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Comment on the upcoming data and forecasts

All eyes on the MPC. As the surprise index seems to have started to consolidate and as the bottom of the current cycle seems to be in sight (at least in the eyes of analysts and MPC members), predicting the next decision becomes difficult. Nevertheless, we expect the Council to cut rates be 25 bps and change its stance to neutral.

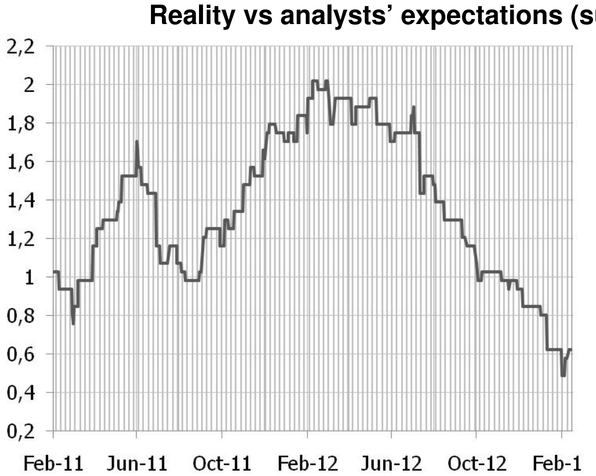
Polish data to watch: March 4th to March 8th

Publication	Date	Period	BRE	Consensus	Prior
NBP repo rate announcement	06.03	Mar	3.50	3.50	3.75

Treasury bonds and bills auctions

Paper	Next auction	Last Offer	Last yield (%)	Prev auction
52 Week T-bills	3/4/2013	1500	3.465	2/4/2013
2Y T-bond OK0715	3/20/2013	3000	3.456	2/13/2013
5Y T-bond PS0418	3/20/2013	4000	3.521	2/7/2013
10Y T-bond DS1023	-	4000	3.847	1/7/2013
20Y T-bond WS0429	-	4000	3.896	1/7/2013

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



Comment
Another slight correction after retail sales release (possitive surprise mainly due to statistical effects). Analysts seem to finally internalize the depth of current slowdown. No publications next week, therefore no room for changes in the index.

* 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

- We see more risks towards stagnation (not contraction) in H1 2013. External developments (moderate growth in Germany, zero growth in euro zone) are not dynamic enough to offset deceleration in domestic demand. Consumption growth close to zero (zero savings rate, deleveraging urgently needed), negative investment growth rate (public investment as an original damper to growth, private investment to dip into negative territory soon on weak demand prospects), restrictive fiscal policy.
- A faster re-acceleration of the euro zone economy and low statistical base seem to be the most obvious reasons for a rebound of the Polish economy in H2 2013. However, given the scale of slack in investment and consumption any rebound generated this way may be only moderate (about 2%y/y growth rates in Q4 2013). Poland has entered a period of weaker growth.
- Polish government committed to the convergence path, though in an unorthodox way. Very limited room for fiscal stimulation due to limited financial markets tolerance for higher debt. GG deficit no higher than 4% (minor impact for the economy, support for Polish bonds).
- Inflation set to moderate in the near term on statistical effects (high base from 2012) and in mid-term on lower core inflation (close to 1% in mid 2013). CPI inflation at below 2.0% in January 2013. The possibility for significant undershooting of inflation target in 2013 is high.
- MPC reluctant to lower rates to below 3.5%. Weak economy and falling inflation still justify further rate cuts. 3.25% base rate as an ultimate base rate level.

Financial markets

- 2013 most likely not a ”bond year”. Global ”rotation” of assets poses headwind for debt.
- Polish bonds clearly more sensitive to core markets developments. Ultimately global recovery (or monetary stimulus withdrawal) and rising core yields (ECB ruling out refi rate cuts, Fed discussing exit strategy) may adversely affect Polish bonds.
- Fundamental reasons for lower yields in Poland stay intact but ... february more hawkish MPC statement a game changer for short term bonds.
- We still expect POLGB’s to stay at historically low levels (10Y below 4.50% in yield). As Polish bonds relative valuations look stretched and global recovery is set to continue Polish yield curve should eventually steepen.
- Cyclical behavior of the Polish zloty far weaker than in 2008-2011 as current account has been narrowing and euro zone disintegration risks were put aside with ECB put. Hence we expect only slight weakening of the zloty with 4.22/25 (technical analysis) acting as a hard resistance.
- Volatility on both FX and FI lower due to so-called ECB put.

