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Table of contents

Comment on the upcoming data and forecasts

On Wednesday inflation expectations will be published. It may fall to 4.9% from 5.2% in January. Lower reading will ease threat of higher inflation persistence (but only by a bit). On Thursday Polish PMI will be announced. After suprisingly high January reading it may correct a bit. However, Polish real data remain strong and Ifo index in Germany (with high correlation to Polish PMI) sustained growing trend and there is nor reason that PMI will diverge. Polish Statistical Office will publish GDP growth rate for Q4. It should stay at the level of previous reading. According to our view the GDP growth was driven mostly by investment and net exports.

Polish data to watch: February 27 to March 2

Publication	Date	Period	BRE	Consensus	Prior
Inflation expectations y/y (%)	29.02	Feb	4.9		5.2
PMI (p.)	1.03	Feb			52.2
GDP y/y (%)	1.03	Q4	4.2		4.2

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

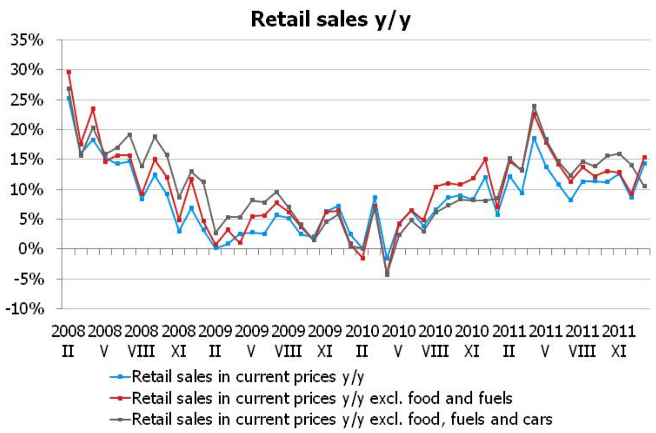
F - forecast

Economics

Retails sales higher mainly due to base effects and nondurable goods. Skepticism about persistence of PLN appreciation and maintained hawkish rhetoric in the „Minutes”.

Retail sales in January rose by 14.3% YoY (market consensus at 13%, our forecasts at 13.8%) against 8.6% YoY in December.

It should be noted that retail sales remained under severe influence of base effects in the area of car sales. In the previous year - due to tax code changes connected with VAT repayment as a cost of car with cargo compartment - car sales collapsed by 50% MoM in January. In this year's January, after car sales had returned to „normal” levels of seasonal drops of around 30% MoM, annual growth rate was inflated towards 30%, which added round 2-3pp. to overall retail sales growth rate. Moreover, overall solid retail turnover resulted from significant increase in food sales (10.7% YoY against 1.7% YoY in previous month) what was also caused partially by base effects (we estimate it at 4-5pp in case of food sales, therefore +1-2pp in overall sales). After stripping base effects food sales grew by solid 5%. However, which central banker would draw conclusions about the state of consumption on the basis of category which does not at all determine consumption trends? Factoring out the overvaluation stemming from base effects, retail sales should be regarded as closer to 10%, therefore about 3/4 of the headline reading (see the graph).



Turning to other categories, fuel sales was maintained at high level (about 20% MoM for n-th time in row) but pharmaceuticals sale pace decreased (correction after December's law changes affecting drugs reimbursement policy). The sales pace of newspapers, books and other sale in specialized stores also significantly decreased. Apart from above mentioned categories sales pace also decreased in clothing and footwear category as well as in durable goods category (furniture, radio, TV and household appliances).

Leaving arithmetic aside and sticking to economic mechanisms, conclusions should concentrate on the simple fact that sales is supported by non-durable goods and durable goods (excluding cars) are slowly slipping away. It supports our view of falling individual consumption growth. In spite of current income increases, consumer confidence remains adverse and higher share of income will probably be used to strengthen household balance (decreasing consumption growth is consistent with our forecasts of slide in household loans).

