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Comment on the upcoming data and forecasts

After lower (0.4% y/y) than expected preliminary reading (published lately experimentary by Statistical Office) the final publication of GDP growth in Q1'2013 will be treated as a test of the new Statistical Office's methodology. We think that any reading between 0.4-0.7% (or even slightly wider interval; the upper limit is the previous market consensus) will not bring a huge surprise. Regardless the flash estimate we do not change our 0.6% forecast, which is based on deeper drop of investment activity (-6.8%) and consumption growth slightly above zero (+0.3%).

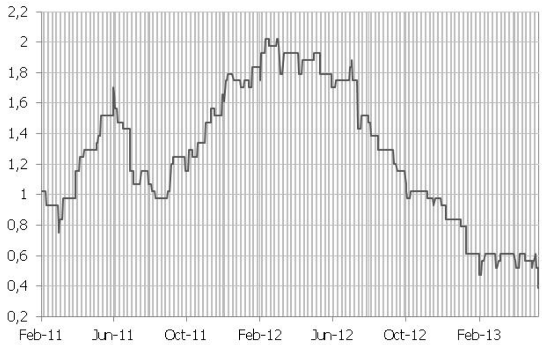
Polish data to watch: May 27th to May 31th

Publication	Date	Period	BRE	Consensus	Prior
GDP y/y (%)	29.05.	Q1'13	0.6	0.4 (p)	0.7 (r)
Inflation expectations y/y (%)	31.05.	May	0.9	0.9	1.1

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	-	2500	2.748	4/23/2013
5Y T-bond PS0418	-	5500	2.550	5/9/2013
10Y T-bond DS1023	-	3000	3.290	5/16/2013
20Y T-bond WS0429	-	150	3.464	5/16/2013

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



Comment

The surprise index broke the side trend (which lasted from the beginning of 2013) from the up-side. This happened after lower than expected (but in line with our forecasts) PPI and retail sales data. Next week should not bring huge surprises after recently published flash estimate of GDP growth in Q1.

* 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 already dipped into negative territory on high uncertainty and 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 revival 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 rate 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").
- We are in the middle of one of the steepest disinflation phases in Polish history. CPI inflation much below 1% in Q2 2013 (close to 0% in mid 2013). The possibility for significant undershooting of inflation target in 2013 is our base case.
- Although the MPC is unwilling to communicate a launch of a new easing cycle we believe further cuts are still in the pipeline on the basis of weak macroeconomic conditions, persisting low interest rates environment in Europe and low inflation. Moreover, individual members have recently turned more dovish. So far we expect reference rate to fall to 2-2.25%.

Financial markets

- Given our below consensus view on growth, inflation and NBP rates we stay contructive on short-term bonds (we acknowledge that the biggest move has already materialized). Note that NBP may also use uconventional tools to boost banks' demand for government papers.
- Over the next few months we are neutral on Polish long term bonds. No major credit repricing of POLGBs in sight (budget adjustment seems to be already priced in). Poland will preserve its quasi safe haven 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 story for future (3 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	4.5	1.9	1.0
CPI Inflation y/y (average %)	4.3	3.5	2.8	4.2	3.7	0.7
Current account (%GDP)	-5.3	-1.6	-4.5	-4.9	-3.5	-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	2.25

	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2013 Q1 F	2013 Q2 F	2013 Q3 F	2013 Q4 F
GDP y/y (%)	3.5	2.3	1.3	0.7	0.6	0.8	1.2	1.7
Individual consumption y/y (%)	1.7	1.3	0.2	-0.2	0.3	1.0	1.6	1.9
Public Consumption y/y (%)	-1.0	0.4	1.6	-0.6	0.2	0.5	0.5	0.5
Investment y/y (%)	6.8	1.4	-1.7	-4.1	-6.8	-4.5	-3.0	-2.5
Inflation rate (% average)	3.9	4.0	3.9	2.9	1.3	0.6	0.2	0.7
Unemployment rate (% eop)	13.3	12.4	12.4	13.4	14.3	13.9	13.5	14.2
NBP repo rate (% eop)	4.50	4.75	4.75	4.25	3.25	2.75	2.25	2.25
Wibor 3M (% eop)	4.94	5.13	4.92	4.11	3.39	2.95	2.45	2.45
2Y Polish bond yields (% eop)	4.62	4.60	4.05	3.14	3.19	2.50	2.50	2.50
10Y Polish bond yields (% eop)	5.50	5.15	4.69	3.74	3.94	3.40	3.50	3.60
EUR/PLN (eop)	4.15	4.22	4.12	4.08	4.18	4.15	4.05	4.00
USD/PLN (eop)	3.11	3.35	3.20	3.09	3.26	3.25	3.24	3.20

