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Polish Weekly Review

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Comment on the upcoming data and forecasts

Another batch of monthly macro releases is due next week. We expect wages to have accelerated in January on statistical base effects and very good momentum in manufacturing (which often leads the broader aggregate). The accompanying surge in employment will, however, reflect changes in CSO's sample and not necessarily a positive development in the real economy. Industrial output data are, again influenced mainly by working day effects (-1 y/y vs. +1 y/y in the previous month). We expect last month's negative surprise (related probably to the arrangement of holidays and weekends) to partly reverse and offset the negative working day effects. Producer prices, on the other hand, are bound to remain stable, both on y/y and m/m basis.

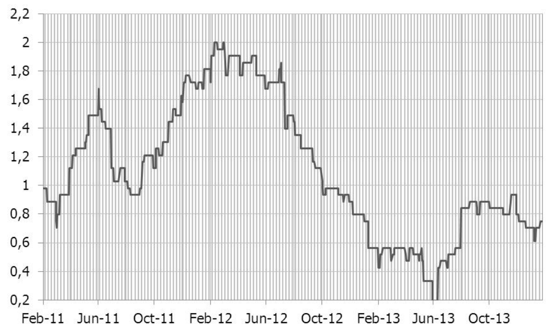
Polish data to watch: February 17rd to February 21th

Publication	Date	Period	mBank	Consensus	Prior
Budget performance YTD (%)	17.02	Jan			
Average wage y/y (%)	18.02	Jan	4.6	3.3	2.7
Employment y/y (%)	18.02	Jan	0.6	0.6	0.3
PPI y/y (%)	19.02	Jan	-0.9	-0.9	-0.9
Sold industrial output y/y (%)	19.02	Jan	3.8	3.5	6.6
MPC Minutes	20.02	Feb			

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	-	2000	3.882	2/13/2014
10Y T-bond DS1023	-	2000	4.541	2/13/2014
20Y T-bond WS0429	-	150	3.464	5/16/2013

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



Comment

Down after CPI data. For months now price data (CPI, PPI) have been bringing the index down, whilst real-sphere data (PMI, output) favoured increases. Next week is bound to be the same story (PPI and IP in focus).

* 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).

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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 2.7% 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	-1.5	-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	2.7	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

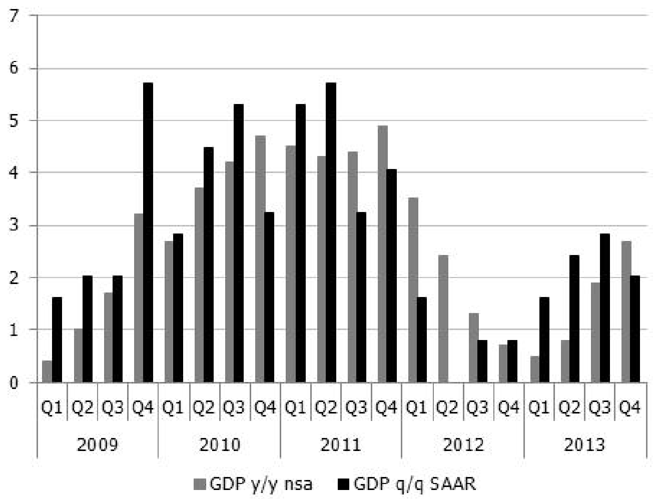
Economics

Another week in the Goldilocks zone

Recent publications (flash GDP and CPI) did nothing but reassured the MPC in its view on the economy and prompted a few optimistic comments from the Council members. GDP is accelerating nicely along the path set a few months ago and a 3.5% growth target this year is slowly becoming more and more likely. Inflation, on the other hand, remains virtually nonexistent. A perfect setup for stable rates continues. However, this Goldilocks economy, as we repeatedly indicated, will not last forever and something has to give. We believe it will be inflation and expect a significant re-acceleration in the second half of the year. Let's review today's releases in detail.

