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Comment on the upcoming data and forecasts

On Wednesday MPC will announce its decision regarding interest rates. We do not expect a change in repo rate and MPC is set to remain in the recently turned on wait-and-see mode. The statement should make next decisions conditional on incoming new data, however, expecially the comments after the meeting may carry some more dovish notes as lukewarm February data failed to plant any optimism within MPC members. This nothwistanding, speech does not need to translate into action and we suspect that after the last unexpected 50bp cut the doves may surrender in April and even do not put another cut for the vote. The question remains, however, how long will this consensus within MPC last? In March we expect inflation and wages to fall significantly (to ca. 1% and below 2% respectively), similarly to still very weak data from the real sphere - negative growth rates of industrial output, construction and retail sales. As a result, we won't be surprised with GDP growth in Q1'2013 lower than in Q4'2012 (some comments concerning economic indicators are presented in *Economics* section). Such a divergence from the NBP projection path for both inflation and GDP will raise expectations for further easing.
On Friday NBP will publish money supply data. Increase in the M3 growth rate comes from the need to rebuild savings rate (retail deposits grow by more than 8%) and low statistical base on corporate deposits (which adds ca. 0.6pp).

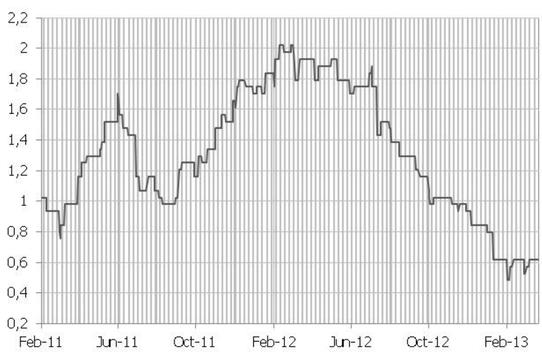
Polish data to watch: April 8th to April 12th

Publication	Date	Period	BRE	Consensus	Prior
MPC decision (%)	10.04.	Apr	3.25	3.25	3.25
M3 y/y (%)	12.04.	Mar	6.0	5.8	5.6

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	4/25/2013	3000	3.170	3/22/2013
5Y T-bond PS0418	4/25/2013	3000	3.432	3/22/2013
10Y T-bond DS1023	4/15/2013	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

With almost no publications (only PMI - read more in *Economics* section) surprise index remained unchanged. We expect index to consolidate further in April.

* 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 set to come no sooner than at the turn of H1/H2, 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. The government prepares the markets for a budget revision (Kotecki: „a revision should be regarded a standard step given volatile growth conditions").
- 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 much below 1% in Q2 2013. The possibility for significant undershooting of inflation target in 2013 is high.
- Although the MPC tried to communicate the end of the easing cycle after 50bp cut in March we believe one more cut is possible on the basis of weak macroeconomic conditions.

Financial markets

- Given our below consensus view on growth and NBP rates we stay bullish on short-term bonds. Note that NBP may also use uconventional tools to boost banks' demand for government papers.
- Over the next few months we are also constructive on Polish long term bonds. MPC (through steepening of the curve) made long-term papers more attractive and provided foreign investors with arguments against leaving the Polish bond market. No major credit repricing of POLGBs yet (budget adjustment seems to be already priced in). Poland will preserve its quasi safe haeven status and benefit from low yield environment in Europe.
- Ultimately, global recovery (or monetary stimulus withdrawal) and rising core yields may adversely affect Polish bonds (only modestly higher yields). This, however, seems to be a strory for more distant future (6 months plus).
- Cyclical behavior of the Polish zloty far more moderate 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 strong resistance.
- Volatility on both FX and FI lower.

