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Polish Weekly Review

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Table of contents

Comment on the upcoming data and forecasts

February begins with PMI data. The most recent drop in German PMI suggests - via the usual correlations - a downward correction in Polish data as well. However, an upside surprise is possible since the recovery in industry has considerable momentum. The March meeting of Monetary Policy Council is unlikely to change the dovish stance of monetary policy in Poland. Rates in hold, obviously and the commitment to keep interest rate low will be reinforced by a dovish inflation projection: higher growth but largely unchanged, very benign inflation path. It is likely that according to central bank staff, NBP's CPI target will be reached in likely 2016.

Polish data to watch: March 3rd to March 7th

Publication	Date	Period	mBank	Consensus	Prior
Manufacturing PMI (pts.)	03.03	Feb	"54,7"	"54,8"	55.4
MPC decision (%)	05.05	Mar	2.50	2.50	2.50

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	3/6/2014	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

Unchanged. A relatively quiet week ahead with one surprise: PMI data. If one judges from the previous months, there is a lot of room for surprises here.

* 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.
- The turmoil in Ukraine made us put a downside risk to our forecast. We see a potential fallout amounting to 0.2-0.4pp. of 2014 GDP growth. We are going to monitor situation closely as prolonged conflict is also very likely to negatively affect: 1) Polish trade with other eastern partners (e. g. Kazakhstan, Russia), 2) Polish investment activity through the uncertainty channel; we cannot exclude that such an effect would be far more devastating than trade linkages (though less likely).
- 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 re-launch of EU funding. Thus, 2-3 years of solid economic growth are our baseline scenario.
- Inflation stays subdued for the next few months and this is going to dominate the outlook for Polish rates supporting stable NBP benchmarks.
- We expect first rate hikes to materialize at the turn of 2014/2015. The MPC is dovish, inflation projection is going to emphasize non-inflationary growth and MPC members are afraid of massive inflows of portfolio capital that could overly strengthen the zloty. We still believe than in longer horizon the MPC is going to be caught off guard by upward sloping inflation path that 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 European low yield environment, still dovish MPC (much more than the official statement suggest) 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 and absorb part of funds originally re-directed from EMs to Europe (cross-over investors set to generate marginal demand).
- Liquidation of OFEs' bond portfolios changes the structure of Polish debt funding (higher percentage of foreign investors and possibly lower market liquidity). Thus, Polish bonds are set to be more than ever exposed to global trends (positive now and negative due to globally rising yields in H2). In the short term the issue of rebalancing global bond indices is worth to be monitored.
- 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	2013	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	1.4
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	2.75

	2013 Q1	2013 Q2	2013 Q3	2013 Q4	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	2.1	2.5	2.5	2.5	2.8
Public Consumption y/y (%)	-0.1	4.3	1.7	2.1	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	1.0	1.5	1.2	2.0
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	2.75
Wibor 3M (% eop)	3.39	2.73	2.67	2.71	2.65	2.65	2.65	2.95
2Y Polish bond yields (% eop)	3.19	3.07	3.06	3.05	3.00	3.00	3.10	3.10
10Y Polish bond yields (% eop)	3.94	4.34	4.48	4.35	4.30	4.30	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	3.16	3.13	3.15

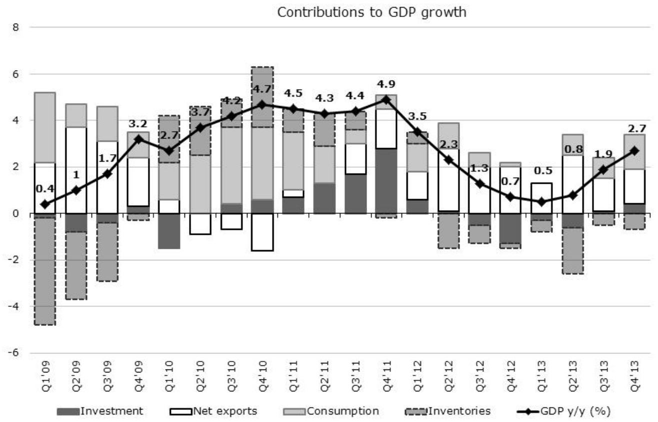
F - forecast

Economics

Preliminary GDP data in line with flash estimate. Temporarily GDP growth is going to be non-inflationary.

