BRE BANK SA

THE BEST FINANCIAL INSTITUTION FOR DEMANDING CUSTOMERS

FINANCIAL MARKETS DEPARTMENT

PAGES: 8

WARSAW, APRIL 22, 2011

POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

PREVIEW: The week of April 22nd 2011 to April 28th 2011

Indicator	Date of release	Period	BRE forecast	Consensus	Last	Comment
Retail sales	Apr 27	Mar	**1.5%**	7.2%	12.2%	The bottom-up analysis suggests that March will be a month with huge base effects from last year (Easter sales is out form March reading as it falls in late April), which drive retail sales to the bottom temporarily. In May (April reading) situation reverses.

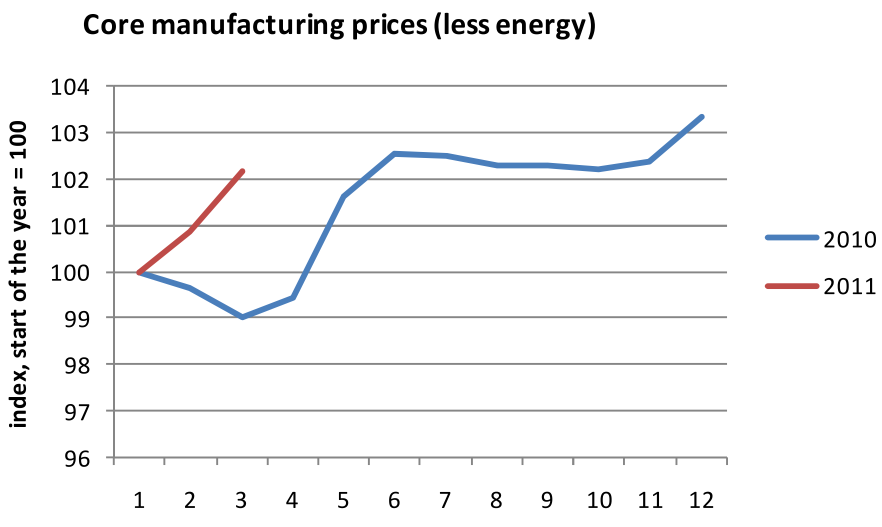
In Focus / Macroeconomics

Historical high in producer prices, thriving construction but softer industrial output (a one-off?)

Industrial output decelerated in March to 7.0% y/y from 10.7% recorded in February. The drop is partially attributable to statistical base effect from last year, however, to much extent it was “clean” manufacturing which decline weighted on the aggregate (so far it travelled in upward trend, and we think that the recent reading is only temporary disturbance). As Poland is synchronized with Germany, and manufacturing there enjoys a prolonged upswing (also in terms of leading indicators), the drop in Poland may be of one-off nature (see also the positive business tendency indicators, as compiled on quarterly basis by the National Bank of Poland). The risk factors are present, though, with car manufacturing at the fore and anticipated supply chain disruptions within 1-2 months (Japan committed itself yesterday that all factories will be operating at former capacity until December).

Construction output accelerated to 22.4% y/y and the upswing is broad-based (infrastructure investment and a turnaround in real estate). Overall, Q1 ended with average construction growth close to 20%, clearly supported by relatively milder winter and faster pick-up of construction activity (Poland is synchronized well with Germany in this respect as well). This fact bodes well for investment activity in Q1 which (in terms of national accounts) may have accelerated towards 7.0% on annual basis.

Producer prices surprised to the upside, reaching record high growth of 9.3% y/y. Growth of prices stems solely from manufacturing where prices rose by 1.8% on monthly basis. Nearly a third of this is due to energy prices, the rest comes from passing costs onto final buyers. Taking into account the huge base effects from last year (we show them in a graph below) we count on a steady decline (in y/y terms) of producer prices in the coming months. Should the rises in manufacturing have only cost character, they will disappear as soon as global price pressures dissipate.



