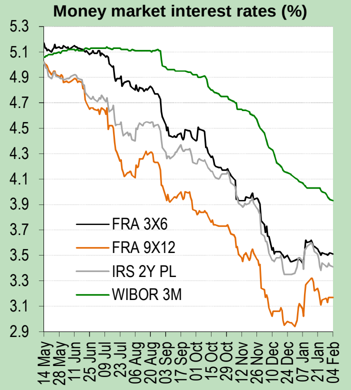
Bank Zachodni WBK

Rates and FX Outlook

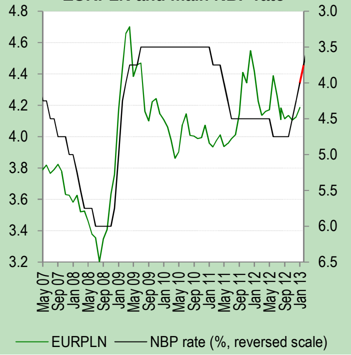
Polish Financial Market

February 2013

Money market interest rates (%)



EURPLN and main NBP rate



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- **Our view presented last month has materialised – the outcome of the MPC's meeting in January disappointed fixed income investors, while the following data releases brought another downward trend in yields.** However, the month ended with yields higher as compared to end-December. This was due to the fact that the MPC not only cut rates cautiously by 25bps, but also suggested an upcoming pause in easing cycle. This caused a move by around 30bps across the curve to almost 3.40% in 2Y and above 3.60% in 5Y. The suggested pause in easing cycle is very unlikely to materialise and market re-started to price-in such a scenario after data publication. First, inflation indicators are still in clear downward trend: headline CPI below the NBP target (2.4%), core inflation below the lower end of tolerance band around the CPI target (1.4%), PPI deflation of 1.5%. Secondly, economic activity data for December were all (much) below the market consensus: double-digit fall in industrial production, above 20%YoY slump in construction, retail sales decrease on annual basis. However, even after theses pieces of information, which were extremely dovish, the interest rate market has struggled to reach December minima. The downward move in 2Y and 5Y in the second half of January was of around 20bps. The long-end of the curve after going back to 3.80% from slightly above 4% in mid-January, showed another upward move in yield in the last week of the month. This was driven mainly by external factors (weakening of 10Y Bund).
- **We continue to expect the next interest rate cut at the February meeting of the MPC. We also still believe that there would be no pause even in March, as the next data will confirm continuation of slowdown and CPI inflation falling further (probably below 2%).** This means that there might be still room for some strengthening at the short end of the curve, though December's minima might be hard to achieve. Additionally, there is still a risk that despite data flow the MPC will continue to suggest a pause in easing cycle, which could bring another wave of debt market weakening. We believe that buying on dips might provide some support in the short term, but bearish trend might return on the market if Bunds start upward trend. Overall, we see a range trading in the Polish interest rate market in the following weeks.
- **Our baseline scenario assumes that the zloty will remain under negative pressure in coming months.** It comes from mainly domestic factors: further deterioration in economic activity - we still expect the economy to bottom out in 1Q2013 - might renew expectations on more aggressive rate cuts later this year. However, one should notice that information about a debate on joining EMU, which will start in mid-February, has supported domestic currency. Notwithstanding, we expect the EURPLN at around 4.17 on average in February.

This report is based on information available until 4th February

Short- and Medium-term Strategy

Interest rate market

	Change (bps)		Level	Expected trend	
	Last 3M	Last 1M	end-January	1M	3M
Reference rate	-0.75	-0.25	**4.00**	↘↘	↘↘
WIBOR 3M	-78	-16	**3.95**	↘	↘↘
2Y bond yield	-65	11	**3.19**	→	→
5Y bond yield	-68	19	**3.39**	→	→
10Y bond yield	-65	20	**3.92**	→	→
2/10Y curve slope	0	8	**72**	→	→

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:** WIBOR rates have continued the downward trend, but the scope of decline in January was lower than we had expected. We foresee further gradual decrease in WIBORs as the central bank will remain in an easing mode in coming months. As regards FRA contracts, the downward move is rather limited as market is pricing-in significant rate cuts (by 75bps) in 9 months horizon.
	Short end: The front ends of the curves have fully priced-in further monetary easing. Therefore market reaction for rate cuts will be rather limited, while investors might be more sensitive to upcoming macro data, in particular industrial output. Yields should remain in horizontal trend.
	Long end: Yields of both 5Y and 10Y are more dependent on core markets, in particular 10Y sector is strongly linked to Bunds. Buying on dips might provide some support in the short term. Situation in peripheries will remain in the spotlight due to parliamentary election in Italy later this month. Therefore long term bonds might be under pressure.
	Risk factors to our view: No major changes as compared with previous month. More aggressive rate cuts this month might result in overreaction by market players and more significant decline in both yields and money market rates. Situation on core markets is still crucial.

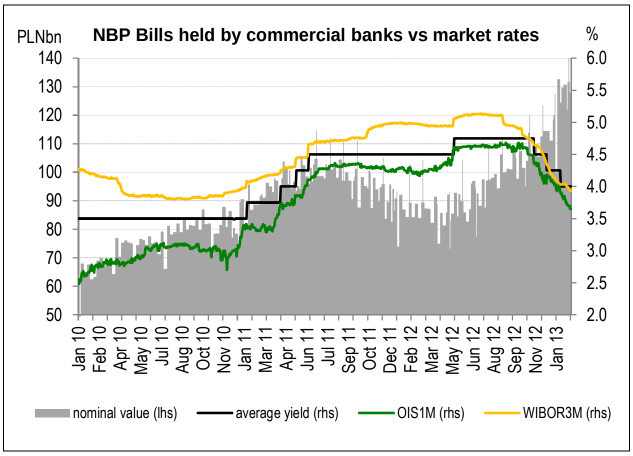
FX market

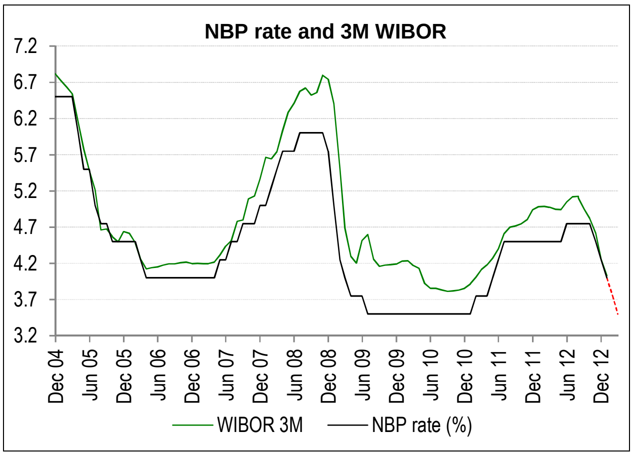
	Change (%)		Level	Expected trend	
	Last 3M	Last 1M	end-January	1M	3M
EURPLN	1.3	2.4	**4.19**	→	→
USDPLN	-2.9	-0.4	**3.09**	↗	→
CHFPLN	-1.0	0.1	**3.39**	→	→
GBPPLN	-1.1	1.1	**5.07**	→	→
EURUSD	4.3	2.8	**1.36**	↘	→

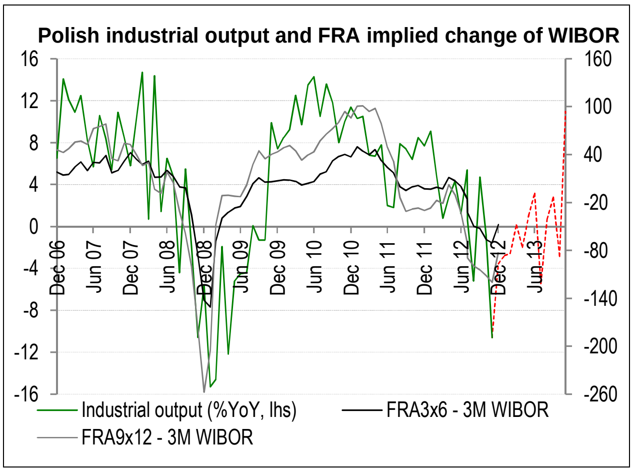
Note: Single arrow down/up indicates at least 1.5% expected move down/up, double arrow means at least 5% move

FX: our view and risk factors	
PLN FX market	**EUR:** Despite some improvement in mood on global markets the zloty has remained relatively weak against the euro, mainly due to domestic factors. Situation will not change significantly this month as we predict the EURPLN at around 4.17 on average. The zloty might positively react on the debate on joining the EMU, which will start on 18 February.
	USD: Market sentiment continues to prove extremely bullish and this stance keeps the USD clearly on the back. The EURUSD has already tested 1.37, with charts projection 1.38 as the next target. But in our opinion decrease in the EURUSD rate is more likely, therefore do not exclude some increase in the USDPLN later this month.
	CHF: The SNB has maintained status quo as regards the EURCHF floor. We expect the CHFPLN to be traded in relatively narrow range in medium term.
	Risk factors to our view: The zloty is likely to come under additional pressure, mainly an increasing constructive growth outlook. However, still more aggressive rate cut by the MPC together with very weak macro data might cause a significant depreciation of the zloty against the main currencies.

