



## POLAND WEEKLY REVIEW

### MACROECONOMICS AND FINANCIAL MARKETS

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#### PREVIEW: The week of April 8<sup>th</sup> 2011 to April 14<sup>th</sup> 2011

Indicator	Date of release	Pe- riod	BRE forecast	Consen- sus	Last	Comment
CPI Inflation y/y	Apr 13	Mar	<b>4.0%</b>	3.8%	3.6%	The rise owes much to food inflation which may pose and upside surprise. Plus solid growth of fuels, but this can be easily calculated and is currently reflected by market consensus. Core inflation 1,8% y/y.
C/A balance EUR	Apr 13	Feb	<b>+50mln</b>	-470mln	-930mln	Significant upside surprise which once occurred in February 2009. Surplus in trade balance (imports seem to have decelerated, in line with the reversion of substitution effects). Huge EU inflow, partially compromised by the outflow.

## In Focus / Macroeconomics

### NBP rates up by 25bp. Hawkish statement.

MPC increased the interest rates by 25bp on Tuesday, as expected. The statement is much more hawkish than previously (and then even can be expected prior to the meeting). It seems MPC has finally realized where the risks lie. Both inflationary expectations and high level of inflation are headline was the primary cause of the hike. MPC openly expressed its concerns about increasing inflationary pressures and spoke about continuation of the tightening cycle (previously it was expressed only as a "tightening process" – something thought to be less obvious and foreseeable than the cycle). We got accustomed to MPC changing their view on the perspectives of the Polish economy. This time, probably as a result of monthly data, MPC assesses that the probability of weaker consumption demand is on decrease, while the situation of financial enterprises is "very good" (very uncommon wording taking into consideration the usually conservative tone of central bank statements).

Currently expressed inflationary concerns of the MPC may be strengthened by the data to be released and to some extent by the ECB behavior in the future (paraphrasing famous Bob Solow's words: what looks like a cycle, is a cycle...). More specifically, we expect March inflation reading to surprise on the upside (mainly due to food prices) towards 4.0% - a level considered by many MPC members (usually dovish Kazmierczak may formulate a lower bound of urgency of MPC in this context) as alarming. Moreover, recent data on unemployment rate proved much better than earlier estimates (13.1% vs 13.5% previously reported) what seems to make a huge difference for some MPC members, so far unconvinced by employment numbers. Summing up, we believe that expectations of another NBP rate hike (either in May or June) should materialize over the coming weeks.

Recent development of Polish bonds (higher prices of long term bonds and flattening of the curve with simultaneous higher expectations of faster monetary tightening) seems to be theoretically supported by the end of worries about uncontrolled growth of inflation and monetary policy errors (it is typical for base markets though). Parallel moves dominate on the emerging markets and monetary tightening (especially tightening accompanied by higher inflation records – both the hard data and inflationary expectations) should correspond with an upward move of the yield curve. We expect that such scenario may materialize in the weeks to come. As we expected higher expectations of rate hikes resulted in appreciation of PLN against EUR.

We still support our opinion that the scale of monetary tightening in Poland may turn out to be smaller than it is priced-in by the market (it will be hard for MPC to keep on raising interest rates as soon as inflation, due to base effects, will begin to decelerate). The rates should be increased this year by further 50 bp. It is too early to implement receive strategy though – the risk of an increase in bond yields seems to be too big. Just to make it clear – the direction of yields on base markets may have substantial influence on Polish bonds.

### 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	<b>4.4↑</b>	<b>4.4↑</b>
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

### *No surprise*

As we notified after the inflation expectations data at 4.6% y/y the Tuesday's 25bp rate hike seemed to be a done deal. And it definitely was. The ECB did not surprise either starting the rate hike cycle with 25bp. As Trichet's comments stayed quite moderate the still existing threat over the second round effects would definitely result in further tightening process in a future. In a meanwhile, the Polish MPC changed its rhetoric. It became more hawkish suggesting the started cycle was not likely to be near its end. That might suggest the possible March CPI reading on April 13th over 4.0% could raise speculations on another hike already even in May. In MPC's hawk Kazimierczak opinion the inflation figure over 4.0% could trigger some danger signal and might lead to the further, even more aggressive rate hikes in a near future. That scenario seems quite reasonable and fully corresponds to what we have analyzed for the last couple of weeks. If our CPI estimates on April 13th over 4.0% are right, we expect the further, accelerating paying pressure in the short end of a 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	5/30/2011	-	4.458%	3/28/2011
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

