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

Andrzej Torój
analyst
tel. +48 22 526 70 34
andrzej.toroj@brebank.pl

Financial Markets Department
(business contacts)

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

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

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

Financial Markets Sales Department
(business contacts)

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

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

We used to think for some time that owing to stability issues (in which it seemed MPC has had more interest recently) the willingness of MPC to raise rates will be predominant. It seems now we have been misled and there may be no clear strategy for rates and the future communication scheme will remain cautious. Therefore there may be no indication in June's statement regarding the July hike (uncertainty is too high for closing all emergency exits) and the recent rise of borrowing costs may be the final one this year. Hopefully, we do not expect MPC to be so eager for cutting rates (in this respect markets may be wrong), since inflation stays stubbornly high.

Polish data to watch: June 4th to June 8th

Publication	Date	Period	BRE	Consensus	Prior
MPC decision	06.06.		4.75	4.75	4.75

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	3.5	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

Polish economy shall not avoid slowdown

In q1 the GDP growth rate decreased to 3.5% y/y from 4.3% in 2011q4. The outcome - although close to the forecast consensus - is already a strong indication that Poland shall not avoid the cyclical slowdown, as suggested above all by the structure of growth.

As regards the GDP components, the consumption growth disappointed. Private consumption - in spite of a double-digit retail sales dynamics (and, interestingly, also of the acceleration in value added in most categories of market services) grew in q1 by mere 2.1% (unchanged in comparison with 2011q4). Consumption dynamics has turned out to be about 0.7 p.p. lower than in the NBP projection. As compared to 2011q4, the annual growth rate of investment fell (from 9.7% to 6.7%; the downward revision of the entire path of investment in 2011 is also noteworthy). It was a limited growth rate of investment in machinery and equipment that stood behind the lower overall rate. This can be concluded by comparing the growth rates of value added in construction and investment (the former accelerates, the latter decelerates). This means that a cyclical slowdown starts to affect the attractiveness of investment strictly associated with output or with expectations of future demand path in the private sector. It is worth to note that the story was very different last quarter which means that the uncertainty shock has had impact on Poland as well.

In q1 inventories and net exports contributed positively to the GDP growth (0.8 and 0.7 p.p. respectively). The latter value might indicate a (past) revision of foreign trade data (lower trade deficit). Also, in q1, the consolidation efforts by the Ministry of Finance were continued. Public consumption fell by 1.3% y/y, which strongly indicates that the fiscal policy will not support the GDP growth in the coming quarters.

On the supply side, it was predominantly the value added in industry that disappointed (growth fell from 6.6% to 3.4%). The dynamics of the remaining categories either accelerated (construction, trade, transport, information and communication, financial and insurance activities, real estate activities) or remained broadly unchanged / fell insignificantly (housing and restaurants, professional, scientific and technical activities, public administration and national defence). In the coming quarters, we expect the GDP dynamics to fall in a monotonous way. At the end of 2012 it shall arrive at 2% y/y. Also, the dynamics of private consumption will be falling further, except for a possible local spike during the Euro 2012 - mainly thanks to services - but do not expect fireworks. The outlook for a quick rebound of investment remains increasingly doubtful. Apart from the phasing-out infrastructural projects, it can also be negatively affected by the cautiousness of enterprises when launching new projects.

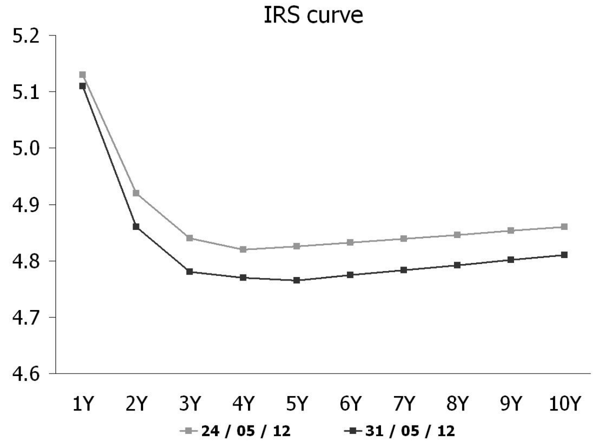
From the MPC's point of view, this data should be neutral, but only if treated in a way „expected, hence neutral". However, not once the MPC proved to be rather erring on the side of optimism ex ante, and on the opposite side ex post. Therefore we think the data may have added a pinch (not necessarily a small one) of salt to the MPC's assessment of the growth outlook. The more so since the future ECB behavior (and the state of the euro zone's economy) stays a big unknown to the MPC. We used to think for some time that owing to stability issues (in which it seemed MPC has had more interest recently) the willingness to raise rates will be predominant. It seems now we have been misled and there may be no clear strategy for rates and the future communication scheme will remain cautious. Therefore there may be no indication in June's statement regarding the July hike (uncertainty is too high for closing all emergency exits) and the recent rise of borrowing costs may be the final one this year. Hopefully, we do not expect MPC to be so eager for cutting rates (in this respect markets may be wrong), since inflation stays stubbornly high.

