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Comment on the upcoming data and forecasts

First week of the month, here comes PMI release. We expect and improvement but without fireworks as PMI couterparts aborad did not jump forward in a spectacular way, they just moved. 4 September also brings focus on MPC meeting which is held again after holiday break in August. We do not expect any change in policy. However, recent governor's Belka remarks resembling a sort of forward guidance may be built into a statement. We do not expect anything spectacular since a radical move would violate the current fragile consesus. Nevertheless, MPC meeting may be read by the markets as dovish.

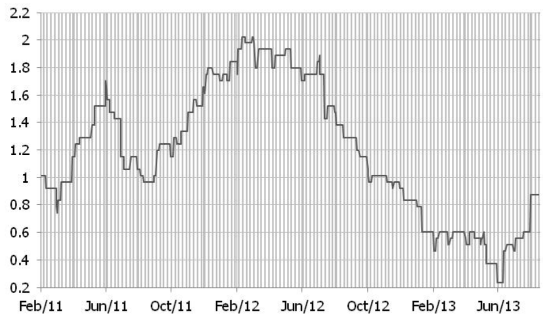
Polish data to watch: August 26th to August 30th

Publication	Date	Period	BRE	Consensus	Prior
Manufacturing PMI	02.09	Aug	52.0	51.7	51.1
MPC's rate announcement	04.09		2.5	2.5	2.5

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 OK0716	9/5/2013	3000	2.961	8/7/2013
5Y T-bond PS0718	9/5/2013	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. GDP was not surprising at all. Retail sales forecasts were revised upwards just before the publication. It was sufficient step to make a higher reading neutral for surprise index.

* 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

- We are looking for corrective lower yields near term.
- In mid term long end bonds are not a safe bet. Nothwistanding the local factors, global recovery (or monetary stimulus and liquidity withdrawal by the Fed) and rising core yields will adversely affect Polish bonds.
- 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

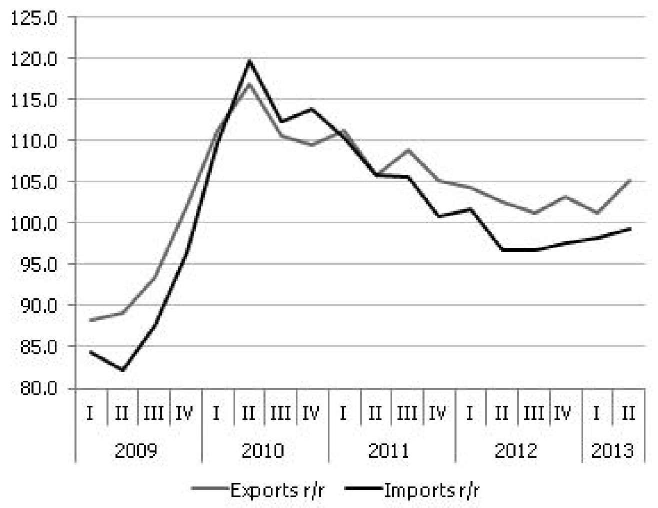
	2013 Q1	2013 Q2 F	2013 Q3 F	2013 Q4 F	2014 Q1 F	2014 Q2 F	2014 Q3 F	2014 Q4 F
GDP y/y (%)	0.5	0.7	1.3	2.1	2.4	2.5	3.1	3.2
Individual consumption y/y (%)	0.0	0.2	1.2	1.9	2.2	2.3	2.4	2.4
Public Consumption y/y (%)	-0.5	3.9	3.0	2.0	0.3	0.3	0.3	0.3
Investment y/y (%)	-2.0	-3.8	-1.8	-1.0	-0.5	1.8	3.0	3.8
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	3.00	3.00	3.10	3.20	3.20	3.30
10Y Polish bond yields (% eop)	3.94	4.34	4.40	4.70	4.80	4.80	5.00	5.20
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

