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Comment on the upcoming data and forecasts

The first round of economic releases coming up next week. On Monday, balance of payments data will be published (last piece of September data). Focus is put on Current Account balance - we expect it to widen by almost 400M EUR (more than the current market consensus projects), despite a trade surplus. On Wednesday, the Central Statistical Office will publish data on inflation in October. Along with the consensus, we expect a decline in yearly inflation rate. The reasons for this are clear - high statistical base in energy, fuel and food prices and a marked decline in core inflation. Inflationary pressures are receding. On the same day, NBP will release October's broad money data - another decline in annual growth rate of M3 is expected (lower contribution of household deposits, negative growth rate in corporate deposits, high statistical base in other categories). Lastly, data on government budget performance in the first 10 months of the year will be published on Thursday.

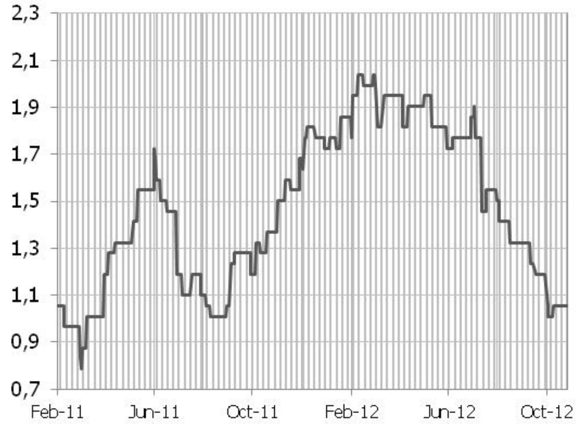
Polish data to watch: November 12th to November 16th

Publication	Date	Period	BRE	Consensus	Prior
Current Account (Mio EUR)	12.11.	Sep	-998.00	-732.00	-633.00
M3 Money Supply YoY (%)	14.11	Oct	7.1	7.2	7.6
CPI YoY (%)	14.11	Oct	3.4	3.4	3.8
Budget perf. Ytd (%)	15.11	Oct			60.4

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	-	5000	3.856	10/23/2012
5Y T-bond PS0418	-	4000	3.900	11/8/2012
10Y T-bond DS1021	-	3000	4.496	10/23/2012
20Y T-bond WS0429	-	4000	5.563	5/10/2012

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



Comment
No releases last week - next week surprise index might resume downtrend (analysts' still too optimistic about Polish economy).

* 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 (there were some minor revisions after NBP's inflation report). Polish economy is set to enter recession in H1 2013 (negative GDP growth in y/y terms) and substantial acceleration afterwards is so far unlikely.
- External developments in H1 2013 (euro zone fails to accelerate soon) at most neutral for Polish exports (and GDP).
- 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).
- Weaker domestic demand is the main cause of recession. Consumption stagnates due to extremely low savings rate (the value of assets also fell recently) and negative real income growth. Infrastructure gap puts public investment growth into (substantial) negative rates; private investment suffers from weak outlook (tipping point in corporate lending).
- 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 returns to target in Q1 2013 (gas price cuts announced in 1-2 months uderpin the scenario).
- MPC to apply proper easing cycle started already in November. Realization of our scenario set to force MPC to cut more than they previously think is necessary. We bet on 150bps easing.

