



## POLAND WEEKLY REVIEW

### MACROECONOMICS AND FINANCIAL MARKETS

**IN FOCUS /  
MACROECONOMICS**

- MPC leaves rates unchanged at 6.0% • pages 2

**FIXED INCOME**

- Another volatile week • page 2-3

**FI  
RECOMMENDATION**

- Use volatility to pay short FRA curve. Buy bonds on dips.

**MONEY MARKET**

- Very cheap end of the reserve
- Bullish wave stopped by the MPC statement • pages 3

**MM  
RECOMMENDATION**

- Buy 9m and 1Y polonia at current levels

**FOREIGN EXCHANGE**

- Zloty stronger
- Volatility curve lower • pages 4

**FX  
RECOMMENDATION**

- Hold long PLN
- Hold short vega and gamma

**MARKET PRICES  
CONTACT LIST  
DISCLAIMER**

- page 5
- page 6
- page 7

#### PREVIEW: The week of August 1<sup>st</sup> to August 7<sup>th</sup>

Indicator	Date of release	Period	BRE fore- cast	Consen- sus	Last	Comment
MinFin's infla- tion forecast y/y	Aug 1	Jul	4.8%	4.7-4.8%	4.6%	The tension flowing from elevated fuels is slowly fading. Food prices seem stronger than a year ago (-1.0% m/m). Moderate increases in core categories are adding to the picture. We see 'net' core inflation at 3.5% y/y up from 3.4% reported in the previous month.

## In Focus / Macroeconomics

### MPC leaves rates unchanged at 6.0%

The decision was largely expected; the same does not apply to the statement, though. We decipher it as a more dovish than the previous one, while most analysts claim it conveys sharper message on more hikes.

The balance of risks presented in the statement seems unchanged (with some semantic changes pointing towards the problems of the real sphere). Although the GDP growth is expected to decelerate, it will still be accompanied by unfavorable relation between wages and labor productivity. At the same time the MPC looks for the period of elevated inflation (mainly of supply-side origin) which may pose problems with anchoring inflation expectations.

As for the other arguments, the MPC expects slower GDP growth to mitigate nominal wage tension – elevated growth rate of earnings is at the moment the prime reason why the monetary policy stance remains restrictive. As inflation remains much above the target, the MPC had no choice but to strongly commit itself to bring it lower. It may however, prepare the public that the return to 2.5% will be more prolonged, and it explicitly did. This kind of rhetoric implies – in our opinion – that the monetary policy may be less aggressive than anticipated.

The current exchange rate, as we expected, drew much attention of the MPC. The consensus view among the rate-setters is the following: the current pace of appreciation has probably exceeded the growth of equilibrium exchange rate. Such a wording may imply that the MPC expects or rather would like to see (owing to the decelerating exports growth) the zloty weaker.

One of the moderate rate setters – J. Czekaj – expanded on the official statement by conditioning the next rate moves primarily on corporate wages data. He expects the economic and wage growth to moderate in the coming quarters, acknowledging at the same time that the majority of the Committee may now switch to wait-and-see mode. His comments contrast with that of Wasilewska-Trenkner pushing for at least one more hike.

We estimate the likelihood of monetary tightening this summer at 60-70%. Accelerating inflation (watch the release of the FinMin's inflation forecast on Friday) may stimulate the hawkish wing of the MPC to adjust the rates and fight the rising consumer inflation expectations. These actions may spark some confusion among market participants and contribute to sharp shifts in rate expectations. Turning to mid-term rate perspectives, the MPC is likely to avoid aggressive rate moves, leaning towards less active monetary policy in general. That is why we expect the decisive signals to come directly from the economy. Only moderate feedback effects to inflation, lower oil prices, stronger zloty and more pronounced economic slowdown in Poland and Europe as well are to set the direction for the Polish debt market in the fourth quarter.

### 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

### Another volatile week

Last week market showed again some strength. Before RPP decision strong receiving interest pushed 1y3s down to the level of 6.66% and 5y to 6.17%, making more than 50 and 60 bp. retracement from the last months highs. The rally was stalled shortly after "hawkish" comment indicating possibility of further rate hikes to curb inflation. We still remain neutral, although flows we see indicate good appetite for receiving rates especially in the 5y sector, on the other hand

we see little value in selling FRA below WIBOR fixing. We like paying curve up to 9 moths and we like buying bonds against that up to 5y. We don't quite like shape of market as it moves in jumps, we rather trade than put big prop positions on.

Use volatility to pay short FRA curve. Buy bonds on dips.

