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Polish Weekly Review

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Comment on the upcoming data and forecasts

Many important releases coming up next week. See the Economics section for more details.

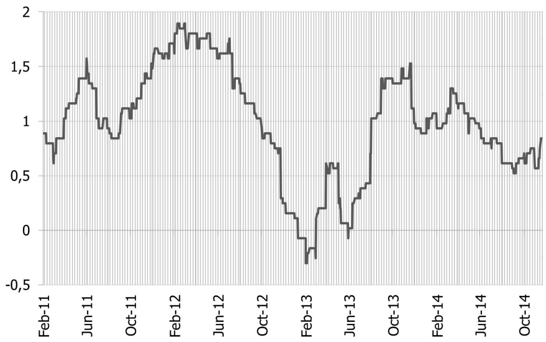
Polish data to watch: December 15th to December 19th

Publication	Date	Period	mBank	Consensus	Prior
CPI y/y (%)	15.12	Nov	-0.5	-0.4	-0.6
Exports (mio EUR)	15.12	Oct	15500	14653	14251
Imports (mio EUR)	15.12	Oct	15550	14408	13637
Current account balance (mio EUR)	15.12	Oct	-678	-356	-235
Core CPI y/y (%)	16.12	Nov	0.5	0.5	0.2
Average gross wage y/y (%)	16.12	Nov	3.2	3.6	3.8
Employment y/y (%)	16.12	Nov	0.9	0.9	0.8
Sold industrial output y/y (%)	17.12	Nov	0.0	0.8	1.6
PPI y/y (%)	17.12	Nov	-1.3	-1.1	-1.2

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

Unchanged - no important data releases. Next week brings numerous publications and the most important are: CPI on Monday and industrial output on Wednesday. Plenty of opportunities for surprise.

* 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).

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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 Risk of easing is going to accompany each upcoming meeting.

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	11.4
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	10.6	11.4
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	3.40	3.42	3.43	3.45	3.51

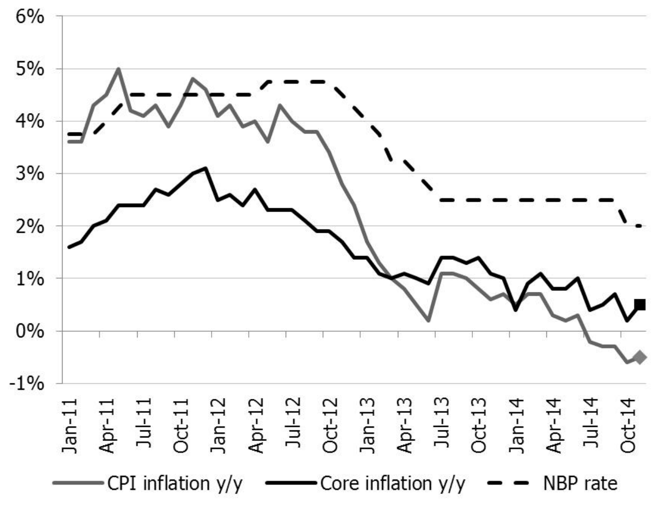
F - forecast

Economics

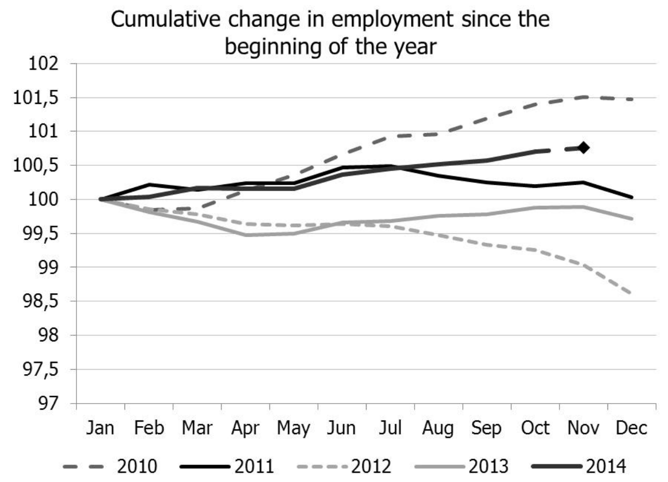
Data preview: on-going disinflation amid fairly strong labor market and unspectacular real sphere data

Leaving global risks aside, we enter the new week with a fresh round of domestic data releases. All in all, the upcoming publications should confirm the high-frequency data to be on weak side (=no fresh momentum in the economy) and nominal data to underpin strong disinflation (CPI, PPI, falling prices of oil and petrol that can be observed real-time). Such a combination should leave expectations for monetary easing unscathed. Rate cuts can be resumed in each of the upcoming meetings.

