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Comment on the upcoming data and forecasts

The forthcoming week brings more hard data. We expect growth rate of wages (Tuesday) to decrease by 1 pp. as a result of unfavorable working days effects (0 y/y vs. +1 y/y last month), softer flexible component of wages (especially in manufacturing), and high statistical base in mining. Simultaneously released employment increases on monthly basis pushing the annual growth rate up close to zero. The abovementioned calendar effects also negatively influence the industrial output (released on Thursday). However we stress a risk to the upside after recalculations factoring in the latest information. Also on Thursday comes the PPI release, which is set to indicate a further deflation of producer prices supported by the falling commodity prices (annual growth improves on base effects). The MPC's minutes (Thursday) are going to be a non-event regarding the current monetary policy stance.

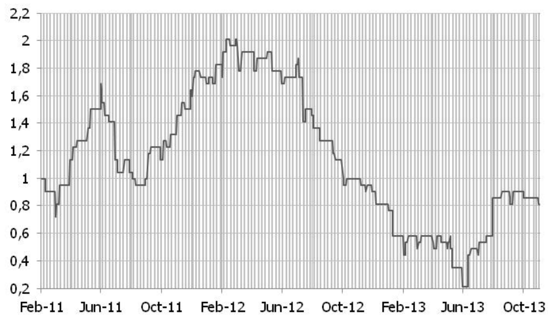
Polish data to watch: October 18th to November 22st

Publication	Date	Period	BRE	Consensus	Prior
Wages y/y (%)	19.11	Oct	2.6	2.9	3.6
Employment y/y (%)	19.11	Oct	-0.2	-0.2	-0.3
Industrial output y/y (%)	21.11	Oct	3.5	4.4	6.2
PPI y/y (%)	21.11	Oct	-1.1	-1.2	-1.4
MPC Minutes	21.11	Nov			

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

Slightly up after GDP but down after lower than expected CPI reading (this surprise is not really surprising if we take history into consideration). Polish surprise index has therefore continued to consolidate. We expect it to resume the uptrend later this year.

* Surprise index presents in a synthetic way how the market was surprised by 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. After GDP growth reached 1.9% in Q3, 2.4% reading in the final quarter is possible. 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	1.4	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	1.9	2.4	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 (%)	-0.1	4.3	3.0	2.0	0.3	0.3	0.3	0.3
Investment y/y (%)	-2.1	-3.2	-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	4.30	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

GDP accelerates while CPI inflation stays muted (only due to low food prices).

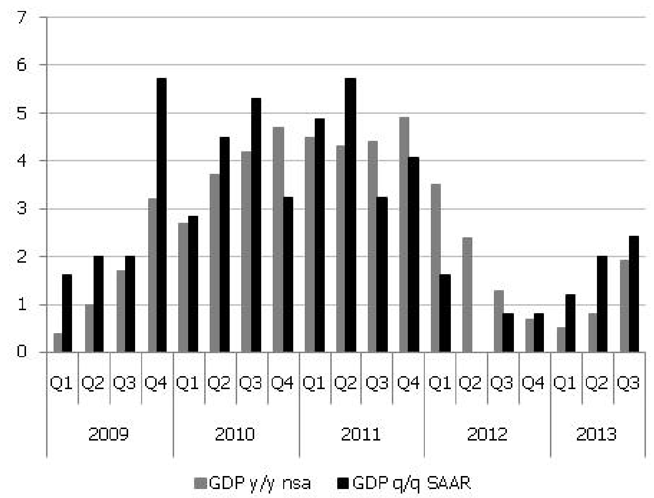
Accelerating growth and low inflation are usually hard to reconcile. However, so far financial markets seem to believe this time will be different. It will not.

Faster GDP growth growth is going to ramp up core inflation which is now rising faster than headline CPI and is likely to reach 2% in early 2014 and then even may be squeezed towards 2.5% (more and more by demand pressures). MPC is well aware that such levels of core inflation are dangerous in case any negative supply shock happens (food prices, fuel prices) as in such circumstances headline CPI easily overshoots inflation target. It is also true that exogenously low inflation readings (generated by items to which consumers are price insensitive) stimulate consumption and - in turn GDP growth.

