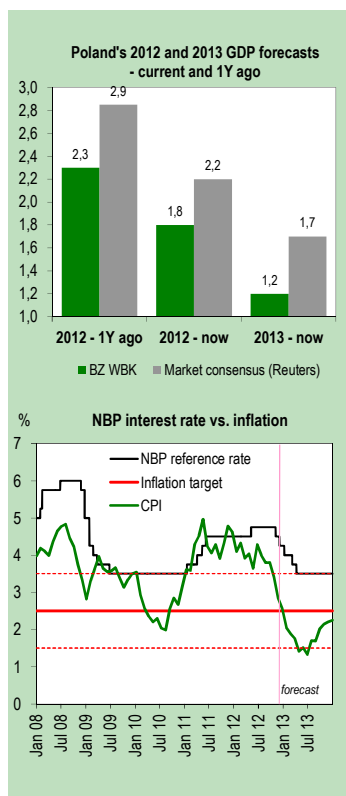


MACROscope

Polish Economy and Financial Markets

December 2012



In this issue:

How deep the bottom of the cycle?	2
No inflationary pressure (for some time already)	3
Slowdown in loans. For how long?	4
MPC behind the curve. Will overreact again?	5
MPC – whose voice is important?	6
Budget – amendment or repeat of 2012?	7
Bond market – when/whether the end of rally?	8
Zloty – will we see a correction?	9
Market monitor	10
Economic calendar	11
Economic data & forecasts	12

Maciej Reluga
Chief Economist
+48 22 586 8363

Piotr Bielski
+48 22 586 8333

Agnieszka Decewicz
+48 22 586 8341

Marcin Luzziński
+48 22 586 8362

Marcin Sulewski
+48 22 586 8342

Email: ekonomia@bzwbk.pl

2013 – Close to the edge

▪ **A year ago, when we presented the scenario for 2012, we did not expect that our economic growth projection of 2.2% (against consensus of 2.9%) would prove overly optimistic.** As a matter of fact, the beginning of the year was quite good (triggering a temporary improvement of projections), however, the scale of the economic slowdown witnessed already from the second quarter may make it difficult to achieve a two-percent growth this year. In line with our projections, **at the beginning of the year, the Polish economy will be on the edge of recession** and although we assume that it will be possible to avoid that adverse scenario, it should be admitted that (given possible forecast error) the question about the risk of recession is not unjustified. **More importantly, however, we project that each subsequent quarter of 2013 will be better than the previous one and at the year-end the economic growth may top 2%.** The key driving force will be exports whose revival in 2013 will be driven, among others, by a better situation in the euro zone. Although we can hardly be optimistic about the next year's fixed investments, it seems that the consumption growth will not remain at the historic low recorded in 3Q2012. In 2H2013, we should see an indirect impact of export revival on the domestic demand. Yet, before that happens, a clear decrease of inflation and relatively high indexation of social benefits will boost disposable income in real terms.

▪ **The clear downward trend of inflation has already commenced and, in our view, will continue in the subsequent months.** The scenario, which the Monetary Policy Council has not been willing to accept for quite a long time, is just materialising (clear economic slowdown and quick inflation drop). A year ago, when writing about the monetary policy, we assumed two interest rate cuts (which actually took place recently). Though we were afraid that a majority of the MPC members could have problems with making pre-emptive decisions, we did not expect the Council to be so much "behind the curve" to continue with rate hikes when the domestic demand was falling. Probably, as usually, the MPC will be "chasing" the decreasing inflation and so we expect further interest rate cuts by 75bps (smaller than priced-in by the market).

▪ **2013 will be another year when the Polish public debt will be edging on 55% of the GDP.** The threshold will probably not be surpassed (according to the Polish methodology). Nevertheless, the risk of the budget amendment resulting from a slowdown deeper than assumed by the government, together with the end of the interest rate cutting cycle by the MPC may prompt some holders of the Polish bonds to take profits. That will be even more likely if the FX market sees the correction of the Polish currency. We envisage such a risk in 1Q2013 with the average annual EURPLN rate projected at 4.15.

The contents presented beside shows topics discussed in this report. As usually, the table with detailed quarterly projections is placed at the end of the report.

We have the pleasure to inform you that we were ranked first in Poland in the Bloomberg's survey verifying the accuracy of economic projections and covering ca. 400 institutions monthly. Additionally, our result was the second best in the world.

Financial market on 11 December 2012:					
NBP deposit rate	2.75	WIBOR 3M	4.32	EURPLN	4.1025
NBP reference rate	4.25	Yield on 2-year T-bond	3.23	USDPLN	3.1645
NBP lombard rate	5.75	Yield on 5-year T-bond	3.51	CHFPLN	3.3870

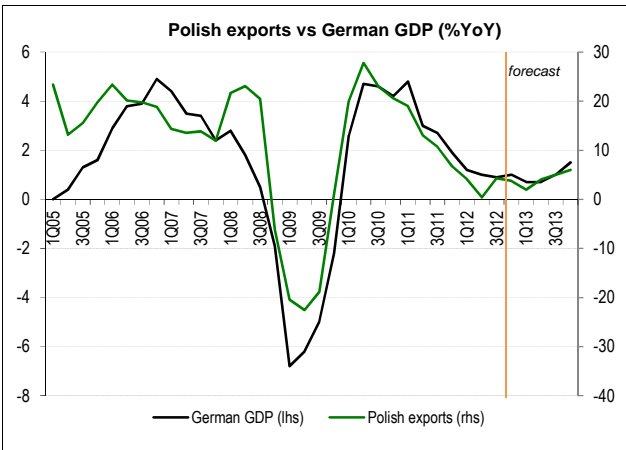
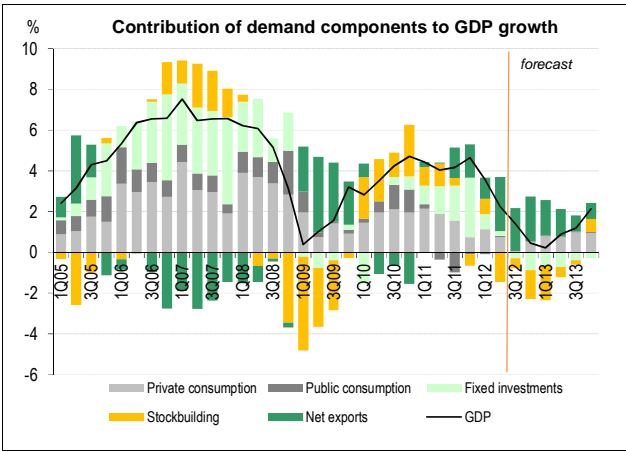
This report is based on information available until 11.12.2012

How deep the bottom of the cycle?



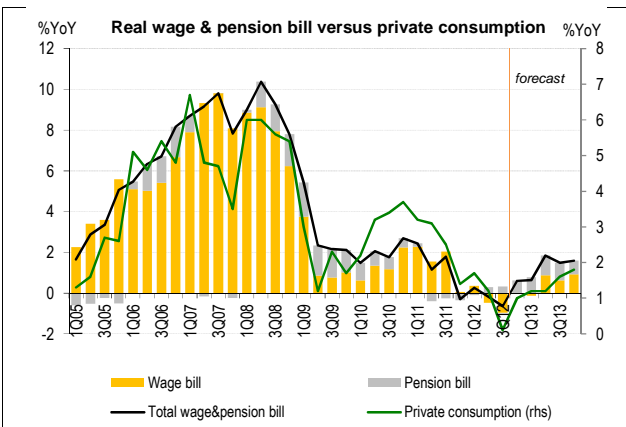
GDP growth will be close to zero at the turn of the year

- We expect the business cycle in the euro zone to bottom out in the last quarter of this year, and then a slow recovery will begin. Weakness of euro zone's demand is weighing on Polish exports as well as on the domestic demand, as uncertainty about the economic situation encourages Polish consumers and entrepreneurs to spend money more carefully.
- Poor situation of the labour market and decline in real disposable income (also due to high inflation) translated into weakness of private consumption. Data for 1Q already showed that Polish consumers were financing their consumption with savings. In the following quarters they have cut on spending strongly, hence private consumption growth in 3Q2012 was the lowest ever (0.1%YoY).
- In 3Q expenditures on gross fixed capital formation fell by 1.5% in annual terms. Private companies reduced their investment plans due to the uncertain economic situation. Public investment weakened due to the depletion of EU funds and completion of many investments related to Euro 2012.
- In 4Q we expect a further slowdown of economic growth, down to 0.5%YoY. At the turn of the year, gross accumulation will be the weakest element of GDP growth (strong declines in fixed investments and inventories). Private consumption may revive slightly, but its growth will remain anaemic. Net exports will also contribute positively, as imports are slowing down faster than exports.
- We expect the business cycle to bottom out at the turn of 2012 and 2013 with the lowest annual growth rate in 1Q13 (0.2%). In our view the seasonally adjusted QoQ growth may be negative in at least one quarter, which means that we will be on the edge of the recession and the risk of its occurrence is, in our view, not so low.



