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

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Comment on the upcoming data and forecasts

Next week brings several important releases. Despite unfavorable difference in the number of working days (0 vis-a-vis +1) and a lack of any statistical base from last year, we expect retail sales to accelerate on the back of rebounding food sales after a surprising drop in the previous month (similiar one-off happened in 2009). Unemployment rate held steady in October, as reported by the Ministry of Labor in its preliminary release. We expect that the flash estimate of GDP growth in Q3 will be confirmed at 1.9% on Friday. We attribute the acceleration to higher household consumption growth and stable (y/y) investment.

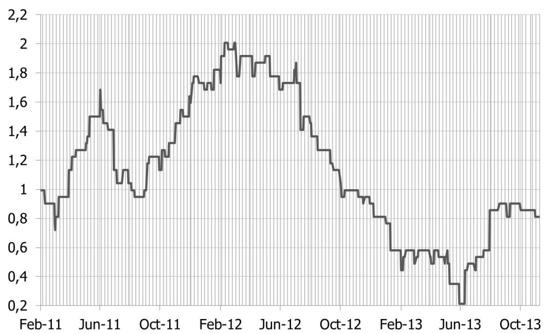
Polish data to watch: October 25th to November 29st

Publication	Date	Period	BRE	Consensus	Prior
Unemployment rate (%)	26.11	Oct	13.0	13.0	13.0
Retail sales y/y (%)	26.11	Oct	4.3	4.3	3.9
GDP y/y (%)	29.11	Q3	1.9	1.9	1.9
Inflation expectations (%)	29.11	Nov	0.9	0.9	0.9

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 - all of last week's publications turned out more or less within market consensus. Few occasions for surprises next week, thus another pause for the index is very likely.

* 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. 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

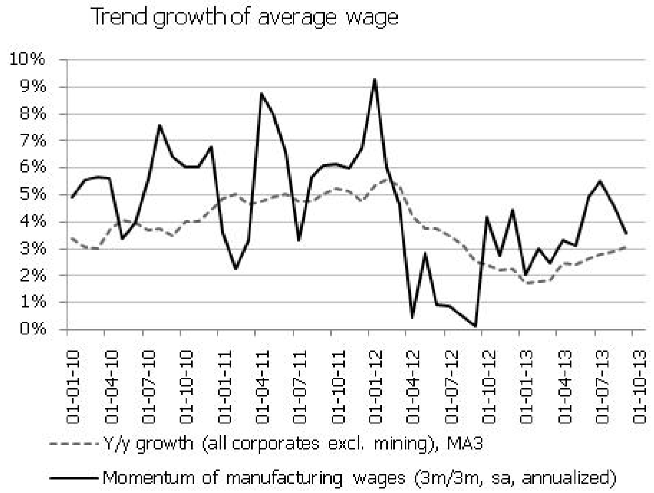
Economy steadily marching forwards. MPC enjoying the (so far) stable environment.

Last week the data on labor market and industry saw the light. Despite working day toing and froing wage growth is forming an upward trend - notably visible in both manufacturing and total economy excl. mining. Employment is also taking off, albeit gradually and from low growth levels. Despite all arguments raised against the sustainability of labor market upswing, we believe that employment in support and administrative services is increasing not accidentally but because there is demand for such services connected with rising business activity (this labor market segment has leading properties). Therefore we believe that there is a possibility of upward wage pressure to build gradually in the following quarters; the more so since industry and construction has been lately on steady revival.

