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Polish Weekly Review

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Comment on the upcoming data and forecasts

We end the series of monthly data releases on Monday when the CSO is set to publish the Statistical Bulletin along with retail sales and unemployment data. The strong acceleration of retail sales growth is mainly due to Easter effect. This year, very late Easter pushed most of pre-Easter expenditures to April, as opposed to the previous year (all expenditures in March). As a result, just as the March reading was biased downward, the April one should be biased upward. Downside risks to our forecast are associated with car sales, due to lower than expected car registration numbers for April. Unemployment rate continues to fall, as the Ministry of Labor reported earlier this month. Finally, we end the week (and the month) with the release of detailed GDP data (Friday). While net exports still contributed positively to growth, we expect that it was driven primarily by household consumption (+2.7% y/y) and investment (more than +6% y/y).

Polish data to watch: May 26th to May 30th

Publication	Date	Period	mBank	Consensus	Prior
Retail sales y/y (%)	26.05	Apr	10.7	8.4	3.1
Unemployment (%)	26.05	Apr	13.0	13.0	13.5
Inflation expectations (%)	30.05	May	0.4	0.5	0.5
GDP *final* y/y (%)	30.05	Q1	3.3	3.3	3.3

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 PS0719	-	4000	3.406	5/8/2014
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

Unchanged - all releases from last week were broadly in line with expectations. Next week brings two macro publications that could move our index. Given recent trends for both of them, it might be prudent to expect positive surprises.

* 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

- 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).
- 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 (food price deflation and strong labor market are to boost consumtion going forward). We see substantial support from investment activity already materializing. 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 (nontradables prices show moderate inflation though).
- The MPC has already acknowledged low inflation and possible negative spillovers from Ukraine events. We feel the MPC is focused on strenghtening low rates environment and stay very dovish (this includes a risk of a rate cut if zloty strenghtens significantly, inflation drops and ECB delivers). 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

- We are positive on Polish bonds due to global signals (easing from the ECB and the Fed tries to talk down rate hikes by drawing attention to fundamental weaknesses in the labor market) and local factors (the possibility of softer growth in mid-year due to Ukraine / Russia, play on renewed monetary easing or correction of expectations regarding natural interest rate level for Poland). Furthermore, Poland might be increasingly seen as a high-yield alternative to euro area, especially if Polish track record of stable growth and very low FX volatility is considered.
- 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. Debt crisis style sell off in peripheral countries (low growth and low inflation means more austerity (=even worse equilibrium) or decisive ECB intervention) would make Polish assets suffer in the short-term, mid-term consequences rather favorable due to expectations for lower rates also in Poland.
- 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	3.3	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	2.75	2.80	2.90
10Y Polish bond yields (% eop)	3.94	4.34	4.48	4.35	4.23	3.55	3.90	4.50
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	3.01

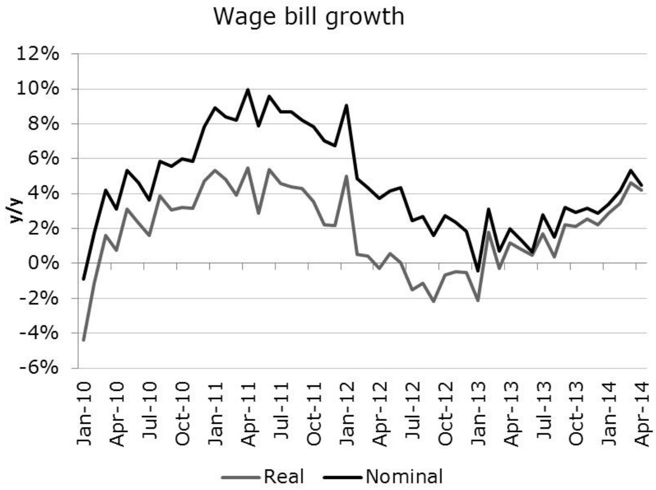
F - forecast

The economy is on track. Monetary easing still in play due to low inflation, ECB policy and strengthening zloty.