F - forecast

Economics

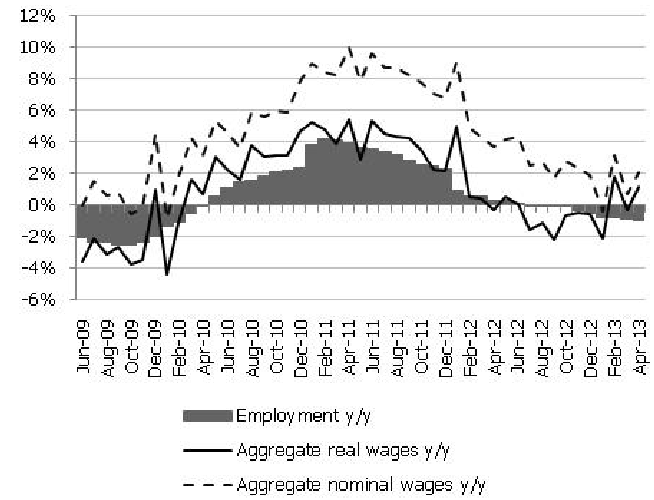
Rate cut in June seems a done deal

This week brought the last package of April data, which still paints a quite gloomy picture of the Polish economy (for details please read below). All publications fare far worse than forecasts, there is no sign of a solid turnaround in activity and hence no hope for inflationary pressures to emerge. What is more, current inflation is heading lower (in the summer we wouldn't be surprised by CPI close to 0%), much below the latest NBP projection (from March).

For the first time in several months the „Minutes" revealed a grand agreement (majority of members!) that „in the coming quarters the CPI inflation was likely to stay below the March projection, which - along with the uncertainty over the pace of economic recovery in Poland - increases the risk of inflation running below the target in the medium term". As „the Council's decisions in the coming months will depend on the assessment of the incoming data with regard to probability of inflation remaining markedly below the NBP target in the medium term" it seems reasonable to conclude that even in May the MPC was ready for further cuts, which has recently been confirmed by comments of individual members. We think that cut in June is a done deal, similarly to another one waiting in the pipeline for July. As the moods turned recently more dovish, the risk of a 50bp cut in each of the meetings is relatively high. Therefore we see the target repo rate close to 2%.

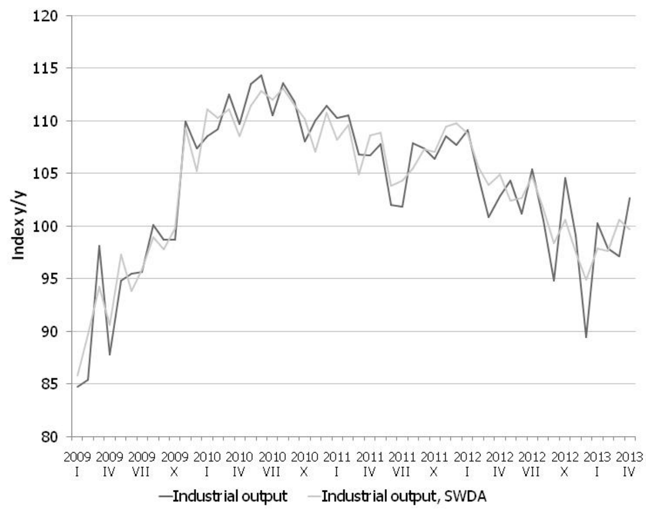
As always, below we present a brief summary of the data published this week.

Employment in enterprise sector shed 11k jobs in April. It means that the seasonally-driven turnaround in employment (pent-up demand for labor after longer winter) did not happen. Hence, our forecast at -0.7% y/y was proven wrong with the actual number at -1.0%. The business climate in Poland is still gloomy and the labor market weakens in a gradual but persistent manner.



Wages increased by 3.0% y/y (consensus and our forecast: +2.2%). Detailed data confirm our guess as to the reasons for this difference, so catching up in industry and construction after the long winter and unexpected bonuses in mining and telecommunication services. The most important message is, however, that wage bill increased both in nominal and real terms. In constant prices, wage bill grew at the highest pace since December 2011 (if we exclude one-offs). Very low inflation continues to offer significant support for private consumption. Our preliminary estimates indicate that total household income grew by as much as 2% y/y in Q2.