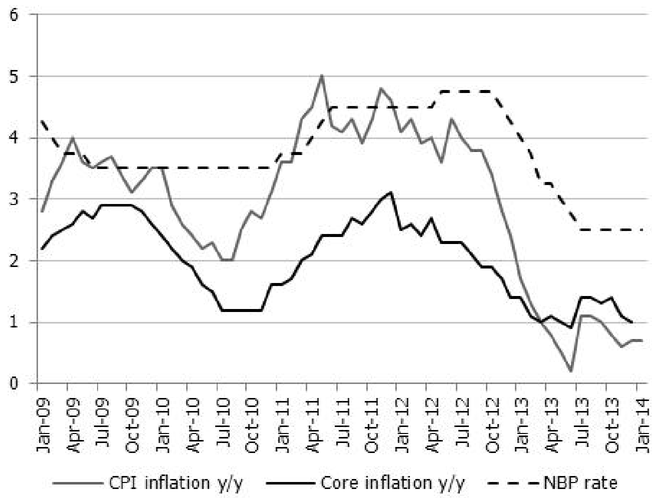
GDP on track, although slightly below expectations

GDP grew by 2.7% y/y in the fourth quarter, slightly below forecasts (consensus: +2.8%; our forecast: +2.9%). It should be stressed that these are preliminary data, subject to revisions (at the end of the month and in a more comprehensive manner in April). Thus we would not focus on slight deviations from the preliminary annual estimate (some information might not have been included in the latter). The most important takeaway is that the economy remains on a growth trajectory and with good momentum (q/q growth in Q3: 0.7%; Q4: 0.5%). The economy steadily accelerates on annual basis.



Inflation remains (very) low

In January consumer prices grew by 0.7% (our forecast: 0.8%; market consensus: 0.9%). Even though these are preliminary data and might be revised along with the introduction of new CPI basket, inflationary pressures are nowhere to be seen. As it is usually the case in January, we do not know the exact details of the publication, save for the fact that food prices grew by 1.4% m/m (in line with our calculations and regional releases), housing prices increased by 0.2% (gas price hikes had a bigger influence than the cut in electricity prices), clothing and footwear decreased by 3.9% (along the seasonal pattern). The only surprise can be found in the Transport category which declined by 1% - this perhaps is related to the January discounts on airline tickets. This, however, is a result of competition, not a weak economy.



CPI will grow in the coming months due to base effects and exogeneous factors (possibly higher food prices and delayed effects of alcohol excise hike). Even though the accelerating economy should be partly reflected in enterprises' pricing policies, standard transmission models suggest that only in the second half of the year can we expect purely endogenous reasons for higher prices to appear.

Bond yields fell after the CPI release (about 2 bps) but mainly on the front end, as compared to the GDP release which prompted a more even shift of the entire curve. The data reaffirm the current consensus within the MPC (growth without inflation in 2014). The March staff projections will further confirm that view (we expect a flat CPI path and a steeper GDP trajectory). In our view it is a temporary equilibrium and the Council will start raising interest rates at year end (which means that forward guidance will quietly expire) as the second wave of CPI growth kicks in - this time related to rapidly closing output gap. Nevertheless, the European context (a likely cut by the ECB amid deflationary risks) suggest that the Polish bond market should be viewed favourably (hence lower yields). The more so since Poland is vastly different than the EMs dubbed as 'fragile'.

