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

Andrzej Torój, PhD
analyst
tel. +48 22 526 70 34
andrzej.toroj@brebank.pl

Financial Markets Department
(business contacts)

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

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

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

Financial Markets Sales Department
(business contacts)

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

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

Retail sales data for June to be released on Thursday – our forecast 8.0% (versus consensus 7.7%). No visible and quantifiable EURO 2012 effect. Historically, peaks were observed in some host countries, but in May if any, and hence already behind, anyway. One working day less than a year ago. We can also expect an acceleration in sales of food and non-specialised markets at the cost of durable goods. As regards the unemployment rate, 12.4% is the government's forecast and we see no need to argue this time. No EURO 2012 effect either, but the reliability of historical comparisons may be limited due to methodological differences in unemployment rate definitions.

Polish data to watch: July 23rd to July 27th

Publication	Date	Period	BRE	Consensus	Prior
Retail sales y/y (%)	26.07.	June	8.0	9.0	7.7
Unemployment rate (%)	26.07.	June	12.4	12.2	12.6

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	18/25-10-12	5000	4.361	7/19/2012
5Y T-bond PS0417	8/1/2012	4800	4.784	6/20/2012
10Y T-bond DS1021	12/19-09-12	4000	5.349	5/10/2012
20Y T-bond WS0429	12/19-09-12	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	5.3	3.75

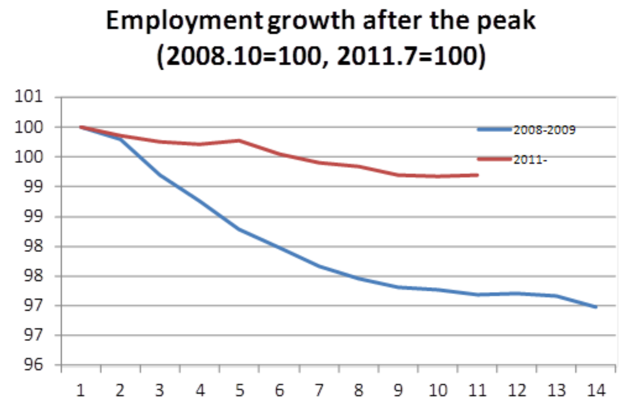
	2011 Q3	2011 Q4	2012 Q1	2012 Q2 F	2012 Q3 F	2012 Q4 F
GDP y/y (%)	4.2	4.3	3.5	3.0	2.5	1.4
CPI Inflation y/y (average %)	4.1	4.6	3.9	4.1	3.8	3.2
Repo rate (end of period %)	4.50	4.50	4.50	4.75	4.75	4.25

F - forecast

Economics

Meager employment numbers, still decent growth of employment

Employment in the enterprise sector grew by 0.1% y/y in June (market consensus 0.2%, our forecast 0.2%). In absolute terms, employment expanded by 1.6k in the last month, a meager number taking into consideration the boost EURO2012 may have given to payrolls in services. Therefore falling trend in employment (excluding temporary effects) stays intact but also stays gradual (see the graph for comparison with 2008-2009). We expect payroll reductions to become more pronounced in the coming months, along with the GDP trajectory, taking into account that the slowdown has not yet reached its bottom (we expect it at the turn of 2012/2013). We cannot rule out negative changes in employment in y/y terms and expect accelerating growth in unemployment rate (disagreeing, at the same time, with the Ministry of Labour forecasts below 13% at the end of the year).