Money Market







More liquidity in the banking system

- Liquidity in the banking system increased in January, however as in previous months commercial banks invested their funds in NBP's bills. Consequently, it pushed the shortest rates down. At the end of January's reserve period Polonia rate declined to 3.11%. Due to broadly expected rate cut at February's rate-setting meeting we saw some downward pressure on the offer side. Notwithstanding, Polonia rate has returned to the level near the reference rate at the end of the month.
- The front end of the OIS curve (1M, 3M) continued significant declines as expectations on further monetary easing renewed after poor macro data. Rates declined on monthly basis by 33bps for 1M and by 26bps for 3M, reaching fresh record lows. On the other hand longer rates (up to 1Y) have started to move up or stabilise as market believed in a pause in upcoming months (after rate cuts in both February and March). Currently, the OIS curve is pricing a lot of interest rate cuts (100bps), so further declines are rather unlikely. However, weak macro data releases later this month should support some decline on the front end.

WIBOR rates may fall further, limited room for lower FRA

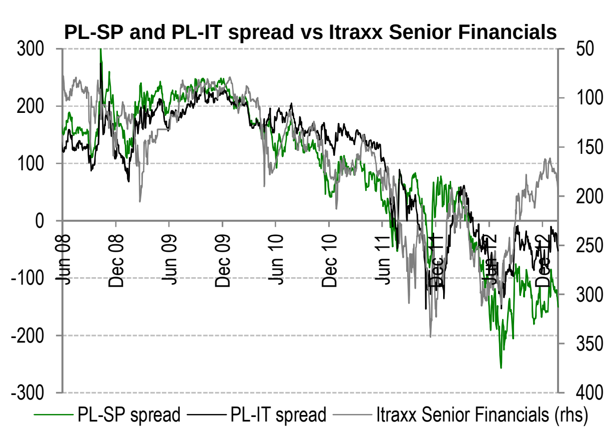
- After the January's MPC meeting the weekly pace of decline of WIBOR rates clearly faded. One week after the meeting this was only 1bp (3M and 6M were even stable), while in December and at the beginning of 2013 the average weekly scale of decline was 9bps. Slowdown (which was probably due to suggestion of pause in NBP rate cuts mentioned by the MPC) seems to have been only temporary. After December's data on retail sales and 2012 GDP the WIBOR rates started to decline again more visibly.
- Suggestion on pause in the easing cycle initiated some higher volatility on the FRA market. Rates 3x6, 6x9 and 9x12 rebounded after the January's Council's meeting by ca. 20-30bps. Domestic macro data halted the upward momentum, but the decline was limited by some weakening on the bond market.
- Elżbieta Chojna-Duch, one of two MPC members who have so far been constantly supporting rate cuts deeper than 25bps said after the 2012 GDP data that now it is too late for an aggressive easing of monetary policy and the adopted model of gradual rate cuts should be continued. Our base-case scenario envisages rate cuts by 25bps in February and in March. Lower NBP rates shall support the gradual downward trend of WIBOR rates in the following months.
- However, as the MPC is late with interest rate cuts, the market may start to price-in some revival in economic growth as monthly data show improvement (even when the Council keeps its easing bias). Thus, if the pattern presented on the third chart holds also this time, then despite further NBP rate cuts (and lower WIBOR), the room for further decline in FRA may be limited (3x6 is around 3.50% and this is our target for NBP reference rate in this cycle).

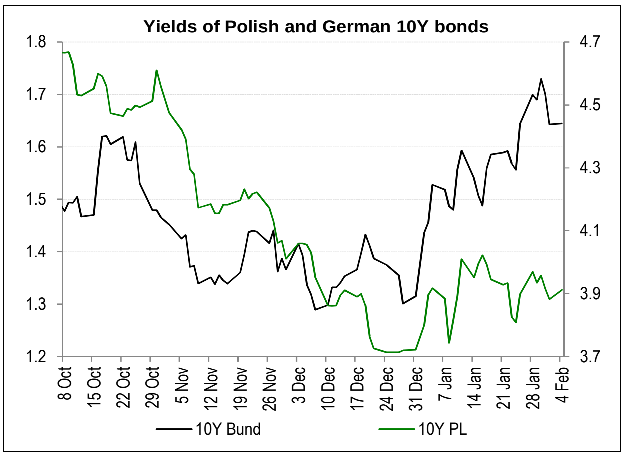
Money market rates (%)

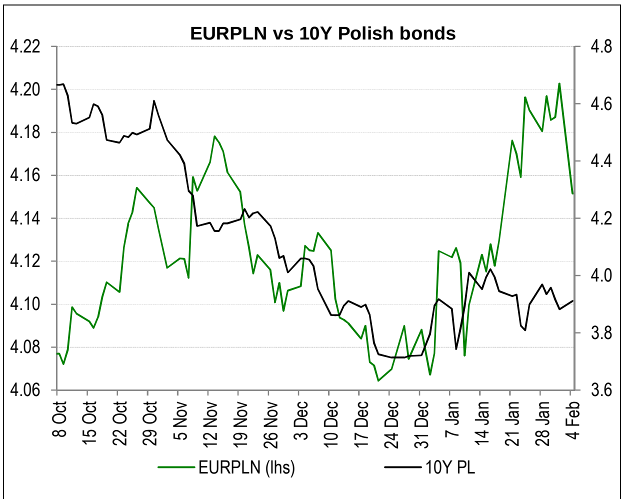
	Reference rate (%)	Polonia (%)	WIBOR (%)				OIS (%)				FRA (%)			
			1M	3M	6M	12M	1M	3M	6M	12M	1x4	3x6	6x9	9x12
End of January	**4.00**	**3.92**	**4.03**	**3.95**	**3.91**	**3.81**	**3.70**	**3.57**	**3.40**	**3.25**	**3.81**	**3.51**	**3.25**	**3.17**
Last 1M change (bp)	-25	18	-18	-16	-17	-17	-33	-26	2	7	-5	5	18	23
Last 3M change (bp)	-75	-85	-74	-78	-82	-91	-79	-77	-68	-57	-70	-65	-57	-55
Last 1Y change (bp)	-50	-40	-72	-104	-109	-119	-60	-70	-90	-108	-119	-151	-172	-174

Sources: Reuters, BZ WBK

IRS and T-Bond Market







Upward correction of yields in January

▪ The suggestion of a possible pause in monetary policy easing cycle after the MPC meeting and upward move of yields of the 10Y Bunds triggered weakening of Polish bonds. Short and long end of the domestic curve surged by 30bps while 5Y yields by 40bps. Poor economic data helped to recover slightly, but at the end of January the curve was above record levels by ca. 10bps in case of 2Y bonds and just over 20bps for 5Y and 10Y debt. Thus, the bond curve steepened in January (2-10 spread was temporarily at 79pts, highest level since late September 2012).

▪ The scale of upward move recorded in case of the IRS rates was slightly smaller than on the bond market. However, the pace of return towards all-time lows seen in late 2012 was higher than in case of bonds. At the end of January 2Y IRS was only 9bps above record low (9bps for 5Y and 16bps for 10Y).

Macro data and stronger Bunds to support Polish bonds

▪ The first chart shows that domestic bonds benefited from the turmoil related to the debt crisis thanks to positive perception of domestic economy and relatively high yields. Consequently, the Polish 10Y bonds outperformed Spanish and Italian debt (which was reflected in narrowing of yield' spreads) amid rising worries over euro zones' peripheries (higher Itraxx).

▪ Developments on the core market also have some impact on Polish debt, mainly on the middle and long term one. Still, recent surge of yields of 10Y German bonds was neutralized by dovish domestic data.

▪ The Italian parliamentary elections due in late February may generate uncertainty among investors regarding the willingness of the new government to continue with austerity measures and may revive worries over the pace at which the debt crisis will be dealt with (we elaborate more on recent polls in International Bond Markets section, page 8). Consequently, latest weakening of German debt may be utilized to protect from any possible risk aversion at more convenient conditions.

▪ We find this likely, that combination of dovish domestic macro data (January's CPI might have declined even below 2%, which will support expectations for a next rate cut in March) and lower demand for risky assets (lower yields of Bunds amid uncertainty regarding the result of Italian elections) may provide support for Polish bonds. Still, we expect yields of 2Y, 5Y and 10Y will stay in the range where the lower band is determined by the record-low levels from end-December and the upper by the local peak from January. The room for more visible strengthening may be limited by elevated EURPLN.

