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Polish Weekly Review

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Comment on the upcoming data and forecasts

After an avalanche of data from last week, this time we take a breather. Retail sales data and unemployment rate are published on Thursday (but the publication date is uncertain, sad but true), and that's all. We expect retail sales to come out higher than market consesus on the back of strong demand for autos and general acceleration in sections driven by warm weather. However, the acceleration may have been more agile without negative base effect on the back of late easter this year. Unemployment rate is poised for another substantial drop in March. Substantial fall in jobless rate stems from 3 factors: i) accelerating employment, ii) favorable weather conditions, iii) active policies aimed at the unemployed. The first of the three is the most likely to stay intact due to cyclical upswing.

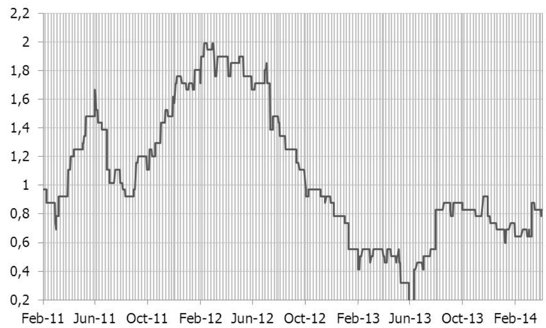
Polish data to watch: April 21st to April 25th

Publication	Date	Period	mBank	Consensus	Prior
Retail sales y/y (%)	23.04	Mar	6.5	5.9	7.0
Unemployment rate y/y (%)	23.04	Mar	13.6	13.6	13.9

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	4/23/2014	3500	3.066	3/6/2014
5Y T-bond PS0718	4/23/2014	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

CPI came out lower than expected, pulling the index down. The next day, however, wage growth in March turned out to be higher than anticipated. Thus, Polish surprise index is unchanged on a monthly basis. Next week brings a few possible surprises - unemployment and retail sales.

* 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 a non negligible risk of a rate cut in Poland (negative spillovers from Ukraine amid strong zloty vs. EM currecies may be seen by the MPC as an excuse to abandon stable rates policy). Although a cut itself is not our baseline, it may draw investors' attention from time to time.
- We are neutral/positive on longer bonds due to conflicting global signals (QE talks at the ECB and inevitable rate normalization in the US due to better data).
- Escalation of conflict in Ukraine would be disruptive for Polish assets in the short-term. Mid-term it translates into lower growth and underpins lower rates for longer.
- 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 still close to local 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 (%)	0.4	0.8	2.0	2.7	3.0	3.1	3.6	4.3
Individual consumption y/y (%)	0.0	0.1	1.0	2.1	2.3	2.6	2.8	3.1
Public Consumption y/y (%)	0.1	5.0	3.0	3.1	2.0	2.0	2.0	3.0
Investment y/y (%)	-2.4	-3.3	0.5	2.0	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	2.72	2.72	2.72
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	3.01	2.96	2.97

