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Comment on the upcoming data and forecasts

Next week we end the streak of macro releases with retail sales and unemployment data. As for the former, we expect a slight slowdown on the back of negative working day effect and the fading of a one-off (increased sales in non-specialized stores due to new waste bill). As for the latter, our original forecast of no change (13,1% just as in July) had to be revised downwards after initial estimates from the Ministry of Labor and Social Policy published earlier this month.

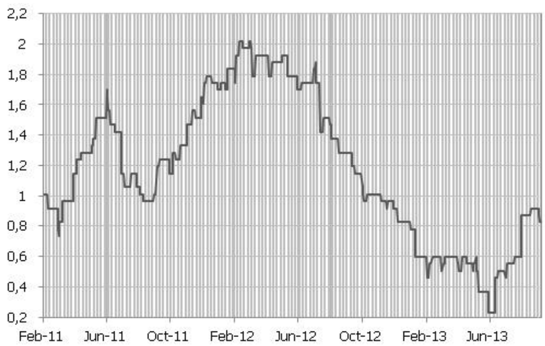
Polish data to watch: September 23th to 27th

Publication	Date	Period	BRE	Consensus	Prior
Unemployment rate (%)	24.09	Aug	13.0	13.0	13.1
Retail sales y/y (%)	24.09	Aug	2.4	2.8	4.3

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 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

Down on wages and PPI. We view this setback as a minor fluctuation, though. Trends in surprise indices are always bumpy.

* 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 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. 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 the pension reform. This - along with the political 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. 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, as rates have been pun on hold at least until end-2013. 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

- In the mid term Polish Local factors including economic upturn and liquidation of OFE assets suggest higher liquidity risk premium on Polish bonds. Global recovery and rising core yields will additionally adversely affect Polish bonds.
- Zloty capped by risk of NBP FX intervention. It should gradually strenghten on the back of cyclical recovery in Poland.

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 Q1	2013 Q2	2013 Q3 F	2013 Q4 F	2014 Q1 F	2014 Q2 F	2014 Q3 F	2014 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

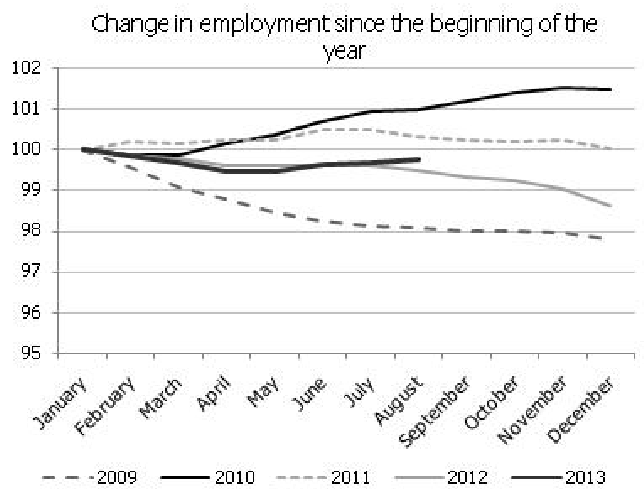
F - forecast

Economics

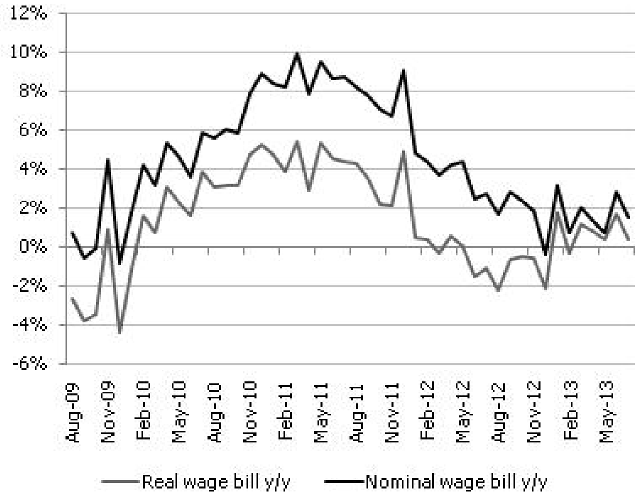
Calendar effects temporarily cloud positive momentum in the Polish economy

At first glance, some of the macro figures published this week seem like a setback to the recovery and have been considered as such by some economists and pundits. This is unjustified, as macro figures jump up and down around trends due to transitory effects such as the number of working days in a given month. We argue that there is a positive momentum in the Polish economy and, as usual, present a detailed review of this week's macro releases below.