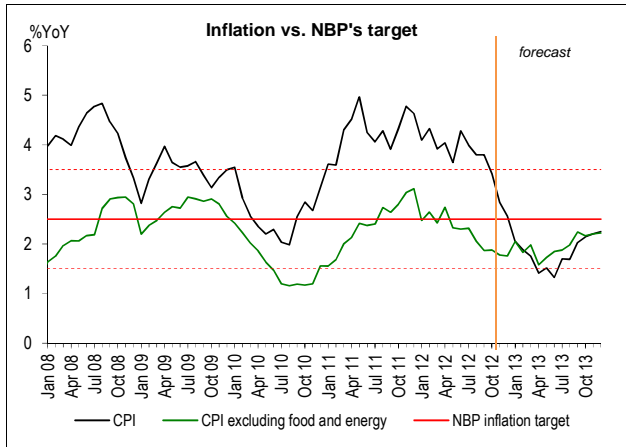
Recovery in exports, inflation drop will help consumption

- Polish exports have done quite well in 2012 (increased by 3.7% in January-October, according to the CSO data). This was supported by the weaker zloty, which increased the profitability of sales abroad. Additionally, Polish companies have responded to the slowdown in major trading partners with geographical differentiation of sales. That is why Poland recorded a spectacular growth in exports to countries like Russia, Ukraine, Hong Kong, India and Mexico. As regards breakdown by products, a strong growth was recorded by export of food (14%YoY) and capital goods (11%). Situation in other sectors was also decent, with the exception of exports of passenger cars, which are actually collapsing (-24%).
- Economic revival in Polish major trading partners, which we are expecting in 2013, will have a positive impact on exports to these countries. If the slowdown continues, then we can expect a weakening of the zloty, which will increase the price competitiveness of domestic products.
- Plunge of inflation driven among others by decrease in fuel and gas prices (see next page for details) will translate into faster growth of real disposable income. Together with high indexation of social benefits in 2013 this will positively influence private consumption.
- We expect a further decline in investment in 2013. Interest rate cuts may provide some relief for the private companies, but actually most of them are financing investments with own resources, so their assessment of future economic conditions may be more important as regards investment plans. Downward trend in public investments may be limited by activity of *Inwestycje Polskie* public-owned investment company.
- We expect a gradual acceleration of growth in 2013. After the trough 1Q of 2013 each consecutive quarter will be better and at the year-end we will a growth rate of around 2%YoY.



Source: CSO, Eurostat, BZ WBK

No inflationary pressure (for some time already)



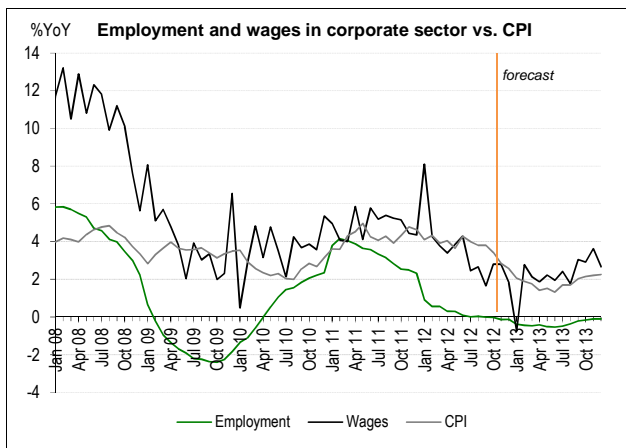
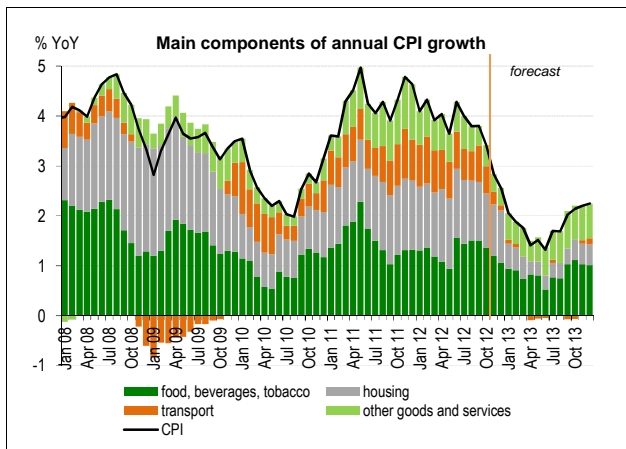
CPI inflation will reach inflation target soon

▪ We have written about lack of inflationary pressure in the Polish economy for some time already. This situation is best reflected by declining core inflation (from 3.1%YoY in December 2011 to 2.5% in January 2012 and 1.9% in October). The MPC did not take this into account and still believed in a miraculous continuation of robust GDP growth, which will translate into demand pressure on prices and will trigger second round effects. As we all know, the scenario expected by the MPC has not materialised, and we have witnessed a sharp deceleration in GDP growth and private consumption.

▪ As we mentioned on the previous page, we expect a rebound in private consumption in 2013, but its growth will still remain relatively weak and therefore will not generate an upward price impulse. Additionally, the NBP studies show that during periods of economic slowdown and negative output gap the pass-through effect from exchange rate to inflation rate is weaker, so even a possible depreciation of the domestic currency as a result of a turmoil in global financial markets, should not result in a significant increase in inflation.

▪ Recently the favourable (for inflation) demand situation was also joined by supportive supply-side factors: a slowdown in food and fuel prices (base effects, which we expected earlier) and the reduction of gas prices (according to our estimates this effect will deduct ca. 0.2-0.3pp from the CPI). Still, food and fuel prices remain a main source of uncertainty in forecasts for 2013. We are expecting a moderate increase in food prices, at ca. 3%YoY and a stabilisation of fuel prices. Core inflation will fluctuate around 2%YoY.

▪ Factors described above will translate into a sharp drop in consumer prices inflation in 2013. We estimate that already in January the CPI may be below inflation target, while the whole-year average may be lower than 2%.



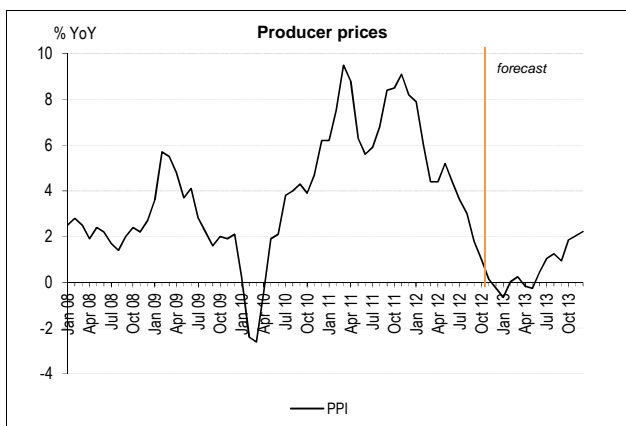
Labour market situation is favourable for inflation...

▪ We expect a continuation of this year's trends in the labour market also in 2013. Employment in the enterprise sector will decrease slightly, although it may stabilise in the middle of the year. At the end of the year some upward momentum of employment may appear, provided that the euro zone rebounds, translating into higher demand for Polish goods from abroad.

▪ Given the economic slowdown and reluctance of companies to hire, the pressure on wage growth will be rather weak. In our opinion, wages in the enterprise sector will post slow growth by 2-3% in the course of year 2013 (still, it will be above inflation).

▪ Unemployment will move in an upward trend. We estimate that it can reach as much as 14% at the end of 2013.

▪ The situation on the labour market will be one of factors supporting our forecast of low growth in consumer prices.



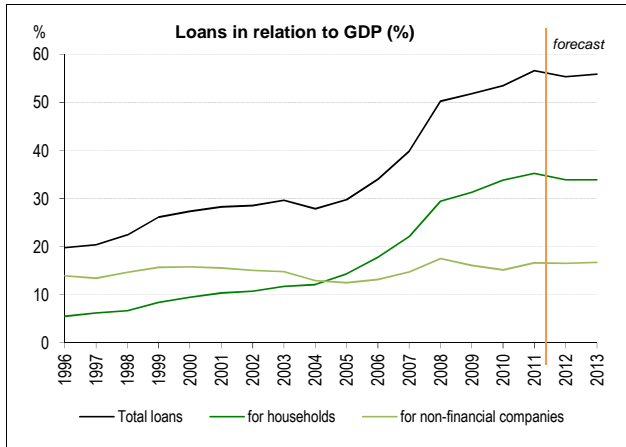
... similarly as PPI deflation

▪ Slowing growth of producer prices will be another factor contributing to the decrease of CPI. Over the last few months we have seen a sharp decline of this inflation measure - from 9.1%YoY in November 2011 (local maximum) to 1.0%YoY in October 2012. We expect that the PPI will oscillate around 0-2% in 2013 and may even temporarily fall below zero.

▪ A significant decrease in PPI inflation reflects the weakness of upward pressure on producer prices. This has been partly a result of weaker demand for industrial goods and a strong slowdown in industrial production, and partly of stabilised commodity prices on global markets and low increase of wage cost. This means that producers will not see a need to pass the rising costs on to consumers.

Source: CSO, NBP, BZ WBK

Slowdown in loans. For how long?

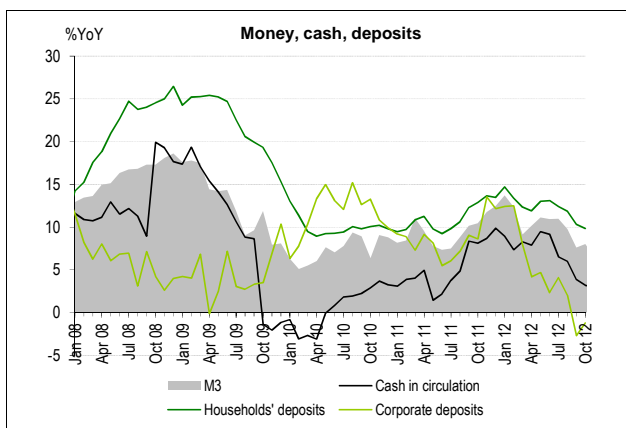
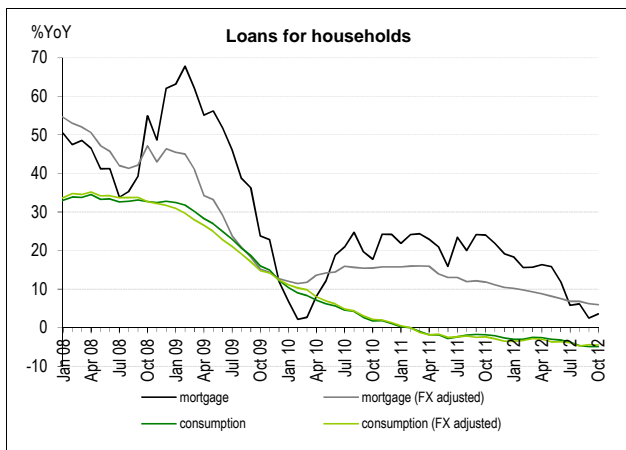
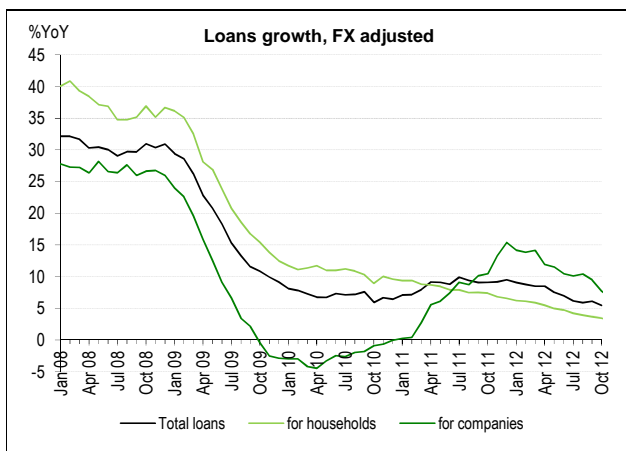


The deepest collapse in the credit market for years

- The slowdown of economic growth in recent quarters was accompanied by a clear slowdown in new loans in the Polish banking system. Bank debt of non-financial companies stopped to increase in almost all sectors. While in 2009 the economic slowdown strongly affected the corporate loans, this time the growth rate of loans to households was heavily undermined, falling to the lowest level in history.
- The scale of the downturn in the credit market has been confirmed by the fact that the year 2012 will probably be the second (after 2004) from the beginning of the nineties, in which the ratio of total loans to GDP will decrease.

