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## Comment on the upcoming data and forecasts

M3 data are hardly a shocker, usually go unnoticed. However, they are important for analytic purposes. We enter the period of last year's high statistical base. It may entail corporate deposits growth below zero. Still relativelly high growth of household deposits is supported by still atractive rates offered on savings products by banks.

### Polish data to watch: October 5th to October 11th

| Publication | Date | Period | BRE | Consensus | Prior |
|---|---|---|---|---|---|
| M3 Supply | 11.10. | Sep | 8.0 | 8.5 | 9.5 |

### 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 | 10/23/2012 | 5000 | 4.361 | 7/19/2012 |
| 5Y T-bond PS0417 | 11/8/2012 | 1000 | 4.361 | 10/4/2012 |
| 10Y T-bond DS1021 | 10/23/2012 | 3000 | 4.944 | 9/19/2012 |
| 20Y T-bond WS0429 | 11/8/2012 | 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 |

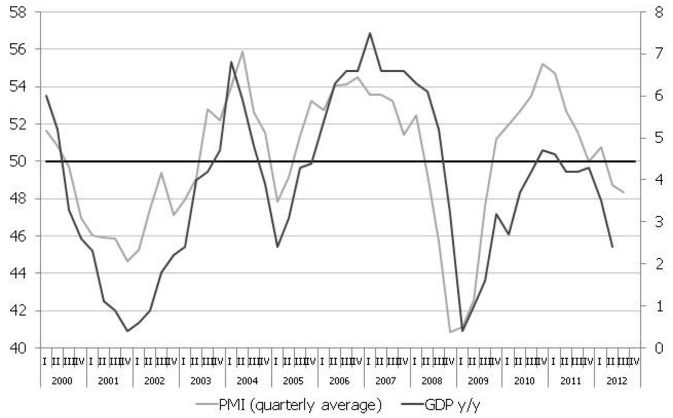
| | 2011 Q3 | 2011 Q4 | 2012 Q1 | 2012 Q2 | 2012 Q3 F | 2012 Q4 F |
|---|---|---|---|---|---|---|
| GDP y/y (%) | 4.2 | 4.3 | 3.5 | 2.4 | 2.0 | 1.3 |
| CPI Inflation y/y (average %) | 4.1 | 4.6 | 3.9 | 4.0 | 3.9 | 3.2 |
| Repo rate (end of period %) | 4.50 | 4.50 | 4.50 | 4.75 | 4.75 | 4.25 |

F - forecast

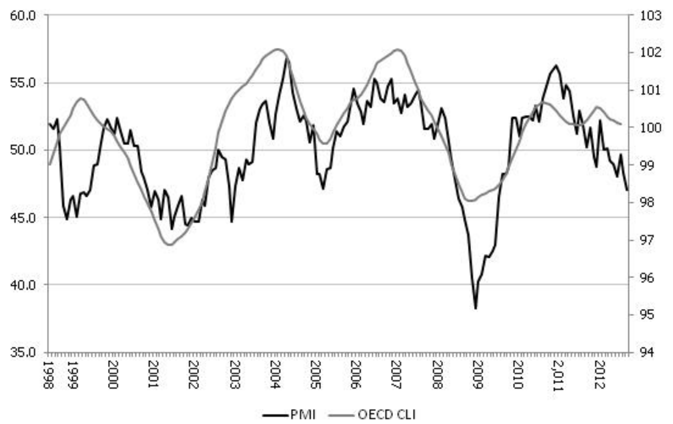
# Economics

## PMI plunges further

Polish PMI index caved in September to 47pts from 48.3pts in the prior month. The weakness is seen all across the board. Output index fell at the fastest rate since June 2009, new orders reduction gained in pace (the most important negative contribution came from domestic orders - it only confirms our thesis that „this time it is different”: global slowdown falls into fertile ground of domestic problems in the Polish economy with limited space of fiscal policy stimulation). Interestingly, employment index fell below 50pts threshold. This goes hand in hand with our observations coming from detailed analysis of employment in enterprise sector. Sector by section, many sections have already reached a peak, and - given the serially correlated nature of employment - falls are set to be extended further. It is also worth to note that enterprises are again in cost-cutting mode which also does not bode well for employment and wages. At the same time firms face falling demand, therefore measures of price pressures are stable since it is hard (or impossible) to pass higher prices to consumers.




