



POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

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MACROECONOMICS**

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RECOMMENDATION**

- Receive on upticks. Buy PS0414

MONEY MARKET

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**MM
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- Offer 3,6M polonia above 2.5%.

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**FX
RECOMMENDATION**

- Short EURPLN
- Short vega

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PREVIEW: The week of March 13th to March 19th

Indicator	Date of release	Pe-riod	BRE forecast	Consen-sus	Last	Comment
CPI Inflation y/y	Mar 13	Feb	3.6%	3.2%	3.1%	Near 10% growth of fuel prices, higher prices of food, the rest of electricity hikes. Core inflation (excluding food and energy) at 2.6% y/y, to be published March 21.
C/A Balance mln EUR	Mar 13	Jan	-1600	-1315	-1920	Negative EU transfers balance, lower private transfers, better income account. Growth of exports at -30.5% y/y and imports -26.5% y/y. C/A to GDP ratio at 5.5%.
M3 Supply y/y	Mar 13	Feb	17.5%	17.0%	17.7%	Substantial monthly growth rate stemming from high growth of the PLN value of currency deposits. Statistical base effects working towards lower reading.

Wages y/y	Mar 17	Feb	5.1%	5.2%	8.1%	Falling trend extended. Lower business activity drives down the bonus component of wages.
Employment y/y	Mar 17	Feb	-0.8%	-0.2%	0.7%	Deeper falls of business activity indicators. Further anecdotal evidence on group lay-offs.
Industrial output y/y	Mar 18	Feb	-19.1%	-16.6%	-14.9%	Business activity indicators concerning sold industrial output and new orders trending lower. Sharp drop of industrial output in February stems not only from halted production but primarily from lower demand. Statistical base effects in 2008 working towards lower reading; an upward risk posed by relatively solid auto production (as reported by Samar).
Producer prices y/y	Mar 18	Feb	3.8%	3.4%	3.0%	Higher prices of oil and most PLN denominated commodities (range extending from 10 to 27% on monthly basis). Next round of electricity hikes.

In Focus / Macroeconomics

Polish fiscal policy and government's efforts to buy time

The Ministry of Finance sends mixed signals on the government deficit management strategy. On the one hand, the Minister of Finance Jan Rostowski tries to convince investors the deficit will be left intact, on the other, his Deputy Suchocka-Roguska claims the government's room for maneuver in case of sharper slowdown is limited which may result in a rise of budget revenue shortfall. In these circumstances the budget amendment will be necessary and its timing relies much on the global risk aversion measures; till then government PR skills and flexibility of budget gap financing will be an important virtue.

According to M. Boni (who leads the team of government strategic economic advisers, and who is – by the way – a very close Prime Minister Tusk associate) higher budget deficit is inevitable. The Deputy Finance Minister Suchocka-Roguska thinks there is no room for further cuts in government spending above what had been done within the government package of savings: 19.2 bn PLN totally, with some 9 bn reflecting the true savings, not accounting tricks. In her opinion, there is no way to cut on government subventions; it is also unlikely to save on investment outlays as many contracts have been recently signed what may entail damage claims in case they are broken. The limited scope of cuts on the expenditure side is accompanied by rather slim chances to raise revenues (according to Boni, the increase of the rental contribution has not been discussed yet). And reality bites as the growth rate of state revenues slows down (in February alone revenues were 2 bn short of the plan). Next month's reading on budget deficit may be double-digit, forcing the government to finally coin a specific plan of actions.

As for the prospects for the whole year, looming economic slowdown, rising saving rate and consumption dynamics slipping to below 2% y/y in 2009 would most likely erode the tax base and translate into state budget being short of at least 20 bn revenues. State budget deficit is thus most likely to exceed 30 bn PLN (vs. 18.2 planned) and the general government deficit to top 3% of the GDP mark. Will the government succeed in funding the budget gap? As for now, the government's tactics of funding the budget at the very short end of the yield curve proved to be working quite well. Due to falling overnight rates and systemic over-liquidity, banks seem to absorb any supply of T-bills. Bonds with longer maturities are still under pressure due to looming budget deficit worries.

In the short-term global risk aversion flip (see the ongoing bear market rally and US proposal to increase the funds at IMF's disposal) has a potential to significantly support EM currencies along with EM bonds. Crucial for the government's time-buying strategy are the developments on the global financial markets. For the next 2-4 months we see the government to aggressively apply its PR skills, which accompanied with some, very well marketable but – to be honest – minor support from EBI and World Bank (total 4 bn EUR) are likely to prevent the market from pricing the worst scenario. The very first signs of economic recovery, which we envisage for the second half of 2009, will probably decrease the country risk and allow, given the more attractive and much steeper yield curve, for funding higher budget deficit.

