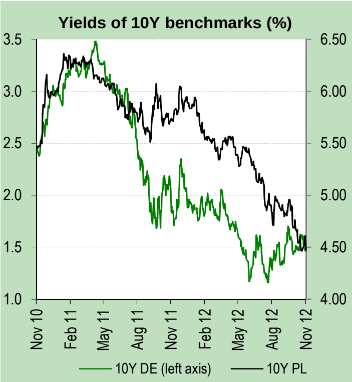
Bank Zachodni WBK

Rates and FX Outlook

Polish Financial Market

November 2012



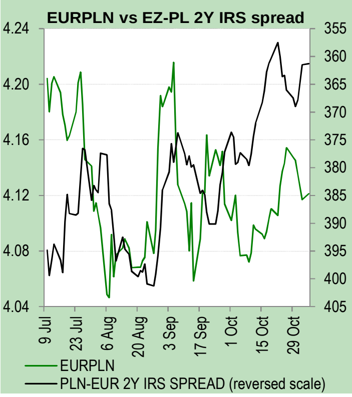


Table of contents:

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- **The November's MPC meeting will be the key issue for the Polish market. The NBP is a latecomer in the CEE region as regards the monetary easing decisions.** Hungarian central bank cut the rates three times in a row, while the Czech monetary authority slashed the policy rates to the all-time low of 0.05%. **Interest rate cut by 25bps seems to be almost a deal done** – the conditions set by the Council last month have been met, and latest data delivered even more evidence that monetary policy easing is needed and justified. Still, the official post-meeting statement will be crucial, and especially whether the MPC will herald a beginning of easing cycle. We uphold our stance assuming three cuts (25bp each) until the end of Q1 2013. The risk is that when CPI falls to (or below) target and economy slows sharply the MPC may even cut more. The beginning of the monetary easing cycle will somewhat reduce relative attractiveness of PLN, but will support the front end of the curve.
- **As expected monthly data from real economy in Q3-2012 confirmed further deceleration in economic activity. We predict GDP growth at 1.7%YoY in Q3** (down from 2.3% in Q2), while market consensus is at 1.8%YoY. The slowdown was driven not only by decelerating exports, but also by faltering domestic demand. We expect the beginning of Q4 will bring some improvement in the headline figures (industrial and construction output), but this will be driven mainly by working days effect. Meanwhile, inflation is expected to start falling (to 3.5% in October and below 3% in December), and data from labour market will remain weak.
- **In the *Special focus* we present key points concerning the borrowing needs for 2013.** As regards this matter, year 2012 can be viewed as successful for the Ministry of Finance, which not only has decreased the cost of debt issuance on both domestic and foreign markets, but also has expanded foreign investors' base. The Ministry gathers prefunds, which at the end of this year might account for at least 20% (even 25%) of borrowing target for 2013. We think the Ministry of Finance should not have significant problems with meeting its 2013 borrowing needs. The risk factors include escalation of debt crisis in the euro zone and much slower than currently predicted GDP growth in Poland, which may dent foreign investors' appetite for Polish securities. In general, we expect the yield curve to move downwards in the first part of the year and upwards in the second half of 2013.
- **The zloty exchange rate climbed from ca. 4.07 in early October to ca. 4.15 at the end of the month** due to a rather choppy global market sentiment, as investors were concerned about unfavourable companies' results and to weak domestic macro data, which amplified expectations for interest rate cuts. The zloty pared some of its losses at the beginning of November, but it may remain under pressure due to higher risk aversion and easing of domestic monetary policy. We see the average level of EURPLN at 4.15 in November.

This report is based on information available until 5th November

Short- and Medium-term Strategy

Interest rate market

	Change (bps)		Level	Expected trend	
	Last 3M	Last 1M	end-October	1M	3M
Reference rate	0	0	**4.75**	↘↘	↘↘
WIBOR 3M	-38	-19	**4.73**	↘↘	↘↘
2Y bond yield	-36	-19	**3.84**	↘↘	↘↘
5Y bond yield	-33	-11	**4.08**	↘↘	↘↘
10Y bond yield	-29	-12	**4.56**	↘	↘
2/10Y curve slope	7	6	**72**	↗	→

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:** As we predicted, profit-taking after October's decision to keep rates unchanged was only short-lived, and money market rates have continued their downward trend due to poor macro data and more dovish statement from the MPC. Materialization of rate cut this month will support drops of WIBOR and FRA rates, which might intensify if the Council announces the beginning of monetary easing cycle.
	Short end: As we expected, the front ends of the curves (both bond and IRS) have benefited from interest rate cut expectations, especially just before the November's meeting. Decision to trim rates this month and suggestion to start easing cycle should continue to favour short-term instruments in coming weeks.
	Long end: Continued strong demand for Polish bonds from non-residents keeps yields at all-time lows on the mid and long-end of the curve. We foresee further gradual decline in yields, but with lower scope than previously seen.
	Risk factors to our view: We think that interest rate cut this month proves to be almost a deal done. However, if the MPC does not announce the beginning of monetary easing cycle, we foresee investors to take profit and rates increase across the board.

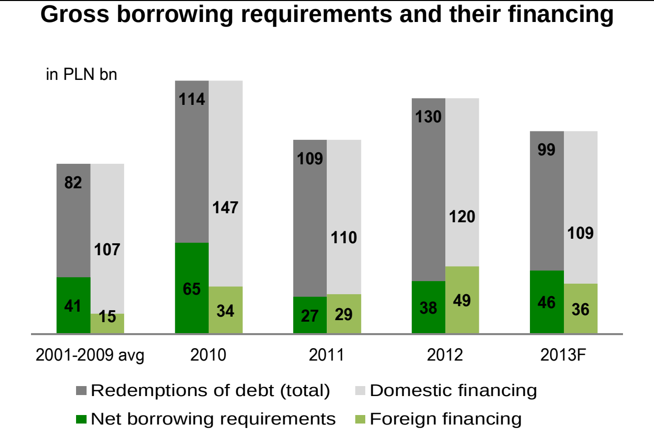
FX market

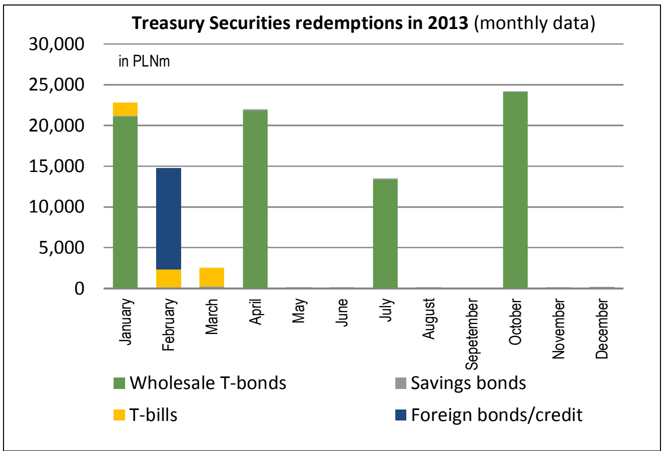
	Change (%)		Level	Expected trend	
	Last 3M	Last 1M	end-October	1M	3M
EURPLN	0.6	0.5	**4.14**	→	↗
USDPLN	-5.1	0.1	**3.18**	↗	↗
CHFPLN	0.1	0.7	**3.42**	→	↗
GBPPLN	-2.5	-0.6	**5.13**	→	→
EURUSD	5.2	-0.4	**1.29**	→	↘

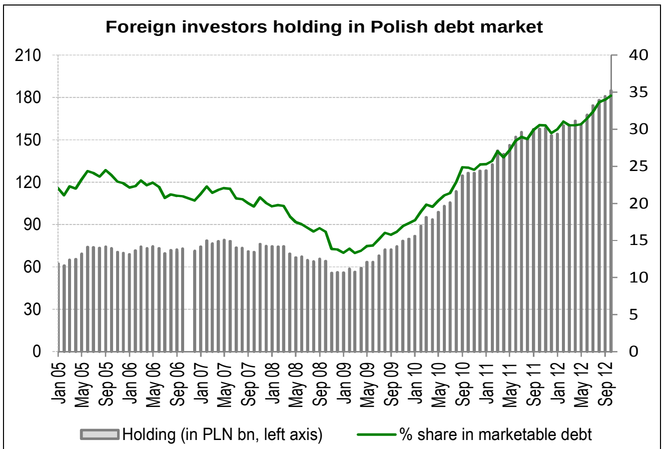
Note: Single arrow down/up indicates at least 1.5% expected move down/up, double arrow means at least 5% move

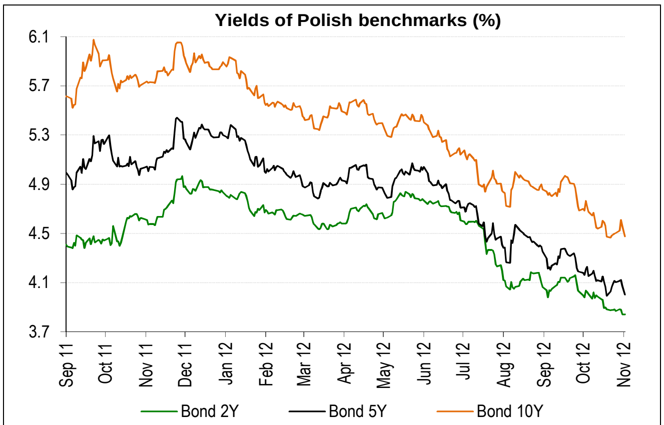
FX: our view and risk factors	
PLN FX market	**EUR:** We expect the zloty to remain under moderate pressure from the MPC's rate cuts, but also global mood as this month is full of important events. We expect the EURPLN to remain relatively stable in November, while in medium term rate should shift up towards 4.20 on average in Q1 2013.
	USD: The EURUSD is likely to remain in the familiar 1.2780-1.3050 trading range this month. However, the expansive ECB policy might continue to weigh on the single currency. Therefore we expect the EURUSD to fall slightly in coming months. Consequently, the USDPLN might continue the upward move towards 3.30 in 3 months horizon.
	CHF: We uphold our stance that the Swiss central bank will keep EURCHF floor unchanged at 1.20 in coming months. We predict gradual changes in the CHFPLN this month, while in medium term the upward move is still valid.
	Risk factors to our view: Situation in Greece and Spain is still the reference for global market mood. However, if euro benefits from the new market scenario (mainly QE3 in the US and OMT in euro zone), it will create the base for more risk appetite across the markets.

