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Comment on the upcoming data and forecasts

On Friday retail sales and unemployment data will be published. We expect lower retail sales growth due to base effect from the previous year (mainly on cars and fuels) and difference in working days (minus 2 in December 2011). However, we have to admit an upward risk to the forecast given the higher realisation of industrial output (the link is statistically sifgnificant). The Ministry of Labor announced that unemployment hit 12.5% in December. Given the more pronounced drop in employment, we expect the final figure to be 12.6%.

Polish data to watch: January 16 to January 20

Publication	Date	Period	BRE	Consensus	Prior
Retail sales y/y (%)	27.01.	Dec	10.0	10.6	12.6
Unemployment rate (%)	27.01.	Dec	12.6	12.6	12.1

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	3/14/2012	6000	4.724	1/19/2012
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

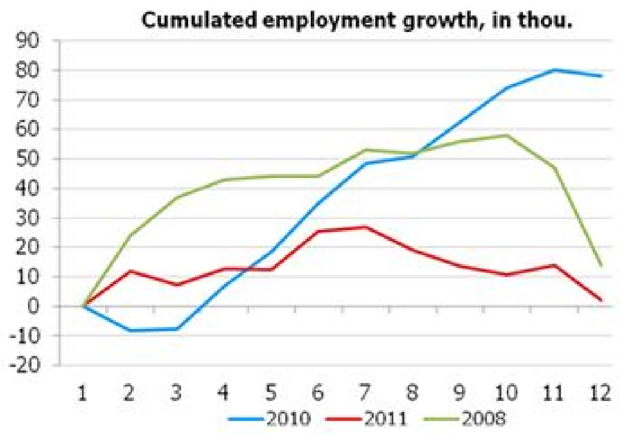
	2011 Q1	2011 Q2	2011 Q3	2011 Q4 F	2012 Q1 F	2012 Q2 F
GDP y/y (%)	4.5	4.3	4.2	4.0	3.6	3.0
CPI Inflation y/y (average %)	3.7	4.2	4.1	4.6	4.1	3.7
Repo rate (end of period %)	4.0	4.5	4.5	4.5	4.5	4.5

F - forecast

Economics

Disappointing growth of employment

Enterprises shed 12k jobs in December, generating sub-consensus annual growth of 2.3%. The number falls short of our expectations, especially given mild winter, high inertia of various employment sub-categories and stability of business tendency indicators. Therefore the reading poses some risk on labor market, however in our case it is only the timing (not the scale of the slowdown) which is a surprise. We confirm we expect fall in 2012 employment, but in a much more moderate scale than in 2009 given the earlier beginning of adjustment, more flexible regulation (variable hours worked) and more solid financial results of companies.



Corporate wages stabilized at 4.4% y/y in December. Given the moderate weakening of the labor market we expect these rate of growth to persist going forward.

Robust manufacturing growth

In December, Polish industrial output increased by 7.7% y/y after it recorded 9.1% increase in November. In SA terms industrial output even sped up from 9.2% to 9.5% y/y.

One should note that, so far, there are no tangible signs of economic slowdown in industrial sector. The diffusion index stabilized at the very high level - 26 out of 36 sections for the second consecutive month recorded positive annual growth rates. These are both exports oriented and domestic demand oriented sections which drive the industrial output at the moment. The zloty is definitely one of key factors boosting competitiveness of the industry and leading to massive substitution effects - more costly imports are being substituted by domestic production. We also detect an increasing importance of private investment demand which is set to offset a former engine of growth, the infrastructure investment.

Turing to short-term perspectives, December's growth of output does not mark a local high given the fact that in January 2011 there were fewer working days, composition of holidays favored merging day offs into long weekends and air temperatures were relatively low. What is more, our estimates suggest that Q4 GDP may have slightly exceeded 4.0% which is truly a stunning number given the trajectory of national accounts followed by e. g. Germany. As construction industry recorded 14.6% growth which composition favors infrastructure projects, it also supports our view that investment (as measured in GDP) should have exceeded 9% on annual basis in Q4.

Thinking more in mid-term, business activity indicators (as published lately by NBP) suggest the changes in current and expected situation within enterprises are minor. Even though there is some deceleration in demand expectations it is running in a relatively moderate way, therefore much more benign than in 2008/2009.

