BRE BANK SA

POLISH WEEKLY REVIEW

April 27, 2012

Bureau of Economic Analysis
(research)

Ernest Pytlarczyk, PhD, CFA
chief economist
tel. +48 22 829 01 66
ernest.pytlarczyk@brebank.pl

Marcin Mazurek, PhD
senior analyst
tel. +48 22 829 01 83
marcin.mazurek@brebank.pl

Paulina Ziembinska
analyst
tel. +48 22 829 02 56
paulina.ziembinska@brebank.pl

Artur Płuska
analyst
tel. +48 22 526 70 34
artur.pluska@brebank.pl

Financial Markets Department
(business contacts)

Lukasz Barwicki
head of trading
tel. +48 22 829 01 93
lukasz.barwicki@brebank.pl

Inga Gaszkowska-Gebska
institutional sales
tel. +48 22 829 01 67
inga.gaszkowska-gebska@brebank.pl

Bartlomiej Malocha, CFA
money market
tel. +48 22 829 01 77
bartlomiej.malocha@brebank.pl

Jaroslaw Stolarczyk
structured products
tel. +48 22 829 01 67
jaroslaw.stolarczyk@brebank.pl

Marcin Turkiewicz
fx market
tel. +48 22 829 01 67
marcin.turkiewicz@brebank.pl

Reuters pages:
BREX, BREY, BRET

Bloomberg:
BRE

SWIFT:
BREXPLPW

BRE Bank S.A.
18 Senatorska St.
00-950 Warszawa
P. O. BOX 728
tel. +48 22 829 00 00
fax. +48 22 829 00 33
http://www.brebank.pl

Table of contents

Comment on the upcoming data and forecasts

On Monday Polish inflation expectations will be published. They may rise to 4.4% from 4.2% in March. Higher reading will strenghten the case (at least in the eyes of some MPC members) of higher infation persistence and thus it may be further argument for MPC in favour of interest rate hike. On Wednesday Polish PMI will be published. After March downside surprise and weak data from the real sphere (especially industrial and construction output) we expect deterioration, although less significant in comparison with European indices.

Polish data to watch: April 30 to May 4

Publication	Date	Period	BRE	Consensus	Prior
Inflation expectations y/y (%)	30.04	Apr	4.4		4.2
PMI (pts)	02.05.	Apr	49.2		50.1

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	6/20/2012	7500	4.759	4/19/2012
5Y T-bond PS1016	6/20/2012	7500	5.004	4/19/2012
10Y T-bond DS1021	5/23/2012	2500	5.478	3/21/2012
20Y T-bond WS0429	5/23/2012	3600		1/12/2011

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	4.1
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

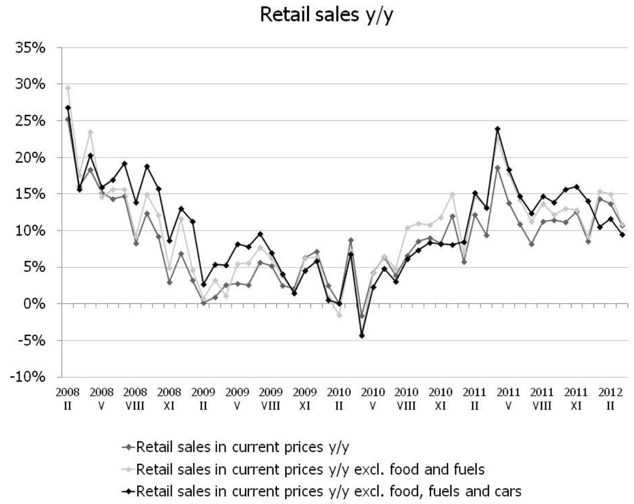
	2011 Q1	2011 Q2	2011 Q3	2011 Q4	2012 Q1	2012 Q2 F
GDP y/y (%)	4.5	4.3	4.2	4.3	3,6	2.8
CPI Inflation y/y (average %)	3.7	4.2	4.1	4.6	3.9	4.2
Repo rate (end of period %)	4.0	4.5	4.5	4.5	4.5	4.75

