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

Financial Markets Department
(business contacts)

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

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

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

Jaroslaw Stolarczyk
structured products
tel. +48 22 829 01 67
jaroslaw.stolarczyk@brebank.pl

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

On Monday employment and wages data will be published. In employment we predict marginal seasonal growth. Wages in manufacturing stabilized at level above 5%. Generally labor market seems to have achieved temporary low growth equilibrium. On Tuesday industrial production and PPI inflation will be released. Lower forecasts in production due to statistical base effects and overall deceleration of economic activity.

Polish data to watch, June 27 to June 30

Publication	Date	Period	BRE	Consensus	Prior
Employment (r/r, %)	18-07-2011	Jun	3.4	3.5	3.6
Wages (r/r, %)	18-07-2011	Jun	4.4	4.8	4
Industrial production (r/r, %)	19-07-2011	Jun	4.9	5.8	7.7
PPI (r/r, %)	19-07-2011	Jun	5.6	5.6	6.5

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	8/10/2011	3000	4.840	6/9/2011
5Y T-bond PS0416	8/10/2011	3000	5.614	18/5/2011
10Y T-bond DS1020	7/21/2011	2250	6.210	1/12/2011
20Y T-bond WS0429	9/22/2011	250	6.246	1/12/2011

Macroeconomic forecasts

Wskaźnik	2007	2008	2009	2010	2011F
GDP y/y	6.5	4.8	1.7	3.8	4.2
CPI Inflation (average), y/y	2.4	4.3	3.5	2.8	4.3
Current account (%GDP)	-4.5	-5.3	-1.6	-4.5	-4.9
Unemployment rate (end of period)	11.4	9.5	11.9	12.3	11.9
Repo rate (end of period)	5.0	5.0	3.5	3.50	4.75

	2010			2011		
	Q2	Q3	Q4	Q1F	Q2F	Q3F
GDP y/y	3.5	4.2	4.5	4.4	4.5	4
CPI Inflation (average), y/y	2.1	2.6	2.9	3.7	4.2	4.2
Repo rate (end of period)	3.5	3.5	3.5	4	4.50	4.50

F - forecast

Economics

Polish inflation down on month and in mid-term (projection) as well.

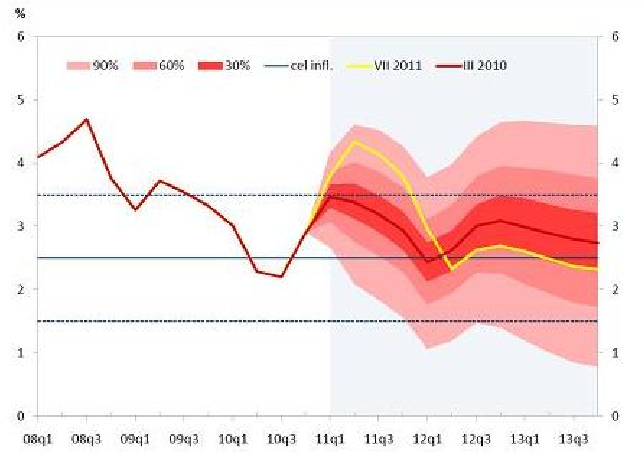
According to NBP's experts, inflation will monotonically deteriorate in the forthcoming 4 quarters. New projection implies that in the mid-term (at the end of 2013) inflation path will be about 0.4pp lower than in projection from March and therefore below the target rate (changes mainly due to reference rate hikes in Q2 2011 and assumption on decreasing food and energy prices growth rate). What is more, projected GDP growth is also lower than previously forecast due to monetary tightening, cost pressures and planned fiscal tightening.

It seems ironic that Belka's statement that the further inflation goes up the faster it fall came true after one month... After CPI hit 5.0% y/y in May, it went down to 4.2% in June (market expectations 4.8%). The main driver of inflation were food prices which decreased 1.8% on the last month (it looks like a correction of recent extraordinary rises, it also follows regional patterns - sharp falls in seasonal food were recorded the day before in Czech Republic and Hungary); also there was a surprise in communications (1.7% down) on some promotion in one of cellular networks. Other categories were hardly surprising and we cannot spot a reliable clue on the change of recent (upward) trend. We estimate core inflation at 2.4% - this most stable measure is still pointing upwards, reinforcing the one-off flavor of the headline reading.

