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Polish Weekly Review

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Comment on the upcoming data and forecasts

Light week in terms of economic data. Preliminary data on unemployment has already been released by the Ministry of Labor and Social Policy (unemployment rate unchanged at 12%).

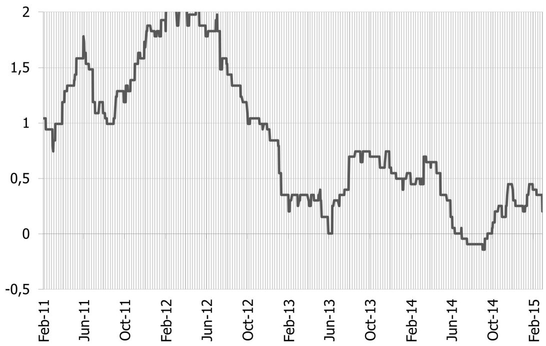
Polish data to watch: March 23th to March 27th

Publication	Date	Period	mBank	Consensus	Prior
Unemployment rate %	24.03	Feb	12.0	12.0	12.0

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 DS0725	-	2000	2.366	3/12/2015
20Y T-bond WS0428	-	20	2.092	3/12/2015

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



Comment

Polish surprise index at ytd lows due to negative surprise in retail sales data. There's only one release next week (unemployment rate) and it shouldn't surprise - preliminary data released by the Ministry of Labor indicate a reading in line with consensus.

* 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% and we are close to the bottom in terms of annual growth rate.
- 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.
- Momentum of inflation recorded a turnaround and we await higher readings in coming months. However, GDP gap is too wide to generate inflation pressure and therefore inflation is going to stay low (very low).
- MPC did its part delivering 50bps cut in March. Official communication states that the cycle has been concluded and rates are going to stay at 1.5%. At the same time rate hikes are miles away since there is no inflation in sight and the new MPC (starting job in 2016) may be even more dovish.

Financial markets

- We are semi-defensive on Polish bonds and prefer the 5Y sectors as we do not believe in prompt monetary tightening, way ahead of the ECB.
- MPC concluded the easing cycle at 1.5% and rate cut expectations can only be fueled by substantial PLN strengthening due to QE-connected inflows, high real interest rates and improving cyclical position of the Polish economy.

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	1.60	1.60	1.60	1.70
10Y Polish bond yields (% eop)	4.23	3.45	3.05	2.52	2.10	2.10	2.30	2.40
EUR/PLN (eop)	4.17	4.16	4.18	4.29	4.10	4.05	4.05	4.05
USD/PLN (eop)	3.03	3.04	3.31	3.54	3.87	3.82	3.93	4.05

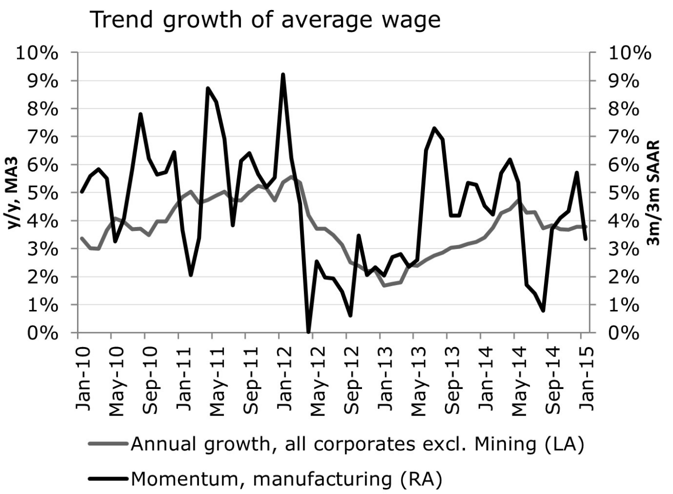
F - forecast

Economics

The economy is steaming forward but don't think about rate hikes. This time could really be different.

