



## POLAND WEEKLY REVIEW

### MACROECONOMICS AND FINANCIAL MARKETS

<b>IN FOCUS / MACROECONOMICS</b>	<ul style="list-style-type: none"> <li>Inflation within the MPC target, upcoming data to show the economy experiences strong headwinds</li> </ul>	• page 2
<b>FIXED INCOME</b>	<ul style="list-style-type: none"> <li>New year. New hope.</li> </ul>	• page 3
<b>FI RECOMMENDATION</b>	<ul style="list-style-type: none"> <li>Hold short ASW bonds</li> </ul>	
<b>MONEY MARKET</b>	<ul style="list-style-type: none"> <li>Cheap beginning of the year</li> <li>150 bps of fast cuts already in the curve</li> </ul>	• pages 3-4
<b>MM RECOMMENDATION</b>	<ul style="list-style-type: none"> <li>Sell 2,3M polonia on local tops.</li> </ul>	
<b>FOREIGN EXCHANGE</b>	<ul style="list-style-type: none"> <li>Zloty stronger</li> <li>Volatility lower</li> </ul>	• pages 4-5
<b>FX RECOMMENDATION</b>	<ul style="list-style-type: none"> <li>Sell optics</li> <li>Short vega</li> </ul>	
<b>MARKET PRICES CONTACT LIST DISCLAIMER</b>		<ul style="list-style-type: none"> <li>• page 6</li> <li>• page 7</li> <li>• page 8</li> </ul>

#### PREVIEW: The week of January 9<sup>th</sup> to January 15<sup>th</sup>

Indicator	Date of release	Pe-riod	BRE forecast	Consen-sus	Last	Comment
M3 Supply y/y	Jan 14	Dec	16.9%	17.8%	18.1%	Softer M3 dynamics stemming from statistical base effects and stagnation of corporate deposits. Lower outflow from investment funds.
CPI Inflation y/y	Jan 14	Dec	3.3%	3.3%	3.7%	Food prices moving along seasonal patterns; considerable, 10% drop of fuel prices. Core inflation excluding food and energy at 2.8%, down from 2.9% in November (scheduled for release Jan 21).

## In Focus / Macroeconomics

### Inflation within the MPC target, upcoming data to show the economy faces strong headwinds

The MinFin's inflation forecast printed 3.4% y/y, a touch above our forecast and market consensus (both 3.3%). The breakdown released some days after the publication reveals the Ministry's pessimism regarding fuel prices and recreation and culture (on this field we see strong potential for lower reading, hence the divergence from our forecast). This way inflation has finally come back to the targeted MPC range.

As for the real sphere, fresh PMI reading confirmed the trends pointed earlier by other business tendency indicators. The headline figure dropped in December to 38.3 pts from earlier recorded 40.5 pts with current production ailing to 36.3 pts from 40.2 a month ago. We feel quite comfortable with this level of purchasing manager index as our real sphere forecasts are far from being optimistic. With the lack of other macroeconomic data we decided to elaborate more on our forecasts for the coming month. There is another meaningful rationale for this – the dynamics of contemporary economic processes shifts attention of the MPC members towards high frequency data.

Industrial output (to be released Jan 20) may diverge substantially downwards from the market consensus (-0.7% y/y). First of all, business activity indices are horrible (PMI including). Secondly, one should carefully count the number of working days – simple arithmetic shows 2 more working days on annual basis. However, there is strong anecdotal evidence suggesting some of manufacturing entities were actually shut down for the Christmas break and onwards as order books were (and, in fact, still remain) practically wiped out (the process is most severe in case of automotive and steel industry). That is why we put our IO forecast at -5.8% y/y.

