



## POLAND WEEKLY REVIEW

### MACROECONOMICS AND FINANCIAL MARKETS

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### PREVIEW: The week of June 27<sup>th</sup> to July 3<sup>rd</sup>

Indicator	Date of release	Period	BRE fore-cast	Consen-sus	Last	Comment
MinFin's infla-tion forecast	Jul 1	Jun	4.5%	4.5%	4.4%	This time the headline CPI is shaped mainly by fuel prices and the costs of food. The additional feedback effects remain limited as measured by net core inflation (3.3% y/y) and the new measure excluding energy and food (still 2.1-2.2% y/y).

## In Focus / Macroeconomics

### Rates at 6.0% and inconsistent signals sent by the MPC

The statement issued after the decision speaks the same hawkish voice as the fresh inflation projection (we mean mainly the official risks attached to the presented path), however, the rate-setters themselves, in comments that followed the statement release, have substantially softened the message. They seem to have got lost the track of the economy – thereby more and more comments rely on other central banks: ECB and lately even the Fed. We expect another tightening move to come in August/September should our forecast of core inflation come true. Otherwise the growth concerns will outweigh and October inflation projection will be of no help even to the ultimate hawks, allowing the rates to stay at 6.0% till the end of the cycle.

The statement issued after the meeting clearly indicated an increasing risk of further inflation growth, even though economic growth is set to gradually slow down. "Classical" factors which have reduced that risk so far, as very good financial standing of companies or globalization effects, seem to be not as much underlined as they used to be. The projection showed an elevated inflation path in 2008 and 2009 and gradual decline towards the target in 2010. The risks to inflation path mentioned in the Raport on inflation are clearly on the upside; the same message is delivered by the estimated growth rates on core inflation (headline excluding prices of energy and food): 4.0% in 2009 and 3.8% in 2010. These are clearly hawkish numbers, provided the MPC members regard the projection as a meaningful one.

Despite the abovementioned reservations, we believe that the probability of the next rate hike remains high and it may materialize in 2 or 3 months' time, which is now to some extent reflected by market expectations. Hence, should interest rates were to rise again, it would happen in August or September, when the CPI inflation will probably peak. Our baseline scenario assumes that CPI may hit temporarily 5% and the net inflation will probably reach (but not significantly exceed) 4%. The "new" core inflation measure (net of food, fuel and energy prices) should maintain close to 3% in the mid run.

The inflation peak itself is, however, irrelevant to the monetary policy as it reflects mainly statistical effects. It is composition of inflation (and the feedback effects from higher energy prices and tightening labor market) which matters most for the rate-setters (our preliminary analysis suggests those effects are still limited). Thus, we would not attach so much importance to the inflation projection release in October. By that time much more will be known about effects of the energy price growth and the new ECB policy direction should be clarified, which may provide much more arguments for policy makers than the projection per se. With worsening growth prospects (rising lending costs, weak external demand and deteriorating competitiveness due to increasing manufacturing costs) it is likely that the hike we expect will become the only one, focused mainly on shaping inflationary expectations just before or just after the peak.

As the CPI inflation should gradually decline in the Q4 2008, Polish MPC will feel much more comfortable keeping the interest rates unchanged, even though the inflation rate will be still above the target. The latter is indeed, to a great extent, due to food and energy prices, which cannot be affected directly by interest rates, which excessive level may harm economic growth.

#### MEDIUM-TERM FORECASTS

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

*New projection. Still wait-and-see.*

Most important event of the last week was the publication of the latest inflation projection, as for some time MPC's members were reiterating, that this document should give better outlook of the potential future path of the CPI and growth, and therefore give the market some hints about possible central bank's rate moves. But it doesn't look like the picture is any clearer now. Moreover, quite hawkish statement justifying the 25bp hike was followed by relatively soft comments from Council members. That allowed the curve to move back by some 10bp from somehow elevated levels we observed before. It doesn't look that we can expect any aggressive tightening in the nearest future, at least till we see how the inflation will peak this year, and whether or not will it tend to slow down afterwards. We also think that later on we can be observing more signals of economy slowing down. From that perspective bond yields in short end of the curve seem quite attractive here - cash market is easing, scope for hikes is limited, forward rates are high. For the time being we prefer shorter duration and expect some steepening of the yield curve.

