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Polish Weekly Review

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Comment on the upcoming data and forecasts

A light week ahead of us. On Tuesday the Central Statistical Office will publish its monthly Statistical Bulletin - an important. On Friday details for Q4 GDP will be released. While it is possible that the flash figure will be revised (flash GDP has been revised upwards in 3 out of 7 instances), it would be most interesting to take a look at the breakdown. We expect (on the basis of annual figures published in January) that consumption slowed down marginally to 2.9% and that investment growth remained robust at 8.8%.

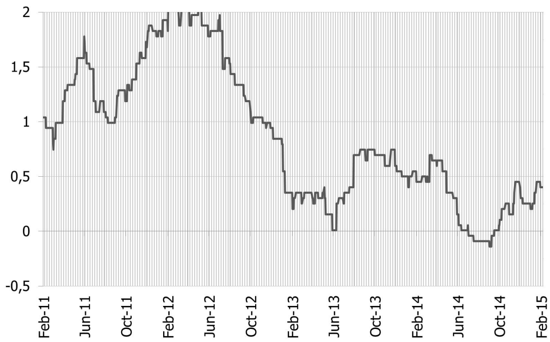
Polish data to watch: February 23th to February 27th

Publication	Date	Period	mBank	Consensus	Prior
Unemployment (%)	24.02	Jan	12.1	11.9	11.5
GDP YoY (%) *final*	27.02	Q4	3.0	3.0	3.0

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

No suprises, despite a flurry of data releases. Next week brings only one opportunity for surprise - unemployment rate.

* 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. Sell-offs related to Grexit fears or Grexit itself will prove to be short-lived.
- We use recent correction to re-enter longs in 10y sector. Thus, we remain constructive on Polish bonds and expect Polish 10Y yield to fall below the US 10Y yield.
- 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

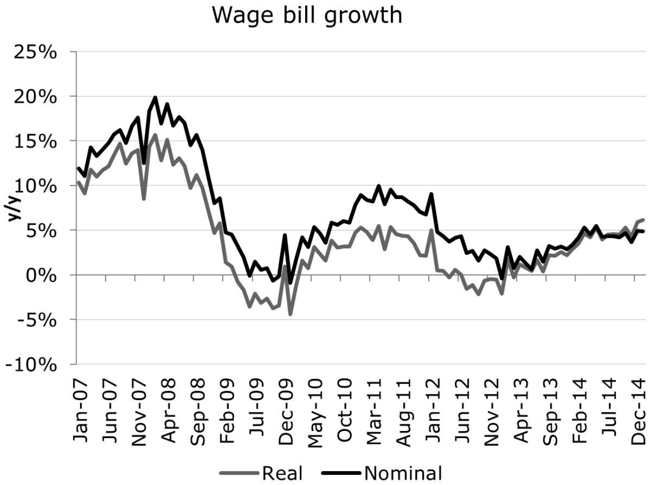
The economy is looking fine but inflation outlook and fear of portfolio capital inflows will spark additional rate cuts in the coming months

A flurry of data came out this week and the headlines were mostly met with disappointment. We beg to differ. All negative surprises were due to one-off effects or factors independent from the business cycle. A careful look at the data reveals that the momentum in the economy remains solid which bodes well for the coming quarters. But this is not the main story in monetary policy. As seen in recent Minutes and Belka's recent comments, monetary policy is largely influenced by poor inflation outlook and fear of portfolio capital inflows. Thus, easing is still in the cards and we expect at least 50 bps of cuts in the coming months, starting from March.

As usual, below you will find our summary of this week's data releases.