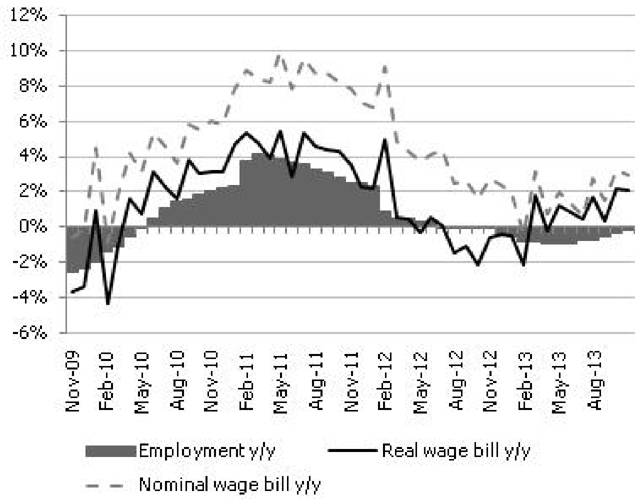
At a time when economy is sending signals of further strengthening, MPC is not eager to acknowledge this and strengthens forward guidance (FG) until mid-2014. This strengthening is proceeding along strange lines. Commitment to keep rates low appears really out of the blue (see the most recent ”Minutes”), without any discussion on merits of such sentence on economic outcomes, especially without rates being at zero lower bound. Such attitude should bear important questions. Why? Is it going to be effective? We do not have satisfactory answer to the first question which affects the reply for the latter. In our opinion there is a high risk for forward guidance to be time inconsistent, especially given our more optimistic scenario. We think MPC may be tempted to abandon FG earlier than it technically expires and rates are going to be lifted in Q4 2014. It is not what the market is pricing in at the moment.

But let's get down to earth for a moment and take a look for the details of publications.

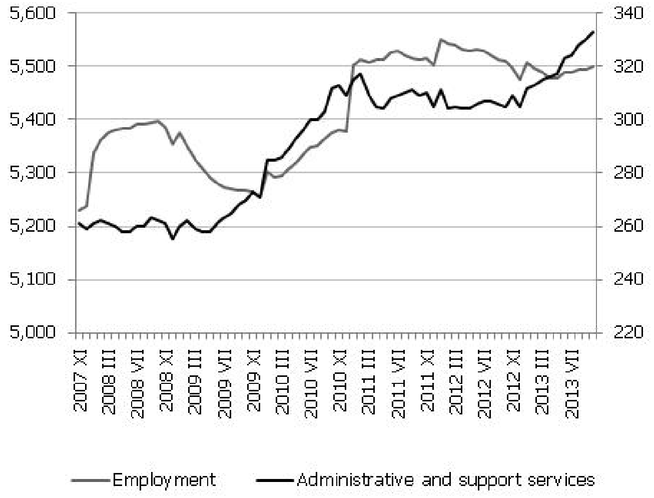
Wages in an upward trend. Average wages increased by 3.1% y/y in October, beating expectations (2.9%) and our forecast (2.6%). The preliminary nature of publication precludes any comment on the source of the surprise. One can note, however, that wages decelerated less than low statistical base in mining and working day effects (0 y/y vs. +1 y/y in the previous month) would suggest. Although wage growth remains muted, as compared to historical averages, there are signs of steepening trend in the recent data. We estimate (see the graph below) that the trend growth of wages accelerated to 2.5-3.0% from 1.5-2.0% noted earlier this year. We can thus suspect that wage pressures will gradually increase with (partial) tightening of the labor market.

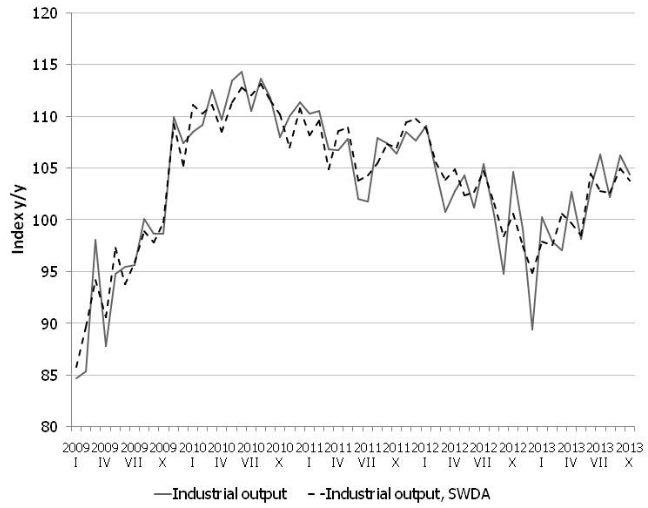


Real wage bill decelerated only marginally (2.1% y/y vs. 2.2% y/y in September), confirming once again that household consumption has strong fundamentals. The more so since inflation remains muted amid supply factors (food and fuels).