GDP in Q4 rose by seasonally adjusted 0.6% q/q, slightly above the flash estimate (+0.5%), and non-seasonally adjusted 2.7% y/y, in line with the preliminary reading. The economy stays on an upward path and sustains decent momentum.

The breakdown of national accounts on average confirms our previous estimates based on annual figures and flash reading. Consumption accelerated from 1.2% in Q3 (slight upward revision) to 2.1% in Q4. Fixed business investment growth advanced from 0.6% in Q3 to 1.3% in Q4. Domestic demand advanced by 1.2% y/y after 0.5% in Q3. The growth generated primarily in exports is slowly becoming more and more broad based and we think this process is going to be strengthened in the coming quarters.



The data do not change the fundamental picture of the Polish economy; it gives only a more detailed view on the facts we were already aware of. Therefore, we expect the upward path of expansion to continue in the coming quarters. Consumption is supported by rising wages, strengthening labor market, growing households' optimism and - last but not least - lesser burden imposed by credit servicing costs (the effect of lower rates - monetary policy works in this field). We also see investment growing, mainly on supply constraints (capacity utilization was unaffected by recent GDP slowdown) and receding uncertainty (with some risks on this field - see below); the story of EU funds is important although the visible boost from this factor is going to come in late 2014. We still see the economy growing by 3.5% in 2014 and on an upward trajectory in consecutive quarterly GDP readings. Risk factor stems from Ukraine. At this point, it is fairly certain that political turmoil is going to lead to a deep recession. Taking into account the trade linkages, possible (temporary) transport disruptions and (temporary) rise of uncertainty, it may shave off 0.2-0.4pp. from Polish GDP growth (we published a little bit more on this topic in the last weekly report). What is important, however, the aforementioned risks are not going to derail the (positive) cyclical tendencies in Polish economy and - as exogenous factors - are likely to be made up for later, in following years.

MPC still thinks the upswing is going to be non-inflationary. Although we are far from following this route in medium term, recent conjunction of factors supports the scenario of low inflation in coming months. First of all, food prices can be subject to downward pressure. Recent developments over the swine fever resulted not only in a ban of Polish pork exports to Russia, but also to China (which accounts for 80% on Polish exports of pork). Given the fact that such bans are usually quite prolonged (and this time Polish meat producers may even permanently lose market share since Great Britain and France are to fill the gap with their exports of pork...). we see the downward pressure on food prices mounting. What is more, PLN proved to be resilient to EM-driven sell off. Deflationary pressures imported from euro zone only add to the picture in which inflationary pressures in Poland stay subdued for longer than we previously thought. Such a constellation of data is going to support expectations for (at least) a longer period of low rates in Poland. We see the start of normalization of rates at the turn of 2014/2015 and the tightening cycle to be a shallow one (100 bps).

