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Comment on the upcoming data and forecasts

On Monday industrial production and PPI data will be published. Our production forecasts hit the relatively low consensus reading. Economic indicators and new orders point downwards with more and more ovisible slow down in construction sector. In PPI we do not expect further revisions. Our higher forecast is based mostly on Zloty depreciation and possible transfer of gas price increase also to other sections (this dependence is statistically significant but weak). On Tuesday NBP will publish core CPI reading - our calculations point to 2.7-2.8% growth rate mainly on apparel and housing prices growth. On Friday Statistical Office publishes last April data. We expect lower 8% growth of retail sales (consumer sentiment lowers, statistical base subtracts 1-2bp., reverse effect on clothing and footwear compared to March, lower contribution of food and beverages) and decrease of unemployment rate (seasonally adjusted rate remains stable, in recent months lower labor supply).

Polish data to watch: May 14 to May 18

Publication	Date	Period	BRE	Consensus	Prior
Industrial production y/y (%)	21.05.	Apr	2.8	2.8	0.7
PPI y/y (%)	21.05.	Apr	4.4	4.2	4.5
Core CPI y/y (%)	22.05.	Apr	2.7	2.4	2.4
Retail sales y/y (%)	25.05.	Apr	8.0	9.4	10.7
Unemployment rate (%)	25.05.	Apr	12.8	12.8	13.3

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	4200	5.047	5/18/2012
10Y T-bond DS1021	7/11/2012	4000	5.349	5/10/2012
20Y T-bond WS0429	7/11/2012	4000		5/10/2012

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	4.2	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

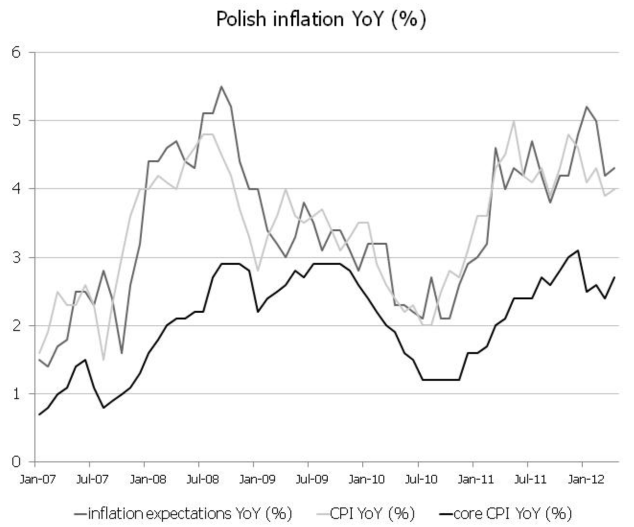
	2011 Q1	2011 Q2	2011 Q3	2011 Q4	2012 Q1	2012 Q2 F
GDP y/y (%)	4.5	4.3	4.2	4.3	3.6 (F)	2.8
CPI Inflation y/y (average %)	3.7	4.2	4.1	4.6	3.9	4.2
Repo rate (end of period %)	4.0	4.5	4.5	4.5	4.5	4.75

F - forecast

Economics

CPI accelerating...again, but labor market weakens

April CPI Inflation accelerated again towards 4% threshold. However, contrary to our expectations, the rise was not propelled by exogenous factors alone (food prices, fuel prices and state-controlled prices) but rather by core-loadings (wearing apparel, non-fuel transport categories, non-energy elements of lodging and housing). Food prices delivered even a downside surprise, but it was rather driven by vegetables that diverged from seasonal trends (there may be some payback in May then). We estimate core inflation at 2.7-2.8% in April. As for the coming months, May is likely to bring inflation at around 4.0% (with an upside risk); June and July are likely to mark this year's highs (4.5% - Greetings from the EURO2012!). Inflation is expected to settle below 4% at the very end of the year.

