BRE BANK SA

POLISH WEEKLY REVIEW

February 1, 2013

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Comment on the upcoming data and forecasts

All eyes on the MPC. After some unfortunate statements regarding a pause in the easing cycle, the Council has announced (through statements made by its members) another 25 bps cut in February. We are under the impression that a broader consensus has emerged within the Council - that rates should be cut to 3.50% eventually. Thus, the council's statement is likely to include a conditional announcement of further easing. The coming fall in inflation and possible replacement of Mr Winiecki with a dove (Winiecki is likely to be sentenced in a criminal trial on February 13th - he already lost once) should allow the repo rate to be lowered to 3.25% eventually. Expectations for monetary easing should remain high at least in the first half of the month.

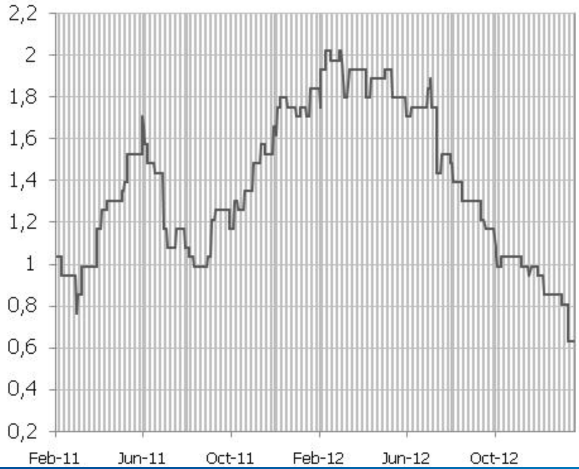
Polish data to watch: February 4th to January 8th

Publication	Date	Period	BRE	Consensus	Prior
NBP rate announcement	06.02	Feb	3.75	3.75	4.00

Treasury bonds and bills auctions

Paper	Next auction	Last Offer	Last yield (%)	Prev auction
52 Week T-bills	2/4/2013	3600	3.560	1/9/2013
2Y T-bond OK0714	-	1300	3.285	1/23/2013
5Y T-bond PS0418	2/7/2013	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
Unchanged from last week - annual GDP did not surprise after all (market consensus was spot on this time). Next week should not bring any surprises - repo rate decisions are hardly a shocker.

* 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	2.0	0.6
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

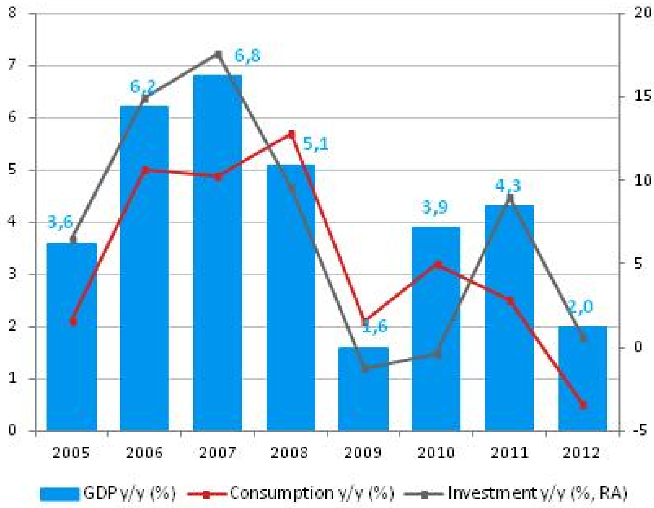
	2012 Q1	2012 Q2	2012 Q3	2012 Q4 F	2013 Q1 F	2013 Q2 F	2013 Q3 F	2013 Q4 F
GDP y/y (%)	3.6	2.3	1.4	0.9	-0.5	-0.2	1.0	1.8
Individual consumption y/y (%)	1.7	1.2	0.1	-0.9	0.8	1.0	1.8	2.1
Public Consumption y/y (%)	-0.8	0.5	0.2	0.0	0.5	0.5	0.5	0.5
Investment y/y (%)	6.0	1.3	-1.5	-5.5	-6.0	-6.0	-3.5	-2.0
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	3.50	3.25	3.25	3.25
Wibor 3M (% eop)	4.94	5.13	4.92	4.11	3.65	3.40	3.40	3.40
2Y Polish bond yields (% eop)	4.62	4.60	4.05	3.14	3.20	3.20	3.20	3.30
10Y Polish bond yields (% eop)	5.50	5.15	4.69	3.74	3.80	3.90	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	3.26	3.25	3.28	3.20

