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Comment on the upcoming data and forecasts

Two releases next week and only one is actually relevant. Manufacturing PMI should continue to strengthen, as both domestic (domestic demand is slowly rebuilt) and external factors (the long recession in the Eurozone is finally over) are unequivocally positive for the Polish economy. Even a reading above 50 is not out of the question. Inflation expectations will probably follow the last drop in CPI - no surprises here.

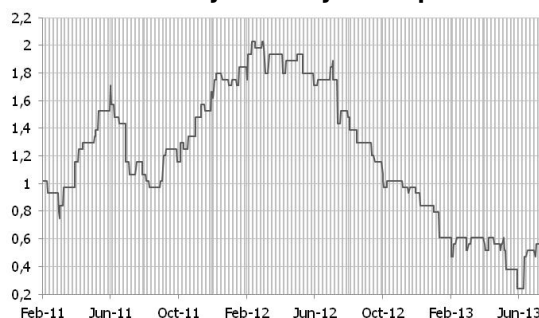
Polish data to watch: July 29th to August 2nd

Publication	Date	Period	BRE	Consensus	Prior
NBP inflation expectations (%)	31.07	Jul	0.2	0.4	0.4
Manufacturing PMI (pts)	01.08	Jul	49.8		49.3

Treasury bonds and bills auctions

Paper	Next auction	Last Offer	Last yield (%)	Prev auction
52 Week T-bills	-	3000	3.485	3/4/2013
2Y T-bond OK0715	-	2500	2.748	4/23/2013
5Y T-bond PS0718	-	4500	3.303	6/6/2013
10Y T-bond DS1023	-	3000	3.290	5/16/2013
20Y T-bond WS0429	-	150	3.464	5/16/2013

Reality vs analysts' expectations (surprise index* for Poland)



Comment

Unchanged - retail sales came out better than expected but it was not enough of a surprise to move the index. Manufacturing PMI is the only relevant data release next week. We admit, there is some potential for a positive surprise. The index will probably resume growth in the next month, as the rebound in economic activity begins to show itself in economic figures.

* Surprise index presents in a synthetic way how the market was surprised by



Our view in a nutshell

Fundamentals

- Available data confirm stagnation in H1 2013.
- However, we expect economic recovery in H2 2013. The rebound will be driven by a re-acceleration of the euro zone economy (see the end of austerity), rebound in real income and recovering private consumption. Low rates trigger rotation in households assets. Given the scale of slack in investment (infrastructure in particular) and consumption, rebound generated this way may be initially moderate (no more than 2% y/y growth rate in Q4 2013), albeit higher than current market consensus dominated by rather gloomy visions.
- Polish government committed to the convergence path, though in a very unorthodox and elastic way. As the European Commission gave the government two additional years to bring down GG deficit towards 3%, budget amendment is coming at PLN +16 bn to deficit. This - along with the political business cycle - opens room for fiscal stimulation. Formal acceptance of the EC (and overall trend of consolidation's fatigue) suggests the market should digest this information easily.
- We witnessed the steepest disinflation phase in Polish history. CPI inflation close to 0% in mid 2013 but is to rise slowly in Autumn and in 2014.
- Despite low inflation, there is no support for further easing within the MPC, the more so since the momentum in the real economy improved. July rate cut marked the end of the easing cycle. We expect first rate hikes to materialize at the turn of 2014/2015 and think that NBP projections of both GDP and inflation for 2014 are too pessimistic.

Financial markets

- We stay constructive on short-term bonds (ECB supports low rates in Europe introducing Fed-style forward guidance, NBP follows although in a less straightforward way and at the moment only via governor's rhetoric, not the statement of the whole body). Note that NBP may also use unconventional tools to boost banks' demand for government papers (we believe in such scenario even more after most recent outflow of foreign funds from bond market and FX intervention).
- Ultimately, global recovery (or monetary stimulus and liquidity withdrawal) and rising core yields will adversely affect Polish bonds. Fed-induced higher volatility has already been doing its job, especially on the long end.
- The "wall of money" obscured the cyclicity of the Polish currency. This fact was revealed when expectations on QE tapering accelerated and the zloty dynamically breached 4.22/25 and broke out of the 1 year range. We expect a return below 4.20 when the economy accelerates visibly (long into H2) or/and rate hike expectations gain momentum (a turn of 2013/2014).

