



## POLAND WEEKLY REVIEW

### MACROECONOMICS AND FINANCIAL MARKETS

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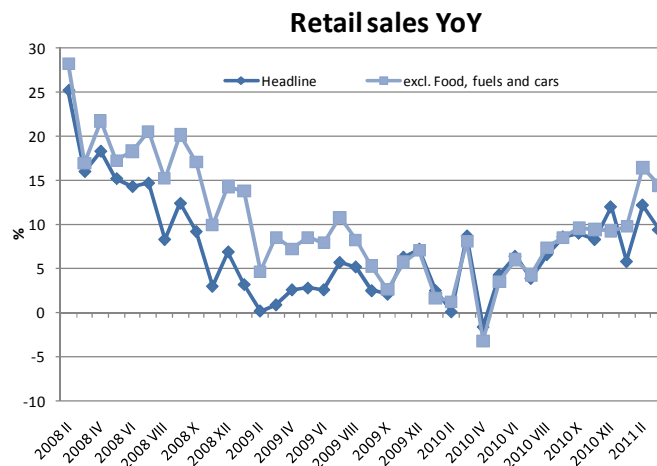
#### PREVIEW: The week of April 29<sup>nd</sup> 2011 to May 5<sup>th</sup> 2011

Indicator	Date of release	Pe- riod	BRE forecast	Consen- sus	Last	Comment
<b>PMI</b>	May 2	Apr	<b>55.5</b>	-	54.8	Better business tendency indicators, high PMI reading in Germany.

**In Focus / Macroeconomics**

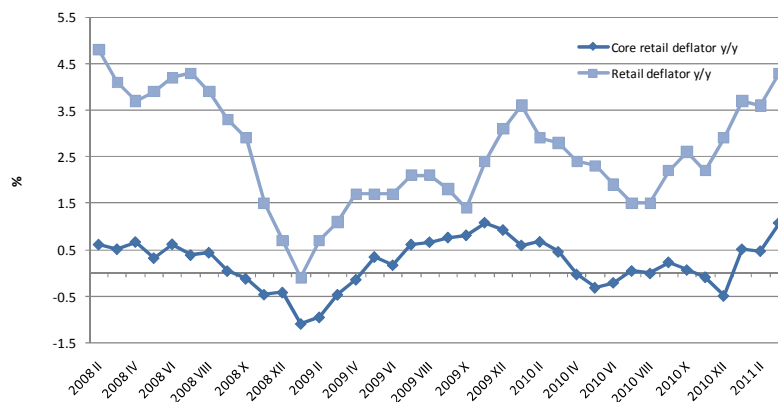
**Retail sales soaring, despite Easter-linked base effects**

Retail sales noted 9.4% y/y growth, despite huge base effects connected with unusually late Easter. Excluding volatile and price driven food, fuel and car sales, retail sales is still unscathed (despite a minor correction), following upward trend (see the graph below). Constant growth of employment and wages (accompanied by the overall brightening of labor market situation) is likely to support private consumption. We expect retail sales growth to follow 10% on average (with a possibility of a very, very positive surprise in April, owing to the base effect working in opposite direction than in March) in months to come.



Turning to details, especially encouraging was auto sales which rose 32.5% from February (and accelerates since the start of the year, when VAT-related trough was noted). Spectacular (especially taking account of late Easter) was growth in food sales (+14.3% m/m) and sales in non-specialized stores (+15.6% m/m), both usually spike during Christmas and Easter. Such a strong growth in the aforementioned categories occurring more than 3 weeks before Easter makes sense when we take into account the growth of food prices, which occurred in March. Much of the growth may be then stemming from precautionary shopping (necessities which are easy to store).

**Core retail sales deflator (excl food and fuels), and headline sales deflator**



As usual we also looked at retail sales deflators (headline, and core – stripping food and energy). Both are on the rise, the headline one actually on a level of 4.3%, core at 1.1%

(see the graph). The spillover effects of higher energy and food are visible then, however, at this stage it is hard to tell the temporary cost pressures from far fetching relative price adjustment.

The data do not dissolve the May/June decision problem of the MPC. We think that the recent collaboration with the Ministry of Finance (MF) has moved the conduct of monetary policy, at least as far as current supply-side induced price rises are concerned, away from interest rate management and towards exchange rate management (to delivered with additional EUR supply from MF). We think that such a strategy may be like a thumping on thin ice though, and the best MPC can do is to back the MF with fast rate hike (preferably in May and June) in order to gain credibility amidst high inflation expectations and – additionally – erase impression of basing solely on exchange rate management (and we all know such a strategy was not successful once, in late 2010). Nevertheless this time MPC may be willing to embark once again on experimental path as the zloty strength is expected to be drawing from MF EUR sale and not portfolio inflows. Moreover, the MPC seems overly complacent with the current state of inflationary pressures (they may think that in the short-term inflation rise will be capped by exchange rate developments) and may wait until new forecasts concerning the medium-term are published; until then the exchange rate experiment will be going on. This way it would make sense to consider July as a month of another hike. The more inflation expectations in May break above 5% (publication at the end of May), the more pressure there will be on the MPC to act earlier.

