

Rates and FX Outlook

Polish Financial Market

February 2012

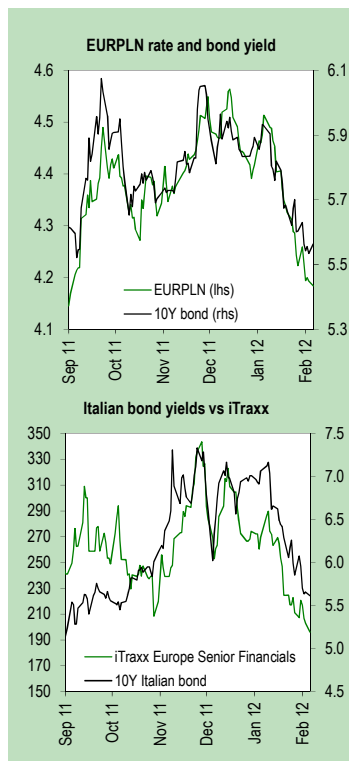


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Maciej Reluga
Chief economist
+48 22 586 8363

Piotr Bielski
+48 22 586 8333

Agnieszka Decewicz
+48 22 586 8341

Marcin Luziński
+48 22 586 8362

Marcin Sulewski
+48 22 586 8342

▪ The start of 2012 brought surprisingly strong performance of risky assets, including PLN denominated bonds and equity which led to a significant appreciation of the Polish currency. In the absence of major negative news, this was driven by a few better-than-expected economic data as well as improved liquidity amid more QE pursued by the ECB (not officially declared, but in practice conducted through LTRO) and possibility of the QE3 by Fed. At the same time, however, negotiations over the second bailout package for Greece and PSI are ongoing, while Portuguese bonds are still under pressure. The fiscal pact (even if ratified, which is not certain, for example in the light of French elections) does not seem to provide a necessary solution for the euro zone structural problems. Or maybe even the opposite, it may cause a deeper and longer recession in the euro zone periphery. This brings us to the final point. Despite recovery in some economic statistics, the euro zone is already in recession and this year will be very difficult in terms of economic performance which does not support risky assets. Overall, the above-mentioned risk factors suggest that the Polish currency, which has been recently driven by the global rather than local factors, may depreciate in the following weeks/months, after gaining almost 5% against euro in January.

▪ Though in our view the Polish local factors were of lower importance, they added somehow to the positive performance of domestic assets and the currency. These included: positive overall picture of the economy, hawkish bias of the central bank and very effective strategy of the government in terms of bond issuance.

▪ Firstly, GDP data for 2011 showed growth of 4.3% confirming the outperformance of the Polish economy within the EU. Additionally, first publication of data for 2012 indicated sharp rebound in PMI. Nevertheless, we can already see some negative tendencies in Polish exports and in the labour market, thus we do not change our forecast of 2.3% GDP growth this year. This is based on the slowdown in exports (already observed), consumption (very weak 4Q11, according to our estimates) and investment (two-digit annual growth recorded in 4Q11 not likely to be maintained in 2012).

▪ Secondly, the expected slowdown in the economy, together with disinflation process throughout the year, make the interest rate hikes unlikely, in our view. We interpret recent comments by the members of the Monetary Policy Council as an anti-inflation rhetoric aimed at curbing inflation expectations, rather than a clear indication of upcoming interest rate hike. Especially, as the European Central Bank may deliver one more cut in the following months. We still see a rate cut in Poland as more likely than tightening (and if the latter materialises, it may be similar to the case of the EBC in 2011).

▪ Finally, while the gross borrowing needs of the government increased this year by ca. 20% to PLN176bn, after January they are already covered in one-third. The Ministry of Finance took advantage of positive sentiment and issued a large amount of papers on both local and international markets. This creates a large room for manoeuvre in terms of supply in the remainder of the year and thus any yields increase in the Polish bond market will be rather driven by the global sentiment (combined with the zloty depreciation). Therefore, in the short-term we see a possibility for correction in the bond market after the recent rally.

This report is based on information available until 6th February

Short- and Medium-term Strategy

Interest rate market

	Change (bps)		Level end-Jan	Expected trend	
	Last 3M	Last 1M		1M	3M
Reference rate	0	0	4.50	→	→
WIBOR 3M	8	0	4.99	→	→
2Y bond yield	5	-17	4.67	↗	→
5Y bond yield	-3	-30	5.00	↗	↗
10Y bond yield	-16	-33	5.56	↗	↗↗
2/10Y curve slope	-21	-16	90	→	↗↗

Note: Single arrow down/up indicates at least 5 bp expected move down/up, double arrow means at least 15 bp move

Rates: our view and risk factors

PLN rates market	<p>Money market: Premium reflected in WIBOR did not fall after year-end and rates for all tenors above 3M maintain around 5%. This will most likely continue. We see the NBP reference rate flat and the MPC to keep tightening bias in upcoming months, though market is not likely to price-in rate hikes.</p> <p>Short end: 2Y bond rallied 17bp in January and at the same time FRA and IRS market moved up (10-20bp) due to hawkish comments by the MPC. Next economic data will be strong, but falling CPI (we see 4.2% for Jan.) should stabilise short-end of the curve with asset swap spread in 2Y segment moving higher from minus 24 at the end of January. Bond yields moderately up in 1M horizon.</p> <p>Long end: As we see a room for zloty weakening, long-term bonds should be also affected with yields rising from current lows, more significantly in 10Y segment in 3M horizon. No major moves in long IRS expected, which would lead to the curve steepening (currently inversion in 2/5Y segment).</p> <p>Risk factors to our view: CPI inflation release in mid-February as the main local driver for rates. We forecast 4.2% from 4.6%, which would support short end (mostly FRA and IRS, as bonds rallied enough). However, market forecast range from 4.0% to 4.7%, which shows the scale of uncertainty.</p>
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FX market

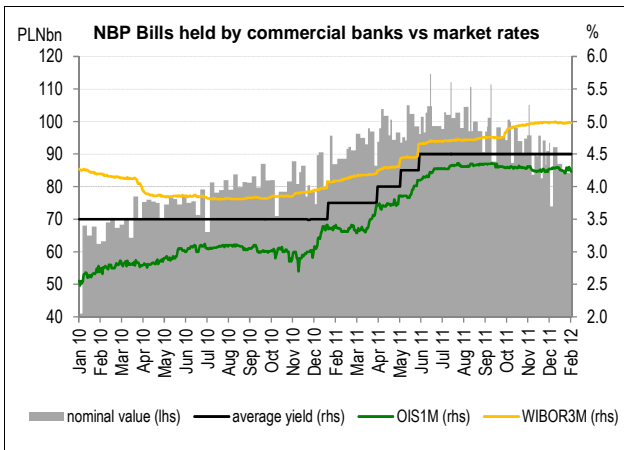
	Change (%)		Level end-Jan	Expected trend	
	Last 3M	Last 1M		1M	3M
EURPLN	-2.68	-4.30	4.23	↗	↗↗
USDPLN	3.25	-6.27	3.20	↗	↗↗
CHFPLN	-1.57	-3.52	3.51	↗	↗
GBPPLN	1.64	-4.17	5.05	→	↗↗
EURUSD	-5.74	2.10	1.32	↘	↘

Note: Single arrow down/up indicates at least 1.5% expected move down/up, double arrow means at least 5% move

FX: our view and risk factors

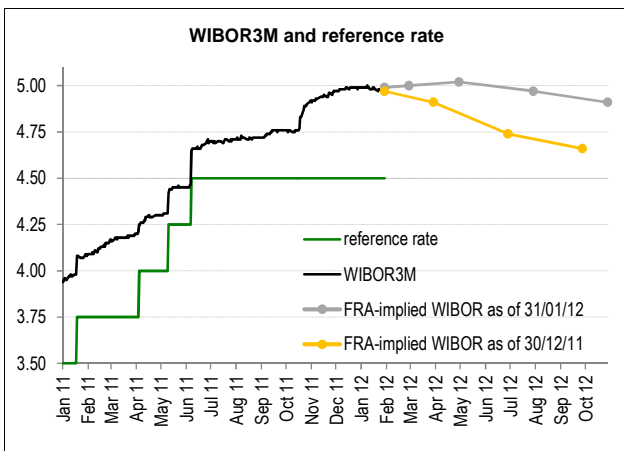
PLN FX market	<p>EUR: Sharp zloty appreciation in Jan. 2012 driven mainly by significant shift in global sentiment. We still see risk for zloty weakening in the following months even up to the levels observed at the start of the year (depending on global impulse). In one-month horizon we forecast EURPLN rate at ca. 4.30.</p> <p>USD: EURUSD maintains above 1.30 and we see a room for the rate going down in a few months' (weeks') time with the target at 1.28 at the end of Q1. If this is driven by global risk factors, it would be yet another argument for the Polish currency to weaken against the majors.</p> <p>CHF: Trend in CHFPLN similar to EURPLN in short-term, while later the SNB may attempt to raise EURCHF currency floor from current 1.20. This is quite possible given further increase in unemployment and CPI in negative territory, as the currency is overvalued. This would limit depreciation of the zloty against the Swiss franc.</p> <p>Risk factors to our view: If risk appetite still dominates globally and continues further in February-March (with no negative news on euro front), the zloty may gain further with next important technical levels at 4.10-4.12 and around 4.0-4.05 against the euro.</p>
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Money Market



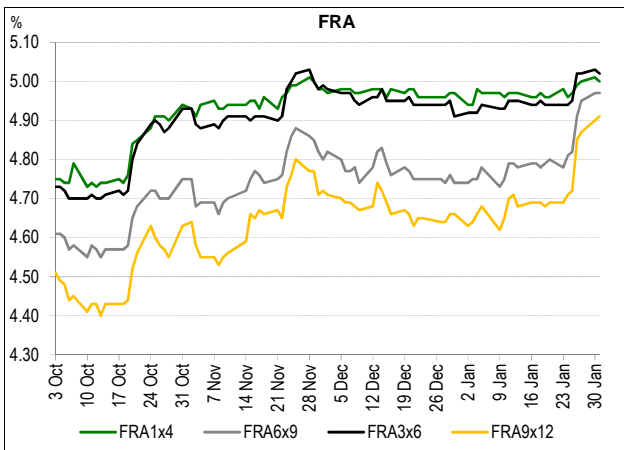
Banking sector liquidity is still favourable...