F - forecast

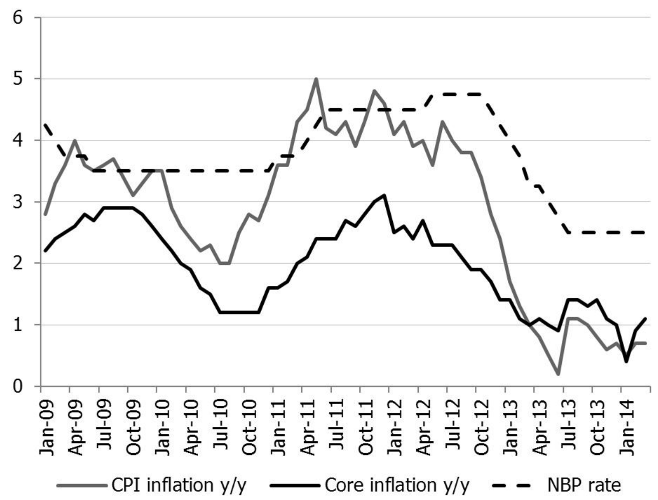
Economics

Low inflation amid strengthening domestic demand and risks stemming from exports

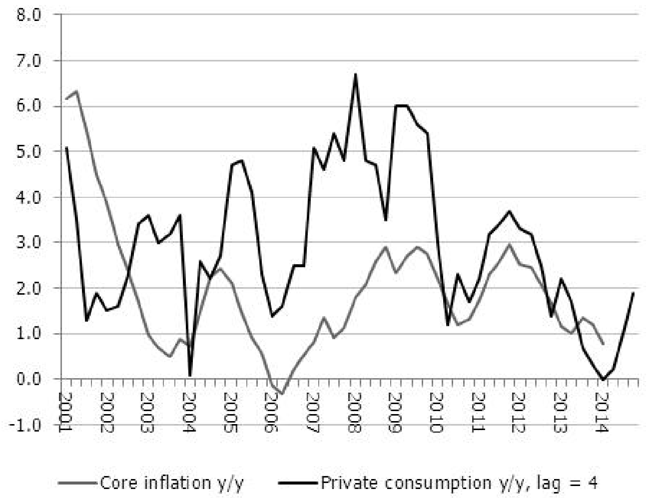
Recent bout of data confirms the domestic engine of growth is accelerating whereas exports may be suffering from solid deceleration of demand from Russia and Ukraine. Such a setup is in our opinion very unlikely to derail the cyclical upswing but may be sufficient to challenge already optimistic growth expectations and transform into a soft patch manifested in flat GDP growth path in H1. At the same time inflation stays subdued, rising only on statistical base effects and one-off price increases in telecommunications. Low inflation view is being shared by the majority of MPC at the moment (such an information is revealed by the MPC „Minutes"). However, as far as growth is concerned there seems to be a subtle split for believers in high growth and those who indicate risks to such scenario. As we think there is still plenty of time before inflation starts to mirror demand pressures (we bet on it in H2), growth issues may take the upper hand for now. Therefore, the more frequent negative surprises in the data (look for them in sections that are geared to exports), the more eager the MPC may be to ease policy further. We remind the readers that a rate cut is not our baseline scenario (nor for the MPC) but riding on a wave of expectations for such a step may be a tactical step with a decent payout.

As usual, below you find our detailed take on recent publications.

Low inflation, not only on the consumer's side. In March CPI grew by 0.7%, unchanged from the previous month's reading. Food prices dropped by 0.4% m/m which makes for a strong deviation from typical seasonal patterns. The full price effects of recent alcohol excise tax hike are yet to be observed - they are likely to occur only after Easter. Surprises on the positive side were noted in communications prices (Internet fees) as well as entertainment and culture (cable TV). Changes occurring in these categories are unpredictable and acyclical so there is a good reason to exclude them from the analysis. Had these prices behaved normally, CPI would have come at +0.6% y/y.

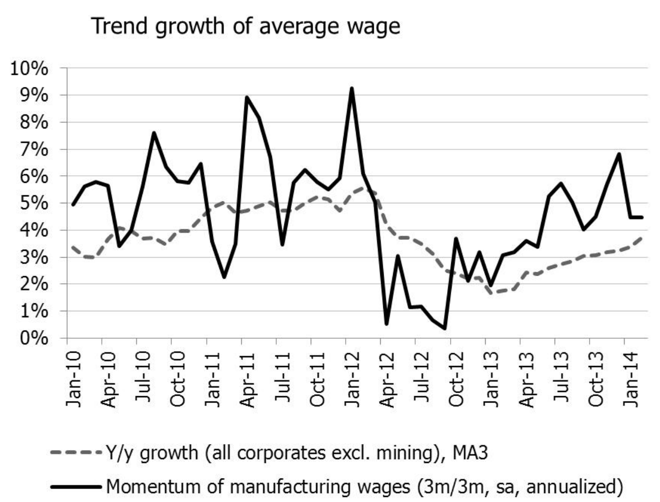


Inflation reached the bottom in the first quarter. In the coming months a steady march upwards will be led by statistical base effects first. The excise tax hikes should also eventually feed into retail prices, supporting this trend. For now, it would however be foolish to think that inflation rises due to fundamental, theoretically grounded factors. This will change in the second half of the year, when core CPI decisively turns around, reflecting a closing output gap (see the graph below).