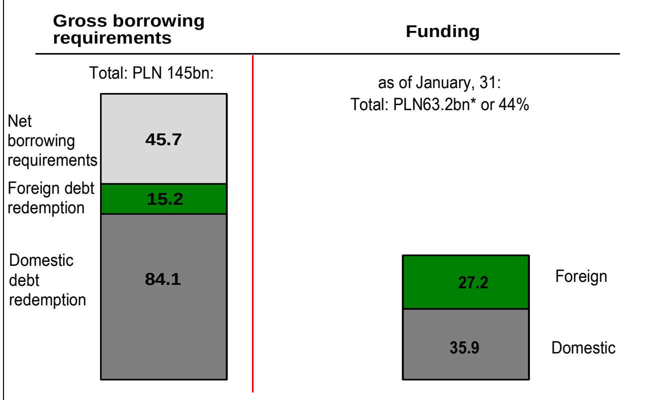
Bond and IRS market (%)

	T-bills	BONDS			IRS			Spread BONDS / IRS (bps)		
	52-week	2Y	5Y	10Y	2Y	5Y	10Y	2Y	5Y	10Y
End of January	**3.54**	**3.19**	**3.39**	**3.92**	**3.44**	**3.45**	**3.71**	**-25**	**-6**	**21**
Last 1M change (bps)	-26	11	19	20	8	9	14	3	10	6
Last 3M change (bps)	-71	-65	-68	-65	-71	-75	-66	6	7	1
Last 1Y change (bps)	-97	-148	-161	-165	-147	-135	-116	-1	-26	-49

Sources: Reuters, BZ WBK

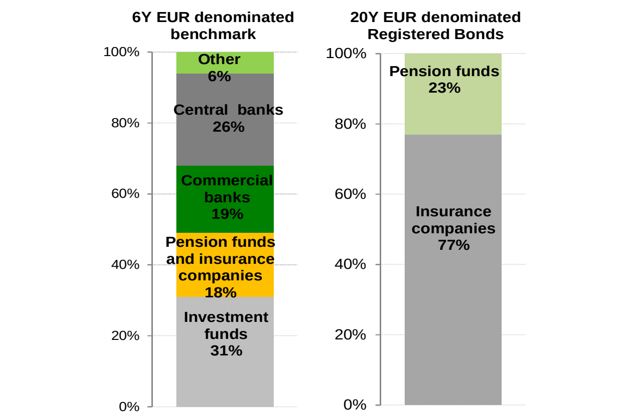
Treasury Securities Supply Corner

Gross borrowing requirements in 2013

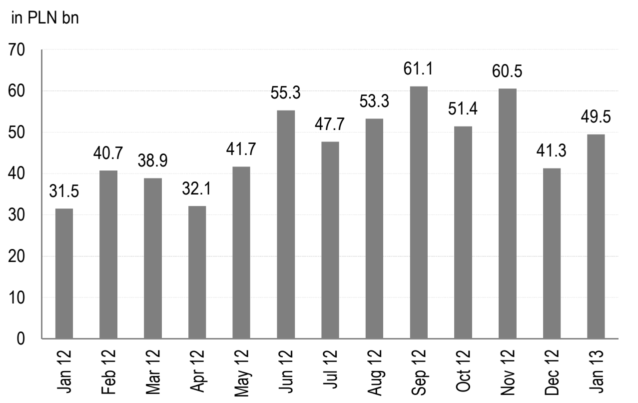


** inflow to the budget from the issuance on the EUR market on Feb 4, 2013 included*

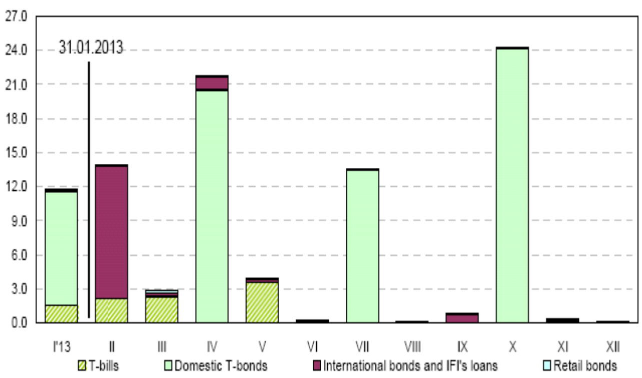
Institutional distribution of eurobonds issued in January 2013



Funds in PLN and in foreign currency held by MoF



State Treasury debt redemptions in 2013 (monthly data, PLNm)



Sources: Ministry of Finance, BZ WBK

The Ministry of Finance in action in January

- January has been a very successful month for bond issuance on both domestic and foreign markets. After the very light supply of Treasury Securities at the end of 2012, the beginning of 2013 brought heavy offers of wholesale bonds. The Ministry tapped bonds on the domestic debt market worth PLN17.4bn, which accounted for nearly 50% of maximum planned target for Q1 2013.
- The tender of a new 2Y benchmark OK0715 and 5Y benchmark PS0418 was a record one in term of demand and sales. Demand amounted to PLN19.8bn in total at standard auctions and PLN8.3bn at top-up ones. The Ministry of Finance sold OK0715 worth PLN1.29bn at 3.285% and PS0418 worth PLN12.39bn at 3.437%, with yields below interbank. According to the Ministry of Finance a record high demand was generated by both domestic and foreign investors. We think that auction results confirmed that higher yields (increased by some 25-30bps on the secondary market) created an opportunity for underweight portfolios to increase positions.
- The Ministry was also very active on the foreign market in January. As we mentioned in January's report it successfully launched 6Y Eurobonds worth €1bn at the beginning of the month. However, at the end of January the Ministry sold a 20-year EUR denominated Registered Bonds under German law for a nominal amount of €300m. The Registered Bonds maturing on 4 February 2033 were priced 104.8bps over mid-swap rate or with yield of 3.359%. They were allocated to long-term investors from Germany, representing pension funds (23%) and insurance companies (77%).
- To sum up, at the end of January the Ministry has financed 44% of the 2013 borrowing requirements. Auctions in January, and especially the second one, supported plans of securing 50% of this year's borrowing requirements at the end of Q1. However, according to the Ministry's officials if market situation remains favourable, debt issuance (both in PLN and in foreign currency) might reach 50% completion rate. What is more, liquidity cushion in PLN and FX has reached the level of PLN50bn at the end of January.

Supply for February is still relatively heavy

- The Ministry of Finance will offer in February 5Y benchmark PS0418 and floating rate T-bonds WZ0117 worth PLN3.0-6.0bn) and OK0715/DS1023/WS0429/WZ0124 (depending on market conditions) worth PLN2.0-6.0bn. Diversified offer confirms great flexibility to mixed market environment, but the value has remained relatively high. Probably, the Ministry wants to take advantage of still good market conditions to secure financing as soon as possible. In our opinion, a wide range of T-bonds should attract demand, particularly in context of still solid foreign demand.
- After a long pause, the Ministry offered 20-week T-bills worth PLN1.0-2.0bn. The auction attracted strong demand worth PLN7.7bn (including PLN644n at top-up tender), which, in our opinion, was generated mainly by local commercial banks. The Ministry sold T-bills worth PLN1.75bn (including PLN300m at top-up tender) with yield at 3.465% (down from 3.56% in January).
- As for the redemption side, in February the Ministry of Finance redeems eurobonds worth ca. €2.8bn (05.02). We believe that foreign investors will decide to rollover funds from redemption, supporting auctions on the domestic market.

Treasury Securities Supply Corner

Total issuance in 2013 by instruments (in PLNm, nominal terms)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
T-bonds auction	17,358	9,000	7,000	9,500	6,500	5,000	5,500	1,000	5,500	11,000	3,100		80,458
T-bills auction	3,603	1,747											5,350
Retail bonds	150	154	154	154	154	154	154	154	154	154	114	157	1,807
Foreign bonds/credits	4,140	1,301		2,500	2,000	1,800					2,000		13,741
Prefinancing and financial resources at the end of 2012	39,150												39,150
Total	**64,401**	**12,202**	**7,154**	**12,154**	**8,654**	**6,954**	**5,654**	**1,154**	**5,654**	**11,154**	**5,214**	**157**	**140,506**
Redemption	11,686	13,854	2,791	22,261	4,024	1,894	13,497	134	561	24,213	408	183	95,506
Net inflows	**52,715**	**-1,652**	**4,363**	**-10,107**	**4,630**	**5,060**	**-7,843**	**1,020**	**5,093**	**-13,059**	**4,806**	**-26**	**45,000**
Rolling over T-bonds													**0**
Buy-back of T-bills/bonds													**0**
Total	**52,715**	**-1,652**	**4,363**	**-10,107**	**4,630**	**5,060**	**-7,843**	**1,020**	**5,093**	**-13,059**	**4,806**	**-26**	**45,000**
Coupon payments	*2,492*			*7,322*			*1,955*		*1,497*	*9,685*			*22,951*

Note: Our forecasts – shaded area

Schedule Treasury Securities redemption by instruments (in PLNm)