Fixed income

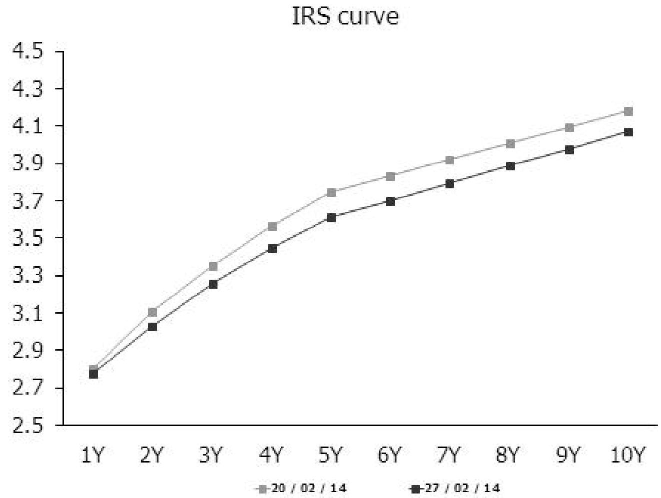
Resilience

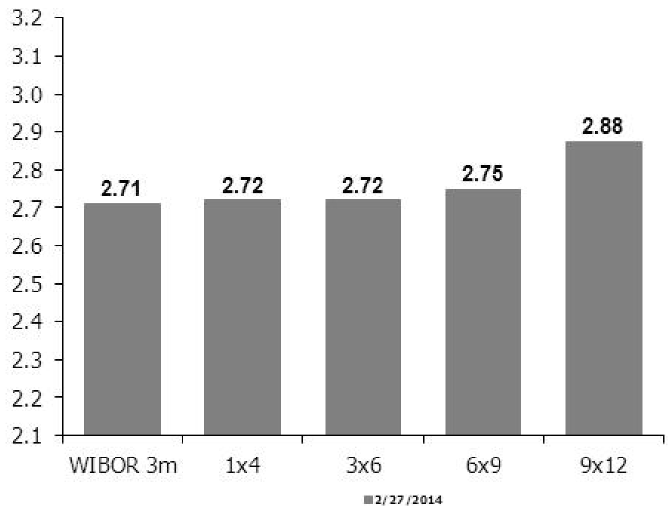
Turkish ”crisis”. Ukrainian ”crisis”. Poland seems to be resilient tor such risks. Too resilient. Despite all the problems at the beginning of the year, i.e. tapering and the removal of Pension Funds from bond market, DS1023 is around the lowest levels this year (4.35%). We believe that this bullish sentiment might be over soon.

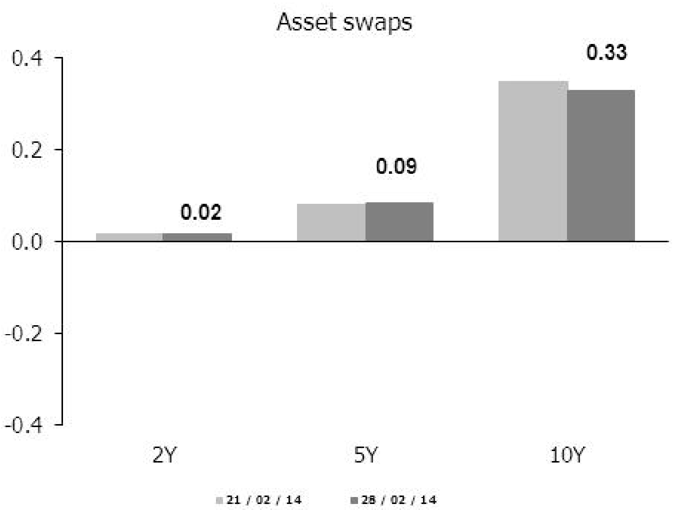
The big question might be if the MPC is going to maintain ’forward guidance’. With the new CPI projection, we think that the market expects new guidance until the end of Q3 but that might not be the case. The economy is better and better, CPI is going to be higher, we believe that MPC should at least keep all options open.

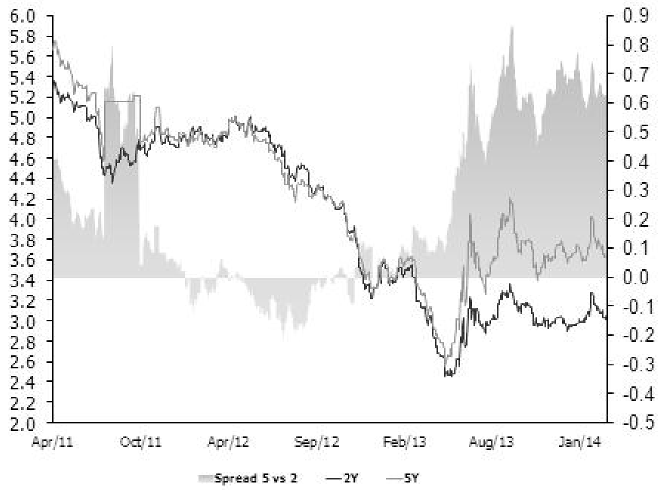
In the previous recommendations we suggested long position on PolGbs. At current levels risks are more balanced and we like to sell, especially 5Y bonds that should suffer the most if we see any potential CPI or rate hike risks.

