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FINANCIAL MARKETS DEPARTMENT

PAGES: 8

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POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

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

Indicator	Date of release	Period	BRE forecast	Consensus	Last	Comment
CPI inflation y/y	Nov 13	Oct	**3.2%**	3.2%	3.4%	Food prices close to seasonal pattern. Fuel prices falling by more than 2.0% on monthly basis. Core inflation at 2.9%. Risk of a lower reading on price developments in Czech Republic and Hungary. .
M3 Supply y/y	Nov 13	Oct	**10.3%**	9.9%	9.7%	M3 supply elevated by PGE's IPO (more than PLN 15 bn of credit incurred for initial offering, to stay on bank deposits during the turn of the months).
Employment y/y	Nov 18	Oct	**-2.5%**	-2.5%	-2.4%	Majority of business tendency indicators in rising trend. Another minor drop of employment on monthly basis; definitely not a negative development.
Wages y/y	Nov 18	Oct	**2.2%**	2.7%	3.3%	One working day less on an annual basis. Last reading distorted by wages in mining. October is the last month of high statistical base effect from last year (undervaluation of annual growth of wages).
Industrial output y/y	Nov 19	Oct	**-2.5%**	-2.1%	-1.3%	One working day less on annual basis. Systematic growth of business tendency indicators. Seasonally adjusted growth rate closer to -1.0% y/y, compared to -2.1% a month earlier.
Producer prices y/y	Nov 19	Oct	**1.9%**	1.7%	1.6%	Industrial metals and oil prices higher. Minor zloty depreciation. Business activity indicators point to a acceleration

						of producer prices on annual basis.

In Focus / Macroeconomics

Surprisingly narrow C/A deficit

September saw a C/A deficit at the level of EUR -57 mln. Taking into account the revisions in the August data (+124mln vs previously reported -69mln) such a situation is only a small deterioration, tantamount to stability of C/A flows. Market consensus expected a sharp widening in current account deficit to EUR -470mln.

Such a positive development stems primarily from trade balance which improved to -4mln from -348mln a month ago (revised upwards from -431mln). Shrinking deficit is a result of outperforming exports (-17,1% y/y) what can be easily reconciled with surging German industrial output in September as Polish industry serves there as an important supplier of intermediate goods. Imports growth rate stayed close to the one recorded a month ago (-26.4% y/y), accelerating a bit on a process of inventory building in the wholesale trade (wearing apparel). Other accounts, including income, transfers and services proved to be rather not surprising; we saw overall softening there, probably of one-off nature. Short-term perspectives of such a composition of the current account are positive (slightly higher net exports and probably faster re-stocking) and corroborate our 1.7% y/y GDP growth forecast for Q3. Current developments and textbook recovery scenario made us revise growth forecast for 2010 towards the upper band of the range quoted so far, namely 3.0% y/y.

As for the financial side of the balance of payments, C/A deficit is still safely covered by foreign direct investment (C/A deficit on a rolling 12-month basis is in 89% financed by the net FDI flows). Although the trends with this respect recently have slowed down a bit, outlook is still bright owing to the plans of large sales of state-owned assets (privatization), to be cumulated in 2010. Looking at the current situation only, the missing 11% in financing is more than covered by the purchases of government bonds, amounting to EUR 1113mln in September).

C/A deficit widens gradually and this tendency, excluding factors of one-off origin, is likely to be maintained in the coming quarters. Such developments, however, should be regarded as normal, especially taking account the relative stability of private consumption and high absorption in order to finance and physically accomplish various investment projects (mostly infrastructural, soon to be followed by the machinery and equipment of the private firms). Thereby widening C/A account is unlikely to entail any actions connected with rising country risk (including another round of PLN sell-off). There are some one-off risk factors, though, including substantial dividend payments (PZU-Eureko case) and data revisions. The latter point seems especially relevant as errors and omissions account came back to rising trend and it may be distributed within various accounts along with quarterly data publication, driving C/A deficit higher.

MID-TERM FORECATS

Indicator	2006	2007	2008	2009	2010
GDP y/y (%)	6.1	6.5	4.8	1.5	**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	12.0	12.5
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 chages from the last release with arrows showing the direction of chages

Fixed Income

Finally some moves on the market.

