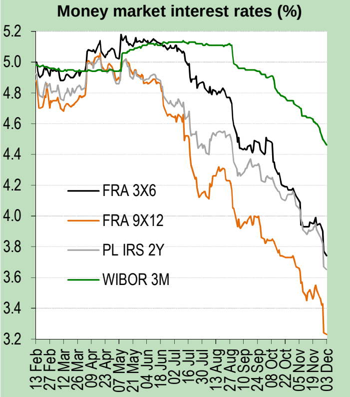
Rates and FX Outlook

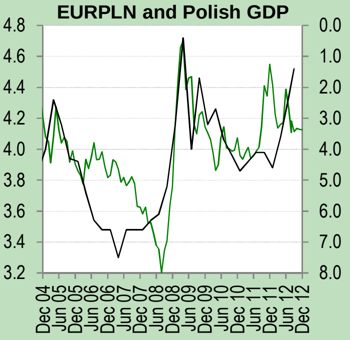
Polish Financial Market

December 2012

Money market interest rates (%)



EURPLN and Polish GDP



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- **At the start of November the Monetary Policy Council cut main interest rates by 25bps (bringing the reference rate to 4.50%) and announced the beginning of monetary easing cycle.** The Council's decision was supported by the results of November's projections of inflation and GDP, showing a marked slowdown in economic growth and drop of inflation significantly below the target in the medium run. The overall scale of interest rate cuts in the cycle has not been clearly specified. The comments of MPC members suggest quite wide range of possible cuts, between 50 and 125bps, and the market expectations are close to the upper limit of the range. After release of weaker than expected Q3 GDP data, the expectations for deeper monetary policy easing intensified. **We predict another rate cut by 25bps in December** (which is consistent with market consensus)**, and the next one most likely in January. After publication of next NBP's projections in March the Council will probably continue monetary easing, bringing the NBP reference rate to 3.5% by April.**
- **The Q3 GDP data was a negative surprise, showing growth of only 1.4%YoY, and a general weakness of domestic demand.** The biggest disappointment was a sudden stop in private consumption, which rose by merely 0.1%YoY. The data for the third quarter, together with recent monthly statistics, triggered another downward revision of our economic forecasts for this and next year. It seems likely that the bottom of economic cycle is still ahead and GDP growth may get close to zero at the start of 2013, after which a gradual recovery is possible. At the same time, **inflation rate will continue downward trend started in October, falling to 2.8% in November and below the 2.5% inflation target at the very start of 2013**.
- **Polish bond market has rallied in November and, in our opinion, there is still some room for lower rates across the curve.** However, December's MPC decision in line with expectations might cause a short-lived correction. We believe that even though a series of interest rate cuts is already priced-in, bond market will remain strong (at least) until year-end.
- **Ahead of the MPC decision the zloty slightly weakened in relation to the main currencies.** However, we think that a conservative cut by only 25bps may be supportive for the zloty, with a possibility of testing 4.10 by the EURPLN. All in all we forecast EURPLN at 4.13 on average in the last month of the year.

This report is based on information available until 3rd December

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Short- and Medium-term Strategy

Interest rate market

	Change (bps)		Level	Expected trend	
	Last 3M	Last 1M	end-November	1M	3M
Reference rate	-0.25	-0.25	**4.50**	↘↘	↘↘
WIBOR 3M	-50	-24	**4.49**	↘	↘↘
2Y bond yield	-73	-50	**3.34**	↘	→
5Y bond yield	-80	-52	**3.55**	↘	→
10Y bond yield	-85	-55	**4.01**	→	→
2/10Y curve slope	-12	-5	**67**	→	→

Note: Single arrow down/up indicates at least 5bps expected move down/up, double arrow means at least 15bps move

Rates: our view and risk factors	
PLN rates market	**Money market:** We uphold our view that WIBOR rates will continue gradual decline, adjusting to the NBP reference rate. However, after December's MPC decision to cut rates by 25bps we do not rule out some profit taking, especially on the FRA market, which is pricing-in more aggressive monetary easing after weak Q3 GDP data. Any correction should be only short-lived.
	Short end: The front end of the curves (both bond and IRS) have continued to benefit from interest rate cut expectations, reaching new all-times low. We see potential for a bit higher yields if the MPC cuts rates in line with our expectations (only by 25bps) this month, but correction should be short-lived and yields will return to gradual decline trend.
	Long end: November brought further decline in yields to all-time lows on the mid and long-end of the curve. We foresee this trend to continue also in the last month of the year. However, the scope of decline in yields of 10Y might be limited by situation on Bunds.
	Risk factors to our view: We think that the MPC will deliver a 25bps rate reduction this month. However, if the MPC decides to change rates more aggressively than predicted, yields would probably test new historic lows. We think the scenario assuming that the MPC will keep rates unchanged is rather unlikely taking into account growth and inflation outlook.

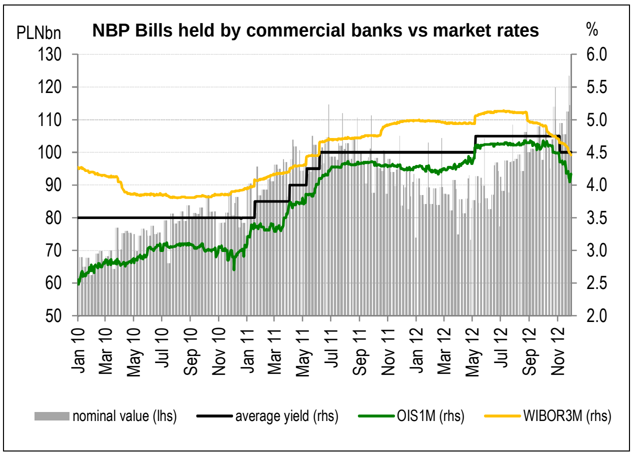
FX market

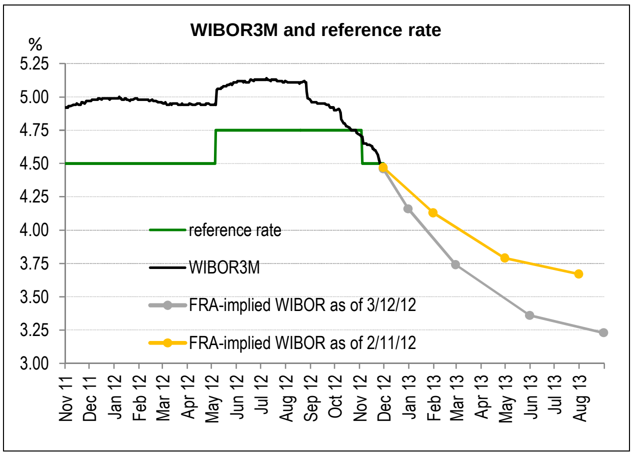
	Change (%)		Level	Expected trend	
	Last 3M	Last 1M	end-November	1M	3M
EURPLN	-1.8	-0.7	**4.11**	→	→
USDPLN	-5.3	-0.7	**3.16**	→	↗
CHFPLN	-2.2	-0.5	**3.41**	→	→
GBPPLN	-4.0	-1.3	**5.06**	→	→
EURUSD	3.6	0.0	**1.30**	→	↘

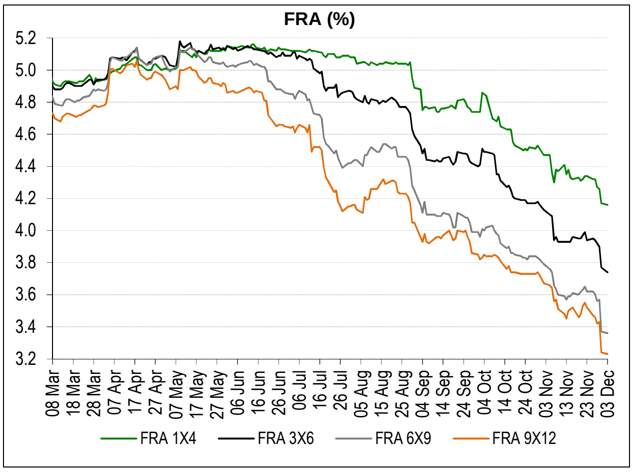
Note: Single arrow down/up indicates at least 1.5% expected move down/up, double arrow means at least 5% move

FX: our view and risk factors	
PLN FX market	**EUR:** In November the zloty was a bit stronger than we predicted. However, weaker than expected Q3 GDP growth put some pressure on the zloty as expectations for more radical cuts intensified. We do not exclude that the zloty will slightly gain if the MPC decides to reduce rates by only 25bps.
	USD: The EURUSD has stayed in the wide range of fluctuation between 1.27 and 1.317. In coming months we foresee the rate to decline towards the bottom of the limit. Consequently, the USDPLN might continue the upward move towards 3.30 in 3 months horizon.
	CHF: The situation does not change significantly and the Swiss central bank has been keeping the EURCHF floor unchanged (at 1.20). Changes in CHFPLN dependent on EURPLN.
	Risk factors to our view: Choppy trading will likely dominate the FX market in coming weeks. However, if investors believe that the current EMU and US impasses will be solved by the year-end, we expect risk-on mood to prevail, supporting emerging market currencies.

