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Comment on the upcoming data and forecasts

Another batch of monthly macro data is due to be released next week. We expect that declines in employment (release on Tuesday) have slowed down further, in line with recent trends and relevant business tendency indicators. Data on wages will probably come on the softer side, due to negative working day effects and a lack of bonuses in copper mining. Less favorable YoY difference in the number of working days should also bring down industrial output growth. Positive surprise in PMI and very good numbers on car production offer some space for positive surprises, though. PPI has probably ticked up on higher commodity prices (somewhat cushioned by stronger Zloty). Lastly, from MinFin's comments we have already learned the budget deficit slightly widened in August, therefore Monday's detailed data on state finances will not surprise.

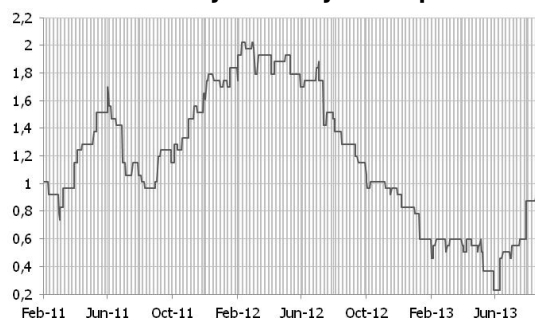
Polish data to watch: September 9th to August 13th

Publication	Date	Period	BRE	Consensus	Prior
Core inflation y/y (%)	16.09	Aug	1.4	1.4	1.4
Budget performance YTD (%)	16.09	Aug			73.0
Employment y/y (%)	17.09	Aug	-0.6	-0.6	-0.7
Wages y/y (%)	17.09	Aug	2.4	2.8	3.5
Industrial output y/y (%)	18.09	Aug	2.3	2.7	6.3
PPI y/y (%)	18.09	Aug	-0.7	-0.7	-0.8

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 OK0116	-	5000	2.961	9/5/2013
5Y T-bond PS0718	-	5000	3.303	9/5/2013
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 - CPI came out exactly in line with expectations. There is some room for surprises next week with industrial output and prices data in the pipeline. The index stays in uptrend.

* 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).



Our view in a nutshell

Fundamentals

- Available data confirm that the long-awaited recovery began at the turn of Q2/Q3.
- The upswing is driven by a rebound in real income and recovering private consumption. Low rates trigger rotation in households assets towards overnight deposits. Given the scale of slack in investment (infrastructure in particular) and consumption, rebound generated this way may be initially moderate (ca. 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 strengthen 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. The European Commission gave the government two additional years to bring the GG deficit down to 3%, and a budget amendment (at PLN +16 bn) was just passed. Furthermore, additional boost to public finances comes from pension reform. This - along with the political 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. 0.2% inflation growth was the lowest in the cycle. A spike in July - although to large extent exogenous - marks the beginning of new upward trends, both in headline and the core. Inflation stays subdued in historical standards, though.
- Rebound in growth and inflation practically erases easing bias in MPC. Therefore July rate cut definitely 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

- Local factors including economic upturn and liquidation of OFE assets suggest higher liquidity risk premium on Polish bonds. Global recovery (or monetary stimulus and liquidity withdrawal by the Fed) and rising core yields will additionally adversely affect Polish bonds. Such a set-up favors negative stance on Polish bonds. Forward rates are starting to look too low given the upcoming recovery and gradually rising inflation (set to hit NBP target in mid 2014).
- The "wall of money" obscured the cyclical 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). At the moment QE tapering game is going to support the weakness of the zloty.

BRE forecasts

	2009	2010	2011	2012	2013F	2014F
GDP y/y (%)	1.6	3.9	4.5	1.9	1.1	3.0
CPI Inflation y/y (average %)	3.5	2.8	4.3	3.7	1.1	2.2
Current account (%GDP)	-1.6	-4.5	-4.9	-3.5	-1.9	-2.6
Unemployment rate (end of period %)	12.1	12.4	12.5	13.4	13.7	13.3
Repo rate (end of period %)	3.50	3.50	4.50	4.25	2.50	3.00