Last week finally brought some excitement to the FI market. Positive sentiment returned and the curve moved down quite sharply by some 10-15bp. We've also observed further steepening in the 2y-5y sector. Tuesday's auction of new 2Y bond OK0712 met very good demand from the investors and MinFin successfully placed 5bio at average rate 5.03%. Friday's publication of October's CPI is likely to support the market, if MinFin's forecast of 3.1 y/y is confirmed. Our estimate is 3.2%, but with downside risks, so 3.1 is seems possible. Marketwise we think that this recent steepening of the curve is getting seriously overdone. It maybe giving some positive carry in the short term, but looking at such position from longer perspective, in a year it will result in being receive 1y and pay 4y (not a very good, if not worst position to have while you're in the middle of the hiking cycle). Also looking at forward rates, both 1y2y and 1y3y trade above 6% and 1y4y close to that level. We definitely don't think it is a reasonable pricing and consider this as a receiving opportunity. Therefore we decided to open receiving position in 2y2y forward (entry level 6.10%, currently at 6.05%).

TRADE IDEAS:

Hold 2y bonds. Receive 2y2y forward.

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	12/7/2009	-	4.223%	10/26/2009
2Y T-bond OK0712	12/2/2009	-	5.115%	11/10/2009
5Y T-bond PS0415	12/2/2009	-	5.736%	9/9/2009
10Y T-bond DS1019	-	-	6.340%	5/20/2009
20Y T-bond WS0429	-	-	6.300%	9/23/2009

Money Market

Negligible 3M repo

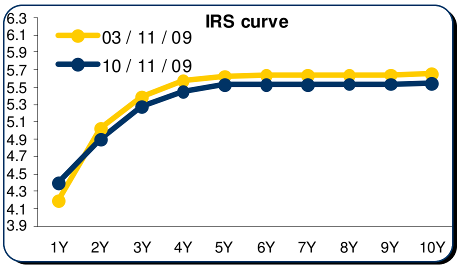
Market in lethargy

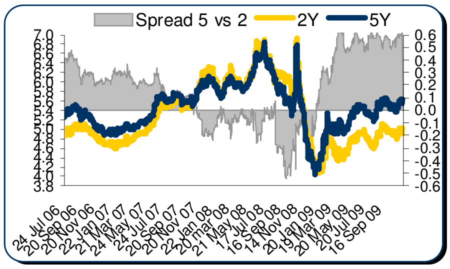
Boring week with the cost of carry 20-30 bps below the main rate. 3M repo with the central bank almost inexistent (almost PLN 300 mln). No figures, therefore no volatility, moreover that even figures have been unable to wake the market up lately. Open market operation will be substantial tomorrow in a range PLN 55-60 billion. We think that the carry will be cheaper and cheaper, providing extremely low shortest rates at the end of reserve period.

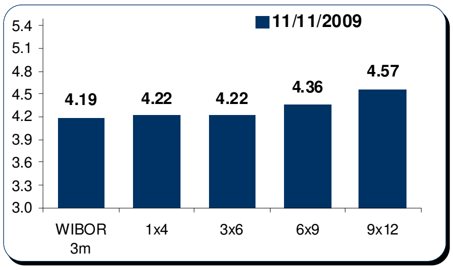
TRADE IDEAS:

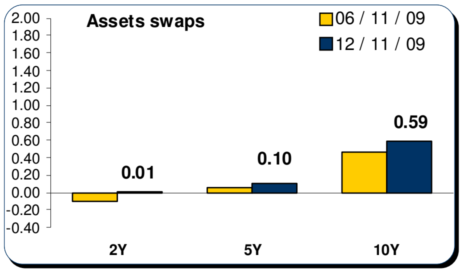
Sell 2W polonia.

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty stronger – Strong reversal in sentiment.

The rise in global risk appetite plus much better then expected current account number in Poland were the main drivers for the zloty during the last week. The EUR/PLN has dropped from 4.2740 last Thursday high to 4.1190 this Wednesday low, and is now consolidating in the 4.1200/4.1700 range.

Implied volatility lower

Stronger zloty is a usual catalyst for a lower volatility curve. Recent slide in EUR/PLN has caused also the slide in EUR/PLN volatility curve. The front end i.e. 1month moved from 14% mid to 12.75% mid this (Thursday) morning, the fall in the longer end were much less impressive as it corrected from 12.85% mid to 12.55% mid now. The short term risk reversals are also lower as some market participants rushed to buy (buy back?) lower strikes in the front end i.e. 4.05 30 November 09 or 22 December 09 4.0350 – both traded in good amounts via brokers.

TRADE IDEAS:

SPOT
Main supports / resistances:
EUR/PLN: 4.0650 / 4.1850
USD/PLN: 2.7000 / 2.8500

Keep short EURPLN

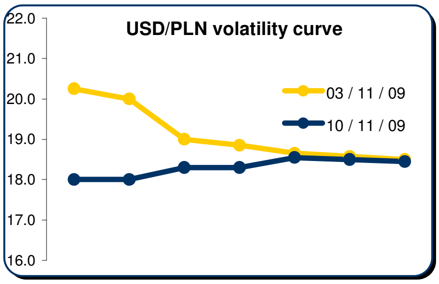
After the strong move south in EUR/PLN (15 “groszy” or big figures) within the week, we look for same consolidation in 4.1200/4.1850 range. We prefer to sell on spikes with a new, lower stop loss at 4.2400, and profit taking target still at 4.0650.

