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

Reuters pages:
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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 manufacturing data will be published. In industrial output there are no signs of abrupt downward trend amplification (seasonally adjusted manufacturing sector grew even faster in October than in September, no difference in working days). Similarly we expect PPI to maintain its trend (increases in coke and mining driven by weaker exchange rate, increases in copper and oil prices). On Tuesday core CPI will increase to 3.0% (due to new price-list of refunded drugs). On Thursday Central Statistical Office will publish retail sales growth rate (negative statistical base on cars, positive on fuels, no base effects on clothing, fuels inflation adds more than 4pp.) and unemployment rate (seasonal increase in number of unemployed). On Thursday also MPC Minutes from November meeting will make clear whether there was motion of a hike.

Polish data to watch: December 19 to December 23

Publication	Date	Period	BRE	Consensus	Prior
Industrial production y/y (%)	19.12	Nov	6.0	5.9	6.5
PPI y/y (%)	19.12	Nov	8.7	8.6	8.5
Core CPI y/y (%)	20.12	Nov	3.0	3.0	2.8
Retail sales y/y (%)	22.12	Nov	10.6	10.5	11.2
Unemployment rate (%)	22.12	Nov	12.1	12.0	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 PS1016	-	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	4.0	2.8
CPI Inflation y/y (average %)	4.3	3.5	2.8	4.2	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	2011 Q4 F
GDP y/y (%)	4.4	4.7	4.5	4.3	4.2	3.6
CPI Inflation y/y (average %)	2.6	2.9	3.7	4.2	4.1	4.4
Repo rate (end of period %)	3.5	3.5	4.0	4.5	4.5	4.5

F - forecast

Economics

Significant growth of inflation rate in November

Annual inflation grew from 4.3% to 4.8% in November. Increase is mainly attributed to higher food (1.2% m/m), fuel prices (3.2% m/m) and a new price-list of refunded drugs introduced in the mid-November (health category rose by 2.3% m/m). Therefore core CPI increased to 3.0% from 2.8% recorded in October. Prices remained stable among others in the following categories: restaurants and hotels, recreation and culture, communication, miscellaneous goods and services. Therefore apart from EURPLN-tied prices, the price-propagation mechanism does not work, most likely as a reaction to current a bit weaker and/or expected weaker demand. Hence, indeed truly endogenous price pressure remains under control.

Looking forward we expect CPI to stay on similar level in December. Although a purely statistical decrease of inflation is likely to occur in the beginning of 2012, we do not expect a far reaching fall below target rate (2.5%), but rather horizontal movement around upper limit of target range (3.5%). The main reason are lagged effects of weaker zloty and rise of state-controlled prices.

Elevated inflation levels increase expectations for monetary tightening (Hungary scenario), which was reflected in market interest rates growth after release (by 5bp). However, we are far away from plunging into Hungary's despair since the starting position in terms of fiscal policy and monetary policy is way better. Although comments from few of the MPC members pours salt on the wound (Kaźmierczak and Glapiński's commitment to submit motion of a hike should the outlook for inflation's return to the target in the mid-2012 deteriorate, Hausner and Zielińska-Głębocka see higher probability of rate hikes than rate cuts) we see further tightening as a low probability scenario. Taking into account growing risks of recession in euro zone and heightened uncertainty, rate hike would have dire consequences for entrepreneurs and households (also due to improvement in monetary policy transmission as the FX structure of new mortgage is changing towards PLN). We expect MPC to assess growth risks with cautiousness and in longer term, as inflation rate falls, to seek for easing opportunities, which in our base scenario will materialize in cuts in H1'2012.

