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Polish Weekly Review

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This is a special, two-week edition of Polish Weekly Review. We will be back in 2014.

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Comment on the upcoming data and forecasts

Forthcoming week brings the release of Statistical Bulletin, including retail sales and unemployment data, a coda to the November's macro figures. After the Ministry of Labour and Social Policy's preliminary estimates, we decided to slightly revise our unemployment rate forecast of down to 13,2%. The growth rate of retail sales most likely decelerated to 2.5%, due to the unfavorable working days difference (-2 y/y). Upward trends are intact, though. New Year brings two releases - Manufacturing PMI and quarterly revision of current account data. As for the former (obviously more important), we cannot put a number on our forecast yet but we expect another increase, as German and Eurozone PMIs surprised to the upside.

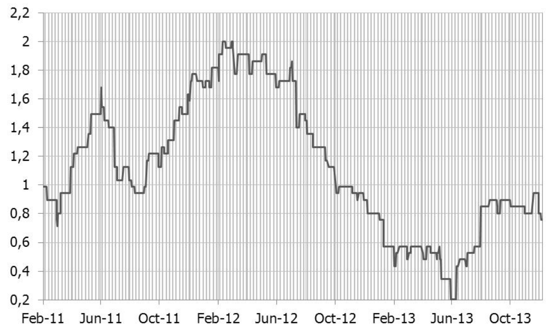
Polish data to watch: December 23rd to January 3rd

Publication	Date	Period	mBank	Consensus	Prior
Retail sales y/y (%)	23.12	Nov	2.5	3.3	3.1
Unemployment rate (%)	23.12	Nov	13.2	13.2	13.0
Inflation expectations (%)	31.12	Dec	0.6	0.7	0.7
Manufacturing PMI (pts.)	02.01	Dec		54.8	54.4
Current account (m EUR)	02.01	Q3		-2303	362

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

Lots of releases, only one slightly negative surprise in PPI data. Thus, Polish surprise index continues to move sideways. Note, however, that almost all negative surprises are generated by inflation-related data. Real sphere is surprising on the upside.

* 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, 2.9% 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%. Consensus view has been converging to our bullish scenario.
- 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 see potential for upside surprises in 2014, though.
- 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

- Price action on Polish bonds was probably distorted by local investors at the end of the year. 5-10 year sector looks rich now.
- 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 long end 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	1.5	3.3
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	2.7	2.9	3.0	3.4	3.7
Individual consumption y/y (%)	0.0	0.2	1.0	1.9	2.6	2.5	2.5	2.8
Public Consumption y/y (%)	-0.1	4.3	1.7	1.2	1.0	0.3	1.9	2.5
Investment y/y (%)	-2.1	-3.2	0.6	4.0	6.0	8.0	8.0	8.0
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

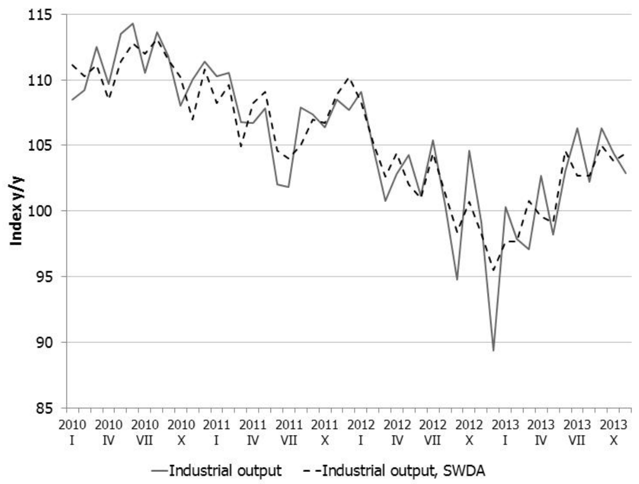
Economics

Upwswing strenghtens

Last week brought us data on labor market and manufacturing. Also the MPC took its opportunity to attract our attention with the publication of „Minutes", however, the lecture was rather uninspiring and we feel more and more confident that rate setters are likely to be caught off guard when growth accelerates, and – more importantly – inflation surprises to the upside. As for the aforementioned data, we skip elaboration on labor market figures as they merely confirm the positive trends. We instead offer a take on industrial output and construction since they seem to become the power horse of the current upswing and somewhat surprise even our above-market expectations. Q4 GDP surprise (2.7-3.0%) can now be taken for granted. However, markets behave as if the possibility of higher rates did not exist. Higher growth and inflation in 2014 are set to challenge this view and lead to rate hikes at the end of 2014.