BRE forecasts

	2008	2009	2010	2011	2012	2013 F
GDP y/y (%)	5.1	1.6	3.9	4.5	1.9	1.0
CPI Inflation y/y (average %)	4.3	3.5	2.8	4.2	3.7	0.8
Current account (%GDP)	-5.3	-1.6	-4.5	-4.9	-3.5	-1.9
Unemployment rate (end of period %)	9.5	12.1	12.4	12.5	13.4	13.7
Repo rate (end of period %)	5.00	3.50	3.50	4.50	4.25	2.50

	2012	2012	2012	2012	2013	2013	2013	2013
	Q1	Q2	Q3	Q4	Q1	Q2 F	Q3 F	Q4 F
GDP y/y (%)	3.5	2.3	1.3	0.7	0.5	0.5	1.2	1.7
Individual consumption y/y (%)	1.7	1.3	0.2	-0.2	0.0	0.4	1.3	1.9
Public Consumption y/y (%)	-1.0	0.4	1.6	-0.6	-0.5	0.3	0.5	0.5
Investment y/y (%)	6.8	1.4	-1.7	-4.1	-2.0	-4.5	-3.0	-2.5
Inflation rate (% average)	3.9	4.0	3.9	2.9	1.3	0.5	0.3	0.9
Unemployment rate (% eop)	13.3	12.4	12.4	13.4	14.3	13.2	13.3	13.7
NBP repo rate (% eop)	4.50	4.75	4.75	4.25	3.25	2.75	2.50	2.50
Wibor 3M (% eop)	4.94	5.13	4.92	4.11	3.39	2.73	2.70	2.70
2Y Polish bond yields (% eop)	4.62	4.60	4.05	3.14	3.19	3.07	2.85	2.90
10Y Polish bond yields (% eop)	5.50	5.15	4.69	3.74	3.94	4.34	4.00	4.40
EUR/PLN (eop)	4.15	4.22	4.12	4.08	4.18	4.33	4.20	4.10
USD/PLN (eop)	3.11	3.35	3.20	3.09	3.26	3.32	3.36	3.36

F - forecast

Economics

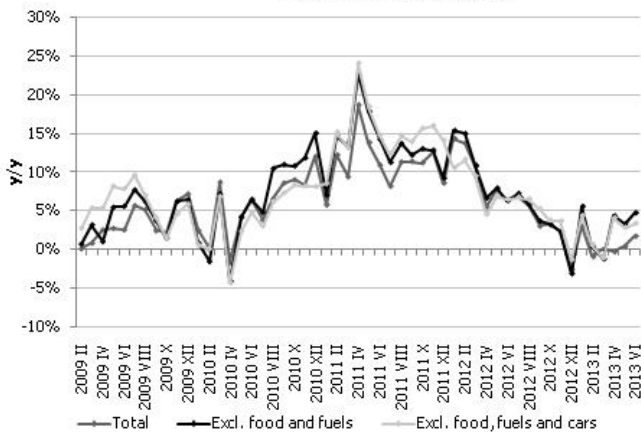
Retail sales continue to trend upwards

In June retail sales grew by 1.8% y/y (our forecast: +1.7%, market consensus: +1.0%) in nominal terms and by an impressive 2.6% (fastest real growth since July 2012). Granted, the acceleration is partly attributable to working day effects (+1 p.p. by our count) but the details of the release are nevertheless encouraging.

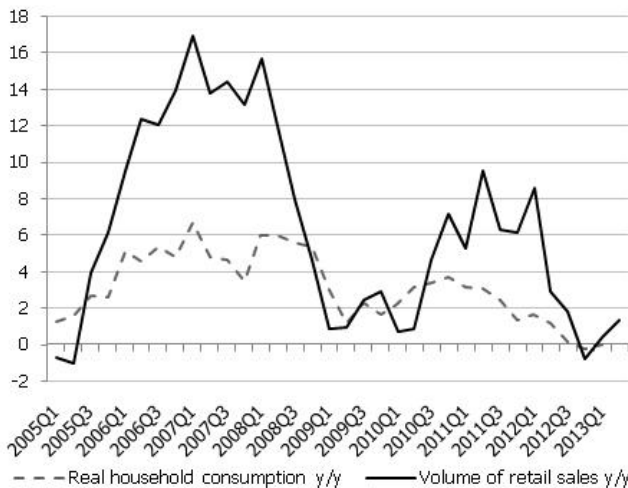
contribution from household consumption in Q2 GDP numbers. We expect the current trend to continue in the following months: labor market has already stabilized, households have amassed considerable funds and their incomes received a boost from a series of positive price shocks.