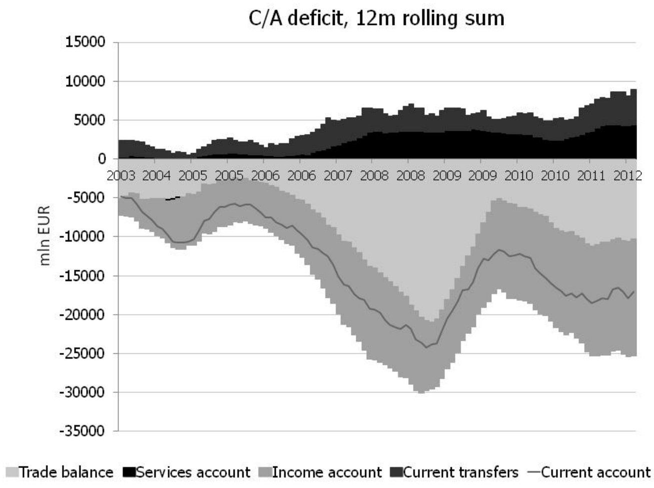


Average employment in enterprises sector increased in April only by 0.3% y/y compared to expected and recorded in previous month 0.5%. On monthly basis employment decreased third month in a row by 0.1% which equals to more than 8.3 thous. of workplaces (cumulated workplaces drop from February-April exceeded 20 thous.). In the months to come we expect further deterioration in employment level - monthly growth rate should stay in (-0.2)-0.0% range, which may result in negative annual rates in the second half of 2012.
Average wages in enterprises sector increased only by 3.4% y/y after 3.8% in March in spite of no difference in working days. Due to its lagging nature for the business cycle, interpretation of a single wages reading may be biased, but still we believe that in the forthcoming months trend on wages will further decrease. Negative real annual growth rate of wages with lower employment poses further threat to consumption.

Labor market data deepen MPC's dilemma on lower growth rate (especially consumption) and perspective of elevated inflation at least for 4 months. However, rate-setters may take into consideration that deceleration in the real sphere does not affect core inflation (it was a fact that was stubbornly repeated in the recent statements and also in „Minutes"). This fact, still optimistic business activity assessment (see the latest business tendency indicators released by the NBP) and combining high inflation risk first with zloty weakness and then with not sufficient risk premium in the shortest rates (the way of arguing not typical for the Polish MPC so far) suggest that the risk of another rate hike (excluding June, communication's wise) stays high. Therefore the seemingly divergence in the Polish monetary policy and the rest of the region and also the world may seem strange only at first sight.

Some quick thoughts on Polish balance of payments

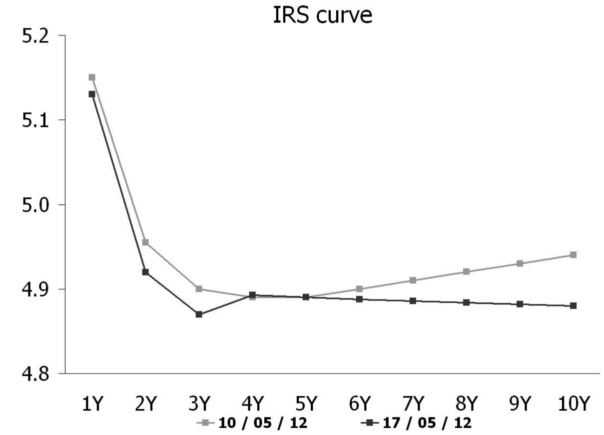
1. Current account proved better than expected in March: EUR -228mln vs -1585mln in February (expectations at -1000mln). The boost comes form expected part (large EU transfer, ca +900mln EUR) and unexpected part (narrowing of trade gap).
2. 2) Trade gap narrowing stems from lower imports. We have been expecting such a development for some months owing to lower consumption and possibly lower investment demand (infrastructure). The process is - as always - quite abrupt in NBP's statistics. Overall we expect trade balance to drift more towards zero (on average) in coming months, first on slowing domestic demands, second on better exports prospects (accelerating Germany, recent PLN depreciation).
3. 3) Owing to some revisions and favorable trade balance in March, net exports contribution in Q1 amounts to 0+. Therefore our forecast of 3.4-3.6% GDP growth in Q1 2012 makes perfect sense and all components finally fit (publication on May 31).

