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Comment on the upcoming data and forecasts

May PMI data will be published on Monday. Although data from last month (positive surprises from German economic indicators, decent industrial production growth and increase of Polish official indicators published by Statistical Office) created some space for PMI growth, some dark sides from their detailed analysis almost disqualify increase above recessionary 50 pts. On Wednesday MPC will announce its June decision. Latest negative surprises affected MPC's rethoric and therefore we expect another rate cut on June meeting. 25bp. seem most probable, but we do not exclude chances for 50 bp. cut as the Council might want to speed up after misdiagnosis of the economic upturn. Latest zloty depraciation should not affect the decision in June.

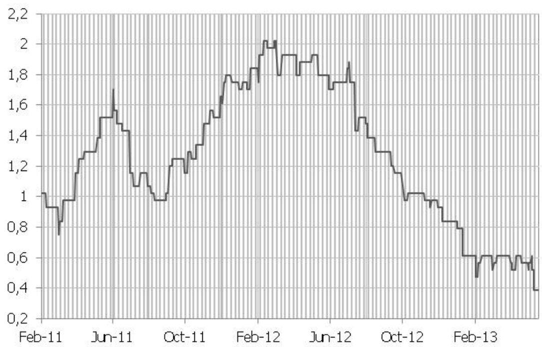
Polish data to watch: June 3rd to June 7th

Publication	Date	Period	BRE	Consensus	Prior
PMI (pts)	3.06.	May	48.0	47.8	46.9
MPC decision (%)	5.06.	Jun	2.75	2.75	3.00

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	6/6/2013	5500	2.550	5/9/2013
10Y T-bond DS1023	-	3000	3.290	5/16/2013
20Y T-bond WS0429	-	150	3.464	5/16/2013

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



Comment
No surprise from the only GDP final publication (details read in macro section) enabled surprise index to remain unchanged. Still, we see high probability that the index has not reached its bottom yet (many May data may surprise on the downside).

* 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 revival 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 rate 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 close to 0% in mid 2013. The possibility for significant undershooting of inflation target in 2013 is our base case.
- Although the MPC is unwilling to communicate a launch of a new easing cycle we believe further cuts are still in the pipeline on the basis of weak macroeconomic conditions, persisting low interest rates environment in Europe and low inflation. Moreover, individual members have recently turned more dovish. So far we expect reference rate to fall to 2.25%.

Financial markets

- Given our below consensus view on growth, inflation and NBP rates we stay contructive on short-term bonds (we acknowledge that the biggest move has already materialized). Note that NBP may also use uconventional tools to boost banks’ demand for government papers.
- Ultimately, global recovery (or monetary stimulus withdrawal) and rising core yields may adversely affect Polish bonds.
- The ”wall of money” obscured the cyclicality of the Polish currency. This fact was revealed when expectations on QE tapering accelerated and the zloty dynamically breached 4.22/25 and broke out of the 1 year range. Although we think that the market probably overshoot the timing of QE tapering, the environment changed towards less zloty friendly. Therefore we expect a return below 4.20 no sooner than when economy accelerates visibly (long into H2) or rate cut expectations halt and begin to turn-around (a turn of 2013/2014).

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	0.7
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	13.9
Repo rate (end of period %)	5.00	3.50	3.50	4.50	4.25	2.25

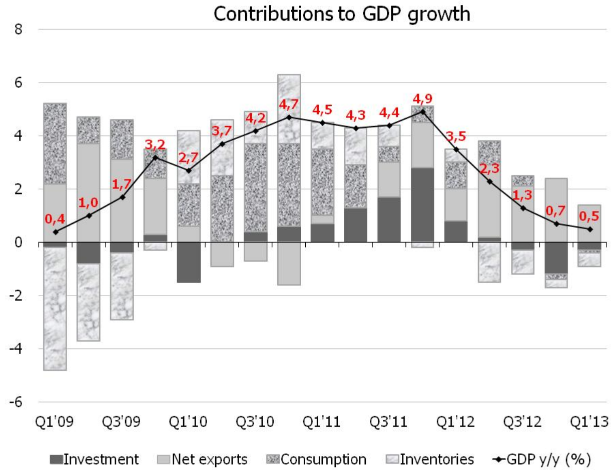
	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2013 Q1 F	2013 Q2 F	2013 Q3 F	2013 Q4 F
GDP y/y (%)	3.5	2.3	1.3	0.7	0.5	0.6	1.2	1.7
Individual consumption y/y (%)	1.7	1.3	0.2	-0.2	0.0	0.5	1.3	1.9
Public Consumption y/y (%)	-1.0	0.4	1.6	-0.6	-0.5	0.5	0.5	0.5
Investment y/y (%)	6.8	1.4	-1.7	-4.1	-2.0	-4.5	-3.0	-2.5
Inflation rate (% average)	3.9	4.0	3.9	2.9	1.3	0.6	0.2	0.7
Unemployment rate (% eop)	13.3	12.4	12.4	13.4	14.3	13.4	13.3	13.9
NBP repo rate (% eop)	4.50	4.75	4.75	4.25	3.25	2.75	2.25	2.25
Wibor 3M (% eop)	4.94	5.13	4.92	4.11	3.39	2.95	2.45	2.45
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	4.25	4.20	4.15
USD/PLN (eop)	3.11	3.35	3.20	3.09	3.26	3.33	3.36	3.46

