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Comment on the upcoming data and forecasts

On Monday, the NBP will publish its latest Report on Inflation. Even though the outline of its newest CPI and GDP projections are already known (see the Economics section), detailed results as well as assumptions for the forecast would still be extremely interesting. On Friday, the NBP will release most of its share of monthly figures. We expect that current account was more or less balanced in May owing to a surplus in trade and stable income and services balances. Finally, money supply growth has likely accelerated last month but its details should remain rather unchanged - dynamics of household deposits decelerated and corporate deposits continued to be accumulated.

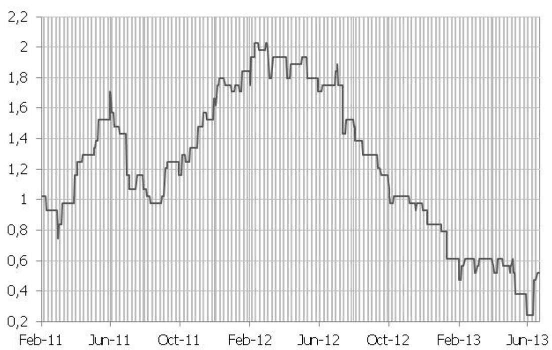
Polish data to watch: July 8th to July 13th

Publication	Date	Period	BRE	Consensus	Prior
NBP Inflation Report	08.07	Jul			
Current account (mio EUR)	13.07	May	0	-193	468
Exports (mio EUR)	13.07	May	12920	12930	13279
Imports (mio EUR)	13.07	May	12709	12725	12678
M3 y/y (%)	13.07	Jun	7.1	6.7	6.5

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	-	2500	2.748	4/23/2013
5Y T-bond PS0718	-	4500	3.303	6/6/2013
10Y T-bond DS1023	-	3000	3.290	5/16/2013
20Y T-bond WS0429	-	150	3.464	5/16/2013

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



Comment

PMI markedly suprised on the upside, therefore the index increased a bit. We still struggle to make up for last month's losses, thus it is too early to signal a turnaround.

* 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

- Available data confirm stagnation in H1 2013.
- We expect economic revovery in H2 2013. The rebound will be driven by a re-acceleration of the euro zone economy (see the end of austerity), rebound in real income and recovering private consumption. Low rates trigger rotation in households assets. However, given the scale of slack in investment (infrastructure in particular) and consumption, rebound generated this way may be initially moderate (no more than 2% y/y growth rate in Q4 2013).
- 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. The government prepares the markets for a budget revision and PM Tusk considers it more likely than lack thereof.
- We are in the middle of one of the steepest disinflation phases in Polish history. CPI inflation close to 0% in mid 2013.
- Despite low inflation, there is no support for further easing within the MPC. July rate cut marked the end of the easing cycle. NBP projections of GDP and inflation for 2014 may be too pessimistic.

Financial markets

- We stay contructive on short-term bonds (ECB breaks away from the Fed and supports low rates in Europe). Note that NBP may also use unconventional tools to boost banks' demand for government papers (we believe in such scenario even more after most recent outflow of foreign funds from bond market and FX intervention).
- Ultimately, global recovery (or monetary stimulus and liquidity withdrawal) and rising core yields will adversely affect Polish bonds. Fed-induced higher volatility has already been doing its job, especially on the long end.
- The "wall of money" obscured the cyclicality of the Polish currency. This fact was revealed when expectations on QE tapering accelerated and the zloty dynamicaly breached 4.22/25 and broke out of the 1 year range. Although we think that the market probably overshoot the timing of QE tapering, the environment changed towards less zloty-friendly. Therefore we expect a return below 4.20 no sooner than when the economy accelerates visibly (long into H2) or rate cut expectations halt and begin to turn-around (a turn of 2013/2014).

