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Comment on the upcoming data and forecasts

On Monday PMI in manufacturing for September will be published. We expect further decrease to 51.1 points consitent with lower economic indicators in Germany and euro zone (actually below threshold of 50 points). Ths scenario is supported by industrial slow-down and worse business survey results. On Tuesday and Wednesday MPC rate meeting will take place. We expect that interest rates will be left at the current level. Recent industrial production and retail sales data showed surprisingly good lasting economy momentum. MPC will not cut interest rates and change bias because of higher zloty volatility.

Polish data to watch: October 3 to October 7

Publication	Date	Period	BRE	Consensus	Prior
PMI	3.10	Aug	51.1		51.9
MPC decision (%)	4-5.10	Oct	4.5	4.5	4.5

Treasury bonds and bills auctions

Paper	Next auction	Last Offer	Last yield (%)	Prev auction
52-week T-Bills	-	600	4.578	5/30/2011
2Y T-bond OK0114	-	3000	4.469	8/10/2011
5Y T-bond PS0416	10/19/2011	3000	5.256	8/10/2011
10Y T-bond DS1021	-	3000	5.803	7/21/2011
20Y T-bond WS0429	-	250	6.246	1/12/2011

Macroeconomic forecasts

Wskaźnik	2008	2009	2010	2011 F	2012 F
GDP y/y (%)	4.8	1.7	3.8	3.8	3.2
CPI Inflation y/y (average %)	4.3	3.5	2.8	4.3	3.1
Current account (%GDP)	-5.3	-1.6	-4.5	-4.9	-4.3
Unemployment rate (end of period %)	9.5	11.9	12.3	11.9	11.5
Repo rate (end of period %)	5.00	3.5	3.5	4.5	4

	2010 Q3	2010 Q4	2011 Q1	2011 Q2	2011 Q3 F	2011 Q4 F
GDP y/y (%)	4.2	4.5	4.4	4.3	3.7	3.7
CPI Inflation y/y (average %)	2.6	2.9	3.7	4.2	4.2	4.2
Repo rate (end of period %)	3.5	3.5	4	4.5	4.5	4.5

F - forecast

Economics

Polish government approved state budget act draft for 2012 and Debt Management Strategy

According to data drawn from Debt Management Strategy, the borrowing requirements in the years 2011-12 are assumed respectively at PLN 35.7 bn and PLN 47.3 bn. Let us take a deeper view at them.

2012 budget draft assumes budget deficit at the level of PLN 35 bn and was prepared on the basis of growth rate at the level of 4% and average CPI growth at the level of 2.8%. In comparison with the assumptions from May, revenues of state budget have been increased by PLN 2 bn. According to our macro outlook, and including debt crisis in euro area and connected uncertainty, the assumptions seem too optimistic as the structure of growth will change towards less investment and individual consumption. Hence, also the assumed deficit seems out of reach.
State budget act draft for 2012 assumes that in current year the budget deficit and EU funds deficit will amount to respectively PLN 35.7 bn and PLN 15.4 bn next year (in line with the budget act for 2011 deficits were set respectively at PLN 40.2 bn and PLN 15.4 bn). Pension reform costs will amount to PLN 15.5 bn, loans granted PLN 4.3 bn, net privatization PLN 7.4 bn, liquid funds saved on liquidity management 22 bn and other borrowing requirements about PLN 0.4 bn. In total these items sum up to PLN 41.9 bn. Divergence between assumed borrowing requirement at PLN 35,7 bn and PLN 41,9 bn probably arises from the fact, that MoF could use in its calculation lower state budget deficit. Couple of times there was mentioned, that probable State deficit will amount below PLN 30 bn.

According to forecasts from Debt Management Strategy in the years 2012-15, the public debt will rise from 52.8% in 2010 to 53.8% in current fiscal year. In the forthcoming years 2012-13 public debt will systematically decrease and finally settle below 50% of GDP, i.e. below the first threshold foreseen included in the Public Finance Act. During the calculation of public debt, the Ministry of Finance adopted PLN exchange rates vs EUR and USD respectively at the level of 4.35 and 3.18, therefore exchange rate movements are the main driver of higher public debt to GDP ratio.

