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 Tuesday retail sales data will be published. Business survey results point to a stronger retail sales (in particular in apparel, weaker sales of durables).

Polish data to watch, July 25 to July 29

Publication	Date	Period	BRE	Consensus	Prior
Retail sales (r/r, %)	26-07	Jun	11.9	11.8	13.8

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 DS1021	11/16/2011	3000	5.803	7/21/2011
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	4.2	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

Business activity is experiencing soft patch, prices and wages react accordingly

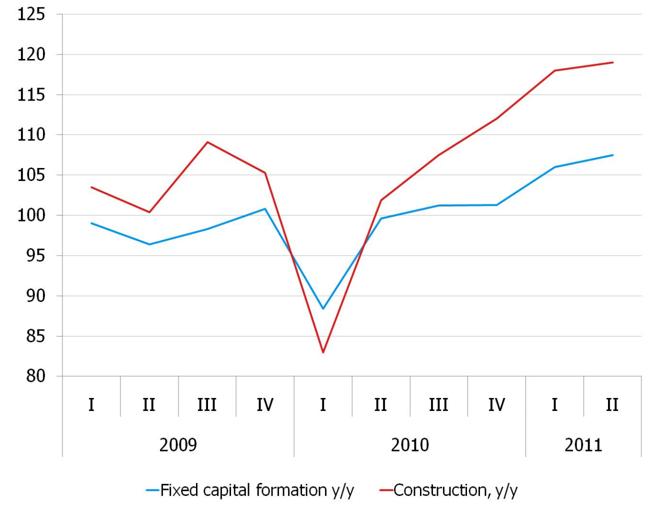
Fresh NBP report on business activity suggests that some moderation in the real sphere is on the horizon, accompanied by a fall of direct and potential inflationary pressures.

Real sphere. Structurally, business environment is constantly improving (demand barrier is slowly evaporating). However, after sharp recovery firms expect some moderation in demand. Such a view cast shadow on investment activity (the bright spot here is rising capacity utilization which should force firms to invest in the near but so far undefined future) and employment, which both go hand in hand. More specifically, employment and investment activity softens in sections connected with the global cycle (which seems distorted at the moment), mainly manufacturing. Domestically producing sections (including construction, services, retail trade) fare relatively well in both investment and employment. However, this may slowly change as infrastructure boom is coming slowly to an end (possibly in mid 2012) and private consumption may experience lagged setbacks connected with high prices and rising foreign currency mortgage costs. Drawing from permanent income hypothesis (PIH) and marginal propensities to consume out of temporary and permanent income, we conclude that consumption growth can be lowered by 0.4-1.2pp. versus the baseline which could be considered as a trend growth expectation, formulated in late 2010. The aforementioned factors can flatten Polish GDP growth (3.8-4.0%) in the coming quarters, however, it is not a turnaround in the cycle, as some factors which affect real sphere with the lag (supply chain disruptions, higher prices and mortgage installments) are slowly dissipating.

Incoming data are confirming the overall softening of the real sphere. Polish industrial output decelerated to 2.0% y/y from 7.4% y/y recorded in May; in SA terms it decelerated to 4.5% y/y. Only 23 out of 34 sections saw annual growth in output. Output fell the most in such sections as machinery, computers and electronic devices i.e. in export oriented sections (it is then no surprise that export sections formulate the most cautious forecasts).

Current data also support the view, that investment demand is mostly generated by infrastructure investment. Construction output recovery remained on track rising by 17% y/y in June. The construction is still sky-rocketing on infrastructure projects (40.2% y/y) and special projects (22.8% y/y). Recent growth allows us to estimate that Q2 fixed capital formation may be close to 7.5-8.0% y/y (see the graph below).

