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Comment on the upcoming data and forecasts

A bundle of macro data to be released on Friday afternoon: CPI, CA and M3. As regards CPI, our call is much more optimistic than the market with 3.9% against the consensus of 4.1%. We expect the base inflation to remain at 2.3% y/y, coupled with slight decreases in fuel and food prices in m/m terms (0.8% each). Hotels and restaurants up by 2-3%, but also a remarkable decline in footwear and clothing (widespread sales). Our forecast of current account surplus stems from a massive surplus in EU transfers (1071 M EUR!). Further positive contributors are lower import bill of oil, modest dividends and lower deficit in the income account. Low deficit in terms of trade balance persists (exports 12100 M EUR, imports 12480 M EUR), just like a small surplus in services. We expect the M3 y/y dynamics to continue the downward trend, in spite of further seasonal growth in enterprises' deposits at a subdued pace. There is more uncertainty around retail deposits that have been fluctuating a lot on a monthly basis. The households' deposits should grow seasonally, with annual dynamics remaining at 12% y/y after correcting for PLN appreciation. The base effects in smaller categories of M3 essentially cancel out.

Polish data to watch: July 9th to July 13th

Publication	Date	Period	BRE	Consensus	Prior
CPI y/y (%)	13.07.	June	3.9	4.1	3.6
M3 y/y (%)	13.07.	June	11.6	11.5	11.4
Current account (M EUR)	13.07.	May	301.0	-258.0	-573.0

Treasury bonds and bills auctions

Paper	Next auction	Last Offer	Last yield (%)	Prev auction
52 Week T-bills	-	3000	4.470	3/26/2012
2Y T-bond OK0714	7/19/2012	7500	4.759	4/19/2012
5Y T-bond PS0417	7/19/2012	4800	4.784	6/20/2012
10Y T-bond DS1021	7/11/2012	4000	5.349	5/10/2012
20Y T-bond WS0429	7/11/2012	4000	5.563	5/10/2012

Macroeconomic forecasts

Wskaźnik	2009	2010	2011	2012 F	2013 F
GDP y/y (%)	1.7	3.8	4.3	2.5	2.1
CPI Inflation y/y (average %)	3.5	2.8	4.2	3.6	2.8
Current account (%GDP)	-1.6	-4.5	-4.9	-2.5	-1.5
Unemployment rate (end of period %)	12.1	12.4	12.5	13.5	14.4
Repo rate (end of period %)	3.5	3.5	4.5	4.5	3.75

	2011	2011	2012	2012	2012	2012
	Q3	Q4	Q1	Q2 F	Q3 F	Q4 F
GDP y/y (%)	4.2	4.3	3.5	3.0	2.5	1.4
CPI Inflation y/y (average %)	4.1	4.6	3.9	4.1	3.8	3.2
Repo rate (end of period %)	4.50	4.50	4.50	4.75	4.75	4.50

F - forecast



Economics

MPC on hold, lower inflation projection

In line with expectations, MPC left interest rates unchanged in July's meeting. Yet, the diagnosis of the Polish economy presented in the communique has worsened. The paths of key macro variables in the latest inflation projection, presented at the same time, were lowered (GDP growth and inflation by 0.2-0.3 p.p. with inflation reverting to the target in mid-2013). In spite of this, the MPC maintained the sentence regarding the possibility of further monetary policy adjustment in the communique, in case the prospects of inflation's target-reversal deteriorate. Such a sentence, contrasting with the rest of the statement and projection results, is no more than an attempt to „smooth” the transition of MPC's rhetoric and hence stand for the credibility of the body that decided to hike rates no later than 2 months ago.

MPC to soften rhetoric in autumn

A similar message was conveyed in the press conference after the meeting. Governor Belka admitted that the outlook for growth is currently deteriorating, inflationary pressure – subsiding, and the MPC is „normalising” the interest rates – whereby further steps towards this normalisation could be postponed. This was obviously in contrast to Belka's remark that he was more afraid of weak growth than of inflation. For a few times did the MPC members (Każmierczak) deliberate about scenarios in which they could cut rates. Nonetheless, the general impression from the conference was not so dovish and confirmed how strongly (as far as in a dichotomy with business cycle diagnosis) the MPC's behaviour can be determined by the issue of defending reputation. In our view, the MPC's stance can change in the Autumn, when new data confirm the depth of the economic slowdown and inflation declines markedly. After the ECB's refi and deposit rates were cut by 25 bp this week, expectations of monetary easing in Poland can grow when CPI data for June is released next Friday.



