



POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

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PREVIEW: The week of January 31st 2011 to February 3rd 2011

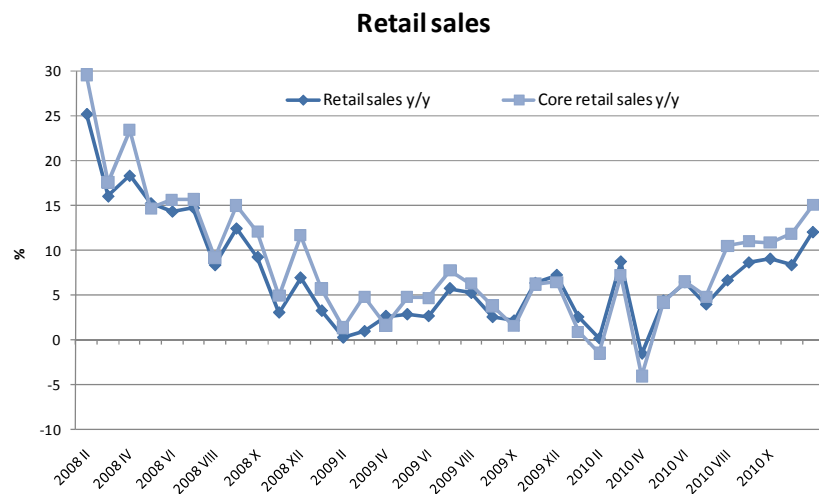
Indicator	Date of release	Pe- riod	BRE forecast	Consen- sus	Last	Comment
PMI	Feb 1	Jan	56.0pts.	-	56.3pts.	Business activity indicators softening oraz stable (abroad). Therefore light correction seems possible.

In Focus / Macroeconomics

High growth of retail sales in December

Retail sales growth accelerated in December to 12% YoY from previously reported 8.3% YoY. Increase in retail sales dynamics is mainly due to more business days, substitution effects before VAT rate changes along with underlying legislative regulations (VAT and company cars) and - las but not least - fundamentally higher Christmas spending.

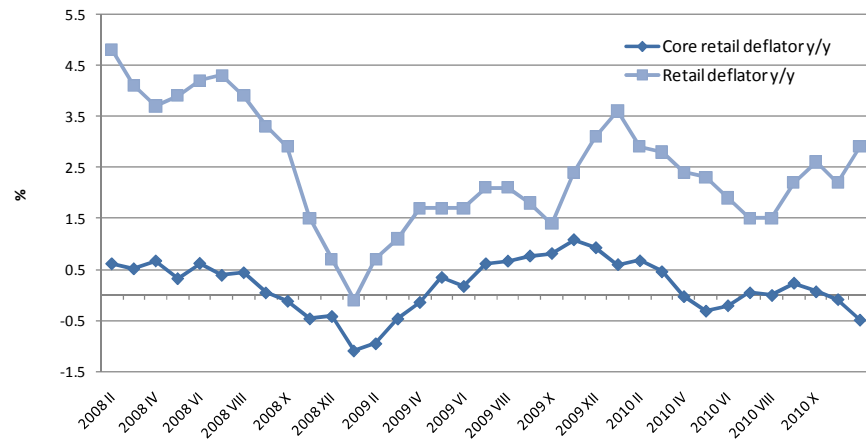
Main drivers affecting growth are food (return of positive dynamics), sales in specialized stores and "others" category (highly variant, not homogeneous, which accelerated to 5.5% from 2.2% in November). Moreover, car sales (over 38% in reference to 22% in previous month, clear impact of one-off effects) and fuel sales (17.2% YoY nominal growth, 5.7% in real terms; dynamic of fuel prices turned out twice higher than in analogous inflation data...) contributed to retail sales increase.



Trend on core sales category (excluding food and fuels) strengthened in December, but a slight turnaround in the beginning of the year can be expected due to substitution effects. However, we do not expect this effect to affect medium-term trends. Thus, we look for a return to 12-15% (maybe higher) dynamics in core retail sales in the spring/summer. Growth in current wages and tightening in labor market will support consumption from current income and – at the same time – positively influence the expected “permanent income”, which can only reinforce the aforementioned current income effect.

