Bureau of Economic Analysis
(research)

Ernest Pytlarczyk, PhD, CFA
chief economist
tel. +48 22 829 01 66
ernest.pytlarczyk@brebank.pl

Marcin Mazurek, PhD
senior analyst
tel. +48 22 829 01 83
marcin.mazurek@brebank.pl

Paulina Ziembinska
analyst
tel. +48 22 829 02 56
paulina.ziembinska@brebank.pl

Andrzej Torój, PhD
analyst
tel. +48 22 526 70 34
andrzej.toroj@brebank.pl

Financial Markets Department
(business contacts)

Lukasz Barwicki
head of trading
tel. +48 22 829 01 93
lukasz.barwicki@brebank.pl

Bartlomiej Malocha, CFA
money market
tel. +48 22 829 01 77
bartlomiej.malocha@brebank.pl

Marcin Turkiewicz
fx market
tel. +48 22 829 01 67
marcin.turkiewicz@brebank.pl

Financial Markets Sales Department
(business contacts)

Inga Gaszkowska-Gebska
institutional sales
tel. +48 22 829 01 67
inga.gaszkowska-gebska@brebank.pl

Jacek Jurczyński
structured products
tel. +48 22 829 15 16
jacek.jurczynski@brebank.pl

Reuters pages:
BREX, BREY, BRET

Bloomberg:
BRE

SWIFT:
BREXPLPW

BRE Bank S.A.
18 Senatorska St.
00-950 Warszawa
P. O. BOX 728
tel. +48 22 829 00 00
fax. +48 22 829 00 33
http://www.brebank.pl

Table of contents

Comment on the upcoming data and forecasts

This week the most important data on the real sphere see the light. The publication streak starts with industrial output on Monday. One working day more on annual basis, solid PMI numbers and considerable improvement in July's VAT revenues suggest output may have staged a rebound which we estimate above market consensus of 3.8%. The same applies to retail sales (more closely related to VAT revenues). On nominal side, producer prices (Monday) are set for another decline, led mainly by further zloty appreciation and mounting slack in the economy. On the consumer's side, core inflation remained stable on higher (monthly basis) prices of package holidays. Overall, the data are likely to spupport a (one-off) brighter picture of the Polish economy. It will be enough to further postpone (at least to some extent) rate cut expectations but not enough the revert overal, falling trend. Last but not least, the qualitative description in the „Minutes" is likely to support the sentiment generated by the data on the real sphere as the MPC is not ready for fast rate cuts, mainly because of credibility issues.

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

Publication	Date	Period	BRE	Consensus	Prior
Industrial output y/y	20.08.	July	4.5	3.8	1.2
Producer prices y/y	20.08.	July	3.8	3.8	4.4
Core inflation y/y	21.08.	July	2.3	2.2	2.3
MPC „Minutes""	23.08.	-	-	-	-
Retail sales y/y	24.08.	July	7.0	6.5	6.4

Treasury bonds and bills auctions

Paper	Next auction	Last Offer	Last yield (%)	Prev auction
52 Week T-bills	-	3000	4.470	3/26/2012
2Y T-bond OK0714	18/25-10-12	5000	4.361	7/19/2012
5Y T-bond PS0417	12/19-09-12	4000	4.361	8/1/2012
10Y T-bond DS1021	12/19-09-12	4000	5.349	5/10/2012
20Y T-bond WS0429	12/19-09-12	4000	5.563	5/10/2012

Macroeconomic forecasts

Wskaźnik	2009	2010	2011	2012 F	2013 F
GDP y/y (%)	1.7	3.8	4.3	2.5	2.1
CPI Inflation y/y (average %)	3.5	2.8	4.2	3.6	2.8
Current account (%GDP)	-1.6	-4.5	-4.9	-2.5	-1.5
Unemployment rate (end of period %)	12.1	12.4	12.5	13.5	14.4
Repo rate (end of period %)	3.5	3.5	4.5	4.3	3.50

