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

Flash GDP release will probably point out to Q1 as the bottom of the current cycle. YoY dynamics have probably slightly decelerated (from 0.7 to 0.6%) on continued slump in investment and only modest growth of individual consumption. We expect M3 money supply growth to have accelerated in April on favourable base effects (for corporate deposits) and high interest in retail deposit and other saving products. All in all, the desire to rebuild private savings continues to drive M3. CPI inflation further decelerated and likely amounted to 0.6% y/y in April. The reasons for this decline are straightforward: modest growth in food prices (confirmed by Czech data), fall in fuel prices and on-going disinflation in core categories (core inflation also declined), e.g. a full-blown price war in telecom services. We also expect current account and trade figures to be quite unexpected. According to our forecasts, March probably brought the largest trade and current account surpluses in Polish history, largely reflecting on-going weakness in internal demand (seen for instance in retail and wholesale sales data) rather than a re-acceleration in foreign markets. Finally, budget data published by the Ministry of Finance will likely show that budget decifit widened in April as tax revenues continued to underperform.

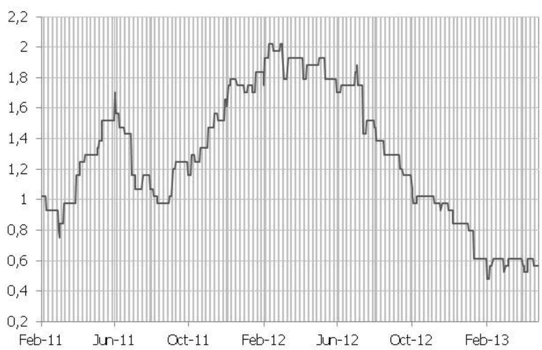
Polish data to watch: May 13th to May 17th

Publication	Date	Period	BRE	Consensus	Prior
GDP *flash* y/y (%)	14.05	Q1	0.6	0.7	0.7
M3 y/y (%)	14.05	Apr	7.6	7.1	6.6
CPI y/y (%)	15.05	Apr	0.6	0.7	1.0
Current account (mln EUR)	15.05	Mar	792	-33	854
Exports (mln EUR)	15.05	Mar	12850	12780	12090
Imports (mln EUR)	15.05	Mar	11800	12550	11488

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	5/16/2013	3000	3.515	4/11/2013
20Y T-bond WS0429	5/16/2013	4000	3.896	1/7/2013

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



Comment

Unchanged from last week (no data). The first batch of April data comes out next week but with no significant potential for surprises.

* 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. So far we expect reference rate to fall to 2.5%.

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	2.50

	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	3.00	2.50	2.50
Wibor 3M (% eop)	4.94	5.13	4.92	4.11	3.39	3.20	2.70	2.70
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

The MPC resumes easing

Last Wednesday, the MPC cut all rates by 25bp (repo rate is now at record low of 3%) and opened doors for further easing. We expected a more decisive move but even a 25bps cut surprised Polish analysts who were too concerned by the political rifts within the Council and forgot about macroeconomic considerations. The cut was justified, in line with our expectations, by the scale of negative surprises and deviations from the current NBP inflation projection. Officially, the Council chose to cut by 25 bps in order to proceed smoothly and avoid shocking markets. The diagnosis of economic developments from the official statement is surely not optimistic, nor was the tone of the press conference afterwards. Governor Belka spoke about "quasi-stagnation" and an unsatisfying structure of Polish growth (contracting domestic demand). The tone of the statement (the last paragraph in particular) turned out to be more dovish than last month. 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*. More importantly, references to developments in the real sphere were excluded from the statement - we interpret this as a dovish move. The message of the conference was not as unambiguous as that of the statement's. Governor Belka repeatedly refrained from announcing new cuts only to point out that there is a lot of room for further cuts, that the Council's stance remains accommodative, and to formulate pessimistic forecasts on his own.

As for the perspectives of monetary policy, we expect more cuts, mainly due to strong disinflation leading to even larger gap vis-a-vis the NBP projection in the coming months. In the summer, CPI might drop close to 0% y/y, core CPI will decelerate as well (full-blown price war in telecommunication services). However, June might not be the right time for another cut - the Council must be constantly stimulated by new releases, April figures might not look bad (favorable working day effect) and the Q1 GDP is widely expected to be similar in headline to Q4. New inflation projection will be published in early July and that should be a convenient moment for a cut. New central path of inflation will probably lie below the NBP target within the whole forecast horizon - maybe not below the previous path but nevertheless will quite clearly indicate that the easing done so far failed to re-accelerate inflation (commodity prices as well as global and Polish GDP growth were previously overestimated).

