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Comment on the upcoming data and forecasts

Another batch of economic data for July will be released next week. We believe that the consensus underestimates improving momentum in retail sales growth (to be released on Monday). The figures will be influenced by strong momentum in durable goods, statistical base (positive on automobile, food and retail sale in non-specialized stores, negative in „other") and positive contribution of working day effect. To sum up – retail sales have reached the trough. The release will be accompanied by report on unemployment: a slight decrease in the unemployment rate is expected. On Friday the final GDP data for Q2 as well as NBP inflation expectations are published.

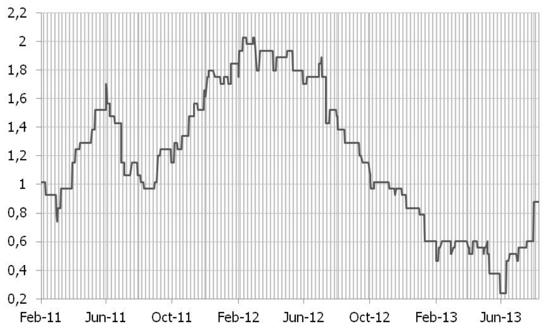
Polish data to watch: August 26th to August 30th

Publication	Date	Period	BRE	Consensus	Prior
Retail Sales r/r (%)	26.08	Jul	4.5	2.8	1.8
Unemployment rate (%)	26.08	Jul	13.0	13.1	13.2
NBP inflation expectations (%)	30.08	Aug	1.3	0.4	0.4
GDP *final* y/y (%)	30.08	Q2	0.8	0.8	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 OK0715	-	3000	2.961	8/7/2013
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, last week's data releases didn't bring any significant suprises. Next week there is only retail sales data that offers any opportunity to move the index higher.

* 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 economy hit the bottom in Q1, recovery is in the pipeline.
- 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 (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 the GG deficit down to 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. 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

- Better string of data is able to generate positive momentum on rate hike expectations.
- Long end bonds are 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

	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 F	2013 Q3 F	2013 Q4 F	2014 Q1 F	2014 Q2 F	2014 Q3 F	2014 Q4 F
GDP y/y (%)	3.5	0.7	1.3	2.0	2.4	2.5	3.1	3.2
Individual consumption y/y (%)	1.7	0.7	1.6	1.9	2.2	2.3	2.4	2.4
Public Consumption y/y (%)	-1.0	-0.5	0.2	0.2	0.3	0.3	0.3	0.3
Investment y/y (%)	6.8	-3.5	-2.0	-1.2	-0.5	1.8	3.0	3.8
Inflation rate (% average)	3.9	0.5	1.1	1.3	1.8	2.2	2.4	2.5
Unemployment rate (% eop)	13.3	13.2	13.2	13.7	14.3	13.0	12.9	13.3
NBP repo rate (% eop)	4.50	2.75	2.50	2.50	2.50	2.50	2.50	3.00
Wibor 3M (% eop)	4.94	2.73	2.70	2.70	2.70	2.70	2.70	3.20
2Y Polish bond yields (% eop)	4.62	3.07	3.00	3.00	3.10	3.20	3.20	3.30
10Y Polish bond yields (% eop)	5.50	4.34	4.40	4.70	4.80	4.80	5.00	5.20
EUR/PLN (eop)	4.15	4.33	4.20	4.10	4.05	3.95	3.90	3.90
USD/PLN (eop)	3.11	3.32	3.36	3.36	3.29	3.25	3.25	3.25

