BRE BANK SA

POLISH WEEKLY REVIEW

February 17, 2012

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Comment on the upcoming data and forecasts

On Thursday Statistical Office will publish Bulletin with retail sales and unemployment rate data. Our near consensus forecast is based on a high base from the previous year (which adds about 5pp.) and pretty good economic sentiment. Unemployment rate rises in January according to the seasonal pattern, the scale of growth will confirm whether December reading indicates a positive trend or was just one-off caused by good weather. Also on Thursday NBP will publish "Minutes" from February meeting, in which we do not expect any breakthrough information - the distribution of risks (especially inflation) and the relevant variables (inflation, FX market) was presented by governor Belka at the latest conference. Crucial for further MPC's actions will be March inflation projection.

Polish data to watch: February 20 to February 24

Publication	Date	Period	BRE	Consensus	Prior
Retail sales y/y (%)	23.02.	Jan	13.8	13.3	8.6
Unemployment rate (%)	23.02.	Jan	13.2	13.1	12.5
MPC Minutes	23.02.	Feb			

Treasury bonds and bills auctions

Paper	Next auction	Last Offer	Last yield (%)	Prev auction
52 Week T-bills	2/27/2012	2000	4.510	1/30/2012
2Y T-bond OK0114	3/14/2012	5500	4.688	2/9/2012
5Y T-bond PS1016	3/14/2012	5500	5.020	2/9/2012
10Y T-bond DS1021	3/21/2012	3000	5.511	2/1/2012
20Y T-bond WS0429	3/21/2012	3000		2/16/2011

Macroeconomic forecasts

Wskaźnik	2008	2009	2010	2011	2012 F
GDP y/y (%)	5.1	1.6	3.8	4.3	2.8
CPI Inflation y/y (average %)	4.3	3.5	2.8	4.3	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	12.5	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	2012 Q1 F	2012 Q2 F
GDP y/y (%)	4.5	4.3	4.2	4.2	3.6	3.1
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

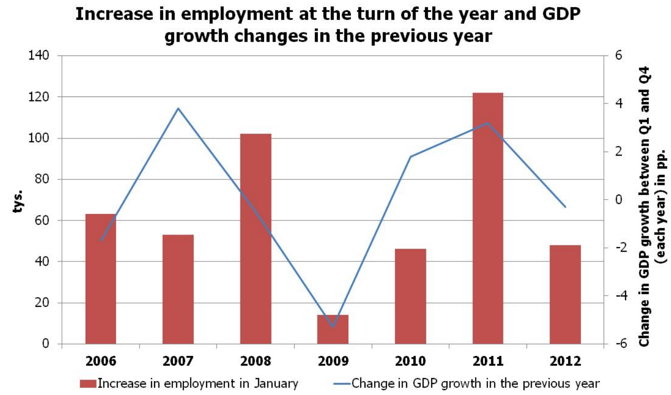
Economics

January inflation a game changer for the MPC

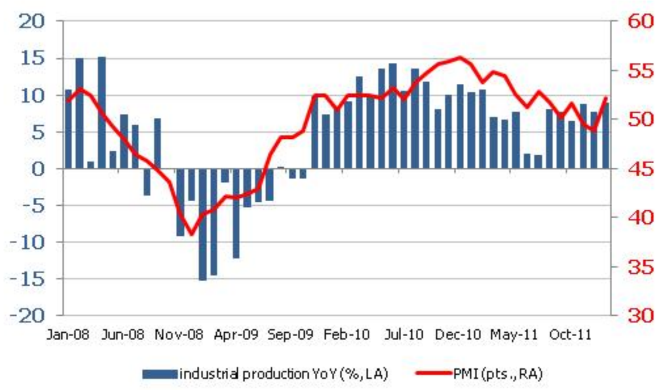
Last week was full of Polish data.

Firstly, January inflation hit 4.1% vs 4.6% recorded in the previous month. This data is - as usual - subject to revision in March as soon as the fresh inflation basket is implemented. The one and only surprise comes from wearing apparel where prices dropped by almost 4% on monthly basis. It may look strange that we expected rises in wearing apparel given the last year's drop but the basis for such a behavior of prices was clear: VAT rises on the children's clothes. This effect has been more than offset by seasonal drops in prices and a pass-through of a stronger zloty. We expect that next month's inflation is about to come out at a level close to the January reading (we do not quote exact number as there will be a revision in March, though) or to be a little bit higher owing to base effects. However, next months will be overall marked with lower inflation which is expected to fall towards 3.0% in the year end.

