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Comment on the upcoming data and forecasts

On Tuesday unemployment and retail sales data will be published. Along with the slowdown visible in employment, Labor Ministry announced that unemployment rate went higher to 11.7% in September. In case of retail sales we expect the downward movement to be resumed as recent data was accidentally and temporarily positively distracted.

Polish data to watch: October 24 to October 28

Publication	Date	Period	BRE	Consensus	Prior
Retail sales y/y (%)	25.10.	Sep	8.1	9.9	11.3
Unemployment rate (%)	25.10.	Sep		11.6	11.6

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	-	3600	5.105	10/19/2011
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	3.5	3.2
CPI Inflation y/y (average %)	4.3	3.5	2.8	4	3.4
Current account (%GDP)	-5.3	-1.6	-4.5	-4.9	-3.6
Unemployment rate (end of period %)	9.5	11.9	12.3	12.3	12.8
Repo rate (end of period %)	5.00	3.5	3.5	4.5	4.0

	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	3.6	3.4
CPI Inflation y/y (average %)	2.6	2.9	3.7	4.2	4.1	3.8
Repo rate (end of period %)	3.5	3.5	4.0	4.5	4.5	4.5

F - forecast

Economics

Polish economy slows down, although moderately compared with 2008-2009

The latest flow of data suggest the economy is slowing down only moderately while inflation stays quite high (especially in early stages of distribution chains, as shown by producer prices). Such combination of data, mixed with recent zloty depreciation and ensuing currency interventions, encourage MPC to embark on defensive stance (rates on hold but without clear future direction). Even though we think the slowdown will be lesser than in 2008-2009, the window for rate cuts will open at the start of 2012 as more and more MPC members believe that in current circumstances the natural interest shifted lower.

Employment in enterprise sector decreased by 0.1% m/m in September. On yearly basis growth rate of employment fell from 3.1% to 2.8%. Decrease of employment by 5.5k is significant and contrasts with usual market seasonality. Therefore labor market is weakening and during forthcoming months this tendency should strengthen (the fresh NBP analysis shows - according to the „Minutes" from the previous MPC meeting - that on balance more firm expects reduction in employment). Enterprises facing uncertainty simply reduce hiring plans. Comparing the slowdown with 2008-2009, the intensity of lay-off is seems lower. We have just reached the peak in terms of SA employment data and making any quantitative comparisons of hard data is so far impossible on a reasonable sample). We have to rely on qualitative factors: looser monetary policy, ample liquidity, more flexible law, better prospects for private investment.

Although employment surprised to the downside, wages growth leveled-ff only moderately to 5.1% y/y from 5.4% in August. Decent growth stems mainly from past rises in mining sector that shifted the base. By the way it should be stressed that wages are lagging the business cycle. Therefore for some time, despite more explicit signs of economic slowdown (take a look on decreasing employment), wages may still grow moderately and may be used (and indeed are used at the moment) by MPC as an argument against swift rate cuts.

Industrial output slowed in September also only a bit to 7.7% y/y; in seasonally adjusted terms there was actually an acceleration to 7.1% from 5.4% in August. The percentage of growing sections was close to all time average, therefore stays „normal" (there is no evidence that the good result is stemming from outliers, nor that output will entirely escape the slowdown). We still see brisk performance in export sections (furniture, metals, automotive industry), therefore the current scenario for German economy (slowdown but not recession) bodes well for future path of manufacturing in Poland in comparison with 2008-2009 slowdown. Of course the current growth is unsustainable (mind the PMI behavior and the gap between current manufacturing growth), but we do not expect and dramatic downshifts on the horizon (especially towards swift outright falls). In the nearest future, the boost from restoring capacities in automotive sector globally may run out of fuel, shaving off a few percentage points from manufacturing growth. However, at the same time Polish firms may gradually enjoy increasing competitive advantages flowing from zloty depreciation. On balance, we expect GDP growth to stay decent, close to 3% in 2012.

