Department 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

Department of Financial Markets
(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

Department of Financial Markets Sales
(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

On Monday the Statistical Office will publish revisions of national accounts for 2012 and 2013 (along with 2nd fiscal notification). Significant changes to the historical figures could potentially reshape GDP forecasts for the second half of the year. Unemployment rate, to be published on Tuesday, will probably remain at the previously noted levels of 13%. The retail sales data should come out on the strong side, in line with recently observed uptrend. Our higher-than-consensus forecast is motivated by the favorable working days effect (+1 y/y) and positive statistical base in food sales. Those statistical effects will be most likely reinforced by the positive contribution of automobile sales.

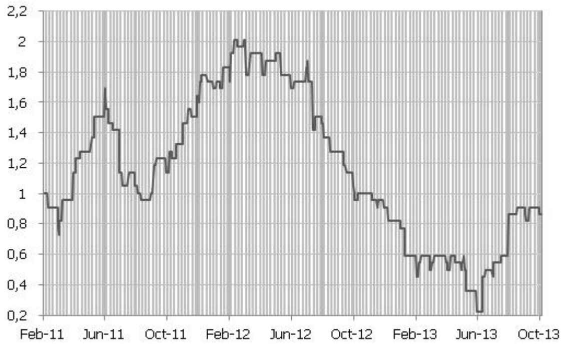
Polish data to watch: October 21st to 25th

Publication	Date	Period	BRE	Consensus	Prior
National accounts revision	21.10	2012/2013			
Unemployment rate (%)	22.10	Sep	13.0	13.0	13.0
Retail sales y/y (%)	22.10	Sep	5.5	4.6	3.4

Treasury bonds and bills auctions

Paper	Next auction	Last Offer	Yield on the prev auction (%)	Prev auction
52 Week T-bills	-	3000	3.485	3/4/2013
2Y T-bond OK0116	22-10-2013	5000	2.961	9/5/2013
5Y T-bond PS0718	-	3500	3.819	10/3/2013
10Y T-bond DS1023	22-10-2013	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 negative surprise on CPI moved index slightly lower. In the forthcoming week the retail sales release offers opportunity for a positive surprise but probably not strong enough to move the 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 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.
- 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 suggests the potential gains are rather limited which is consistent with the amount of risk foreign investors wish to hold in current circumstances.
- Short rates, we think, are close to the absolute floor.
- 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	13.2
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	14.1	12.8	12.5	13.2
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	4.60	4.70	4.80	5.00	5.20	5.50
EUR/PLN (eop)	4.18	4.33	4.22	4.10	4.05	3.95	3.90	3.90
USD/PLN (eop)	3.26	3.32	3.12	3.04	2.99	3.10	3.20	3.25

F - forecast

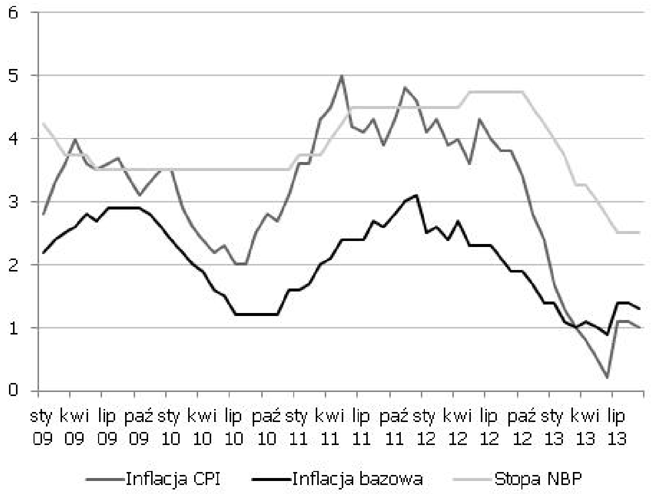
Economics

In September economic activity strengthened but not as much as expected

Last week was abundant in data from the real economy. CPI, average wage, employment, industrial and construction output, all were published this week. The releases came in a rather mixed tone. Both the labor market and the industrial output data disappointed and inflation surprisingly fell, driven by a one-off. However, it should not be interpreted as a harbinger of easing growth momentum, we still think that the recovery is proceeding.