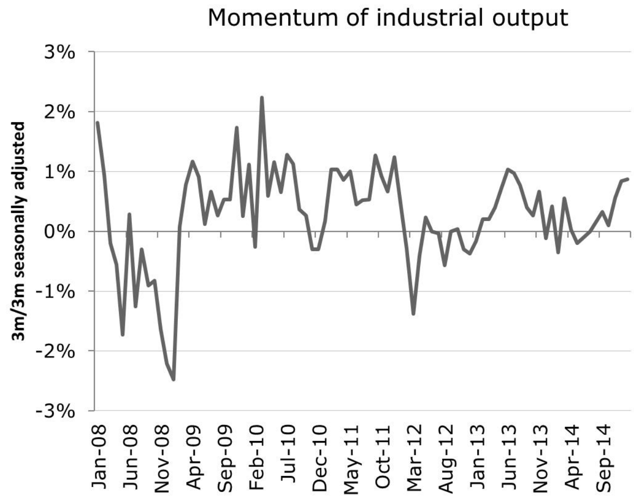
Average wage rose in January by 3.6% y/y comparing to 3.7% in December. This release is slightly better than market consensus (3.3%). It is worth noticing that calendar effects were negative in January (-1 y/y against +1 y/y in December). However, without specific data it is hard to find reasons for this surprise. We think that this rise could be driven by revival in manufacturing and steeping of wage trend in this category. If we are correct, it would mean that December's surprise was not an outlier but a beginning of new, steeper trend. Strong labour market in Poland (which is still catching up with the EU) is a structural phenomenon - high labour intensity and poor demographics (working age population is shrinking) are also helping.

Because of record low inflation and stable nominal revenue real wage bill reaches next cyclical records - in January its yearly dynamics amounted to 6.2% and nearing its pre-crisis levels. In the following months we are expecting relatively high wage dynamics, which would support private consumption. We also forecast the economy to accelerate steadily in the next quarters.



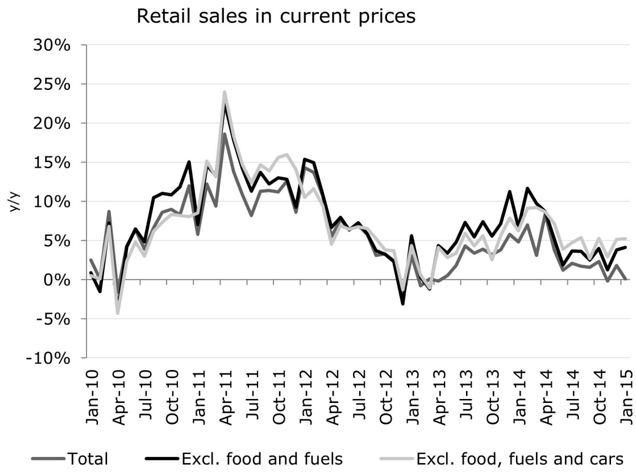
Employment in the corporate sector grew by 1.2% y/y, below forecasts (ours: 1.7%, market consensus: 1.5%) but it should not be seen as a negative surprise. In January the Central Statistical Office changes its statistical sample of enterprises monitored on a monthly basis, thereby creating a discontinuity. Actual job creation is masked by entry and exit effects. Having said that, we can note that this year's increase in employment is higher than in the previous year but lower than multi-year average. The whole year is shaping to be a good one for employment, as reflected in strengthening macroeconomic environment and rising sentiment indicators. NBP's quarterly survey of enterprises is particularly optimistic with respect to hiring plans. We expect employment to increase by 1.5-2% in the whole year.

In January Polish **industrial output** grew by 1.7% y/y after a 7.9% increase in December. The figure came out slightly below expectations - on our part we can say that car production turned out to be in line with SAMAR data published earlier but we overstated second-round effects in industries with close ties to car production. Having said that, underlying momentum was strong in January. After seasonal adjustments, industrial output grew by 4% y/y and 0.4% m/m. 22 industries recorded positive y/y growth rates and the remaining ones were mostly non-cyclical, idiosyncratic ones, such as coal mining, coke and oil refining products and electricity generation. Export-oriented as well as cyclical sections all grew on annual basis.



2015 thus begins on a more or less positive note for the industrial sector. GDP growth in the first quarter might be close to the one recorded in Q4 (i.e. close to 3% y/y) due to base effects but the momentum is steadily improving.

Retail sales slowed down in nominal terms from 1.8% in December to 0.1% in January. This result is just slightly below market expectations and our revised forecast. When analysing the figures, we need to take into consideration the large slide in fuel sales (-16.5% y/y) and another gyration in the category „Others" (-12.4%). Core categories maintained solid growth rates, despite the calendar effects being against them. After excluding food and petroleum prices retail sales grew by 4.1% y/y (3.8% in December) while without food, petroleum and car prices it amounted to 5.2% - just as one month ago. This means that demand for durable goods in Poland remains stable. Taking into consideration high demand for consumer services and steady growth in disposable incomes this suggest that consumption should keep its recent pace: 2.5 - 3% y/y.



