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Comment on the upcoming data and forecasts

More data from the real sphere. High statistical base effects in mining and continued downtrend in manufacturing are likely to bring down annual wage growth even lower, with only a slight cushion from positive working day effects (+1 y/y, +3 m/m). Negative trends in employment are bound to continue as well - we expect a slightly deeper fall than in December. However, this time it is all about the change of sample at the start of each year - so do not jump into conclusions should data diverge because probably it would indicate nothing fundamentally important. On Tuesday the Central Statistical Office will publish figures on industry. We predict that industrial output dynamics slightly rebounded in January on a positive difference in working days. The headline figure is unlikely to be anywhere near zero, though. Continued slump in industrial output is accompanied by (and clearly having an impact on) broadening PPI deflation (virtually unchanged exchange rates and commodity prices).

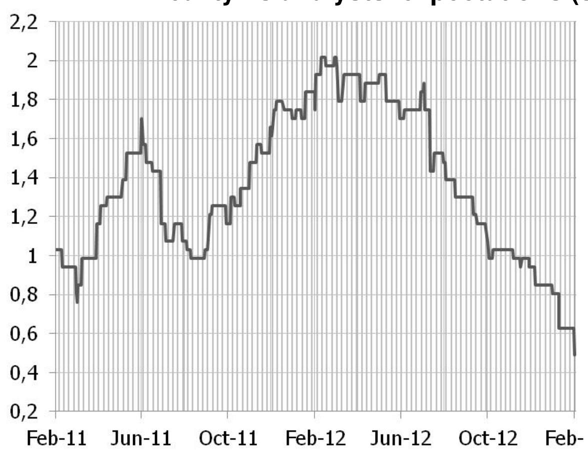
Polish data to watch: February 18th to February 22th

Publication	Date	Period	BRE	Consensus	Prior
Corp. wages y/y (%)	18.02	Jan	2.0	1.0	2.4
Corp. employment y/y (%)	18.02	Jan	-0.6	-0.9	-0.5
Industrial output y/y (%)	19.02	Jan	-2.5	-2.8	-10.6
PPI y/y (%)	19.02	Jan	-1.3	-1.1	-1.1
Construction output y/y (%)	19.02	Jan	-18.0	-19.7	-24.8

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	-	3000	3.456	2/13/2013
5Y T-bond PS0418	3/7/2013	4000	3.521	2/7/2013
10Y T-bond DS1023	-	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
Down again because inflation decelerates even faster than analysts anticipate. Next week brings important releases from the real sphere - surprises should be smaller than one month ago as analysts seem to finally internalize the depth of current slowdown (but maybe not entirely).

* 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

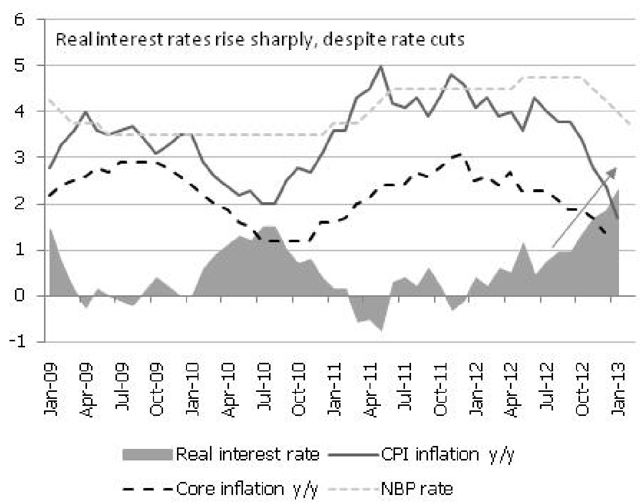
F - forecast

Economics

Inflation fell to the lowest level in 5 years

CPI inflation hit 1.7% y/y in January, down from 2.4% in December (our call was for 1.8%). As is always the case in January, official breakdown of inflation is scarce. We know for sure that food prices went up by 1.2% m/m (therefore the risk stemming from regional food surprises materialized), clothing and footwear prices shed 3.4%, housing cheapened by 0.1% and transport by 0.6%. The effect of lower gas prices and fuel prices is evident. However, also core categories are under disinflationary pressure which we expect to continue, although we cannot pin down the exact core inflation number for January.