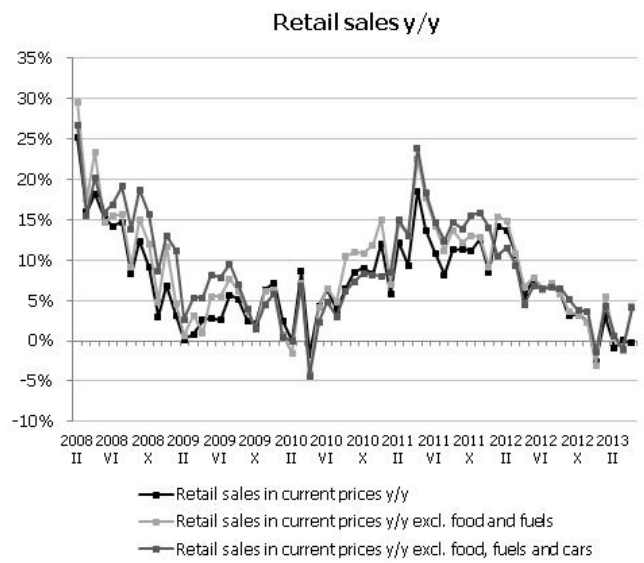
Industrial output grew in April by 2.7% y/y but mainly due to working days effect (+1 y/y). In seasonally adjusted terms, production actually slightly decreased (-0.3% y/y). Since it is the second month in a row with stable IO dynamics, it is probably fair to conclude that industry has finally stabilized. Only stabilized. The much-anticipated turnaround, driven by post-winter catching up, did not materialized, contrary to what the recent numbers on car production had implied.



Output grew in 25 out of 34 sections, many of them export-oriented such as cars, furniture and electrical equipment. Could this be the beginning of the long-anticipated export-led recovery? Perhaps yes, but we are doubtful as to the strength and momentum of this rebound (the euro zone which captures 4/5th of Polish exports is still struggling). It is also possible that the structure of industrial output growth was heavily influenced by working days effect (different elasticities with respect to changes in working days). As business climate surveys consistently indicate, relatively good situation of exporters is counteracted by ongoing weakness in domestic demand. The latter takes the upper hand and we need much better performance of the former to see the difference in the data.

Producer prices went down in April by 2.0% y/y. It was even more pronounced decline than we expected (market consensus -1.5% y/y, our call -1.7%). The drop was mainly driven by a sharp fall in commodity prices complemented by relatively high statistical base from the last year. Of course the capacity slack also left its mark. Disinflation on producer's side is proceeding unabated.

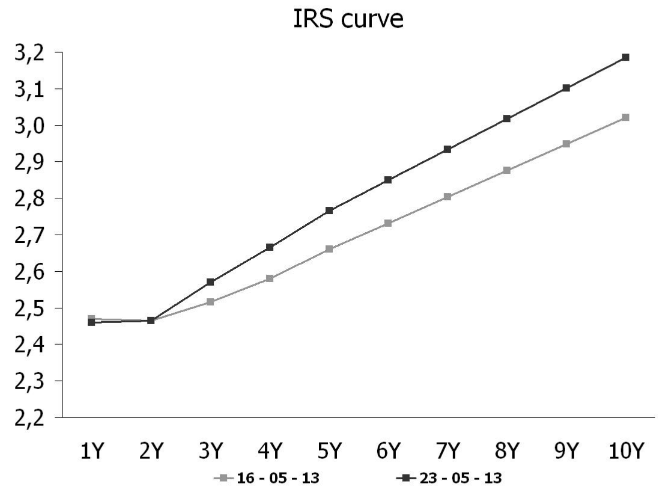
Retail sales decreased in April by 0.2% y/y (market consensus +1.0%, our forecast -0.5%). In real terms sales practically did not change with respect to the previous month. The one to blame for such a weak reading was again Easter effect (this year reflected fully in March data, while in 2012 in March and April), which reduced growth rate of food sales to -3.6% y/y (-13.1% m/m), fuels sales to 8% y/y and sales in non-specialized stores from 16.8% in March to only 4.9% in April. The counterweight that enabled headline to remain around zero was surprisingly high durable goods sales - motor vehicles (+5.8% y/y), house appliances (+8.9% y/y) and others category (sales in DIY stores). As a result core retail sales (with food and fuels excluded) increased by 4.4% y/y. The data do not indicate negative trend reversal yet (various factors such as better weather or positive working days effect might have influenced this one-month growth), especially that consumer confidence indicators dropped further in April. We'll monitor closely if this positive signs from durables sales stay intact in the months to come. If they do, that would surely indicate better consumer sentiment. The results of the latest consumer survey by the CSO certainly point out to improved sentiment.