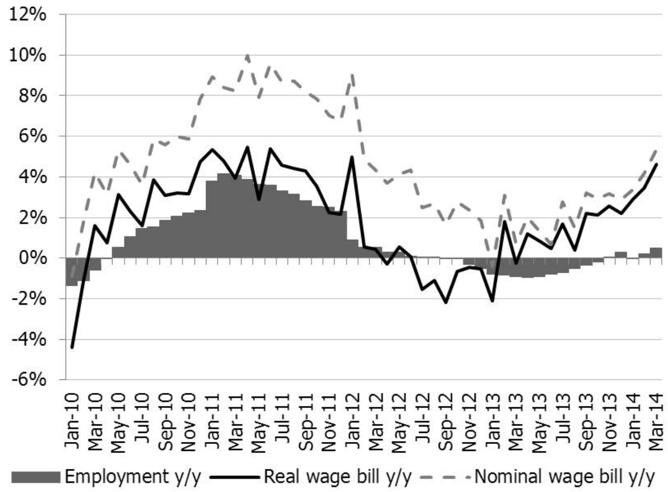


Producer prices went down by 1.3% y/y (prev. -1.4%, market consensus -1.2%), in line with our forecast. Our estimates suggest that prices were depressed by falling copper prices (8% down only in March, as measured by PLN value), oil prices and stubbornly low price expectations of producers. We do not see any symptoms of a turnaround within the underlying trend. Disinflationary upswing is confirmed from every corner (NBP activity survey, PMIs) and the slow drift of annual gauge of producer prices will be procured mainly by statistical base effects.

Labor market surprises positively. Tightening trend is evident. Corporate wages grew by 4.8% in March. Every month we are forced to comment on a preliminary release and postpone any sector-by-sector analysis until the Statistical Bulletin is published (April 23rd or 24th). Nevertheless, we believe that the acceleration in y/y dynamics can be traced back to low statistical base in manufacturing and construction. This, however, does not mean that releases close to and above 4% are an anomaly - we would like to stress the fact that the uptrend in wages has steepened recently and is close to 3.7-4.0% y/y.

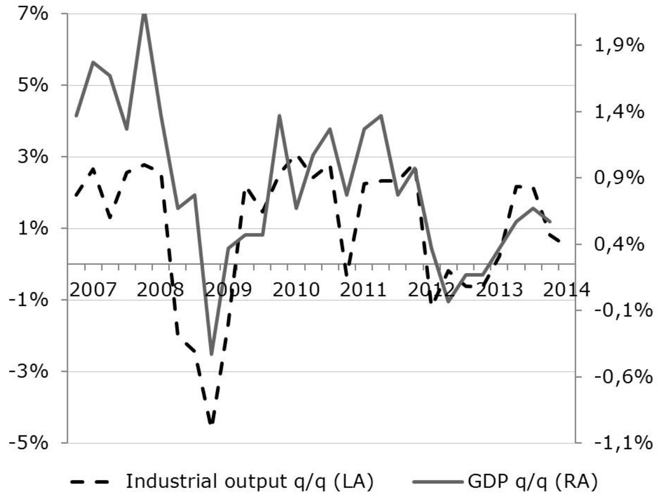


In real terms wages grew at the fastest rate since January 2009. Simple calculations yield robust figures for nominal and real wage bill, as well (respectively: 5.3% y/y and 4.6% y/y) - in both cases highest growth rates since Q3'11. Granted, these numbers look pale in comparison to what was recorded during the boom years of 2007-2008, one has to remember that right now the income base is deepening, not broadening (almost all comes from wage growth, not employment growth). In such circumstances household consumption should accelerate beyond 2% y/y.



