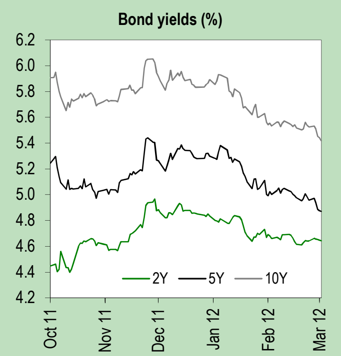
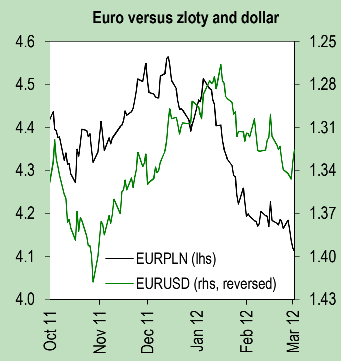
Bank Zachodni WBK

Rates and FX Outlook

Polish Financial Market

March 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

Email: ekonomia@bzwbk.pl

- **In February we saw the continuation of rally in risky assets.** This was visible in the Polish bond market, which strengthened significantly and the local currency appreciated again. As regards the bond curve, fall in yields was observed mostly in the middle and long-end of the curve (another 10 bps down after 30 bps in January), while the zloty gained another 2% against the euro (almost 5% in January). The main factor behind positive sentiment on the Polish market was positive global mood after a few better-than-expected data and expectations for second LTRO by ECB.
- **The economic data published recently on the Polish economy indeed showed good performance**. Figures for January in terms of both production and sales, as well as our forecasts for February-March, suggest that slowdown in Q1 may not be as significant as one could have previously expected. Also, the end of 2011 was quite impressive with GDP in Q4 above expectations (4.3%YoY), mainly due to sharp rebound in fixed investments (double-digit growth). At the same time, consumption seems to continue the slowdown and therefore the growth breakdown should not be overly worrisome from the point of view of the central bank. Nevertheless, the Monetary Policy Council still keeps the so-called restrictive bias, suggesting a possibility of rate hike.
- **We do not think a rate hike may be on the agenda this year**. It is quite clear that 12M CPI staying much above the target for a number of months already creates some internal pressure within the MPC, which does not feel comfortable with “high growth + high inflation” environment. However, we think that within the next few months inflation will reach the upper end of tolerance range around the target (3.5%) and together with an economic slowdown more visible in statistics for March, this should change the rhetoric of the Council. Before this happens, we will see a small inflation increase in the figure for February, so it is hard to expect a continuation of yields decrease at the short-end of the curve. As regards the long end, we expect a correction to take place in March, though the global moods will be critical. While the data on the Polish Treasuries holders show that the rally was initiated in January by foreign investors, it looks like it continued in February mostly due to local players.
- **Similarly as in case of expected correction in 5-10Y segment, deterioration in global sentiment may be a reason for some weakening of the zloty in March.** Against our expectations presented a month ago, the EURPLN broke quite strong support area at around 4.15 and declined to 4.093 (lowest level since mid-August). We believe at this stage a possibility of profit taking after recent rally of the zloty is getting higher. We still do not exclude a more significant weakening of the Polish currency in case of some negative developments regarding the procedure and results of debt restructuring in Greece.

This report is based on information available until 2nd March

Short- and Medium-term Strategy

Interest rate market

	Change (bps)		Level	Expected trend	
	Last 3M	Last 1M	end-Feb	1M	3M
Reference rate	0	0	**4.50**	→	→
WIBOR 3M	-1	-3	**4.96**	→	→
2Y bond yield	-22	-1	**4.65**	→	→
5Y bond yield	-38	-12	**4.89**	↗	↗
10Y bond yield	-50	-11	**5.45**	↗	↗
2/10Y curve slope	-28	-10	**80**	↗	↗

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

Rates: our view and risk factors	
PLN rates market	**Money market:** WIBOR rates still elevated and this is not likely to change soon. FRA started to price-in a possibility of rate cut in 4Q12, but the MPC keeps hawkish bias and this will not change until CPI falls to ca. 3.5% (data for March-April, to be released in 2Q).
	Short end: After sharp downward move in 2Y yield in January, February saw stabilisation. We see similar scenario for March, though there is a risk of correction towards 4.70% as we expect CPI inflation for February (release in mid-March) above market consensus, together with hawkish bias of the MPC and strong economic figures. Also, potential for 2Y swap to increase from current 4.80%.
	Long end: Rally continued in 5Y segment against our expectations. We still expect the correction of recent sharp downward move in yields, back to important levels of 5% for 5Y and 5.50% for 10Y bonds. IRS curve should stay rather flat at ca. 4.80%.
	Risk factors to our view: Another wave of optimism and improvement in global moods would lead to further gains in the Polish bond market, which would reinforce the 2012 rally even more. If this is accompanied by positive inflation surprise (the lowest market forecast at 3.8%), market may start to price-in monetary easing earlier than we currently expect (2H 2012).

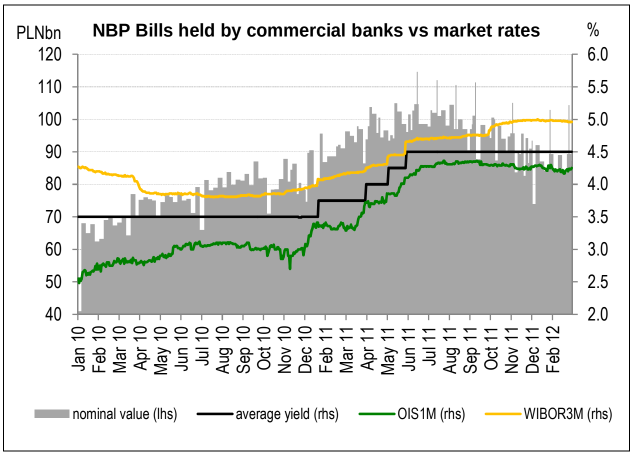
FX market

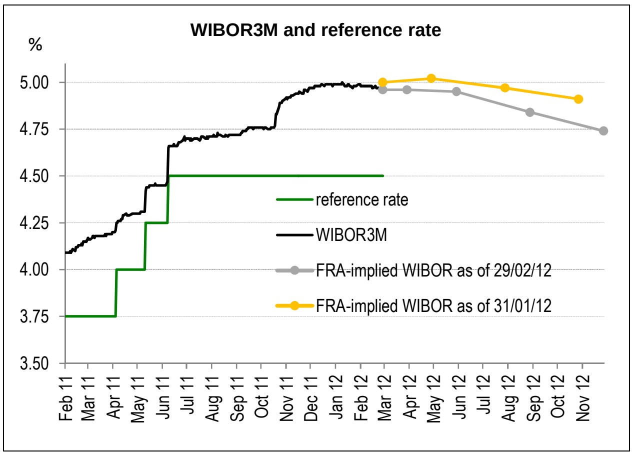
	Change (%)		Level	Expected trend	
	Last 3M	Last 1M	end-Feb	1M	3M
EURPLN	-9.1	-2.1	**4.14**	↗	↗
USDPLN	-10.3	-4.1	**3.07**	↗	↗↗
CHFPLN	-7.5	-2.1	**3.43**	→	↘
GBPPLN	-8.0	-3.0	**4.90**	↗	↗
EURUSD	1.3	2.0	**1.35**	↘	↘↘

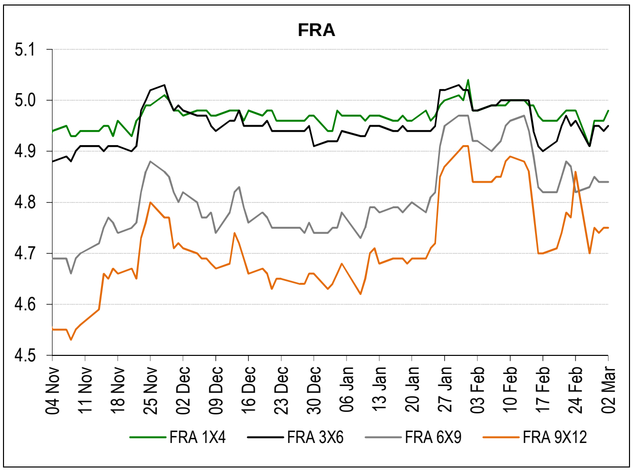
Note: Single arrow down/up indicates at least 1.5% expected move down/up, double arrow means at least 5% move

FX: our view and risk factors	
PLN FX market	**EUR:** Risk factor to our last month's view materialised and risk appetite dominated the global markets. EURPLN approached the indicated technical level of 4.10 and rebounded slightly at the start of March. We see this upward move to continue towards 4.20.
	USD: EURUSD started the downward trend as expected and if this is continued, the pressure on the Polish currency would be more significant against the greenback than against the euro. This trend should be more visible in three-month time.
	CHF: Possible upward move in EURCHF (the SNB may attempt to raise EURCHF currency floor from current 1.20) would limit the scale of zloty weakening against the Swiss franc in March.
	Risk factors to our view: Greece restructuring deal goes smoothly and the market prices no risk connected with further steps in the euro zone (fiscal package implementation, elections in France and Greece etc.). Another risk-on rally would bring EURPLN below recent low of 4.10, towards 4.0.

Money Market







Polish banking sector is continuously overliquid

▪ As expected, February ended with overbuilt reserve level. Therefore, the NBP executed one additional open market operation mopping up PLN15.0bn excess liquidity on 28 February. The rest of the surplus liquidity was traditionally invested in the form of deposits at the NBP - at the end of February it was nearly PLN3bn.

