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Polish Weekly Review

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Comment on the upcoming data and forecasts

Friday is the only day with publications next week. GDP data for Q4 should show a minor deceleration of growth. However, do not expect spectacular deviations from the consensus as GDP figures for the last quarter stem from the data on the whole 2014 that has been already published. CPI print should be more interesting with massive fuel drops and still low food prices leading the headline number towards -1.3% y/y. Current account data are set to show relative stability; nothing really interesting to add.

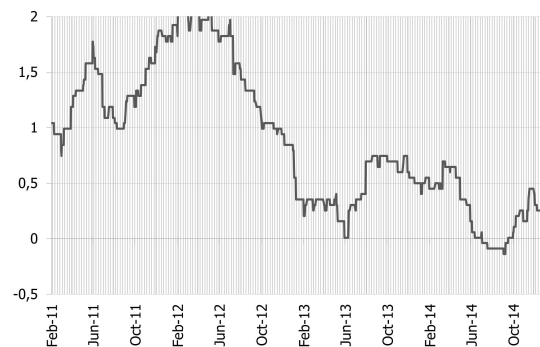
Polish data to watch: February 9th to February 13th

Publication	Date	Period	mBank	Consensus	Prior
GDP YoY (%)	13.02	Q4	3.1	3.1	3.3
M3 YoY (%)	13.02	Jan	9.0	9.0	8.4
Current account balance (mio EUR)	13.02	Dec	-235	-400	-268
Export (mio EUR)	13.02	Dec	12000	12091	13556
Import (mio EUR)	13.02	Dec	12400	12480	13652

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 OK0717	2/12/2015	2000	1.653	1/22/2015
5Y T-bond PS0720	2/12/2015	3000	2.007	1/22/2015
10Y T-bond DS1025	-	1500	2.295	2/5/2015
20Y T-bond WS0429	-	500	2.308	2/5/2015

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



Comment

Only one publication this week but what a surprise (see Economics for more details)! Although PMI release was 2 points above the market consensus, we are still at a lower level than one year ago.

* 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

- 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 demand lets economy pass through relatively unscathed. The source of strength 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.
- H2 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 negative and strengthens the impact of high real interest rates. GDP growth is too low to close output gap. Inflation is going to stay low.
- MPC got stuck in decision process but the combination of deflation and global factors points to a resumption of further easing. We expect 25bp cut in March. Next ones to follow suit with cumulative reach of 50+.

Financial markets

- Prolonged deflation, MPC's easing bias and euro QE are set to support Polish bonds in the mid term.
- Rally has stalled and we see some reasons for correction.
- Zloty to strengthen in the mid-term on euro QE and high real interest rates (carry trades).

mBank forecasts

	2010	2011	2012	2013	2014	2015F
GDP y/y (%)	3.7	4.8	1.8	1.7	3.3	3.5
CPI Inflation y/y (average %)	2.8	4.3	3.7	0.9	-0.1	-0.6
Current account (%GDP)	-4.5	-4.9	-3.5	-1.3	-1.2	-1.8
Unemployment rate (end of period %)	12.4	12.5	13.4	13.4	11.5	10.3
Repo rate (end of period %)	3.50	4.50	4.25	2.50	2.00	1.50

