



POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

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PREVIEW: The week of February 12^{ve} 2010 to February 19th 2010

Indicator	Date of release	Pe-riod	BRE forecast	Consensus	Last	Comment
C/A balance EUR	Feb 12	Dec	-757mln	-847mln	-1200mln	Relative high income deficit, very low EU inflow. Higher growth of imports and exports (-4.0% y/y and +9.8% respectively) stimulated by base effects and minor improvement in business climate (seemingly better exports environment). Watch the revisions of the recent data.
M3 Supply y/y	Feb 12	Jan	7.8%	7.8%	8.1%	All categories in trend.
CPI Inflation y/y	Feb 15	Jan	3.5%	3.5%	3.5%	State-controlled prices growing close to the last year's pace. Moderate growth of food prices (+1.0% m/m – confirmed by our model basing on the Czech data) and fuels (+2.2% m/m). Core inflation at 2.3% - to be published in March, along with revised data for January and February (new consumption basket).
Wages y/y	Feb 16	Jan	3.3%	3.1%	6.5%	Lower number of working days; no boost from extraordinary payments in mining.
Employment y/y	Feb 16	Jan	-2.9%	-2.3%	-1.8%	Last month saw <i>increases</i> of employment in some manufacturing sections – a very positive signal. Business tendency indicators in upward trend. Lower growth of employment is purely statistical – new sample of enterprises is entering public statistics.

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Industrial output y/y	Feb 18	Jan	3.0%	6.5%	7.4%	Two working days less on annual basis. Low base from 2009. Atmospheric conditions work against high growth of industrial output. High uncertainty regarding one-off effects.
Producer prices y/y	Feb 18	Jan	0.5%	0.9%	2.1%	Very strong base effects from the last year (interference of rising fuel prices, plunging zloty and increases of state-controlled prices. Prices in manufacturing excl. energy still falling.

In Focus / Macroeconomics

Prepare for surprises in macro data

This time we offer you a very brief overview of the macro data, to be published within the 7 days. We concentrate on the big picture, the detailed thoughts and the numbers are presented in the table above.

Referring to the title, next days may bring plenty of surprises. We had to face a lot of one-off factors while preparing the short term macroeconomic forecasts for the Polish economy (hard to pin down state-controlled price increases, ambiguous effects of low temperatures and extreme snowfall) and some difficulties concerning the statistical features of the data (technical and beyond our reach). The former refer mostly to the forecasts of CPI and industrial output, the latter concern labor market data (employment) and balance of payments.

However, one should not dig much into temporary volatility and accidentally miss forest for the trees. We expect it will be possible to isolate one-off effects and confirm that Poland is on the recovery track. None of the published data is likely to push MPC into any direction (either more hawkish or dovish). The focal point of most MPC members will be fresh inflation projection (likely to show higher GDP growth and slowly mounting inflationary pressures within monetary policy horizon) but still, in an environment of volatile data and falling inflation (widely expected fall of inflation in coming months is inevitable and this view is unlikely to be shaken by flat January reading) it is unlikely for the MPC members to even change the monetary policy bias from neutral (although there may be some dissenters). Moreover, on the fragile path of economic recovery pro-growth MPC is unlikely to hamper price-competitiveness of the Polish economy by supplying the market with an good excuse (change the bias towards restrictive) to push the zloty exchange rate higher.

MID-TERM FORECATS

Indicator	2007	2008	2009	2010	2011
GDP y/y (%)	6.5	4.8	1.7	3+	4.5
Inflation rate (% , average)	2.4	4.3	3.5	2.3	2.9
Current account (% of GDP, average)	-4.5	-5.3	-1.3	-2.3	-3.7
Unemployment rate (end-of-year)	11.4	9.5	11.9	12.1	10.9
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	3.0	3.8	3.3
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 changes from the last release with arrows showing the direction of changes

Fixed Income

The opportunity.

Last week yet again we saw some good volatility on the curve. On the back of external factors, Polish yields rose significantly up to 5.68 in the 5y, spread on the 5y5y PLN against EUR rose to 145 bp as the widest level. Volatility continued on Polish bonds, at some point of time taking WS0922 below 96.00 mark (we were stopped out on our reduced position). But, on Monday everything has changed, and by Wednesday everybody was keen on buying bonds yet again. 2y auction drew yet again record demand and Ministry of Finance sold total of 6.6 bio of bonds (taking the whole year number to 47 bio). Privatization revenues are still looking good (3.7 bio so far) so the financing is secured at a level of 50 bio. Flow wise, market seems very liquid, despite sharp moves, it doesn't seem that we are anywhere close to any liquidity issue. As far as the

bigger picture is concerned, it looks very much unchanged, the range is still in place, combination of volatility and liquidity is definitely inviting. Next week we will have some economic releases, but they will bring little change. There is one major change though, and we think it is likely to happen. Time is generally working in favor of PLN bond prices. The Greece/Portugal/Spain situation will be resolved soon, or the repricing will be completed. The evidence from Polish market suggest that this external events have only temporary influence on the Polish bonds market. The big thing will be the economic picture that will start to emerge from data starting in March (we are entering falling CPI environment), and this can be a trigger for breaking the current range. We see 5-10y bonds to fall in yield and stick to the idea of 2y2y rates decline.