Positive surprise in employment

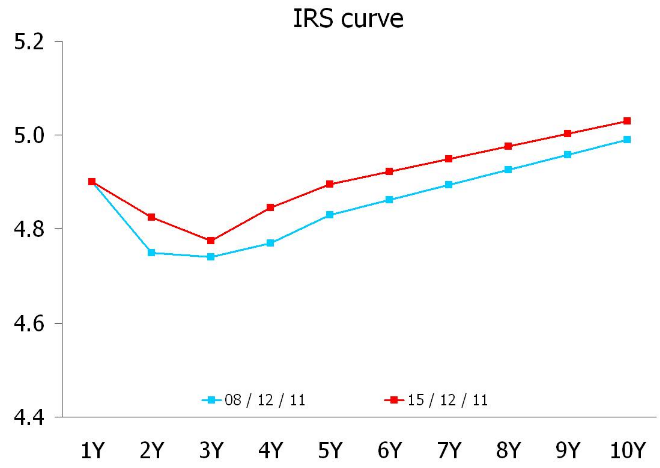
Employment in enterprise sector rose by 3k in November, quite surprisingly given the negative seasonality in the data. We think it stems from two reasons. First of all, warm and dry Autumn could have supported employment in construction (we do not know the details of the data yet). Secondly, as we have indicated in recent comments, labor market is more resilient than during the slowdown initiated in 2008, which is confirmed in growth rate of business tendency indicators. Therefore we expect gradual, down-movement in employment during the coming months, but with no avalanche as spotted in 2008.

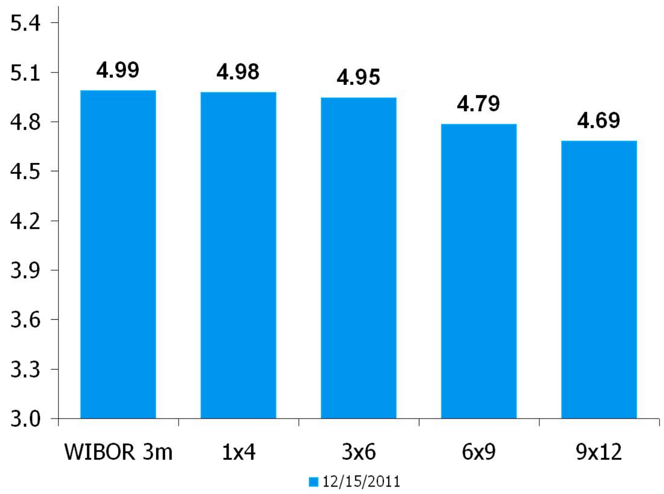
As far as the growth of wages is concerned, 4.4% on annual basis reflects mainly some shift in bonuses in mining. We think the growth rate in manufacturing, central to business cycle considerations, are still running high, round 5%. However, wages are lagging, not leading indicator in the cycle. Therefore the moderation is on the horizon. As a bottom line one has to note that in terms of starting point, consumption is to undergo some setbacks in the future although in comparison with 2008-2009 it is unlikely to go under siege since labor market as a whole is to stay overall in much better shape than in the latest slowdown.