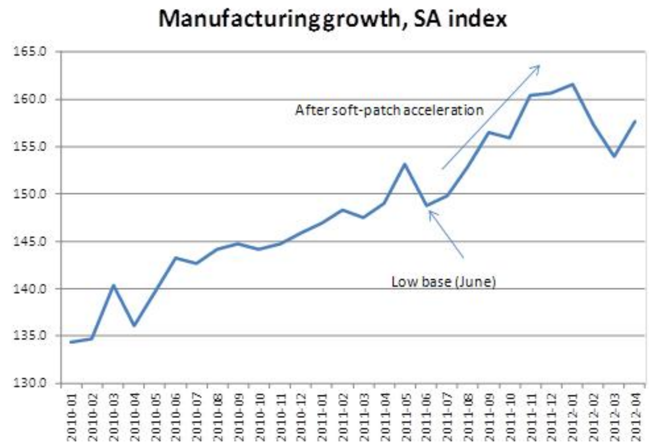
On the other hand, growth of wages seems encouraging (increase from 3.8 to 4.3 in y/y terms) but hard to explain with fundamentals. Most likely, it is a result of rescheduled bonuses paid in copper mining. It is too early for wages to be affected by the state of the economy, as the slowdown so far has been highly gradual. Wage dynamics is usually affected a few months after the slowdown intensifies, i.e. at a lag with respect to the business cycle.

Market rates rose a bit after the publication (round 2bp). However, it was the release of industrial output data on Wednesday that mattered much more as decisive for rates in the near term.

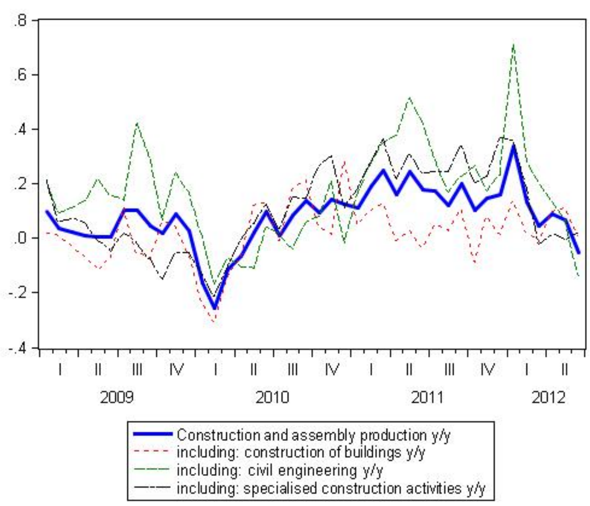
Very soft industrial output. Infrastructure came to a halt and shifts reverse gear

Output. Industrial output grew in June by 1.2% y/y (market consensus 3.8%, our forecast based on auto production data 5.4%). Manufacturing itself grew by 1.8% y/y, which is not an impressive result, either. A highly negative contribution for the entire production aggregate came from mining, as well as electricity, gas and water supply.

Taking into account a positive base effect from last year (see the graph), output growth is very soft and when we strip sections possibly accelerated by EURO2012 (such as food), it is even softer (negative). These sections will probably put a drag on the July's figures. It is global slowdown that affects the Polish economy along with spreading softness of internal demand. A growing contribution to the slowdown of the Polish economy is being generated by exports, with production of furniture at -8.8% y/y in June and production of cars at -7.2% y/y. We expect those two factors to exert even more negative pressure in the months to come with the latter spreading possibly also to 2013. Therefore it is in July when we can see a negative industrial output print and owing to more and more negative base effects (see the graph) next months are set to be weaker.



Construction and assembly production fell in June by 5.1% y/y. This was actually much worse than market expectations, even on the pessimistic side (our forecast: +2.2%, market: +4.5%), and it has been the worst reading since the bottom in the first half of 2010. This time is different, however, which can be concluded from the sub-sectoral breakdown of the decline. There were in fact positive y/y growth rates in the construction of buildings (0.5%) and specialised construction activities (2.1%). The substantial drop was entirely due to civil engineering, which fell by as much as 14.0%. In our view, this indicates a strong dying-out effect of big infrastructural projects. It also confirms the scenario of a negative contribution of public investment to GDP in the coming quarters.



Producer prices hit our forecast (4.4%, as compared to 5.0% in the previous month). The monthly dynamics in manufacturing was negative at -0.5% – quite a lot, historically. However, for now it is only commodity prices that exert negative pressure on inflation in manufacturing. Cyclical easing of price pressure is set to come along with the more pronounced slowdown in the real sphere we are witnessing now. Assuming neutral scenario for commodity prices this may bring annual producer price inflation down to zero before year's end.

