**Bureau of Economic Analysis**
(research)

Ernest Pytlarczyk, PhD, CFA
*chief economist*
tel. +48 22 829 01 66
ernest.pytlarczyk@brebank.pl

Marcin Mazurek, PhD
*senior analyst*
tel. +48 22 829 01 83
marcin.mazurek@brebank.pl

Paulina Ziembinska
*analyst*
tel. +48 22 829 02 56
paulina.ziembinska@brebank.pl

Artur Płuska
*analyst*
tel. +48 22 526 70 34
artur.pluska@brebank.pl

**Financial Markets Department**
(business contacts)

Lukasz Barwicki
*head of trading*
tel. +48 22 829 01 93
lukasz.barwicki@brebank.pl

Inga Gaszkowska-Gebska
*institutional sales*
tel. +48 22 829 01 67
inga.gaszkowska-gebska@brebank.pl

Bartlomiej Malocha, CFA
*money market*
tel. +48 22 829 01 77
bartlomiej.malocha@brebank.pl

Jaroslaw Stolarczyk
*structured products*
tel. +48 22 829 01 67
jaroslaw.stolarczyk@brebank.pl

Marcin Turkiewicz
*fx market*
tel. +48 22 829 01 67
marcin.turkiewicz@brebank.pl

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BREXPLPW

**BRE Bank S.A.**
18 Senatorska St.
00-950 Warszawa
P. O. BOX 728
tel. +48 22 829 00 00
fax. +48 22 829 00 33
http://www.brebank.pl

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## Comment on the upcoming data and forecasts

On Monday industrial production and PPI data will be published. Our relatively high forecast is based on growing economic indicators, strong car production and low statistical basis from 2010. In producer prices we expect delayed and secondary effects of commodities prices (in spite of recent slow-down trend on i.e. copper, gold and oil), in plus is also acting slight PLN depreciation. On Tuesday NBP will confirm growth of core CPI inflation. On Friday Statistical Office will publish retail sales data - we expect maintenance of current strong trend supported by nominal effects on fuels (contribution to growth ca. 3.6pp) and food. Car sales may grow due to supply effects (similarly as in other countries). Unemployment rate behaves as in 2009 (almost 100% correlation in last 4 months and similar business cycle phase).

### Polish data to watch: November 21 to November 25

| Publication | Date | Period | BRE | Consensus | Prior |
|---|---|---|---|---|---|
| Industrial production y/y (%) | 21.11. | Oct | 8.3 | 7.0 | 7.7 |
| PPI y/y (%) | 21.11. | Oct | 8.6 | 8.3 | 8.1 |
| Core CPI y/y (%) | 22.11. | Oct | 2.8 | 2.6 | 2.6 |
| Retail sales y/y (%) | 25.11. | Oct | 10.5 | 10.4 | 11.4 |
| Unemployment rate (%) | 25.11. | Oct | 11.9 | 11.9 | 11.8 |

### Treasury bonds and bills auctions

| Paper | Next auction | Last Offer | Last yield (%) | Prev auction |
|---|---|---|---|---|
| 52 Week T-bills | - | 600 | 4.578 | 5/30/2011 |
| 2Y T-bond OK0114 | - | 3000 | 4.469 | 8/10/2011 |
| 5Y T-bond PS0416 | - | 2500 | 5.147 | 11/16/2011 |
| 10Y T-bond DS1021 | - | 3000 | 5.803 | 7/21/2011 |
| 20Y T-bond WS0429 | - | 250 | 6.246 | 1/12/2011 |

### Macroeconomic forecasts

| Wskaźnik | 2008 | 2009 | 2010 | 2011 F | 2012 F |
|---|---|---|---|---|---|
| GDP y/y (%) | 5.1 | 1.6 | 3.8 | 3.8 | 2.8 |
| CPI Inflation y/y (average %) | 4.3 | 3.5 | 2.8 | 4.0 | 3.6 |
| Current account (%GDP) | -5.3 | -1.6 | -4.5 | -4.9 | 3.6 |
| Unemployment rate (end of period %) | 9.5 | 12.1 | 12.4 | 12.6 | 12.8 |
| Repo rate (end of period %) | 5.0 | 3.5 | 3.5 | 4.5 | 4.0 |

| | 2010 Q3 | 2010 Q4 | 2011 Q1 | 2011 Q2 | 2011 Q3 F | 2011 Q4 F |
|---|---|---|---|---|---|---|
| GDP y/y (%) | 4.2 | 4.5 | 4.4 | 4.3 | 4.1 | 3.6 |
| CPI Inflation y/y (average %) | 2.6 | 2.9 | 3.7 | 4.2 | 4.2 | 4.2 |
| Repo rate (end of period %) | 3.5 | 3.5 | 4.0 | 4.5 | 4.5 | 4.5 |