BRE forecasts

	2008	2009	2010	2011	2012	2013 F
GDP y/y (%)	5.1	1.6	3.9	4.3	2.0	1.0
CPI Inflation y/y (average %)	4.3	3.5	2.8	4.2	3.7	1.6
Current account (%GDP)	-5.3	-1.6	-4.5	-4.9	-2.6	-2.0
Unemployment rate (end of period %)	9.5	12.1	12.4	12.5	13.4	14.2
Repo rate (end of period %)	5.00	3.50	3.50	4.50	4.25	3.25

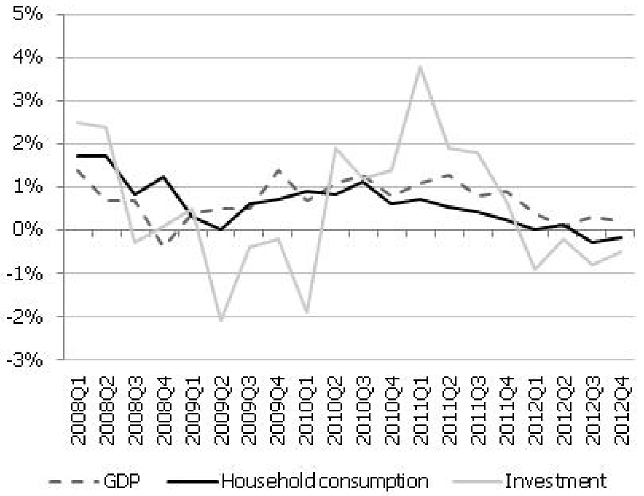
	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2013 Q1 F	2013 Q2 F	2013 Q3 F	2013 Q4 F
GDP y/y (%)	3.6	2.3	1.4	1.1	-0.2	0.5	1.3	2.0
Individual consumption y/y (%)	1.7	1.2	0.1	1.0	0.8	1.3	1.8	2.1
Public Consumption y/y (%)	-0.8	0.5	0.2	0.0	0.5	0.5	0.5	0.5
Investment y/y (%)	6.0	1.3	-1.5	-0.3	-5.2	-3.0	-2.5	-1.3
Inflation rate (% average)	3.9	4.0	3.9	2.9	1.6	1.4	1.5	1.8
Unemployment rate (% eop)	13.3	12.4	12.4	13.4	14.7	13.9	13.5	14.2
NBP repo rate (% eop)	4.50	4.75	4.75	4.25	3.50	3.25	3.25	3.25
Wibor 3M (% eop)	4.94	5.13	4.92	4.11	3.65	3.50	3.50	3.50
2Y Polish bond yields (% eop)	4.62	4.60	4.05	3.14	3.30	3.30	3.40	3.40
10Y Polish bond yields (% eop)	5.50	5.15	4.69	3.74	4.00	4.00	4.10	4.30
EUR/PLN (eop)	4.15	4.22	4.12	4.08	4.15	4.10	4.05	4.00
USD/PLN (eop)	3.11	3.35	3.20	3.09	3.14	3.21	3.24	3.20

