

Rates and FX Outlook

Polish Financial Market

May 2012

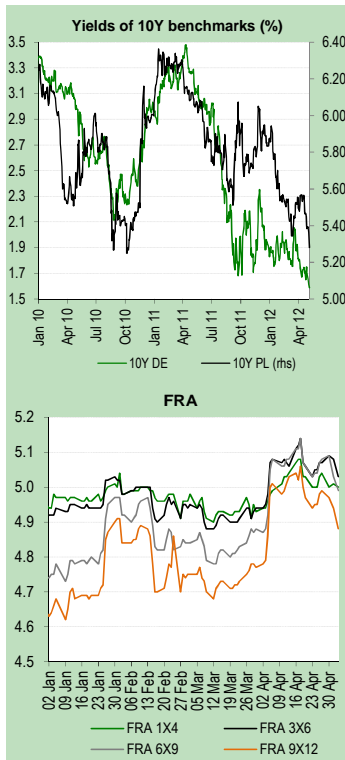


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- **Last month we wrote that one cannot rule out the possibility that a few members of the MPC could put a motion to HIKE interest rates soon.** And indeed, it turned out that rate hike proposal was voted already in April (3 out of 10 members in favour). What is more, after the April's meeting the Council released very hawkish statement suggesting a possibility of rate hike in May. There were even some comments suggesting that in April the MPC prepared for or preannounced a hike to be delivered at the next meeting, so if they do not increase rates there might be a problem of credibility. In our opinion, the MPC indeed unnecessarily created a pressure on itself (no man asked for). However, in April the Council also listed conditions, which could make interest rate hike unnecessary. In our opinion, these conditions were met – CPI inflation below 4% and, what is more important, weak or very weak economic data (except retail sales) – and therefore we do not forecast a rate hike in May. We acknowledge it will be a close call. If the MPC keeps rates unchanged, the hawkish bias will be probably maintained with no major changes in the communiqué. On the other hand, if there is a hike, the justification of the decision will be the most interesting given that NBP's inflation projection shows CPI inflation going down to the target in the medium-term and in the light of NBP's business climate report suggesting limited wage pressure (low risk of second-round effect).
- **In line with our expectations short-end of the curve was under pressure due to central bankers' hawkish comments, which have been offset later during the month by the economic data releases. However, long-end saw another wave of surprising rally with 5Y and 10Y yields even below minimum recorded in March.** Irrespective whether the MPC increases the interest rates in May or not, the statement will remain relatively hawkish and will underline that tightening of monetary policy in future cannot be excluded, depending on next macro data. Consequently, we do not expect that in case of a rate hike the statement will suggest that this was only a single move. In this scenario, the short end of the yield curve moves clearly up and starts to price-in next rate hike in June-July. If the official rate stays unchanged – and this is our base scenario – the statement will probably still continue to indicate risk of a rate hike. As a result of such a decision, FRA rates and 2Y bond yield would fall, but the move would be limited by the risk of a rate hike next month. What is more, later during the month, we expect that data on April's inflation to be a nasty surprise (CPI at 4% or even above, against consensus of 3.9%) and may push market rates further up. Still, the following macro data will confirm that demand pressure on consumer prices is and should remain rather limited. Overall, interesting month ahead with a lot of volatility expected in fixed income market. The long-end will be driven mostly by global factors with the still favourable demand-supply balance limiting increase in yields.
- **Our view of EURPLN breaking 4.18 has materialised, though the Polish currency lacks additional factors driving further depreciation.** Therefore, we keep the view of some stabilisation in the FX market in the short-term, still not excluding a more significant upward move in EURPLN (towards or above 4.26) amid risk off in global markets.

This report is based on information available until 4th May

Short- and Medium-term Strategy

Interest rate market

	Change (bps)		Level end-Apr	Expected trend	
	Last 3M	Last 1M		1M	3M
Reference rate	0	0	4.50	→	→
WIBOR 3M	-4	1	4.95	→	→
2Y bond yield	0	9	4.67	→	↗
5Y bond yield	-13	-6	4.87	→	↗
10Y bond yield	-17	-9	5.40	→	↗
2/10Y curve slope	-16	-18	73	→	→

Note: Single arrow down/up indicates at least 5 bps expected move down/up, double arrow means at least 15 bps move

Rates: our view and risk factors

PLN rates market	<p>Money market: As expected, WIBOR rates almost flat. FRA increased due to higher risk of monetary policy tightening. Currently market prices-in 50/50 (or a bit less) probability of hike in May as the NBP's Governor vote will be probably decisive. Risk of rate hike later this year will be maintained as we foresee CPI inflation to stay slightly above 4%YoY in coming months, limiting decrease in FRA rates.</p> <p>Short end: Moderate increase in 2Y yield last month, as we expected. Second half of April brought decrease in 2Y benchmark yield, with strong support level at 4.60%. If the MPC keeps rates unchanged in May, this should positively affect the front end, but CPI inflation release later during the month (4-4.1% again) could bring some increase in yields.</p> <p>Long end: While we expected some stabilisation, April brought yields of 5Y and 10Y bonds falling. At the start of May they were even below minimum levels noted in mid-March. Global risk factors may bring the yields up again, though we are far from important resistance levels at 4.95% for 5Y and 5.40% for 10Y. We expect IRS curve to slightly steepen, with 2-10Y spread widening.</p> <p>Risk factors to our view: The risk-case scenario of rate hike by the MPC would lead to increase in yields at the short-end, especially as hawkish rhetoric would be maintained. At the long-end global moods will be important, but the effect of low supply will limit yields increase. Overall, in the risk-case scenario of two hikes in following months, we can see the scenario of inversed bond curve.</p>
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FX market

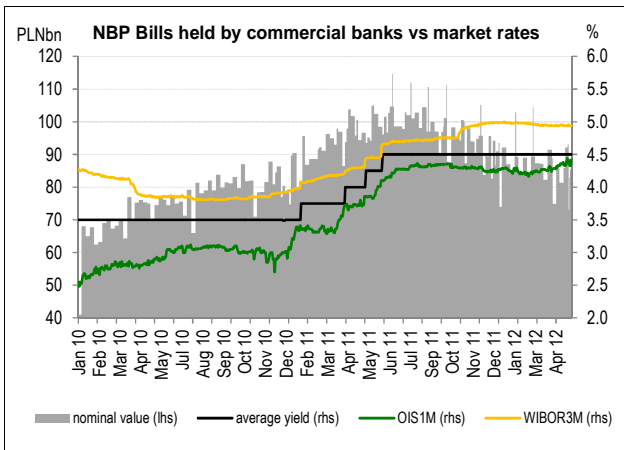
	Change (%)		Level end-Apr	Expected trend	
	Last 3M	Last 1M		1M	3M
EURPLN	-1.3	0.3	4.17	→	↗
USDPLN	-1.6	1.0	3.15	→	↗↗
CHFPLN	-0.7	0.8	3.48	→	↘↘
GBPPLN	1.5	2.7	5.12	→	→
EURUSD	0.3	-0.8	1.32	→	↘

Note: Single arrow down/up indicates at least 1.5% expected move down/up, double arrow means at least 5% move

FX: our view and risk factors

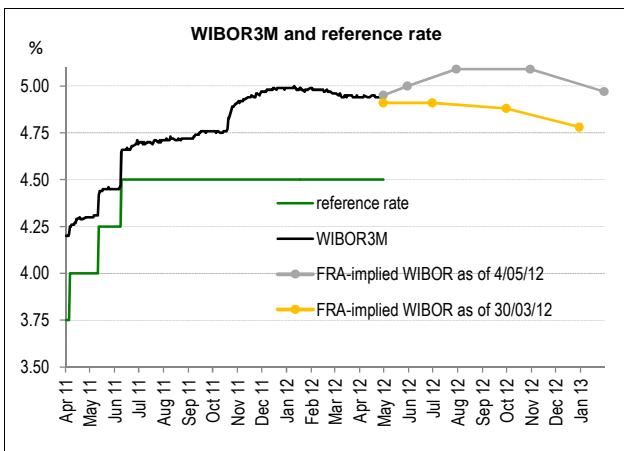
PLN FX market	<p>EUR: The EURPLN has stayed in wide range 4.16-4.20, temporarily rising above 4.20. There are still a lot of risk factors, which could push rate to test resistance level of 4.20 again, and its breaking would open the room to further increase, even above 4.24. Rather not in May.</p> <p>USD: We uphold our bearish EURUSD view, expecting the rate to continue downward trend in coming weeks. As a consequence we foresee a moderate weakening of the zloty against the US dollar (more significant weakening in 3M horizon).</p> <p>CHF: There is still possibility that the SNB raises EURCHF currency floor from current 1.20 due to lower growth and disinflation, supporting moderate zloty strengthening vs. the Swiss franc.</p> <p>Risk factors to our view: Another wave of positive mood in global markets (lower worries regarding euro zone's periphery and/or QE3 announcement by Fed and further stimulus by EBC). Rate hike by the MPC may also bring some short-term temporary zloty appreciation.</p>
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Money Market



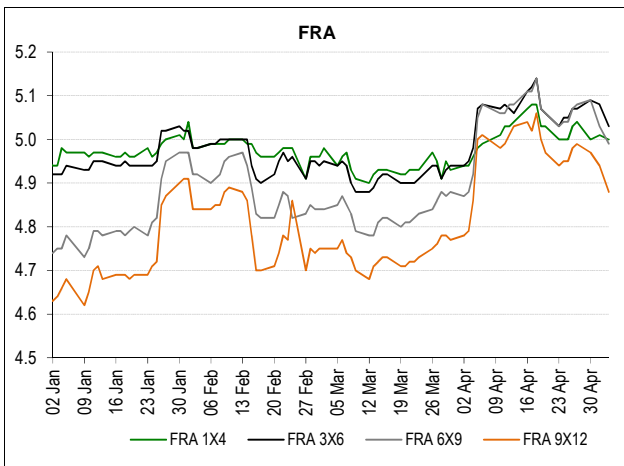
Short-term rates slightly down, while OIS rates up

- As expected, April brought some decrease of short-term WIBOR (with maturity up to 1M), however rates stayed slightly above the reference rate (on average). We noted also fall in Polonia rate, slightly below 4% at the end of month. It mainly resulted from high liquidity in the banking sector (banks every week roll over money bills worth of ca. PLN85bn). Also, we saw huge net cash inflows in April of around PLN17bn with the significant part of it going to the banking sector.
- Increased risk of interest rate hike was more visible in OIS rates. In April rates climbed sharply (by 10-30bps along the curve), with the highest increase (over 20bps) in case of rates between 6M and 1Y. At the end of April 3M OIS rate was traded still slightly below 4.50%, reflecting still relatively high availability of money in the banking system.