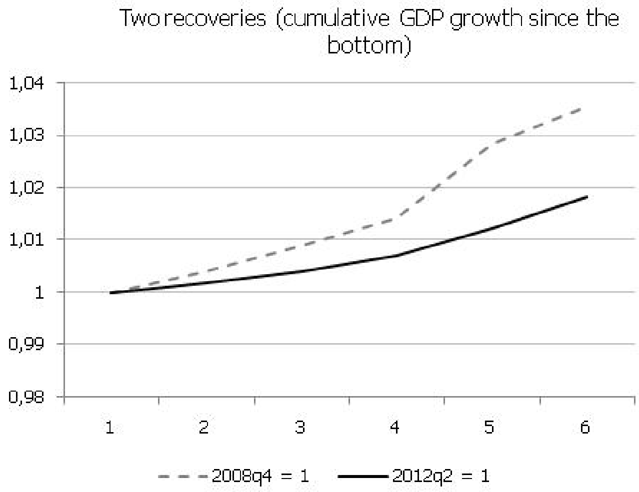
The current Autumn lull cannot last forever. Complacency unleashed by low inflation readings and overall climate of appraisal towards expansionary monetary policy generates anchoring bias and pins down short-end of the curve at current low levels. Meanwhile, the combination of rising core inflation and growth usually leads central banks to normal textbook reaction: monetary tightening. We therefore think that in current state of expectations, financial markets may be caught on the wrong foot. Of course this kind of adjustment may take a while. Nonetheless we sustain our scenario of rate hikes in the final quarter of 2014, faster than is already priced in.

The details of GDP and inflation releases are the following.

GDP accelerated visibly. Q3 brought GDP growth at 1.9% y/y (flash data, to be confirmed at the end of the month). Growth momentum looks better and better with every passing quarter. Having started the year at +0.3%, growth improved to +0.5% in Q2 only to settle at 0.6% in Q3 (translating into 2.4% SAAR).

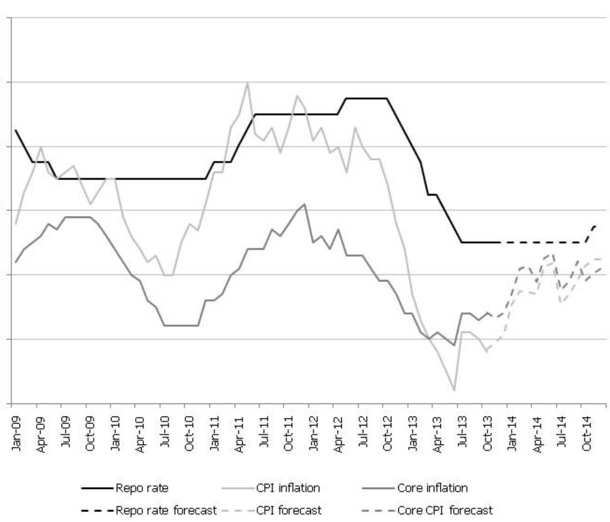


Breakdown of the data is not available given the flash nature of the publication. We estimated that acceleration stemmed mainly from improved consumption growth, stabilizing investment activity and still positive net exports contribution. It is also possible that - similar to Q2 - public consumption contributed to growth more than is commonly thought.



Polish economy embarked on an upward growth trajectory. However, compared to the upswing started in 2008, current episode looks more modest (see the graph). So far the upswing is export-driven. Subsequent quarters are set to reveal stronger domestic demand: consumption already started to accelerate, private investment is so far limited but we expect firms to spend more as soon as uncertainty dissipates. Last but not least, we await more expansionary fiscal policy and public investment to kick in H2 2014. Meanwhile, Q4 GDP growth may reach 2.5% with decent momentum and statistical base effects helping to pump annual figures.

Headline inflation drops on food prices, core inflation rises. CPI inflation dropped in October to 0.8% y/y from 1.0% in September. The reason for this lies in food prices which fell on a monthly basis, marking a new seasonal low for October. On the other hand - core categories increased on average (helped by a one-off spike in communications generated by pricing changes among GSM operators). We estimate that core inflation accelerated to 1.4% from 1.3% in the previous month.



The next months will be marked more and more by statistical base effects. Therefore, we expect a gradual acceleration of headline CPI towards the NBP's target in mid-2014. Such an acceleration will be accompanied by rising core measures which already display an upward trend at this very moment. We think it would be a good reason for the MPC to lift rates up at the end of 2014, the more so since GDP growth is set to be more sustainable until this date. The central bank is well aware that when core inflation is running close to 2% (a scenario for mid 2014), any negative supply shock in food and fuel markets may lead to substantial overshooting of headline CPI, generating a risk of anchoring inflation expectations at much higher level, especially in environment of stronger growth and tighter labor markets.