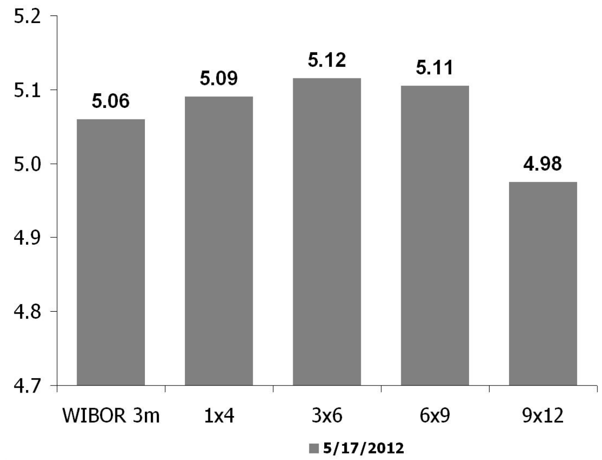


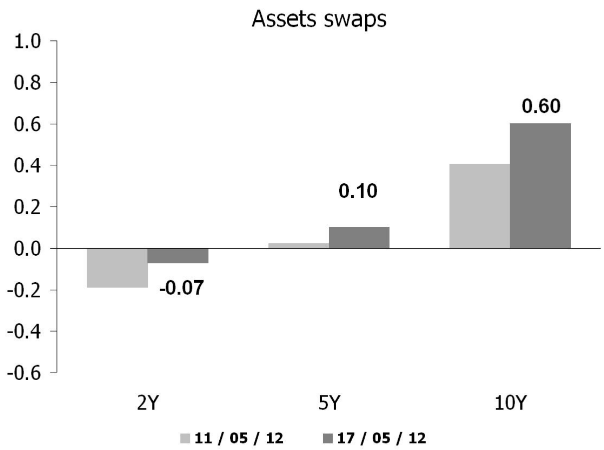
Fixed income

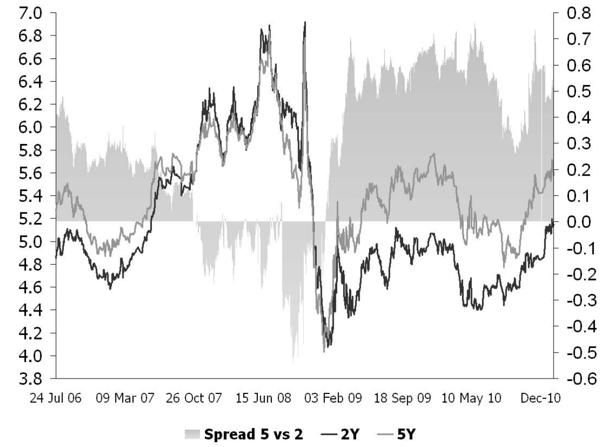
It's rates, not bonds

The move north in rates that has begun after last week's rate hike continued on Monday and noth 2y and 5y reached 5% mark again. However later on this move reversed and constant receiving interest prevailed. Amid worsening global sentiment the Finance Ministry successfully placed over 4bio of new 5-year benchmark PS0417. MPC members, who intended to withhold any individual comments on rates didn't quite do so and, surprisingly were quite dovish in their stance, suggesting wait-and-see attitude and expressed views on CPI coming back to target in the beginning of next year. Main theme of the week from trading perspective was widening of asset swaps practically across the curve. It seemed that rates had diverged completely from bonds, with former representing macro outlook and the latter credit risk solely. Apparently our preference for bonds over swaps turned out to be wrong as swaps moved down by almost 15bp whereas bonds lost a few bps. We are a little confused about what's going to happen next, as scale of impact of global risk-off story isn't really predictable. Nevertheless we would still lean towards lower rates and would expect bonds to recover some of previous losses. Main risk we see in the short term is the MPC, which will most likely leave rates unchanged on June meeting, but it is possible they will give some hint about possible tightening in July. That would of course put more pressure on the front end but 2y and longer shouldn't get hit.









