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Comment on the upcoming data and forecasts

On Monday Polish PMI will be published. After February downside surprise and weak data from the real sphere (especially industrial output, which however might have been biased by low temperatures) we expect further deterioration, although less significant in comparison with European indices' trends. On Wednesday MPC is to announce interest rate decision. Recent hawkish comments stipulating a need for a hike already in April (Hausner, Glapiński) were followed by avalanche of Belka's dovish comments (the congestion does not seem for us a really incidental one) and therefore we are inclined to say that something resembling a compromise within the MPC has been reached. The MPC will then continue to be hawkish in their statements but without a follow up in interest rates. More importance is now attached by MPC members to credibility and delegation problems resulting from failure to deliver price stability. Therefore we await some months of stable rates, with a possibility that markets will be ignoring softer real data, given the recent skew in the MPC.

Polish data to watch: March 26 to March 30

Publication	Date	Period	BRE	Consensus	Prior
PMI (pts.)	2.04.	Mar	49.5		50.0
MPC rate decision	4.04.	Apr	4.5	4.5	4.5

Treasury bonds and bills auctions

Paper	Next auction	Last Offer	Last yield (%)	Prev auction
52 Week T-bills	-	3000	4.470	3/26/2012
2Y T-bond OK0114	4/19/2012	4000	4.535	3/16/2012
5Y T-bond PS1016	4/19/2012	3000	4.837	3/8/2012
10Y T-bond DS1021	4/11/2012	2500	5.478	3/21/2012
20Y T-bond WS0429	4/11/2012	3000		2/16/2011

Macroeconomic forecasts

Wskaźnik	2008	2009	2010	2011	2012 F
GDP y/y (%)	5.1	1.6	3.9	4.3	2.8
CPI Inflation y/y (average %)	4.3	3.5	2.8	4.3	3.6
Current account (%GDP)	-5.3	-1.6	-4.5	-4.9	-3.6
Unemployment rate (end of period %)	9.5	12.1	12.4	12.5	13.6
Repo rate (end of period %)	5.0	3.5	3.5	4.5	4.0

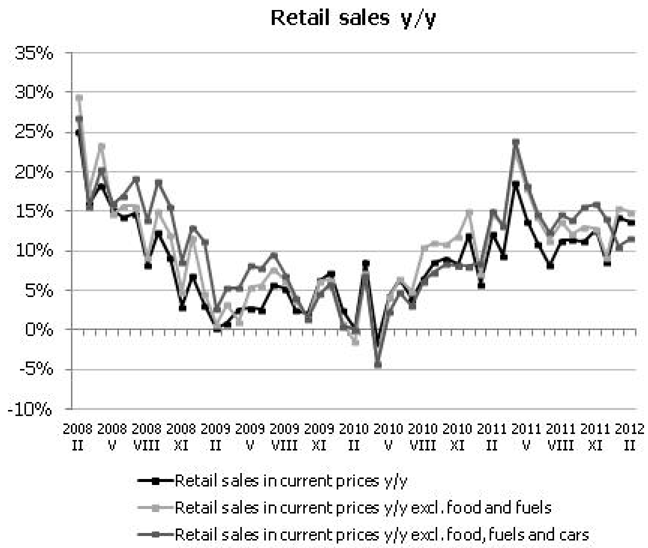
	2011 Q1	2011 Q2	2011 Q3	2011 Q4	2012 Q1 F	2012 Q2 F
GDP y/y (%)	4.5	4.3	4.2	4.3	3.8	3.5
CPI Inflation y/y (average %)	3.7	4.2	4.1	4.6	4.1	3.9
Repo rate (end of period %)	4.0	4.5	4.5	4.5	4.5	4.5