Recommendation: take profit, sell 5Y bonds.







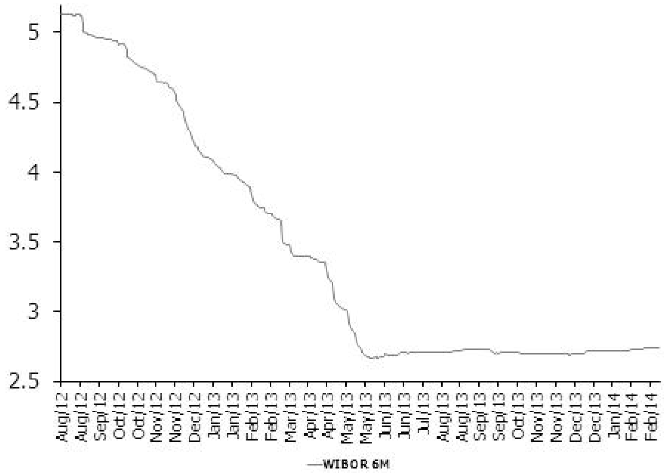


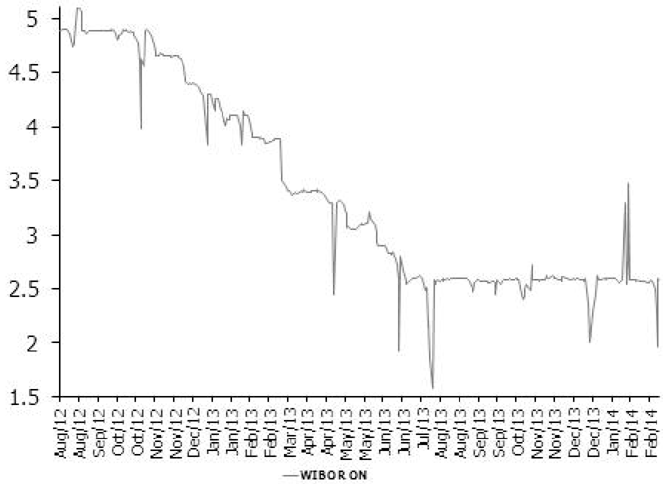
Money market

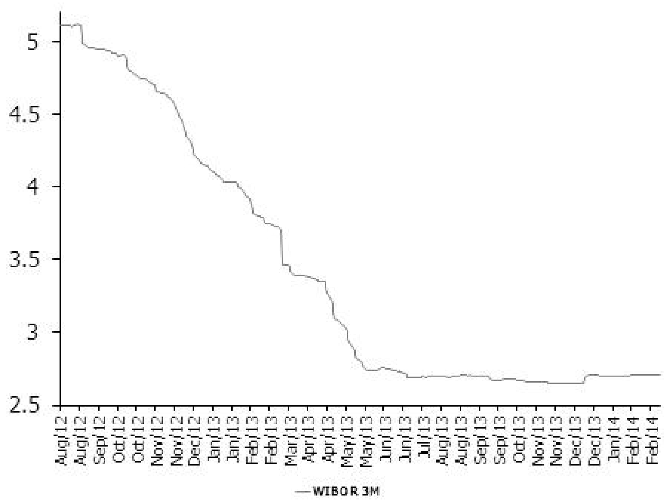
Cheap week behind us. A stable and very cheap week for Polish money rates. After underbid Friday's OMO Polonia fell to 2%, the Central Bank was pushed to conduct an additional OMO on Monday. As we expected, it didn't sterilise the market (after last month's situation) and rates fluctuated around 2% until Wednesday. Nice profit for Polonia sellers.

