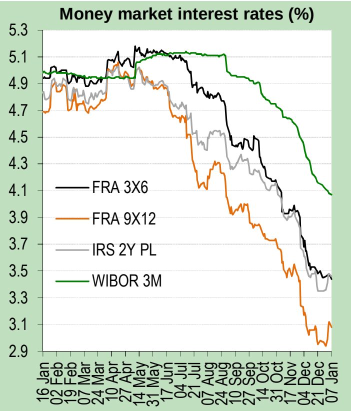
Bank Zachodni WBK

Rates and FX Outlook

Polish Financial Market

January 2013



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- **A year ago, when we presented the scenario for 2012, we did not expect that our economic growth projection of just slightly above 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 suggests that **at the beginning of the year, the Polish economy will be on the edge of recession**. We assume that it will be possible to avoid that adverse scenario. **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, which 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 should 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). As usually, the MPC has started to "chase" the decreasing inflation and the market continues to price-in aggressive easing cycle. We expect further interest rate cuts cumulatively by 75bps in three gradual, (too) cautious moves by 25bps. Even if such a decision disappoints market players in January, we believe that CPI inflation fall below the target together with continuation of weak macroeconomic data (production and sales this month) will bring positive trend on the Polish interest rate market in the upcoming month.
- **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 during the year (after in 2012 yields of Polish bonds fell as much as 177bps and 214bps in 2Y and 10Y segments). That will be even more likely if the FX market sees the continuation of the correction of the Polish currency, which has started at the beginning of 2013. We envisage such a risk in 1Q2013 and we forecast the average annual EURPLN rate at ca. 4.15.

This report is based on information available until 7th January

Short- and Medium-term Strategy

Interest rate market

	Change (bps)		Level	Expected trend	
	Last 3M	Last 1M	end-December	1M	3M
Reference rate	-0.50	-0.25	**4.25**	↘↘	↘↘
WIBOR 3M	-81	-38	**4.11**	↘↘	↘↘
2Y bond yield	-94	-25	**3.09**	↘	→
5Y bond yield	-99	-35	**3.20**	↘	→
10Y bond yield	-96	-28	**3.73**	↘	→
2/10Y curve slope	-2	-3	**64**	→	→

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

Rates: our view and risk factors	
PLN rates market	**Money market:** December's decline in WIBOR rates was more significant than we had expected. We foresee downward trend to continue in coming weeks, with WIBOR 3M falling towards 3.80% at the end of January. As regards FRA contracts we expect rates to return to downward move after macro data releases, in particular CPI inflation and industrial output.
	Short end: The short ends of the curves ended 2012 at the lowest levels in history. In the first days of 2013 this segment lost less in comparison with other sectors. January's rate cut is fully priced-in, however upcoming macro data should be supportive for bond market, especially on the front end.
	Long end: Yields of both 5Y and 10Y also reached new record lows at the end of last year. At the beginning of 2013 the correction was the most significant in 10Y segment, however, we think it was only a short-term breather for market players ahead of January's MPC meeting and data releases. Situation on core markets is a risk factor for 10Y sector.
	Risk factors to our view: If the MPC decides to distort the monetary easing cycle by cutting rates more aggressively this month, we do not exclude overreaction by market players and more significant decline in both yields and money market rates.

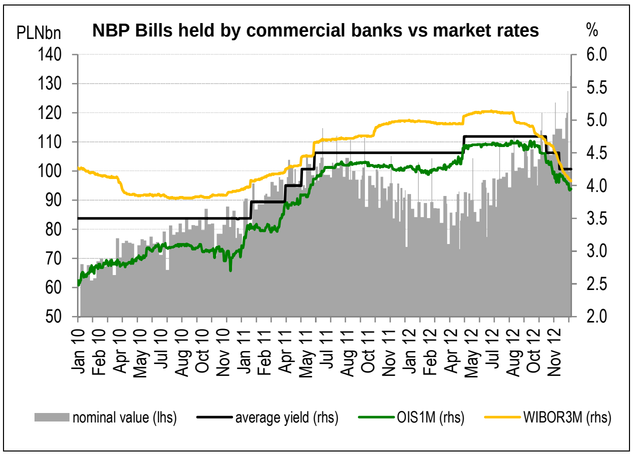
FX market

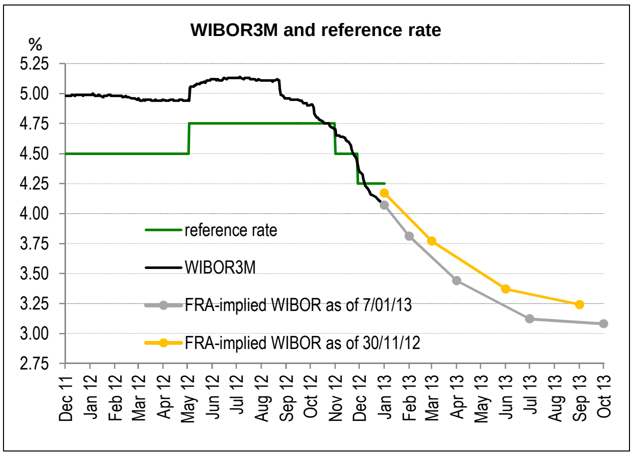
	Change (%)		Level	Expected trend	
	Last 3M	Last 1M	end-December	1M	3M
EURPLN	-0.6	-0.4	**4.09**	→	↗
USDPLN	-2.5	-1.9	**3.10**	→	↗↗
CHFPLN	-0.4	-0.6	**3.39**	→	↗
GBPPLN	-2.8	-1.0	**5.01**	→	↗
EURUSD	1.9	1.4	**1.32**	→	↘

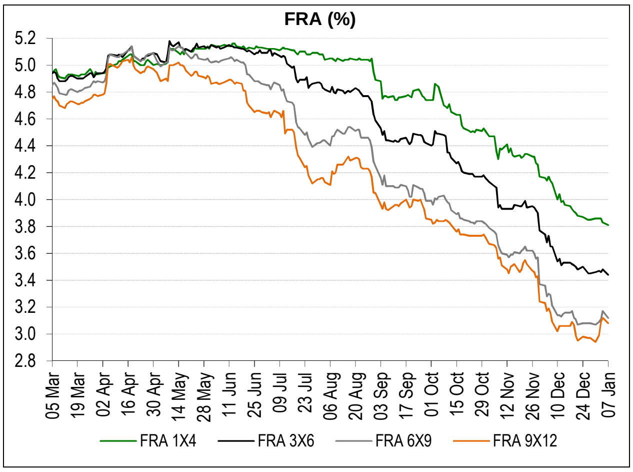
Note: Single arrow down/up indicates at least 1.5% expected move down/up, double arrow means at least 5% move

FX: our view and risk factors	
PLN FX market	**EUR:** The zloty ended the 2012 a bit stronger than we predicted. Correction in the first days of 2013 resulted mostly from external factors. We foresee the EURPLN to remain in horizontal trend, expecting the average rate at 4.10 this month. We still see risk of more considerable depreciation of the zloty in the medium term.
	USD: The EURUSD has surely lost some shine since its recent peaks as the US fiscal cliff was averted. But we think that the 1.30 area has already offered some base building. This month we foresee rather horizontal trend of the EURUSD and consequently range trading on the USDPLN.
	CHF: The SNB has maintained status quo as regards the EURCHF floor and this strategy will be uphold also this year. This month we expect the CHFPLN to remain relatively stable, but in medium term the trend is rather upwards.
	Risk factors to our view: More aggressive rate cut by the MPC together with very weak macro data might cause a significant depreciation of the zloty against the main currencies. However, if risk-on mood prevails globally, it might limit losses of the zloty.

Money Market







Volatile start of the new year

- Liquidity situation of the banking system has stayed favourable in December. Every week domestic banks invested over PLN100bn in NBP's bills. Consequently, at the end of the year cash surplus in the system was higher than expected, which translated into lower cost of carry. The shortest rates fell well below the reference rate, with Polonia rate declining towards 3.1%. However, the beginning of new year has started with some increase in market rates, notwithstanding rates remain still below the reference one.
- As we predicted, the last month of 2012 brought further decline in money market rates. However, the scale of decline was a bit lower in comparison with the previous month. OIS curve went down by 2-28bps (with the deepest fall in case of 6M and 1Y) against a fall of 33-47bps in November. From the very beginning of the new year we had a big upward move on OIS rates (by 5-10bps) ahead of the MPC's meeting and macro data releases. There are expectations for another 100 bps cut in the OIS curve, but we are still a bit cautious, assuming that the MPC will trim rates by 75bps (in total) till the end of 1H2013.