Fixed income

Fear of the dark

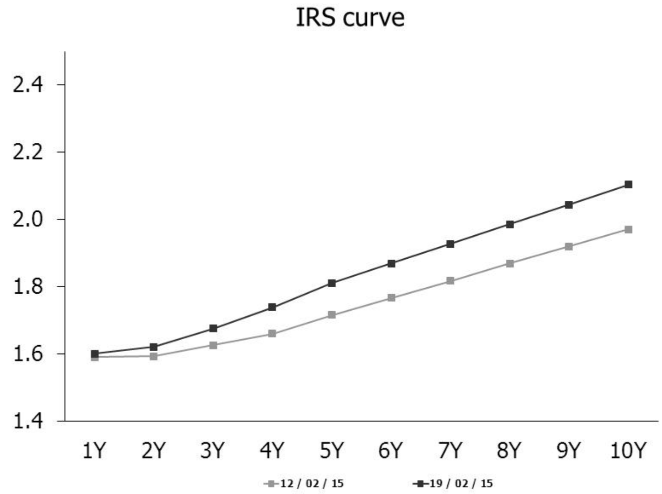
Seems that early Feb sell-off has completely changed the market's perception of rates. One may even say that bonds are well offered at any level. Neither a series of weaker US data nor local ones haven't changed anything.

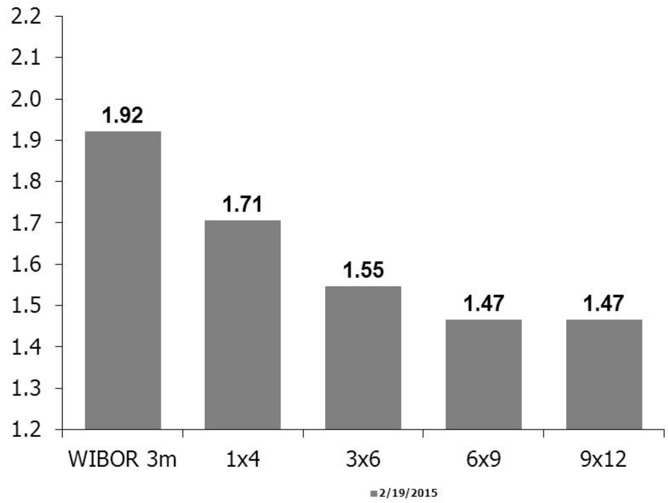
The closer the Fed meeting is, the stronger the fears that tightening is more likely are.

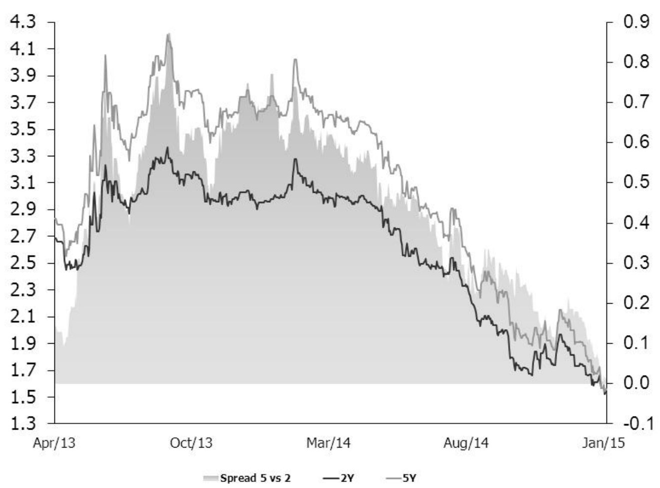
Yield-wise (10Y benchmark) - the sell-off lasted from 1.95 low to 2.35, then retraced by 50% to 2.15. This week have been sold once again to 2.35 and are trading as high as 2.30 now. Close to 10Y UST which is trading 2.10.

Why does the market take the US story so seriously? Mostly because of a lack of any local story - we priced in a 50 bps cut, the MPC is likely to deliver, so... Now, of two stories which are left on the table - US tightening and Grexit, both are discouraging...

Therefore, we suggest to use stronger supply and bid 4Y bonds at 1.95-1.90. 25bp cut would make them decent carry trade for hard days, 50 bps cut would make these days way better.