FRA rates have started to discount interest rate hike

- WIBOR rates, despite extremely hawkish rhetoric after the MPC meeting in April, remained relatively stable. Macroeconomic data published later in April also had rather limited impact on WIBORs levels. In monthly terms 3M WIBOR rate increased by 1bp to 4.95%, while rates between 6 and 12 months climbed by 2bps to 4.98%.
- FRA market, as in previous month, was more volatile. As expected, in April the MPC kept interest rates unchanged, however the Council released extremely hawkish statement, which was interpreted by some market players as pre-announcing a rate hike in May. It caused rates growth by 10-15bps, above 5% in case of longer tenors, immediately taking off rate cuts expectations and starting to price in hike in coming months. March CPI data took some breath for the market, however after corporate wages showed higher than expected growth FRA rates have continued upward trend towards 5.15% in case of FRA3x6 and FRA6x9.
- Trading environment has changed significantly after much weaker than expected industrial output data (0.7%YoY vs. consensus of 5%). This caused a price off in the May rate hike expectations and FRA rates moved 5-10bps down. Retail sales data were almost in line with expectations, therefore it did not change any arguments for the potential hike/not hike dispute. All in all, FRA curve moved up by 10-20bps in monthly terms in April, in which FRA9x12 was traded near the current level of WIBOR 3M.
- We uphold our base scenario that the MPC will keep interest rates unchanged in May, however it will maintain its strong hawkish rhetoric. While WIBOR rates could slightly move down, we foresee more significant downward move in case of FRA rates. However, FRA decrease will be limited ahead of April's CPI reading (we see relatively high figure). On the other hand, data from real economy may bring negative surprise again.

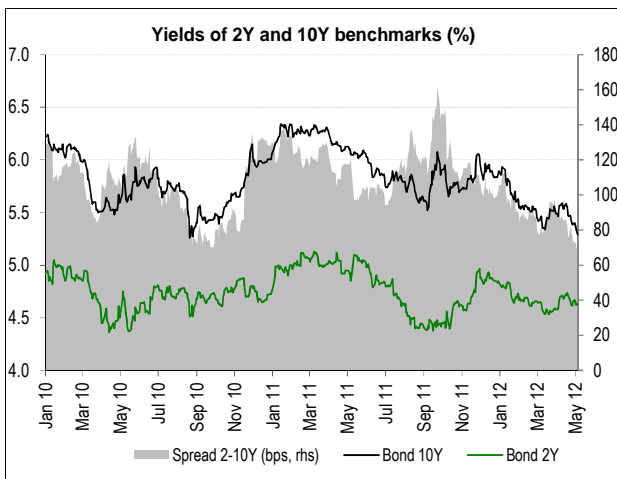
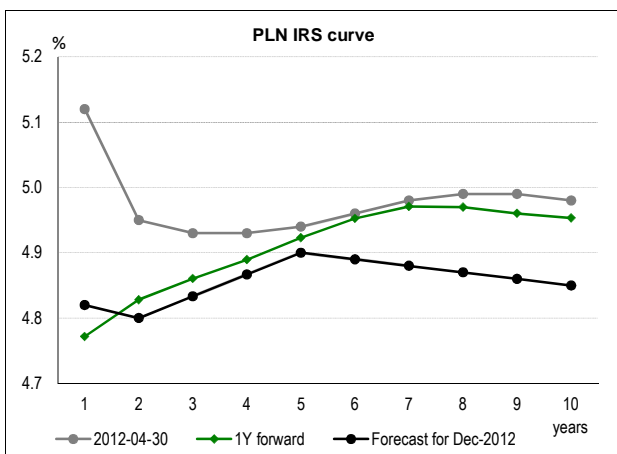
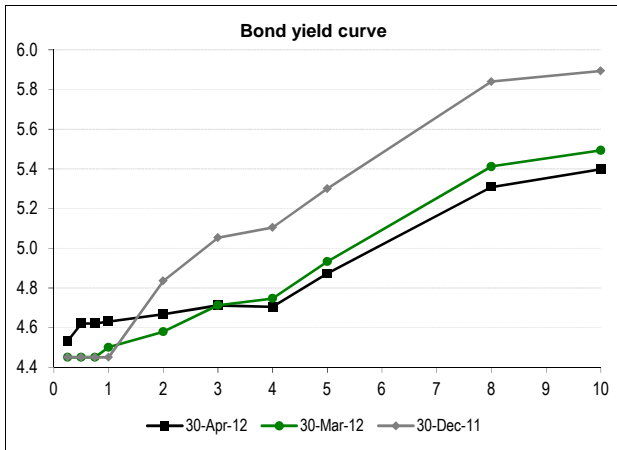


Money market rates (%)

	Reference rate (%)	Polonia (%)	WIBOR (%)				OIS (%)				Spread WIBOR / OIS (bp)			
			1M	3M	6M	12M	1M	3M	6M	12M	1M	3M	6M	12M
End of April	4.50	3.98	4.72	4.95	4.97	4.98	4.41	4.47	4.51	4.53	31	48	46	45
Last 1M change (bp)	0	-36	0	1	1	2	13	20	26	28	-13	-19	-25	-26
Last 3M change (bp)	0	-9	-4	-4	-4	-3	16	20	21	19	-20	-24	-25	-22
Last 1Y change (bp)	50	107	62	65	47	32	68	61	49	24	-6	4	-2	8

Sources: Reuters, BZ WBK

IRS and T-Bond Market



Short-end under pressure, while longer bonds rebounded

Unexpectedly, the MPC's statement after April's meeting sharply increased possibility of interest rate hike in forthcoming months, even in May, especially that market was vary on whether the Council would ease monetary policy or keep rates on hold. Monetary policy tightening was not what market had been betting on, so after the MPC's conference yields rapidly moved up. The March CPI release did not have any significant influence on a yield curve. Market sentiment improved significantly after bond auction (OK0714 and PS1016), which attracted PLN15bn of bids and after the weak March industrial output release. It pushed yields down by some 10bps.

Positive mood was also supported by dovish statement of Andrzej Bratkowski from the MPC, who said that he did not see any inflation pressure and rates should stay unchanged in May and June. As a result yields on mid and long-end of the curve fell towards minimum levels since mid-March. In monthly terms yield curve moved up by 6bps on the front end, while on mid and long-end yields fell by 6bps and 10bps, respectively, with yield of 10Y at 5.40%.

IRS rates increased sharply and the scope of the growth was more significant than on the bond market. Increased possibility of rate hike pushed 1Y rate over 5.15%, while rates between 2Y and 10Y increased over 5%, reaching the highest level since July-August 2011. IRS curve has continued to flatten, with 2-10Y spread narrowing to nearly 1bps, the level observed in mid-March. To sum up, in April IRS curve moved upward by 5-15bps, with the lowest increase at the long-end.

We expect some upward move on the bond market

The beginning of May showed the strength of Polish debt market. Despite low activity (due to two holidays) bond yields have continued downward trend. Yield of 10Y bond fell below 5.30% (beating the minimum reached in mid-March), while yield of 2Y stayed slightly above 4.60%. As a consequence yield curve flattened, with 2-10Y spread below 70bps. At the same time we also noted IRS curve to move down by 8-12bps, with 10Y IRS falling below 4.90%.

In our opinion coming weeks could bring upward move of yields. The front end of the curve will remain under pressure of strong hawkish rhetoric of the MPC. Additionally, CPI reading for April may be above 4% again, which could bring some negative sentiment in the front-end. Other macroeconomic data, released later during the month should confirm gradual slowdown of the economy.

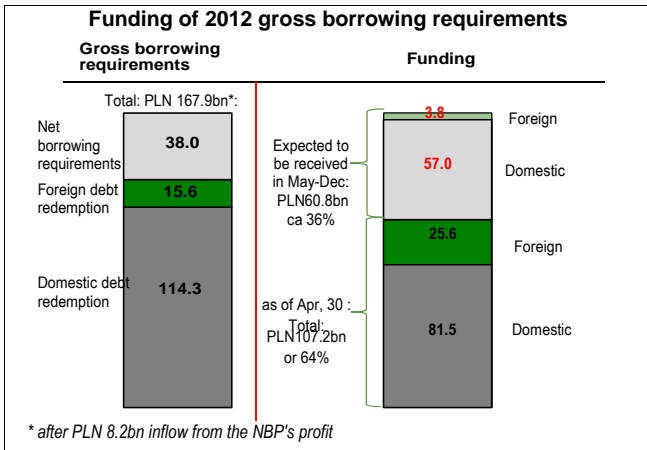
The long-end will remain under influence of global mood. Higher risk aversion due to some deterioration of situation in peripheries of euro zone may result in further increase in yield of 10Y benchmark. However, the upward move will be limited given low supply in forthcoming months and the May's auction results will show the real interest in 10Y sector.

