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Comment on the upcoming data and forecasts

On Wednesday we expect MPC to leave repo rate unchanged as inflation remains on elevated level (our forecasts for Friday reading exceeds market consensus) and real sphere has not really disappointed yet. On Friday CPI is published. The reading is pushed up by further food and fuel prices growth. We expect core CPI to increase to 3.2% due to the new price-list of refunded drugs introduced in the mid-November (half of which will be therefore still reflected in December). In current account data for November we forecast still positive transfers and much lower income deficit (last negative number was a reflection of large coupon payment). Against seasonal tendencies we expect imports and exports to remain on similar levels as in October. On Friday also money supply M3 will be published. We treat an unexpected growth in corporate deposits in November as one-off and forecast a return of M3 to previous (still growing) trend.

Polish data to watch: January 9 to January 13

| Publication | Date | Period | BRE | Consensus | Prior |
|-------------------|--------|--------|------|-----------|-------|
| NBP repo rate (%) | 11.01. | Jan | 4.50 | 4.50 | 4.50 |
| CPI y/y (%) | 13.01. | Dec | 4.8 | 4.6 | 4.8 |
| C/A (mln EUR) | 13.01. | Nov | -663 | -1525 | -1622 |
| M3 y/y (%) | 13.01. | Dec | 10.9 | 11.1 | 11.6 |

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 | 4.2 | 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 | 13.6 | |
| Repo rate (end of period %) | 5.0 | 3.5 | 3.5 | 4.5 | 4.0 | |
| | 2011 Q1 | 2011 Q2 | 2011 Q3 | 2011 Q4 F | 2012 Q1 F | 2012 Q2 F |
| GDP y/y (%) | 4.5 | 4.3 | 4.2 | 3.6 | 3.4 | 2.8 |
| CPI Inflation y/y (average %) | 3.7 | 4.2 | 4.1 | 4.6 | 3.7 | 3.5 |
| Repo rate (end of period %) | 4.0 | 4.5 | 4.5 | 4.5 | 4.5 | 4.0 |

F - forecast

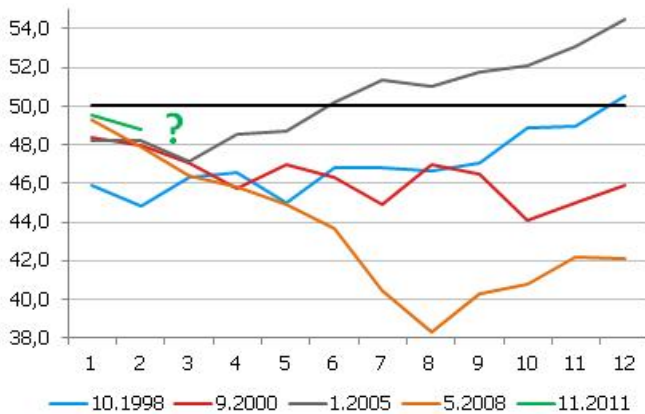
Economics

PMI falls in December, as expected

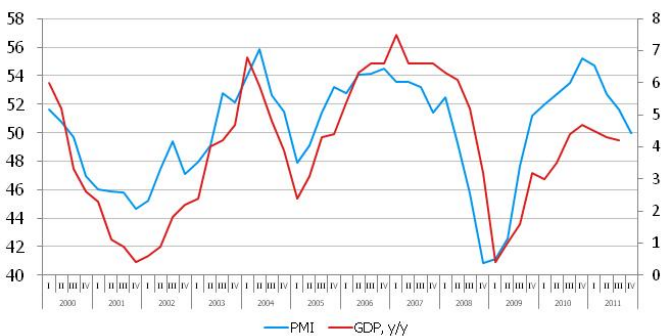
As we expected, PMI for the Polish economy dug deeper into the slowdown territory recording a level 48,8pts (vs 49.5pst last month). Therefore the number marks the weakest industrial activity since December 2009. However, it contrasts with actual manufacturing numbers, hovering still around 6-8% level on annual basis. We think the slowdown has so far a mental dimension (growing number of risks breeds pessimists but leaves actual production levels unaffected) but nothing lasts forever and economic activity is set to contract - albeit only gradually - in coming quarters. Historical analysis suggests PMI indices are characterized by high inertia - once they plunge below 50pts the return to the surface lasts several months.

