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FINANCIAL MARKETS DEPARTMENT

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POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

PREVIEW: The week of July 7th to August 13th

Indicator	Date of release	Period	BRE forecast	Consensus	Last	Comment
C/A balance, EUR	Aug 11	Jun	**+196 mln**	+138 mln	+207mln	Better industrial output and retail sales (relevant categories) although exports and imports affected by base effects from the last year. Relatively high current transfers account on private transfers; worse income account (to be extended in coming months on dividend payments).
M3 Supply, y/y	Aug 13	Jul	**13.8%**	13.5%	14.3%	M3 supply within recent trend (last month saw an one-off jump on tax returns).

In Focus / Macroeconomics

PMI confirms the turning point have been reached

Purchasing Manager Index surged in July from 43.0pts to 46.5pts marking a record monthly gain since 1998 when the survey was started. The growth of output index alone proved to be even more spectacular – from 43.1pts to 48.9pts which is close to theoretical neutral level. Business activity is contracting at the smallest pace since June 2008.

Surging PMI accompanied by better hard data in manufacturing confirms the economy have probably reached a trough at the turn of Q2 and Q3. The comment attached to the publication (it is a pity that it is only narrative) suggest the activity rebounded in almost all fields: output, new orders, employment. The ratio of new orders to stocks (a solid leading indicator of manufacturing output) reached the highest level since March 2008 and is driven mainly by new orders which translates into a very healthy growth potential (we remind the reader it is possible that the most abrupt destocking is already behind us – for reference see the Q4 2008 and Q1 2009 GDP data).

It is also interesting to take a quick look at price developments. Although input costs have fallen only marginally, respondents reported a more pronounced drop of final goods' prices. It seems that both depressed demand and market competition keep producer prices within falling trend. Such a tendency is also supported by the appropriate business tendency indicators provided by the Central Statistical Office – the coincidence of readings may be quite meaningful as they draw from different sources.

As for the short-term PMI implications, there is an upside risk to our (to be honest – quite optimistic) forecast of industrial output (-2.9% y/y versus market consensus at -3.8%). At the mid-term it gives a tailwind for our revised GDP forecast for 2009 – owing to better supply side developments and more pronounced net exports contribution we expect GDP to grow by 1.0%. Finally, we also expect other institutions and banks to slowly embark on a process of upward revisions of GDP forecasts (see e.g. IMF and EC announcements).

Ministry of Finance expects inflation to stabilize in July at 3.5%

The Ministry estimates inflation at 3.5% y/y, a touch above market consensus situated at 3.4%. This time, the Ministry also published the details of the forecast. Food prices dropped by 1.4% in July; there was a considerable jump in tobacco products (+8.8%), connected with excise tax, and moderate increase in fuels (+3.3%). Most important core categories also recorded moderate growth.

The MinFin forecast does not differ much from our assessment. Growth of prices seems to be persistent, especially in case of core inflation. We expect this measure of inflation to have risen to 2.8-2.9% in July form 2.7% in June. Right on the back of inflation inertia and statistical base effects we expect CPI inflation to top 3.5-4.0% at the end of the year, above the upper bound of central bank inflation target.

The publication traditionally attracted some attention of MPC members. Wasilewska-Trenkner claimed the repo rate had reached a minimum in the current cycle. Other MPC members (Filar, Czekaj) – probably impressed by the PMI reading (see the piece above) – talked about the turnaround in the economy. Higher CPI inflation and more and more reliable signs of improving business activity make the scenario of no further cuts the most possible one. We think the June's cut was the last one in the easing cycle.

MID-TERM FORECASTS

Indicator	2006	2007	2008	2009	2010
GDP y/y (%)	6.1	6.5	4.8	1.1	2.0
Inflation rate (%, average)	1.0	2.4	4.3	3.4	1.8
Current account (% of GDP, average)	-2.1	-4.5	-5.3	0.2	-2.9
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	3.50	3.75

Indicator	2008		2009			
	Q3	Q4	Q1	Q2	Q3	Q4
GDP y/y (%)	4.7	2.9	0.8	1.2	0.8	1.6
Inflation rate (%, average)	4.7	3.8	3.2	3.7	3.4	3.5
NBP repo rate (end-of-quarter)	6.00	5.00	3.75	3.50	3.50	3.50

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

Fixed Income

Range trading continues

Market stayed within relatively narrow range during the week. Ministry of Finance published their CPI estimate - 3.5% y/y was quite in line with other forecasts, therefore caused hardly any reaction. Wednesday's bond auction attracted very good demand (bid/cover ratio was close to 2.5) and MinFin managed to sell 4.5bio of 2Y bonds. We think market will stay within a range for some time. Current levels look seems to be lower band of the range to us, especially in the front end. We don't see more rate cuts coming, Wibor rates seem to have reached some equilibrum levels, yet FRAs trade some 15bp lower cash market stays very low for some time already, so support for the front end either stays unchanged or worsens; from that perspective downside potential seems quite limited and we've decided to take small pay position in the front end of the curve.

