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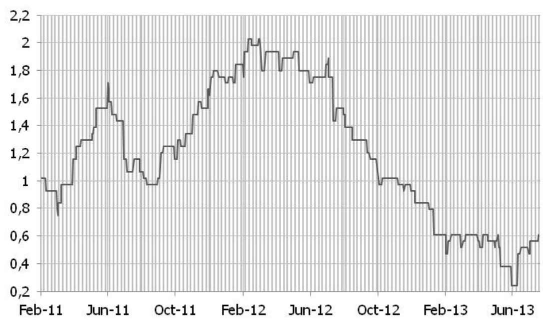
Comment on the upcoming data and forecasts

No data releases next week. However, we would like to draw your attention to our summary of this month's data releases (the Economics section).

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

Polish surprise index ticked up - PMI turned out to be much higher than analysts anticipated. No data releases next week, therefore no surprises. The index is clearly forming an upward trend, though.

* Surprise index presents in a synthetic way how the market was surprised by macroeconomic releases (it is constructed on daily basis as weighted average of differences between selected releases and Bloomberg forecast consensus).

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Our view in a nutshell

Fundamentals

- Available data confirm economy hit the bottom in Q1, recovery is in the pipeline.
- The upswing will be primarily driven by a rebound in real income and recovering private consumption. Low rates trigger rotation in households assets towards current accounts. 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. Better business activity in the euro zone is going to strenghten the upswing trajectory, but we do not believe it is crucial for recovery to come at all.
- 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 amendement 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 overal trend of consolidation's fatigue) suggests the market should digest this information easily.
- We witnessed the steepest disinflation phase in Polish history. 0.2% inflation growth was the lowest in the cycle. From July on prices are set to slowly accelerate. Core inflation is going to stay rather subdued, though.
- 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 in late 2014 and think that NBP projections of both GDP and inflation for 2014 are be too pessimistic.

Financial markets

- Better string of data is able to generate positive momentum on rate hike expectations. We still 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).
- Longer end is not a safe bet. Nothwistanding the local factors, 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 cyclicality of the Polish currency. This fact was revealed when expectations on QE tapering accelerated and the zloty dynamicaly 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). At the moment QE tapering game is going to support the weakness of the zloty.

BRE forecasts

	2008	2009	2010	2011	2012	2013 F
GDP y/y (%)	5.1	1.6	3.9	4.5	1.9	1.1
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 Q1	2012 Q2	2012 Q3	2012 Q4	2013 Q1	2013 Q2 F	2013 Q3 F	2013 Q4 F
GDP y/y (%)	3.5	2.3	1.3	0.7	0.5	0.7	1.3	2.0
Individual consumption y/y (%)	1.7	1.3	0.2	-0.2	0.0	0.7	1.6	1.9
Public Consumption y/y (%)	-1.0	0.4	1.6	-0.6	-0.5	-0.5	0.2	0.2
Investment y/y (%)	6.8	1.4	-1.7	-4.1	-2.0	-3.5	-2.0	-1.2
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