F - forecast

# Economics

## Higher inflation reading and projection, MPC Minutes not so dovish as suggested by headlines

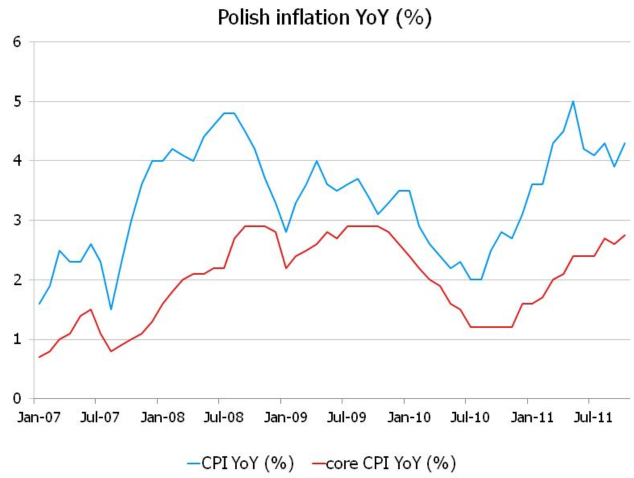
October's inflation rate increased to 4.3% y/y from 3.9% recorded in September. Increase is mainly attributed to foreign exchange rate changes (mostly visible in clothing and footwear category, which gained 3.1% m/m), food (1.0% m/m) and fuels (3.4% m/m). Core CPI grew by 0.2pp to 2.8% y/y mainly due to before mentioned clothing category (in other categories cost pressures are not so evident).

There are several scenarios of future inflation path coined by NBP and MPC. Recently published inflation projection path was revised upwards mainly on weaker PLN expectations, affecting core categories. Somehow counter-intuitively, NECMOD model turned out higher inflation forecast with more benign assumptions: lower foreign growth and inflation expectations, lower expected interest rates. It is probably because of weaker exchange rate that allowed for higher inflation path, coupled with - perhaps - some interfering at experts' level. According to NBP model, headline inflation will reach the target at the turn of 2013 and 2014. Quite the opposite view is presented by some MPC members. For instance, Chojna-Duch (probably taking into account risks of downward revision of foreign growth and lower futures prices for commodities - mentioned also as downward risk factors in the NBP inflation report) suggested possibility of reaching target even in the first half of 2012. Such a view was swiftly challenged by Kazimierczak, who had said the current inflation level is worrying (he had even stated - for the second time in his career as a central banker - that rate hikes do not seem to have effect on inflation).

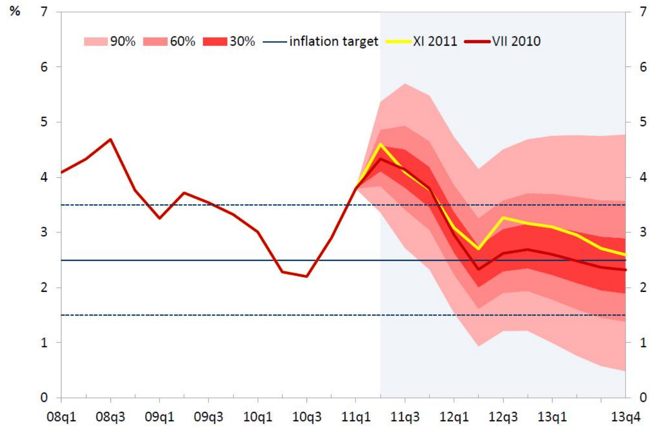
We also do not share Chojna-Duch's optimism since we expect lately observed trends (rising fuels prices, pro-inflationary FX effects) to stay in place in the months to come. Although a purely statistical decrease of inflation is likely to occur in the beginning of 2012 (an end of VAT base effect, high base generated by significant growth of food and energy prices in the beginning of 2011), it will not be as significant as market expects and CPI will be able to survive running close to upper end of NBP's target as there can be expected a simultaneous rise of state-controlled prices and excise duties on fuels, not mentioning - last but not certainly least - delayed effects of PLN depreciation.