- The Polish banking system is consistently overliquid. Every week, on the regular Friday's auction, NBP sells bills worth over PLN80bn. Favourable banking sector position in terms of liquidity has been recently accompanied by a slight fall in OIS rates, mainly up to 3M, which clearly reflects the availability of the money in the banking system.
- We foresee that this situation in the Polish banking sector will continue, especially as some signs of slowdown in the credit market should be expected throughout 2012. However, despite the expected LTRO by the ECB at the end of February, the situation in European banking system is still highly uncertain, which translates into interbank market freeze. The Polish banks will probably still prefer buying the NBP bills rather than lending money to other banks.
- For February the minimum reserve requirement level was set at PLN29.1bn. Similarly as in previous months, February has started with overbuilt reserve level.



...but MPC's hawkish rhetoric influences money market

- Hawkish statements by the MPC members, including NBP governor Marek Belka, limited expectations for interest rate cuts this year. After these comments FRA rates increased and started to price-in interest rates hikes (FRA rates 1x4 and 3x6 increased to slightly above 5%). This was especially the case after data releases suggesting robust economic performance (2011 flash GDP growth and January's PMI reading exceeded forecasts). As a result, the FRA-implied expected 3M WIBOR rates showed a significant increase in January as compared to the levels at the end of 2011 (see chart).
- However, the beginning of February brought some corrective move on FRA rates. It seems that following the recent zloty strengthening, the market is pricing-in that the MPC will be less willing to raise interest rates in a few months' horizon, as the overall restrictiveness of monetary policy has increased.
- Therefore, February's statement to the Council's decision could be crucial for money market rates. Any indication that rates will be kept unchanged in coming months (even till mid-year) should further support a moderate fall of FRA rates. At the same time, it is hard to expect that the spread between WIBOR and NBP rate will be significantly lower (we expect it to fall only in 2H 2012).
- In short term we expect WIBOR rates to fluctuate around the current level, with possible slight decrease. In the medium term we uphold our view that the MPC will decide to cut rates (not sooner than in 2H12) due to deterioration in economic growth prospects and falling CPI inflation. As a consequence, we predict more significant downward move of WIBOR rates and narrowing spread vs. the official reference rate.

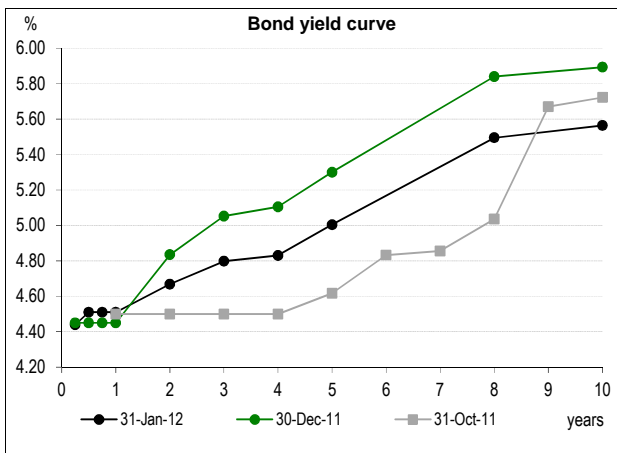


Money market rates (%)

	Reference rate (%)	Polonia (%)	WIBOR (%)				OIS (%)				Spread WIBOR / OIS (bp)			
			1M	3M	6M	12M	1M	3M	6M	12M	1M	3M	6M	12M
End of January	4.50	4.32	4.75	4.99	5.00	5.00	4.30	4.27	4.30	4.33	45	72	70	67
Last 1M change (bp)	0	85	-2	0	0	0	3	-2	1	5	-5	2	-1	-5
Last 3M change (bp)	0	20	4	8	6	6	-1	-1	4	15	5	9	2	-9
Last 1Y change (bp)	75	91	90	90	68	50	91	78	64	46	-1	12	4	4

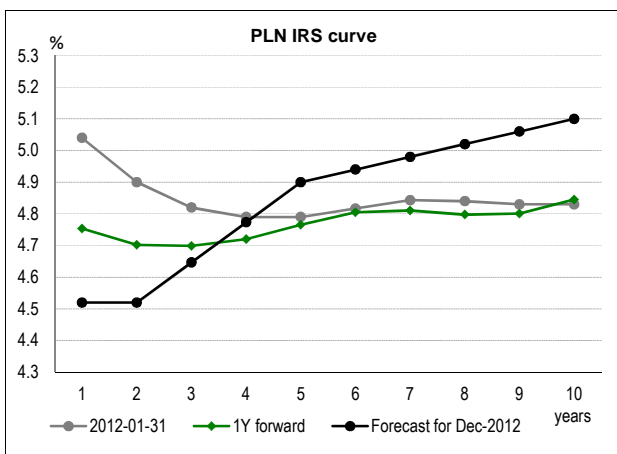
Sources: Reuters, BZ WBK

IRS and T-Bond Market



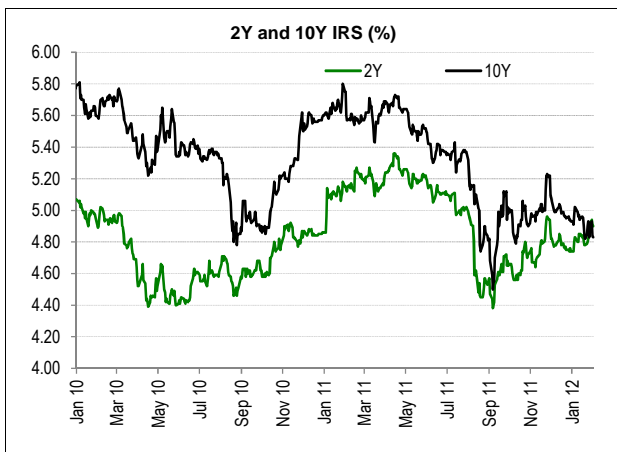
Bond yields sharply down at the start of 2012

- Contrary to earlier expectations, the beginning of the year brought a significant improvement in moods on global markets, which translated into higher appetite for risky assets, including Polish bonds.
- As a result, mid- and long-end of the curve strengthened sharply, testing support levels at 5.00% in case of five-year benchmark and 5.60% in case of ten-year benchmark. The latter was even broken at the end of January (the former only temporarily). Yield of two-year benchmark also fell, but the scale of strengthening was much lower, as expectations for monetary tightening renewed after hawkish comments of the MPC members. Therefore yield curve significantly flattened, with 2-10Y spread narrowing to 90bps, down from over 100bps at the end of 2011.
- We also observed IRS rates moving up in the short-end of the curve, driven by rate hikes expectations. This led to the increase in 1Y IRS to above 5%, while two-year rate moved up to above 4.90% at the end of January. At the same time, rates for longer tenors fell with 10Y below 4.90%. Five-year has been relatively stable around 4.80%.



We expect correction after January's rally

- Currently bond yields are traded around their support levels at 4.60% for 2Y, 5.00% for 5Y and 5.50% for 10Y. The key domestic events, which could strongly affect the market include the MPC meeting and the following macroeconomic data. It is widely expected that the Council keeps rates unchanged, therefore the market players will concentrate on the statement. It is hard to expect more hawkish view than presented in recent comments, so any change in rhetoric of the MPC towards more dovish stance would support the short end. We believe that January CPI reading, showing the headline rate decrease to 4.2%YoY will be favourable for the 2Y sector. At the same time, next releases of production and retail sales will confirm the outperformance of the Polish economy. Supply environment (over 30% coverage of borrowing needs and moderate offer of Treasury papers in coming months) is also supportive for the debt market.
- However, domestic factors might be overshadowed by uncertain global situation, especially regarding the euro zone sovereign debt problems (e.g. Greek negotiations on PSI and second bailout package). If global moods deteriorate, it would result in a profit taking after recent significant gains in the mid- and long-end of the curve. In more turbulent period, the two-year sector should be recognised as more safe. Therefore if a negative scenario comes true we foresee the yield curve steepening, as two-year benchmark yield should remain relatively stable compared with 5Y and 10Y sectors.