Secondly, employment in enterprise sector increased by 0.9% y/y vs 2.3% last month. The jump in the variable does not indicate a rapid deterioration of employment but rather past developments in 2011. Every time there is a jump in employment in January, it comes solely from annual changes in the sample of enterprises, therefore it is a technical correction which does not influence our view for 2012. We still stick to the scenario of stabilization (small drops) of employment in 2012, hence the slowdown is set to be much milder in 2012 compared to 2009. Wages grew by a stunning 8.1% vs 4.4% last month. As wage growth is a smooth variable, such a jump hardly announces a change in trend and can be rather attributed to some one-off payments (bonuses). Next months are set to bring wage growth again towards 4-5. Persevere, but gradual loosening of the labor market situation should prevent wage growth from acceleration but also from deceleration, as seen in 2009.



Thirdly, an upward trend in industrial production has been confirmed - output grew in January by 9.0% y/y after 7.7% in December. Growth was reported in 29 out of 34 sections, most significantly rising in exports oriented sections. Export is still supported by relatively weak zloty entailing growing competitiveness (which compensates for weakening external demand) and strong cyclical domestic demand (which is somehow substituting for expensive imports). What is more, construction output significantly diverged from seasonal patterns and grew by 32.2% y/y. In relation to January of 2011, an increase in production was recorded in all divisions of construction, mostly in entities specializing in civil engineering (by 69.1%), which we relate with infrastructural projects for EURO 2012. Construction of buildings grew by 12.5% y/y as developers tend to hurry with started projects as new regulations come into force (lowering demand and imposing new obligations on developers). What is more, in plus acted also difference in working days, good weather and distribution of holiday days (6th January).

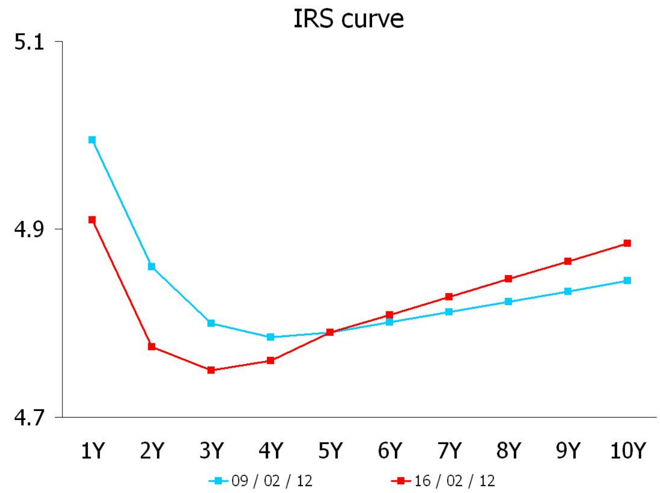


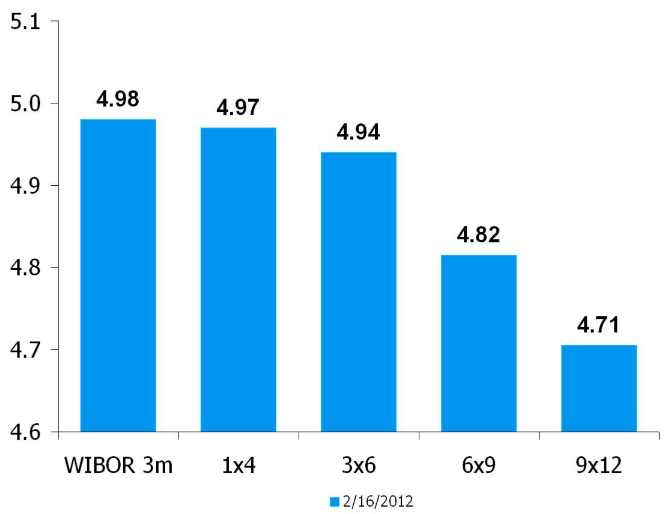
Development of inflation and real sphere data is set to be underpinned by the fresh inflation projection. This fact, and the visible pass through of exchange rate (highlighted in the latest Belka's comments) are expected to soften MPC's rhetoric. It is definitely inflation which is a game changer for the MPC . One should be aware that inflation falling below 4% mark may stimulate much more dovish comments from the MPC circles. We expect rates to be left unchanged in H1 as data distribution (production and consumption remain in stable trends, the slowdown in employment is set to be much milder in 2012 compared to 2009, CPI slowly falling towards the target rate in the mid-term) supports present interest rates level, which seems safe for both savings and investment. The gradual fall of inflation and slowly retreating real sphere should however lead towards generating expectations for monetary easing in H2 2012.

