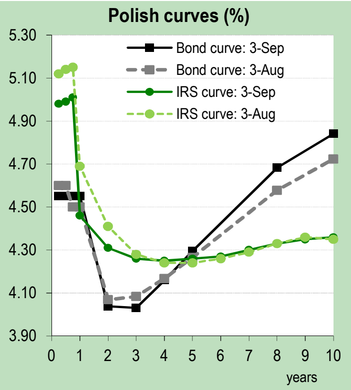
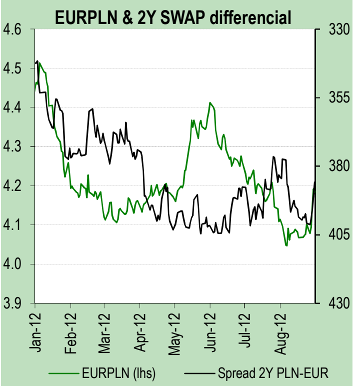
Bank Zachodni WBK

Rates and FX Outlook

Polish Financial Market

September 2012





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- **The long-awaited correction on the Polish foreign exchange market took place at the end of August.** This was driven by intensification of expectations for interest rates reductions in Poland after the Hungarian central bank cut rates and the NBP Governor started to speak in a more dovish tone. Additionally, GDP growth data for Q2 showed quite significant slowdown from 3.5% to 2.4% with falling domestic demand. All these local factors will be still important for the Polish market in the near future and additionally the political and global central banks' agenda is very heavy for September. Therefore, one should expect more volatility after relatively calm summer months.
- **While in July the Polish Monetary Policy Council still kept the restrictive bias, it seems quite obvious that current and expected macroeconomic situation calls for swift change of approach.** Actually, it is interesting that already in July two members of the MPC supported motions to cut interest rates (one by 25 bps and one by 50 bps). We think that in the following months it will be easier to find a majority to support such a decision, especially as the MPC may find itself in hot water over the rate hike decision taken in May. It was then commented as controversial (at least by us), while today it is clear that monetary tightening took place just in the middle of the quarter when the domestic demand contracted on annual basis. The Council increased rates by 25 bps arguing the outlook for Polish economy is more optimistic than the majority of analysts assume. The reality is that slowdown is even deeper that assumed by the most pessimistic forecast (our forecast of 2.6% was the lowest for Q2). Overall, we think it is time to unwind the May's hike and start monetary easing, though we are not so certain that the MPC would do it already at the September's meeting.
- **The weaker-than-expected GDP data for Q2 lead us to change the forecasts for the remainder of the year and 2013 even despite the fact that first releases for Q3 were not that bad**. The problem is that small rebound in industrial output and retail sales in July was driven to a large extent by temporary factors (number of working days etc.) and the following months will most likely confirm the continuation of slowdown. We forecast GDP growth in range 1.5-2.0% in 2H2012, which may put some additional pressure on the Polish currency. In 2013 we see growth of around 2% with some recovery during the year. The outlook for the Polish zloty depends also to a large extent on central banks' activity as well as political events in the euro zone scheduled for the next couple of weeks. For September we expect EURPLN to trade on average around 4.20, while at the same time the short-end of the curve may find further support in expectations regarding monetary policy – even no rate cut in September would be offset by weak data.

This report is based on information available until 3rd September

Short- and Medium-term Strategy

Interest rate market

	Change (bps)		Level	Expected trend	
	Last 3M	Last 1M	end-August	1M	3M
Reference rate	0.00	0.00	**4.75**	→	↘↘
WIBOR 3M	-12	-12	**4.99**	→	↘↘
2Y bond yield	-72	-13	**4.06**	↘	↘
5Y bond yield	-66	-5	**4.35**	↘	↘
10Y bond yield	-59	1	**4.86**	→	→
2/10Y curve slope	12	14	**79**	→	↗

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

Rates: our view and risk factors	
PLN rates market	**Money market:** Market has priced-in earlier monetary easing than previously expected. As a consequence WIBOR 3M fell below 5 0%. If the MPC decides to postpone the rate cut till October (which is our base-case scenario) a correction on FRA market may prove to be short-lived as weak macro data will be published later this month and pricing-in of monetary easing should not change much.
	Short end: The short-end of the curve strengthened significantly due to intensification of expectations for rate cuts faster than previously expected. Yield of 2Y bonds fell to this year's low near 4%, which is a crucial support level and it could be tested later this month. We foresee more significant downward move in case of IRS and asset swap narrowing.
	Long end: Steepening trend to continue. We see some room for further increase in 5-10Y spread. Due to uncertainty of the global situation we expect yield of 10Y to be traded between 4.75-4.95%.
	Risk factors to our view: The MPC decides to cut rates in September by 25bps (or even 50bp). As a consequence the short-end of the curve would fall sharply and yield curve steepen significantly.

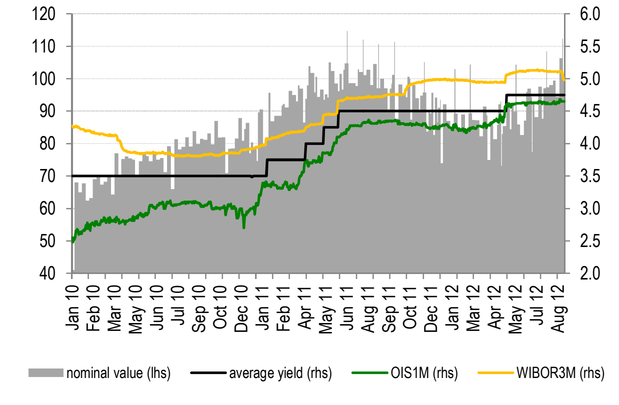
FX market

	Change (%)		Level	Expected trend	
	Last 3M	Last 1M	end-August	1M	3M
EURPLN	-4.7	1.8	**4.18**	→	↗
USDPLN	-5.7	-0.5	**3.34**	↗	↗↗
CHFPLN	-4.7	1.9	**3.48**	→	↗
GBPPLN	-3.8	0.4	**5.28**	→	→
EURUSD	1.1	2.3	**1.25**	→	↘

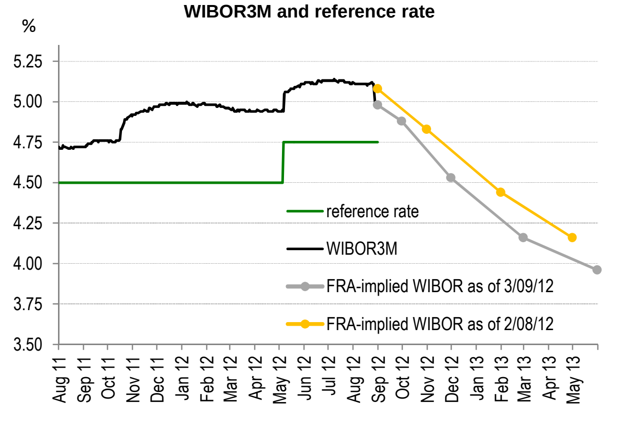
Note: Single arrow down/up indicates at least 1.5% expected move down/up, double arrow means at least 5% move

FX: our view and risk factors	
PLN FX market	**EUR:** The zloty has remained under pressure of interest rate cuts expectations and global mood. The current risk picture calls for more volatility over time and disappointment of central banks' decisions create upside risk for the EURPLN. In medium term we expect the rate to continue its upward move with the target at 4.28 on average in November.
	USD: Hopes for central banks actions should anchor the EURUSD around 1.25. As a consequence we foresee the USDPLN to remain near current level till the end of month. However, disappointment of central banks' action might result in the EURUSD decline towards 1.20, which will translate into the zloty weakening against the US dollar in medium term.
	CHF: We uphold our scenario, assuming the EURCHF around 1.20. We predict the CHFPLN to remain near 3.50.
	Risk factors to our view: Determined and effective actions of central banks will translate into higher risk appetite. Emerging market currencies will benefit from mood improvement, including the zloty. As a consequence the EURPLN could come back to downward trend.