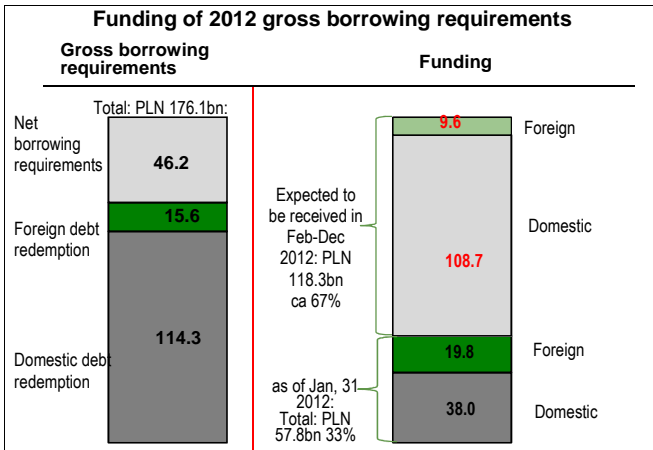


Bond and IRS market (%)

	T-bills	BONDS			IRS			Spread BONDS / IRS (bp)		
	52-week	2Y	5Y	10Y	2Y	5Y	10Y	2Y	5Y	10Y
End of January	4.51	4.67	5.00	5.56	4.91	4.80	4.84	-24	20	72
Last 1M change (bp)	6	-17	-30	-33	17	0	-9	-34	-30	-24
Last 3M change (bp)	1	5	-3	-16	17	-1	-8	-12	-2	-8
Last 1Y change (bp)	36	-33	-88	-77	-24	-89	-91	-9	1	14

Sources: Reuters, BZ WBK

Treasury Securities Supply Corner



Nearly 1/3 of gross requirements already financed

The beginning of 2012 was favourable for the Polish Ministry of Finance, as it successfully launched its issuance plan for 2012. In January the Ministry issued €750m and \$1bn in international markets, which together with wholesale T-bonds sold in domestic market gave total issuance worth PLN24.8bn. Additionally, there was a loan from the International Financial Institution (IFI) worth of PLN1.4bn.

Together with financial resources available at the end of December 2011, the ministry collected funds worth PLN57.8bn, which accounted for 33% of this year borrowing requirements. At the end of January, the so-called liquidity cushion (funds in PLN and foreign currency held by the MF) amounted to PLN30.5bn.

Issuance completion after the first month of the year suggests that the ministry effectively benefited from the positive mood in global financial markets. Therefore, it seems that the strategy which worked quite well in 2011 - to collect as much as possible funds in the first half of the year - is also in force this year.

Issuance plan for February in line with expectations...

In February the Ministry plans to offer wholesale bonds worth PLN5.0-12.0bn. It is in line with previously announced planned supply for Q1 2012. The ministry clearly suggested that it had no plans of increasing its liquidity cushion by expanding supply of Treasury papers in Q1 above the levels set in Q1 supply statement (planned offers between PLN18.0-29.0bn).

In case of T-bills, the February's offer is only between PLN1.0-2.0bn. As a consequence, overall debt in T-bills will be reduced by PLN2.6-3.6bn. 52-week T-bills auction will take place at the end of February.

The Ministry also plans to concentrate on "a few smaller" foreign issues after January issues in EUR and USD as well as loans from the IFI. The officials signalled that they consider another issue of retail bonds on the Japanese market. We would like to recall that in July 2011 the first time in history Poland launched 4-year retail targeted Samurai bond worth of JPY25bn. It was priced at 71 bps over the swap rate implying the yield of 1.25%.

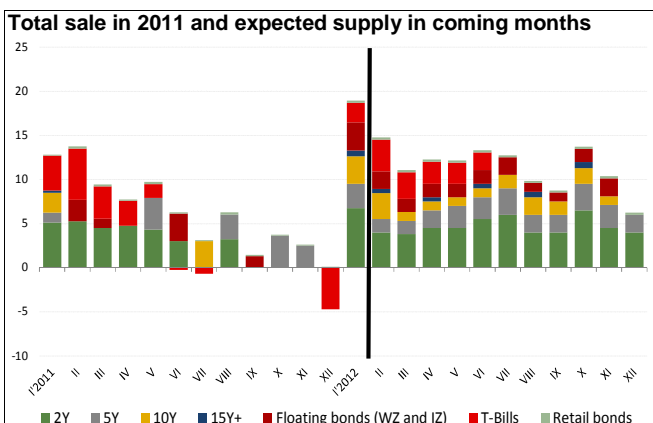
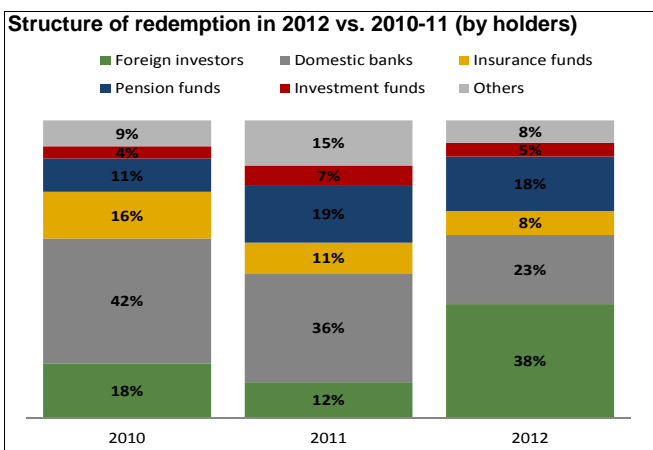
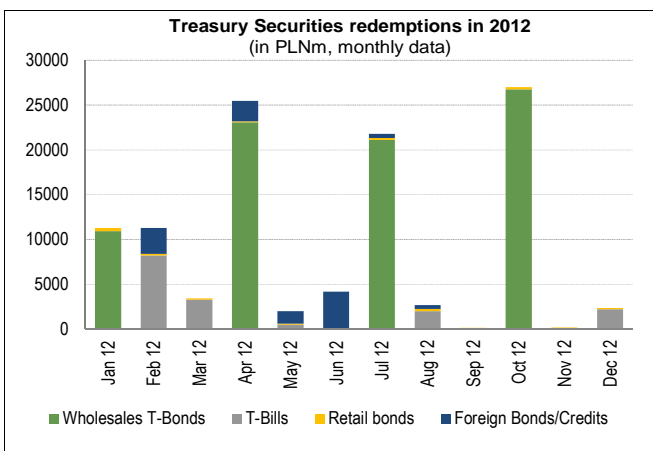
... but with a bit different auctions' schedule

However, it is worth noting some important changes in auction schedule. Unexpectedly, the Ministry resigned from the switch tender and decided to offer 10Y benchmark DS1021 at the regular auction. Commenting on the February supply, the Ministry's representatives explained that it resulted from low availability of papers maturing in 2012 and considerable interest in the paper on offer. Other auctions are scheduled as previously planned.

Although this decision confused the market, the auction of DS1021 was met with relatively solid demand. The Ministry sold DS1021 worth PLN2.94bn with the average yield of 5.511% (vs. 5.899% at January's switch tender).

We expect that both auctions of OK0414/PS0416 and WZ0117 will attract healthy demand. Positive market sentiment is still supportive for auctions. Moreover, in our opinion interest rate of WZ0117 in January – July coupon period above 5% per annum should be an additional positive factor.

Overall, limited offers of auctioned wholesale papers should be supportive for the investors' sentiment, balancing possible negative impact of the global mood deterioration.



Sources: Ministry of Finance, BZ WBK

Treasury Securities Supply Corner

Total issuance in 2012 by instruments (in PLNm, nominal terms)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
T-bonds auction	10 820	10 437	7 800	9 500	9 500	11 080	12 500	9 600	8 500	12 450	8 600	4 000	114 786
T-bills auction	2 223	3 588	3 000	2 500	2 400	2 000							15 711
Retail bonds	250	250	250	250	250	250	250	250	250	250	250	250	3 000
Foreign bonds/credits	6 579		2 210	4 480	3 368				4 350		1 050		22 036
Total	19 871	14 275	13 260	16 730	15 518	13 330	12 750	9 850	13 100	12 700	9 900	4 250	155 534
Redemption	11 297	8 397	6 648	23 203	3 137	2 778	25 718	3 127	1 058	27 014	924	2 368	115 668
Net inflows	8 574	5 879	6 612	-6 473	12 380	10 552	-12 968	6 723	12 042	-14 314	8 976	1 882	39 866
Rolling over T-bonds	6 309												6 309
Buy-back of T-bills													
Total	14 883	5 879	6 612	-6 473	12 380	10 552	-12 968	6 723	12 042	-14 314	8 976	1 882	46 174
Coupon payments	1 451			7 211			1 497		1 455	7 413			19 026

Note: Our forecasts – shaded area

Schedule Treasury Securities redemption by instruments (in PLNm)

