

Rates and FX Outlook

Polish Financial Market

June 2012

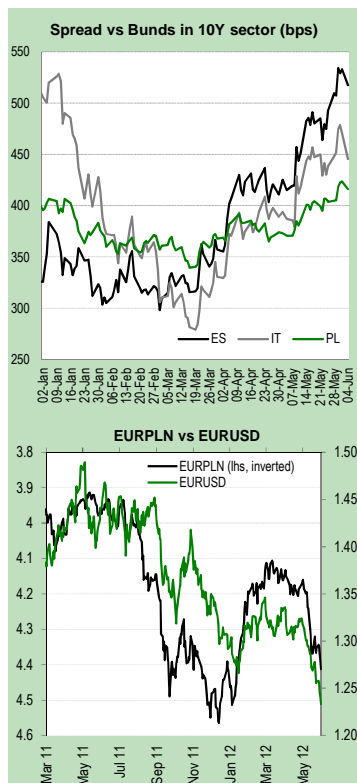


Table of contents:

Short- and Medium-term Strategy	2
Money Market	3
IRS and T-Bond Market	4
Treasury Securities Supply Corner	5
Treasury Securities Holders	7
International Bond Markets	8
Foreign Exchange Market	9
FX Technical Analysis Corner	10
Poland vs. other countries - economy	11
Poland vs. other countries - markets	12
Central Bank Watch	13
Economic Calendar and Events	14
Economic and Market Forecasts	15

Maciej Reluga
Chief economist
+48 22 586 8363

Piotr Bielski
+48 22 586 8333

Agnieszka Decewicz
+48 22 586 8341

Marcin Luziński
+48 22 586 8362

Marcin Sulewski
+48 22 586 8342

Email: ekonomia@bzwbk.pl

- **The Monetary Policy Council decided to hike interest rates in May, though the accompanying statement was relatively dovish.** The market interpreted the move as a one-off and the weakening at the front end of the curve was rather temporary. We see the upcoming MPC meeting as non event for the market (flat rates, statement with some hawkish bias) and in terms of central banks' activity the ECB meeting and Fed's President speech in Congress will be much more important. Any suggestions on central banks further support for the economy would give some breath for the markets. In June, the focus of attention will be still on Greece (elections) and broader euro zone prospects, given another summit at the end of month.
- **Our forecasts of monthly economic indicators for May to be released this month, show that trends observed recently should be continued.** As 1Q12 GDP figure indicated, the economic slowdown has started and first publication for 2Q (including PMI for May) confirmed the trend. The interest rate market will concentrate on inflation figure and if our forecast materialises (CPI at 3.7% against consensus of 3.9%) the front-end of the curve should gain, at least temporarily. The inflation fall from 4% in April will not be the beginning of downward trend and the next few months may again bring the inflation rate towards 4%. That is why, the risk of another (unnecessary) rate hike would hang over the markets limiting downward move in yields. The long-end of the curve will be under influence of global factors and if we see another wave of risk aversion due to euro zone's problems, the level of 5.60% for ten-year bonds might be reached. However, one should remember that with 70% of borrowing needs already covered by the Polish government, the balance between demand and supply in the Polish bond market remains favourable and would limit the upward pressure on yields.
- **Our view for the zloty depreciation, which we have been presenting in this report for the last couple of months, have finally materialised.** Nevertheless, we have to admit that timing of this movement came as a surprise as in May we forecasted some stabilisation in the Polish FX market. There is no doubt that the main driver behind the zloty movement is still the global risk, with euro zone's problems as the main factor (high relationship between EURPLN and yields of peripheral bonds or EURUSD). Therefore, the main events to watch include (in order of appearances in June): ECB meeting, Greek elections, and EU summit. In the previous month EURPLN broke the level of 4.40 a few times and it might be tested again if global moods deteriorate due to Greek elections. Next important resistance levels are 4.44 and 4.47. The pressure on the zloty may be also put by falling EURUSD. Nevertheless, during the second half of June may bring some relief assuming pro-bailout government is formed in Greece and no disappointment is expected after the EU summit. Overall, we expect that average EURPLN in June will be slightly below levels recorded at the end of May (ca. 4.35).

This report is based on information available until 1st June

Short- and Medium-term Strategy

Interest rate market

	Change (bps)		Level end-May	Expected trend	
	Last 3M	Last 1M		1M	3M
Reference rate	25	25	4.75	→	→
WIBOR 3M	15	16	5.11	→	→
2Y bond yield	13	11	4.78	↘	↘
5Y bond yield	13	14	5.02	→	→
10Y bond yield	0	5	5.45	→	→
2/10Y curve slope	-13	-6	67	→	↗

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	Money market: WIBOR rates increased significantly after the May's rate hike. We expect a gradual increase in WIBOR 3M towards 5.15%. However, quotation of FRA 9x12 suggests that market has started to price-in interest rates cuts in H1 2013.
	Short end: The front end of the curve should be supported by limited expectations for interest rates hikes. Though the MPC will keep a hawkish bias, another hike won't be signalled. In mid-June CPI inflation figure will be published and we expect fall to 3.7%YoY. Other data will confirm economic slowdown. This should support scenario of decline in two-year yield towards 4.70%.
	Long end: Deep-seated concerns about financial turmoil in the euro zone peripheries will keep mid and specifically the long-end of the curve under pressure. Therefore we foresee yields of 5Y and 10Y bonds to remain in a horizontal trend. Strong support level for 10Y IRS is 4.80%.
	Risk factors to our view: The risk-case scenario assumes more hawkish rhetoric and higher than we expected reading of CPI in May. It would put strong pressure on short end and could result in curve flattening. For the long end global factors are the main drivers and materialisation of worst-case scenario as prolong problems in Greece and Spain may result in further yields increase.

FX market

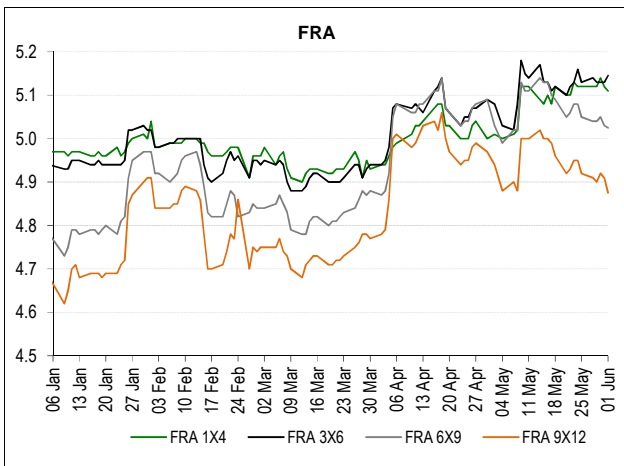
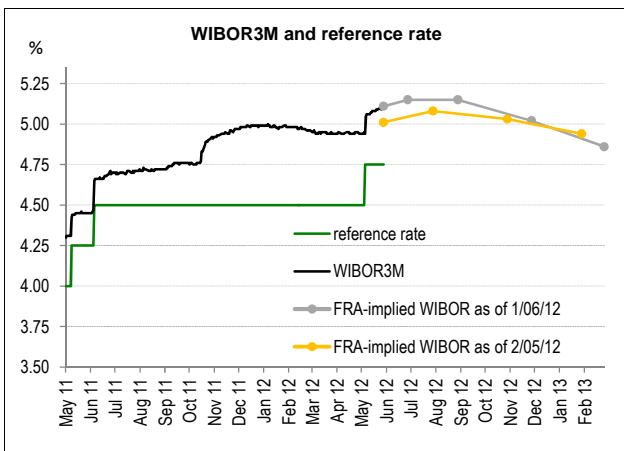
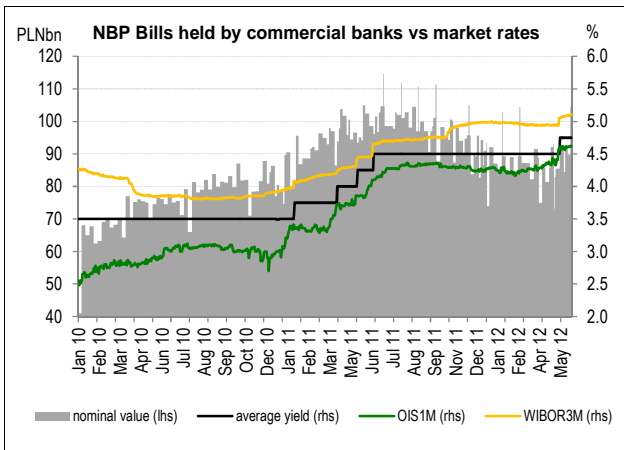
	Change (%)		Level end-May	Expected trend	
	Last 3M	Last 1M		1M	3M
EURPLN	6.1	5.2	4.39	→	→
USDPLN	15.1	12.3	3.54	→	→
CHFPLN	6.5	5.0	3.65	→	→
GBPPLN	12.0	7.1	5.49	↘	↘
EURUSD	-7.8	-6.3	1.24	→	→

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	EUR: The EURPLN currently trading slightly below 4.40. Important technical resistance levels at 4.44 and 4.47 and additional possibility of NBP/BGK intervention limiting zloty depreciation. We assume rate below 4.40 in 2 half of June, though it would depend on news from the euro zone.
	USD: After significant fall we expect the EURUSD to oscillate around 1.24. If our scenario materialises, the USDPLN might stabilise near 3.50 on average in June.
	CHF: Driven by the same factors as EURPLN with a possibility that the SNB raises EURCHF currency floor from current 1.20, which would imply more zloty strengthening against the CHF.
	Risk factors to our view: Uncertainty of the euro zone peripheries favours the US dollar. Additional sharp risk-off after Greek elections and ahead of EU summit bringing EURUSD to below 1.20. As a result EURPLN could break the important resistance around 4.47-4.48.

