BRE BANK SA

POLISH WEEKLY REVIEW

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Comment on the upcoming data and forecasts

New week, lots of data releases - read more in the Economics section.

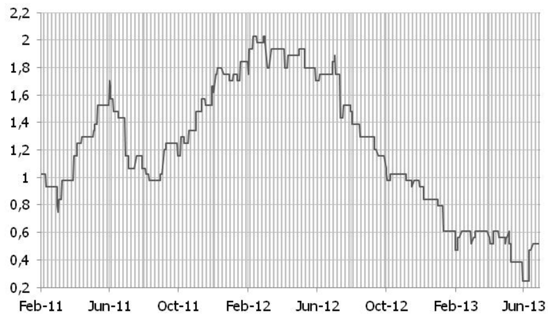
Polish data to watch: July 15th to July 19th

Publication	Date	Period	BRE	Consensus	Prior
CPI y/y (%)	15.07	Jul	0.4	0.3	0.5
Corp. wages y/y (%)	16.07	Jul	2.9	2.1	2.3
Corp. employment y/y (%)	16.07	Jul	-0.9	-0.9	-0.9
Core inflation y/y (%)	16.07	Jul	0.8	0.9	1.0
Industrial output (%)	17.07	Jul	2.1	1.5	-1.8
PPI y/y (%)	17.07	Jul	-1.8	-1.8	-2.5

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 OK0715	-	2500	2.748	4/23/2013
5Y T-bond PS0718	-	4500	3.303	6/6/2013
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

Unchanged (no significant data). Next week brings crucial releases (CPI and industrial output) and there is a potential for positive surprises, especially when it comes to inflation (see the Economics section for a detailed analysis).

* 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 stagnation in H1 2013.
- We expect economic recovery in H2 2013. The rebound will be driven by a re-acceleration of the euro zone economy (see the end of austerity), rebound in real income and recovering private consumption. Low rates trigger rotation in households assets. However, given the scale of slack in investment (infrastructure in particular) and consumption, rebound generated this way may be initially moderate (no more than 2% y/y growth rate in Q4 2013).
- Polish government committed to the convergence path, though in an unorthodox way. Very limited room for fiscal stimulation due to limited financial markets tolerance for higher debt. The government prepares the markets for a budget revision and PM Tusk considers it more likely than lack thereof.
- We witnessed the steepest disinflation phase in Polish history. CPI inflation close to 0% in mid 2013 but is to rise slowly in Autumn and in 2014.
- Despite low inflation, there is no support for further easing within the MPC. July rate cut marked the end of the easing cycle. We expect first rate hikes to materialize at the turn of 2014/2015 and think that NBP projections of both GDP and inflation for 2014 are be too pessimistic.

Financial markets

- We stay contructive on short-term bonds (ECB supports low rates in Europe introducing Fed-style forward guidance, NBP follows although in a less straigtforward way and at the moment only via governor's rhetoric, not the statement of the whole body). Note that NBP may also use unconventional tools to boost banks' demand for government papers (we believe in such scenario even more after most recent outflow of foreign funds from bond market and FX intervention).
- Ultimately, global recovery (or monetary stimulus and liquidity withdrawal) and rising core yields will adversely affect Polish bonds. Fed-induced higher volatility has already been doing its job, especially on the long end.
- The "wall of money" obscured the cyclicality of the Polish currency. This fact was revealed when expectations on QE tapering accelerated and the zloty dynamicaly breached 4.22/25 and broke out of the 1 year range. We expect a return below 4.20 no sooner than when the economy accelerates visibly (long into H2) or/and rate hike expectations gain momentum (a turn of 2013/2014).

