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Polish Weekly Review

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Comment on the upcoming data and forecasts

A quiet week ahead of us. Friday brings the release of M3 data. We expect M3 growth to accelerate on statistical base effects (nonmonetary financial institutions, corporate, household deposits) and good momentum in household deposits. Next week the SAMAR institute will publish car production figures for November, while the Central Statistical Office will release international trade data for October. Release dates for the latter two publications are unknown at this time, however.

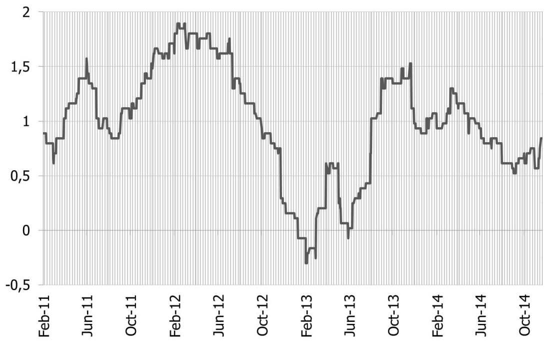
Polish data to watch: December 8th to December 13th

Publication	Date	Period	mBank	Consensus	Prior
M3 y/y (%)	13.12	Nov	8.5	7.9	7.7

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	-	2000	1.653	10/23/2014
5Y T-bond PS0719	-	3000	2.007	10/23/2014
10Y T-bond DS1025	-	2000	3.114	9/4/2014
20Y T-bond WS0429	-	150	3.464	5/16/2013

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



Comment

The PMI turned out much better than most analysts had expected. Thus, Polish surprise index extended its gains last week. Next week it should remain unchanged as no important publications are scheduled for the week ahead.

* 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

- We stick to our view that Poland entered softpatch but recovery will not be derailed. The soft patch, which contrasts with high frequency data, looks shallower than we expected. Growth stalled around 3%. Note that nominal GDP growth is very low.
- Despite regional (Russia, Ukraine) and European headwinds (soft euro zone growth), stable domestic demands lets economy pass through relatively unscathed. The source of strengh lies in consumption (both private and public) and relatively good moods among firms (production continued but so far accumulated as stocks) that commonly used sentiment indices probably understated.
- 2015 is expected to bring more (positive) exogenous components to the Polish cycle. We may see first effects of credit easing in the euro area. Pension reform, along with the political cycle, opens room for fiscal stimulation. We expect significant fiscal stimulus in 2015 onwards, focused mainly on public infrastructure spending and fueled by the re-launch of EU funding.
- 2-3 years of economic expansion are our baseline scenario but growth rates may prove to be more moderate than we expected few months ago.
- Inflation stays very low (negative) for next 2-3 quarters (longer than NBP projects). Momentum of inflation is already negative and strengthens the impact of high real interest rates.
- MPC got stuck in decision process but the combination of deflation and global factors points to a risk of further easing. The timing is hard to pin down precisely.

Financial markets

- Prolonged disinflation and MPC's easing bias are set to continously affect POLGBs. The ECB is firmly on the path towards sovereign QE. This makes positive spillovers on Polish markets very likely, offering support for Polish bonds.
- Expectations for monetary easing proved to be important factor of PLN weakness but the Zloty should be seen as too strong (and both MoF and NBP are encouraging its weakness). There is very little price action and zloty stays at the mercy of carry trades (high real rates) stimulated by structural trades for European QE. At this very moment the real risk if for PLN appreciation. However, appreciation would only make MPC easing case more compelling. All in all, between rock and a hard place – 4,20 is the natural habitat of EURPLN (+/- 5 figures on both sides).

mBank forecasts

	2010	2011	2012	2013	2014F	2015F
GDP y/y (%)	3.7	4.8	1.8	1.7	3.4	3.5
CPI Inflation y/y (average %)	2.8	4.3	3.7	0.9	0.1	0.2
Current account (%GDP)	-4.5	-4.9	-3.5	-1.3	-0.9	-1.8
Unemployment rate (end of period %)	12.4	12.5	13.4	13.4	11.9	11.5
Repo rate (end of period %)	3.50	4.50	4.25	2.50	2.00	1.75

