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Polish Weekly Review

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Comment on the upcoming data and forecasts

Another quiet week ahead of us. Little attention is paid to inflation expectations and rightly so - they follow actual CPI readings very closely. Manufacturing PMI report for April should, on the other hand, by closely watched. Although a modest rebound in German indices (PMI and Ifo) offers some room for improvement in Polish industry as well, we are inclined to believe that Ukrainian - Russian conflict was still weighing on the sentiment of Polish manufacturers. Hence, PMI should stabilize around last month's levels.

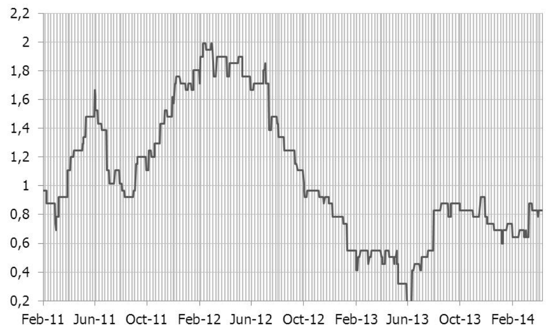
Polish data to watch: April 28th to May 2nd

Publication	Date	Period	mBank	Consensus	Prior
PMI manufacturing (pts.)	02.05	Apr	54.1	54.1	54.0

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	-	800	3.024	4/23/2014
5Y T-bond PS0718	-	5300	3.549	4/23/2014
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

One day, two releases, two surprises, Polish surprise index... unchanged. Reason? Sharply up because of unemployment and sharply down after retail sales. Next week brings only one possible surprise - the PMI.

* 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

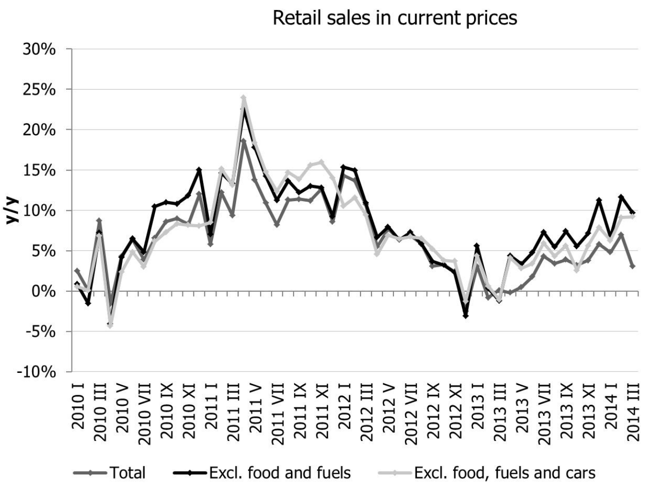
	2013 Q1	2013 Q2	2013 Q3	2013 Q4	2014 Q1 F	2014 Q2 F	2014 Q3 F	2014 Q4 F
GDP y/y (%)	0.4	0.8	2.0	2.7	3.0	3.1	3.6	4.3
Individual consumption y/y (%)	0.0	0.1	1.0	2.1	2.3	2.6	2.8	3.1
Public Consumption y/y (%)	0.1	5.0	3.0	3.1	2.0	2.0	2.0	3.0
Investment y/y (%)	-2.4	-3.3	0.5	2.0	3.8	5.3	7.5	8.5
Inflation 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

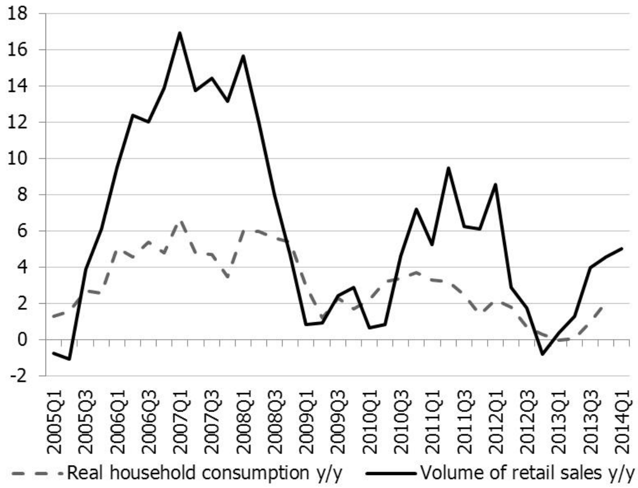
Economics

Retail sales missed expectations. Easter effect accompanied by softer auto sales is to be blamed.