The next year will be difficult too

- In 2013 the situation on the credit market will continue to be difficult. Beginning of the year can still be a period of deepening stagnation, but we assume that a light recovery for demand for loans may appear in the later part of the year.
- In particular, loans to households may grow slightly faster than this year, mainly due to a halt of decline in consumer loans. Total debt in this category has declined gradually over the past two years, but we are expecting that a slight increase in this category in 2013 is possible due to improvements in the growth of real disposable income, falling interest rates and easing of banks' lending criteria in this segment due to changes in Recommendation T, which were announced by the Financial Supervision Authority.
- Growth rate of mortgage loans has strongly decelerated. In 2012, the total debt of households due to mortgages will probably increase only slightly by ca. PLN6bn (1.9%YoY), as compared to PLN53bn in 2011 (19.2%YoY). Although up to a large extent it is a result of the strengthening of the zloty, the actual demand for mortgages has also weakened (according to our estimates, growth in mortgages after adjusting for exchange rate fluctuations in 2012 will amount to around PLN16.5bn, i.e. 5%YoY, compared with PLN29bn in 2011). Imminent recovery in this sector cannot be expected, but rising housing affordability (as a result of falling real estate prices) and a structural shortage of houses in relation to the number of households should help the mortgages growth rate to remain at a moderate level (about 4%YoY after FX adjustment).
- We are expecting that corporate loans will grow in 2013 at a small scale, at a pace similar to this year's. This segment will be underpinned by, among others, a modest (but positive) growth of private sector investment. The increase in loans to companies also would be promoted by implementation of programme of *Inwestycje Polskie* public-owned investment company, provided that this entity will start relevant projects already in 2013.

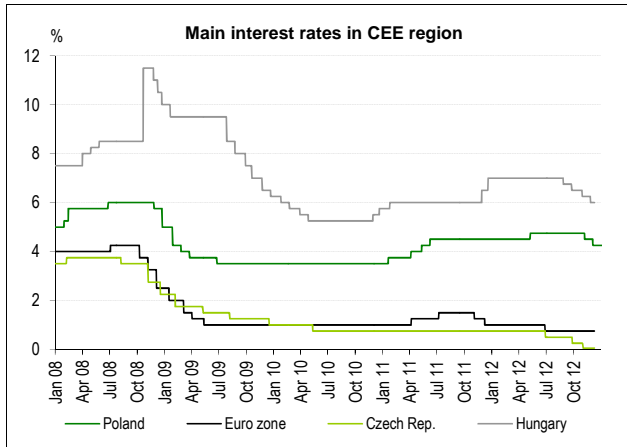


Source: NBP, BZ WBK

Corporate deposits shrink, households' deposits decelerate

- A clear decline in economic activity has negatively affected the corporate results, which led to a slight decline in their deposits. In case of households, there has been a moderate slowdown in deposit growth with a clear change in their breakdown (a strong increase of time deposits at the expense of current and savings accounts).
- We expect that the contraction of corporate deposits will not be persistent, provided that our scenario concerning gradual recovery in economic growth in the coming quarters will materialise. However, decline in household deposits' growth may be even deeper, because improvement of their financial situation will take place with some delay in relation to the economic recovery and in the first phase it will be mainly due to the decline in inflation rather than to growth of nominal income.

MPC behind the curve. Will overreact again?



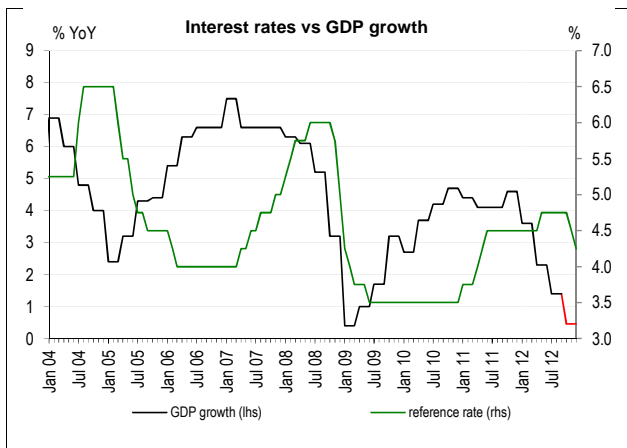
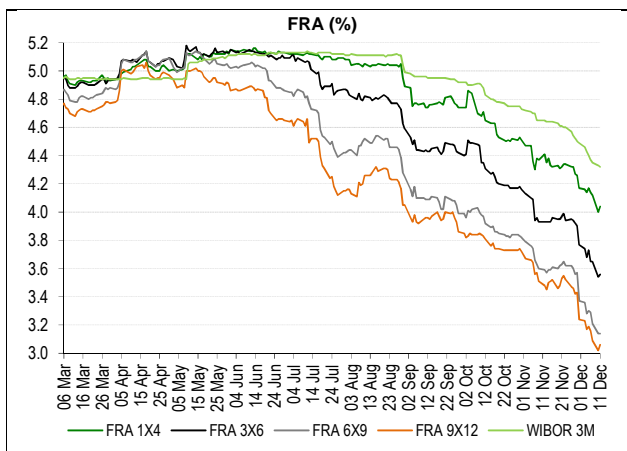
Delayed cuts have already come. What next?

■ In November and December the Monetary Policy Council has finally implemented long-awaited interest rate reductions in two cuts by 25bps, bringing the reference rate down to 4.25%. This move was possible when the Council became sure about persistence of economic slowdown and lack of inflationary risks in medium term.

■ It is worth noting that the MPC members needed as much as three quarters of slowing GDP growth in a row (from 4.6%YoY in 4Q2011 to 1.4%YoY in 3Q2012) to notice the persistence of slowdown and a need to cut interest rates. This means that the MPC actions surely cannot be described as “pre-emptive”. It would actually be possible provided that the monetary policy easing had been implemented one year ago. Moreover, the Council hiked rates by 25bps in May, i.e. in the very middle of the quarter when domestic demand was falling on an annual basis. The monetary policy actions should aim at limiting production and prices volatility (act counter-cyclically). The move implemented by the MPC in May was acting in the opposite direction.

■ Comments of the MPC members clearly show that more cuts are on cards. These members of the Council, who would support quick and decisive moves, are in our view in minority so cuts deeper than 25bps at once should not be expected. We are forecasting another cut by 25bps in January, then the Council will make a pause in order to wait for results of the new NBP projection in March. Then the MPC will cut rates by other 50bps (in two moves), bringing the reference rate down to 3.50%.

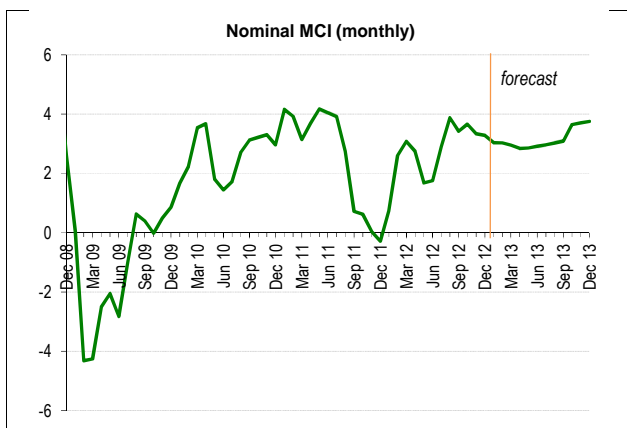
■ FRA market is anticipating more considerable cuts as compared to our forecast. According to FRA market, the reference rate of the central bank may be as low as 3.00% in the middle of the next year.



Delayed decision = overreaction (again)?

■ As we already noted, decision to cut interest rates came too late. This is, in our view, resulting from the fact that the Council tends to concentrate too much on events, which already happened (backward-looking policy), instead of these, which are about to happen. Some MPC members are also giving a high priority to policy of positive (yet moderately) real interest rates. However, based on their comments, we guess that real rate means current nominal rates minus current inflation rate.

■ This means that when the Council sees inflation plunging below 2% and GDP growth sliding well below 1% (and we are anticipating such developments in 1-2Q2013), then it may overreact and cut interest rates more considerably. Such a move would mean overreaction again, as the economy should start to recover in 2Q2013. Given the backward-looking policy of the MPC, we see some downward risk for our forecast of interest rates at 3.50%.



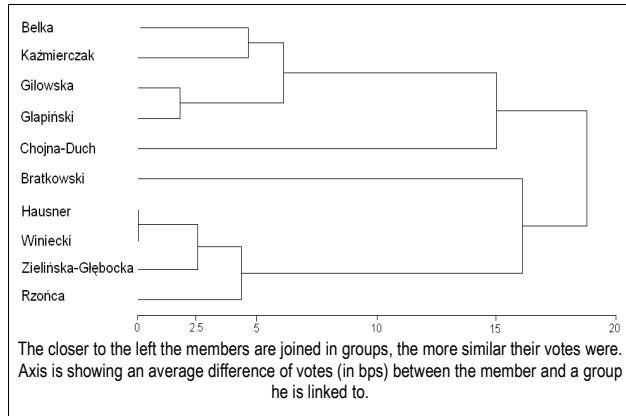
What about monetary policy restrictiveness in 2013?

