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## Comment on the upcoming data and forecasts

On Wednesday labor market data will be published. We expect slight employment growth rate decrease in line with behaviour and only little seasonal contribution (in construction, trade, accomodation and catering). Previous high wages reading was supproted mainly by shift of bonuses in mining. In July we expect return to trend with negative effect of working days. On Thursday we expect industrial production growth rate to reach 3.3% (although motor vehicles production eased significantly in July, which implies reading closer to 2%) as construction remains high and stable and after strong rebound of manufacturing PMI. Higher PPI inflation comes from the end of high statistical base effect and increasing commodities prices in USD and PLN.

### Polish data to watch: August 15 to August 19

| Publication | Date | Period | BRE | Consensus | Prior |
|---|---|---|---|---|---|
| Employment y/y (%) | 17-08 | Jul | 3.4 | 3.5 | 3.6 |
| Wages y/y (%) | 17-08 | Jul | 4.0 | 5.0 | 5.8 |
| PPI y/y (%) | 18-08 | Jul | 6.0 | 5.7 | 5.6 |
| Industrial production y/y (%) | 18-08 | Jul | 3.3 | 3.6 | 2.0 |
| Core CPI y/y (%) | 19-08 | Jul | 2.3 | 2.4 | 2.4 |

### Treasury bonds and bills auctions

| Paper | Next auction | Last Offer | Last yield (%) | Prev auction |
|---|---|---|---|---|
| 52-week T-Bills | 10/3/2011 | 600 | 4.578 | 5/30/2011 |
| 2Y T-bond OK1013 | 10/12/2011 | 3000 | 4.469 | 10/8/2011 |
| 5Y T-bond PS0416 | 10/19/2011 | 3000 | 5.256 | 10/8/2011 |
| 10Y T-bond DS1021 | 10/19/2011 | 3000 | 5.803 | 7/21/2011 |
| 20Y T-bond WS0429 | 9/22/2011 | 250 | 6.246 | 1/12/2011 |

### Macroeconomic forecasts

| Wskaźnik | 2008 | 2009 | 2010 | 2011 F | 2012 F |
|---|---|---|---|---|---|
| GDP y/y (%) | 4.8 | 1.7 | 3.8 | 4 | 3.5 |
| CPI Inflation y/y (average %) | 4.3 | 3.5 | 2.8 | 4.3 | 3.1 |
| Current account (%GDP) | -5.3 | -1.6 | -4.5 | -4.9 | -4.3 |
| Unemployment rate (end of period %) | 9.5 | 11.9 | 12.3 | 11.9 | 11.5 |
| Repo rate (end of period %) | 5.00 | 3.5 | 3.5 | 4.5 | 4.5 |

| | 2010 Q3 | 2010 Q4 | 2011 Q1 | 2011 Q2 F | 2011 Q3 F | 2011 Q4 F |
|---|---|---|---|---|---|---|
| GDP y/y (%) | 4.2 | 4.5 | 4.4 | 4.2 | 3.7 | 3.7 |
| CPI Inflation y/y (average %) | 2.6 | 2.9 | 3.7 | 4.2 | 4.2 | 4.2 |
| Repo rate (end of period %) | 3.5 | 3.5 | 4 | 4.5 | 4.5 | 4.5 |

F - forecast

# Economics

## Back to current account deficit, perspectives positive though

Current account deficit amounted to EUR 1569 mln. The rise in the deficit is an effect of EU funds driven changes in transfers account: EUR 1662 mln surplus recorded in May shrank to 144 mln. Income balance widened a bit to EUR -1227 mln, mostly on one off dividend payment by one of Warsaw Stock Exchange listed banks. Services balance recorded EUR 452 mln surplus against 272 mln last month.