▪ For March the minimum reserve requirement level was set at PLN29.1bn. In the first week of March commercial banks purchased NBP's bills worth PLN87.3bn (vs nearly PLN89bn in previous week). It suggests WIBOR O/N rate stabilization around the reference rate in the first half of the month, while the second half of March could bring higher volatility on the short end of WIBOR rates.

▪ Sentiment on the money market improved a bit, bringing OIS rates slightly down by 4-6bps on average. At the end of February 3M OIS rate was traded below 4.25%. It reflects quite high availability of money in the banking system. However, it is noteworthy that OIS market liquidity is rather low.

▪ Thanks to better global moods there was also improvement in terms of long-term funding in foreign currencies with EURPLN basis swaps falling by 2-5bps (currently 5 and 10Y ca. -70 bps).

WIBOR rates should fall gradually

▪ February brought some gradual fall of WIBOR rates by 1-3bps, however WIBOR rates between 6M and 1Y have remained flat. We noted some increase in investors' activity on the 3M, but it is still too low to push market rates down, especially taking into account uncertain situation on the global market. However, the spread between 3M WIBOR and NBP's rate narrowed only by 3bps in monthly terms.

▪ After some deterioration due to hawkish MPC statement, sentiment improved later during the month due to lower-than-expected CPI for January and ahead of LTRO. Market believed that the MPC will not be in a hurry to hike interest rates, keeping "wait and see" stance in coming months. FRA rates moved down by 4-17bps compared with the end of January. The most significant decrease in FRA rates (above 10bps) was noted in case of longer tenors 6x9 and 9x12. As a consequence, currently the FRA rates clearly show lower path of WIBOR 3M in coming months. It is also suggested that market has started to discount a cut by 25bps in H2 2012.

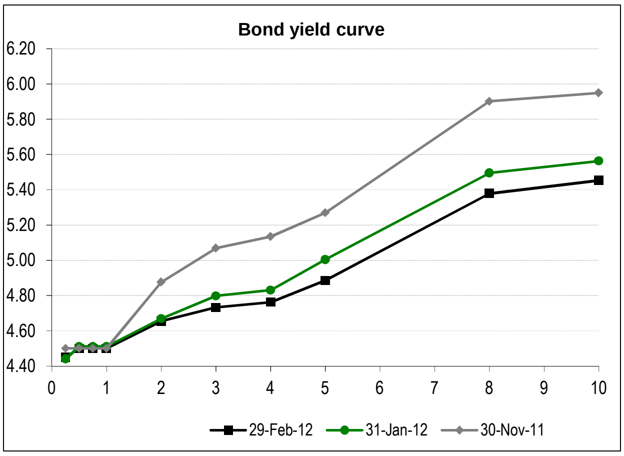
▪ We are a bit more optimistic than market in case of interest rates cuts later this year. Our baseline scenario assumes two cuts by 25bps each in H2 2012 due to significant slowdown of GDP growth and falling headline CPI. Therefore we expect WIBOR rates decrease to be subdued till mid-year (strongly dependent on the inflation CPI readings and in general on global mood). We predict a more significant downward move no sooner than in H2 2012.

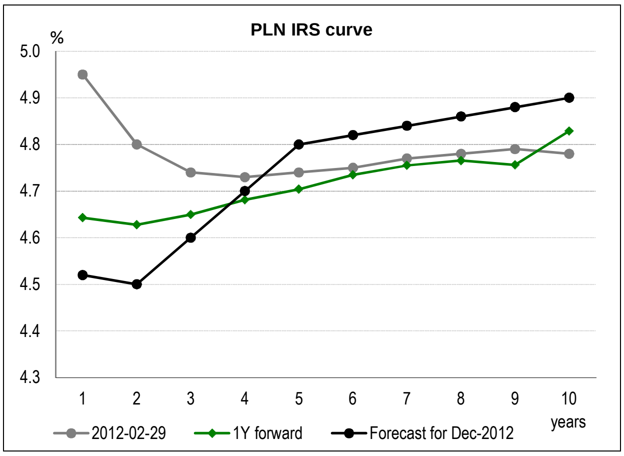
Money market rates (%)

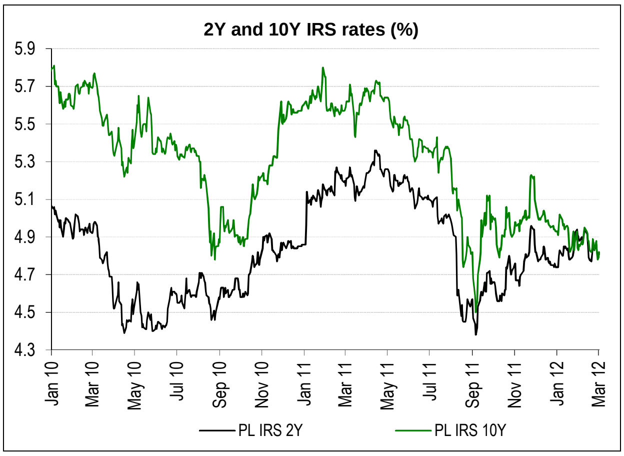
	Reference rate (%)	Polonia (%)	WIBOR (%)				OIS (%)				Spread WIBOR / OIS (bp)			
			1M	3M	6M	12M	1M	3M	6M	12M	1M	3M	6M	12M
End of February	**4.50**	**4.51**	**4.74**	**4.96**	**4.98**	**4.98**	**4.23**	**4.23**	**4.23**	**4.23**	**51**	**73**	**75**	**75**
Last 1M change (bp)	0	124	-1	-2	-3	-3	-6	-14	-13	-14	5	12	10	11
Last 3M change (bp)	0	9	-1	0	1	1	-8	-9	-11	-12	7	9	12	13
Last 1Y change (bp)	75	128	85	81	61	44	84	70	46	18	1	11	15	26

Sources: Reuters, BZ WBK

IRS and T-Bond Market







Domestic bond market has continued to rally in February

▪ Positive sentiment on the domestic debt market has continued in February. As we predicted the January CPI reading surprised strongly on the downside and caused quite a strong rally on the short end of the curve. 2Y benchmark yield fell towards 4.61% (the lowest level since November 2011). However, after information that in March the MF also refrained from switch tender we noted some sell-off on the short-end of the curve and 2Y benchmark ended the month with yield 4.65% (which means decrease by only 2bps as compared with the end of January).

▪ We observed a more significant move at the mid and long end of the curve. In monthly terms yields decreased by over 10bps. Yields of 5Y and 10Y benchmarks broke support levels at 5.00% and 5.50%, respectively. At the end of February they were traded around 4.89% in case of 5Y (the lowest level since September 2011) and 5.45% in case of 10Y (the lowest level since October 2010).

▪ Better inflation release for January also helped IRS rates to recover. The 1Y IRS fell below 5% towards 4.93% (the minimum level in February), while 2Y rate dropped towards 4.77%. More gradual decrease was noted in case of rates on mid and long-end of the IRS curve. It is noteworthy that 10Y IRS decreased temporarily below 4.80% (the lowest level since the beginning of October 2011). However, last days of February brought some corrective move on the short end, offsetting earlier gains.

We expect upward correction move

▪ Recent market conditions are still favourable for debt market: positive global sentiment after LTRO, which should support higher appetite for risky assets, while on the domestic side: comfortable budget liquidity situation and expected significantly lower supply after April. However, after strong rally in the first two months we expect upward correction move in yields in 5Y+ segment, though there is a risk of further rally in short run and the situation on the core markets will be crucial – uncertainty about Greek debt restructuring will put some pressure on the long end of the Polish curve.

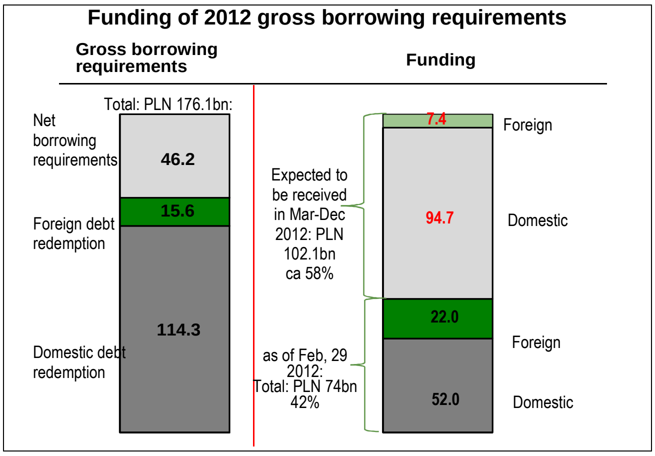
▪ The key point in March, especially for the short-end, will be new inflation and GDP projections (some details will be known after the March rate setting meeting) and CPI inflation reading for February (together with the final figure of January). We do not expect significant changes in CPI inflation path compared with the November's projection. We also think that the MPC will keep previous hawkish rhetoric. This, together with our forecast of CPI inflation for February (4.2%YoY vs. market consensus at 4.1%) should keep the short-end of the bond curve at elevated levels (increase towards 4.70% in coming weeks possible).