F - forecast

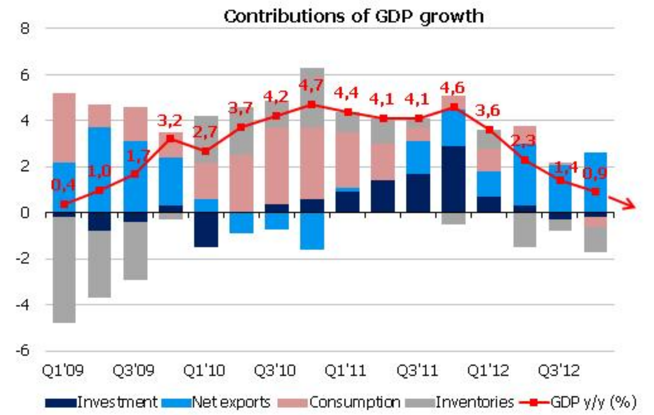
Economics

GDP rose by 2.0% in 2012 but private consumption marked historic bottoms

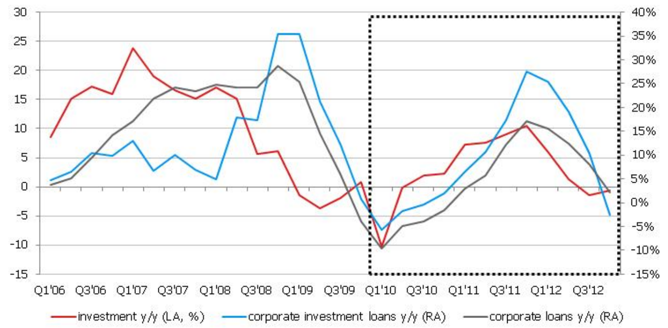
2012 ended with 2.0% GDP growth (4.3% in 2011). Private consumption rose by only 0.5% (2.5% in 2012) and fixed capital formation advanced by 0.6% (8.1% in 2011). The publication allows us to pretty accurately pin down Q4 data, and therefore the true pulse of the economy.



It seems GDP growth in Q4 amounted to 0.9% y/y which translated into near zero sequential sadj q/q growth.



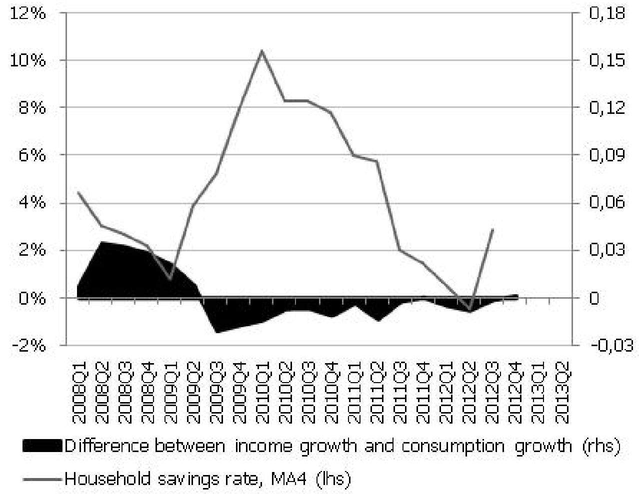
Private consumption fell by little more than 1.0% y/y which shows that any guidance given by historical comparisons is misleading (we refer here to common statements that negative growth of consumption on annual basis is impossible - it is not). However, the sharp drop in personal consumption in Q4 can reasonably be attributed to delayed direct payments of EU funds to farmers. The decrease in aggregate income is roughly 4 bn PLN - just enough to explain the drop. Without this effect, consumption would likely have printed at 0% or slightly higher - as implied by aggregate income growth. Therefore we keep sticking to economic reasoning rather than boundaries implied by past cycles (when savings rate is zero real income is a king) and argue for very weak consumption in 2013. As for investment, it was a real surprise for us to see that Q4 may have even shown a rebound towards -0.5% y/y from -1.5% y/y. It stands with a sharp contrast with the data on credit, manufacture of durable and capital goods and construction.