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	2/15/2010	-	3.851%	2/8/2010
2Y T-bond OK0712	3/10/2010	-	4.972%	2/10/2010
5Y T-bond PS0415	3/10/2010	-	5.736%	12/2/2009
10Y T-bond DS1019	2/19/2010	-	6.046%	5/20/2009
20Y T-bond WS0429	2/19/2010	-	6.170%	9/23/2009

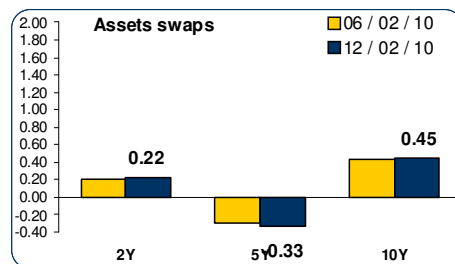
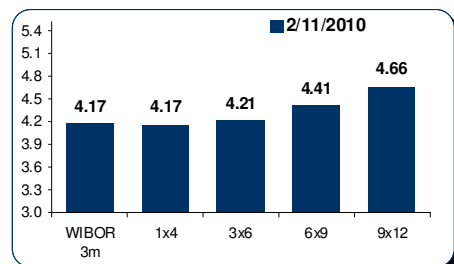
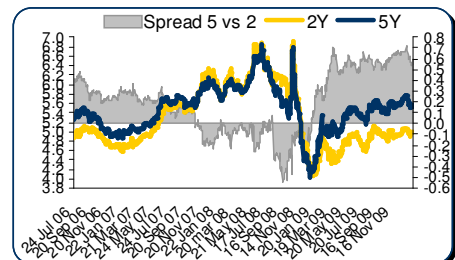
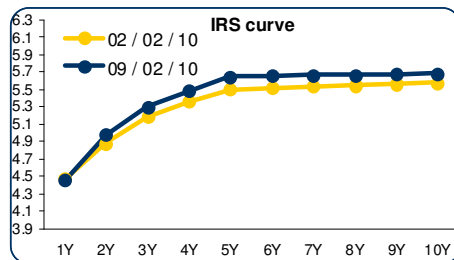
Money Market

First pooled repo operation behind us

Bullish sentiment still dominates after excellent 2Y bond auction

Shortest rates down since the demand for the money bills did not match the supply (63 vs 67 billion PLN). Therefore, 4 billion surplus of the cash in the system did its job and we could see the cost of carry nearby the 2.5%. First repo operation with the pool indicates the willingness of the central bank to match the maturing amounts from the previous operations. If this is correct, it could be perceived as a first step in the exit scenario (from the quantitative easing of the monetary policy). Banks will have to increase the repo rates to take part of the stake. This week average yield for 3M operation was 12 bps higher than the minimum rate (3.87 vs 3.75%). This pooled operations should not have any significant impact on the overall liquidity of the system. We still think that the only consequence may be decreasing amount of the on the run money bills issues. Excellent demand for 2Y bonds proves a bullish sentiment of the investors. The MM curves went down 5-10 bps on follow.

FIXED INCOME & MONEY MARKET CHARTS



Foreign Exchange

Zloty stronger

High level of public debt of Southern Europe Euro members was the main factor in last week trading session. On Monday, EURPLN tested twice the high of 4.1200, but that level has held the up move. Pullback to Thursday's 4.02 was driven by long positions (short Zloty) squaring and positive statements on "Greece agreement". Market positioning seems light at the moment. Worth to mention is the fact that, EURUSD vs EURPLN correlation works again.

Implied volatility mixed

Volatility curves have followed both, spot level and realized volatility. While 4.12 was tested we faced jump in the implied volatility, EUR/PLN 1month reached 13.6% mid, the mid for 1year was 13.0%. The move of the USD/PLN curve was even more extended, 1year reached 19.5% (2% higher than the last week!) with spot trading at 3.00 (7% higher!). Later in the week, both curves were heading lower with stronger Zloty and better risk appetite. On Thursday EURPLN 1month was traded at 12.5% and 1year has dropped to 12.80% mid, 1 year for USDPLN has corrected at 18.9%.

