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Comment on the upcoming data and forecasts

The second batch of February data comes out next week. On Monday the CSO will publish labor market data: we expect wages to have sharply rebounded from January lows, mainly due to low statistical base from the previous year; employment, on the other hand, shows now signs of improvement (larger declines). The National Bank of Poland will also publish official estimates of core CPI that day. Tuesday brings releases from the industry. After a surprisingly good January, year-on-year growth of industrial output has likely dropped back into negative territory. A horizontal trend in industrial production is very likely to form, as no significant signs of improvement have appeared so far. Weakness in industry will be confirmed by another decline in producer prices, albeit less pronounced than last month. Finally, on Friday the CSO will finish this month's series of releases with retail sales and unemployment data. As for the former, we expect a small y/y increase, the latter has probably increased again, mainly due to seasonal factors. However, seasonally adjusted unemployment rate has recently been rising by ca. 0.1 percentage points per month, indicating an underlying deterioration in labor market conditions.

Polish data to watch: March 18th to March 22nd

Publication	Date	Period	BRE	Consensus	Prior
Corp. wages y/y (%)	18.03	Feb	3.7	2.7	0.4
Corp. employment y/y (%)	18.03	Feb	-1.0	-0.9	-0.8
Industrial output y/y (%)	19.03	Feb	-2.5	-2.0	0.3
PPI y/y (%)	19.03	Feb	-0.5	-0.5	-1.2
Retail sales y/y (%)	22.03	Feb	1.0	0.7	3.1
Unemployment rate (%)	22.03	Feb	14.6	14.5	14.2

Treasury bonds and bills auctions

Paper	Next auction	Last Offer	Last yield (%)	Prev auction
52 Week T-bills	-	3000	3.485	3/4/2013
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

A few publications but only one surprise - CPI significantly below consensus is a negative surprise, therefore the index declines again. Next week is ripe with data releases - the outlook is mixed, the index should start bottoming out.

* 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 (low 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. We expect Poland to be exempted from EDP deficit procedure in summer this year. Rating upgrade by two major rating agencies is quite likely as well.
- 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 below 1% in Q2 2013. The possibility for significant undershooting of inflation target in 2013 is high.
- The March decision of 50bps rate cut concludes the monetary easing cycle that started in November 2012. It appears unlikely that the Council will resume easing.

Financial markets

- 2013 most likely not a ”bond year”. Global ”rotation” of assets poses headwind for debt.
- Monetary easing cycle came to an end. MPC (through steepening of the curve) made long-term papers more attractive and provided foreign investors with arguments against leaving the Polish bond market. Increasing the so called roll-down might favor increases in domestic investors’ duration
- Polish long term bonds now even 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.
- We still expect POLGB’s to stay at historically low levels (10Y below 4.50% in yield).
- 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	1.1
Current account (%GDP)	-5.3	-1.6	-4.5	-4.9	-3.6	-2.5
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	0.5	0.9	1.4	2.0
Individual consumption y/y (%)	1.7	1.2	0.1	-1.0	0.4	1.0	1.8	2.3
Public Consumption y/y (%)	-0.8	0.5	0.2	0.2	0.5	0.5	0.5	0.5
Investment y/y (%)	6.0	1.3	-1.5	-0.3	-3.0	-3.0	-2.0	-1.5
Inflation rate (% average)	3.9	4.0	3.9	2.9	1.4	1.0	0.9	1.1
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	3.25	3.25	3.25	3.25
Wibor 3M (% eop)	4.94	5.13	4.92	4.11	3.40	3.40	3.40	3.40
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	3.90	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