Financial markets

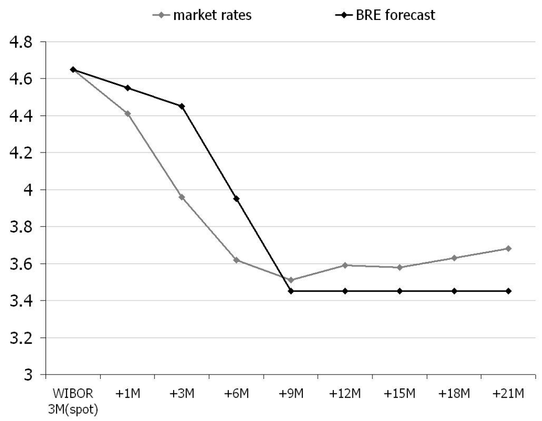
- Zloty moderately weaker towards the end of the year. Despite weaker economy and lower rates usual cyclical pattern for EURPLN set to be distorted by more balanced fiscal policy and accompanying lower current account deficit.
- Despite recent rally there is still room for lower rates in the short (monetary easing, carry trades) and the long end (mild risk-off supports Polish bonds, no signs of any credit risk rise in the next weeks, if not months).
- Volatility 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	2.1	0-0.5
CPI Inflation y/y (average %)	4.3	3.5	2.8	4.2	3.8	2.5
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	13.0	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 F	2012 Q4 F	2013 Q1 F	2013 Q2 F	2013 Q3 F	2013 Q4 F
GDP y/y (%)	3.6	2.3	1.6	1.0	-0.6	-0.4	0.4	1.4
Individual consumption y/y (%)	1.7	1.2	0.8	0.7	0.5	0.3	0.6	1.1
Public Consumption y/y (%)	-0.8	0.5	1.2	1.2	0.5	0.5	0.5	0.5
Investment y/y (%)	6.0	1.3	-3.0	-6.0	-7.0	-6.0	-5.0	-3.0
Inflation rate (% average)	3.9	4.0	3.9	3.2	2.6	2.4	2.3	2.5
Unemployment rate (% eop)	13.3	12.4	12.4	13.0	13.2	13.3	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	4.45	3.95	3.45	3.45	3.45
2Y Polish bond yields (% eop)	4.62	4.60	4.05	3.70	3.50	3.50	3.75	3.80
10Y Polish bond yields (% eop)	5.50	5.15	4.69	4.20	4.00	4.20	4.50	4.65
EUR/PLN (eop)	4.15	4.22	4.12	4.25	4.30	4.20	4.10	4.00
USD/PLN (eop)	3.11	3.35	3.20	3.32	3.23	3.11	3.15	3.20

F - forecast

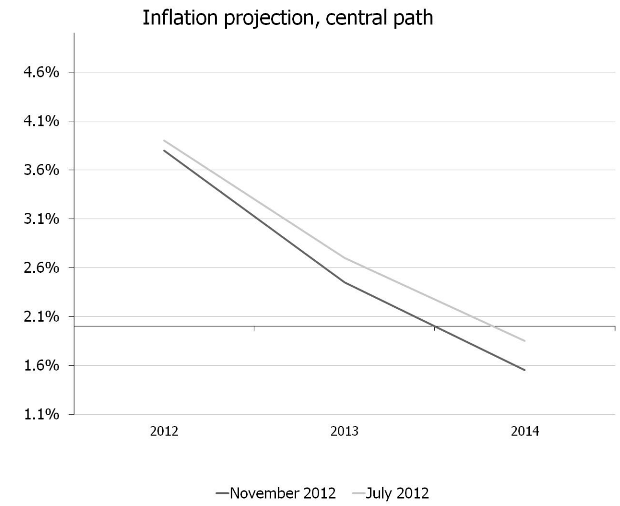


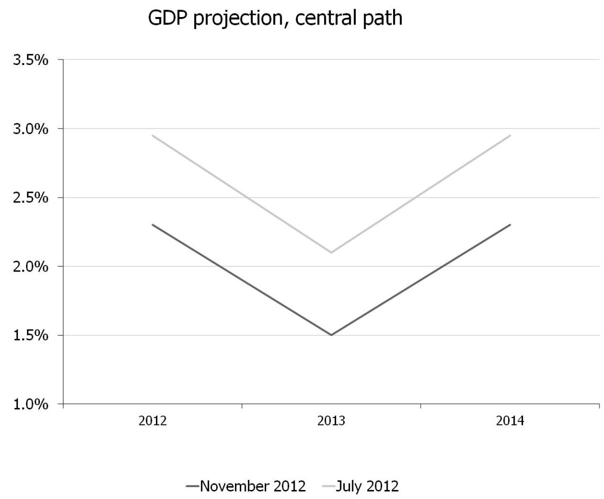
Economics

MPC cuts rates by 25 bps and announces a new monetary easing cycle

Reputational issues and uncertainty (in MPC's view) regarding the impact of more aggresive cuts on the financial markets (especially, PLN exchange rate) forced the MPC to cut rates by only 25 bps.