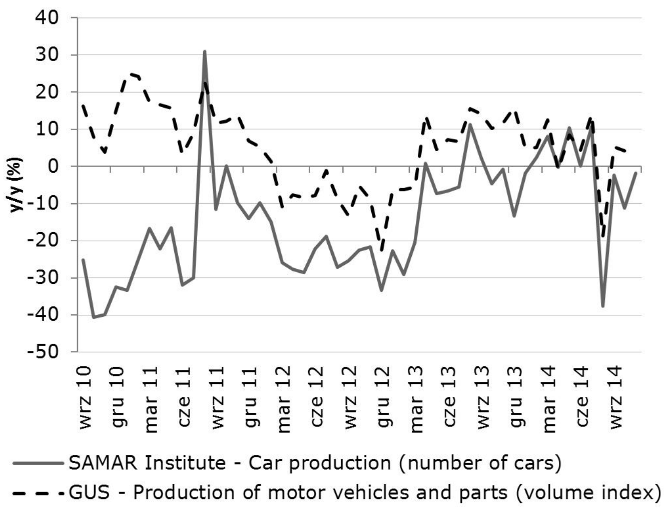
We start the week with inflation data on Monday. We expect CPI to accelerate a bit to -0.5% (market consensus -0.4%) but to stay negative. Low food prices (confirmed by regional readings), low fuel prices (we await more cuts at the pump in coming months) and overwhelming lack of inflationary pressures in core categories (that can easily be extended due to the Yuan depreciation, lower inflation in China and adjustment of relative prices to low prices of food and fuels) are the name of the game – not only for now but also for 2015, or at least for its first part. Disinflation in consumer prices is underpinned by very low producer prices (we expect -1.3% y/y vs -1.1% y/y consensus view, publication on Wednesday) that absolutely lack momentum (competitive forces at the times of positive supply shocks are keeping prices more than in check).



Labor market is going to show further, gradual strengthening. Employment growth at 0.9% y/y (market consensus) and wages running at 3.2% y/y should be enough to keep consumption running close to 3%. Some business indicators have reached a plateau with regard to employment; some came off recent highs but only marginally. We do not treat it as a signal of an imminent turnaround in the labor market. Rather we do not see any signals that employment gains should accelerate above 4-5k monthly average. It is going to be sufficient to keep employment growth slightly below 1.0% y/y in coming months, at least in the corporate sector with 9+ employees. The bigger picture is more positive and seasonally adjusted unemployment rate has been falling for several months to lowest level in 5 years.



Real sphere is not going to deliver any fireworks this month, confirming near zero momentum in manufacturing and retail sales. No difference in working days and possibly strong negative base effect form last year encourage to bet on zero growth in y/y terms. Data on auto production failed to enlighten us in this respect as the correlation between production figures (SAMAR vs GUS) broke down last month, and - more important - the pass through of auto output to other manufacturing sections is an unstable variable. The same is partially true with regard to auto sales, however, the sharp drop reported for November suggest that our consensus forecast of 1.9% y/y growth in retail sales (publication in the following week) is subject to downside risk.



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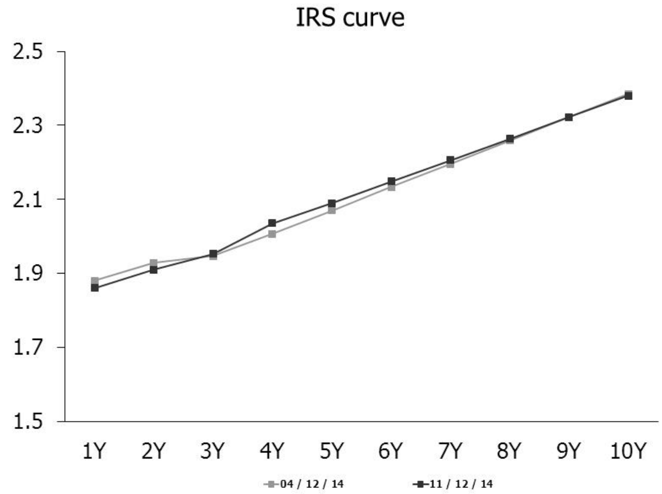
Fixed income