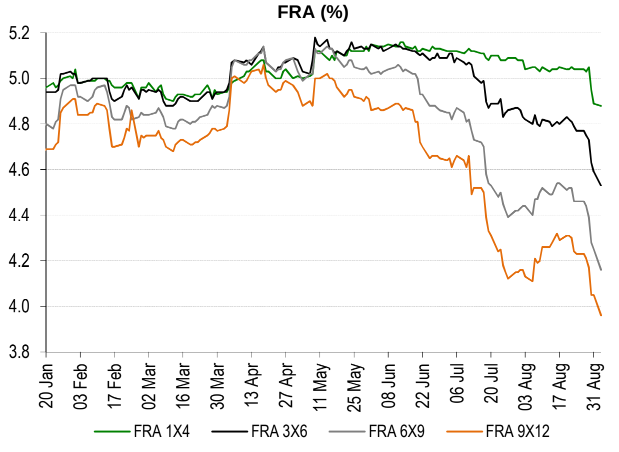
Money Market



NBP Bills held by commercial banks vs market rates



WIBOR3M and reference rate



FRA (%)

OIS rates continued downward move

- Liquidity situation in banking sector has remained favourable in August. Despite a substantial surplus of cash in the system (day before the last day of the reserve it reached PLN9bn) shortest rates remained well above the main market rate (with Polonia rate near 5%). It was unusual situation. However, the beginning of a new reserve period has started with lower rates, including Polonia rate near the reference rate.
- OIS rates have continued the downward move in August. However, the scope of decline in monthly terms was much lower in comparison with July (2-13pbs vs 5-31bps). OIS 3M ended the month at 4.46%. Taking into account current level of Polonia rate, we think that OIS rates suggest that the MPC will cut rates by 100bps in total in one year horizon, with the first cut in September/October, which is in line with expectations on FRA market.

Market players expect fast action by the MPC

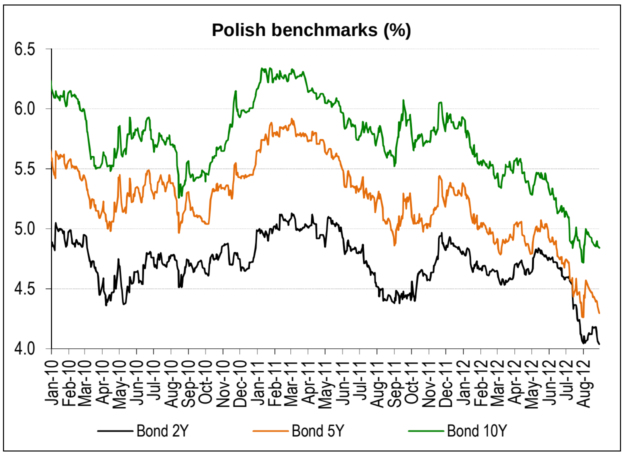
- The better part of August was very calm on money market. WIBOR rates changed very little, stabilising between 5.10-5.12% in case of 3M. As for FRA market, changes in rates were caused by mixed economic releases. While rates of 1x4 and 3x6 remained in rather tight range, rates 6x9 and 9x12 after significant decline (to 4.40% and 4.11%, respectively) have started to move up due to changes in rate cuts expectations.
- July's MPC minutes, which showed that the Council voted two motions for cuts (by 50 and 25bps) and weaker than expected Q2 GDP data (confirming slowdown of the Polish economy) turned into further decline in rates (both WIBOR and FRA). One should notice that after GDP data release WIBOR rates with maturity 3M+ decreased by 5-7bps in daily terms, the highest intra-day decline since June 2009. In the same time FRA rates fell by 10-12bps. One should notice that at the end of August WIBOR 3M was slightly below 5.0%, discounting nearly a half of 25bps cut even at September's meeting.
- We decided to change our interest rate scenario for this year and for 2013. Currently we expect rate cuts by 50bps in total till year-end (with the first move most likely in October) and the next one by 25bps at the start of 2013. As a consequence, we revised downward our WIBOR forecasts, which assumes WIBOR 3M to decrease to slightly 4.60% at the end of December.
- Recently we saw significant decline in FRA rates with 9X12 below 4%. The market is still pricing-in monetary easing by nearly 100bps in one year period. However, market players are expecting a faster action of the Council, assuming the first move in September/October. We think that no cut in September could result in some short-term profit taking after significant rally, which was observed ahead of the meeting.

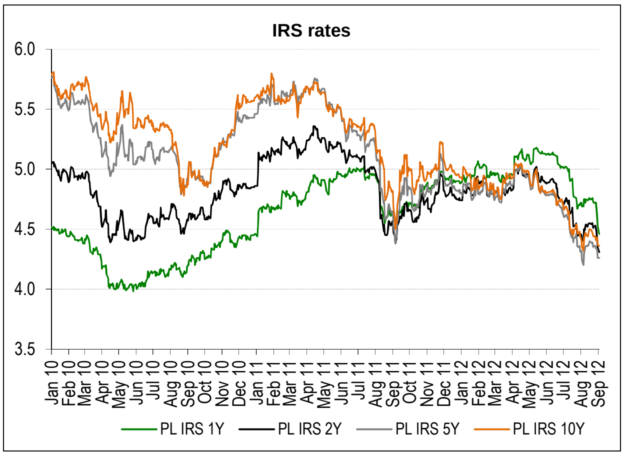
Money market rates (%)

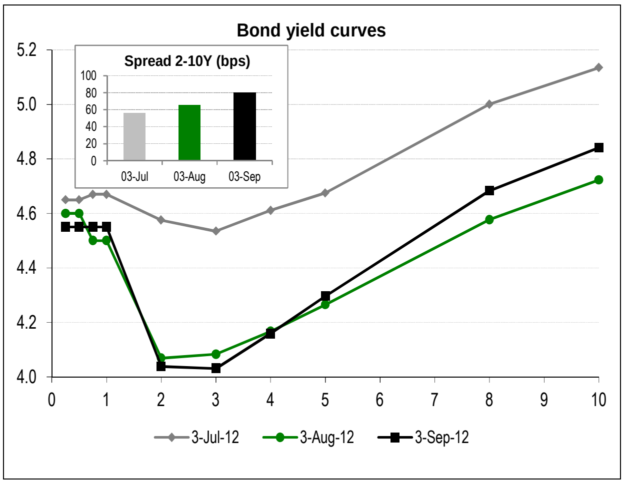
	Reference	Polonia	WIBOR (%)				OIS (%)				FRA (%)			
	rate (%)	(%)	1M	3M	6M	12M	1M	3M	6M	12M	1x4	3x6	6x9	9x12
End of August	**4.75**	**4.78**	**4.90**	**4.99**	**5.01**	**5.02**	**4.65**	**4.46**	**4.24**	**4.03**	**4.89**	**4.59**	**4.25**	**4.05**
Last 1M change (bp)	0	8	-1	-12	-13	-13	2	-7	-14	-13	-19	-28	-17	-10
Last 3M change (bp)	0	-13	-2	-12	-12	-12	3	-18	-44	-65	-23	-54	-78	-86
Last 1Y change (bp)	25	137	29	27	17	15	33	16	1	-13	18	-8	-27	-34

Sources: Reuters, BZ WBK

IRS and T-Bond Market







Q2 GDP data supported the front end of the curve

- The beginning of August brought further significant strengthening of Polish bonds. Strong rate cuts expectations pushed yield of 2Y down to 4.04%, a new this year's minimum and the lowest level since March 2006. Despite quite positive mood for the fixed income assets, investors decided to take profits along the curve, which resulted in yields increase by 15-20bps. The bearish market mood, especially on the long end, had been additionally fuelled by quite strong rise in long term yields on core markets. Macroeconomic data releases, especially lower than expected July's CPI reading stopped the uptrend of yields, which found their resistance levels at 4.20% for 2Y, 4.60% for 5Y and 5.05% for 10Y. At that levels some investors found a good opportunity to purchase bonds.
- The end of August brought significant strengthening of bonds, especially on the short-end of the curve. It came from weaker Q2 2012 GDP data, which confirmed the slowdown of the Polish economy, renewing expectations that the MPC would cut rates later this year. Yield of 2Y benchmark fell again to this year minimum, while yield curve steepened, with 2-10Y spread widening to 80bps.
- IRS rates had remained relatively stable for most of the month. After release of GDP data rates rallied quite significantly, with front-end gaining the most (1Y fell by 13bps, 2Y by 12bps, while 5Y wend down by 6bps and 10Y by 3bps).

The steepening trend is in place

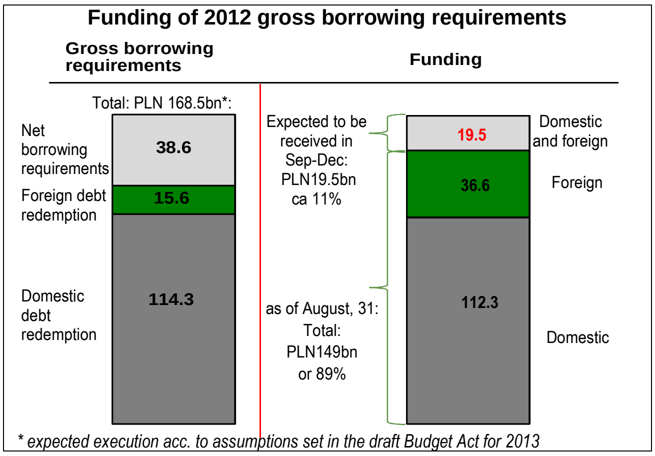
- Economic slowdown finally becomes a fact and perspectives for H2 2012 are rather weak (GDP growth slowdown to below 2%). Therefore, we decided to revise our interest rates expectations, assuming that the Council will start monetary easing in October, after signalling such a decision at its September's meeting. We predict that the MPC will trim rates by 50bps in total (two times) till year-end.
- Expected monetary easing in October and next in November should continue to favour short-term instruments and keep the steepening trend in place (both in case of bonds and IRS). However, yield of 2Y benchmark has fully priced-in rate cuts by 75-100bps and potential for further significant decrease is limited. We foresee yield of 2Y to anchor between 4.00-4.10%, with possibility of testing both limits.
- We expect Polish bond curve to remain steep in the 2-10Y segment. While the 5-10Y spread is trading only 10bps below this year's maximum level, i.e. 63bps, the 2-5Y spread still has some room to flatten (current spread is at 28bps vs this year's minimum at near zero). In case of IRS we foresee further steepening, with 2-5Y spread to come back to positive territory.
- The long-end of the curve will depend on global mood. Uncertainty is strong and risk factors call for more volatility. We foresee yield of 10Y to be traded between 4.75-4.95%.