The statement is disenchanting - the MPC has definitely changed its assessment of economic climate. The council admitted that there had been a deterioration in economic conditions leading to reduced wage and inflation pressures. This diagnosis is supported be results of Central Bank's latest inflation projection. Forecasted GDP and inflation paths were lowered by as much as 0.5 percentage points. Next year, GDP will (according to central projection) grow by 1.5 percent (as compared to 2.1 percent projected earlier). Inflation will converge to NBP's target faster (in a few quarters) and even drop below it in the medium run. It has also been stated that GDP growth rate will remain below its potential for several years (a very strong statement itself).



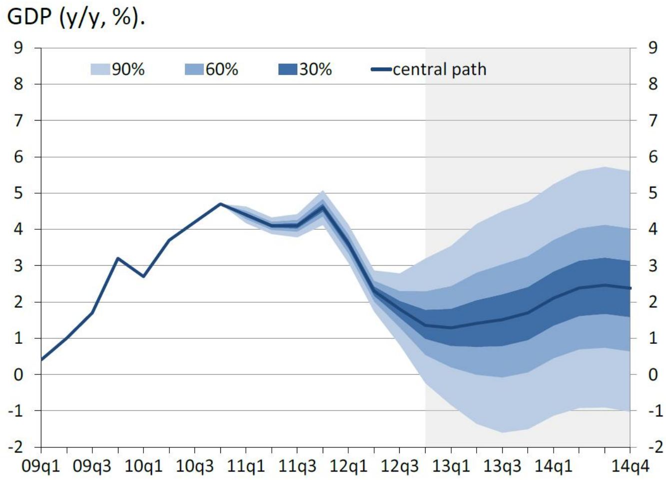


Forward guidance remains unchanged from last month's statement. It points out to a further interest rate cut in December. Such a notion was strenghtened by M. Belka on a press conference following the meeting.

In our opinion, actual GDP and inflation paths might turn out to be lower than NBP's projections (a recession in 2013Q1, inflation on target by the end of 2013Q1). This will trigger a deeper easing cycle: a total cut of 125 bps has already been priced in by the markets, some analyts predict only 75 bp, we think that 150 bps will be adequate. Cuts in steps of 25 bps will occur on a monthly basis.

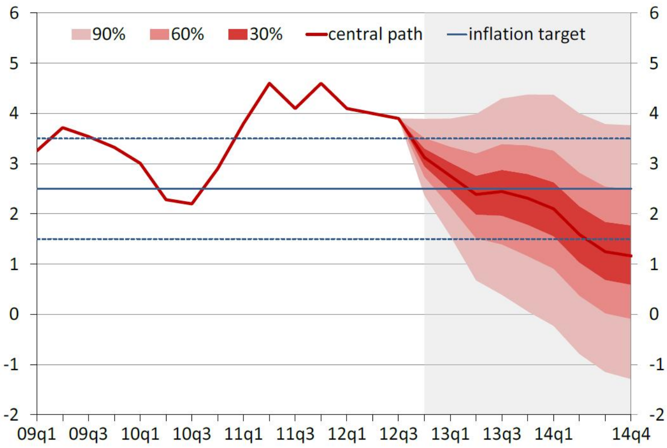
Inflation projection dovish enough to justify deep easing cycle

Fresh inflation projection is much softer than the previous one. It looks like as if there was a shift of mid to long term view within the NBP division responsible for the preparation of the report.



First of all, GDP growth is expected to decline towards 1% in H1 2013 and recovers only slightly thereafter. With 2.0-2.9% potential GDP growth expected. There indeed will be years before GDP actual growth exceeds that of the potential (it is so far the first time ever when projection points to years, not quarters, of ongoing slack in the economy). As for the details, investment is projected to reach a trough at -3.4% in 2013 and sustain minor contraction also in 2014. On the other hand private consumption is projected to remain relatively stable at 1.3% in 2013 and accelerate to 2.0% in 2014. Risks to GDP forecast concentrate around the problems in the euro zone and the weakness of domestic demand (including the vague program for public investment outlined in prime minister's Tusk second expose). We think these risks are set to materialize and therefore expect Polish economy to contract in annual terms in H1 2013.

CPI inflation (y/y, %).



