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Polish Weekly Review

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Comment on the upcoming data and forecasts

Monday brings the Manufacturing PMI release. Last month's surge was strong but not confirmed by other sentiment indicators (CSO and EC ESI), therefore we are leaning towards a downward correction in the PMI. It should not be seen as a sign of weaker sentiment. On Tuesday the two-day MPC meeting begins. A new staff projection will be presented during the meeting and we expect it to be a dovish one: markedly lower CPI path and only marginally higher GDP path. This will justify a resumption of monetary easing and we expect the Council to cut rates by 25-50 bps (we attatch the same probabilities to both scenarios) in one swift move.

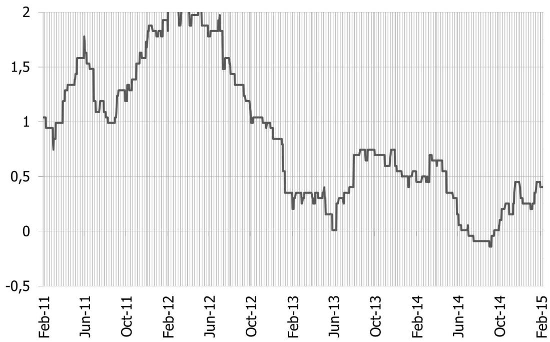
Polish data to watch: March 2nd to March 6th

Publication	Date	Period	mBank	Consensus	Prior
PMI manufacturing	02.03	Feb	54.6	54.5	55.2
MPC decision (%)	04.03	Mar	1.50	1.75	2.00

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 (unemployment came out in line with forecasts, GDP was only a revision). Next week brings only one opportunity for surprise - Manufacturing PMI

* 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

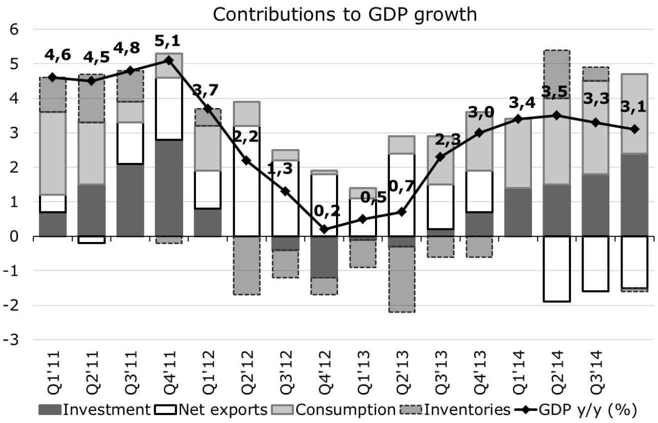
	2010	2011	2012	2013	2014	2015F
GDP y/y (%)	3.7	4.8	1.8	1.7	3.3	3.5
CPI Inflation y/y (average %)	2.8	4.3	3.7	0.9	-0.1	-0.6
Current account (%GDP)	-4.5	-4.9	-3.5	-1.3	-1.2	-1.8
Unemployment rate (end of period %)	12.4	12.5	13.4	13.4	11.5	10.3
Repo rate (end of period %)	3.50	4.50	4.25	2.50	2.00	1.50

	2014 Q1	2014 Q2	2014 Q3	2014 Q4	2015 Q1 F	2015 Q2 F	2015 Q3 F	2015 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	3.1	2.8	2.8	3.2	3.4
Public Consumption y/y (%)	0.1	3.7	3.5	3.7	2.0	3.0	3.0	3.0
Investment y/y (%)	11.2	8.7	9.9	9.0	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	4.10	4.10	4.05	4.05
USD/PLN (eop)	3.03	3.04	3.31	3.54	3.60	3.66	3.75	3.86

F - forecast

Poland: Decent GDP growth in Q4 with strong structure

Poland's GDP grew in Q4 by 3.1% instead of 3.0% indicated by the flash release. The structure of growth is very encouraging: a 9% rise in investment and a 3.1% increase in household consumption. Domestic demand rose by 4.6% while negative net export contribution amounted to 1.5 pp. Comparing different sections we see dynamics similar as in previous quarter with the few exceptions of transport and warehousing (transition from solid growth to stagnation, though the volatility of this series is naturally high). Although base effects were negative, growth in financial and insurance activity ascended significantly.