We would not like to revise our H1 2013 scenario in which GDP contracts on annual basis. Situation in the labor market is not going to bring relief for consumption. We also doubt we have reached a trough in investment activity, the more so since base effects will be additional headwind in H1 2013. Residual components of GDP are also unlikely to support GDP growth since net exports contribution is falling and inventory formation encounters strong base effect from Q1 2012. To sum up, even purely arithmetically it would be hard to reach positive GDP growth in H1.

Counter-cyclical behavior of household savings rate

In the previous slowdown household savings rate sharply rebounded from near-zero levels, growing by at least ten percentage points. The adjustment took place within one year and savings rate has been declining for the next two years. In early 2012 it dropped into negative territory. Given historical experiences, we can reasonably expect that household savings rate bounces back (and it did) and will continue to grow. If we assume that the current rebalancing started in mid-2012 (as data suggest rather unequivocally) and that this process requires a year to complete, we can expect that savings rate will continue to grow at least until the end of the second quarter. Such rebalancing implies that consumption grows slower than disposable income (the path of which is already rather meagre). One-off effects notwithstanding, a flat grow path for personal consumption in the first half of the year is likely. And here is what we regard as flat consumption path. After the trough at 1.2% y/y in Q2 2009, consumption accelerated afterwards to 3.2% y/y in the following year. This time we expect consumption growing by no more than 1% in H1 - this is flat.



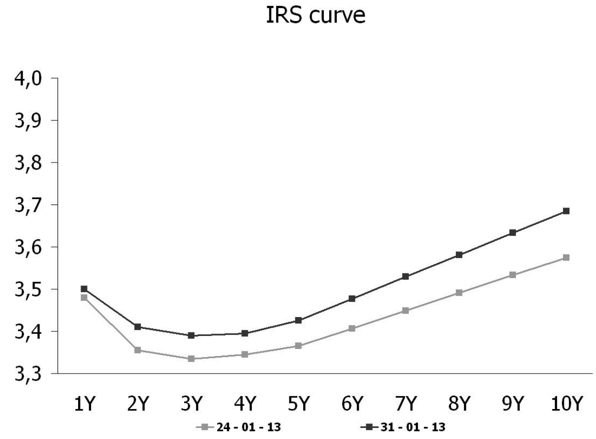
Tuesday's data and particularly a steep fall of consumption demand suggest shrinking inflationary pressures and perspectives for a substantial fall of inflation (including core one). It is a strong signal for continuation of monetary easing towards 3.25%.

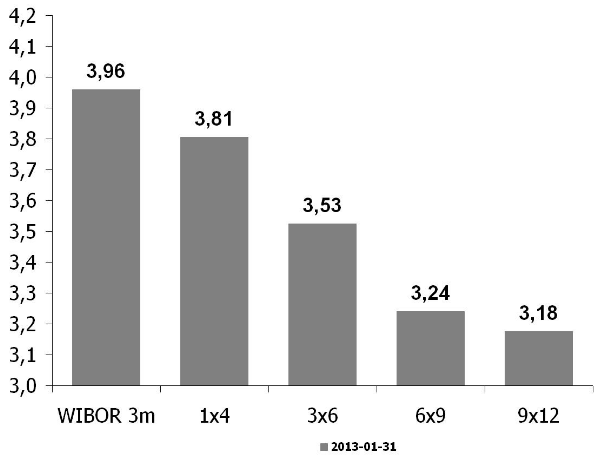
Zloty appreciated slightly just after the data (investors may have been positioned more negatively), short term rates rose a bit. We think the market concentrated on big 2012 numbers instead of Q4 momentum and its implications for H1 2013.