Inflation. Lower business activity, along with the absorption of recent price shocks affect price pressures. Specifically, we observe a moderation in inflation expectations (enterprises) and this helps to drive prices of final goods somewhat lower (in terms of growth). Moreover, price expectations are firmly anchored and costs policies among enterprises remain strict. Therefore recent price rises are not going to affect wages in 50% of enterprises, and 20% have already done some adjustments (this seems to be reflected by the spikes in wage growth recently). That said, it is reasonable to expect wage pressures to moderate somewhat in the near term. Moreover, strict cost policy is reflected in the relation between labor productivity and wages. Only in 10% of firms this relation diverges in negative way (wages running above productivity), whereas in 2007-2008 this adverse relation did appear in about 30% of enterprises. Such a behavior allows firms to raise their profit margins, which in turn influences positively the financial results (generating a liquidity cushion for hard times) - this is definitely a positive development.

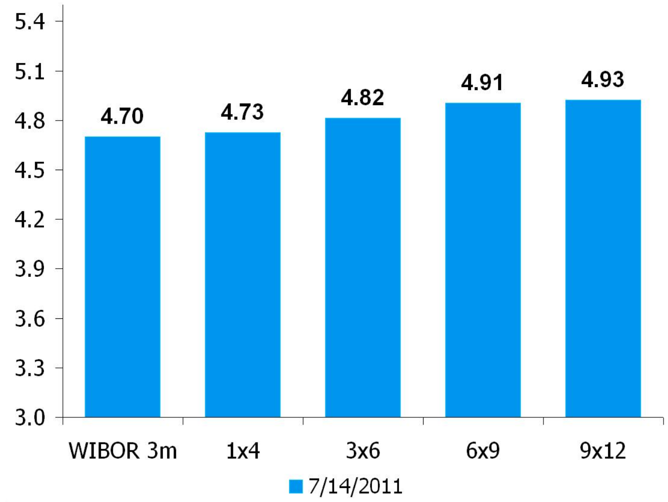


Bottom line. Although there is some moderation in the cards reflecting some past developments, firstly it should be rather minor (in terms of its potential to disturb the cycle), secondly it is poised to dissipate possibly after I-II quarters. Regardless of the duration of the moderation, it seems so far sufficient to sweep inflationary pressures away. We think this would give MPC comfort to end this year without additional tightening.

Fixed income

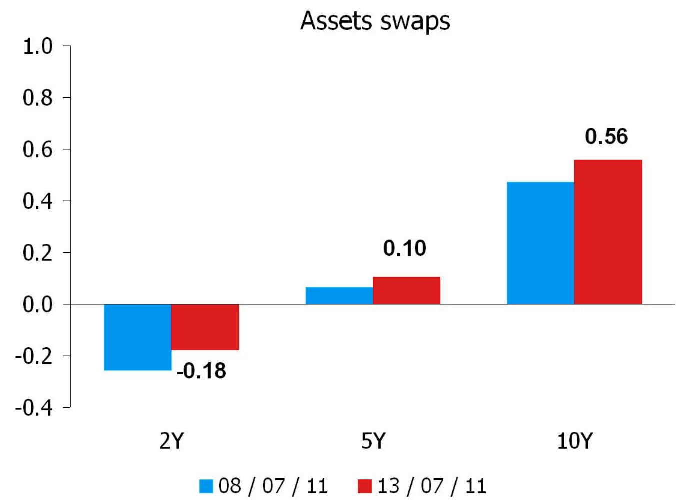
Wait-and-see.

