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

Piotr Bartkiewicz
analyst
tel. +48 22 526 70 34
piotr.bartkiewicz@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

Jacek Jurczyński
structured products
tel. +48 22 829 15 16
jacek.jurczynski@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

All the main publications from this week happen on Thursday. Our slightly above-consensus forecast of inflation is based on higher fuel prices (1.2% m/m), EU-driven increases in tobacco prices and stable food prices (0.5% m/m). Prices in the core basket remain in downtrend though - core CPI rate should fall to 1.4% y/y. At the beginning of the year new weights in the inflation basket are introduced, which may have changed the previous release by ca. -0.1pp. According to our forecasts current account deficit widened in January due to higher payments on national debt influencing the balance of income. Compared to the previous month, net transfers from the EU were lower in January but trade balance improved on exports acceleration. In money supply data we expect slightly higher growth rate as a result of steady growth of household deposits (by more than 7% y/y) and low statistical base on „others" category, which subtracts ca. 0.5-0.7 pp from the headline growth. Some risk comes from recent interest in riskier assets (such as mutual funds), which are substitutive to safe deposits.

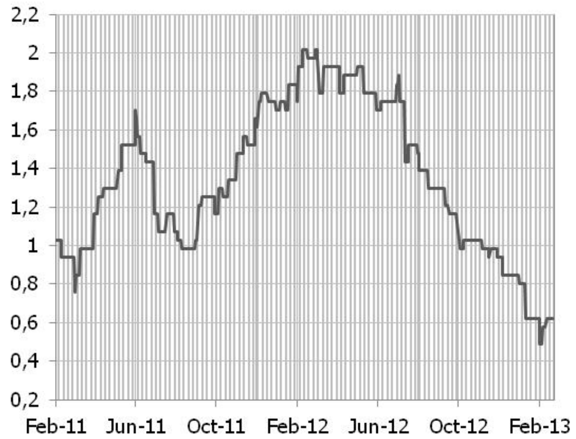
Polish data to watch: March 11th to March 15th

Publication	Date	Period	BRE	Consensus	Prior
CPI y/y (%)	14.03.	Feb	1.6	1.5	1.7
C/A balance (mln EUR)	14.03.	Jan	-1685	-1547	-1204
Exports (mln EUR)	14.03.	Jan	12550	11999	10640
Imports (mln EUR)	14.03.	Jan	12700	12475	11852
M3 y/y (%)	14.03.	Feb	5.3	5.0	4.5

Treasury bonds and bills auctions

Paper	Next auction	Last Offer	Last yield (%)	Prev auction
52 Week T-bills	-	3000	3.485	3/4/2013
2Y T-bond OK0715	3/20/2013	3000	3.456	2/13/2013
5Y T-bond PS0418	3/20/2013	4000	3.521	2/7/2013
10Y T-bond DS1023	-	4000	3.847	1/7/2013
20Y T-bond WS0429	-	4000	3.896	1/7/2013

Reality vs analysts' expectations (surprise index* for Poland)



Comment
Past week with no macro publications kept surprise index unchanged. Analysts seem to finally internalize the depth of current slowdown - further index changes depend on Thursday data.

* Surprise index presents in a synthetic way how the market was surprised by macroeconomic releases (it is constructed on daily basis as weighted average of differences between selected releases and Bloomberg forecast consensus).

Our view in a nutshell

Fundamentals

- We see more risks towards stagnation (not contraction) in H1 2013. External developments (moderate growth in Germany, zero growth in euro zone) are not dynamic enough to offset deceleration in domestic demand. Consumption growth close to zero (low savings rate, deleveraging urgently needed), negative investment growth rate (public investment as an original damper to growth, private investment to dip into negative territory soon on weak demand prospects), restrictive fiscal policy.
- A faster re-acceleration of the euro zone economy and low statistical base seem to be the most obvious reasons for a rebound of the Polish economy in H2 2013. However, given the scale of slack in investment and consumption, any rebound generated this way may be only moderate (about 2%y/y growth rates in Q4 2013). Poland has entered a period of weaker growth.
- Polish government committed to the convergence path, though in an unorthodox way. Very limited room for fiscal stimulation due to limited financial markets tolerance for higher debt. We expect Poland to be exempted from EDP deficit procedure in summer this year. Rating upgrade by two major rating agencies is quite likely as well.
- Inflation set to moderate in the near term on statistical effects (high base from 2012) and in mid-term on lower core inflation (close to 1% in mid 2013). CPI inflation at close to 1% in Q2 2013. The possibility for significant undershooting of inflation target in 2013 is high.
- The March decision of 50bps rate cut concludes the monetary easing cycle that started in November 2012. It appears unlikely that the Council will resume easing.

