Bureau of Economic Analysis
(research)

Ernest Pytlarczyk, PhD, CFA
chief economist
tel. +48 22 829 01 66
ernest.pytlarczyk@brebank.pl

Marcin Mazurek, PhD
senior analyst
tel. +48 22 829 01 83
marcin.mazurek@brebank.pl

Piotr Bartkiewicz
analyst
tel. +48 22 526 70 34
piotr.bartkiewicz@brebank.pl

Marek Ignaszak
analyst
tel. +48 22 829 02 56
marek.ignaszak@brebank.pl

Financial Markets Department
(business contacts)

Bartlomiej Malocha, CFA
head of interest rates trading
tel. +48 22 829 01 77
bartlomiej.malocha@brebank.pl

Marcin Turkiewicz
head of fx trading
tel. +48 22 829 01 67
marcin.turkiewicz@brebank.pl

Financial Markets Sales Department
(business contacts)

Inga Gaszkowska-Gebska
institutional sales
tel. +48 22 829 01 67
inga.gaszkowska-gebska@brebank.pl

Jacek Jurczyński
structured products
tel. +48 22 829 15 16
jacek.jurczynski@brebank.pl

Reuters pages:
BREX, BREY, BRET

Bloomberg:
BRE

SWIFT:
BREXPLPW

BRE Bank S.A.
18 Senatorska St.
00-950 Warszawa
P. O. BOX 728
tel. +48 22 829 00 00
fax. +48 22 829 00 33
http://www.brebank.pl

Table of contents

Comment on the upcoming data and forecasts

The week begins with the revision of current account data for Q2 (we expect a downward revision by approx. 400m EUR, mainly because of lower trade surplus) and the release of inflation expectations, which most likely rose in response to recent increases in inflation. The manufacturing PMI will be published on Tuesday. Although the domestic factors are rather favorable, the recent downward correction on its German and European counterparts motivates our conservative forecast of PMI, slightly lower than the consensus. The improving momentum in the economy will be a further argument for holding rates constant during October meeting. The gradual recovery and low inflationary pressures have been already internalized by the MPC. "Everything goes as we expected" - that would be the message conveyed by the statement and the after-decision meeting.

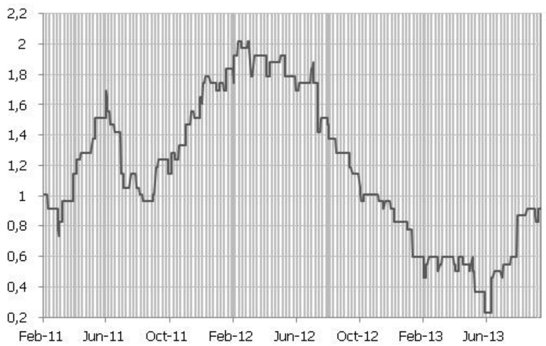
Polish data to watch: September 23th to 27th

Publication	Date	Period	BRE	Consensus	Prior
NBP inflation expectations (%)	30.09	Sep	1.1	1.0	0.4
Current account balance (mio EUR)	30.09	Q2	1000	1453	-2055
Manufacturing PMI (pts)	01.10	Sep	52.4	52.5	52.6
MPC rate decision (%)	02.10	Oct	2.50	2.50	2.50

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

The positive surprise in retail sales was not large enough to move the index. The fall in unemployment rate was, however, rather unexpected, hence the index jumped. Next week brings only one important release - Manufacturing PMI (three positive surprises in a row).