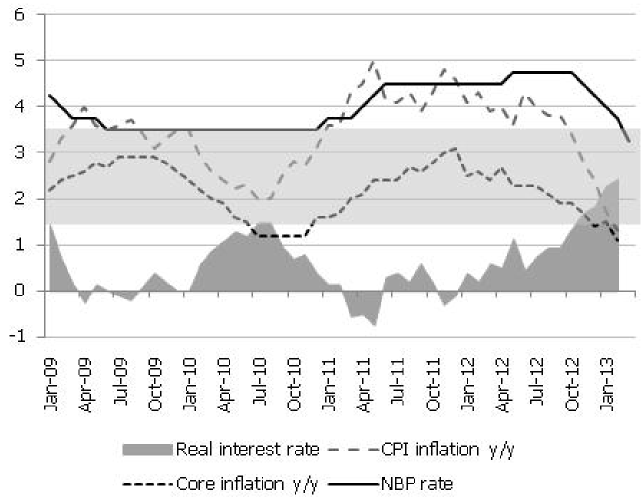
F - forecast

Economics

CPI inflation hits a 6-year low

In February CPI inflation declined to 1.3% from 1.7% y/y in January (changes in the inflation basket didn't influence that figure in a substantial way). This means that prices of consumer goods grew at a lowest rate since October 2006.

Deviations from our forecast and market consensus (+1.6 and +1.5% y/y, respectively) stem mainly from a decline in food prices and higher disinflation in core categories. Regarding food prices we expected an increase of 0.5% (confirmed by data from regional peers), which makes a drop of 0.2% a surprise. The increase in fuel prices (+1.1%) is in line with expectations. As for the core categories, we are surprised mostly by a steep drop in prices of communication services (-3% m/m). This, as the CSO notes in its press release, is mainly due to large discounts offered by mobile service providers. Core inflation has probably fallen to 1.5% in January and to an astonishing 1.1-1.2% in February. For official figures we have to wait until Monday.



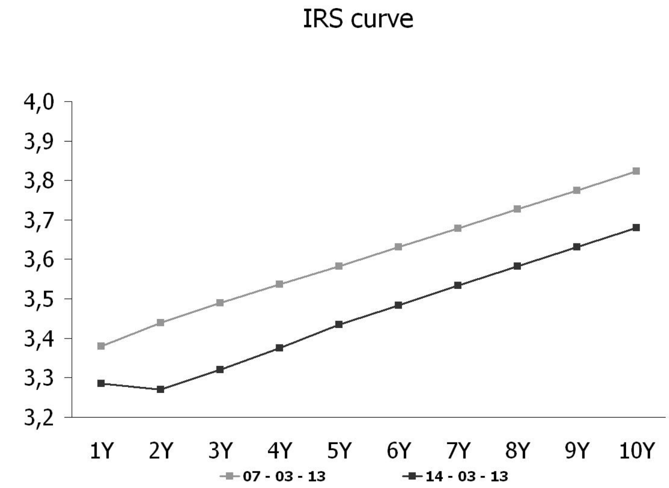
In the coming months we expect CPI to decline even further. In March, CPI growth will likely drop to 1.1% and will continue to fall and hit a low of 0.8-0.9% in the summer (well below NBP's target band). The fall in core CPI will be even more pronounced, with a minimum at the end of the year.

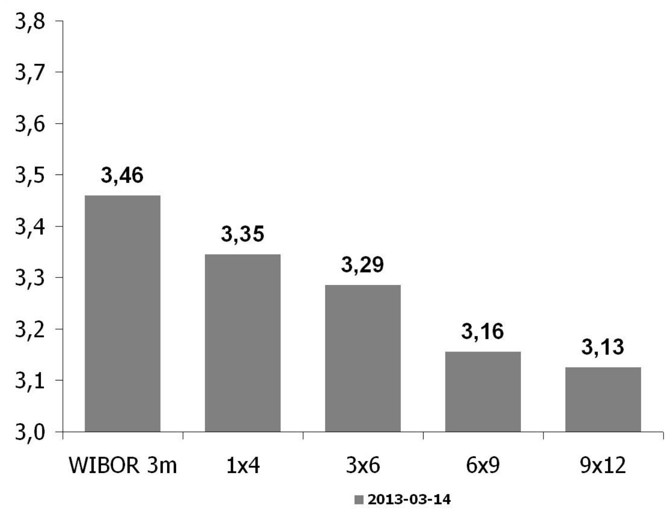
As inflation unexpectedly falls below the lower band of NBP target band, the MPC might be tempted to reconsider its new and relatively unanimous (until today) wait-and-see stance. Even more so, because the latest inflation projection assumes much smoother downward path for inflation (only in Q2'2013 CPI was to fall below NBP's target range - to ca. 1.4%). Latest figures imply that inflation should fall below 1% in 3-4 months and may remain below 1.5% even till the end of the year. Lately, governor Belka said that the Council will closely monitor divergences from new projection as the indicators of future monetary decisions. Thus, Thursday's data increased expectations for further easing (literally - zloty depreciated by ca. 0.5 gr., rates decreased by ca. 3-5bp. across the whole curve). Prof. Winiecki commented after publication that such a headline "is an effect of one-off factors and he does not expect inflation below 1% in the months to come", which may be just an indicator of differences among MPC members coming back in the nearest future - let's wait for comments from other member of the Council. As of now we do not see any basis to change our scenario for the NBP rate (stable for a few more quarters) - our attention will be focused on the scale of economic slowdown in the first half of the year. Thus, data releases from the real sphere should be closely monitored.