Money Market







Liquidity situation in banking sector remains favourable

- Liquidity situation in banking sector did not change significantly in November. Like in previous months, domestic banks ended the month with overbuilt reserve level. During regular weekly open market operations funds over PLN100bn were invested in NBP's bills. Notwithstanding, the central bank has tried to keep Polonia rate near to the reference rate. Usually December is a relatively cheap month due to waning activity ahead of year-end, hence the system liquidity is carefully kept at necessary level. We expect this year to be no exception.
- Bullish sentiment has continued on the OIS market. In monthly terms OIS rates went down by 33-47bps, pricing-in cuts by 100bps in total in 9 months' time, in which by 50bps in coming 3 months. We perceive this scenario as realistic.

WIBOR rates have continued their downward trend

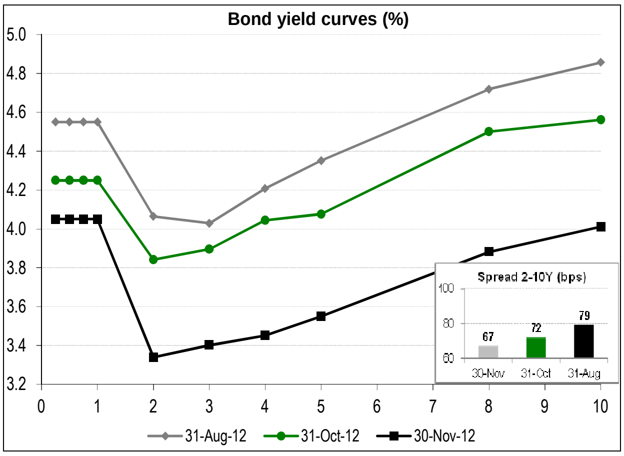
- After a huge surprise in October the MPC managed to start a monetary easing cycle in November, trimming official interest rates by 25bps. The scale of changes in money market rates seemed quite limited as WIBOR rates fell only by 5-6bps, while reaction on FRA contracts was mixed (only FRA6x9 declined by 3bps, other rates increased by 1-8bps). Consecutive weeks in November brought further adjustments in both WIBOR and FRA rates to macro data releases. However, the Q3 GDP release was definitely the highlight of the month. The figure came much below market consensus (at 1.4%YoY vs. 1.8%YoY) and brought about another wave of bullish sentiment, especially in case of FRA rates. They fell by 9-20bps (with the highest scope of change in case of contracts for 6 and 9 months), showing intensification of market expectations on deeper than 25bps rate reduction in December. FRA also suggest that WIBOR 3M may decline slightly below 3.25% in 9 months horizon. On the other hand, changes in WIBOR rates were limited after GDP data release and they declined by only 1-2bps. Notwithstanding, in monthly terms WIBOR 3M went down by 24-28bps, fully pricing-in the official rate reduction.
- We and market expect a 25bps cut this month, yet a motion on a deeper move is highly probable. We think that the Council will uphold its cautious approach, trimming rates by only 25bps. Taking into account that such a decision is widely expected we foresee limited decline in WIBOR rates after announcement. However, the downward trend will continue in next weeks. According to our prediction average rate of WIBOR 3M will be at 4.38% in December.
- In case of FRA rates we do not rule out some profit-taking after rate cut by only 25bps. However, we think that possible correction will be only short-lived as the Council will continue monetary easing cycle due to visible slowdown in Polish economy and disinflation trend.

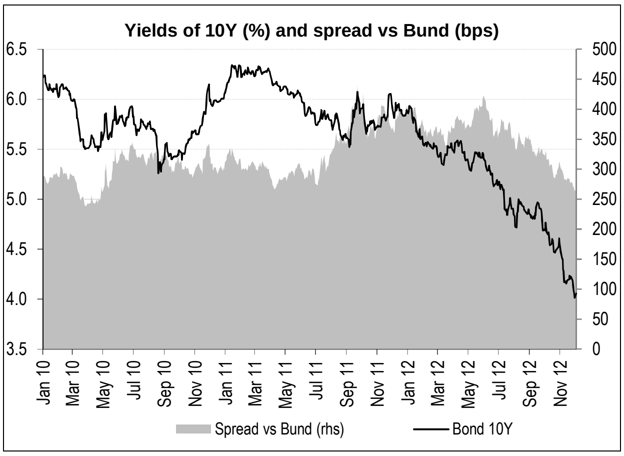
Money market rates (%)

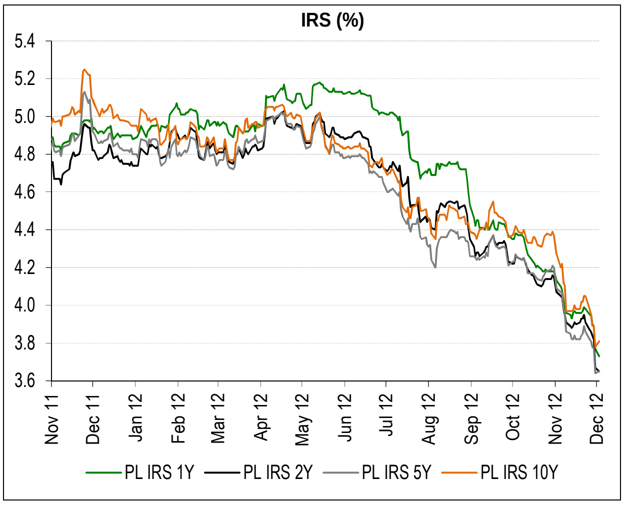
	Reference rate (%)	Polonia (%)	WIBOR (%)				OIS (%)				FRA (%)			
			1M	3M	6M	12M	1M	3M	6M	12M	1x4	3x6	6x9	9x12
End of November	**4.50**	**4.51**	**4.51**	**4.49**	**4.46**	**4.44**	**4.05**	**3.87**	**3.65**	**3.46**	**4.17**	**3.77**	**3.37**	**3.24**
Last 1M change (bp)	-25	-26	-26	-24	-27	-28	-44	-47	-43	-36	-34	-39	-45	-48
Last 3M change (bp)	-25	-27	-39	-50	-55	-58	-60	-59	-59	-57	-72	-82	-88	-81
Last 1Y change (bp)	0	2	-24	-48	-51	-53	-26	-46	-66	-84	-81	-121	-145	-147

Sources: Reuters, BZ WBK

IRS and T-Bond Market







Yields of Polish bonds at all-time lows …

- November has been another month in a row of rally on Polish bonds. Positive sentiment stems from many factors, in which the most important ones are: (1) still **solid foreign demand,** which allows the MF to reduce cost of issuance on both domestic and foreign markets. Moreover, at the end of October, the share of non-residents rose to a new record high of 35.6%; (2) **expectations that the MPC will continue monetary easing in coming months** after starting the cycle at November's meeting. Clearly worse GDP growth in Q3 2012 (1.4%YoY vs expectations of 1.8%YoY) left no doubt as to possible MPC's decisions, confirming our and market expectations that the interest rates would be cut by 25bps (or even more) this month; (3) **positive feedback from Moody's**. According to Moody's analysts, Polish bonds are a safe haven in CEE and „prudent liability management operations and a credible fiscal policy framework are key factors underpinning the sovereign's creditworthiness and will lead to further improvements in Poland's credit profile". All above-mentioned factors helped to improve investors' mood and to bring yields and IRS rates down to all-time lows. As we predicted the front-end and mid of the curves benefited a bit more than the long-end.
- Last month, the spread of Polish 10Y benchmark to Bunds narrowed to 265bps, the lowest level since April 2010. One should notice that 5Y CDS spreads remained below 90bps and ended November at 85bps, very close to level for France (near 80bps). In our opinion it confirms status of Polish bonds as a safe haven assets in CEE.

… but require new triggers to decline further

- Polish bond yields and IRS rates reached the new record-low levels last month. Ahead of the December's MPC meeting investors decided to take profits after significant strengthening in last days of November. We believe that further movement of the curve requires new triggers from foreign or domestic sources. What is more, currently a series of interest rate cuts (by 100bps in total) is priced-in. Room for testing new historic lows, especially on the short-end, would need support in shape of much more dovish statements of MPC members or of more aggressive decisions (cuts by more than 25pbs). Therefore, we think that December's decision to trim rates by only 25bps might result in some profit-taking, but any correction should be only short-lived as upcoming macro data will confirm further deceleration in economic activity and disinflation trend in CPI.
- Yields on the long-end of curve will be more vulnerable to the situation on core markets and foreign investors' appetite for risky assets. Till the end of the year bonds should be strong, continuing the downward trend. We expect fluctuations in range of 3.25-3.45% for 2Y, 3.45-3.65% for 5Y and 3.95-4.15% for 10Y. Still, sentiment on Bunds might weigh on the long-end of the curve.