CPI inflation accidentally dropped in September

In September inflation ticked down from 1.1% y/y to 1.0%. The reason for the drop is a one-off effect in Educational services (-6.9% m/m) - according to new law, it is forbidden to charge for extracurricular activities in public kindergartens. All other categories behaved as expected: fuel prices recorded a modest increase (1.8% m/m), food prices were unchanged (which places the reading in the left tail of the distribution of price changes and is consistent with CPI releases from other CEE countries). Core categories, save for the above mentioned Education, behaved in line with usual seasonal patterns and core CPI would have been unchanged if not the one-off (official data to be published tomorrow).

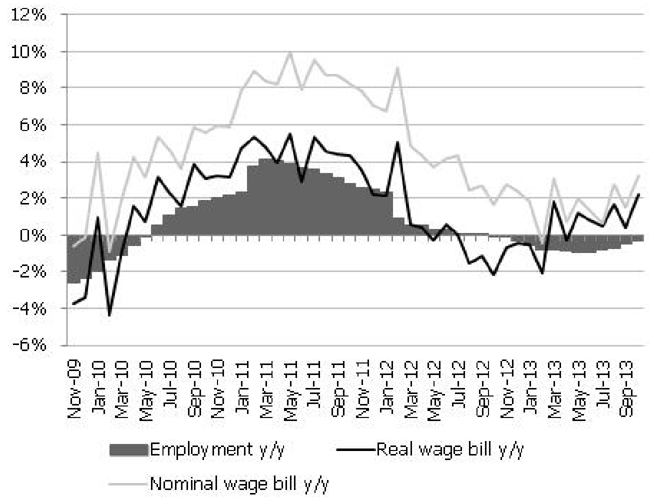


In October inflation is expected to remain at the levels observed in September or slightly lower (the available data still do not support the view that food prices are rising). In the coming months the CPI will be driven mainly by base effects and changes of administered prices such as the increase of excise tax on spirits. We expect CPI to reach the inflation target in the middle of 2014.

Even though inflation is going to accelerate in the coming months on base effects, the times of good old demand-driven inflationary pressures are yet about to come. Generally, global inflation outlook is benign, as reflected in market pricing. In such circumstances even a gradual (albeit unexpected) acceleration has potential to shock markets. This is a story for 2014, though. Right now Poland is stuck with low inflation.

Labor market remains stable

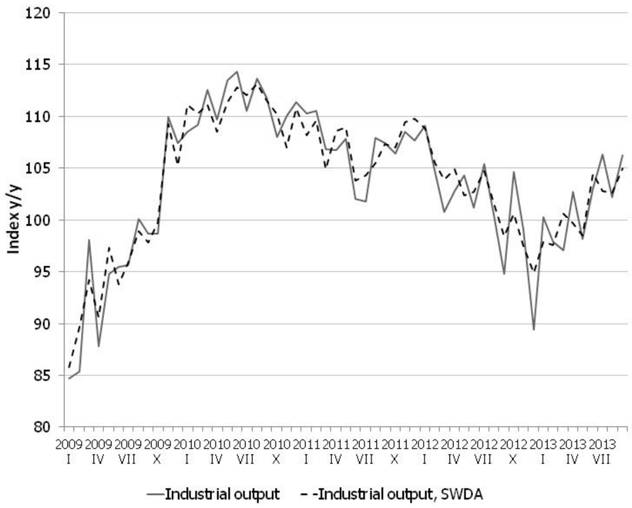
Annual growth of corporate wages increased from 2.0% to 3.6% - slightly higher than market consensus (and close to our forecast). Wednesday's data is merely a preliminary release - we can only speculate that a favorable difference in the number of working days and shifts of bonuses in copper mining are behind the figure. Stripped from these effects, the figure would probably have settled at 2-2.5%. In the coming months we can only count on a very flat trajectory - low wage dynamics is now a part of the landscape, since Polish enterprises are constantly forced to control their costs.