As shown by the "Minutes" from the latest MPC meeting, the Committee is now expecting a moderate growth slowdown accompanied by a gradual fall of inflation. Normally, this should be linked to easing bias. This time, however, the MPC sticks to the scenario of stable rates. Of course arguments of fast growth recorded in producer prices (last spike towards 8.1% was entirely caused by zloty weakness) and inflationary zloty behavior are reasonable; by the way that is why we expect inflation to be falling only gradually in 2012. However, in our opinion the true reason behind neutral bias is connected with preserving status quo in rates differential between EUR and PLN as easy policy would be inconsistent with FX interventions (which NBP does not exclude in the future).

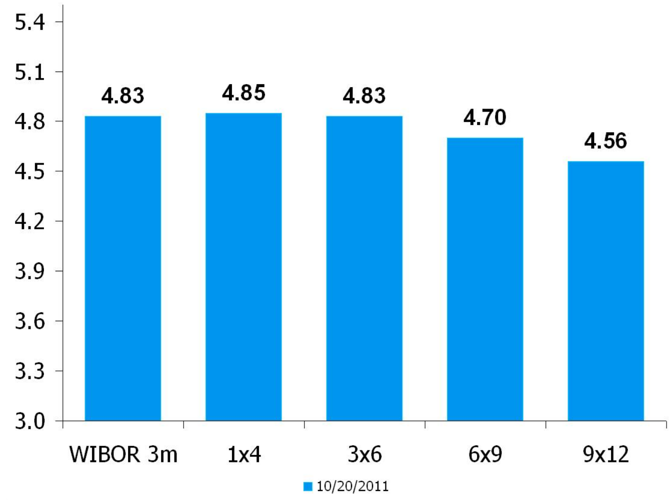
The window of opportunity for rate cuts opens in 2012 when inflation decelerates and GDP growth slows down (in times of heightened uncertainty like now, the MPC always look into the big picture portrayed in quarterly national accounts, overlooking noisy monthly publications). It is important to note than more and more MPC members suggest that current environment favors structurally lower rates as productivity gains are lower (allowing for lower natural interest rates) and global environment (on public and private sector deleveraging) is poised for structurally lower growth rate. That is why we think the rates may go down even in case when the slowdown at the turn of 2011 and 2012 turn out to be only moderate.