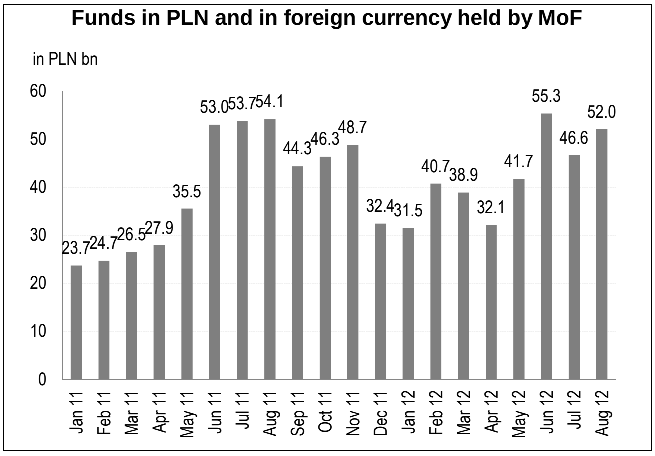
Bond and IRS market (%)

	T-bills	BONDS			IRS			Spread BONDS / IRS (bp)		
	52-week	2Y	5Y	10Y	2Y	5Y	10Y	2Y	5Y	10Y
End of August	**4.55**	**4.06**	**4.35**	**4.86**	**4.35**	**4.26**	**4.37**	**-29**	**9**	**49**
Last 1M change (bp)	5	-13	-5	1	-9	-6	-8	-4	1	9
Last 3M change (bp)	-26	-72	-66	-59	-54	-52	-43	-18	-14	-16
Last 1Y change (bp)	5	-38	-71	-80	-18	-39	-47	-20	-32	-33

Sources: Reuters, BZ WBK

Treasury Securities Supply Corner

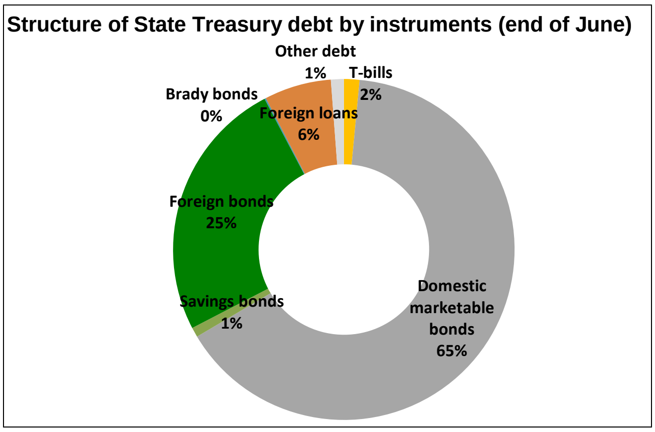




Bond auctions scheduled in September

	Planned supply (bnPLN)	Change of yields since 1.08.2012	Change of yields since 1.01.2012	Yield at last auction
		6.09.12*		
WZ/PS	-	-/-2bps	-	-/4.36
		19.09.12		
IZ0823	2.0-4.0	-	-	-
WZ0121		-	-	-
DS1021		-4bps	-101bps	5.56

*Switch auction



Sources: Ministry of Finance, BZ WBK

The 2012 borrowing needs to fulfil until end of October

▪ As we mentioned in previous report in August the MF activity on the primary market was very light. At the end of this month this year's borrowing requirements were financed in nearly 90%. While presenting issuance plan for September the head of debt department Piotr Marczak said that this year's borrowing needs will be completed until the end of October at the latest. He added that till year-end, the Ministry plans the proceeds from issuance on the primary market to be over PLN15bn less than spending on debt redemption and servicing (now it is near 31bn). It confirms the prospects of thin supply in the rest of the year, which should be a supportive factor for bond market.

▪ The liquidity situation of the Polish budget is very favourable. At the end of August the Ministry held funds worth ca. PLN52bn (both in PLN and in foreign currency), up from PLN46.6bn in previous month.

The MF has started pre-financing the 2013 requirements

▪ In September the MF increases slightly its activity on the primary market. The Ministry will offer 5Y benchmark PS0417 and floating-rate bonds WZ0117 on switch tender, buying back bonds maturing between October 2012 and January 2013. In this way the MF officially announced that it starts pre-financing the 2013 borrowing requirements. We would like to recall that now the amount outstanding of OK1012 is worth ca. PLN20.3bn and nearly 50% of this sum is owned by foreign investors.

▪ At standard auction (which will take place on 19 September) the Ministry decided to offer floating rate bonds WZ0121, 10Y benchmark DS1021 or inflation-linked bonds IZ0823 worth PLN2.0-4.0bn. However, the structure of final supply (bonds and value of offer) will be announced 2 days before the tender, strongly depending on the market conditions.

▪ As expected the Ministry once again has resigned from selling of T-bills and short-term bonds this month. We think that lack of 2Y benchmark in September's issue plan should support 5Y sector as the 5Y benchmark PS0417 could represent the front-end of the curve. On the other hand we foresee some interest in purchasing floating-rate bonds, especially from domestic commercial banks. It will be the last chance to buy these instruments with a high coupon. One should notice that in July 2012 – January 2013 period coupon rate amounted to 5.15%. However, we think that investors would like to purchase these instruments at lower prices as compared to previous auctions.

The MF announced buyback of Brady's

▪ Announcing the September's issuance plan the Ministry also mentioned that it has planned to redeem before maturity all of the Brady's RSTA and PAR bonds worth USD297m on October 27. Piotr Marczak, the head of Debt Department in the Ministry, explained that "yields on these bonds are currently higher than the cost of financing on the American market, and the prices of Brady's bonds on the secondary market are above their nominal value. In order to carry out a pre-maturity buyback, we will use a call option which gives us the right to redeem a part or the total at the nominal value on each day of interest payment (twice a year)."

▪ This decision in general should support the market, showing that current budget situation is favourable and the MF will use liquidity cushion to buy back bonds (not only foreign ones), especially if market conditions deteriorate significantly.

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	4,000	4,000	2,000	0	75,462
T-bills auction	2,223	5,778	3,000										11,001
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					29,569
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**	**4,160**	**4,150**	**2,150**	**150**	**149,854**
Redemption	11,297	3,981	5,275	20,795	4,906	2,778	20,459	3,191	1,122	21,427	2,256	2,368	99,855
Net inflows	**41,540**	**15,749**	**8,496**	**-6,183**	**4,896**	**12,080**	**-14,467**	**4,450**	**3,038**	**-17,277**	**-106**	**-2,218**	**49,998**
Rolling over T-bonds	6,309			7,966		2,459	4,908						**21,641**
Buy-back of debt*										**995**			**995**
Total	**47,848**	**15,749**	**8,496**	**1,782**	**4,896**	**14,539**	**-9,559**	**4,450**	**3,038**	**-18,272**	**-106**	**-2,218**	**70,644**
Coupon payments	*1,451*			*7,211*			*1,497*		*1,455*	*8,038*			*19,741*

*Note: Our forecasts – shaded area, */ expected buy-back of Brady's*

Schedule Treasury Securities redemption by instruments (in PLNm)