One-off or not, the market outpriced more from not a complete single hike it was discounted in the Autumn (more than 10bp down the curve) before publication. Blank period in MPC calendar is likely to support such a movement, along with a weaker set of data following soft path fallout from abroad (debt crisis at the eurozone periphery is also a strong supporter of wait-and-see stance). However, we do not believe that such a tendency is likely to stay there for longer than 2-3 months. Core inflation is not going to level-off sharply anytime soon. Therefore, we may the start to price in more hikes in September/October, the more so energy prices are set to rise in coming months, marking the beginning of a secular trend connected with aggressive investment process in power stations owing to the obsolescence of capital. Also the "hard" data may start surprising to the upside as soon as soft patch ends and it would be then hard to price out further hikes. However, it is distant future and the trend towards lower rate expectations in the coming month will prevail.

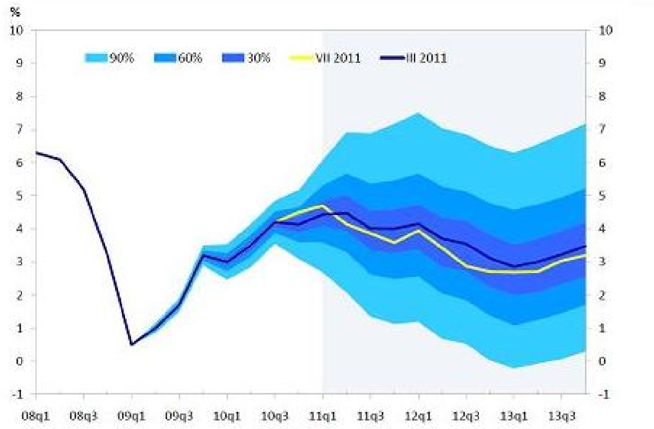
MPC members comments support (although in various ways) statement made after the decision in July. Kazmierczak and Zielinska-Glebocka remain hawkish as they point at still high NBP inflation projection (according to which inflation won't level-off below 4% in 2011) and uncertain return to the target rate in the mid-2012, which imposes risks on redistribution of national income and intensified inflationary pressures. Such comments, which do not focus on one-off June data lay foundations for possible Autumn hike. On the contrary, dovish Chojna-Duch (who voted against hikes in April and May) stressed June inflation decrease and risks which further monetary tightening can pose for economic growth (especially simultaneously with fiscal tightening). Still, majority of MPC shares the "wait-and-see" Belka's view.

Chart 1: CPI projection (March and July)



Source: NBP

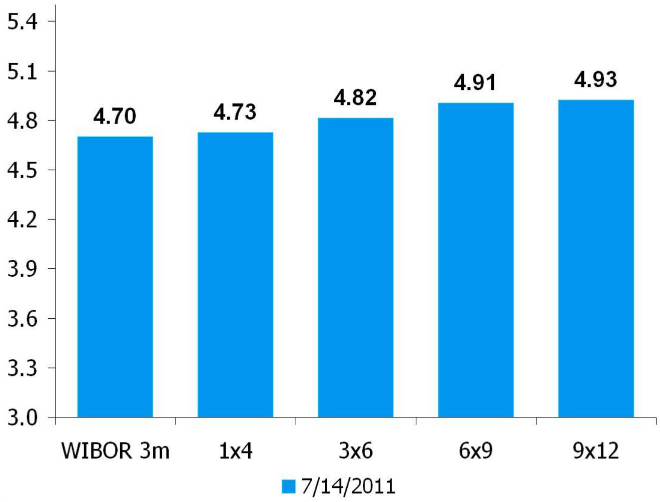
Chart 2: GDP growth projection (March and July)



