Bank Zachodni WBK

Eyeopener – Details of 2010 budget

8 September 2009

- **In reaction to news on 2010 budget there was strong rise in local bond yields and moderate zloty weakening**
- **Today the 2010 budget draft will be discussed by the government**
- **US markets return to activity after the long weekend, but no major data releases**

Yesterday global financial markets were rather stable, which was connected with the day off in the US. European equity markets showed positive performance after gains recorded in Asia. Higher risk appetite supported the Polish currency, which weakened only temporarily in reaction to high central budget deficit planned for the next year. Rating agencies S&P and Moody's said that plan regarding the next year fiscal policy were already reflected in the current assessment of Poland's rating and thus should not be a negative surprise. This supported the zloty. After a rise to 4.126 during the day, the EURPLN rate fell to ca. 410 at the end of the session. EURUSD remained stable, trading around 1.43.

A significant negative reaction to budgetary news was observed in the fixed income market. Yield curve moved up by 7-9 bp and the similar scale of increase was observed in case of FRA and IRS rates. The Ministry of Finance sold 52-week T-bill worth PLN806m with demand of PLN1.54bn and the average yield at 4.388% (much higher than 4.274% recorded a week ago). Activity in the core bond markets was moderate amid lack of US investors. Today in the morning yields of 10Y Treasuries and Bunds were at 3.42% and 3.24%, respectively. Moods in equity markets maintained rather positive with some gains in Asia. As a result, the zloty exchange rate is lower today – EURPLN fell below 4.09 with EURUSD rising to 1.437.

Yesterday the Ministry of Finance presented details of macroeconomic assumptions for 2010-13 period. We maintain the opinion that they are rather conservative and better economic performance may bring slightly lower budget deficit. Budgetary plan for the next year assumes GDP acceleration from 0.9% this year to 1.2% (our estimates at 1.2% and 1.6%, respectively), with domestic demand growth of 1.3% (2.2%), private consumption at 0.9% (1.2%), fixed investments 0.3% (1.7%) and average inflation rate at 1% (2.3%). The average EURPLN exchange rate was assumed at 4.08 (3.90) and average reference rate at 3.50% (3.67%). Next year domestic budget and budget connected with EU funds will be separated. In the domestic budget the deficit of PLN52.2bn is planned. The assumed rise in tax and non-tax revenues is at 6.2% to PLN245.5bn, which is connected with forecasted acceleration in indirect taxes and corporate income tax. Spending level is at PLN297.7bn. It is worth noticing the substantial increase in transfer to the Social Security Fund by PLN7.5bn (25%YoY as compared to the plan for 2009) and the significant increase in costs of foreign debt servicing by PLN2bn or 33%. The deficit of the UE funds' budget is assumed at PLN15.3bn, which leads to further increase in financing needs of the government next year. According to deputy finance minister Dominik Radziwiłł they will be at ca. PLN203bn (after including revenues from privatisation) vs. PLN163bn scheduled for this year. In EU methodology (with net T-Bills issuance) the gross borrowing needs will rise to PLN147bn from PLN109bn last year. There was doubling of privatisation proceeds to PLN24.7bn written in the budget, which will finance to some extent increase of spending to Demographic Reserve Fund by ca. PLN6bn, which will give a small improvement in the account of privatisation revenues and their disposal. Net borrowing needs will rise from ca. PLN52bn to ca. PLN82bn, mainly due to higher central budget deficit, EU funds budget deficit and increase in demographic reserve. Assumed level of T-bills maturing next year at PLN44bn is quite low taking into account that according to the FinMin data PLN42.8bn T-bills mature in 2010, and this year PLN20.3bn were left to rollover. The Finance Ministry may continue to repurchase T-bill amid good liquidity situation, especially at the end of the year (in order to lower the debt-to-GDP ratio) or may finance T-bills fully with bonds issuance (which is advisable in order to avoid problems with refinancing next year), nevertheless the value of T-bills maturing this year is very high. According to the project the net borrowing needs will be financed with domestic financing at PLN60.9bn (+77%YoY, mainly marketable bonds PLN50bn: +37%YoY) and foreign financing at PLN20.8bn (+120%YoY including PLN13.3bn of net bonds issuance and additional PLN8bn of granted loans from EIB and World Bank). According to the Finance Ministry the central budget deficit will rise this year to only ca. PLN22.5bn, below PLN27.2bn assumed in the amendment. The finance minister Jacek Rostowski said the 3-year plan of lowering the deficit (update of convergence programme) will be presented in December. He also announced the introduction of 4-year budget planning based on the new public finance bill. In order to strengthen the credibility of fighting the deficit the first such plan may be presented early in 2010.

In our opinion, the significant rise in borrowing requirements is negative for the debt market and will put a pressure on gradual rise in yields. Difficult fiscal situation will also be conducive to corrections of the zloty in periods of heightened risk aversion in the global markets. However, prospects for Polish public finances are not that bad so that alter our expectations of a gradual zloty appreciation in the medium-term.

