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## Table of contents



## Comment on the upcoming data and forecasts

We kick off with current account data released by the NBP. We expect the CA deficit to have declined slightly mainly due to a larger trade surplus (weak exports but even weaker imports). On Monday the Central Statistical Office will publish latest CPI figure. Our below-consensus forecast is based on revised (using Czech and Hungarian data) projection of food prices. Core inflation is likely to have declined even further (to 1,0% y/y) - official figure will be published by the NBP on Tuesday. Wednesday brings labor market data. We expect that a marginally larger (as compared to the previous month) y/y decline in employment will be accompanied by modest wage growth. The latter was probably brought down by working day effects and weather-related problems in construction sector. Finally, data from the industrial sector (Thursday) will confirm our rather gloomy view of Polish economy. Because of weather-related disruprions and delays, as well as unfavourable difference in working days industrial output has likely fallen even deeper on a y/y basis (same applies to construction output). Price pressures were probably contained, as commodities prices fell and business tendency indicators signalled no significant price hikes.

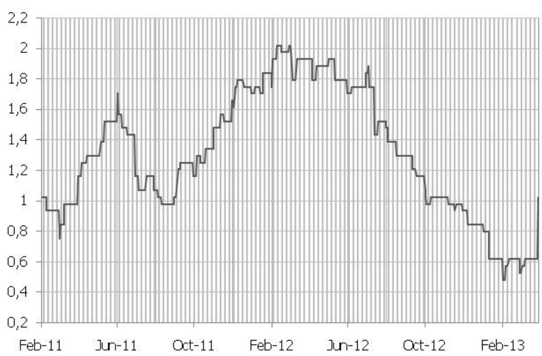
### Polish data to watch: April 15th to April 19th

| Publication | Date | Period | BRE | Consensus | Prior |
|---|---|---|---|---|---|
| CPI y/y (%) | 15.04 | Mar | 1.0 | 1.1 | 1.3 |
| Current Account (mio EUR) | 15.04 | Feb | -1201 | -1507 | -1546 |
| Corp. wages y/y (%) | 17.04 | Mar | 1.8 | 2.8 | 4.0 |
| Corp. employment y/y (%) | 17.04 | Mar | -0.9 | -0.9 | -0.8 |
| Industrial output y/y (%) | 18.04 | Mar | -2.5 | -2.5 | -2.1 |
| PPI y/y (%) | 18.04 | Mar | -0.6 | -0.5 | -0.4 |

### Treasury bonds and bills auctions

| Paper | Next auction | Last Offer | Last yield (%) | Prev auction |
|---|---|---|---|---|
| 52 Week T-bills | - | 3000 | 3.485 | 3/4/2013 |
| 2Y T-bond OK0715 | 4/25/2013 | 3000 | 3.170 | 3/22/2013 |
| 5Y T-bond PS0418 | 4/25/2013 | 3000 | 3.432 | 3/22/2013 |
| 10Y T-bond DS1023 | - | 3000 | 3.515 | 4/11/2013 |
| 20Y T-bond WS0429 | - | 4000 | 3.896 | 1/7/2013 |

### Reality vs analysts' expectations (surprise index* for Poland)




**Comment**

With almost no publications (only M3) surprise index remained unchanged. Due to harsh winter conditions in March, there is some potential for negative surprises in next week's data releases (industrial output is the most likely suspect).

* Surprise index presents in a synthetic way how the market was surprised by macroeconomic releases (it is constructed on daily basis as weighted average of differences between selected releases and Bloomberg forecast consensus).