Source: NBP

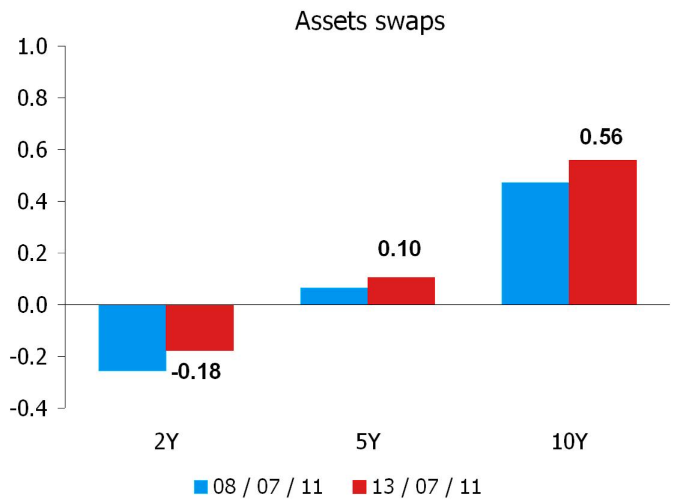
Fixed income

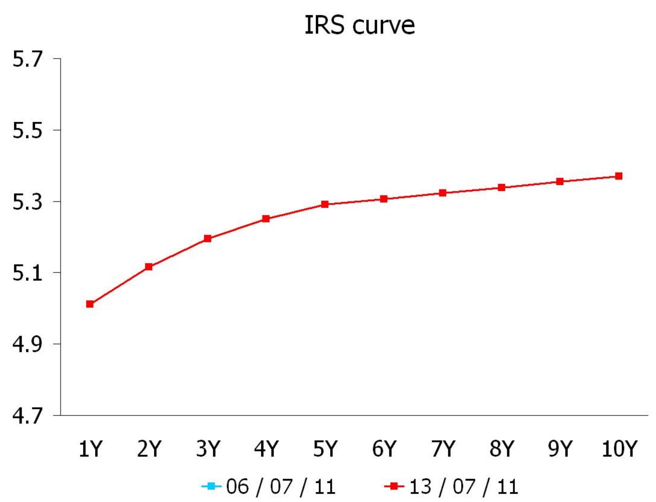
CPI not so scary anymore.

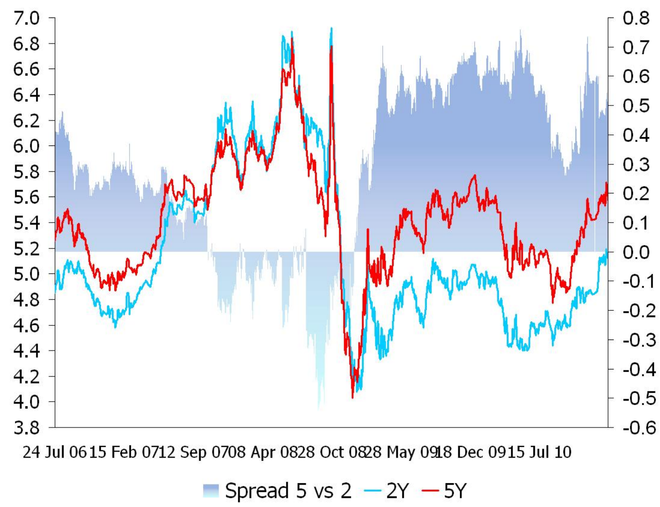


CPI data surprised the market again, first time this year on the downside though. Headline figure falling from 5.0% to 4.2% caused quite a massive rally on rates. Curve moved down rapidly by some 10bp parallely, then the move continued, adding few more bp, with 2y and 5Y trading lowest at 4.95% and 5.13% respectively. Only one month of lower inflation is surely not enough to announce the end of the tightening cycle, but definitely something has changed. It looks more likely now, that the 100bp hikes already made could actually be sufficient to contain inflation, which probably have topped already and will start moving back towards target. Would the pace of that be satisfactory for the rate setters or whether we won't see another higher reading this year, which could result in another 25hike by the end of year is to early to decide. Nevertheless this one more hike is still priced in the curve. What's more interesting is the shape of the curve further on. Market seems to be constantly in the denial phase and forward curve remain positive in 1y1y and 1y2y sectors. Moreover 1y2y is not only higher, but also steeper which is completely unjustifiable.

Since we've just witnessed a significant move, some consolidation at these levels or even some correction seems likely. However if we see further confirmations from other data and next months' inflation figures, we should see MPC claiming they've achieved what they wanted and therefore end of the hiking cycle. Next step from that point would be finally seeing that beginning of next year CPI will start falling very, very quickly due to massive base effects. If we see additionally any sign of economic slowdown or effect of CHFPLN rate on consumer spending, that would be the point where market will start pricing in easing next year, and those forwards will invert. No matter how long this denial phase lasts, such scenario is inevitable.



