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Polish Weekly Review

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Comment on the upcoming data and forecasts

Each and every interesting figure for Polish economy sees the light in coming week. Publications start with labor market (Tuesday). We await visibly stronger growth in employment but this stems from technical, statistical factors reflecting past behavior of the economy (sharp fall in unemployment rate can be a good proxy what to expect). Wages are set to maintain upward momentum. We revised industrial output upwards (from minus to strong plus), reflecting good performance of auto sector; we see symptoms of euro zone demand’s revival as well. In the same vein, we also upgraded retail sales with major drag imposed by nominal effects (fuel sales). Producer prices are likely to record another solid drop on the basis of fuel (and generally – oil) prices. However, at the start of the year there is a possibility of an upward correction of some pricelists on the basis of higher USDPLN; energy prices went up in January. Hence we do not expect anything more spectacular than current market consensus.

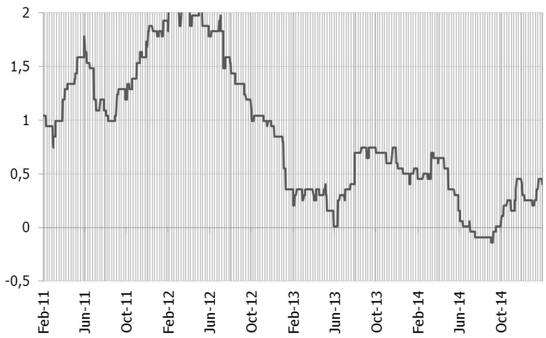
Polish data to watch: February 16th to February 20th

Publication	Date	Period	mBank	Consensus	Prior
Average gross wage y/y (%)	17.02	Jan	3.3	3.3	3.7
Employment y/y (%)	17.02	Jan	1.7	1.5	1.1
Industrial output y/y (%)	18.02	Jan	3.2	1.8	7.9
PPI y/y (%)	18.02	Jan	-2.9	-2.9	-2.5
Retail sales y/y (%)	18.02	Jan	1.1	0.6	1.8
Construction output y/y (%)	18.02	Jan	2.1	2.0	5.0
MPC Minutes	19.02	Feb			

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	-	1500	1.667	2/12/2015
5Y T-bond PS0720	-	3500	1.987	2/12/2015
10Y T-bond DS1027	-	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

Huge positive surprise from previous week was entirely offset by few small negative releases this Friday. Current account came out quite lower than expected, while GDP and CPI were just sligthly (0.1 %) below survey median. The next week brings us as many as 6 possible surprises – twice as much as this week.

* 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

- 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 strengh lies in consumption (both private and public) and relatively good moods among firms 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.
- Low inflation and risk of assymetric strenghtening of the zloty encourage MPC action. We expect 25/50bp 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.
- We use recent correction to re-enter longs in 10y sector.
- Zloty to strenghten 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 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	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	12.0	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

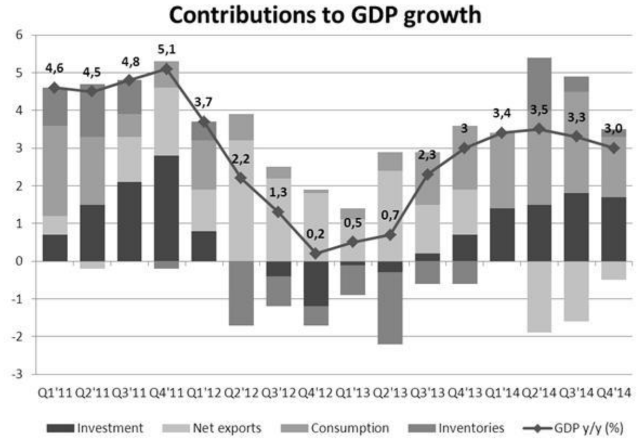
F - forecast

Economics

GDP slowed slightly at the turn of the year: 3.0% in Q4

According to flash release of GDP, last quarter of 2014 ended with 3.0% growth (0.6% QoQ after 0.8% QoQ in the previous quarter). It confirms our expectations that yoy growth rates will bottom out at the turn of the year (2014Q4 and 2015Q1), thus ending the soft patch.