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	1.1
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	3.00

	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	1.0	1.3	1.5
Individual consumption y/y (%)	1.7	1.2	0.1	-1.0	0.3	1.0	1.6	1.9
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	-4.5	-4.5	-3.0	-2.5
Inflation rate (% average)	3.9	4.0	3.9	2.9	1.4	0.9	0.8	1.1
Unemployment rate (% eop)	13.3	12.4	12.4	13.4	14.4	13.9	13.5	14.2
NBP repo rate (% eop)	4.50	4.75	4.75	4.25	3.25	3.00	3.00	3.00
Wibor 3M (% eop)	4.94	5.13	4.92	4.11	3.40	3.20	3.20	3.20
2Y Polish bond yields (% eop)	4.62	4.60	4.05	3.14	3.00	3.00	3.10	3.10
10Y Polish bond yields (% eop)	5.50	5.15	4.69	3.74	3.80	3.70	3.85	4.10
EUR/PLN (eop)	4.15	4.22	4.12	4.08	4.15	4.15	4.05	4.00
USD/PLN (eop)	3.11	3.35	3.20	3.09	3.14	3.25	3.24	3.20
F - forecast								

Economics

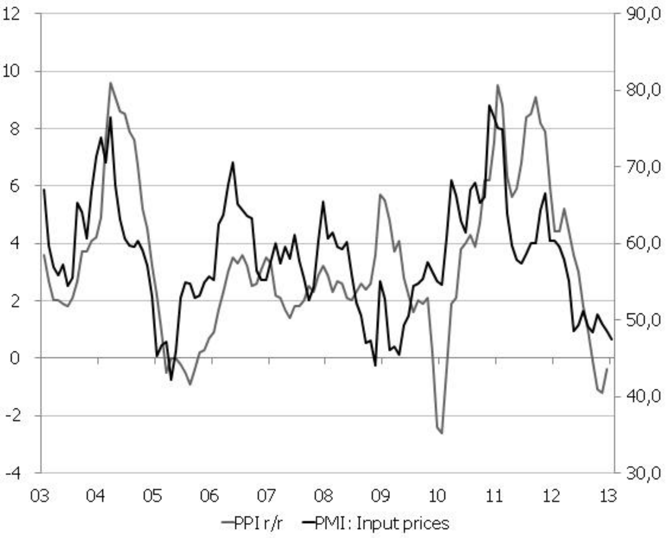
No good news from Polish PMI

In line with our expectations Polish PMI dropped in March by 0.9 pts to 48.0 pts signaling a continuation of deterioration in the industrial sector.

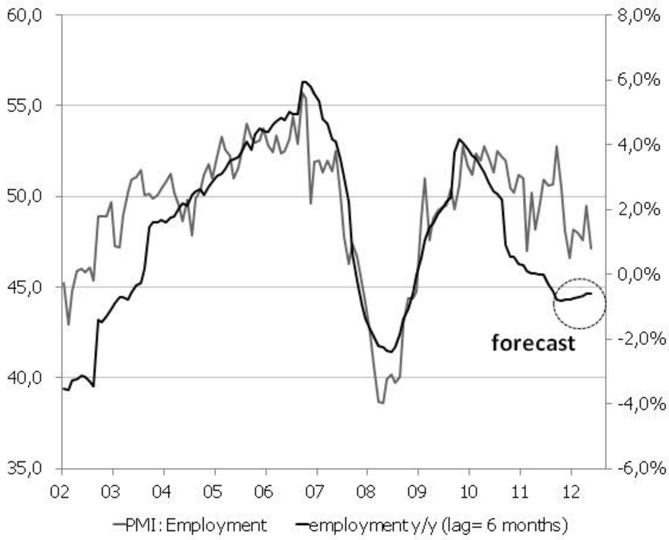
The fall in March was broad-based with all but one PMI's components declining (only backlogs of work index increased slightly, but remained on the historically low level below 43 pts indicating only a bit slower but still historically fast contraction). Some information from the detailed data is worth mentioning.

Firstly, in all European PMI data the downtrend in new export orders is gaining pace (in Poland it was the fastest since November), which surely confirms our concerns about the timing (not to mention the scale) of global upturn (yet not only in peripheral Europe, but also in Germany, USA and Asia) and more specifically its impact on Polish economy. Unfortunately Polish official data on new orders are too volatile to compare them to anything (sad but true) and therefore we can reason only on qualitative level.