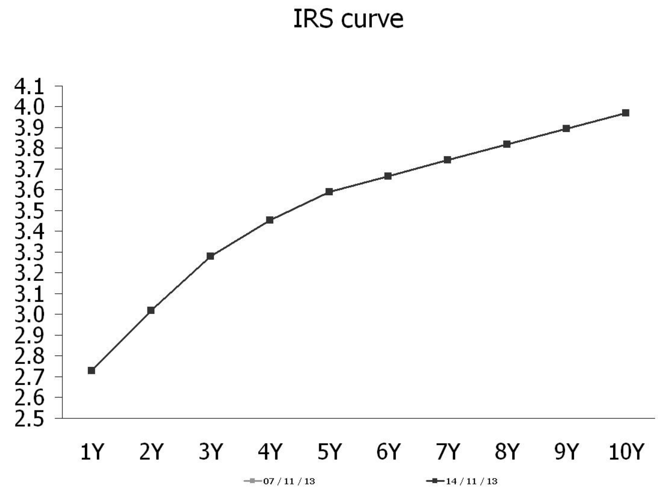
Fixed income

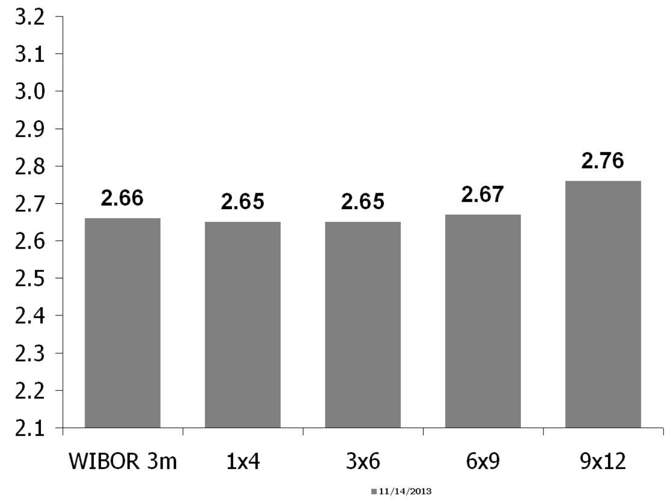
Carry them in!

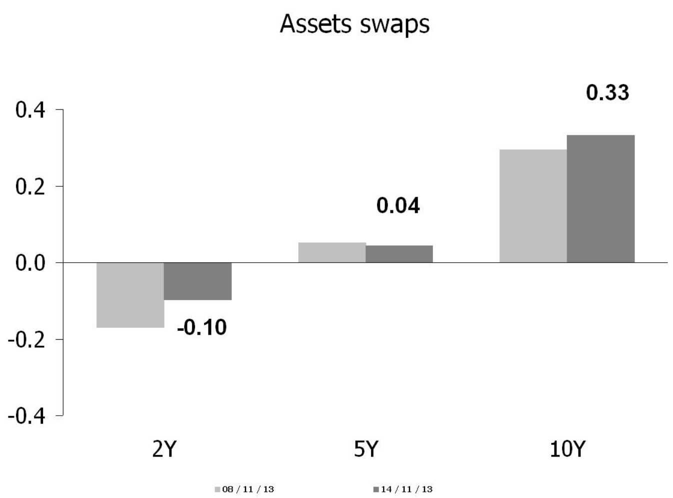
We know that the Polish economy is growing, we know the European one possibly does as well, we know the American one definitely does. But would it cause pressure to tighten monetary policy? Sure it will, but the key is when.

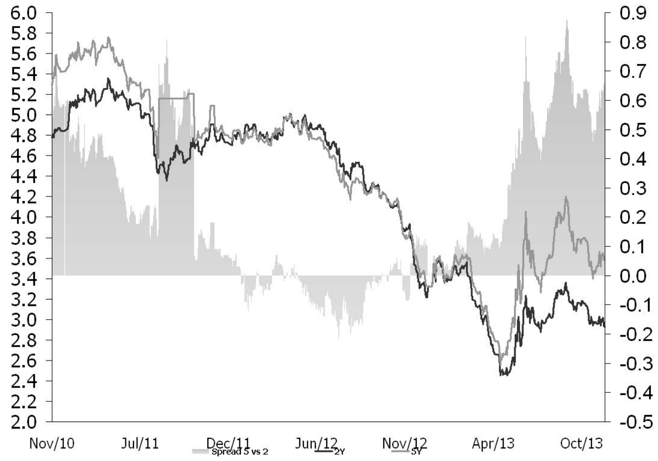
All three mentioned countries' CBs see growth as fragile and CPIs below targets. We still see local MPC as dovish, still are astonished by the ECB cut, still recon Yellen comments as pro-growth policy. Will it cause bonds to rally? Rather not - bonds have priced in (at least partly) tapering, and it's the way of no return now.

