



POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

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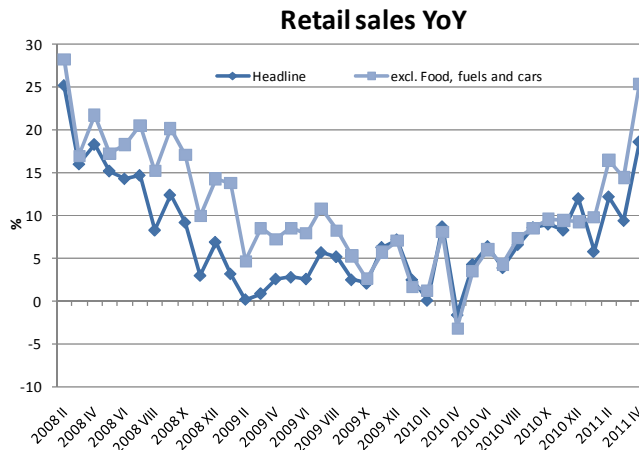
PREVIEW: The week of May 20th 2011 to May 26th 2011

Indicator	Date of release	Pe-riod	BRE forecast	Consensus	Last	Comment
PMI	Jun 1	May	53.6pts	-	54.4pts.	Large sentiment swings abroad, probably connected with supply chain problems. Unlikely that Poland will go through unscathed.

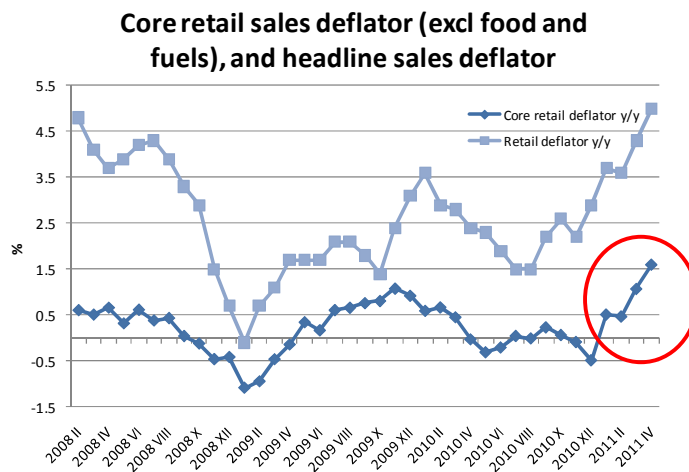
In Focus / Macroeconomics

Retail sales sky high in April on base effects. Granted mean reversion in May but upward trend intact. MPC to hike in June.

Retail sales grew by 18.6% y/y in April, beating the consensus by more than 3 percentage points. Such a high growth is not a surprise taking into consideration huge base effects (both the effects of mourning after the catastrophe in Smolensk and late Easter – in the latter case it mainly affected food sales). Spectacular growth was also reported excluding food, fuels and cars (see the graph) – this trend should be sustained and contribute to the growth of individual consumption expenditure. We keep our previous view that deceleration of retail sales (or later also private consumption) is for now only a myth. Perspectives for retail sales remain bright due to improving conditions in the labor market (growing wages, employment and falling unemployment – which remains a proxy for permanent income of households). In the coming months we expect the sales growth to amount to about 10% y/y (mainly on reversing base effects – the underlying trend remains intact).



On the price side we see another acceleration of retail sales deflator from 4.3% to 5% y/y (such levels were previously reported in 2007-2008, when the tightening cycle was in full throttle). The core deflator, on the other hand, tripled over the past 2 months, which suggests that the inflationary pressure spreads to other categories (see the graph).



Even though such a spectacular growth of retail sales will not be repeated in coming

**MID-TERM
FORECATS**

months (reversal of base effects!), such a development will not influence the structural strength of private consumption and mounting price structures. Therefore we expect the MPC to hike interest rates already in June, acting according to the recently shaped view (mind the remarks by Glapinski where he states that there is some kind of consensus among MPC) that fast rate hikes limit the total scale of tightening. What is more, we feel that many MPC members are willing to fetch for another hike before GDP growth fades a bit (strange reasoning, but true...by the way – it is not our base scenario, we look for flat growth path but without weakening). Moreover, the majority of MPC members speaks about the stability of rates in H2 (it is another argument for frontloading hikes in H1). Inflationary expectations should support MPC (data release on 31 May). Even though higher inflation in May and June is a widely expected phenomena it will be given wide media coverage. Not once such events proved to be destabilizing for inflation expectations (and from here also for nominal wages). That is why it may be an important for MPC to deliver a hike, especially when governor Belka believes that the MPC is so effective in tempering wage increases during the bargaining process.

