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FINANCIAL MARKETS DEPARTMENT

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POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

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PREVIEW: The week of December 5th to December 11th

Indicator	Date of release	Period	BRE forecast	Consensus	Last	Comment
No significant releases						

In Focus / Macroeconomics

Polish government announces fiscal package, slashes GDP growth forecasts but sticks to the earlier 2009 deficit figure

At the weekend, Polish PM Tusk announced a government rescue package estimated at total of 91.3 PLN bn. One should not, however, see the program as having a lot in common with the typical fiscal stimuli packages which are gaining on popularity in other economies. Polish rescue package includes:

- state guarantees for corporate credits (up to 40 PLN bn),
- extra loans for S&M enterprises (up to 20 PLN bn) to be granted by the state owned BGK bank,
- acceleration of EU founds absorption (16.8 PLN bn),
- stimulation of private consumption by sustaining the already agreed personal income tax rate cuts (8 PLN bn),
- extending the period of energy market regulation (Polish energy sector watchdog will limit the uncontrolled energy tariffs increases and its adverse impact on the industry's competitiveness),
- temporary tax incentives for new investments,
- launching the "solidarity reserve" to be financed with higher excise taxes.

Along with the announcement of a fiscal package the government, in line with market expectations, revised the 2009 budget assumptions. It lowered the GDP forecast from 4.8 to 3.7% for 2009 and revised downwards both the budget revenues and spending by 1.7 PLN bn which allowed the previously set 18.2 PLN bn budget deficit to be sustained. Such a minor revision of budget revenues is conditional to doubtful assumptions of continuously strong private consumption, though.

Although the government seems to have correctly detected the main problems concerning the functioning of the lending channel (see state guaranties and credits for S&M enterprises as well as the acceleration of implementing EU co-founded investments) the package is unlikely to kick-start the economy. We would rather be looking for a first signs of recovery as late as at the end of 2009 with economy tumbling in the first quarters of 2009. Such a scenario is even more likely as the most recent GDP release clearly pointed to an abrupt slump of investment demand (fixed capital formation growth slowed from 15.6 to a mere 3.5% y/y while private consumption rose at a solid rate of 5.1% y/y in the third quarter).

It is the landmark of the Polish fiscal package that it has almost nothing in common with fiscal stimuli announced in other economies (it does not cause the deficit to increase!?). Strikingly, the package even offers some aspects of fiscal tightening (see higher excise tax rates). Furthermore, the 91 PLN bn number has been artificially inflated by including the means already agreed on in the draft version of the 2009 budget (EU co-funded spending, PIT rate cuts among others). One should note that the government could not afford extending the deficit at the moment. Taking into account the founding needs and roll-overs (above 110 PLN bn in total in 2009) as well as continuously high risk aversion on the debt market even very limited fiscal expansion could result in an abrupt market reaction.

As we expect the GDP growth to slow to below 2% y/y next year, the budget revenues may in fact undershoot by 7-12 PLN bn making the government amend the budget again during the fiscal year. Such an approach (foreign investors in particular are very likely see through the FinMin's strategy) may result in another (probably temporary) Polish bond sell-off at the beginning of 2009. We see the combination of negative budget news, tumbling economy and more volatile/weaker zloty in the first quarter of 2009 as uniformly working towards such a scenario.

Inflation falling, rates to follow soon

On Monday, the Ministry of Finance announced its inflation forecast which places the price growth at 3.8% y/y (after 4.2% announced by the statistical office last month). Although inflation is falling, the pace of decline is slower than the one recorded in euro zone – it puts a question mark on meeting the Maastricht criteria. We think inflation criterion will be temporarily violated in coming months, however, this will hardly bother the MPC which is focusing more and more on the real sphere of the economy.

The forecast of the Ministry does not differ much from our assessment (almost identical breakdown suggests much may rely upon rounding – we place CPI growth at 3.9%) and shows inflationary pressures are slowly receding – core inflation excluding food and energy is likely to remain on the last month's level and it is only a matter of time when we see outright falls. The headline figure (and also the net core inflation excluding food and fuels) still suffers from the ongoing deregulation of the energy market. The future situation on this field has abruptly changed in recent days though, allowing clear downward trend of inflation to continue unaffected. Polish watchdog announced it is not going to let energy increase more than 4-5% in coming year (there is a possibility that price ceilings for enterprises will be revived as well). The scale of price increases practically wipes out a scenario of another local peak of inflation at the beginning of 2009 (it is worth to mention that not so long ago the estimates of some MPC members were placing inflation at a range from 4.0 to even 4.8% y/y then). It is then mainly the phase of the business cycle (Poland lags the euro zone by 2-3 quarters) and the fallout of recent deregulation which speaks in favor of a scenario in which the Maastricht criterion may be temporarily violated (indeed, last month it was).

The violation does not seem to be a problem for now, as the MPC focuses on mid-term horizon (which was explicitly voiced in the last statement), characterized by falling inflation and meager economic growth. What is more, the consensus in the MPC is slowly drifting towards faster monetary easing, designed to help the ailing economy (recent PMI reading confirmed that the growth forecast for 2009 is put under asymmetric risk; we still expect no more than 1.8% y/y). M. Pietrewicz, the most dovish MPC member recently urged for faster rate decreases and placed the lower bound for the rates in 2009 at 4.0%, making it a benchmark case for the other rate-setters.