Falling PMI corroborates the falling trend in the economy. The same conclusions can be drawn from different, more smooth business activity indicators such as OCED CLI (see the graph). As for the coming data, we feel comfortable with our below consensus growth of employment forecast (-0.1% y/y vs 0.0% implied by market consensus) and put downside risk to our -3.4% y/y call on industrial output.

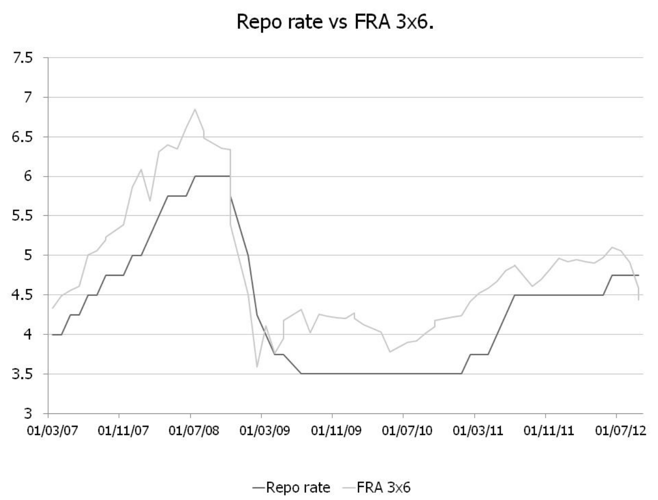



Last but not least, some technical considerations also demand attention. If surveyed enterprises asses the condition of their firms compared to the last year, next months are unlikely to bring a correction upwards which is usually inherent in survey measures. What is more, recently polish PMI index lost its positive correlation with its European counterparts which points to rising negative influence of domestic factors.

## Rates on hold. Cut pre-announced for November.

Contrary to market consensus and market expectations the MPC left rates on hold. Thereby MPC stayed indifferent to worsening economic activity despite the fact it mentioned its disinflationary impact in the statement ("In the opinion of the Council, inflation will decrease gradually over the coming months, as the statistical base effect wanes amidst slowing demand in the economy"). It seems the MPC is continuing a controversial defence of its credibility after the odd decision to hike rates in May. To this end the MPC aims to avoid „abrupt” moves and proceed as neutrally as it could - synchronizing a cut with the fresh inflation projection. A cut was practically pre-annouced for November. However, judging from Belka’s anxiety during the conference, the decision was not his idea. Such a situation does not make further MPC movements any more transparent.

But one thing is certain. The MPC once again confirmed it seems to spend too much time in its tenure behind the curve. It was evident in case of interest rate hikes in 2011, „leftover” rate hike in May 2012) as can be seen from the graph portraying the confusion of the market participants (rising spreads between FRAs and Repo rate). Such a behavior of the MPC limits the counter-cyclical traits of monetary policy in Poland. Moreover, the claims (to be honest, flowing from many MPC members) of negligible effects of monetary policy are not economically viable, go counter the economic mainstream and sum up to economic nihilism, good for various „economic bugs”, but not for people from prestigious Monetary Policy Committee.



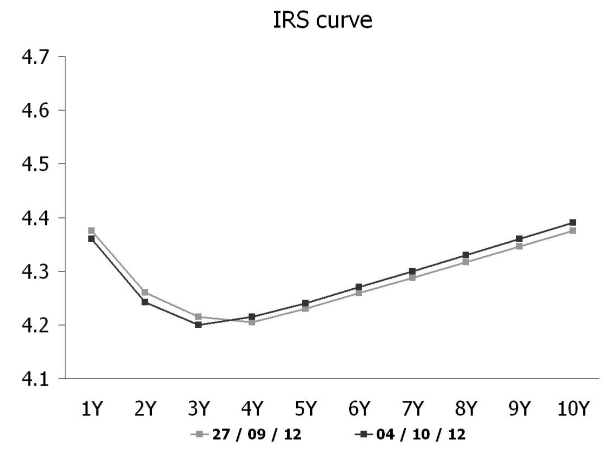

We think that recent regulation and risk-limiting actions undertaken by banks on their own that halted the creation of credit denominated in foreign currencies have substantially improved effectiveness of monetary policy. Recent MPC inaction has its price. With no interest cut and strong zloty (too strong given the phase of the cycle) Polish GDP is set to dive relatively more and we shall not exclude a scenario in which it reaches y/y growth rate close to zero at the start of 2013.

