



POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

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PREVIEW: The week of October 30th to November 5th

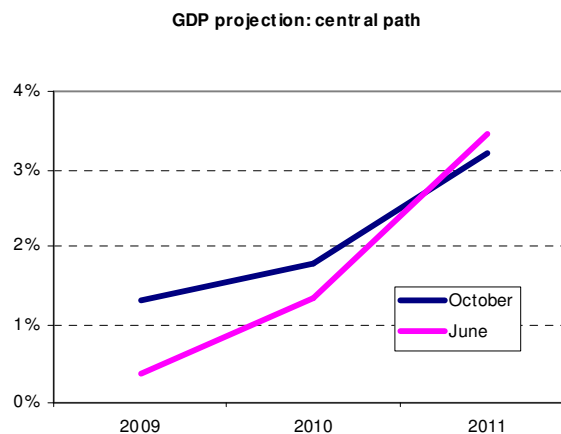
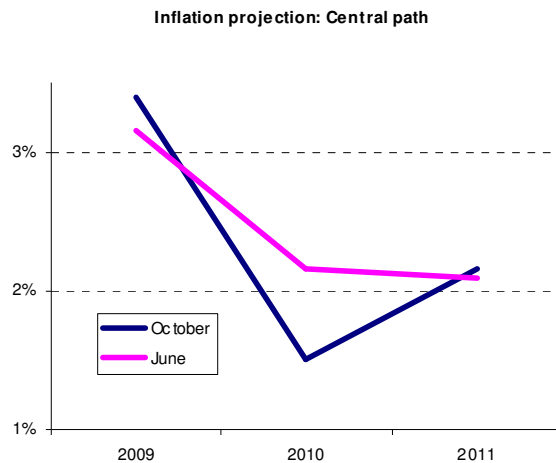
Indicator	Date of release	Pe-riod	BRE forecast	Consen-sus	Last	Comment
MinFin's inflation forecast y/y	Nov 2	Oct	3.2%	-	3.4%	Growth of food prices at the lower range of seasonal pattern, fuel prices continued downside. Core inflation expected at 2.9%.
PMI pts	Nov 2	Oct	48.8	-	48.2	Strong growth of PMI counterparts abroad, decent rises of domestic business activity indicators.

In Focus / Macroeconomics

MPC changes bias to neutral

No one expected rates to be changed and those predicting the switch to neutral mode (with us among them) proved to be right. Although the MPC refrains to bluntly quote its bias (as it used to some years ago as a part of communication with the market), the balance of risks of undershooting and overshooting the inflation target in monetary policy horizon serves this end well. Right now the probability of inflation staying above the target is equal to the probability of inflation staying under the target – such a statement is commonly regarded as neutral monetary policy stance.

In our opinion, the decision is deeply rooted in the results of the fresh inflation projection which presents V-shaped inflation path and acceleration of GDP growth this year and the next (see the graphs below). Higher GDP growth is accompanied by lower inflation – a scenario of seemingly non-inflationary growth. When we take into account that it is the current data which determines the markets' behavior most in emerging countries, non-inflationary growth is consistent with receding interest rate hikes expectations and support for POLGBs prices.



As we sketched recently in our research note concerning the nature of 2009 inflation, the bottom of V-shaped inflation path is mostly determined by statistical base effects and as a such should not result in a continuation of monetary easing – especially taking into account the relative strength of the labor market and ongoing expansion of the economy. Moreover, it is the very end of the projection which we should look at as it shows acceleration of inflation within 2010 monetary policy horizon (which will be covered by the brand new MPC). We would like to emphasize that it is not the level of inflation but its momentum which plays a decisive role for rate setters.

As for the coming months, the perspectives for the monetary policy are rather "boring", to use an expression popularized recently by member Noga. Some rate-setters put it bluntly that the rates will stay intact till the end of the year (Filar), some wrap up "no-change" scenario into the neutral monetary policy stance which has been just adopted (Czekaj). The very first months of the new MPC will be a wait-and-see period, with some monetary tightening realized via very low inflation path and falling ex post real interest rate. And then? When we adjust the reasoning to the facts listed above, rate hikes in H2 2010 should be regarded as a baseline scenario.

MID-TERM FORECATS

Indicator	2006	2007	2008	2009	2010
GDP y/y (%)	6.1	6.5	4.8	1.5	2.0-3.0
Inflation rate (% , average)	1.0	2.4	4.3	3.5	2.3
Current account (% of GDP, average)	-2.1	-4.5	-5.3	-1.2	-2.9
Unemployment rate (end-of-year)	14.9	11.4	9.5	12.3	12.8
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	0.8	1.1	1.7↑	3↑
Inflation rate (% , average)	4.7	3.8	3.2	3.7	3.5	3.4
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

Sharp correction.