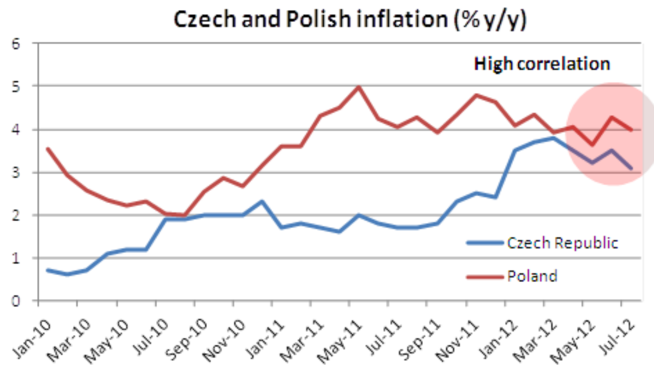
	2011 Q3	2011 Q4	2012 Q1	2012 Q2 F	2012 Q3 F	2012 Q4 F
GDP y/y (%)	4.2	4.3	3.5	2.7	2.2	1.4
CPI Inflation y/y (average %)	4.1	4.6	3.9	4.0	3.9	3.2
Repo rate (end of period %)	4.50	4.50	4.50	4.75	4.75	4.25

F - forecast

Economics

Inflation drops to 4.0%. Unexpectedly low wages.

Consumer prices in July decelerated to 4.0% y/y after they had recorded 4.3% y/y in June. The main driver of the deceleration were food prices that leveled off by 2.2% on monthly basis, fuel prices that dropped by 2.4% and wearing apparel that seasonally decreased by 2.4%. The one offsetting force were prices in recreation and culture, affected by package holidays' prices (domestic ones dropped by 2.7% whereas international by 9.1%). The behavior of Polish inflation almost perfectly reflects the developments in the Czech economy and this applies also to the breakdown. Our calculations show that core inflation remained flat at 2.3% y/y in July.



Next month is likely to bring a slight drop of inflation towards 3.9%. Apart from a base effect on the whole inflation basket, we believe that dry and hot beginning of August and then wet and relatively cold somehow prevented seasonal food items from falling a lot; the more so since the drop recorded in July was a bit more pronounced than usual.

Labor market data were ambiguous. Employment came at 0.0% y/y, therefore as we expected. So far the dynamics of the labor market is low. However, we think that lay-offs are set to intensify as soon as the slowdown becomes more entrenched (and as soon as it filters through decisions of enterprises with an usual time lag). Wages generated a surprise rising 2.4% y/y versus 4.1% expected (we and the market consensus) and 4.3% recorded in the prior month. It may be a tricky surprise, though. Wage growth is smooth as wage cotracts overlap. Therefore it takes time for the slowdown in the economy to be reflected in wages. We think the culprit for downward surprise lies traditionally in mining where some bonuses were not paid in the same amount as in the previous year. Thus we end up in a situation where a surprise look seemingly impressive but does not carry much insight - we do not revise our above consensus industrial output forecast for July (to be published on Monday).

Inflation data catalyzed a minor drop in market rates (2bp) but wage data completely erased it. Lack of further information on wages may provoke some strange, dovish comments from the MPC's side. However, we think that the majority would still present the lack of willingness for fast cuts. It is obvious that this stems from credibility issues. This and a series of somewhat better data for July (industrial output, sales), possibly non-dovish „Minutes" and the ongoing, global reallocation towards more risky assets are factors that can deepen the upward correction in Polish bond yields and swap rates.

Polish budget - temporary improvement in VAT revenues

Budget deficit increased from 20.1 to PLN 24.3bn. Budget performance was worse as compared with previous year (July2012/June2012 deficit increased by 3bn, last year it was only PLN1bn). Comparisons with official plan are naive as there was 8bn NBP profit transfer in June that was not included in the original budget plan.

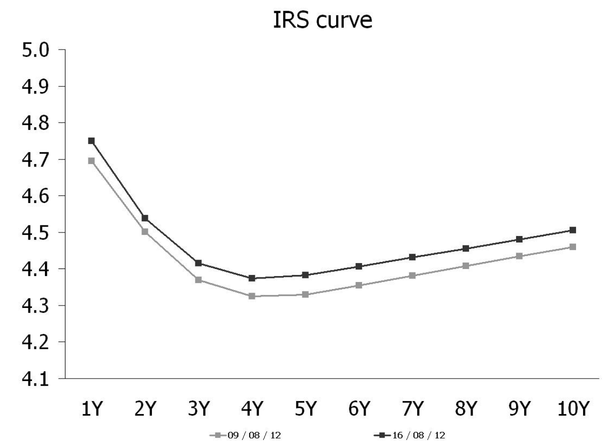
As for the budget details, VAT revenues in July were flat in annual terms (almost -13%yoy in June) but still below last year's level on compounded basis. The data are not great but also point to a slight rebound in economic activity in July. Hence, we stick to our forecasts of almost 5% y/y increase in Industrial output and 7% increase in retail sales. One has to add that one month is not enough to upgrade the whole quarter and also mid-term forecasts (Q2 GDP growth below 2%, slowing consumption, slowing investment, no significant fiscal stimulation, slowing infrastructure against negative/neutral external environment). Slowing growth is set to exert further negative pressure on VAT revenues (we regard this July's improvement as a one off) and other tax revenues. Therefore it would be hard for the government to stick to its convergence plan and we cannot exclude that in such circumstances the government is going to look for some non-standard measures to improve budget performance (see the action undertaken in 2011). Moreover, in these circumstances any fiscal stimulation becomes hard to implement.

