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FINANCIAL MARKETS DEPARTMENT

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POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

PREVIEW: The week of March 12ve 2010 to March 18th 2010

Indicator	Date of release	Period	BRE forecast	Consensus	Last	Comment
C/A balance EUR	Mar 12	Jan	**-423mln**	-575mln	-1034	Trade surplus at +600mln owing to acceleration of exports (still solid industrial output growth) and meager results recorded in wholesale trade (imports).
M3 Supply y/y	Mar 12	Feb	**5.6%**	5.6%	6.2%	In trend.
CPI Inflation y/y	Mar 15	Feb	**2.9%**	3.0%	3.6%	The beginning of the high statistical base effects. Revision of consumption basket (total effect -0.1pp.). Very moderate food price growth (with risk towards lower). Core inflation at 2.4% y/y.
Wages y/y	Mar 16	Feb	**3.2%**	2.6%	0.5%	The effects of the lack of some irregular payments fades away in February.
Employment y/y	Mar 16	Feb	**-1.0%**	-1.0%	-1.4%	Brisk sentiment indicators in manufacturing, construction and retail. The beginning of upward impact of base effects.
Industrial output y/y	Mar 17	Feb	**9.0%**	8.6%	8.5%	No difference in working days. High 2009 base. Decent business tendency indicators.
PPI y/y	Mar 17	Feb	**-2.2%**	-2.1%	0.2%	Huge base effects from the last year (EURPLN depreciation + state-controlled price rises). Lower prices of copper and oil.

In Focus / Macroeconomics

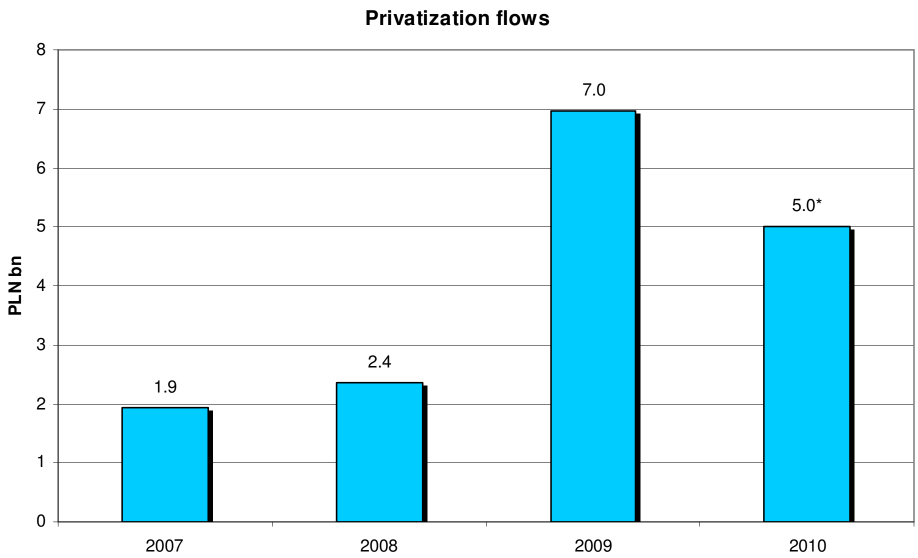
Some not really new but encouraging fiscal news

Minister Rostowski expects the public sector deficit to have reached 7.0% in 2009. According to the updated convergence program, the deficit figure for 2010 is likely to fall towards 6.9%, i.e. roughly PLN 97.5bn in nominal terms, on the basis of the GDP growth path presented by the Ministry. Recently we have been hearing a lot from the various sources (Kotecki, Boni) that this year's central budget deficit is likely to be lower by PLN 10-15bn than originally planned (we remind the reader the budget was constructed on quite pessimistic assumptions). Should this more optimistic scenario come true, the public sector deficit in 2010 may come lower at 6.0-6.4%.

Apart from lower borrowing needs alone, the Ministry is consequently pursuing the policy of ensuring the stability of funding. This strategy consists of 3 points:

1) Enormous feel of the market from the Ministry side which allows for flexible financing and very successful auctions, confirming good sentiment towards Polish debt.

