

Eyeopener – Strong rise in risk appetite

2 June 2009

- Zloty and local bonds gained in reaction to considerable rise in risk appetite globally after strong PMI in China and new positive data from the US and the euro zone
- Domestic PMI rose in May, but weaker than expected, the FinMin's inflation estimate above the market consensus
- Today data from the US housing market

The start of the week was marked by strong rise in risk appetite after positive data from China (slight decline of the PMI index to 53.1 pts, though the third month in a row above 50 pts; with increase in export orders index to above 50pts for the first time in many months). Global sentiment was positively influenced by smaller than expected decline in US consumer spending and increase of their incomes instead of expected decline. The oil prices were rising and there was a significant strengthening of the euro against the dollar to ca. 1.42 from 1.413 at the opening and 1.415 in late trading on Friday. The dollar recovered part of its losses after higher than expected core PCE prices index for April. At the end of the session the EURUSD rate was at 1.416. The rise in demand for stocks resulted in substantial weakening of the core debt markets and another jump in yields (to 3.65% for 10Y Treasuries and to 3.67% for 10Y Bunds, similar levels were seen today in the morning, though yesterday in the evening yields of 10Y Treasuries peaked at 3.73%). The core bonds were negatively affected by the news on GM bankruptcy leading to take-over by the US government, which limited the uncertainty regarding the automotive industry and supported risk appetite, and at the same time increased concerns about the debt supply. The market moods were also supported by the euro zone manufacturing PMI index, which significantly increased to 40.7 from 36.8 against preliminary estimates and market expectations at 40.5. The US ISM index rose to 42.8 from 40.1 against expected 42.0.

Along with the improvement in global market moods and rising EURUSD, the zloty strengthened against major currencies. The EURPLN rate fell in the first part of the day from 4.51 at the opening to ca. 4.43, and afterwards it started rising to ca. 4.46 and at the end of the day reached 4.442. The USDPLN rate declined at the end of the day to 3.138 from 3.192 in the morning. As compared to Friday the zloty appreciated to the euro by ca. 1.4%, the forint gained 1.7%, and Czech crown strengthened by 0.7%. Today the zloty was traded at slightly weaker levels than at yesterday's close.

In the domestic interest rate market there was a strengthening together with appreciating zloty and higher risk appetite. Results of yesterday's T-bills auction were quite good. The FinMin sold PLN2.125m of 52-week T-Bills amid very large demand (PLN9.4bn) at average yield of 4.872%. The FinMin said that at Wednesday's auction it will offer 2Y bonds OK0112 and 5Y bonds PS0414 worth totally PLN3-5bn.

According to data released yesterday, the Polish manufacturing PMI index inched up to 42.5 from 42.1, while market was expecting a more rapid growth to 42.8. This implies slight decrease in fall of economic activity (13th straight month of the index below 50). The Ministry of Finance said in yesterday's statement that it predicts inflation to fall to 3.8%YoY in May from 4.0% in April, amid monthly price growth of 0.6%. Our forecast points to 3.6%YoY, and market consensus is at 3.7%YoY. In the afternoon the ministry said that according to its calculations, contribution of food prices to monthly CPI change reached ca. 0.33pp, and contribution of fuel prices is ca. 0.1pp. According to our estimates, this translates to price growth in food and non-alcoholic drinks by ca. 1.4-1.5%MoM, versus our assumption about slight increase by 0.6%MoM after 1.6%MoM in April. In transport we assumed price growth by ca. 1.5%MoM, while estimate resulting from FinMin's information suggested slightly lower increase. At the same time, according to FinMin's Sławomir Dudek, in August inflation will approach 2.5% (in our predicted inflation path we assumed inflation in August at 3%), and in subsequent months it will stabilise close to this level. Assuming that this scenario is fulfilled, CPI would have to drop substantially in monthly terms in three straight months, most likely due to reversal of upward trend in food prices.

The most dovish MPC member Mirosław Pietrewicz said yesterday that FinMin's inflation forecast is higher than he expected and it may affect inflation unfavourably in next months. Pietrewicz revised his opinion about a need of deep rate cuts. In his opinion a cut in June is not a deal done, and it will be dependent on June's inflation projection. If the projection shows that inflation is not falling as fast as earlier was expected, then it may affect a scale of further monetary easing, however not the direction of rate changes. According to Pietrewicz, if GDP projection shows a fall in annual rate growth to zero or below, then the Council should counter negative trends in the economy. In his opinion, there is still a room for rate cuts by 75 bp. In scenario that we assume, inflation will stay above the tolerance band around target only temporarily, which will allow for continuation of monetary easing. The most hawkish MPC member Dariusz Filar said yesterday that in his opinion there is no need to cut rates in June due to slight inflation decline and rebound of activity indices in Europe. Hawkish Marian Noga said today in interview with *Puls Biznesu* daily that currently he sees no possibility to cut rates, and to have such option, inflation would have to go down below 3.8%YoY predicted by the FinMin, and the new projection would have to show a fall in inflation in the medium run.