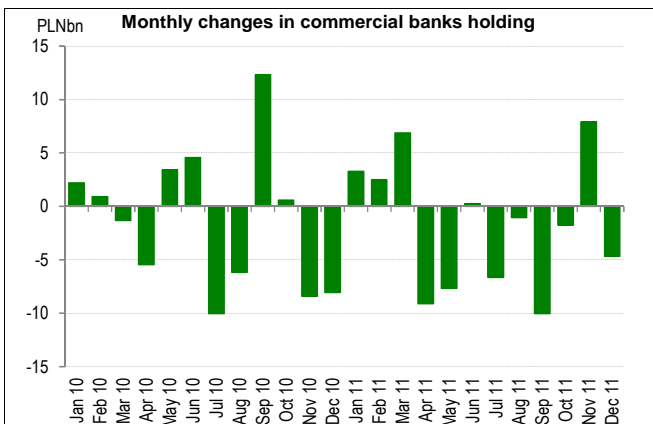
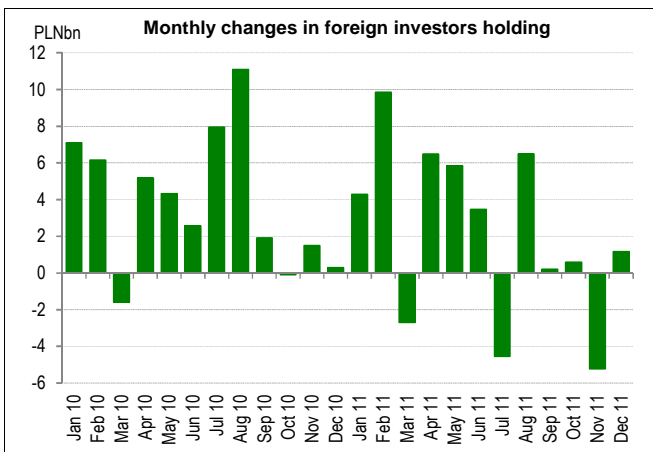
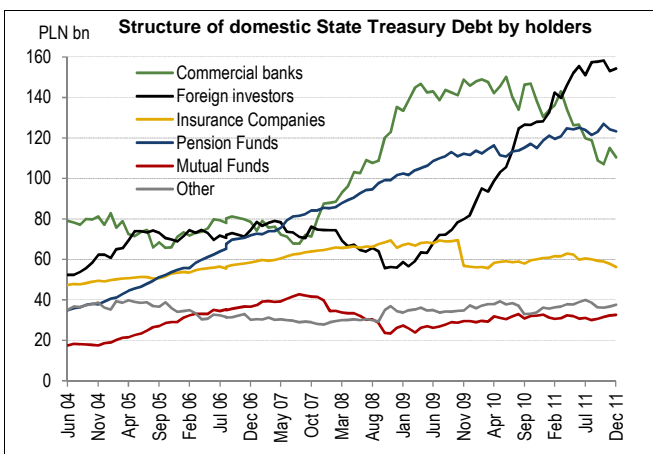
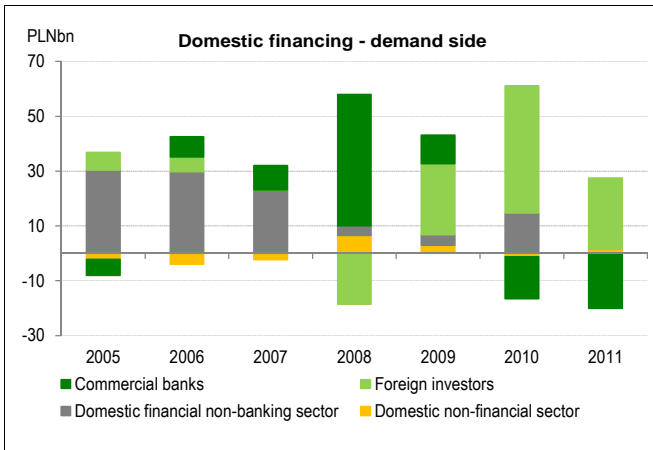
	Bonds	Bills	Retail bonds	Total domestic redemption	Foreign Bonds/Credits	Total redemptions
January	10 946		351	11 297		11 297
February		8 215	182	8 397		8 397
March		3 294	129	3 423	3 225	6 648
April	23 071		132	23 203		23 203
May		505	117	622	2 516	3 137
June			112	112	2 666	2 778
July	21 090		218	21 308	4 410	25 718
August		1 997	248	2 245	882	3 127
September			176	176	882	1 058
October	26 749		265	27 014		27 014
November			208	208	716	924
December		2 223	146	2 368		2 368
Total 2012	81 856	16 234	2 283	100 373	15 296	115 668
Total 2013	82 468	1 592	1 698	85 758	14 825	100 583
Total 2014	37 809	0	628	38 437	17 448	55 885
Total 2015	78 880	0	485	79 365	14 329	93 694
Total 2016	42 072	0	91	42 162	16 871	59 033
Total 2017+	168 166	0	3 288	171 454	127 337	298 791

Schedule wholesales bonds redemption by holders (data at the end of December 2011, in PLNm)

	Foreign investors	Domestic banks	Insurance Funds	Pension Funds	Mutual Funds	Individuals	Non-financial sector	Other	Total
Q1 2012	4 474	3 100	1 083	1 815	413	155	189	1 368	12 597
Q2 2012	12 563	5 243	2 240	2 264	654	102	44	1 131	24 241
Q3 2012	8 580	6 012	1 648	5 714	1 285	235	45	1 292	24 812
Q4 2012	9 612	7 306	1 270	4 557	1 405	96	404	2 134	26 783
Total 2012	35 228	21 662	6 240	14 351	3 756	588	682	5 926	88 433
	40%	24%	7%	16%	4%	1%	1%	7%	100%
Total 2013	34 330	12 789	12 522	13 938	3 323	422	726	4 508	82 557
	42%	15%	15%	17%	4%	1%	1%	5%	100%
Total 2014	9 635	7 002	4 230	10 123	3 464	346	468	2 828	38 097
	25%	18%	11%	27%	9%	1%	1%	7%	100%
Total 2015	18 143	22 384	7 402	17 731	5 688	145	539	3 682	75 713
	24%	30%	10%	23%	8%	0%	1%	5%	100%
Total 2016	11 086	5 633	3 341	18 264	3 948	59	227	2 128	44 686
	25%	13%	7%	41%	9%	0%	1%	5%	100%
Total 2017+	44 051	33 834	21 807	47 792	11 497	267	1 000	5 433	165 680
	27%	20%	13%	29%	7%	0%	1%	3%	100%

Sources: Ministry of Finance, BZ WBK

Treasury Securities Holders



Foreign investors - key player on the Polish debt market

As expected, the 2011 gross borrowing requirements had been financed mainly by foreign investors, who increased their portfolio by nearly PLN26bn (down from PLN46.5bn increase in 2010). The participation of domestic investors was much lower, as the non-banking sector financed it only by PLN1.5bn (vs PLN13.6bn in 2010). Domestic commercial banks reduced their exposure to Polish sovereign debt by PLN20bn (following reduction by PLN15bn in 2010).

We think that the breakdown of investors financing gross borrowing requirements in 2012 will be more or less similar to 2011. The important role will be played by foreign investors (though in lower scale than in 2011) and domestic non-banking institutions.

Starting from the beginning of 2009 foreign investors have continued to increase holding of Polish government securities. At the end of 2011 non-residents' portfolio accounted for 30% of total debt in marketable Treasury Securities. In December 2011 non-residents expanded their portfolio by PLN1.2bn, after fall by nearly PLN6bn in previous month. At the end of 2011 portfolio of foreign investors amounted to PLN154.2bn.

The structure of foreigners' holding in wholesale bonds showed that non-banking financial sector strengthened its position on the Polish debt market. In 2011 the sector increased its involvement in Polish T-bonds by PLN32.5bn (as compared to the change by PLN38.8bn in 2010) to PLN129.3bn, which accounted for nearly 85% of total non-resident holding. On the other hand, foreign banks decreased their holding in Polish bonds by PLN5.7bn to PLN16.2bn.

It seems that foreign investors were very active on the Polish bond market also in January, increasing their holding further. We expect this trend to continue in 2012, assuming that the global financial market will show signs of stabilisation later during the year.

Domestic banks reduced their holding in T-bonds

In 2011 domestic banks were mainly on the supply side, reducing their holding in T-bonds to PLN103.3bn. However, it is worth noting that commercial banks were very active on the switch tenders in last months of 2011, helping the ministry to pre-finance the 2012 borrowing requirements.

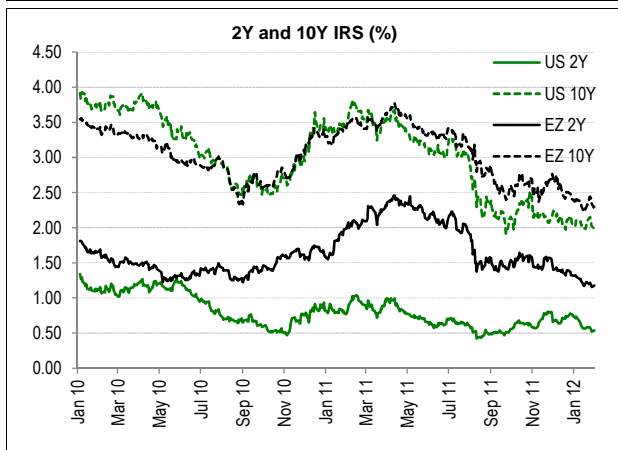
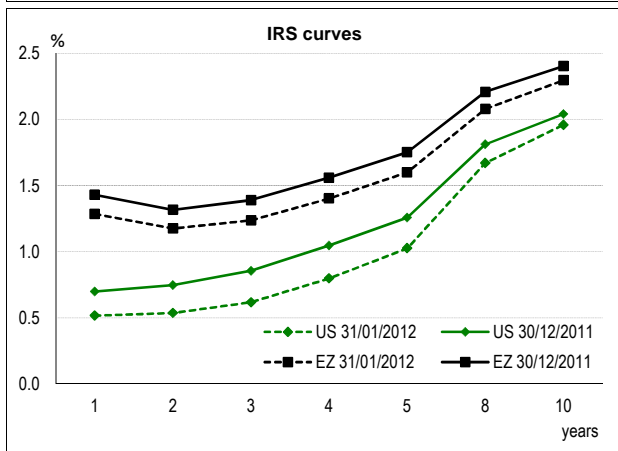
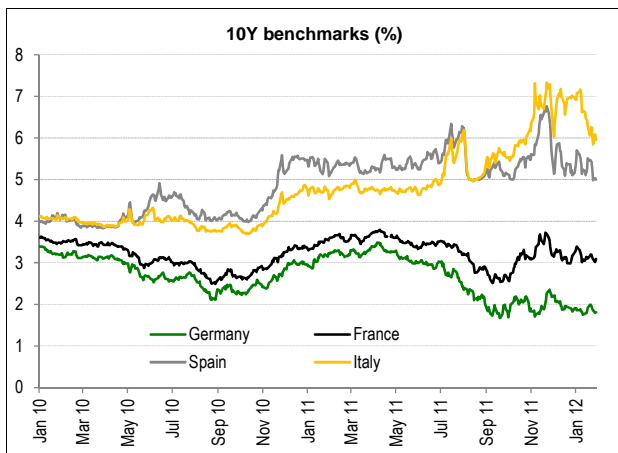
We think that 2012 will be the third year in a row of decreasing commercial banks' holding in Treasury Securities. However, the scale of their portfolio reduction will be probably significantly lower as compared to the previous year. Additionally, buy-sell back transactions with the Ministry of Finance would lead to increase of reported holdings of Treasuries by the commercial banks, so we forecast that their portfolio will maintain over PLN100bn throughout the year.