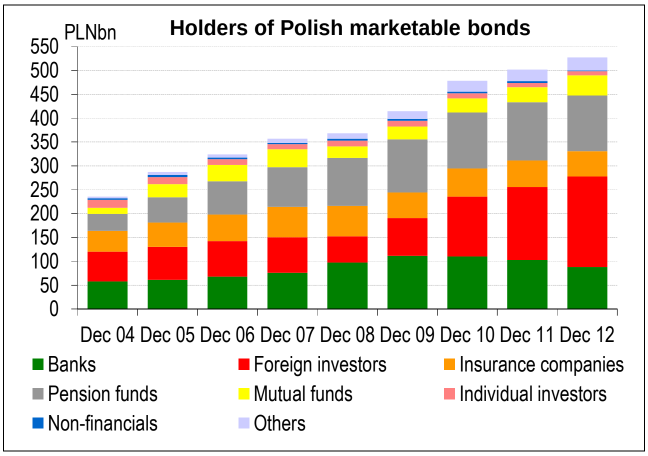
	Bonds	Bills	Retail bonds	Total domestic redemption	Foreign Bonds/Credits	Total redemptions
January	10,001	1,592	93	**11,686**		**11,686**
February		2,190	148	**2,338**	11,516	**13,854**
March		2,329	212	**2,541**	250	**2,791**
April	20,521		140	**20,661**	1,600	**22,261**
May		3,603	172	**3,775**	250	**422**
June		1,747	147	**1,894**		**147**
July	13,393		105	**13,497**		**13,497**
August			134	**134**		**134**
September			111	**111**	450	**561**
October	24,120		94	**24,213**		**24,213**
November			158	**158**	250	**408**
December			183	**183**		**183**
Total 2013	68,035	11,461	1,698	**81,191**	14,316	**95,507**
Total 2014	61,666		1,248	**90,276**	18,320	**105,102**
Total 2015	78,880		677	**59,586**	16,618	**77,034**
Total 2016	59,378		485	**79,365**	17,620	**93,694**
Total 2017	67,278		91	**59,469**	11,766	**76,340**
Total 2018+	183,657		3,288	**213,794**	146,214	**348,760**

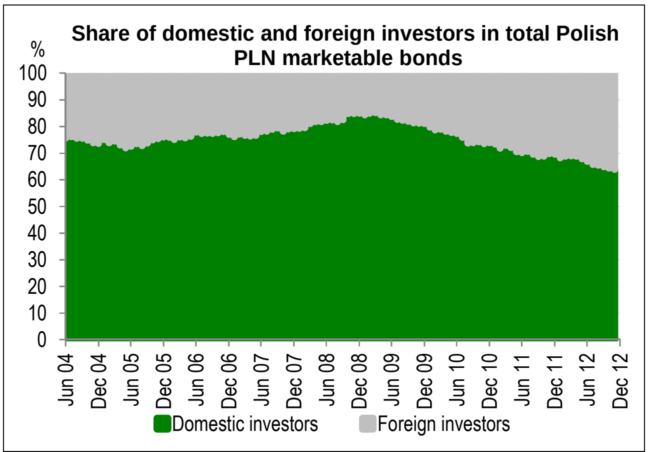
Schedule wholesales bonds redemption by holders (data at the end of December 2012, in PLNm)

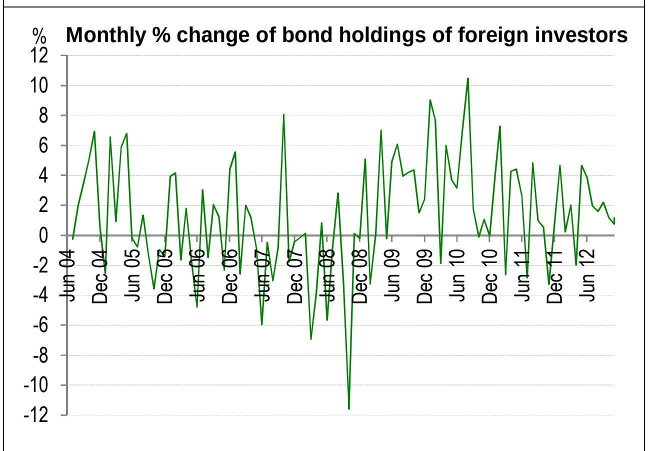
	Foreign investors	Domestic banks	Insurance Funds	Pension Funds	Mutual Funds	Individuals	Non-financial sector	Other	Total
Q1 2013	3,370	3,190	1,156	347	406	132	151	1,276	10,028
Q2 2013	7,729	5,067	2,488	2,318	652	59	294	1,938	20,545
Q3 2013	8,993	758	1,200	732	257	140	16	1,336	13,431
Q4 2013	8,501	2,008	7,007	4,137	572	116	29	1,794	24,165
Total 2013	**28,593**	**11,022**	**11,850**	**7,533**	**1,887**	**448**	**490**	**6,345**	**68,169**
	42%	**16%**	**17%**	**11%**	**3%**	**1%**	**1%**	**9%**	**100%**
Total 2014	33,870	8,746	4,772	7,148	3,144	413	116	3,747	61,956
	55%	14%	8%	12%	5%	1%	0%	6%	100%
Total 2015	26,262	20,272	7,191	14,633	6,483	174	403	3,533	78,951
	33%	26%	9%	19%	8%	0%	1%	4%	100%
Total 2016	18,477	6,726	4,216	22,665	7,670	54	81	2,767	62,656
	29%	11%	7%	36%	12%	0%	0%	4%	100%
Total 2017	25,471	11,279	5,592	14,863	6,656	55	83	3,279	67,278
	38%	17%	8%	22%	10%	0%	0%	5%	100%
Total 2018+	57,199	29,711	19,175	50,527	15,890	191	359	7,936	180,989
	32%	16%	11%	28%	9%	0%	0%	4%	100%

Sources: Ministry of Finance, BZ WBK

Treasury Securities Holders







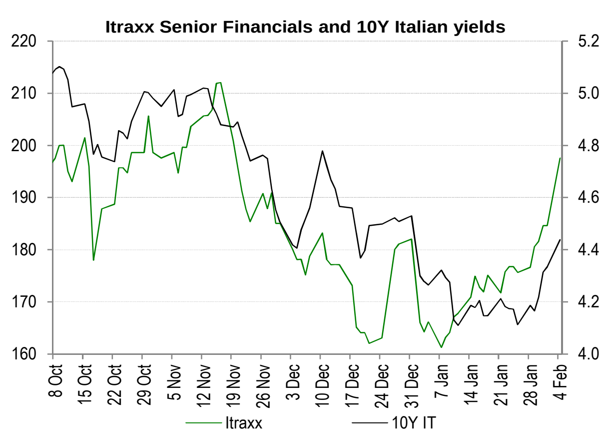
Foreign investors bond portfolio at record high (again)

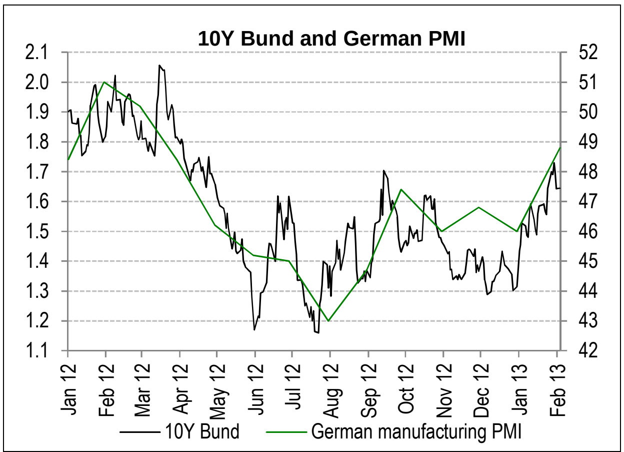
- At the end of 2012 foreign investors held Polish marketable bonds worth PLN190bn (record high level established already 8th month in a row). Director of Debt Department in the Ministry of Finance, Piotr Marczak, added that in January the inflow of foreign funds was even higher than in the last month of 2012. At the end of December foreign investors held slightly over 36% of total Polish PLN marketable bonds (also record high level).
- During the whole 2012 foreign investors increased their holdings by PLN37.4bn compared to an annual increase by PLN27.7bn in 2012 and by PLN46.2bn in 2011. On the annual basis, portfolio of OK series bonds increased in nominal terms by PLN19.5bn (70% of that amount is OK0114). Holdings of PS series bonds increased by PLN21.9bn and DS by PLN19.2bn.
- In December foreign investors increased their holdings by ca. PLN2bn, mainly due to purchases of short term bonds.
- Domestic investors as a whole cut exposure by PLN12.3bn in 2012. Polish banks reduced their engagement in Polish debt by PLN15.5bn (already 3rd consecutive year of selling bonds after withdrawing PLN7.1bn in 2011 and PLN1.6bn in 2010). The only significant group of Polish investors that increased holdings of domestic debt during the year were mutual funds (by PLN10.1bn – clearly more than PLN1.4bn in 2011 and PLN3.4bn in 2010).
- After December Polish banks reduced their holdings by PLN3.7bn (mainly due to selling the PS0417) to the lowest share in total marketable debt since data are collected (16.6%). The same case is with insurance companies and individuals. Also regards the total of domestic investors, the share was lowest in history.