Both domestic and foreign data indicate that at the moment we are at the bottom of a mini cycle in economic activity (or that a small soft patch is almost over). Statistical perturbations resulting from base effects (e.g. in investment) can cause GDP dynamics in Q1 to fall slightly, however we are absolutely sure that Polish economy is accelerating and following months' data would confirm this. We forecast that in the last quarter of 2015 GDP dynamics could exceed 4% – driven by new wave of infrastructure expenditures and stable consumption dynamics.

MPC would not take this release into account when deciding at its next meeting. Until monotonous acceleration of GDP (absolutely non a baseline scenario in present NBP projections – we think it would stay this way in March publication) will not be confirmed by actual releases, MPC could focus on record low inflation and cut rates (our forecast – at least 25). Low rates and low inflation globally (it may already be reverting but it's still low and could not reach its target in midterm) favour thinking of low rates in Poland (and their convergence with the Eurozone as well), however the very same inflation and signs of recovery in the Eurozone could be closing optimal window for rate cuts for financial markets.

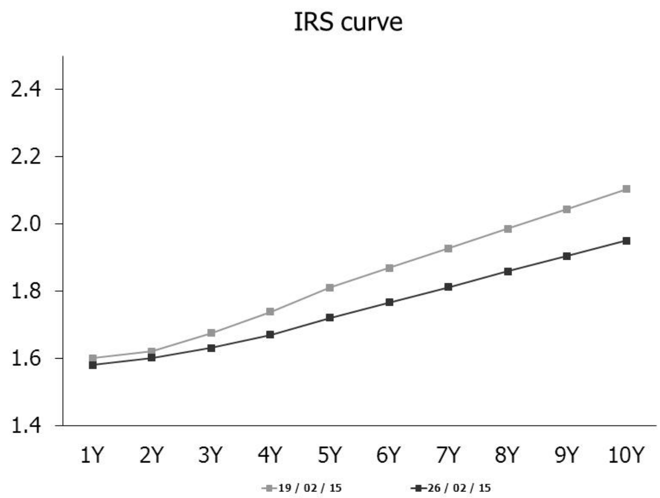
Fixed income

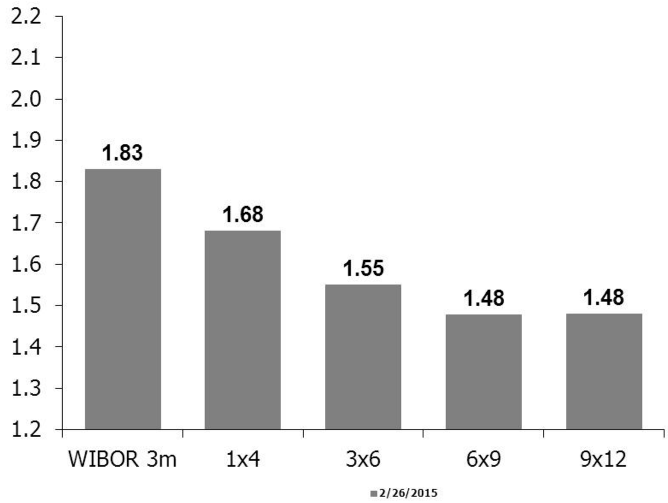
Waiting for the MPC

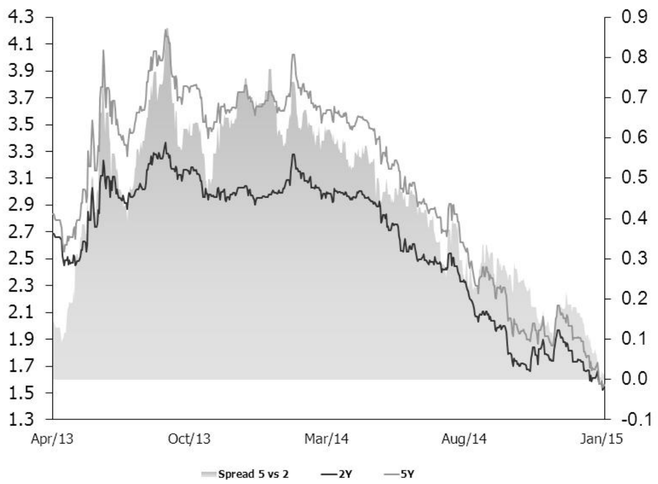
This week all eyes were on Fed Chair Yellen's Congressional testimony which was broadly supportive for bonds as she presented a "patient" stance with rate hikes. Market was short and as a result Polish bonds were traded 20 bps lower in yield terms (DS0725 2,10% from 2,33% last Friday), yields of periphery Eurozone countries and Germany touched all time lows, 10Y UST was traded below 2%.