The FinMin said yesterday that an amendment of this year's central budget will be prepared and sent to the parliament until July 7.

Today no domestic events are scheduled. Abroad we will get the US pending home sales data for April with market consensus pointing to 0.5%MoM rise.

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F/X rates (today's opening)

EURUSD	1.4116	CADPLN	2.8830
USDPLN	3.1597	DKKPLN	0.5990
EURPLN	4.4580	NOKPLN	0.5073
CHFPLN	2.9425	SEKPLN	0.4232
JPYPLN*	3.2763	CZKPLN	0.1669
GBPPLN	5.1731	HUFPLN	1.5955

Financial market review - 1 Jun 09

The zloty trading ranges

	min	max	open	close	fixing
EURPLN	4.4288	4.5132	4.5120	4.4425	4.4447
USDPLN	3.1098	3.1978	3.1938	3.1381	3.1248
EURUSD	1.4121	1.4242	1.4131	1.4158	-

T-bonds

TERM	Yield (%)	Change (bp)	Last auction	Average yield
2Y	5.40	-6	13.05	5.669
5Y	5.75	-3	1.04	6.039
10Y	6.25	-4	141.05	6.335

IRS rates (Mid)

TERM	PL		US		EA	
	%	Change (bp)	%	Change (bp)	%	Change (bp)
1Y	4.38	0	0.90	4	1.50	4
2Y	4.72	-2	1.42	11	1.78	7
3Y	4.99	-6	2.06	17	2.31	11
4Y	5.20	-5	2.60	21	2.59	6
5Y	5.33	-4	3.02	21	2.90	6
8Y	5.51	-3	3.73	33	3.54	8
10Y	5.58	-4	3.98	26	3.78	8

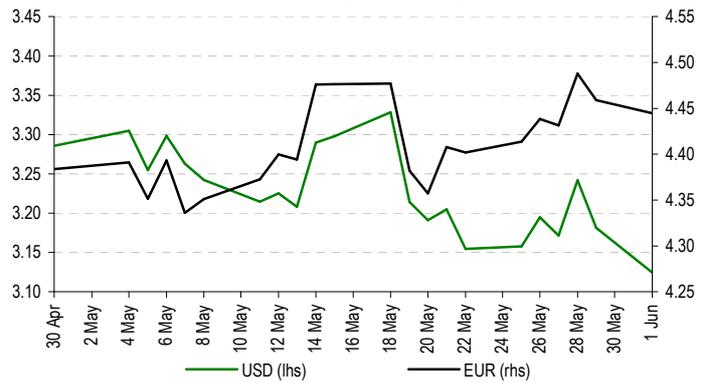
WIBOR rates

TERM	%	Daily change (bp)
O/N	3.84	131
T/N	3.85	15
SW	3.80	5
2W	3.84	1
1M	4.01	0
3M	4.62	0
6M	4.73	2
9M	4.89	2
1Y	5.04	1

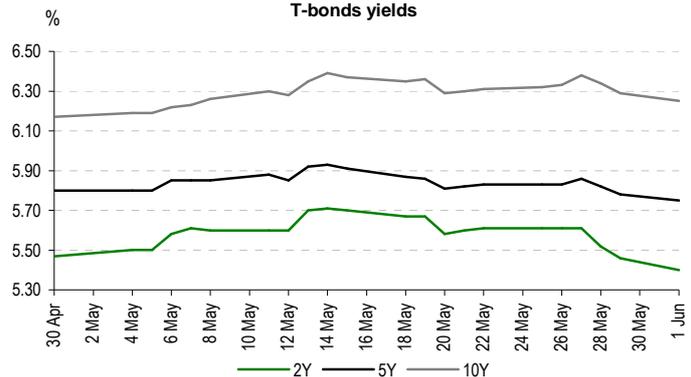
FRA rates (Mid)

TERM	%	Daily change (bp)
1X2	3.91	3
3X6	4.18	-1
6X9	4.16	-2
9X12	4.28	0
3X9	4.29	-4
6X12	4.33	-1

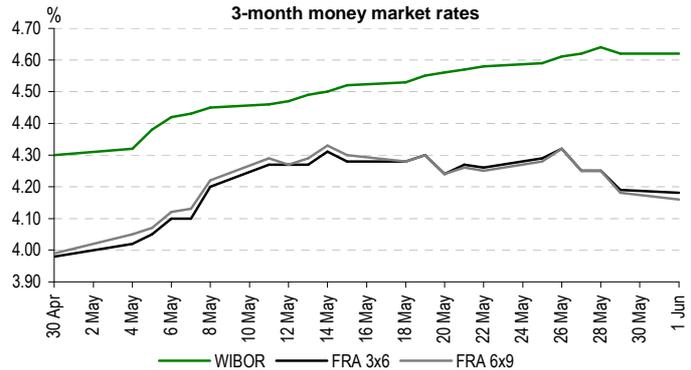
Zloty exchange rate (fixing)



T-bonds yields



3-month money market rates



* for 100 JPY

Source: Reuters

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