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Polish Weekly Review

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Comment on the upcoming data and forecasts

The monthly series of hard data begins with current account publication on Wednesday. Amid lower surplus on transfer account and slightly better income balance, the main driver of widening CA deficit is seasonal worsening of trade account. Friday brings some further publications. The CPI is expected to remain low as a result of abating fuel prices and subdued growth of food prices. The changes in administered prices (electrical energy and gas) offset each other and the effect of increasing excise tax on spirits may be spread over time, as the existing stock of beverages will be gradually leaving inventories. Furthermore, the GDP reading will most probably show that the economy expanded in Q4 at the decent pace of 2.9% yoy. However, the Friday's release won't present any details and we will have to wait two weeks more in order to obtain detailed structure of GDP growth. At last but not at least, money supply should continue recent trends, with retail deposits performing slightly better than last year, though.

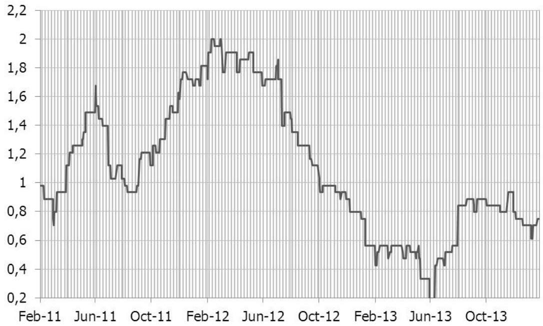
Polish data to watch: February 10rd to February 14th

Publication	Date	Period	mBank	Consensus	Prior
Current account (mio EUR)	12.02	Dec	-1106	-1279	-984
Exports (mio EUR)	12.02	Dec	11700	11550	13594
Imports (mio EUR)	12.02	Dec	12300	12091	13587
GDP y/y (%)	14.02	Q4	2.9	2.9	1.9
M3 y/y (%)	14.02	Jan	6.4	6.1	6.1
CPI y/y (%)	14.02	Jan	0.9	0.8	0.7

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 OK0716	-	1200	3.181	2/6/2014
5Y T-bond PS0718	2/13/2014	2400	3.474	1/23/2014
10Y T-bond DS1023	2/13/2014	4000	4.348	1/23/2014
20Y T-bond WS0429	2/13/2014	150	3.464	5/16/2013

Reality vs analysts' expectations (surprise index* for Poland)



Comment

Slightly up (and bounced off a local bottom) after a strong PMI release. Next week brings several releases but only CPI has the potential of surprising markets.

* 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.
- GDP growth accelerated to 3.0% in the final quarter of 2013. We are also bullish on 2014 and expect the Polish economy to grow by 3.5% (4% in the final quarter). 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

- We are constructive on Polish bonds (outright in a few month perspective and vs. German bunds in a longer perspective). The main reasons are positive Polish credit story (sustainable recovery, lower debt to GDP ratio due to OFE revamp, good chance of a rating upgrade) along with still dovish MPC and decent real yields.
- Correlation of Polish bonds with other EM countries ought to be much lower than in the past. At the end of the day, Poland should be seen rather as a satellite state of the euro zone, not a typical EM.
- Liquidation of OFE's bond portfolios changes the structure of Polish debt funding (higher percentage of foreign investors and possibly lower market liquidity). Thus, Polish bonds are set the be more than ever exposed to global trends (positive now and negative due to globally rising yields in H2).
- Zloty should gradually strengthen on the back of cyclical recovery in Poland. However, basket sell-offs (all EMs) might temporarily weigh negatively on the Zloty. Any depreciation is unlikely to be deep (as in the "Fragile Five") as Poland's fundamentals are comparably strong (record low CA deficit, high real rates, low short-term foreign debt, etc.). Let's not forget about the possibility of NBP interventions should things get out of line with reason.