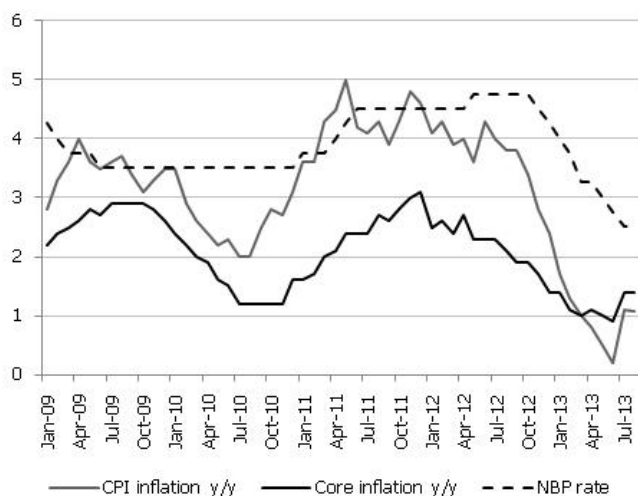
	2013	2013	2013	2013	2014	2014	2014	2014
	Q1	Q2	Q3 F	Q4 F	Q1 F	Q2 F	Q3 F	Q4 F
GDP y/y (%)	0.5	0.8	1.3	2.1	2.4	2.5	3.1	3.2
Individual consumption y/y (%)	0.0	0.2	1.2	1.9	2.2	2.3	2.4	2.4
Public Consumption y/y (%)	-0.5	3.9	3.0	2.0	0.3	0.3	0.3	0.3
Investment y/y (%)	-2.0	-3.8	-1.8	-1.0	-0.5	1.8	3.0	3.8
Inflation rate (% average)	1.3	0.5	1.1	1.3	1.8	2.2	2.4	2.5
Unemployment rate (% eop)	14.3	13.2	13.2	13.7	14.3	13.0	12.9	13.3
NBP repo rate (% eop)	3.25	2.75	2.50	2.50	2.50	2.50	2.50	3.00
Wibor 3M (% eop)	3.39	2.73	2.70	2.70	2.70	2.70	2.70	3.20
2Y Polish bond yields (% eop)	3.19	3.07	3.10	3.20	3.30	3.30	3.30	3.30
10Y Polish bond yields (% eop)	3.94	4.34	4.80	5.00	5.00	5.10	5.20	5.50
EUR/PLN (eop)	4.18	4.33	4.20	4.10	4.05	3.95	3.90	3.90
USD/PLN (eop)	3.26	3.32	3.21	3.15	3.13	3.15	3.20	3.25

F - forecast

Economics

CPI inflation stable in August

In August CPI held at 1.1% y/y, in line with market consensus and our forecast. The details of the release also did not surprise: the monthly fall in food prices (1.3% m/m) matched last year's and our forecast; fuel prices grew by a modest 0.5%. Core inflation remained stable at 1.4% y/y, as almost all categories exhibited very little change, with two exceptions: clothing and footwear (2-3% declines, purely seasonal in nature).



Preliminary estimates indicate that CPI should accelerate slightly to 1.2% (core inflation to 1.6%) in September whereas significant increases in inflation are expected to occur later this year when the base effects from the end of the last year start to play a more significant role. The already announced hike of the excise tax on spirits is going to be the additional factor accelerating inflation at the beginning of 2014 (NBP Economic Institute estimates its impact on prices at 0.1 pp.). As soon as in January 2014 CPI inflation is expected to amount to 2% and to reach the NBP's target in mid-2014.

The release didn't influence FI and FX markets. The stabilization of inflation in August is only a short break in the uptrend which is set to increasingly impact market expectations regarding the interest rates. Along with gradual economic recovery the inflationary pressures are expected to reappear. As a result forwards on long rates will face upward pressure.