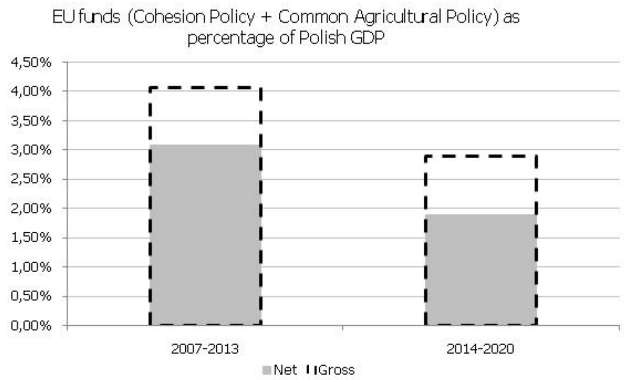
We expect that next month's are likely to bring further easing in inflationary pressures. So far we failed to detect and significant and persistent upward pressure on food prices (the last surprise may owe much to the "start-of-the-year" effect), and disinflation in core categories is strong. However, there will be some variation connected with the change of consumption basket. Basket exchange is going to influence only the level of inflation, not the overall tendency.



After the publication the yield curve shed several basis points (the front end reacted proportionally more, even 8bp). Knee jerk reaction on the zloty stopped at slightly above 4.19. We think that the fresh data increase the likelihood of a rate cut in March even considering the fact that Mr Winiecki is not going to be ousted from the MPC. Green light for cuts should be given not only by the inflation projection (it may be U-shaped but monetary policy relevant horizon is expected to be still well anchored), but also by the fact that the MPC is still chasing inflation - as mirrored in rising real interest rates (see the graph). Therefore we think that the current rates level is going to be deemed insufficient to stimulate the economy. All in all we expect MPC to proceed with 25bps cut.

New EU budget - the devil is in the details

The results of the last EU summit were welcomed as a great success on behalf of Prime Minister Tusk and the Polish government. On the surface, they are indeed impressive. Despite significant pressure to reduce EU expenditures resulting in a smaller overall budget (for the first time in history), Poland managed to increase its share in EU expenses, securing a sizeable 106 bn EUR (constant prices) for years 2014-2020 (as compared to 102 bn in years 2007-2013). Later this week, Piotr Serafin, Deputy Minister of Foreign Affairs clarified that the actual amount might exceed 500 bn PLN and that only a slight increase in Poland's contribution to the EU is projected by the government. A closer investigation reveals several drawbacks of the deal.



First, Poland's economy has grown significantly since the beginning of the previous EU programming period and growth is set to continue to grow in the coming years. Thus, EU funds granted to Poland in the coming years are bound to be smaller in relation to the size of the economy. This effect will be enhanced by nominal appreciation of the Zloty, as the exchange rate is obviously the key parameter that determines how large EU expenditures in Poland will actually be. Assuming a modest appreciation path for EURPLN (3.80 in 2020), we estimate that funds-to-GDP ratio will decrease from 4.1 to 3.2% (net from 3.1 to 2.2%). A more dynamic appreciation, such as one projected by the Ministry of Finance itself (ca. 3.50 in 2015 already), would bring this ratio even lower.

Second, the 106 bn figure is the gross amount. Poland also contributes to the EU budget and net EU expenditures are those that matter most. If we assume the contribution to remain at 1% of GDP, as it has been in case of "older" EU members, and adopt a modest scenario for GDP, we will arrive at a 40% increase in total contribution - from 23 to 33 bn EUR (constant prices) over the entire period. Even Mr Serafin's estimate of 30bn is still an increase greater in magnitude than the increase in gross EU funds. Thus, net payments from EU budget should drop regardless of unit of measure. Our estimates put the decrease at 10%.

Last but not least, there is the question of macroeconomic impact of the new package. As the shape of new operational programmes is yet unknown, we can only make educated guesses regarding the structure of new EU funds . Certain shifts from

[1]Models employed by the Ministry of Regional Development suggest that EU funds managed to increase GDP growth by as much as 1.8 percentage points at peak (2009). Projections for years 2014-2020 indicate