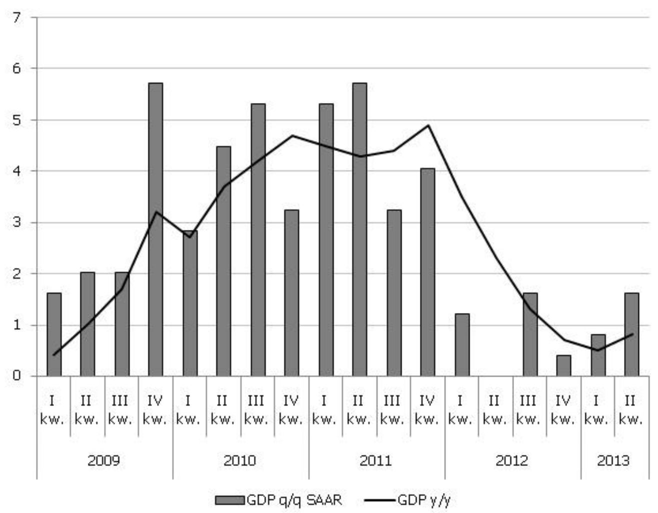
Economics

Detailed GDP release confirms that economy is accelerating

Second estimate of GDP confirmed the flash estimate at 0.8% y/y after 0.5% y/y a quarter ago (momentum accelerated from +0.2% q/q sa to +0.4%).



The growth was generated mostly by net exports (+2.5pp contribution). Exports accelerated driven by some sort of upswing in the core and periphery in the euro zone. However, imports stagnated in dynamic terms and this fact propelled trade surplus to historical high (see the graph and how sluggishly imports evolved). A huge surprise was generated also by public consumption (+3.9% y/y after flat or even negative prints for several quarters). From this perspective fiscal consolidation looks like a fiction (the more so since money was probably spent on not productive consumption).



On the other hand, private consumption barely grew (+0.2% after 0.0% in Q1). We think that consumers in Q2 were only ready to spent money. Action will take place in H2 2013 and due to low base, acceleration may be meaningful (especially in sequential terms). Fixed business investment dropped by 3.8% y/y which is connected with negative statistical base in construction; momentum in this measure is improving and outlays on machinery and equipment – judging from the composition of industrial output - may have recorded a solid plus in Q2. Usually pro-cyclical inventories contributed highly negatively in Q2 (-1.9pp) breaking the cyclical pattern. It seems demand side outpaced supply side so much that it entailed a sharp reduction in inventories. It is a good sign since another quarters are likely to bring both continuation of cyclical upswing and solid restocking which may act as an additional boost.

Macroeconomic environment implies the basis for upswing has a solid footing. On one hand, consumption rebounds (slowly, but sill) driven by the end of saving cycle, improvement in real income and record low NBP rates (consumers are really ready to spend in Q3, as shown by the rotation of assets towards more liquid current accounts). On the other, the doldrums in euro zone has probably come to an end which generates positive demand shocks (unanticipated at this stage) from abroad. Such a two-handed upswing has a substantial chance to proceed further. We expect GDP growth to reach 2.0% in Q4 2013.

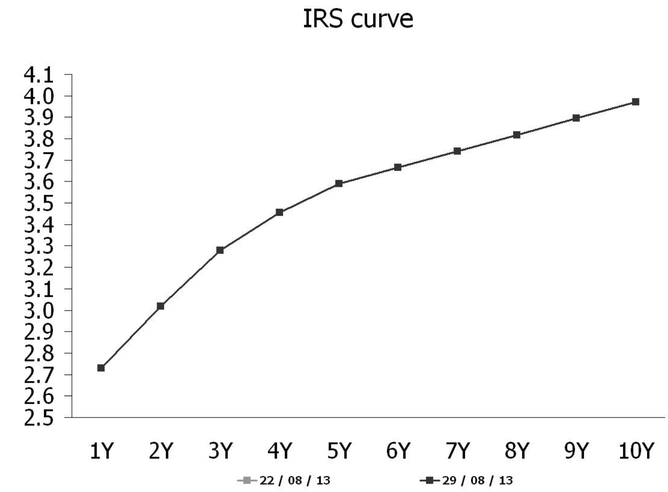
The data were neutral for the market (stable fixed income market, zloty stronger a bit). As for the MPC decision, still low consumption and negative growth of investment are good enough to support pretty dovish tones in the statement and during the conference.