WIBOR rates below the reference rate, to continue decline

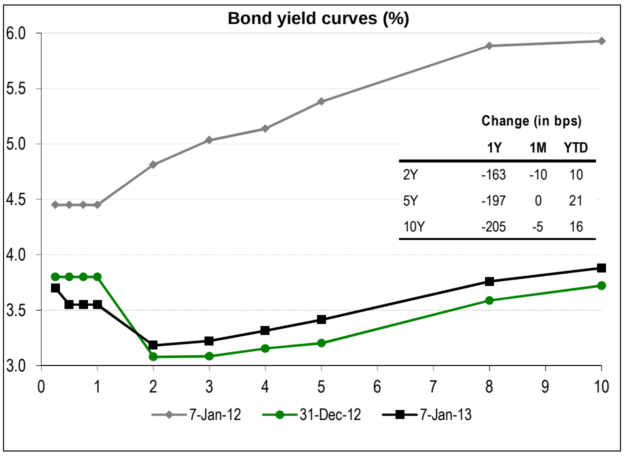
- December was another consecutive month of WIBOR decline. In monthly terms rates fell by 30-46bps (with the deepest decrease in case of 1Y), much more than in November (decline by 24-28bps). One should notice that at the end of the 2012 WIBOR rates from 1M till 1Y were below the reference rate, in which 1Y rate fell below 4.0%. Furthermore, WIBOR decline since the end of August (Q2 GDP data release) till 2012-end amounted to between 69bps for 1M and 114bps for 1Y, in which WIBOR 3M fell by 100bps, i.e. two times more than the reference rate (by 50bps in total). The beginning of the new year has not changed the trend, rates have been continuing the gradual decline.
- The start of the new year is more volatile on FRA market. After reaching new all-time low (in which FRA 9x12 fell below 3%), in the first days of 2013 rates have started climbing ahead of the January's rate-setting meeting. Consequently, market expectations on scale of WIBOR rate decline have changed – for the first time since late November the market expects 3M WIBOR to be lower by less than 100bps in next 6 months.
- In January investors will focus on the MPC meeting and macro data (mainly CPI inflation and industrial output). This month's rate cut (by 25bps) is a done deal, however one cannot exclude that upcoming macro data (we foresee CPI below the NBP's target and sharp decline in production) might again strengthen rate cuts expectations. Consequently, we foresee WIBOR to continue its gradual decline, with 3M rate close to 3.80% at the end of month (average at 3.95%).

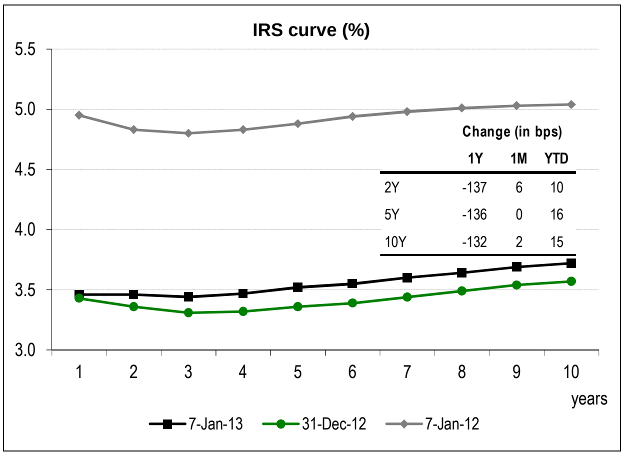
Money market rates (%)

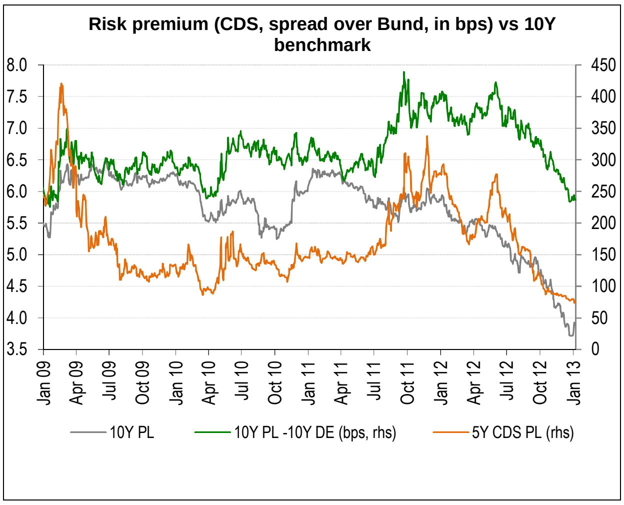
	Reference	Polonia	WIBOR (%)				OIS (%)				FRA (%)			
	rate (%)	(%)	1M	3M	6M	12M	1M	3M	6M	12M	1x4	3x6	6x9	9x12
End of December	**4.25**	**3.74**	**4.21**	**4.11**	**4.08**	**3.98**	**4.03**	**3.83**	**3.38**	**3.18**	**3.86**	**3.46**	**3.07**	**2.94**
Last 1M change (bp)	-25	-77	-30	-38	-38	-46	-2	-4	-27	-28	-31	-31	-30	-30
Last 3M change (bp)	-50	-97	-69	-81	-86	-97	-56	-52	-72	-79	-88	-94	-92	-91
Last 1Y change (bp)	-25	55	-56	-87	-91	-101	-24	-46	-91	-110	-111	-149	-169	-172

Sources: Reuters, BZ WBK

IRS and T-Bond Market







New all-time lows in yields at the end of 2012

▪ As we predicted, December's cut by 25bps had a rather limited impact on yields and rates as the market seemed a little bit disappointed with the scale of easing (some investors had expected a 50bps move). Correction was short-lived and the downtrend has continued, supported by data releases, which confirmed not only weak economic activity, but also continuation of disinflation trend. Consequently, at the end of 2012 both IRS rates and bond yields reached fresh all-time lows. In monthly terms bond curve went down by 26-35bps (with the deepest decline in 5Y), while IRS by 21-31bps (in 2Y). In general, investors on Polish interest rate market can summarise the year 2012 as a very good one. Polish bonds outperformed the Czech ones, but benefited less than Hungarian securities.

▪ The first days of the new year brought significant correction on bonds and rates. As yields on core markets went up, Polish assets followed this move and rates were pushed up by 10-25bp, with long-end losing the most. What is more, high supply of long terms bonds at the first auction in 2013 only increased the sell-off dynamics amid low liquidity (particularly as regards foreign investors). We think that the correction at the beginning of the new year is nothing more than a short-term breather for market players ahead of January's MPC meeting and data releases.

Macro data strengthen rate cuts expectations

▪ Considering that correction at the beginning of 2013 has been caused by external factors, we believe that in coming weeks yields and rates will return to the downward move. The January's MPC decision to cut rates is priced-in, but we believe that it will most likely signal further easing to come, which should support further decline along the curves. However, if the MPC decides to suggest a pause in easing cycle in anticipation of March edition of inflation and GDP projections, one cannot exclude further upward pressure on yields along the curve, but it also should be short-lived.

▪ In our opinion, macroeconomic releases may be crucial for investors this month. We believe that upcoming data should again intensify expectations on quick and more aggressive moves by the MPC and support bullish sentiment on the market as we foresee a two-digit decline in industrial output and CPI inflation to decrease below the NBP's inflation target and continue falling in 2013. Therefore we do not exclude that yields and rates might reach fresh lows in coming weeks.

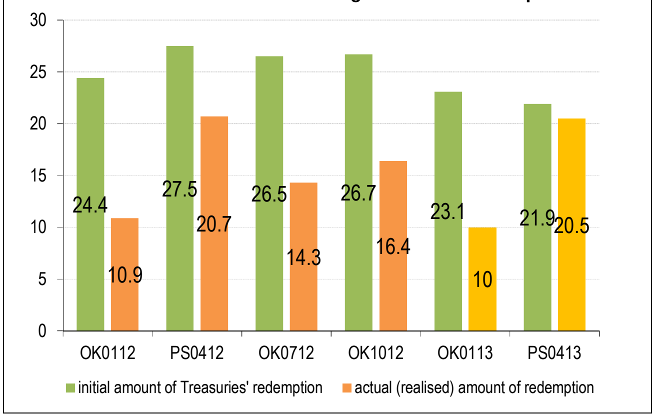
▪ The first days of 2013 confirmed that 10Y yield is linked more closely to the situation in the core markets, in particular, to the quotations of the German Bunds with the same maturity. Further sale-off of safe assets may limit potential of long term bonds strengthening and consequently may result in further steepening of the curve – the trend which is observed also in global markets.