Employment showing steady sequential growth. Employment in the enterprise sector rose by 5k on a monthly basis which allowed annual growth to improve to -0.2% from -0.3% noted in the previous month. Although the reading was widely expected, it has been important for us to see that recent trends in labor market have not been derailed and September's, poorer reading was a one-off exuberance. The true direction (upwards) is still given by business tendency indicators which grow unabated. As employment and investment are highly correlated (especially in emerging markets), uncertainty is a key driver not only for investment, but also for employment. Both aggregates should accelerate as soon as uncertainty fades. However, labor-intensive nature of Polish economy allows employment to accelerate earlier despite relatively low capacity utilization.





Last but not least, recently there was some market talk that employment in Poland grows because of public sector hiring. We find such statements flawed. It is true that the majority of jobs is created in administrative and support services, but this category has nothing to do with public sector. It consists of labor-intensive jobs, undertaken - as the name of the category states - as a support to other activity. Such services have leading nature for other sections in the economy (at least it was true in the previous cycle but economically the concept is also viable), and point to nothing else but a slow tightening of the labor market. It is important to note, though, that the tightening is proceeding fast in low-skilled workers category, therefore it is the sector where we can expect wage pressures to emerge first (anecdotal evidence supports this line of reasoning).

Industrial output figures consistent with an upward trend. Industrial output grew by 4.4% y/y (seasonally adjusted +3.8%), along with consensus and slightly above our forecast. The drop in y/y dynamics reflects calendar and working day effects which cause monthly fluctuations around an upward trend of +1p.p. per month. Output grew in 26 branches of industry and the list involves both export-oriented and domestic-oriented industries. One has to note, however, that the latter group rebounded only a few months ago, significantly later than the former. As domestic demand returned to play in Q3, industrial output began to accelerate in a significant way. A good start to Q4 suggests that the economy remains on track to achieve a 2.5% (y/y) growth in the last three months of the year.

Construction output dropped by 3.2% (-6.1% seasonally adjusted) and this is a positive surprise (market consensus indicated a 5%-ish drop). A large m/m increase also confirms that construction is still heading upwards. The upswing is driven not only by stable public investment but also by recovering private activity. Consider, for instance, that housing starts surged by 35% y/y and 15% m/m in October, as reported by the Central Statistical Office on Tuesday.

