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## Comment on the upcoming data and forecasts

On Wednesday employment and wage data will be published. We expect slightly lower employment growth against last month's reading, but with no sudden deterioration of momentum (stable business tendency indicators). As for wages we estimate a slowdown to 4.0%. Wage dynamics is affected by two main factors: two days less on annual basis and some bonuses in mining sector that have been shifted from November to December. On Thursday PPI and industrial output will be announced. The reading of PPI is under the influence of the rise of oil and copper prices and slightly weaker PLN exchange rate. Producers' price expectations stay elevated (at 5-10pp.). Industrial output's growth pace is expected to decrease significantly. December is the month of contradictions: strong momentum in data, strong basis effects from previous year generated by very long December and strong basis effects comming from energy utilities (warm December). On Friday NBP will announce core inflation. After CPI announcement we estimate that core inflation slightly rose to 3.1%.

### Polish data to watch: January 16 to January 20

| Publication | Date | Period | BRE | Consensus | Prior |
|---|---|---|---|---|---|
| Employment y/y (%) | 18.01. | Dec | 2.40 | 2.40 | 2.50 |
| Wages y/y (%) | 18.01. | Dec | 4.0 | 4.4 | 4.4 |
| PPI y/y (%) | 19.01. | Dec | 8.5 | 8.2 | 8.9 |
| Industrial production y/y (%) | 19.01. | Dec | 3.5 | 6.5 | 8.7 |
| Core CPI y/y (%) | 20.01 | Dec | 3.1 | 3.1 | 3.0 |

### Treasury bonds and bills auctions

| Paper | Next auction | Last Offer | Last yield (%) | Prev auction |
|---|---|---|---|---|
| 52 Week T-bills | 1/31/2012 | 2000 | 4.520 | 1/9/2012 |
| 2Y T-bond OK0114 | 1/19/2012 | 5000 | 4.577 | 8/10/2011 |
| 5Y T-bond PS1016 | 2/9/2012 | 4000 | 5.246 | 10/16/2012 |
| 10Y T-bond DS1021 | 2/16/2012 | 3000 | 5.803 | 1/12/2012 |
| 20Y T-bond WS0429 | 2/16/2012 | 3600 | 5.931 | 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 | 4.0 | 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

## Lower inflation in December

Inflation in December surprised by falling to 4.6% (our expectation 4.8%, market consensus 4.6%) from 4.8% recorded in the previous month. Lower reading was supported by higher statistical base and more moderate (but still high given the seasonal pattern) growth of food prices (+0.9% m/m). Still high remained the growth of fuel prices (+1.2%) and pharmaceuticals (+1.6%; reflecting the after effects of the implementation of the new regulation concerning refunded drugs). Other categories increased only moderately (housing, energy), remained stable (recreation and culture, education, telecommunication) or recorded outright falls (wearing apparel).

We estimate that core inflation went up in November to 3.1%. Next month, owing to statistical base effects connected with VAT changes, headline inflation (and core as well) are set to fall, with headline possibly close or even below 4.0%.

MPC probably acknowledged this figure, but the change of the recent hardened stance is still some weeks away. We think that some of hawkish bias may be take off after January inflation, and along with further softening of the real sphere momentum (as for the longer perspective see the piece on MPC meeting below).

## MPC has adjusted to current data

MPC left rates unchanged and the wording of the statement was adjusted to the current inflow of data. Specifically, the MPC explicitly stated that the risk of elevated inflation in the forthcoming months has risen. Moreover, the scale of GDP slowdown is lower than expected so far. As a consequence Belka reasoned that in such an environment the probability of rate cuts is lower.