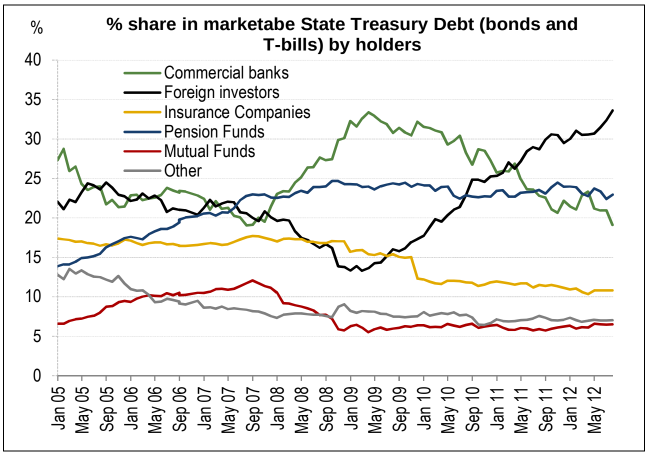
	Bonds	Bills	Retail bonds	Total domestic redemption	Foreign Bonds/Credits	Total redemptions
January	10 946	0	351	**11 297**		**11 297**
February		3 799	182	**3 981**		**3 981**
March		1 997	129	**2 125**	3 150	**5 275**
April	20 663		132	**20 795**		**20 795**
May		2 223	117	**2 339**	2 567	**4 906**
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	20,262		265	**20,527**		**20,527**
November		1,332	208	**1,540**	716	**2,256**
December		2,223	146	**2,368**		**2,368**
Total 2012	66,211	13,571	2,283	**82,065**	15,891	**97,955**
Total 2013	82,468	6,110	1,698	**90,276**	14,825	**105,102**
Total 2014	58,958		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+	210,506		3,288	**213,794**	134,966	**348,760**

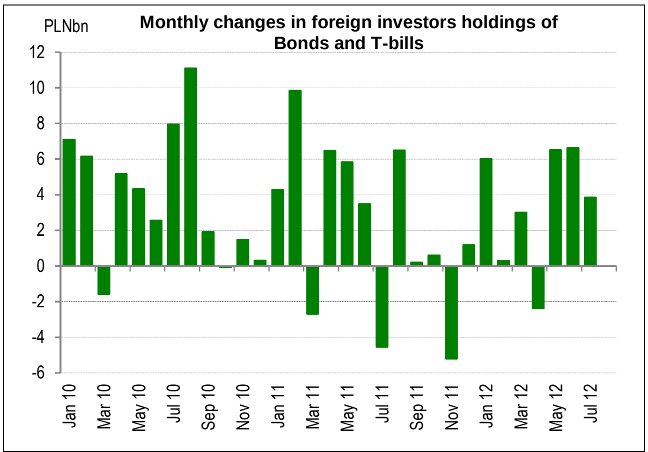
Schedule wholesales bonds redemption by holders (data at the end of July 2012, in PLNm)

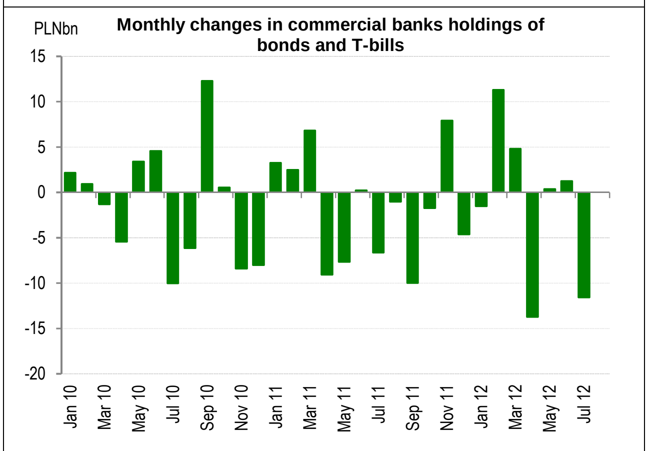
	Foreign investors	Domestic banks	Insurance Funds	Pension Funds	Mutual Funds	Individuals	Non-financial sector	Other	Total
Q1 2012	0	0	0	0	0	0	0	0	0
Q2 2012	0	0	0	0	0	0	0	0	0
Q3 2012	0.3	0.0	0.0	0.0	0.0	33.1	0.3	0.8	35
Q4 2012	11,114	4,018	791	1,504	525	84	30	2,231	20,296
Total 2012	**11,114**	**4,018**	**791**	**1,504**	**525**	**117**	**30**	**2,232**	**20,331**
	55%	**20%**	**4%**	**7%**	**3%**	**1%**	**0%**	**11%**	**100%**
Total 2013	37,375	11,643	13,021	11,815	3,609	491	97	4,552	82,602
	45%	14%	16%	14%	4%	1%	0%	6%	100%
Total 2014	26,417	9,707	5,171	10,520	3,353	424	116	3,540	59,248
	45%	16%	9%	18%	6%	1%	0%	6%	100%
Total 2015	24,140	21,307	6,887	16,131	5,282	194	783	4,226	78,951
	31%	27%	9%	20%	7%	0%	1%	5%	100%
Total 2016	14,431	8,412	6,083	24,170	6,651	47	85	2,795	62,673
	23%	13%	10%	39%	11%	0%	0%	4%	100%
Total 2017+	63,896	40,295	23,793	56,445	13,460	256	554	8,311	207,011
	31%	19%	11%	27%	7%	0%	0%	4%	100%

Sources: Ministry of Finance, BZ WBK

Treasury Securities Holders







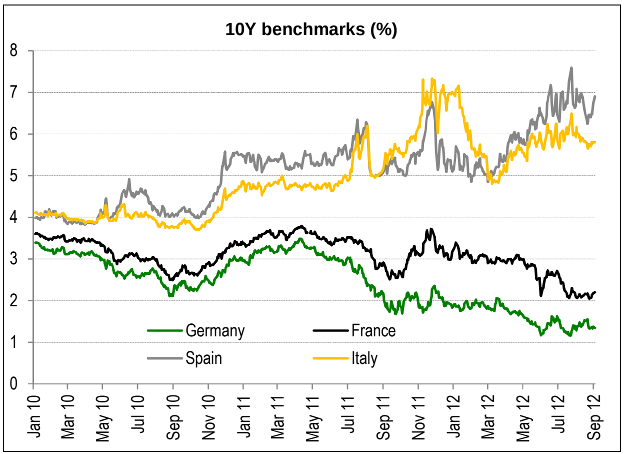
Foreign investors increase their portfolio to record high

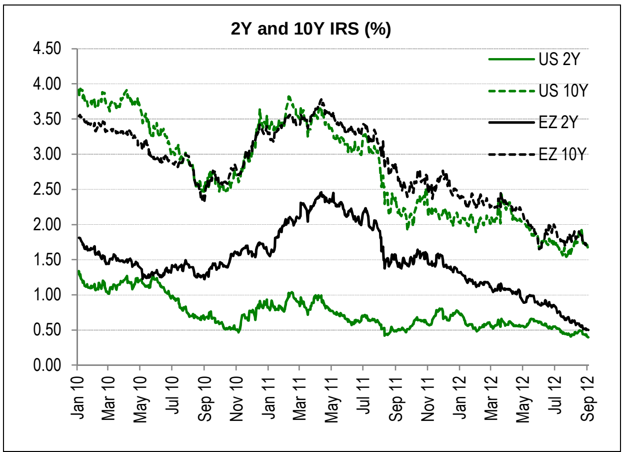
- The total value of Polish marketable debt declined in July by PLN8.7bn. To large extent that was due to maturing OK0712. Exposure of foreign investors reached record high in July for third month in a row. Their share in total debt is also highest in the history and they remain the biggest single holder of Polish debt.
- Non-resident investors increased their portfolio for 3rd month in a row. However, the nominal increase is getting lower and lower (from PLN7.4bn in May to PLN3.4bn in July). Foreign banking sector was the biggest contributor to higher value of bond portfolio. Purchases of this group of investors concentrated in the short-end and middle of the yield curve. Biggest increase of holdings was recorded in case of OK0714 (by PLN2.6bn to PLN2.7bn – investors rapidly started to accumulate new benchmark). Also new 5Y benchmark (PS0417) was often purchased and banks' holding of this security increased to PLN1.78bn from PLN504.8m in June.
- Quite the opposite situation occurred in case of domestic investors where banks were mostly responsible for smaller engagement among Polish debt holders. However, it is worth to notice that the reduction was caused to large extent by maturing OK0712 (in June Polish banks held PLN6.2bn of this 2Y bond). Due to this event, monthly reduction was biggest since September 2011. Just like in case of foreign banks, domestic one also purchased new 2Y benchmark (PLN1.4bn).
- Regarding other groups of Polish investors, insurance companies cut their holdings by PLN1.2bn versus June (biggest monthly decline since December 2011). Again, that was mainly due to maturity of OK0712.
- In case of other remaining types of investors there were no major changes in value of held bonds.