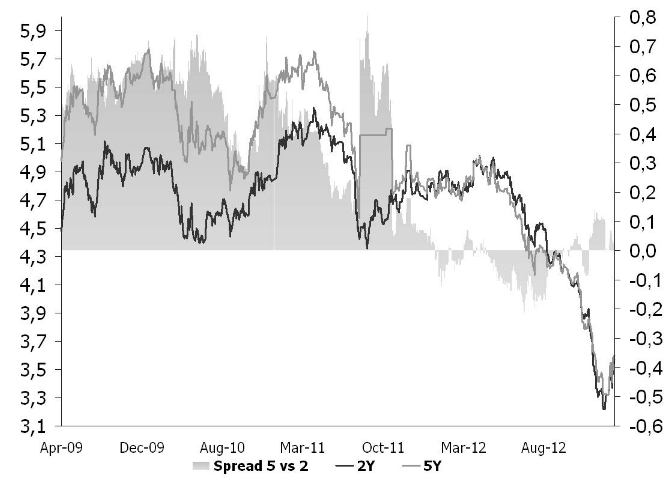
Fixed income

Rally continues

Under normal circumstances once the MPC announced finishing the easing cycle, one could expect rates to stabilize rather than to rally. But considering how the Council's communication has differed from their actual decisions it shouldn't really be surprising that market didn't really took that statement seriously and kept rallying during the week, bringing curve 20bp lower. Inflation that surprised on the downside only let the move accelerate. Market is currently pricing in another 25-50bp of cuts till the end of the year. Very low CPI will likely stay for quite a while allowing for further cuts, especially if we don't see signs of those expected recovery in the second half of the year. Directionally we don't really see much value in the curve, what we think is a serious aberration is the shape of it. 1Y1Y forward doesn't really price in any tightening from lowest levels, 1Y2Y forward prices in maybe 25 hike. Current rate levels are definitely not neutral from rate setters' perspective, would it happen that it gets lowered even further, we should be expecting rates normalization coming sooner than later, as soon as economic environment allows. Cut (if to continue) will materialize around summer, when CPI will be lowest, and potential rebound doesn't happen. From that perspective, steepener spreads 1Y ag 1Y1Y or 1Y2Y look like a very cheap and safe bet with quite significant potential.