As we excepted such a wording, we are not scared. First of all the MPC still has a huge load of backward looking reasoning. They would rather stick to the data already seen than try to formulate expectation with regard to the future. Therefore the so far strong momentum leaves no other option than to stick to hawkish bias (or even strengthen it), the more so since the MPC sees little risk to real sphere stemming from domestic developments. It has also merits in terms of stabilizing exchange rate (so far the main source of inflation increases). We think that as soon as inflation levels off below 4% and GDP growth fades (the first important GDP reading will be published at the end of May), MPC will not have any objections for lowering interest rate. The more so since Belka is famous for rapid view changes and would not object such a move (or even support this when fiscal consolidation will be implemented as planned) and even minor adjustment may prove more effective than in the past because of the change in structure of new credit flow, this time mostly PLN denominated.

## Green light for cancelling excessive deficit procedure by European Commission against Poland in 2013

European Commission (EC) acknowledged that Poland among three other countries (Belgium, Malta and Cyprus) except Hungary made significant and adequate improvement in fiscal consolidation effort aiming to reduce excessive general government deficit. Poland has been obliged by EC in mid-2009 to reduce excessive deficit by the year of 2012. The positive assessment of Polish fiscal consolidation efforts that denote the erase of excessive deficit by the year of 2012, means automatically the lack of necessity to take additional measures by EC against Poland in the area of excessive deficit procedures and allow canceling it finally in 2013.

Economy commissioner Olli Rehn indicated during conference speech that Polish general government deficit will amount in 2012 to slightly over 3% of GDP. Moreover, the strength of Polish economy has been noted. EC in November's forecasts has foreseen higher Polish general government deficit at around GDP 4%, much higher than Polish authorities forecast (2.9%). According to economy commissioner's clarification, this autumn forecasts did not include pension reform and additional fiscal measures effects that have been taken recently by Polish authorities. That is why the Polish government forecasts differed from EC forecasts. All these measures have been precisely introduced in Minister's of Finance letter of 21th December 2011, addressed to economy commissioner. Undertaken efforts allow credible reduction in excessive general government deficit, what was ultimately admitted by Olli Rehn. Thanks to fiscal consolidation and its positive assessment by EC, Poland will avoid consequences arising from new regulations referred to so-called „six pack" that went into effect from mid-December 2011. In case of permanent breach of general government deficit limits foreseen in European Treaties by countries from outside of euro area, the so-called „six pack" give EC possibilities to publicize weaknesses of national fiscal budgets and even implement fiscal sanctions. These sanctions probably will be implemented against Hungary.

Favorable EC decision in the area of excessive deficit procedure and positive assessment of Polish economy support PLN and debt market as well. Our estimates of deficit reduction to the level of 3% of GDP are very close to Polish authorities and EC forecasts. We consider that even in case of worse economic scenario (1% recession) Poland can align with the target deficit by using additional savings and revenues (over PLN 25 bn). According to our estimates, public debt (according to domestic accounting rules) amounted to GDP 53.9% in 2011 and will amount to GDP 53.5% in 2012, i.e. below the second prudential limit foreseen in the public finance act. In turn, the general government debt (EU accounting methodology) according to our assumptions in 2011 amounted to GDP 56.9%. Significant difference in amounts between domestic and EU methodology arises from State Road Fund debt, that finances infrastructure investments.