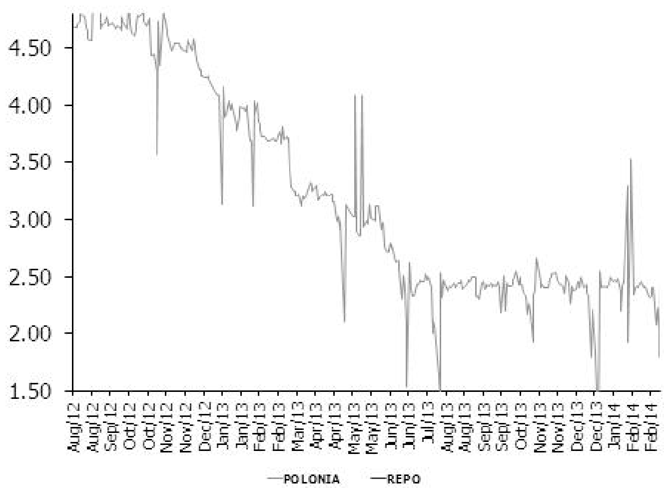
Thursday was last day of reserve and rates came back to the reference rate lvl as Central Bank made regular additional OMO. Today's one was underbid by 1.5 bn PLN but as it's the beginning of reserve, rates should stay in a 2.40-2.50 range.

Our recommendation is to start getting pay on derivatives after ECB meeting and new CPI Projection.





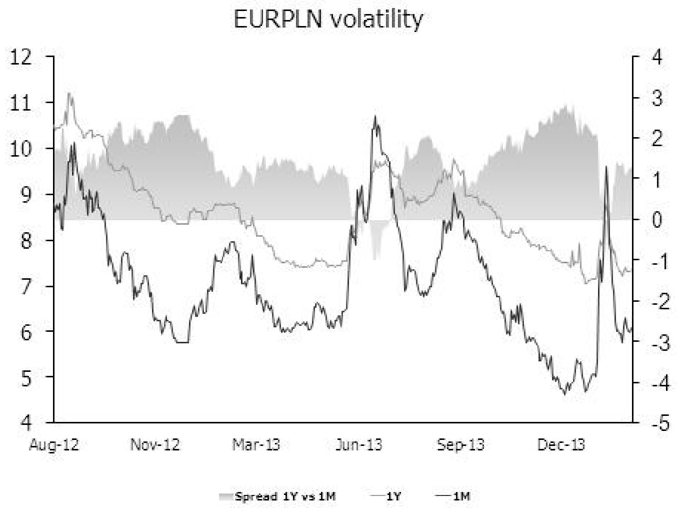




Forex

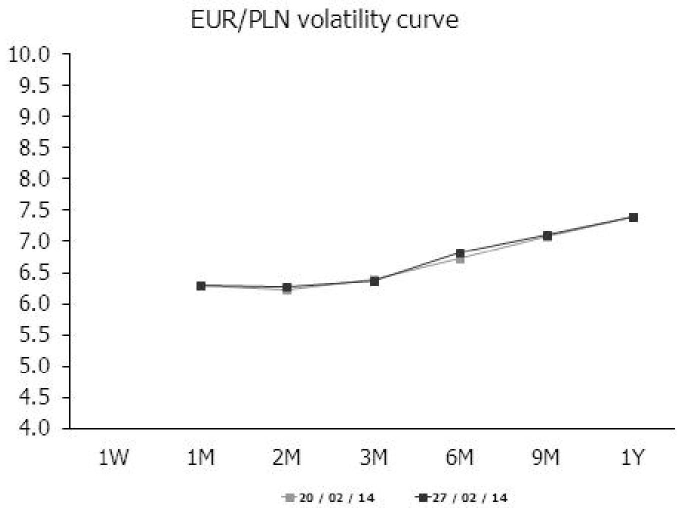
Choppy market Last week moves on EURPLN were covered by the 4.1480 - 4.1896 range. The Zloty wasn't too immune to the escalating situation in Ukraine and the political crisis in Turkey once again - EURPLN was pushed again from 4.15 to the level of almost 4.19. Better macroeconomic data in Poland (retail sales, GDP) and in the Eurozone were ignored in the light of the intensifying political and economic risks in Ukraine. Till these concerns end, we will not able to come back below the 4.14 level.

Vols higher The correlation of weaker PLN and higher Vols is working as usual, even though the option market's reaction was really muted. Last week, the 1 month EUR/PLN ATM was traded in the range 5.8% / 6.7%. 3M ATM mid was higher by 0.1% in comparison to last week, and fixed at 6.2%, the 6 month ATM rose by 0.25% and today is at 6.75%. The skew was bid with a higher spot. USD/PLN was far more interesting as currency spread (difference between USD/PLN vol and EUR/PLN vol) was higher by roughly 0.25% - 0.5% across the curve.