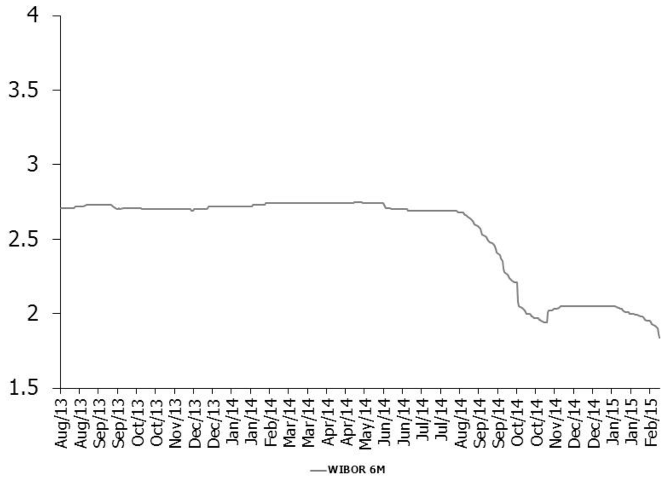
Money market

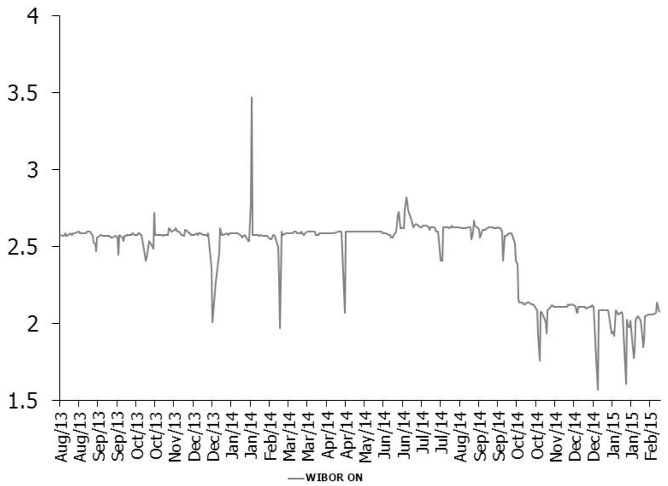
Nervous week behind us

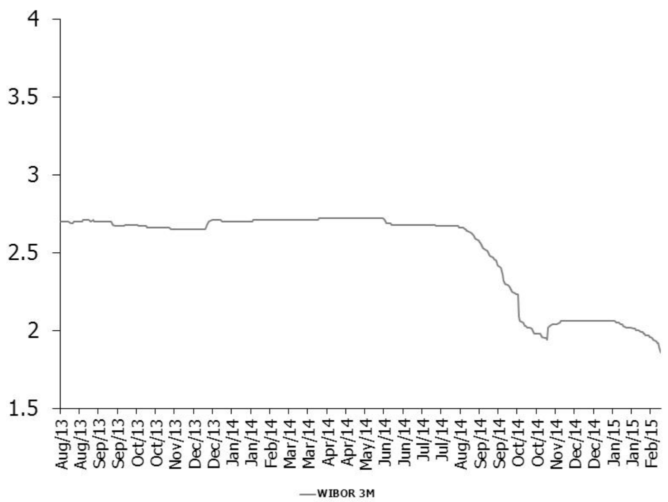
Beginning of the week was quite nervous. Polonia rose to 2.07% as market was a bit short on cash. Situation stabilized on Wednesday and Polonia came back under 2.00%.

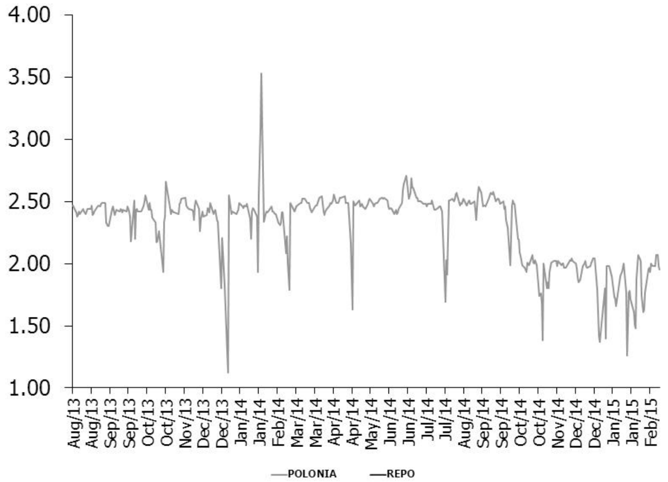
As a rate cut is coming, WIBORs are failing 1-3 bps every day. Looks like they are discounting now 25 bps cut in March and possibility of a rate cut in April. 3M deposit was traded at 1.75% so shortest bonds, like DS1015 with yield at 1.67 are looking more than attractive.