F - forecast

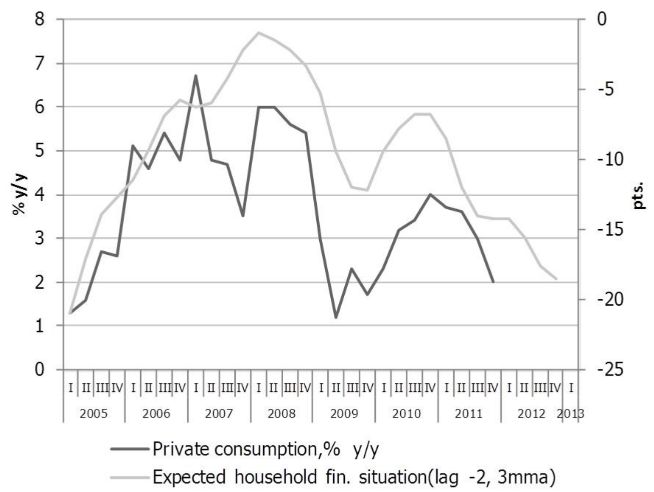
Economics

Retail sales boosted by Easter effect. MPC ready for a hike in May (but watch for ECB).

Retail sales decelerated in March to 10.7% y/y (vs 13.7% recorded earlier). Growth on monthly basis amounted to 15.7% which is rather a disappointing number given the setup of Easter holidays. This notion is confirmed by our synthetic (trimmed) retail sales indicators depicted on the graph.



Therefore we think that retail sales is going to show more cyclical weakness ahead given the moderation of wages and with still very cautious assessment of households' financial situation. As for the latter indicator, we sustain the view that current levels are consistent with private consumption (national accounts) running no faster than 1-1.5% in the H2 with a possibility of some temporary stabilization in H1 (so far consistent with the data of monthly frequency) - the relationship is depicted in the graph below.



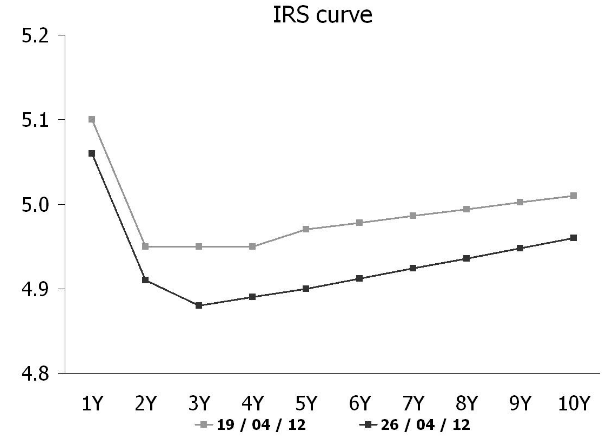
Although we think that retail sales data are weaker and should be interpreted at least neutrally, the MPC does not necessarily share this opinion. The majority of rate-setters regards the current data as at least mixed (poor output offset by retail sales) and - according to the recent „Minutes", they are fixed at inflation. One can read that „the majority of Council members found that - given a likely persistence of factors fuelling inflation that are beyond the direct influence of domestic monetary policy - the limited scale of expected economic slowdown might not decrease inflationary pressure to a degree sufficient for inflation returning to the target in the medium term" and „most Council members pointed that - as elevated inflation was largely driven by factors beyond the direct influence of the domestic monetary policy - the increase in the NBP interest rates should primarily prevent persisting heightened inflation expectations, mounting wage pressures and emerging of second-round effects". We think that those notion may be key for understanding the policy response in May. Since it is almost certain that inflation is not going to slip away before Autumn, postponing rate increase on the basis on the need for crunching more numbers make no sense. The more so since MPC highly relies on the recent NBP's report on economic activity stating - despite recent rather disappointing mixed of real data - that economy is rather gaining, not losing momentum. Adding to the above also the prejudice that even though there will be some moderation of growth ahead, 2013 will be better, MPC is ready to deliver what was actually announced and hike rates already in May. There is one, significant risk factor to this scenario. When M. Draghi from ECB decides to signal some sort of more easing in May on the basis of recent solid repricing of risks to euro zone growth, this would be also a game changer for the MPC, which in such circumstances would rather cease fire (and take on the view that the positive scenario for the real sphere is not actually the one most likely to come true).

