



POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

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PREVIEW: The week of December 10th 2010 to December 16th 2010

Indicator	Date of release	Pe-riod	BRE forecast	Consensus	Last	Comment
Current account, EUR	Dec 13	Oct	-1090mln	-1153mln	-1153mln	Large trade gap persists. Seasonally higher balance of services, a bit higher balance of transfers.
CPI inflation, y/y	Dec 14	Nov	2.9%	2.9%	2.8%	Although the Ministry of Finance calls for 2.8%, recent food evolution from the Czech economy suggests 0.4% m/m growth of food prices is half the dynamics it really was posted. Plus minor growth of fuel prices. Core inflation at 1.3%.
M3 Supply, y/y	Dec 14	Nov	8.7%	8.8%	6.3%	Last months growth influenced by base effects.
Employment, y/y	Dec 16	Nov	2.2%	2.2%	2.1%	We expect last trends to continue. Apart from boom periods, November is usually seasonally softer than October.
Wages, y/y	Dec 16	Nov	4.4%	4.3%	3.9%	No difference in working days. High growth of wages in manufacturing. Extra payments in mining.

In Focus / Macroeconomics

MPC waiting for higher investment activity to pick up

Last week was uneventful with regard to local data. Hopefully, MPC members had a lot to say. Traditionally we heard from a whole spectrum of thoughts on monetary policy, which stay bi-polar (although with the dovish line of thinking still at the fore).

On the one hand there are scents of hawkishness in the wording of Rzonca and Bratkowski. The former claims that current GDP growth exceeds potential GDP growth and thereby the Polish economy generates inflationary pressures. Moreover, the risks of accelerating inflation within monetary policy horizon not only did not vanish but are set to rise onwards. Bratkowski calls simply for a rate hike within 3-month horizon citing the situation in the labor market (somehow he recalls some of his ideas connected with a preemptive rate hike, which he abandoned recently being afraid of too rapid zloty appreciation). However, they only paint the background in the ongoing MPC discussions and seem irrelevant for now.

On the other hand, there are members from the more dovish side. Interestingly, they are exploiting the investment channel, brought up to the discussion by the governor Belka. Kazmierczak thinks there is no need for a hike when the labor market is relatively soft and economic activity is going to fade at the start of 2011 (indeed it is possible with regard to individual consumption which is somehow put forward now, driven by substitution effects connected with announced VAT changes; such a view neglect the pickup in investment activity though). He would not like to end up with a scenario in which too fast rate-hike dampens still fragile growth (mostly investment activity). Low investment growth bothers Zielinska-Glebocka as well. However, the message delivered by this MPC member is at least mixed – no later than 2 weeks ago she claimed the MPC is behind the curve. This line of thought has disappeared so far. We have an impression that the wording of some MPC members is more than it is commonly believed affected by the current issues (the strength of the zloty).

Our call for rates remains intact. The majority of MPC is willing to see the growth of investment before it takes any action. As December, January and February meetings are out from various reasons, and the data for investment activity will be published no sooner than at the turn of February and March, we expect March to be the first credible date of action. However, as the growth of core inflation would be hard to decompose in search for pure demand factors as there usually are many regulated price hikes at the start of the year, and EURPLN rate may strengthen till then, there are also good reasons to postpone hikes to Q2 (especially when Belka's global thinking dominate and ECB will stay as unwilling to tighten as it is right now).

MID-TERM FORECATS

Indicator	2007	2008	2009	2010	2011
GDP y/y (%)	6.5	4.8	1.7	3.8	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	-2.8	-3.8
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	3.50	4.50

Indicator	2009		2010			
	Q3	Q4	Q1	Q2	Q3	Q4
GDP y/y (%)	1.7	3.1	3.0	3.5	4.2	4.5
Inflation rate (% , average)	3.5	3.3	3.0	2.1	2.6	2.8
NBP repo rate (end-of-quarter)	3.50	3.50	3.50	3.5	3.5	3.50

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

Fixed Income

Few weeks left to the end of a business year. Without any crucial economic data released, the activity on the Polish FI market has been quite limited for the last couple of days. Although the bonds market started to perform better pushing the prices to the month highs, the still existent EU financial crisis threat made a strong resistance and generated a moderate sell-off in longer maturities within the last few days. As a result the yield curve steepened again pushing 2y10y

Flatteners now

spread up to nearly 77 points (about 45 points up move from November 11th). The short end of a curve didn't change much (2-3 points up on a general bearish mood), but the recent comments from MPC members about the necessity to solve the rate hike matter within a few months time might trigger some receiving interest on FRA spreads... especially 3x6s ag 9x12s around 50 points that should imply a decent value in that scenario.

