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Comment on the upcoming data and forecasts

Because of local holidays, this is a special, two-week edition of our weekly review.

Inflation expectations, as we already noted, are strictly adaptive. Thus, they are set to follow recent drops in CPI inflation. In our view Manufacturing PMI is bound for a small-scale rebound but unfavorable business climate (see recent German releases) prevents any substantial improvements. All eyes will, however, be pointed at the MPC. Contrary to what most analysts predict, we expect the Council to resume easing in May already - for the following reasons. First, recent data releases have shown that the economy not only failed to rebound but also slowed down in a more pronounced way than previously thought (revisions of Q4 GDP put the figure at only 0.7% y/y). Second, there are no clear and inambiguous indications of a future rebound - Q1 and Q2 are set to be just as grim as Q4. Third, inflation has also fallen below NBP's projections and might hit record lows in the summer. Last but not least, comments from relevant MPC members (Hausner) came on the dovish side. Thus, there will probably be a motion to cut rates and it will be supported be enough members of the Concil (with gov. Belka as the swing voter). Even a 50 bps cut (to make up for the time wasted on waiting and seeing) is not out of the question. Especially if the ECB cuts rates next week which looks very likely at the moment.

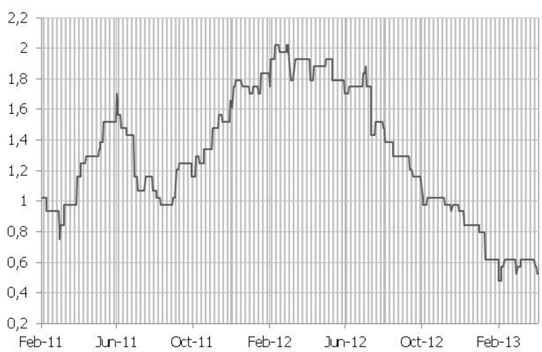
Polish data to watch: April 29th to May 10th

Publication	Date	Period	BRE	Consensus	Prior
NBP Inflation Expectations (%)	30.04	Apr	1.3	1.6	1.6
Manufacturing PMI (pts.)	02.05	Apr	48.5		48.0
MPC decision (%)	08.05	May	2.75	3.25	3.25

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	-	2500	2.748	4/23/2013
5Y T-bond PS0418	-	8000	2.899	4/23/2013
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

Unemployment rate unexpectedly fell, therefore the surprise index registered a rise. We expect the index to remain in horizontal trend for the weeks ahead. The next two weeks bring only one important release but we do not expect it to be a large enough surprise.

* 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 already dipped into negative territory on high uncertainty and 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”).
- We are in the middle of one of the steepest disinflation phases in Polish history. CPI inflation much below 1% in Q2 2013 (close to 0.5% in mid 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 cuts are still in the pipeline on the basis of weak macroeconomic conditions, persisting low interest rates environment in Europe and low inflation. So far we expect 75bp or more.

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 haven 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 story 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	4.5	1.9	1.0
CPI Inflation y/y (average %)	4.3	3.5	2.8	4.2	3.7	0.8
Current account (%GDP)	-5.3	-1.6	-4.5	-4.9	-3.5	-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	2.50

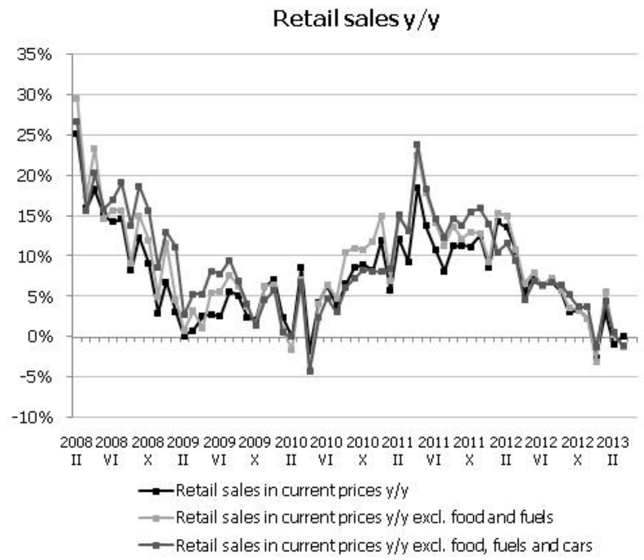
	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2013 Q1 F	2013 Q2 F	2013 Q3 F	2013 Q4 F
GDP y/y (%)	3.5	2.3	1.3	0.7	0.4	0.8	1.2	1.7
Individual consumption y/y (%)	1.7	1.3	0.2	-0.2	0.3	1.0	1.6	1.9
Public Consumption y/y (%)	-1.0	0.4	1.6	-0.6	0.5	0.5	0.5	0.5
Investment y/y (%)	6.8	1.4	-1.7	-4.1	-4.5	-4.5	-3.0	-2.5
Inflation rate (% average)	3.9	4.0	3.9	2.9	1.3	0.6	0.4	0.7
Unemployment rate (% eop)	13.3	12.4	12.4	13.4	14.3	13.9	13.5	14.2
NBP repo rate (% eop)	4.50	4.75	4.75	4.25	3.25	2.50	2.50	2.50
Wibor 3M (% eop)	4.94	5.13	4.92	4.11	3.39	2.70	2.70	2.70
2Y Polish bond yields (% eop)	4.62	4.60	4.05	3.14	3.19	2.50	2.50	2.50
10Y Polish bond yields (% eop)	5.50	5.15	4.69	3.74	3.94	3.40	3.50	3.60
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