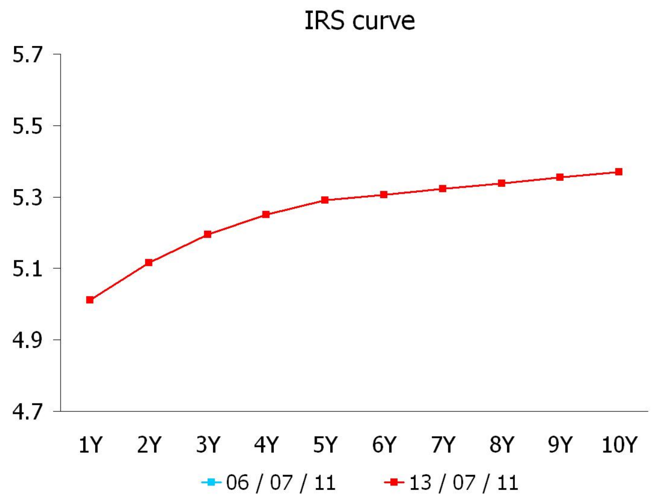
The last week didn't add anything spectacular to the overall situation on the Polish FI market. After the massive pullback in yields on the last CPI data, the yield curve stayed around the last lows with 1y IRS traded down at 4.92% and 2Y at 4.96% respectively. Though we could observe some profit taking at these levels with the quite substantial volumes traded the market seemed to stay quite balanced. The new 10Y treasury bond benchmark auctioned on Thursday 21st attracted quite a huge demand coming from both domestic and foreign investors. Yielded around 5.82% the new securities were sold close to the old DS1020 benchmark level.

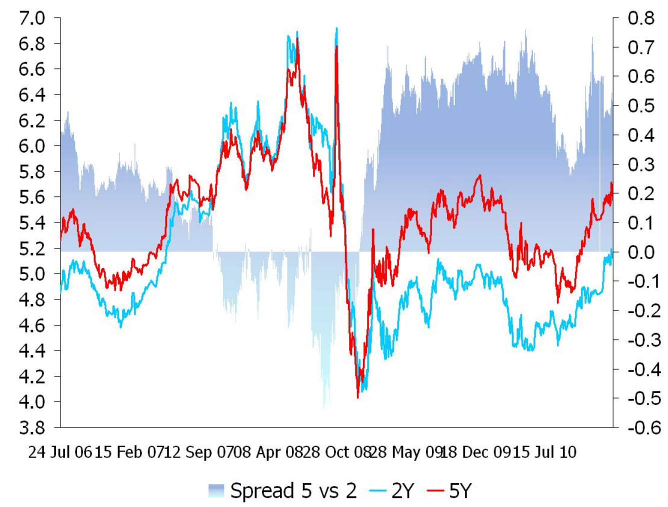


The last economic data this month showed both wages and industrial output would not support the hawks in the MPC, but we should keep in mind all July data were likely to be distorted somehow especially the inflation data might have been an one-off slump on the domestic vegetables ban to Russia.

Looking at the yield curve, the market prices in nearly one 25bp hike this year and goes flat in forward rates through the next one. Taking into account the last macro data might not support the next 50-75 BP hikes scenario played by some market analysts and might show even the close end of the tightening cycle in Poland, we could not see any real value on a curve at these levels. We assume the market is likely to stay calm till at least the next CPI release. We expect that figure to show direction for the next trading strategy with a moderate upside risk that could emerge some paying pressure in the short end of a curve especially when the September's FRA contract trades only few bps over the current Wibor rate.