Last week we observed significant correction on the FI market. Curve moved up by more than 20bp from previous week's lows, 2y traded above 5.00% and 5y above 5.60%. Also bond prices pulled back a lot - PS0414 by 100 ticks, cancelling whole previous rally. However, at these levels POLGB's started to look attractive again and MinFin successfully sold 5.5 bio of bonds on a switch auction. As expected, the MPC has left rates unchanged but changed their bias to neutral, clearly signaling the cutting cycle has come to an end. Just like we thought previously that the rally had been a little overdone and correction was due, now we feel that this weakening has gone a bit too far, especially as it seems to be driven by external factors ('risk aversion') mainly. On the other hand however, such factors are quite unpredictable in terms of how much they can last and to what extent they can move the market further. Therefore we decided to close our pay position in 2Y at 5.00% (taking 20 bp profit) and reduce our FRA steepeners by half (3x6 - 9x12 at +30, 6x9 - 12x15 at +60, both 10bp from entry levels). We'll be looking now to rebuild FRA steepeners if the market pulls back from current highs. We also added receive position in 2y bonds, as we like to use carry over coming months, we think that short bonds may go into 1y repo operation with NBP (due in November) and we may see a temporary squeeze in front end papers. FRA steepeners should work well as hedge for that trade. Next week MinFin will publish their inflation forecast. We see it easing to 3.2% y/y, that would definitely be a supportive factor and we could see lower yields again.

TRADE IDEAS:

Close pay position in 2Y. Reduce FRA steepeners by adding 2y bonds long position.

AUCTIONS

	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	6.142%	12/9/2008
26 Week T-bills	-	-	4.456%	5/4/2009
52 Week T-bills	11/2/2009	-	4.223%	10/26/2009
2Y T-bond OK0112	11/10/2009	-	5.115%	9/2/2009
5Y T-bond PS0415	12/2/2009	-	5.550%	10/7/2009
10Y T-bond DS1019	-	-	6.340%	5/20/2009
20Y T-bond WS0429	-	-	6.300%	9/23/2009

Money Market

Cheap carry influences the cash curve

Change in an unofficial bias

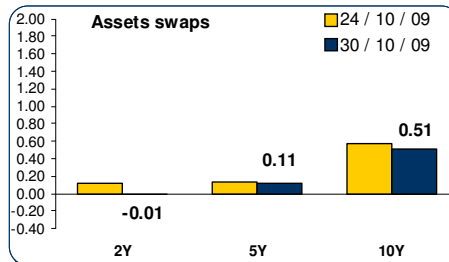
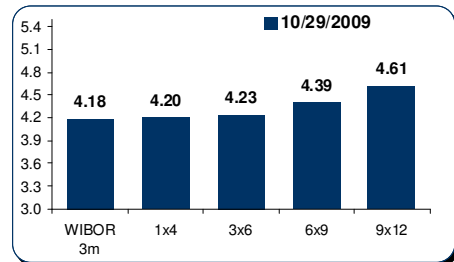
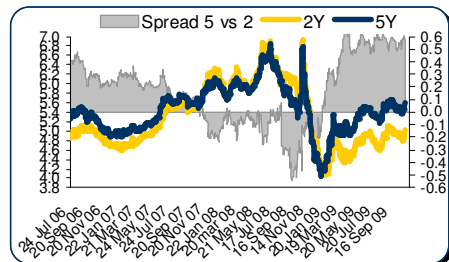
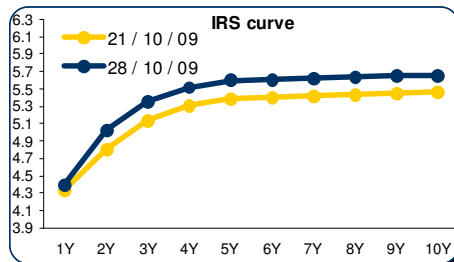
TRADE IDEAS:

FIXED INCOME & MONEY MARKET CHARTS

Cheap end of the reserve became a fact and nothing will change it. OIS contracts still show a strong believe in a continuation of the current trend (sustained surplus of the cash in the system). If the market is wrong the Polonia curve would go up at least 50 bps for longer terms and 100 bps for the shortest ones. However, we support the market view and believe that at least another 3-6M will be similar to the passing one.

The MPC did not change any rates but they change the unofficial bias to neutral. It means that current easing cycle is definitely over, at least for this team. 52-week T-bills average yield stable during the weekly tender at 4.25%.

Offer 3-6M OIS.



Foreign Exchange

Zloty weaker

The zloty has weakened, due to negative impact from Asian and U.S bourses to global sentiment. We started the week on 4.17 , reached 4.2900 high and has corrected to 4.2400 mid range after the better then expected GDP number from US. Highest correlated crosses are, beside obvious CE3, EURUSD and EURJPY.

Implied volatility higher

Zloty volatility curve is the perfect example of real sticky-to-strike market. The higher the spot, the higher volatility i.e. 1 month moved from 13 up to 14.5, 1 year from 12.4 mid to 13.25 (paid on Thursday). There was also a good demand for out of the money calls, strikes like 4.4500, 4.5500, what of course has translated into higher risk reversals (3.25 % paid 25d RR in 3 month).

