Bureau of Economic Analysis
(research)

Ernest Pytlarczyk, PhD, CFA
chief economist
tel. +48 22 829 01 66
ernest.pytlarczyk@brebank.pl

Marcin Mazurek, PhD
senior analyst
tel. +48 22 829 01 83
marcin.mazurek@brebank.pl

Paulina Ziembinska
analyst
tel. +48 22 829 02 56
paulina.ziembinska@brebank.pl

Piotr Bartkiewicz
analyst
tel. +48 22 526 70 34
piotr.bartkiewicz@brebank.pl

Financial Markets Department
(business contacts)

Lukasz Barwicki
head of trading
tel. +48 22 829 01 93
lukasz.barwicki@brebank.pl

Bartlomiej Malocha, CFA
money market
tel. +48 22 829 01 77
bartlomiej.malocha@brebank.pl

Marcin Turkiewicz
fx market
tel. +48 22 829 01 67
marcin.turkiewicz@brebank.pl

Financial Markets Sales Department
(business contacts)

Inga Gaszkowska-Gebska
institutional sales
tel. +48 22 829 01 67
inga.gaszkowska-gebska@brebank.pl

Jacek Jurczyński
structured products
tel. +48 22 829 15 16
jacek.jurczynski@brebank.pl

Reuters pages:
BREX, BREY, BRET

Bloomberg:
BRE

SWIFT:
BREXPLPW

BRE Bank S.A.
18 Senatorska St.
00-950 Warszawa
P. O. BOX 728
tel. +48 22 829 00 00
fax. +48 22 829 00 33
http://www.brebank.pl

Table of contents

Comment on the upcoming data and forecasts

This week we are awaiting GDP data for 2012. After recent publications we think that it would be a real (growth) miracle if GDP growth hit 2.1% (implying Q4 GDP growth in the vicinity of 1.0%), as PM Tusk supported by the chief of Central Statistical Office had implied. We stick to hard data and algebra and argue that GDP growth in 2012 was within 1.8-1.9% which implies Q4 GDP growth at 0.2-0.5%. We await private consumption growth at 0.7% (with a potential of a negative surprise in public consumption) and private investment at -1.3%. This implies that private consumption is going to break a taboo in Q4 and fall in y/y terms (-0.2%). Investment activity is set to be lower than we thought - at -5.5% y/y. After the recent (negative) surprise in net exports we think that its contribution will be lower than we previously inferred, rather at +2.6pp. than at +2.8pp. Regardless of whether growth rate for 2012 is at 1.8% or 1.9%, it is fair to bet at seasonally adjusted Q4 GDP growth rate in the negative territory. As for inflation expectations, they are well set-up to go below 3.0%. It seems reasonable to call even for 2.8%.

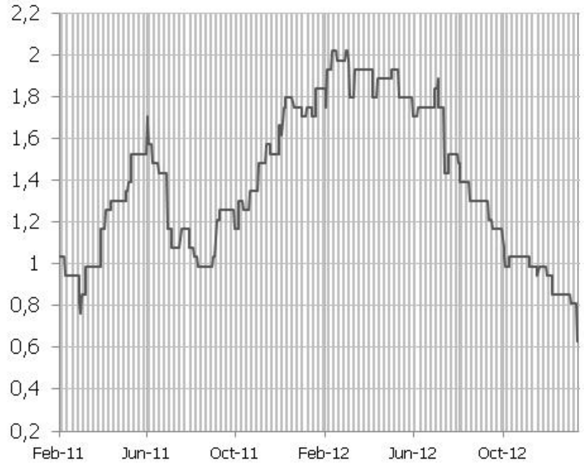
Polish data to watch: January 21st to January 25th

Publication	Date	Period	BRE	Consensus	Prior
Preliminary GDP (%)	29.01	2012	1.8-1.9	2.1	4.3
NBP inflation expectations (%)	31.01	Dec	2.8		3.4
Manufacturing PMI (pts.)	01.02	Jan			48.5

Treasury bonds and bills auctions

Paper	Next auction	Last Offer	Last yield (%)	Prev auction
52 Week T-bills	-	3600	3.560	1/9/2013
2Y T-bond OK0714	-	1300	3.285	1/23/2013
5Y T-bond PS0418	-	9500	3.437	1/23/2013
10Y T-bond DS1021	-	4000	3.847	1/7/2013
20Y T-bond WS0429	-	4000	3.896	1/7/2013

Reality vs analysts' expectations (surprise index* for Poland)



Comment
Lower again after retail sales and unemployment. Thus, the index fell from a cliff in the last two weeks, as the full scale of last year's slowdown has finally unfolded. The downtrend is set to continue next week with the release of annual GDP (see our comment above).

