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## Comment on the upcoming data and forecasts

Only retail sales this week. We expect that this figure is set to support our view of fading private consumption. Again, sections dealing with durables are expected to take the hardest hit. However, do not expect an abrupt disaster...consumers will drop out gradually.

### Polish data to watch: August 19 to August 25

| Publication | Date | Period | BRE | Consensus | Prior |
|---|---|---|---|---|---|
| Core inflation y/y (%) | 19-08 | Jul | 2.4 | 2.4 | 2.4 |
| Retail sales y/y (%) | 24-08 | Jul | 9.4 | 10.1 | 10.9 |

### 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 | 10/12/2011 | 3000 | 4.469 | 10/8/2011 |
| 5Y T-bond PS0416 | 10/19/2011 | 3000 | 5.256 | 10/8/2011 |
| 10Y T-bond DS1021 | 10/19/2011 | 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 | 3.2 |
| 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 | 4.0 |

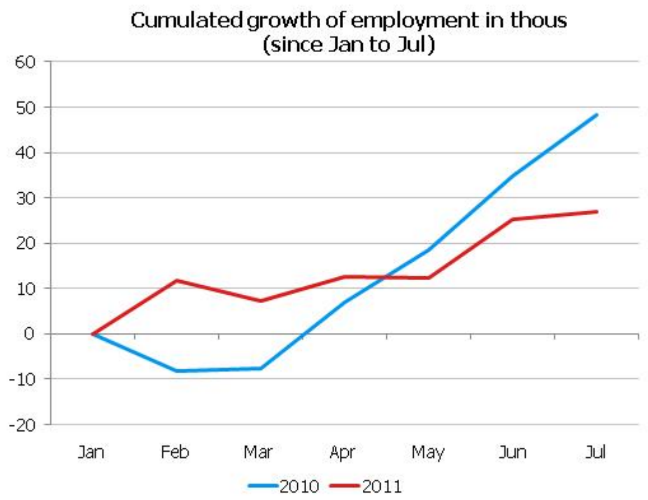
| | 2010 Q3 | 2010 Q4 | 2011 Q1 | 2011 Q2 F | 2011 Q3 F | 2011 Q4 F |
|---|---|---|---|---|---|---|
| GDP y/y (%) | 4.2 | 4.5 | 4.4 | 4.2 | 3.7 | 3.7 |
| CPI Inflation y/y (average %) | 2.6 | 2.9 | 3.7 | 4.2 | 4.2 | 4.2 |
| Repo rate (end of period %) | 3.5 | 3.5 | 4 | 4.5 | 4.5 | 4.5 |

F - forecast

# Economics

## Deterioration on the labor market and further decrease of industrial output. Slowdown time!

Employment in enterprise sector increased by 3.3% YoY in July (down from 3.6% in June). On monthly basis employment stagnated (1.6k in seasonally unadjusted data is ridiculously slow). Such a reasoning is nicely described by the comparison between 2010 and 2011. After a good start (cumulated employment growth) employment came to a halt. No doubt why as uncertainty about the real sphere is daunting; therefore a falling trends in business activity indicators are not a correction in tendency - rather we have reached the inflection point and employment is set to be at most relatively stable in coming months.




So far wages diverge with faltering employment momentum. Wages growth in July decreased only to 5.2% YoY from 5.8% YoY in June (inflated by bonus payments in mining sector). This increase fits into a range observed in previous months and we think it rather reflects past momentum of the economy and not the actual state (wage growth is a lagging indicator). We think that wage expansion is set to slow in coming months (business surveys show that the majority of enterprises has already adjusted wages and only a small fraction is expected to do some fine tuning in the future). However, decent growth observed at the moment can be used (at least for some time) as an argument against looser monetary policy by some MPC members.

Industrial output slowed down to 1.8% YoY in July from 2.0% YoY in June. In seasonally adjusted basis output growth amounted to 4.6% YoY. The outcome can be tied with slowing foreign demand (German economy is tightly synchronized with global cycle and stays under influence of slowing economies in Asia) and declines in non-durable goods sectors pointing to a shrinking domestic demand. We estimate that in forthcoming months industrial output will grow below 5% YoY. In third and fourth quarter 2011 also the GDP growth will explicitly decrease to 3.5-3.7% from 4.2% estimated so far for the second quarter.

