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Comment on the upcoming data and forecasts

All eyes on the MPC. Next week, the Council will convene for a two-day meeting and announce its decision regarding interest rates. Despite poor GDP figures for the third quarter (below NBP's projections and well below MPC's optimistic assessment), we expect the Council to remain cautious and avoid drastic and hasty decisions. The MPC is also skeptical regarding the pace of disinflation. Thus, another 25-bps cut is the most likely course of action at the moment, even though market expectations are likely to shift back and forth between 25 and 50 bps. We also predict that the accompanying statement will probably be even more dovish than before. Earlier next week Manufacturing PMI for November will be published. As the index has been increasingly difficult to forecast, there are reasons to expect both a rise (working day effects, better sentiment in the Eurozone) and a drop (slowdown in the real sphere).

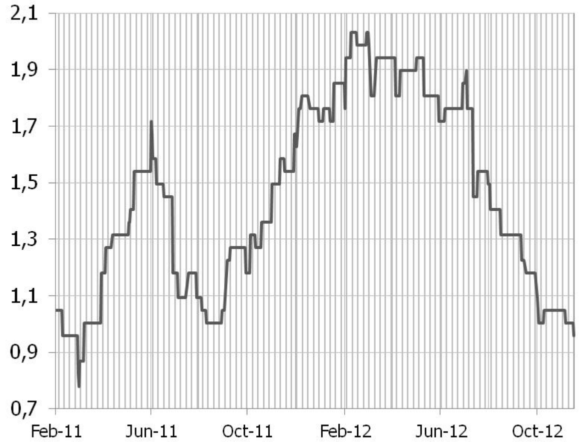
Polish data to watch: December 3th to December 7th

Publication	Date	Period	BRE	Consensus	Prior
Manufacturing PMI	03.11	Nov	47.3	47.2	48.3
MPC decision	05.11	Dec	4.3	4.3	4.5

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	-	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
The index resumed its downward trend after Friday's GDP release - exactly as we expected. Next week should come without surprises.

* 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). Polish economy is set to enter recession in H1 2013 (negative GDP growth in y/y terms). We see H2 2013 in more positive light, though, mainly due to global recovery.
- 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 inflation at 2.0-2.5% in January 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

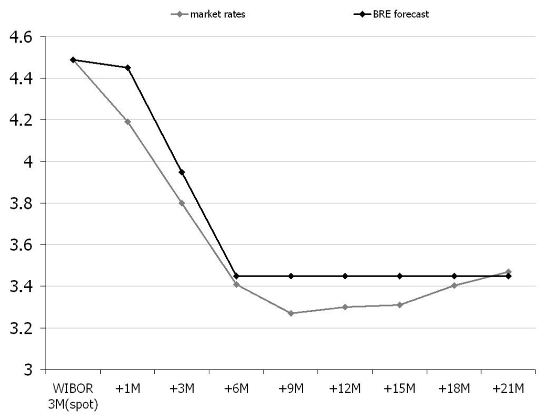
- Zloty moderately weaker towards the end of the year. Despite weaker economy and lower rates usual cyclical pattern for EURPLN set to be distorted by more balanced fiscal policy and accompanying lower current account deficit.
- Despite recent rally there is still room for lower rates in the short (monetary 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). As the ongoing C/A rebalancing is rating positive, the process should prove positive for Polish bonds.
- As global recovery and intra euro spreads compression continues and core yields rise accordingly 2013 quite likely not a "bond year" on Polish market as well. Polish bond yields should still remain low by historical standards, though.
- 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	0.5
CPI Inflation y/y (average %)	4.3	3.5	2.8	4.2	3.7	1.9
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	2012 Q4 F	2013 Q1 F	2013 Q2 F	2013 Q3 F	2013 Q4 F
GDP y/y (%)	3.6	2.3	1.4	0.7	-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	-4.0	-6.0	-5.0	-5.0	-3.0
Inflation rate (% average)	3.9	4.0	3.9	2.9	2.0	1.7	1.8	2.0
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	3.40	3.35	3.50	3.75	3.80
10Y Polish bond yields (% eop)	5.50	5.15	4.69	4.00	3.90	4.10	4.50	4.65
EUR/PLN (eop)	4.15	4.22	4.12	4.20	4.20	4.15	4.10	4.00
USD/PLN (eop)	3.11	3.35	3.20	3.28	3.16	3.07	3.15	3.08