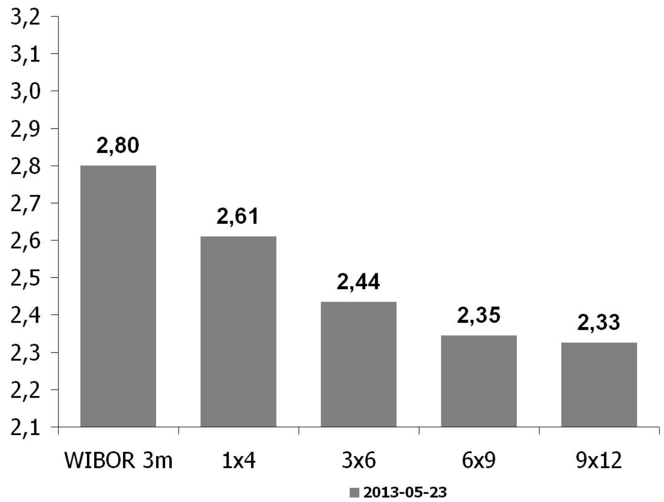


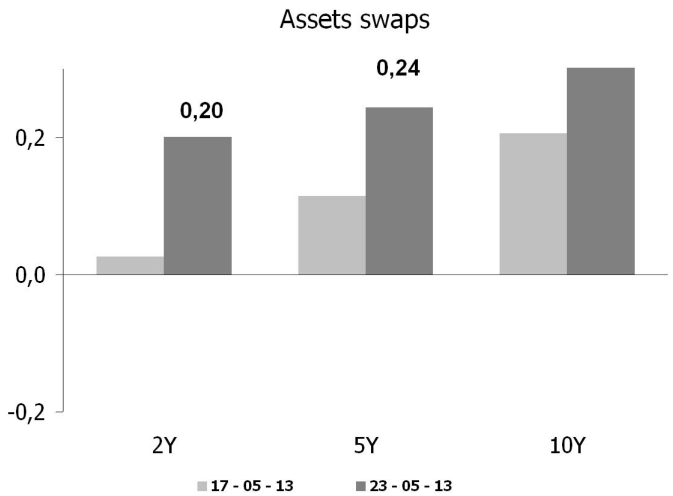
Fixed income

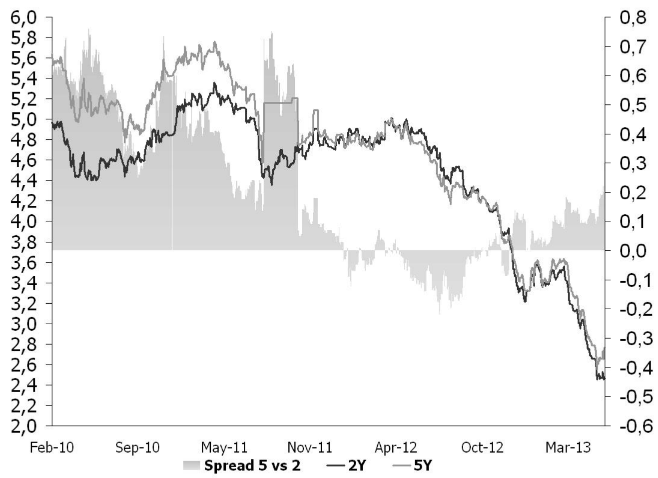
Yes, there is a risk

On fixed income market, we have local data, which can move the market some 3-5bp, and global trends, which can move the market 20bp per day. This week's most important news was Bernanke's comment about possibile Quantitative Easing Exit plan. Market reacted with panic selloff in long end bonds, yields went up some 20bp, investors realised that there is a risk for this 'cheap money forever' scenario. While we agree with steepening trend this maybe time to think about possible risk on short end of the curve and take profit on long end. Wibors are very low, already pricing fast 2 rate cuts and 9x12 fra at 2.27 is another 50bp lower. Definitelly, 'no rate cut' in June would be a surprise and while this in not our base scenario, possible payoff is worth betting on this. Keep in mind that volatility is huge and liquidity is very fragile at the moment.