Special focus – Financing the borrowing needs for 2013









Sources: Ministry of Finance, BZ WBK

The 2013 borrowing requirements lower than in 2012

- According to the 2013 budget draft the gross borrowing needs (redemptions plus net borrowing requirements) will amount to ca. PLN145bn (down from PLN168.5bn in 2012). Lower redemptions helped to cut the gross borrowing requirements, more than offsetting the higher net needs (mainly due to upward revision of next year's central budget deficit).
- Substantial debt redemptions in 2013 will take place in January (domestic bonds worth PLN21.1bn), February (FX bonds worth €3bn), April (domestic bonds worth PLN21.9bn), July (domestic bonds worth PLN13.4bn) and in October (domestic bonds worth PLN23.4bn).
- There remains a high risk that next year's GDP growth will be slower than forecasted by the Ministry at 2.2% and even our prediction at 1.9%. It creates a risk for the government's tax receipts prediction. However, we see this risk as limited due to possible revenues from NBP's profit and spending discipline.

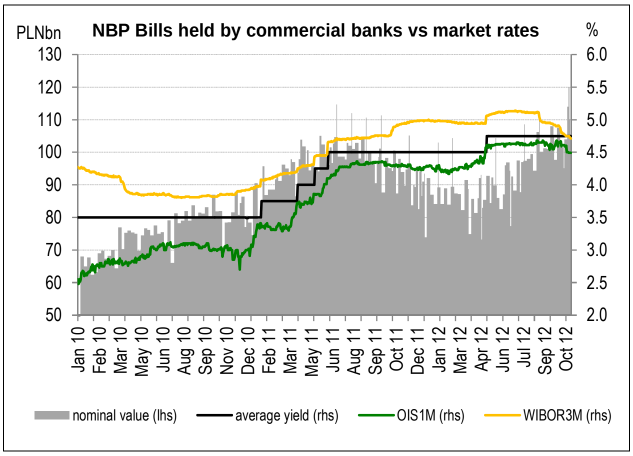
The MF has started to build a safety cushion for 2013

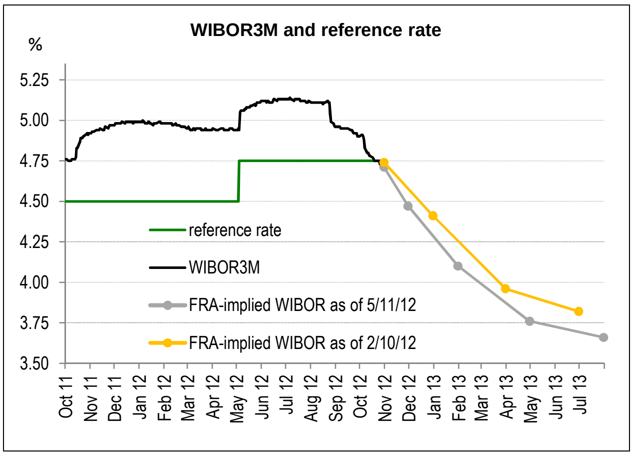
- The Ministry met the 2012 gross borrowing target in early October. Currently it is in process of pre-financing the 2013 borrowing needs through not only switch tender, but also regular tenders, which currently are more efficient. The Ministry has already pre-financed nearly 10% of the next year target, benefiting from low yield levels. Moreover, it has secured needs in foreign currencies for the first two months for 2013 (i.e. ca. €4bn in total) by launching bonds on the international markets.
- The Ministry's aim is to prefund at least 20% of the 2013 borrowing requirements. We think that goal is realistic to achieve and in our opinion it might reach even 25% of next year's target. Taking into account strong demand for Polish bonds from foreign investors (whose base is increasing) we foresee the Ministry to build a safety liquidity cushion that will cover a large part of the redemptions scheduled for the first half of next year. Consequently, it means lower supply in 2013.

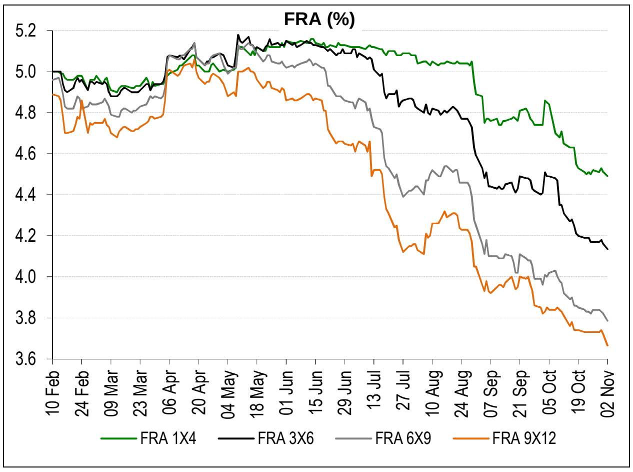
Foreign investors keep dominant position in financing

- The structure of domestic debt issuance will strongly depend on the market conditions, but the Ministry will maintain a flexible approach to individual auction. In our opinion, offer will concentrate on the mid and long end of the curve (to fulfil medium term strategy assuming an increase of average debt duration) and also on floating-rate instruments. We think that both 2Y bonds and T-bills offer will be limited, but the Ministry might can increase it if market conditions deteriorate.
- In 2012 inflows of foreign portfolio capital have remained at elevated level as their share of holding (in total marketable domestic debt) reached nearly 35% at the end of September. We believe that foreign investors are likely to roll over a majority or even the whole sum, which they will receive from redemption and coupon payments next year (PLN35bn), keeping a dominant position in financing borrowing requirements.
- However, potential outflows of foreign investors in case of significant external shocks (as increase in risk-averse mood) might be the main risk. However, we foresee potential to significant sell-off of Polish debt by non-residents should be limited as Polish bonds still offer attractive rate of returns.
- The mix of lower supply, continued strong demand from foreign investors and rate cuts expectations results in further yields decline in H1 of next year. However, some rebound in economy and increase in yields on core markets might put some negative pressure on Polish bond yields later in 2013.
- All in all we think that the Ministry of Finance should have no serious problems with financing its borrowing target.

Money Market







OIS rates show modestly aggressive scenario for rates…

- Liquidity situation of banking sector has remained favourable. However, the end of October's reserve period was unusual. Surprisingly, the central bank decided to conduct two NBP bills auctions. Apart from regular open market operations the central bank conducted another auction for 4-day money bills. This additional auction was an unprecedented event and we think a new strategy shows clearly the NBP's determination to keep cash rates close to the main market rate.
- Bullish sentiment on the money market is still present. We think that rate reduction by 25bps in November is a deal done, but the timing and scale of consecutive cuts remain in question. OIS market prices-in cuts amounting to 125bps in total in 6 months. We perceive this scenario to be a bit too aggressive. Therefore we do not exclude some profit taking.

…the same as FRA market

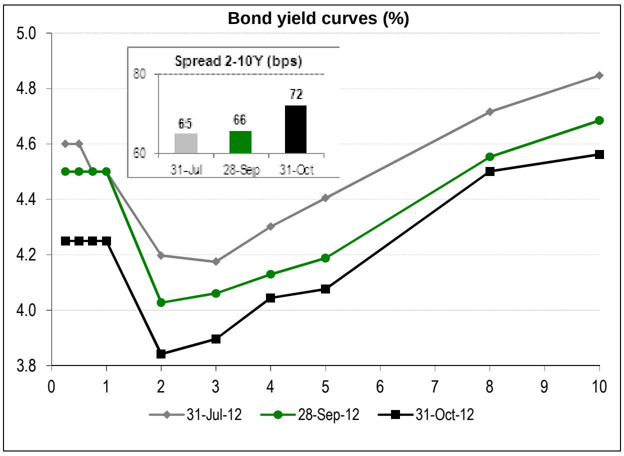
- The MPC's decision to keep interest rates unchanged in October disappointed the market players, despite a clear (but still conditional) suggestion that interest rates can be cut in November. Consequently, investors decided to take profit after significant strengthening. FRA rates increased by 1-12 bps, with the highest growth in case of 1x4 and 3x6. In the same time WIBOR rates went up by 1-5bps.
- The correction move was only short-lived. Next week of October brought a continuation of subdued downward trend in WIBOR and FRA rates. It is worth to point out that since the release of weaker than expected data on 2Q GDP growth in late August the 3-12M WIBOR declined already by just nearly 40bps, below the reference rate level.
- The significant decline in money market rates (especially in case of FRA) was observed at the beginning of November, just before the MPC meeting. It might suggest that market players are nearly sure that the Council will not only cut rates but also announce the beginning of monetary easing cycle. FRA rates decreased by 14-26bps, with highest decrease in case of 1x4 and 3x6. Investors still expect WIBOR 3M to decline further by a bit more than 100bps in 9 months horizon.
- Our baseline scenario assumes that the Council will cut rates by 25bps this month. Such a decision is strongly expected therefore investors will focus on the MPC's statement after the meeting, looking for any suggestion about probable total scale of monetary easing. We foresee WIBOR rate to decline after the MPC's decision by ca. 10bps and then continue to move downward next weeks. According to our prediction average rate of WIBOR 3M will be at 4.52% in November. Expectations for more rate cuts might bring rate towards 4.4% on average next month.

