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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 20th to November 27th

Indicator	Date of release	Period	BRE forecast	Consensus	Last	Comment
Core inflation y/y	Nov 21	Oct	**2.9%**	2.8%	2.9%	No improvement in core inflation, lagged effects of state-administered prices and EURPLN depreciation still in place.
Retail sales y/y	Nov 25	Oct	**2.1%**	2.3%	2.5%	Data on car sales confirm the probability of lower reading. Retail business activity indicators improving only slowly, with high variation on a disaggregated basis.
MPC decision	Nov 25	-	**3.5%**	3.5%	3.5%	Almost no-event. There are some comments (Slawinski) that the 12-motnh repo operation will be put into the set of monetary tools.

In Focus / Macroeconomics

No doubts anymore – labor market stays resilient

October corporate wages came lower than expected, but close to our forecast, reaching 2.0% y/y growth. Taken at face value, such a growth rate confirms further deceleration of wages compared to September (3.3%). We are more likely though to consider this as a normalization after one-off higher reading, influenced mainly by some bonuses in mining. It is possible then that the dynamics of wages reached a trough in the cycle – taking into consideration statistical effects alone, they are likely to push the growth rate higher in coming months. Simple statistical base is set to coincide with more fundamental developments in the quarters to come, which stem from employment and unemployment rate developments.

Unemployment rate is the simplest measure of labor underutilization, and its most important medium-term determinant is the growth of employment (leaving aside the developments of total labor force). October employment reading proved to be far better then expected as it stabilized at -2.4% y/y, and a monthly increase of 1k workers was recorded (quite surprising taking account the nine months of consecutive drops). Owing to the developments in the business activity indicators (with a clear uptrend in employment visible), recent developments in real figures corroborate our for long endorsed view that the labor market is (and is also likely to be in the future) much more resilient than during the former 2000-2001 slowdown episode. As consecutive facts seem to perfectly fit our view, we feel free to leave the ensuing comment on future developments almost intact, compared to earlier issues of the weekly report.

We believe the labor market resilience may be linked to greater flexibility of enterprises (mind that the majority of jobs was shed in the very beginning of the slowdown, along with decent drop of sentiment) which allowed them to preserve profit margins. Also government programs contributed to contemporary situation by introducing flexible working hours (is seems enterprises exercised natural trade-off between working hours and employment in favor of the latter, a definitely less disastrous outcome from expected disposable income perspective). At this stage -2.4% growth rate seems the minimum in the current cycle and a solid turnaround is on the horizon at the beginning of 2010, as the supply side expansion sets in (manufacturing). That is why we expect private consumption to have reached a trough in the current cycle already in Q2. The subsequent rise of the unemployment rate is unlikely to take its toll as it is related to the inflow of alumni, who – to be honest – does not alter their material status at all: they have been excluded from labor force and they will be counted as unemployed (both cases entail no earnings, although unemployment rate rises). Generally, we are skeptical as for the use of traditional keynesian consumption functions (relating consumption to the growth of disposable income alone) pointing instead to factors affecting expectations: relative stability of the labor market (job prospects, as measured by current employment trends), rising consumer confidence and positive wealth effects (stock exchange, high deposit rates, CHFPLN appreciation – a relief for Swiss credit holders).

As for the monetary policy perspectives, taking into account allegedly very benign 2010 inflation perspectives (which we partially described in one of the latest weekly issues) the market is very unlikely to dig into the better labor market data right now and bring together two important facts which will have to be challenged by the new MPC in H2 2010 and onwards: accelerating inflation (although from low level, which – by the way – does not seem to be a problem at the beginning of monetary policy tightening, see 2007 episode) and relatively tight labor market, quite a nasty ingredients for mounting inflationary pressures.

Polish industry heading for V-shaped recovery; core producer prices stable

October saw only very limited decline in industrial output (-1.2% y/y vs. -2.3% recorded in September). In seasonally adjusted terms industrial output recorded its first annual increase of 0.6% (-2.1% in September). Interestingly, better than expected industrial output figure is not only a result of a surge in auto industry – positive annual dynamics was recorded in 15 out of 34 sections, marking thereby the broad base for the ongoing recovery. The most recent developments in the Polish industry have been significantly boosted by rapid acceleration going on in the German industry. We think that in coming months the headline IP figure will turn positive. Favorable working-days and statistical-base effects are set to work together with the underlying trend (improvement) in fundamentals.
Producer prices accelerated a bit towards 2.0% y/y form 1.6% in September, close to our expec-

tations (1.9% y/y). It is better to look at monthly momentum, though. This way the monthly growth in manufacturing prices at 0.3% is commodity and EURPLN driven. Stripping those effects (and looking at the core PPI in manufacturing, the more meaningful measure in case of looking for trends) leaves monthly growth rate at 0.0% - the same as month ago. In regional comparison (not only other CEEs but also western economies) prices in manufacturing are quite stable then (no downside trend on the horizon, contrary to the development in the West). Resilient economy should prevent producer prices from decreasing (on a sustainable, monthly basis). However, it does not refer to annual growth rate of PPI, falling on base effects from early 2009 which will add to the picture of alleged non-inflationary growth in early 2010.