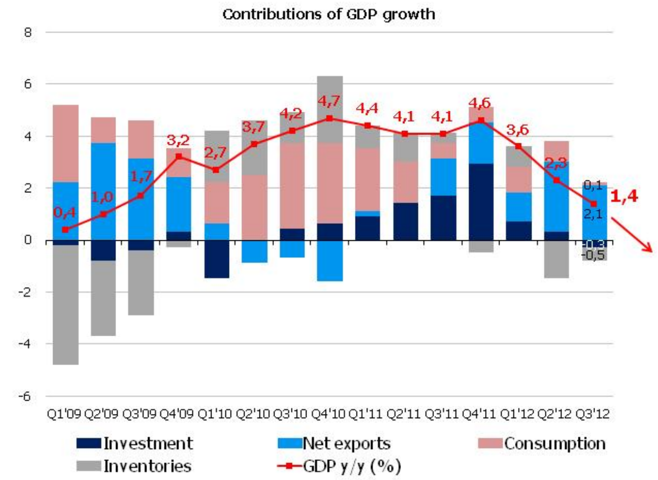
F - forecast



Economics

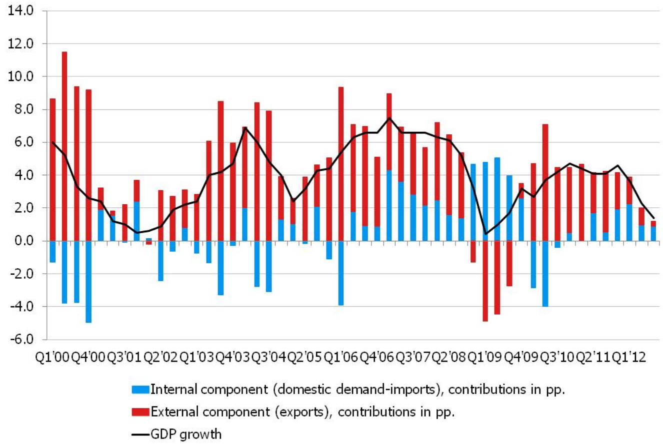
GDP - yet another disappointment

GDP growth in Q3 slowed again, to 1.4% y/y from 2.3% reported previously. The reading was close to our expectations and below the market and the NBP projection (1.8%). It is better not to look at seasonally adjusted data since they show even an acceleration of sequential GDP growth over Q2 (+0.4% vs +0.2%). However, a technical remark for non-nerds: seasonal adjustment filters are extremely biased at the ends of statistical sample, therefore they rather blur than clarify the picture stemming from the most recent data.



The structure of growth points to further decline of domestic demand (-0,7% vs -0.2% reported previously). The main culprit was lower growth of private consumption (only +0.1% y/y vs 1.2% in the previous quarter). It is the lowest growth of consumer spending in the entire history of modern statistical data for the Polish economy. Consumers hit the wall: with no savings it is a percentage of real disposable income that comprises consumption. Therefore, in Q4 we are heading to refute the alleged impossibility of negative consumption growth in Poland. Investment growth posted negative 1.5% y/y in Q3 (down from +1.3% in Q2). Quick look at value added in construction (-5.8% y/y vs +2.0% in Q2) reveals it was infrastructure spending on the driver's seat. Therefore there is further downside potential on total investment since negative growth of private investment and residential investment are yet to come (the former on the basis of slowing momentum in the economy and arising slack, the latter on oversupply and falling prices in the housing market).

Residual components of demand-composed GDP were close to our expectations. In case of change of inventories, it is statistical base effect that drove this category higher vs the previous quarter (-0.5pp vs -1.5pp. in Q2). There will be no such mercy in the coming quarters as soon as usual pro-cyclicality kicks in. As for net exports, the long-lasting divergence between GUS and the NBP data was erased (therefore we witnessed substantial decrease in NX contribution towards 2.1pp. vs 2.7pp. in the previous quarter). Therefore the whole path of NX contributions will be lower in the coming quarters with a peak in Q4 and then a fast decline afterwards, even towards negative at the end of 2013. The lack of PLN depreciation (contrary to 2009) does not bode well for net exports in H2 2013.