Financial markets

- 2013 most likely not a ”bond year”. Global ”rotation” of assets poses headwind for debt.
- Monetary easing cycle came to an end. MPC (through steepening of the curve) made long-term papers more attractive and provided foreign investors with arguments against leaving the Polish bond market. Increasing the so called roll-down might favor increases in domestic investors’ duration
- Polish long term bonds now even more sensitive to core markets developments. Ultimately, global recovery (or monetary stimulus withdrawal) and rising core yields (ECB ruling out refi rate cuts, Fed discussing exit strategy) may adversely affect Polish bonds.
- We still expect POLGB’s to stay at historically low levels (10Y below 4.50% in yield).
- Cyclical behavior of the Polish zloty far weaker than in 2008-2011 as current account has been narrowing and euro zone disintegration risks were put aside with ECB put. Hence we expect only slight weakening of the zloty with 4.22/25 (technical analysis) acting as a hard resistance.
- Volatility on both FX and FI lower due to so-called ECB put.

BRE forecasts

	2008	2009	2010	2011	2012	2013 F
GDP y/y (%)	5.1	1.6	3.9	4.3	2.0	1.0
CPI Inflation y/y (average %)	4.3	3.5	2.8	4.2	3.7	1.6
Current account (%GDP)	-5.3	-1.6	-4.5	-4.9	-3.6	-2.5
Unemployment rate (end of period %)	9.5	12.1	12.4	12.5	13.4	14.2
Repo rate (end of period %)	5.00	3.50	3.50	4.50	4.25	3.25

	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2013 Q1 F	2013 Q2 F	2013 Q3 F	2013 Q4 F
GDP y/y (%)	3.6	2.3	1.4	1.1	0.5	0.9	1.4	2.0
Individual consumption y/y (%)	1.7	1.2	0.1	1.0	0.4	1.0	1.8	2.3
Public Consumption y/y (%)	-0.8	0.5	0.2	0.2	0.5	0.5	0.5	0.5
Investment y/y (%)	6.0	1.3	-1.5	-0.3	-3.0	-3.0	-2.0	-1.5
Inflation rate (% average)	3.9	4.0	3.9	2.9	1.5	1.4	1.5	1.8
Unemployment rate (% eop)	13.3	12.4	12.4	13.4	14.7	13.9	13.5	14.2
NBP repo rate (% eop)	4.50	4.75	4.75	4.25	3.25	3.25	3.25	3.25
Wibor 3M (% eop)	4.94	5.13	4.92	4.11	3.40	3.40	3.40	3.40
2Y Polish bond yields (% eop)	4.62	4.60	4.05	3.14	3.30	3.30	3.40	3.40
10Y Polish bond yields (% eop)	5.50	5.15	4.69	3.74	3.90	4.00	4.10	4.30
EUR/PLN (eop)	4.15	4.22	4.12	4.08	4.15	4.10	4.05	4.00
USD/PLN (eop)	3.11	3.35	3.20	3.09	3.14	3.21	3.24	3.20