Assuming that the EU system collapse bet is short-lived and the market seems to trade quite chaotic till the end of a year, we could consider to find any value in a yield curve anyway. As the MPC is seen to hike rates in the first half of a year (in the second half CPI might go flat or more likely reverse the upward trend) there could be an opportunity to receive 100 points on 1y5y spread considering the 1y4y forward over 6%, the highest point of a forward curve, might become tempting to be received even outright.

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	12/25/2010	-	4.056%	10/25/2010
2Y T-bond OK1013	-	-	4.798%	12/1/2010
5Y T-bond PS0416	-	-	5.137%	10/13/2010
10Y T-bond DS1020	-	-	5.772%	11/17/2010
20Y T-bond WS0429	-	-	6.170%	9/15/2010

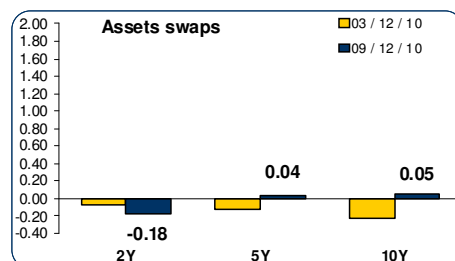
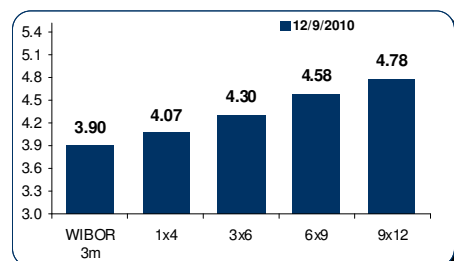
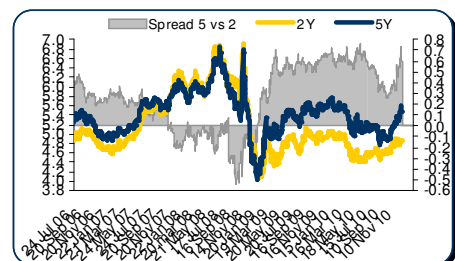
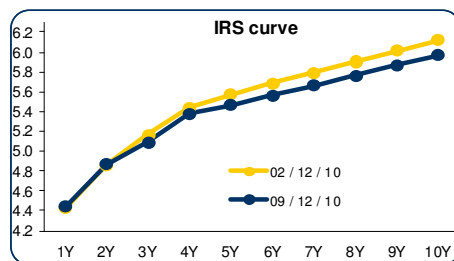
Money Market

Cheap beginning of the month

Surprising 2-day OMO on Wednesday

Cheap beginning of the month as banks bought pln 80.8 bln of money bills out of maturing 87.8 bln. December is traditionally a month of higher uncertainty (Xmas plus end of the year) therefore players feel more secure with over liquidity. On Monday MinFin bought back pln 2.5 bln of the shortest T-bills which resulted in additional cash inflow. All together we had almost 10 bln cash surplus and the central bank decided to do additional 2-day OMO in 10 bln. Having said 'more secure with over liquidity' no wonder that demand was only pln 3.6 bln and rates even though slightly higher are still below 3%. We have to mention that this unusual OMO would do more harm than good if all the papers would have been bought. Temporary squeeze and chaos, disability to plan any cash or cash derivatives positions would be the main problems. Pricing of deposits, fx swaps, BSB or ois would be extremely difficult wondering if this event would be repeated any day. In our opinion sticking to regular operations is best solution and if market feels comfortable with cash excess it should be honoured. At least it can be hedged away. Otherwise the biggest volatility and risk would be from the main regulator side and in effect trading the mentioned instruments would be restricted only to ON or stopped completely. And this is not what the central bank wants saying they support market development.

FIXED INCOME & MONEY MARKET CHARTS



Foreign Exchange

Zloty bit weaker

This week EURPLN opened at 3.98 on the back of better sentiment. But yield theme, main driver these days, is a volatile benchmark. US bonds sell-off at midweek has turned direction and 4.0650, this week's high, was traded on Wednesday. Are 3.98 and 4.11 rates new range boundaries? Time will tell. Coming end of year and volatile core markets keeps PLN liquidity at lower levels.

Short end lower

Lower realized volatility (weekly about 7%) and EURPLN's rate below recent highs has pressured short end of implied curve. 1M has lowered from 11.4 to 10.75 whilst 3M and 1Y were traded at previous levels, respectively 11.4 and 12.1. Smile and currency spread has also stayed untouched, levels are 3.0% for 3M 25D RR and 8% for USDPLN vs EURPLN currency spread. Worth to notice is fact that in contrast to EURPLN, USDPLN realized volatility slightly exceed implied – 1W realized 20.5 to 19.25 implied.

