BRE BANK SA

POLISH WEEKLY REVIEW

August 5, 2011

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Comment on the upcoming data and forecasts

On Thursday current account data will be published - we expect a slowdown in both exports and imports. Balance of services is expected stable, balance of income lower (250 mln EUR dividend payment of PKO SA), balance of current transfers again on low levels (net transfer from UE slightly negative compared to huge positive value from the previous month). On Friday inflation and monetary agregate data will be released. Food prices deacrease (1.6% m/m) and energy prices increase (4% m/m) with gasoline rise keeps CPI on high levels. Core CPI ease lower to 2.2-2.3% due to wearing apparel sales.

Polish data to watch: August 1 to August 5

Publication	Date	Period	BRE	Consensus	Prior
C/A (mln EUR)	11-08	Jun	-1738	-1456	0
CPI y/y (%)	12-08	Jul	4.3	4.3	4.2
M3 y/y (%)	12-08	Jul	7.2	7.5	7.1

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	7/21/2011	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

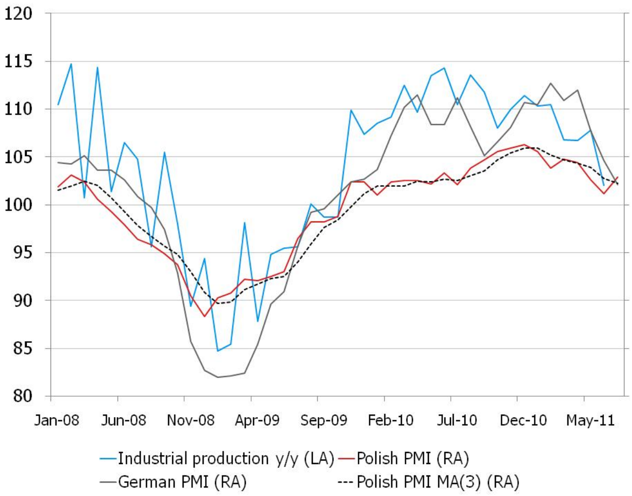
	2010 Q3	2010 Q4	2011 Q1	2011 Q2 F	2011 Q3 F	2011 Q4 F
GDP y/y (%)	4.2	4.5	4.4	4.2	3.7	3.7
CPI Inflation y/y (average %)	2.6	2.9	3.7	4.2	4.2	4.2
Repo rate (end of period %)	3.5	3.5	4	4.5	4.5	4.5

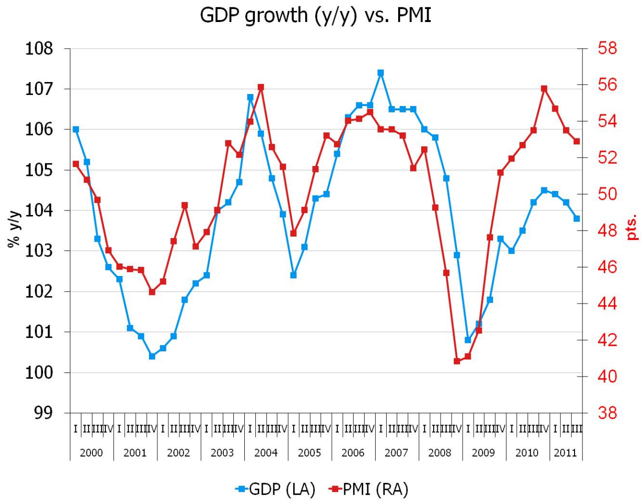
F - forecast

Economics

PMI rises - more weakness on the horizon possible, though

PMI in July rose by 1.7 points to 52.9pts for the first time in the last four months. The level of the index indicates an overall improvement in the Polish industry - currently PMI stands higher than average before the crisis (from June 1998 to April 2008). However, we think the PMI index has recently embarked on a short-term downward trend (or on stabilization at low levels at least), reflecting slowdown in the global economy. That is why this month's rise does not look like an upward reversal but a simple correction in a broader downward movement (stabilization). The picture is corroborated by purely technical thinking: short term average is still pointing down.