Today's data moved the market. Zloty went weaker (almost 2 figures), interest rates decreased by impressive 7bp (mind the fact that we are just after a massive rally). After such a reading there will be bets on a 50bp cut in December. We would rather stick to 25bp, though, as MPC would not like to act as if it lost control over the business cycle.

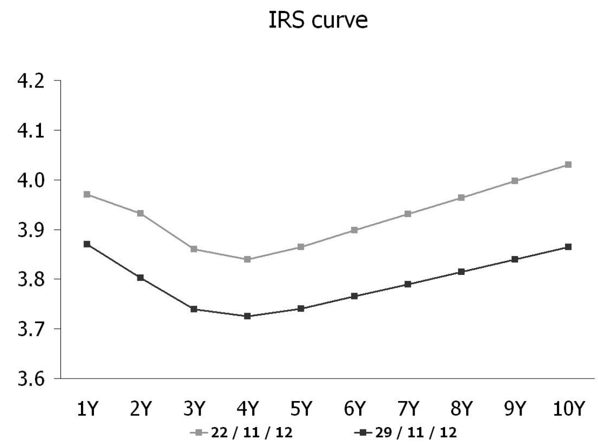
It is not going to be long before other analysts realize that being optimistic is not the best attitude at this phase of the cycle (we think Polish economy is heading towards a shallow recession in H1 2013). GDP contraction is determined by the internal component of the business cycle (see the decomposition in the graph) and, for 1-2 quarters, will be immune to signals of growth reacceleration in some parts in the global economy (US, some Asian countries). We are well aware of the fact that even if relatively unimportant for Polish growth, incoming green shoots in the global economy are set to support equities and increase interest rates globally. However, the latter is not the scenario that can be easily applied to the Polish economy since MPC is backward-looking and reacts to the past data. Therefore it is not the possible rebound in late 2013 but the current slump that is going to preoccupy the Polish MPC in the coming months. With considerably lower inflation (again, reaction to already forming slack in capacity utilization) it opens room for expectations on massive interest rate cuts in Poland.

