mBank.pl

December 13, 2013

Polish Weekly Review

Department of Economic Analysis
(research)

Ernest Pytlarczyk, PhD, CFA
chief economist
tel. +48 22 829 01 66
ernest.pytlarczyk@mbank.pl

Marcin Mazurek, PhD
senior analyst
tel. +48 22 829 01 83
marcin.mazurek@mbank.pl

Piotr Bartkiewicz
analyst
tel. +48 22 526 70 34
piotr.bartkiewicz@mbank.pl

Marek Ignaszak
analyst
tel. +48 22 829 02 56
marek.ignaszak@mbank.pl

Department of Financial Markets
(business contacts)

Bartlomiej Malocha, CFA
head of interest rates trading
tel. +48 22 829 01 77
bartlomiej.malocha@mbank.pl

Marcin Turkiewicz
head of fx trading
tel. +48 22 829 01 67
marcin.turkiewicz@mbank.pl

Department of Financial Markets Sales
(business contacts)

Inga Gaszkowska-Gebska
institutional sales
tel. +48 22 829 01 67
inga.gaszkowska-gebska@mbank.pl

Jacek Jurczyński
structured products
tel. +48 22 829 15 16
jacek.jurczynski@mbank.pl

mBank 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.mbank.pl

Table of contents

Our view in a nutshell page 2
Economics page 3
- CPI inflation falls due to low food prices and discounts in telecommunication services.

Fixed income page 4
- Keep calm and carry on

Money market page 5
- Liquidity stable with chances for lower carry till the end of the month

FX market page 6
- Frozen...
- Gamma in demand

Comment on the upcoming data and forecasts

The forthcoming week brings the release of monthly budget performance (on Monday), which should confirm the MinFin representatives' statements predicting this year's deficit to be lower than it was assumed in the budget amendment. The labour market data are to be released on Tuesday. The growth rate of average wages has most likely slowed down in November (to 2.6 % y/y) as a result of unfavorable calendar effects (-2 working days y/y). On the other hand, we expect the employment reading to show the first y/y gain in a long time, mainly due to base effects, however. The calendar effect was also a main force shaping industrial output in November (to be published on Wednesday) - according to our below–consensus forecast the growth rate of industrial output abated to a meager 0.5% y/y. Furthemore, the deflation of producer prices continued, as both exchange rates and commodity prices remained stable in November. The release of MPC's minutes on Thursday will be a non-event, as usual recently.

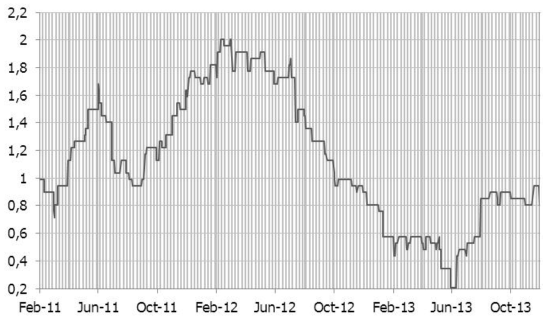
Polish data to watch: December 16nd to December 20th

Publication	Date	Period	mBank	Consensus	Prior
Core inflation y/y (%)	16.12	Nov	1.4	1.4	1.4
Mean wage y/y (%)	17.12	Nov	2.6	2.9	3.1
Employment y/y (%)	17.12	Nov	0.1	0.1	-0.2
Sold industrial output y/y (%)	18.12	Nov	0.5	1.6	4.4
PPI y/y (%)	18.12	Nov	-1.3	-1.2	-1.3
MPC Minutes	19.12	Dec			

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	-	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

Last week's gains erased by very low CPI reading from today (see the Economics section). Polish surprise index still without a clear uptrend. Next week brings a few releases from the real sphere but the potential for surprises is limited.