F - forecast

Economics

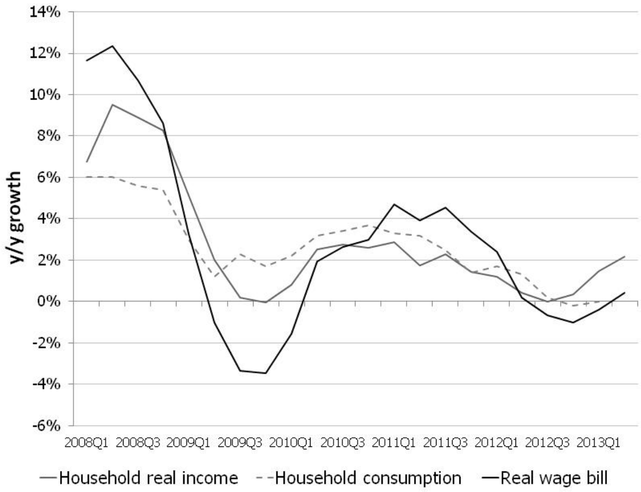
Q1 GDP growth confirms business activity worsened. The trough has been reached, though.

Q1 GDP growth was better than stipulated by the flash reading (+0.5% vs +0.4%) but still worse than the results for Q4 2012 when +0.7% was reached. Business activity worsened further but we think the trough has already been reached.



Domestic consumption was stagnant in Q1, investment dropped by 2% (previously by 4.1%). The comparison of value added in construction (solid deceleration towards double-digit decreases) and the overall growth of investment suggests private investment posed a sort of a turnaround in Q1, at least according to quarterly data. Higher frequency data do not confirm this view. We only want to remind the readers that recently, after revisions, investment growth converged to the number derived from high frequency data. As for other components, inventory formation subtracted only 0.5pp. from growth what allowed domestic demand dynamics to come back to levels recorded in Q3 2012 i.e. -0.9%. Net exports added 1.4 pp. to GDP growth and this seems rather a conservative number given our own calculations. The most probable direction of change in GDP composition (after revisions) is the one punishing investment (towards minus 4-5%) and favoring net exports (towards 1.8-2.0%).

We think that the economy reached a trough in Q1. Next quarters are set to bring a turnaround in consumption (along with the increases in real disposable income) but this time investment is going to be slightly lagging the cycle (at least in the very first phase of a turnaround) as firms have to gain confidence in better economic activity. Full year GDP is going to be close to 1%, so less than in 2012, but GDP expansion path is set to be accelerating.



Interest rate market (FRA) reacted with some repricing of rate cuts but it was rather minor. The longer end weakened along with the global fire sale of bonds. EURPLN breached 4.2140 - the level guarding the upside for more than a year; the risk of going further upwards has materially risen.

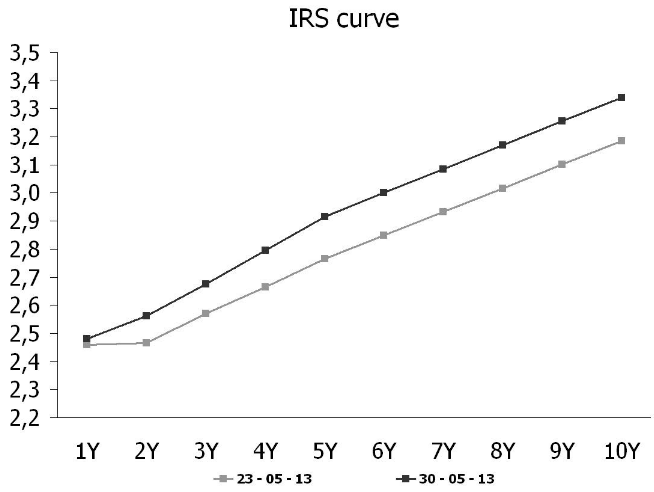
The structure of GDP growth confirms the weakness of domestic demand. Given the moods within the MPC, rate-setters are now prone to extending this weakness for the latter part of the year or even for years. Therefore cuts in June and July meetings look safe. However, the decision context will be changing in H2 2013. There will be some turnaround in GDP growth and inflation. Given expectations of QE tapering the Polish monetary policy will be more lose in relative terms. This, in turn, may make zloty more elastic with respect to rate disparity. In such circumstances the eagerness of MPC to further easing is going to fall to zero.