Implications for MPC behaviour. Despite some allergic comments by Kazmierczak that the MPC's reputation is at stake weaker data are unlikely to be neglected by the Committee. Falling inflation, worsening perspectives for fiscal policy (hiccup in tax receipts suggest there may be more fiscal tightening in the pipeline to conform with the targets outlined in the convergence report) and real economy weakness are enough for the MPC to engage in a fully fledged easing cycle (100bp+) in the Autumn. The scale of negative surprise for some MPC members (their macro scenario is still for very shallow slowdown followed by strong recovery) suggests more than standard 25bps steps will be taken into account. The easing cycle is likely to be initiated in October/November. We still belive that for investors it is of equal importance not only to see the realization of macro scenario (deep slowdown in our case) but also see a convergence of consensus view towards ours. Although it have not happened yet the rate cuts scenario priced in now (due to stop-loss hunting) looks too rapid.

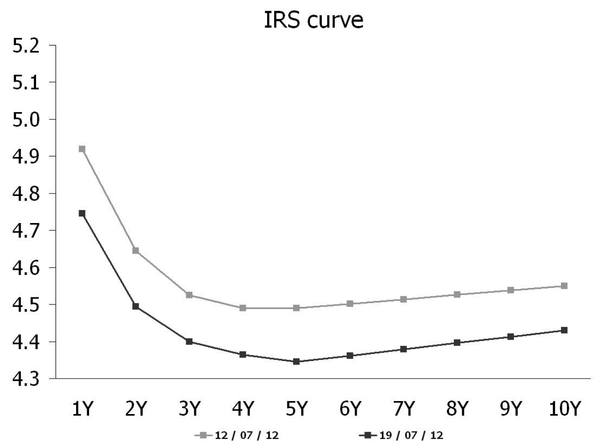
Fixed income

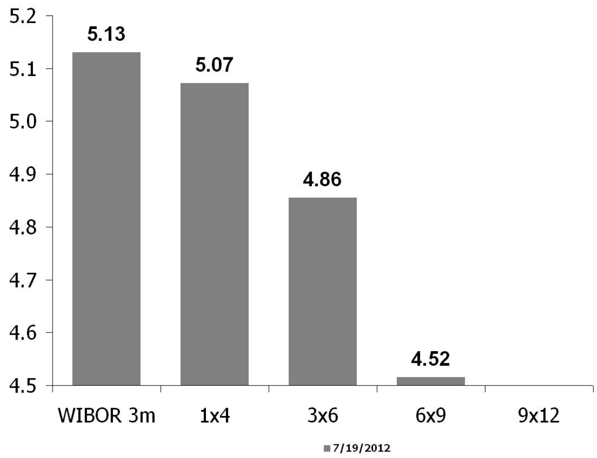
Take profit

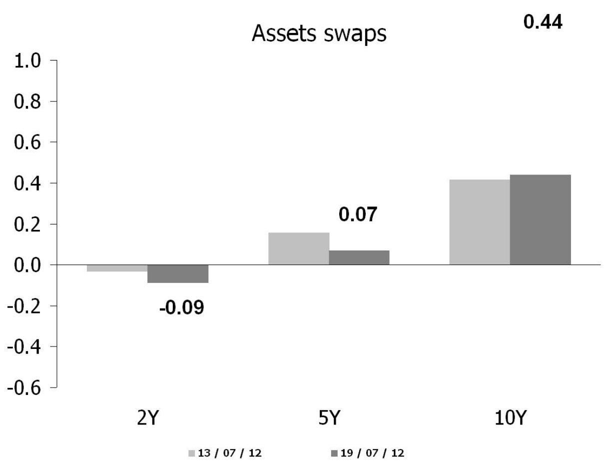
Quite a busy week behind us with an unexpected macro data readings and massive rollercoaster in market sentiment. Though the wage data at 4.3% might have been a trigger to take some profits from the latest rally levels, the industrial output figure at 1.2% had totally reversed the sentiment pushing down rapidly the short end of the curve to the new lows. As a result the market had priced the interest rate cuts in September, October, November, January, April and a chance in June by nearly 125bp in total. The yield curve obviously went steeper trading 2y5y spread from -24bp lowest to -9 points. The bond curve also started to steepen massively in 5y10y sector as 10y bonds heavily underperformed 5y and shorter bonds.