* 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.
- 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.
- The upswing has recently been driven by exports that behaves much better than in previous upswing episodes (Polish economy is more competitive and more geografically diversified). Consumption has already joined and we see no obstacles for its further, gradual strenghtening. We expect the support from investment activity to kick in more substantially at the start of 2014. Private investment is to be supported by receding uncertainty, public investment is to benefit from new EU co-financed projects.
- 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.
- 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 an upward sloping inflation path should eventually result in tightening.

Financial markets

- Short term we are constructive on Polish bonds up to the belly of the curve due to current low inflation, carry trades, neutral positioning and determination of global central banks to anchor official rates. For December we also like 5-10 year due to positioning of local investors and a perceived cheapness of the Polish curve. Temporary weakness of the data ahead (at a time when MPC is still in a nirvana state, preocuppied with strenghtening forward guidance instead of searching for signals of improving economy) is also supportive.
- 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.

mBank 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	0.9	1.7
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	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	1.0	1.9	2.2	2.3	2.3	2.4
Public Consumption y/y (%)	-0.1	4.3	1.7	2.0	0.3	0.3	0.3	0.3
Investment y/y (%)	-2.1	-3.2	0.6	1.0	1.5	2.5	3.5	4.5
Inflation rate (% average)	1.3	0.5	1.1	0.8	1.4	1.7	1.5	2.1
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	2.65	2.65	2.65	2.65	3.20
2Y Polish bond yields (% eop)	3.19	3.07	3.06	2.80	3.00	3.30	3.30	3.30
10Y Polish bond yields (% eop)	3.94	4.34	4.48	4.30	4.60	5.00	5.20	5.50
EUR/PLN (eop)	4.18	4.33	4.22	4.15	4.05	3.95	3.90	3.90
USD/PLN (eop)	3.26	3.32	3.12	3.07	2.99	3.10	3.20	3.25

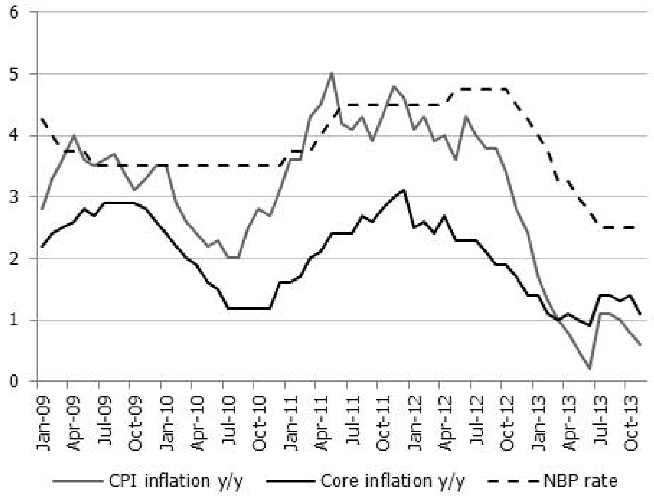
F - forecast

mBank.pl

Economics

CPI inflation falls due to low food prices and discounts in telecommunication services.

CPI inflation fell to 0.6% y/y in November from 0.8% y/y in the previous month (market consensus and our forecast amounted to +0.9%). Both the drop and the surprise are due to food prices and telecom services. In the former category we have just recorded another reading close to historical lows (+0.2% m/m), all the more surprising given the already very low October dynamics. Moreover, detailed real-time data actually indicated an upside risk for our forecast, eased only by releases from the Czech Republic and Hungary. The steep drop in communication services is a direct result of price discounts offered by operators. Other categories behaved more or less along with seasonal patterns or real-time data (fuels).



Core inflation dropped to 1.0-1.1% y/y from 1.4% y/y recorded in the previous month. However, it would have remained unchanged if telecom services were excluded. In our view, it is desirable to do so, as price declines in this category are related to deregulation and strategic price wars and have no direct relation to the state of the economy. Official core CPI data (to be published on Monday by the NBP) should account for this in certain series (CPI ex. most variable prices).

