



## POLAND WEEKLY REVIEW

### MACROECONOMICS AND FINANCIAL MARKETS

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- Play range/stay away
- Short vega

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### PREVIEW: The week of January 16<sup>th</sup> to January 22<sup>nd</sup>

Indicator	Date of release	Pe-riod	BRE forecast	Consensus	Last	Comment
Employment y/y	Jan 19	Dec	2.6%	2.7%	3.1%	Anecdotal evidence on group lay-offs. Employment falling on monthly basis; further deterioration of business indicators.
Wages y/y	Jan 19	Dec	5.7%	7.4%	7.8%	Bonuses in mining paid mainly in November. Falling business activity speaks for further deceleration of wages.
Industrial output y/y	Jan 20	Dec	-5.8%	-0.7%	-8.9%	2 working days more on annual basis. Empty order books caused some enterprises to shut down completely in Christmas period (anecdotal evidence). Further deterioration of business tendency indicators on current output and new orders.
PPI y/y	Jan 20	Dec	1.8%	2.0%	2.2%	Falling prices of main commodities and faltering business activity to offset PLN depreciation versus majors.
Core inflation y/y	Jan 21	Dec	2.8%	2.8%	2.9%	Core inflation excluding food and fuels fell from 4.7% to 4.5%. Trends on both measures of core inflation to be extended through into coming months.

## In Focus / Macroeconomics

### Inflation in December within MPC comfort zone. Exports in retreat.

Inflation in December proved to be lower than MinFin's forecast and matched our estimate of 3.3% y/y. As for the breakdown, the seasonal pattern of food prices was confirmed (+0.8% m/m) accompanied by substantial drop of fuel prices (-9.0% m/m). Prices in housing category stabilized. Thus, core inflation rose only moderately on monthly basis what dragged down the core inflation excluding food and energy to 2.8% y/y from earlier recorded 2.9% y/y ("old" core measure excluding food and fuels decelerated from 4.7% to 4.5%).

Rapid fall of inflation owes much to the falling costs of fuels which appear to be a global phenomenon. As for now, the data was not informative about the potential inflation pressure related to weaker zloty. The economy is sharply losing momentum, which enables economic forces to set in further and drives down inflation towards the MPC target which may be reached in mid 2009.

Deceleration of real sphere is somehow imported from abroad – we found confirmation of this thesis in today's data on exports (December saw an outright fall of this aggregate by 11.9% y/y). This way the long heralded slump of export activity (suggested earlier by business activity indicators – namely the new export orders) has finally realized. Moreover, it is rather unlikely that it will be only temporary – global recessions were historically accompanied by the periods of softening trade. Naturally, the pattern of global trade and industrial output is likely to be reflected in Polish manufacturing as well. Till now we witnessed a substantial drop of output concerning durable goods (including investment ones). As the slowdown gains momentum there is another predominant force – shrinking demand for intermediate goods. There is then a large potential for further drops of Polish manufacturing activity as it serves as a large supplier for parts and intermediate goods for further assembling done in western economies. The period of damped business activity becomes slowly internalized by the MPC members who admit that inflation has gone to the background for some time, paving the way for further monetary easing.

As usual, the inflation data release provoked many rate-setters to express their opinions (Wasilewska-Trenkner, Pietrewicz, Noga, Czekaj, Filar, Slawinski). New insights were concentrated mainly on the scope of monetary easing. It seems the MPC members have reached a consensus on this field, conditioning the size of the cut on industrial output data. Given the rising probability of gloomy figures next week (we forecast industrial output to decline at 5.8% y/y) we slightly overweight our rate expectations towards 75bp. cut.

#### MID-TERM FORECASTS

Indicator	2006	2007	2008	2009
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

Indicator	2008			2009	
	Q2	Q3	Q4	Q1	Q2
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

#### Asset-swaps tighter, curve steeper.

Last week market fluctuated within a relatively narrow range, driven mostly by currency moves and sentiment in the region. Recent tendencies - steepening of the curve and narrowing asset swap spreads continued also. CPI reading at 3.3% y/y, dovish comments from MPC members and a rate cut by ECB still support front end of the curve. Next week's set of data - Industrial Production and PPI should be also positive for rates and rate cut expectations could therefore increase. Position wise we're still quite neutral, we still like short papers, as they have much room to over perform derivatives, as cash tends to be cheap and Wibor fixings, though moving down all the time, still remain somehow elevated.