### **RECOMMENDATION:**

Long in 1y-3y sector. Curve to steepen.

### **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	7/14/2008	-	6.760%	6/16/2008
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

*Still chance for cheap end of the reserve*

Quite a substantial open market operation (13.5 billion pln vs 11 billion expected) pushed the carry up, since all the bills were purchased. Flow from the maturing June 08 turned out to be effectively smaller (only part of the cash supported the system, rest was ceased by maturing BSB transactions with MinFin), which helped the shortest rates to stay high. Tomorrow is the last day of the reserve and everything is possible due to another OMO. However, we see greater probability of poor demand and hence shortest rates falling down around 50 bps.

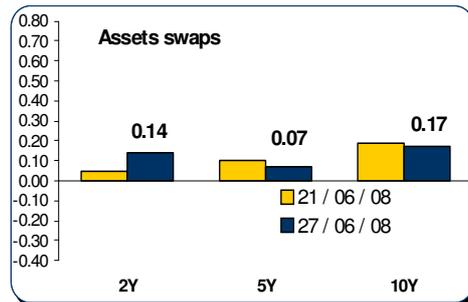
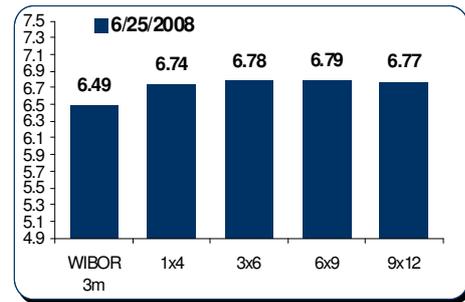
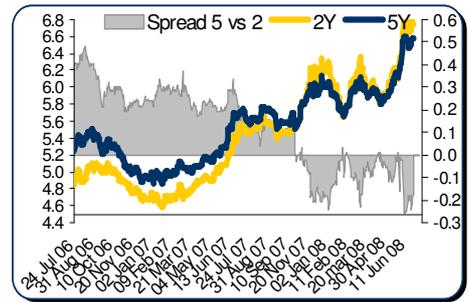
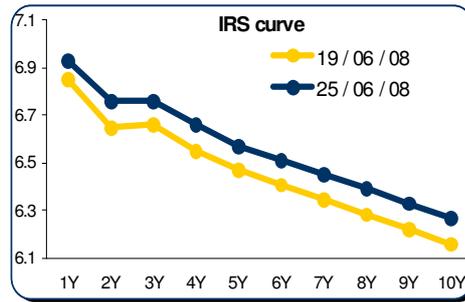
*Some comments from the MPC members in opposition to official statement.*

The MPC hiked all the rates by 25 bops just as literally everyone expected. Main rate is now 6%, Lombard rate 7.5% and deposit rate 4.5%. The statement after the decision was pretty bearish; however some separated comments were just the other way round. Hence, the first incentive pushed yields up and then we faced nice rally down (10-15 bps). Now the market sees another hike somewhere between August and September depending on current sentiment, believing that this would be the last hike in this cycle. We are less optimistic and consider possibility of further tightening in monetary policy late autumn.

### **RECOMMENDATION:**

Pay 6,9,12M on dips.

**FIXED INCOME & MONEY MARKET CHARTS**



**Foreign Exchange**

*Zloty mixed*

Since Friday PLN touched low at 3.3512 and broke Monday's opening reaching 3.3825. Zloty was tracking core markets and wavering with changes of global sentiment.

*Volatility curve lower*

Summer market took place, curve is flatter with 1M traded at 6.2 and 1Y at 6.05.