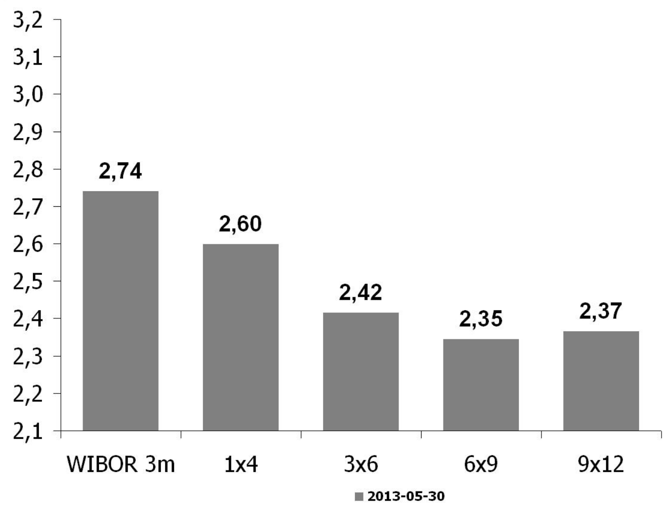
Fixed income

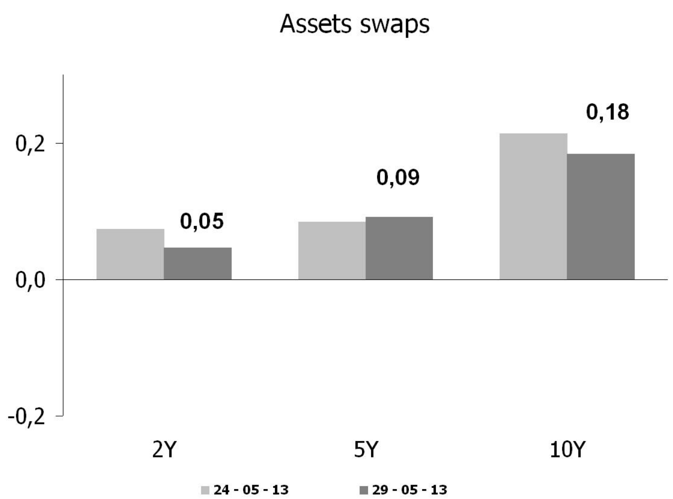
Panic on the market

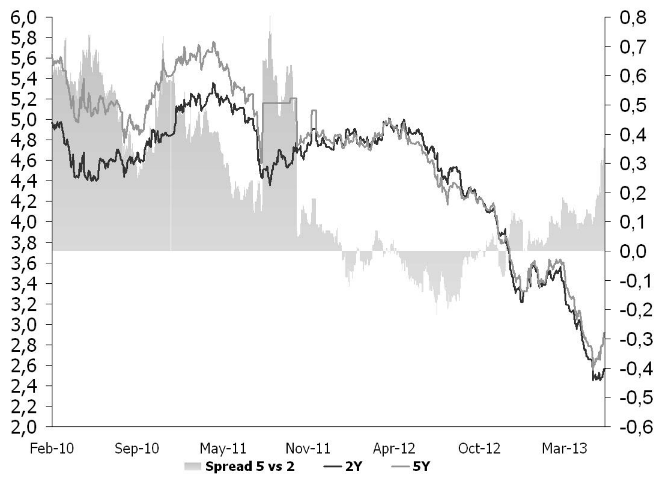
New week, the same story. Selloff on bonds continued, as investors realised that without QE those bonds look expensive. Yields on 10 year bonds went up another 30bp and now with weakening currency there is a pressure even on the short end of the curve.