### *Expensive carry despite the huge surplus*

Cost of carry surprisingly high taking into consideration that we started the weekend with the surplus of the cash in the system amounting to 11 bln pln. It grew to 14 billion and the central bank decided to do additional OMO on Wednesday. The supply of the papers was out of the space (pln 25 billion) but the demand was quite low (7 billion pln), which left the market with the surplus of 7 billion pln. Despite those facts ON rates well only 20-30 bps below the main rate, which was very unusual. The question is whether we are facing any structural problems in liquidity distribution (other than credit lines) or someone is overbuilding the reserve just in case after March squeeze.

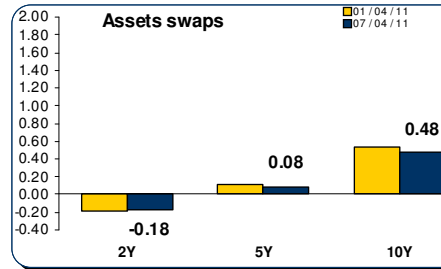
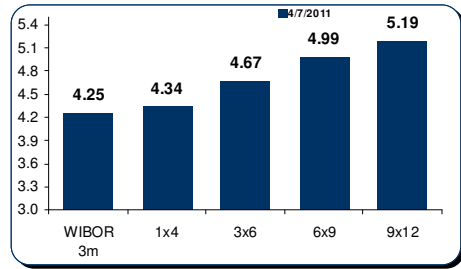
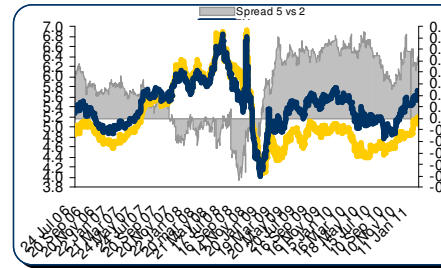
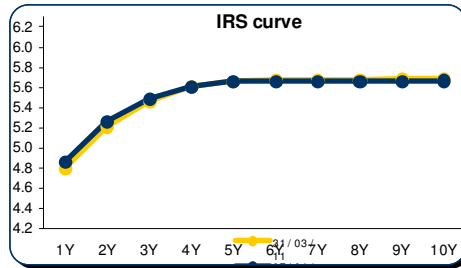
### *The MPC raised all the rates by 25 bps*

### *T-bills stable*

The MPC raised all the rates by 25 bps as expected. The ECB also did the same tightening for the euro zone. The highlight of next week will be CPI figure which will help in further timing assumption for local monetary policy authorities.

T-bills stable at weekly tender with an average yield of 4.46%. It should be cheaper in price on Monday.

**FIXED INCOME & MONEY MARKET CHARTS**



## Foreign Exchange

*Zloty stronger*

This week's trading was dominated by post rates hike MPC comments. Although rates hike has not surprised anyone, mildly hawkish post decision comments have caught market on square PLN positioning. As a result PLN has started to trade stronger side touching 3.95 early Friday.

*Vols lower*

Implied volatility, already priced at 12 months low, is still heading lower. Low realized readings and strongly ranged EURPLN's rate effectively discourages potential vega buyers. This week's numbers are: 1M 7.75 (last week 7.7), 3M 8.7 (8.95), 1Y 10.45 (10.55). Smile and currency spread have been traded at similar levels as in previous week.