Bond and IRS market (%)

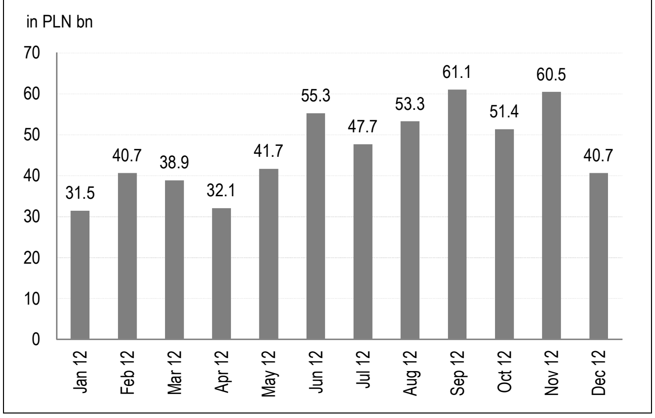
	T-bills	BONDS			IRS			Spread BONDS / IRS (bps)		
	52-week	2Y	5Y	10Y	2Y	5Y	10Y	2Y	5Y	10Y
End of December	**3.80**	**3.08**	**3.20**	**3.72**	**3.36**	**3.36**	**3.57**	**-28**	**-16**	**15**
Last 1M change (bps)	-25	-26	-35	-29	-31	-28	-21	5	-7	-8
Last 3M change (bps)	-60	-92	-98	-98	-86	-87	-80	-6	-11	-18
Last 1Y change (bps)	-65	-177	-212	-214	-140	-147	-138	-37	-65	-76

Sources: Reuters, BZ WBK

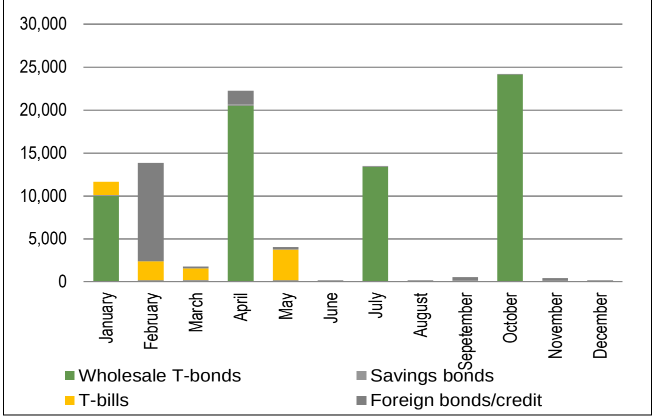
Treasury Securities Supply Corner



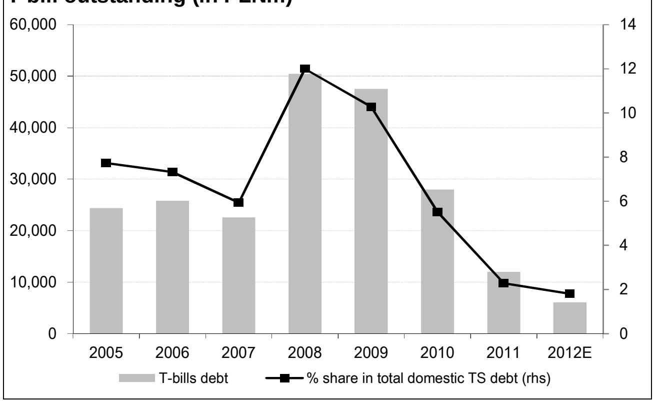
Reduction of risk of refinancing Treasuries' redemption



Funds in PLN and in foreign currency held by MoF



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



T-bill outstanding (in PLNm)

Sources: Ministry of Finance, BZ WBK

Start of 2013 with a favourable liquidity conditions

- The Ministry of Finance remained active on the primary market in December 2012. Positive market mood was used as an opportunity to replace the ultra-short bonds (OK0113 and PS0413) by long term ones, as the ministry launched WS0922 and WS0429 worth PLN1.8bn. Another switch auction of bonds maturing in April 2013 (and in July 2013) is preliminarily planned for March and will depend on market conditions.
- In December the Ministry successfully repurchased Eurobonds at the first such an auction in history. Just before that auction P. Marczak, director of the Public Debt Department in the Ministry of Finance, said "we would be happy with the redemption of 5% (EUR150m) of bonds maturing in February with value of EUR3bn". The Ministry bought back Eurobonds worth EUR220.5m in total.
- As predicted, the new year has started with comfortable conditions for the Ministry of Finance as the 2013 borrowing requirements were financed in 27%. Funds in PLN and in foreign currency held by the MF amounted to ca. PLN41bn at the end of December, with lion's share in foreign currency.

Issuance plan for Q1 quite high, but realistic

- The Ministry plans to tap wholesale bonds worth PLN25.0-35.0bn at 5-6 standard auctions in January-March period. Deputy minister of finance W. Kowalczyk commented on issuance plan for 1Q2013 that the ministry "wants to finance at least half of this year's borrowing needs already by the end of first quarter. In the second half of the year, after summer break, we can start prefinancing of next year's requirements and this may result in our return to foreign markets".
- In January the Ministry of Finance plans to hold two tenders, tapping DS1023 and WS0429 worth PLN3.0-5.0bn and a new series of zero coupon bonds OK0715 and PS0418 worth PLN5-10bn. Offer of T-bills (20-week worth PLN2-3bn), after long pause, will complete the supply. As expected, 20-week T-bills attracted a strong demand (PLN10.9bn). The MF sold papers worth PLN3.6bn (more then planned) at 3.56%.
- Some investors treated the size of planned issue in Q1 as higher than expected. In our opinion, however, if positive trend on global markets prevails, the ministry will have no problems with selling majority of offer on primary market.
- The first auction of 2013 was quite successful for the Ministry. It tapped DS1023 and WS0429 worth ca. PLN3.7bn in total, in which sale of 10Y benchmark amounted to PLN3.2bn. However, total demand was at PLN4.9bn, below upper limit of planned supply (PLN3.0-5.0bn). Additionally, yields at the auction were a few basis points higher than levels on the secondary market. Results of the auction disappointed, particularly in comparison with auctions in 2012. Nevertheless we are still optimistic, and expect a solid demand for Polish assets. We believe that auction of new 2Y bonds and 5Y benchmark later this month (23 January with settlement on 25 January) will confirm our expectations. We think that liquidity situation will be supportive for this auction. In January flows on the market will amount to PLN10bn from OK0113 redemptions and PLN2.5bn from interest payments from floating rate WZ series (25 Jan).
- In January the MF decided to offer 6Y eurobonds worth €1bn. Bonds were priced 65bps above average swap rate. Deputy minister of finance W. Kowaczyk commented that currently market conditions are favourable, in particular, due to strong demand from foreign investors. We do not rule out that non-residents might decide to rollover funds from eurobonds' redemption, which take place in February (ca €2.8bn).

Treasury Securities Supply Corner

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

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
T-bonds auction	13,000	8,500	7,000	9,500	6,500	5,000	5,500	2,500	5,500	13,000	4,000	500	80,500
T-bills auction	3,603												3,603
Retail bonds	150	154	154	154	154	154	154	154	154	154	154	157	1,847
Foreign bonds/credits	1,100	2,000		2,500	2,000	1,800		3,500		3,000	4,000		19,900
Prefinancing and financial resources at the end of 2012	39,150												39,150
Total	**57,003**	**10,654**	**7,154**	**12,154**	**8,654**	**6,954**	**5,654**	**6,154**	**5,654**	**16,154**	**8,154**	**657**	**145,000**
Redemption	11,686	13,854	2,791	22,261	4,024	147	13,497	134	561	24,213	408	183	93,761
Net inflows	**45,317**	**-3,200**	**4,363**	**-10,107**	**4,630**	**6,807**	**-7,843**	**6,020**	**5,093**	**-8,059**	**7,746**	**474**	**51,238**
Rolling over T-bonds													0
Buy-back of T-bills/bonds													0
Total	**45,317**	**-3,200**	**4,363**	**-10,107**	**4,630**	**6,807**	**-7,843**	**6,020**	**5,093**	**-8,059**	**7,746**	**474**	**51,238**
Coupon payments	*2,492*			*7,322*			*1,955*		*1,497*	*9,685*			***22,951***

Note: Our forecasts – shaded area

Schedule Treasury Securities redemption by instruments (in PLNm)

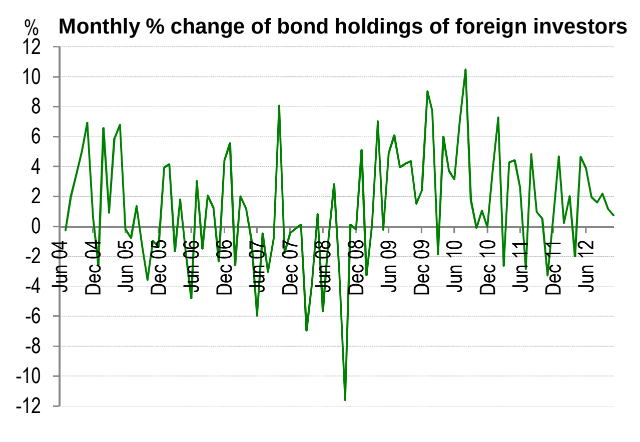
	Bonds	Bills	Retail bonds	Total domestic redemption	Foreign Bonds/Credits	Total redemptions
January	10,001	1,592	93	**11,686**		**11,686**
February		2,190	148	**2,338**	11,516	**13,854**
March		2,329	212	**2,541**	250	**2,791**
April	20,521		140	**20,661**	1,600	**22,261**
May			172	**172**	250	**422**
June			147	**147**		**147**
July	13,393		105	**13,497**		**13,497**
August			134	**134**		**134**
September			111	**111**	450	**561**
October	24,120		94	**24,213**		**24,213**
November			158	**158**	250	**408**
December			183	**183**		**183**
Total 2013	68,035	6,110	1,698	**75,843**	14,316	**90,159**
Total 2014	61,666		1,248	**90,276**	18,320	**105,102**
Total 2015	78,880		677	**59,586**	16,618	**77,034**
Total 2016	59,378		485	**79,365**	17,620	**93,694**
Total 2017	67,278		91	**59,469**	11,766	**76,340**
Total 2018+	183,657		3,288	**213,794**	146,214	**348,760**

