



## POLAND WEEKLY REVIEW

### MACROECONOMICS AND FINANCIAL MARKETS

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#### PREVIEW: The week of December 24<sup>th</sup> 2010 to January 6<sup>th</sup> 2011

Indicator	Date of release	Pe-riod	BRE forecast	Consensus	Last	Comment
FinMin's inflation forecast	Jan 3	Dec	3.1-3.2%	-	2.7%	Higher fuel prices and possibly higher food prices (strong signals from wholesale market), seemingly also christmas-driven. Core inflation
PMI	Jan 3	Dec	56.3pts	-	55.9pts	Record high Ifo and German PMI. Extension of rising trend.

**We would to wish You Merry Christmas and wonderful trades in 2011!  
 We will be back with Your favorite weekly report at the start of the year.**

## In Focus / Macroeconomics

### NBP rates on hold

MPC decided to leave repo rate unchanged at 3.50%. Turning to the statement, the assessment of the real sphere still errs on the side of caution. More specifically, the MPC indicates that improvement in consumption may be temporary (widely cited substitution effects) and investment activity is stagnating. Although wage pressures are still assessed as moderate (the same applies to broader demand pressures, as measured by core inflation) the MPC admits that headline CPI may be driven higher by supply factors and regulatory actions (VAT hike).

Despite high expectations, QE2.0 did not bring any significant acceleration of portfolio capital inflows towards Poland. That is why the passage concerning the increased capital inflows was erased from the statement. According to Belka, the change indicates the balance of risks has tilted towards rate hikes (of course as a consequence of the lack of PLN appreciation which used to be regarded as a substitute for rate hikes).

Such signals from MPC will encourage market participants to engage in a play for a rate hike in January (so far there is 40% probability of a hike in OIS curve). The ongoing speculation will be supported by psychological factors. Usually the December meeting is regarded as inconclusive, as various MPC members used to indicate. That leaves a question: there was no hike for it was not necessary or...there would have been one but the MPC did not want to act against "tradition". The final outcome of the January meeting will be closely tied to the EURPLN rate (we see a potential towards stronger zloty – see the fresh decision to expand IMF's FCL as an expansion of liquidity cushion). Moreover, we still think that MPC (in the absence of pure demand pressures and muted investment activity) would like to see a meaningful signs that widely expected CPI readings filter to inflation expectations and make price rises self-reinforcing. Such assessment may take time, especially in dovish-biased MPC. That is why we still see a first rate hike in Q2, although the moods in the MPC (and measures of inflation expectations) need to be carefully monitored.

### 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

### Christmas Time Part II

Very quiet week without any particular interest on a yield curve behind us. The MPC meeting held on Wednesday, 22nd proved to be the only event that might have been of any interest worth to mention. Though the statement after the meeting didn't bring any breakthrough itself, the press conference headed by Central Bank's Governor Belka ended up with a slightly hawkish atmosphere. He stressed out they decided to leave rates unchanged because of low inflationary pressure and moderate wage growth, but finally added that the MPC saw the lower risk of strong capital inflows into Polish economy in the potential event of interest rate rise so the balance of risks has moved in favor of that scenario in the near future. The central banker said also the MPC was ready to see the CPI acceleration in coming months and it would keep checking for any signs of inflationary pressure.

Concluding, the probability of tightening cycle starting with January has risen slightly and would be finally dependent on macro data released. On the other hand the market has been playing the interest rise scenario for the last couple of months rolling the FRA contracts month by month. As a result there has been no real value to pay the curve now as it has priced almost the 100bp move already (the MPC members stressed the potential cycle wasn't likely to exceed 75bp). Assuming the market was always overreacting, we would try to take advantage from receiving any "blow" on a FRA curve.