Trade balance deficit widened slightly to EUR 1065 mln (the highest reading this year). A slight change in trade deficit resulted from decrease in exports (EUR 11888 mln), but not in imports (flat overall and still strong, as derived from June's data). We consider that this shift from exports to imports does not initiate a new trend, but rather ends an old one which we supported throughout many months by now. So far we thought that consumption will be the main driver of the Polish GDP growth. Therefore we supported a widening C/A deficit on the back of falling exports (led by global contraction of trade and global slowdown) and stable imports. Latest revision of our forecasts shows that we have ceased to believe in such a scenario and turned for the worse, especially with regard to private consumption (consumers burdened by high prices and high mortgage servicing costs). Therefore falling exports will be in coming months accompanied by falling imports (even faster than exports). Such a sequence of data is set to result in lower trade deficit, and in turn lower C/A deficit. Such a development is also consistent with stylized facts for the Polish economy. Most cases of GDP slowdown are connected with improvement in trade balance and - in turn - current account balance.

Zloty implications. So far zloty remains under overwhelming pressure of bouts of risk aversion and global growth worries. Those worries are spilling slowly to Polish economy although GDP slowdown is not the strong part of the consensus at the moment; therefore we cannot exclude a hit from this side in the coming months. Rebalancing factors (expected narrowing of C/A) should support the zloty in the mid-term, accompanied by the completed process of (downward) forecasts revision and possibly another story of green shoots (2012). Therefore zloty is set to remains broadly stable at 4+ versus the EUR; appreciation may be resumed in 2012.

## Inflation surprisingly lower at 4.1%

Inflation in July hit 4.1% on annual basis (we forecast 4.3%). The fall stems from well-behaving (accordingly to the regional developments) food prices, supported by falls recorded in wearing apparel (-2.3% m/m). To our astonishment, some kind of divine touch cast fuel prices down by 0.2% m/m (according to our usually very accurate calculations based on actual prices at gas stations, fuel prices went up by 4.0%) - this divergence explains fully our forecasting "mistake". As for other categories, housing recorded an increase owing to gas tariffs hikes, recreation and culture went up by 0.8%,education by 0.3%, and hotels and restaurants by 0.3%. We assess core inflation to have stayed at last month's 2.4% level.

Short-term factors speak in favor of similar levels of inflation. More specifically, food prices may prove a bit higher than implied seasonally as exports to Russia has been revived in August. What is more, the mess with fuel prices may imply that the 'level' of prices is too low and this may generate a solid correction higher in August. Last, but not least, also current exchange level may allowed some importers to lift their prices (exchange rate channel is the most effective in terms of monetary transmission and this time it made monetary policy considerably easier). Core categories also seem to move in stable, upward trends.

Switching to mid-term, we think that market play for fast rate cuts is premature. Although the reasoning based on global slowdown is correct, the lags necessary to make it work are far too long to apply to MPC reasoning, especially when the slowdown has not been visible in the data yet (but sure it will be soon). What is more, inflation problems has not evaporated, what is reflected by stable core inflation. There are also some administered price hikes in the pipeline (energy, transport). Therefore we do not believe inflation will easily come back to target in 2012. The MPC has also hands tied by the high exchange rate and possible destabilization of inflation expectations (mind that we are still in a phase in which wage settlements are taking place based on past developments - until this process fades away, higher inflation may be easily translated into higher wages). We expect MPC to stay cautious for a while, both in wording and actions.

