



POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

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PREVIEW: The week of April 16th 2010 to April 22nd 2010

Indicator	Date of release	Pe-riod	BRE forecast	Consen-sus	Last	Comment
Wages y/y	Apr 19	Mar	3.4%	3.2%	2.9%	Positive contribution of working days effect (1 day more). Growth of wages in manufacturing on the rise.
Employment y/y	Apr 19	Mar	-0.5%	-0.7%	-1.1%	"Zero plus" monthly growth rate of employment. Substantial improvement in relevant business activity indicators across all sections. Turnaround after weak February.
Industrial output y/y	Apr 20	Mar	10.4%	10.2%	9.2%	Positive contribution of working days effect (1 day more). Solid growth of business tendency indicators, higher orders in Germany. Probably non-negligible, positive effect from more favorable working conditions.
Producer prices y/y	Apr 20	Mar	-2.6%	-2.5%	-2.4%	Strong PLN appreciation effects level-off rising the influence of higher prices of oil and copper.
Core inflation y/y	Apr 22	Mar	2.0%	2.1%	2.2%	Inflationary pressure remains very moderate.
MPC "Minutes"	Apr 22	-	-	-	-	In current circumstances (new Governor, FX intervention) those "Minutes" should be regarded as nothing more but history.

In Focus / Macroeconomics

Inflation falling on base effects

CPI inflation fell in March to 2.6% y/y from 2.9% in the previous month, matching market expectations and the earlier forecast of the Ministry of Finance. The fall of inflation stems primarily from base effects from 2009 (massive PLN depreciation, state-controlled price hikes). As for the momentum of inflationary processes, it seems close to neutral at the moment (only 0,3% on monthly basis). We estimate that core inflation also remained in neutral territory (+0.2% m/m) which translated into 2.0-2.1% annual growth. Next months will bring further deceleration of annual inflation indices (headline and core) on statistical base effects. We expect CPI inflation to fall to 2.1-2.2% y/y in April and then, in the Summer, below 2.0%.

Falling inflation and exchange rate policy pursued by the NBP (irregular currency interventions) have potential to lull hike expectations. Moreover, we shall not exclude a scenario in which the market may temporarily bet on rate cuts, regarded as a natural consequence of a policy aimed at weakening the zloty. However, such expectations may be revised as inflection point in CPI path come closer. The influence of base effects will peter out after July/August and CPI inflation will embark on a rising path, reflecting partially the mechanisms working in a more mature economic expansion phase. Current zloty-oriented NBP policy may nothing but to stimulate such a behavior of prices.

We expect market participants to be caught off guard by the MPC reaction (dominated by declared hawks), which will be forced to react in an environment of revival of inflationary pressures. We thus not change our view that rate hikes probability till the end of the year stays high.

MID-TERM FORECASTS

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	-1.6	-2.7	-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	2.6-2.8	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

Last Friday market saw the first FX intervention on the market in 10 years time. Yields have reacted by some 5-7bp fall in IRS yields, especially in the front part of the curve as market started to play the pattern of lower yields for extended period of time. We also had seen a good demand for the short end bonds coming especially from foreign investors. Monday market was not active, after Presidential plane crash. Next days the pattern of lower yields and steeper curve has prevailed. We saw the lows trading on Wednesday morning when 2y touched 4.40 level pricing no hikes this year and only 75bp hikes in the whole cycle. New 10y benchmark auction drew decent demand but price action afterwards showed some signs of the bonds saturation, as prices have fallen, especially in the 10y sector (despite IRS trading lower). Trend in the falling WIBOR rate was maintained, as 3M and 6M rate has dropped to sub 3.90% and 4.10% respectively within a week. We think 3M WIBOR will now start to stabilize around 3.85%-3.90%. **We still maintain our view that rates hikes are more likely than the rate cuts (even with last FX intervention)** but we have to admit that the macro/political situation is changing at a great pace. **The things to be watched right now is the trend in the CPI (whether it falls below 2% in summer months) and appointment of new CB head (which can in our opinion may promote faster euro entry but at the same time also join hawk camp).**

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	4/19/2010	-	3.839%	4/12/2010
2Y T-bond OK0712	5/5/2010	-	4.541%	4/7/2010
5Y T-bond PS0415	4/21/2010	-	5.736%	12/2/2009
10Y T-bond DS1019	6/16/2010	-	5.586%	4/14/2010
20Y T-bond WS0429	6/16/2010	-	6.170%	9/23/2009