BRE forecasts

	2008	2009	2010	2011	2012	2013 F
GDP y/y (%)	5.1	1.6	3.9	4.5	1.9	1.0
CPI Inflation y/y (average %)	4.3	3.5	2.8	4.2	3.7	0.8
Current account (%GDP)	-5.3	-1.6	-4.5	-4.9	-3.5	-1.9
Unemployment rate (end of period %)	9.5	12.1	12.4	12.5	13.4	13.9
Repo rate (end of period %)	5.00	3.50	3.50	4.50	4.25	2.50

	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2013 Q1 F	2013 Q2 F	2013 Q3 F	2013 Q4 F
GDP y/y (%)	3.5	2.3	1.3	0.7	0.5	0.5	1.2	1.7
Individual consumption y/y (%)	1.7	1.3	0.2	-0.2	0.0	0.4	1.3	1.9
Public Consumption y/y (%)	-1.0	0.4	1.6	-0.6	-0.5	0.3	0.5	0.5
Investment y/y (%)	6.8	1.4	-1.7	-4.1	-2.0	-4.5	-3.0	-2.5
Inflation rate (% average)	3.9	4.0	3.9	2.9	1.3	0.6	0.2	0.9
Unemployment rate (% eop)	13.3	12.4	12.4	13.4	14.3	13.4	13.3	13.9
NBP repo rate (% eop)	4.50	4.75	4.75	4.25	3.25	2.75	2.50	2.50
Wibor 3M (% eop)	4.94	5.13	4.92	4.11	3.39	2.70	2.70	2.70
2Y Polish bond yields (% eop)	4.62	4.60	4.05	3.14	3.19	2.85	2.85	2.90
10Y Polish bond yields (% eop)	5.50	5.15	4.69	3.74	3.94	4.20	4.00	4.40
EUR/PLN (eop)	4.15	4.22	4.12	4.08	4.18	4.30	4.20	4.15
USD/PLN (eop)	3.11	3.35	3.20	3.09	3.26	3.31	3.36	3.40

F - forecast

Economics

Eventful weak ahead. Data to underpin the merits of ending rate cut cycle.

After a rather uneventful week we are heading for several days of important macro releases. Their weight is based on two facts: 1) real sphere data (almost) complete the data set that can be used to pin down the GDP growth rate in Q2, 2) inflation data are set to announce the level at which the series turns around in the current cycle. We are rather optimistic on the real sphere (some sort of stabilization in the labor market, positive industrial output data, somewhat lesser falls in construction) and expect higher CPI inflation, which due to bumpy behavior of food prices is likely to be very close to the last month's reading of 0.5% rather than 0.2% stipulated by our original estimate. The incoming mix is going to underpin expectations that the easing cycle is over. Therefore it is a idiosyncratic negative decoction for local bonds. And here are the specifics (we compare our forecasts to Bloomberg consensus that can be modified during the month and hence reflects the inflow of fresh information).

Inflation (15th July). We expect headline CPI to fall only marginally towards 0.4% y/y in June (previous reading 0.5%, market consensus 0.3%). The revision of our earlier forecast is based on food prices behavior (specifically potatoes) that are most likely to reflect the Czech pattern - they did last year and we have no reason to think they are going to diverge this time. At the same time we expect core inflation to ease from 1.0% in May to 0.8% in June (market consensus) owing to price shifts in telecommunications. Should our inflation forecast come true, the level shift implies also that the subsequent readings will be higher. We stick to our scenario that 2014 will be marked by inflation exceeding 1% with the average rather close to 1.8% (base effects alone will boost price growth by 1pp.).

Employment and wages (16th July). Business activity indicators on employment and the breakdown of employment figures suggest that the trough in y/y growth rate has probably been reached (our forecast, market consensus and previous reading at -0.9% y/y). Next months are likely to bring job creation at the level of 0+ and we are heading back to more normal job growth at the turn of 2013/2014 (round 5-10k monthly increments). Wage growth stays subdued and much of the variation stems from bonuses in mining (our forecast 2.9%, market consensus 2.1%, prior 2.3%).

Industrial output (17th July). After much better than expected PMI figures we have grown more confident that the same is going to apply to industrial output (our forecast 2.1%, market consensus 1.3%, previous reading -1.8%). Among the factors supporting the reading are: neutral difference in working days (versus -1 y/y in the previous month) and relatively substantial base effect from the last year (1-2pp. boost to current reading).