## Our view in a nutshell

### Fundamentals

- We see more risks towards stagnation (not contraction) in H1 2013. External developments (moderate growth in Germany set to come no sooner than at the turn of H1/H2, zero growth in euro zone) are not dynamic enough to offset deceleration in domestic demand. Consumption growth close to zero (low savings rate, deleveraging urgently needed), negative investment growth rate (public investment as an original damper to growth, private investment to dip into negative territory soon on weak demand prospects), restrictive fiscal policy.
- A faster re-acceleration of the euro zone economy and low statistical base seem to be the most obvious reasons for a rebound of the Polish economy in H2 2013. However, given the scale of slack in investment and consumption, any rebound generated this way may be only moderate (about 2%y/y growth rates in Q4 2013). Poland has entered a period of weaker growth.
- Polish government committed to the convergence path, though in an unorthodox way. Very limited room for fiscal stimulation due to limited financial markets tolerance for higher debt. The government prepares the markets for a budget revision (Kotecki: „a revision should be regarded a standard step given volatile growth conditions").
- Inflation set to moderate in mid-term on lower core inflation (below 1% in mid 2013). CPI inflation much below 1% in Q2 2013. The possibility for significant undershooting of inflation target in 2013 is our base case.
- Although the MPC tried to communicate the end of the easing cycle after 50bp cut in March we believe more cuts are possible on the basis of weak macroeconomic conditions and persisting low interest rates environment in Europe.

### Financial markets

- Given our below consensus view on growth and NBP rates we stay bullish on short-term bonds. Note that NBP may also use uconventional tools to boost banks' demand for government papers.
- Over the next few months we are also constructive on Polish long term bonds. MPC (through steepening of the curve) made long-term papers more attractive and provided foreign investors with arguments against leaving the Polish bond market. No major credit repricing of POLGBs yet (budget adjustment seems to be already priced in). Poland will preserve its quasi safe haeven status and benefit from low yield environment in Europe.
- Ultimately, global recovery (or monetary stimulus withdrawal) and rising core yields may adversely affect Polish bonds (only modestly higher yields). This, however, seems to be a strory for more distant future (6 months plus).
- Cyclical behavior of the Polish zloty far more moderate than in 2008-2011 as current account has been narrowing and euro zone disintegration risks were put aside with ECB put. Hence we expect only slight weakening of the zloty with 4.22/25 (technical analysis) acting as a strong resistance.
- Volatility on both FX and FI lower.

### BRE forecasts

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 F |
|---|---|---|---|---|---|---|
| GDP y/y (%) | 5.1 | 1.6 | 3.9 | 4.3 | 2.0 | 1.0 |
| CPI Inflation y/y (average %) | 4.3 | 3.5 | 2.8 | 4.2 | 3.7 | 1.1 |
| Current account (%GDP) | -5.3 | -1.6 | -4.5 | -4.9 | -3.6 | -2.5 |
| Unemployment rate (end of period %) | 9.5 | 12.1 | 12.4 | 12.5 | 13.4 | 14.2 |
| Repo rate (end of period %) | 5.00 | 3.50 | 3.50 | 4.50 | 4.25 | 2.75 |

| | 2012 Q1 | 2012 Q2 | 2012 Q3 | 2012 Q4 | 2013 Q1 F | 2013 Q2 F | 2013 Q3 F | 2013 Q4 F |
|---|---|---|---|---|---|---|---|---|
| GDP y/y (%) | 3.6 | 2.3 | 1.4 | 1.1 | 0.4 | 0.8 | 1.2 | 1.7 |
| Individual consumption y/y (%) | 1.7 | 1.2 | 0.1 | -1.0 | 0.3 | 1.0 | 1.6 | 1.9 |
| Public Consumption y/y (%) | -0.8 | 0.5 | 0.2 | 0.2 | 0.5 | 0.5 | 0.5 | 0.5 |
| Investment y/y (%) | 6.0 | 1.3 | -1.5 | -0.3 | -4.5 | -4.5 | -3.0 | -2.5 |
| Inflation rate (% average) | 3.9 | 4.0 | 3.9 | 2.9 | 1.4 | 0.9 | 0.8 | 1.1 |
| Unemployment rate (% eop) | 13.3 | 12.4 | 12.4 | 13.4 | 14.4 | 13.9 | 13.5 | 14.2 |
| NBP repo rate (% eop) | 4.50 | 4.75 | 4.75 | 4.25 | 3.25 | 3.00 | 2.75 | 2.75 |
| Wibor 3M (% eop) | 4.94 | 5.13 | 4.92 | 4.11 | 3.39 | 3.20 | 2.95 | 2.95 |
| 2Y Polish bond yields (% eop) | 4.62 | 4.60 | 4.05 | 3.14 | 3.19 | 2.90 | 2.70 | 2.70 |
| 10Y Polish bond yields (% eop) | 5.50 | 5.15 | 4.69 | 3.74 | 3.94 | 3.40 | 3.50 | 3.70 |
| EUR/PLN (eop) | 4.15 | 4.22 | 4.12 | 4.08 | 4.18 | 4.15 | 4.05 | 4.00 |
| USD/PLN (eop) | 3.11 | 3.35 | 3.20 | 3.09 | 3.26 | 3.25 | 3.24 | 3.20 |