„Minutes" from 9th November MPC meeting reveal indeed that many MPC members see long-lasting, above target inflation rate as a high probability scenario. In particular, interesting part of discussion concerned commodities prices with majority expecting growing trends for structural reasons (excess of demand over supply) or overliquidity on financial markets. As an additional argument for higher inflation in longer-term speak also recent extraordinary expansive monetary policy of major central banks.

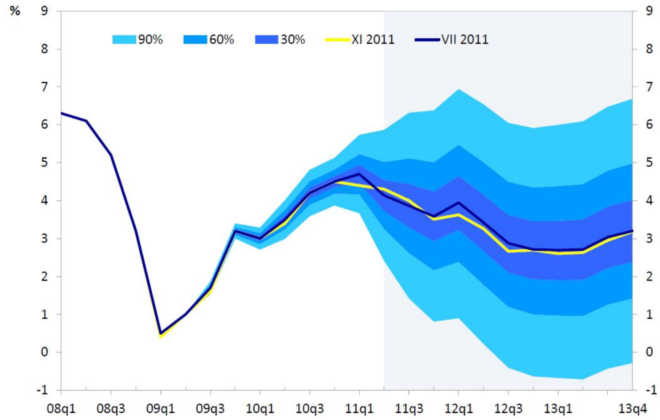
On the other hand, minutes-revealed perspectives of GDP growth remain quite optimistic. It is confirmed by inflation projection where changes in GDP growth path are attributed mainly to previous overestimation of consumption growth and slightly lower investment growth rate. Interestingly, NBP expects individual consumption to deteriorate only to 2.5% in 2013 and




Projekcja NBP: Inflacja




Projekcja NBP: PKB



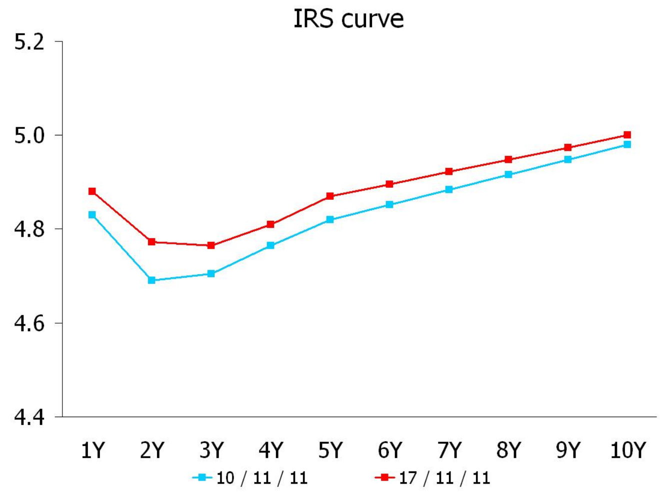
investment growth to slow only on the basis of reversal of public contribution with still stable/growing private contribution. Anyhow, lasting strength of consumption seems little mysterious with assumed higher unemployment rate, lowered wages and employment paths. Although, it would be plainman's mistake to question model results at this stage, seemingly to big a portion of intertia pencilled in equations describing consumptions behavior and its determinants may be a culprit. Simultaneously, NBP revised (upwards) net exports forecast in line with consumption reduction and FX effects (which were also mentioned in „Minutes" as automatic stabilizing factors supporting exports). Turning back to „Minutes" only, MPC members maintained relatively positive outlook of Polish economy (stable banking system, good liquidity of entrepreneurs, high competitiveness of Polish goods). Proponents of negative scenario (i.e. in investment activity) seem to remain in minority.

