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Comment on the upcoming data and forecasts

On Thursday C/A data will be published. We expect C/A deficit to remain more or less stable on relatively high, negative trade balance (ca. EUR 1100 mln). Oil import bill might have only slightly decreased in February, and we see that imports (as modelled statistically) remain quite strong whereas exports stagnate (link to weak manufacturing in February). On Friday CPI and M3 will be published. Our forecast of inflation lies in market consensus. Decline in growth rate compared to previous month results from statistical base. Food and energy prices remain high, core inflation should decline by 0.1pp. to 2.5%. Significant drop in money supply growth rate results also from base effect (in March 2011 there was 16bn PLN transaction made by Santander) and decline in corporate deposits (on March 5th KGHM bought Quadra for 9bn PLN). Other monatary aggregates remain in their trends.

Polish data to watch: March 26 to March 30

Publication	Date	Period	BRE	Consensus	Prior
C/A (mln EUR)	12.04.	Feb	-1765.0	-1335.0	-1831.0
CPI r/r (%)	13.04.	Mar	3.9	3.9	4.3
M3 r/r (%)	13.04.	Mar	9.2	10.0	12.6

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	4.75

	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	4.75

F - forecast

Economics

Unchanged PMI points to stagnation in manufacturing

Polish PMI in manufacturing remained almost unchanged in March posting a slight gain of 50.1pts from50.0pts in February, a little more than market expected. The result indicates no improvement in overall business conditions in the goods-producing sector and highlights that the stronger January reading (52.2pts.) was more of an outlier, so that the near-term outlook is close to stagnation.

The weakness of business conditions reflected mainly a lack of incoming new orders (which declined marginally, but for the 4th time in the last 5 months) as they draw more and more persistent trend indicating weakness of both domestic and foreign demand. Lack of new work lead to cut of manufacturers' purchasing volumes and marginal contraction in employment. Manufacturing output growth was maintained in March for 32nd consecutive month, but the rate of expansion remained weak, which was also reflected in contraction of post-production inventories. Average input prices rose sharply - firms highlighted increased costs of fuel and oil-based products in particular. Producers partly passed on higher costs to consumers - average prices charged rose for the 24th successive month, but the rate of growth eased.

Despite lower market expectations (49.6pts) the reading close to 50pts should be regarded as low. With February much lower industrial output growth (4.6% y/y and our expectations for March are on similar level), weakening of labor market and forecasted consumption slowdown (already seen in GDP for Q4'2011 and expected to be also reflected in after-Easter months in retail sales) PMI confirms our forecasts of moderate growth deceleration in 2012. What is more, Polish PMI is in the short-term highly correlated with German PMI in manufacturing, which recently behaves in a quite volatile manner. However, in medium-term German index moves in line with trends imposed by Ifo - therefore we expect that narrow range for both PMIs will be sustained in the months to come (decreases similar to the ones from 2008 are low probability scenario).

MPC announces interest rate hike

In spite of MPC leaving interest rates unchanged in April the statement leaves no doubt that „the expected mild economic slowdown in Poland over the monetary policy horizon increases the probability of inflation remaining above the target in the medium term. Given the above, the Council will consider tightening of monetary policy in the nearest future, unless signs of considerable economic weakening n Poland appear and the outlook for inflation returning to the target fails to improve." Such a statement practically means announcement of rate hike in May, which was massive surprise for analysts - no local analyst surveyed at the end of March pointed on even one hike during the next 6 months.

Such a blunt announcement of a hike can be seen as contrasting with the first informative part of the statement and earlier press Belka's comments, but not with single rate-setters' hike declarations (with simultaneous no need to rush). Informative part of the statement assesses global economic growth as low/moderate and inflation as elevated by high commodity prices. Evaluation of recent macro data from Polish economy remains conservative. However MPC highlights signals (e.g. industrial and construction output, leading business indicators, labor market; retail sales being an exception) of „some" weakening of economic growth, but other indicators (e.g. retail sales - we still wonder how the MPC can make judgements on such a poor quality data) indicate that „the slowdown should not be considerable". MPC emphasized weakening of producer prices and decline in inflation expectations. In the short-term Council expects „some decline" in inflation, but it will probably remain above the NBP's inflation target due to persistently high commodity prices and high growth in regulated prices. Mid-term inflation view points still moderation, however a conviction of this fact seems a little bit softened.

