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

The last batch of April data comes out next week. We expect wages (to be published on Monday) to have followed recent trends and post a meager +2,2% y/y. On the other hand, the long winter might have pushed some seasonal increases in employment into April, thereby slightly increasing y/y dynamics. On Tuesday the Central Statistical Office will publish industrial data. We expect output to have increased quite strongly on favorable working day effects and catching up after the long winter. Producer prices have, on the other hand, experienced another steep decline, exacerbated by a fall in commodity prices and a slight PLN aprreciation. Finally, we end this week with the release of the Statistical Bulleting along with unemployment and retail sales data. As for the former, we expect a fall in line with seasonal patterns. As for the latter - we forecast a slight decline due to reverse Easter effect and on-going weakness in categories such as clothing and building material.

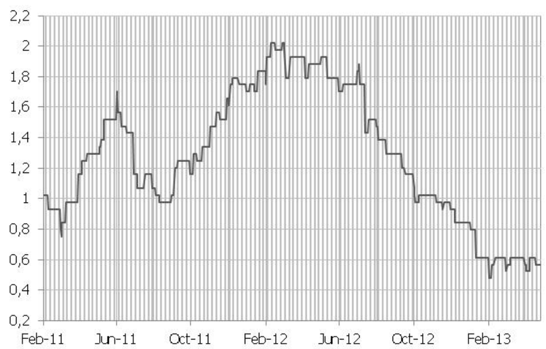
Polish data to watch: May 20th to May 24th

Publication	Date	Period	BRE	Consensus	Prior
Wages y/y (%)	20.05	Apr	2.2	2.2	1.6
Employment y/y (%)	20.05	Apr	-0.7	-0.9	-0.9
Industrial output y/y (%)	21.05	Apr	4.0	2.9	-2.9
PPI y/y (%)	21.05	Apr	-1.7	-1.4	-0.6
Retail sales y/y (%)	24.05	Apr	-0.5	1.0	0.1
Unemploment rate (%)	24.05	Apr	14	13.9	14.3

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 flash GDP estimate for Q1 was an unpleasant surprise but it was compensated by a smaller than expected fall in inflation. Therefore, unchanged from last week. Next week brings the last batch of April data and we cannot rule out a positive surprise in industrial output.

* 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

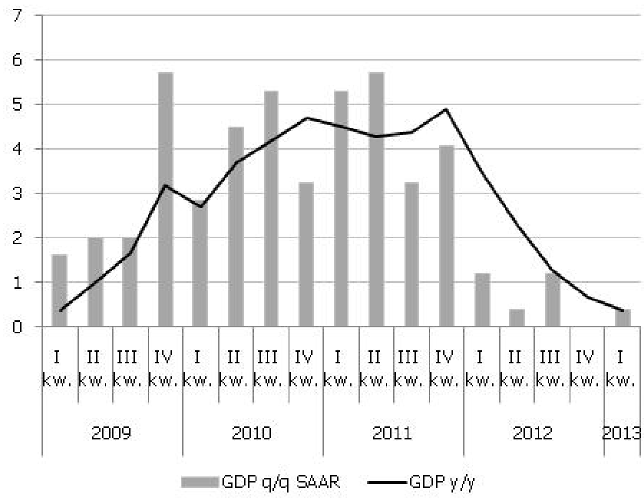
	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2013 Q1 F	2013 Q2 F	2013 Q3 F	2013 Q4 F
GDP y/y (%)	3.5	2.3	1.3	0.7	0.4	0.8	1.2	1.7
Individual consumption y/y (%)	1.7	1.3	0.2	-0.2	0.3	1.0	1.6	1.9
Public Consumption y/y (%)	-1.0	0.4	1.6	-0.6	0.2	0.5	0.5	0.5
Investment y/y (%)	6.8	1.4	-1.7	-4.1	-6.8	-4.5	-3.0	-2.5
Inflation 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	2.50	2.50
Wibor 3M (% eop)	4.94	5.13	4.92	4.11	3.39	2.95	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