The data proved neutral for the market. Given the whole range of thoughts given by the MPC members, widely anticipated May hike was more of a flip of a coin. Then the results of the talks between NBP and MoF were revealed…and everything became clear. The main conclusion after the talk is the following: NBP is willing to cooperate with the MoF very closely. More specifically, MoF obliged itself to sell regularly some of its EUR holdings (max EUR 13-14bn) in the market instead of exchanging them in non-market separate account in NBP, in order to limit the interbank market over-liquidity (or more precisely, limit the pace of its growth). Such a move was warmly welcomed by governor Belka who said it “makes monetary policy easier” (of utmost importance is not only the shot in over-liquidity’s head but also – and possibly overwhelmingly – commitment (?) to cap the zloty). At the same time Rostowski said that such a cooperation will limit the scope for rate hikes.

Cooperation between NBP and MoF and relying only on exchange rate to fight inflation is tricky: the balance between better PLN flows (EUR selling) and fixing current carry (especially given the determination of ECB to hike further) is hard to be pre-determined. Thus we expect some nervous trading as some investors may contest such a policy and try to prove Polish administration wrong. Such a scenario will be avoided if the cooperation of MoF and NBP is complemented with logical, and persevere MPC rate hike commitment. Therefore, the joint statement by the FinMin and the Central Bank does not rule out the rate hike as soon as in May. Such a scenario would be given additional support should inflation expectations surprise to the upside already in April (although much more probable is solid acceleration in May).

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	4.2	4.2
Inflation rate (%, average)	3.0	2.1	2.6	2.9	3.7	4.3
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

Talk, talk, talk …

After surprisingly high reading of CPI, rates were cruising lower during last week. Dovish comments from Glapinski and Chojna-Duch supported the ongoing sentiment. Market paid more attention to weaker industrial output reading (which wasn't that low after all, and if you look at construction which came above 20% y/y the data looked quite good to us) than to record high PPI (9.3% y/y). On Wednesday we had monster switch auction, where MinFin sold 2.5 bio of 5y fixed bond and 3.5 bio of 5y floater. That also supported sentiment especially on the longer end of the curve. DS1020 and PS0416 started to slowly climb in price breaking old range levels. But the real highlight of the week was joint conference of Minister of Finance Rostowski and NBP Governor Belka. They announced outright sell of UE funds on the local market and both underlined that this should ease pressure to hike rates in current cycle. In the reaction 2y traded at 5.24 as the low (post inflation high market was 5.42) 5y traded at 5.66 (post inflation 5.75 was reached) curve steepened in 2y5y sector. Additional boost to the market was given by the "holiday period buying" as a lot of players were "parking cash" ahead for longer weekend. 2y bonds gain almost 40 cents (same as 5y bonds) in just one week time, 2y and 5y bonds trade very rich to the swaps, 10y bonds are also getting expensive.

Our view assumes that RPP is going to hike rates just once over next two meetings, after that we will have a holiday period. Belka will most likely want to delay hikes once again but it is worth remembering that he has switched his stance quite dramatically twice already this year. Any surprise from investment or wages can change him into hawk in just matter of days. Bonds and currency can be talked down by MinFin or Central Bank, but CPI and CPI expectations – they just cannot. Our feeling is that CPI is not anchored anywhere close to 2.5% NBP target. RPP can underline they operate in longer perspective, the predominant feeling is that they are very much current data driven. And most likely they are heading for a major policy mistake. So far though the music is still playing. Our call for next week is to wait for retail sales, which will come low and pay rates (we think December contract in FRA market) and 5y swaps after data release playing for very high inflation expectations and a hike in May, which after recent comments was nicely priced out from the curve. We also stay away from bonds, as for us they look like a forced trade.

Happy Easter.