F - forecast

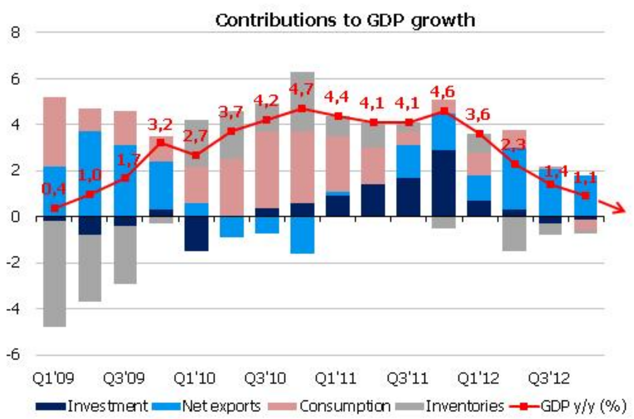
Economics

Q4 GDP growth beats expectations

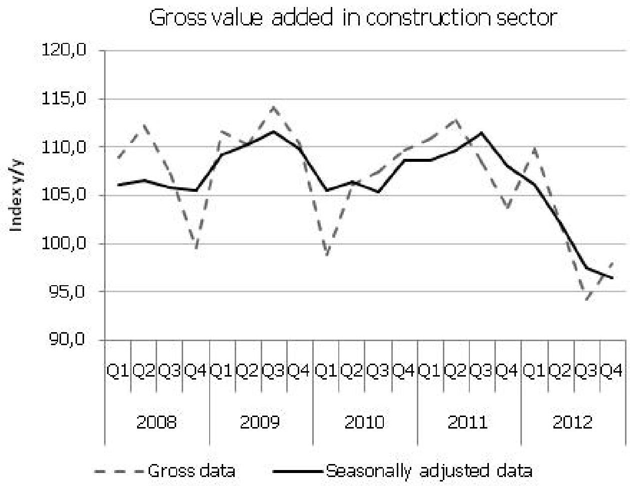
GDP grew by 1.1% y/y in the fourth quarter (as compared to +1.4% y/y in the third). Curiously, GDP also grew on a quarterly basis by 0.2% (a slight decline was expected). These figures could of course be extracted from annual GDP estimate published earlier this year (+2.0%) but the issue of accuracy remained.



The composition turned out to be similar to expectations. Consumption declined by 1% in annual terms (after growing by 0.1% in Q3) and investment declined only by 0.3% y/y (after a 1.5% decline in Q3). Overall, internal demand contracted by 0.7% - an identical rate was reported in the previous quarter. As inventories subtracted only 0.1 percentage points from the headline rate, the only remaining source of growth was from net exports (+1.8 percentage points – a decrease from +2.1 recorded in the third quarter). On a sectoral basis, we observe negative dynamics in industry and trade, as well as construction. The latter contracted at a slower rate than in the previous quarter, in spite of worse sold output dynamics in this sector.



Fourth quarter GDP growth above expectations is of course a higher starting point for subsequent quarters and a reason to revise forecasts for the first half of the year upwards. No credible signals of upswing of economic activity have been observed so far. Today's PMI release has a poor composition (output still contracts), poor labor market conditions are bound to extend for the first half of the year and consumers still struggle to rebuild savings. It is also worth noting that all negative trends are still intact and the apparent rebound in investment can at least partly be attributed to one-off effects in construction activity (low statistical base from 2011Q4 - see the graph below). Seasonally adjusted investment growth is still in downtrend. In the first half of the year private and public investment should continue to have a negative contribution to growth.



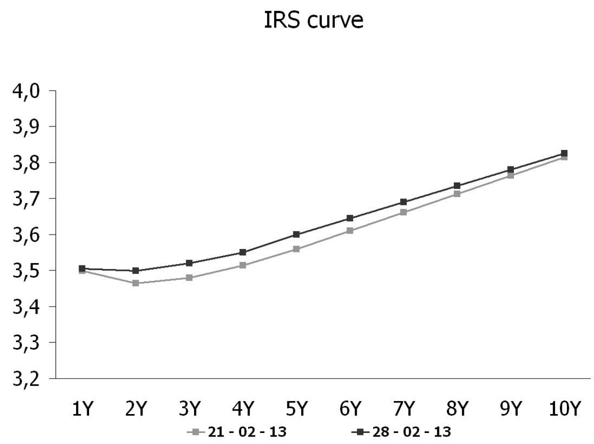
The release sparked an increase in market interest rates. From the MPC's point of view, they are still neutral – recession in consumer demand and further drops in inflation are powerful arguments in favor of easing. We expect the MPC to cut rates in March (it is a close call though) and move to a neutral stance.