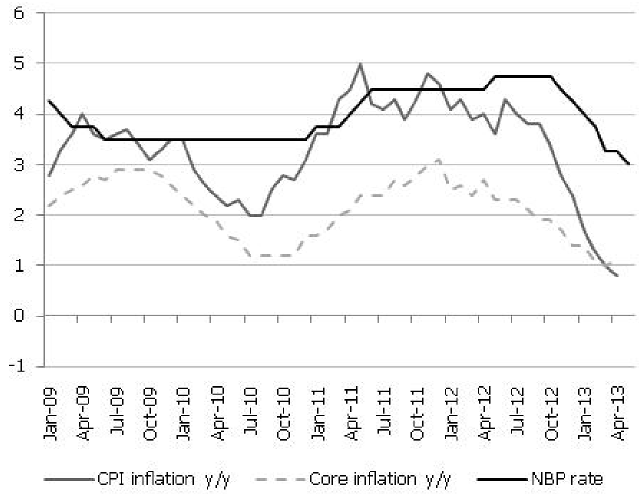
Economics

Combination of low growth and low inflation strengthens the case for monetary easing yet again

Q1 GDP growth came out at 0.4% y/y vs 0.7% in the previous quarter. It is a flash estimate, an "experimental" reading (to quote the Central Statistical Office), so we think there is a scope for revision as soon as detailed data are published (May 29). Regardless of the final figure we think that higher frequency data imply that the trough in activity did not happen in Q4 but in Q1 instead. Moreover, we think it is now safe to say that Poland did not enter technical recession only because of... pure luck. Q1 is the fifth consecutive quarter with q/q growth below 0.5%.



As we already know, low growth in Q1 was accompanied by low and decreasing inflation. The latter followed into April, as CPI growth in April went down to 0.8% y/y from 1.0% in March. The decrease was facilitated by moderate food prices (+0.4% m/m), lower fuel prices (-1.0% m/m) and falls recorded in majority of core categories. Upward pressure on prices was exerted by wearing apparel but its behavior does not diverge from normal seasonal pattern. We forecast CPI inflation at 0.6% and we would have been there if only core inflation went down instead of up (from 1.0 to 1.1%). The slight increase in core inflation is a one-off event, facilitated by the end of promotions for newspapers and magazines, as well as a halt in the price war between mobile phone operators.



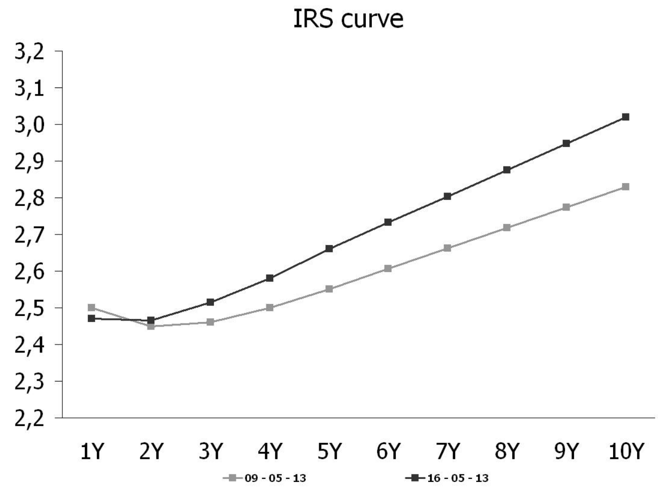
We think that the steep disinflation is not over. On lower fuel prices, lower energy prices and ongoing price wars within the suppliers of cellular and digital tv networks, inflation is set to get closer to 0% in holiday period. Recent relevant announcements also include lower electricity prices for consumers and large cuts in railway ticket prices by the largest carrier (PKP Intercity). Consumer price growth may drop to 0.6% y/y in May already.