BRE forecasts

	2008	2009	2010	2011	2012	2013 F
GDP y/y (%)	5.1	1.6	3.9	4.5	1.9	1.0
CPI Inflation y/y (average %)	4.3	3.5	2.8	4.2	3.7	0.8
Current account (%GDP)	-5.3	-1.6	-4.5	-4.9	-3.5	-2.5
Unemployment rate (end of period %)	9.5	12.1	12.4	12.5	13.4	13.9
Repo rate (end of period %)	5.00	3.50	3.50	4.50	4.25	2.50

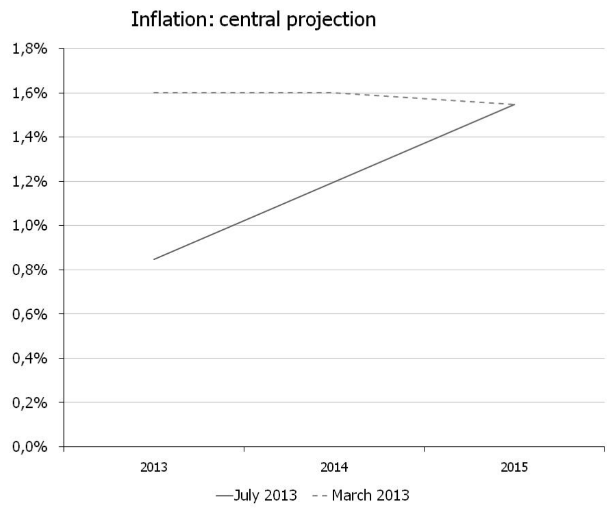
	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2013 Q1 F	2013 Q2 F	2013 Q3 F	2013 Q4 F
GDP y/y (%)	3.5	2.3	1.3	0.7	0.5	0.6	1.2	1.7
Individual consumption y/y (%)	1.7	1.3	0.2	-0.2	0.0	0.5	1.3	1.9
Public Consumption y/y (%)	-1.0	0.4	1.6	-0.6	-0.5	0.5	0.5	0.5
Investment y/y (%)	6.8	1.4	-1.7	-4.1	-2.0	-4.5	-3.0	-2.5
Inflation rate (% average)	3.9	4.0	3.9	2.9	1.3	0.6	0.2	0.9
Unemployment rate (% eop)	13.3	12.4	12.4	13.4	14.3	13.4	13.3	13.9
NBP repo rate (% eop)	4.50	4.75	4.75	4.25	3.25	2.75	2.50	2.50
Wibor 3M (% eop)	4.94	5.13	4.92	4.11	3.39	2.70	2.70	2.70
2Y Polish bond yields (% eop)	4.62	4.60	4.05	3.14	3.19	2.70	2.70	2.80
10Y Polish bond yields (% eop)	5.50	5.15	4.69	3.74	3.94	4.00	4.00	4.20
EUR/PLN (eop)	4.15	4.22	4.12	4.08	4.18	4.30	4.20	4.15
USD/PLN (eop)	3.11	3.35	3.20	3.09	3.26	3.31	3.36	3.40
F - forecast								

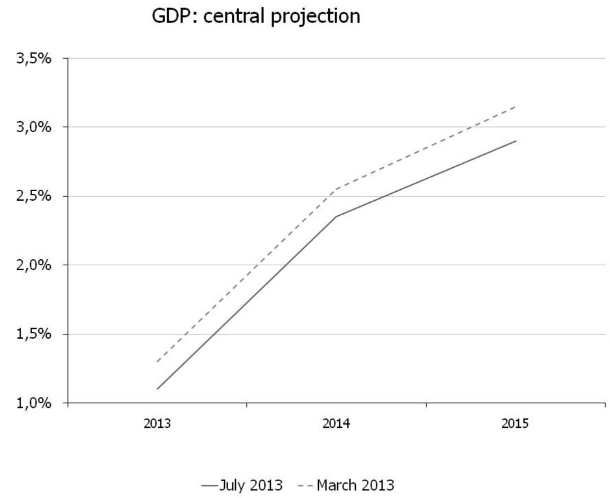
Economics

The final cut

In line with analysts' expectations, the MPC cut rates by 25 bps, bringing the reference rate down to 2.50%. As we anticipated, the statement announced that the easing cycle had indeed been ended: "The decision to lower NBP interest rates made at the current meeting ends the loosening cycle of monetary policy". This was confirmed during the press conference by Governor Belka who was full of optimism regarding the future of the Polish economy. He also stated that he would happily see the economic situation improving so markedly that the Council would be willing to raise interest rates. Such a declaration by a central banker is a clear indication as to which scenario would be favored by the Council in right macroeconomic circumstances.