### 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	4.3
NBP repo rate (end-of-quarter)	3.50	3.5	3.5	3.50	4.00	4.25

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

## Fixed Income

### Holidays

Not much trading for the last couple of days due to Easter Holidays. The local pullback in yields has been stopped by the surprisingly higher than expected retail sales data released on Wednesday 27th, but even though the impact to the market was quite limited as most of the foreign players went for long holidays. Inflation expectations data however came at 4.0%, significantly lower than previous reading. It seems that positive sentiment we've observed for the past couple of weeks is likely to continue for a while as MPC is likely to leave rates unchanged in May. Bond auctions should also be absorbed since the market's appetite for duration is still in place. Nevertheless we think scope for the rally is limited and lower yield levels will likely create an interesting paying opportunity.

### AUCTIONS

	next auc.	offer	avg yield last	last auc-tion 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

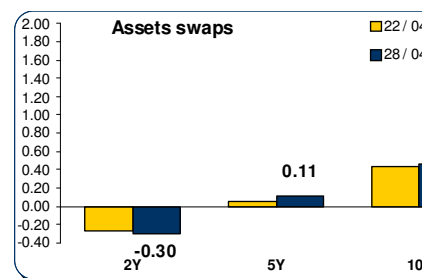
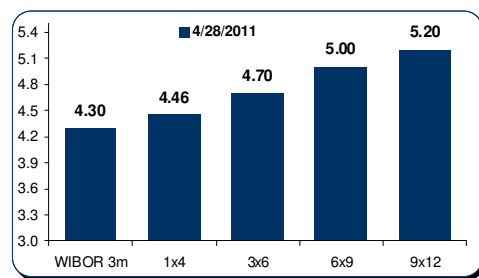
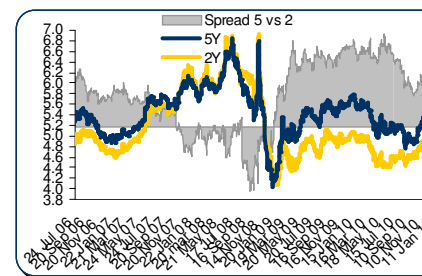
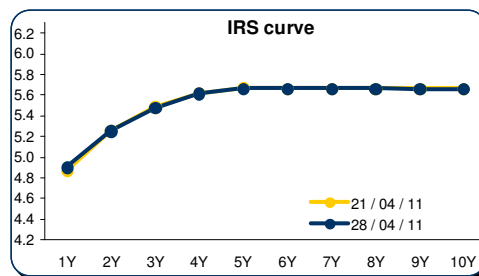
Cost of carry 40 bps below the main rate

Reduced liquidity of the markets due to holidays

Stable cost of carry at the level around 40 bps below the main market rate. Additional OMO reduced the cash surplus from pln 7 bln to 2 bln. The demand was below 50% of the supply, which was much too extensive at pln 10 bln and that might have frightened potential buyers. End of the reserve should be really cheap not only due to the surplus (which is very likely to be high after tomorrow's OMO) but also because of the longer weekend (increased risk aversion).

Higher than expected retail sales (9.4 against 7.2%) was completely ignored by the market mainly because of the reduced liquidity of the markets due to the holidays in Warsaw and in London.

### FIXED INCOME & MONEY MARKET CHARTS



## Foreign Exchange

Zloty bit stronger

Announced but has not realized yet. In those short words we may describe MoF plans. What has happened since conference then? EURPLN has broken strong 3.94 support and deepen it just to 3.92 area from where corporate flows took us back to 3.94. Market is long PLN, global sentiment steamed by weak USD is supporting those positions. So where is the MoF? It has not appeared yet but we should remember that MoF/NBP deal is: stronger PLN for lower rate hikes, in other words current level is not an issue.

Vols untouched

Another week with implied curve kept in refrigerator. Weekly realized is about 7.7%, so 1W and 1M vols are. Longer tenor have been traded at: 3M 8.7 (8.7 a week ago), 1Y 10.50 (10.55). Smile has been traded at similar levels as in previous week. Currency spread (USD/PLN vs EURPLN) driven by corporate flow has bounced about 0.5% (6.25% from 5.75% last week).