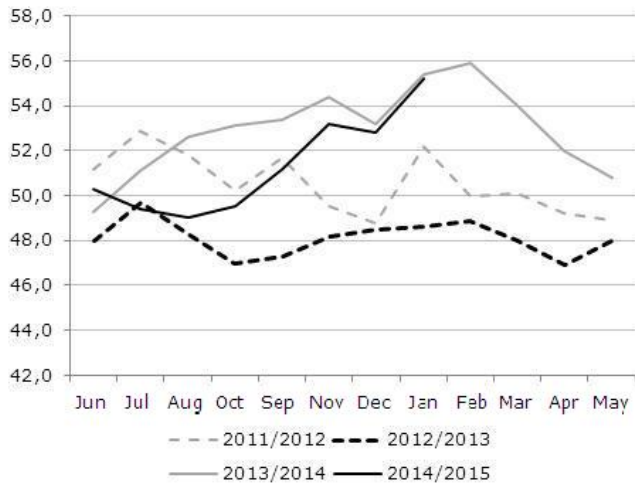
	2014	2014	2014	2014	2015	2015	2015	2015
	Q1	Q2	Q3	Q4 F	Q1F	Q2F	Q3 F	Q4 F
GDP y/y (%)	3.4	3.5	3.3	3.1	2.8	3.1	3.5	4.4
Individual consumption y/y (%)	2.9	3.0	3.2	2.9	2.8	2.8	3.2	3.4
Public Consumption y/y (%)	0.1	3.7	3.5	2.4	2.0	3.0	3.0	3.0
Investment y/y (%)	11.2	8.7	9.9	8.8	6.0	6.0	7.0	9.0
Inflation rate (% average)	0.6	0.2	-0.3	-0.7	-1.4	-0.9	-0.4	0.5
Unemployment rate (% eop)	13.9	12.0	11.5	11.5	12.1	11.0	10.2	10.3
NBP repo rate (% eop)	2.50	2.50	2.50	2.00	1.50	1.50	1.50	1.50
Wibor 3M (% eop)	2.71	2.68	2.28	2.06	1.64	1.66	1.66	1.66
2Y Polish bond yields (% eop)	3.01	2.51	2.00	1.79	1.50	1.50	1.55	1.65
10Y Polish bond yields (% eop)	4.23	3.45	3.05	2.52	1.80	1.80	2.30	2.60
EUR/PLN (eop)	4.17	4.16	4.18	4.29	4.25	4.20	4.15	4.10
USD/PLN (eop)	3.03	3.04	3.31	3.54	3.66	3.68	3.84	3.90

F - forecast

Economics

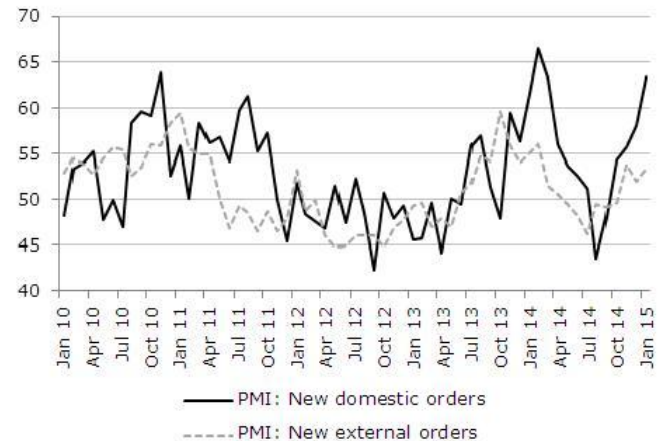
Huge surprise in PMI index

In January PMI in manufacturing grew from 52.8 to 55.2. This is much above even most optimistic economic forecasts (our estimate, though being one of the highest at 53.2 was far too pessimistic). 2.4 gain was highest since January 2012, overall level has not been so high since February 2014.



Although this growth looks outstanding, special circumstances needs to be taken into consideration. Firstly, PMI index showed large gyrations during last years and a pattern of sharp increase in January after decline in December occurred three times during the last five years (2011/2012, 2013/2014 and 2014/2015). Secondly, in the last quarters PMI tended to overreact in both ways - up and down. CSO and EC indices were much more stable; we do not expect such large deviations in January releases of those data. Thus we should not interpret the latest reading as a sharp improvement of economic situation but rather as a confirmation of its relatively good shape. By the way, the strengthening of CHF against PLN could have allegedly influenced sentiment of managers while filling the survey. We do not see this as a meaningful factor. Correlation between financial situation of enterprises and its managers' households is typical mainly for small and medium companies, which are only represented in small numbers in the survey.