Interestingly, latest NBP staff projections (mid-term forecasts of CPI and GDP growth - see graphs below) stand in stark contradiction to Belka's optimism. The projections indicate that, despite the massive monetary easing undertaken, GDP will grow slower than in the previous projection. Inflation still does not return to target within the forecast horizon. Thus, the projection itself would justify further easing. Why won't that happen? Firstly, there is no majority within the Council to support such a motion - even Bratkowski (the arch-dove) claimed that further cuts might turn out to be pro-cyclical. Belka also cited external factors and the coming rebound of the Polish economy (again, contrary to the projection). Taken altogether, these arguments raise the bar very high. According to Belka, rates will remain unchanged until the end of the year.





In our view, the July cut was the last in cycle. Turning to NBP forecasts, we think that NBP projections underestimate GDP growth and inflation (massive base effects) in 2014. To put it in a gentle way, NBP experts have never been particularly fast at capturing turning points. We agree, which was our long-held view, that for the next few months inflation will virtually stay at zero. However, real-sphere data may confirm an approaching economic recovery.

We continue to assert that global / European factors are more important for Polish bond yields, especially long durations, than the local ones (fiscal and monetary policy, pension reform). The ECB's commitment to keep interest rates low "for an extended period of time" should support Polish rates despite the fact that no further cuts are in the pipeline. Moreover, broad introduction of forward guidance, first by the Fed and now by the BoE and the EBC, increases the chance that Polish monetary authority might also try to refine its communication, despite the fact that easing cycle was ended. It is a hypothesis but Belka's comments are the place to look for evidence.

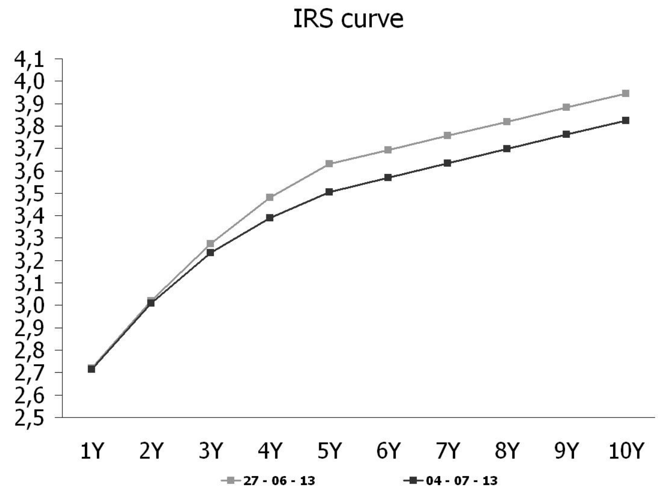
Fixed income

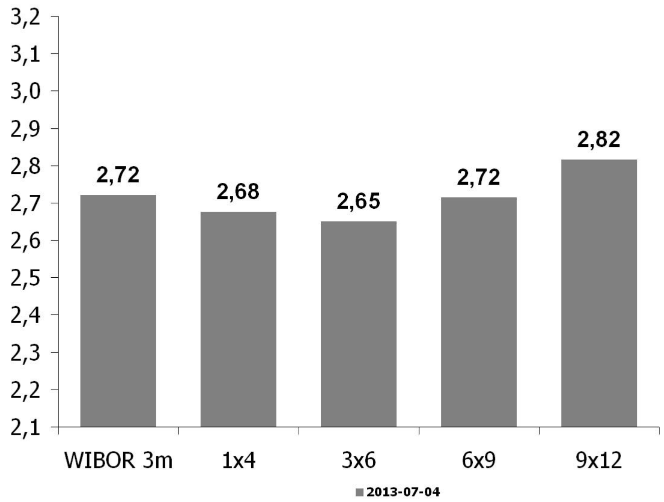
Rate cut as expected, but...