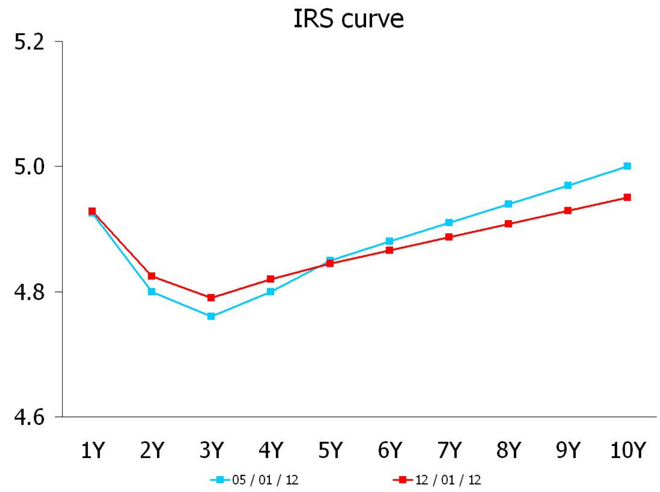
# Fixed income

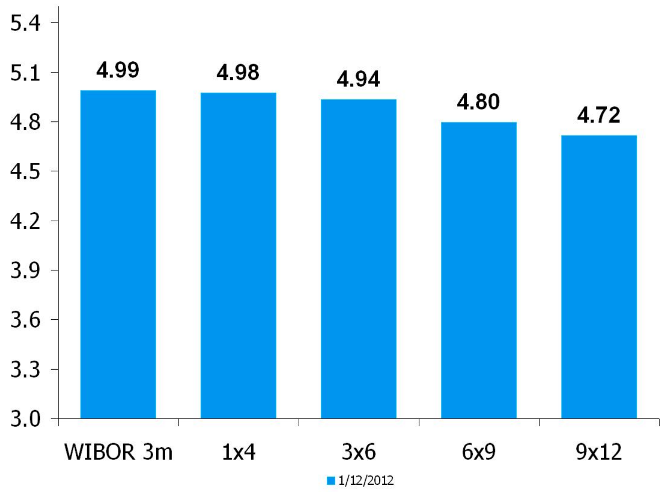
## Flatteners

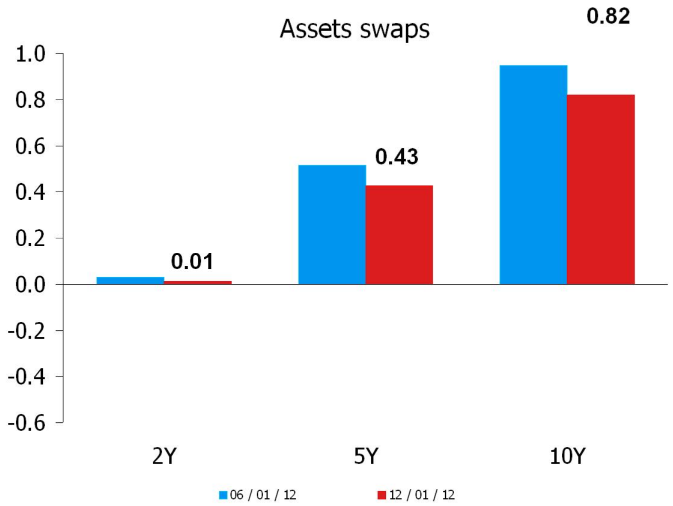
After he Hungarian bear market had vanished on Monday morning, the bulls returned with the double impact on PLN longer dated bonds. That resulted in further flattening of a yield curve especially in 2y5y that traded down at +1. The first regular treasury bonds auction this year attracted quite a good demand yielding 5.25% on 5Y PS1016 benchmark.

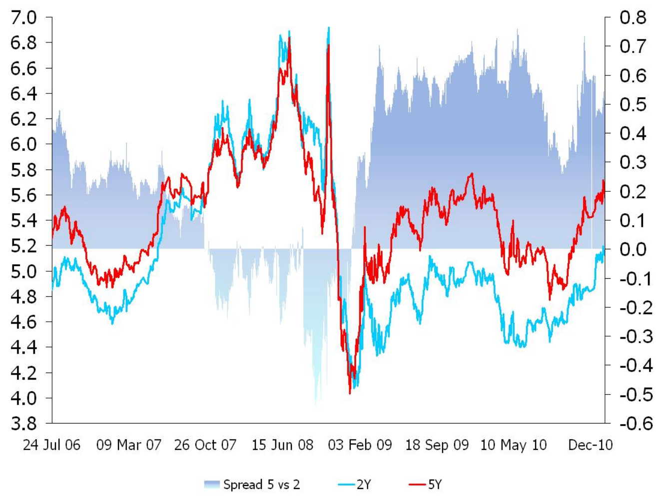
The MPC meeting on Wednesday did not bring any change in monetary policy parameters although the rhetoric had been changed a little bit towards more hawkish stance. The Council maintained its belief the CPI would have stayed in a higher level for the next couple of months but it also stressed the possible economic slowdown in Poland should not be so deep as it previously expected and the turmoil in EU would not jeopardize substantially the domestic economy. As a result, the probability of a rate cuts in the first half of a year slightly decreased.