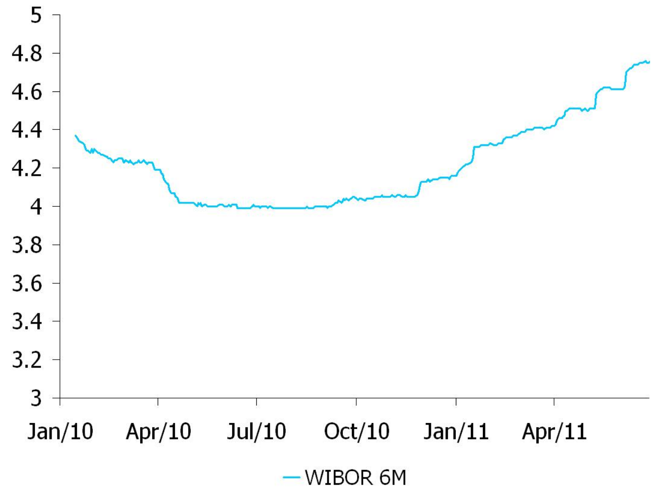


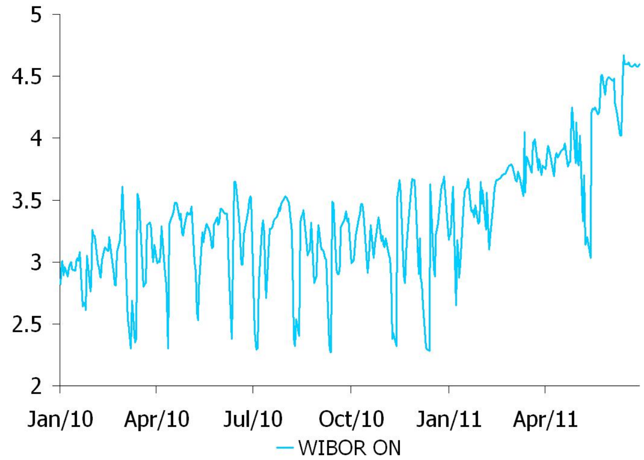
Money market

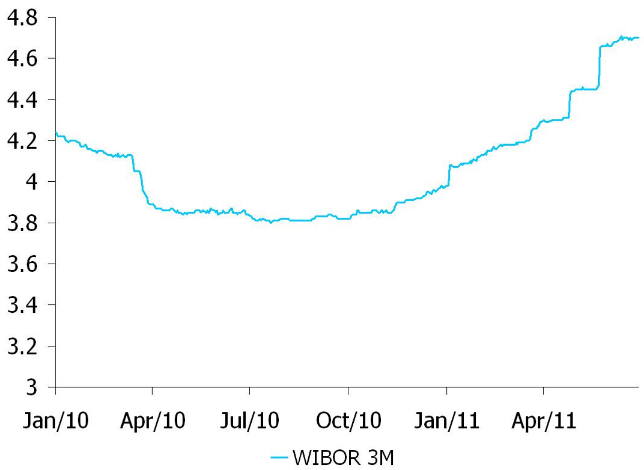
The central bank still eager to influence the shortest rates. Bullish outburst on global factors supported by local figures.

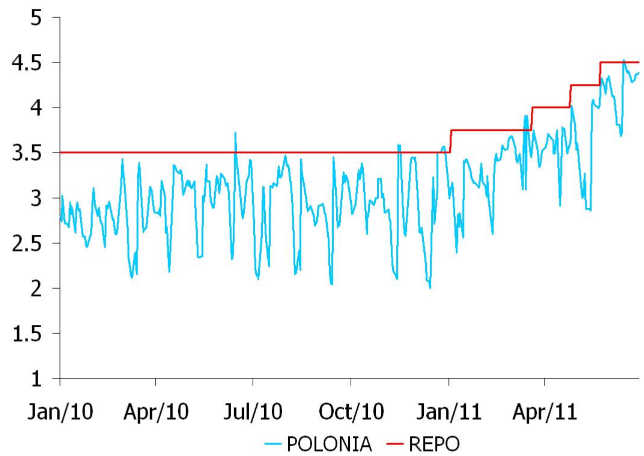
Cost of carry still stable with the 20-25 bps deviation from the main market rate. The central bank is really determined to keep it this way, and the best evidence is additional OMO this week. It was not only on Wednesday (usually it was Tuesday) but also with the polonia index fixing above 4.3% the previous day (usually this level does not trigger the auction). There must have been any additional cash flow from the MinFin, that could make downward pressure on the shortest rates and made the central bank react. After 5 billion of additional money bills were sold, rates remained stable. Last week of the reserve will be a challenge for the central bank, and their performance may influence the ois curve for longer.

Bullish sentiment for Polish market was mainly driven by the Greek case or more precisely its proposed solution. Local figures were also supportive (industrial output at 2% vs 5.8% expected), however the real movement was seen on the global factors. Short debt became very expensive from the local perspective after considering the growth in the cost of carry. However, internationals can obtain much cheaper financing via fx swaps, therefore it still makes sense to them, however ridiculous it seems to us.