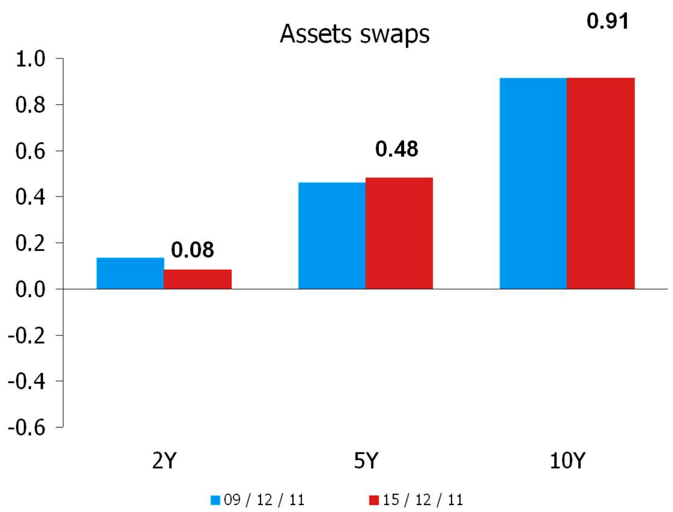
Fixed income

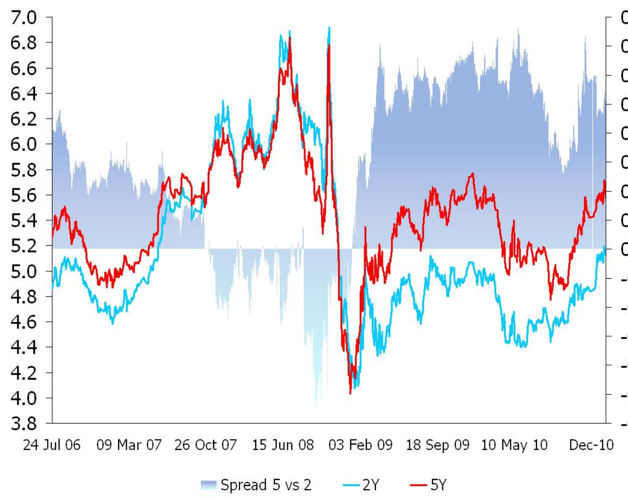
Holiday season part I

With holiday season approaching quickly, it has been a quiet week on the fixed income market. Tuesday's publication of November's CPI data was actually the last event that could have influenced the market in any way. Despite a negative surprise (4.8% y/y, half a percentage point higher than previous month, higher than market forecast of 4.5%), impact was quite moderate. Front end of the curve jumped by some 4-5bp only temporarily, as that move was perceived as a receiving opportunity by majority of the players. For the rest of the week rates constantly drifted lower amid low turnover (gravity works after all) . As it seems we have reached the end of trading year already it's hard to expect any significant changes in terms of prices for the upcoming week (apart from what has been a major driver recently i.e. global sentiment and 'crisis' stories, however Polish FI market seemed to have lost it's direct correlation to other markets, or, more precisely, became quite immune to negative news).