F - forecast

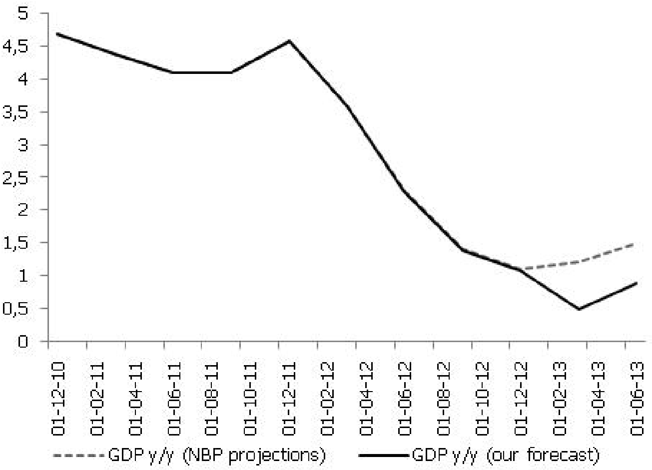
# Economics

## MPC leaves rates unchanged, further cuts still possible

The Monetary Policy Council did not surprise this time and left interest rates unchanged (repo rate at 3.25%). Despite more optimistic assessment of global business climate (as the US appears to enter another soft patch, this view seems slightly outdated), the Council acknowledged that the Polish economy is still weak and that any future rebound would probably be modest.

The last paragraph of the statement turned out to be similiar to the one released after February meeting. It reads: ”The Council’s decisions in the following months will depend on the assessment of the incoming data with regard to the probability of inflation remaining markedly below the NBP inflation target in the medium term and regarding economic activity” Let’s not forget that the Council has already cut rates (in March) after releasing a similiar-sounding statement in February. During the press conference governor Belka directly referred to the issue of ending the easing cycle by saying that ”he has never closed the doors to further easing”. Another cut was not directly announced (Belka’s reluctance can probably be associated with the need to build a new consensus within the Council after the previous decisive move) but the assessment of the economy (inflation below central bank forecasts and low economic growth) suggests just that in the future. His inclination toward continuing the easing could also be inferred from his comments regarding the unprecedented actions by the Bank of Japan, BoJ-related huge flows of Asian funds to the Polish bond market that followed (fears of a ”sudden stop” are therefore subdued for now) and undesirable strenghtening of the Zloty.

Risks of another cut will return in May already. At the June meeting (which takes place after Q1 GDP release) they might just turn the tide. Resumption of easing might, apart from macroeconomic factors (i.e. divergence of GDP and inflation from NBP projections - see graphs below) probably be fueled by monetary expansion in the Eurozone and by final burial of the myth that NBP rates should include a very high risk premium vis-a-vis ultra-low rates in the world (or even the region - see Czech Republic). In our view the room for further cuts is larger than 50 bps. If March CPI surprises on the downside (lower than 1% y/y and well below the projection), the market might start to price in a full easing cycle of at least 100 bps. Probability of such event is high, as dynamic disinflation we are experiencing right is not due to an idiosyncratic shock but rather part of a regional (or even pan-European or global - lower food and fuel prices) tendency.