* Surprise index presents in a synthetic way how the market was surprised by macroeconomic releases (it is constructed on daily basis as weighted average of differences between selected releases and Bloomberg forecast consensus).

Our view in a nutshell

Fundamentals

- Consensus view on the Polish economy still too optimistic (we expect more growth forecasts downgrades along with further deterioration in high frequency data).
- We expect Polish economy to enter recession in H1 2013 (negative GDP growth in y/y terms). External developments (meager growth in Germany, zero growth in euro zone) are not dynamic enough to offset deceleration in domestic demand. Consumption growth close to zero (zero savings rate, deleveraging urgently needed), negative investment growth rate (public investment as an original damper to growth, private investment to dip into negative territory soon on weak demand prospects), restrictive fiscal policy.
- We find it hard so far to pin down factors facilitating a rebound in H2 2013. A faster re-acceleration of the euro zone economy seems to be the most obvious one as we leave government programs aside (given time lags in their implementation). However, given the scale of slack in investment and consumption any rebound generated this way cannot be a meaningful one. Poland has entered a period of weaker growth.
- Polish government committed to the convergence path, though in an unorthodox way. Very limited room for fiscal stimulation due to limited financial markets tolerance for higher debt. GG deficit no higher than 4% (minor impact for the economy, support for Polish bonds).
- Inflation set to moderate in the near term on statistical effects (high base from 2012) and in mid-term on lower core inflation (close to 1% in mid 2013). CPI inflation at below 2.0% in January 2013. The possibility for significant undershooting of inflation target in 2013 is high.
- Monetary easing cycle started already in November. MPC is backward-looking so we expect rates to fall to 3.25%, as soon as weaker economy leaves its print on inflation. Rising real interest rates make further interest cuts look easier, so does strong zloty.

Financial markets

- 2013 most likely not a ”bond year”. Global ”rotation” of assets poses headwind for debt.
- Polish bonds clearly more sensitive to core markets developments. It is also more clear that global recovery (or monetary stimulus withdrawal) and rising core yields (ECB ruling out refi rate cuts, Fed discussing exit strategy) may adversely affect Polish bonds as well.
- Fundamental reasons for lower yields in Poland (much lower inflation and growth, monetary easing, carry trades, yield pickup, credit risk well contained) stay intact.
- We still expect POLGB’s to stay at historically low levels. However, curve should steepen. DM funds are pushed for more diversification and are faced with lower high grade issuances. Therefore compression in intra euro spreads should not be critical for Polish bonds.
- Cyclical behavior of the Polish zloty far weaker than in 2008-2011 as current account has been narrowing and euro zone disintegration risks were put aside with ECB put. Hence we expect only slight weakening of the zloty with 4.22/25 (technical analysis) acting as a hard resistance.
- Volatility on both FX and FI lower due to so-called ECB put.

BRE forecasts

	2008	2009	2010	2011	2012 F	2013 F
GDP y/y (%)	5.1	1.6	3.9	4.3	1.9	0.5
CPI Inflation y/y (average %)	4.3	3.5	2.8	4.2	3.7	1.6
Current account (%GDP)	-5.3	-1.6	-4.5	-4.9	-2.6	-2.0
Unemployment rate (end of period %)	9.5	12.1	12.4	12.5	13.4	14.2
Repo rate (end of period %)	5.00	3.50	3.50	4.50	4.25	3.25