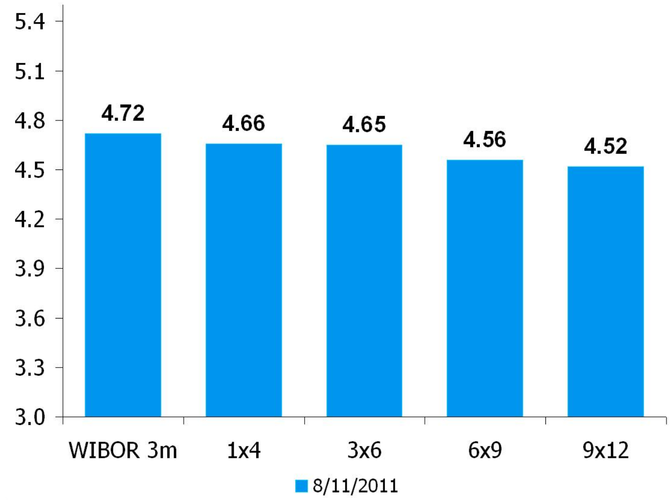
# Fixed income

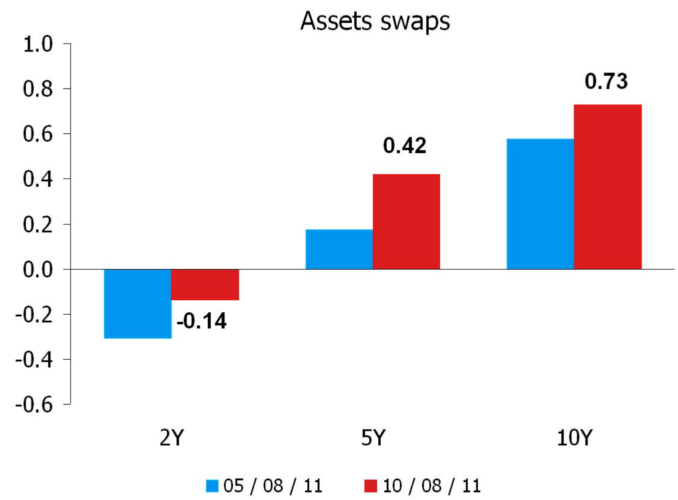
## Stop-losses

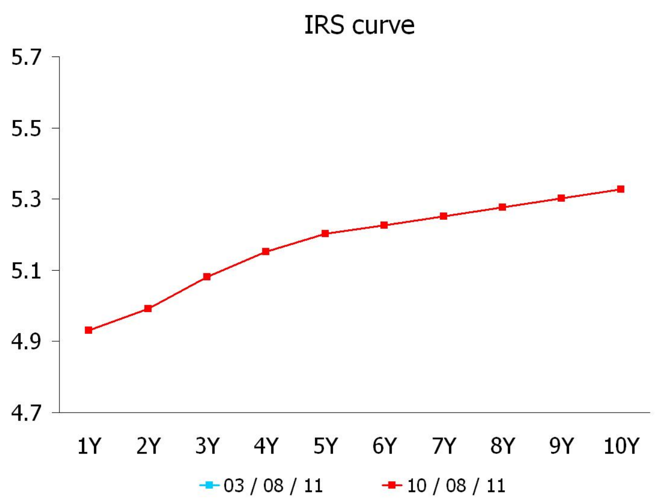
Quite a busy week behind us. After the US downgrade, the panic on the global markets outraged on Monday. The risk of a global slowdown pushed the yields to the lowest levels since October 2010. The vast majority of the global investors who played for the further tightening in Poland this year decided to cut theirs positions rapidly.

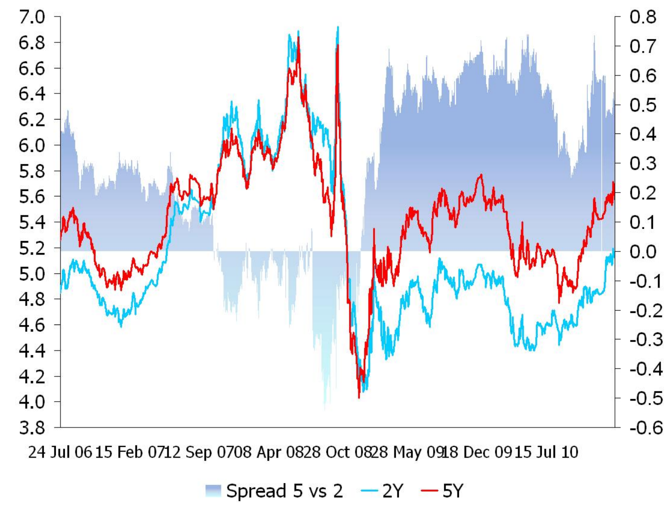
The yield curve went down by 30-35 bp in 2Y pricing 21x24s FRA contract even 50 points below the current Wibor rate. At the same time the curve resteepend massively trading 2y10y spread around 50 points with the real huge pressure upside. The market looks like some of international players might start to bet on the recent turn in the monetary policy in Poland pricing the probability of the rate cuts already at the end of this year. We think such an attitude could be slightly premature taking into account the expected CPI level and quite good resistance of the domestic economy to the global turmoil that had been demonstrated in 2008/2009.