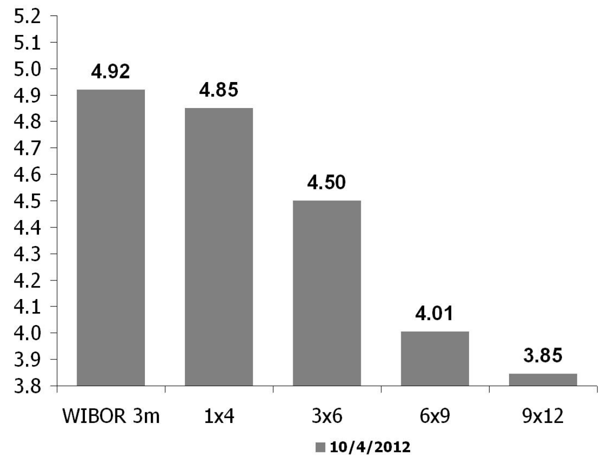
Leaving some more subtle considerations aside, we expect rates to be cut in November by 25bp. The policy of small steps will be continued in the following months but the whole cycle will be deeper than 100bps already accepted by the MPC given the preferred conditionality on real interest rate (to stay positive to stimulate saving). Next moths will be a wake-up call. Deeper slowdown and dovish inflation projection are set to encourage expectations for a more normal easing cycle, closer in magnitude to previous ones ( 200bp).

# Fixed income

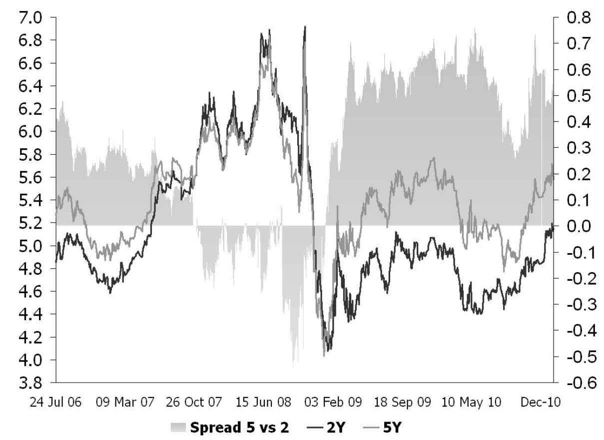
## Surprise

The MPC failed again in communication with the market. Contrary to both economists survey and the market expectations the Council decided to leave interest rates unchanged. The front-end FRA contracts players lost around 15-20bp on a negative yield curve pricing 80%-90% probability of an easing cycle start in October. The rest of a yield curve remained unchanged with a slight rollercoaster trading on a daily basis. Though the probability of a November rate cut would seem to be greater than ever, one should still await for the current macro data to be fully aware of a consequences of the potential November's hold (the MPC policy proved to be extremely unpredicatble). We would be still betting on lower rates and try to receive the local tops. Offsetting the Council decision risk we would run towards more bonds than FRAs especially when Min Fin was almost done with its 2012 borrowing needs and we could see any rating downgrade threat according to the rating agencies' statements.