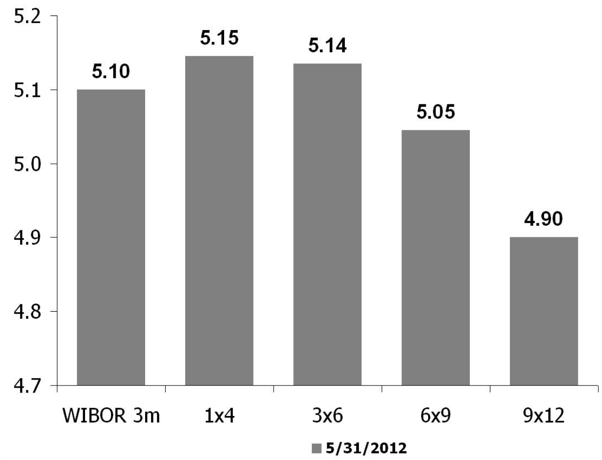
Fixed income

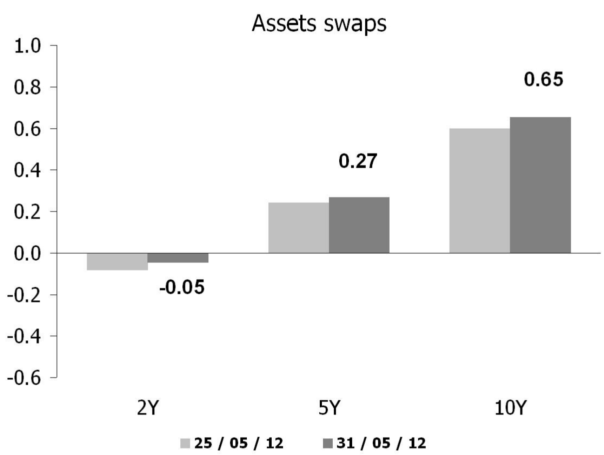
Fear factor

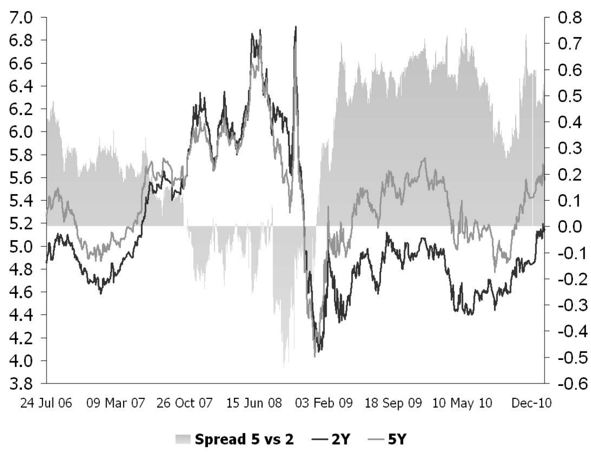
Last week didn't really brought much development on the FI market. Turnover stayed relatively low, receiving interest prevailed on rates side, bonds on the other hand were more vulnerable to global sentiment. 5y5y over euro widened by 35bp to as much as 275bp. Local data and factors have been quite neglected, as GDP was quite neutral from rates perspective, and supply plans for June published by Finance Ministry (one regular 5y papers auction and floaters on the switch) helped long end of the curve only temporarily.

We don't really expect much change of the picture in the nearest future. Next week's holidays will probably limit trading activity to just one day with both ECB and MPC decision. We don't expect Polish ratesetters to be hawkish in the current environment which would be genrally supportive for the curve, but it seems long way before external factors stop influencing POLGBs prices. All in all we still see scope for a sell-off very limited and once situation starts improving and data continue pointing towards a slowdown there is a lot of room for a rally. Fear and panic are always temporary.