2) Privatization. The Ministry announced recently it had sold PLN 1.1bn worth of Bogdanka shares to private investors (the whole offer was absorbed by open pension funds). This way the total amount of state-asset sales amounted to roughly PLN 5bn this year (out of the plan of 25bn enclosed in the budget bill) after 2,5 months. We assume than the pace of privatization is likely to accelerate further into the year, along with better situation in equity markets and further progress in the list of ready-to-be-sold companies (among the "cigar-butts" there are Warsaw Stock Exchange, PZU, ENEA, PGE). Assuming at least on average linear growth of privatization flows PLN 25 bn is within reach.



* Completed so far, i.e.10th March 2010. The plan for the whole year assumes total PLN 25 bn.

3) Extraordinary payments. To this point alone the most important factor is NBP profit transfer. We cannot exclude positive surprise as Ministry announced the dividend payment may be close to PLN 10bn whereas so far NBP insisted on rather 4bn. The exact payment will rely upon accounting issues, and we expect the Ministry of Finance to be stubborn and hard negotiator.

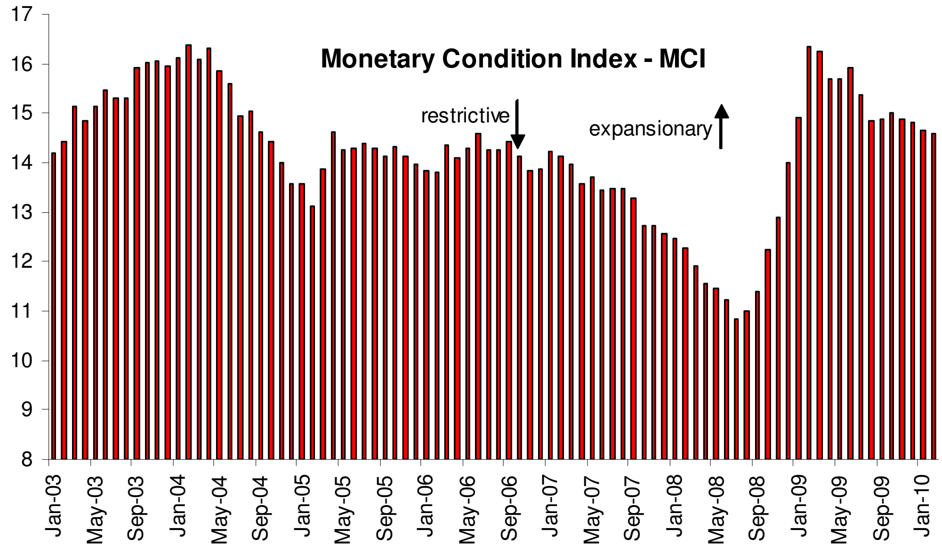
Polish MPC more and more focused on the zloty

All MPC members speaking this week focused on the zloty exchange rate related issues. NBP governor Skrzypek noted that zloty is now overvalued (or deviates from equilibrium level). In his opinion stronger zloty may well lead inflation rate lower, which in turn may translate into no need of monetary tightening.

A. Rzonca, seen as a hawk, acknowledged that stronger zloty may slow economic recovery. However, he conditioned the monetary tightening on whether or not inflation rate falls as suggested by the statistical base effects.

The most surprising proved to be the comment by A. Bratkowski (also seen as a hawk). In his opinion the no rate hikes scenario is the most likely for this year (market prices in about 50bp tightening this year). Bratkowski indicates that such a scenario may result form too risky outlook for the global economy including problematic Greek fiscal policy. Bratkowski also thinks that a premature rate hikes would lead to stronger zloty which would harm recovery. Strikingly, Bratkowski sees the NBP role in preventing zloty appreciation in interventions on the shallow FX market. Furthermore, MPC member discredited the NBP inflation projection as a tool for conducting monetary policy. This line of thinking even more strikingly places him very close to such declared doves like A. Kazmierczak.