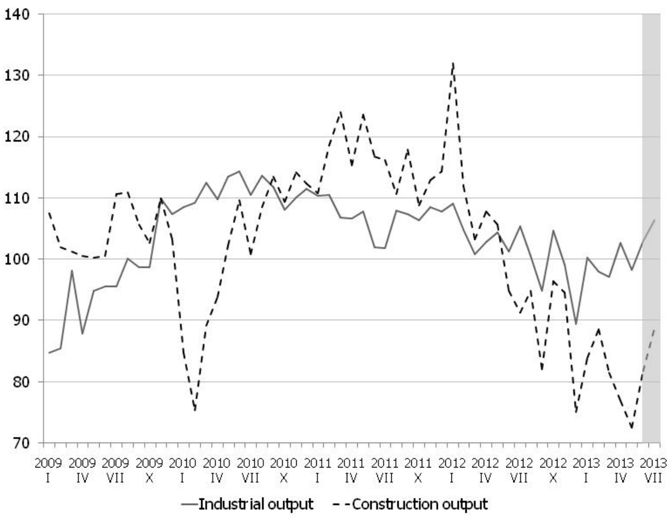
The time for solid data has come

We witnessed only timid signs of better sentiment in the last few weeks. However, having a strong belief in macroeconomic mechanisms and the specifics of business cycle, we wanted to see something more in them than just mere green shoots. It seems August is going to be the month marking the beginning of a streak of solid domestic data. We got assured by better PMI reading (above 50) and we think the real data will follow. It is also worth noticing that when economy is at inflection point, the volatility of forecast rises, opening doors for (in our opinion positive) surprises. Therefore not only the data can be better, but also surprise index can go upwards as market consensus is still conservative (analysts have tendency to err on the side of pessimism at the bottoms). All this considered and along with a turnaround in inflationary processes (both PPI and CPI are set to be marching upwards) a lot of space for expectations on monetary tightening in 2014 is made. It is too soon to speculate on the timing and scale, though. However, it is good time to ride on market momentum. Bad times for bonds are coming.

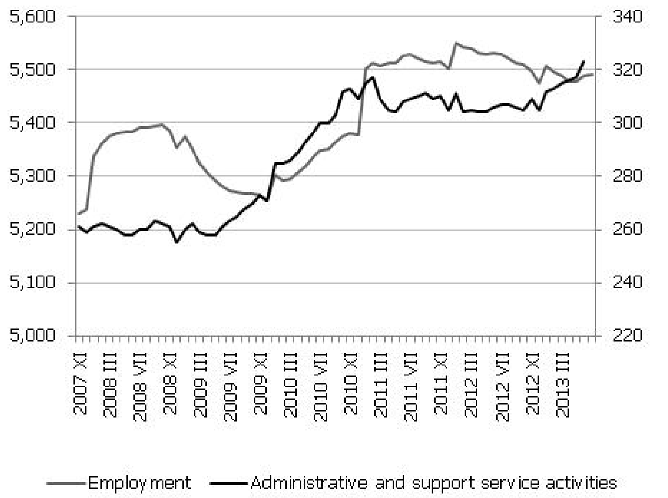
Let's take a more detailed look at the upcoming releases (and the specific one that assured us).

PMI index rose from 49.3 to 51.1 beating expectations by more than a point. For the first time since March 2012 the index is again above 50 and the increase alone is the biggest since January 2012. The structure of growth is reassuring. Not only output increased but also new orders (the original impulse came from foreign orders, now domestic orders joined in a quite spectacular way). Therefore, our scenario that recovery will be primarily driven domestically is valid. At first glance employment reading is a bit disappointing. However, this index correlates well with annual growth of employment (in the enterprise sector) with a lag. This is consistent with the slowly improving trajectory of employment we witness right now.

Output, construction, retail sales. Industrial output is likely to rise by 6.4% (market consensus 5.1%, previous 3.0%). This is because one working day more on annual basis and the mounting momentum in manufacturing (we are close to the levels seen in 2011). There are also some positive base effects from last year, and - last but not least - solid growth of PMI index should give rise to optimism. Construction is also rebounding from all time lows (our forecast -11.3%, consensus -12.2%, previous 18.3%). Increases in this category are almost solely driven by statistical base. Judging on the number of contracts signed, the real boost for public infrastructure should come at the turn of 2013/2014. In the environment of overall better data retail sales cannot be a laggard, the more so since we had high hopes regarding private consumption. Incoming data (and the structure of sales) assures us that the trough in sales has been already reached and rising real income, firming labor market and the end of cyclical rebuild of savings are paving their way for consumer optimism. This time we expect sales to increase by 4.5% (market consensus 2.8%, previous 1.8%) propelled by improving momentum, one working day more, and base effects from last year.

