



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

Piotr Bartkiewicz
analyst
tel. +48 22 526 70 34
piotr.bartkiewicz@brebank.pl

Marek Ignaszak
analyst
tel. +48 22 829 02 56
marek.ignaszak@brebank.pl

Piotr Bartkiewicz
analyst
tel. +48 22 526 70 34
piotr.bartkiewicz@brebank.pl

Financial Markets Department
(business contacts)

Bartłomiej Malocha, CFA
head of interest rates trading
tel. +48 22 829 01 77
bartlomiej.malocha@brebank.pl

Marcin Turkiewicz
head of fx trading
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

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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>

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Comment on the upcoming data and forecasts

Current account balance will be released on Monday. The data will be strongly influenced by the EU transfers and seasonal anomalies in the trade account (we expect a modest surplus). Probably the most important event is the flash GDP estimate (to be released on Wednesday). We expect the growth rate in Q2 to be slightly higher than in Q1. The positive contribution of well performing manufacturing production will be offset by a continued slowdown in construction. CPI (also released on Wednesday) is expected to rebound strongly, partly due to one-offs (hike in waste disposal fees, decrease in costs of electrical energy and roaming). Furthermore M3 growth rate data is also to be released next week - we expect the trend on money supply growth rates to stabilize.

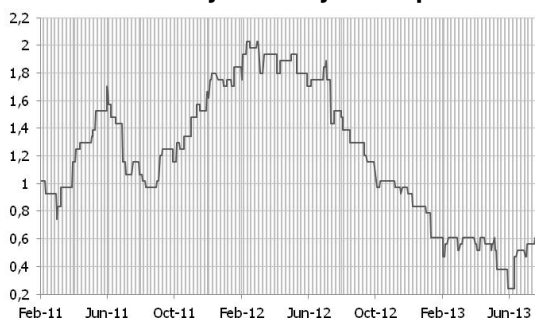
Polish data to watch: August 12th to August 16th

| Publication | Date | Period | BRE | Consensus | Prior |
|--------------------------------|-------|--------|-------|-----------|-------|
| Current account (mln EUR) | 12.08 | Jun | -67 | 225 | 574 |
| Exports (mln EUR) | 12.08 | Jun | 12740 | 12770 | 12385 |
| Imports (mln EUR) | 12.08 | Jun | 12600 | 12521 | 12272 |
| GDP q/q <i>preliminary</i> (%) | 14.08 | q2 | 0.7 | 0.8 | 0.5 |
| CPI y/y (%) | 14.08 | Jul | 0.7 | 0.5 | 0.2 |
| M3 y/y (%) | 14.08 | Jul | 7.2 | 7.1 | 7.1 |

Treasury bonds and bills auctions

| Paper | Next auction | Last Offer | Last yield (%) | Prev auction |
|-------------------|--------------|------------|----------------|--------------|
| 52 Week T-bills | - | 3000 | 3.485 | 3/4/2013 |
| 2Y T-bond OK0715 | - | 3000 | 2.961 | 8/7/2013 |
| 5Y T-bond PS0718 | - | 4500 | 3.303 | 6/6/2013 |
| 10Y T-bond DS1023 | - | 3000 | 3.290 | 5/16/2013 |
| 20Y T-bond WS0429 | - | 150 | 3.464 | 5/16/2013 |

Reality vs analysts' expectations (surprise index* for Poland)



Comment

Polish surprise index unchanged – there were no data releases this week. CPI release next week offers the best chance for surprises – the number of one-offs this time makes the figure very difficult to forecast. The index is clearly forming an upward trend, though.

* Surprise index presents in a synthetic way how the market was surprised by macroeconomic releases (it is constructed on daily basis as weighted average of differences between selected releases and Bloomberg forecast consensus).