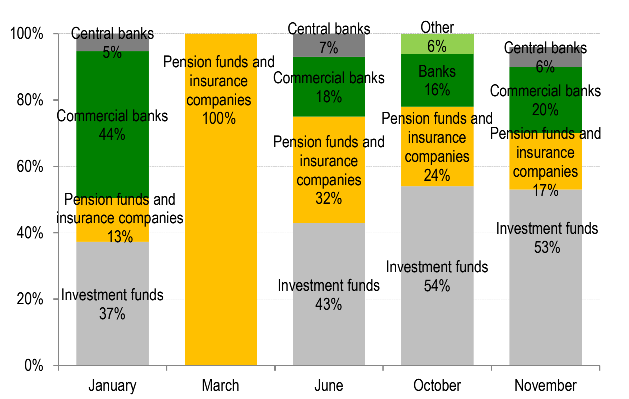
Bond and IRS market (%)

	T-bills	BONDS			IRS			Spread BONDS / IRS (bps)		
	52-week	2Y	5Y	10Y	2Y	5Y	10Y	2Y	5Y	10Y
End of November	**4.05**	**3.34**	**3.55**	**4.01**	**3.67**	**3.64**	**3.78**	**-33**	**-9**	**23**
Last 1M change (bps)	-20	-50	-52	-55	-48	-56	-59	-2	4	4
Last 3M change (bps)	-50	-73	-80	-85	-68	-62	-61	-5	-18	-24
Last 1Y change (bps)	-45	-154	-172	-194	-119	-132	-132	-35	-40	-62

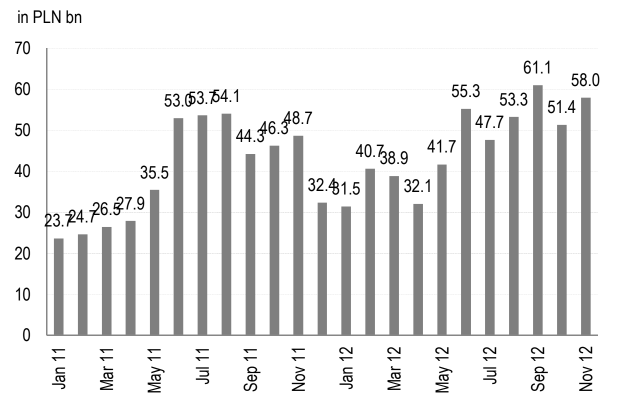
Sources: Reuters, BZ WBK

Treasury Securities Supply Corner

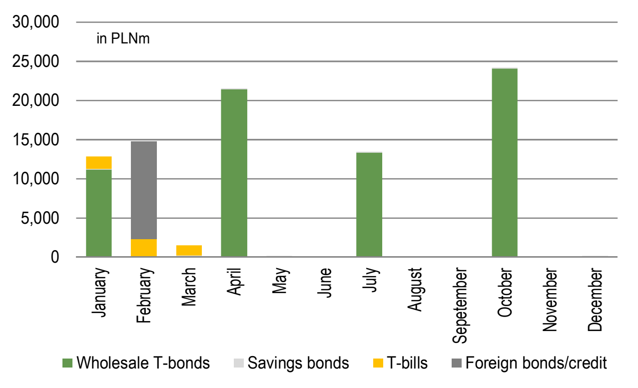
Institutional distribution of eurobonds in 2012



Funds in PLN and in foreign currency held by MoF



State Treasury debt redemptions in 2013 (monthly data)



Auction schedule for December

Switch auction			
Date of tender	Settlement date	T-bonds to be offered	T-bonds to be repurchased
6 Dec 2012	10 Dec 2012	WS0922 / WS0429	OK0113 / PS0413
Buy-back auction of EUR nominated T-bonds			
Date of tender	Settlement date	Series	Nominal value of buy-back (EUR m)
17 Dec 2012	19 Dec 2012	EUR20130205	Up to 200

Sources: Ministry of Finance, BZ WBK

The Ministry successfully collecting funds for 2013

- Starting from the beginning of October, Poland's Ministry of Finance has concentrated on the 2013 borrowing requirements pre-financing. In November, like in previous month, the Ministry was very active on both domestic and foreign market, successfully issuing Treasury papers.
- As regards the domestic market, it is worth noting the switch tender results. Demand and sale values reached the record high at PLN16.0bn and PLN10.2bn, respectively. Moreover, the new 10Y benchmark DS1023 was sold with the lowest yield in history, while floating-rate bonds WZ0117 were sold at a premium (slightly above their nominal value), first time since August 2011.
- Piotr Marczak, the head of Public Debt Department in Finance Ministry, commented on auction results that foreign investors dominated on the switch tender. Non-residents exchanged bonds maturing in January 2013 for floating-rate instruments WZ0117 and WZ0121. It was, in our opinion, an unusual situation, especially as fixed-rate bonds continue to dominate the foreign investors' portfolio (at the end of September their share made 95% of total holding).
- As we mentioned above, sale of eurobonds was a success as well. In November the Ministry decided to re-open the 12Y bonds denominated in €, taking advantage of the historically lowest yields on that market. Consequently, the Ministry sold bonds worth €750m (increasing amount of bonds maturing on 9 July 2024 to €2.5bn) at a record low yield, i.e. 3.21% or 135bps above mid-swap. We would like to recall that original bond offer issued in October 2012 was priced at 143bps above mi-swap (or 3.385%). The breakdown of purchasing institutions suggests that bonds were allocated mainly to the stable investors base, including, among others, central banks (6% of issuance).
- To sum up, after November's issues Poland's Ministry has funds to cover nearly 75% of its 2013 FX borrowing needs and over 20% of its 2013 total borrowing requirements. We uphold our stance that thanks to switch tenders the Ministry will pre-finance ca. 25% of next year's target. One should notice that the MF held over PLN58bn in PLN and FX liquidity cushion at the end of November.

December's offer in line with expectations

- The Ministry of Finance has taken advantage of positive mood on the market and decided to offer the longest term bonds (WS0922 and WS0429) at the switch tender, repurchasing OK0113 and PS0413. This type of auction will be rather neutral for the market, but also (what is more important) will allow the Ministry to extend the average maturity of domestic debt without increasing the debt value. We believe that lack of regular auction should be a supportive factor for secondary market. According to Marczak, "the December auction will be the last switching auction before a longer break. In the initial months of 2013 we plan to conduct regular auctions only".
- The Ministry of Finance plans also a buyback of bonds denominated in €, maturing on February 5, 2013. The Ministry plans to buy-back up to €200m (or more or less 5% of total outstanding amount of €3bn. In this way Poland wants to make more efficient use of the accumulated FX means than locking them up in deposits. Moreover, the Ministry consider the buyback to be "another step to a broader introduction of Polish €-denominated bonds to be traded on the domestic financial market. Marczak stated that "next year we plan to launch trade in Polish eurobonds on the e-platform run by BondSpot".

Treasury Securities Supply Corner

Total issuance in 2012 by instruments (in PLNm, nominal terms)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
T-bonds auction	10,820	11,503	10,560	9,012	8,341	4,974	5,842	4,411	3,549	13,741	4,526		**87,279**
T-bills auction	2,223	5,778	3,000										**10,330**
Retail bonds	216	248	212	210	210	210	150	156	160	150	150	150	**2,221**
Foreign bonds/credits	7,979	2,200	0	5,390	1,251	9,675		3,075		7,228	5,722		**42,518**
Prefinancing and financial resources at the end of 2011	31,600												**31,600**
Total	**52,837**	**19,729**	**13,772**	**14,611**	**9,802**	**14,859**	**5,992**	**7,642**	3,709	21,119	10,398	150	**173,948**
Redemption	11,297	3,981	5,275	20,795	4,906	2,778	20,459	3,191	1,122	17,639	2,256	2,368	**96,068**
Net inflows	**41,540**	**15,749**	**8,496**	**-6,183**	**4,896**	**12,080**	**-14,467**	**4,450**	2,586	3,480	8,142	-2,218	**77,881**
Rolling over T-bonds	6,309			7,966		2,459	4,908		5,613		10,236	0	**37,490**
Buy-back of T-bills													**0**
Total	**47,848**	**15,749**	**8,496**	**1,782**	**4,896**	**14,539**	**-9,559**	**4,450**	8,199	3,480	18,378	-2,218	**115,370**
Coupon payments	*1,451*			*7,211*			*1,497*		1,455	9,294			**21,171**

Note: Our forecasts – shaded area

Schedule Treasury Securities redemption by instruments (in PLNm)