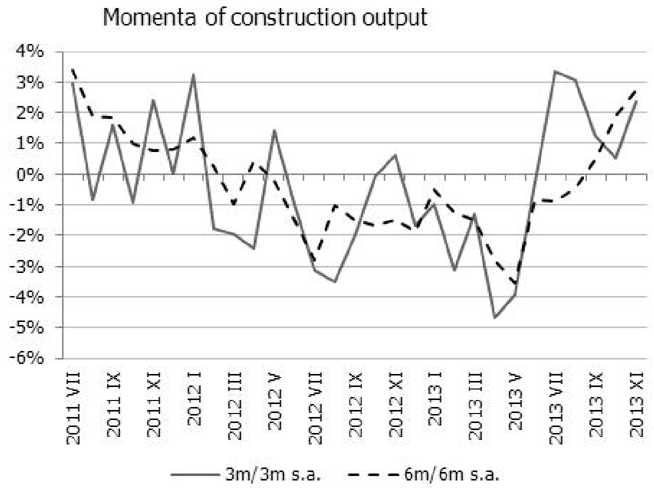
Just before we proceed to the details we would like to wish you all Merry Christmas and eventful 2014!

Industrial output grew by 2.9% y/y in November, little changed from the October reading of +4.4% y/y. This happened despite a very unfavorable working day effect (-2 y/y) which suggested – if one assumed a flat trend or momentum - a reading within a 0-1% range. This suggests a significant acceleration in industrial activity which wasn't reflected in seasonally adjusted data, though (+4.4% y/y and -0.3% m/m). The latter surprised us once again but we advise not to read too much into it since seasonal adjustments are statistical office's Achilles' heel. The sectoral breakdown is very similar to the previous month's – a mix of exports-oriented industries (cars and motor vehicles, other transport equipment, furniture, electrical equipment) and industries producing mainly for the domestic market (rubber and plastic), incl. construction (basic metals). At the moment the drag comes only from industries in structural decline (pharmaceuticals, computers and electronic equipment).



The drop in industrial output dynamics is a minor hiccup in an otherwise quite impressive upward trend. In December, due to calendar effects and low statistical base from last year (December '12 marks the bottom of the cycle in most industries), industrial output should grow in a two-digit pace, perhaps by 12% or more. Along with very good data from the construction sector, the release suggests that the economy will grow by an impressive 2.7-3.0% y/y in the fourth quarter.

Paradoxically, the biggest surprise in the release came from construction, which – despite significant negative calendar effects and last year's statistical base – declined in November only by 2.9% y/y (whereas our forecast as well as consensus totaled to well below -10%). Ex post such a good reading of construction could be attributed to the unusually high temperatures in November, which boosted construction works and enabled to replicate very good reading from November last year (unfortunately such effects are hard to capture ex ante). Seasonally adjusted data: -4.2% y/y, i.e. lower than rough data, are strikingly counterintuitive and we would like to focus rather on accelerating momentum in construction (c.f. the graph below). It confirms our view that construction sector will be one of the factors that will contribute to the growth of Polish GDP that is higher than currently reflected in the consensus.

