



## POLAND WEEKLY REVIEW

### MACROECONOMICS AND FINANCIAL MARKETS

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#### PREVIEW: The week of November 6<sup>th</sup> to November 13<sup>th</sup>

Indicator	Date of release	Period	BRE forecast	Consensus	Last	Comment
C/A	Nov 12	Sep	-1.9 bn EUR	-1.9 bn EUR	-1.7 bn EUR	Import and export dynamics lifted upwards owing to the positive working days difference. A substantial drop of current transfers balance owing to the lower inflow of EU funds in September. C/A to GDP ratio at 5.0%.
CPI Inflation y/y	Nov 13	Oct	4.1%	4.2%	4.5%	Modest rises of food prices and lower prices of fuels. Net core inflation at 4.3% y/y; new measure excluding food and energy at 3.0% y/y (to be published on November 20).

## In Focus / Macroeconomics

### Chances for November rate cut 50:50 and growing...

As far as the pure macro data releases are concerned, this week has not changed much the picture of the economy. Falling inflation and weaker supply side are still on the agenda but these factors, turning to the monetary policy prospects, are not taken for granted by all MPC members. The thaw in MPC moods is coming relatively slowly, with some unusually dovish dissenters, including swing-voter Czekaj. The growing need to confirm the inflation projection in the current data encourage MPC to monitor the real sphere even more thoroughly – in our opinion, it will be decisive for monetary policy outlook next year. In the short term, zloty stability, interest rate disparity and decisions of other central banks (CNB, SNB, BOE, ECB cut the rates this week) may prove to be crucial.

#### FinMin inflation forecast

On Monday, the Ministry of Finance issued its CPI inflation forecast. Consumer prices are set to rise by 4.2% y/y, slightly above our estimate of 4.1% y/y. The divergence may stem from a bit different perception of food prices: MinFin's estimate sets them at 0.9% m/m whereas – in our opinion – the growth was no higher than 0.7%. As for the year's end inflation, the Ministry envisages price growth at 4.0%. We are more optimistic though, with forecast range of 3.6-3.9%.

#### Polish PMI data

Just before the CPI forecast, the data on PMI survey came into the light. As we expected, the index showed another, consecutive month of decline, settling this time at 43.7 pts. There were some surprises in the composition of the index, though. Just as expected, indices for employment and new orders softened considerably. On the other hand, the current output index posed the second month of modest – but still – growth. We found a significant correlation between monthly variations of manufacturing (seasonally adjusted and calculated on annual basis) and current output PMI index. This makes us revise the forecast for industrial output in October or, at least, warn of considerable upside risk to the reading (we originally expected a 1% y/y decline). The abovementioned relationship proved itself valuable as it sent a correct signal a month ago when seasonally adjusted industrial production was indeed above the reading from the previous month.

Apart from this month's surprises, we point to outright falls of industrial output in coming months – November and December figures should include the fallout of effects connected with shrinking foreign demand and the limited availability of financing funds (such a scenario is backed by the constantly falling level of new orders component from PMI survey).

#### MPC

As usual, there were plenty of comments of the MPC members which show that, apart from the neutral stance taken during the last meeting, the consensus in the body is slowly tilting dovish. We hardly expect the most hawkish members to abruptly change their wording towards momentary easing but it is symptomatic that the talk of the timing of "monetary policy change" has gained on importance. It is also worth to note that the tendency of MPC members to confirm the projection in the incoming data rose further. Luckily, we heard some further insights from swing-voter Czekaj. He thinks the MPC should consider the behavior of other central banks. Moreover, in his opinion "the probability or even the need to relax monetary policy is becoming more and more obvious".

We think there is 50% chance of monetary easing in November. The FX situation (still high volatility) reduces the scale of the immediate easing, though. It is also the real sphere data (the data may still fail to reveal the exact depth of economic slowdown) which speaks against substantial MPC movements in the near term. We sustain our view that arguments in favor of deeper economic slowdown are going to pop up in coming months. Limited new orders have been recently backed by the tightened credit conditions, which may pose an additional restraint for the Polish economy. The probability of monetary easing till the end of the year substantially exceeds the one attached to the scenario of flat rates. Furthermore, 100 bps cumulative cut stays scheduled for the next year.