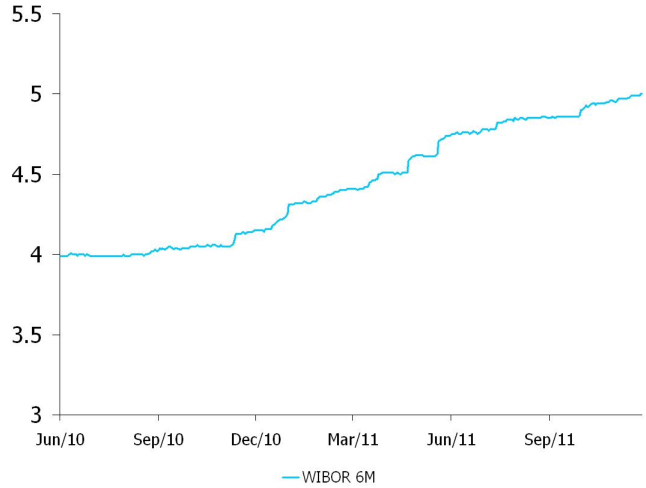


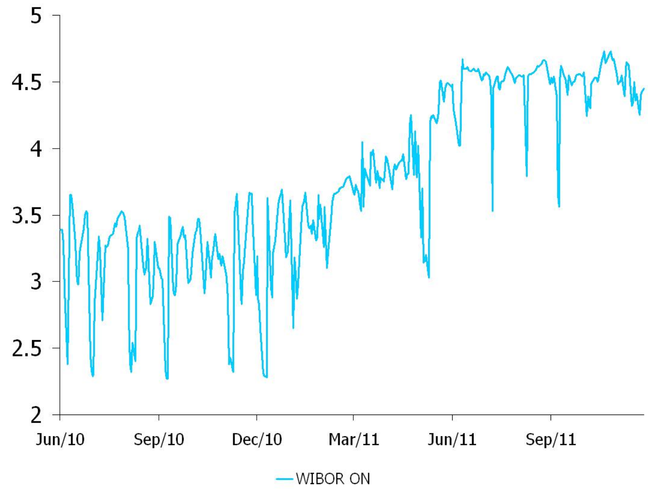
Money market

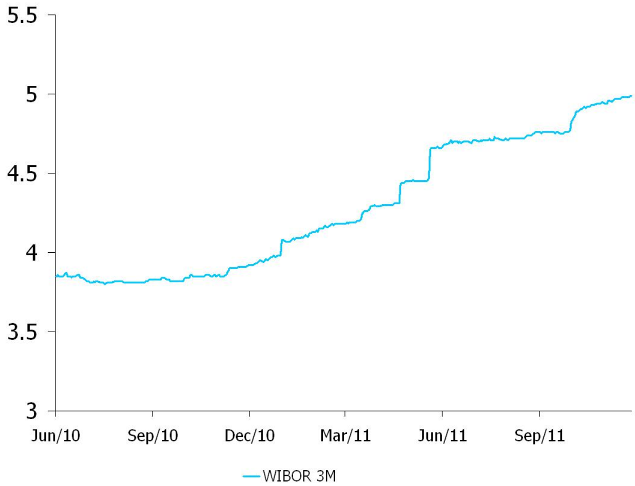
Just cheap carry. CPI paired off by stronger zloty.

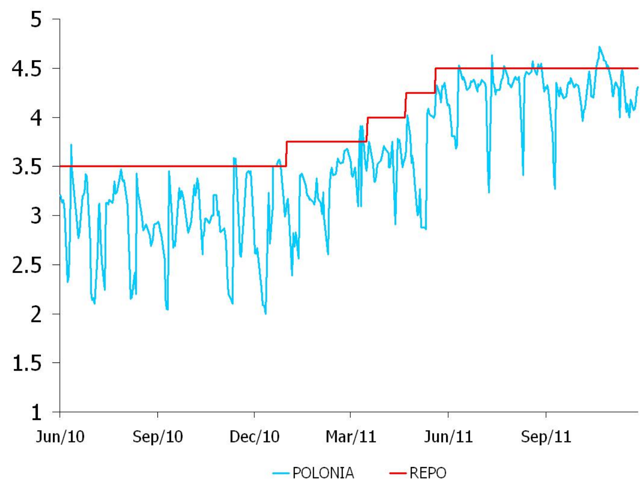
Today's OMO was underbid by pln 10 bln which leaves huge surplus of the cash in the system. Overnight deposits are trading much below 4% and this can be the case till the end of the year, despite almost certain additional operations trying to sterilize the market and bring polonia index back nearby the main market rate (4.5%). Reasoning of the market is very simple and mentioned in previous reports by us. High liquidity aversion before Christmas and the year end.

CPI much above expectations at 4.8% vs 4.4%. This triggered temporary shift in rates, however rapidly put off by the stronger pln. Not much trading expected next week as we are approaching the holidays. Today's wages ignored by the market and the same will probably happen with the PPI, IO, core CPI and retail sales next week.