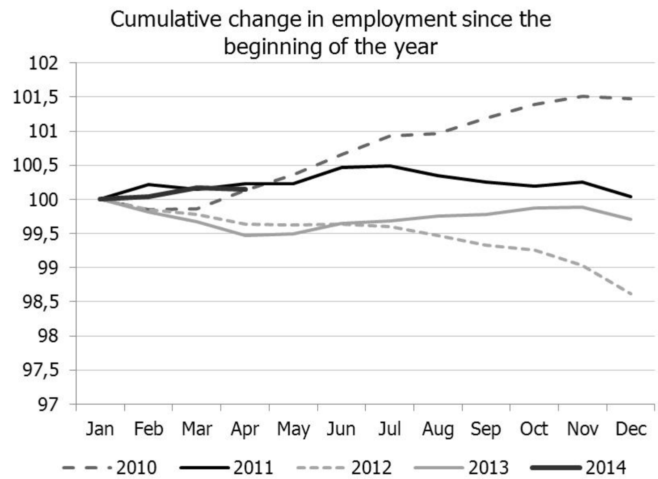
In comparison with the previous week's releases (GDP and inflation), this week we witnessed a rather boring set of macro figures. These mostly confirmed that the economy is moving nicely and in line with recent trends, while the few slight surprises we've noted can reasonably be attributed to one-off factors such as shifts in seasonal patterns caused by the extremely mild winter. The Ukrainian / Russian turmoil appears to be either completely benign or masked by increased demand from Western Europe. In any case, industry has at the worst stalled (with growth rates flattening) in recent months. The MPC, on the other hand, seems to be preoccupied with low inflation. Rate cut talk continued in recent days (with Belka claiming that inflation is „too low" and Bratkowski assigning a 10% probability to a rate cut) and the game is still on. Such a setup supports Polish bonds along the whole curve and the increased awareness of political risks in Eurozone periphery (resulting in the recent sell-off) seems to be the only limiting factor (possible short term disruptions).

As usual, here's our take on last week's releases.

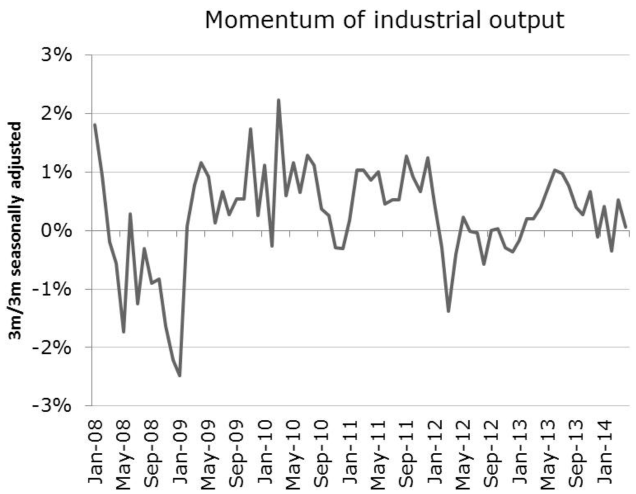
Corporate wages grew by 3.8% y/y in April, following a 4.8% increase in March. The reading was close to the consensus and to our forecast (both 4.0%). Every month, we are forced to comment on a preliminary release and postpone any sector-by-sector analysis until the Statistical Bulletin is published. Nevertheless, we believe that the deceleration in y/y dynamics can be traced back to deviation from seasonal pattern in mining and a continuation of low dynamics in the energy sector. We affirm our stance that the current trend in wage dynamics is approaching 4% and will be steepening further in the following months. The above considerations apply also to the changes in real wage bill, which is growing at the pace of 4.2% y/y. Such a dynamic indicates significant acceleration of private consumption, most likely amounting to approximately 3% y/y as compared to stagnation we have witnessed as recently as few quarters ago. The fundamental factors driving wage growth encompass: the labor-intensive and Germany-dependent model of Polish economy, unfavorable demographic changes (that put downward pressure on labor supply) as well as low labor costs in comparison with other European countries. These suggest that there's a scope for further significant growth of wages in Poland.