PMI order assesment



Publication is of course also positive in the details. Assessment of output grew to 57.6 (second highest in last 4 years, only behind February 2014). Solid increase in new orders (also highest since February 2014) is proceeding within sluggish external demand. In our opinion, domestic demand is still the main driver here (see the chart). The report cast further evidence on stability and strength of labour demand – rise in this subcategory in January confirms optimistic forecasts presented in the last NBP report. There is no breakthrough in inflation expectations. Production costs did almost not change comparing to previous month, meanwhile final goods prices were falling in a pace which has not been seen since September. The latter was a result of competitive pressure and customer demands.

Although PMI release confirms relatively good shape of Polish economy, further slide in yearly GDP dynamics in Q1 is still possible, because of weak correlation between PMI and GDP.



MPC to cut rates in March

On its February meeting MPC kept interest rates unchanged. Reference rate is still equal to 2%. However, during the conference governor Belka almost announced a cut in March. There was one significant change in MPC wording – monetary policy loosening is now only conditioned by extended deflation period and not by worsening of economic growth. This way, Polish monetary policy could be somehow coordinated with ECB policy and suit global environment of record low interest rates and deflation. An obvious argument in favour of cuts on the next meeting is the release of inflation projection, which should confirm negative output gap, extended deflation period and failure of inflation target delivery.

Governor Belka explained MPC's reasons for „postponing” cuts from February to March: preserving stability of Polish currency after turmoil caused by SNB and ECB decisions and Greek elections as well. In our opinion the postponement of a cut is rather a result of the compromise reached among MPC members. Such a reasoning implies that Hausner can join the pro-cut majority but with his special understanding of monetary policy boxed in the policy „line” concept. Knowing his aversion to extreme rate changes and latest statements made by Bratkowki (after proposing cuts by 100bp on December's meeting he now calls for several cuts in 25bp steps) we should expect the smallest possible cut (25bp) in March. Governor Belka's remarks about possible space for larger cuts can possibly constitute a backing for a whole easing cycle and a last-ditch attempt to find a 50bp cut majority.

Leaving behind analysis of possible scenario on the next MPC meeting, we see that inflation trajectory and dangerous strengthening of zloty could result in cumulative cuts larger than 50bp.

Fixed income

A PT which started everything...

This week has started in a profit taking mode what, combined with supply coming from the MoF, pulled up yields by 12-15 bps when MPC started talking. Wednesday press conference (after no cut decision) had encouraged some buyers but they were too few to sustain current levels.

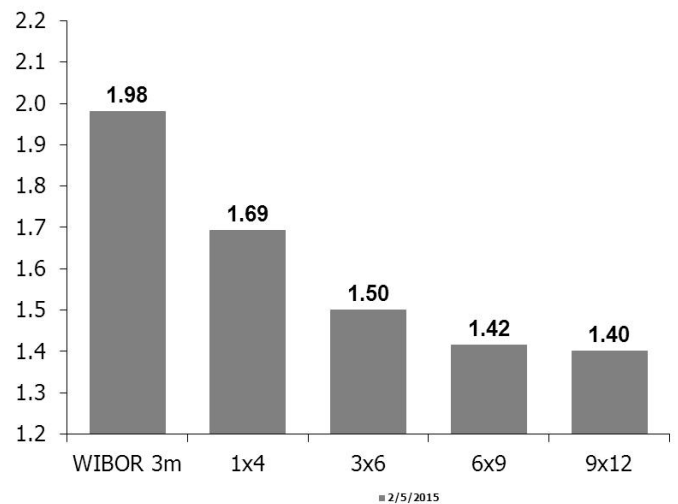
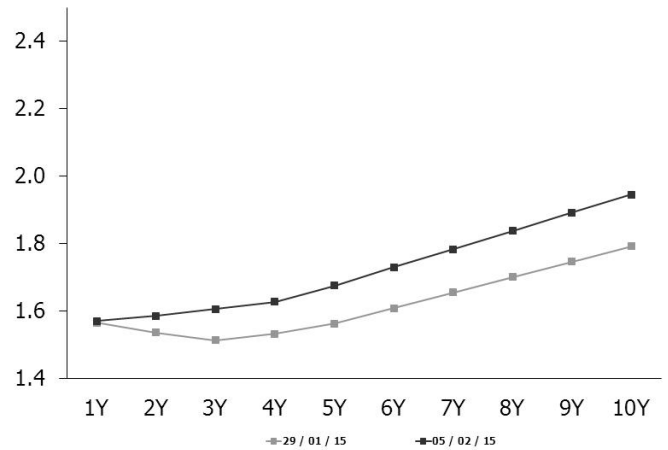
On Thursday market, still well offered, placed bid on long end auction. MF sold about PLN 6 bn of bonds. Again, there were too few real buyers to cope with supply and yields bounced next 5bps (20 in total from all time low).