mBank forecasts

	2009	2010	2011	2012	2013F	2014F
GDP y/y (%)	1.6	3.9	4.5	1.9	1.6	3.5
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	-1.7	-2.3
Unemployment rate (end of period %)	12.1	12.4	12.5	13.4	13.4	13.0
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	3.0	3.1	3.3	3.5	4.0
Individual consumption y/y (%)	0.0	0.2	1.0	2.0	2.5	2.5	2.5	2.8
Public Consumption y/y (%)	-0.1	4.3	1.7	1.2	2.0	2.0	2.0	3.0
Investment y/y (%)	-2.1	-3.2	0.6	1.3	4.5	5.9	7.1	8.0
Inflation rate (% average)	1.3	0.5	1.1	0.8	1.2	1.7	1.6	2.4
Unemployment rate (% eop)	14.3	13.2	13.0	13.4	13.9	12.6	12.4	13.0
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	2.71	2.65	2.65	2.65	3.20
2Y Polish bond yields (% eop)	3.19	3.07	3.06	3.05	3.10	3.10	3.20	3.25
10Y Polish bond yields (% eop)	3.94	4.34	4.48	4.35	4.30	4.50	4.80	5.00
EUR/PLN (eop)	4.18	4.33	4.22	4.15	4.15	4.10	4.05	3.95
USD/PLN (eop)	3.26	3.32	3.12	3.02	3.11	3.21	3.24	3.25

F - forecast

MPC keeps rates on hold. Belka remains dovish as inflation moves into focus.

Not surprisingly, the MPC put rates on hold last Wednesday. The main reference rate stands thus at 2.50%. Forward guidance remained unchanged (rates on hold until mid-2014). The statement also acknowledged additional signals of economic recovery, while stressing the lack of inflationary pressures and stable production costs.

Such a vision of non-inflationary economic growth was also prevalent during the Governor's press conference. Mr Belka confirmed signals of growth spilling over the economy. He remained, however, skeptical as to the labor market prospects and the possibility of accelerating wages. Here it is where we are not in agreement with Mr Belka, as we are seeing the first signs of tightening labor market and expect strong figures this year (at year end: employment +2% y/y, wages +4.5% y/y). While Belka was focused on economic growth in the previous conferences, this time he has put much more weight on low inflation. The latter, in his opinion, is not worrisome, on the contrary, it is a desired and comfortable situation, one that delays the mere thought of rising rates. The change in tone might be related to the recent shift in the balance of powers within the Council, now that the majority of the Council supports his pragmatic (and de facto dovish) monetary policy that rhymes well with the European environment of low rates and low inflation. Thus, it would be naive to think that the Council could signal tightening now. Belka distanced himself from Hausner's view and his team's super-optimistic forecasts and underlined that market pressures to raise interest rates were exerted upon high inflation EMs (obvuiously not Poland). Thus, the MPC is not going to fuel market expectations for several months.

While there is nothing strange in the lack of inflation in the early phases of economic recovery, we believe it cannot last forever. Polish enterprises are now mostly restructured and the fact that capacity utilization barely fell during the last downturn both are strong indications that investment and employment will increase in the coming months. When GDP accelerates to 4%, a significant increase in core inflation is very likely as well. In our view (CPI coming back to target) such a scenario will lead to rate hikes. It will, however, happen no sooner than in late 2014.

Fixed income

Bargain hunt

Besides the 'rationality' of recent market stories, we may find some patterns in its behavior. On one hand, the 'crisis' is hardly seen on weekly charts, on the other hand - volatility was traded at below average volumes.

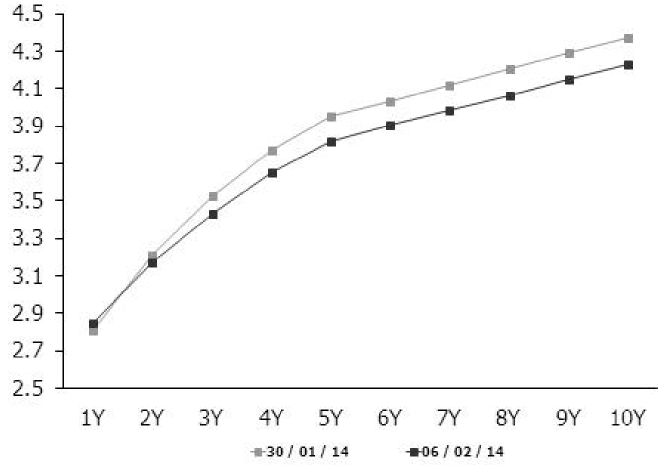
Regarding the first remark, it is obvious that Poland lays way closer to Germany than e.g. Turkey. It's simply hard to trade us apart from the fundamental view. As for the second remark, foreigners hold about 44% of outstanding POLGBs now. The lack of OFE assets, barely felt during everyday trading, forces us to redefine the market model. Seems we should trade higher Beta now! Higher, not necessary rational, volatility.