and credit crunch issues). It is perhaps also worth mentioning that GDP growth retreats only slowly, without a sharp slowdown recorded in 2008-2009. Moreover, GDP expansion falters only marginally despite non-existent boost from public consumption (negative GDP growth contribution, very positive during 2008-2009 slowdown) and commonly expected fiscal tightening (rise of social contribution). Of course there is a solid contribution from infrastructure investment but this type of GDP booster pays a lot for itself as it is a medium to long-term growth generating machine (high marginal productivity, solid boost to social rate of return to capital). Furthermore, solid public investment is unlikely to experience a sudden stop. It would be rather gradual slowdown, and there is a high probability of substitution with fledgling private investment. We expect GDP growth in 2012 to be close to 2.8%. It is perhaps not very enlightening to state that the actual depth of the slowdown crucially depends on euro zone situation. Therefore we monitor changes in political and business setup in euro zone closely and are ready to react promptly with forecasts regarding Polish economy.

Historical PMI paths after first decline below 50 mark



Turning to details, better turned out to be current measures depicting business activity. Another increase, although marginal, was indicated in manufacturing output. However, respondents are more cautious with regard to labor market - index describing employment plunged below 50pts. According to the narrative evidence, such a situation is consistent with lower new orders and cost-cutting pressures. The main reason of falling PMI were new orders (the magnitude of the drop is the highest since June 2009) and new export orders.



Composition of current and leading indicators suggests that Polish economy is entering the very early slowdown phase (much of which can be erased as soon as expectations start to focus again on business activity rather than risks, peripheral woes



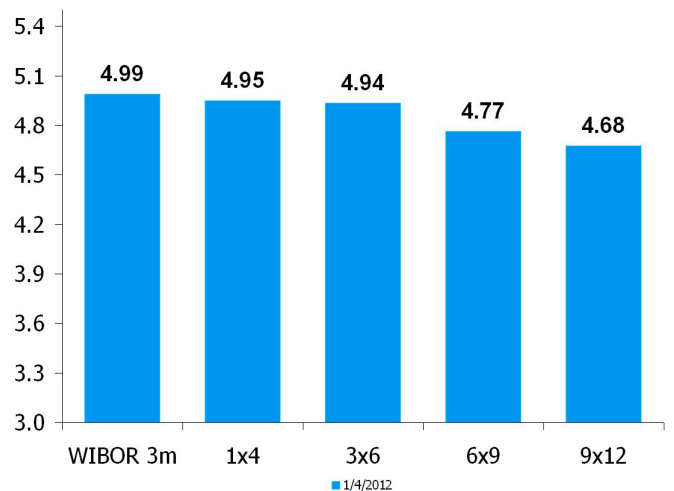
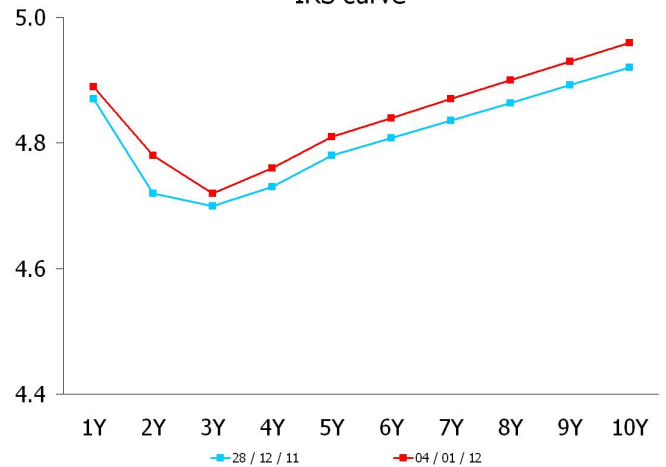
Fixed income

