



POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

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PREVIEW: The week of June 10th 2011 to June 16th 2011

Indicator	Date of release	Pe- riod	BRE forecast	Consen- sus	Last	Comment
C/A balance EUR bn	Jun 14	Apr	-1066	-950	-1376	Lower deficit on exogenous factors linked to higher transfer from EU. Trade balance broadly unchanged.
M3 Supply y/y	Jun 14	May	8.0%	8.1%	9.1%	In trend, after one-off effects have been wiped out.
CPI Inflation y/y	Jun 15	May	4.6%	4.5%	4.5%	Food prices close to seasonal pattern. Minor correction/stabilization in fuels. Core inflation at 2.2% y/y.
Wages y/y	Jun 16	May	5.3%	5.5%	5.9%	In trend. One working day more.
Employment y/y	Jun 16	May	3.8%	3.8%	3.9%	In limbo. Some temporary flattening of job creation due to higher uncertainty. Positive perspectives still in place.

In Focus / Macroeconomics

Another hike and a pause

The MPC decided for another regular hike, meeting our expectations. The repo rate stands now at 4.50%. At the same time MPC communicated that delivered monetary tightening should facilitate a return of inflation back to target in the mid-term. Such a sentence is a new item in the statement and suggests a pause in monetary tightening for some months (such a reasoning was supported by the governor Belka who stated at the conference that the series of fast rate hikes was concluded in June).

Turning to the other parts of the statement, the diagnosis of the real sphere remained optimistic: it points to investment demand pick-up and ongoing improvement in the labor market. The growth-flattening issue which bothered some MPC members recently did not find much space in the statement. The same applies to the supply-side factors (mainly food prices) which may influence the behavior of inflation in a downward manner.

The change of MPC rhetoric (accompanied by the revision of expectations on further monetary tightening – the whole curve dipped 10bps) is likely to be further supported by inflation projection which will include a recent series of hikes (and the baseline scenario will be calculated at 4.50% repo rate) and the turnaround of inflation in the summer months (influenced additionally, most likely downwards, by prices of fruits and vegetables). Those local factors, accompanied by global growth flattening, and longer period of structurally low rates abroad, should end with a continuous support for Polish bonds.

We expect the next hike may come in Autumn but such a scenario is conditional to further rise of core inflation and continuation of solid GDP growth. We would like to stress that (locally) cyclical factors seems deeply entrenched and should carry economy over the soft patch generated by global factors, and continuing periphery woes (risk aversion and rises in CHF/PLN rate which – even at current levels – strikes credit holders again making the scars from 2008/2009 ready to open up again and inflict some pain). Although it is not our baseline scenario, the aforementioned issues pose certain risks.

MID-TERM FORECATS

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	-4.9
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	4.4	4.3	4.4
Inflation rate (% , average)	2.1	2.6	2.9	3.7	4.5	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

End of the cycle.

The MPC hiked rates again the third consecutive time, bringing main rate to 4.50%. Such outcome was broadly expected by the market and therefore didn't cause any significant reaction itself. What was more important was the comments that followed the decision. Rate setters clearly stated that after they managed to concentrate the tightening in the past few months, now they can and will afford a longer pause. That shouldn't have really been a great surprise. The MPC has always been relatively dovish and tended not to overreact with rate increases. Concentrating the moves earlier definitely gives the rate setters some comfort and time to analyze the impact of their decisions. However market apparently did not believe that the cycle had been near the end already and therefore bonds rallied across the curve. Yields moved down by some 10bp in the first reaction and another 5-10bp dur-

AUCTIONS

ing next two days with 2y-5y sector flattening by most. What has happened looks a little extreme, and some correction is possible from current levels. However mid-term perspectives are still supportive for fixed income. The pause in tightening cycle will likely last at least till October. In the meantime we'll probably see inflation has topped and starts to fall. Other economic data are likely to be little softer also. Ministry of Finance will limit bonds issuance as they have already managed to finance 60% of their yearly needs to reduce further supply. It is imaginable that this hike was the last one this year and there's still one more priced in the curve. Also contracts like 1y2y and 1y3y forward should trade negatively to 1y1y. Therefore further flattening of 2y5y is most likely scenario.