* 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 as measured by historical standards. 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.
- H2 is going to be substantially better than H1. Q3 already close to 1.5% and the possibility of exceeding 2% in Q4 monotonically rises. Such a growth is higher than current market consensus dominated by rather gloomy visions.
- 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. Although inflation stays subdued, a new uptrend has began. We expect 1.5% by the end of the year and inflation target is going to be reached in mid 2014.
- 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

- Short term it is wise to stay constructive on Polish bonds due to (temporary) global reinstalation of QE-induced carry trades. However, unleashed volatility suggest the potential gains are rather limited which is consistent with the amount of risk foreign investors wish to hold in current circumstances.
- 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	1.3	3.2
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	13.5	13.5
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	1.6	2.1	2.6	3.0	3.4	3.7
Individual consumption y/y (%)	0.0	0.2	1.2	1.9	2.2	2.3	2.3	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	-1.0	1.0	1.5	2.5	3.5	4.5
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	13.0	13.5	13.9	12.7	12.5	12.9
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	3.13	3.08	3.11	3.15	3.20	3.25

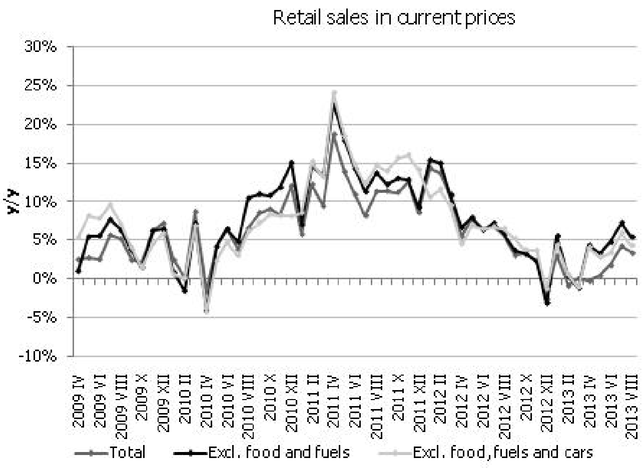
F - forecast

Economics

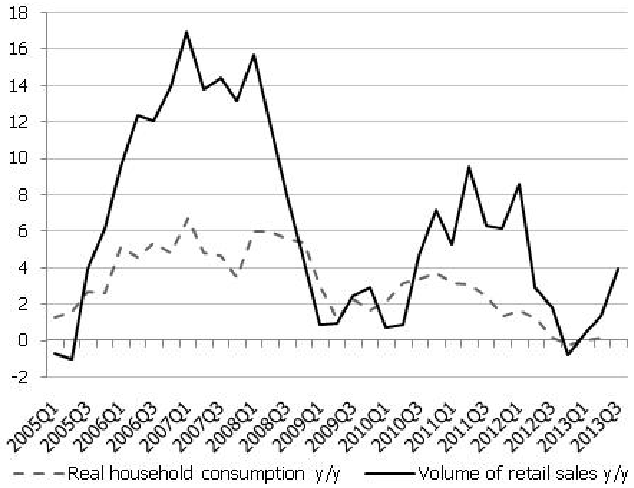
Retail sales beat expectations and confirm a strong Q3

August retail sales turned out higher than expected (3.4% vs. 2.8%). Although the difference itself isn't spectacular, working days effects (-1 y/y in August vs. +1 y/y in July) as well as the m/m slowdown in sales of waste collection equipment (due to fading effects of new waste collection regulations) implied a much slower growth rate. We estimated the impact of both effects at approx. 2 pp., and forecast the figure to amount to 2.4%.

The details of the release, similarly to the last month's data, look optimistic. Unsurprisingly, the growth rates of categories highly correlated with the number of working days fell last month (automobiles, fuels, pharmaceuticals, newspapers). When controlled for working day effects, they remain in line with upward trends observed since the beginning of the year. Most of the surprise is due to the dynamic increase in food sales (probably a result of inherent volatility in the series), had this category behaved according to our expectations, the whole release would have been very close to our forecast.



So far, real retail sales have grown by 3.9% in Q3. Be advised that such an acceleration used to imply a 2.5% growth rate in household consumption, however the relation has softened recently due to significant structural changes in the retail sector.



