



POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

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PREVIEW: The week of August 13th 2010 to August 20th 2010

| Indicator | Date of release | Period | BRE forecast | Consensus | Last | Comment |
|-----------------------|-----------------|--------|--------------|-----------|-------|---|
| CPI inflation y/y | Aug 13 | Jun | 2.2% | 2.1% | 2.3% | Negative base effects. Higher food prices (upside risks to the FinMin forecast). Stable fuel prices. Core inflation to slide to 1.2% y/y. |
| Corporate wages y/y | Aug 17 | Jul | 3.9% | 3.9% | 3.5% | Negative working day effect. Wages in manufacturing rise at above 5% y/y rate. |
| Employment y/y | Aug 17 | Jul | 1.5% | 1.4% | 1.1% | Wheatear related pickup. Better business survey indicators. |
| Industrial output y/y | Aug 18 | Jul | 14.2% | 12.3% | 14.5% | Rising new orders indicators. Strong demand from Germany. |
| PPI y/y | Aug 18 | Jul | 3.3% | 3.3% | 1.9% | Price expectations of producers are spinning out of control. Massive base effects from 2009. |

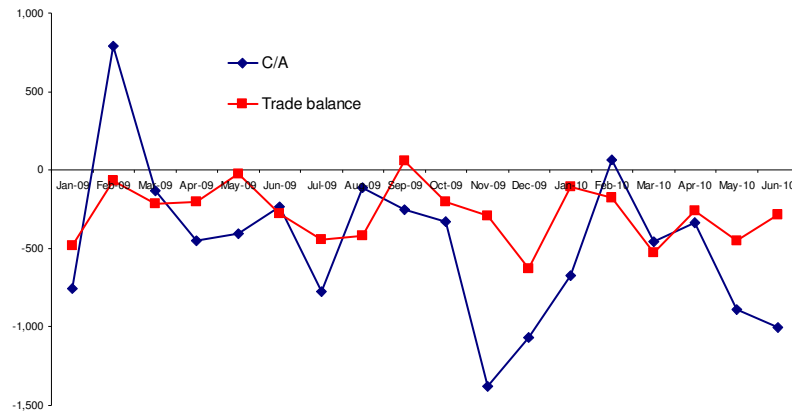
In Focus / Macroeconomics

Poland's June C/A deficit widened to EUR 1.0 bn on dividend payments to foreign investors

June C/A deficit widened to EUR 1.0 bn from 889mn reported in May (the May C/A deficit has been revised from 268 mn).

The deterioration of the C/A is not a result of wider trade gap, which in fact narrowed to EUR 287 mn from 450 mn recorded in May. The widening is attributable to some one off and seasonal effects related to lower EU transfers and higher dividends payments to foreign investors amounted to as much as 752 bn. The exports rose in June by 28.6% y/y, imports increased by 27.8% y/y indicating that 1) Polish foreign trade is fairly balanced, 2) economy is still driven by exports which in turn is boosted by rising demand in Germany 3) the exports is continuously stimulated by improved price competitiveness and the weaker zloty.

In our baseline scenario we see revival of foreign demand (especially from Germany) which along with weaker zloty will continuously support Polish exports. Thus, net exports contribution to GDP growth may still be positive in the quarters to come. We also expect restocking cycle to continue in the next 1-2 quarters pushing GDP growth rates toward 4% y/y. Private consumption is poised to recover as well but the pace of recovery may be more modest, which should allow for more balanced growth of imports. On the other hand, the income balance may deteriorate the current account due to better corporate profits and rising trend of repatriated revenues. Overall, the current account deficit should remain at about -2.0 % GDP this year and only gradually widen next year.



MID-TERM FORECASTS

| Indicator | 2007 | 2008 | 2009 | 2010 | 2011 |
|-------------------------------------|------|------|------|------|------|
| GDP y/y (%) | 6.5 | 4.8 | 1.7 | 3.6 | 4.2 |
| Inflation rate (% , average) | 2.4 | 4.3 | 3.5 | 2.8 | 3.5 |
| Current account (% of GDP, average) | -4.5 | -5.3 | -1.6 | -1.8 | -2.9 |
| 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 | 3.75 | 5.00 |

| Indicator | 2009 | | | | 2010 | |
|--------------------------------|------|------|------|-----|------|------|
| | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 |
| GDP y/y (%) | 1.7 | 3.1 | 3.0 | 3.8 | 4.0 | 4.1 |
| Inflation rate (% , average) | 3.5 | 3.3 | 3.0 | 2.1 | 2.6 | 3.2 |
| NBP repo rate (end-of-quarter) | 3.50 | 3.50 | 3.50 | 3.5 | 3.5 | 3.75 |