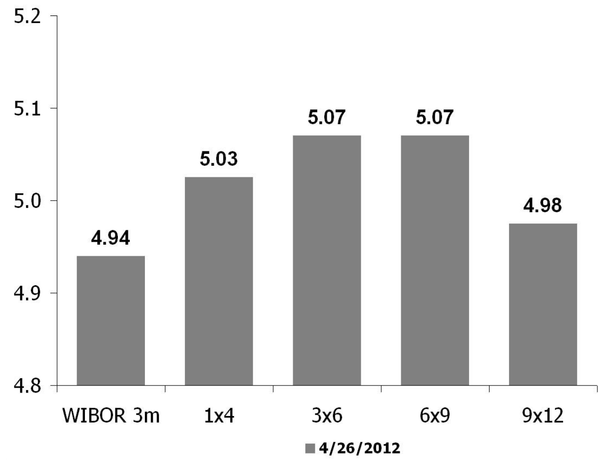
Fixed income

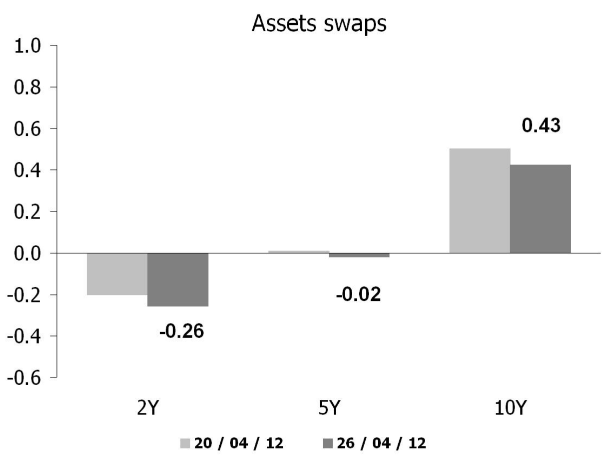
Long story

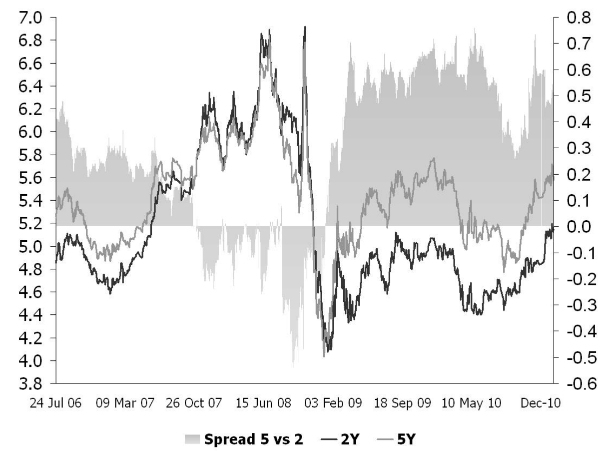
The past week was the festival of rate-setters' comments. The scale ranged (as usual) from very dovish comments by Bratkowski who doesn't see any inflation pressure and sees rates unchanged now and in some future to Winiecki, who wants to hike rates now and even open a rate hiking cycle due to stubborn inflation and very shallow GDP slow down, which will not be enough to bring CPI to target. Data only made the discussion louder, as after low IP and PPI looked like doves may have the upper hand, but retail sales and probably inflation expectations (they should print higher compare to last month) will put hawks in the driving seat. Market on rates followed to some extent, at moment we are pricing full 25 bp (the top was full 25 and 50% risk of the another 25 bp move following month), rest of the curve was more or less unaffected. The reason was good news from the fiscal side and good performance on the core markets. Bond market on the other side had completely detached itself from rates. The main market driver was (and still is) maturity of PS0412 bonds and huge cash inflow into bonds. Floating bonds are breaking new levels almost every day, short end ASW are at the ever lows. The trend is likely to continue, as one have to admit PLN assets are looking cheap comparing to other CEE bonds and they look much safer compared to Italian/Spanish/Belgian bonds. All in all, the bond market picture is unlikely to change anytime soon, we may have a brief moments of correction on the back of some risk events, worse econ readings, but secular trend is clearly for much lower bond yields in Polish government bonds.

On rates... MPC looks like they have decided and made their mind. While we cannot neglect their opinion (as it is MPC that sets rates) we tend to think (and everyday with bigger conviction) that economy had turned the corner. Growth is slowing, CPI can still be high (most likely it will rise again towards 4%+ level) but it has nothing to do with demand. The rebalancing has started already and the trend will be very strong. Again for rates it means they will be lower, maybe not now but in 1y, 2y time definitely. MPC can do little about it being so focused on spot CPI. To sum up in what is now a very long weekly report ahead of a very long weekend in Poland. Economy is rebalancing, and it is on the way to reduce deficits both external and fiscal, the latter due to proposed measures. CPI is high, but demand is already low. We like receiving spreads, we like to stay long bonds.