What is interesting, core retail sales deflator decelerated further (-0.5% YoY from 0.1% reported in November). This measure will be highly important in observing demand pressures in inflation, as it excludes governed prices increases, which can disturb the standard core inflation measures in the beginning of 2011.

Core retail sales deflator, and retail sales deflator



Data remain neutral from MPC's point of view. Being aware of substitution effects and their impact on consumption, MPC will wait for data from 2011 to evaluate the persistence of recent growth.

MID-TERM FORECASTS

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	-3.1	-3.8
Unemployment rate (end-of-year)	11.4	9.5	11.9	12.3	10.9
NBP repo rate (end-of-year)	5.00	5.00	3.50	3.50	4.25

Indicator	2010				2011	
	Q1	Q2	Q3	Q4	Q1	Q2
GDP y/y (%)	3.0	3.5	4.2	4.5	4.2	3.8
Inflation rate (% , average)	3.0	2.1	2.6	2.9	3.3	3.4
NBP repo rate (end-of-quarter)	3.50	3.5	3.5	3.50	3.75	4.00

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

Fixed Income

Trader's time

Last week the PLN market remained very volatile. Trying to find its direction it has become quite sensitive to what was going on the core markets then. Following the EUR curve it tested the years' highs at 5.17% on 2Y and 4.72% on 1Y last Friday but seemed to give a huge opportunity for receivers who had managed to push the curve down by 5-6bps on Monday. To the market surprise few MPC "hawks" released quite dovish comment on a current monetary policy stance suggesting the Council might restrain from further tightening in the 1Q as they didn't see any danger that might jeopardize the inflation. Moreover, they pointed out the Council was aware the higher CPI is temporary (may top 3.6% within few months) and was very likely to reverse in the 2H to the monetary policy target. As a result the FRA contracts fell rapidly another 5-6bps and the downside trend on a yield curve continued till Wednesday. As the core markets hit their short term support we could expect another upward move. So did the PLN. Technically the curve went up nearly to its Fridays resistance with a more steeper shape (2Y up to 5.14% and 5y up to 5.65% with) and was very likely to be received there. The longer end of a curve trades in a 10-15 bp range.... go and get it !

The short end of the curve, after the quite decent fall in the very beginning of the week, re-

mained unchanged with 3x6 FRA traded at 4.45% and 9x12 FRA at 4.97% respectively. Concluding, if we assume the MPC gives hints the higher CPI is inevitable (external factors) but temporary event, and the further tightening might be very dangerous to the strong developing economy, we still believe there is a huge value receiving the front end of a curve. Moreover, if there is no hike in March we could risk another one in the 2Q (April or May). The tightening cycle in 2H is less probable having the CPI in downtrend. As the market prices 90bp up over current Wibor rate in 9 months..... stay received.

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	2/2/2011	-	4.056%	10/25/2010
2Y T-bond OK1013	2/9/2011	-	4.984%	1/5/2011
5Y T-bond PS0416	2/9/2011	-	5.642%	1/5/2011
10Y T-bond DS1020	2/16/2011	-	6.210%	1/12/2011
20Y T-bond WS0429	2/16/2011	-	6.246%	1/12/2011

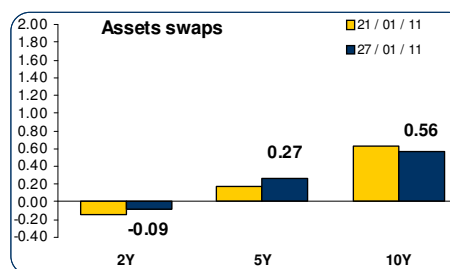
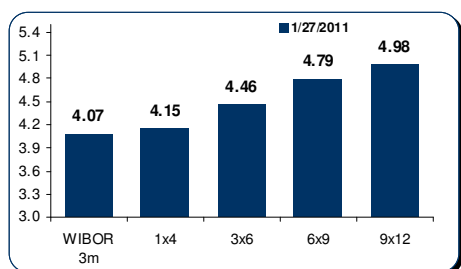
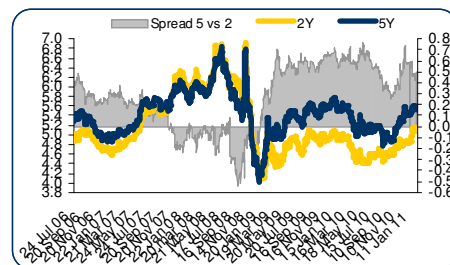
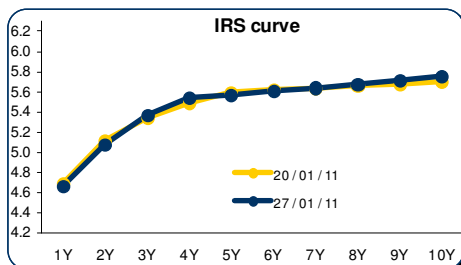
Money Market

