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Comment on the upcoming data and forecasts

We expect C/A balance to widen in July. The widening stems from two different factors: both working in the same direction. The first one is wider trade deficit on higher imports of crude oil. The second is connected with some dividend payments (WIG20) and also larger coupon payments on government debt. However, we highlight that the forecast is subject to unusually large uncertainty. As we have already written, recently published GDP data suggest that Q2 C/A should be subject for revision (up). It is tricky whether it is promulgated already when NBP publishes monthly data on BoP (Sep 11) or when it publishes quarterly forecasts (month's end). Our forecast assumes the latter scenario. As for inflation, modest deceleration towards 3.9% results from almost seasonal drops in food prices, somehow larger cuts in wearing apparel amidst moderately higher fuel prices. Inflation is set to be a significant decision factor for the MPC. Mind, however, that the hurdle for passing an all-clear-for-a-cut MPC criterion is only a lack of acceleration of CPI (our forecast fulfills the criterion).

Polish data to watch: September 3rd to September 7th

Publication	Date	Period	BRE	Consensus	Prior
C/A (mln EUR)	11.09.	Jul	3.9	3.8	4.0
CPI y/y (%)	13.09.	Aug	-1763	-1285	-1240

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	12/19-09-12	4000	4.361	8/1/2012
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	2.2	1.5
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 %)	3.50	3.50	4.50	4.25	3.25

	2011	2011	2012	2012	2012	2012
	Q3	Q4	Q1	Q2	Q3 F	Q4 F
GDP y/y (%)	4.2	4.3	3.5	2.4	2.0	1.3
CPI Inflation y/y (average %)	4.1	4.6	3.9	4.0	3.9	3.2
Repo rate (end of period %)	4.50	4.50	4.50	4.75	4.75	4.25

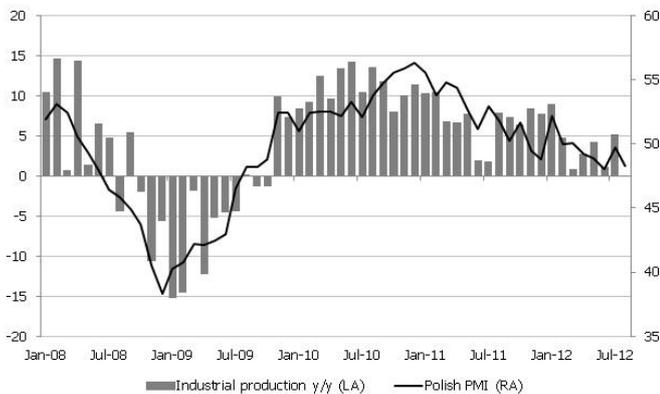
F - forecast

Economics

PMI below expectations

The PMI index worsened in August to 48.3 pts and remained in contraction territory for the fifth consecutive month. The recovery in the previous month, which we properly assessed as correction, was followed by a broad based deterioration of all the components of the headline index. Falling output and new orders (especially export orders - due to stronger zloty) were accompanied by the drop of employment index (which although is still slightly above 50 pts, will be surely dragged into contraction zone in line with official labor data and sector slowdown). Manufacturers try to support current production by fulfilling backlogs (they declined for the fifteenth month running), which poses risk for future output level. Inflationary pressures remained weak, partly because of the stronger zloty.

Industrial production vs PMI



PMI data, like recent much lower than expected GDP reading, fit into the picture of negative surprises (surprise index declines monotonically since the beginning of Q2'2012- see chart), which underpins the downtrend in the Polish economy. Such a reading supports also our lower than market consensus (and negative!) industrial production forecast.

Polish surprise index



MPC opened the door for rate cuts

MPC did not change interest rates level on the September meeting. What is more, speculation about inflation target change proved to be unfounded - any change was neither proposed nor discussed by any MPC member. The statement is much milder and opens the door for rate cuts ("Should the incoming data confirm further weakening of economic conditions, and should the risk of increase inflationary pressure be limited, the Council will consider adjustment of monetary policy"), which we expect to start in October due to progressing slowdown in the real sphere (especially visible in lower wages and negative growth rate of industrial production). Restrained MPC rhetoric suggests only traditional 25bp. move, but we do not rule out the possibility of 50bp. cut - one should remember that MPC used to be very sensitive to upcoming macroeconomic data (milder reaction on lower GDP data was mainly because of reputational reasons), which may surprise negatively before the October meeting. Till the year end we expect 50-75 points of monetary easing.