Forecasts of public debt are encumbered by high exchange rate risk. In case of further debt crisis escalation and slowing global economy, foreign investors outflow and deeper pln depreciation may be expected. Should situation gets out of control, the Ministry of Finance is armored in foreign liquidity of over EUR 6 bn (not mentioning the NBP with almost EUR 70 bn of reserves) and partly these foreign means are currently used to ease the pressure on exchange rate. Higher sell off of foreign funds through BGK should be expected at the end of the year, according to Ministry of Finance statement.
Additionally, MoF has power to intervene on Treasury Securities market, what has been recently seen. In this area, the Ministry has quite large financial buffer. 50 bn liquidity cushion grants a lot of firepower in case yields become too high from the MoF perspective.

The debt servicing costs to GDP in 2011 are expected to rise to the level of 2.5%, in 2012 to 2.7%. In forthcoming years this ratio is expected to ease systematically and in 2015 achieve finally the level of 2.2%. Temporary increase in the debt servicing costs to GDP ratio will result from zloty depreciation and gradually increasing volume of the State Treasury debt. The decrease in this ratio is caused by expected zloty appreciation and positive effect of GDP growth over volume of debt servicing costs.

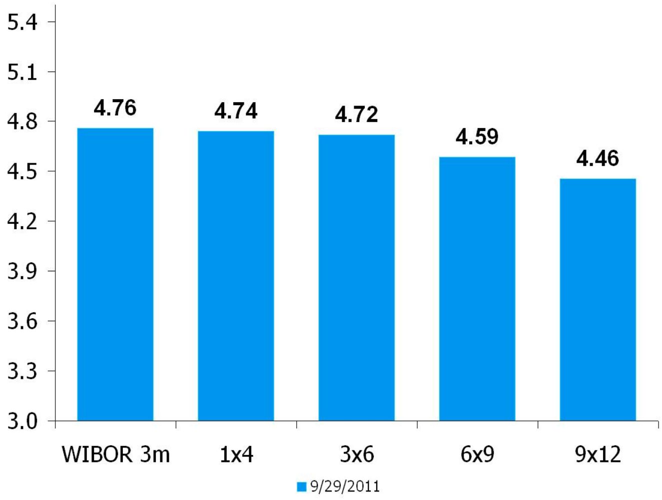
Domestic market will still remain main source of financing the State budget borrowing requirements. The share of foreign financing is expected to remain at the level of 20-30%. Quite wide extent of acceptable share of foreign debt arose from the calculation of exchange rate risk on the one hand and mentioned flexible approach towards currency of issue on the other. The refinancing risk is expected to be further decreased by issuance of medium and long-term liquid bonds. The interest rate risk is currently at acceptable level, so it is expected to be maintained between 2.5-4.0 years in the horizon of Debt Management Strategy.
Simultaneous flexible approach to financing and the range of acceptable share of foreign debt in the State Treasury debt will not create comfortable conditions for financing borrowing requirements on foreign markets. According to the last Ministry of Finance statements, and what is proved in state budget act draft in the following fourth quarter, new foreign issuance on USD market is expected to take place. The volume of new issuance was assumed at level of USD 1.0-1.5 bn. In conjunction with weaker zloty and current EMU debt crisis, the share of foreign debt will temporary exceed acceptable level, i.e. about 31%.

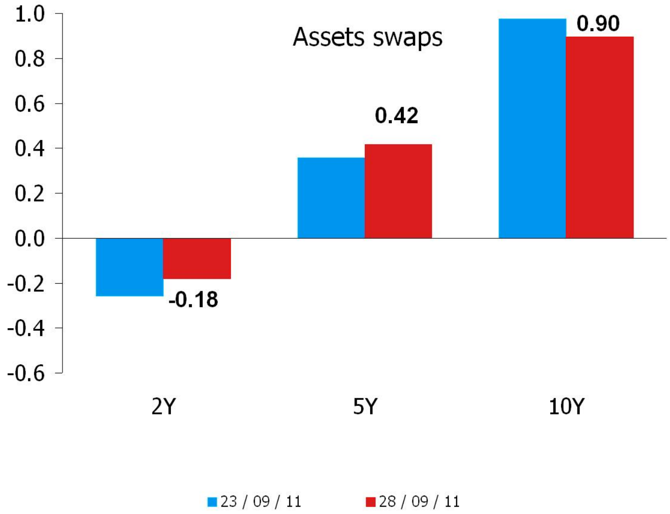
Because of last changes in the pension funds law, the significance of these investors will systematically diminish. The magnitude will be moved on the banking sector and insurance entities. Besides domestic investors, foreign investors will become more important. MoF expects there still will be significant inflow of foreign investors towards Poland. Of course there will be temporary outflows. However, in Ministry's view they should be amortized by structural over liquidity of domestic banking sector and additional tools applied when necessary.