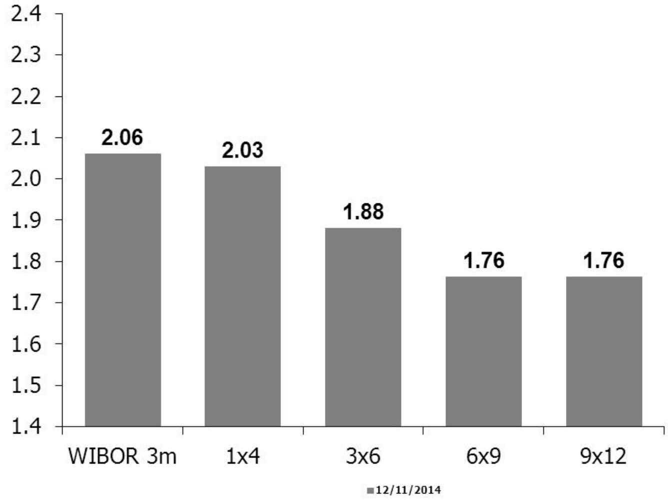
Risk Off

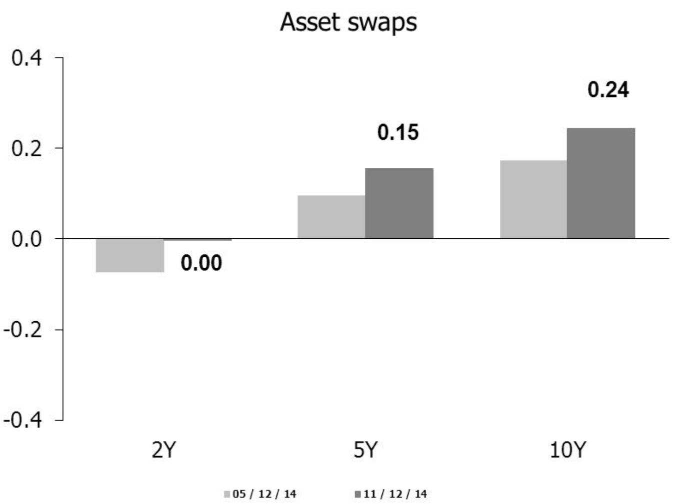
POLBGs trading almost unchanged on a week-to-date basis. Yield-wise bonds price in slightly less than one 25bps cut - which is fair as we are still in easing bias. Long end bonds, usually strongly correlated with global story are trading somewhere between Greece problems, ECB's QE and Wednesday's Fed meeting. All heavy weight information...

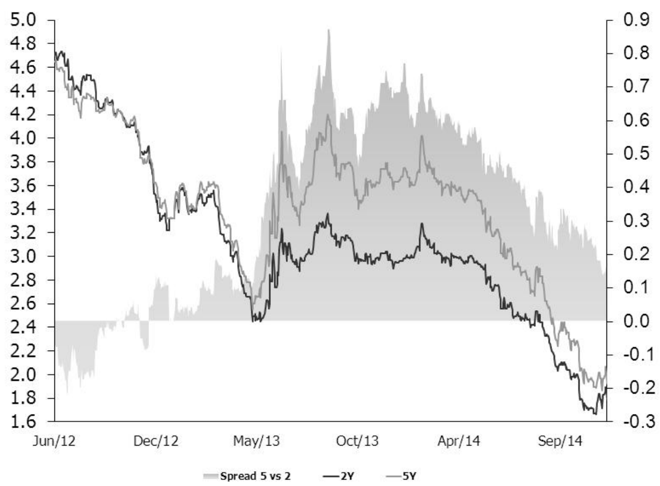
If compared as 5Y10Y bond spread, 10s have narrowed by 35 bps (40bps since September). Considering all mentioned before, we prefer to focus on the local story, especially on coming CPI and production data. Therefore, we avoid long 10Y bonds exposure and still look for buying dips strategy on 2Y and 5Y bonds. Targets are, respectively, 2.00 and 2.30.

Cheapest buys (related to curve shape) are current benchmarks – OK0716 and PS0719.