F - forecast

Economics

Solid improvement in high frequency data confirms the upswing

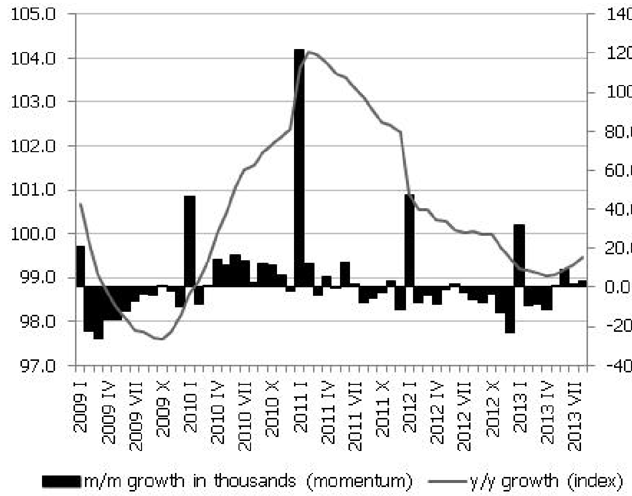
It seems the period when we elaborated on the gloomy state of the economy is definitely over. Recent stream of data confirms gradual upswing. As usual, more smooth labor market data delivered less excitement than prints on industrial output. However, a recipe for a successful upswing demands improvement in both dimensions - hopefully it is visible. It is always good to also have second order confirmation in prices - maybe not CPI, which is now driven by exogenous factors, but rather at the earlier stage of processing - PPI serves this purpose well and gathers momentum.

We think that GDP growth will be rising towards 2.0% at the end of the year. That is why we expect that both market consensus (still in shock after the soft Q1 and focused on prolonged stagnation of the Polish economy) and the NBP (see the GDP projection with prevailing downside risks) are set to be surprised by the scale of upswing in H2.

Recent interview with governor Belka confirms the consensus for stable interest rates for several months (some sort of forward guidance). It is a fragile equilibrium in our opinion. In order to sustain it, Belka is not going to push for longer period of low interest rates. At the same time monetary policy assumptions (stabilization of polonia rate around the repo) are not going to be relaxed either.

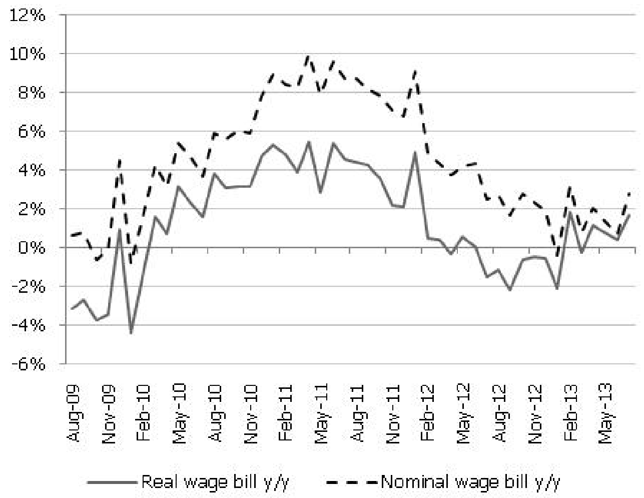
Let’s take a quick look at recent publications.

Employment in the enterprise sector rose in July by almost 2k on monthly basis. Therefore annual growth of employment improved to -0.7% from -0.8%. We sustain our view that the trough in the labor market has been reached and it is possible that annual dynamics of employment will rear its head above zero until the end of the year. Such a view is corroborated by the momentum in disaggregated data and business tendency indicators as well.

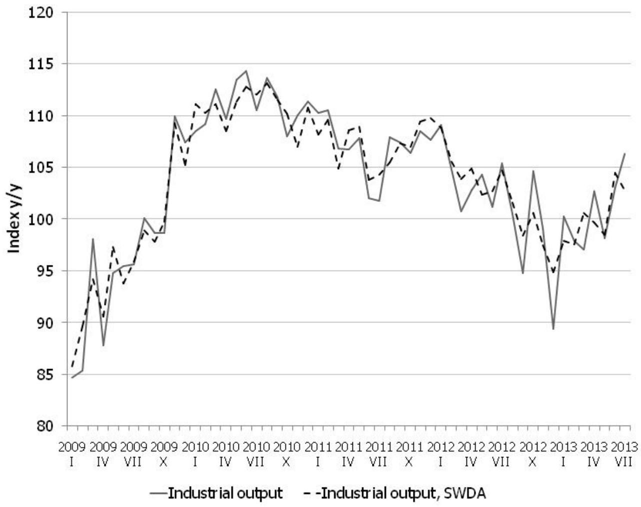


rysunek employemnt

Along with a gradual improvement in employment, **wages grew more swiftly** as well (to 3.5% y/y from 1.4% y/y). Although it is not yet endogenous acceleration of wages which we expect to emerge as soon as economy accelerates and labor market tightens (as the breakdown of wages has not been revealed yet, the reason for higher wages lies mostly in base effects), it is sufficient - especially in real terms - to support faster growing consumption.