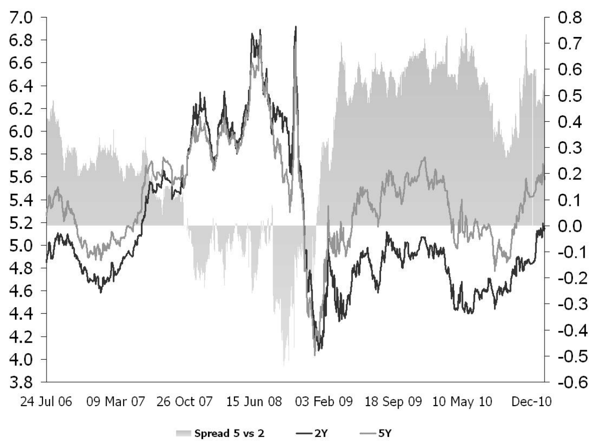
On Thursday evening we had an interview with Kaźmierczak (MPC hawk) to the local TV station. He stressed that MPC obeys primarily inflation mandate, GDP growth is slowing down but there was nothing like an recession expected. He believed GDP would have to rebound in second half of 2013 and the Central Bank would need to be consistent and would not risk its reputation after recent hike; therefore talking about rate cuts was quite premature. MPC needed to clearly see CPI trending down until it would think of any bias change.

We think, with all respect to the market, we had already priced-off the whole last tightening cycle coming back to the 3.50-3.75% repo rate again in 12M forward rates. We believe taking profits on these levels would be reasonable.