We still can only estimate disaggregated demand aggregates in flash releases. Annual figures provided by GUS suggest that Q4 GDP was brought down by slowing consumption (from 3.2% to ca. 2.9% y/y) and investment (from 9.9% to 8.8%). The former could have flattened out because of higher savings rate and lack of further acceleration in demand for consumer services. We already know that real retail sales remained flat in Q4. Investment growth, on the other hand, remained strong. We still do not know the breakdown of investment by asset types for the past releases but if previous quarters are any guide, we can at least claim that public investment contributed strongly.

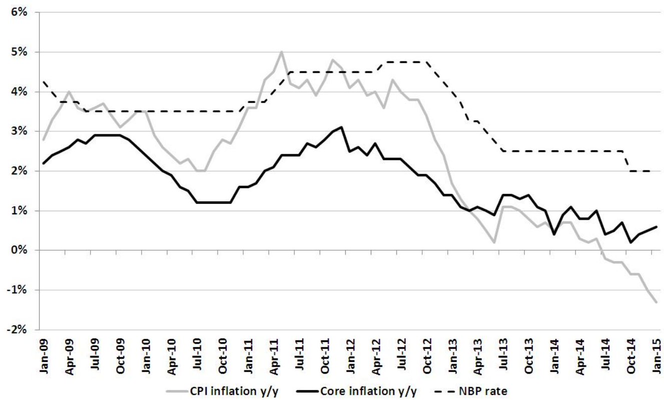


Economic activity is subject to downside risks in the short-term: slower exports growth to Russia, uncertainty shock cast by CHFPLN increase (to a lesser extent). Those risks are unlikely to derail the cycle, though. Next quarters are expected to bring stable consumption growth, supported by the development in the labor market (which suggest structural improvement providing wage and employment growth closer to 5% rather than GDP - like 3%), low fuel prices and positive income effects stemming from deflation. 2015 should also bring decent growth in investment activity, supported by infrastructure demand in late 2015. We see also some symptoms of revival of euro zone's demand.

MPC is going to ignore the data. They reckoned that it is inflation, not GDP data that demand monetary policy attention (see next part).

New deflation record

In January deflation kept intensifying. Inflation hit -1.3% yoy, month ago it was -1.0%. Once again its main drivers were food prices (growth lower than seasonally implied; we want to add that momentum from previous year is repeating itself and we do not see any signs of change) and fuel prices (decline 7% mom). January was just another month with zero momentum in most inflation categories. Low base on pharmaceuticals moved base inflation to 0.6%.



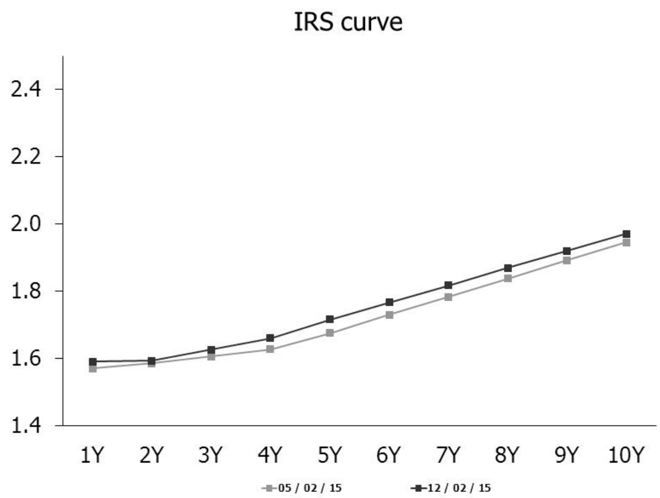
What will happen in the following months? Inflation could stabilize at current levels, mainly because decline in fuel prices has stopped. We want to point that there are absolutely no signs of price rebound among other categories. Inflation is going remain below zero longer than NBP forecasted. This means a significant correction of inflation path in the next NBP projection. Thus, March is going to bring rate cuts. Another argument in favor of resuming cuts is asymmetric risk of strengthening of the Zloty as a result of incoming QE in the Eurozone and inflow of portfolio capital (this is almost a citation taken from one MPC member). We see room for 50bp or more.