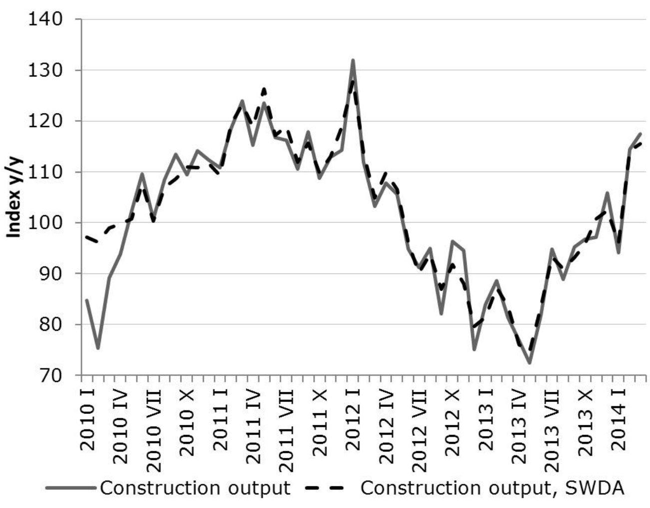
Employment in enterprise sector rose by 0.5% y/y (more than our forecast and market consensus of 0.4% y/y). Although the sector breakdown is a big unknown at this stage, the reading is positive and confirms tightening in the labor market which we expect to continue.

Possibly export-led disappointment in industrial output. Industrial output growth accelerated from 5.3% y/y in February to 5.4% y/y in March. And even though, similar to the previous month's release, industrial output was lowered by poor performance of mining (-6.3% y/y) and energy generation (-7.3% y/y), manufacturing disappointed as well. Despite a favorable statistical base from last year, manufacturing output accelerated only slightly - from 7.3% to 7.7%. Thus, while upward trends are still intact, we tend to consider March data as disappointing. On a monthly basis industrial output grew by 0.2% (seasonally adjusted). This is yet another sign that there is a distinct lack of upward momentum in the Polish industry.



April, with base effects reversing, should bring a slight deceleration of output growth (to about 4%). Such an initial forecast comes with a larger-than-usual margin of error, related to uncertainty about the political and economic effects of on-going crisis in Ukraine.

And just as in the previous month, construction was again the brightest part of the release. Contrary to some expectations, there was no negative payback from the record-high growth in February. Output grew by 24.2% on a monthly basis (in line with seasonal pattern) and 17.4% y/y. Obviously, weather has been very supportive in March as well (high temperatures, little precipitation, especially when compared to March 2013) but when this effect recedes in the coming months, it should be masked by base effects from the previous year. Finally, it must be noted that companies have relatively full order books (as measured by GUS in its enterprise surveys) and private investment (nonresidential and residential alike - easy to verify by the sheer number of cranes over major cities) has already rebounded strongly. The dichotomy between a possible soft patch in foreign demand and accelerating domestic demand is becoming more and more visible in high-frequency data. Considering that public infrastructure investments are set to take off in mid-2014, there is little to fear when it comes to domestic demand.