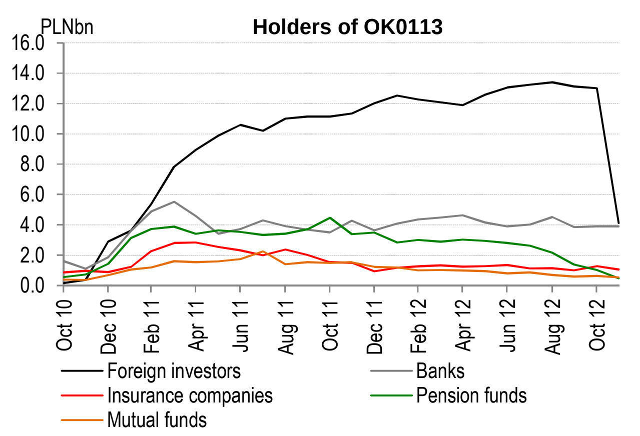
Schedule wholesales bonds redemption by holders (data at the end of November 2012, in PLNm)

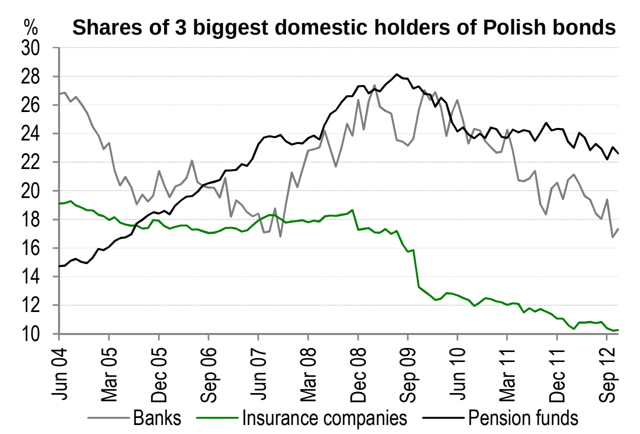
	Foreign investors	Domestic banks	Insurance Funds	Pension Funds	Mutual Funds	Individuals	Non-financial sector	Other	Total
Q1 2013	4,128	3,894	1,061	489	548	186	154	776	11,235
Q2 2013	8,065	5,476	2,446	2,736	721	59	80	1,880	21,462
Q3 2013	9,110	564	1,334	812	473	96	13	1,031	13,431
Q4 2013	8,735	2,370	6,905	4,443	660	117	29	906	24,165
Total 2013	**30,038**	**12,303**	**11,746**	**8,478**	**2,401**	**458**	**276**	**4,593**	**70,293**
	43%	**18%**	**17%**	**12%**	**3%**	**1%**	**0%**	**7%**	**100%**
Total 2014	32,415	9,408	5,651	7,396	2,856	441	126	3,664	61,956
	52%	15%	9%	12%	5%	1%	0%	6%	100%
Total 2015	26,089	20,801	7,210	14,857	5,504	173	820	3,497	78,951
	33%	26%	9%	19%	7%	0%	1%	4%	100%
Total 2016	17,384	7,622	4,555	23,222	6,930	54	75	2,754	62,596
	28%	12%	7%	37%	11%	0%	0%	4%	100%
Total 2017	25,731	11,845	5,576	14,444	6,231	60	83	3,307	67,278
	38%	18%	8%	21%	9%	0%	0%	5%	100%
Total 2018+	56,046	29,449	19,397	50,914	14,859	202	355	7,929	179,152
	31%	16%	11%	28%	8%	0%	0%	4%	100%

Sources: Ministry of Finance, BZ WBK

Treasury Securities Holders







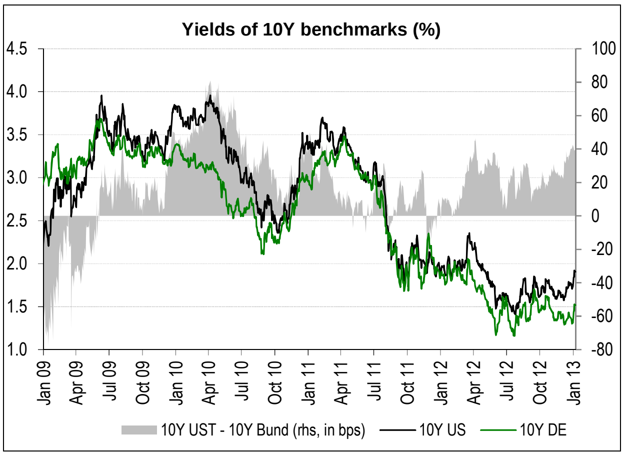
Foreign investors dominated November's switch auction

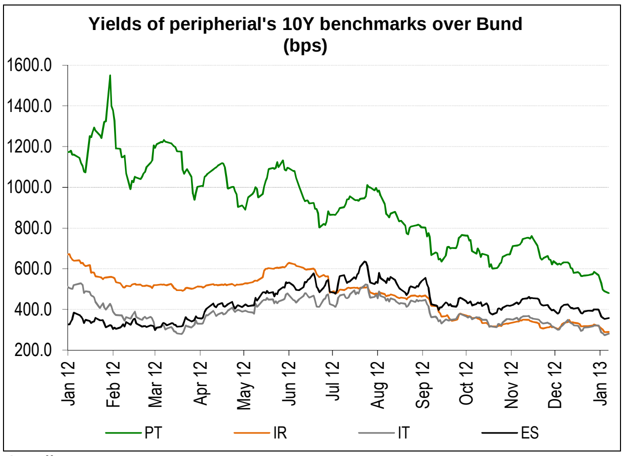
- November was the seventh month in a row when portfolio of Polish PLN-denominated bonds held by foreign investors reached all-time high. On the other hand, the pace of monthly purchases was the weakest in the last 7 months. If the pattern seen since the beginning of 2011 (shown on the chart of monthly change of bond holdings) will hold in the next months, then some reduction of engagement by the foreign investors in the nearest future shall not be surprising.
- Recent data on holders of Polish debt confirmed comments of the Ministry of Finance that foreign investors were very active on the switch auction carried in November. In fact, this group has probably entirely dominated this auction. Foreign investors reduced their portfolio of OK0113 by PLN8.9bn in November, while on the bond switch auction PLN9.9bn of this 2Y bond was repurchased by the Ministry. Furthermore, the Ministry sold WZ0117 and WZ0121 worth in both cases PLN4.4bn, while foreign investors held at the end of November PLN4.3bn and PLN4.4bn of these bonds more than at the end of October.
- November's high annual pace of growth of the bond portfolio held by particular categories of foreign investors (banks for example – see table below) was the result of low base effect (last year a reduction of engagement was recorded). In November 2012 the monthly change of value of portfolio did not deviate visibly from what it was seen in recent months.
- In November domestic investors increased their holdings of Polish bonds after two months of reduction of engagement. Furthermore, the monthly pace of accumulation (as well as the nominal monthly increase) was highest since March 2012. Out of the three biggest domestic holders of Polish bonds, only commercial banks and insurance companies decided to buy some securities in November (the biggest contribution was provided by purchase of PS0413 and WZ0115 by banks). Still, the chart shows that shares of TOP3 domestic holders have stayed in the downward trend for at least three years.
- Polish mutual funds increased their holdings to PLN38.8bn, the highest level for 5 years. December's data are likely to show that during the last month of the year their portfolio increased further.