On the other hand no scenario could be excluded as we cannot be 100% sure how the next global crisis might influence the domestic economy and when it would be an appropriate moment for the Central Bank to intervene. However, keeping in mind the last crisis we may start to trade the same pattern as we had traded during the last one. Considering the Central Bank would be forced to supply the market with a cheap cash again we consider selling Polonia against paying FRAs.



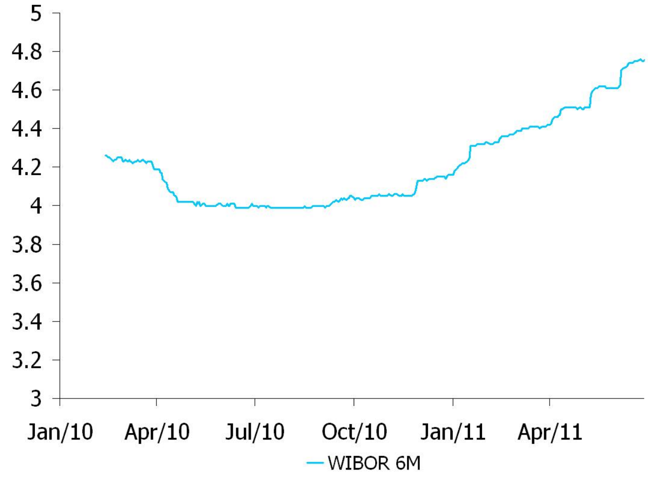



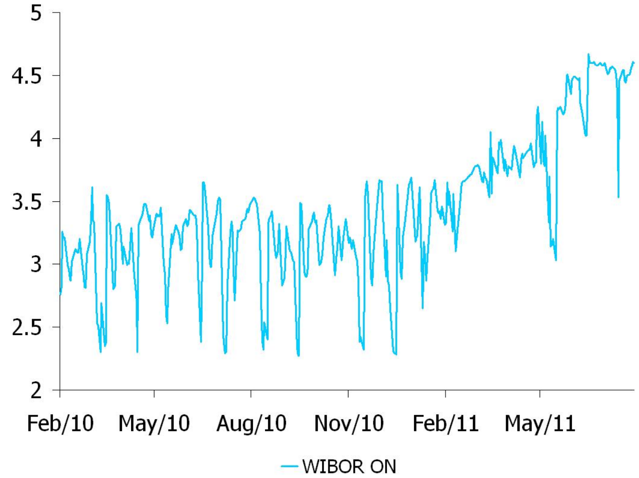
## Money market

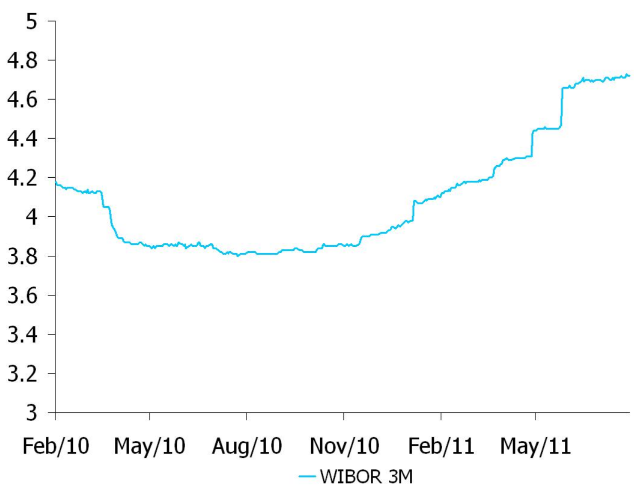
### Higher cost of carry resulted in lower demand for the money bills. Rates cuts in the curve.