Rapid improvement on the supply side of the economy will be working towards further stabilization of Polish labor market and improvement of domestic demand perspective. In such a scenario, the risk of fiscal collapse seems pretty limited. Strategically, we thus bet on zloty strengthening, further risk premium compression and flattening of the yield curve. Near term, this scenario is to be made more likely as soon as the Q3 GDP data see the light (we expect GDP to have grown by at least 1.7% y/y).

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	3.0
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

Poor IDS auction.

The main trend we observed on the market last week was yields coming lower both in 2y and 5y. The lowest levels we saw was 2y trading at 4.86% and 5y at 5.51%; curve steepened by some additional 2 bp. in 2y5y sector, 5y10y spread was rather offered and trading around 1 bp level. 2y bonds outperformed rest of the bond curve, as for example yield on the OK0712 dropped 7bp within a week. What has changed sentiment a little on the local market was the IDS auction (road bonds issued by BGK). Bond sale went pretty poor, with small demand and very low average price (this bond got cheaper by some 10bp to the government bond curve, currently standing at 55 bp. over). This made us decide to reduce 50% of our position in short term bonds (taking 20 bp. profit). We are maintaining receive position in 2y2y IRS (currently standing at 6.05% level entry at 6.10%). We think that 2y5y spread is very steep, and is pushed up only from carry perspective. We think much better value offers receiving forward IRS especially in the middle part of the curve (forward curve has still bell shape). They look good from carry perspective as well as the outright level seems inviting. With bonds we still favor front end of the curve and we will be looking to this again, in case of any sell off, or we will wait for the primary auction to add to our position.

TRADE IDEAS:

Stay receive in 2y2y IRS (currently at 6.05), reduce short bonds holdings.

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

Cost of carry 15-25 bps below main rate

Friday's CB bills tender left almost 2 bln surplus in the market. Banks bought all PLN 55.5 bln papers from the offer. There was even small reduction of 4.84%. This week short-term rates were 15-25 bps below main rate.

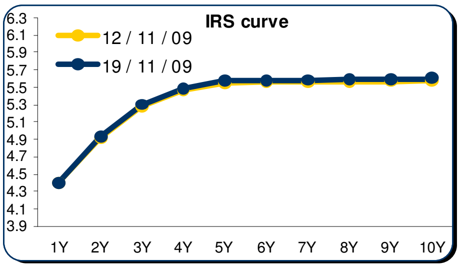
Imperceptible 6M repo

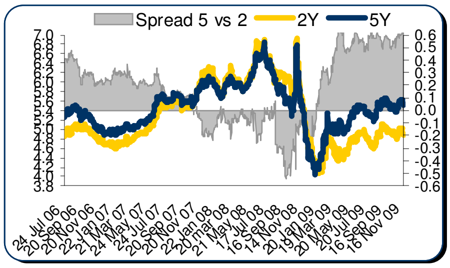
We think that banks will attend next OMO more carefully and demand will be lower than on previous one especially that the end of reserve requirement period is coming. At the 6M repo on Tuesday demand was only PLN 21 million in comparison to PLN 2.3 bn maturing.

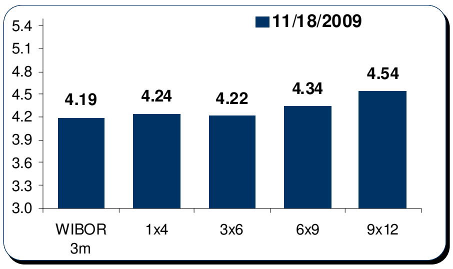
TRADE IDEAS:

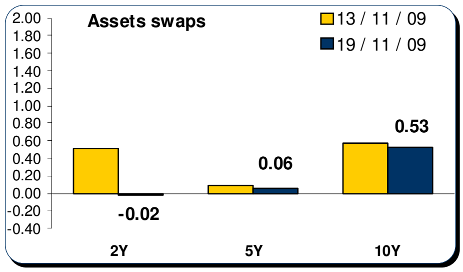
Offer 3M OIS at current level

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty weaker

Zloty strengthening in previous weeks was driven by global sentiment warming. Several forecasts with targets at 4.00 and 3.80 were published so "market' had unanimous view for zloty. Zloty had strengthened 5.5% since early November and we had seen various names entering short EURPLN positions. While low at 4.08 this week was reached, global unwinding of risky assets has started EURPLN correction. We believe such replying of global basket will last in next weeks and influence of local data is limited. Highest correlated crosses are, beside obvious CE3, EURUSD and EURJPY.