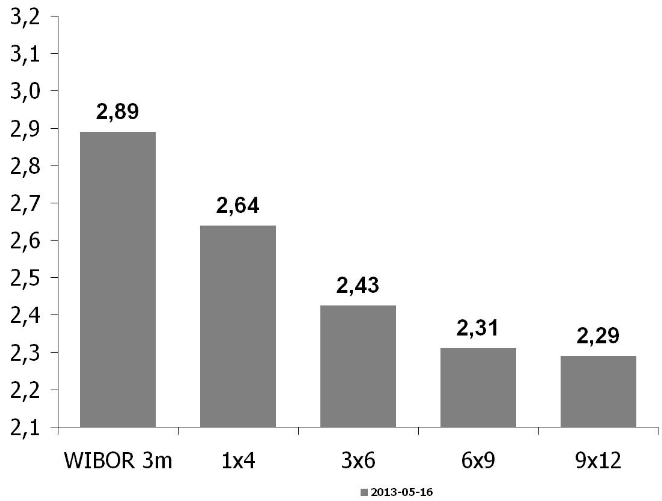
Implications of this week's readings for the MPC decision are clear. We think it has already sealed a rate cut at the June meeting. The recent cut in May addressed only falling inflation and uncertainty that GDP growth behaved differently from the NBP forecasts (the MPC optimistically assumed that the economy has already bottomed out in Q4). Now it is a reality. And as we also think that 25bps cut was rather small in comparison with the scale of surprises concerning inflation and GDP path, MPC has no time to waste. This week's surprise in inflation should (and probably will) be treated as one-off event and, after all, inflation is still falling. Recent comments from MPC members suggest this may be indeed an interesting story for MPC members: 1) even before the data there was probably a consensus for a rate cut in June (GlapiĹ„ski), 2) the MPC is inherently more dovish than its statement since it does not want to officially pre-commit.