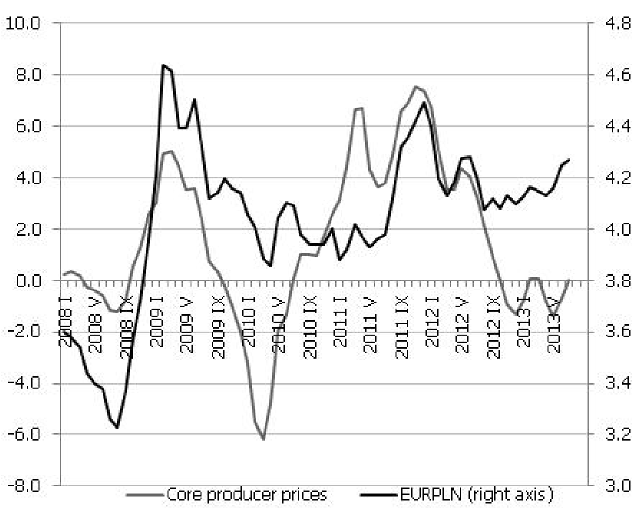


July industrial output beat analysts’ estimates rising by 6.3% y/y (previous 2.8%). In seasonally adjusted terms output increased by 2.8% vs. 4.5% in June (we do not think, however, that the seasonal adjustment is a very accurate one given the volatility of Polish series). Higher industrial output in July should not be seen as a one-off - positive growth rates were recorded in 27 out of 34 sections. Both exports and domestic demand drive Polish output. As early as 2-3 months ago we drew your attention to the fact that despite negative y/y growth rates, actual m/m momentum of Polish industry had improved significantly. As soon as base effect have worn off, annual growth rate accelerates as well.



However, the biggest positive surprise came from the construction sector. **Construction output** declined by a mere 5.2% y/y and it is the best result of the sector since last Autumn. The surprise (since statistical base effects are obvious) is, of course partly due to working day effects and very favorable weather, but the momentum is nevertheless very good. In our view, two-digit declines in construction output are the thing of the past. In the coming months, the sector will be supported not only by public orders but also by the resurgence of private investment. The first glimpse of the latter we saw in latest housing data - housing starts grew by 9.9% m/m and are already up by ca. 25% from the bottom (the turn of 2012 and 2013).

Producer prices continued upward march in July reaching -0.8% y/y. Although annual growth seems subdued, monthly momentum is decent (almost 0.4% on average in recent 3 months). Recent acceleration stems mostly from endogenous factors (price adjustment on the basis of higher exchange rate in environment of higher business activity) and revisions. Exogenous factors (slightly positive net effect of lower electricity prices and higher waste collection prices) were of minor importance. We think that recent streak of data confirms our view that downside pressure on producer prices has ended. Higher business activity is going to encourage firms to adjust their prices faster to exchange rate level (this process came to a halt along with a dip in economic activity) - see the graph to see the scope for re-alignment. All in all we expect faster growing producer prices in the future.