Lower activity of the supply side connects logically to softer growth of wages. We assess its dynamics at 5.7%, down from 7.4% recorded last month. The ongoing slowdown eats through employment as well. Our forecast at 2.6% y/y is lower than market consensus (2.7%) and the November reading (3.1%). The Ministry of Labour has recently given the flavor of the dynamics of the labor market deterioration: according the fresh estimates we are likely to see the unemployment rate to top 9.5% in December (after 9.1% in November) with the number of vacancies falling by 25% m/m. Quite important for the MPC (but heavily disturbed by seasonal patterns) will be retail sales data. Deterioration of business tendency indicators and the possible (but still relatively slow) build-up of savings rate are likely to partially offset the positive working-days effect – we expect the retail sales dynamics to stay close the November's one at 2.5% y/y (market consensus 6.1%).

As for the other data, we may see a slight improvement of C/A balance from -2.1 bn EUR to -1.9 bn EUR (close to market consensus). Underlying factors include seasonal rise in transfers and income account accompanied by severely damped export and imports dynamics (16.5% y/y and 12.4% y/y accordingly). The signs of softening business activity (and deteriorated financial standing of companies) may be also looked up in the M3 supply data. Lower growth of broad M3 base (16.9% vs market consensus at 17.8%) owes much to statistical base effects and stagnation of corporate deposits.

As usual in the first part of the month we heard a lot from central bankers (Filar, Noga, Sławiński, Wasilewska-Trenkner and Pietrewicz). The speeches suggest the frozen core in the MPC has somehow melted – virtually only Wasilewska-Trenkner opposes fast rate hikes suggesting to confront current data with the upcoming inflation projection. The other extreme is presented by Pietrewicz who thinks the MPC should take decisive steps (including 75bp cut) to counteract economic slowdown (he revised his GDP forecast downwards to 1.0% in 2009). Apparently, he is also the one explicitly suggesting the MPC focus has shifted towards short-term data inflow.

The bottom line is that the December's set of data is going to show the disinflationary processes are on the run what enables the MPC to continue monetary easing aggressively. Along with the publication of the real sphere data the MPC consensus is likely to slowly drift towards 75bp cut.

<b>MEDIUM-TERM FORECATS</b>	<b>Indicator</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>
	GDP y/y (%)	6.1	6.5	5.0	<1.5
Inflation rate (% , average)	1.0	2.4	4.3	2.9	
Current account (% of GDP, average)	-2.1	-4.5	-5.3	-5.7	
Unemployment rate (end-of-year)	14.9	11.4	9.5	12.2	
NBP repo rate (end-of-year)	4.00	5.00	5.50	3.00	

<b>Indicator</b>	<b>2008</b>			<b>2009</b>	
	<b>Q2</b>	<b>Q3</b>	<b>Q4</b>	<b>Q1</b>	<b>Q2</b>
GDP y/y (%)	5.8	4.7	3.0	1.5	1.0
Inflation rate (% , average)	4.3	4.7	3.8	3.2	2.8
NBP repo rate (end-of-quarter)	6.00	6.00	5.00	3.75	3.25

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

## Fixed Income

*New Year, new hope.*

Last week was rather volatile on the IR market. Looks like holiday break and start of New Year put some more energy into players. Activity is fairly good and liquidity is much better compared to any period in last quarter of 2008, but we fear it may be very temporary, as players still refuse to make market direct. Overall rates went down some 40 bp, then come back 15-20 bp. The main theme of the week was steepening of the curve with 5y10y leading the way. Front end of the curve remained well offered as Wibors are still slowly marching down. Next week we will start the series of data which will confirm easing trend on Polish rates, we expect CPI to print lower than expected, but current valuations seem to us a bit overdone. We are neutral position wise, we don't see value in receiving rates over here. We like holding short bonds in ASW.