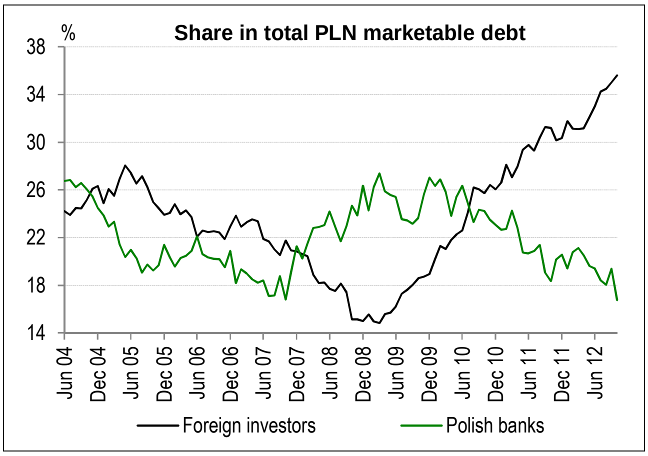
	Bonds	Bills	Retail bonds	Total domestic redemption	Foreign Bonds/Credits	Total redemptions
January	10 946	0	351	**11 297**		**11 297**
February		3 799	182	**3 981**		**3 981**
March		1 997	129	**2 125**	3 150	**5 275**
April	20 663		132	**20 795**		**20 795**
May		2 223	117	**2 339**	2 567	**4 906**
June			112	**112**	2 666	**2 778**
July	14,341		218	**14,559**	4,900	**19,459**
August		1,997	248	**2,245**	946	**3,191**
September			176	**176**	946	**1,122**
October	16,438	0	265	16,703	950	17,653
November		1,332	208	1,540	716	2,256
December		2,223	146	2,368		2,368
Total 2012	**62,388**	**13,571**	**2,283**	**78,242**	**16,841**	**95,082**
Total 2013	70,159	6,110	1,698	**90,276**	14,825	**105,102**
Total 2014	61,666		628	**59,586**	17,448	**77,034**
Total 2015	78,880		485	**79,365**	14,329	**93,694**
Total 2016	59,378		91	**59,469**	16,871	**76,340**
Total 2017+	245,463		3,288	**213,794**	134,966	**348,760**

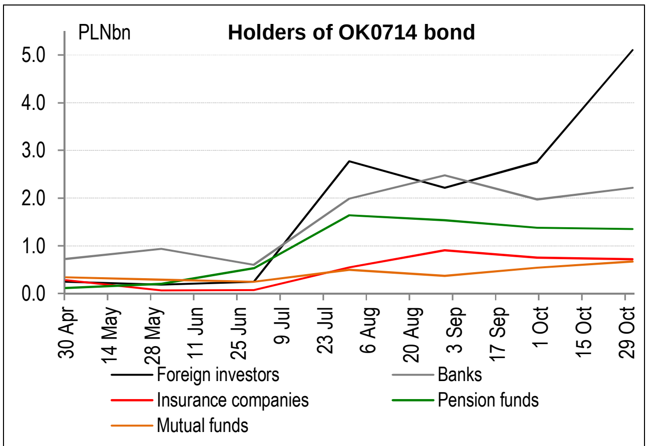
Schedule wholesales bonds redemption by holders (data at the end of October 2012, in PLNm)

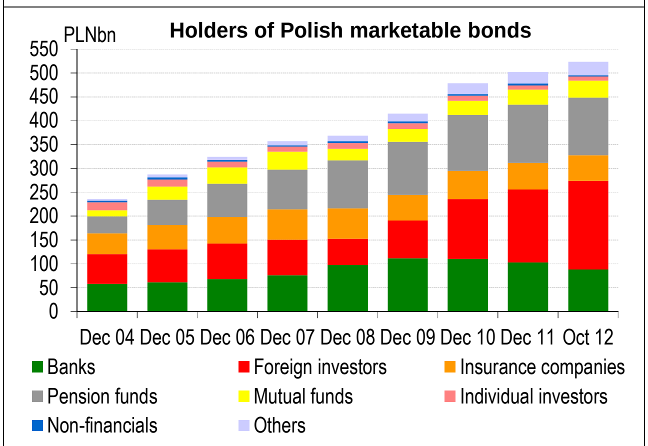
	Foreign investors	Domestic banks	Insurance Funds	Pension Funds	Mutual Funds	Individuals	Non-financial sector	Other	Total
Q1 2012	0	0	0	0	0	0	0	0	0
Q2 2012	0	0	0	0	0	0	0	0	0
Q3 2012	0	0	0	0	0	0	0	0	0
Q4 2012	0	0	0	0	0	33	1	0	34
Total 2012	**0**	**0**	**0**	**0**	**0**	**33**	**1**	**0**	**34**
	0%	**0%**	**0%**	**0%**	**0%**	**97%**	**2%**	**1%**	**100%**
Total 2013	38,820	10,300	12,292	9,329	2,559	464	271	6,610	80,645
	48%	13%	15%	12%	3%	1%	0%	8%	100%
Total 2014	32,802	10,245	5,364	6,776	2,699	438	124	3,507	61,956
	53%	17%	9%	11%	4%	1%	0%	6%	100%
Total 2015	25,926	19,341	7,019	16,493	5,117	171	757	4,126	78,951
	33%	24%	9%	21%	6%	0%	1%	5%	100%
Total 2016	16,758	8,073	4,283	24,377	6,200	52	75	2,765	62,583
	27%	13%	7%	39%	10%	0%	0%	4%	100%
Total 2017+	72,011	39,732	24,563	63,610	19,674	260	510	11,301	231,661
	31%	17%	11%	27%	8%	0%	0%	5%	100%

Sources: Ministry of Finance, BZ WBK

Treasury Securities Holders







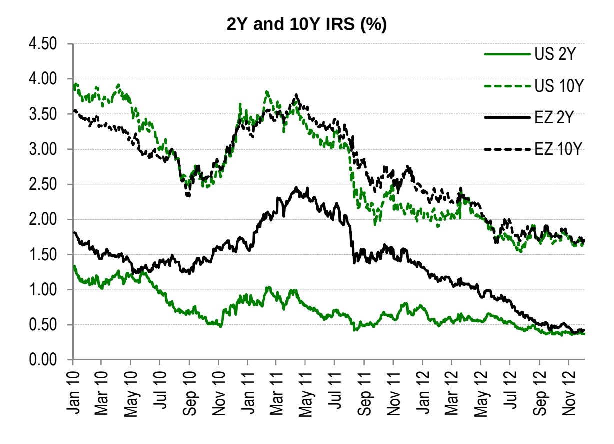
Polish banks cut exposure to domestic debt

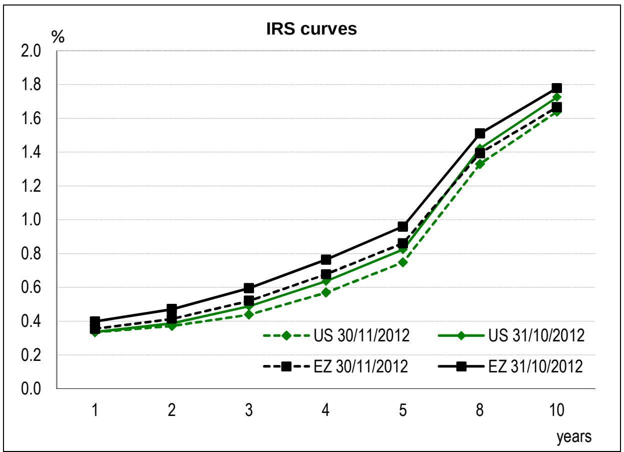
- Value of Polish marketable debt declined in October by ca. PLN3bn. This was a result of maturity of OK102 bond and issuances at two standard auctions.
- Foreign investors were holding PLN10.4bn (63% of total issuance) of OK1012 and despite the buyback of this paper they managed to increase their total holdings of Polish marketable debt to a new record high at PLN186.3bn. Purchases of this group of investors were focused on short end and the middle of the curve.
- Last month we pointed that foreign investors held 36% of OK0714 at the end of September, well below over 50% average for remaining bonds of OK series. We suggested that this group may continue to increase its engagement in OK0714 benchmark in the upcoming months and this forecast materialized as soon as in October. Foreign investors increased their holdings from PLN2.8bn to PLN5.1bn (to nearly 50% of total issuance).
- Total value of Polish banks' bond portfolio contracted quite significantly, by PLN14.3bn, just one month after the most aggressive purchase since February. Consequently, at the end of October the share of this group in total marketable debt was the lowest since comparable data is available (June 2004). Interestingly, only ca. PLN3.9bn of this reduction was due to the maturity of OK1012. Excluding this event, monthly reduction of exposure to the domestic bonds was the biggest since September 2011 (without this adjustment it was the highest since data is available). Most visible withdrawals were recorded in case of DS1019 and OK0114 (by ca. PLN1bn in both cases), PS0417 (by PLN1.2bn) and floating rate debt (WZ0118 by PLN1.8bn and WZ0115 by PLN2.4bn).
- Polish pension funds increased their holdings by PLN4.0bn, the highest monthly increase for a year. This group focused on the middle and long end of the curve. Pension funds hold 40% of total issuance on new 10Y benchmark (DS1023 offered for the first time in late October). This group purchased also floating coupon bonds (WZ0115 for nearly PLN3.0bn, WZ0118 for just over PLN1.5bn and Wz0121 for PLN1.0bn).
- Polish mutual funds increased their portfolio by PLN3.8bn, the highest monthly increase since data is available. The most considerable purchases were recorded in case of WZ0117 (by PLN1.2bn), PS0417 (by PLN0.9bn) and DS1023 (by PLN0.8bn).