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Fixed income

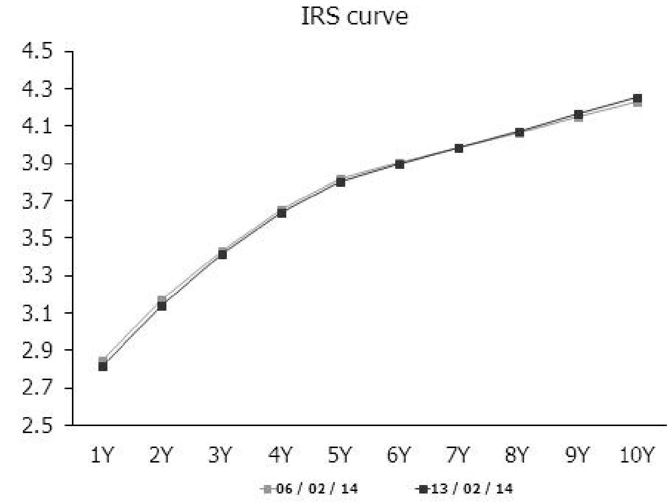
Listening to old stories

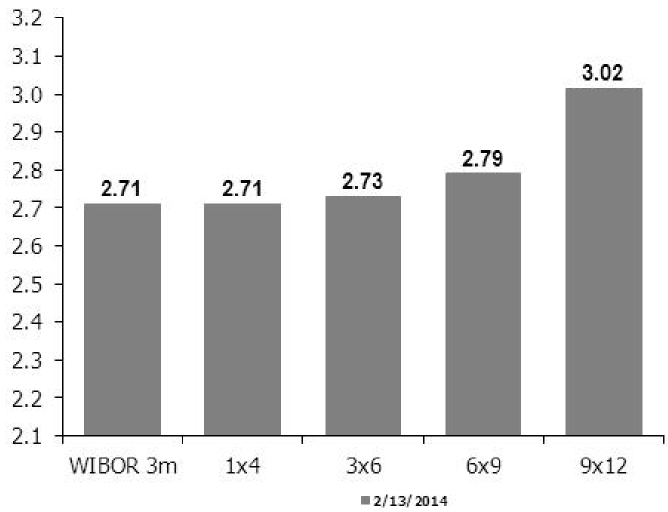
Old but refurbished. During the 1.5 months this year we have traded rates, credit, pension funds, tapering, slowdown and recovery. Haven't we already known about them?

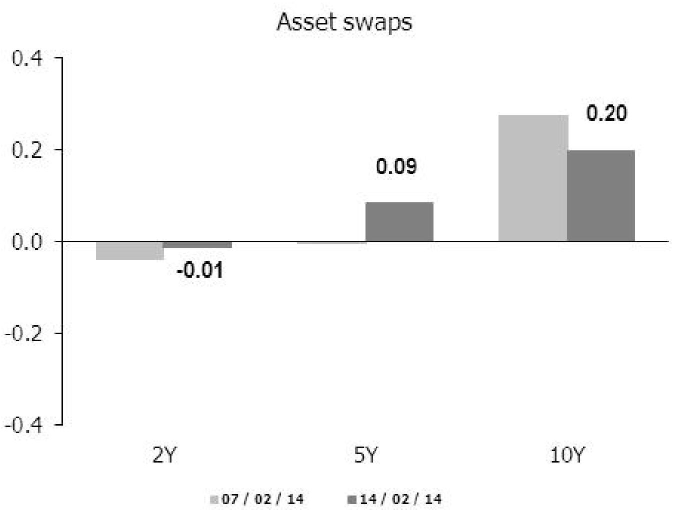
But somehow, apart from the tape being played at the moment, POLGBs trade within the very same range, let's say 10Y benchmark trades between 4.25-4.70 in yields (last 6M). Isn't the best strategy then to counter range boundaries by finding just a proper tone? Isn't a justified opinion that possible breaking out of this range would require a systemic change? Let's try to find such one.

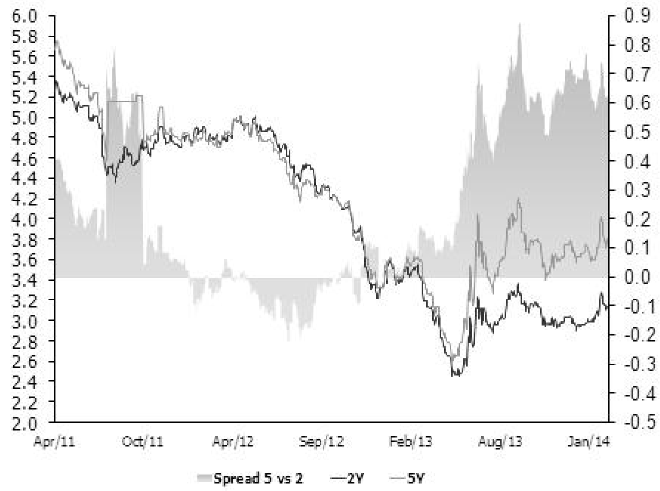
Local side - forward guidance, low CPI, decent GDP growth. Regional/Global - dovish ECB, neutral FED - both comfortable with rates, some bad credit on the EU. Result - NONE. Till forward guidance works, we will be skewed for long bond strategy. And we either felt comfortable (sic!) with the range defined above. But something in the back of my head tells me - those tapes were played so many times... it's very likely we may stick to current 'mid range' levels for longer. Does it change anything? NO.