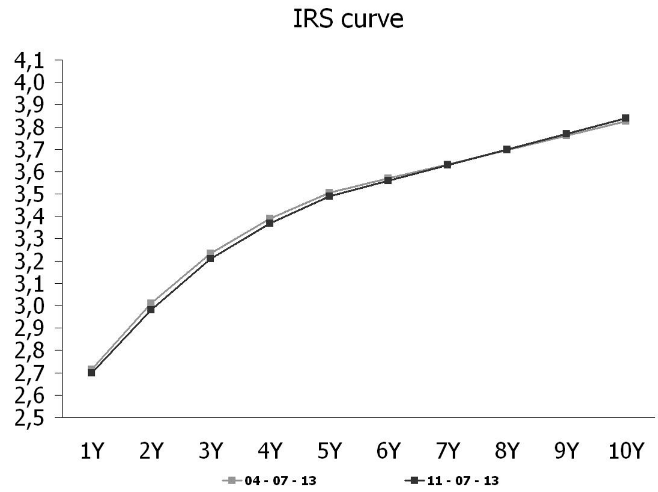
Q2 GDP growth (to be released in a flash form on 14th August). Recent news flow from the Central Statistical Office (Witkowski) took rather less optimistic note. Although the official stance still suggests Q2 GDP growth is going to be close to Q1 reading, the risk for lower reading has risen. We see no need to follow the clues drawn from this information (even though GUS should know better, they still operate on the same dataset as we are and... their track record is rather miserable). We stick to our view that GDP growth will be at the level recorded in Q1. This is a forecast conditional on our forecasts for June releases. Should they come materially higher, it also shift GDP growth forecasts higher and vice versa.

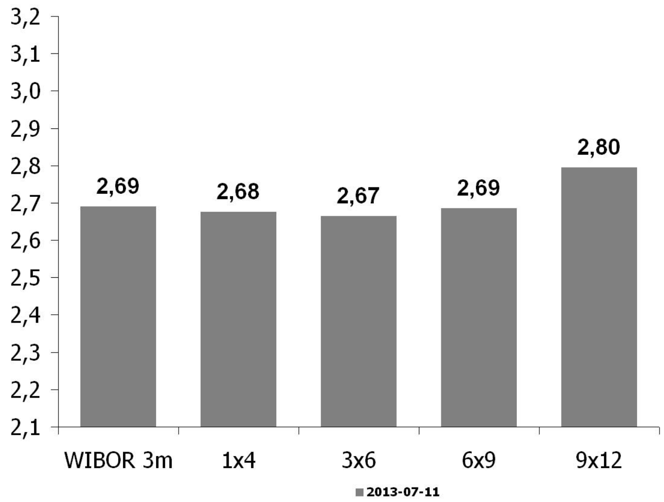
Fixed income

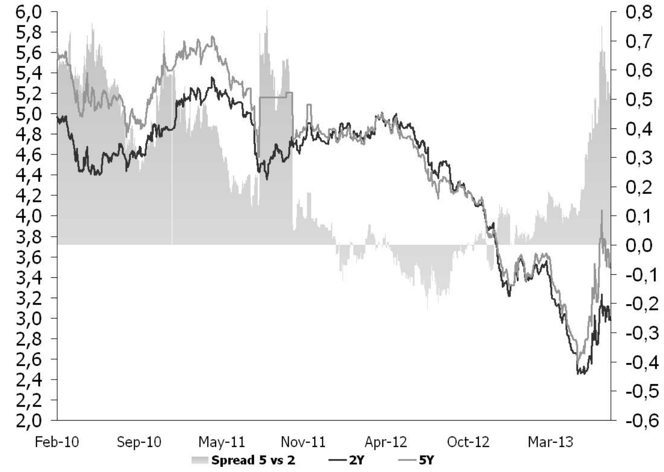
Changing sentiment

Fixed income market was very volatile in recent weeks. Last week volatility was still high but sentiment changed a few times and overall yields did not move much. There is a chance for some kind of vacation mood now. We got used to 'Fed's tapering story', there is limited bond supply from MinFin side and budget deficit, confirmed, but far from final announcements. Obviously, there are local data incoming, but with quite strong MPC statement about the end of the cycle, we think that market reaction should be limited here. This is why we expect the market to calm down next week, with a possibility of yields going down a little, just because of carry and stable client-oriented inflows.

Recommendation: Buy Oct16 bond on dips.