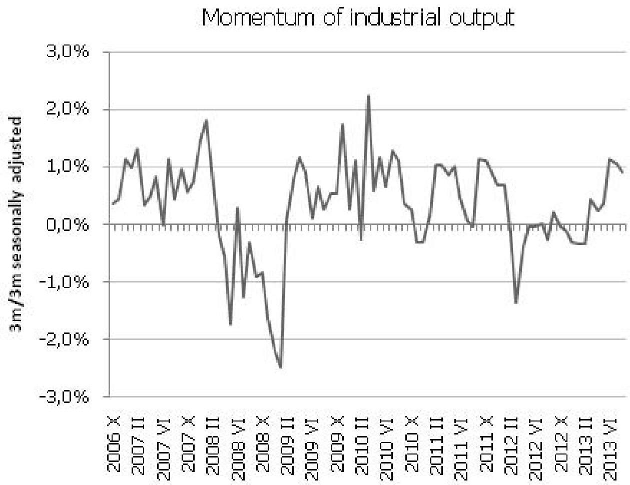
Employment fell by 0.5% yoy (our forecast and market consensus: -0.6%) which translates into a modest monthly increase of ca. 4 thousand jobs. This comes as a surprise for one simple reason - typical seasonal pattern suggests a small decrease in the number of employed. In fact, this has been the best August since 2007 when the Polish labor market enjoyed an unprecedented boom. In comparison, August 2010 brought only 2 thousand new jobs. This suggests that: (1) the economy is strong enough to warrant new hiring; (2) the labor market reacts differently to changes in business climate than a few years ago and the GDP dynamics required to generate a sustained increase in employment has decreased since.



Wage growth rate declined to 2% y/y from 3.5% y/y last month, below market consensus but close to our forecast. No details were revealed, therefore we can only speculate that the slowdown results from the negative working day effect (-1 y/y), high statistical base from last year and shifts of bonuses in copper mining. The release in the range of 2%-2.5% is entirely consistent with the recent trend. In the next few months wages are expected to increase slightly - the modest growth rate is the "new normal" for the Polish economy - entrepreneurs still have to control costs (and this is an employer's market anyway).



Industrial output grew by 2.2% y/y, in line with our forecast and slightly below market consensus (2.3 and 2.7%, respectively). Working day effects (-1 y/y vs. +1 y/y in the previous months) brought the headline figure down but it is - not for the first time - somewhat surprising that seasonally adjusted y/y dynamics also dropped. In spite of this riddle, the momentum of industrial output remains fairly strong (see graph below). Production grew in 26 out of 34 sections - a typical mix of exports-oriented and domestic-oriented sectors - which confirms our previous observations regarding strong fundamentals of the on-going recovery.



Producer prices decreased by 1.1% (our forecast and the consensus: -0.7%) - the effect of lower the prices in the manufacturing sector resulting from the decrease in coke prices. The core PPI (excluding coke and fossil fuels) again didn't change, which is consistent with the slight strengthening of zloty last month. Today's figure, as well as the stabilization of core CPI, confirms that the inflation pressure in Polish economy remains subdued.

Despite favorable weather conditions (at least according to GUS), **construction output** plummeted by 11.3% y/y (consensus -9%; our forecast; -8.9%). The slump can be partly attributed to the negative difference in the number of working days (-1 y/y). Seasonally adjusted figure amounts to -9,8%.

In relation to August of 2012, a decrease in production was recorded in all divisions of construction. The release should be cautiously interpreted, since the series tends to be very volatile and such a slump by no means should be treated as the harbinger of the economic slowdown. In our view next months will bring a gradual improvement in the construction sector along with the stabilization in public investments and growth in the private ones (first gains y/y in December). The view is supported by the uptrend in the number of housing starts (the data released yesterday) and a stabilization in the number of construction permits (with a possible turnaround).

The very same effects that negatively affected August figures, will work to their advantage in September (we expect that industrial output will grow by 7-8% y/y). Altogether, available data paint a fairly optimistic picture for the economy in Q3. Our early estimates pin down GDP growth for the third quarter at even 2.0% y/y - in hindsight it is obvious that the slump in construction was an enormous drag on the economy.

