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Comment on the upcoming data and forecasts

On Tuesday in line with market concensus we expect improvement in the current transfers balance (more than 1 bn EUR), with practically no change in the income and services accounts. The trade balance should come with greater deficit due to significant drop of exports (already reflected in recent disastrous results of industrial production - monthly growth rates in many sections are lower by 10-15pp than in 2011). On Thursday NBP will publish money supply M3, which we expect to seasonally drop by 1-1,1% m/m. Deposits remain in the slow downtrend. The most important publication comes however on Friday - our forecast point to significant drop of CPI inflation below 2%, which mainly comes from 9% reductions in gas prices. Excluding food and fuels core inflation should come slightly higher (ca. 1.6-1.7%, publication in March) because of base effects after new price-list of refunded drugs introduced in 2012.

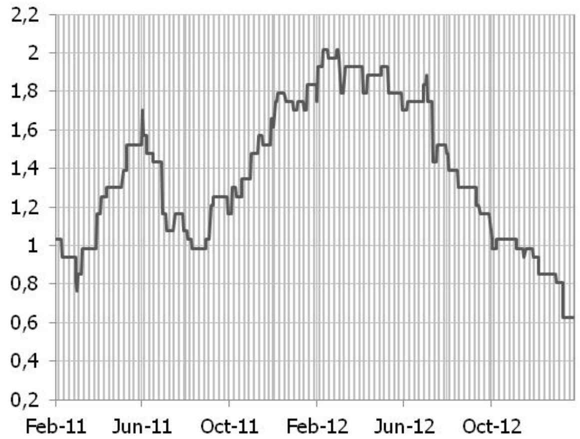
Polish data to watch: February 11th to January 15th

Publication	Date	Period	BRE	Consensus	Prior
Current account deficit (mln EUR)	12.02.	gru	-906	-851	-1490
Export (mln EUR)	12.02.	gru	10650	10884	13023
Import (mln EUR)	12.02.	gru	11300	11470	13417
M3 y/y (%)	14.02.	sty	4.2	4.3	4.6
CPI y/y (%)	15.02.	sty	1.8	1.9	2.4

Treasury bonds and bills auctions

Paper	Next auction	Last Offer	Last yield (%)	Prev auction
52 Week T-bills	-	1500	3.465	2/4/2013
2Y T-bond OK0715	2/13/2013	1300	3.285	1/23/2013
5Y T-bond PS0418	3/7/2013	4000	3.521	2/7/2013
10Y T-bond DS1023	2/13/2013	4000	3.847	1/7/2013
20Y T-bond WS0429	2/13/2013	4000	3.896	1/7/2013

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



Comment
Unchanged from last week with no macro publications and only MPC decision in the past week.

* 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 is still too optimistic.
- We expect Polish economy to enter recession in H1 2013 (negative GDP growth in y/y terms). External developments (moderate 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.
- A faster re-acceleration of the euro zone economy and low statistical base seem to be the most obvious reasons for a rebound of the Polish economy in H2 2013. However, given the scale of slack in investment and consumption any rebound generated this way may be only moderate (about 2%y/y growth rates in Q4 2013). 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 very hawkish but ... backward-looking so we expect rates to fall to 3.25%, as soon as weaker economy leaves its print on inflation.

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. 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.
- Fundamental reasons for lower yields in Poland stay intact but ... february more hawkish MPC statement a game changer for short term bonds.
- We still expect POLGB's to stay at historically low levels (10Y below 4.50% in yield). As Polish bonds relative valuations look stretched and global recovery is set to continue Polish yield curve should eventually steepen.
- 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	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	-0.6	-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	3.50	3.50	3.50
2Y Polish bond yields (% eop)	4.62	4.60	4.05	3.14	3.30	3.30	3.40	3.40
10Y Polish bond yields (% eop)	5.50	5.15	4.69	3.74	4.00	4.00	4.10	4.30
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