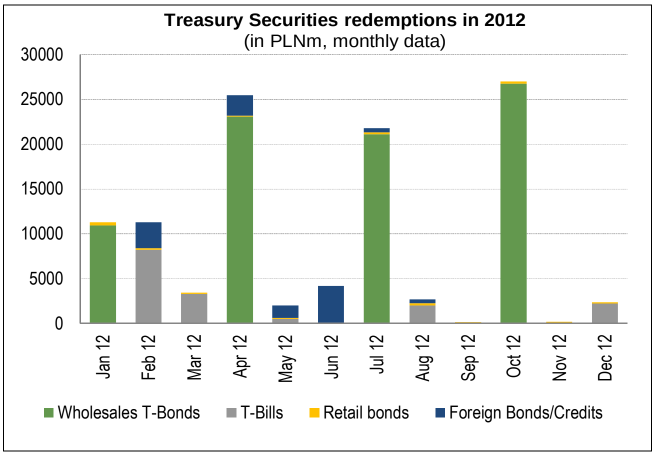
Bond and IRS market (%)

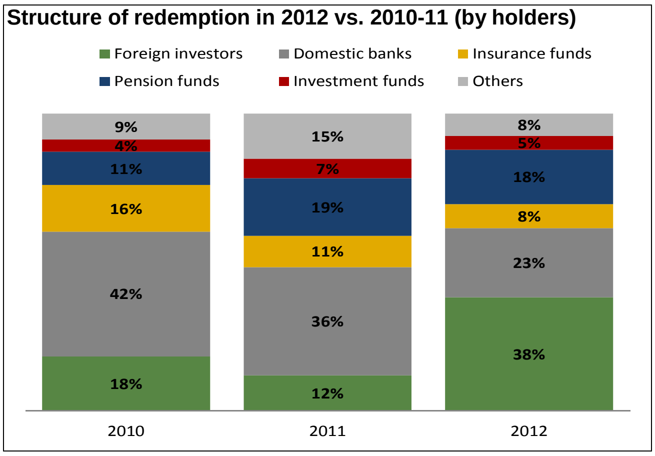
	T-bills	BONDS			IRS			Spread BONDS / IRS (bp)		
	52-week	2Y	5Y	10Y	2Y	5Y	10Y	2Y	5Y	10Y
End of February	**4.50**	**4.65**	**4.89**	**5.45**	**4.80**	**4.74**	**4.78**	**-15**	**15**	**67**
Last 1M change (bp)	-1	-4	-17	-15	-12	-10	-9	8	-7	-6
Last 3M change (bp)	5	-31	-52	-57	-14	-35	-44	-17	-17	-13
Last 1Y change (bp)	-3	-41	-94	-78	-39	-87	-79	-2	-7	1

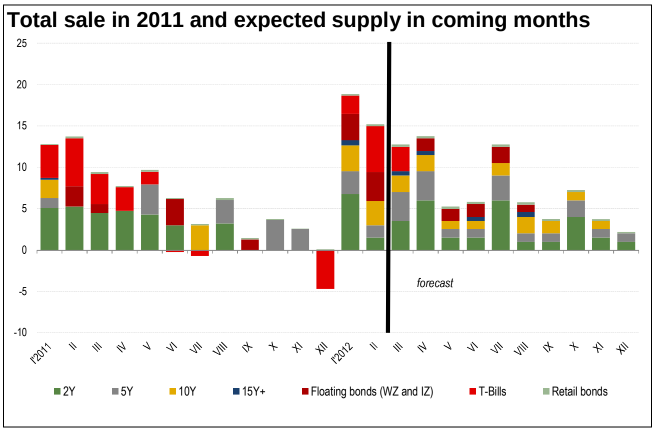
Sources: Reuters, BZ WBK

Treasury Securities Supply Corner









Sources: Ministry of Finance, BZ WBK

The MF benefited from favourable market conditions

- Poland's Ministry of Finance successfully launched debt securities on both domestic and foreign markets. In February wholesale bonds worth ca. PLN11.5bn (up from PLN10.8bn in January) were sold, with healthy demand and yields lower compared with previous auctions. On the other hand, as expected the MF reduced its debt in T-bills (by ca PLN2.4bn), offering 52-week bills at one auction only.
- In February the MF was active also on foreign market, offering a 10-year EUR denominated Registered Bonds under German law. The Ministry sold bonds (maturing on 24 February 2022) worth €527m with yield of 4.814% (or 242bps over mid-swap rate).
- To sum up, at the end of February the MF financed nearly 42% of its gross borrowing requirements. At the end of the month the liquidity cushion (both in PLN and in foreign currency) increased to ca. PLN40bn (up by almost PLN10bn compared to end of January). Current budget liquidity situation is still supportive for the bond market, allowing the MF to limit supply in the following months.

The March offer of debt securities in line with predictions

- The MF's issuance plan for March is more or less in line with expectations. In three auctions in March the MF will offer fixed-rate securities, i.e. PS1016, OK0114 and DS1021/WS0429 worth of PLN4.0-9.5bn in total.
- The MF has continued its strategy to reduce debt in T-bills. In March there will be only one auction of 52-week T-bills (at the end of the month) worth PLN1.0-3.0bn, which means debt decrease in these instruments by ca. PLN 0.3-2.3bn. We find it noteworthy that the Finance Ministry's public debt department director Piotr Marczak said that the Ministry could proceed to another buy-back of T-bills. Due to low offer of T-bills in March, we foresee this instruments to remain relatively expensive.
- Commenting on the foreign exchange borrowing needs, Marczak said that "to realise the base-case scenario in terms of foreign financing, one more benchmark issue denominated in euro or dollar would be necessary". Therefore, we decide to change our issuance prediction, currently expecting the next issue on the foreign market in the second half of 2012.
- We believe that the structure of supply is a response to current market demand and therefore we see no problems with selling the whole March offer.

Auction schedule slightly modified, as in February

- As in February, the Ministry refrained from switch tender, offering the 5Y benchmarks PS1016 at regular auction instead. Such a decision came from low liquidity of short-term bonds. We would like to recall that foreign investors hold most of outstanding amount of bonds, which will be redeemed this year (nearly 40%) and they are rather not active on switch tenders. Therefore, we do not exclude that the MF may significantly reduce number of switch auctions this year, but it will depend on market conditions.
- At the end of March the MF will announce issuance plan for 2Q12. In 2Q12 as a whole we expect rather limited supply of wholesale T-bonds, but only in April the offer of securities will be high due to high redemption of PS0412 (worth PLN23bn) and coupon payments (worth ca. PLN7bn).
- Overall, Marczak highlighted: "if the market situation allows, in March and April we will maintain the above-average pace of borrowing needs' financing", and then the FinMin will reduce the supply of Treasury Securities significantly. Limited offer should support bond market in medium term, reducing negative impact of possible sentiment deterioration.

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	11,503	9,500	13,500	5,000	5,380	12,500	5,500	3,500	6,000	3,500	2,000	88,703
T-bills auction	2,223	5,778	3,000	0	0	0							11,001
Retail bonds	213	250	250	250	250	250	250	250	250	220	200	200	2,833
Foreign bonds/credits	7,979	2,200	0	0	0	0	0	0	4,200	0	3,000	0	17,379
Prefinancing and financial resources at the end of 2011	31,600												31,600
Total	**52,835**	**19,732**	**12,750**	**13,750**	**5,250**	**5,630**	**12,750**	**5,750**	**7,950**	**6,220**	**6,700**	**2,200**	**151,516**
Redemption	11,297	3,981	5,275	23,203	4,855	2,778	25,718	3,127	1,058	27,014	924	2,368	111,598
Net inflows	**41,537**	**15,751**	**7,475**	**-9,453**	**395**	**2,852**	**-12,968**	**2,623**	**6,892**	**-20,794**	**5,776**	**-168**	**39,918**
Rolling over T-bonds	6,309	0	0	0	0	0	0	0	0	0	0	0	**6,309**
Buy-back of T-bills													**0**
Total	**47,846**	**15,751**	**7,475**	**-9,453**	**395**	**2,852**	**-12,968**	**2,623**	**6,892**	**-20,794**	**5,776**	**-168**	**46,227**
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)

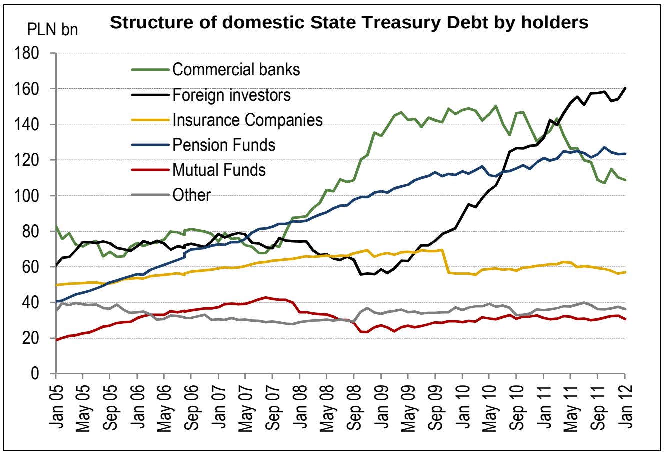
	Bonds	Bills	Retail bonds	Total domestic redemption	Foreign Bonds/Credits	Total redemptions
January	10,946	0	351	**11,297**	0	**11,297**
February	0	3,799	182	**3,981**	0	**3,981**
March	0	1,997	129	**2,125**	3,150	**5,275**
April	23,071	0	132	**23,203**	0	**23,203**
May	0	2,223	117	**2,339**	2,516	**4,855**
June	0	0	112	**112**	2,666	**2,778**
July	21,090	0	218	**21,308**	4,410	**25,718**
August	0	1,997	248	**2,245**	882	**3,127**
September	0	0	176	**176**	882	**1,058**
October	26,749	0	265	**27,014**	0	**27,014**
November	0	0	208	**208**	716	**924**
December	0	2,223	146	**2,368**	0	**2,368**
Total 2012	81,856	12,238	2,283	**96,378**	15,221	**111,598**
Total 2013	82,468	3,781	1,698	**87,948**	14,825	**102,773**
Total 2014	47,084	0	628	**47,712**	17,448	**65,160**
Total 2015	78,880	0	485	**79,365**	14,329	**93,694**
Total 2016	48,023	0	91	**48,114**	16,871	**64,985**
Total 2017+	175,263	0	3,288	**178,551**	134,966	**313,518**