As far producer prices are concerned, they hit 8.1% on annual basis, a marked deceleration from a high o 9.1% recorded a month ago. However, as we look into the core PPI (0.5% mom vs 0.6% last month) the loss of momentum is minor. Therefore base effects are responsible for much of the deceleration. Given the robust growth of industrial output, inflationary momentum in producer prices is here to stay.

Rate cuts postponed

While labor market weakens moderately (the one and only dark spot in the recent releases), data from industrial sector provide nothing but a confirmation of recent very optimistic MPC view. Polish MPC, as it was the case in summer 2011, is now pretty sure of what to be done with the rates. In the summer the MPC was convinced that the rates should go up, now that they should stay where they are, which is confirmed by recent comments from MPC members (Hausner, Zielińska-Głebocka). What is more, Glapinski reveals his surprisingly hawkish attitude („rate hike if CPI stays above 4% by the end of Q1'12"). Nevertheless such opinions should be taken with a pinch of salt as they do not represent majority view. Moreover let us remind that the Committee had changed its mind in the Summer due to macro factors. This time around, one will have to wait longer for such an impulse but finally one's expectation (and following it monetary policy loosening) should come true. However, given the momentum in the data expectations for rate cuts are unlikely to pop up soon, the more so since the new inflation projection (to be published in March) is likely to show higher inflation (which according to our forecasts is to stay above 4% level for few months) and higher GDP growth (a 3% plus for this year). All in all we shift rate cuts into H2 grom Q2.

The above described expected (and current) behavior of the MPC may be perceived by investors as a sign of responsibility. Therefore it should support the zloty and the reduction of risk premia in long-dated bonds.

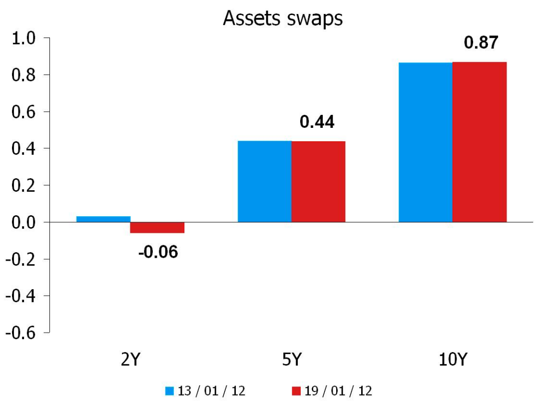
Fixed income

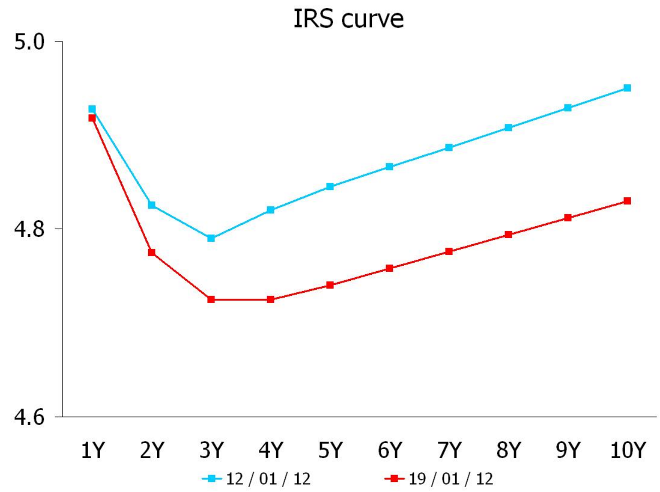
Everybody is doing good job

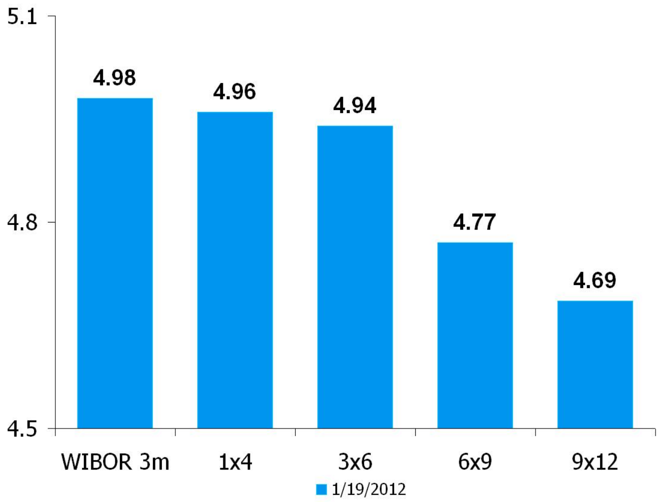
Last week we had nice volatility on PLN rates and bonds. Main event were data releases and auction in OK0114 bond. MPC members were also quite vocal and spoke in surprisingly hawkish tone. The blueprint of the week was very good performance of bonds and rates especially in 5y and 10y tenors. We saw nice inflows into bonds especially on the 2y bond auction which triggered some 16.5 bio PLN demand. Through the week prices on 5y bonds rose some 50 cents, 10y bonds some 80 cents, we saw very good activity especially from international players.