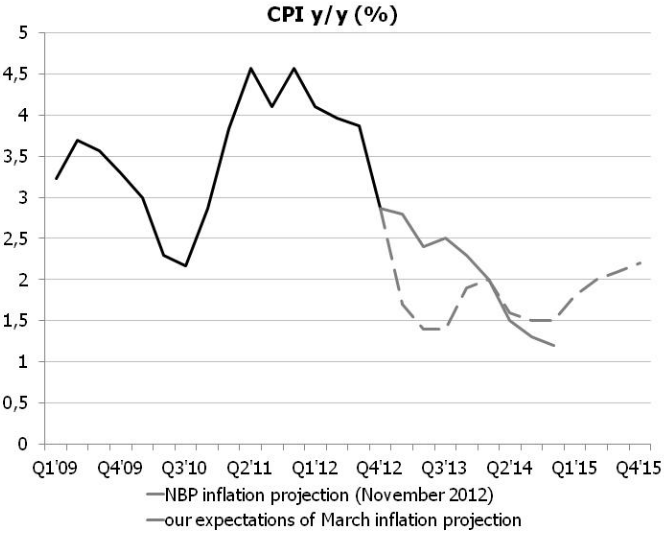
MPC cut rates by another 25bp. and surprises again by its hawkishness

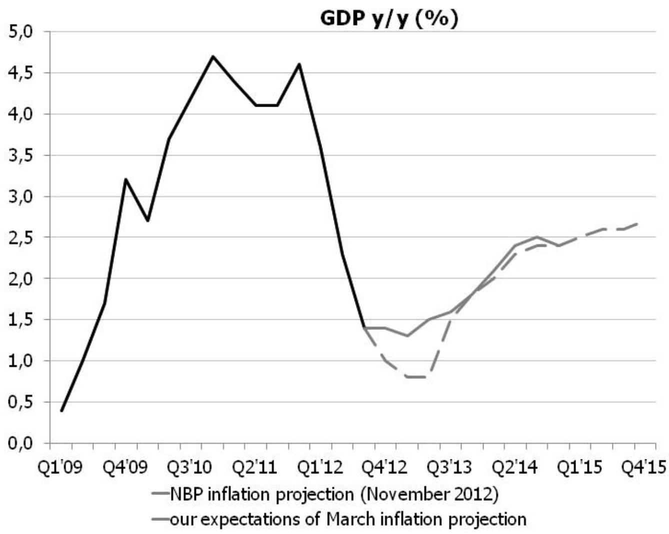
In line with market expectations MPC cut interest rates by 25bp. to 3.75% and again revealed rather gloomy assessment of economic activity in Poland. However, similarly to the previous month MPC surprised by excluding word „easing” from the last sentence regarding possible future decisions - instead of the January „the Council does not rule out further monetary policy easing” they stated that „Decisions of Council in the following months will depend on the assessment of the incoming data on economic developments and inflationary pressure, including the results of the March NBP macroeconomic projection.” Obviously such a change should be read as hawkish.

During the conference Belka tried to impair the strength of this last sentence by stressing that MPC has not change its easing bias to neutral and does not rule out another rate cut in March (to quote „any move but hike is possible in March”). Belka also repeatedly pointed to tentative signs of economic stabilization, but these related mainly to foreign demand (e.g. surprisingly and contrary to our calculations saying that in Q4 2012 quarterly GDP growth was higher than in Q3). The impression is that MPC’s hawkishness (it hardly surprises in the other direction) is based mostly on the anticipated developments in both global and domestic (in the second half of this year) economies and not the current situation. It is possible that the Council’s desire for achieving wider consensus brought the neutral proposition of next decision dependence on March inflation projection.

Then, how will the March projection look like? Let’s estimate possible outcomes. Compared to November the starting point will be lower for both GDP and inflation projection implying lower forecasts of both variables in 2013. GDP path should be lower (but not significantly) in the whole forecast horizon. Inflation paths from March and November projections might meet (or even cross) in 2014 due to base effects from 2013 (decreases of gas prices). The newly published forecasts for 2015 should point to CPI return near (but below) the NBP target rate.

Presented estimates of March projection should support March rate cut, but as always it may bring various interpretations (in 2012 MPC was still tightening monetary policy seeing inflation projection path falling below target in 2014). Still, March remains the one reasonable moment for another rate cut not only justified by new projection, but also with the accurate rate level of 3.5% (as pointed by several Council members) MPC could prepare the market for longer break in the easing cycle with much more hawkish rhetoric (from reputational reasons to be expected regardless the decision itself). Such a sequence preceded by better data from the real sphere published in February and a trend on core markets to mute monetary policy easing should reduce expectations for more rate cuts during current cycle in Poland. Nevertheless, regarding drop of inflation below NBP target range in Spring and lasting recession in internal demand (which became reality yet in Q3 2012) we stick to our scenario of 3.25% rate level with the risk coming from specific decision criteria among MPC members (only to mention Taylor rule results). Such a divergence supported by current surprisingly hawkish rhetoric will surely lead to correction of already aggressive rate cut expectations.