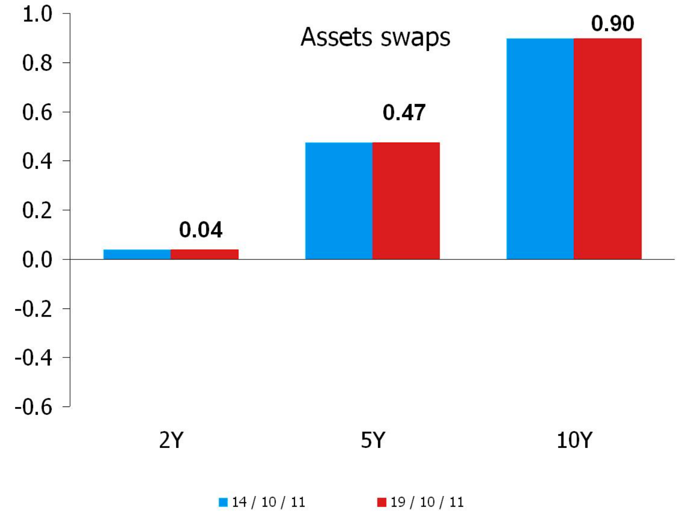
Fixed income

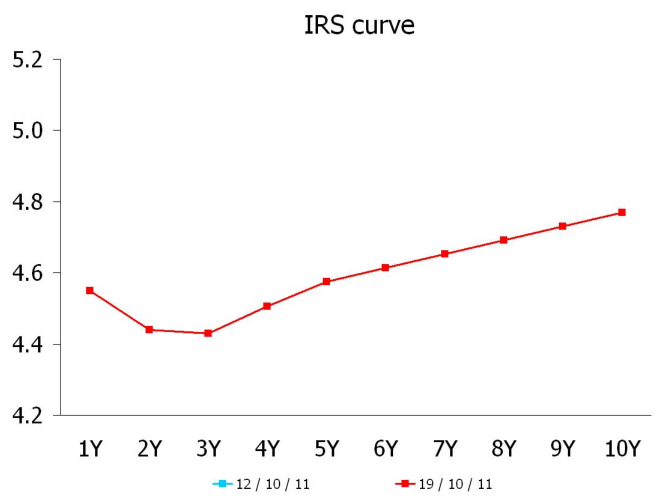
Interesting week on FI market

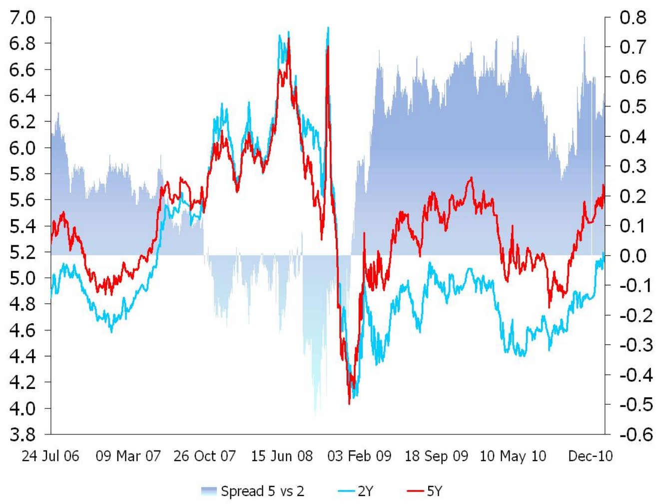
Last week was quite interesting on Polish FI market. In the first half of the week rates traded within narrow range amid low turnover. Sentiment was quite good, and factors that could have impacted the market, were rather ignored; industrial output and PPI data both surprised on the upside, coming at 7.7% and 8.1% y/y versus 5.2% and 7.5% expected. Reaction was very muted, with front end pushing up by some 2bp. Also some comments from MPC were in quite hawkish tone, stating that 'part of the council see rates being hiked rather that cut next year', but that was totally ignored as well. Wednesday's auction of new 5Y benchmark PS1016 attracted very good demand (bid/cover at 3.5) and FinMin successfully placed 3bio (top of offered range). Somehow sentiment has changed rapidly on Thursday, driven by two factors. Firstly, as recently basis swaps have narrowed and implied yield in EURPLN fx forwards jumped up significantly, more and more aggressive interest to pay for cash appeared from international names. That had to finally impact Wibor rates, which moved up by few bps, causing a real avalanche which hit everything from 1x4 FRA to 2Y. On top of that global sentiment started to weigh on the market as well, causing some sell-off across the bond curve.

Those moves, and especially the scale of that look paranoid to us. It is a every-year tendency, that cash market pushes higher as end of year comes closer, as local banks are reluctant to lend cash over the year end. However one must not forget that banking system is massively overliquid (size of typical weekly open market operation is around 100bio PLN), therefore it's almost impossible to imagine a sustainable squeeze in depo market (especially that nothing happens in the very front end). Therefore move in Wibor rates in unlikely to continue and definitely not in that pace. Yet lowest forward in 2Y horizon is only 30-35bp below spot rate and it's not really pricing any policy easing. Adding to the global sentiment which seems to be assuming a global systemic collapse, risk are actually skewed the other way, and moves like that only create valuable receiving opportunities. Once the sentiment improves (and could it actually get any worse?), 2Y will start pricing in rate cuts again, reaching 4.40% level, and bonds will rally strongly...