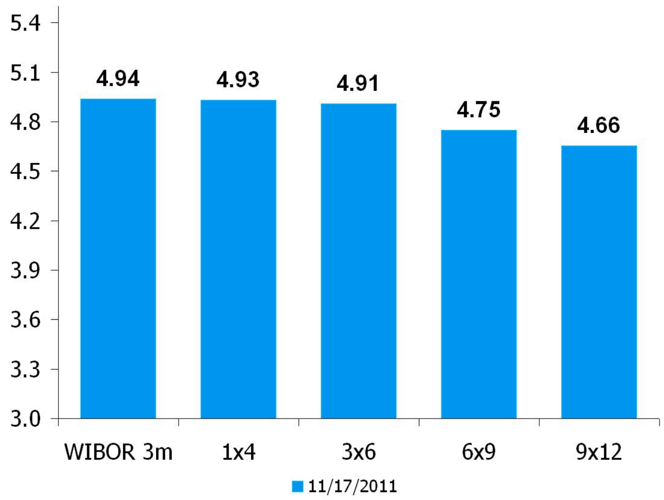
NBP projection and presented in „Minutes" MPC's stance support our view that the Committee will maintain wait-and-see attitude in the months to come as uncertainty on financial market remains high and strongly affected by external political decisions. What is more, swift rate cuts can be safely excluded owing to weak PLN and recent NBP's exchange rate intervention policy. Space for monetary loosening will open in the beginning of 2012 with lower foreign growth and lack of current necessity to control debt-to-GDP ratio by interventions on FX market, although it will require decrease of inflation rate at least to upper limit of the target rate (which at the very beginning of new year may be hard to achieve).