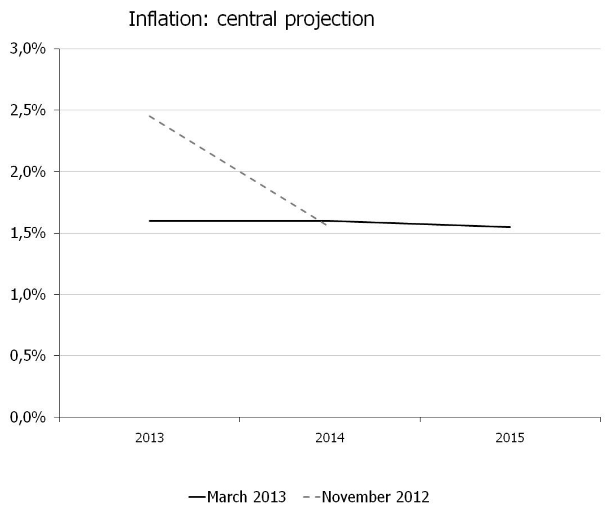
F - forecast

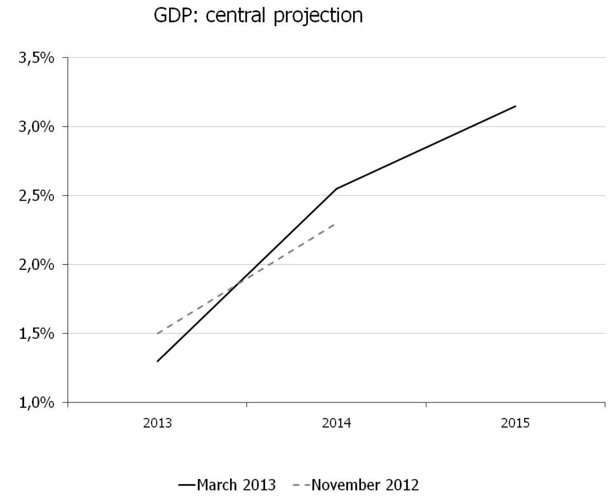
Economics

MPC ends the cycle with a bang

The Council surprised the market (which remained skeptical of any further cuts) with a 50 bps cut, thereby lowering the repo rate to 3.25%, the lowest level in history. Such a move is substantiated by the state of the economy: household consumption and internal demant in recession, inflation dropped well below the Central Bank's target. We predicted a 25 bps cut but consistently expected that the rate will evenetually be reduced to 3.25%.

The MPC quite unambiguously indicated that the current monetary easing cycle has come to an end - the statement contains a significant sentence: "The March decision concludes the monetary easing cycle that started in November 2012". Such an interpretation of the statement was confirmed during the press conference when gov. Belka even used the phrase "wait and see". Granted, this does not preclude further cuts but we are under the impression (reading between the lines) that any other scenario would require a dovish majority in the MPC that does not exist and is unlikely to appear in the future. The decision was motivated by the results of latest inflation projection. Within the entire forecast horizon inflation is projected to remain below NBP's target, which - in light of MPC's mandate of price stability - provides enough room for rate cuts. Rebound in GDP growth is very slow and the 2013 forecast has been revised downwards from 1.5 to 1.3% y/y. Main results of the projection are presented below:





It appears unlikely that the Council will resume easing - it has been indicated during the press conference that actual macro figures would have to "substantially" deviate from projection's central path to force a change in the Council's mindset. The Council has already internalized inflation undershooting the target as well as a very flat grow path in the second part of the year. Reputational issues also make further cuts unlikely.

Wednesday's statement should calm market expectations regarding interest rate cuts. The end of the cycle should work in favor of steepening the yield curve. This tendency will be supported by global trends (upswing in the US) and a better (in our view) second half of the year. A total of 150 bps in rate cuts is enough to moderately boost consumption later this year and the same applies to private investment (credit demand curve is not vertical).

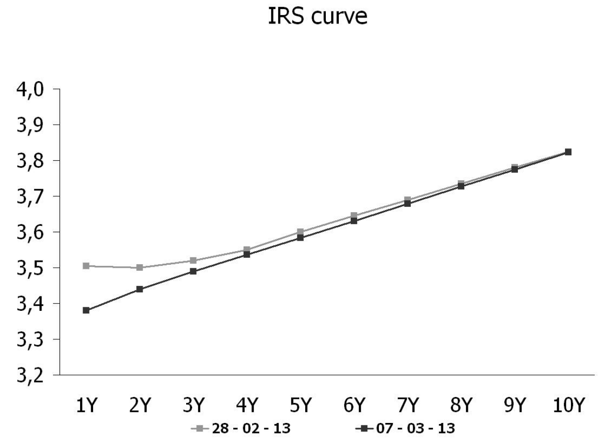
One should also note that the MPC (through steepening the curve) made long-term papers more attractive and provided foreign investors with arguments against leaving the Polish bond market. Increasing the so called roll-down might favor increases in domestic investors' duration. This should be an imminent implication of the MPC action. Long term perspective we investigate in the previous paragraph.

