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Comment on the upcoming data and forecasts

Thursday's preliminary release of the Q3 GDP will be the most important event in the forthcoming week. We expect the pace of economic growth to accelerate in the third quarter. Such a view is supported by the improvements visible in virtually all data available on a monthly basis, which indicate a significant contribution of personal consumption as well as an improving momentum of investment. Tuesday's current account release is to show a slight widening of the CA balance due to the deficit on the transfer account amid slightly higher trade surplus. The CPI (to be released on Thursdays) is expected to stabilize as a result of lower food and fuel prices and a slight downward pressure from core inflation (to be published on Friday), the latter decreasing due to low clothing prices. Also on Thursday the NBP will publish the data on M3. In our view the monetary aggregate has decreased in October as a result of a lower growth of households' deposits. The preliminary budget performance is to be released on Friday, however the earlier statements of MoF representatives suggest that the cost of debt servicing pushed the budget deficit up to approx. 40b PLN.

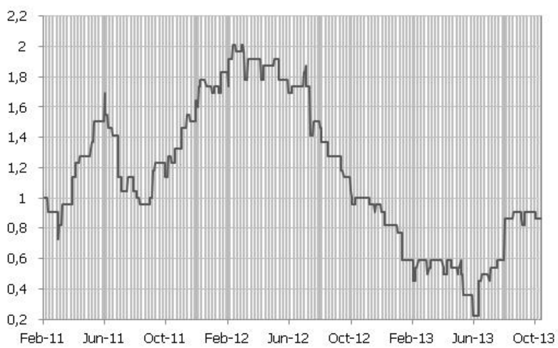
Polish data to watch: October 11th to November 15st

Publication	Date	Period	BRE	Consensus	Prior
Current Account (m EUR)	12.11	Sep	-814.0	-822.0	-719.0
Export (m EUR)	12.11	Sep	13750.0	13719.0	12451.0
Import (m EUR)	12.11	Sep	13200.0	13266.0	12187.0
GDP y/y (%)	14.11	Q3	1.6	1.7	0.8
M3 y/y (%)	14.11	Oct	5.5	5.8	6.1
CPI y/y (%)	14.11	Oct	1.0	1.0	1.0
Core CPI y/y (%)	15.11	Oct	1.2	1.3	1.3

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	-	3000	2.983	11/7/2013
5Y T-bond PS0718	-	4000	3.589	11/7/2013
10Y T-bond DS1023	11/20/2013	2000	4.302	10/22/2013
20Y T-bond WS0429	-	150	3.464	5/16/2013

Reality vs analysts' expectations (surprise index* for Poland)



Comment

Unchanged – no data last week. Several releases next week but historically only CPI was capable of surprising significantly.

* 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. Better business activity in the euro zone has already strenghtened the upswing trajectory.
- So far, H2 has been substantially better than H1. Q3 growth probably reached 1.6% and the possibility of growth significantly exceeding 2% in Q4 has risen. We are also bullish on 2014 and expect the Polish economy to grow by at least 3.2%. Such a growth is higher than current market consensus dominated by caution and disbelief.
- Pension reform, along with the political cycle, opens room for fiscal stimulation. We expect significant fiscal stimulus from 2014 onwards, focused mainly on public infrastructure spending and fueled by the relaunch of EU funding. Thus, 2-3 years of solid economic growth are our baseline scenario.
- Inflation stays subdued for the next few months supporting stable NBP rates.
- Inflation target is going to be reached in mid 2014, albeit temporarily. We expect first rate hikes to materialize in late 2014 as we believe that NBP projections of both GDP and inflation for 2014 are too pessimistic and upward sloping inlfation path should result in tightening.

Financial markets

- We are strong believers in economic recovery and are bearish on longer bonds.
- However, we stay constructive on Polish short term bonds due to current low inflation, carry trades, duration aversion of local players and determination of global central banks to anchor official rates.
- 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 long term yields will additionally adversely affect Polish bonds.
- Zloty 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