Our view in a nutshell

Fundamentals

- Available data confirm economy hit the bottom in Q1, recovery is in the pipeline.
- The upswing will be primarily driven by a rebound in real income and recovering private consumption. Low rates trigger rotation in households assets towards overnight deposits. Given the scale of slack in investment (infrastructure in particular) and consumption, rebound generated this way may be initially moderate (no more than 2% y/y growth rate in Q4 2013), albeit higher than current market consensus dominated by rather gloomy visions. Better business activity in the euro zone is going to strengthen the upswing trajectory, but we do not believe it is crucial for recovery to come at all.
- Polish government committed to the convergence path, though in a very unorthodox and elastic way. As the European Commission gave the government two additional years to bring the GG deficit down to 3%, budget amendment is coming at PLN +16 bn to deficit. This - along with the political business cycle - opens room for fiscal stimulation. Formal acceptance of the EC (and overall trend of consolidation's fatigue) suggests the market should digest this information easily.
- We witnessed the steepest disinflation phase in Polish history. 0.2% inflation growth was the lowest in the cycle. From July on prices are set to slowly accelerate. Core inflation is going to stay rather subdued, though.
- Despite low inflation, there is no support for further easing within the MPC, the more so since the momentum in the real economy improved. July rate cut marked the end of the easing cycle. We expect first rate hikes to materialize in late 2014 and think that NBP projections of both GDP and inflation for 2014 are too pessimistic.

Financial markets

- Better string of data is able to generate positive momentum on rate hike expectations. We still note that NBP may also use unconventional tools to boost banks' demand for government papers (we believe in such scenario even more after most recent outflow of foreign funds from bond market and FX intervention).
- Longer end is not a safe bet. Notwithstanding the local factors, global recovery (or monetary stimulus and liquidity withdrawal) and rising core yields will adversely affect Polish bonds. Fed-induced higher volatility has already been doing its job, especially on the long end.
- The "wall of money" obscured the cyclicity of the Polish currency. This fact was revealed when expectations on QE tapering accelerated and the zloty dynamically breached 4.22/25 and broke out of the 1 year range. We expect a return below 4.20 when the economy accelerates visibly (long into H2) or/and rate hike expectations gain momentum (a turn of 2013/2014). At the moment QE tapering game is going to support the weakness of the zloty.

BRE forecasts

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 F |
|-------------------------------------|------|------|------|------|------|--------|
| GDP y/y (%) | 5.1 | 1.6 | 3.9 | 4.5 | 1.9 | 1.1 |
| CPI Inflation y/y (average %) | 4.3 | 3.5 | 2.8 | 4.2 | 3.7 | 0.8 |
| Current account (%GDP) | -5.3 | -1.6 | -4.5 | -4.9 | -3.5 | -1.9 |
| Unemployment rate (end of period %) | 9.5 | 12.1 | 12.4 | 12.5 | 13.4 | 13.7 |
| Repo rate (end of period %) | 5.00 | 3.50 | 3.50 | 4.50 | 4.25 | 2.50 |

