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FINANCIAL MARKETS DEPARTMENT

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POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

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PREVIEW: The week of November 20th to November 27th

Indicator	Date of release	Period	BRE forecast	Consensus	Last	Comment
GDP growth	Nov 30	Q3	**1.7%**	-	1.1%	Private consumption 2.5%, fixed capital formation -3.2%. Net exports contribution at +2.2pp. and rebound in inventories to -1.6pp.
FinMin's inflation forecast	Dec 1	Nov	**3.4-3.5%**	-	3.1%	Low statistical base effects on fuels. Food prices close to seasonal pattern with a kind of sharper turnaround after low October (upside surprises in vegetables, tea and coffee, butter). Core inflation at 2.9% y/y.
PMI	Dec 1	Nov	**49.8pts**	-	48.8pts	Further improvement in domestic and foreign business tendency indicators. Domestic liquidity problems (credit rationing for enterprises) slowly receding.

In Focus / Macroeconomics

Normalization of retail sales; summer excessive turnover boosts Q3 GDP

October retail sales matched our expectations of -2.1%, placing itself slightly below market consensus. The sales decelerated quite substantially after the holidays, eliminating thereby the excessive turnover generated during the summer months. It seems we have reached some kind of stabilization, which is likely to gradually transform into moderate growth. Our baseline scenario relies on relative tightness of the labor market (which is the dominant factor in terms of determining the future income perspectives). That is why we expect the positive "employment effect" (going hand in hand with consumer confidence) to be more important for private consumption than slowdown recorded in disposable income alone (which, by the way, suffered less compared to the previous slowdown episode). Simple view basing on the latter precludes any effects stemming from important expectations channel and possibly positive wealth effects.

Although "exuberance" recorded in retail sales during the summer months is past right now, it may still shape market expectations via the fresh GDP reading (concerning Q3 with inflated retail sales). **We expect the GDP growth rate to reach 1.7%** - above 1.1% in Q2 and 0.8% in Q1. As for the breakdown, we expect firmer private consumption (2.5% vs 1.9% recorded in the previous quarter) and our reasoning is also backed by higher VAT incomes. Relative stability applies also to fixed capital formation – we expect the growth rate at -3.2% (after -3.0% in the previous quarter) basing on a surge in construction activity recorded in summer months. Q3 net exports contribution may be close to the level recorded in Q1 (about +2.2pp.); we may expect a rebound in inventories, although the contribution is likely to remain negative (-1.6pp.). All the above mentioned factors speak in favor of a fundamental rebound in the domestic demand, which we expect to continue also in Q4.

Rates on hold, as expected. No surprises in the statement.

The MPC kept the rates unchanged with its base rate at 3.5%. The Council reiterates that the risks to inflation outlook are balanced, which should be read as an unofficial commitment to a neutral stance in the monetary policy. The MPC acknowledges that global economy is recovering from the recession and the GDP growth may prove stronger than expected. Our attention attracted, however, the assessment of next year's inflation perspectives. The Council sees 2010 inflation path to be critically determined by statistical base effects resulting from unprecedented zloty depreciation and state controlled price hikes in H1 2009. Very similar diagnosis has been presented in our research in mid-October, when we estimated that inflation may drop by as much as 1.5pp. in H1 2010 due to statistical base effect. **We still believe that falling annual inflation rate in H1 2010 may restrain interest rate hike expectations, which along with improving GDP outlook is to support Polish bonds (long end of the sovereign yield curve should benefit from expected risk premium compression).**

Turning to the near term perspective, the MPC is very clearly waiting their term out (nine of the ten MPC members will be replaced over the course of January and February.). It means no changes of monetary policy parameters. We expect the rates to be eventually increased in H2 2010 (repo rate at 4.0 at the year end) as an immediate response to reviving inflationary pressure (see economic recovery taking hold, labor market improving, a new launch of a catching up process in wages). Although no details on the new MPC members have been officially provided yet, we believe that the new MPC will see euro adoption as its strategic objective, which in turn would imply monitoring inflation convergence criterion and, on average, more restrictive monetary policy in mid term.

MID-TERM FORECATS

Indicator	2007	2008	2009	2010	2011
GDP y/y (%)	6.5	4.8	1.7	3.0	4.5
Inflation rate (%, average)	2.4	4.3	3.5	2.3	2.9
Current account (% of GDP, average)	-4.5	-5.3	-1.2	-2.9	-3.7
Unemployment rate (end-of-year)	11.4	9.5	12.0	12.5	10.5
NBP repo rate (end-of-year)	5.00	5.00	3.50	4.00	5.50

Indicator	2009				2010	
	Q1	Q2	Q3	Q4	Q1	Q2
GDP y/y (%)	0.8	1.1	1.7	3.2	3.2	2.9
Inflation rate (%, average)	3.2	3.7	3.5	3.5	3.3	2.1
NBP repo rate (end-of-quarter)	3.75	3.50	3.50	3.50	3.50	3.50

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

Fixed Income

Sentiment driven market.

