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Comment on the upcoming data and forecasts

The structure of the recent PMI was already weak, implying further loses. However, owing to somewhat better reading in Germany we are not utterly bearish on the reading, therefore calling only for a small, but consecutive decline. As for MPC's decision the real and final corroboration of our interest rate cut call for October was interview with governor Belka. He states that markets should prepare for monetary easing. Although the headlines were mixed (on the one hand real interest rates high among regional peers, on the other they should be there stimulating savings rate - no doubt this is a macro-stability issue), the most important passages link to domestic inflationary pressures and economic imbalances. Prices are lifted by exogenous factors and domestic inflationary pressures are negligible. Imbalances are starting to wane. And as MPC has no influence on commodity prices then, using Belka's words, it should act on fronts where it can do something. It seems straight for us that such a reasoning implies supporting the ailing real sphere and cutting interest rates.

Polish data to watch: September 24th to September 28st

Publication	Date	Period	BRE	Consensus	Prior
PMI	1.10.	Sep	48.0		48.3
MPC decision	3.10.		4.5	4.5	4.8

Treasury bonds and bills auctions

Paper	Next auction	Last Offer	Last yield (%)	Prev auction
52 Week T-bills	-	3000	4.470	3/26/2012
2Y T-bond OK0714	10/18/2012	5000	4.361	7/19/2012
5Y T-bond PS0417	10/18/2012	4000	4.361	8/1/2012
10Y T-bond DS1021	10/10/2012	3000	4.944	9/19/2012
20Y T-bond WS0429	10/10/2012	4000	5.563	5/10/2012

Macroeconomic forecasts

Wskaźnik	2009	2010	2011	2012 F	2013 F
GDP y/y (%)	1.7	3.8	4.3	2.2	1.5
CPI Inflation y/y (average %)	3.5	2.8	4.2	3.6	2.8
Current account (%GDP)	-1.6	-4.5	-4.9	-2.5	-1.5
Unemployment rate (end of period %)	12.1	12.4	12.5	13.5	14.4
Repo rate (end of period %)	3.50	3.50	4.50	4.25	3.25

	2011 Q3	2011 Q4	2012 Q1	2012 Q2	2012 Q3 F	2012 Q4 F
GDP y/y (%)	4.2	4.3	3.5	2.4	2.0	1.3
CPI Inflation y/y (average %)	4.1	4.6	3.9	4.0	3.9	3.2
Repo rate (end of period %)	4.50	4.50	4.50	4.75	4.75	4.25

F - forecast

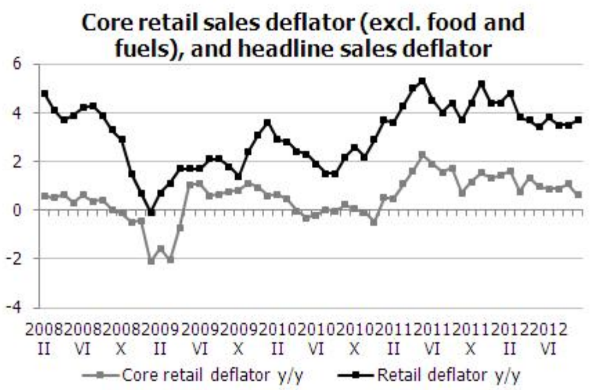
Economics

Retail sales soft in details

Retail sales decelerated to 5.8% y/y in August vs 6.9% y/y in the previous month. The fall would have been more articulated without the usual volatility in some series ("other" category, food prices) and base effects in home appliances and wearing apparel. What is more, there is some recurring weakness in auto sales which is again shrinking on annual basis (it was December last year that saw the latest negative print). Therefore the retail data are weak enough to support the notion of further deceleration of the Polish economy. Another (however minor) leg down in core retail sales growth seems to perfectly summarize the ongoing story.

