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FINANCIAL MARKETS DEPARTMENT

PAGES: 8

WARSAW, MARCH 25, 2011

POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

PREVIEW: The week of March 25th 2011 to March 30th 2011

Indicator	Date of release	Period	BRE forecast	Consensus	Last	Comment
NO SIGNIFICANT RELEASES						

In Focus / Macroeconomics

Lower current account deficit. No revision (at least for now). Errors and omissions remain high.

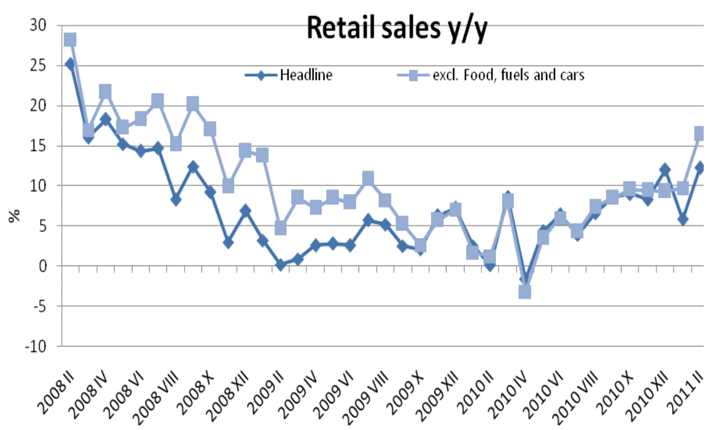
Current account deficit in January amounted to 930 mln EUR. The deficit was therefore closer to our estimates based on Central Statistical Office trade balance data than previous forecast based on economic aggregates. The reason why data release was rescheduled is now clear: BoP asked (central statistical Office – GUS) for explanation of imports deceleration recorded in January; also the list of entities which have reached the monthly and quarterly reporting threshold has been revised (this issue explains frequent revisions of quarterly data).

As far as current account components are concerned, an increase in exports to 10201 mln EUR and substantial decrease in imports to 9926 mln EUR was reported. A surplus in trade balance was therefore reported (275 mln EUR), while models based on macro aggregates (production and sales) estimates suggested a deficit, twice as big as actually reported surplus. While this tendency is supported by consumption substitution effects in 2011 Q1, the scale of adjustment seems to be huge. As far as other components are concerned, services balance decreased to 259 mln EUR, income balance deficit increased to -1305 mln EUR and current transfers deficit increased to -159 mln EUR.

The direct reaction of the market was appreciation of zloty against the euro (by about 1 figure, to 4.0450 and later to 4.0250). There remains a question of current account data credibility in the eyes of investors while errors and omissions remains substantially negative; only in January it amounted to 1593 mln EUR (3.5% of GDP in annual terms). Why did the Zloty depreciate in January (as well as in February by the way) when only a small disequilibrium in current account flows was reported? Don't we have to do with a situation when equilibrium exchange rate implied by the current flows in the Polish economy is at a much higher level than it is now and the trend that appears to be upward has been generated by speculative transactions of investors "pushing" the market at a relatively low volumes, while the "true" ratio of current account deficit to GDP (including errors and omissions) amounts to 7%? Such a high level of deficit (hidden or not) would affect investors' sentiment towards the zloty (IMF assumes that 5% deficit cannot be sustained without depreciation). When speculative transactions vanish (or in other words financing becomes scarcer) we will be back to equilibrium generated by real cash flows. The longer depreciation of Zloty contrasts with improvement of official current account data, the sooner it will happen.