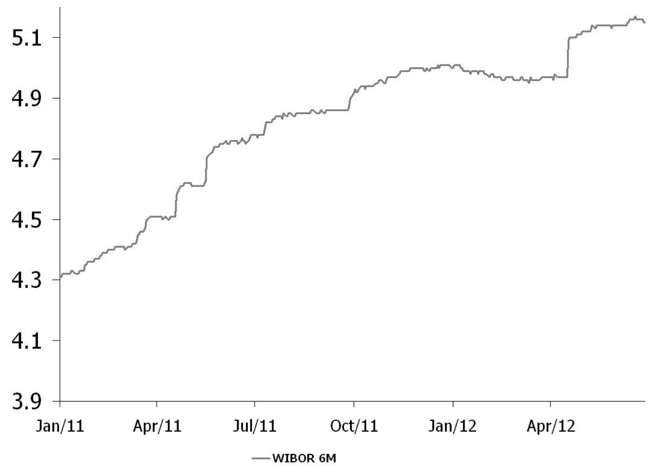


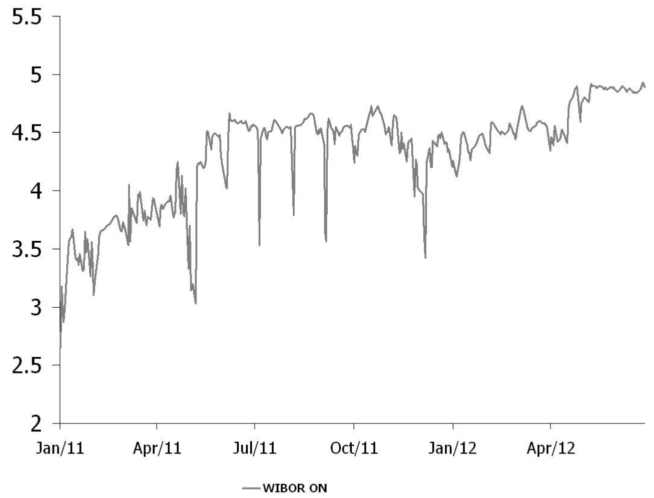


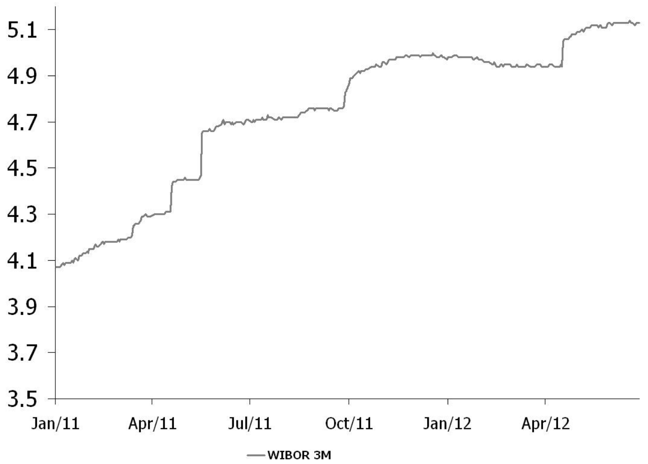
Money market

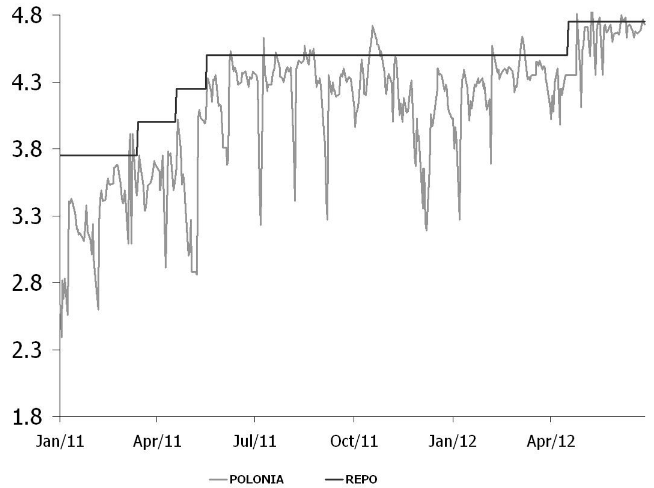
Weak industrial output Last week we had a industrial output reading which came out lower than market consensus. This sent market lower, and on Thursday's stop losses came through the market. Now it looks like the market has finally found some support, after having priced in 75 bp cuts in the near future.

Today's NBP auction was underbid and market is left with 10 bio surplus since it is close to the month end and banks are less flexible in managing reserves. We can see some downside in cash, so it will be interesting next week to see whether the NBP does additional OMO and how big it is. We were pointing out that central bank is worried about small daily turnover in overnight, it could be easily supported if they wouldn't drain all the cash from the market.





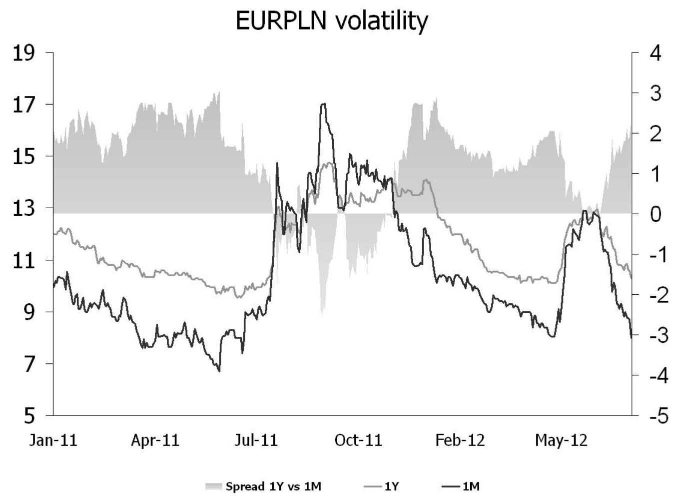




Forex

Stalemate. The EUR/PLN is hovering just above the strong support at 4.1450. Healthy appetite for PLN denominated bonds and PKO BP shares (7% was offered by the government) are keeping the EUR/PLN close to this year's low (4.0855). On the other hand the dovish comments from MPC and crisis of euro area peripheral countries are preventing PLN from reaching the new highs. The stalemate is going to continue, for the time being.