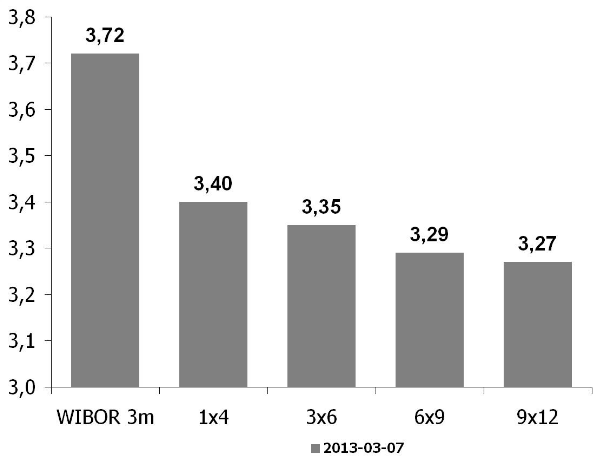
Fixed income

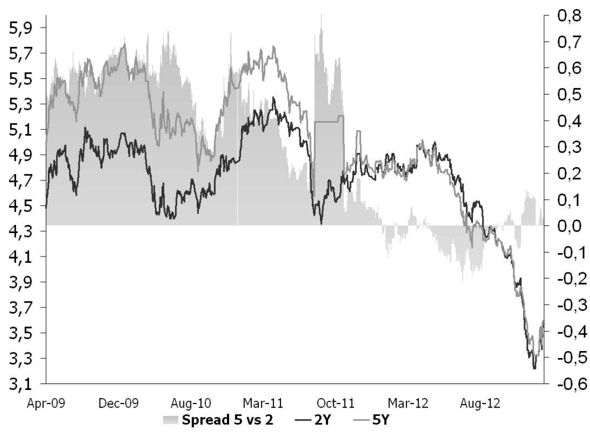
The easing cycle summary

For the last 12 months the market participants have struggled hard to understand the way the Polish MPC runs its policy and the mechanism of decision making. From April 2012 we encountered the huge discrepancy to how the market analysts and traders believed the yield curve should look like and the Council's decisions together with the skill to communicate with the market. Few months before the thoroughly analyzed and broadly expected economic slowdown in Poland the MPC decided to raise the repo rate and generated huge losses among the market participants. When the economy started to collapse in the H2 it looked obvious the Council should start to lower rates as quickly as it was possible by 50-75bp in the first shot just to offset the previous unnecessary tightening in May and to overtake the yield curve. To the market surprise it never happened. Moreover, after November and December 25bp moves when the market expected more substantial action in January the governor Belka announced the near end of the easing. Finally after the neutral or even hawkish stance on a conference after the February meeting together with the quite promising economic data (both industrial output, retail sales and Q4 2012 GDP data much better than expected suggesting the slowdown might have not been such deep as we doomed) the market participants believed the MPC released the signal to pause in March or end the cycle with another 25bp down. Moreover, before the Wednesday's meeting even the most dovish members stressed there was no point to cut more than 25bp at that moment of the cycle. The risk-reward analysis pointed both 25bp cut or a hold as equal probable generating the huge value to pay at the still substantial inverted FRA curve. The MPC hit the market with the 50bp ending the cycle and leaving the huge losses and misunderstanding on the market again. The front end of a yield curve fell by 25-30bp with a very nervous trading. That was the history.

As we expected already in June 2012 the repo rate fell by 150bp from 4.75% in May to 3.25%. In our opinion the easing cycle is likely to be over though we could not exclude the market would play another 25bp at the July CPI projection (June-July CPI lowest reading projected). The yield curve has steepened quite a bit after the meeting trading 2y5y spread at 15 points (6 points lowest reading before the meeting) and would likely to follow that direction further in the coming months. All spreads look like to be paid especially 1y2y fwd ag 1y1y fwd that seems to be a bargain now (very steep reds and almost flat greens). The short end of a curve has no longer value. The longer end of a curve would likely to follow the core markets now more than ever (the monetary policy factor has been vanished). As a market strategy we would prefer not to be exposed at that moment and wait for another set of economic data seeking for any value that might reappear.