	2012 Q1	2012 Q2	2012 Q3	2012 Q4 F	2013 Q1 F	2013 Q2 F	2013 Q3 F	2013 Q4 F
GDP y/y (%)	3.6	2.3	1.4	0.2-0.5	-0.7	-0.2	0.9	1.9
Individual consumption y/y (%)	1.7	1.2	0.1	-0.2	0.2	0.5	1.0	1.5
Public Consumption y/y (%)	-0.8	0.5	0.2	0.0	1.0	1.0	1.0	1.0
Investment y/y (%)	6.0	1.3	-1.5	-5.5	-6.0	-5.0	-5.0	-3.0
Inflation rate (% average)	3.9	4.0	3.9	2.9	1.8	1.4	1.5	1.8
Unemployment rate (% eop)	13.3	12.4	12.4	13.4	14.0	13.9	13.5	14.2
NBP repo rate (% eop)	4.50	4.75	4.75	4.25	3.75	3.25	3.25	3.25
Wibor 3M (% eop)	4.94	5.13	4.92	4.11	3.65	3.30	3.30	3.30
2Y Polish bond yields (% eop)	4.62	4.60	4.05	3.14	3.20	3.10	3.20	3.30
10Y Polish bond yields (% eop)	5.50	5.15	4.69	3.74	3.80	3.80	4.00	4.20
EUR/PLN (eop)	4.15	4.22	4.12	4.08	4.30	4.15	4.10	4.00
USD/PLN (eop)	3.11	3.35	3.20	3.09	3.31	3.25	3.28	3.20

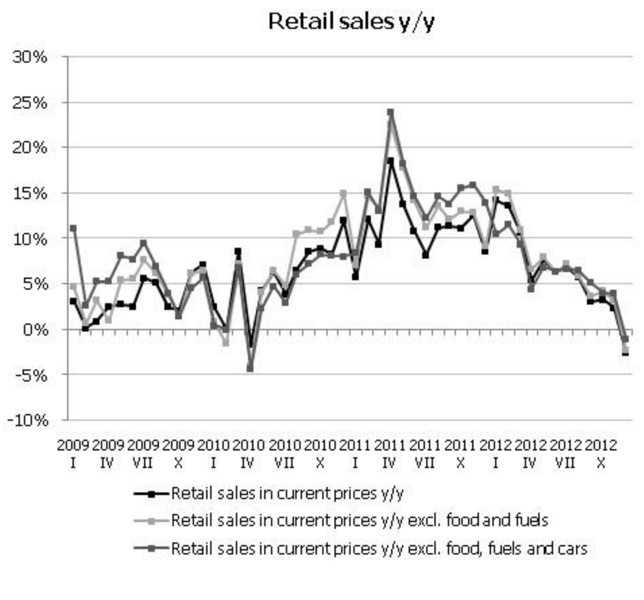
F - forecast

Economics

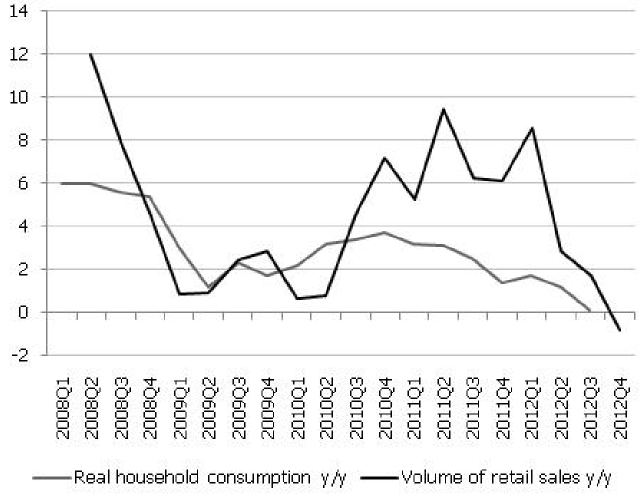
Weakness here, weakness there. Our call for 1H recession stays in.

