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Table of contents

Economics page 2
- Retail sales still trending downwards

Fixed income page 3
- Downtrend

Money market page 4
- Release on carry supported the interbank turnover
- Market has already priced a lot

FX market page 5
- Strong gains
- Small rebuilt

Comment on the upcoming data and forecasts

Not a very data-rich weak, with its only highlight being Wednesday's PMIs as the pioneering publication for July. Our low expectations follow a sequence of last week's poor preliminary readings for Germany, where both PMIs and Ifo surprised on the downside. This would also remain in line with expected negative GDP dynamics for Germany in q2.

Polish data to watch: July 30th to August 3rd

Publication	Date	Period	BRE	Consensus	Prior
NBP Inflation Expectations (%)	31.07.	July			3.7
PMI	01.08.	July	47.3		49.0

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	18/25-10-12	5000	4.361	7/19/2012
5Y T-bond PS0417	01-08-2012	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	4.25	3.5

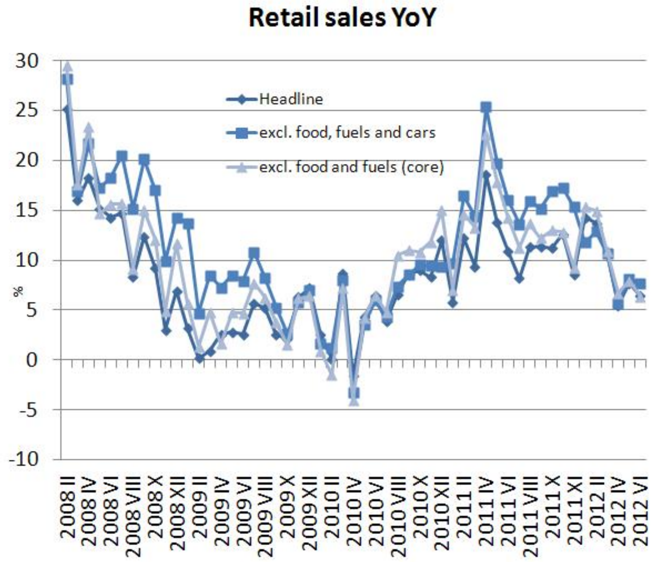
	2011 Q3	2011 Q4	2012 Q1	2012 Q2 F	2012 Q3 F	2012 Q4 F
GDP y/y (%)	4.2	4.3	3.5	2.7	2.2	1.4
CPI Inflation y/y (average %)	4.1	4.6	3.9	4.1	3.9	3.2
Repo rate (end of period %)	4.50	4.50	4.50	4.75	4.75	4.25

F - forecast

Economics

Retail sales still trending downwards

Retail sales grew in June by 6.4% y/y (after 7.7% in the previous month). After excluding foods and fuels, the sales dynamics amounted to 6.3%, and if we additionally exclude automobiles – 7.6%. This provides a fairy stable picture, though mainly supported by one-offs.

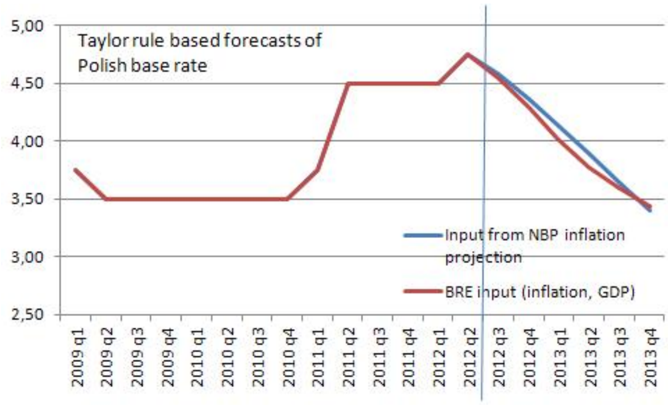


The sales figures are in fact quite poor, especially seen in the context of current one-off effects. There were above all high increases in foods sales (around 6-7% for the second consecutive month), sales in non-specialised stores (around 13-15% for the second consecutive month), as well as in the category „furniture, radio, TV and household appliances" (22-24% for the second time, as well). Although the EURO 2012 impact should first of all be scanned for in services (and not really sales of goods), the narrow range of categories suspected of pumping up the data for goods encompasses the abovementioned baskets precisely. The remaining significant baskets are visibly downward trending: the growth rate of automobile sales nearly hit zero (only +1% against 7.2% last time); the dynamics of fuel sales also fell (from 12.6% to 7.7%), along with a marked slowdown in the category „others" (-2.6%, although this figure alone should not be overstated due to high intrinsic volatility of this category as such).