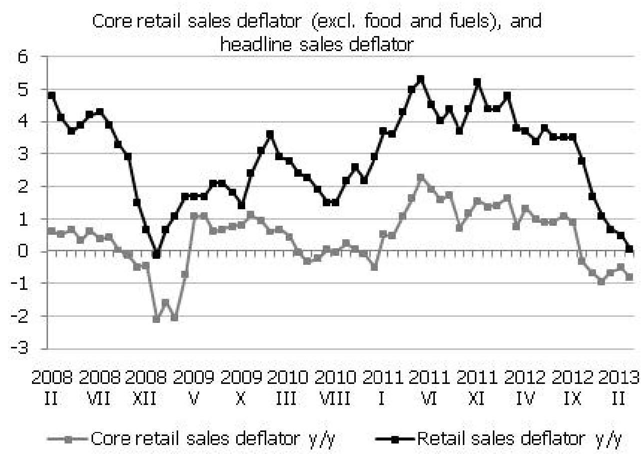
Economics

Retail sales figures indicate a slow rebound in household consumption

Retail sales barely grew in March reaching +0.1% y/y. In real terms sales stagnated. It means that price growth on retail side was close to zero. After stripping fuel and food sales (more or less this reflects the Easter effect) retail sales dropped by 1.2% y/y.



The composition confirms that Easter was responsible for a large chunk of retail sales growth (notable acceleration of food sales from +1.8% to +8.9%). However, sales of durable goods was weak enough to offset this (stagnant sales of home appliances, stable negative growth of auto sales) and "other" category completed the job.