**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	2/2/2010	-	4.056%	10/25/2010
2Y T-bond OK1013	1/5/2011	-	4.798%	12/1/2010
5Y T-bond PS0416	1/5/2011	-	5.137%	10/13/2010
10Y T-bond DS1020	1/12/2011	-	5.772%	11/17/2010
20Y T-bond WS0429	1/12/2011	-	6.170%	9/15/2010

**Money Market**

*Cost of carry down*

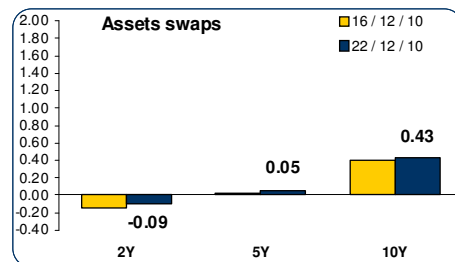
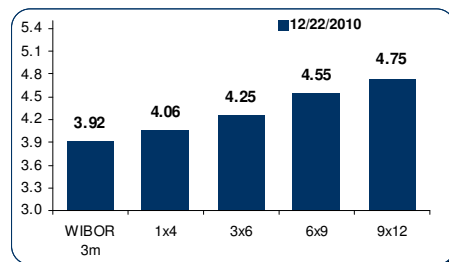
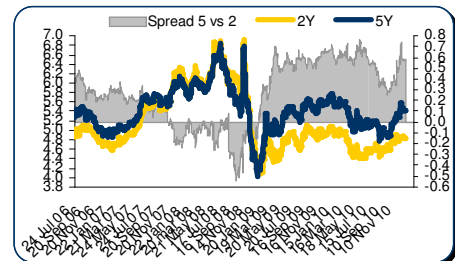
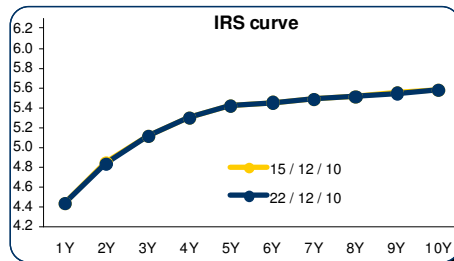
*Additional OMO again a failure*

*No change by the MPC*

Cost of carry down this week due to huge surplus of cash that was left after underbid OMO (77 vs pln 84 bln). The central bank was trying to squeeze the market offering additional 3-day papers on Tuesday but again the auction was 4 highly underbid (3.4 vs 11 bln pln). Truth is and we were pointing this out many times that money market likes to be long in periods of higher operational risk like December (Christmas plus end of the year). Therefore, the central bank should just accept the fact and do not try to add unnecessary volatility with unexpected auctions.

The MPC did not change any of the monetary policy parameters, which was fully expected. The January play can show up, although we see many reasons for the cycle to start no sooner than in March (CPI projection, strong currency, willingness to see the figures proving the hike).

**FIXED INCOME & MONEY MARKET CHARTS**



## Foreign Exchange

*Zloty stable*

Uneventful week for the Zloty. In line with most of the markets, during last week Zloty was moving in a very tight range, which for EUR/PLN translated into 3.9650/4.0050. A lot of markets participants have already finished trading for this year, as well as customers which were extremely quiet during last seasons. The word on the street is that BGK (state owned bank executing orders for Ministry of Finance) is selling EUR/PLN on spikes ...

*Volatility lower*

Short term realized volatility is at its lows. As an obvious result, the short end of the curve was heavily offered (1 week mid 9.0 % and 1 month mid 10.0% ). The back end of the curve was untouched with mid of 1 year at 12.25 %. The currency spread (USD/PLN versus EUR/PLN) is unchanged around 8%.