We expect retail sales to decelerate further in the coming months. The most striking rationale comes from the weak labor market (monthly drops of employment, substantially lower growth of wages) which affects current income of households. Another headwind is the lack of possibility to smooth consumption as with record low saving rate and credit rationing, many households may have hit the wall. Weakness in retail sales is going to translate into even lower growth of consumption (national accounts). We should bear in mind, however, that significant amount of slack in consumption has already come from limited consumption of services.

Retail sales prices remained almost stable, but we saw a slight increase in core prices (see the graph). We would not put a dime on a bet that it is something more than a usual volatility of the series. Trend reversal seems impossible given the building slack in the economy.



Markets stayed unimpressed after the data.

We expect rate cut in October

Recent MPC statement outlined the neccesary conditions for a rate cut: moderation of inflation and the lack of improvement in the real sphere. All price indicators came lower in September (August data), industrial output posted a print that was close to zero, retail sales decelerated somewhat not in an impressive manner but the details of sales report were soft enough. Moreover, it is clear now that the government struck a balancing act between some stimulation and sticking to consolidation in the mid-term, giving thereby more leeway to monetary easing.

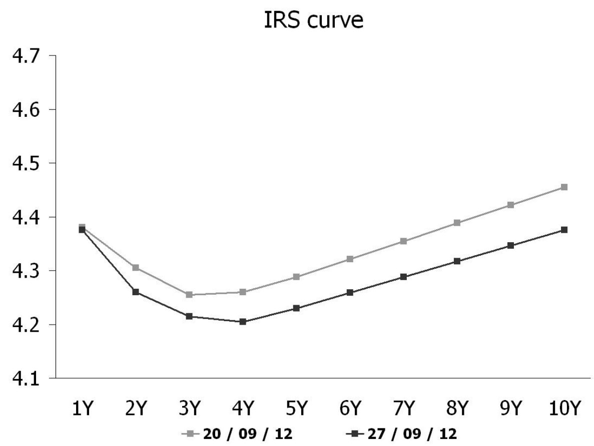
Recently published monetary policy assumptions for 2013 do not change our view since they do not convey any realy new innovations. They introduce a term of macro-stability (monetary policy preventing a formation of imbalances in the economy), but actions connected with the term have been already applied by MPC (e. g. some form of exchange rate management, stimulation of savings by high real interest rates leading to stabilization of the banking sector's financing side). Assumptions somehow elaborate more on the flexibility of monetary policy by giving an appraisal of central bank actions taken so far. However, it is nothing new in monetary policy since also earlier monetary policy assumptions were build on the fact that the reaction of monetary auuthorities is conditional to the assesment of the persistence of shocks imposed upon the economy. All in all, new monetary policy assumptions are unlikely to slow down the easing process.

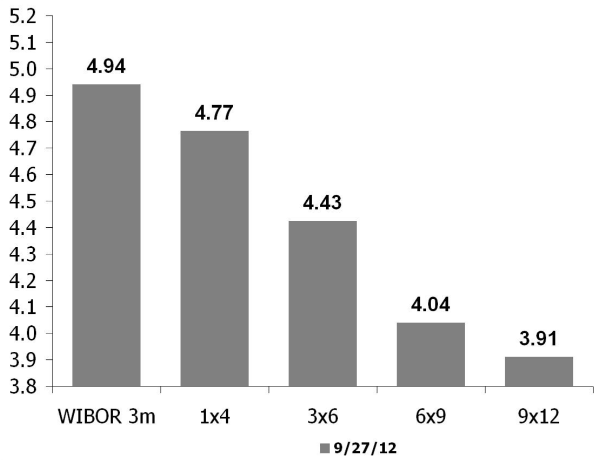
The real and final corroboration of our interest rate cut call for October was interview with governor Belka. He states that markets should prepare for monetary easing. Although the headlines were mixed (on the one hand real interest rates high among regional peers, on the other they should be there stimulating savings rate - no doubt this is a macro-stability issue), the most important passages link to domestic inflationary pressures and economic imbalances. Prices are lifted by exogenous factors and domestic inflationary pressures are negligible. Imbalances are starting to wane. And as MPC has no influence on commodity prices then, using Belka's words, it should act on fronts where it can do something. It seems straight for us that such a reasoning implies supporting the ailing real sphere and cutting interest rates.