This data, coupled with continuously weak financial situation of households (business cycle queries by CSO), progressing labour market weakness and the necessity to reconstruct the savings rate, pave a decreasing trajectory for consumption. Although hosting the European football championships has historically brought about peaks in the consumption dynamics regarding the quarter in which games took place (*vide* e.g. EURO 2008, while 2004 was a different story due to the additional impact of EU enlargement...), this time the underlying trend for consumption is probably strong enough to offset it. The last observation is supported by the – already observable – deterioration in budget revenues from VAT. Bottom line, we expect the consumption in q2 to have grown slower than in q1 and the dynamics of entire GDP to have equalled around 2.7%.

A drop in market rates by 5bp followed this release. The market reacted significantly, although the reading came actually not very far from the consensus. The reason is that this publication fit very well into the recent sequence of negative surprises. In this context, we do not change our view that the MPC will probably decide to cut rates as soon as this year, probably in October or November (we bet the latter so far) and by more than 25 bp.

We also did some calculation based on official estimates of the Taylor rule provided by the NBP research. Under the assumption of minimal positive equilibrium real interest rate (it was the main point in recent MPC rhetoric) in both cases 1) with an input from NBP inflation projection and 2) with our forecasts for inflation (higher than NBP) and GDP (lower than NBP) we got very similar forecasts for the WIBORM3M (and then REPO rate). Rates should thus fall by 125-150bps by the end of 2013. The result is astonishingly close to what is currently priced in by the market.