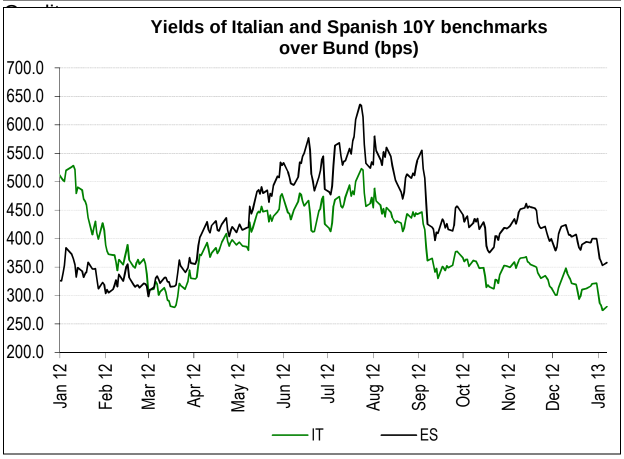
Holders of marketable PLN bonds	Nominal value (PLN, bn) End Nov	End Oct	End 3Q 2012	End 2Q 2012	Nominal value (PLN, bn) End 2011	End 2010	End 2009	% change in November MoM	QoQ	YoY	Share in TOTAL (%) in Nov
Domestic investors	339.9	336.9	341.8	352.9	349.8	354.1	336.2	0.9	-	-3.1	64.4
Commercial banks	91.4	87.7	102.0	102.1	103.3	110.4	112.1	4.3	-	-9.8	17.3 (+0.6pp)
Insurance companies	54.1	53.5	54.7	57.0	55.5	59.5	53.8	1.2	-	-5.2	10.3
Pension funds	119.3	120.6	116.7	120.3	122.2	117.0	111.0	-1.1	-	-2.0	22.6 (-0.4pp)
Mutual funds	38.8	36.2	32.5	33.0	31.7	30.2	26.8	7.0	-	24.4	7.4 (+0.4pp)
Others	36.2	38.8	35.9	40.5	37.1	37.0	32.5	7.2	-	9.2	6.9% (-0.6pp)
Foreign investors*	187.7	186.3	184.2	174.0	152.5	124.8	78.6	0.7	-	23.9	35.6
Banks	27.8	27.4	27.8	22.6	16.2	21.9	17.4	1.7	-	70.7	5.3
Non-bank fin. sector	151.4	150.2	147.5	143.1	129.3	96.8	58.0	0.8	-	17.7	28.7
Non-financial sector	5.2	5.4	5.6	5.2	4.5	4.2	2.3	-4.8	-	28.2	1.0 (-0.1pp)
TOTAL	527.6	523.2	526.0	526.9	502.3	478.9	414.8	0.8	-	5.0	100

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

International Bond Markets







We foresee horizontal trend on core market

- In December the US fiscal cliff remained in the centre of attention. Lack of agreement has shifted investors' demand towards safe haven assets. However, during the month the mood changes strongly depended on news flow. Decision to support the Spanish banking sector by the ESM and the buy-back of part of Greek debt were positive for risky assets, while the increased political uncertainty in Italy and worsening macro outlook for euro zone were supportive for Bunds and UST. In general, in monthly terms Bunds curve went down by 4-10bps, with the deepest decline in 5Y, while UST curve moved up by 10-13bps at the mid and long-end mainly due to better than expected macro data readings (retail sales, industrial output, labour market).
- The agreement about the "fiscal cliff" in the US was reached none too soon. One should notice that the outcome allows only to avert falling over the cliff as spending cuts will have to be agreed in two months, while the debt ceiling still has to be raised. Overall, euphoria on the market in the first days of 2013 shifted investors' interest from safe haven to more risky assets. Consequently, yield of 10Y UST increased by 18bps to 1.92%, while 10Y Bunds climbed to 1.53%, up from 1.32% at the end of 2012.
- Uncertainty on the market still exists, therefore we foresee bonds on core markets to be still well bid in coming weeks (even till Q1-end). We expect yields on 10Y benchmarks to be traded in horizontal trend between 1.75-2.00% (US Treasuries) and 1.30-1.50% for Bunds.

Auction results will test risk-on mood

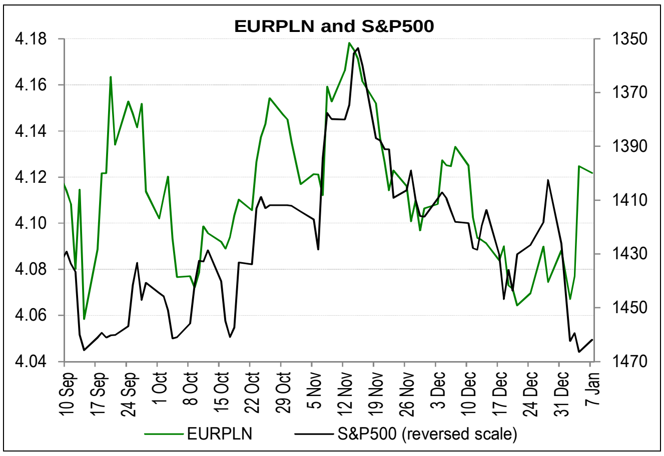
- In the last month of 2012 sentiment towards peripheral debt markets was mixed, strongly depending on news flow and auction results. All in all, at the end of 2012 yield of 10Y benchmark in Spain was only slightly higher (by 22bps) than at the beginning of the year, while in Italy it decreased by 248bps to 4.53%. More significant decline in yields was noted in case of Portugal and Ireland by 655bps and nearly 400bps, respectively.
- At the beginning of the new year risky assets outperformed after success of budget negotiations in the US. "Peripheral" debt markets went higher and premium on 10Y bonds over Bunds narrowed by nearly 50bps, both in Spain and in Italy.
- In coming weeks situation on the market will strongly depend on macro data and auction results, which, in particular, will show whether the market is in risk-on mood. We do not exclude gradual decline in yields of peripheral's debt, however, upcoming election in Italy (late February) might be the main risk factor.

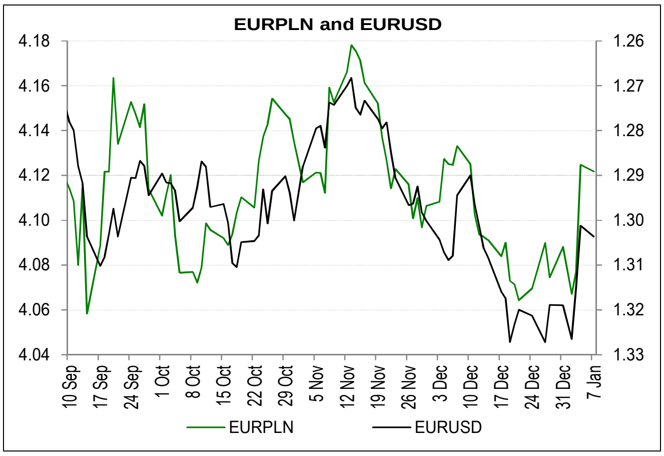
Euro zone's issuance plans and completion in 2013 (€ bn)

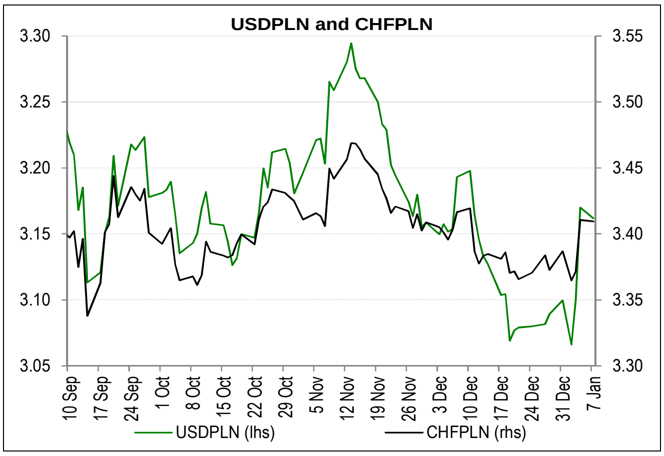
	Total redemptions	Deficit	Borrowing needs	Expected bond supply	% of completion (YtD)
Austria	15.9	6.3	22.2	22.2	-
Belgium	30.3	8.8	40.0	37.0	-
Finland	6.8	5.6	12.4	12.4	-
France	105.5	61.6	171.1	170.0	5.0
Germany	157.0	17.1	174.1	174.1	3.0
Greece	9.7	11.6	21.3	0.0	-
Ireland	5.1	12.5	17.6	10.0	-
Italy	154.7	25.5	180.2	180.2	-
Netherlands	31.5	15.2	46.7	50.0	-
Portugal	5.9	7.4	13.3	3.0	-
Spain	61.9	48.4	133.3	113.4	-
Total	**584.3**	**220.0**	**832.2**	**772.3**	**2.0**