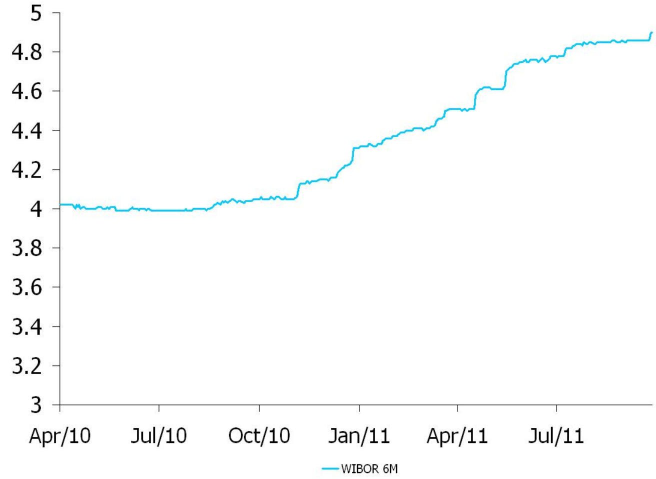


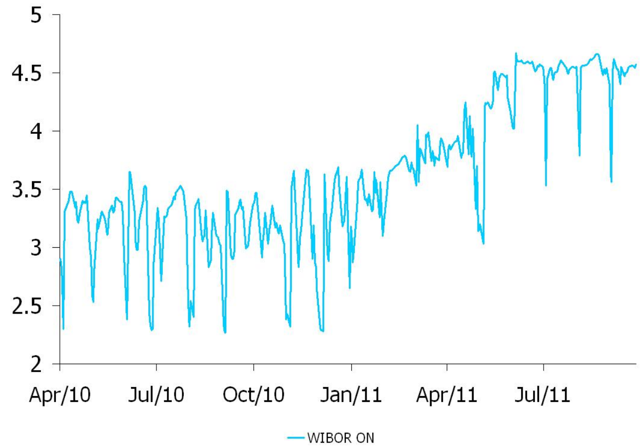
Money market

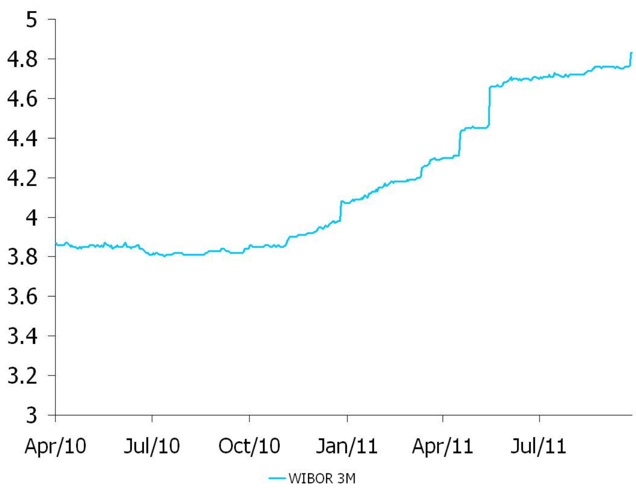
Wibor rates up

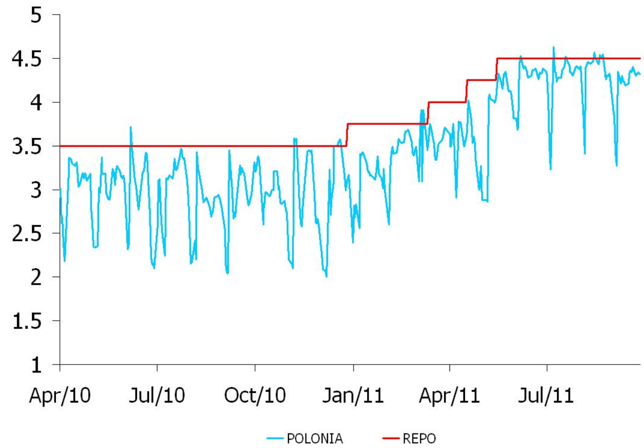
Cost of carry was stable all over the week at 4.3-ish levels. Next week will be probably much cheaper, firstly due to coupon payments from DS bonds and maturity of DZ bonds, and secondly due to the end of the reserve requirements settlement period.
Wibor rates went up (3M and 6M) by a few bps and in our opinion it was caused by the international banks that are trying to finance themselves through the turn of the year. Deposit rates for those tenors are following the fx swaps implied yields, and we think that the movement is not completed yet. Moreover, the 1M wibor will also be under pressure in the year end.

Figures last week were mainly in line with expectations with the exception of the industrial production, which was much better at 7.7%. Such a figure along with the falling CPI and weak currency, is postponing any monetary policy loosening in the nearest future.





