BRE BANK SA

POLISH WEEKLY REVIEW

December 10, 2012

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Comment on the upcoming data and forecasts

The first batch of this month's data comes out on Thursday. Current account balance (October data) will probably be influenced by on-off factors (coupon payments, large transfer of EU funds) but the downtrend will still be visible. We also expect to register yet another trade surplus, as weakening internal demand depresses imports and exports still grow on a month-to-month basis. Inflation is likely to have registered another significant decline in November, thus dropping very close to NBP's target. Reasons for this decline are clear - high statistical base in energy, food and pharmaceuticals; significant fall in fuel prices, modest increases in food prices and a fall in core inflation as inflationary pressures from the real sphere recede. Finally, the NBP will publish its data on broad money growth on Friday. We expect annual dynamics of M3 to further decline as we enter the period of high statistical base in corporate and household deposits.

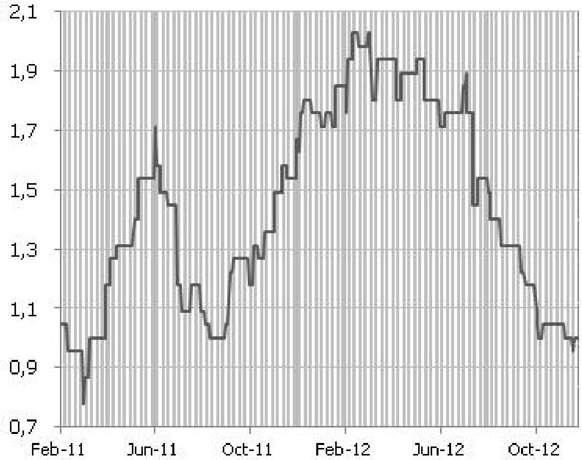
Polish data to watch: December 10th to December 14th

Publication	Date	Period	BRE	Consensus	Prior
Current Account Balance (mio EUR)	13.12	Oct	-1172.0	-1053.0	-1137.0
Exports (mio EUR)	13.12	Oct	13230.0	12940.0	12578.0
Imports (mio EUR)	13.12	Oct	13100.0	13100.0	12494.0
CPI YoY (%)	13.12	Nov	2.8	3.0	3.4
M3 Money Supply YoY (%)	14.12	Nov	7.0	6.6	8.0

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
Slightly higher after a surprisingly good PMI release. There is some space for surprises in the coming week, as data on inflation, broad money growth and current account data will be published.

* 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 only slightly 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).
- Monetary 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

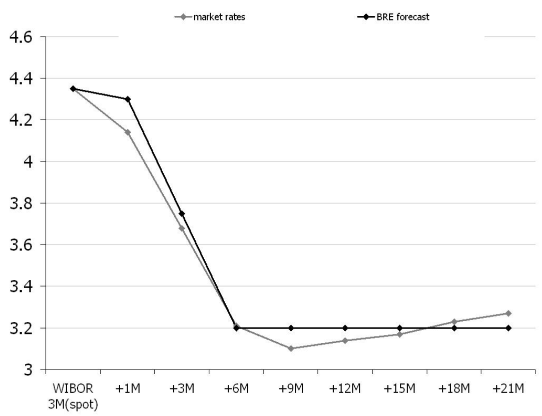
- Zloty moderately weaker towards the end of the year. Despite weaker economy and lower rates usual cyclical pattern for EURPLN set to be distorted by more balanced fiscal policy and accompanying lower current account deficit.
- Despite recent rally there is still room for lower rates in the short (much lower inflation, 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	3.20	3.10	3.20	3.40	3.50
10Y Polish bond yields (% eop)	5.50	5.15	4.69	3.95	3.80	3.90	4.20	4.40
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