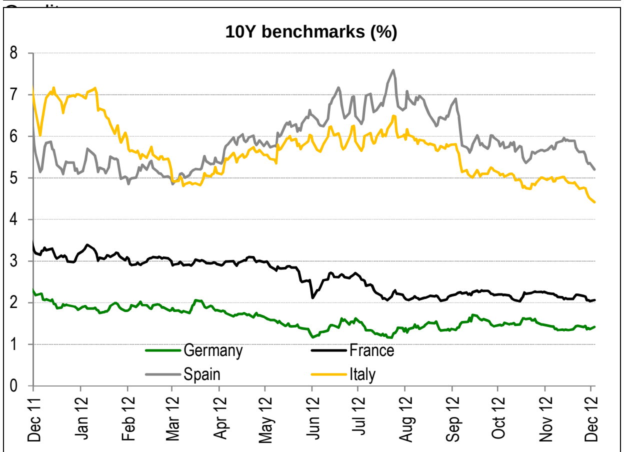
Holders of marketable PLN bonds	Nominal value (PLN, bn)				Nominal value (PLN, bn)			% change in October			Share in TOTAL (%) in Oct
	End Oct	End Sep	End Q2 2012	End Q1 2012	End 2011	End 2010	End 2009	MoM	QoQ	YoY	
Domestic investors	336.9	341.8	352.9	361.5	349.8	354.1	336.2	-1.4	-	-2.5	64.4 (-0.6pp)
Commercial banks	87.7	102.0	102.1	110.9	103.3	110.4	112.1	-14.0	-	-4.8	16.8 (-2.6pp)
Insurance companies	53.5	54.7	57.0	54.3	55.5	59.5	53.8	-2.1	-	-7.7	10.2 (-0.2pp)
Pension funds	120.6	116.7	120.3	120.7	122.2	117.0	111.0	3.3	-	-3.0	23.0 (+0.9pp)
Mutual funds	36.2	32.5	33.0	31.3	31.7	30.2	26.8	11.6	-	22.4	6.9 (+0.8pp)
Others	38.8	35.9	40.5	44.3	37.1	37.0	32.5	8.1	-	-6.8	7.4 (+0.6pp)
Foreign investors*	186.3	184.2	174.0	163.2	152.5	124.8	78.6	1.2	-	19.0	35.6 (+0.6pp)
Banks	27.4	27.8	22.6	24.3	16.2	21.9	17.4	-1.6	-	40.9	5.2 (-0.1pp)
Non-bank fin. sector	150.2	147.5	143.1	131.7	129.3	96.8	58.0	1.8	-	15.0	28.7 (+0.7pp)
Non-financial sector	5.4	5.6	5.2	4.4	4.5	4.2	2.3	-3.3	-	26.9	1.0 (-0.1pp)
TOTAL	523.2	526.0	526.9	524.7	502.3	478.9	414.8	-0.5	-	4.2	100

**Total for Foreign investors does not match sum of values presented for sub-categories due to omission of irrelevant group of investors. Sources: Min Fin, BZ WBK*

International Bond Markets







Risk-off mood supported safe haven assets

- Safe haven assets rallied in the first part on November, supported by unresolved situation in Europe and uncertainty ahead of the regional elections in Spain. A significant improvement of market moods in mid-November was possible thanks to a row of positive data from the US economy (especially from housing market). Still, after the US presidential election (re-election of President Obama) the investors' sentiment was undermined markedly by concerns about the US fiscal outlook, so prices of safe haven bonds stabilized on high levels. In November investors were also concerned about global growth outlook (the European Commission significantly revised down its economic growth forecasts) and debt problems in Greece as well as about Spanish reluctance to take ask for the ECB intervention.
- All factors mentioned above caused that yields of the US treasuries declined by almost 30bps (in case of 10Y benchmark) from the October peaks (10Y reached 1.55%), while the German curve continued its downward move pushing the 10Y Bund down to 1.32%. However, anticipated progress of negotiations on "fiscal cliff" in the US, agreement on bailout tranche payment and re-evaluation of the international aid programs allowing for a remarkable debt relief for Greece, limit the pressure to push the yields to new local or historical lows, thus Bunds and the US Treasuries ended the month with slightly higher yields.

Yields of periphery performed strongly

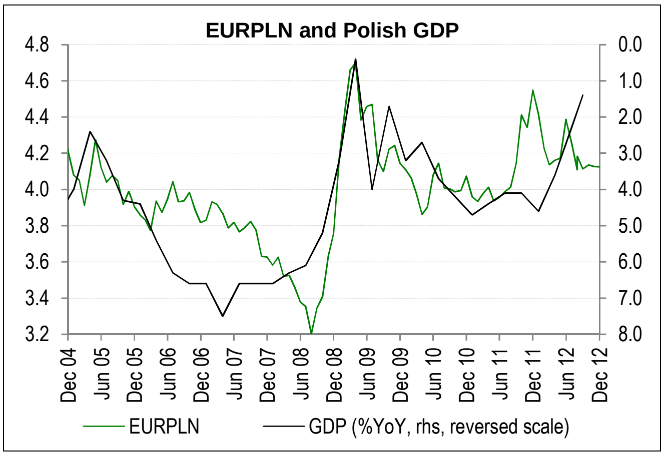
- In November both Italian and Spanish bonds gained significantly. One should notice that yields of Italian/Spanish bonds fell below this year's minimums, posted at the beginning of March, shortly after the second 3Y LTRO. The end-of-the-year rally on peripheral bonds is partly a consequence of the ECB's commitment to support the periphery.
- In coming weeks there will be two events (excluding macro data releases) which may fuel the volatility on core market. The first one is the ECB meeting. It is likely that the central bank will keep interest rates unchanged, but some members may support a cut. The last event is the US "fiscal cliff". The final outcome of negotiations on this issue will probably be positive, which will translate into a risk-accumulating pattern, adding to the positive mood in peripheral countries. However, the risk that fiscal cliff talks may fail will weigh on the core market quotations until the end of December, as consensus between Republicans and Democrats is unlikely to be reached soon. Taking all these facts under consideration and including increasing trust in European ability to face critical situation in periphery we foresee further spread tightening between peripheral and core bonds.

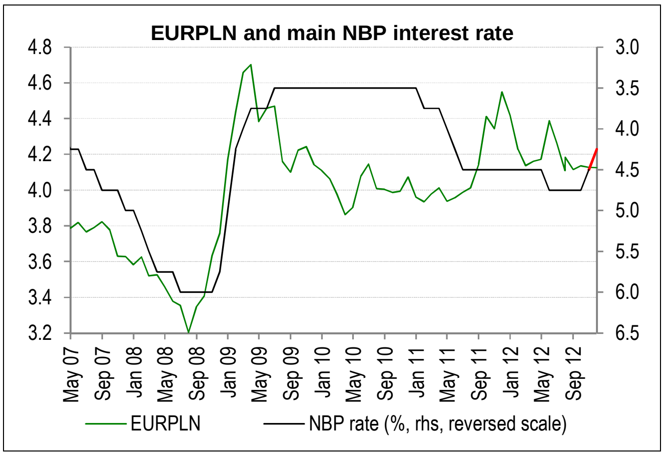
Euro zone's issuance plans and completion in 2012 (€ bn)

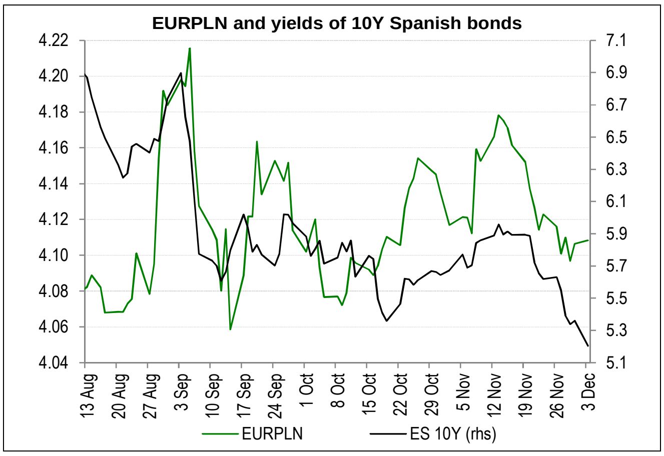
	Total redemptions	Deficit	Borrowing needs	Expected bond supply	% of completion (YtD)
Austria	14	8.3	22.3	22.3	**93**
Belgium	27.9	7	34.9	26.0	**113**
Finland	6.3	7.5	13.8	13.8	**95**
France	101.7	78.7	180.4	178	**110**
Germany	157	26.6	183.6	170	**102**
Greece	33.2	16.2	49.4	-	**-**
Ireland	5.5	13.7	19.2	-	**-**
Italy	192.2	41.1	233.3	233.3	**93**
Netherlands	29.7	12.3	42	60.0	**105**
Portugal	12.9	17.4	30.3	-	**-**
Spain	50.1	36.2	86.3	85.9	**109**
Total	**630.5**	**265.0**	**895.5**	**789.2**	**102**