Bond and IRS market (%)

	T-bills	BONDS			IRS			Spread BONDS / IRS (bp)		
	52-week	2Y	5Y	10Y	2Y	5Y	10Y	2Y	5Y	10Y
End of April	4.63	4.67	4.87	5.40	4.95	4.94	4.98	-28	-7	42
Last 1M change (bp)	13	9	-6	-10	13	8	6	-4	-14	-16
Last 3M change (bp)	12	-6	-24	-23	1	6	5	-7	-30	-28
Last 1Y change (bp)	-3	-28	-87	-73	-31	-73	-66	3	-14	-7

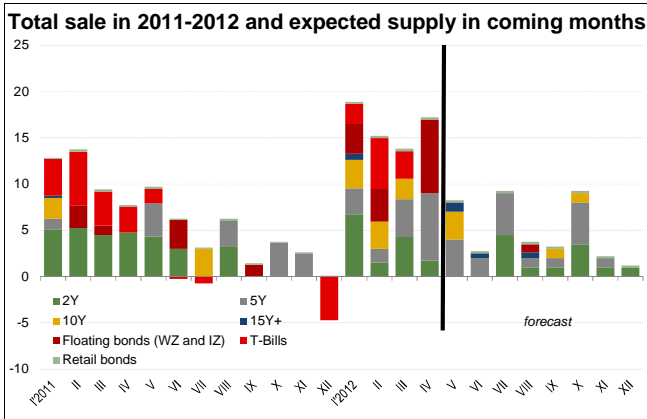
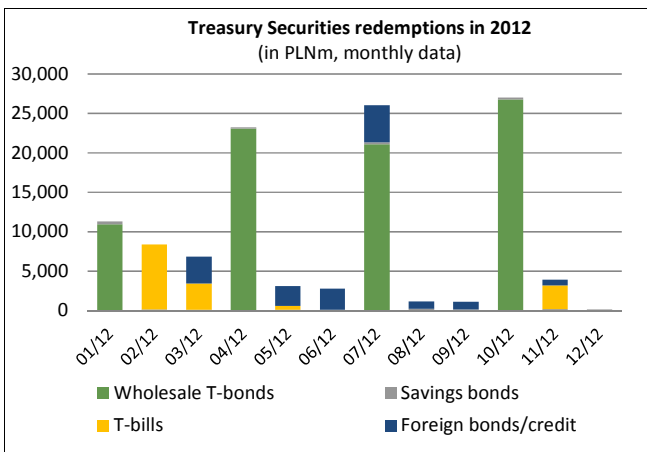
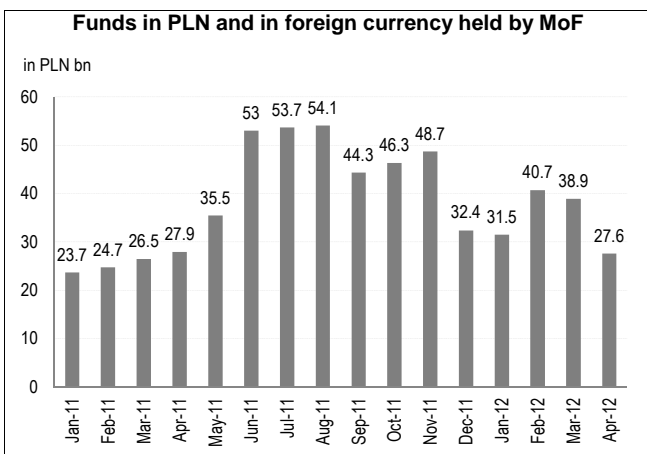
Sources: Reuters, BZ WBK

Treasury Securities Supply Corner



The Ministry of Finance has successfully launched TS

- As expected, April's switch tender attracted high interest of investors. To recall, market players could have purchased floating-rate T-bonds WZ0117 and WZ0121 instead of PS0412, OK0712 and OK1012 bought back by the Ministry of Finance. The Ministry sold WZ papers worth ca. PLN8bn, in which sale of WZ0117 accounted for 70% of total amount.
- Auction results of OK0714 and PS1016 showed that Polish bond market was supported by domestic factor. The Ministry sold bonds worth ca. PLN9bn in total, with yield of 4.759% in case of OK0714 and 5.004% in case of PS1016 (slightly below the level on the secondary market). Demand recorded during both auctions (standard and non-competitive) was solid and amounted to PLN 17.6bn in total.
- The Ministry was also active on the foreign market. It launched a dual-tranche of Swiss franc denominated bonds worth of CHF825m in total. The Ministry sold (1) 3-years floating-rate bond, maturing on 14 August 2015 and priced at 125bps over 3M CHF LIBOR rate and (2) 6-years fixed-rate bond, maturing on 15 May 2018 with yield at 2.31% (or 170bps over mid-swap rate). According to the Ministry's statement, bonds were placed among diversified group of investors solely from Switzerland.
- All in all funding of 2012 gross borrowing needs is highly advanced. At the end of April it amounted to almost two-thirds.
- At the end of April liquidity cushion in PLN and FX-denominated funds amounted to PLN30bn. As we predicted, the Ministry reduced the amount of liquidity reserve, allocating a part of the sum for redemption and servicing of Treasury papers maturing April 25.



The May issuance plan focuses on mid- and long end

- The Ministry of Finance announced that in May it holds only two auctions of wholesale T-bonds. Investors will have an opportunity to purchase long-term bonds (DS1021 / WS0429) and a new 5Y benchmark (PS0417). Moreover, the Ministry did not rule out to enlarge offers by floating rate T-bonds WZ0117 and zero-coupon T-bond OK0417, respectively, if market conditions change significantly. The planned supply will reach the level of PLN2-4bn on each auction.
- In case of T-bills, the Ministry resigned from offering these instruments, in line with previous announcement. In May the amount of T-bills to be redeemed amounts to PLN0.5bn. Therefore the debt outstanding will decrease below PLN12bn.
- In terms of foreign financing, the Ministry plans to issue 5Y bonds on the Japanese market at the beginning of May. The previous auction in the Japan's market was in July 2011, with the amount of 25bn yen of 4-year retail targeted Samurai bond.
- As expected, May's debt supply is relatively limited compared to previous months, showing high flexibility of the issuer amid volatile market environments. Relatively low supply of T-bonds and lack of T-bills tenders stem from the high coverage of 2012 borrowing needs. The effect of low supply will continue to exist in coming months, supporting T-bond market. As we already mentioned, we foresee the Ministry to start pre-financing process of the 2013 borrowing requirements in Q3 2012. We would like to recall that last year thanks to rolling over T-bonds by switching auction, buybacks of both T-bills and foreign bonds as well as higher than planned financial resources at the end of 2011, the Ministry of Finance has started this year with funding worth of PLN30bn.

Sources: Ministry of Finance, BZ WBK

Treasury Securities Supply Corner

Total issuance in 2012 by instruments (in PLNm, nominal terms)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
T-bonds auction	10,820	11,503	10,560	9,012	8,000	2,500	7,000	3,500	3,000	6,500	2,000	0	74,395
T-bills auction	2,223	5,778	3,000										11,001
Retail bonds	216	248	212	210	210	210	210	210	210	220	200	200	2,555
Foreign bonds/credits	7,979	2,200	0	5,390	1,043						2,405		19,016
Prefinancing and financial resources at the end of 2011	31,600												31,600
Total	52,837	19,729	13,772	14,611	9,253	2,710	7,210	3,710	3,210	6,720	4,605	200	138,567
Redemption	11,297	3,981	5,275	20,795	4,855	2,778	24,323	3,127	1,058	22,851	3,924	2,368	106,632
Net inflows	41,540	15,749	8,496	-6,183	4,397	-68	-17,113	583	2,152	-16,131	681	-2,168	31,935
Rolling over T-bonds	6,309			7,966									14,274
Buy-back of T-bills													0
Total	47,848	15,749	8,496	1,782	4,397	-68	-17,113	583	2,152	-16,131	681	-2,168	46,209
Coupon payments	1,451			7,211			1,497		1,455	7,413			19,026

Note: Our forecasts – shaded area

Schedule Treasury Securities redemption by instruments (in PLNm)