We recommend buying OK0116 and DS1015, hedging it by 6x9 FRA at 1.48.





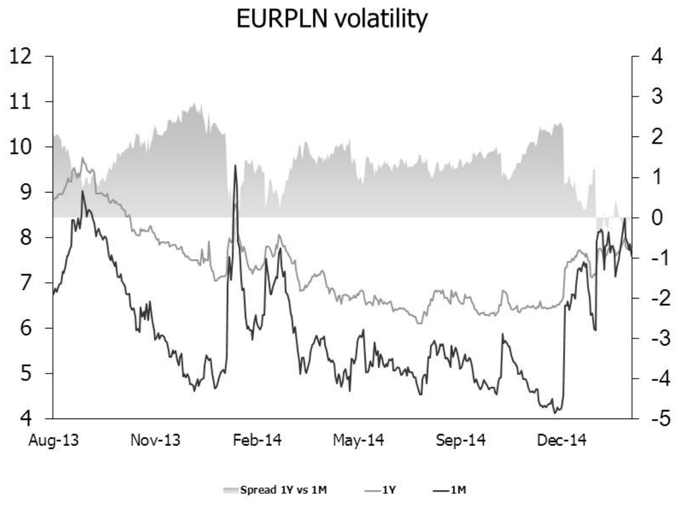




Forex

Consolidation After the wild swings of last weeks, EUR/PLN is finally finding equilibrium in the 4.1600-4.200 range. The ECB QE, rebound in EUR/CHF (it is an immediate benefit to the Polish economy), high real interest rates 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 the next meeting. Furthermore, we still have risks connected with Greece as well as with Ukraine and Russia. That's why we expect consolidation and/or a correction higher. Which does not change the fact that in the bigger picture fundamentals are still PLN positive.

Options – Vols lower It was a rather calm week on the spot market so implied volatility curves have melted. We are lower across the curve in both main currency pairs, EUR/PLN and USD/PLN. EUR/PLN 1 month ATM mid fixed today at 7.1 (0.9% lower than last Friday), 3 months EUR/PLN are 7.2% (0.7% lower) and finally 1 year is 7.55% (0.45% lower). 1Y USD/PLN ATM were given at 13.1 on Thursday (0.6 lower then mid from last Friday). The skew is also better offered.



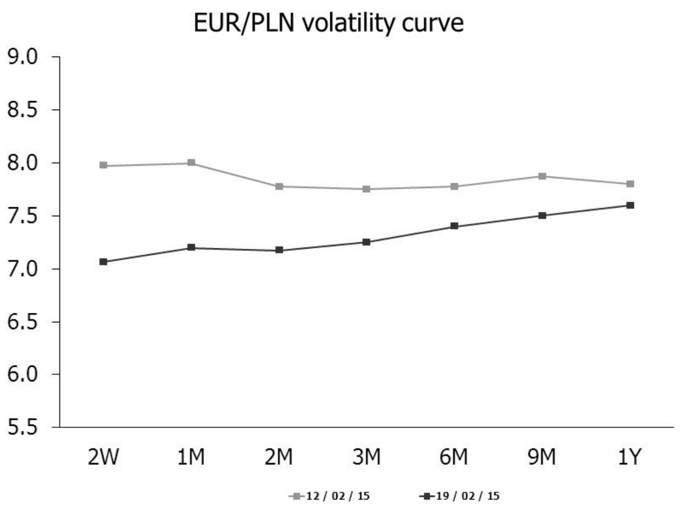
Short-term forecasts

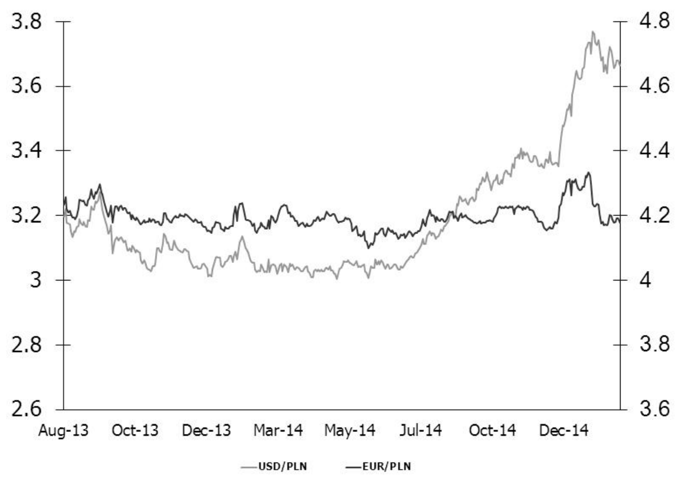
Main supports / resistances:
EUR/PLN: 4.14 / 4.24
USD/PLN: 3.60 / 3.90