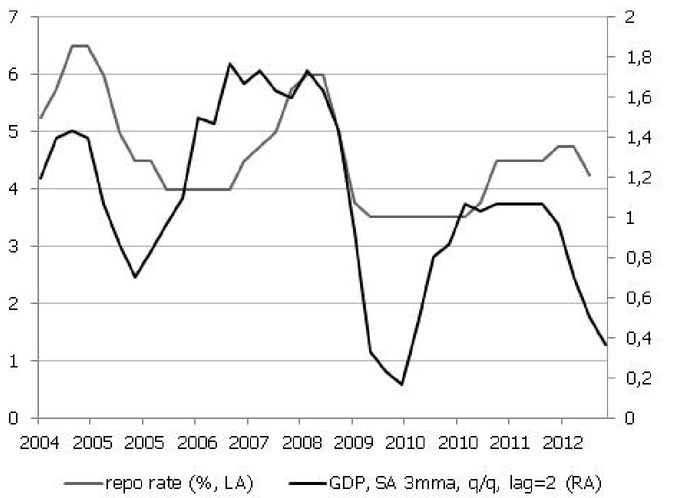
F - forecast



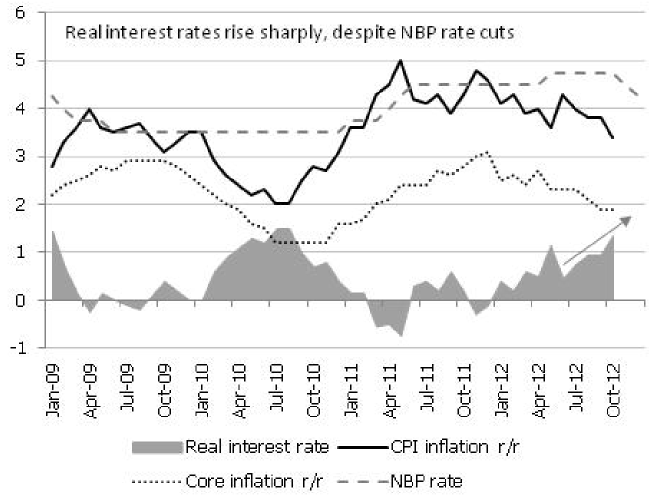
Economics

MPC cuts rates by 25 bps and announces another cut

No suprisises on Wednesday, as the MPC cut interest rates by 25 bps and announced another cut in January. The statement was very dovish which relates to latest macroeconomic data, including the baffling (for the MPC) weakness of private consumption, labor market deterioration and likely decline in economic activity in this quarter. The mid-term risk of inflation falling below NBP's target has also been confirmed. The statement ended with exactly the same sentence as the previous one: "If new data confirm that the weakening of economic sentiment is sustained and the risk of strengtening inflationary pressures is constrained, the Council with continue with monetary easing". During the press conference, this phrase was directly interpreted by Gov. Belka as an announcement of another rate cut. Mr Belka also pointed out that the consensus of opinions within the Council is one of gradual cuts, unless "something drastic happens". In our view, this means that cuts deeper than 25 bps have not been explicitly announced. Mr Belka also stressed that the MPC "cannot allow the monetary easing cycle to stop". With respect to growth perspectives the tone of the press conference was much more pessimistic, as compared to the statement and the previous conference. Mr Belka did not dismiss recession-related questions but argued about the definition of recession. He also admitted that upswing scenarios were neither considered, nor discussed during the meeting of the Council. Finally, he suggested that policy of positive real interest rates could be abandoned under certain conditions, as the situation is turbulent.



In our opinion, the most important clues as to the direction of monetary policy are statements regarding interest rate disparity (according to Mr Belka, too large disparity makes Polish bonds too atractive) and possibility of increasing space for interest rate cuts (if core inflation drops below NBP's projection (too conservative, in our view). Sustained interest in Polish bonds and currency, which does not depreciate as fast as it should in economic downturns, suggests that the MPC sees that rates could be cut significantly without weakening the Zloty to levels that would accelerate inflation. The stable historical relation between internal demand and core inflation suggests, on the other hand, that the latter should fall below 1% in the coming quarters - more than the Council anticipates at the moment as the space for interest rate cuts. We also stand firm by our forecast of annual GDP decline in the first half of 2013.



We expect that the current easing cycle will amount to a total of 150 bps cuts in NBP rates. January will bring another cut, most likely again by 25 bps, as the Council is not unanimous (the reality emphasised by Mr. Belka) and its members are entrentched in their positions. The likelihood of a deeper cut in January is considerable, though.