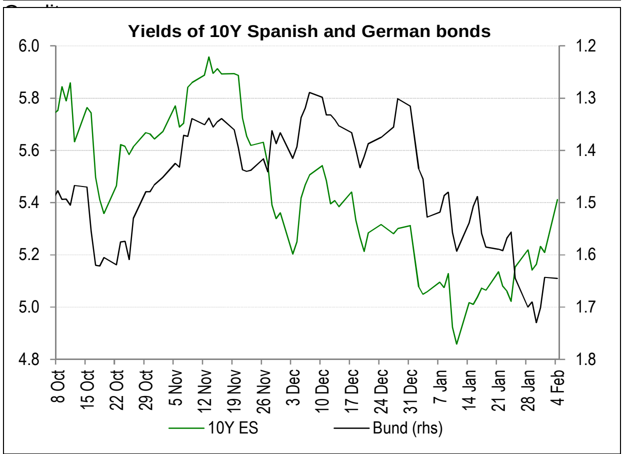
Holders of marketable PLN bonds	Nominal value (PLN, bn)				Nominal value (PLN, bn)			% change in December			Share in TOTAL (%) in Nov
	End Dec	End Nov	End 3Q 2012	End 2Q 2012	End 2011	End 2010	End 2009	MoM	QoQ	YoY	
Domestic investors	337.5	339.9	341.8	352.9	349.8	354.1	336.2	-0.7	-1.3	-3.5	64.0 (-0.4pp)
Commercial banks	87.8	91.4	102.0	102.1	103.3	110.4	112.1	-4.0	-14.0	-15.1	16.6 (-0.7pp)
Insurance companies	52.8	54.1	54.7	57.0	55.5	59.5	53.8	-2.5	-3.5	-4.9	10.0 (-0.2pp)
Pension funds	117.4	119.3	116.7	120.3	122.2	117.0	111.0	-1.6	0.6	-4.0	22.3 (-0.4pp)
Mutual funds	41.7	38.8	32.5	33.0	31.7	30.2	26.8	7.6	28.4	31.7	7.9 (+0.6pp)
Others	37.8	36.2	35.9	40.5	37.1	37.0	32.5	4.4	5.3	2.1	7.2 (+0.3pp)
Foreign investors*	189.9	187.7	184.2	174.0	152.5	124.8	78.6	1.2	3.1	24.5	36.0 (+0.4pp)
Banks	28.4	27.8	27.8	22.6	16.2	21.9	17.4	2.1	2.2	75.2	5.4 (+0.1pp)
Non-bank fin. sector	153.1	151.4	147.5	143.1	129.3	96.8	58.0	1.1	3.8	18.4	29.0 (+0.3)
Non-financial sector	5.2	5.2	5.6	5.2	4.5	4.2	2.3	0.4	-7.5	15.7	1.0
TOTAL	527.4	527.6	526.0	526.9	502.3	478.9	414.8	0.0	0.3	5.0	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







Italian elections in the spotlight

- In January the downward trend of yields of long-term Spanish and Italian bonds was halted. After very successful auctions of these two issuers, yields of 10Y debt rebounded from 4.07% for Italy (lowest since November 2010) and from 4.84% for Spain (lowest since March 2012) to levels seen at the beginning of the year (partly due to outlook of heavy supply in coming months).
- Italian elections will likely attract investors' attention later this month. Recent polls (from late January) show Democratic Party is running first with support of ca. 38%. Its leader, Bersani, wants to cut taxes for low- and middle-tier earners and raise taxes on the rich. Although he claims the necessity to meet deficit reduction target, his ally in the coalition has criticized Monti's austerity and labour reforms.
- Former PM Berlusconi's People of Liberty party has around 27% of support and comes second in the poll. Berlusconi has also promised to cut taxes. He also claims the EU's fiscal compact is hitting growth and that the ECB should be a lender of last resort.
- Coalition under Monti is on 3rd place with support of ca. 15-16% of voters. Given the fact that the parties whose elections programs include some plans of discussion on the austerity measures are occupying two first positions with quite strong support, worries over carrying on with austerity measures in Italy may be in the spotlight in February. Thus, on peripheries of the euro zone some weakening may be observed. Still, as the ECB's OMT is ready to be used when requested, the potential for increase of yields of Italian and Spanish bonds seems to be limited.

Optimistic data weakened Bunds

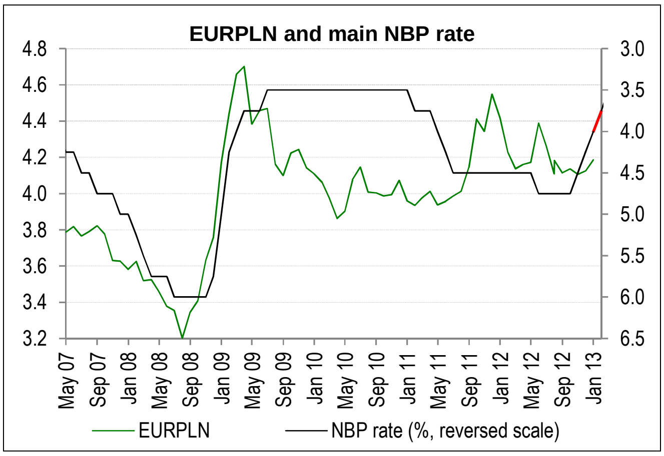
- Decent quarterly results of US companies and optimistic data from the euro zone (German ZEW, PMI, Ifo) improved global market sentiment and put negative pressure on Bunds. Broader glance at the market points, that yields of 10Y German bonds are currently very close to resistance level at around 1.8% that has been preventing them from visible weakening since 3Q2012. In the nearest future two factors may play main role this market. First, the uncertainty regarding results of Italian elections may support demand for safe assets. Second, if next macro data confirm improvement in the European economy, then investors may prefer more risky opportunities and just like recently Bunds may continue to weaken. We expect the risk related to result of Italian elections and postponed US "fiscal cliff" will encourage investors to take advantage over recent weakening of Bunds and in February German debt may recover slightly.

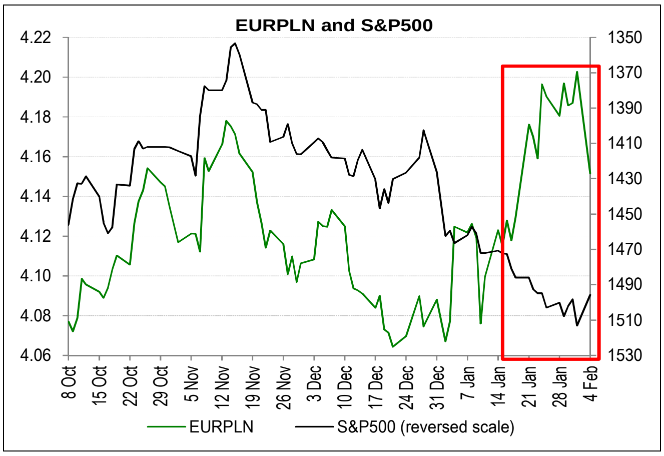
Euro zone's issuance plans and completion in 2013 (€ bn)

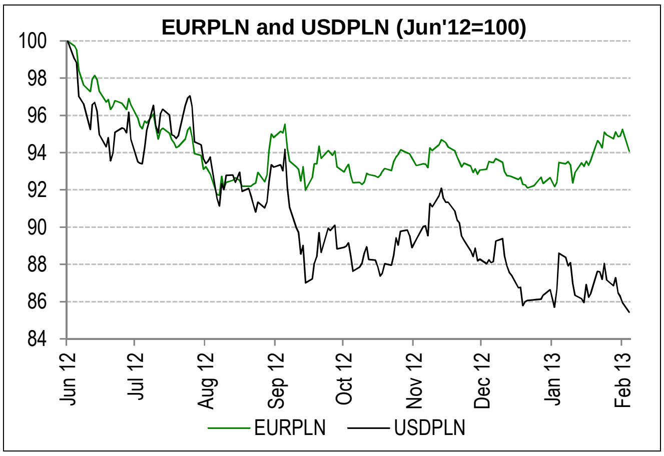
	Total redemptions	Deficit	Borrowing needs	Expected bond supply	% of completion (YtD)
Austria	15.9	6.3	22.2	22.2	**5.0**
Belgium	30.3	8.8	40.0	37.0	**11.0**
Finland	6.8	5.6	12.4	12.4	**7.0**
France	105.5	61.6	171.1	170.0	**10.4**
Germany	157.0	17.1	174.1	174.1	**10.4**
Greece	9.7	11.6	21.3	0.0	**-**
Ireland	5.1	12.5	17.6	10.0	**25.0**
Italy	154.7	25.5	180.2	180.2	**13.0**
Netherlands	31.5	15.2	46.7	50.0	**10.6**
Portugal	5.9	7.4	13.3	3.0	**84.0**
Spain	61.9	48.4	133.3	113.4	**15.0**
Total	**584.3**	**220.0**	**832.2**	**772.3**	**12.0**