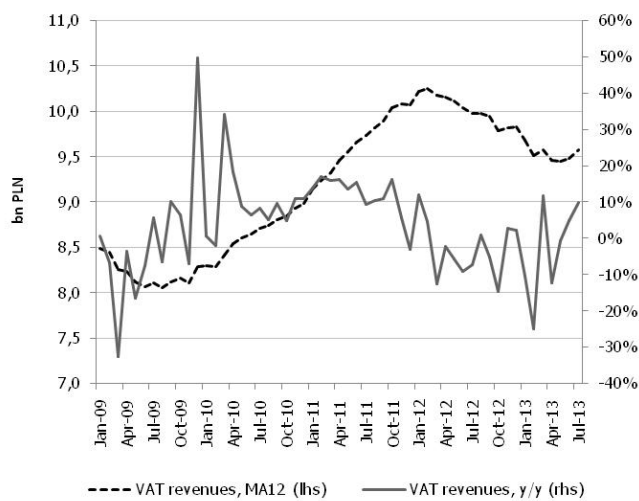
| | 2012 | 2012 | 2012 | 2012 | 2013 | 2013 | 2013 | 2013 |
|--------------------------------|------|------|------|------|------|------|------|------|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 F | Q3 F | Q4 F |
| GDP y/y (%) | 3.5 | 2.3 | 1.3 | 0.7 | 0.5 | 0.7 | 1.3 | 2.0 |
| Individual consumption y/y (%) | 1.7 | 1.3 | 0.2 | -0.2 | 0.0 | 0.7 | 1.6 | 1.9 |
| Public Consumption y/y (%) | -1.0 | 0.4 | 1.6 | -0.6 | -0.5 | -0.5 | 0.2 | 0.2 |
| Investment y/y (%) | 6.8 | 1.4 | -1.7 | -4.1 | -2.0 | -3.5 | -2.0 | -1.2 |
| Inflation rate (% average) | 3.9 | 4.0 | 3.9 | 2.9 | 1.3 | 0.5 | 0.3 | 0.9 |
| Unemployment rate (% eop) | 13.3 | 12.4 | 12.4 | 13.4 | 14.3 | 13.2 | 13.3 | 13.7 |
| NBP repo rate (% eop) | 4.50 | 4.75 | 4.75 | 4.25 | 3.25 | 2.75 | 2.50 | 2.50 |
| Wibor 3M (% eop) | 4.94 | 5.13 | 4.92 | 4.11 | 3.39 | 2.73 | 2.70 | 2.70 |
| 2Y Polish bond yields (% eop) | 4.62 | 4.60 | 4.05 | 3.14 | 3.19 | 3.07 | 2.85 | 2.90 |
| 10Y Polish bond yields (% eop) | 5.50 | 5.15 | 4.69 | 3.74 | 3.94 | 4.34 | 4.00 | 4.40 |
| EUR/PLN (eop) | 4.15 | 4.22 | 4.12 | 4.08 | 4.18 | 4.33 | 4.20 | 4.10 |
| USD/PLN (eop) | 3.11 | 3.35 | 3.20 | 3.09 | 3.26 | 3.32 | 3.36 | 3.36 |

F - forecast

Economics

Preliminary budget figures indicate rebound in economic activity

According to comments from various high-ranking MinFin officials, budget deficit barely changed after July and remained on schedule. Keeping up with the ambitious schedule in the face of a severe downturn is indicative of unconventional measures - NBP's profit (more than 5 bn PLN) is traditionally a "surprise" (a very small amount is always assumed) and the state pension fund's (FUS) deficit is financed with a loan instead of a subsidy. Nevertheless, the yawning shortfall in tax revenues has already forced the government to amend the budget - the amendment is expected to be unveiled later this month.



Beyond the often uninformative aggregates we like to look at VAT expenditures, as these (despite the lag) are closely related to (nominal) domestic demand. As MF reported, VAT revenues have increased by 10% y/y in July which marks a continuation of recent uptrend. The turnaround is visible regardless of the choice of indicators, as seen on the graph above. Furthermore, the solid increases in VAT revenues might actually lead to an upside surprise in budget performance in the latter half of the year. While the amendment is needed either way, a stronger-than-expected rebound in indirect taxes could change the mix of measures the government is deploying in the amendment (2/3 - increase in deficit, 1/3 - expenditure cuts), possibly completely reducing the need to cut expenditures.



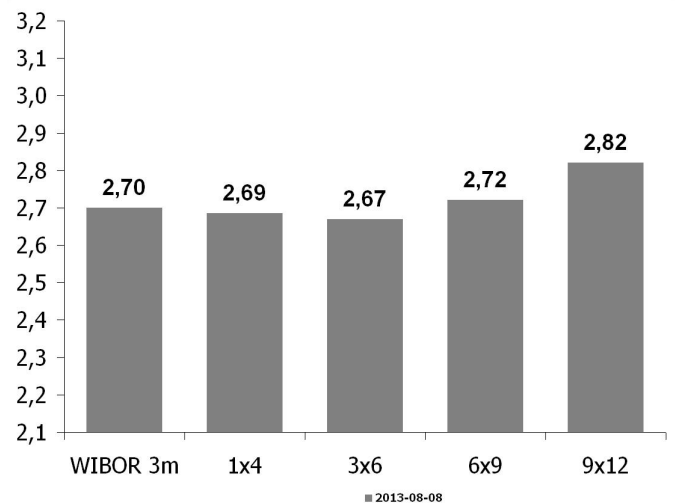
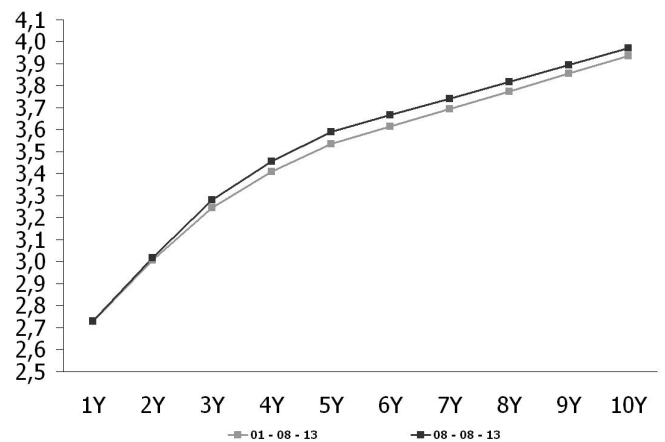
Fixed income