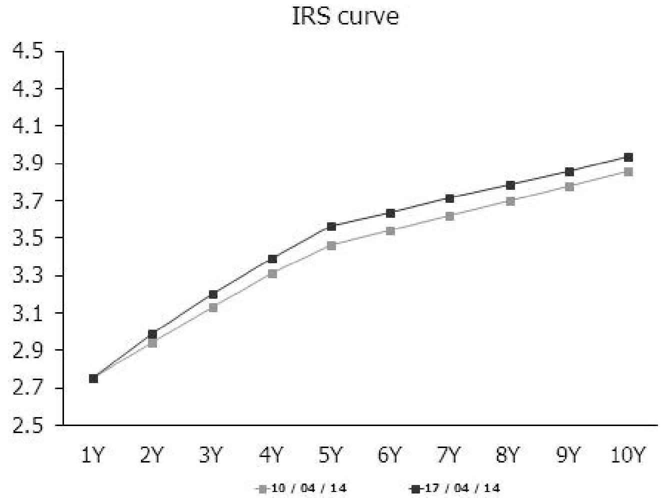


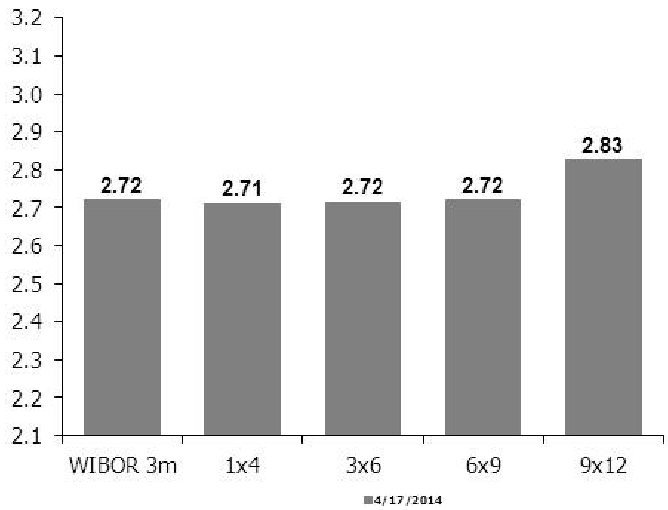
Fixed income

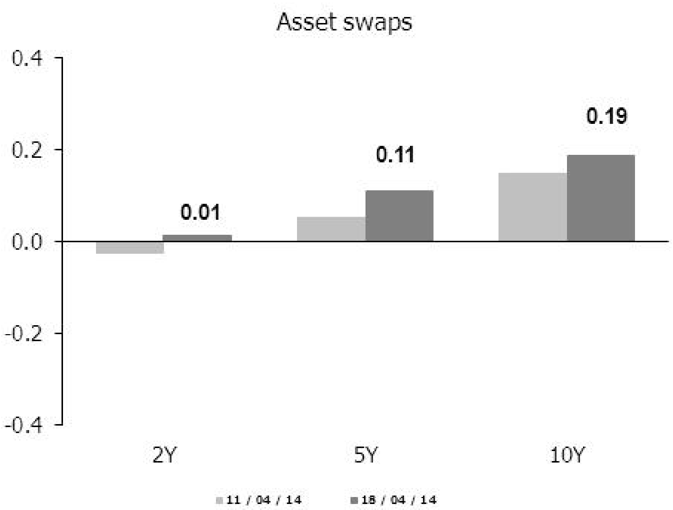
Preparing for the last auction

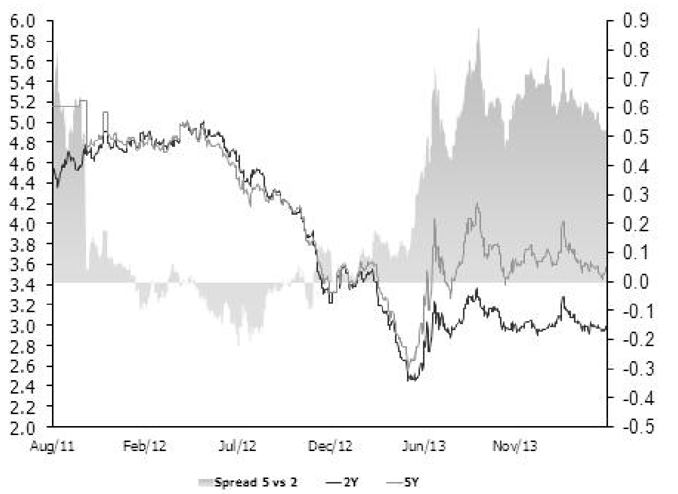
Last week on fixed income market should have been calm. There was nothing really new on our market - CPI data came out low (0.7% YoY) as expected, US kept showing very solid numbers, we were talking about possible ECB QE, Ukrainian 'crisis' was far from over. Quite the contrary, price action on the bond market was quite brutal - with low turnover, yield of DS1023 went up from 4.00% to 4.12%. We think current levels are more reasonable.

Invesors are preparing for last 'big' auction (MinFin announced earlier that they going to lower the supply of bonds after April). We don't think bonds can rally before the auction (supply up to 10bln is enough for all buyers), but after its results we may see some positive sentiment again.