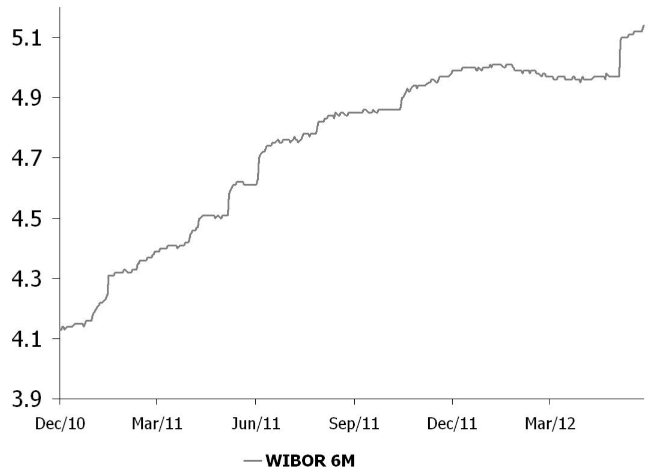
Money market

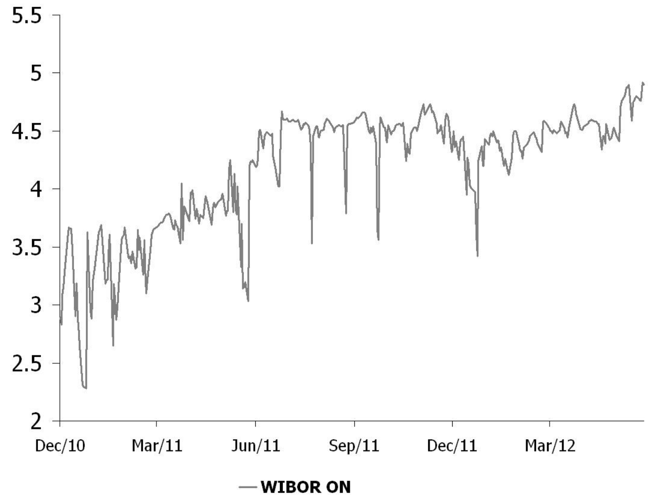
Further tightening of polonia and reference rate spread. Short term rate futures below wibors.

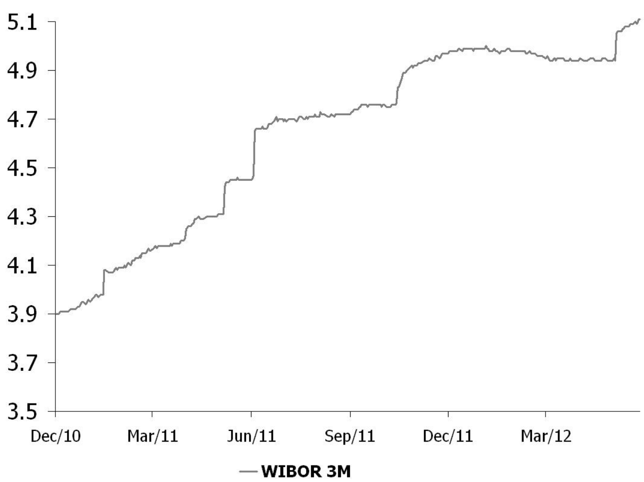
A bit cheaper end of the reserve after exclusion of the very last and very expensive day. Looks like the market is not willing to let the shortest rates fall down and we can observe further tightening of the main rate-polonia spread. June should be similar since we do not see any factors that could help in improving the liquidity redistribution in the Polish sector. To sum up, liquidity of the sector very high, however with the very asymmetric layout and very inefficient redistribution facilities.

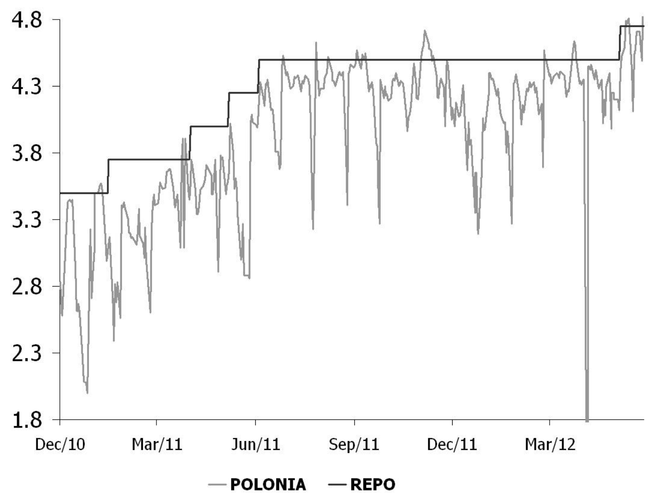
Front end still looks cheap. Wibor rates go up, club med countries are not feeling better, corporate debts roll-over ahead for a huge amounts, Polish zloty very weak. It all should be an argument for higher front end rates, not to mention still existing possibility of a rate hike. Therefore we keep up our recommendation of staying pay.