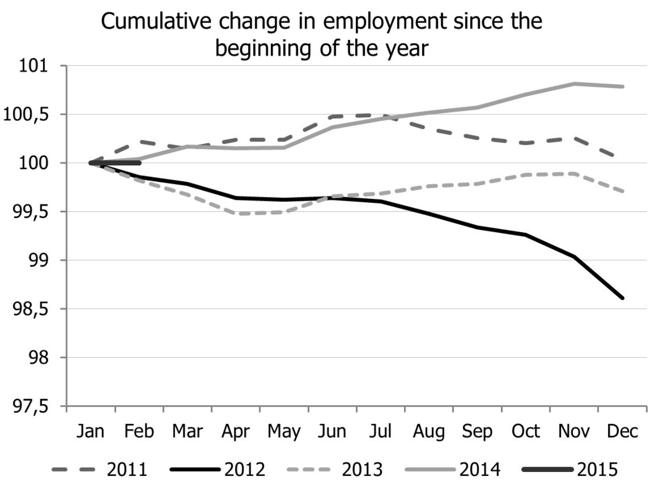
The series of data releases for February was a mixed bag. While wages held steady and industrial output data was particularly strong, employment and retail sales surprised to the downside. We advise the Reader not to put too much emphasis on flagging retail sales and employment. These are likely distorted by one-off effects and, as such, are not the best indicator of the cyclical position of the economy. Manufacturing, on the other hand, clearly is - the upswing has been nothing short of astonishing over the past few months. Barring any base effects in Q1 GDP release, economic growth will accelerate steadily this year. Does this mean that we should be preparing for rate hikes already? We do not think so. Any bets on Polish monetary policy must include the general European context (low inflation, low rates, euro QE). It is unlikely that the NBP will be frontrunning the EBC in monetary tightening as premature tightening would send the PLN flying. Thus, we do not believe that rate hikes are coming next year. At the same time the market may be positioning for quite a different outcome following rates outside Polish economy.

Average wage rose in February by 3.2%, in line with market consensus and our forecast (both 3.2%). Once again we do not have detailed data breakdown into sectors (those will be available with the release of the Statistical Bulletin next week). However, the slowdown (comparing to previous month) could be driven by concurrence of negative factors: high base in mining and seasonal shift in remuneration in transport services. Taking also into account random gyrations, February's release goes along with trend, currently 3.5% (see chart below).



Nominal wage bill decelerated from 4.9 to 4.5% y/y and has practically been unchanged for a year. If it wasn't for new record lows in inflation, we wouldn't have seen 6%+ annual growth in real wage bill. Currently, it obviously supports private consumption. One has to remember, though, that the upcoming increase in inflation, if not accompanied by commensurate acceleration in nominal wages, will curtail income base for consumption. For that reason, wage data will require more scrutiny in the coming months.

Employment in the enterprise sector held steady in February at last month's level of 5573k. Annual growth rate stayed also unfazed at 1.2%. While preparing the forecast we pointed to a turnaround in business tendency indicators (manufacturing, construction). However, usually employment follows with a lag (sometimes a significant one). As there were no fundamental reasons to be overly pessimistic (solid growth, growing optimism, cyclical recovery in the euro zone starting), we remained positively biased and therefore opted for 1.3% growth in employment. Negative surprise (taken at face value and without the detailed breakdown) says nothing. We treat it as a one-off until Statistical Bulletin sees the light (next week); we suspect that there is a major mass layoff standing behind the surprise.



In February **industrial production** rose by 4.9% after a 1.7% rise in January. This result was slightly higher than market consensus but consistent with our forecast. It means that Polish industry kept its positive momentum: after seasonal adjustment yearly dynamic amounted to 4.7% comparing to 4.0% in January and 5.0% in December 2014. Another solid m/m growth (1.3%) lifted momentum to new cyclical maxima. 24 out of 34 sections grew - mainly export-oriented ones. Among those sections which fell were (as previously): coal mining, coke production, energy generation. Those are not cyclical branches - the latter show further signs of acceleration. The reason for this quickening could be found in positive surprises from Eurozone economy (rebound in car industry for instance).