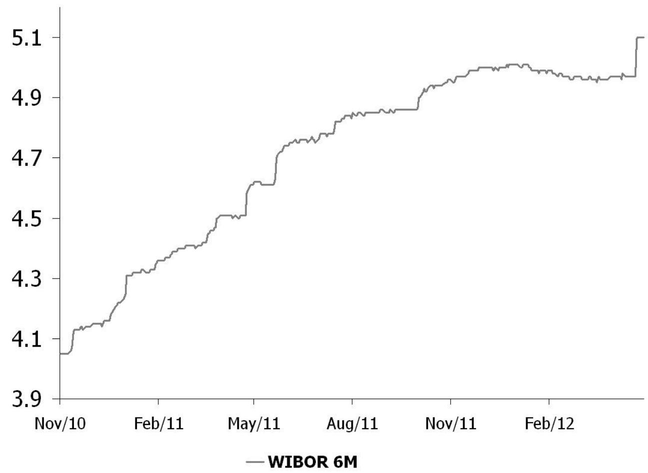
Money market

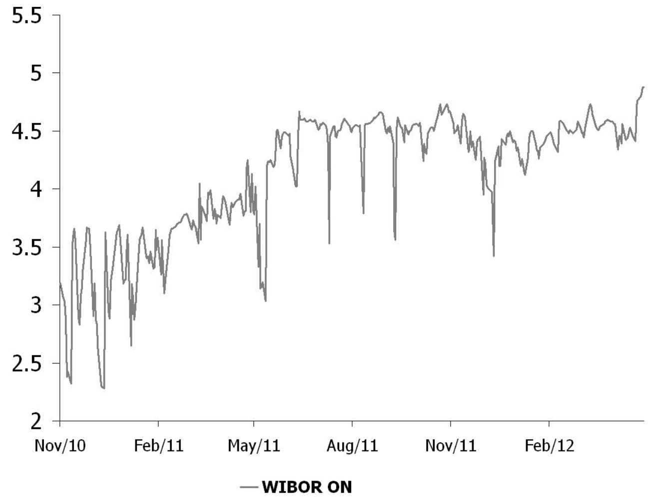
Expensive carry to release next week. Global sentiment affected currency and bonds.

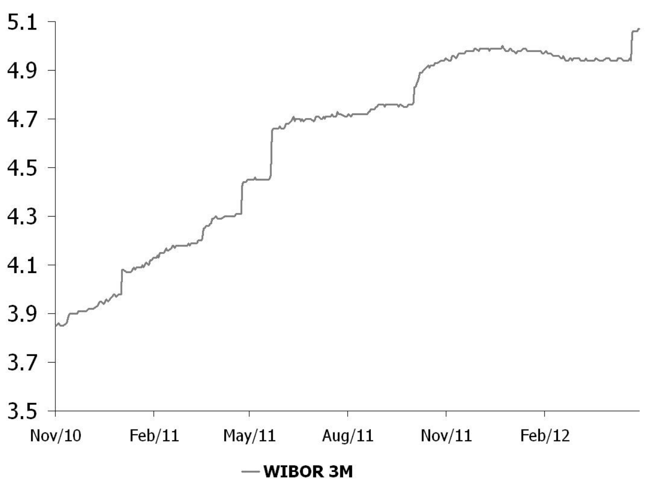
Expensive week as far as the cost of carry is concerned. Liquidity gap for the system reached 6 billion pln, and the polonia index was being fixed above the main market rate. This was corrected during today's OMO, since market bought 3 billion pln less bills than needed for the square account and 6 billion less than the supply (84.4 ag 90 billion pln). As a result we will observe falling shortest rates by around 20-30 bps for the next week.

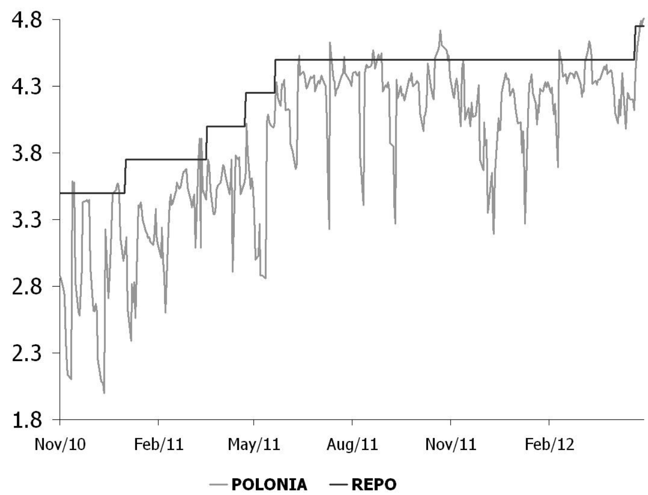
A bit higher then expected CPI figure (4% vs 3.9%) was not a direct incentive for the explosion of a bearish sentiment. This was global sentiment (mainly Greece never ending story) that significantly weakened Polish currency and also triggered risk off mode for bonds. Front end still does not believe in further tightening of the monetary policy, that is why we see value in paying it. We think that there is substantial risk of another hike in July. Some front end contracts are a zero cost hedge against further tightening.