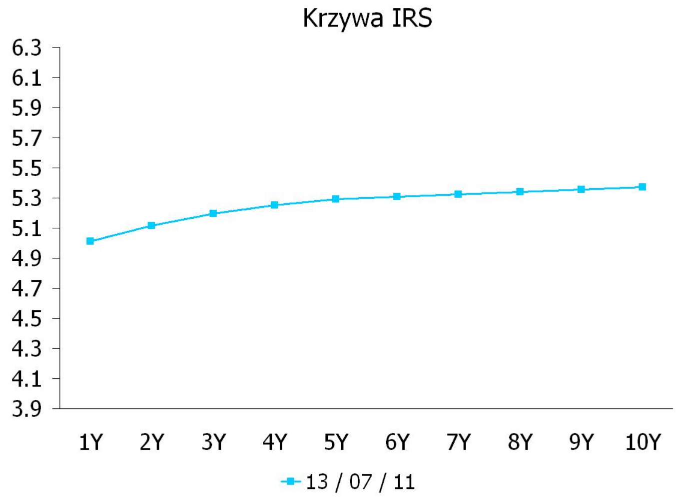






Forex

Zloty stronger. We have started this week playing more optimistic tune. All eyes were focused on The European Leaders to find the remedy, for current European fever. The meeting seems to deliver what the market wanted, and all the risk assets rallied on the back of that. With EURCHF cross traded higher, EURPLN has broken 4.0050 support and marked weekly low at 3.9710 (top about 4.0450).

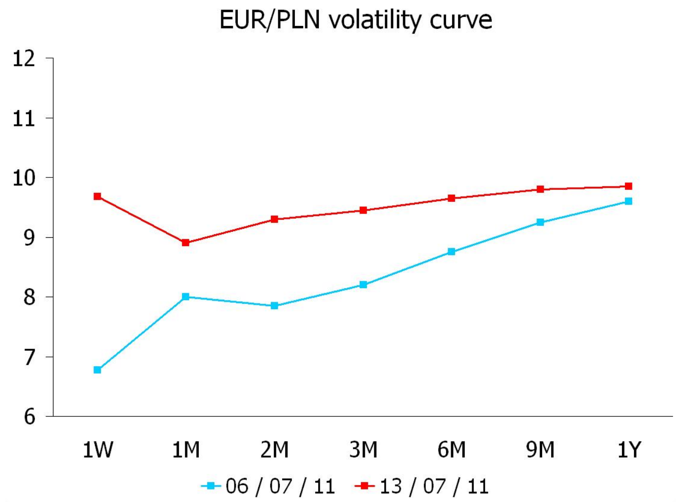


Volatility bit lower. A big portion of uncertainty is still being served to the market. So despite slightly stronger PLN and lower realized (8.8% weekly) we still see some demand for volatility. As a result implied curve have been traded at slightly lower levels: 8.5 for 1M (9.0 a week ago), 3M 9.2 (9.6), 1Y 9.85 (10.1). Risk reversals and USDPLN vs EURPLN spread has stayed at same levels.