In our view, even if CPI stays elevated in the Q1 the „gravity" of the rate cuts would likely be moved to the second half of 2012 making 1y1y fwd quite attractive to receive at current levels. Regardless the chaotic trading from the very beginning of a year and sometimes huge interests on a particular point of a yield curve (steepeners stop losses) we would prefer to receive on a local highs.



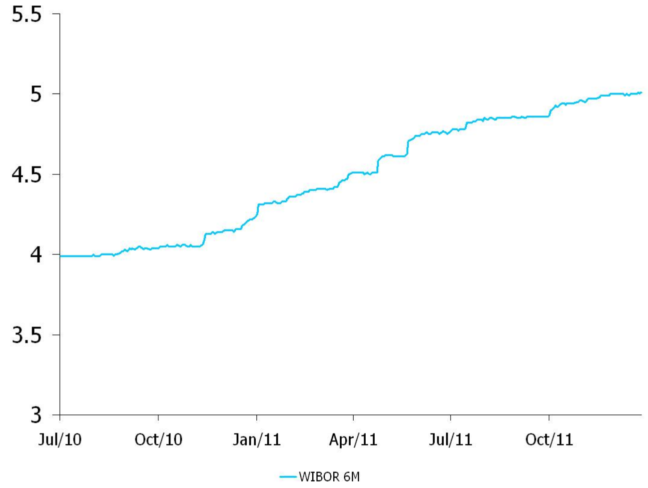
# Money market

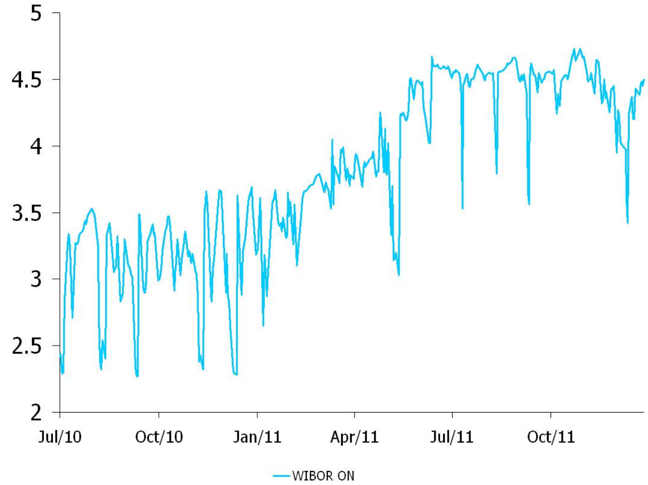
## Stable carry. MPC more hawkish. New on-the-run T-bill.

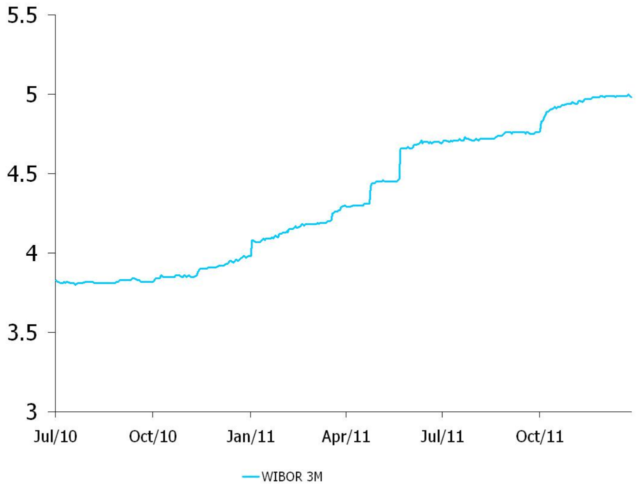
Cost of carry stable and nearby the main market rate. Can be a bit lower next week after today's OMO (87 bln pln bought out of 90.5 on the offer) unless the Tuesday brings the additional one.