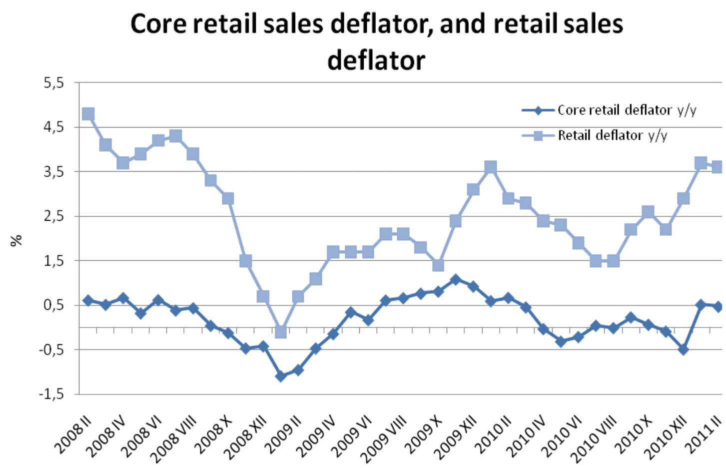
Strong retail sales data

Retail sales grew by 12.2% yoy in February, compared to 5.8% in January, when substitution effects related to tax deductions and VAT rate hike hit the sales. In February, dynamic growth in all sections was reported. Sales of food grew by 5.2% compared to 0% in January. Motor vehicles sales amounted to 7.2% yoy, compared to -4.1% yoy, respectively. Even a greater rebound in other demand categories was reported (see the graph below).



Tighter labor market (accelerating employment, stable growth of wages) provokes further improvement in retail sales. It seems substitution effects we mentioned for some time hit retail only in January and consumers slowly come back to old habits. Therefore we expect retail sales growth to come back to 10% y/y in coming months.

As usual we calculated retail sales deflator and core retail sales deflator (excluding price-driven food and fuels). Stabilization of this measures (or even a slight fall in case of core deflator) after a surge in January corroborates a hypothesis that price action in January was mainly due to increased VAT rates. Current nominal data does not reflect inflationary pressures, however, it may change in coming months.



The data implied only little increase in yields and zloty strengthening from 4.0430 to 4.0300. It should be emphasized that Zloty reacts limitedly to the data which usually used to have positive impact on the exchange rate. Therefore possible imbalance in current account (and unexplained errors and omissions balance) seems to be an important medium-term weakening factor for Polish currency. Retail sales data will probably reinforce MPC in belief of fast interest rates hike necessity (moreover because MPC used to highlight weakening demand in the Polish economy). We expect the MPC to raise interest rates in April. The market is 50/50 split on April hike.

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	3.7
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	11.9
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	4.4	**4.4↑**	**4.4↑**
Inflation rate (%, average)	3.0	2.1	2.6	2.9	3.7	3.7
NBP repo rate (end-of-quarter)	3.50	3.5	3.5	3.50	3.75	4.25

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

Fixed Income

Rate hike

The MPC is determined to rise rates in April despite quite surprising macro data. Few comments from the Council members last week has proved the rate hike schedule is already set for April and possibly in June. As it has been already priced in a yield curve, the crucial question is how the external situation might deteriorate the rate outlook. The political instability in Northern Africa, still existing concerns about the EU peripheral countries standing combined with the constant food prices growth are likely to adversely affect our base scenario. As we previously assumed, the CPI path showed its peak above 4% in 2nd quarter and the whole rate hike cycle around 75bp we were quite determined to receive any rates that priced over 100bp scenario. Now, we decided to take profits on our receivers as we see some upside risks within the next weeks. We believe the 25bp rate hike is quite inevitable and it's quite unlikely to take additional value being received at these levels. We are also affraid the next CPI data might be as the same surprising as the previous one. This time it might go over 4% even and push the short end of the curve to the year's highs again. No matter if we are right on MPC decision, the first time this year, we would find a good opportunity to take payers on a chance.

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	3/28/2011	-	4.291%	1/31/2011
2Y T-bond OK1013	4/13/2011	-	5.113%	3/9/2011
5Y T-bond PS0416	4/20/2011	-	5.642%	1/5/2011
10Y T-bond DS1020	4/20/2011	-	6.210%	1/12/2011
20Y T-bond WS0429	4/20/2011	-	6.246%	1/12/2011

Money Market

Lower core CPI figure balanced by the higher retail sales

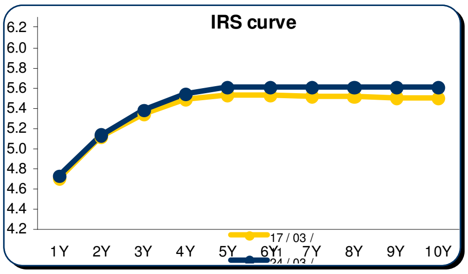
New T-bill benchmark will have nice outstanding