Short-term forecasts:

SPOT

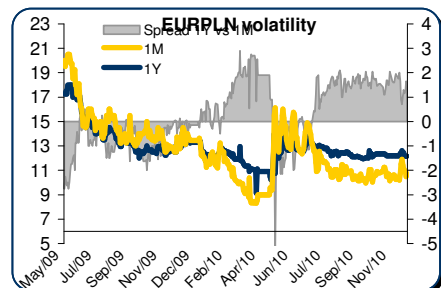
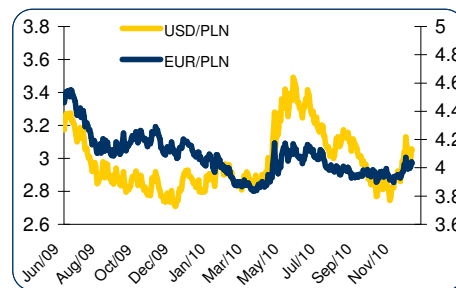
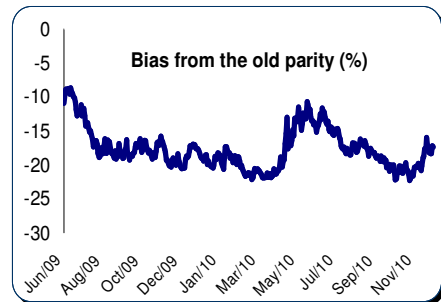
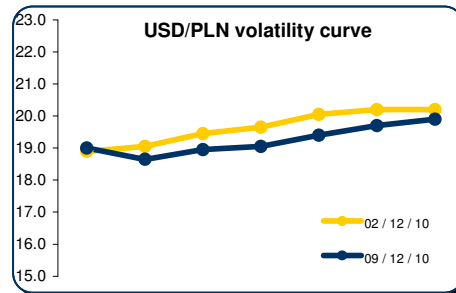
Main supports / resistances:
 EUR/PLN: 3.9800 / 4.0800
 USD/PLN: 2.8750 / 3.1500

Recent price action has limited already lower Zloty liquidity. We expect 3.95-4.08 wide range trading where tone will be set by European debt market and EURUSD spot.

OPTIONS

Lowered liquidity and volatile core markets. Long USDPLN gamma netted by EURPLN short one should extract undervalued EURPLN vs EURUSD correlation for relatively small theta.

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
03/12/10	3.76%	3.88%	4.07%	3.98%	4.27%	4.20%
06/12/10	3.80%	3.88%	4.00%	4.01%	4.22%	6.59%
07/12/10	3.80%	3.90%	4.05%	6.49%	4.25%	4.24%
08/12/10	3.83%	3.90%	4.05%	6.49%	4.25%	4.24%
09/12/10	3.83%	3.90%	4.05%	4.03%	4.40%	4.24%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
03/12/10	4.03%	4.22%	4.54%	4.74%	4.72%
06/12/10	4.02%	4.20%	4.56%	4.77%	4.70%
07/12/10	4.04%	4.25%	4.56%	4.77%	4.75%
08/12/10	4.00%	4.25%	4.55%	4.76%	4.72%
09/12/10	4.03%	4.26%	4.54%	4.75%	4.71%

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
03/12/10	4.20%	4.03%	4.85%	4.78%	5.59%	5.47%	6.18%	5.96%
06/12/10	6.59%	4.00%	4.84%	4.77%	5.53%	5.46%	6.05%	5.96%
07/12/10	4.24%	4.05%	4.85%	4.71%	5.50%	5.44%	6.02%	5.95%
08/12/10	4.24%	4.05%	4.87%	4.67%	5.48%	5.48%	6.02%	5.98%
09/12/10	4.24%	4.05%	4.87%	4.69%	5.47%	5.50%	5.96%	6.01%

PRIMARY MARKET RATES

Last Primary Market Rates

	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	10/09/27	11/09/27	96.189	3.92%	600	1150	580
OK0113	10/12/01	13/01/26	90.550	4.80%	4000	9322	4076
PS0416	10/10/13	16/04/25	99.300	5.14%	3000	3414	2491
DS1020	10/09/15	19/04/25	98.383	5.46%	3000	8953	3000

FX VOLATILITY

date	USD/PLN 0-delta straddle				25-delta RR		25-delta FLY	
	1M	3M	6M	1Y	1M	1Y	1M	1Y
03/12/10	18.65	19.20	19.25	19.90	3.40	4.75	0.65	0.88
06/12/10	18.55	18.95	19.35	19.90	3.40	4.75	0.65	0.88
07/12/10	18.40	18.95	19.35	19.90	3.40	4.75	0.65	0.88
08/12/10	18.60	18.95	19.35	19.90	3.40	4.75	0.65	0.88
09/12/10	18.65	19.05	19.40	19.90	3.40	4.75	0.65	0.88

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
03/12/10	3.0172	3.9968	-18.2%
06/12/10	3.0057	3.9974	-18.3%
07/12/10	2.9955	4.0078	-18.3%
08/12/10	3.0558	4.0415	-17.2%
09/12/10	3.0508	4.0330	-17.4%

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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