■ In the course of 2012, the monetary policy restrictiveness index MCI was moving in an upward trend, which was due to NBP interest rate hike in May and, more considerably, to strengthening of the zloty after a substantial depreciation at the end of 2011.

■ We are expecting a slight decline of monetary policy restrictiveness in the upcoming months due to easing cycle implemented by the MPC and thus falling money market WIBOR rates. Stronger declines of the index will however be halted by the FX market developments. In our view the zloty exchange rate will be oscillating around to 4.15 in 2013 (details at the following pages), i.e. it will depreciate slightly as compared with current levels.

Source: CBs, Reuters, BZ WBK

MPC – whose voice is important?



Two groups of voting alike

- We have analysed the results of MPC votes since the beginning of current term (till October) using the cluster analysis in order to see, which members were voting similarly.
- The tree graph reveals two groups of members voting alike. The first one comprises of Hausner, Winiecki, Zielińska-Głębocka and Rzońca. What is interesting, Hausner and Winiecki have always voted the same, while Zielińska-Głębocka voted differently from Winiecki only once. Second group comprises of: Belka, Kaźmierczak, Gilowska and Glapiński. The second group is more heterogeneous and its votes are more similar to the final opinion of the Council. Chojna-Duch and Bratkowski are clear outsiders. Even though their votes were similar recently, the average difference between them is 18.8bps.



Gilowska (1.09)

Rzońca (1.07)

Winiecki (1.06)

Hausner (1.05)

Kaźmierczak (1.05)

Glapiński (1.03)

Zielińska-Głębocka (0.82)

Belka (0.77)

Bratkowski (0.21)

Chojna-Duch (0.18)



Index is between 0 and 2. A vote for the majority view is given a score of 1. A vote for a more hawkish (less dovish) decision than the majority view has a score of 2 and a vote for a less hawkish (more dovish) decision than the majority view has a score of 0. Value of the index for a given MPC member is a weighted average of points for all votes. Recent votes have higher weights, more distant – lower.

Numbers directly by the name are values of the index for period since the beginning of current term of office of the current MPC and NBP governor.

Direction of the restrictiveness axis reflects our expectations regarding direction of interest rate changes in the nearest 12 months.

The NBP governor in minority in 2012

Last year has brought some interesting changes in results of the Monetary Policy Council votes. Andrzej Bratkowski, one of the strongest supporters of interest rate hike in last two years, became a strong proponent of monetary policy easing (he has probably noticed threats linked to the upcoming slowdown and hence falling risk of rising inflationary pressure). Only Bratkowski and traditionally “dovish” Elżbieta Chojna-Duch refused to support the controversial interest rate hike in May and both are strongly supporting interest rate cuts from July on. Necessity to retreat from the May hike was acknowledged by the NBP governor Marek Belka (and Anna Zielińska-Głębocka) in October. Still, the “hawkish” faction of the MPC proved strong enough to keep rates unchanged in that month in spite of this change and in spite of absence of Zyta Gilowska. This means that the NBP governor Marek Belka was in minority for the first time in this term. One should take into consideration that the opinion of the NBP Governor may not be crucial for the MPC decisions in the upcoming months.

Who of the 6 hawks is most likely to change the mind?

Is the breakdown of MPC votes going to change in the upcoming months? This seems very probable, as some MPC members pay much attention to current macroeconomic data, which – according to our forecasts – will show a rapid decline of inflation below target and a further deceleration of economic activity growth. Based on MPC comments expressed over the course of last few months, we guess that this factor is likely to boost the eagerness-to-cut of Andrzej Kaźmierczak and Jerzy Hausner. We think that change of Andrzej Rzońca's and Jan Winiecki's opinions are rather unlikely, while votes by Zyta Gilowska (who was absent during last few months) and Adam Glapiński are big question marks.

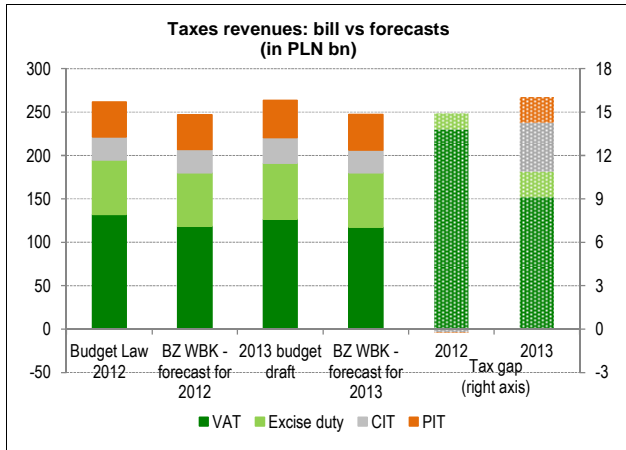
What are the desired scales of rate cuts?

As for the time being, it seems that there is a quite strong consensus within the MPC that the easing cycle did not come to an end yet. Adam Glapiński admitted recently that rate cut in January is “almost certain”. Still, opinions on desired scale of reductions are still strongly diversified. Some MPC members (like Glapiński) think that the Council should take a break after January. According to Jan Winiecki, room for interest rate cuts is rather limited. In opposition to Winiecki, Andrzej Bratkowski is supporting a quick decline of the reference rate to 3.00%. Bratkowski and Chojna-Duch still think that rates should be reduced with moves deeper than 25bps, but, according to Bratkowski, chances for gathering a majority to support such decisions are slim. Marek Belka admitted recently that further rate cuts are “highly probable”, as drop of inflation will be quick and persistent. It is worth noting that even the radical Bratkowski thinks that easing cycle should come to an end in 1Q2013 at the latest.

Overall, we assume that during the next few meetings of the Monetary Policy Council motions to cut interest rates by more than 25bps will not assemble the support of majority of the Council. Additionally, we assume that the MPC would like to finish the easing cycle in March/April (if the most dovish member of the MPC admits so) with a possibility of a break in the cycle in February. Consequently, we forecast that interest rates will fall cumulatively by 75bps.

Source: NBP, BZ WBK

Budget – amendment or repeat of 2012?



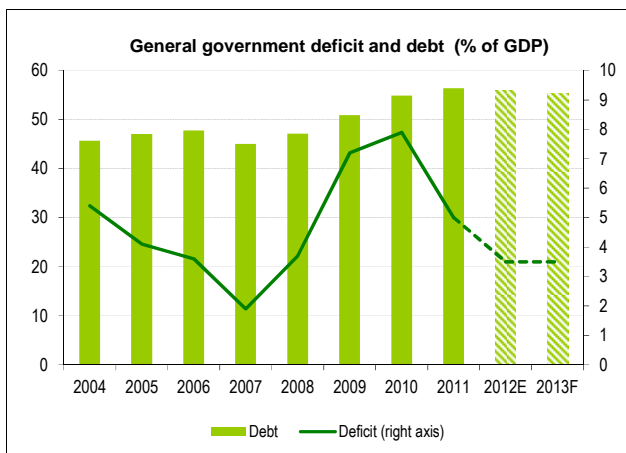
Too optimistic assumptions. And what now?

▪ We have written about too optimistic macroeconomic budget assumptions for some time already, especially as regards GDP growth. Breakdown of growth in 2013 (net exports will remain the main driver), but also the weak labour market situation and deteriorating companies' financial results are questioning the assumptions next year's tax revenues.

▪ Taking the above-mentioned factors into consideration, we estimate that shortfall of receipts (we assume YoY growth rates of PIT and excise duties at ca. average inflation, and growth rates of VAT and CIT at close to zero) may reach even PLN15-18bn. This year's shortfall, due mostly to lower VAT receipts (annual plan was realised in ca. 76% at the end of October), was balanced by higher non-tax receipts (realisation at 116% of plan due to payment of NBP's profit) and some spending discipline.

▪ As for 2013, spending-side discipline might not be enough, but also it is worth to question whether it would make sense, as this could lead to a deeper slowdown. Also, it is hard to expect NBP profits at the level from previous year. Therefore, we cannot rule out that the government would be forced to raise indirect taxes or to amend budget bill during the year. Such a change was not even ruled out by the finance minister himself, who stressed the external factors as main reasons for a possible budget amendment in 2013. Another option would be an increase of deficit outside the central budget.

▪ Overall, one should expect the government to conduct a cautious fiscal policy (given public debt close to Public Finance Act thresholds). However, the general government deficit is not likely to fall to 3% of GDP, but will rather maintain at ca. 3.5% achieved this year.

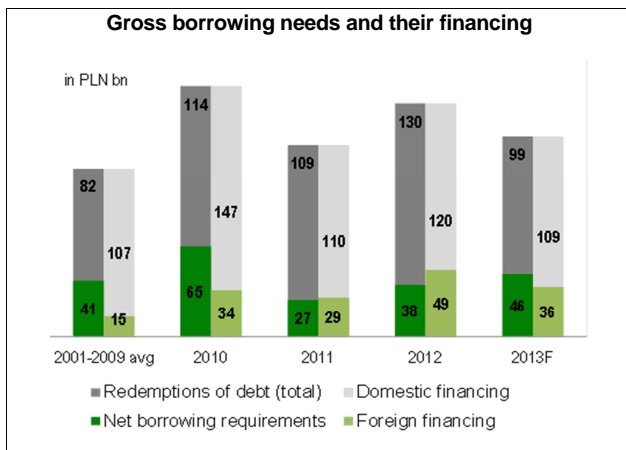


Higher net issuance, but not gross

▪ In November's MACROscope edition we presented details about borrowing needs for 2013 and breakdown of their financing. Budget draft for 2013 is assuming the gross borrowing needs to be lower by ca. 14% (decline to ca. PLN145bn from PLN168.5bn), mainly due to lower debt buybacks. On the other hand, net borrowing need are to rise to ca. PLN45.7bn from ca. PLN38bn in 2012, which is mostly a result of higher budget deficit (PLN35.6bn) and lower privatisation receipts.