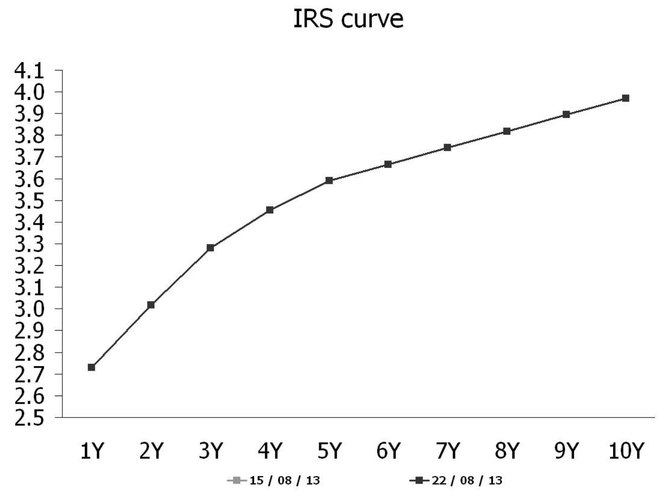


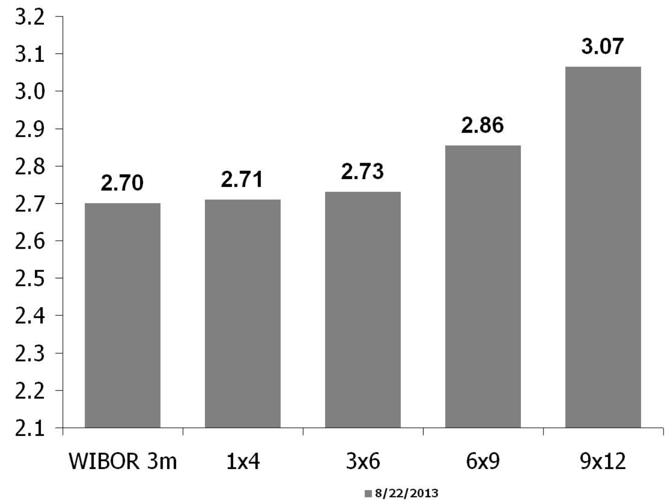
Fixed income

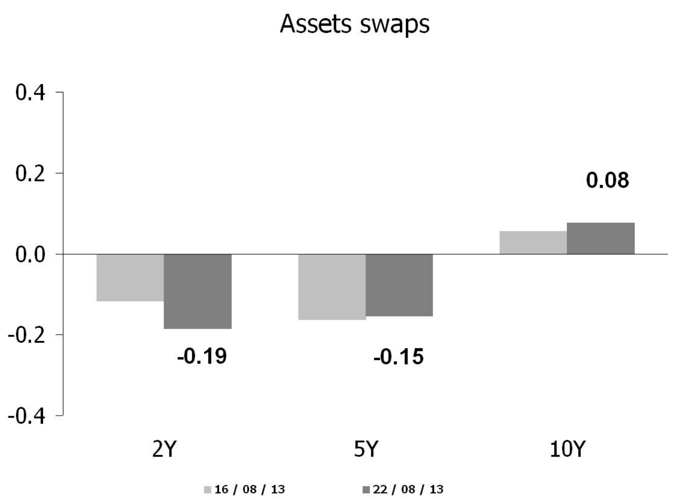
Following core markets

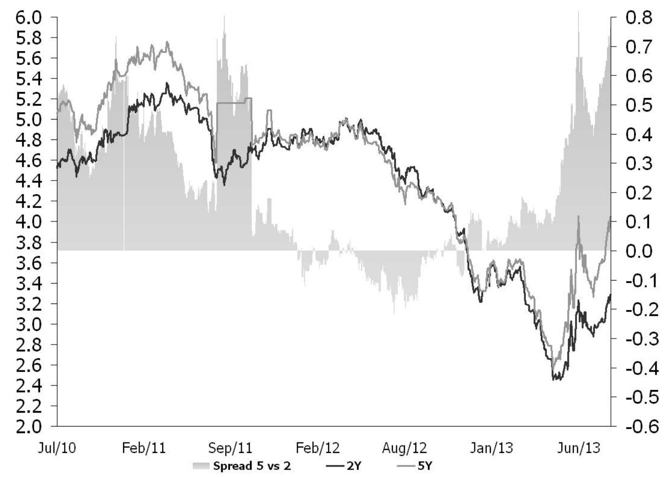
Polish rates, especially in the long end of the curve, seem to be almost perfectly correlated with the core rates. 2Y IRS was quite stable, which implied 2Y10Y spread increase by 15bp during the last few days. Given the fact that Polish data this month are little higher than expected we think the trend is going to be continued. The question is whether the next MPC statement can change that. We do not expect so, especially we cannot see any spectacular volume of trades.

Anyway, have a nice end of holidays!