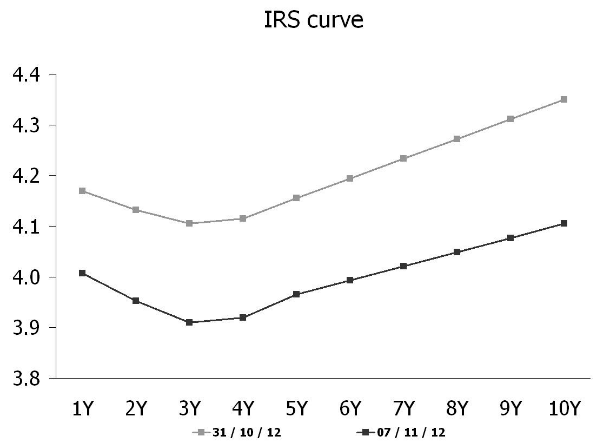
Despite the classic mantra of risks (of exogenous nature: commodity prices, EU regulation policy on carbon dioxide emission rights) does not prevent inflation to fall, in a monotonic way, to the vicinity of 1% (!) in 2014; return to target is expected in NECMOD framework in Q1/Q2 2013. Recently announced gas price cuts are set to accelerate the disinflation process. We think that Q1 will be the time when inflation is in the target. It is important to note that the drop of inflation is clearly of economic nature (amidst better labor productivity and opened output gap), driven by core inflation falling towards 0.9% in 2014. It perfectly corresponds to much simpler models based on the growth on consumption (including the one we used to present so far).

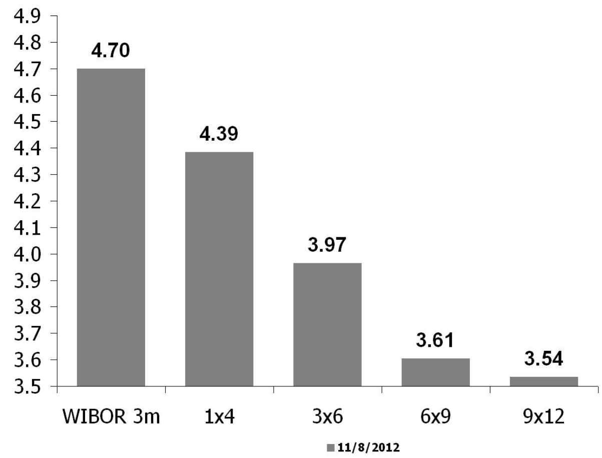
Food for thought. Inflation projection is presented under the assumption of stable rates (4.75% repo rate). A forward looking Taylor rule applied to the presented forecast suggest rates could be cut more than 150bps in the current cycle (after the July's run of projection the scale of easing was equal to 125bps). With 125bps market pricing, 75-100bp consensus among analysts, and the (in our opinion) high probability of recession H1 2013, there is plenty of room for further adjusting rate cut expectations.