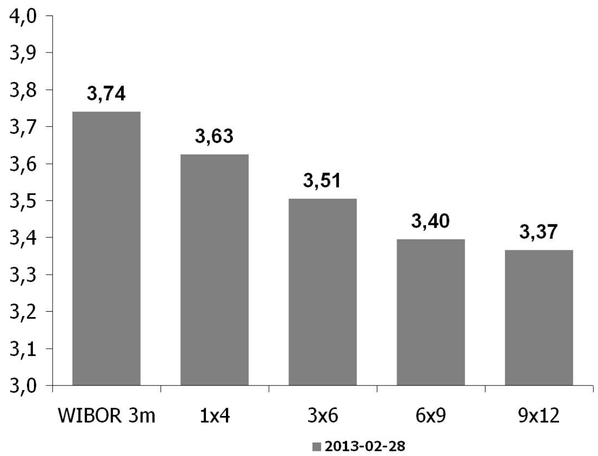
Fixed income

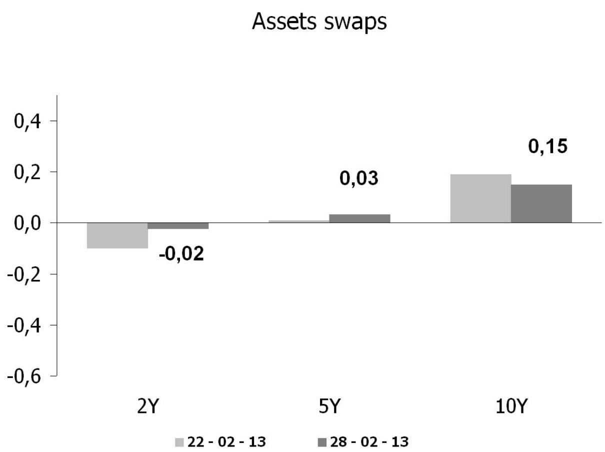
Ahead of MPC meeting

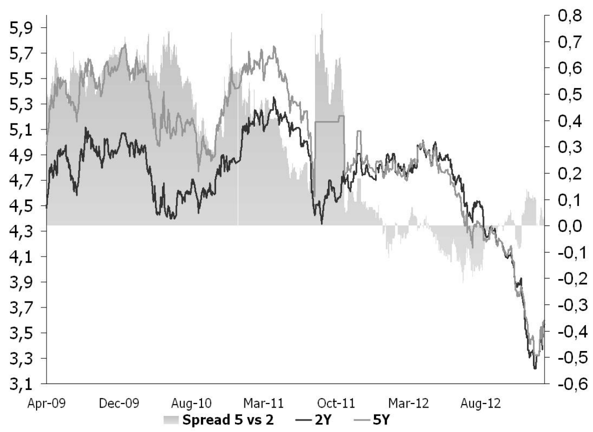
A week ahead of MPC meeting the Polish market stayed under pressure from both domestic economic data and global turmoil on core markets. On Monday we had central bank governor Belka on the tape. He stressed Poland was already in gradual rebound and expected better than 1.2% yty growth in 2013. One can ask whether Belka's comment came from his knowledge of CPI projection, or it was just "the spirit of optimism" he had been referring to a few times at recent press conferences (PM Tusk has used the same kind of rhetoric while speaking about recent economic developments). Opening on rates and bonds was slightly negative, 2y is 3,50/53 (some 2 bp higher) 5y is opening 3,59/62 (also some 2 bp higher). Another market driver hit the prices at 10.00 CET. Polish retail sales data was a positive surprise beating market expectations of +0.7% by coming out at +3.1% yty. Rebound was driven mainly by working days effect though. Among sections we saw better car sales numbers which was again a rebound after very depressed December. As we anticipated better retail sales number, the reading did not change our negative assessment of economic activity in Q1.

The market reaction after the figures seemed to be quite nervous. 2y swap traded at 3,56 as the high (some 3 bp higher from the opening and some 6 bp higher from the close). 2y5y was not really moving +9 looked to be the middle. 10y bonds after falling on the opening were stabilizing in the longer run. The yield curve started to flatten especially in 5y10y sector as the core markets rallied quite substantially. To acquire a more clear view on what we could expect from the next MPC meeting we were only missing the MPC Hausner's opinion. In his TV interview he said that a rebound might be stronger compared to what was previously expected (we didn't see it that way, data we saw this month reflect weakness of December more than overall strength). It looked like cut in March was getting a bit less likely, still our call is either for a cut and change of stance to wait-and-see or no cut and doors opened to cuts if the economy slowed further.