Money Market



Spread between reference rate and Polonia tightened

- The Polish banking sector liquidity situation was following its standard path in May. Banks have invested slightly above PLN85bn in NBP's bills on average. May was a relatively expensive month, with a bit cheaper end of the reserve period. It seemed like the market was not willing to let the shortest rates to fall down. However, we noted further tightening of spread between the reference rate and Polonia. At the end of May it was slightly below 20bps.
- As regards OIS market, rates increased significantly after the hike of official interest rates (by nearly 10bps). Later OIS rates have stabilised at the elevated level. Assuming stable spread between the reference rate and Polonia, current OIS rates clearly suggest that market participants expect the MPC to keep interest rates unchanged for a longer time.
- We think that situation will not change significantly in June. Banking sector's liquidity should remain high, however with the very asymmetric outline. Banks have started the new reserve period with overbuilt level (PLN29.9bn vs minimum reserves of ca PLN28.9bn for June).

FRA rates increased sharply after the MPC's decision

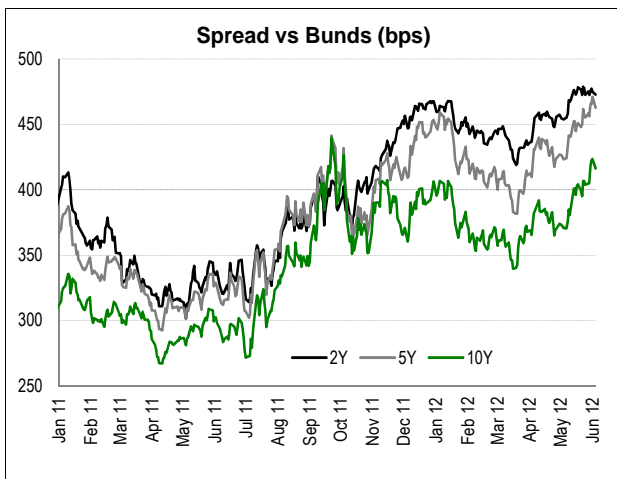
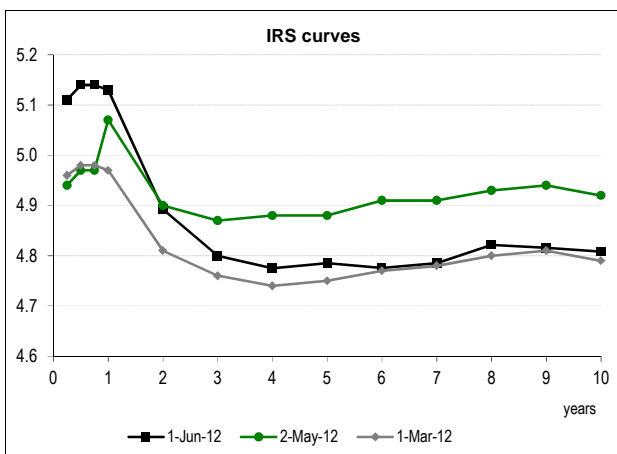
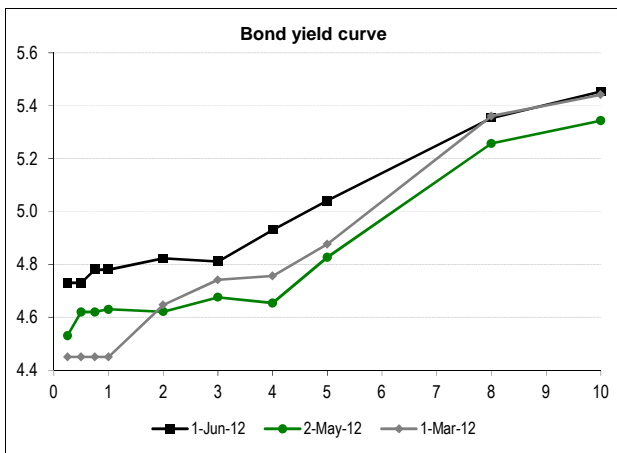
- Unexpectedly, risk of interest rates hike materialised at the May rate-setting meeting. The Council decided to tighten the monetary policy by increasing official NBP's rates by 25bps (in which the reference rate to 4.75%) and explained this move by persistently elevated CPI inflation. The market immediately adjusted to the new situation, with sharp increase in FRA rates by 10bps. WIBOR rates increased by 11-18bps, with the WIBOR 1M recording the most considerable increase. However, after the NBP's press conference, expectations for further hikes scaled back as investors interpreted the Council's decision as a one-off. In our view, macroeconomic data released later in the month confirmed such an interpretation.
- As a consequence of diminishing hike expectations, FRA rates started to decrease gradually. FRA9x12 fell below 5.0%, ending the month slightly below 4.90%. In some respect it could reflect not only expectations for narrowing of WIBOR3M-reference rate spread, but also for interest rates cuts in the first half of 2013.
- We revised our forecasts of WIBOR 3M upward after the MPC's decision. We assume that the MPC will keep interest rates unchanged until the year-end, and we expect WIBOR 3M to increase gradually towards 5.15% in that period. In our view CPI inflation will slow down visibly in Q4 2012 and that would be supportive for stable rates or even for a slight decline in the last months of the year. However, the influence of CPI decline could be limited due to low liquidity on the market towards the end of the year.

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 May	4.75	4.91	4.92	5.11	5.13	5.14	4.62	4.64	4.68	4.68	30	47	45	46
Last 1M change (bp)	25	93	20	16	16	16	21	17	17	15	-1	-1	-1	1
Last 3M change (bp)	25	40	18	15	15	16	39	41	45	45	-21	-26	-30	-29
Last 1Y change (bp)	50	205	56	66	52	38	74	63	55	32	-18	3	-3	6

Sources: Reuters, BZ WBK

IRS and T-Bond Market



The MPC and situation in peripheries determined mood

- The MPC meeting turned out to be the main market driver at the beginning of that month. The Council's decision to hike rates by 25bps resulted in yields increase by around 10bps along the bond curve. However, the relatively dovish statement, which suggested that it could be only a one-off event, helped the market to rebound slightly. In the second half of May bonds remained relatively stable, taking into account volatility on "peripheral" debt market and on the FX market. However, yields climbed by 16-25bps from this year's minimum (and by 5-14 bps in one month), with the smallest changes in case of 10Y tenor.
- As regards IRS market, rates increased to 5% along the curve after monetary policy tightening. In the following days the IRS rates started to decrease significantly in five- and ten-year sectors, reaching the lowest level since mid-March. In monthly term IRS curve moved down by 0-18bps, with the lowest scope of decline in case of one- and two-year. As a consequence, asset swap spread widened across the curve. It seemed that IRS rates diverged from bonds, with former instrument reflecting the macro outlook and the latter pricing-in mainly the sovereign risk. The scale of impact of global risk-off is hard to predict. 10Y IRS is currently oscillating around important support level at 4.80% and this level should effectively limit any downward move. In our opinion, the market would need additional factors, such as global mood improvement or low CPI reading, to cause that level to be tested.

Global moods will be the key, short-end under CPI impact

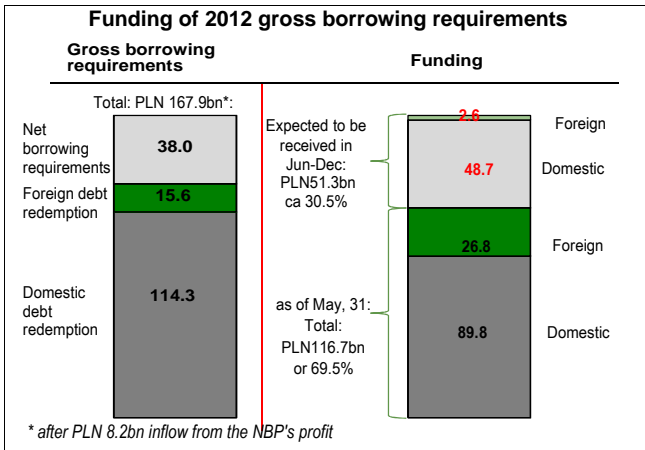
- Under current circumstances, domestic factors have only a limited ability to influence government bonds. The market mood still depends strongly on the development of the European debt crisis, especially on the upcoming parliamentary election in Greece and situation in the Spanish banking sector. Therefore, 10Y sector will remain under pressure and the potential spill-over of risk aversion could result in yield rising even towards 5.60% (currently this is a strong resistance level, which effectively stopped yield growth during the April's sell-off). We think a potential for further yields decline at the long end is rather limited. Overall, trading range for 10Y bond between 5.40-5.60% for 10Y is still valid, though one cannot exclude the upper and bottom bound to be tested.
- As regards the five-year paper we see the range between 4.95-5.15%. However, a temporary fall below the lower end of the range is possible after the low CPI reading for May, assuming there is no deterioration in global moods.
- The short end of the curve will strongly depend on CPI inflation outlook and still hawkish rhetoric of the MPC could limit gains. However, our forecast of CPI at 3.7% might result in test of important supports at 4.75% for two-year bond.