Bold denotes changes from the last release with arrows showing the direction of changes

Fixed Income

Some volatility and some curve twists

Last week we saw some volatility on the market. Curve has flattened massively with 1y3s staying in 4.20ish territory and 5y trading at low at 5.10. At some point during the week 5y10y spread traded as low as 4 bp, but than fly started to be offered and 5y10y is currently trading at 9 bp. Bonds activity was rather small, 2y bonds and 0922 were trading rather heavily, the performer of the week was 0415. There is a possibility that the August auction was the last regular auction of this bond, which may have boosted the trade. Positive bond sentiment was maintained after bonds in core market rallied, and even some spread widening which happened in the second part of the week didn't spoil the rally. On Thursday we saw very good receiving interest in 1y and 2y which on shallow market pushed 1y1y by some 10 bp lower to the level of 4.95. Right now curve is pricing more hikes in 1y time than in 2y time, so hikes are looking to be front loaded and only of a normalization nature. The sudden receiving of 5y10y spread made 5y look artificially (especially looking at the forwards). The FRA payer is working very well on the other hand. We are starting to see that 5x8 PLN FRA is starting to be bid above strip level, which suggest a little that people are starting to hedge against seasonal higher WIBOR rates in December. Tom is Friday 13th, and CPI publication. This will be the lowest CPI figure in 1y time for sure, maybe even in 2y time. Ahead of us prolonged period with CPI of about 3.5% (according to our economic forecast). We know it is mainly food prices, but what is worth remembering is the sequence of episodes consumer will be faced with. First it is said food prices, in autumn we will get second gas price hike (related to exchange rate mainly) after that with New Year VAT increase, excise TAX increase. Labor market is not weak, so the inflation expectations have some favorable environment to grow, and stabilize well above inflation target. Trial period for new RPP has just finished.

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 | 2010-08-016 | - | 3.976% | 8/9/2010 |
| 2Y T-bond OK1012 | 9/1/2010 | - | 4.759% | 8/4/2010 |
| 5Y T-bond PS0415 | 9/1/2010 | - | 5.373% | 8/4/2010 |
| 10Y T-bond DS1020 | 9/15/2010 | - | 5.790% | 6/16/2010 |
| 20Y T-bond WS0429 | 9/15/2010 | - | 6.170% | 9/23/2009 |

Money Market

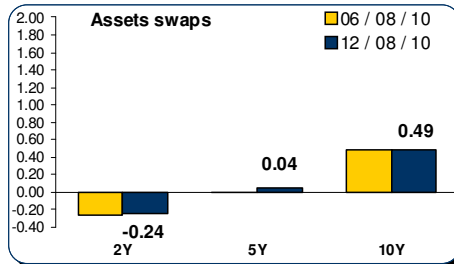
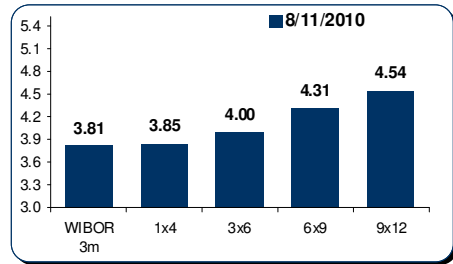
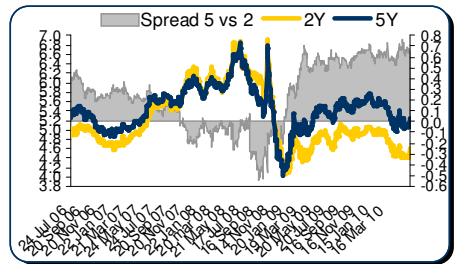
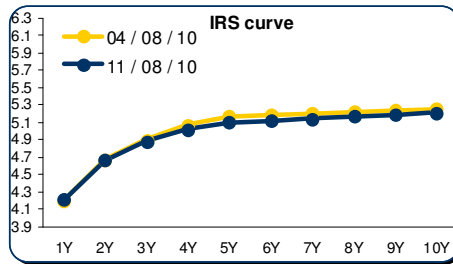
Heat hits market activity

It was another quiet week for Money Market with very low turnover. Open Market Operation made market squared and short term depo rates were staying stable at the range 3,2-3,4%. Tuesday's 3M repo was rather insignificant from the market point of view as both the repo pool (100 mln PLN) and demand (87 mln PLN) were tiny. As there are two relatively expensive weeks behind us and the end of reserve in coming the probability that one or more of remaining tenders will be underbidded is increasing.