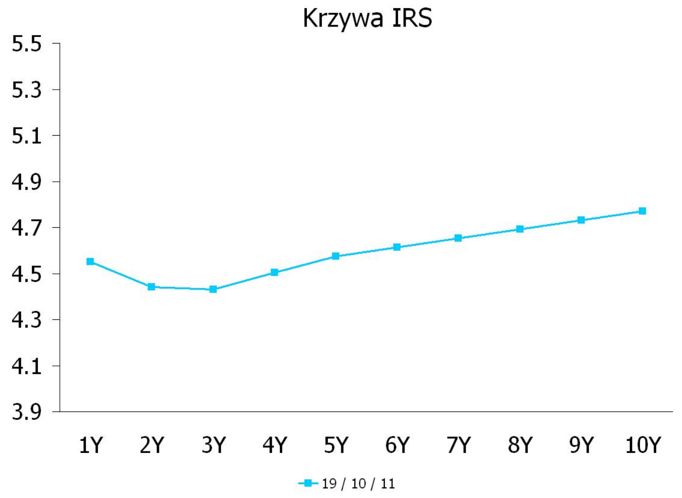




Forex

Zloty weaker The Polish Zloty marked its top this week on Monday, reaching 4.2650 just above strong support for EUR-PLN at 4.2500. After the strong deterioration in global sentiment because of the EU problems, EURPLN bounced to 4.3810 on Tuesday. Same consolidation was needed in the 4.3250/4.3850 range, and we broke out higher to 4.4250 top on Thursday night.

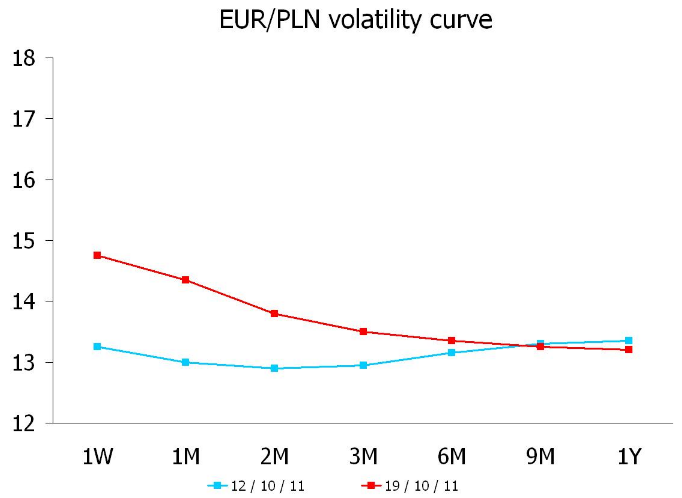
Volatility higher The correlation weaker Zloty - higher volatility curve is working as usual. The EURPLN curve moved higher with weaker PLN, the move of course affected the most the front end curve i.e (1 month from 13.0% mid moved to 15.25%, 3m from 13.00% to 14.00% and 1y from 13.0% to 13.70%). The risk reversals have jumped by 0.5 - 0.75% and currency spread (USD/PLN minus EUR/PLN) rose by 0.5%.