▪ Higher-than-expected net borrowing needs may stem from higher realisation of deficit (e.g. due to a possible amendment of 2013 budget bill). Still, even in a scenario of significant tax revenues gap, the gross borrowing needs will be probably slightly lower as compared to 2012.

▪ We can see no major threats for the gross borrowing needs financing. The finance resort will step into 2013 with "liquidity cushion" worth slightly more than 25% of the whole year borrowing plan. In our view this factor will limit the risk of considerable weakening of domestic debt in 2013.

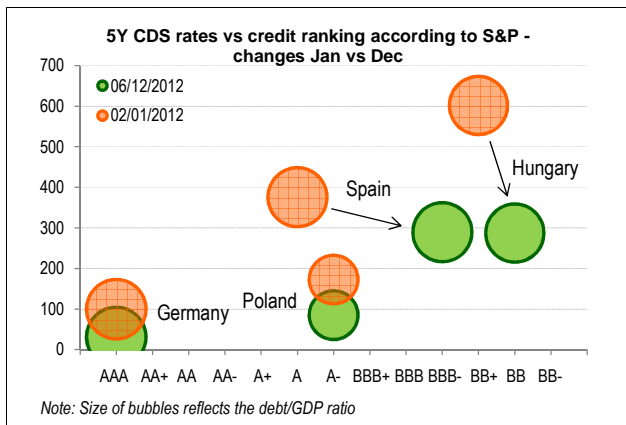


Will Poland stand out positively?

▪ Asking the above question at the beginning of the year we expected that the international perception of Poland would improve in 2012. Our scenario has materialised - Polish assets gained the status of "safe haven" and the rating remained unchanged, while ratings of many other EU countries have been reduced by a few grades. As a result, the Polish government can issue debt at a lower cost (though we did not it forecast it to be that low), 5Y CDS is close to the level of France and spread to Bunds has significantly narrowed.

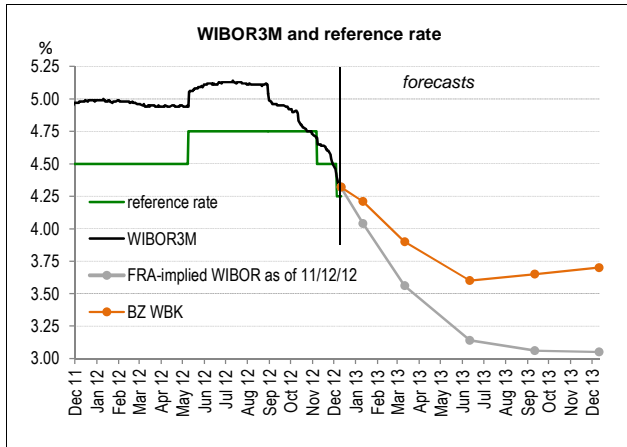
▪ The share of foreign capital in PLN government bond market reached the historical maximum. It is a sign of confidence, but also of a risk factor if the crisis in the euro zone re-escalate.

▪ Path of the government deficit reduction below 3% of GDP has been extended due to the economic slowdown. However abolition of the excessive deficit procedure in 2013 is still possible.



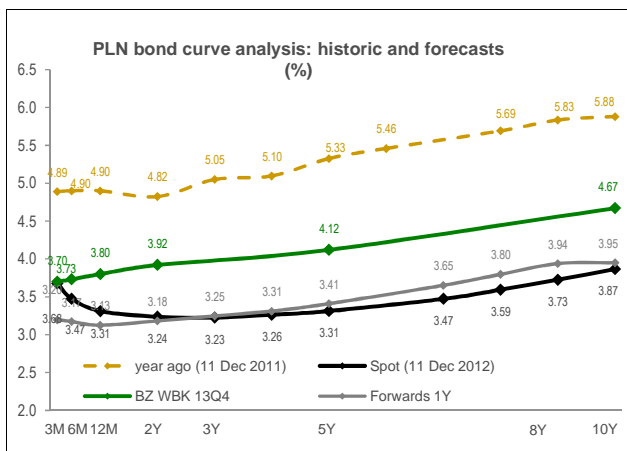
Source: Finance Ministry, CSO, Reuters, BZ WBK

Bond market – when/whether the end of rally?



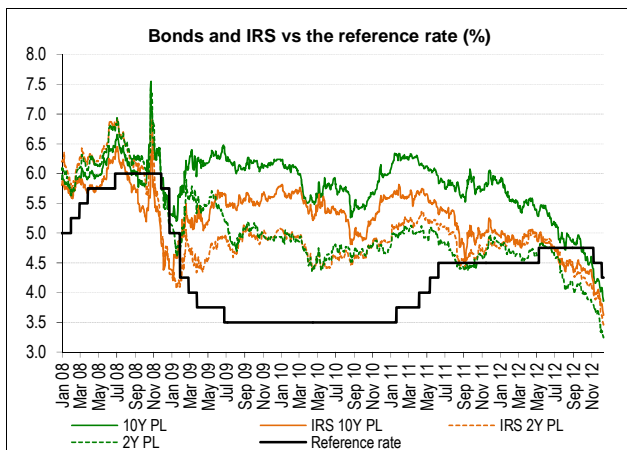
The market aggressively pricing-in further WIBOR decline

- Throughout most of this year, the money market rates remained elevated. It was a result of, among others, high inflation oscillating around 4%YoY, which led the MPC to hike interest rates in May. Only worse-than-expected GDP data for Q2 did fuel expectations of rate cuts and strongly stimulated a decrease in WIBORs. The downward trend was supported by the onset of the monetary easing policy at the meeting in November along with the announcement of the easing cycle. The cut followed in December when the Q3 GDP data proved worse than expected.
- FRA contracts are aggressively pricing-in the interest rate cuts in 2013. The market is expecting 3M WIBOR rates to decline by nearly 125bps over the next 9 months. In our view, the scale of cuts may prove smaller than expected which may send an impulse stimulating an increase in market rates in the second half of next year.



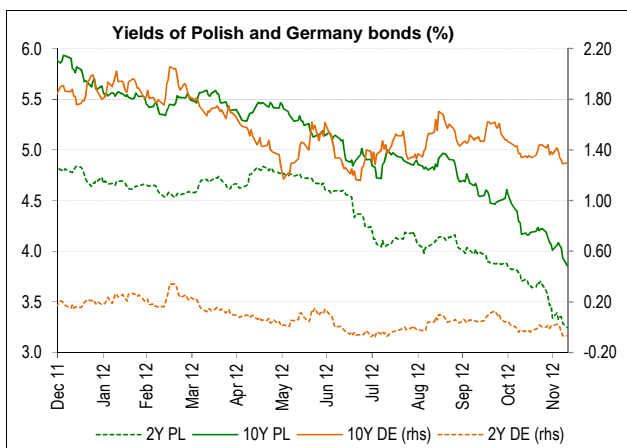
Bond yields hit all-time low

- Investors on Polish interest rate market can summarise the year 2012 as a very good one. As we expected, the bond yield declined along the curve, however, the scale of the decline proved to be much bigger than we envisaged and totaled 155bps for 2Y, 188bps for 5Y and 196bps for 10Y. What is more, towards the end of the year, bond yields hit new historic floors. It was a result of a few factors, including: (1) significant inflow of the foreign capital (at the end of October, non-residents held slightly over 35% of the bonds issued to the domestic market), (2) flexible issue policy pursued by the Finance Minister which made it possible to end the financing of this year's borrowing needs in early October, (3) rating agencies' positive response to the actions taken by the government in an attempt to reduce the deficit and the public finance sector's debt, (4) despite slowdown, positive prospects for GDP growth.
- Declines were also recorded in IRS, though they were less spectacular than in the case of the bond market. The yield curve moved downward by 122-130bps, with the biggest declines recorded in 1Y rates (effect of expected interest rate cuts).



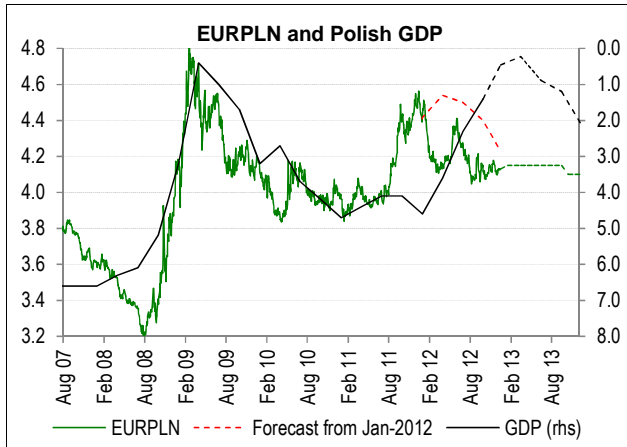
Room for further yields decline is low

- Expectations of the monetary policy easing to continue should be conducive to a decline, or at least stabilisation of the 2Y yield at close to the all-time low. The continuation of interest rate cycle with reductions by 25bps in the face of poor macro data may trigger the market's overreaction in terms of expectations of the rate cut scale. As a consequence, we cannot rule out subsequent lows to be hit at the short end of the curve. Signals of the improving economic situation or changes in the MPC's approach may create pressure, driving the yields up in the two-year segment and it may materialise in the second half of next year. Possible earlier corrections, if any, may prove short-lived given the next data releases on inflation. It is worth to notice that in the previous cycle IRS rates started to climb despite the fact that the MPC continued monetary policy easing.
- 10Y yield is linked more closely to the situation in the core markets, and in particular, to the quotations of the German bond with the same maturity. Increase in the yield of the German benchmark may stimulate increase in the yield of the domestic 10Y. In our view, bond yield increase in the long end of the curve may prove to be more significant than in the short end, which will consequently cause the curve to become increasingly steep.
- One of the key risk factors is strong reliance on foreign investors, as they still perceive the Polish assets to be quite attractive. We believe that any potential scale of the outflow would be limited by the fact that long-term investors increased their share in the Polish debt market.



Source: NBP, Reuters, BZ WBK

Zloty – will we see a correction?