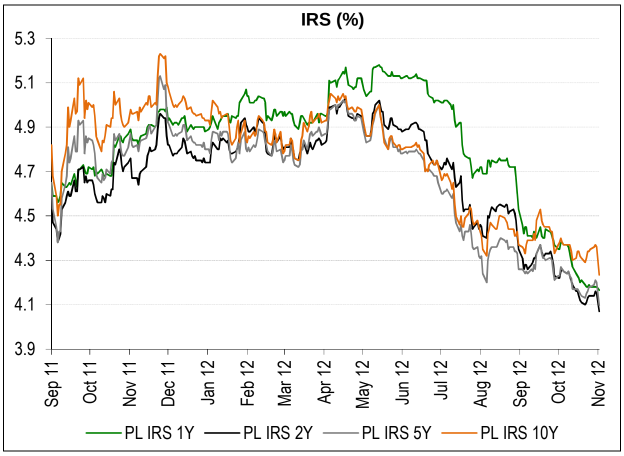
Money market rates (%)

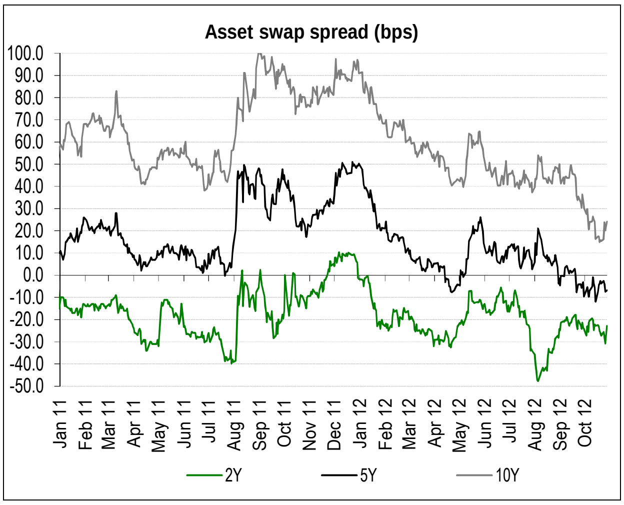
	Reference rate (%)	Polonia (%)	WIBOR (%)				OIS (%)				FRA (%)			
			1M	3M	6M	12M	1M	3M	6M	12M	1x4	3x6	6x9	9x12
End of October	**4.75**	**4.77**	**4.77**	**4.73**	**4.73**	**4.72**	**4.49**	**4.34**	**4.08**	**3.82**	**4.51**	**4.16**	**3.82**	**3.72**
Last 1M change (bp)	0	-15	-13	-19	-21	-23	-6	-4	-7	-14	-23	-26	-17	-14
Last 3M change (bp)	0	7	-14	-38	-41	-43	-14	-19	-30	-34	-57	-71	-60	-43
Last 1Y change (bp)	25	47	6	-18	-21	-22	18	6	-18	-36	-43	-77	-93	-91

Sources: Reuters, BZ WBK

IRS and T-Bond Market







Polish bonds have continued to perform strongly

- Polish bonds performance was mixed at the beginning of the October, but ended the month much stronger. The October MPC sitting outcome surprised negatively as the Council kept the rates on hold while our baseline scenario and median market forecast had been pointing to 25bps rate cut. As a consequence the yield curve shifted up by 4-6bps across the board.
- Investors' disappointment with the MPC was only short-lived. Demand for bonds was supported by poor macroeconomic data (decline in industrial output, fall in employment and real wages), a noticeable change in bias by some "hawkish" members of the MPC, which increase probability of rate cut in November and continuous strong demand from foreign investors. All factors mentioned above reduced yields of benchmarks (mainly 2Y and 5Y) to all-time lows. Consequently, in monthly terms yield curve shifted down by 11-19bps (with the lowest decline in case of 5Y bonds).
- The scope of changes in IRS rates was significantly different compared to bond market. The front end of the curve, supported by interest rates cut expectations, but also downward move in yields, went down by 6-19bps in monthly terms (with the highest decline in 1Y rate). The mid and long-end of the IRS curve remained relatively stable, with rates oscillating around 4.20% for 5Y and 4.35% for 10Y at the end of October.

The MPC and foreign investors determine the direction

- Ahead of November's MPC meeting yields of Polish government bonds reached new all-time lows. We think that the 25bps rate cut seems a done deal this month. But the markets will await the main figures of the November inflationary projection and the post-meeting press release, which should provide more input to assess whether the currently priced-in rate cut path is credible. Notwithstanding, we expect another downward move of the front end, but also mid of the curve due to announcement of the monetary easing cycle.
- Our scenario of 2Y benchmark yield decrease to 3.90% materialized last month. It came mainly from low supply, strong expectations for interest rate cuts in coming months and continuous demand from foreign investors. Currently it is likely that yield might break support level at 3.80% and decline even towards 3.70% in coming months.
- The drop in yields has been driven by foreign investors' appetite for Polish debt. Further increase of non-residents' share will cause not only lower yields across the board, but also higher volatility. As a consequence we do not rule out that after significant decline in yields (especially on the long-end) some investors will decide to take profit. However, relatively low supply perspectives remain additional supportive factor for bond market.
- To sum up we expect bond yields to hover within 3.80-4.00% for 5Y and 4.30-4.50% for 10Y.

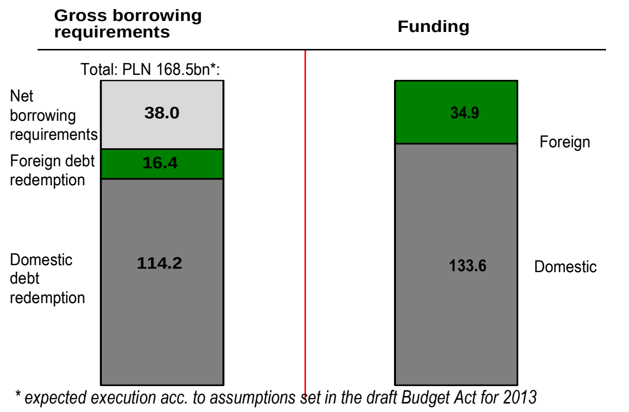
Bond and IRS market (%)

	T-bills	BONDS			IRS			Spread BONDS / IRS (bp)		
	52-week	2Y	5Y	10Y	2Y	5Y	10Y	2Y	5Y	10Y
End of October	**4.25**	**3.84**	**4.08**	**4.56**	**4.15**	**4.20**	**4.36**	**-31**	**-12**	**20**
Last 1M change (bp)	-25	-19	-11	-12	-8	-1	3	-11	-10	-15
Last 3M change (bp)	-25	-36	-33	-29	-29	-12	-9	-7	-21	-20
Last 1Y change (bp)	-25	-78	-96	-116	-59	-61	-56	-19	-35	-60

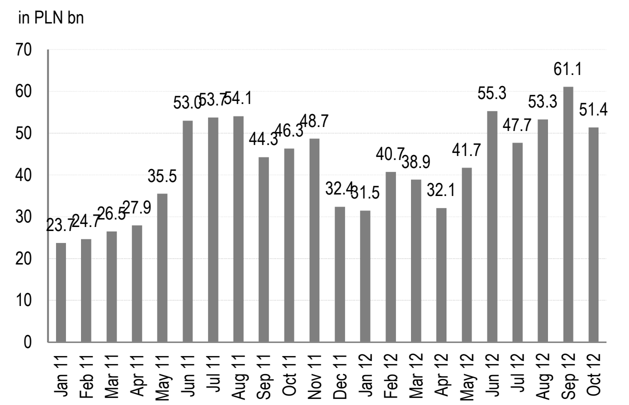
Sources: Reuters, BZ WBK

Treasury Securities Supply Corner

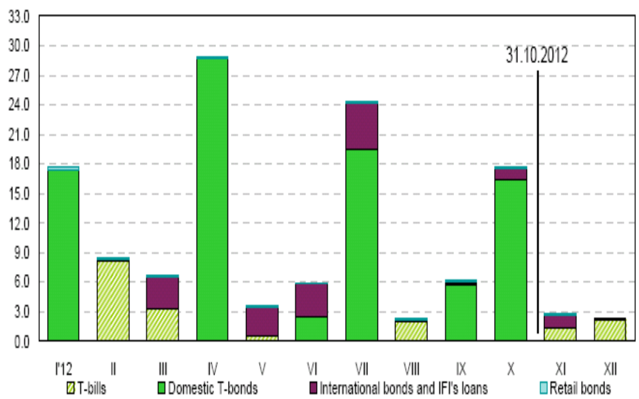
Funding of 2012 gross borrowing requirements



Funds in PLN and in foreign currency held by MoF



State Treasury debt redemptions in 2012 (as of 31 Oct 2012)



Auction schedule for November

Regular auction			
Date of tender	Settlement date	Series	Expected offer (in PLN m)
8 Nov 2012	12 Nov 2012	PS0418	2,000 – 4,000
Switch auction			
Date of tender	Settlement date	T-bonds to be offered	T-bonds to be repurchased
21 Nov 2012	23 Nov 2012	DS1023 / WZ0117 / WZ0121	OK0113 / PS0413

Sources: Ministry of Finance, BZ WBK

Borrowing requirements for 2012 covered in 100%

- Poland's Ministry of Finance completed the 2012 borrowing needs worth PLN168.5bn at the beginning of October after issuing bonds on EUR market (worth €1.75bn).
- As regards the financing breakdown of 2012 gross borrowing needs (see chart), the domestic market was dominant (like in previous years), with share of 71.2%.
- Sale of Treasury securities on the domestic market was a main vehicle of financing - with share of 59.4% in total financing in 2012. One should notice that this year the Ministry has been very active on the foreign market as foreign funding reached PLN48.5bn, which is significantly higher than in 2011 (PLN28.7bn).
- As previously announced, the Ministry bought back all outstanding Brady Bonds (i.e. RSTA and PAR) worth USD297m (in nominal terms) on the interest payment date falling on October 27th. As a result of that operation the Ministry fulfilled the agreement with London Club banks made in 1994.
- According to the Ministry officials, liquidity cushion denominated in PLN and FX amounted to ca. PLN51bn at the end of October. We would like to point out that in October the PLN-cushion declined due to bond redemption and servicing payments amounting to PLN25.7bn, while the cushion in foreign currency increased.