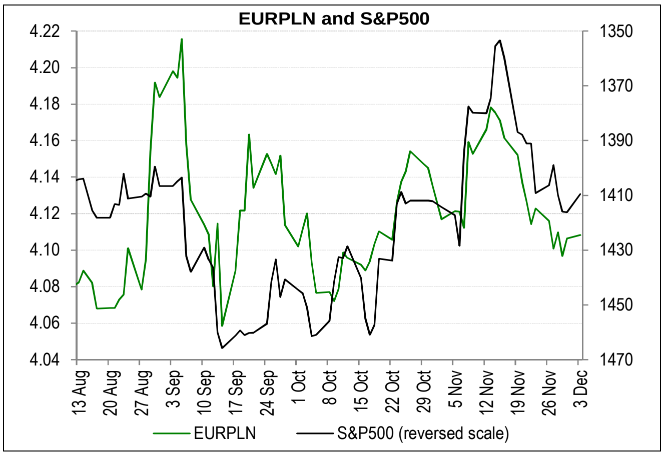
Source: Reuters, BZ WBK

Foreign Exchange Market









Sources: Reuters, BZ WBK

Domestic currency weaker after GDP data…

- November was a pretty volatile month for the EURPLN. Just like we suggested, the case of Polish monetary policy provided a depreciation impulse for the zloty. After the MPC cut rates by 25bps in early November and signalled this was a beginning of an easing cycle, the EURPLN surged in the following days to just above 4.19 (highest level since early September).
- Still, the weakening of domestic currency proved temporary as investors' hopes for Eurogroup agreement on tranche for Greece started to play the main role on the market. As a result, the zloty pared losses suffered after the rate cut and continued to gain further. In late November the EURPLN tested the support at 4.10 (it reached 4.08). The exchange rate did not manage to stay below this level for longer, as the zloty was hit by weaker-than-expected data on Polish 3Q GDP data. Consequently, at the beginning of December the EURPLN was around 4.12.

… and may temporarily gain after MPC decision…

- We expect the MPC to cut NBP rates by 25bps in December. Disappointing GDP data boosted market hopes that scale of monetary easing may be more aggressive, so a conservative cut by only 25bps may be supportive for the zloty. This would be a similar situation to the one in September, when the MPC kept rates on hold after disappointing GDP data for Q2 fuelled hopes for a rate cut (the EURPLN plunged from 4.18 to 4.08 within a few days).

… but more easing and weaker growth should harm zloty

- In general, we expect the zloty to remain under pressure in December (and at least during first months of 2013) as more data is expected to confirm weak economic growth in Poland and as the MPC is likely to continue the easing cycle. After the 3Q data on GDP we clearly revised downward our forecasts of economic growth in 2013 and, as falling inflation and deteriorating situation in the economy will prevent the MPC from switching to neutral stance too fast, the domestic factors will continue to constrain the appreciation potential of the zloty. Even if we are correct expecting some temporary appreciation of the domestic currency after cautious decision of the MPC, the statement is likely to remain dovish and giving more room for further rate cuts.
- In our view, given current market and economic situation, the domestic factors may put negative pressure on the zloty while global events may be neutral or positive. The Eurogroup has agreed on new conditions of Greek aid package and it seems that case of this country may be off the spotlight for some time. Furthermore, conditions of voluntary debt buyback revealed by Greece were positively perceived by the market and it is expected that this operation will be successful. Yields of 10Y Spanish bonds fell to ca. 5.2%, the lowest level since March, while Italian ones posted 4.40%, the lowest level since December 2011. Lower worries over developments in Europe may support the zloty, just like they did recently as shown on the chart of EURPLN and 10Y Spanish bond yields. As the ECB's OMT program is on the stand-by, the potential for more visible and long-lasting weakening of peripheral debt seems to be limited and thus any negative impulse on the zloty should be only temporary and subdued.
- The talks on avoiding the fiscal cliff in the US may currently attract most investors' attention. Although there is still no sign of agreement, investors seem to be rather optimistic regarding the changes for avoiding automatic fiscal tightening at the start of 2013. In the first half of November the S&P500 plunged, but deal on Greece pushed stock prices up again.
- All in all, we expect the average EURPLN to be at 4.13 in the last month of the year.

FX Technical Analysis Corner

EURPLN

- After breaking out from the triangle formation, the upward momentum of the EURPLN soon terminated. The exchange rate did not manage to break first short term resistance at ca. 4.19 (local peak from late September), so now it is unlikely to reach 4.28.
- The EURPLN rebounded from the support level at 4.08, but ADX oscillator points that the strength of trend is so far low.
- Given the fact that the EURPLN remained in the range of 4.06-4.20, after retreating from the lower band, it may continue to increase to ca. 4.16-4.18.

EURUSD

- After breaking the downward line of consolidation and 200-day SMA the EURUSD continued to decline, but failed to reach next support (at 1.26).
- Interestingly, despite strong rally from 1.266 to 1.307, the ADX shows that the strength of the trend is rather low.
- The area between the trend line and the peak at 1.317 is an important area of resistance. If broken, the exchange rate may approach 1.317 and if not, then it may decline to ca. 1.29.

Sources: Reuters, BZ WBK

Poland vs other countries - economy

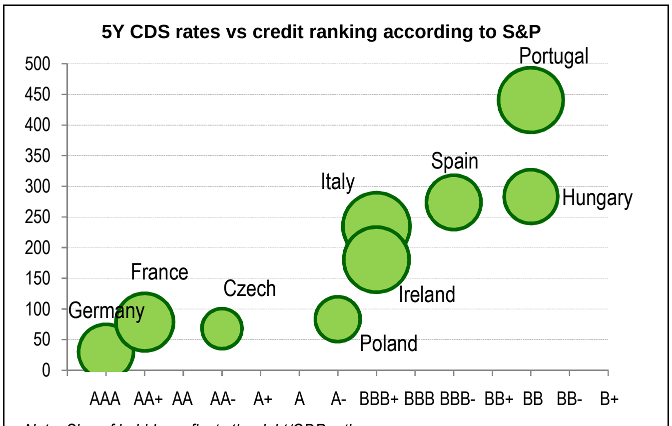
Main macroeconomic indicators (European Commission's forecasts)

	GDP* (%)		Inflation* (HICP, %)		C/A balance (% of GDP)		Fiscal Balance (% of GDP)		Public Debt (% of GDP)	
	2012F	2013E	2012F	2013E	2012F	2013E	2012F	2013E	2012F	2013E
Poland	**2.4**	**1.8**	**3.8**	**2.6**	**-3.9**	**-3.3**	**-3.4**	**-3.1**	**55.5**	**55.8**
Czech Republic	-1.3	0.8	3.6	1.1	-2.9	-2.1	-3.5	-3.4	45.1	46.9
Hungary	-1.2	0.3	5.6	5.3	1.6	2.6	-2.5	-2.9	78.4	77.1
EU	-0.3	0.4	2.7	2.0	0.4	0.9	-3.6	-3.2	86.8	88.5
Euro area	-0.4	0.1	2.5	1.8	1.1	1.5	-3.3	-2.6	92.9	94.5
Germany	0.8	0.8	2.1	1.9	5.7	5.0	-0.2	-0.2	81.7	80.8

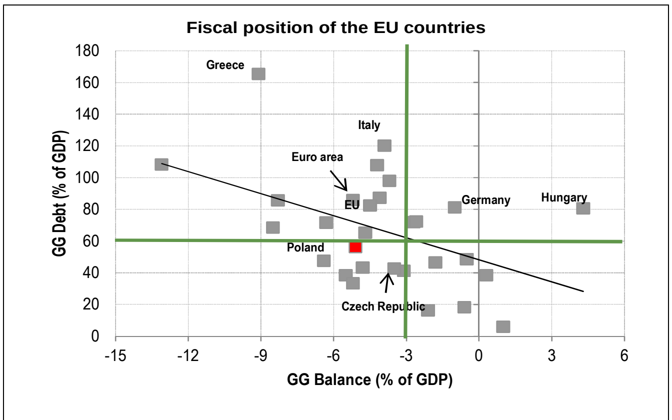
*Note: * European Commission – Autumn 2012*