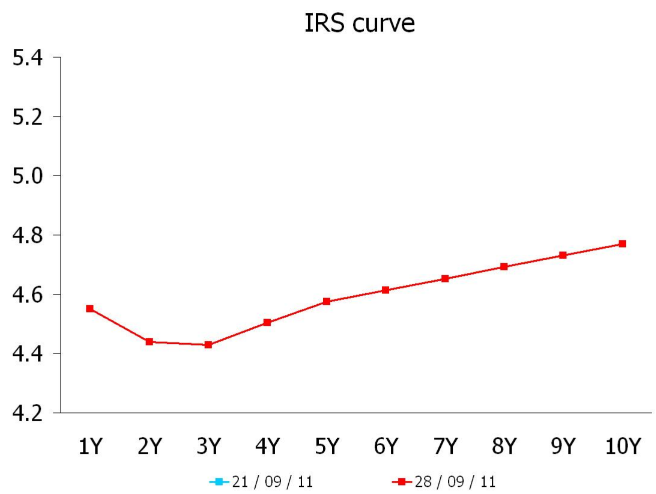
Fixed income

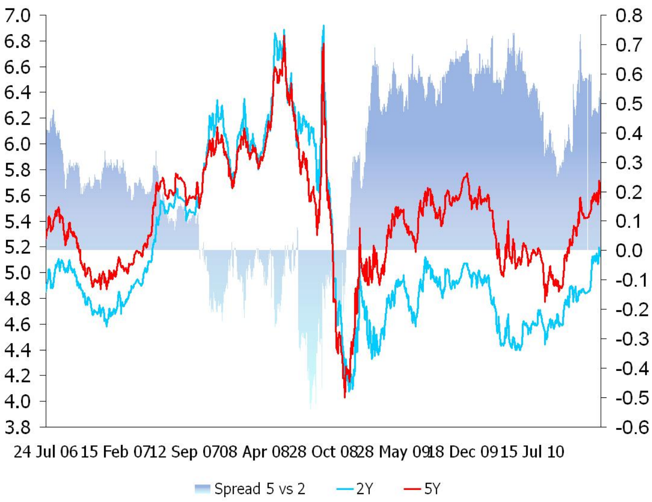
Again some volatility on the market

Last week we had again some volatility on the market. The biggest event was joined intervention of NBP and Ministry of Finance on the FX market. Additionally BGK was buying 10y bonds on the BondSpot platform. This made some impression on the market as 10y bonds for the whole next week traded 100-150 cents higher compared to previous week lows, most of the buying we saw from local community, both banks (redemption of 0911, bank books were rebuilding liquidity portfolios) and funds. Internationals were net sellers especially in October bonds (there is a coupon payment coming at the end of the month). On the rates curve looks to be locked in range both in 2y and 5y with slight pressure on steepening. Despite big tickets going through market was not able to break out from 4.60/4.75 range in 2y and 4.75/4.90 in 5y. 5y5y forward narrowed from 250 bp to sub 200 points but mainly due to rise in EUR rates. We had comments from CB Belka, underlining that intervention was not aimed at defending any EURPLN level, CB is rather concerned about volatility in the market. Belka expressed view that at present there is no need to change rates as CPI is elevated, but growth is expected to slow. Next week October 9th Poland will hold parliamentary elections which should allow PO to stay as the leading force in the lower house, the question though remains what coalition will rule. With no party having majority and possibility of 5 parties in the next parliament the political risk seems to be on the rise. As far as markets we are taking off our bullish flattener and we are becoming neutral here.