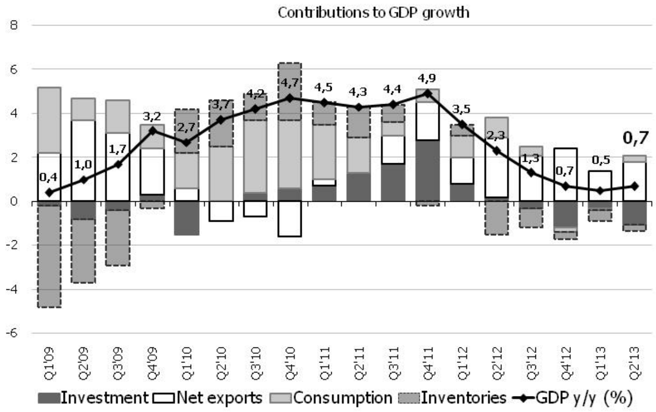


Labor market. We see more and more signs that this market is one the mend. Let's tackle employment first. Recent rise was not driven by seasonal factors and employment in "administrative and support service activities" is on the rise. We see this category as an analogous to temporary help services and regard it as a leading indicator; last time it preceded a turnaround in employment - why should this time be different? We expect employment to decrease by -0.7% y/y (market consensus -0.7%, previous -0.8% y/y). It is an improvement since monthly advance stays positive (1-5k) in a seasonally weaker month.



Prices. Food prices (we see more and more evidence that seasonal drops in vegetables will be smaller than in recent years), fuel prices and garbage collection fees are driving inflation higher towards 0.7% (previous 0.2%, market consensus - 0.5%). Also, producer prices began marching upwards. This time we see them falling in annual terms (but with slowly rising monthly momentum) by -1.0% (previous -1.5%, market consensus -0.9%). We think that due to improving industrial output also producers will be more encouraged to match their prices with the level of exchange rate - therefore, some kind of closing the gap (upward pressure on prices) can be visible in coming months.

GDP. Advance estimate on Q2 2013 is set to be published on August 14. We expect a moderate turnaround (0.7%, market consensus 0.8%) but models based solely on industrial output suggest far better results (1.3%...). However, owing to downbeat results of construction we stick to the lower number and a slight upward risk. As for composition, consumption is set to accelerate to 0.7% (market consensus 0.4%), investment to stay in the doldrums on poor construction results (-3.5%, market consensus -3.2%). It is important to note that it is possible for net exports to increase its contribution to growth (cyclically odd) and for inventory contribution to stay at low levels (also cyclically odd). We think the latter two pieces of information can be reconciled if our growth mechanism proves correct. The turnaround in consumption was not anticipated by enterprises, therefore they were forced to sell out of supplies and this, in turn, limited imports.