**RECOMMENDATION:**

Hold short ASW bonds

## AUCTIONS

	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	6.142%	12/9/2008
26 Week T-bills	-	-	6.197%	12/9/2008
52 Week T-bills	1/12/2009	-	6.211%	12/9/2008
2Y T-bond OK0711	2/4/2009	-	5.054%	1/7/2009
5Y T-bond PS0413	2/4/2009	-	5.616%	12/17/2008
10Y T-bond DS1019	2/11/2009	-	5.724%	12/17/2008
20Y T-bond WS0429	1/14/2009	-	5.992%	9/10/2008

## Money Market

*Cheap beginning of the year*

*150 bps of fast cuts already in the curve*

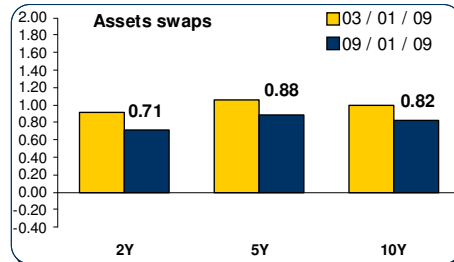
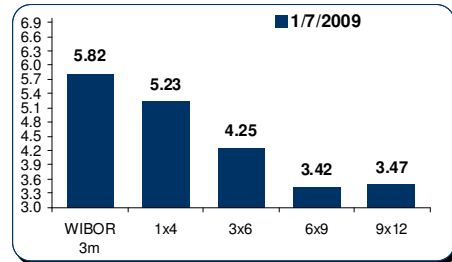
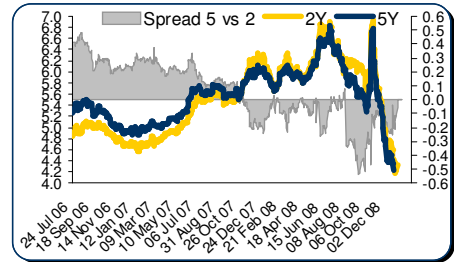
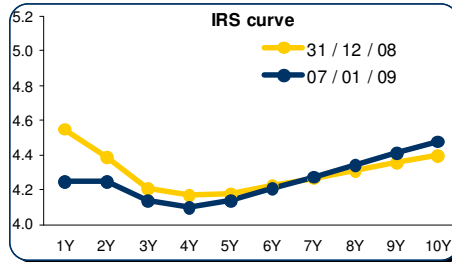
We started the New Year with a substantial cash surplus in the system (around 10 billion pln), hence the reserve has already been nicely overbuilt and shortest rates started to drop nearby the deposit rate in the central bank. Although there is an open market operation tomorrow, we think that the cash surplus will persist.

As for longer terms some warm-up has been made and 3 cuts in the row, 50 bps each are already in the ois curve. Cash market is much higher due to large liquidity premium. This may get back to normal the sooner the faster rates will drop.

**RECOMMENDATION:**

Sell 2,3M polonia on local tops.

**FIXED INCOME & MONEY MARKET CHARTS**



**Foreign Exchange**

*Zloty stronger*

This week zloty opened at 4.1400 and strengthened toward 3.8850. New year's liquidity improvement and risk appetite growth were reasons behind it.

*Volatility lower*

This year's implied volatilities seems to be spot sensitive, so with higher vols supply coming with lower spots we have seen 1Y traded at 18.1 (end of last year high 22.5) and 1M at 27 (realized volatility still at high levels)

**RECOMMENDATION:**

SPOT

*Sell upticks*

Main supports / resistances:  
 EUR/PLN: 3.8500 / 4.2000  
 USD/PLN: 2.7000 / 3.1500

