



POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

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

Indicator	Date of release	Pe-riod	BRE forecast	Consen-sus	Last	Comment
No significant releases						

In Focus / Macroeconomics

MinFin's forecasts inflation on a still relatively high level

The Ministry of Finance announced that CPI inflation fell in May to 3.8% y/y from 4.0% recorded in April. We expect lower growth rate of prices (3.5-3.6% y/y), though. The divergence lies in the estimated dynamics of food prices: we bet on a moderate growth (0.7-0.9% on monthly basis) whereas the Ministry expects food costs to have surged by almost 1.5%.

Although driven by food prices, the publication wreak havoc with even usually dovish MPC members (not mentioning the hawkish ones), who seem to be still impressed by the recent data on GDP growth (+0.8% y/y in Q1). The publication mostly affected extremely dovish Pietrewicz, who ceased to be certain on June's cut. He was strongly supported by hawkish members (Noga, Filar) with the latter suggesting even the coming turn in implicit monetary policy bias (from easy to neutral). Only Nieckarz stayed firmly in dovish trenches, pressing for the need for a fast rate cut to support ailing real sphere. Swing voter Czekaj conditioned the result of the looming meeting on the exact CPI reading (is it going to be actually lower than MinFin's forecast?) and the behavior of inflation in monetary policy horizon (will the projection show the return of inflation to the target in mid 2010?).

We are quite surprised by the rate-setters' reaction. The published GDP data are not optimistic at all: instead of GDP growth, more attention should be given to domestic demand. This aggregate posted the second consecutive fall on qoq seasonally adjusted basis and given the softness of private consumption and investment it is unlikely to recover soon. Net exports is going to support GDP growth but what matters for the monetary policy now is domestic demand. Taking this line of thought, contemporary elevated CPI inflation does not pose a significant concern as it may "plummet like a stone" (borrowing expression from BoE governor, M. King) in 2010. Potential risks arise from the factors beyond the MPC control (food and oil prices) and are quite unlikely to be built into inflation expectations in the current "crisis" environment.

That is why we expect inflation projection, not the current data, to be of utmost importance during the coming MPC meeting. It is likely to show lower GDP growth and inflation falling to the target in 2010. We also think that the MPC is going to consider the effects of another pause in monetary easing on money market rates (another good reason for a rise of 3M WIBOR), which may pose additional burden for consumers. We can also point to the fact that the recovery of Polish manufacturing (as reflected by the PMI index) will be rather gradual and closely connected to business activity abroad. Adding to those factors also some regrets of recently very significant governor Skrzypek (he wishes the cuts in Q1 had been deeper) we end up with a still good chance for monetary easing in June.

MID-TERM FORECASTS

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	12.8 ↓	13.5 ↓
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	0.8	-0.7 ↑	-1.1 ↑	0.5
Inflation rate (% , average)	4.7	3.8	3.2	3.1	2.5	2.4
NBP repo rate (end-of-quarter)	6.00	5.00	3.75	3.50	3.25	3.25

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

Fixed Income

Worsening sentiment

The sentiment on the fixed income market has changed this week. Rates climbed up by some 15-20 across the curve, with 5y and 10y reaching new highs this year at 5.50 and 5.70%. Ministry of Finance successfully placed 5bio of 2y and 5y bonds on auction. New 2y paper attracted reasonable bids, while demand for 5y was more moderate - not surprising, as asset swaps have narrowed the most in this sector of the curve to some 20-25bp. Shorter maturities look much better from that perspective, and we still like 0711 with ASW spread close to 50bp. From data perspective, Ministry of Finance published their CPI forecast at 3.8% y/y. If such reading is confirmed, it could have negative impact on the front end, as it lowers the probability of a rate cut this month. Our forecast is a bit lower however, we expect the figure at 3.6%, which together with new inflation projection should result in 25bp easing in June. However in the meantime PLN rates can be quite vulnerable to global sentiment and situation on forex. Position wise, we stay long in 0711 ASW and wait for better levels to enter an outright position.

RECOMMENDATION:

Stay long 0711 in asset-swap.