Turning to details, MPC noticed some improvement in the international financial markets, but is somewhat concerned about the increase in global commodity prices (which, besides still high inflation expectations, is the only mentioned threat to falling inflation path in the medium term). Still, in the opinion of the Council, inflation will decrease gradually over the coming months as the statistical base effects wane amidst slowing demand in the economy. Polish macroeconomic data are assessed as weaker than expected, but MPC still makes an impression of lessening the scale of slowdown (for example by highlighting highly negative contribution of inventories in the latest GDP data decline, relatively high July readings of industrial production and retail sales or assessing increased labour force participation as a reason of elevated unemployment rate). However, we can easily repel all these arguments - inventories are highly pro-cyclical, all the other monthly macro data will soon prove that July readings were only outliers and all the declines (e.g. in wages, corporate lending, BAEL unemployment rate) are set to continue.

The decision caused some increase in the short end of the curve (so there were some expectations on cuts in September) and slight zloty appreciation.



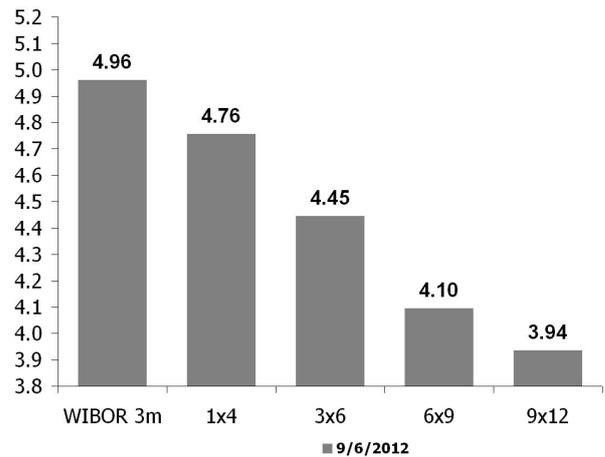
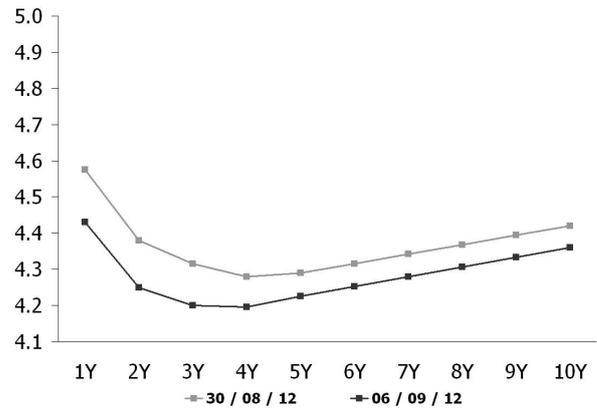
Fixed income

Ready to cut

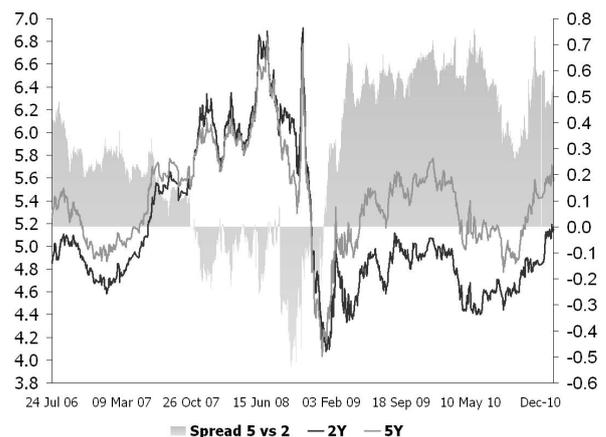
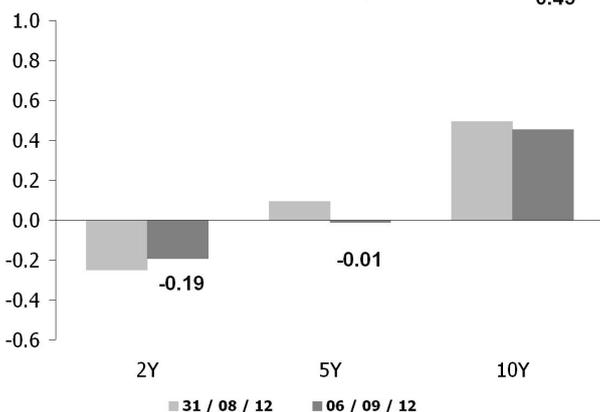
There was a central banks meeting week. As the whole world was seeking a new hope from the ECB, the PLN market stayed focused on whether the MPC was capable to adjust their policy to the visible signs of a deep slowdown in Poland. As some market players started to bet the interest rate cut on Wednesday's meeting the front of a yield curve slid massively trading 1y3s IRS down to 4.42%. Even though the MPC left the rates unchanged, the pressure to pay the front end FRA rates back turned out to be very short lived. Following the April's market communication strategy, NBP governor Belka announced on a press conference that the Council was ready to cut interest rates in October if the next macro data had proven the slowdown. As a result the strong receiving interest especially in the front end of a yield curve persisted, pushing the forward rates down by another 5-10bp.