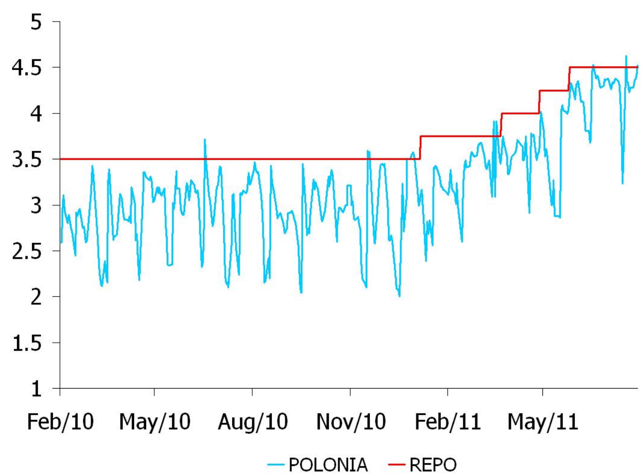
Growing cost of carry followed by lower demand during the OMO auction makes us think that the week ahead has pretty good chances to be cheaper. However, let us not forget that the central bank can do additional auction if the fall would be substantial.

Extremely bullish sentiment came from nowhere and the curve dropped 20 bps. Right now rate cuts are being discounted and we think its quite surprising and premature. CPI is still well above the upper band of the target and the slowdown is not yet to come. Moreover, the currency weakened during last days and any fast cut would drive us to much higher levels for pln, and this is not what authorities like. Therefore, the most probably strategy as far as the MPC is concerned, would be to wait and see for the prolonged time period. Cuts are possible next year, however second half looks better then the first one. All in all we perceive current levels as a great opportunity to buy.



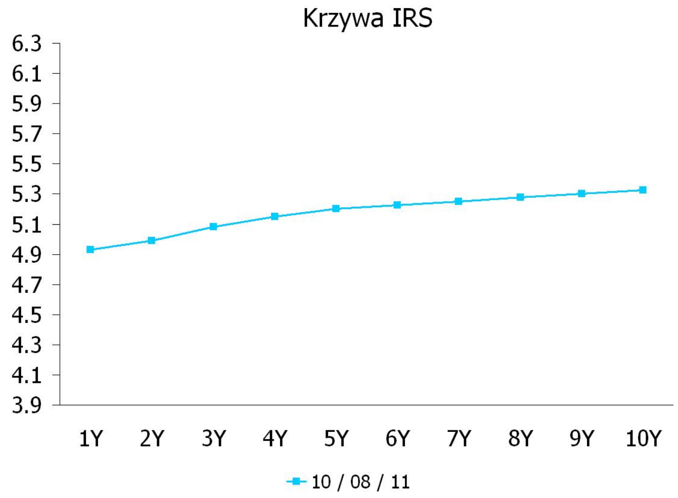



# Forex

**Złoty weaker** Its good to be unique!! After days of overperforming we have moved to other side of scale. Since Moday's 4.03 bottom to Wednesday's 4.23 top Zloty has lost to EUR about 5%, as compared to 2% move on EURHUF cross must make impression. Why global storm has postponed its coming? Probably its all about stock and bonds performance. Huge selloff on these markets has forced closing PLN exposure.

**Volatility higher** Not position hedging but chasing realized volatility (19% weekly) has sharply pulled implied curve higher. Highest trades were: 1M 15.5 (10.3 week ago), 3M 14,5 (10.4), 6m 14.0(10.6).The RR run has followed ATMs shaping flat 5.0 curve (2.75 mid tenors week ago), the currency spread ( USD/PLN vs EUR/PLN) also higher by 0,75% to 9.25 level.