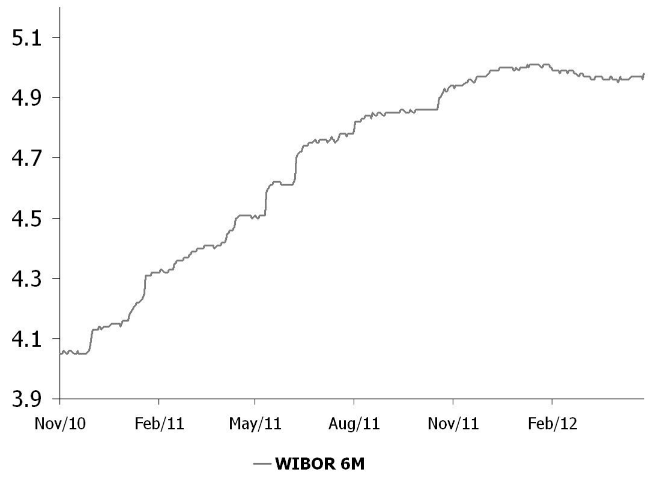
Money market

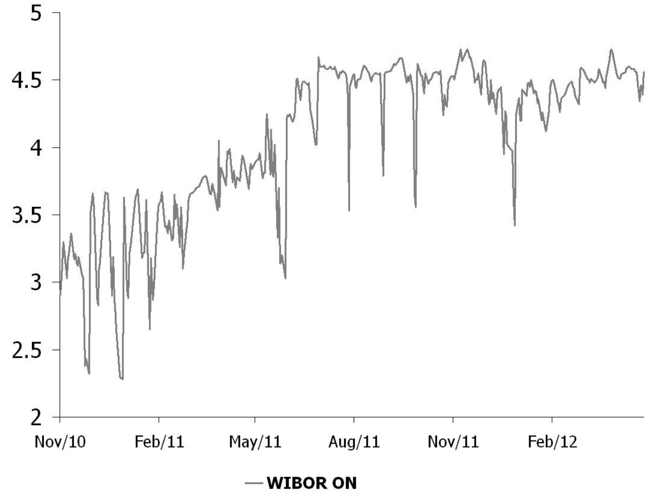
Cash remained high despite the incentives for cheapness. 50/50 for the next MPC meeting.

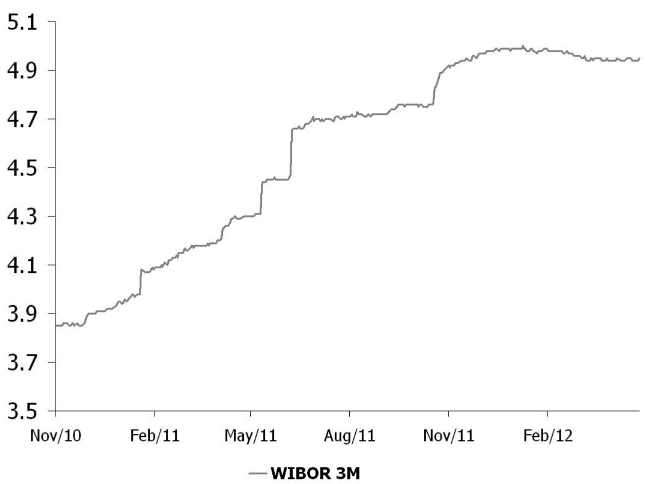
Cash remained relatively high comparing to its surplus in the system. Huge bond cash net inflow was completely washed off from the system, which for us is quite an achievement (just to recall we were expecting around 17 billion pln inflow partially paired off by the MinFin's BSB activity, but not all of it). To sum up, we had all incentives for cheap end of the reserve but the market was not responding in a usual way. Therefore one could conclude any structural changes for the liquidity lay-out and its redistribution facilities. Lets keep an eye on this issue.