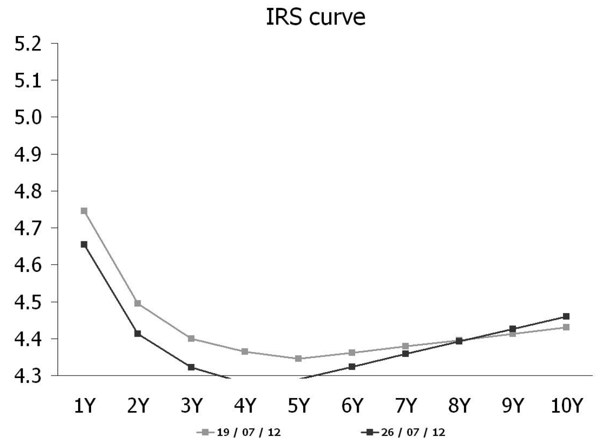


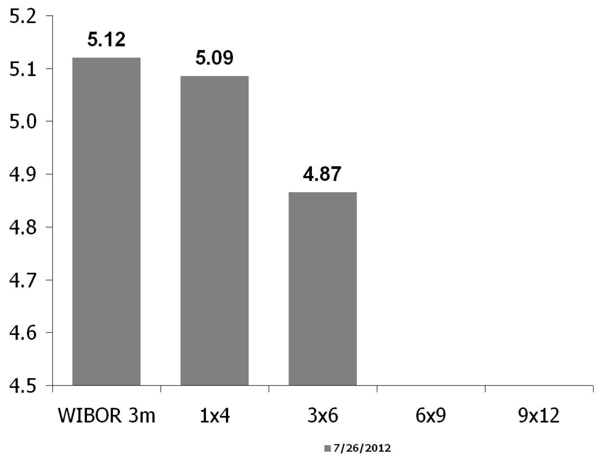
Fixed income

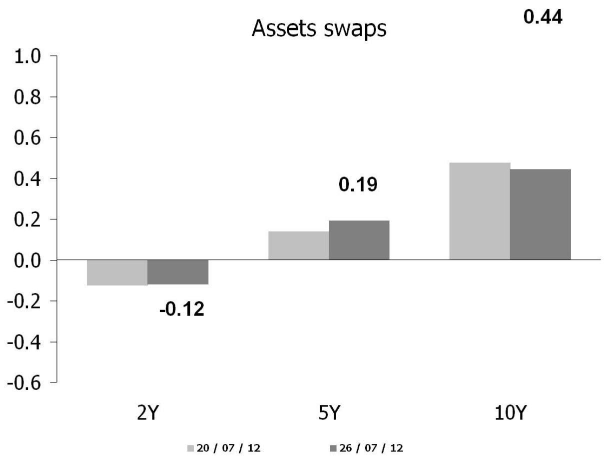
Downtrend

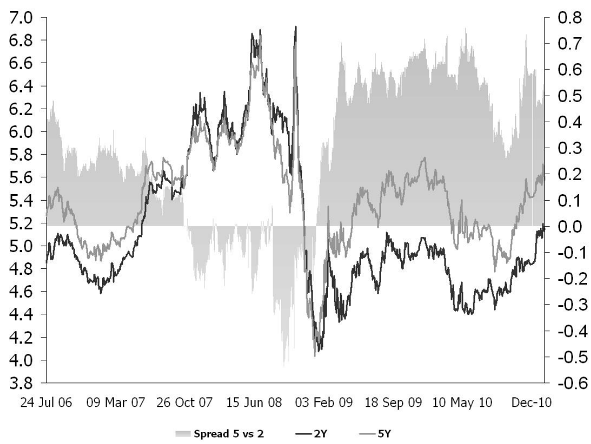
The profit taking in rates that we had expected last week turned out to be very short-lived. The market took some profits on longer-dated bonds, pushing the yield curve by some 5-10bp up with the steeper shape (2y10y dealt at +7 and 5y10y at +15). In the meanwhile, we had some MPC members reviewing the current economy standing on tape. The central bank's chief Belka stressed the domestic market was quite resilient, but dependent on developments in euro area. While CPI rise had nothing to do with demand pressures, the Polish rates seemed to stay high relative to other countries. That might give little guidance, the MPC started to move towards more neutral stance for rates. Moreover, the MPC dove Chojna-Duch announced she would be ready to back any rate cut starting from September's meeting, if the motion was placed. The reversed sentiment on rates after the comments was fuelled by the retail sales data that came out lower to any consensus despite EURO 2012. The front end of the curve plunged to the new lows trading 1y IRS at 4.67% and 2y at 4.40%.

It looks quite obvious that even the MPC hawks tend to avoid the risk of lost reputation after the last tightening in May, the question is when they start cutting. Despite the visible slowdown, the hawkish part of MPC cannot see any reason for rapid easing at the moment but they have just started to signal they might change their minds after the September's and October's data. As the market has already priced over 100bp easing, the vital question is not if they cut this year but when it starts and with what scale. We think that, regardless of the scope and the timing of easing we would prefer to stay received in rates up to 2y anyway.