**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	4.75

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	5.75	5.25	5.00

*Bold denotes changes from the last release with arrows showing the direction of changes*

**Fixed Income**

*Last week...do you remember?*

Today (Thursday 06 November 2008) ECB, BOE, SNB, CNB all cut rates by a magnitude of at least 50 bp. Today's PLN curve is trading at the lowest point in year, touching 5.90 in the 3x6 FRA and 5.60 in 2y IRS. Two weeks ago curve was 100-150 bp higher. A month ago curve was where it is right now. We struggle hard to believe all this noise had no reason, we also struggle a lot to find the reason. Within month market was betting equally for cuts and hikes and cuts again. We would like to write a little bit about economy, or a little bit about market, positioning, our view, but we have none. Best we can advice is to take the profit from the last 2 weeks gift. Maybe rates need to be 100 bp lower, maybe they will be there in 2 weeks time, but on the other had maybe they will be 100 bp higher. Toss a coin. With insignificant exposure we now appreciate the luxury of no risk. Market will create opportunity sooner or later. After all there has to be reason...

**RECOMMENDATION:**

Close all receive positions

**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	2/6/2008	-	5.926%	10/1/2008
10Y T-bond DS1019	2/13/2008	-	6.054%	4/9/2008
20Y T-bond WS0429	12/9/2008	-	5.992%	9/10/2008

**Money Market**

*Cheap carry on and on*

*Another massive rates cuts in Europe*

*Polish MPC unpredictable at the moment*

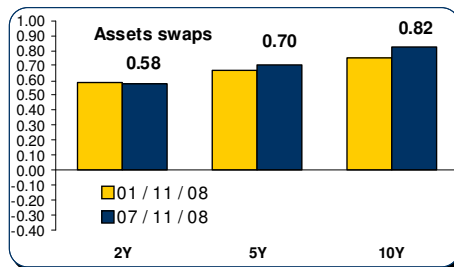
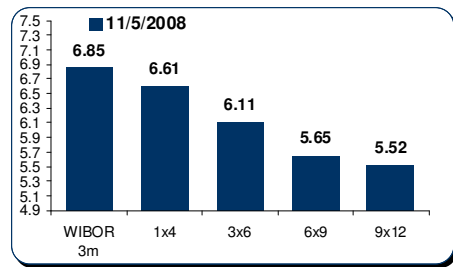
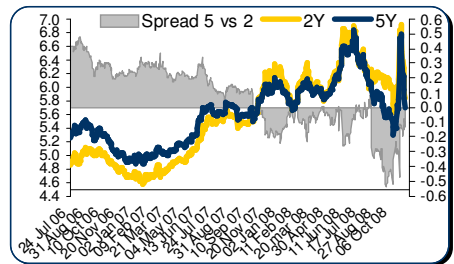
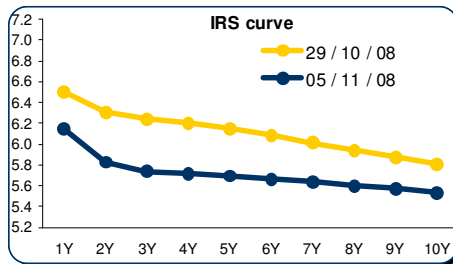
Very cheap end of the reserve plus very cheap beginning of the new one. Another repo auction supporting the system in the cash let the cash surplus grow to 9 billion pln. No lending to the central bank on 'just in case' basis gives us similar perspective for the carry as we could observe in October. So it seems that cheap carry will stay with us for a while.

Another massive rates cuts (CNB,SNB,BOE,ECB) triggered another bullish wave for pln derivatives rates. The cut play is for the November meeting and few more highly concentrated in time. Thing is that now one can not easily separate rates cuts from liquidity premium, hence different scenarios may result in the same curve shape. Moreover, for OIS market it is hard to separate rates cut from cheap carry discounting. To sum up there hardly is any market now, spreads had widened, the MPC decision is unpredictable considering the latest comments from the MPC members.

**RECOMMENDATION:**

Stay neutral if you can.

**FIXED INCOME & MONEY MARKET CHARTS**



**Foreign Exchange**

This week zloty opened around 3.50 levels and weakened from 3.4800 low toward 3.6300 resistance pulled by growing risk aversion. Reason was wave of rate cuts across the Europe.

Zloty slightly weaker

Volatility curve has been traded slightly lower – EUR/PLN 1M was quoted at 30.00 and 1Y at 15.00 while week before quotations had been at 40.0 and 18.0. USD/PLN 1M was traded at 45.00 and 1Y at 25.00.