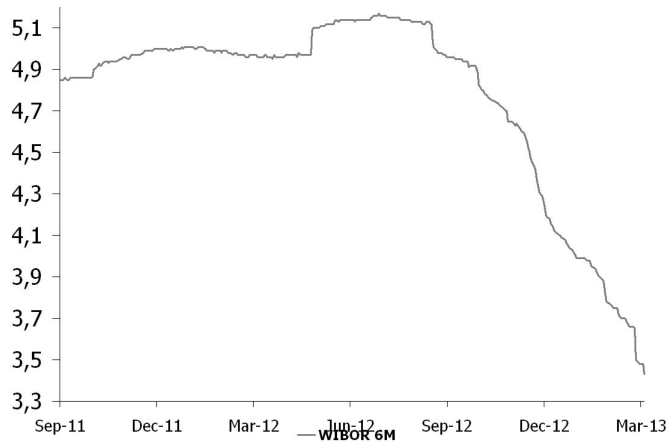


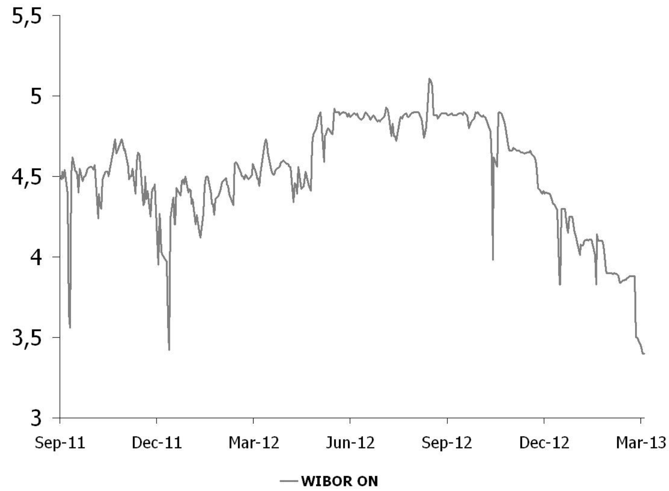


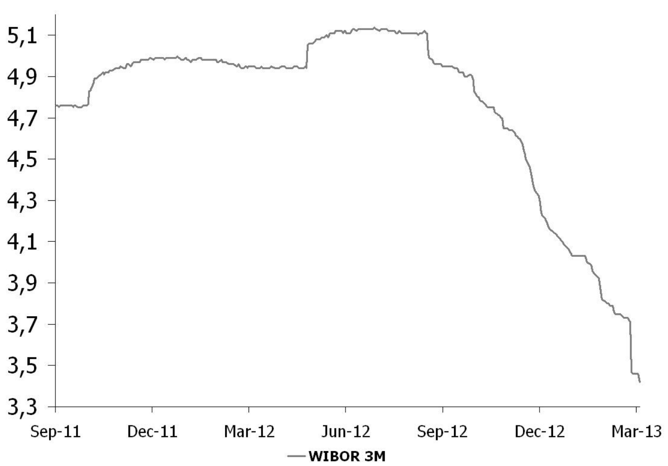
Money market

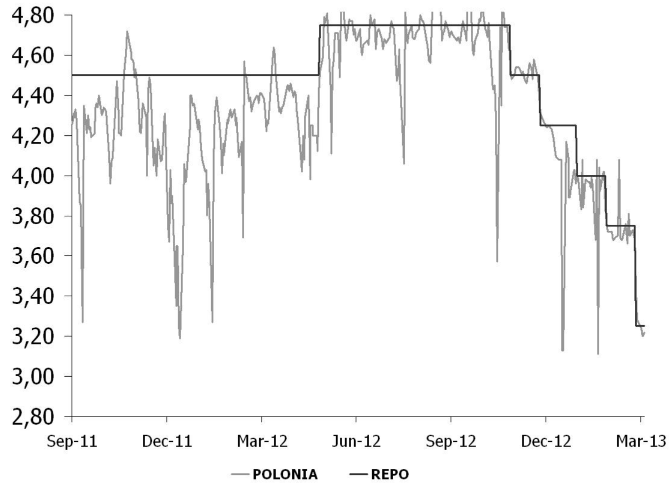
Surprisingly low CPI. After Thursday CPI reading (1.3% vs expected 1.5%) market fully priced in another 25 bp. cut in the near future. Hard not to agree with that given the last figures. Although the scope for further cuts seems to be very limited as CPI should bottom in June and start to pick up after that.

NBP announcement. On the NBP web page there is an information about changes in additional OMO operation. Starting from 2nd May only banks that quote Wibor are allowed to take part in extra OMOs. It doesn't affect regular and additional OMOs on last day of the reserve period. Therefore we think that is not a significant change and should have very limited impact.