Sovereign ratings

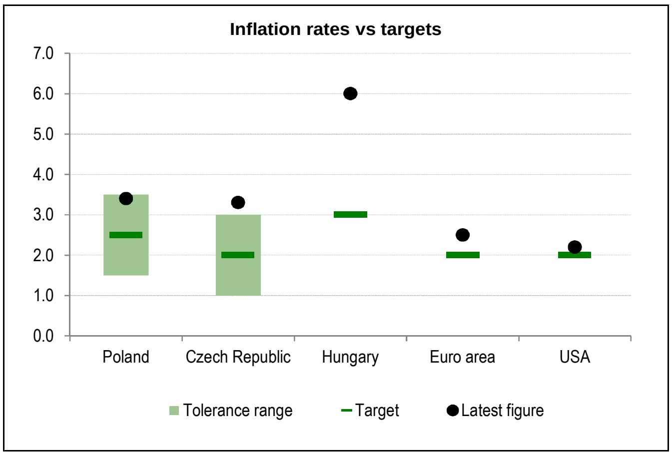
	S&P		Moody's		Fitch	
	rating	outlook	rating	outlook	rating	outlook
Poland	A-	stable	A2	stable	A-	stable
Czech	AA-	stable	A1	stable	A+	stable
Hungary	BB	stable	Ba1	negative	BB+	negative
Germany	AAA	stable	Aaa	negative	AAA	stable
France	AA+	negative	Aa1	negative	AAA	negative
UK	AAA	stable	Aaa	negative	AAA	negative
Greece	CCC	negative	C	---	CCC	stable
Ireland	BBB+	negative	Ba1	negative	BBB+	stable
Italy	BBB+	negative	Baa2	negative	A-	negative
Portugal	BB	negative	Ba3	negative	BB+	negative
Spain	BBB-	negative	Baa3	negative	BBB	negative

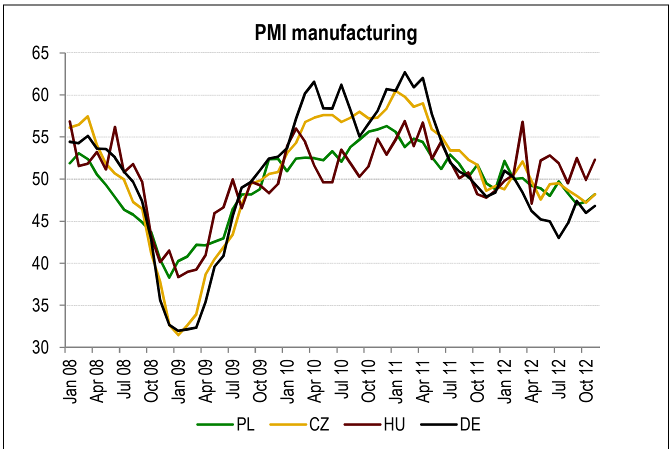


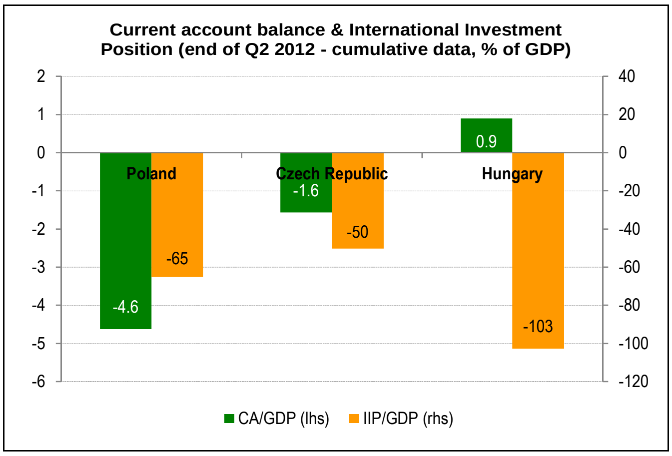
Note: Size of bubbles reflects the debt/GDP ratio



Note: final data for 2011





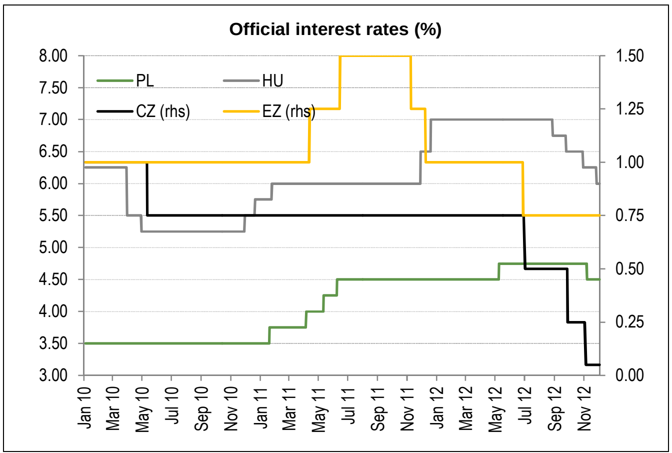


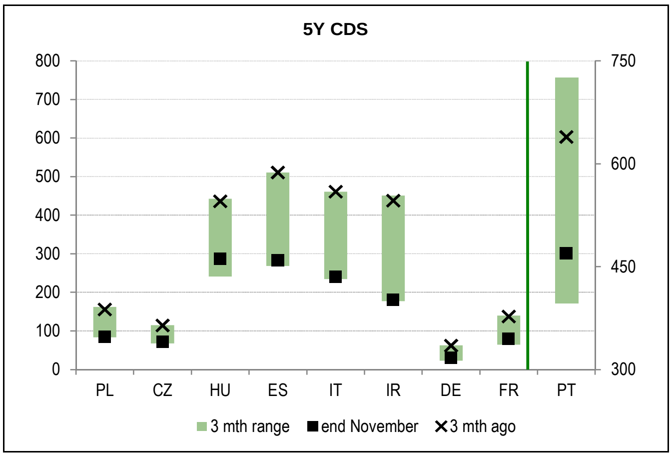
Source: stat offices, central banks, Reuters, BZ WBK, EC

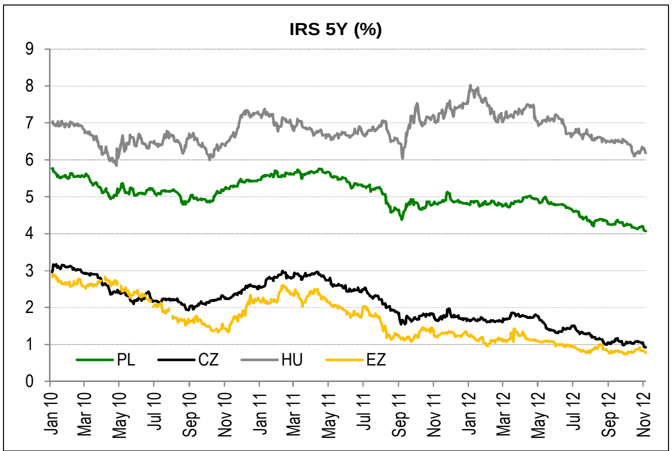
Poland vs other countries - market

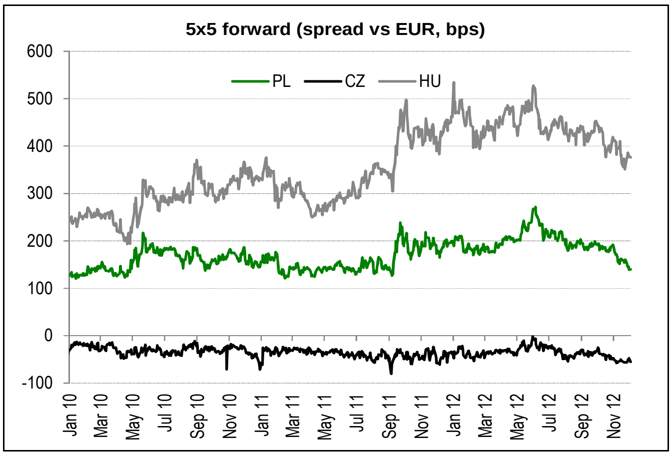
Main market indicators (%)