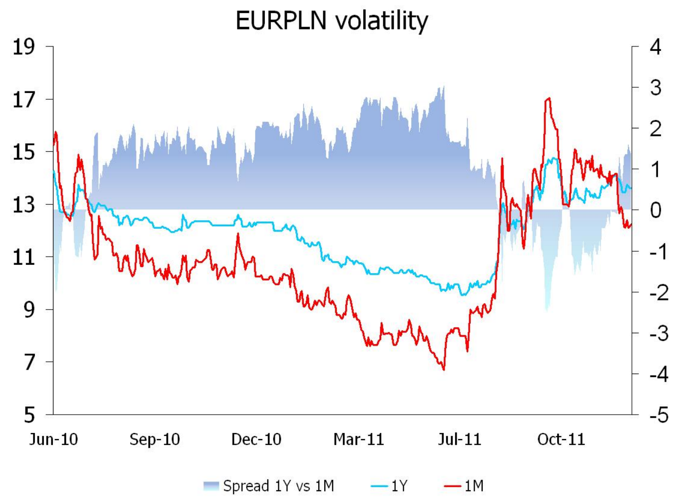




Forex

Lower in the range. The falling EUR/USD was not enough to make EUR/PLN go above 4.60 strong resistance in a first attempt. The high for EUR/PLN was 4.5990 and later in the week, the Polish currency regained same of its shine, touching 4.4800 on Friday (after Reuters headline, Dept. Finance Minister was quoted as saying that 4.00 at the year end very probable?? Later corrected to 2012 end year!). Nevertheless, the end year is approaching, and we expect that the probability of hard currency selling by Ministry of Finance increases.

Vols steepened. The frontend vols on EUR/PLN are under the constant pressure, with 1w EUR/PLN being sold at 10.75 and 1 month fixed at extremely low 11.5 %. The 3 month were given at 13%, the backend 6m and 1y is holding relatively well with mids at 13.35% and 13.65 % respectively. The market is in limbo, with low liquidity and most market participants already focused on the new year. The risk reversals and currency spread unchanged from the last week.