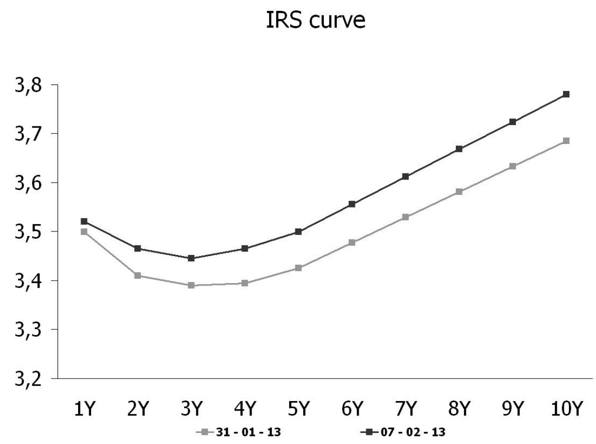


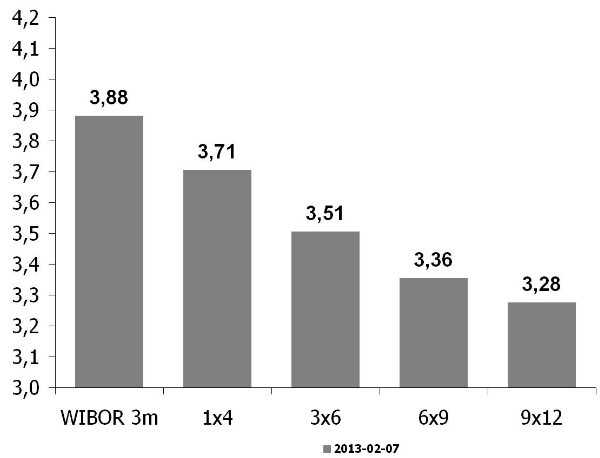


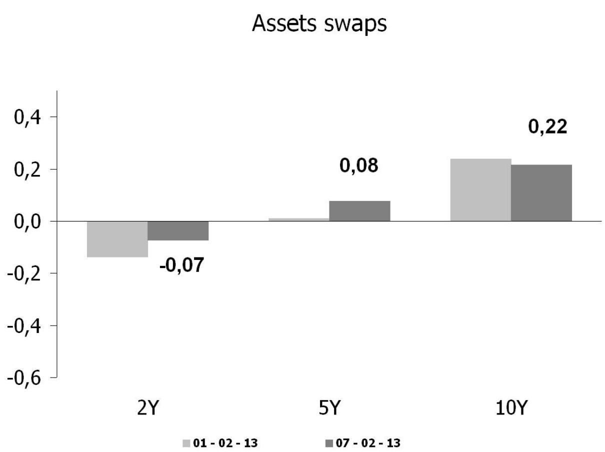
Fixed income

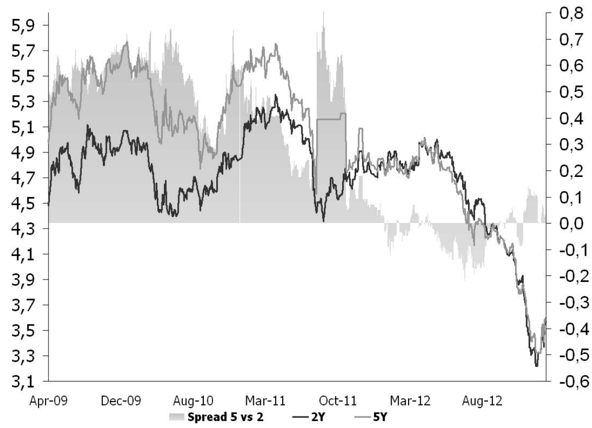
Time to pause?