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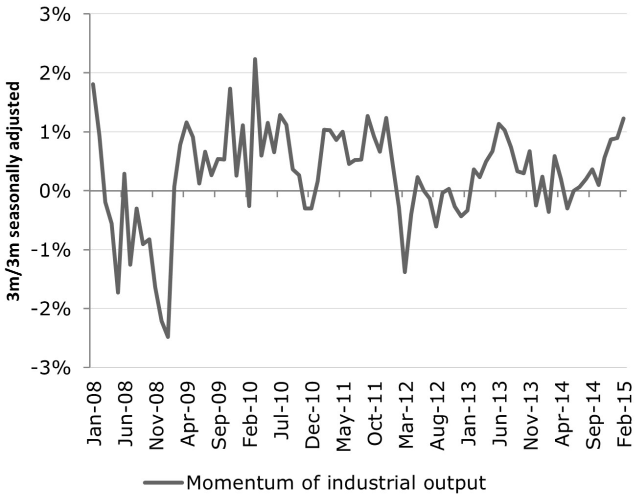
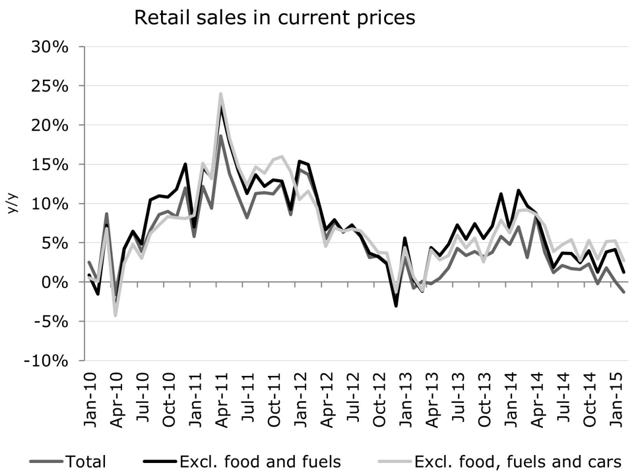
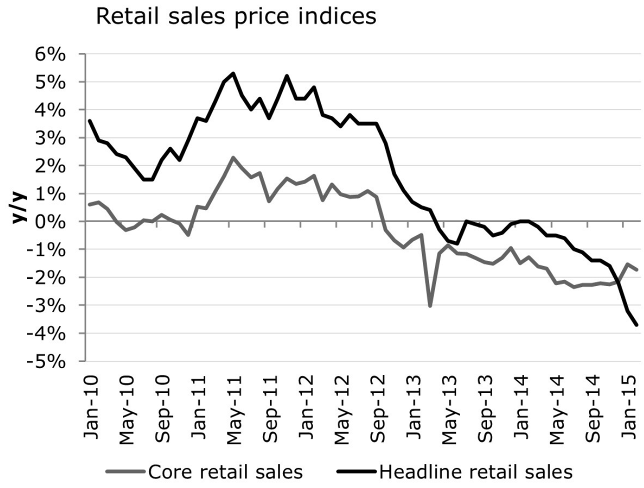


Retail sales unexpectedly fell 1.3% y/y. "Other sales" category did not continue the drop from January, as we expected, but auto sales disappointed given the favorable macro environment (growing optimism, growing real disposable income and low interest rates); statistical base from last year was strong enough to iron out annual growth rate. Also, food sales was weak, but we would regard this very case as noise (March is going to be fuelled by Easter sales) as there is no fundamental reason for such a change in one month time.