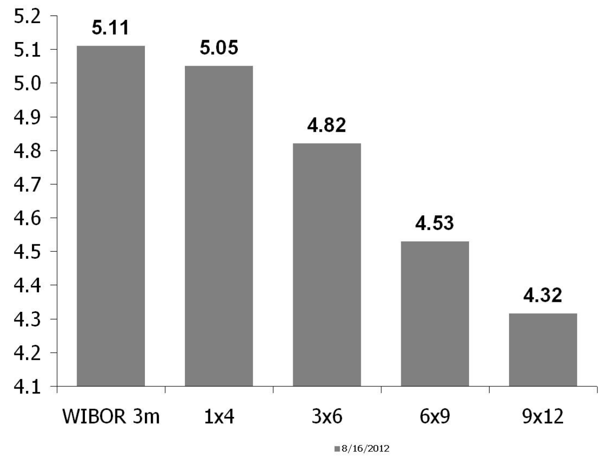
Fixed income

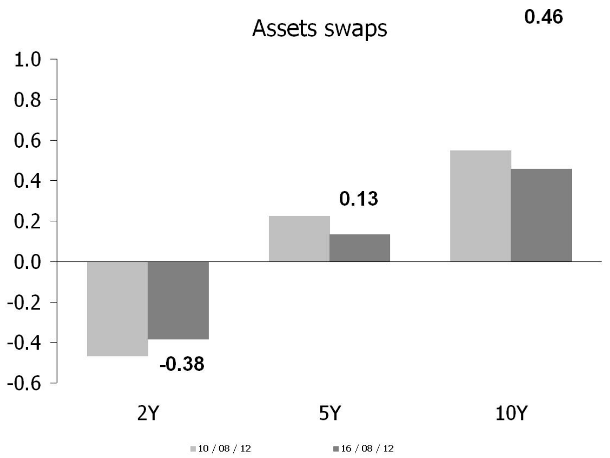
Profit taking

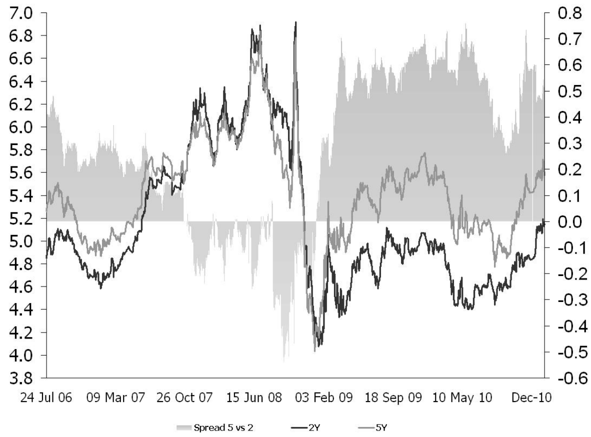
Our market diagnosis was right. As we expected the market took some profits along the yield curve last week. Almost fully priced easing cycle and the historic low long term yields had revoked quite substantial paying interest pushing rates up to 15-20bp. The bearish market had been additionally fueled by quite strong rise in long term yields in core markets. The lower than expected July CPI reading at 4.0% stopped the uptrend only for a while.

We found it a good opportunity to reenter receiving positions in a front end of a yield curve selling 6x9 and 9x12 at 4.55% and 4.30% respectively as we still believe a substantial monetary easing cycle is likely to start in the Autumn. We would also think of taking some steepeners (2y5y spread still around 16 points negative) as the global uptrend in long term yields might influence the PLN curve sooner or later.