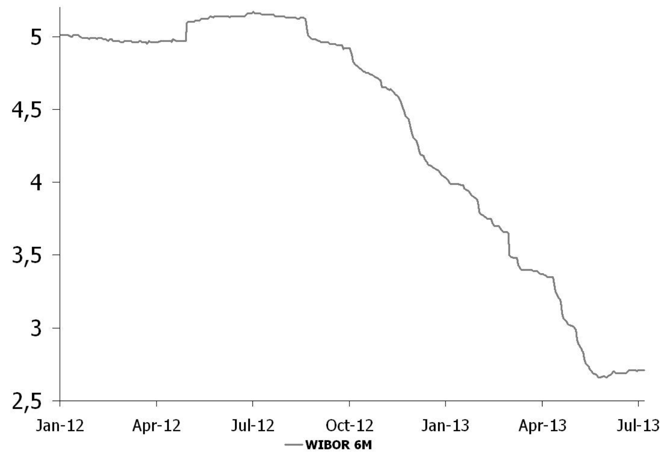


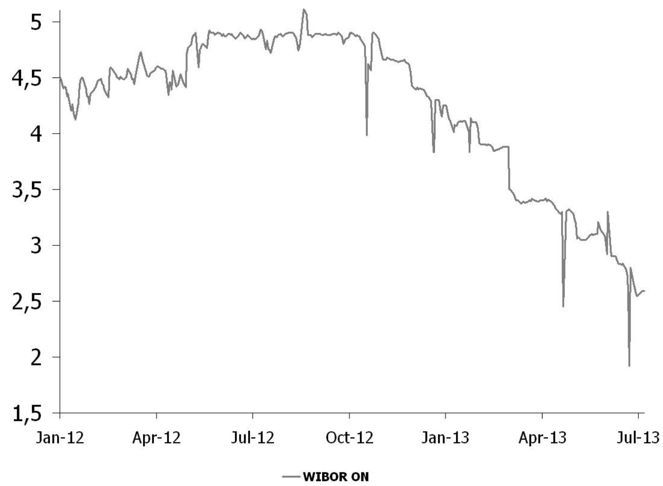


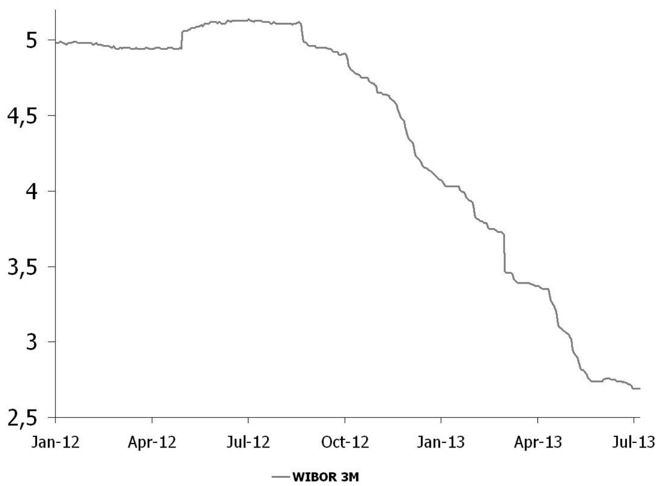


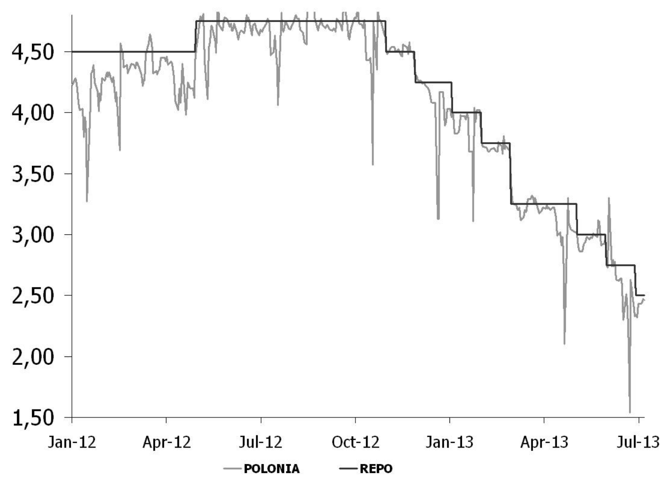
Money market

A new consensus Following last week's MPC meeting the market came to a consensus that rates will stay on hold for around 9 months and that only then there are some chances for a hike. Therefore, the OIS curve stays flat around 2,40 lvl until 9M tenor and around 2,47 in 1Y. Is it premature? Given the CPI projection and the time required to get back to lower band (1.5%) one may think so, although rates are really low now and comments from the dovish wing of MPC shows a consensus in leaving rates stable until year end. All in all, we see a slight value in receiving 9M and 1Y polonia as rate hike won't occur and there is always a chance they cut or just that the market will price it in.