A new 5Y benchmark on the agenda

- The detailed debt supply calendar for November (published at the end of October) was in line with quarterly issuance plan. However, the offer at the regular auction (on 8 November) was a surprise as the Ministry is going to launch a new 5Y T-bond PS0418. Moreover, the Ministry is using a favourable market situation and strong demand on Polish debt assets to reduce cost of issuing by decreasing the level of coupon. In case of the new 5Y bonds it was set at 3.75%, i.e. by 1pp lower than in previous series of PS0417 (4.75%).
- When commenting the issuance plan for this month P. Marczak, the head of Public Debt Department in Finance Ministry, said that the new 5Y benchmark is offered in November as the authorities consider calling off a regular bond tender in December.
- On 1 November the Ministry launched 5Y (maturing on 8 November 2017) and 15Y (maturing on 8 November 2027) bonds denominated in Japanese yen worth JPY66bn in total. The bonds were priced at 67bps and 117bps over the swap rate what implies yields of 1.05% and 2.50%, respectively. Taking into account that the total value of sale was two times higher than originally planned, the scenario that the Ministry decides not to offer T-bonds in December seems highly probable.

The MF has started to pre-finance next year's needs

- The Ministry of Finance has successfully started the pre-financing of borrowing requirements for 2013. After regular auctions in October proceeds accounted for nearly 10% (or PLN13.7bn) of the next year's needs.
- According to P. Marczak, the Ministry plans to pre-finance at least 20% of the 2013 borrowing needs defined at PLN145bn. He pointed out that "by the end of the year we have the comfort of choosing only attractive offers". In our opinion a goal near 25% of pre-financing is realistic to achieve.

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	4,000	0	**86,752**
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	2,647		**39,443**
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**	**6,797**	**150**	**170,347**
Redemption	11,297	3,981	5,275	20,795	4,906	2,778	20,459	3,191	1,122	17,653	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**	**4,541**	**-2,218**	**74,279**
Rolling over T-bonds	6,309			7,966		2,459	4,908		5,613				**27,254**
Buy-back of T-bills													
Total	**47,848**	**15,749**	**8,496**	**1,782**	**4,896**	**14,539**	**-9,559**	**4,450**	**8,199**	**3,480**	**4,541**	**-2,218**	**101,533**
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)

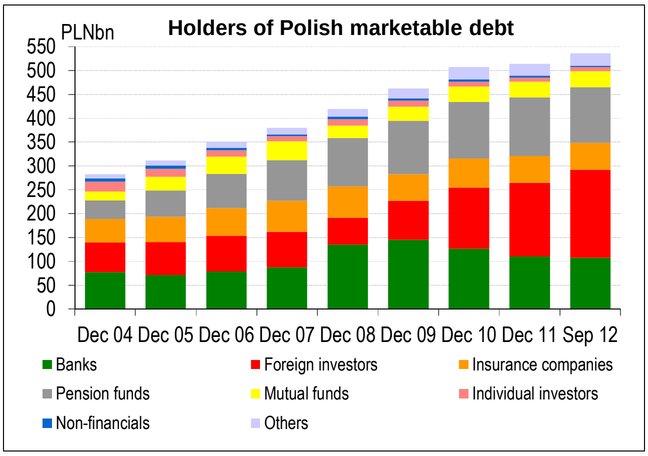
	Bonds	Bills	Retail bonds	Total domestic redemption	Foreign Bonds/Credits	Total redemptions
January	10 946	0	351	**11 297**		**11 297**
February		3 799	182	**3 981**		**3 981**
March		1 997	129	**2 125**	3 150	**5 275**
April	20 663		132	**20 795**		**20 795**
May		2 223	117	**2 339**	2 567	**4 906**
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	80,511	6,110	1,698	88,319	14,825	103,144
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+	219,667		3,288	222,955	134,966	357,922

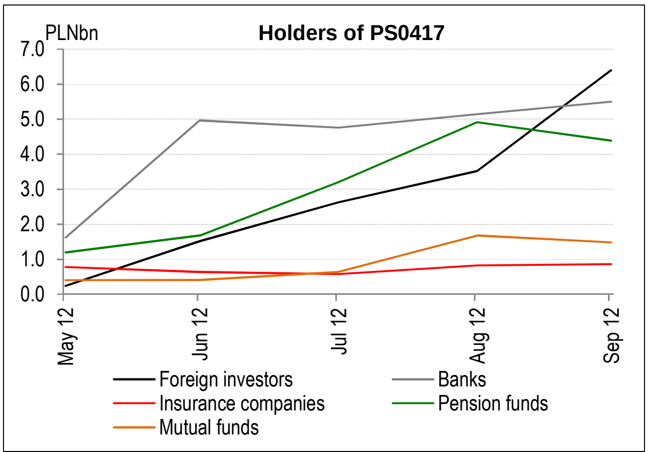
Schedule wholesales bonds redemption by holders (data at the end of September 2012, in PLNm)

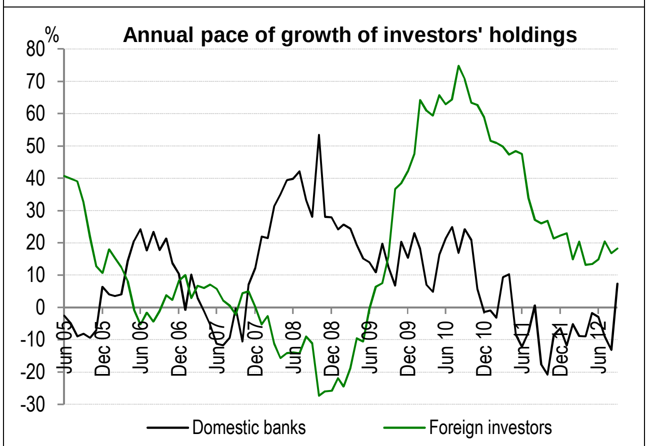
	Foreign investors	Domestic banks	Insurance Funds	Pension Funds	Mutual Funds	Individuals	Non-financial sector	Other	Total
Q1 2012	0	0	0	0	0	0	0	0	0
Q2 2012	0	0	0	0	0	0	0	0	0
Q3 2012	0	0	0	0	0	0	0	0	0
Q4 2012	10,360	3,859	768	362	324	83	30	687	16,473
Total 2012	**10,360**	**3,859**	**768**	**362**	**324**	**83**	**30**	**687**	**16,473**
	63%	**23%**	**5%**	**2%**	**2%**	**1%**	**0%**	**4%**	**100%**
Total 2013	37,167	11,669	12,372	11,335	2,890	494	144	4,574	80,645
	46%	14%	15%	14%	4%	1%	0%	6%	100%
Total 2014	28,537	11,166	5,232	7,593	2,706	436	109	3,468	59,248
	48%	19%	9%	13%	5%	1%	0%	6%	100%
Total 2015	23,596	22,370	7,298	14,607	5,817	189	778	4,297	78,951
	30%	28%	9%	19%	7%	0%	1%	5%	100%
Total 2016	15,010	10,031	4,502	24,734	5,469	51	92	2,740	62,630
	24%	16%	7%	39%	9%	0%	0%	4%	100%
Total 2017+	69,507	42,900	24,509	58,063	15,287	249	564	9,571	220,651
	32%	19%	11%	26%	7%	0%	0%	4%	100%

Sources: Ministry of Finance, BZ WBK

Treasury Securities Holders







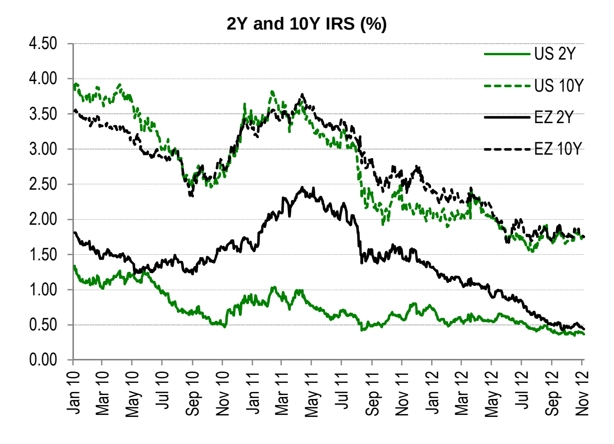
We owe more and more to foreign investors