Friday was kind of nail in the coffin while US nonfarm payrolls proved US economy is holding very well.

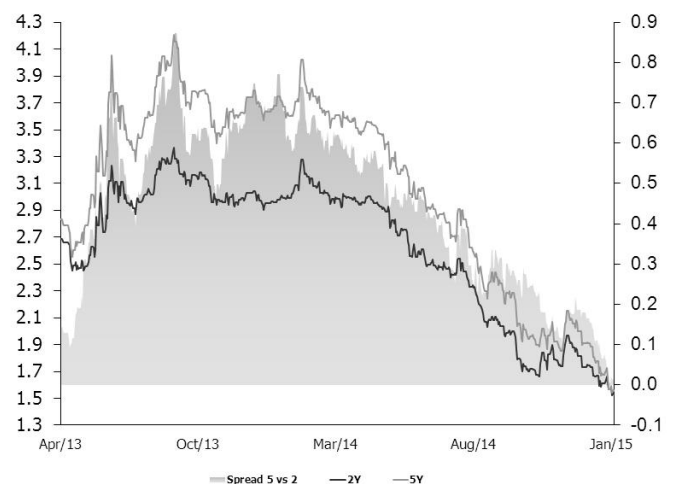
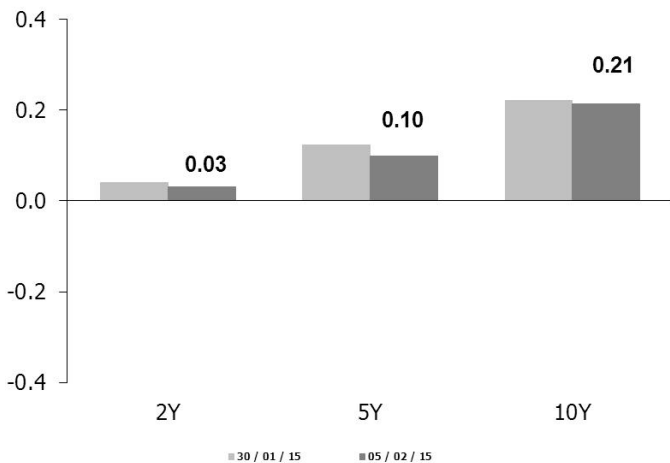
Pure story of selling... Should we jump in this train or rather place bid somewhere?

We do like MPC story among this storm, hence we choose option number two and bid 4Y bonds at 1.75 – 1.80.