Taking a broader view, retail sales excluding the most volatile categories (see the graph) are moving sideways. At the same time retail prices are dropping like a stone (the next graph). We would be surprised if current favorable macro environment did not produce better retail sales readings. However, it may be the case that Poland is undergoing a transformation towards service consumption fairly fast (as a proof let's see the smooth path of GDP growth and stable consumption growth given ups and downs in retail sales) and acceleration of retail sales will not be substantial. All in all we think that consumption is not going to be the main driver of the cycle in 2015. It is not going to be far off 3% growth either. We think that the biggest potential to generate increments in consumption lies in public sector. The same applies to investment demand. Business equipment demand soared already in 2014 and now it is government's part to start with infrastructure outlays.

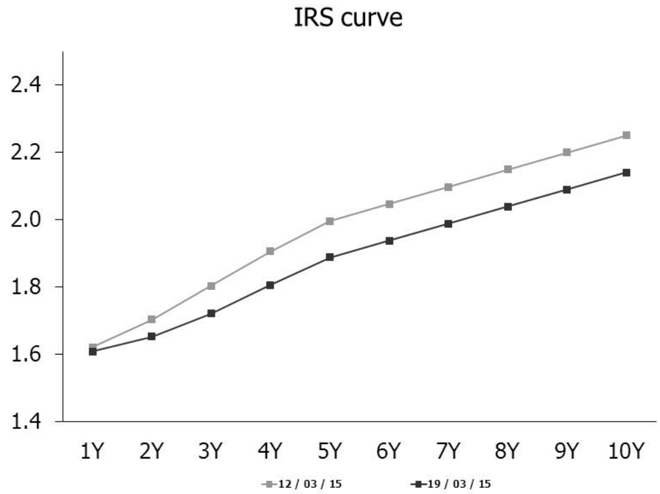


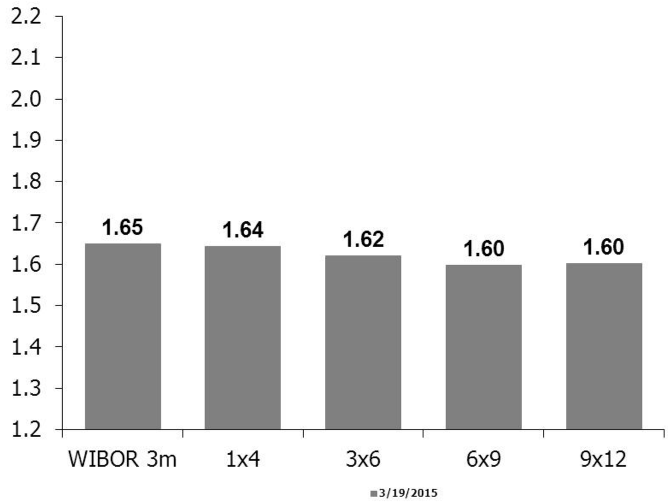
As expected, **producer prices** dropped in February by 2.7% on annual basis. Prices were stagnant compared to January. Higher oil prices, PLN depreciation (towards USD) helped to achieve a bottom in annual growth. However, the momentum in manufacturing stays very weak. Prices in manufacturing are still on the fall (this time by 0.1% on the month) at face value; without oil prices the drop amounts to 0.6% on January. At his cyclical juncture there is no automatic mechanism that would translate higher costs to higher prices; margins seem to be depressed as a consequence. Cyclical upswing in 2015 (we see more and more green shoots in euro zone) can be beneficial for pricing power. At this moment there is no price pressure in manufacturing sector.