Data had no effect on the market - no wonder since global sentiment (bullish) is a key factor on Polish FI and FX markets. However, this lends further credibility to the MPC's decision to end the easing cycle and should strengthen expectations for rate hikes in 2014.

Retail sales in current prices



With stable food and fuel sales, core categories proved to be the key to recovery in the headline index. Consumers' expenditures on durable goods continue to be strong: sales of furniture, electronics and home appliances grew by 5.7%; sales of clothing and furniture increased by 10.9%; sales of drugs and cosmetics grew by 6.5%. Last but not least, cars and motor vehicles remained a bright spot, again with a double digit growth. As a result, all measures of core retail sales marched upward in June (2.7 to 4.8% y/y vs. 2.8 to 3.5% in May). Finally, retail sales net of food and fuels increased by 5.9% in constant prices. The difference between nominal and real dynamics, both in headline and core sales confirms a strong disinflationary push.



The whole quarter thus ends on a positive note, with real retail sales growing on average by 1.3% which suggest a positive



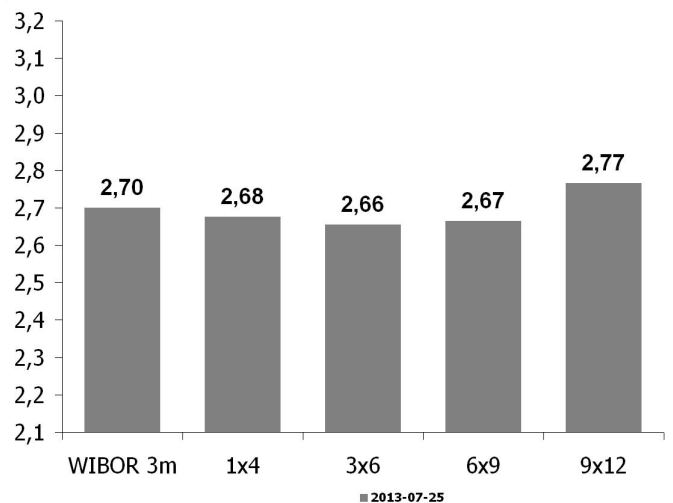
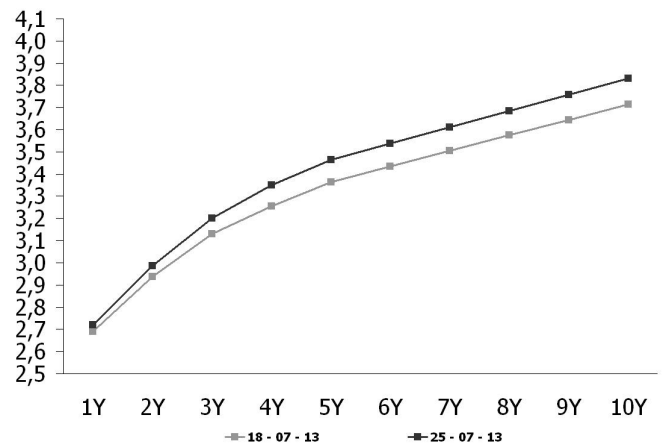
Fixed income