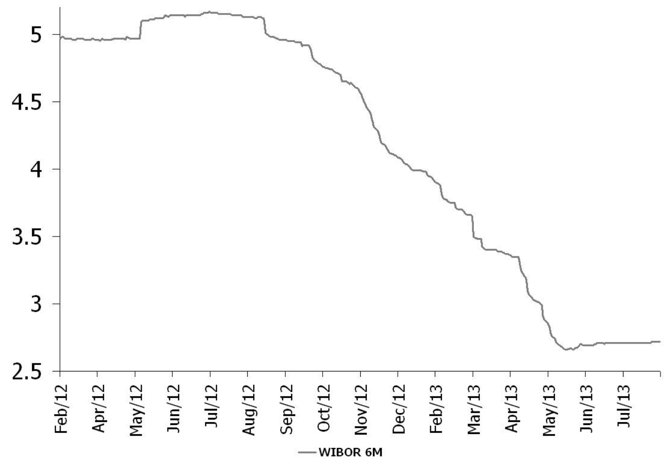


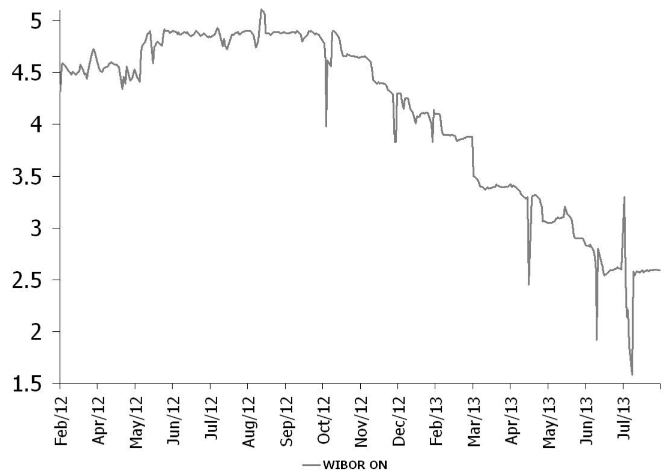


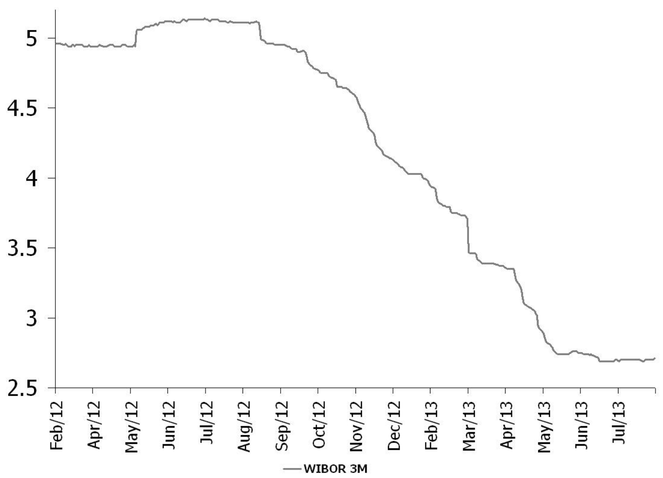
Money market

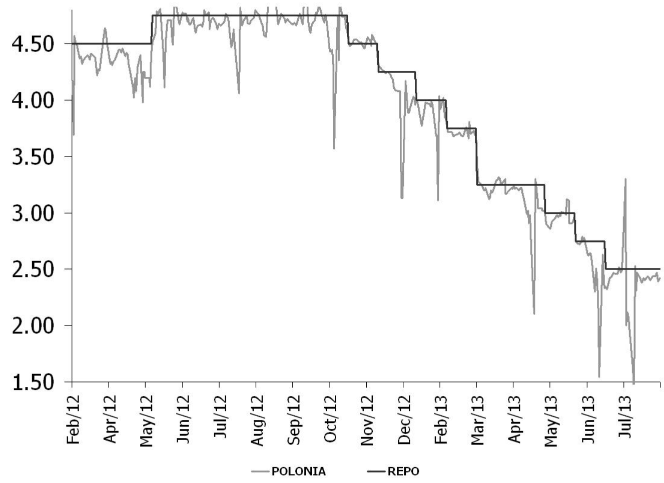
Relatively expensive month All the money bills taken (128.5 bln pln) with some over bidding. It is just enough to sqare the market during last week of the reserve. Since last day of current settlement period is Friday (2 auctions regular and extra one at the end of the day) we do not expect the shortest rates to move down.