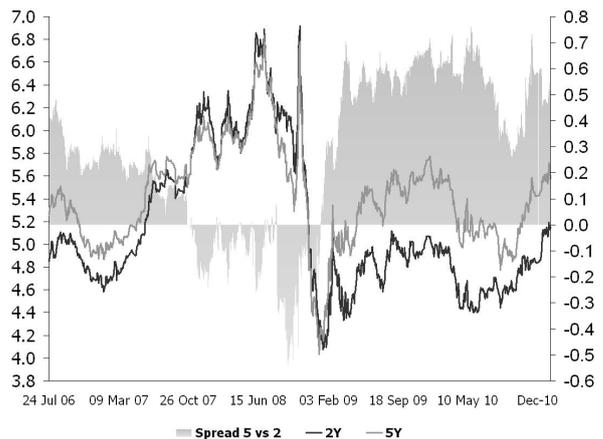
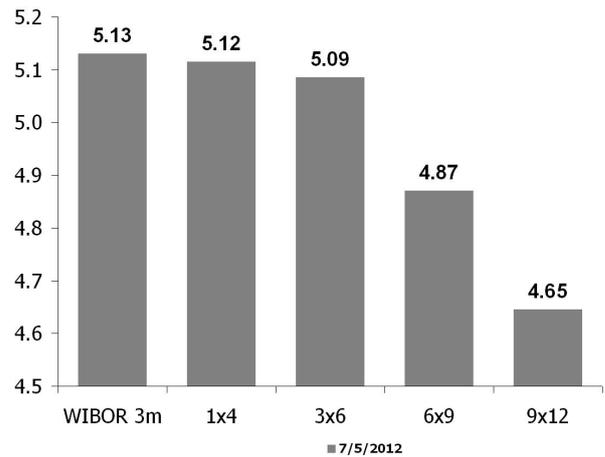
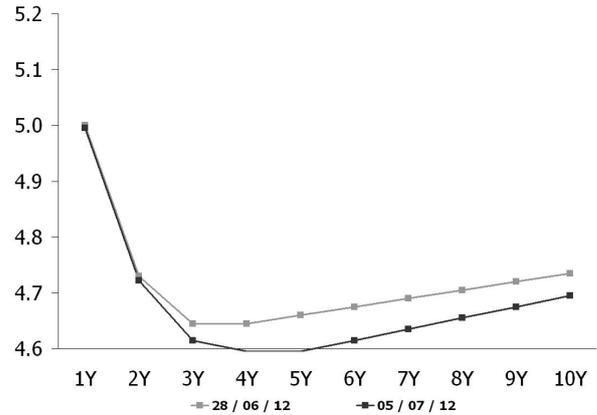
Fixed income

Awaiting fresh impulse

As for a week with MPC decision, the market remained relatively quiet. At the beginning of the week, rates continued to drift lower along with further flattening. On Wednesday, NBP rates were left unchanged and the comments from Council members drifted a little towards more dovish stance, however definitely not in a scale which had already been implied in the yield curve. Nevertheless, the reaction to the decision and press conference was somehow subdued.

Once again FinMin's switched auction turned out as a success - bond prices reached levels close to recent peaks just ahead of the tender and close to 5bio of 5 and 10 year maturities were bought. Later on some correction started, and bond yields pushed higher by some 10bp in the 10y-sector. Rates also followed the direction, but in a limited scale. In mid-term perspective, we remain positive on the rates, we consider the recent move as beginning of a consolidation phase which seems natural – considering the scale of the rally. We cannot find now much reason for a significant repricing of the bond market, on the other hand. For the rally to continue, we would definitely need some fresh support, coming either from macro data or from MPC's rethorics. It's hard to count on the latter, the former would also need some time to happen. Possibly next week's CPI data could be another trigger (we see it at 3.9% y/y, so below market consensus). In case of such outcome, we would expect some bullish steepening of the curve.