Last week brought the final series of publications for 2012 (we are only short of trade balance data, but the final outcome for Q4 is pretty much predetermined after October and November), and we ended the year on an especially weak note. As it would be tempting to say that it can only be better, business activity survey conducted (regularly) by the NBP suggests otherwise - no end of the malaise is in sight. We see signals that some elements of our view has been recently internalized by the MPC and obstacles for cuts lies elsewhere than in macro factors. As soon as Winiecki is ousted (the final trial starts 13 February) the road for broader consensus among MPC is opened and therefore a room for further rate cuts, including one in February (already a done deal). We think the inflow of data from the economy is not going to discourage rate cuts (including next week's 2012 GDP that is going to confirm very weak Q4 - see the comment to the upcoming data in the front page) and ultimately the repo rate will be cut to 3.25%. Let's look at some publications from the previous week in a more detailed way.

Retail sales - the final blow in 2012. Not once in the coherent series of retail sales (from 2007) was the growth of this aggregate so disappointing. Retail sales dropped by 2.5% y/y (our call -1.1%, market consensus +1.4%) and weakness is seen all across the board (see the graph). Negative growth of retail sales popped up only once, in April 2010 when the national mourning (after the fatal plane crash in Smolensk) wiped out retail activity. But then the dip was relatively shallow (-1.6%). In such perspective the current reading looks even more ugly since nothing such spectacular (we mean in non-macro factors) happened that prevented consumers from shopping.



Of course there is a negative difference in working days but it explains around 2pp. of the weakness, not 5pp. We think that owing to zero savings rate consumers hit the binding budget constraint of real income. This category already dips on annual basis and further drops in employment (and subsequently wages) are likely to keep it at most flat in H1 (even with falling inflation), casting shadows over consumption growth. We calculate that consumption growth in Q4 2012 was negative (see the graph) and will be only flat afterwards. Should weakness in the labor market intensify (a very likely scenario) any turnaround in the H2 2013 is set to be very shallow as well.



NBP business activity survey. After recent publications we have grown more certain in our negative scenario for H1 2013. Therefore, we tried very hard to pin down the factors that can prove our call wrong. We failed in our quest for growth - firms have grown even more pessimistic regarding the current situation - although there are some sparks of brightening in some sections (they look rather like variations around the trend but not like viable symptoms of a medium-term turnaround), they are very shallow given the scale of recent drops. It is definitely too little to call our scenario off. It is also important to note that signals from the real sphere are reinforced by signals from the nominal side (pricing behavior - whether on the product side or the factor side - weakened further, firms and employees are losing pricing power).

Some details of the survey deserve to be served. Namely, companies grew more pessimistic as they cut development plans (and investment activity). Authors of the report conclude (which is rather unusual for NBP analysts since they rather abstain from strong judgements) that such a behavior may "postpone the upswing in activity even further". Firms also limited the use of bank credit which is now mostly channeled into financing current day-to-day operations. Shrinking investment activity coincides with plans to extend slight employment cuts. Interestingly, exporters report that their situation got worse since they were forced to foregone a larger part of margins. High break-even exchange rate for exports (3.80-90 rather than 3.50-60 in 2009-2010) and lower spot rate are likely to bring the multiplier of exports down. Moreover, exporters do not observe a turnaround in export orders. Either they overlooked a better activity readings from Germany, or the upswing suggested by those indicators is overstated.

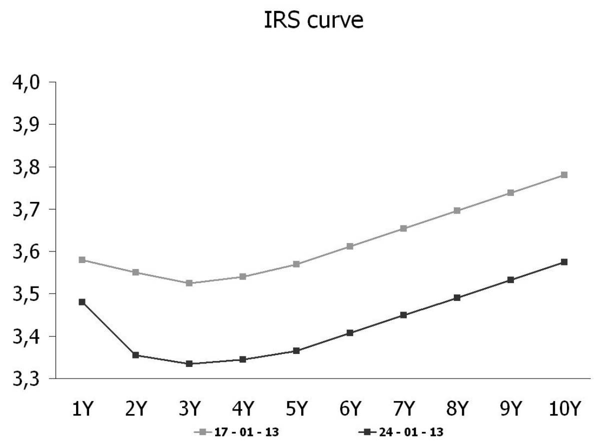
Business activity report prepared by the NBP is important not only because of its timeliness for tracking changes in the broad economy but also for its influence on the MPC which - not once - referred to the details of the report and used them as a reliable input (especially when the signals from the real economy were mixed, at least in MPC's assessment). This time we see nothing in this survey that can discourage MPC from easing.