Strategy remains the same: **Keep bonds.**





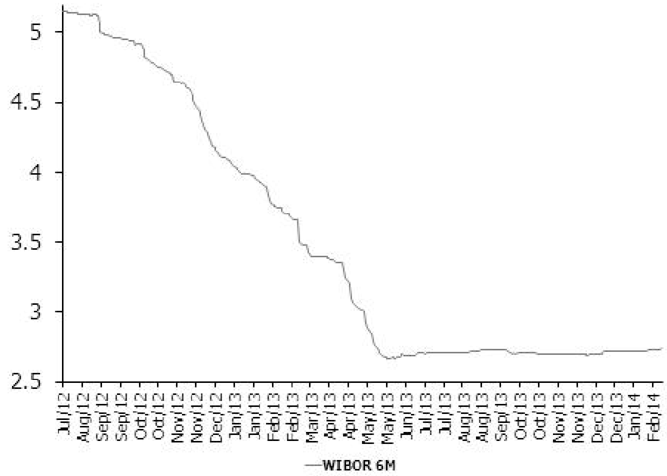


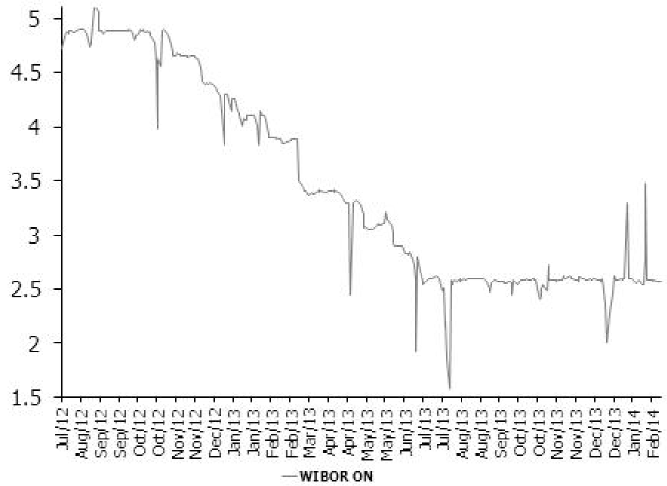


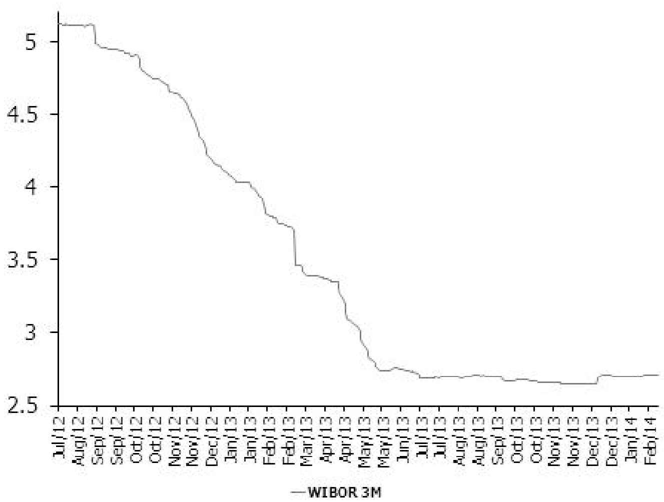
Money market

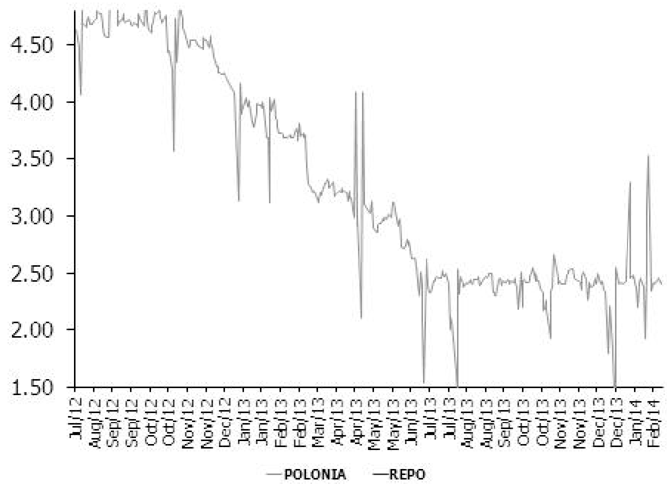
Stable week for short rates POLONIA fluctuated around 2.41 despite the fact that last week's OMO was underbid by 4 bn PLN. Today's OMO was underbid as well (by 5 bn PLN), but this time additional OMO on Tuesday is more likely as end of reserve is coming up.

