Eyeopener – daily update

Higher risk aversion

23 May 2006

Today core inflation for April and business climate indicators for May will be published but they should have limited influence on the market, given it is driven by global events (higher risk aversion). Anyway, while core inflation data will not be fundamentally bad as regards inflation prospects, the headline figures would not be supportive for the fixed income market. Yesterday Polish bonds weakened by a few basis points though during the day were slightly supported by falling yields of Treasuries and Bunds. Stock exchange index WIG20 collapsed by 5.57%. The zloty depreciated although to much smaller extent.

Yesterday, another two central bankers took the floor – Dariusz Filar and Andrzej Sławiński. They presented quite similar view on official interest rates suggesting they should stay on hold for some time. Therefore, it is not surprising that, after several such comments from central bankers, market expects stable interest rates in Poland at least until the end of 2006 (according to yesterday's Reuters poll).

What's hot today

Core inflation to increase moderately

Core inflation and business climate today

Today at 14:00 local time, the NBP will publish core inflation measures for April and the CSO will release business climate indicators for May. Business climate indicators should show continuation of optimistic trends seen earlier and this confirm that the economy keeps gaining strength. Meanwhile, according to our estimates, net inflation increased in April to 1%YoY from 0.7%YoY in March. However, this would not mean strengthening of underlying inflationary pressure, yet an effect of surge in energy costs that are not excluded from net inflation.

***Bottom line:* Although the data will not be fundamentally bad as regards inflation prospects, the headline figures will not be supportive for the fixed income market.**

Central bankers cement market expectations

According to MPC's Sławiński rates should stay on hold

Yesterday, another two central bankers took the floor. Andrzej Sławiński, who is seen as moderate rate-setter said that Poland's economy is evolving in line with the central bank's latest inflation projection, allowing it to leave interest rates on hold. In his opinion, only if the path of events were to start significantly varying from the projection, some reasons would appear to start considering possible fine-tuning of rates. Sławiński also said the zloty was guarded from the worst effects of recent emerging market weakness by Poland's strong balance of payments position. According to him, looking from the medium-term perspective, the zloty's recent reaction to events on global markets was relatively limited. Moreover, he is not concerned about recent increase in inflation rate. "The rise of CPI in April was chiefly the result of oil and gas prices. The rise in food prices was a seasonal effect," he said. "Currently, there is no reason to expect inflation will reach the bank's target

… and he sees zloty reaction to recent global events as moderate

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Quite surprisingly, Filar presented similar opinion on rates

… as long as inflation projection does not change, rates will be stable

Filar mentioned a couple of risk factors (e.g. zloty exchange rate)

faster than within the horizon in which monetary policy acts. From the bank's point of view, the situation is still very positive", concluded Sławiński. Such way of thinking on inflation developments and prospects for monetary policy is very similar to ours. What is interesting, similar opinions are also shared by Dariusz Filar, who is seen by the market as an advocate of tight monetary policy. He said yesterday that as long as inflation projections continued to show that the path of inflation had not significantly changed, the present parameters of monetary policy were correct for reaching the central bank's target and added that April's increase in producer and consumer prices did not signal a change of trend. In his opinion, Polish interest rates should remain on hold until the NBP's inflation projections showed a resurgence of price pressure. Among risk factors for future inflation, Filar mentioned the zloty exchange rate which may be more volatile than to date due to uncertainty over the future of interest rate decisions in the United States. He also said that the central bank would have to closely watch retail sales data, fuel prices and labour market statistics. Uncertainty linked to parliamentary work on the 2007 budget bill is also seen by Filar as a potential risk factor.

Market participants are unanimous expecting no change in official rates this year, while some of them see z possibility of hike next year

Filar's comments show that Halina Wasilewska-Trenkner is still the only one MPC member who explicitly mentioned a possibility of rate hike in a foreseeable future. Therefore, it is not surprising that vast majority of market participants expect the reference rate to remain on hold for considerable period. All 14 analysts surveyed by Reuters expected the bank to keep its main rate at 4% when it meets on May 30-31 and until December. The poll also showed 7 out of 12 analysts saw rates steady until May 2007, though 5 of them expected the bank could order a 25-50bps hike in that period.