	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	6/27/2011	-	4.577%	5/30/2011
2Y T-bond OK1013	7/13/2011	-	4.840%	6/9/2011
5Y T-bond PS0416	7/13/2011	-	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

Next hike expected in the Autumn

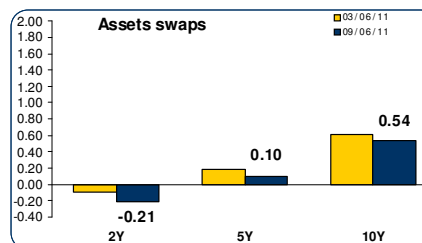
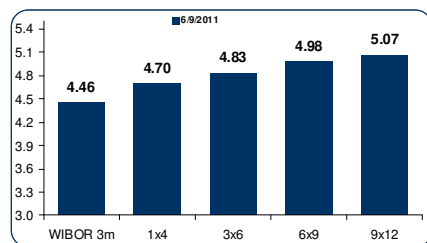
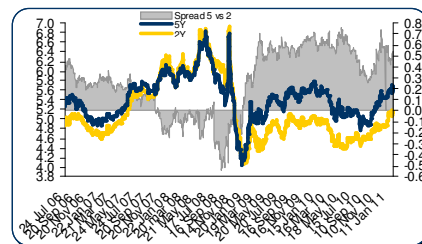
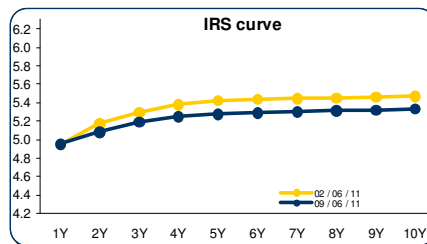
Last week MPC hiked rates for the fourth time this year to 4.50%. Decision was rather expected, what could be a bit surprise was the post meeting comments from NBP governor Belka said they want to wait now for some time with next steps. That caused the OIS curve to flatter. 1Y came 5 bp down. Now the market expects next rate hike in the Autumn.

Cost of carry returned to normal

Ministry of Finance has to be in good condition, after the buy-back auction of June t-bills they called off 3 out of 4 auctions planned for July. We will also have buy-back of July bills in the 20th of June. Thanks to that, 2012 t-bills stay calm at 4.55 lvls after the hike.

Cost of carry returned to normal, now its 20-25bp below reference rate. We will have an interesting end of the reserve period, NBP announced they will do an additional OMO during 29th of June in the second part of the day. They want to drain excess liquidity from the banks to reduce the difference between the reference rate and polonia rate. We think it will have not big use to the banks unless it will be done after the third elixir session.

FIXED INCOME & MONEY MARKET CHARTS



Foreign Exchange

Zloty has stuck

Still quiet on the Zloty front... Narrow, lower than 1% range, has been sustained and this week numbers are 3.9380/3.9750. Neither PLN nor EUR rate hike was able to rock EURPLN's rate to any direction. We see as threat possible further drop in world equities but on the other hand MoF was again seen on market. Still stuck then?

Implied curve lower

Driven by low realized volatility readings (another week about 6%) implied curve has slipped a bit. Tenors were traded as specified below: 1M 7.2% (7.5% week ago), 3M 8.0 (8.3), 1Y 9.95 (10.15). Smile and EURPLN vs USDPLN currency spread were traded at very same levels.