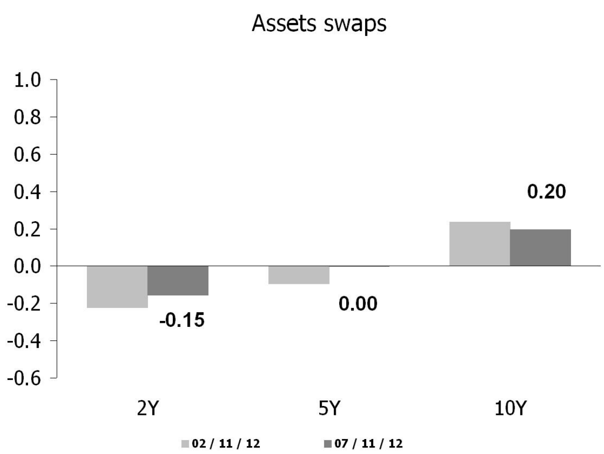
Fixed income

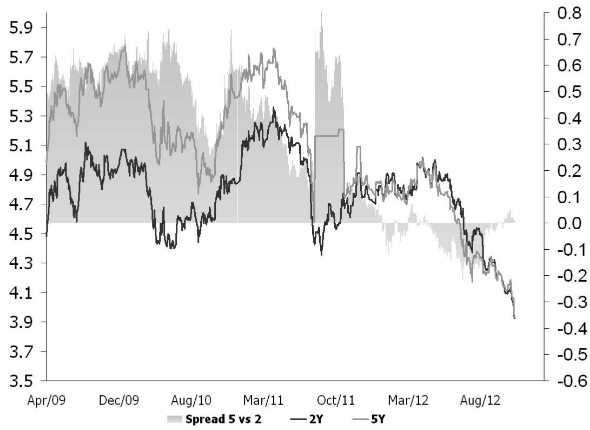
Rate cut

After the huge surprise in October the RPP managed to start a monetary easing cycle in November with 25bp cut in all rates. The broadly expected decision that should have triggered the profit-taking opportunity resulted in further plunge of the yield curve driven by strong buying in 10y bonds sector. The awkward trades had distorted the whole yield curve by pushing 2y-10y spread down from +20 to +7 points, which looked completely out of control and had no reasonable and economic background. It turned out that stop-loss procedures always follow its own rules. The short end of the curve also suffered but the scale of moves looked quite limited as the Wibor rate fell only by 5bps and the FRA contracts have already priced a total of 150bp cuts in a cycle with a perfect 15bp-20bp dropdown along monthly forwards. We do not see any further value in these levels. As the market looks like stopping losses along the curve, we would grab an opportunity to occasionally pay the bottoms and seek the opportunity to trade towards a steeper curve that should be a more natural long-term strategy anyway. Actually, we were one of the few who believed in a further slowdown of the economy and were expecting 125-150bp interest rate cuts in a whole cycle (our most dovish competitors bet for up to 75bp). We took all that happened last week as a fully priced market scenario with no further real market value to receive.