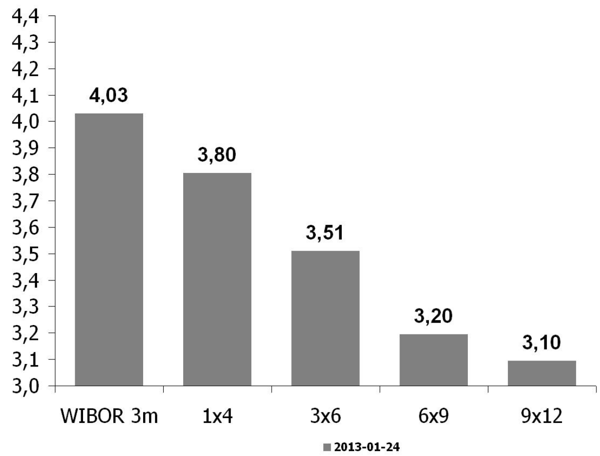
MPC "Minutes". Once again a very strange report. We thought that a change in MPC's wording after the January statement was triggered by some temporary change in their assessment of the economy. Now we know that it had not been the case. The whole "Minutes" are very dovish (including real sphere and the outlook for inflation) apart from the last passage which states that some members suggested that further cuts may build imbalances in the economy in the long term. Apart from how odd such comments sound (is it growth or business cycle the MPC is dealing with?) they show there were some problems with building the majority. As soon as Winiecki is ousted (and this is very likely, the last trial starts February 13.), Hausner's power (a swing voter) also shrinks and it will be easier to build a consensus for further rate cuts. We are closer and closer to the period when macro data take the upper hand in the MPC again.

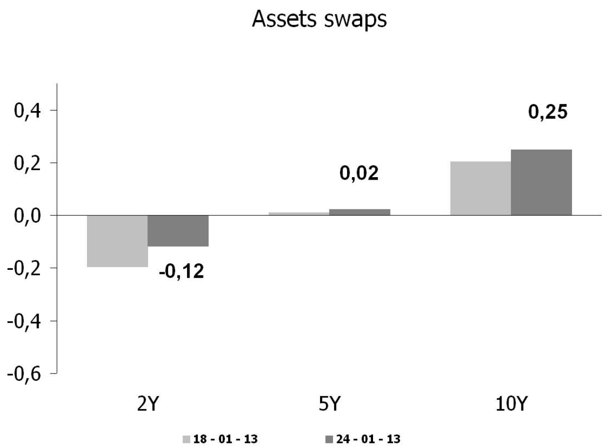
Fixed income

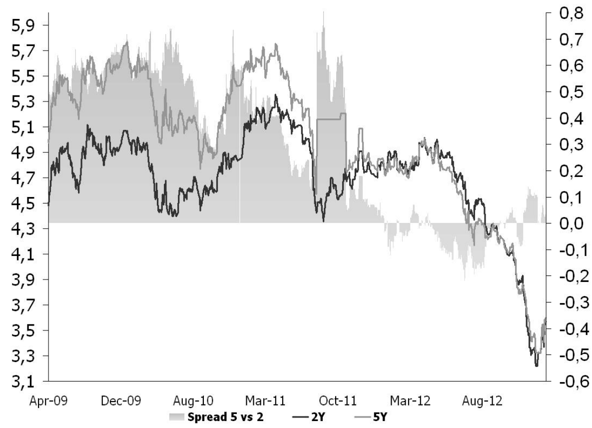
Trading steeper

5Y treasury bonds auction and December retail sales data seemed to be the main driver on PLN yield curve. The surprisingly huge volume auctioned triggered bulls to hit the lows in the longer end of a curve trading down 5y at 3.37% and 10y at 3.57% respectively. The negative reading in retail sales at -2.5% confirmed the country had entered the deeper slowdown and reassured the market the MPC would not be able to hold an easing cycle at least to the March CPI projection. The yield curve has priced 3% intervention rate again that could pave way to reentering paying positions. Our base scenario assumes two more rate cuts by 25bp in February and March with the substantial risk of a pause together with neutral bias change. As we cannot see any value to receive anything on a FRA curve (even 1x4s and 2x5s FRA has no value to sell at the moment) we would try to have some paying positions especially in reds. Moreover, as the core markets look as rebounding from historically low yields, the pressure on PLN curve might continue with a steeper shape.