It comes clearly from the statement that inflation is a thorn in MPC's flesh. During the conference Belka shed even more light on that issue telling for example that inflation was rarely so high as it is recently and even temporary decline (as expected in March) won't change the fact that prices rise on average too fast. This aggressive rhetoric concerning inflation is also supported by MPC's strong belief in the strength of Polish economy („expected slowdown does not come, it is merely postponed in time, over and over", „hike would proof strength of our economy"). What is more, Council seems to be proud of being the only in the world to keep „normal" monetary policy.

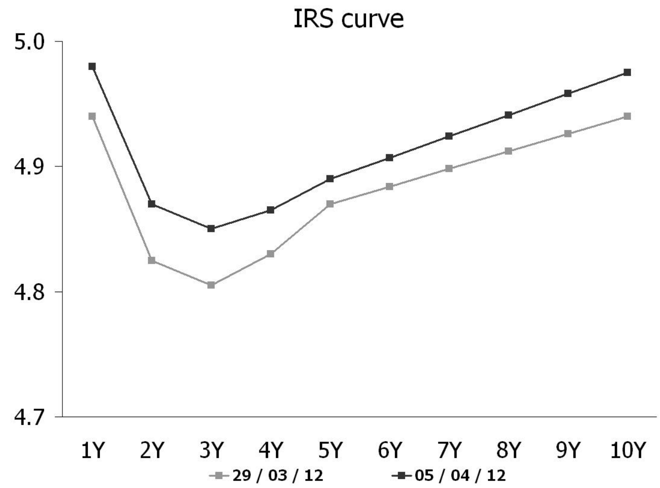
Despite our expectations of lower macro data published this month, they may not be sufficient to discourage MPC from hike and therefore situation needs to be closely monitored. Nevertheless, the announced tightening would be only incidental (one, maximum two hikes by 25bp. before inflation effects of EURO2012 materialize) and would not lead the full tightening cycle. In the second half of the year we expect both weakening of economic activity and decline in inflation (to be more precise: CPI will increase in the Summer and then decline in the Autumn to about 3%). Such an environment and other central banks' monetary policy should soften MPC's rhetoric.