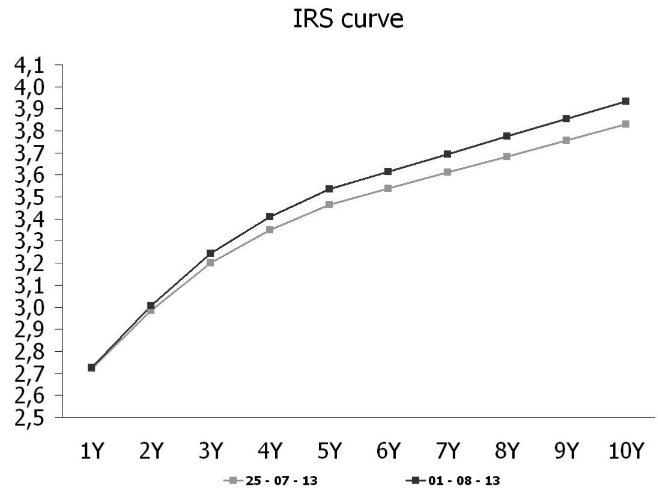


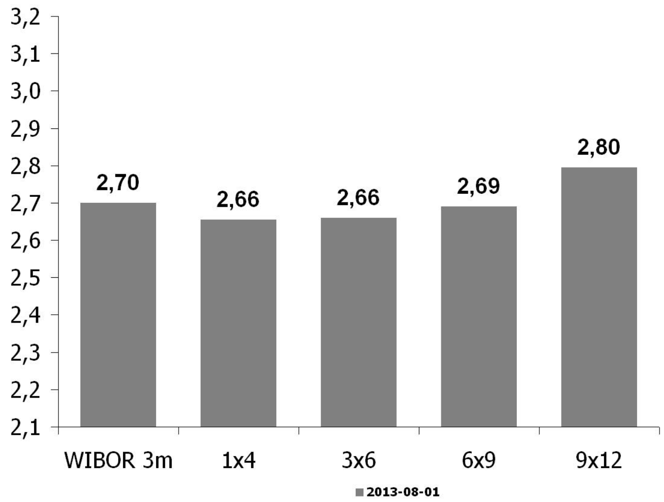
Fixed income

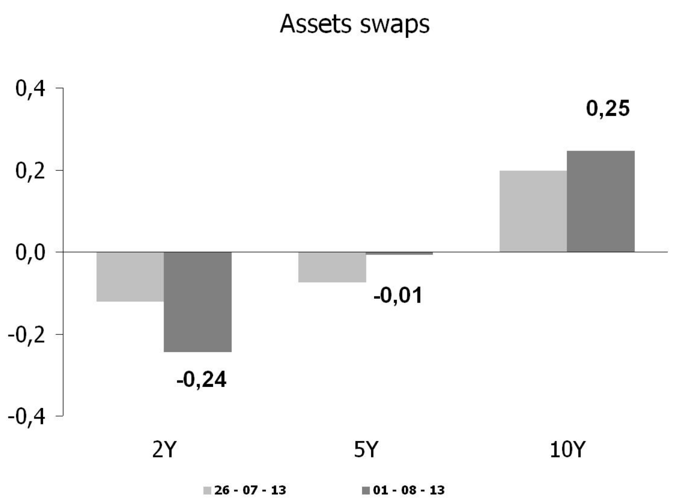
Market creates opportunities

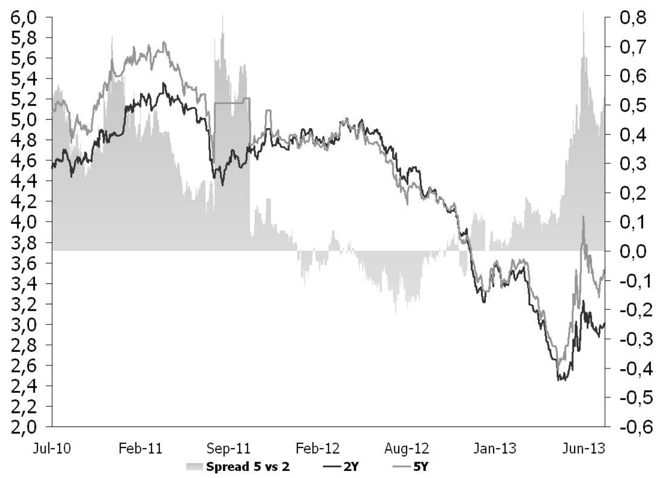
The Polish Fixed Income market follows its bigger brother - core markets. Present trend on cores is dominated by the question when (not if!) the global recovery forces Central Banks to withdraw from loose monetary policies. As it is still, in our opinion, a more US-based recovery than a global one (whereas the market is constantly cooled by Fed Chairman's words - tapering is (still) data dependent), on average we see this economy's trend as slightly upward-sloped. Translated into market conditions, it means a slightly upward trend on global rates which, with current low liquidity, works thrown into high volatility environment.

Our view is to trade those volatile trend's deflections. We closed our carry trade on such spike (long PS1016) and we are biased to buy on dips at current levels. Simply, cheap cash so widely announced (ECB, NBP) should support bond levels:
5Y 3.55 (4.00 high)
10Y 4.30 (4.50 high)
Buy 10s on last 4.50 high.