Successful T-bills tender

On Monday MinFin sold 1,31 bln PLN 52 week bills at the av. yield 3,976% (which is exactly the same as on previous tender two weeks before). The demand was 3,3 bln PLN.

FIXED INCOME & MONEY MARKET CHARTS



Foreign Exchange

Zloty consolidates

This week EURPLN has almost replicated last week's range - 3.9630-4.0270 as against to 3.9770-4.0260 range.

It was another week of side trading around 4.00 level, what indicates that phase of consolidation has been started. Low potential for further zloty gains (in common market opinion) makes Zloty more exposed for weakening side but still decent demand for risk counters its effect. Highest correlated benchmarks are, invariably, EURUSD, EURJPY, S&P (respectively -0.89, -0.9, -0.9)

Implied volatility untouched

Although EURPLN is (so far) relatively narrowly ranged, range bounds are traded "actively" - weekly realized volatility values at 9.0%. Summer (last 2M) close-close realized volatility slightly lowered to at 9.5% (9.9 last week).

When compared those facts to present implied ATM curve - 1M 11.0, 3M 11.75, 1Y 12.5%, 3M25D RR 3.5% - we see that, indeed, downside move in EUR/PLN is priced as a lower chance. Or in the other words, the current ATMs and RRs are quite high in comparison to spot. Upside on the other hand usually translates into higher implied volatility - correlation of 3M ATM and spot level values 0.85 in yearly terms. Is implied curve fairly price then? EURPLN vs USDPLN currency spread is priced at 6.75% level.

Short-term forecasts:

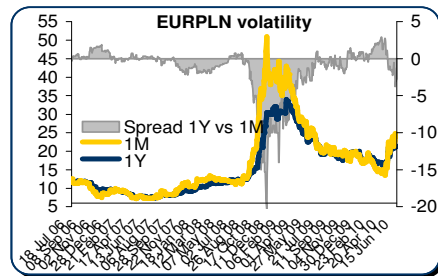
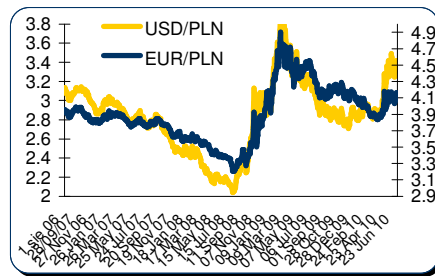
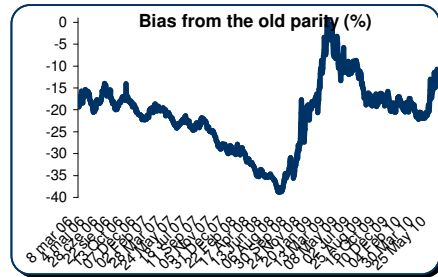
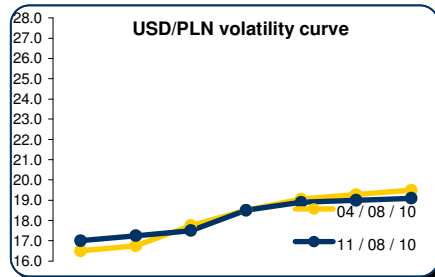
SPOT
 Main supports / resistances:
 EUR/PLN: 3,9400 / 4.0700
 USD/PLN: 2,9500 / 3.2000

Boxed in the range . Breaking lower through 3.94 needs new, stronger signal. Price action around 4.0250 has exposed decent Zloty demand there, but the risk of zloty sell off due to external factors persists. Expected range 3,90/4,10

OPTIONS

Current underlying performance is likely to push implied lower, aiming this year lows level. Still play vega range. We like a idea of installing the long Vanna position i.e via long term risk reversals, albeit the risk reversals are still high, but the current spot level works in favor of such a trade.