Secondly, the rate of discounting in output prices accelerated to a series record (since 2003) with index reaching only 44.8 pts. Firms reported a must to offer discounts in order to remain competitive. Generally, the correlation between PMI price indices and official PPI and CPI data is time-variant (see charts below), but in medium term rather track trends, which additionally to the above qualitative conclusions supports our scenario of inflation downtrend in the months to come.

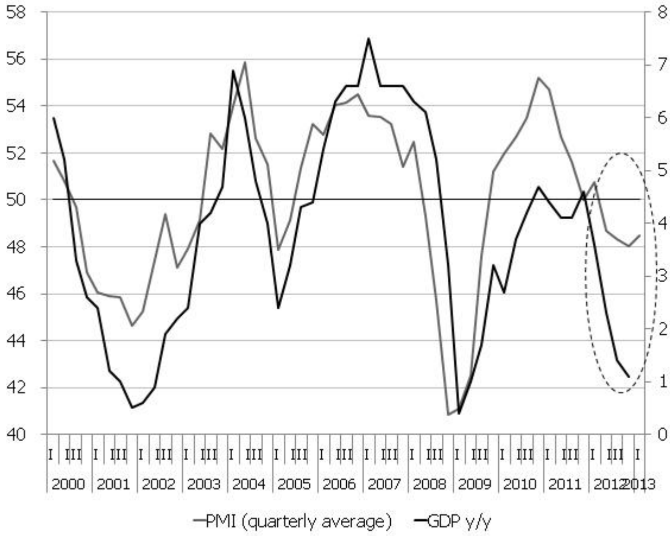


Thirdly, PMI points to the longest sequence of job shedding in over 3 years as the employment sub index declined for the seventh consecutive month in March. Simple model based on PMI suggests that we are now near the bottom of employment growth rate (see chart below) but the turning reflects mainly statistical effects not the change in net growth of the number of employees. This is in line with our medium-term forecasts.



Last but not least, yet more optimistically, one should notice that in March (and most probably also in April, which can be proved just by a quick glance outside the window) all the industrial data might be affected by the current weather anomaly (for the first time in 15 years March was colder than February) and therefore output drops should be treated with caution (it is possible that there will be some pent-up demand afterwards, corroborating our scenario of somewhat more dynamic rebound in H2).

We have stressed many times that quantitative reasoning based on the headline PMI is not reliable especially on monthly basis. Apart from the employment index, which works with 6 months lag and on smoother quarterly data, we have also found quarterly relations with PMI-output-index and smoothed industrial production and PMI-finished-goods-stocks-index (not seasonally adjusted) with nominal inventories. The former does not give any indication of output rebound, while the latter indicates a more substantial contribution of inventory formation than the one drawn from a significant base effect from the last year. Talking about quantitative analysis we have to stress, however, that in the current phase of the cycle headline PMI level does not reflect the scale of the slowdown and therefore the upturn shown on the quarterly chart below is not a reliable signal - especially that this is only a slight one quarter increase. Index declined further in March and all the above mentioned qualitative analysis points not only that the fast upturn of Polish economy is a very low-probability scenario in H1, but also casts a shadow over the bottoming of GDP growth in Q4'2012.