The MPC meeting did not surprise the market (25bp cut broadly expected) but proved the easing cycle might come to its end in the near future. As we suggested couple of weeks ago the Council was not eager to cut the main rate below 3.50% even though we could face further signs of the economy slowdown in next months. The impact on a yield curve was quite moderate assuming the curve had still 3.00% intervention rate implied. The longer FRA rates went up by 10bp with the Wibor rates slightly down that made the curve more positive or in other words „less inverted one”. To our surprise the market still believes the coming poor economic data would force the Council to lower rates further. Moreover, looking at FRA rates from 3x6s to 9x12 only 2.75% or lower main rate would justify to take a receive position then. Taking into consideration we had 100bp cuts behind us and a psychological 3.50% bottom rate in Poland according to what the governor Belka tried to aware the market of we could see a quite high probability the pause in March. If we were right there might be a huge value to pay any rates on the curve, especially up to 2Y. The recent MinFin announcing it might switch from 10y to short end financing would help here for sure.







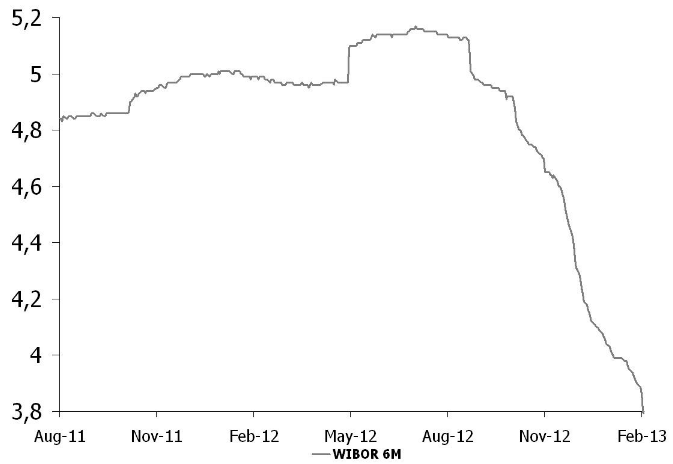


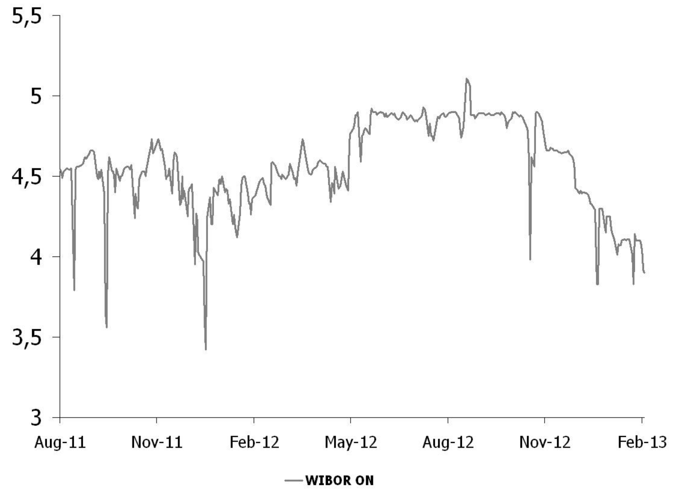
Money market

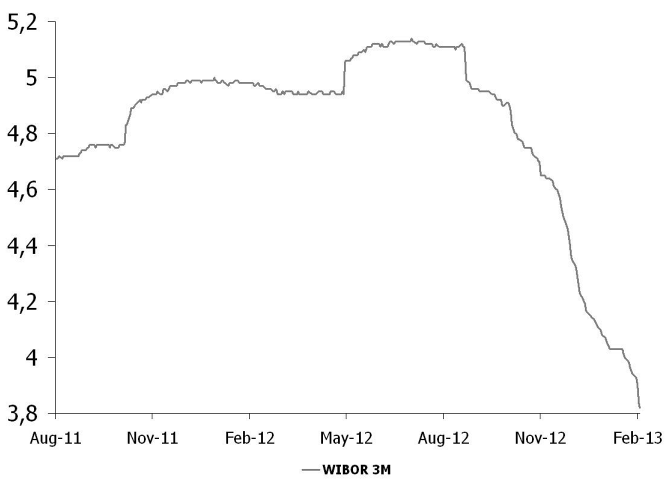
Stable cost of carry Cash stable with the more or less squared system. Today's OMO brought 123,5 bln pln supply and was fully absorbed. This also leaves the market square for coming days.