Indicator	2007	2008	2009	2010	2011
GDP y/y (%)	6.5	4.8	1.7	3.8	4.4
Inflation rate (% , average)	2.4	4.3	3.5	2.8	4.1
Current account (% of GDP, average)	-4.5	-5.3	-1.6	-3.1	-4.8
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	4.75

Indicator	2010			2011		
	Q2	Q3	Q4	Q1	Q2	Q3
GDP y/y (%)	3.5	4.2	4.5	4.5	4.4	4.4
Inflation rate (% , average)	2.1	2.6	2.9	3.7	4.3	4.3
NBP repo rate (end-of-quarter)	3.5	3.5	3.50	4.00	4.50	4.50

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

Fixed Income

It is still cheap

Activity on the FI market was quite limited this week. Rates however kept pushing higher amid low turnover and the curve moved up by some 5bp in a parallel manner. Retail sales data surprised on the upside, which could somehow justify pressure on front rates. However it seems that in terms of tightening cycle it has been priced in already. Further comments from MPC members clearly suggest that rate setters are ready to undertake further actions rather sooner than later, which could also let them finish the cycle at lower level. And actually such scenario is the most likely outcome at the moment. Inflation will probably top within a month or two at level not much higher from recent reading. We may see hike already next month, possibly another one or two in 3Q and that would be it. Continuing the cycle into next year, what market starts to price in again doesn't really seem justified. We stick to our previous view that curve should flatten from here with 5y outperforming 10y sector and corrections like the one we observed this week create nice buying opportunity. Decent demand on this week road bonds auction also supports this view, as there is clearly some appetite for risk and duration.

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	6/9/2011	-	5.112%	5/12/2011
5Y T-bond PS0416	6/9/2011	-	5.614%	18/5/2011
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

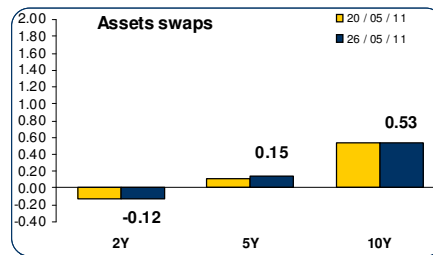
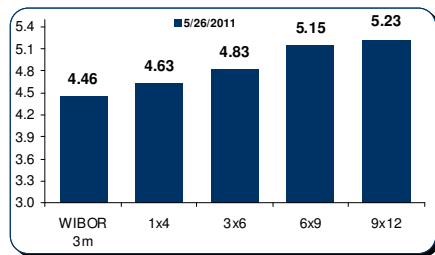
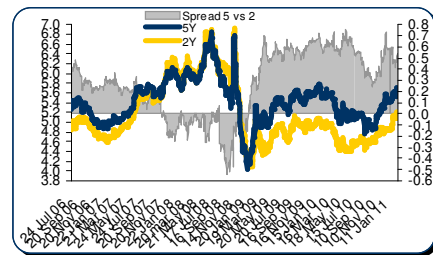
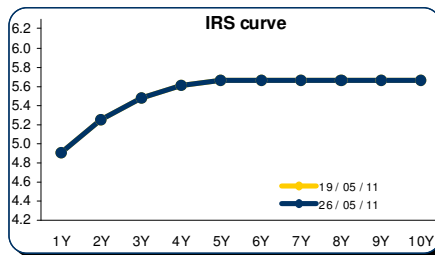
Swing in cost of carry?

New T-bills on monday

Extremely cheap month heads to an end, and the question is whether something is going to change in terms of carry in June. We see a high chance for that to happen, especially when liquidity desks will start to believe in a rate hike.

After good results on Monday's 44 weeks t-bill auction, prices fell a bit during the week. Next week we have new issue of 52 weeks. We would try to buy with yield not less than 4.65. If market expectations rate hike in June realizes, we will have reference rate at 4.50, and possible more rate hikes to come. On the other hand we see a huge cash stock in ministry of finance so they won't be forced to sell t-bills at low price.

FIXED INCOME & MONEY MARKET CHARTS



Foreign Exchange

Zloty weaker

PIGS have come back to play... Worse global sentiment, driven once again by Greece fears, combined with MoF absence has driven PLN to 3.99 high. Since MinFin's hard currency selloff took place Zloty is 2% weaker – decent PLN supply we would say.

Short end higher

A bit monotonous move has not affected realized volatility significantly – it has jumped from 6% week ago to 7.3%. So despite higher spot implied volatility curve has reacted slightly – some short end buying. Tenors were traded as specified below: 1M 8.1 (7.6 week ago), 3M 8.5 (8.4), 1Y 10.3 (unchanged). Smile and EURPLN vs USDPLN spread were traded at very same levels.