IRS curve



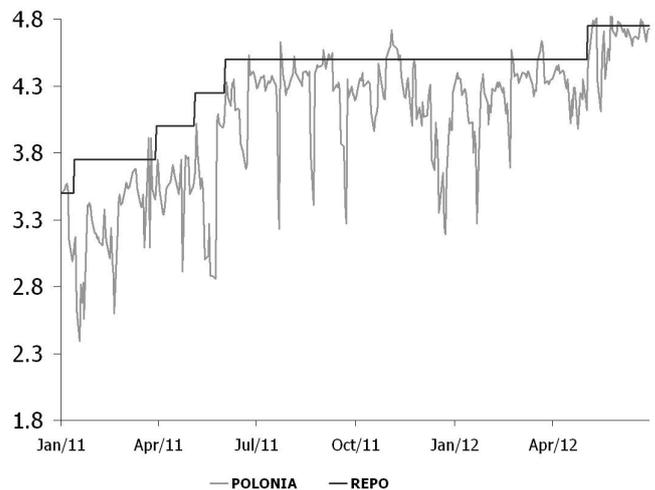
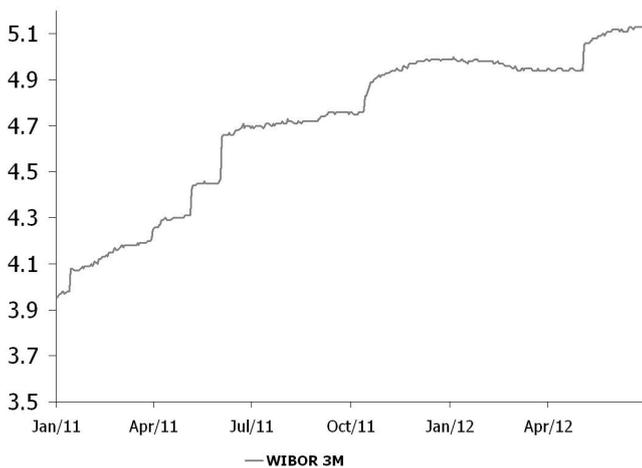
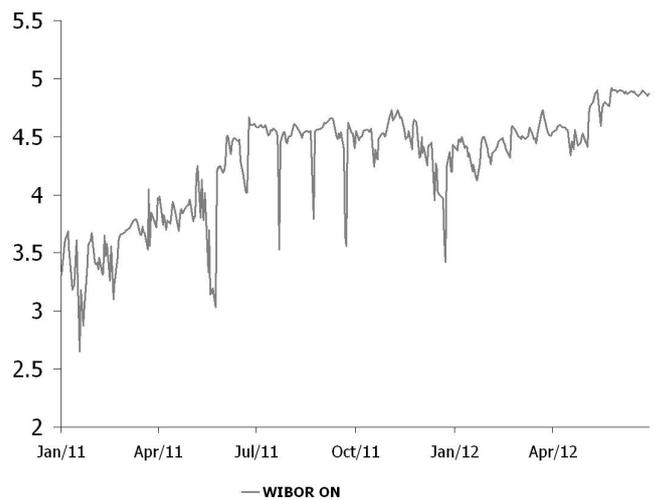
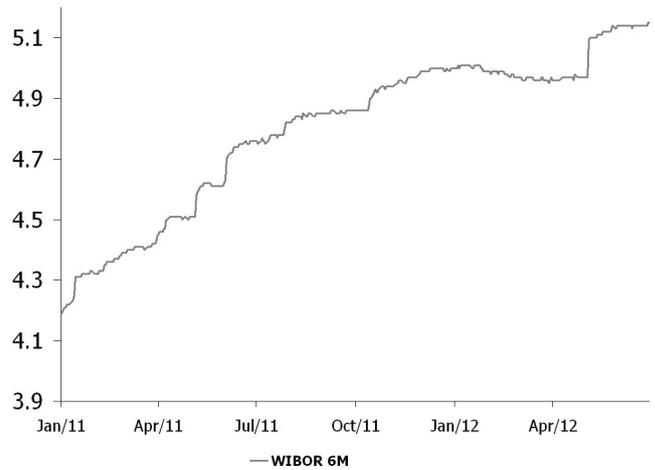


Money market

Rates on hold

Last week the MPC left Polish rates unchanged which was widely expected by the market participants. What moved market a bit was the afternoon press conference. Market is pricing cuts to come this Autumn but governor Belka didn't mention any cuts at all. What is more, he said they still watch the data and are ready to act if prospects of inflation coming down worsen. Although the move wasn't significant, 1y polonia rose around 3 bp, so did 1y3s. The market wants to have the position open and since there is no chance of a hike (in markets' view) everyone wants to be receive.