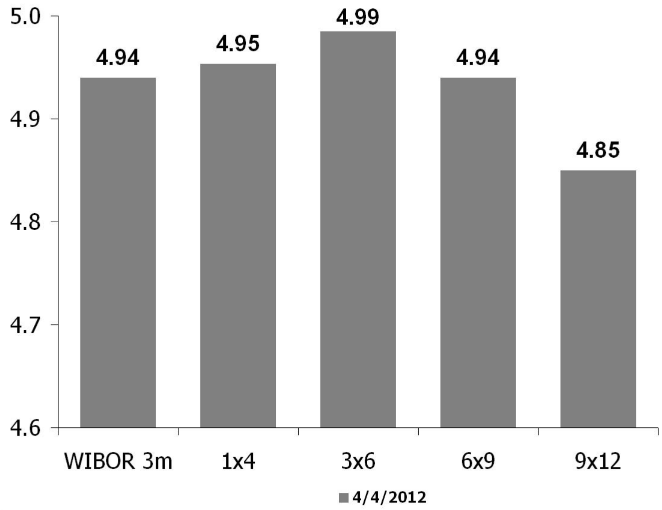
Fixed income

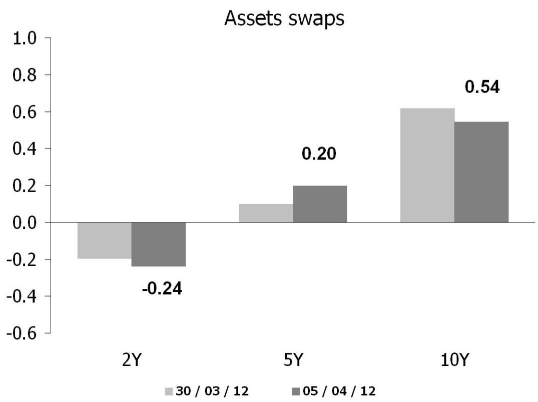
Big surprise

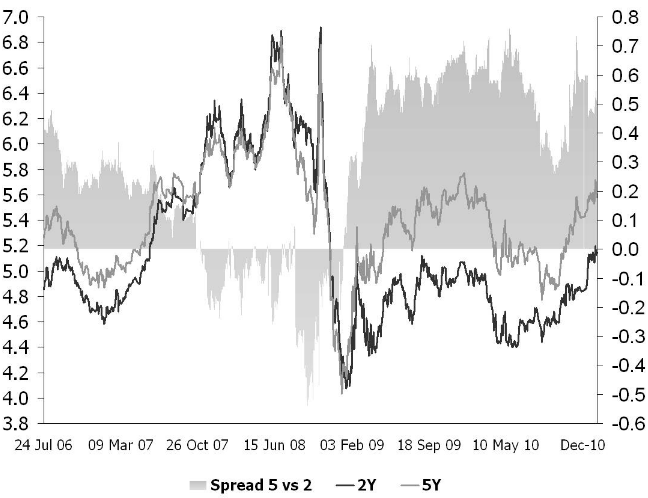
Main event of the passing week was the MPC meeting. Rates were left unchanged, however change of the rhetorics was quite shocking. Surprisingly, Mr. Belka somehow gave in to the group calling for rate hike for some time and almost clearly announced such a move on the next meeting. Market was vary before on whether we should expect some easing later this year, or whether rates would be kept on hold for a little longer. Nevertheless tightening wasn't what market had been betting on, so the conference was followed by rapid and significant repricing. 1Y and 2Y moved up by more than 15bp, 5Y almost that much.

We have to admit we were wrong as well with our 'no chance for a hike call', under current circumstances it's difficult to argue with what's happening to the front of the curve. However we don't think it's justified to extend the sell-off into 5y sector. We're in the final stage of the tightening cycle, the moment when rates should have peaked already. With markets' general tendency to overreact, it's possible that this final adjustment would be followed by expectations of another cycle and rates can move even higher. We don't want to participate in a move that we don't think can be fundamentally justified, so we would rather stay on the sidelines here and watch further developments before there's a good time to enter positions again. Nevertheless, next big move in rates will be likely down, not up.