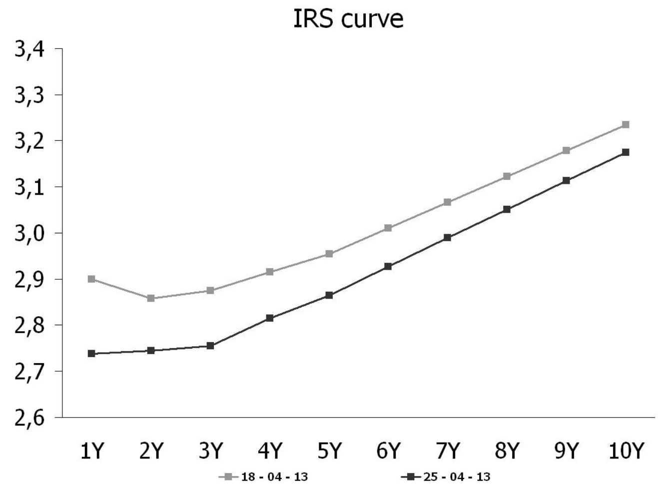


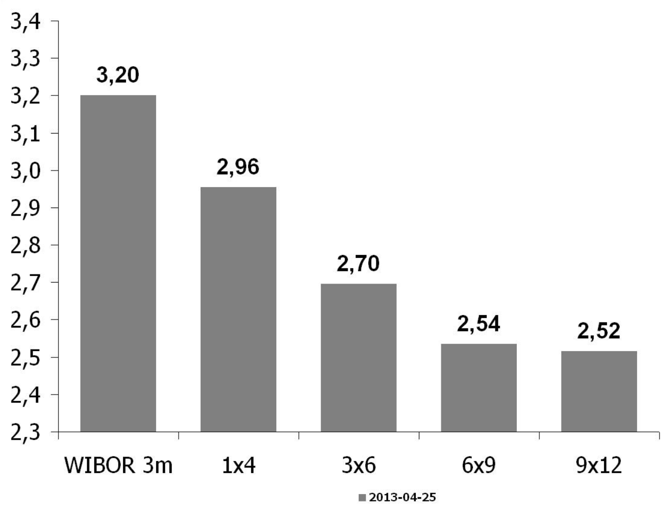
Retail sales were up by 0.4% in real terms in Q1 2013 (vs -0.8% in Q4 2012) which corroborates our view that consumption in Q1 was slightly better at +0,3-0,4% y/y (vs -0.2% in Q4 2012). It is also consistent with accounting based on real disposable income of households. However, such a rebound in consumption carries only statistical flavor since reacceleration is proceeding in a glacial pace, insufficient to bring a turnaround in moods of consumers and firms. As the MPC got stuck in a scenario which did not materialize, ans as economy fails to accelerate and inflation is heading for all-time lows, the only reasonable reaction is to cut rates. We expect this to happen in May already and possibly by 50bps since MPC waited for too long.

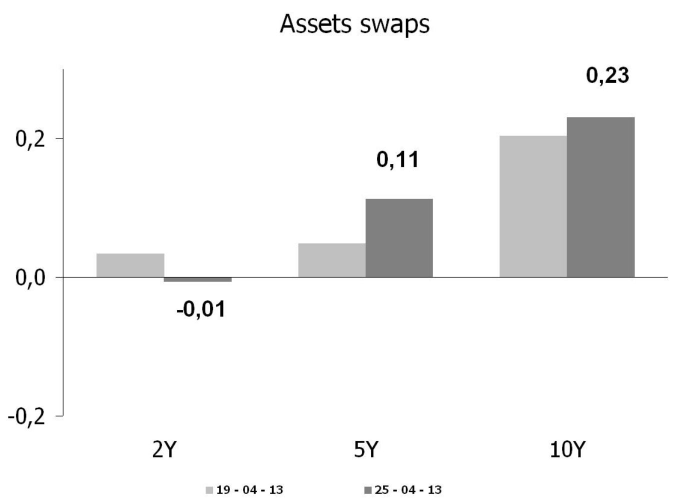
Fixed income

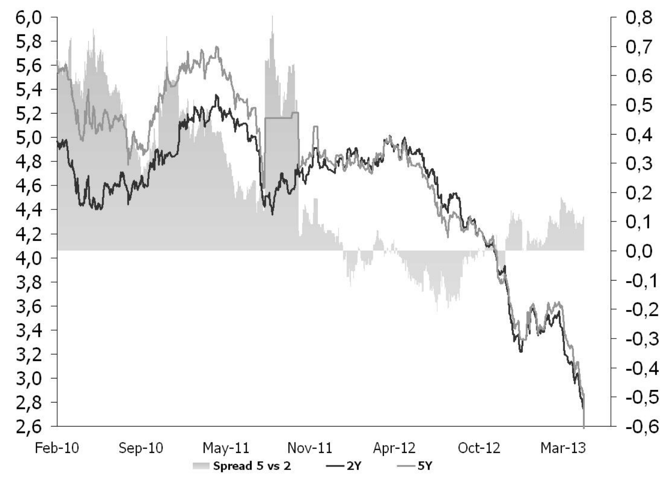
Ahead of long May weekend

Last week we had very big bonds auction with 12 bio of bonds sold into 25 bio demand. We also had quite a significant slide of Wibor rate as locals were lending 6m cash in deposits quite aggressively. We also had GG deficit which came higher compared to market expectations, at 3.9%. For us though, the most important was GDP revision for 4Q 2012 (to 0.7 from 1.1 mainly due to a slump in investment). We learnt two things: 1) economy was/is in much worse shape to what market and MPC thought, 2) market pricing and decisions made by MPC were based on false arguments. Moreover, the trough of economic activity is still likely ahead of us. Market reaction was very strong, especially on the front end of the curve. Market is now implying 3m Wibor to be around 2.5% in 9 months time. 5y bonds yield 2.85% (again heavily below current repo rate). Curve is finally starting to steepen, also on bonds, and while 2y and 5y bonds trade at new high or close to new high 10y bonds are slightly underperforming. We have a week with plenty of local holidays in Poland. As far as strategy, we will have only two real trading days and ECB decision that will come in the middle of the long weekend. Central banks, especially major ones, as compared to NBP can surprise market on the positive side. The problem is that surprise may come on shallow, illiquid market in the middle of a very long weekend. We advice preparing in advance. Stay long bonds up to 5y, stay receive in rates up to 2y.