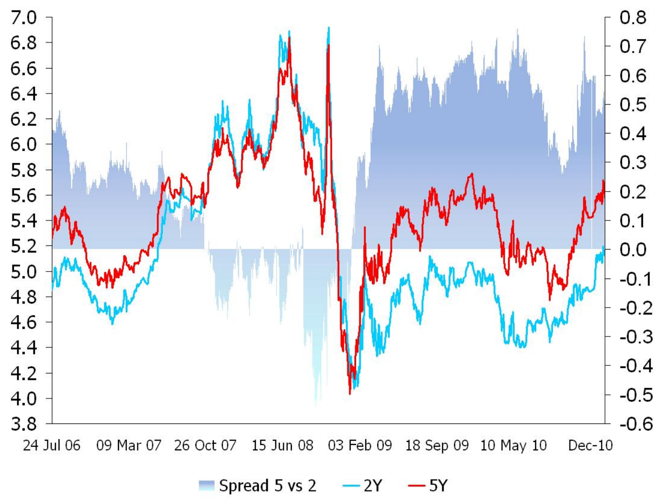
Question now is where are we heading from here. Data (inflation, IP, most likely retail sales) are conforming that any slowdown in economic activity is going to be very shallow. Sentiment of manufacturers and consumers may be declining, but the real data show the opposite. External risks sound more like an fading echo and they can trigger from time to time some correction in asset prices, but they matter much less for domestic economy. Ministry of Finance yet again is doing very good job using window of opportunity to fund large portion of deficit early during the year, just as a precaution, which investors seem to appreciate (larger offers draw higher demand and not necessarily lower prices).

Hawkish MPC supports EURPLN although we have to make one remark here. We trust that they can be still hawkish with higher CPI projection and higher GDP trajectory compared to the last year, but we also believe they will not decide to hike rates. Being worried about weaker EURPLN exchange does not justify adding further risk to the real sphere. Economy is probably as balanced as it can be at moment. One should (if can and Polish MPC definitely has bought themselves some time) wait to see how developments in eurozone will proceed, how fiscal steps of government will play out, and finally, is the worsening sentiment of manufacturers and households going to transfer into real economy. Rates can go higher, and we are keen to see them going higher, but not when ECB is cutting rates to zero and applying LTRO operations in fear of recession at our neighbors. Rates also can go higher if CPI (even core CPI) is pushed up by demand factors not by fuel prices, direct and indirect hikes. Rates should not go higher with employment definitely on the falling trend and fiscal austerity in sight. MPC is hawkish, which may be seen as a sign or responsibility. We looking forward to MPC being responsible, but nothing more. Middle to long end bonds should perform very well under this scenario. We are big fans.