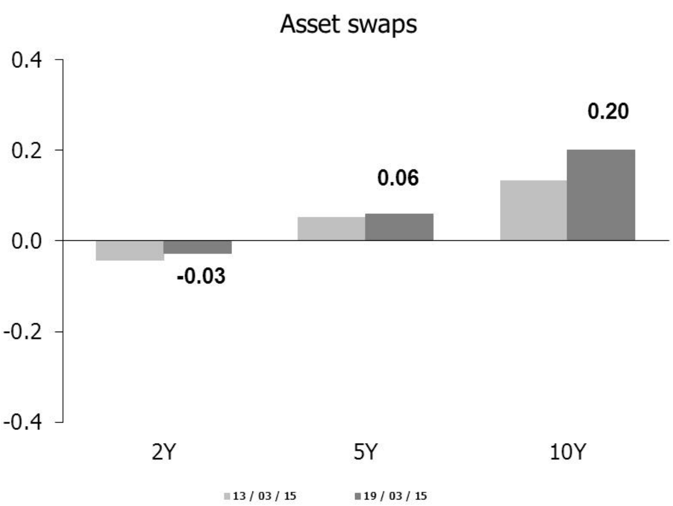
Fixed income

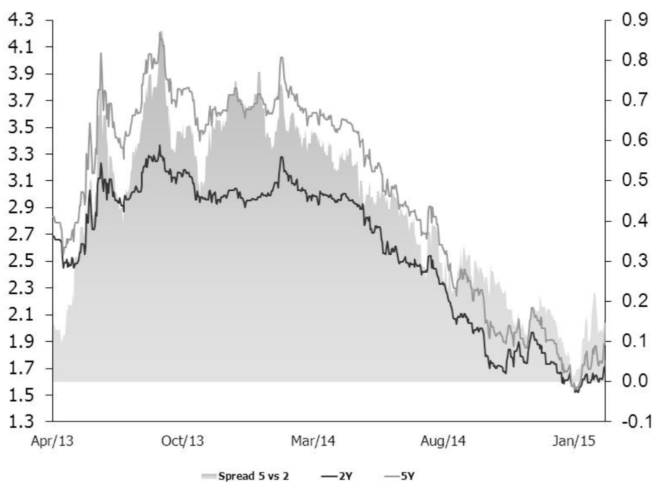
Saved

This week on fixed income market we had quite significant sentiment change. "Old Story" about rate hikes in US, attractiveness of their bonds compared to EM ones and lack of cheap money reversed after Fed's meeting. Suddenly rate hikes in the U.S. are not that frightening, it seems that Fed's members are not "immune" to global story and strong USD could have changed the tone of their comments. Yield of DS0725 fall from 2.45 to 2.22 and now market is reevaluating possible options for MPC. With our CPI at -1.6% and biggest supply (10Y auction) of this month already a history, long end bonds should be well supported at least till the end of March.