Cheap end of the reserve despite intervention

6m t-bills unaffected by the hike

Last OMO significantly underbid, therefore the cost of carry dropped to the deposit rate in the central bank. To help up a bit additional OMO was held on Tuesday, and again failure to sterilize the market. Rates stabilized around 100 bps below the main market rate, which proves that the bid side is drawing the cards, not the central bank. It put the ois market under pressure, since the deviation of the polonia index from the main rate was priced at 35 bps. It is almost certain that it will be much more. Therefore, we still think that longer terms are massively overpriced and should be sold (the curve discounts 75 bps hikes plus too small deviation). 6M t-bills only touch cheaper despite the rates hike. The average yield was 4.08 vs 4.05 before the hike. 52-week benchmark can also be expensive in terms of other 1Y benchmarks.

FIXED INCOME & MONEY MARKET CHARTS



Foreign Exchange

Is Zloty forming new range?

This week EURPLN has opened about 3.8650 rate and after few sessions has left this area heading to 3.91 weekly top. There were no new signals just simple demand/supply game. In fact hard to count on new component in present Zloty equation and forming new range with market slightly long PLN is very likely. Domestic interest rate policy is driver compound these days.

Implied curve lower

Zloty bullish forecasts (down to 3.55 this year) and low realized readings (about 9.5%) has brought here vega sellers. New, flatter curve has been traded at: 1M tenor 9.2 (10.25 week ago), 3M 10.3 (11.0), 1Y 11.6 (12.2). Jointly we has observed some smile selling – 3M down from 2.5 to 2.3 and EURPLN vs USDPLN currency spread – new 3M level is 6.7 (7.2 week ago and about 8 at beginning of year).

SPOT

Short-term forecasts:

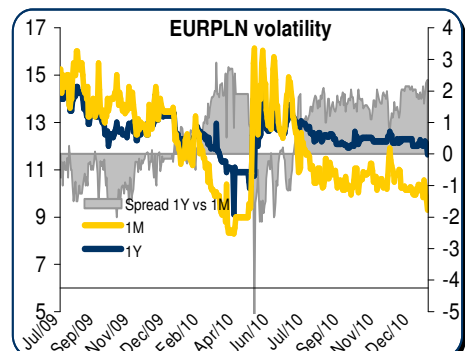
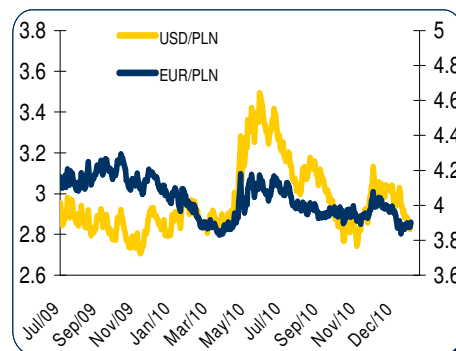
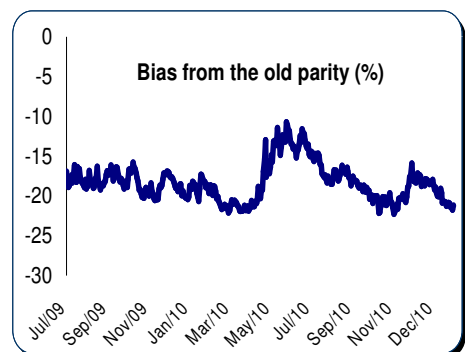
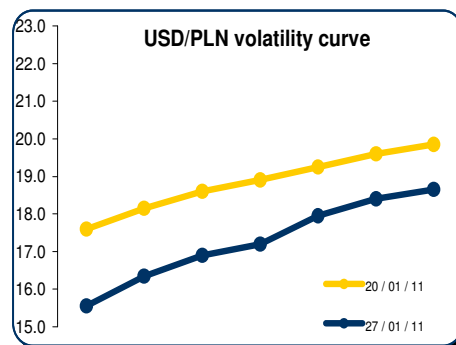
Main supports / resistances:
 EUR/PLN: 3.8600 / 3.9200
 USD/PLN: 2.8000 / 2.9000