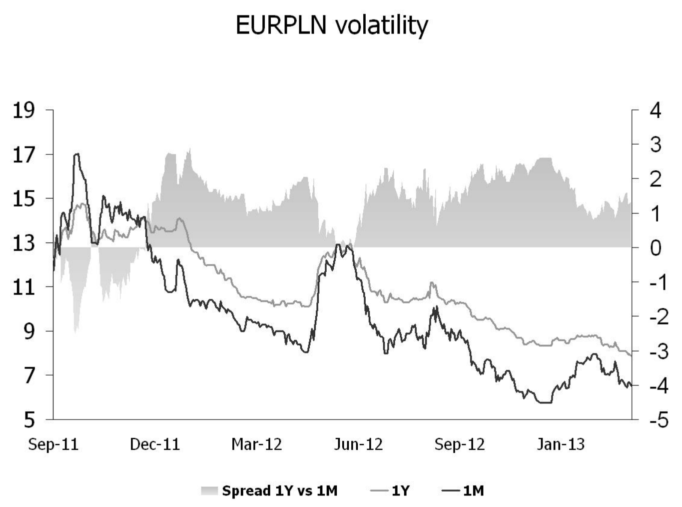




Forex

Back in range. The EUR/PLN was trying to break to the downside with several failed attempts at 4.1300 support. The surprisingly low CPI brought EUR/PLN back above 4.15, and we are back in the well defined 4.13/4.17. The biggest question is if MPC is really done with cuts? We are waiting for future macro figures for clues.

Lower again. The frontend may have it ups and downs, due to gamma demand and supply but, the drift lower in the backend is constant. Whole EUR/PLN ATM curve is lower: 1 month mid today is 6.3% (down from 6.9% last week), 3 month ATM is 6.9% (descent from 7.3 %) and 1 year is 7.8% (lower by 0.2%). The currency spread (deference between USD/PLN vol and EUR/PLN vol) is again well offered, with EURUSD rebound from the lows. The skew is bettered offered still, as a Vanna does not represent much of the value at present.

