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Comment on the upcoming data and forecasts

The data set is rather unexciting for the upcoming week. Nevertheless, inflation expectations are set to be published. Taking into accout the usual correlation with past inflation data we expect a rise towards 4.5-4.6%. As for other publications, quarterly C/A figures are set to see the light. Owing to the enhancement and broadening of the sample (standard in quarterly data) we expect amplification of the short-term trend, therefore a larger C/A deficit than posted by monthly data.

This is the last Weekly edition for this year. Therefore we wish you all Merry Christmas and happy New Year. We will be back in January.

Polish data to watch: December 26 to December 30

Publication	Date	Period	BRE	Consensus	Prior
C/A balance (EUR bn)	30.12	Q3			-3.4
NBP expectations inflation (%)	30.12	Dec	4.6		4.2

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	12.8
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	2.8	3.1
CPI Inflation y/y (average %)	3.7	4.2	4.1	4.6	3.8	3.3
Repo rate (end of period %)	4.0	4.5	4.5	4.5	4.5	4.0

F - forecast

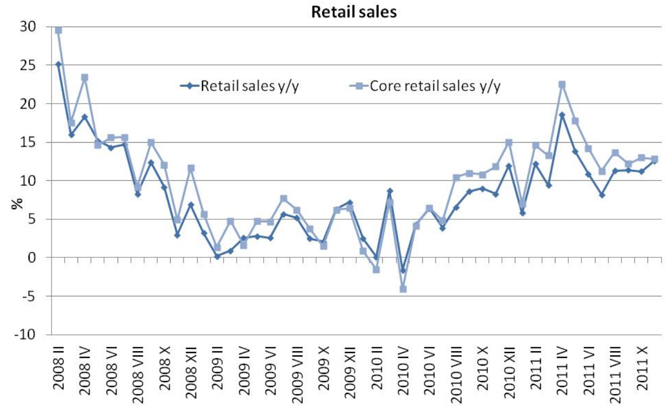
Economics

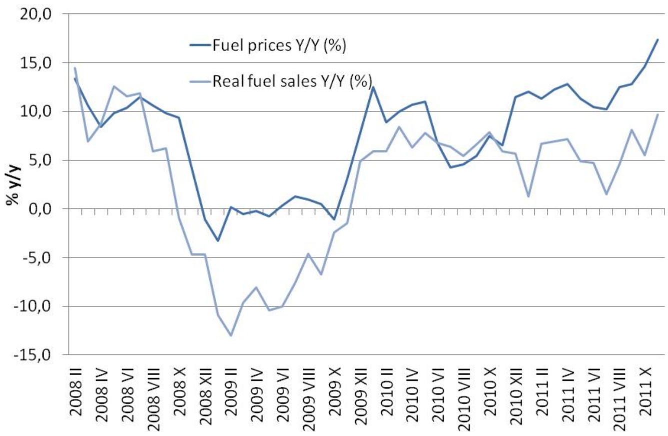
Industrial output continues to grow vigorously. Retail sales follows, but mainly in nominal terms.

Despite unfavorable economic environment in global markets, industrial output is still marching on with no signs of momentum deceleration. We link this resilience with exchange rate weakness, helping to unclog trade channels. This resilience does not spread to retail sales. Although it staged impressive 12.6% YoY, much of it comes from price effects and volatile categories. Hence, we find positive scenarios for consumption, formulated on the basis or current retail sales, as a bit cumbersome. Let's turn to details.

Industrial output in November rose by 8.8% YoY against 7.8% YoY in October. In seasonally adjustment terms growth rate amounted to 9.2% YoY against 7.0% in October. Diffusion index is still at a high level. The increase was recorded in 26 of 34 sections (in last month 25, and two months ago 24), what means that solid activity is broad based. The growth was recorded especially in export sections (such like manufacture of metal products +18.6% and manufacture of vehicles +14.9%). Output is supported by weak exchange rate and rising competitiveness of Polish exports. The rising competitiveness on the one side partly mitigates weakening external demand and, on the other side, coincide with strong cyclical domestic demand, which in recent time in greater extent shifted from infrastructure investment projects to enterprise investment projects (business equipment).