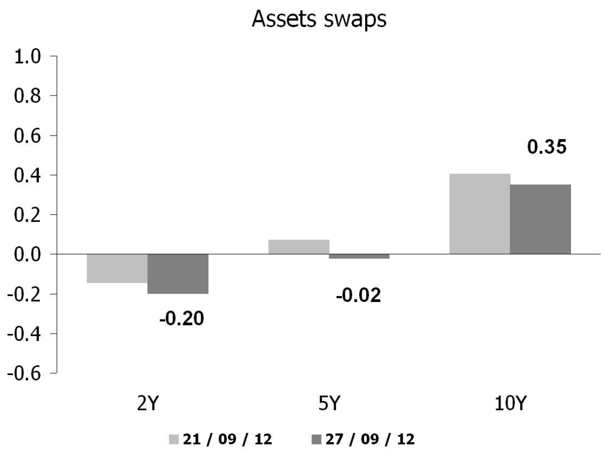
Fixed income

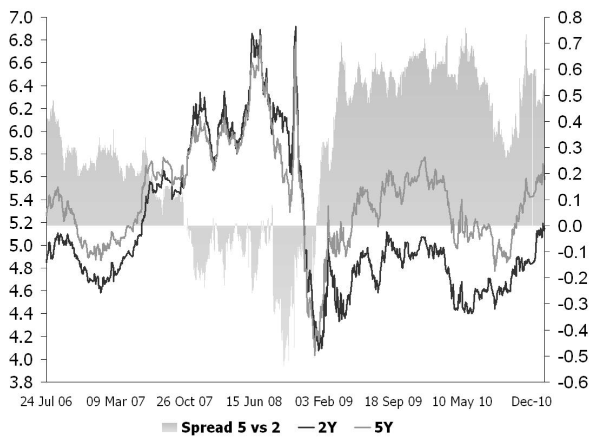
Preparing for a cut.

Market rallied strongly last week on both bonds and rates. Swap curve moved down by more than 10bp along with bonds up to 5y. 10y papers outperformed the rest and gained ca. 20bp. Interview with NBP Governor Belka was quite dovish, as 'markets should prepare for an easing cycle', we think it will start already next week. Also monetary policy guidelines stating that 'Polish CB to be flexible on CPI return to target amid shocks' suggest that rate cuts could happen rather sooner then later. EUR 2.3bio credit lines granted from EIB would reduce next year borrowing needs, no risk to Polish rating according to S&P also somehow justifies the flattening move. We remain positive on rates here, we think however that front end and the belly of the curve have greater value, as we expect rate cut next week followed by weak set of data which altogether should push yields even lower.





