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FINANCIAL MARKETS DEPARTMENT

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POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

PREVIEW: The week of March 26th 2010 to April 1st 2010

Indicator	Date of release	Period	BRE forecast	Consensus	Last	Comment
MPC decision	Mar 31	-	**3.5%**	3.5%	3.5%	Weak retail sales adds to MPC's perception on uncertainty regarding the outlook for the real sphere (and consumption in particular). We expect rather benign comment. We advise to carefully monitor the informal "bias" issue. However, as it is purely technical statement (in terms of objective probabilities), the MPC may well wait until next projection (June).
MinFin's inflation forecast y/y	Apr 1	Mar	**2.4-2.5%**	-	2.9%	Base effects from 2009 are taking their toll. Core inflation roughly at 2.1% y/y.
PMI	Apr 1	Mar	**53.9 pts**	-	52.4 pts	Increases of business tendency indicators at home and abroad (especially quite a surge in eurozone PMI's and German Ifo). Better weather conditions (seasonal adjustment has hardly accounted for bad weather in Jan-Feb).

In Focus / Macroeconomics

Arctic weather probably responsible for weak retail sales but…

After the publication of weak construction and rather poor performance of VAT revenues it was quite clear that retail sales was next in the queue, especially in connection with anecdotal evidence of weather-related weaker sales in supermarkets. Base effects form last year (relative low sales in some sections) could have been the only saviour in here but they actually failed. Retail sales decelerated to 0.1% y/y after 2.5% y/y recorded in January. The outcome seems even worse after taking account of the more favorable difference in working days (0 instead of -2).

We think that February drop is another, after January, weather-related one-off. Sections which contributed most to the deceleration of the aggregate were: home appliances (-15.7% y/y after -5.7% y/y in January), food (-4.9% after -3.3%), car sales (-12.8% after -2.4%), another drag in other category (-3.6% vs. -6.3% last month); all four likely to turn around in the forthcoming months, especially after some industry insiders are pointing to rising sales already in March.

As for the longer perspective, we expect the rising trend of retail sales to stay intact. Among the major fundamental factors there is stabilization of labor market (we prefer employment to unemployment rate as it is free form institutional factors and misleading movements of labor force). Such a stability should transfer into consumer confidence (yet another growth of GUS consumer expectations index in March) and outweigh the deceleration of wage fund growth (by the way lower than observed during 2001 slowdown episode). We also expect to see positive spillover effects (on consumption via expectations channel) from various sections of the economy (manufacturing, transport, telecommunications), recently confirmed by the representatives of the central statistical office (GUS).

And last but not least, as far as the title "but" is concerned, poor retail sales poses some short-term risk for budget performance and points to more dovish MPC wording. We shall not exclude a scenario in which deficit figures surprise negatively in the next few months. We see this as a threat the longer bonds to continue the rally. Falling inflation (and more benign MPC's wording) may clearly work in the opposite direction.

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

Lets try something else … just try.

Last week turned out to be surprisingly quiet one without any major events or news. As the prospects of a near-term interest rate increases faded after a few MPC dovish comments, market found its' new equilibrium at the lowest level this year. Swap curve was trading in a new 10bp band with a limited turnover (2y 4.70%-4.80%, 5y 5.27%-5.37%, 10y 5.44%-5.54%). What's interesting, the shape of the curve remained pretty unchanged even though we saw a quite aggressive receiving interest on both 5Y and 10Y likely coming from some stop losses on 5Y5Y fwd over EUR long positions (2y5y spread at around 55-56 points and 5y10y spread at 16-17 points looks unchanged).

We think the market is a little bit overdone and has priced in probably all positive scenarios (except from the country debt upgrade that seems to be the last reason to receive the long end still).

On a short end of the curve we won't argue with the market, currently thinking that Poland may not need interest-rate hikes in a near future. Next MPC meeting most likely will come with a current neutral policy bias. Falling CPI and rather dovish tone can still put a downward pressure on rates. But, saying all that, **we also think that market has gone too far pricing now around sub 100 bp hikes happening within 2y time frame, and only 50bp next year**…While the first and the second one (50 bp hikes this year) is fair (with current market dynamics risk skewed downwards), **50 bp hikes next year…it is cheap**, if not very cheap option. That is why we see 1y2y spread widening. The MPC may be dovish, CPI may be falling, but taking into account positioning, and our perspective of future CPI/rate path, 40bp on the spread seams to be inviting level.