Corporate **employment** grew by 0.7% on annual basis, slightly below market consensus and our forecast (0.8%). On a monthly basis, employment actually registered a tiny drop (by around 900 jobs). The lack of detailed data forces us, as in each month, to speculate about the reasons for the surprise. While it is possible that the weaker-than-expected result is due to a one-off shift in seasonal hiring patterns (the lack of winter allowed for earlier start to certain seasonal jobs), it does not explain the drop itself - after all, employment usually increases in April, save for economic downturns (and business tendency indicators for April were generally encouraging). Nevertheless, ytd employment growth is still strong this year - on par 2010-2011 and obviously above the dismal performance in years 2012-2013 (see the graph below).

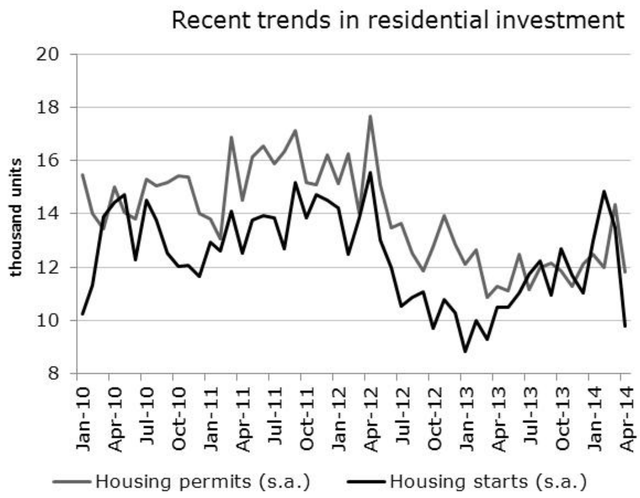


The annual dynamics of **industrial output** in April totaled to 5.4%, which is exactly the reading we witnessed last month. The figure was close both to consensus and to our forecast. The April's data, similarly to the March one, was negatively influenced by the production of energy and hot water supply. On the other hand, despite high (albeit a modest one) statistical base from recent year, manufacturing grew by 7.3% y/y. On seasonally adjusted basis, the annual dynamics decreased to 5.3% from last month's 5.7%. In terms of the momentum (3 month average), industrial production has stabilized. 27 out of 34 sections experienced growth on annual basis. Growth was driven mainly by the exports sectors and the sections with close ties to the construction.



The distinct feature of recent industrial production readings is the lack of significant momentum, thus we can assume that the Polish industrial sector is waiting for a demand impulse. The negative one (triggered by the tensions in Ukraine), seems not to be strong enough so as to derail the recovery. When it comes to prospective, future impulses, we could expect a new wave of infrastructural investment in the second half of the year (a positive one), as well as the increasing anxiety over the stability of the Eurozone (a negative one).

Construction output grew by 12.2% on annual basis (seasonally adjusted -5.4% m/m and +13.3% y/y), materially below the consensus forecast of almost 20% y/y. Moreover, construction slowed down despite significant and positive statistical base and contrary to seasonal patterns that implied a solid m/m increase. The surprise was foreshadowed by housing data published yesterday (20-30% m/m declines in the number of housing starts and permits). This offers a way to solve the puzzle. Construction activity has suffered from adverse effects of early spring - the beginning of the year was phenomenally good for the sector and multiple projects that would otherwise have begun in April, have already started in February and March. Thus, there is no reason to doubt that construction is in for a very good year, thanks to the revival of private investment (already happening) and expected launch of public infrastructure projects in the second half of the year.