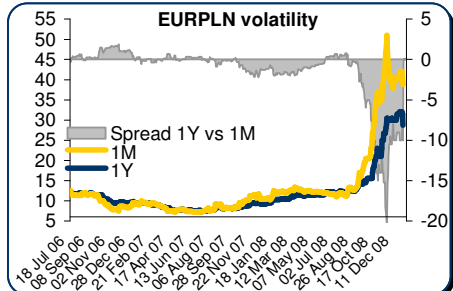
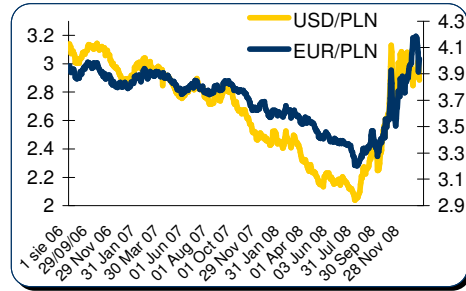
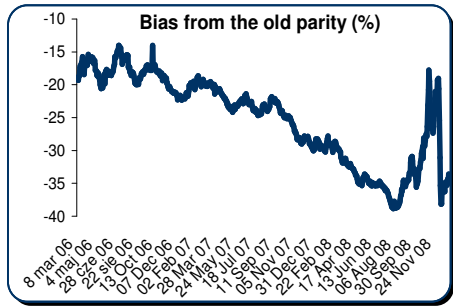
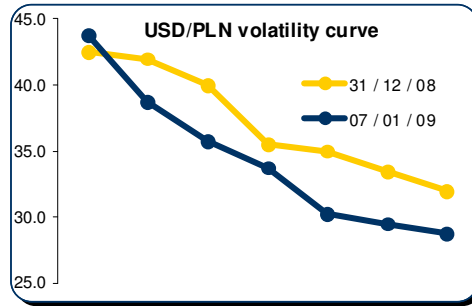
*Short vega*

This year has started with decent demand for PLN, although in medium term we see some risk for zloty weakening, we suggest selling on upticks at 4.08/4.12 with S/L 4.22 and P/T at 3.85.

OPTIONS

We believe in receiving some benefits from selling vega, especially 6M-1Y tenors.

**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
31/12/08	5.70%	5.88%	5.88%	6.49%	5.80%	6.59%
02/01/09	5.70%	5.84%	5.80%	5.84%	5.80%	5.84%
05/01/09	5.72%	5.84%	5.81%	5.82%	5.81%	5.85%
06/01/09	5.85%	5.82%	5.90%	5.81%	5.80%	5.83%
07/01/09	5.79%	5.81%	5.84%	5.76%	5.90%	5.82%

**FRA MARKET RATES**

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
31/12/08	5.43%	4.54%	3.52%	3.51%	3.62%
02/01/09	5.43%	4.54%	3.52%	3.51%	3.62%
05/01/09	5.23%	4.18%	3.34%	3.36%	3.40%
06/01/09	5.23%	4.22%	3.35%	3.33%	3.44%
07/01/09	5.23%	4.25%	3.42%	3.47%	3.47%

**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
31/12/08	6.59%	5.08%	5.57%	5.29%	5.72%	5.69%	5.73%	5.76%
02/01/09	5.84%	5.05%	5.57%	5.29%	5.71%	5.68%	5.72%	5.76%
05/01/09	5.85%	5.05%	5.57%	5.34%	5.71%	5.67%	5.71%	5.76%
06/01/09	5.83%	5.05%	5.56%	5.30%	5.71%	5.65%	5.72%	5.75%
07/01/09	5.82%	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	08/12/09	09/12/09	94.091	6.21%	1800	6800	1910
OK0711	09/01/07	11/07/25	88.230	5.05%	3500	10494	3596
PS0413	08/12/17	19/10/25	100.558	5.62%	2500	3578	1742
DS1017	08/12/17	19/10/25	98.186	5.72%	4500	3521	2340

**FX VOLATILITY**

date	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
	1M	3M	6M	1Y	1M	1Y	1M	1Y
31/12/08	42.00	35.50	35.00	32.00	8.50	8.50	1.40	1.40
02/01/09	42.00	35.50	35.00	32.00	8.00	8.00	1.40	1.40
05/01/09	42.00	35.50	35.00	32.00	8.00	8.00	1.40	1.40
06/01/09	39.50	35.50	33.00	31.50	8.00	8.00	1.40	1.40
07/01/09	38.75	33.75	30.25	28.75	8.00	8.00	1.40	1.40

**PLN SPOT PERFORMANCE**

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
31/12/08	2.9618	4.1721	-34.31%
02/01/09	2.9910	4.1137	-34.34%
05/01/09	3.0088	4.0613	-33.56%
06/01/09	3.0214	3.9170	-33.88%
07/01/09	2.8844	4.0159	-34.02%

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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