We believe the next industrial output data are likely to show the negative reading and the MPC would have no excuse to leave interest rates at the current level. We would still be eager to receive any local highs on the front end of a curve outright or as a spread against 5y or 10y occasionally.

IRS curve



Assets swaps

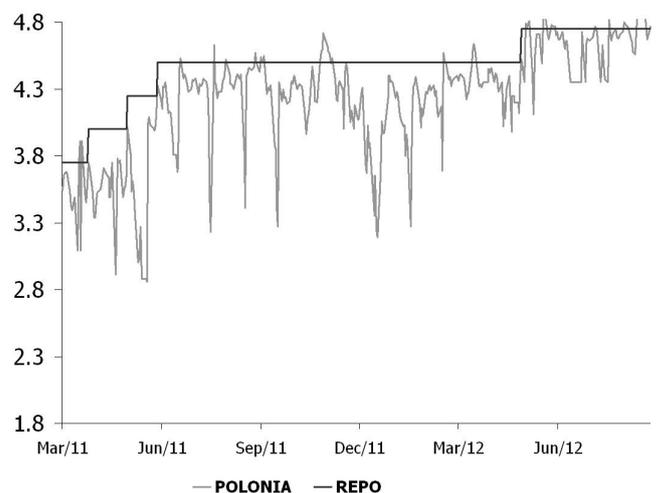
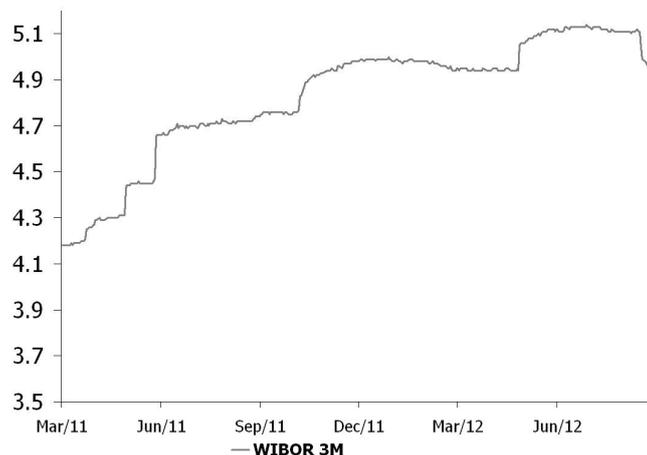
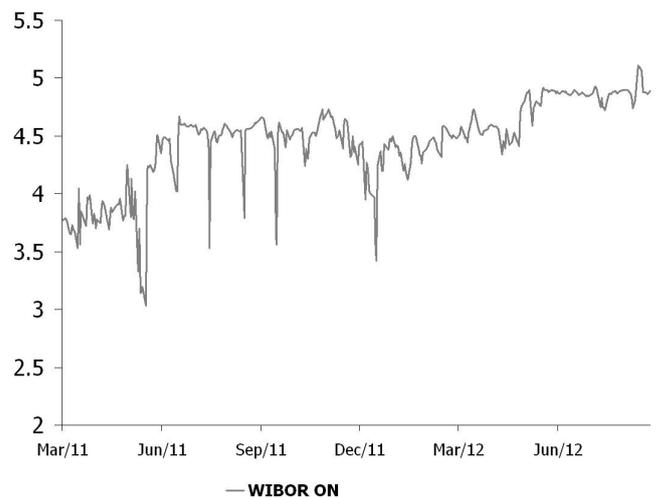
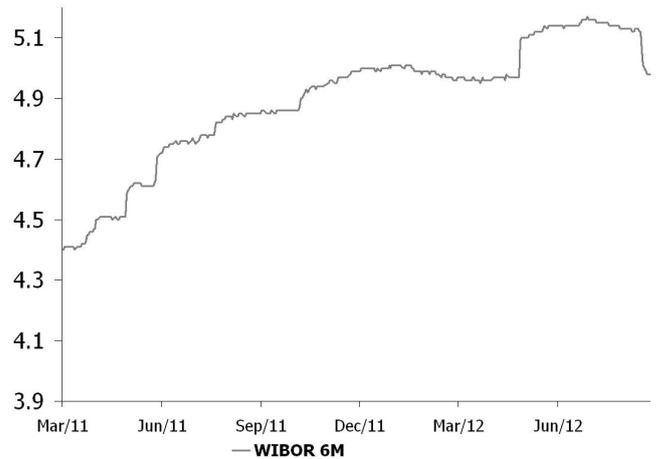




