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Polish Weekly Review

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Comment on the upcoming data and forecasts

The MPC meeting will take place on Tuesday and Wednesday. Although we expect the interest rates to remain unchanged, the forthcoming meeting not necessarily has to be a non–event. Committee members will assess in more detail the impact of conflict between Ukraine and Russia on Polish economic growth and inflationary pressures, which in turn can contribute to extending the forward guidance to the year's end (as suggested by some of committee members). However, the expectation of first rate hike have already shifted to the end of first quarter of 2015, hence the market reaction for the prospective MPC's actions should be subdued. Furthermore, Friday's current account publications will end the macro readings' series for February. We expect the current account deficit to narrow, mainly due to a significant trade account surplus (totaling to 500 m EUR). The latter will by driven by seasonal surge in export and concomitant increase of import being a result of an accelerating domestic demand. In addition, seasonal factors will contribute to the narrowing of the income account and balanced transfer account. As a result, the current account deficit will most likely amount to 212 m EUR.

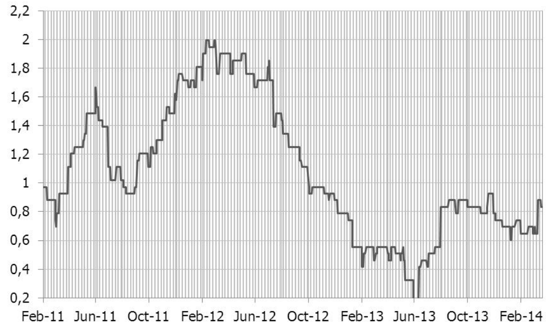
Polish data to watch: April 7th to April 11th

Publication	Date	Period	mBank	Consensus	Prior
MPC decision (%)	09.04	Apr	2.50	2.50	2.50
Current account (mio EUR)	11.04	Feb	-212	-533	-1135
Exports (mio EUR)	11.04	Feb	13650	13462	13503
Imports (mio EUR)	11.04	Feb	12150	13025	12084

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	-	3500	3.066	3/6/2014
5Y T-bond PS0718	-	2000	3.882	2/13/2014
10Y T-bond DS1023	-	3500	4.261	4/3/2014
20Y T-bond WS0429	-	150	3.464	5/16/2013

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



Comment

Slightly down after the PMI release (more in the Economics section). Therefore, the Polish surprise index remains in a horizontal trend.

* 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 2013. The upswing is going to be continued.
- However, the events in Ukraine made us put a slight downside risk to our near term forecasts in a form of a short soft patch. We therefore flattened GDP growth path in H1 and assume a catch up thereafter. Therefore we are still 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 strengthening. 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 re-launch of EU funding. Thus, 2-3 years of solid economic growth are our baseline scenario.
- Inflation stays subdued (or even very low) for the next few months supported by a possibility of lower meat prices and deflating tradables basket.
- The MPC has already acknowledged low inflation and possible negative spillovers from Ukraine events. As a consequence forward guidance has been strengthened – that practically means stable rates till the end of the year. We feel the MPC is focused on strenghtening low rates environment and stay very dovish (this includes a risk of a rate cut). Although we await normalization of monetary policy in 2015, low inflation, strong zloty (vs EM basket) makes discussion of rate hikes non-existent at the moment.

Financial markets

- Local factors still speak in favor of Polish bonds including a continuation of positive credit story and Poland's status a regional safe haven. Poland is seen as a satellite of euro zone, not a typical EM. Therefore it can absorb part of funds originally re-directed from EMs to Europe (cross-over investors). We are bullish on Polish short term bonds due to non negligible risk of a rate cut in Poland (negative spillovers from Ukraine amid strong zloty vs. EM cur100ecies may be seen by the MPC as an excuse to abandon stable rates policy).
- We are neutral/positive on longer bonds due to conflicting global signals (QE talks at the ECB and rate normalization in the US).
- Polish fundamentals (low CA deficit, high real rates, low short-term foreign debt, accelerating GDP growth) speak in favor of the zloty in mid-term on cyclical basis and as far as potential differentiation among EMs is concerned. Short-term, however, Ukraine events and ensuing risk aversion changes dynamics against the zloty that may be trading weaker. The more so since the PLN is at highs towards its peers in CEE, tempting to be the first best solution to limit investors's exposition on the region.