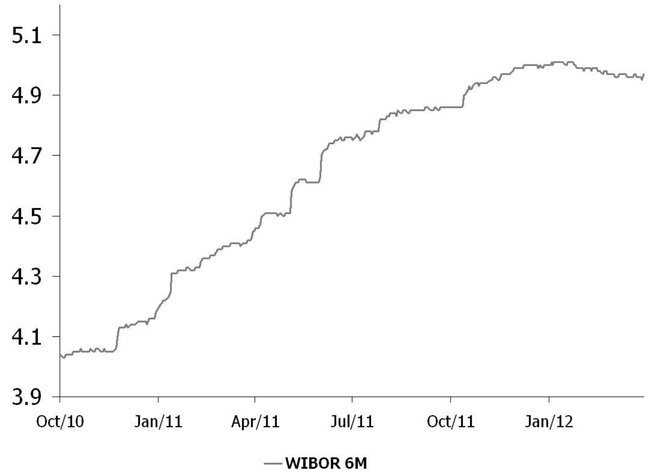
Money market

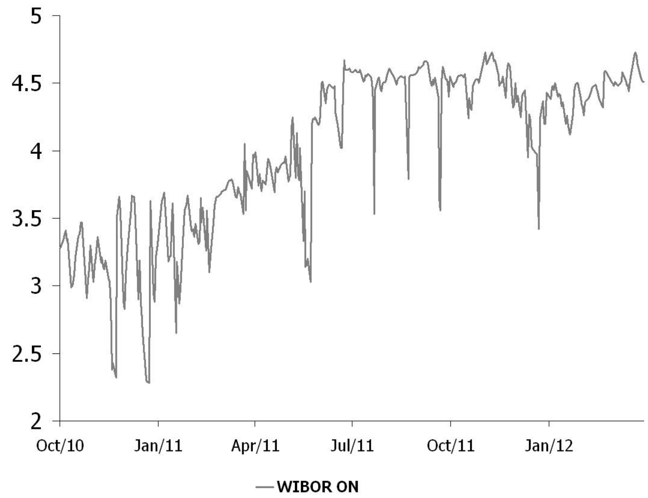
Very expensive start of the reserve despite huge surplus. Governor Belka extremely hawkish.

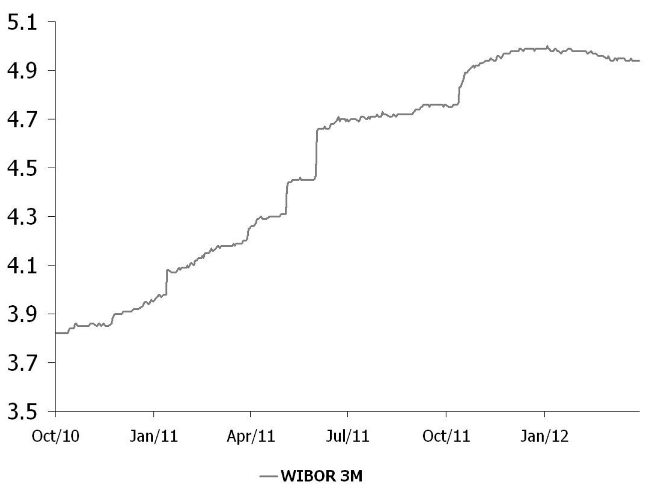
Expensive beginning of the reserve despite the huge surplus of the cash in the system. Looks like the market is building the reserve. OMO results were reserve neutral (pln 85.7 bn), however the offer was quite aggressive at 90 bn. We do not expect additional operation next week, and cash should be traded nearby the main market rate. Later on in April there is a huge net cash inflow from maturing PS0412 bonds, coupons from the rest of PS April bonds and WS April bonds. It will be difficult to sterilize this flow, therefore maybe this month, the end of the reserve give some relief to fund seekers. Current liquidity situation may be caused by large offshore positions that are being financed via bsb trades, that in turn lift the cash pricing.

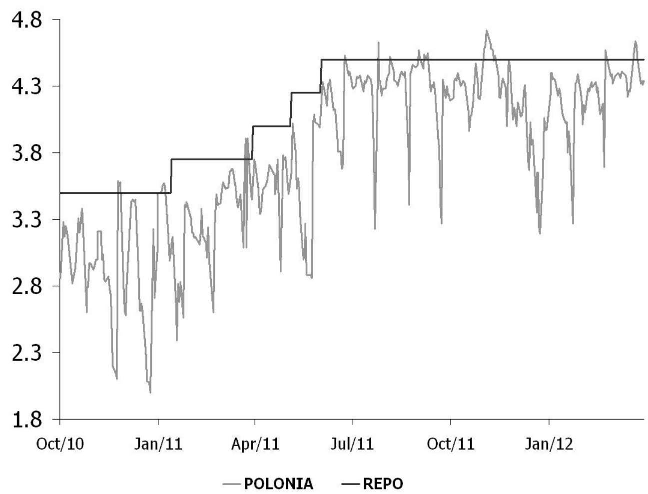
The MPC did not change any of the monetary policy parameters, however the conference turned out to be a breaking point. Governor Belka gave extremely hawkish feedback, and reputation wise after such a tone, we should see the rates hike in May. Otherwise the MPC may start loosing market confidence. After the conference yields rose across all the curves by 10-20 bps. Rate cuts expectations are priced off from the front end. Some markets are pricing the hike in May, some are more reluctant. All in all only bullish figures may change the sentiment now, nonetheless the May MPC meeting will be under huge bearish pressure regardless.

Sell weeks in polonia oiss, buy 6M on dips.