Vols at lows. We have touched the multiyear's support zone for EUR/PLN volatility curve. The levels of 1m 7.75% and 1y 10.25% (mids), historically good buying levels. The skew is also offered and currency spread (difference between USD/PLN minus EUR/PLN) crushed to 6.5% in the frontend and 7% in the backend. The USD/PLN 1y traded in good amount at 17.3%.

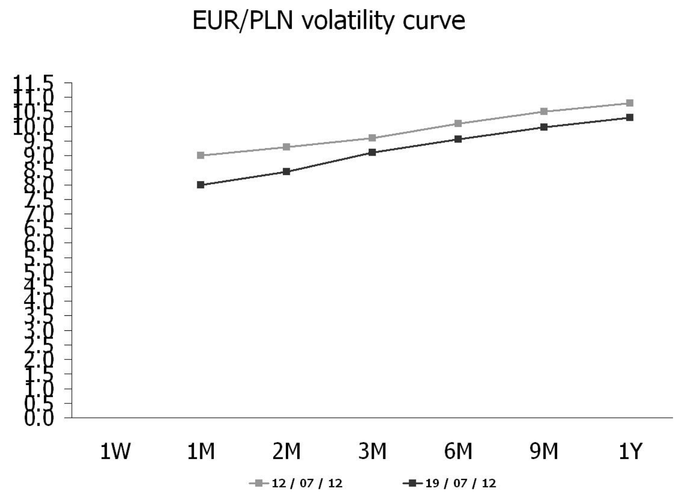


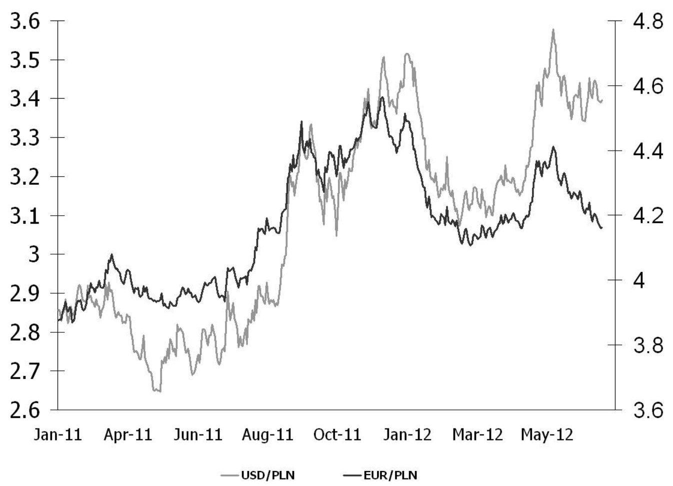
Short-term forecasts.

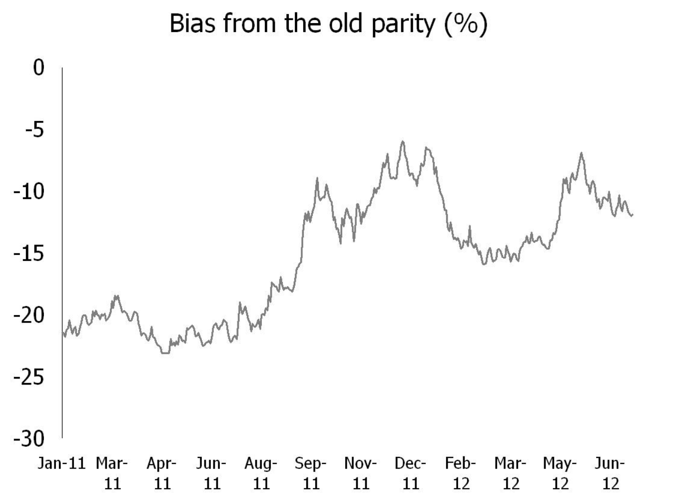
Main supports and resisances
EUR/PLN: 4.1450 / 4.2350
USD/PLN: 3.3200 / 3.4700

Spot. We would like to buy EUR/PLN at 4.1250/4.1450 level with stop at 4.100 and hopes for 4.2000. We have the feeling that there is certain level of stops on short PLN just under 4.1500. Once it clears, EURPLN may have some potential to go back to 4.20/4.23 region.