Waiting for a trend

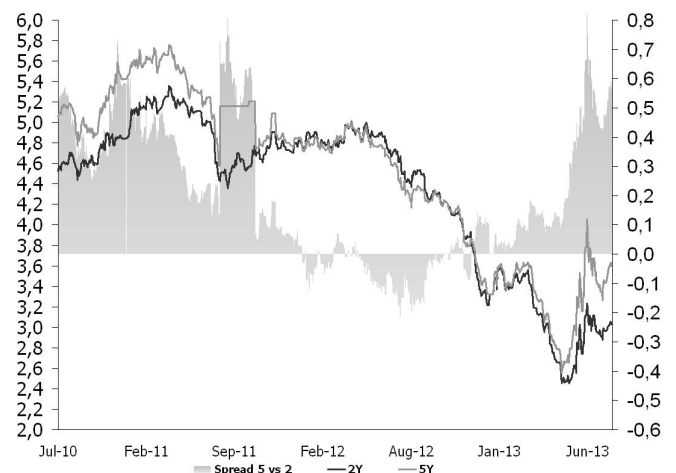
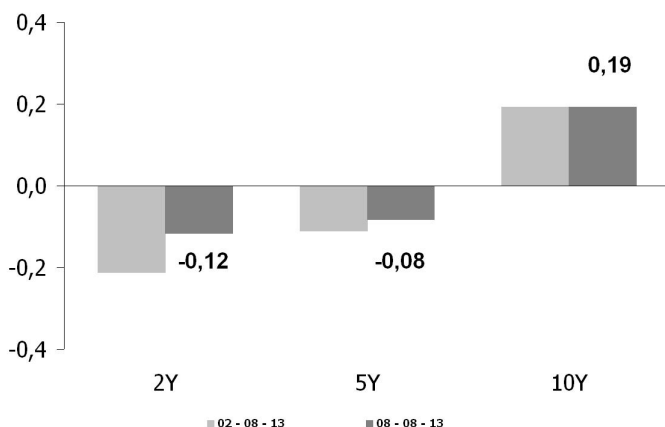
Last week the rollercoaster on PLN rates persisted. The correlation between upward and downward moves on the domestic yield curve and the core markets remained substantially high.

We could observe some paying interest in 2y5y spread (which went up by 10-12bp from 47 to 59) that was supposed to be driven by the clients' inflows. What was interesting and most awkward to us, was that the short end of the yield curve still traded below the WIBOR rates and that the market still underestimated the scale and the pace of the domestic economy recovery. We expect that the next 2 weeks will bring a crucial reversal in macro data (the bottom readings seem to be behind us) that might show we could face a really strong signal for higher inflation, better industrial output and retail sales resulting in growing expectations that the next tightening cycle could be closer than anyone expected. As we look at the yield curve, we believe all forward rates over 9 months are completely mispriced and worth paying before the figures.