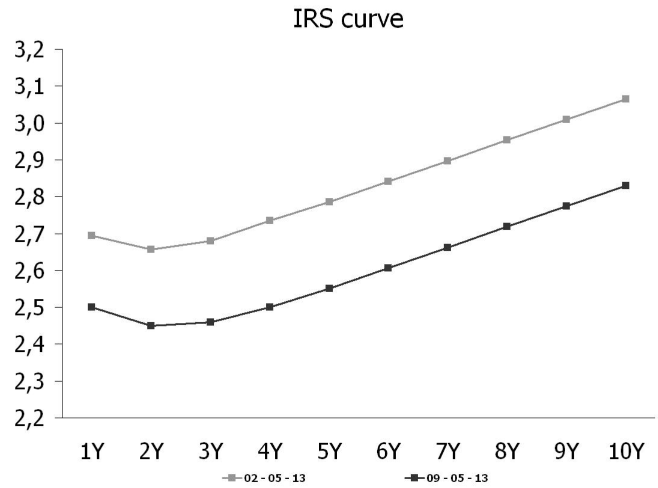
We would like to stress that the room for further cuts is enormous for fundamental reasons (yawning output gap, CPI much below even the target band) as well as due to investors' tolerance for lower yields. The Council's insistence on conducting monetary policy in a conventional, old-fashioned way will only marginally influence the scale of cuts (as it failed to do so by far). Sustained fall in inflation and reinvigorated expectations for further easing will continue to offer support for bonds up to 5y.

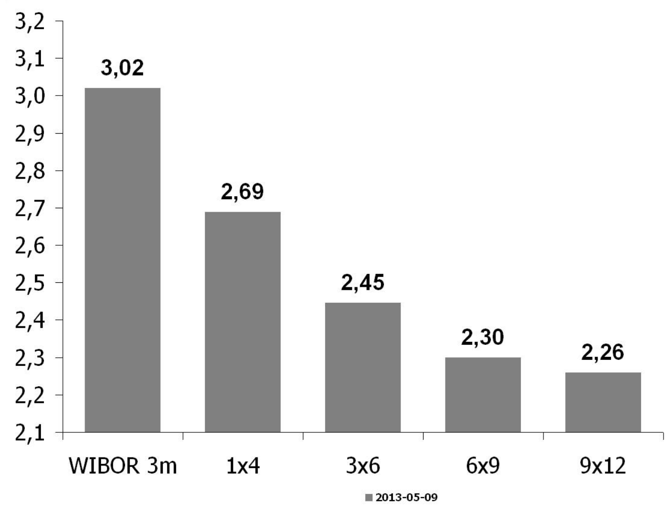
Fixed income

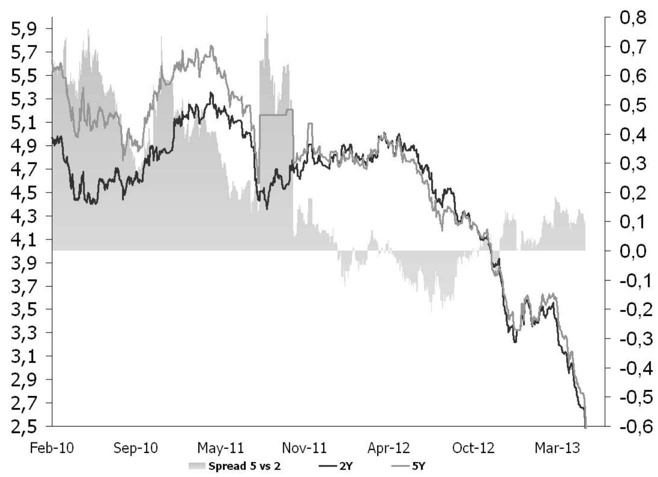
Profit taking

Main event of the passing week was the MPC decision. Even though a rate cut seemed to have been fully priced in, it caused another strong wave of bond buying and pushed rates in the front end of the curve to levels which could be justified only by repo rate falling to 2% this year. We expected positive sentiment to continue after ECB and NBP decisions, but we think market overreacted a little, especially that Mr. Belka's comments were quite unclear in terms of further rate path, as he almost simultaneously stated that rate cut doesn't mean the MPC starts a new cycle, while on the other hand rates are "oceans away" from unconventional policy, which would normally suggest they will be slashed further considering both inflation and growth levels.