Global sentiment dominates

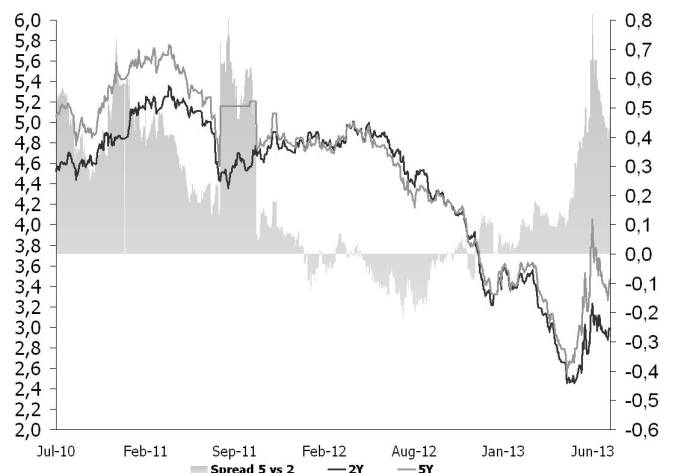
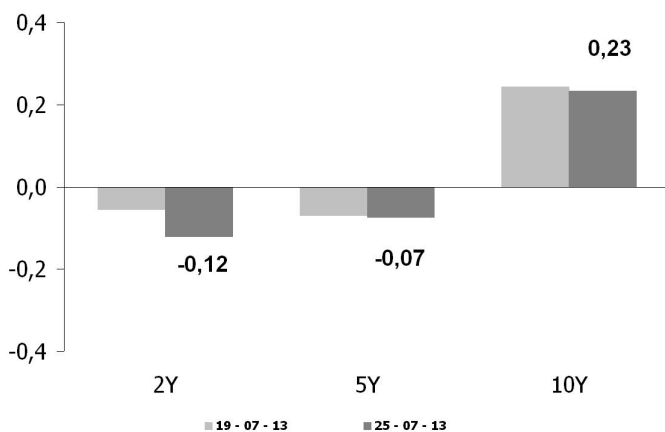
Sentiment on the Fixed Income market is, yet again, dominated by global moves. This week German 10year Bunds and US Treasuries suffered a lot because of speculation about faster growth and, as a result, rate hikes in the future. On PolGBs yield of Oct23 went from 3.75 on Monday up to 4.05 this Thursday. Our carry trade on PS1016 is still looking good, despite strong retail sales data that came out this Thursday. Next week we expect POLGBs auction plan for August to be announced. Market should be prepared for an auction on 15th August. Turnover is lower and lower so we keep our carry trade, but we have to watch carefully which way the global mood is going.

Good Luck!

IRS curve



Assets swaps

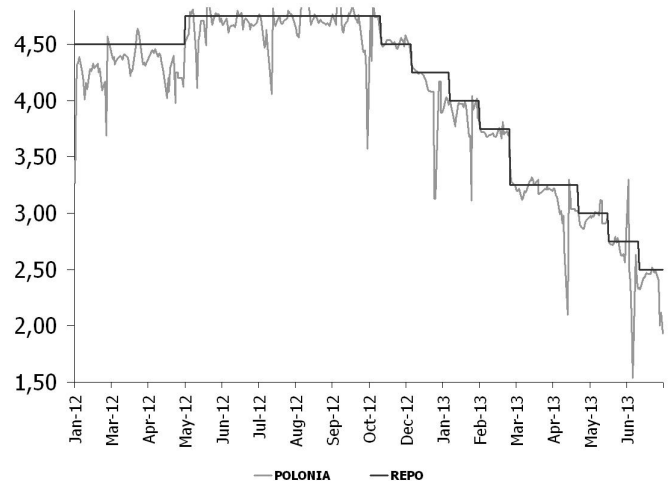
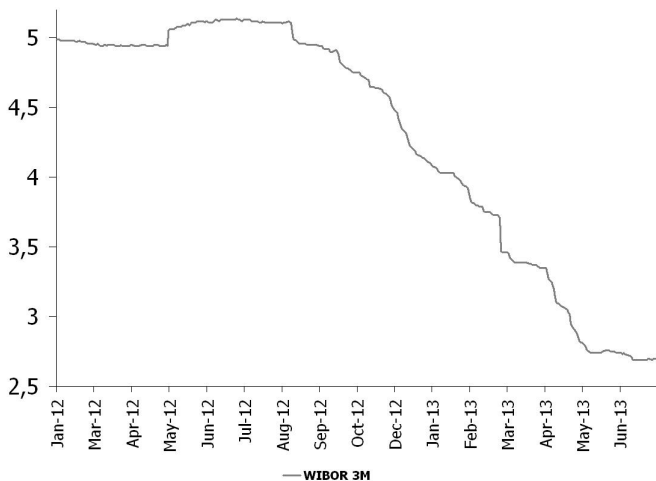
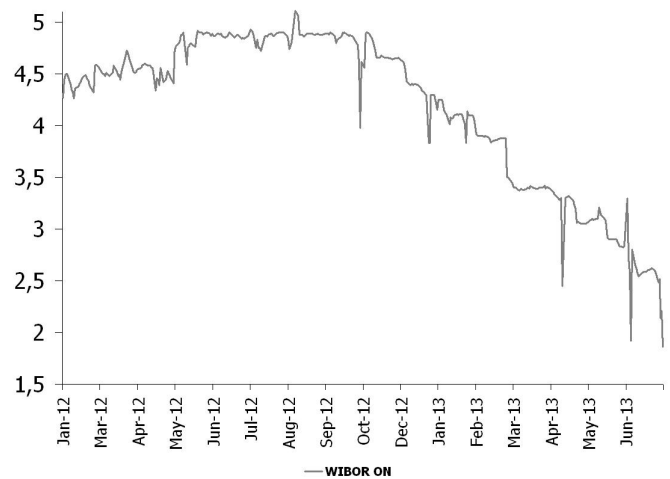
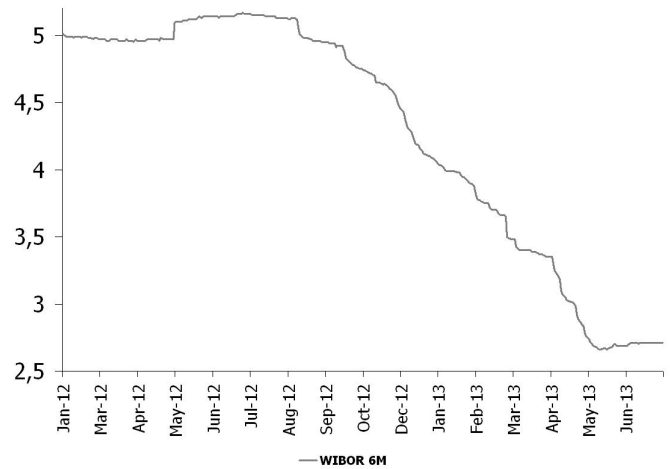