TRADE IDEAS:

SPOT

Main supports / resistances:
 EUR/PLN: 4.0650 / 4.3000
 USD/PLN: 2.7500 / 3.0000

Keep short EURPLN

We still like the idea of being short. Sell at 4.27 with 4.31 S/L and 4.06 target, 4.14 support lies

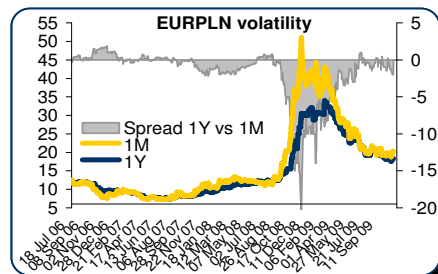
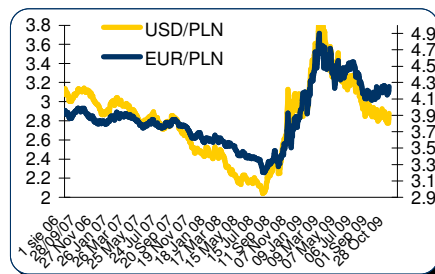
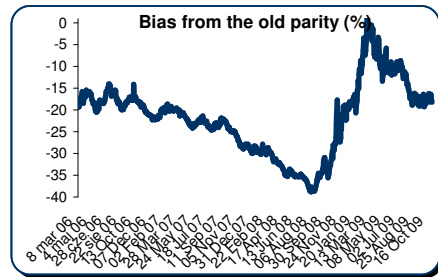
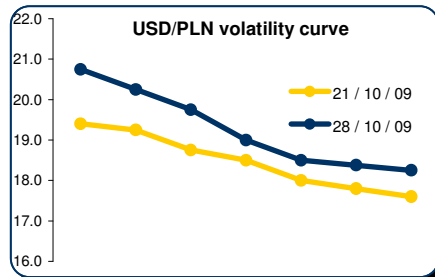
between. Nevertheless EURPLN is being bid, the economy is doing well and macroeconomics forecasts are being revising up. We believe, it may attract foreign investors here.

Sell vega

OPTIONS

We believe PLN vols remain sticky-to-strike so spot forecast is key feature. Believing in PLN we are short 6M 25D delta put. On other hand being short 1M/2M Risk Reversals should provide profitable gamma structure.

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
22/10/09	4.06%	4.18%	4.20%	4.23%	4.35%	4.38%
23/10/09	4.07%	4.18%	4.21%	4.22%	4.39%	6.59%
26/10/09	4.08%	4.18%	4.18%	6.49%	4.34%	4.37%
27/10/09	4.05%	4.18%	4.18%	4.21%	4.38%	4.37%
28/10/09	4.06%	4.18%	4.15%	4.21%	4.34%	4.38%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
22/10/09	4.20%	4.20%	4.27%	4.47%	4.50%
23/10/09	4.20%	4.20%	4.26%	4.46%	4.51%
26/10/09	4.20%	4.21%	4.28%	4.47%	4.54%
27/10/09	4.20%	4.19%	4.25%	4.45%	4.50%
28/10/09	4.19%	4.20%	4.27%	4.48%	4.52%

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
22/10/09	4.38%	4.31%	4.87%	4.98%	5.46%	5.59%	5.49%	6.10%
23/10/09	6.59%	4.31%	4.85%	4.96%	5.45%	5.58%	5.52%	6.09%
26/10/09	4.37%	4.27%	4.88%	4.97%	5.47%	5.60%	5.55%	6.10%
27/10/09	4.37%	4.27%	4.90%	4.99%	5.51%	5.67%	5.56%	6.14%
28/10/09	4.38%	4.28%	5.03%	5.02%	5.60%	5.71%	5.66%	6.17%

PRIMARY MARKET RATES

Last Primary Market Rates

	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	09/10/26	10/10/26	95.905	4.22%	500	1758	431
OK0112	09/10/07	12/01/25	89.179	5.12%	4500	11890	4500
PS0414	09/09/09	14/04/26	100.003	5.74%	2000	2159	1108
DS1017	09/04/08	19/10/25	94.460	6.22%	2500	4846	1820

FX VOLATILITY

date	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
	1M	3M	6M	1Y	1M	1Y	1M	1Y
22/10/09	19.40	18.50	18.10	17.75	2.50	4.00	0.70	0.95
23/10/09	19.90	18.75	18.35	18.00	2.50	4.00	0.80	0.95
26/10/09	20.00	18.75	18.35	18.00	3.00	4.25	0.80	0.95
27/10/09	20.25	19.00	18.50	18.25	3.00	4.25	0.80	0.95
28/10/09	20.25	19.00	18.50	18.25	3.25	4.50	0.80	0.85

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
22/10/09	2.8044	4.1956	-16.42%
23/10/09	2.7816	4.1790	-16.49%
26/10/09	2.7750	4.1721	-17.41%
27/10/09	2.8230	4.2013	-17.88%
28/10/09	2.8779	4.2540	-18.24%

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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