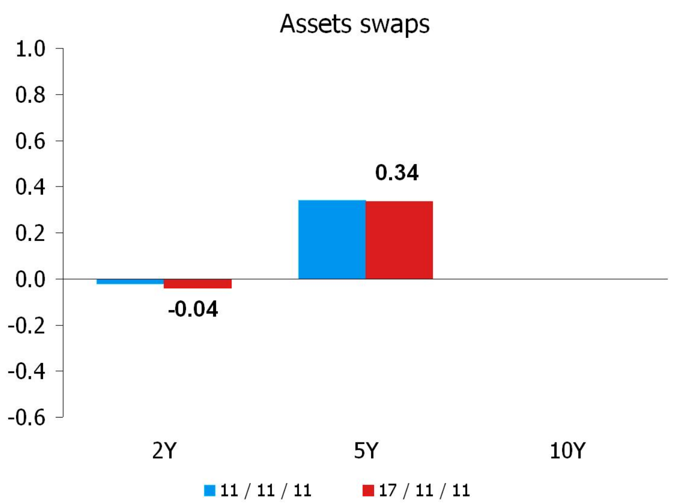
# Fixed income

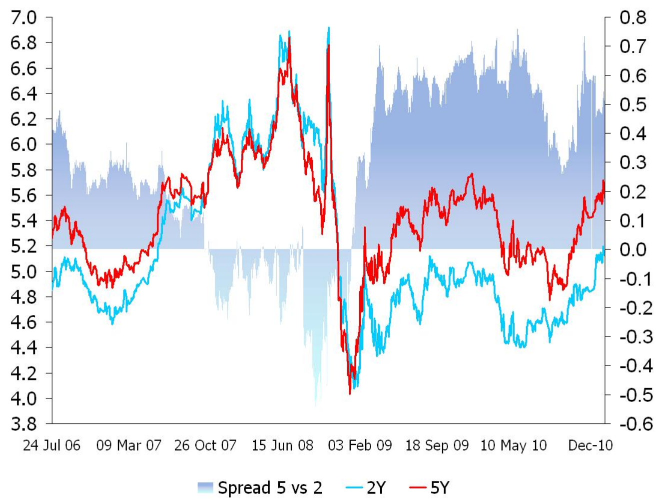
## It's time to buy

There were quite a few important local events this week that were driving the fixed income market. On Tuesday details of the latest inflation projection have been published. Those turned to be quite negative for the front end of the curve as according to current prediction, CPI is not going to fall to the NBP's target of 2.5% till 2014. Moreover, later same day inflation data for October surprised on the upside (4.3% vs 4.0% expected). Suprisingly that even had negative impact on the long end the curve. On Wednesday the FinMin successfully placed 2.5 bio of 5Y benchmark, PS1016 at 5.15% avg yield. Paying pressure continued across the curve, with 2Y moving the most. Minutes form the last MPC minutes showed some change in their rethorics, as some members already start seeing possibility of policy easing, still far from actual actions, but considering that 6x9 FRA trades at level, where Wibor fixed a month ago, just before recent move (that happened only due to liquidity/end of year reasons), there is apparent value in receiving from current levels. Long awaited opening speech from PM Tusk shows that the government is aware of the necessity of fiscal reforms and that there are actual things that would be done - reducing tax incentives, increasing pension contribution, introducing income tax for farmers and gradually raising retirement age. For some time now Polish market remained under pressure, which was caused by negative global sentiment, uncertainty about EU future, spreading debt crisis. We think it's about time to start looking at local fundamentals again. These are definitely supportive and as soon as investors' fears start to fade, there will be more appetite for risk and since levels here create opportunity, there is time and scope for a rally, possibly quite a strong one.