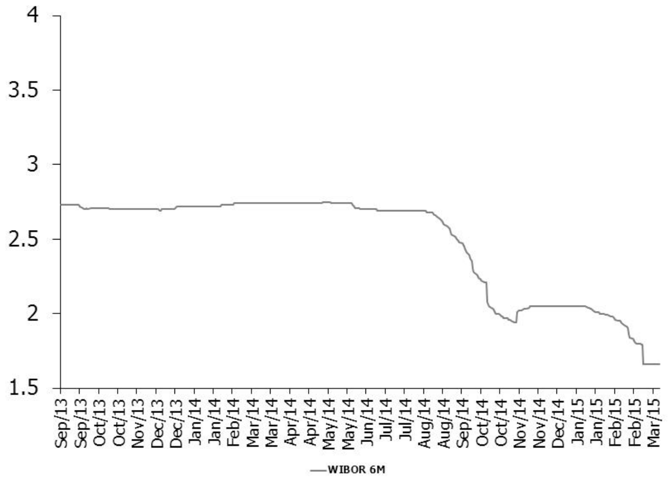


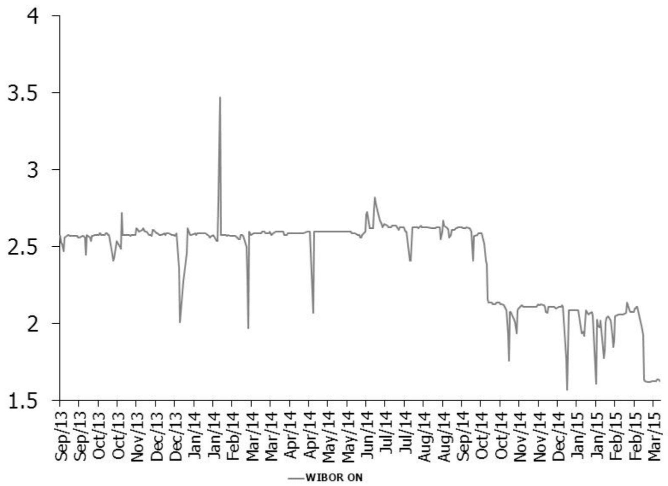
Money market

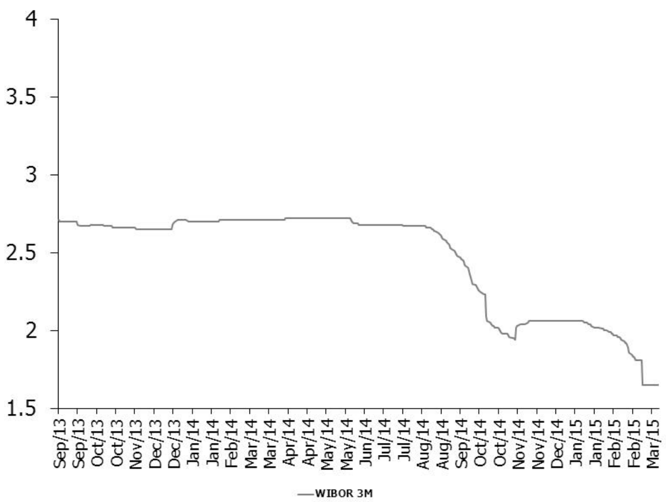
Stable week behind us

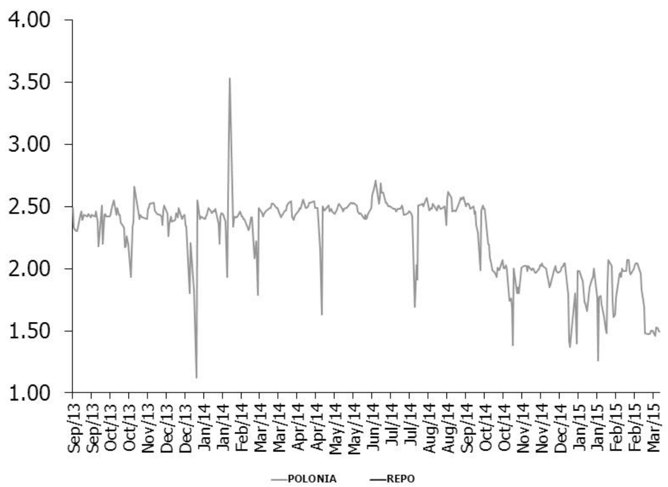
With small ON deposits turnover (200 mln to 1bn) Polonia fluctuated around 1.50. As Friday's OMO squares the market next week should be same.

1Y OIS price stabilized at 1.41-1.46. As it should stay stable we recommend to play range: OIS - FRA spread (e.g. 1Y OIS vs 6*9 FRA) that should fluctuate between 15 and 20. For the shortest bonds we recommend buying OK0116 at 1.58.