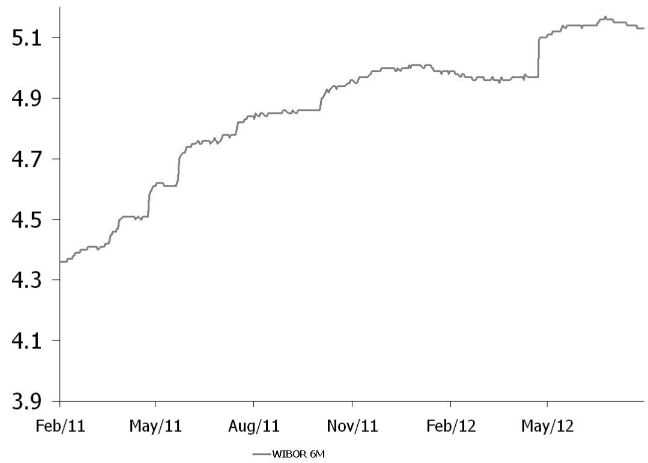


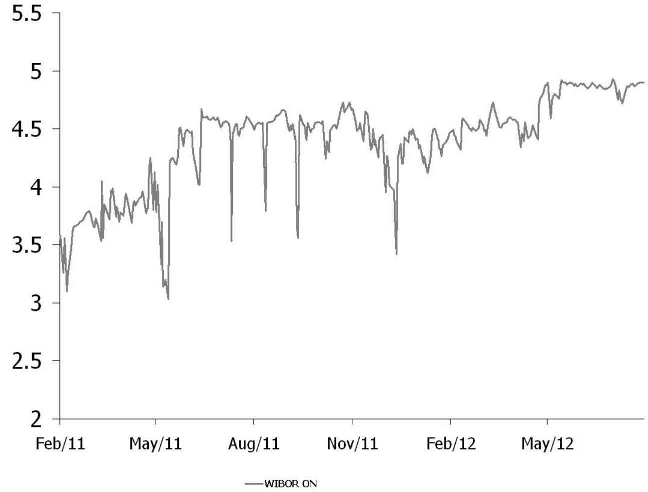
Money market

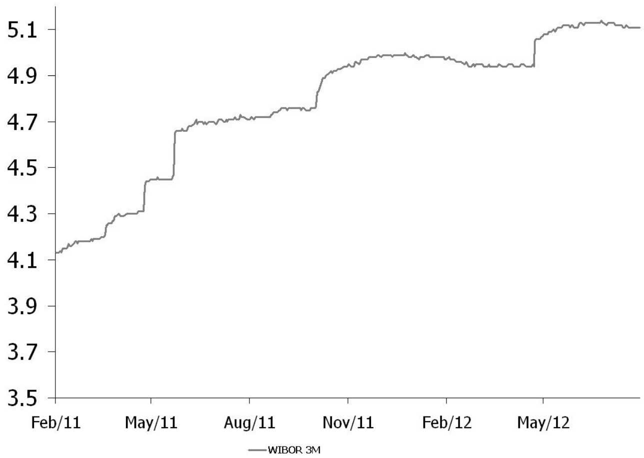
Stable cost of carry. Cost of carry stable nearby the main market rate. Lower demand for money bills (pln 94.3 bln bought out of pln 97.5 bln offered) should push the shortest rates lower. Unless the central bank does additional OMO, the rates should be lower and lower as we are approaching the end of the reserve requirements settlement period.

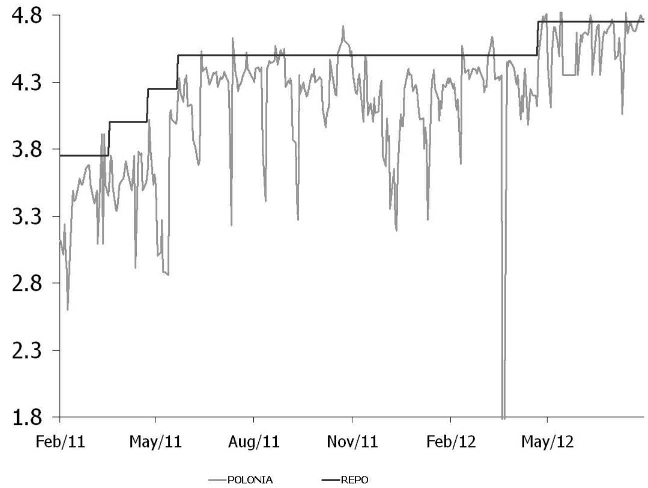
Bit lower CPI without impact on rates. No thrills for the longer term. CPI slightly lower then expectations (4% ag 4.1%), however without any significant impact on rates. 4% is still well above the upper band of the corridor, thus the rates should be left unchanged during the September MPC meeting.