Forex

Still in the range The uneventful MPC meeting (rates unchanged), and hawkish rhetoric's from the Central Banker Marek Belka, was not enough to push the market out of it s range 4.1250 - 4.1850, the latter was the fresh high of the week. The fresh high is slightly above the previous 4.1750 strong resistance line, where some of the market participants have seen the government owned GBK offers in the past. We believe that the global developments will take the driving seat, and the performance of Spanish bonds, EUR/USD will guide us from now on.

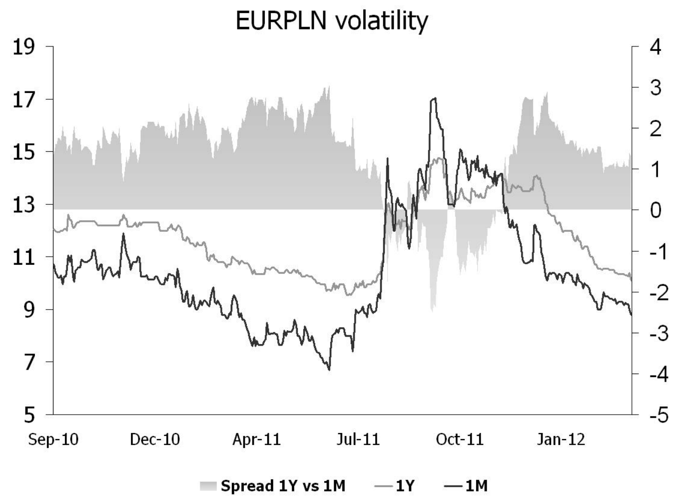
Fresh lows marked With the quiet start of the week, and Easter looming on the horizon, we finally marketed fresh lows for both main currency curves (EUR/PLN, USD/PLN). The main trades were, 1 year ATM EUR/PLN was given at 10.15%, the 6 month USD/PLN was given at 15.75%. The 1 month EUR/PLN was offered at 8.8% which also marks the lowest offer this year. This lows proved to be unsustainable, as the sourer global sentiment took the EUR/PLN 0.25 higher and the change in USD/PLN curve was even bigger 0.5/0.7% as the move on spot was USD driven.

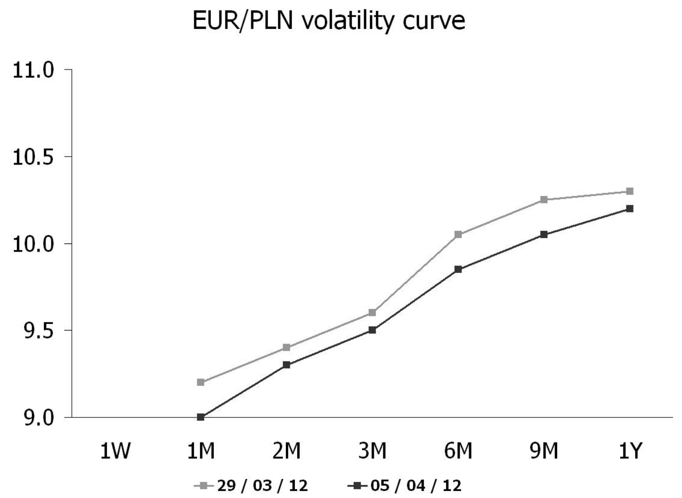
Short-term forecasts.

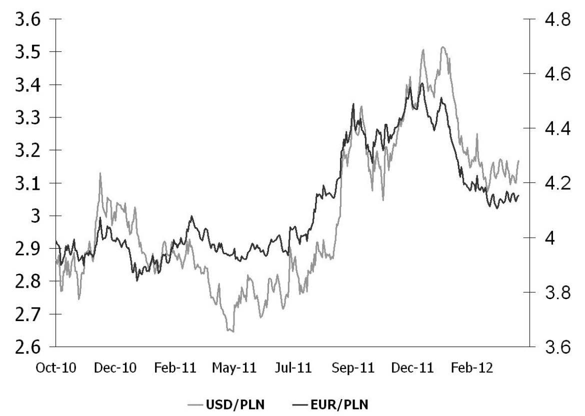
Main supports and resisances
EUR/PLN: 4.1000 / 4.2000
USD/PLN: 3.0500 / 3.2500