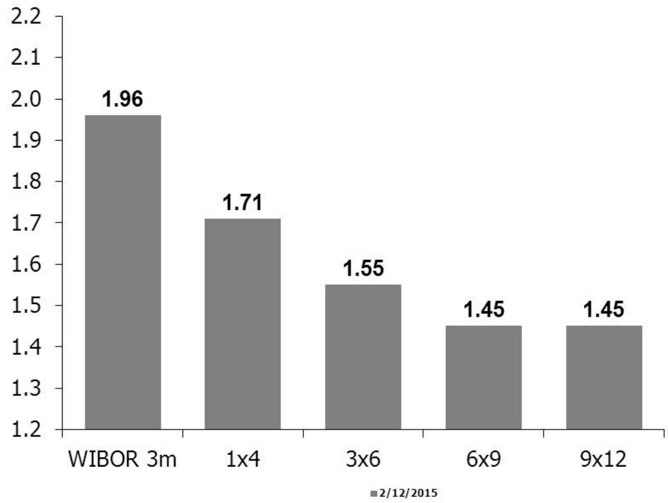
Fixed income

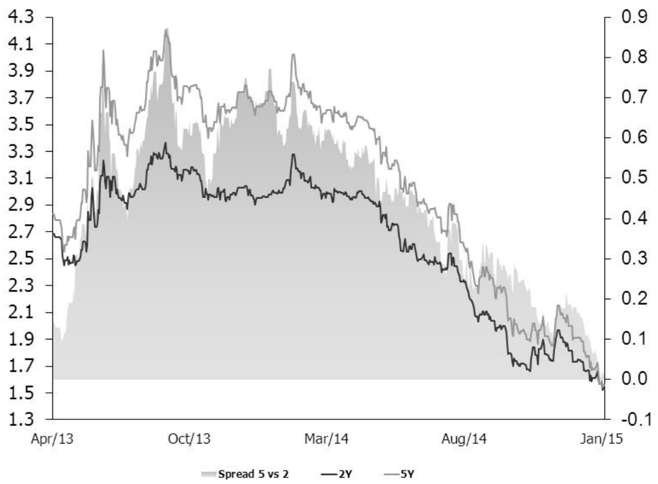
”Unfortunate” timings

We had another nervous week on Polish fixed income market. At the beginning, problems with Greek debt and still surprisingly good data from the US economy put heavy pressure on fresh long DS0725 positions. Wave of forced closing positions pushed its yield to 2 months high (2.32%) and another POLGB auction (OK0717 and PS0420) was under pressure. We feel that it was unfortunate timing and not all ’natural’ buyers filled their bond demand. At the end of the week retail sales data from the US changed market sentiment rapidly and our long end bonds are trading now around 2.18.

2 weeks ago demand for POLGBs seemed infinite. Now investors changed their mind and don’t want to keep big positions, MPC members still are not convinced how deep rate cuts should be. Keep in mind that there is lack of bond supply in coming weeks (next auction on 12th March) and that is why we like long asset position on bonds (especially on cheap to rest of bonds PS0420).