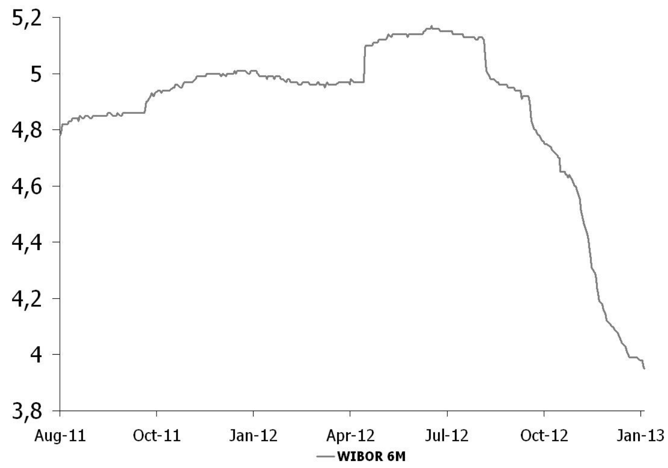


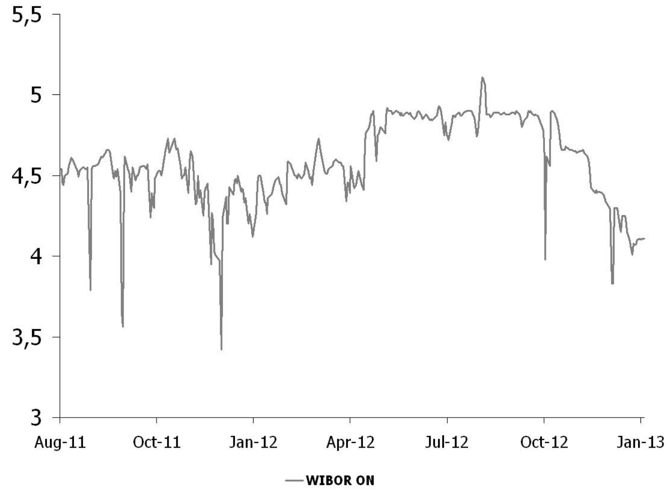


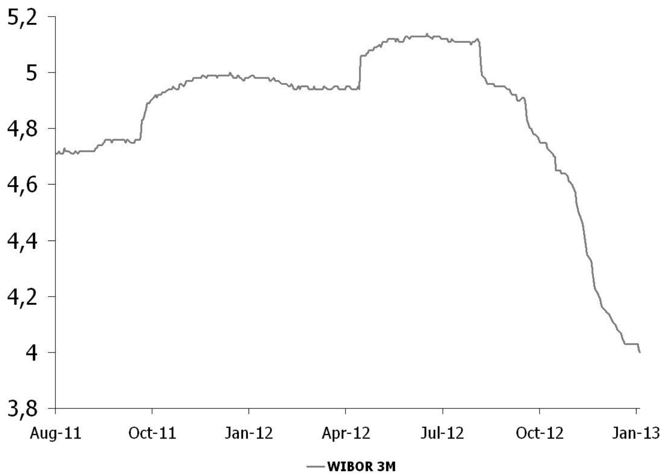
Money market

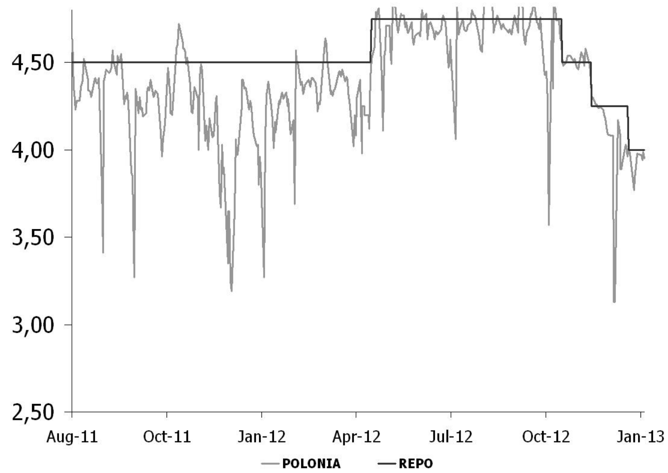
Volatile cash rates Substantially lower demand for money bills (121 bln pln vs 129 bln pln on the offer) will push the shortest rates down. Since we are approaching the end of the reserve we bet on additional OMO on Monday or Tuesday. All in all, shortest rates will be quite volatile till Wednesday.