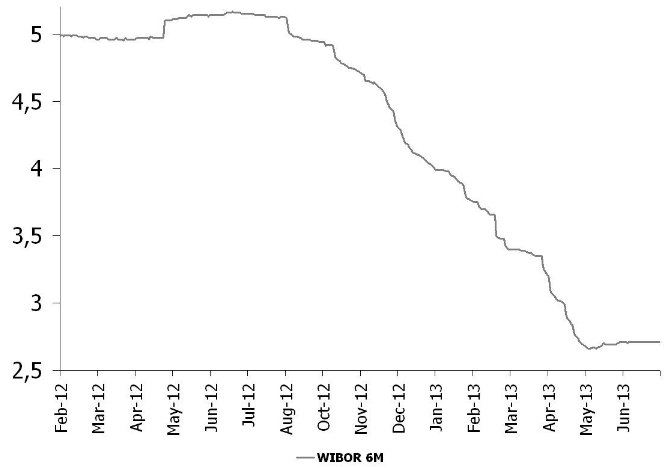


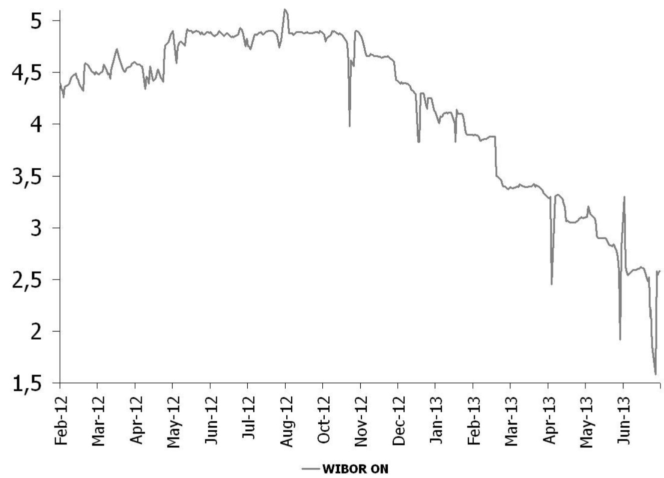


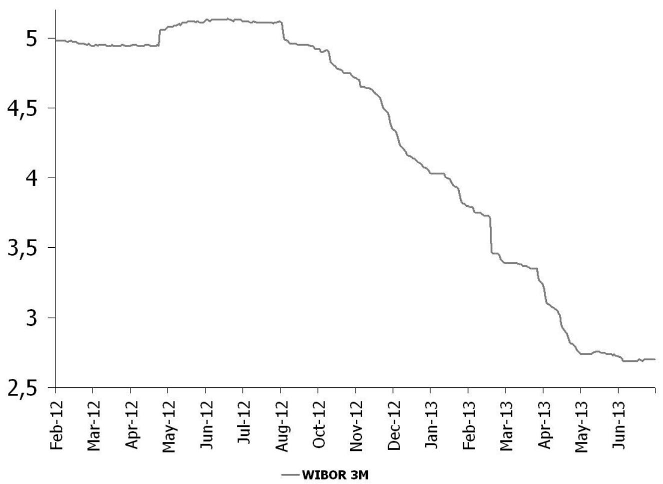


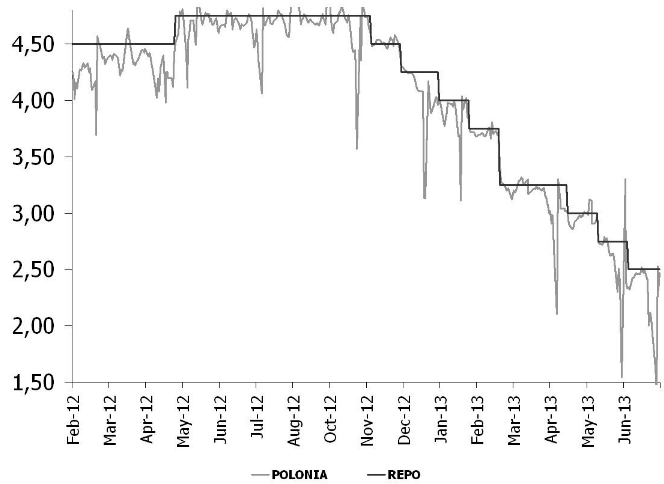
Money market

Another cheap end of the month We had another cheap end of the month and that has become a bit of a rule already. Monthly spread between Polonia and the reference rate went to 25 bp and that's a lot more than the market is pricing now in short OIS. That's probably mainly due to people still believing that the NBP will get back to sterilizing the market in a proper manner and also paying interest from fx swap desks. Our idea is to enter receive 1y OIS vs pay 9x12 FRA to benefit from cheap cash. And on the FRA side any further rate cut won't affect WIBOR as much as the Polonia and a possible hike would cause WIBOR to shoot up a lot anticipating more than one hike. Last but but not least, the December factor should work for that strategy as cash is always cheap on the year end and WIBORs tend to go higher (banks try to get 6M cash to boost their liquidity ratios).