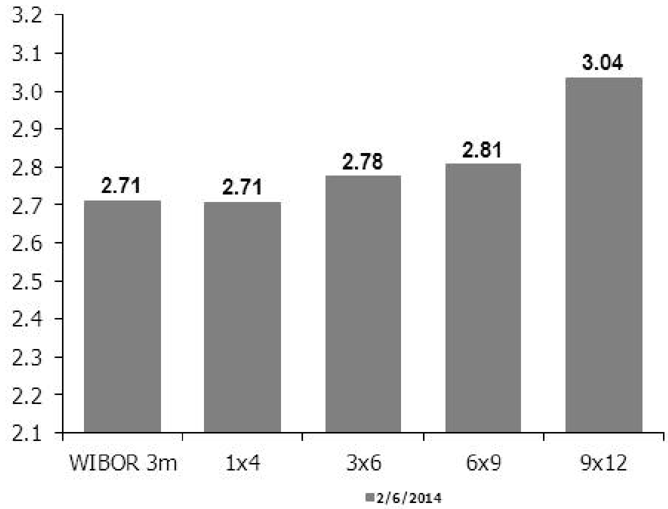
How it's gonna be, then? Until the MPC feels comfortable with current rate levels, we are skewed for the buy side. Last sell-off gave us a bargain to buy 3.30% on 2Y bonds and 3.70% on 3Y bonds - about 80 and 120 bps of positive carry while kind of forward guidance was set!

Now, with improved market sentiment, while the market buys back short bonds, we see 2.90 and 3.30 as exit levels. As Polish bonds trade closer to upper band of this move, if you missed this move, simply wait. Use the volatility... and hunt for bargains.

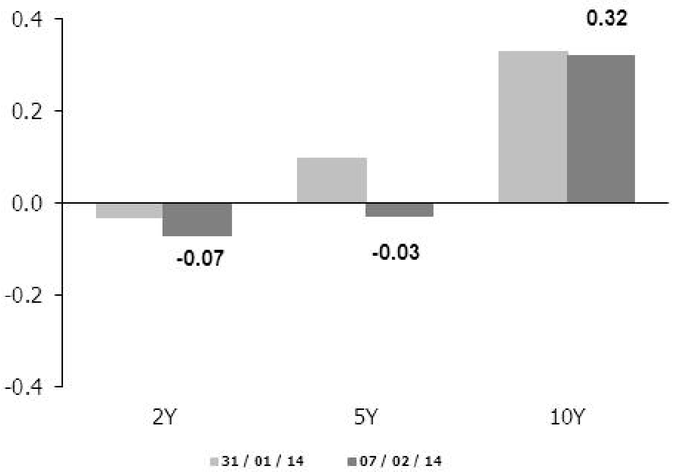
Recommendation: Take profit and wait with renewing long or keep position.