Money market

Cheap week As one could expect, last days of the reserve period were very cheap. Polonia went down to 2% on Monday and fluctuated around it for the whole week. Even additional OMO on Tuesday couldn't prevent it. Unemployment rate in June was same as consensus (13.2%). Retail sales rose 1.8% in annual terms (consensus was 1,15%).

As next Tuesday is end of the reserve and liquidity desks bought just 124 bio PLN bills out of 130 bio offered, it's going to be very cheap at the beginning of next week. After Tuesday Polonia should be back at around 2,45.





Forex

Consolidation. The risk is on again. PLN is much stronger and EUR/PLN has dropped to 4.2330 as a result (stop losses of PLN shorts were a vital ingredient for the move). Bernanke is dovish and Polish budget problems have been widely ignored. One has to respect the price action, so even though, the end of QE was also heralded, the risk rally is on. We are in the skeptic camp and think we are more in 4.22/4.25-4.35/4.37 EUR/PLN range. The US macroeconomic figures will guide us from now on.

Volatility still falling. Correlation between PLN and vols proved itself strong one more time. As a consequence we have a continuation of a sell-off in vols. 1 month EUR/PLN ATM is 7.4% (lower by 0.4%), 3 months fixed also at 7.4% (lower by 0.6%), 1 year is 8.9% (lost 0.2%). The curve is steeper now. The risk reversals held their last week levels, and currency spread (difference between USD/PLN and EUR/PLN) was better offered.

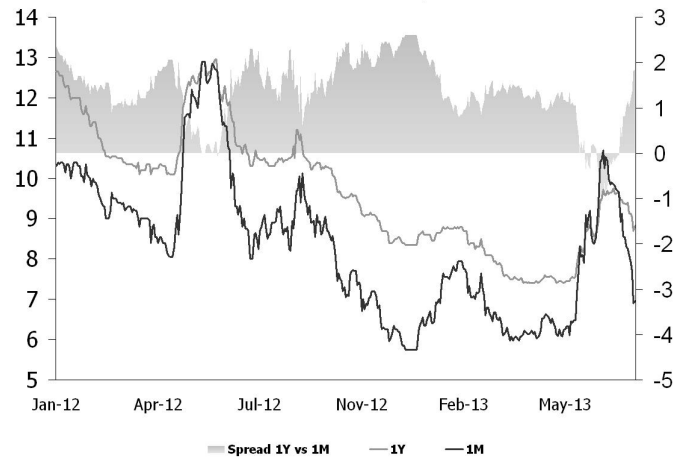
Short-term forecasts

Main supports and resistances
 EUR/PLN: 4.2000 / 4.3700
 USD/PLN: 3.1500 / 3.4000

