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FINANCIAL MARKETS DEPARTMENT

PAGES: 8 WARSAW, APRIL 30, 2009

POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

PREVIEW: The week of May 1st to May 7th

Indicator	Date of release	Period	BRE forecast	Consensus	Last	Comment
PMI	**May 4**	Apr	**43.5pts**	-	42.1pts	Better domestic business tendency indicators and improvement of business activity abroad.
MinFin's inflation forecast y/y	**May 4**	Apr	**3.8%**	-	3.6%	Higher reading mainly on food prices (another monthly jump of 1% or more). Core inflation remains moderate at 2.4% y/y after 2.5% a month ago (scheduled for release 21 May).

In Focus / Macroeconomics

Polish rates on hold

In line with market expectations Polish MPC kept the REPO rate unchanged at 3.75% in April. The Committee wrote in the statement that clogged credit channel and lower external demand will be working towards lower GDP in the coming quarters. Turning to inflation perspectives, the statement indicates that temporarily elevated inflation levels should be linked to higher food prices, zloty depreciation and rising state-controlled prices. Although the MPC continuously expects inflation to decline in the mid-term on the back of lower domestic demand and weaker labor market, it skipped the usual passage indicating that further monetary easing will bring the economy on the stable growth path. The statement, however, contrasts with the NBP governor Skrzypek comments that monetary policy is still in an easing mode.

The Q&A session brought some additional insights as far as the decision making process in the Committee is concerned. Firstly, one might have got an impression that at least part of the Committee was really scarred by the zloty's abrupt reaction to the negative budget news, so they decided not to interfere with the market by refraining from any changes in rate policy. Secondly, some members, including influential Slawinski, seemed to place (too much) emphasis on the so called green shoots (some upside surprises in industrial output and business survey indicators) and suggested to cease the monetary easing. Thirdly, one cannot rule out that some members could not accept the possibility that naïvely calculated real interest rate (repo rate minus inflation) might turn negative in May. Finally, as indicated by more and more hawkish Wojtyna, postponing the ERM2 entry might induce higher zloty volatility and further upside risks for inflation. In Wojtyna's opinion, without such a stabilizing factor, the MPC may have to conduct more restrictive monetary policy in the future.

As far as short-term monetary policy outlook is concerned, the rates may stay well unchanged in May. Our reasoning is that April inflation rising to 3.7-3.8%, far above the upper bound of NBP inflation target, and real sphere data surprising on the upside may really put a brake on rate cuts. We expect the MPC to resume the easing as soon as in June, when the inflation for May is to show a significant decline due to state-controlled gas price cut and new inflation projection (probably pointing to lower GDP and declining inflation in mid-term) is to be released. We see the rates ultimately falling to 3.0-3.25% by the end of the year on the back of a marked deterioration in domestic demand (very pronounced overinvesting in many sectors and rising unemployment) and lower inflationary pressures consequently.

Closer look at the coming data

Coming month will be once again stamped by higher inflation which may trigger another correction in rate expectations. Additional support on this field will be given by better real sphere data, beginning with higher PMI reading. Although there are definitely some green shoots, we regard those as a short-term correction in falling trend. Adverse effects stemming form deteriorating labor market and dried credit financing are yet to materialize fully, along with further fallout of overinvestment manifesting itself in severe cuts in investment activity.

The string of publications will begin with PMI (Monday 4 May). Better local business tendency indicators accompanied by higher activity abroad are likely to lead the index towards 43.5pts in April (after 42.1pts recorded in March). That day also the inflation forecast of the Ministry of Finance sees the light. We expect inflation to have gone upwards to 3.7-3.8% y/y in April mainly on higher food prices whereas core inflation is likely to fall to 2.4% y/y from 2.5% a month ago. Official data will be published on 14 May and 21 May respectively. The forecast may have already lost some of its surprising potential as the representatives of the Ministry have already announced the rise of inflation in April. It is worth to mention that elevated inflation will be a temporary phenomenon connected with food prices and some first-round effects of the zloty depreciation. Slowly EURPLN appreciation and clearly negative monthly momentum in manufacturing prices (which drives PPI to 5.4% this month) are likely to confirm the return of inflation to the target within medium term.