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 May	4.81	4.78	5.02	5.45	4.89	4.78	4.80	-11	24	65
Last 1M change (bp)	18	11	14	5	-6	-16	-18	17	30	23
Last 3M change (bp)	31	13	13	0	9	4	2	4	9	-2
Last 1Y change (bp)	18	-25	-58	-61	-33	-73	-72	8	15	11

Sources: Reuters, BZ WBK

Treasury Securities Supply Corner



70% of planned 2012 borrowing needs completed

The May's Treasury Securities issuance plan was fully completed. The Ministry of Finance launched DS1021 and WS0429 bonds worth PLN4.09bn in total and a new 5Y benchmark PS0417 worth PLN4.25bn. The amount of sale slightly exceeded initially planned supply. Both auctions attracted solid demand, with bid-cover ratio at 2.06 for new 5Y benchmark bonds and 1.34 for DS1021 (similarly to the level noted in March, i.e. 1.39). Auctions' yields were close to the secondary market levels or even slightly lower as in case of PS0417. To sum up, the May's auctions' results show that Polish bond market is relatively resistant to unfavourable developments in the euro zone.

As previously announced, the Ministry of Finance sold 5Y retail Samurai bond worth JPY25bn. It was priced at 100bps over the swap rate, which stands for a yield of 1.49%. It was the second issue of retail bonds on the Japanese market. The previous issuance of 4Y instruments took place in July 2011.

The Ministry successfully launched bonds on both domestic and foreign markets. At the end of May 2012, the gross borrowing requirements (after including the NBP profit contribution to the budget) were covered nearly in 70%. It places Poland among the best-positioned countries in terms of YTD issuance completion. The Ministry also announced that its liquidity cushion (i.e. funds in PLN and in foreign currencies held by MoF) has reached the level of PLN41bn at the end of May (up from PLN28bn at the end of April).

Supply activity will take a breather in June

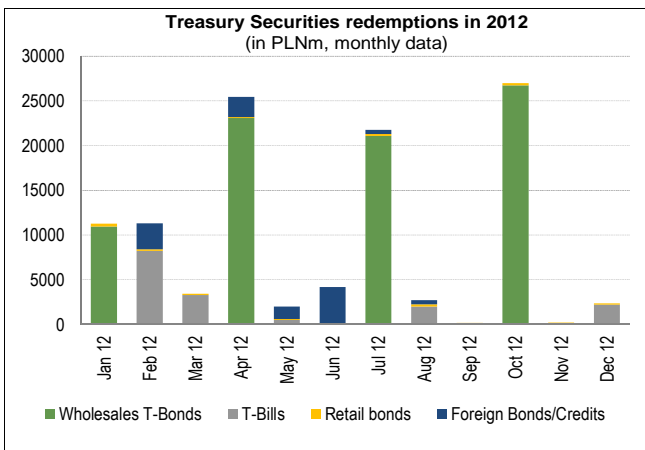
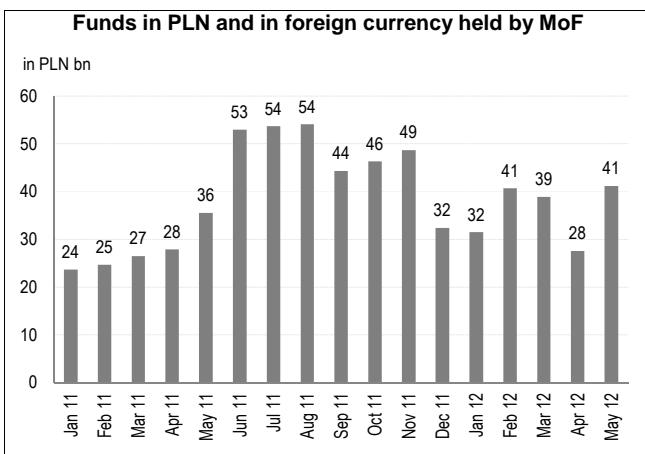
The Ministry of Finance published its issuance plan for June, showing a limited number of auctions and a low supply (in line with earlier announcements). The offer is prepared flexibly depending on market conditions, which has been highly volatile recently.

In June the Ministry will offer floating rate and/or inflation-linked bonds at a switch tender (instead of buying back bonds maturing later this year, i.e. OK0712 and OK1012) and 5Y benchmark PS0417 at a regular auction (with possibility to expand the supply by offering 2Y benchmark OK0714 if market conditions change significantly). Investors will also be able to purchase infrastructure bonds IDS1022 (up to PLN 2bn), issued by BGK for the National Road Fund. Moreover, details confirmed that there are no T-bills in June's plan; earlier the Ministry wanted to offer 51-week papers.

The June supply is significantly lower compared with previous months, clearly showing that currently the Ministry can give a breather to market participants due to high coverage of this year's borrowing requirements (near 70%). One should notice that, according to the MF officials, "Poland will sell PLN25bn less in Treasury papers until the year-end than it planned before".

According to the MF the nominal amount of debt to be redeemed in June-December period is equal to PLN59.4bn, including domestic T-bonds redemption worth PLN42.3bn. The Ministry plans that proceeds from the TS issuance in the above-mentioned period shall bring ca. PLN42.0bn to the budget.

As regards plan of foreign market issuances, Piotr Marczak, the director of Public Debt Department in the Ministry of Finance, said that the Ministry is monitoring the markets to find the best possible moment for such an issue, as it seeks to close foreign financing for this year with no pressure from the current liquidity position. In his opinion the Ministry considers both a public offer and a private-placement financing.



Auction calendar in June			
Auction date	Settlement date	Series	Planned offer (PLN m)
20-06-2012	22-06-2012	PS0417*	2,000 – 4,000
27-06-2012	29-06-2012	IDS1022	Up to 2,000

**In case of a significant change in the market conditions it is possible to offer OK0714*

T-bond switching auction			
Auction/settlement date	Settlement bonds	Source bonds	Outstanding amount (PLN m)
14-06-2012 / 18-06-2012	WZ0117 / WZ0121 / IZ0823	OK0712	19,695
		OK1012	22,586

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	8 341	4 000	6 000	4 000	3 000	6 000	2 000		75 236
T-bills auction	2 223	5 778	3 000										11 001
Retail bonds	216	248	212	210	210	210	210	216	220	220	200	200	2 571
Foreign bonds/credits	7 979	2 200	0	5 390	1 251				2 600				18 819
Refinancing and financial resources at the end of 2011	31 600												31 600
Total	52 837	19 729	13 772	14 611	9 802	4 210	6 210	4 216	5 220	6 220	2 200	200	139 227
Redemption	11 297	3 981	5 275	20 795	4 906	2 778	24 813	3 191	1 122	22 851	3 924	2 368	107 302
Net inflows	41 540	15 749	8 496	-6 183	4 896	1 432	-18 603	1 025	4 098	-16 631	-1 724	-2 168	31 926
Rolling over T-bonds	6 309			7 966									14 274
Buy-back of T-bills													
Total	47 848	15 749	8 496	1 782	4 896	1 432	-18 603	1 025	4 098	-16 631	-1 724	-2 168	46 200
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)