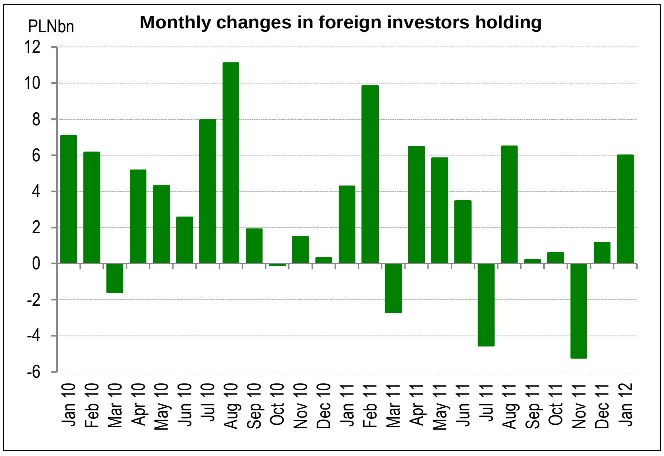
Schedule wholesales bonds redemption by holders (data at the end of January 2012, in PLNm)

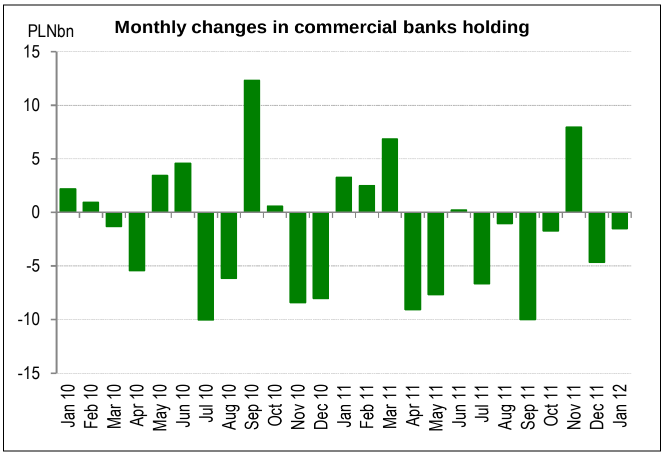
	Foreign investors	Domestic banks	Insurance Funds	Pension Funds	Mutual Funds	Individuals	Non-financial sector	Other	Total
Q1 2012	0	0	0	0	0	56	4	6	65
Q2 2012	12,458	4,592	1,962	2,210	452	97	87	1,248	23,105
Q3 2012	8,621	5,758	1,457	2,911	928	182	41	1,227	21,125
Q4 2012	9,918	6,118	1,541	4,269	1,684	94	404	2,755	26,783
Total 2012	**30,997**	**16,468**	**4,961**	**9,390**	**3,064**	**428**	**535**	**5,236**	**71,079**
	44%	**23%**	**7%**	**13%**	**4%**	**1%**	**1%**	**7%**	**100%**
Total 2013	35,115	12,314	12,711	13,753	3,409	476	104	4,675	82,557
	43%	15%	15%	17%	4%	1%	0%	6%	100%
Total 2014	13,969	8,798	4,612	10,778	3,314	362	130	2,889	44,852
	31%	20%	10%	24%	7%	1%	0%	6%	100%
Total 2015	19,785	23,809	7,006	18,349	5,042	147	743	3,998	78,880
	25%	30%	9%	23%	6%	0%	1%	5%	100%
Total 2016	12,283	6,218	3,555	19,847	3,896	58	364	2,143	48,365
	25%	13%	7%	41%	8%	0%	1%	4%	100%
Total 2017+	47,448	29,842	22,702	49,895	10,846	273	1,112	7,394	169,510
	28%	18%	13%	29%	6%	0%	1%	4%	100%

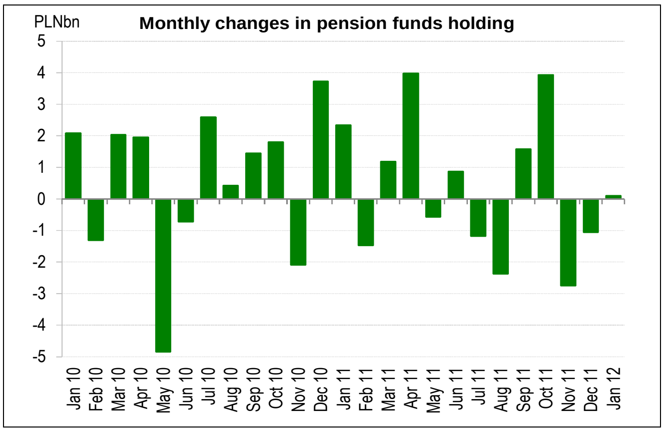
Sources: Ministry of Finance, BZ WBK

Treasury Securities Holders









Sources: Ministry of Finance, BZ WBK

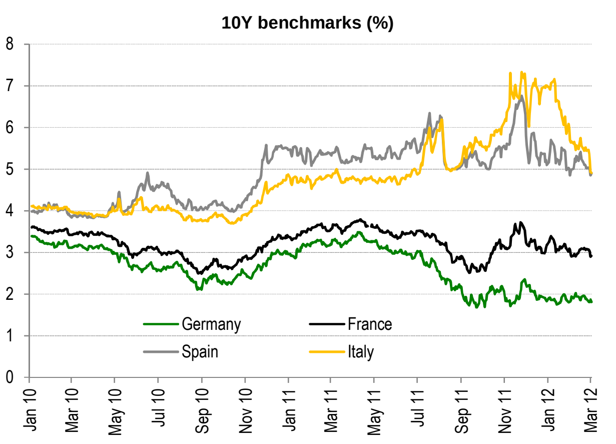
Strong foreign capital inflows in January…

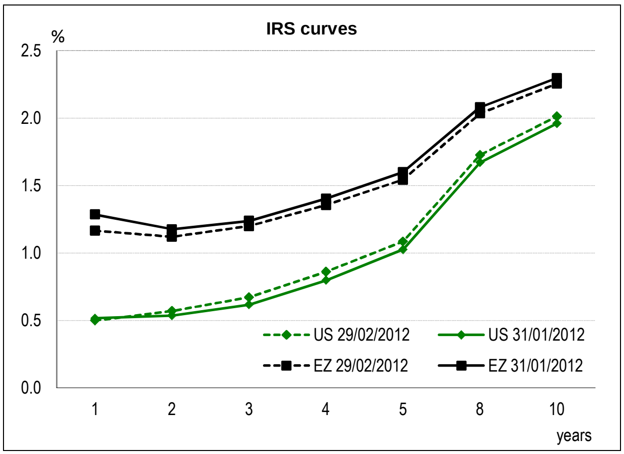
- The structure of holdings at the end of January showed that foreign investors were the most active on the Polish debt market. They continued buying Polish debt securities heavily this month, after increasing their holdings by PLN26bn in 2011. In January non-residents increased their portfolio by ca PLN6bn in total (they raised T-bonds share by ca PLN7.1bn in nominal terms and decreased T-bills holding) to ca. PLN160bn, the highest level in history. It accounted for 31% of total debt in marketable Treasury Securities. It is worth to notice that foreign investors not only reinvested funds (from redeemed OK0112 and from sell of T-bills), but also invested a fresh capital.
- In January foreign banks, after seven month in a row of fall, increased their holding in Polish bonds by ca. PLN4.4bn to PLN20.6bn (slightly above the level observed in September 2011). Their demand concentrated mainly on floating rate bonds (increase by ca. PLN1.1bn) and 2Y segment (especially 2Y benchmark OK0114). As a consequence foreign banks increased their share in Polish bonds debt to 12.9%, up from 10.6% in December 2011.
- However, foreign non-bank financial sector still plays a dominant role in the Polish bond market, with portfolio slightly above PLN132bn (the highest level in history). It accounted for nearly 83% of total Polish debt in marketable bonds (down from ca. 85% in December 2011). In monthly terms their holding in bonds increased by PLN2.9bn; they rolled over funds from redeemed OK0112 into current 2Y benchmark, i.e. OK0114, but also purchased bonds with maturity up to 5-year.
- Commenting on issuance plan for March, Marczak from the Ministry of Finance said that in February foreign investors' activity on the domestic bond market was limited. However, we think that positive global sentiment was supportive for Polish bonds in February and we do not exclude some gradual increase in foreign investors' holdings. We believe that non-residents will take opportunities to purchase bonds at lower prices on corrective move expected by us in March.