In case of other domestic investors, pension funds (OFE) expanded their portfolio in 2011, but the annual increase was significantly lower as compared to the previous years (by ca. PLN4.5bn vs. over PLN10bn on average in 2008-2010 period). It resulted from lower transfers to OFE. This year we expect further increase of pension funds' holding.

The end of 2011 brought increase of investment funds' holding. We predict this trend to continue in coming months, but a growth will be subdued.

Sources: Ministry of Finance, BZ WBK

International Bond Markets



Relatively strong demand on auctions in euro zone

- The beginning of the year brought heavy supply of debt securities in the euro zone and for some time it was treated as a main risk factors for market sentiment. However, Italian and Spanish debt auctions have benefited from the positive effects of the ECB's three-year LTRO in December, which was one of the factors behind moods improvement. As a result, auctions offers were fully allocated and in some cases, bid-cover ratio exceeded 2.0.
- At the end of January this year's borrowing needs of the euro zone countries were covered on average in 12.9%, with the realisation over 20% in Austria, Spain and Finland.

Peripherals sovereign debt strengthened

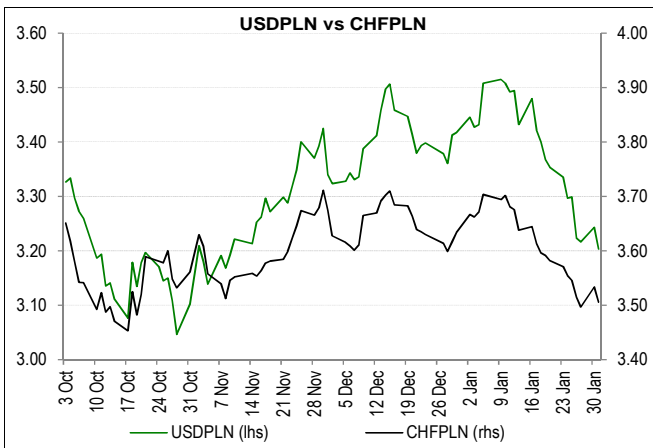
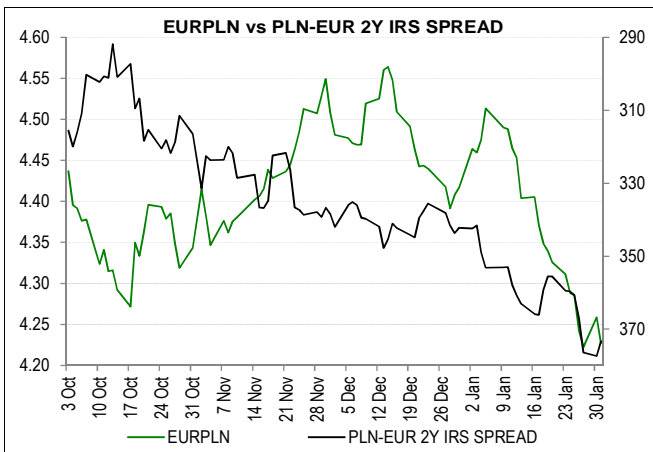
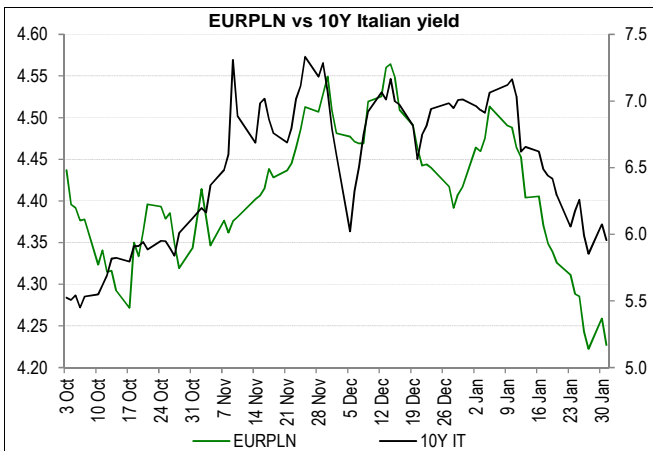
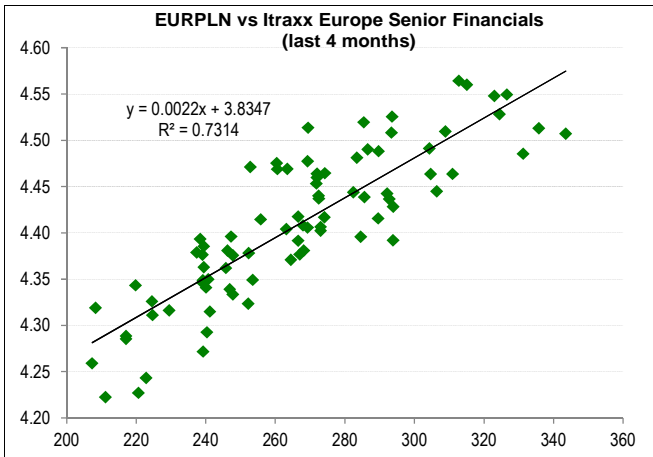
- In general, uncertainty regarding the PSI has sustained safe-haven securities i.e. the US Treasuries and Bunds, which oscillated around the lowest levels in history. The scale of investors' worries was also reflected in negative yields of Germany T-bills at January's auctions.
- After January's meeting, Fed unexpectedly announced that the Fed funds rate will remain "exceptionally low at least through late 2014". After this decision 2-5Y Treasuries spread slightly narrowed and we do not rule out this tendency to be continued in coming weeks.
- Despite issuance pressure at the beginning of this year and rating downgrades of most euro zone countries, the periphery bonds (mainly Italian and Spanish), strengthened, while Portuguese debt has remained under pressure, especially as some rumours appeared that Portugal (as Greece) will need debt restructuring and another financial support. At the end of January Italian 10Y benchmark yield fell below 6%, while Spanish 10Y benchmark yield decreased below 5%. At the same time 10Y benchmark in Portugal hit all-time high (with maximum level over 17%).
- Positive sentiment caused spread tightening of the periphery debt markets vs. Bunds. In case of Italy it narrowed to ca. 400bps at the end of January, while for Spain it was near 300bps.
- The auction calendar for the coming weeks is still relatively heavy and the situation in Greece will maintain high level of market uncertainty. On the other hand, 3Y LTRO scheduled for the last day of February should support the middle and short-end of the curve. It is expected that bids for refinancing operations will double the amount at the December's auction. If such a scenario materialises, it might be a supportive factor for peripherals debt.

Euro zone's issuance plans and completion in 2012 (€bn)

	Total redemptions	Deficit	Borrowing needs	Expected bond supply	% of completion
Austria	14	8.3	22.3	22.3	28.3
Belgium	27.9	7	34.9	26	18.8
Finland	6.3	7.5	13.8	13.8	21.8
France	101.7	78.7	180.4	178	13.4
Germany	157	26.6	183.6	170	
Greece	33.2	16.2	49.4		
Ireland	5.5	13.7	19.2		
Italy	192.2	41.1	233.3	233.3	7.4
Netherlands	29.7	12.3	42	60	8.1
Portugal	12.9	17.4	30.3		
Spain	50.1	36.2	86.3	86.3	23.2
Total	630.5	265.0	895.5	789.7	12.9

Source: Reuters, BZ WBK

Foreign Exchange Market



Lower worries over situation in euro zone backed zloty

At the very start of the year we saw zloty depreciation, to ca. 4.50 against the euro, after significant interventions of NBP and state-owned BGK bank drove EURPLN artificially down in last days of 2011. However, in January as a whole the zloty performed surprisingly well and gained 4.3% versus the euro, 6.3% versus dollar and 3.5% versus Swiss franc.

Several factors contributed to zloty's appreciation, but in our view the lower worries over developments in the euro zone played the main role (see charts on the left). Spain, Italy, Portugal, France managed to issue bonds at lower yields than on previous auctions amid very decent demand (partly fuelled by ECB's 3Y LTRO). That clearly led to lower yields on the secondary market of peripheral Europe and decline in CDS.

Apart from the support provided by global factors, positive performance of the Polish economy and hawkish bias of domestic central bank also fuelled downward trend of the EURPLN. It seems that when risk appetite dominates on the market and investors seek the best opportunities to allocate cash, Poland is perceived as a good place to invest.

Awaiting new impulse

Beginning of the year clearly showed that despite persisting uncertainty regarding developments in the euro zone, investors do not refrain from buying risky assets. It seems that market participants somewhat got used to continuous presence of risk factors and only a new (or currently not fully discounted) factor may trigger another wave of high risk aversion.

However, if we conduct such analysis further, another bunch of positive information might be needed to help risky assets to maintain recent gains. Latest macro data publications backed hopes that upcoming deceleration of economic growth will not be as severe as feared and currently market may be waiting for next positive surprises in that area.