”Minutes” from February meeting, alike in January, indicate that it is somehow obvious for MPC members that the decline in GDP growth turns out to be more limited than it was expected several months ago. Some members of MPC still stay skeptical about possibility of maintaining high GDP growth pace in the near future due to a possibility of a sudden stop of investment, negative influence of weaker global economic activity, risk of far weaker private consumption growth and negative influence of stronger PLN on the real economy. However, somehow bullish assessment on GDP prevail (what can be seen from rate-setters' statements).

In the area of inflation MPC members were cautious towards recent PLN appreciation simultaneously indicating uncertainty about exchange rate changes in the future. Therefore, even after taking into account an expected GDP growth slowdown (of some magnitude), the perspectives for returning to inflation target are far from rosy. MPC members emphasized that energy prices growth will push up inflation and CPI hovering above the target for an extended period creates a risk of transmission on bargaining process and, in turn, on wages. Therefore not accidentally the recent „Minutes” note a veiled indication that MPC has failed to deliver price stability in the recent 12 months - it is a hawkish statement, the most hawkish in the whole document. Concerns about such a state of affairs are set to be a significant factor influencing MPC behavior. Hawkish rhetoric will be maintained, the more so since the real interest rate is regarded as low by some MPC members.

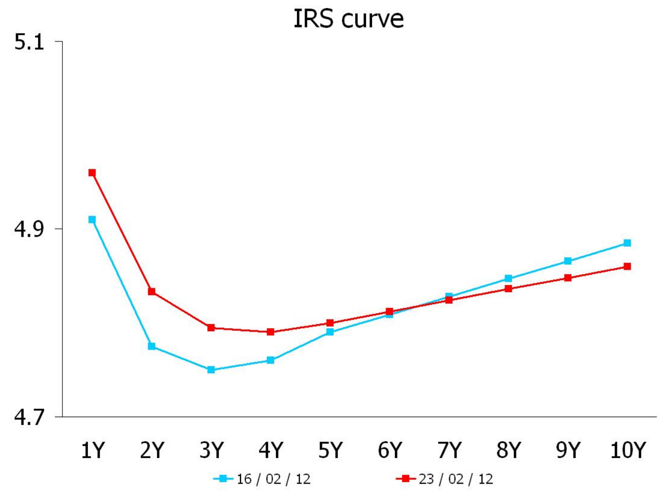
MPC unanimously agreed to leave interest rate unchanged. Alike in January, they emphasized possibility of interest rate hike in case of higher economic growth and simultaneous higher inflation. In distinction to previous „Minutes”, considerations about loosening monetary policy were erased from the text. Therefore the most probable scenario for the forthcoming quarters is a period with unchanged interest rates. Such a scenario is set to be reinforced by the inflow of data. The situation looks different in case of rate expectations. Although the first cuts are priced in in December, falling inflation (from March on) may result in further flattening of FRA curve, as rate cuts may be brought forward by a little bit.