Retail sales rose by 3.1% in March, much below market consensus (5.7%) and our forecast (6.5%). The weakness disappears on closer inspection. Like never before, only a small fraction of before-Easter sales occurred in March (only 8% m/m growth in food sales, 13% increase in non-specialized stores). There is much to be made up for in April. Apart from Easter distortions, we witnessed an unexpected weakness in auto sales (only 12.3% y/y after 25% y/y a month before). It seems that press releases on unprecedented demand due to tax reasons were flawed or supply constraints came into force (in the latter case some sales may pop up in April). A clear picture of sales is offered by synthetic indices excluding food and fuels (9.7% y/y vs 11.7% in the previous month) and additionally excluding motor vehicles (9.2% vs 9.1% a month before). From this angle there is no break in upward trend - see the graph for confirmation.



The origins of negative surprise suggest that we may see a double-digit growth of sales in April However, poor March result is going to leave its trace on Q1 consumption where some flattening of growth is going to be seen. Of course it has nothing to do with Eastern events since consumption and domestic demand are well shielded from negative trade shocks of small magnitude. Those are more visible in industrial output and exports but - as already said - are of lesser importance. Therefore, we think Q1 growth is set to fall somewhere between 3.1 and 3.3%. Adverse export shocks are likely to affect the whole H1 when GDP growth is seen to be flatter than in a scenario in which momentum gained in 2013 is carried over to 2014 without disruptions. Lost product is going to be made up in H2 and we withhold 2014 GDP growth at 3.5%.



We do not think that retail sales volatility around March and April has any potential to distort the positive scenario of the MPC. Recently the moods there have even grown more optimistic with 3.5-3.7% GDP growth taken for granted by some rate-setters. We are well aware that the better the consensus, the easier it gets roiled by negative surprises. Therefore, we still think that negative surprises in the data may bear some expectations for additional monetary accommodation. However, at current juncture and with the consensus so strong, there has to be an exogenous factor (ECB's QE for instance and ensuing PLN appreciation) to give those expectations a chance to come true, at least in the weeks ahead.