Construction output increased by 16.4% YoY in July, therefore was a bit slower than in the previous month. Production expansion in sections associated with infrastructure spending returned to normal levels (20-30% YoY, after 40-50% in the last two months). On the back of the fact that record EU funds are still int the pipeline to be spent, we rather consider this minor slowdown as connected with a holiday break. Therefore we expect construction output growth to come back to 20+ levels in September (and possibly in August).

PPI increased by 5.9% YoY. On monthly basis prices increased by 0.4%, whereas in manufacturing by 0.3% (after excluding prices connected with energy the growth amounted to 0.2%). Because of high level of exchange rate, manufacturing prices will also increase in August (we are also stepping out of a period of high statistical base). Hence, inflation tensions on the producer's side will not rapidly ease and PPI will remain over CPI (in annual terms). Although expected slowdown should contribute to a change in price policies pursued by enterprises, this process will proceed with a lag and can be possibly balanced by the behavior of energy prices (treated partly by investors as insurance against inflation, especially in the front of record high global money supply).

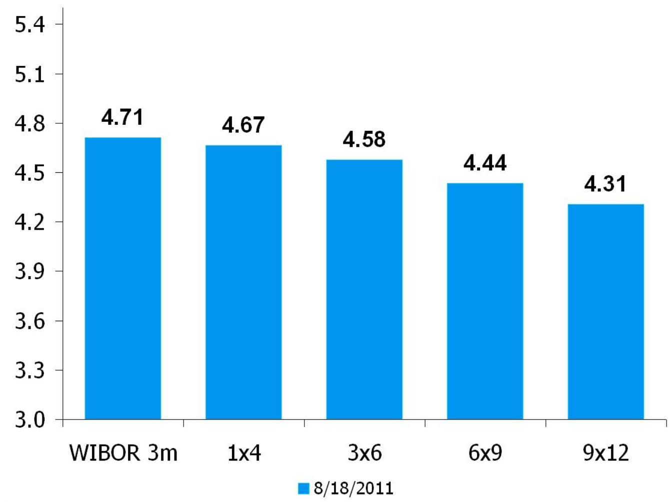
In the most immediate future MPC will not decide to ease monetary policy (high wages, inflation and potentially devastating impact on the PLN should all be taken into consideration). However, as rate setters tend to be asymmetrically worried about real sphere, they may loose monetary policy as soon as it does not stay in conflict with exchange rate stability. Therefore a correction in rates may take place at the place at the beginning of 2012. It could be a perfect time since CPI decrease can be considered then as a good background for lower interest rates.

