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FINANCIAL MARKETS DEPARTMENT

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WARSAW, DECEMBER 4, 2009

POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

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PREVIEW: The week of December 4th to December 10th

Indicator	Date of release	Period	BRE forecast	Consensus	Last	Comment
No significant releases						

In Focus / Macroeconomics

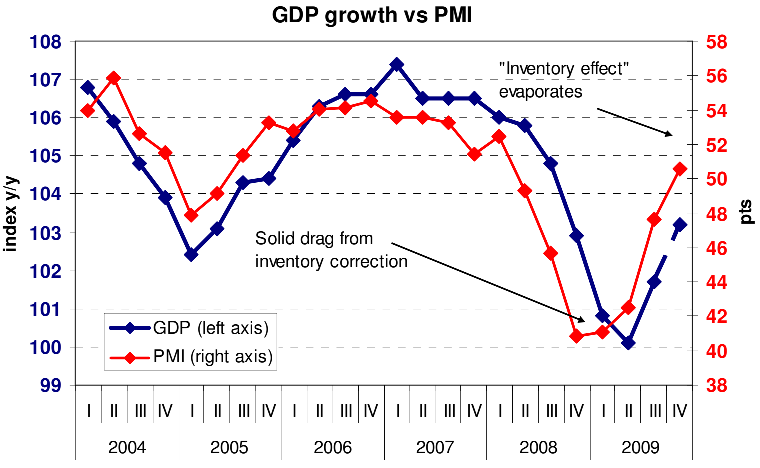
Q3 GDP growth confirmed at 1.7% - heading for strong Q4

GDP growth rate reached 1.7% y/y in Q3 (above market consensus of 1.5% but meeting our expectations) after 1.1% in Q2. Going through the breakdown, we see acceleration of private consumption (close to our call) to 2.2% y/y from previously reported 1.7%. Also fixed capital formation surprised to the upside (-1.5% y/y versus -3.0% in the previous quarter) owing to strong results recorded in construction during the summer months. Net exports contribution amounted to 3.0pp. and variation of private inventories subtracted 2.6pp. (only a minor improvement compared to the previous quarter's contribution of -2.7pp.). Owing to positive developments in private consumption and investment, domestic demand accelerated from -2.1% y/y to -1.2% y/y.

Departing for a while from the quarterly accounts, also higher frequency data suggest the economy is gaining speed. Recently published PMI index surged to 52.4pts from 48.8pts in October, breaching the theoretical threshold separating average monthly growth of manufacturing (i.e. the momentum of the supply side) from contraction. The breakdown of the index reveals a surge in output and new orders (both well beyond 50pts), only minor contraction of employment (the smallest number for 19 months) and an indication of rising price tensions of manufacturing output. The publication has far reaching implications for the economy in the short- and the mid-term perspective.

In the short-term, PMI confirms our November forecasts. More specifically, it corroborates our view that industrial output is likely to accelerate sharply to 6.8% (with risk balance skewed to the upside) not only on base effects from the last year, but also as a result of rising momentum of the supply side. Higher output is likely to go hand in hand with further stabilization of employment which translates into a rebound in annual growth rate of this aggregate to -2.2% y/y (only +/- 2k m/m) from -2.4% recorded in October (market consensus is still at a conservative -2.3% y/y; although the divergence seems minor, it may change perception of the labor market from a drag to the economy to one of the main stabilizing forces via the private consumption channel). The PMI also sheds some light on the nominal sphere, rising the probability of a sharper rise of producer prices (+0.1% m/m compared with the consensus view of -0.1%).

As for the mid-term perspectives, tight correlation between PMI and GDP growth confirms our earlier results based the supply side model. We estimate the Q4 growth rate at 3.2% y/y (see the graph below).



Q4 solid GDP growth pose a solid base for further turnaround in 2010 as soon as second-order effects set-in (positive feedback loops from the supply to the demand side). More specifically, we expect private consumption to stabilize in the next quarter and come back to the rising tendency afterwards. Consumers are likely to be supported by the labor market developments (stabilization of employment) and rising consumer confidence. As for the fixed capital formation, contemporary growth rate may have been somehow inflated by the turnaround in construction activity, but still, private business confidence points to a sharp revival in the coming quarters (which may – this time – compensate for the seasonally frozen infrastructure projects). **Inventories correction has finally come to an end (mind the contributions, revised downwards for this year's quarters: -5.2pp. (!), -2.7pp. and -2.6pp. now) and we are heading for the process of inventory build up. Potential headwinds in 2010 may come from net exports (large statistical base effects from last year, more import-intensive exports). However, we expect those to be almost fully compensated for by the inventory cycle. That is why we see a good chance for GDP growing by 3.0% in 2010.**