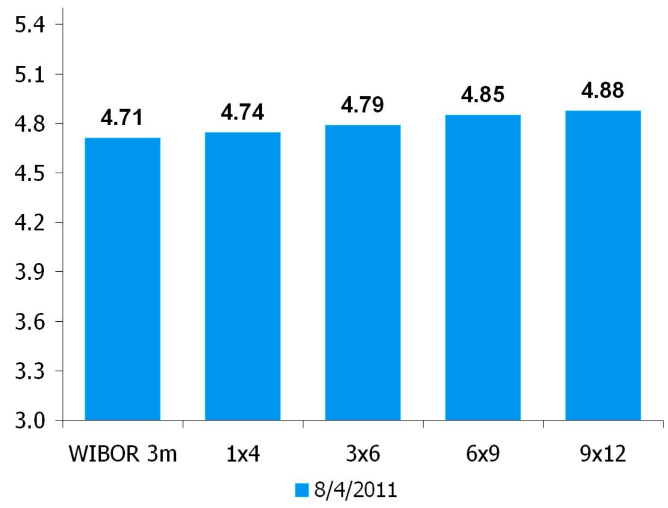
Looking into details, after drop in June, new orders grew in July, followed by the fastest output growth since April. Employment grew for 12th month on the trot, while on the inflation side production costs increased at a slowest pace since March 2010, alike final goods prices that were weakened by competition pressure. The only sub-index with value below 50 points was index of new export orders. Therefore the picture seems to favor domestic market over the foreign one. This reflects mainly the aforementioned slowdown in global trade, accompanied by stable demand from infrastructure driven industries (the outperformance in some construction sectors can be felt and seen). We think it is possible that domestic market will falter a bit in the months to come, hit by lower consumption spending, as soon as consumers step back on the basis of higher prices and higher servicing costs of mortgage loans.

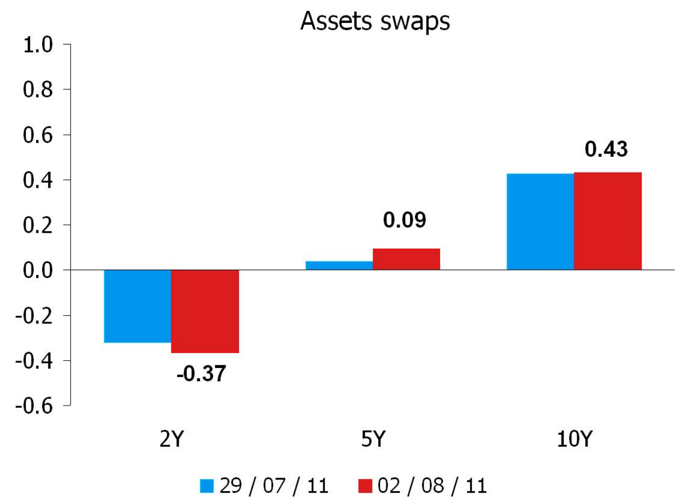
However, the slowdown is not going to be pronounced, given the counterbalancing movement in EU driven infrastructure spending. Judging on past correlation which so far has proven to be fairly accurate (see the graph), recent PMI moderation is consistent with 3.8% growth in Q3 (more deceleration, possibly towards 3.5-3.6% at the start of 2012 is in the pipeline). We remind the reader, though, that upcoming Q2 figures (end of month) will be still fairly strong (4.2% GDP growth, 4.5% consumption growth and 7.5% in fixed capital formation).