Retail sales in November rose by 12.6% YoY against 11.2% YoY in October. The aggregate after excluding food and fuels remained only stable. Diving into details, November was another month of decelerating vehicle sales and, on the contrary, accelerating fuel sales, of which growth pace amounted to +27.1% YoY. What caught our attention is a strange behavior of real fuel sales reaction for price rises which we observed lately on a monthly basis. Deeper scrutiny and longer plot shows that this is not a local aberration but a usual tendency. As we do not know the theory which propels retail fuels sales (in small open economy) along with the rise in their prices we have to blame poor data quality (more technically, even after stripping price effect, the real growth of fuels still has strong nominal component within...). Turning to other categories, food prices also heavily contributed to the nominal increase in sales of the whole category, 3% against 3.3% in previous month (in real terms monthly growth stayed at sub-zero level). Retail sales in unspecialized shops remained at quite high level, it amounted to almost 30% (effects of November 1st and 30th); it is a small-weight category, though. Sales growth in furniture, TV and home appliances slightly decreased (6.5% against 10.1% in previous month) which fits natural variance. Quite big surprise was invoked by other categories in retail sales, where increase amounted to 17.1% YoY (a very volatile and heavy-weighting category).





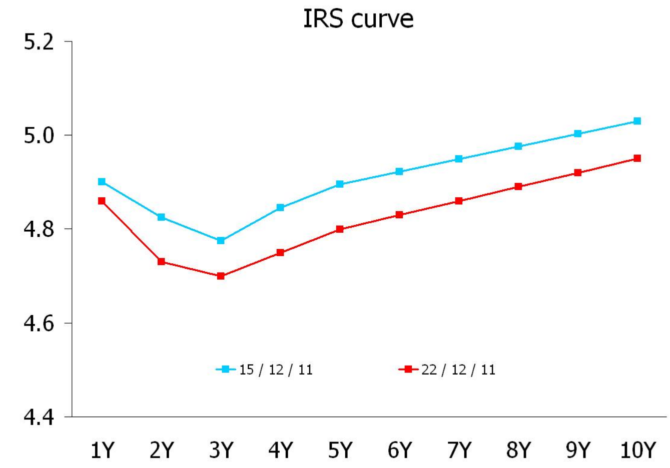
Data should be interpreted with caution. It is definitely a good point that retail sales does not indicate a sudden stop of private consumption. However, the structure of data - propelled by price movements and volatile categories, suggests the adjustment moment is looming quickly. Therefore we are not impressed by the data (although we cannot exclude a one more surprise in December as the data are presented in seasonally unadjusted terms) and thrive in a scenario of consumption deceleration in 2012, driven mainly by price effects, balance sheet adjustments and slightly weaker labor market.

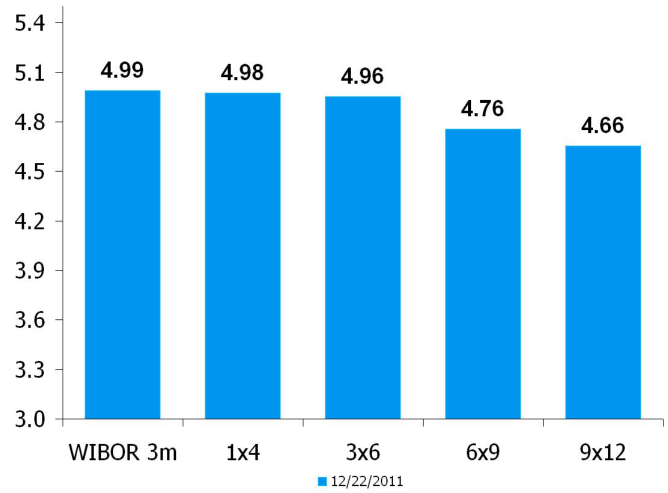
Strong current inflow of the data (for now - regardless of its sustainability) will support MPC hawkish bias in the context of high inflation. We assume that along with weakening economic performance and consumption (combined real, nominal and basis effects) MPC rhetoric will concentrate more on real sphere of economy. Along with the decrease in inflation it will open some room to interest rate cuts, which - in our opinion - can take place in Q2.