mBank forecasts

	2009	2010	2011	2012	2013	2014F
GDP y/y (%)	1.6	3.9	4.5	2.0	1.6	3.5
CPI Inflation y/y (average %)	3.5	2.8	4.3	3.7	0.9	1.0
Current account (%GDP)	-1.6	-4.5	-4.9	-3.5	-1.3	-1.9
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	2.50

	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	3.0	3.1	3.6	4.3
Individual consumption y/y (%)	0.0	0.2	1.0	2.1	2.3	2.6	2.8	3.1
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	3.8	5.3	7.5	8.5
Inflation rate (% average)	1.3	0.5	1.1	0.8	0.7	1.0	0.8	1.6
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	2.50
Wibor 3M (% eop)	3.39	2.73	2.67	2.71	2.71	2.65	2.65	2.65
2Y Polish bond yields (% eop)	3.19	3.07	3.06	3.05	3.01	3.00	3.10	3.10
10Y Polish bond yields (% eop)	3.94	4.34	4.48	4.35	4.23	4.20	4.60	5.00
EUR/PLN (eop)	4.18	4.33	4.22	4.15	4.17	4.20	4.10	4.00
USD/PLN (eop)	3.26	3.32	3.12	3.02	3.04	2.99	2.94	2.97

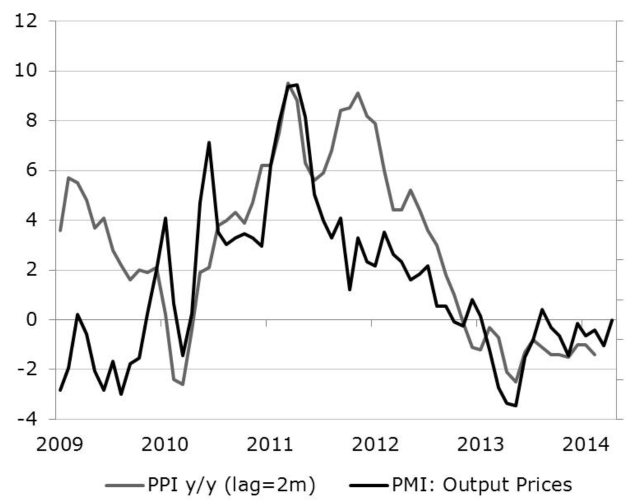
F - forecast

Economics

Soft patch is arriving. No worries, though. At this point we do not expect nothing more than a short-term flattening of GDP growth, not a reversal.

PMI index in March dipped to 54.0 from 55.9 in the previous month. It was the biggest single drop since February 2012. Part of the drop reflected a moderation in German PMIs, part was stemming from the fallout of Ukrainian crisis (both exports and sentiment were affected), as outlined by the anecdotal evidence attached to the report accompanying the publication.

The details confirm the source of problems. New orders eased by 4.5 and the drop was severe by historical standards (see the graph) which usually marked the beginning of a slowdown of growth (at least). The data show a divergence between export orders and domestic ones with the latter holding steady along the lines of our thinking that Polish GDP growth is turning more domestic.



Also, employment assessment went unscathed confirming gradual growth. The same applies to prices (see the graph) and everything but the inflation pressure is on the horizon.