IRS curve



Asset swaps

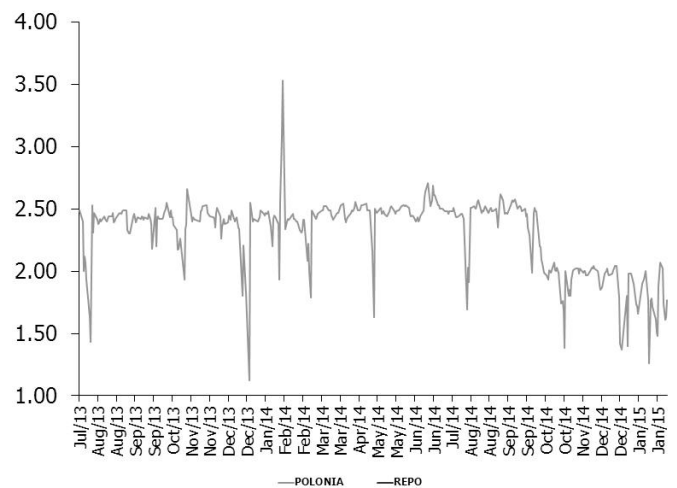
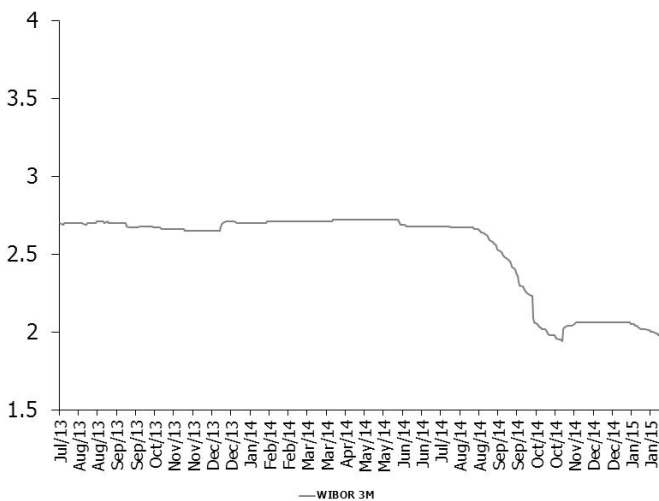
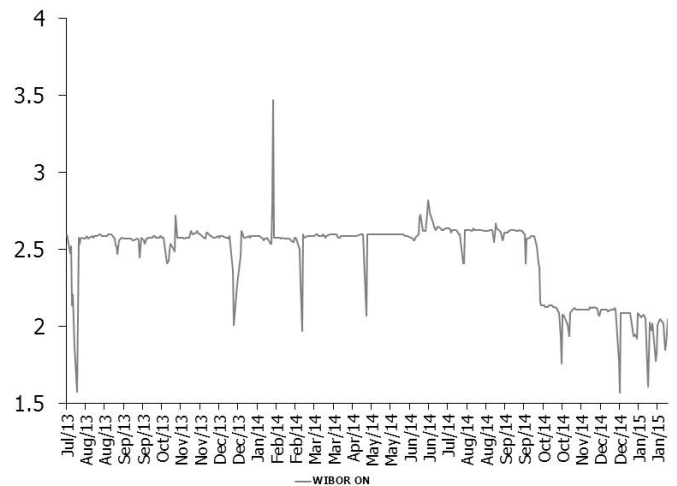
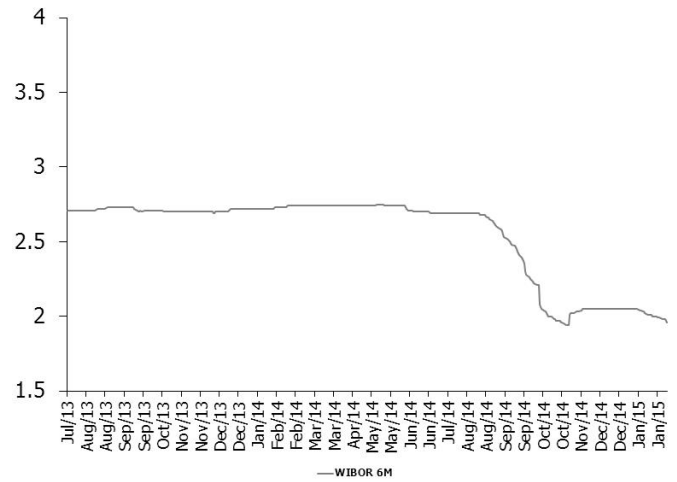


Money market

Cheap week behind us

As it was MPC meeting on Wednesday, cash was cheap. Polonia fluctuated around 1.70%. As today's OMO was just a bit under-bid next week should be stable with cash rates slightly under 2.00%.