Producer prices fell by 0.7% y/y (in line with market consensus and our forecast), having declined by -1.3% y/y in the previous month. The much slower decline is, however, a result of base effects - on a monthly basis producer prices actually fell a little. The lack of cost pressure from commodities (largely unchanged in PLN terms, prices of mining output fell slightly) continues to result in subdued factory gate prices. Core manufacturing (excluding coke and petroleum refining) prices fell again by 0.1% m/m. As a result, price pressures on the producers' side are nonexistent.

Fixed income

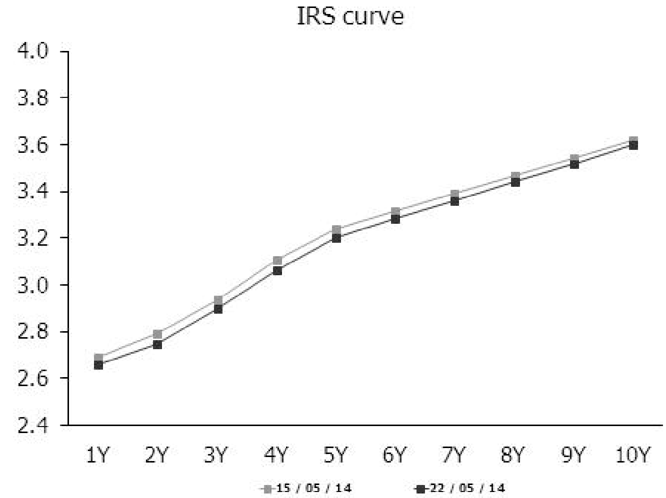
Mixed expectations

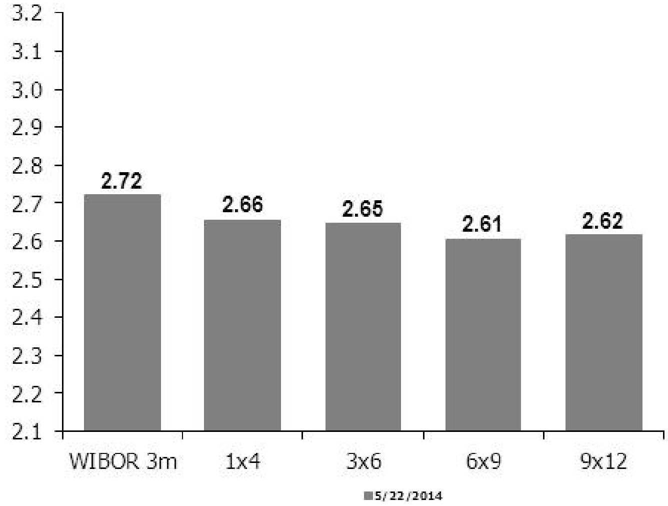
What are market talks now? ECB QE, dovish FED, possibly rate cut by NBP. All of those are obviously considered as bullish signals. No wonder POLGBs came back on the upside path again. Recent sell-off (DS1023 form 112,80 to 110,80 – 25bps) was explained by profit-taking / stoploss-pushing on a bit heavy market. So after marking a low, the market has negated the recent move and DS1023 is trading as high as 102,15 now.