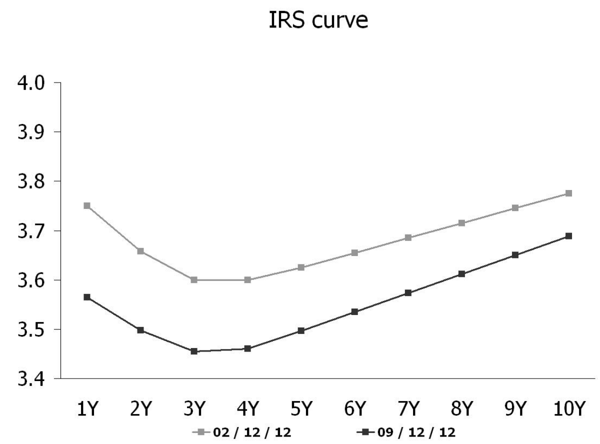
Fixed income

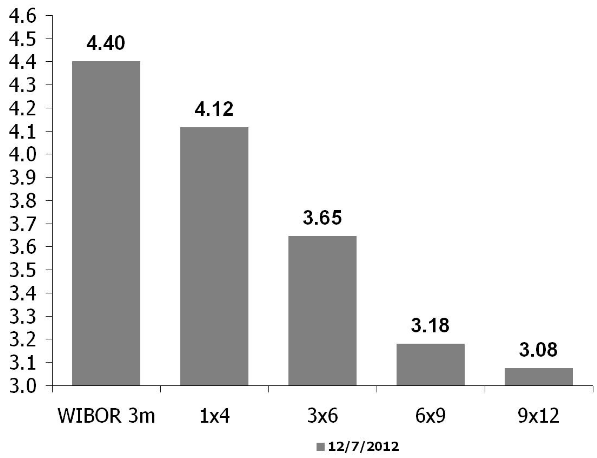
Post RPP

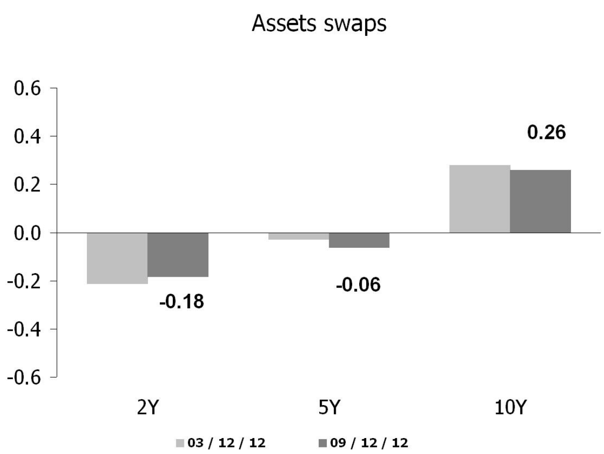
The RPP's decision to cut interest rates by 25 bps made quite limited impact on the yield curve on Wednesday as the market looked a little bit disappointed with the scope. Short-term FRA contracts that had already priced the high probability of the 50bp move went up by 8-10bp but this seemed to be short-lived as Wibors continued to slide again. The yield curve has flattened in 2y5y by few points with a general downtrend in rates and still existent massive demand for domestic treasury securities especially in 5y sector. The market started to receive again, finally pushing the whole curve down by around 15 points.

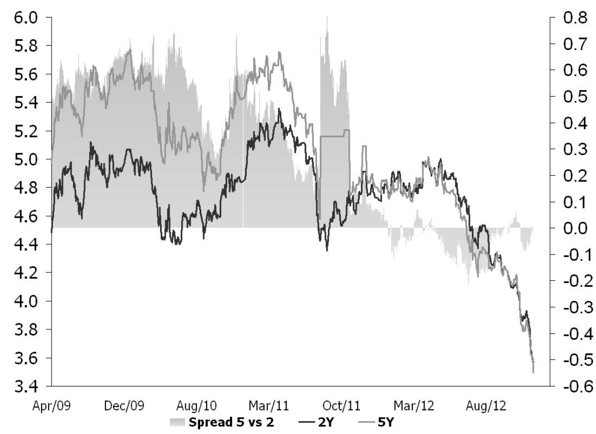
We had comments from MinFin about the budget deficit. It came at around 30 bio PLN (34.5 bio in last month). It looks like annual target of around 32 bio is pretty achievable, depending only on the amount of extra spending government wants to make still this year.

We think the downtrend on rates will continue as the really scary slowdown data will be published within the next few months from now. We expect much more accelerated drop in Wibor rates starting from January, as the CPI data is set to hit the 2% level in the very beginning of the new year and with the highest ever probability of more than 25bp rate cut next month. Receive anything you can up to 5Y and fasten your seat belts carefully.