RECOMMENDATION:

Recommendation: Pay 9x12 FRA. Pay 2Y.

AUCTIONS

	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	6.142%	12/9/2008
26 Week T-bills	-	-	4.456%	5/4/2009
52 Week T-bills	8/10/2009	-	4.220%	8/3/2009
2Y T-bond OK0112	9/2/2009	-	4.974%	8/5/2009
5Y T-bond PS0414	8/12/2009	-	5.549%	7/15/2009
10Y T-bond DS1019	9/9/2009	-	6.340%	5/20/2009
20Y T-bond WS0429	9/9/2009	-	6.340%	5/20/2009

Money Market

Huge surplus of the cash left by the CB to boost bond demand

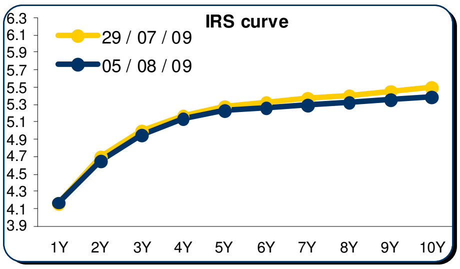
3M repo will not be important next week

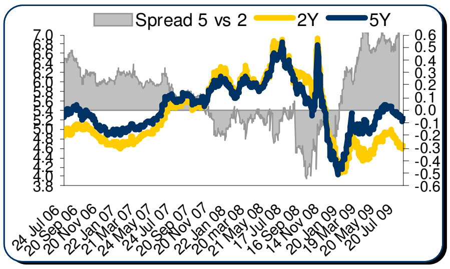
Very cheap beginning of the new reserve, as the central bank decided to support the MinFin. They left huge surplus of the cash on Friday, in our opinion, just to boost the demand for the OK0112 auction. The goal was achieved. Shortest rates slightly above 2% were another incentive to buy the papers. Demand reached 12 billion pln and the average yield was 4.97% versus consensus at 5.05%. Since the next week we have another bond auction, situation can remain unchanged, and this should be enough to see the cost of carry very low through the whole current reserve settlement period. This in turn pushed all the ois levels down.
Next week we have also 3M repo facility with the central bank. We do not expect any substantial demand.

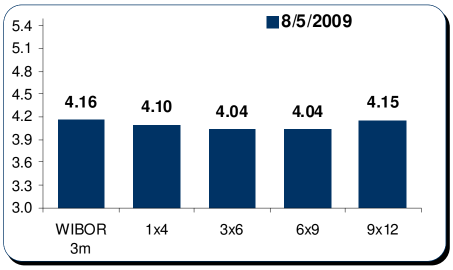
RECOMMENDATION:

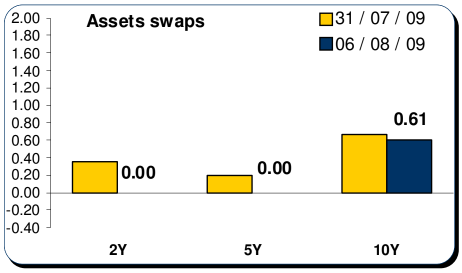
Offer polonia at current levels.

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty in consolidation phase

This week zloty has opened at 4.1400, hit new low at 4.0800 and got back to 4.1550 in corrective mode. Global sentiment stays mixed with higher probability of correction what stopped zloty appreciation..

Implied volatility bit higher

Part of investors believe zloty touched low. We saw some profit taking on vols: 1M is traded at 15.00 (13.5 last week low) and 1Y 13.75 (13.25 low).