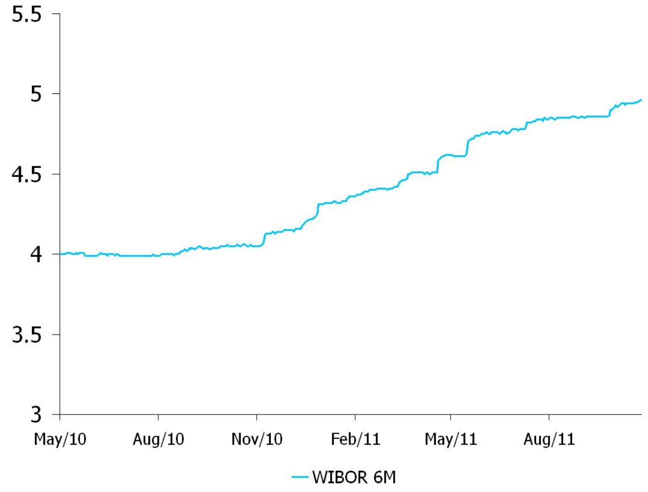



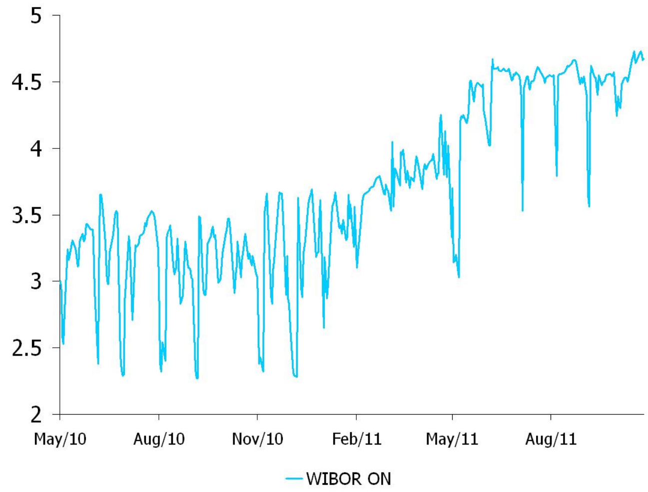
# Money market

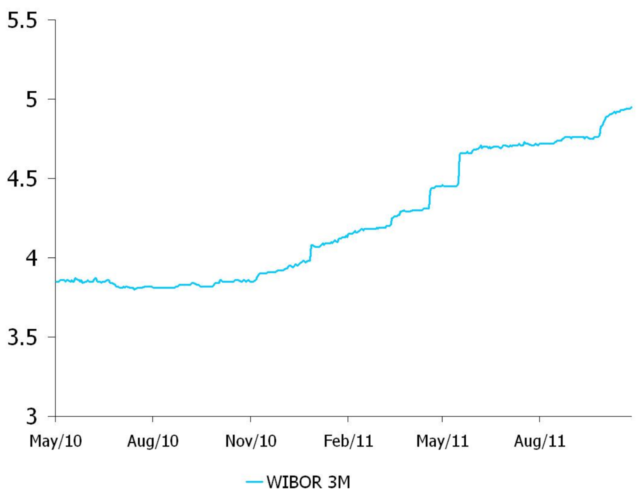
## OIS curve flattening

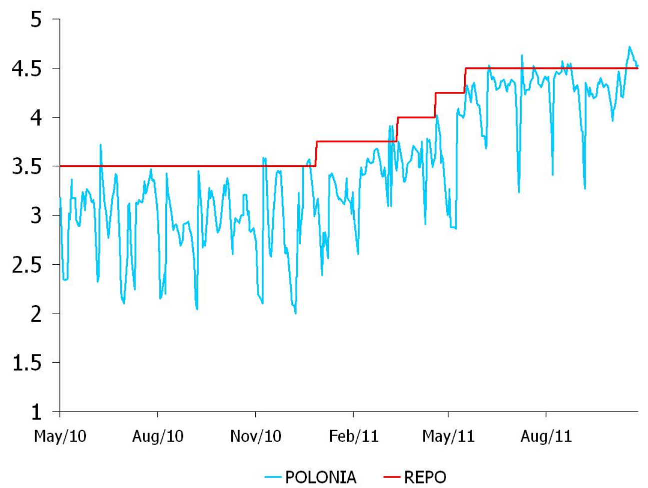
We had a CPI reading last week which came out much higher than market was expecting and finally we saw some move in long end Polonia. One year moved up around 8 bp and the curve became almost flat. Despite last week's move we still see spread between 1y3s against 1y Polonia at multi-month high, therefore we would try to enter short this spread at around 70. We expect 3M wibors to come back lower in the beginning of 2012.

We head into month's end, usually volatile period on cash market.



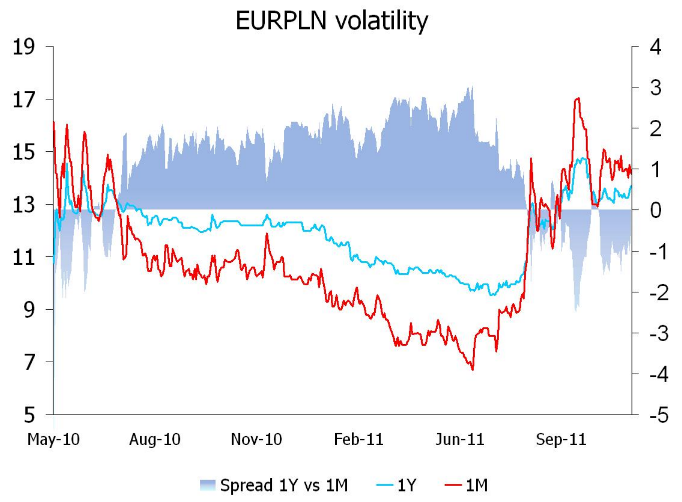



## Forex

**Still in range** The upper part of the range (4.25/4.30-4.45/4.50) was tested this week, with a EUR/PLN high printed at 4.46. On Friday, positive momentum in global risk sentiment (EUR/USD above 1.3550) and very constructive Prime Minister Tusk expose caused PLN to rebound to 4,4050. We must remember it is just words, and we have to wait and see what of that shall became law and whether this triggers an action on the rating outlook for Poland. The state owned BGK was active seller of hard currencies during the week.

**Volatility curve flattener** The lack of real thrill and fat theta bills were the reasons why the front end of volatility curve has collapsed (from 15.0% mid last week to 12.75%). The extremely expensive to hold, out of the money calls in front end were especially hard hit this week. The mid and back end of the curve was holding extremely well , as market still expecting the black scenario, but not just now. The currency spread and the risk reversals were roughly unchanged.