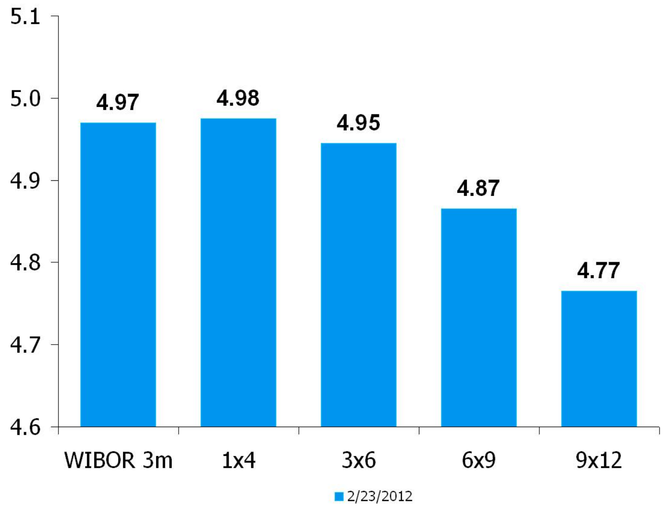
Fixed income

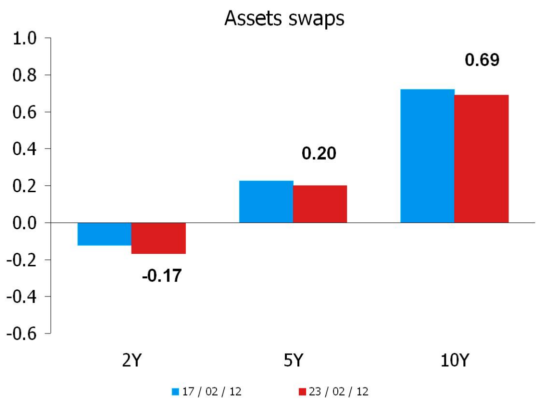
Awaiting fresh signals

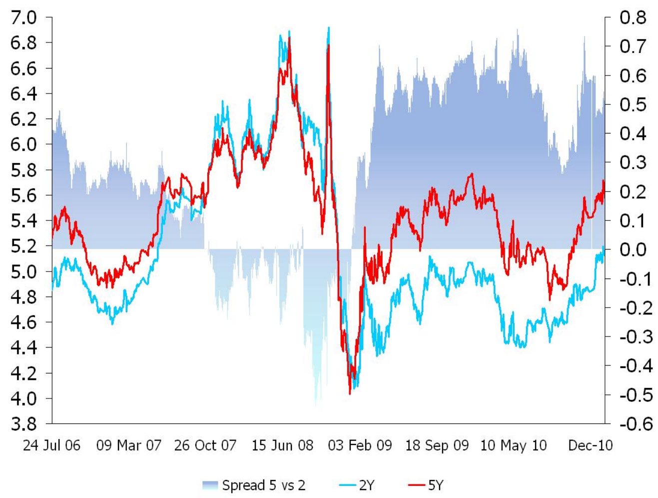
The market has found its short term equilibrium. The sharp downside move after the CPI release last week paved the way for some profit taking, additionally fueled by still existent hawkish MPC stance and quite high wages and retail sales data. The yield curve went up by 7-10bp and surprisingly 2y5y spread has turned to 4 points negative again. Trying to make some market analysis we should focus on few things. Regardless of the hard data some of the MPC members would likely to maintain their hawkish stance just to keep the currency rate controlled at the certain level. That action proved to have a positive impact on PLN rate as one of the major inflation factors. As the recent CPI data has surprisingly fell from 4.6% to 4.1% the next release is likely to anchor around 4.0% with the downside risk on an annual basket change. As a result of the very high basis in 2011 the annual consumer price index would very likely cross the upper 3.5% band of the monetary policy target in March/April then and falling down further in a coming months.

Considering the fact that Ministry of Finance announced it would cover around 40% of its borrowing needs to the end of February we may generate the most probable market scenario for the next few months. First, the MPC hawkish stance is just a „tool" to keep the zloty strong that proved to be the better idea than to intervene direct on the FX market as it was in the H2 last year. If it has such a positive influence on inflation rate as we expect, the market would very likely price the rate cuts again in favor of receiving 2Y IRS to 4.50% at least. Second, the limited PLN treasury bonds supply in the coming quarters may result in „detaching" the cash instrument from the yield curve for a long time in favor of accumulating the asset swaps further.