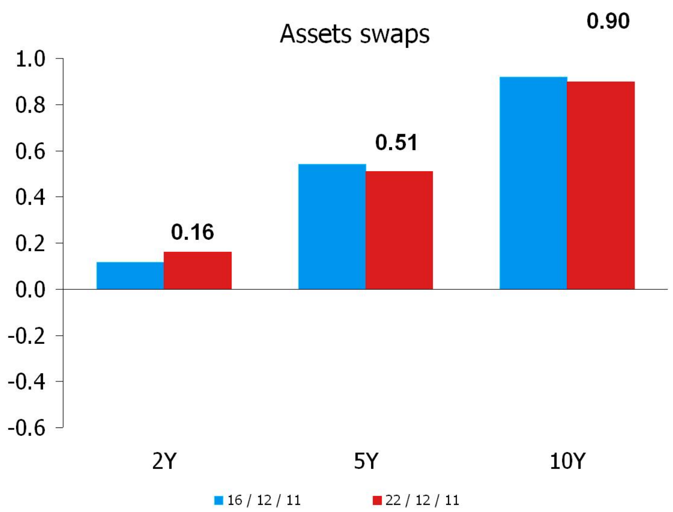
Fixed income

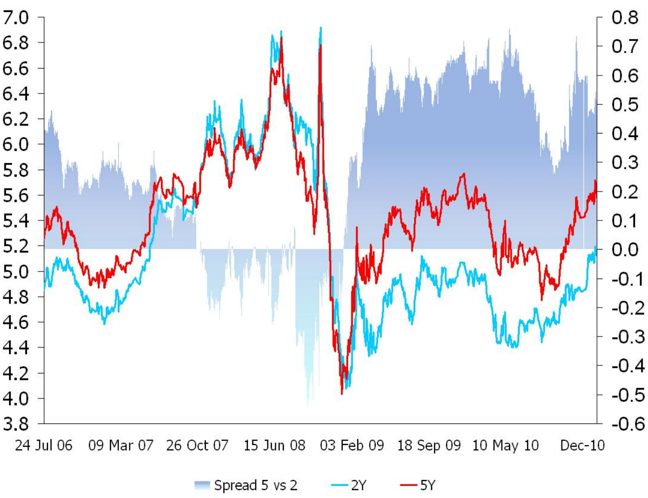
Let's wait.

Holiday activity has reached PLN rates market. Despite quite handsome news flow (IP, PPI, retail sales, core CPI, minutes) market remained unaffected. One has to admit though, that if it had not been the last weeks of the year, the data should have made an impression. Economic activity is not slowing down, and CPI is staying stubbornly high. Other thing is that European Central Banks (ECB, Norwegian, Swedish, Danish) are already cutting rates, so open question is when window of opportunity will open for NBP to follow. It is rather clear that Poland will not follow Hungarian's. The diffrences are more than visible, Poland is „the golden boy" preserving Central Bank independence, pursuing fiscal reforms, supporting EU and IMF. All that we are now left with is actually waiting for CPI to fall back, growth to moderate, investors to fall back in love with Polish bonds and PLN to appreciate. Actually it is only one of the above that is needed to have much lower rates, and probability of such event is definitely not priced in the by market, fortunately, as there is still time to put ones position on. Rest is just waiting.