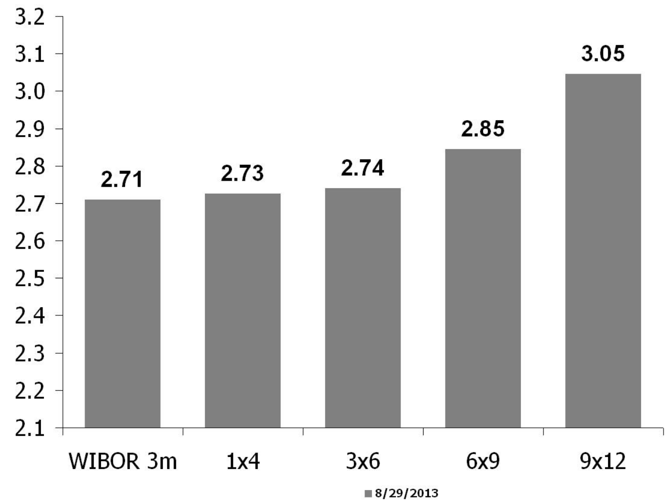
Fixed income

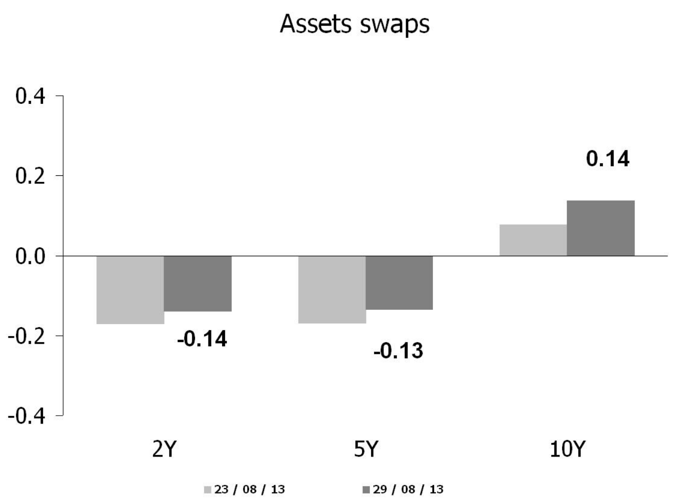
New factor

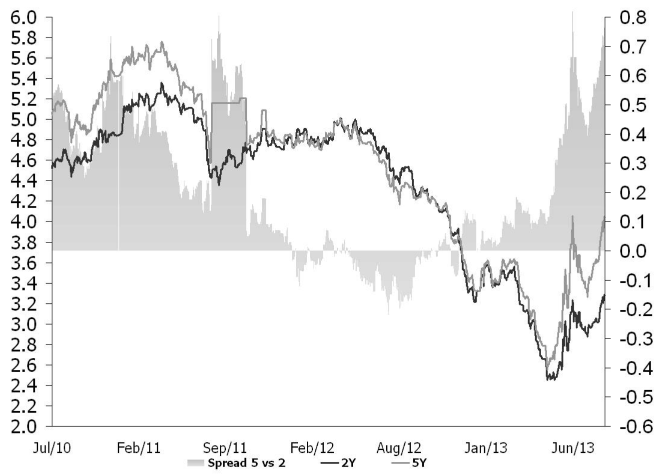
After weeks of folowing every BP change of German Bund, our fixed income market found new 'inspiration'. Syria. Suddenly we saw global 'flight to quality' trend and POLGBs were not in 'safe heaven' basket anymore. As a result, despite lower yields on core markets, our 5Y swap reached 4.10 region again. This implies forward rates well above 4.50%, level that looks high if market expectations, about sharp economic recovery, are not correct. There is also a possibility of softer tapering path if the data from US surprise negatively (like New Home Sales did).

For now we see that market moves are a little bit random (news from Syria are quite unpredictable in both ways), so one could use it to sell 5Y swap at good level. Therefore our recommendation: sell 5Y Swap on upticks.