Last week rates fluctuated within some 7bp spread. After some strengthening in the first half of the week, recent sentiment change pushed the yields back up. MPC's decision (leaving rates unchanged) and comments had absolutely no impact on the market. On the switch auction Ministry of Finance sold almost 3.5bio of bonds. Position wise we don't change our view. We still think the steepening is overdone in 2y5y sector. 2y2y forward at 6.10% still seems an attractive receiving opportunity. On the bond side we still keep small position in the front end, profiting from cheap financing. However if current weakness persists, we'll be looking to add to this position, possibly on the auction next week.

TRADE IDEAS:

Stay receive 2y2y forward. Look to buy bond on dips.

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

Cheap end of the reserve

Last week of the reserve was extremely cheap, with the shortest rates slightly above 2% and growing deposit in the central bank. The start of the new reserve will be determined by today's open market operation. The supply will be 55 billion pln or more. The question is whether the market buys it or not.

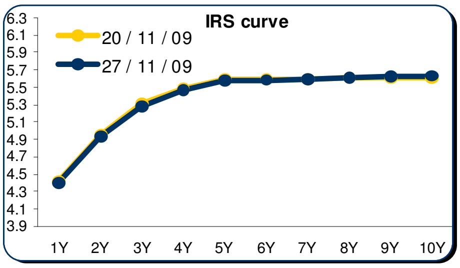
No demand for T-bills buy back

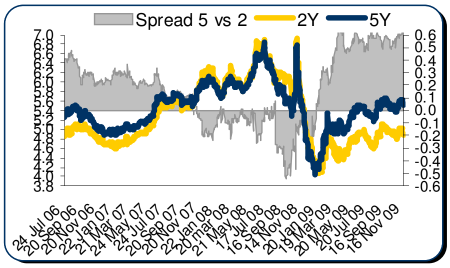
The MPC left all the rates unchanged. The comment by all means was towards the neutral bias. We expect any movement (increase) no sooner then next midyear. Unsuccessful T-bills buy back. The demand was next to nothing, which is not surprising in the over-liquid system.

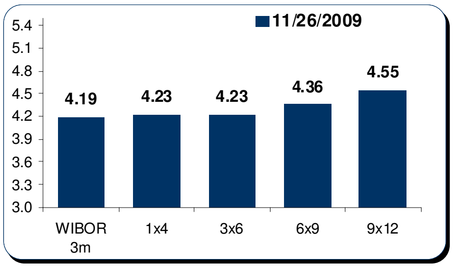
TRADE IDEAS:

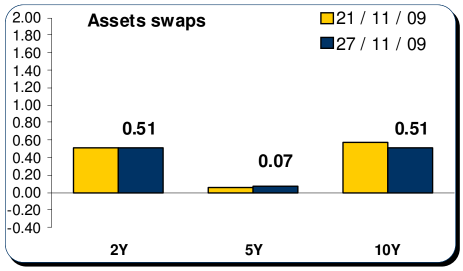
Offer OISs up to 6m at current levels.

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty in wide range

Recent correction in Zloty strength was stopped by 38.2% Fibonacci at 4.1650 during last Friday. EUR/USD new high at 1.5140 was not enough to break the strong EUR/PLN support at 4.0650. And now, with the global sentiment much more sour because of Dubai news and potential flow from Eureco dividend payment, the market is being well-bid. Today (Friday) we have reached the fresh highs at 4,1980. We expect that to fade, and still consider EUR/PLN boxed in the wide range 4.0650-4.2650.

Implied volatility wobbly

The realized short term volatility was testing the fresh lows levels (1W around 10%). So albeit EUR/PLN has not broken 4.0650 the EUR/PLN volatility curve corrected lower, especially front end (1Month at 12.5% mid with longer being slightly higher, at 12.7% mid). Current (Fridays) risk aversion has reversed this move, the EUR/PLN volatility curve is now high and wide (13.00/15.00 1 month and 12.75/14.50 for 1 year. Risk reversals and currency spread (USD/PLN vs EUR/PLN) have jumped as well.