Any correction to be used for paying the rates Very strong local figures, very good German figures plus waiting for the Fed and its start of tapering push the rates up. We are closely following core markets now with local figures supporting the movement north. The trend has changed for good and only softer than expected Fed could change it. If this is the case we would use this opportunity to take payers before another good (at least expected) set of local data for August.





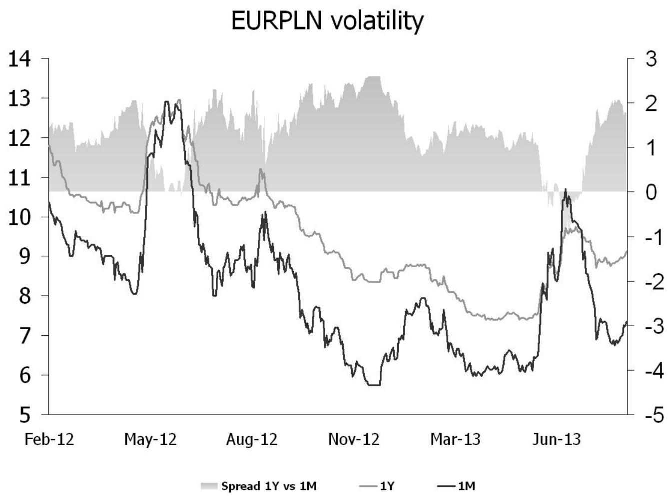




Forex

Firmly in range The main event of the week, namely FOMC minutes, gave us more conviction about tapering that is inevitably approaching. The PLN losses were quite modest with EUR/PLN high at 4.2550, USD/PLN flirted with 3.1900. Generally we are still enjoying a summer time 4.22/4.27 range. The local factors are supporting PLN but it s global sentiment that is firmly in the driving seat. In comparison to BRL, ZAR or TRY, PLN is being treated by the market really gently! And I am not assuming it's because of the possible NBP intervention.

Slightly Higher The threat of FOMC action has weaken the PLN and in the consequence moved EURPLN vol curve higher. The frontend gained most with 1 month EUR/PLN ATM mid fixing today at 7.5 % (0.7 % higher then last Friday), 3 months rose by 0.4% to 8%, 1 year is up by 0.2% to 9.1%. Nevertheless we are still hovering just above this years lows, and market dynamic is really not existing. The skew is cosmetically higher. The currency spread (difference between USD/PLN and EUR/PLN) is also slightly higher ...