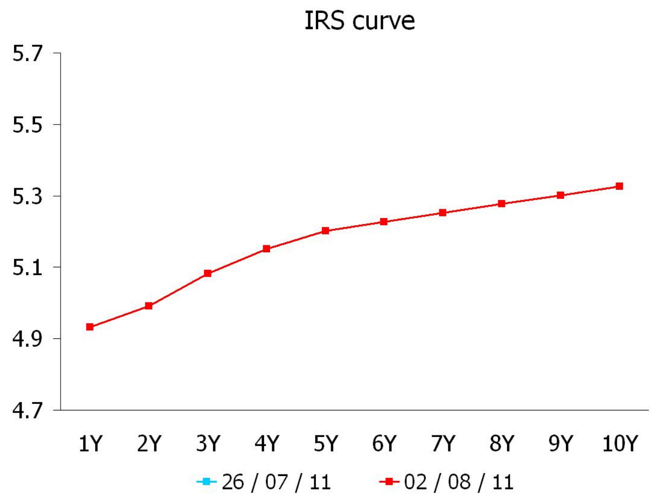
Fixed income

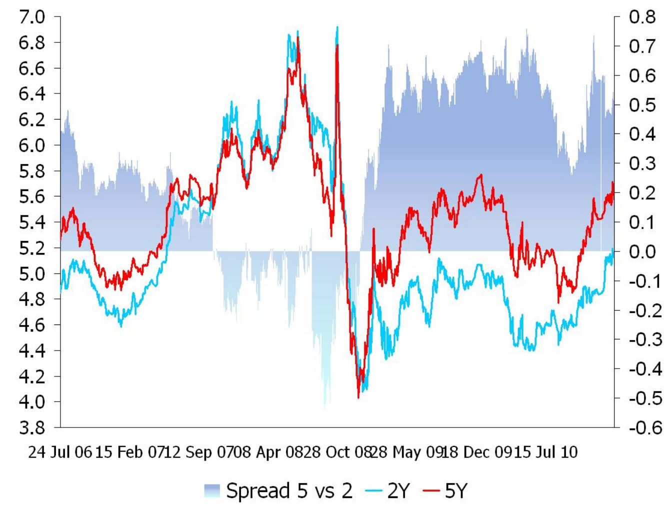
Massive rally

Amid global turmoil, polish fixed income market turned out to be a safe haven. Massive flow to buy bonds pushed the curve lower and significantly flatter. 2y, 5y and 10y moved down by some 15, 20 and 25bp respectively to again lowest levels this year. Even though we saw likeliness of such scenario, as we pointed out ridiculuously high forwards levels few weeks ago, we're quite surprised by the pace and scale of recent move. Now, when all further policy tightening has been priced out almost completely and FRA spreads from 9x12 to 21x24 trade negatively and 2Y bond yield equals main rate and there's no carry anymore, this rally starts to look a little overdone. We only saw one lower CPI figure (still much above the target though) and economy is still far from some turning point, where we could start considering rate cuts, yet we're just few bp from actually pricing them in. There are of course still some mispricings in the curve (for instance 1y2y forward which is even steeper than it was before the move), but overall some correction from current levels is the most likely outcome, therefore selling into this rally seems to be the best strategy here. For the rally to continue, we would have to see another positive surprise from inflation reading next week and that isn't something we would be willing to bet on...