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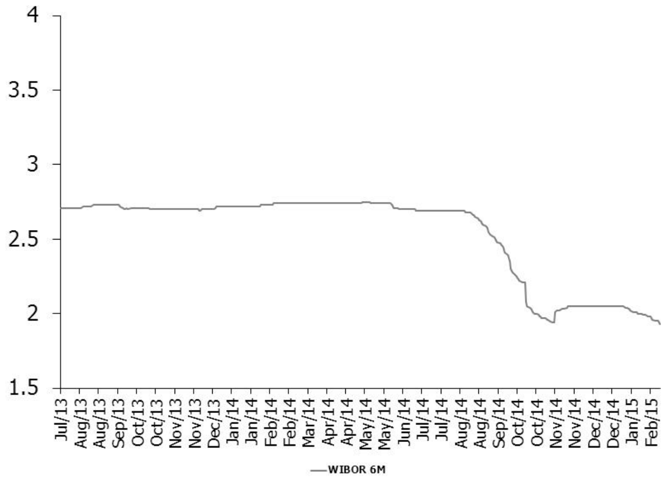
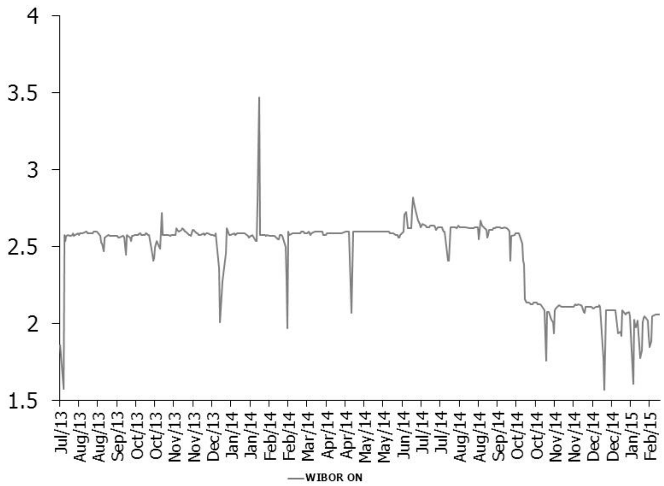
Money market

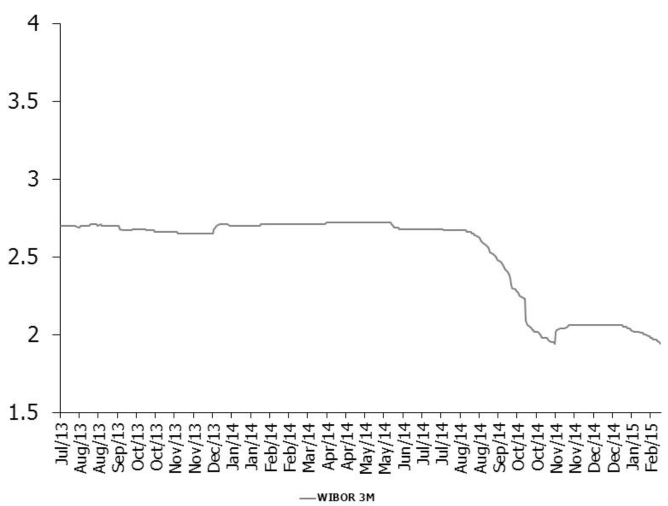
Quiet week behind us

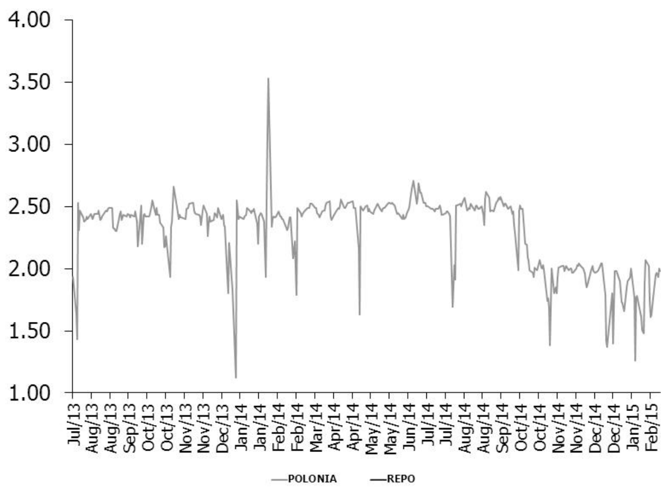
Quiet week behind us (on cash market of course). Polonia fluctuated under 2.00 for the whole week. Next week should be stable despite the fact that today's OMO was overbid by 3 bn PLN.