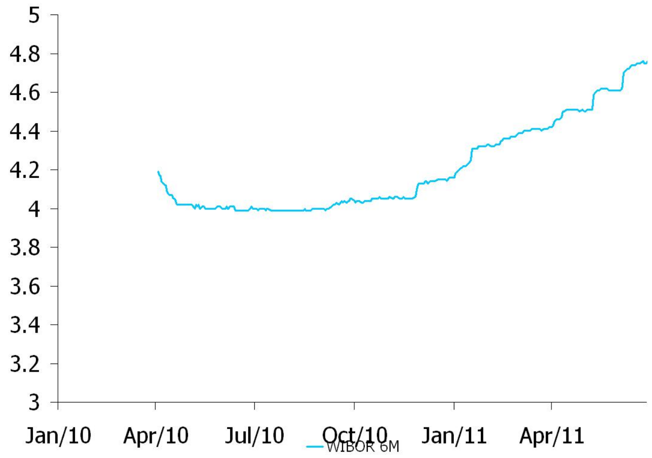


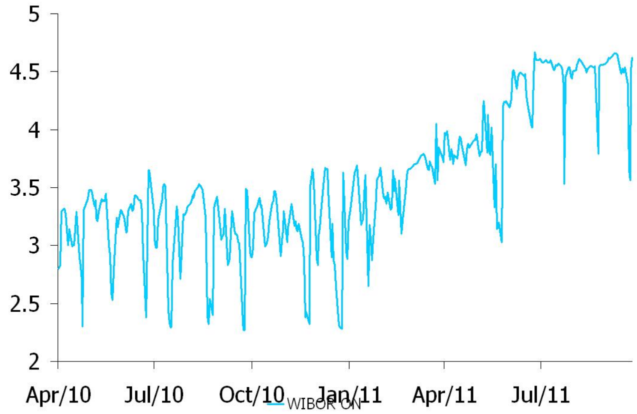
Money market

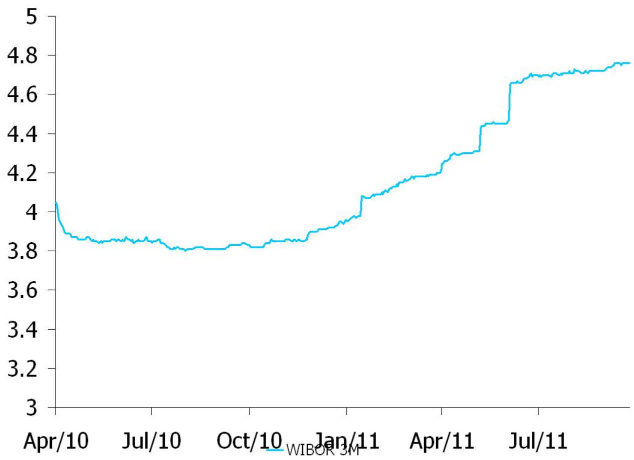
Calm quarter-end

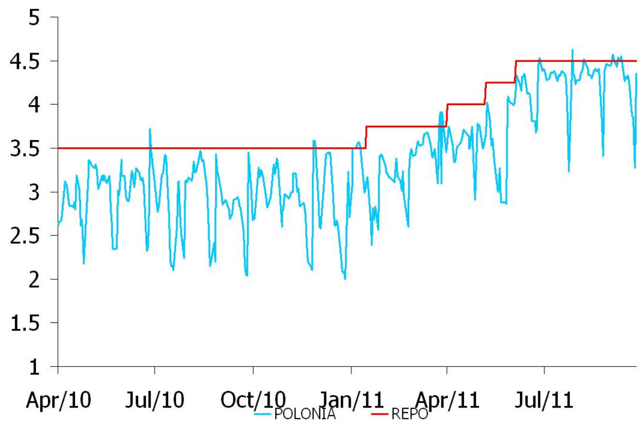
As one could expect last week of the reserve period was very cheap. Polonia went below 4% on Friday and every next day it was cheaper and cheaper. Even additional OMO on monday couldn't prevent it. Liquidity desks just want to have enough cash for the few last days, especially in these hard times. Next week we get back to normalcy, and Polonia should fix around 4,40+.

We head to a MPC meeting next week. Market expects no move, so the most important will be the press conference. I would expect rather hawkish statement from NBP, as they desperatly wants to strengthen currency.