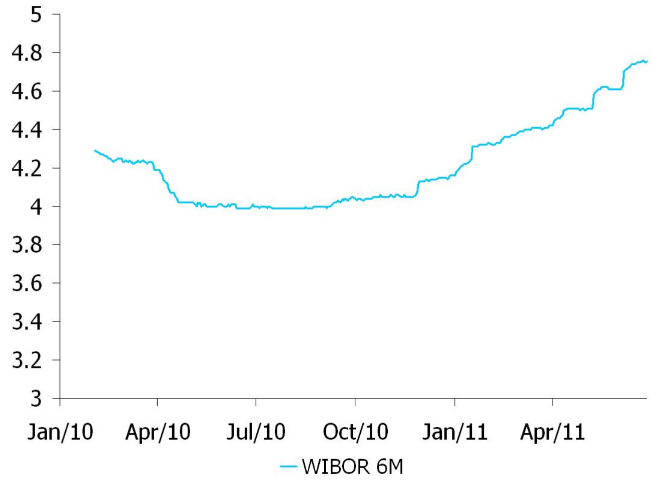


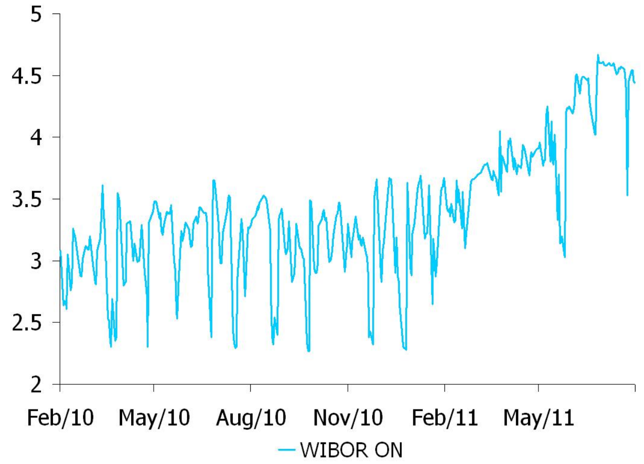
Money market

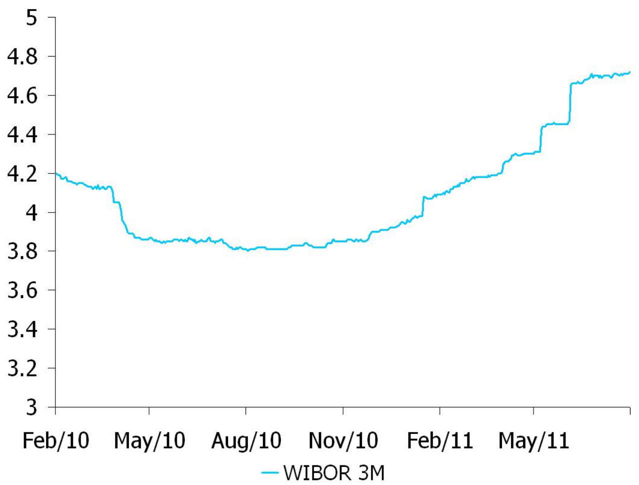
Cost of carry back up. Bullish sentiment for Polish assets.

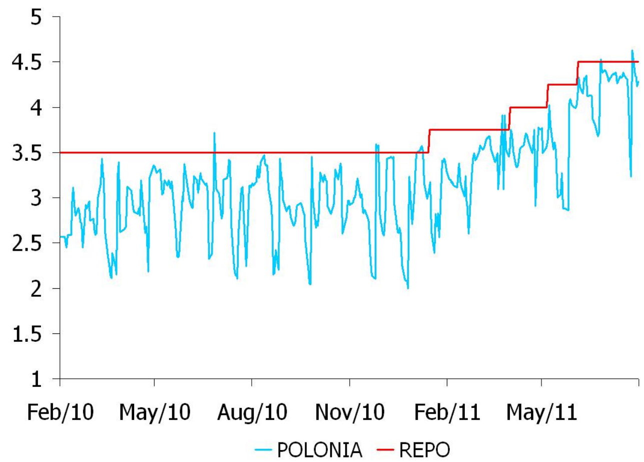
Cost of carry back to the levels close to the main market rate. We bet that August will be much more expensive then July, since the end of the reserve is on Tuesday, therefore two auctions of the money bills close enough each other to left no place for the drop observed in July. We think that the central bank will start doing additional omo's as soon as next week unless today's auction would be a success.

Bullish sentiment explosion for the rates, first on the bonds buying then on the stop losses (Poland again relatively safe asset). Bonds, especially the shortest ones, unattractive from the local point of view (cost of carry based on Wibor in general), nonetheless still attractive for the foreigners (much cheaper financing via fx swaps). We think that sooner or later reprising of those is inevitable. CPI next week can be surprising figure and the risk of higher output is undervalued.