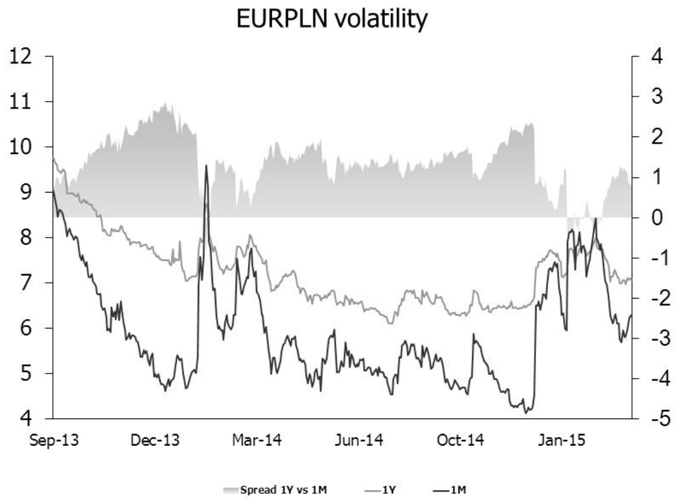


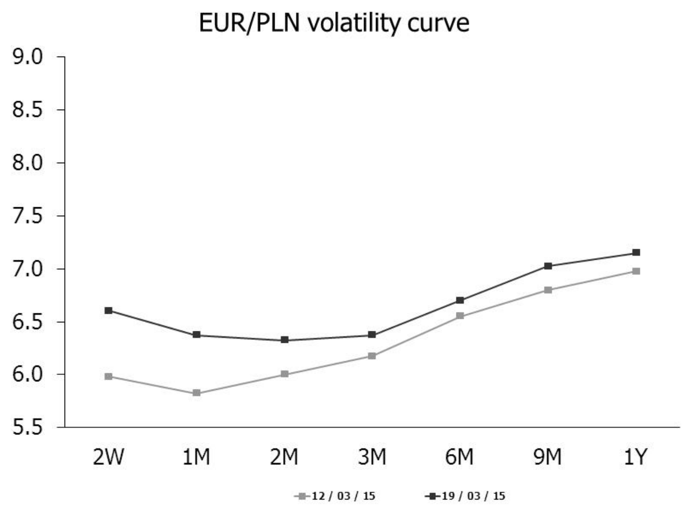


Forex

PLN consolidating/upside bias EUR/PLN was still consolidating in the current range 4.1140-4.1600 for the whole week. Technically we are at the support of this year's wider range (4.10-4.30) but we have seen no material rebound as yet. Zloty is likely to stay under influence of ECB printing machine going at full speed and Polish MPC promised to keep rates at current level. What makes a difference is FOMC message that strong/stronger dollar may/will influence rate hikes decisions, potentially reducing the premium for being long USD. It affects the second most important currency pair against PLN, namely USD/PLN. As a consequence we are becoming more PLN bullish, as both leading pairs EUR/PLN and USD/PLN may not act in the contradictory manner anymore.

Options - higher This week buyers of gamma were very active on the market so the beginning of the EURPLN volatility curve crept higher than a week ago. 1 month EUR/PLN ATM is fixing this Friday at 6.2% (0.4% higher), 3 months ATM increased from 6.1% to 6.3%. 1 year ATM is fixing at 7.0% (0.1% lower then week ago). The skew was little offered with the whole curve shifting by roughly 0.1%. The currency spread (difference between USD/PLN and EUR/PLN) was also better offered due to more positively correlated EUR/USD with EUR/PLN.