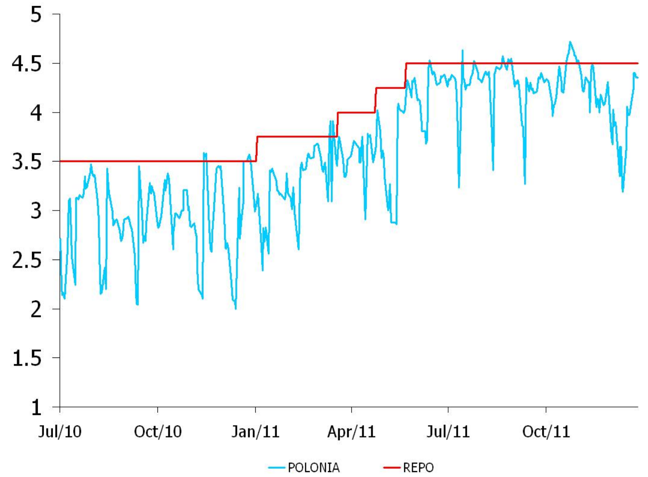
Positive sentiment for the short end despite the Hungarian turmoil and expected higher local CPI figure. Even quite hawkish MPC conference did not push the rates up. It seems that consensus for rates cuts this year is strong and driving the sentiment, plus was well supported by the stronger zloty and good week for the stock exchange. We think that this optimism is a bit premature and that we will see higher levels soon. The MPC rhetoric postpones the potential easing, which now is more probable in Q3 then Q2.

T-bills auction was held on Monday after over 6M break. It came better then expected not only in the bid-to-cover ratio terms (2.5) but also in a yield term, which was higher than expected (4.52% vs 4.45%). The one price auction (the change made this year) was in favour of the market this time.



