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FINANCIAL MARKETS DEPARTMENT

PAGES: 8

WARSAW, OCTOBER 30, 2008

POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

PREVIEW: The week of October 30th to November 6th

Indicator	Date of release	Period	BRE forecast	Consen-sus	Last	Comment
MinFin's inflation forecast y/y	**3 Nov**	Oct	**4.1%**	4.1-4.2%	4.5%	Food prices relatively stable, fuel prices continue to fall. Thereby we see a sizeable base effect from the last year when food and fuel prices continued to grow rapidly. Core "net:" inflation at the level from the last moth – 4.3% y/y; new core measure at 3.0%.

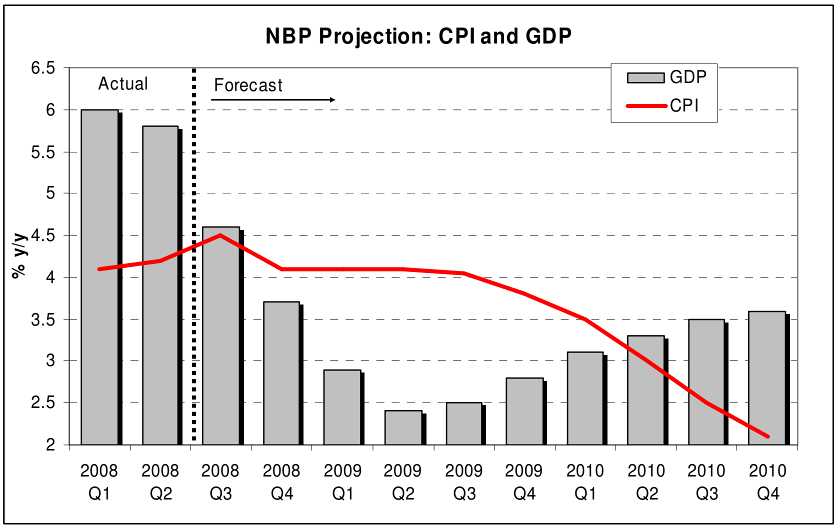
In Focus / Macroeconomics

Polish rates on hold. Watch exchange rate developments to fix the timing of monetary easing.

Polish MPC kept all its rates unchanged at the October meeting. The governor Skrzypek indicated however that during the extraordinary meetings this month (at least two of them) cutting the reserve requirements was debated.

In the statement, the MPC heavily focused on financial market turbulences and their adverse effect on economic growth. Deteriorating economic prospects have also been confirmed by the newest inflation projection released complementary to the MPC statement (see the graphs below). According to the projection, the GDP growth rate is to fall to 2.6% y/y in 2009. Surprisingly, the projected inflation path remained on elevated levels of 4.2 and 2.9% in 2009 and 2010 respectively, diverging from the trends outlined in projections released by other central banks. Inflation forecast diverges substantially from the results we presented some weeks ago in which we relied upon the IRF functions from the NECMOD model. To our content, the raw output form the model indeed resembles the path we sketched earlier – the source of divergence lies in the fine tuning undertaken by the central bank experts.

As for the projection assumptions we especially question relatively elevated inflation abroad and the trends in exogenous prices of energy and food. As for the outcomes it is surprising that factors driving core inflation remained intact, including dubious response lag of private consumption and investment – we still think that the worst is going to come already in 2009 and not in 2010, quite opposite to the NBP results. It is also doubtful that net exports rise in the whole covered horizon (it seems that strong forces impairing the ability of Polish firms to sell goods abroad have been compromised by the NBP analysts). We continue to believe that lower oil and food prices, excess of supply domestically and abroad will outweigh the impact of higher electricity prices leading inflation much below the NBP projection in the coming quarters.



Turning to main part of the communiqué, abandoning the tightening bias signaled by several MPC members prior to the meeting has found its confirmation (the passage of possible rate hikes has been dropped). The Committee also indicated that it may react to the incoming monthly data and will monitor the liquidity in the financial market.