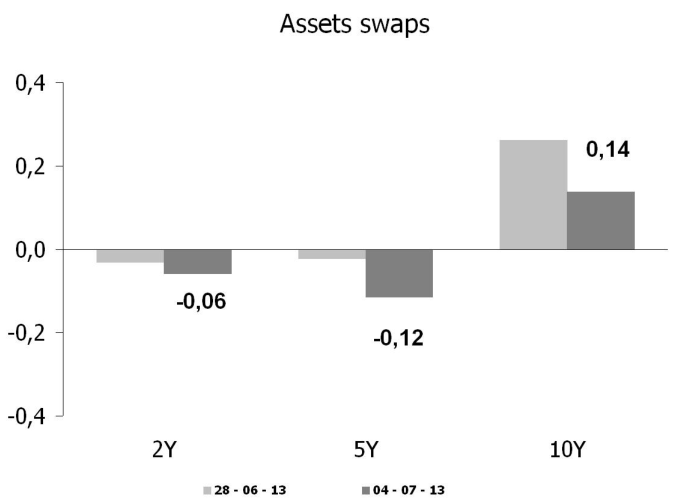
It seems that the market was caught on wrong positioning. As compared to recent highs we have faced a decent rally:
2y - 3.25% high, 3.92 week close, -33 pts
5y - 4.00% high, 3.38 week close, -62 pts
10y - 4.55% high, 3.94 week close, -61 pts

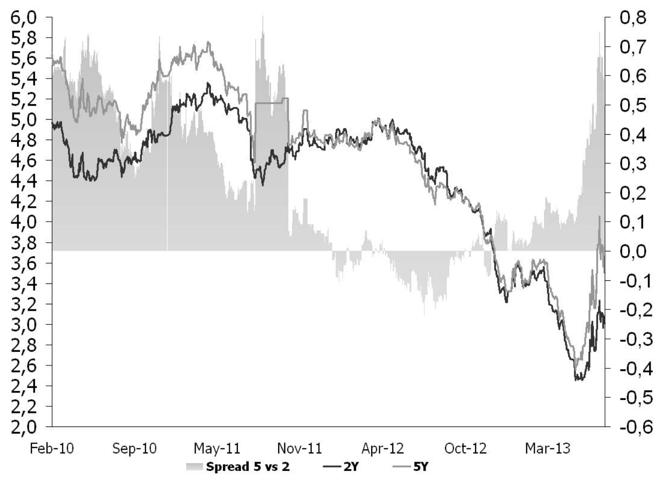
What was behind that move? As we wrote in our previous weekly report, core bears had run out of steam and, as high beta market, mid- and long end POLGBs followed this move. Target (4.00% 10Y) was easily taken. Short end bonds have found strong support in cheap (2.55%) cash. As a result 1Y bond made a 30pts rally (!).

We cashed our last week recommendation and closed long bonds position. Thoughts for next week(s)? We believe that the market underestimates the improvement in the global/local economy and that main trend on global yields remains unchanged. We would sell 5y bonds on upticks.