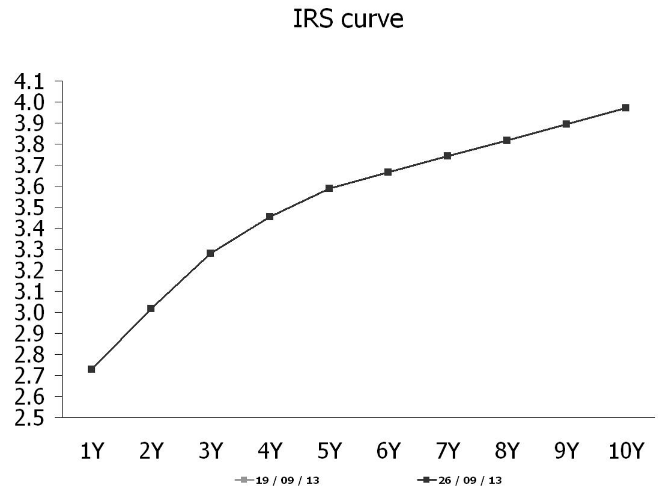
We do not change our baseline scenario. Significant growth in sales, gradually increasing consumer sentiment and real-locating savings from term deposits to O/N accounts are the harbingers of incoming recovery. In our opinion, consumption will lead the incoming recovery, it has already grown in Q2 and we expect a more pronounced acceleration in Q3. In fact, August data have prompted us to upgrade our forecasts for the second half of the year. We now expect the economy to grow by 1.6% and 2.1% in Q3 and Q4, respectively.

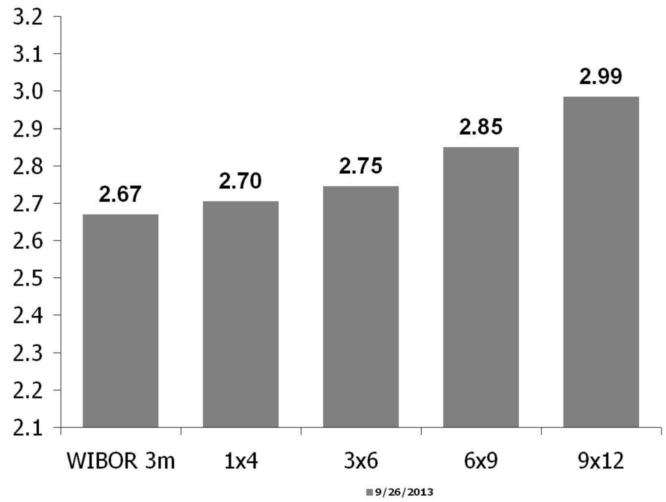
The release didn't influence the market and shouldn't have, as we are still in early stages of the recovery. The MPC is focused on extending its forward guidance beyond this year and working out a consensus on the path of interest rates. Market expectations for rate hikes are slowly being pushed into the second half of 2014, as even the most hawkish members of the Council do not envision a hike before late 2014. However, it looks we are now heading into a better month (September releases) in terms of real data. Therefore the process of postponing rate hike expectations may be reversed.