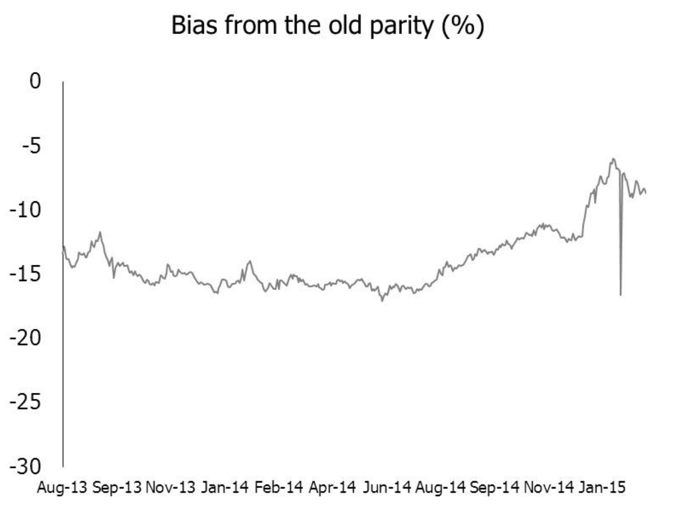
Spot We took profit on longs in EUR/PLN from 4.1700 at 4.1950 on Wednesday.

We have reinstated long EUR/PLN position at 4.1650 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 We are flat now, but our next move is to buy EUR/PLN Vega, as realized volatility is picking up nicely. All we need are a few days of relative calmness and we should see vols melting. We think the levels to buy are 6.8% 6 months EUR/PLN and 7.2% 1 year. Nevertheless, it looks like the vols market is back to life.







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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
2/13/2015	1.99	1.94	1.97	1.83	1.83	1.81	1.71	1.54	1.44	1.45	1.47	1.45
2/16/2015	1.89	1.93	1.78	1.82	1.81	1.80	1.70	1.55	1.44	1.44	1.46	1.45
2/17/2015	1.91	1.92	1.80	1.81	1.83	1.80	1.72	1.57	1.49	1.49	1.51	1.51
2/18/2015	1.80	1.92	1.70	1.80	1.74	1.80	1.72	1.58	1.50	1.50	1.55	1.50
2/19/2015	1.85	1.89	1.78	1.76	1.85	1.76	1.71	1.55	1.47	1.47	1.51	1.48

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
2/13/2015	1.810	1.606	1.595	1.582	1.695	1.824	1.955	2.197
2/16/2015	1.800	1.630	1.610	1.576	1.718	1.918	1.968	2.172
2/17/2015	1.800	1.712	1.625	1.700	1.765	2.052	2.028	2.292
2/18/2015	1.800	1.628	1.665	1.679	1.845	1.933	2.135	2.312
2/19/2015	1.760	1.622	1.620	1.626	1.810	1.972	2.103	2.285

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
2/13/2015	7.90	7.68	7.73	7.75	7.75	2.58	0.58
2/16/2015	7.73	7.65	7.70	7.75	7.75	2.58	0.58
2/17/2015	7.86	7.78	7.81	7.75	7.75	2.58	0.64
2/18/2015	7.60	7.53	7.68	7.75	7.75	2.53	0.59
2/19/2015	7.20	7.25	7.40	7.60	7.60	2.51	0.59

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
2/13/2015	4.1783	3.6552	3.9383	3.0753	1.3650	0.1510
2/16/2015	4.1812	3.6665	3.9364	3.0917	1.3621	0.1513
2/17/2015	4.1904	3.6788	3.9369	3.0983	1.3610	0.1514
2/18/2015	4.1905	3.6784	3.9167	3.0868	1.3608	0.1518
2/19/2015	4.1770	3.6631	3.8818	3.0821	1.3662	0.1524

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