F - forecast

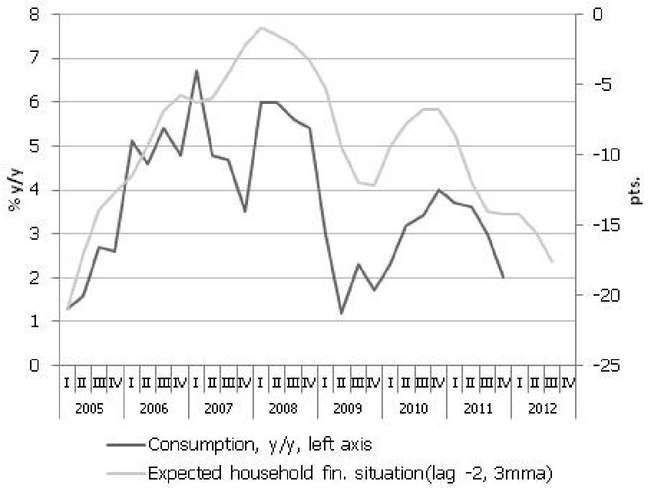
Economics

Retail sales - no symptoms of a more pronounced slowdown

Retail sales decelerated a bit in February to 13.7% from 14.3% recorded in the prior month. Growth was recorded despite relatively substantial base effect from the last year (which can be assessed at -2-3pp. at the start). What is more, despite the fact that only 3 out of 9 sections accelerated in annual terms, the strength of various aggregates is clearly visible as they are only very gradually escaping from local highs depicted in recent months. On aggregate we may see that excluding cars, fuels and food retail sales even accelerated, though only a bit.



Taking a mid-term view, we believe retail sales (or more broadly - consumption) should decelerate and remain depressed in the course of 2012. This reasoning is based on a fact that owing to adverse shocks imposed upon consumers (prices, exchange rate, slowly deteriorating labor market), they should reassess their expected permanent income, along the lines of expected financial situation of an average household (see the graph). The fact that consumer confidence simply neglects decent growth of wages (not only January was a surprise, but also February's income growth proved to be substantial, excluding volatile mining) suggests they are not of permanent origin (or they are not regarded as permanent ones, yet - in this case the reasoning should be softer, but we do not think this is really the underlying case. . .). And since marginal propensity to consume out of windfall income is not zero, we observe this as a hard-to-explain monthly movements in retail sales. We believe the situation should converge to mid-term view in the coming months, starting with March retail sales, when the opposite effect of consumption out of windfall income (decent deceleration of wages) should be visible.

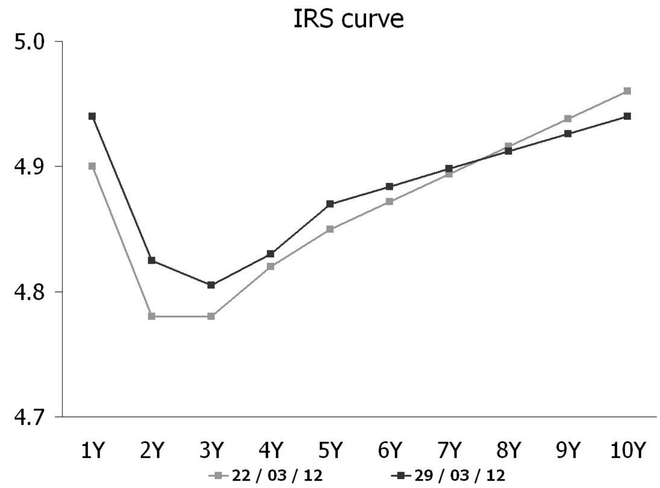


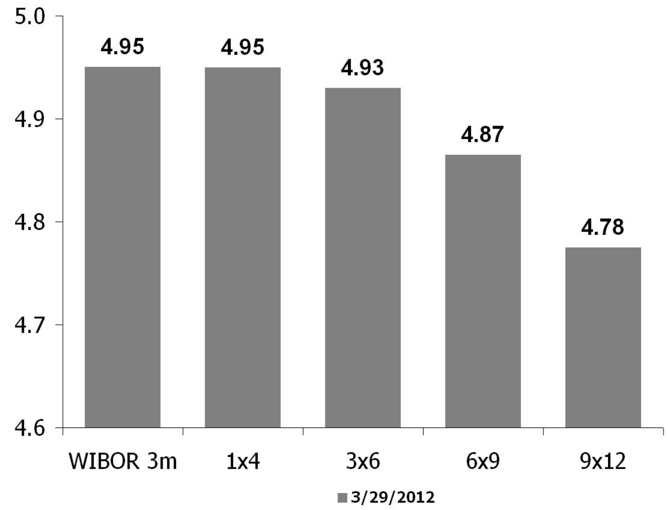
The same reasoning, however, may not really apply to the MPC. Against this backdrop, recent hawkish comments stipulating a need for a hike already in April (Hausner, Glapiński) may fall on fertile ground. However, after the recent avalanche of Belka's dovish comments (the congestion does not seem for us a really incidental one) we are inclined to say that something resembling a compromise within the MPC has been reached. The MPC will then continue to be hawkish in their statements but without a follow up in interest rates. This view will be prevailing one until inflation visibly decelerates and settle within the target, and real sphere soften more. Given the current rhetoric and possible credibility and delegation problems (MPC has so far failed to deliver price stability) we think that rate-setter will be rather willing to stick more to inflation leg in their mandate, contrary to their previous track record. Therefore we await some months of stable rates, with a possibility that markets will be ignoring softer real data, given the recent skew in the MPC.