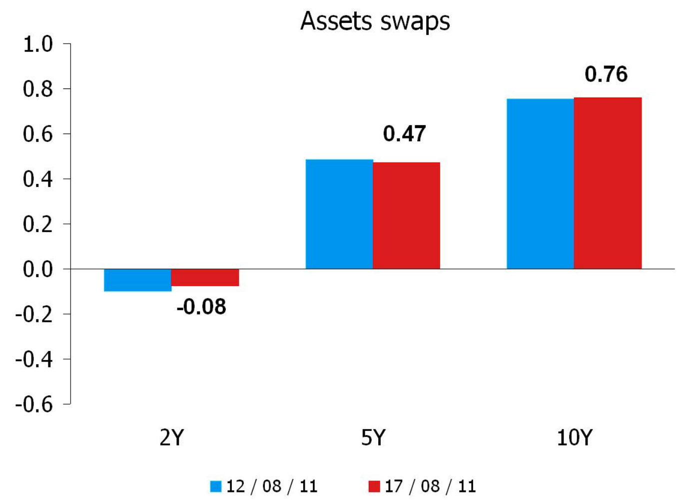
# Fixed income

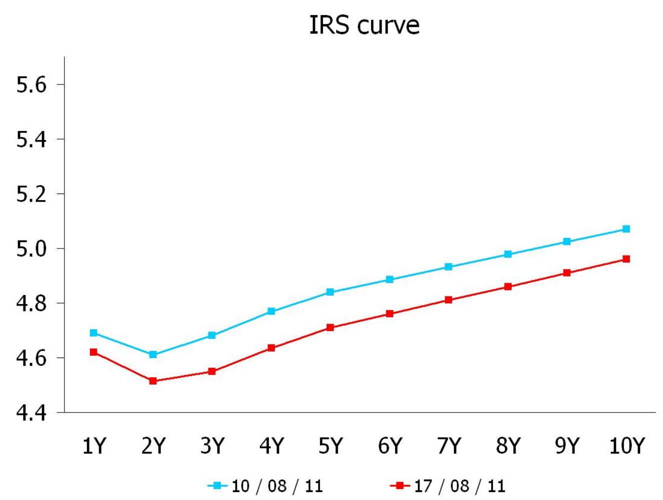
## Continous rally

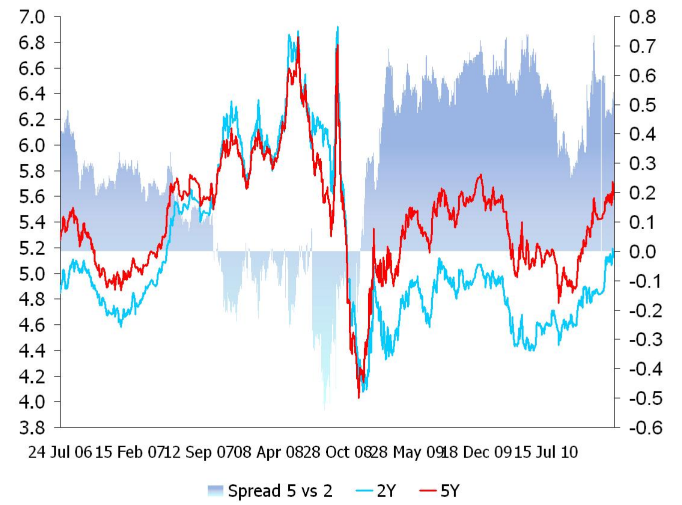
Already last week we thought that levels achieved on Polish rates, especially in the front end were a bit too optimistic, yet market rallied further strongly. 2Y moved down by 20bp, curve flattened significantly, with 5Y and 10Y strenghtening by 30 and 35bp respectively. Scenario that is priced in the curve at the moment includes quite fast and deep rate cuts in the near future. Considering Wibors' reluctancy to follow policy easing (the lower the rate, the stronger the effect), we would have to see 50bp cuts till January and at least another 50bp during next year for the 2Y swap to reach break-even point. That can of course happen, but definitely isn't the most likely outcome, and that only allows not to lose on the trade.

On the other hand, further forwards on the curve are higher and quite steep, as we were to see some 'emergency' cuts and then policy normalisation. What is more likely to happen is a regular easing cycle due to economy slowing down - not as aggressive, longer lasting and not reversing rapidly. Therefore we see curve flattening further in 2Y-5Y sector and steepening in 5Y-10Y. We also think bonds up to 5y maturities should be well supported - there will be no issuances of short maturities, there are rate cut perspective, they have decent yield (especially from international investors' perspective and basis swaps levels).