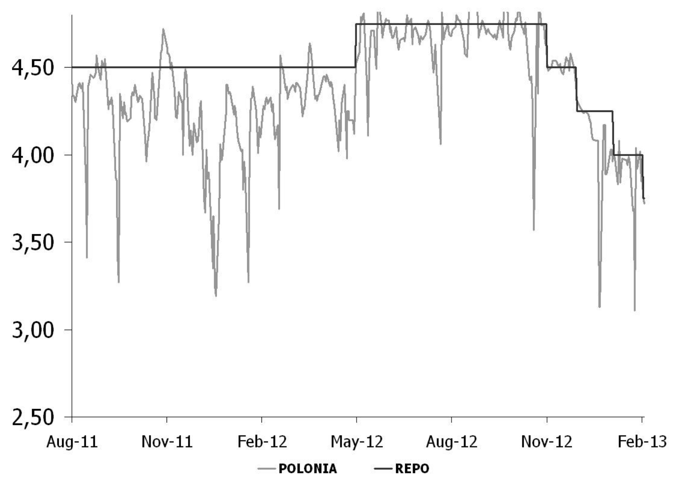
Rates down by 25 bps The MPC cut all rates by 25 bps in line with expectations. The conference was on the dovish side (comparing to the last one) but more and more we have „the pause" wording at the back of our heads. Therefore, we still see value in keeping the payers. The March meeting bet is like flipping the coin at the moment, hence the scale of the cycle play is more reasonable then timing itself.

T-bills only for liquidity managers We also had second this year T-bills auction (5M papers this time) and second time it went expensive (3.465%). It may suite for liquidity management purposes, however for trading the negative cost of carry makes it useless.





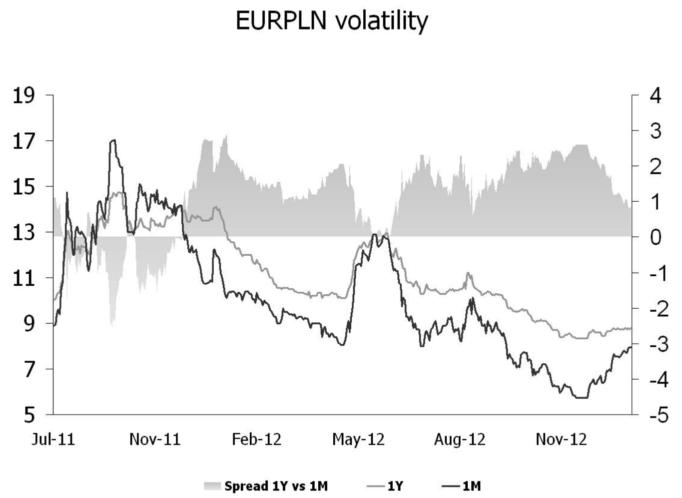




Forex

Choppy in range We have started the week with the enormous PLN buying flow, which took EUR/PLN from high 4.2080 on Friday to 4.1350 on the Monday morning. There was same buying interest from the lows and we reached back to under the 4.20 till the MPC spoke up with less dovish tone. The bigger picture is that we are still in the wide 4.15/4.20 range and the move to 4.1350 was the false break due to the customer flow only. Less dovish MPC and more dovish EBC suggest however we may see a PLN uptrend slowly gathering momentum.

Tic higher frontend The frontend was well supported, because of the healthy EUR/PLN moves, gamma was worth heaving. The 1 week EUR/PLN is higher by ca. 1.0% and now 8% mid, the 1 month EUR/PLN mid is 0.2% higher, 7.8% mid today, the rest of the curve is roughly unchanged with EURPLN 6month ATM mid 8.1% and 1 year EURPLN ATM mid 8.7%. The skewness is roughly unchanged, but the currency spread (USD/PLN vols minus EUR/PLN vols) found more sellers (1 month c/s was given at 3.6%) and we feel it is well offered.