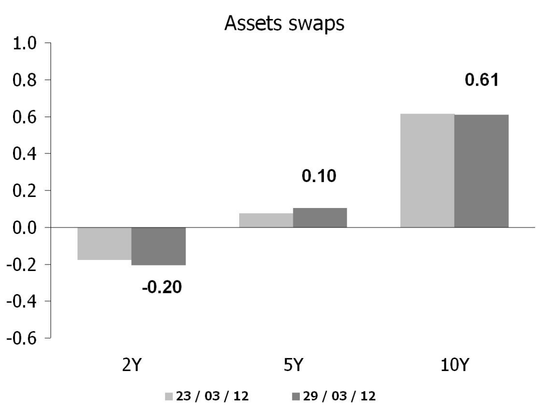
Fixed income

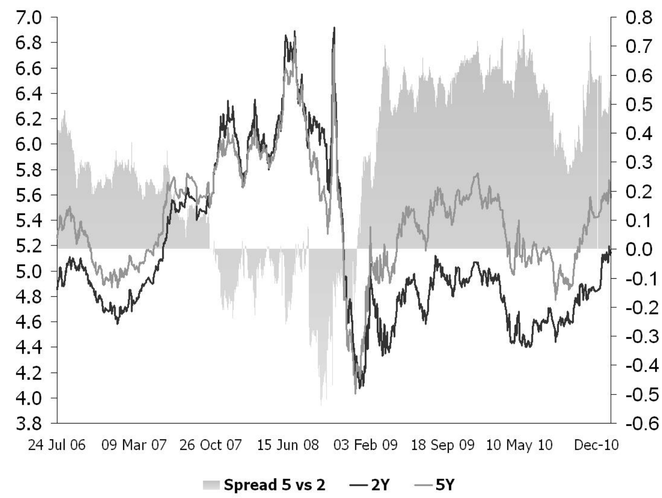
Enough of correction

Negative sentiment prevailed on the FI market this week. Bonds remained under pressure, especially in 5y and 10y sector, where yields moved up by some 8bp. By the end of the week market reached some sort of equilibrium and flows balanced. In our opinion scale of the correction was surprisingly large. We agree with some uncertainty regarding next week's MPC decision, but even if rate hike materialises (which we don't think would happen), it wouldn't be very negative for the curve. FinMin already managed to finance over 50% of this year needs, therefore further supply will be significantly limited. Spreads over Euro remain wide and there is definitely some potential also. Nevertheless we think that economic data will become most important driver in the medium term. Inflation expectations already fell from 5% to 4.2%, despite food prices we think March CPI will fall below 4% and MPC will then change rethorics - there were already some signals in Governor Belka's comment that growth and risks to that must be taking into consideration when making rate decisions. All in all there isn't really much room for a sell-off, yet there is a lot of room for a rally.