So, the soft patch is arriving. The initial scale of PMI moderation could have been exaggerated as firms might have been taken aback by the speed of events and very alarming media coverage. Nevertheless, February reading possibly marked the local maximum. Fundamentals of the Polish economy are still good on the domestic side but regional environment went sour. Our static, export based calculations regarding the negative growth spillovers from Russia and Ukraine (not only issues concerning the war climate going on but weak cyclical position of both economies even just before the political events kicked in) are still valid. 0.4-0.8% reduction in whole year economic growth in the most painful scenario is what we may expect. In current circumstances we applied a flattening of GDP growth in H1 and we are holding onto it (soft patch scenario). Of course we are unable to measure the extent of disruption in transport (longer stops at the border, more scrutinized controls) and the uncertainty effect. We believe that NBP's research department can do substantially better and the work is in progress.

We already know that even crude calculations concerning the risks from the east made MPC extend forward guidance until the end of Q3. Current message conveyed in various rate setters' statements suggests that they can do more and promise to hold rates steady until the end of Q4.

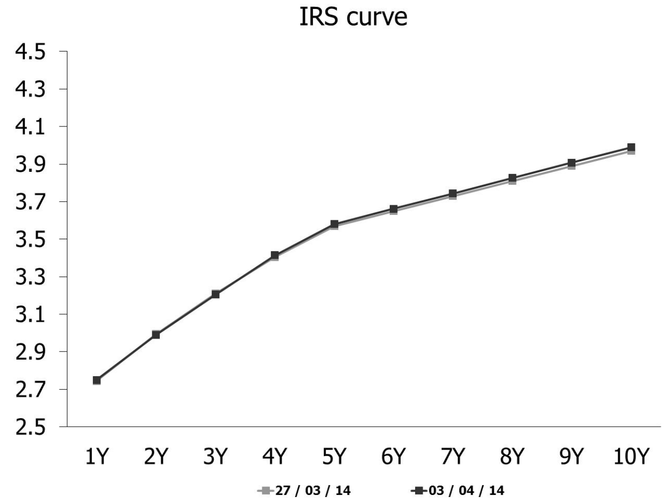
Is this all? We think that in the upcoming meeting the MPC will arrive at some more precise list of risks concerning the adverse environment of the Polish economy (even in a quantitative way). This may be sufficient to put Q4 FWG into statement. However, given the strength of the zloty, very low inflation and successful implementation of the rate cuts in Hungary (down to the same level as Poland's rates = it seems investors do not demand such high risk premia as they did in the past), it may be compelling case for the MPC to do even more, even consider a rate cut. It is not our baseline scenario for now but we think that this risk is going to rise in April and top during the May meeting because these are the months when the fresh bout of data may show that the real sphere is negatively affected in a way possibly going beyond the original estimates of the MPC. Those effects may be hard to distill from monthly data and MPC's reaction function is going to be skewed more than usual to tracking monthly data and acting on the basis of risk management.