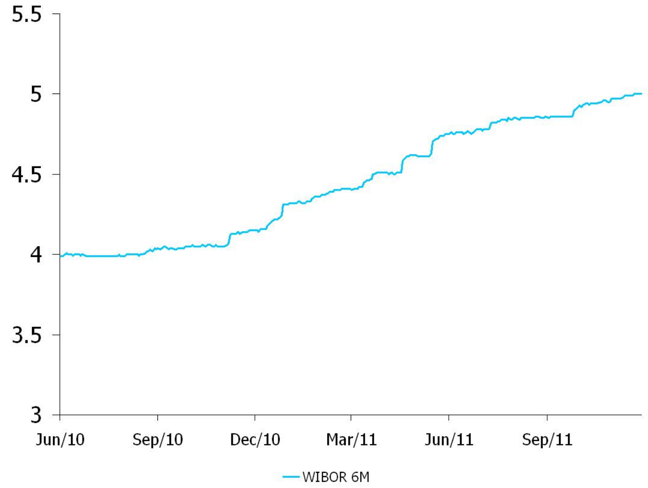


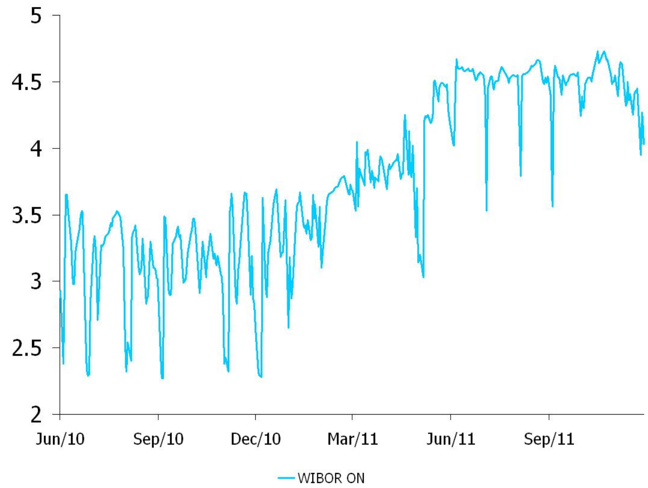
Money market

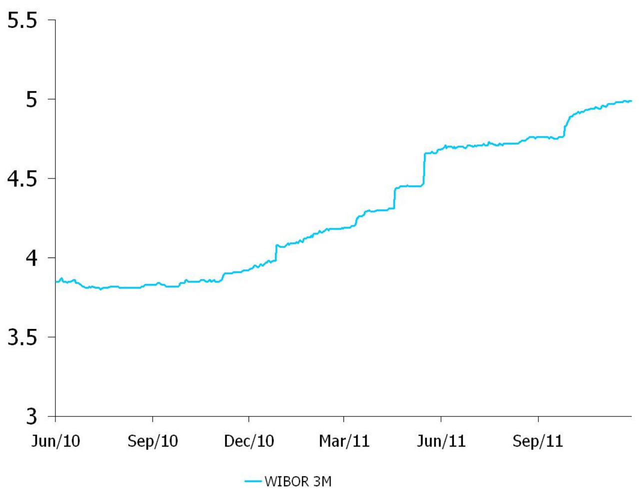
Carry cheaper and cheaper. Bearish figures vs bullish sentiment.

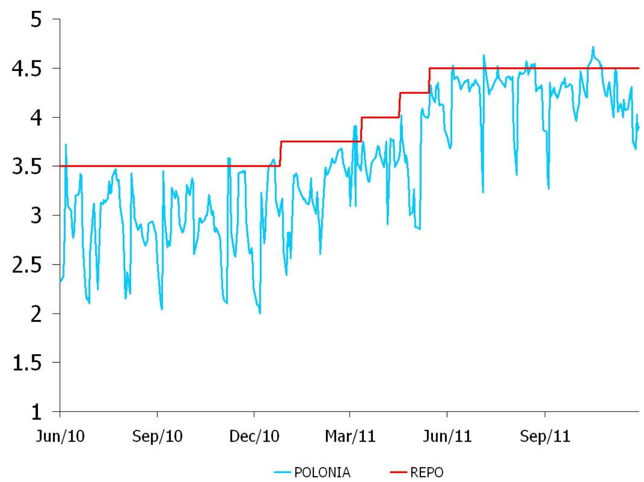
Cost of carry still down in line with our forecast, and now we can be almost certain that it can be only cheaper those few days forward to the year end. Although we do have OMO ahead today, we think that risk aversion wins and the carry will fall further.

Christmas mood is already here, therefore neither higher core CPI (3%) nor high retail sales (12.6%) were reflected in any price movement. Sentiment is rather positive and strongly supported by strengthening pln.









Forex

Zloty stronger. The Zloty is much stronger, approaching the strong support at 4.4250, without the BGK actually touching the market (selling hard currency). He was seen on the toy several times but he was not selling USD nor EUR on the market directly. It is not, that the world is in better shape, it rather that, sellers of PLN simply have decided to wait till next year, when the threat of direct interventions would be minimal. The BIG question is now, what BGK would do on the last days/day of the year?. Would they will be satisfied with the current EUR/PLN rate and stay away from the market, or as they saved „ammunition" for that day it would have to be unloaded anyway...