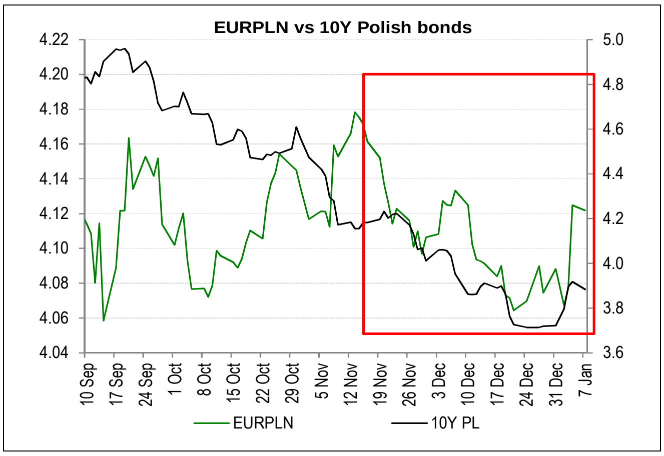
Source: Reuters, BZ WBK

Foreign Exchange Market









Sources: Reuters, BZ WBK

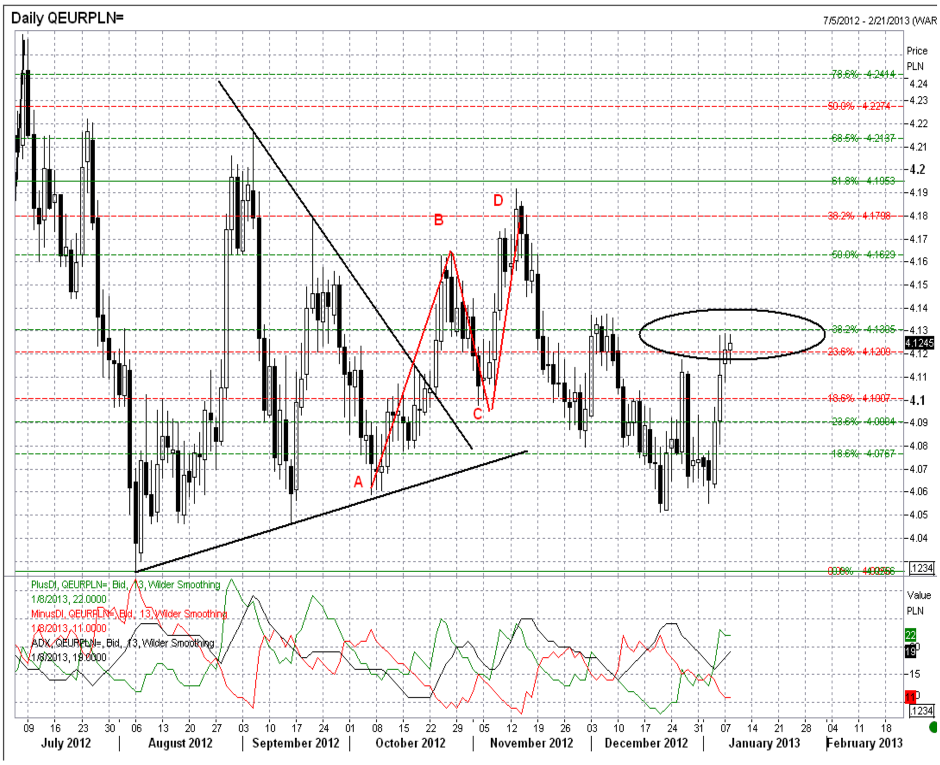
Still no major changes on the EURPLN market

- Just like we expected, cautious move of the MPC (a rate cut by only 25bps in early December) supported slightly the zloty. Furthermore, investors were pricing-in that at the last meeting of the year the Fed will replace the expiring "Operation Twist" with more bond purchases and this also backed the domestic currency versus the euro and the dollar. Consequently, in the first part of the month the EURPLN dropped to 4.05, lowest level since mid-September. In the following weeks situation on the domestic FX market was driven by changes of investors' expectations regarding the possibility of avoiding the fiscal cliff in the US. All in all, on average the EURPLN was at 4.10 in the last month of the year versus our forecast at 4.13.
- In 2012 Polish zloty appreciated by 8.4% versus the euro, 10% versus the dollar, 7.6% vs. Swiss franc, 6.3% vs. British pound. Domestic currency performed vs. the euro better than Hungarian forint (it gained 7.2%) and Czech koruna (stronger by 1.6%). Double digit gains of the zloty occurred for example versus Japanese Yen (19.6%), Romanian Leu (11%).

Global moods offset local factors (rate cuts, weak data)

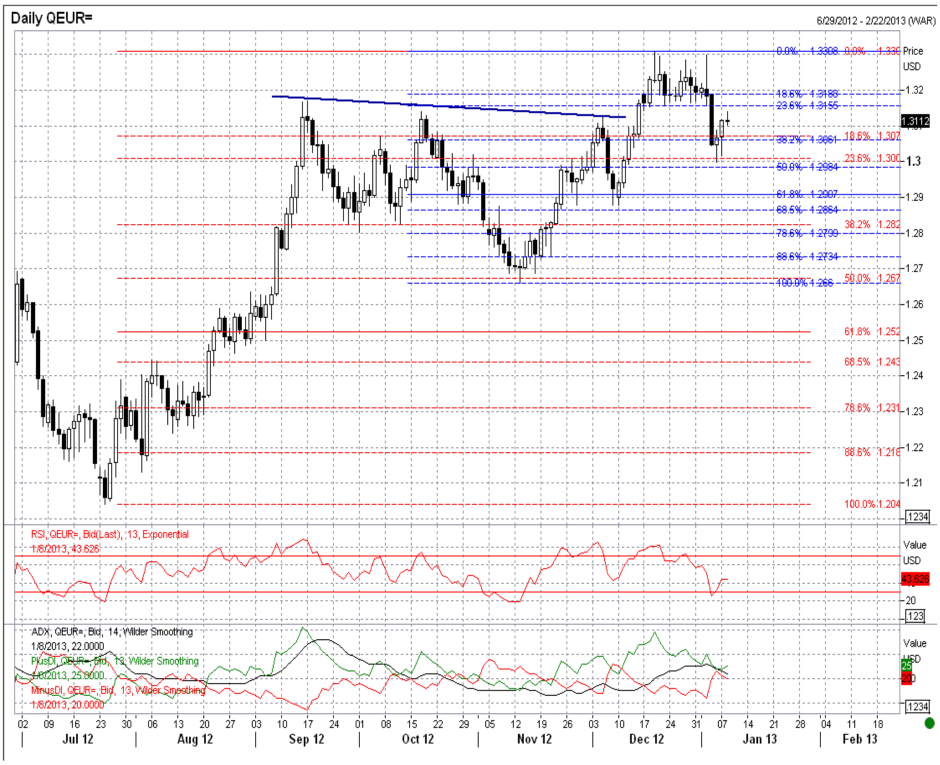
- We sustain our opinion presented in December that, given current market environment, the domestic factors that may put negative pressure on the zloty, while global ones are likely to be rather neutral or positive. Last month we mentioned the Greek issue has been closed for some time after the next tranche of aid was disbursed and voluntary debt buyback was successful. Now it seems this is also the case with US budget situation, at least to some extent.
- At the beginning of 2013 the zloty depreciated versus main currencies. The increase of the EURPLN to ca. 4.13 and the USDPLN to 3.17 at the beginning of 2013 means the zloty has so far lost 1.3% vs. the euro and 2.9% vs. the dollar. It is worth to remind that during first days of the past year the zloty was underperforming only slightly more visibly – it lost 1.4% vs. the single currency and 3.1% vs. the greenback. At the beginning of 2012 the global market sentiment was very poor but a few positive surprises from macro data releases and successful auctions on the peripheries of the euro zone improved investors' moods. Currently the uncertainty (related to depth of economic slowdown of global and Polish economy and the US budget) is also present on the market, though it is clearly lower than at the beginning of 2012. Latest US data proved better than expected and yields on the euro zone's peripheral debt market are in the downward trend. This supports hopes that this time global sentiment will also improve or at least stabilise. If this actually happens, then the potential for zloty's depreciation due to expectations for more rate cuts by the MPC (suggestion of more easing to come is likely to be included in the statement from the January's MPC meeting) may be limited. During the first days of 2013 the zloty detached from the S&P500, but decent correlation of the EURPLN and the US stock index (4-month correlation at -53%) suggests situation on this market remains one of main factors driving the zloty. Notice that quarterly earnings reporting season in the US is about to start shortly.
- One of the internal factors that may trigger some weakening of the zloty is the situation on the Polish FI market. Yields of domestic bonds retreated from all-time lows and if positive global market sentiment persist, they will become less attractive for investors (yields of Polish debt surged when 10Y German bonds weakened after agreement on the US budget was announced). If the upward momentum of domestic bond yields continues, this may also prevent the zloty from benefiting from positive market sentiment. Our base scenario assumes the EURPLN will stay in the range of 4.05-4.14 in January and the exchange rate will be on average at 4.10.

FX Technical Analysis Corner



EURPLN

- The EURPLN did not manage to reach upper band of consolidation at ca. 4.16-4.18.
- Generally, the situation on the EURPLN market did not change significantly during the past month. ADX is below 20pts and this confirms there is no strong trend currently regarding the EURPLN.
- Vital levels for upcoming weeks are resistance at ca. 4.14 (consisting from local peak from late November and two Fibonacci retracements) and support at 4.05 (minimum from mid-December).



EURUSD

- The EURUSD did not manage to break the resistance at 1.317 at first attempt and pulled back just below suggested support at 1.29.
- In early December the EURUSD tested the support at 1.30 (23.6% of upward momentum seen from mid-July). Furthermore, at 1.2984 there is a 50% retracement of the upward move seen since mid-November) and this together creates first area of support.
- On weekly terms ADX indicates the upward trend still obeys, though its strength abated recently.
- Divergence with RSI suggested the exchange rate may not break this support, at least at first attempt and this might have just been the case.