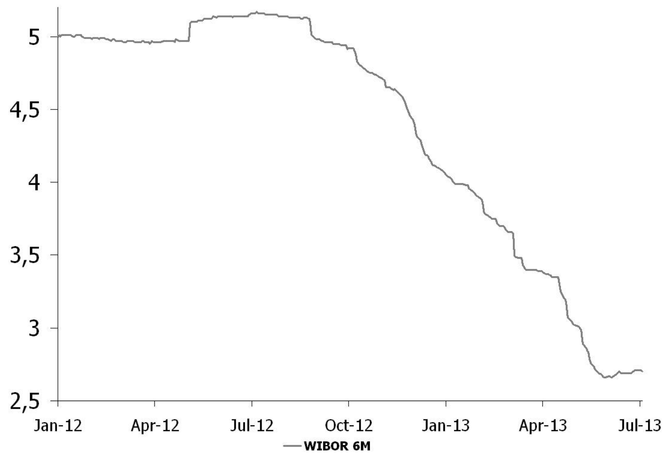


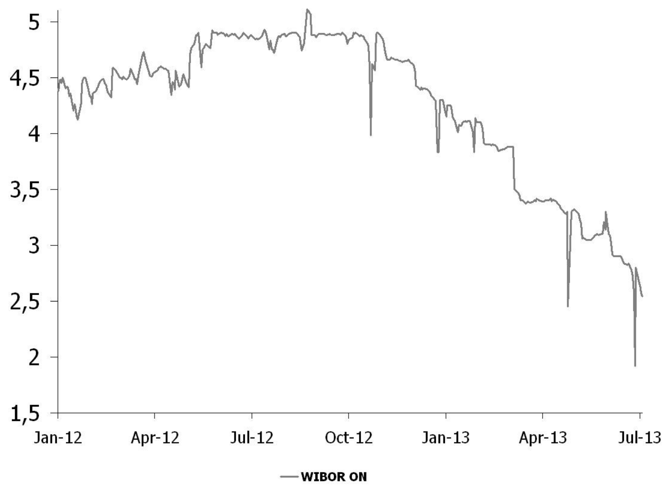
Money market

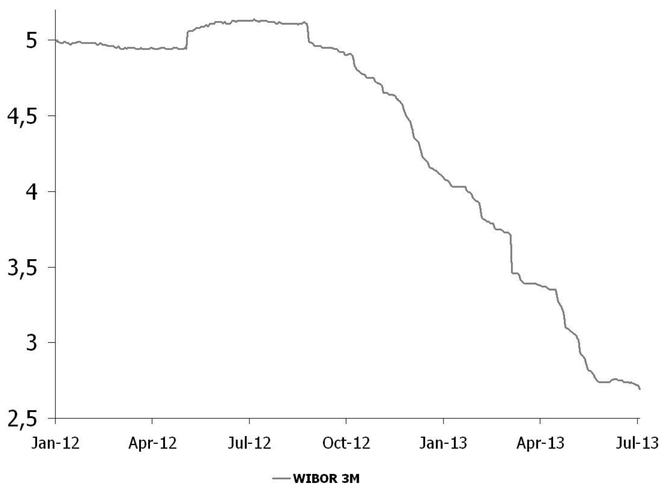
Liquidity squared After 2 very cheap weeks the central bank managed to sterilise the market during today's regular OMO. 128.5 out of 129 bln money bills were taken. We calculated 126.5 bln pln to square the market. It definitely supported the shortest rates that have been well below the main rate lately.

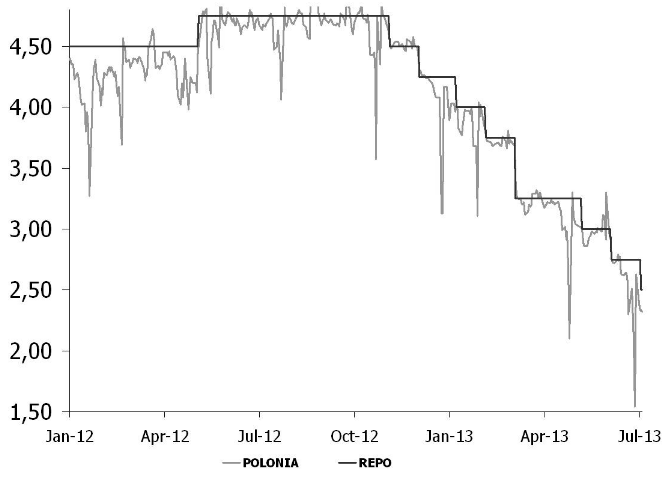
Cut plus lower yields on core markets equals rally The MPC cut all the rates by 25 bps, saying it is definitely the end of the cycle. It was fully priced in but still the cut boosted the rally that came from core markets. We perceive short bonds as very attractive, since they can be a superb substitute for money bills after the cycle. No move on rates expected for a prolonged period can convince liquidity managers that rolling over 7-day bills at 2.5 may be replaced by buying, for example, 6M papers with yields as high as 2,65%! Therefore, bonds up to 2Y look really attractive. Same with floaters yielding wibor +20-30 bps at current pricing.