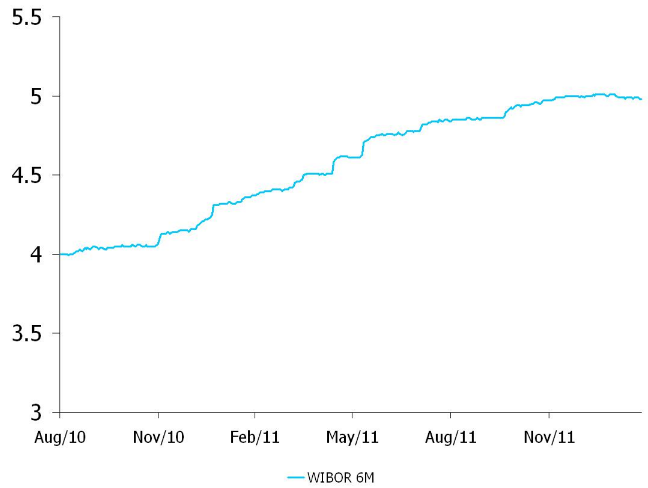
Money market

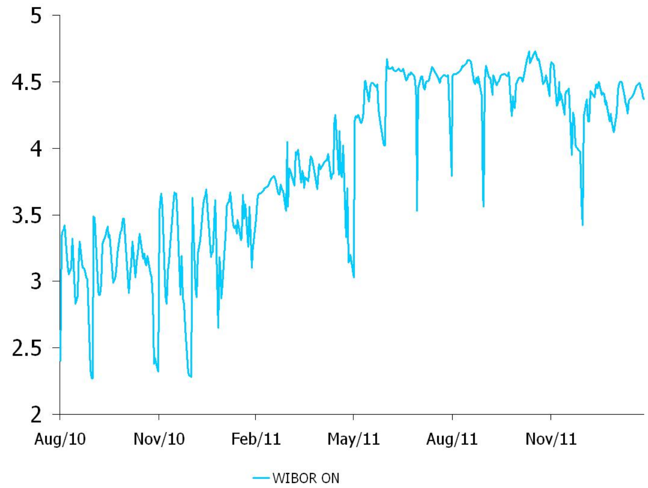
Cheap end of the reserve ahead. Range trading and waiting for the CPI projection and figure.

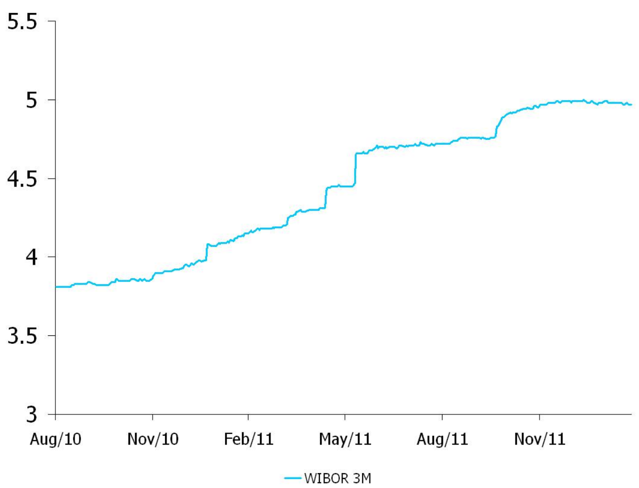
Cost of carry lower and lower proportionally to the growing surplus of cash in the system. Today's OMO leaves the market with surplus of around 5 billion pln, and it means that the end of the reserve is going to be very cheap.

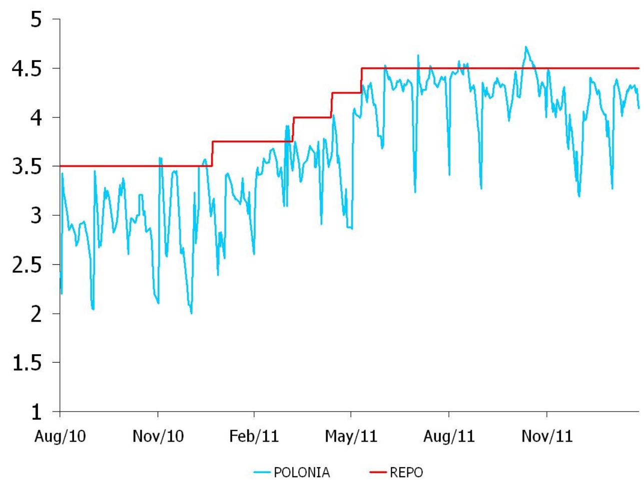
Nothing much as far as the trading is concerned. Some more hawkish comments from the MPC, some less expectations for the fast cuts, however all in all range trading. On Monday we have new benchmark T-bill auction and since this becomes a scarce good, it is going to be expensive. We see the price range at 4.48-4.52%.

Since we do not have any relevant figures (Q4 GDP growth could have been more or less derived from the data for the whole 2011) next week it should be again calm and quite, accumulating the energy for the CPI projection and the figure itself.