Interest rate cuts and low GDP growth will not let zloty gain

▪ First two months of the current year saw a rapid appreciation of the zloty. Domestic currency, like other risky assets, was trimming losses incurred at the end of 2011. After extremely pessimistic moods seen at the turn of 2011 and 2012, publications of better than expected macroeconomic data abroad, and successful auctions of euro zone's peripheral countries (supported by two three-year LTROs), worked in favour of higher risk appetite. EURPLN fell from ca. 4.50 to 4.10 at the start of 2Q and although – in line with our forecasts – subsequent months saw waves of currency depreciation, the move at the start of the year caused that exchange rate path observed in 2012 was below the one that we had predicted.

▪ Charts on the left suggest that further slowdown of GDP growth and further interest rate cuts by the MPC might initiate a weakening of the zloty in the months to come. However, in our view the fact that since the start of 4Q2012 the EURPLN has been staying in range 4.06-4.22 is suggesting that monetary policy easing and scope of more significant economic slowdown is already largely priced-in by the market. The risk factor for the EURPLN average at 4.15 in the first half of 2013 is in our view the domestic economic situation. Potential budgetary problems due to deeper economic slowdown could activate some weakening of the debt market and trigger withdrawal of some investors from domestic assets.

▪ Assuming that the bottom of economic cycle in Poland and in the euro area takes place in 4Q2012 or 1Q2013, we see chances for slight strengthening of domestic currency in the second half of 2013 (to ca. 4.10 per euro). The market will start pricing-in the looming economic revival, so such conditions should be supportive for the zloty (and other risky assets classes).

Good prospects for euro thanks to central banks

▪ EURUSD will probably finish this year slightly below level seen at the start of 2012 (1.29 versus 1.31). The euro trimmed losses incurred in 2Q mainly thanks to ECB's reaction to the strengthening of the debt crisis in the euro zone (launch of the OMT programme) and start of the third round of quantitative monetary easing in the US by the FOMC.

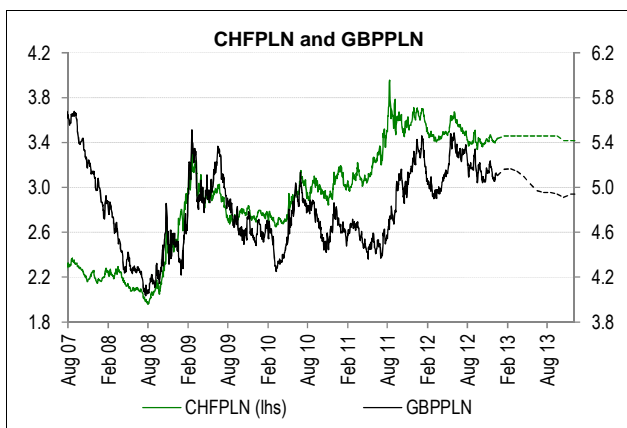
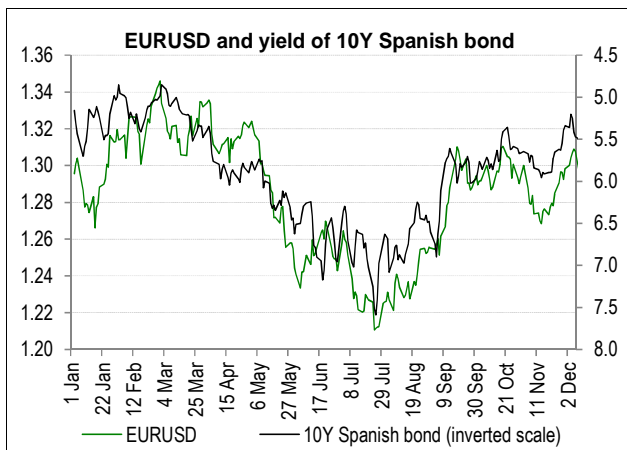
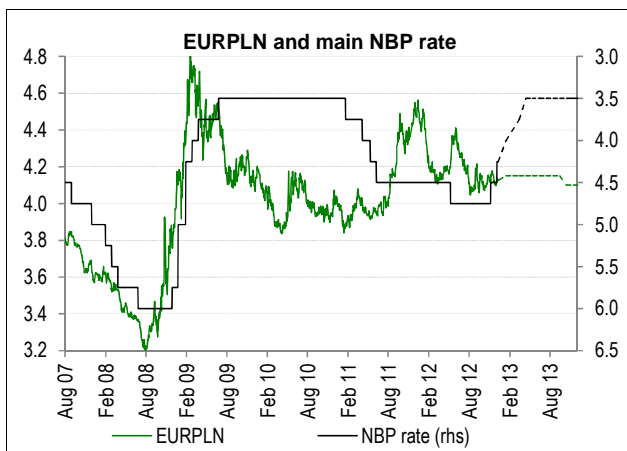
▪ We think that under influence of new signals suggesting that the euro area's economy is sinking into recession, the euro may be under pressure versus dollar in the first half of 2013. Moreover, worries about debt problems will be recurring due to parliamentary election in Italy and Germany. The risk factor for the scenario of EURUSD drop in 1Q2013 is that the deteriorating economic situation may spur investors' hopes for increasing the scale of supporting and stabilising actions of the major central banks. We think that at the end of next year the EURUSD will be near 1.34, but earlier it may reach 1.25 – the lowest level since August 2012.

Zloty may appreciate versus British pound

▪ We think that the behaviour of the EURGBP will positively affect the zloty strength versus the British pound. A potential of pound's depreciation against the euro to 0.84-0.83 (from ca. 0.805) is warranted by weak situation of UK economy. The Bank of England will probably maintain loose monetary policy (with a possibility to increase further the value of bond purchase, exerting negative pressure on the currency).

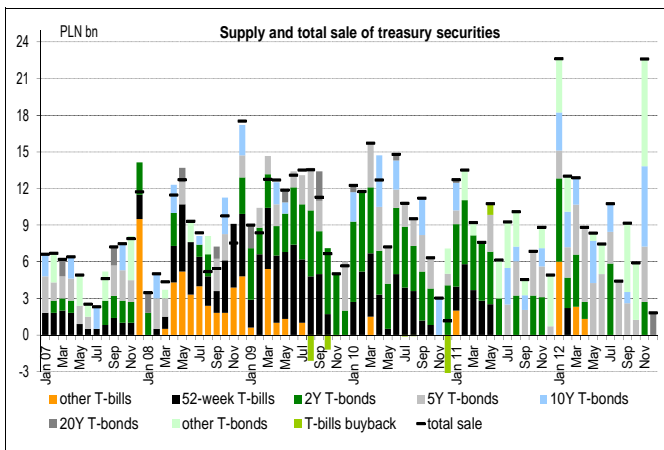
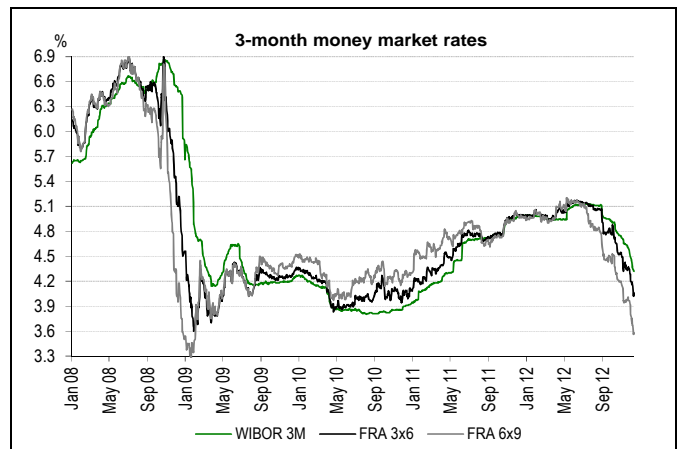
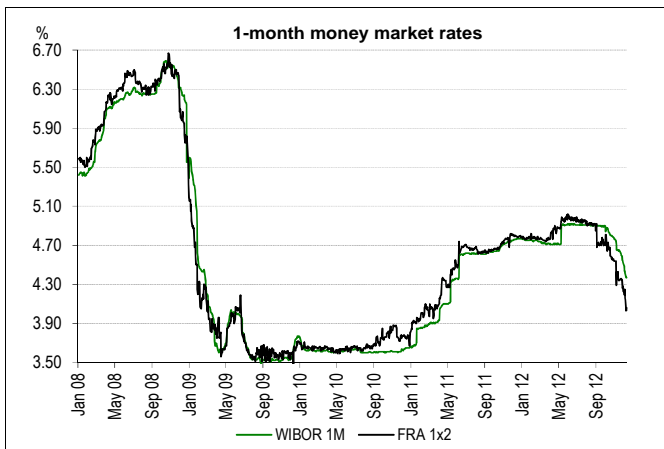
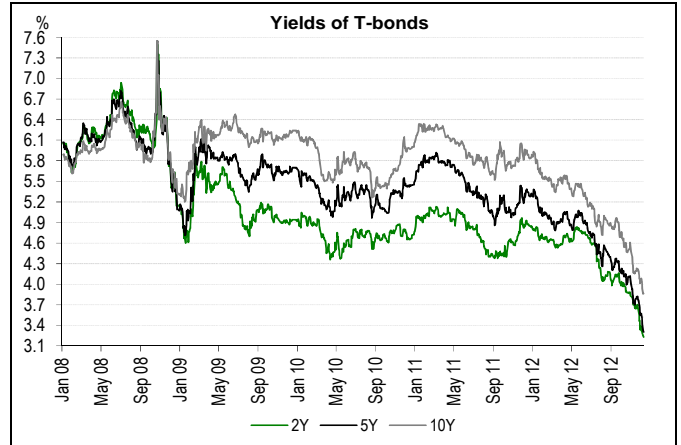
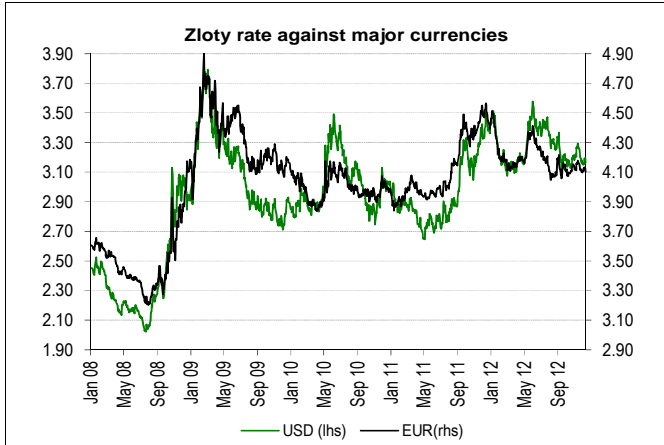
▪ There is a smaller potential of zloty appreciation versus the Swiss franc. We think that EURCHF will not depart substantially from the floor 1.20 set by the SNB. Therefore, CHFPLN behaviour will be most of the time following movements in EURPLN market.