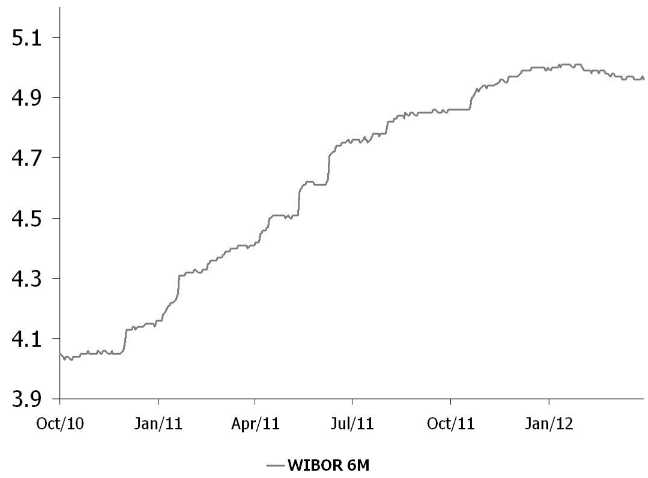
Money market

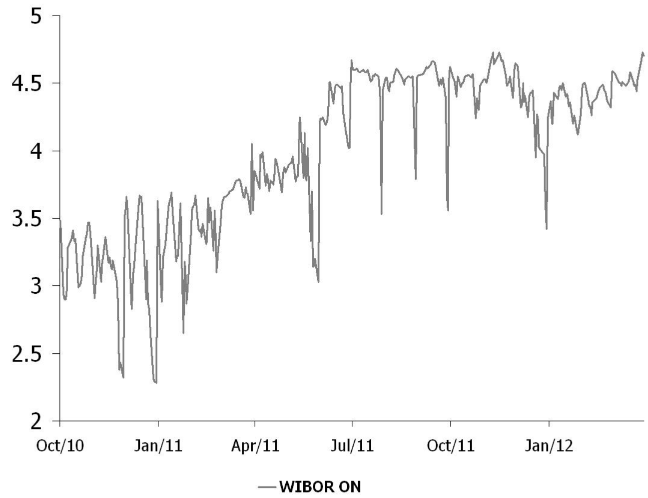
Expensive month behind. Good retail sales and hawkish comments from the MPC.

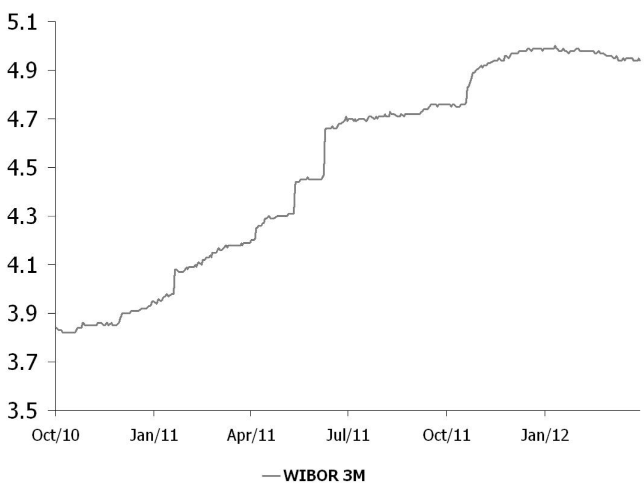
Very expensive end of the reserve settlement period, with the cost of carry exceeding the main market rate. It looks like it was a pure consequence of the demand during the OMO auctions, that were exceeding the amounts necessary for the balanced liquidity. Certainly we cannot exclude that any other external factors disturbed the liquidity layout and distribution, however we bet on OMOs. Since we have really expensive month behind plus we have Easter in April, experience suggests falling carry and a cheap month ahead.

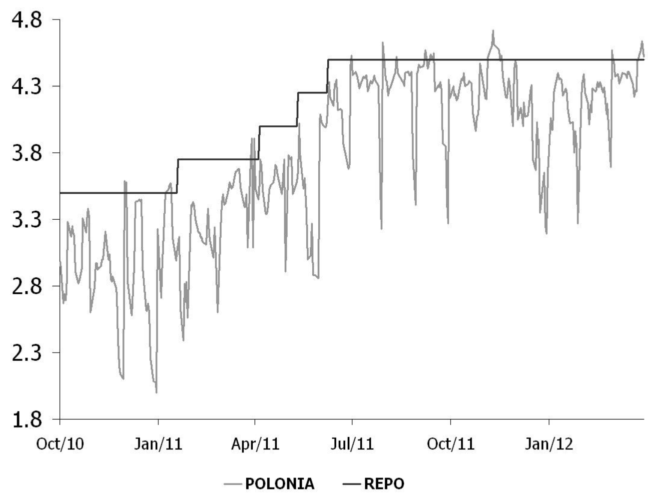
As for trading, still bearish supported by impressive retail sales figure and by some really hawkish comments from the MPC members (Hausner,Glapinski). Although, the governor Belka was trying to soften the hawkish impression left by his council mates, sentiment will change no sooner then after the decision, which is to be taken next Wednesday.