The day after inflation figures balance of payments data see the light (15 May). We expect C/A balance to have turned negative again in March mainly on lower inflow of EU funds. The trend remains positive though as external rebalancing (relatively higher fall of imports than exports) is likely to lead trade balance into positive territory in the coming months.

Series of the "hard" data on real sphere begins with labor market (19 May). We expect employment to stay in falling trend (another 20k+ fall on monthly basis what drives the annual growth to -1.4% in April), accompanied parallel movement of wages (4.6% y/y in April vs 5.7% in March). Industrial output (20 May) is likely to surprise positively (consistent with higher PMI) despite negative base effects (Easter holidays and negative difference of working days) reaching 8.6% y/y decline after 0.9% fall in March when base effects worked towards upward surprise. Monthly publications from the real sphere will be complete as soon as the retail sales data is published (the date yet to be announced). We expect the retail activity in April to improve slightly (+0.6% y/y after 0.8% decline a month ago) mainly on base effects, boosted cross-border trade and higher sales of autos inflated by the scrapping bonus abroad – the trend in most important durable categories remains negative, though, and confirms our quite negative view on consumption in 2009 (growth rate of 1-2%).

At the end of the month, there are also Q1 2009 GDP data to be published (29 May). At 1.0% y/y they are likely to confirm negative trends in consumption and business investment. Extending those we are likely to enter negative territory in Q2 and Q3. The resurgence in annual growth rates is unlikely to take place before an year end, but still, recovery will be sluggish.

MID-TERM FORECATS

Indicator	2006	2007	2008	2009	2010
GDP y/y (%)	6.1	6.5	4.8	0.0	2.0
Inflation rate (%, average)	1.0	2.4	4.3	3.0	2.0
Current account (% of GDP, average)	-2.1	-4.5	-5.3	-3	-2.5
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	3.25	4.00

Indicator	2008		2009			
	Q3	Q4	Q1	Q2	Q3	Q4
GDP y/y (%)	4.7	2.9	1.0	-1.0	-1.5	0.4
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	3.25	3.25

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

Fixed Income

No cut. Rates lower following sentiment.

Last week wasn't very exciting on the FI market, rates mainly followed global sentiment and currency market. MPC decided to leave rates unchanged, comments that followed were not very dovish, it seems that we might not see another cut at least till June. We don't change our view for the curve, still see upside risks in the 5y and 10y sector. Moreover, we' re not that optimistic about front end either. With no direct impulse in form of a rate cut, and with cash market stabilizing closer to repo rate, upside pressure on Wibors would rather continue to build up. Therefore we've decided to close our receivers in 3x6 FRA. We still see value in 2y bond, instead of outright long however, we prefer asset-swap position in that sector. In terms of economic data, only important issue will be CPI forecast, that MinFin will publish beginning of the week. As our forecast for the figure is 3.7 y/y with upside risks, so we might see a negative surprise there, as overall consensus is somehow lower.

RECOMMENDATION:

Reduce front end receivers, add 2y asset-swap position.

AUCTIONS

	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	6.142%	12/9/2008
26 Week T-bills	-	-	4.242%	3/30/2009
52 Week T-bills	5/4/2009	-	4.957%	4/28/2009
2Y T-bond OK0711	5/13/2009	-	5.615%	4/1/2009
5Y T-bond PS0414	5/6/2009	-	6.039%	4/1/2009
10Y T-bond DS1019	5/20/2009	-	6.224%	4/8/2009
20Y T-bond WS0429	5/20/2009	-	5.369%	1/14/2009

Money Market

Quite expensive end of reserve settlement period

Interest rates left unchanged

T-bill's yields up at the tender.

Although there was nice cash surplus short term interest rates were quite high this week. All because of non-symmetric liquidity distribution in the system and huge (19,5 billion PLN) Central Bank bills tender last Friday. Surprising is the fact that after few more expensive days on the market there was 6 billion deposit at Central Bank yesterday. Today Central Bank offered 16,5 billion PLN 8-day CB bills and there is a chance for cheaper beginning of new reserve requirement period.