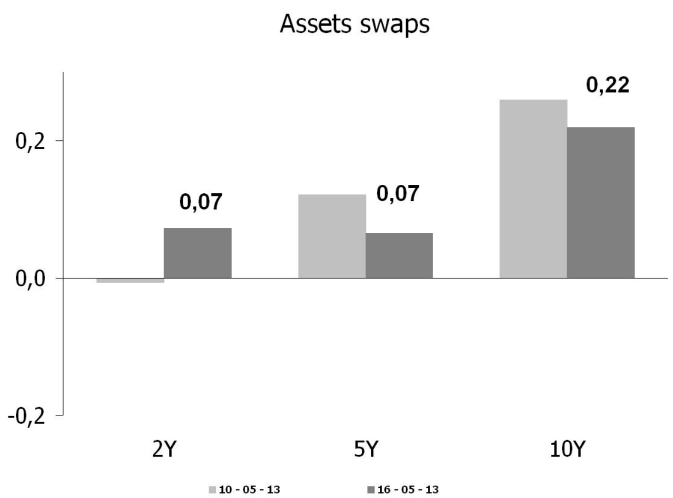
Fixed income

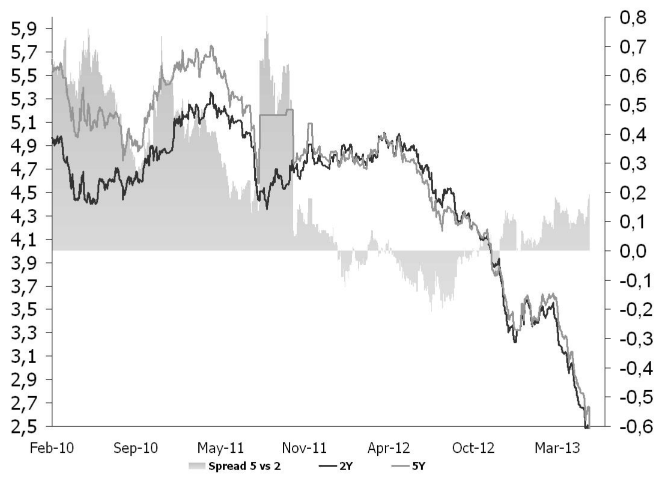
Correction

It’s been quite interesting and volatile week on the FI market. Rates continued to push higher along with significant steepening, especially in the 5y-10y sector. Lower than expected GDP data had some positive impact on the front end of the curve, causing further steepening. CPI on the other hand came slightly above market consensus, reversing price action once again. Despite not very best sentiment, The Finance Ministry managed to sell close to 5.5 bio of bonds on Thursday auction. MPC members’ comments after data weren’t really conclusive, yet leaning more towards further easing, possibly already next month. It’s been the first serious correction after 100bp rally in 10Y, but it seems it is a correction only, not a reversal of the trend. We think that the market will be more and more vulnerable to upcoming data releases at current levels, but as long as CPI is falling and moving towards 0, and there won’t be any strong signs of economic recovery, more monetary easing will be priced in and front end of the curve should be well supported. If that happens, further steepening is also quite likely.







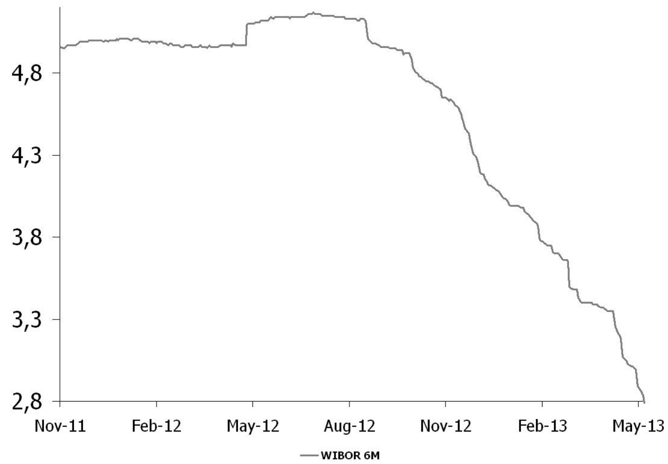


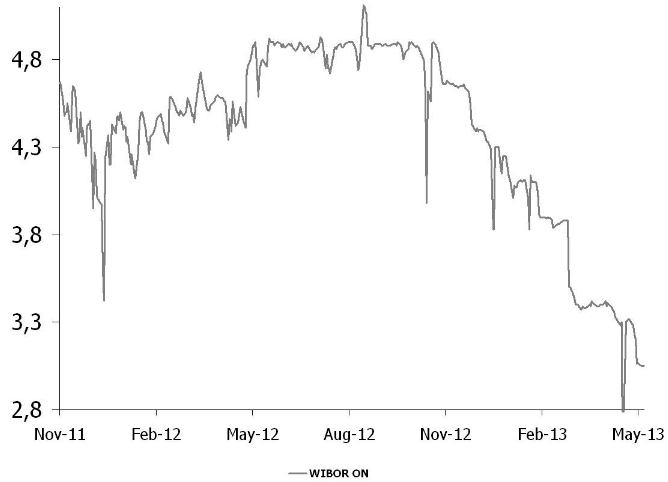
Money market

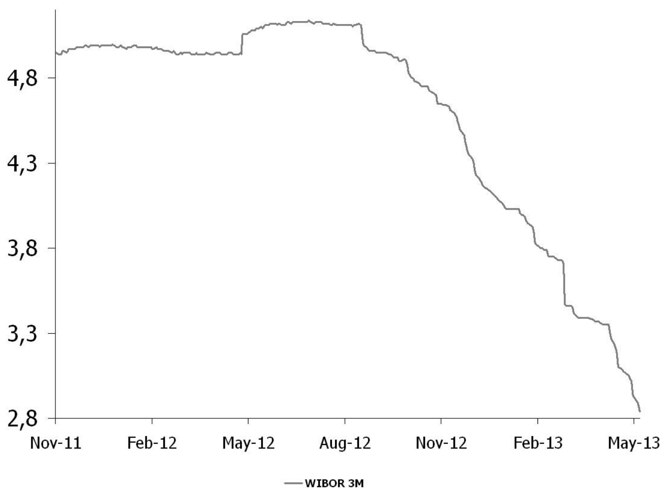
Liquidity stable Liquidity stable which means Polonia rate nearby the main market rate. After today's OMO it should not change next week.

