



POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

IN FOCUS / MACROECONOMICS	<ul style="list-style-type: none"> • <i>Huge surprise. Inflation reached 5% y/y – highest since 2011</i> 	<ul style="list-style-type: none"> • <i>pages 2-3</i>
FIXED INCOME	<ul style="list-style-type: none"> • <i>CPI</i> 	<ul style="list-style-type: none"> • <i>page 3</i>
MONEY MARKET	<ul style="list-style-type: none"> • <i>High CPI</i> • <i>Cost of carry and NBP</i> 	<ul style="list-style-type: none"> • <i>page 4</i>
FOREIGN EXCHANGE	<ul style="list-style-type: none"> • <i>Zloty weaker</i> • <i>Implied curve higher</i> 	<ul style="list-style-type: none"> • <i>page 5</i>
MARKET PRICES CONTACT LIST DISCLAIMER		<ul style="list-style-type: none"> • <i>page 6</i> • <i>page 7</i> • <i>page 8</i>

PREVIEW: The week of June 17th 2011 to June 23rd 2011

Indicator	Date of release	Pe-riod	BRE forecast	Consensus	Last	Comment
Retail sales	Jun 22	May	14.2%	13.1%	18.6%	Last acceleration was supported by base effects from last year. Therefore recent levels are unsustainable. However, the trend in most categories seem deeply entrenched – hence our forecast.

In Focus / Macroeconomics

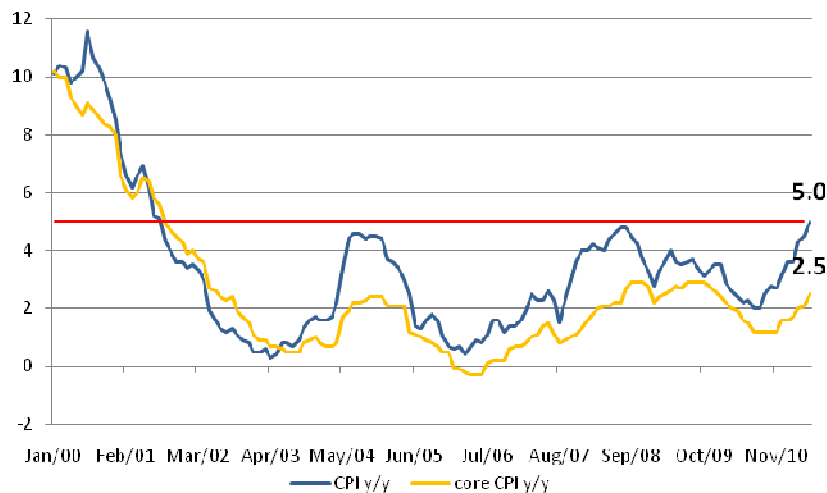
Huge surprise. Inflation reached 5% y/y – highest since 2011

In May inflation reached 5% y/y after 4.5% in April. Analysts' expectations were around 4.5%. Inflationary surprise is mainly due to lasting increases in food prices (1.3% m/m), strong health (0.8% m/m) and clothing and footwear (1.9% m/m) price growth. Clothing and footwear prices rose third month in a row as an effect of methodological changes (which aims to standardize Polish and European methodologies). Methodological changes could have also affected the seasonal pattern of food prices.

In other categories prices grew more moderately, but still faster than just few months ago. According to our calculations core inflation increased in May by 0.4pp. to 2.5%. We have an impression that inflation growth is increasingly reflecting rises in prices of services which would mean that higher inflation level may be more persistent in the mid-term.

Turning to short-term perspectives, we assume that next month inflation will decrease/stabilize, mainly due to seasonal vegetables and fruits prices decrease and fuel prices stabilization. However, core inflation will grow steadily.

After the publication market reacted only with limited yields increase (2-year rate grew by 4bp.). However, yields went down just after the publication of employment and wages (both weaker), which confirmed that wait-and-see approach the MPC has already embarked on can have its own merits. Such a statement is confirmed by the recent rate-setters' comments (Chojna-Duch, Bratkowski, Belka): all speak the same way – there is no necessity for further rate hikes (as Belka put it bluntly: the fact that inflation shot up implies that inflation will also fall quickly...). Such a strategy will find support in the coming inflation projection which is likely to show slower growth and lower inflation (both aggregates will be calculated with the assumption of sharply higher repo rate – 4.5% – than in March – 3.75%). Summing up, we do not expect the MPC to hike in July. However, current inflation levels will not allow for correction in monetary tightening. Moreover, persistent core inflation (with CPI falling possibly less than expected) may force MPC to resume tightening in the Autumn.