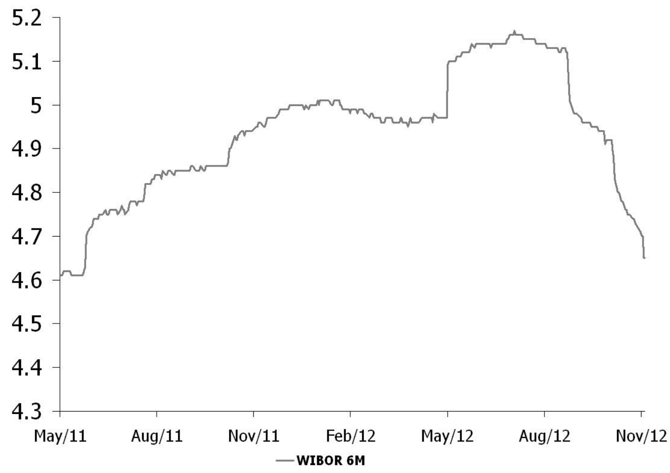


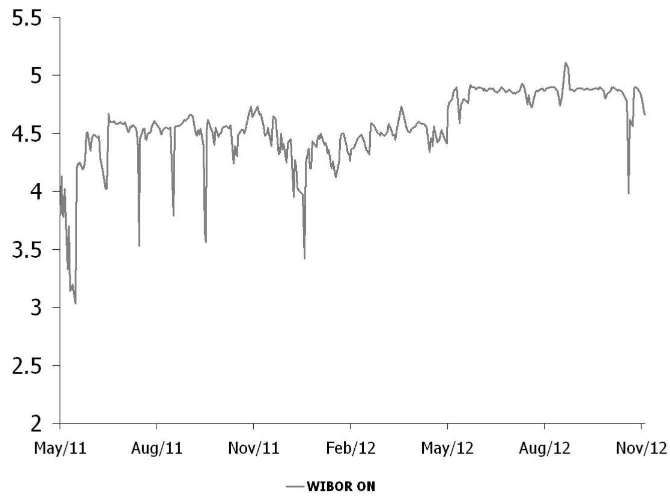


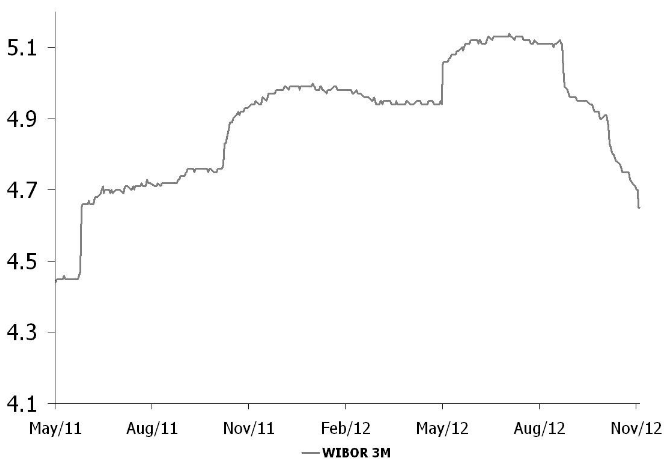
Money market

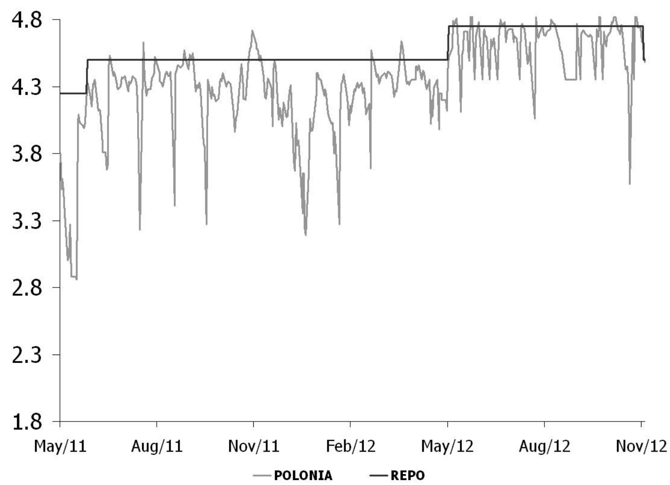
25 bps cut has started the cycle Liquidity stable near the main market rate. After today's OMO it is not going to change much since the market looks square (109 bln pln of money bills was bought).

A lot in the curve but no reason to price off anything now The MPC cut all the rates by 25 bps stating clearly that the cycle has just started. Another 25 bps cut should be done in December and the market sees another 100 bps in consecutive moths, with 25 bps step each. The value that can occur is in increasing scale of the step to 50 bps or/and in pausing for any month. Furthermore, given the unreal (from the local perspective) demand for Polish bonds we do not see the chance to price off anything in the foreseeable future. Moreover, to stop demand for bonds we would need the outside incentive which also looks very unlikely as of now. Local figures are expected to be on the bulls' side this month. To sum up, there is a lot in the curve but that does not mean that the trend can be stopped soon.









Forex

Zloty weaker. On Wednesday zloty experienced its biggest loss this week, roughly 1.0%, bringing EUR/PLN to 4.1750. The resistance at 4.1800 is capping the move so far, but the stronger resistance zone at 4.20/4.22 seems to be a real target. The mix of the factors like: interest rate cut, weaker macro data, sourer risk sentiment was responsible for PLN depreciation. Is it enough to break out of the well-established 4.10/4.20 range... I have to see it to believe it. However, let's not forget about the potential MoF offers which may potentially emerge anytime.

Volatility higher. The move up in spot was naturally accompanied by the move up in Vols. But the move was half-hearted as the spot is still in well-known 4.10/4.18 range. Thus, only short-term volatilities have moved higher. 1W vol EURPLN jumped from 6.7% to 7.5%, 1M vol increased from 6.8% to 7.3%, 3M vol increased from 7.4% to 7.7%. Risk reversals from all tenors were in demand, and as the result, skew moved 0.25% higher.

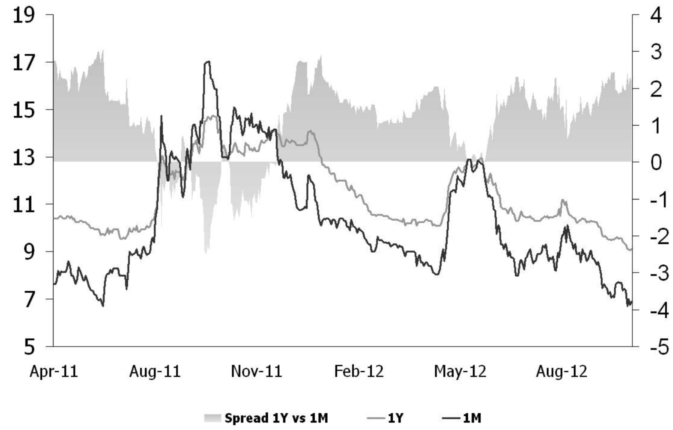
Short-term forecasts.