AUCTIONS

	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	6.142%	09/12/2008
26 Week T-bills	-	-	4.456%	04/05/2009
52 Week T-bills	08/06/2009	-	4.872%	01/06/2009
2Y T-bond OK0112	01/07/2009	-	5.456%	03/06/2009
5Y T-bond PS0414	01/07/2009	-	5.783%	03/06/2009
10Y T-bond DS1019	10/06/2009	-	6.340%	20/05/2009
20Y T-bond WS0429	10/06/2009	-	6.340%	20/05/2009

Money Market

Expensive beginning of reserve settlement period

After huge OMO last Friday (27.5 bn PLN) POLONIA went up from 2,3% last day of reserve requirement period to 3.62% on the first day. Central Bank took all cash surpluses from the system and right now short term rates are close reference rate.

This week we could have noticed that WIBOR stopped growing up. Probably market have found equilibrium level that reflect credit risk and market liquidity.

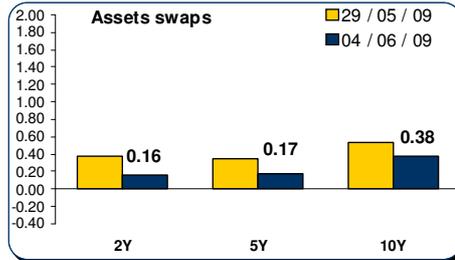
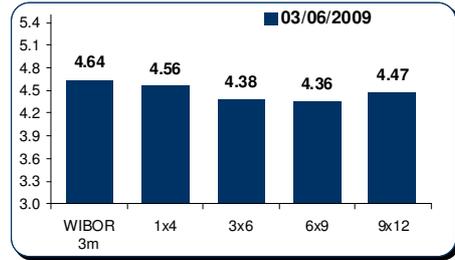
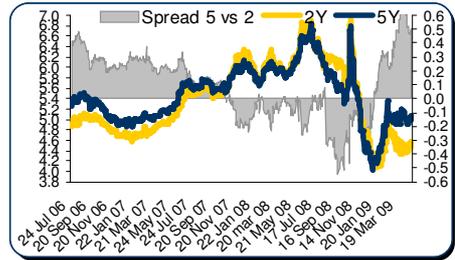
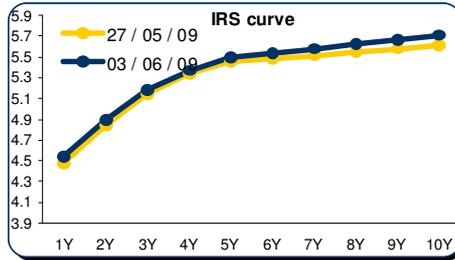
T-bill's yields up at the tender.

The average yield on Polish 52-week T-bill at primary tender down to 4.872% from 5.074%. Demand was 9.4 billion PLN and the Ministry sold all 2.125 billion papers from the offer.

RECOMMENDATION:

Pay FRA 3x6, 6x9 at current level.

FIXED INCOME & MONEY MARKET CHARTS



Foreign Exchange

Zloty volatile

This week zloty has opened at 4.4300 and weakened to 4.5450. Zloty sharply strengthened on low Monday's liquidity driven by good GDP data and weakened with worse regional sentiment caused by Latvia problems.

Implied volatility untouched

Despite quite volatile spot trading volatility curve stays pretty same. We need to break through 4.45 or 4.55 to move it.

RECOMMENDATION:

