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FINANCIAL MARKETS DEPARTMENT

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POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

PREVIEW: The week of April 15th 2011 to April 21st 2011

Indicator	Date of release	Period	BRE forecast	Consensus	Last	Comment
Wages y/y	Apr 18	Mar	**3.8%**	4.3%	4.1%	No difference in working days. Trend in manufacturing leveled off somewhat.
Employment y/y	Apr 18	Mar	**4.3%**	4.3%	4.1%	In trend, which seems somewhat stronger than could be thought at the start of the year. Business activity indicators pointing north.
Producer prices y/y	Apr 19	Mar	**8.4%**	8.2%	7.3%	Another exchange-driven rise, accompanied by the ongoing commodity boom.
Industrial output y/y	Apr 19	Mar	**8.9%**	9.7%	10.7%	Risks to industrial output lie ahead – temporary shutdowns on supply shortages from Japan.
Core inflation y/y	Apr 20	Mar	**2.0%**	1.8%	1.7%	Mainly EURPLN related rises. Price rises slowly spilling among various categories.
MPC "Minutes"	Apr 21	-	-	-	-	Decision was unanimous. The statement was precise enough so we do not expect any new striking features.

In Focus / Macroeconomics

C/A deficit narrows, large revision of January data

C/A deficit narrowed in February to EUR 685mln and proved less optimistic than our forecast (close to 0). However, the divergence is simply explainable – January C/A deficit was revised upwards toward EUR 1334 mln. We expect major revision in June (as earlier announced by the NBP). Interestingly, net errors and omissions went considerably down in February to EUR 100mln, a level we have not seen for several years…

Turning to details of the C/A, relatively balanced trade account is noticeable: in February it amounted to EUR -163 mln while in January EUR 67 mln deficit was reported (compared to -600 reported earlier - this difference is responsible for error in our forecast of C/A). Low deficit should be attributed to a reversal of substitution effects from the end of last year. The thesis finds confirmation especially in the growth of exports and imports - they are on similar level (in terms of annual growth) for the second consecutive month (it does not happen often). In the coming 2-3 months such tendency should be sustained.

As far as other current account components are concerned, no major surprises were reported: balance of services remained at EUR 200 mln surplus, balance of income also stabilized (EUR -1314 mln), balance of current transfers improved due to high EU transfers (+EUR 555 mln).

Current account deficit in 2010 amounted to 3.2% of GDP while in 2011 it will be higher (5-6% GDP) due to the BoP data revision (at least 1 pp. in terms of current account deficit to GDP ratio) - as Mr. Sobota (NBP) officially informed.

A 4.3% spike in inflation

Annual inflation rate jumped in March to the 4.3% y/y level from 3.6% y/y in February, compared to 3.9% y/y of analysts' expectations.

The main reason of such a growth is monthly increase in food prices in a scale of 2.1%. We have to highlight that although this level is not a surprise, Central Statistical Office releases from previous months reported surprisingly low growth of food costs. Prices grew remarkably also in such categories as fuels (+3.1% m/m), clothing and footwear (+3.1% m/m, mainly as an effect of weaker Zloty), restaurants and hotels (0.5% m/m) and others (0.7% m/m).

Core inflation increased from 1.7% to 1.9-2.0%. In the forthcoming months we expect stabilization/gradual growth of price levels due to not only higher food prices, but also more and more noticeable increases in other categories. Inflation will start decreasing no sooner than in May/June and the timing will mainly depend on harvest level (more specifically: the inflow of new grains), weather in the new season of agricultural production and global trends (for today prices downfall is a low probability scenario, more possible is price stabilization or local correction, while supply adjustments made so far may still fall short of demand).

The situation which the MPC faces now seems hard. It is not only fight against inflation expectations but also with the belief (market belief?) the MPC would be unable to deliver price stability in the mid-term. We expect lots of comments from MPC members aimed at extinguishing expectations that MPC lost control over inflation and is behind the curve and chases inflation. However, so far rate-setters did not meet our expectations – each and every comment had a flavor of urgency for raising rates (except for Chojna-Duch). Finally, Belka cooled the atmosphere a bit repeating the MPC is in a cycle, but monetary policy is not designed to act on a single high inflation data; he reiterated the earlier view that inflation is set to fall in the course of the year. We think that the governor had no intention to cool rate hike expectations but rather to trim the state of urgency which popped up after the comments of more hawkish rate-setters. Therefore we think there will be market play for a 50bps hike in May. However, the MPC probably realizes that delivering such a hike would only reinforce market beliefs that situation got out of control. Therefore it is much more likely that MPC will deliver a hike in May, and then also consider June.