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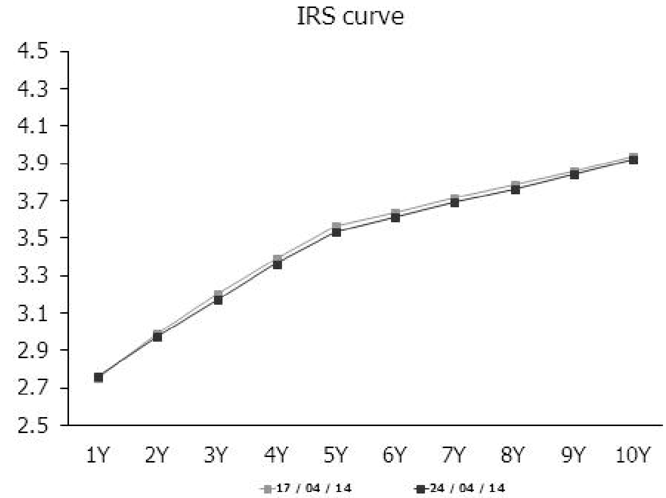
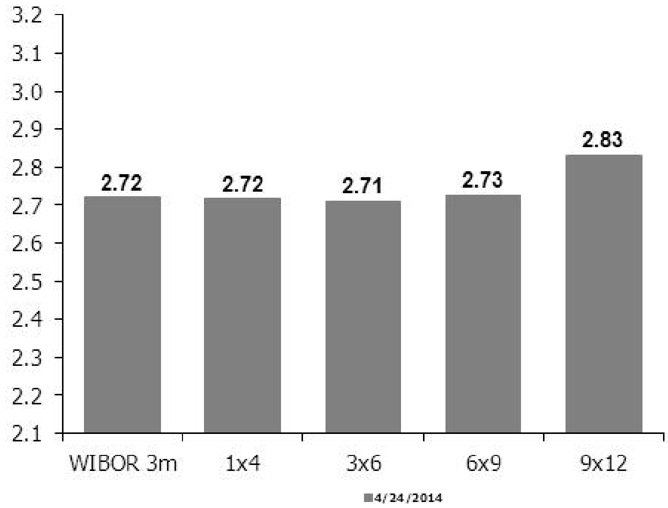
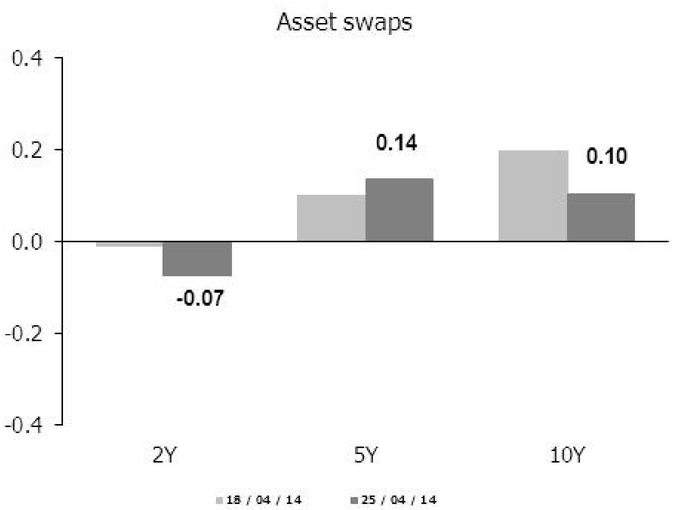
Fixed income

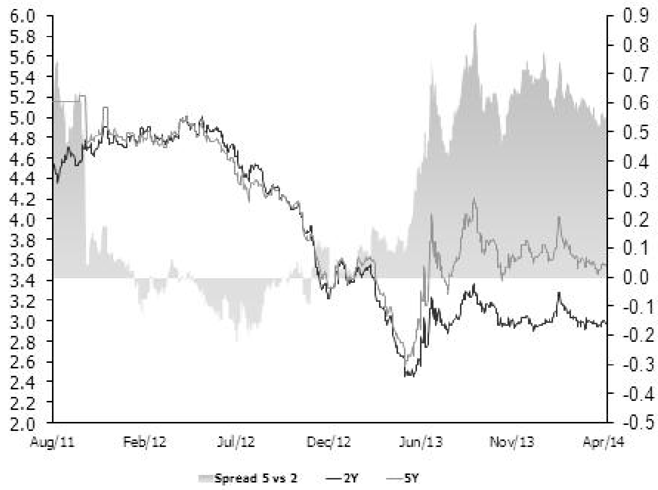
'Ukrainian Spoof'? Not again.

It was a bullish year so far. Just as it should have been. The yield of DS1023 went down from 4.50% in January to 4.10% currently, because of record low inflation, Pension Fund 'reform' that eased budget deficit pressure, and possible QE in the Euroland. If you consider good carry on bonds, long position was the only reasonable one. However, there have been significant 'upbeats' on yields - one when Turkish Central Bank increased it's main rates by 550bp and one when Russian-Ukrainian tensions were the strongest. In traders' terminology we could call these accidents as 'spoofs' and the question is, is it going to happen again? In our opinion investors are more resilient against such pressure right now and with lower supply of bonds in comming months we can see a rally on PolGbs, especially in the belly of the curve.