Use any upward correction on rates to receive them.





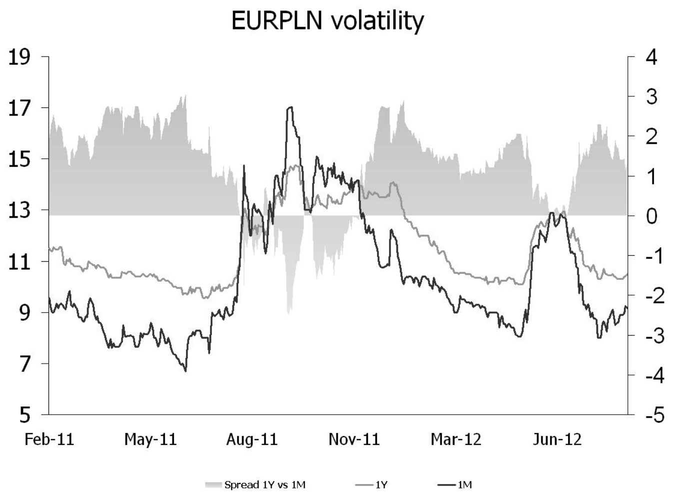




Forex

PLN at highs. As Wednesday was public holiday in Poland, activity during the whole week was subdued. The main drivers are still the same, global sentiment and the chance of US QE3. The local factors, data seem not to have strong influence on PLN at the moment. The EUR/PLN holds the 4.040/4.1000 range for one more week. There were two or three trials to break through 4.1, but the Zloty hold out and we came back in the vicinity of the 4.07.

Stable. During the most time of the last week the Zloty was traded in the narrow range and realized volatility has fallen. So there is nothing strange that the ATM's Volatility and the skew were hammered hard especially this short term. The fresh optimism is winning. The 1 week moved down from 9.0% to 7.75%, 1 month from 9.0% to 8.4%. 1 year is now 10.35%. 1 year 25D Risk reversals dropped from 3.7% to 3.5%, 3m 25d RR is now 2.25% versus 2.4% last week

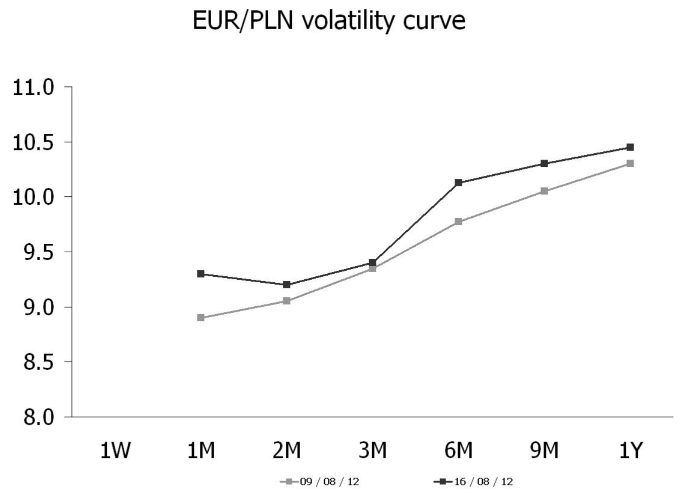


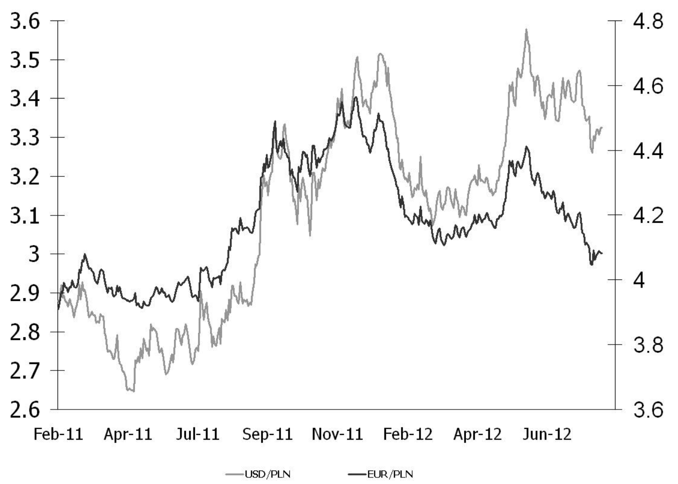
Short-term forecasts.