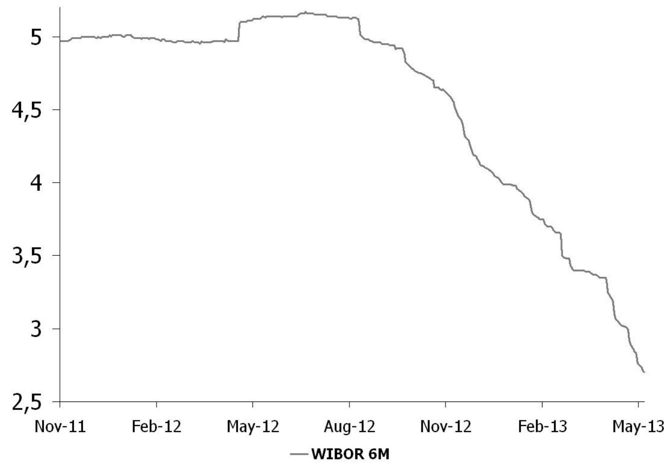


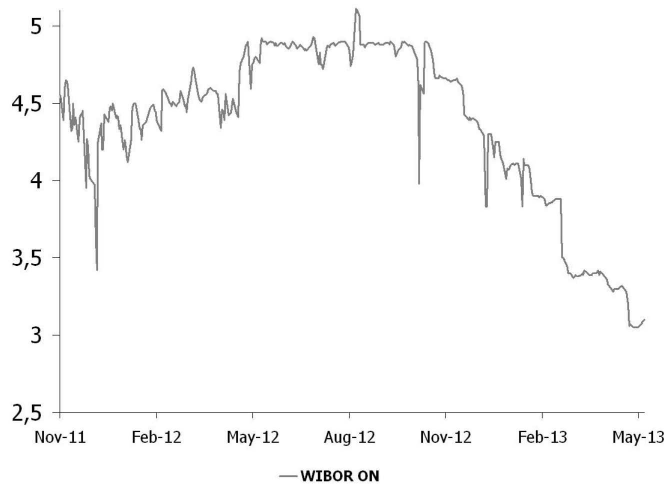


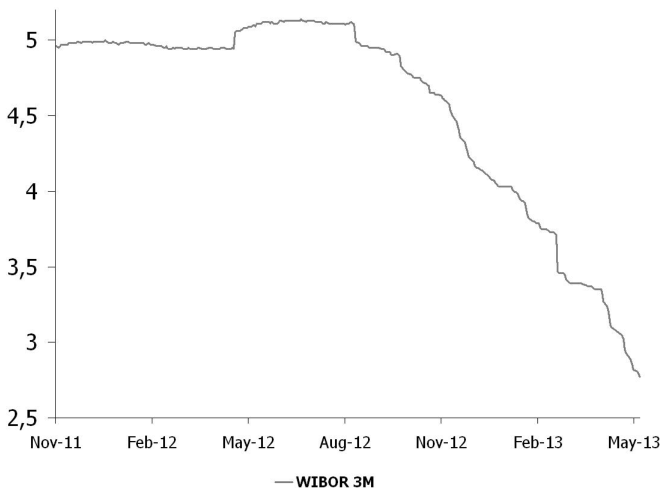
Money market

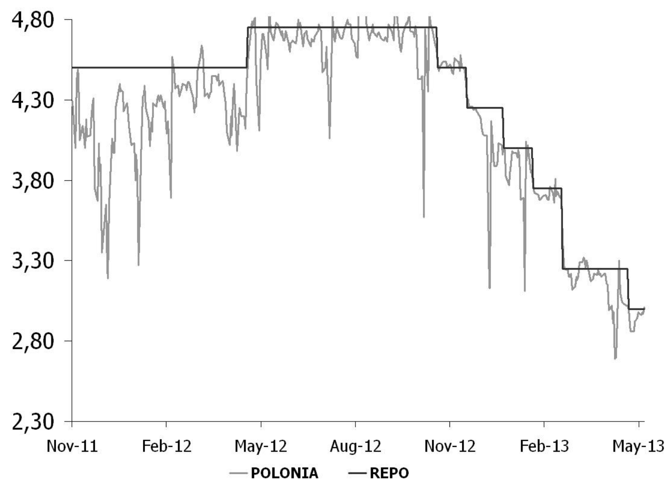
Liquidity stable Liquidity stable that means polonia rate nearby the main market rate. After today's OMO it should not change next week. Industrial output and retail sales supported bullish view. Also signals from the MPC side leave no doubt.