These dovish comments notwithstanding we still think one has to closely monitor the risk of monetary bias change in the coming MPC meetings. Our impression is that informal bias change may be backed by some dovish MPC members, who do not necessarily link the change in the assessment of future inflation perspectives to the actual course of monetary policy. We also uphold our view that interest rate hikes may be well postponed into the future (end of 2010) and the realized interest rate path will be below that implied by forward rates. The MPC seems to be strongly focused on the zloty stability, so (in our opinion inevitable) zloty appreciation may reduce the willingness of the MPC to hike the rates – looking at the broad monetary conditions index plotted in the picture below, there is in fact a significant dose of restriction penciled in via the EURPLN behavior. Similarly, falling inflation (due to base effects) will also play as an important card in hands of those who do not welcome any kind of factors preventing Polish economy to recover.



Unfortunately, such a backward looking MPC may well stimulate markets to bet on extreme rate scenarios (weaker or not stronger zloty today, higher inflation → impression that MPC is falling behind the curve → steepening of the FRA curve) and not necessarily stabilize the zloty exchange rate.

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	-1.5	-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	3.1	3.0	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 chages from the last release with arrows showing the direction of chages

Fixed Income

Who is who part II?

Last week was very interesting on the FI market. Two most important highlights. First was Mr. Bratkowski comment about monetary policy and not only. Second was the 2y bond auction drawing record demand yet again.

The comments from Bratkowski stood at odds with everything that was earlier announced by governor Skrzypek. While head of MPC indicated possibility of change in both stance of MPC and higher rates trajectory, Bratkowski decisively said rates should stay on hold at least till the end of the year. He was also afraid of zloty strengthening. In our opinion zloty becomes the center of focus of the current MPC, which is a new phenomenon. All in all, the curve rallied massively in all sectors, and we even had some bullish flattening with 2y and 5y breaking the current range on the down side (the lowest trade were 4.82 and 5.43 respectively). Front end of the curve moved lower by some 15 basis points and 9x12 are currently trading some 40bp. above current 3M Wibor. The big question is what is actually happening with the views of the MPC council. Skrzypek, who used to represent dovish view is turning into leading hawk, while the hawkish (expected to be hawkish) wing of the MPC is sending dovish comments to the market. Our opinion is that for now we have to accept the fact that there can be some internal tactical games that are happening within the newly constructed body and they can cause extra volatility on the market. We maintain our view that monetary policy will be one of the most important factors to watch in the coming week/months.

The 2y bond auction went very well (again). The new issue we observed was increased purchases of bonds by bank books, which suggest that overliquidity is starting to make impact. Banks are struggling to give credits to real economy due to weak capital base, so the money goes into front end of the curve. The buying continued after the auction and prices rose to this year highs. Successful privatization (more than 5 bio so far) foreign issuances (another 470 mio CHF added) the NBP profit (almost forgotten), all shows that the supply on the primary market can be limited severely in the second part of the year. Adding to that decreasing risk premiums (over Greece as well as positive resolution of coming presidential elections) together with rebalancing economy (low CPI and stable GDP growth) can really put pressure on local yields, especially in the long part of the curve. We will be not surprised to see 10Y sector trading close to 5% yield in not very distant future.

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	3/15/2010	-	3.936%	3/8/2010
2Y T-bond OK0712	4/7/2010	-	4.895%	3/10/2010
5Y T-bond PS0415	4/14/2010	-	5.736%	12/2/2009
10Y T-bond DS1019	4/21/2010	-	6.103%	2/19/2010
20Y T-bond WS0429	4/21/2010	-	6.170%	9/23/2009

Money Market

Stable short term depo in a range 2.6-2.8

It was very calm week for depo market with short-term rates in a range of PLN 2.6-2.8 bn every day. We can still observe some bids above the offers for ON deposits which is caused by growing asymmetry in the liquidity layout. We can expect next week to be similar.