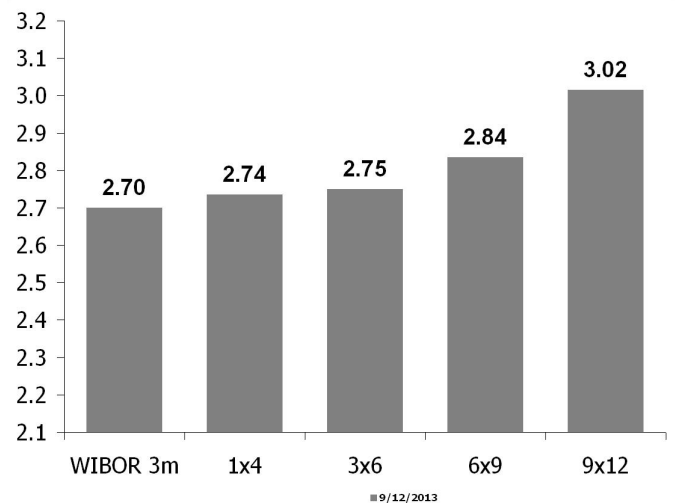
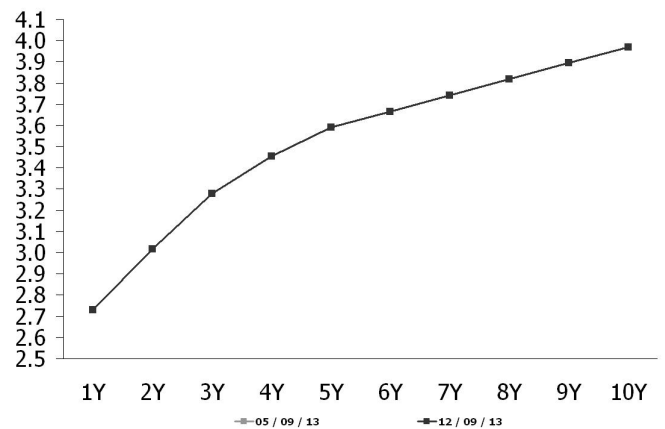
Fixed income

Big move

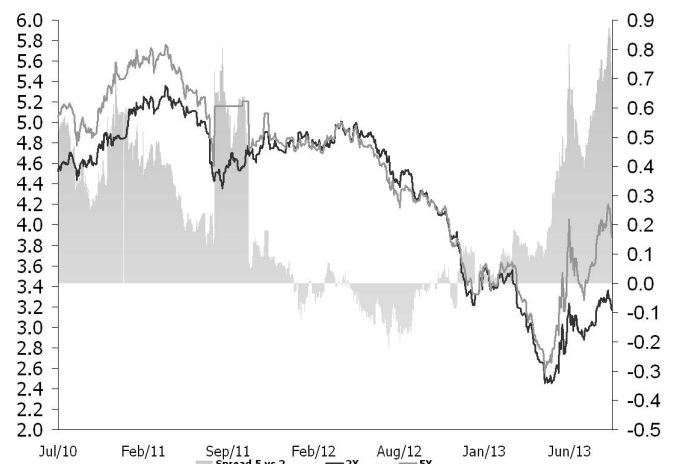
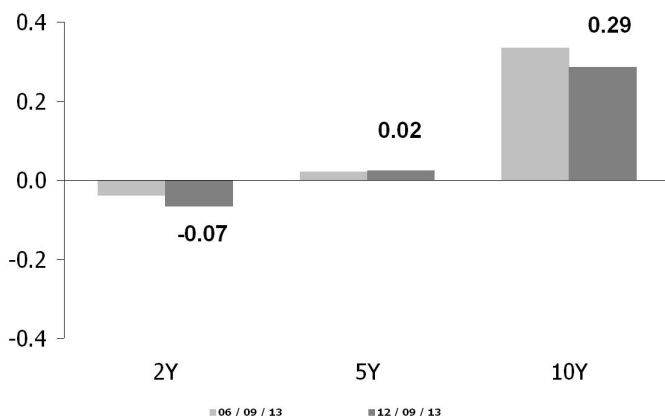
After a couple of weeks of a bear market the PLN yield curve topped last Friday with 5y trading at 4.35% and 2y at 3.41%, respectively. Looking at the forwards it seemed obvious that the market had already priced in the next rate hike cycle trading 1y3y forward rate at over 5.15% and the upside risk on the curve was supposed to be limited. As the global sentiment was very volatile and closely correlated with the current economic data, it seemed only a question of time when market participants would decide to take profits on those high yields. The trigger to the deepest correction came from the US market with weaker non-farm payrolls. Though we predicted such a scenario last week, the scale of the move downside along the curve turned out to be a great surprise. With a massive drop in the longer end (5y and 10y around 45-50bp) the curve flattened aggressively from 94 point in 2y5y at highs to around 69 points at lows.