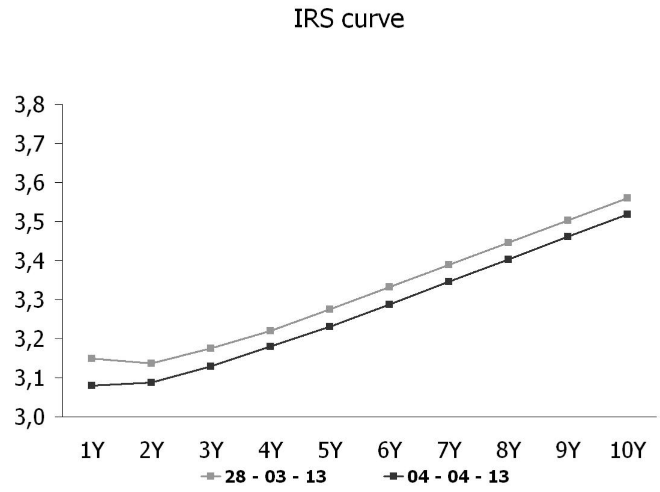


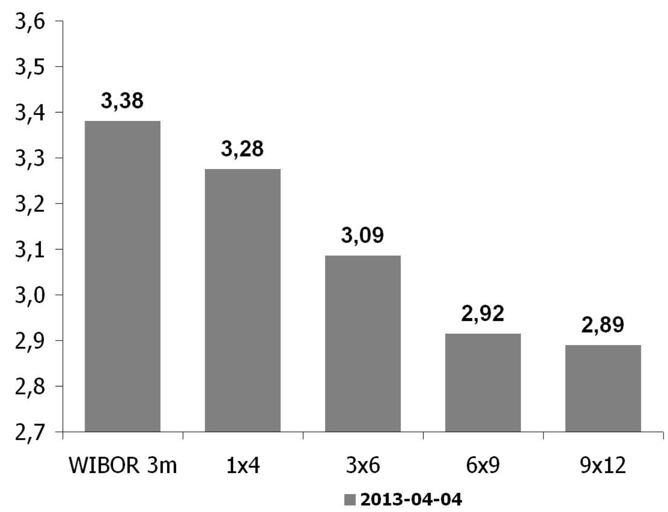
Fixed income

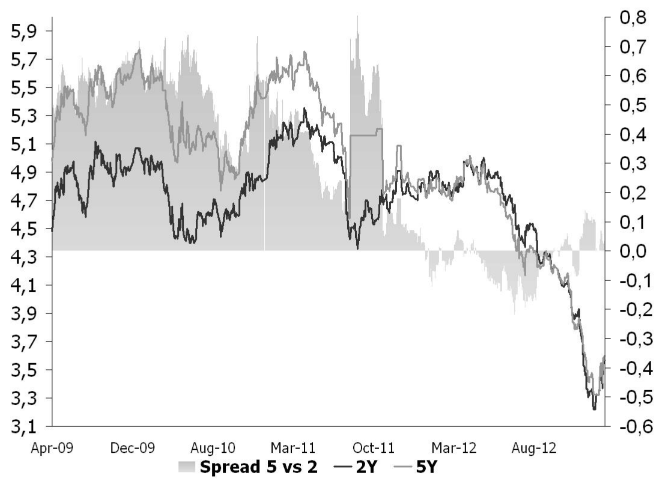
Don't forget about Korea

Last week we had quite a nice rally in bonds and rates. Longer end bonds have outperformed both swaps and shorter end bonds as most of the ASW widening was reversed. There was no significant data from local market (apart from first estimate of budget deficit after March at 25 bio versus 21.5 bio). We had some comments from Ministry of Finance officials about strains on the fiscal side opening door to budget revision. We also had Belka speech about euro entry with quite bold demand about scrapping ERM2 mechanism. All in all local data/news flow have been on the light side. Massive bond performance came from combination of 1) fresh buying by local bank books 2) inflows from foreign funds 3) eventual street stoploss (we saw people taking short positions ahead of end of the quarter as some people wanted to play against „window dressing").

Next week we will have MPC decision (most likely rates on hold) and auction in longer end bonds (fixed and floater). As far as MPC is concerned, comment is again quite important but one month is probably too little time to see significant change in wording. Recent NBH action and CNB rhetoric open way for unconventional moves by NBP (growing liquidity in local banking system?) which may be not immediate, but they should be considered as one of the options in the menu. Any hints about such a move could trigger quite significant market reaction. Other thing to watch is OFE (Open Pension Funds) debate. Our call is that MinFin holds the upper hand. Most likely solution they will propose will have 1) positive short term budget implications, 2) positive short term debt implications 3), miscellaneous longer term impact especially on the public sector side (undisclosed future liabilities to retirees). One should agree that visible effect will have more material meaning for market behavior. All in all, we don't change our core view here (though we are bit surprised by very strong performance of ASW and we still think WZXXXX bonds are expensive) we see value in holding bonds up to 5y sector (actually adding one on any sell offs), we see curve steeper from here (2y5y our preferred sector), and more importantly rates have not yet bottomed. And don't forget about Korea.