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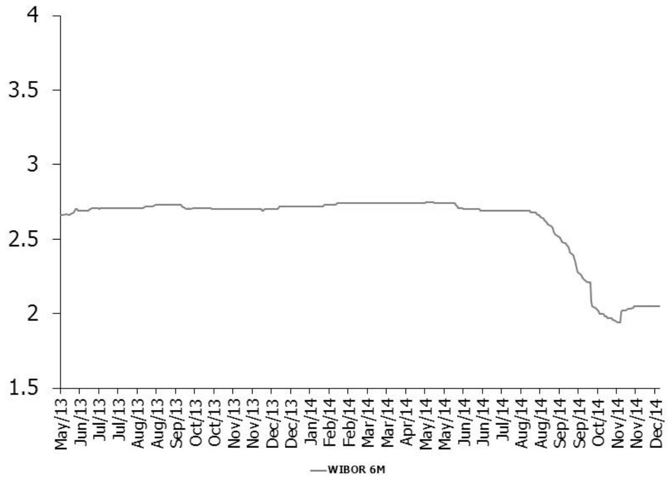
Money market

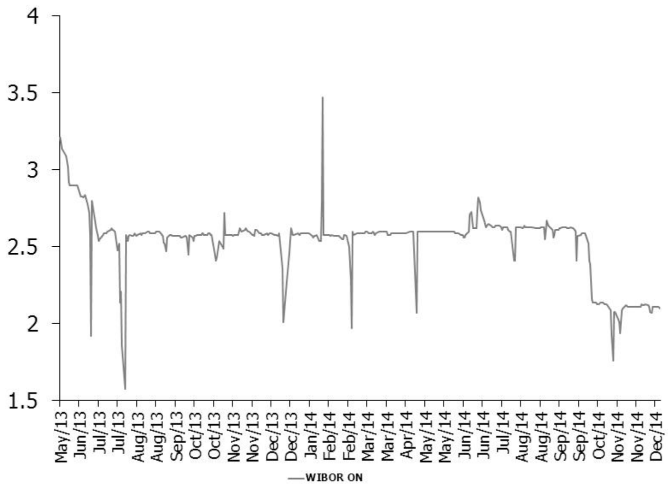
Stable week behind us

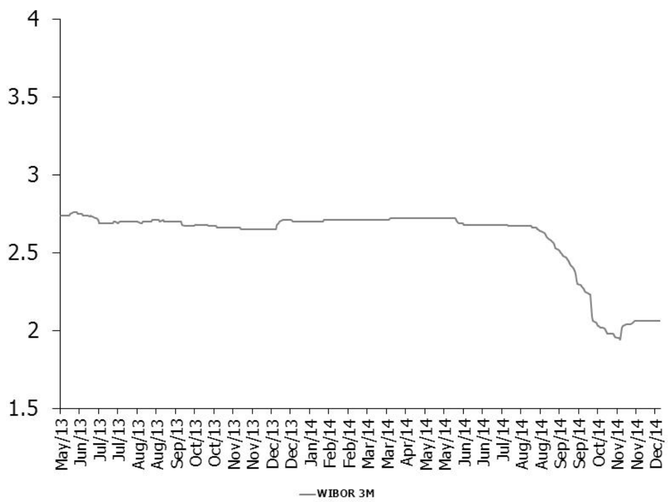
Stable week behind us. Polonia fluctuated around 2.00 for the whole week. Next week should be a bit cheaper as today's OMO was underbid by 3.5 bn PLN.

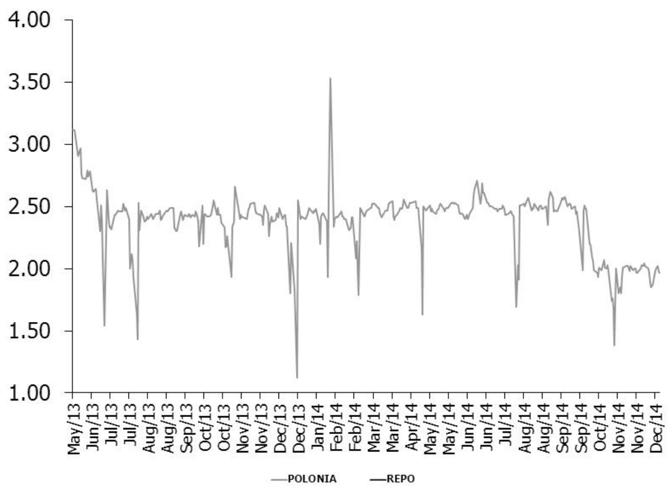
Our strategy from last week to buy 1Y OIS and sell 9x12 with 8 bps spread was very successful. Now this spread is just 2 bps, so maybe it's a good time to buy it?