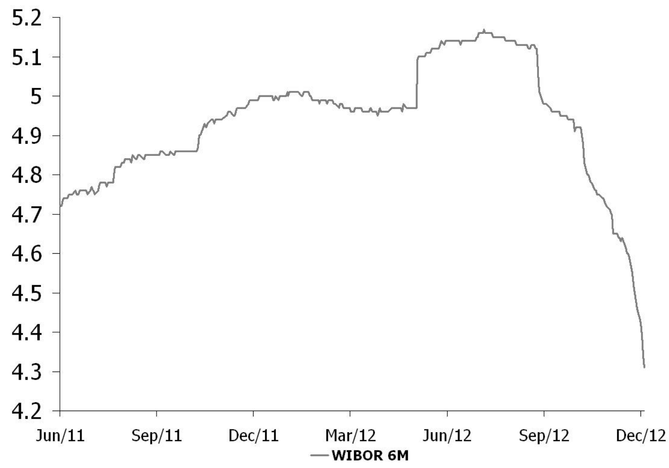


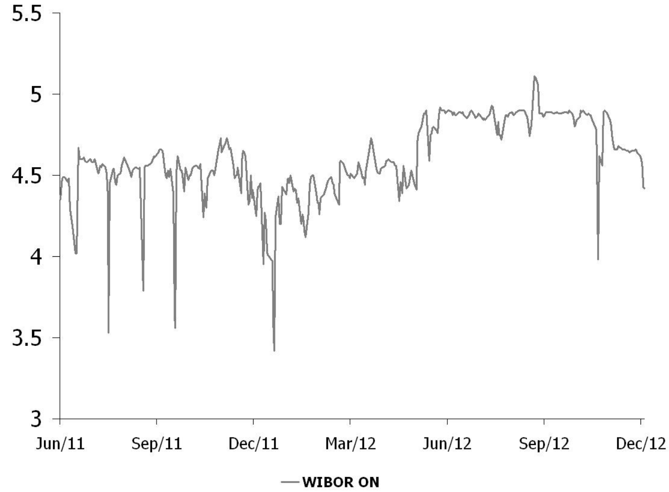


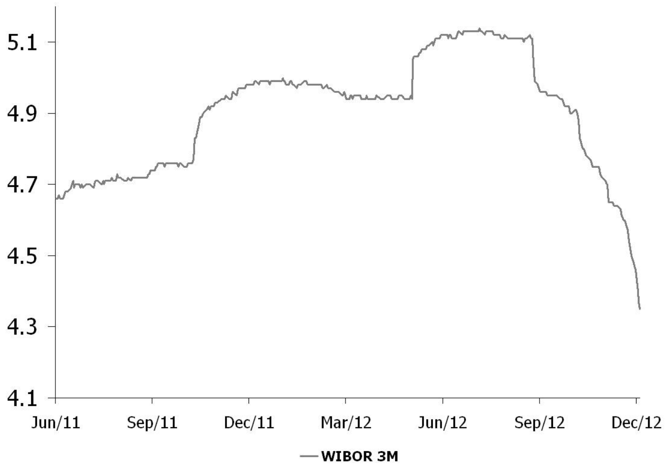
Money market

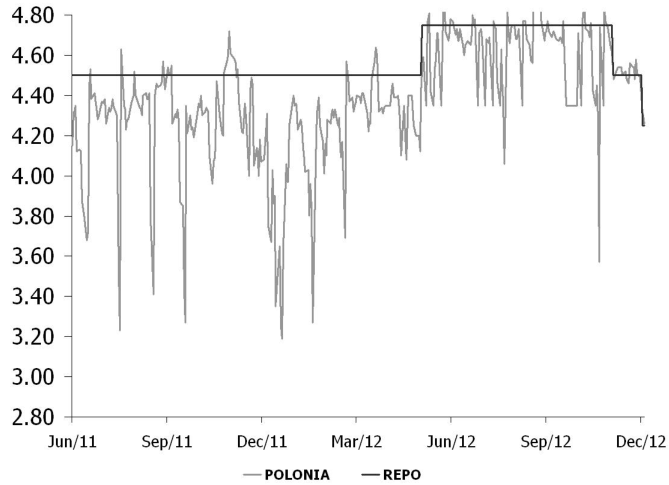
Good chance for a lower carry in December Liquidity of the system stays squared after today's OMO (114.5 bln pln of money bills sold), which means that shortest rates will oscillate around the main market rate. We still think that there is a good chance that closer to the end of the year risk aversion will push the market toward higher cash surplus in the system, hence lowering the cost of carry.