Deteriorating economic outlook (we expect this to be highlighted by monthly data in

November and December) and falling inflation as well are to weigh on MPC member comments and consequently – on the upcoming decisions. Some members, influential Slawinski including, have already signaled door opened for cutting rates – "sooner or later the rates will mirror the economic slump". That is why we see the high likelihood of a November rate cut. ECB rate reduction (implying at the same time higher risk premium in Polish rates) and actions of other European central banks are to work in this direction. We uphold, however, our view that exchange rate developments are to be critical for the exact timing of rate cuts.

MEDIUM-TERM FORECATS

Indicator	2006	2007	2008	2009
GDP y/y (%)	6.1	6.5	5.1	3.0
Inflation rate (%, average)	1.0	2.4	4.4	2.9
Current account (% of GDP, average)	-2.1	-4.5	-4.6	-5.3
Unemployment rate (end-of-year)	14.9	11.4	9.4	9.6
NBP repo rate (end-of-year)	4.00	5.00	6.00	5.00

Indicator	2008			2009	
	Q2	Q3	Q4	Q1	Q2
GDP y/y (%)	5.8	4.8	4.0	3.5	3.5
Inflation rate (%, average)	4.3	4.7	3.8	3.5	3.3
NBP repo rate (end-of-quarter)	6.00	6.00	6.00	5.75	5.25

Bold denotes chages from the last release with arrows showing the direction of chages

Fixed Income

Madness has come to an end.

It happens once every two or three years when market creates very nice opportunity. It seems that what we've observed recently was a gift that you get once in a decade. It's quite likely that the bonds that traded above 8% these days will not reach those levels again before their maturity. The pace of the pullback, almost as fast as the weakening confirms, that such levels cannot hold for long, as there was no fundamental justification for them. So now, after panic is (hopefully) over, we can start looking at fundamentals again. And these are somehow supportive. The MPC has changed their stance towards neutral and some of the members seem to have adopted easing bias already. Weakening of the currency doesn't seem to be the issue for rate setters, definitely not the reason to even consider tightening, as some market players had been apparently expecting - actually our rates staying at current levels with ECB cutting, means widening disparity and our MPC will be somehow forced to decrease this difference. In addition we see this month's set of economic data very supportive for rates - CPI just above 4%, wages well below 10% and negative industrial output y/y. From that perspective yields should definitely be lower, much lower. So if you got one of those gifts last week - keep it, if you didn't there is still much value in the curve.

RECOMMENDATION:

Stay receive.

AUCTIONS

	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	6.560%	10/27/2008
26 Week T-bills	-	-	6.409%	9/15/2008
52 Week T-bills	11/17/2008	-	6.395%	10/20/2008
2Y T-bond OK0710	12/3/2008	-	6.471%	8/6/2008
5Y T-bond PS0413	11/5/2008	-	5.926%	10/1/2008
10Y T-bond DS1019	TBA	-	6.054%	4/9/2008
20Y T-bond WS0429	12/9/2008	-	5.992%	9/10/2008

Money Market

Extremely cheap end of reserve settlement period

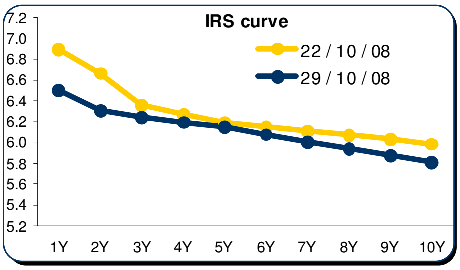
T-bill's yields up at the tender.