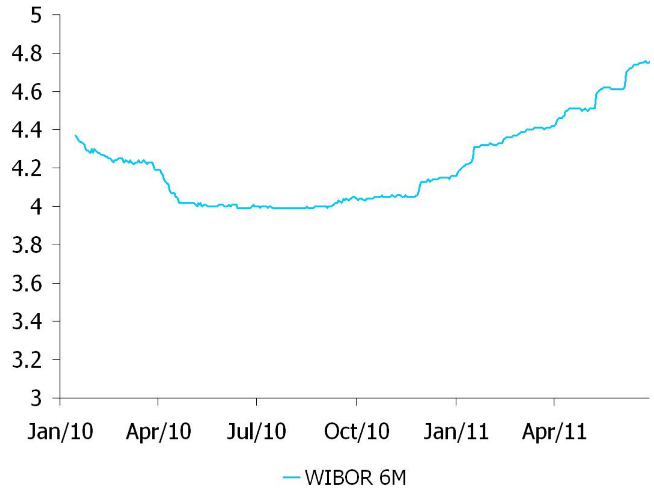


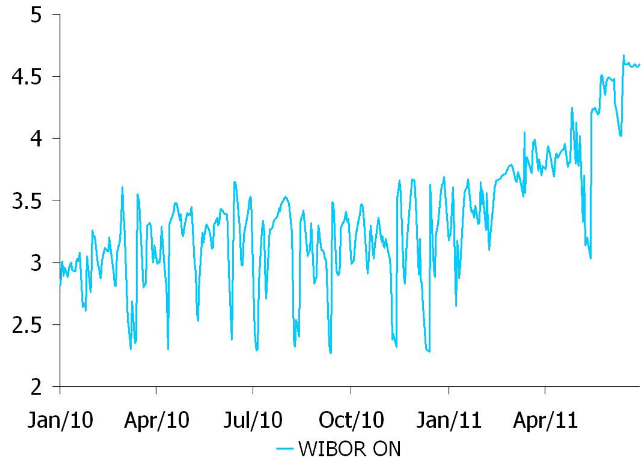


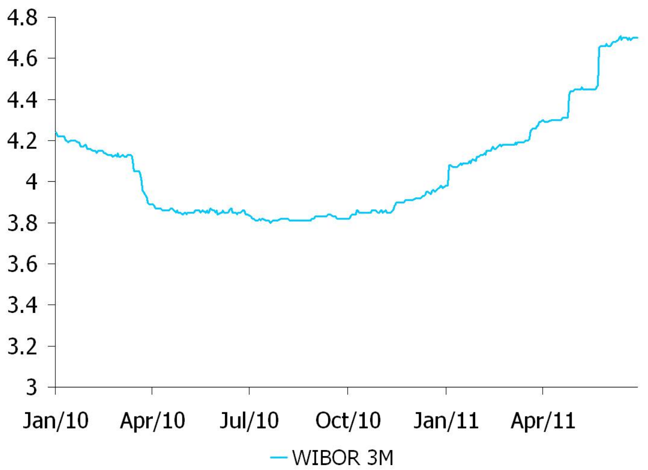
Money market

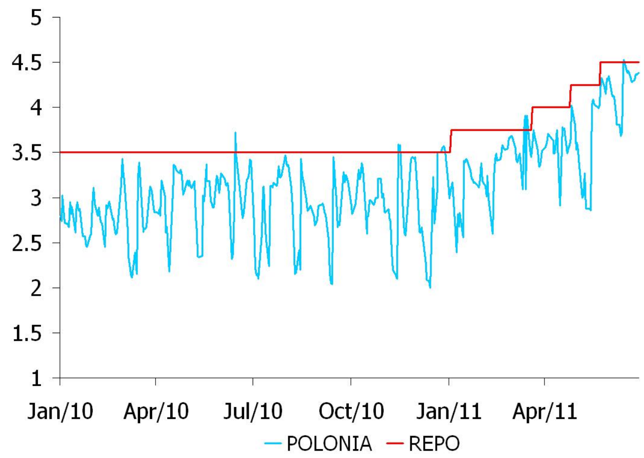
Last day of the reserve with additional OMO.

Stable cost of carry at levels 10-20 bps below the main market rate. The central bank is still determined to sterilize the market to keep the polonia rate as stable as possible. Again they announced that additional OMO will be held on the last day of the settlement period (since its Friday this month, there will be two OMOs), and it seems that this procedure will become permanent. Huge surprise on the CPI print. The index dropped to 4.2% from the 5% last month and against 4.8% expectations. This moved the curves 10-15 bps down, excluding the polonia curve which stayed at spot. The latter is now flat considering the capitalization effect, therefore no expectations for further monetary policy tightening is being discounted. It may be the case if the CPI is in downward trend, however it is probably a bit too soon and we still see one more hike probability this year at 55%.