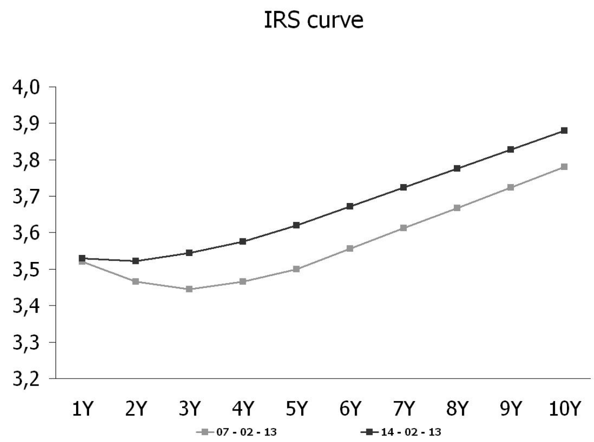
demand-boosting infrastructural investments toward innovation and R&D support, and from non-reimbursable grants to loans and guarantees, have already been signalled. Thus, the immediate impact might be even smaller in magnitude than simple comparison of funds-to-GDP ratios would suggest. Trivial arithmetic suggests that impact on GDP growth rate (but not on GDP level) might turn negative as soon as in 2016. Long-term effects depend on how well the government manages the aforementioned transition. A recent report by the World Bank makes it painfully clear that innovation support system is far from effective at the moment.

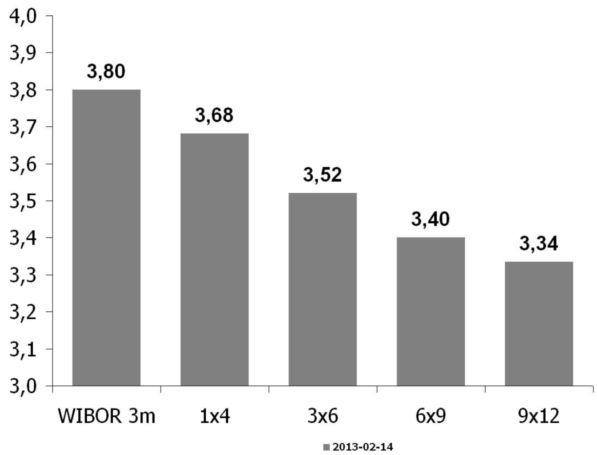
much smaller or even negative deviations from baseline growth path.

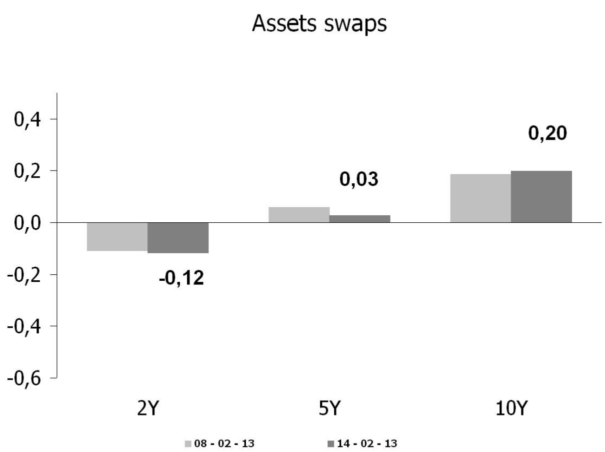
Fixed income

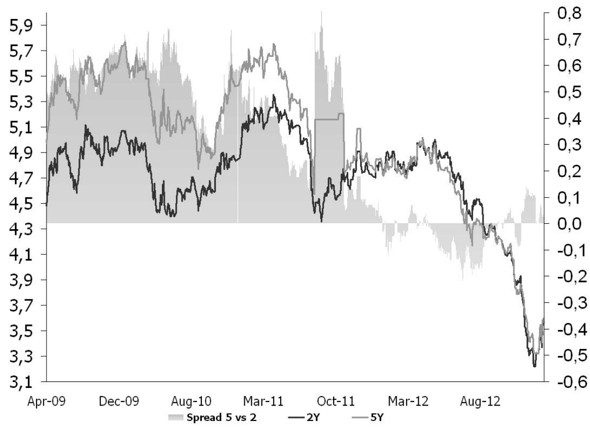
Lower CPI

Upside pressure on the rates continued this week, especially in the front end. 2Y an 5Y moved up by some 10bp, 5y10y flattened by few bps. All in all the move has been noticeable so far, as front end forwards moved by ca. 40bp from this year's lowest levels, which called for some correction ahead of data. In the meantime, awaited ruling in MPC Winiecki's case have been announced; being found not guilty means no change in the Council and therefore with every next cut, support for further easing will be harder to find. Nevertheless as recent CPI reading surprised on the downside (1.7% vs 2.0% expected) comments from rate setters shifted towards more dovish once again. All in all it seems we are in the part of the cycle when data matters the most, but even if those keep coming on the soft side, we think downside potential is quite limited - we expect rates to stay in a range for a while here, think we've just seen the upper range, on further strengthening, we'd be looking to pay the bottom.