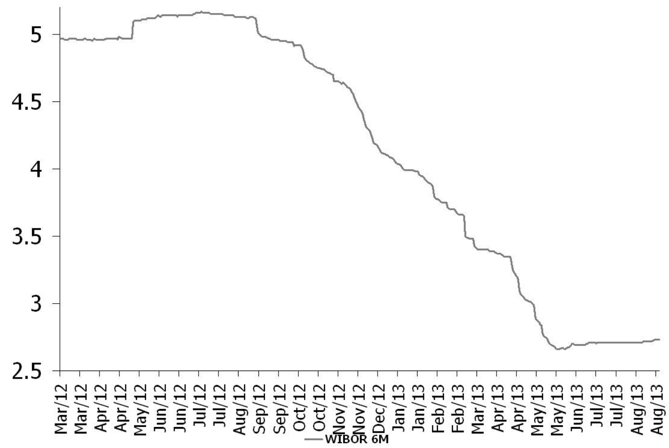


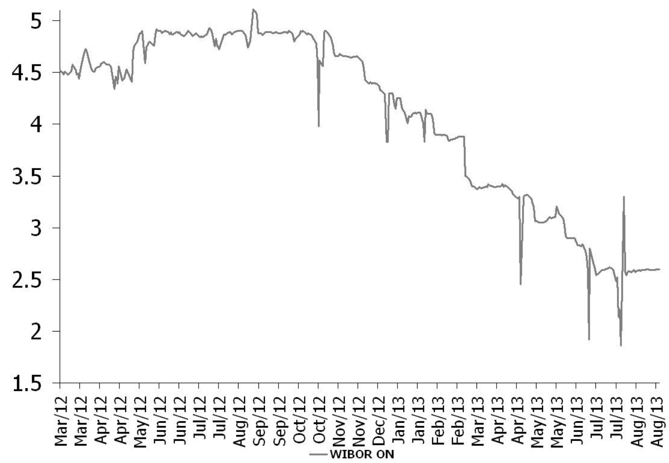


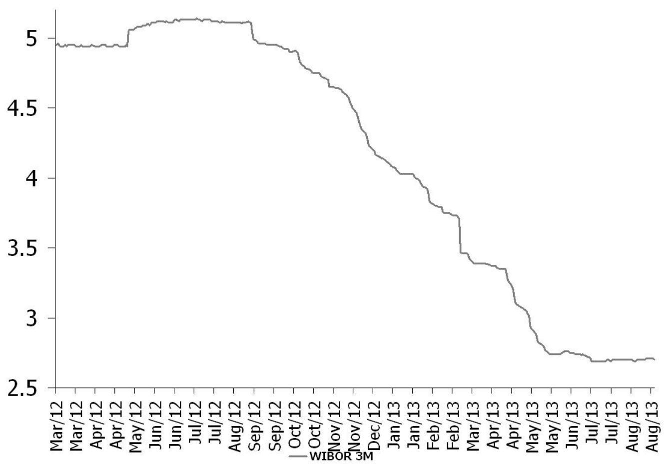
Money market

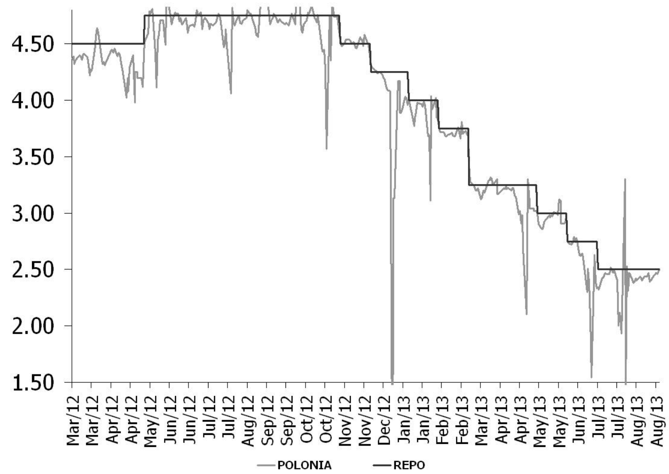
New reserve with a substantial surplus Last day of the reserve and Friday which means two OMOs, one regular and one extra. During regular banks bought much less bills then was offered (112 bln vs 128 bln pln), which means that we start the new reserve with substantial surplus. Is it enough to push the shortest rates significantly down? Not really, to early in the settlement period. Is extra OMO possible on Tuesday? Yes, 20% probability with the same argument as above.