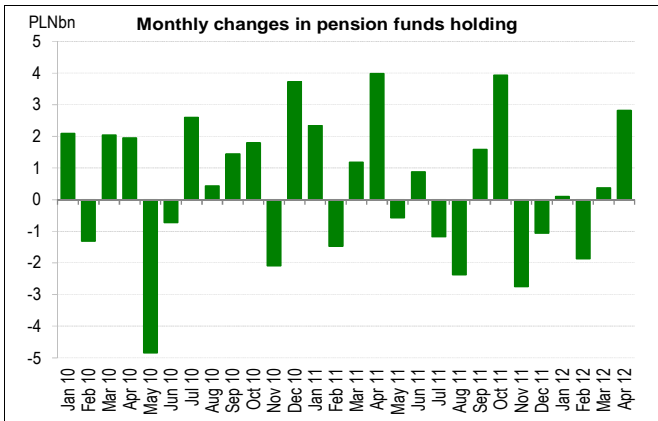
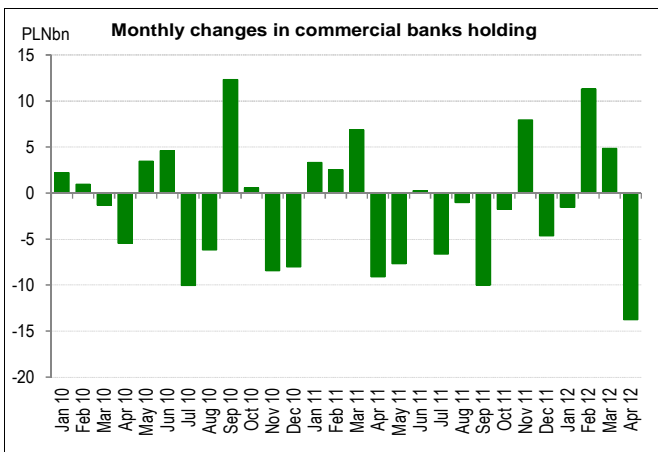
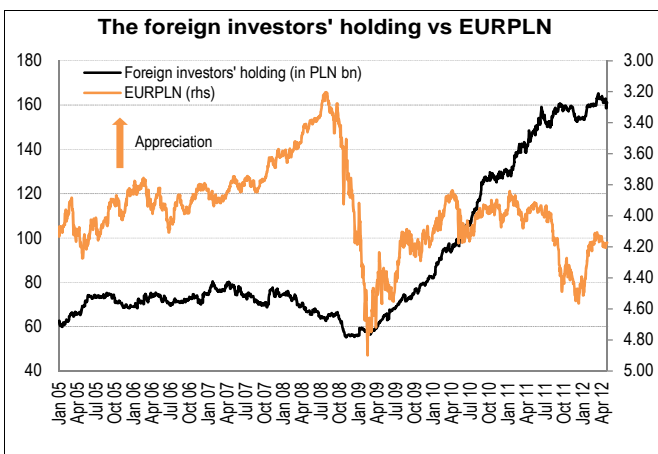
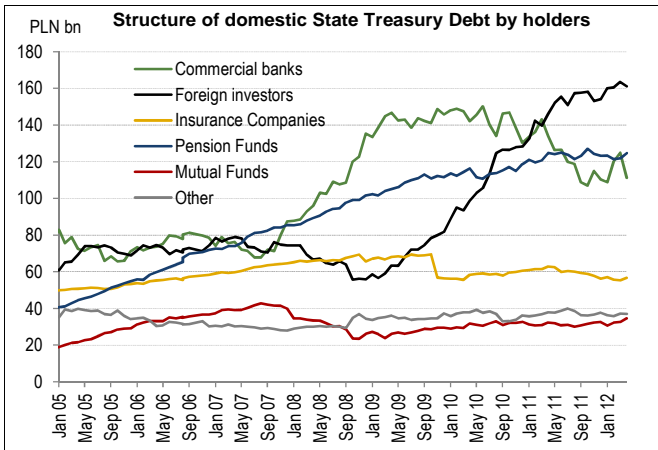
	Bonds	Bills	Retail bonds	Total domestic redemption	Foreign Bonds/Credits	Total redemptions
January	10 946	0	351	11 297		11 297
February		3 799	182	3 981		3 981
March		1 997	129	2 125	3 150	5 275
April	20 663		132	20 795		20 795
May		2 223	117	2 339	2 567	4 906
June			112	112	2 666	2 778
July	19 695		218	19 913	4 900	24 813
August		1 997	248	2 245	946	3 191
September			176	176	946	1 122
October	22 586		265	22 851		22 851
November		3 000	208	3 208	716	3 924
December		2 223	146	2 368		2 368
Total 2012	73 889	13 571	2 283	89 743	15 891	105 634
Total 2013	82 468	6 110	1 698	90 276	14 825	105 102
Total 2014	51 379		628	52 007	17 448	69 455
Total 2015	78 880		485	79 365	14 329	93 694
Total 2016	52 103		91	52 194	16 871	69 065
Total 2017+	185 414		3 288	188 702	134 966	323 668

Schedule wholesales bonds redemption by holders (data at the end of April 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	0	0	0	0	0	31	3	1	34
Q3 2012	8 018	5 734	1 337	1 839	1 049	122	68	1 561	19 729
Q4 2012	9 726	4 695	1 697	2 893	1 383	80	30	2 117	22 620
Total 2012	17 744	10 429	3 034	4 732	2 433	233	101	3 679	42 384
	42%	25%	7%	11%	6%	1%	0%	9%	100%
Total 2013	36 035	12 907	12 389	12 705	3 274	483	299	4 510	82 602
	44%	16%	15%	15%	4%	1%	0%	5%	100%
Total 2014	19 827	9 835	5 425	10 099	4 244	413	132	3 431	53 406
	37%	18%	10%	19%	8%	1%	0%	6%	100%
Total 2015	22 525	23 941	7 106	15 331	5 044	192	638	4 173	78 951
	29%	30%	9%	19%	6%	0%	1%	5%	100%
Total 2016	11 663	9 692	4 599	28 416	5 030	49	227	2 798	62 473
	19%	16%	7%	45%	8%	0%	0%	4%	100%
Total 2017+	52 179	38 404	22 795	52 138	13 061	275	790	6 573	186 216
	28%	21%	12%	28%	7%	0%	0%	4%	100%

Sources: Ministry of Finance, BZ WBK

Treasury Securities Holders



Non-residents decreased slightly their holding in debt

■ In April foreign investors' involvement in Polish debt decreased by PLN2.4bn to PLN161.2bn due to reduction in share of T-bonds by PLN3.2bn and to increase in holding of T-bills by PLN0.8bn. The fall in T-bonds mainly came from redemption of PS0412. One should notice that non-banking financial sector rolled-over nearly 80% of redeemed papers (as the MF previously suggested), decreasing its holding in Polish bonds by only PLN1.1bn to PLN130.5bn. At the same time, foreign banks reduced their involvement by PLN2.1bn to PLN22.2bn. Even though the value of Polish bonds held by foreign investors declined, it still accounts for ca. 30.7% of total marketable domestic debt denominated in Polish zloty.

■ As regards the breakdown of foreign investors' portfolio at the end of April, non-residents sold bonds maturing in 2012 (OK0712 and OK1012) and purchased papers with maturity up to 3 years. One should notice that non-banking financial sector increased its involvement in the longer end of the curve (mainly in DS1020, DS1021 and WS0422 by nearly PLN2bn). All in all, the non-banking financial sector keeps its leading position on the Polish debt market and also in financing borrowing needs.

■ The European Commission said in its latest recommendation for Poland that the ownership structure of Poland's public debt is a potential risk factor. In its opinion, a roll-over of maturing debt requires continued willingness of foreign investors to keep a constant share of Polish assets in their portfolios. Taking into account the uncertain situation in the euro zone, we do not rule out a further decrease in foreign investors' holdings if global mood deteriorates significantly, putting an additional pressure on the zloty.

■ On the other hand, when releasing the June's issuance plan MF's Piotr Marczak commented that "in May we saw an inflow of foreign capital on the Polish debt market. The scale of this inflow could be the highest in whole year". It could mean that foreign investors take opportunity to purchase Polish debt assets looking for a higher rate of return (though with a bit higher risk) as Bunds hit record lows.

Domestic investors mostly roll-over maturing debt

■ In April the value of domestic banks' holding also decreased, mainly due to redemption of PS0412. Total value of domestic banks' involvement amounted to PLN111.2bn and was lower by PLN5.8bn as compared to the previous month. However, Polish banks were holding PS0412 papers worth PLN9.6bn at the end of March, which means that they decided to roll-over nearly 40% of held PS0412.

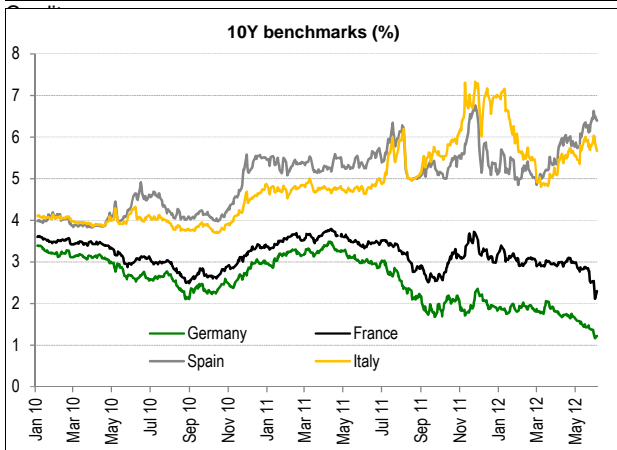
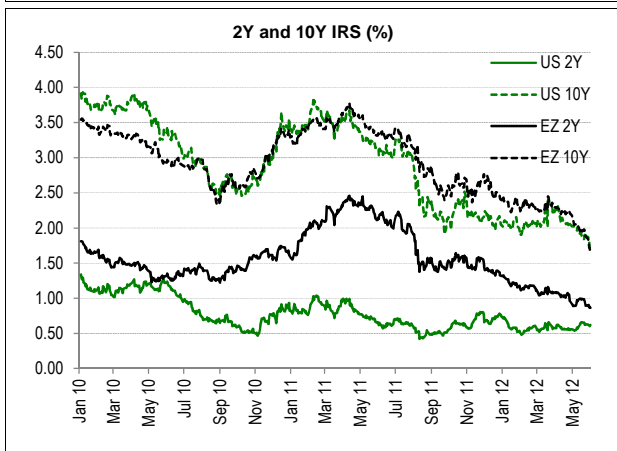
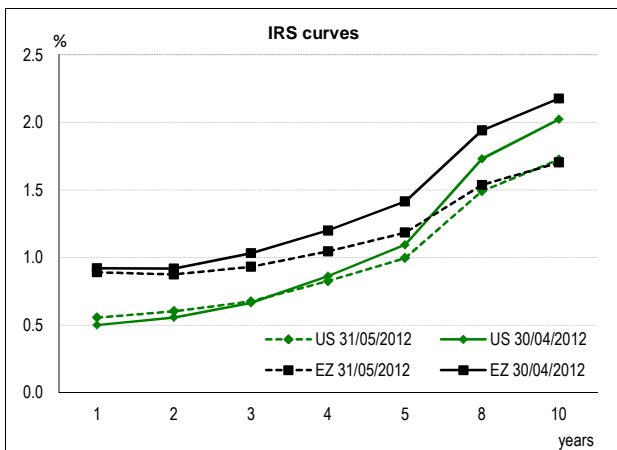
■ As regards the instrument breakdown, Polish banks increased their share in floating rate bonds (by nearly PLN8bn), and reduced their involvement on the front-end of the curve (mainly in OK1012 by PLN2.1bn).