Pay short rates in 3-6 months sector.





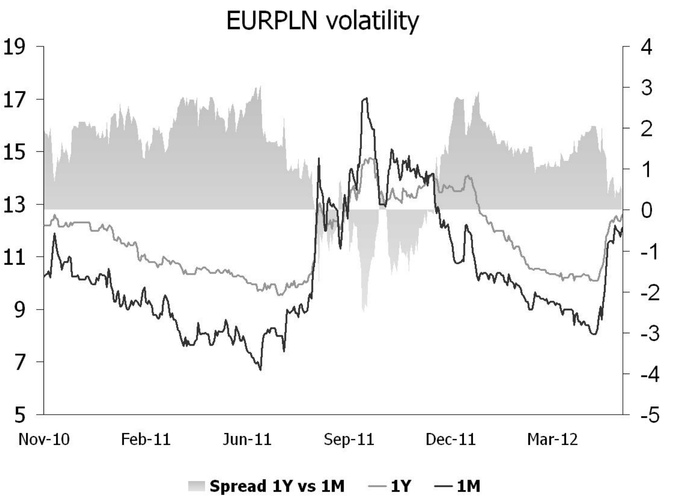




Forex

Breaking higher The consolidation of EUR/PLN in the wide 4.3050/4.4050 range seems to be over. The sourer and sourer global sentiment it's taking it's tool on Zloty, and even aggressive BGK/Ministry of Finance currency selling, can only smooth the pass of deterioration. Current high is 4.4250, but much important resistance level looms at 4.4350 and above that, the way to 4.5000 is being open. The global sentiment is a core driver of PLN, and we doubt that any local news may stand in the way.

Creeping higher The core volatility curves (i.e EUR/USD) are moving higher... The EUR/PLN broke through 4.4000... The vols on both main currency pairs (EUR/PLN, USD/PLN) are also higher as an obvious result. The 1 month ATM EURPLN mid is now 12.5% versus 11.85% mid last week, the change for EUR/PLN 1Y is 12.7% now in comparison with 12.4%. The currency spread (difference between USD/PLN versus EUR/PLN) is higher 0.25%, roughly 7.85% + the whole curve. The Skew is also decently bid.

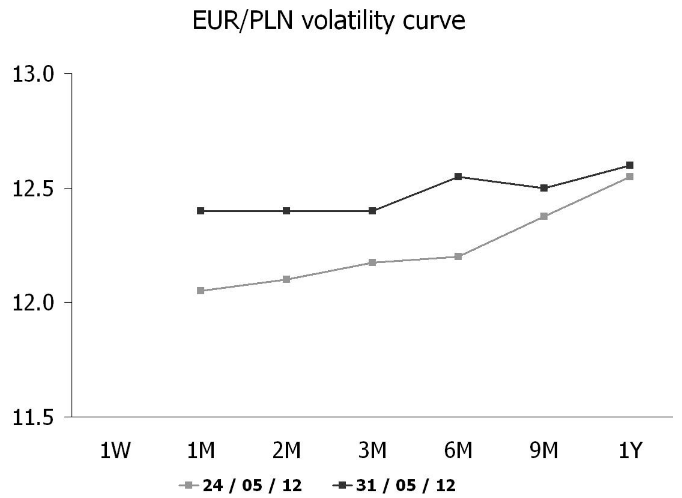


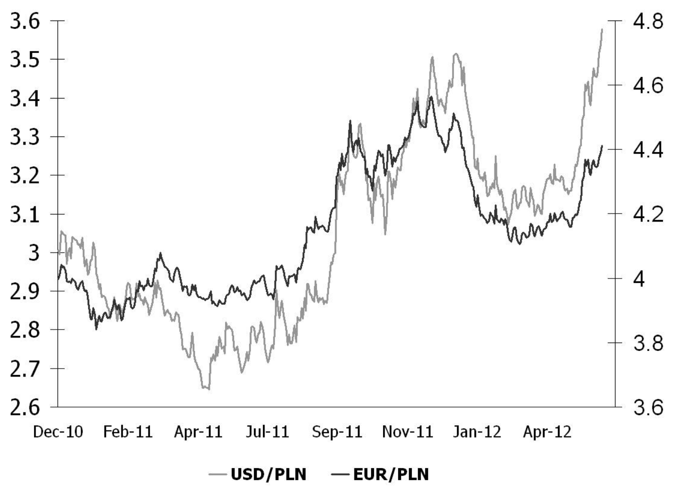
Short-term forecasts.