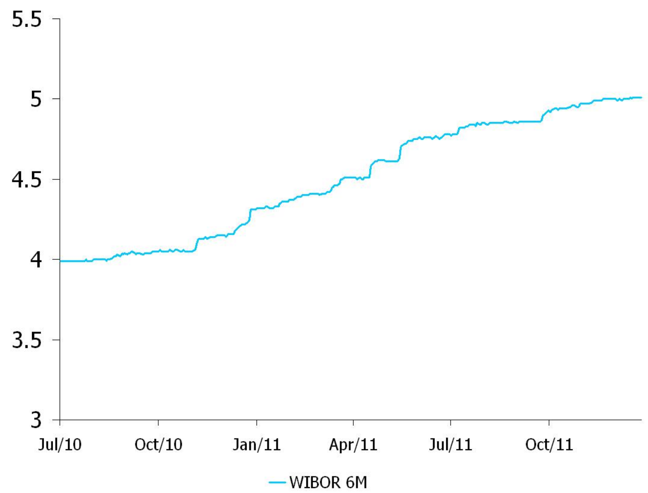
Money market

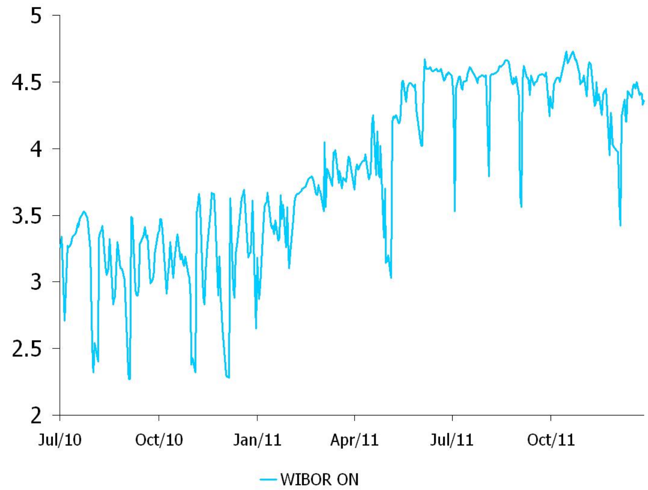
Substantial surplus of the cash makes additional OMO on Tuesday highly likely. Stunning IO figure and some bearish MPC comments. Risk on supported by stronger pln and excellent debt auctions.

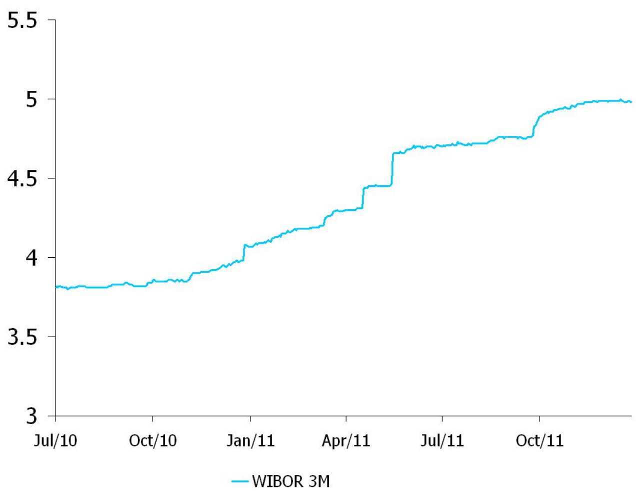
Cost of carry deteriorating day to day and the situation can be sustained by the low demand during today's OMO (89 bln pln bought out of 96 bln on the offer). However, the surplus in the system will reach around 7 billion pln on Monday, which makes additional OMO highly likely on Tuesday.

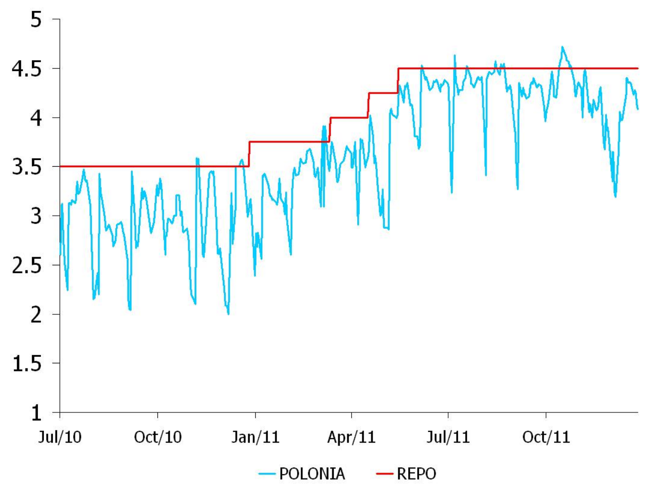
Surprisingly high industrial output figure triggered some more comments from the MPC members, which are quite bearish. It seems that there is no chance for a fast rate cut, and they keep stressing that probability of hike is much higher now. Next figure (except of the core CPI which is known at 3.1%) is the retail sales, which should also be very high and support hawks. We think that the MPC will stay on hold at least till March when the new CPI projection is to be presented. This projection is very likely to show relatively high CPI pattern plus a bullish outlook for GDP. Another arguments for hawks.