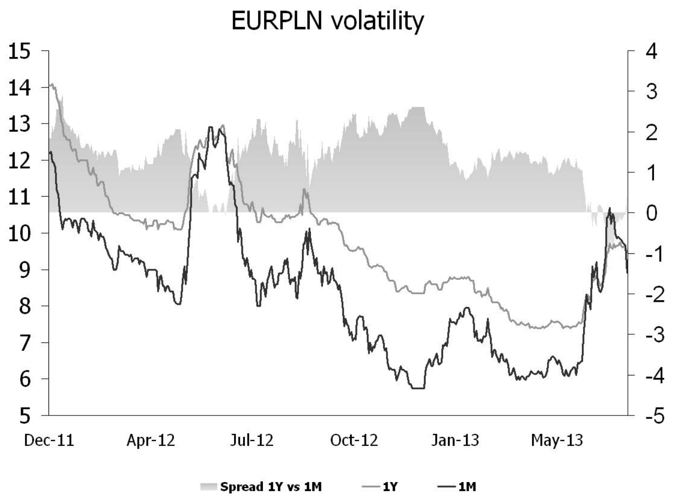




Forex

EURPLN trading sideways EUR/PLN fluctuated in the 4.27/4.35 range this week. The reaction to the market shocker produced by Bernanke was somehow muted. EUR/PLN was testing the support zone, namely 4.2950/4.3050, but so far it held well. It seems like the market still needs to digest the Fed announcement. The global is without a doubt the driving force for the PLN. Local factors, end of easing cycle, threat of CB intervention are PLN positive.

Volatility curve tic lower Sellers of Vega dominated this week. It started from a huge supply in the frontend (2 months EUR/PLN were given at 9.2% in amount close to 100 EUR). The whole curve moved down as a result. The 1 month EUR/PLN ATM fixed this Friday at 8.8% (1% lower than 1 week ago). The rest of benchmarks for EURPLN are 3 months 9.2% (0.5% lower) and 1 year 9.6% (0.1%)lower. The skew and currency spread (difference between USD/PLN vol and EUR/PLN vol), were both better offered.