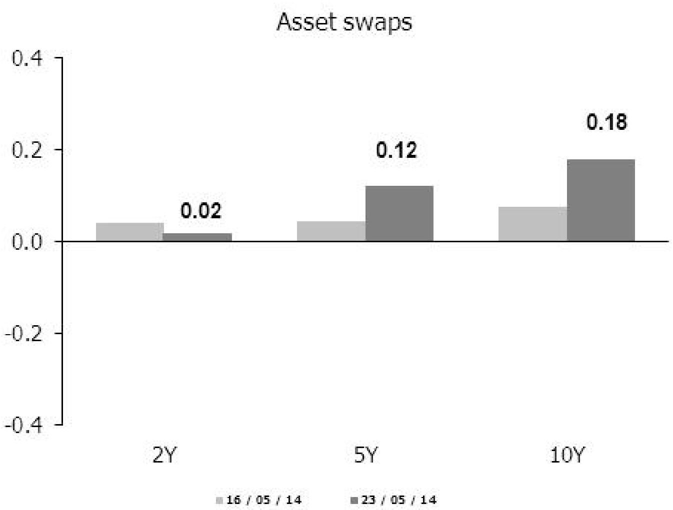
As we have no doubt about the perception of Fed as bit dovish, no doubt that the ECB will take some action either, the last interview with Mr Bratkowski has cooled down market expectations for rate cuts. He strongly pointed that even potential deflation but in decent GDP growth environment is not rate cut setup. Again no wonder, as the NBP sees Polish potential GDP growth at 2,5-3,0%.

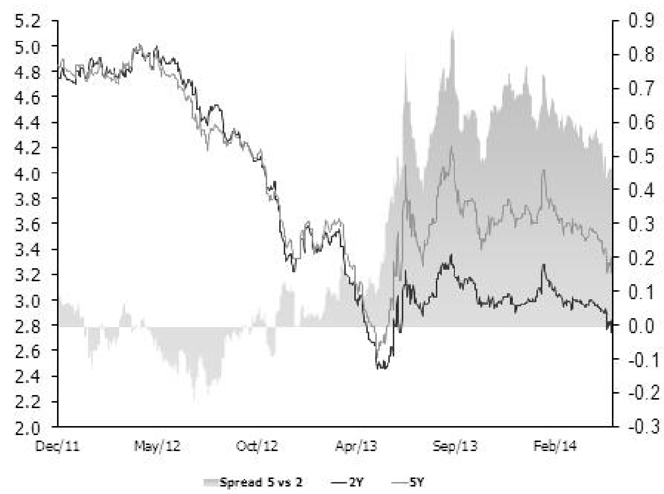
So, no cut (probably) but bullish regional/global environment? With low inflation (about 0,5%) and decent GDP growth (3,5-4,0%) environment? First (bit obvious conclusion) is curve flattening. 2Y bonds trading about WIBOR rate (that is so expensive), 10Y 100bps above them. Too steep.

Sell 2-3Y bonds, buy 8-10Y bonds. 100bps (now) entry level, 60bps P/T, 125bps S/L