Syria triggered risk-off for EM Market is ready for rates correction after rapid movement in previous week, however Syria case is very disturbing, since EM currencies went under huge pressure. PLN remain the strongest one in the EM basket, however risk is very skewed to the upside. It is the main obstacle for pln rates to take a break in their march north, especially that core markets are lower after weak data from USA. We also expect quite a soft stance from the MPC side on Wednesday.





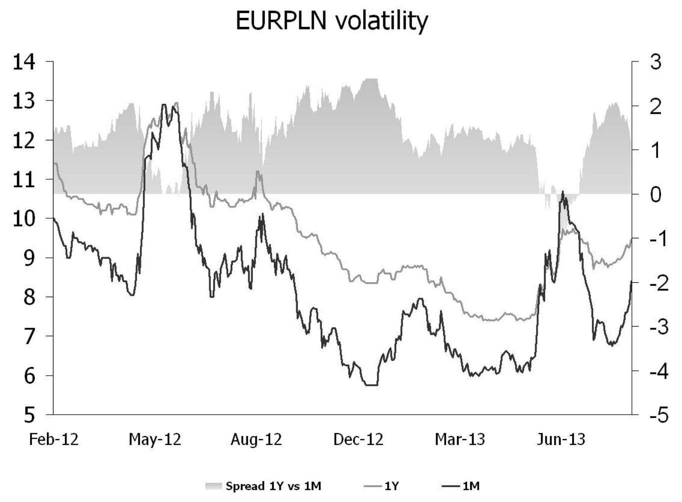




Forex

PLN weaker The growing risk off environment (Syria) finally pushed EUR/PLN through 4.26/4.27, reaching as high as 4.2970. It was a wave of stop losses and momentum trades trying to buy "the break" at 4.2650. The move squeezed a lot of PLN longs, and maybe encouraged same speculative zloty shorts. But we don't believe it's a game changer , so far 4.30/4.32 resistance zone is not even scratched, and we now need some fresh fuel to sustain that move up, we don't really see that coming in a very short term. We expect consolidation in 4.24/4.29 zone as the positioning is much lighter now.

Healthy higher The weaker PLN, as usual forced voles to the upside. The 1 month EUR/PLN ATM mid is today (Friday 30th of August) 8.25% versus 7.5% a week ago. 3 month EUR/PLN ATM mid is 8.5% (0.5% higher) and 1 year EUR/PLN is 9.4 (0.4 higher). The skew was in demand, the currency spread (difference between USD/PLN VOL and EUR/PLN VOL) was also bid and moved higher roughly 0.35% around the curve. We looking for consolidation and possible slide lower ..