Local factors become less important so all eyes on core markets.





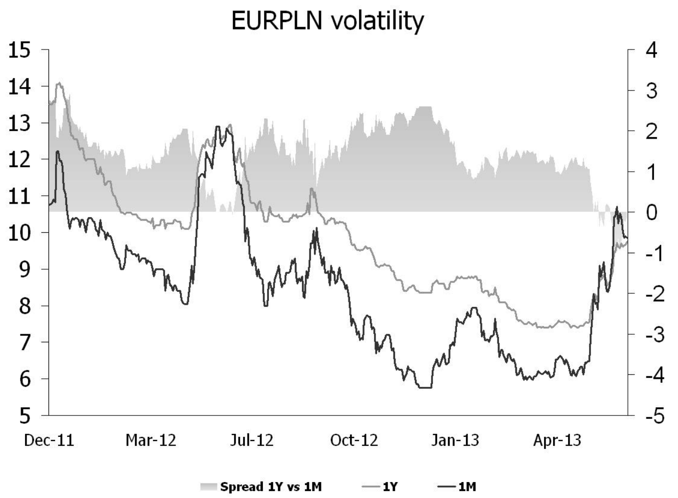




Forex

Zloty stronger Last week EURPLN was traded broadly sideways in the 4.31 - 4.35 range until the double whammy of the NBP ending the cutting cycle and the dovish tone for the Euro from the Draghi comments fuelled the appetite for risk. EURPLN has dropped as a stone from 4.31 before the announcement to 4.2650. Reaction was very violent as hedges were squeezed and long positions were washed out.

Volatility curve flattened The realized volatility for EUR/PLN is still very high: 1M ATM around 9.8% (long gamma position has performed very good), but positive sentiment on global market was the reason of a little sell-off in implied vols. The EUR/PLN ATM benchmarks are: 1w ATM mid 10.5%, 3 month mid 9.7% and 1 year 9.6%. The skew is also a little lower.