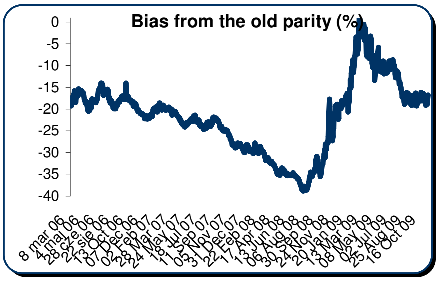
OPTIONS

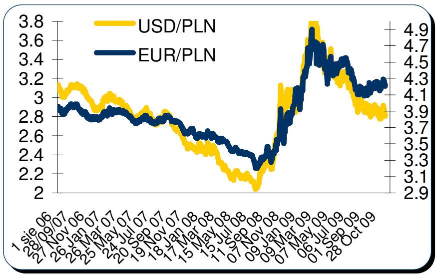
Keep short I vega

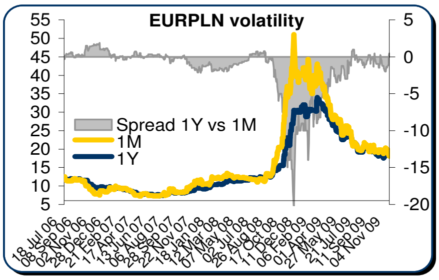
We would like to keep our short Vega position for the time being. The consolidation of zloty at the current levels or stronger zloty should provoke more Vega sellers, and the volatility curve should move even lower. The short term sold risk reversal strategy has worked out nicely and we also would like to keep that position. As we feel that, the move to the downside can be fiercer then the other way around.

FX CHARTS


USD/PLN volatility curve
03 / 11 / 09
10 / 11 / 09


Bias from the old parity (%)


USD/PLN
EUR/PLN


EURPLN volatility
Spread 1Y vs 1M
1M
1Y

MARKET PRICES UPDATE

MONEY MARKET RATES

Money market rates (Closing mid-market levels)

date	3M		6M		1Y	
	FXSW	WIBOR	FXSW	WIBOR	FXSW	WIBOR
04/11/09	4.09%	4.19%	4.19%	4.20%	4.36%	4.38%
05/11/09	4.04%	4.19%	4.19%	4.21%	4.36%	6.59%
06/11/09	4.12%	4.19%	4.17%	6.49%	4.34%	4.38%
09/11/09	4.07%	4.19%	4.30%	4.20%	4.56%	4.37%
10/11/09	4.07%	4.19%	4.18%	4.20%	4.37%	4.38%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
04/11/09	4.20%	4.23%	4.37%	4.60%	4.59%
05/11/09	4.21%	4.24%	4.39%	4.63%	4.61%
06/11/09	4.21%	4.24%	4.39%	4.62%	4.62%
09/11/09	4.21%	4.23%	4.39%	4.63%	4.59%
10/11/09	4.21%	4.23%	4.39%	4.62%	4.61%

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
04/11/09	4.38%	4.43%	5.03%	4.94%	5.64%	5.70%	5.69%	6.14%
05/11/09	6.59%	4.16%	5.02%	4.92%	5.63%	5.70%	5.66%	6.15%
06/11/09	4.38%	4.16%	5.02%	4.92%	5.63%	5.68%	5.66%	6.13%
09/11/09	4.37%	4.14%	4.95%	4.92%	5.58%	5.63%	5.59%	6.12%
10/11/09	4.38%	4.13%	4.90%	4.91%	5.53%	5.63%	5.54%	6.13%

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
OK0712	09/11/10	12/07/25	87.600	5.03%	5000	8759	5000
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
04/11/09	19.75	18.75	18.65	18.50	3.25	4.50	0.80	0.85
05/11/09	19.50	18.75	18.60	18.35	3.25	4.50	0.80	0.85
06/11/09	19.50	18.75	18.60	18.35	3.25	4.50	0.80	0.85
09/11/09	18.50	18.75	18.60	18.35	3.25	4.50	0.80	0.85
10/11/09	18.00	18.30	18.55	18.45	3.25	4.50	0.80	0.85

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
04/11/09	2.8908	4.2662	-18.28%
05/11/09	2.8754	4.2680	-18.73%
06/11/09	2.8485	4.2437	-18.89%
09/11/09	2.8195	4.2245	-18.00%
10/11/09	2.8031	4.2043	-16.74%

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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