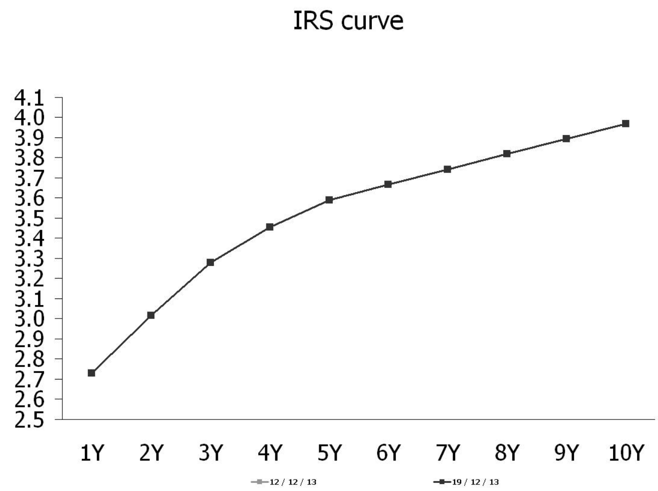


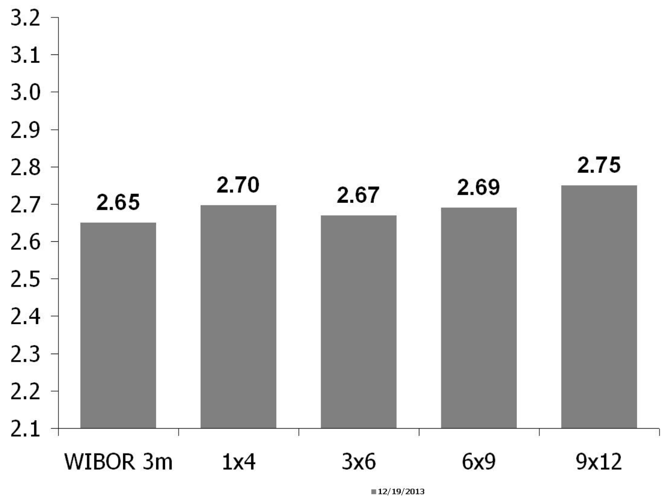
Fixed income

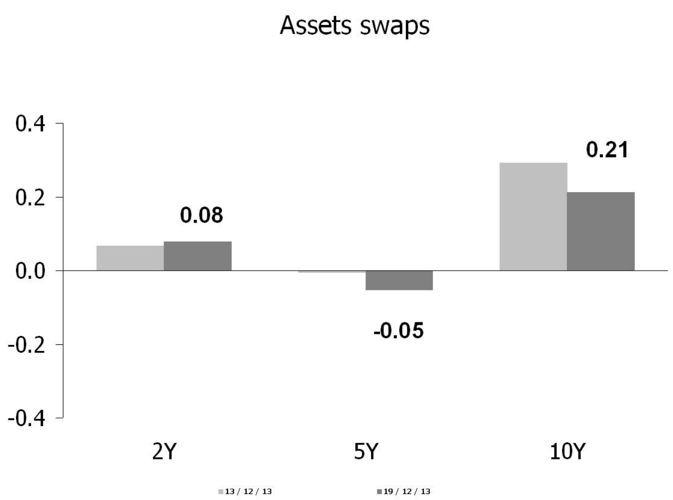
Mission accomplished

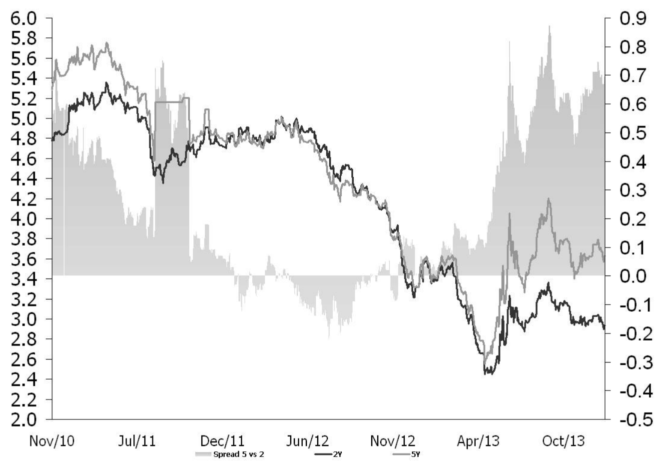
So, year 2013 is almost history now. It was a very exciting one on fixed income, despite record low repo rates we have seen sharp price declines, especially on long end of the curve. Changes in Polish pension funds system are definitely going to affect next year's activity on the market. At the end of the year we also got our 'tapering', maybe not complete, but at least started. Market was well prepared and it did not cause any panic selloff, there was even some decent demand for long end bonds, so our repeated recommendation (buy 5Y bonds) at last paid off.