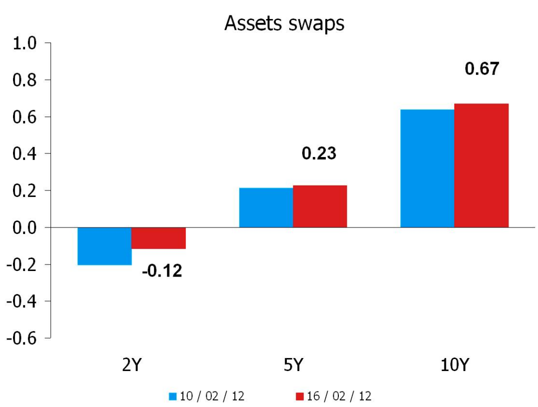
Fixed income

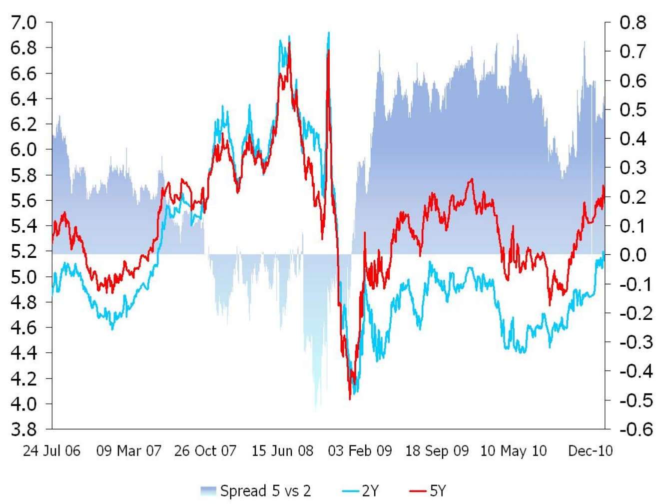
Game changer

The most important event last week was definitely the publication of CPI data. The actual number (4.1%) surprised strongly on the downside and caused quite a strong rally on the short end of the curve. Over two days 2y IRS moved down by some 15bp, 5y gained some 10bp, 10y moved a bit as well. Overall it's been quite significant repricing of what had happened recently, when market definitely overreacted to hawkish comments from the MPC and started actually pricing in rate increases... Such a data could be a significant game changer in the medium term. Most likely within two month from now, we'll see inflation below 4%, also inflation projection next month could be much lower than some had previously expected. If so, than rate setters' rethorics is likely to shift towards more dovish and concentrated on growth perspective rather than inflation. With 9x12 at 4.70% and 1y1y forward at 4.55% there is still room for 2y rates to move down and further steepening of the curve is what we expect. 2y rates and 5y bonds still have much value. The move we observed in the past few days hasn't happened, it has only started.