Our recommendation is to buy PS0415 (2.80 lvl) and 1Y OIS Polonia (at 2.49 - 2.51 lvl) to hedge it. Additionally, PS0415 and WZ0115 will be the only bonds for switch tenders in autumn.









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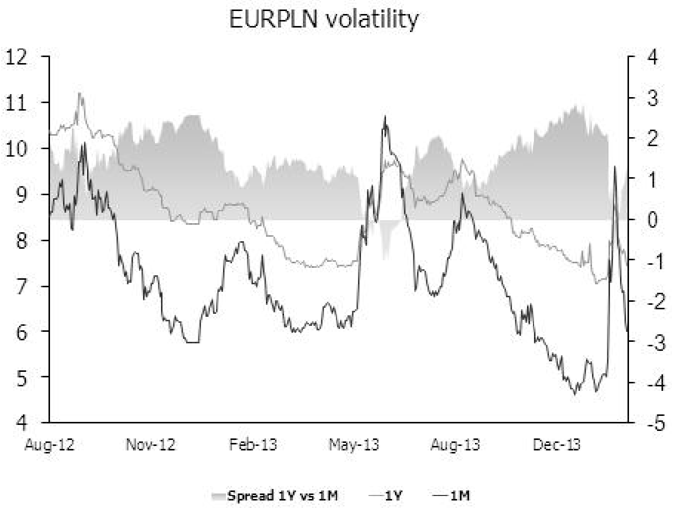
Forex

At main support 2 weeks after the peak in EM crisis, EUR/PLN is grappling with a support zone 4.13-4.15 which constituted a floor for almost a year. 4.26 seems a very distant memory already, a bad dream, and the only stops we see are executed actually on PLN shorts. That is how we see it, a massive stop loss scenario on both sides of the market (first stops on PLN longs then on shorts), which tell us really little about the further developments. The bigger picture is that we are still in the 4.10-4.30 range, and playing that range seems the most logical approach for us in the current environment.

Lower vols Stronger PLN irrevocably provokes lover volatility levels. We are lower across the curve in both main currency pairs, EUR/PLN and USD/PLN. EUR/PLN 1 month ATM mid fixed today at 6.0 (0.5% lower than last Friday), 3 months EUR/PLN are 6.2% (0.6% lower) and finally 1 year is 7.3% (4.45% lower). 6 months EUR/PLN ATM were traded at 6.6 in good amount. The skew is better offered, in line with currency spread (USD/PLN vol minus EUR/PLN vol).