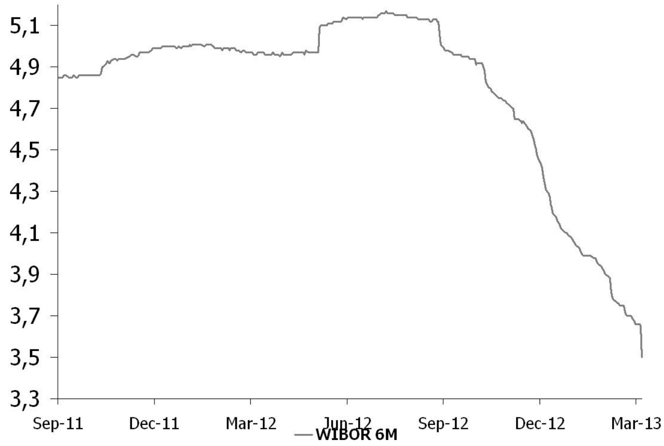


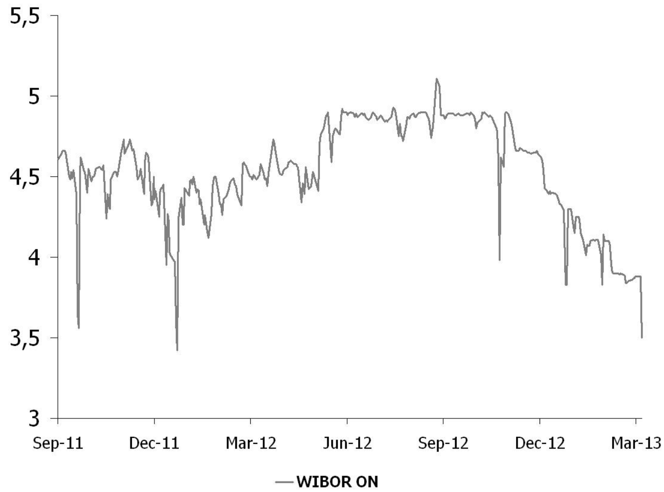
Money market

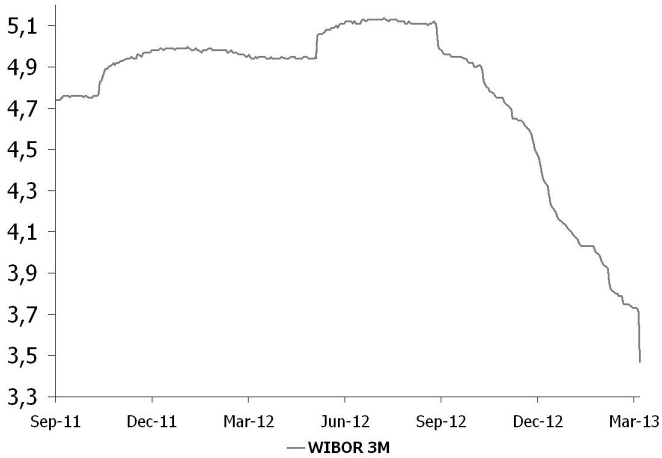
Surprising 50 bps cut Cash should soften a bit next week, since after today's underbid OMO (125.5 vs 127.5 bln pln) we are left with 2 bln pln cash surplus in the system. There is some balanced interest to trade 3M deposits nearby 3.4% level, which should anchor the Wibor rates close to where we are now (3.46% 3M and 3.49% 6M). However, steepener should be more visible soon.

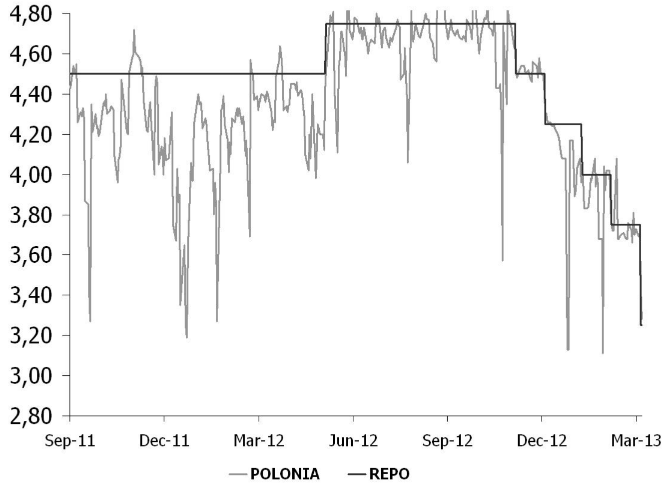
Upcoming data looses value The MPC unexpectedly cut all the rates by 50 bps signalling at the same time that the move is a full stop of this cycle. Since before the decision market was more for a hold than a cut, the curves needed to reprice quite rapidly. Longer IR contracts dropped 15-25 bps since expectations of one cut were already built in. Shortest, like week Oiss, moved accordingly full 50 bps.