In the coming months CPI will gradually rise but should remain below the central bank's target and its lower band. Thus, rate hike expectation won't be generated by inflation. In December CPI should accelerate to 0.8% y/y. We are well aware (and the MPC will surely see that as well) that for now CPI will be driven mainly by base effects.

Nevertheless, inflationary pressures are going to build up, albeit slowly. Our GDP forecasts are generally higher than those of the NBP and we also rely on anecdotal evidence (supported by the movement of employment in basic services) that labor market starts to tighten, especially for blue collar workers. This is going to support a rising trend in core inflation. We also do not see evidence for continuation of benign behavior of food prices. Last but not least, negative statistical base generated by the last two inflation prints pushes inflation up at the end of 2014 – exactly when there will be a thorough discussion on the future shape of the Polish monetary policy.

FX market completely ignored inflation data. However, the reaction on the FI market was lively. Market rates outside the range of current forward guidance went down by about 10bp and corrected slightly thereafter by 5bp; the movement was bigger on bonds than swaps. Low inflation only supports and for some months is going to support the current equilibrium of low expected interest rates. It also corroborates the current consensus within the MPC and tendencies of rate setters to rather prolong than cut the period of expected stable rates. All this should support Polish short term debt. As for the longer dated papers, we expect them to become more immune to the movement in G3 space in anticipation of the Fed decision on Wednesday. Tactically, that is basically all. In longer horizon we do not change the call for rate hikes in the end of 2014 despite the fact that the market's view is drifting in the opposite direction. Neither we expect rate cuts, even when ECB decides to lose monetary policy further.