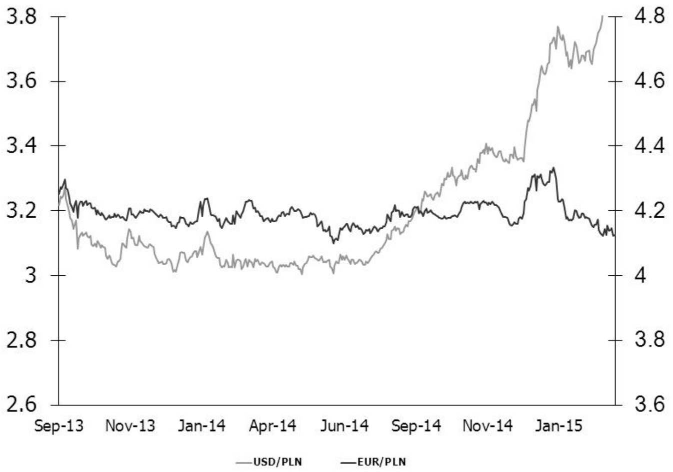


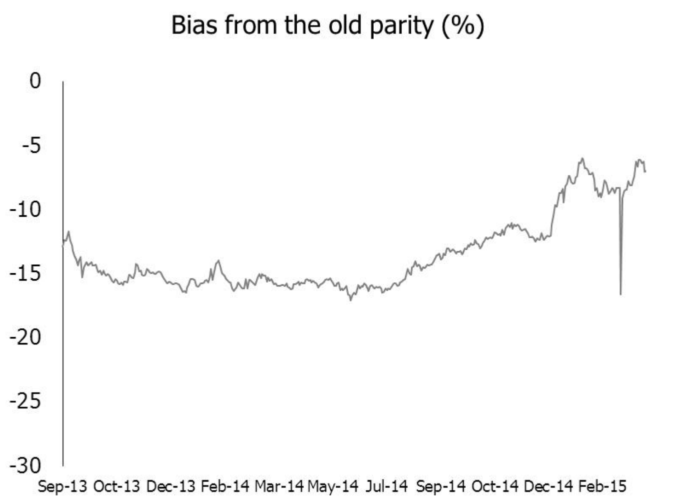
Short-term forecasts

Main supports / resistances:
EUR/PLN: 4.08 / 4.18
USD/PLN: 3.60 / 3.95

Spot Short USD/PLN.
We are short USD/PLN at 3.8700, and we are ready to add at 3.90 with stop at 3.9300 and profit taking at 3.7500.

Options The FOMC has created enormous realized volatility, especially in EUR/USD and other USD/XXX crosses. It is very likely that the market will continue to be choppy at best. But in the longer term, the relative nature of the FOMC policy should reduce substantially the heat of the markets. We are trimming our long Vega in the backend but sticking to long Vanna in both EUR/PLN and USD/PLN.





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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
3/13/2015	1.68	1.65	1.68	1.56	1.58	1.58	1.63	1.61	1.60	1.63	1.69	1.62
3/16/2015	1.79	1.65	1.66	1.56	1.56	1.58	1.65	1.62	1.61	1.63	1.68	1.63
3/17/2015	1.66	1.65	1.67	1.56	1.57	1.58	1.66	1.63	1.62	1.64	1.69	1.64
3/18/2015	1.60	1.65	1.68	1.56	1.47	1.58	1.65	1.60	1.59	1.61	1.65	1.61
3/19/2015	1.72	1.65	1.81	1.56	2.02	1.58	1.64	1.62	1.60	1.60	1.63	1.62

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
3/13/2015	1.580	1.579	1.710	1.668	2.053	2.104	2.320	2.453
3/16/2015	1.580	1.589	1.703	1.667	2.033	2.058	2.293	2.439
3/17/2015	1.580	1.581	1.713	1.681	2.044	2.075	2.304	2.459
3/18/2015	1.580	1.568	1.685	1.642	1.995	2.052	2.255	2.447
3/19/2015	1.580	1.575	1.653	1.626	1.887	1.947	2.140	2.341

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
3/13/2015	5.98	6.30	6.68	7.10	7.10	2.29	0.63
3/16/2015	6.20	6.33	6.68	7.08	7.08	2.29	0.63
3/17/2015	6.25	6.35	6.68	7.10	7.10	2.29	0.64
3/18/2015	6.30	6.35	6.65	7.08	7.08	2.29	0.63
3/19/2015	6.38	6.38	6.70	7.15	7.15	2.29	0.63

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
3/13/2015	4.1529	3.9141	3.8940	3.2225	1.3604	0.1521
3/16/2015	4.1373	3.9260	3.9116	3.2356	1.3578	0.1516
3/17/2015	4.1397	3.9034	3.8971	3.2178	1.3622	0.1518
3/18/2015	4.1450	3.9073	3.8960	3.2230	1.3646	0.1522
3/19/2015	4.1230	3.8596	3.8926	3.2003	1.3650	0.1503

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