IRS curve



Assets swaps

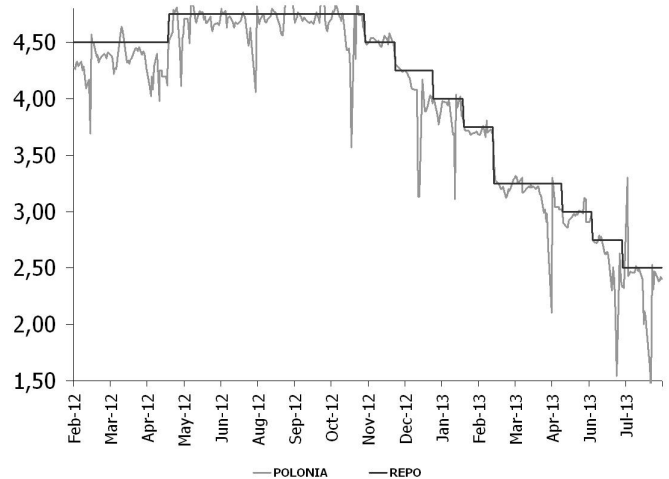
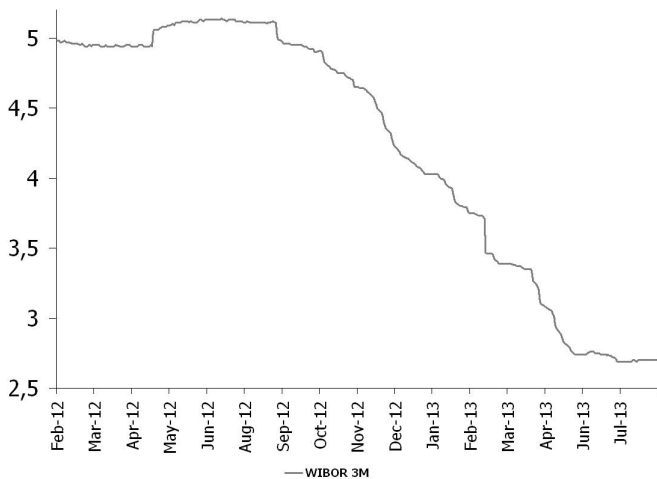
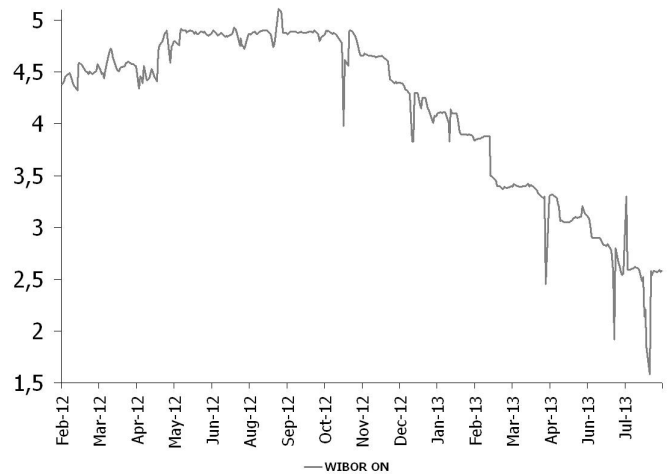
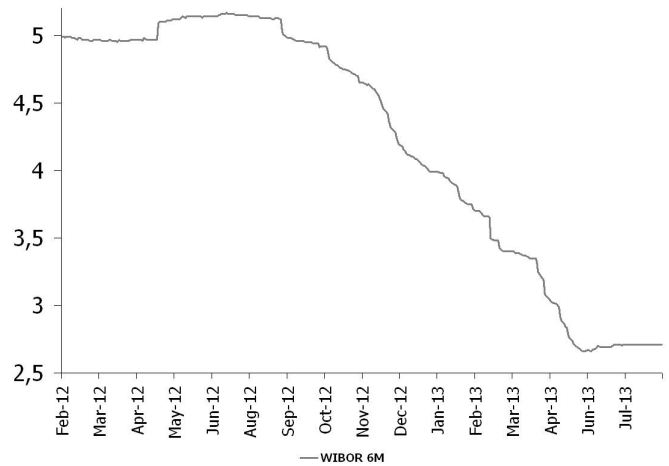




Money market

Holiday mood rules Nothing much really for short rates. Full holiday mood that is going to be strongly supported by next week's public holiday, hence longer weekend for many.