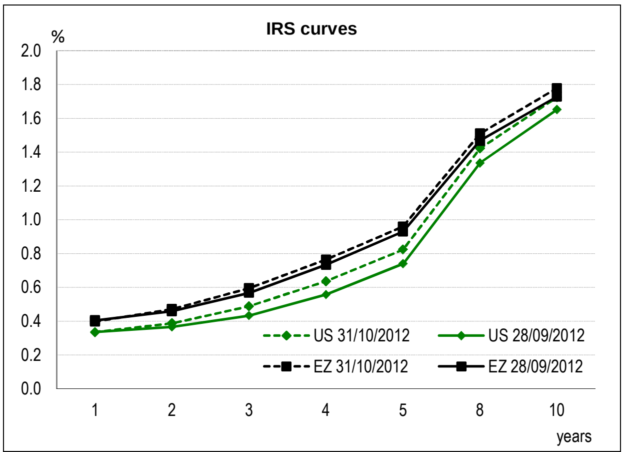
- At the end of September the Polish PLN marketable debt amounted to nearly PLN526bn, up from PLN522.6bn at the end of August. Slightly over 35% of this volume was in hands of foreign investors. This group held debt worth PLN184.2bn (more by nearly PLN4bn compared to end-August) and that was 5th consecutive record.
- Over a half of this monthly increase of holdings was driven by the purchase of 5Y benchmark PS0417 (+PLN2.9bn). At the end of September foreign investors held 34% of the total issuance of this bond.
- Foreign investors held 36% of total issuance of OK0714 at the end of September. It is worth to notice that this figure sits well below non-residents' engagement in other OK bonds (for example, this group of investors holds 54% of OK0114 or even 64% of OK0713). So far, the Ministry of Finance issued only PLN7.6bn of OK0714 (versus PLN21.8bn of OK0114 and PLN13.4bn of OK0713). As next auctions of OK0714 will take place next year, it should not be surprising if foreign investors continue to accumulate this 2Y bond.
- Polish banks increased their holdings by PLN7.7bn. This was the first increase after 5 months of reducing engagement and highest monthly gain since February '12. The share in total marketable debt increased to highest levels since May '12. This group of investors purchased mainly floating-coupon bonds (WZ0115, WZ0118, WZ0121, WZ0117).
- Domestic banks were the sole group of Polish major investors who increased their holdings of bonds. Pension funds, mutual funds and insurance companies sold debt worth PLN6.8bn (most aggressive reduction of portfolio of these three groups in total since November '09). Currently pension funds hold nearly PLN117bn, lowest amount since November '10. In case of insurance companies and mutual funds, their engagement is lowest since March '12.
- September's data show that the tendencies seen during the past few months showed some sign of possible reversal. Although foreign investors continued to accumulate Polish debt (for the 5th consecutive month), domestic banks entered the market aggressively.

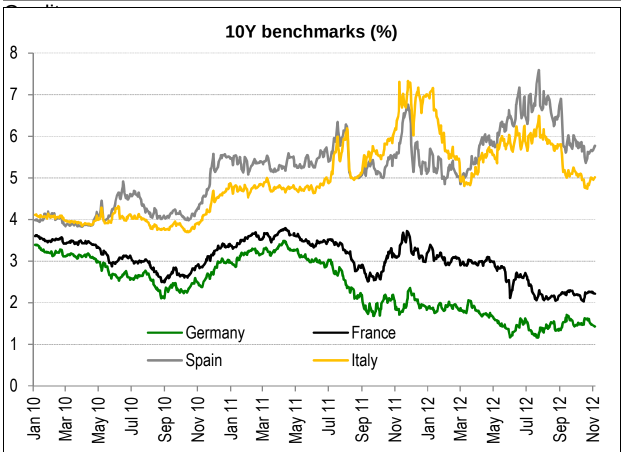
Holders of marketable PLN bonds	Nominal value (PLN, bn) End Sep	End Aug	End Q2 2012	End Q1 2012	Nominal value (PLN, bn) End 2011	End 2010	End 2009	% change in September MoM	QoQ	YoY	Share in TOTAL (%) in Sep
Domestic investors	341.8	342.4	352.9	361.5	349.8	354.1	336.2	-0.2	-3.2	-0.2	65.0 (-0.5pp)
Commercial banks	102.0	94.3	102.1	110.9	103.3	110.4	112.1	8.2	-0.12	7.4	19.4 (+1.4pp)
Insurance companies	54.7	56.3	57.0	54.3	55.5	59.5	53.8	-3.3	-4.1	-6.4	10.4 (-0.4pp)
Pension funds	116.7	119.8	120.3	120.7	122.2	117.0	111.0	-2.6	-3.0	-2.67	22.2 (-0.7pp)
Mutual funds	32.5	34.3	33.0	31.3	31.7	30.2	26.8	-5.3	-1.5	12.2	6.2 (-0.4pp)
Others	35.9	37.5	40.5	44.3	37.1	37.0	32.5	-4.3	-18.2	-10.5	6.8 (-0.4pp)
Foreign investors*	184.2	180.2	174.0	163.2	152.5	124.8	78.6	1.6	5.9	18.2	35.0 (+0.5pp)
Banks	27.8	26.1	22.6	24.3	16.2	21.9	17.4	6.4	23.2	36.2	5.3 (+0.3)
Non-bank fin. sector	147.5	146.2	143.1	131.7	129.3	96.8	58.0	0.9	3.1	14.4	28.1 (+0.1)
Non-financial sector	5.6	4.9	5.2	4.4	4.5	4.2	2.3	14.7	7.5	37.1	1.1 (+0.1)
TOTAL	526.0	522.6	526.9	524.7	502.3	478.9	414.8	0.7	-0.2	5.6	100.0

**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







Yields of safe haven assets consolidate

- Government bond yields in the major markets (US, Germany) have continued to climb moderately across the curves due to slightly better-than-expected macroeconomic data, but mainly in response to a sharp shrinkage of the European risk premium. However, the end of October brought some risk-off mood due to worries about Greece, but also about situation in Spain. As a result Bunds and US Treasuries rallied gradually, trimming partly earlier losses. To sum up, in monthly terms the US curve shifted upward by 6-17bps, while Bund curve climbed by 2-10bps.
- Situation on core markets has remained uncertain. One of the key issues will be the ECB meeting, especially taking into account that possibility of further rate cut by the central bank (by 25bps) increased.
- To sum up, current situation should still favour the front end of the curve, while yields of bonds with longer maturity might consolidate, mainly due to developments in real economy. As a consequence we do not exclude some yield curve steepening in coming weeks. In medium term we expect yields of safe haven assets to increase gradually.

Market is still waiting for Spain's aid request

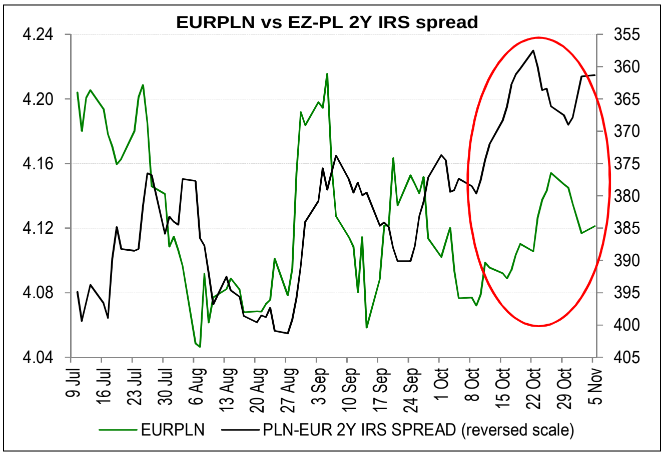
- In October both Italian and Spanish bond curves have stabilized near levels that could be regarded as consistent with debt sustainability. This most likely reflects a combination of factors, in which the most important is the possibility of a targeted ECB intervention. Despite negative news flow about Spain (including the downgrade of credit rating by the S&P, and also for regions by Moody's) the reaction on Spanish bond market was not extreme. It might come from the fact that Spain has completed nearly 95% of its 2012 funding needs.
- The situation in Italy is a bit different compared with Spain. Italy is lagging compared with other euro zone countries in completion of this year budgetary needs. At the end of October it was nearly 80% (vs 95% in Spain and 91% on average in the euro zone), less than in the same period of 2011 (87%). Consequently, at the end of October yields of 10Y benchmark were at 5% for Italy (17bps lower in comparison with the end of September) and 5.67% for Spain (30bps lower than at the end of previous month).
- The calendar still contains some risk events (including results of presidential election in the US, Troika's report about Greece, regional election in Spain), which may trigger volatility on peripheral debt markets. We remain convinced that Spain's aid request is only a matter of time. Therefore we do not exclude some flows back into peripheral markets in coming weeks/months. We foresee both Italian and Spanish bonds to stay within limited ranges.