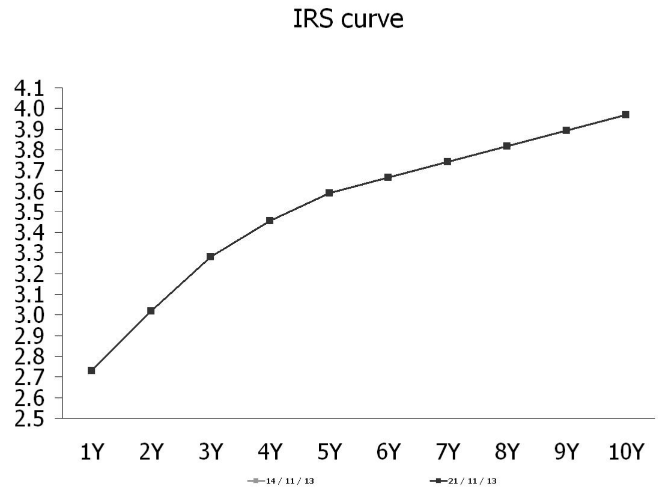
Fixed income

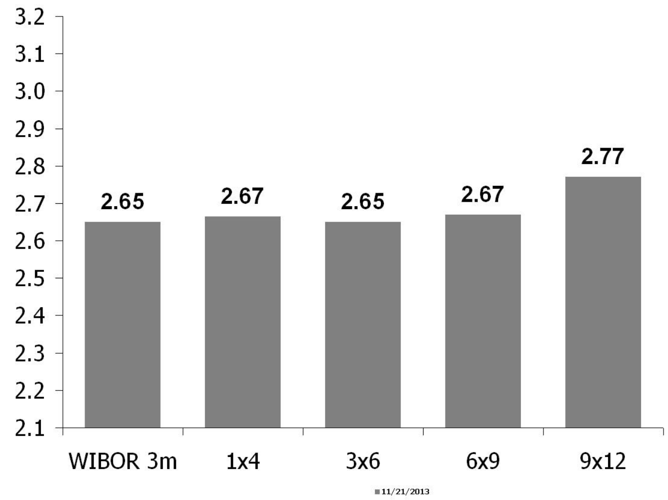
Carry on

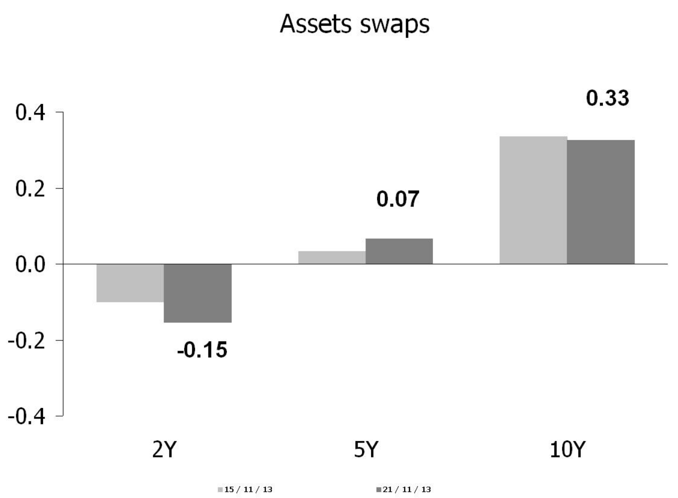
The most important event of this week on fixed income market was the switching auction (with very good results - PLN 5.5 bln of bonds sold). It turned out to be a good opportunity to buy long end bonds. Neither Fed Minutes nor Polan's new Minister of Finance could change the relatively good sentiment on the long end of the curve.

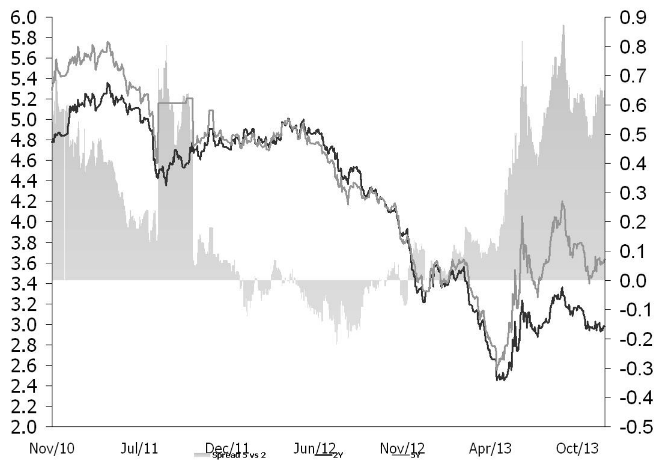
We believe that the end of the year should support carry trades here. With only one switching auction left, supply should be limited. Central Banks are pushing short rates lower and lower, and our CPI is definitely under control. With this in mind even relatively good growth could be good for our long end bonds (it mitigates budget deficit problems).

Recommendation: keep long position in 5 year bonds or even switch to 10 year ones.



