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Comment on the upcoming data and forecasts

In the coming week the Central Statistical Office will publish a sizeable package of macroeconomic data. The first test for our forecasts will come in Monday when CPI data is published. A low statistical base and increases in food and fuel prices will contribute to a visible acceleration of yearly inflation rate. Our forecast has already been positively tested last week by Czech and Hungarian data. On Tuesday, a first round of labor market data will come out: we expect employment to decrease very slighly as employment in many sections has already reached a top. Growth of wages is forecast to decelerate, mainly due to working days effect. Last but not least, a new release of industrial data (Wednesday) will likely point out to a deterioration in business conditions, following unfavorable data from Germany. We expect industrial production to modestly decline on yearly basis, due to smaller number of working days, statistical base effects and deteriorating conditions in the real economy (as confirmed by a sharp decline in vehicle production as well as advance indicators such as Polish PMI). As for the NBP data, our forecast for C/A seems to be subject to dowside risk (higher defict) after the data on trade (GUS) were published.

Polish data to watch: October 15th to October 19th

Publication	Date	Period	BRE	Consensus	Prior
CPI Inflation	15.10.	Sep	4.1	4.0	3.8
Current account balance (mln EUR)	15.10.	Aug	-737.0	-1100.0	-1027.0
Employment	16.10.	Sep	-0.1	0.0	0.0
Wages	16.10.	Sep	1.8	2.7	2.7
PPI Inflation	17.10.	Sep	1.7	1.7	3.1
Industrial output	17.10.	Sep	-3.4	-4.1	0.5

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

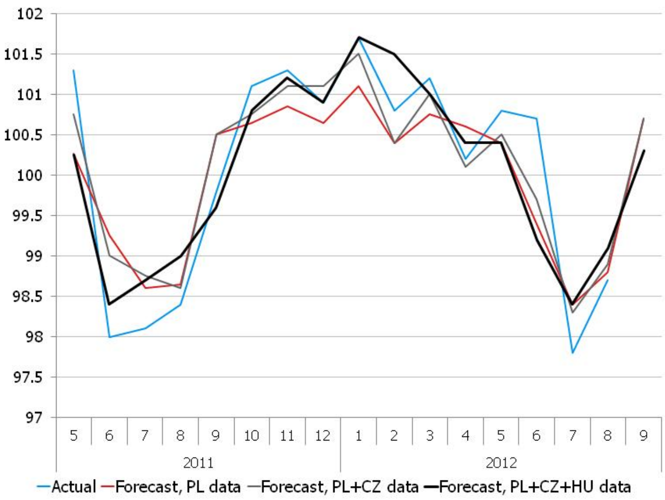
F - forecast

Economics

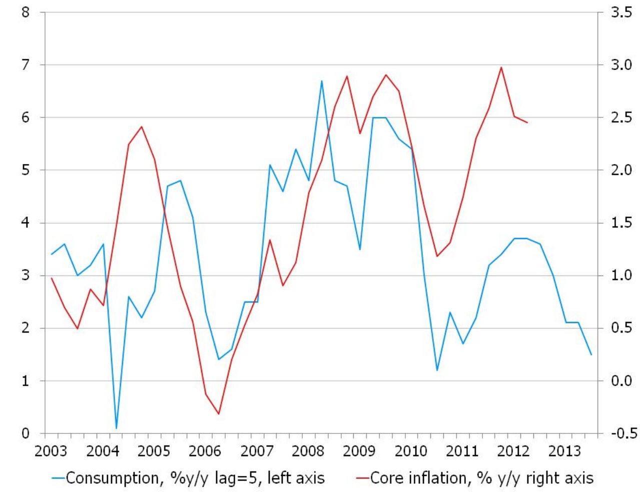
We found some confirmation for our forecasts for the coming week