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 |
| 05/08/10 | 3.70% | 3.81% | 3.89% | 3.89% | 4.14% | 4.13% |
| 06/08/10 | 3.67% | 3.81% | 3.90% | 3.89% | 4.15% | 6.59% |
| 09/08/10 | 3.69% | 3.80% | 3.89% | 6.49% | 4.13% | 4.13% |
| 10/08/10 | 3.70% | 3.81% | 3.90% | 3.89% | 4.12% | 4.13% |
| 11/08/10 | 3.71% | 3.81% | 3.91% | 3.89% | 4.15% | 4.13% |

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

| date | 1X4 | 3X6 | 6X9 | 9X12 | 6X12 |
|----------|----------|-------|-------|-------|-------|
| | 05/08/10 | 3.88% | 4.00% | 4.23% | 4.47% |
| 06/08/10 | 3.86% | 4.00% | 4.27% | 4.51% | 4.46% |
| 09/08/10 | 3.86% | 3.97% | 4.20% | 4.42% | 4.45% |
| 10/08/10 | 3.84% | 3.99% | 4.27% | 4.49% | 4.45% |
| 11/08/10 | 3.86% | 4.00% | 4.30% | 4.54% | 4.48% |

FIXED INCOME MARKET RATES

Fixed Income Market Rates (Closing mid-market levels)

| date | 1Y | | 2Y | | 5Y | | 10Y | |
|----------|-------|-------|-------|--------|-------|--------|-------|--------|
| | WIBOR | TB | IRS | OK0112 | IRS | PS0511 | IRS | DS1017 |
| 05/08/10 | 4.13% | 3.70% | 4.67% | 4.40% | 5.18% | 5.13% | 5.26% | 5.70% |
| 06/08/10 | 6.59% | 3.70% | 4.71% | 4.44% | 5.15% | 5.14% | 5.22% | 5.71% |
| 09/08/10 | 4.13% | 3.70% | 4.69% | 4.43% | 5.14% | 5.15% | 5.20% | 5.70% |
| 10/08/10 | 4.13% | 3.70% | 4.68% | 4.44% | 5.14% | 5.16% | 5.23% | 5.70% |
| 11/08/10 | 4.13% | 3.70% | 4.66% | 4.42% | 5.10% | 5.14% | 5.21% | 5.70% |

PRIMARY MARKET RATES

Last Primary Market Rates

| | au. date | maturity | avg price | avg yield | supply | demand | sold |
|--------|----------|----------|-----------|-----------|--------|--------|------|
| 52W TB | 10/08/09 | 11/08/09 | 96.135 | 3.98% | 1500 | 3348 | 1312 |
| OK1012 | 10/08/04 | 12/10/24 | 90.185 | 4.76% | 3000 | 7762 | 3719 |
| PS0415 | 10/08/04 | 15/04/25 | 100.236 | 5.43% | 2000 | 4741 | 2281 |
| DS1019 | 10/06/16 | 19/04/25 | 95.807 | 5.79% | 3000 | 2965 | 2430 |

FX VOLATILITY

| date | USD/PLN 0-delta straddle | | | | 25-delta RR | | 25-delta FLY | |
|----------|--------------------------|-------|-------|-------|-------------|------|--------------|------|
| | 1M | 3M | 6M | 1Y | 1M | 1Y | 1M | 1Y |
| 05/08/10 | 16.75 | 18.50 | 19.05 | 19.50 | 3.00 | 5.35 | 0.75 | 0.95 |
| 06/08/10 | 16.75 | 18.50 | 19.05 | 19.50 | 3.00 | 5.35 | 0.75 | 0.95 |
| 09/08/10 | 16.75 | 18.50 | 19.05 | 19.50 | 3.00 | 5.35 | 0.75 | 0.95 |
| 10/08/10 | 16.75 | 18.50 | 19.05 | 19.50 | 3.00 | 5.35 | 0.75 | 0.95 |
| 11/08/10 | 16.75 | 18.50 | 19.05 | 19.50 | 3.00 | 5.35 | 0.75 | 0.95 |

PLN SPOT PERFORMANCE

PLN spot performance

| date | USD/PLN | EUR/PLN | bias |
|----------|----------|---------|---------|
| | 05/08/10 | 3.0618 | 3.9860 |
| 06/08/10 | 3.0731 | 3.9881 | -16.23% |
| 09/08/10 | 3.0494 | 3.9871 | -17.23% |
| 10/08/10 | 3.0143 | 3.9727 | -17.49% |
| 11/08/10 | 3.0448 | 3.9992 | -17.66% |

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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