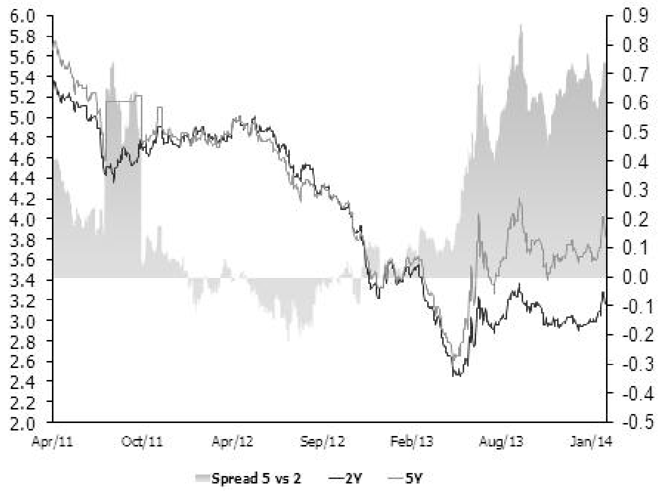
IRS curve





Asset swaps

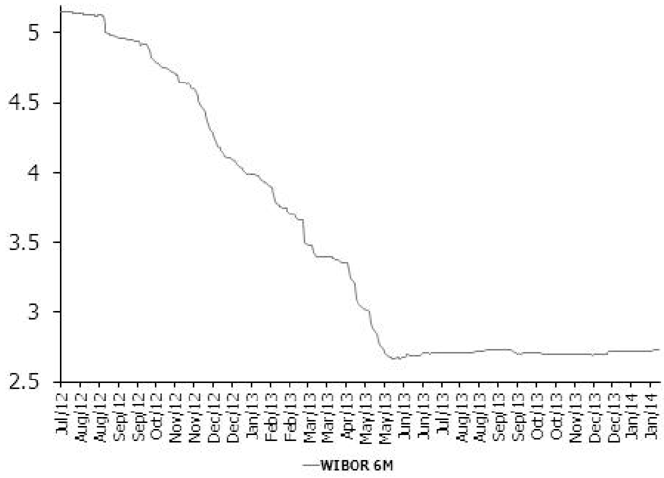


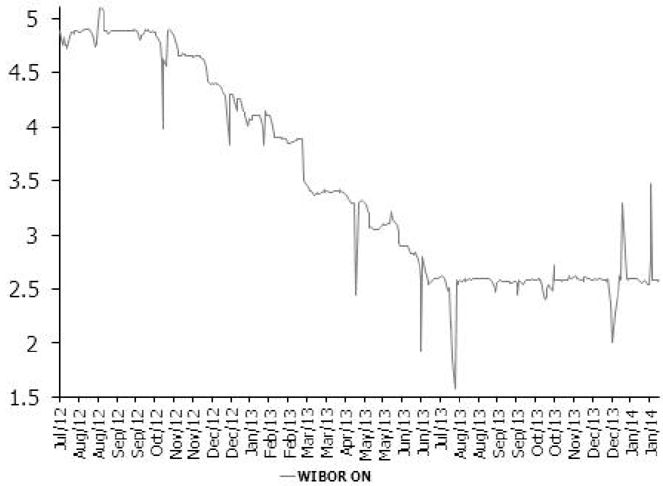


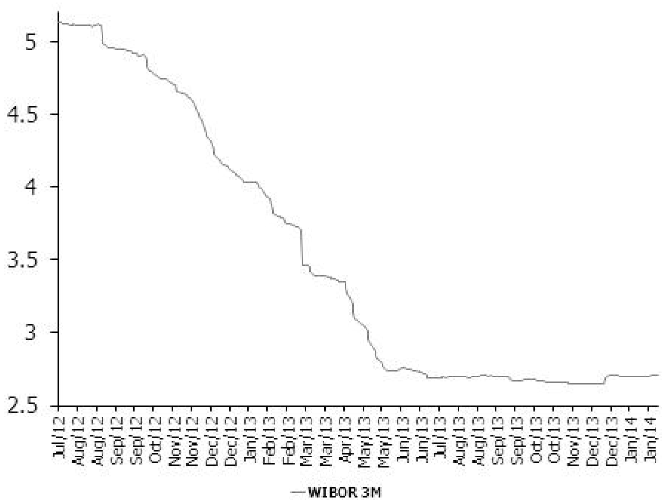
Money market

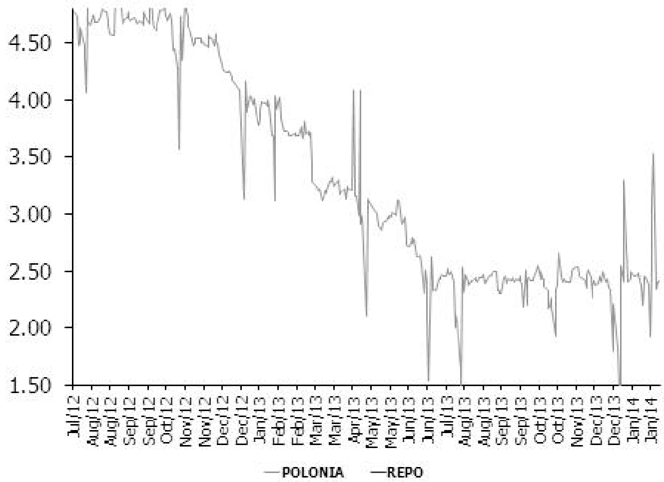
Quiet week on the Polish cash market Despite Friday's OMO (31.01) was underbid, cash rates haven't fallen and Polonia fluctuated around 2.42. Next week should be stable as well. After Pension Funds vanished from the REPO market, it is getting a bit harder to finance long bond positions and, surprisingly, it is easier to cover shorts.