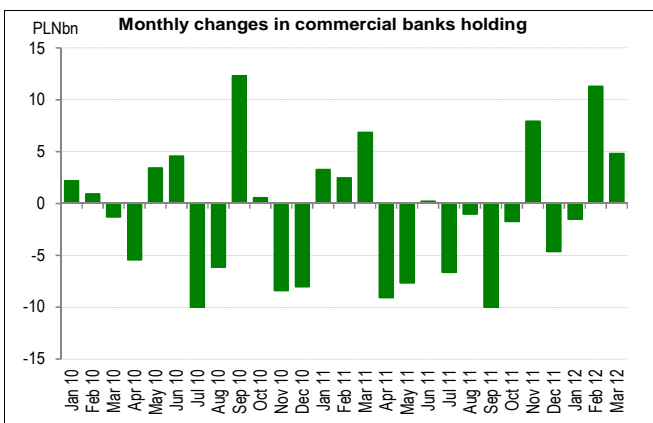
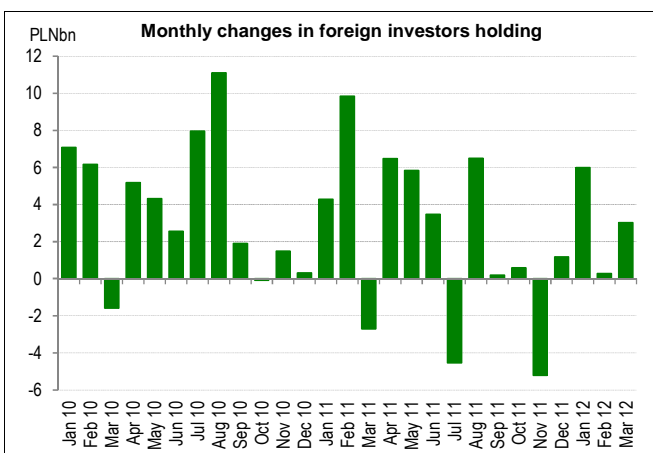
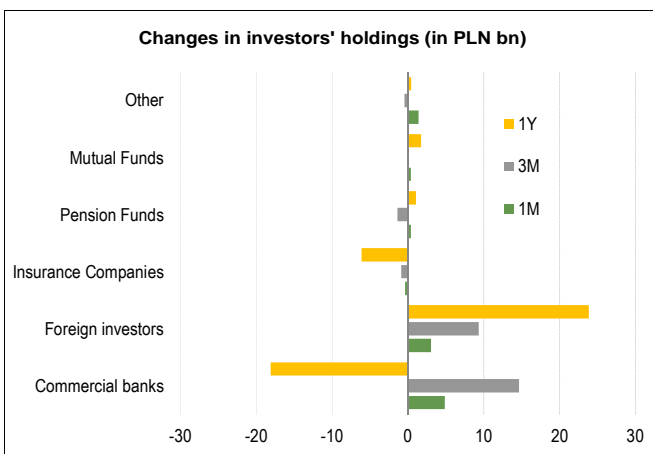
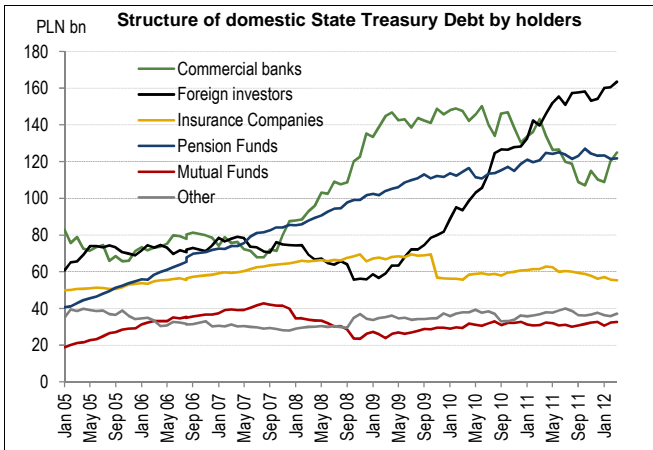
	Bonds	Bills	Retail bonds	Total domestic redemption	Foreign Bonds/Credits	Total redemptions
January	10,946	0	351	11,297	0	11,297
February	0	3,799	182	3,981	0	3,981
March	0	1,997	129	2,125	3,150	5,275
April	20,663	0	132	20,795	0	20,795
May	0	2,223	117	2,339	2,516	4,855
June	0	0	112	112	2,666	2,778
July	19,695	0	218	19,913	4,410	24,323
August	0	1,997	248	2,245	882	3,127
September	0	0	176	176	882	1,058
October	22,586	0	265	22,851	0	22,851
November	0	3,000	208	3,208	716	3,924
December	0	2,223	146	2,368	0	2,368
Total 2012	73,889	13,571	2,283	89,743	15,221	104,964
Total 2013	82,468	6,110	1,698	90,276	14,825	105,102
Total 2014	51,379	0	628	52,007	17,448	69,455
Total 2015	78,880	0	485	79,365	14,329	93,694
Total 2016	52,103	0	91	52,194	16,871	69,065
Total 2017+	185,414	0	3,288	188,702	134,966	323,668

Schedule wholesales bonds redemption by holders (data at the end of March 2012, in PLNm)

	Foreign investors	Domestic banks	Insurance Funds	Pension Funds	Mutual Funds	Individuals	Non-financial sector	Other	Total
Q1 2012	0	0	0	0	0	0	0	0	0
Q2 2012	5,914	9,576	2,071	2,713	669	88	102	1,973	23,105
Q3 2012	8,116	6,458	1,347	2,660	1,096	127	38	1,283	21,125
Q4 2012	10,873	6,844	1,118	4,101	1,441	81	31	2,294	26,783
Total 2012	24,903	22,879	4,536	9,474	3,206	296	171	5,549	71,013
	35%	32%	6%	13%	5%	0%	0%	8%	100%
Total 2013	36,373	12,468	12,075	12,840	3,221	488	212	4,925	82,602
	44%	15%	15%	16%	4%	1%	0%	6%	100%
Total 2014	17,692	9,993	4,787	10,903	3,946	426	132	3,790	51,669
	34%	19%	9%	21%	8%	1%	0%	7%	100%
Total 2015	21,940	22,536	6,770	14,813	4,650	189	717	7,317	78,932
	28%	29%	9%	19%	6%	0%	1%	9%	100%
Total 2016	12,766	10,140	4,363	20,362	4,276	44	552	2,634	55,136
	23%	18%	8%	37%	8%	0%	1%	5%	100%
Total 2017+	49,535	32,871	21,726	52,315	11,989	272	844	8,672	178,223
	28%	18%	12%	29%	7%	0%	0%	5%	100%

Sources: Ministry of Finance, BZ WBK

Treasury Securities Holders



Non-resident flows very strong again

The Ministry of Finance data showing breakdown of investors on the fixed income market showed strong increase of inflows from abroad in March. Holdings of Polish bonds by non-residents once again reached a new all time high with their portfolio at PLN163.6bn at the end of March. It accounted for 30.5% (flat compare with previous month) of total debt in marketable and non-marketable (savings) Treasury Securities (TS). Foreign investors upped their holdings by PLN3.0bn in monthly terms, mainly by increasing share in T-bonds (by PLN3.2bn) and slightly reducing in T-bills (by PLN0.2bn). On a quarterly basis, in 1Q 2012 non-residents increased their holdings by PLN9.3bn, which was ca. PLN2bn less than in the analogous period of last year.

March was a fourth month in a row of high activity of foreign banks on the Polish debt market. Their holdings increased over the month by PLN2.4bn to PLN24.3bn (the highest level since June 2011). Foreign banks' demand mainly concentrated on front-end and mid of the curve, in which they significantly increased share of 5Y benchmark PS1016 (by PLN1bn). All in all, foreign banks increased their share in Polish bonds debt to nearly 15% of total non-residents portfolio (up from 13.7% in previous month). In Q1 2012 foreign banks portfolio raised by ca. PLN8bn vs. increase by PLN6.3bn in the same period of 2011.

As regards foreign non-bank financial sector, in March it slightly raised its holding in Polish bonds by ca. PLN0.5bn to PLN131.7bn. It accounted for nearly 81% of non-resident portfolio in total (down from ca. 82% in previous month). In quarterly terms foreign non-bank financial sector expanded its portfolio by PLN2.4bn, nearly two times less in comparison with the same period of 2011.

Commenting on issuance plan for May, Piotr Marczak, the head of Ministry's debt department, said that in April foreigners' holdings could go down as PS0412 papers mature. At the end of March foreigners had ca. PLN6bn of this paper, while until April 25 they decided to roll over 80% of this amount.

Domestic investors are still on the demand side

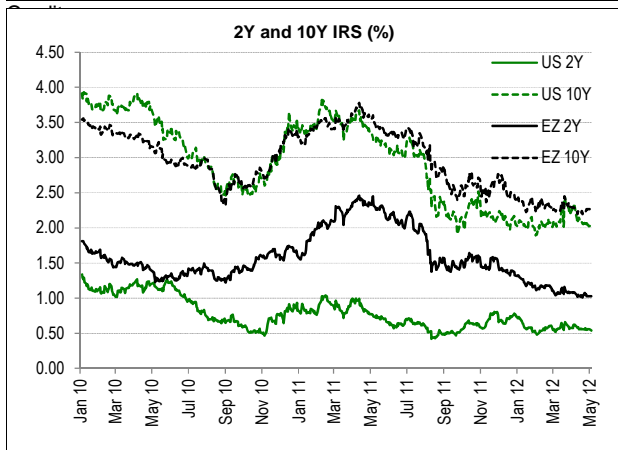
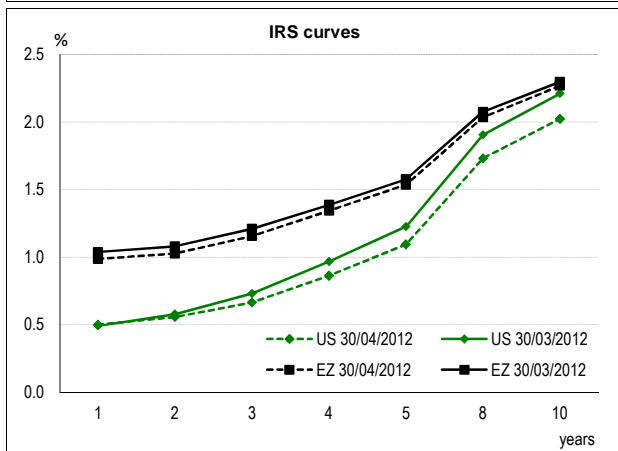
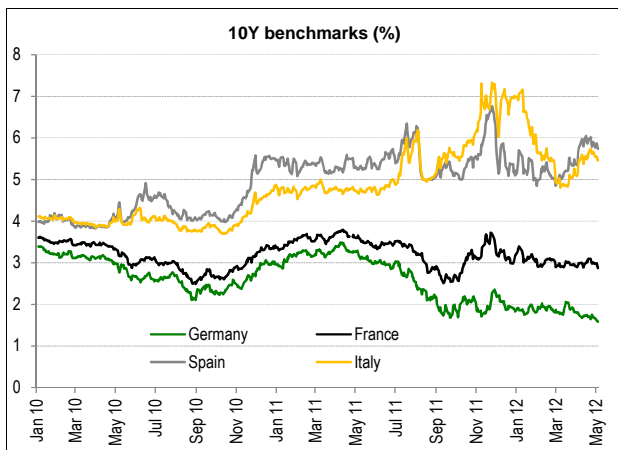
In March local investors have stayed on the demand side, excluding insurance companies (they reduced portfolio by ca. PLN0.4bn to PLN55.4bn). The main purchaser was sector of commercial banks, which increased portfolio by PLN4.8bn to nearly PLN125bn (the highest level since mid-2011). It accounted for 23.3% of total debt in marketable and non-marketable TS. In 1Q12 local banks increased their holding by PLN14.6bn (PLN12.7bn in 1Q2011) and half of this sum was buy-sell back transactions with the Ministry. Local banks increased their position in T-bonds by PLN4.1bn to PLN110.9bn, purchasing assets across the curve, mainly PS0412 (up by PLN4.7bn in monthly terms) and PS1016 (PLN1.4bn). On the other hand, they reduced position in floating rate papers by PLN3.7bn (mainly in WZ0115). We believe that banks were very active on bond auctions in April and rolled over most of their holdings in PS0412 (PLN9.6bn).