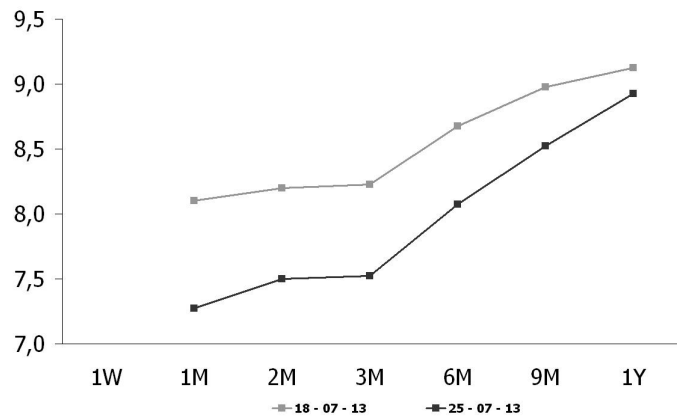
Buy EUR/PLN. Last week's longs stopped at 4.2150. We have bought EUR/PLN again at 4.2060. We are ready to add at 4.1950 and have a stop below 4.1850. We were sceptical about getting to the same position, just after the stop loss but we think the risk/reward is strongly in favor of such position.

Derivatives. Volatility has corrected strongly and we are in full summer mode with liquidity being thin at best. In our opinion, by the book the adjustment period with US QE being reduced/ended should produce higher volatility in due time. For the time being the market proves us wrong, so we have to follow the US numbers to learn more.

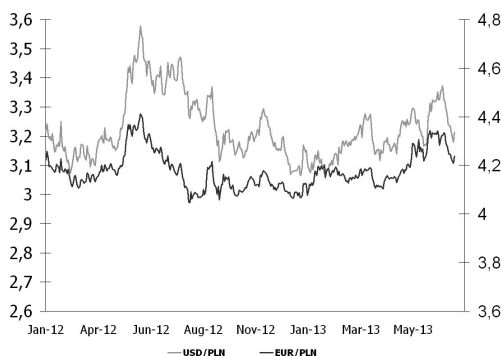
EURPLN volatility



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
7/19/2013	2.43	2.70	2.55	6.49	2.77	6.59	2.66	2.65	2.64	2.72	2.90	2.71
7/22/2013	2.44	2.69	2.52	2.61	2.73	2.63	2.66	2.64	2.62	2.69	2.80	2.72
7/23/2013	2.45	2.70	2.52	2.61	2.74	2.63	2.67	2.65	2.64	2.70	2.84	2.71
7/24/2013	2.43	2.70	2.56	2.61	2.77	2.63	2.68	2.66	2.68	2.77	2.92	2.77
7/25/2013	2.41	2.70	2.55	2.61	2.78	2.63	2.68	2.66	2.67	2.77	2.92	2.76

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
7/19/2013	6.590	3.353	3.292	3.275	3.420	3.351	3.630	3.873
7/22/2013	2.630	3.114	3.263	3.148	3.370	3.270	3.575	3.755
7/23/2013	2.630	2.992	3.218	3.137	3.325	3.237	3.525	3.759
7/24/2013	2.630	2.992	3.218	3.137	3.325	3.237	3.525	3.759
7/25/2013	2.630	2.992	3.218	3.137	3.325	3.237	3.525	3.759

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
7/19/2013	7.90	8.18	8.63	9.13	9.13	2.50	0.76
7/22/2013	7.68	8.05	8.48	9.03	9.03	2.50	0.76
7/23/2013	6.90	7.35	7.93	8.70	8.70	2.42	0.72
7/24/2013	6.96	7.35	7.93	8.83	8.83	2.42	0.72
7/25/2013	7.28	7.53	8.08	8.93	8.93	2.66	0.77

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
7/19/2013	4.2457	3.2348	3.4321	3.2267	1.4373	0.1637
7/22/2013	4.2296	3.2142	3.4209	3.2135	1.4363	0.1631
7/23/2013	4.2186	3.2001	3.4117	3.2143	1.4305	0.1627
7/24/2013	4.2090	3.1800	3.3964	3.1758	1.4177	0.1621
7/25/2013	4.2387	3.2143	3.4247	3.2141	1.4299	0.1634

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