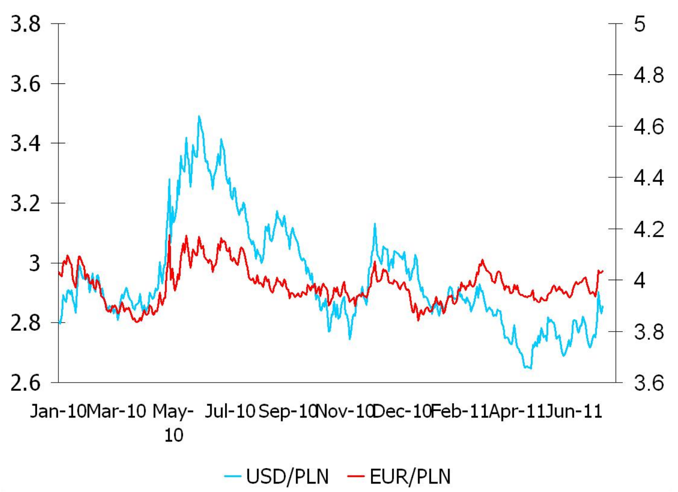
Short-term forecasts

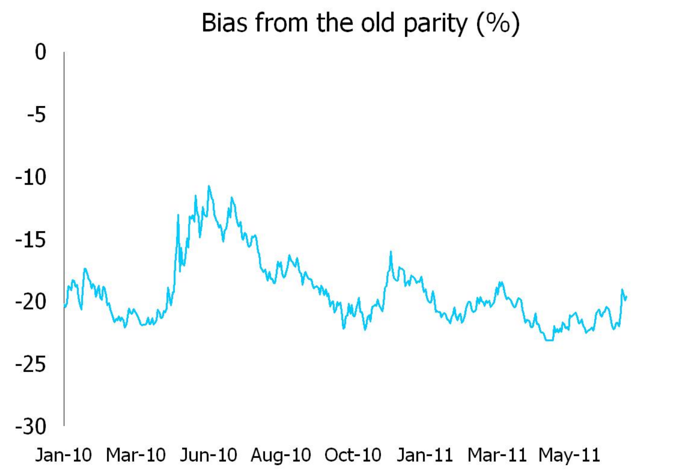
Main supports and resisances
EUR/PLN: 3.9500 / 4.0400
USD/PLN: 2.7300 / 2.8500

Spot. 4.06 was not traded, EURPLN has strengthen to 3.8770. Sell upticks 4.01.



Derivatives. Our long gamma is on the break even, and we think it is still worth to keep, for the time being. We will see if the new fresh optimism set by European Leaders will last , and really solve the problem of the peripheral countries. The same logic applies to longer term Vega, it is still hovering above this years lows , and we still see better risk/reward profile in being long Vega.





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
7/14/2011	4.60	4.70	4.64	4.67	4.47	4.76	4.76	4.90	5.01	5.07	5.13	5.10
7/15/2011	4.60	4.70	4.65	4.66	4.75	6.59	4.74	4.89	5.01	5.07	5.12	5.08
7/18/2011	4.58	4.70	4.65	6.49	4.75	4.75	4.71	4.83	4.91	4.95	4.99	4.98
7/19/2011	4.60	4.69	4.65	4.65	4.75	4.75	4.73	4.82	4.91	4.93	4.95	4.96
7/20/2011	4.62	4.70	4.70	4.66	4.75	4.76	4.73	4.82	4.90	4.94	4.95	4.96

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
7/14/2011	4.760	4.570	4.967	4.713	5.152	5.286	5.267	5.823
7/15/2011	6.590	4.530	4.976	4.771	5.171	5.327	5.296	5.835
7/18/2011	4.750	4.530	4.991	4.738	5.206	5.374	5.326	5.915
7/19/2011	4.760	4.570	4.992	4.716	5.202	5.332	5.327	5.875
7/20/2011	4.760	4.570	4.966	4.753	5.176	5.310	5.316	5.863

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1M	1Y
7/14/2011	8.90	9.35	9.63	10.00	10.00	2.74	0.34	0.56
7/15/2011	8.90	9.35	9.63	10.00	10.00	2.74	0.34	0.56
7/18/2011	8.95	9.30	9.60	9.90	9.90	2.74	0.34	0.56
7/19/2011	9.10	9.45	9.63	10.10	10.10	2.74	0.34	0.56
7/20/2011	8.85	9.15	9.45	9.85	9.85	2.63	0.34	0.56

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
7/14/2011	4.0291	2.8309	3.4743	3.5857	1.4982	0.1649
7/15/2011	4.0343	2.8545	3.4909	3.6012	1.4894	0.1646
7/18/2011	4.0402	2.8753	3.5204	3.6377	1.4837	0.1651
7/19/2011	4.0242	2.8372	3.4547	3.5878	1.4855	0.1646
7/20/2011	4.0014	2.8218	3.4325	3.5789	1.4801	0.1633

Disclaimer