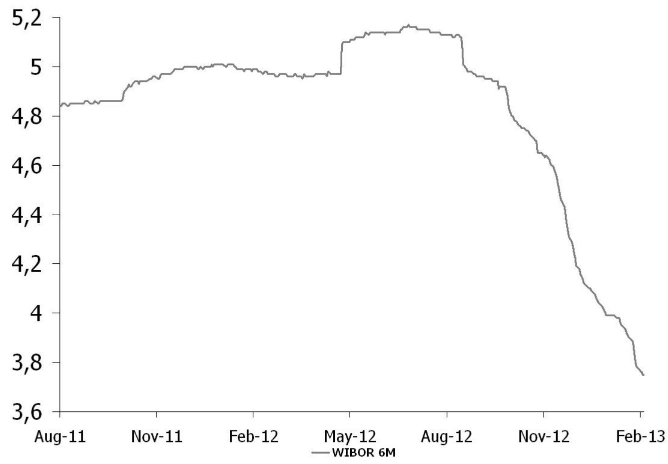


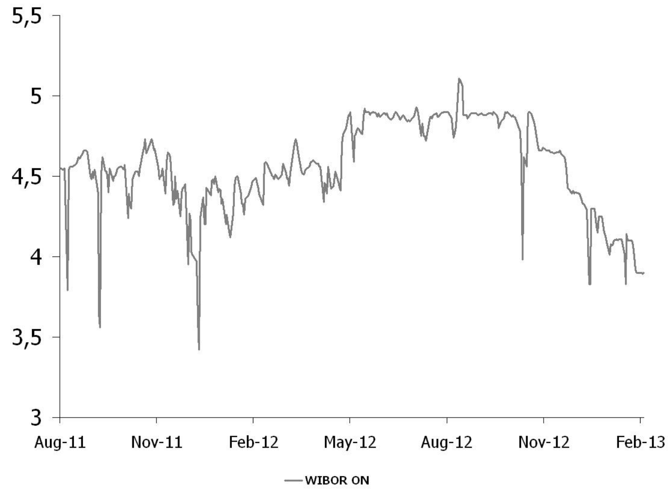


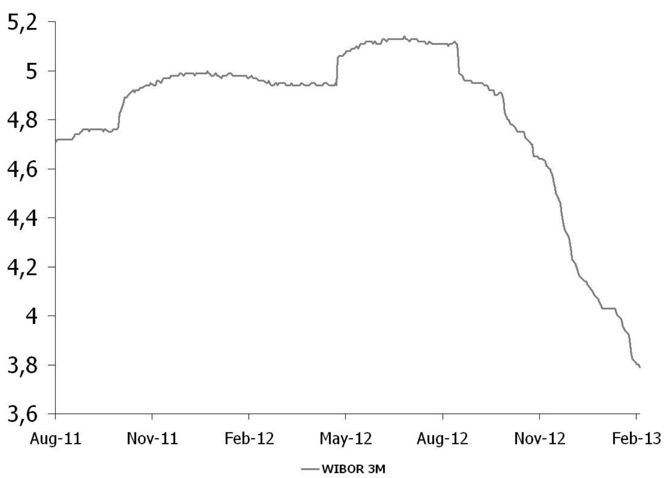
Money market

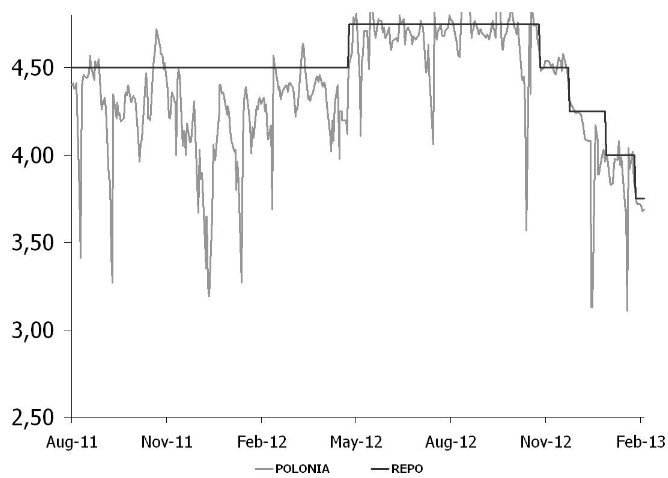
Polonia should be lower next week Lower intake of money bills during today's OMO (120 vs 122 bln pln on the offer) should make the lowest rates go a bit down. We think that Polonia index has a good chance to drop by around 10 bps from now during the coming days.