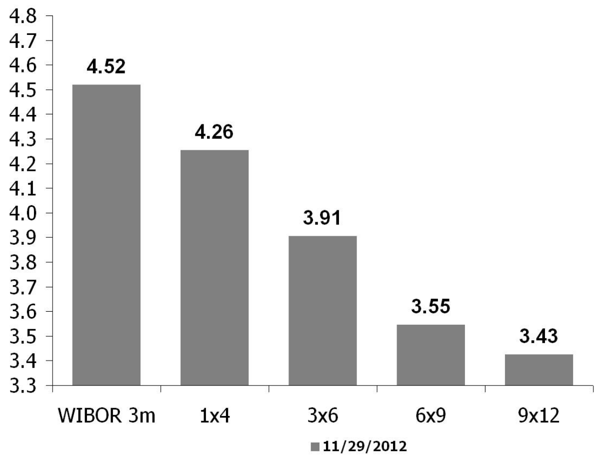
Fixed income

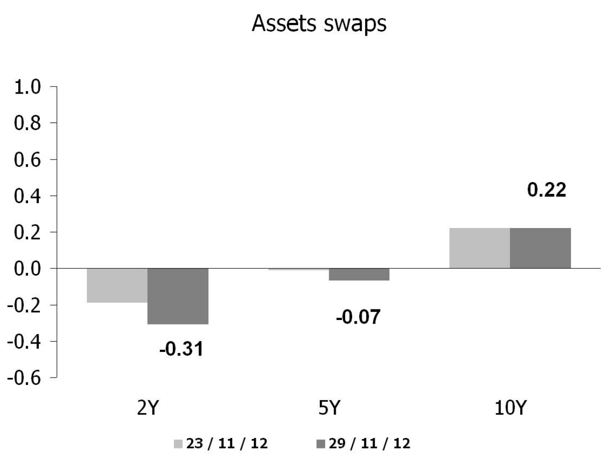
Unstoppable rally

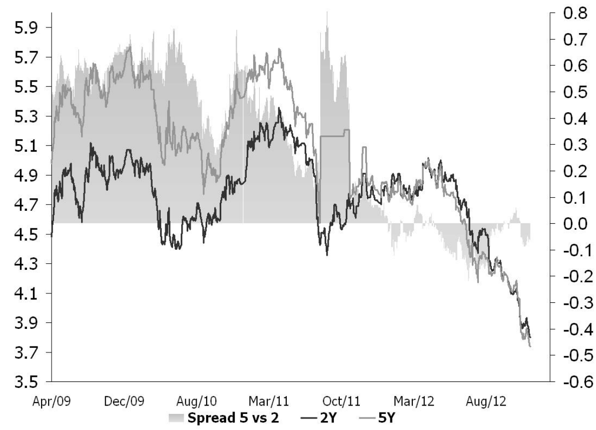
What looked like some technical correction last week didn't really last long. This week started with positive sentiment that kept improving gradually. Lower than expected GDP data accelerated the move. Overall, curve moved down by almost 25bp. Constant flow to buy POLGBs lasted long enough for the market to start losing liquidity. Even though levels might seem extreme and rally overdone, it's difficult to find a trigger that could reverse current trend. Macro data show that the economy is deteriorating, growth is slowing and a recession is looming. CPI is probably the next thing likely to start surprising on the downside.

Nevertheless the MPC remains quite relaxed which caused the market to price in more and more easing - currently target for main rate is at 3.00% by Q3 2013. We think that rate setters will not cut rates by more than 25bp during any meeting in the nearest future. That means that we started from relatively high nominal interest rate levels, first cut was apparently delayed by a few month already and now the adjustments will be slower than falling CPI and deteriorating growth. It somehow resembles the last hiking cycle - postponed small steps resulted in nervous reaction by the end of it and that's the scenario that will be most likely priced in by the market this time. We apparently called for this rally to end a bit too early, but even though the extent is significant, it's still not time to turn negative here.