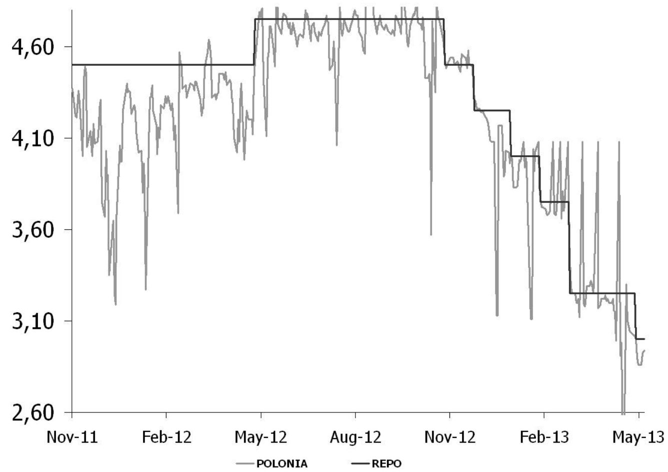
Figures beyond consensus boost volatility 3 offsetting surprises as far as the local figures are concerned. Firstly, 1q GDP flash (new approach by GUS) that surprised a lot on the downside (0.4% vs. 0.7% expected). Secondly, higher CPI figure (0.8% vs 0.6% expected) followed by higher core CPI (1.1% vs 0.8% expected). All this caused nothing but higher volatility for rates. Market still prices 100 bps cut within next 6 months (6*9 FRA 2.29, 9*12 FRA 2.25), which seems to be a lot even after very bullish interview given by the key swing voter Mr Hausner. We think that there is very skewed payoff coming from mentioned contracts, certainly in favour of pay positions. Moreover, if one likes to dismantle the politics inside the MPC more then the real data, it would be even more profitable to have payers on the front end, since the MPC consensus was quite reluctant to aggressive easing priced in by the market, at least so far.

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 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 co-tracts have still less then 75 bps cuts priced in).





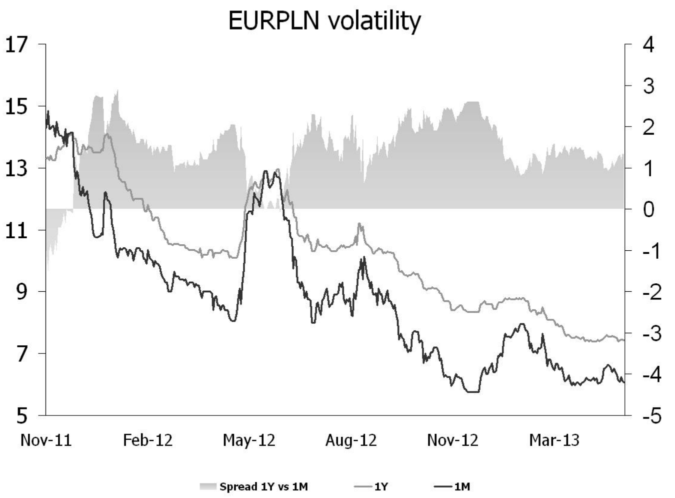




Forex

PLN weaker The USD buying pushed EUR/PLN,to the upper part of the current range (4.10 - 4.20). So far the high was 4.1945 and a small sell-off in polish bonds also helped to fuel the move. The move up is tired in our eyes, and we expect the retrace to the middle of the range, namely 4.15 and possibly lower. The next week production figure will be watched closely, but the local story is not really decisive. The global sentiment, demand for USD or its supply, is the driving force in the market.