# Fixed income

## One very long week

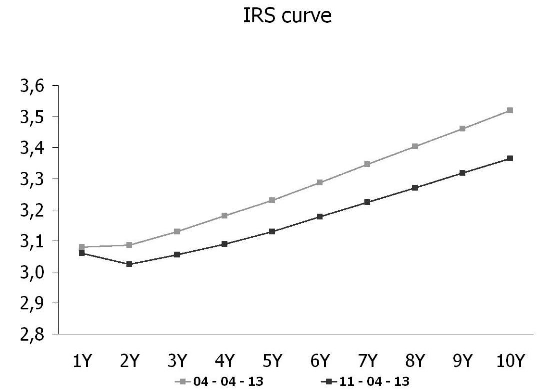
Last week we had some volatility in PLN rates and bonds. Monday huge rally with record low levels on yields and on rates' levels, Wednesday RPP decision with pretty neutral comments (taken by market as not so dovish to allow further rally in rates), Thursday auction, which triggered some profit taking on longer dated bonds (as market was expecting fireworks at record low level of yields) and Friday warning from Moody's about possible negative rating implications should the government decide to move assets from OFE (private pension funds) to the state. All in all, market managed to stabilize very close to all time highs, while some market participants seek way to take a profit or to push yields higher. Main themes of such trades are: 1) future rebound of the economy; 2) very low nominal rates and MPC being hawkish traditionally; 3) growing fiscal risk with budget revision looming.

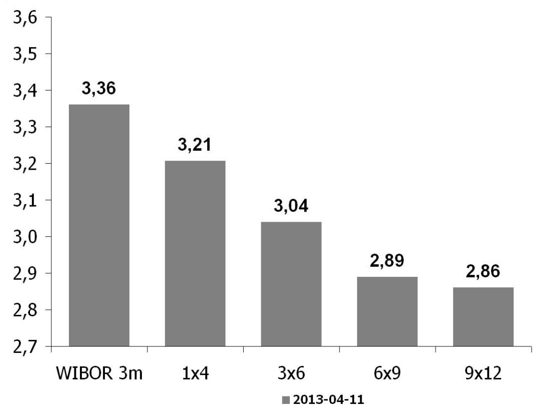
While we understand the fear, let's try to stick to facts (facts, but you may want to call them our opinion as well).

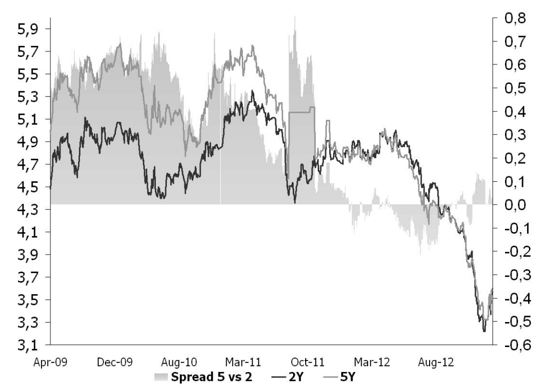
1) Future rebound, honestly, there is no evidence behind such a thesis. What we have, is a possible pattern for future growth which can be spurred by lower official rates. Let's check who benefits from lower rates. It will not be exporters, as lower NBP rate did not manage to weaken EURPLN at all. It will not be consumers, who are still deleveraging and rebuilding savings, also their confidence is not boosted by labor market which is in pretty weak shape. Lastly, investment is more dependent on economic sentiment and future return rates, Poland was doing perfectly fine with much higher rates when growth prospects were rosy, and lower NBP rate is not the tool to address the issue. All in all, promise of future growth is in our opinion equal to risk of further weakness in the economy, especially if we look at what is happening in core Europe.

2) Hawkish MPC did cut rates by 150 bp in 4 months cutting by 50 bp in the meeting they had decided to wait for the effect of the cuts. We think if they manage to stay equally hawkish with CPI heading to 0.5% pretty fast and growth prospects being only a promise (not to mention other CB actions which Belka may not appreciate but still he lives in the world where monetary policy has to be an effective tool), we can count on further rates reductions (again more to what market ever priced before they were actually delivered).