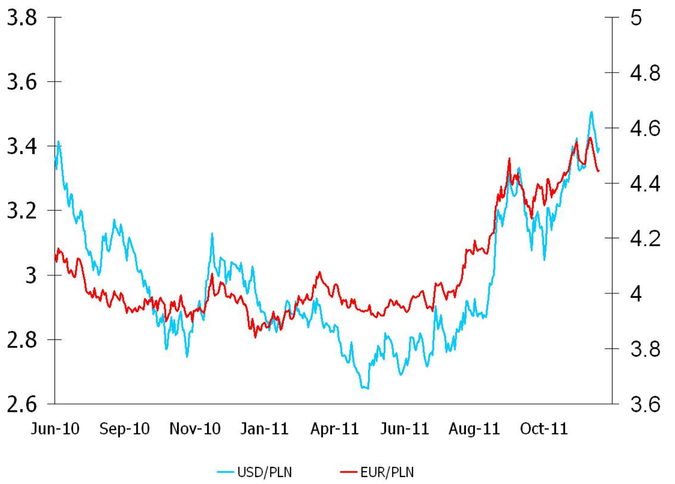
Vols lower. What seemed low levels last week (frontend), it is even lower today, with 1 week mid 9.25% vs 10.50% last week and 1 month 10.25% mid vs 11.00% last week. In the mid/back end the 6 month were traded at 13.1%, only to be paid at 13.5% on the nest day and came back offered at 13.40%, 5 minutes later. That alone describes perfectly the state of mind of the market... and we do not think it will change this year. The currency spread (difference between USD/PLN and EUR/PLN) is being slashed nowadays, it already lowered about 2% in last few weeks hovering just above 8% from above 10 recently. Is it a structural change or simply theta related sells is still to be determined.

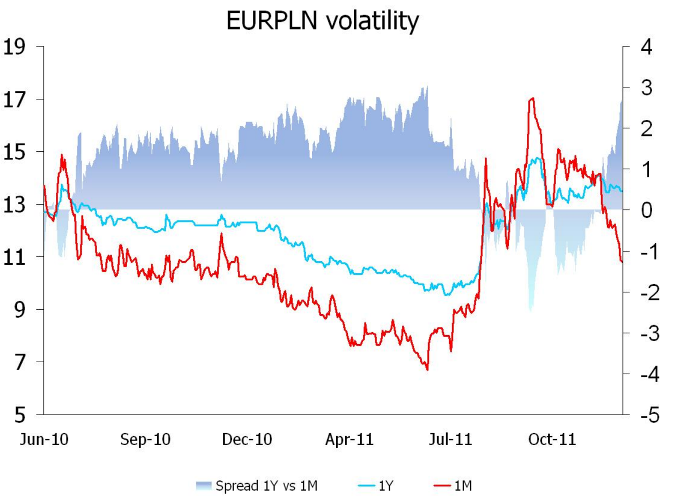
Short-term forecasts

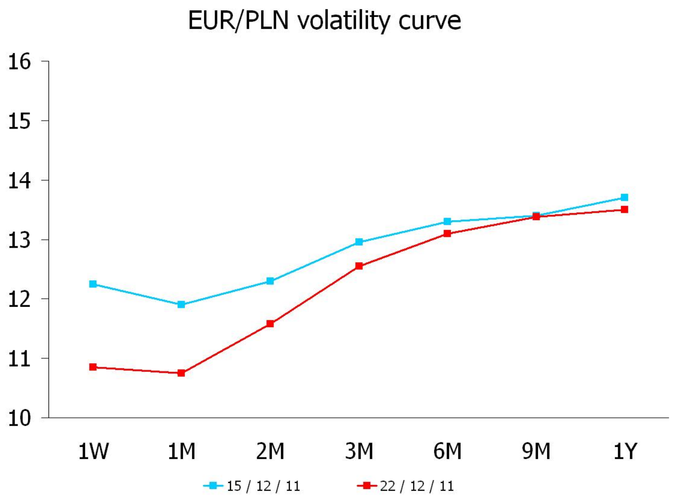
Main supports and resisances
EUR/PLN: 4.4000 / 4.6000
USD/PLN: 3.3500 / 3.5500