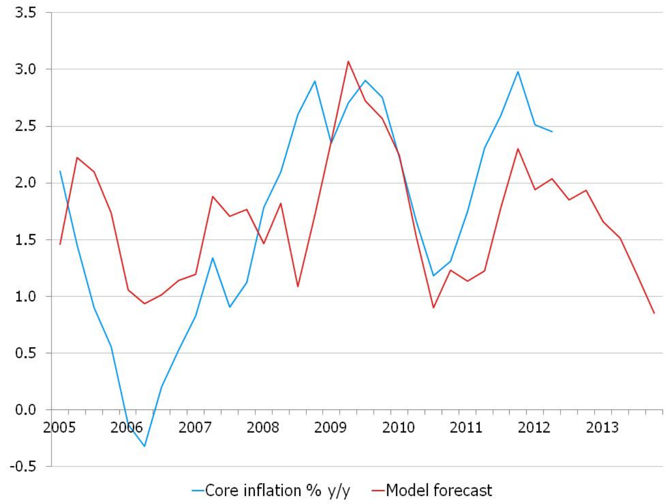
The upcoming week is pretty stuffed with the publications from the nominal side of the economy and the real sphere as well. The real side is definitely going to confirm the need for monetary easing. Somehow higher reading of inflation may at face value complicate things a bit. However, the MPC decision is set to be based on inflation projection and the macroeconomic relations combined in the NECMOD model should allow for a considerable fall of inflation (importantly - core inflation) within monetary policy horizon. On the back of this we believe the MPC will deliver a rate cut at the November meeting.

CPI Inflation (Monday). After the publication from the Czech and Hungarian economy we are pretty comfortable with our 4.1% forecast (market consensus 4,0%). It is not only about food prices (the comparison of model forecast with actual data is portrayed on the graph; remember that we always confront the crude econometric forecasts with the detailed data on food items - this time conclusions are safely convergent), but also other categories (wearing apparel, package holidays) which seem to be in line.

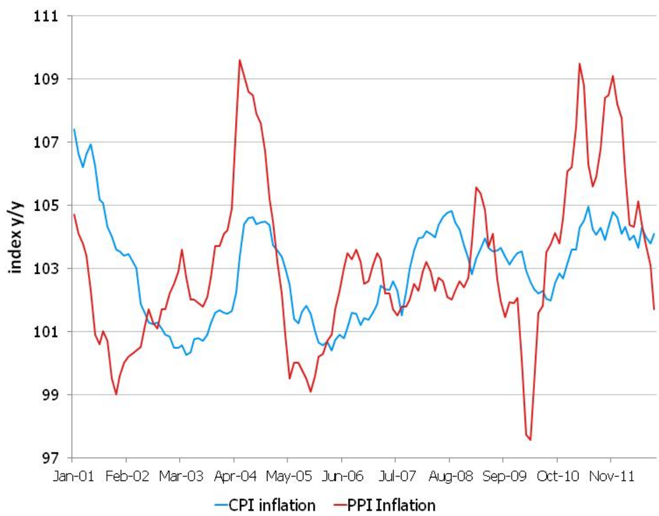


As for the longer term, the disinflationary impact of economic slack is taking its toll. Below we depict a relation between consumption and core inflation (we looked for actual data in order to avoid guestimates on potential growth) and our core inflation forecast (on the basis of this relation) including a minor depreciation of the zloty (towards 4.30 in the year end). Although the model forecast does not hold in terms of levels, mind the accuracy with regard to the direction of changes. We think that the recent and ongoing slack generates a huge disinflationary impact about which MPC has to realize in the coming months.





PPI inflation (Friday). With little help of statistical effects, economic slack has brought down the growth of producer prices well below CPI inflation. According to the very simple "graphical analysis" (which of course has much to do with price transmission mechanism) we are clearly in disinflationary territory. We expect PPI inflation to reach 1.7% y/y (market consensus 1.7%).



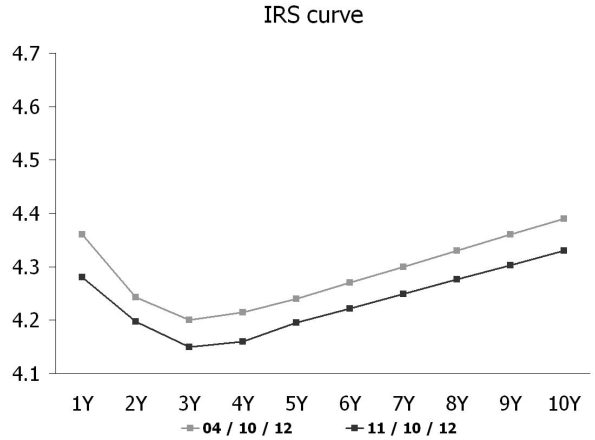
Wages and employment (Tuesday). We have seemingly entered a phase in which wages are subdued due to economic slack. We expect this trend to continue, the more so since there are more symptoms in detailed analysis of employment trends that point that point to a fakt that many sections have reached a peak in terms of payrolls and we may expect acceleration of lay-offs in the coming months. Our lower than consensus forecast for employment (-0.1% y/y vs 0.0% consensus) already reflects this observation. As for wages we expect deceleration towards 1.8% (market consensus 2.7%).