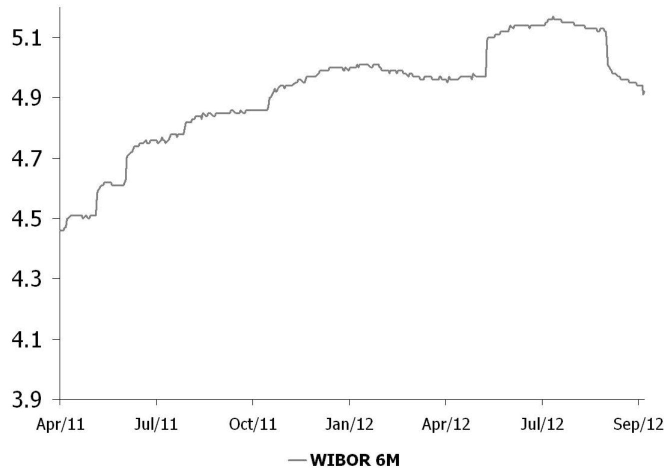


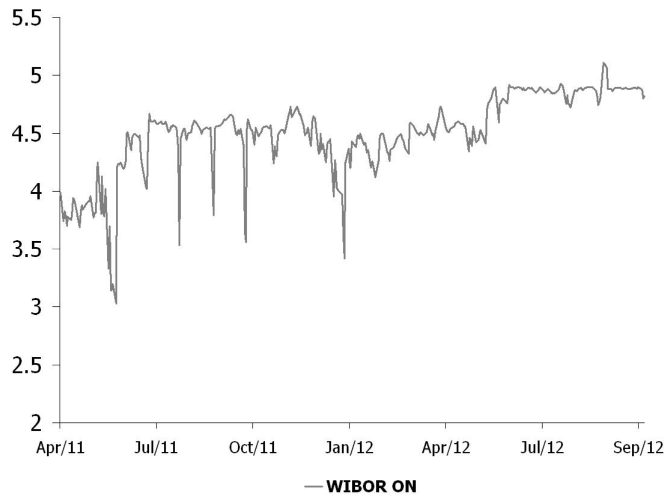


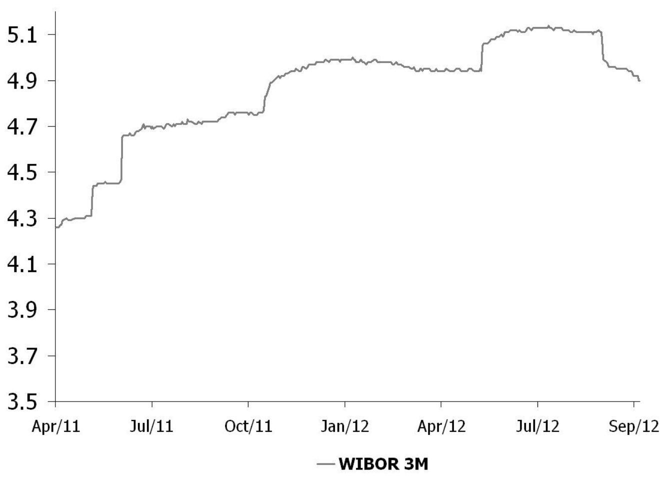
## Money market

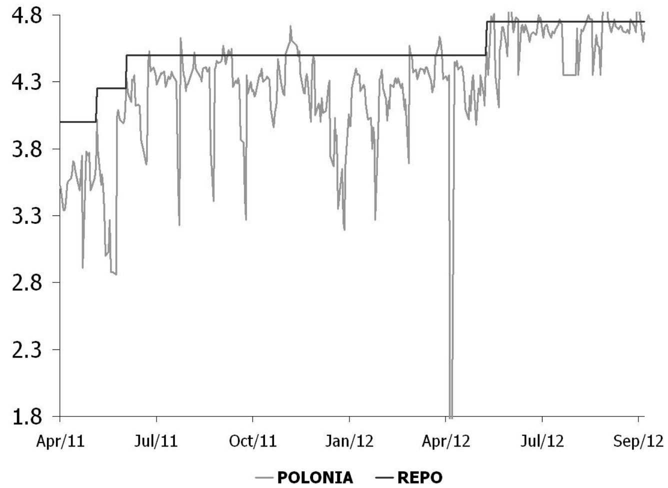
**Cost of carry up next week.** Shortest rates will definitely go up next week since today's OMO leaves the market in shortage (107,5 bln pln bought, 105 bln pln was to square the market). It still surprises us why the banks insist on buying so many bills having history of financing them with losses. Nonetheless, it is not going to be cheap and that is for sure.

**Is November a safe bet on cut?** The MPC surprised the market not cutting the rates after such a week set of data from the real economy. Probably reputational reasons took over the common sense, however for us it is not saving reputation. It is eroding it even more. They kind of pre-announced the cut in November, though. However, if the CPI reading is above 4% again (which is likely this month), will they care about negative production (which is also very likely)?