The MPC decision leaves the market immune for upcoming local data at least for some time. Global factors may be scenario changer but only within the narrow range. Therefore, the most probable scenario, at least for some time, points low volatility environment. Lets keep the fingers crossed for some unexpected action!







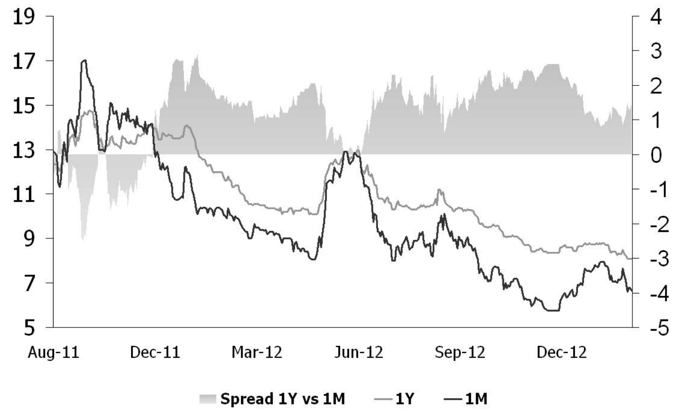


Forex

Storm in the glass The news of the week was a shocking decision of MPC to cut the rates by 50bp. and call it the end of the cycle. EUR/PLN soared from 4.1200 to 4.1650 in the blink of an eye. The end of the cycle heralded on the MPC conference, calmed the stormy waters and zloty began to slowly regain same of its shine. The bigger picture is we still in the range 4.12/4.17, but if EUR/PLN was not able to move substantially higher on the surprising 50bp. cut, we should probably pin the 4.10/4.12 as a possible target, if any positive news arise.

Tic Lower The inability of EUR/PLN to break out the range, the extremely low realized volatility (especially on daily basis) and all the above forced the vol curve lower again. 1 month EUR/PLN ATM mid fixed this week at 6.25% (6.7% last week), 3 month EUR/PLN ATM is lower by 0.3% to 6.9%, 1 year EUR/PLN ATM hardly changed 8.0% (8.1% last week). The currency spread (deference between USD/PLN and EUR/PLN) was better offered with EUR/USD firmly above 1.30.

EURPLN volatility



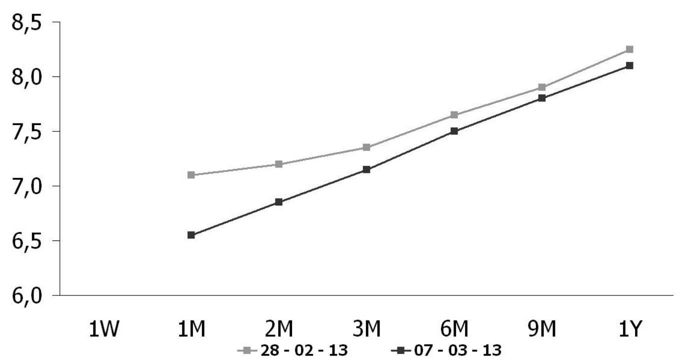
Short-term forecasts

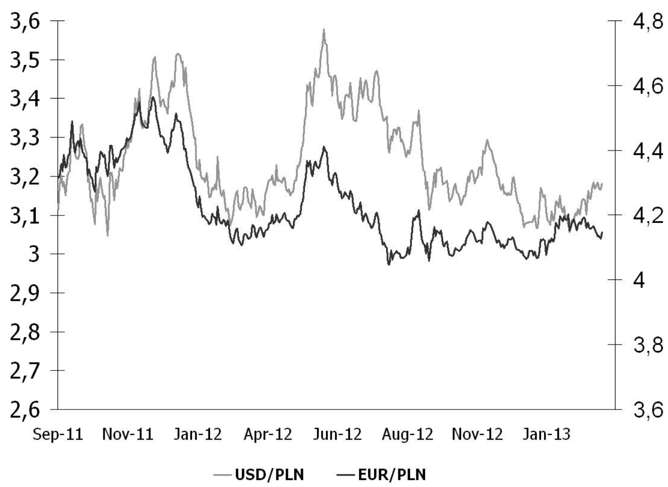
Main supports and resistances
EUR/PLN: 4.1000 / 4.1700
USD/PLN: 3.0500 / 3.2000