Back to switching bonds, PS0415 is now 1.50%. Too expensive for us. Next one, OK0715 with yield around 1.70 and small outstanding (9.5 bn PLN) looks much more attractive.









Forex

PLN – weaker In the first three days of the last week the EUR/PLN hold pretty well - most of the activity took place in the vicinity of 4.16. Then new information about Greek election arrived, concerns for Ukraine and Russia have given a kick to the market and put some pressure on risky assets (weaker equities and commodities, stronger fixed income, softer EM currencies). But the Zloty was holding on very well, relative to the level of risks. It lost just 0.5% reaching 4.1840 level (Friday afternoon). Generally Greek elections, weak economy of the UE countries and deflation risks are still the sources of all possible bad news, so the move of EUR/PLN to the upside is still likely. But it does not change the fact that the bigger picture and fundamentals are still PLN positive (in addition to dovish ECB and the chance for QE).

Volatility (tic) higher TThe move up in spot was naturally accompanied by the move up in Vols - but the move was half-hearted. 1M vol. increased from 4.0% to 4.3%, 3M vol increased from 4.9% to 5.1% and 1Y is at 6.5% (0.1% higher). This lack of power on EUR/PLN option market was compensated by the increase of demand on vega in USD/PLN. The currency spread (difference between USD/PLN vol and EUR/PLN vol) has gained between 0.4 - 0.6% to aprox. 5.5%. So finally 3 months USD/PLN ATM is now at 10.7% (0.5% higher then week ago), 6m ATM is at 11.2% (0.4% higher then week ago), 1Y ATM is at 11.9% (0.7% higher then week ago). The skew was roughly unchanged.

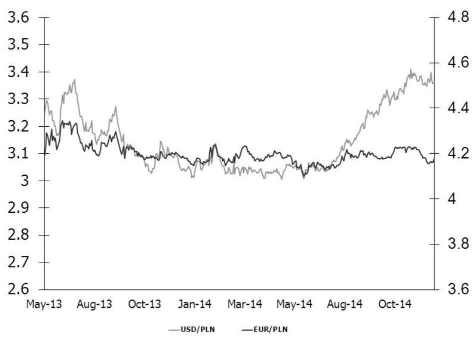
Short-term forecasts

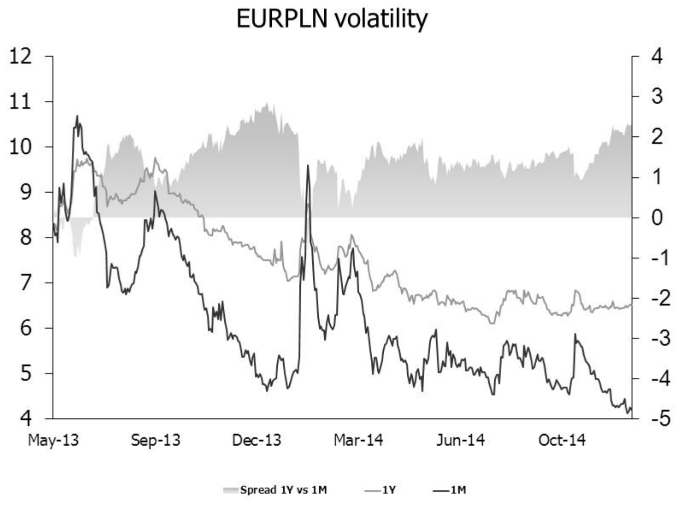
Main supports / resistances:
EUR/PLN: 4.14 / 4.24
USD/PLN: 3.30 / 3.45