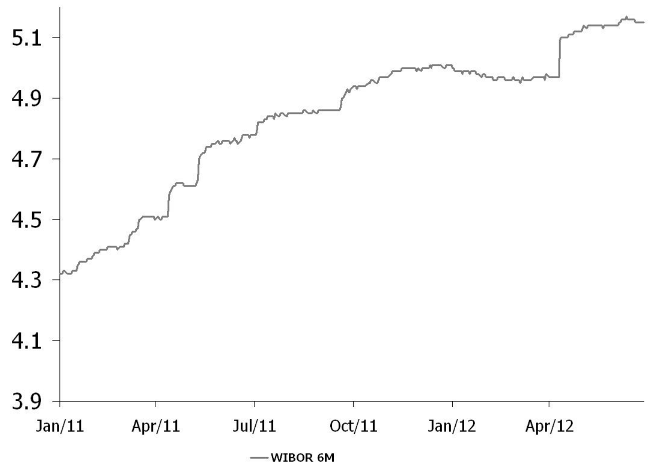






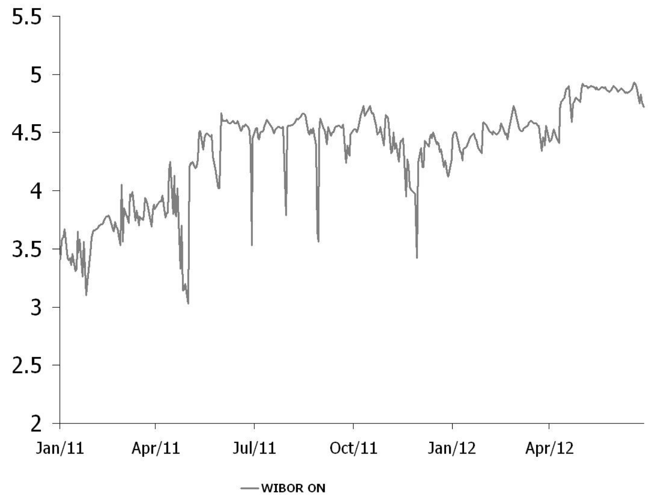
Money market

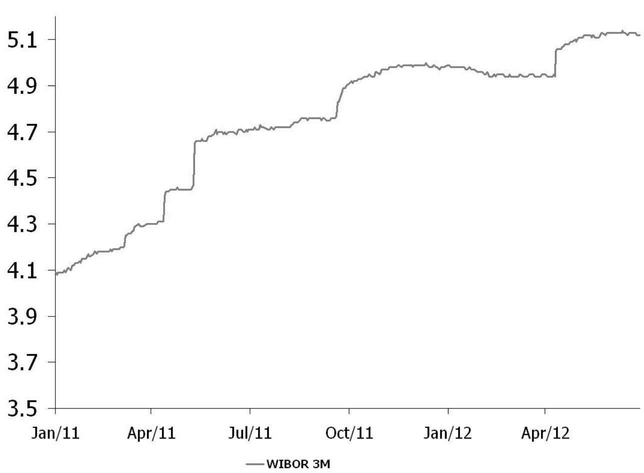
Release on carry supported the interbank turnover. Cheaper end of the reserve comparing to what we were lately used to. The central bank was trying to sterilise the market on Tuesday, however it seems that the system needs a bit cheaper cost of carry (with the FI yields at today's levels, the carry around the main rate becomes a real pain). We also see growing asymmetry in the system's liquidity layout, which explains the deposits in the central bank showing up with rates being quoted well above 4%. Another fact that proves our theory about the frequent interventions is that, along with the falling cost of carry, we see the interbank turnover growing significantly to the decent levels (couple of yards instead of few hundreds on polonia). Therefore, it should be clearly visible to the central bank that defending the goal with questionable logic, which is stabilising the polonia index near the main rate, has huge side effect – killing the interbank market.

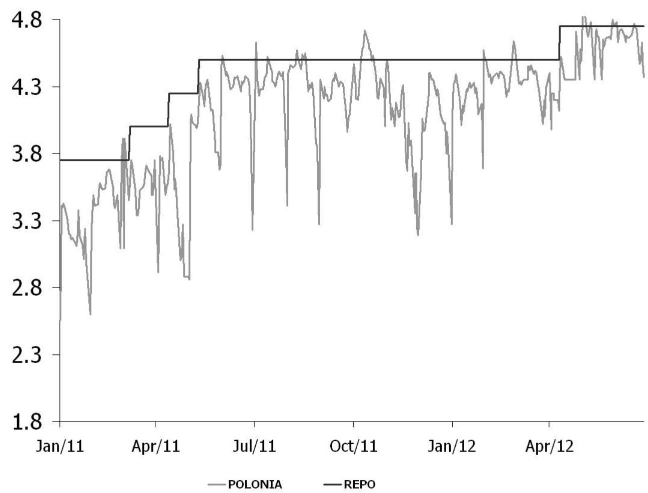


Market has already priced a lot. Huge bullish wave supported by the weak retail sales, unemployment, stronger currency and some really dovish comments from the MPC side. The market has already priced 100-125 bps of the quite fast cuts (depending on the market sector), with the FRA contracts (2*5,2*8) seeing 25 bps cut as soon as in September. We think that such timing bet is probably well overdone.