3) Fiscal side only confirms how weak Polish economy is, extra issuances are granted but there is silver lining to it. Poland can actually afford some fiscal stimulation (since Belka and MPC folks are trying to run "conventional" monetary policy) with very little harm to the market. And let's be serious, we are talking about 10-15 bio more of bonds this year, it is hard to imagine that it will end in something more serious than a 5-10 bp move on yields. We are entering a period of economic releases which should point to further economic deceleration. Most likely we will have some comments from MPC members (which are equal to noise in our opinion). Lastly MinFin is preparing the market for budget amendment and will also try to sell OFE reform as market-friendly. Preference is to stay receive in rates up to 2y, we also think bonds up to 5y offer value here. We prefer to stay with facts.

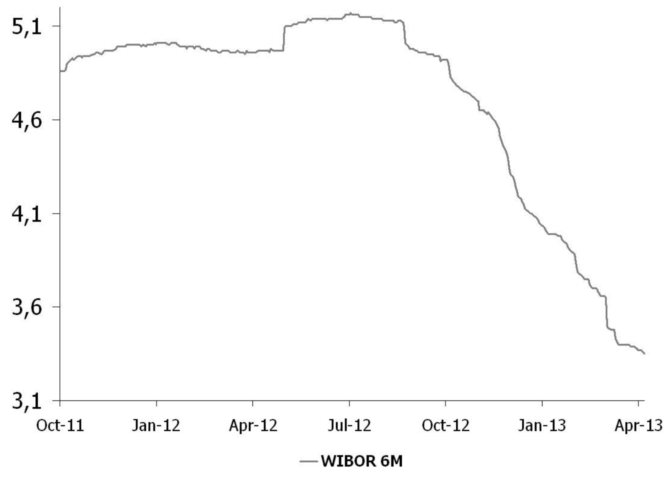



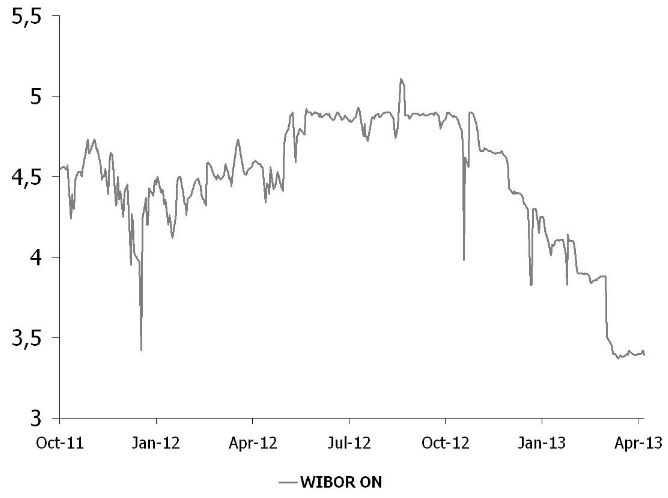



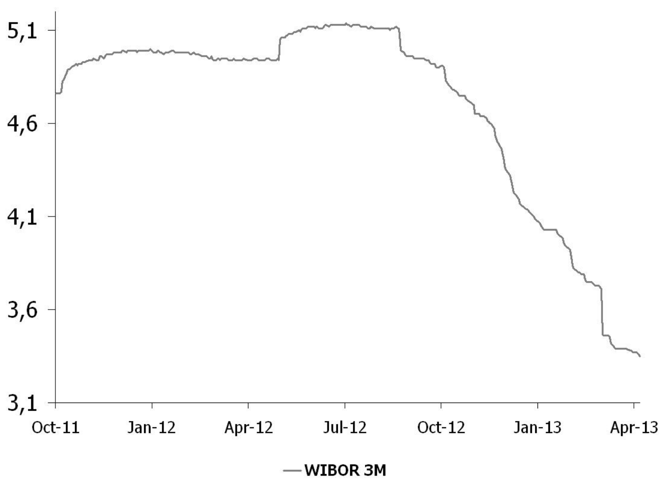
## Money market

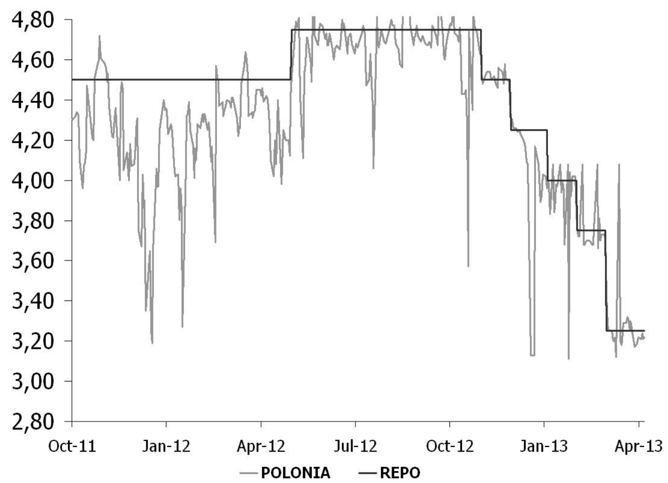
**Additional OMO possible** 124 bln worth of money bills taken during today's OMO. The supply was 4 bln pln higher and we perceive this 4 bln as necessary to square the market. Therefore, additional OMO on Tuesday is likely.

**Some more cuts ahead?** Volatile week with the MPC decision on the table. No one was expecting the cut but everyone was waiting for the comments afterwards. The tone was on the dovish side with high data dependency and "not a closed door" story (50 bps cut in March and the comment after were pointing the end of the cycle at least for the