Derivatives. 1 week on EUR/PLN atm is now only 7.75% mid, it is really low but the historical (realized) volatility is even lower at 6.84%. We are not in the hurry to buy the frontend, as the low realized volatilities may stay here for a while. But we are better bid for longer dates in EUR/PLN, believing in its mean reverting characteristics.







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
7/13/2012	4.93	5.13	5.12	6.49	5.10	6.59	5.10	4.98	4.72	4.48	4.35	4.70
7/16/2012	4.97	5.12	4.98	5.06	4.98	5.06	5.09	4.98	4.72	4.50	4.29	4.74
7/17/2012	4.90	5.13	5.13	5.06	5.10	5.06	5.10	4.98	4.72	4.51	4.31	4.74
7/18/2012	4.98	5.13	4.98	5.06	4.95	5.06	5.10	4.90	4.59	4.38	4.12	4.64
7/19/2012	4.99	5.13	5.04	5.05	5.09	5.06	5.07	4.86	4.52	4.30	4.15	4.49

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
7/13/2012	6.590	4.813	4.613	4.580	4.435	4.591	4.496	4.911
7/16/2012	5.060	4.813	4.630	5.294	4.410	4.576	4.470	5.013
7/17/2012	5.060	4.813	4.670	4.553	4.460	4.607	4.515	4.959
7/18/2012	5.060	4.813	4.553	4.488	4.385	4.484	4.440	4.859
7/19/2012	5.060	4.813	4.495	4.409	4.345	4.413	4.430	4.869

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
7/13/2012	8.75	9.65	10.15	10.85	10.85	3.91	0.84
7/16/2012	8.75	9.45	9.90	10.60	10.60	3.91	0.84
7/17/2012	8.70	9.45	9.90	10.60	10.60	3.85	0.84
7/18/2012	8.00	9.10	9.55	10.30	10.30	3.81	0.78
7/19/2012	8.00	9.10	9.55	10.30	10.30	3.81	0.78

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
7/13/2012	4.2055	3.4463	3.5018	4.3479	1.4501	0.1656
7/16/2012	4.1939	3.4353	3.4924	4.3458	1.4527	0.1650
7/17/2012	4.1782	3.3973	3.4791	4.2961	1.4530	0.1647
7/18/2012	4.1705	3.3950	3.4730	4.2948	1.4592	0.1650
7/19/2012	4.1596	3.3900	3.4630	4.3109	1.4616	0.1643

Disclaimer

Distribution and use of this publication The review note is based on the information available to the public. This review creates exclusively a marketing information as defined in Paragraph 9 Section 1 of the Decree of Minister of Finance dated November 20, 2009 on procedures and conditions to be followed by investment firms and banks mentioned in Article 70 Section 2 of Law on Trading in Financial Instruments dated July 29, 2005 as well as by custody banks. This review note is provided to you for information purposes only and is not intended as advice on any particular matter or as recommendation, offer or solicitation for purchase of sale of any financial instrument and should not be taken as such. BRE Bank SA, its directors, officers, executives, managers, servants or agents expressly disclaim all liability to any person in respect of any-thing, and in respect of the consequences of anything, done or omitted to be done, wholly or partly, in reliance upon the whole or any part of the contents of this review note. The opinions and estimates contained herein reflect the current judgment of the author(s) on the date of this document and are subject to change without notice. The opinions pointed in review do not necessarily correspond to the opinions of BRE Bank SA. The past performance of financial instruments is not indicative of future results. No assurance can be given that any financial instrument or issuer described herein would yield favourable investment results. BRE Bank and/or its principals or employees may have a long or short position or may transact in the financial instrument(s) and/or securities referred to herein or may trade in such financial instruments with other customers on a principal basis. No client or other reader should act or refrain from acting on the basis on any matter contained in it without taking specific independent professional advice on the particular facts and circumstances in issue. Copyright protection exists in this publication and it may not be, even partially, reproduced of distributed without the prior written agreement with BRE Bank SA.