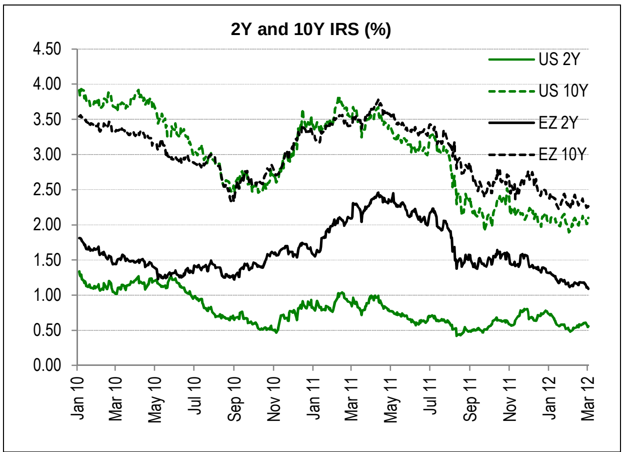
… while domestic players more active only in February

- In January 2012 domestic investors were relatively passive on the bond market, keeping their portfolios more or less stable or even reduced their positions (mainly domestic commercial banks).
- At the end of January Polish banks' holdings were at PLN108.8bn (in which transactions with the MF amounted to PLN2.8bn), the lowest level since September 2011. Commercial banks reduced their positions in bonds, decreasing share in bonds with maturity up to 2Y and from long end of the curve. However, banks purchased current 2Y and 5Y benchmarks (OK0114 and PS1016) and floating rate bonds (mainly WZ0115). On the other hand they increased also share of T-bills in their portfolio.
- Investment funds (TFI) were also active on the supply side. TFI reduced their position by nearly PLN2bn to PLN30.7bn (the lowest level since September 2011).
- Pension funds are still the main player on the domestic debt market with portfolio worth PLN123.3bn at the end of January (nearly stable level compared to December 2011).
- We believe that domestic investors were more active on debt market in February, increasing their holdings in marketable bonds. They mainly purchased bonds from mid and long-end of the curve as their positions in those sectors were underweight. Therefore, as the rally was initiated in January by foreign investors, continuation in February was due to local players.

International Bond Markets







The European banking sector more liquid

- In February the ECB conducted its second three-year long-term refinancing operation (LTRO), providing €529.5bn in cheap liquidity to 800 lenders. The LTRO allows banks to borrow the funds at a very low 1% rate, making it a more attractive alternative. It caused money market rates to continue their downwards trend.
- The optimism related with the LTRO is already behind us and currently the main question is how banks use these resources, especially taking into account information that at the beginning of March banks have invested slightly above €800bn in form of 1-day deposit in the ECB.

Choppy mood on core debt markets

- In February investors' attention mainly focused on the developments in Greece (PSI negotiations, EU approval of the next tranche of aid). The prolonged negotiations about the bailout have increased investors' nervousness and shifted their demand to safe assets, i.e. Bunds and the US Treasuries.
- Global sentiment improvement has been recently driven mainly by expectations on LTRO. It caused yields on core markets to continue the upward trend. At the end of February 10Y Bunds were traded at 1.82%, while 10Y Treasuries at 1.93%, with the spread 10Y US-DE widening to slightly above 10bps, up from 4bps at the end of January.
- The German and US bond curves remain quite steep, with spreads 2-10Y slightly above 160bps on the both markets.

More optimism on peripherals after LTRO

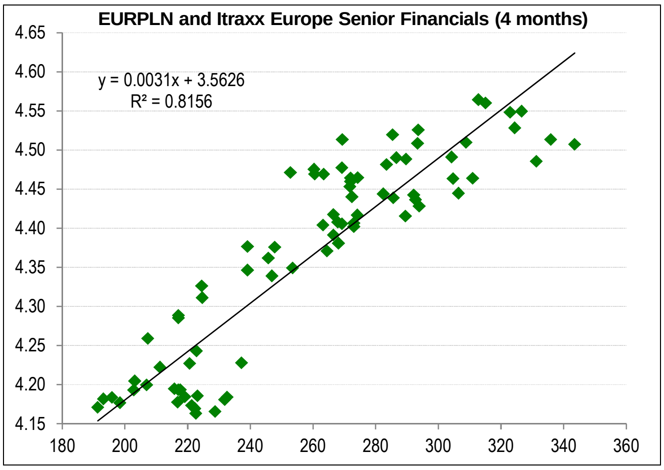
- Despite relatively heavy supply on the European market, peripheral debt benefited from global sentiment improvement. Peripheral countries of the euro zone successfully launched their bonds, with lower yields.
- Spanish bonds still outperformed Italian debt at all maturities, but the difference decreased significantly in recent weeks. Yields on Italian 10Y bonds have been recently only around 20bps higher than their Spanish equivalents (down from nearly 100bps at the end of January). It was because Italian banks were most active during LTRO, using this money to purchase Italian bonds, contributing to reduction of sovereign debt yields.
- Keeping in mind the wave of cheap liquidity, it is difficult to look for the signals of a strong reversal of recent trend (at least in the medium term). However, in nearest weeks market uncertainty will be still connected with Greece, especially progress of debt restructuring process and also due to fairly demanding supply on European market (with strong offer of debt by Belgium, France, Italy and Germany).

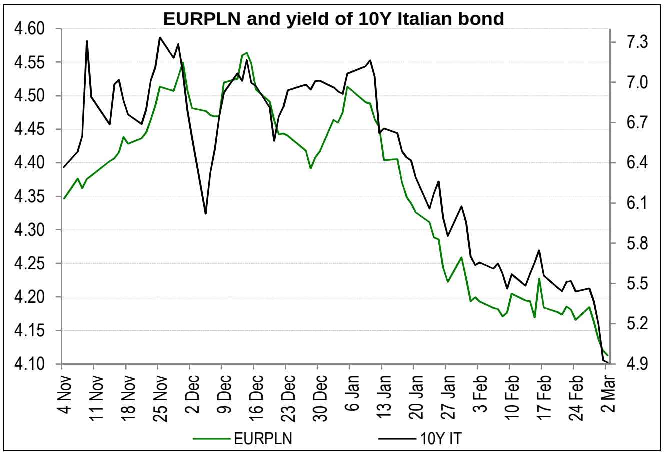
Euro zone's issuance plans and completion in 2012 (€ bn)

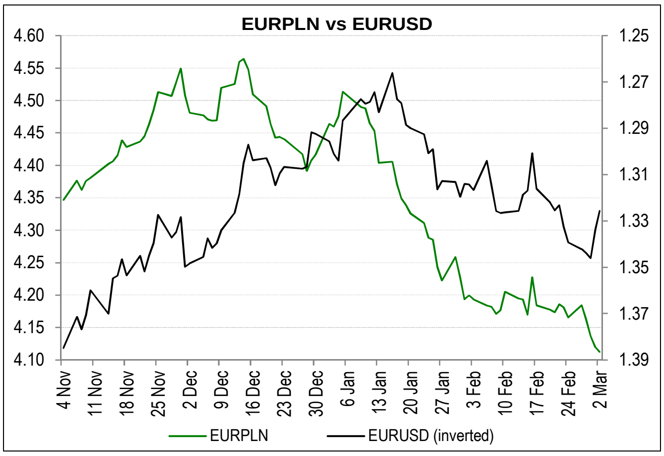
	Total redemptions	Deficit	Borrowing needs	Expected bond supply	% of completion (YtD)
Austria	14	8.3	22.3	22.3	28.3
Belgium	27.9	7	34.9	26	31.6
Finland	6.3	7.5	13.8	13.8	25.4
France	101.7	78.7	180.4	178	23.4
Germany	157	26.6	183.6	170	17.2
Greece	33.2	16.2	49.4	-	-
Ireland	5.5	13.7	19.2	-	-
Italy	192.2	41.1	233.3	233.3	14.6
Netherlands	29.7	12.3	42	60	30.2
Portugal	12.9	17.4	30.3		
Spain	50.1	36.2	86.3	86.3	39.0
Total	**630.5**	**265.0**	**895.5**	**789.7**	22.3

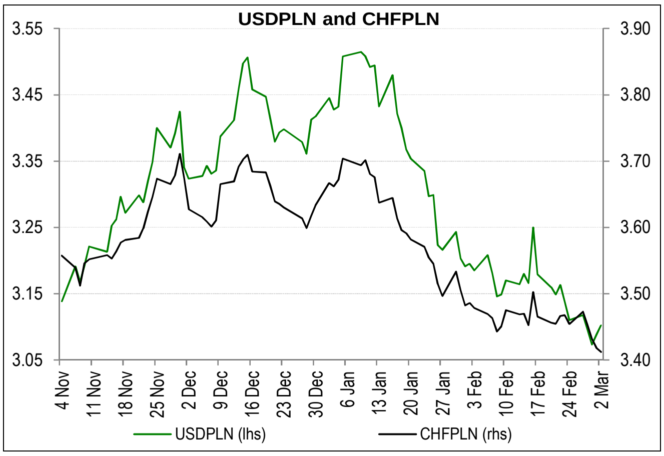
Source: Reuters, BZ WBK

Foreign Exchange Market









Sources: Reuters, BZ WBK

Zloty still driven by global moods improvement…

- During February the zloty gained versus main currencies but at slower pace than it was recorded in January. Last month the domestic currency gained 2.1% versus the euro, 4.1% versus the dollar and 2.1% versus the Swiss franc.
- It seems that the zloty continued to benefit from December's ECB LTRO as well as from expectations for strong demand at February's 3Y refinancing operation. The 4-month correlation of EURPLN with iTraxx index increased over the past month (from over 73% to nearly 82%). Tighter relationship was also recorded with yields of 10Y Italian bonds (4-month correlation surged from 62% to nearly 87%). That clearly shows that lower worries as regards European debt problems continued to play main role on the Polish FX market.
- Even as the second bailout package for Greece was finally agreed, the market reaction was rather muted. First, investors have been pricing in such a decision. Second, details of the agreement show there are still open questions regarding bailout package and central scenario of expected developments relies on optimistic assumptions. Also positive market sentiment that emerged after it was announced that 800 banks (versus 523 in December) borrowed from the ECB €529.5bn for 3 years was short-lived as next data showed that record €777bn was deposited back to the central bank.