We do not think there is a chance for more positive sentiment at the moment at least from market perspective. That is why we suggest to close any risky positions and prepare for Merry Christmas!



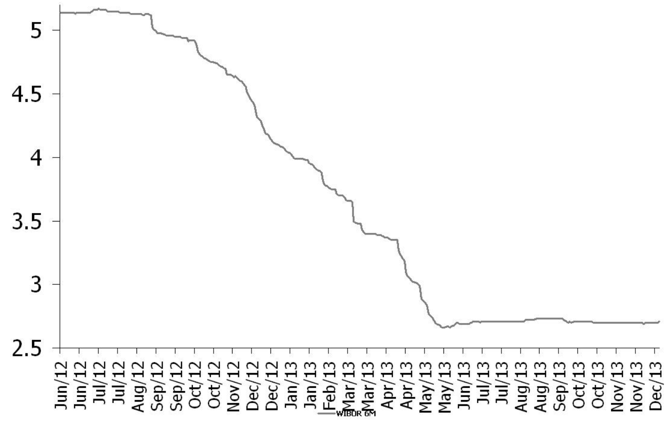


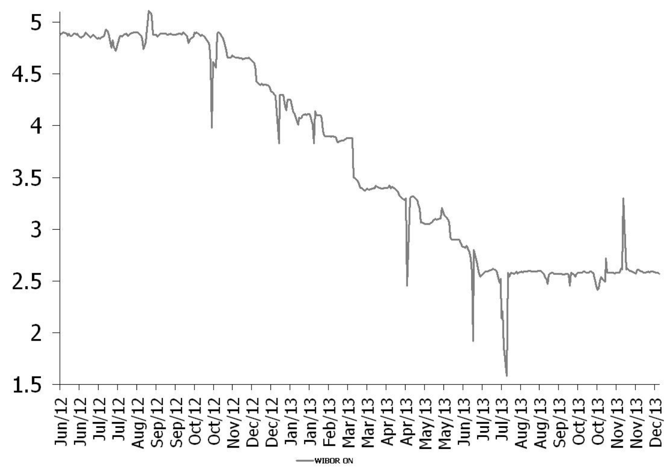


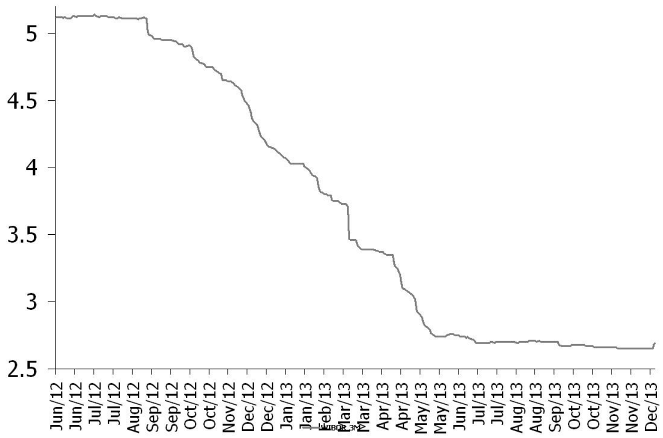


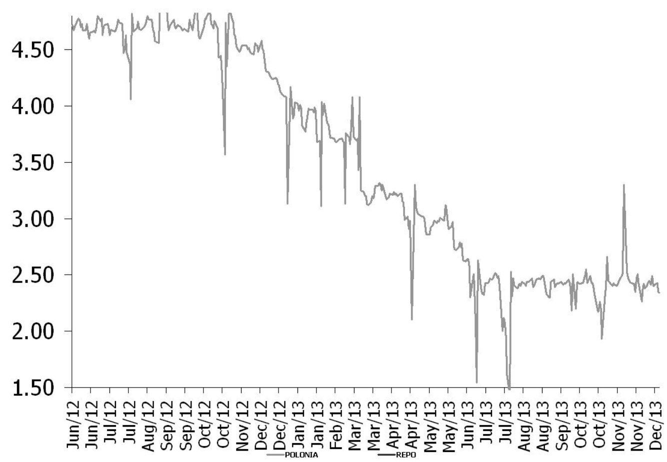
Money market

Cheaper week Cheaper week while POLONIA fluctuated around 2.38 as auction on 13th was underbid. Demand on today's auction was lower as well. Central Bank offered 127.5 bln money bills, and banks bought just 117. That might suggest very cheap next week or additional OMO on Monday.