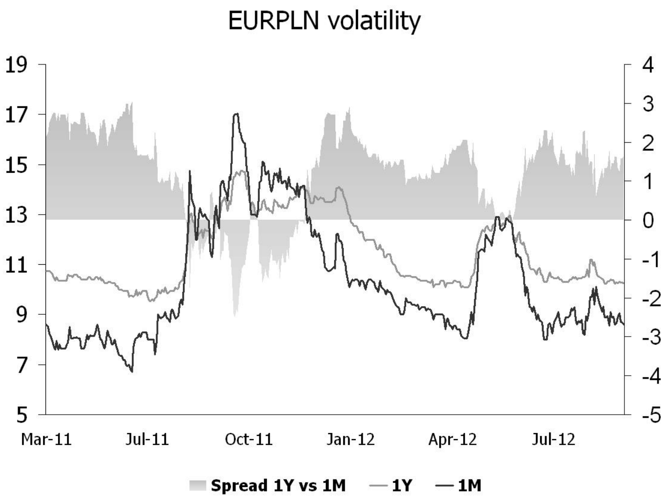



# Forex

**Unstoppable PLN** Looks like the glass is full in half again. The much better then expected ISM numbers from US, ECB actions that should put the lid on European bonds yields. On the top of it the Polish MPC has decided to leave the rates unchanged, which means that the cuts are postponed for the month if the figures support such move. The EURPLN is slowly breaking to the downside through 4.06/4.09 support zone. The move is slow, but gaining traction.

**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.

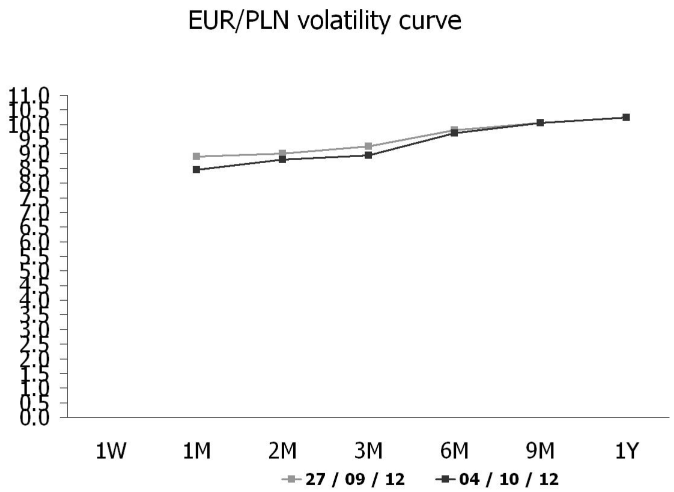


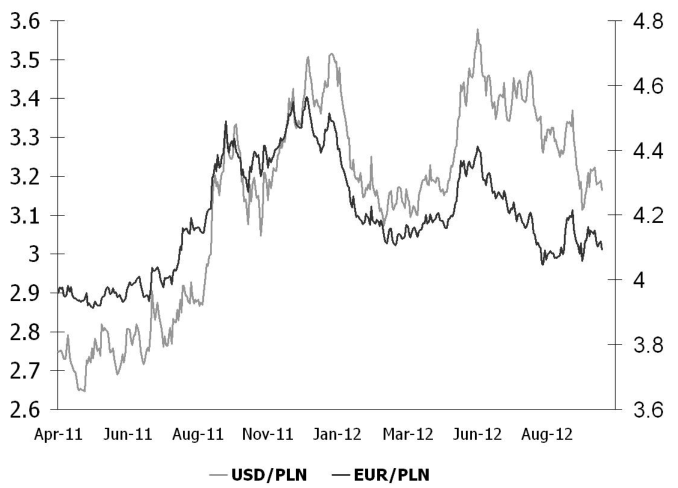

## Short-term forecasts.

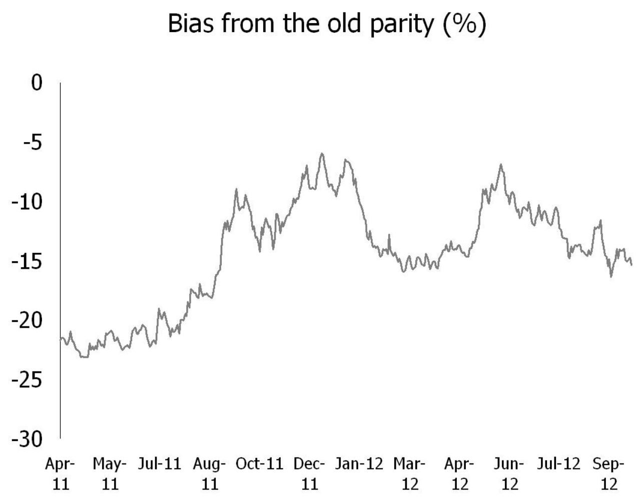
Main supports and resisances
EUR/PLN: 4.0500 / 4.1800
USD/PLN: 3.0500 / 3.2100