As we suggested last week, we found it very attractive to receive 1y3y forward rate at around 5.20% and we had decided to close it down on Thursday when the market hit the level of 4.50%. Assuming the market seems to stay in the uptrend, we would tend to pay the rates at back on the local lows with the new resistance on 5y at 4.50%. Good luck!

IRS curve



Assets swaps

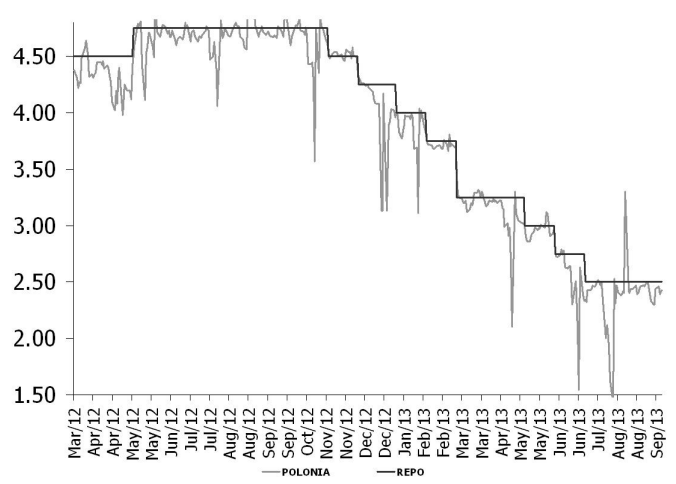
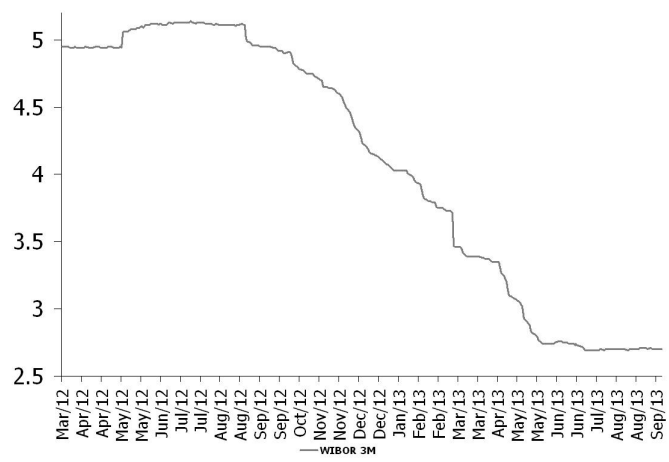
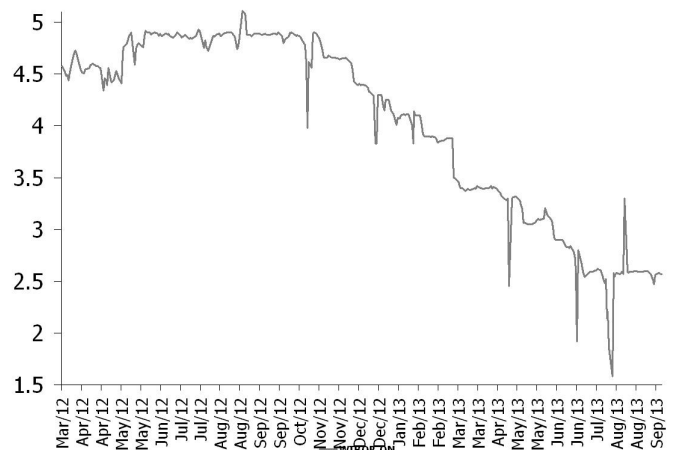
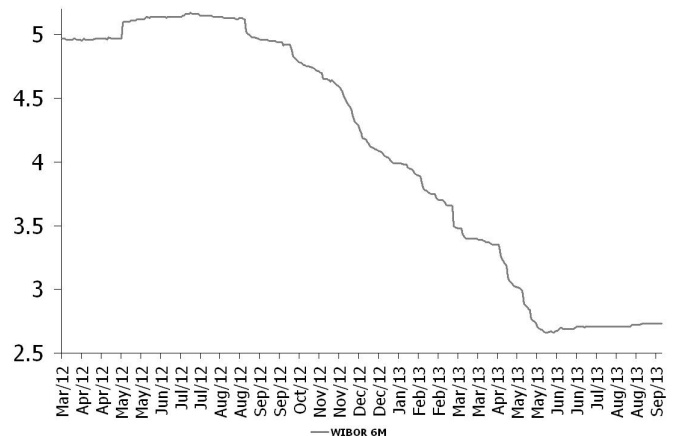