Average 3M repo yield down by 8 bps

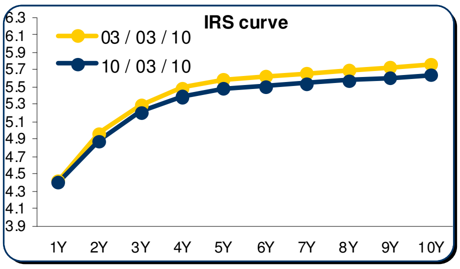
On Tuesday NBP offered 3M repo collateralized in PLN and EUR. Central Bank pool was PLN 3 bn which almost covered PLN 3.5 bn maturing from previous tender. Banks bid only PLN 480 mln and CB accepted all offers at an av. yield 3.77% (in comparison with 3.85 on the last tender).

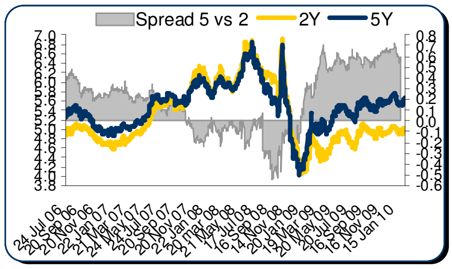
On Thursday CB announced that they will probably quit from 6M repo next quarter. This is their next step in exit from quantitative monetary policy easing after pooling repo operations. In our opinion this will have no impact on system liquidity.

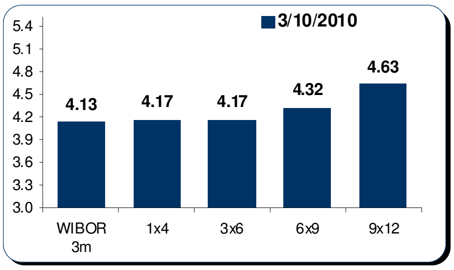
T-bills yields up at the tender

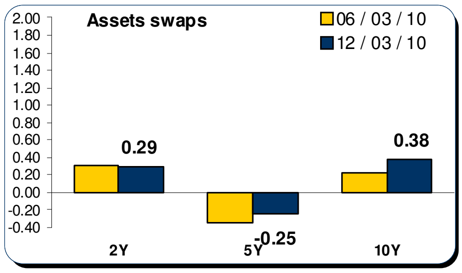
On Monday MinFin offered 52-week t-bills. Banks demand was almost PLN 2 bln and MinFin sold 1 bln PLN bills at an av. yield 3.936% (against 3.883% last week).

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty mixed

Last week EURPLN hit new low 3.8575 and since then has started consolidation phase. Although global investment sentiment remains favourable for zloty, MPC members, worried by zloty strengthening, by several statements stopped zloty buying and pushed market to take profit on long zloty positions. Buyers, nonetheless, has met suppliers and just 3.9125 high was reached so far. Worth to mention is fact EURPLN vs EURUSD correlation has decreased with actual value around -0.2.

Implied volatility lower

At beginning of week EURPLN curve, the same as spot, traded new lows – 1M 9.75, 1Y 11.7. Stopping/reversing EURPLN downward trend increased realized weekly volatility from 5 to 8%. It elevated a curve a bit, but compared to curve's shape (1M 10.0, 1Y 11.8) it still looks quite low. We also have observed 3.95-4.00 strikes buying interests with end of month dates of maturity.

Short-term forecasts

SPOT

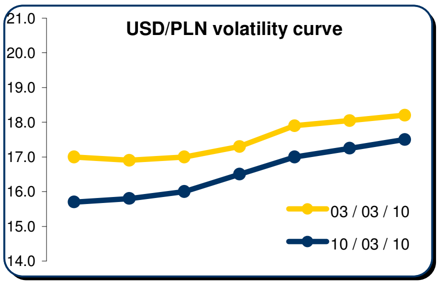
Main supports / resistances:
EUR/PLN: 3.8500 / 4.0500
USD/PLN: 2.8200 / 3.0000

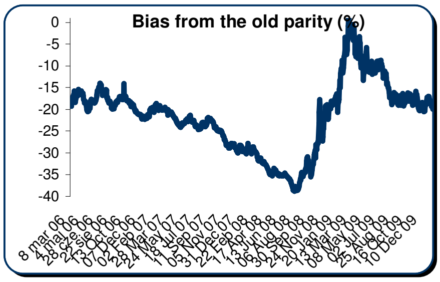
Depending on level of global sentiment we differentiate 3 important levels: 4.00, 4.05 and 4.10. Simple profit taking should take EURPLN to 3.99/4.00 (around 50% of down move) whilst global risk reduction would easily be traded around 4.10.