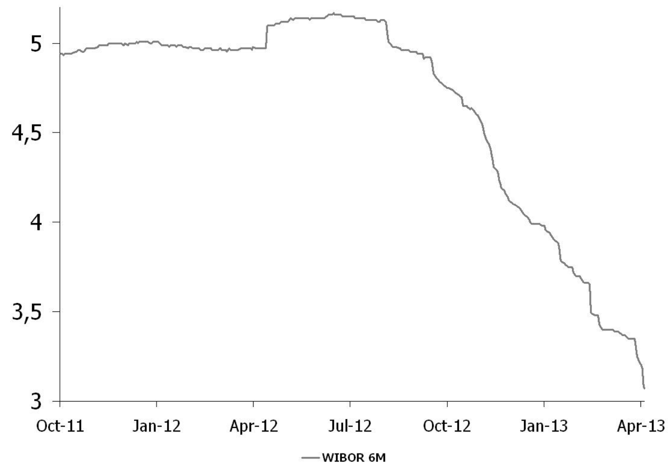


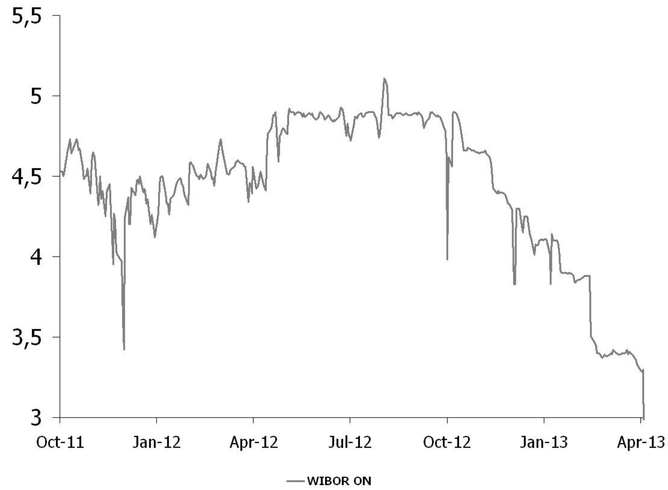


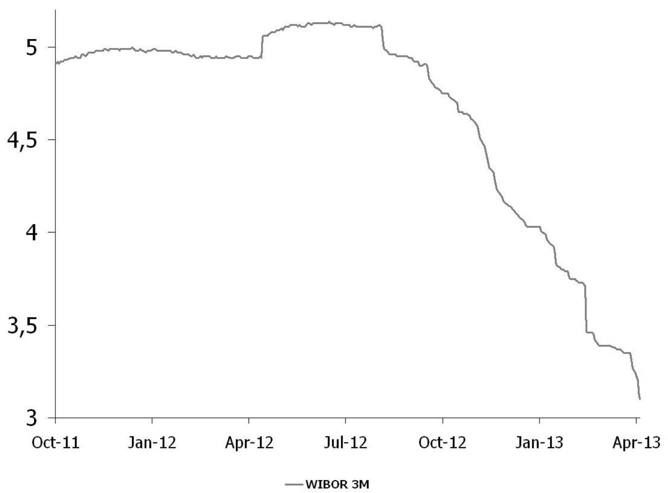
Money market

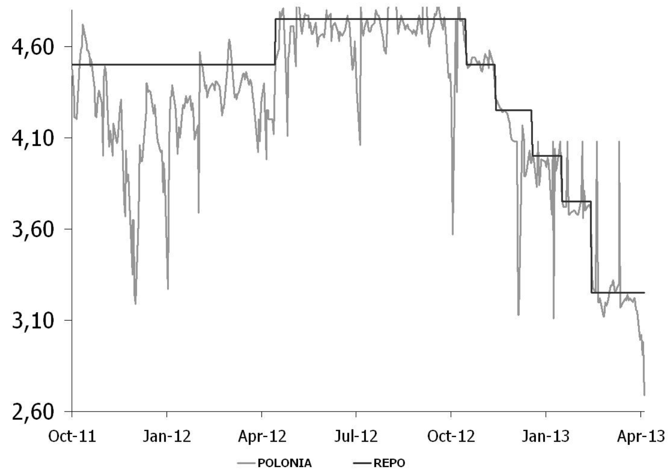
Short cash on the floor level Very cheap end of the reserve requirement settlement period as banks bought 10 bln less money bills yesterday (regular OMO day earlier due to long weekend next week). Shortest rates dropped to 2% and will be back near 3,25% on Monday (regular OMO on the last day of the reserve).