Our recommendation is to buy short OIS (under 6M at 2.38 - 2.40), sell 1Y OIS (at 2.53 - 2.55) and 9*12 FRA (3.00 - 3.05).





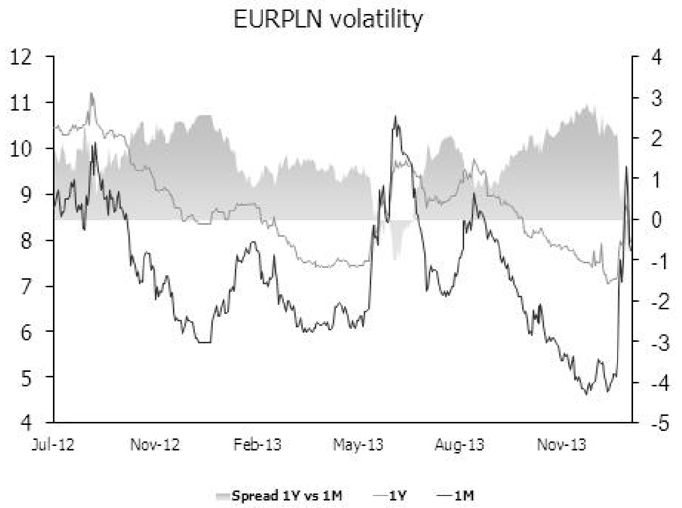




Forex

PLN rebound EUR/PLN tested 4.26 high last Friday only to fall hard to the 4.17 support this Friday. Well, to be very honest I don't think we should seek logic in this move. It is for sure connected with the positioning of the market participants. The market was long EM, so now it is much cleaner, with stop losses executed in various currency pairs. When the conviction of the global risk off got too well propagated, and the positions adjusted, we were going through stops on the other side. I'm afraid we are back in the "old range" now (4.14-4.20) and last weeks were just a bad dream.

Lower The correlation between vols and spot level is still strong, XXX/PLN vols were heavily offered with stronger PLN. The liquidity was poor, and after each trade, the curve was moving down almost by the whole spread. 1 month EUR/PLN ATM mid is now 6.8% (2.5% lower than last Friday), 3 months are now 7.1% (1.4% lower) and finally 1 year at 7.8% (0.8% lower). The realized volatility is still well above average so gamma should be supported for the time being. The skew was also better offered, with the currency spread roughly unchanged.