**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.



# 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 |
| 9/28/2012 | 4.58 | 4.92 | 4.58 | 4.84 | 4.55 | 4.85 | 4.75 | 4.42 | 3.99 | 3.87 | 3.94 | 4.05 |
| 10/1/2012 | 4.77 | 4.92 | 4.75 | 4.84 | 4.70 | 4.85 | 4.73 | 4.45 | 4.01 | 3.88 | 3.84 | 3.99 |
| 10/2/2012 | 4.72 | 4.92 | 4.72 | 4.84 | 4.70 | 4.84 | 4.74 | 4.42 | 3.96 | 3.81 | 3.84 | 3.96 |
| 10/3/2012 | 4.45 | 4.90 | 4.58 | 4.81 | 4.55 | 4.83 | 4.89 | 4.50 | 4.01 | 3.84 | 3.90 | 4.00 |
| 10/4/2012 | 4.55 | 4.90 | 4.55 | 4.82 | 4.50 | 4.83 | 4.85 | 4.50 | 4.01 | 3.85 | 3.88 | 4.00 |

| 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 |
| 9/28/2012 | 4.850 | 4.813 | 4.210 | 4.052 | 4.195 | 4.187 | 4.340 | 4.680 |
| 10/1/2012 | 4.850 | 4.813 | 4.205 | 4.021 | 4.180 | 4.228 | 4.355 | 4.720 |
| 10/2/2012 | 4.840 | 4.813 | 4.200 | 3.999 | 4.195 | 4.228 | 4.370 | 4.680 |
| 10/3/2012 | 4.830 | 4.813 | 4.235 | 4.064 | 4.245 | 4.208 | 4.395 | 4.710 |
| 10/4/2012 | 4.830 | 4.813 | 4.243 | 4.049 | 4.240 | 4.246 | 4.390 | 4.714 |

| EUR/PLN 0-delta stradle | | | | | 25-delta RR | | 25-delta FLY |
|---|---|---|---|---|---|---|---|
| Date | 1M | 3M | 6M | 1Y | 1M | 1Y | 1Y |
| 9/28/2012 | 9.05 | 9.15 | 9.80 | 10.30 | 10.30 | 3.50 | 0.76 |
| 10/1/2012 | 8.70 | 9.15 | 9.78 | 10.28 | 10.28 | 3.50 | 0.76 |
| 10/2/2012 | 8.70 | 9.10 | 9.78 | 10.28 | 10.28 | 3.50 | 0.76 |
| 10/3/2012 | 8.60 | 9.00 | 9.73 | 10.25 | 10.25 | 3.49 | 0.76 |
| 10/4/2012 | 8.45 | 8.95 | 9.70 | 10.25 | 10.25 | 3.47 | 0.76 |

| PLN Spot performance | | | | | | |
|---|---|---|---|---|---|---|
| Date | EURPLN | USDPLN | CHFPLN | JPYPLN | HUFPLN | CZKPLN |
| 9/28/2012 | 4.1138 | 3.1780 | 3.4008 | 4.0950 | 1.4502 | 0.1634 |
| 10/1/2012 | 4.1020 | 3.1809 | 3.3925 | 4.0775 | 1.4397 | 0.1636 |
| 10/2/2012 | 4.1115 | 3.1833 | 3.3982 | 4.0758 | 1.4381 | 0.1637 |
| 10/3/2012 | 4.1202 | 3.1896 | 3.4044 | 4.0780 | 1.4404 | 0.1648 |
| 10/4/2012 | 4.0933 | 3.1646 | 3.3768 | 4.0302 | 1.4319 | 0.1635 |

# Disclaimer