Rally continues Still extremely bullish. Market already prices more then 75 bps cut with the first step expected in May. We tend to start paying rates if 100 bps will be discounted. Short bonds may gain in value further since they lag the IRSs. As of now, short bonds and long OISs are still a good receive idea. FRA and 2Y IRS should be the first choice to pay soon (possibly after CPI for April, if headline comes below 1%).





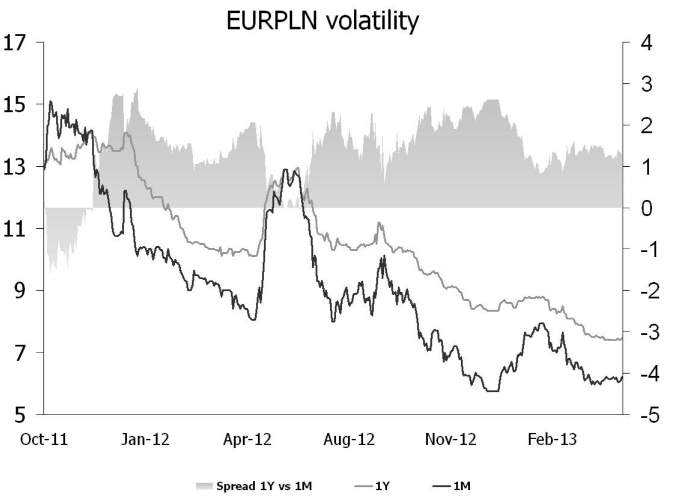




Forex

PLN weaker PLN should've seen it coming. This week finally the post-BOJ euphoria started to evaporate, and stop losses kicked in, this time on PLN longs. The rate cut by MPC is getting more and more certain, with some expecting even 50 BP cut in May, the PLN bears would say. Even though, the rate cuts will weaken local currency only if there will be less demand for Polish bonds, otherwise it will be more less neutral. We are still viewing EUR/PLN as rangy, and ready to fade a big enough move, in either direction.

Vols higher The vols are higher, there is a rare occasion to write that. Of course the bids for short end, gamma dominate but the 2 month EUR/PLN got paid at 6.5% and there were better bids along the curve both EUR/PLN and USD/PLN. 1 month EUR/PLN ATM mid fixed today at 6.5% (0.3% higher), 3 month EURPLN is 6.8 (also 0.3%), the backend 6 month today at 7.1% and 1 year 7.6% moved up by 0.1%. The skew was better bid, with risk reversals higher by 0.25%, especially in the frontend.