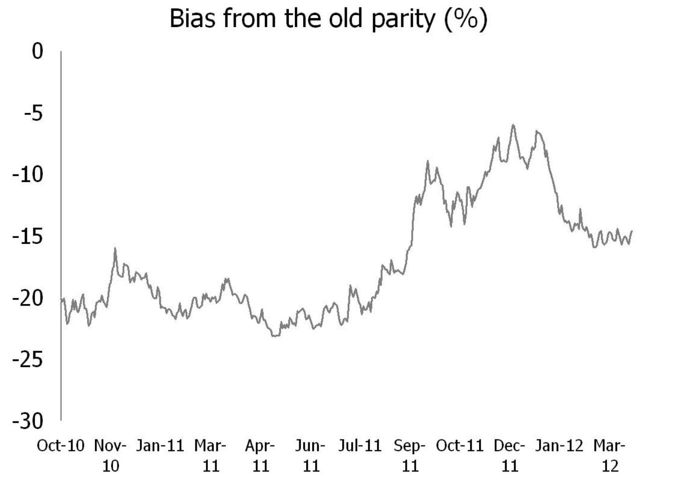
Spot. Still in the range. We entered the long EUR/PLN position on the supposition that "what is not going down, must go up"...a highly analytical approach. Long 4.1550, we will add 4.1350 with a stop below 4.1200, and the hopes for breaking 4.20.

Derivatives We have closed the short Vega/Gamma position in EUR/PLN this week. The Theta/gamma ratio was not that attractive any more with such a low implied volatilities. On USD/PLN, we still believe it s a good value to be short long end, and eventually install the hedge for short gamma by purchasing a mid curve strike. It makes even more sense, as the curve is really steep, and being long mid curve and short backend, gamma neutral, is still Theta positive.









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
3/30/2012	4.59	4.94	4.61	4.86	4.62	4.86	4.94	4.93	4.85	4.76	4.67	4.88
4/2/2012	4.57	4.94	4.90	4.86	4.65	4.86	4.94	4.94	4.87	4.78	4.66	4.88
4/3/2012	4.45	4.94	4.74	4.85	4.47	4.86	4.94	4.94	4.88	4.79	4.67	4.90
4/4/2012	4.57	4.94	4.87	4.86	4.88	4.86	4.95	4.99	4.94	4.85	4.75	4.96
4/5/2012	4.57	4.94	4.87	4.87	4.88	4.87	4.95	4.99	4.94	4.85	4.75	4.96

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
3/30/2012	4.860	95.670	4.799	4.604	4.837	4.936	4.920	5.538
4/2/2012	4.860	4.500	4.795	4.674	4.830	4.953	4.910	5.504
4/3/2012	4.860	95.728	4.810	4.618	4.840	4.923	4.920	5.481
4/4/2012	4.860	95.728	4.870	4.632	4.890	5.088	4.975	5.518
4/5/2012	4.870	95.728	4.870	4.632	4.890	5.088	4.975	5.518

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
3/30/2012	9.20	9.55	10.00	10.25	10.25	3.62	0.65
4/2/2012	9.00	9.55	10.15	10.40	10.40	3.62	0.65
4/3/2012	8.80	9.25	9.75	10.10	10.10	3.62	0.65
4/4/2012	9.00	9.50	9.85	10.20	10.20	3.62	0.65
4/5/2012	9.00	9.50	9.85	10.20	10.20	3.62	0.65

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
3/30/2012	4.1616	3.1191	3.4540	3.7979	1.4077	0.1678
4/2/2012	4.1428	3.1017	3.4401	3.7483	1.4096	0.1673
4/3/2012	4.1327	3.0990	3.4335	3.7780	1.4040	0.1674
4/4/2012	4.1495	3.1503	3.4449	3.8120	1.4063	0.1688
4/5/2012	4.1544	3.1678	3.4526	3.8543	1.4019	0.1685

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