	2014 Q1	2014 Q2	2014 Q3	2014 Q4 F	2015 Q1F	2015 Q2F	2015 Q3 F	2015 Q4 F
GDP y/y (%)	3.4	3.5	3.3	3.0	2.8	3.1	3.5	4.4
Individual consumption y/y (%)	2.9	3.0	3.2	3.0	2.8	2.8	3.2	3.4
Public Consumption y/y (%)	0.1	3.7	3.5	2.4	2.0	3.0	3.0	3.0
Investment y/y (%)	11.2	8.7	9.9	7.0	6.0	6.0	7.0	9.0
Inflation rate (% average)	0.6	0.2	-0.3	-0.3	-0.3	0.0	0.5	0.7
Unemployment rate (% eop)	13.9	12.0	11.5	11.9	12.6	11.8	10.9	11.5
NBP repo rate (% eop)	2.50	2.50	2.50	2.00	1.75	1.75	1.75	1.75
Wibor 3M (% eop)	2.71	2.68	2.28	2.10	1.89	1.91	1.95	1.95
2Y Polish bond yields (% eop)	3.01	2.51	2.00	1.80	1.80	1.90	2.00	2.08
10Y Polish bond yields (% eop)	4.23	3.45	3.05	2.50	2.50	2.50	2.70	3.08
EUR/PLN (eop)	4.17	4.16	4.18	4.15	4.10	4.05	4.00	4.00
USD/PLN (eop)	3.03	3.04	3.31	3.32	3.28	3.29	3.33	3.33

F - forecast

Rates remain unchanged, MPC keeps its easing bias. Belka accepts losing pro-cuts majority.

MPC did not change interest rates during December meeting, as most economists forecasted. Overall, the message remained the same: further cuts are still on the table if only data shows symptoms of slowdown and economics environment will keep its sluggish growth rate.

Favourable GDP growth for Q3 and improvement of other economic indices such as PMI, could have prevailed once again (as stated in November by prof. Chojna-Duch). Governor Belka, after accepting that he lost the pro-cut majority in the Council, is now willing to save face. It is likely that rate cuts weren't even voted on the meeting. In order to accomplish that he altered MPC-s communication: it will no longer respond to deflation automatically. In most of his answers, however, he mainly expressed concerns for economic growth and ability of Polish companies to adjust to deflation, which could influence investment. He also referred to stabilization of current GDP growth as an optimistic scenario.

Views on future monetary policy should be updated. For sure, one thing has not changed - a single member can still distort decision making process. Mr Belka's attempts to defend his reputation could raise the bar for resumption of cuts to a higher level. The pro-cut momentum is over - in the real economy we still observe neutral momentum, though Polish economy can yet bottom out (in y/y terms) in 2014Q4 or 2015Q1. In order to resume cuts, the MPC is waiting for strong impulses. They can come from the Eurozone or from the strengthening Zloty. Polish currency could keep rising because real interest rates in current regime are incredibly attractive for carry trades. Possibility of this scenario prevents us once again from treating MCP statements literally. We do not see MPC paralysed because of forward guidance. Bearing in mind MPC's easing bias, any cuts driven by realization of potential risk would be consistent with it's communicates. This scenario should not happen before March, which is still quite far away from now.

Because of deflation reasons, markets still price in risks of further rate cuts. We expect that inflation will stay below zero till 2015Q2. December could look gloomy due to negative releases of industrial production and construction output. Further impulses will come from abroad: low oil prices, strong USD, Japanese QE and rate cuts in China. This could lead to rate cuts in other Southeast Asian countries and even devaluation of yuan. We do not need look so far away to see other rate cuts drivers. CEE national banks could cut their rates after EBC will launch its long-awaited QE (after this month's meeting we expect the ECB to broaden its asset purchase programme in January already). Even if all this would not convince MPC to continue cuts, the markets will price them in.