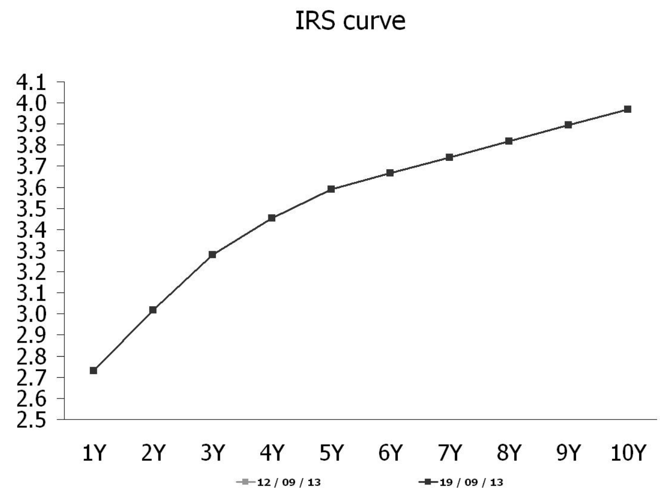
Both releases barely moved markets. Taken altogether, they should be seen as a positive sign indicating solid fundaments of the on-going recovery. In effect, we expect interest rates expectations to rise (of course one have to concern also the momentum in the global economy and temporary setbacks from issues such as the Fed or fights in US Congress) and the yield curve to become steeper.

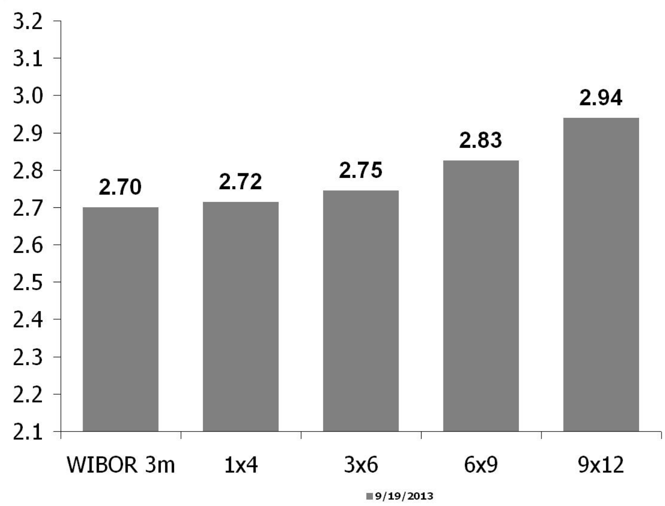
Fixed income

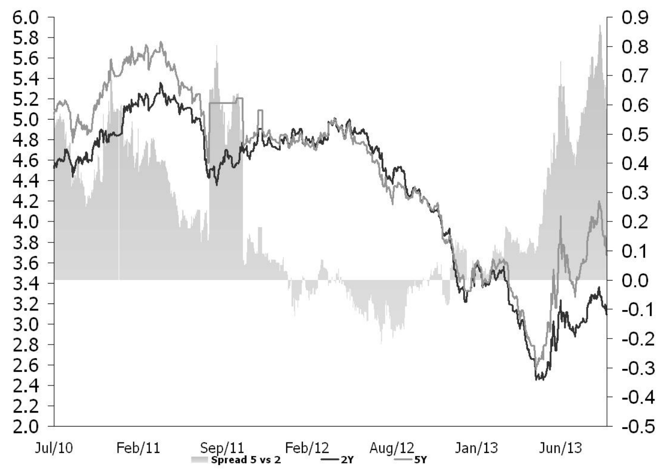
A life after FED

With local story hiding in the shadow of global developments, the market had stepped into 'wait and see mode' before FED meeting. The curve's benchmarks were traded down to 3.20 for 2Y and 3.85 for 5Y IRS, 10Y bond benchmark at 4.40. More dovish than expected statement triggered some more rally on PL rates marking lows at 3.01 for 2Y, 3.60 for 5Y and 4.20 for 10Y POLGB. So that's about history. What's now, then?

As mentioned a week ago, we have used this event to pay slightly rates. Especially the flattened forward curve makes current level (about 4.00%) of 2Y2Y forward a decent bet. In common market opinion tapering is just postponed, not cancelled. Why not give them a try? On the contrary, the widely announced long period of low rates creates some value in 3Y bonds which slightly underperformed in the recent rally. Wider (than the curve suggests) assets swaps in this tenor should also support our view.