New Year, old stories

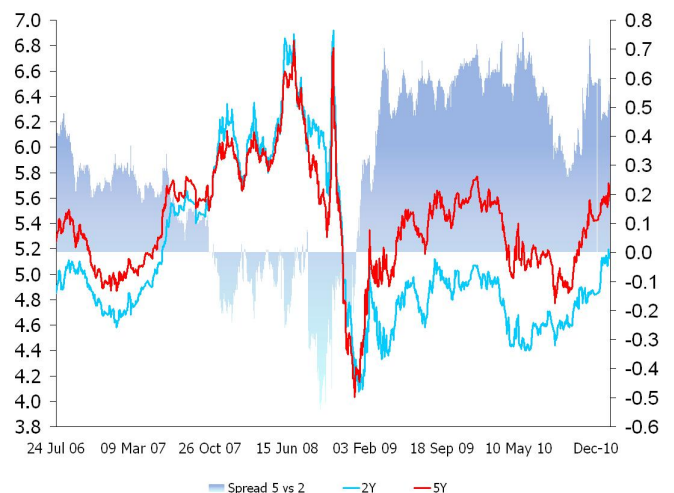
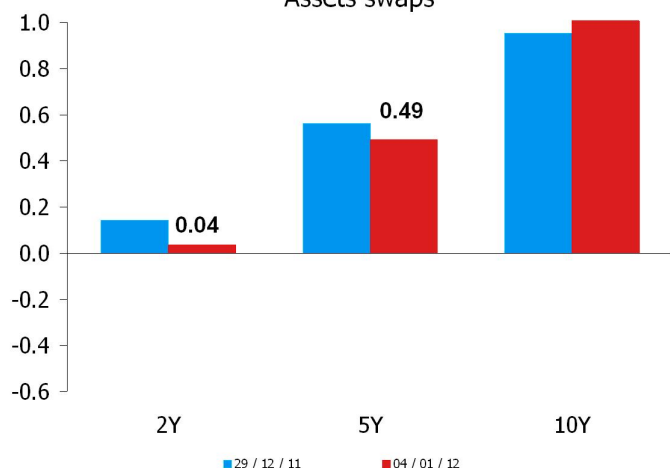
New year's positive sentiment on the FI market lasted less than a day. Later on, worsening sentiment and situation in Hungary prevailed and PLN yields started pushing higher. As a result rates went up by 10-15 bp along with some steepening. Despite the sentiment, bonds seem to be finding reasonable support on continuously lower levels. On Wednesday the Ministry of Finance successfully placed over 6bio of papers on switch auction, half of that being 10y benchmark DS1021. On the issuance field they seem to be quite on the safe side, if further tenders this month go similarly well, they will have completed quarter of this year total already by the end of January.

It seems that beginning of this year will be shaky and markets will stay nervous. In such circumstances we'd rather concentrate on trading and playing range than directional positions. However in longer perspective we're quite positive on the market. Even if CPI stays elevated, once we start seeing serious signs of upcoming slowdown, MPC's rhetorics is likely to shift towards more neutral/dovish than it currently is. If some reform are introduced by government, that could be reflected in ratings and/or outlook improvements. All in all we expect that current market turmoils are likely to create some nice entry point to build a mid-term receive position.