Vols higher The correlation of weaker PLN and higher Vols is working as usual, even though the option market reaction was really muted. The 1 month EUR/PLN ATM mid was higher by 0.1% in comparison to last week, and fixed at 6.1%, the 3 month rose by the same magnitude and today is 6.6%. The backend was up by 0.2%, 1 year EUR/PLN ATM fixed at 7.5%. The skew was bid with a higher spot. USD/PLN was far more interesting as currency spread (difference between USD/PLN vol and EUR/PLN vol) was higher by roughly 0.5% across the curve and 1 year USD/PLN rr 25D was traded at 3.25 in good size.

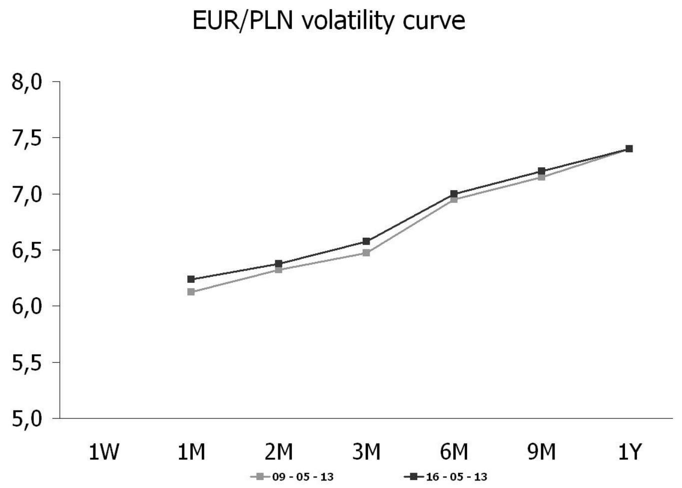


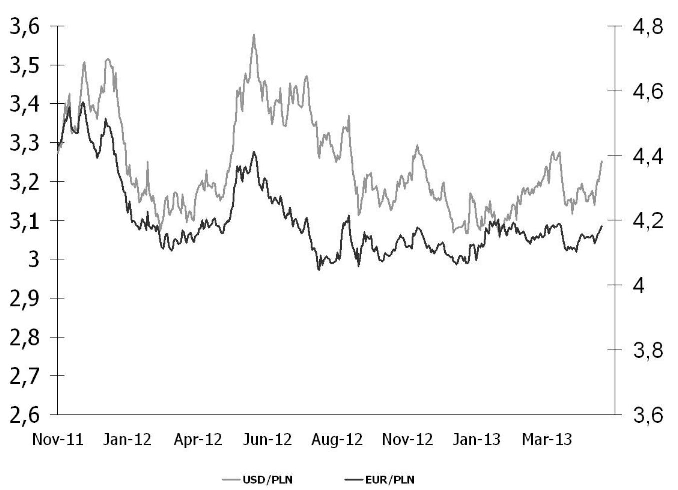
Short-term forecasts

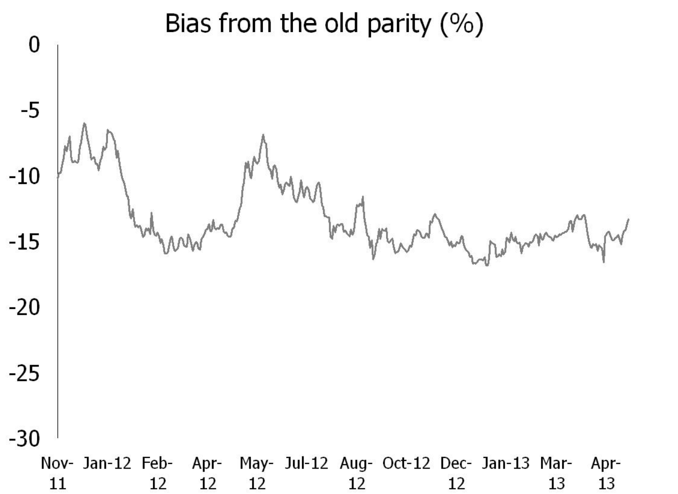
Main supports and resistances
EUR/PLN: 4.0850 / 4.1900
USD/PLN: 3.0500 / 3.3000

Sell EUR/PLN We are already short at 4.1850 with room to add at 4.20 and stop above 4.2100. We don't have any particular reason to be long PLN, beside the fact that the entrance level seems to be attractive. We hope for a move back below 4.15 and possibly to 4.12.