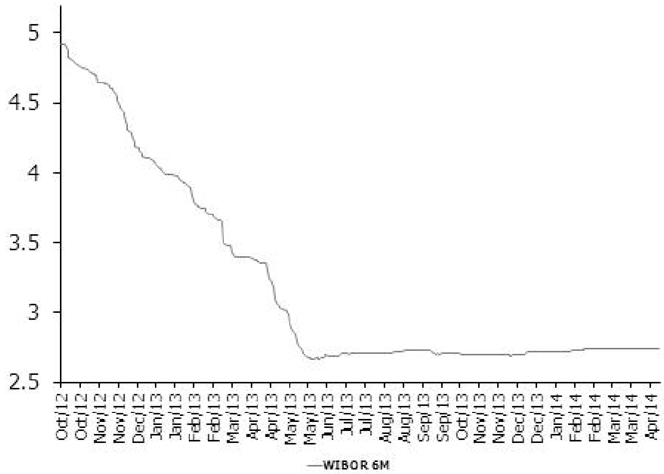


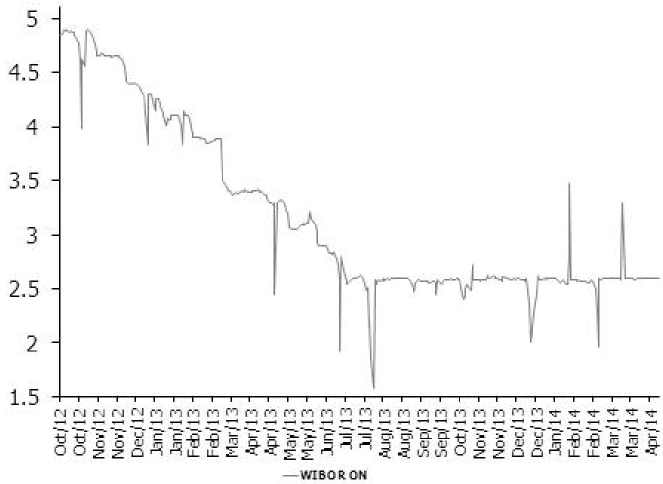
Money market

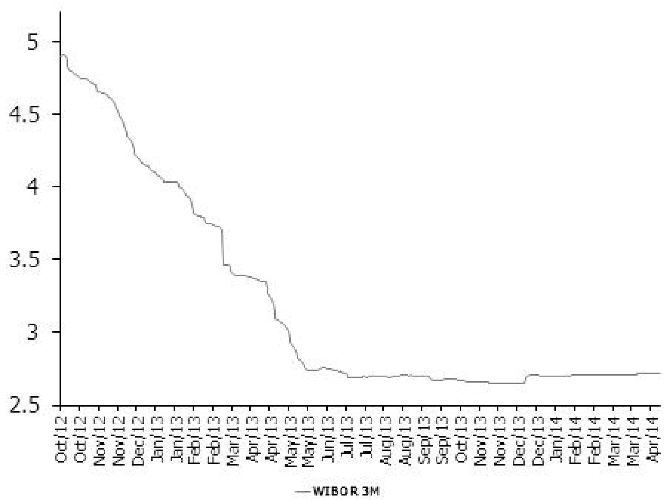
Tedious lack of volatility Shorter week due to Easter behind us and another shorter week due to national holidays ahead imposed a vacation mood on the local market. No volatility whatsoever, no thrill at all. Market is completely ignoring the escalation of the Ukrainian issue, local and global economic data etc. Some emotions during the bond auction but also with a very limited impact.

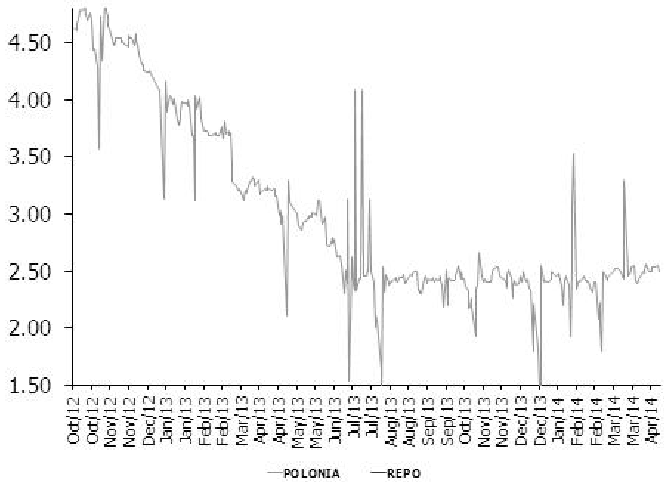
End of the reserve requirement settlement period should be much cheaper then last days. Banks bought 10 billion less of money bills then the central bank had offered. Last month was surprisingly expensive having in mind the scale of over liquidity in the system. Moreover, no additional OMOs were involved. The Polonia to reference rate spread became positive for the last couple of weeks, which is a bit strange to us. We are closely observing this trend.