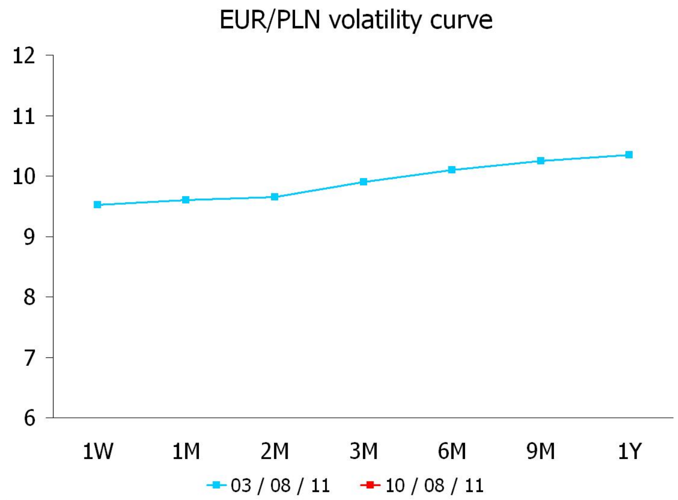


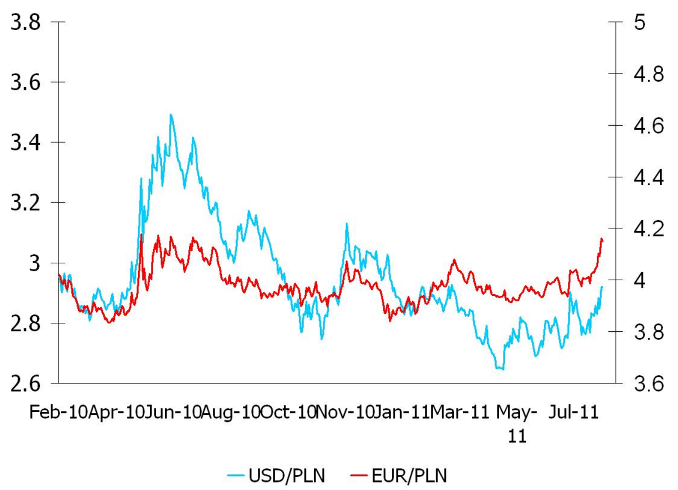

## Short-term forecasts

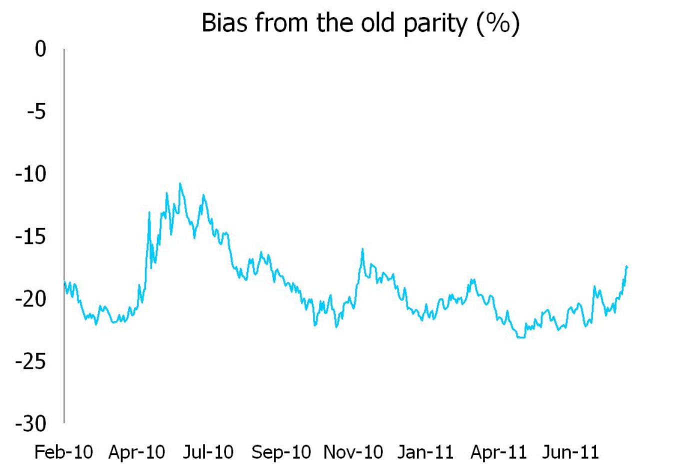
Main supports and resisances
EUR/PLN: 3.9600 / 4.0650
USD/PLN: 2.8200 / 2.8900

**Spot.** We have closed our EURPLN long at 4.12 and have seized an opportunity to shorten at 4.20. We think 4.06/4.10 zone offers a support now and will slower strengthening/correction pace, tactical buy EURPLN offers good risk reward. On the other side we would sell above 4.20 with the short stop at 4.24.

**Derivatives.** We did not resist the temptation to close our long backend Vega at Thursdays spike (6month paid at 14%). We still hold long gamma, as it performs really nicely. We would take a back seat at the moment , but generally we will try to reenter long Vega position at more acceptable levels ( 11 % 3 months, 11.00 % 6 months).



# Market prices update

| Money market rates (mid close) | | | | | | | FRA rates (mid close) | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Date | FXSW 3M | WIBOR 3M | FXSW 6M | WIBOR 6M | FXSW 1Y | WIBOR 1Y | 1x4 | 3x6 | 6x9 | 9x12 | 12x15 | 6x12 |
| 8/4/2011 | 4.55 | 4.72 | 4.67 | 4.72 | 4.51 | 4.77 | 4.74 | 4.84 | 4.92 | 4.93 | 4.91 | 4.96 |
| 8/5/2011 | 4.60 | 4.71 | 4.65 | 4.72 | 4.72 | 6.59 | 4.75 | 4.82 | 4.88 | 4.89 | 4.89 | 4.93 |
| 8/8/2011 | 4.68 | 4.71 | 4.70 | 6.49 | 4.78 | 4.77 | 4.74 | 4.79 | 4.85 | 4.88 | 4.86 | 4.91 |
| 8/9/2011 | 4.60 | 4.73 | 4.73 | 4.72 | 4.78 | 4.77 | 4.72 | 4.80 | 4.85 | 4.87 | 4.83 | 4.91 |
| 8/10/2011 | 4.60 | 4.72 | 4.73 | 4.73 | 4.78 | 4.77 | 4.74 | 4.79 | 4.84 | 4.85 | 4.84 | 4.87 |