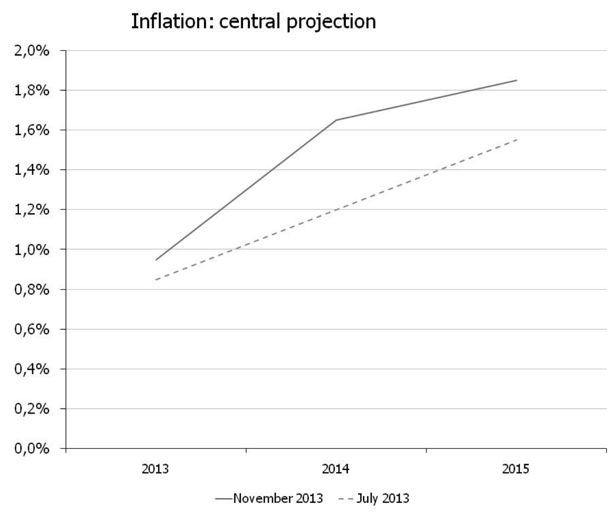
	2013 Q1	2013 Q2	2013 Q3 F	2013 Q4 F	2014 Q1 F	2014 Q2 F	2014 Q3 F	2014 Q4 F
GDP y/y (%)	0.5	0.8	1.6	2.1	2.6	3.0	3.4	3.7
Individual consumption y/y (%)	0.0	0.2	1.2	1.9	2.2	2.3	2.3	2.4
Public Consumption y/y (%)	-0.5	3.9	3.0	2.0	0.3	0.3	0.3	0.3
Investment y/y (%)	-2.0	-3.8	-1.0	1.0	1.5	2.5	3.5	4.5
Inflation 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	2.67	2.70	2.70	2.70	2.70	3.20
2Y Polish bond yields (% eop)	3.19	3.07	3.05	3.00	3.15	3.30	3.30	3.30
10Y Polish bond yields (% eop)	3.94	4.34	4.43	4.10	4.60	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

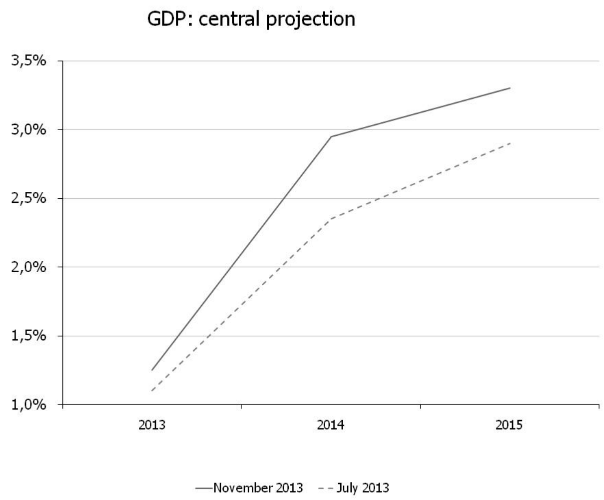
F - forecast

Economics

Polish MPC does not even think about tightening

At November's meeting the MPC left its benchmark rate unchanged at 2.5%, in line with our expectations. Unsurprisingly, the Council has also rephrased its *forward guidance* and commited itself to keep the main interest rate unchanged until at least mid-2014 (whereas according to the former forward guidance it was until the end of 2013). Regarding economic growth, the tone of Council's statement was rather neutral (MPC is aware of lower activity in USA and China and the gradual recovery in Poland). However, it was confirmed that, according to MPC's members, inflationary pressures in the economy will remain subdued. This view was supported by the new inflation projection, in which inflation forecast is higher than the one in July's projection, albeit remains below the inflation target within whole forecast horizon. During the press conference governor Belka has stressed that the rate hikes are highly improbable in first half of 2014, since inflation will remain low for a prolonged period of time and GDP growth is expected to be below its potential value. Governor confirmed that the new *forward guidance* is supported by all of the MPC's members. However, it's again a rather ineffective tool of shaping market expectations, since in their public declarations most of Council members advocate for a longer period of loose monetary policy.