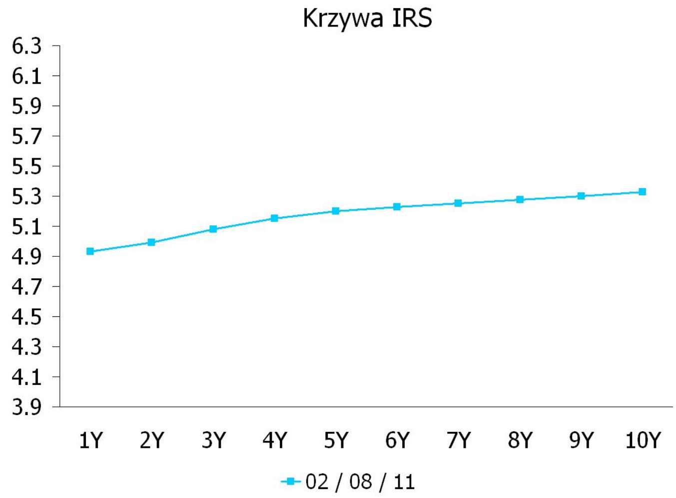






Forex

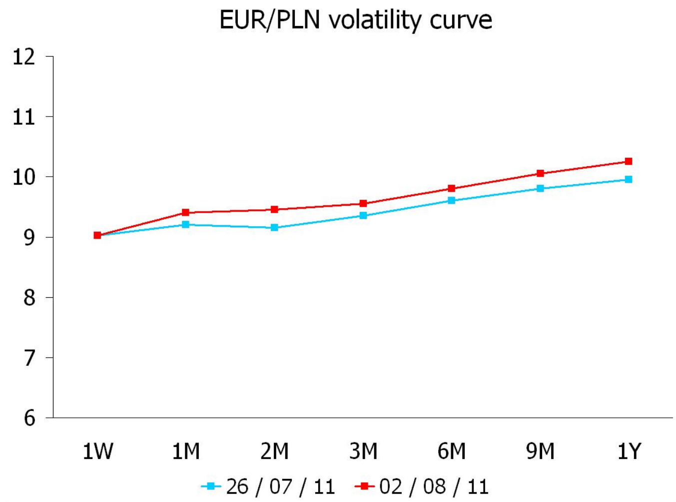
Volatile majors Just when we thought that US and EU debt crisis has died down a bit, risk aversion has hit us back. Spreading ghost of US economy slowdown has provoked rush for "risk free" assets. As a consequence growing CHF and JPY's exchange rates has forced CBs reaction. FX interventions took place and have changed markets playable tone to rock and roll. But there is green island among this storm and it's called EUR-PLN. Range for this week was 3.98-4.045, its about 1.5% (EURCHF about 5.7%!). We may call its MoF effect, or we are „safe haven" out of the sudden.



Volatility higher Economy slowdown - growing risk aversion - volatility buying that is casual relationship. So despite disappointing EURPLN's price action (weekly realized about 9.0%) strong vol buying interest has appeared. Implied curve have been traded violently higher with new levels at: 10.3 for 1M (9.0 a week ago), 3M 10.4 (9.4), 1Y 10.6 (10.0). The RR 25d were in demand, up around 0,4 % the whole curve, the currency spread (USD/PLN vs EUR/PLN) also higher by 0.5 %.