Pay front end on dips.





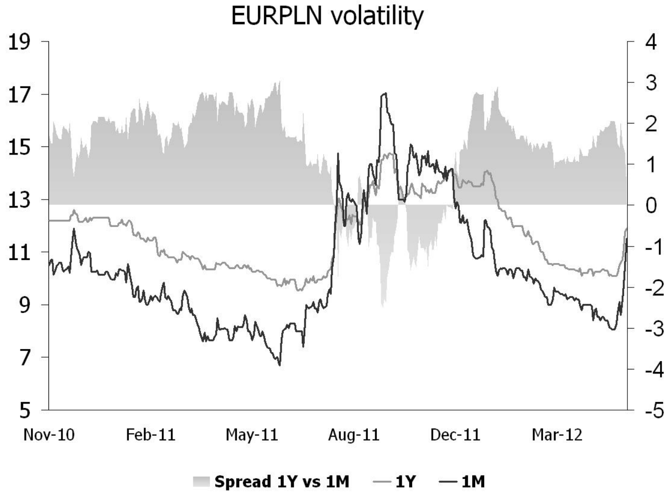




Forex

Zloty weaker The fear of an uncontrolled default of the Greek government and the exit of Greece from the euro zone - has increased, after it became clear that Greece will again hold parliamentary elections in due course. Financial markets have reacted heavily. The zloty has made one of it's biggest weekly loss this year of more than 3.2%, bringing EUR/PLN to 4.40 on Wednesday in the morning. Later better then expected C/A figures and Ministry of Finance who had sold EU funds on the market have helped the Zloty and EUR/PLN had slipped back to 4.35. In the end of the week EUR/PLN was traded in the range 4.3300/4.3750.

Spiked higher Volatilities on Zloty blasted higher with the rest of the markets: 1M vol EUR/PLN jumped from 8.6% to 11.7%, 1Y vol jumped from 10.5% to 12.2%.The skew also shot aggressively up - risk reversals jumped around 0.5% around (now 25RR 3M is 3.5%, 25RR 1y is 4.7%), and currency spread (the difference between EUR/PLN and USD/PLN) surged another week by 0.75-1%, and now is around 7.5%.

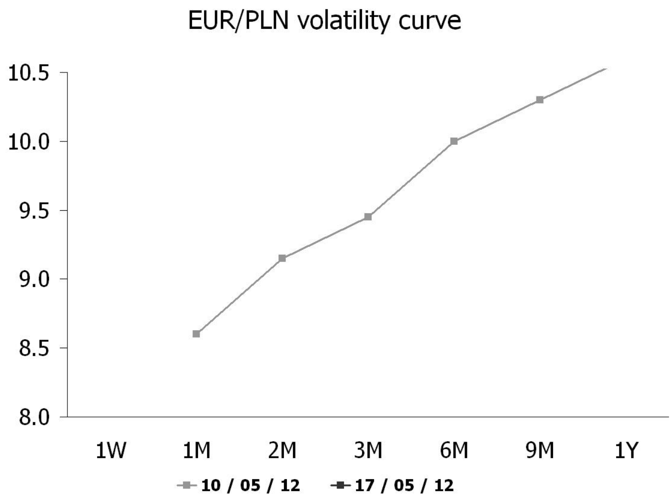


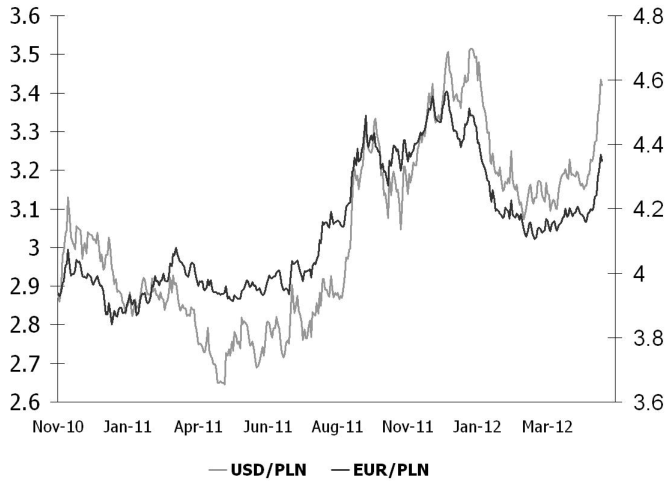
Short-term forecasts.