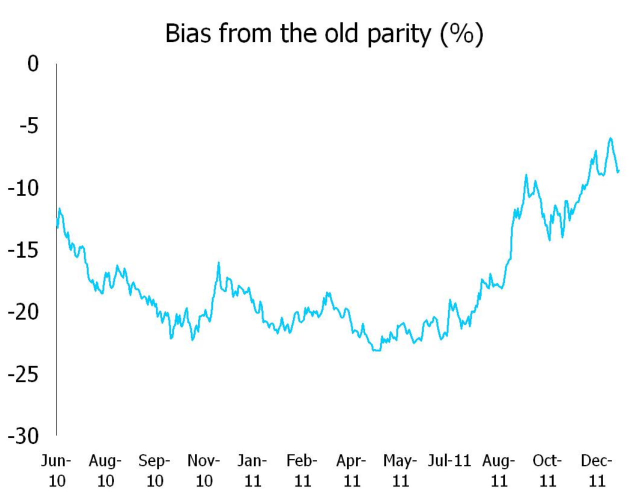
Spot. We are currently at the bottom of the range, and we are becoming more eager to buy EUR/PLN on dips. We cannot exclude the GBK will be active on the last days/day of the year but it should be followed by the correction higher on the beginning of the new year. Our ideal entry point is 4,38/4,41 with a stop bellow 3,35 and target 4,50/4,53. The trade is recommended in 1/2% of the usual trading amount as the liquidity is poor and that won't be any better...

Derivatives. We are stubbornly long mid term Vega . We have managed to buy 6 months at 13,1% and we are still on bids around, slightly bellow 13%... None of the structural problems of the European debt was solved, just yet. We look forward for a new wave of increased volatility, from the beginning of the New Year...




EURPLN volatility
19
17
15
13
11
9
7
5
4
3
2
1
0
-1
-2
-3
-4
-5
Jun-10
Sep-10
Dec-10
Apr-11
Jul-11
Oct-11
Spread 1Y vs 1M
1Y
1M


EUR/PLN volatility curve
16
15
14
13
12
11
10
1W
1M
2M
3M
6M
9M
1Y
15 / 12 / 11
22 / 12 / 11


Bias from the old parity (%)
0
-5
-10
-15
-20
-25
-30
Jun-10
Aug-10
Sep-10
Nov-10
Jan-11
Feb-11
Apr-11
May-11
Jul-11
Aug-11
Oct-11
Dec-11

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
12/16/2011	4.82	4.99	4.78	4.90	4.78	4.90	4.98	4.95	4.76	4.68	4.61	4.77
12/19/2011	4.85	4.98	4.79	4.90	4.79	4.90	4.97	4.95	4.78	4.67	4.60	4.79
12/20/2011	4.82	4.99	4.80	4.90	4.85	4.90	4.98	4.95	4.76	4.67	4.59	4.78
12/21/2011	4.75	4.99	4.79	4.90	4.79	4.89	4.97	4.94	4.75	4.65	4.52	4.76
12/22/2011	4.85	4.99	4.96	4.90	4.90	4.89	4.98	4.96	4.76	4.66	4.55	4.78

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
12/16/2011	4.900	4.823	4.765	4.882	4.825	5.367	4.975
12/19/2011	4.900	4.815	4.760	4.906	4.830	5.355	4.970
12/20/2011	4.900	4.817	4.740	4.879	4.810	5.321	4.960
12/21/2011	4.890	4.619	4.730	4.885	4.800	5.322	4.950
12/22/2011	4.890	4.814	4.730	4.890	4.800	5.310	4.950

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1M	1Y
12/16/2011	11.60	12.90	13.25	13.65	13.65	5.01	0.62	0.76
12/19/2011	11.48	12.80	13.25	13.65	13.65	5.01	0.62	0.76
12/20/2011	10.90	12.55	13.10	13.50	13.50	4.86	0.90	0.81
12/21/2011	10.80	12.55	13.10	13.50	13.50	4.68	0.56	0.82
12/22/2011	10.75	12.55	13.10	13.50	13.50	4.68	0.61	0.82

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
12/16/2011	4.5094	3.4586	3.6842	4.4425	1.5006	0.1788
12/19/2011	4.4910	3.4470	3.6828	4.4257	1.4772	0.1778
12/20/2011	4.4635	3.4148	3.6634	4.3811	1.4755	0.1759
12/21/2011	4.4424	3.3793	3.6391	4.3440	1.4748	0.1744
12/22/2011	4.4438	3.3933	3.6352	4.3458	1.4499	0.1735

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