In our view, the risk of zloty's depreciation due to problems in the euro zone and signals indicating slowdown of economic growth in Europe has not abated. Recent set of better than expected data may increase market's appetite for more positive surprises and any disappointment might trigger profit taking and change in current market sentiment.

Also, as we do not expect rate hike in coming months and we perceive recent hawkish comments as only verbal interventions (in order to anchor inflation expectations). If the MPC changes the wording amid inflation fall, which would lead to lower market rates, this might be an additional factor behind zloty weakening.

Forint outperforms CEE currencies after sell-off

Hungarian forint gained in January most in CEE3 currencies. After earlier huge depreciation triggered by risk of not receiving loan due to clash with European Commission and IMF on controversial central bank legislation, Hungarian currency regained strength. That was due to signals from the Hungarian government on willingness to include changes in law.

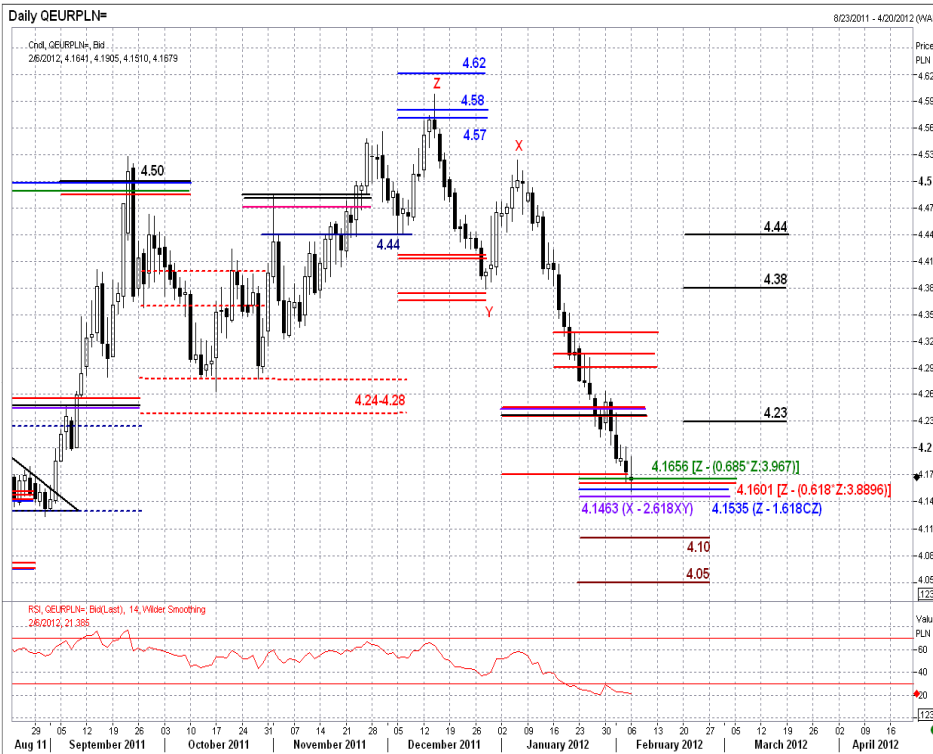
As Czech koruna also benefited from high demand for risky assets, the EURCZK declined in recent days to important psychological level of 25.0. The EURHUF also reached key level of support at ca. 288. If the above-mentioned levels are broken, rates may decline further to 24.6 and 280, respectively, but this would be possible with "no bad news" scenario.

Relief of market sentiment supports euro vs dollar

The EURUSD increased to 1.323 after reaching 1.26 in mid-January due to improved market mood. The EURCHF dropped slightly as the SNB's governor stepped down and the market was not sure whether his successor will be determined to defend the floor at 1.20.

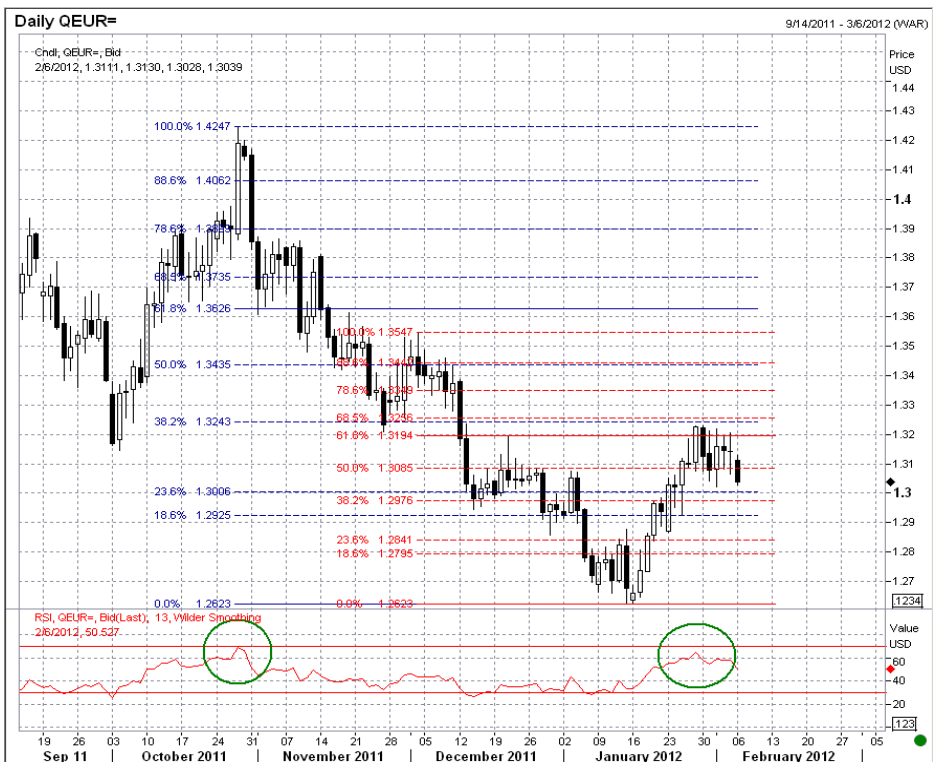
Sources: Reuters, BZ WBK

FX Technical Analysis Corner



EURPLN

- The exchange rate broke several important supports before it reached the lowest level since September 2011 at 4.151.
- Currently, the EURPLN is close to next crucial support derived from Fibon analysis. Additionally, this level of ca. 4.16 is important on weekly charts.
- Another factor in line with the view of domestic currency depreciation is the divergence of the RSI and the EURPLN. We observe the oscillator establishing local lows (since some time), while the exchange rate is only approaching levels from late August 2011. Similar divergence is observed also on weekly chart.
- This factor, together with the EURUSD being below important resistance – see chart below – gives higher chance for the zloty's depreciation.



EURUSD

- The exchange rate approached quite strong resistance at ca. 1.325 where levels from two retracements meet. Additionally, low at 1.321 set in late January 2012 and peak from late December 2011 (1.3197) provide additional resistance.
- RSI indicated some divergence in late January as the oscillator was close to maximum from October 2011 while the EURUSD was quite far from 1.43.
- The above-mentioned factors suggest downward move of the EURUSD, but so far support at 1.30 prevents the euro from suffering bigger depreciation.
- Also the fact that market remains very short the euro (despite recent cut of EURUSD shorts) constrains potential for more visible decline.
- Crucial levels for the EURUSD in coming weeks are 1.32-1.325 and 1.30.