■ Other three main groups of domestic investors, i.e. insurance companies, pension funds and investment funds expanded their holding in domestic debt, with pension funds posting the highest monthly growth. Their holding amounted to PLN124.6bn (increase by PLN2.8bn, the highest monthly change since October 2011). Pension funds purchased mainly PS0416 and PS1016 worth PLN8.1bn in total, but also WZ series (net increase by ca. PLN1bn). At the same time pension funds sold bonds maturing later this year (OK0712 and OK1012 worth ca. PLN2bn in total) and some DS series (PLN1.2bn).

■ As regards insurance companies and investment funds, their holdings reached level of PLN56.7bn and PLN34.6bn (the highest since February 2008), respectively.

Sources: Ministry of Finance, BZ WBK

International Bond Markets



Core bonds remain strong, reaching historical lows

▪ The international debt market has remained risk averse, maintaining high demand for German papers and the US Treasuries. Risk-off escalated after collapse of government talks in Greece. The situation stabilised slightly after the EU summit. However, a row of negative news from Spain, concerns about its banking sector and worries that it may need support from the EU/IMF to cover its borrowing needs pushed 10Y German Bund yields to new all-time lows (below 1.20%). At the same time yield of 2Y bonds turned negative, suggesting that some investors do not exclude scenario of Grexit (and risk of a total break-up of the euro zone). In case of US Treasuries, yield of 10Y fell below 1.50%.

▪ In a current uncertain environment, demand for safe-haven assets should remain strong. Therefore, the investors' bias towards German Bunds and US Treasuries has remained unchanged. We foresee core curves to continue to flatten.

Situation in Spain and Greece

▪ Increased risk aversion hit the euro zone peripheries' assets. As worries about Spanish government's debt intensified due to nationalization of Bankia, the yield of 10-year Spanish bonds increased to 6.60% (at the end of May), reaching the highest level since November 2011. In case of Italian bonds, 10Y yield went up towards 6% at the end of May, with spread over Bunds reaching nearly 480bps, the highest level since January as the LTRO impact has also waned.

▪ We think that appetite for periphery is very unlikely to pick up substantially in the upcoming weeks. The European Central Bank meeting and parliamentary election in Greece are key events in June. We expect the monetary authority to keep baseline economic expectations rather unchanged (staff projections), but to put a lot more emphasis on downside risks. Any suggestion that the bank might continue the unlimited provision of liquidity with longer maturities (some peripheral banks obtained more capital and might benefit from long term liquidity) should support the market. Rate cuts are still on cards and we do not rule out that they may be discussed already in June. However, in our opinion, the ECB will keep interest rates unchanged until the situation in Greece is clarified.

▪ It is difficult to forecast who will win parliamentary election in Greece (scheduled for 17 June). If the pro-bailout parties gather majority of votes, it should calm the market down and relax the tense situation.

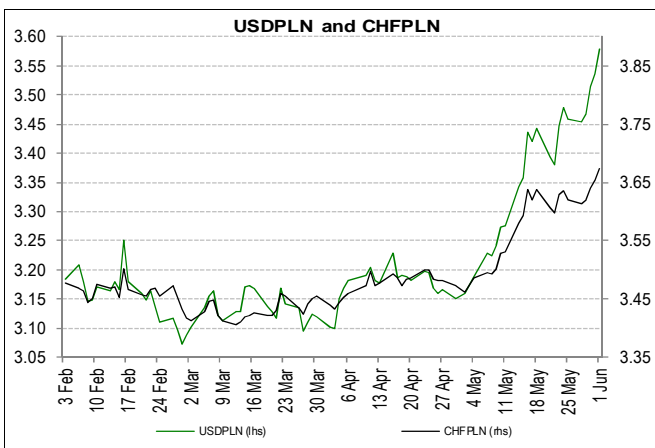
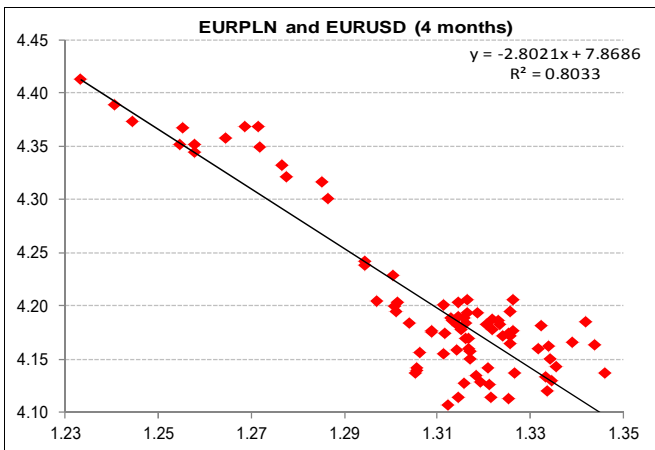
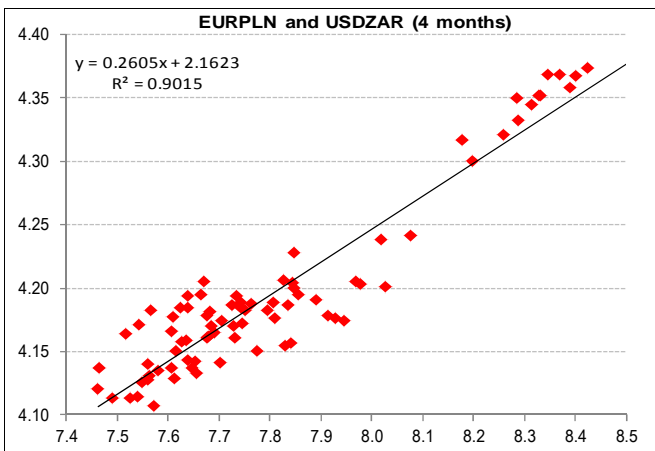
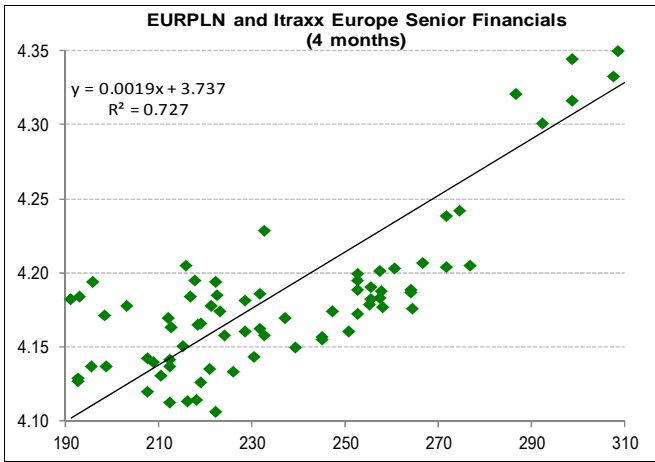
▪ Towards the end of June, the market will concentrate on possible solutions to be proposed during the EU summit (fiscal union, banking union, Eurobonds etc.) and their impact on euro zone's prospects.

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	45
Belgium	27.9	7	34.9	26.0	78
Finland	6.3	7.5	13.8	13.8	44
France	101.7	78.7	180.4	178	55
Germany	157	26.6	183.6	170	46
Greece	33.2	16.2	49.4	-	-
Ireland	5.5	13.7	19.2	-	-
Italy	192.2	41.1	233.3	233.3	41
Netherlands	29.7	12.3	42	60.0	57
Portugal	12.9	17.4	30.3	-	-
Spain	50.1	36.2	86.3	85.9	56
Total	630.5	265.0	895.5	789.2	50

Source: Reuters, BZ WBK

Foreign Exchange Market



Sharp depreciation of the zloty

▪ The zloty plunged during the past month as the domestic currency did not manage to further resist the growing pressure from the euro zone's peripheries. In May the zloty depreciated by 5.5% against the euro, 12% against the dollar and 5.6% against the Swiss franc.

▪ Just as we pointed last month, the case of Greek elections played an important role on the FX market in May. Uncertainty triggered by unsuccessful attempts to form a new government (and consequently a necessity to conduct next election on 17 June) and by clearly higher risk of Grexit caused an immense risk aversion and triggered a turmoil on the global market. Additionally, the market was worried about Spanish banking sector. As yields of the 10Y Spanish bonds surged over 6.7% (highest level since November '11), Italian ones jumped above 6% (first time since January) and EURUSD plunged below this year's low at 1.2623, the upward trend of EURPLN accelerated and the exchange rate reached temporarily nearly 4.43 while the USDPLN exchange rate increased temporarily to just above 3.60 (highest since April '09).