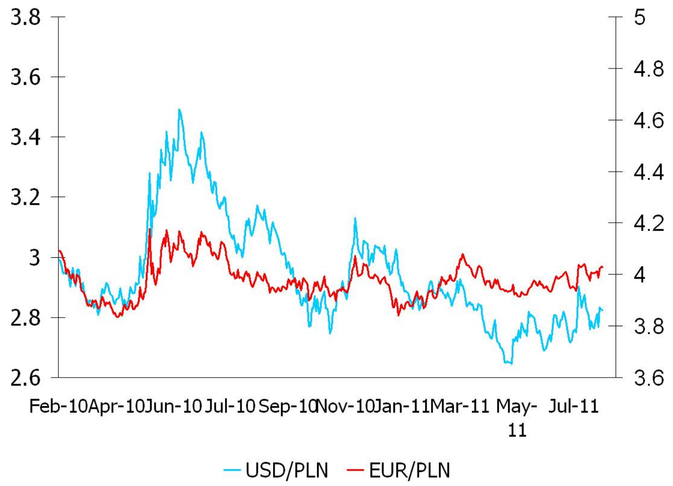
Short-term forecasts

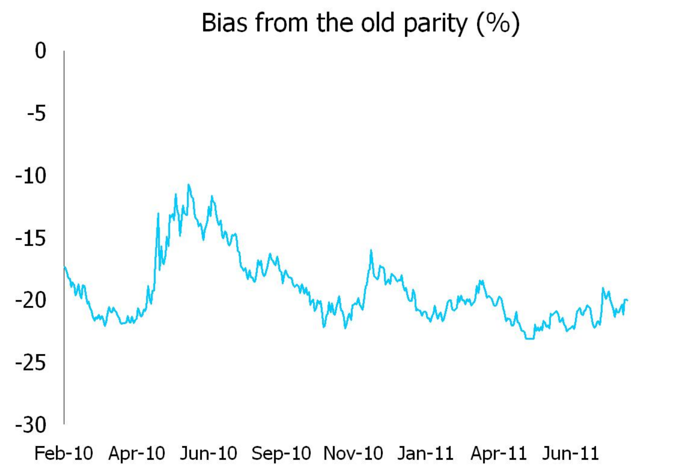
Main supports and resisances
EUR/PLN: 3.9600 / 4.0650
USD/PLN: 2.8200 / 2.8900



Spot. We are trapped between risk aversion and the flow. We see good risk reward to build some short PLN position on the dips in 4.00/4.03 area. When flow dries we may have a spike, eventually taking 4.06 resistance to 4.12 this year high. We mark 3.9800 as a stop.

Derivatives. Good news and the bad news, for those who followed our suggestion to be long Gamma and Vega in XXX/PLN space. Starting from the bad news, the long gamma is not really performing. But the long Vega positions pays the Theta bill! We stick to our long Vega and looking forward to add to it, on dips. We see really strong demand from foreigners (hedge for bonds ?) , if CDS for Poland tick up it may only intensify.





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
7/27/2011	4.55	4.71	4.68	4.67	4.66	4.75	4.75	4.84	4.94	4.98	4.98	4.97
7/28/2011	4.61	4.70	4.65	4.68	4.70	6.59	4.73	4.84	4.93	4.97	4.99	4.98
7/31/2011	4.62	4.71	4.68	6.49	4.64	4.75	4.75	4.83	4.94	4.98	4.99	4.99
8/1/2011	4.63	4.71	4.70	4.68	4.62	4.75	4.74	4.84	4.94	4.98	4.99	4.99
8/2/2011	4.57	4.71	4.69	4.68	4.60	4.76	4.74	4.84	4.94	4.98	4.97	4.99

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
7/27/2011	4.750	4.570	5.000	4.688	5.235	5.301	5.375	5.831
7/28/2011	6.590	4.530	5.007	4.662	5.247	5.282	5.377	5.820
7/31/2011	4.750	4.530	5.018	4.697	5.250	5.287	5.379	5.804
8/1/2011	4.760	4.570	4.981	4.542	5.200	5.263	5.325	5.797
8/2/2011	4.760	4.570	4.955	4.589	5.120	5.214	5.323	5.754

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1M	1Y
7/27/2011	8.85	9.25	9.55	10.10	10.10	2.81	0.34	0.55
7/28/2011	8.85	9.25	9.55	10.10	10.10	2.81	0.34	0.55
7/31/2011	8.90	9.45	9.73	10.03	10.03	2.81	0.34	0.55
8/1/2011	8.95	9.20	9.55	10.05	10.05	2.91	0.34	0.54
8/2/2011	9.40	9.55	9.80	10.25	10.25	3.11	0.34	0.54

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
7/27/2011	4.0060	2.7644	3.4563	3.5574	1.5001	0.1650
7/28/2011	4.0082	2.7880	3.4795	3.5884	1.5001	0.1654
7/31/2011	4.0125	2.8109	3.5080	3.6220	1.4847	0.1658
8/1/2011	3.9859	2.7683	3.4973	3.5759	1.4876	0.1650
8/2/2011	4.0225	2.8331	3.6342	3.6621	1.4926	0.1666

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