Short-term forecasts:

SPOT

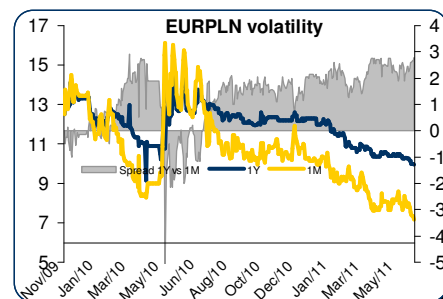
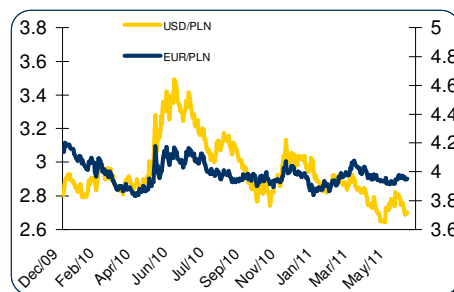
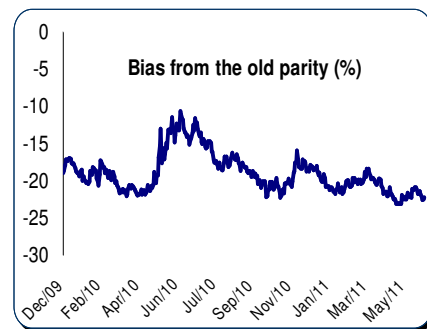
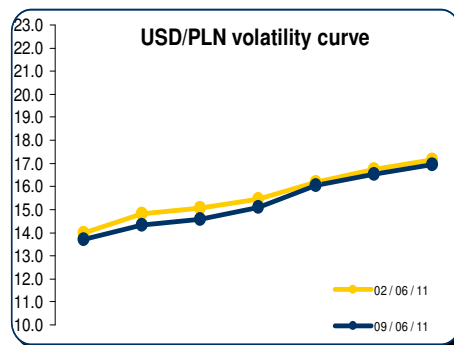
Main supports / resistances:
 EUR/PLN: 3.9400 / 4.0050
 USD/PLN: 2.7000 / 2.9000

Once again 3.94 (bottom boundary of our range) was defended. But its hard to book profit on fixed asset, isn't it? Stay away.

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
03/06/11	4.35%	4.45%	4.52%	4.51%	4.67%	4.66%
06/06/11	4.32%	4.45%	4.50%	4.51%	4.64%	6.59%
07/06/11	4.36%	4.45%	4.50%	6.49%	4.62%	4.66%
08/06/11	4.49%	4.46%	4.52%	4.51%	4.60%	4.66%
09/06/11	4.52%	4.46%	4.57%	4.52%	4.62%	4.66%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
03/06/11	4.60%	4.83%	5.15%	5.21%	5.18%
06/06/11	4.62%	4.75%	5.05%	5.16%	5.14%
07/06/11	4.62%	4.83%	5.04%	5.15%	5.14%
08/06/11	4.62%	4.83%	5.05%	5.16%	5.14%
09/06/11	4.62%	4.83%	5.04%	5.16%	5.13%

FIXED INCOME MARKET RATES

Fixed Income Market Rates (Closing mid-market levels)						
date	1Y		2Y		5Y	
	WIBOR	TB	IRS	OK0112	IRS	PS0511
03/06/11	4.66%	4.64%	5.16%	5.07%	5.42%	5.60%
06/06/11	6.59%	4.65%	5.15%	4.95%	5.39%	5.51%
07/06/11	4.66%	4.64%	5.16%	4.92%	5.38%	5.49%
08/06/11	4.66%	4.63%	5.08%	4.90%	5.28%	5.41%
09/06/11	4.66%	4.59%	5.08%	4.87%	5.28%	5.38%

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	11/01/05	16/04/25	97.078	5.64%	6500	2795
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
03/06/11	14.53	15.30	16.10	17.00	2.50	4.00
06/06/11	14.73	15.15	16.05	16.95	2.50	4.00
07/06/11	14.68	15.15	16.05	16.95	2.50	4.00
08/06/11	14.58	15.10	16.05	16.95	2.50	4.00
09/06/11	14.33	15.10	16.05	16.95	2.50	4.00

PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
03/06/11	2.7315	3.9598	-21.9%
06/06/11	2.7071	3.9621	-22.2%
07/06/11	2.6891	3.9476	-22.5%
08/06/11	2.6943	3.9490	-22.5%
09/06/11	2.7040	3.9550	-22.3%

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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