Employment in enterprise sector went up on monthly basis by around 1k which is rather a meager number. Although it was sufficient to boost annual growth from -0.5% to -0.3%, it does not really fit to a continuation of short-term upward trend. Neither it is a game changer, though. Business activity indicators (e. g. the one from PMI) are reaching new highs and elasticity of employment with respect to growth has recently risen (therefore labor market is set to pick up before GDP growth reaches 3%, a historical threshold for employment growth). It is really tough to turn pessimistic at this moment. We still think the upswing is proceeding but we have just witnessed a cross-month hiccup.

Industrial output data slightly disappointed

Industrial output grew by 6.2% y/y in September, below market consensus and our forecast (7.1 and 7.9%, respectively). Since it is a result significantly below the one implied by seasonal patterns and working day effects, we are certainly disappointed. Adjusted for the above mentioned effects, industrial output grew by 5% y/y and 1.4% m/m - although higher than last month's data, it implies that the momentum of industrial production has somewhat weakened. We do not treat this as a bad omen, it is rather an inherent property of the series. The distribution of output growth by sector suggests that export-oriented branches still fare better than the domestic ones.



Taken altogether, Q3 data on industrial and construction output indicate that economic growth accelerated from the second quarter - we stand by our forecast of +1.5%. In October, industrial output will probably decelerate to 4-4.5% on the back of less favorable calendar effects.

Producer prices went down in September by 1.4% y/y (after -1,1% in August), close to our forecast. The deceleration had one-off nature since it were base effects that exerted downward pressure whereas monthly growth stayed above 0, at 0.2%. Slowly rising business activity supports rising momentum of producer prices. Statistical base effects for the next 3 months work in the same vein on annual comparisons. Therefore producer prices are likely to exceed 0% y/y at the end of the year. However, it is still long way down between positive annual growth and emergence of cost pressures.

Construction output fell by 4.8% annually (-6% in seasonally adjusted terms), in line with both our forecast and market consensus (-3.6% and -6%, respectively). As usual, one can conclude that negative base effects are gradually fading out along with incoming recovery. Interestingly, we observed growth in one subsector - for the first time in many months.

Implications for monetary policy

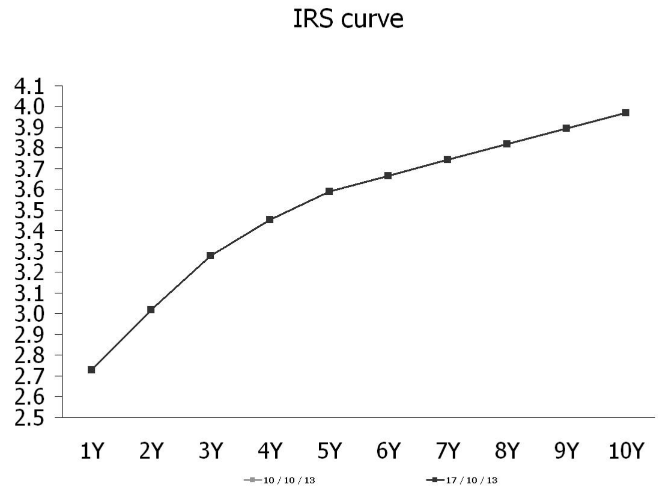
The unambiguous data fit the MPC's baseline scenario: a gradual recovery amid very limited inflationary pressures - some of the most vocal members of the Council suggest that CPI will return to target in 2015. This indicates, in addition to the passiveness of the MPC, that the Council will prefer to extend the period of loose monetary policy, especially after the resignation of a hawkish MPC member (a possible replacement for Gilowska is Osiatyński, the President's advisor and a known ultra-dove). We expect the first rate hike to take place in Q4 2014.