**RECOMMENDATION:**

**AUCTIONS**

	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	6,061%	2008-04-14
26 Week T-bills	-	-	6,220%	2008-04-14
52 Week T-bills	2008-08-11	-	6,850%	2008-07-14
2Y T-bond OK0709	2008-08-10	-	6,500%	2008-07-09
5Y T-bond PS0413	2008-09-03	-	6,155%	2008-05-07
10Y T-bond DS1017	2008-10-08	-	6,054%	2008-04-09
20Y T-bond WS0922	2008-09-12	-	6,080%	2008-05-14

**Money Market**

*Very cheap end of the reserve*

*Bullish wave stopped by the MPC statement*

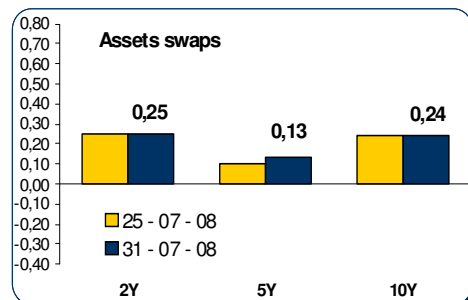
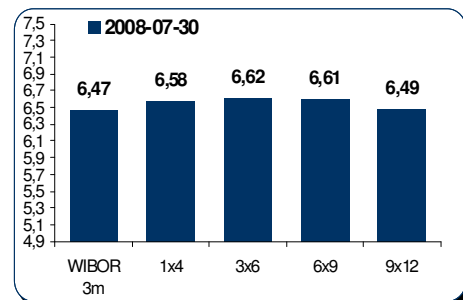
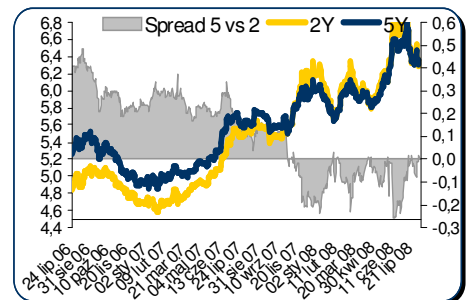
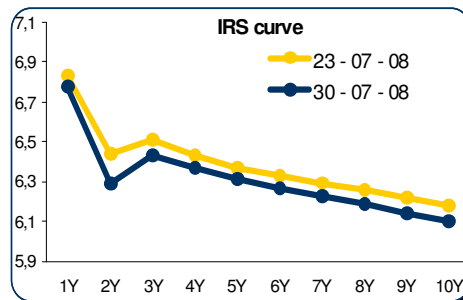
Very cheap end of the reserve and to tell the truth very cheap the whole week. This time it was just too small open market operation (12.9 billion pln against 13,5-14 billion expected), and nothing more. Hence, the demand was 30% higher and cost of carry dropped immediately after the results, getting lower and lower every other day. Last day of the reserve was at levels negligibly higher then 4.5%, which is the deposit rate of the central bank.

Lower then expected retail sales (14.2 vs 16% expected) triggered another bullish wave. Rates dropped another 10-15 bps, and no hikes discounted anymore. It was nice opportunity to buy, and take profit after the MPC statement. Rates were left unchanged, but tightening bias sustained. Therefore, we again have one more hike built in the curve. Tomorrow's CPI forecast by MinFin will be crucial for further movement.

**RECOMMENDATION:**

Buy 9m and 1Y polonia at current levels.

**FIXED INCOME & MONEY MARKET CHARTS**



## Foreign Exchange

*Zloty stronger*

This week EUR/PLN fell from 3.2565 to 3.2022 approaching the support at 3.2000. USD/PLN oscillated between 2.0274-2.0775. The Polish MPC left the reference rate unchanged at 6.00% in line with market expectations. The breakthrough of 3.2 level and further zloty appreciation is anticipated in forthcoming days.

*Volatility curve lower*

EUR/PLN volatility curve has flattened with 1M at 6.70 and 1Y at 6.35 against 7.00 and 6.40 previous Thursday. USD/PLN volatility curve has declined as well, 1M dropped from 11.80 to 11.25 while 1Y from 12.30 to 11.90.