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

Yet another calm week

Last week was rather calm on the FI market. Rates traded in a very narrow range, and activity was limited due to US holiday period. Main event was GDP release and bonds auction (with new 5y benchmark PS0415). Both events had very little impact on the curve, and it is really hard to make some kind of pattern from the current price action. Demand for Polish bonds remained solid and Ministry of Finance seems to have situation very much under control (5.5 bio of bonds sold on Wednesday yet again). Our view is still unchanged, we stay receive in 2y2y IRS and we would like to add 10y bonds to our position. We see developments on the fiscal side not as dramatic as they may be viewed (better GDP with conservative assumption from MinFin, extra measures, such as excise tax, VAT refund in January 2011 etc). We also see new MPC as very determined to join ERM soon, and they can be seen as rather hawkish, which would support flattening trade, adding to that our view about falling CPI below RPP range it makes us to go for duration. 2y2y trade supports our current outright view of rates falling in the beginning of the year, plus it addresses the steepness of the curve in 2y5y area.

TRADE IDEAS:

Stay receive in 2y2y, buy long end bonds on dips

AUCTIONS

	next auc.	offer	avg yield last	last auction date
13 Week T-bills	TBA for 2010	-	6.142%	12/9/2008
26 Week T-bills	TBA for 2010	-	4.456%	5/4/2009
52 Week T-bills	TBA for 2010	-	4.223%	10/26/2009
2Y T-bond OK0712	TBA for 2010	-	5.099%	12/2/2009
5Y T-bond PS0415	TBA for 2010	-	5.736%	12/2/2009
10Y T-bond DS1019	TBA for 2010	-	6.340%	5/20/2009
20Y T-bond WS0429	TBA for 2010	-	6.300%	9/23/2009

Money Market

Cheap month ahead

The fact that the extremely cheap end of the reserve was unavoidable was not convincing enough to some of the market participants. Less then pln 48 billion of money bills was purchased out of pln 55.5 billion on the offer. This in turn provided huge surplus of the cash for the new settlement period. Since we have December we can expect a cautious behavior during following auctions, thus the very low carry is the most probable scenario till the end of this year.

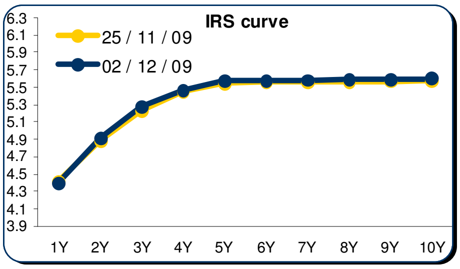
Waiting for new incentives and new year

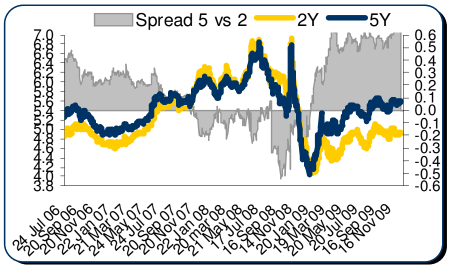
Nothing interesting for trading. Everyone is waiting for the new incentives like the changes in the MPC, any correlation breakdown or surprising figures. No T-bills auction this month.

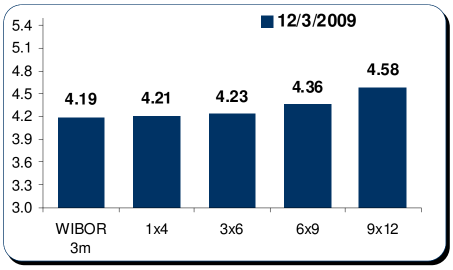
TRADE IDEAS:

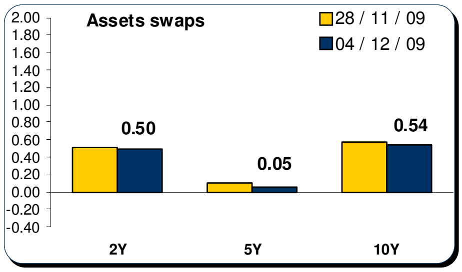
Sell 1M polonia.

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty stronger

The impact of the Dubai story was limited and short lived. The mixture of better global sentiment plus stronger than expected Polish GDP for third quarter (+1.7%) has helped polish zloty. After testing 4.1750 / 4.1950 resistances, we are now in consolidation phase in 4.0800/4.13000 range, just above strong (pivotal ?) support 4.0650.

Implied volatility lower

Stronger zloty as usually, has translated into lower volatility curve. The trade of the week was the 6 month EUR/PLN ATM paid 13.75 % (Monday) and given 12.80 % (Tuesday). The Risk reversals have followed the path of the ATM's (25d RR 1Year is lower now, mid 3.75% in comparison to 4.25 % mid earlier in the week).