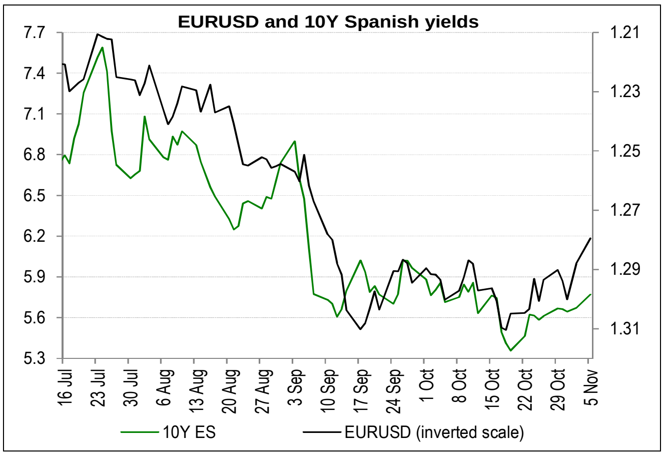
Euro zone's issuance plans and completion in 2012 (€ bn)

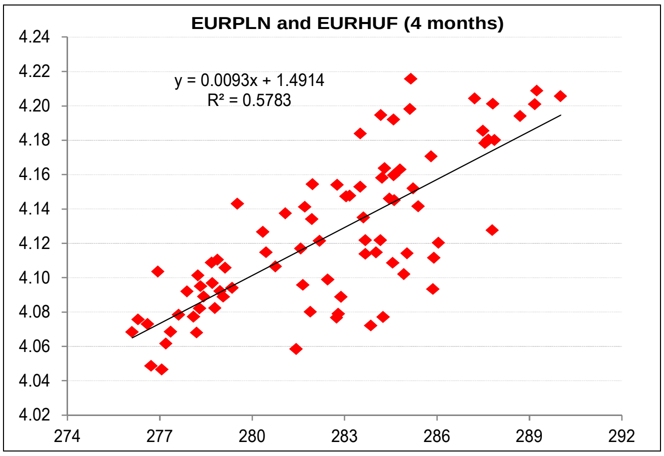
	Total redemptions	Deficit	Borrowing needs	Expected bond supply	% of completion (YtD)
Austria	14	8.3	22.3	22.3	**87**
Belgium	27.9	7	34.9	26.0	**99**
Finland	6.3	7.5	13.8	13.8	**95**
France	101.7	78.7	180.4	178	**99**
Germany	157	26.6	183.6	170	**91**
Greece	33.2	16.2	49.4	-	**-**
Ireland	5.5	13.7	19.2	-	**-**
Italy	192.2	41.1	233.3	233.3	**80**
Netherlands	29.7	12.3	42	60.0	**98**
Portugal	12.9	17.4	30.3	-	**-**
Spain	50.1	36.2	86.3	85.9	**95**
Total	**630.5**	**265.0**	**895.5**	**789.2**	**91**

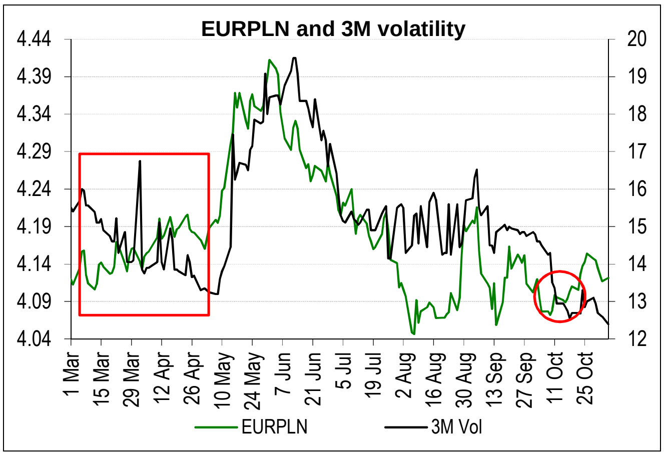
Source: Reuters, BZ WBK

Foreign Exchange Market









Sources: Reuters, BZ WBK

EURPLN breaks upper band of consolidation…

- For the better part of the past month the volatility on the PLN FX market was clearly lower than in previous months. The 3M volatility of the EURPLN was declining (from ca. 15pts to 12pts) as the exchange rate was rising steadily inside the narrowing consolidation seen on the chart since early September.
- The market sentiment was quite shaky during the past month as investors were much concerned about 3Q earnings of the US companies and disappointed that Spain so far did not ask for help. Furthermore, the negative pressure on the zloty was put by strengthening expectations for rate cuts by the MPC.
- In late October the risk aversion gained steam and poor data on domestic retail sales fuelled expectations the MPC will cut rates. Consequently, the EURPLN broke the upper band of the consolidation and reached nearly 4.16 (highest level since late September). Our view presented last month that there may be more visible move of the EURPLN in October materialized, as the zloty depreciated by 0.8% vs. the euro, nearly 1% vs. the Swiss franc and stayed flat vs. the dollar.

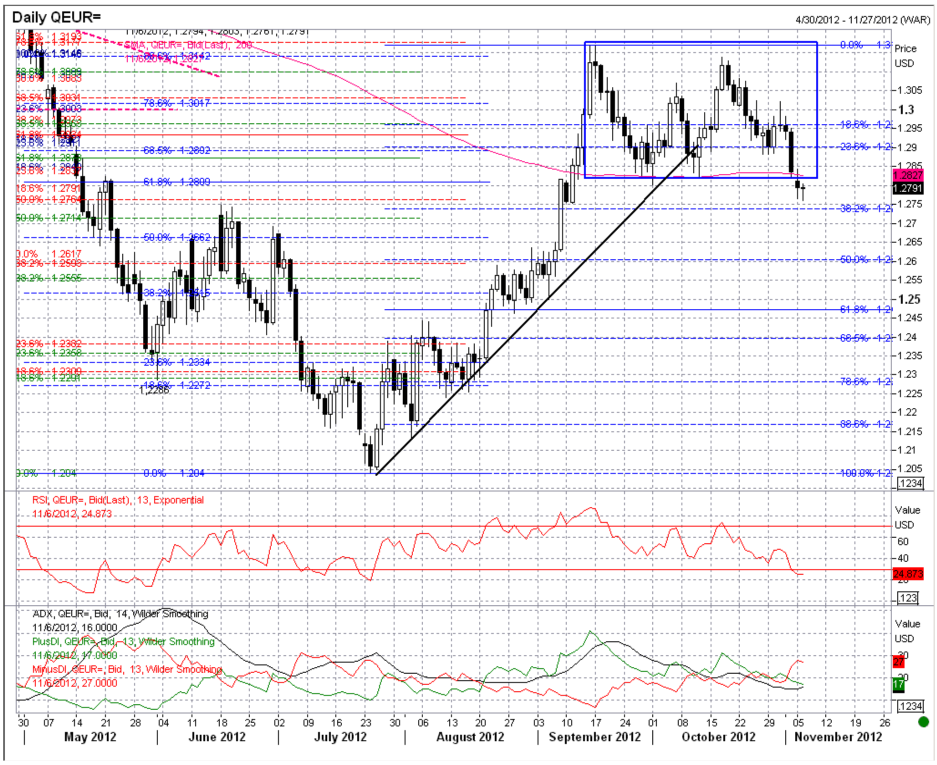
… and the zloty may continue to depreciate in November

- The correlation of the EURPLN with its main drivers (S&P500 and PLN-EUR IRS spread) declined in October. However, the correlation with the US stock market (-0.52 vs. -0.77 in early October) is one of the most important factors that potentially can influence the zloty. During October the correlation of the EURPLN with the EURUSD strengthened (from -0.08 to -0.3). It may be vital factor given the fact that the correlation of the EURUSD with the 10Y Spanish yields increased from -0.79 to -0.92. Recently the market started to worry much more about the situation in Greece and if the uncertainty on whether the next tranche will be disbursed persist, this may have some negative impact on the zloty (through the EURUSD channel).
- Still, although the risk aversion played main role during the past month, the S&P500 declined only by 3.4% from the local peak. Yields of the 10Y Spanish and Italian bonds advanced, but the scale and pace of growth was rather muted. This may indicate that despite justified worries over outlook for global economy and uncertainty when (if only) Spain will ask for help and how the case of Greece will be solved, there is no rush to start massive withdrawal from capital market and to sell peripheral bonds (as the Fed and OMT are on the stand-by).
- We expect the domestic currency to remain under moderate pressure also from NBP rate cuts. The fact that Hungarian and Czech central banks have reduced rates already three times since July (by total 75bps to 6.25% and by total 70bps to 0.05%, respectively) may determine the investors' perception of the whole CEE region as prone to monetary policy easing. Furthermore, as negotiations between Hungarian government and the IMF are in progress, any depreciation of the forint may have negative impact on the zloty.
- Interestingly, when the EURPLN broke the upper band of the consolidation, the 3M volatility remained around 13pts. Similar divergence – though at clearly smaller scale – was observed in March and April '12 and in the following months the EURPLN surged to nearly 4.45. Although we do not expect such a strong depreciation of the zloty this time, such an analogy is in line with our view of more depreciation of the domestic currency to come.
- To sum up, in our view the EURPLN has still some potential to increase in the remainder of the year and in first months of 2013. Even though the technical analysis suggests the exchange rate may head even towards 4.28 (find more on the next page), we anticipate clearly smaller scale of zloty's depreciation. This month the EURPLN shall be at 4.15 on average and up to ca. 4.20 in 1Q '13.

FX Technical Analysis Corner

EURPLN

- EURPLN broke the upper band of consolidation and surged to nearly 4.16.
- Price projection from the formation of consolidation points to an increase to ca. 4.28. Two Fibonacci retracement levels meet close to this level. First resistances at 4.18 and 4.22 need to be broken and if this happens, then the exchange rate may head towards 4.28. If we assume, that the EURPLN stayed in this range for 2 months, then it should take approximately 2 months to reach 4.28.
- First support for the EURPLN is at 4.10.



EURUSD

- The exchange rate broke the line of the upward trend but that did not initiate any visible downward move. Potential for a decline was long well limited by the 200-day moving average.
- Still, in early November this MA line was broken and the EURUSD may reach first support at 1.2738 (38.2% Fibonacci retracement) soon.
- The ADX oscillator shows the trend is on the downside, but the strength of this tendency is currently rather low (ADX below 20-25).
- Next vital support levels are at 1.26 and 1.24.