We still like our position on 9x12fra. Wibors are too low compared to repo rate and now when we hear doubts about further rate cuts trend on wibors should stop. Long end bonds on the other hand looks quite attractive now, yields are resonable there and we can't rule out some reverse on 'end of QE' trade. Also, it is way too early to call for rate hikes next year so for agressive short term traders we suggest 'buy 10 year bonds'.





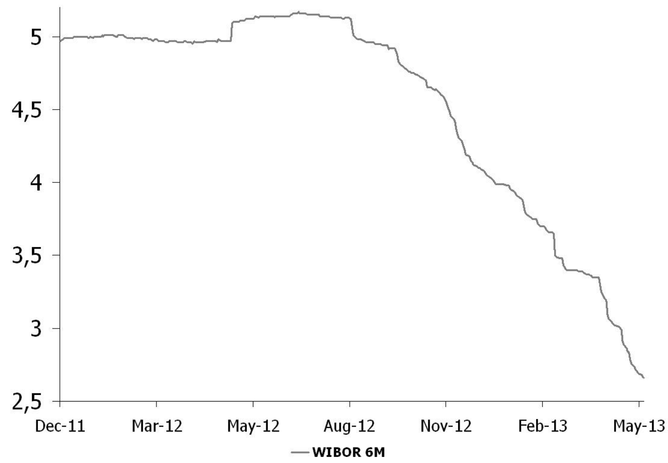


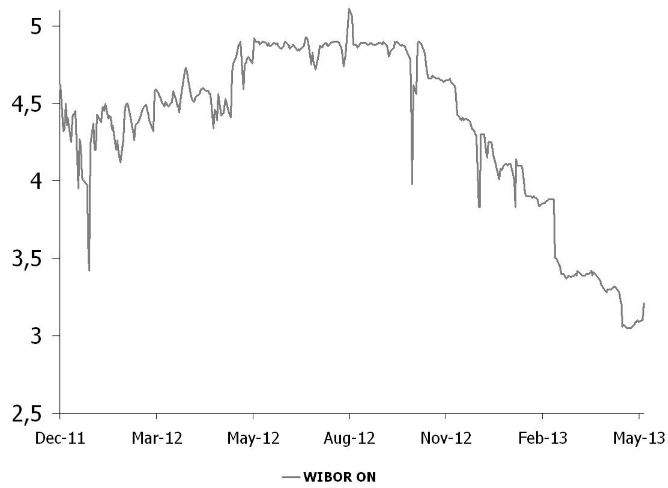


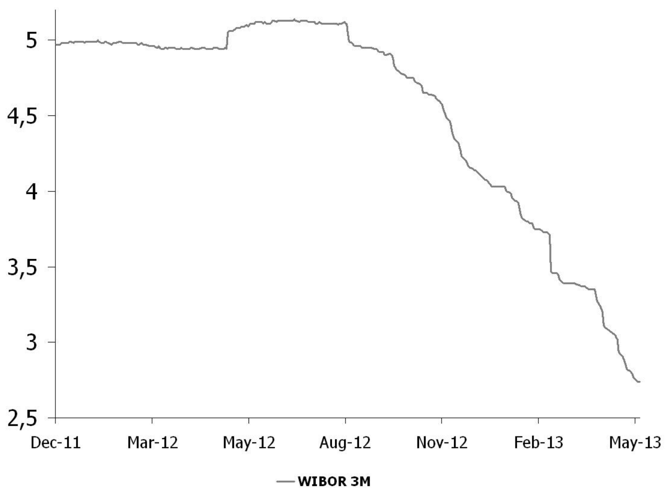
Money market

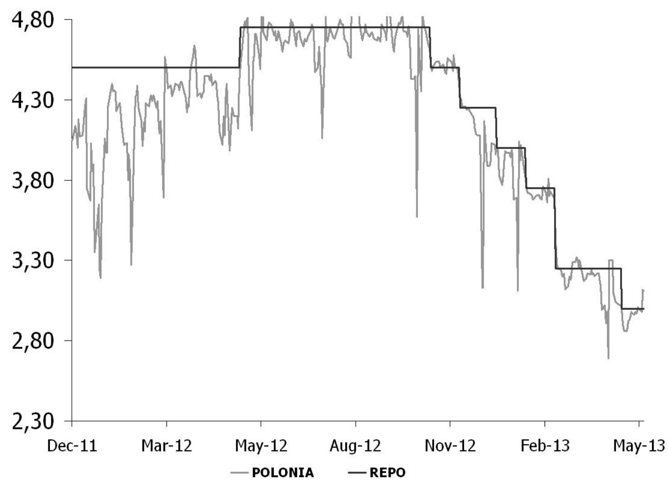
We perceive current bearish sentiment on the front end as an opportunity to sell Appetite for money bills should be high before the rates cut expectations. General liquidity is stable with the surplus of around 130 billion pln, being sterilized during regular OMOs.