Sell long ois contracts at current levels.





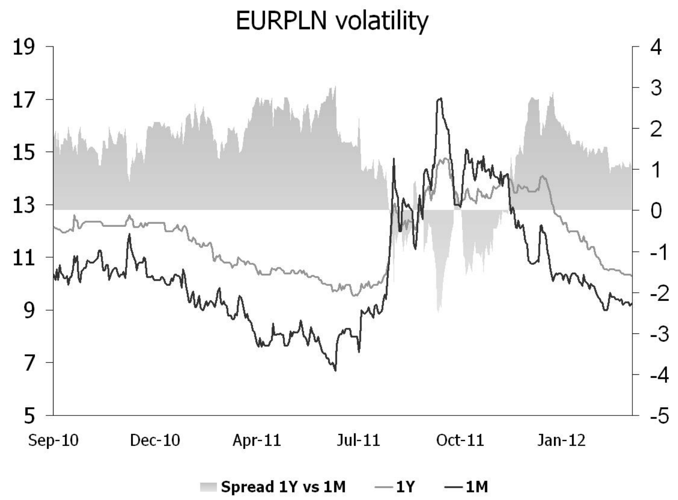




Forex

Zloty play the range Last week EURPLN was traded in a narrow range 4.1200 - 4.1700. At the beginning of the week the Zloty gained after double-digit growth in Polish retail sales in February and hawkish comments from Central Bank. A rise in German business confidence also eased nerves over the region's slowdown and bucked up our currency. In the mid of the week situation was changed. EURPLN was traded aggressively higher as the risk off environment prompted further position reduction. However when EURPLN moved towards 4.17 level Ministry of Finance appeared on the offer.

Volatility consolidating We had another week with not much change on volatility market. As EURPLN was traded in very low range the Theta bills forced some Gamma selling: 1M was sold at 9.0 and 1W was traded even below. On longer end of the curve we have strong support as we are still at the same levels as week before (3 month mid 9.45%, 1 year mid 10.40%). The currency spread (USD/PLN - EUR/PLN) is lower in the front of the curve: 1m fell from 6.0% to 5.5%. 1y was at approx. 6.5%.

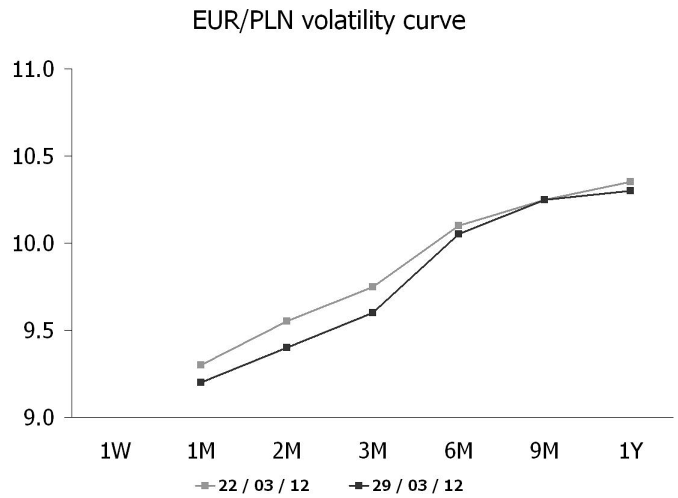


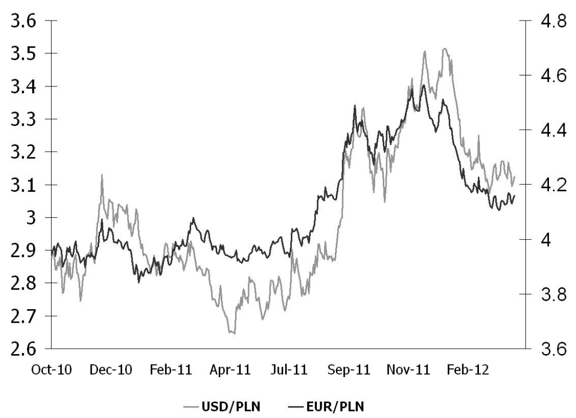
Short-term forecasts.