TRADE IDEAS:

SPOT

Main supports / resistances:
EUR/PLN: 4.0650 / 4.2500
USD/PLN: 2.6800 / 2.9200

The 4.0650 support exposed

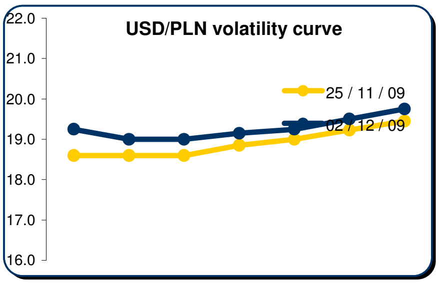
The gravy train of the polish zloty strength is loosing a bit of steam in the 4.1000 region (again !), but the crucial pivotal support of 4.0650 is being exposed. We suggest to take profit of part of the long zloty position here or lower the stop loss to 4.1200/4.1300 EUR/PLN. Resell at 4.2300 spike (with 4.28 S/L) or at the clear break of 4.0650.

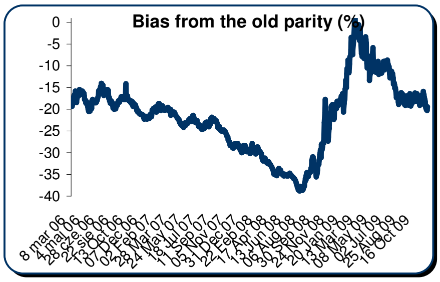
OPTIONS

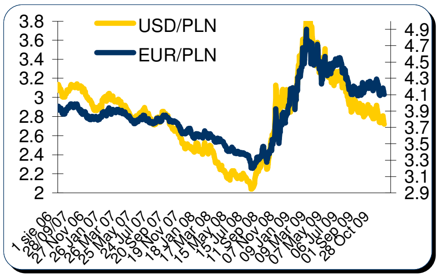
Keep short Vega

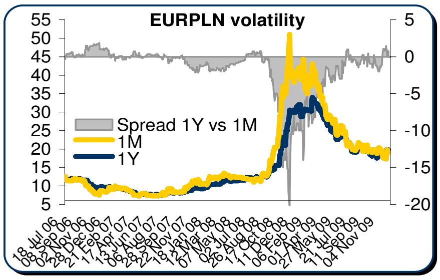
We believe PLN volatility is remaining sticky-to-strike so spot forecast is the key feature. Believing in PLN we are short 6M 25D delta put to secure we will be short Vega with the stronger zloty. The same logic applies to being long, longer end risk reversal in USD/PLN, plus the advantage to be long Vega USDPLN if global (dollar driven) crisis comes back.

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
26/11/09	4.09%	4.19%	4.20%	4.20%	4.37%	4.38%
27/11/09	4.06%	4.19%	4.20%	4.20%	4.38%	6.59%
30/11/09	4.09%	4.19%	4.18%	6.49%	4.36%	4.38%
01/12/09	4.15%	4.19%	4.20%	4.20%	4.38%	4.38%
02/12/09	4.08%	4.19%	4.22%	4.20%	4.39%	4.38%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
26/11/09	4.24%	4.24%	4.36%	4.58%	4.56%
27/11/09	4.23%	4.22%	4.33%	4.54%	4.55%
30/11/09	4.23%	4.23%	4.36%	4.55%	4.55%
01/12/09	4.23%	4.23%	4.36%	4.59%	4.56%
02/12/09	4.23%	4.24%	4.36%	4.58%	4.55%

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
26/11/09	4.38%	4.18%	4.93%	4.91%	5.57%	5.64%	5.63%	6.14%
27/11/09	6.59%	4.16%	4.92%	4.93%	5.57%	5.67%	5.63%	6.20%
30/11/09	4.38%	4.11%	4.92%	4.91%	5.60%	5.65%	5.61%	6.16%
01/12/09	4.38%	4.08%	4.94%	4.90%	5.59%	5.64%	5.61%	6.17%
02/12/09	4.38%	4.17%	4.91%	4.90%	5.57%	5.62%	5.60%	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	09/12/02	12/07/25	87.692	5.10%	5000	5472	1440
PS0414	09/12/02	15/04/25	98.691	5.78%	5000	5614	3629
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
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
30/11/09	19.75	19.50	19.50	19.75	3.25	4.50	0.80	0.85
01/12/09	19.75	19.50	19.50	19.75	3.25	4.50	0.80	0.85
02/12/09	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
26/11/09	2.7875	4.1485	-19.72%
27/11/09	2.8051	4.1808	-20.13%
30/11/09	2.7538	4.1431	-20.16%
01/12/09	2.7392	4.1264	-20.29%
02/12/09	2.7185	4.1044	-19.38%

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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