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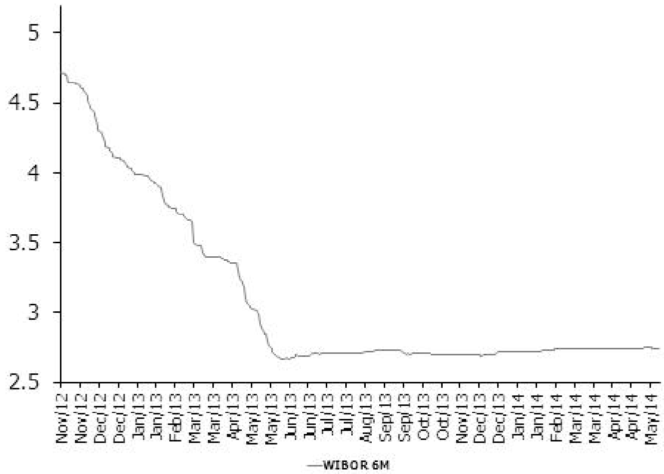
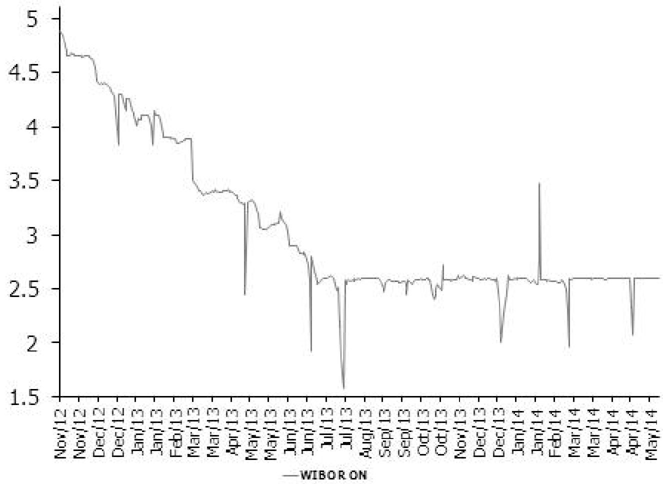
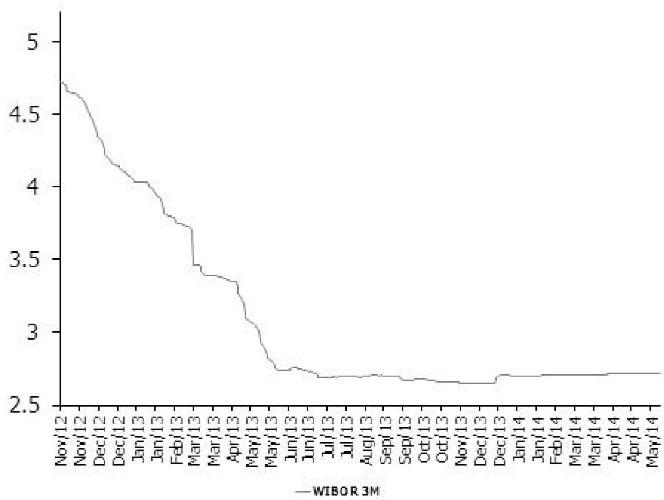
Money market

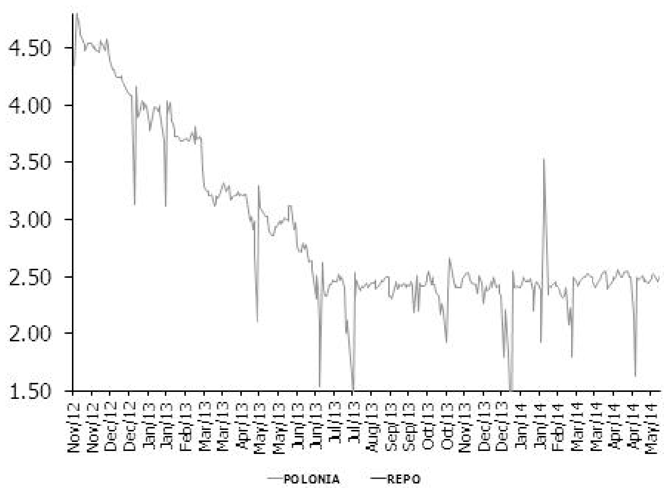
Expensive week behind and ahead of us. Polonia fluctuated a bit under 2.50 and after today's OMO (113.6 vs 112 offer) it will be probably same next week. Last week of reserve won't be cheap this month.

Recommendation: After Belka's statement about deflation, market pushed all short FRA's under WIBOR by 10 bps. Also 1Y OIS was dealt around 2.40. Our recommendation is to buy short FRAs under WIBOR and sell short OIS (3-9M) to hedge it at 2.43.









Forex

PLN stronger. EUR/PLN collapsed to 4.1505 from 4.1970 last week's high. The move was fueled by the widespread expectations of the rate cut and possible announcement of QE by the ECB, and general market optimism. As a result, strong gains in EM versus EUR, especially TRY, ZAR, HUF were seen, PLN was simply mimicking that move in the smaller scale. Technically 4.14/4.15 is a strong support zone and we expect it to hold till ECB.