MID-TERM FORECASTS

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	4.5
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	4.9↑	4.6↑
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**CPI**

The market belief the tightening cycle could be near its end was slightly premature. The last CPI figure published on Wednesday, 15th showed that nobody would be real safe with the anticipated overall scope of the further MPC actions. The inflation soared to the highest level for the last 10 years topping unexpectedly 5.0% in May, making it possible to see another interest rate hikes this year. Though the MPC members comments remained quite moderate and the market perception excluded the 4th consecutive hike in July, the previous history had proved there was no real pattern in MPC decisions and the market should stay ready for unexpected. On the other hand, the last massive drop in yields made it possible to take profits on a previous "end-of-a cycle" strategy and even take some paying positions on a chance for the curve had moved up by 10-12bp from its bottom.

Anyway, the market looks like a little bit confused at the moment. We don't see any spectacular moves on a curve for the next couple of weeks but the slight upward trend in yields seems to be very likely before the MPC meeting in July. The main question is if the MPC is still eager to assure the markets they are ready to act quickly to curb inflation or they tend to come back to its "wait-and-see" strategy and will face the risk to stay behind the curve again this year.

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	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**Higher CPI**

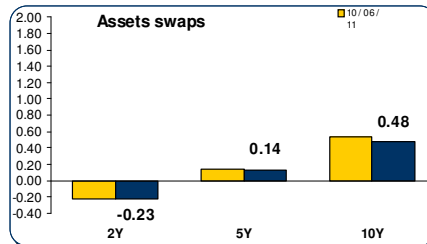
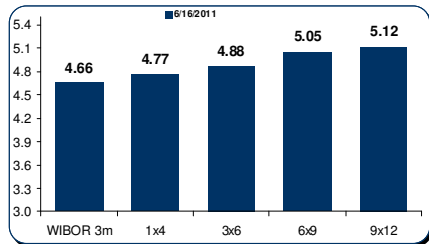
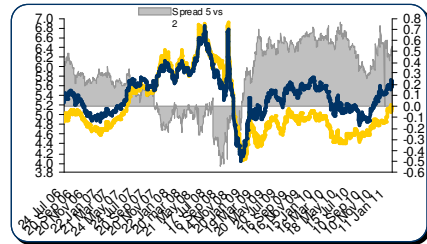
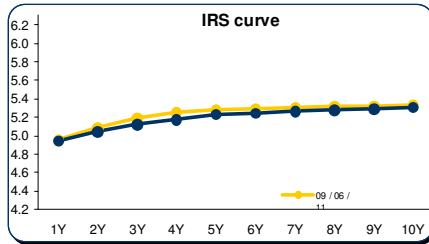
Dovish post meeting statement from NBP governor caused the front end curve to flatten. The market started to believe that the cycle may have already ended. Unfortunately for these we had a CPI reading for May coming, which went extreme 5% ag. 4.5% estimated. One year OIS went 5 bp higher, same with t-bills. Quickly after the figure, number of MPC members started cooling down the market, that there is no way they going to hike in July and the rise in yields stopped.

Cost of carry and NBP

Since the beginning of June cash stays very expensive (4.20%-4.35%), and the NBP makes everything to make it that way. We had another additional OMO on Tuesday when cash was only 35 pips below reference rate. It doesn't look to get any better, minutes showed the MPC members voted for decreasing spread between deposit and Lombard

FIXED INCOME & MONEY MARKET CHARTS

rates, motion failed. Hard times for carry trades especially when there's no new auctions. MinFin announced there is high probability they won't issue any t-bill in third quarter.



Foreign Exchange

Zloty weaker

Storm has come. As soon as Trichet has confirmed ECB's "strong vigilance" the market has changed its tone to bearish. Risk was aggressively sold with both: Greece crisis and US equity being in scope as indicators. Zloty reaction was violent – 2% wakening in 1 day. In EURPLN's rates term range was 3.9245-3.9905.

Implied curve higher

Sharp upmove, weekly realized about 7.9%. So response was easy to foresee. Smile and implied were heavily paid with benchmarks being traded at: 1M 7.8% (7.2% week ago), 3M 8.4 (8.0), 1Y 10 (9.9), 3M 25D RR 1.9 (1.4). EURPLN vs USDPLN currency spread has followed EURPLN and EURUSD runs noticing 0.75 vol uptick.