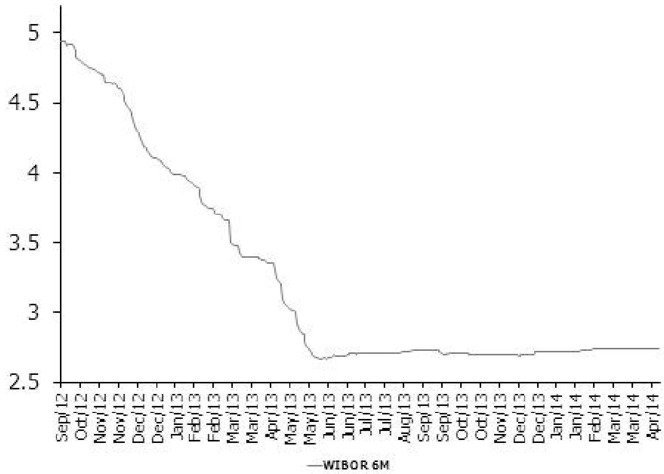


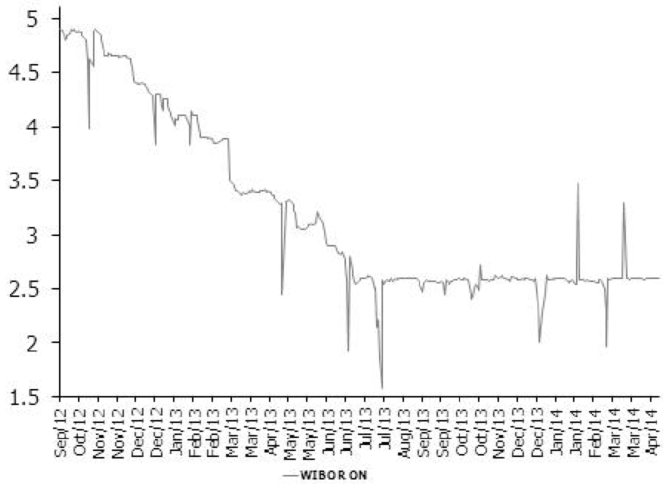


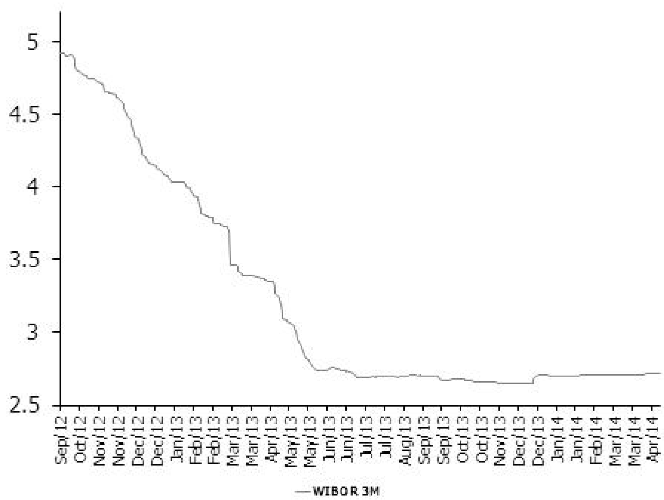
Money market

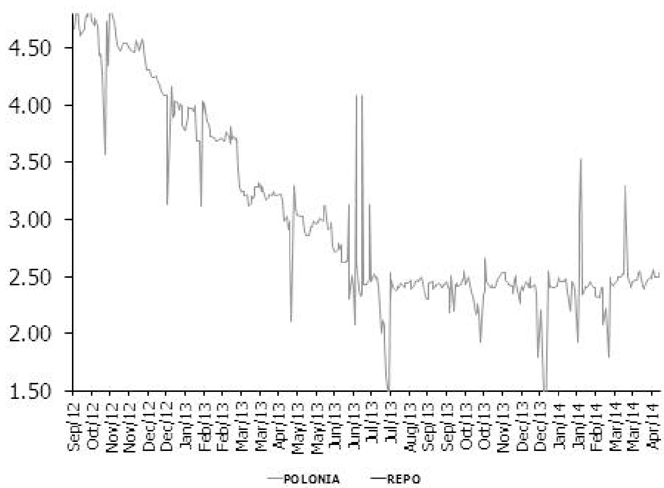
Expensive. Again. Expensive. Again. Polonia fluctuated around 2.50. At today's auction the NBP offered 109.5 bn money bills (just the exact amount to square the market) and banks bought all of it. Next week will be expensive for sure.