SPOT

Short-term forecasts:

Main supports / resistances:  
 EUR/PLN: 3.9000 / 3.9800  
 USD/PLN: 2.6200 / 2.7200

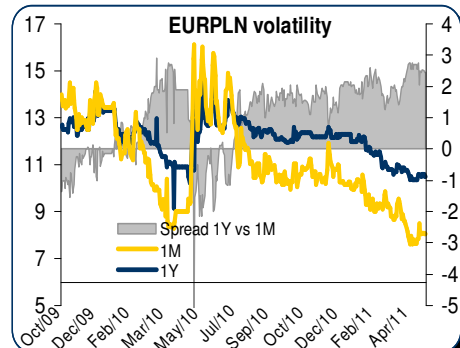
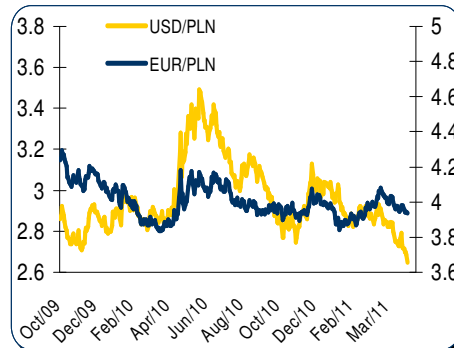
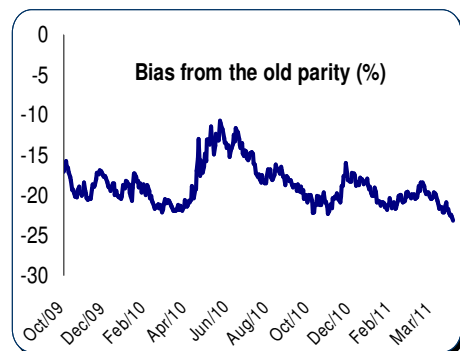
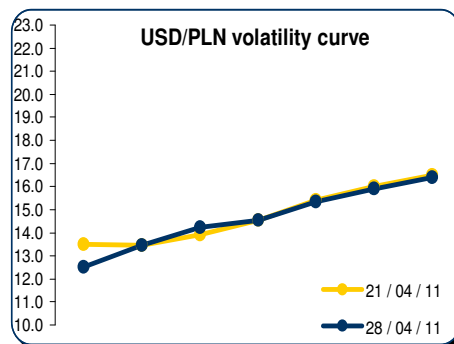
Unfortunately we have not revisited our desired level to entry PLN long. But without MoF

taking “real” action and market keeping long PLN position global sentiment will remain our regular driver so we may not exclude upticks. Sell at 3.96 and (if) 3.98 with S/L 4.01 and P/T at 3.90. “Real” action will deepen target to 3.80.

**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
22/04/11	4.17%	4.29%	4.42%	4.41%	4.54%	4.56%
25/04/11	4.25%	4.29%	4.42%	4.41%	4.56%	6.59%
26/04/11	4.18%	4.30%	4.50%	6.49%	4.73%	4.56%
27/04/11	4.25%	4.30%	4.39%	4.41%	4.58%	4.56%
28/04/11	4.19%	4.30%	4.43%	4.41%	4.57%	4.56%

**FRA MARKET RATES**

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
22/04/11	4.57%	4.83%	5.04%	5.28%	5.32%
25/04/11	4.57%	4.83%	5.03%	5.27%	5.32%
26/04/11	4.47%	4.83%	4.96%	5.20%	5.17%
27/04/11	4.47%	4.70%	4.99%	5.20%	5.17%
28/04/11	4.47%	4.70%	4.99%	5.20%	5.17%

**FIXED INCOME MARKET RATES**

Fixed Income Market Rates (Closing mid-market levels)						
date	1Y		2Y		5Y	
	WIBOR	TB	IRS	OK0112	IRS	PS0511
22/04/11	4.56%	4.65%	5.26%	4.99%	5.67%	5.72%
25/04/11	6.59%	4.65%	5.26%	4.99%	5.67%	5.72%
26/04/11	4.56%	4.65%	5.22%	4.94%	5.63%	5.73%
27/04/11	4.56%	4.64%	5.25%	4.95%	5.66%	5.75%
28/04/11	4.56%	4.64%	5.25%	4.95%	5.66%	5.77%

**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**

date	USD/PLN 0-delta stradle				25-delta RR	
	1M	3M	6M	1Y	1M	1Y
22/04/11	13.48	14.55	15.40	16.50	2.00	3.65
25/04/11	13.48	14.55	15.40	16.50	2.00	3.65
26/04/11	13.58	14.50	15.40	16.50	2.00	3.65
27/04/11	13.83	14.60	15.40	16.50	1.95	3.65
28/04/11	13.48	14.55	15.35	16.40	1.85	3.65

**PLN SPOT PERFORMANCE**

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
22/04/11	2.7135	3.9536	-22.2%
25/04/11	2.7135	3.9536	-22.2%
26/04/11	2.6975	3.9423	-22.5%
27/04/11	2.6838	3.9421	-22.7%
28/04/11	2.6504	3.9353	-23.1%

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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