Bottom line: ***Market expects interest rates in Poland to remain on hold at least until the end of 2006. Such expectations are cemented by more and more comments from central bankers.***

Market monitor

Amid increased inflation fears with possible U.S. economic slowdown and rising rates in United States as well as in the euro zone that could negatively affect the financial results of companies, investors massively sold stocks and commodities on many international markets, while purchasing "safe haven" U.S. Treasuries. In the result index WIG20 including stocks of the 20 biggest companies on the Warsaw stock exchange collapsed by 5.57%. Zloty weakened as well, however the scale of depreciation was much smaller as the EURPLN rate rose by 0.5% from 3.9513 to 3.9728. The USDPLN rate marginally fell from 3.102 to 3.1002. Zloty weakened following the losses incurred by other emerging market currencies, which were started by the South African rand and fuelled by depreciation of Turkish lira. The EURUSD rate increased from ca. 1.273 to 1.2814 as the single currency was supported by the Trichet's statement on inflation and comments of Greek and Dutch finance ministers who stated they were not worried by strong euro.

The emerging markets sell-off on the bond market continued on Monday starting in the morning. During the day Polish debt slightly recovered following the significant rise of bond prices on the core markets. In the result yields were a few basis points higher than at Friday's closing. Statements of

MPC members Andrzej Sławiński and Dariusz Filar on no need of changing rates until the economic scenario develops according the central bank's projection were rather neutral for the market. 10Y U.S. Treasuries strengthened and their yields fell from 5.07% at Friday's closing to 5.01% hitting 4.99% during the day (and to 5.03% overnight), while yields of German Bunds declined from 4.02% to 3.92%.

At yesterday's auction the Ministry of Finance sold PLN1.0bn of 52-week T-bills at average yield of 4.064%. The demand of investors amounted to PLN1.52bn. The ministry informed as well that it is going to offer at Wednesday's switch tender 7Y DS1013 bonds in exchange for bonds maturing this year: PLN7.91bn of OK0806, PLN12.96bn of PS1106, PLN936m of DZ0706.

***Bottom line*: There was a heavy sell-off on the emerging markets. Polish currency depreciated as well though to much smaller extent. WIG20 bourse index plummeted by 5.57% driven by commodities companies stocks. Bonds weakened as well though during the day were slightly supported by falling yields of Treasuries and Bunds.**

International update

No important data were scheduled for yesterday and no data is going to be released today.

ECB's president Jean Claude Trichet commented yesterday the EBC will be very vigilant on inflation and introducing reforms increasing productivity. Chief economist of the European Central Bank Otmar Issing added that the ECB will tighten the monetary policy if the economy develops as expected.

The zloty trading ranges (19.05.2006)

	Min	Max	Open*	Close**	Fixing
EUR	3.9475	3.9728	3.9513	3.9728	3.9590
USD	3.0950	3.1250	3.1020	3.1002	3.1023

*** 6:30 GMT, ** 15:00 GMT**

The EUR/USD trading range (19.05.2006)

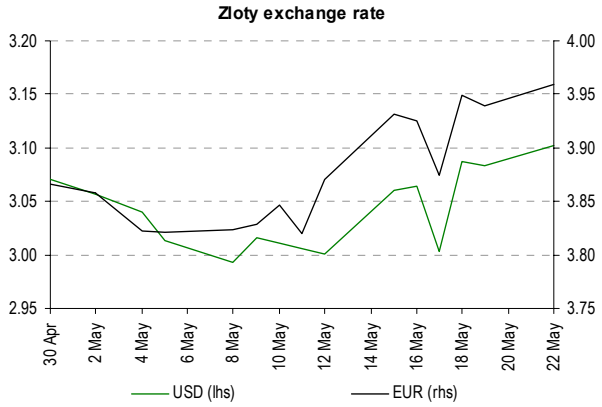
	Min	Max	Open*	Close**
EUR/USD	1.2695	1.2865	1.2727	1.2814