### Short-term forecasts:

SPOT

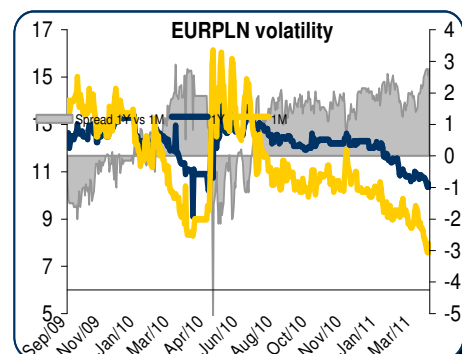
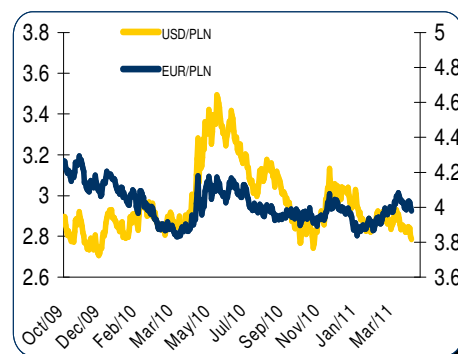
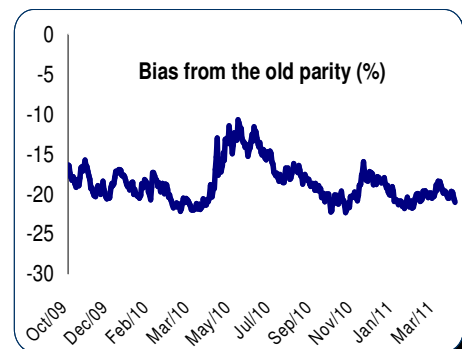
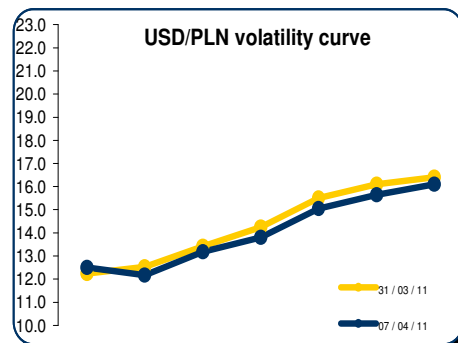
Main supports / resistances:  
 EUR/PLN: 3.9000 / 4.0200  
 USD/PLN: 2.7000 / 2.8800

We have closed our long at 3.97. EUR vs PLN interest rates parity (and its predictions) has not changed significantly. Positioning is long PLN. Touching 3.90 and correction to 4.00 is highly likely.

OPTIONS

We think it offers a good 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
01/04/11	4.12%	4.19%	4.28%	4.31%	4.45%	4.47%
04/04/11	4.10%	4.19%	4.31%	4.31%	4.47%	6.59%
05/04/11	4.05%	4.20%	4.32%	6.49%	4.47%	4.48%
06/04/11	4.15%	4.25%	4.30%	4.32%	4.51%	4.51%
07/04/11	4.17%	4.25%	4.40%	4.33%	4.52%	4.51%

**FRA MARKET RATES**

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
01/04/11	4.32%	4.57%	4.85%	5.08%	5.00%
04/04/11	4.32%	4.58%	4.88%	5.10%	5.06%
05/04/11	4.34%	4.60%	4.87%	5.10%	5.11%
06/04/11	4.34%	4.61%	4.87%	5.16%	5.11%
07/04/11	4.34%	4.62%	4.92%	5.15%	5.11%

**FIXED INCOME MARKET RATES**

Fixed Income Market Rates (Closing mid-market levels)							
date	1Y		2Y		5Y		
	WIBOR	TB	IRS	OK0112	IRS	PS0511	IF
01/04/11	4.47%	4.57%	5.23%	5.04%	5.68%	5.79%	5.7
04/04/11	6.59%	4.55%	5.23%	5.02%	5.66%	5.78%	5.6
05/04/11	4.48%	4.56%	5.25%	5.03%	5.66%	5.75%	5.6
06/04/11	4.51%	4.57%	5.25%	5.04%	5.64%	5.75%	5.6
07/04/11	4.51%	4.57%	5.26%	5.08%	5.66%	5.74%	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**

date	USD/PLN 0-delta stradle				25-delta RR		2
	1M	3M	6M	1Y	1M	1Y	
01/04/11	12.43	14.25	15.35	16.25	1.70	3.45	0.
04/04/11	12.13	13.90	15.15	16.10	1.70	3.50	0.
05/04/11	12.08	13.90	14.85	16.10	1.70	3.45	0.
06/04/11	12.18	13.90	15.10	16.10	1.60	3.50	0.
07/04/11	12.18	13.80	15.05	16.10	1.45	3.50	0.

**PLN SPOT PERFORMANCE**

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
01/04/11	2.8455	4.0312	-19.8%
04/04/11	2.8395	4.0325	-19.8%
05/04/11	2.8388	4.0253	-19.9%
06/04/11	2.7986	3.9989	-20.7%
07/04/11	2.7863	3.9823	-21.0%

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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