Next week's key event for Polish fixed income market is the MPC decision. Market consensus is 25 bps cut but no change decision (less probable) or 50 bps cut can't be fully ruled out. The question mark is if we see other cut/cuts or only a one-off decision as more than 50 bps is currently priced in.

With an open question about MPC next steps, more volatile and data dependent UST market we recommend to take profit on 4Y bonds (last week recommendation) and sit on the sidelines waiting for the MPC decision next week.







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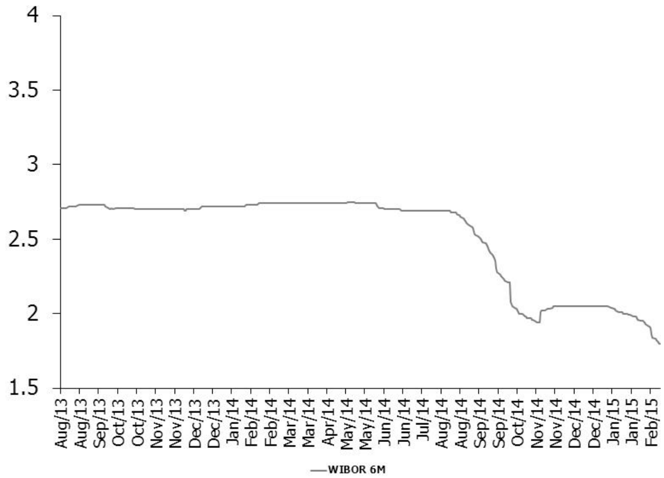
Money market

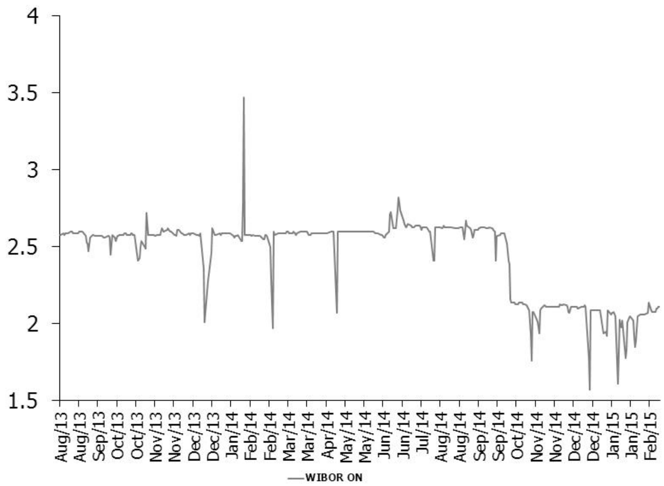
Expensive week behind us

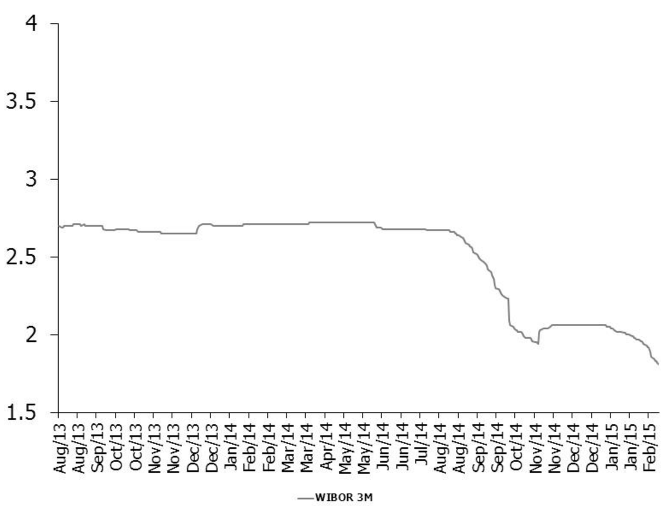
As it was last week of reserve with additional OMO on Friday market was square. Next week we have MPC meeting (with 25 bps rate cut in curve) so it should be a bit cheaper.