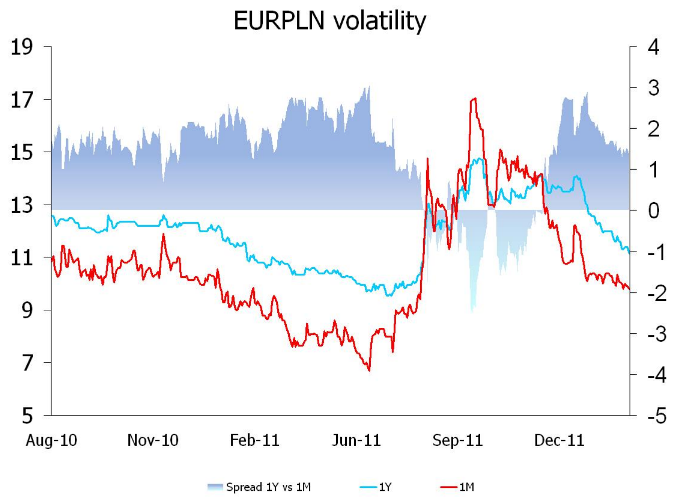






Forex

Zloty stable It was a very calm week for the Zloty. Our currency was supported by improved global market sentiment, and good economic data from the Polish economy. This week's range was very narrow, 4.1550/4.2025 for EUR/PLN. This consolidation, after healthy PLN gains is most likely to be continued for time being. The ECB's LTRO II will be a crucial factor...

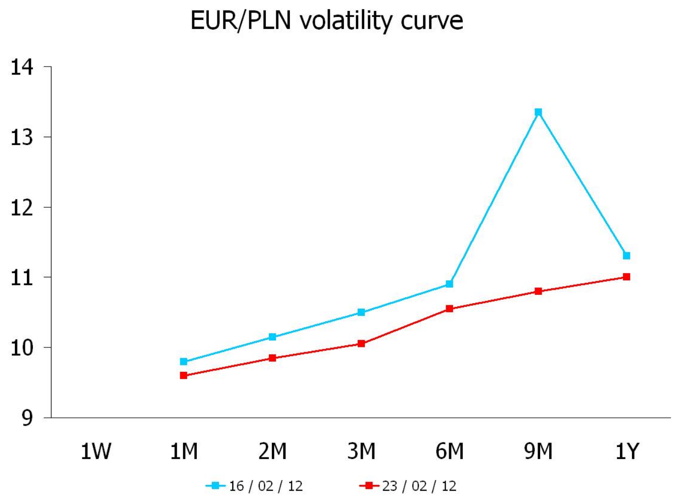


Volatility lower The fresh optimism is winning. The 1 month moved down from 9.75% to 9.2%, 6m was given 10.5% (drop from 10.8% last week), 1 year is now 10.9% versus 11.3% last week. Despite the Atm's volatility are lower, RR are at the same levels as week before: 3m 25RR is 3.1, 1Y 25RR is 4.0. Currency spread (deference between USD/PLN minus EUR/PLN) moved down from 7.3% to 7.0%.

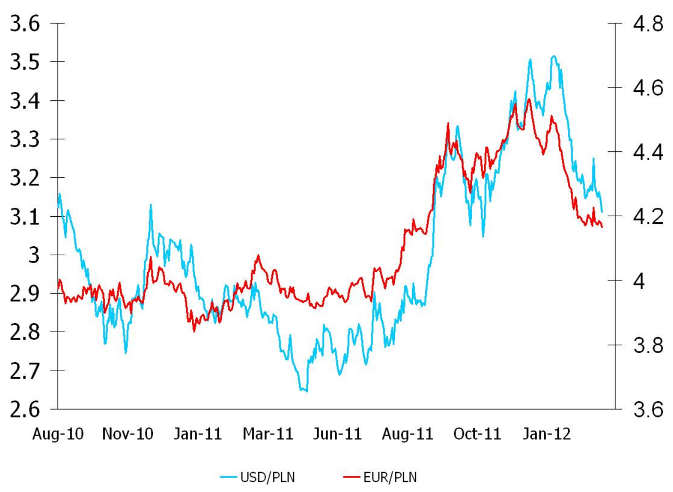
Short-term forecasts.