Sources: Reuters, BZ WBK

Poland vs other countries - economy

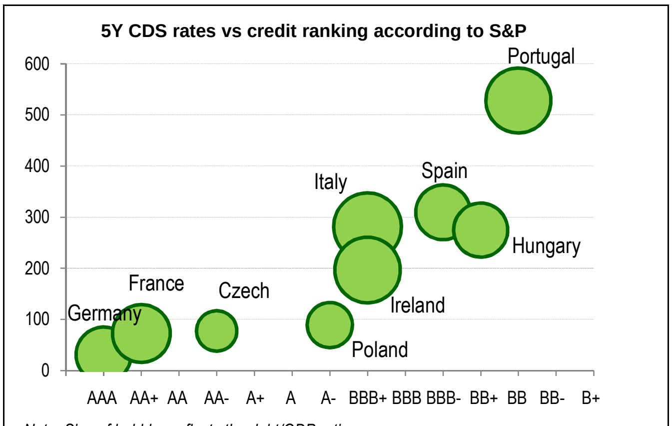
Main macroeconomic indicators (European Commission's forecasts)

	GDP* (%)		Inflation* (HICP, %)		C/A balance (% of GDP)		Fiscal Balance (% of GDP)		Public Debt (% of GDP)	
	2011	2012F	2011	2012F	2011	2012F	2011	2012F	2011	2012F
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

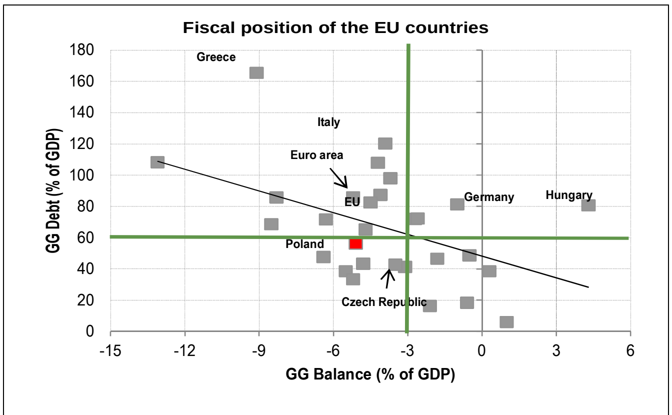
*Note: * European commission – May 2012*

Sovereign ratings

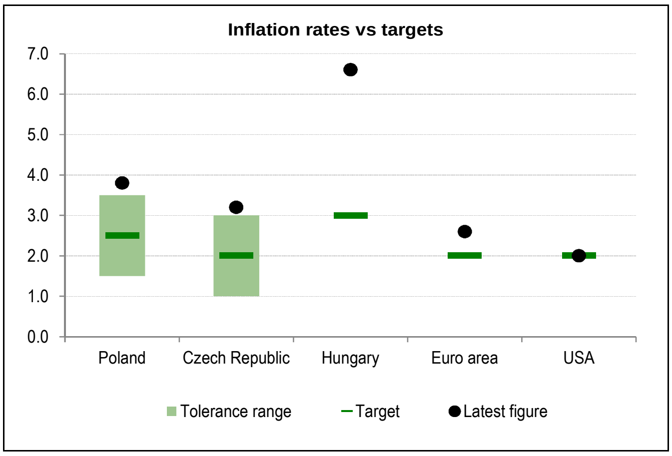
	S&P		Moody's		Fitch	
	rating	outlook	rating	outlook	rating	outlook
Poland	A-	stable	A2	stable	A-	stable
Czech	AA-	stable	A1	stable	A+	stable
Hungary	BB+	negative	Ba1	negative	BB+	negative
Germany	AAA	stable	Aaa	negative	AAA	stable
France	AA+	negative	Aaa	negative	AAA	negative
UK	AAA	stable	Aaa	negative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

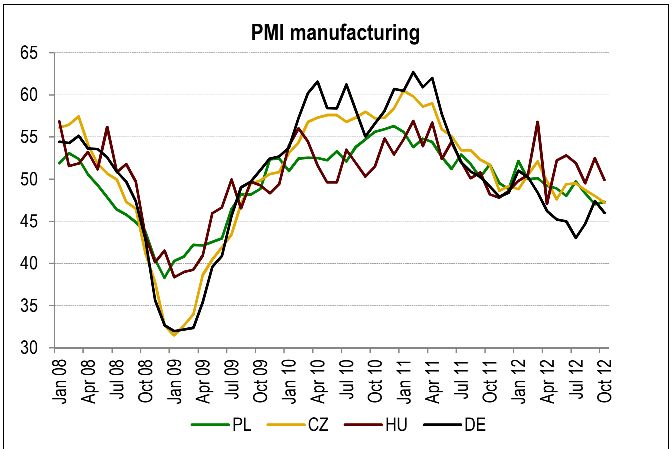


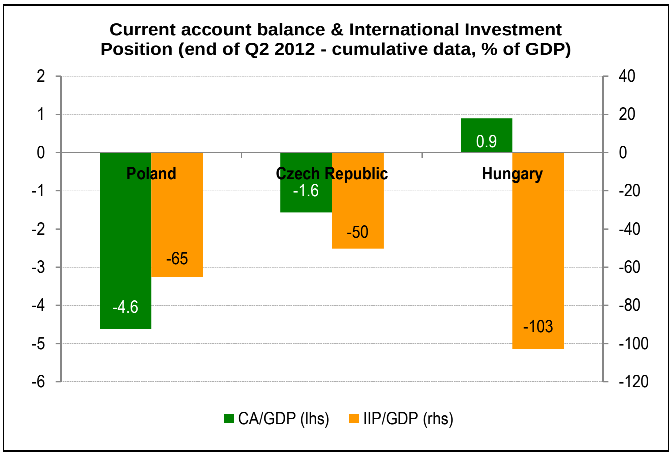
Note: Size of bubbles reflects the debt/GDP ratio



Note: final data for 2011





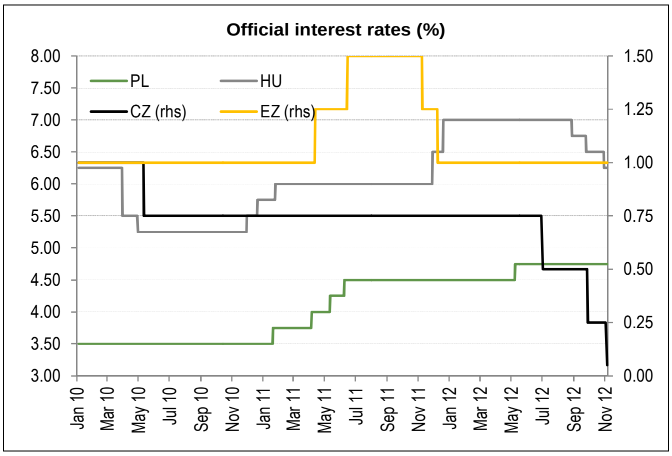


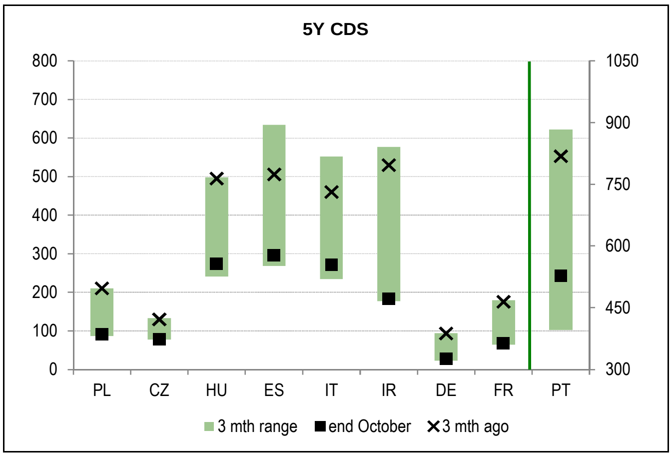
Source: stat offices, central banks, Reuters, BZ WBK, EC

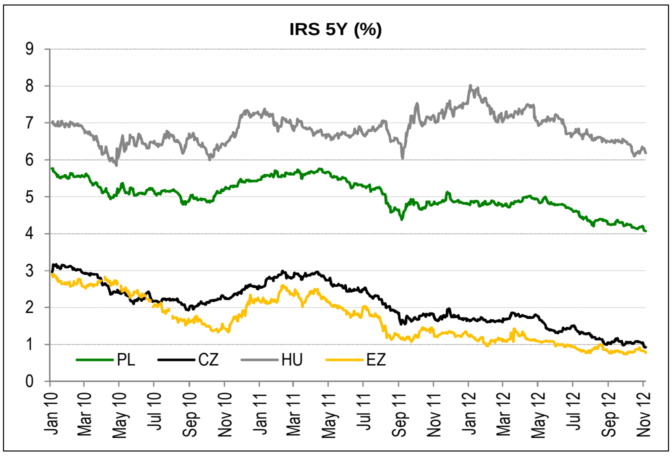
Poland vs other countries - market

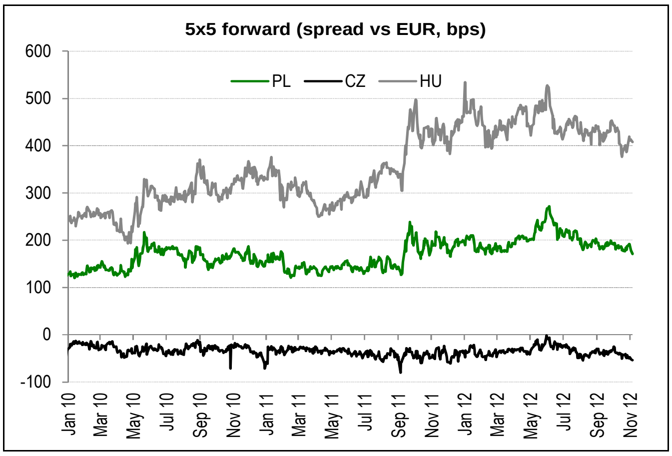
Main market indicators (%)