IO and retail sales supported bullish view Our view is: cut in June (25 bps) then cut in July (25 or 50 bps) and it is fully priced in. After the summer the real economy data should strongly support wait and see mode. Therefore, we still like paying 9*12 Fra against receiving 9 and 12M ois (those cotracts have still less then 75 bps cuts priced in).





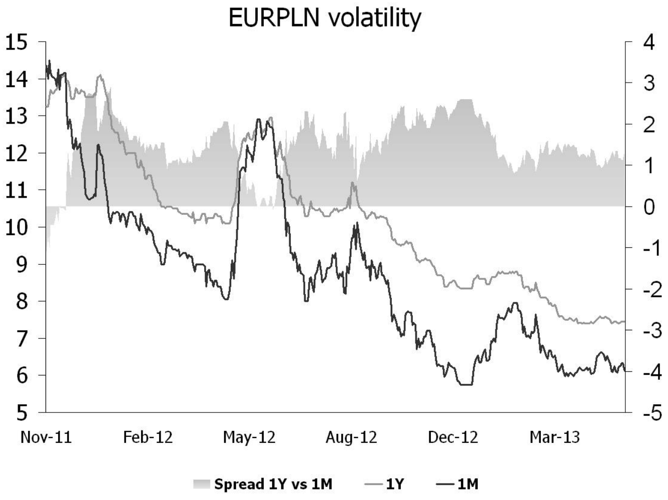




Forex

PLN at crucial resistance The market sentiment changed from bad to worse. The hint of possible end of QE in US created threat for Polish bonds and for currency as a logical consequence. The strong expectations for MPC rate cut for at least 25 BP, are also adding fuel to this move. EUR/PLN finally has managed to break 4.20 resistance (4.2120 high so far), but the market was far from panic. We think it will settle down this time, and we see the most probably slide back to 4.17, even if we take 4.22 stops first. What happen to the PLN, when they really stop QE, that's another matter. And a real cause for concern.

Vols higher Vols are higher for a second week in a row, a very rare thing in the last months. The frontend, namely EUR/PLN 1 month ATM is today higher by 0.3% in comparison to last week, at 6.5%. The mid and the end of the curve are both up by 0.1% to 7.1% (6 month) and 7.6 (1 year). The skew is better bid by roughly 0.2% along the curve. The currency spread (difference between USD/PLN vol and EUR/PLN vol) was also better bid, thanks to USD turbulences.