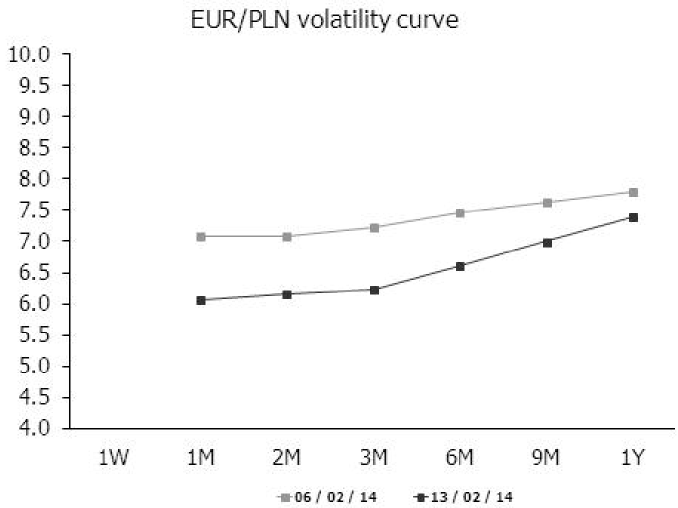


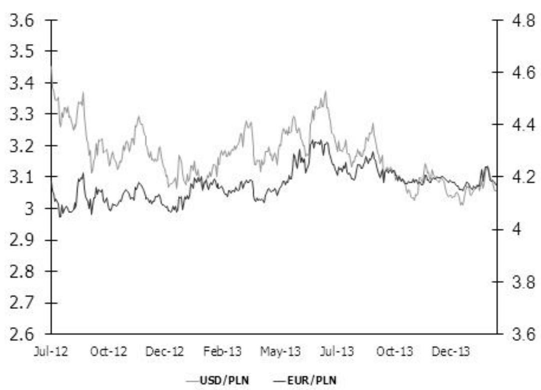
Short-term forecasts

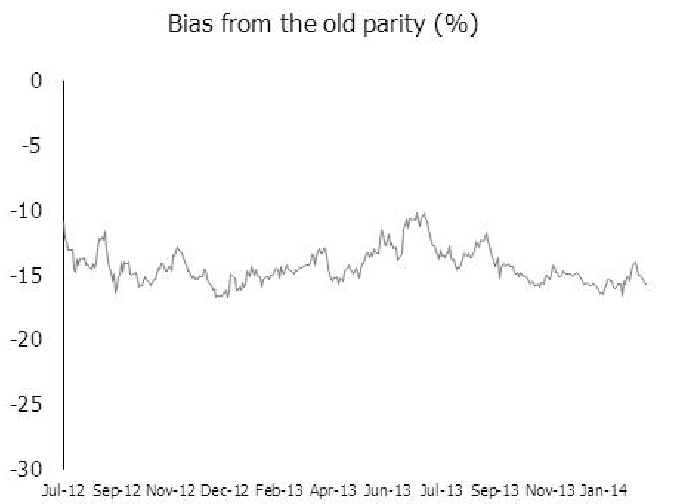
SPOT Main supports / resistances:
EUR/PLN: 4.1400 / 4.2000
USD/PLN: 3.0000 / 3.1500

Play range We are long in EUR/PLN at 4.1470 with a possibility to add at 4.1250 and the stop at 4.1070. We are hoping for a move back to 4.19/4.20 resistance zone. There XXX/PLN is mostly driven by position liquidation and customer flow, there is little to ”play on” fundamentally.

Neutral We are shocked by the speed in which the vols have melted in EUR/PLN and USD/PLN. It is starting to tempt us to put some bids in the mid/backend of the curve. We had a period of the healthy pick up in realized volatility, and we think the market seems to forget about it, a little too quickly. From the realized volatility now it is better case to be on bid in Vega, Gamma than in January, when we were at realized volatility lows.







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
2/10/2014	2.60	2.71	2.62	2.63	2.65	2.67	2.72	2.72	2.76	3.01	3.19	2.89
2/11/2014	2.60	2.71	2.72	2.63	2.92	2.67	2.71	2.73	2.78	3.01	3.19	2.88
2/12/2014	2.51	2.71	2.61	2.64	2.84	2.68	2.73	2.74	2.79	3.02	3.20	2.88
2/13/2014	2.61	2.71	2.72	2.64	2.68	2.68	2.71	2.73	2.79	3.02	3.23	2.87
2/14/2014	2.61	2.71	2.72	2.64	2.68	2.68	2.71	2.73	2.79	3.02	3.23	2.87

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
PS0718	2/13/2014	7/25/2018	94.45	3.88	2000	4405	2220
DS1023	2/13/2014	10/25/2023	95.80	4.54	2000	3702	1791

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0715	5Y IRS	PS0718	10Y IRS	DS1023
2/10/2014	2.670	2.743	3.100	3.104	3.720	3.776	4.130	4.463
2/11/2014	2.670	2.867	3.135	3.131	3.768	3.850	4.205	4.495
2/12/2014	2.680	2.867	3.140	3.119	3.800	3.876	4.230	4.525
2/13/2014	2.680	2.867	3.140	3.129	3.805	3.891	4.255	4.453
2/14/2014	2.680	2.867	3.140	3.129	3.805	3.891	4.255	4.453

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
2/10/2014	6.88	7.08	7.48	7.80	7.80	2.79	0.73
2/11/2014	6.25	6.30	6.90	7.65	7.65	2.79	0.73
2/12/2014	6.00	6.20	6.70	7.45	7.45	2.78	0.70
2/13/2014	6.05	6.23	6.60	7.40	7.40	2.94	0.78
2/14/2014	6.05	6.23	6.60	7.40	7.40	2.94	0.78

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
2/10/2014	4.1822	3.0683	3.4196	3.0034	1.3491	0.1520
2/11/2014	4.1798	3.0581	3.4149	2.9858	1.3501	0.1518
2/12/2014	4.1686	3.0552	3.4036	2.9822	1.3521	0.1516
2/13/2014	4.1752	3.0532	3.4170	2.9929	1.3378	0.1517
2/14/2014	4.1530	3.0334	3.3974	2.9765	1.3449	0.1516

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