IRS curve



Assets swaps



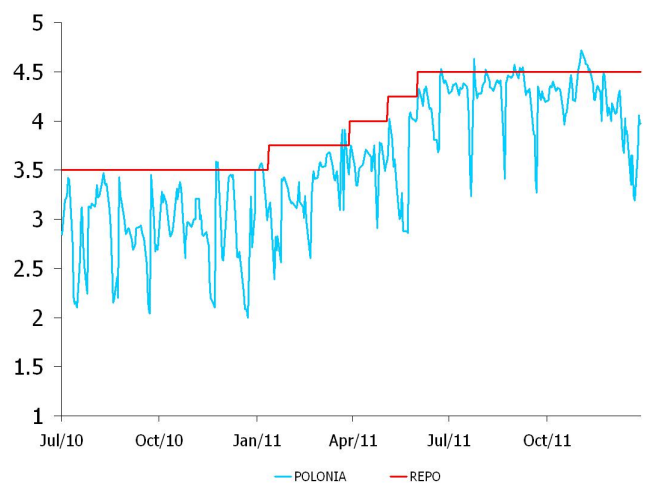
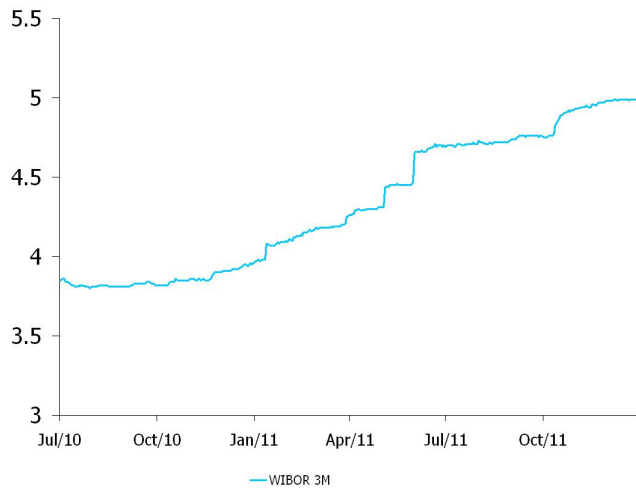
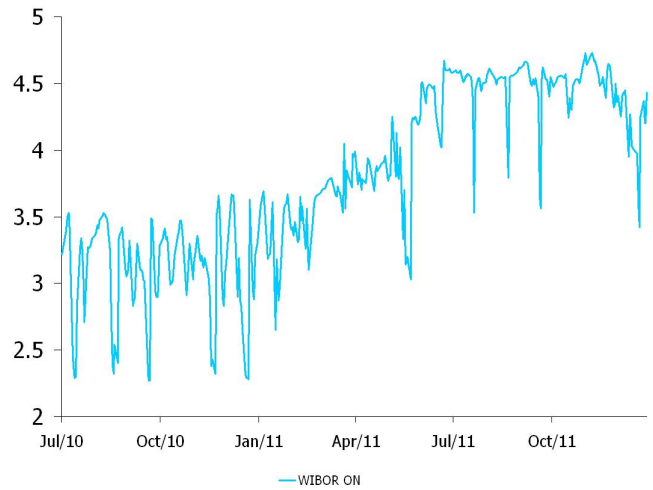
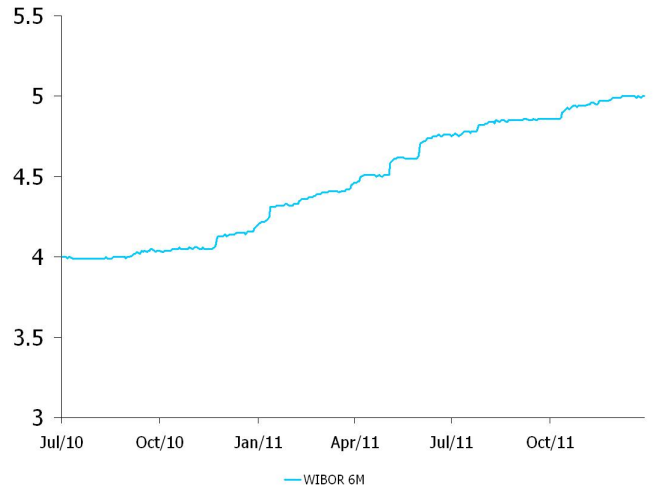


Money market

Carry up next week. Hungary dominated the region. T-bills auction on Monday, after a very long brake.

Still New Year's mood, therefore restricted activity of both local and off shore players. Cost of carry up to 4% and the sentiment is upward biased, since the amount of the money bills in the system has today increased to 92 billion pln from last week's 74 billion pln (OMO offer was at 95 billion pln). We see the cost of carry up at 4.25+ level in coming days.

Hungary dominated the trend for the polish IR derivatives, pushing rates higher. Weaker zloty plus high CPI expectations will keep the MPC on hold next week. Global outlook will still be more important than local factors. Short papers (especially the switching ones) are very expensive, which does not look good for the Monday's T-bills auction. Nonetheless, the demand can be substantial since the market loves those papers, and there is high probability of the restricted supply also this year, after 1Q.





Forex

Zloty weaker , at the middle of the range. The widely expected correction higher in EUR/PLN, started with a war over December 30 fixing. The BGK was selling huge amounts of hard currencies direct with Polish banks and on Reuters 2002, the rest of the market was on the bid. The noise was so huge that, we had reversed spread on the Reuters 2002 as most of the banks run out of lines with BGK (or the other way around). The EUR/PLN fixed at 4.4168 finally. After the fixing, buyers have prevailed and Zloty lost more then 1%. After the small consolidation, the EUR/PLN hit the high of the week at 4.5240 (so far). We think that PLN losses, washed the end of year effect from the EUR/PLN rate. Now the local factors would play the secondary role, as global sentiment will take over the driving seat. The wide range for now is 4.40/4.60. . .