Without pension funds the cash market is less volatile and in the longer period Polonia will be around reference rate. But fortunately there is still risk related with end of the month when rates might fall. So it might be a good idea to buy short (1, 2 and 3W) OIS at the beginning of the month and sell 1M OIS.









Forex

PLN weaker in range EUR/PLN tested the 4.1980 high before a sharp reversal back to 4.1810 on the back of Geneva agreement easing same of the geopolitical tensions. Time will show how it unfolds. EUR/PLN is still ready to move higher in a wider (4.16 - 4.24) range. The possible easing action from ECB and the geopolitical tension in Ukraine is keeping the EUR/PLN between the rock and a hard place.

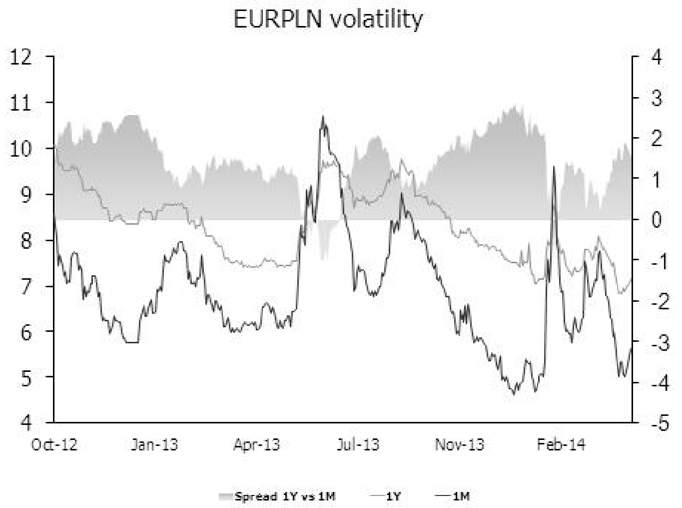
Vols bit higher The bids for Gamma/Vega finally crept back to the market. With their help, the vols are off their lows, the main gains were noted in the frontend. Where 1 month EUR/PLN ATM mid is this holiday Friday at 5.6% (0.6% higher than the last week). 3 month EUR/PLN are higher by 0.5% to 6.1%, and finally 1 year fixed at 7.2% (0.2% higher). The skew was also in demand with bids for 1 month and 3 month RR, driving the RR higher by roughly 0.2%.

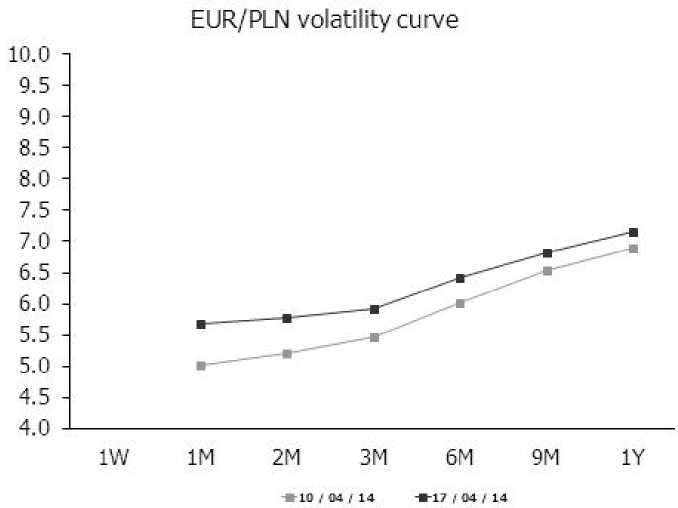
Short-term forecasts

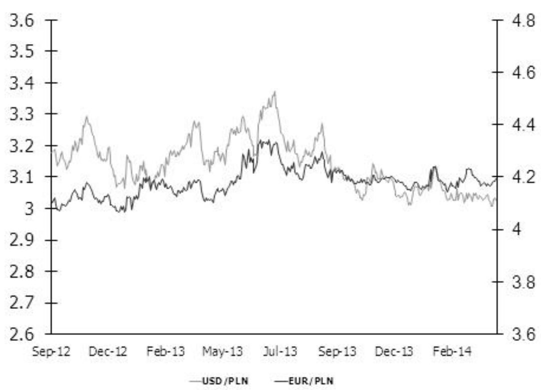
SPOT Main supports / resistances:
EUR/PLN: 4.1400 / 4.2600
USD/PLN: 3.0000 / 3.1500