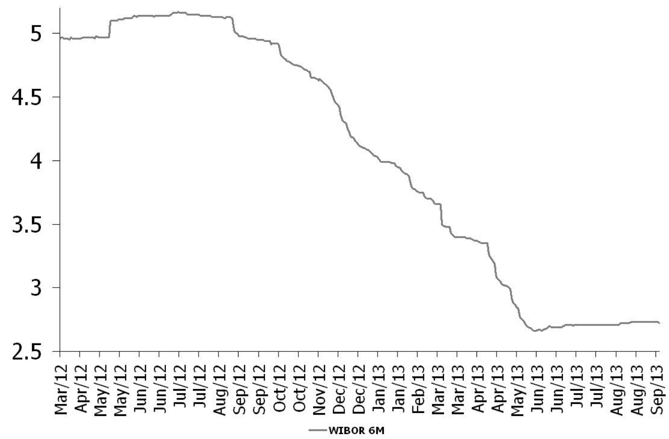






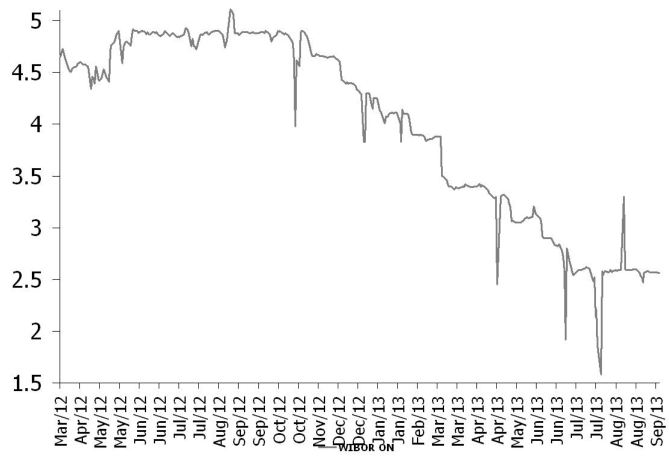
Money market

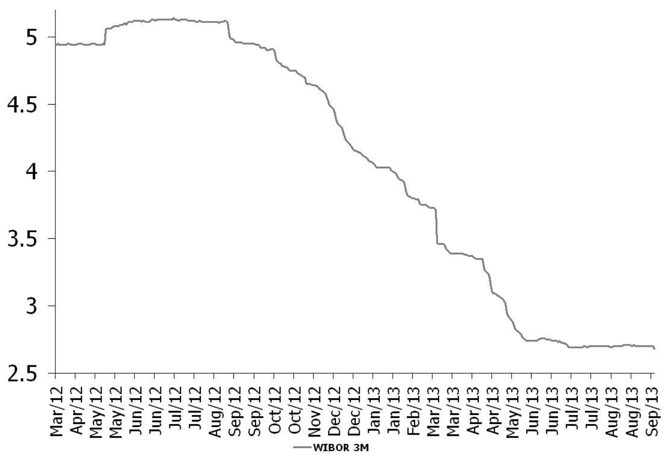
Liquidity stable with chances for lower carry next week Liquidity stable nearby the main market rate. We see some potential for lower cost of carry next week (last week of the reserve period) since market bought 2.5 bln pln less money bills then necessary for square during today's OMO.

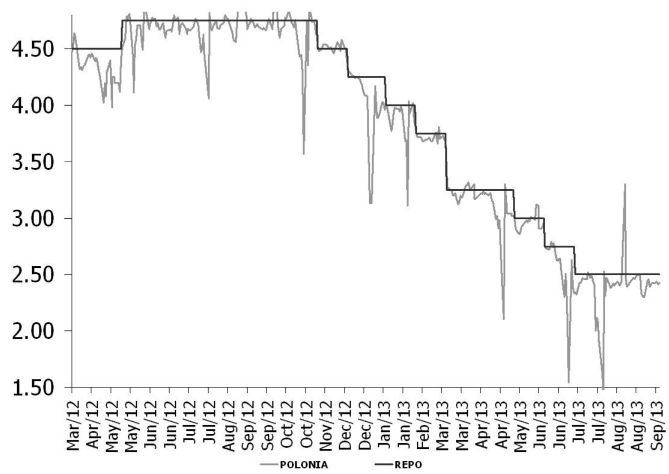


Fed detonated a bullish bomb Extremely bullish with the rapid drop in rates after FED delayed the tapering. Rates dropped 15-20 bps along the curve, which we perceived as an opportunity to buy. Like with the case of OFE, initial reaction was very emotional and rates should go up soon, reflecting more natural shape of the forward rates. The curve itself should be much more steep, especially in the 5-10Y sector. We still see value in entering payers at current levels.