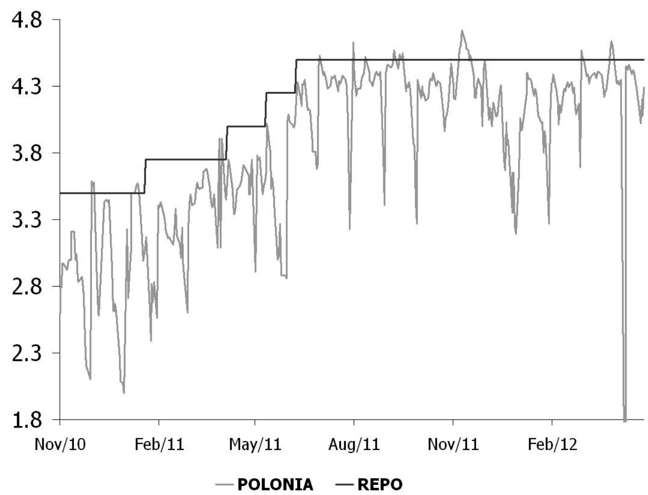
Retail sales almost in line with expectations, therefore did not change any arguments for the potential hike/not hike dispute. Probability looks like 50/50, and the only game changer could be rates cut to be possibly announced by the ECB. Nonetheless, we would rather be squared for the next MPC meeting.

Stay neutral.





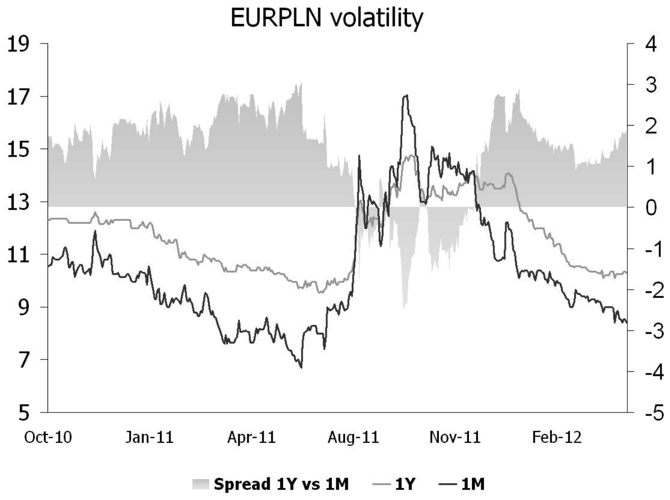




Forex

Range is intact he EUR/PLN held the 4.1600/4.2200 range for one more week. The main drivers are still the same: global sentiment and the development in peripheries countries. The local factors, data plus the rate hike expectations seems not to have strong influence on PLN at the moment. The longest w/e this year is looming on the horizon, with 1st and 3rd being the Polish holidays, which adds to current already „holiday" sentiment.

Consolidating at lows The current 3 years low in EURUSD vols is inevitably taking its tool on the XXX/PLN volatility curves. The both main curves EUR/PLN and USD/PLN are hovering around this year low and at the 3 years supports lines. The realized volatility is even lower till 3 month pivot , only above the 3 month the realized volatility is slightly above the implied. The risk reversals and flies are also being sold, the RR are in average down about 0.2% and flies about 0.15%. The Currency Spread (USD/PLN minus EUR/PLN) is more less stable (6.25 bid and given for 6 month).