Short-term forecasts:

SPOT

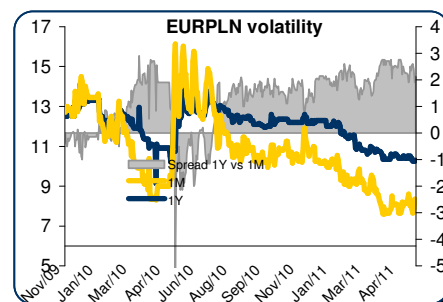
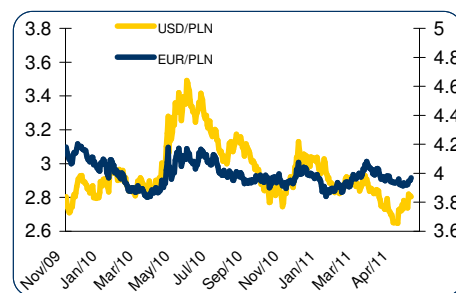
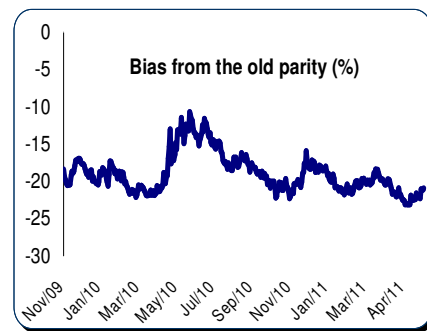
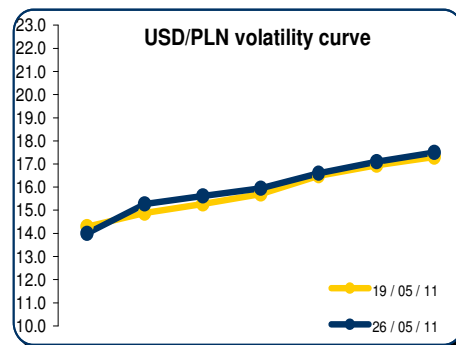
Main supports / resistances:
 EUR/PLN: 3.9450 / 4.0050
 USD/PLN: 2.7000 / 2.9000

S/L at 3.98 was cleared. We haven't seen MoF on the market. Without this inflow 3.9450-4.0050 range is most likely with even more pressure on upside.

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. Although cheap in numbers, hard to see it profitable - we have squared long gamma.

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
20/05/11	4.35%	4.45%	4.50%	4.51%	4.63%	4.66%
23/05/11	4.37%	4.45%	4.53%	4.51%	4.67%	6.59%
24/05/11	4.37%	4.45%	4.52%	6.49%	4.65%	4.66%
25/05/11	4.36%	4.46%	4.52%	4.52%	4.65%	4.66%
26/05/11	4.33%	4.46%	4.49%	4.52%	4.65%	4.66%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
20/05/11	4.57%	4.68%	4.96%	5.14%	5.08%
23/05/11	4.58%	4.69%	4.98%	5.15%	5.12%
24/05/11	4.57%	4.83%	4.98%	5.15%	5.12%
25/05/11	4.58%	4.72%	4.99%	5.15%	5.12%
26/05/11	4.57%	4.83%	5.00%	5.15%	5.11%

FIXED INCOME MARKET RATES

Fixed Income Market Rates (Closing mid-market levels)

date	1Y		2Y		5Y		10Y	
	WIBOR	TB	IRS	OK0112	IRS	PS0511	IRS	DS1017
20/05/11	4.66%	4.64%	5.20%	5.07%	5.49%	5.60%	5.51%	6.04%
23/05/11	6.59%	4.60%	5.20%	5.05%	5.48%	5.62%	5.50%	6.05%
24/05/11	4.66%	4.60%	5.19%	5.02%	5.48%	5.62%	5.51%	6.09%
25/05/11	4.66%	4.58%	5.20%	5.06%	5.50%	5.62%	5.52%	6.09%
26/05/11	4.66%	4.58%	5.20%	5.07%	5.50%	5.64%	5.56%	6.09%

PRIMARY MARKET RATES

Last Primary Market Rates

	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	11/01/31	12/01/31	95.841	4.35%	2000	2968	1961
OK0113	11/04/13	13/01/26	89.159	5.16%	5500	7385	4758
PS0416	11/01/05	16/04/25	97.078	5.64%	6500	2795	1140
DS1020	11/01/12	19/04/25	93.022	6.21%	2250	4252	2250

FX VOLATILITY

date	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
	1M	3M	6M	1Y	1M	1Y	1M	1Y
20/05/11	14.68	15.55	16.30	17.25	2.05	3.80	0.40	0.88
23/05/11	14.88	15.50	16.30	17.25	2.35	4.00	0.40	0.88
24/05/11	15.28	15.80	16.55	17.50	2.35	4.00	0.40	0.88
25/05/11	15.28	15.95	16.60	17.50	2.30	4.00	0.40	0.88
26/05/11	15.28	15.95	16.60	17.50	2.30	4.00	0.40	0.88

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
20/05/11	2.7377	3.9207	-22.3%
23/05/11	2.8193	3.9437	-21.1%
24/05/11	2.8024	3.9481	-21.2%
25/05/11	2.8100	3.9511	-21.1%
26/05/11	2.8033	3.9685	-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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