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	5/12/2011	-	5.642%	1/5/2011
10Y T-bond DS1020	7/20/2011	-	6.210%	1/12/2011
20Y T-bond WS0429	7/20/2011	-	6.246%	1/12/2011

Money Market

Risk aversion is growing due to holidays

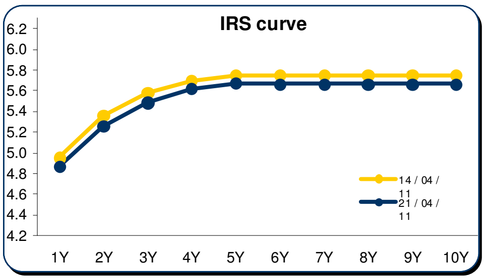
MinFin and central bank willing to cooperate to fight inflation

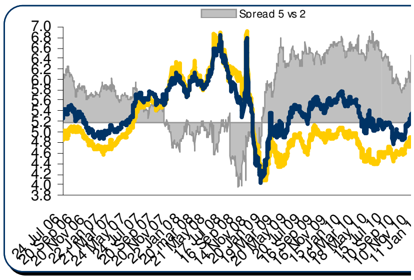
Relatively cheap week despite quite good demand during the OMO (102 bln pln vs 104 bln pln on the offer). Market is short for about 2 bln pln comparing to the reserve requirement, however it should be adjusted with surplus during today's money bills auction. Since holidays usually increase risk aversion, we expect cheap carry next week.

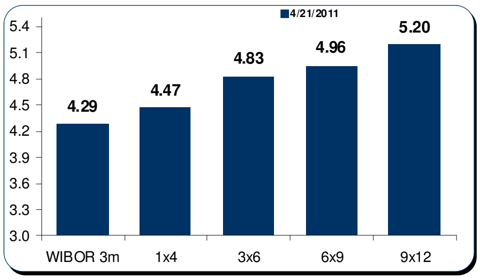
Mixed figures did not disturb the market with wages and industrial output below expectations (4 vs 4.3% and 7 vs 9.7% expected) against PPI and core CPI above expectations (9.3 vs 8.2% and 2 vs 1.8% expected). What impacted the market was agreement between the central bank and MinFin to strengthen the currency in return for more loose monetary policy. PLN gained 3 figures and the rates dropped 7 bps just discounting the news. All this decreases the probability for the rates hike in May significantly.

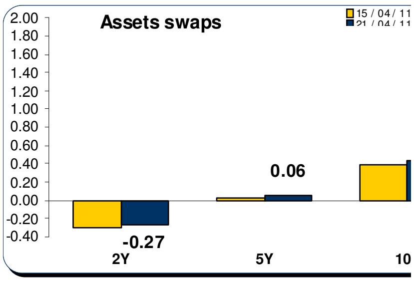
Two T-biils auctions this week due to Easter with an average yield 4.59% on Monday and 4.58% on Thursday. Next auction will be held on 9th May. Those papers on the secondary market are a bit more expensive after comments mentioned above.

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty in range

Started at 3.9450, touched 4.00 just to came back to 3.94 again – those were this week range boundaries. What was story behind? Global sentiment unwind (possible Greek debt's restructuring and S&P USA debt's downgraded outlook) was the explanation of forced closing of long PLN positions and 4.00. Down move was started while sentiment has improved and strenghtened (1% appreciation) when we all had welcomed new official

player on FX market – Ministry of Finance itself. Quote: "Poland to implement regular (!!!) sales of EU funds on domestic spot market" – MoF and NBP statement. Just to complete the picture:
•Last year MoF sold about 2 bn of EUR (at the market, sales via NBP was much higher).
•This year funds are about 13-14 bn of EUR.

Most likely is scenario while they sell into weakening to limit depreciation than sell at any level.Is the upside limited then?

Vols untouched

Upside move followed immediately by downside has increased realized volatility to 8% (6.6% week ago, both in weekly terms). Implied volatility curve, reflecting bit higher historic but narrow range also is still traded at almost same levels. This week ATM's are priced at: 1M 8.0 (last week 7.85), 3M 8.7 (8.8), 1Y 10.65 (10.55). It is still open question how market will response for MoF/NBP statement (has it already answered?) If those selloffs will actually be only "sell on upticks" most of pressure will influence smile.
Smile has been traded at similar levels as in previous week. Currency spread has bounced about next 0.25%.