Recommendation 2Y bonds still good for carry trades.





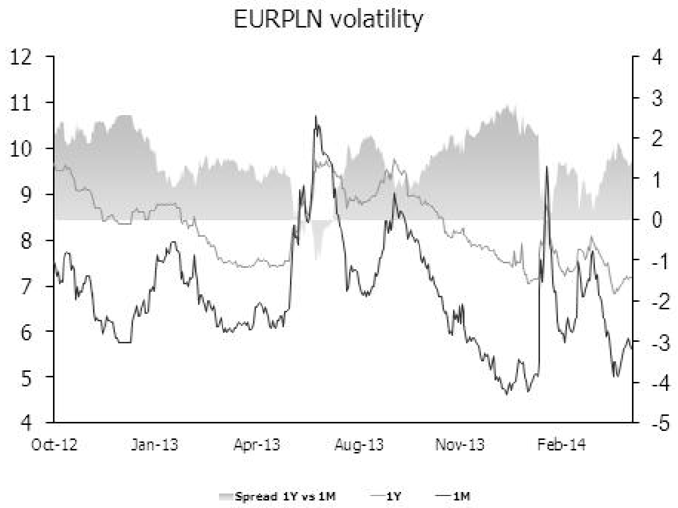




Forex

PLN weaker in range EUR/PLN was traded very stable in the vicinity of 4.19 until Thursday evening, when tensions in Ukraine increased further. Then EUR/PLN went north and has decisively broken the 4.1980/4.20 psychological resistance zone (local high) and reached 4.2080. But hasn't stayed there too long. Now it's traded around 4.2020. Time will show what was it worth, with EUR/PLN still ready to move higher in 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 consolidating During the first three days of last week the Zloty was very stable, traded in a narrow range 4.175/4.1900 and realized volatility fell. So there was nothing strange that the ATM's Volatility were traded lower around 0.5%. But after the deterioration of atmosphere and EURPLN's move over 4.20, the bids for gamma and vega have appeared and finally now volatilities are identical as week before. 1 month EUR/PLN ATM mid is around 5.6%, 3 month EUR/PLN is 6.1%, and finally 1 year fixed at 7.25%.