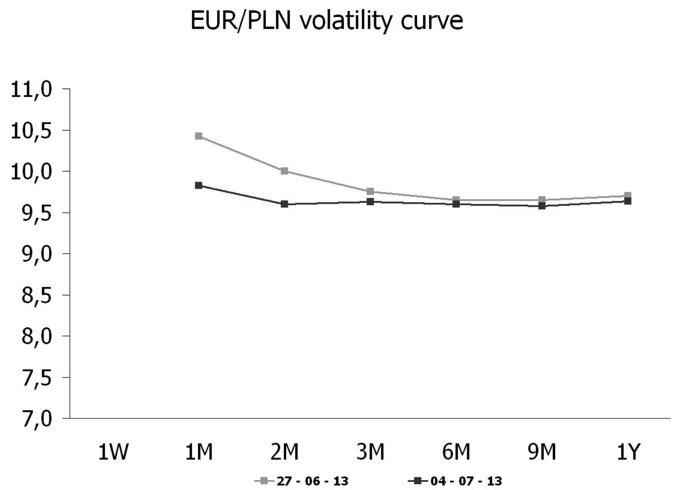


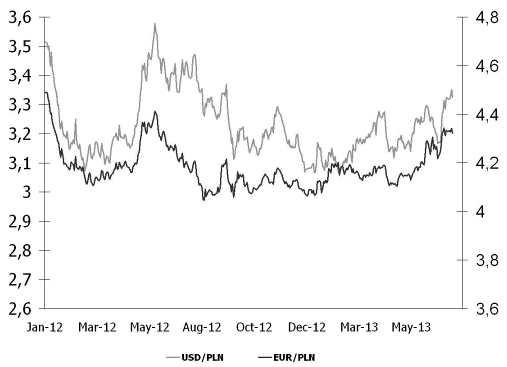
Short-term forecasts

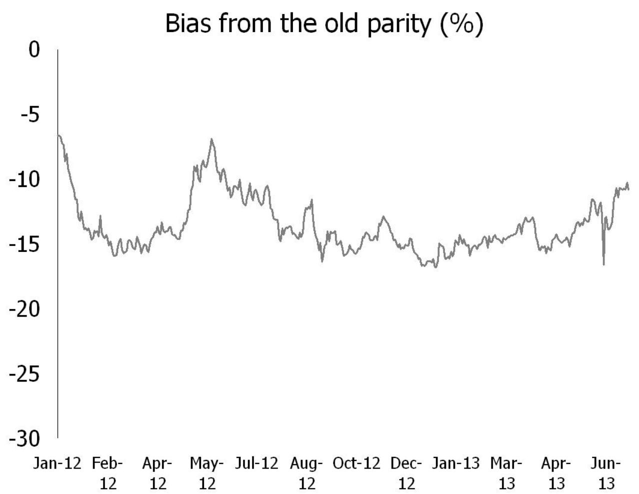
Main supports and resistances
EUR/PLN: 4.2200 / 4.3500
USD/PLN: 3.1500 / 3.4000

Stay sidelined It was a wild washout of the short Zloty, which took a number of the markets stops (ourselves included). EURPLN remains heavy on the divergence in rate expectations and probably will trade in lower range with the next support at 4.22 / 4.25 and resistance 4.30/4.35.

Derivatives. Short-term realized volatility shot up significantly! If the realized volatilities stay that high we can have next leg higher in XXX/PLN vol space. We think volatility is back for good. We look for a correction/consolidation to show the bid for Vega. In such volatile environment it might be sensible to have also a positive position in gamma.







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
6/28/2013	2.41	2.73	2.57	2.61	2.76	2.61	2.65	2.67	2.72	2.85	3.12	2.82
7/1/2013	2.43	2.72	2.48	2.61	2.59	2.61	2.64	2.63	2.71	2.84	3.11	2.83
7/2/2013	2.45	2.72	2.58	2.61	2.77	2.61	2.64	2.61	2.65	2.75	2.95	2.73
7/3/2013	2.46	2.71	2.56	2.61	2.66	2.61	2.67	2.67	2.74	2.88	3.03	2.85
7/4/2013	2.50	2.69	2.57	2.60	2.66	2.61	2.68	2.65	2.72	2.82	2.99	2.80

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
6/28/2013	2.610	3.353	3.292	3.275	3.420	3.351	3.630	3.873
7/1/2013	2.610	3.114	3.263	3.148	3.370	3.270	3.575	3.755
7/2/2013	2.610	2.992	3.218	3.137	3.325	3.237	3.525	3.759
7/3/2013	2.610	2.992	3.218	3.137	3.325	3.237	3.525	3.759
7/4/2013	2.610	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
6/28/2013	10.00	9.68	9.58	9.60	9.60	2.93	0.73
7/1/2013	9.85	9.63	9.65	9.65	9.65	2.93	0.73
7/2/2013	9.90	9.60	9.65	9.65	9.65	2.93	0.73
7/3/2013	9.85	9.75	9.68	9.75	9.75	2.93	0.73
7/4/2013	9.83	9.63	9.60	9.64	9.64	2.85	0.66

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
6/28/2013	4.3292	3.3175	3.5078	3.3527	1.4664	0.1669
7/1/2013	4.3323	3.3210	3.5125	3.3351	1.4714	0.1666
7/2/2013	4.3265	3.3222	3.5027	3.3301	1.4727	0.1663
7/3/2013	4.3416	3.3516	3.5288	3.3619	1.4727	0.1667
7/4/2013	4.3213	3.3246	3.5048	3.3358	1.4629	0.1659

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