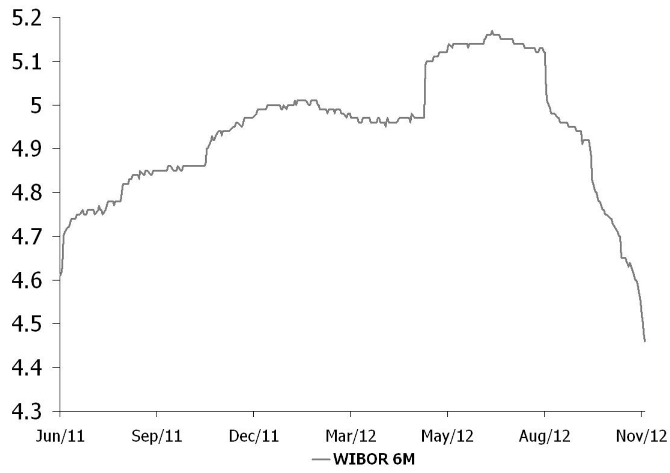


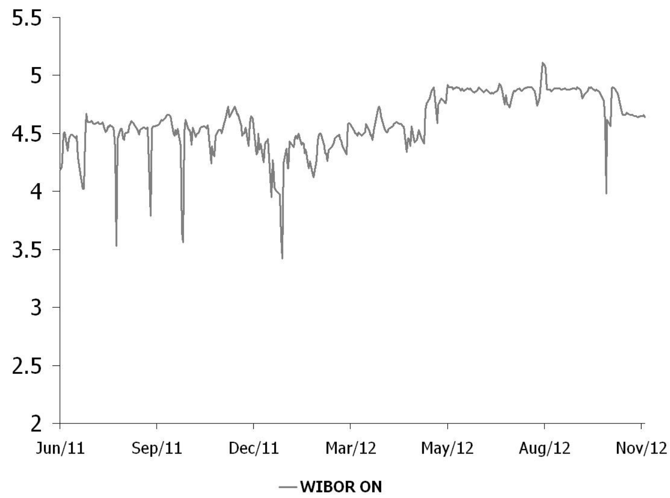


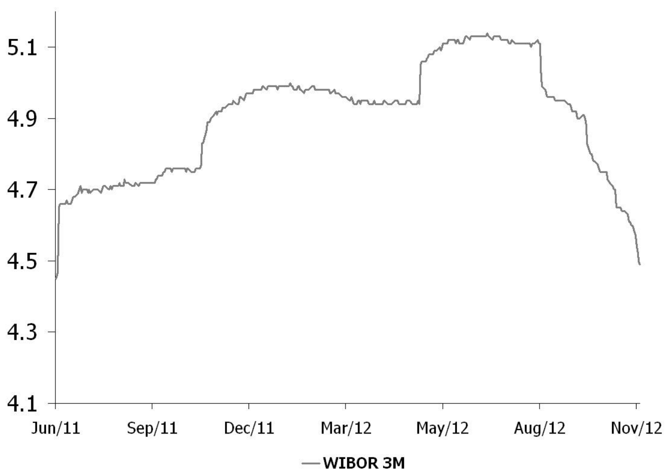
Money market

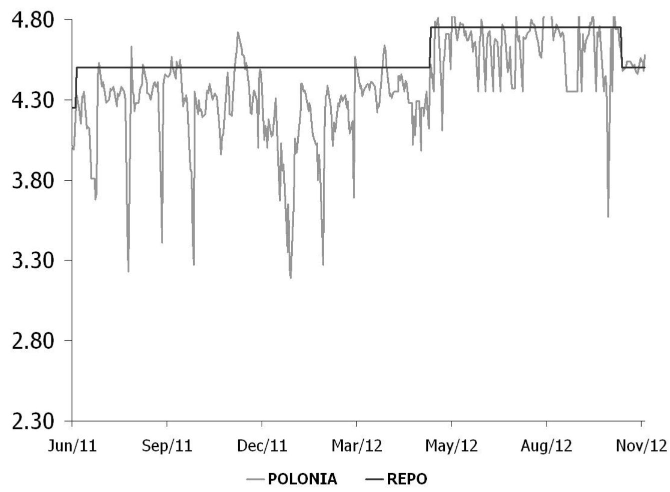
Based on historical experience, December should bring cheap carry End of the reserve passed without any major disturbances, and we are approaching the new settlement period with a quite balanced market. Today's OMO was well oversubscribed (117.8 vs 114.5 bln pln) and the intake will keep the shortest rates nearby the main market rate. Usually December is a cheap month due to vanishing activity, hence careful cherishing of the system liquidity. We expect this year not to be an exception, however we need another week or so to notice.

GDP in Q3 much below expectations Today's Q3 GDP release was definitely the highlight of the week. The figure came much below market consensus (at 1.4% vs 1.8%) and brought about another wave of bullish attacks. Front end curve dropped another 10 bps discounting another 125 bps rate cut coming very soon. 50 bps play for the January meeting becomes very likely.







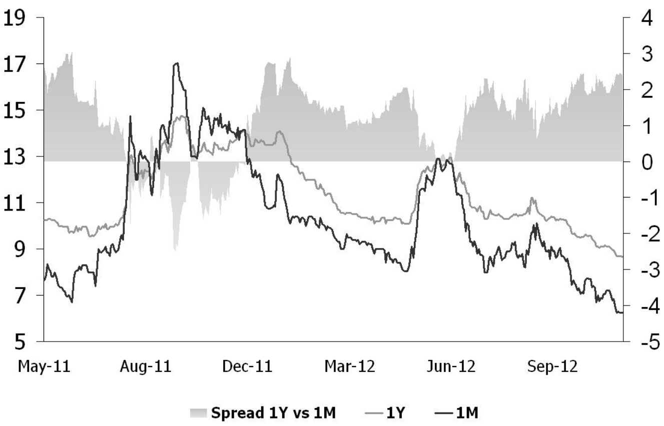


Forex

Stable In the first four days of last week EUR/PLN held pretty well - most of the activity took place in the vicinity of 4.0950. On friday morning, after GDP figures were publihed (weaker than expected), Zloty regained vigor and exploded touching 4.11 levels. Poor data will weigh on the zloty and on the MPC which can be more aggressive (decision regarding rates next week). Thus, in the coming days EURPLN probably will try to reach 4.1200 in order to reverse the downward sloping trend.