Money market

Liquidity for the system sugared Liquidity pretty much squared, therefore the polonia index stayed close to the main market rate. Next week we will have exactly the same scenario, since after today's OMO we are square again.

The MPC opened the door for cuts No rate cut this month and the MPC statement soft but not to the extent the market expected. The doors are opened for easing in October, however the MPC remains extremely data sensitive. If the data is not too bad, we may have to wait till November, then the scale of the first easing may jump to 50 bps. Having said that, we are waiting impatiently for the CPI, IO and retail sales figures for August.





Forex

PLN Stronger EUR/PLN almost reached 4.22 only to head dive to 4.1175 on the very next day! The catalysts were „no cut” by Polish MPC (with mild accommodation language) and a heavy artillery of ECB that from now will be on will guard of EU peripheral countries yields. We think that market is a little bit too nervous in it’s reactions. The interest rates will come in it’s due time, and we have got to see if the ECB will be successful with his OMT operation.

Lower with stronger PLN The correlation, stronger PLN translates into lower Vols, worked one more time. The most impressive drop was in the frontend 1m atm was given at 9.5% and 9.45 % from a 10.25% mid! The backend slipped by roughly 0.25% to current 10.3% mid 6m and 10.7% mid 1 year. The skew and currency spread (deference between USD/PLN and EUR/PLN), are both better. Offered now in comparison to last week.

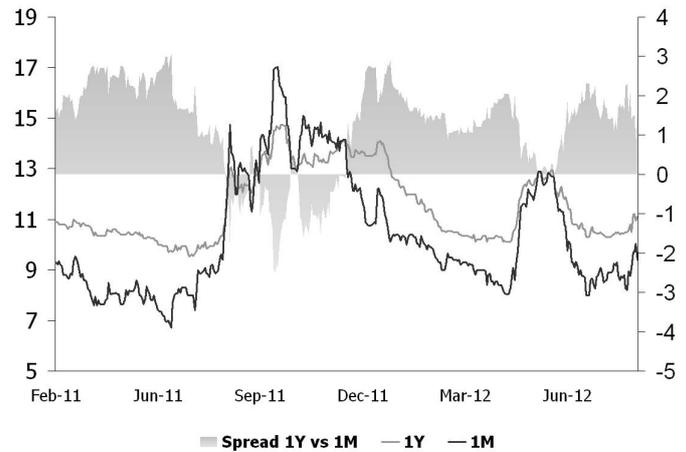
Short-term forecasts.

Main supports and resisances
EUR/PLN: 4.1000 / 4.2000
USD/PLN: 3.2250 / 3.3700

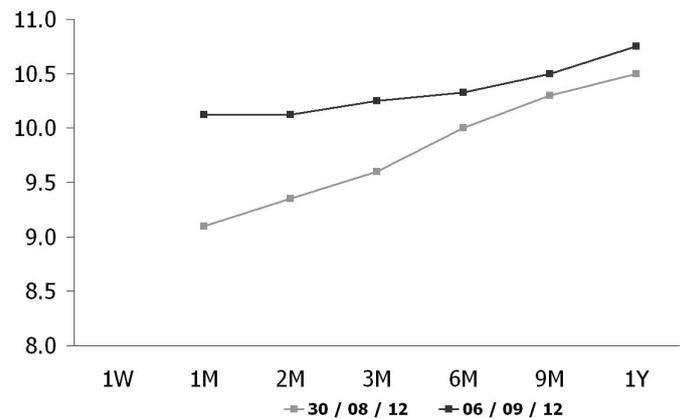
Spot. We are long at 4.14 with a stop below 4.10 and hopes for retest of 4.22.