With low CPI across the world but still weak growth POLGBs have stuck in the safe range. In our opinion, current (1-2 months) lack of inflationary pressures creates decent room for carry traders. Low CPI but growing GDP numbers lower credit risk, money is and will be (December!) cheap. Buy bonds then - especially 4-5Y where yields looks especially attractive.







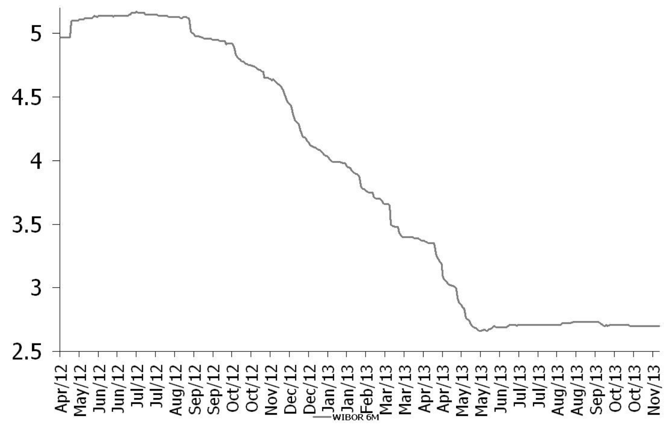


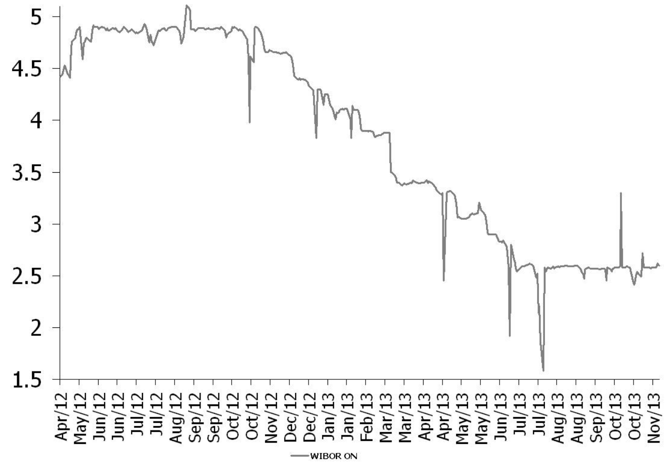
Money market

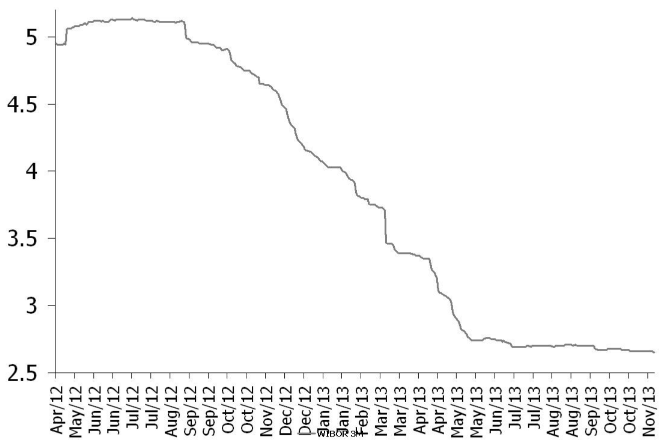
Cost of liquidity higher on money bills intake Higher cost of liquidity on high intake of money bills by the market participants. It will not change next week since today's OMO again sterilized the market (125 bln pln of money bills sold).