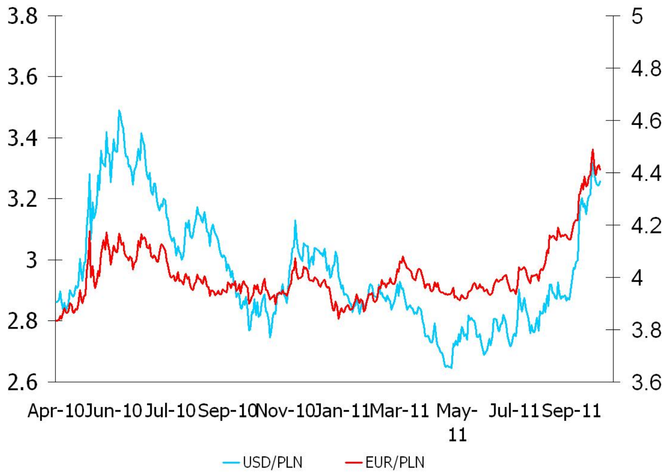








Forex



Trading with authorities Last week, while the Zloty had attempted to test 4,5370 - 27-months low against the euro, amid same, old fears, NBP (Polish Central Bank) and BGK (aka Ministry of Finance) launched an unprecedented (date to note - Friday 23.09.2011) coordinated intervention on the forex and debt markets. As a result of their action Zloty gained over 3% and decent part of positioning was washed away. But as post intervention low was not broken (4.36) Zloty has started losing its value almost every next day. Although depreciation was stopped by next action of BGK on Thursday and some mysterious NBP activity we close this week about mid of interventional selloff. No real change then?

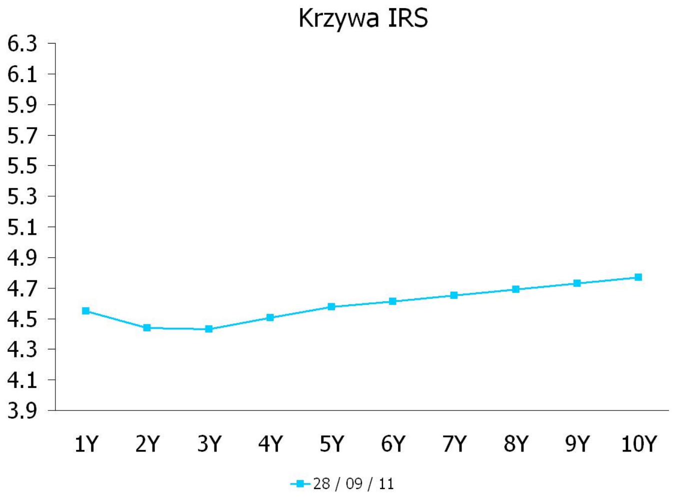
Volatility lower Interventions of BKG and NBP taken last week and better chance for next ones in the future have caused EURPLN have lost part of its positive skewness. It is, or at least supposed to be, simply capped. That's why the reduction off RR was the first reaction after interventions (especially at the beginning of the curve - 1m 25RR fell from 5,2% to 4,2%, 3M 25RR fell from 5,7% to 5,1%). The selloff was also visible in ATM's in short terms (the 1m ATM fell from 17,5% to 16,25% , 3M atm fell from 16% to 15,5%).

Short-term forecasts

Main supports and resisances
EUR/PLN: 4.3500 / 4.4500
USD/PLN: 3.1500 / 3.3500

Spot. Market expects continuation of interventions so we think the Zloty is going to play a range 4,35-4,45 to the euro. But we think market is going to test NBP intervention and if we observe the global flight from risk then we could see EURPLN testing month highs once again.

Derivatives. CB Governor Marek Belka said that further interventions in Poland's foreign exchange are possible if there is a threat of the zloty's excessive volatility. So if such action will be effective the realized volatility should head lower. Implied volatility curve then, which now is much higher than realized, should also fall. That's why we suggest being short vega especially in 2m-3m tenors as action is likely to take place close to end of the year.