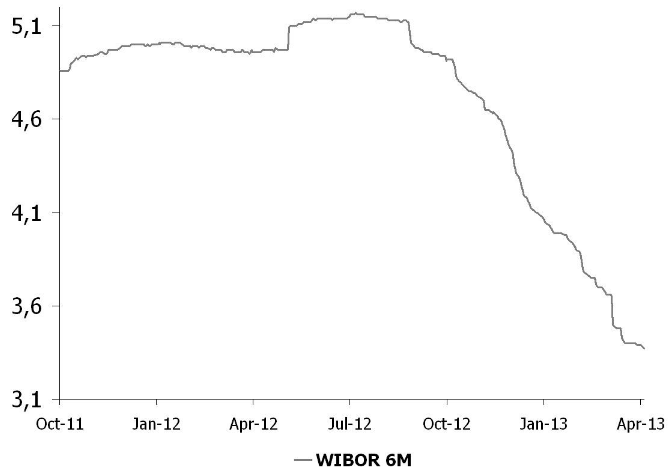


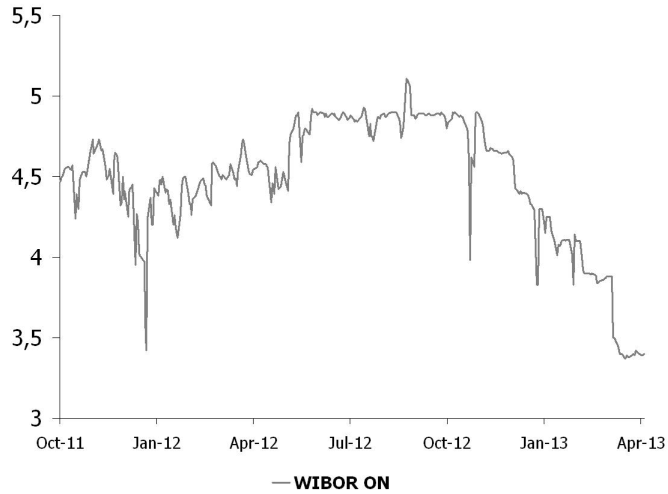


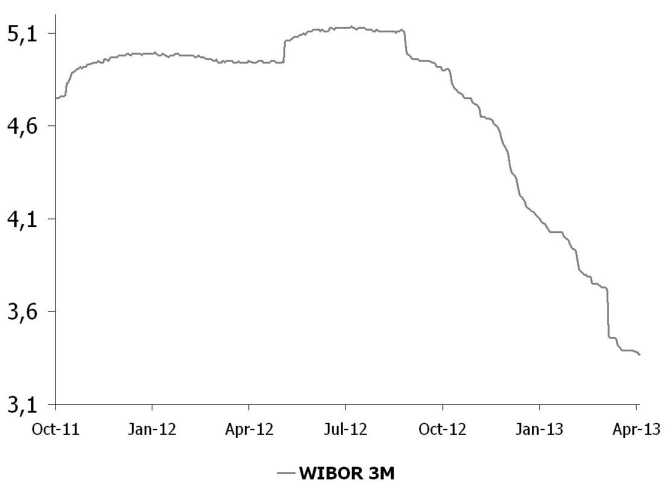
Money market

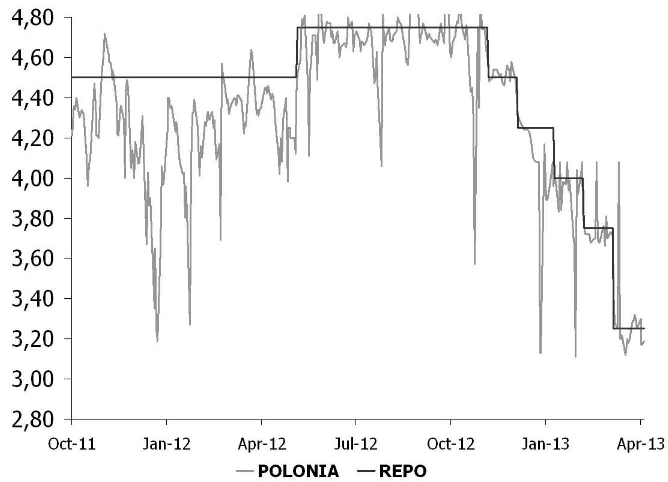
Bullish on global factors. Huge surplus of the cash at the beginning of the reserve requirement settlement period has just been sterilised today during the regular OMO (on Tuesday additional OMO was not sufficient enough). Market bought 128.5 billion pln worth of money bills, which should be just right to keep the shortest rates nearby the main rate.

Waiting for the MPC. Bullish beginning of the month mainly on global factors. Market expects 50 bps cut within next 6 months, bonds are well bid. Next event on the local agenda is the MPC meeting (no change expected) and its conference which will be carefully watched. Any correction should be used to receive the rates before the CPI in the middle of the month.