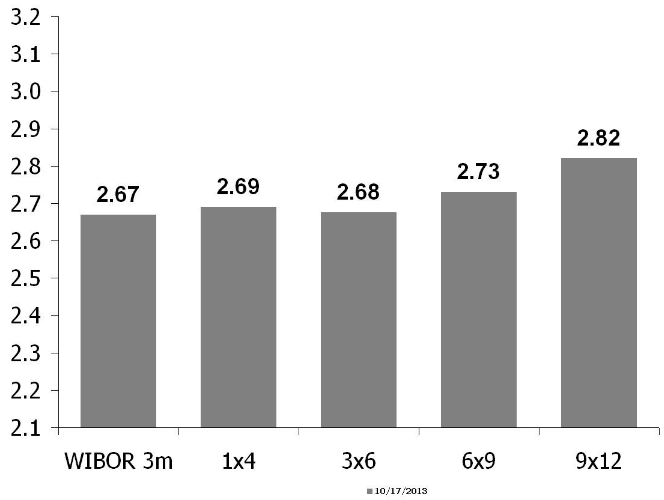
Fixed income

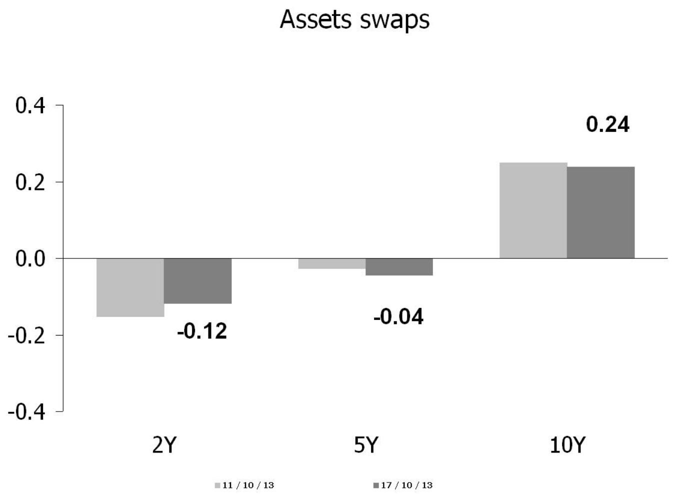
Resistance

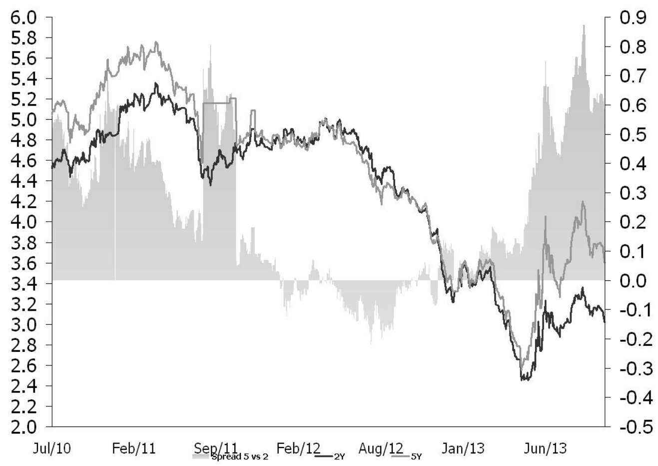
Last week the PLN market remained in a downward sentiment in yields. As there were no significant triggers justifying the bear market the drifting down in yields seemed to be inevitable especially when the first rate hikes risk had been pushed further in the future even beyond the Q4 2014. Looking at the steepness of a yield curve the market had found it a bargain to receive the whole bunch of forward rates till the end of next year assuming the risk/reward premium at 60bp (12xN rate) over a current WIBOR rate might have been worth to take. The bond market also did well, driven by foreign inflows pushed the long term yields down by over 30bp. As a result the 1y1y fwd rate fell to the last resistance level of 3.18% pricing only 50bp hike in the next 21 months. The Ministry of Finance had a great opportunity to successfully deliver some more treasury securities with a very high prices again (next Tuesday auction planned up to 12 bln in notional with longest duration).