Krzywa IRS
6.3
6.1
5.9
5.7
5.5
5.3
5.1
4.9
4.7
4.5
4.3
4.1
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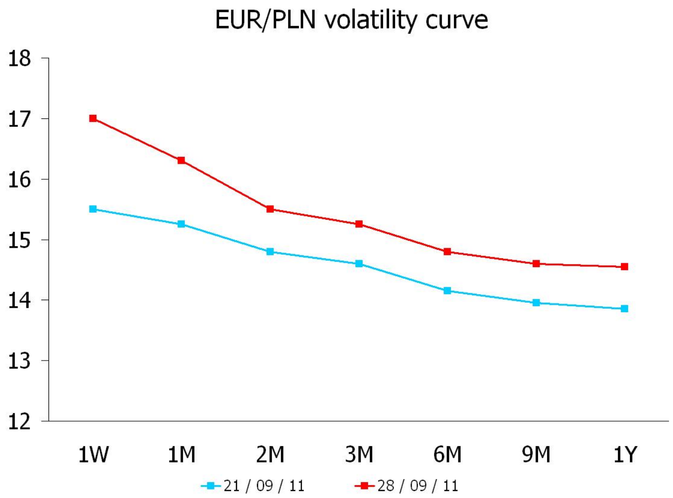
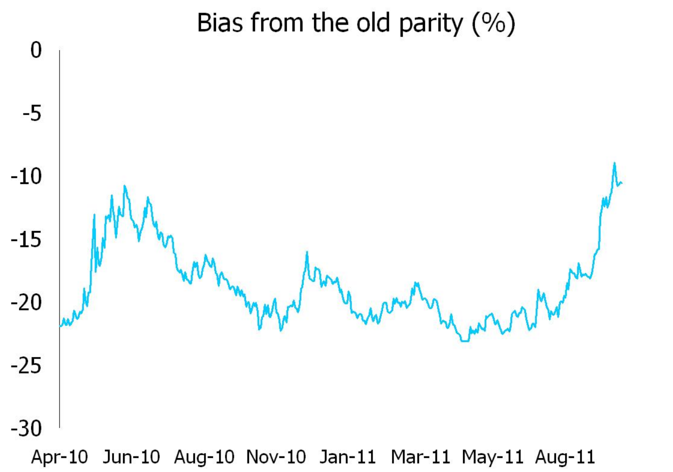
1Y
2Y
3Y
4Y
5Y
6Y
7Y
8Y
9Y
10Y
28 / 09 / 11


EUR/PLN volatility curve
18
17
16
15
14
13
12
1W
1M
2M
3M
6M
9M
1Y
21 / 09 / 11
28 / 09 / 11


Bias from the old parity (%)
0
-5
-10
-15
-20
-25
-30
Apr-10
Jun-10
Aug-10
Nov-10
Jan-11
Mar-11
May-11
Aug-11

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
9/22/2011	4.59	4.75	4.54	4.75	4.57	4.79	4.71	4.68	4.50	4.38	4.31	4.57
9/23/2011	4.59	4.76	4.55	4.75	4.57	6.59	4.75	4.70	4.52	4.40	4.34	4.63
9/26/2011	4.54	4.76	4.71	6.49	4.75	4.79	4.76	4.73	4.63	4.51	4.44	4.68
9/27/2011	4.55	4.76	4.60	4.75	4.69	4.79	4.75	4.72	4.63	4.53	4.47	4.72
9/28/2011	4.56	4.76	4.60	4.75	4.68	4.79	4.74	4.71	4.62	4.52	4.48	4.70

Last primary market rates							
Paper	Au. date	Maturity	Avg. price	Avg. yield	Supply	Demand	Sold
52W TB	1/31/2011	1/31/2012	95.84	4.35	2000	2968	1961
OK0113	4/13/2011	1/26/2013	89.16	5.16	5500	7385	4758
PS0416	1/5/2011	4/25/2016	97.08	5.64	6500	2795	1140
DS1020	1/12/2011	4/25/2019	93.02	6.21	2250	4252	2250

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0113	5Y IRS	PS0416	10Y IRS	DS1019
9/22/2011	4.790	4.570	4.720	4.481	4.925	5.327	5.130	6.094
9/23/2011	6.590	4.530	4.726	4.469	4.921	5.279	5.121	6.096
9/26/2011	4.790	4.530	4.735	4.550	4.920	5.313	5.115	5.978
9/27/2011	4.790	4.570	4.665	4.487	4.785	5.184	4.940	5.870
9/28/2011	4.790	4.570	4.681	4.501	4.846	5.262	5.021	5.917

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1M	1Y
9/22/2011	17.00	15.80	14.90	14.50	14.50	5.13	0.61	0.90
9/23/2011	17.00	15.80	14.90	14.50	14.50	5.13	0.61	0.90
9/26/2011	17.00	15.75	15.10	14.70	14.70	5.13	0.60	0.90
9/27/2011	17.03	15.55	14.98	14.65	14.65	5.13	0.61	0.86
9/28/2011	16.30	15.25	14.80	14.55	14.55	5.02	0.62	0.86

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
9/22/2011	4.4510	3.2917	3.6191	4.3119	1.5238	0.1792
9/23/2011	4.4900	3.3171	3.6745	4.3497	1.5547	0.1810
9/26/2011	4.4113	3.2766	3.6095	4.2839	1.5227	0.1782
9/27/2011	4.3915	3.2563	3.5971	4.2582	1.5223	0.1784
9/28/2011	4.4180	3.2463	3.6173	4.2446	1.5340	0.1800

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