▪ The depreciation of the zloty would have been even bigger if the BGK had not been more active on the domestic FX market and the NBP had not intervened verbally.

Uncertainty to remain on the market

▪ Just like in the previous month, it seems that results of Greek elections will be most important factor driving the FX market. The opinion polls show that two parties with biggest support (pro-austerity New Democracy and SYRIZA opposing further savings) constantly change lead before elections scheduled for 17 June. Uncertainty about the final results and how soon the new government will be established (Greece is running out of cash and further savings of €11.5bn are required until end of June to disburse another tranche from the IMF/EU) is likely to limit the potential for any long-lasting rebound of risky assets. Additionally, recently the market switched its attention to Spain so the case of its banking system and fiscal situation of the country is another source of uncertainty.

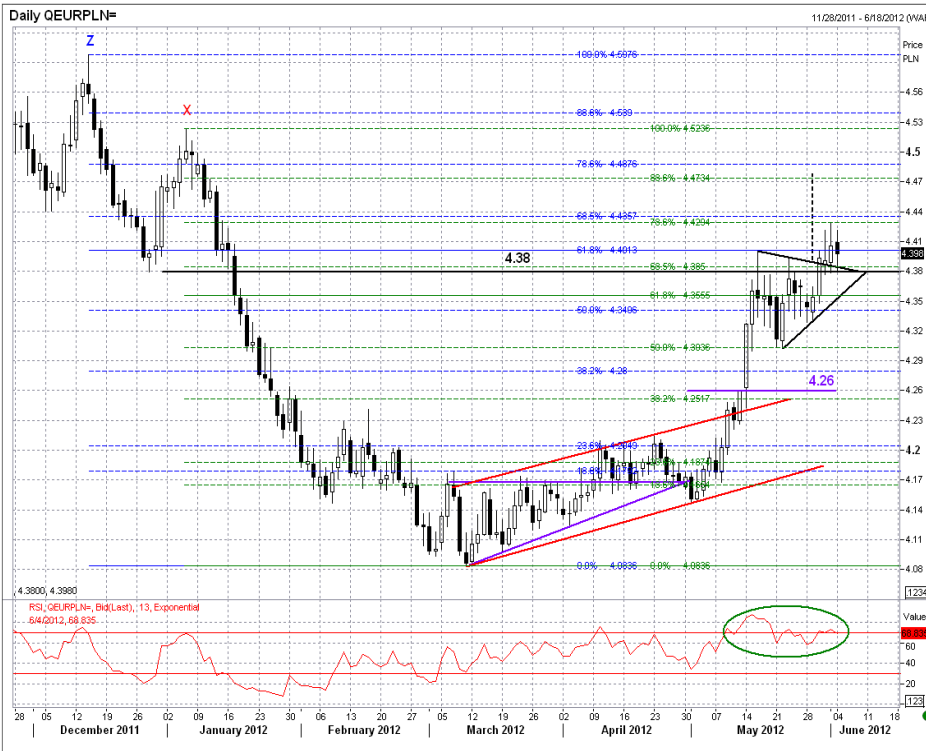
▪ Relationship analysis still indicates that the developments on the euro zone peripheries continue to be the most important driver of the zloty. Negative pressure is put by both rising yields of peripheral bonds and by the falling EURUSD. Furthermore, a massive weakening was observed in other emerging markets. The USDRUB exchange rate surged by over 12% and the USDZAR by more than 10%. The forint and the Czech koruna also lost value in May (by 5.8% and 3.2%, respectively).

▪ Latest data show that short bets on the euro reached an all-time high (203k) beating record from the beginning of the year. Still, if the euro's recovery was to be repeated this time, some new positive factors would have to emerge. In our opinion, even a possible reduction of number of short bets does not give much hope for any more visible and long-lasting increase of the EURUSD.

▪ In the previous month EURPLN broke the level of 4.40 a few times and it might be tested again if global moods deteriorate due to Greek elections. Next important resistance levels are 4.44 and 4.47. The pressure on the zloty may be also put by falling EURUSD (technical analysis indicates that the room for further decline to 1.22 is open). Consequently, USDPLN may increase further. Nevertheless, the second half of June may bring some relief assuming pro-bailout government is formed in Greece and no disappointment is expected after the EU summit. Overall, we expect that average EURPLN in June will be slightly below levels recorded at the end of May (ca. 4.35) and USDPLN at 3.50.

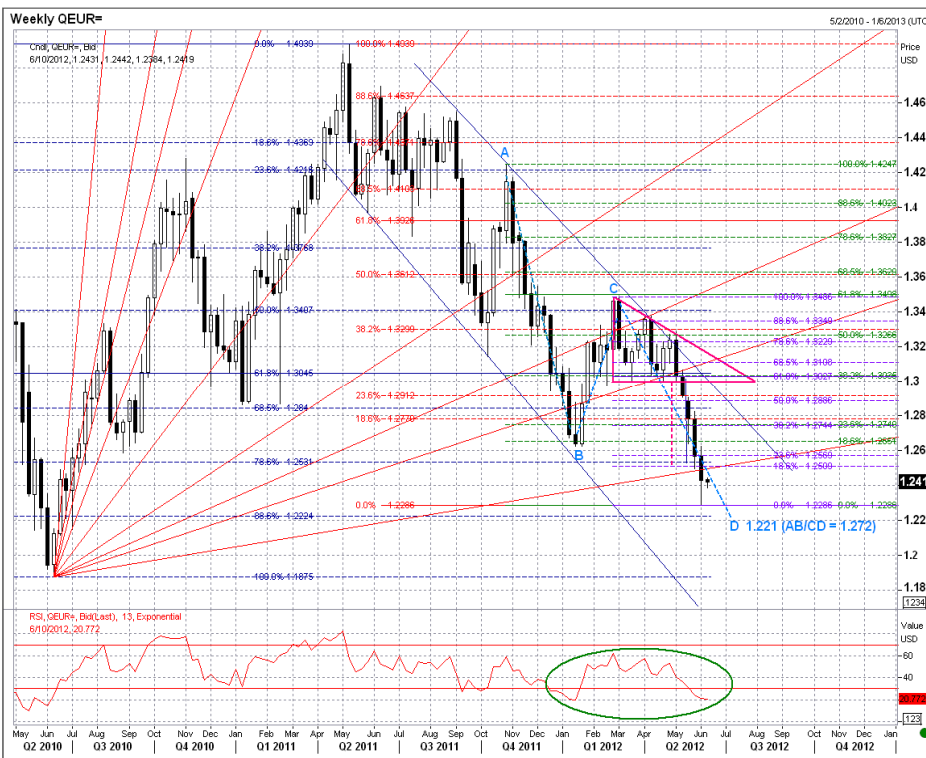
Sources: Reuters, BZ WBK

FX Technical Analysis Corner



EURPLN

- EURPLN broke the upper band of the upward trend and surged to just below of 4.43.
- Earlier, triangle pattern was drawn on the chart and in early June the EURPLN broke upper band of that formation.
- So far the resistance area built of two Fibo retracements prevents the EURPLN from reaching 4.47, which is projected level from triangle pattern.
- Apart from the resistance mentioned above, also divergence with the RSI might constrain upward momentum.



EURUSD

- The exchange rate broke the 1.30 support and reached 1.2286, well deeper than projection from triangle pattern indicated.
- Latest minimum is not too far away - regarding the time scale - from the next Fibo support (1.2224). At 1.221 latest movements would draw quite strong Fibo pattern and that would suggest at least a slight rebound.
- There is also a divergence with the RSI and this also indicates that some rebound may take place soon.
- First resistance is a last angle in Gann Fan (at ca. 1.25) but stronger one seems to be that at ca. 1.275.