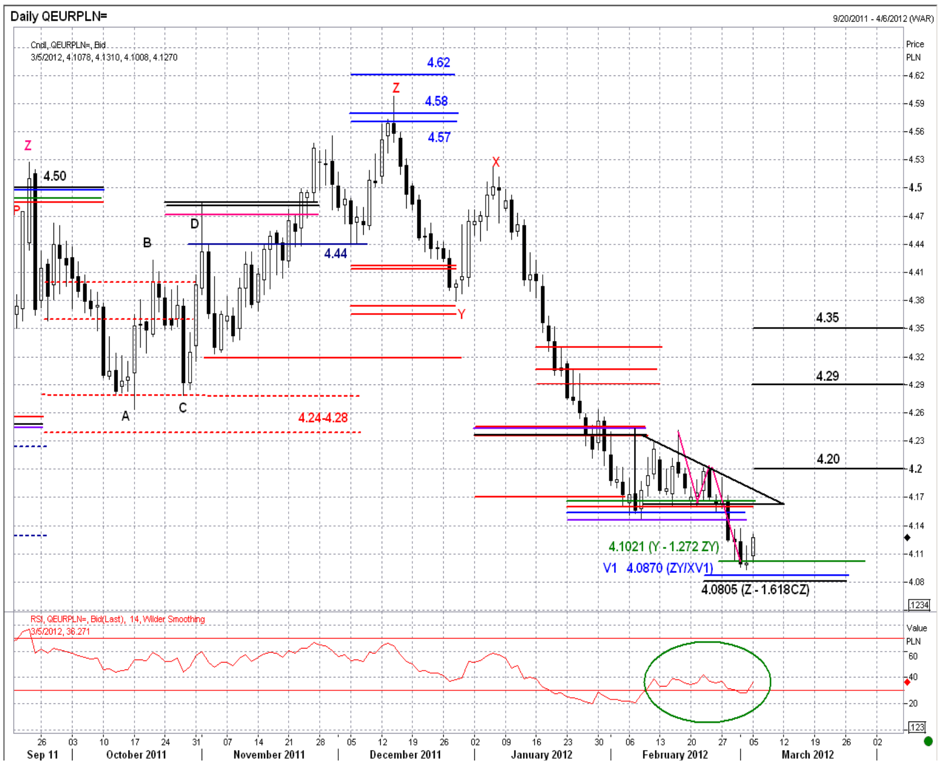
... but correction getting more likely

- We expect the zloty to depreciate in March. In our view, the market has currently run out of fuel that has been supporting risky assets since the beginning of the year. For the time being there is no option of third LTRO, while the past two clearly played an important role in recent months regarding performance of the zloty. Furthermore, as we mentioned a month ago, latest macro data supported hopes that the economic slowdown in Europe will be less severe than feared and currently the market seems to be already pricing this positive scenario. If we add that recently expectations for Fed's QE3 also diminished, there is a limited number factors, that could support investors' demand for risky assets. As a result, the risk of profit taking from recent rally of (among others) the zloty is getting higher. Developments in Greece (the procedure and results of debt restructuring) shall be most important regarding situation on the Polish FX market in March.
- We anticipate that zloty's depreciation versus the dollar will be more pronounced due to expected gradual decline of EURUSD. On the other hand, weakening of the domestic currency versus the Swiss franc shall come from higher EURPLN as EURCHF should remain relatively stable.
- Strong performance of Polish currency prompted us to lower the forecasts of EURPLN. Now we anticipate the exchange rate to be at 4.25 on average in 2012 (versus 4.34 expected previously). We still expect some more visible increase of the EURPLN in ca. mid year, but given the recent decline of the exchange rate the upward move shall have smaller reach than we initially expected.

Forint surprisingly stable

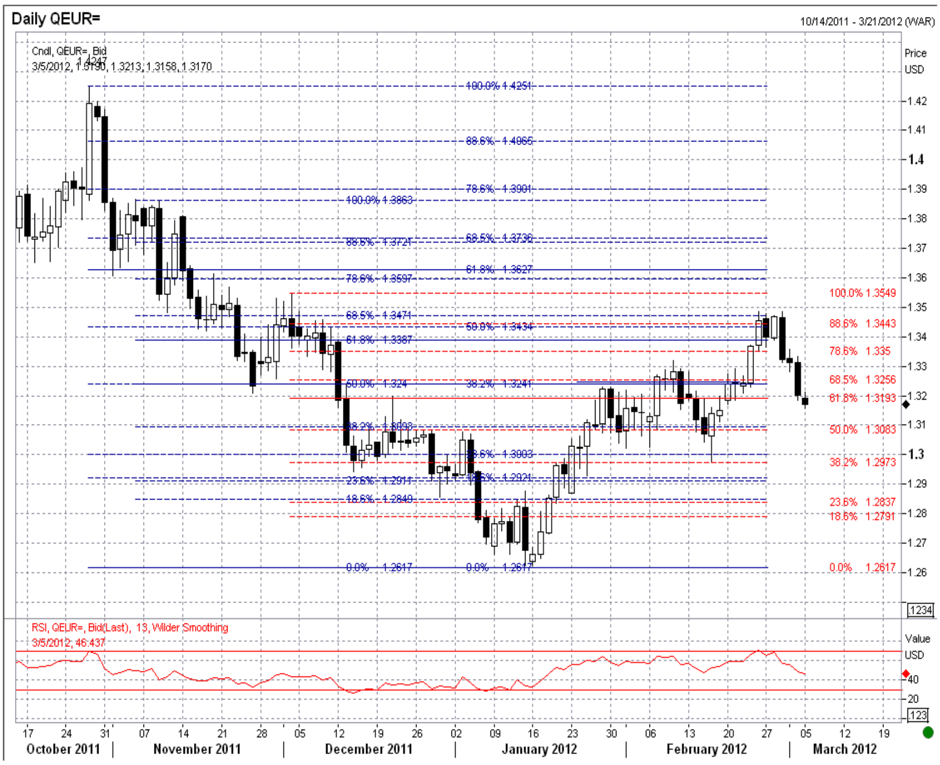
- HUF performed surprisingly well given prevailing risk factors. Some temporary depreciation – that hit also the zloty – was observed when S&P warned that freeze of Hungarian cohesion funds may have a negative impact on country's rating. On monthly basis HUF gained 1.21% versus EUR.
- The Czech koruna gained over the past month. That was due to relatively positive market sentiment persisting on the market, as well as the fact of being perceived as the CEE safe haven currency when situation in the region deteriorated slightly amid developments in Hungary. In February Czech koruna gained 1.02% versus the euro.

FX Technical Analysis Corner



EURPLN

- The EURPLN broke quite strong support area at 4.1463-4.1656 and declined to 4.093 (lowest since mid-August).
- The exchange rate rebounded from next support at ca. 4.10. The move up is confirmed by 3-wave structure (plotted on the chart) and divergence of the EURPLN and the RSI (the exchange rate established new local lows while the oscillator did not).
- As the EURPLN rebounded to ca. 4.12 from 4.10, the risk of falling to ca. 4.08 (the projection from triangle pattern) declined.
- We expect the EURPLN to end month close to first resistance (4.20).



EURUSD

- The EURUSD broke resistance at ca. 1.325 and headed to next level constraining room for an upward move at just below 1.35.
- Three Fibonacci retracements meet at around 1.343-1.347 and the exchange rate did not manage to stay above that area for a longer period of time.
- Levels mentioned above are also important on weekly basis and it seems that upward correction seen since the beginning of the year has just ended and the downward trend lasting since Q2 2011 is now resumed.
- We see downward risk for our forecast of the EURUSD at 1.32 at the end of March.

Sources: Reuters, BZ WBK

Poland vs other countries - economy

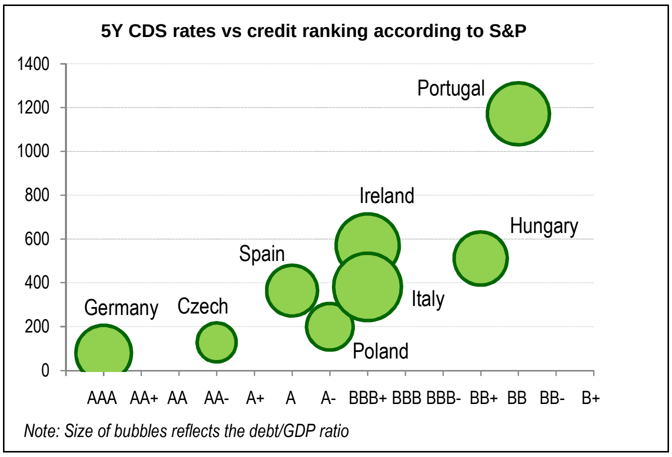
Main macroeconomic indicators (European Commission's forecasts)