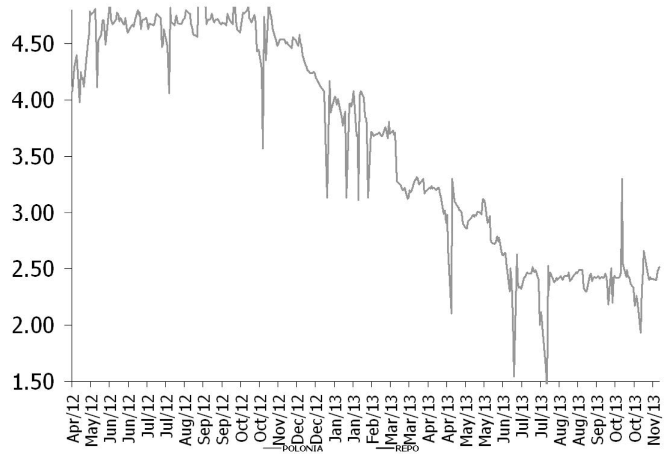
Core CPI more interesting then the headline Front end glued by the local version of forward guidance (no change in rates till the end of June 2014) and also on global trend to keep the short rates down. GDP reading (1.9%) paired by much lower CPI (0.8%), driven by decreasing food prices in the whole region. Core CPI index should play much higher role for the market (1.4% today) reflecting growing price pressure after excluding food and energy, which are not under control of the monetary body whatsoever. It has been ignored for some time and we think it is just coming back to the market's attention. At least it should.

As of now the whole IR market is characterised by lower volatility and low turnover. We are waiting for any drivers coming either from core markets or from local figures next week. By then we do not expect anything thrilling.





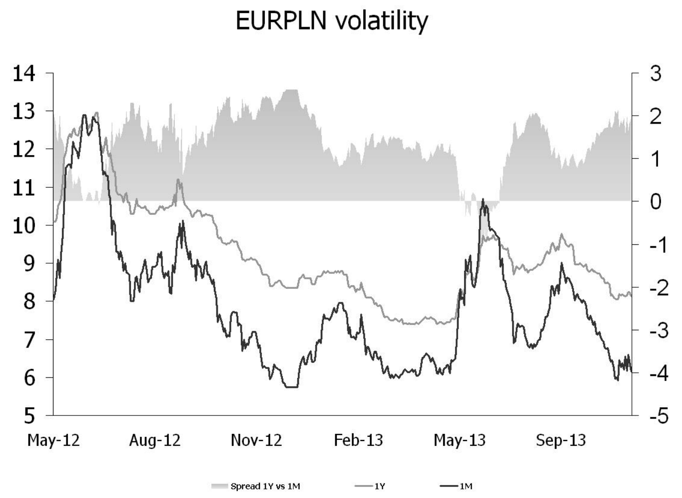




Forex

Still in range The stronger than expected NFP made the renewed talk about tapering possible and it pushed EURPLN to 4.22 area on Monday. But there it struggled to gain any momentum and more dovish commentary from the ECB and the Fed have lent the emerging market a slightly firmer tone. Additionally, Zloty was supported with strong GDP and the presence of BGK on the offers. Finally, EURPLN has come back to the old range 4.17-4.1950 - progress from here should be mainly defined by external factors.

Vols lower Steady gains of the Zloty and extremely low realized volatility made the current fall in implied vols tumble again. 1 month EUR/PLN ATM is 5.6% mid from 6.0% mid last week, 3 months 6.3% mid versus 6.5%, and 1Y mid is 8.0%, 0.1% lower. The biggest drop was in the currency spread (difference between USD/PLN and EUR/PLN) roughly 0.3%. The skew was slightly better offered.