Vols higher. At the very last day of the year the buyers come back with vengeance. The EURPLN atm 6m was paid 13.5% and 1y was paid at 13.75%. The whole run has moved higher, especially in the frontend (which was sold off so brutally just before the Christmas). The risk reversals are touch higher with 2 month 25d RR paid at 3.6 %. The liquidity is a little better...

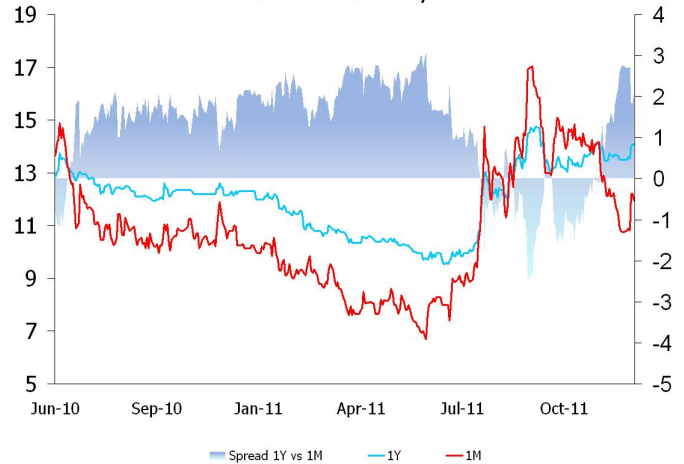
Short-term forecasts

Main supports and resisances
 EUR/PLN: 4.4600 / 4.6000
 USD/PLN: 3.3500 / 3.6000

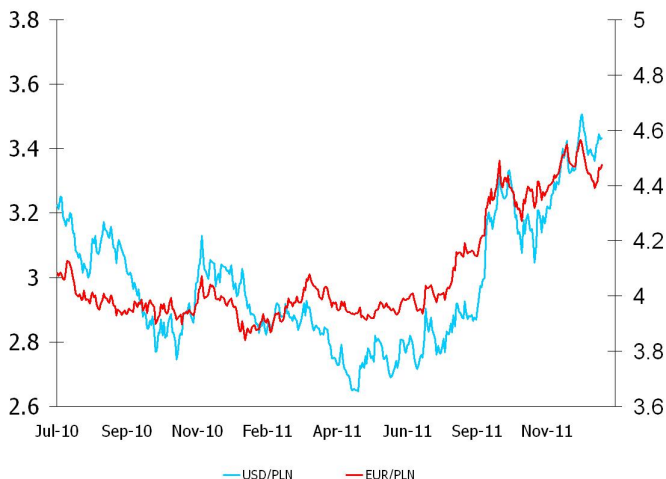
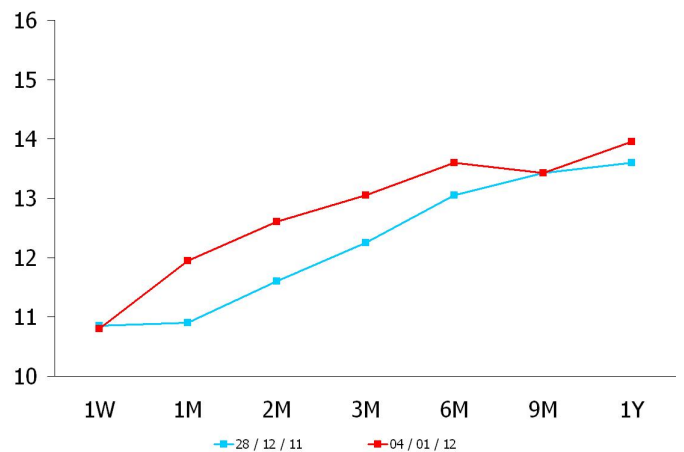
Spot. We are in the middle of the wide 4.40/4.60 range. But with a sour global sentiment (Hungary !) and free falling in EUR/USD, we think the test of 4.60 is more likely. The ideal entry point is 4.47/4.49 zone with a stop at 4.44 and P/T at 4.58/4.60.