Main supports and resistances
EUR/PLN: 4.1000 / 4.2000
USD/PLN: 3.1500 / 3.3000

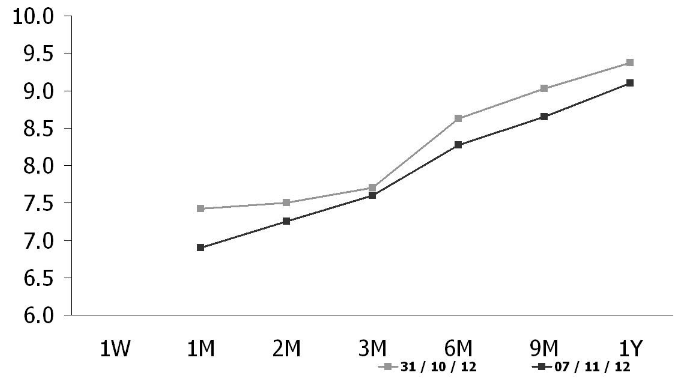
Spot. Dovish comments from the MPC conference had its toll on the Zloty but we doubt it is a game changer. We believe playing the wide range is still the best approach. Even considering unsettled global environment the 4.10/4.20 range is likely to hold, above 4.25 resistance zone we think the market will have to face the BGK "firepower".

Derivatives. Vols are consolidating at the new "Post Lehman" lows. The main/leading currency pairs i.e. EURUSD curves are in the same situation. It may look cheap, but realized volatilities are not really encouraging for a rush to buy it.

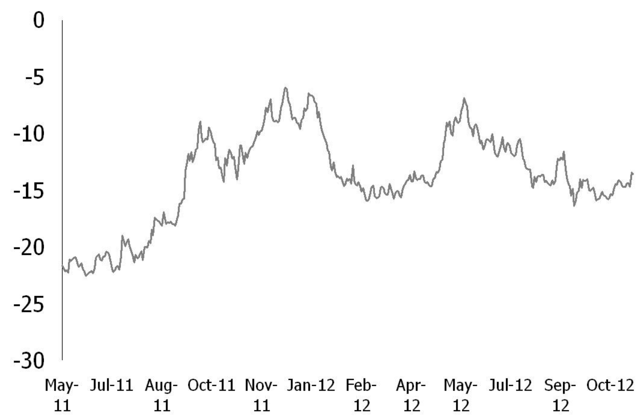
EURPLN volatility



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
11/2/2012	4.52	4.72	4.50	6.49	4.43	6.59	4.48	4.13	3.82	3.67	3.71	3.84
11/5/2012	4.45	4.71	4.43	4.61	4.38	4.60	4.48	4.10	3.75	3.65	3.63	3.76
11/6/2012	4.53	4.70	4.53	4.60	4.45	4.60	4.38	4.09	3.74	3.64	3.68	3.74
11/7/2012	4.38	4.70	4.38	4.60	4.38	4.60	4.30	3.95	3.62	3.53	3.57	3.64
11/8/2012	4.48	4.65	4.43	4.55	4.35	4.55	4.39	3.97	3.61	3.54	3.56	3.61

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
11/2/2012	6.590	4.813	4.050	3.828	4.070	3.975	4.250	4.487
11/5/2012	4.600	4.813	4.015	3.825	4.035	3.919	4.170	4.385
11/6/2012	4.600	4.813	4.005	3.834	4.060	3.945	4.210	4.403
11/7/2012	4.600	4.813	3.953	3.798	3.965	3.964	4.105	4.302
11/8/2012	4.550	4.813	3.925	3.791	3.933	3.868	4.080	4.296

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
11/2/2012	6.70	7.55	8.30	9.10	9.10	3.41	0.75
11/5/2012	7.00	7.60	8.23	9.10	9.10	3.41	0.75
11/6/2012	6.75	7.50	8.18	9.05	9.05	3.41	0.75
11/7/2012	6.90	7.60	8.28	9.10	9.10	3.36	0.75
11/8/2012	6.85	7.55	8.28	9.10	9.10	3.36	0.75

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
11/2/2012	4.1169	3.1965	3.4109	3.9821	1.4621	0.1630
11/5/2012	4.1213	3.2211	3.4158	4.0155	1.4605	0.1634
11/6/2012	4.1211	3.2223	3.4135	4.0155	1.4583	0.1631
11/7/2012	4.1122	3.2031	3.4058	3.9853	1.4614	0.1624
11/8/2012	4.1593	3.2655	3.4496	4.0852	1.4635	0.1635

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