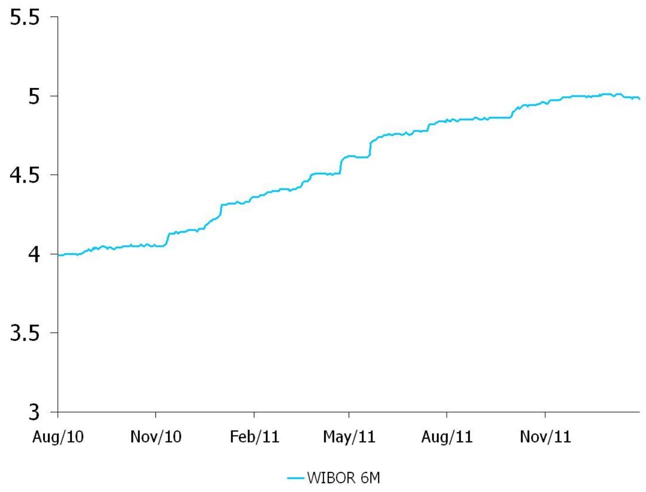
Money market

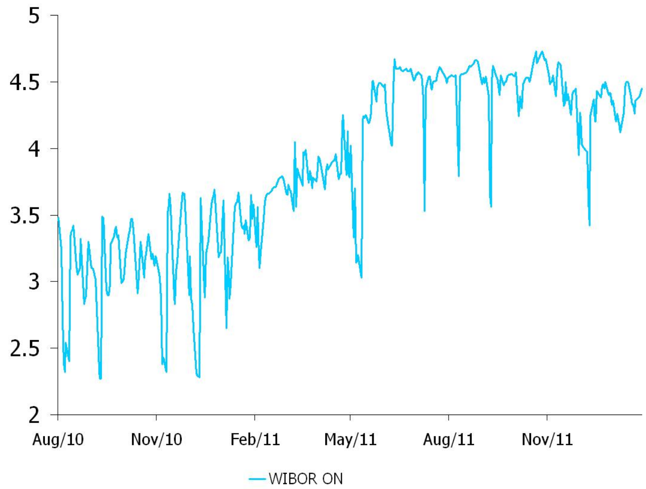
Carry should be cheaper next week. Break-through CPI fall. Greece still a threat.

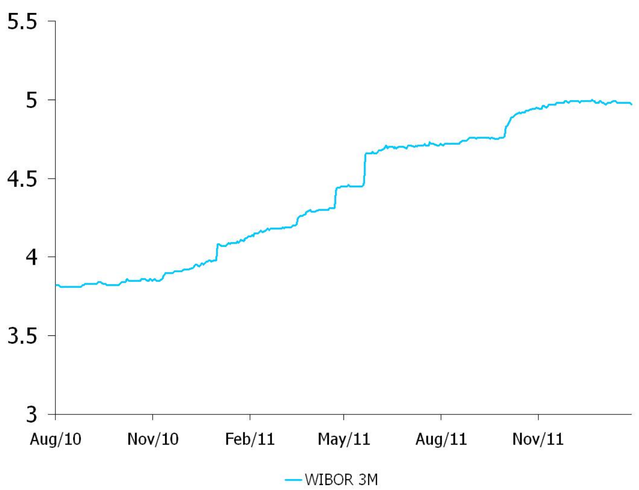
Stable cost of carry for the whole week around 4.2 level. Smaller demand during today's OMO should provide a cash surplus and fall of the shortest rates. We bet on the very cheap end of the reserve and so does the ois market with 1w contracts being quoted as low as 4.1%.

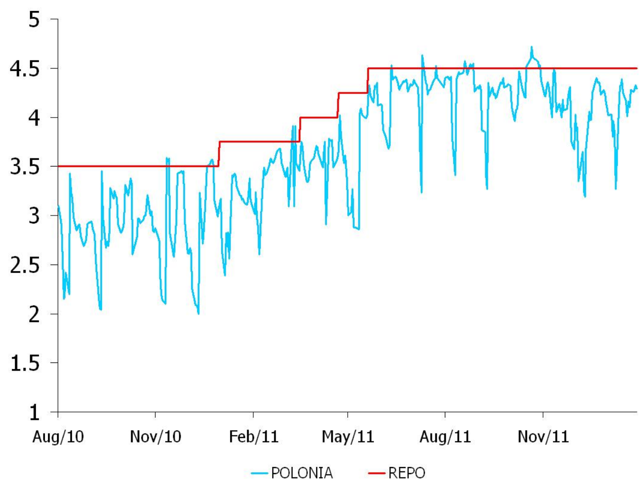
Impressively low CPI figure (4.1% down from 4.6% and vs 4.3% expected) triggered bullish wave. Front end lost between 5 to 15 bps depending on the contract. Higher wages did not change the sentiment (high reading probably due to one off factors) and then lower production supported the movement. So did the stronger PLN.