We were trying to stay rather neutral within the last couple of weeks as we realized the equal risk/reward bet in the market at those levels, we were not really sure how the global market turmoil would be solved. Today we seek for value on the curve trying to pay 9x12/21x24 spread at around 55 points. We would also tend to go short in longer maturity bonds as we believe the greater supply is very likely to emerge the reversal in that short downtrend.





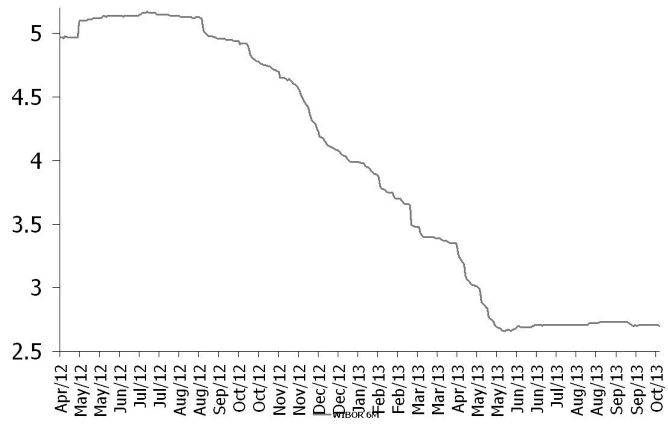


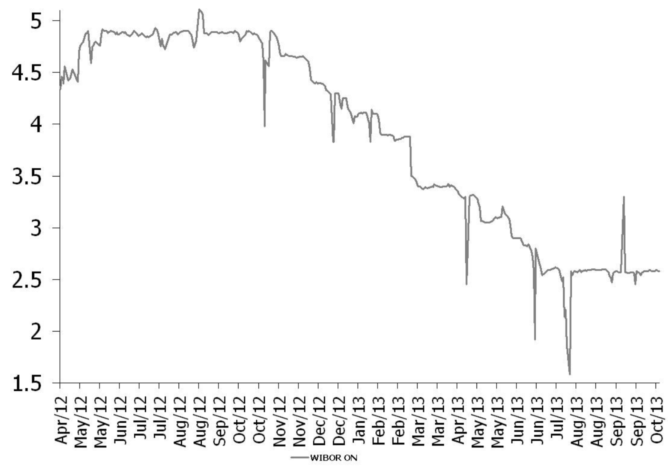


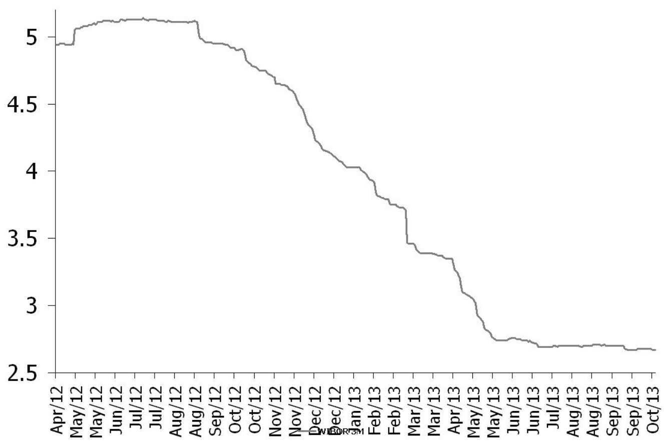
Money market

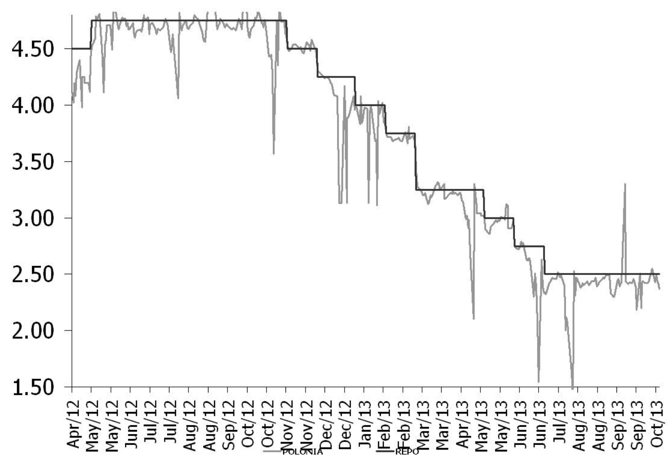
Additional OMO on Tuesday? Shortest rates were still high last week since liquidity was drained by the regular OMO last Friday. The closer the end of the reserve we are the higher risk aversion, therefore today's auction was well underbid (119 bln pln vs 126 bln pln on the offer). It should bring some lower rates but also additional OMO on Tuesday.

2Y forward rate implies only 50 bps hike Longer rates down on a flow driven wave. Figures were ignored since they were very close to consensus. We perceive current levels on the front end as a good entry for payers. We believe that once the flow and stop losses are over we should bounce back since 2Y forward rate implies only 50 bps hikes plus no other risk premium.