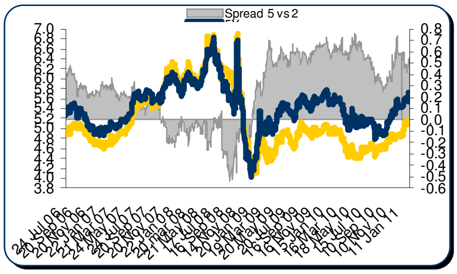
A bit cheaper week with additional OMO on Wednesday preventing the rates from falling. Today we will have the answer what we can expect during the last few days of the reserve settlement period. We bet on falling cost of carry.

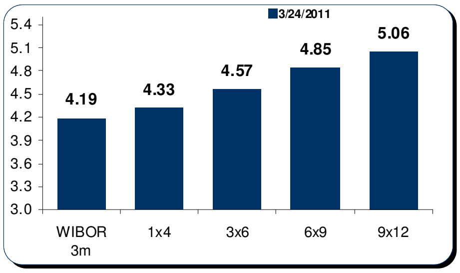
Lower than expected core CPI (1.7 vs 2.1 %) balanced by higher retail sales (12.2 vs 7.1%). Market bet for the next MPC is now 60/40 for the hike.

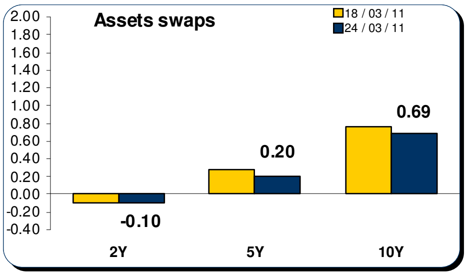
T-bills more expensive during the tender with the average yield of 4.46%. Next auction will sell the new benchmark which will be carried on for the whole April and May.

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty relief rally

After touching 4.1230 last Wednesday night on the back of potential nuclear catastrophe, we are now heaving the relief rally in the Zloty. Till now it took us back to 4.0115 low. The announcement of relatively good current account number on Monday plus a very robust retail sales, also gave Zloty additional boost. We are now expecting consolidation with 3,97/3,99 major support zone.

Vols lower

The spike in vols was very short lived, as the front end was sold again aggressively with 1m mid 8.7% vs last week 9.4% rest of the curve (3M 9.4 % vs 9.9 %, and 1Y 10.75 % vs 10.9 %). The memory of 4.1200 traded stayed only in the backend of the curve, for the short end volatility holders, the current theta bill seems to be the only concern.

Short-term forecasts:

SPOT

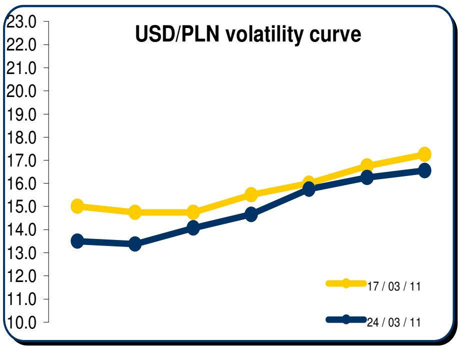
Main supports / resistances:
EUR/PLN: 3.9700 /4.1250
USD/PLN: 2.8000 / 3.9500

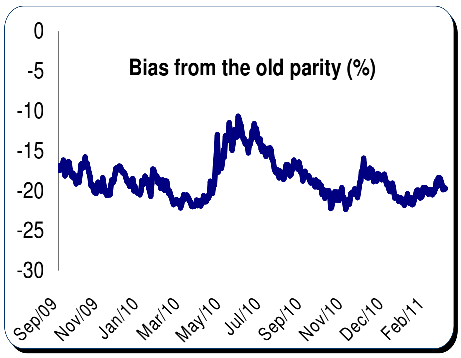
Longs in EUR/PLN closed at 4,1200. We now look for a consolidation phase with a messy price action. In general we would like to get long again ideally in 4,01 region with a stop loss below 3,9700 and hopes to revisit 4,0800 again.