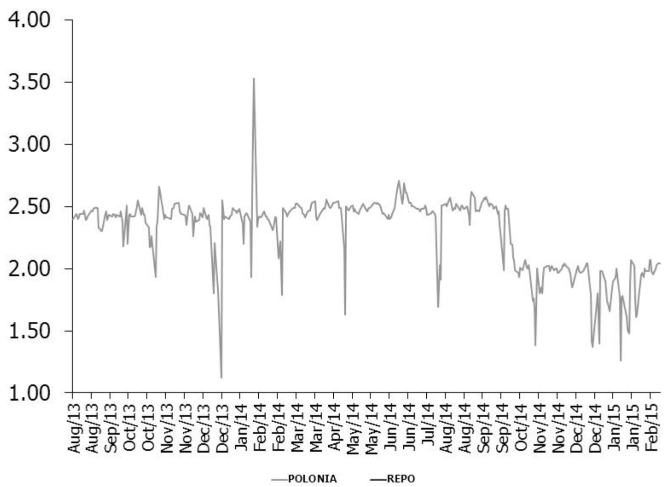
OIS curve discounts two rate cuts. One in March and one in April. As it's a bit more in longer FRA we recommend selling OIS's. Good lvl to sell 1Y OIS is 1.48 and 6M at 1.50. To hedge it use 6X9 at 1.50. When rates normalize, WIBOR's should be around 10-15 bps over reference rate.

Buy OK0116 at 1.60 as it's the cheapest bond at the curve.





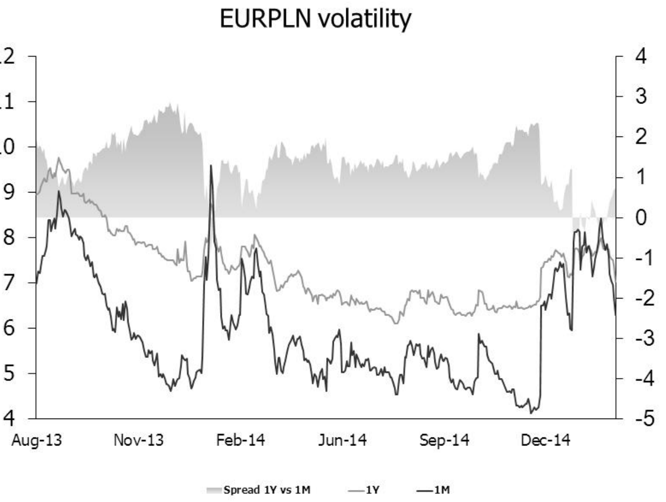




Forex

PLN even stronger EUR/PLN keeps on gently sliding lower, setting the fresh low at 4.1460 (last time seen in December). Realized volatility was really small last week. The risk is getting bit more digital in the next week, as we have mammoth-like events, namely MPC rate decision along with ECB meeting and US employment report. Possible rate cut delivered by the MPC and good data from US economy supporting Fed's normalization policy could push EURPLN towards 4.2. But it does not change the fact that bigger picture fundamentals are still PLN positive.

Options – Vols lower The lack of real thrill and fat theta bills were the reasons why the front end of volatility curve collapsed. 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 6.0 (1.1% lower than last Friday), 3 months EUR/PLN are 6.3% (0.9% lower) and finally 1 year is 7.1% (0.45% lower). The skew is also a touch lower, along with the currency spread (difference between USD/PLN vol and EUR/PLN vol, which decreased by around 0.75% and now is at 5.0-5.25%.