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	3/29/2010	-	3.941%	3/22/2010
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

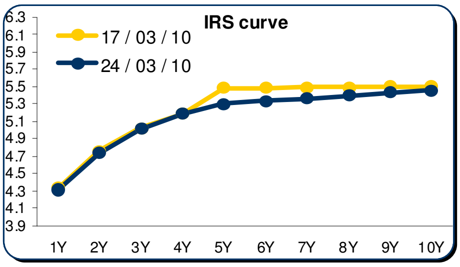
Cost of carry falling down dramatically

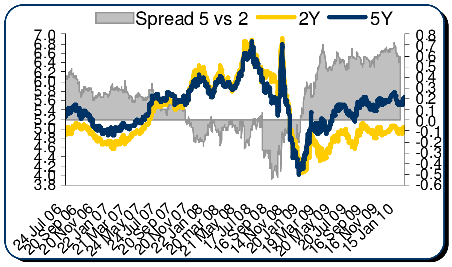
The cost of carry last week was falling down dramatically, just as we were forecasting in our last report and for exactly the reasons mentioned. The surplus of cash is snowballing and yesterday we could have observed 7-billion deposit in the central bank (mainly due to maturing PS0310 bond along with the coupons + PLN 15 billion inflow minus 2.5 billion from the settlement of the T-bills). Polonia rate fell to 2.15%. We think that this situation will last until the end of the current reserve period, which is Tuesday.

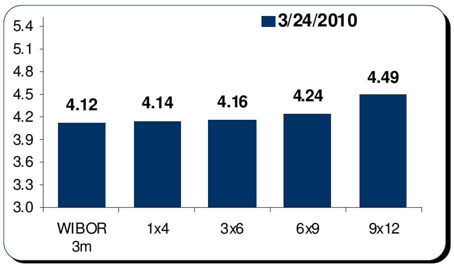
Core CPI and retail sale supportive for the bulls

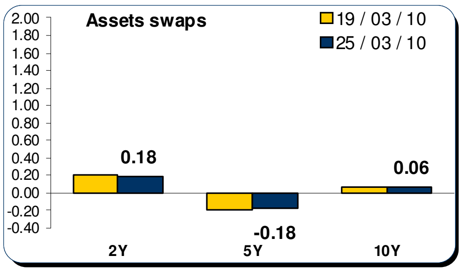
Bullish sentiment get stronger after the core CPI figure (2.2 vs 2.4% expected) and a really poor retail sales figures (0.1 vs 3.9% expected). Downgrade of Portugal without any significant echo, which can be quite surprising.

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty in range

EUR/PLN spend the week consolidating in a tight range 3.8500/3.9300. It seems that the cross is pretty much immune for any external shocks, like the falling EUR/USD or the Fitch downgrading Portugal. Technically we can say that, at 3.85 we have a double bottom, the resistance is at 3.95 and 4.00. Only the break of 4.0350 pivotal level may neglect the downtrend of EUR/PLN .

Implied volatility stable

The historic of EUR/PLN and USD/PLN is again much bellow the implied volatility values. And the only reason, why the both main zloty curves were not sold aggressively, was the increase of EUR/USD implied volatility. It has managed to support the EUR/PLN curve and even take the USD/PLN volatility higher (as currency spread of USD/PLN against EUR/PLN has reached 5.75% mid from the 5.25% mid last week).