Nothing unexpected on short term cash. It's a beginning of a new month, rates are stable around 4.70. Next week we should hold to these levels as well.





Forex

Zloty stronger. In the beginning of the week hopes for an ECB rate cut sustained optimism and EUR/PLN remained on a downside trend. It was even trading below 4.19 but finally failed to break 4.18. Thursday was the day of many events: ECB decision, good US ADP and China rate's cut, which should be read as positive for emerging markets – finally falling EUR/USD has thwarted the decline of EUR/PLN towards 4.15. Now EUR/PLN corrects higher to 4.22.

Vols softer. After the EU summit and measures to strengthen the banking system, the sentiment was improved and we had another week with falling volatilities. The 1 month moved down from 10.3% to 9.0% (13% percent of nominal value!), 6 month from 10.9% to 9.8% (10% percent of nominal value!), 1 year is now 10.7% versus 11.45% last week (almost 7% percent of nominal value!). 1 year 25D risk reversal is now around 4.0%, 3m 25d RR is now 2.75% versus 3.0% last week. The currency spread (difference between USD/PLN and EUR/PLN) consolidated around 7.5%.

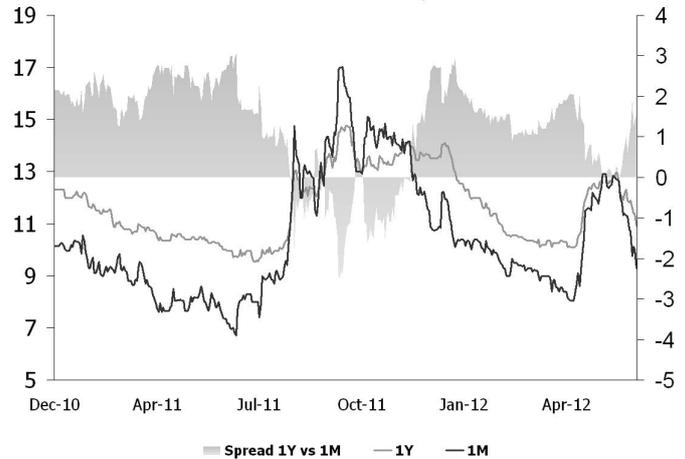
Short-term forecasts.

Main supports and resistances
EUR/PLN: 4.1500 / 4.2800
USD/PLN: 3.3000 / 3.4800

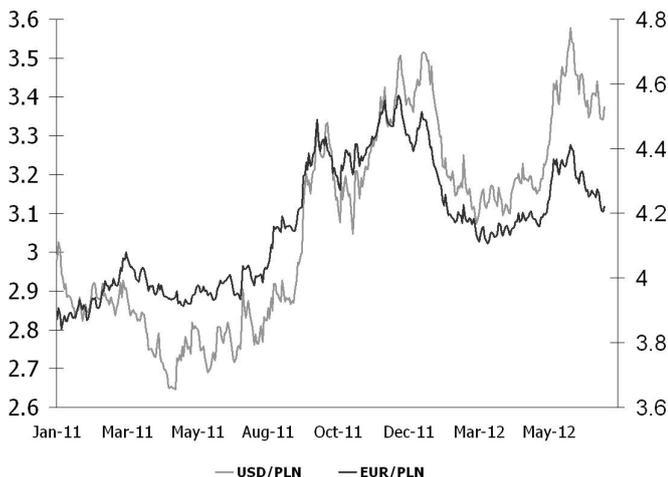
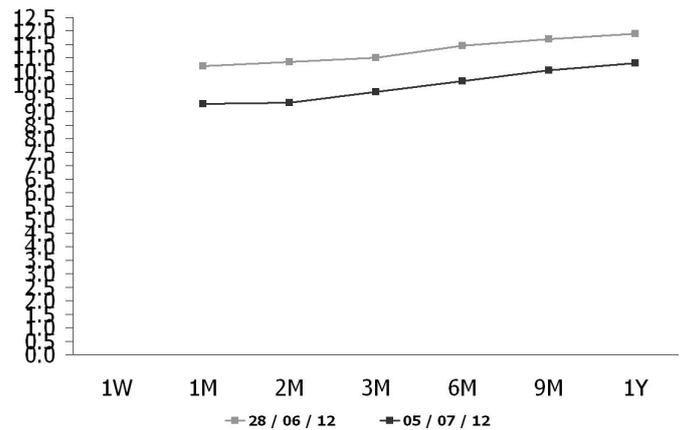
Spot. The zloty rally was impressive but the scope for further appreciation depends mostly on external factors and the behavior of EURUSD. EUR/PLN 4.22 seems to be local resistance but falling EURUSD and any negative news could bring a rebound to 4.25. We would stay sidelined at the moment.