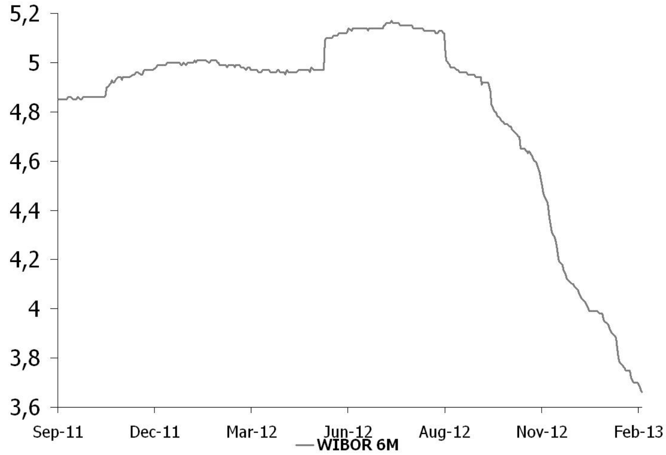


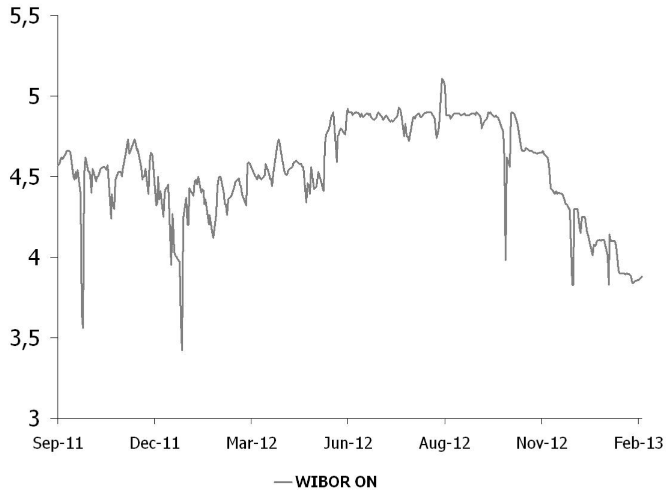


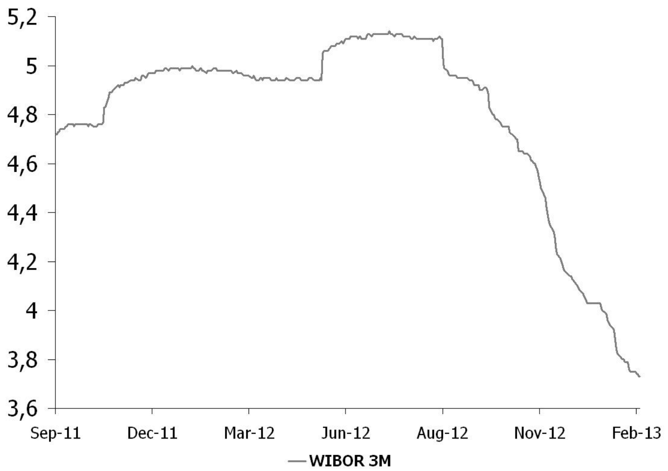
Money market

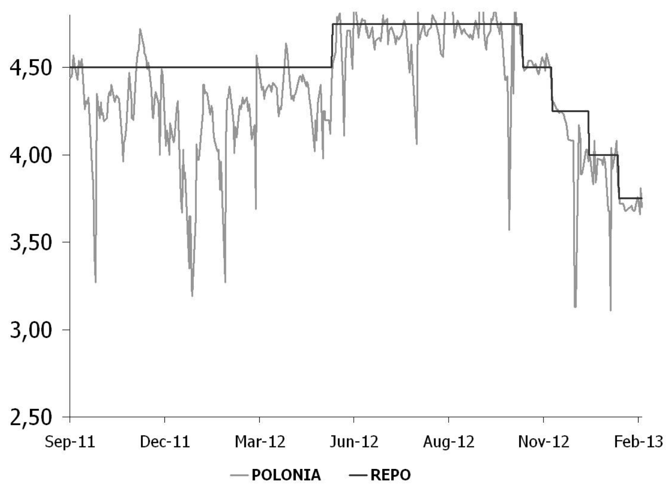
Expensive end of the month Cash has been trading quite high lately, even during last week of the month. As a result, 1 month spread between Polonia and reference rate came down to 5 bps. That's 6 bps tighter than last week and 15 bps tighter than a month ago. We could have expected that to happen as these levels were already seen last year and we had only temporary "cheapness" due to Christmas and New Year. We think that assuming 8 bps spread in the long term is good for OIS price calculations.