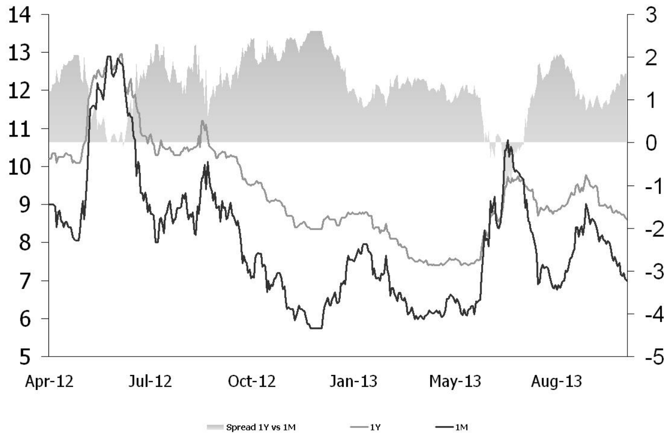


Forex

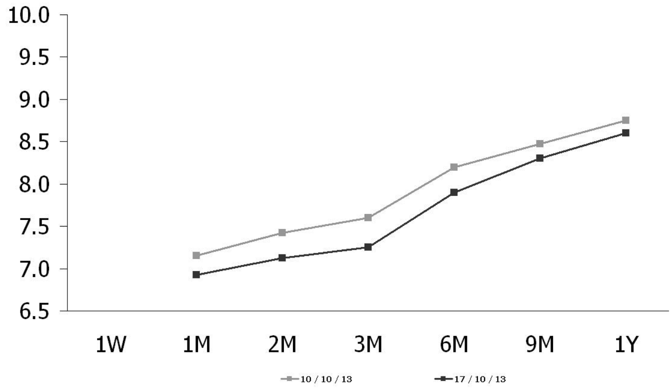
PLN higher The financial world was holding it's breath waiting for the resolution to the US shutdown. The relief USD rally after the successful voting was short lived, and the USD started to get hammered across the board. The correlation between weaker USD and stronger PLN proved to be working one more time. Well, we've been the PLN advocates for some time now and we welcome this move, even though we think that weaker dollar alone is a bit ill-chosen reason for that. In the end it is the world's leading economy showing its weaknesses, which is more of a reason for the risk off than the reverse. 4.20 and 4.16 was the respective range of EUR/PLN this week, and USD/PLN is grappling with its long time support zone at 3.04/3.06. The demand for USD/PLN is slowing, reversing the EUR/PLN slide.

Vols lower The move down in vols was quite parallel this time. Especially the falling realized volatility was the main reason why implied EUR/PLN vols are lower. 1 month implied EUR/PLN ATM mid is 6.7% this Friday (0.3% lower then week ago) while the realized one is only 5.3%! 3 months are 7.2% (0.5% lower) while realized is 6.4%. 1Y atm is 8.6% (0.2% lower then week ago), while realized is 7.5%, and it's a multi-year minimum. The skew and currency spread were also tic better offered.