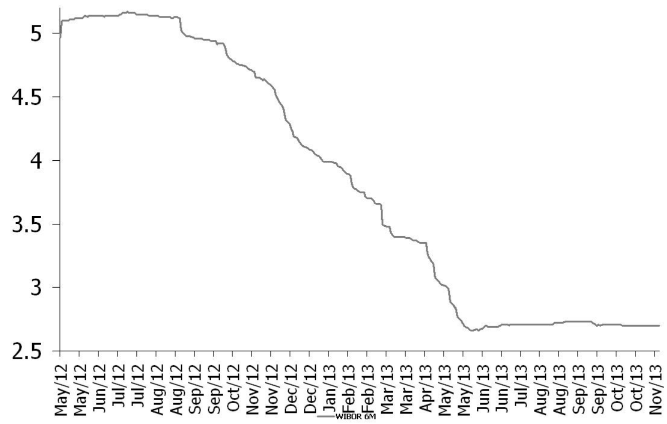




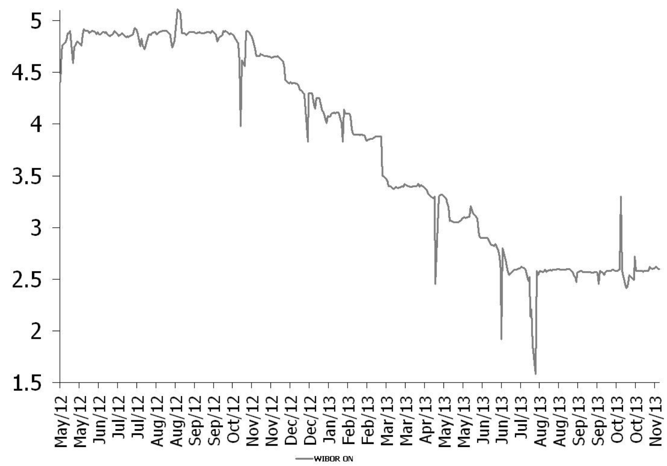


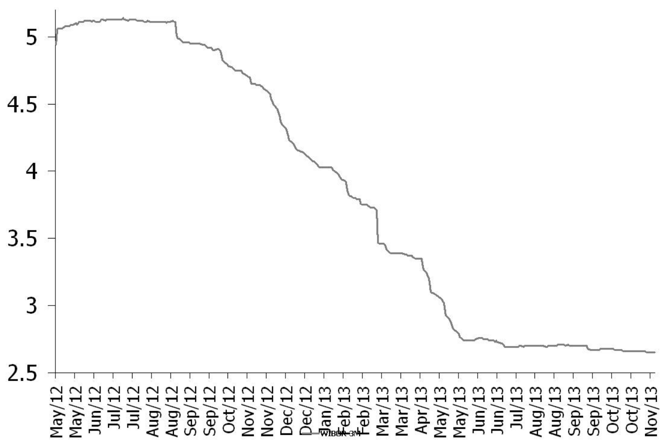
Money market

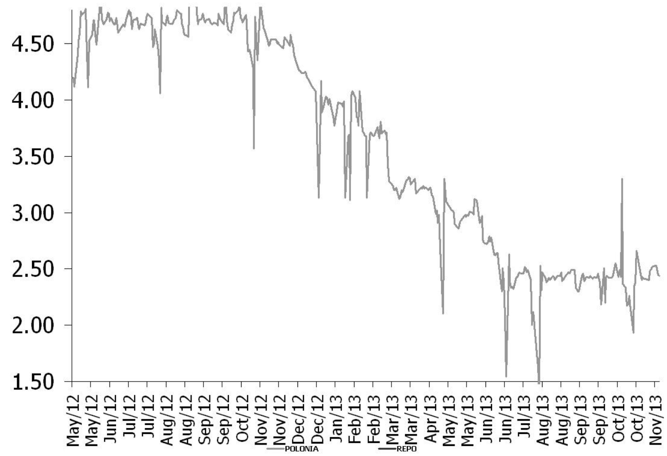
Cheaper end of the reserve Some relief for shortest rates possible since the market absorbed much less money bills then was on the offer (123 bln pln vs 127 bln pln). Additional OMO is likely, however it is the last week of the reserve requirement settlement period, therefore everything is possible. All in all we think that no matter what, we should see cheaper cash and the question is by how much (depending on additional OMO).