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

Another CPI shock

Main driver for the market this week was the inflation data which once again surprised the market jumping to 4.3% y/y vs. 3.8% expected. Market reaction was of course rapid and significant - rates moved up by some 10-12bp across the curve, with front end suffering the most. Also comments from the MPC members were mainly in hawkish tone, pointing out that such inflation means necessity to act promptly, ie. hike rates again already in March, which had been priced in by the market already. However, later comments from Belka were definitely more balanced, making May decision definitely not a done deal. Nevertheless increasing risks to further inflation path are becoming more of an issue.

From market perspective, higher inflation and its impact on rates was our main idea for the past few weeks. As the scenario has materialized, we find it reasonable to take profit on pay positions here. In longer term the upside trend in rates seems most likely scenario at the moment, however in the short term some pull-back is likely considering Belka's comments; also further data this month will definitely not be as shocking as the CPI. In case rates move lower, we'll be looking to take pay positions again, we also see steepening risks, as market might start pricing scenario, where MPC falls behind the curve if dissonance between data and Council dovishness continues.

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	5/12/2011	-	5.163%	4/13/2011
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

CPI was a surprise

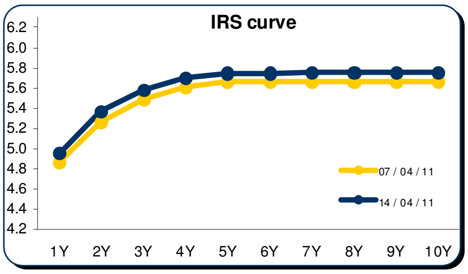
T-bills cheaper

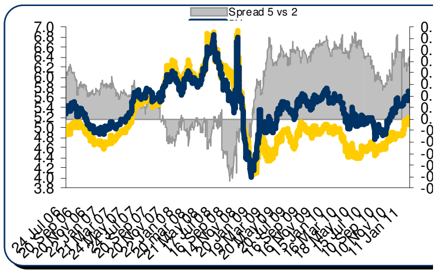
Carry this week was around 50 bps lower than the main market rate, despite additional OMO on Tuesday. Seems that after squeeze in March people want to have peaceful Easter, hence the appetite for risk on liquidity desks is lower.

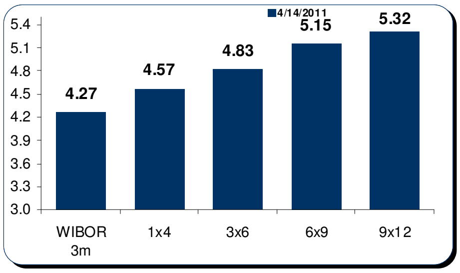
CPI much above expectations (4.3 vs 3.9%) pushed the rates sharply up by 10-15 bps. The May play is not whether there will be a hike but is it going to be a pick between 25 or 50 bps. We think that 50 bps is not likely, especially after yesterday's interview with the head of the central bank. Next week's figures (wages, employment and industrial output) should calm down the market for another bit.

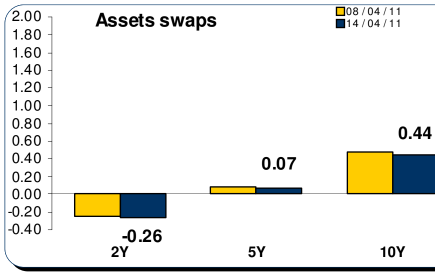
T-bills bit cheaper during the last tender with an average yield going up by 4 bps to 4.5%. Next tender should bring further deterioration of the price, around 5 bps in the yield terms.

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty stronger

A bit hawkish MPC has received new ammo – surprisingly high CPI print (4.3 vs. expected 3.8%) and in common market view next hikes are only matter of (near) time. But currency reaction was hardly noticeable – we have slightly deepen last week low (3.9435 vs. 3.9505). Reason? “Market” is already long PLN and global risk level is at higher records.

Vols untouched/bit higher

Implied volatility curve, driven by low realized (6.6% weekly) is still traded about this year’s lowest levels. This week ATM’s are priced at: 1M 7.85 (last week 7.75), 3M 8.8 (8.7), 1Y 10.55 (10.45). Inversely than previous weeks these low levels became bided a bit. Will it provide some support here? Probably yes. Smile has been traded at similar levels as in previous week. Currency spread has bounced about 0.5%.