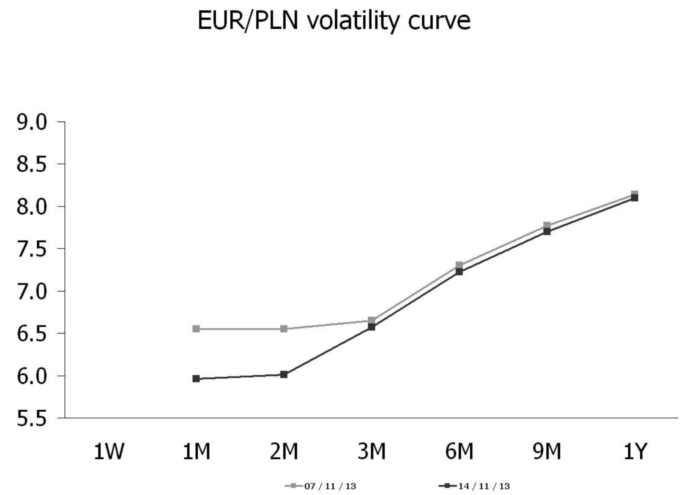


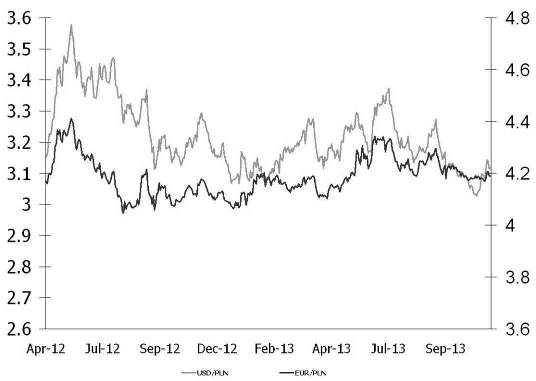
Short-term forecasts

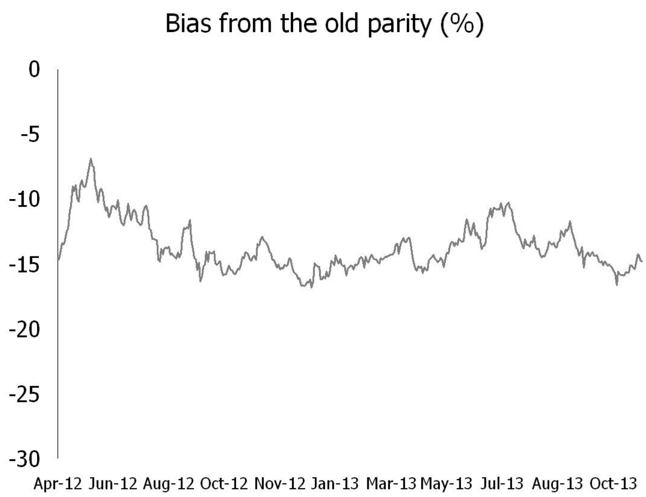
SPOT Main supports / resistances:
EUR/PLN: 4.1400 / 4.2200
USD/PLN: 3.0000 / 3.2000

Play range The range (4.1450/4.22) is really mighty, and so far it contained all the moves. We will still try to play it, but our favored strategy is to sell spikes EUR/PLN. 4.19/4.20 is a sell zone with a stop above 4.2150 and with hopes to test 4.1400/4.1450 support level.

Hold long Vega in Backend We are still long backend EUR/PLN. It is still a modest long, and we also still have some 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 realized volatility is not really encouraging buyers. The vols are cheap and even though they may stay here for 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
11/7/2013	2.66	2.66	2.70	2.60	2.75	2.65	2.68	2.67	2.69	2.76	2.91	2.76
11/8/2013	2.42	2.66	2.56	2.60	2.78	2.65	2.67	2.67	2.69	2.80	2.97	2.76
11/12/2013	2.47	2.66	2.57	2.60	2.80	2.65	2.67	2.67	2.69	2.79	2.98	2.74
11/13/2013	2.36	2.66	2.47	2.60	2.69	2.65	2.66	2.66	2.69	2.77	2.95	2.75
11/14/2013	2.48	2.65	2.58	2.60	2.80	2.65	2.65	2.65	2.67	2.76	2.93	2.73

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
11/7/2013	2.650	2.653	2.943	2.855	3.515	3.578	3.970	4.256
11/8/2013	2.650	2.613	3.000	2.830	3.635	3.687	4.085	4.380
11/12/2013	2.650	2.689	3.018	2.856	3.650	3.699	4.125	4.432
11/13/2013	2.650	2.654	2.940	2.851	3.600	3.655	4.045	4.370
11/14/2013	2.650	2.556	2.930	2.833	3.580	3.624	4.000	4.333

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
11/7/2013	6.55	6.65	7.30	8.14	8.14	2.51	0.75
11/8/2013	6.18	6.50	7.30	8.15	8.15	2.51	0.75
11/12/2013	6.43	6.65	7.40	8.25	8.25	2.64	0.69
11/13/2013	6.15	6.73	7.33	8.13	8.13	2.80	0.79
11/14/2013	5.96	6.58	7.23	8.10	8.10	2.55	0.67

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
11/7/2013	4.1696	3.0844	3.3806	3.1241	1.4073	0.1616
11/8/2013	4.1799	3.1133	3.3979	3.1698	1.4121	0.1549
11/12/2013	4.2066	3.1448	3.4140	3.1543	1.4083	0.1557
11/13/2013	4.2061	3.1358	3.4147	3.1517	1.4060	0.1555
11/14/2013	4.1890	3.1150	3.3984	3.1195	1.4054	0.1542

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