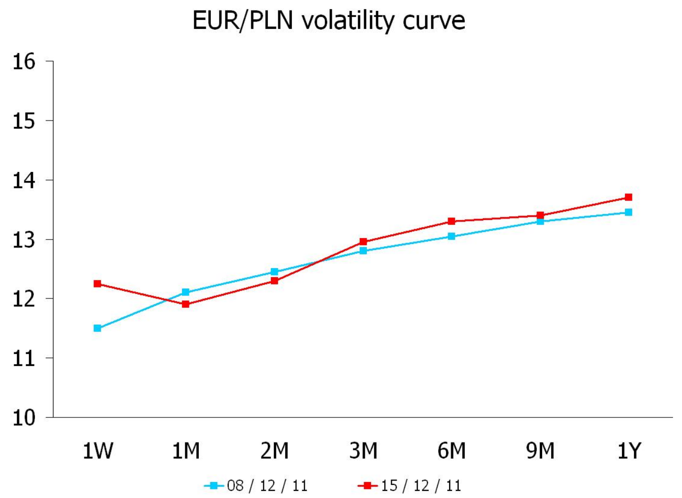


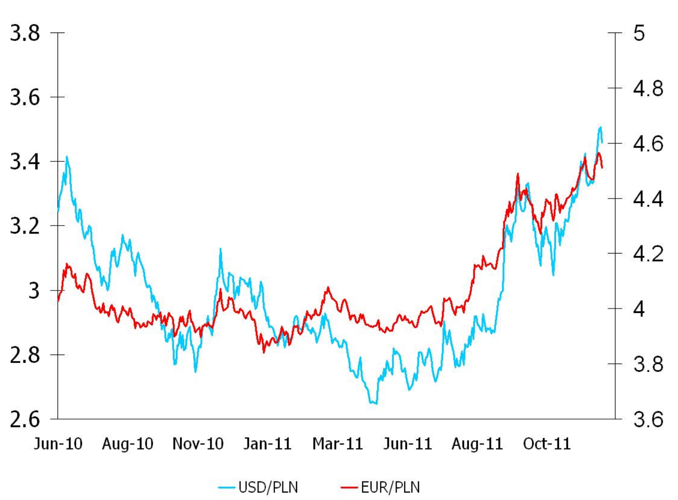
Short-term forecasts

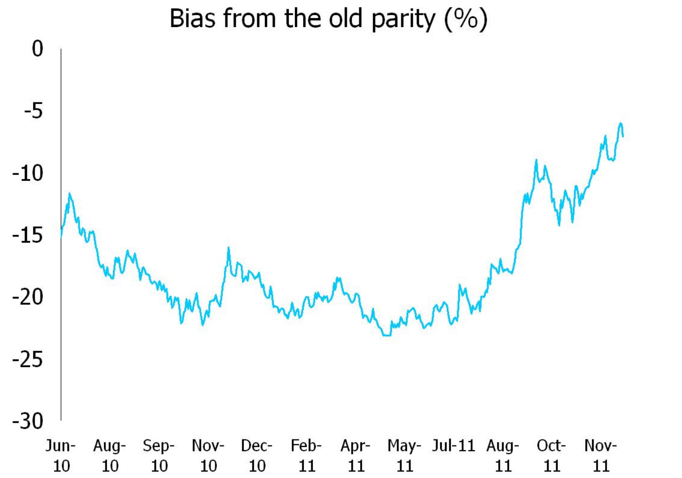
Main supports and resisances
EUR/PLN: 4.4000 / 4.6000
USD/PLN: 3.3500 / 3.5500

Spot. We believe that GBK will be more and more active on the market till the end of year, and that's force us to fade tops, rather then buy dips on EUR/PLN. Ideally we would like to sell at 4.54/56 space and set stop loss above 4.60 with profit taking at 4.43/45.

Derivatives. We are core long 3/6 months sector in ATMS in EUR/PLN. Would like to average Vega bellow 13% (6 months - 1 year), but we doubt we will have this opportunity this year. The levels of bellow 11% on 1week are becoming increasingly tempting for possible purchase, as the possible interventions may create additional volatility...







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
12/9/2011	4.75	4.98	4.83	6.49	4.79	6.59	4.97	4.94	4.75	4.65	4.59	4.82
12/12/2011	4.79	4.98	4.78	4.89	4.78	4.89	4.98	4.97	4.78	4.69	4.61	4.78
12/13/2011	4.75	4.98	4.79	4.89	4.79	4.89	4.98	4.96	4.82	4.71	4.68	4.83
12/14/2011	4.75	4.98	4.78	4.89	4.78	4.89	4.98	4.97	4.81	4.71	4.69	4.84
12/15/2011	4.75	4.99	4.78	4.90	4.78	4.90	4.98	4.95	4.79	4.69	4.63	4.79

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
OK0114	8/10/2011	1/25/2013	89.58	4.58	5000	4934	1889
PS1016	10/19/2011	10/25/2016	98.44	5.11	3600	11200	3638
DS1021	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
12/9/2011	6.590	4.797	4.750	4.886	4.840	5.300	4.990
12/12/2011	4.890	4.810	4.780	4.937	4.875	5.387	5.035
12/13/2011	4.890	4.753	4.815	4.971	4.880	5.373	5.010
12/14/2011	4.890	4.820	4.825	4.950	4.895	5.405	5.030
12/15/2011	4.900	4.822	4.825	4.909	4.895	5.377	5.030

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1M	1Y
12/9/2011	12.40	13.05	13.35	13.75	13.75	4.83	0.60	0.51
12/12/2011	12.10	13.05	13.30	13.70	13.70	4.83	0.60	0.51
12/13/2011	12.13	13.05	13.30	13.60	13.60	4.83	0.44	0.71
12/14/2011	12.25	13.00	13.40	13.60	13.60	5.03	0.44	0.71
12/15/2011	11.90	12.95	13.30	13.70	13.70	5.01	0.29	0.71

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
12/9/2011	4.5195	3.3875	3.6653	4.3572	1.4750	0.1767
12/12/2011	4.5255	3.4117	3.6694	4.3820	1.4832	0.1771
12/13/2011	4.5600	3.4587	3.6917	4.4434	1.4947	0.1777
12/14/2011	4.5642	3.4977	3.7025	4.4872	1.5033	0.1779
12/15/2011	4.5481	3.5066	3.7096	4.4942	1.4981	0.1777

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