Bearish market on longer end of the curve touched short end just a bit. The highest point on 1Y OIS was 1.50 and as situation had calmed down it fell to 1.43% discounting two rate cuts (in 25 bps clips in March and April) and some probability of a third one in the second part of the year. Same happened with 1Y bonds. OK0116 fall to 1.55% today reaching 1.63% top on Wednesday.









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Forex

Choppy The EUR/PLN has rebuild from last week low at 4.1544 low to 4.2244 high this week before good news from Minsk sent it back to 4.1635 low. Is clear that volatility is back. And that's our main conclusion. The headline which would not have moved the EUR/PLN more than 70-90 pips in the past, it is now causing the 3/4 big figures move, easily. We need to adapt to changed market characteristic, it is even welcomed from the trading point of view. We still think that EUR/PLN is in the range, but now this range is considerably wider 4.14/4.34. We are still inclined to play this range, and looking for mean reverting moves to the center of range namely 4.24ish. Fundamentally one may argue for stronger PLN because of ECB QE or weaker PLN because of the MPC rate cutting cycle which is soon about to begin, or because of geopolitical tension. Our approach is more opportunistic.

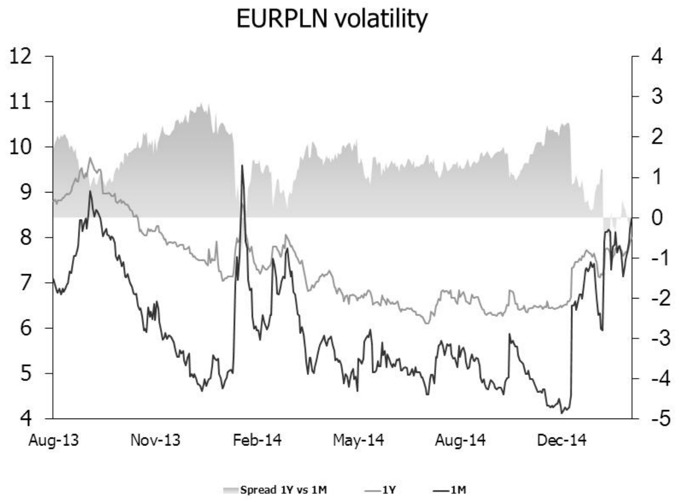
Options – Vols bit higher The relatively strong PLN is no longer enough to melt EUR/PLN vol curve. The historic volatility is providing the support for vols as long as Gamma positions are able to finance the Theta bills. The current volatility is raising hopes for more, and these hopes can be fulfilled. 1 month EUR/PLN ATM mid is this Friday at 8.0% (0.4% higher), 3 months are 7.9% (0.4% higher) and finally one year is fixing at 8% (0.3% higher). The currency spread (difference between USD/PLN and EUR/PLN vols jumped higher by roughly 0.35%. The 3 month USD/PLN given last week at 12.80 were this week bid 13.75!. Skew was also better bid.