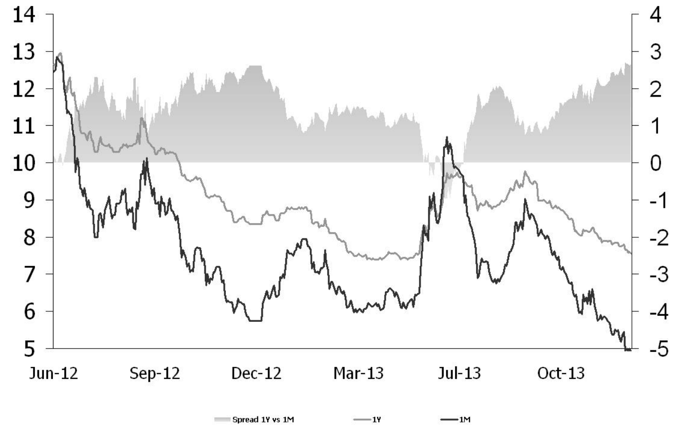


Forex

PLN stronger The glass can be always half empty or half full. Looks like the market has chosen to assume that the low rates in US are here to stay, and we should not worry about the beginning of tapering cycle. The glass is half full at least for PLN, where EUR/PLN finally crashed through the 4.17 support and looks ready to grapple with this year's low of 4.1450. The presence of state-owned bank on the offers is also helpful. The liquidity is changing from poor to worse, and think the year end price action is random.

Gamma for sell The bid for gamma in the frontend is all gone and the very distant memory already. The frontend got sold massively, with the 1 week being the biggest victim (2% lower). 1 month EUR/PLN ATM mid is fixing at 4.5% (0.5% lower then last Friday), 3 months EUR/PLN is 5.7% (0.3% lower), and 1 year – 7.6% (0.1% lower). In theory, the currency spread should be better bid after Fed's announcement but it has not, as it is the only thing left to sell to cover Theta bills. Skew roughly unchanged, with 6 months EUR/PLN RR 25D trading at 2.0%.

EURPLN volatility



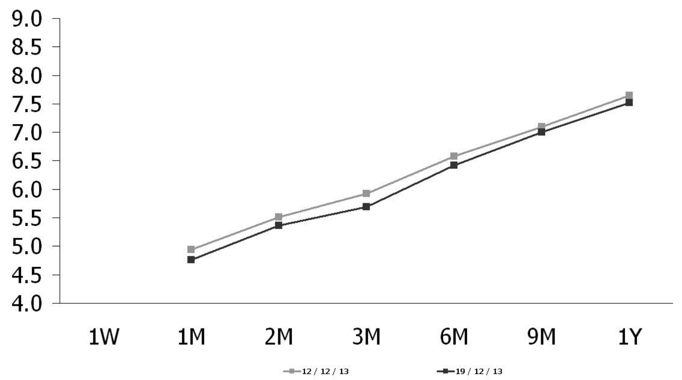
Short-term forecasts

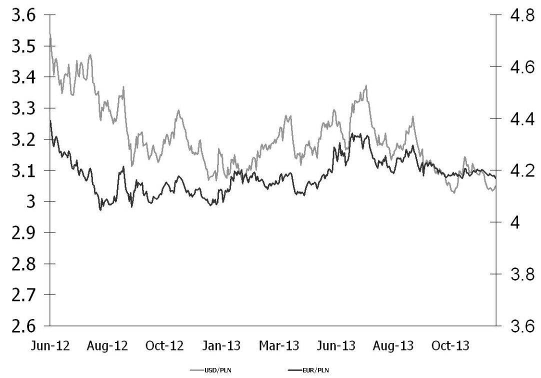
SPOT Main supports / resistances:
EUR/PLN: 4.1400 / 4.2200
USD/PLN: 3.0000 / 3.2000