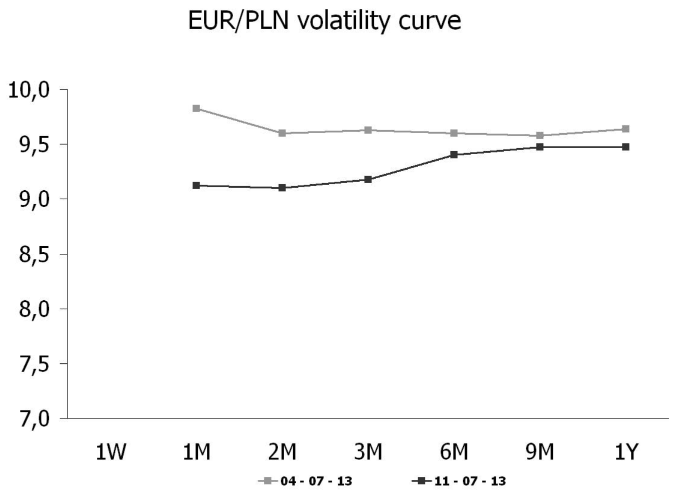


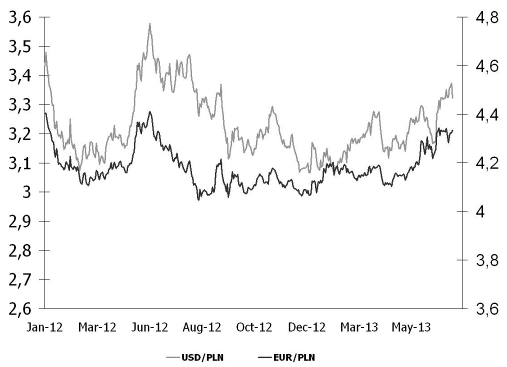
Short-term forecasts

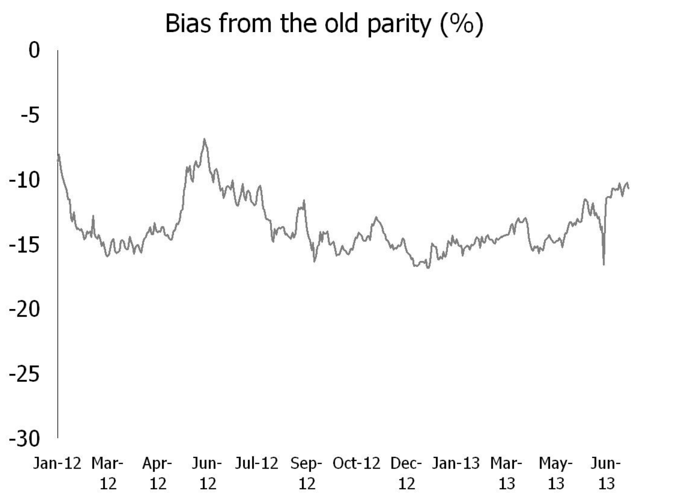
Main supports and resistances
EUR/PLN: 4.2200 / 4.3500
USD/PLN: 3.1500 / 3.4000

Sell EUR/PLN We think the market is bit tired with the upside. There is still the NBP with potential intervention, and after Bernanke the risk of tapering seems a bit more distant. We short 4.3350 ready to add 4.3550 with stop at 4.37 and hopes for 4.25ish...

Derivatives. The correlation between vols and spot is still really strong. Vols melted significantly from last week with stronger PLN. We believe it is worth to be selectively long Vega still (we prefer ATMS in 6 month to 1 year). We are also long downside gamma. Even if we are going to have a calmer holiday period ahead of us, sooner or later we would have to face the end of US money printing.







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
7/5/2013	2.44	2.69	2.61	6.49	2.81	6.59	2.68	2.69	2.76	2.88	3.10	2.87
7/8/2013	2.49	2.69	2.52	2.61	2.63	2.63	2.68	2.68	2.72	2.84	3.03	2.86
7/9/2013	2.47	2.69	2.62	2.61	2.84	2.63	2.66	2.67	2.68	2.80	2.96	2.82
7/10/2013	2.46	2.69	2.62	2.61	2.83	2.63	2.66	2.66	2.68	2.82	2.97	2.80
7/11/2013	2.47	2.69	2.59	2.61	2.71	2.63	2.68	2.67	2.69	2.80	2.95	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	OK0113	5Y IRS	PS0416	10Y IRS	DS1019
7/5/2013	6.590	3.353	3.292	3.275	3.420	3.351	3.630	3.873
7/8/2013	2.630	3.114	3.263	3.148	3.370	3.270	3.575	3.755
7/9/2013	2.630	2.992	3.218	3.137	3.325	3.237	3.525	3.759
7/10/2013	2.630	2.992	3.218	3.137	3.325	3.237	3.525	3.759
7/11/2013	2.630	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
7/5/2013	9.73	9.68	9.60	9.60	9.60	2.92	0.75
7/8/2013	9.70	9.63	9.60	9.65	9.65	2.92	0.75
7/9/2013	9.65	9.60	9.60	9.60	9.60	2.90	0.73
7/10/2013	8.91	9.20	9.38	9.48	9.48	2.81	0.73
7/11/2013	9.13	9.18	9.40	9.48	9.48	2.76	0.73

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
7/5/2013	4.2824	3.3245	3.4682	3.3242	1.4546	0.1656
7/8/2013	4.3105	3.3576	3.4811	3.3136	1.4609	0.1660
7/9/2013	4.3234	3.3588	3.4769	3.3189	1.4710	0.1675
7/10/2013	4.3240	3.3724	3.4811	3.3709	1.4741	0.1670
7/11/2013	4.3345	3.3225	3.4949	3.3405	1.4775	0.1670

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