Pension funds (OFE) are still one of the main player on the domestic bond market. At the end of March OFE holdings posted PLN0.4bn increase to PLN121.8bn, which accounted for 22.7% of total debt. In Q1 pension funds reduced their holdings by PLN1.4bn (vs. increase by PLN2.1bn in 1Q11).

We think that local investors' portfolio could also slightly fall in April due to redemption of PS0412 (at the end of March domestic investors hold PS0412 worth of PLN17.1bn). Better part of this sum was rolled over in April and the rest could be invested in May.

Sources: Ministry of Finance, BZ WBK

International Bond Markets



Elevated risk aversion supported safe-haven assets...

- Yields of Bunds and US Treasuries have continued to stay low. Yield of 10Y Treasuries fell below 2% in April due to renewed concerns about the euro area, the risk of a slowdown in China and a weak March US job report. At the end of April it reached 1.88%, the lowest level since February. In the same time yield of 10Y Bund has also continued its downward trend, reaching the minimum level near 1.65%.

- The downward trend in yields on both markets has continued at the beginning of May as April's labor market data in the U.S. were weaker than expected amid speculation that the Fed may consider additional stimulus measures to boost the economy. It also came from worries that elections in Europe may result in leadership changes and inflame the region's sovereign-debt crisis.

- The spread between 10Y US Treasuries and 10Y Bund has gradually widened to ca. 45bps at the beginning of April, while next weeks brought again its narrowing towards 25bps at the end of April. The German yield curves moved down by 10-20bps, with the high decline in 5Y sector. Yield of 2Y benchmark fell below 0.1%, the lowest rate in history. The US curve also fell by 7-25bps, with the more visible deepening in 10Y sector. It caused yield curve flattening, with 2-10Y spread narrowing towards 165bps, down from 182bps at the end of March.

...while peripheries still under pressure

- Italian and Spanish bonds have benefited significantly from the ECB's two LTROs. However, due to uncertain situation in Spain, the yield curves of the two sovereigns started moving higher. Yield of 10Y Spanish bond tested 6%, while Italian 10Y increased slightly above 5.70%. Relatively positive results of Spanish debt auction slightly supported the market after some sell-off connected with the S&P's decision to downgrade Spanish credit rating. All in all, in monthly terms yields of 10Y Spanish and Italian bonds moved up by 38bps and 43bps, respectively.

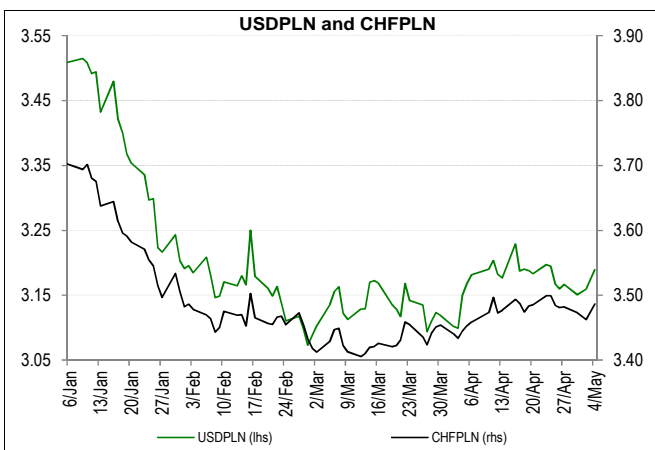
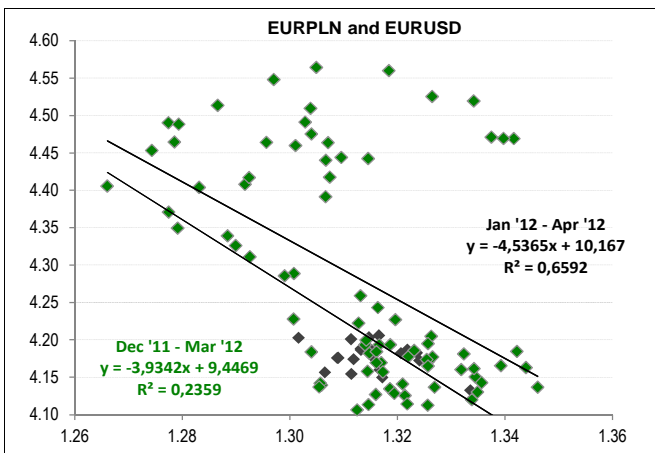
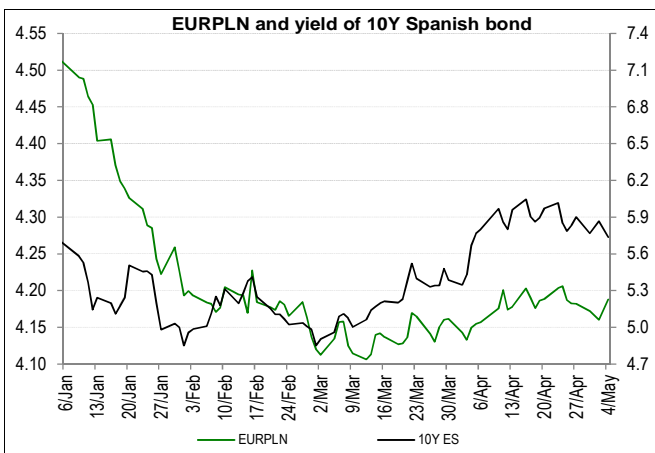
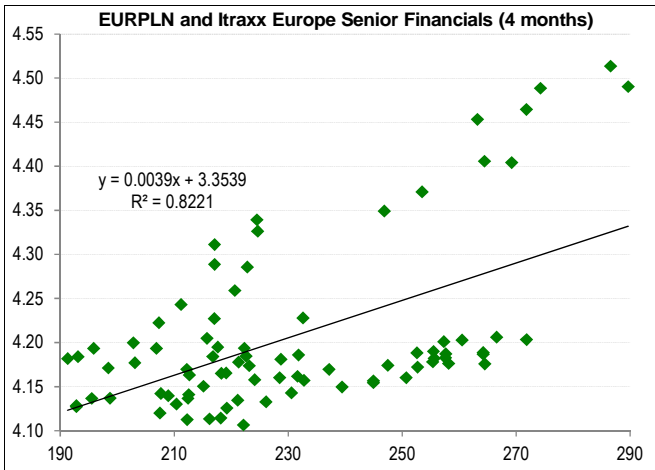
- We think that uncertainty on peripheries will prolong and weigh on the long end of the curves. Weak macroeconomic data also add uncertainty to overall picture. The list of potential risk events on the horizon is fairly long, including: debate on the fiscal compact, regional election in Germany (North Rhine-Westphalia, 13 May), the Irish referendum (end of May), Moody's potential rating revision on European banks (the decision should be announced by mid-May). On the other hand, investors are likely to wait for more macroeconomic data, which could clear up a bit economic perspectives. All factors mentioned above could put pressure on periphery in coming weeks.

Euro zone's issuance plans and completion in 2012 (€bn)

	Total redemptions	Deficit	Borrowing needs	Expected bond supply	% of completion (YtD)
Austria	14	8.3	22.3	22.3	39.8
Belgium	27.9	7	34.9	26.0	65.3
Finland	6.3	7.5	13.8	13.8	31.7
France	101.7	78.7	180.4	178	45.8
Germany	157	26.6	183.6	170	36.5
Greece	33.2	16.2	49.4	-	-
Ireland	5.5	13.7	19.2	-	-
Italy	192.2	41.1	233.3	233.3	28.3
Netherlands	29.7	12.3	42	60.0	47.2
Portugal	12.9	17.4	30.3	-	-
Spain	50.1	36.2	86.3	85.9	53.0
Total	630.5	265.0	895.5	789.2	39.7

Source: Reuters, BZ WBK

Foreign Exchange Market



Zloty slightly weaker in April

- During the past month the zloty depreciated slightly versus main currencies (by 0.25% vs. the euro and 1% vs. the dollar), even despite it recovered in late April.