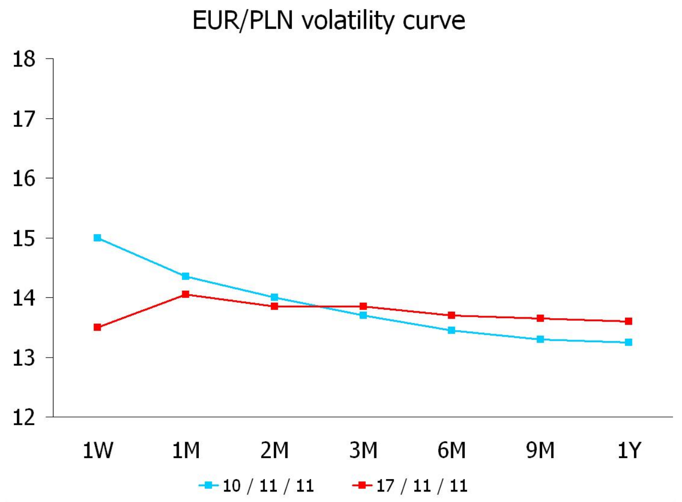


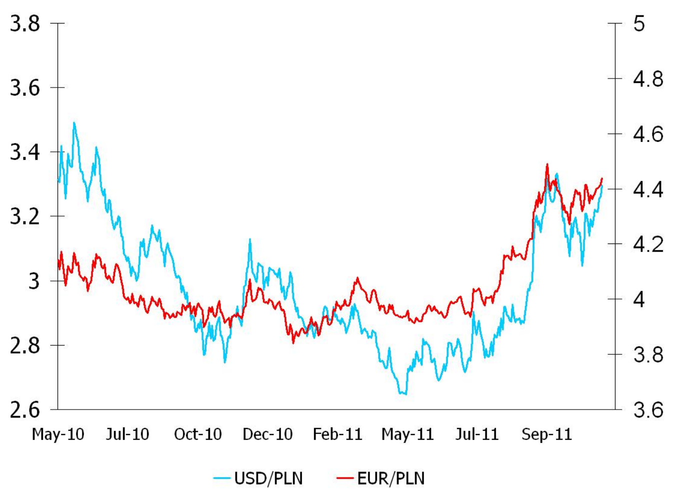

## Short-term forecasts

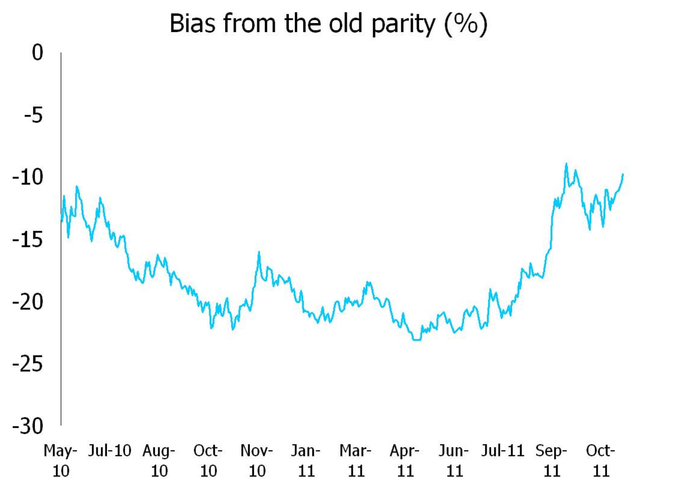
Main supports and resisances
EUR/PLN: 4.3500 / 4.4700
USD/PLN: 3.1500 / 3.3200

**Spot.** We are already short EUR/PLN at 4.4400, hoping for move to 4.3700 (stop loss at 4.4800). The positive Prime Minister expose, the pick up in global risk and inability to break 4.4700 make us think it is time to test the downside in EUR/PLN 4.3700 first target...

**Derivatives.** View unchanged. The ideal position to have is to be long Vega in 3m-6m and short out of the money call for December. The net effect is the long Vega and long Gamma and only tiny theta. EUR/PLN should be protected from rising to high too fast as our CB and the Ministry of Finance are the potential sellers till the year end. Then we will be at the markets mercy, and with no clear solution to the euro zone's sovereign debt crisis problems we should keep the core long in Vega. We opportunistically adding short term ATM gamma to the book, as the levels are much more interesting at 12.5 % then 15.50% week ago. And the move down is equally good to the move up, once a long Gamma with a difference the 25/35 delta puts are the cheapest points on the curve ( from point of view of Gamma/Theta ratio ).