majority of market participants). Therefore, we think that May meeting can bring the announcement of the cut in July. We also see high probability of another cycle (50-75 bps further cuts) and not one-off event on top of previous steps. Coming data (low CPI and weak IO) will definitely support the bulls. We think that now is the time to close any payers and re-enter receivers. We again like buying belly curve bonds and selling OISs (OIS lag FRA expectations by some 25 bps).



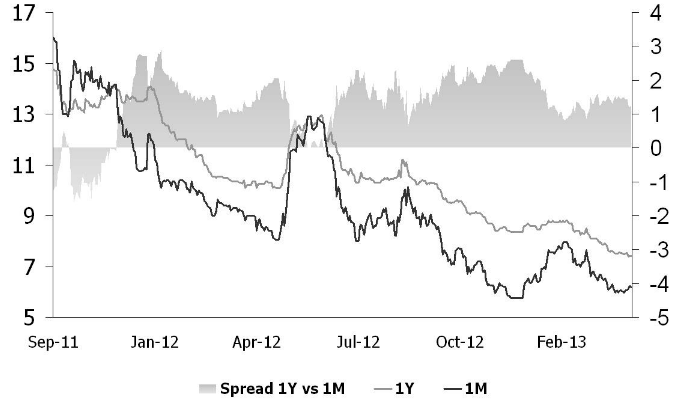



# Forex

**Strong gains.** The Japanese euphoria reached Poland. EUR/PLN has dropped like a stone from 4.1900 last Friday to 4.0930 this Thursday. The speed of the move has taken many (us at least) by the surprise. We don't really see a fundamental link between starting QE in Japan (which will be gradually released during next 2 years), and PLN appreciation of such magnitude. The PLN shorts from Cyprus crisis were the most likely to blame, for that nasty squeeze. There are still hopes for the next rate cut cycle, so we for time being we assume 4.0930 low is in place.

**Tic lower.** The correlation between stronger PLN, lower vol is still alive. And with stronger Zloty the vol curve is a touch lower. Even it is not really logical, as we have witnessed the spike in realized volatility which should support vol. Anyway, EURPLN 1 month atm mid fixed at 6.0% today (unchanged from last week). The 3 month fixed 6.5% and 1 year 7.0% (both periods 0.1% lower). The currency spread (difference between USD/PLN and EUR/PLN) was sold hard, loosing about 0.5% in the backend. The skew was better offered in both currency pairs.