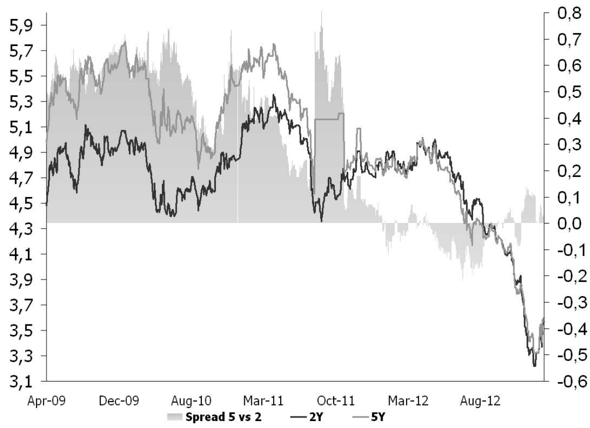
Fixed income

Flow-driven market

Last week was relatively quiet on PLN FI market, with rates and bonds fluctuating within narrow spreads, driven by flows solely. GDP data came out within market consensus and therefore didn't have much impact on the market. Results of December rate vote were quite surprising, as rate cut seemed to have been backed up mainly by the hawks. In addition, NBP Governor suggested during his speech in the Senate that Polish rates should be "relatively stable" within 3.50% - 4.75% range, which suggests that there's just two more cuts to go, yet the market still prices in rates at 3% by the end of the year. What's surprising is the flattening flow in 2y-5y sector that we've seen recently and almost flat forward curve in 1y-1y. We think that whether the market is right (and cuts will be deeper) or easing will stop sooner, normalization of the shape of the curve from the lowest point onwards is inevitable. Having covered 44% of this year's financing needs after January, the Ministry of Finance keeps offering relatively big amounts of bonds on tenders, with up to 12 bio across the curve to be auctioned in February. Though last sale was quite a successful one, we think that demand for POLGBs at current levels is very likely to be diminishing. All in all we should see some upward pressure on Polish rates along with steepening.