Derivatives. The strong floor for EUR/PLN vols (1m ATM 8%, 1y mid 10.0 %), has already has proven itself several times in the last 3 years. The Vols are still at levels which are attractive for buyers. We are keeping the core long in the backend Vega in EURPLN.

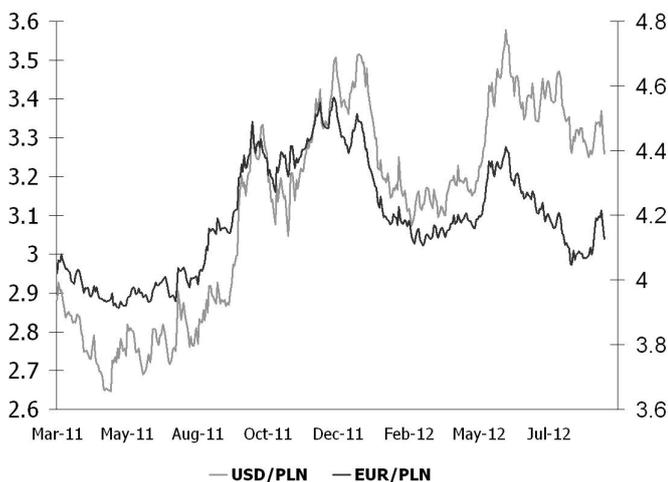
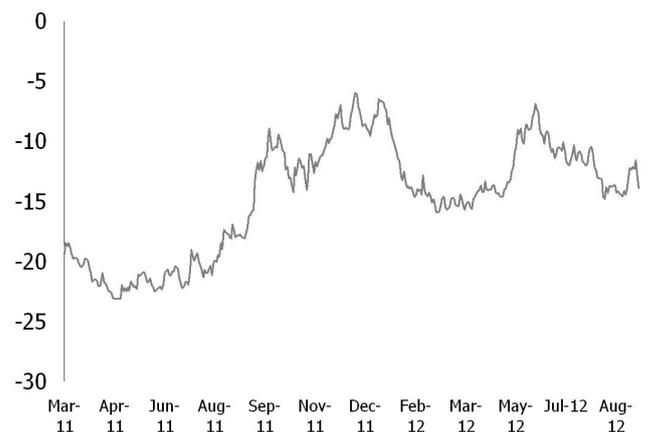
EURPLN volatility



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
8/30/2012	4.93	5.04	5.03	4.96	4.98	4.97	4.95	4.65	4.30	4.08	4.03	4.28
8/31/2012	4.63	4.99	4.89	6.49	4.85	6.59	4.94	4.60	4.26	4.05	4.02	4.25
9/3/2012	4.88	4.98	4.95	4.89	4.88	4.91	4.87	4.54	4.16	3.96	3.90	4.16
9/4/2012	4.68	4.97	4.83	4.88	4.70	4.90	4.72	4.49	4.16	3.93	3.91	4.12
9/6/2012	4.63	4.96	4.70	4.88	4.58	4.90	4.76	4.45	4.10	3.94	3.88	4.08

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
8/30/2012	4.970	4.813	4.380	4.112	4.290	4.397	4.420	4.917
8/31/2012	6.590	4.813	4.320	4.071	4.230	4.325	4.370	4.864
9/3/2012	4.910	4.813	4.295	4.062	4.245	4.315	4.360	4.846
9/4/2012	4.900	4.813	4.268	4.041	4.240	4.243	4.360	4.826
9/6/2012	4.900	4.813	4.250	4.059	4.225	4.215	4.360	4.814

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
8/30/2012	9.10	9.60	10.00	10.50	10.50	4.35	1.14
8/31/2012	9.70	10.30	10.80	11.20	11.20	4.35	1.14
9/3/2012	9.70	10.30	10.80	11.20	11.20	3.82	0.63
9/4/2012	10.05	10.30	10.48	10.95	10.95	3.83	0.78
9/6/2012	10.13	10.25	10.33	10.75	10.75	3.81	0.78

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
8/30/2012	4.1919	3.3397	3.4911	4.2473	1.4730	0.1681
8/31/2012	4.1838	3.3353	3.4839	4.2460	1.4757	0.1684
9/3/2012	4.1981	3.3398	3.4958	4.2622	1.4724	0.1686
9/4/2012	4.1944	3.3281	3.4926	4.2434	1.4760	0.1686
9/6/2012	4.1580	3.2955	3.4508	4.2019	1.4630	0.1681

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