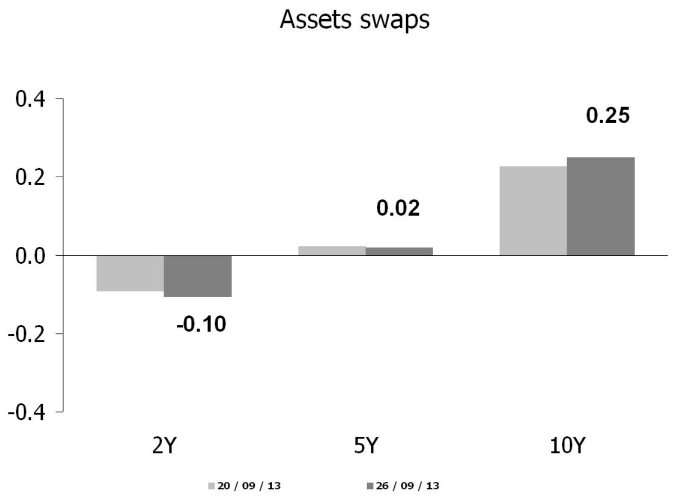
Fixed income

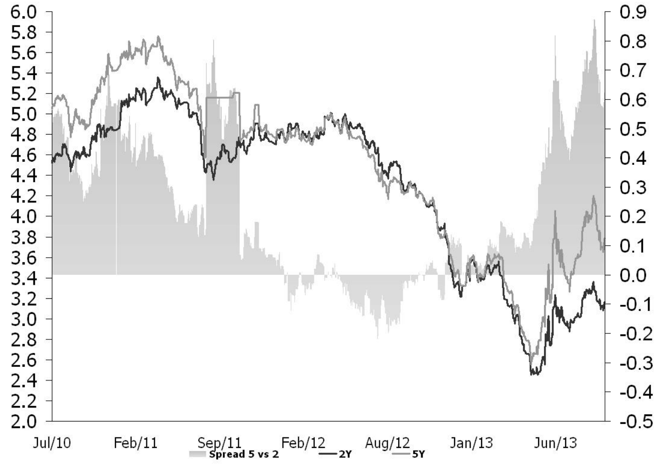
Interesting Auction

This week, despite positive global mood on fixed income, POLGBs were under pressure. Big event - switching auction where you could buy DS1023 and WZ0119 - surprised negatively. Relatively low demand and prices below secondary market rates caught investors off guard and caused a panic selloff in second part of the week. 10 year bond benchmark yield went up from 4.25 to 4.40. With less demand from local pension funds and quite low interest from foreign investors, we expect auctions to have bigger impact on the market in next few months. That is why we recommend selling 5Y benchmark (PS0718) asset swap. Current level +3, target +15.