**RECOMMENDATION:**

Hold short term 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	1/19/2009	-	4.885%	12/1/2009
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	2/11/2009	-	5.369%	1/14/2009

**Money Market**

*KRNBP0312 buy-out is coming*

*CPI in line with expectations*

*Bigger scale of the January rates cut possible after production figure*

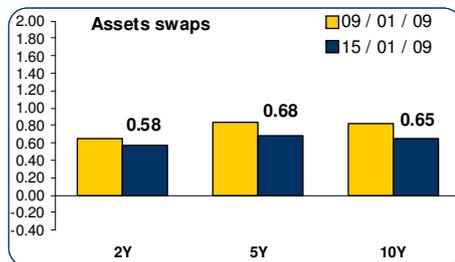
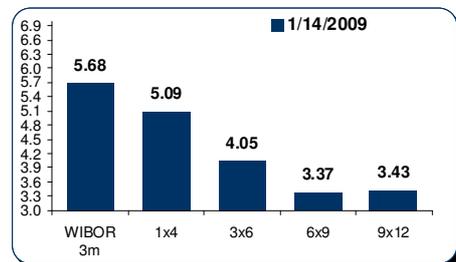
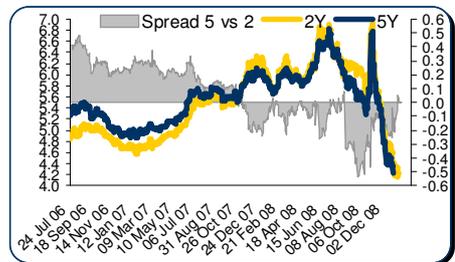
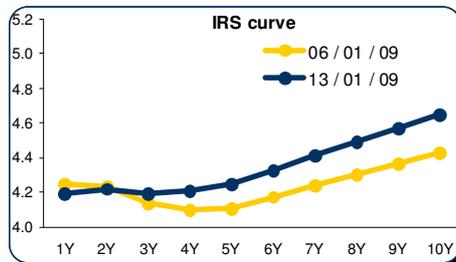
Another cheap week despite of the substantial demand during the regular open market operation (16 billion pln against maturing 6.7 billion pln). It seems that market prefers this situation to squeeze which is understandable, and we can not exclude that cheap carry will persist for couple of coming months. Additional factor supporting this view is early buy-out of the KRNBP0312 bonds. Along with their coupon, the system will gain 8.2 billion pln. Of course voices about realising the credit activities or credit lines because of that may be ignored short term. Such things do not happen from day to day. It will take months! The only weak point is that maturing repo with the central bank may not be rolled over. We had a flavour of this on Tuesday when only 0.7 billion pln was rolled over out of maturing 2.7 billion pln. However, the more variables the higher probabilities of cheap carry, just due to safety reasons, which are still on.

As for longer terms CPI in line with expectations and the market is quite unified as for rates cut view. 50 bps in January is certain and after another bullish figures 75 bps play may occur.

**RECOMMENDATION:**

Sell 3m polonia.

**FIXED INCOME & MONEY MARKET CHARTS**



## Foreign Exchange

*Zloty weaker*

This week zloty opened at 4.0270 and weakened toward 4.2450. Worse regional sentiment was reasons behind it.

*Volatility lower*

Implied volatilities are spot driven, weaker spot moved 1M implied volatility from 27 to 33 and 1Y's move was from 18.1 to 21, whilst realized volatility stayed at same levels.

**RECOMMENDATION:**

SPOT

*Play range/stay away*

Main supports / resistances:  
EUR/PLN: 4.0000 / 4.3050  
USD/PLN: 2.8000 / 3.3300