Offer long oiss at current levels.



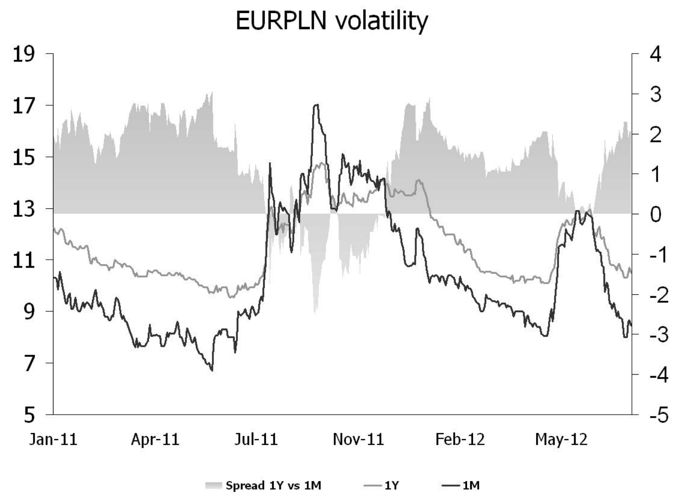




Forex

Strong gains. After a flirt with 4,2200, EUR/PLN plunged to 4,1225 on the back of ECB comments, which raised the hopes for a miracle. One can dispute what the reason behind the move is, but the price action speak for itself. We believe that the several s/l where executed on the move down. After such a sharp move down, EUR/PLN the most probably will enter a consolidation phrase, waiting for the ECB to save the Europe next Thursday.

Vols at lows. The EURPLN curve rebuilt slightly from it lows, the frontend moved up by roughly 0.75%, from to 1m ATM 7.75% mid to 8.5% mid. For the backend the move was smaller, as 1Y ATM marks 10.50% mid versus 10,25% last week. The Skew and currency spread (difference between USD/PLN minus EUR/PLN) was also better bid. The biggest trade was 6 month EURPLN ATM traded at 10% in good amount (9,5 mid last week).

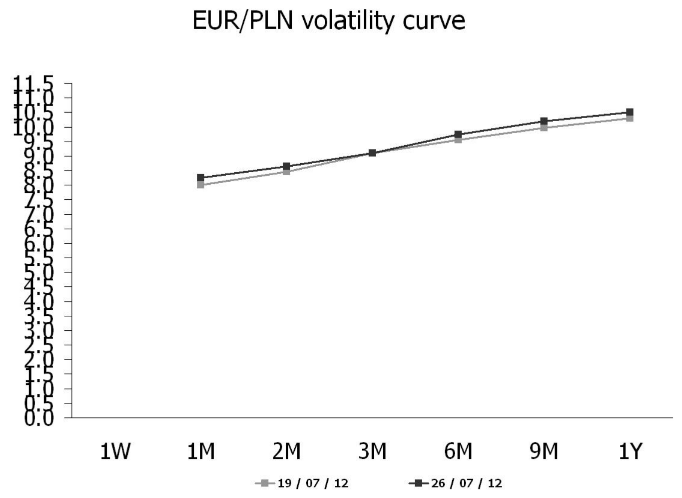


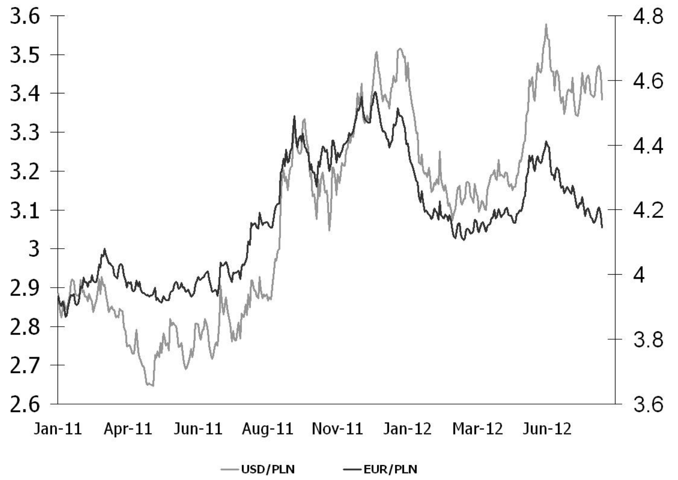
Short-term forecasts.