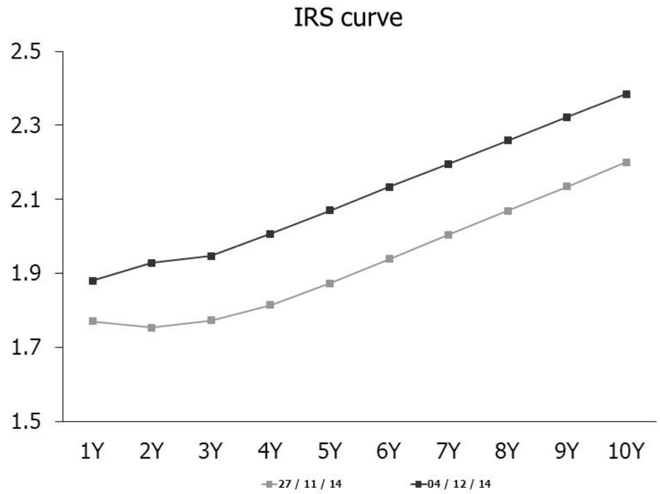
Fixed income

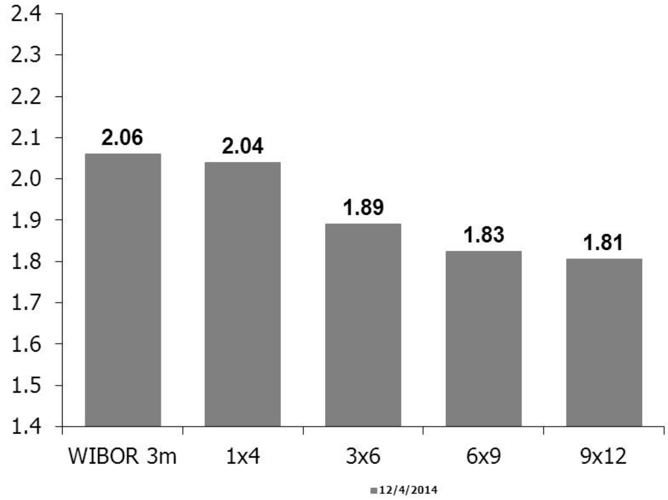
Post-ECB

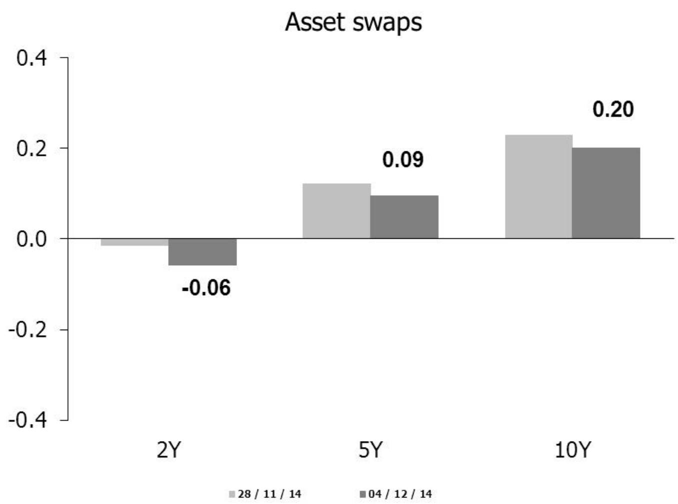
Last week the Fixed Income market was focused on hopes that both Polish MPC and the ECB could deliver more easing action. While the Polish Council was supposed to leave the rates unchanged (after stronger GDP and PMI readings no one really believed Belka would find a majority for a cut this time), everybody seemed confident Mr. Draghi was ready to deliver QE within a scale the market expected. This combination of lost faith in Belka and high hopes on Draghi put the yield curve the most flat-shaped this year. Unfortunately, both central bankers disappointed the markets for some extent that resulted in heavy sell-off of longer dated bonds and led to re-steepening of a yield curve (2y10y spread moved up rapidly from 40 to 47 points that still makes the curve one of the flattest ones in the region).

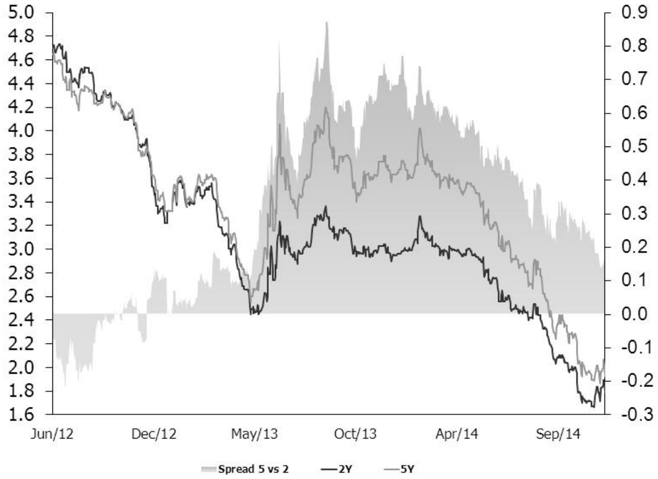
What we can expect till the end of a year? December always had its own rules of market behavior. Once we could observe the panic sell-off of cash assets just to flash the year-end profits, on the other hand we faced the never-ending rally ahead of new year. Let's better focus on economic data.