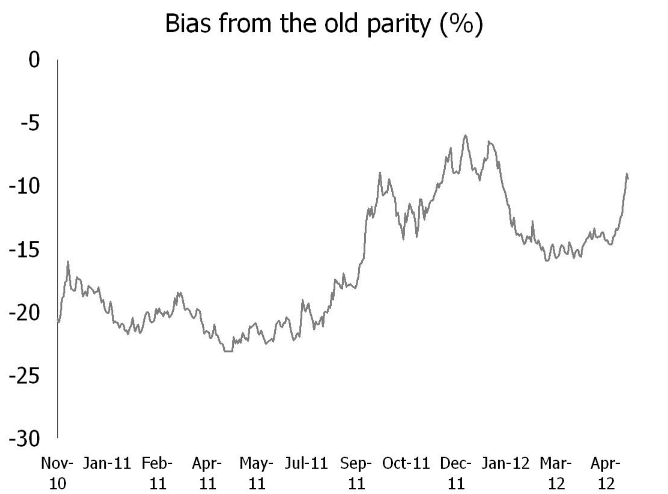
Main supports and resisances
EUR/PLN: 4.2500 / 4.4500
USD/PLN: 3.2000 / 3.55000

Spot. The violent move up on Zloty is the knee jerk reaction to the global turbulences (very serious to be admitted), but the polish fundamentals in contrast are still looking quite positive. We are better sellers of EUR in 4.37/4.39 region with a stop just above 4.40 hoping for a move to/bellow 4.30/4.28 where we would like to reverse to long EUR/PLN.

Derivatives The wild upswing in Vol was shocking in it's magnitude. The 10% level in 1 year EUR/PLN has acted as a steel floor one more time, now we are back in the mid of the wide 10-14% range. We look for a correction/consolidation to show the bid for Vega. The risk rally, volatility being so cheap seems to be, all gone. The LTRO sponsored party is about to end in tears...







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
5/11/2012	4.70	5.06	4.88	5.00	4.82	5.00	5.12	5.14	5.11	5.00	4.74	5.13
5/14/2012	4.64	5.06	4.95	5.00	5.03	5.00	5.09	5.17	5.13	5.02	4.80	5.16
5/15/2012	4.72	5.06	5.00	5.00	4.82	5.00	5.08	5.13	5.13	5.00	4.76	5.14
5/16/2012	4.70	5.07	5.15	5.00	5.02	5.01	5.09	5.13	5.13	5.00	4.77	5.12
5/17/2012	4.71	5.07	4.83	5.00	4.88	5.00	5.09	5.12	5.11	4.98	4.79	5.10

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
5/11/2012	5.000	4.813	4.978	4.789	4.935	4.958	4.960	5.367
5/14/2012	5.000	4.813	5.003	4.844	4.975	5.040	5.005	5.467
5/15/2012	5.000	4.813	4.978	4.858	4.910	5.023	4.940	5.453
5/16/2012	5.010	4.813	4.950	4.813	4.880	5.010	4.920	5.479
5/17/2012	5.000	4.813	4.920	4.850	4.890	4.990	4.880	5.481

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
5/11/2012	9.20	9.65	10.15	10.70	10.70	3.84	0.61
5/14/2012	9.75	10.10	10.60	11.15	11.15	3.84	0.61
5/15/2012	10.45	10.80	11.25	11.75	11.75	3.94	0.65
5/16/2012	11.50	11.55	11.65	11.90	11.90	4.00	0.64
5/17/2012	11.55	11.65	11.88	12.10	12.10	4.01	0.63

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
5/11/2012	4.2413	3.2765	3.5313	4.1010	1.4657	0.1682
5/14/2012	4.3000	3.3422	3.5808	4.1725	1.4706	0.1697
5/15/2012	4.3160	3.3579	3.5932	4.2023	1.4766	0.1698
5/16/2012	4.3682	3.4353	3.6371	4.2752	1.4765	0.1703
5/17/2012	4.3490	3.4194	3.6210	4.2556	1.4684	0.1706

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