Sources: Reuters, BZ WBK

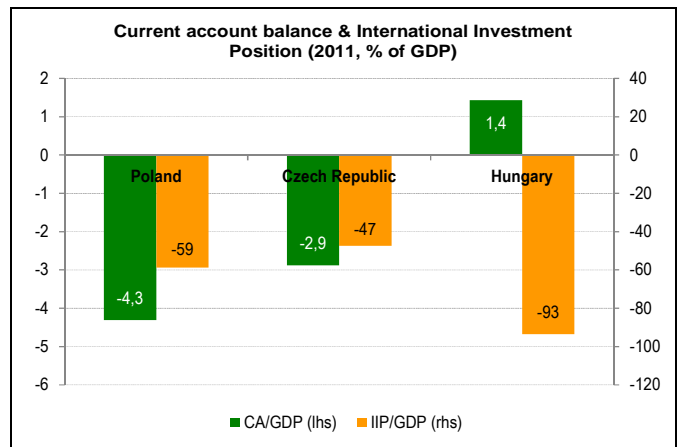
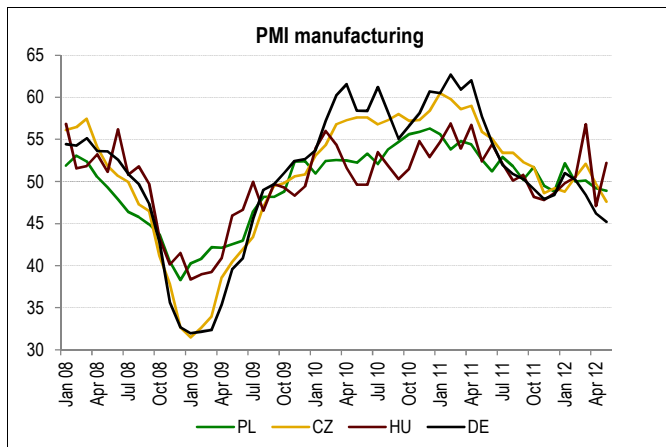
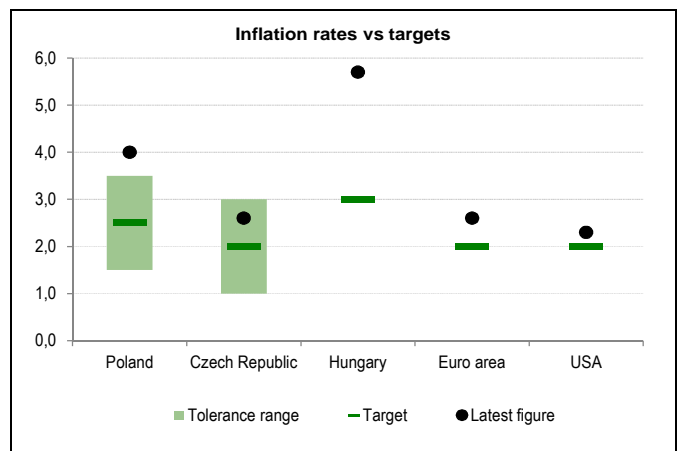
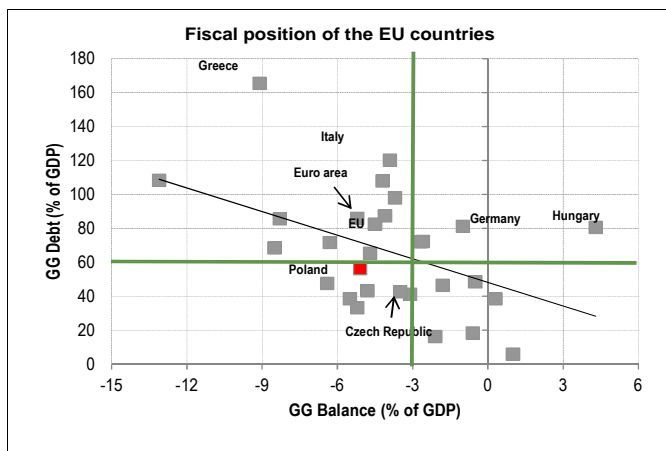
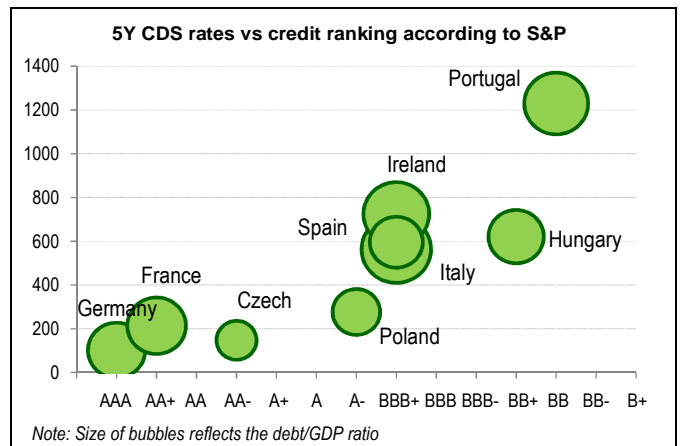
Poland vs other countries - economy

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	2.7	3.9	3.7	-4.3	-3.9	-5.1	-3.0	56.3	57.1
Czech Republic	1.7	0.0	2.1	3.3	-3.6	-3.2	-3.1	-2.9	41.2	41.9
Hungary	1.7	-0.3	3.9	5.5	0.9	2.2	4.3	-2.5	80.6	76.5
EU	1.5	0.0	3.1	2.6	0.0	0.3	-4.5	-3.6	82.5	84.9
Euro area	1.5	-0.3	2.7	2.4	0.1	0.6	-4.1	-3.2	87.2	90.4
Germany	3.0	0.7	2.5	2.3	5.3	4.7	-1.0	-0.9	81.2	82.2

Note: * European commission – May 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

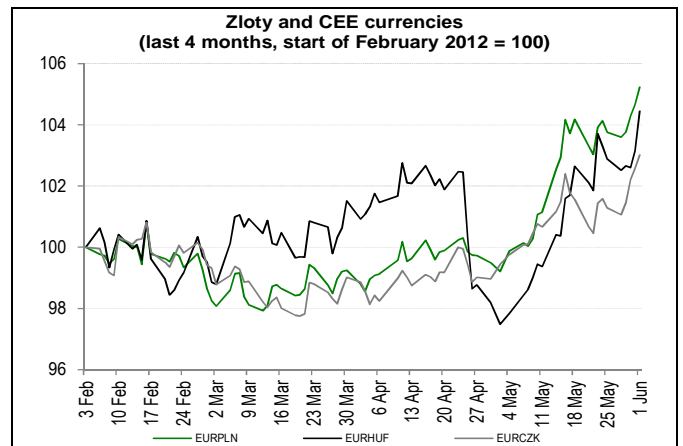
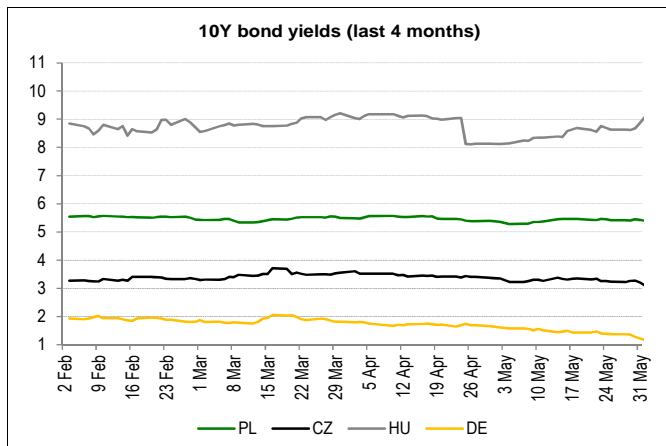
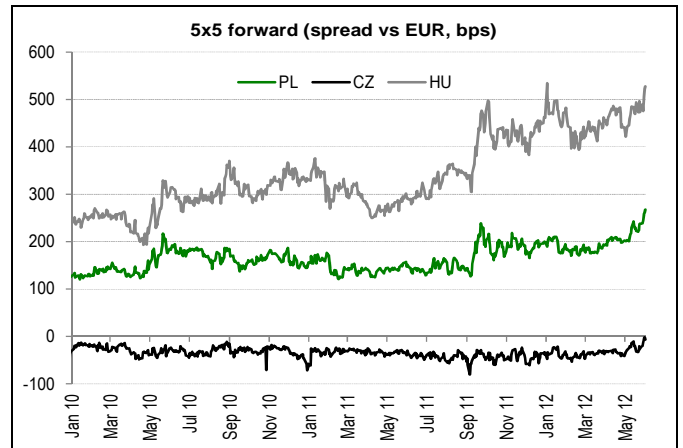
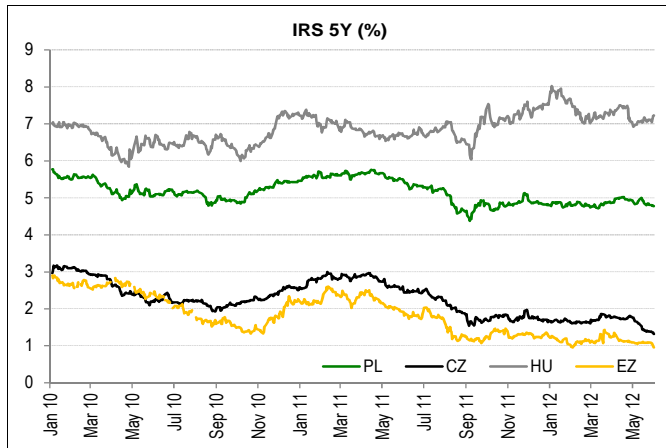
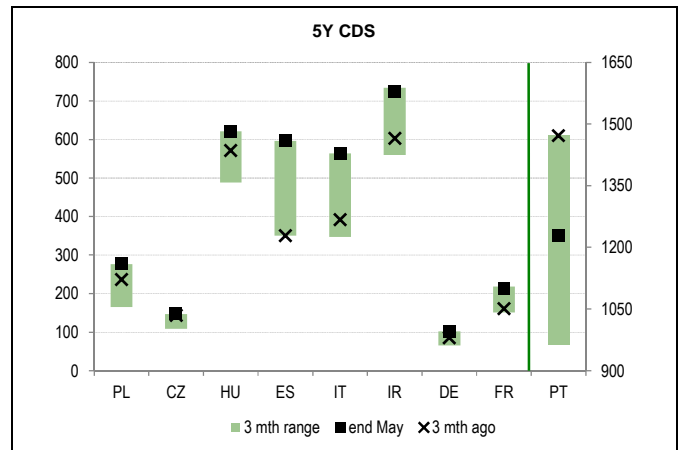
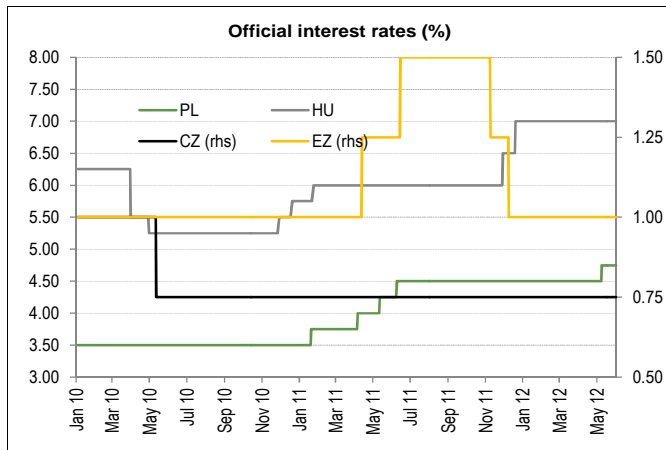