- During the month, the negative pressure on the zloty was put mainly by the uncertainty over the situation in the euro zone's peripheries. Yields of the 10Y Spanish bonds increased temporarily over 6% and pared gains recorded due to two ECB's LTROs. Italian debt was also under pressure (yields reached highest levels since February, at 5.77%). Additionally, minutes from March FOMC meeting were surprisingly hawkish and that cut bets for QE3. Consequently the EURPLN broke the resistance area at 4.17-4.18 (that was constraining potential for upward move of the exchange rate since the beginning of March) and surged to nearly 4.22, highest since mid-February. In late April the zloty recovered slightly due to strengthened hopes for more easing in the US.

- As we suggested last month, the French presidential and Greek parliamentary elections had visible impact on global and domestic FX market in late April and early May. Victory of François Hollande and high support for anti-austerity parties in Greece fuelled worries over further developments in Europe and put negative impact on risky assets. Additionally, final PMI for euro zone's economies deteriorated outlook for economic growth. Nevertheless, EURPLN still trades around 4.20.

- It is worth to notice that in early April, the EURCHF broke the floor at 1.20 (it reached 1.1992) for the first time since September '11. Still, that initiated only verbal intervention of the SNB and in contrast to what we had expected, the floor was not moved up.

Little room for improvement in market moods

- We do not see many factors supporting global market moods in the near future. Results of French and Greek elections will keep worries over situation in the euro zone alive and that shall limit the potential for zloty's appreciation. Additionally, weak macro data from the US and Europe may limit room for return of market optimism and will make investors more sensitive for comments of central bankers.

- During the past month the 4-month correlation of the EURPLN with the EURUSD increased substantially. In early May the EURUSD is very close to an important level of support at 1.30 (there were already four attempts to break that level since February), while the potential for an upward move is limited by the upper line of the downward trend observed since Q2 2011. Since the beginning of the year investors have been cutting short bets on the EURUSD and that makes even higher chances for stronger dollar. If the scenario of EURUSD materialises, it may drive the EURPLN higher.

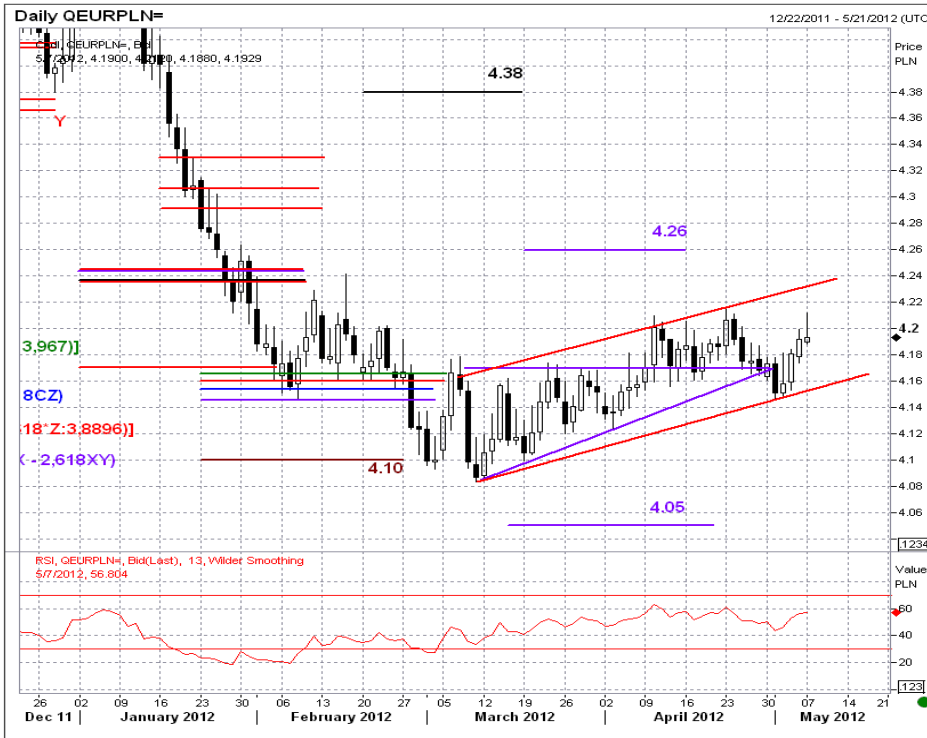
Forint supported by hopes for agreement with the IMF

- Just as we suggested last month, EURCZK and EURHUF, just like the EURPLN, broke resistance areas (at 24.8 and 295 respectively) and CEE3 currencies started to depreciate due to persisting risk aversion. Czech koruna was under additional pressure from unstable political situation in that country. The EURCZK maintained the upward trend during April and in early May reached a resistance at 25.2 (level since February). Since late April the EURHUF clearly started to decline due to hopes for prompt agreement with the IMF (the exchange rate plunged from nearly 300 to 282). Due to risk aversion present on the market in early May it rebounded to 288.

- It seems that the case of EC/IMF deal shall continue to have visible impact on forint and the koruna will be mainly driven by swings of global market sentiment.

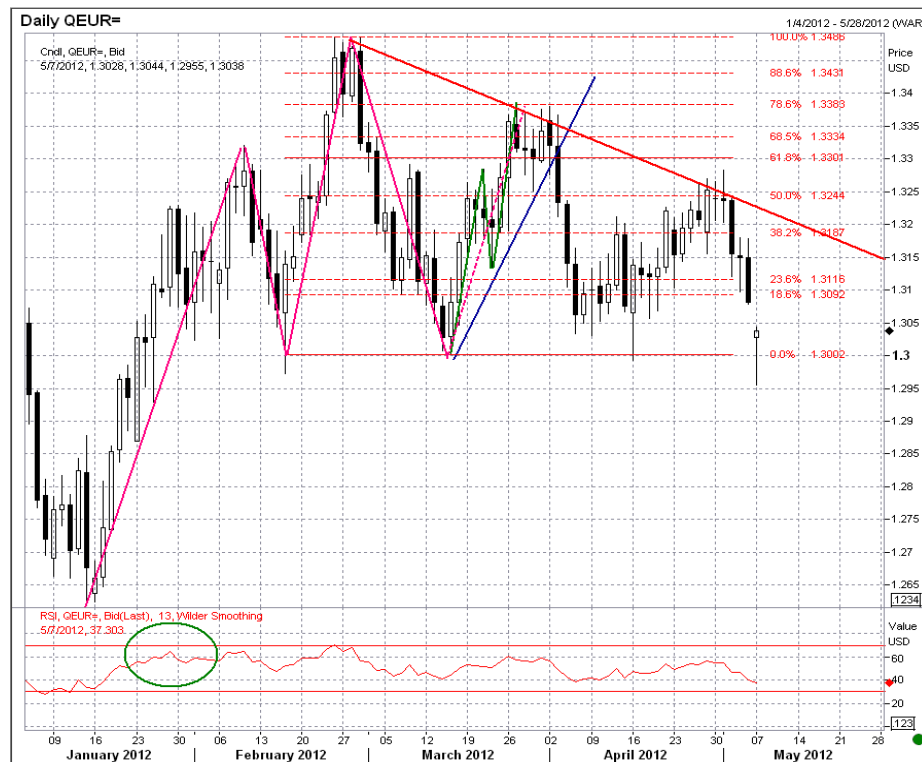
Sources: Reuters, BZ WBK

FX Technical Analysis Corner



EURPLN

- EURPLN broke resistance area at 4.17-4.18, but so far is reluctant to head towards 4.26, the projection from triangle pattern.
- Currently, the exchange rate stays in the upward trend. The pace of growth is rather limited and thus it may take a few months before the EURPLN will reach 4.26.
- Lately we recorded a divergence between the RSI and EURPLN (the oscillator reached lowest level since beginning of past month while the exchange rate did not).
- We expect EURPLN will be close to 4.20 on average in May.



EURUSD

- Just as indicated last month, the EURUSD tested important support at 1.30. Furthermore, suggestions that it may be too risky to expect a materialisation of SHS pattern at that time proved justified, as the EURUSD did not manage to break 1.30.
- In early May EURUSD tested the support at 1.30 fourth time since February.
- On weekly charts the EURUSD is still printing a triangle formation (1.30 as a support and upward band of downward trend observed since Q2 2011 limits potential for stronger euro) and we are still waiting for the exchange rate to leave that area.