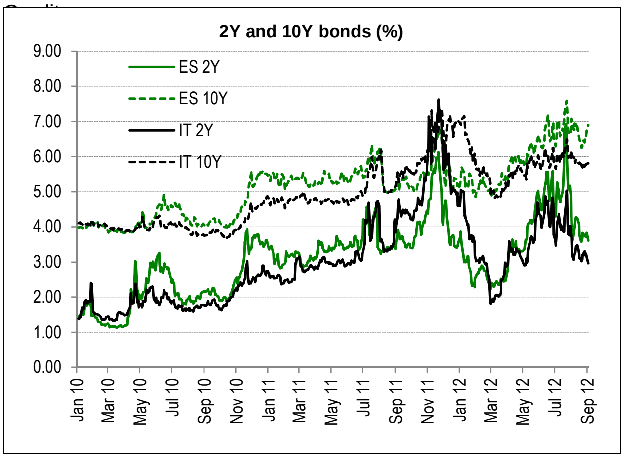
Holders of marketable bonds	Nominal value (PLN, bn)				Nominal value (PLN, bn)			% change in July			Share in TOTAL (%) in July
	End July	End June	End Q2 2012	End Q1 2012	End 2011	End 2010	End 2009	MoM	QoQ	YoY	
Domestic investors	340.8	352.9	352.9	361.5	349.8	354.1	336.2	-3.4	-	-4.1	65.8
Commercial banks	95.4	102.1	102.1	110.9	103.3	110.4	112.1	-6.6	-	-9.0	18.4
Insurance companies	55.7	57.0	57.0	54.3	55.5	59.5	53.8	-2.2	-	-5.9	10.8
Pension funds	120.6	120.3	120.3	120.7	122.2	117.0	111.0	0.2	-	-0.7	23.2
Mutual funds	32.9	33.0	33.0	31.3	31.7	30.2	26.8	-0.3	-	13.6	6.4
Others	36.2	40.5	40.5	44.3	37.1	37.0	32.5	-19.7	-	-11.6	7.0
Foreign investors*	177.4	174.0	174.0	163.2	152.5	124.8	78.6	2.0	-	20.5	34.2
Banks	28.9	22.6	22.6	24.3	16.2	21.9	17.4	27.8	-	24.9	5.6
Non-bank fin. sector	139.7	143.1	143.1	131.7	129.3	96.8	58.0	-2.3	-	18.5	27.0
Non-financial sector	6.0	5.2	5.2	4.4	4.5	4.2	2.3	14.3	-	53.6	1.2
TOTAL	518.2	526.9	526.9	524.7	502.3	478.9	414.8	-1.7	-	3.1	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







Investors to adopt a cautious approach

- A summer mood prevailed on the core market in August– thin liquidity and rather stable investors' sentiment. The absence of negative surprises stemming from the macro data, but also political voices, suggesting the euro zone leaders' commitment "to do everything to maintain the common currency" supported the financial markets, especially high-yielded bonds. As a consequence we observed some profit-taking on the safe haven instruments, which translated into increase in yield of 10Y benchmarks: above 1.80% in case of the US Treasuries (the highest level since May) and to 1.55% in case of Bunds.
- Markets have remained on the cautious side ahead of Jackson Hole at the end of August and central banks' meetings in September. It has shifted demand on the US Treasuries and Bunds, which yields come back to the downward trend. One should also notice that yields curves narrowed again after significant widening in mid-August.
- The Fed chairman B. Bernanke did not announce QE3 in Jackson Hole, reiterating the Fed's easing stance. Therefore the August jobs report (which will be published on September, 7) becomes crucial in gauging the odds of QE. Moreover, several important "risk" events are scheduled for the coming weeks, potentially leading to some volatility, including: the ECB meeting, the German Constitutional Court ruling on the ESM and the Ecofin meeting. The focus will be on the much-awaited ECB meeting. We think that it is unlikely that the ECB will announce a yield cap or a very detailed strategy for bond purchasing. Thus, we see some room for investors to be disappointed, potentially triggering a bit of risk-off.

Central banks' meeting crucial for peripheries' debt

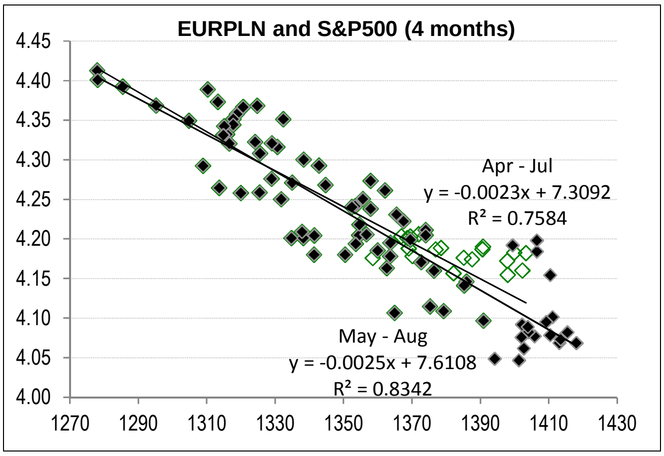
- Italian and Spanish yields have decreased sharply due to speculation about the ECB's purchase programme. This was partly confirmed by the ECB as in August the bank said that the purchases would be focused on the short-term maturities. Rumours about the introduction of a "yield cap" pushed yields down sharply. However, after the Bundesbank repeated its opposition to all kinds of ECB sovereign bond buying, enthusiasm waned quickly. Yields of Spanish bonds climbed at the end of August (after three weeks decline) due to information that Catalonia will need to tap a government rescue fund. As a consequence, the Spanish bonds lost slightly in August (yield of 10Y benchmark increased by 6bps in monthly terms), while Italian debt gained, with yield decrease by 25bps in 10Y sector.
- Situation on the euro zone peripheries will strongly depend on the ECB's decision. Some disappointment could translate into yields increase (mainly on the long-end), but profit-taking should be only short-lived. The front end will be well bidded.

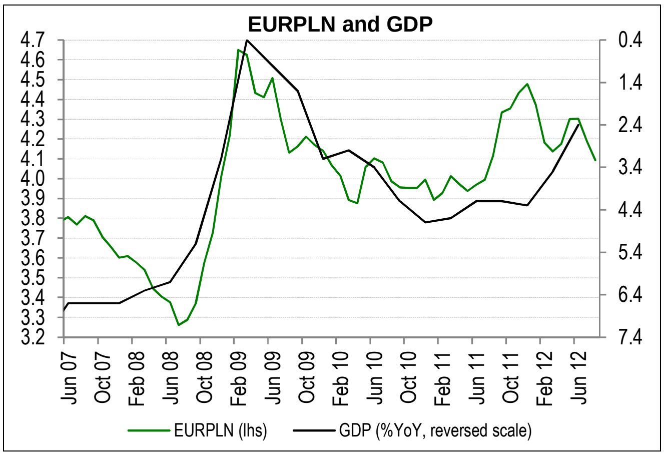
Euro zone's issuance plans and completion in 2012 (€ bn)

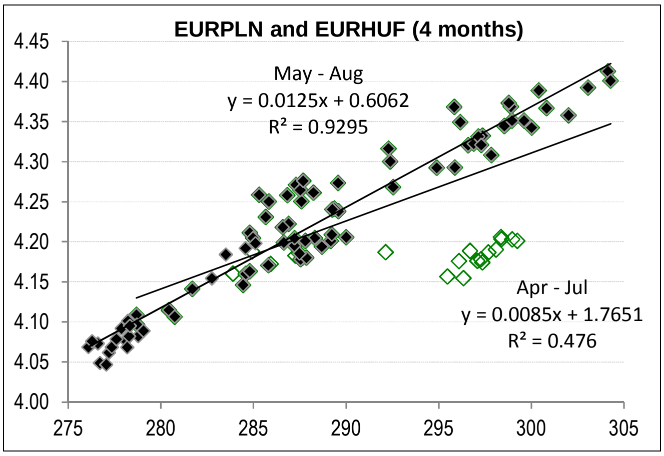
	Total redemptions	Deficit	Borrowing needs	Expected bond supply	% of completion (YtD)
Austria	14	8.3	22.3	21.6	75
Belgium	27.9	7	34.9	31.5	74
Finland	6.3	7.5	13.8	13.8	55
France	101.7	78.7	180.4	178.0	74
Germany	157	26.6	183.6	175.0	67
Greece	33.2	16.2	49.4	-	-
Ireland	5.5	13.7	19.2	-	-
Italy	192.2	41.1	233.3	216.0	59
Netherlands	29.7	12.3	42	60.0	85
Portugal	12.9	17.4	30.3	-	-
Spain	50.1	36.2	86.3	85.9	69
Total	**630.5**	**265.0**	**895.5**	**781.7**	69