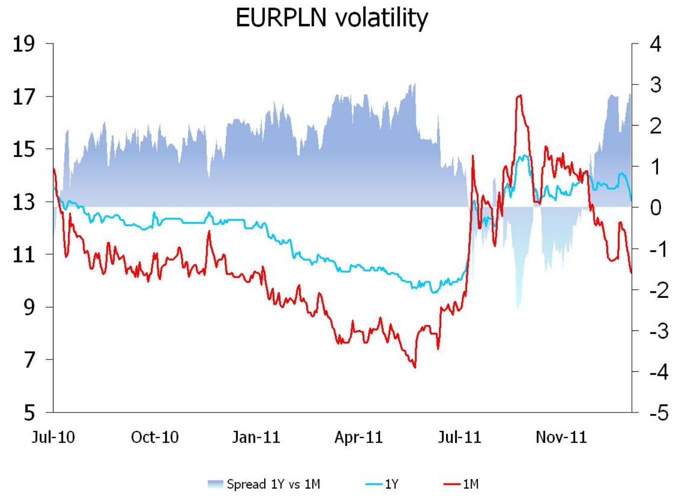



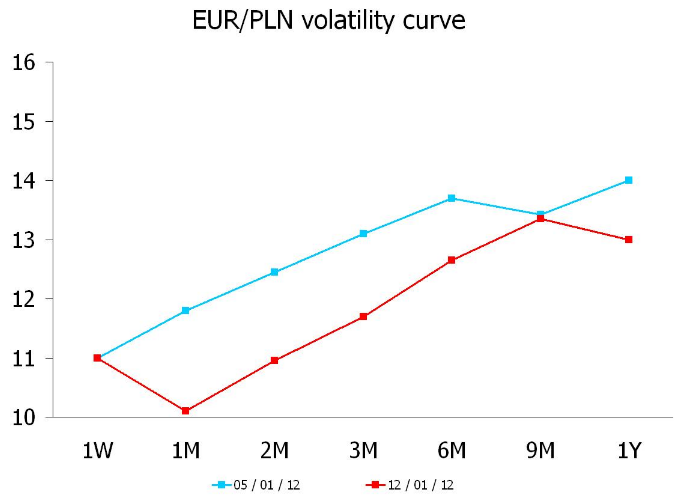



## Forex

**Zloty shorts squeezed.** The Zloty shorts were squeezed out with vengeance. After touching 4.5235 this year high, the EUR/PLN collapsed to 4.3950, the move bellow 4.4300 was fuelled by the wave of stop losses. The better global sentiment (good bond auctions) was of course the factor, but the real reason behind the sharp move down was really crowed trade aiming 4.70 in EUR/PLN. It was a recommendation of the main investments houses, and the market was caught short PLN. Bigger picture is unchanged, range moved down a little and it s now 4.30/4.55.




**Vols collapsed.** The ATM's Volatility, the skew, and currency spread (difference between USD/PLN and EUR/PLN), all was hammered hard. The fresh optimism is winning. The 1 month moved down from 12% to 9.25% (23% percent of nominal value!), 6 month from 13.6% to 12.1% (11% percent of nominal value!), 1 year is now 12.2% versus 13.85% last week (12% of nominal value!). 1 year 25D Risk reversals dropped from 5.4% to 4.5%, 3m 25d RR is now 3.3% versus 4.2% last week. Currency spread is down from 9% to 7.5%. Well the move was dramatic and that's probably overdone, we expect same correction up, next week.

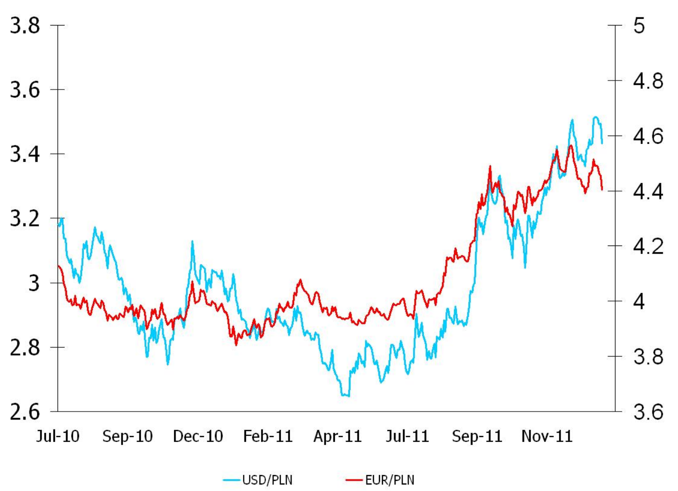


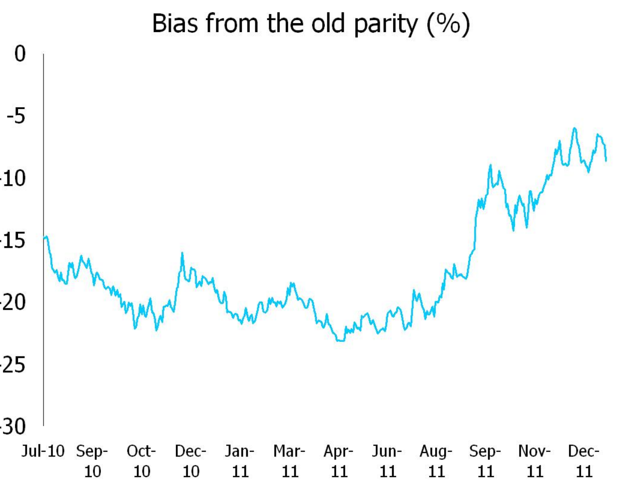

### Short-term forecasts.

Main supports and resisances
EUR/PLN: 4.3000 / 4.5500
USD/PLN: 3.3500 / 3.5000

**Spot.** We were stopped out on our long EUR/PLN position at 4.4300. But we are not really convinced the crisis is over. In our opinion the range simply moved down a little and it is 4.30/4.55 now. Consequently we are better bids in 4.35/4.37 region with 4.33 s/l and hoping for move to 4.45.