▪ In our view, at the end of 2013 the zloty may be stronger by more than PLN0.10 against the British pound as compared to current levels (4.94 versus 5.08) and should remain stable against Swiss franc.



Source: CSO, NBP, Reuters, BZ WBK

Market monitor



Treasury bill auctions in 2011/2012 (PLNm)

Auction date	OFFER	DEMAND/SALE
26.05.2011	Repurchase tender	1444/940
30.05.2011	52-week: 500-600	2667/505
20.06.2011	Repurchase tender	356/256
11.07.2011	Repurchase tender	2498/724
19.12.2011	Repurchase tender	4331/2247
27.12.2011	Repurchase tender	2939/2486
09.01.2012	49-week: 1000-2000	5402/2223
30.01.2012	30-week: 1000-2000	3249/1997
30.01.2012	51-week: 1000-2000	4225/1592
27.02.2012	52-week: 1000-2000	6711/2190
26.03.2012	52-week: 1000-3000	5402/2223
23.04.2012	31-week	3116,5/1332,1

* based on data of the Ministry of Finance

Treasury bond auctions in 2011/2012 (PLNm)

month	date	First auction			Second auction			Switch auction			
		T-bonds	offer		date	T-bonds	offer		date	T-bonds	offer
December	-	-	-	-	14.12	OK/PS	-	-	04.01	OK/PS/OK	WZ/IZ/PS
January '12	12.01	IZ/PS/WS	1000-4000	4067	19.01	OK0114	3000-6000	6753	01.02	DS1021: 1000-3000	2937
February	09.02	OK0114/PS1016	3500-5500	5049	16.02	WZ0117	1000-3000	3518	08.03	PS1016: 1500-3000	4080
March	14.03	OK0114	1500-3500	-	21.03	DS1021/WS0429	1000-2500	-	05.04	PS/OK	WZ
April	19.04	OK0714/PS1016	5000-9000	-	-	-	-	-	-	-	-
May	10.05	DS1021/WS0429	2000-4000	4092.3	16.05	PS0417	2000-4000	-	14.06	OK0712/OK1012	WZ/IZ
June	20.06	PS0417	2000-4000	-	-	-	-	-	05.07	OK0712/OK1012	PS0417/DS1021
July	19.07	OK0714	2000-5000	-	-	-	-	-	05.09	OK1012/OK0113	WZ0117/PS0417
August	01.08	PS0417	2000-4000	-	-	-	-	-	-	-	-
September	19.09	WZ /DS /IZ	2000-4000	3458.8	-	-	-	-	-	-	-
October	4.10	WZ /PS	3000-5000	5900.9	23.10	OK0714/DS1023	5000-9000	7840.5	-	-	-
November	8.11	PS0418	2000-4000	4526.3	-	-	-	-	21.11	OK0113/PS0413	DS/WZ
December	-	-	-	-	6.12	OK0113/PS0413	-	-	6.12	OK0113/PS0413	WS

* with supplementary auction, ** primary auction, *** demand/sale, **** in February and March 2012 the MF refrained from switch tenders

Source: MF, Reuters, BZ WBK

Economic calendar

MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY
10 December DE: Exports (Oct) EZ: Sentix index (Dec)	11 DE: ZEW index (Dec) US: Trade balance (Oct)	12 EZ: Industrial output (Oct) US: Fed decision	13 PL: CPI (Nov) PL: Balance of payments (Oct) US: Retail sales (Nov)	14 PL: Money supply (Nov) DE: Flash PMI – manufacturing (Dec) EZ: Flash PMI – manufacturing (Dec) EZ: HICP (Nov) US: Industrial output (Nov) US: Core CPI (Nov)
17	18 PL: Wages and employment (Nov)	19 PL: Industrial output (Nov) PL: PPI (Nov) DE: Ifo index (Dec) US: House starts (Nov) US: Building permits (Nov)	20 PL: Core inflation (Nov) PL: MPC minutes EZ: Consumer confidence index (Dec) US: GDP (Q3) US: Home sales (Nov) US: Philly Fed index (Dec)	21 PL: Retail sales and unemployment rate (Nov) GB: GDP (Q3) US: Personal income (Nov) US: Consumer spending (Nov) US: Core PCE (Nov) US: Michigan index (Dec)
24 US: Durable goods orders (Nov)	25	26 US: S&P/Case-Shiller home price index (Oct)	27 US: Consumer confidence index (Dec) US: New home sales (Nov)	28 US: Pending home sales (Nov)
31 PL: Inflation expectations (Dec) US: Chicago PMI index (Dec) CN: PMI – manufacturing (Dec)	1 January Market holiday	2 PL: Balance of payments (Q3) PL: PMI – manufacturing (Dec) DE: PMI – manufacturing (Dec) EZ: PMI – manufacturing (Dec) US: ISM – manufacturing (Dec)	3 US: ADP report (Dec)	4 DE: PMI – services (Dec) EZ: PMI – services (Dec) US: Non-farm payrolls (Dec) US: Unemployment rate (Dec) US: ISM – services (Dec)
7 EZ: Sentix index (Jan)	8 DE: Exports (Nov) DE: Industrial orders (Nov)	9 PL: MPC decision DE: Industrial output (Nov)	10 GB: BoE decision EZ: ECB decision	11 US: Trade balance (Nov)
14 PL: Money supply (Dec)	15 PL: CPI (Dec) US: Retail sales (Dec)	16 PL: Core inflation (Dec) US: Industrial output (Dec)	17 US: House starts (Dec) US: Building permits (Dec)	18 PL: Industrial output (Dec) PL: PPI (Dec) US: Flash Michigan (Jan)

MPC meetings and data release calendar for 2013

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
ECB meeting	10	7	7	4	2	6	4	1	5	2	7	5
MPC meeting	8-9	5-6	5-6	9-10	7-8	4-5	2-3	20	3-4	1-2	5-6	3-4
MPC minutes	24	21	21	25	23	20	-	22	19	17	21	19
GDP*	-	-	1	-	31	-	-	30	-	-	29	-
CPI	15	15 ^a	14 ^b	15	15	13	15	14	13	15	14	13
Core inflation	16	-	15	16	16	14	16	16	16	16	15	16
PPI	18	19	19	18	21	19	17	20	18	17	21	18
Industrial output	18	19	19	18	21	19	17	20	18	17	21	18
Retail sales	-	-	-	-	-	-	-	-	-	-	-	-
Gross wages. employment	18	18	18	17	20	18	16	19	17	16	19	17
Foreign trade	about 50 working days after reported period											
Balance of payments*	2	-	28	-	-	-	-	-	-	-	-	-
Balance of payments	18	12	14	-	-	-	-	-	-	-	-	-
Money supply	14	14	14	-	-	-	-	-	-	-	-	-
Business climate indices	22	21	22	22	22	21	22	23	20	22	22	20