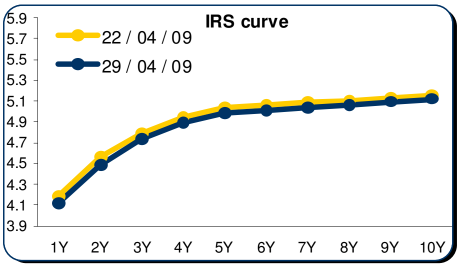
On Wednesday MPC decided to leave interest rate unchanged.

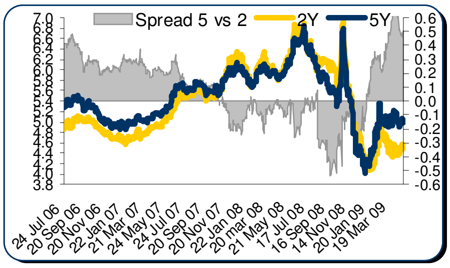
The average yield on Polish 52-week T-bill at primary tender up to 4,957% from 4,837%. Demand was 2,3 billion PLN and the Ministry sold 1,2 billion papers from the offer.

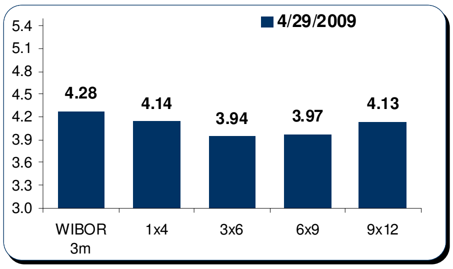
RECOMMENDATION:

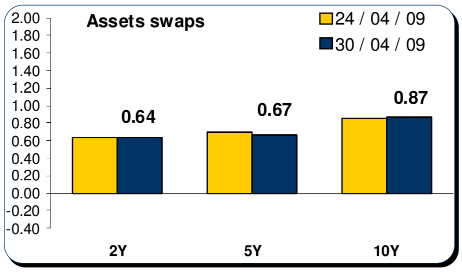
Stay neutral

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty in range

This week zloty has opened at 4.4700, weakened toward 4.5600 just to strengthen to 4.3650. Zloty tracks core markets, remains with high negative correlation with EURUSD and EURJPY crosses.

Implied volatility lower

Market seems to be little long vega, and although vols still are "sticky to strike" we see more pressure on downside. 1M is traded at 22.5 and 1Y at 18.25.

RECOMMENDATION:

SPOT

Main supports / resistances:
EUR/PLN: 4.2200 / 4.6000
USD/PLN: 3.1800 / 3.5000

Short EURPLN

We see 4.55 as key level. Breaking of it on upside could stop strenghtening of PLN in medium term. Till then we are sellers at 4.50-4.55 with 4.22 target.

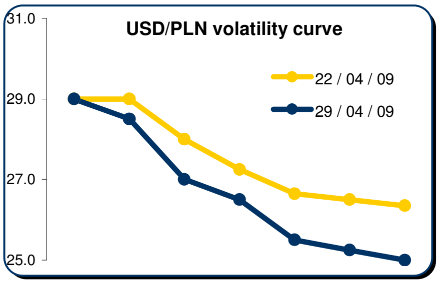
OPTIONS

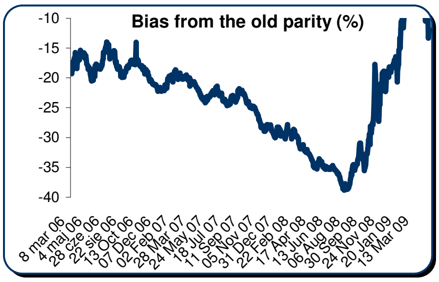
Vols looks a bit offered here, so we suggest wait for higher levels to entry short vega. Selling