**Derivatives** We were stopped on our long Vega position. The market gapped lower violently in the way that, usually was reserved to up moves (crisis situations). Sidelined at the moment.



# 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 |
| 1/5/2012 | 4.81 | 4.99 | 5.00 | 4.90 | 4.93 | 4.90 | 4.97 | 4.94 | 4.78 | 4.68 | 4.63 | 4.80 |
| 1/9/2012 | 4.66 | 4.99 | 4.39 | 4.90 | 4.69 | 4.90 | 4.96 | 4.94 | 4.74 | 4.64 | 4.61 | 4.76 |
| 1/10/2012 | 4.61 | 5.00 | 4.41 | 4.91 | 4.74 | 4.91 | 4.98 | 4.96 | 4.76 | 4.66 | 4.61 | 4.76 |
| 1/11/2012 | 4.61 | 4.99 | 4.79 | 4.90 | 4.74 | 4.90 | 4.98 | 4.96 | 4.78 | 4.70 | 4.66 | 4.81 |
| 1/12/2012 | 4.61 | 4.99 | 4.64 | 4.91 | 4.64 | 4.91 | 4.98 | 4.94 | 4.80 | 4.72 | 4.67 | 4.82 |

| 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 |
| 1/5/2012 | 4.900 | 4.568 | 4.800 | 4.830 | 4.850 | 5.365 | 5.000 |
| 1/9/2012 | 4.900 | 4.566 | 4.770 | 4.815 | 4.840 | 5.368 | 4.970 |
| 1/10/2012 | 4.910 | 4.557 | 4.760 | 4.816 | 4.840 | 5.383 | 4.940 |
| 1/11/2012 | 4.900 | 4.533 | 4.820 | 4.828 | 4.850 | 5.383 | 4.960 |
| 1/12/2012 | 4.910 | 4.544 | 4.825 | 4.837 | 4.845 | 5.273 | 4.950 |

| EUR/PLN 0-delta stradle | | | | | 25-delta RR | | 25-delta FLY | |
|---|---|---|---|---|---|---|---|---|
| Date | 1M | 3M | 6M | 1Y | 1M | 1Y | 1M | 1Y |
| 1/5/2012 | 11.80 | 13.10 | 13.70 | 14.00 | 14.00 | 4.84 | 0.37 | 0.66 |
| 1/9/2012 | 11.05 | 12.15 | 13.20 | 13.60 | 13.60 | 4.84 | 0.37 | 0.66 |
| 1/10/2012 | 10.65 | 11.95 | 12.85 | 13.45 | 13.45 | 4.83 | 0.48 | 0.67 |
| 1/11/2012 | 10.30 | 11.80 | 12.70 | 13.05 | 13.05 | 4.83 | 0.43 | 0.97 |
| 1/12/2012 | 10.10 | 11.70 | 12.65 | 13.00 | 13.00 | 4.83 | 0.37 | 0.67 |

| PLN Spot performance | | | | | | |
|---|---|---|---|---|---|---|
| Date | EURPLN | USDPLN | CHFPLN | JPYPLN | HUFPLN | CZKPLN |
| 1/5/2012 | 4.5135 | 3.5081 | 3.7037 | 4.5679 | 1.4020 | 0.1742 |
| 1/9/2012 | 4.4902 | 3.5150 | 3.6940 | 4.5727 | 1.4302 | 0.1740 |
| 1/10/2012 | 4.4883 | 3.5083 | 3.7015 | 4.5659 | 1.4292 | 0.1738 |
| 1/11/2012 | 4.4645 | 3.4919 | 3.6807 | 4.5396 | 1.4358 | 0.1733 |
| 1/12/2012 | 4.4532 | 3.4945 | 3.6756 | 4.5397 | 1.4361 | 0.1733 |

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