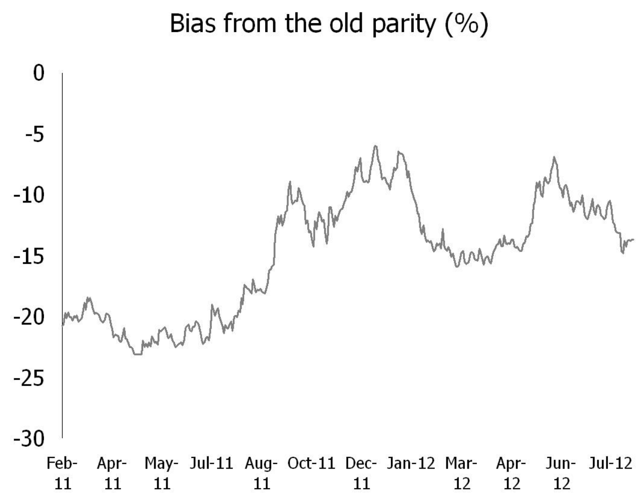
Main supports and resisances
EUR/PLN: 4.0250 / 4.1400
USD/PLN: 3.2400 / 3.4000

Spot. Play the range. 4.10 should be tough to get through in the absence of any fresh impulses. In turn 4.0 is the psychological support and it should see some decent bids on the way to this level. We actually think that lack of QE 3 is a game changer.

Derivatives. Hold vega. We are holding our core long in the backend of EURPLN curve. We are eager to add to the position if we see a substantially lower levels (arr. 1%). We still believe in the mean reverting nature of the vols, and hoping to see a upticks in vols in the weeks to come.







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
8/9/2012	4.98	5.11	4.99	6.49	5.02	6.59	5.01	4.79	4.49	4.26	4.12	4.51
8/10/2012	4.90	5.11	4.99	5.03	4.97	5.04	5.05	4.82	4.52	4.26	4.11	4.56
8/13/2012	4.95	5.11	5.00	5.03	4.90	5.04	5.04	4.81	4.49	4.26	4.14	4.53
8/14/2012	4.93	5.11	5.05	5.03	5.03	5.03	5.04	4.82	4.49	4.29	4.10	4.52
8/16/2012	4.75	5.11	4.79	5.03	4.79	5.03	5.05	4.82	4.53	4.32	4.13	4.56

Last primary market rates							
Paper	Au. date	Maturity	Avg. price	Avg. yield	Supply	Demand	Sold
52W TB	5/30/2011	5/30/2012	95.57	4.58	600	2667	505
OK0114	8/10/2011	1/25/2013	89.58	4.58	5000	4934	1889
PS1016	10/19/2011	10/25/2016	98.44	5.11	3600	11200	3638
DS1021	7/21/2011	10/25/2021	99.53	5.80	3000	5608	3000

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0113	5Y IRS	PS0416	10Y IRS	DS1019
8/9/2012	6.590	4.813	4.501	4.066	4.329	4.509	4.460	4.943
8/10/2012	5.040	4.813	4.525	4.060	4.350	4.573	4.460	5.007
8/13/2012	5.040	4.813	4.490	4.130	4.338	4.546	4.450	4.980
8/14/2012	5.030	4.813	4.495	4.122	4.335	4.544	4.436	4.969
8/16/2012	5.030	4.813	4.538	4.154	4.383	4.515	4.505	4.962

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
8/9/2012	8.90	9.35	9.78	10.30	10.30	3.57	0.77
8/10/2012	8.90	9.35	9.78	10.30	10.30	3.57	0.77
8/13/2012	8.95	9.50	9.88	10.40	10.40	3.57	0.78
8/14/2012	9.25	9.50	9.98	10.40	10.40	3.56	0.78
8/16/2012	9.30	9.40	10.13	10.45	10.45	3.55	0.78

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
8/9/2012	4.0615	3.2915	3.3816	4.1925	1.4652	0.1616
8/10/2012	4.0771	3.3195	3.3949	4.2287	1.4661	0.1625
8/13/2012	4.0823	3.3202	3.3989	4.2477	1.4643	0.1627
8/14/2012	4.0888	3.3059	3.4048	4.2098	1.4652	0.1630
8/16/2012	4.0820	3.3253	3.3998	4.2007	1.4668	0.1639

Disclaimer