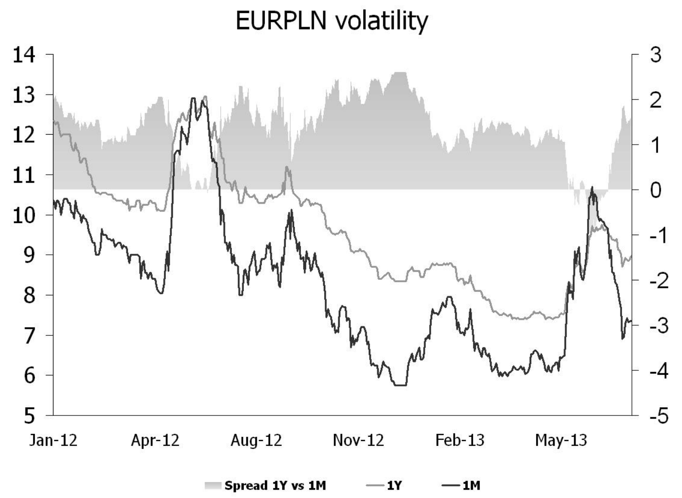


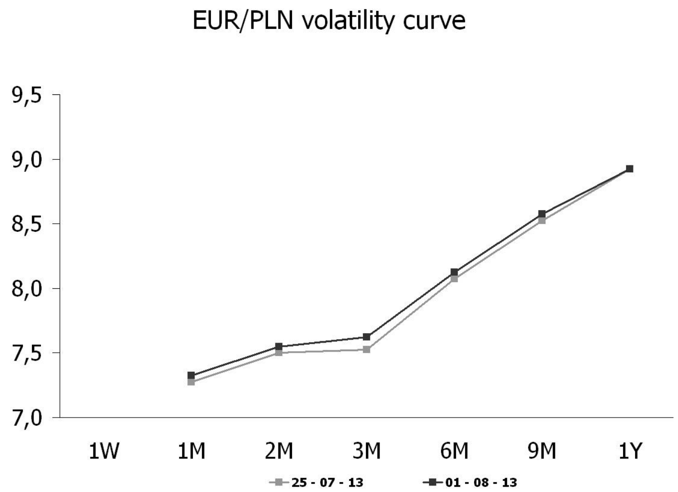


Forex

EUR/PLN higher USD is starting to shine again, after a series of better than expected US figures. As a consequence, the USD/EM uptrend is likely to regain traction. EUR/PLN held the support at 4.2000 ideally and after the consolidation we have broken the 4.2500 resistance and we are now ready to test 4.29/4.30. It is USD/PLN that is in fact the leading cross - here the support at 3.15 also held and provoke rebound. The POLBONDS are on sale, with yields rising in the US. All the above suggest we may see the retest of 4.30/4.32 zone. However, weaker than expected NFP could actually slow the move.

Volatility consolidating Weaker PLN and the vols have stopped falling. We are consolidating at levels roughly unchanged from last week. Demand for Gamma/Vega finally is contracting supply. The vols are almost unchanged from last week. With 1 month EUR/PLN ATM mid being 7.4% (unchanged), 3 months are 0.1 p.p. lower to 7.6%, and 1 year is up 0.1 p.p. to 9%. The USD/PLN also attracted the same buyers with a big buyer noted in 2 month. The skew is unchanged from last week. We need to break the 4.30/4.32 EURPLN to see vols marching up again.