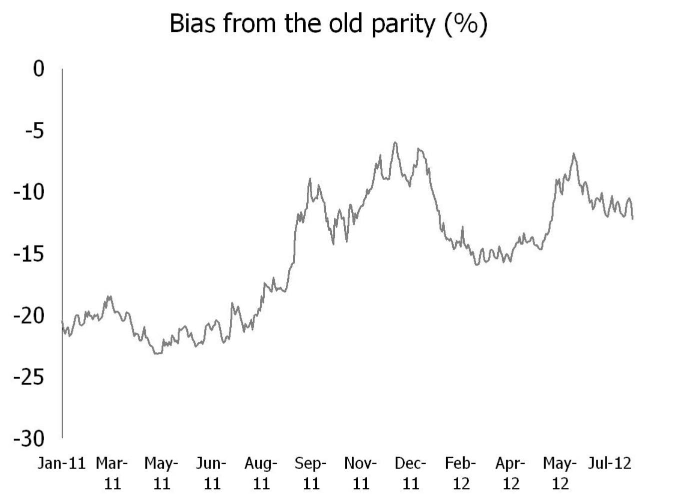
Main supports and resisances
EUR/PLN: 4.1450 / 4.2350
USD/PLN: 3.3200 / 3.4700

Spot. Unchanged from the last week. We would like to buy EUR/PLN at 4.1250/4.1450 level with stop at 4.1000 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. The buying of Vega was a dominant note for the whole week. With the stronger Złoty, EUR/PLN curve should consolidate/reverse some of its gains. The broader picture does not change, we are close to the historic lows in EUR/PLN Vols and the preferred strategy is buying backend of the curve.







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
7/20/2012	4.60	5.13	4.65	6.49	4.95	6.59	5.09	4.89	4.53	4.32	4.10	4.50
7/23/2012	5.03	5.13	5.20	5.05	5.00	5.06	5.07	4.86	4.48	4.24	4.11	4.49
7/24/2012	4.76	5.12	5.13	5.05	5.08	5.05	5.10	4.89	4.51	4.27	4.13	4.59
7/25/2012	4.91	5.12	4.95	5.05	5.02	5.05	5.08	4.85	4.49	4.21	4.10	4.49
7/26/2012	4.91	5.12	5.08	5.05	5.02	5.06	5.09	4.87	4.42	4.14	3.96	4.40

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
7/20/2012	6.590	4.813	4.495	4.373	4.345	4.483	4.430	4.906
7/23/2012	5.060	4.813	4.515	4.463	4.410	4.514	4.510	4.976
7/24/2012	5.050	4.813	4.525	4.359	4.440	4.614	4.555	5.030
7/25/2012	5.050	4.813	4.490	4.367	4.423	4.537	4.540	4.957
7/26/2012	5.060	4.813	4.413	4.295	4.290	4.482	4.460	4.903

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
7/20/2012	8.00	9.10	9.55	10.30	10.30	3.82	0.77
7/23/2012	8.60	9.40	9.75	10.50	10.50	3.82	0.77
7/24/2012	8.65	9.20	9.95	10.70	10.70	4.16	1.09
7/25/2012	8.45	9.00	9.75	10.50	10.50	4.15	1.09
7/26/2012	8.25	9.10	9.75	10.50	10.50	4.15	1.09

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
7/20/2012	4.1629	3.3961	3.4662	4.3208	1.4617	0.1637
7/23/2012	4.1800	3.4529	3.4809	4.4235	1.4521	0.1634
7/24/2012	4.2011	3.4678	3.4990	4.4336	1.4597	0.1642
7/25/2012	4.2087	3.4719	3.5043	4.4360	1.4551	0.1649
7/26/2012	4.1853	3.4523	3.4847	4.4174	1.4558	0.1640

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