Slightly long PLN market positioning works like a magnet with 3.92 as point where it lays. Surely S/L were placed above it. We would sell there on confirmation 3.92 will hold and play range or at 3.96 while it breaks. S/L at 3.93 in 1st case 4.01 in 2nd. P/T in both at 3.83.

OPTIONS

Successful defense of 3.92 area will increase probability of forming new range (3.86-3.92?) we would be gamma sellers then.

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
21/01/11	4.01%	3.98%	4.21%	4.14%	4.42%	4.34%
22/01/11	3.96%	3.98%	4.20%	4.15%	4.40%	6.59%
25/01/11	3.94%	4.08%	4.23%	6.49%	4.37%	4.39%
26/01/11	3.94%	4.07%	4.19%	4.21%	4.36%	4.39%
27/01/11	3.98%	4.07%	4.18%	4.21%	4.33%	4.39%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
21/01/11	4.17%	4.52%	4.82%	5.01%	5.01%
22/01/11	4.18%	4.53%	4.83%	5.03%	5.01%
25/01/11	4.19%	4.53%	4.83%	5.03%	5.06%
26/01/11	4.18%	4.54%	4.84%	5.03%	5.01%
27/01/11	4.16%	4.49%	4.81%	5.00%	4.96%

FIXED INCOME MARKET RATES

Fixed Income Market Rates (Closing mid-market levels)							
date	1Y		2Y		5Y		
	WIBOR	TB	IRS	OK0112	IRS	PS0511	IF
21/01/11	4.34%	4.20%	5.15%	5.01%	5.62%	5.80%	5.7
22/01/11	6.59%	4.20%	5.15%	5.01%	5.62%	5.80%	5.7
25/01/11	4.39%	4.17%	5.07%	4.92%	5.53%	5.73%	5.6
26/01/11	4.39%	4.15%	5.08%	4.95%	5.57%	5.76%	5.6
27/01/11	4.39%	4.15%	5.08%	4.99%	5.57%	5.83%	5.7

PRIMARY MARKET RATES

Last Primary Market Rates							
	au. date	maturity	avg price	avg yield	supply	demand	sc
52W TB	10/09/27	11/09/27	96.189	3.92%	600	1150	58
OK0113	10/12/01	13/01/26	90.550	4.80%	4000	9322	40
PS0416	10/10/13	16/04/25	99.300	5.14%	3000	3414	24
DS1020	11/01/12	19/04/25	93.022	6.21%	2250	4252	22

FX VOLATILITY

date	USD/PLN 0-delta stradle				25-delta RR		2
	1M	3M	6M	1Y	1M	1Y	
21/01/11	17.75	18.45	18.90	19.55	2.50	4.55	0.
22/01/11	17.75	18.45	18.90	19.55	2.50	4.55	0.
25/01/11	17.00	17.85	18.55	19.25	2.20	4.55	0.
26/01/11	16.70	17.45	18.20	18.90	2.05	4.35	0.
27/01/11	16.35	17.20	17.95	18.65	2.20	4.35	0.

PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
21/01/11	2.8779	3.8936	-21.0%
22/01/11	2.8779	3.8936	-21.0%
25/01/11	2.8558	3.8777	-21.5%
26/01/11	2.8280	3.8777	-21.8%
27/01/11	2.8508	3.9009	-21.2%

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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