EURPLN volatility



EUR/PLN volatility curve



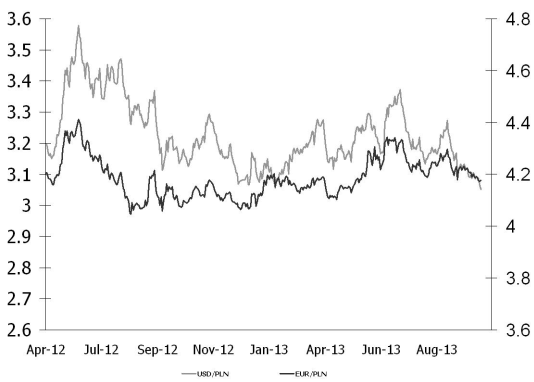
Short-term forecasts

SPOT Main supports / resistances:
EUR/PLN: 4.1450 / 4.2000
USD/PLN: 3.0000 / 3.1500

Neutral Patience finally paid off. We have closed our short EUR/PLN from 4.23 at 4.1650. Getting there was a really lengthy and slow process, which makes us think that is more of a coincidence then a robust trend (or we just got tired of waiting). Tactically, we are ready to reload EUR/PLN shorts at 4.1950/4.2050 region with stop above 4.23 and hopes for 4.13.

Hold long Vega in Backend Volatility was once again for sell this week, with the ATM's and skew being well offered. But the number of ifs, is the global economy seems to grow rather then the other way around. We are by choice slightly long in longer tenors (above 9 months), and in case of the same local sell-off in risk we are ready to sell the short end (bellow 3 months). The rationale for this is that we believe that the nearing the end of the year the EUR/PLN will attract more and more official protection from the MoF.

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
10/11/2013	2.35	2.68	2.47	2.61	2.70	2.65	2.70	2.74	2.81	2.94	3.13	2.91
10/14/2013	2.36	2.68	2.46	2.61	2.73	2.65	2.70	2.74	2.79	2.91	3.10	2.90
10/15/2013	2.39	2.67	2.48	2.61	2.71	2.65	2.72	2.74	2.80	2.90	3.05	2.88
10/16/2013	2.43	2.67	2.48	2.61	2.71	2.65	2.69	2.69	2.79	2.89	3.03	2.88
10/17/2013	2.40	2.67	2.47	2.61	2.70	2.65	2.69	2.68	2.73	2.82	2.96	2.78

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
10/11/2013	2.650	2.659	3.133	2.980	3.770	3.744	4.170	4.420
10/14/2013	2.650	2.762	3.118	2.929	3.745	3.651	4.150	4.343
10/15/2013	2.650	2.732	3.083	2.940	3.695	3.628	4.110	4.346
10/16/2013	2.650	2.676	3.080	2.938	3.705	3.628	4.135	4.351
10/17/2013	2.650	2.744	3.020	2.903	3.605	3.561	4.035	4.274

EUR/PLN 0-delta stradle						25-delta RR			25-delta FLY
Date	1M	3M	6M	1Y		1M	1Y		1Y
10/11/2013	7.13	7.55	8.20	8.73		8.73	2.77		0.79
10/14/2013	7.20	7.60	8.18	8.73		8.73	2.77		0.79
10/15/2013	7.05	7.48	8.04	8.66		8.66	2.78		0.03
10/16/2013	7.00	7.48	7.98	8.61		8.61	2.79		0.77
10/17/2013	6.93	7.25	7.90	8.60		8.60	2.74		0.75

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
10/11/2013	4.1861	3.0850	3.3977	3.1385	1.4203	0.1641
10/14/2013	4.1925	3.0936	3.3927	3.1467	1.4194	0.1642
10/15/2013	4.1855	3.0893	3.3889	3.1360	1.4153	0.1635
10/16/2013	4.1755	3.0854	3.3814	3.1364	1.4096	0.1626
10/17/2013	4.1738	3.0625	3.3858	3.1274	1.4114	0.1626

Disclaimer