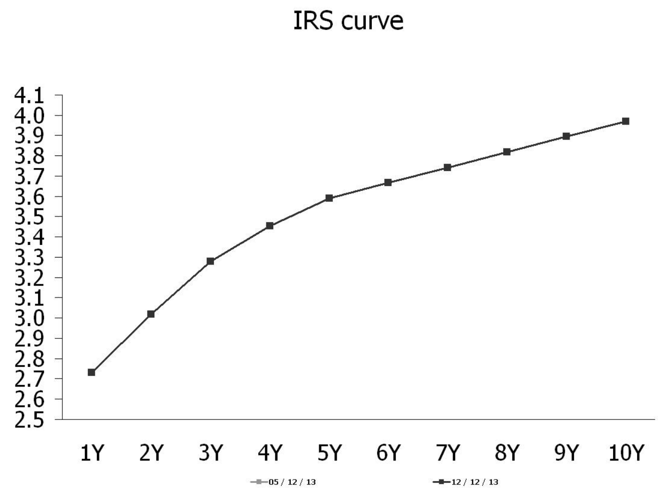
mBank.pl

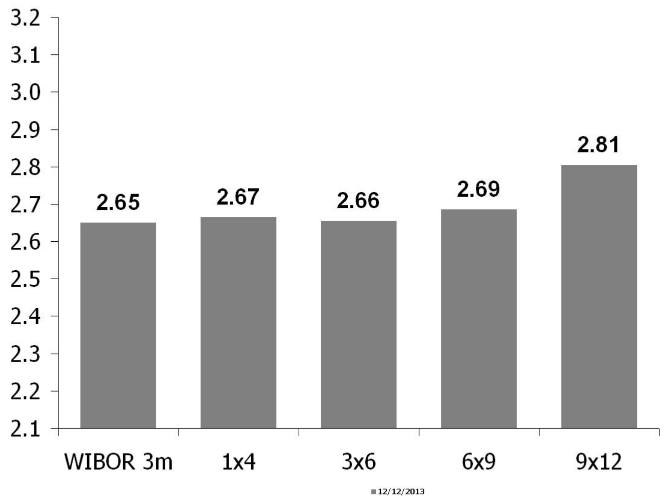
Fixed income

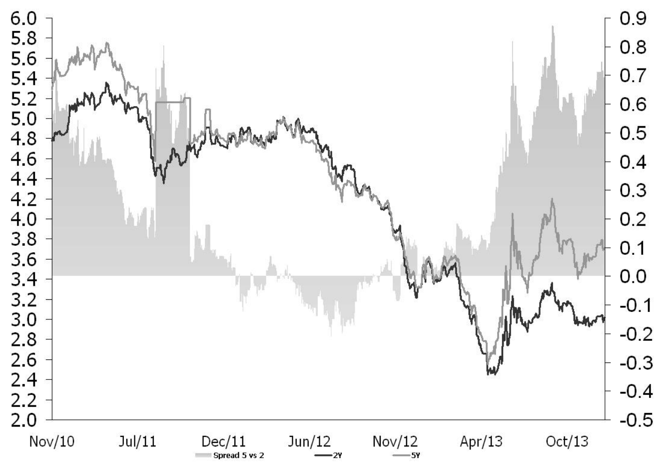
Keep calm and carry on

Neither good US economic data nor a bit more hawkish ECB's comments made the market lose faith in Polish bonds. We withheld 3.75% level on 5Y benchmark and thereafter recovered 10 bps to 3.65%. It's December, realized volatility fell to about 5% on a weekly basis (35% was this year's high), and we are starting to feel the smell of Christmas trees but... tapering woes still cool the market. Fairly? We know it may cause some (probably big) perturbations if finally push comes to shove but we also know that at least the US market seems well prepared to deal with it. We also know that having it later than sooner is going to limit any impact.

We keeps our view then: keep calm and carry on. Still 5y looks the best.