Short-term forecasts

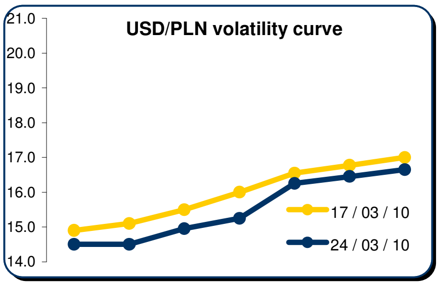
SPOT
Main supports / resistances:
EUR/PLN: 3.8500 / 4.0000
USD/PLN: 2.8000 / 3.9500

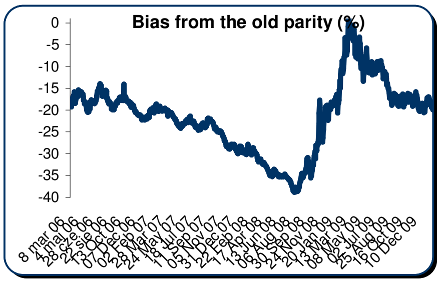
Nothing has changed from the last week. Present trend is targeting 3.80. Any corrections may go towards 3.9500/3.9700 level which seem appropriate to exploit fundamental appreciating trend in the zloty.

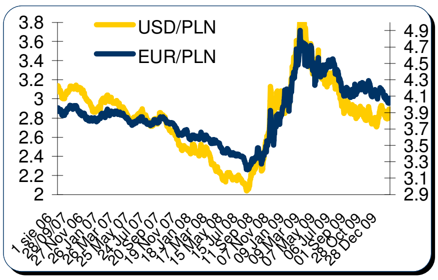
OPTIONS

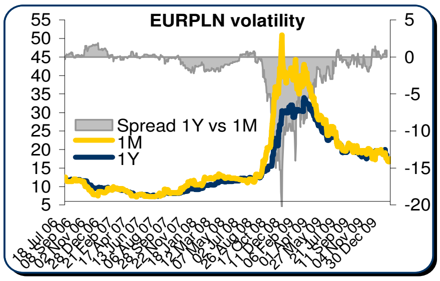
The low historical volatility become more and more a dominant factor. The most probable scenario would be the one in which the front end of the curve (1-4 months) goes down; watch also local spikes. Long Risk Reversals are still likely to gain due to positive Vanna. .

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
18/03/10	4.01%	4.12%	4.12%	4.13%	4.32%	4.33%
19/03/10	4.05%	4.14%	4.10%	4.14%	4.32%	6.59%
22/03/10	4.00%	4.12%	4.15%	6.49%	4.34%	4.34%
23/03/10	4.03%	4.13%	4.25%	4.13%	4.53%	4.33%
24/03/10	4.03%	4.12%	4.13%	4.14%	4.33%	4.34%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
18/03/10	4.14%	4.14%	4.22%	4.47%	4.43%
19/03/10	4.13%	4.14%	4.21%	4.50%	4.42%
22/03/10	4.13%	4.16%	4.26%	4.51%	4.45%
23/03/10	4.14%	4.17%	4.27%	4.53%	4.47%
24/03/10	4.14%	4.17%	4.28%	4.53%	4.47%

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
18/03/10	4.33%	3.85%	4.75%	4.49%	5.48%	5.07%	5.47%	5.57%
19/03/10	6.59%	3.85%	4.78%	4.54%	5.35%	5.16%	5.53%	5.60%
22/03/10	4.34%	3.90%	4.81%	4.52%	5.39%	5.19%	5.52%	5.61%
23/03/10	4.33%	3.86%	4.78%	4.49%	5.36%	5.14%	5.51%	5.54%
24/03/10	4.34%	3.84%	4.73%	4.49%	5.30%	5.13%	5.46%	5.52%

PRIMARY MARKET RATES

Last Primary Market Rates

	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	10/03/15	11/03/15	96.184	3.92%	1000	2610	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

date	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
	1M	3M	6M	1Y	1M	1Y	1M	1Y
18/03/10	14.50	15.25	16.25	16.65	2.50	3.70	0.60	0.90
19/03/10	14.50	15.25	16.25	16.65	2.50	3.70	0.60	0.90
22/03/10	14.50	15.25	16.25	16.65	2.50	3.70	0.60	0.90
23/03/10	14.50	15.25	16.25	16.65	2.50	3.70	0.60	0.90
24/03/10	14.50	15.25	16.25	16.65	2.50	3.70	0.60	0.90

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
18/03/10	2.8285	3.8723	-21.36%
19/03/10	2.8285	3.8909	-21.67%
22/03/10	2.8285	3.9136	-21.36%
23/03/10	2.8285	3.8963	-21.52%
24/03/10	2.8285	3.8766	-21.18%

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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