*** 6:30 GMT, ** 15:00 GMT**

F/X rates (today's opening)

EURUSD	1.2849	CADPLN	2.8017
USDPLN	3.0883	DKKPLN	0.5341
EURPLN	3.9686	NOKPLN	0.5129
CHFPLN	2.5650	SEKPLN	0.4252
JPYPLN*	2.8152	CZKPLN	0.1410
GBPPLN	5.8420	HUFPLN*	1.5066

*per 100 units



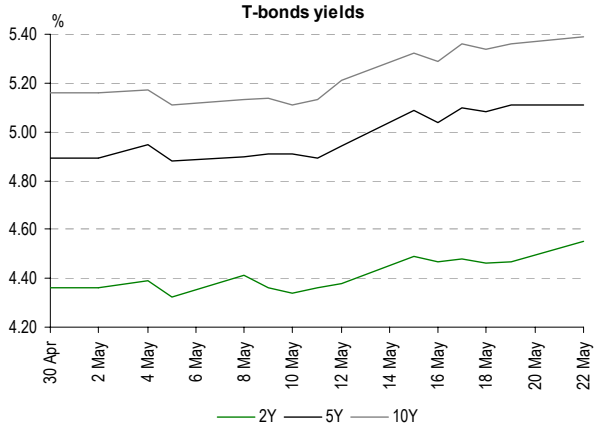
Fixed income markets (19.05.2006)

	PL		US		DE	
Term	Yield	Change (bp)	Yield	Change (bp)	Yield	Change (bp)
2Y	4.47	0	4.95	-1	3.26	-5
3Y	4.74	4	4.94	-2	3.41	-5
4Y	4.92	-1			3.53	-6
5Y	5.11	0	4.95	-2	3.61	-7
8Y	5.29	3			3.84	-7
10Y	5.39	3	5.04	-2	3.93	-7

T-bond auction

Date		Offer	Bid	Sale	Avg. Yield	Prev. Avg. Yield	Change
			PLN m		%		bp
04.05	2Y*	2 160	9 174	2 160	4.447	4.370	8
17.05	5Y*	2 000	5 150	2 000	5.031	4.708	32
12.04	10Y*	2 160	5 685	2 160	4.978	4.936	4

* with a supplementary auction

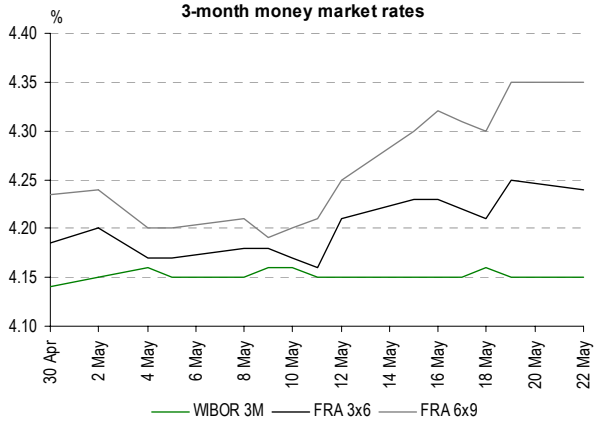


WIBOR rates (19.05.2006)

Term	Rates	Change (bp)
O/N	4.13	0
T/N	4.13	1
SW	4.13	1
2W	4.13	1
1M	4.13	1
3M	4.15	1
6M	4.21	1
9M	4.26	1
1Y	4.27	1

Forward Rate Agreements (19.05.2006)

Term	Mid	Change (bp)
1x2	4.14	0
3x6	4.21	-1
6x9	4.32	0
9x12	4.43	-2
3x9	4.29	2
6x12	4.41	2



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