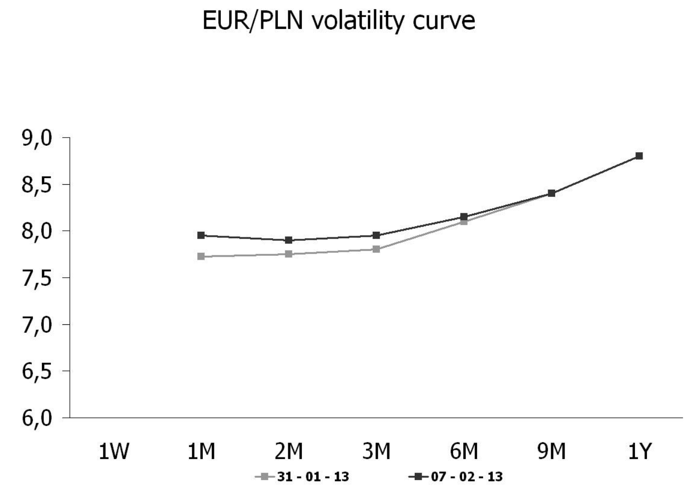


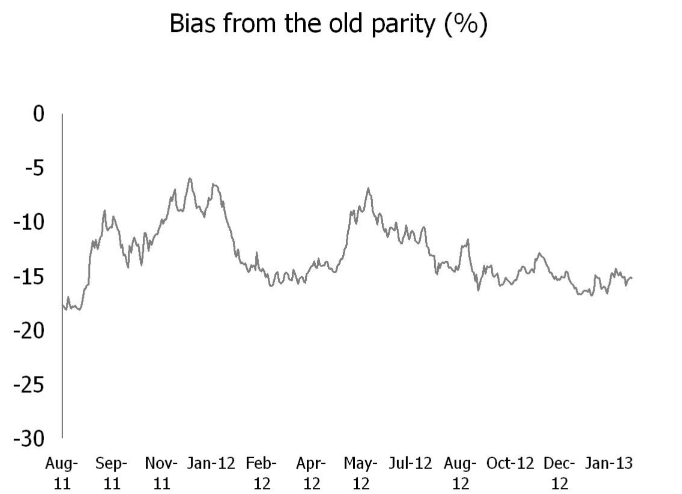
Short-term forecasts

Main supports and resistances
EUR/PLN: 4.1400 / 4.2100
USD/PLN: 3.0000 / 3.2000

Spot We think the less dovish MPC and more dovish ECB should support PLN versus EUR in the mid term. It will not be a straight, fast move but a slow bumpy slide, and the negative correlation with Polish government bonds may as well come back „to be played". Because of the above, we prefer to sell 4.1800/4.2000 zone with a stop above 4.2100 and hopes for a move below 4.1400.

Derivatives The higher realized volatility for the frontend is a very constructive sign supporting EUR/PLN volatility curve. We are starting to think that selective longs in the mid curve of EURPLN are the position to have. 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
2/1/2013	3.65	3.94	3.58	6.49	3.48	6.59	3.79	3.52	3.24	3.18	3.15	3.27
2/4/2013	3.61	3.93	3.50	3.79	3.42	3.69	3.80	3.51	3.26	3.17	3.14	3.27
2/5/2013	3.56	3.92	3.57	3.78	3.50	3.68	3.77	3.49	3.26	3.16	3.14	3.28
2/6/2013	3.63	3.88	3.57	3.74	3.52	3.66	3.74	3.58	3.32	3.24	3.23	3.33
2/7/2013	3.52	3.84	3.52	3.70	3.50	3.60	3.71	3.51	3.36	3.28	3.26	3.36

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
2/1/2013	6.590	3.353	3.292	3.275	3.420	3.351	3.630	3.873
2/4/2013	3.690	3.114	3.263	3.148	3.370	3.270	3.575	3.755
2/5/2013	3.680	2.992	3.218	3.137	3.325	3.237	3.525	3.759
2/6/2013	3.660	2.992	3.218	3.137	3.325	3.237	3.525	3.759
2/7/2013	3.600	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
2/1/2013	7.70	7.80	8.10	8.75	8.75	3.03	0.67
2/4/2013	7.93	7.95	8.15	8.80	8.80	3.03	0.67
2/5/2013	7.95	8.03	8.20	8.75	8.75	3.34	0.79
2/6/2013	7.95	7.95	8.15	8.80	8.80	3.02	0.67
2/7/2013	7.95	7.95	8.15	8.80	8.80	3.02	0.67

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
2/1/2013	4.2028	3.0744	3.3991	3.3344	1.4376	0.1636
2/4/2013	4.1515	3.0563	3.3564	3.2807	1.4206	0.1620
2/5/2013	4.1700	3.0831	3.3929	3.3215	1.4246	0.1626
2/6/2013	4.1801	3.0868	3.3841	3.2936	1.4231	0.1624
2/7/2013	4.1882	3.0886	3.4017	3.2912	1.4240	0.1659

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