Front end up with 9*12 movement of 20 bps (2,25 to 2,45%). QE end story plus sell off on core markets were the main drivers plus weakening Polish currency as a booster for the trend. We think it is a great opportunity to close any payers or open receivers. We still see 50-75 bps cuts till August plus very weak economy data for May. This should bring us back to the levels from this week's correction. Stay calm and load the guns!





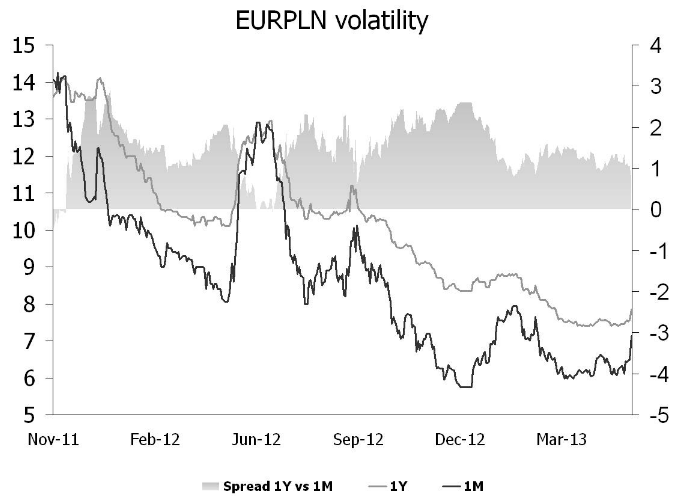




Forex

Choppy market The bad sentiment on the Zloty continued. The hint of possible end of QE in US created threat for polish Bonds and for currency as a logical consequence and a real big outflow was observed. The zloty has made one of it's biggest weekly loss this year of more than 2.3%, bringing EUR/PLN to 4.2950 on Friday. It appears that BGK/Ministry of Finance currency selling can only smooth the pass of deterioration.

Highest level this year Volatilities on Zloty blasted higher with the rest of the markets: 1M vol EUR/PLN jumped from 6.5% to 8.5%, 1Y vol jumped from 7.6 % to 8.4%.The skew also shot aggressively up - risk reversals jumped around 0.9% around (now 25RR 3M is 2.5%, 25RR 1y is 2.7%.).