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
5/9/2013	2.61	2.95	2.53	6.49	2.53	6.59	2.69	2.45	2.30	2.26	2.28	2.31
5/13/2013	2.54	2.90	2.42	2.76	2.42	2.72	2.70	2.49	2.36	2.34	2.37	2.38
5/14/2013	2.54	2.89	2.50	2.74	2.50	2.70	2.68	2.44	2.29	2.26	2.30	2.31
5/15/2013	2.56	2.87	2.48	2.74	2.43	2.70	2.68	2.45	2.31	2.29	2.31	2.33
5/16/2013	2.61	2.84	2.51	2.69	2.47	2.67	2.64	2.43	2.31	2.29	2.32	2.33

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
5/9/2013	6.590	3.353	3.292	3.275	3.420	3.351	3.630	3.873
5/13/2013	2.720	3.114	3.263	3.148	3.370	3.270	3.575	3.755
5/14/2013	2.700	2.992	3.218	3.137	3.325	3.237	3.525	3.759
5/15/2013	2.700	2.992	3.218	3.137	3.325	3.237	3.525	3.759
5/16/2013	2.670	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
5/9/2013	6.13	6.48	6.95	7.40	7.40	2.55		0.73
5/13/2013	6.25	6.63	7.00	7.45	7.45	2.55		0.73
5/14/2013	6.11	6.63	7.00	7.45	7.45	2.55		0.73
5/15/2013	6.08	6.63	6.95	7.43	7.43	2.55		0.73
5/16/2013	6.24	6.58	7.00	7.40	7.40	2.58		0.73

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
5/9/2013	4.1285	3.1392	3.3572	3.1803	1.4088	0.1599
5/13/2013	4.1570	3.2051	3.3441	3.1496	1.4152	0.1610
5/14/2013	4.1606	3.1998	3.3549	3.1564	1.4077	0.1608
5/15/2013	4.1725	3.2340	3.3349	3.1575	1.4293	0.1606
5/16/2013	4.1822	3.2521	3.3570	3.1730	1.4349	0.1610

Disclaimer

Distribution and use of this publication The review note is based on the information available to the public. This review creates exclusively a marketing information as defined in Paragraph 9 Section 1 of the Decree of Minister of Finance dated November 20, 2009 on procedures and conditions to be followed by investment firms and banks mentioned in Article 70 Section 2 of Law on Trading in Financial Instruments dated July 29, 2005 as well as by custody banks. This review note is provided to you for information purposes only and is not intended as advice on any particular matter or as recommendation, offer or solicitation for purchase of sale of any financial instrument and should not be taken as such. BRE Bank SA, its directors, officers, executives, managers, servants or agents expressly disclaim all liability to any person in respect of any-thing, and in respect of the consequences of anything, done or omitted to be done, wholly or partly, in reliance upon the whole or any part of the contents of this review note. The opinions and estimates contained herein reflect the current judgment of the author(s) on the date of this document and are subject to change without notice. The opinions pointed in review do not necessarily correspond to the opinions of BRE Bank SA. The past performance of financial instruments is not indicative of future results. No assurance can be given that any financial instrument or issuer described herein would yield favourable investment results. BRE Bank and/or its principals or employees may have a long or short position or may transact in the financial instrument(s) and/or securities referred to herein or may trade in such financial instruments with other customers on a principal basis. No client or other reader should act or refrain from acting on the basis on any matter contained in it without taking specific independent professional advice on the particular facts and circumstances in issue. Copyright protection exists in this publication and it may not be, even partially, reproduced of distributed without the prior written agreement with BRE Bank SA.