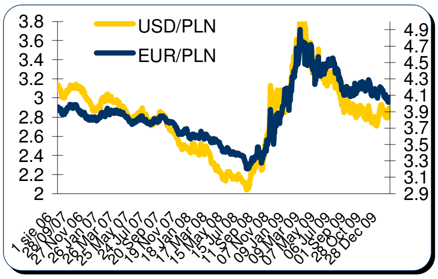
OPTIONS

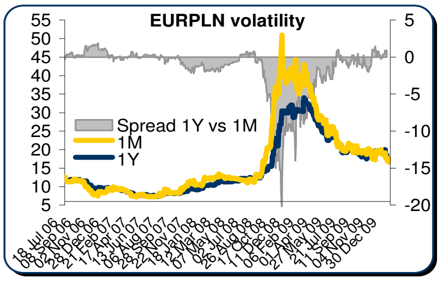
EURPLN spot market strengthened slowly, it is still good time for playing vols range by long vanna. Good tenors are 3M-6M as the most liquid and transparent. Short vega is good idea for the ones expecting higher spot.

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
04/03/10	4.05%	4.15%	4.13%	4.15%	4.33%	4.35%
05/03/10	4.06%	4.15%	4.12%	4.14%	4.34%	6.59%
08/03/10	4.06%	4.14%	4.13%	6.49%	4.34%	4.35%
09/03/10	4.01%	4.13%	4.15%	4.14%	4.31%	4.34%
10/03/10	4.02%	4.13%	4.12%	4.13%	4.34%	4.34%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
04/03/10	4.17%	4.19%	4.40%	4.63%	4.57%
05/03/10	4.17%	4.17%	4.38%	4.62%	4.57%
08/03/10	4.17%	4.19%	4.43%	4.68%	4.62%
09/03/10	4.15%	4.20%	4.43%	4.73%	4.64%
10/03/10	4.19%	4.21%	4.43%	4.73%	4.64%

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
04/03/10	4.35%	3.84%	4.96%	4.67%	5.61%	5.22%	5.77%	6.00%
05/03/10	6.59%	3.83%	4.98%	4.74%	5.60%	5.25%	5.75%	5.98%
08/03/10	4.35%	3.83%	4.95%	4.71%	5.57%	5.22%	5.69%	5.93%
09/03/10	4.34%	3.82%	4.90%	4.68%	5.53%	5.23%	5.66%	5.91%
10/03/10	4.34%	3.82%	4.88%	4.62%	5.48%	5.16%	5.64%	5.83%

PRIMARY MARKET RATES

Last Primary Market Rates

	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	10/03/08	11/03/08	96.173	3.94%	1000	1900	1000
OK0712	10/03/10	12/07/25	89.280	4.90%	5400	17000	5448
PS0415	09/12/02	15/04/25	98.691	5.78%	5000	5614	3629
DS1019	10/02/19	19/04/25	95.629	6.10%	2000	5570	2000

FX VOLATILITY

	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
date	1M	3M	6M	1Y	1M	1Y	1M	1Y
04/03/10	16.05	16.75	17.30	17.70	2.50	3.70	0.60	0.90
05/03/10	16.05	16.75	17.30	17.70	2.50	3.70	0.60	0.90
08/03/10	15.80	16.50	17.00	17.50	2.50	3.70	0.60	0.90
09/03/10	15.50	16.30	16.90	17.50	2.50	3.70	0.60	0.90
10/03/10	15.20	16.10	16.75	17.25	2.50	3.70	0.60	0.90

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
04/03/10	2.8670	3.9141	-18.71%
05/03/10	2.8568	3.8848	-19.65%
08/03/10	2.8372	3.8774	-19.89%
09/03/10	2.8577	3.8837	-18.83%
10/03/10	2.8531	3.8750	-18.90%

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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