As the MPC governor Belka stressed for a third time the door to further monetary easing was still open and strictly dependent on closely monitored progress of CPI and economic growth, we can assume the market would be playing cuts on all Council meetings at least till March. We expect both CPI and industrial output data turning to negative surprise this month that might easily reverse the current bearish tone into positive. We seek to find the local tops on a curve to re-enter receivers before the figures and we believe the market would be ready to switch the „bullish mode" button ON and price the cuts in again in Q1 2015.









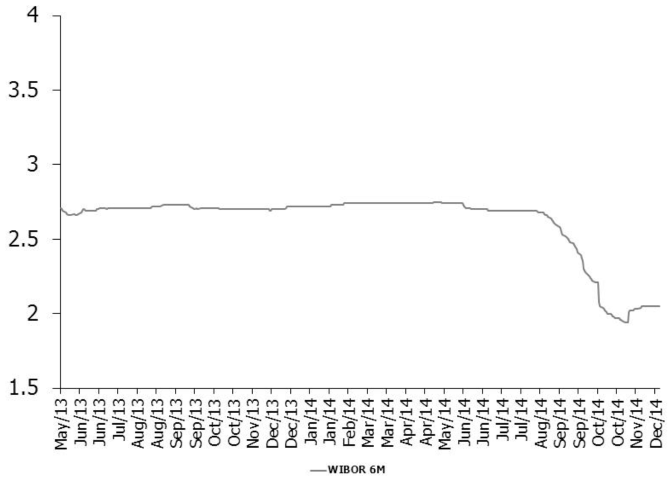
Money market

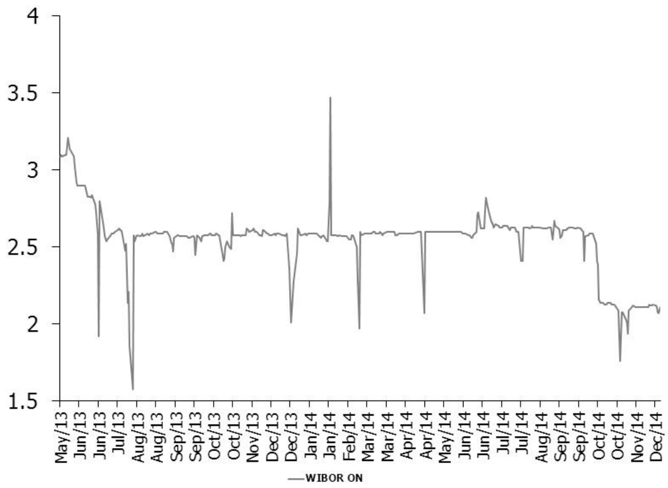
Cheap week behind us

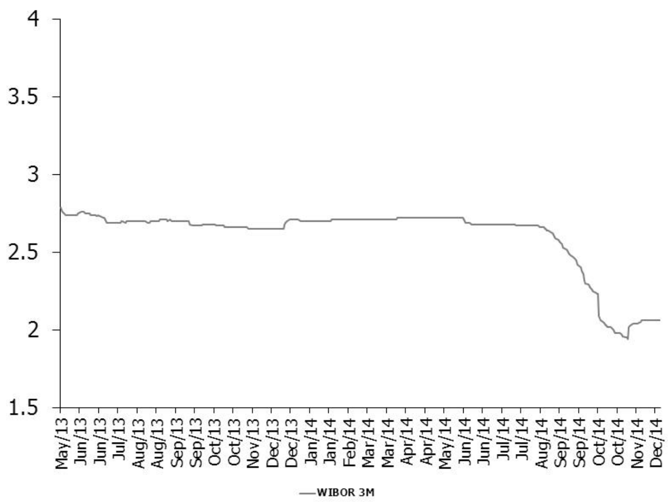
Cheap week behind us with Polonia fluctuating under 1.90%. Firstly, there was a huge surplus of cash (around 10 bn PLN), secondly we had MPC meeting with possibility of a rate cut (small but still).