As MPC announced further rate cuts we recommend buying short bonds like OK0116 and PS0416 with yield around 1.58. Also selling shortest OIS's might be a good idea. 3M OIS is now around 1.57, 6M is 1.45. As 3x6 FRA passed MPC meeting in May spread 3x6 vs 9x12 narrowed from 22bps to 13bps. As rate cut in March is coming banks started to lower WIBOR and it will probably fall until the MPC meeting so buying any 0x3 FRA might be tricky.



Forex

Consolidation After the wild swings of last weeks, EUR/PLN is finally finding its equilibrium in 4.1550 – 4.1920 range. The ECB QE, lack of MPC actions are the main reasons why PLN is keeping its strong tone. The ECB QE is here to stay but the MPC approach may change as quickly as next meeting. The hints of the possible cuts are quite vocal from the MPC already. This and the general rangy nature of EUR/PLN makes us think that we should drift higher next week. Strong NFP are another reason for at least temporary weaker PLN.

Options – Vols bit lower The frontend EUR/PLN was temporary lower with stronger PLN. But this was quickly reversed 1 month was paid at 7.3% and 7.7%. EUR/PLN 1 month ATM is this Friday at 7.6% mid (0.2 lower), 3 months are 7.5% (0.3% lower), 1 year is fixing at 7.7% (0.1% lower). The currency spread was bit softer USD/PLN 3 month was given at 12.8%. The Skew was also softer by 0.2% in average.

Short-term forecasts

Main supports / resistances:

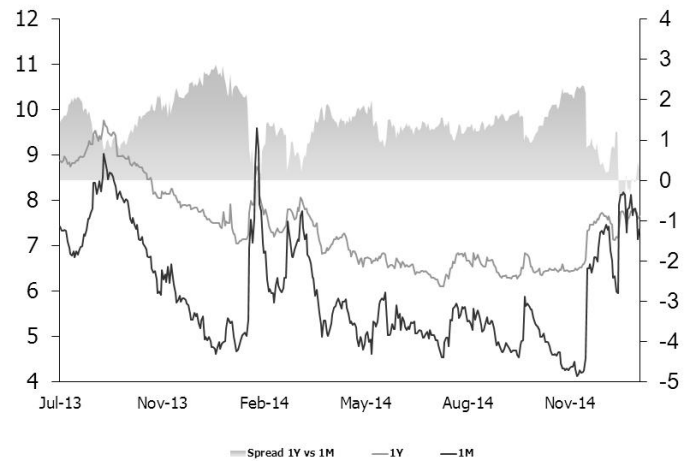
EUR/PLN: 4.13 / 4.25

USD/PLN: 3.60 / 3.90

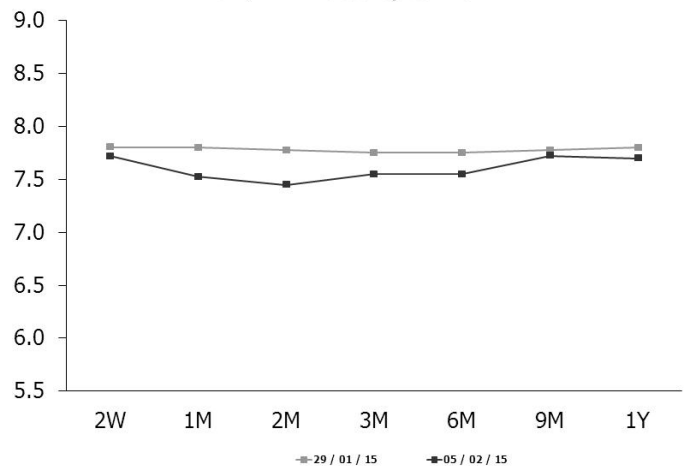
Spot – Longs stopped We have reinstated long EUR/PLN position at 4.1650 and we are ready to add at 4.1450 with a stop below 4.1300 and the P/T at 4.22+. We are believers in rangy nature of EUR/PLN, so even with a support of ECB QE we think it is more likely to at least correct to 4.22+ prior to further PLN gains (if they materialize).