Weak figures take pause in rate cuts off the table Retail sales much below expectations at -2.5%; minutes from the January's MPC meeting did not justify hawkish conference; both factors pushed the front end 10 bps down. The cut in February seems to be done. No pause in monetary easing is going to be on the table any time soon. Weaker currency is not a problem anymore in this environment. Having said that, we still think there is a lot in the curve (100 bps fully priced in) and the only value to be captured would still come from payers.





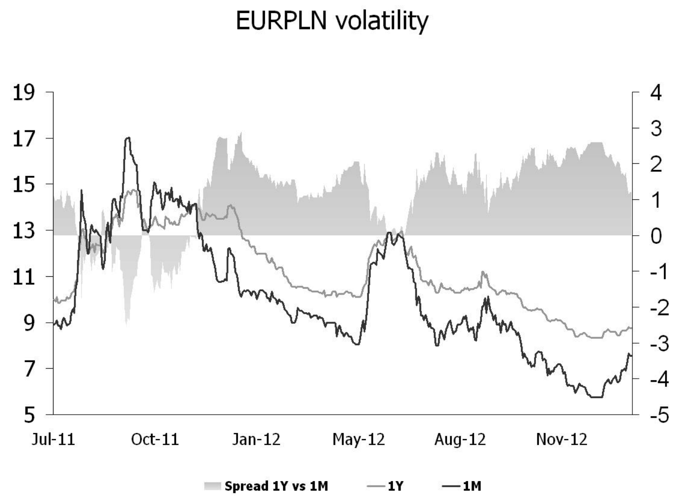




Forex

PLN Weaker This week weak Polish retail sales numbers added fuel to the EUR/PLN uptrend, and we set the high of the week at 4.1970 tic below the main 4.20/4.22 resistance zone. The PLN generally traded on the back foot during the whole week, even though we had a SPO of PKO BP which caught market off guard and brought EUR/PLN to the weekly low of 4.1515. The 4.13/4.15 constitutes now support zone. The Fridays IFO and LTRO Repayment Announcement brought us back to the middle of the current 4.15/4.22 range.

Consolidation For the most of the week we have seen the consolidation at higher levels. The frontend is tic higher as we get closer to the main resistance at 4.20 in EUR/PLN, but the change is cosmetic: 1 month EURPLN ATM mid is today 7.6%, 0.3 higher than last week. The body of the curve 3 month EUR/PLN ATM is now 7.7% and 1Y EUR/PLN is 8.8%, both unchanged from last week. The currency spread (difference between USD/PLN versus EUR/PLN) got much better offer, as EUR/USD retraced it's march south. The skew was also bit better offered with 1Y risk reversal offered and traded at 3.25%.