There were some local figures (wages, IO and PPI) all quite bullish, nonetheless completely ignored in the waiting mode for the FED. Since the next important local figure is CPI mid October, till then we will probably closely follow core markets. Having said that, all eyes on US figures, Bund and US Treasuries.







Forex

PLN hectic The FOMC proved to be a real market mover this time. The announcement of "no tapering" took us for a wild ride. EUR/PLN dropped like a stone from 4.2300 to 4.1430 low only to be claimed back to 4.2355 on the very next day. That is a lot… We think that when dust finally settles we will have a risk rally in the end. And with the government's end-of-the-year interest to protect PLN against weakening too far, we think we should have a slow slide towards 4.13/4.10.

Vols lower It was a digital. After FOMC announcement the vols moved lower quite aggressively. 1 month is today 8.1 % (lower 0.3), 3 month is 8.7% (lower by 0.5), 1 year is 8.9% (lower 0.6%). It's easy to notice that the longer tenors suffered most, the front end is supported by moving spot but we expect that it will calm down soon. The skew and currency spread (the difference between USD/PLN vol and EUR/PLN vol) found better offers as a result.

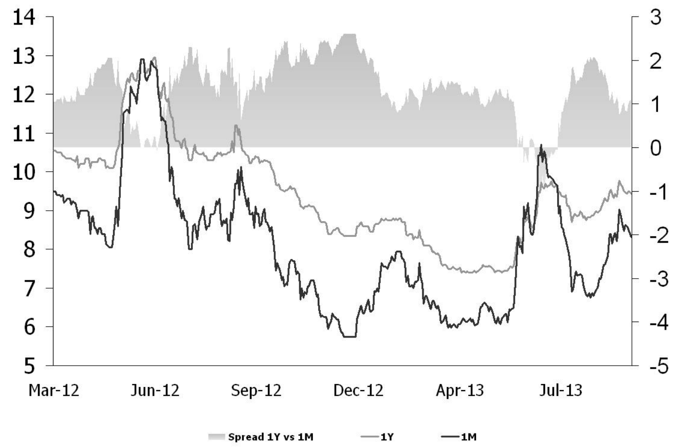
Short-term forecasts

SPOT Main supports / resistances:
EUR/PLN: 4.1400 / 4.2500
USD/PLN: 3.0500 / 3.3000

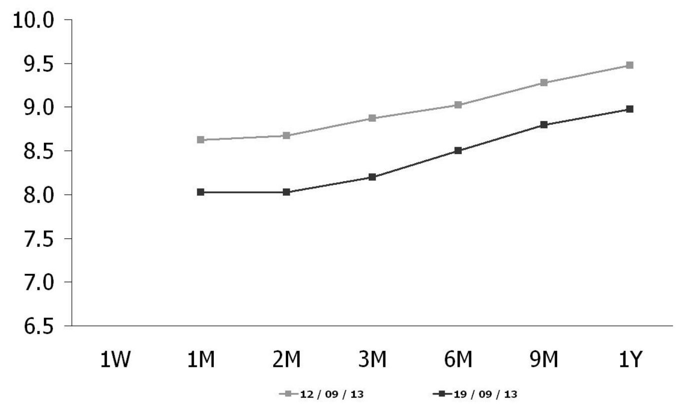
Sell EUR/PLN The lack of tapering is a bullish PLN factor, the main reason why PLN depreciated this year was the threat of tapering. Short term it's more noise, stop loss hunting, position adjustment theme, but in general PLN should find its way to the stronger side. Short EUR/PLN 4.2300 with a stop at 4.2600 and hopes for a retest of 4.1450 low.