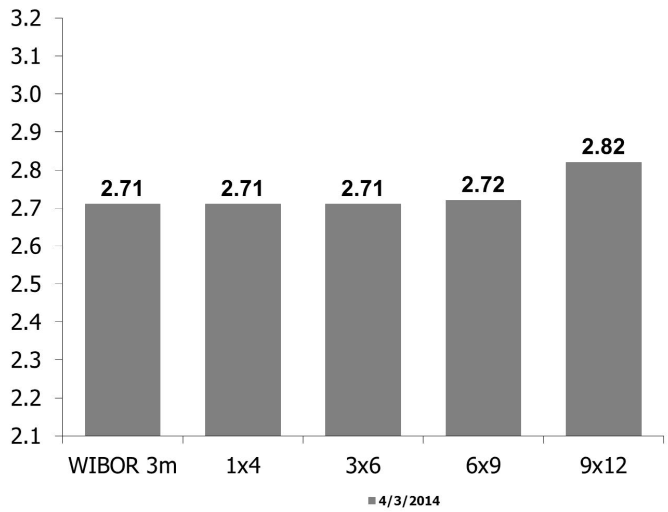
Fixed income

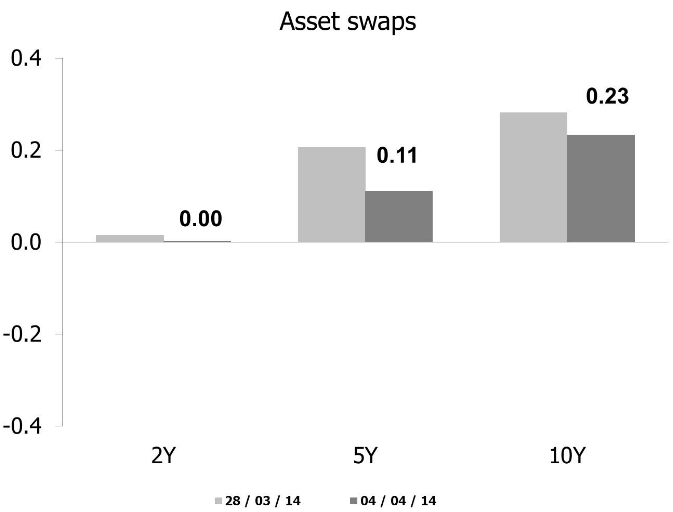
New Idea

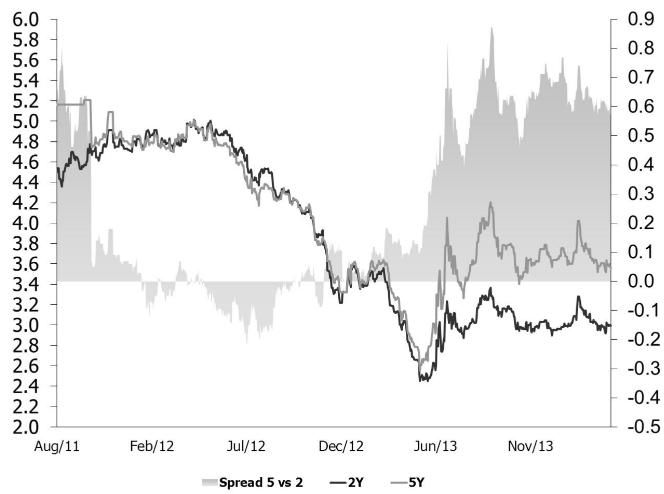
Another very positive week on Fixed Income market. Big news was an auction, with DS1023 and WZ0119 on the offers and again it was a successful one. MinFin sold 5.8 bln pln and now we have bullish sentiment on the market. Bunds/Treasuries yields are low, Ukrainian conflict is an old story, everyone expects low CPI. We agree with all that but current yields are getting low and we struggle to find new reasons to buy bonds. Obviously, carry is a good one, but with 3.45% on 5 year bond we would like to wait for a better opportunity to buy bonds, maybe later this month (an auction in 2 weeks (?)).

Recommendation: Take profit on 5Y bonds at current levels and wait for new ideas.