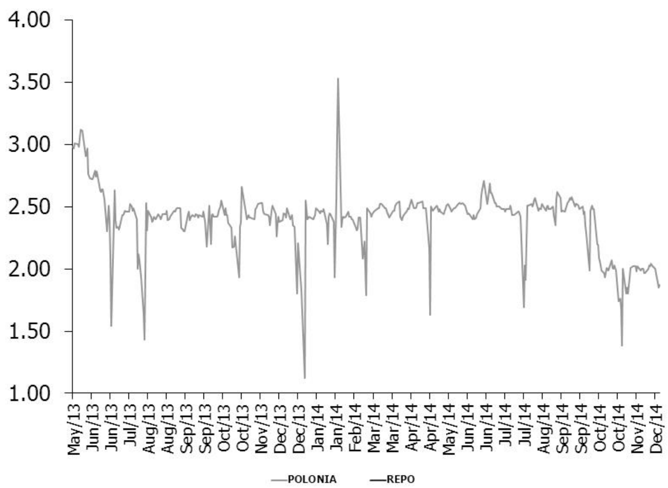
After MPC statement, rates decreased and curve steepened. While last week 1Y2Y IRS spread was flat now it is at 3 bps. Also spread between OIS's and FRA's widened. In our opinion it's a good time now to buy 1Y OIS and sell 9x12 FRA with 8 bps spread while just 2 weeks ago it was flat or even negative.

As we noted last week, the rally in switching papers has begun and the shortest floater was traded today at 0.7%. Next one is PS0415, and with yield around 1.60 it still looks very attractive.







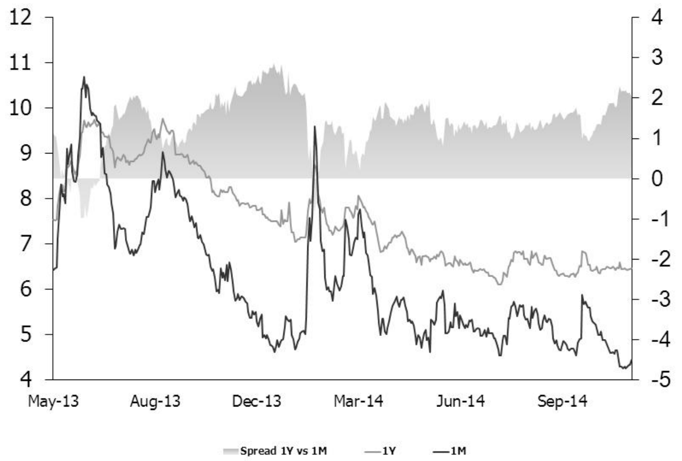


Forex

PLN – march upwards continues EUR/PLN keeps on sliding lower. It set a fresh low at 4.1465 (last time seen in July), before stabilizing/correcting at 4.16ish. The lack of rate cut from MPC plus still relatively dovish ECB (even if hopes were higher) were the reasons why zloty was shining so bright. We are a bit skeptical this has a chance to continue. Technically we expect consolidation and/or correction higher. Of course this does not change the fact that bigger picture and fundamentals are still PLN positive.

Vols – mixed performance There was some demand to cover shorts in Gamma before MPC/ECB but it melted again, once these events were out of the way. The EUR/PLN vol curve had mixed performance. 1 month EUR/PLN ATM mid is this Friday at 4.0%, it was given yesterday at 4.25% (0.3% lower than last Friday). 3 months ATM are 4.9% (0.1 higher) and finally 1 year is fixing at 6.4 (0.1% lower). The Skew and Currency Spread (difference between USD/PLN and EUR/PLN) were roughly unchanged.