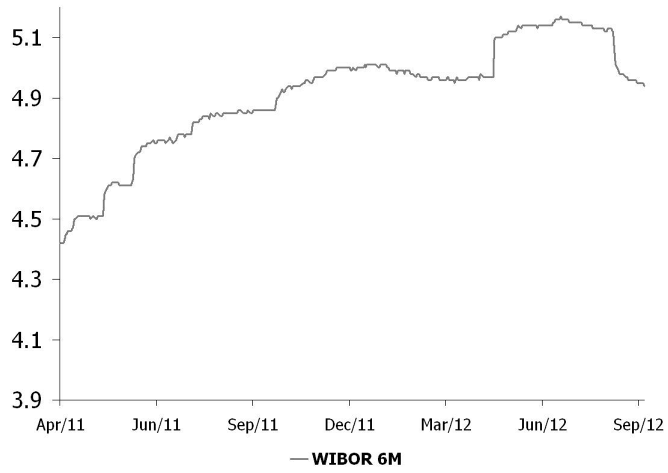


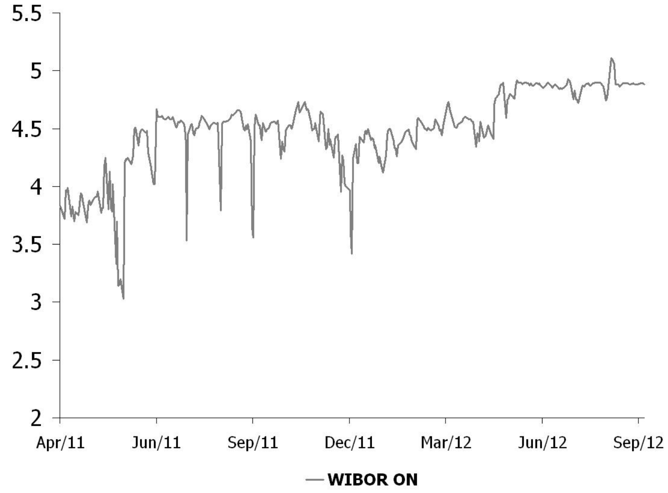


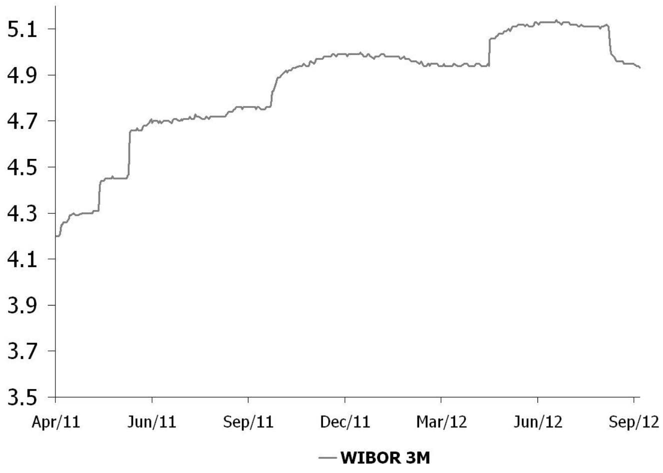
Money market

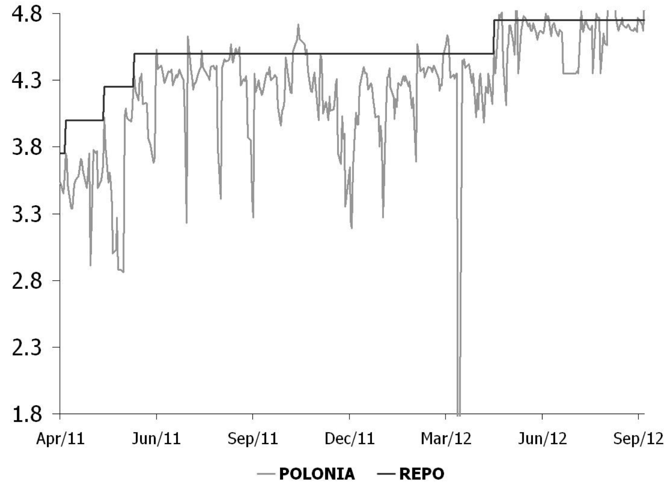
Cost of carry should soften a bit. Cost of liquidity should soften next week since we are approaching the new reserve with a decent cash surplus.

We expect 25 bps cut next week. Highlight of the week will be definitely MPC meeting. We expect that rates will be cut by 25 bps. Next step in November supported by weaker and weaker real economy data. Market after bearish while is rallying massively again, discounting the scenario presented above. We are keeping our receivers on derivatives and we are happy with front end bonds too.