Once again Finance Ministry managed to sell bonds at a tender at record low levels - 6.5 bio of new 5Y benchmark were sold at 2.55%. Two weeks ago we recommended staying long ahead of long weekend, ECB and NBP. Those events are already behind us and yields are significantly lower. There will be CPI published on Wednesday, that would be another supportive data, but we doubt if that would be enough for the rally to continue. We think chances of correction are growing and market vulnerability to any better macro data is definitely bigger. Therefore we think it's good time to close receivers, we would even consider building some pay positions either at current levels or if reaction to CPI number is positive.



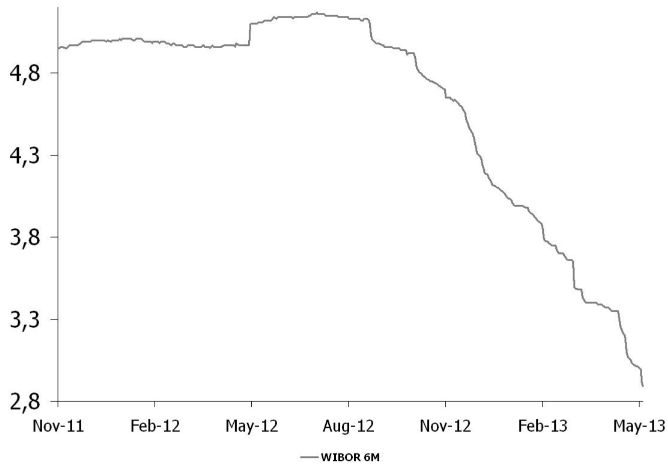


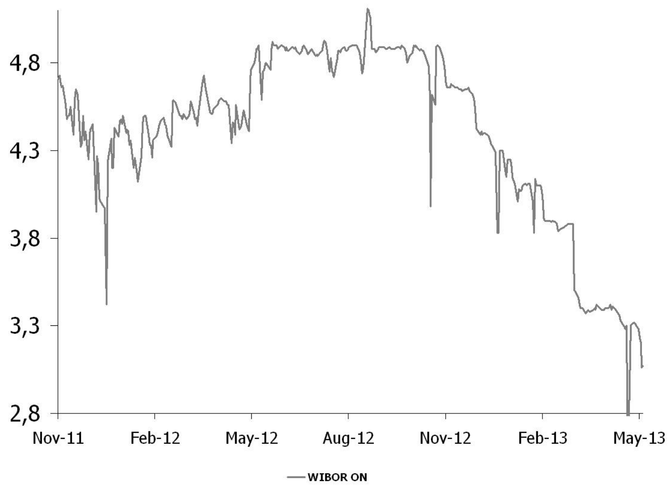


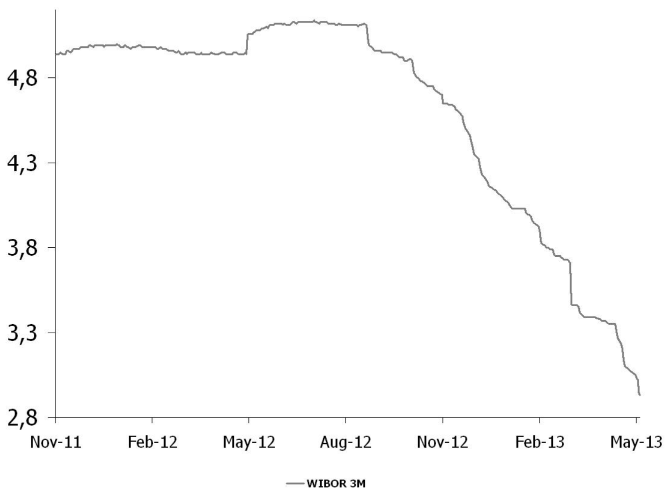
Money market

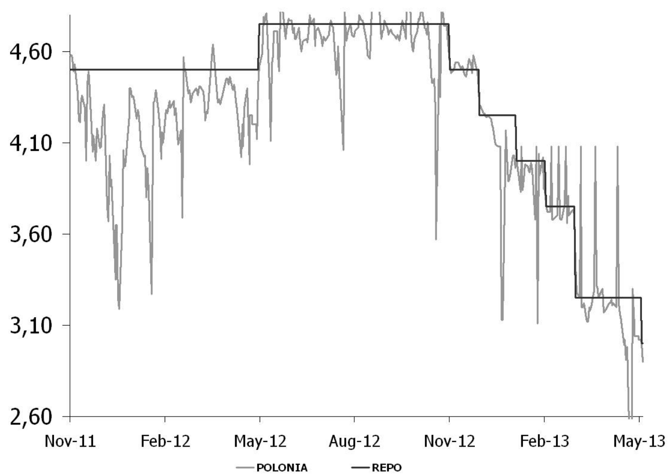
25 bps cut and dovish conference Shortest rates stable nearby the main rate level. Today's OMO (130 bln pln) squared the market nicely, therefore it should stay that way for the coming week.