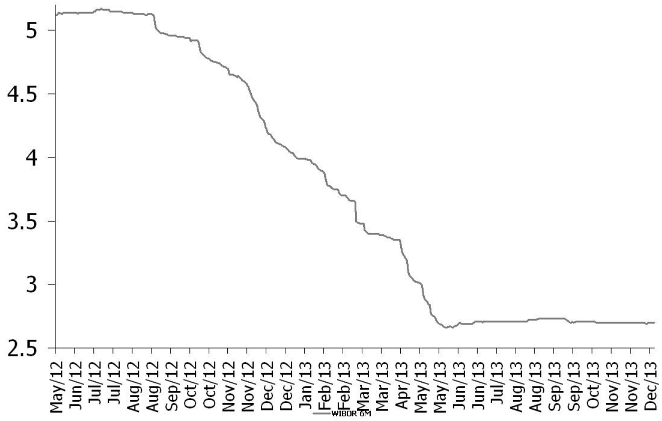


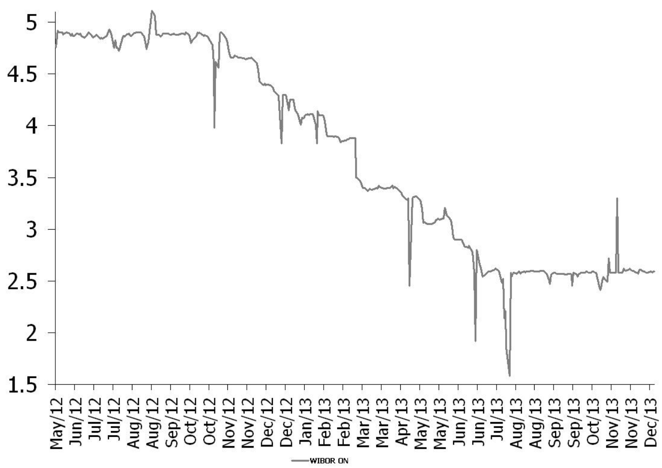
mBank.pl

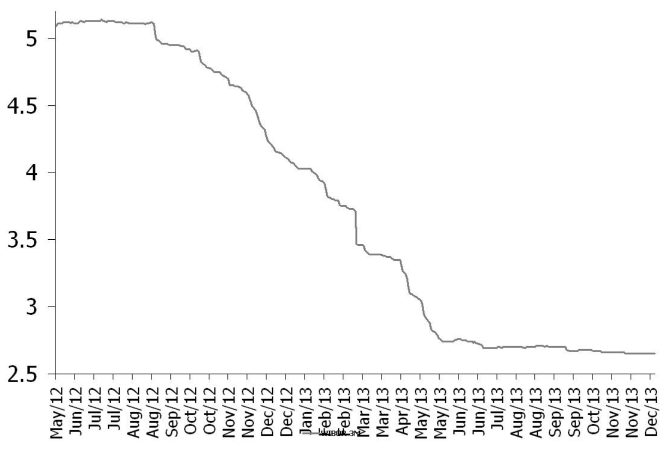
Money market

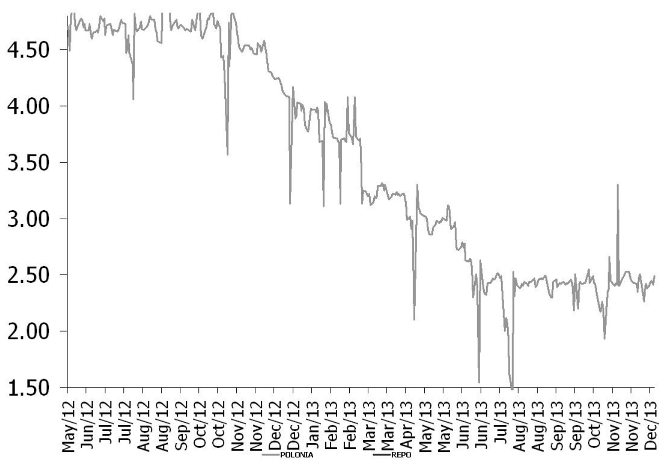
Liquidity stable with chances for lower carry till the end of the month SLiquidity stable nearby the main market rate. We see some potential for lower cost of carry next week and till the end of the month, since risk aversion is growing before holidays and the end of the year. Additional OMO likely next week since today market bought 5 bln less money bills then was on the offer side by the Central Bank. Nevertheless the demand should be decreasing.

Fed crucial for futher sentiment on local debt CPI figure much below consensus (0.6% vs 0.9% expected) mainly on food and telecoms. It pushed the front end down rapidly and then the market stabilised half way. Next week Fed is going to be crucial for local rates. Tapering in December risk is being discounted in higher and higher scale. This could cause sharp sell off on bonds, but initial reaction should be only temporary. No tapering (our base scenario) should support local debt nicely in current trend.







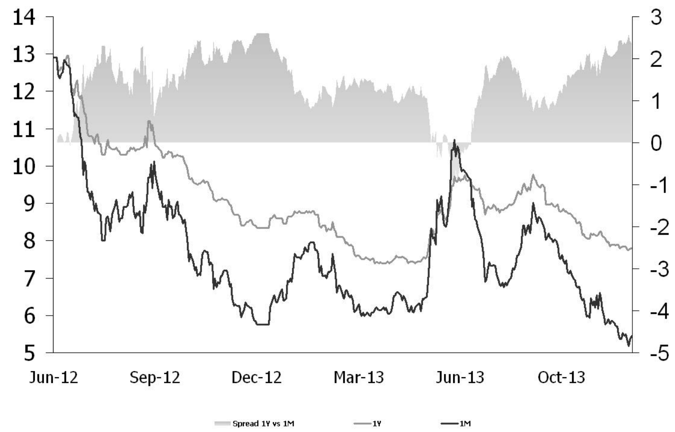


Forex

Frozen... 4.2050-4.1750 constitutes this week's range. Nothing to report really. The market is happy to sit on its hands with a „waiting for the Fed" excuse. But to be honest, if they do not taper or taper in a gentle way, we will have a small recalibration, few figures right/left, and them back into coma. We do not see any momentum in EUR/PLN at the moment. Nothing obvious is also on the horizon to create it.