MPC policy still lagging market expectations Still bullish despite the 25 bps cut (some expectations for 50 bps existed), which leaves the MPC further behind the curve. Again the market plays 50 bps cut in January (the cut itself was practically announced during the post decision conference), and again probably it will be only 25 bps leaving inflated expectations unharmed. The market discounts another 125 bps of a very aggressive monetary easing, which will be probably supported by coming data from the real economy. The majority in the MPC will probably stay very cautious, again lagging behind the market scenario. If the macro data carries in very weak outputs, the risk of bigger and deeper cuts will persist. This in turn will favour the front end rates and short maturity bonds.







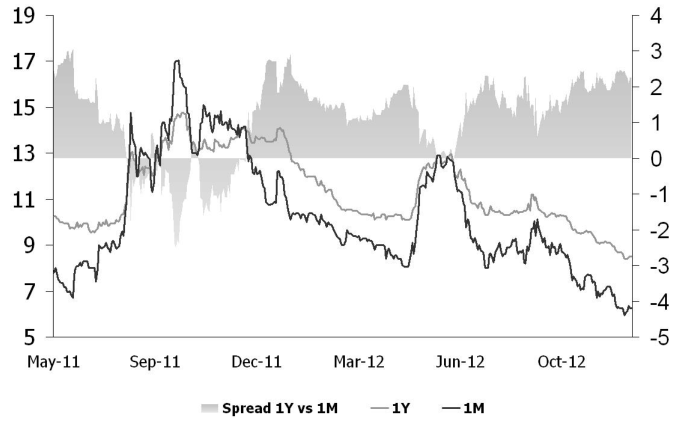


Forex

Touch weaker The MPC cut interest rates by 25 bps this week and signalled that further cuts are in the pipeline. Some even had hoped for 50BP cut, and the PLN was bought just after the announcements but it was short-lived. We are still in the limbo, the price action (or lack of it) is really disappointing, and we may expect that this kind of trading will continue as liquidity evaporates close to the end of the year. Technically 4.15/4.17 is the resistance zone and 4.08/4.10 constitutes the support.

Slightly higher The losses of PLN, inevitably led into the vol uptick. The trade of the week was 1 year EUR/PLN ATM traded at 8.6% in good amount, but it is still far from fireworks. The frontend was better bid before the MPC announcement, only to be sold just after the MPC press conference. In general, the vol curve is a tic higher then the last week close. Skew and currency spread (deference between USD/PLN minus EUR/PLN) is roughly unchanged.

EURPLN volatility



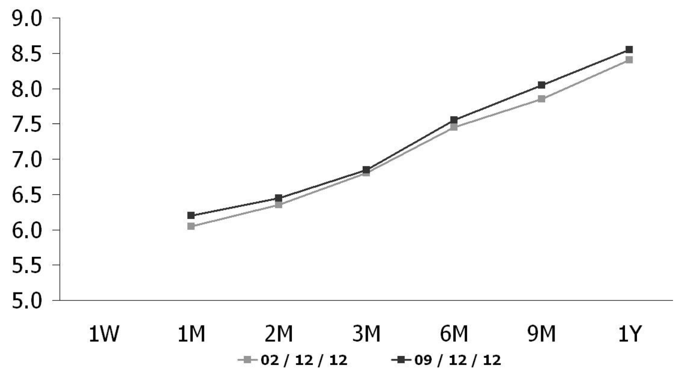
Short-term forecasts.