Spot The view is unchanged. We still believe in the range trading, with a selling EUR/PLN spikes, the preferred strategy. Ideally we would like to sell 4.16, add 4.18 with a stop above 4.20, and hopes for 4.10. The longs in EUR/PLN we keep light and adopt short s/l.

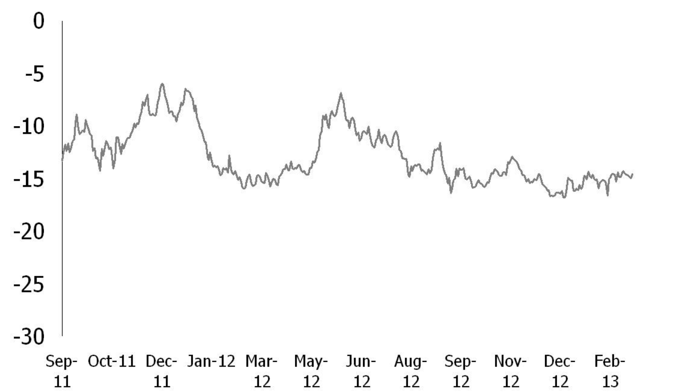
Derivatives Unchanged from the last weeks.
The current sell off in vols does not really change the bigger picture, in general the current levels are ultra low and close to pre Lehman. We think that selective longs in the middle of the curve of EURPLN are the position to have. We still need the confirmation from the realized volatility to show more aggressive bids on the market. The preferred strikes are close to ATM.

EUR/PLN volatility curve





Bias from the old parity (%)



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
3/1/2013	3.55	3.73	3.52	3.56	3.65	3.50	3.64	3.53	3.43	3.37	3.39	3.47
3/4/2013	3.55	3.73	3.52	3.56	3.55	3.51	3.66	3.55	3.46	3.40	3.44	3.50
3/5/2013	3.59	3.72	3.61	3.56	3.64	3.51	3.65	3.57	3.48	3.44	3.45	3.51
3/6/2013	3.47	3.71	3.46	3.55	3.49	3.50	3.37	3.35	3.32	3.33	3.40	3.38
3/7/2013	3.30	3.47	3.42	3.40	3.47	3.43	3.40	3.35	3.29	3.27	3.33	3.33

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
3/1/2013	3.500	3.353	3.292	3.275	3.420	3.351	3.630	3.873
3/4/2013	3.510	3.114	3.263	3.148	3.370	3.270	3.575	3.755
3/5/2013	3.510	2.992	3.218	3.137	3.325	3.237	3.525	3.759
3/6/2013	3.500	2.992	3.218	3.137	3.325	3.237	3.525	3.759
3/7/2013	3.430	2.992	3.218	3.137	3.325	3.237	3.525	3.759

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
3/1/2013	6.60	7.10	7.55	8.10	8.10	2.78	0.60
3/4/2013	6.80	7.10	7.55	8.10	8.10	2.78	0.60
3/5/2013	6.80	7.25	7.55	8.10	8.10	2.77	0.60
3/6/2013	6.65	7.25	7.55	8.10	8.10	2.79	0.60
3/7/2013	6.55	7.15	7.50	8.10	8.10	2.79	0.60

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
3/1/2013	4.1432	3.1769	3.3846	3.4265	1.4035	0.1615
3/4/2013	4.1350	3.1837	3.3737	3.4015	1.3935	0.1609
3/5/2013	4.1361	3.1665	3.3691	3.4006	1.3864	0.1611
3/6/2013	4.1269	3.1660	3.3510	3.3890	1.3770	0.1616
3/7/2013	4.1472	3.1808	3.3630	3.3779	1.3866	0.1624

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