GDP better than expected After low CPI some time ago we received a set of better-than-expected data from economy. Last puzzle was today's GDP reading, wich came really strong at +1.1% y/y vs +0.9% expected. This forced people to start believing that March rate decision can be "Unchaged". We think that will be the play until the meeting.









Forex

Still in range The range is still there, moved only a little to the downside. The 4.1350/4.1750 contained all the EUR/PLN moves for the week. The top of the range 4.1750 was reached on the back of the turmoil following Italian elections, but it quickly faded. PLN acted more like a safe heaven then a risky asset from then on. After a good news from the Japanese Rating Agency (rating upgrade for Poland) and better-then-expected GDP numbers for Q4, we were testing the support level at 4.1300/4.1350. The main event next week is the MPC meeting, with perspectives for a cut being more and more at risk.

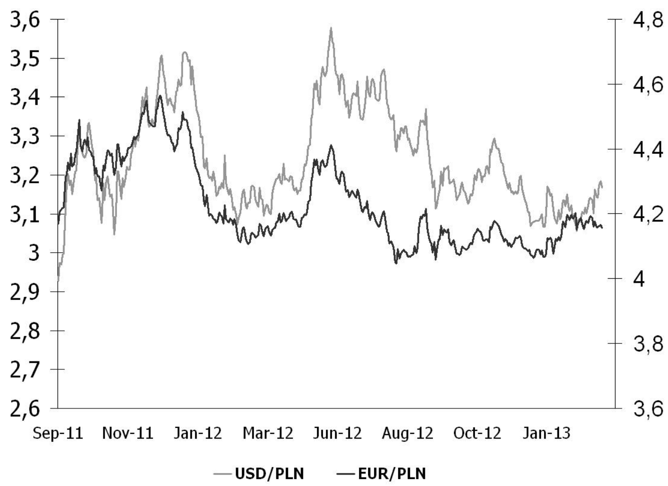
Wobbly The usual pattern. We went higher with a weaker PLN (4.17ish), the frontend being the main beneficent of the move, plus the buyers of the skew reemerged. The currency spread, difference between USD/PLN and EUR/PLN volatility soared from the lows, gaining roughly 1% on the day after the results of Italian elections were announced. The USD/PLN outright vol and skew was in high demand, with 2 month 3.30 traded as high as 13.6%. With a stronger PLN, however, the vols came down again heavily. On a weekly basis, 1 month EUR/PLN ATM mid was 0.3% lower to 6.7%, 3 month is now 7.2% (0.1% lower), and 1 year decreased by the same degree to 8.1% mid.

Short-term forecasts

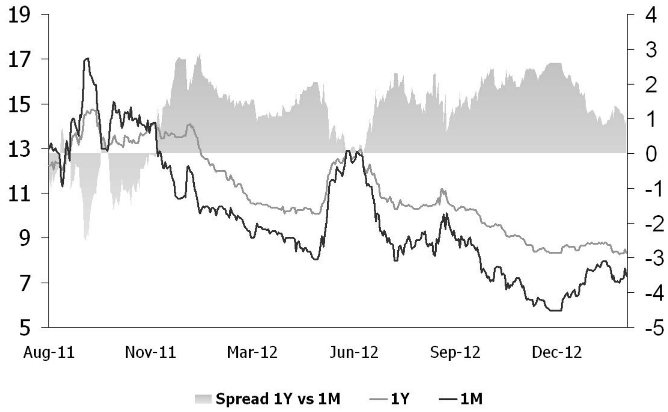
Main supports and resistances
EUR/PLN: 4.1400 / 4.2100
USD/PLN: 3.0500 / 3.2600

Spot The view is unchanged. We still believe in range trading, with selling at EUR/PLN spikes being a preferred strategy. Ideally, we would like to sell 4.1700, add 4.19 with a stop above 4.20, and hopes for 4.13. The longs from 4.13 we treat much more tactically...