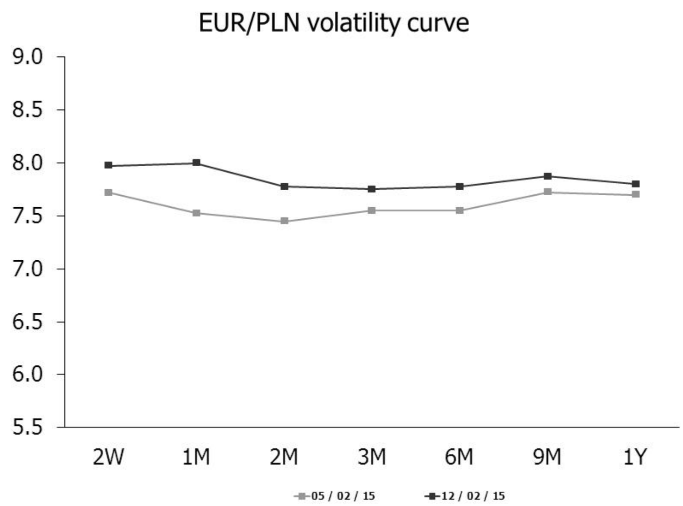
Short-term forecasts

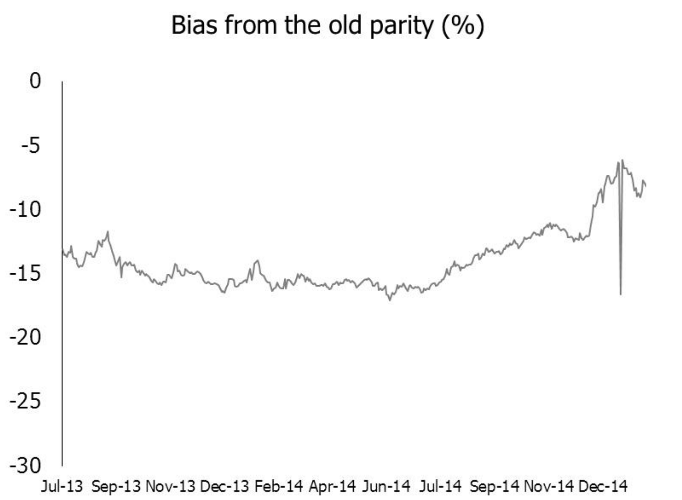
Main supports / resistances:
EUR/PLN: 4.14 / 4.34
USD/PLN: 3.60 / 3.90

Spot We took profit on longs in EUR/PLN from 4.1650 at 4.2200. We have reinstated long EUR/PLN position at 4.1700 and we are ready to add at 4.1500 with a stop below 4.1350 and the P/T at 4.23+. We believe in mean reverting move to 4.24, as the start of the easing cycle in PLN is looming on the horizon.

Options – 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, neither. We are sidelines at this moment. If anything we are rather buyers on the dips.







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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
2/6/2015	1.80	1.97	1.69	1.86	1.74	1.84	1.71	1.50	1.45	1.45	1.49	1.46
2/9/2015	1.82	1.97	1.72	1.85	1.76	1.84	1.75	1.55	1.47	1.48	1.53	1.51
2/10/2015	1.84	1.96	1.72	1.85	1.78	1.83	1.71	1.55	1.51	1.50	1.54	1.52
2/11/2015	1.80	1.96	1.80	1.85	1.80	1.83	1.75	1.55	1.49	1.48	1.51	1.51
2/12/2015	1.84	1.95	1.74	1.84	1.77	1.82	1.71	1.55	1.45	1.45	1.49	1.46

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
2/6/2015	1.840	1.603	1.618	1.643	1.725	1.896	1.985	2.236
2/9/2015	1.840	1.618	1.644	1.682	1.795	1.917	2.070	2.289
2/10/2015	1.830	1.623	1.656	1.707	1.810	1.954	2.075	2.323
2/11/2015	1.830	1.682	1.658	1.717	1.825	1.964	2.120	2.325
2/12/2015	1.820	1.592	1.593	1.580	1.715	1.812	1.970	2.186

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
2/6/2015	7.70	7.55	7.60	7.68	7.68	2.56	0.59
2/9/2015	7.93	7.75	7.80	7.80	7.80	2.56	0.59
2/10/2015	8.20	7.90	7.90	7.90	7.90	2.59	0.59
2/11/2015	8.43	8.00	8.03	8.00	8.00	2.59	0.59
2/12/2015	8.00	7.75	7.78	7.80	7.80	2.58	0.58

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
2/6/2015	4.1695	3.6395	3.9540	3.1037	1.3612	0.1504
2/9/2015	4.1760	3.6811	3.9861	3.1066	1.3595	0.1508
2/10/2015	4.2017	3.7220	4.0192	3.1331	1.3576	0.1515
2/11/2015	4.1999	3.7094	4.0068	3.0960	1.3598	0.1517
2/12/2015	4.1884	3.6926	3.9706	3.0862	1.3604	0.1513

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