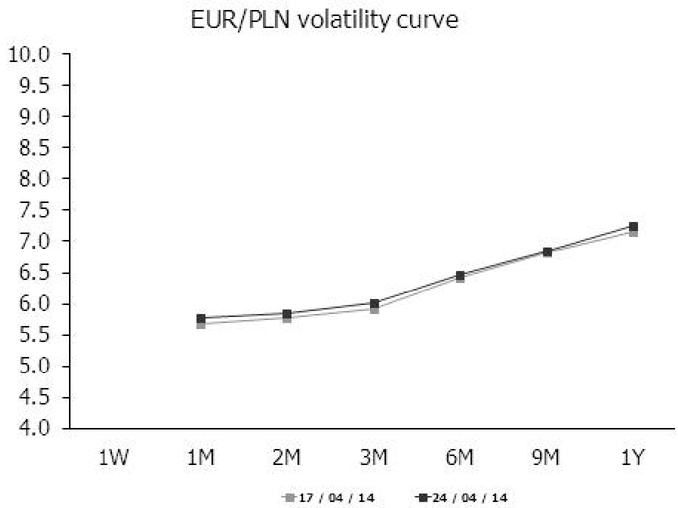


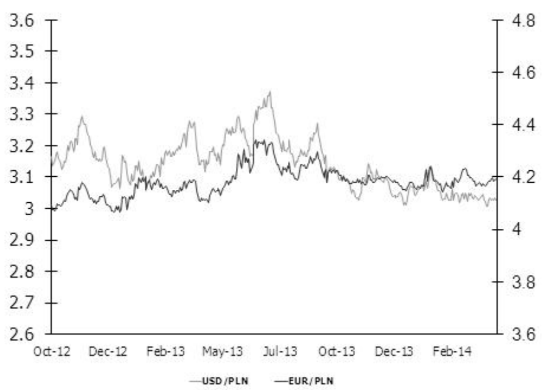
Short-term forecasts

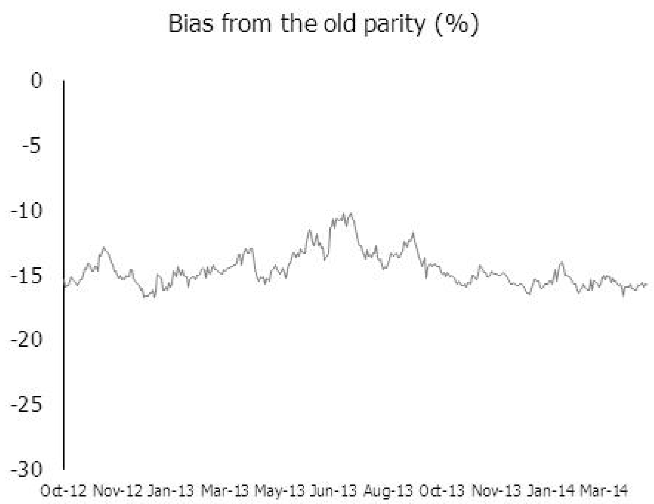
SPOT Main supports / resistances:
EUR/PLN: 4.1400 / 4.2600
USD/PLN: 3.0000 / 3.1500

Play range We still assume we are in the range, which now would most probably be at 4.16 - 4.24. We are more keen to sell spikes with ideal entry levels at 4.23-4.24, stops above 4.25 and hopes for a move below 4.19. The move is painfully slow, so patience is required.

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







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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
4/21/2014	2.73	2.72	2.78	2.64	2.69	2.69	2.72	2.72	2.73	2.95	2.98	2.78
4/22/2014	2.72	2.72	2.85	2.64	2.94	2.69	2.72	2.72	2.72	2.83	2.99	2.77
4/23/2014	2.49	2.72	2.62	2.64	2.84	2.69	2.72	2.72	2.74	2.84	2.99	2.79
4/24/2014	2.58	2.72	2.70	2.64	2.92	2.69	2.72	2.71	2.73	2.83	2.97	2.76
4/25/2014	2.58	2.72	2.70	2.64	2.92	2.69	2.72	2.71	2.73	2.83	2.97	2.76

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
4/21/2014	2.690	2.760	3.003	2.993	3.550	3.656	3.940	4.144
4/22/2014	2.690	2.657	2.980	2.913	3.560	3.685	3.960	4.024
4/23/2014	2.690	2.664	2.980	2.986	3.540	3.654	3.940	4.126
4/24/2014	2.690	2.641	2.975	2.903	3.535	3.672	3.920	4.024
4/25/2014	2.690	2.641	2.975	2.903	3.535	3.672	3.920	4.024

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
4/21/2014	5.85	5.98	6.44	7.15	7.15	2.96	0.72
4/22/2014	5.74	5.90	6.40	7.18	7.18	2.96	0.72
4/23/2014	5.63	5.98	6.40	7.18	7.18	2.93	0.72
4/24/2014	5.78	6.01	6.48	7.24	7.24	2.93	0.73
4/25/2014	5.78	6.01	6.48	7.24	7.24	2.93	0.73

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
4/21/2014	4.1820	3.0265	3.4293	2.9549	1.3631	0.1524
4/22/2014	4.1890	3.0340	3.4307	2.9584	1.3649	0.1526
4/23/2014	4.1914	3.0273	3.4337	2.9535	1.3643	0.1525
4/24/2014	4.1893	3.0285	3.4327	2.9584	1.3583	0.1526
4/25/2014	0.0000	0.0000	3.4466	2.9584	1.3579	0.1531

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