Surprisingly low CPI Bearish sentiment dominated this week (MPC member trial result was broadly awaited, "not guilty" cut the story about dovish wing being strengthened by a new member), until CPI reading today afternoon. 1.7% was lower even comparing to the softest forecasts and it caused a sharp front end reaction. Curve lost around 10 bps. We still think that payers are the right position (curve prices 50-75 bps of further fast easing) and tend to use any substantial drop to increase the bet.







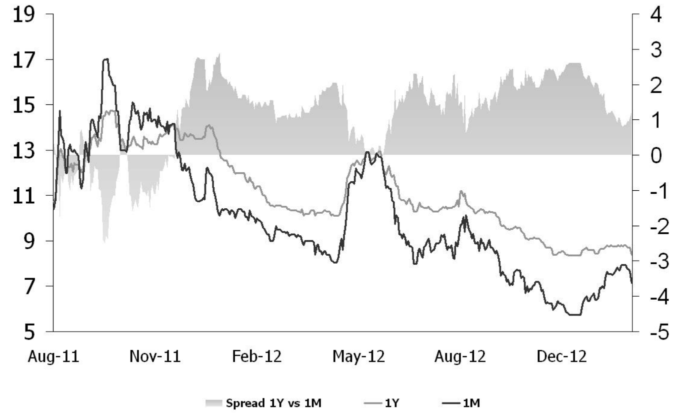


Forex

Going nowhere 4.1400 - 4.1900 range holds for another week. And there is very little to say about that, EUR/PLN is being dragged and pulled by flows, the once forgotten negative correlation with Polish bonds is back. But to be very honest, we are trading water and we think it will continue. Or in other words we see no game changing event on the horizon.

USD/PLN vol is on sale The inability of EUR/PLN to break out of range finally translated in to the move lower in EUR/PLN vols. The 1 month was given at 7.3% in good amount and the whole curve adjusted to the lower levels (1 month EUR/PLN ATM mid is now 7.1%versus 7.8% last week, 3 month is now 7.4% roughly 0.4% lower and 1 year fixed 0.2% lower at 8.5%). The sell-off in USD/PLN was much deeper and it was not only the AMTs (1 year given at 13.40% and 3 month given at 11.35%) but also skew 3 month 25 delta R/R given at 1.8 (flat with EUR/PLN!). The move was quite impressive but looks justified from the point of view of the correlation map.