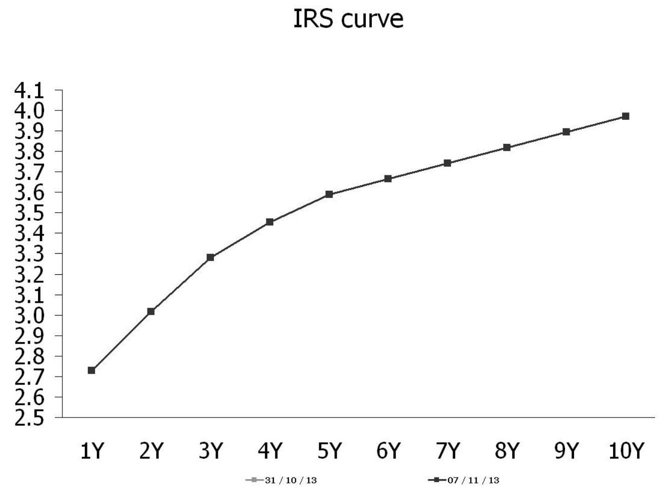
We expect a significantly higher GDP growth and, correspondingly, higher inflation (in H2 2014) than the recent projections. In effect, in our view, the hikes will take place in late 2014, rather than in 2016 as mechanically indicated by the new projections (but not the forward guidance). However, in the nearest future the markets can move their expectations regarding the beginning of monetary tightening to the early 2015. Such a reshaping of the consensus will be supported by (temporarily) very low inflation both in Europe and in Poland. Secondly, it is evident that global central banks have already changed (ECB) or are in the process of changing (Fed) their communications strategy to anchor short term rates. That it why we think Polish short end rates will stay low for the next few months and all the economic recovery (which we strongly believe), tapering, and higher future inflation (especially if central banks continue to stimulate already recovering economies) will be reflected in rising long end rates and steepening yield curves.

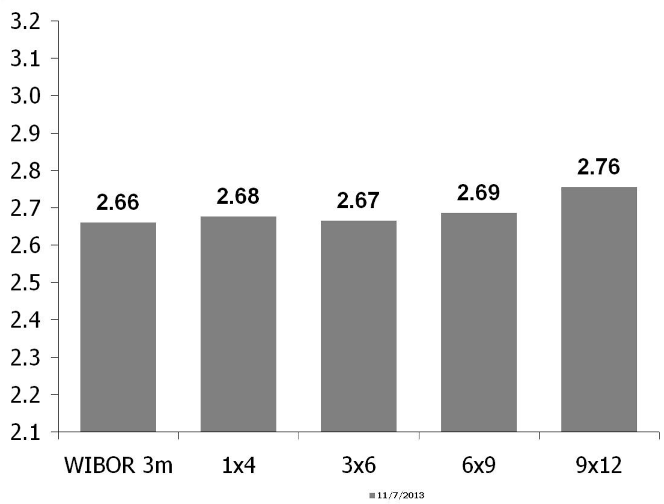
Fixed income

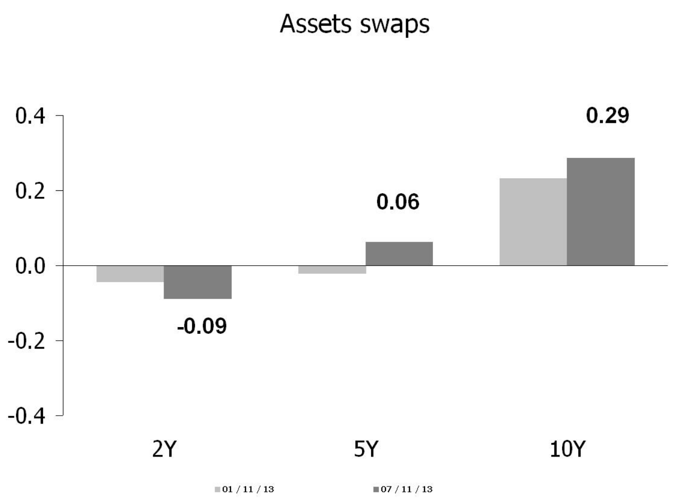
Back to the old plan

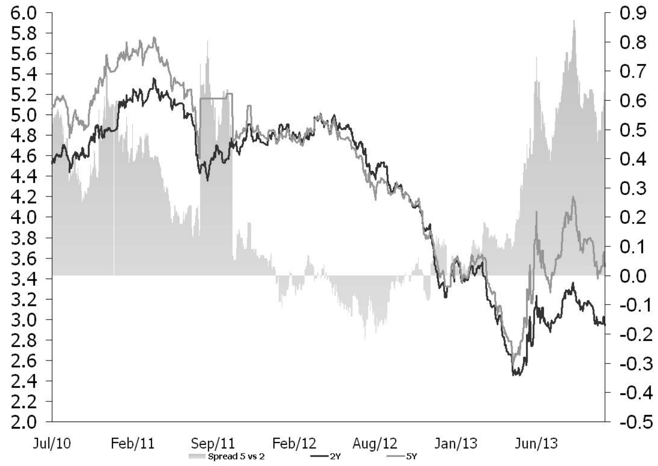
In a few weeks the whole Polish forward rate curve collapsed by 100bps. We now price in first rate hikes in Q1 of 2015 (compared to Q3 of 2014 expected month ago). ECB did cut rates unexpectedly, which obviously caused even more bullish sentiment here in Poland. We had a very good auction (3bln of OK0116 and 4bln of PS0718 sold) but keep in mind that almost full demand for 5 year bonds was filled (that shows MinFin's determination in keeping duration as long as possible) which should keep the curve steep for now.