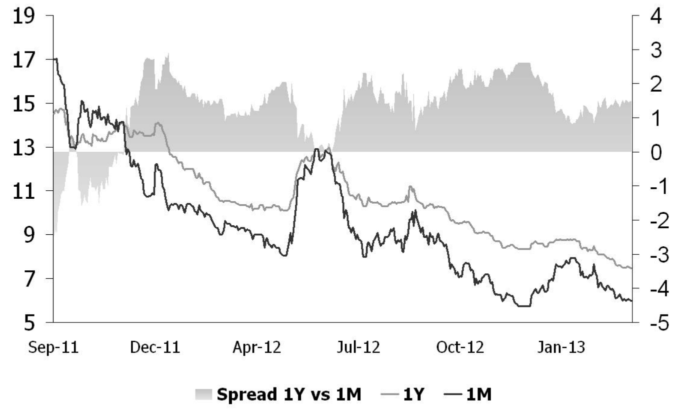


Forex

In range. Very little to report on EUR/PLN, extremely narrow range, 4.16/4.20 covers a week. We will have MPC decisions on 10th of April, the majority expects that rates to stay unchanged. Any dovish rhetoric on MPC conference would be having a negative effect on Zloty. The potential damage is most probably limited, as BOJ will be printing money with full speed, and demand for Polish government bonds seems endless.

Cosmetic changes. Proximity of 4.20 and the full calendar of global events, were the reasons which gave a EUR/PLN vol curve a cosmetic push higher. 1 month EUR/PLN mid fixed at Friday at 6.0 it was (0.1%) higher than a last week, 3 month were paid at 6.65% (0.35% higher), 1 year was paid at 7.5% (unchanged). USD/PLN vol was slightly better bid because of the customers demand. The skew was generally unchanged.