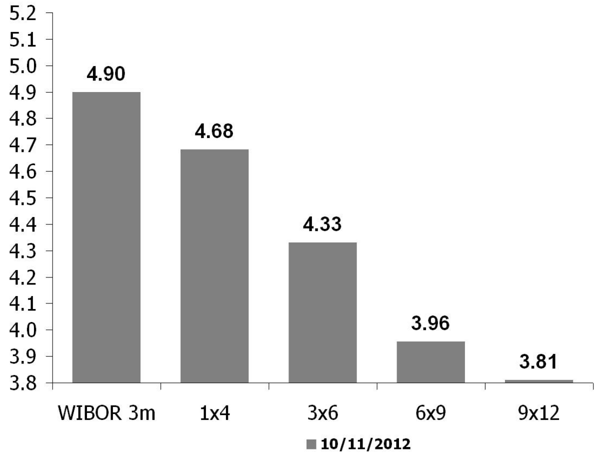
Industrial output (Friday). Everything (negative difference in working days, further fall of PMI, negative statistical base effect) points to a negative print of industrial output. However, after PMI figures had tilted the risk to the downside, the data on auto output (better in y/y terms despite all the ”gloomies” mentioned above) suggest the risk is once again symmetrical to our forecast or only slightly downside. Overall we stick to -3.4% y/y (market consensus -4.1%). We will be able to make a more precise estimate after the wage figures.

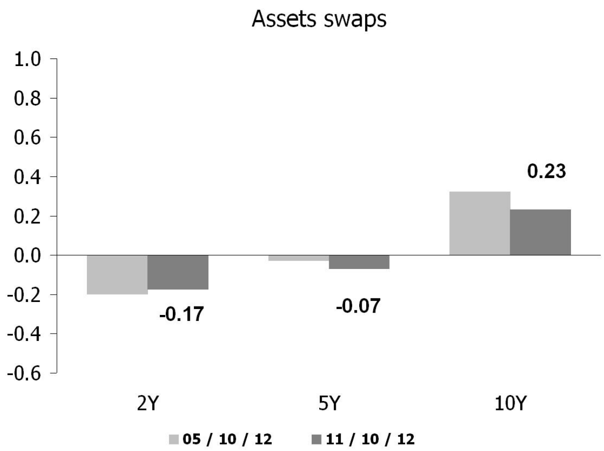
Fixed income

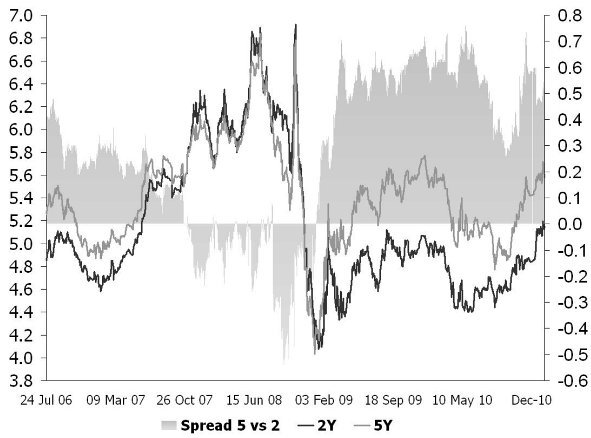
Enough is enough.

We must admit that our view on the market this year might have been a little boring, as regardless of data, news and market dynamics we held to our bullish attitude and long POLGBs positions. Now we start thinking that everything we have based our scenario on seems to have materialized. Economy is slowing down and monetary policy easing cycle has been priced in. Yield levels must be definitely tempting for the Finance Ministry to prefinance as much of future borrowing needs, therefore low-supply-story is not longer a case here. Market dynamics is showing signs of trend exhaustion as well - rally is accelerating, flows seems more and more stop-loss or stop-in driven, we start seeing offers coming from international players, who have been buyers through all this move. We start hearing government's promises to support economic growth in the coming years, it won't take long before market starts asking obvious question 'where would money to realise those promises come from?'. All in all, we really don't think there is much scope for this rally. Of course, as bond yields fell by some 180bp without any serious correction, it might continue for another 10 or 20bp, we don't mind missing that and we're happy to sell into this rally and close risk positions. We're not negative. Just not yet, we still need to see some confirmation of a reversal before entering short positions.