Short-term outlook

SPOT

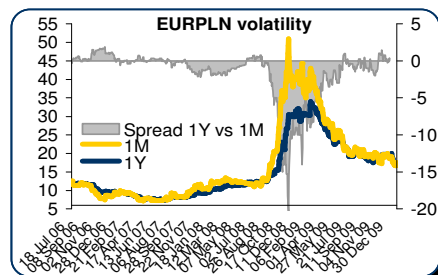
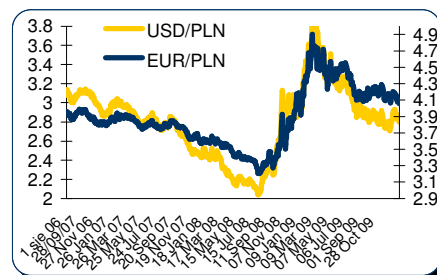
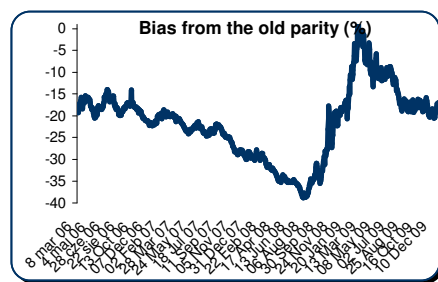
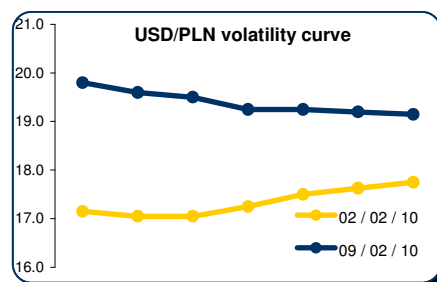
Main supports / resistances:
 EUR/PLN: 3.9500 / 4.1600
 USD/PLN: 2.8700 / 3.0000

We are still Zloty positive but we cannot exclude that, the Greece cancer will not spread to other the other southern EU countries. We see EURPLN falling to 3.9800.

OPTIONS

Present EUR/PLN range is 3.9500-4.1600, during last 7 months it was 4.0000-4.3000. EUR/PLN volatility curve ranged between 11.5% -14% (3M) since then. We see higher Vanna in these range trading conditions. As soon as local fundamentals will add to improved (hopefully) global sentiment we also see lower Vega.

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
05/02/10	4.14%	4.20%	4.16%	4.20%	4.36%	4.40%
08/02/10	4.12%	4.20%	4.17%	4.19%	4.37%	6.59%
09/02/10	4.13%	4.19%	4.15%	6.49%	4.37%	4.39%
10/02/10	4.00%	4.19%	4.15%	4.19%	4.38%	4.40%
11/02/10	4.10%	4.17%	4.10%	4.18%	4.30%	4.38%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
05/02/10	4.22%	4.25%	4.42%	4.67%	4.61%
08/02/10	4.23%	4.26%	4.43%	4.69%	4.63%
09/02/10	4.22%	4.26%	4.44%	4.72%	4.65%
10/02/10	4.23%	4.27%	4.46%	4.72%	4.64%
11/02/10	4.20%	4.25%	4.44%	4.70%	4.63%

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
05/02/10	4.40%	3.67%	5.02%	4.69%	5.63%	5.34%	5.70%	6.14%
08/02/10	6.59%	3.67%	5.01%	4.68%	5.67%	5.35%	5.68%	6.15%
09/02/10	4.39%	3.67%	4.98%	4.69%	5.65%	5.34%	5.68%	6.13%
10/02/10	4.40%	3.67%	4.97%	4.66%	5.64%	5.31%	5.67%	6.12%
11/02/10	4.38%	3.67%	4.97%	4.66%	5.64%	5.31%	5.67%	6.12%

PRIMARY MARKET RATES

Last Primary Market Rates

	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	10/02/08	11/02/08	96.252	3.85%	1200	3134	1090
OK0712	10/02/10	12/07/25	88.795	4.97%	5500	12417	5500
PS0415	09/12/02	15/04/25	98.691	5.78%	5000	5614	3629
DS1019	10/01/20	19/04/25	96.009	6.05%	2000	6596	2409

FX VOLATILITY

date	USD/PLN 0-delta straddle				25-delta RR		25-delta FLY	
	1M	3M	6M	1Y	1M	1Y	1M	1Y
05/02/10	19.60	19.25	19.25	19.15	3.00	4.50	0.60	0.90
08/02/10	19.60	19.25	19.25	19.15	2.75	4.25	0.60	0.90
09/02/10	19.00	19.00	19.15	19.15	2.50	3.75	0.60	0.90
10/02/10	18.80	18.85	19.00	19.05	2.25	3.75	0.60	0.90
11/02/10	18.35	18.65	18.90	19.00	2.25	3.75	0.60	0.90

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
05/02/10	2.9915	4.0921	-19.14%
08/02/10	2.9896	4.0916	-18.28%
09/02/10	2.9673	4.0779	-18.37%
10/02/10	2.9463	4.0595	-18.80%
11/02/10	2.9503	4.0548	-18.68%

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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