Stay aside We are not getting too excited with the current slide in EUR/PLN. We see current market conditions as not playable, and as a consequence doing as little as we can till the New Year. The 4.12/4.15 may eventually get us in bottom-fishing mode, but that's only if. The government may also be tempted to do a little of window dressing tricks, pushing PLN stronger.

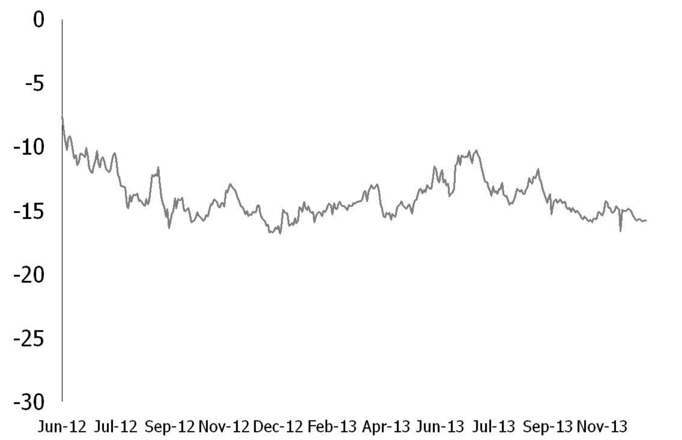
Cautiously long backend We closed the short gamma before Fed, which may have been logical but really unnecessary. The rest of the frontend shorts in Vega are about to expire soon, and we will be left with backend longs in Vega. We feel comfortable with it, as tapering is on and higher volatility should come in due time.

EUR/PLN volatility curve





Bias from the old parity (%)



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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
12/13/2013	2.50	2.65	2.57	2.60	2.82	2.65	2.66	2.66	2.68	2.79	2.96	2.79
12/16/2013	2.52	2.65	2.58	2.60	2.64	2.65	2.65	2.66	2.68	2.76	2.95	2.75
12/17/2013	2.55	2.65	2.60	2.60	2.65	2.65	2.65	2.66	2.66	2.76	2.91	2.72
12/18/2013	2.34	2.68	2.47	2.60	2.69	2.65	2.69	2.67	2.68	2.74	2.89	2.74
12/19/2013	2.52	2.69	2.64	2.61	2.85	2.65	2.70	2.67	2.69	2.75	2.89	2.75

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
12/13/2013	2.650	2.726	2.970	3.037	3.670	3.666	4.175	4.468
12/16/2013	2.650	2.732	2.953	3.020	3.625	3.568	4.125	4.391
12/17/2013	2.650	2.730	2.943	3.009	3.610	3.578	4.110	4.378
12/18/2013	2.650	2.718	2.900	3.002	3.570	3.539	4.070	4.329
12/19/2013	2.650	2.738	2.935	3.014	3.630	3.578	4.145	4.358

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
12/13/2013	5.00	5.93	6.58	7.65	7.65	2.55	0.72
12/16/2013	4.91	5.83	6.53	7.58	7.58	2.55	0.72
12/17/2013	5.00	5.78	6.50	7.60	7.60	2.55	0.65
12/18/2013	4.90	5.75	6.70	7.55	7.55	2.63	0.72
12/19/2013	4.76	5.69	6.43	7.53	7.53	2.55	0.71

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
12/13/2013	4.1844	3.0432	3.4228	2.9397	1.3795	0.1522
12/16/2013	4.1784	3.0350	3.4202	2.9461	1.3864	0.1517
12/17/2013	4.1788	3.0360	3.4212	2.9496	1.4008	0.1515
12/18/2013	4.1800	3.0393	3.4208	2.9550	1.3994	0.1510
12/19/2013	4.1700	3.0490	3.4055	2.9320	1.3966	0.1506

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