**MID-TERM
FORECATS**

Indicator	2006	2007	2008	2009	2010
GDP y/y (%)	6.1	6.5	4.8	0.0	3.0
Inflation rate (% average)	1.0	2.4	4.3	3.0	2.0
Current account (% of GDP, average)	-2.1	-4.5	-5.3	-4.9	-4.5
Unemployment rate (end-of-year)	14.9	11.4	9.5	13.5	13.9
NBP repo rate (end-of-year)	4.00	5.00	5.00	3.50	4.00

Indicator	2008		2009			
	Q3	Q4	Q1	Q2	Q3	Q4
GDP y/y (%)	4.7	2.9	1.0	-0.5	-1.0	0.7
Inflation rate (% average)	4.7	3.8	3.3	2.8	2.5	2.4
NBP repo rate (end-of-quarter)	6.00	5.00	3.75	3.50	3.50	3.50

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

Fixed Income

Overall picture improving

Last week wasn't very exciting on the fixed income market, however as it seems that appetite for risk is generally growing, sentiment on PLN market is also gradually improving. Weakening potential of the currency seems somehow limited in the medium-term, which also supports the sentiment. As we said a week ago, we were looking for better entry levels for receive positions, but it doesn't look that we're about to see yields much higher in the near future. CPI will be probably the only data in this month's set, that could be rates negative, so if followed by some uptick in yields, we think that would be a receiving opportunity. Cash should stay cheap which makes bonds even more attractive with asset-swap spread close to 100bp. Current EURPLN level wouldn't probably be an obstacle to cut rates by at least 25bp this month, possible cutting of NBP deposit rate in larger scale or lowering of obligatory reserve would bring cash even lower, making long bond positions looking even better. Looks it is time to take some risk.

RECOMMENDATION:

Receive on upticks. Buy PS0414

AUCTIONS

	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	6.142%	12/9/2008
26 Week T-bills	-	-	4.385%	3/9/2009
52 Week T-bills	3/16/2009	-	4.491%	3/9/2009
2Y T-bond OK0711	4/1/2009	-	5.804%	3/4/2009
5Y T-bond PS0413	4/1/2009	-	6.053%	3/4/2009
10Y T-bond DS1019	4/8/2009	-	5.724%	12/17/2008
20Y T-bond WS0429	4/8/2009	-	5.369%	1/14/2009

Money Market

Liquidity still boosted

Short end of the carry curve dominated the pricing of other MM instruments

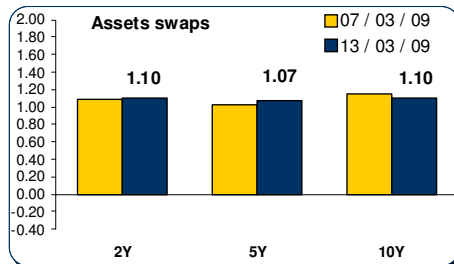
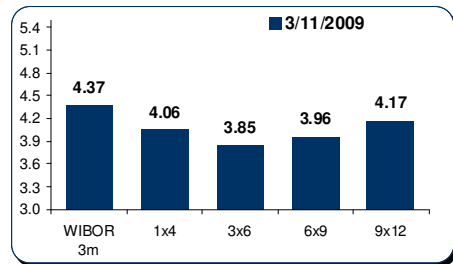
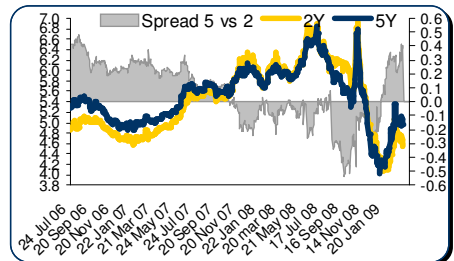
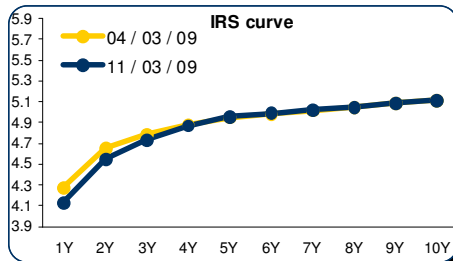
Liquidity still boosted, shortest rates nearby the deposit rate in the central bank. The regulator proved its intentions to follow this scenario, and 3rd time in a row offered only 13.5 billion pln of money bills. Demand is growing geometrically, hence the reduction rate amounted to 72% during last auction and will be probably somewhere around 85-90% tomorrow. To put some more pressure on interbank lending, cut in the deposit rate is very likely.

Short end of the carry curve dominated the pricing of other MM instruments. Now it is more about building in cheap carry then discounting possible scenarios of the monetary policy. Still credit lines are the main obstacle for the central bank to succeed in its strategy.

RECOMMENDATION:

Offer 3,6M polonia above 2.5%.

FIXED INCOME & MONEY MARKET CHARTS



Foreign Exchange

Zloty stronger

This week zloty has opened at 4.6550, weakened toward 4.76 just to strengthen down to 4.4520. Its global equities rally has made EURPLN longs unwinding.

Implied volatility untouched

Although vols seems to be more "sticky to strike" on upside than downside, we see pressure for lower curve anyway, 1M was traded at 26.5 and 1Y at 22.0 at end of week.