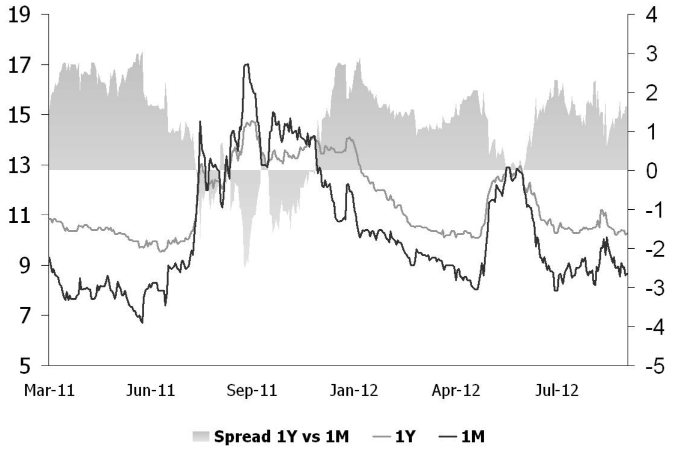


Forex

Consoldiation then lower 4.1800 resistance was too hard to crack. The retrace from there took it's time to consolidate in 4.12/4.16 range. Today (Friday) we have broken decisively through 4.1200 support zone. The Spanish budget was the catalyst, causing the risk-on rally, higher EUR/USD and stronger PLN. Is it substantial? Well, the plans are about to be ambitious, if they translate into reality it is whole different story...

Vols slightly lower Vols are slightly lower, which is understandable, as the correlation stronger zloty - lower vols is strongly in place. The changes also are really cosmetic, 1month is now 8.5% mid ATM (0.3% lower then a week ago), the 6 months are now 9.6% mid ATM (9.9% last week). Actually the 6 months were taken at 9.85% just before the Spanish budget news. The skew and currency spread is roughly unchanged.

EURPLN volatility



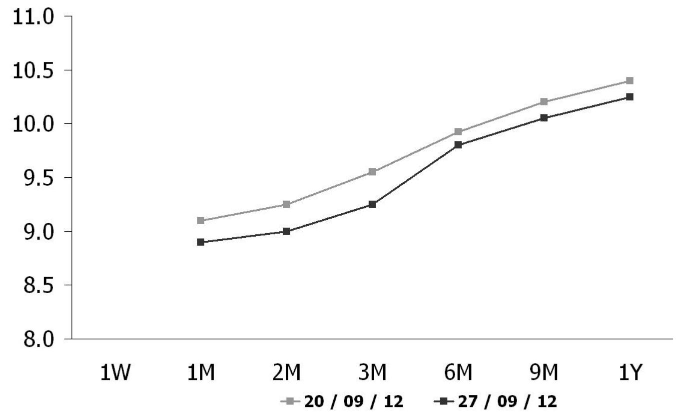
Short-term forecasts.

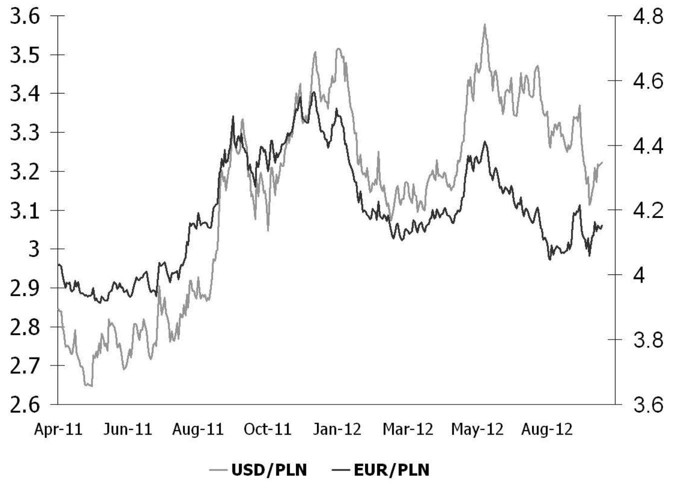
Main supports and resisances
EUR/PLN: 4.0500 / 4.1800
USD/PLN: 3.0500 / 3.2100

Spot. We don't see a high probability trade at the moment. We are slightly skewed to the upside in EUR/PLN as the rate cuts and Polish macro are sad facts. But timing is the key...