**Short-term forecasts:**

SPOT

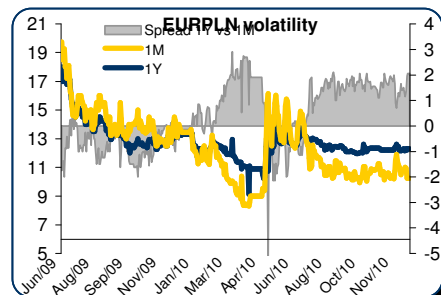
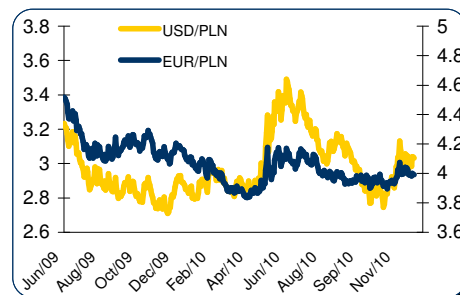
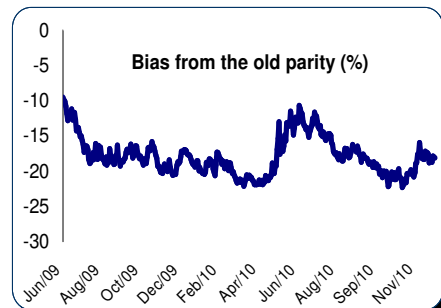
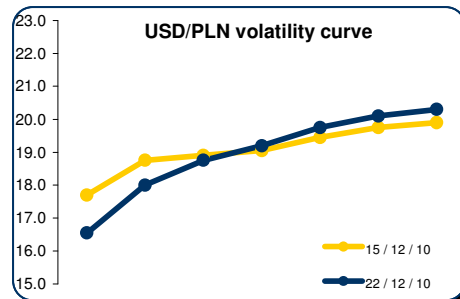
Main supports / resistances:  
 EUR/PLN: 3.9600 / 4.0100  
 USD/PLN: 3.0000 / 3.1000

The market is getting thinner and thinner, as we getting closer to Christmas and New Year. In such a illiquid market conditions, the move can be shallow or unreasonably big. It is better to only observe and stay aside!

**FX CHARTS**

OPTIONS

The realized volatility is even lower than the last week's!. Good news for the short gamma holders, we would like to keep this position for the week to come.



**MARKET PRICES UPDATE****MONEY MARKET RATES**

## Money market rates (Closing mid-market levels)

date	3M		6M		1Y	
	FXSW	WIBOR	FXSW	WIBOR	FXSW	WIBOR
16/12/10	3.80%	3.91%	4.04%	4.04%	4.24%	4.24%
19/12/10	3.87%	3.91%	4.05%	4.04%	4.25%	6.59%
20/12/10	3.81%	3.91%	4.16%	6.49%	4.40%	4.24%
21/12/10	3.88%	3.92%	4.04%	6.49%	4.24%	4.25%
22/12/10	3.80%	3.92%	4.15%	4.05%	4.40%	4.25%

**FRA MARKET RATES**

## FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
16/12/10	4.04%	4.28%	4.57%	4.78%	4.74%
19/12/10	4.00%	4.24%	4.54%	4.75%	4.72%
20/12/10	4.00%	4.25%	4.55%	4.76%	4.72%
21/12/10	4.00%	4.24%	4.55%	4.74%	4.73%
22/12/10	3.98%	4.25%	4.54%	4.75%	4.72%

**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
16/12/10	4.24%	4.05%	4.85%	4.71%	5.43%	5.45%	5.60%	5.99%
19/12/10	6.59%	4.05%	4.84%	4.72%	5.42%	5.43%	5.58%	5.99%
20/12/10	4.24%	4.05%	4.84%	4.71%	5.43%	5.46%	5.58%	6.00%
21/12/10	4.25%	4.05%	4.84%	4.75%	5.43%	5.47%	5.58%	6.00%
22/12/10	4.25%	4.04%	4.84%	4.75%	5.43%	5.47%	5.58%	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
16/12/10	18.10	18.95	19.45	19.95	3.00	4.35	0.65	0.88
19/12/10	18.05	19.25	19.75	20.30	3.00	4.35	0.65	0.87
20/12/10	18.05	19.25	19.75	20.30	3.00	4.35	0.65	0.87
21/12/10	18.15	19.30	19.75	20.30	3.00	4.35	0.65	0.87
22/12/10	18.00	19.20	19.75	20.30	3.00	4.35	0.65	0.87

**PLN SPOT PERFORMANCE**

## PLN spot performance

date	USD/PLN	EUR/PLN	bias
16/12/10	3.0125	3.9896	-18.3%
19/12/10	2.9840	3.9837	-18.7%
20/12/10	3.0396	3.9998	-17.9%
21/12/10	3.0370	3.9944	-18.0%
22/12/10	3.0322	3.9909	-18.1%

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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