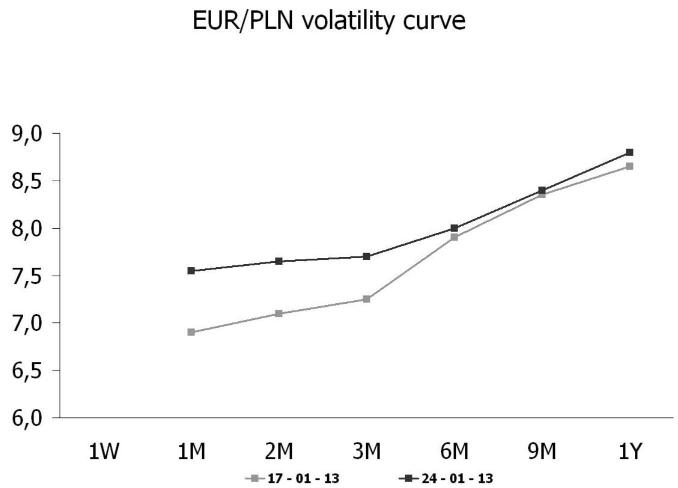


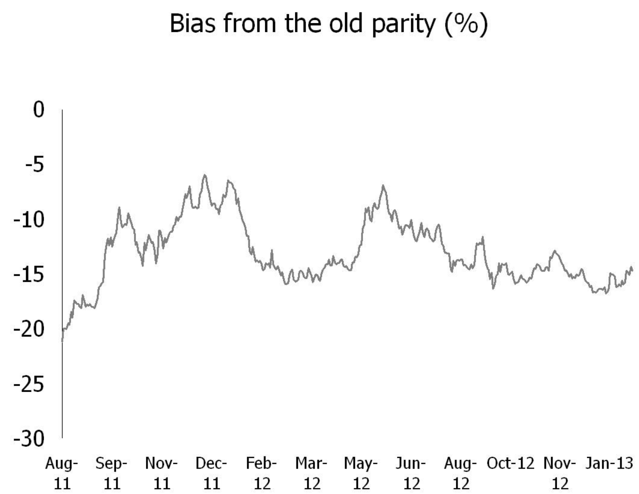
Short-term forecasts

Main supports and resistances
EUR/PLN: 4.1300 / 4.2200
USD/PLN: 3.0600 / 3.2000

Spot. Profit on longs taken at 4.1900. Square. As we were not able to decisively break out through 4.20/4.22 resistance zone, our bias moved back to neutral from PLN bearish. After the set of bad macro figures, we think there is more room for surprise on the PLN positive side. As the consequence we prefer to sell EUR/PLN at 4.19/4.20 with stop above 4.2250 and hopes to drop back to 4.1400.

Derivatives. We are starting to think that selective longs in mid of the curve of EURPLN are the position to take. We still need confirmation from the realized volatility to show more aggressive bids on the market. The preferred strikes are close to ATM.





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
1/18/2013	3.78	4.03	3.73	6.49	3.63	6.59	3.84	3.57	3.30	3.22	3.22	3.30
1/21/2013	3.73	4.03	3.68	3.88	3.59	3.76	3.82	3.56	3.30	3.22	3.24	3.32
1/22/2013	3.70	4.03	3.69	3.88	3.56	3.76	3.81	3.52	3.25	3.19	3.19	3.28
1/23/2013	3.84	4.03	3.78	3.88	3.69	3.76	3.82	3.53	3.22	3.13	3.13	3.23
1/24/2013	3.75	4.01	3.65	3.86	3.58	3.75	3.80	3.51	3.20	3.10	3.10	3.20

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
1/18/2013	6.590	3.353	3.292	3.275	3.420	3.351	3.630	3.873
1/21/2013	3.760	3.114	3.263	3.148	3.370	3.270	3.575	3.755
1/22/2013	3.760	2.992	3.218	3.137	3.325	3.237	3.525	3.759
1/23/2013	3.760	2.992	3.218	3.137	3.325	3.237	3.525	3.759
1/24/2013	3.750	2.992	3.218	3.137	3.325	3.237	3.525	3.759

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
1/18/2013	7.35	7.35	7.95	8.70	8.70	3.11	0.72
1/21/2013	7.65	7.80	8.05	8.80	8.80	3.11	0.72
1/22/2013	7.55	7.75	8.05	8.75	8.75	3.11	0.72
1/23/2013	7.55	7.75	8.05	8.75	8.75	3.11	0.72
1/24/2013	7.55	7.70	8.00	8.80	8.80	3.10	0.68

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
1/18/2013	4.1294	3.0925	3.3067	3.4396	1.4109	0.1610
1/21/2013	4.1762	3.1351	3.3648	3.5028	1.4272	0.1632
1/22/2013	4.1700	3.1341	3.3689	3.5352	1.4198	0.1631
1/23/2013	4.1591	3.1195	3.3587	3.5320	1.4137	0.1624
1/24/2013	4.1964	3.1503	3.3857	3.5188	1.4225	0.1641

Disclaimer