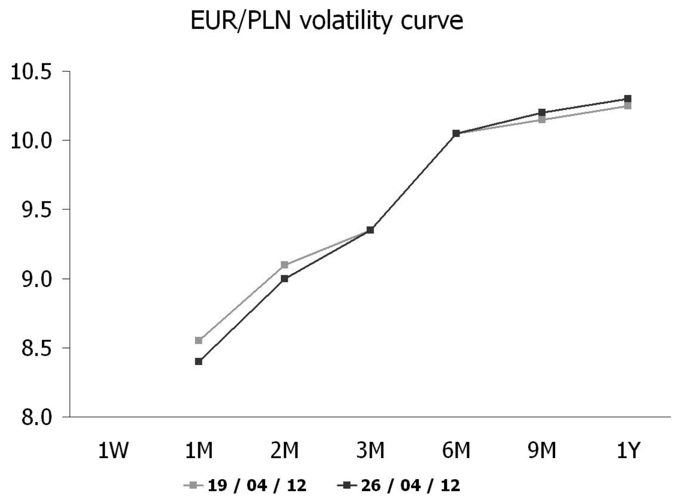


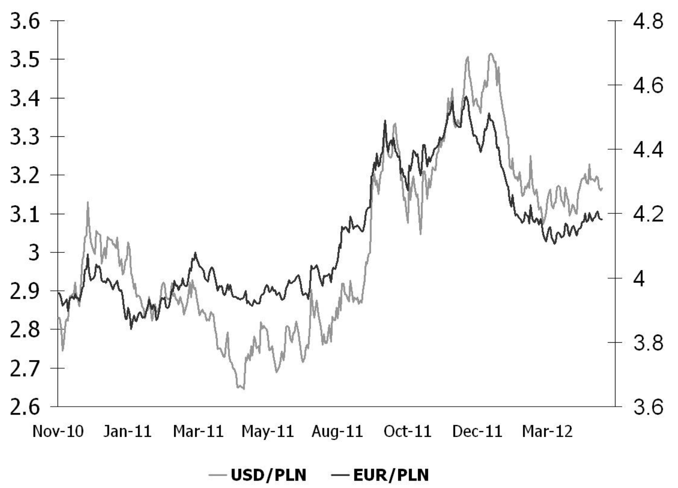
Short-term forecasts.

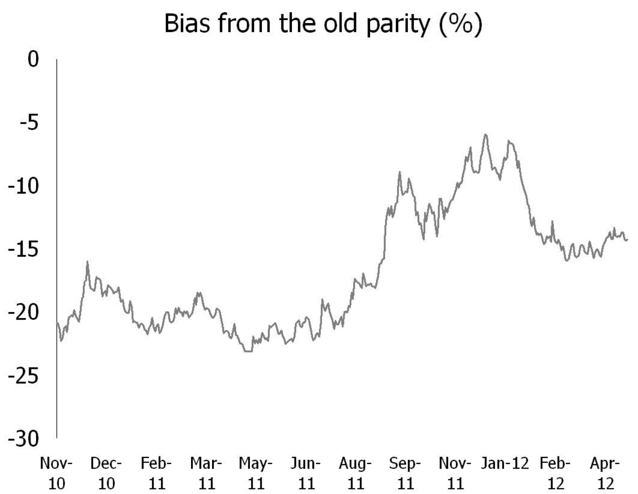
Main supports and resisances
EUR/PLN: 4.1500 / 4.2300
USD/PLN: 3.1000 / 3.2500

Spot. Play the range 4.1600/4.2000. It is the name of the game at the moment. One should be only disciplined with a short stop outside the current range level as the more time we spent within the range the probability of the strong breakout increases.

Derivatives We are square in EUR/PLN Vega/Gamma. 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 purchase a mid curve strike. It's 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
4/20/2012	4.47	4.94	4.49	6.49	4.50	6.59	5.02	5.07	5.07	4.98	4.78	5.09
4/23/2012	4.64	4.94	4.68	4.87	4.69	4.87	5.02	5.05	5.05	4.96	4.82	5.07
4/24/2012	4.75	4.94	4.64	4.87	4.65	4.87	5.00	5.04	5.03	4.93	4.79	5.03
4/25/2012	4.64	4.94	4.85	4.87	4.69	4.88	5.02	5.06	5.06	4.97	4.73	5.08
4/26/2012	4.58	4.94	4.63	4.86	4.63	4.87	5.03	5.07	5.07	4.98	4.78	5.07

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
4/20/2012	6.590	4.650	4.920	4.719	4.944	4.953	4.970	5.472
4/23/2012	4.870	4.600	4.920	4.668	4.930	4.953	5.003	5.483
4/24/2012	4.870	4.590	4.880	4.715	4.920	4.912	4.970	5.430
4/25/2012	4.880	4.590	4.910	4.625	4.900	4.887	4.960	5.408
4/26/2012	4.870	4.650	4.910	4.654	4.900	4.880	4.960	5.385

EUR/PLN 0-delta stradle					25-delta RR			25-delta FLY
Date	1M	3M	6M	1Y		1M	1Y		1Y
4/20/2012	8.40	9.35	10.00	10.25		10.25	3.65	0.60
4/23/2012	8.55	9.40	10.10	10.35		10.35	3.65	0.60
4/24/2012	8.55	9.40	10.10	10.35		10.35	3.56	0.63
4/25/2012	8.40	9.35	10.05	10.30		10.30	3.56	0.63
4/26/2012	8.40	9.35	10.05	10.30		10.30	3.47	0.58

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
4/20/2012	4.1885	3.1828	3.4853	3.8961	1.4117	0.1686
4/23/2012	4.2033	3.1972	3.4991	3.9440	1.4086	0.1678
4/24/2012	4.2059	3.1946	3.4992	3.9368	1.4096	0.1680
4/25/2012	4.1870	3.1675	3.4841	3.9018	1.4332	0.1681
4/26/2012	4.1825	3.1599	3.4809	3.8952	1.4560	0.1689

Disclaimer