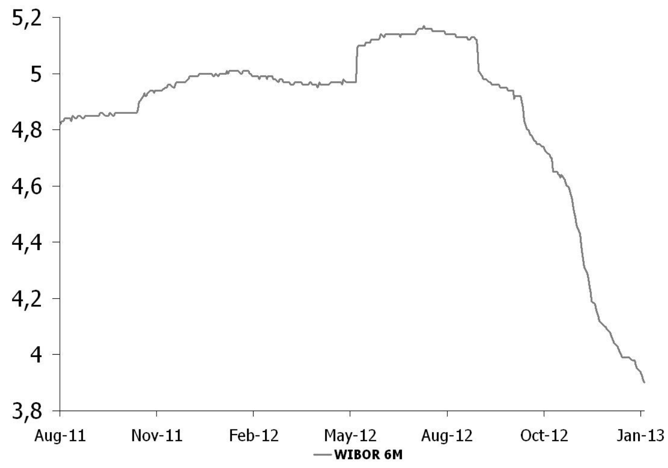


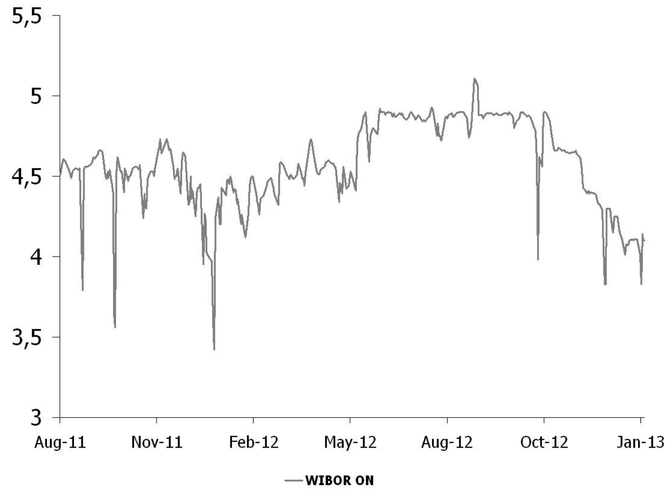


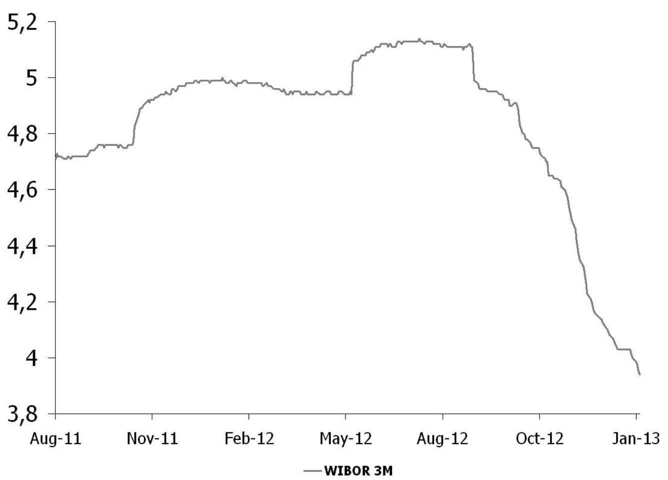
Money market

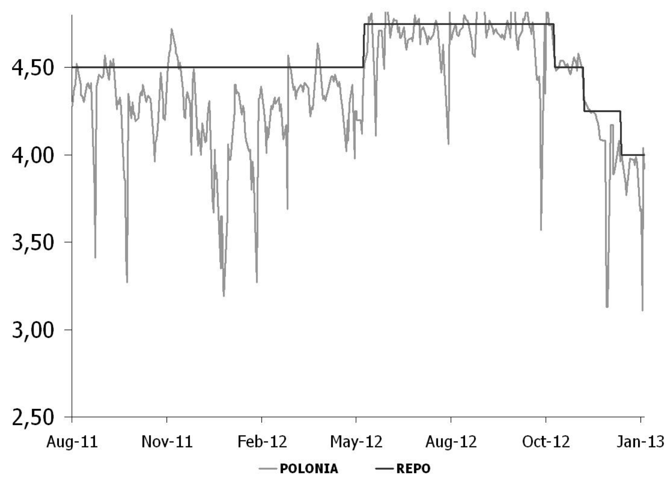
Market is square cash Market is pretty much square cash after today's OMO (126 bln pln), however we see much pressure on the offer side due to broadly expected rates cut next week. Therefore, cash will trade a bit cheaper that it would normally do.

Payers still attractive Two figures this week: GDP for 2012 and PMI for January. GDP was on the weak side, however better then expected. It proves the slowdown, however market wanted more pessimistic reading. PMI slightly below expectations and without any significant impact. All in all the week ends with much better paying interest and front end rates some 5 bps higher comparing to last week's closing. We consequently keep our view, which sees all value in keeping payers and increasing the pay position. Market still prices another 100 bps cut within next 6 months. We bet on 50-75 bps movement (February and March then a pause), which leaves enough space for payers to perform very well.