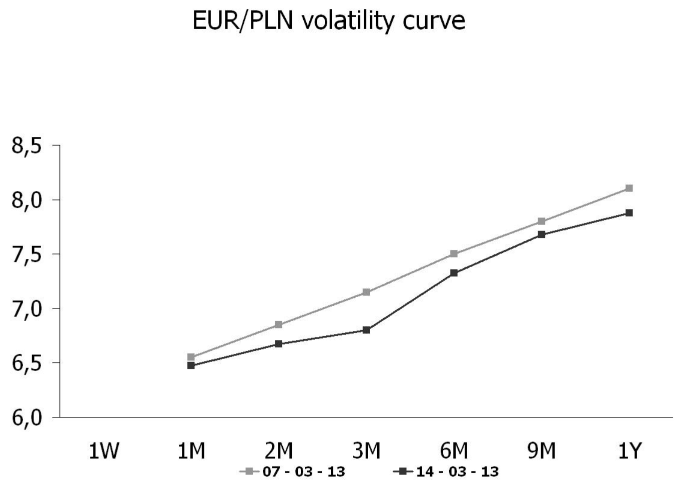


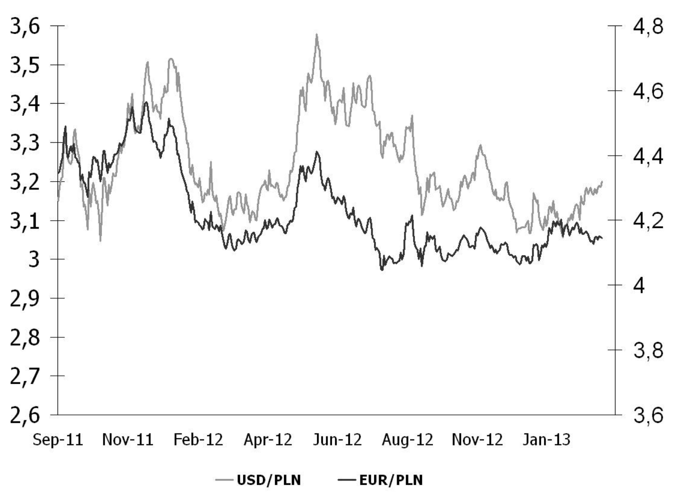
Short-term forecasts

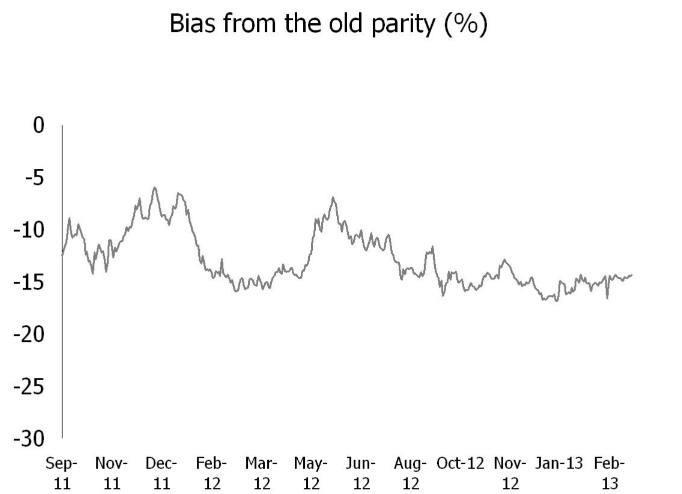
Main supports and resistances
EUR/PLN: 4.1250 / 4.1750
USD/PLN: 3.0500 / 3.2500

Spot. Back in old range 4.125/4.175. Lets play this range, with full conviction. The news screens, may as well be turned off, because thinking is unnecessary burden in this market.

Derivatives. We have changed our selective Vega buying recommendation to a neutral one. The realized volatility is constantly descending (especially if we look at daily basis). It does not bode well for Vega longs. The vols are cheap in comparison to the historic ones, but they are quite expensive to the realized volatilities. Stay aside.







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
3/8/2013	3.22	3.46	3.37	6.49	3.45	6.59	3.40	3.37	3.29	3.28	3.33	3.33
3/11/2013	3.19	3.46	3.32	3.38	3.36	3.42	3.38	3.35	3.28	3.26	3.31	3.35
3/12/2013	3.25	3.46	3.36	3.38	3.45	3.42	3.37	3.34	3.24	3.23	3.28	3.31
3/13/2013	3.24	3.46	3.33	3.38	3.44	3.42	3.36	3.32	3.21	3.19	3.25	3.27
3/14/2013	3.18	3.45	3.32	3.38	3.43	3.42	3.35	3.29	3.16	3.13	3.17	3.22

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
3/8/2013	6.590	3.353	3.292	3.275	3.420	3.351	3.630	3.873
3/11/2013	3.420	3.114	3.263	3.148	3.370	3.270	3.575	3.755
3/12/2013	3.420	2.992	3.218	3.137	3.325	3.237	3.525	3.759
3/13/2013	3.420	2.992	3.218	3.137	3.325	3.237	3.525	3.759
3/14/2013	3.420	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
3/8/2013	6.45	7.05	7.45	8.05	8.05	2.65	0.60
3/11/2013	6.68	7.00	7.35	7.93	7.93	2.65	0.60
3/12/2013	6.68	7.00	7.40	7.95	7.95	2.86	0.74
3/13/2013	6.53	6.95	7.35	7.88	7.88	2.86	0.74
3/14/2013	6.48	6.80	7.33	7.88	7.88	2.86	0.73

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
3/8/2013	4.1497	3.1690	3.3583	3.3172	1.3911	0.1631
3/11/2013	4.1390	3.1828	3.3475	3.3119	1.3687	0.1620
3/12/2013	4.1500	3.1887	3.3643	3.3217	1.3599	0.1619
3/13/2013	4.1484	3.1863	3.3663	3.3260	1.3497	0.1618
3/14/2013	4.1448	3.2000	3.3539	3.3202	1.3572	0.1619

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