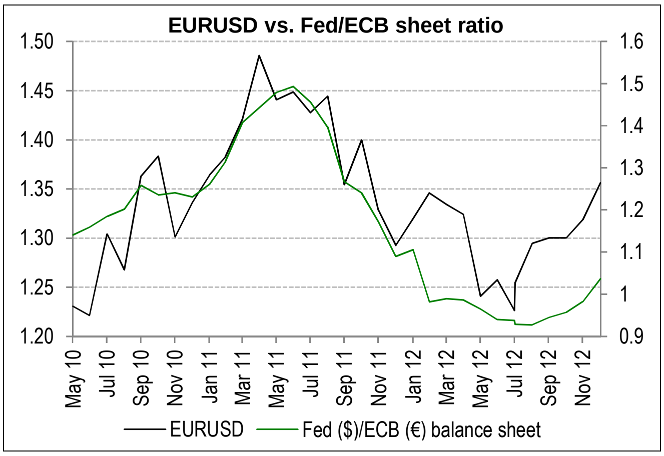
Source: Reuters, Bloomberg, BZ WBK

Foreign Exchange Market









Sources: Reuters, BZ WBK

Weaker zloty due to expectations for rate cuts

- Last month we suggested that zloty's depreciation observed in early 2013 was quite similar to what we have seen at the beginning of 2012. We pointed that market sentiment may improve and this will limit the potential for weakening of the domestic currency due to expectations for NBP rate cuts.
- The global market did improve (since closing date of previous report S&P500 increased by 3.5%, the EURUSD increased by nearly 5%), but EURPLN surged by ca. 2%. The importance of domestic data proved much stronger than we anticipated. The EURPLN was pushed above the upper band of the suggested range of 4.05-4.14 after the weaker than market expected (and in line with our forecast) data on Polish industrial output. In the following weeks the zloty remained under negative pressure of strengthened expectations for NBP rate cuts. As a result, the EURPLN temporarily broke 4.21 and approached the highest level since early September. The zloty managed to pare some losses as PM Tusk announced a debate on the implementation of the euro to be held in mid-February.

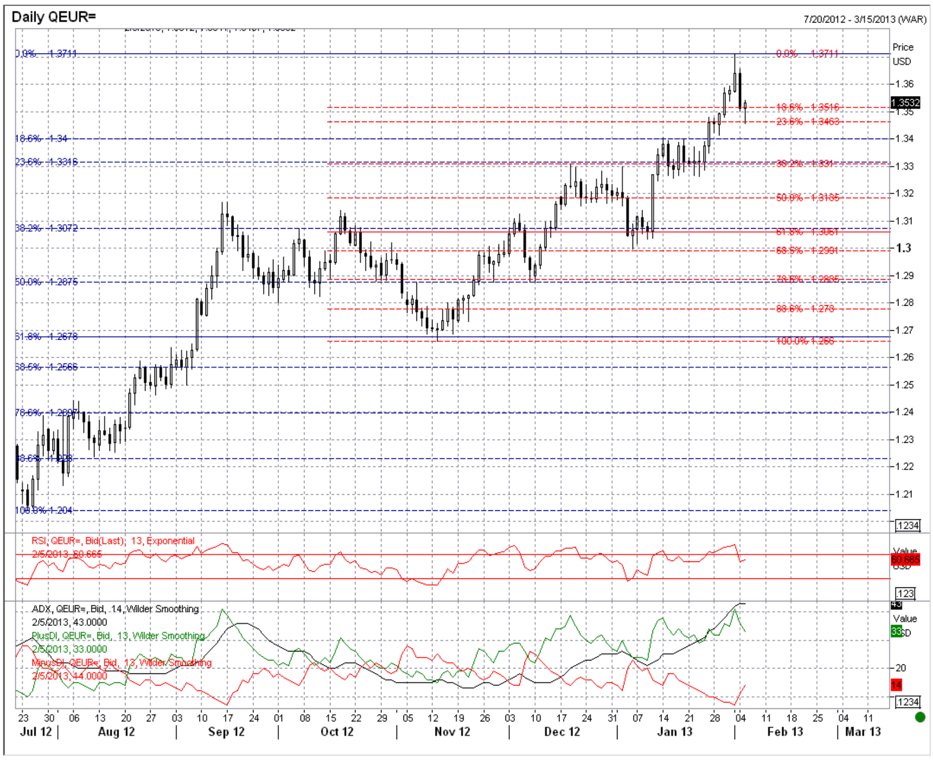
Little room for lower EURPLN

- The third chart shows that since early September (soon after the weaker than expected data on domestic 2Q GDP growth was released and the NBP governor suggested in an interview that the bias of the MPC has changed) the EURPLN detached somewhat from the USDPLN. The zloty stopped gaining versus the euro amid improving global market sentiment (expectations for rate cuts started to play main role) and appreciated versus the dollar only due to higher EURUSD.
- Currently, we do not see a big potential for closing of this gap soon. First, the MPC is late with NBP rate cuts and may maintain easing bias as long as it sees falling inflation (we expect bottom for the CPI in June). We expect the Council will cut rates by 25bps in February and leave door open for more easing in coming months. Second factor that is constraining room for lower EURPLN are (so far only) verbal interventions from the government and central bank pointing that further appreciation of the zloty may be harming for Polish economy. This is similar situation to one observed in case of Czech koruna. The EURCZK surged in January from 25 to ca. 25.7. The increase was fuelled by comments from the Czech central bank on possible interventions aiming at weakening the koruna versus the euro.
- As regards the EURUSD, recent data and information from Europe (strong improvement of PMI, Ifo and ZEW, commercial banks paying back loans from the LTRO to the ECB) proved supportive for the euro. The exchange rate surged temporarily above 1.37 (highest since November 2011). The size of EBC balance sheet declined and as Fed is likely to maintain its bond buying program, the ratio of Fed to ECB balance sheet is likely to increase further. This should be supportive for the euro versus the dollar. Thus, we do not see much room for lower EURUSD. The risk factor that may initiate temporary correction from local peak is uncertainty regarding the result of Italian parliamentary elections (the exchange rate may pull back to ca. 1.33-1.34).
- To sum up, we expect the average EURPLN at 4.17 in February. The gap between the EURPLN and USDPL may only slightly narrow when the euro pares some gains due to the uncertainty related to results of Italian elections.

FX Technical Analysis Corner

EURPLN

- The EURPLN broke the resistance at ca. 4.14 and the upward move was halted only at just above 4.21 (close to peak from early September).
- Despite some higher volatility, the situation on the EURPLN market again did not change significantly during the past month (the exchange rate is still below peak from early September), only the upper band of possible range trading moved up.
- Vital levels for upcoming weeks are resistance at ca. 4.21 (next resistance levels at 4.23 and 4.28) and support at 4.16 (next support at 4.12).



EURUSD

- The EURUSD rebounded from the support at 1.30 and continued to increase in the following weeks.
- The exchange rate did not manage to break support are at ca. 1.345. ADX still points the upward trend is in place (and is strong).
- Weekly chart indicates the EURUSD may head towards 1.38 in the following weeks.

Sources: Reuters, BZ WBK

Poland vs. other countries - economy

Main macroeconomic indicators (European Commission's forecasts)

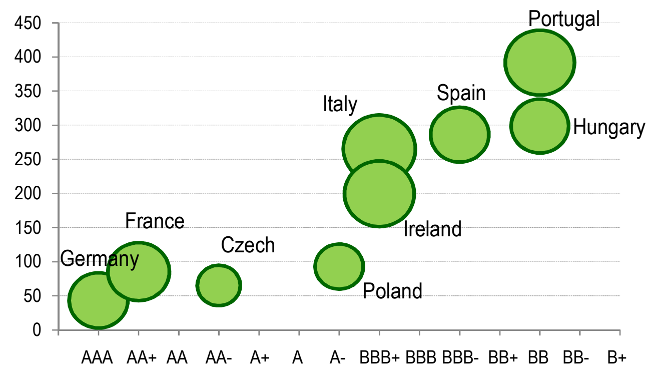
	GDP (%)		Inflation (HICP, %)		C/A balance (% of GDP)		Fiscal Balance (% of GDP)		Public Debt (% of GDP)	
	2012F	2013E	2012F	2013E	2012F	2013E	2012F	2013E	2012F	2013E
Poland	**2.4**	**1.8**	**3.8**	**2.6**	**-3.9**	**-3.3**	**-3.4**	**-3.1**	**55.5**	**55.8**
Czech Republic	-1.3	0.8	3.6	1.1	-2.9	-2.1	-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