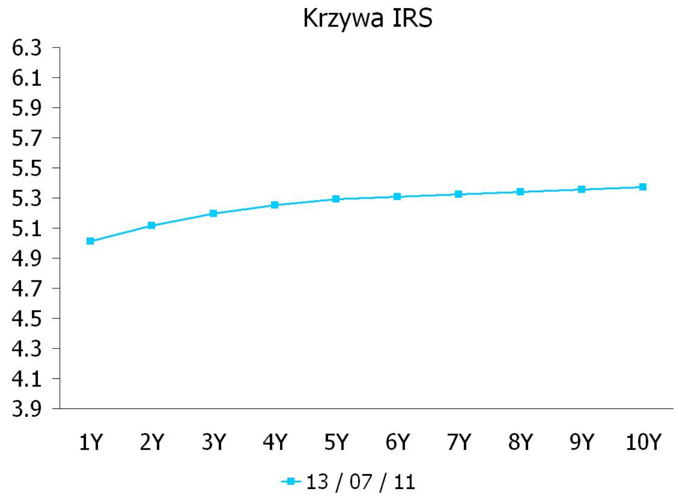




Forex

Zloty weaker. Credit ratings outlook story continues. Zloty, hand in hand with other risky assets, was trading heavily weaker side, closing upside move as 3% weaker against EUR and 6% against USD. In rates terms ranges were: 3.9480-4.0680 for EURPLN cross and 2.7730-2.9350. Once again European situation determines market behavior. And although local factors have taken back seats on this rollercoaster, its worth to mention CPI has printed very low reading 4.2%. If followed by next ones our carry advantage may simply disappear.

Volatility higher. Risk reversal is the name of the game. We have finished last week with RR levels at:1M 1.2 and 3M 2.0 and traded this week highs at 1M 2.2 and 3M at 2.6. ATMs, driven by high realized levels (weekly vol at 11.3) have jumped from curve: 1M 7.2, 3M 8.3, 1Y 9.7 to week highs at: 1M 9.25, 3M 9.7, 1Y 10.1. By end of weeks, with slightly stronger Zloty, volatility curve have traded slightly lower vols. USDPLN vs EURPLN spread was traded at 8.75, close to this year high.