SPOT

Main supports / resistances:
 EUR/PLN: 4.3800 / 4.6000
 USD/PLN: 3.0000 / 3.3500

Stay away/Buy dips

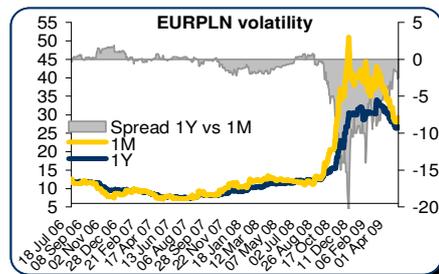
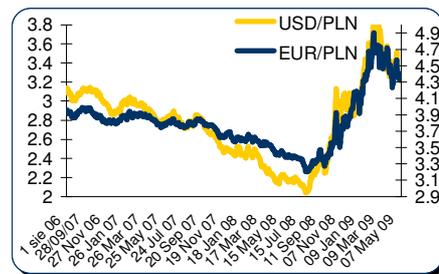
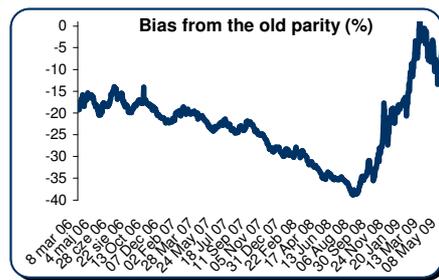
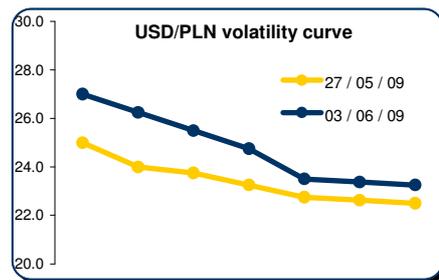
Zloty follows global equity play, we see high correlation with JPY crosses. We still see more risk on upside (4.65-4.70).

Sell vega on upticks

OPTIONS

Vols looks a bit offered here, so we suggest wait for higher levels to entry short vega (20 vol for 1Y).
 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		6M		1Y	
	FXSW	WIBOR	FXSW	WIBOR	FXSW	WIBOR
28/05/09	4.49%	4.62%	4.57%	4.61%	4.87%	4.92%
29/05/09	4.47%	4.64%	4.58%	4.69%	4.88%	6.59%
01/06/09	4.50%	4.62%	4.57%	4.63%	4.88%	4.94%
02/06/09	4.50%	4.63%	4.60%	4.64%	4.91%	4.94%
03/06/09	4.49%	4.64%	4.62%	4.64%	4.90%	4.95%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
	28/05/09	4.56%	4.29%	4.28%	4.42%
29/05/09	4.55%	4.32%	4.32%	4.46%	4.49%
01/06/09	4.50%	4.25%	4.25%	4.37%	4.44%
02/06/09	4.48%	4.25%	4.25%	4.37%	4.42%
03/06/09	4.46%	4.20%	4.19%	4.30%	4.38%

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
28/05/09	4.92%	5.05%	4.79%	5.15%	5.43%	5.75%	5.64%	6.17%
29/05/09	6.59%	5.10%	4.77%	5.15%	5.40%	5.75%	5.64%	6.17%
01/06/09	4.94%	5.04%	4.74%	5.09%	5.36%	5.64%	5.60%	6.04%
02/06/09	4.94%	5.07%	4.77%	5.09%	5.38%	5.65%	5.60%	6.06%
03/06/09	4.95%	5.09%	4.89%	5.05%	5.49%	5.66%	5.71%	6.09%

PRIMARY MARKET RATES

Last Primary Market Rates

	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	09/05/25	10/05/25	95.120	5.07%	2500	9419	2125
OK0112	09/06/03	12/01/25	86.909	5.46%	4000	6658	4018
PS0414	09/06/03	14/04/26	99.835	5.78%	1000	1614	971
DS1017	09/04/08	19/10/25	94.460	6.22%	2500	4846	1820

FX VOLATILITY**PLN SPOT PERFORMANCE**

date	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
	1M	3M	6M	1Y	1M	1Y	1M	1Y
28/05/09	24.50	23.75	23.00	22.75	3.50	5.25	1.25	1.25
29/05/09	25.50	24.25	23.25	23.00	3.50	5.25	1.25	1.25
01/06/09	25.50	24.25	23.25	23.00	3.50	5.25	1.25	1.25
02/06/09	26.00	24.25	23.25	23.00	4.00	5.25	1.25	1.25
03/06/09	26.25	24.75	23.50	23.25	4.00	5.25	1.25	1.25

PLN spot performance

date	USD/PLN	EUR/PLN	bias
28/05/09	3.2418	4.4876	-9.32%
29/05/09	3.1812	4.4588	-8.96%
01/06/09	3.1248	4.4447	-11.39%
02/06/09	3.1789	4.4846	-11.95%
03/06/09	3.1528	4.4872	-11.19%

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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