Source: European Commission – Autumn 2012

Sovereign ratings

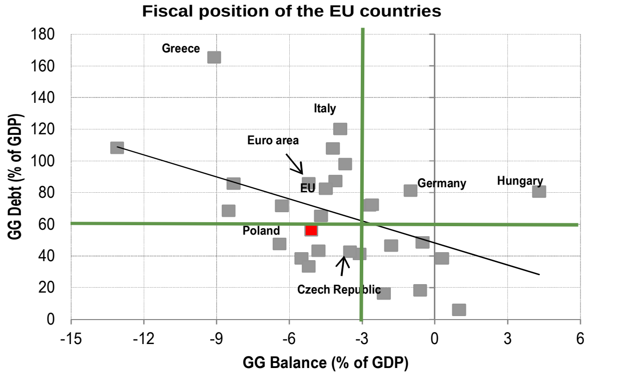
	S&P		Moody's		Fitch	
	rating	outlook	rating	outlook	rating	outlook
Poland	A-	stable	A2	stable	A-	stable
Czech	AA-	stable	A1	stable	A+	stable
Hungary	BB	stable	Ba1	negative	BB+	negative
Germany	AAA	stable	Aaa	negative	AAA	stable
France	AA+	negative	Aa1	negative	AAA	negative
UK	AAA	negative	Aaa	negative	AAA	negative
Greece	B-	stable	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

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



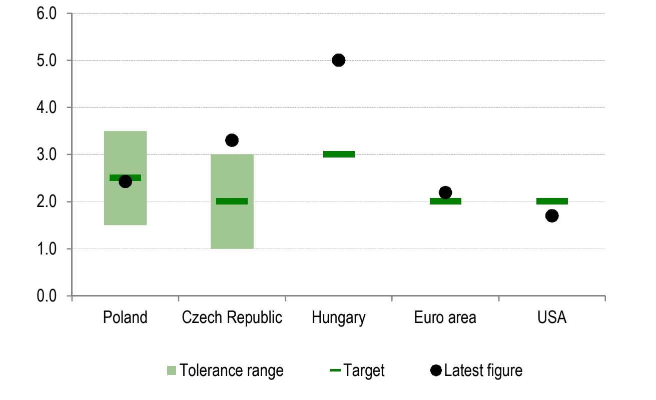
Note: Size of bubbles reflects the debt/GDP ratio

Fiscal position of the EU countries

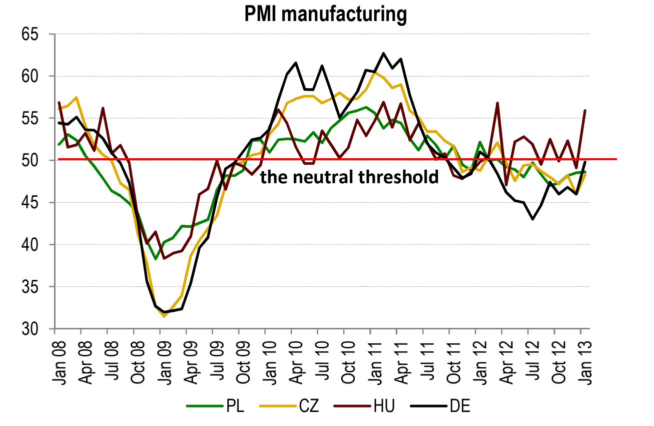


Note: final data for 2011

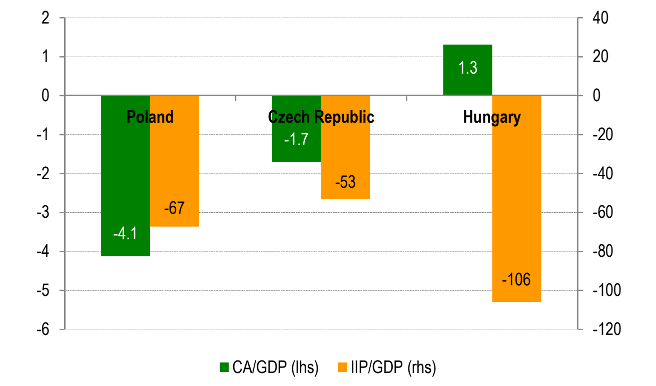
Inflation rates vs targets



PMI manufacturing



Current account balance & International Investment Position (end of Q3 2012 - cumulative data, % of GDP)

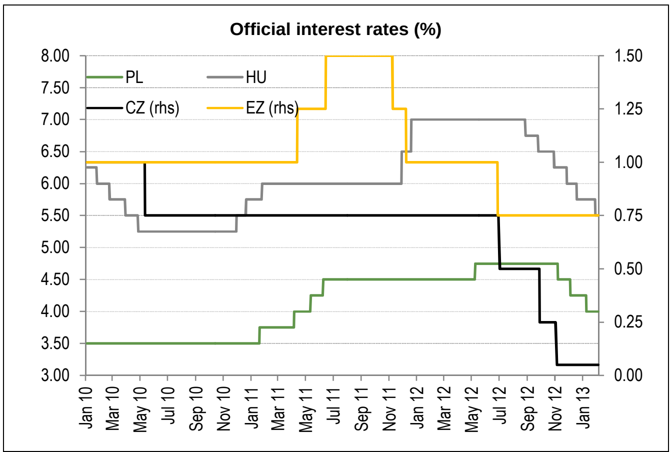


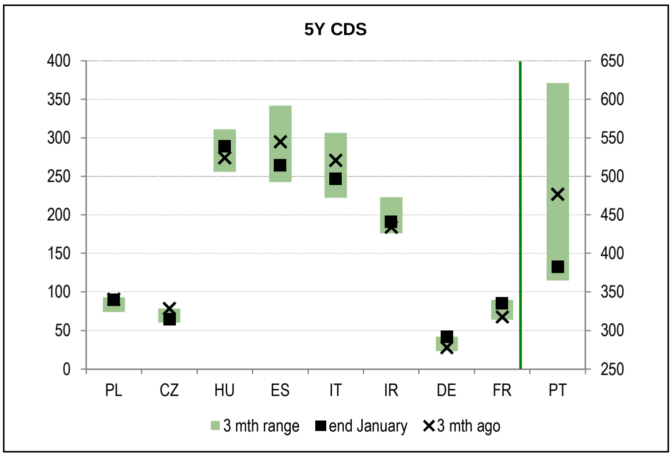
Source: stat offices, central banks, Reuters, BZ WBK, EC

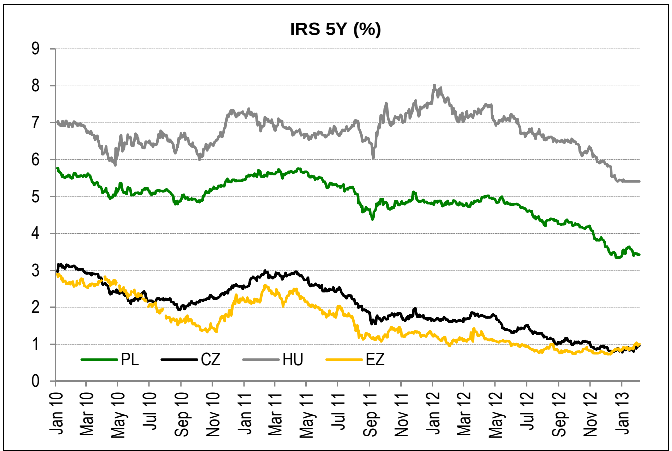
Poland vs other countries - market

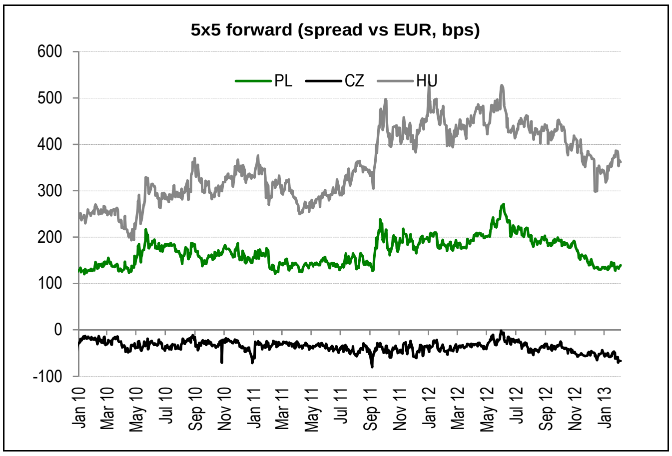
Main market indicators (%)