Implied volatility bit higher

As usual, the EUR/PLN volatility curve was mimicking the developments on zloty. We have seen lower, flattish (like 12.75 to 12.5) curve with zloty around 4.10 and then some profit taking while the zloty was trading at 4.15. Week ends 1M at 13.1 and 1Y at 12.6.

TRADE IDEAS:

SPOT

Main supports / resistances:
EUR/PLN: 4.0650 / 4.3200
USD/PLN: 2.7000 / 2.9500

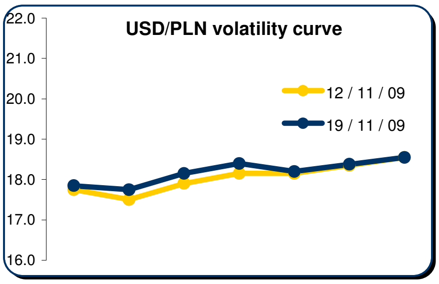
Sell EURPLN

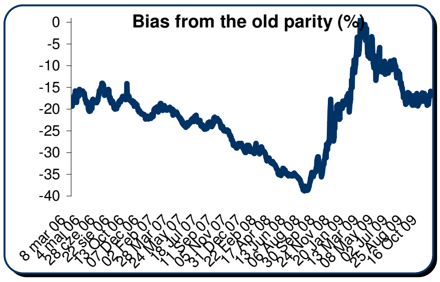
We wait for end of correction as much lighter positioning of market creates opportunity to break 4.0650 finally. Desired level for re-enter short EURPLN is 4.20-4.25, 4.33 is S/L signal. Favouring global environment is needed for breaking such strong support. If won't happen P/T we would place at recent, 4.08, lows.

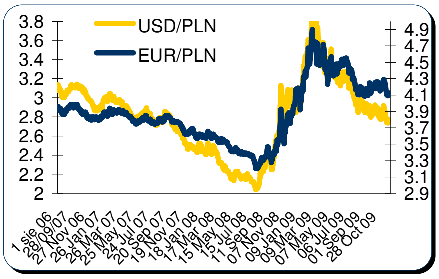
Sell vega

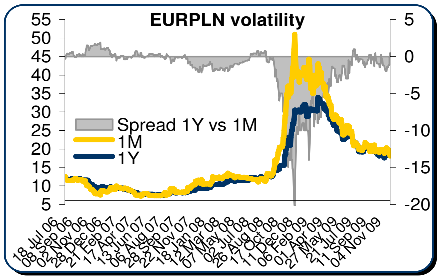
OPTIONS
We like being short 6M 25D put. Short vega and long vanna profile suits most current sticky-to-strike market characteristic.

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
13/11/09	4.10%	4.19%	4.18%	4.20%	4.37%	4.38%
16/11/09	4.14%	#ARG!	4.21%	4.20%	4.37%	6.59%
17/11/09	4.09%	4.19%	4.24%	6.49%	4.39%	4.38%
18/11/09	4.09%	4.20%	4.21%	4.21%	4.39%	4.39%
19/11/09	4.09%	4.19%	4.19%	4.21%	4.36%	4.38%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
13/11/09	4.22%	4.24%	4.40%	4.61%	4.60%
16/11/09	4.22%	4.22%	4.36%	4.57%	4.57%
17/11/09	4.22%	4.22%	4.36%	4.57%	4.57%
18/11/09	4.22%	4.21%	4.34%	4.54%	4.54%
19/11/09	4.23%	4.22%	4.34%	4.55%	4.54%

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
13/11/09	4.38%	4.17%	4.89%	4.90%	5.54%	5.62%	5.55%	6.12%
16/11/09	6.59%	4.16%	4.87%	4.89%	5.52%	5.59%	5.53%	6.11%
17/11/09	4.38%	4.15%	4.88%	4.90%	5.52%	5.61%	5.55%	6.14%
18/11/09	4.39%	4.17%	4.91%	4.91%	5.56%	5.62%	5.58%	6.15%
19/11/09	4.38%	4.17%	4.93%	4.91%	5.57%	5.63%	5.60%	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 1M	3M	6M	1Y	25-delta RR 1M	1Y	25-delta FLY 1M	1Y
13/11/09	17.50	18.15	18.15	18.55	3.25	4.50	0.80	0.85
16/11/09	17.50	18.15	18.15	18.55	3.25	4.50	0.80	0.85
17/11/09	17.50	18.15	18.15	18.55	3.25	4.50	0.80	0.85
18/11/09	17.60	18.25	18.15	18.55	3.25	4.50	0.80	0.85
19/11/09	17.75	18.40	18.20	18.55	3.25	4.50	0.80	0.85

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
13/11/09	2.7631	4.1135	-17.08%
16/11/09	2.7400	4.1008	-16.81%
17/11/09	2.7415	4.0967	-15.83%
18/11/09	2.7367	4.0909	-16.45%
19/11/09	2.7770	4.1288	-16.61%

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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