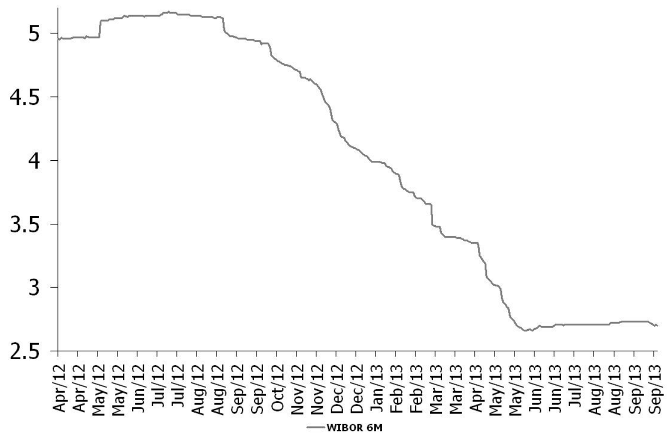


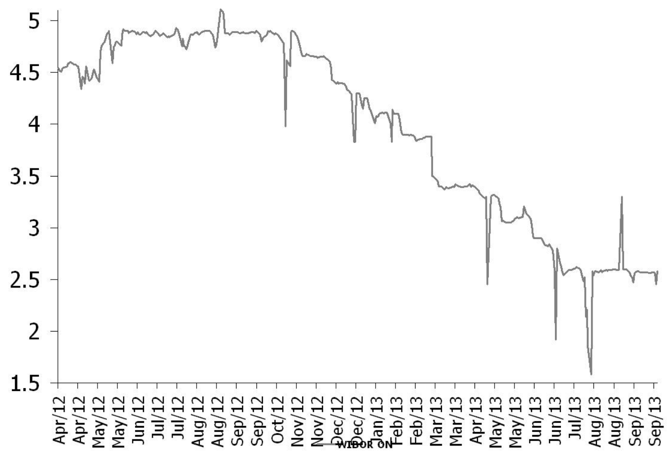


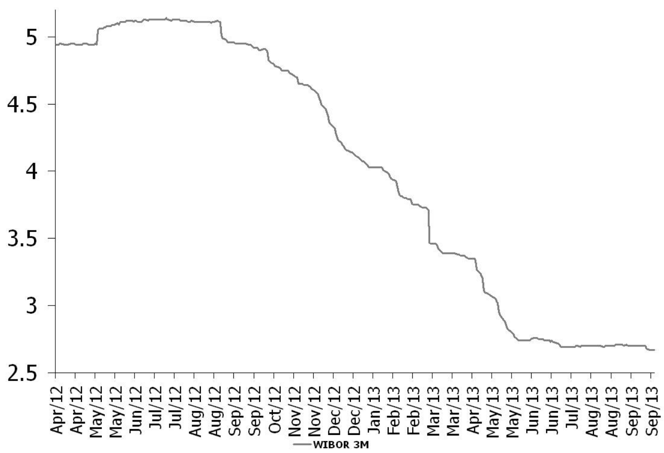
Money market

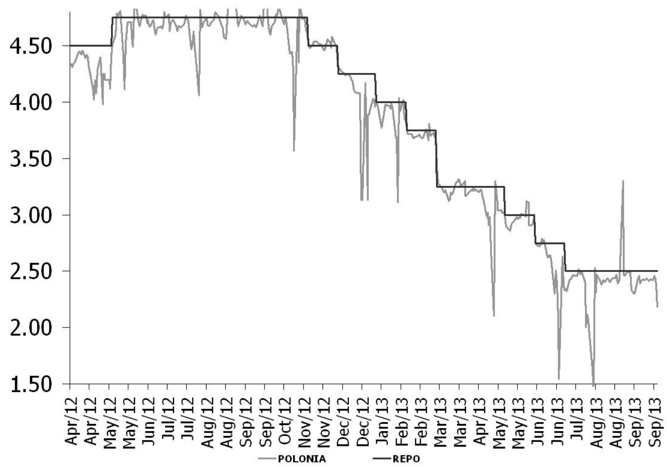
Fairly stable liquidity Quite an easy end of the reserve with surplus sterilised during 2 OMOs auctions Today. Although the market is square today, the regular OMO went weak (116 bln pln vs 130 bln pln needed to square the system next week) leaving the market massively over liquid starting on Monday. However, since it is the beginning of the new reserve we do not expect shortest rates to go down a lot, and we do not expect additional OMO on Tuesday.

We expect bullish correction on rates Longer rates were resistant to core market latest rally and we even faced slight correction in rates (10 bps up). If the core markets still outperform local one, we believe rates should go down a bit. We also see some flows for selling rates at current levels. If ECB delivers next LTRO (we think probability is quite low in October) it should definitely boost expected correction and create great opportunity to reload payers.







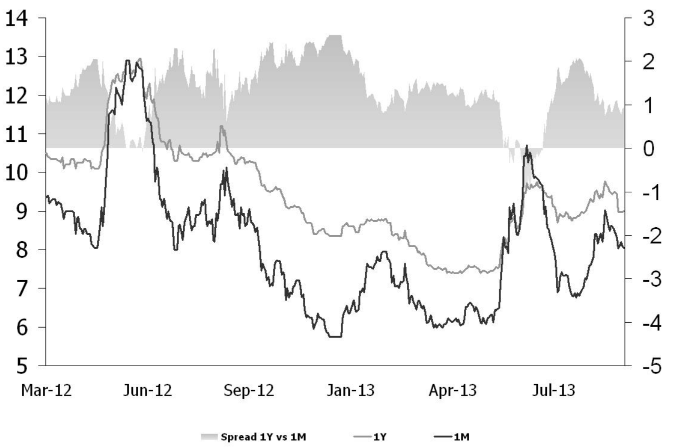


Forex

PLN stable It was a really boring week on EUR/PLN. The post-FOMC move to 4.1450 is a distant past. The EUR/PLN bounced back above 4.20, and we are now firmly in 4.20/4.24 range. We still think the balance of risks should point to the stronger PLN, with Polish macro data improving and tapering postponed for the time being. There is no momentum whatsoever and that is the case not only with EUR/PLN...