Money Market

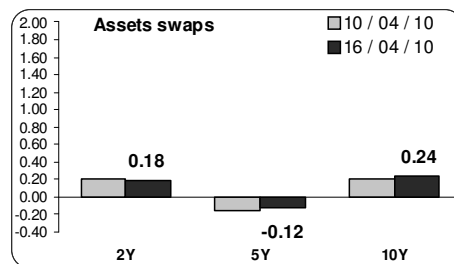
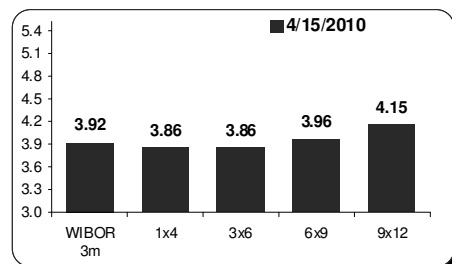
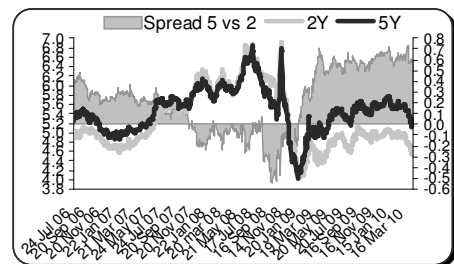
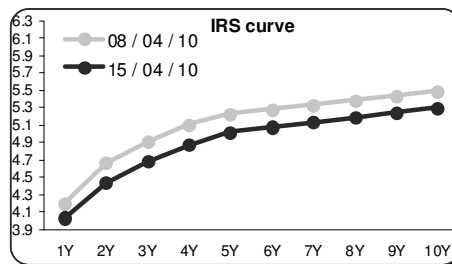
Sector liquidity is still growing

Big chance for carry to remain relatively low till the end of the month, despite maturing 6M repo next Thursday (PLN 5.2 billion outflow). 3M repo this week restricted to only PLN 400 mio, which supports the view that quantitative easing of the monetary policy comes to an end. It does not change a thing for the sector as a whole, since overall liquidity is still growing and huge amounts of money bills are on the run (PLN 75 billion during last auction).

Intervention at least theoretically means low rates

After central bank's intervention last Friday the likelihood of rates hikes significantly decreased. The market right now is pricing only 25 bps hike somewhere around the year end. However, we would not be surprised if the first step in tightening is made no sooner than next year. Right now the question is whether the prolonged period of the low rates will not trigger bigger unitary scale of the tightening (50 bps steps) and a shorter (more intensive) period for the whole tightening cycle.

FIXED INCOME & MONEY MARKET CHARTS



Foreign Exchange

Zloty traded in range

During last week, Zloty has been heavily influenced by the last Friday NBP's surprising intervention. Such an unexpected move (last intervention took place 10 years ago) made zloty immune for the outer positive signals. Nor Greece's bonds auction or good US data announcement, haven't had much effect on zloty. EURPLN rate has found top at 3.8970 and then the bottom at 3.8520 (close to intervention level). The amount of EUR purchased by NBP was limited (approximately 100 EUR) but the psychological resistance for PLN is still in place.

Implied volatility lower

The ATM and most of all short term risk reversals jumped, on the back of the intervention. But, as the following price action was rather disappointing for the gamma owners, the ATM run and the risk reversals have given away all their gains and more. Especially the back-end volatility has corrected lower i.e. 6 months EURPLN mid vol. is 9.6 % mid versus 10.4% mid last Thursday.