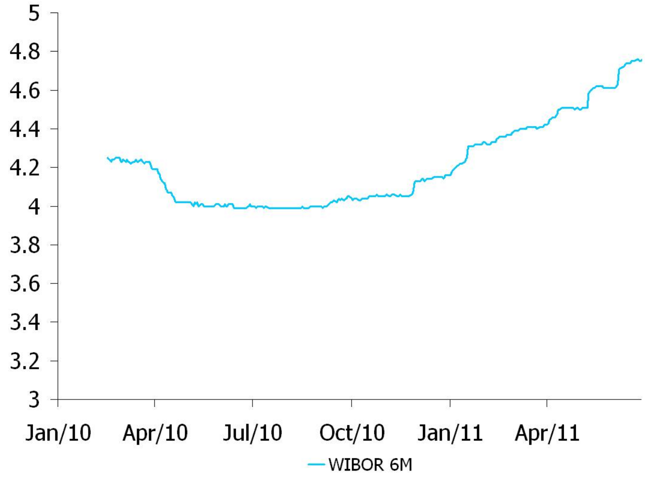



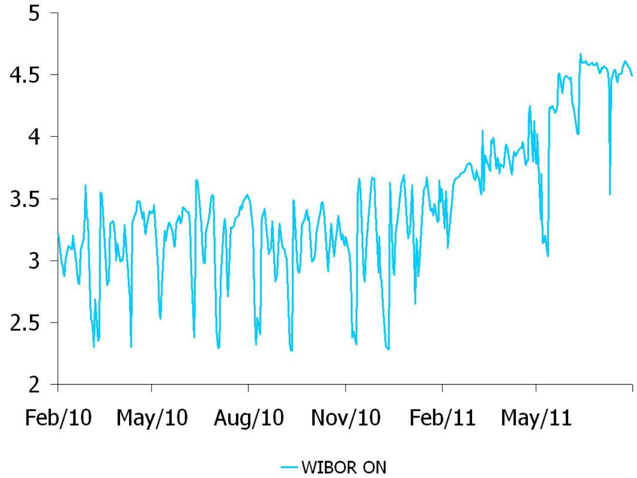
## Money market

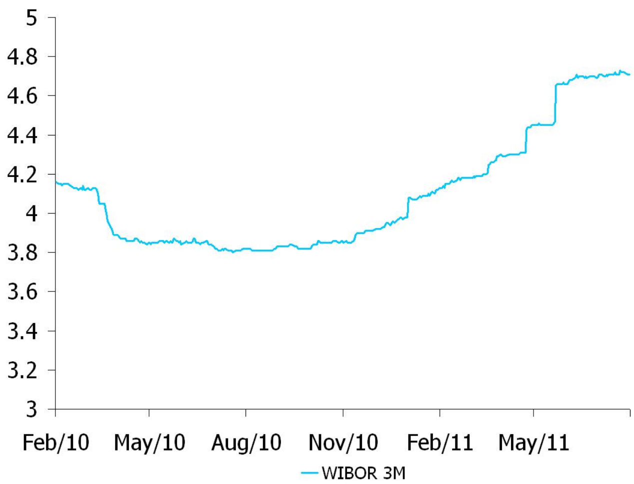
### Carry to grow nex week. Industrial output su-portive for bulls.

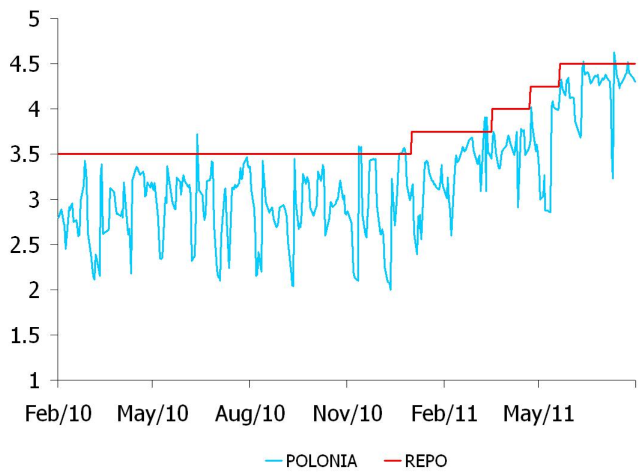
Cost of carry was stable throughout the week nearby 4.3% level. Today's OMO was substantial and the demand met the supply, which indicates growing short rates next week. Continuation of the bullish sentiment for longer rates supported by lower than expected industrial output figure. Market ignored worse wages and PPI and even weakening currency.

Looks like the slowdown will be continued, however accompanied by CPI still well above the upper band of the goal. Therefore we think that the most probable scenario is wait-and-see mode by the MPC and rates cuts can occur no sooner then at the beginning of next year. Having said that curve up to 2Y looks really low and attractive for potential buyers. We keep up our view to take pay position at current levels.



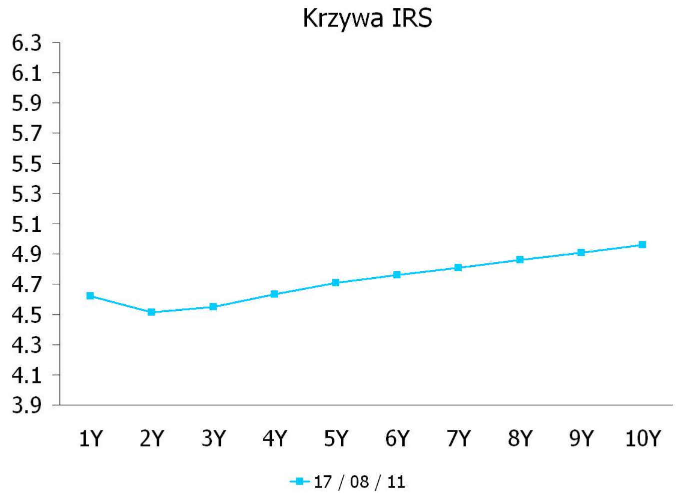



# Forex

**Risk On / Risk Off again** It was a choppy and volatile week for the Zloty. EUR/PLN has corrected lower to 4.1200 from its last week 4.2440 high but then the risk off hit the market again. On Thursday what looked at the time as slow correction higher, turned into the full stop loss scenario and we reached 4.2250 top before correcting lower again. The liquidity is getting poorer and poorer...