Short-term forecasts:

SPOT

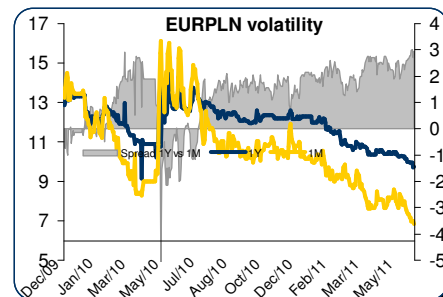
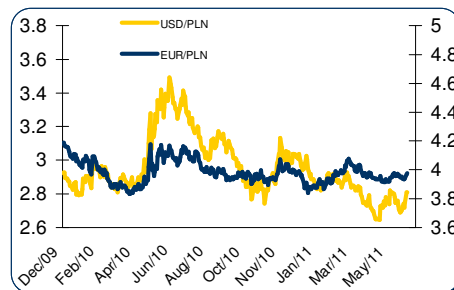
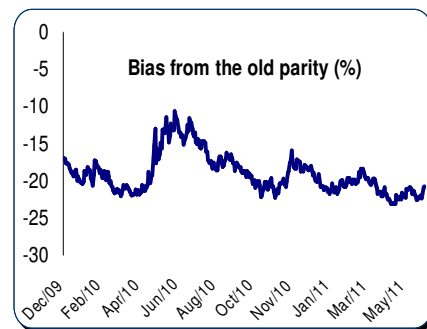
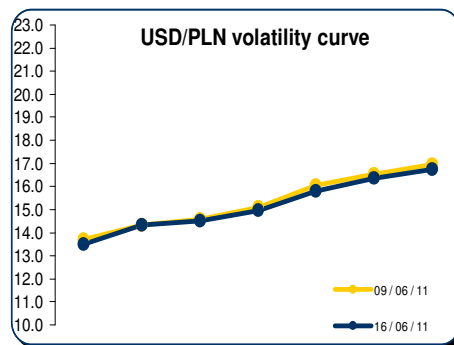
Main supports / resistances:
 EUR/PLN: 3.9400 / 4.0050
 USD/PLN: 2.7000 / 2.9000

Well, although range was not eroded yet it is hard to foresee when Greece crisis will be solved. Market will trade bearish mode till then but so far we do not see much room for upside. Buy dips?

FX CHARTS

OPTIONS

The volatility curve is better bid across, especially in the front end. But it is only a small correction in this year's strong downtrend. We keep our core long, in mid and backend of the curve and wait for further developments. We don't like to go long gamma just after the spike, we believe there would be better levels for that....



MARKET PRICES UPDATE**MONEY MARKET RATES**

Money market rates (Closing mid-market levels)						
date	3M		6M		1Y	
	FXSW	WIBOR	FXSW	WIBOR	FXSW	WIBOR
10/06/11	4.55%	4.47%	4.57%	4.53%	4.62%	4.67%
13/06/11	4.56%	4.47%	4.60%	4.60%	4.65%	6.59%
14/06/11	4.57%	4.66%	4.60%	6.49%	4.72%	4.73%
15/06/11	4.70%	4.66%	4.62%	4.62%	4.65%	4.74%
16/06/11	4.34%	4.66%	4.75%	4.63%	4.72%	4.74%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
10/06/11	4.69%	4.83%	5.05%	5.14%	5.14%
13/06/11	4.67%	4.83%	4.97%	5.07%	5.13%
14/06/11	4.70%	4.83%	4.98%	5.07%	5.07%
15/06/11	4.72%	4.78%	4.95%	5.02%	5.03%
16/06/11	4.72%	4.81%	4.97%	5.04%	5.06%

FIXED INCOME MARKET RATES

Fixed Income Market Rates (Closing mid-market levels)						
date	1Y		2Y		5Y	
	WIBOR	TB	IRS	OK0112	IRS	PS0511
10/06/11	4.67%	4.59%	5.05%	4.82%	5.23%	5.37%
13/06/11	6.59%	4.61%	5.08%	4.82%	5.26%	5.36%
14/06/11	4.73%	4.62%	5.11%	4.87%	5.31%	5.42%
15/06/11	4.74%	4.62%	5.15%	4.91%	5.35%	5.46%
16/06/11	4.74%	4.62%	5.16%	4.93%	5.37%	5.50%

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
10/06/11	14.13	15.10	16.05	16.90	2.50	4.00
13/06/11	14.13	15.10	16.05	16.90	2.50	4.00
14/06/11	14.33	14.85	15.75	16.70	1.95	3.70
15/06/11	14.33	14.95	15.80	16.75	1.95	3.70
16/06/11	14.33	14.95	15.80	16.75	1.95	3.70

PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
10/06/11	2.7216	3.9413	-22.2%
13/06/11	2.7426	3.9324	-22.1%
14/06/11	2.7203	3.9335	-22.3%
15/06/11	2.7499	3.9433	-21.9%
16/06/11	2.8069	3.9678	-20.9%

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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