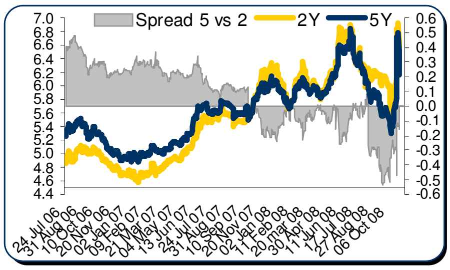
Extremely cheap end of reserve settlement period. As a result of repo operations offered week ago, there is a nice cash surplus in the system. Reserve requirement at the Central Bank is overbuilt. Short term interest rate in the interbank system are very low and almost reached deposit rate with CB. Despite the fact that the short rates are low volume of all interbank deals is small in comparison with a few months ago. Banks prefer to place money with CB rather than on the market. Tomorrows regular OMO can be a crucial to absorb nice cash surplus from the system. Also a beginning of new settlement period can increase interbank rates. On Wednesday MPC has left rates unchanged as expected. The main interest rate remains at 6.0%. The average yield on Polish the 13-week T-bill up to 6.560% from 6.257%. In total, The Ministry sold only 0.703 billion PLN of papers from 1 billion PLN offer.

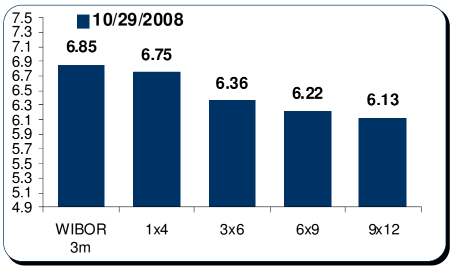
RECOMMENDATION:

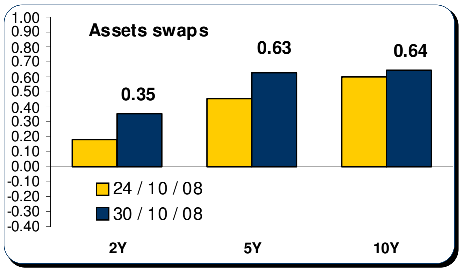
Sell 1Y OIS

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty stronger

This week zloty has improved its performance and recovered from 3.8690 as Monday's opening to 3.46 bottom. Despite of variety of actions calming down global and local risk aversion we are still facing extremely high volatility. Dollar's range was 3.13-2.61 in PLN terms.

Volatility still high

Volatility curve has been traded at new highs – EUR/PLN 1M was quoted at 40.00 and 1Y at 18.00 while week before quotations had been at 28.0 and 15.5. USD/PLN 1M moved from 35.00 to 45.00 and respectively 1Y from 22.00 to 25.00.

RECOMMENDATION:

SPOT

Main supports / resistances:
EUR/PLN: 3.4500 / 3.7500
USD/PLN: 2,6700 / 3.3900

Buy PLN

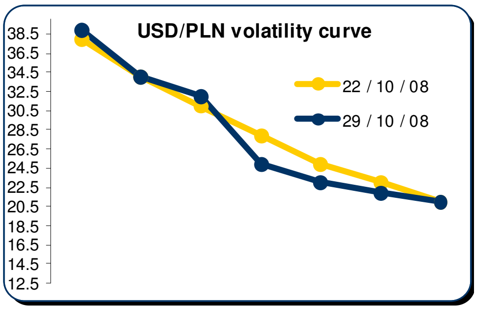
PLN market is likely to receive benefits from global sentiment's warming. We see 3.75 as good level to entry PLN longs.