Gamma in demand The market was all about purchasing Gamma before the Fed. Short term options expiring day or two after the Fed, strikes 4.16, 4.1750, 4.20, you name it, all was in high demand pushing 1 week 2% vols higher. The rest of the run hardly changed. 1 month EUR/PLN ATM mid is still 5%, 3 months 6%, 6months 6.7% (0.05% lower) and finally 1 year now is 7.7% (0.1% lower). The currency spread (difference between USD/PLN vol and EUR/PLN vol) is higher roughly by 0.25-0.5%... also because of the Fed, and USD driven rise in volatility. The skew is unchanged from last week.

EURPLN volatility



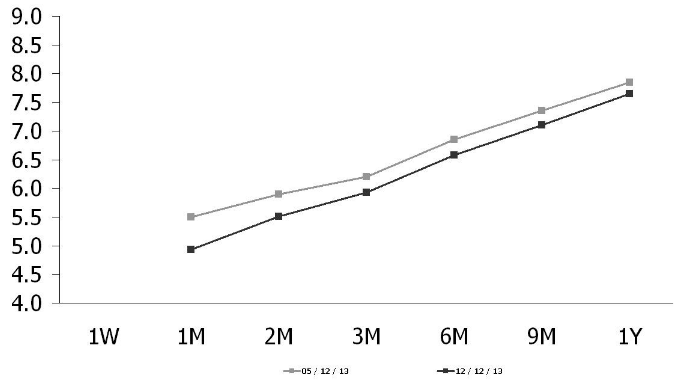
Short-term forecasts

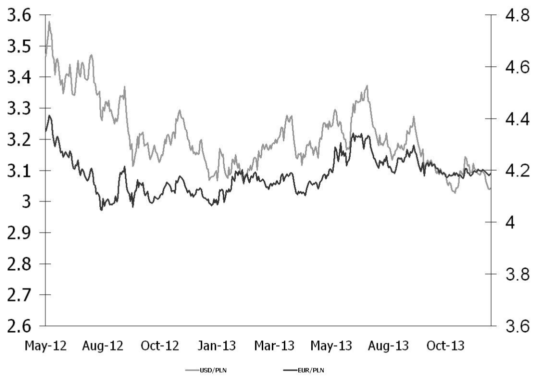
SPOT Main supports / resistances:
EUR/PLN: 4.1400 / 4.2200
USD/PLN: 3.0000 / 3.2000

Stay aside / fade extremes We have decided to change attitude. With such tight ranges and heavy positioning, market is 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.

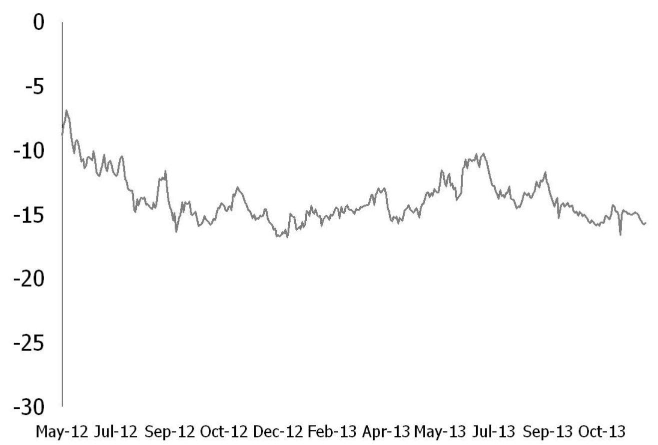
Cautiously long backend We still long backend EUR/PLN. It is still modest long, and we also still have some shorts in the frontend. And not to muddle the view, we have to confess that we don't see any obvious volatility triggers on the horizon. The realized volatility is not really encouraging buyers. The vols are cheap and even though they may stay here for the time being we think the risk reward is skewed to be long backend Vega.