Money market

Market square for liquidity needs Surprisingly stable week for shortest rates, taking into consideration that we had quite a substantial shortage of cash in the system. Today's OMO squares the market but we cannot exclude cheaper carry next week. Looks like the current liquidity layout in the system changes the redistribution facilities in a positive way.

Emotions off as far as OFE reform is concerned After a very emotional reaction of the market to the OFE reform, markets calmed down and we are now on the levels even lower then before. MinFin has no details except for the overall shape of the plan. Their agenda is to close legislation before the end of the year. The transfer of assets from OFE would then be no sooner then on April 1st, it clearly indicates that the earliest possible term for the bill to be valid is July 1. Lots of time yet... no details known and those are really crucial to this reform.





Forex

PLN stronger Post US NFP data, the price action was really one way only, the risk rallied hard, and PLN was no exception. Syrian peace talks also added fuel to the move. As a consequence, EUR/PLN fell free from 4.31 last Friday and reached 4.2050 lows before consolidation within the 4.2050/4.2250 area. We think market went a little too far and a little too fast to break 4.18/4.20 support zone at first attempt. We are not even a week before the decisive FOMC meeting, so we expect consolidation in 4.20/4.25 zone till FOMC. No action on tapering or really small move like 10 yards, with a calm geopolitical background, and we may eventually see the clean break through 4.18/4.20 support layer.

Vols consolidating With stronger PLN vols are lower, especially in the frontend. 1 month EUR/PLN ATM is 8.4% mid (0.6% lower), 3 months EUR/PLN is 8.7% (0.3% lower), and 1 year fixed at 9.5% also 0.3% lower then last week. The skew is also touch lower, along with the currency spread (difference between USD/PLN vol and EUR/PLN vol). The slide in vols was slowed by quickly approaching FOMC meeting. If it turns out to be a non-event, vols will tumble again.

Short-term forecasts

SPOT Main supports / resistances:

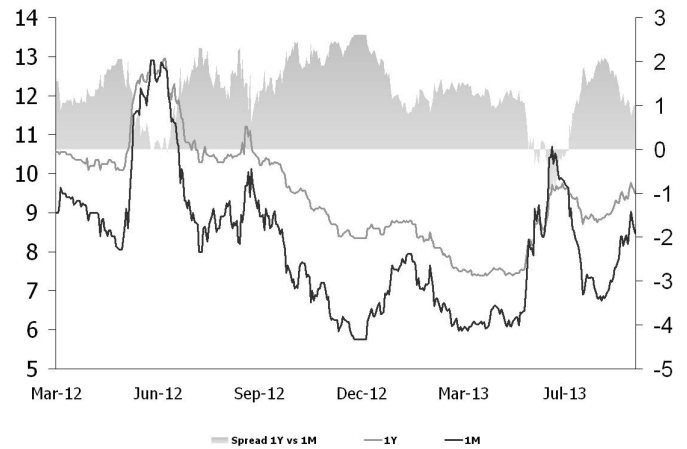
EUR/PLN: 4.2000 / 4.3400

USD/PLN: 3.0500 / 3.3000

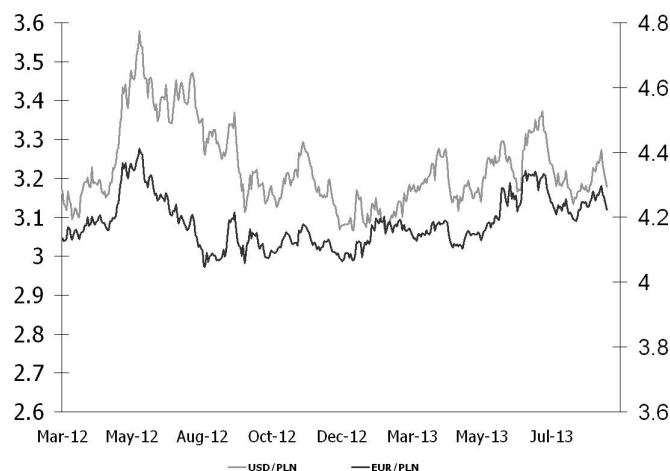
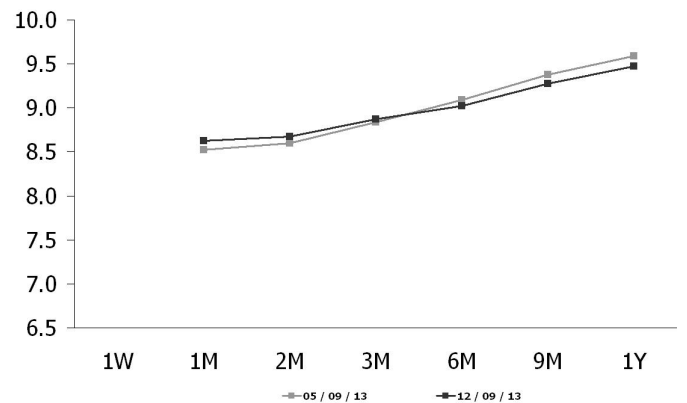
Play range The impressive PLN gains forced us to close our PLN longs, and we are even being tactically long EUR/PLN at 4.2125 with stop at 4.1900 and hopes for 4.25+. But the bigger picture is more and more PLN-attractive in our eyes, the closer to the year end we may get more and more "government protection on the upside". Even the slightly more hawkish FOMC may be not enough to break through "official offers" at 4.30+.

Derivatives Taking into account the magnitude of the spot move down in EUR/PLN, the correction in vols was quite cosmetic. The same conclusions may be drawn if you compare implied to realized volatility, or compare i.e. 3 month EUR/PLN and same period of EUR/USD vol. The shortend in PLN vols, seems to us, is quite vol expensive in 1-4 months tenors.

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
9/6/2013	2.31	2.70	2.52	6.49	2.84	6.59	2.73	2.77	2.86	3.05	3.28	3.03
9/9/2013	2.35	2.70	2.41	2.63	2.62	2.67	2.74	2.76	2.86	3.04	3.28	3.01
9/10/2013	2.34	2.70	2.53	2.63	2.85	2.67	2.74	2.77	2.88	3.05	3.29	3.03
9/11/2013	2.60	2.70	2.63	2.63	2.67	2.67	2.74	2.76	2.86	3.03	3.21	2.98
9/12/2013	2.35	2.70	2.52	2.63	2.84	2.67	2.74	2.75	2.84	3.02	3.17	2.97

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
9/6/2013	6.590	3.353	3.292	3.275	3.420	3.351	3.630	3.873
9/9/2013	2.670	3.114	3.263	3.148	3.370	3.270	3.575	3.755
9/10/2013	2.670	2.992	3.218	3.137	3.325	3.237	3.525	3.759
9/11/2013	2.670	2.992	3.218	3.137	3.325	3.237	3.525	3.759
9/12/2013	2.670	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
9/6/2013	9.03	9.08	9.25	9.78	9.78	3.07	0.80
9/9/2013	8.84	9.15	9.25	9.66	9.66	3.07	0.80
9/10/2013	8.66	9.09	9.23	9.63	9.63	3.05	0.79
9/11/2013	8.48	8.88	9.03	9.50	9.50	3.09	0.79
9/12/2013	8.63	8.88	9.03	9.48	9.48	3.09	0.79

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
9/6/2013	4.2975	3.2732	3.4673	3.2833	1.4267	0.1668
9/9/2013	4.2700	3.2357	3.4543	3.2552	1.4205	0.1655
9/10/2013	4.2637	3.2181	3.4465	3.2156	1.4227	0.1651
9/11/2013	4.2408	3.1955	3.4211	3.1864	1.4182	0.1644
9/12/2013	4.2238	3.1782	3.4128	3.1944	1.4022	0.1639

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