Source: stat offices, central banks, Reuters. BZ WBK, EC

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 May	2011	end of May	2011	end of May	2011	end of May
Poland	4.50	4.75	4.99	5.11	5.88	5.45	405	421	279	273
Czech Republic	0.75	0.75	0.78	0.84	3.59	3.21	176	198	173	145
Hungary	7.00	7.00	7.24	7.19	9.90	8.86	807	764	610	611
Euro area	1.00	1.00	1.36	0.67						
Germany					1.83	1.22			100	102



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				Investors focus on new staff projections, especially on the CPI perspectives in 2013. The ECB is ready to act if necessary
	Market implied »				-6	-12	-12	
UK	Forecast	0.50	0.50	0.50				Rates on hold, but after weaker than expected data from real economy the market starts to discount a higher probability of a further round of QE.
	Market implied »				-1	-3	-4	
US	Forecast	0-0.25	0-0.25	0.25				Expectations on QE3 have renewed after May's non-farm payrolls.
	Market implied »				3	7	13	
Poland	Forecast	4.75	4.50	4.75				The MPC intensifies its hawkish rhetoric, suggesting interest rates hike in July, which will depend on a new projection of CPI and GDP.
	Market implied »				1	2	-8	
Czech	Forecast	0.75	0.75	0.75				At this moment, it appears more likely that the move will be upward though this doesn't necessarily have to happen any time soon.
	Market implied »				21	13	8	
Hungary	Forecast	7.00	7.00	7.00				The NBH could start monetary loosening a bit earlier due to economic activity deterioration.
	Market implied »				15	24	18	

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

Economic Calendar and Events

Date	Event:	Note:
6-Jun	PL MPC Meeting – interest rate decision	Our forecast and market consensus: the MPC will keep interest rate unchanged
	EZ ECB Meeting – interest rate decision	Our forecast and market consensus: 1.00%
	DE Auction of 5Y bonds	Offer: €5.0bn
7-Jun	SP Auction of 2Y, 4Y and 10Y bonds	Offer: €1.5-2.5bn
	FR Auction of long term bonds (7Y, 10Y, 15Y, 50Y)	Offer: €7.0-8.0bn
	GB BoE Meeting – interest rate decision	Market consensus: 0.50%
13-Jun	PL CPI for May	Our forecast: 3.7%YoY due to subdued food prices growth
14-Jun	PL Switch tender	-
	DE Auction of 10Y bonds	Offer: €5.0bn
17-Jun	GR Parliamentary election	
19-Jun	PL Employment and wages for May	We foresee further decline in employment and moderate growth in wages
20-Jun	PL Industrial output for May	We expect industrial output growth at 4.0%YoY, above market consensus (2.7%YoY)
	PL Core inflation measures for May	We expect core inflation exc. food & energy prices at 2.7%YoY
21-Jun	PL Auction of PS0417	Offer: PLN2.0-4.0bn
	PL Minutes of the June's MPC's meeting	-
	EZ Eurogroup meeting	-
22-Jun	EU EcoFin meeting	-
26-Jun	HU NBH Meeting – interest rate decision	Our forecast: 7.00%
28-Jun	PL Retail sales for May	We foresee moderate growth at 8.1%YoY, above market consensus at 7.3%YoY
	CZ CNB Meeting – interest rate decision	Our forecast: 0.75%
28-29 Jun	EU The EU summit	-
4-Jul	PL MPC Meeting – interest rate decision	Our forecast: We uphold our view that the MPC will keep rates stable till year-end
5-Jul	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	1,618.7	349.4	369.8	376.1	429.4	370.5	393.3	400.0	455.0
GDP	%YoY	1.6	3.9	4.3	2.7	4.6	4.2	4.2	4.3	3.5	2.5	2.4	2.4
Domestic demand	%YoY	-1.1	4.6	3.7	1.2	4.3	4.2	2.9	3.2	2.7	0.6	0.8	0.9
Private consumption	%YoY	2.1	3.2	3.1	1.9	3.7	3.6	3.0	2.1	2.1	1.7	1.8	2.0
Fixed investments	%YoY	-1.2	-0.2	8.3	4.9	5.4	6.8	8.1	9.7	6.7	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	12.3	12.6	13.5
Current account balance	EURm	-12,152	-16,493	-15,917	-11,467	-3,135	-3,359	-4,459	-4,964	-3,623	-1,649	-2,671	-3,524
Current account balance	% GDP	-3.9	-4.7	-4.3	-3.0	-4.8	-4.9	-4.6	-4.3	-4.4	-4.0	-3.5	-3.0
General government balance	% GDP	-7.4	-7.8	-5.1	-3.0	-	-	-	-	-	-	-	-
CPI	%YoY	3.5	2.6	4.3	3.9	3.8	4.6	4.1	4.6	4.1	4.0	4.1	3.5
CPI ^a	%YoY	3.5	3.1	4.6	3.1	4.3	4.2	3.9	4.6	3.9	4.1	4.2	3.1
CPI excluding food and energy prices	%YoY	2.7	1.6	2.4	2.6	1.7	2.3	2.6	3.0	2.5	2.8	2.7	2.5
EUR/PLN	PLN	4.33	3.99	4.12	4.27	3.94	3.96	4.15	4.42	4.23	4.28	4.34	4.24
USD/PLN	PLN	3.12	3.02	2.96	3.39	2.88	2.75	2.94	3.28	3.23	3.34	3.50	3.49
GBP/PLN	PLN	4.86	4.66	4.75	5.23	4.62	4.48	4.73	5.16	5.07	5.21	5.30	5.23
Reference rate ^a	%	3.50	3.50	4.50	4.75	3.75	4.50	4.50	4.50	4.50	4.75	4.75	4.75
WIBOR 3M	%	4.42	3.94	4.54	5.07	4.10	4.43	4.72	4.91	4.97	5.03	5.14	5.15
Yield on 52-week T-bills	%	4.54	3.96	4.51	4.64	4.37	4.62	4.54	4.50	4.50	4.70	4.75	4.62
Yield on 2-year T-bonds	%	5.17	4.72	4.81	4.70	5.01	4.97	4.54	4.71	4.66	4.73	4.74	4.66
Yield on 5-year T-bonds	%	5.65	5.31	5.44	4.97	5.79	5.60	5.17	5.19	5.02	4.97	5.01	4.87
Yield on 10-year T-bonds	%	6.11	5.74	5.98	5.46	6.27	6.03	5.77	5.83	5.58	5.43	5.46	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 1st June 2012 and has been prepared by:

ECONOMIC ANALYSIS DEPARTMENT

ul. Marszałkowska 142. 00-061 Warszawa. fax +48 22 586 83 40

Email: ekonomia@bzwbk.pl Web site (including Economic Service page): <http://www.bzwbk.pl>

Maciej Reluga – Chief Economist

tel. +48 022 586 83 63. Email: maciej.reluga@bzwbk.pl

Piotr Bielski +48 22 586 83 33

Agnieszka Decewicz +48 22 586 83 41

Marcin Luziński +48 22 586 83 62

Marcin Sulewski +48 22 586 83 42

TREASURY SERVICES DEPARTMENT

Poznań

pl. Gen. W. Andersa 5
61-894 Poznań
tel. +48 61 856 58 14/30
fax +48 61 856 44 56

Warszawa

ul. Marszałkowska 142
00-061 Warszawa
tel. +48 22 586 83 20/28
fax +48 22 586 83 40

Wrocław

ul. Rynek 9/11
50-950 Wrocław
tel. +48 71 369 94 00
fax +48 71 370 26 22

This publication has been prepared by Bank Zachodni WBK S.A. for information purposes only. It is not an offer or solicitation for the purchase or sale of any financial instrument. All reasonable care has been taken to ensure that the information contained herein is not untrue or misleading. But no representation is made as to its accuracy or completeness. No reliance should be placed on it and no liability is accepted for any loss arising from reliance on it. Bank Zachodni WBK S.A., its affiliates and any of its or their officers may be interested in any transactions, securities or commodities referred to herein. Bank Zachodni WBK S.A. or its affiliates may perform services for or solicit business from any company referred to herein. This publication is not intended for the use of private investors. Clients should contact analysts at and execute transactions through a Bank Zachodni WBK S.A. entity in their home jurisdiction unless governing law permits otherwise. Copyright and database rights protection exists in this publication.