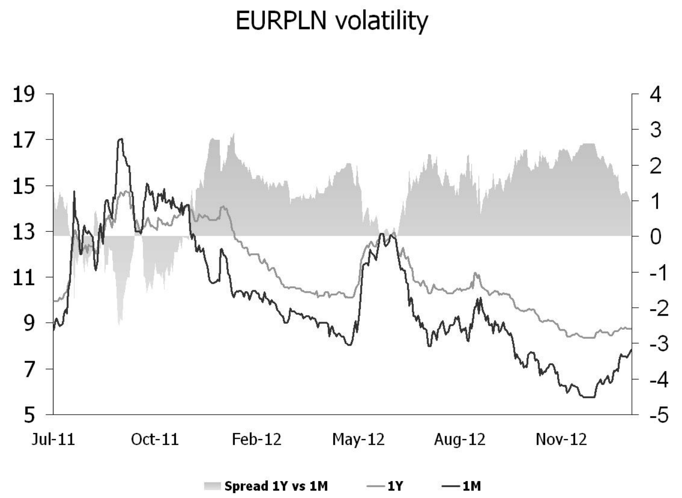




Forex

Range 4.165/4.215 We have formed new range 4.1650/4.2150, which contained this week's moves. The march north of EUR/USD and EUR/JPY was widely ignored by PLN, the correlation higher EUR/USD lower EUR/PLN seems to be getting out of fashion. The main event for the zloty is next week's (5th-6th February) MPC meeting. Everybody expects a 25bp cut, but the MPC conference will be closely watched for further hints.

Consolidation We have seen both way interest this week, with EUR/PLN and USD/PLN broadly unchanged from last week. The EUR/PLN ATMS benchmarks are: 1 month mid 7.6%, 3 month mid 7.7% and 1 year 8.7%. There are still selling currency spread mood (USD/PLN vol - EUR/PLN vol), with 1 month C/S traded at 3.5%. The skew is unchanged.