RECOMMENDATION:

SPOT

Main supports / resistances:
 EUR/PLN: 4.4000 / 4.8000
 USD/PLN: 3.4000 / 3.8000

Short EURPLN

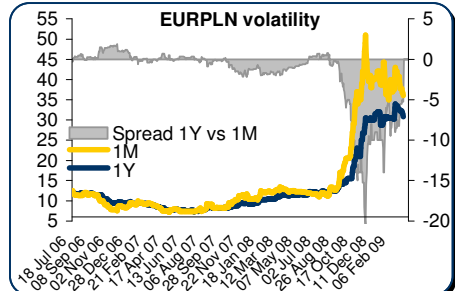
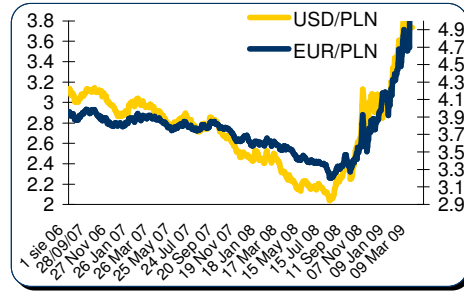
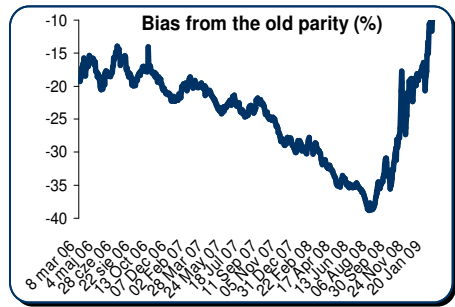
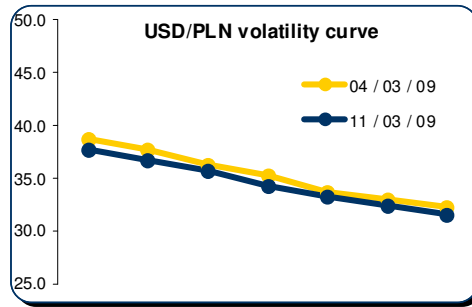
Zloty is gaining on EURPLN longs unwinding, target 4.40 is still in play so short is our position. But nothing last forever, keeping short EURPLN we should monitor global risk appetite level most closely.

Short vega

OPTIONS

EURPLN target is 4.40, curve will be lower there. We still like to keep some short vega. For hedging we suggest buying KO options as it is cheaper due to barrier pricing on high volatility market. Exporters may have some benefits from selling Risk Reversals as it is nearly highs (7 vols favour call).

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
05/03/09	4.26%	4.44%	4.35%	6.49%	4.36%	6.59%
06/03/09	4.26%	4.40%	4.32%	4.35%	4.33%	4.36%
09/03/09	4.23%	4.38%	4.32%	4.32%	4.33%	4.34%
10/03/09	4.23%	4.37%	4.28%	4.31%	4.29%	4.33%
11/03/09	4.22%	4.37%	4.28%	4.31%	4.29%	4.32%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
05/03/09	4.32%	4.15%	4.20%	4.40%	4.35%
06/03/09	4.32%	4.08%	4.17%	4.32%	4.28%
09/03/09	4.28%	4.05%	4.13%	4.27%	4.27%
10/03/09	4.25%	3.98%	4.06%	4.23%	4.18%
11/03/09	4.21%	4.03%	4.15%	4.33%	4.26%

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
05/03/09	6.59%	4.97%	4.63%	5.70%	4.93%	5.99%	5.10%	6.32%
06/03/09	4.36%	4.97%	4.64%	5.73%	5.06%	6.08%	5.22%	6.38%
09/03/09	4.34%	4.97%	4.74%	5.80%	5.11%	6.13%	5.27%	6.42%
10/03/09	4.33%	4.96%	4.68%	5.76%	5.06%	6.09%	5.21%	6.31%
11/03/09	4.32%	4.96%	4.55%	5.70%	4.96%	6.03%	5.12%	6.21%

PRIMARY MARKET RATES

Last Primary Market Rates							
	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	09/03/09	10/03/09	95.241	4.94%	1800	3007	1854
OK0711	09/03/04	11/07/25	87.404	5.80%	3800	3199	2090
PS0414	09/03/04	14/04/25	98.663	6.05%	2500	1305	640
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
05/03/09	37.75	35.25	33.75	32.25	7.00	7.25	1.40	1.40
06/03/09	37.75	35.25	33.75	32.25	7.00	7.25	1.40	1.40
09/03/09	37.75	35.25	33.75	32.25	7.00	7.25	1.40	1.40
10/03/09	36.75	34.25	33.25	31.75	7.00	7.25	1.40	1.40
11/03/09	36.75	34.25	33.25	31.50	7.00	7.25	1.40	1.40

PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
05/03/09	3.7358	4.6955	-0.29%
06/03/09	3.7358	5.6955	-2.44%
09/03/09	3.7358	6.6955	-2.79%
10/03/09	3.7358	7.6955	-3.35%
11/03/09	3.7358	8.6955	-2.14%

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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