The market is definitely very volatile, currently we use the opportunity (strangely high Non Farm-Payrolls) to close our short position on PS718 and even go long there (lack of bond supply at the end of the year should support this market).





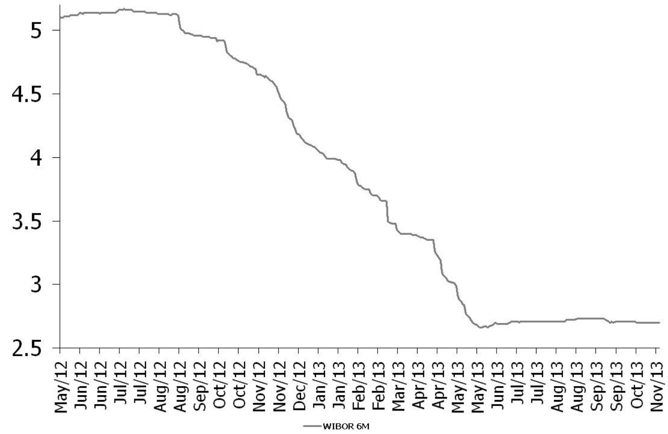


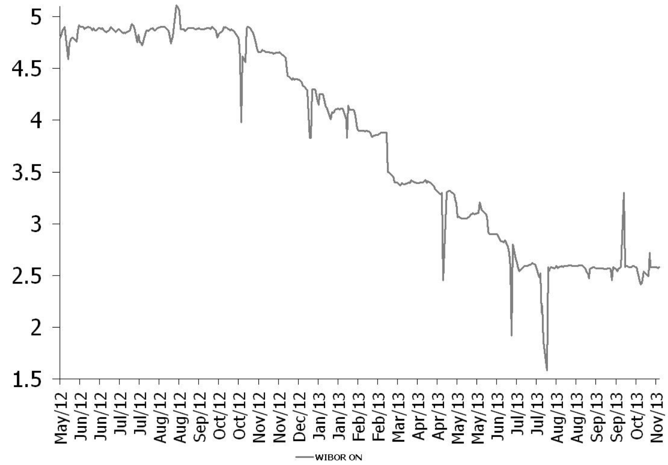


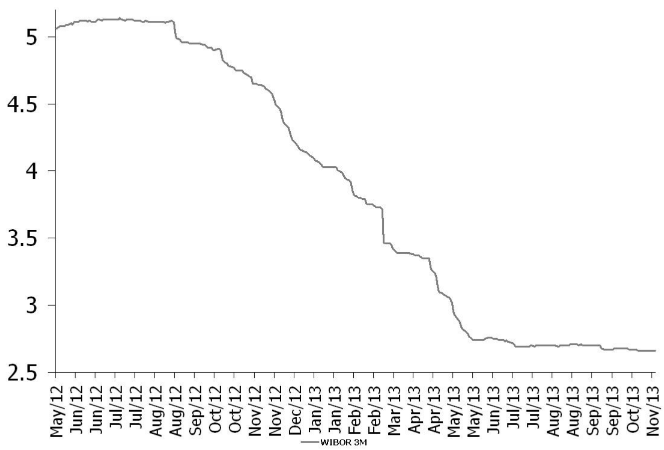
Money market

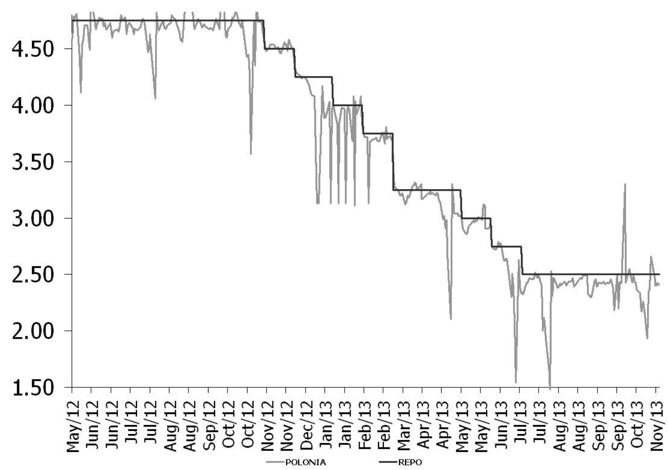
Cheap week ahead Quite stable week for the money market after extremely expensive last day of reserve (Polonia fixed for the long weekend at 2.66). From Monday Polonia rate fluctuated around 2.42%. Friday's OMO (8.11) was almost 6 bn overbid (133,150 vs 127,500) what might cause cheaper next week.