**Lower / higher again** The identical situation like on spot. After initial sell off of vols the market stabilized around 12.2% well off last week highs (6m paid 14% last week ). With the spike in spot, the vols jumped aggressively again, together with risk reversals and fly. We do not give any specific level for the reason that liquidity is being demolished by this wide swings, and the spreads are extremely wide. So after the 1y atm being sold at 12.1% in good amount, we are now enjoying the price of 12,0%-13,5% , please make your own conclusions how much did it rose.

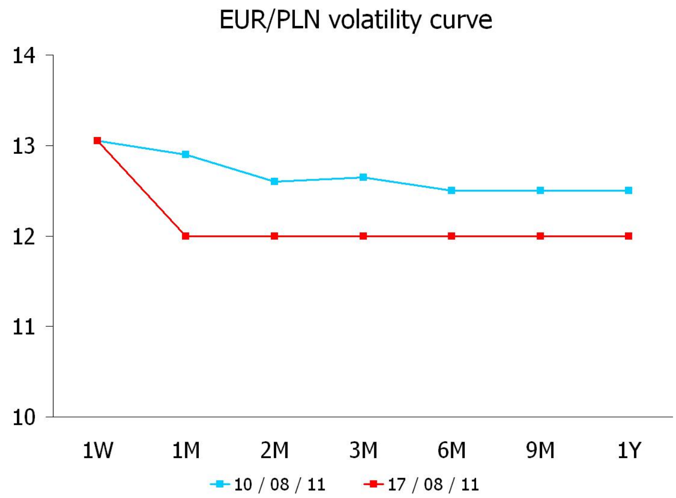


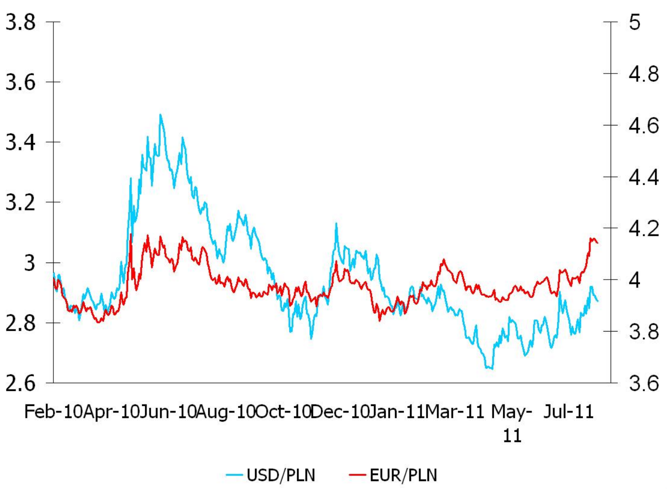

## Short-term forecasts

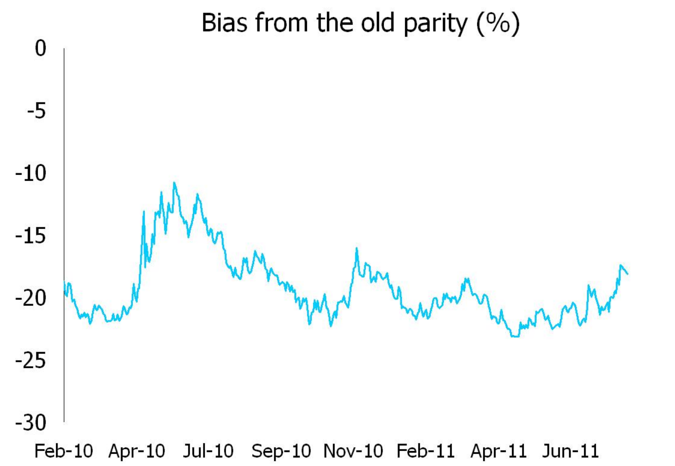
Main supports and resisances
EUR/PLN: 4.1600 / 4.2500
USD/PLN: 2.8500 / 3.0000

**Spot.** It s starting to look really ugly for PLN (risk in general). The wobbly global sentiment is not letting PLN settle back to sleep. As risk of the gaps of spot are clearly to the upside, we are now much more careful in going long PLN, then we historically used to be. We see a new wide range 4,15 - 4,25 And we would be more brave to buy EUR/PLN lows than sell EUR/PLN tops. Our macroeconomic fundamentals are no longer relevant...