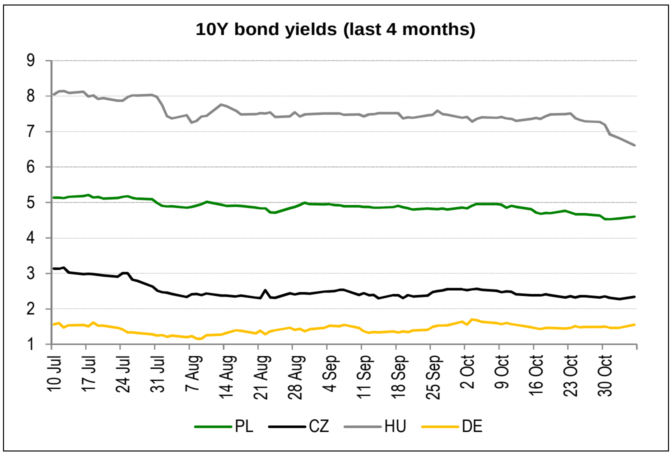
	Reference rate (%)		3M market rate (%)		10Y yields (%)		10Y Spread vs Bund (bps)		CDS 5Y	
	2011	2012F	2011	end of October	2011	end of October	2011	end of October	2011	end of October
Poland	**4.50**	**4.25**	**4.99**	**4.73**	**5.88**	**4.56**	**405**	**309**	**279**	**91**
Czech Republic	0.75	0.05	0.78	0.32	3.59	2.19	176	73	173	78
Hungary	7.00	6.25	7.24	6.28	9.90	7.00	807	553	610	275
Euro area	1.00	0.50	1.36	0.20						
Germany					1.83	1.47			100	28

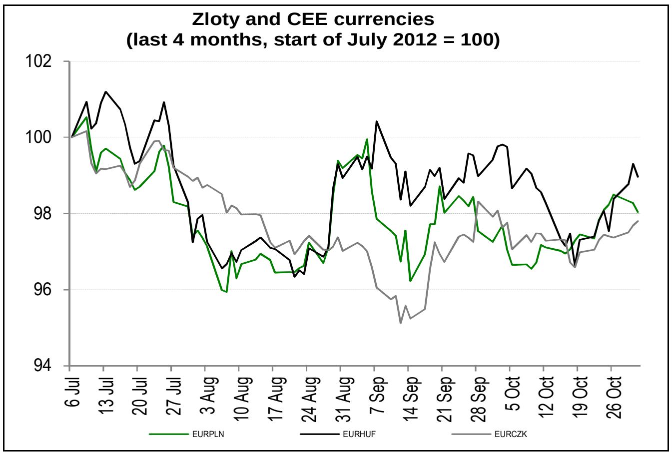












Source: stat offices, central banks, Reuters, BZ WBK, EC

Central Bank Watch

					Expected changes (bps)			Risks
		Last	2011	2012F	1M	3M	6M	
Euro	Forecast	0.75	1.00	0.50				The possibility of further monetary policy easing still exists. However, market will concentrate on a new EC macro forecasts this month
	Market implied »				0	0	-1	
UK	Forecast	0.50	0.50	0.50				BoE is like to remain on hold on both assets purchase and official rates. However, the Council might suggest further easing bias if the outlook deteriorates
	Market implied »				-1	-3	-3	
US	Forecast	0-0.25	0-0.25	0-0.25				Presidential election crucial, results might determine the US monetary policy in medium terms
	Market implied »				0	0	-1	
Poland	Forecast	4.75	4.50	4.25				The Council might stay on hold, waiting for more visible deterioration in economic activity (i.e. Q3 GDP data) or decide to cut more aggressively (by 50bps)
	Market implied »				-24	-61	-95	
Czech	Forecast	0.05	0.75	0.05				The official interest rates is close to zero. CNB can now concentrate fully on unconventional tools, where FX intervention is the most probable tool
	Market implied »				26	19	17	
Hungary	Forecast	6.25	7.00	6.25				Further rate cuts may come in upcoming quarters, but the speed of cuts may slow down
	Market implied »				-19	-38	-86	

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

Economic Calendar and Events

Date		Event:	Note:
6-Nov	US	US Presidential Election	
7-Nov	**PL**	**MPC Meeting – interest rate decision**	**We foresee the MPC to cut rates by 25bps**
	DE	Auction of 5Y bonds	Offer: €4.0bn
8-Nov	**PL**	**Auction of 5Y T-bonds PS0418**	**Offer: PLN2.0-4.0bn**
	EZ	ECB Meeting – interest rate decision	Rates on hold
	SP	Auction of 3Y, 6Y and 20Y bonds	Offer: €3.5-4.5bn
9-Nov	EU	Ecofin meeting (about budget)	-
12-Nov	EZ	Eurogroup meeting	-
14-Nov	**PL**	**CPI for October**	**Our forecast: 3.5%YoY (slightly above consensus)**
	IT	Auction of medium and long term bonds	-
	DE	Auction of 2Y bonds	Offer: €5.0bn
19-Nov	**PL**	**Employment and wages for October**	**We foresee annual growth in employment on negative territory (-0.1%YoY), while growth in wages (1.7%) well below market predictions**
20-Nov	**PL**	**Industrial output and PPI for October**	**We are more optimistic than market, expecting industrial output growth at 4.9%YoY (vs 2.0%), but rebound is only thanks to statistical effect**
21-Nov	**PL**	**Core inflation measures for October**	**We expect core inflation exc. food & energy prices at 1.9%YoY**
	PL	**Switch tender**	**Offer: DS1023, WZ0117, WZ0121; Buy back: OK0113, PS0413**
	DE	Auction of 10Y bonds	Offer: €4.0bn
22-Nov	SP	Auction of bonds	-
22-28-Nov	**PL**	**Retail sales for October**	**We foresee moderate growth at 3.2%YoY, below market consensus**
27-Nov	HU	NBH Meeting – interest rate decision	Rates on hold
28-Nov	DE	Auction of 5Y bonds	Offer: €3.0bn
29-Nov	IT	Auction of medium-term bonds	-
30-Nov	**PL**	**Q3 2012 GDP**	**We predict economic activity to slow to 1.7% due to decline in investment and weak consumption**
5-Dec	**PL**	**MPC Meeting – interest rate decision**	**We foresee the MPC to cut rates by 25bps**
6-Dec	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	1,596.6	1,661.2	370.7	388.3	393.0	445.2	384.1	401.9	407.2	465.9
GDP	%YoY	3.9	4.3	2.2	1.9	3.6	2.3	1.7	1.3	1.3	1.8	2.1	2.3
Domestic demand	%YoY	4.6	3.4	-0.5	0.9	2.5	-0.4	-1.8	-1.6	-0.5	0.3	1.7	1.8
Private consumption	%YoY	3.2	2.5	1.3	1.5	1.7	1.2	1.0	1.1	1.4	1.5	1.6	1.7
Fixed investments	%YoY	-0.4	9.0	-0.4	-2.7	6.0	1.3	-3.0	-2.0	-5.0	-4.0	-3.0	-1.0
Unemployment rate [a]	%	12.4	12.5	13.5	13.8	13.3	12.3	12.4	13.5	14.0	12.4	12.6	13.8
Current account balance	EURm	-18,129	-17,977	-11,915	-5,511	-4,515	-2,164	-2,313	-2,923	-2,137	-758	-1,277	-1,339
Current account balance	% GDP	-5.1	-4.9	-3.1	-1.4	-5.1	-4.6	-3.8	-3.1	-2.5	-2.1	-1.8	-1.4
General government balance	% GDP	-7.9	-5.0	-3.5	-3.0	-	-	-	-	-	-	-	-
CPI	%YoY	2.6	4.3	3.8	2.3	4.1	4.0	3.9	3.1	2.4	1.9	2.3	2.5
CPI [a]	%YoY	3.1	4.6	2.8	2.5	3.9	4.3	3.8	2.8	2.3	1.8	2.5	2.5
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	1.8	2.1	2.3
EUR/PLN	PLN	3.99	4.12	4.19	4.15	4.23	4.26	4.14	4.15	4.21	4.15	4.15	4.10
USD/PLN	PLN	3.02	2.96	3.27	3.21	3.23	3.32	3.31	3.22	3.33	3.26	3.17	3.08
CHF/PLN	PLN	2.90	3.34	3.48	3.37	3.50	3.55	3.44	3.43	3.51	3.39	3.32	3.28
GBP/PLN	PLN	4.66	4.75	5.17	5.01	5.26	5.34	5.12	5.13	5.07	4.94	4.91	5.12
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	4.91	4.13	4.97	5.04	5.06	4.58	4.15	4.06	4.12	4.19
Yield on 2-year T-bonds	%	4.72	4.81	4.36	3.91	4.66	4.71	4.22	3.85	3.72	3.87	3.98	4.07
Yield on 5-year T-bonds	%	5.31	5.44	4.61	4.13	5.02	4.93	4.43	4.07	4.00	4.05	4.18	4.27
Yield on 10-year T-bonds	%	5.74	5.98	5.10	4.75	5.58	5.38	4.91	4.52	4.46	4.78	4.88	4.87

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

This analysis is based on information available until 5th November 2012 and has been prepared by:

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