* quarterly data. ^a preliminary data for January. ^b January and February

Source: CSO, NBP, Ministry of Finance, Reuters, Bloomberg

Economic data and forecasts

Monthly economic indicators

		Nov 11	Dec 11	Jan 12	Feb 12	Mar 12	Apr 12	May 12	Jun 12	Jul 12	Aug 12	Sep 12	Oct 12	Nov 12	Dec 12
PMI	pts	49.5	48.8	52.2	50.0	50.1	49.2	48.9	48.0	49.7	48.3	47.0	47.3	48.2	48.5
Industrial production	%YoY	8.5	7.7	9.1	4.8	0.8	2.8	4.3	1.2	5.4	0.6	-5.2	4.6	0.4	-9.2
Construction production	%YoY	13.0	14.6	32.2	12.0	3.5	8.1	6.2	-5.2	-8.7	-5.0	-17.9	-3.6	-11.3	-16.1
Retail sales ^a	%YoY	12.6	8.6	14.3	13.7	10.7	5.5	7.7	6.4	6.9	5.8	3.1	3.3	2.9	3.1
Unemployment rate	%	12.1	12.5	13.2	13.4	13.3	12.9	12.6	12.3	12.3	12.4	12.4	12.5	12.8	13.3
Gross wages in enterprises sector ^a	%YoY	4.4	4.4	8.1	4.3	3.8	3.4	3.8	4.3	2.4	2.7	1.6	2.8	2.8	1.8
Employment in enterprises sector	%YoY	2.5	2.3	0.9	0.6	0.6	0.3	0.3	0.1	0.0	0.0	0.0	0.0	-0.1	-0.1
Export (€)	%YoY	8.1	5.7	6.2	4.4	2.5	2.6	-1.6	0.4	10.9	3.9	-0.3	4.9	2.1	4.1
Import (€)	%YoY	3.2	3.5	6.9	5.6	1.5	-3.1	-2.1	-5.4	2.0	-3.3	-3.0	0.0	-1.2	-1.1
Trade balance	EURm	-772	-1 139	-687	-883	-544	-421	-842	-376	-231	-63	84	-100	-355	-573
Current account balance	EURm	-1 294	-1 890	-1 994	-1 909	-585	-734	-403	-1 025	-711	-609	-1 137	-1 291	-1 065	-1 223
Current account balance	% GDP	-4.9	-4.9	-5.0	-5.3	-5.1	-4.9	-4.9	-4.6	-4.3	-4.0	-3.9	-3.6	-3.5	-3.3
Budget deficit (cumulative)	PLNbn	-21.6	-25.1	-5.3	-16.5	-23.0	-24.8	-27.0	-21.1	-24.3	-22.9	-21.1	-34.1	-30.3	-35.0
Budget deficit (cumulative)	% of FY plan	53.7	62.5	15.1	47.2	65.6	70.9	77.1	60.2	69.6	65.5	60.4	97.5	86.7	100.0
CPI	%YoY	4.8	4.6	4.1	4.3	3.9	4.0	3.6	4.3	4.0	3.8	3.8	3.4	2.8	2.6
CPI excluding prices of food and energy	%YoY	3.0	3.1	2.5	2.6	2.4	2.7	2.3	2.3	2.3	2.1	1.9	1.9	1.8	1.8
PPI	%YoY	9.1	8.2	7.9	6.0	4.4	4.4	5.2	4.4	3.6	3.0	1.8	1.0	0.1	-0.3
Broad money (M3)	%YoY	11.8	12.5	13.7	12.4	9.1	10.2	11.1	11.0	11.0	9.8	7.6	8.0	6.5	4.9
Deposits	%YoY	11.2	11.7	12.8	12.5	8.5	10.0	10.8	10.4	10.9	9.5	7.9	8.1	6.2	4.7
Loans	%YoY	14.6	14.4	14.5	13.0	12.8	13.4	13.1	10.7	7.5	7.1	5.4	5.4	4.3	2.4
EUR/PLN	PLN	4.43	4.48	4.37	4.18	4.14	4.18	4.30	4.30	4.19	4.09	4.14	4.11	4.13	4.13
USD/PLN	PLN	3.27	3.40	3.39	3.16	3.13	3.17	3.36	3.43	3.41	3.30	3.22	3.17	3.22	3.20
CHF/PLN	PLN	3.60	3.65	3.61	3.47	3.43	3.47	3.58	3.58	3.49	3.41	3.42	3.40	3.43	3.44
Reference rate ^b	%	4.50	4.50	4.50	4.50	4.50	4.50	4.75	4.75	4.75	4.75	4.75	4.75	4.50	4.25
WIBOR 3M	%	4.94	4.98	4.99	4.97	4.95	4.94	5.05	5.12	5.13	5.10	4.95	4.82	4.62	4.38
Yield on 52-week T-bills	%	4.48	4.55	4.51	4.50	4.48	4.58	4.75	4.75	4.64	4.58	4.53	4.42	4.14	4.07
Yield on 2-year T-bonds	%	4.73	4.86	4.75	4.66	4.58	4.67	4.77	4.71	4.46	4.12	4.09	3.94	3.66	3.25
Yield on 5-year T-bonds	%	5.19	5.30	5.20	5.00	4.88	4.97	4.97	4.85	4.58	4.43	4.28	4.12	3.78	3.37
Yield on 10-year T-bonds	%	5.85	5.88	5.74	5.53	5.45	5.50	5.41	5.24	4.99	4.88	4.85	4.59	4.21	3.90

Source: CSO, NBP, Finance Ministry, BZ WBK own estimates; ^a in nominal terms, ^b at the end of period

Quarterly and annual economic indicators

		2010	2011	2012	2013	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13	3Q13	4Q13
GDP	PLNbn	1,416.6	1,523.2	1,593.7	1,635.8	370.7	388.3	392.1	442.6	377.9	396.4	401.6	459.8
GDP	%YoY	3.9	4.3	1.8	1.2	3.6	2.3	1.4	0.5	0.2	0.9	1.2	2.1
Domestic demand	%YoY	4.6	3.4	-0.2	0.0	2.5	-0.4	-0.7	-1.7	-1.5	-0.4	0.4	1.4
Private consumption	%YoY	3.2	2.5	1.0	1.4	1.7	1.2	0.1	1.0	1.2	1.2	1.6	1.8
Fixed investments	%YoY	-0.4	9.0	-0.5	-2.5	6.0	1.3	-1.5	-3.0	-5.0	-4.0	-2.0	-1.0
Industrial production	%YoY	9.0	7.7	1.5	1.5	4.9	2.8	-0.1	-1.3	-1.2	1.5	1.3	4.2
Construction production	%YoY	4.6	16.3	-4.5	-8.7	13.8	2.2	-11.0	-10.8	-12.4	-9.2	-7.2	-7.7
Retail sales ^a	%YoY	6.1	11.2	6.6	2.7	12.6	6.5	5.3	3.2	2.3	1.4	3.4	3.8
Unemployment rate ^b	%	12.4	12.5	13.3	13.8	13.3	12.3	12.4	13.3	14.6	13.0	13.2	13.8
Gross wages in enterprise sector ^a	%YoY	3.9	5.2	3.7	2.2	5.2	3.9	2.8	2.9	2.0	2.9	2.8	3.4
Employment in enterprise sector	%YoY	-0.2	1.9	0.0	-0.4	0.2	0.2	-0.1	-0.1	-0.4	-0.4	-0.3	-0.2
Export (€)	%YoY	22.8	12.1	3.1	4.3	4.1	0.4	4.3	3.8	2.0	4.0	5.0	6.0
Import (€)	%YoY	24.9	12.2	-0.4	2.3	4.3	-3.5	-1.6	-0.7	-1.2	1.1	5.5	4.0
Trade balance	EURm	-8,893	-10,059	-4,994	-2,317	-2,115	-1,641	-210	-1,028	-945	-623	-405	-344
Current account balance	EURm	-18,129	-17,977	-12,715	-5,902	-4,515	-2,164	-2,457	-3,579	-2,118	-769	-1,379	-1,637
Current account balance	% GDP	-5.1	-4.9	-3.3	-1.5	-5.1	-4.6	-3.9	-3.3	-2.7	-2.3	-2.0	-1.5
General government balance	% GDP	-7.9	-5.0	-3.5	-3.5	-	-	-	-	-	-	-	-
CPI	%YoY	2.6	4.3	3.7	1.8	4.1	4.0	3.9	2.9	1.9	1.4	1.8	2.2
CPI ^b	%YoY	3.1	4.6	2.6	2.2	3.9	4.3	3.8	2.6	1.8	1.3	2.0	2.2
CPI excluding food and energy prices	%YoY	1.6	2.4	2.2	2.0	2.5	2.5	2.1	1.8	2.0	1.7	2.0	2.2
PPI	%YoY	2.1	7.6	3.5	0.7	6.1	4.7	2.8	0.3	-0.1	0.0	1.1	2.0
Broad money (M3) ^b	%YoY	8.8	12.5	4.9	2.8	9.1	11.0	7.6	4.9	5.4	4.5	4.2	2.8
Deposits ^b	%YoY	9.1	11.7	4.7	3.1	8.5	10.4	7.9	4.7	4.7	4.4	4.2	3.1
Loans ^b	%YoY	9.2	14.4	2.4	3.7	12.8	10.7	5.4	2.4	3.6	4.5	5.5	2.4
EUR/PLN	PLN	3.99	4.12	4.19	4.14	4.23	4.26	4.14	4.12	4.15	4.15	4.15	4.10
USD/PLN	PLN	3.02	2.96	3.26	3.19	3.23	3.32	3.31	3.19	3.26	3.24	3.17	3.08
CHF/PLN	PLN	2.90	3.34	3.48	3.45	3.50	3.55	3.44	3.42	3.46	3.46	3.46	3.42
Reference rate ^b	%	3.50	4.50	4.25	3.50	4.50	4.75	4.75	4.25	3.75	3.50	3.50	3.50
WIBOR 3M	%	3.94	4.54	4.92	3.75	4.97	5.04	5.06	4.61	4.07	3.60	3.62	3.69
Yield on 52-week T-bills	%	3.96	4.51	4.50	3.70	4.50	4.69	4.58	4.21	3.40	3.54	3.82	4.04
Yield on 2-year T-bonds	%	4.72	4.81	4.30	3.50	4.66	4.71	4.22	3.62	3.20	3.34	3.62	3.84
Yield on 5-year T-bonds	%	5.31	5.44	4.54	3.64	5.02	4.93	4.43	3.76	3.29	3.44	3.80	4.04
Yield on 10-year T-bonds	%	5.74	5.98	5.02	4.17	5.58	5.38	4.91	4.23	3.83	4.01	4.27	4.57

Source: CSO, NBP, Finance Ministry, BZ WBK own estimates; ^a in nominal terms, ^b at the end of period

This analysis is based on information available until 11.12.2012 has been prepared by:

ECONOMIC ANALYSIS DEPARTMENT

ul. Marszałkowska 142. 00-061 Warszawa. fax +48 22 586 83 40

Email: ekonomia@bzwbk.pl Web site (including Economic Service page): <http://www.skarb.bzwbk.pl>

Maciej Reluga – Chief Economist

tel. +48 22 586 83 63. Email: maciej.reluga@bzwbk.pl

Piotr Bielski +48 22 586 83 33

Agnieszka Decewicz +48 22 586 83 41

Marcin Luzziński +48 22 586 83 62

Marcin Sulewski +48 22 586 83 42

TREASURY SERVICES DEPARTMENT

Poznań

pl. Gen. W. Andersa 5
61-894 Poznań
tel. +48 61 856 58 14/30
fax +48 61 856 44 56

Warszawa

ul. Marszałkowska 142
00-061 Warszawa
tel. +48 22 586 83 20/38
fax +48 22 586 83 40

Wrocław

ul. Rynek 9/11
50-950 Wrocław
tel. +48 71 369 94 00
fax +48 71 370 26 22

This publication has been prepared by Bank Zachodni WBK S.A. for information purposes only. It is not an offer or solicitation for the purchase or sale of any financial instrument. All reasonable care has been taken to ensure that the information contained herein is not untrue or misleading. But no representation is made as to its accuracy or completeness. No reliance should be placed on it and no liability is accepted for any loss arising from reliance on it. Bank Zachodni WBK S.A., its affiliates and any of its or their officers may be interested in any transactions, securities or commodities referred to herein. Bank Zachodni WBK S.A. or its affiliates may perform services for or solicit business from any company referred to herein. This publication is not intended for the use of private investors. Clients should contact analysts at and execute transactions through a Bank Zachodni WBK S.A. entity in their home jurisdiction unless governing law permits otherwise. Copyright and database rights protection exists in this publication.