**RECOMMENDATION:**

SPOT  
Main supports / resistances:  
EUR/PLN: 3.2000 / 3.2700  
USD/PLN: 2.0150 / 2.0800

*Hold long PLN*

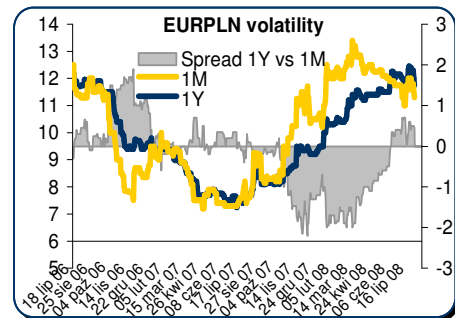
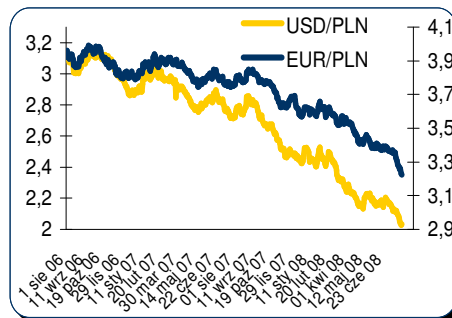
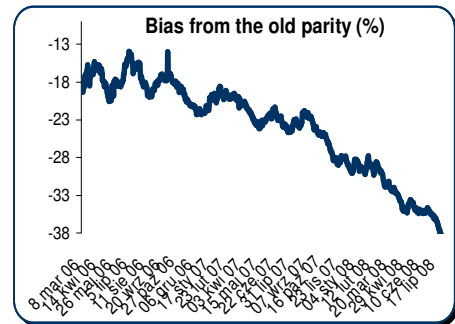
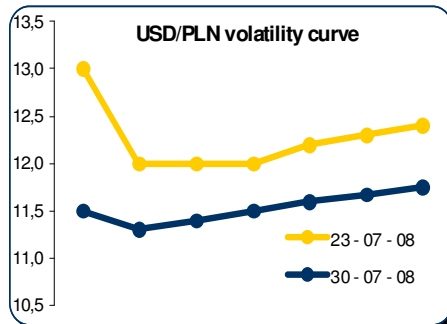
The current market outlook suggests keeping long PLN positions, leaving the stops near 3.24 with take profits at 3.15.

*Hold short vega and gamma*

OPTIONS

Keep short vega and gamma due to probable volatility decline resulting from ongoing holiday season.

**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
24-07-08	6,49%	6,49%	6,60%	6,59%	6,75%	6,75%
25-07-08	6,47%	6,49%	6,59%	6,59%	6,74%	6,74%
28-07-08	6,45%	6,47%	6,55%	6,57%	6,73%	6,73%
29-07-08	6,55%	6,47%	6,65%	6,56%	6,79%	6,72%
30-07-08	6,22%	6,46%	6,40%	6,55%	6,72%	6,71%

**FRA MARKET RATES**

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
24-07-08	6,64%	6,71%	6,71%	6,61%	6,71%
25-07-08	6,63%	6,68%	6,68%	6,57%	6,67%
28-07-08	6,63%	6,64%	6,63%	6,53%	6,63%
29-07-08	6,59%	6,57%	6,56%	6,44%	6,55%
30-07-08	6,58%	6,62%	6,61%	6,49%	6,60%

**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
24-07-08	6,75%	5,08%	5,57%	5,29%	5,72%	5,69%	5,73%	5,76%
25-07-08	6,74%	5,05%	5,57%	5,29%	5,71%	5,68%	5,72%	5,76%
28-07-08	6,73%	5,05%	5,57%	5,34%	5,71%	5,67%	5,71%	5,76%
29-07-08	6,72%	5,05%	5,56%	5,30%	5,71%	5,65%	5,72%	5,75%
30-07-08	6,71%	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	08-07-14	09-07-14	93,596	6,77%	1200	3253	1298
OK0710	08-07-02	10-07-25	87,143	6,92%	1000	2250	1000
PS0413	08-04-07	13-04-25	96,211	6,16%	1800	3129	1800
DS1017	08-07-09	17-10-25	91,480	6,50%	700	2461	705

**FX VOLATILITY**

date	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
	1M	3M	6M	1Y	1M	1Y	1M	1Y
24-07-08	11,80	12,00	12,10	12,30	0,65	0,75	0,30	0,35
25-07-08	11,80	12,00	12,10	12,30	0,65	0,75	0,30	0,35
28-07-08	11,80	12,00	12,10	12,30	0,65	0,75	0,30	0,35
29-07-08	11,50	11,70	11,85	12,00	0,65	0,75	0,30	0,35
30-07-08	11,30	11,50	11,60	11,75	0,65	0,75	0,30	0,35

**PLN SPOT PERFORMANCE**

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
24-07-08	2,0710	3,2690	-37,63%
25-07-08	2,0529	3,2564	-37,98%
28-07-08	2,0405	3,2602	-38,08%
29-07-08	2,0276	3,2301	-38,58%
30-07-08	2,0331	3,2245	-38,59%

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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