Rebound in car production 25 bps cut and the dovish conference pushed the front end another 20 bps down. Fra market sees another 100 bps cut within 6 month time. No 50 bps play yet. OIS market still lags by one cut, therefore we sustain our strategy to receive 6-12M Ois versus paying 6*9 and 9*12 FRA. We think that CPI figure next week can fuel cut expectations, however it looks like the main rate at 2% level should be the floor for now (It is already priced in). After CPI it may be a good chance to close receivers before the industrial production figure, which can be better then widely expected (2.5%) due to rebound in car production (first time since 18 months).
As for rate cuts, we think that the most probable scenario would be 25 bps in June and 25-50 bps in July.





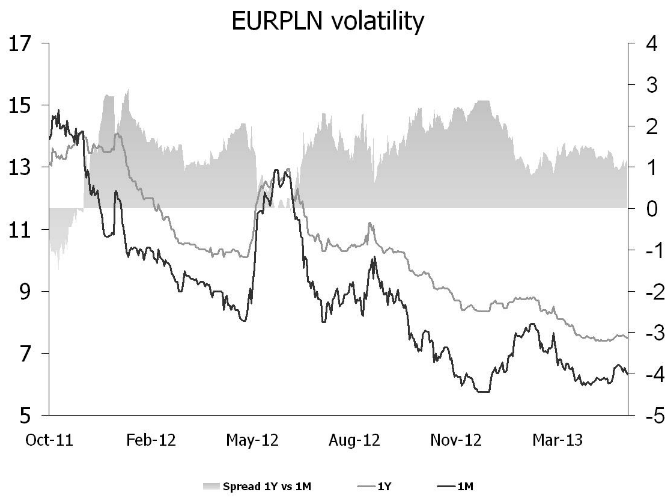




Forex

PLN still in range The range (4.11 - 4.19) holds unscratched with this week's levels (4.12 - 4.16). The rate cut of 25 bp was not enough to weaken PLN substantially. After the first knee-jerk reaction, PLN actually managed to strengthen on the very day. The reasons behind that are obvious, the neverending appetite for Polish bonds. Foreign bond holders may become a real threat for PLN in the future, but the timing is everything.

Vols lower The sellers are back in control. As a consequence, the EURPLN 1 month ATM fixed today at 6.1% (0.4 lower then a week before), 3 month ATM is 6.5% (0.3 lower), 6 month is 6.85% (0.3% lower) and 1 year lowered by 0.2% to 7.2%. The biggest fun was on the USD/PLN where currency spread (difference between USD/PLN and EUR/PLN) dropped by 0.75% all over the curve only to regain half of the losses after EUR/USD sharp fall to 1.3000. The skew was roughly unchanged.