EURPLN volatility



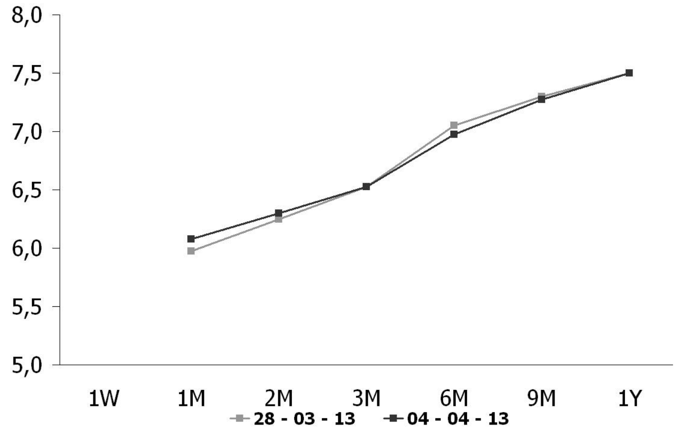
Short-term forecasts

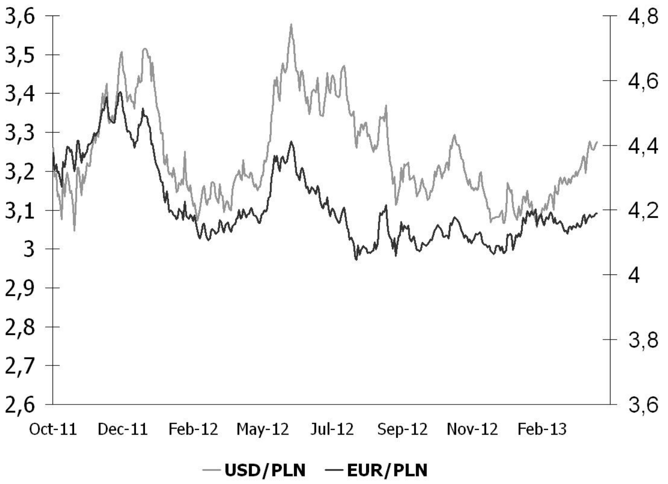
Main supports and resistances
EUR/PLN: 4.1250 / 4.2000
USD/PLN: 3.1500 / 3.3000

Spot. The range is getting tighter and tighter, but selling spikes is still the most probably the best option available. Sell 4.1950 add 4.2150 with stop above 4.23 and hopes for the move below 4.15.

Derivatives. Unchanged from the last alteration of strategy. So, we had changed our selective Vega buying recommendation to a neutral one. The realized volatility is constantly descending (especially if we look at daily basis). It does not bode well for Vega longs. The vols are cheap, in comparison to the historic ones, but they are quite expensive to the realized volatilities. Stay aside.

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
3/30/2013	3.19	3.39	3.09	6.49	3.08	6.59	3.31	3.15	3.07	2.98	3.00	3.02
3/31/2013	3.19	3.39	3.09	6.49	3.08	6.59	3.31	3.15	3.07	2.98	3.00	3.02
4/2/2013	3.13	3.38	3.02	3.29	3.03	3.29	3.31	3.15	2.99	2.95	2.99	3.01
4/3/2013	3.06	3.38	3.02	3.28	3.05	3.28	3.31	3.15	2.97	2.93	2.96	3.01
4/4/2013	3.06	3.37	3.03	3.28	3.05	3.28	3.28	3.09	2.92	2.89	2.91	2.96

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
3/30/2013	6.590	3.353	3.292	3.275	3.420	3.351	3.630	3.873
3/31/2013	6.590	3.114	3.263	3.148	3.370	3.270	3.575	3.755
4/2/2013	3.290	2.992	3.218	3.137	3.325	3.237	3.525	3.759
4/3/2013	3.280	2.992	3.218	3.137	3.325	3.237	3.525	3.759
4/4/2013	3.280	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
3/30/2013	6.05	6.55	7.00	7.55	7.55	2.77	0.65
3/31/2013	6.05	6.55	7.00	7.55	7.55	2.77	0.65
4/2/2013	6.03	6.53	7.00	7.50	7.50	2.88	0.72
4/3/2013	5.98	6.53	6.98	7.48	7.48	2.88	0.72
4/4/2013	6.08	6.53	6.98	7.50	7.50	2.80	0.72

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
3/30/2013	4.1774	3.2590	3.4323	3.4646	1.3726	0.1621
3/31/2013	4.1774	3.2590	3.4323	3.4646	1.3726	0.1621
4/2/2013	4.1813	3.2552	3.4422	3.4968	1.3822	0.1619
4/3/2013	4.1898	3.2693	3.4416	3.4951	1.3924	0.1621
4/4/2013	4.1898	3.2750	3.4457	3.4310	1.3853	0.1622

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