SPOT

Short-term forecasts:

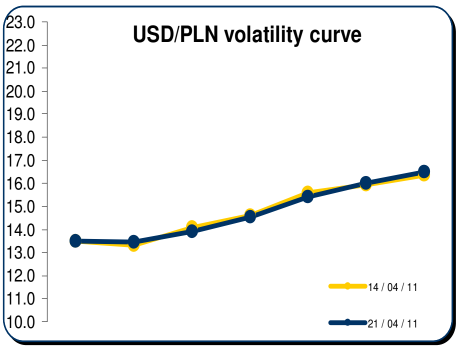
Main supports / resistances:
EUR/PLN: 3.9000 /3.9800
USD/PLN: 2.6800 / 2.7800

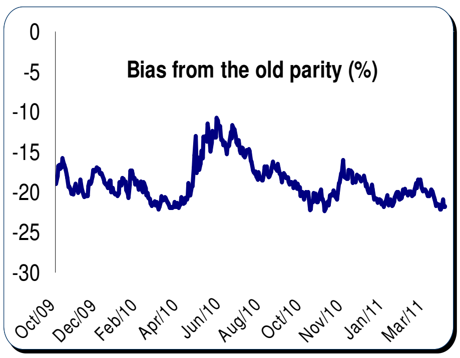
Market is square. Signals are positive – rate hikes (although not necessary in May), MoF statement, global development. Sell 3.97/3.98 for 3.90, S/L 4.01.

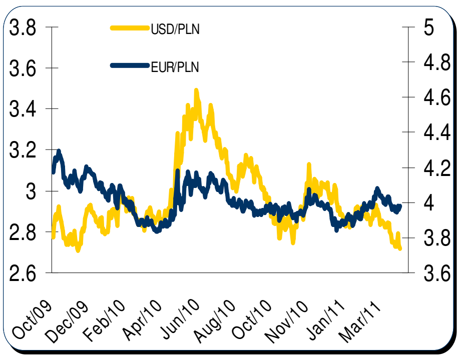
OPTIONS

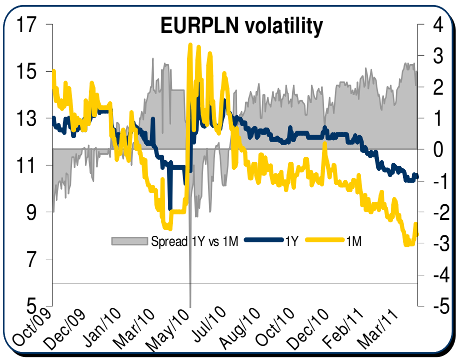
We think the back end of the curve is well supported, taking into account the lowest levels since 2008 and the fact that due to expected rate hikes the forward delta gamma offers additional value. The possible "market interventions" should limit the upside potential in the short term but on the other way it should add to the realized volatility as markets will start to "play that tune" . In our opinion being long in 35 delta EURPLN puts against short 15/20 delta calls provides the cheap gamma profile .

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
15/04/11	4.20%	4.27%	4.40%	4.37%	4.55%	4.54%
18/04/11	4.15%	4.27%	4.40%	4.37%	4.55%	6.59%
19/04/11	4.20%	4.30%	4.35%	6.49%	4.51%	4.57%
20/04/11	4.20%	4.29%	4.40%	4.40%	4.55%	4.56%
21/04/11	4.20%	4.29%	4.40%	4.41%	4.55%	4.56%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
15/04/11	4.46%	4.71%	5.03%	5.24%	5.19%
18/04/11	4.59%	4.79%	5.15%	5.36%	5.28%
19/04/11	4.57%	4.83%	5.15%	5.32%	5.32%
20/04/11	4.57%	4.83%	5.15%	5.27%	5.32%
21/04/11	4.57%	4.83%	5.03%	5.27%	5.32%

FIXED INCOME MARKET RATES

Fixed Income Market Rates (Closing mid-market levels)

date	1Y		2Y		5Y	
	WIBOR	TB	IRS	OK0112	IRS	PS0511
15/04/11	4.54%	4.64%	5.35%	5.05%	5.76%	5.79%
18/04/11	6.59%	4.63%	5.33%	5.07%	5.74%	5.81%
19/04/11	4.57%	4.63%	5.34%	5.05%	5.75%	5.80%
20/04/11	4.56%	4.64%	5.32%	4.98%	5.73%	5.78%
21/04/11	4.56%	4.65%	5.26%	4.99%	5.67%	5.72%