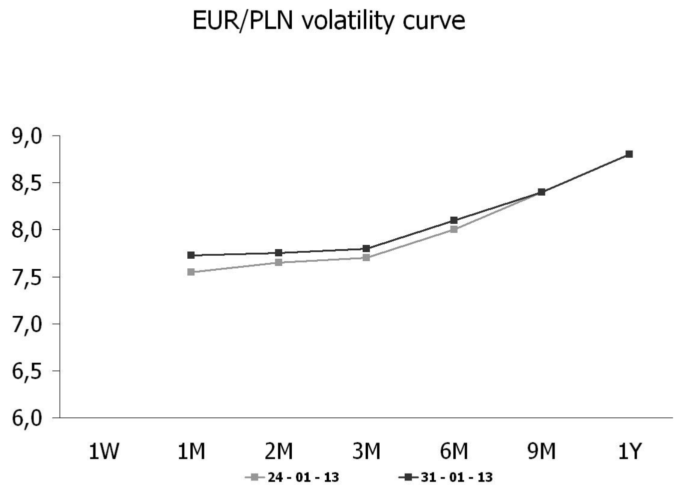


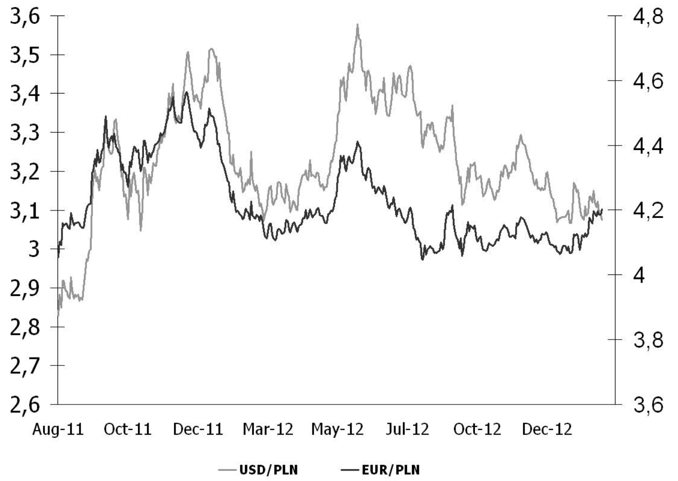
Short-term forecasts

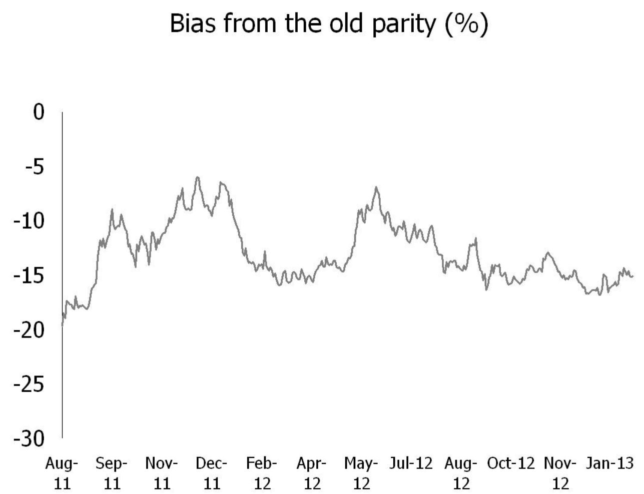
Main supports and resistances
EUR/PLN: 4.1300 / 4.2200
USD/PLN: 3.0600 / 3.2000

Spot After the week of consolidation around 4.20 we think to play range is the most reasonable approach. Buy EUR/PLN in 4.17/4.18 region with stop below 4.1550 and hopes for 4.21 or alternatively sell 4.21/4.22 with a stop above 4.2350 and eyes on 4.18. Keep disciplined stop, and stay alert during MPC conference.

Derivatives We are staring to think that selective longs in mid of the EURPLN curve are the position to have. We still need the 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
1/25/2013	3.70	4.00	3.67	6.49	3.58	6.59	3.80	3.52	3.23	3.16	3.17	3.25
1/28/2013	3.66	3.99	3.53	3.84	3.41	3.74	3.81	3.51	3.23	3.15	3.14	3.27
1/29/2013	3.79	3.98	3.65	3.83	3.58	3.73	3.81	3.51	3.19	3.14	3.10	3.23
1/30/2013	3.67	3.96	3.65	3.82	3.56	3.72	3.80	3.50	3.23	3.16	3.13	3.25
1/31/2013	3.65	3.95	3.60	3.81	3.52	3.71	3.81	3.53	3.24	3.18	3.16	3.27

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
1/25/2013	6.590	3.353	3.292	3.275	3.420	3.351	3.630	3.873
1/28/2013	3.740	3.114	3.263	3.148	3.370	3.270	3.575	3.755
1/29/2013	3.730	2.992	3.218	3.137	3.325	3.237	3.525	3.759
1/30/2013	3.720	2.992	3.218	3.137	3.325	3.237	3.525	3.759
1/31/2013	3.710	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
1/25/2013	7.50	7.65	7.95	8.75	8.75	3.10	0.67
1/28/2013	7.60	7.80	8.00	8.75	8.75	3.10	0.67
1/29/2013	7.68	7.85	8.00	8.75	8.75	3.10	0.68
1/30/2013	7.83	7.85	8.00	8.75	8.75	3.10	0.68
1/31/2013	7.73	7.80	8.10	8.80	8.80	3.10	0.68

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
1/25/2013	4.1903	3.1186	3.3680	3.4352	1.4092	0.1639
1/28/2013	4.1805	3.1074	3.3531	3.4243	1.4071	0.1634
1/29/2013	4.1969	3.1229	3.3763	3.4456	1.4110	0.1637
1/30/2013	4.1858	3.0938	3.3629	3.3870	1.4184	0.1633
1/31/2013	4.1870	3.0874	3.3890	3.3934	1.4318	0.1635

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