Derivatives. Vols have come off significantly over the past 3 weeks. We have experienced a very healthy supply of Vega. Realised volatilities are significantly higher than implied volatilities (for example 1m 11.5% realised versus 9.0% implied, 1y 11.4% realised versus 10.7 implied). Therefore we like to buy outright vanillas as gamma looks to be performing.

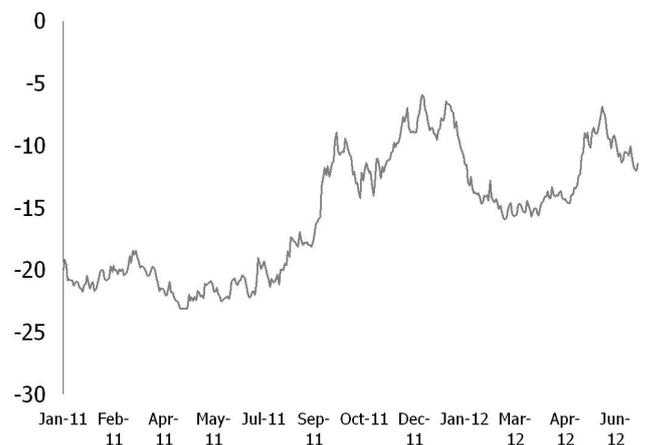
EURPLN volatility



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
6/29/2012	4.94	5.13	5.15	5.04	5.07	5.05	5.11	5.09	4.85	4.62	4.42	4.84
7/2/2012	5.08	5.13	5.09	5.04	5.09	5.05	5.13	5.10	4.86	4.64	4.44	4.85
7/3/2012	4.99	5.13	5.15	5.04	5.07	5.05	5.11	5.10	4.86	4.64	4.43	4.89
7/4/2012	4.92	5.13	5.38	5.05	5.25	5.05	5.10	5.08	4.86	4.65	4.42	4.86
7/5/2012	4.70	5.13	5.05	5.05	5.00	5.05	5.12	5.09	4.87	4.65	4.42	4.86

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
6/29/2012	5.050	4.813	4.665	4.667	4.585	4.725	4.680	5.154
7/2/2012	5.050	4.813	4.690	4.632	4.590	4.710	4.670	5.162
7/3/2012	5.050	4.813	4.703	4.662	4.570	4.699	4.675	5.179
7/4/2012	5.050	4.813	4.715	4.612	4.581	4.722	4.685	5.126
7/5/2012	5.050	4.813	4.723	4.630	4.595	4.755	4.695	5.164

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
6/29/2012	9.75	10.40	11.00	11.60	11.60	3.71	0.67
7/2/2012	10.13	10.63	10.88	11.40	11.40	3.71	0.67
7/3/2012	10.00	10.30	10.80	11.40	11.40	3.80	0.92
7/4/2012	9.30	9.75	10.25	10.90	10.90	3.70	0.58
7/5/2012	9.30	9.75	10.15	10.80	10.80	3.70	0.67

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
6/29/2012	4.2613	3.3885	3.5477	4.2613	1.4784	0.1664
7/2/2012	4.2308	3.3456	3.5217	4.1999	1.4810	0.1663
7/3/2012	4.2110	3.3427	3.5052	4.1890	1.4786	0.1649
7/4/2012	4.2046	3.3415	3.5005	4.1870	1.4754	0.1648
7/5/2012	4.2221	3.3743	3.5142	4.2367	1.4716	0.1651

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