Vols consolidating The realized volatility decreased dramatically in comparison to the last week's wild swings. On the other hand, the PLN is weaker now, which usually was driving vols higher. As a result, the changes to the EUR/PLN vol curve are purely cosmetic. 1 month EUR/PLN ATM fixed at 7.9 % (0.2% lower then the last week), 3 months are unchanged at 8.2%, and 1 year is 0.1 higher, at 9.0%. The skew is roughly unchanged, and the currency spread (difference between USD/PLN vol and EUR/PLN vol) was slightly better bid (0.2% higher across the curve).

EURPLN volatility



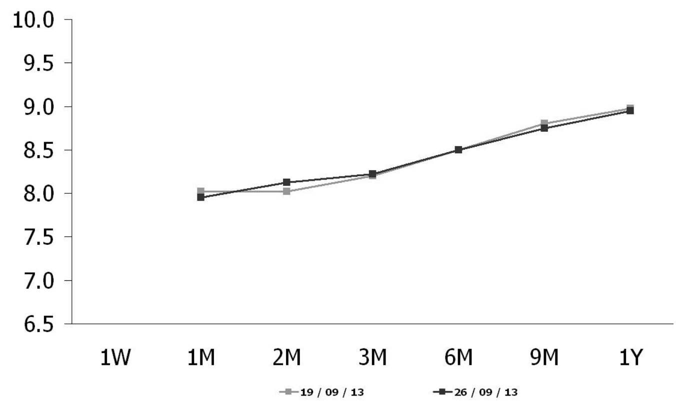
Short-term forecasts

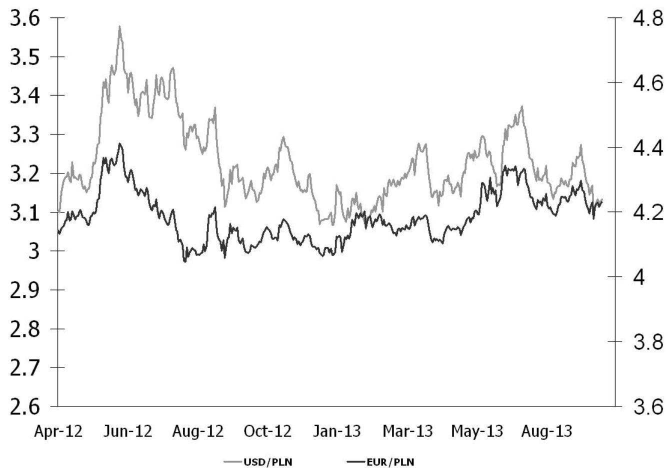
SPOT Main supports / resistances:
EUR/PLN: 4.1900 / 4.2600
USD/PLN: 3.0500 / 3.3000

Sell EUR/PLN The lack of tapering is a bullish PLN factor, the main reason why PLN depreciated this year was the tapering threat. Short term it is a 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. The price action is a bit disappointing but we see no reason to change this view yet...

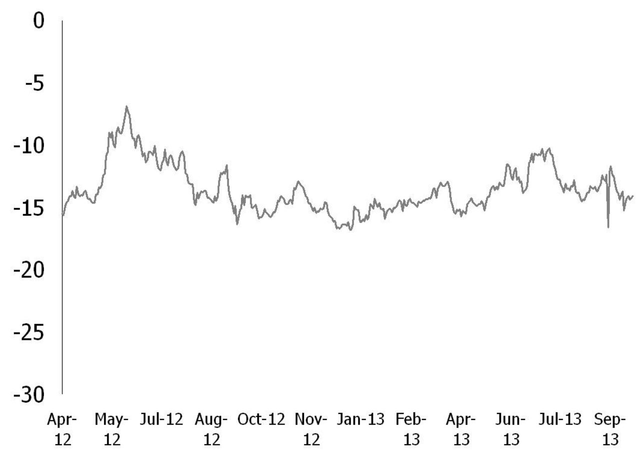
Derivatives The volatility is sharply lower on FOMC news, with the big risk for PLN postponed for the time being. We don't see a lot of value in the EUR/PLN vol curve at the moment. We see the wild swings in spot but that's a post-FOMC shock and most likely we will be back soon to low realized volatility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