EURPLN volatility



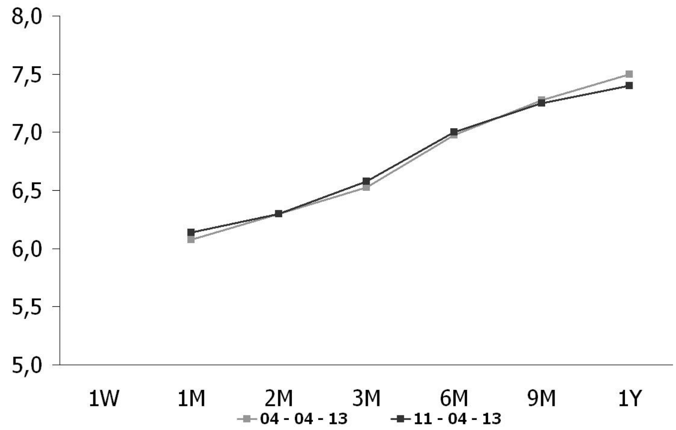

## Short-term forecasts

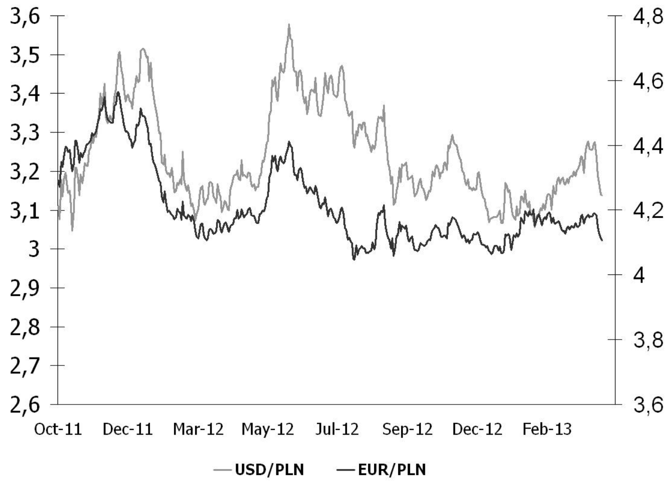
Main supports and resistances
EUR/PLN: 4.0850 / 4.1900
USD/PLN: 3.0500 / 3.3000

**Buy EUR/PLN.** Buy EUR/PLN now (4.1150) add 4.0950, and set stop below 4.0850. We are fading this PLN strength, we still see risks in Europe (Slovenia?), or low CPI number on Monday which may fuel hopes for next rate cuts. Our ideal profit taking is 4.1750.

**Derivatives.** Unchanged from the last alteration of strategy. So, we had changed our selective Vega buying recommendation to a neutral one. The realized volatility is constantly descending (especially if we look at daily basis). It does not bode well for Vega longs. The vols are cheap, in comparison to the historic ones, but they are quite expensive to the realized volatilities. Stay aside.

EUR/PLN volatility curve




Bias from the old parity (%)

# Market prices update

| Money market rates (mid close) | | | | | | | | FRA rates (mid close) | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Date | FXSW 3M | WIBOR 3M | FXSW 6M | WIBOR 6M | FXSW 1Y | WIBOR 1Y | 1x4 | 3x6 | 6x9 | 9x12 | 12x15 | 6x12 |
| 4/6/2013 | 3.12 | 3.37 | 3.10 | 3.27 | 3.09 | 3.27 | 3.24 | 3.02 | 2.85 | 2.82 | 2.82 | 2.83 |
| 4/7/2013 | 3.12 | 3.37 | 3.10 | 3.27 | 3.09 | 3.27 | 3.24 | 3.02 | 2.85 | 2.82 | 2.82 | 2.83 |
| 4/9/2013 | 3.10 | 3.36 | 3.00 | 3.26 | 3.01 | 3.26 | 3.17 | 3.03 | 2.84 | 2.81 | 2.82 | 2.86 |
| 4/10/2013 | 3.09 | 3.36 | 3.02 | 3.26 | 3.04 | 3.26 | 3.21 | 3.04 | 2.86 | 2.82 | 2.86 | 2.88 |
| 4/11/2013 | 3.06 | 3.35 | 3.02 | 3.25 | 3.07 | 3.25 | 3.21 | 3.04 | 2.89 | 2.86 | 2.88 | 2.92 |