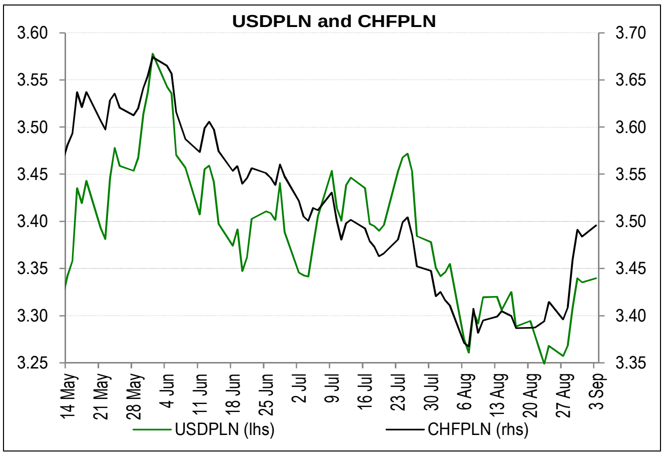
Source: Reuters, BZ WBK

Foreign Exchange Market









Sources: Reuters, BZ WBK

Zloty weaker after comment of NBP governor & GDP data

- Just as we suspected, the positive momentum after the ECB meeting was continued on the Polish FX market, but that was only a temporary move. In early August the EURPLN reached 4.026 (lowest level for a year) but in the following weeks the exchange rate stayed in the range of ca. 4.05-4.10.
- The relationship of the EURPLN with the EURUSD remained insignificant while still quite strong correlation of the domestic currency with the S&P500 indicates the zloty was long backed by expectations for the QE3. US stock indexes rising to highest level since April helped the EURPLN to stay relatively close to local lows for a better part of August.
- At the end of the month the EURPLN successfully tested the resistance at 4.10 due to strengthening worries over the global economic growth. As it appeared in the following days, it was only a beginning of zloty's depreciation. Dovish comment of the NBP governor on switch of MPC's bias and disappointing data on Polish Q2 GDP put further very negative pressure on the domestic currency. Consequently, the EURPLN tested 4.20 and ended the month just below that level. As a result, in August the zloty depreciated versus the euro and Swiss franc by ca. 1.7% and gained 0.2% versus the dollar.

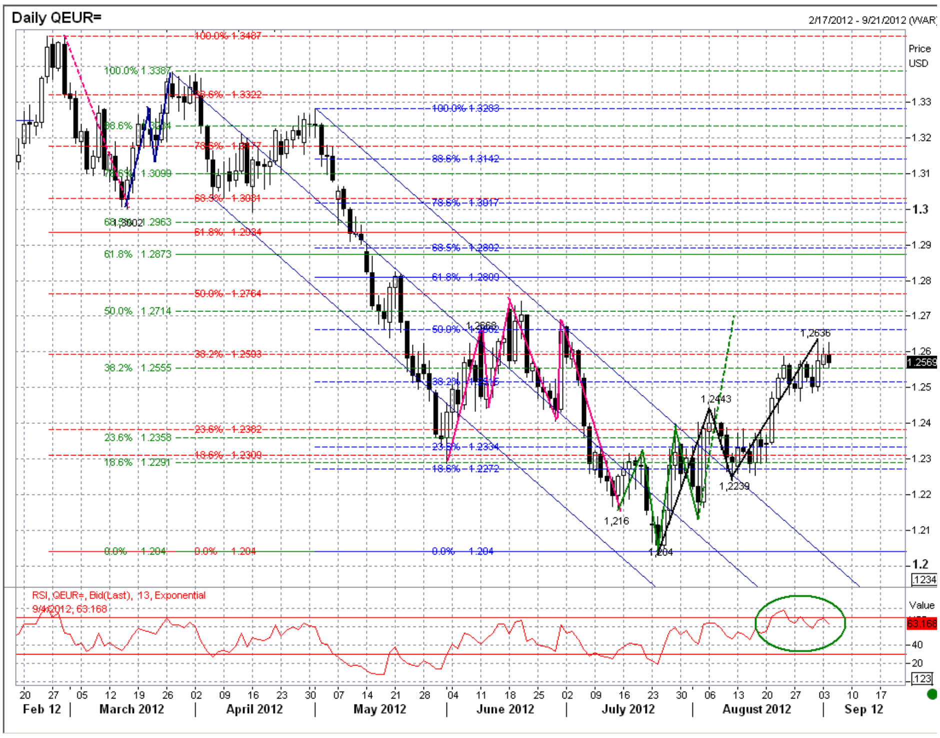
Very heavy calendar for September to affect PLN

- Despite the end of holidays, September is likely to be quite a hot month on the FX market as the calendar is full of events of great importance for prospects of the euro zone. Last days of August seem to be pretty good omen of high volatility to stay on the market. In the first week of September investors will focus on the outcome of the ECB meeting. It is rather unlikely to us that the central bank will present final solution to tensions on the financial market as the Bundesbank still opposes bond buying. Furthermore, the ECB may to wait until the German Constitutional Court makes its judgment on the ESM (September 12th). Consequently, the ECB is rather likely to try to buy some time and sustain hopes for more action in the future and thus the negative reaction for the outcome of the central bank meeting may be limited.
- Also in the middle of the month (September 13th) the FOMC holds its meeting. After Bernanke's speech in Jackson Hole in late August it seems that coming payrolls data will determine whether – in market's view – the Fed will decide to expand monetary stimulus as soon as in September.
- Regarding last comment of the NBP governor indicating the MPC is closer to rate cuts than hikes and the unexpected rate cut in Hungary, it is worth to notice that the relationship of the EURPLN and the EURHUF clearly tightened during August. It was a rate cut by the MNB that triggered forint's depreciation and the zloty followed that development. Possibility of further cuts was not excluded by the Hungarian MPC. Moving forward, the statement of Marek Belka also contributed somewhat to zloty's depreciation in late August. Consequently, the change of monetary policy bias and (sooner or later) rate cuts by the MPC may put some additional negative pressure on the zloty.
- The case of euro zone debt crisis will also surely play crucial role. In mid-September meeting of the Ecofin is scheduled and at the end of the month or early October Troika is expected to release a report of reform progress in Greece.
- To sum up, September may be quite volatile month not only due to global events but also domestic factors. We expect the EURPLN to be on average at 4.18, but given the uncertainty of how the above-mentioned important events may influence the market, there is quite high risk regarding this forecast.

FX Technical Analysis Corner

EURPLN

- EURPLN did not manage to break support at 4.026 and in late August advanced above the resistance at 4.10.
- The exchange rate is now slightly below next vital resistance area at 4.20-4.22 (two Fibo retracements are accompanied by local peak from July) If it is broken, EURPLN may head towards ca. 4.30.
- Apart from this strong resistance, the potential for further increase is limited by divergence with the RSI.



EURUSD

- Upward band of downward trend and cloud of Fibo resistance levels were broken and the exchange rate advanced above 1.26. That is less than projection from H&S formation indicated last month (1.27).
- In early September, the EURUSD is testing next group of Fibonacci resistance levels (though less tight than the one broken in August). Furthermore, last wave of upward move has pretty strong Fibonacci properties. Another factor that may limit potential for further increase is a divergence of the EURUSD and RSI.
- The exchange rate may test 1.27 but room for further increase seems to be rather limited.

Sources: Reuters, BZ WBK

Poland vs other countries - economy

Main macroeconomic indicators (European Commission's forecasts)

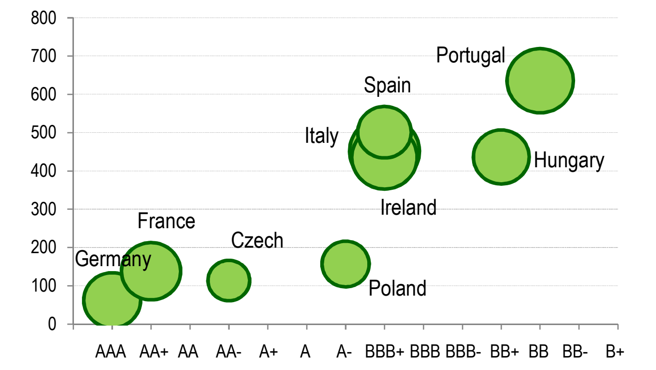
	GDP* (%)		Inflation* (HICP, %)		C/A balance (% of GDP)		Fiscal Balance (% of GDP)		Public Debt (% of GDP)	
	2012F	2013F	2012F	2013F	2012F	2013F	2012F	2013F	2012F	2013F
Poland	**2.7**	**2.6**	**3.7**	**2.9**	**-3.9**	**-4.2**	**-3.0**	**-2.5**	**57.1**	**57.5**
Czech Republic	0.0	1.5	3.3	2.2	-3.2	-3.2	-2.9	-2.6	41.9	44.0
Hungary	-0.3	1.0	5.5	3.9	2.2	3.7	-2.5	-2.9	76.5	76.7
EU	0.0	1.3	2.6	1.9	0.3	0.7	-3.6	-3.3	84.9	84.9
Euro area	-0.3	1.0	2.4	1.8	0.6	1.0	-3.2	-2.9	90.4	90.9
Germany	0.7	1.7	2.3	1.8	4.7	4.5	-0.9	-0.7	82.2	80.7