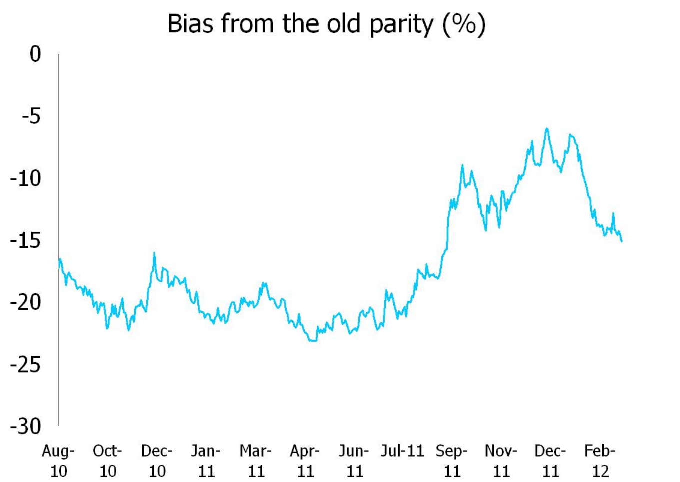
Main supports and resisances
EUR/PLN: 4.1000 / 4.2900
USD/PLN: 3.0000 / 3.2500

Spot. On the big picture we are still in the wide 4.10/4.29 range. With a good global sentiment, rally on EUR/USD, and LTRO next week which will be probably a trigger for a good rally to risky markets, we think the test of 4.12 is more likely. The ideal entry point is 4.21/4.22 zone with a stop at 4.26 and P/T at 4.1450/4.12



Derivatives The bigger picture is getting more and more constructive for the short Vega holders. The historic volatilities are falling, the realized skew is also well bellow implied. All that, plus a better global sentiment, progressing „damage control" over situation in Greece, ECB's LTRO on the horizon, may translate into further support for risky assets, PLN included. The correlation with stronger Zloty and lower volatility is still very strong.





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
2/17/2012	4.58	4.97	4.63	6.49	4.63	6.59	4.96	4.90	4.80	4.69	4.58	4.83
2/20/2012	4.42	4.98	4.63	4.89	4.65	4.89	4.98	4.93	4.81	4.70	4.56	4.81
2/21/2012	4.42	4.97	4.75	4.89	4.47	4.89	4.98	4.95	4.84	4.73	4.61	4.85
2/22/2012	4.58	4.97	4.75	4.88	4.60	4.89	4.98	4.96	4.87	4.77	4.66	4.91
2/23/2012	4.42	4.97	4.47	4.88	4.47	4.89	4.98	4.95	4.87	4.77	4.70	4.89

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
2/17/2012	6.590	4.520	4.760	4.637	4.768	4.994	4.810	5.530
2/20/2012	4.890	4.450	4.740	4.631	4.740	4.969	4.810	5.514
2/21/2012	4.890	4.520	4.785	4.650	4.760	4.992	4.850	5.534
2/22/2012	4.890	4.520	4.830	4.663	4.795	5.019	4.850	5.561
2/23/2012	4.890	4.450	4.833	4.665	4.800	4.999	4.860	5.551

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
2/17/2012	10.00	10.55	10.90	11.40	11.40	3.46	0.84
2/20/2012	9.90	10.50	10.90	11.40	11.40	3.46	0.84
2/21/2012	9.90	10.50	10.90	11.40	11.40	3.46	0.74
2/22/2012	9.80	10.15	10.65	11.15	11.15	3.46	0.84
2/23/2012	9.60	10.05	10.55	11.00	11.00	3.45	0.80

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
2/17/2012	4.1840	3.1790	3.4654	4.0244	1.4423	0.1673
2/20/2012	4.1775	3.1598	3.4565	3.9727	1.4496	0.1676
2/21/2012	4.1735	3.1488	3.4547	3.9449	1.4558	0.1677
2/22/2012	4.1857	3.1635	3.4663	3.9456	1.4577	0.1676
2/23/2012	4.1810	3.1380	3.4676	3.9196	1.4514	0.1668

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