EUR/PLN volatility curve





Bias from the old parity (%)



mBank.pl

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
12/6/2013	2.46	2.65	2.61	2.60	2.82	2.65	2.64	2.65	2.70	2.84	3.06	2.81
12/9/2013	2.50	2.65	2.60	2.60	2.83	2.65	2.67	2.65	2.70	2.82	3.01	2.78
12/10/2013	2.47	2.65	2.59	2.60	2.84	2.65	2.64	2.65	2.68	2.81	3.00	2.78
12/11/2013	2.45	2.65	2.50	2.60	2.55	2.65	2.67	2.66	2.70	2.81	2.99	2.79
12/12/2013	2.48	2.65	2.59	2.60	2.83	2.65	2.67	2.66	2.69	2.81	3.00	2.79

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
12/6/2013	2.650	2.415	3.043	2.914	3.790	3.770	4.300	4.535
12/9/2013	2.650	2.526	3.015	2.941	3.730	3.670	4.240	4.456
12/10/2013	2.650	2.403	2.970	2.910	3.690	3.636	4.190	4.427
12/11/2013	2.650	2.483	3.008	2.916	3.700	3.669	4.200	4.468
12/12/2013	2.650	2.515	3.018	2.891	3.710	3.700	4.205	4.439

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
12/6/2013	5.30	6.10	6.75	7.75	7.75	2.56	0.64
12/9/2013	5.18	6.13	6.75	7.75	7.75	2.56	0.64
12/10/2013	5.35	6.10	6.78	7.78	7.78	2.56	0.72
12/11/2013	5.45	6.20	6.80	7.80	7.80	2.56	0.63
12/12/2013	4.94	5.93	6.58	7.65	7.65	2.55	0.64

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
12/6/2013	4.1925	3.0673	3.4238	3.0021	1.3870	0.1526
12/9/2013	4.1883	3.0534	3.4211	2.9623	1.3914	0.1523
12/10/2013	4.1822	3.0425	3.4181	2.9474	1.3894	0.1524
12/11/2013	4.1803	3.0386	3.4221	2.9661	1.3859	0.1524
12/12/2013	4.1878	3.0415	3.4252	2.9588	1.3803	0.1527

Disclaimer

Distribution and use of this publication The review note is based on the information available to the public. This review creates exclusively a marketing information as defined in Paragraph 9 Section 1 of the Decree of Minister of Finance dated November 20, 2009 on procedures and conditions to be followed by investment firms and banks mentioned in Article 70 Section 2 of Law on Trading in Financial Instruments dated July 29, 2005 as well as by custody banks. This review note is provided to you for information purposes only and is not intended as advice on any particular matter or as recommendation, offer or solicitation for purchase of sale of any financial instrument and should not be taken as such. mBank SA, its directors, officers, executives, managers, servants or agents expressly disclaim all liability to any person in respect of any-thing, and in respect of the consequences of anything, done or omitted to be done, wholly or partly, in reliance upon the whole or any part of the contents of this review note. The opinions and estimates contained herein reflect the current judgment of the author(s) on the date of this document and are subject to change without notice. The opinions pointed in review do not necessarily correspond to the opinions of mBank SA. The past performance of financial instruments is not indicative of future results. No assurance can be given that any financial instrument or issuer described herein would yield favourable investment results. mBank and/or its principals or employees may have a long or short position or may transact in the financial instrument(s) and/or securities referred to herein or may trade in such financial instruments with other customers on a principal basis. No client or other reader should act or refrain from acting on the basis on any matter contained in it without taking specific independent professional advice on the particular facts and circumstances in issue. Copyright protection exists in this publication and it may not be, even partially, reproduced of distributed without the prior written agreement with mBank SA.

©mBank 2013. All rights reserved.