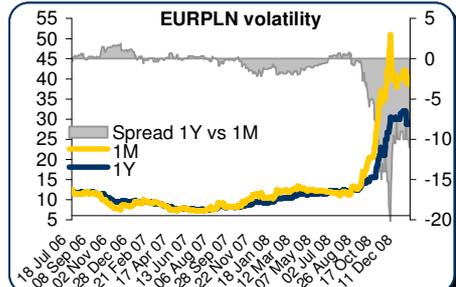
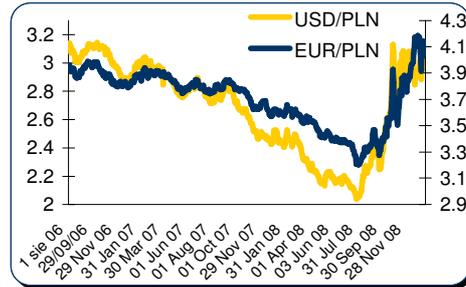
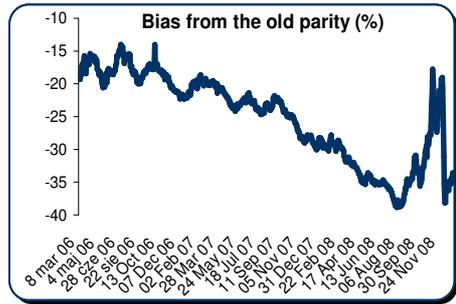
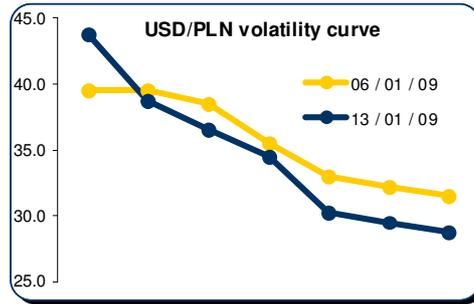
*Short vega*

Sentiment worsened and market seems to be long currency again. On the other hand decent part of customers currency shorts was closed. All of this reduces chance for next sharp up-move. Thereat we suggest playing 4.00-4.30 range or simply stay-away strategy.

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
07/01/09	5.79%	5.81%	5.81%	6.49%	5.90%	6.59%
08/01/09	5.68%	5.77%	5.90%	5.76%	5.79%	5.78%
09/01/09	5.62%	5.76%	5.84%	5.74%	5.71%	5.76%
12/01/09	5.60%	5.72%	5.78%	5.72%	5.75%	5.72%
13/01/09	5.59%	5.68%	5.70%	5.69%	5.69%	5.70%

**FRA MARKET RATES**

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
07/01/09	5.23%	4.25%	3.42%	3.47%	3.47%
08/01/09	5.25%	4.26%	3.43%	3.52%	3.50%
09/01/09	5.20%	4.24%	3.43%	3.49%	3.50%
12/01/09	5.09%	4.12%	3.40%	3.44%	3.47%
13/01/09	5.10%	4.12%	3.42%	3.47%	3.48%

**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
07/01/09	6.59%	5.14%	4.25%	5.02%	4.14%	5.14%	4.48%	5.44%
08/01/09	5.78%	5.14%	4.33%	5.04%	4.27%	5.15%	4.64%	5.46%
09/01/09	5.76%	5.10%	4.24%	4.89%	4.25%	5.08%	4.61%	5.43%
12/01/09	5.72%	4.95%	4.16%	4.79%	4.21%	4.94%	4.60%	5.30%
13/01/09	5.70%	4.95%	4.22%	4.80%	4.25%	4.93%	4.65%	5.30%

**PRIMARY MARKET RATES**

Last Primary Market Rates							
	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	08/01/12	09/01/12	95.293	4.89%	600	4140	505
OK0711	08/12/09	11/07/25	86.996	5.47%	2500	8037	2930
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
07/01/09	38.75	33.75	30.25	28.75	8.00	8.00	1.40	1.40
08/01/09	38.75	33.75	30.25	28.75	8.00	8.00	1.40	1.40
09/01/09	38.75	33.75	30.25	28.75	8.00	8.00	1.40	1.40
12/01/09	38.75	33.75	30.25	28.75	8.00	8.00	1.40	1.40
13/01/09	38.75	34.50	30.25	28.75	8.00	8.00	1.40	1.40

**PLN SPOT PERFORMANCE**

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
07/01/09	2.8844	3.9170	-34.02%
08/01/09	2.9561	4.0159	-33.62%
09/01/09	2.9551	4.0478	-33.90%
12/01/09	3.0183	4.0344	-32.94%
13/01/09	3.1162	4.1435	-33.78%

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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