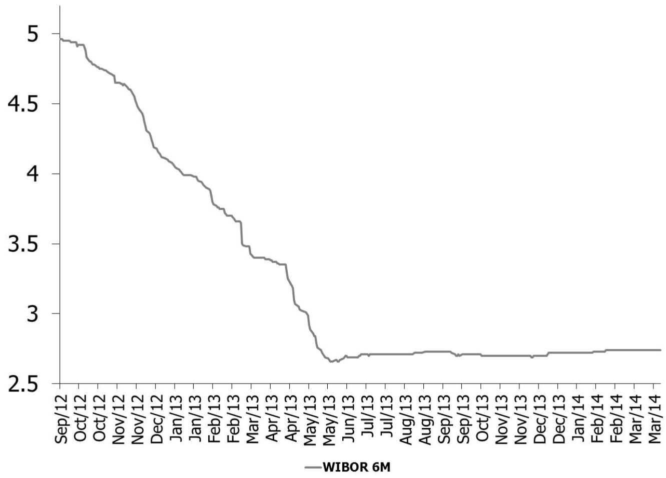


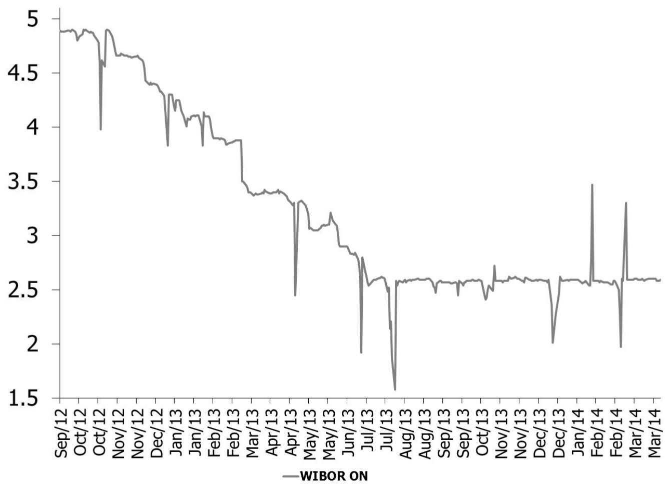
Money market

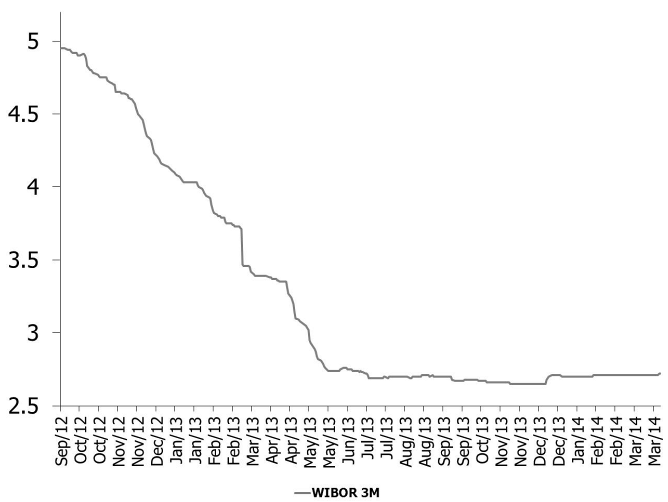
Expensive week ahead Despite huge surplus of cash after Friday's OMO (16 billion) Polonia fluctuated around 2.40%. At todays OMO NBP offered 3.5 bn bills more that it will square the markets so next week might be expensive.

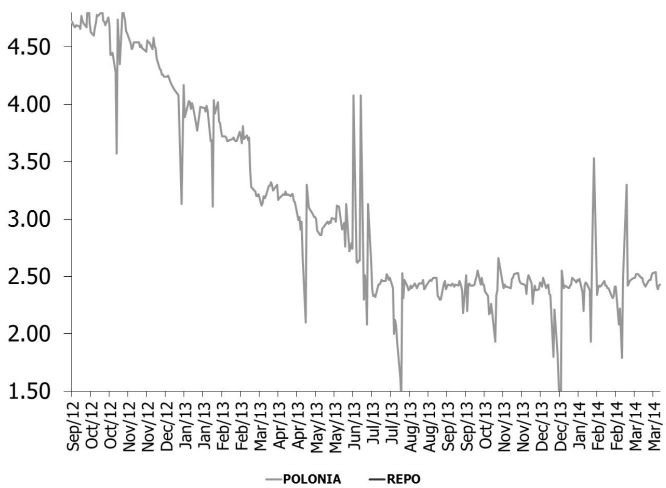
We recommend selling 1M OIS and hedge it by 1W OIS as it should be cheap at the end of April due to end of reserve and holidays at the beginning of May. Also, buy PS0415.

Also, be prepared for a possible rate cut on Wednesday.