We expect December data (sharply falling industrial output, softer retail sales and wage growth) to be poor enough to warrant another (25 bps. or even 50 bps) cut in December. From then on, expectations on more decisive steps (50 bp. or oven more) may gain on strength. When we look at the shape of the FRA curve it seems the market still underestimates the risk of massive rate cuts at the turn of the year.

MEDIUM-TERM FORECATS

Indicator	2006	2007	2008	2009
GDP y/y (%)	6,1	6,5	5,2	1,8
Inflation rate (%, average)	1,0	2,4	4,3	3,3
Current account (% of GDP, average)	-2,1	-4,5	-4,6	-5,7
Unemployment rate (end-of-year)	14,9	11,4	9,4	11,2
NBP repo rate (end-of-year)	4,00	5,00	5,50	4,25

Indicator	2008			2009	
	Q2	Q3	Q4	Q1	Q2
GDP y/y (%)	5,8	4.7	**3,5**	**2,1**	**1,6**
Inflation rate (%, average)	4,3	4.7	3,8	3,5	3,3
NBP repo rate (end-of-quarter)	6,00	6,00	5,50	5,00	4,50

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

Fixed Income

Rally continues

Rally on the market continued this week and yields have been reaching new lows every day. At the moment curve prices in policy easing to some 3.50% by mid 2009 and stabilization at those levels. Not that we don't agree with such scenario - it is possible, however it's quite difficult to expect we could see rates going much lower than that. Therefore we see further strengthening potential is quite limited. The very front end of the curve seems to have greatest value, as rate cuts should be concentrated in this sector. So we still like the 3x6/6x9 spread at current levels, but we decided to close the 1y/10y steepener and concentrate risk in the shorter maturities - recent widening of the 5y5y forward spread can result in pressure for lower rates in the long end of the curve. We also think that bonds at present ASW levels are very attractive, especially that WIBOR rates don't necessary have to follow potential main rate movements immediately.

RECOMMENDATION: Add to 3x6/6x9 spread at current levels.

AUCTIONS

	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	6.268%	12/1/2008
26 Week T-bills	-	-	6.391%	12/1/2008
52 Week T-bills	-	-	6.398%	12/1/2008
2Y T-bond OK0710	12/10/2008	-	6.471%	8/6/2008
5Y T-bond PS0413	2/6/2009	-	5.926%	10/1/2008
10Y T-bond DS1019	2/13/2009	-	6.054%	4/9/2008
20Y T-bond WS0429	12/9/2008	-	5.992%	9/10/2008

Money Market

Cheap carry is here

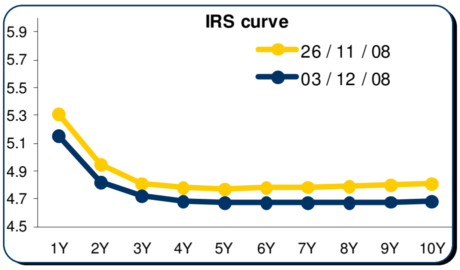
Very cheap end of the reserve was not a surprise to anyone. Moreover, relatively cheap beginning of the new one was also easy to predict, since over 5 billion pln of excess cash could not vanish before the next regular OMO. December is a very specific month (Christmax plus the end of the year), and historically cash was very cheap, so probably this time the scenario will be quite similar as well.

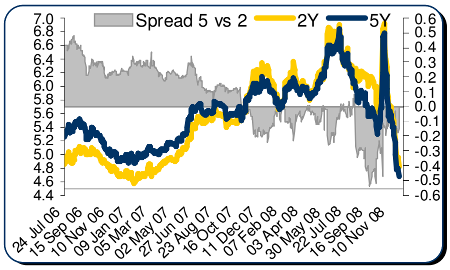
More aggressive rates cut expected

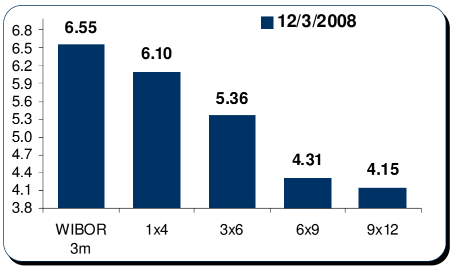
For longer terms still illiquid market with wide spreads and no will / possibility to change it. However, rates are going down discounting faster or / and deeper rates cuts. The CPI projection made by the MinFin was just in line with expectations at 3.8%.

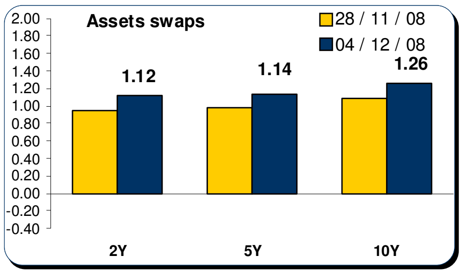
RECOMMENDATION: Sell 3M polonia OIS

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty weaker

This week zloty found low at 3.7900 and was traded on weaker side reflecting worsening of global sentiment. So far this week high was at 3.9050.