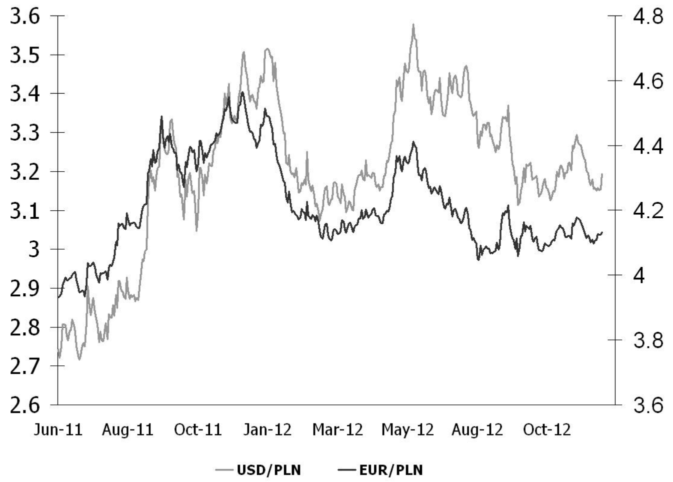
Main supports and resistances
EUR/PLN: 4.0800 / 4.1500
USD/PLN: 3.1500 / 3.2500

Spot. Play the range approach is still intact. We would sell EUR/PLN in the 4.14/4.16 region with stop above 4.1750 and hopes for a dive below 4.10 again. Or alternatively buy EUR/PLN at 4.07/4.09 level with stop bellow 4.0550 and eyes on 4.1250+.

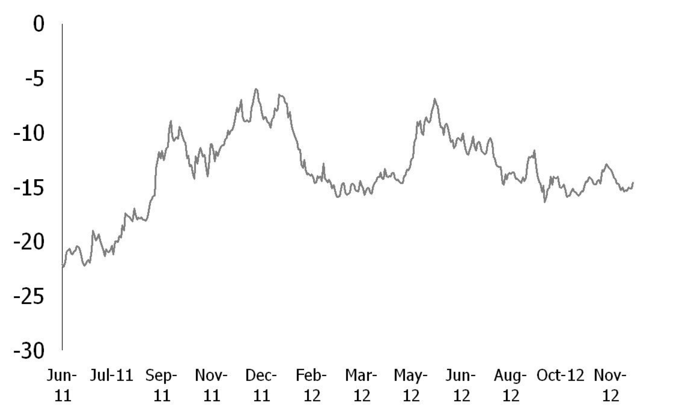
Derivatives. The XXX/PLN vols are back at theirs post-Lehman lows, but the realized volatility is not really encouraging buyers. We think we should stay sidelined for the time being, the picture is blurred and since the end of the year is so close, profit protection is an obvious strategy.

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
11/30/2012	4.23	4.49	4.11	6.49	3.94	6.59	4.18	3.81	3.41	3.24	3.27	3.41
12/3/2012	4.14	4.46	3.98	4.33	3.80	4.31	4.14	3.76	3.37	3.23	3.22	3.34
12/4/2012	4.09	4.43	3.95	4.31	4.00	4.30	4.15	3.72	3.32	3.19	3.20	3.29
12/5/2012	4.03	4.40	3.93	4.27	3.78	4.25	4.14	3.73	3.32	3.18	3.18	3.29
12/6/2012	4.05	4.37	3.95	4.24	3.80	4.20	4.14	3.69	3.29	3.15	3.20	3.29

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
11/30/2012	6.590	4.813	3.658	3.393	3.625	3.581	3.775	4.028
12/3/2012	4.310	4.813	3.638	3.425	3.625	3.597	3.800	4.080
12/4/2012	4.300	4.813	3.590	3.378	3.600	3.585	3.790	4.107
12/5/2012	4.250	4.813	3.598	3.377	3.580	3.558	3.780	4.079
12/6/2012	4.200	4.813	3.557	3.388	3.557	3.519	3.740	4.057

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
11/30/2012	6.05	6.80	7.45	8.40	8.40	3.19	0.72
12/3/2012	6.15	6.85	7.45	8.40	8.40	3.19	0.72
12/4/2012	6.35	6.95	7.50	8.45	8.45	3.19	0.71
12/5/2012	6.25	6.95	7.50	8.50	8.50	3.18	0.72
12/6/2012	6.25	6.95	7.50	8.50	8.50	3.19	0.72

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
11/30/2012	4.1064	3.1585	3.4088	3.8213	1.4645	0.1630
12/3/2012	4.1083	3.1498	3.4050	3.8354	1.4593	0.1625
12/4/2012	4.1273	3.1575	3.4010	3.8496	1.4643	0.1634
12/5/2012	4.1251	3.1516	3.3956	3.8318	1.4585	0.1634
12/6/2012	4.1247	3.1538	3.4031	3.8257	1.4582	0.1638

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