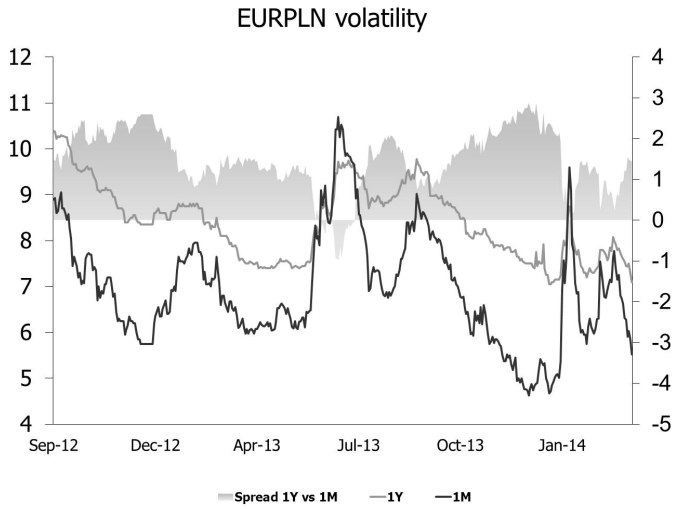




Forex

PLN strong close to resistance EUR/PLN was descending all week, falling from the week top of 4.1810 to 4.1610 low, so far. Calmer geopolitical situation was behind what we used to call an old-fashioned ”risk on” with TRY and HUF noting healthy gains. PLN was not an exception, rising close to this year’s highs. The bigger picture remains the same, as there is really little PLN factor in EUR/PLN price action, we expect the EUR/PLN to stay in the wider 4.13-4.26 range.

Volatility still falling 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 5.0% (0.9% lower then last Friday), 3 months are now 5.75% (1.0% lower!!!) and finally 1 year at 6.9% (0.5% lower). The skew and currency spread was also better offered.