Sources: Reuters, BZ WBK

Poland vs. other countries - economy

Main macroeconomic indicators (European Commission's forecasts)

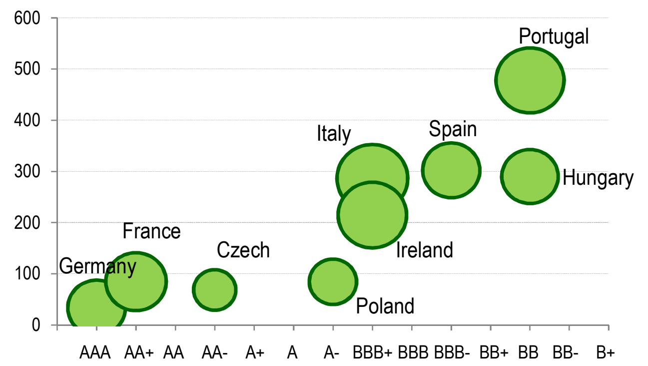
	GDP (%)		Inflation (HICP, %)		C/A balance (% of GDP)		Fiscal Balance (% of GDP)		Public Debt (% of GDP)	
	2012F	2013E	2012F	2013E	2012F	2013E	2012F	2013E	2012F	2013E
Poland	**2.4**	**1.8**	**3.8**	**2.6**	**-3.9**	**-3.3**	**-3.4**	**-3.1**	**55.5**	**55.8**
Czech Republic	-1.3	0.8	3.6	1.1	-2.9	-2.1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

Source: European Commission – Autumn 2012

Sovereign ratings

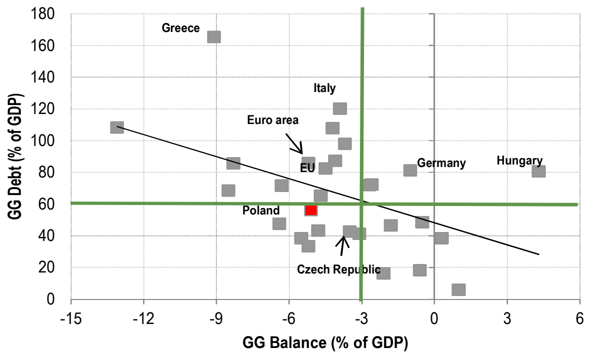
	S&P		Moody's		Fitch	
	rating	outlook	rating	outlook	rating	outlook
Poland	A-	stable	A2	stable	A-	stable
Czech	AA-	stable	A1	stable	A+	stable
Hungary	BB	stable	Ba1	negative	BB+	negative
Germany	AAA	stable	Aaa	negative	AAA	stable
France	AA+	negative	Aa1	negative	AAA	negative
UK	AAA	negative	Aaa	negative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

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



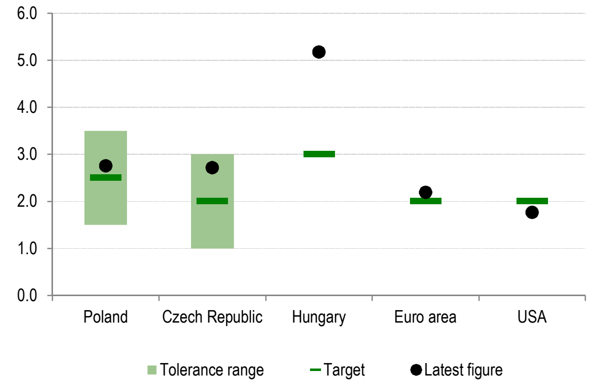
Note: Size of bubbles reflects the debt/GDP ratio

Fiscal position of the EU countries

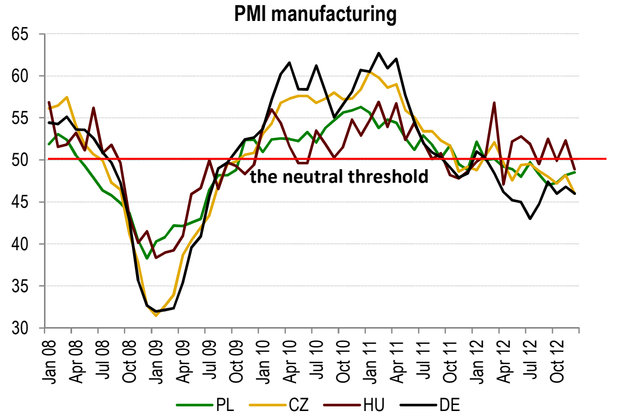


Note: final data for 2011

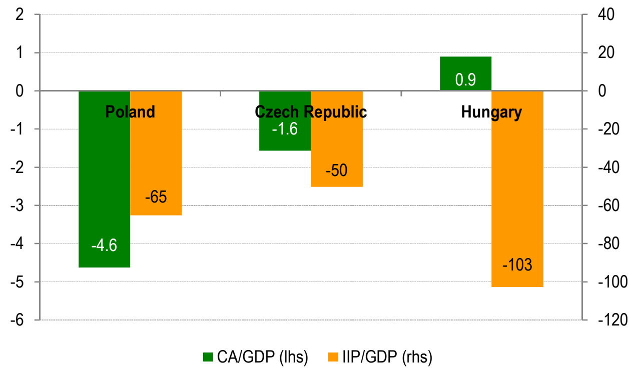
Inflation rates vs targets



PMI manufacturing



Current account balance & International Investment Position (end of Q2 2012 - cumulative data, % of GDP)

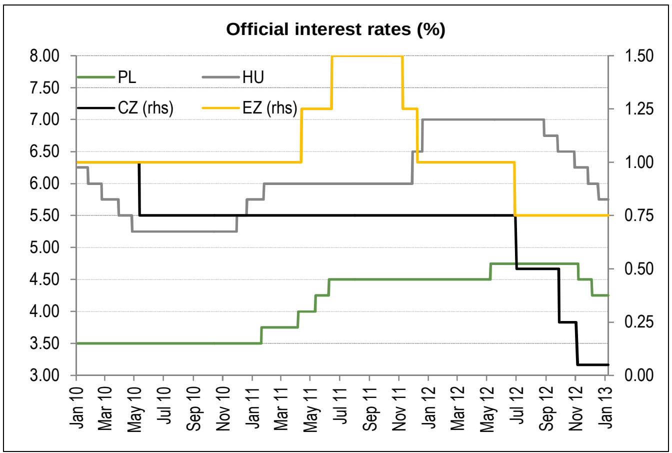


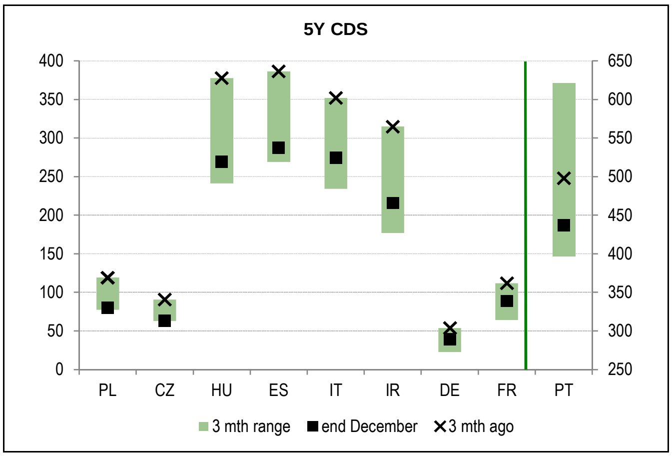
Source: stat offices, central banks, Reuters, BZ WBK, EC

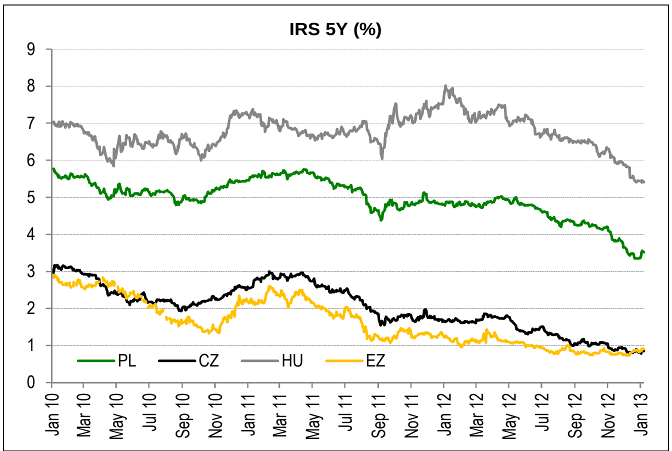
Poland vs other countries - market

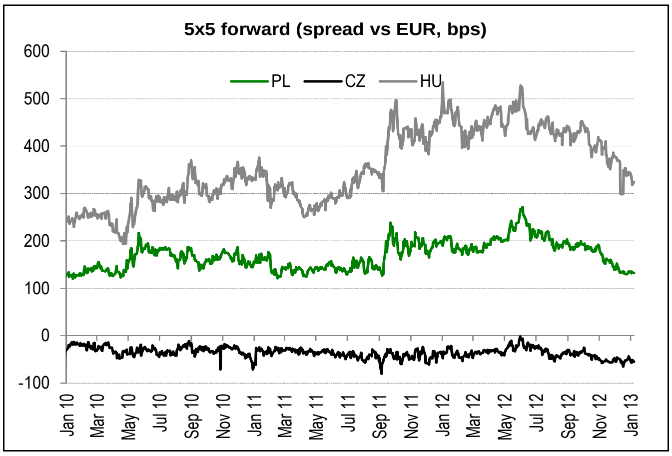
Main market indicators (%)