Although the above is our base scenario, the market has been quite bullish lately and mainly supported by the stronger pln and improving global sentiment (mainly good debt auctions in EU countries but also by local one with the bid-to-cover ratio at 2.5 and dropping yields). This makes us think that taking pay positions at current levels could be a good idea. We cannot exclude rate hike play if above mentioned expectations materialise.





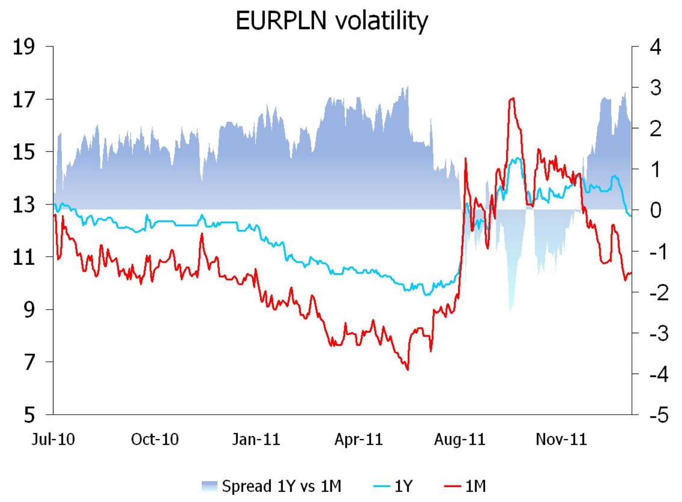




Forex

Złoty stronger It was another very good week for the Zloty, which gained almost 2.5% against the euro (from 4.4072.close last Friday collapsed to 4.2990 this Friday morning) and gained almost 4.75% against the dollar (from 3.4754 close last Friday dropped to 3.31 this Friday morning). Our currency benefited from improved global market sentiment, while yields on government bonds were at one-month lows, and good economic data from the Polish economy.

Vols lower After a downward plunge on volatility in the previous week, this week we was rather calm. On Monday we noticed a little rebound after mass downgrades but as this information was expected by the market, the volatility came back to previous levels: 3m - 11%, 1Y - 12.2%. Risk reversals were still offered: 1Y 25RR dropped from 4.5 % to 3.9%, 3m 25d RR is now 2.9% versus 3.3% last week. Currency spread was also lower - now is around 7%. Only gamma has been well bid with front end: 1m was at 10.25% versus 9.25% last week.

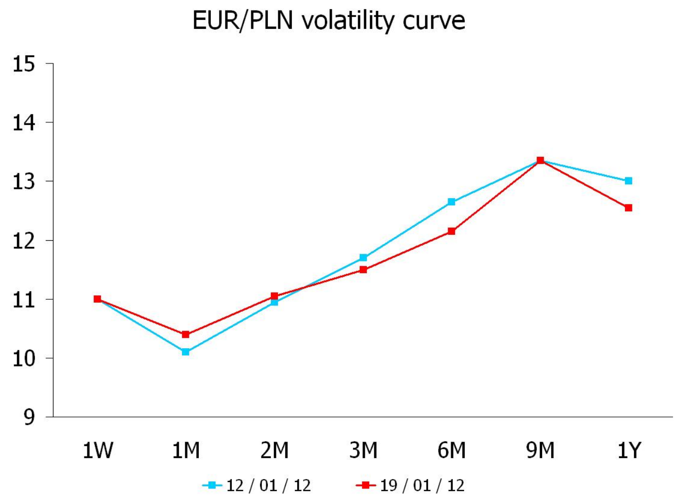


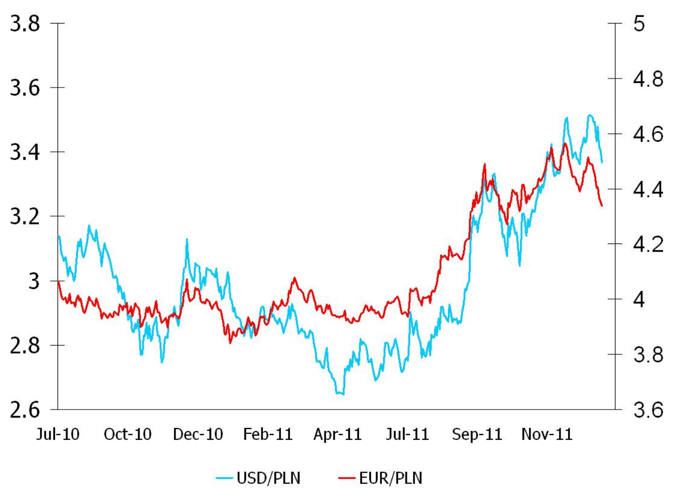
Short-term forecasts.