TRADE IDEAS:

SPOT

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

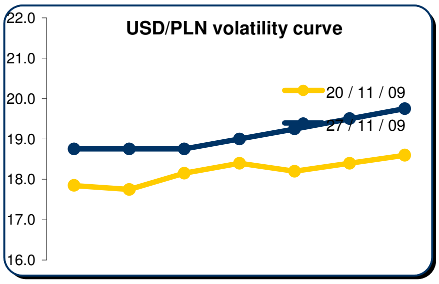
Sell spikes EURPLN

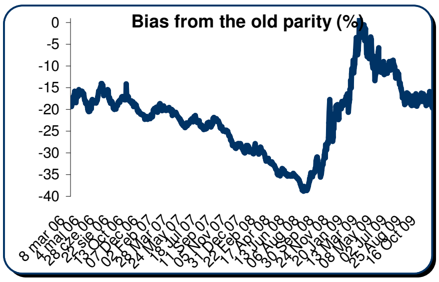
We saw good buying interests between 4.10-4.12, that has provided the sufficient protection for strong 4.0650 support (intact). The Dubai story has hit us hard on Friday, and EURPLN has reached the 4.1980 high. We stick to our view of good fundamentals of Poland, and we are eager to resell the EUR/PLN at 4.2100/4.2400 region with the stop loss at 4.2700 and P/T at 4.1000.

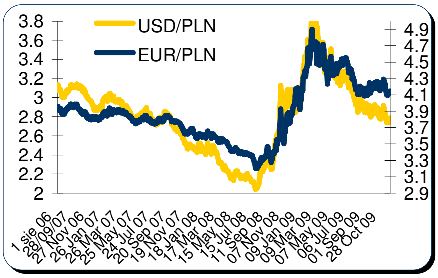
Keep short vega

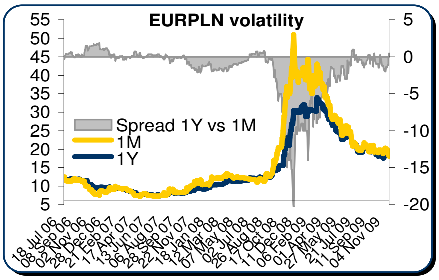
OPTIONS
We like being short 6M 25D put. Short vega and long vanna profile suits most, current sticky-to-strike market characteristic. We would also use that opportunity (high front end volatility) to sell a little gamma to secure a good theta for Christmas.

FX CHARTS


USD/PLN volatility curve
20 / 11 / 09
27 / 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
21/11/09	4.05%	4.19%	4.17%	4.21%	4.34%	4.38%
24/11/09	4.13%	4.19%	4.17%	4.20%	4.56%	6.59%
25/11/09	4.05%	4.19%	4.23%	6.49%	4.37%	4.38%
26/11/09	4.05%	4.19%	4.20%	4.20%	4.35%	4.38%
27/11/09	4.09%	4.19%	4.19%	4.20%	4.37%	4.38%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
21/11/09	4.21%	4.22%	4.34%	4.53%	4.54%
24/11/09	4.24%	4.22%	4.34%	4.54%	4.54%
25/11/09	4.23%	4.23%	4.35%	4.57%	4.56%
26/11/09	4.24%	4.24%	4.36%	4.56%	4.56%
27/11/09	4.24%	4.22%	4.35%	4.57%	4.56%

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
21/11/09	4.38%	4.16%	4.94%	4.92%	5.59%	5.65%	5.61%	6.18%
24/11/09	6.59%	4.08%	4.93%	4.92%	5.56%	5.63%	5.60%	6.15%
25/11/09	4.38%	4.14%	4.88%	4.90%	5.55%	5.62%	5.57%	6.13%
26/11/09	4.38%	4.18%	4.93%	4.91%	5.57%	5.64%	5.63%	6.14%
27/11/09	4.38%	4.18%	4.93%	4.91%	5.57%	5.64%	5.63%	6.14%

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

	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
date	1M	3M	6M	1Y	1M	1Y	1M	1Y
21/11/09	17.75	18.40	18.20	18.60	3.25	4.50	0.80	0.85
24/11/09	17.25	18.20	18.20	18.70	3.25	4.50	0.80	0.85
25/11/09	18.60	18.85	19.00	19.45	3.25	4.50	0.80	0.85
26/11/09	18.75	19.00	19.25	19.75	3.25	4.50	0.80	0.85
27/11/09	19.75	19.50	19.50	19.75	3.25	4.50	0.80	0.85

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
21/11/09	2.7422	4.1341	-17.20%
24/11/09	2.7588	4.1210	-18.19%
25/11/09	2.7517	4.1201	-19.29%
26/11/09	2.7875	4.1485	-19.72%
27/11/09	2.7875	4.1485	-19.72%

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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