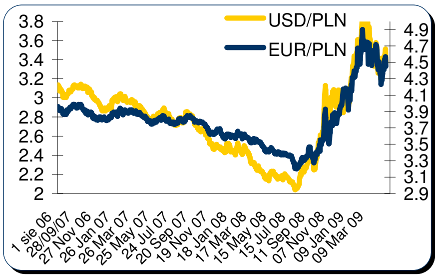
Short gamma

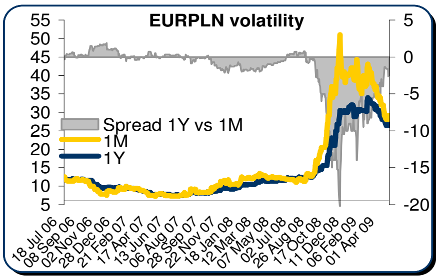
gamma, however, looks as good idea.
For hedging we suggest buying KO options as it is cheaper due to barrier pricing on high volatility market.
Exporters may have some benefits from selling Risk Reversals as it is nearly highs (5 vols favour call).

FX CHARTS









MARKET PRICES UPDATE

MONEY MARKET RATES

Money market rates (Closing mid-market levels)

date	3M FXSW	3M WIBOR	6M FXSW	6M WIBOR	1Y FXSW	1Y WIBOR
23/04/09	4.05%	4.24%	4.25%	6.49%	4.30%	6.59%
24/04/09	4.05%	4.24%	4.25%	4.27%	4.30%	4.41%
27/04/09	4.13%	4.26%	4.25%	4.28%	4.30%	4.43%
28/04/09	4.16%	4.27%	4.25%	4.29%	4.40%	4.45%
29/04/09	4.16%	4.28%	4.27%	4.30%	4.42%	4.46%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
23/04/09	4.05%	3.92%	3.94%	4.10%	4.03%
24/04/09	4.08%	3.94%	3.98%	4.09%	4.09%
27/04/09	4.16%	3.99%	4.02%	4.20%	4.13%
28/04/09	4.15%	3.99%	4.02%	4.21%	4.17%
29/04/09	4.17%	4.02%	4.04%	4.22%	4.17%

FIXED INCOME MARKET RATES

Fixed Income Market Rates (Closing mid-market levels)

date	1Y WIBOR	1Y TB	2Y IRS	2Y OK0709	5Y IRS	5Y PS0511	10Y IRS	10Y DS1017
23/04/09	6.59%	4.91%	4.56%	5.12%	5.02%	5.68%	5.13%	5.99%
24/04/09	4.41%	4.96%	4.53%	5.17%	4.99%	5.69%	5.14%	6.00%
27/04/09	4.43%	4.91%	4.57%	5.17%	5.06%	5.69%	5.18%	6.00%
28/04/09	4.45%	4.91%	4.55%	5.19%	5.03%	5.69%	5.15%	6.03%
29/04/09	4.46%	4.90%	4.48%	5.12%	4.98%	5.65%	5.12%	5.99%

PRIMARY MARKET RATES

Last Primary Market Rates

	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	09/04/28	10/04/20	95.228	4.96%	1500	2365	1215
OK0711	09/04/01	11/07/26	88.147	5.62%	2000	4384	2144
PS0414	09/04/01	14/04/26	98.748	6.04%	1500	2427	1514
DS1017	09/04/08	19/10/25	94.460	6.22%	2500	4846	1820

FX VOLATILITY

date	USD/PLN 0-delta stradle 1M	3M	6M	1Y	25-delta RR 1M	1Y	25-delta FLY 1M	1Y
23/04/09	29.25	27.50	26.15	26.85	5.00	6.00	1.25	1.25
24/04/09	29.00	27.50	26.15	26.50	5.00	6.00	1.25	1.25
27/04/09	29.00	27.00	26.00	26.00	4.50	6.00	1.25	1.25
28/04/09	28.50	27.00	26.00	25.50	4.50	5.75	1.25	1.25
29/04/09	28.50	26.50	25.50	25.00	4.00	5.50	1.25	1.25

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
23/04/09	3.3862	4.4147	-9.27%
24/04/09	3.3810	4.4763	-10.37%
27/04/09	3.4456	4.5380	-10.35%
28/04/09	3.5108	4.5678	-13.35%
29/04/09	3.3680	4.4498	-11.85%

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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