*Note: * European commission – May 2012*

Sovereign ratings

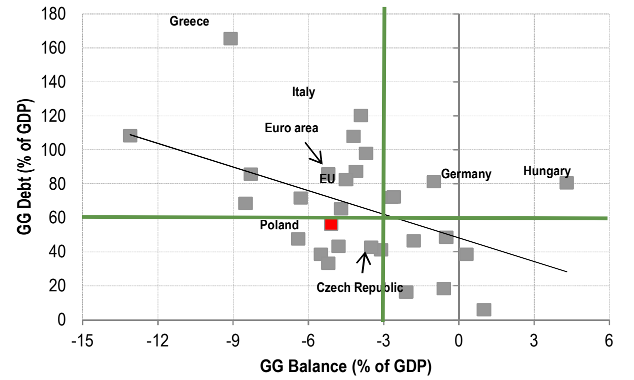
	S&P		Moody's		Fitch	
	rating	outlook	rating	outlook	rating	outlook
Poland	A-	stable	A2	stable	A-	stable
Czech	AA-	stable	A1	stable	A+	stable
Hungary	BB+	negative	Ba1	negative	BB+	negative
Germany	AAA	stable	Aaa	negative	AAA	stable
France	AA+	negative	Aaa	negative	AAA	negative
UK	AAA	stable	Aaa	negative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

5Y CDS rates vs credit ranking according to S&P

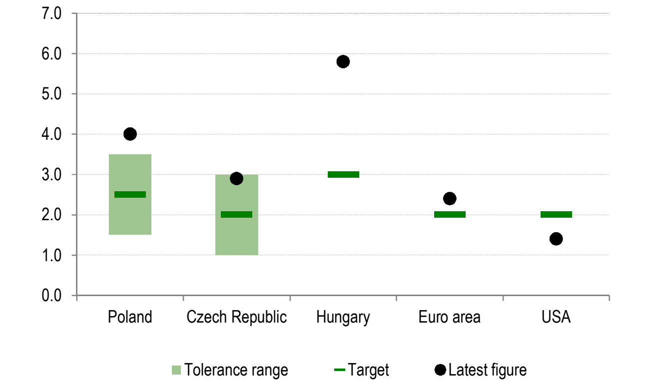


Note: Size of bubbles reflects the debt/GDP ratio

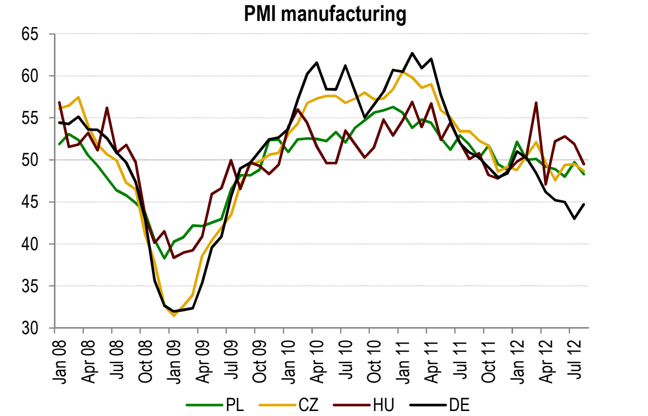
Fiscal position of the EU countries



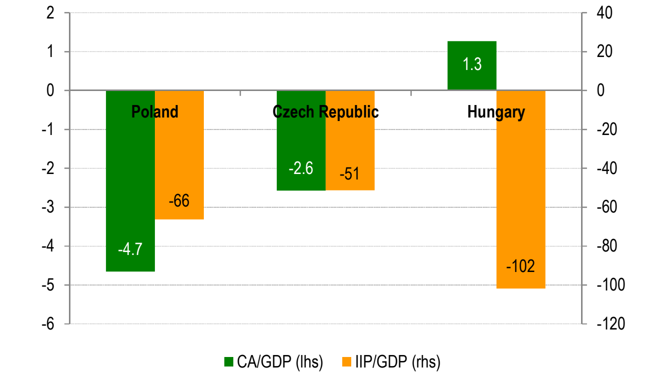
Inflation rates vs targets



PMI manufacturing



Current account balance & International Investment Position (end of Q1 2012 - cumulative data, % of GDP)

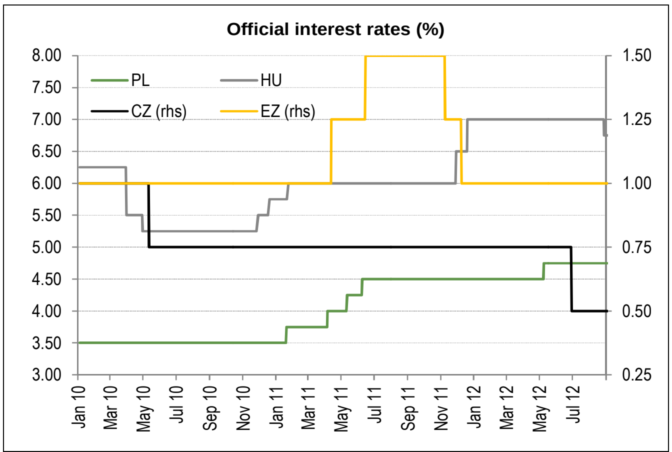


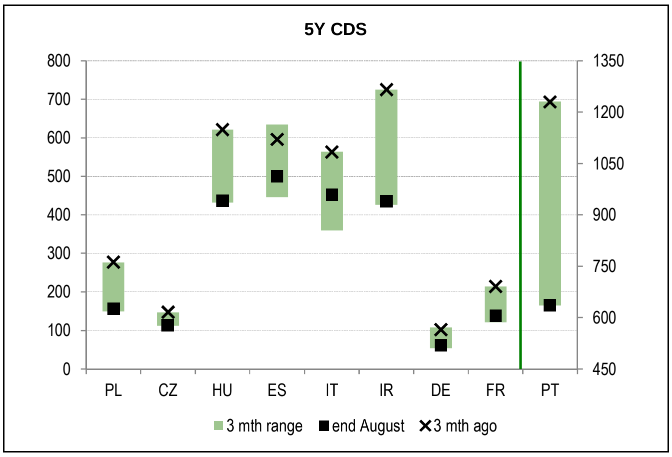
Source: stat offices, central banks, Reuters. BZ WBK, EC

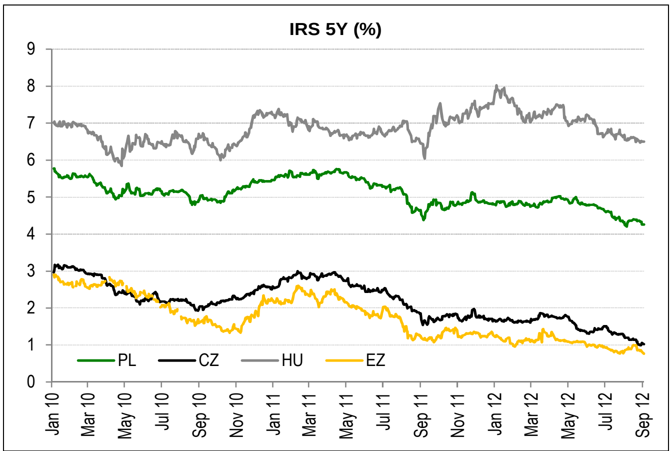
Poland vs other countries - market

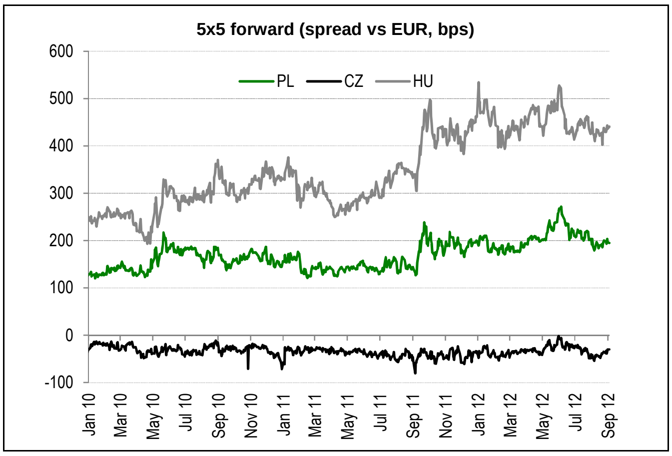
Main market indicators (%)