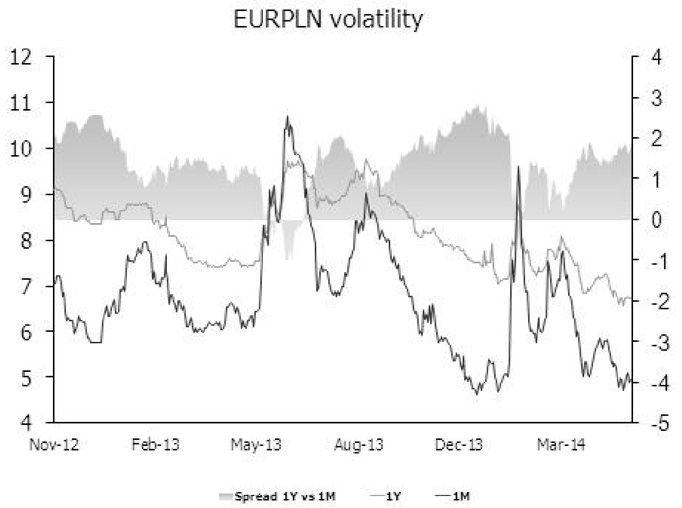
Vols choppy. The EUR/PLN were drifting lower for the most of the week, (2 months given at 5.0 % , 3 months given at 5.2 %), in sympathy with stronger PLN. The market has changed heart, on Friday with the curve jumping higher, especially frontend, (3 month were paid at 5.4 %). We are closing the week almost unchanged to the last week, 1 month EUR/PLN ATM is 5.2 % (higher by 0.35 %). 3 months is 5.5 % (0.1% lower) and finally 1 year is fixing at 6.8 % (0.1 % higher). The picture is blurred, but at least we see some interest, the fine tuning before ECB the most likely. Skew generally unchanged.

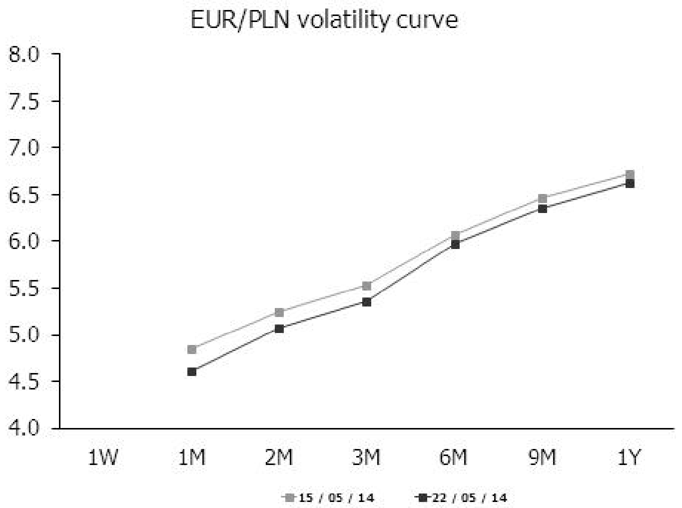
Short-term forecasts

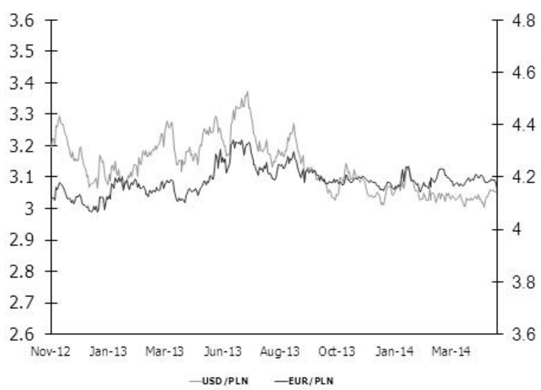
SPOT Main supports / resistances:
EUR/PLN: 4.1400 / 4.2600
USD/PLN: 3.0000 / 3.1500