SPOT

Short-term forecasts:

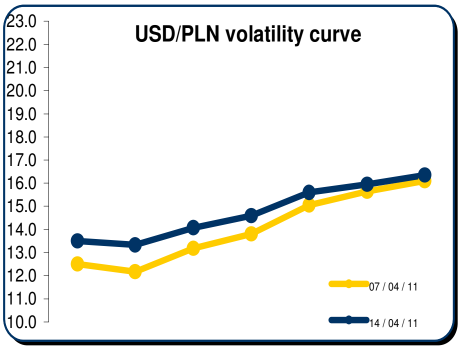
Main supports / resistances:
EUR/PLN: 3.9000 /4.0100
USD/PLN: 2.7000 / 2.8800

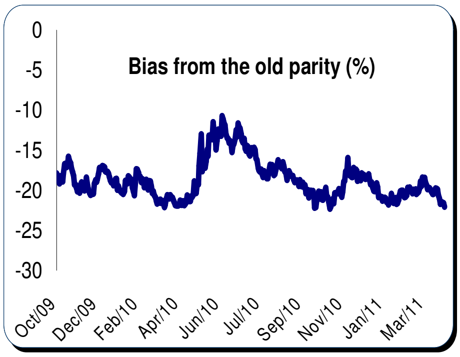
Renewed rate hikes expectations and global woes on the other hand. Positioning is long PLN. Play range.

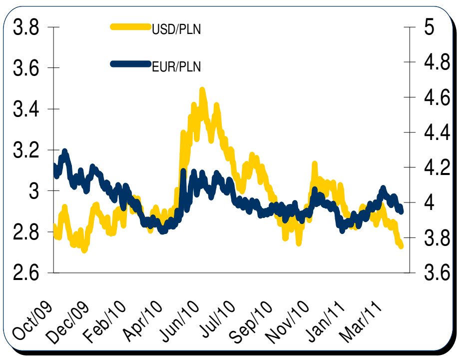
OPTIONS

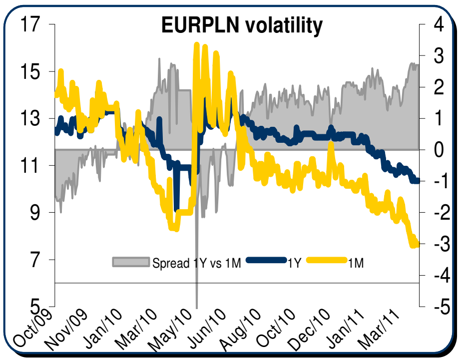
We think it offers a good bargain to buy a 2 month ATMs for Gamma and longer end ATMS for Vega position. EUR/PLN run is just above this year’s lows and we think it may revisit the higher levels.

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
08/04/11	4.15%	4.21%	4.39%	4.33%	4.52%	4.48%
11/04/11	4.15%	4.21%	4.36%	4.35%	4.52%	6.59%
12/04/11	4.15%	4.26%	4.35%	6.49%	4.52%	4.52%
13/04/11	4.20%	4.27%	4.35%	4.36%	4.52%	4.53%
14/04/11	4.20%	4.27%	4.40%	4.37%	4.55%	4.53%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
08/04/11	4.38%	4.67%	4.97%	5.21%	5.11%
11/04/11	4.34%	4.63%	4.99%	5.18%	5.11%
12/04/11	4.34%	4.67%	4.99%	5.19%	5.11%
13/04/11	4.37%	4.70%	5.01%	5.21%	5.18%
14/04/11	4.39%	4.72%	5.03%	5.23%	5.19%

FIXED INCOME MARKET RATES

Fixed Income Market Rates (Closing mid-market levels)

date	1Y		2Y		5Y		
	WIBOR	TB	IRS	OK0112	IRS	PS0511	IF
08/04/11	4.48%	4.57%	5.27%	5.03%	5.67%	5.75%	5.6
11/04/11	6.59%	4.56%	5.29%	5.07%	5.69%	5.75%	5.7
12/04/11	4.52%	4.58%	5.28%	5.04%	5.67%	5.75%	5.6
13/04/11	4.53%	4.58%	5.38%	5.12%	5.75%	5.82%	5.7
14/04/11	4.53%	4.62%	5.38%	5.11%	5.75%	5.82%	5.7

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	11/04/13	13/01/26	89.159	5.16%	5500	7385	47
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
08/04/11	12.68	13.90	15.00	16.10	1.45	3.50	0.
11/04/11	12.68	13.90	15.00	16.10	1.60	3.55	0.
12/04/11	13.18	14.10	15.40	16.15	1.85	3.65	0.
13/04/11	13.05	14.10	15.40	16.15	2.08	3.65	0.
14/04/11	13.33	14.60	15.60	16.35	1.85	3.65	0.

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
08/04/11	2.7489	3.9594	-21.7%
11/04/11	2.7501	3.9758	-21.5%
12/04/11	2.7511	3.9726	-21.5%
13/04/11	2.7421	3.9756	-21.6%
14/04/11	2.7297	3.9498	-22.0%

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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