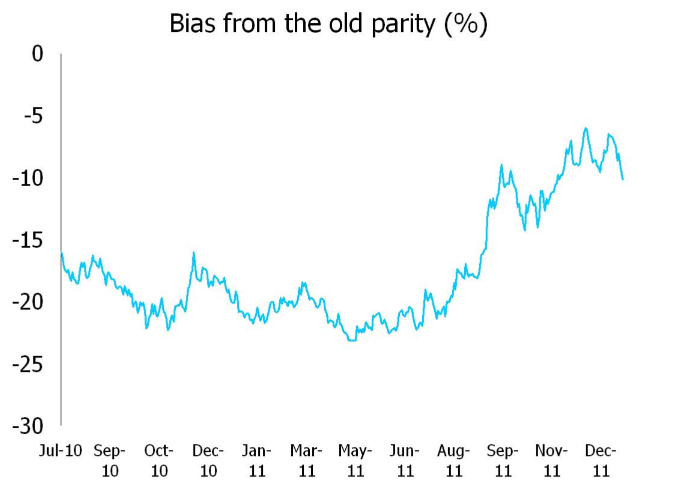
Main supports and resisances
EUR/PLN: 4.2200 / 4.4300
USD/PLN: 3.2500 / 3.4500

Spot. The zloty rally was impressive so many players expects some correction. On the other hand breaking a strong support 4.3 and resistance 1.3 for EURUSD may cause further strengthening of the Zloty. Everything is dependent on risk attitude again. We would stay sidelined at the moment.

Derivatives The euro zone debt problems are not resolved so we wouldn't venture to open short position in vega. Volatility now are in the mid of the range from last year, so still 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
1/13/2012	4.61	4.98	4.65	6.49	4.65	6.59	4.97	4.97	4.80	4.70	4.64	4.85
1/16/2012	4.63	4.98	4.48	4.91	4.50	4.91	4.98	4.98	4.82	4.71	4.64	4.85
1/17/2012	4.60	4.99	4.53	4.91	4.54	4.91	4.97	4.95	4.82	4.72	4.62	4.85
1/18/2012	4.63	4.99	4.67	4.91	4.67	4.91	4.96	4.95	4.80	4.70	4.59	4.81
1/19/2012	4.79	4.98	4.81	4.91	5.00	4.91	4.96	4.94	4.77	4.69	4.58	4.81

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
1/13/2012	6.590	4.705	4.825	4.855	4.855	5.296	4.955
1/16/2012	4.910	4.614	4.810	4.833	4.840	5.284	4.950
1/17/2012	4.910	4.621	4.810	4.805	4.840	5.245	4.940
1/18/2012	4.910	4.582	4.770	4.772	4.790	5.193	4.880
1/19/2012	4.905	4.596	4.775	4.718	4.740	5.177	4.830

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1M	1Y
1/13/2012	10.30	11.55	12.25	12.65	12.65	3.99	0.04	0.67
1/16/2012	10.40	11.55	12.25	12.65	12.65	3.99	0.04	0.67
1/17/2012	10.35	11.50	12.15	12.55	12.55	3.99	0.39	0.72
1/18/2012	10.40	11.50	12.15	12.55	12.55	3.89	0.39	0.72
1/19/2012	10.40	11.50	12.15	12.55	12.55	3.88	0.24	0.67

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
1/13/2012	4.4040	3.4323	3.6376	4.4752	1.4240	0.1724
1/16/2012	4.4056	3.4798	3.6443	4.5306	1.4200	0.1721
1/17/2012	4.3708	3.4215	3.6136	4.4607	1.4063	0.1709
1/18/2012	4.3491	3.4000	3.5959	4.4288	1.4183	0.1703
1/19/2012	4.3391	3.3678	3.5912	4.3894	1.4339	0.1704

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