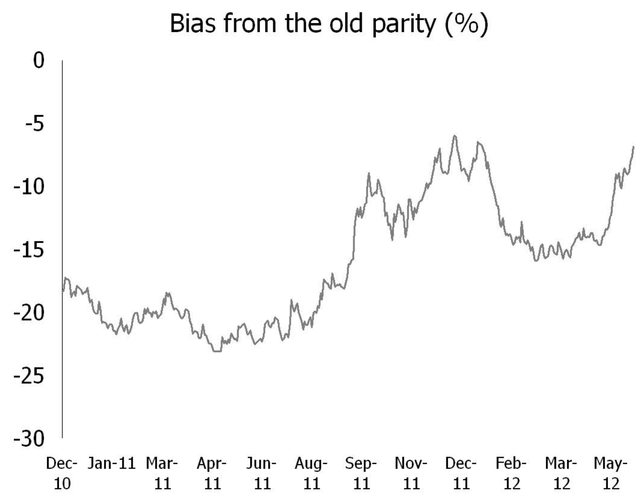
Main supports and resisances
EUR/PLN: 4.3500 / 4.4800
USD/PLN: 3.4000 / 3.7000

Spot. We have negative global sentiment on one side, and the Ministry of Finance currency sells on the other. The Zloty already lost a 8.28% from the strongest level 4.0855 this year in EUR/PLN terms, the deterioration versus USD is much more dramatic 17.28%. We are being prone to the bigger (a few percent) correction, but the trend seems to be tireless. We rather put bids for EUR/PLN in 4.38/4.41 region with stop below 4.35 and hopes for a test of 4.5000, where we revert the position.

Derivatives The level of uncertainty is higher and higher. So in current environment we are strongly exposed to higher levels, the last year highs 15% at 1 month and 14% at 1 year are strongly in sight. Even a relief rally will not change much as the move will keep the gamma being valuable, in other words still bid.







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
5/25/2012	4.77	5.09	4.82	6.49	4.90	6.59	5.10	5.12	5.05	4.92	4.73	5.07
5/28/2012	4.73	5.10	4.83	5.02	4.83	5.02	5.12	5.14	5.05	4.93	4.72	5.05
5/29/2012	4.73	5.09	4.77	5.02	4.77	5.02	5.13	5.13	5.05	4.90	4.67	5.04
5/30/2012	4.74	5.10	4.84	5.02	4.77	5.03	5.12	5.13	5.02	4.89	4.71	5.03
5/31/2012	4.61	5.11	4.91	5.03	4.94	5.04	5.15	5.14	5.05	4.90	4.71	5.04

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
5/25/2012	6.590	4.813	4.895	4.813	4.790	5.032	4.840	5.439
5/28/2012	5.020	4.813	4.880	4.828	4.790	5.025	4.828	5.425
5/29/2012	5.020	4.813	4.870	4.795	4.765	5.016	4.820	5.410
5/30/2012	5.030	4.813	4.860	4.803	4.775	5.056	4.825	5.471
5/31/2012	5.040	4.813	4.860	4.814	4.765	5.032	4.810	5.464

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
5/25/2012	12.00	12.10	12.10	12.40	12.40	4.13	0.64
5/28/2012	11.93	12.05	12.10	12.35	12.35	4.13	0.64
5/29/2012	11.75	12.05	12.15	12.35	12.35	4.13	0.64
5/30/2012	12.10	12.45	12.50	12.60	12.60	4.11	0.61
5/31/2012	12.40	12.40	12.55	12.60	12.60	4.03	0.66

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
5/25/2012	4.3510	3.4589	3.6206	4.3460	1.4522	0.1715
5/28/2012	4.3442	3.4535	3.6126	4.3512	1.4551	0.1716
5/29/2012	4.3511	3.4675	3.6203	4.3607	1.4554	0.1712
5/30/2012	4.3731	3.5139	3.6411	4.4300	1.4636	0.1708
5/31/2012	4.3889	3.5372	3.6545	4.4833	1.4610	0.1708

Disclaimer