Dovish signals and actions from central banks MPC left rates unchanged and suggested that they will be same until half of 2014. Unexpected was cut of rates by ECB (-25bps).





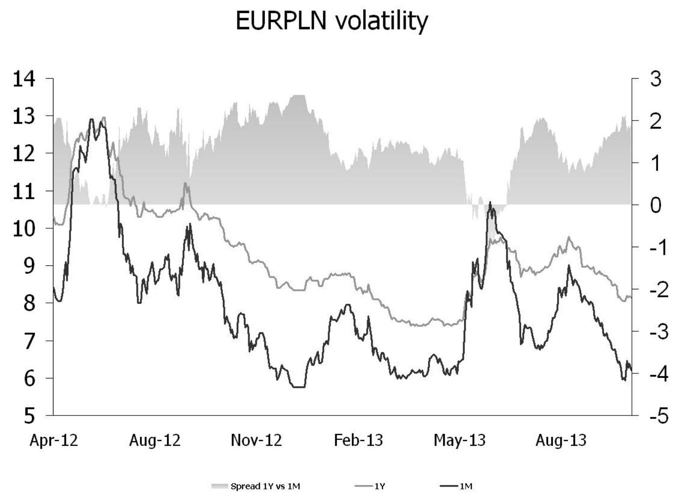




Forex

EUR/PLN more volatile 4.1545-4.2040 during the last 24 hours... The former level (4.1545) was a reaction to ECB rate cut, which theoretically adds shine to PLN. The latter level (4.2040) was just a short squeeze on PLN longs, with no obvious trigger. The stronger then expected NFP are making the renewed talk about tapering possible. The realized volatility is a bit higher, but is it enough to break out of the current 4.14 / 4.24 range? We doubt so...

Vols lower The vols are lower along the curve. 1 month EUR/PLN ATM mid fixed this Friday at 6.0% versus 6.3% two weeks ago, 3 months are 6.5% (0.2% lower), 1 year is 8.1% (0.2%) lower. Actually, the USD/PLN curve is unchanged or even with slightly higher backend (1 year USD/PLN atm 13.25 versus 13.00 two weeks ago). It's of course because EUR/USD vols are bit higher. The skew was better offered.