Derivatives. We are stubbornly long mid term Vega. We have managed to buy 6 months at 13.1% and we are still on bids, but not chasing the market higher. We are in the middle of the range for volatility from last year, fundamentally we think in current global environment its safer to be long Vega. We are waiting for fresh signals from the market . . .

EURPLN volatility



EUR/PLN volatility curve



Bias from the old parity (%)





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 |
| 12/30/2011 | 4.77 | 4.99 | 4.80 | 4.90 | 4.80 | 4.90 | 4.97 | 4.94 | 4.75 | 4.63 | 4.52 | 4.76 |
| 1/1/2012 | 4.77 | 4.99 | 4.80 | 4.90 | 4.80 | 4.90 | 4.97 | 4.94 | 4.75 | 4.63 | 4.52 | 4.76 |
| 1/2/2012 | 4.63 | 4.99 | 4.95 | 4.90 | 4.64 | 4.90 | 4.94 | 4.92 | 4.74 | 4.63 | 4.53 | 4.75 |
| 1/3/2012 | 4.48 | 4.99 | 4.79 | 4.90 | 4.77 | 4.90 | 4.98 | 4.94 | 4.73 | 4.63 | 4.51 | 4.76 |
| 1/4/2012 | 4.78 | 4.99 | 4.80 | 4.90 | 4.80 | 4.90 | 4.95 | 4.94 | 4.77 | 4.68 | 4.60 | 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 |
| 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 |
| 12/30/2011 | 4.900 | 4.564 | 4.710 | 4.869 | 4.770 | 5.344 | 4.920 |
| 1/1/2012 | 4.900 | 4.564 | 4.710 | 4.869 | 4.770 | 5.344 | 4.920 |
| 1/2/2012 | 4.900 | 4.540 | 4.710 | 4.859 | 4.770 | 5.383 | 4.920 |
| 1/3/2012 | 4.900 | 4.557 | 4.700 | 4.820 | 4.750 | 5.298 | 4.890 |
| 1/4/2012 | 4.900 | 4.571 | 4.780 | 4.815 | 4.810 | 5.303 | 4.960 |

| EUR/PLN 0-delta stradle | | | | | 25-delta RR | | 25-delta FLY | |
|-------------------------|-------|-------|-------|-------|-------------|------|--------------|------|
| Date | 1M | 3M | 6M | 1Y | 1M | 1Y | 1M | 1Y |
| 12/30/2011 | 12.20 | 13.15 | 13.65 | 14.05 | 14.05 | 4.69 | -0.88 | 0.22 |
| 1/1/2012 | 12.20 | 13.15 | 13.65 | 14.05 | 14.05 | 4.69 | -0.88 | 0.22 |
| 1/2/2012 | 12.23 | 13.15 | 13.65 | 14.05 | 14.05 | 4.69 | -0.89 | 0.22 |
| 1/3/2012 | 11.95 | 13.05 | 13.70 | 14.10 | 14.10 | 4.68 | 0.68 | 0.46 |
| 1/4/2012 | 11.95 | 13.05 | 13.60 | 13.95 | 13.95 | 4.83 | 0.17 | 0.61 |

| PLN Spot performance | | | | | | |
|----------------------|--------|--------|--------|--------|--------|--------|
| Date | EURPLN | USDPLN | CHFPLN | JPYPLN | HUFPLN | CZKPLN |
| 12/30/2011 | 4.4168 | 3.4174 | 3.6333 | 4.4082 | 1.4196 | 0.1711 |
| 1/1/2012 | 4.4168 | 3.4174 | 3.6333 | 4.4082 | 1.4196 | 0.1711 |
| 1/2/2012 | 4.4640 | 3.4454 | 3.6668 | 4.4786 | 1.4161 | 0.1751 |
| 1/3/2012 | 4.4597 | 3.4277 | 3.6622 | 4.4601 | 1.4155 | 0.1748 |
| 1/4/2012 | 4.4753 | 3.4320 | 3.6714 | 4.4787 | 1.4009 | 0.1738 |

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