Still no drivers for higher volatility Rates very stable across the curve despite the government reshuffle (old ideas with new faces) and figures confirming bouncing back of the Polish economy. We still do not see any drivers to push the rates up, unless anything unexpected happens. In that case sky is the limit since no risk whatsoever is build in prices as of now. Having written that we see no value in receivers and a lot of potential in payers under condition that something is to happen. We see political risk locally and earlier then expected tapering globally as a good bet for those who want to take any risk.





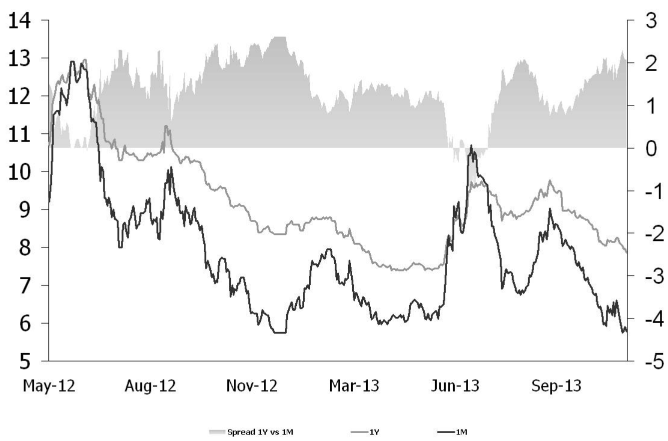


Forex

Still in range The event of the week was for sure the reconstruction of Polish Government, which included the nomination of the new MOF. The market reaction was, to be honest, really disappointing as EUR/PLN barely moved. That only shows how stable is EUR/PLN at the moment, with government-owned state bank still active at the offer side. We are afraid it is the way it's going to be, with Christmas already on the horizon: a 4.17/4.22 range.

Vols lower The really low realized volatility was behind one more decrease in the EUR/PLN vol curve. This Friday 1 month EUR/PLN ATM mid is 5.5% (0.1% lower), 3 months at 6.1% (0.2% lower) and 1 year at 7.9% (0.15 pp. lower). The skew and currency spread (difference between USD/PLN and EUR/PLN vol) was also better offered.

EURPLN volatility



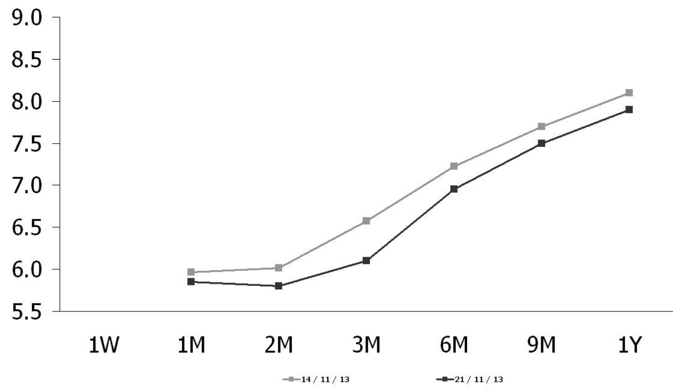
Short-term forecasts

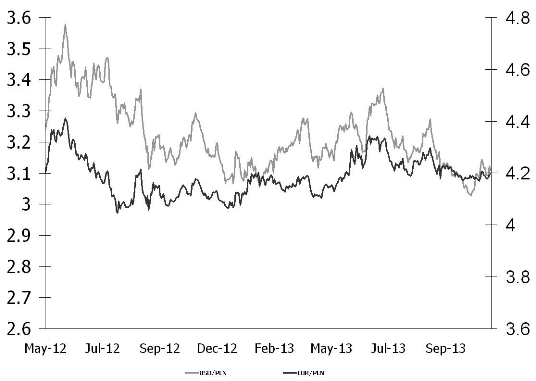
SPOT Main supports / resistances:
EUR/PLN: 4.1400 / 4.2200
USD/PLN: 3.0000 / 3.2000

Stay aside / fade extremes We have decided to change attitude with such tight ranges and heavy positioning (market generally short Gamma). We are square now, as the risk/reward ratio is not really encouraging to be positioned at all. We keep our powder dry and we will likely try to fade extremes if seen. If not, it is almost the end of the year, anyway...