Short-term forecasts

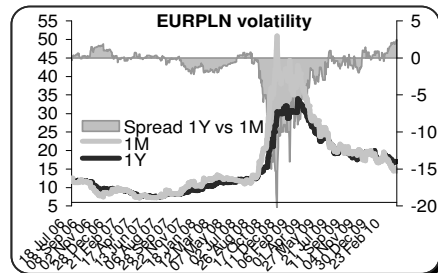
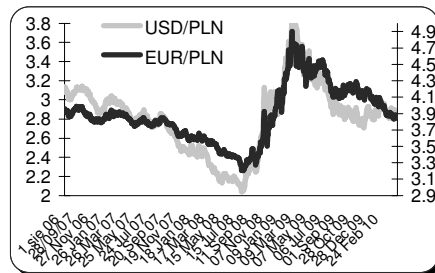
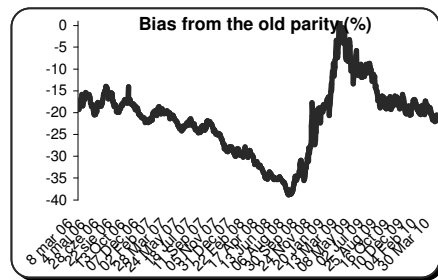
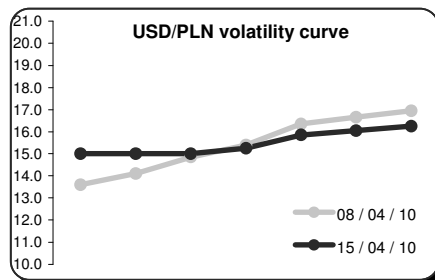
SPOT
 Main supports / resistances:
 EUR/PLN: 3.8000 / 3.9500
 USD/PLN: 2.8000 / 2.9500

So far we were identifying two main factors affecting PLN: good fundamentals affecting positive Zloty forecasts and decent positioning slowing the move. On the top of it, we also have to take into consideration, the probability of NBP intervention. Important levels remain intact: bottom 3.90/95 and 3.70, top: 3.98/4.02.

OPTIONS

The historical volatility is still much below the implied volatility, even with the current lower implied volatility levels; back end volatility have reached the lowest levels this year! Not much to say right now, we wait for further developments.

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
07/04/10	3.85%	4.05%	4.08%	4.09%	4.27%	4.28%
08/04/10	3.84%	4.03%	3.98%	4.07%	4.25%	6.59%
09/04/10	3.84%	3.96%	4.05%	6.49%	4.25%	4.24%
14/04/10	3.80%	3.92%	4.00%	4.04%	4.20%	4.22%
15/04/10	3.84%	3.92%	3.99%	4.02%	4.21%	4.22%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
07/04/10	4.06%	4.08%	4.18%	4.34%	4.32%
08/04/10	4.03%	4.05%	4.18%	4.35%	4.32%
09/04/10	4.00%	4.02%	4.17%	4.38%	4.35%
14/04/10	3.95%	3.95%	4.09%	4.26%	4.24%
15/04/10	3.93%	3.92%	4.05%	4.25%	4.25%

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
07/04/10	4.28%	3.87%	4.60%	4.36%	5.18%	5.03%	5.44%	5.60%
08/04/10	6.59%	3.87%	4.66%	4.40%	5.23%	5.07%	5.49%	5.64%
09/04/10	4.24%	3.87%	4.55%	4.35%	5.14%	4.98%	5.42%	5.62%
14/04/10	4.22%	3.77%	4.44%	4.21%	5.02%	4.90%	5.30%	5.54%
15/04/10	4.22%	3.77%	4.44%	4.21%	5.02%	4.90%	5.30%	5.54%

PRIMARY MARKET RATES

Last Primary Market Rates							
	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	10/04/12	11/04/12	96.263	3.84%	1000	4429	855
OK0712	10/04/07	12/07/25	89.301	4.54%	3000	6726	2999
PS0415	09/12/02	15/04/25	98.691	5.78%	5000	5614	3629
DS1019	10/04/14	19/04/25	97.311	5.59%	3500	7980	3505

FX VOLATILITY

date	USD/PLN 0-delta straddle				25-delta RR		25-delta FLY	
	1M	3M	6M	1Y	1M	1Y	1M	1Y
07/04/10	14.10	15.20	15.90	16.95	2.25	3.75	0.50	0.80
08/04/10	14.20	15.20	15.90	16.70	2.25	3.75	0.50	0.80
09/04/10	15.00	15.25	15.85	16.25	2.25	3.75	0.50	0.80
14/04/10	14.00	14.50	15.20	16.00	2.25	3.75	0.50	0.80
15/04/10	14.00	14.50	15.20	16.00	2.25	3.75	0.50	0.80

PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
07/04/10	2.8675	3.8378	-20.99%
08/04/10	2.8975	3.8526	-20.62%
09/04/10	2.8634	3.8405	-20.79%
14/04/10	2.8325	3.8659	-21.45%
15/04/10	2.8491	3.8641	-21.88%

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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