Volatility stable

As rate of weakening retarded, we have observed no further vols climbing. Levels are 29.0 for 1M and 18.5 for 1Y.

RECOMMENDATION:

SPOT

Main supports / resistances:
EUR/PLN: 3.6500 / 4.0000
USD/PLN: 2.8000 / 3.1500

Buy on dips

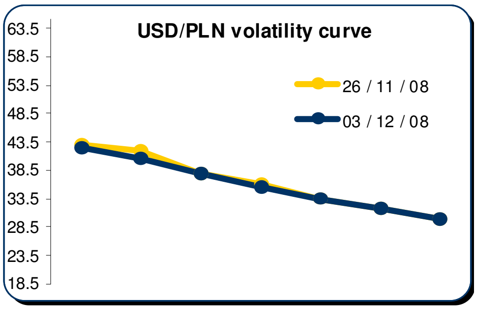
Crisis lasts. We suggest buying EURPLN on dips with 4.00 targets. We also see 3.65 as possible on long currency positions sell-off in case of sentiment improvement.

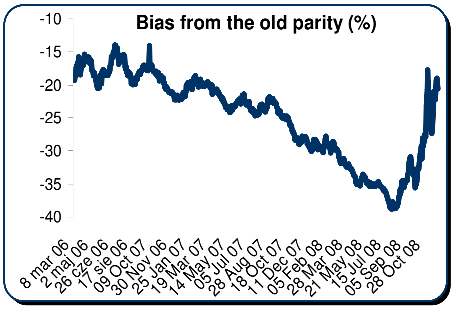
OPTIONS

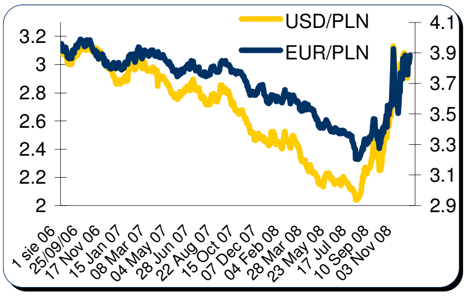
Short gamma/vega

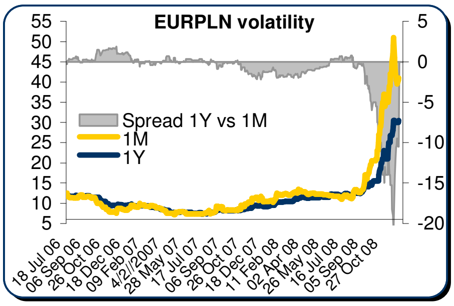
We believe in receiving some benefits from short gamma and vega. Both priced in bad enough scenario.

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
27/11/08	6.49%	6.56%	6.59%	6.49%	6.60%	6.59%
28/11/08	6.46%	6.56%	6.54%	6.54%	6.56%	6.56%
01/12/08	6.44%	6.55%	6.53%	6.53%	6.53%	6.54%
02/12/08	6.46%	6.54%	6.54%	6.52%	6.56%	6.54%
03/12/08	6.42%	6.55%	6.50%	6.52%	6.51%	6.54%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
27/11/08	6.14%	5.45%	4.33%	4.23%	4.50%
28/11/08	6.13%	5.42%	4.30%	4.12%	4.46%
01/12/08	6.12%	5.44%	4.28%	4.15%	4.47%
02/12/08	6.08%	5.38%	4.33%	4.15%	4.40%
03/12/08	6.10%	5.36%	4.31%	4.15%	4.43%

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
27/11/08	6.59%	5.08%	5.57%	5.29%	5.72%	5.69%	5.73%	5.76%
28/11/08	6.56%	5.05%	5.57%	5.29%	5.71%	5.68%	5.72%	5.76%
01/12/08	6.54%	5.05%	5.57%	5.34%	5.71%	5.67%	5.71%	5.76%
02/12/08	6.54%	5.05%	5.56%	5.30%	5.71%	5.65%	5.72%	5.75%
03/12/08	6.54%	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	08/12/01	09/12/01	93.924	6.40%	1800	4743	1806
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

	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
date	1M	3M	6M	1Y	1M	1Y	1M	1Y
27/11/08	40.50	35.50	33.50	30.00	8.50	8.50	1.40	1.40
28/11/08	40.50	35.50	33.50	30.00	8.50	8.50	1.40	1.40
01/12/08	39.50	35.00	33.00	30.00	8.50	8.50	1.40	1.40
02/12/08	40.00	36.00	33.50	30.00	8.50	8.50	1.40	1.40
03/12/08	40.50	35.50	33.50	30.00	8.50	8.50	1.40	1.40

PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
27/11/08	2.9047	3.7578	-22.12%
28/11/08	2.9196	3.7572	-22.24%
01/12/08	3.0338	3.8432	-19.23%
02/12/08	3.0394	3.8340	-19.63%
03/12/08	3.0468	3.8457	-19.03%

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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