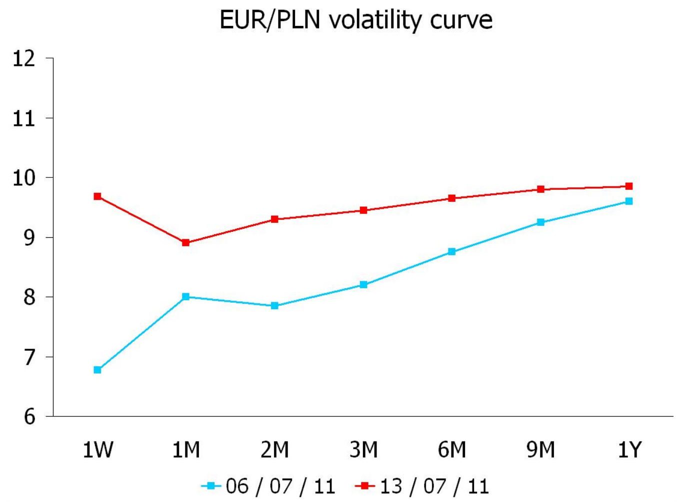


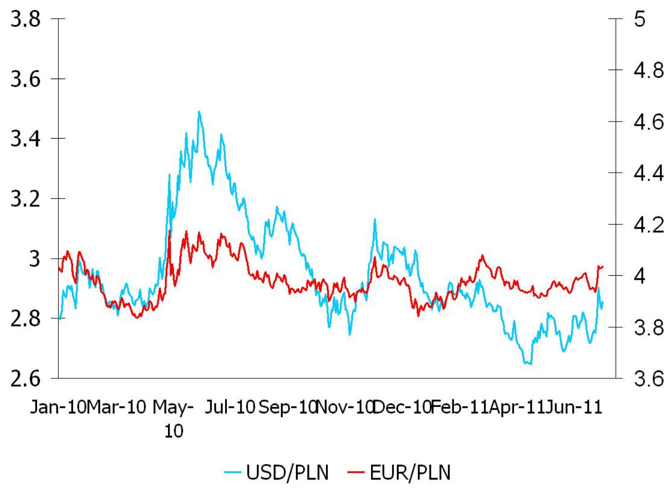
Short-term forecasts

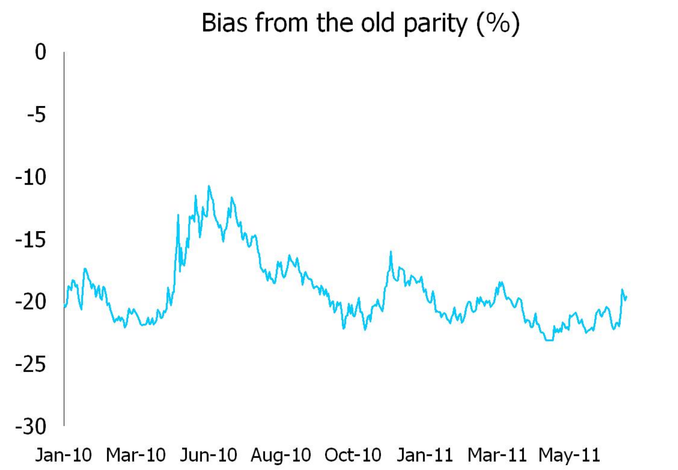
Main supports and resisances
EUR/PLN: 3.9230 / 4.0272
USD/PLN: 2.6800 / 2.8200

Spot. Sell 4.06. 4.07 is crucial level, 76.4% Fibonacci retracement , if hold sell to 4.06 area. Strong support at 4.0050, should accelerate below. Target 3.96, S/L 4.09.

Derivatives. We are adding long gamma to our already long Vega portfolio. Our position is still relatively small, but we are looking forward to add to it on the dips in vols. Well, after the several months of the constant slide of implied volatility, we are starting to think that, maybe (ust maybe) we have already seen the lowest levels this year. Of course is still to be confirmed by the future realized volatility, but it s more and more likely in our view.







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
7/5/2011	4.58	4.7	4.67	4.66	4.53	4.75	4.77	4.88	4.99	5.06	5.08	5.06
7/6/2011	4.54	4.69	4.69	4.66	4.54	6.59	4.72	4.88	4.99	5.05	5.05	5.06
7/11/2011	4.6	4.7	4.65	6.49	4.6	4.76	4.74	4.89	5.00	5.05	5.07	5.08
7/12/2011	4.58	4.7	4.65	4.66	4.52	4.76	4.73	4.90	4.99	5.05	5.08	5.06
7/13/2011	4.6	4.7	4.64	4.67	4.47	4.76	4.76	4.90	5.01	5.07	5.13	5.10

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	4.350	2000	2968	1961
OK0113	4/13/2011	1/26/2013	89.16	5.163	5500	7385	4758
PS0416	1/5/2011	4/25/2016	97.08	5.642	6500	2795	1140
DS1020	1/12/2011	4/25/2019	93.02	6.210	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
7/5/2011	4.750	4.650	5.115	4.859	5.291	5.356	5.371	5.843
7/6/2011	6.590	4.650	5.115	4.859	5.291	5.356	5.371	5.843
7/11/2011	4.760	4.650	5.106	4.856	5.296	5.444	5.391	5.889
7/12/2011	4.760	4.650	5.100	4.886	5.320	5.444	5.425	5.926
7/13/2011	4.760	4.650	4.995	4.819	5.205	5.310	5.315	5.874

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1M	1Y
7/5/2011	8.00	8.20	8.75	9.60	9.60	2.25	0.34	0.62
7/6/2011	8.00	8.20	8.75	9.60	9.60	2.25	0.34	0.62
7/11/2011	7.95	8.35	8.90	9.70	9.70	2.54	0.34	0.56
7/12/2011	9.00	9.50	9.70	10.00	10.00	3.01	0.34	0.87
7/13/2011	8.90	9.45	9.65	9.85	9.85	2.74	0.34	0.56

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
7/5/2011	3.9487	2.7266	3.2288	3.3627	1.4918	0.1626
7/6/2011	3.9531	2.7531	3.2635	3.4001	1.4912	0.1629
7/11/2011	3.9743	2.8123	3.3571	3.4826	1.4977	0.1644
7/12/2011	4.0383	2.9039	3.4817	3.6481	1.499	0.1667
7/13/2011	4.0288	2.8658	3.4472	3.6125	1.4982	0.1657

Disclaimer