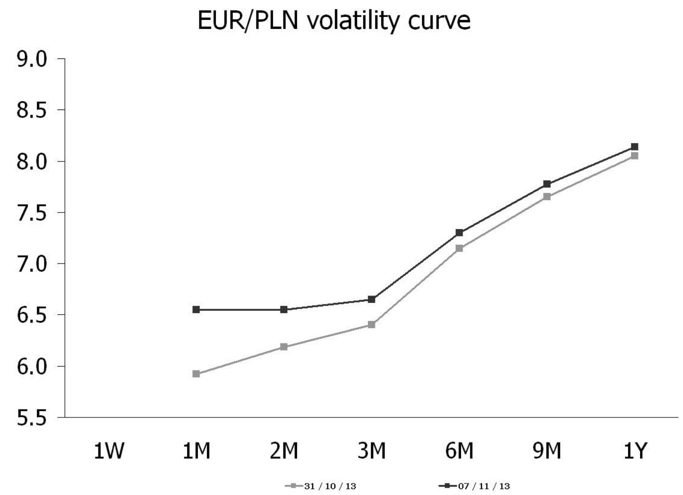


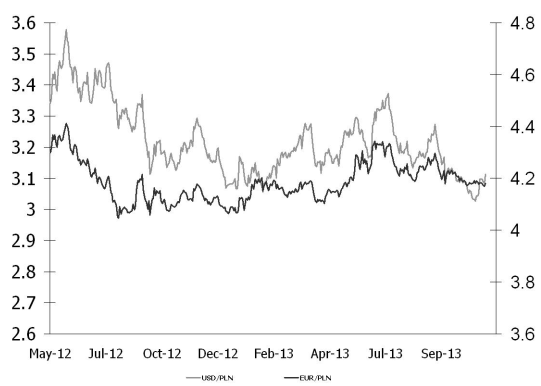
Short-term forecasts

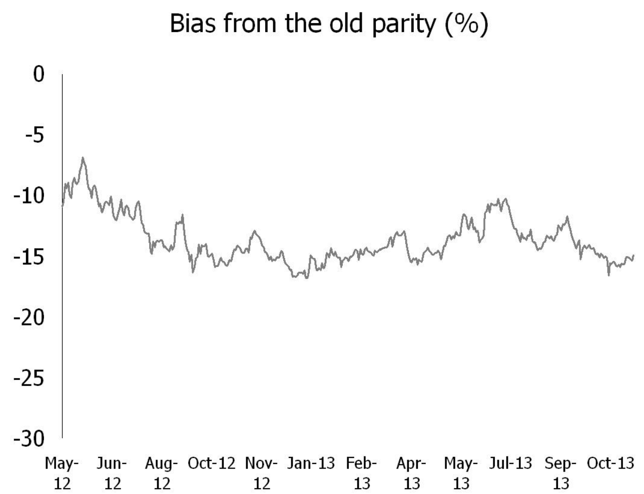
SPOT Main supports / resistances:
EUR/PLN: 4.1400 / 4.2400
USD/PLN: 3.0000 / 3.2000

Play range The markets was quite choppy, bullish and bearish positions had their moments. We feel we should be ready to trade bit wider range now 4.1450/4.4.2450. But it does not change the bigger picture that we are still in the range, and most likely we will stay there till the year end...

Hold long Vega in Backend We are still long backend EUR/PLN. We added long 1 year USD/PLN at 13.25% to the portfolio. It is still a modest long, and we also still have the same shorts in the frontend. And not to muddle the view, we have to confess that we don't see any obvious volatility triggers on the horizon. The vols are cheap and even if we think they may stay here for the time being, we think the risk/reward is skewed to be long backend Vega.







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
10/31/2013	2.39	2.66	2.48	2.60	2.71	2.65	2.68	2.71	2.74	2.82	2.97	2.80
11/4/2013	2.35	2.66	2.49	2.60	2.60	2.65	2.66	2.68	2.71	2.82	2.99	2.79
11/5/2013	2.39	2.66	2.50	2.60	2.71	2.65	2.67	2.68	2.73	2.83	3.01	2.77
11/6/2013	2.35	2.66	2.50	2.60	2.71	2.65	2.66	2.67	2.70	2.79	2.97	2.74
11/7/2013	2.46	2.66	2.55	2.60	2.68	2.65	2.68	2.67	2.69	2.76	2.91	2.76

Last primary market rates							
Paper	Au. date	Maturity	Avg. price	Avg. yield	Supply	Demand	Sold
52W TB	3/4/2013	8/28/2013	98.33	3.49	3000	7324	3084
OK0116	10/22/2013	1/25/2016	93.42	3.07	6000	8278	4841
PS0718	10/3/2013	7/25/2018	94.30	3.82	3500	4243	3008
DS1023	10/22/2013	10/25/2023	97.57	4.30	2000	2376	1416

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0715	5Y IRS	PS0718	10Y IRS	DS1023
10/31/2013	2.650	2.625	2.960	2.917	3.520	3.500	3.925	4.157
11/4/2013	2.650	2.615	3.020	2.896	3.600	3.585	4.020	4.263
11/5/2013	2.650	2.628	3.030	2.923	3.660	3.669	4.100	4.356
11/6/2013	2.650	2.621	2.980	2.832	3.584	3.614	4.035	4.313
11/7/2013	2.650	2.653	2.943	2.855	3.515	3.578	3.970	4.256

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
10/31/2013	5.93	6.40	7.15	8.05	8.05	2.61	0.75
11/4/2013	6.26	6.70	7.30	8.15	8.15	2.61	0.75
11/5/2013	6.38	6.80	7.35	8.18	8.18	2.59	0.74
11/6/2013	6.20	6.70	7.30	8.15	8.15	2.51	0.69
11/7/2013	6.55	6.65	7.30	8.14	8.14	2.50	0.68

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
10/31/2013	4.1766	3.0507	3.3875	3.1045	1.4183	0.1624
11/4/2013	4.1816	3.0975	3.3950	3.1384	1.4127	0.1618
11/5/2013	4.1805	3.0981	3.4004	3.1538	1.4123	0.1618
11/6/2013	4.1728	3.0896	3.3877	3.1336	1.4063	0.1616
11/7/2013	4.1696	3.0844	3.3806	3.1241	1.4073	0.1616

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