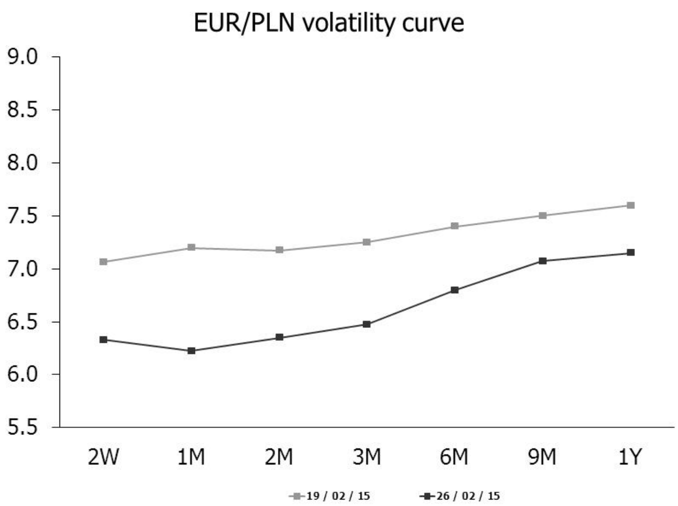


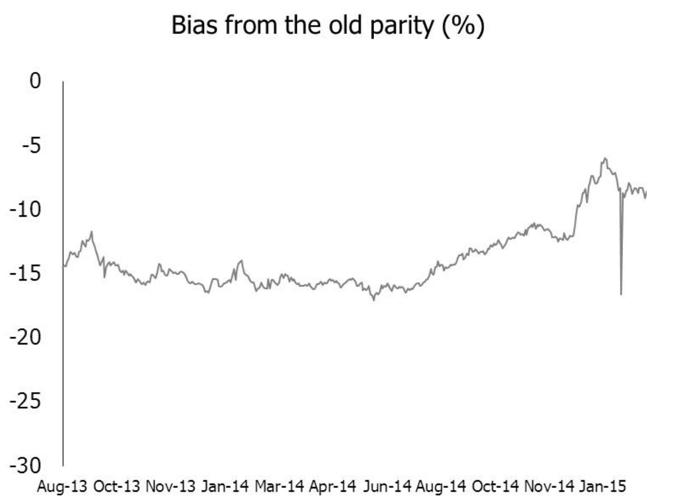
Short-term forecasts

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

Spot We are still long EUR/PLN at 4.1575 with a stop below 4.1350 and the P/T at 4.20+. We believe in mean reverting move to 4.20 as the start of the easing cycle in PLN is looming on the horizon.

Options We are long Vega in the backend as it looks like the vols market is back to life. Implied volatilities have come off significantly over the past 2 weeks. For some tenors realized volatilities are significantly higher than implied volatilities (for example 3m 8.25% realized versus 6.4% implied). We think the levels below 6.8% 6 months EUR/PLN and below 7.2% 1 year are good to buy.





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
2/20/2015	1.87	1.86	1.81	1.74	1.86	1.73	1.70	1.58	1.51	1.51	1.55	1.52
2/23/2015	1.84	1.84	1.80	1.73	1.87	1.72	1.68	1.56	1.51	1.52	1.57	1.52
2/24/2015	1.81	1.83	1.77	1.72	1.85	1.71	1.67	1.55	1.50	1.52	1.54	1.52
2/25/2015	1.71	1.83	1.95	1.71	1.95	1.70	1.69	1.54	1.50	1.51	1.54	1.50
2/26/2015	1.82	1.82	1.78	1.70	1.84	1.70	1.68	1.55	1.48	1.48	1.52	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
2/20/2015	1.730	1.681	1.645	1.664	1.865	2.028	2.165	2.306
2/23/2015	1.720	1.630	1.650	1.670	1.840	2.008	2.130	2.302
2/24/2015	1.710	1.635	1.633	1.611	1.795	1.954	2.060	2.256
2/25/2015	1.700	1.613	1.610	1.631	1.735	1.898	1.982	2.201
2/26/2015	1.700	1.598	1.601	1.688	1.720	1.875	1.950	2.144

EUR/PLN 0-delta stradle						25-delta RR			25-delta FLY
Date	1M	3M	6M	1Y		1M	1Y		1Y
2/20/2015	7.05	7.10	7.30	7.55		7.55	2.45		0.68
2/23/2015	6.96	7.08	7.25	7.50		7.50	2.45		0.68
2/24/2015	6.70	6.90	7.08	7.40		7.40	2.45		0.58
2/25/2015	6.30	6.40	6.80	7.03		7.03	2.45		0.59
2/26/2015	6.23	6.48	6.80	7.15		7.15	2.45		0.59

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
2/20/2015	4.1800	3.6895	3.8781	3.1088	1.3706	0.1523
2/23/2015	4.1777	3.6933	3.8842	3.0967	1.3666	0.1516
2/24/2015	4.1763	3.6948	3.8909	3.0913	1.3657	0.1524
2/25/2015	4.1668	3.6649	3.8653	3.0872	1.3640	0.1520
2/26/2015	4.1542	3.6519	3.8628	3.0764	1.3692	0.1515

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