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
9/20/2013	2.33	2.68	2.49	2.62	2.78	2.66	2.71	2.73	2.84	2.94	3.14	2.93
9/23/2013	2.33	2.67	2.43	2.61	2.71	2.66	2.72	2.74	2.83	2.96	3.12	2.93
9/24/2013	2.32	2.67	2.47	2.60	2.76	2.65	2.70	2.75	2.82	2.95	3.11	2.93
9/25/2013	2.28	2.67	2.39	2.60	2.65	2.65	2.70	2.74	2.83	2.96	3.13	2.94
9/26/2013	2.32	2.67	2.45	2.61	2.72	2.65	2.70	2.75	2.85	2.99	3.17	2.96

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
9/20/2013	2.660	3.353	3.292	3.275	3.420	3.351	3.630	3.873
9/23/2013	2.660	3.114	3.263	3.148	3.370	3.270	3.575	3.755
9/24/2013	2.650	2.992	3.218	3.137	3.325	3.237	3.525	3.759
9/25/2013	2.650	2.992	3.218	3.137	3.325	3.237	3.525	3.759
9/26/2013	2.650	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
9/20/2013	8.13	8.25	8.50	8.98		8.98	3.04		0.79
9/23/2013	8.20	8.30	8.50	8.98		8.98	3.04		0.79
9/24/2013	8.08	8.28	8.51	8.98		8.98	3.01		0.78
9/25/2013	8.05	8.31	8.55	9.00		9.00	3.03		0.78
9/26/2013	7.95	8.23	8.50	8.95		8.95	2.91		0.78

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
9/20/2013	4.2144	3.1152	3.4215	3.1337	1.4125	0.1634
9/23/2013	4.2268	3.1260	3.4292	3.1580	1.4164	0.1632
9/24/2013	4.2291	3.1338	3.4379	3.1621	1.4129	0.1630
9/25/2013	4.2153	3.1234	3.4275	3.1701	1.4041	0.1627
9/26/2013	4.2262	3.1277	3.4379	3.1695	1.4097	0.1634

Disclaimer

Distribution and use of this publication The review note is based on the information available to the public. This review creates exclusively a marketing information as defined in Paragraph 9 Section 1 of the Decree of Minister of Finance dated November 20, 2009 on procedures and conditions to be followed by investment firms and banks mentioned in Article 70 Section 2 of Law on Trading in Financial Instruments dated July 29, 2005 as well as by custody banks. This review note is provided to you for information purposes only and is not intended as advice on any particular matter or as recommendation, offer or solicitation for purchase of sale of any financial instrument and should not be taken as such. BRE Bank SA, its directors, officers, executives, managers, servants or agents expressly disclaim all liability to any person in respect of any-thing, and in respect of the consequences of anything, done or omitted to be done, wholly or partly, in reliance upon the whole or any part of the contents of this review note. The opinions and estimates contained herein reflect the current judgment of the author(s) on the date of this document and are subject to change without notice. The opinions pointed in review do not necessarily correspond to the opinions of BRE Bank SA. The past performance of financial instruments is not indicative of future results. No assurance can be given that any financial instrument or issuer described herein would yield favourable investment results. BRE Bank and/or its principals or employees may have a long or short position or may transact in the financial instrument(s) and/or securities referred to herein or may trade in such financial instruments with other customers on a principal basis. No client or other reader should act or refrain from acting on the basis on any matter contained in it without taking specific independent professional advice on the particular facts and circumstances in issue. Copyright protection exists in this publication and it may not be, even partially, reproduced of distributed without the prior written agreement with BRE Bank SA.