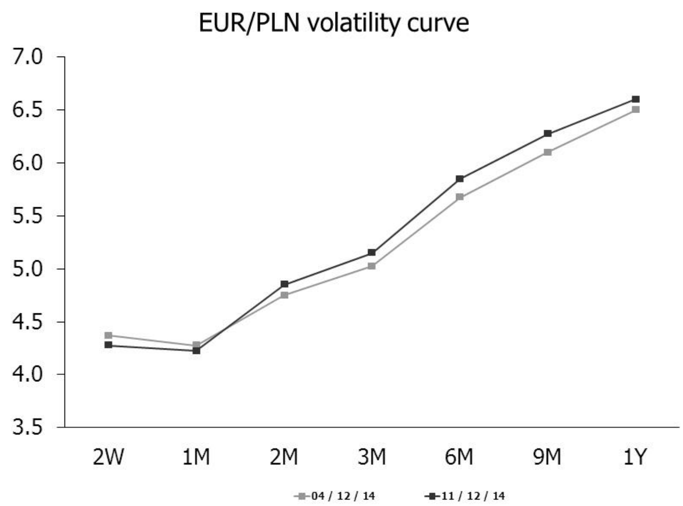
Spot – flat EUR/PLN – Sidelined at the moment. We will try to buy again at 4.1500 with stop at 4.1280 and hopes to see 4.1750 or sell at 4.1900 with stop above 4.21 and 4.14 target.

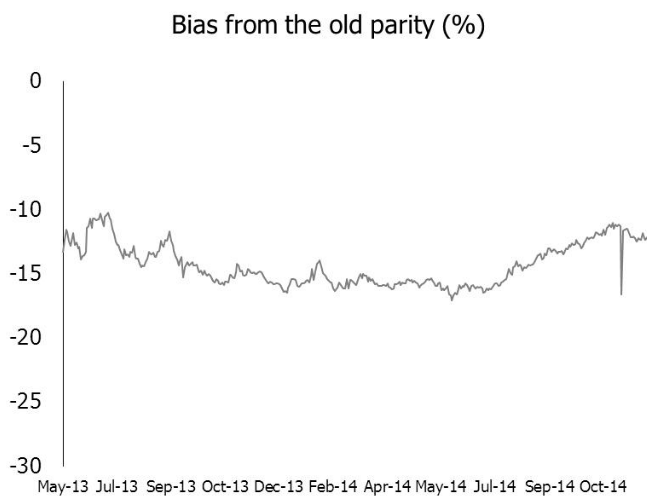
USD/PLN – Sidelined at the moment.

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









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
12/5/2014	1.98	2.06	2.13	1.95	2.19	1.94	2.05	1.93	1.86	1.84	1.88	1.85
12/8/2014	1.93	2.06	1.99	1.95	2.17	1.94	2.04	1.92	1.84	1.81	1.83	1.82
12/9/2014	1.97	2.06	1.96	1.95	1.94	1.94	2.05	1.90	1.80	1.77	1.83	1.79
12/10/2014	1.88	2.06	2.03	1.95	2.10	1.94	2.04	1.89	1.77	1.77	1.82	1.78
12/11/2014	1.92	2.06	1.95	1.95	2.11	1.94	2.03	1.88	1.76	1.76	1.80	1.78

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
12/5/2014	1.940	1.918	1.969	1.895	2.150	2.246	2.455	2.627
12/8/2014	1.940	1.933	1.935	1.914	2.110	2.220	2.410	2.633
12/9/2014	1.940	1.897	1.908	1.915	2.085	2.231	2.344	2.631
12/10/2014	1.940	1.902	1.918	1.962	2.098	2.228	2.381	2.612
12/11/2014	1.940	1.907	1.910	1.908	2.090	2.245	2.380	2.624

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
12/5/2014	4.13	4.98	5.73	6.48	6.48	2.27	0.62
12/8/2014	4.18	5.05	5.73	6.50	6.50	2.27	0.62
12/9/2014	4.25	5.03	5.73	6.53	6.53	2.30	0.47
12/10/2014	4.20	5.03	5.73	6.53	6.53	2.27	0.52
12/11/2014	4.23	5.15	5.85	6.60	6.60	2.27	0.52

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
12/5/2014	4.1585	3.3619	3.4589	2.7938	1.3541	0.1506
12/8/2014	4.1655	3.3978	3.4639	2.8050	1.3591	0.1508
12/9/2014	4.1594	3.3688	3.4594	2.8071	1.3615	0.1505
12/10/2014	4.1595	3.3572	3.4605	2.8178	1.3542	0.1507
12/11/2014	4.1749	3.3611	3.4745	2.8306	1.3568	0.1510

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