Sources: Reuters, BZ WBK

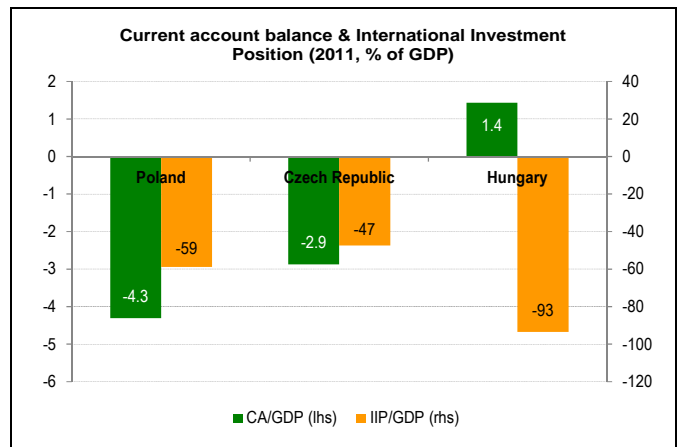
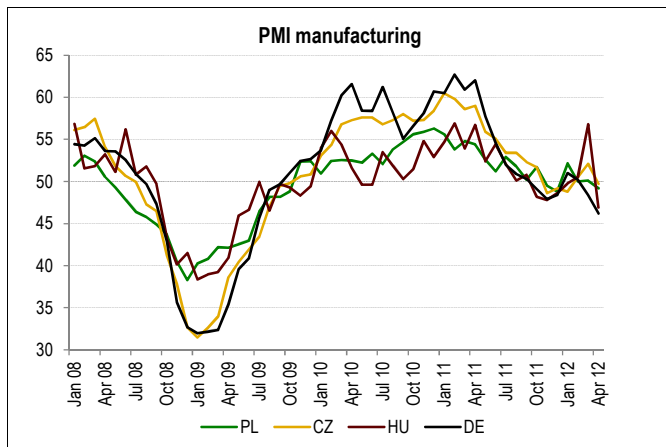
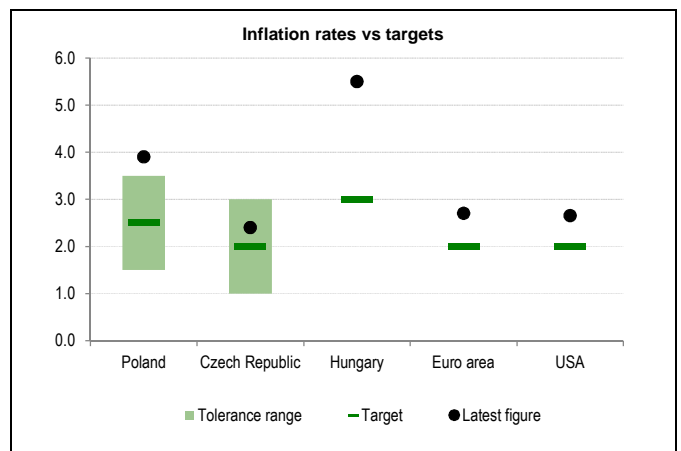
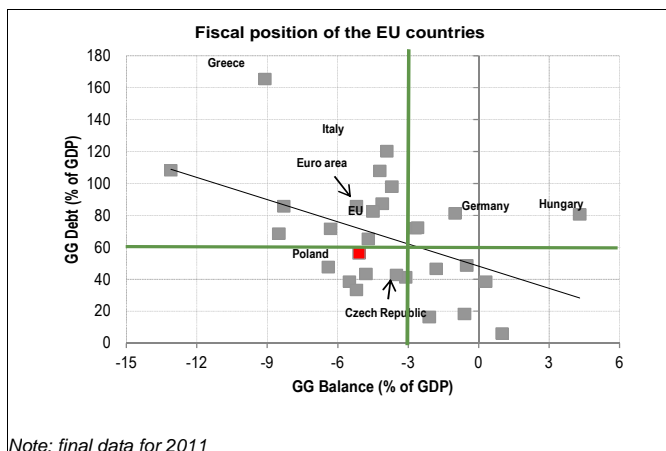
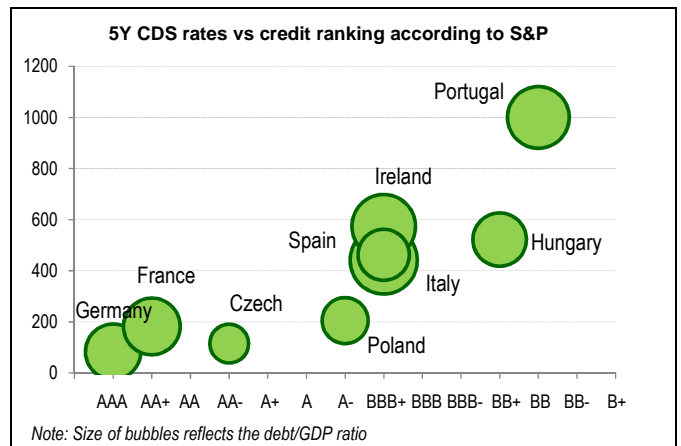
Poland vs other countries - economy

Main macroeconomic indicators (European Commission's forecasts)

	GDP* (%)		Inflation* (HICP, %)		C/A balance (% of GDP)		Fiscal Balance (% of GDP)		Public Debt (% of GDP)	
	2011	2012F	2011	2012F	2011	2012F	2011	2012F	2011	2012F
Poland	4.3	2.5	3.9	3.5	-5.0	-4.3	-5.1	-4.0	56.3	57.1
Czech Republic	1.7	0.0	2.1	3.0	-3.6	-3.2	-3.1	-3.8	41.2	41.9
Hungary	1.7	-0.1	3.9	5.1	1.7	3.2	4.3	-2.8	80.6	76.5
EU	1.5	0.0	3.1	2.3	-0.3	0.0	-4.5	-3.9	82.5	84.9
Euro area	1.4	-0.3	2.7	2.1	-0.1	0.0	-4.1	-3.4	87.2	90.4
Germany	3.0	0.6	2.5	1.9	5.1	4.4	-1.0	-1.0	81.2	81.2

Note: * European commission interim forecast – February 2012

	Sovereign ratings					
	S&P		Moody's		Fitch	
	rating	outlook	rating	outlook	rating	outlook
Poland	A-	stable	A2	stable	A-	stable
Czech	AA-	stable	A1	stable	A+	stable
Hungary	BB+	negative	Ba1	negative	BB+	negative
Germany	AAA	stable	Aaa	stable	AAA	stable
France	AA+	negative	Aaa	negative	AAA	negative
UK	AAA	stable	Aaa	negative	AAA	negative
Greece	CCC	stable	C	---	B-	stable
Ireland	BBB+	negative	Ba1	negative	BBB+	negative
Italy	BBB+	negative	A3	negative	A-	negative
Portugal	BB	negative	Ba3	negative	BB+	negative
Spain	BBB+	negative	A3	negative	A	negative

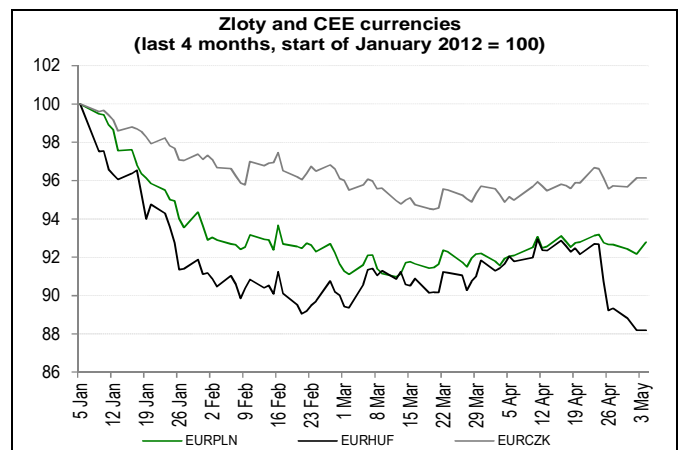
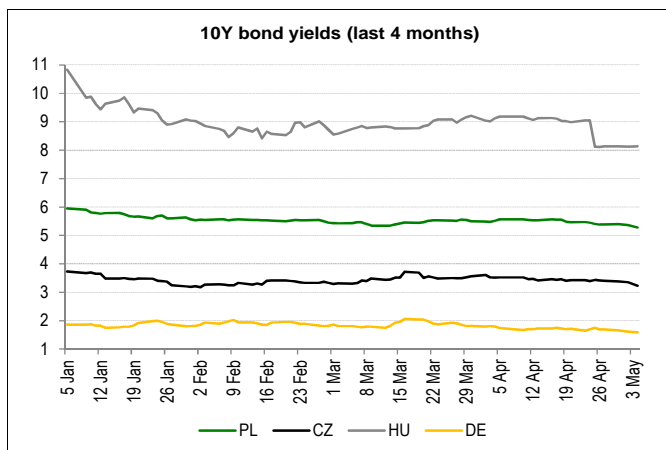
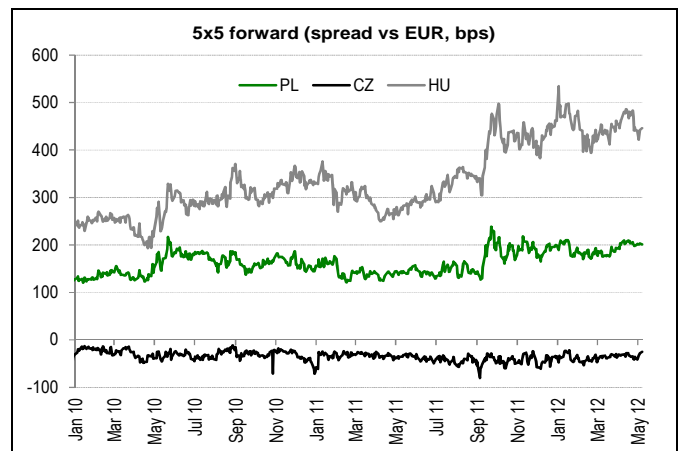
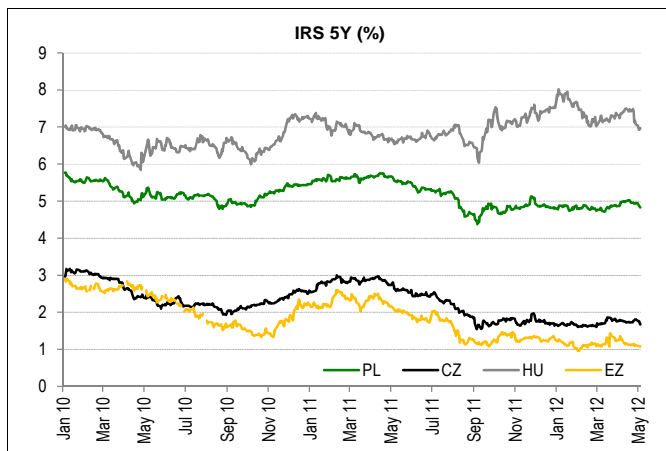
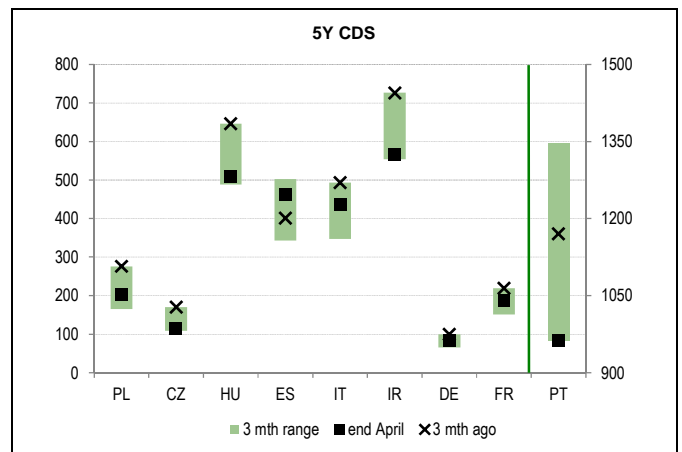
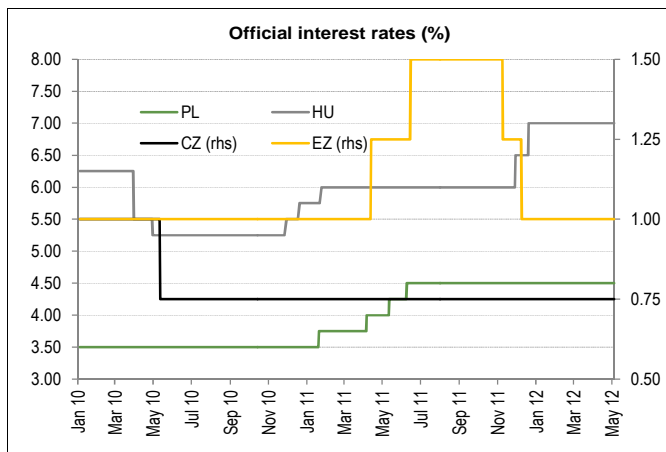