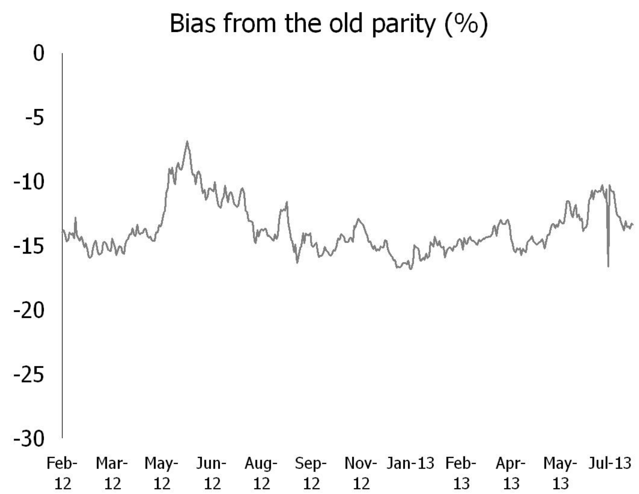


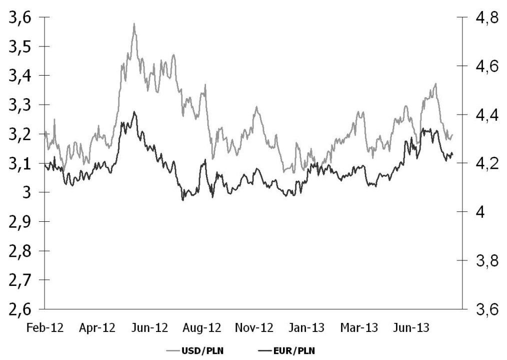
Short-term forecasts

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

Buy EUR/PLN at dips We are still long from 4.2060, we set stop in profit at 4.2150, and we have hopes for 4.29. The rationale for move higher is intact. US yields are rising, and USD/EM is better bid against the series of major currencies like JPY, CHF and emerging ones (ZAR, TRY, BRL). We see no reason why PLN should be an exception.

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. US figures surprised to the upside, tapering even with a dovish FED is on it's way. The gamma/theta performance it not too convincing, to be long Gamma, but our idea to be long mid/back of the curve is firmly on.





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
7/26/2013	2.45	2.70	2.55	6.49	2.67	6.59	2.68	2.66	2.67	2.73	2.93	2.74
7/29/2013	2.38	2.70	2.45	2.61	2.57	2.63	2.67	2.66	2.67	2.76	2.91	2.75
7/30/2013	2.41	2.70	2.45	2.61	2.57	2.63	2.67	2.65	2.67	2.74	2.92	2.74
7/31/2013	2.41	2.70	2.55	2.61	2.77	2.64	2.67	2.65	2.70	2.76	2.98	2.79
8/1/2013	2.40	2.70	2.55	2.61	2.77	2.64	2.66	2.66	2.69	2.80	2.97	2.79

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
7/26/2013	6.590	3.353	3.292	3.275	3.420	3.351	3.630	3.873
7/29/2013	2.630	3.114	3.263	3.148	3.370	3.270	3.575	3.755
7/30/2013	2.630	2.992	3.218	3.137	3.325	3.237	3.525	3.759
7/31/2013	2.640	2.992	3.218	3.137	3.325	3.237	3.525	3.759
8/1/2013	2.640	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
7/26/2013	7.43	7.63	8.05	8.88	8.88	2.66	0.77
7/29/2013	7.33	7.53	8.03	8.85	8.85	2.66	0.77
7/30/2013	7.34	7.68	8.08	8.88	8.88	2.62	0.73
7/31/2013	7.35	7.78	8.18	8.98	8.98	2.64	0.77
8/1/2013	7.33	7.63	8.13	8.93	8.93	2.64	0.77

PLN Spot performance

Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
7/26/2013	4.2295	3.1831	3.4308	3.2257	1.4265	0.1633
7/29/2013	4.2319	3.1859	3.4318	3.2516	1.4209	0.1636
7/30/2013	4.2202	3.1798	3.4198	3.2449	1.4101	0.1632
7/31/2013	4.2427	3.1929	3.4465	3.2674	1.4145	0.1645
8/1/2013	4.2339	3.1961	3.4372	3.2418	1.4129	0.1635

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