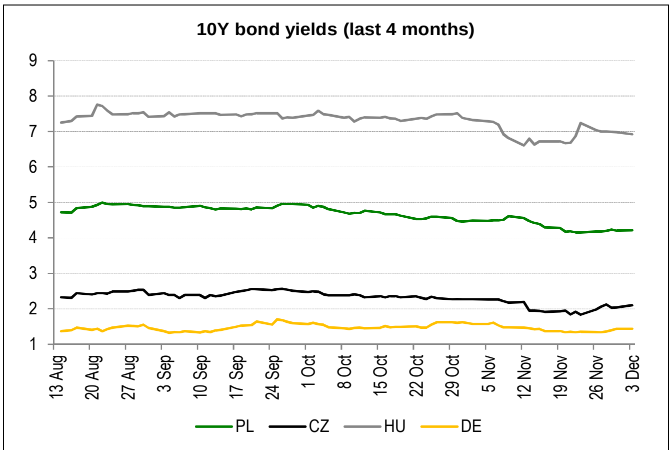
	Reference rate (%)		3M market rate (%)		10Y yields (%)		10Y Spread vs Bund (bps)		CDS 5Y	
	2011	2012F	2011	end of November	2011	end of November	2011	end of November	2011	end of November
Poland	**4.50**	**4.25**	**4.99**	**4.49**	**5.88**	**4.01**	**405**	**265**	**279**	**85**
Czech Republic	0.75	0.05	0.78	0.17	3.59	2.00	176	64	173	71
Hungary	7.00	6.25	7.24	6.00	9.90	6.94	807	557	610	287
Euro area	1.00	0.50	1.36	0.19						
Germany					1.83	1.37			100	30

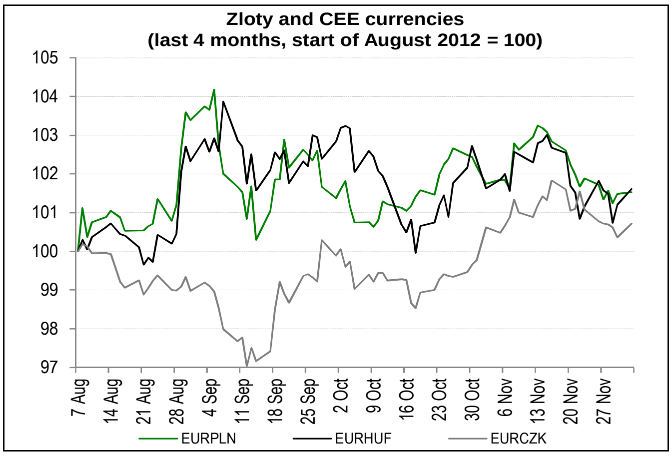












Source: stat offices, central banks, Reuters, BZ WBK, EC

Central Bank Watch

		Last	2011	2012F	Expected changes (bps) 1M	3M	6M	Risks/Events
Euro	Forecast	0.75	1.00	0.75				The possibility of further monetary policy easing still exists. However, a new macro forecasts will be crucial
	Market implied »				0	0	-1	
UK	Forecast	0.50	0.50	0.50				No changes, rates are like to remain on hold. However, the Council might suggest further easing bias if the outlook deteriorates
	Market implied »				1	3	6	
US	Forecast	0-0.25	0-0.25	0.25				It is likely that Fed decides to increase bonds purchasing due expire Operation Twist. Investors concentrate on the growth perspectives foe 2013
	Market implied »				0	1	1	
Poland	Forecast	4.50	4.50	4.25				We uphold our stance that the Council cuts rates by 25 bps, however expectations for more aggressive monetary easing intensified after weaker Q3 GDP data
	Market implied »				-30	-72	-110	
Czech	Forecast	0.05	0.75	0.05				Currently, the CNB will concentrate fully on unconventional tools, where FX intervention is the most probable tool
	Market implied »				31	25	25	
Hungary	Forecast	6.00	7.00	6.00				NBH decided to cut rates by 25 bps at its November's meeting. Further cuts are very probable, but now we foresee the NBH to keep "wait and see" stance
	Market implied »				-17	-33	-83	

Note: Market implied expectations show implied changes in 3M market rates based on FRA rates

Economic Calendar and Events

Date		Event:	Note:
5-Dec	**PL**	**MPC Meeting – interest rate decision**	**We foresee the MPC to cut rates by 25bps**
	DE	Auction of 2Y bonds	Offer: €4.0bn
	SP	Auction of 3Y, 7Y and 10Y bonds	Offer: €3.0-4.0bn
6-Dec	**PL**	**Switch tender**	**Offer: WS0922, WS0429; Buy back: OK0113, PS0413**
	EZ	ECB Meeting – interest rate decision	Rates on hold
11-12-Dec	US	Fed Meeting - interest rate decision	
12-Dec	EU	Ecofin meeting (discussion about banking union)	
13-Dec	**PL**	**CPI for November**	**Our forecast: 2.8%YoY (slightly below consensus)**
	IT	Auction of bonds	-
	SP	Auction of bonds	-
13-14-Dec	EU	European Union Council meeting	-
17-Dec	**PL**	**Buy-back auction of € denominated bonds**	**Nominal value of buy-back: up to €200m**
18-Dec	**PL**	**Employment and wages for November**	**We expect employment decline by -0.1%YoY and subdued growth in wages (by 2.8%) more or less near to market expectations**
	HU	NBH Meeting – interest rate decision	
19-Dec	**PL**	**Industrial output and PPI for November**	**In line with market forecasts we predict industrial output growth at 0.4%YoY and PPI at 0.1%YoY**
	CZ	CNB Meeting – interest rate decision	
20-Dec	**PL**	**Core inflation measures for November**	**We expect core inflation exc. food & energy prices at 1.8%YoY**
22-28-Dec	**PL**	**Retail sales for November**	**We foresee some slowdown in growth**
28-Dec	IT	Auction of medium-term bonds	-
9-Jan 2013	**PL**	**MPC Meeting – interest rate decision**	**We foresee the MPC to cut rates**
10-Jan	EZ	ECB Meeting – interest rate decision	

Source: stat offices, central banks, Reuters, BZ WBK

Economic and market forecasts

Poland		**2010**	**2011**	**2012**	**2013**	**1Q12**	**2Q12**	**3Q12**	**4Q12**	**1Q13**	**2Q13**	**3Q13**	**4Q13**
GDP	PLNbn	1,416.6	1,523.2	1,593.7	1,637.0	370.7	388.3	392.1	442.7	378.3	396.7	401.9	460.1
GDP	%YoY	3.9	4.3	1.8	1.2	3.6	2.3	1.4	0.5	0.2	0.9	1.2	2.1
Domestic demand	%YoY	4.6	3.4	-0.2	0.0	2.5	-0.4	-0.7	-1.7	-1.5	-0.4	0.4	1.4
Private consumption	%YoY	3.2	2.5	1.0	1.4	1.7	1.2	0.1	1.0	1.2	1.2	1.6	1.8
Fixed investments	%YoY	-0.4	9.0	-0.5	-2.5	6.0	1.3	-1.5	-3.0	-5.0	-4.0	-2.0	-1.0
Unemployment rate [a]	%	12.4	12.5	13.5	13.9	13.3	12.3	12.4	13.5	14.0	12.4	12.7	13.9
Current account balance	EURm	-18,129	-17,977	-12,715	-5,902	-4,515	-2,164	-2,457	-3,579	-2,118	-769	-1,379	-1,637
Current account balance	% GDP	-5.1	-4.9	-3.3	-1.5	-5.1	-4.6	-3.9	-3.3	-2.7	-2.3	-2.0	-1.5
General government balance	% GDP	-7.9	-5.0	-3.5	-3.0	-	-	-	-	-	-	-	-
CPI	%YoY	2.6	4.3	3.7	1.9	4.1	4.0	3.9	3.0	2.0	1.5	1.9	2.3
CPI [a]	%YoY	3.1	4.6	2.6	2.3	3.9	4.3	3.8	2.6	1.8	1.4	2.1	2.3
CPI excluding food and energy prices	%YoY	1.6	2.4	2.2	2.0	2.5	2.5	2.1	1.8	2.0	1.7	2.1	2.2
EUR/PLN	PLN	3.99	4.12	4.19	4.14	4.23	4.26	4.14	4.12	4.15	4.15	4.15	4.10
USD/PLN	PLN	3.02	2.96	3.26	3.19	3.23	3.32	3.31	3.19	3.26	3.26	3.17	3.08
CHF/PLN	PLN	2.90	3.34	3.48	3.36	3.50	3.55	3.44	3.42	3.46	3.39	3.32	3.28
GBP/PLN	PLN	4.66	4.75	5.16	4.99	5.07	5.26	5.22	5.10	5.06	5.07	4.94	4.91
Reference rate [a]	%	3.50	4.50	4.25	3.50	4.50	4.75	4.75	4.25	3.75	3.50	3.50	3.50
WIBOR 3M	%	3.94	4.54	4.92	3.75	4.97	5.04	5.06	4.61	4.07	3.60	3.62	3.69
Yield on 2-year T-bonds	%	4.72	4.81	4.31	3.59	4.66	4.71	4.22	3.65	3.41	3.47	3.62	3.84
Yield on 5-year T-bonds	%	5.31	5.44	4.55	3.76	5.02	4.93	4.43	3.82	3.53	3.65	3.82	4.04
Yield on 10-year T-bonds	%	5.74	5.98	5.03	4.23	5.58	5.38	4.91	4.27	4.00	4.08	4.27	4.57

Source: CSO, NBP, Finance Ministry, BZ WBK own estimates; [a] at the end of period

This analysis is based on information available until 3rd December 2012 and has been prepared by:

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