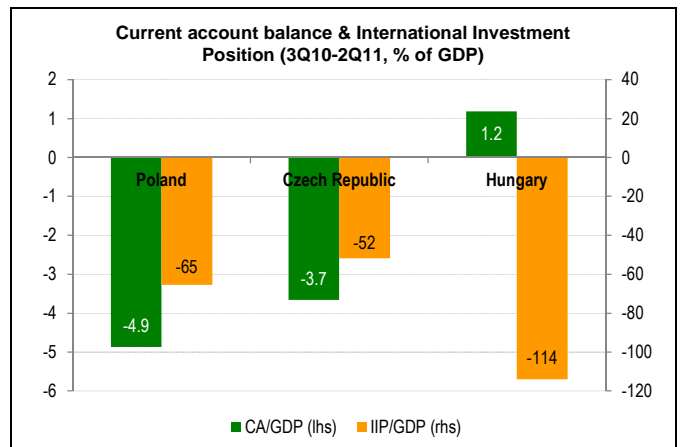
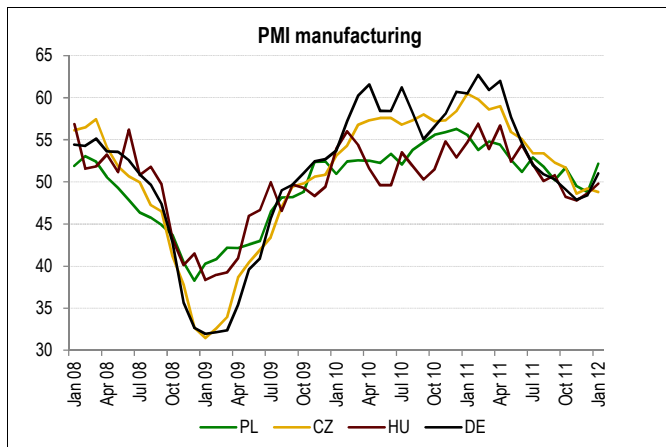
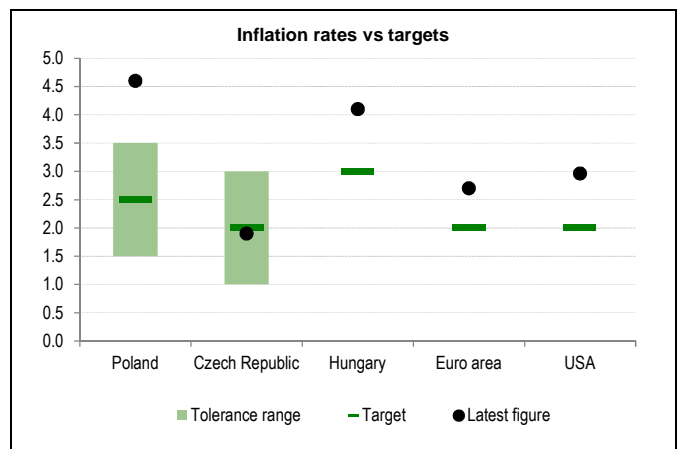
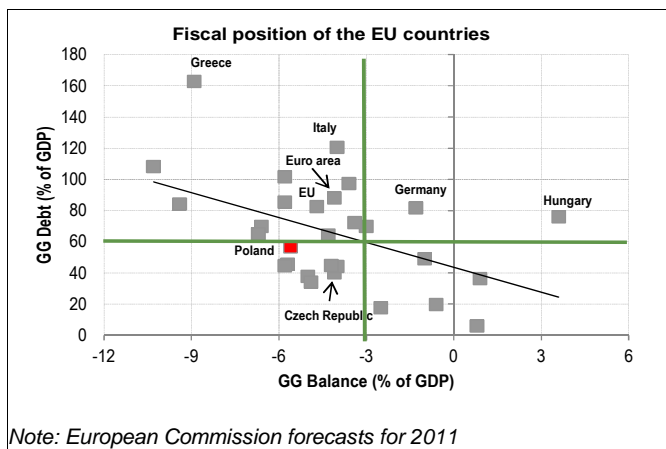
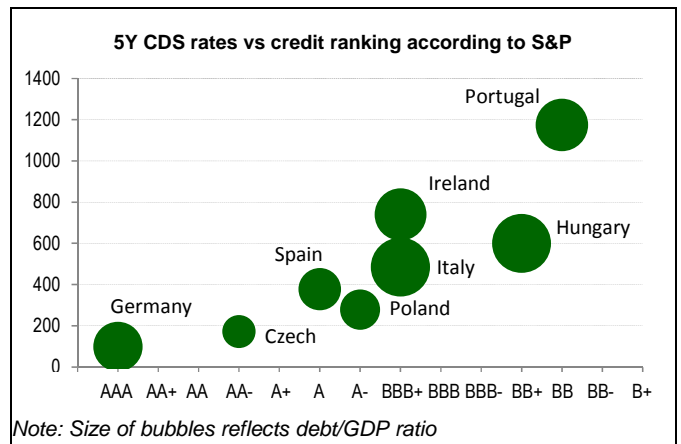
Sources: Reuters, BZ WBK

Poland vs other countries - economy

Main macroeconomic indicators (European Commission's forecasts)

	GDP (%)		Inflation (HICP, %)		C/A balance (% of GDP)		Fiscal Balance (% of GDP)		Public Debt (% of GDP)	
	2011E	2012F	2011E	2012F	2011E	2012F	2011E	2012F	2011E	2012F
Poland	4.3	2.5	3.7	2.7	-5.0	-4.3	-5.6	-4.0	56.7	57.1
Czech Republic	1.8	0.7	1.8	2.7	-3.6	-3.2	-4.1	-3.8	39.9	41.9
Hungary	1.4	0.5	4.0	4.5	1.7	3.2	3.6	-2.8	75.9	76.5
EU	1.6	0.6	3.0	2.0	-0.3	0.0	-4.7	-3.9	82.5	84.9
Euro area	1.5	0.5	2.6	1.7	-0.1	0.0	-4.1	-3.4	88.0	90.4
Germany	3.1	0.3	2.4	1.7	5.1	4.4	-1.3	-1.0	81.7	81.2

	Sovereign ratings					
	S&P		Moody's		Fitch	
	rating	outlook	rating	outlook	rating	outlook
Poland	A-	stable	A2	stable	A-	stable
Czech	AA-	stable	A1	stable	A+	stable
Hungary	BB+	negative	Ba1	negative	BB+	negative
Germany	AAA	stable	Aaa	stable	AAA	stable
France	AA+	negative	Aaa	stable	AAA	negative
UK	AAA	stable	Aaa	stable	AAA	stable
Greece	CC	negative	Ca	---	CCC	negative
Ireland	BBB+	negative	Ba1	negative	BBB+	negative
Italy	BBB+	negative	A2	negative	A-	negative
Portugal	BB	negative	Ba2	negative	BB+	negative
Spain	A	negative	A1	negative	A	negative

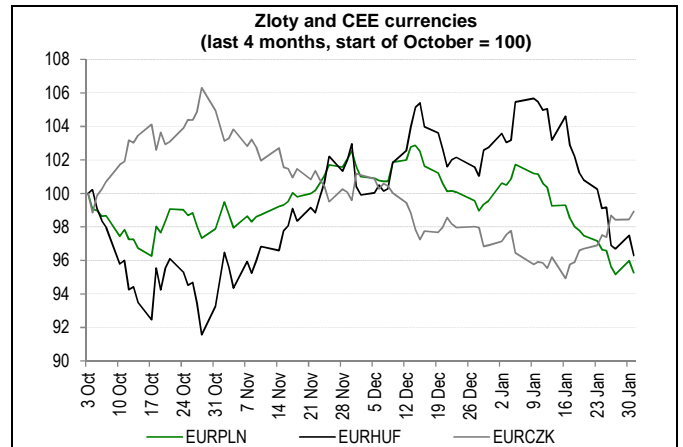
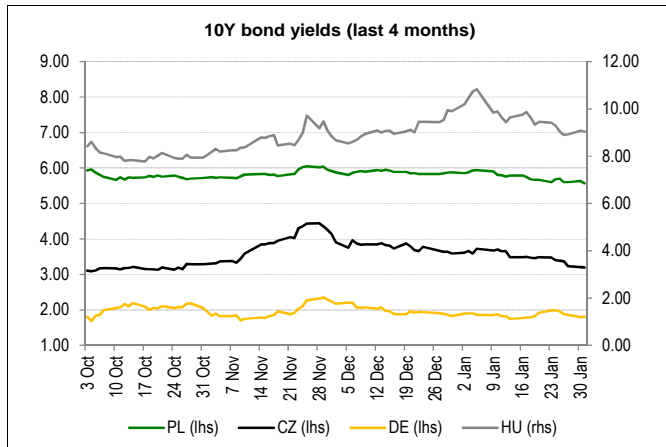
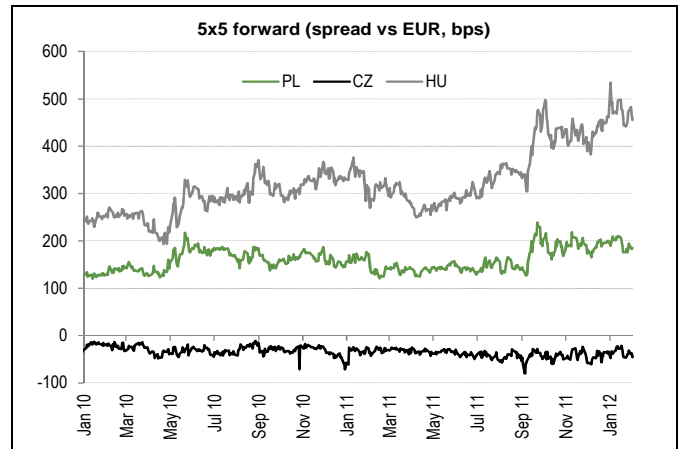
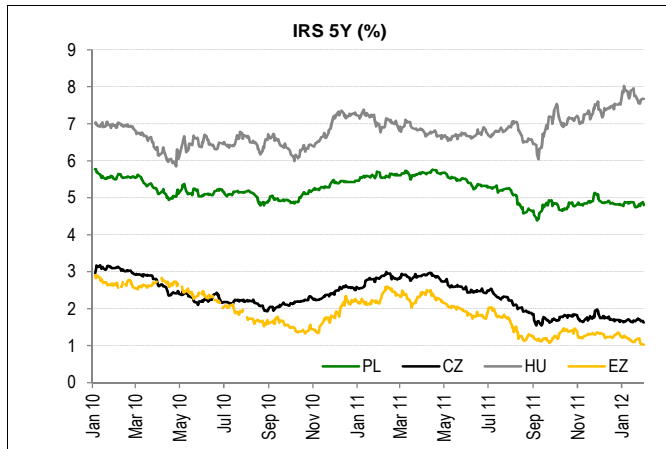
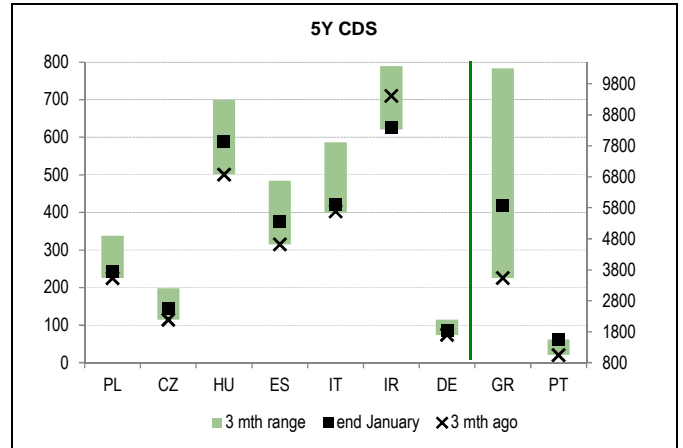
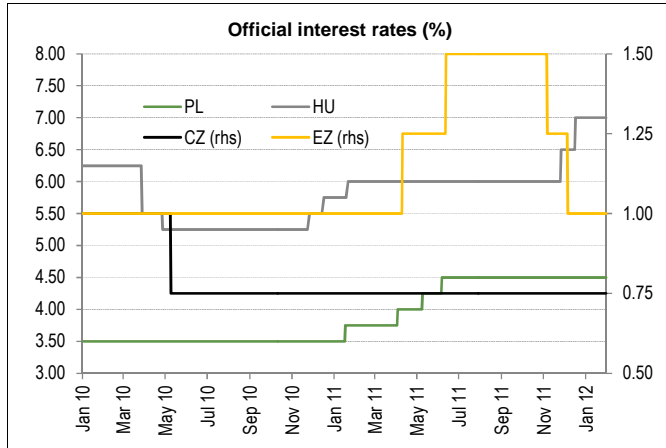