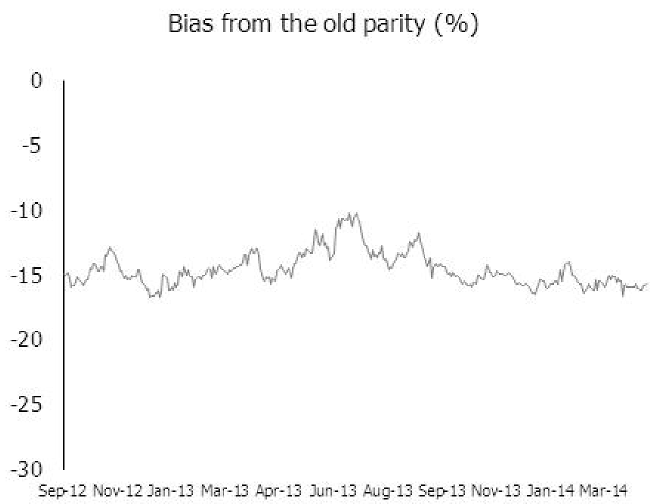
Play range from the long side Unchanged from last week. Already long 4.1650 and ready to add 4.1450 with a stop at 4.1300 and hopes for a move above 4.22. Basically we try not to over-think, if that is a range - play it until the market proves you wrong. The move is painfully slow, so patience is required.

Long vega We have reloaded our longs in mid/back of the vol curve. And the vols seem to have bottomed exactly on the year's lows. The move up has already started and hopefully it will gather speed. To achieve that, EUR/PLN needs to properly break 4.20/4.22 resistance zone first as the reverse correlation between the PLN strength and the level of vol is really strong.









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
4/14/2014	2.54	2.72	2.68	2.64	2.92	2.69	2.72	2.72	2.72	2.81	2.96	2.78
4/15/2014	2.75	2.72	2.80	2.64	3.05	2.69	2.71	2.71	2.73	2.81	2.94	2.78
4/16/2014	2.45	2.72	2.58	2.64	2.81	2.69	2.71	2.71	2.72	2.83	2.98	2.78
4/17/2014	2.55	2.72	2.68	2.64	2.91	2.69	2.71	2.72	2.72	2.83	2.99	2.77
4/18/2014	2.55	2.72	2.68	2.64	2.91	2.69	2.71	2.72	2.72	2.83	2.99	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
4/14/2014	2.690	2.728	2.950	2.940	3.515	3.558	3.915	4.057
4/15/2014	2.690	2.723	2.965	2.973	3.525	3.627	3.930	4.119
4/16/2014	2.690	2.745	2.995	2.980	3.550	3.635	3.945	4.144
4/17/2014	2.690	2.767	2.990	3.005	3.565	3.676	3.935	4.125
4/18/2014	2.690	2.767	2.990	3.005	3.565	3.676	3.935	4.125

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
4/14/2014	5.30	5.65	6.18	7.03	7.03	2.86	0.74
4/15/2014	5.48	5.79	6.25	7.04	7.04	2.86	0.74
4/16/2014	5.64	5.88	6.38	7.15	7.15	2.91	0.73
4/17/2014	5.68	5.93	6.41	7.15	7.15	2.96	0.72
4/18/2014	5.68	5.93	6.41	7.15	7.15	2.96	0.72

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
4/14/2014	4.1855	3.0288	3.4437	2.9772	1.3605	0.1524
4/15/2014	4.1840	3.0325	3.4409	2.9806	1.3609	0.1523
4/16/2014	4.1925	3.0272	3.4461	2.9582	1.3617	0.1527
4/17/2014	4.1968	3.0317	3.4471	2.9720	1.3628	0.1525
4/18/2014	0.0000	0.0000	3.4471	2.9720	1.3628	0.1525

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