EURPLN volatility



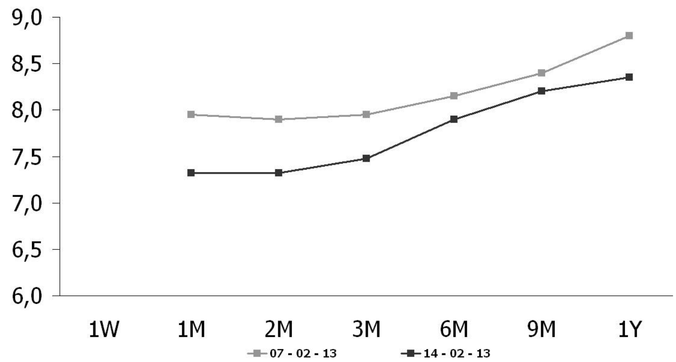
Short-term forecasts

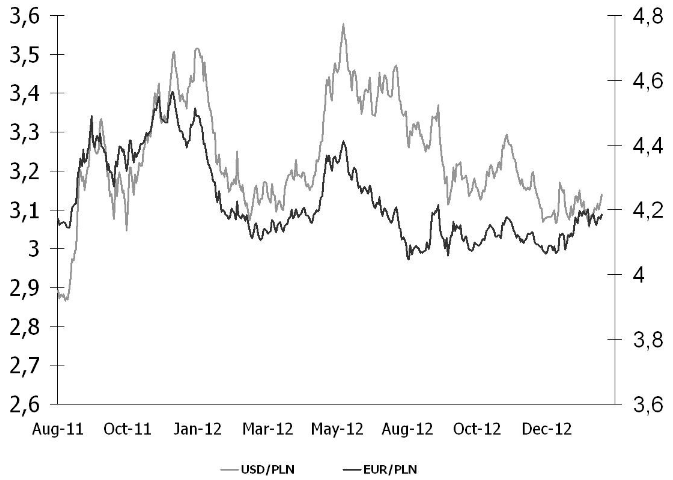
Main supports and resistances
EUR/PLN: 4.1400 / 4.2100
USD/PLN: 3.0000 / 3.2000

Spot We still think playing the range is still the name of the game. We have a small preference to fade tops 4.19/4.21 with a stop above 4.23, and hopes for 4.14. The support zone (4.115/4.135) is a buy level for EUR/PLN with stop below 4.10 and eyes on 4.18+.

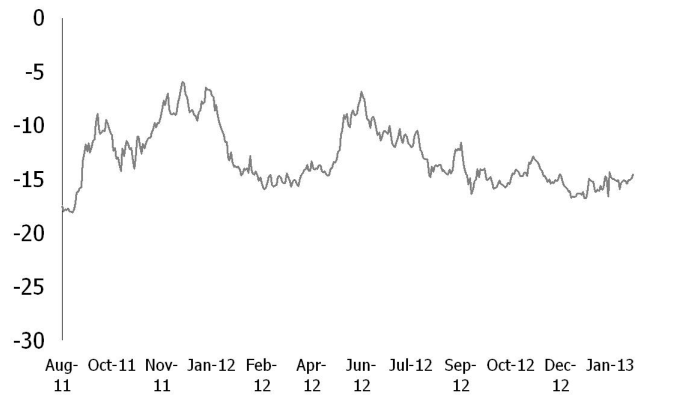
Derivatives The current sell-off in vols does not really change the bigger picture, in general current levels are ultra low and close to pre-Lehmann. We think that selective longs in mid curve of the curve of EURPLN are the position to have. We still need confirmation from the realized volatility to show more aggressive bids on the market. The preferred strikes are close to ATM.

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
2/8/2013	3.61	3.82	3.61	6.49	3.53	6.59	3.71	3.52	3.36	3.28	3.26	3.39
2/11/2013	3.55	3.81	3.49	3.67	3.47	3.58	3.70	3.53	3.41	3.33	3.34	3.45
2/12/2013	3.57	3.80	3.56	3.66	3.55	3.57	3.69	3.53	3.40	3.34	3.36	3.42
2/13/2013	3.58	3.80	3.56	3.66	3.54	3.57	3.71	3.53	3.41	3.33	3.36	3.45
2/14/2013	3.61	3.80	3.60	3.65	3.53	3.56	3.68	3.52	3.40	3.34	3.34	3.47

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
2/8/2013	6.590	3.353	3.292	3.275	3.420	3.351	3.630	3.873
2/11/2013	3.580	3.114	3.263	3.148	3.370	3.270	3.575	3.755
2/12/2013	3.570	2.992	3.218	3.137	3.325	3.237	3.525	3.759
2/13/2013	3.570	2.992	3.218	3.137	3.325	3.237	3.525	3.759
2/14/2013	3.560	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
2/8/2013	7.75	7.85	8.15	8.70	8.70	2.95	0.67
2/11/2013	7.75	7.85	8.15	8.70	8.70	2.95	0.67
2/12/2013	7.65	7.85	8.15	8.70	8.70	2.97	0.68
2/13/2013	7.15	7.35	7.80	8.40	8.40	2.89	0.68
2/14/2013	7.33	7.48	7.90	8.35	8.35	3.10	0.79

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
2/8/2013	4.1670	3.1056	3.3884	3.3504	1.4244	0.1652
2/11/2013	4.1519	3.0991	3.3823	3.3259	1.4257	0.1644
2/12/2013	4.1686	3.1159	3.3909	3.3128	1.4281	0.1648
2/13/2013	4.1781	3.1012	3.3788	3.3248	1.4407	0.1646
2/14/2013	4.1715	3.1209	3.3853	3.3357	1.4267	0.1643

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