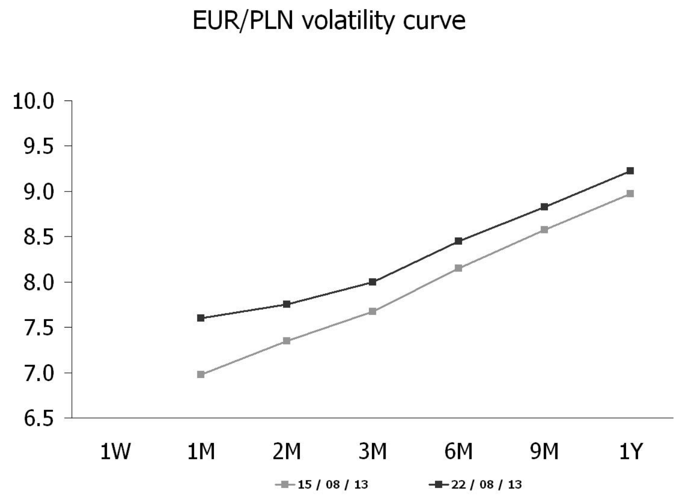


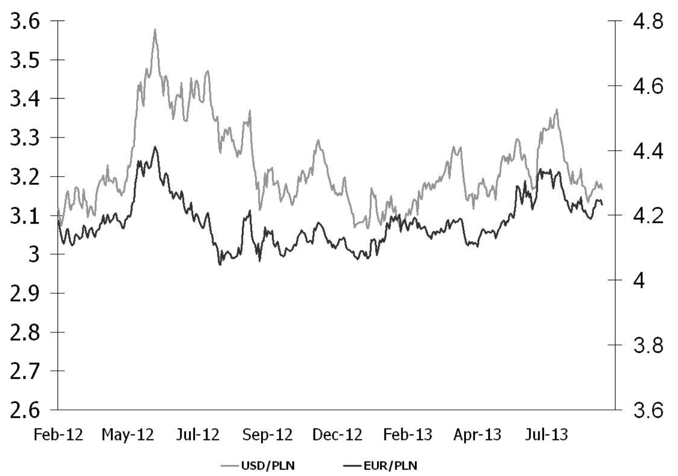
Short-term forecasts

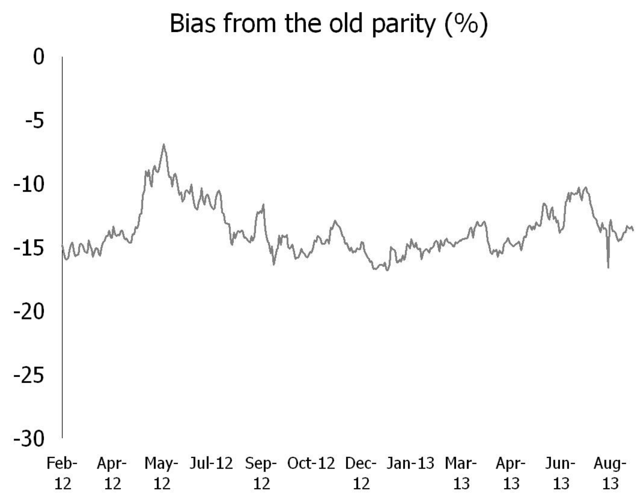
SPOT Main supports / resistances:
EUR/PLN: 4.1500 / 4.3000
USD/PLN: 3.0500 / 3.3000

Play the range The bigger picture favors a range for EUR/PLN - 4.18/4.28 . We are looking to sell 4.26, add 4.28 with a stop above 4.29, and hopes for retest of 4.20. We think that till NFP and FOMC, we may expect little activity and such environment usually favors the Zloty .

Derivatives Strong fundamentals should support Zloty and it made us more cautious for being long EURPLN vol. We have squared some of the frontend vol. We are still tactically long backend of the curve. The correlation of spot and the level of vols is really strong in EUR/PLN. Because of that we can expect higher vol only in tandem with significant weaker Zloty. We don't see that happening in the short period of time.







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
8/16/2013	2.33	2.70	2.51	6.49	2.76	6.59	2.71	2.71	2.81	2.96	3.17	2.93
8/19/2013	2.34	2.70	2.49	2.62	2.76	2.65	2.72	2.73	2.84	3.05	3.27	3.01
8/20/2013	2.36	2.70	2.53	2.62	2.78	2.65	2.72	2.73	2.81	3.00	3.21	2.95
8/21/2013	2.37	2.70	2.52	2.62	2.79	2.66	2.72	2.74	2.83	3.01	3.26	2.97
8/22/2013	2.37	2.70	2.52	2.62	2.81	2.66	2.71	2.73	2.86	3.07	3.31	2.99

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
8/16/2013	6.590	3.353	3.292	3.275	3.420	3.351	3.630	3.873
8/19/2013	2.650	3.114	3.263	3.148	3.370	3.270	3.575	3.755
8/20/2013	2.650	2.992	3.218	3.137	3.325	3.237	3.525	3.759
8/21/2013	2.660	2.992	3.218	3.137	3.325	3.237	3.525	3.759
8/22/2013	2.660	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
8/16/2013	7.00	7.73	8.13	8.95	8.95	2.69	0.76
8/19/2013	7.26	7.88	8.18	8.98	8.98	2.69	0.76
8/20/2013	7.23	7.88	8.25	9.03	9.03	2.82	0.77
8/21/2013	7.35	7.90	8.25	9.13	9.13	2.81	0.77
8/22/2013	7.60	8.00	8.45	9.23	9.23	2.81	0.77

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
8/16/2013	4.2230	3.1665	3.4154	3.2481	1.4105	0.1635
8/19/2013	4.2480	3.1873	3.4384	3.2636	1.4143	0.1647
8/20/2013	4.2468	3.1761	3.4513	3.2655	1.4140	0.1645
8/21/2013	4.2440	3.1698	3.4473	3.2509	1.4147	0.1646
8/22/2013	4.2477	3.1811	3.4408	3.2313	1.4150	0.1650

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