In our opinion this CPI reading changes a lot and cuts off any rate hikes speculations. Looks like the next move will definitely be a cut in rates and the question is about the timing. We bet on second half of the year as of now. Global factors are still valid and the biggest threat is certainly Greece. However this lingering process becomes tedious and maybe the collapse would bring a deep relief?



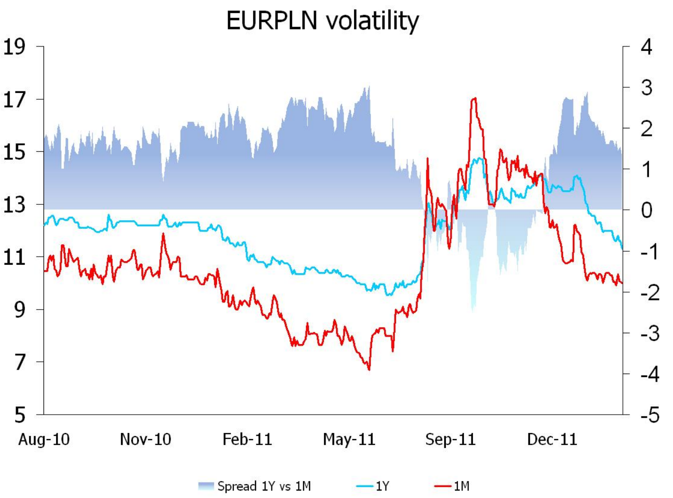






Forex

Choppy market The weekly range so far was 4.16/4.2450 for EUR/PLN. The global (Greek developments) driving the market, as PLN is being treated as a proxy to the region. We think one can expect that to continue. The consolidation after healthy PLN gains will the most probably keep us in the 4.14 /4.29 range for some time...

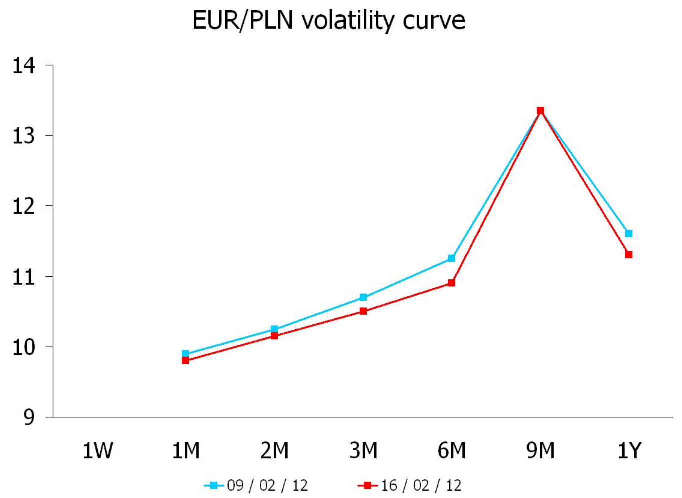


Vols consolidating The 1 year EURPLN was given at 11.3 this year low (13.4 mid 1st of January). But later the climate got more sour on the „unnamed source" news on Greece, and the whole run was pushed higher. The spreads widened, the risk reversals jumped 0.25%, currency spread (deference between USD/PLN minus EUR/PLN) up about 0.3%.

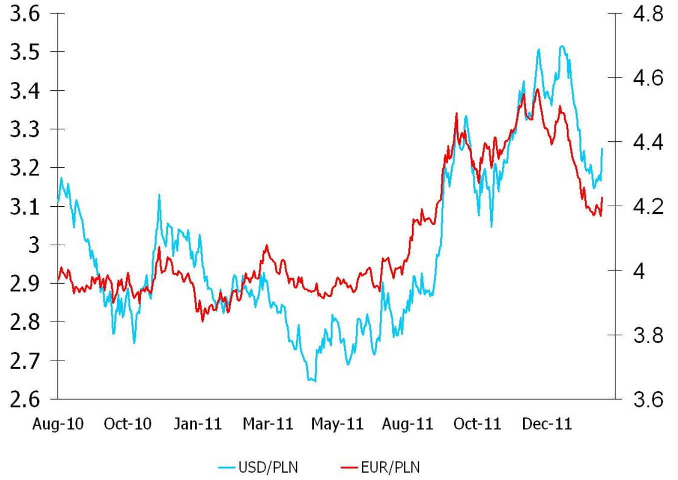
Short-term forecasts.