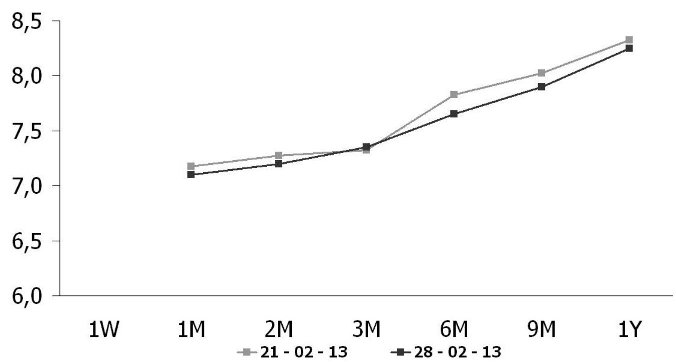
Derivatives The current sell-off in vols does not really change the bigger picture. In general, the current levels are ultra low and close to pre-Lehman. We think that selective longs in mid curve of the curve of EURPLN are the position to have. We still need the confirmation from the realized volatility to show more aggressive bids on the market. The preferred strikes are close to ATM.



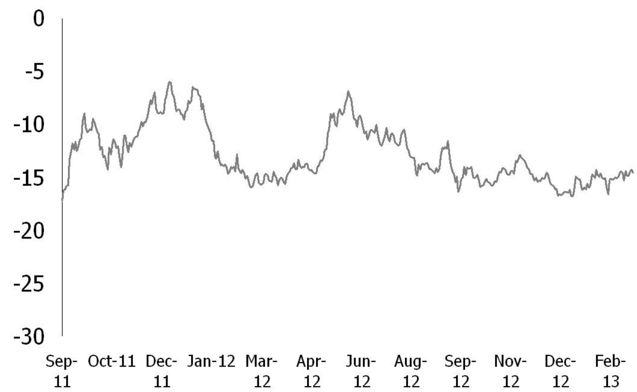
EURPLN volatility



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
2/22/2013	3.55	3.75	3.56	6.49	3.55	6.59	3.63	3.47	3.37	3.31	3.32	3.39
2/25/2013	3.58	3.75	3.50	3.60	3.51	3.52	3.65	3.53	3.42	3.37	3.38	3.46
2/26/2013	3.54	3.74	3.60	3.59	3.63	3.51	3.63	3.48	3.40	3.35	3.38	3.44
2/27/2013	3.57	3.74	3.60	3.58	3.63	3.50	3.63	3.50	3.38	3.33	3.38	3.43
2/28/2013	3.56	3.73	3.59	3.57	3.62	3.50	3.63	3.51	3.40	3.37	3.38	3.43

Last primary market rates							
Paper	Au. date	Maturity	Avg. price	Avg. yield	Supply	Demand	Sold
52W TB	5/30/2011	5/30/2012	95.57	4.58	600	2667	505
OK0114	8/10/2011	1/25/2013	89.58	4.58	5000	4934	1889
PS1016	10/19/2011	10/25/2016	98.44	5.11	3600	11200	3638
DS1021	7/21/2011	10/25/2021	99.53	5.80	3000	5608	3000

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0113	5Y IRS	PS0416	10Y IRS	DS1019
2/22/2013	6.590	3.353	3.292	3.275	3.420	3.351	3.630	3.873
2/25/2013	3.520	3.114	3.263	3.148	3.370	3.270	3.575	3.755
2/26/2013	3.510	2.992	3.218	3.137	3.325	3.237	3.525	3.759
2/27/2013	3.500	2.992	3.218	3.137	3.325	3.237	3.525	3.759
2/28/2013	3.500	2.992	3.218	3.137	3.325	3.237	3.525	3.759

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
2/22/2013	7.15	7.35	7.80	8.30	8.30	2.73	0.69
2/25/2013	7.20	7.35	7.80	8.30	8.30	2.73	0.69
2/26/2013	7.65	7.65	8.00	8.50	8.50	2.78	0.70
2/27/2013	7.30	7.45	7.80	8.30	8.30	2.77	0.60
2/28/2013	7.10	7.35	7.65	8.25	8.25	2.77	0.65

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
2/22/2013	4.1574	3.1443	3.3797	3.3704	1.4198	0.1632
2/25/2013	4.1580	3.1412	3.3878	3.3458	1.4135	0.1628
2/26/2013	4.1613	3.1733	3.4145	3.4395	1.4166	0.1630
2/27/2013	4.1658	3.1841	3.4203	3.4734	1.4070	0.1624
2/28/2013	4.1570	3.1679	3.4072	3.4411	1.4032	0.1622