EURPLN volatility



Short-term forecasts

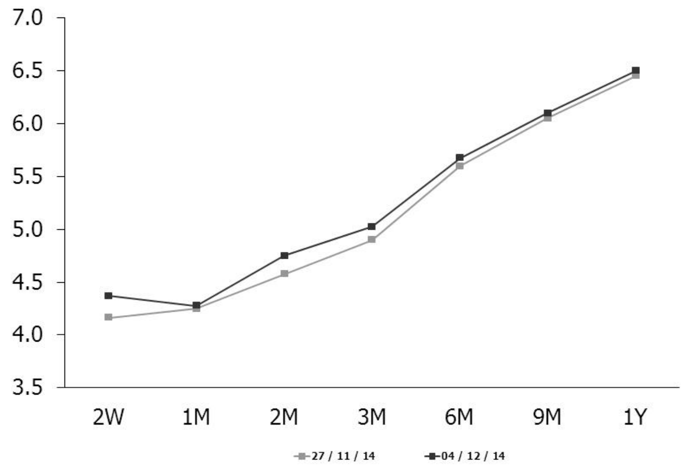
Main supports / resistances:
EUR/PLN: 4.16 / 4.24
USD/PLN: 3.30 / 3.45

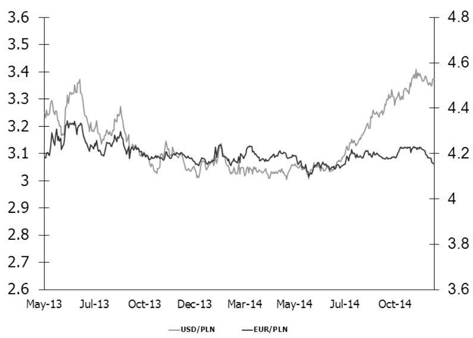
Spot – sidelined at the moment We were stopped out on our longs from 4.1900 and 4.1750 at 4.1650. We do not want to get long again just a few pips below our stop loss. We will try to buy again at 4.1400 with a stop at 4.12 and hopes to see 4.1750 or sell at 4.1900 with stop above 4.21 and 4.14 target.

USD/PLN – we are sidelined at the moment.

Options – Core long 1y Vega Unchanged from the last week. We stick to our core long in Vega in the backend. In 1 month - 3 month sector the vols are looking low, but we are not overall convicted that they are cheap. December with Christmas and New Year's holidays are not really that encouraging to be long gamma.

EUR/PLN volatility curve





Bias from the old parity (%)

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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
11/28/2014	1.99	2.06	1.96	1.95	2.07	1.93	1.96	1.78	1.64	1.64	1.65	1.65
12/1/2014	1.97	2.06	1.97	1.95	2.05	1.93	1.98	1.85	1.72	1.71	1.74	1.74
12/2/2014	2.09	2.06	2.12	1.95	2.10	1.93	1.99	1.84	1.75	1.74	1.76	1.76
12/3/2014	1.86	2.06	1.85	1.95	1.80	1.93	2.03	1.89	1.77	1.78	1.83	1.78
12/4/2014	2.09	2.06	2.08	1.95	1.90	1.94	2.04	1.89	1.83	1.81	1.82	1.82

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
DS1025	6/5/2014	7/25/2025	94.90	3.82	2000	2743	1693

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0715	5Y IRS	PS0718	10Y IRS	DS1023
11/28/2014	1.930	1.752	1.740	1.725	1.855	1.977	2.170	2.399
12/1/2014	1.930	1.902	1.823	1.845	1.912	2.044	2.207	2.458
12/2/2014	1.930	2.005	1.860	1.915	1.982	2.111	2.297	2.523
12/3/2014	1.930	1.920	1.905	1.890	2.055	2.177	2.365	2.596
12/4/2014	1.940	1.881	1.928	1.870	2.070	2.165	2.385	2.585

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
11/28/2014	4.30	4.85	5.63	6.43	6.43	2.32	0.54
12/1/2014	4.33	4.90	5.60	6.45	6.45	2.32	0.54
12/2/2014	4.33	4.90	5.60	6.45	6.45	2.32	0.54
12/3/2014	4.45	4.93	5.60	6.48	6.48	2.27	0.52
12/4/2014	4.28	5.03	5.68	6.50	6.50	2.27	0.52

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
11/28/2014	4.1814	3.3605	3.4788	2.8458	1.3600	0.1512
12/1/2014	4.1788	3.3519	3.4741	2.8334	1.3626	0.1514
12/2/2014	4.1620	3.3466	3.4567	2.8141	1.3584	0.1510
12/3/2014	4.1574	3.3730	3.4556	2.8240	1.3550	0.1505
12/4/2014	4.1538	3.3728	3.4510	2.8123	1.3537	0.1504

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