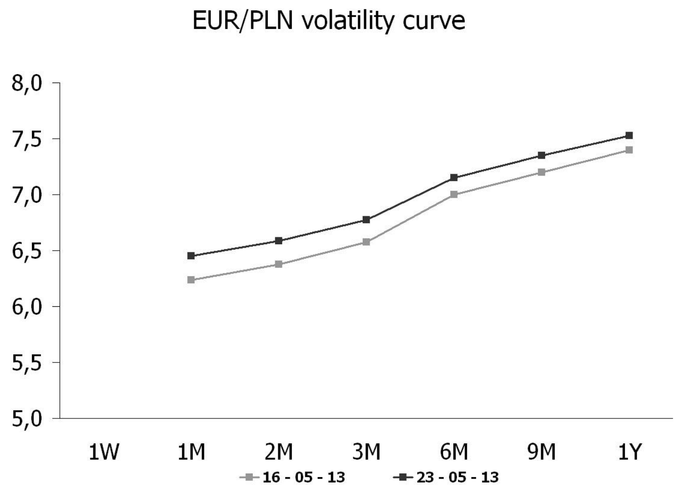


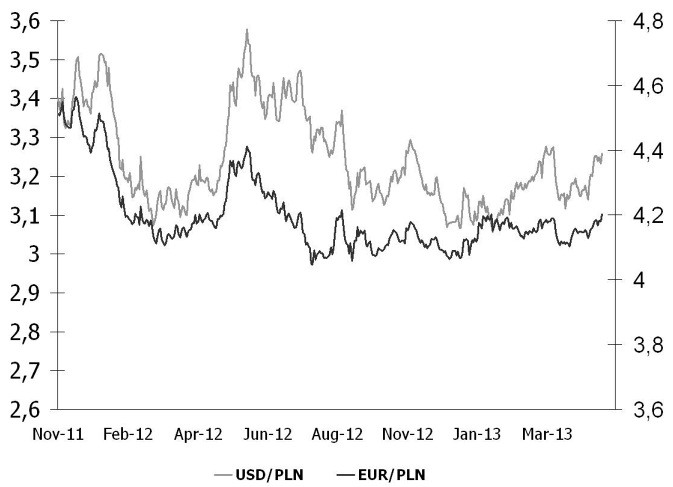
Short-term forecasts

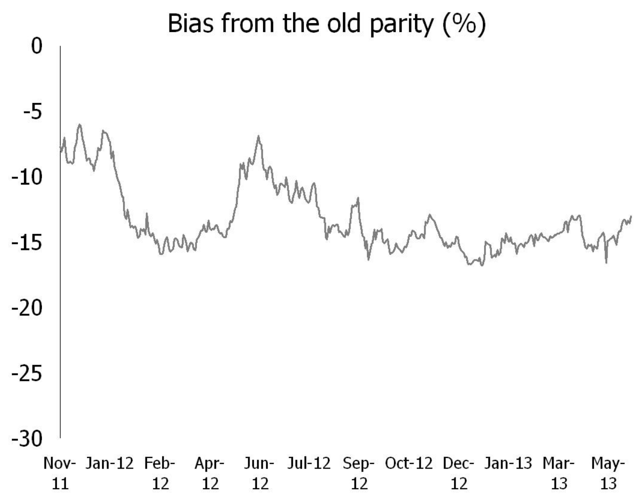
Main supports and resistances
EUR/PLN: 4.1600 / 4.2500
USD/PLN: 3.1000 / 3.3000

Sell EUR/PLN We lighten the short EUR/PLN position from the last week as EUR/PLN broken and hold the important technical resistance (4.20). Being short for about 30% of intended nominal we are ready to add on the spike to 4.2250 with a stop above 4.24 and hopes for move back to 4.1750/4.18. We think that the range levels are being stretched a little, but we are lacking momentum to announce the end of the range trading. At least, not yet...

Derivatives. Unchanged. We have changed our selective Vega buying recommendation, to a neutral one. The realized volatility is constantly descending (especially if we look at daily basis). I 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.







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
5/19/2013	2.66	2.82	2.52	2.66	2.46	2.64	2.64	2.44	2.34	2.31	2.28	2.36
5/20/2013	2.65	2.81	2.58	2.64	2.48	2.62	2.65	2.45	2.36	2.38	2.38	2.42
5/21/2013	2.64	2.80	2.59	2.62	2.54	2.60	2.64	2.46	2.37	2.35	2.39	2.38
5/22/2013	2.65	2.79	2.52	2.61	2.47	2.60	2.63	2.45	2.32	2.30	2.34	2.34
5/23/2013	2.64	2.77	2.52	2.60	2.45	2.59	2.61	2.44	2.35	2.33	2.37	2.37

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
5/19/2013	2.640	3.353	3.292	3.275	3.420	3.351	3.630	3.873
5/20/2013	2.620	3.114	3.263	3.148	3.370	3.270	3.575	3.755
5/21/2013	2.600	2.992	3.218	3.137	3.325	3.237	3.525	3.759
5/22/2013	2.600	2.992	3.218	3.137	3.325	3.237	3.525	3.759
5/23/2013	2.590	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
5/19/2013	6.25	6.65	6.89	7.43	7.43	2.55	0.73
5/20/2013	6.33	6.63	7.00	7.45	7.45	2.55	0.73
5/21/2013	6.33	6.63	7.00	7.45	7.45	2.55	0.73
5/22/2013	6.11	6.48	7.00	7.45	7.45	2.55	0.73
5/23/2013	6.45	6.78	7.15	7.53	7.53	2.58	0.72

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
5/19/2013	4.1834	3.2520	3.3633	3.1688	1.4339	0.1608
5/20/2013	4.1683	3.2380	3.3457	3.1574	1.4367	0.1597
5/21/2013	4.1820	3.2490	3.3570	3.1611	1.4402	0.1597
5/22/2013	4.1813	3.2322	3.3337	3.1418	1.4468	0.1607
5/23/2013	4.2020	3.2587	3.3732	3.2233	1.4386	0.1609

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