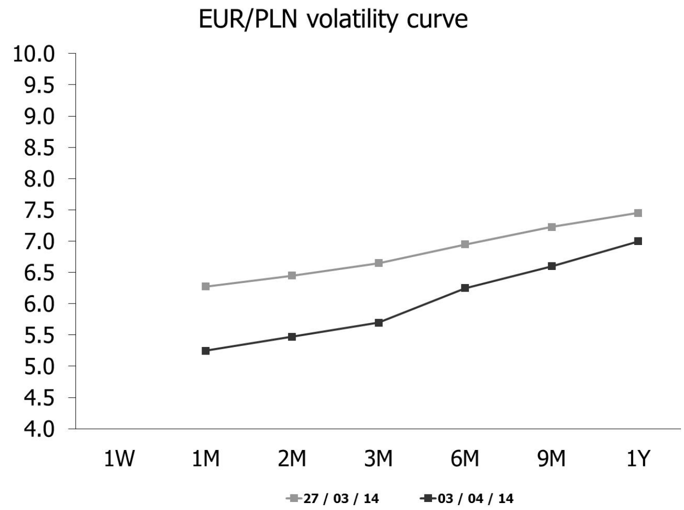


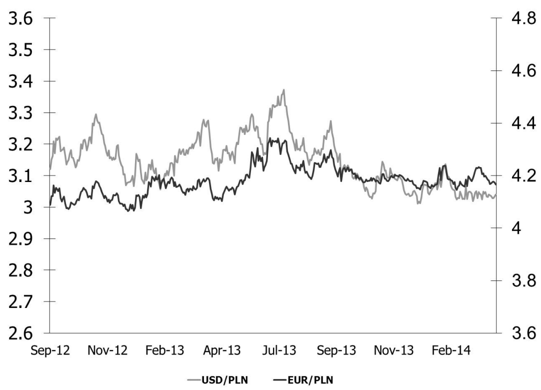
Short-term forecasts

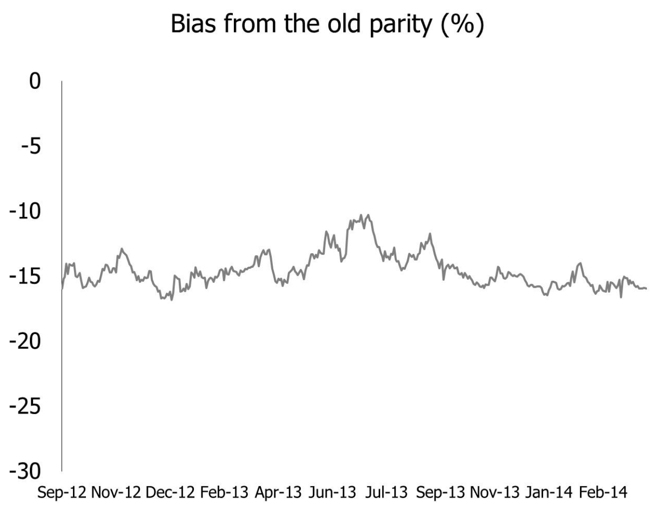
SPOT Main supports / resistances:
EUR/PLN: 4.1400 / 4.2600
USD/PLN: 3.0000 / 3.1500

Play range from the long side Already long 4.1650 and ready to add 4.1450 with a stop at 4.1300 and hopes for a move above 4.22. Basically we try not to over-think, if that is a range - play it until the market proves you wrong.

Long vega We have reloaded our longs in mid/back of the vol curve. The vol curves took another beating as the PLN got stronger. Reverse correlation between PLN strength and the vols being as strong as ever, also the realized volatility was also brushing at year lows. Both factors being obvious reasons for the sell-off in vols. Nevertheless, one has to remember about the mean reverting characteristic of vols, and that alone should lift the curve from the current levels. Or at least that’s what we are hoping for...







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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
3/31/2014	2.84	2.71	2.87	2.64	2.79	2.69	2.71	2.71	2.73	2.84	3.00	2.78
4/1/2014	2.59	2.71	2.72	2.64	2.96	2.69	2.71	2.71	2.73	2.83	2.97	2.81
4/2/2014	2.49	2.71	2.61	2.64	2.85	2.69	2.71	2.71	2.71	2.83	3.01	2.78
4/3/2014	2.68	2.72	2.85	2.64	2.94	2.69	2.71	2.71	2.72	2.82	2.98	2.77
4/4/2014	2.68	2.72	2.85	2.64	2.94	2.69	2.71	2.71	2.72	2.82	2.98	2.77

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	3/6/2014	7/25/2016	93.07	3.07	3500	6104	3754
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
3/31/2014	2.690	2.739	2.980	3.009	3.580	3.763	3.990	4.230
4/1/2014	2.690	2.636	2.980	3.021	3.565	3.714	3.985	4.235
4/2/2014	2.690	2.762	3.000	3.004	3.590	3.752	4.000	4.260
4/3/2014	2.690	2.752	2.990	2.992	3.580	3.690	3.990	4.223
4/4/2014	2.690	2.752	2.990	2.992	3.580	3.690	3.990	4.223

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
3/31/2014	6.03	6.55	6.90	7.50	7.50	2.95	0.77
4/1/2014	5.86	6.43	6.66	7.30	7.30	2.95	0.77
4/2/2014	5.53	6.05	6.40	7.10	7.10	2.94	0.75
4/3/2014	5.25	5.70	6.25	7.00	7.00	2.99	0.73
4/4/2014	5.25	5.70	6.25	7.00	7.00	2.99	0.73

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
3/31/2014	4.1713	3.0344	3.4192	2.9416	1.3586	0.1520
4/1/2014	4.1765	3.0278	3.4286	2.9297	1.3583	0.1520
4/2/2014	4.1774	3.0288	3.4258	2.9175	1.3589	0.1521
4/3/2014	4.1738	3.0330	3.4176	2.9175	1.3545	0.1521
4/4/2014	4.1657	3.0397	3.4052	2.9266	1.3587	0.1518

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