Today's OMO squared the market. Rates up to 2 years stuck waiting for data. Still opportunity to buy some FRAs below or near the current WIBOR rates which might be a good idea. We especially like December contracts, since historically WIBOR was growing at the end of the year. Once it grows it will not slip down again and that is for sure.





Forex

4,2000 support broken Seems like NFP did the trick. After the good but not exceptionally good NFP number, the USD was back on defense. Losses on USD/PLN translated into EUR/PLN, finally breaking the 4.20 (unbreakable support) with a splash. The big question is how come could USD run out of steam with such a big percentage of market participants believing in tapering of QE this year? Technically, after breaking 4.20, EUR/PLN has no real obstacle till 4.15/4.16 support zone.

Front of the curve lower The option market's assumption seems to be that we have to wait till the next NFP and FOMC to get excited again. As a consequence, frontend vol/Gamma was heavily offered on the market. 1 month EUR/PLN ATM mid is fixing 6.8% (0,5 pp. lower then the last week), 3 months are 0.2 pp. lower to 7.4% and 1year is merely 0.1 pp. lower to 8.9%. We have seen healthy demand for USD/PLN vol, especially 2 month and 3 months. Skew is unchanged from the last week.

Short-term forecasts

Main supports / resistances:

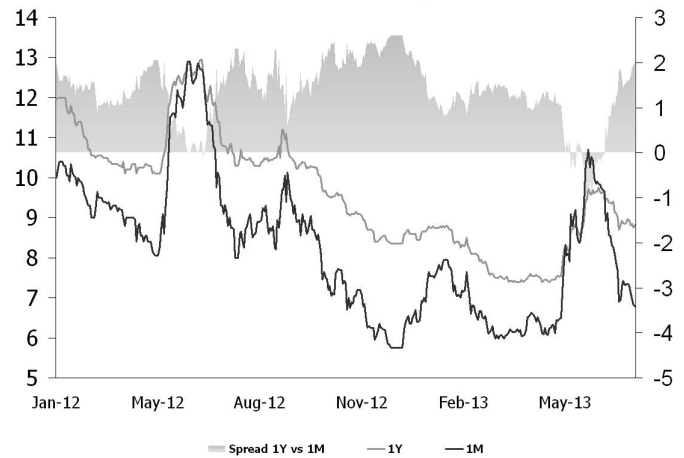
EUR/PLN: 4.1500 / 4.26

USD/PLN: 3.0500 / 3.3000

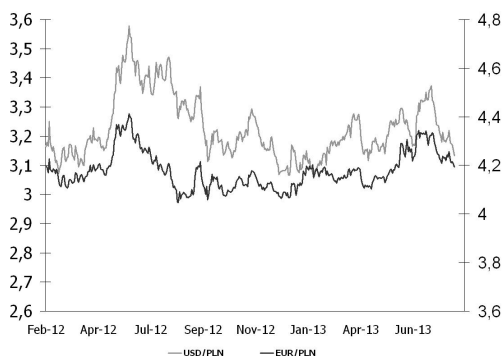
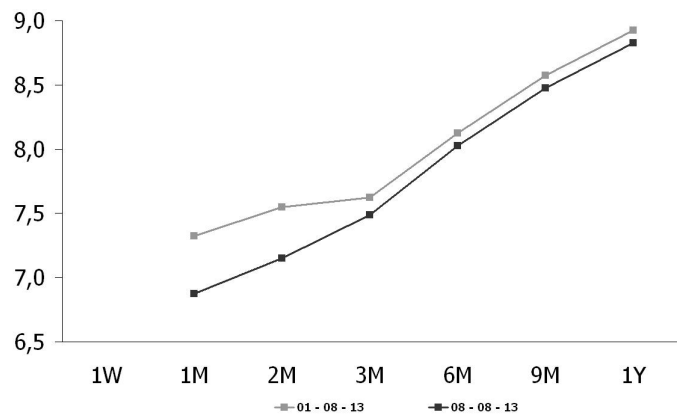
Sidelined Last week long from 4.2060, stopped in profit at 4.2250. Now we are sidelined, the picture is too blurred. Technically we may attempt to sell 4.1980/4.2030 with stop above 4.22 and hopes for 4.1600, but with no real conviction.