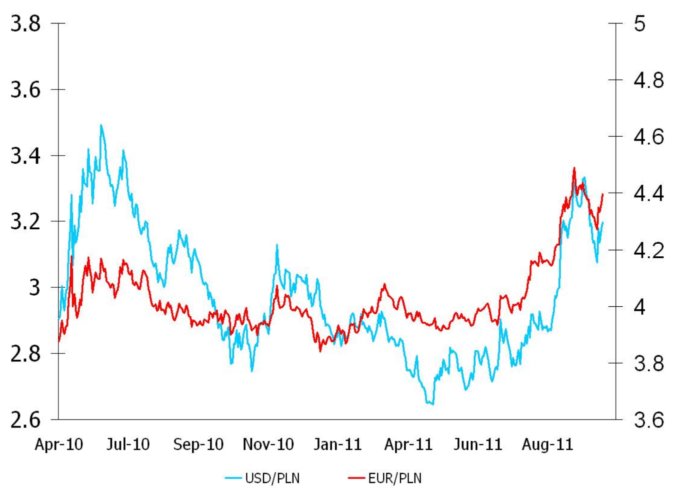
Short-term forecasts

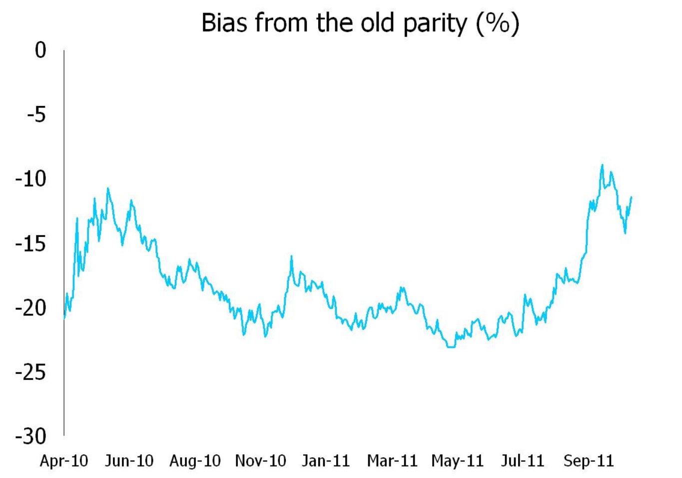
Main supports and resisances
EUR/PLN: 4.2500 / 4.5000
USD/PLN: 3.0500 / 3.3500

Spot. We are taking another attempt to the upside, as global sentiment is sour. The market will be now expecting same actions from BGK and NBP so there will be no surprise advantage, this time. The only question is where not if they will be intervening. Our personal view they should not enter before 4,55/4,60 or till the market gets properly short PLN, otherwise they will finance the cheap entrance into PLN shorts. In general we are buyers on dips till 4,50 were we will try to sell into picks...



Derivatives. The ideal position to have is to be long Vega in 3m-6m and short out of the money call for December. The net effect is the long Vega and long Gamma and only tiny theta. EUR/PLN should be protected from rising to high too fast as our CB and Ministry of Finance are the potential sellers till the year end. Then we will be at the markets mercy, and with no clear solution to Greece problems we should keep the core long in Vega.





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
10/13/2011	4.56	4.75	4.70	4.76	4.55	4.79	4.74	4.71	4.56	4.45	4.31	4.66
10/14/2011	4.58	4.76	4.67	4.76	4.61	6.59	4.74	4.71	4.57	4.43	4.28	4.65
10/17/2011	4.56	4.76	4.70	6.49	4.75	4.79	4.74	4.71	4.55	4.40	4.28	4.62
10/18/2011	4.57	4.76	4.68	4.76	4.62	4.79	4.74	4.71	4.57	4.43	4.33	4.63
10/19/2011	4.59	4.77	4.68	4.76	4.63	4.79	4.74	4.71	4.57	4.43	4.30	4.63

Last primary market rates							
Paper	Au. date	Maturity	Avg. price	Avg. yield	Supply	Demand	Sold
52W TB	5/30/2011	5/30/2012	95.57	4.58	600	2667	505
OK0113	8/10/2011	1/25/2013	89.58	4.58	5000	4934	1889
PS0416	10/19/2011	4/25/2016	98.44	5.11	3600	11200	3638
DS1020	7/21/2011	10/25/2021	99.53	5.80	3000	5608	3000

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0113	5Y IRS	PS0416	10Y IRS	DS1019
10/13/2011	4.790	4.570	4.576	4.467	4.671	5.102	4.881	5.766
10/14/2011	6.590	4.530	4.596	4.488	4.706	5.056	4.921	5.731
10/17/2011	4.790	4.530	4.596	4.488	4.706	5.056	4.921	5.731
10/18/2011	4.790	4.570	4.596	4.488	4.706	5.056	4.921	5.731
10/19/2011	4.790	4.570	4.596	4.488	4.706	5.056	4.921	5.731

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1M	1Y
10/13/2011	12.90	12.80	13.00	13.05	13.05	4.33	0.51	0.82
10/14/2011	12.90	12.80	13.00	13.05	13.05	4.33	0.51	0.82
10/17/2011	13.25	13.15	13.15	13.10	13.10	4.33	0.51	0.82
10/18/2011	14.30	13.85	13.35	13.20	13.20	4.53	0.51	0.81
10/19/2011	14.35	13.50	13.35	13.20	13.20	4.53	0.51	0.81

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
10/13/2011	4.3161	3.1409	3.4974	4.0870	1.4793	0.1745
10/14/2011	4.2925	3.1107	3.4704	4.0448	1.4731	0.1736
10/17/2011	4.2716	3.0759	3.4528	3.9701	1.4659	0.1730
10/18/2011	4.3499	3.1788	3.5246	4.1394	1.4602	0.1759
10/19/2011	4.3334	3.1347	3.4820	4.0821	1.4651	0.1744

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