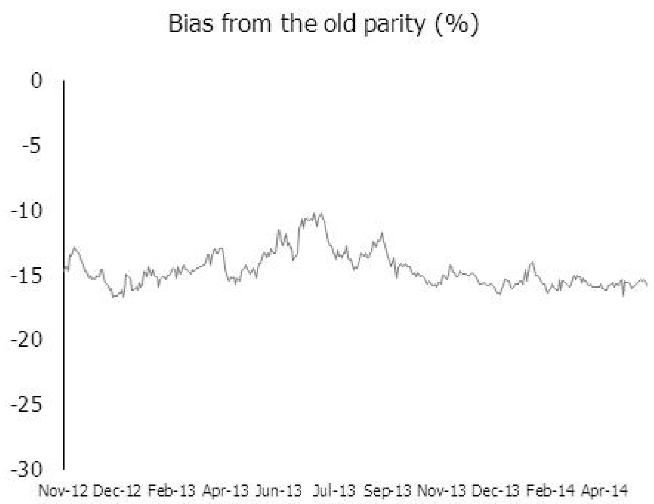
Spot: EUR/PLN Play range. We have missed an entry point, again (wanted to sell at 4.21). We are tactically long now at 4.1550 ready to add 4.1400 with a stop below 4.1300, and hopes for move to 4.19+. It is a purely technical position.

Options: still sidelined. In general still sidelined, skewed to buying VEGA at historically low vols, but also bearing in mind that realized volatility is even lower, well below implied. We are waiting for pick up in realized volatility to enter long position in VEGA. We may be waiting in vain, but risk/reward for entering now short position in Vega is simply not compelling.









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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
5/19/2014	2.62	2.72	2.75	2.64	2.94	2.70	2.68	2.68	2.68	2.68	2.77	2.68
5/20/2014	2.79	2.72	2.81	2.64	2.74	2.70	2.71	2.69	2.67	2.69	2.78	2.70
5/21/2014	2.52	2.72	2.55	2.64	2.60	2.70	2.69	2.64	2.63	2.63	2.68	2.63
5/22/2014	2.71	2.72	2.73	2.64	2.65	2.70	2.66	2.65	2.61	2.62	2.65	2.62
5/23/2014	2.71	2.72	2.73	2.64	2.65	2.70	2.66	2.65	2.61	2.62	2.65	2.62

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	4/23/2014	7/25/2016	93.51	3.02	800	2136	836
PS0719	5/8/2014	7/25/2019	99.25	3.41	4000	5807	4075
DS1023	4/3/2014	10/25/2023	97.95	4.26	3500	4905	3480

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0715	5Y IRS	PS0718	10Y IRS	DS1023
5/19/2014	2.700	2.609	2.800	2.863	3.266	3.333	3.678	3.805
5/20/2014	2.700	2.600	2.835	2.860	3.335	3.406	3.745	3.917
5/21/2014	2.700	2.583	2.740	2.778	3.225	3.406	3.630	3.809
5/22/2014	2.700	2.599	2.745	2.763	3.205	3.327	3.600	3.779
5/23/2014	2.700	2.599	2.745	2.763	3.205	3.327	3.600	3.779

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
5/19/2014	5.10	5.63	6.10	6.75	6.75	2.82	0.71
5/20/2014	4.88	5.53	6.10	6.73	6.73	2.82	0.71
5/21/2014	4.94	5.53	6.08	6.71	6.71	2.82	0.73
5/22/2014	4.61	5.36	5.98	6.63	6.63	2.79	0.70
5/23/2014	4.61	5.36	5.98	6.63	6.63	2.79	0.70

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
5/19/2014	4.1884	3.0558	3.4262	3.0141	1.3740	0.1524
5/20/2014	4.1905	3.0620	3.4273	3.0220	1.3732	0.1525
5/21/2014	4.1885	3.0540	3.4286	3.0254	1.3744	0.1524
5/22/2014	4.1755	3.0525	3.4181	3.0034	1.3753	0.1520
5/23/2014	4.1524	3.0490	3.4003	2.9953	1.3701	0.1514

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