| Last primary market rates | | | | | | | |
|---|---|---|---|---|---|---|---|
| Paper | Au. date | Maturity | Avg. price | Avg. yield | Supply | Demand | Sold |
| 52W TB | 1/31/2011 | 1/31/2012 | 95.84 | 4.35 | 2000 | 2968 | 1961 |
| OK0113 | 4/13/2011 | 1/26/2013 | 89.16 | 5.16 | 5500 | 7385 | 4758 |
| PS0416 | 1/5/2011 | 4/25/2016 | 97.08 | 5.64 | 6500 | 2795 | 1140 |
| DS1020 | 1/12/2011 | 4/25/2019 | 93.02 | 6.21 | 2250 | 4252 | 2250 |

| Fixed income market rates (closing mid-market levels) | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Date | 1Y WIBOR | 1Y T-bill | 2Y IRS | OK0113 | 5Y IRS | PS0416 | 10Y IRS | DS1019 |
| 8/4/2011 | 4.770 | 4.570 | 4.900 | 4.516 | 5.030 | 5.177 | 5.100 | 5.710 |
| 8/5/2011 | 6.590 | 4.530 | 4.887 | 4.581 | 5.057 | 5.231 | 5.147 | 5.724 |
| 8/8/2011 | 4.770 | 4.530 | 4.896 | 4.529 | 5.076 | 5.241 | 5.161 | 5.792 |
| 8/9/2011 | 4.770 | 4.570 | 4.810 | 4.542 | 5.015 | 5.333 | 5.170 | 5.869 |
| 8/10/2011 | 4.770 | 4.570 | 4.610 | 4.472 | 4.840 | 5.259 | 5.070 | 5.798 |

| EUR/PLN 0-delta stradle | | | | | 25-delta RR | | 25-delta FLY | |
|---|---|---|---|---|---|---|---|---|
| Date | 1M | 3M | 6M | 1Y | 1M | 1Y | 1M | 1Y |
| 8/4/2011 | 10.40 | 10.55 | 10.53 | 10.73 | 10.73 | 3.30 | 0.32 | 0.54 |
| 8/5/2011 | 10.40 | 10.55 | 10.53 | 10.73 | 10.73 | 3.30 | 0.32 | 0.54 |
| 8/8/2011 | 10.85 | 10.70 | 10.70 | 10.90 | 10.90 | 3.60 | 0.31 | 0.53 |
| 8/9/2011 | 12.00 | 11.85 | 11.75 | 11.70 | 11.70 | 4.25 | 0.46 | 0.64 |
| 8/10/2011 | 12.90 | 12.65 | 12.50 | 12.50 | 12.50 | 3.62 | 0.47 | 0.65 |

| PLN Spot performance | | | | | | |
|---|---|---|---|---|---|---|
| Date | EURPLN | USDPLN | CHFPLN | JPYPLN | HUFPLN | CZKPLN |
| 8/4/2011 | 4.0278 | 2.8237 | 3.6355 | 3.5537 | 1.4808 | 0.1659 |
| 8/5/2011 | 4.0423 | 2.8572 | 3.7147 | 3.6393 | 1.4785 | 0.1668 |
| 8/8/2011 | 4.0546 | 2.8287 | 3.7220 | 3.6348 | 1.4760 | 0.1673 |
| 8/9/2011 | 4.1033 | 2.8831 | 3.8487 | 3.7303 | 1.4921 | 0.1701 |
| 8/10/2011 | 4.0923 | 2.8485 | 3.9393 | 3.7167 | 1.4923 | 0.1699 |

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