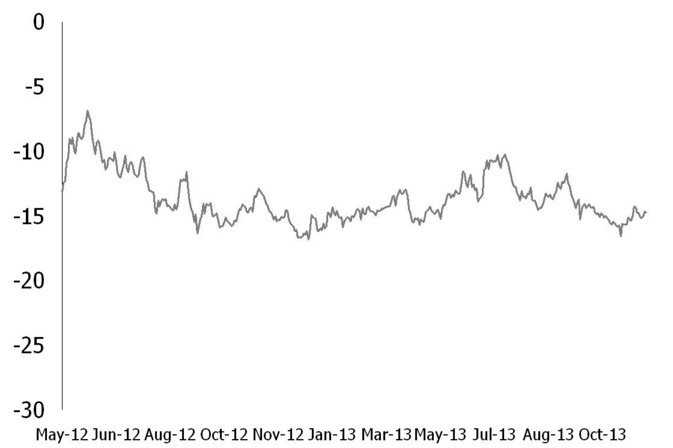
Hold long Vega in Backend We are still long backend EUR/PLN. It is still a modest long, and we also still have some shorts in the frontend. And not to muddle the view, we have to confess that we don't see any obvious volatility triggers on the horizon. The realized volatility is not really encouraging 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.

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
11/15/2013	2.65	2.65	2.70	2.60	2.75	2.65	2.64	2.65	2.67	2.77	2.92	2.76
11/18/2013	2.55	2.65	2.56	2.60	2.78	2.65	2.64	2.65	2.68	2.77	2.95	2.77
11/19/2013	2.51	2.65	2.61	2.60	2.79	2.65	2.64	2.65	2.68	2.77	2.93	2.76
11/20/2013	2.41	2.65	2.51	2.60	2.70	2.65	2.67	2.65	2.67	2.77	2.93	2.76
11/21/2013	2.50	2.65	2.60	2.60	2.82	2.65	2.67	2.65	2.67	2.77	2.93	2.76

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
11/15/2013	2.650	2.562	2.960	2.861	3.610	3.644	4.050	4.385
11/18/2013	2.650	2.616	2.940	2.813	3.590	3.627	4.040	4.380
11/19/2013	2.650	2.612	2.978	2.850	3.605	3.671	4.075	4.417
11/20/2013	2.650	2.607	2.980	2.824	3.605	3.659	4.095	4.430
11/21/2013	2.650	2.550	2.980	2.826	3.630	3.696	4.130	4.456

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
11/15/2013	5.75	6.30	7.13	8.05	8.05	2.55	0.66
11/18/2013	5.80	6.24	7.10	7.95	7.95	2.55	0.66
11/19/2013	5.90	6.23	7.10	7.98	7.98	2.57	0.68
11/20/2013	5.78	6.00	6.80	7.85	7.85	2.56	0.66
11/21/2013	5.85	6.10	6.95	7.90	7.90	2.55	0.66

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
11/15/2013	4.1890	3.1172	3.3926	3.1054	1.4040	0.1544
11/18/2013	4.1805	3.0953	3.3909	3.0962	1.4076	0.1540
11/19/2013	4.1789	3.0925	3.3880	3.1005	1.4074	0.1538
11/20/2013	4.1847	3.0947	3.3960	3.0951	1.4088	0.1533
11/21/2013	4.1933	3.1227	3.4027	3.0941	1.4089	0.1541

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