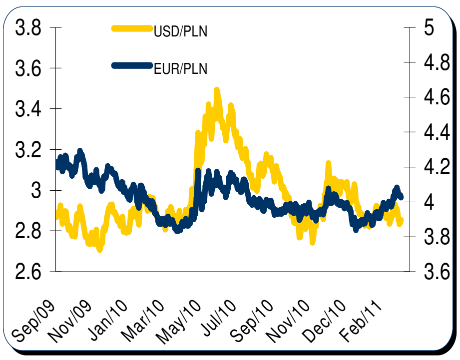
OPTIONS

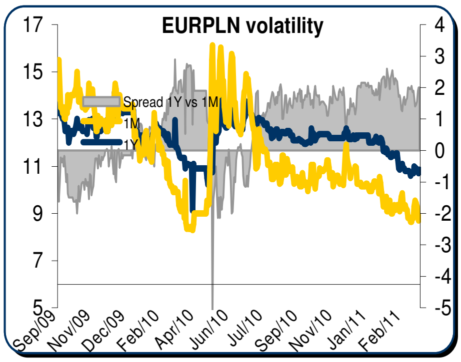
We think it offers a bargain to buy a 2 month ATMs for Gamma and longer end ATMs for Vega position. EUR/PLN run is just above this year's lows and we think it may revisit the higher levels.

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
18/03/11	4.10%	4.18%	4.29%	4.31%	4.46%	4.47%
21/03/11	4.10%	4.18%	4.34%	4.31%	4.47%	6.59%
22/03/11	4.10%	4.18%	4.30%	6.49%	4.45%	4.47%
23/03/11	4.06%	4.19%	4.30%	4.31%	4.45%	4.47%
24/03/11	4.07%	4.19%	4.32%	4.31%	4.47%	4.47%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
18/03/11	4.28%	4.51%	4.82%	5.04%	4.99%
21/03/11	4.26%	4.46%	4.77%	4.99%	4.95%
22/03/11	4.26%	4.51%	4.83%	5.05%	4.99%
23/03/11	4.32%	4.56%	4.85%	5.08%	5.03%
24/03/11	4.32%	4.56%	4.83%	5.04%	5.00%

FIXED INCOME MARKET RATES

Fixed Income Market Rates (Closing mid-market levels)

date	1Y		2Y		5Y		
	WIBOR	TB	IRS	OK0112	IRS	PS0511	IF
18/03/11	4.47%	4.51%	5.12%	5.02%	5.54%	5.81%	5.5
21/03/11	6.59%	4.51%	5.12%	5.00%	5.59%	5.84%	5.5
22/03/11	4.47%	4.55%	5.13%	5.00%	5.62%	5.80%	5.6
23/03/11	4.47%	4.55%	5.14%	5.01%	5.62%	5.80%	5.6
24/03/11	4.47%	4.54%	5.14%	5.04%	5.61%	5.81%	5.6

PRIMARY MARKET RATES

Last Primary Market Rates

	au. date	maturity	avg price	avg yield	supply	demand	sc
52W TB	11/01/31	12/01/31	95.841	4.35%	2000	2968	19
OK0113	11/03/09	13/01/26	91.054	5.11%	4500	10808	45
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

	USD/PLN 0-delta stradle				25-delta RR		2
date	1M	3M	6M	1Y	1M	1Y	1
18/03/11	14.00	15.05	15.85	16.55	2.30	3.80	0.
21/03/11	13.63	15.00	15.80	16.55	2.10	3.60	0.
22/03/11	13.48	14.90	15.75	16.55	1.90	3.60	0.
23/03/11	13.48	14.80	15.70	16.55	1.80	3.55	0.
24/03/11	13.38	14.65	15.75	16.55	1.80	3.55	0.

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
18/03/11	2.8850	4.0615	-18.9%
21/03/11	2.8588	4.0477	-19.4%
22/03/11	2.8358	4.0345	-19.8%
23/03/11	2.8446	4.0353	-19.7%
24/03/11	2.8516	4.0270	-19.7%

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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