Lower again The EURPLN was traded in the narrow range 4.09 - 4.11, so realized volatility is extremely low and it caused decline in implied volatilities again. 1 month EUR/PLN ATM is 5.9 mid from 6.4 mid last week, 6 months 7.5 mid versus 7.8, and 1Y mid is 8.4, 0.3% lower. The all time low in 1Y is 5.7% so still same room. But please note that till 2008 we were having a very strong, structural supply of the Vega from exporters and nowadays it hardly exists... The skew and currency spread (difference between USD/PLN - EUR/PLN vol) is at the same level as week before (1m 4.5%, 1Y - 6%).

EURPLN volatility



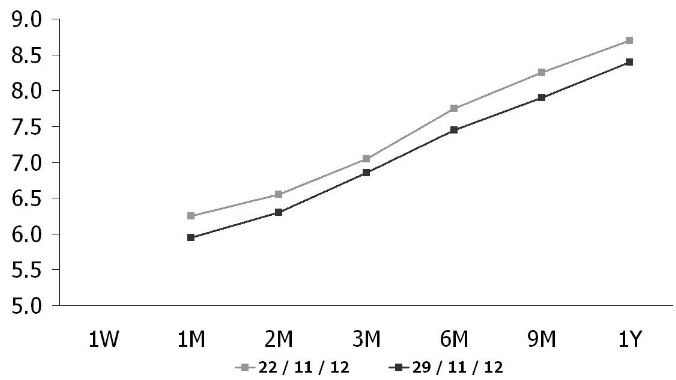
Short-term forecasts.

Main supports and resistances
EUR/PLN: 4.0800 / 4.2000
USD/PLN: 3.1500 / 3.2800

Spot. Play the range 4.08/4.12. It is the name of the game at the moment. But 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 XXX/PLN vols are back at theirs post-Lehman lows, but the realized volatility is not really encouraging buyers. I think we should stay sidelined for the time being, as the picture is blurred and the end of the year is so close, profit protection is an obvious strategy.

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
11/23/2012	4.37	4.60	4.25	6.49	4.13	6.59	4.35	3.96	3.62	3.51	3.55	3.63
11/26/2012	4.30	4.57	4.18	4.45	4.03	4.41	4.32	3.93	3.62	3.47	3.52	3.61
11/27/2012	4.33	4.54	4.25	4.42	4.08	4.39	4.28	3.93	3.61	3.48	3.50	3.62
11/28/2012	4.28	4.52	4.23	4.40	4.08	4.37	4.28	3.92	3.56	3.42	3.45	3.55
11/29/2012	4.25	4.50	4.15	4.38	4.00	4.36	4.26	3.91	3.55	3.43	3.44	3.56

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
11/23/2012	6.590	4.813	3.880	3.694	3.830	3.823	4.010	4.232
11/26/2012	4.410	4.813	3.873	3.627	3.800	3.782	3.970	4.188
11/27/2012	4.390	4.813	3.840	3.576	3.780	3.734	3.930	4.144
11/28/2012	4.370	4.813	3.810	3.516	3.750	3.701	3.865	4.101
11/29/2012	4.360	4.813	3.803	3.497	3.740	3.674	3.865	4.086

EUR/PLN 0-delta stradle				25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
11/23/2012	6.30	7.05	7.75	8.70	8.70	3.17	0.72
11/26/2012	6.25	7.05	7.70	8.70	8.70	3.17	0.72
11/27/2012	6.25	7.05	7.70	8.70	8.70	3.17	0.72
11/28/2012	6.25	7.00	7.65	8.65	8.65	3.18	0.72
11/29/2012	5.95	6.85	7.45	8.40	8.40	3.19	0.71

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
11/23/2012	4.1229	3.1945	3.4208	3.8828	1.4710	0.1625
11/26/2012	4.1160	3.1744	3.4173	3.8671	1.4590	0.1627
11/27/2012	4.1008	3.1634	3.4044	3.8518	1.4571	0.1622
11/28/2012	4.1099	3.1799	3.4151	3.8837	1.4617	0.1626
11/29/2012	4.0968	3.1556	3.4025	3.8412	1.4679	0.1622

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