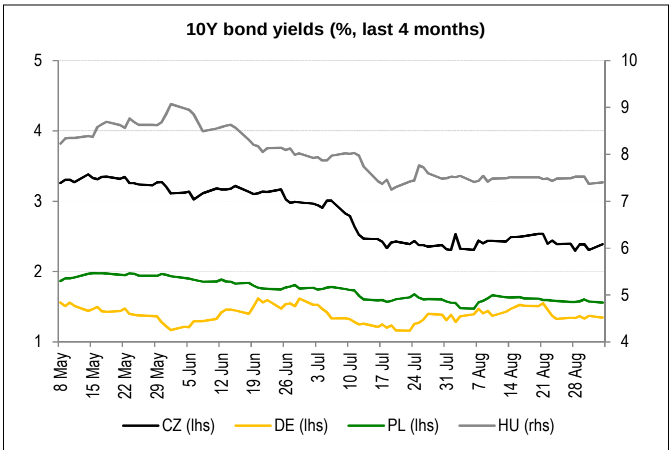
	Reference rate (%)		3M market rate (%)		10Y yields (%)		10Y Spread vs Bund (bps)		CDS 5Y	
	2011	2012F	2011	end of August	2011	end of August	2011	end of August	2011	end of August
Poland	**4.50**	**4.25**	**4.99**	**4.99**	**5.88**	**4.86**	**405**	**349**	**279**	**155**
Czech Republic	0.75	0.50	0.78	0.60	3.59	2.31	176	94	173	114
Hungary	7.00	6.50	7.24	6.90	9.90	7.37	807	600	610	436
Euro area	1.00	0.50	1.36	0.28						
Germany					1.83	1.37			100	62

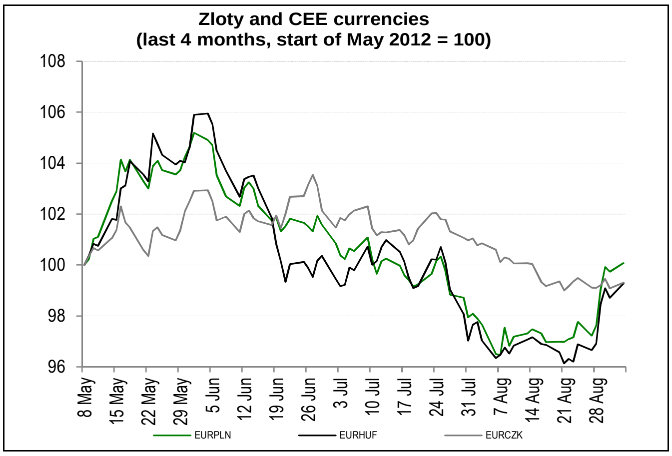












Source: stat offices, central banks, Reuters. BZ WBK, EC

Central Bank Watch

		Last	2011	2012F	Expected changes (bps) 1M	3M	6M	Risks
Euro	Forecast	0.75	1.00	0.50				The ECB keeps interest rates on hold and does not announce any new information about support for peripheries compared with previous meeting
	Market implied »				0	-5	-6	
UK	Forecast	0.50	0.50	0.50				Rates on hold, but market does not exclude a further round of QE.
	Market implied »				-4	-10	-14	
US	Forecast	0-0.25	0-0.25	0.25				Rates on hold. However, speculation of further stimulus is still valid. Jobs report is crucial
	Market implied »				0	-4	-5	
Poland	Forecast	4.75	4.50	4.25				The MPC might decide to cut rates in September due to deeper than expected economic slowdown.
	Market implied »				-10	-40	-74	
Czech	Forecast	0.50	0.75	0.50				The CNB should keep interest rates unchanged till year-end.
	Market implied »				27	6	-10	
Hungary	Forecast	6.75	7.00	6.50				Unexpectedly, the NBH trimmed rates by 25bps in August. If HUF continues to weaken significantly, the NBH could delay further cuts.
	Market implied »				-16	-33	-84	

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

Economic Calendar and Events

Date		Event:	Note:
5-Sep	**PL**	**MPC Meeting – interest rate decision**	**We foresee interest rates to remain unchanged, but the MPC may want to signal a cut**
	DE	Auction of 10Y bonds	Offer: €5.0bn
6-Sep	**PL**	**Switch tender**	**T-bonds to be repurchased: OK1012 and OK0112, bonds to be sold: PS0417 and WZ0117**
	EZ	ECB Meeting – interest rate decision	-
11-Sep	EU	European Commission on Banking Union	
12-Sep	DE	German Constitutional Court decision on ESM	-
	DE	Auction of 5Y bonds	Offer: €5.0bn
13-Sep	**PL**	**CPI inflation for August**	**Our forecast: 3.7%YoY, slightly below market consensus**
	US	FOMC Meeting - interest rate decision	Summary of Economic Projections will be released
	IT	Auction of medium and long term bonds	-
14-15-Sep	EU	Eurogroup / ECOFIN meetings	-
18-Sep	**PL**	**Wages and employment for August**	**We expect muted wages growth (by 2.9%YoY) and employment increase near zero**
19-Sep	**PL**	**Industrial output for August**	**We foresee significant slowdown in industrial output compared with previous month**
	PL	**Auction of WZ0121/DS1021/IZ0823**	**Offer: PLN2.0-4.0bn**
	DE	Auction of 2Y bonds	Offer: €5.0bn
20-Sep	**PL**	**Minutes from August's MPC meeting**	**-**
	PL	**Core inflation measures for August**	**We expect core inflation exc. food & energy prices at 2.2%YoY, above market expectations**
25-Sep	HU	NBH Meeting – interest rate decision	
26-Sep	DE	Auction of 10Y bonds	Offer: €5.0bn
27-Sep	IT	Auction of medium and long term bonds	-
	CZ	CNB Meeting - interest rate decision	-
3-Oct	**PL**	**MPC Meeting – interest rate decision**	**We foresee the MPC to cut rates by 25bps**
4-Oct	**PL**	**Switch tender**	**T-bonds to be repurchased may be securities maturing from October 2012 to January 2013**
	EZ	ECB Meeting – interest rate decision	-
8-Oct	EZ	Eurogroup meeting	-

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	1,416.4	1,524.7	1,597.9	1,666.8	370.5	388.4	394.4	444.6	386.4	404.3	411.3	464.8
GDP	%YoY	3.9	4.3	2.2	1.9	3.5	2.4	1.7	1.5	1.5	2.0	2.0	2.0
Domestic demand	%YoY	4.6	3.7	-0.1	1.1	2.7	-0.2	-1.1	-1.2	-0.2	0.5	2.2	1.6
Private consumption	%YoY	3.2	3.1	1.7	1.7	2.1	1.5	1.5	1.6	1.6	1.7	1.8	1.9
Fixed investments	%YoY	-0.2	8.3	0.0	-2.6	6.7	1.9	-2.0	-2.0	-4.0	-4.0	-3.0	-1.0
Unemployment rate [a]	%	12.4	12.5	13.6	13.6	13.3	12.4	12.5	13.6	14.0	13.5	12.9	13.6
Current account balance	EURm	-16,493	-15,917	-12,216	-7,219	-4,344	-2,702	-2,153	-3,017	-2,243	-947	-1,816	-2,212
Current account balance	% GDP	-4.7	-4.3	-3.2	-1.8	-4.7	-4.5	-3.8	-3.2	-2.6	-2.2	-2.0	-1.8
General government balance	% GDP	-7.8	-5.1	-3.0	-3.0	-	-	-	-	-	-	-	-
CPI	%YoY	2.6	4.3	3.8	2.5	4.1	4.0	3.9	3.3	2.7	2.1	2.5	2.5
CPI [a]	%YoY	3.1	4.6	3.0	2.5	3.9	4.3	4.0	3.0	2.5	2.1	2.5	2.5
CPI excluding food and energy prices	%YoY	1.6	2.4	2.3	2.1	2.5	2.5	2.2	2.1	2.2	2.0	2.2	2.2
EUR/PLN	PLN	3.99	4.12	4.23	4.15	4.23	4.26	4.15	4.27	4.20	4.15	4.15	4.10
USD/PLN	PLN	3.02	2.96	3.35	3.38	3.23	3.32	3.35	3.49	3.48	3.39	3.35	3.29
CHF/PLN	PLN	2.90	3.34	3.52	3.37	3.50	3.55	3.46	3.56	3.50	3.39	3.32	3.28
GBP/PLN	PLN	4.66	4.75	5.23	5.02	5.26	5.34	5.22	5.09	4.91	4.85	5.26	5.34
Reference rate [a]	%	3.50	4.50	4.25	4.00	4.50	4.75	4.75	4.25	4.00	4.00	4.00	4.00
WIBOR 3M	%	3.94	4.54	4.94	4.27	4.97	5.04	5.08	4.66	4.33	4.23	4.25	4.25
Yield on 2-year T-bonds	%	4.72	4.81	4.40	3.90	4.66	4.71	4.21	4.00	3.90	3.90	3.90	3.90
Yield on 5-year T-bonds	%	5.31	5.44	4.66	4.10	5.02	4.93	4.45	4.25	4.10	4.10	4.10	4.10
Yield on 10-year T-bonds	%	5.74	5.98	5.18	4.90	5.58	5.38	4.91	4.85	4.91	4.90	4.90	4.90

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

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

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