**RECOMMENDATION:**

Spot:  
Main supports / resistances:  
EUR/PLN: 3.3400 / 3.4000  
USD/PLN: 2.1000 / 2.1600

*Stay aside/Buy on dips*

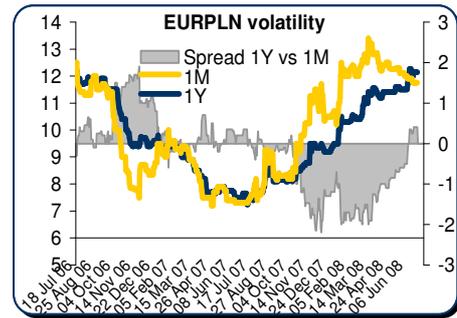
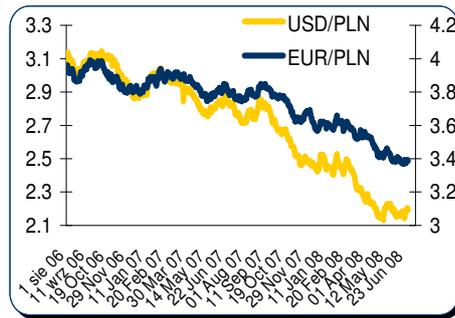
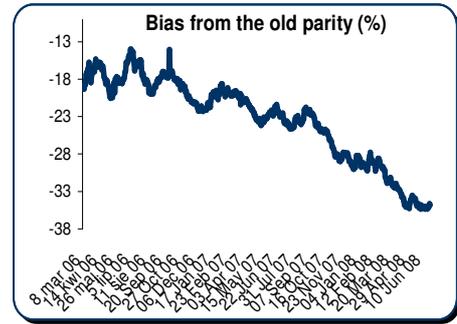
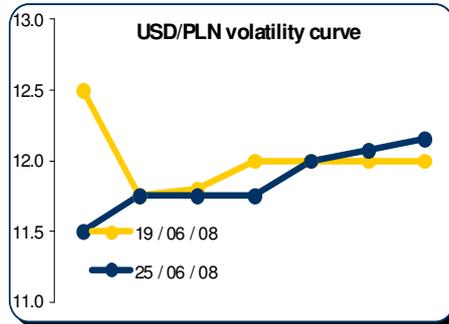
We believe as summer market starts Zloty will become even more vulnerable for outer effects. We see buying at 3.3400 and selling on upticks as two main, non excluding trading ideas.

Options:

*Stay aside/Short EURPLN gamma*

Till summer market lasts we see keeping small amounts of short EURPLN gamma as best idea.

**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
19/06/08	6.32%	6.47%	6.63%	6.65%	6.88%	6.76%
20/06/08	6.37%	6.48%	6.70%	6.65%	6.94%	6.76%
23/06/08	6.37%	6.48%	6.70%	6.66%	6.94%	6.75%
24/06/08	6.39%	6.49%	6.72%	6.67%	6.98%	6.76%
25/06/08	6.40%	6.50%	6.68%	6.70%	6.92%	6.76%

**FRA MARKET RATES**

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
19/06/08	6.73%	6.79%	6.80%	6.78%	6.84%
20/06/08	6.74%	6.81%	6.84%	6.81%	6.88%
23/06/08	6.74%	6.81%	6.85%	6.81%	6.88%
24/06/08	6.75%	6.82%	6.84%	6.80%	6.88%
25/06/08	6.74%	6.78%	6.79%	6.77%	6.83%

**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
19/06/08	6.76%	5.08%	5.57%	5.29%	5.72%	5.69%	5.73%	5.76%
20/06/08	6.76%	5.05%	5.57%	5.29%	5.71%	5.68%	5.72%	5.76%
23/06/08	6.75%	5.05%	5.57%	5.34%	5.71%	5.67%	5.71%	5.76%
24/06/08	6.76%	5.05%	5.56%	5.30%	5.71%	5.65%	5.72%	5.75%
25/06/08	6.76%	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	08/06/09	09/06/09	93.616	6.74%	1400	2748	1320
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
19/06/08	11.75	12.00	12.00	12.00	0.70	0.85	0.30	0.35
20/06/08	11.75	11.75	12.00	12.15	0.70	0.85	0.30	0.35
23/06/08	11.75	11.75	12.00	12.15	0.70	0.85	0.30	0.35
24/06/08	11.75	11.75	12.00	12.15	0.70	0.85	0.30	0.35
25/06/08	11.75	11.75	12.00	12.15	0.70	0.85	0.30	0.35

**PLN SPOT PERFORMANCE**

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
19/06/08	2.1727	3.3890	-35.04%
20/06/08	2.1447	3.3923	-35.32%
23/06/08	2.1755	3.3785	-35.14%
24/06/08	2.1787	3.3734	-35.16%
25/06/08	2.1941	3.3863	-34.83%

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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