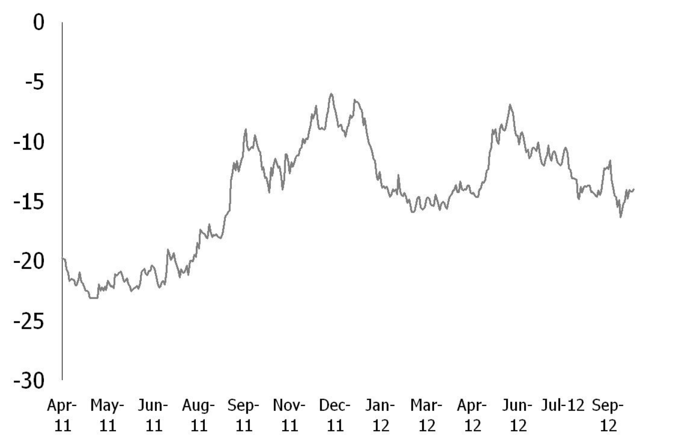
Derivatives. The strong floor for EUR/PLN vols (1m ATM 8%, 1y mid 10.0%), has already has proven itself several times in last 3 years. The Vols are still at levels which are attractive for buyers. We are keeping the core long in the backend Vega in EURPLN.

EUR/PLN volatility curve





Bias from the old parity (%)



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
9/21/2012	4.63	4.95	4.73	4.85	4.71	4.87	4.81	4.46	4.10	3.99	4.00	4.10
9/24/2012	4.45	4.94	4.45	4.85	4.45	4.87	4.82	4.49	4.11	4.00	4.00	4.12
9/25/2012	4.68	4.94	4.74	4.85	4.72	4.87	4.79	4.48	4.11	4.00	4.04	4.11
9/26/2012	4.61	4.94	4.58	4.85	4.55	4.86	4.77	4.45	4.06	3.96	3.98	4.05
9/27/2012	4.74	4.93	4.71	4.84	4.68	4.86	4.77	4.43	4.04	3.91	3.93	4.02

Last primary market rates							
Paper	Au. date	Maturity	Avg. price	Avg. yield	Supply	Demand	Sold
52W TB	5/30/2011	5/30/2012	95.57	4.58	600	2667	505
OK0114	8/10/2011	1/25/2013	89.58	4.58	5000	4934	1889
PS1016	10/19/2011	10/25/2016	98.44	5.11	3600	11200	3638
DS1021	7/21/2011	10/25/2021	99.53	5.80	3000	5608	3000

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0113	5Y IRS	PS0416	10Y IRS	DS1019
9/21/2012	4.870	4.813	4.305	4.161	4.279	4.351	4.456	4.860
9/24/2012	4.870	4.813	4.310	4.174	4.288	4.356	4.440	4.911
9/25/2012	4.870	4.813	4.323	4.174	4.285	4.314	4.430	4.880
9/26/2012	4.860	4.813	4.295	4.067	4.265	4.234	4.416	4.767
9/27/2012	4.860	4.813	4.260	4.061	4.230	4.209	4.375	4.724

EUR/PLN 0-delta stradle						25-delta RR			25-delta FLY
Date	1M	3M	6M	1Y		1M	1Y		1Y
9/21/2012	8.90	9.40	9.93	10.38		10.38	3.58		0.76
9/24/2012	8.93	9.35	9.83	10.38		10.38	3.58		0.76
9/25/2012	8.60	9.20	9.73	10.23		10.23	3.53		0.76
9/26/2012	8.65	9.25	9.83	10.28		10.28	3.52		0.76
9/27/2012	8.90	9.25	9.80	10.25		10.25	3.58		0.75

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
9/21/2012	4.1340	3.1712	3.4126	4.0533	1.4663	0.1669
9/24/2012	4.1528	3.2180	3.4356	4.1250	1.4648	0.1665
9/25/2012	4.1475	3.2136	3.4301	4.1349	1.4647	0.1662
9/26/2012	4.1415	3.2187	3.4251	4.1471	1.4512	0.1661
9/27/2012	4.1518	3.2236	3.4342	4.1497	1.4556	0.1667

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