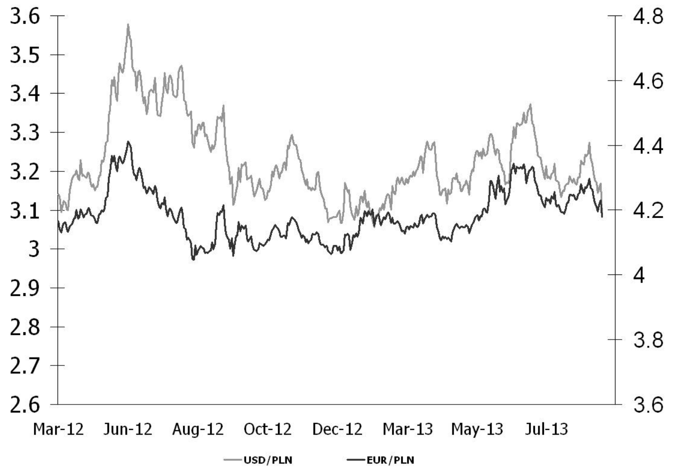
Derivatives Volatility is sharply lower on the FOMC news, with the big risk for PLN postponed for the time being. We don't see a lot of value in the EUR/PLN vol curve at the moment. We see the wild swings in spot but that's a post-FOMC shock, we will most likely be back soon to low realized volatility. The short term (up to 4 months) EUR/PLN is still rather for sell, but to a smaller degree then last week. Similar situation with skew and currency spread.

EURPLN volatility

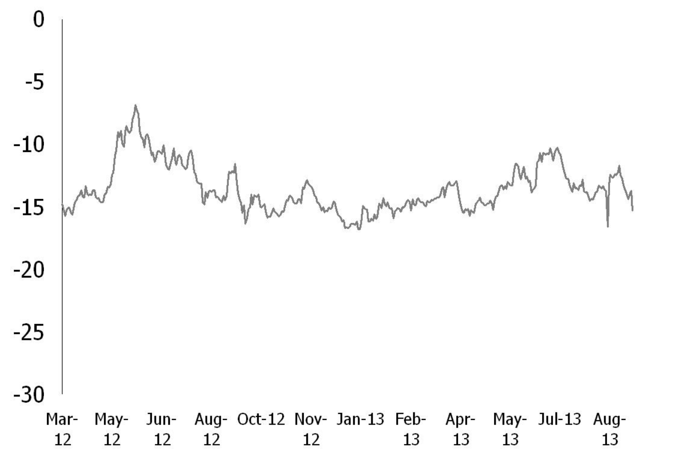


EUR/PLN volatility curve





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
9/13/2013	2.35	2.70	2.53	2.63	2.84	2.67	2.74	2.73	2.84	3.01	3.20	2.97
9/16/2013	2.35	2.70	2.45	2.63	2.66	2.67	2.71	2.74	2.82	3.00	3.14	2.97
9/17/2013	2.34	2.70	2.52	2.63	2.81	2.67	2.71	2.76	2.84	3.01	3.20	2.97
9/18/2013	2.35	2.70	2.46	2.63	2.73	2.67	2.72	2.76	2.84	3.00	3.18	2.95
9/19/2013	2.32	2.70	2.50	2.63	2.79	2.67	2.72	2.75	2.83	2.94	3.09	2.94

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	OK0715	5Y IRS	PS0718	10Y IRS	DS1023
9/13/2013	2.670	3.353	3.292	3.275	3.420	3.351	3.630	3.873
9/16/2013	2.670	3.114	3.263	3.148	3.370	3.270	3.575	3.755
9/17/2013	2.670	2.992	3.218	3.137	3.325	3.237	3.525	3.759
9/18/2013	2.670	2.992	3.218	3.137	3.325	3.237	3.525	3.759
9/19/2013	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
9/13/2013	8.60	8.88	9.03	9.43		9.43	3.09		0.79
9/16/2013	8.53	8.85	9.03	9.50		9.50	3.09		0.79
9/17/2013	8.44	8.76	8.98	9.50		9.50	3.09		0.79
9/18/2013	8.31	8.66	8.98	9.43		9.43	3.12		0.79
9/19/2013	8.03	8.20	8.50	8.98		8.98	3.00		0.78

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
9/13/2013	4.2110	3.1696	3.4024	3.1796	1.3996	0.1634
9/16/2013	4.1961	3.1435	3.3937	3.1789	1.4027	0.1630
9/17/2013	4.2144	3.1552	3.4074	3.1804	1.4078	0.1635
9/18/2013	4.2302	3.1689	3.4217	3.2054	1.4191	0.1641
9/19/2013	4.1790	3.0833	3.3889	3.1195	1.4114	0.1621

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