Derivatives The break of 4.20 support in EUR/PLN made us more cautious about being long EURPLN vol. We have squared the same of the frontend vol. We still tactically long backend of the curve. The correlation between spot and the level of vols is really strong in EUR/PLN. Because of that we can expect higher vol, only in tandem with weaker PLN. We don't see that happening in a short period of time.

EURPLN volatility



EUR/PLN volatility curve



Bias from the old parity (%)





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 |
| 8/2/2013 | 2.38 | 2.70 | 2.49 | 6.49 | 2.70 | 6.59 | 2.68 | 2.67 | 2.71 | 2.81 | 2.99 | 2.80 |
| 8/5/2013 | 2.36 | 2.70 | 2.42 | 2.61 | 2.56 | 2.64 | 2.69 | 2.68 | 2.72 | 2.83 | 2.99 | 2.81 |
| 8/6/2013 | 2.37 | 2.70 | 2.52 | 2.61 | 2.73 | 2.64 | 2.69 | 2.69 | 2.73 | 2.84 | 3.03 | 2.82 |
| 8/7/2013 | 2.37 | 2.70 | 2.51 | 2.61 | 2.73 | 2.64 | 2.66 | 2.67 | 2.73 | 2.84 | 3.01 | 2.82 |
| 8/8/2013 | 2.36 | 2.70 | 2.49 | 2.61 | 2.68 | 2.64 | 2.69 | 2.67 | 2.72 | 2.82 | 2.98 | 2.83 |

| 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 |
| 8/2/2013 | 6.590 | 3.353 | 3.292 | 3.275 | 3.420 | 3.351 | 3.630 | 3.873 |
| 8/5/2013 | 2.640 | 3.114 | 3.263 | 3.148 | 3.370 | 3.270 | 3.575 | 3.755 |
| 8/6/2013 | 2.640 | 2.992 | 3.218 | 3.137 | 3.325 | 3.237 | 3.525 | 3.759 |
| 8/7/2013 | 2.640 | 2.992 | 3.218 | 3.137 | 3.325 | 3.237 | 3.525 | 3.759 |
| 8/8/2013 | 2.640 | 2.992 | 3.218 | 3.137 | 3.325 | 3.237 | 3.525 | 3.759 |

| EUR/PLN 0-delta stradle | | | | | 25-delta RR | | 25-delta FLY |
|-------------------------|------|------|------|------|-------------|------|--------------|
| Date | 1M | 3M | 6M | 1Y | 1M | 1Y | 1Y |
| 8/2/2013 | 7.09 | 7.51 | 8.00 | 8.81 | 8.81 | 2.61 | 0.73 |
| 8/5/2013 | 6.96 | 7.48 | 8.03 | 8.85 | 8.85 | 2.61 | 0.73 |
| 8/6/2013 | 6.83 | 7.41 | 7.94 | 8.75 | 8.75 | 2.67 | 0.77 |
| 8/7/2013 | 6.79 | 7.38 | 7.98 | 8.83 | 8.83 | 2.61 | 0.69 |
| 8/8/2013 | 6.88 | 7.49 | 8.03 | 8.83 | 8.83 | 2.65 | 0.77 |

| PLN Spot performance | | | | | | |
|----------------------|--------|--------|--------|--------|--------|--------|
| Date | EURPLN | USDPLN | CHFPLN | JPYPLN | HUFPLN | CZKPLN |
| 8/2/2013 | 4.2558 | 3.2201 | 3.4350 | 3.2328 | 1.4172 | 0.1637 |
| 8/5/2013 | 4.2211 | 3.1771 | 3.4221 | 3.2279 | 1.4132 | 0.1630 |
| 8/6/2013 | 4.2107 | 3.1744 | 3.4196 | 3.2256 | 1.4084 | 0.1624 |
| 8/7/2013 | 4.2153 | 3.1725 | 3.4208 | 3.2693 | 1.4061 | 0.1622 |
| 8/8/2013 | 4.2045 | 3.1503 | 3.4176 | 3.2707 | 1.4066 | 0.1624 |

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