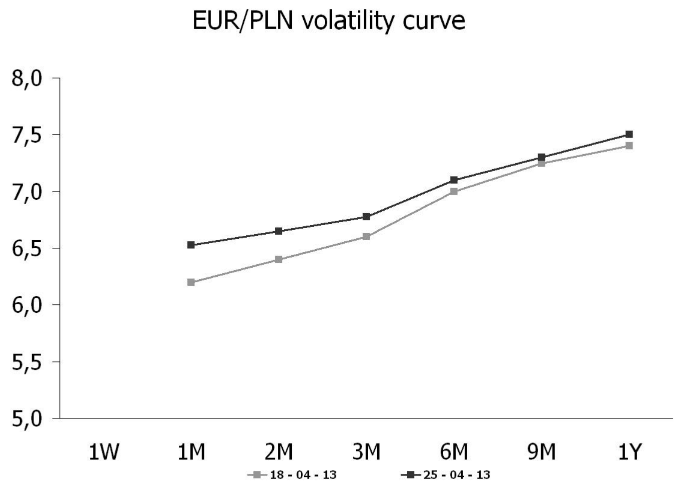


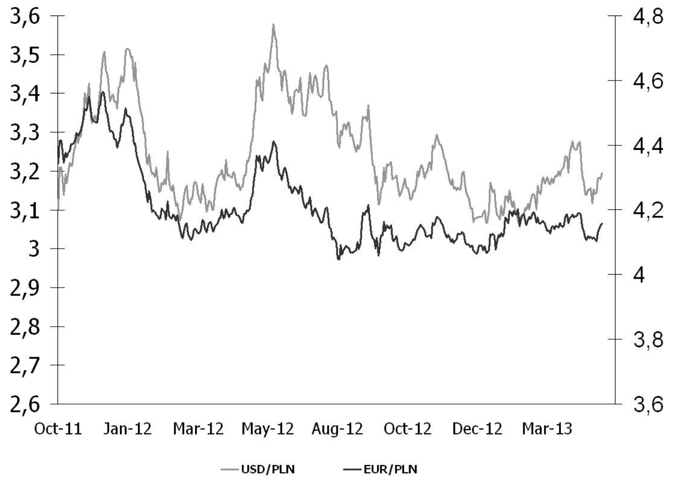
Short-term forecasts

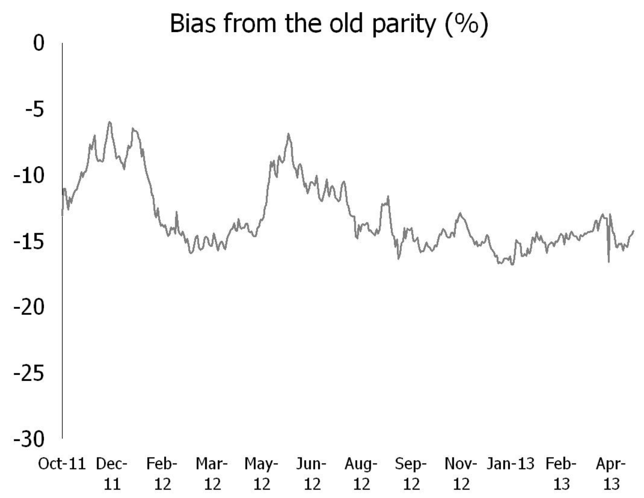
Main supports and resistances
EUR/PLN: 4.0850 / 4.1900
USD/PLN: 3.0500 / 3.3000

Play range. The rate cut, the bond flow, risk on or risk off, it is all smoke in our eyes. The truth is, we are trading water. The 4.09 - 4.19 should cover it. We would like to play that range, by selling 4.1850, adding 4.2050 with stop above 4.23 and hopes for 4.12. Or alternatively buy EUR/PLN at 4.11, add 4.09 with stop below 4.07 and eyes firmly on 4.1800 . We are not really biased to the former or the latter, whatever comes first.

Derivatives. We have 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.







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
4/20/2013	2.98	3.27	2.93	6.49	2.97	6.59	3.08	2.82	2.63	2.61	2.63	2.65
4/21/2013	2.98	3.27	2.93	6.49	2.97	6.59	3.08	2.82	2.63	2.61	2.63	2.65
4/23/2013	2.87	3.22	2.77	3.10	2.76	3.09	2.99	2.73	2.52	2.52	2.54	2.54
4/24/2013	2.94	3.20	2.88	3.08	2.82	3.07	3.00	2.76	2.56	2.54	2.58	2.57
4/25/2013	2.81	3.14	2.80	3.00	2.77	2.97	2.96	2.70	2.54	2.52	2.54	2.54

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
4/20/2013	6.590	3.353	3.292	3.275	3.420	3.351	3.630	3.873
4/21/2013	6.590	3.114	3.263	3.148	3.370	3.270	3.575	3.755
4/23/2013	3.090	2.992	3.218	3.137	3.325	3.237	3.525	3.759
4/24/2013	3.070	2.992	3.218	3.137	3.325	3.237	3.525	3.759
4/25/2013	2.970	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
4/20/2013	6.04	6.49	6.98	7.45	7.45	2.49	0.64
4/21/2013	6.04	6.49	6.98	7.45	7.45	2.49	0.64
4/23/2013	6.08	6.58	7.03	7.43	7.43	2.52	0.71
4/24/2013	6.21	6.70	7.08	7.45	7.45	2.57	0.71
4/25/2013	6.53	6.78	7.10	7.50	7.50	2.57	0.71

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
4/20/2013	4.1118	3.1409	3.3777	3.1652	1.3761	0.1592
4/21/2013	4.1118	3.1409	3.3777	3.1652	1.3761	0.1592
4/23/2013	4.1293	3.1811	3.3840	3.2239	1.3737	0.1590
4/24/2013	4.1403	3.1823	3.3682	3.1952	1.3816	0.1597
4/25/2013	4.1518	3.1792	3.3648	3.2010	1.3760	0.1604

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