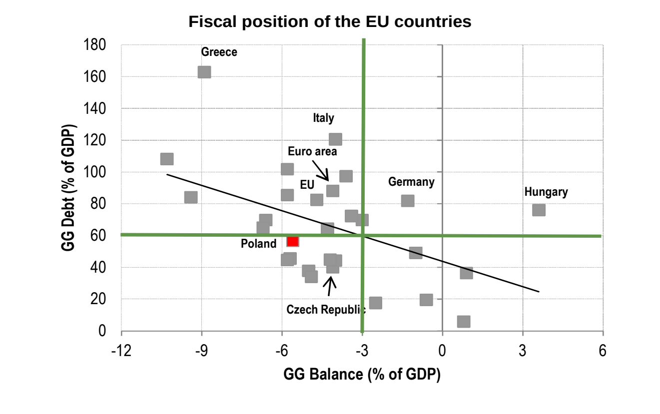
	GDP* (%)		Inflation* (HICP, %)		C/A balance (% of GDP)		Fiscal Balance (% of GDP)		Public Debt (% of GDP)	
	2011E	2012F	2011E	2012F	2011E	2012F	2011E	2012F	2011E	2012F
Poland	**4.3**	**2.5**	**3.9**	**3.5**	**-5.0**	**-4.3**	**-5.6**	**-4.0**	**56.7**	**57.1**
Czech Republic	1.7	0.0	2.1	3.0	-3.6	-3.2	-4.1	-3.8	39.9	41.9
Hungary	1.7	-0.1	3.9	5.1	1.7	3.2	3.6	-2.8	75.9	76.5
EU	1.5	0.0	3.1	2.3	-0.3	0.0	-4.7	-3.9	82.5	84.9
Euro area	1.4	-0.3	2.7	2.1	-0.1	0.0	-4.1	-3.4	88.0	90.4
Germany	3.0	0.6	2.5	1.9	5.1	4.4	-1.3	-1.0	81.7	81.2

*Note: * European commission interim forecast – February 2012*

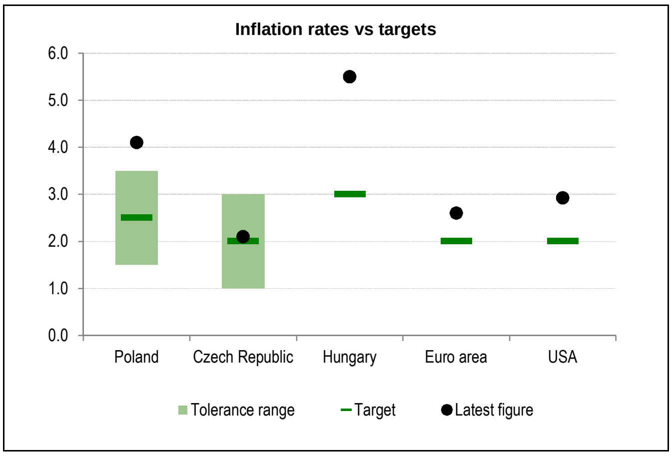
Sovereign ratings

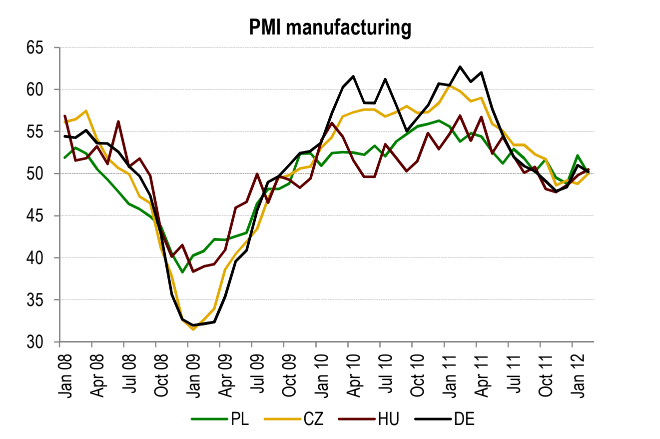
	S&P		Moody's		Fitch	
	rating	outlook	rating	outlook	rating	outlook
Poland	A-	stable	A2	stable	A-	stable
Czech	AA-	stable	A1	stable	A+	stable
Hungary	BB+	negative	Ba1	negative	BB+	negative
Germany	AAA	stable	Aaa	stable	AAA	stable
France	AA+	negative	Aaa	negative	AAA	negative
UK	AAA	stable	Aaa	negative	AAA	stable
Greece	SD	---	C	---	C	negative
Ireland	BBB+	negative	Ba1	negative	BBB+	negative
Italy	BBB+	negative	A3	negative	A-	negative
Portugal	BB	negative	Ba3	negative	BB+	negative
Spain	A	negative	A3	negative	A	negative

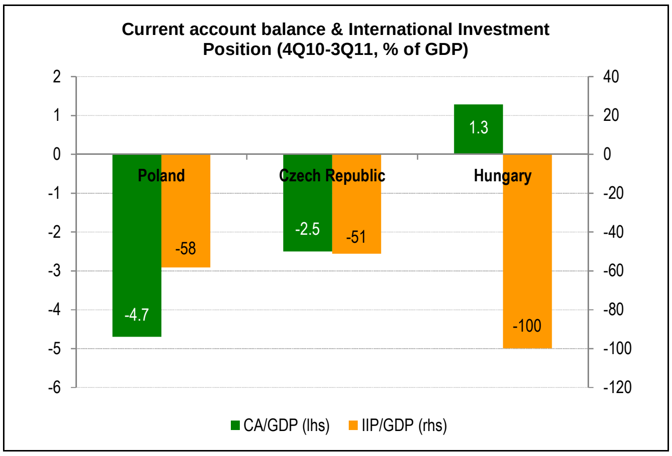




Note: European Commission forecasts for 2011





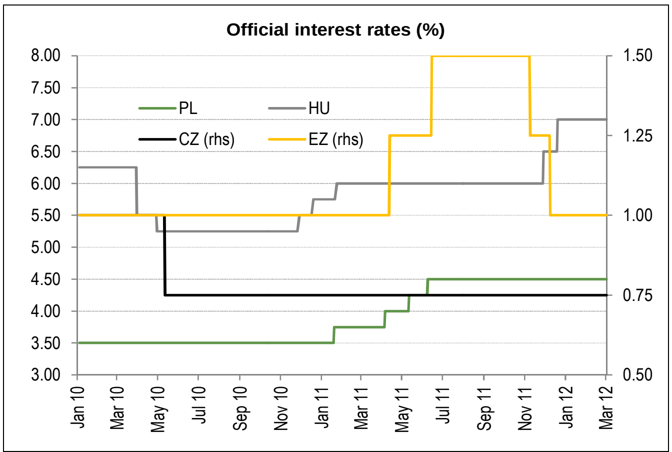


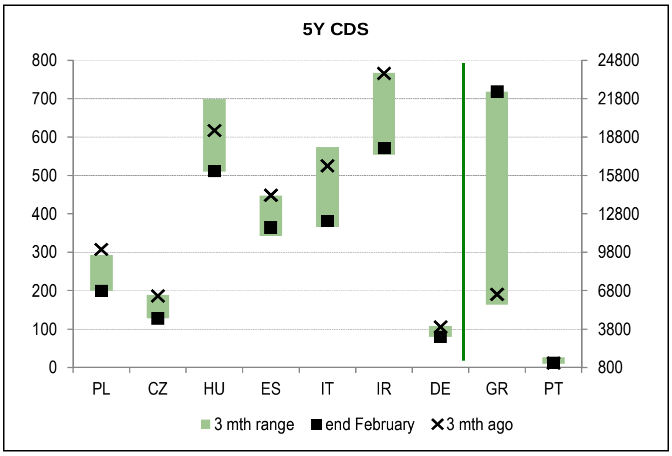
Source: stat offices, central banks, Reuters. BZ WBK, EC

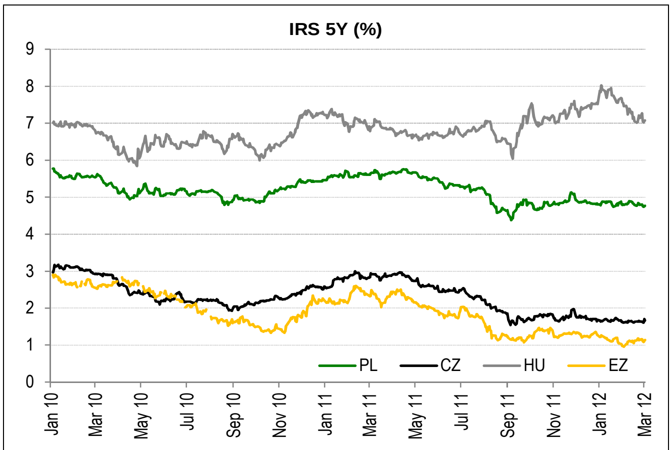
Poland vs other countries - market

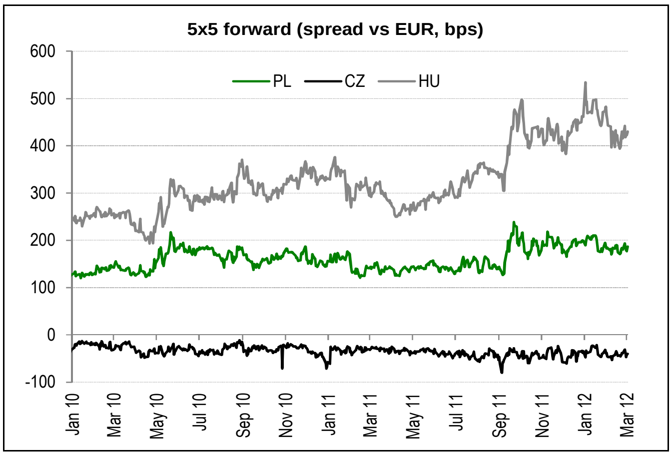
Main market indicators (%)

