05/06/08	11.90	11.80	11.70	11.50	0.70	0.85	0.30	0.35

PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
29/05/08	2.1913	3.4010	-34.69%
30/05/08	2.1913	3.4010	-34.69%
03/06/08	2.1650	3.3827	-35.21%
04/06/08	2.1758	3.3930	-34.96%
05/06/08	2.1522	3.3836	-35.34%

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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