PRIMARY MARKET RATES

Last Primary Market Rates

	au. date	maturity	avg price	avg yield	supply	demand
52W TB	11/01/31	12/01/31	95.841	4.35%	2000	2968
OK0113	11/04/13	13/01/26	89.159	5.16%	5500	7385
PS0416	10/10/13	16/04/25	99.300	5.14%	3000	3414
DS1020	11/01/12	19/04/25	93.022	6.21%	2250	4252

FX VOLATILITY

	USD/PLN 0-delta stradle				25-delta RR	
date	1M	3M	6M	1Y	1M	1Y
15/04/11	13.33	14.60	15.50	16.60	1.85	3.65
18/04/11	13.43	14.50	15.50	16.55	1.85	3.65
19/04/11	13.58	14.50	15.50	16.55	1.85	3.65
20/04/11	13.68	14.45	15.40	16.50	2.00	3.65
21/04/11	13.48	14.55	15.40	16.50	2.00	3.65

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
15/04/11	2.7293	3.9479	-22.1%
18/04/11	2.7608	3.9559	-21.6%
19/04/11	2.7922	3.9815	-21.0%
20/04/11	2.7358	3.9629	-21.8%
21/04/11	2.7183	3.9787	-21.8%

Note: parity on 11/04/00 – USD= 4.3806, EUR=4.2196, basket share 50:50
Mid-market volatility of vanilla option strategies

Contact Details

BRE BANK SA

Ul. Senatorska 18
00-950 Warszawa
P.O. Box 728
Poland

Reuters Pages: BREX, BREY, and BRET

Bloomberg: BRE

SWIFT: BREXPLPW

www.brebank.pl

Forex (BREX) - FX Spot &Options
Marcin Turkiewicz (+48 22 829 01 84) marcin.turkiewicz@brebank.pl
Jakub Wiraszka (+48 22 829 01 73) jakub.wiraszka@brebank.pl
Tomasz Chmielarski (+48 22 829 01 78) tomasz.chmielarski@brebank.pl

Fixed Income (BREP) - FRA, IRS, T-Bonds, T-Bills
Łukasz Barwicki (+48 22 829 01 93) lukasz.barwicki@brebank.pl
Paweł Białczyński (+48 22 829 01 86) pawel.bialczynski@brebank.pl

MM (BREP) - MM
Bartłomiej Małocha, CFA (+48 22 829 01 77) bartłomiej.malocha@brebank.pl
Bogumił Modzelewski bogumil.modzelewski@brebank.pl

Structured Products (BREX)
Jaroslaw Stolarczyk (+48 22 829 01 67) jaroslaw.stolarczyk@brebank.pl
Jacek Derezinski (+48 22 829 01 69) jacek.derezinski@brebank.pl

Institutional Sales (BRES)
Inga Gaszkowska-Gębska (+48 22 829 12 05) inga.gaszkowska-gebska@brebank.pl

Research
Ernest Pytlarczyk, PhD, CFA (+48 22 829 01 66) ernest.pytlarczyk@brebank.pl
Marcin Mazurek, PhD (+48 22 829 0183) marcin.mazurek@brebank.pl
Paulina Ziembińska (+48 22 829 02 56) paulina.ziembinska@brebank.pl
Maciej Pielaszkiewicz (+ 48 22 829 90 34) maciej.pielaszkiewicz@brebank.pl

Financial Markets Department
Phone (+48 22 829 02 03)
Fax (+48 22 829 02 45)

Treasury Department
Phone (+48 22 829 02 02)
Fax (+48 22 829 02 01)

Financial Institutions Department
Phone (+48 22 829 01 20)
Fax (+48 22 829 01 21)

Back Office
Phone (+48 22 829 04 02)
Fax (+48 22 829 04 03)

Custody Services
Phone (+48 22 829 13 50)
Fax

Disclaimer

Distribution and use of this publication