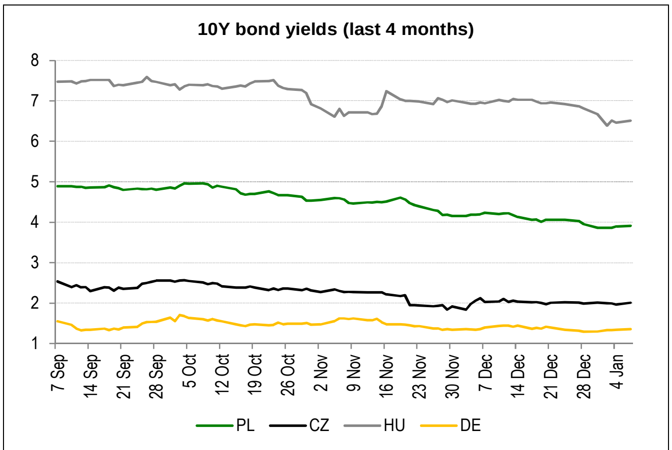
	Reference rate (%)		3M market rate (%)		10Y yields (%)		10Y Spread vs Bund (bps)		CDS 5Y	
	2011	2012	2011	end of December	2011	end of December	2011	end of December	2011	end of December
Poland	**4.50**	**4.25**	**4.99**	**4.11**	**5.88**	**3.72**	**405**	**241**	**279**	**80**
Czech Republic	0.75	0.05	0.78	0.18	3.59	1.86	176	54	173	63
Hungary	7.00	6.00	7.24	5.75	9.90	6.23	807	492	610	269
Euro area	1.00	0.75	1.36	0.19						
Germany					1.83	1.32			100	39

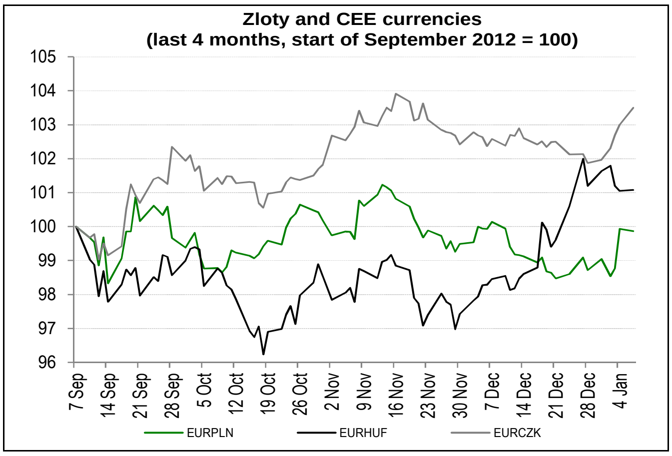












Source: stat offices, central banks, Reuters, BZ WBK, EC

Central Bank Watch

		Last	2012	2013F	Expected changes (bps) 1M	3M	6M	Risks/Events
Euro	Forecast	0.75	0.75	0.75				Rate cut by 25bps is still possible, but in our opinion probability of such scenario is lower than rates on-hold. The ECB might activate OMT programme.
	Market implied »				0	1	2	
UK	Forecast	0.50	0.50	0.50				We foresee rates to remain unchanged. The BoE might be less active on the debt market.
	Market implied »				1	3	7	
US	Forecast	0-0.25	0-0.25	0.25				Interest rates will remain on hold, but Fed is likely to remain very active on the UST market.
	Market implied »				0	-1	-1	
Poland	Forecast	4.25	4.25	3.50				We uphold our stance that the Council cuts rates by 25bps. Probability of a more aggressive monetary easing has increased recently.
	Market implied »				-26	-63	-95	
Czech	Forecast	0.05	0.05	0.05				We uphold our stance that the CNB will concentrate fully on unconventional tools (FX intervention is still very probable).
	Market implied »				30	25	15	
Hungary	Forecast	5.75	5.75	5.00				NBH will continue monetary easing cycle due to weak GDP growth. However, the upcoming change of leadership in 1Q13 poses a significant risk to markets.
	Market implied »				-14	-52	-96	

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

Economic Calendar and Events

Date		Event:	Note:
9-Jan	**PL**	**MPC Meeting – interest rate decision**	**We foresee the MPC to cut rates by 25bps**
	DE	Auction of 5Y bonds	Offer: €5bn
10-Jan	EZ	ECB Meeting – interest rate decision	-
	SP	Auction of medium and long terms bonds	Offer: €3.5-4.5bn
11-Jan	IT	Auction of 3Y bonds	-
15-Jan	**PL**	**CPI for December**	**Our forecast: 2.4%YoY (slightly below consensus)**
16-Jan	**PL**	**Core inflation measures for December**	**We expect core inflation exc. food & energy prices at 1.6%YoY**
	DE	Auction of 10Y	Offer: €5bn
17-Jan	SP	Auction of bonds	-
18-Jan	**PL**	**Employment and wages for December**	**In line with market consensus we expect employment decline by 0.4%YoY and subdued growth in wages by 1.9% YoY**
	PL	**Industrial output and PPI for December**	**Our forecast of industrial output: -10.3%YoY, the most pessimistic. We predict PPI at -0.6%YoY**
21-Jan	EZ	Eurogroup meeting	
22-Jan	EU	Ecofin meeting	
23-Jan	**PL**	**Auction of OK0715 / PS0418**	**Offer: PLN5.0-10.0bn**
28-Jan	IT	Auction of medium and long term bonds	-
29-Jan	HU	NBH Meeting – interest rate decision	-
30-Jan	IT	Auction of medium and long term bonds	
	DE	Auction of 30Y bonds	Offer: €2bn
6-Feb	**PL**	**MPC Meeting – interest rate decision**	
	CZ	CNB Meeting – interest rate decision	
	DE	Auction of 5Y bonds	Offer: €4bn
7-Feb	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	1,594.7	1,634.9	370.7	388.3	392.1	443.6	377.2	396.2	400.7	460.8
GDP	%YoY	3.9	4.3	1.8	1.2	3.6	2.3	1.4	0.5	0.2	0.9	1.1	2.2
Domestic demand	%YoY	4.6	3.4	-0.4	0.0	2.5	-0.4	-0.7	-2.5	-1.6	-0.4	0.4	1.4
Private consumption	%YoY	3.2	2.5	0.9	1.4	1.7	1.2	0.1	0.4	1.1	1.3	1.6	1.8
Fixed investments	%YoY	-0.4	9.0	-1.0	-2.5	6.0	1.3	-1.5	-4.4	-5.0	-4.0	-2.0	-1.0
Unemployment rate [a]	%	12.4	12.5	13.4	13.9	13.3	12.3	12.4	13.4	14.7	13.1	13.4	13.9
Current account balance	EURm	-18,129	-17,977	-12,525	-5,019	-4,515	-2,203	-3,367	-2,440	-2,123	-850	-1,538	-508
Current account balance	% GDP	-5.1	-4.9	-3.3	-1.3	-5.1	-4.6	-4.1	-3.3	-2.6	-2.3	-1.8	-1.3
General government balance	% GDP	-7.9	-5.0	-3.5	-3.5	-	-	-	-	-	-	-	-
CPI	%YoY	2.6	4.3	3.7	1.7	4.1	4.0	3.9	2.9	1.7	1.3	1.7	2.1
CPI [a]	%YoY	3.1	4.6	2.4	2.3	3.9	4.3	3.8	2.4	1.6	1.2	1.9	2.3
CPI excluding food and energy prices	%YoY	1.6	2.4	2.2	1.9	2.5	2.5	2.1	1.7	1.8	1.6	1.9	2.2
EUR/PLN	PLN	3.99	4.12	4.19	4.14	4.23	4.26	4.14	4.11	4.12	4.17	4.16	4.10
USD/PLN	PLN	3.02	2.96	3.26	3.17	3.23	3.32	3.31	3.17	3.16	3.26	3.17	3.08
CHF/PLN	PLN	2.90	3.34	3.47	3.45	3.50	3.55	3.44	3.40	3.42	3.48	3.46	3.42
GBP/PLN	PLN	4.66	4.75	5.16	5.01	5.07	5.26	5.22	5.09	5.10	5.07	4.96	4.93
Reference rate [a]	%	3.50	4.50	4.25	3.50	4.50	4.75	4.75	4.25	3.75	3.50	3.50	3.50
WIBOR 3M	%	3.94	4.54	4.91	3.67	4.97	5.04	5.06	4.58	3.79	3.57	3.62	3.69
Yield on 2-year T-bonds	%	4.72	4.81	4.30	3.43	4.66	4.71	4.22	3.61	3.04	3.24	3.62	3.84
Yield on 5-year T-bonds	%	5.31	5.44	4.53	3.60	5.02	4.93	4.43	3.75	3.14	3.37	3.81	4.08
Yield on 10-year T-bonds	%	5.74	5.98	5.02	4.10	5.58	5.38	4.91	4.22	3.65	3.87	4.31	4.58

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

This analysis is based on information available until 7th January 2013 and has been prepared by:

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