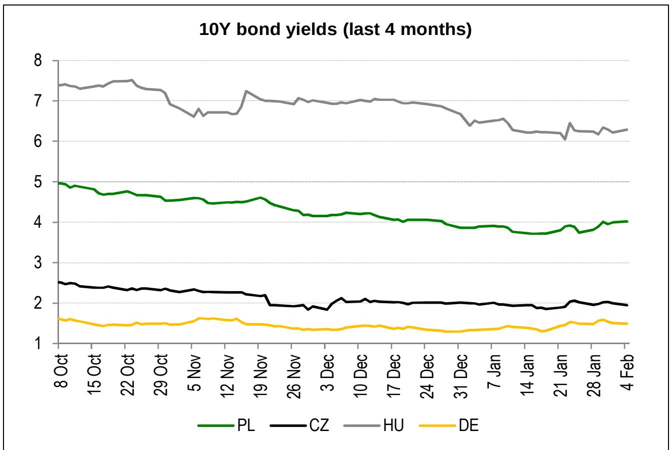
	Reference rate (%)		3M market rate (%)		10Y yields (%)		10Y Spread vs Bund (bps)		CDS 5Y	
	2012	2013	2012	end of January	2012	end of January	2012	end of January	2012	end of January
Poland	**4.25**	**3.50**	**4.11**	**3.95**	**3.72**	**3.92**	**241**	**222**	**80**	**90**
Czech Republic	0.05	0.05	0.18	0.15	1.86	2.08	54	38	63	65
Hungary	5.75	5.00	5.75	5.50	6.23	6.46	492	476	269	289
Euro area	0.75	0.75	0.19	0.23						
Germany					1.32	1.70			39	42

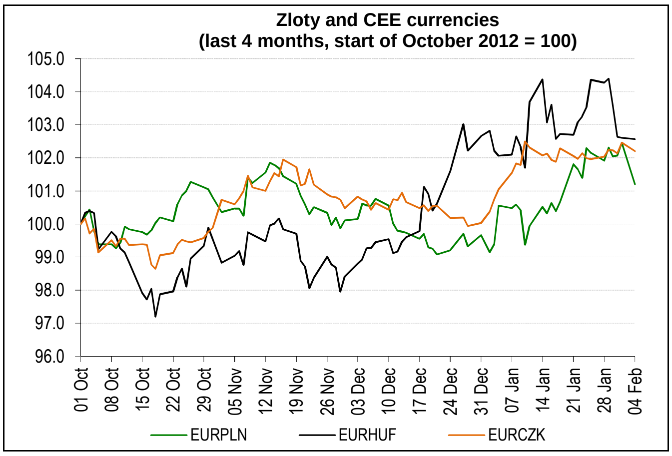












Source: stat offices, central banks, Reuters, BZ WBK, EC

Central Bank Watch

		Last	2012	2013F	Expected changes (bps) 1M	3M	6M	Risks/Events
Euro	Forecast	0.75	0.75	0.75				It seems that the ECB will keep interest rate unchanged. Investors will concentrate on the press conference and Draghi's comments
	Market implied »				1	4	8	
UK	Forecast	0.50	0.50	0.50				The BoE will keep its policy stance most likely unchanged. No press conference is on the agenda.
	Market implied »				1	3	5	
US	Forecast	0-0.25	0-0.25	0.25				Interest rates will remain on hold, but more news about possible Fed exit will strongly affect the UST market.
	Market implied »				0	0	1	
Poland	Forecast	4.00	4.25	3.50				The Council will continue its monetary easing cycle, cutting rates by 25bps. Probability of a more aggressive monetary easing has remained low.
	Market implied »				-13	-42	-67	
Czech	Forecast	0.05	0.05	0.05				Rates on hold. The CNB might intervene directly against the CZK to support the Czech economy.
	Market implied »				32	28	28	
Hungary	Forecast	5.50	5.75	5.00				We uphold our stance that NBH will continue monetary easing in coming months. The upcoming change of NBH governor in 1Q13 poses a significant risk to markets.
	Market implied »				-23	-53	-85	

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

Economic Calendar and Events

Date		Event:	Note:
6-Feb	**PL**	**MPC Meeting – interest rate decision**	**We expect the MPC to cut rates by 25bps**
	CZ	CNB Meeting – interest rate decision	Rates on hold
	DE	Auction of 5Y bonds	Offer: €4bn
7-Feb	EZ	ECB Meeting – interest rate decision	Rates on hold
	PL	**Auction of PS0418 / WZ0117**	**Offer: PLN3.0-6.0bn**
7-8-Feb	EU	The EU Summit	
11-Feb	EZ	Eurogroup meeting	
12-Feb	EU	Ecofin meeting	
13-Feb	**PL**	**Auction of OK0715/DS1023/WS0429/WZ0124**	**Offer: PLN2.0-6.0bn**
	DE	Auction of 2Y bonds	Offer: €5bn
	IT	Auction of medium and long terms bonds	-
15-Feb	**PL**	**CPI for January**	**Our forecast: 1.9%YoY (in line with consensus)**
18-Feb	**PL**	**Employment and wages for January**	**We expect employment decline by 1.3%YoY and muted growth in wages by 1.2%YoY**
19-Feb	**PL**	**Industrial output and PPI for January**	**Our forecast of industrial output: -3.5%YoY (near market consensus). We predict PPI at -1.5%YoY**
20-Feb	DE	Auction of 10Y bonds	Offer: €5bn
24-25-Feb	IT	Parliamentary election	
25-Feb	IT	Auction of T-bonds (zerocoupon, index-linked fixed rate)	-
26-Feb	HU	NBH Meeting - interest rate decision	-
27-Feb	IT	Auction of T-bonds (fixed rate, Euribor-linked floating rate)	
4-Mar	EZ	Eurogroup meeting	
5-Mar	EU	Ecofin meeting	
6-Mar	**PL**	**MPC Meeting – interest rate decision**	
	DE	Auction of 5Y bonds	Offer: €4bn
7-Mar	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	1,599.3	1,643.2	370.7	388.3	392.1	448.2	380.3	397.1	401.7	464.1
GDP	%YoY	3.9	4.3	2.0	1.2	3.6	2.3	1.4	1.0	0.5	1.0	1.3	2.0
Domestic demand	%YoY	4.6	3.4	0.1	-0.2	2.5	-0.4	-0.7	-0.7	-1.0	-0.5	0.0	0.5
Private consumption	%YoY	3.2	2.5	0.5	1.0	1.7	1.2	0.1	-1.0	0.8	0.9	1.0	1.4
Fixed investments	%YoY	-0.4	9.0	0.6	-2.0	6.0	1.3	-1.5	-0.4	-4.0	-4.0	-2.0	-0.2
Unemployment rate [a]	%	12.4	12.5	13.4	14.0	13.3	12.3	12.4	13.4	14.5	13.7	13.5	14.0
Current account balance	EURm	-18,129	-17,977	-12,873	-5,176	-4,515	-2,203	-3,367	-2,788	-2,900	-599	-915	-762
Current account balance	% GDP	-5.1	-4.9	-3.4	-1.3	-5.1	-4.6	-4.1	-3.4	-2.9	-2.5	-1.8	-1.3
General government balance	% GDP	-7.9	-5.0	-3.5	-3.5	-	-	-	-	-	-	-	-
CPI	%YoY	2.6	4.3	3.7	1.8	4.1	4.0	3.9	2.9	1.8	1.3	1.7	2.2
CPI [a]	%YoY	3.1	4.6	2.4	2.3	3.9	4.3	3.8	2.4	1.7	1.2	1.9	2.3
CPI excluding food and energy prices	%YoY	1.6	2.4	2.2	1.9	2.5	2.5	2.1	1.7	1.9	1.6	1.9	2.2
EUR/PLN	PLN	3.99	4.12	4.19	4.14	4.23	4.26	4.14	4.11	4.17	4.16	4.15	4.10
USD/PLN	PLN	3.02	2.96	3.26	3.09	3.23	3.32	3.31	3.17	3.12	3.09	3.09	3.05
CHF/PLN	PLN	2.90	3.34	3.47	3.35	3.50	3.55	3.44	3.40	3.39	3.37	3.35	3.31
GBP/PLN	PLN	4.66	4.75	5.16	5.01	5.07	5.26	5.22	5.09	5.10	5.07	4.96	4.93
Reference rate [a]	%	3.50	4.50	4.25	3.50	4.50	4.75	4.75	4.25	3.50	3.50	3.50	3.50
WIBOR 3M	%	3.94	4.54	4.91	3.62	4.97	5.04	5.06	4.57	3.75	3.51	3.58	3.65
Yield on 2-year T-bonds	%	4.72	4.81	4.30	3.36	4.66	4.71	4.22	3.61	3.19	3.24	3.41	3.61
Yield on 5-year T-bonds	%	5.31	5.44	4.53	3.53	5.02	4.93	4.43	3.75	3.37	3.37	3.56	3.80
Yield on 10-year T-bonds	%	5.74	5.98	5.02	4.07	5.58	5.38	4.91	4.22	3.90	3.91	4.10	4.35

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

This analysis is based on information available until 4th February 2013 and has been prepared by:

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