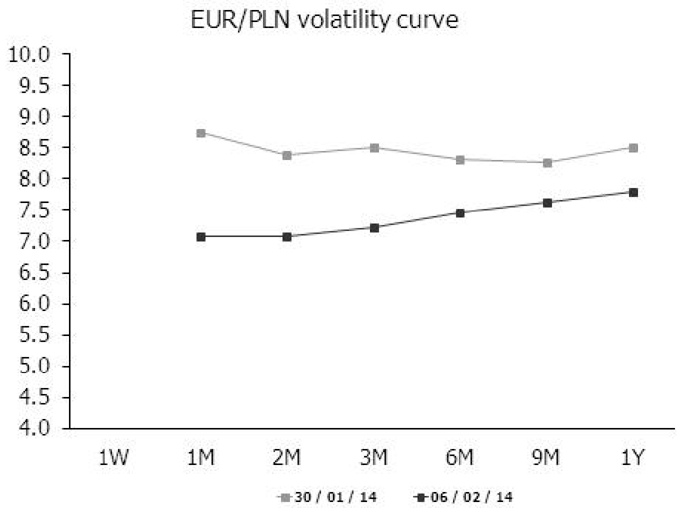


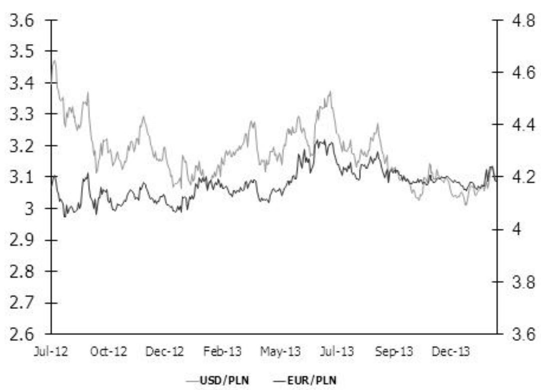
Short-term forecasts

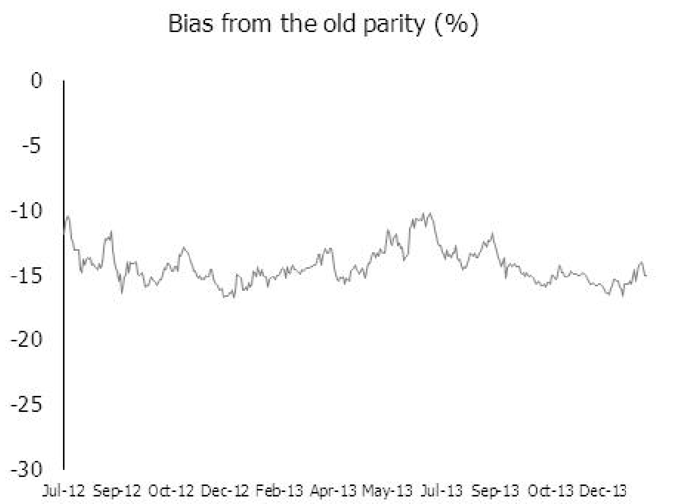
SPOT Main supports / resistances:
EUR/PLN: 4.1400 / 4.2000
USD/PLN: 3.0500 / 3.1500

Play range We were stopped in profit on our longs in EUR/PLN and USD/PLN. We will try to play 4.14 - 4.21 range for the time being. We are looking for the market to stabilize and find its new equilibrium.

Neutral Luckily we are tempted by grid to close our long in the backend when it was well in the money. We are now on the sidelines, and really rush into selling as the realized vol supports owning Gamma and far from trying to "buy the dip" as we think market will not be that easy to push into stops this time







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
2/3/2014	2.64	2.71	2.77	2.63	2.96	2.67	2.70	2.74	2.84	3.05	3.28	2.92
2/4/2014	2.62	2.71	2.75	2.63	2.95	2.67	2.73	2.75	2.83	3.01	3.23	2.91
2/5/2014	2.50	2.71	2.60	2.63	2.82	2.67	2.72	2.75	2.82	3.01	3.23	2.91
2/6/2014	2.60	2.71	2.72	2.63	2.94	2.67	2.71	2.78	2.81	3.04	3.20	2.91
2/7/2014	2.60	2.71	2.72	2.63	2.94	2.67	2.71	2.78	2.81	3.04	3.20	2.91

Last primary market rates							
Paper	Au. date	Maturity	Avg. price	Avg. yield	Supply	Demand	Sold
52W TB	3/4/2013	8/28/2013	98.33	3.49	3000	7324	3084
OK0716	2/6/2014	7/25/2016	92.60	3.18	1200	4594	1384
PS0418	1/23/2014	4/25/2018	101.00	3.47	2400	3160	2440
DS1023	1/23/2014	10/25/2023	97.25	4.35	4000	5290	4125

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0715	5Y IRS	PS0718	10Y IRS	DS1023
2/3/2014	2.670	2.882	3.230	3.179	3.960	4.062	4.370	4.682
2/4/2014	2.670	2.853	3.170	3.106	3.870	3.931	4.280	4.601
2/5/2014	2.670	2.782	3.175	3.127	3.835	3.904	4.240	4.548
2/6/2014	2.670	2.864	3.170	3.101	3.820	3.793	4.230	4.550
2/7/2014	2.670	2.864	3.170	3.101	3.820	3.793	4.230	4.550

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
2/3/2014	9.10	8.70	8.65	8.65	8.65	3.13	0.75
2/4/2014	7.93	7.85	7.90	8.10	8.10	3.13	0.75
2/5/2014	7.76	7.63	7.68	7.95	7.95	3.11	0.72
2/6/2014	7.08	7.23	7.48	7.80	7.80	3.04	0.72
2/7/2014	7.08	7.23	7.48	7.80	7.80	3.04	0.72

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
2/3/2014	4.2375	3.1370	3.4678	3.0791	1.3604	0.1540
2/4/2014	4.2140	3.1189	3.4489	3.0743	1.3575	0.1529
2/5/2014	4.1887	3.0987	3.4254	3.0624	1.3636	0.1521
2/6/2014	4.1860	3.0950	3.4227	3.0487	1.3604	0.1521
2/7/2014	4.1865	3.0857	3.4229	3.0202	1.3570	0.1521

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