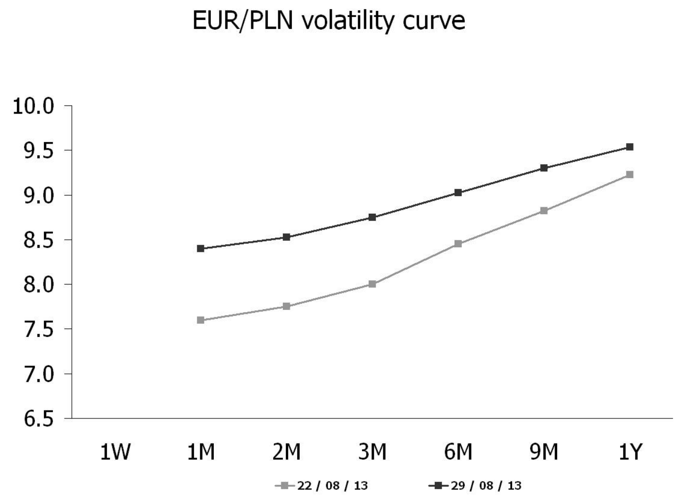


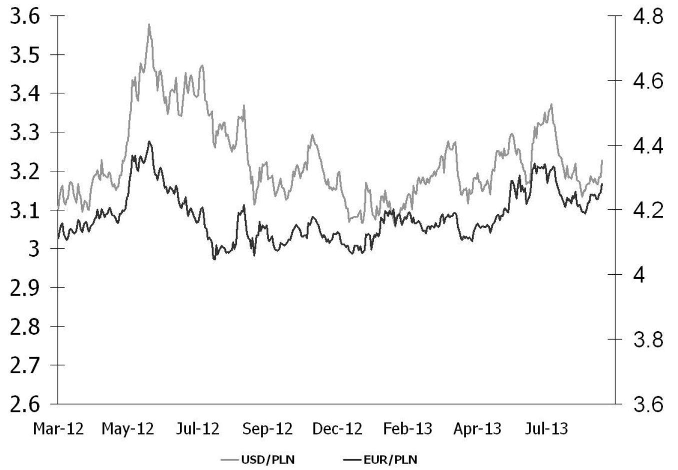
Short-term forecasts

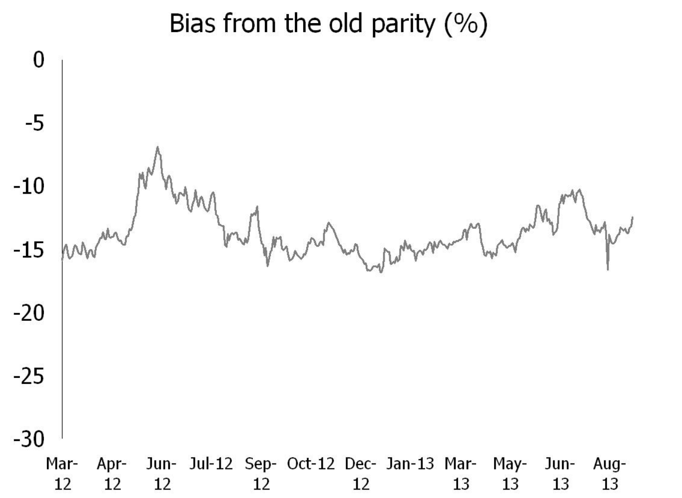
SPOT Main supports / resistances:
EUR/PLN: 4.1500 / 4.3000
USD/PLN: 3.0500 / 3.3000

Play the range from the short side We are short EUR/PLN at average rate 4.2800, we have stop at 4.3050 and we have hopes for 4.2300. We expect wait and see attitude till the next week ECB, US NFP, with a much cleaner books now, and a good portion of the bad news is already priced in. We think we are now more prone to react to the good news.

Derivatives Unchanged from last week. 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
8/23/2013	2.38	2.71	2.53	6.49	2.79	6.59	2.72	2.74	2.86	3.04	3.30	2.99
8/26/2013	2.38	2.71	2.52	2.63	2.82	2.67	2.72	2.74	2.83	3.02	3.26	2.96
8/27/2013	2.38	2.71	2.51	2.63	2.81	2.67	2.72	2.74	2.83	3.03	3.27	3.00
8/28/2013	2.37	2.71	2.58	2.63	2.90	2.66	2.72	2.72	2.85	3.05	3.30	2.99
8/29/2013	2.37	2.71	2.52	2.63	2.81	2.67	2.73	2.74	2.85	3.05	3.29	3.03

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
8/23/2013	6.590	3.353	3.292	3.275	3.420	3.351	3.630	3.873
8/26/2013	2.670	3.114	3.263	3.148	3.370	3.270	3.575	3.755
8/27/2013	2.670	2.992	3.218	3.137	3.325	3.237	3.525	3.759
8/28/2013	2.660	2.992	3.218	3.137	3.325	3.237	3.525	3.759
8/29/2013	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
8/23/2013	7.60	8.15	8.50	9.33	9.33	2.81	0.78
8/26/2013	7.73	8.10	8.50	9.25	9.25	2.81	0.78
8/27/2013	7.83	8.20	8.58	9.25	9.25	2.81	0.78
8/28/2013	8.40	8.78	9.00	9.48	9.48	2.94	0.79
8/29/2013	8.40	8.75	9.03	9.54	9.54	2.94	0.79

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
8/23/2013	4.2323	3.1673	3.4278	3.2042	1.4188	0.1650
8/26/2013	4.2320	3.1658	3.4274	3.2147	1.4180	0.1650
8/27/2013	4.2473	3.1849	3.4522	3.2519	1.4169	0.1654
8/28/2013	4.2555	3.1840	3.4626	3.2661	1.4120	0.1658
8/29/2013	4.2812	3.2269	3.4799	3.2894	1.4242	0.1666

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