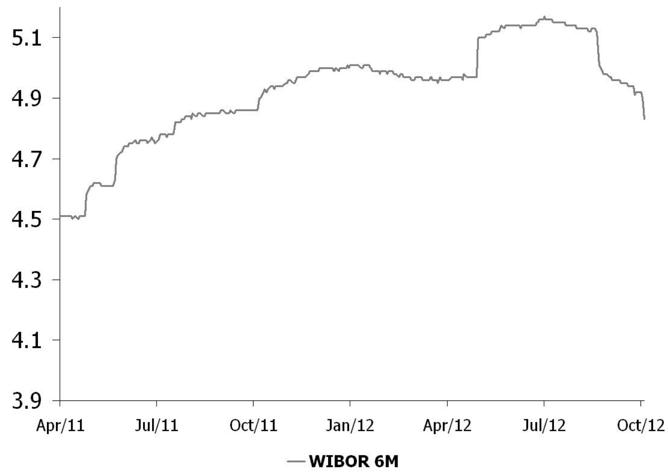


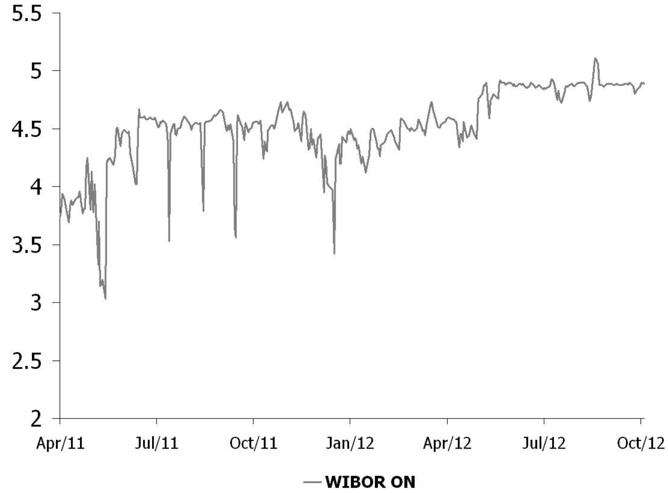


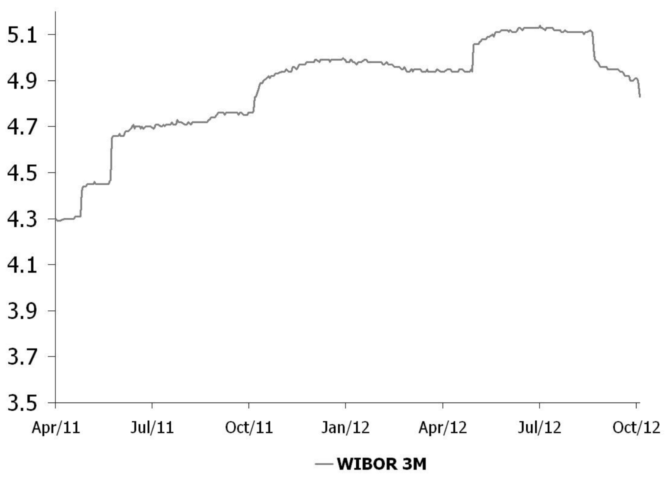
Money market

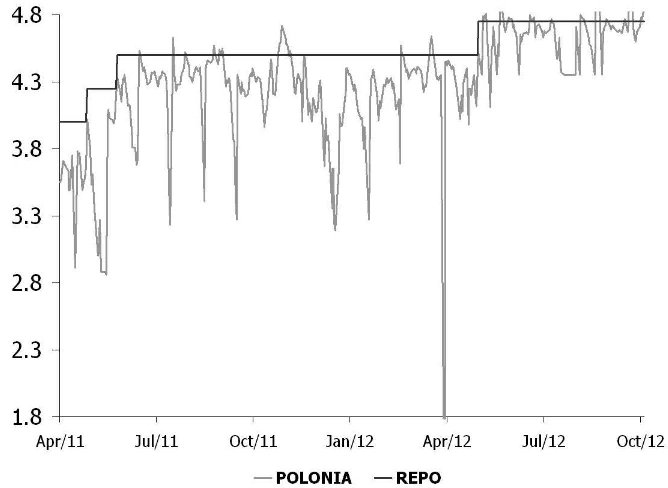
Cost of carry expected slightly below the main market rate Cost of carry in line with our forecast, hence slightly above the main market rate. Next week looks square after today's OMO so we may be slightly below for a change.