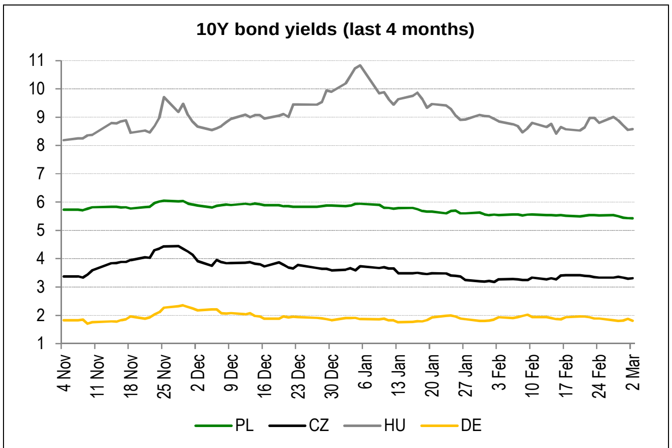
	Reference rate (%)		3M market rate (%)		10Y yields (%)		10Y Spread vs Bund (bps)		CDS 5Y
	2011	2012F	2011	2012F	2011	2012F	2011	2012F	2011
Poland	**4.50**	**4.00**	**4.99**	**4.30**	**5.88**	**5.80**	**405**	**355**	**279**
Czech Republic	0.75	0.75	0.78	-	3.59	-	176	-	**173**
Hungary	7.00	7.00	7.24	-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

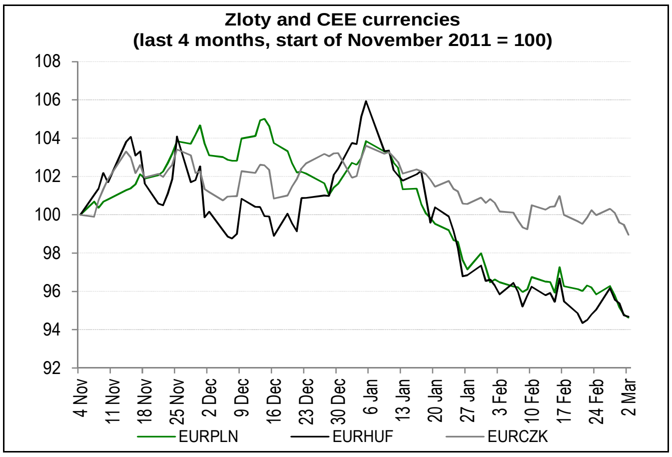












Source: stat offices, central banks, Reuters. BZ WBK, EC

Central Bank Watch

		Last	2011	2012F	Expected changes (bps) 1M	3M	6M	Risks
Euro	Forecast	1.00	1.00	1.00	0	0	0	Currently market expects the ECB to keep interest rates unchanged in March, observing the impact of 3Y LTRO in the financial markets.
	Market implied »				-13	-22	-28	
UK	Forecast	0.50	0.50	0.50	0	0	0	No policy changes are anticipated this month after February's extension of QE
	Market implied »				-5	-11	-15	
US	Forecast	0-0.25	0-0.25	0.25	0	0	0	It is widely expected the FOMC to keep interest rates unchanged. But investors could concentrate on macroeconomic perspectives
	Market implied »				-2	-3	1	
Poland	Forecast	4.50	4.50	4.00	0	0	0	The MPC still remains hawkish as CPI inflation and inflation expectations well above the target. We foresee rates unchanged till mid-year. Rate cuts possible in H2 2012.
	Market implied »				0	-1	-12	
Czech	Forecast	0.75	0.75	0.75	0	0	0	We expect interest rates to remain stable in coming months. Downside risks to growth still argue against monetary policy tightening.
	Market implied »				36	30	26	
Hungary	Forecast	7.00	7.00	7.00	0	0	0	In February Hungary's central bank considered cutting rates for the first time in a year. It is likely that rates will maintain stable until agreement with the IMF/EU.
	Market implied »				-2	-7	-13	

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

Economic Calendar and Events

Date		Event:	Note:
7-Mar	**PL**	**MPC Meeting – interest rate decision**	**Our forecast and market consensus: no change in rates. The new projection will be important.**
	GE	Auction of 5Y T-bonds	Offer: EUR 4bn
8-Mar	PL	Auction of 5Y T-bonds	Offer: PLN1.5-3.5bn
	EZ	ECB Meeting – interest rate decision	Our forecast and market consensus: 1.00%. ECB will present a new macroeconomic forecasts.
	GB	BoE Meeting – interest rate decision	Our forecast and market consensus: 0.50%
8-11 Mar	GR	The final participation in PSI will be announced	-
12-Mar	EZ	Eurogroup Meeting	-
13-Mar	**PL**	**CPI for February**	**Our forecast: 4.2%YoY vs market consensus at 4.1%YoY. StatOffice will also publish the final January CPI data and the 2012 inflation basket.**
	US	FOMC Meeting – interest rate decision	Our forecast and market consensus: 0.00 – 0.25%.
	EZ	ECOFIN Meeting	-
14-Mar	PL	Auction of 2Y T-bonds	Offer: PLN1.5-3.5bn
	IT	Auction of medium-long term bonds	-
15-Mar	FR	Auction of BTAN and OATi	-
16-Mar	**PL**	**Employment and wages for February**	**Weak data, increasing risk of private consumption slowdown.**
19-Mar	**PL**	**Industrial output for February**	**Still strong data, we are above market consensus.**
20-Mar	**PL**	**Core inflation measures for January and February**	
21-Mar	PL	Auction of 10Y and 20Y T-bonds	Offer: PLN1.0-2.5bn
22-Mar	**PL**	**Minutes of the March MPC's meeting**	-
26-Mar	**PL**	**Retail sales for February**	**Strong growth, near two-digit**
	PL	Auction of 52-Week T-bills	Offer: PLN1.0-3.0bn
27-Mar	HU	NBH Meeting – interest rate decision	Our forecast: 7.00%
29-Mar	CZ	CNB Meeting – interest rate decision	Our forecast: 0.75%
	IT	Auction of medium-long term bonds	-
4-Apr	**PL**	**MPC Meeting – interest rate decision**	**Our forecast: the MPC will remain on hold, keeping "wait and see" stance**
	EZ	ECB Meeting – interest rate decision	Our forecast and market consensus: 1.00%

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	1,522.7	1,616.8	349.3	369.3	375.1	428.9	372.7	391.6	398.2	454.3
GDP	%YoY	1.6	3.9	4.3	2.7	4.5	4.3	4.2	4.3	3.3	2.6	2.4	2.4
Domestic demand	%YoY	-1.1	4.6	3.8	1.0	4.4	4.3	3.2	3.3	1.9	0.8	0.9	0.7
Private consumption	%YoY	2.1	3.2	3.1	1.9	3.7	3.6	3.0	2.0	1.8	1.8	1.9	2.0
Fixed investments	%YoY	-1.2	-0.2	8.5	5.2	5.9	6.9	8.5	10.3	9.5	7.0	5.0	3.0
Unemployment rate [a]	%	12.1	12.4	12.5	13.5	13.3	11.9	11.8	12.5	13.6	13.1	12.6	13.5
Current account balance	EURm	-12,152	-16,493	-15,199	-9,761	-3,135	-3,359	-4,709	-3,996	-1,955	-1,612	-3,187	-3,007
Current account balance	% GDP	-3.9	-4.7	-4.1	-2.6	-4.8	-4.9	-4.7	-4.1	-3.8	-3.3	-2.9	-2.6
General government balance	% GDP	-7.3	-7.9	-5.0	-3.5	-	-	-	-	-	-	-	-
CPI	%YoY	3.5	2.6	4.3	3.6	3.8	4.6	4.1	4.6	4.0	3.5	3.9	3.2
CPI [a]	%YoY	3.5	3.1	4.6	2.9	4.3	4.2	3.9	4.6	3.5	3.8	4.0	2.9
CPI excluding food and energy prices	%YoY	2.7	1.6	2.4	2.2	1.7	2.3	2.6	3.0	2.5	2.1	2.2	2.1
EUR/PLN	PLN	4.33	3.99	4.12	4.25	3.94	3.96	4.15	4.42	4.25	4.24	4.31	4.21
USD/PLN	PLN	3.11	3.02	2.96	3.36	2.88	2.75	2.94	3.28	3.23	3.34	3.44	3.44
CHF/PLN	PLN	2.87	2.90	3.34	3.30	3.06	3.16	3.56	3.60	3.51	3.36	3.25	3.08
GBP/PLN	PLN	4.86	4.66	4.75	5.05	4.62	4.48	4.73	5.16	5.07	5.02	5.08	5.05
Reference rate [a]	%	3.50	3.50	4.50	4.00	3.75	4.50	4.50	4.50	4.50	4.50	4.25	4.00
WIBOR 3M	%	4.42	3.94	4.54	4.76	4.10	4.43	4.72	4.91	4.97	4.93	4.79	4.37
Yield on 52-week T-bills	%	4.54	3.96	4.51	4.35	4.37	4.62	4.54	4.50	4.51	4.47	4.36	4.07
Yield on 2-year T-bonds	%	5.17	4.72	4.81	4.61	5.01	4.97	4.54	4.71	4.70	4.65	4.58	4.50
Yield on 5-year T-bonds	%	5.65	5.31	5.44	5.05	5.79	5.60	5.17	5.19	5.07	5.07	5.06	5.00
Yield on 10-year T-bonds	%	6.11	5.74	5.98	5.62	6.27	6.03	5.77	5.83	5.60	5.61	5.66	5.60

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

This analysis is based on information available until 2nd March 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 Luziński	+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