Source: stat offices, central banks, Reuters. BZ WBK, EC

Poland vs other countries - market

Main market indicators (%)

	Reference rate (%)		3M market rate (%)		10Y yields (%)		10Y Spread vs Bund (bps)		CDS 5Y 2011
	2011	2012F	2011	2012F	2011	2012F	2011	2012F	
Poland	4.50	4.00	4.99	4.30	5.88	5.80	405	355	279
Czech Republic	0.75	0.75	0.78	-	3.59	-	176	-	173
Hungary	7.00	7.00	7.24	-	9.90	-	807	-	599
Euro area	1.00	0.75	1.36	1.15	-	-	-	-	-
Germany	-	-	-	-	1.83	2.25	-	-	99.2



Source: stat offices, central banks, Reuters. BZ WBK, EC

Central Bank Watch

		Last	2011	2012F	Expected changes (bps)			Risks
					1M	3M	6M	
Euro	Forecast	1.00	1.00	0.75	0	-25	-25	ECB will keep interest rates unchanged in February. However, we do not rule out interest rates cut in March, when new macro projections will be published
	Market implied »				-14	-28	-36	
UK	Forecast	0.50	0.50	0.50	0	0	0	We expect the BoE to keep interest rates on hold in coming months. But we do not rule out the possibility that QE to be extended further
	Market implied »				-4	-10	-14	
US	Forecast	0-0.25	0-0.25	0-0.25	0	0	0	At January's meeting Fed has prolonged period of the near-zero interest rates till late 2014.
	Market implied »				-6	-8	-7	
Poland	Forecast	4.50	4.50	4.00	0	0	-25	MPC remains hawkish despite downside risk to GDP growth. We foresee rates unchanged till mid-year. Rate cut possible in July, at the earliest.
	Market implied »				1	3	-2	
Czech	Forecast	0.75	0.75	0.75	0	0	0	Downside risks to growth argue against tightening.
	Market implied »				37	32	32	
Hungary	Forecast	7.00	7.00	7.00	0	0	0	Recent HUF strengthening and weak macro data are against monetary policy tightening. Market awaits for deal with the IMF/EU.
	Market implied »				7	28	18	

Note: Market implied expectations show implied changes in 3M market rates based on FRA rates

Economic Calendar and Events

Date	Event:	Note:
8-Feb	PL MPC Meeting – interest rate decision	Our forecast and market consensus: no change
	DE Auction of 5Y Notes	Offer: €4bn
9-Feb	PL Auction of 2Y and 5Y T-bonds	Offer: PLN3.0-6.0bn
	EZ ECB Meeting – interest rate decision	Our forecast and market consensus: 1.00%
	GB BoE Meeting – interest rate decision	Our forecast and market consensus: 0.50%
14-Feb	IT Auction of 3Y and 15Y or 30Y BTPs	-
15-Feb	PL CPI for January – preliminary data	Our forecast: 4.2%YoY, against consensus 4.3%
	ES Auction of Treasury Bonds	-
16-Feb	PL Auction of floating rate T-bonds WZ0171	Offer: PLN1.0-3.0bn
	PL Employment and wages for January	Weak data, supporting slowdown in consumption
17-Feb	PL Industrial output for January	Strong figure, possibly two-digit annual growth
20-Feb	EZ Eurogroup Meeting	-
21-Feb	EU ECOFIN Meeting	-
23-Feb	PL Retail sales for January	Strong growth, visible slowdown expected in Feb.
28-Feb	HU NBH Meeting – interest rate decision	Our forecast: 7.00%
29-Feb	EZ ECB: 3Y Long-term refinancing operation	-
7-Mar	PL MPC Meeting – interest rate decision	Our forecast and market consensus: no change in rates. The new projection will be important to determine future decisions.
8-Mar	EZ ECB Meeting – interest rate decision	Rate cut by 25 bp expected. The new staff forecasts, possibly GDP growth rate for 2012 below zero.

Source: stat offices, central banks, Reuters, BZ WBK

Economic and market forecasts

Poland		2009	2010	2011	2012	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12
GDP	PLNbn	1,343.4	1,415.4	1,531.6	1,623.5	349.3	369.3	375.1	437.9	373.6	391.0	398.0	460.8
GDP	%YoY	1.6	3.9	4.3	2.3	4.5	4.3	4.2	4.1	2.9	2.3	2.2	2.0
Domestic demand	%YoY	-1.1	4.6	3.8	0.7	4.4	4.3	3.2	3.4	1.2	-0.1	0.6	0.9
Private consumption	%YoY	2.1	3.2	3.1	1.8	3.7	3.6	3.0	2.0	1.5	1.8	2.0	2.0
Fixed investments	%YoY	-1.2	-0.2	8.7	4.1	5.9	6.9	8.5	10.8	8.0	4.0	4.0	3.0
Unemployment rate ^a	%	12.1	12.4	12.5	13.3	13.3	11.9	11.8	12.5	13.6	12.9	12.3	13.3
Current account balance	EURm	-12,152	-16,493	-14,953	-8,579	-3,135	-3,359	-4,709	-3,750	-1,184	-1,363	-3,341	-2,691
Current account balance	% GDP	-3.9	-4.7	-4.0	-2.3	-4.8	-4.9	-4.7	-4.0	-3.5	-3.0	-2.6	-2.3
General government balance	% GDP	-7.3	-7.9	-5.0	-3.5	-	-	-	-	-	-	-	-
CPI	%YoY	3.5	2.6	4.3	3.7	3.8	4.6	4.1	4.6	4.0	3.6	3.9	3.3
CPI ^a	%YoY	3.5	3.1	4.6	3.0	4.3	4.2	3.9	4.6	3.6	3.9	4.1	3.0
CPI excluding food and energy prices	%YoY	2.7	1.6	2.4	2.7	1.7	2.3	2.6	3.0	2.9	2.6	2.7	2.5
EUR/PLN	PLN	4.33	3.99	4.12	4.34	3.94	3.96	4.15	4.42	4.32	4.46	4.36	4.23
USD/PLN	PLN	3.11	3.02	2.96	3.45	2.88	2.75	2.94	3.28	3.35	3.53	3.48	3.46
CHF/PLN	PLN	2.87	2.90	3.34	3.36	3.06	3.16	3.56	3.60	3.55	3.50	3.29	3.10
GBP/PLN	PLN	4.86	4.66	4.75	5.16	4.62	4.48	4.72	5.15	5.10	5.31	5.19	5.07
Reference rate ^a	%	3.50	3.50	4.50	4.00	3.75	4.50	4.50	4.50	4.50	4.50	4.00	4.00
WIBOR 3M	%	4.42	3.94	4.54	4.67	4.10	4.43	4.72	4.91	4.99	4.95	4.43	4.33
Yield on 52-week T-bills	%	4.54	3.96	4.51	4.32	4.37	4.62	4.54	4.50	4.51	4.50	4.22	4.05
Yield on 2-year T-bonds	%	5.17	4.72	4.81	4.63	5.01	4.97	4.54	4.71	4.74	4.65	4.57	4.57
Yield on 5-year T-bonds	%	5.65	5.31	5.44	5.09	5.79	5.60	5.17	5.19	5.12	5.08	5.06	5.10
Yield on 10-year T-bonds	%	6.11	5.74	5.98	5.68	6.27	6.03	5.77	5.83	5.68	5.71	5.62	5.70

Source: CSO, NBP, Finance Ministry, BZ WBK own estimates; ^a at the end of period

This analysis is based on information available until 6th February 2012 and has been prepared by:

ECONOMIC ANALYSIS DEPARTMENT

ul. Marszałkowska 142. 00-061 Warszawa. fax +48 22 586 83 40

Email: ekonomia@bzwbk.pl Web site (including Economic Service page): <http://www.bzwbk.pl>

Maciej Reluga – Chief Economist

tel. +48 022 586 83 63. Email: maciej.reluga@bzwbk.pl

Piotr Bielski +48 22 586 83 33

Agnieszka Decewicz +48 22 586 83 41

Marcin Luzziński +48 22 586 83 62

Marcin Sulewski +48 22 586 83 42

TREASURY SERVICES DEPARTMENT

Poznań

pl. Gen. W. Andersa 5
61-894 Poznań
tel. +48 061 856 58 14
fax +48 061 856 55 65

Warszawa

ul. Marszałkowska 142
00-061 Warszawa
tel. +48 022 586 83 20
fax +48 022 586 83 40

Wrocław

ul. Rynek 9/11
50-950 Wrocław
tel. +48 071 370 25 87
fax +48 071 370 26 22

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