Source: stat offices, central banks, Reuters. BZ WBK, EC

Poland vs other countries - market

Main market indicators (%)

	Reference rate (%)		3M market rate (%)		10Y yields (%)		10Y Spread vs Bund (bps)		CDS 5Y	
	2011	2012F	2011	end of April	2011	end of April	2011	end of April	2011	end of April
Poland	4.50	4.50	4.99	4.95	5.88	5.39	405	374	279	203
Czech Republic	0.75	0.75	0.78	0.86	3.59	3.38	176	172	173	114
Hungary	7.00	7.00	7.24	7.23	9.90	8.13	807	647	610	508
Euro area	1.00	1.00	1.36	0.71						
Germany					1.83	1.66			100	83



Source: stat offices, central banks, Reuters. BZ WBK, EC

Central Bank Watch

		Last	2011	2012F	Expected changes (bps)			Risks
					1M	3M	6M	
Euro	Forecast	1.00	1.00	1.00				As expected, the ECB kept rates unchanged in May, but left open the option of further stimulus if economy continues to deteriorate. Rate cut not expected in June.
	Market implied »				-9	-13	-14	
UK	Forecast	0.50	0.50	0.50				Rates on hold. Investors focus on a new GDP growth and CPI inflation forecasts
	Market implied »				0	1	5	
US	Forecast	0-0.25	0-0.25	0.25				Fed signalled that further Fed stimulus is unlikely unless the economy unexpectedly deteriorates. Central bankers "remain prepared to do more" if conditions worsen
	Market implied »				0	2	4	
Poland	Forecast	4.50	4.50	4.50				The MPC hike rates in May and keeps hawkish rhetoric suggesting one more move in June-July
	Market implied »				5	14	14	
Czech	Forecast	0.75	0.75	0.75				As expected the Council hold rates unchanged, but unexpectedly two members voted for interest rate cuts
	Market implied »				39	35	35	
Hungary	Forecast	7.00	7.00	7.00				Possibility of interest rate cuts increase, but we foresee the reference rate to stay unchanged
	Market implied »				-5	-14	-32	

Note: Market implied expectations show implied changes in 3M market rates based on FRA rates

Economic Calendar and Events

Date	Event:	Note:
9-May	PL MPC Meeting – interest rate decision	Our forecast and market consensus: no change in rates. The MPC could again vote a rate hike motion
	GE Auction of 5Y bonds	Offer: €5.0bn
10-May	PL Auction of DS1021 and WS0429	Offer: PLN2.0-4.0bn
	GB BoE Meeting – interest rate decision	Market consensus: 0.50%
14-May	EZ Eurogroup meeting	-
15-May	PL CPI for April	Our forecast: 4.1%YoY vs. market consensus at 3.9%YoY. Hawkish signal for the market
	EU Ecofin meeting	-
16-May	PL Auction of a new 5Y benchmark PS0417	Offer: PLN2.0-4.0bn
	FR Auction of medium term and CPI linked bonds	
	GE Auction of 10Y bonds	Offer: €5.0bn
18-May	PL Employment and wages for April	We foresee stagnation in employment and slight slowdown in wages growth. We are below market consensus
21-May	PL Industrial output for April	We predict low growth of 3.3%YoY
22-May	PL Core inflation measures for April	We expect core inflation (exc. food & energy prices) to stay near 2.4%YoY
23-May	GE Auction of bonds	Offer: €5.0bn
24-May	PL Minutes of the May's MPC's meeting	-
	PL Retail sales for April	We foresee one digit growth in YoY
29-May	HU NBH Meeting – interest rate decision	Our forecast: 7.00%
31-May	PL GDP for Q1 2012 (preliminary reading)	We expect GDP to expand by 3.5%
6-Jun	PL MPC Meeting – interest rate decision	Our forecast: the MPC will remain on hold
7-Jun	EZ ECB Meeting – interest rate decision	Our forecast and market consensus: 1.00%

Source: stat offices, central banks, Reuters, BZ WBK

Economic and market forecasts

Poland		2009	2010	2011	2012	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12
GDP	PLNbn	1,344.4	1,416.4	1,524.7	1,619.3	349.2	369.6	376.2	429.7	369.4	393.7	400.6	455.6
GDP	%YoY	1.6	3.9	4.3	2.7	4.5	4.2	4.2	4.4	3.4	2.7	2.3	2.5
Domestic demand	%YoY	-1.1	4.6	3.7	1.2	4.4	4.1	2.8	3.4	2.6	0.7	0.8	0.9
Private consumption	%YoY	2.1	3.2	3.1	1.9	3.7	3.6	3.0	2.0	2.2	1.7	1.8	2.0
Fixed investments	%YoY	-1.2	-0.2	8.3	5.2	5.9	7.0	8.3	9.8	9.5	7.0	5.0	3.0
Unemployment rate ^a	%	12.1	12.4	12.5	13.5	13.3	11.9	11.8	12.5	13.3	12.5	12.8	13.5
Current account balance	EURm	-12,152	-16,493	-15,917	-12,226	-3,135	-3,359	-4,459	-4,964	-4,420	-1,625	-2,662	-3,519
Current account balance	% GDP	-3.9	-4.7	-4.3	-3.2	-4.8	-4.9	-4.6	-4.3	-4.7	-4.2	-3.7	-3.2
General government balance	% GDP	-7.4	-7.8	-5.1	-3.4	-	-	-	-	-	-	-	-
CPI	%YoY	3.5	2.6	4.3	4.0	3.8	4.6	4.1	4.6	4.1	4.0	4.2	3.6
CPI ^a	%YoY	3.5	3.1	4.6	3.2	4.3	4.2	3.9	4.6	3.9	4.2	4.3	3.2
CPI excluding food and energy prices	%YoY	2.7	1.6	2.4	2.3	1.7	2.3	2.6	3.0	2.5	2.3	2.2	2.1
EUR/PLN	PLN	4.33	3.99	4.12	4.24	3.94	3.96	4.15	4.42	4.23	4.21	4.31	4.21
USD/PLN	PLN	3.11	3.02	2.96	3.33	2.88	2.75	2.94	3.28	3.23	3.23	3.44	3.44
CHF/PLN	PLN	2.87	2.90	3.34	3.32	3.06	3.16	3.56	3.60	3.50	3.46	3.25	3.08
GBP/PLN	PLN	4.86	4.66	4.75	5.13	4.62	4.48	4.73	5.16	5.07	5.08	5.20	5.19
Reference rate ^a	%	3.50	3.50	4.50	4.50	3.75	4.50	4.50	4.50	4.50	4.50	4.50	4.50
WIBOR 3M	%	4.42	3.94	4.54	4.92	4.10	4.43	4.72	4.91	4.97	4.94	4.90	4.87
Yield on 52-week T-bills	%	4.54	3.96	4.51	4.45	4.37	4.62	4.54	4.50	4.50	4.45	4.44	4.42
Yield on 2-year T-bonds	%	5.17	4.72	4.81	4.67	5.01	4.97	4.54	4.71	4.66	4.67	4.70	4.66
Yield on 5-year T-bonds	%	5.65	5.31	5.44	4.93	5.79	5.60	5.17	5.19	5.02	4.90	4.92	4.87
Yield on 10-year T-bonds	%	6.11	5.74	5.98	5.44	6.27	6.03	5.77	5.83	5.58	5.40	5.41	5.37

Source: CSO, NBP, Finance Ministry, BZ WBK own estimates; ^a at the end of period

This analysis is based on information available until 4th May 2012 and has been prepared by:

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