Today the 2010 budget draft will be discussed by the government. Besides, Prime Minister Donald Tusk is going to announce his decision regarding Treasury Minister Aleksander Grad, which may impact assessment of the privatisation plan's credibility. US investors will return to activity today after the long weekend, but there will be no major data releases, so market ranges may remain intact.

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F/X rates (today's opening)

EURUSD	1.4373	CADPLN	2.6455
USDPLN	2.8441	DKKPLN	0.5492
EURPLN	4.0880	NOKPLN	0.4766
CHFPLN	2.6909	SEKPLN	0.4012
JPYPLN*	3.0707	CZKPLN	0.1605
GBPPLN	4.6573	HUFPLN	1.5060

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The zloty trading ranges

	min	max	open	close	fixing
EURPLN	4.0945	4.1261	4.1045	4.1150	4.1249
USDPLN	2.8535	2.8765	2.8628	2.8605	2.8757
EURUSD	1.4321	1.4359	1.4339	1.4336	-

T-bonds

TERM	Yield (%)	Change (bp)	Last auction	Average yield
2Y	**5.14**	**7**	13.05	5.669
5Y	**5.71**	**9**	3.06	5.783
10Y	**6.18**	**8**	20.05	6.335

IRS rates (Mid)

TERM	PL		US		EA	
	%	Change (bp)	%	Change (bp)	%	Change (bp)
1Y	4.49	5	0.60	1	1.15	-3
2Y	**5.11**	**6**	1.26	-2	1.66	-3
3Y	5.44	8	1.89	0	2.11	-2
4Y	5.60	10	2.36	0	2.44	-4
5Y	**5.66**	**9**	2.72	-5	2.70	-3
8Y	5.68	10	3.38	0	3.22	-4
10Y	**5.68**	**14**	3.63	1	3.44	-4

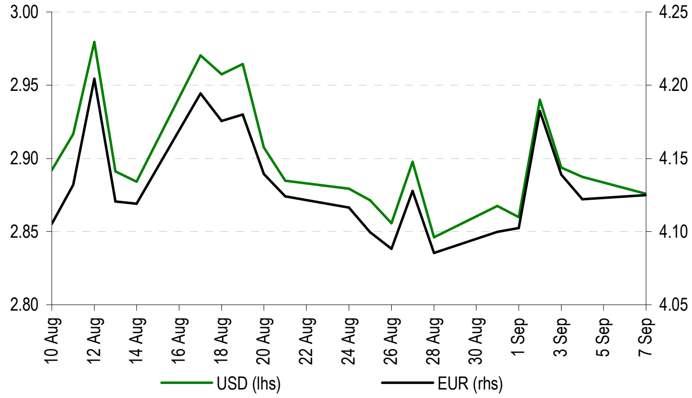
WIBOR rates

TERM	%	Daily change (bp)
O/N	2.73	-54
T/N	2.90	-45
SW	3.35	-7
2W	3.41	-4
1M	3.53	0
3M	4.17	-1
6M	4.33	-1
9M	4.44	-1
1Y	4.49	-1

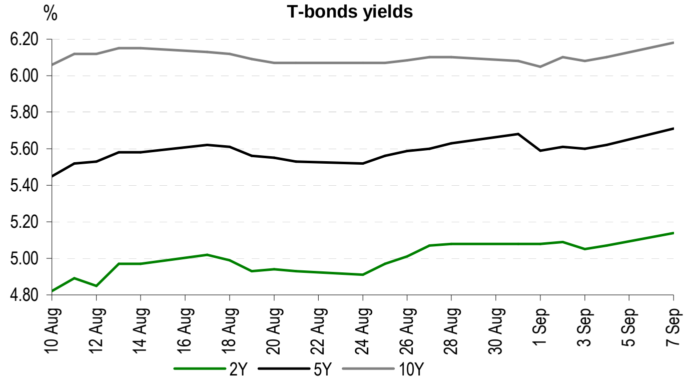
FRA rates (Mid)

TERM	%	Daily change (bp)
1X2	3.50	-16
3X6	4.32	3
6X9	4.47	8
9X12	4.69	9
3X9	4.49	8
6X12	4.67	7

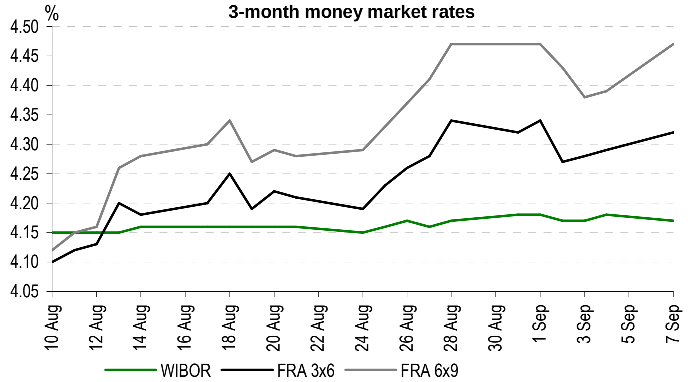
Zloty exchange rate (fixing)



T-bonds yields



3-month money market rates



* for 100 JPY

Source: Reuters

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