A lot is in the curve Waiting for CPI does not ruled out continuation of a bullish wave. Market again sees 125 bps cut, starting November and lasting 9 months. Even Wibor rates dropped another 8 bps discounting the near cut, which is quite unusual but sound. Therefore, it looks like Wibor adjusts smoothly to the new levels and not rapidly after the decision itself. In general a lot is in prices all over the curve, profit taking is possible.







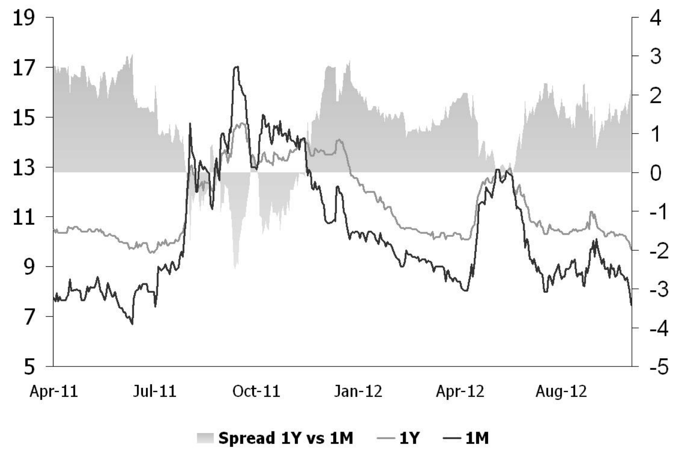


Forex

Zloty weaker 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 The effects of the stronger than expected NFP figures were rather quick to fade, and EUR/PLN were slightly bid despite the fact that the region was largely unmoved and that the NBP is not in a rush to cut. EUR/PLN was traded higher probably because of importer's demand but upside was capped near the 4.1040 resistance and prices slipped back towards first support at 4.0750. Currently it is traded in the mid of 4.0750 - 4.1200 range.

Vols sharply lower Vols are sharply lower again. The whole curve moved sharply to the downside. The 1 year ATM EUR/PLN was given at 9.75%, and now mid is around 9.6% against 10.0% week ago. 3 months EUR/PLN ATM traded at 7.8% versus 8.65% week ago. Current levels 1months EURPLN ATM mid 7.2% against 8.25 week ago. The currency spread also took the hit and is lower by roughly 0.25%: 1M-3M is around 5.6%, 6m-1y is around 6.25%.

EURPLN volatility



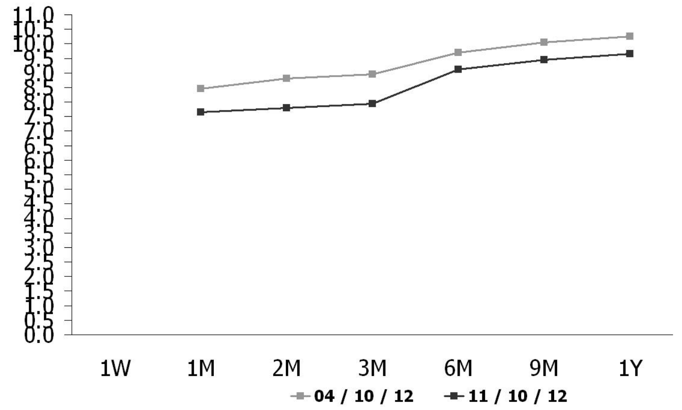
Short-term forecasts.

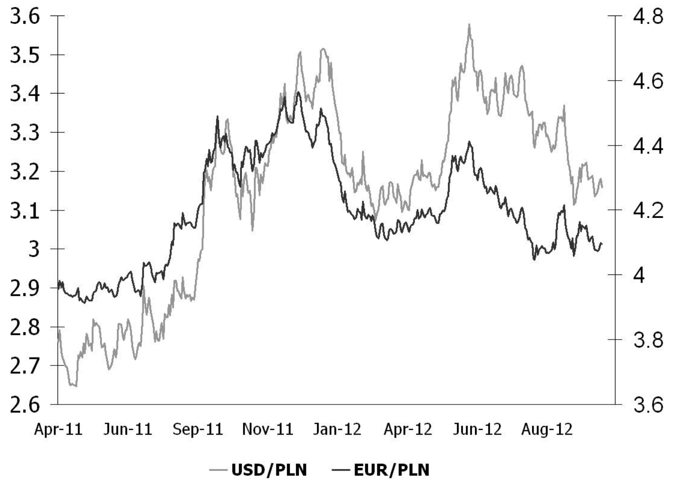
Main supports and resisances
EUR/PLN: 4.0500 / 4.1200
USD/PLN: 3.0500 / 3.2100