# Market prices update

| Money market rates (mid close) | | | | | | | | FRA rates (mid close) | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Date | FXSW 3M | WIBOR 3M | FXSW 6M | WIBOR 6M | FXSW 1Y | WIBOR 1Y | 1x4 | 3x6 | 6x9 | 9x12 | 12x15 | 6x12 |
| 11/9/2011 | 4.67 | 4.93 | 4.85 | 4.84 | 4.83 | 4.84 | 4.93 | 4.89 | 4.68 | 4.55 | 4.46 | 4.70 |
| 11/10/2011 | 4.72 | 4.93 | 4.85 | 4.84 | 4.78 | 4.84 | 4.94 | 4.91 | 4.71 | 4.58 | 4.48 | 4.74 |
| 11/15/2011 | 4.65 | 4.94 | 5.05 | 4.85 | 4.81 | 4.85 | 4.93 | 4.92 | 4.73 | 4.66 | 4.58 | 4.77 |
| 11/16/2011 | 4.69 | 4.94 | 4.93 | 4.86 | 4.81 | 4.86 | 4.95 | 4.92 | 4.74 | 4.66 | 4.60 | 4.80 |
| 11/17/2011 | 4.69 | 4.94 | 5.13 | 4.86 | 4.80 | 4.86 | 4.93 | 4.91 | 4.75 | 4.66 | 4.64 | 4.77 |

| Last primary market rates | | | | | | | |
|---|---|---|---|---|---|---|---|
| Paper | Au. date | Maturity | Avg. price | Avg. yield | Supply | Demand | Sold |
| 52W TB | 5/30/2011 | 5/30/2012 | 95.57 | 4.58 | 600 | 2667 | 505 |
| OK0113 | 8/10/2011 | 1/25/2013 | 89.58 | 4.58 | 5000 | 4934 | 1889 |
| PS0416 | 10/19/2011 | 10/25/2016 | 98.44 | 5.11 | 3600 | 11200 | 3638 |
| DS1020 | 7/21/2011 | 10/25/2021 | 99.53 | 5.80 | 3000 | 5608 | 3000 |

| Fixed income market rates (closing mid-market levels) | | | | | | | |
|---|---|---|---|---|---|---|---|
| Date | 1Y WIBOR | 1Y T-bill | 2Y IRS | OK0113 | 5Y IRS | PS0416 | 10Y IRS |
| 11/9/2011 | 4.840 | 4.425 | 4.665 | 4.621 | 4.810 | 5.111 | 4.965 |
| 11/10/2011 | 4.840 | 4.425 | 4.690 | 4.669 | 4.820 | 5.161 | 4.980 |
| 11/15/2011 | 4.850 | 4.360 | 4.740 | 4.718 | 4.840 | 5.195 | 4.990 |
| 11/16/2011 | 4.860 | 4.425 | 4.765 | 4.725 | 4.875 | 5.176 | 5.025 |
| 11/17/2011 | 4.860 | 4.425 | 4.773 | 4.732 | 4.870 | 5.205 | 5.000 |

| EUR/PLN 0-delta stradle | | | | | 25-delta RR | | 25-delta FLY | |
|---|---|---|---|---|---|---|---|---|
| Date | 1M | 3M | 6M | 1Y | 1M | 1Y | 1M | 1Y |
| 11/9/2011 | 14.25 | 13.85 | 13.55 | 13.40 | 13.40 | 4.61 | 0.70 | 0.96 |
| 11/10/2011 | 14.35 | 13.70 | 13.45 | 13.25 | 13.25 | 4.61 | 0.70 | 0.96 |
| 11/15/2011 | 14.50 | 13.90 | 13.65 | 13.50 | 13.50 | 4.61 | -0.07 | 0.84 |
| 11/16/2011 | 14.15 | 13.85 | 13.80 | 13.70 | 13.70 | 4.63 | 0.53 | 0.61 |
| 11/17/2011 | 14.05 | 13.85 | 13.70 | 13.60 | 13.60 | 4.63 | 0.38 | 0.81 |

| PLN Spot performance | | | | | | |
|---|---|---|---|---|---|---|
| Date | EURPLN | USDPLN | CHFPLN | JPYPLN | HUFPLN | CZKPLN |
| 11/9/2011 | 4.3757 | 3.1925 | 3.5459 | 4.1121 | 1.4092 | 0.1727 |
| 11/10/2011 | 4.3807 | 3.2213 | 3.5519 | 4.1423 | 1.4177 | 0.1720 |
| 11/15/2011 | 4.4064 | 3.2526 | 3.5531 | 4.2205 | 1.3935 | 0.1711 |
| 11/16/2011 | 4.4155 | 3.2621 | 3.5639 | 4.2398 | 1.4096 | 0.1728 |
| 11/17/2011 | 4.4387 | 3.2965 | 3.5773 | 4.2826 | 1.4140 | 0.1730 |

# Disclaimer