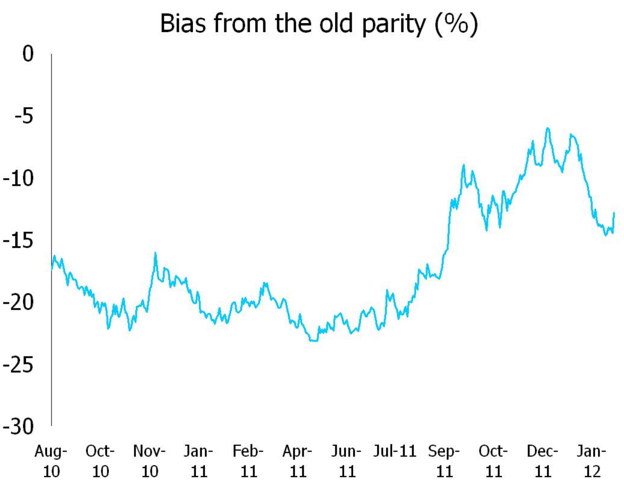
Main supports and resisances
EUR/PLN: 4.1200 / 4.2900
USD/PLN: 3.1000 / 3.3500

Spot. We believe that appetite for risk is still there, so does Greece and never ending European crisis. We expect 4.12/4.15 - 4.29/4.31 range should contain the moves for the next few weeks. We would try to play actively in that range...



Derivatives The picture is blurred. The implied volatility is still well above it's historic ones. Same with Skew... but the ATM's are much lower then the beginning of the year and the Risk reversals also, so we are not chasing that move. . . waiting sidelined for same further developments





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
2/10/2012	4.43	4.98	4.48	4.89	4.65	4.89	5.00	5.00	4.96	4.89	4.76	5.00
2/13/2012	4.42	4.98	4.80	4.89	4.80	4.89	5.01	5.01	4.97	4.88	4.77	4.99
2/14/2012	4.42	4.98	4.47	4.89	4.47	4.89	4.99	5.00	4.94	4.86	4.75	4.98
2/15/2012	4.80	4.98	4.62	4.89	4.62	4.89	4.99	4.96	4.88	4.77	4.64	4.89
2/16/2012	4.42	4.97	4.47	4.88	4.47	4.89	4.97	4.94	4.82	4.71	4.61	4.85

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	DS1019
2/10/2012	4.890	4.450	4.910	4.707	4.860	5.074	4.950	5.587
2/13/2012	4.890	4.520	4.910	4.720	4.860	5.040	4.950	5.563
2/14/2012	4.890	4.520	4.880	4.703	4.840	5.045	4.910	5.553
2/15/2012	4.890	4.520	4.835	4.687	4.825	5.016	4.905	5.547
2/16/2012	4.890	4.450	4.775	4.660	4.790	5.016	4.885	5.553

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
2/10/2012	10.35	10.95	11.45	11.80	11.80	3.40	0.85
2/13/2012	10.10	10.75	11.25	11.60	11.60	3.40	0.85
2/14/2012	10.05	10.70	11.25	11.60	11.60	3.40	0.84
2/15/2012	10.00	10.55	10.95	11.30	11.30	3.50	0.79
2/16/2012	9.80	10.50	10.90	11.30	11.30	3.50	0.74

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
2/10/2012	4.2048	3.1703	3.4752	4.0807	1.4378	0.1673
2/13/2012	4.1948	3.1643	3.4692	4.0720	1.4412	0.1673
2/14/2012	4.1935	3.1801	3.4701	4.0708	1.4388	0.1670
2/15/2012	4.1695	3.1660	3.4523	4.0326	1.4377	0.1660
2/16/2012	4.2276	3.2502	3.5027	4.1255	1.4392	0.1674

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