Spot. We are neutral in our view, we would rather try to play wider range. 4.10 seems to be tough to get through in the absence of any fresh impulses. In turn 4.0 is the psychological support and it should see some decent bids on the way to this level. So buy at 4.0500 with tight 4.0250 stop (this year's low), or sell 4.1000 with also tight 4.1250 stop...

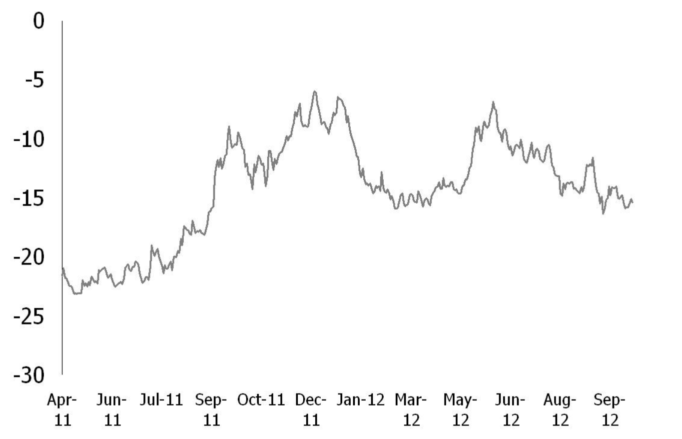
Derivatives. The sell off in the middle and backend is quite impressive. Implied volatilities are at the lowest levels since "Lehman time" but there are still no bids. The closer to year end, the more protection from Minister of Finance PLN may have (last year EUR/PLN was sold by MF to secure that debt to GDP ratio is under control). As the consequence the chances for spikes in vols are less likely for the coming weeks...

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
10/5/2012	4.55	4.90	4.58	6.49	4.58	6.59	4.84	4.47	4.01	3.83	3.85	4.01
10/8/2012	4.61	4.91	4.59	4.82	4.54	4.82	4.70	4.50	4.02	3.85	3.85	4.00
10/9/2012	4.84	4.91	4.82	4.82	4.83	4.83	4.69	4.44	4.00	3.86	3.88	4.03
10/10/2012	4.72	4.90	4.66	4.80	4.66	4.81	4.71	4.35	3.98	3.83	3.87	3.99
10/11/2012	4.66	4.88	4.60	4.78	4.60	4.79	4.68	4.33	3.96	3.81	3.84	3.97

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
10/5/2012	6.590	4.813	4.228	4.030	4.230	4.202	4.363	4.685
10/8/2012	4.820	4.813	4.225	4.043	4.225	4.190	4.365	4.674
10/9/2012	4.830	4.813	4.215	4.049	4.215	4.194	4.365	4.685
10/10/2012	4.810	4.813	4.215	4.646	4.215	4.148	4.365	4.662
10/11/2012	4.790	4.813	4.198	4.024	4.195	4.127	4.330	4.562

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
10/5/2012	8.58	8.85	9.58	10.08	10.08	3.48	0.76
10/8/2012	8.30	8.70	9.55	10.05	10.05	3.48	0.76
10/9/2012	8.05	8.65	9.48	9.95	9.95	3.50	0.76
10/10/2012	7.45	8.05	9.13	9.68	9.68	3.49	0.76
10/11/2012	7.65	7.95	9.13	9.65	9.65	3.47	0.76

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
10/5/2012	4.0766	3.1353	3.3649	3.9971	1.4418	0.1640
10/8/2012	4.0770	3.1430	3.3679	4.0179	1.4343	0.1634
10/9/2012	4.0721	3.1501	3.3613	4.0204	1.4346	0.1635
10/10/2012	4.0788	3.1695	3.3683	4.0478	1.4423	0.1634
10/11/2012	4.0987	3.1819	3.3942	4.0763	1.4511	0.1642

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