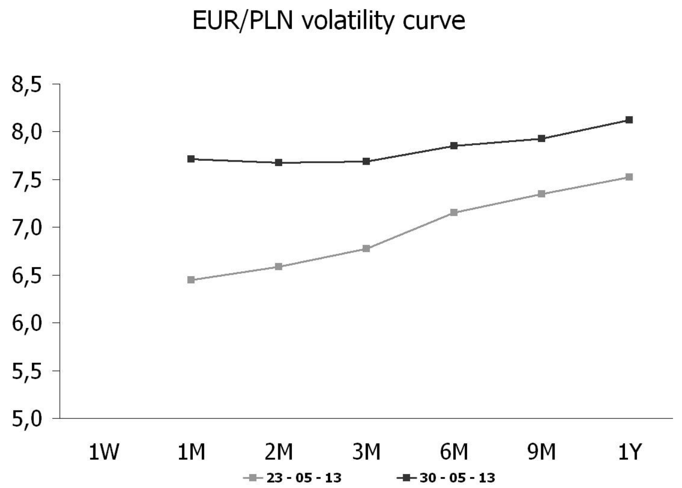


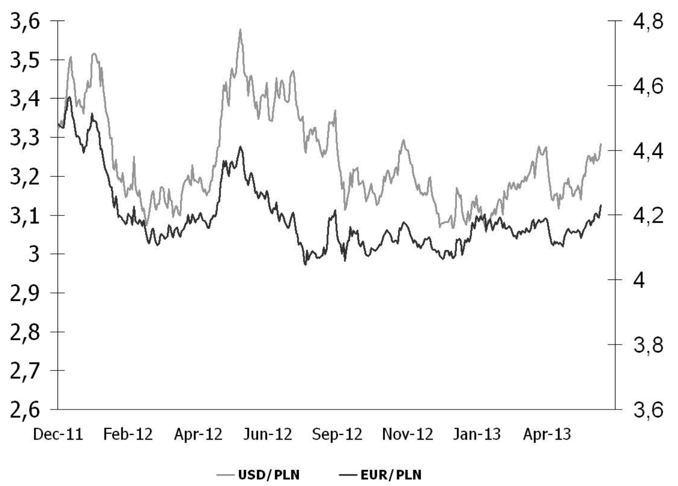
Short-term forecasts

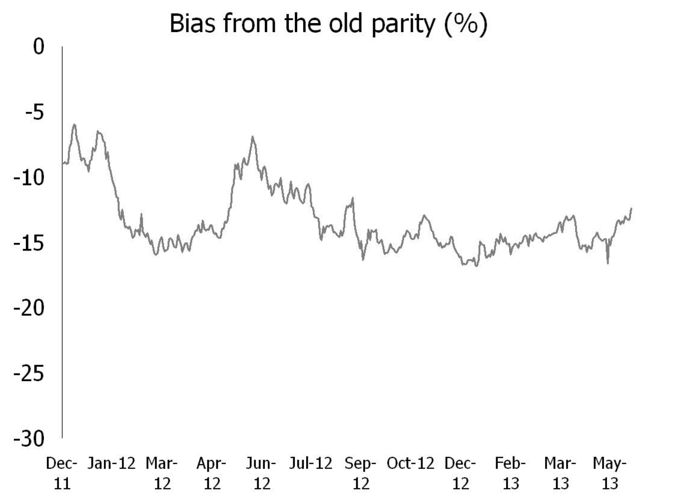
Main supports and resistances
EUR/PLN: 4.2200 / 4.3200
USD/PLN: 3.1500 / 3.3500

Sell EUR/PLN It was a wild washout of the long zloty, which took a number of the market stops (ourselves included at 4.24). We have negative global sentiment on one side, and Ministry of Finance currency sells on the other. The zloty already lost a 7.0 % from the strongest level 4.0250 this year in EUR/PLN terms, the deterioration versus USD is 9.0%. We are being prone to some correction, but the trend seems to be tireless. Stay sidelined or fade the extremes.

Derivatives. The wild upswing in Vol was shocking in it's magnitude. Short term realized volatility shoot up significantly! The EUR/PLN 1 week realized vol jumped from around 4.0% to 8.9%. If the realized volatilities will stay that high we can have next leg higher in XXX/PLN vol space. We look for a correction/consolidation to show the bid for Vega. In such uncertain and volatile environment it might be sensible to have also positive position in gamma.







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
5/25/2013	2.64	2.76	2.48	6.49	2.45	6.59	2.63	2.44	2.29	2.28	2.34	2.38
5/26/2013	2.64	2.76	2.48	6.49	2.45	6.59	2.63	2.44	2.29	2.28	2.34	2.38
5/27/2013	2.63	2.74	2.48	2.58	2.46	2.56	2.60	2.41	2.30	2.28	2.34	2.33
5/28/2013	2.61	2.74	2.52	2.57	2.49	2.56	2.61	2.40	2.31	2.31	2.40	2.36
5/29/2013	2.57	2.74	2.56	2.56	2.54	2.55	2.61	2.41	2.35	2.37	2.47	2.39

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
5/25/2013	6.590	3.353	3.292	3.275	3.420	3.351	3.630	3.873
5/26/2013	6.590	3.114	3.263	3.148	3.370	3.270	3.575	3.755
5/27/2013	2.560	2.992	3.218	3.137	3.325	3.237	3.525	3.759
5/28/2013	2.560	2.992	3.218	3.137	3.325	3.237	3.525	3.759
5/29/2013	2.550	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
5/25/2013	6.43	6.83	7.18	7.55	7.55	2.58	0.73
5/26/2013	6.43	6.83	7.18	7.55	7.55	2.58	0.73
5/27/2013	6.48	6.88	7.15	7.53	7.53	2.50	0.65
5/28/2013	6.49	6.88	7.20	7.55	7.55	2.58	0.73
5/29/2013	7.13	7.23	7.55	7.85	7.85	2.66	0.72

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
5/25/2013	4.2049	3.2400	3.3579	3.1828	1.4483	0.1617
5/26/2013	4.2049	3.2400	3.3579	3.1828	1.4483	0.1617
5/27/2013	4.1950	3.2416	3.3723	3.2132	1.4508	0.1615
5/28/2013	4.1912	3.2465	3.3501	3.1811	1.4497	0.1615
5/29/2013	4.2315	3.2831	3.3832	3.2320	1.4685	0.1632

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