Volatility slightly lower

**RECOMMENDATION:**

SPOT

Main supports / resistances:  
 EUR/PLN: 3.4500 / 3.7500  
 USD/PLN: 2,5000 / 3.1000

Buy PLN

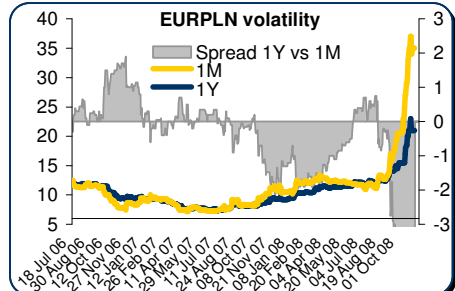
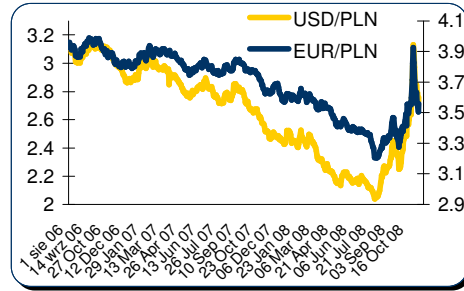
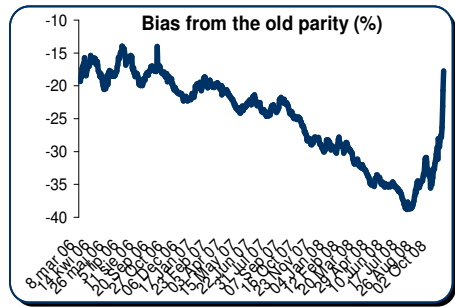
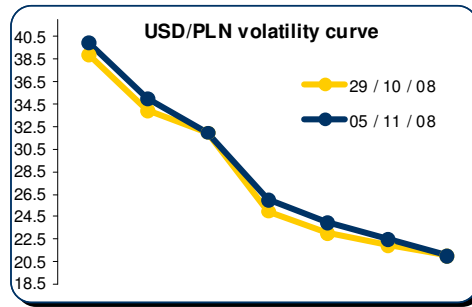
We suggest buying EURPLN on dips up to 3.65, while 3.75 is good level to entry PLN long.

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		6M		1Y	
	FXSW	WIBOR	FXSW	WIBOR	FXSW	WIBOR
30/10/08	6.73%	6.86%	6.76%	6.78%	6.78%	6.81%
31/10/08	6.72%	6.85%	6.75%	6.78%	6.79%	6.81%
03/11/08	6.74%	6.84%	6.78%	6.77%	6.81%	6.80%
04/11/08	6.65%	6.85%	6.67%	6.76%	6.69%	6.80%
05/11/08	6.70%	6.84%	6.72%	6.76%	6.75%	6.79%

**FRA MARKET RATES**

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
30/10/08	6.81%	6.41%	6.25%	6.03%	6.15%
31/10/08	6.79%	6.36%	6.17%	5.98%	6.14%
03/11/08	6.71%	6.23%	5.98%	5.78%	5.92%
04/11/08	6.61%	6.18%	5.83%	5.63%	5.77%
05/11/08	6.61%	6.11%	5.65%	5.52%	5.61%

**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
30/10/08	6.81%	5.08%	5.57%	5.29%	5.72%	5.69%	5.73%	5.76%
31/10/08	6.81%	5.05%	5.57%	5.29%	5.71%	5.68%	5.72%	5.76%
03/11/08	6.80%	5.05%	5.57%	5.34%	5.71%	5.67%	5.71%	5.76%
04/11/08	6.80%	5.05%	5.56%	5.30%	5.71%	5.65%	5.72%	5.75%
05/11/08	6.79%	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				25-delta RR		25-delta FLY	
	1M	3M	6M	1Y	1M	1Y	1M	1Y
30/10/08	35.00	26.00	24.00	21.00	7.00	6.50	0.80	0.80
31/10/08	35.00	26.00	24.00	21.00	7.00	6.50	0.80	0.80
03/11/08	35.00	26.00	24.00	21.00	7.00	6.50	0.80	0.80
04/11/08	35.00	26.00	24.00	21.00	7.00	6.50	0.80	0.80
05/11/08	35.00	26.00	24.00	21.00	7.00	6.50	0.80	0.80

**PLN SPOT PERFORMANCE**

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
30/10/08	2.7300	3.5634	-27.50%
31/10/08	2.8472	3.6330	-27.84%
03/11/08	2.7703	3.5565	-26.34%
04/11/08	2.7946	3.5498	-23.11%
05/11/08	2.7306	3.5046	-20.72%

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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