| Last primary market rates | | | | | | | |
|---|---|---|---|---|---|---|---|
| Paper | Au. date | Maturity | Avg. price | Avg. yield | Supply | Demand | Sold |
| 52W TB | 5/30/2011 | 5/30/2012 | 95.57 | 4.58 | 600 | 2667 | 505 |
| OK0114 | 8/10/2011 | 1/25/2013 | 89.58 | 4.58 | 5000 | 4934 | 1889 |
| PS1016 | 10/19/2011 | 10/25/2016 | 98.44 | 5.11 | 3600 | 11200 | 3638 |
| DS1021 | 7/21/2011 | 10/25/2021 | 99.53 | 5.80 | 3000 | 5608 | 3000 |

| Fixed income market rates (closing mid-market levels) | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Date | 1Y WIBOR | 1Y T-bill | 2Y IRS | OK0113 | 5Y IRS | PS0416 | 10Y IRS | DS1019 |
| 4/6/2013 | 3.270 | 3.353 | 3.292 | 3.275 | 3.420 | 3.351 | 3.630 | 3.873 |
| 4/7/2013 | 3.270 | 3.114 | 3.263 | 3.148 | 3.370 | 3.270 | 3.575 | 3.755 |
| 4/9/2013 | 3.260 | 2.992 | 3.218 | 3.137 | 3.325 | 3.237 | 3.525 | 3.759 |
| 4/10/2013 | 3.260 | 2.992 | 3.218 | 3.137 | 3.325 | 3.237 | 3.525 | 3.759 |
| 4/11/2013 | 3.250 | 2.992 | 3.218 | 3.137 | 3.325 | 3.237 | 3.525 | 3.759 |

| EUR/PLN 0-delta stradle | | | | | 25-delta RR | | 25-delta FLY |
|---|---|---|---|---|---|---|---|
| Date | 1M | 3M | 6M | 1Y | 1M | 1Y | 1Y |
| 4/6/2013 | 6.08 | 6.50 | 6.93 | 7.53 | 7.53 | 2.68 | 0.64 |
| 4/7/2013 | 6.08 | 6.50 | 6.93 | 7.53 | 7.53 | 2.68 | 0.64 |
| 4/9/2013 | 6.23 | 6.55 | 7.00 | 7.43 | 7.43 | 2.65 | 0.71 |
| 4/10/2013 | 6.18 | 6.58 | 7.05 | 7.43 | 7.43 | 2.65 | 0.71 |
| 4/11/2013 | 6.14 | 6.58 | 7.00 | 7.40 | 7.40 | 2.65 | 0.71 |

| PLN Spot performance | | | | | | |
|---|---|---|---|---|---|---|
| Date | EURPLN | USDPLN | CHFPLN | JPYPLN | HUFPLN | CZKPLN |
| 4/6/2013 | 4.1820 | 3.2358 | 3.4389 | 3.3613 | 1.3903 | 0.1622 |
| 4/7/2013 | 4.1820 | 3.2358 | 3.4389 | 3.3613 | 1.3903 | 0.1622 |
| 4/9/2013 | 4.1298 | 3.1696 | 3.3863 | 3.2033 | 1.3908 | 0.1604 |
| 4/10/2013 | 4.1135 | 3.1405 | 3.3727 | 3.1600 | 1.3868 | 0.1593 |
| 4/11/2013 | 4.1061 | 3.1382 | 3.3691 | 3.1502 | 1.3839 | 0.1585 |

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