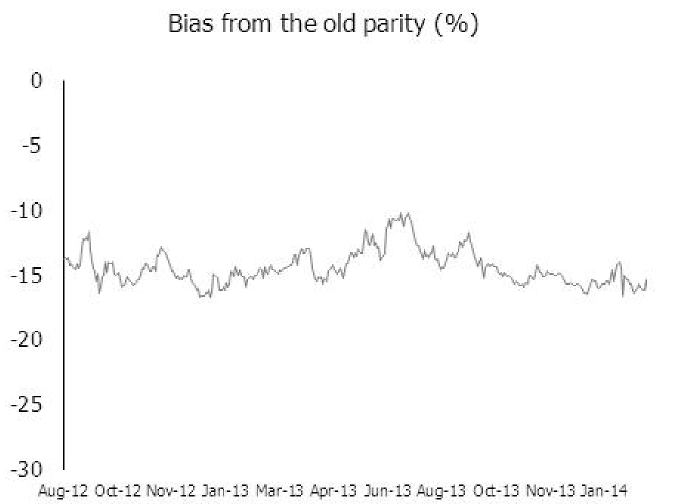
Short-term forecasts

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



Play range As in the week before, we would like to play the 4.14 - 4.20 range by selling 4.1800, adding 4.1900 with stop above 4.2050 and hopes for 4.1500. Or alternatively - buy EUR/PLN at 4.1500, add 4.1400 with stop below 4.1250 and eyes firmly on 4.1800. There XXX/PLN is mostly driven by customer flow and global sentiment, there is little to "play on" fundamentally.

Cautious bid We think volatility is back for good. The next week ECB meeting is the event to be long Gamma, but in general our preferred tenors are in the backend. The dips are providing good buying opportunity. We assume that lower systematic liquidity (without or with a smaller US QE), dragging on conflicts in Ukraine and Turkey will raise the FX volatility.



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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
2/24/2014	2.53	2.71	2.67	2.64	2.91	2.68	2.71	2.73	2.75	2.95	3.05	2.83
2/25/2014	2.54	2.71	2.68	2.64	2.91	2.68	2.72	2.72	2.75	2.90	3.06	2.81
2/26/2014	2.62	2.71	2.65	2.64	2.75	2.68	2.73	2.72	2.75	2.90	3.10	2.80
2/27/2014	2.60	2.71	2.62	2.64	2.67	2.68	2.72	2.72	2.75	2.88	3.05	2.80
2/28/2014	2.60	2.71	2.62	2.64	2.67	2.68	2.72	2.72	2.75	2.88	3.05	2.80

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
2/24/2014	2.680	2.814	3.028	3.059	3.630	3.687	4.080	4.419
2/25/2014	2.680	2.817	3.020	3.046	3.640	3.689	4.090	4.427
2/26/2014	2.680	2.820	3.050	3.045	3.645	3.721	4.105	4.443
2/27/2014	2.680	2.791	3.030	3.046	3.610	3.696	4.070	4.399
2/28/2014	2.680	2.791	3.030	3.046	3.610	3.696	4.070	4.399

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
2/24/2014	6.03	6.23	6.63	7.30	7.30	2.96	0.76
2/25/2014	5.98	6.18	6.58	7.30	7.30	2.96	0.76
2/26/2014	6.08	6.23	6.65	7.35	7.35	2.99	0.78
2/27/2014	6.29	6.38	6.83	7.40	7.40	2.80	0.70
2/28/2014	6.29	6.38	6.83	7.40	7.40	2.80	0.70

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
2/24/2014	4.1638	3.0255	3.4121	2.9559	1.3407	0.1521
2/25/2014	4.1595	3.0264	3.4103	2.9566	1.3397	0.1520
2/26/2014	4.1584	3.0260	3.4094	2.9570	1.3451	0.1521
2/27/2014	4.1851	3.0655	3.4407	3.0078	1.3429	0.1530
2/28/2014	4.1602	3.0254	3.4211	2.9791	1.3409	0.1520

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