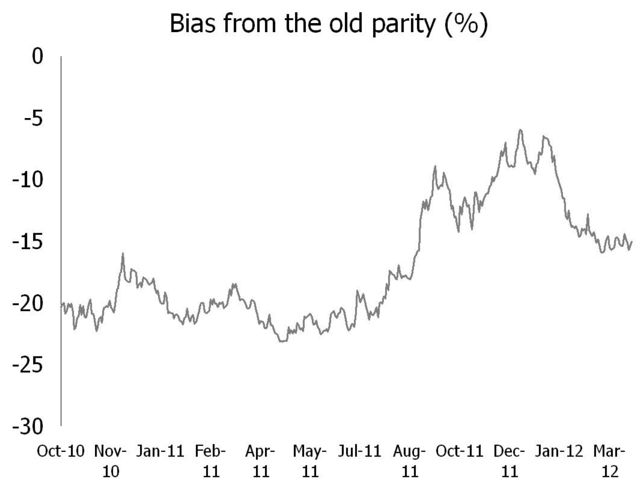
Main supports and resisances
EUR/PLN: 4.1000 / 4.2500
USD/PLN: 3.0000 / 3.2500

Spot. View unchanged from the last week. Play a range, with a skew to the upside (Zloty downside), as Polish fundamentals have started to deteriorate and we are seeing interest to get out of Polish bonds. The technical picture shows that while 4.10/4.1250 support zone holds we are prone to test the upper side namely 4.20 on the road to 4.23/4.25 stronger resistance zone.

Derivatives Some correction in the Zloty uptrend should not have a big impact on volatility curve. The bigger picture is still more constructive for the short Vega holders. Possible higher volatility levels may offer opportunity to sell Vega. The correlations are changing, the EUR/USD is less negatively correlated to EUR/PLN. If the idea of EUR as a founding currency will materialize, that correlation will fall even further. If that would be a case, the USD/PLN vols would be hit hard, and currency spread will lower significantly. We hope so as we hold short USD/PLN Vega, as we prefer it to EUR/PLN short Vega where the move down has run out of steam.







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
3/23/2012	4.73	4.94	4.57	4.86	4.59	4.86	4.93	4.91	4.82	4.72	4.63	4.83
3/26/2012	4.59	4.94	4.75	4.86	4.85	4.87	4.97	4.94	4.84	4.75	4.64	4.87
3/27/2012	4.77	4.94	4.88	4.87	4.77	4.87	4.96	4.94	4.87	4.78	4.66	4.88
3/28/2012	4.49	4.95	5.03	4.87	4.46	4.87	4.95	4.94	4.87	4.78	4.68	4.88
3/29/2012	4.40	4.94	4.74	4.86	4.44	4.87	4.95	4.93	4.87	4.78	4.68	4.88

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
3/23/2012	4.860	4.450	4.760	4.586	4.830	4.905	4.915	5.529
3/26/2012	4.870	4.450	4.820	4.605	4.865	4.915	4.935	5.536
3/27/2012	4.870	4.450	4.815	4.612	4.850	4.925	4.940	5.532
3/28/2012	4.870	4.500	4.820	4.576	4.860	4.943	4.940	5.567
3/29/2012	4.870	95.670	4.825	4.622	4.870	4.973	4.940	5.549

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
3/23/2012	9.30	9.75	10.10	10.35	10.35	3.65	0.67
3/26/2012	9.30	9.75	10.10	10.35	10.35	3.65	0.67
3/27/2012	9.15	9.40	9.90	10.35	10.35	3.65	0.68
3/28/2012	9.25	9.60	10.05	10.30	10.30	3.60	0.68
3/29/2012	9.20	9.60	10.05	10.30	10.30	3.60	0.68

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
3/23/2012	4.1649	3.1417	3.4548	3.8011	1.4188	0.1683
3/26/2012	4.1409	3.1348	3.4360	3.7858	1.4126	0.1678
3/27/2012	4.1300	3.0939	3.4236	3.7357	1.4211	0.1677
3/28/2012	4.1503	3.1100	3.4415	3.7515	1.4207	0.1688
3/29/2012	4.1600	3.1234	3.4510	3.7882	1.4196	0.1684

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