**Derivatives.** We have bought back same of the long Vega position at around 12,50%. And to be honest we have a deja vu of the 2008 (one may call it experience, others the old uncured trauma). What ever it is, being Long Vega and Gamma, you at least know what is your possible Loss ( Theta, even if it may be very high)...Being short Vega, Gamma, Vanna or Volga is a big unknown. Over all we are better bids for above...



# 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 |
| 8/11/2011 | 4.62 | 4.72 | 4.72 | 4.73 | 4.75 | 4.77 | 4.71 | 4.74 | 4.75 | 4.74 | 4.72 | 4.78 |
| 8/12/2011 | 4.58 | 4.72 | 4.75 | 4.73 | 4.80 | 6.59 | 4.70 | 4.66 | 4.57 | 4.54 | 4.44 | 4.63 |
| 8/15/2011 | 4.62 | 4.72 | 4.08 | 6.49 | 4.08 | 4.77 | 4.66 | 4.65 | 4.56 | 4.52 | 4.43 | 4.57 |
| 8/16/2011 | 4.61 | - | 4.74 | 4.74 | 4.77 | - | 4.68 | 4.66 | 4.58 | 4.50 | 4.44 | 4.64 |
| 8/17/2011 | 4.62 | 4.71 | 4.74 | - | 4.77 | 4.77 | 4.67 | 4.66 | 4.56 | 4.50 | 4.44 | 4.67 |

| 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 |
| 8/11/2011 | 4.770 | 4.570 | 4.598 | 4.509 | 4.840 | 5.286 | 5.090 | 5.865 |
| 8/12/2011 | 6.590 | 4.530 | 4.610 | 4.510 | 4.840 | 5.326 | 5.120 | 5.874 |
| 8/15/2011 | 4.770 | 4.530 | 4.615 | - | 4.845 | - | 5.115 | - |
| 8/16/2011 | 4.770 | 4.570 | 4.495 | 4.446 | 4.735 | 5.179 | 5.020 | 5.770 |
| 8/17/2011 | 4.770 | 4.570 | 4.515 | 4.440 | 4.710 | 5.183 | 4.960 | 5.719 |

| EUR/PLN 0-delta stradle | | | | | 25-delta RR | | 25-delta FLY | |
|---|---|---|---|---|---|---|---|---|
| Date | 1M | 3M | 6M | 1Y | 1M | 1Y | 1M | 1Y |
| 8/11/2011 | 13.65 | 13.55 | 13.30 | 13.05 | 13.05 | 4.50 | 0.89 | 0.36 |
| 8/12/2011 | 13.65 | 13.55 | 13.30 | 13.05 | 13.05 | 4.50 | 0.89 | 0.36 |
| 8/15/2011 | 13.50 | 13.15 | 12.90 | 12.70 | 12.70 | 4.47 | 0.46 | 0.60 |
| 8/16/2011 | 13.25 | 12.90 | 12.75 | 12.65 | 12.65 | 4.50 | 0.46 | 0.61 |
| 8/17/2011 | 12.00 | 12.00 | 12.00 | 12.00 | 12.00 | 4.18 | 0.46 | 0.62 |

| PLN Spot performance | | | | | | |
|---|---|---|---|---|---|---|
| Date | EURPLN | USDPLN | CHFPLN | JPYPLN | HUFPLN | CZKPLN |
| 8/11/2011 | 4.1605 | 2.9191 | 3.9562 | 3.8129 | 1.5132 | 0.1720 |
| 8/12/2011 | 4.1509 | 2.9186 | 3.7884 | 3.8066 | 1.5166 | 0.1714 |
| 8/15/2011 | 4.1509 | 2.9186 | - | - | - | - |
| 8/16/2011 | 4.1583 | 2.8914 | 3.7004 | 3.7647 | 1.5390 | 0.1706 |
| 8/17/2011 | 4.1475 | 2.8785 | 3.6734 | 3.7549 | 1.5309 | 0.1700 |

# Disclaimer