RECOMMENDATION:

SPOT

Main supports / resistances:
EUR/PLN: 4.0650 / 4.2700
USD/PLN: 2.8000 / 3.0600

Sell upticks

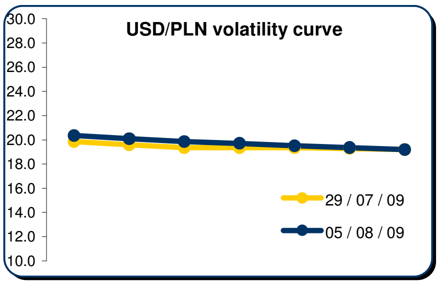
Move was started at 4.55, bottom was at 4.08, that makes probability of correction higher. Good global sentiment supported by good economic data may nip it in the bud. We sell upticks so far

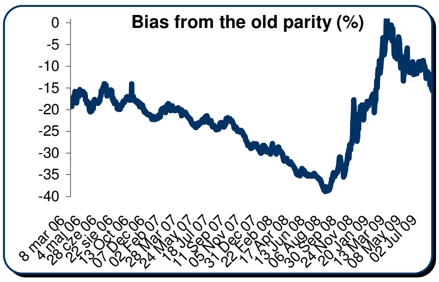
Sell gamma

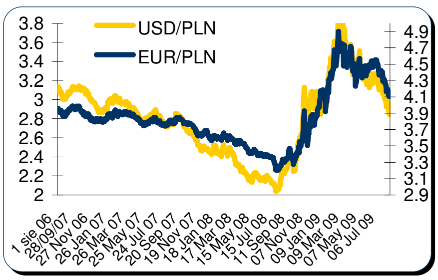
OPTIONS

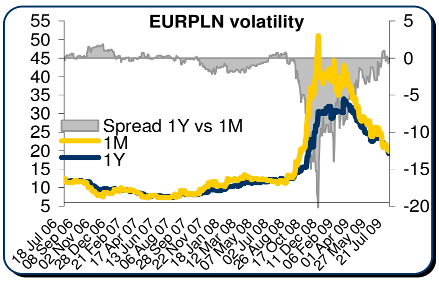
Curve is near this year low but we still see chance for short gamma trade to be profitable.
For hedging we suggest buying KO options as it is cheaper due to barrier pricing on high volatility market.

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
30/07/09	4.10%	4.16%	4.24%	4.26%	4.41%	4.42%
31/07/09	4.10%	4.17%	4.30%	4.26%	4.43%	6.59%
03/08/09	4.09%	4.16%	4.30%	6.49%	4.43%	4.43%
04/08/09	4.10%	4.16%	4.30%	4.27%	4.43%	4.41%
05/08/09	4.12%	4.16%	4.25%	4.27%	4.36%	4.40%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
30/07/09	4.08%	4.02%	4.02%	4.15%	4.23%
31/07/09	4.11%	4.05%	4.05%	4.18%	4.26%
03/08/09	4.10%	4.04%	4.03%	4.18%	4.27%
04/08/09	4.10%	4.03%	4.04%	4.16%	4.24%
05/08/09	4.12%	4.04%	4.04%	4.15%	4.24%

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
30/07/09	4.42%	4.30%	4.65%	4.99%	5.25%	5.46%	5.43%	6.14%
31/07/09	6.59%	4.30%	4.63%	4.98%	5.22%	5.42%	5.41%	6.08%
03/08/09	4.43%	4.30%	4.58%	4.94%	5.16%	5.38%	5.34%	6.00%
04/08/09	4.41%	4.30%	4.64%	4.96%	5.22%	5.39%	5.38%	6.00%
05/08/09	4.40%	4.30%	4.65%	4.96%	5.23%	5.39%	5.39%	6.00%

PRIMARY MARKET RATES

Last Primary Market Rates

	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	09/08/03	10/08/03	59.801	4.22%	1500	3153	1512
OK0112	09/08/05	12/01/25	88.708	4.97%	4500	11232	4502
PS0414	09/07/15	14/04/26	100.782	5.55%	2000	6347	2011
DS1017	09/04/08	19/10/25	94.460	6.22%	2500	4846	1820

FX VOLATILITY

	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
date	1M	3M	6M	1Y	1M	1Y	1M	1Y
30/07/09	19.60	19.35	19.35	19.20	2.50	4.25	1.05	1.15
31/07/09	19.60	19.35	19.35	19.20	0.00	0.00	0.00	0.00
03/08/09	19.60	19.50	19.35	19.20	0.00	0.00	0.00	0.00
04/08/09	20.10	19.70	19.45	19.20	0.00	0.00	0.00	0.00
05/08/09	20.10	19.70	19.50	19.20	0.00	0.00	0.00	0.00

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
30/07/09	2.9737	4.1808	-13.87%
31/07/09	2.9525	4.1605	-14.53%
03/08/09	2.8843	4.1178	-15.13%
04/08/09	2.8465	4.1035	-15.05%
05/08/09	2.8547	4.1090	-15.66%

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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