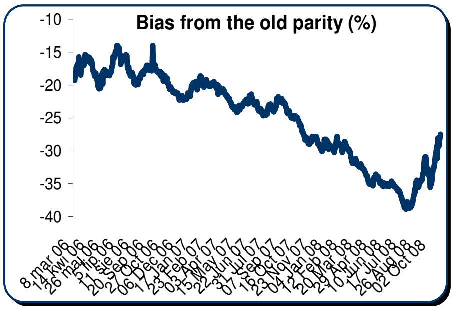
OPTIONS

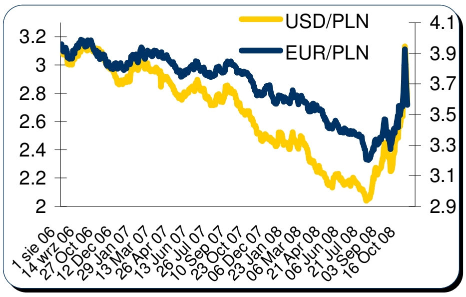
Short vega

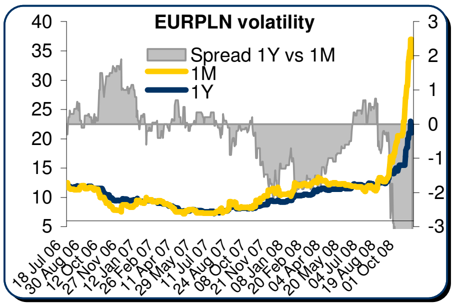
We believe in receiving some benefits from short vega especially on 6M and 1Y selling.

FX CHARTS









MARKET PRICES UPDATE

MONEY MARKET RATES

Money market rates (Closing mid-market levels)

date	3M FXSW	3M WIBOR	6M FXSW	6M WIBOR	1Y FXSW	1Y WIBOR
23/10/08	6.67%	6.85%	6.69%	6.77%	6.73%	6.81%
24/10/08	6.67%	6.87%	6.75%	6.79%	6.78%	6.82%
27/10/08	6.71%	6.86%	6.74%	6.78%	6.78%	6.82%
28/10/08	6.73%	6.85%	6.75%	6.78%	6.80%	6.83%
29/10/08	6.70%	6.86%	6.72%	6.79%	6.74%	6.82%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
23/10/08	6.85%	6.85%	6.79%	6.61%	6.69%
24/10/08	6.91%	6.77%	6.70%	6.65%	6.78%
27/10/08	6.98%	6.93%	6.83%	6.73%	6.84%
28/10/08	6.83%	6.65%	6.53%	6.40%	6.56%
29/10/08	6.75%	6.36%	6.22%	6.13%	6.23%

FIXED INCOME MARKET RATES

Fixed Income Market Rates (Closing mid-market levels)

date	1Y WIBOR	1Y TB	2Y IRS	2Y OK0709	5Y IRS	5Y PS0511	10Y IRS	10Y DS1017
23/10/08	6.81%	5.08%	5.57%	5.29%	5.72%	5.69%	5.73%	5.76%
24/10/08	6.82%	5.05%	5.57%	5.29%	5.71%	5.68%	5.72%	5.76%
27/10/08	6.82%	5.05%	5.57%	5.34%	5.71%	5.67%	5.71%	5.76%
28/10/08	6.83%	5.05%	5.56%	5.30%	5.71%	5.65%	5.72%	5.75%
29/10/08	6.82%	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	08/10/20	09/10/20	93.920	6.40%	1000	739	495
OK0710	08/08/06	10/07/25	88.390	6.47%	1800	3724	1830
PS0413	08/10/01	13/04/25	99.132	5.93%	1800	4924	1856
DS1017	08/10/08	19/10/26	97.121	5.86%	2500	4472	2500

FX VOLATILITY

date	USD/PLN 0-delta stradle 1M	3M	6M	1Y	25-delta RR 1M	25-delta RR 1Y	25-delta FLY 1M	25-delta FLY 1Y
23/10/08	35.00	30.00	26.00	21.00	5.50	5.50	0.80	0.80
24/10/08	35.00	30.00	26.00	21.00	0.00	0.00	0.00	0.00
27/10/08	37.00	31.00	26.00	23.00	0.00	0.00	0.00	0.00
28/10/08	37.00	30.00	25.00	22.00	0.00	0.00	0.00	0.00
29/10/08	34.00	25.00	23.00	21.00	0.00	0.00	0.00	0.00

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
23/10/08	2.9788	3.8212	-28.07%
24/10/08	3.1303	3.9262	-28.24%
27/10/08	3.0823	3.8275	-29.30%
28/10/08	2.9714	3.7128	-28.49%
29/10/08	2.8454	3.6320	-27.81%

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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