Options – Sideline Blurred picture. It is really unusual to see EUR/PLN vols not really benefiting from stronger PLN. The reasons are quite clear: the historic vols are quite elevated and support implied curve. There is not much of the supply of vols as well. We are taking our short in Vega back at tiny p/l, and moving to the sideline.

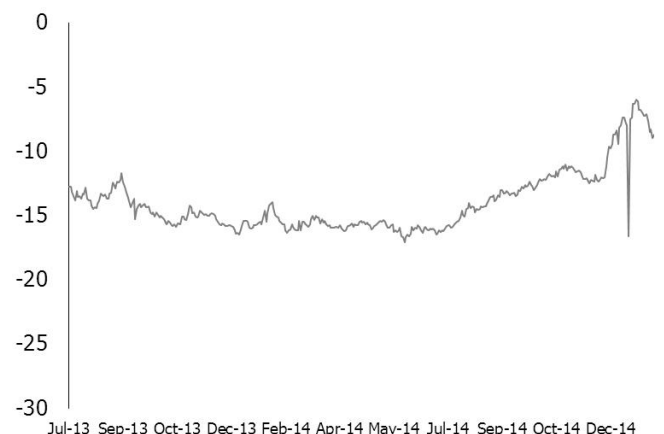
EURPLN volatility



EUR/PLN volatility curve



Bias from the old parity (%)



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
1/30/2015	1.90	2.00	1.89	1.89	1.88	1.87	1.84	1.54	1.35	1.35	1.33	1.37
2/2/2015	1.89	1.99	1.79	1.88	1.68	1.87	1.86	1.59	1.40	1.38	1.41	1.41
2/3/2015	1.78	1.99	1.65	1.88	1.66	1.87	1.86	1.62	1.40	1.39	1.42	1.44
2/4/2015	1.70	1.98	1.57	1.88	1.59	1.86	1.90	1.59	1.39	1.36	1.40	1.42
2/5/2015	1.80	1.98	1.67	1.87	1.70	1.85	1.69	1.50	1.42	1.40	1.43	1.42

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
1/30/2015	1.870	1.614	1.524	1.563	1.555	1.679	1.775	1.996
2/2/2015	1.870	1.586	1.554	1.586	1.585	1.727	1.805	2.042
2/3/2015	1.870	1.623	1.558	1.621	1.595	1.750	1.822	2.069
2/4/2015	1.860	1.627	1.570	1.605	1.615	1.764	1.847	2.085
2/5/2015	1.850	1.609	1.585	1.616	1.675	1.774	1.945	2.159

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1Y	
1/30/2015	7.83	7.70	7.70	7.78	7.78	2.52	0.59	
2/2/2015	7.64	7.70	7.70	7.73	7.73	2.52	0.59	
2/3/2015	7.15	7.30	7.40	7.60	7.60	2.53	0.64	
2/4/2015	7.38	7.40	7.50	7.65	7.65	2.53	0.64	
2/5/2015	7.53	7.55	7.55	7.70	7.70	2.53	0.59	

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
1/30/2015	4.2081	3.7204	4.0179	3.1624	1.3527	0.1513
2/2/2015	4.1762	3.6801	3.9555	3.1260	1.3418	0.1505
2/3/2015	4.1812	3.6886	3.9834	3.1426	1.3495	0.1505
2/4/2015	4.1712	3.6440	3.9375	3.1083	1.3495	0.1502
2/5/2015	4.1739	3.6656	3.9541	3.1237	1.3525	0.1505

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