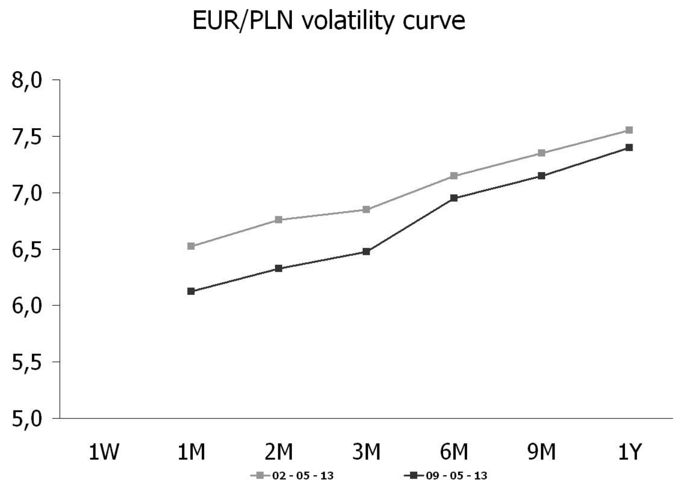


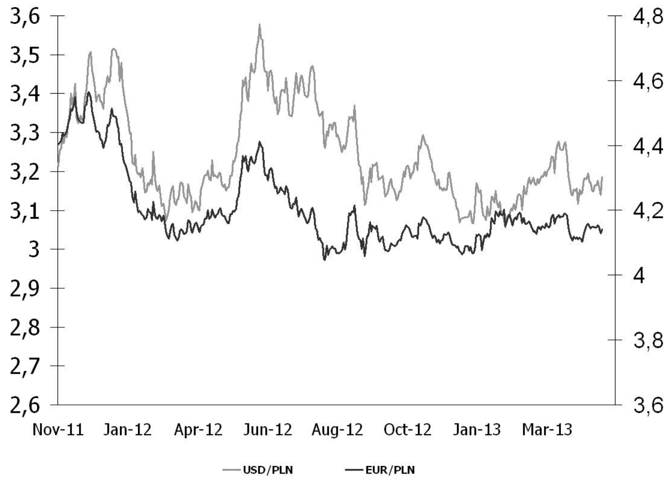
Short-term forecasts

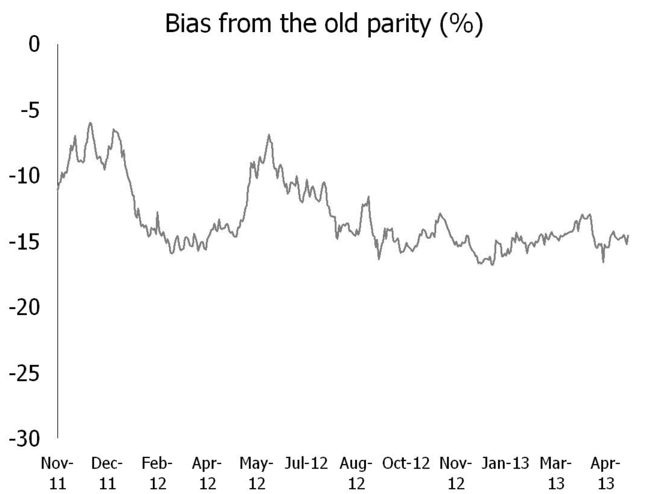
Main supports and resistances
EUR/PLN: 4.0850 / 4.1900
USD/PLN: 3.0500 / 3.3000

Play range. The rate cut, the bond flow, risk on or risk off, it is all smoke in our eyes. The truth is, we are treading water. The 4.09 - 4.19 should cover it. We would like to play that range, by selling 4.1850, adding 4.2050 with stop above 4.23 and hopes for 4.12. Or alternatively buy EUR/PLN at 4.11, add 4.09 with stop below 4.07 and eyes firmly on 4.1800 . We are not really biased to the former or the latter, whatever comes first.

Derivatives. 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). 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.







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
5/2/2013	2.70	3.07	2.73	2.92	2.62	2.90	2.89	2.59	2.42	2.40	2.44	2.42
5/6/2013	2.65	3.05	2.54	2.91	2.59	2.90	2.88	2.60	2.48	2.47	2.49	2.51
5/7/2013	2.75	3.03	2.87	2.90	2.84	2.87	2.83	2.62	2.46	2.44	2.48	2.48
5/8/2013	2.73	3.02	2.84	2.89	2.81	2.86	2.75	2.52	2.34	2.30	2.33	2.33
5/9/2013	2.61	2.95	2.53	2.82	2.53	2.78	2.69	2.45	2.30	2.26	2.28	2.31

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
5/2/2013	2.900	3.353	3.292	3.275	3.420	3.351	3.630	3.873
5/6/2013	2.900	3.114	3.263	3.148	3.370	3.270	3.575	3.755
5/7/2013	2.870	2.992	3.218	3.137	3.325	3.237	3.525	3.759
5/8/2013	2.860	2.992	3.218	3.137	3.325	3.237	3.525	3.759
5/9/2013	2.780	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
5/2/2013	6.53	6.85	7.15	7.55	7.55	2.56	0.71
5/6/2013	6.53	6.83	7.18	7.55	7.55	2.56	0.71
5/7/2013	6.43	6.78	7.10	7.53	7.53	2.57	0.73
5/8/2013	6.31	6.61	7.05	7.50	7.50	2.57	0.73
5/9/2013	6.13	6.48	6.95	7.40	7.40	2.58	0.73

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
5/2/2013	4.1485	3.1492	3.3950	3.2386	1.3928	0.1615
5/6/2013	4.1479	3.1646	3.3760	3.1844	1.4007	0.1619
5/7/2013	4.1550	3.1767	3.3774	3.2064	1.3978	0.1614
5/8/2013	4.1487	3.1609	3.3684	3.1986	1.4126	0.1602
5/9/2013	4.1285	3.1392	3.3572	3.1803	1.4088	0.1599

Disclaimer