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Polish Weekly Review

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Comment on the upcoming data and forecasts

Along with improvements in Poland's main trading partners (sharp increase in German Ifo index stands out in particular), Polish PMI should grow again by a modest amount. Compared to previous historical episodes, this would amount to a very steep recovery. December's MPC meeting, on the other hand, is unlikely to bring any tweaks to current monetary policy stance. No change in rates, obviously. Moreover, the Council promised to keep rates unchanged until mid 2014 and we expect that commitment to be reaffirmed in the statement.

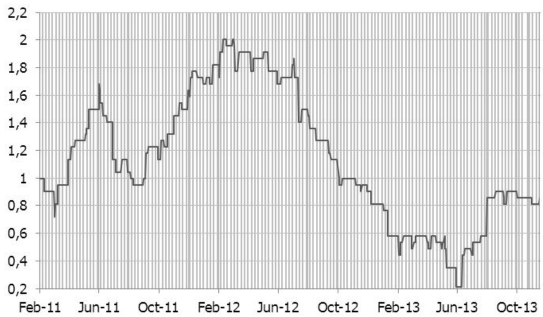
Polish data to watch: December 2nd to December 6th

Publication	Date	Period	BRE	Consensus	Prior
Manufacturing PMI (pts)	02.12	Nov	54.1	53.7	53.4
MPC decision (%)	04.12	Dec	2.5	2.5	2.5

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 OK0116	-	3000	2.983	11/7/2013
5Y T-bond PS0718	-	4000	3.589	11/7/2013
10Y T-bond DS1023	-	2000	4.302	10/22/2013
20Y T-bond WS0429	-	150	3.464	5/16/2013

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



Comment

Unchanged: GDP print merely confirmed the preliminary release, retail sales surprised on the downside but within the usual noise level and without impact on the index. Next week should not bring any surprises (upward trend already acknowledged by analysts).

* 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

- Available data confirm that the long-awaited recovery began at the turn of Q2/Q3.
- After GDP growth reached 1.9% in Q3, 2.4% reading in the final quarter is possible. We are also bullish on 2014 and expect the Polish economy to grow by at least 3.2%. Such a growth is higher than current market consensus dominated by caution and disbelief.
- The upswing has been recently driven by exports that behaves much better than in previous upswing episodes (Polish economy is more competitive and more geografically diversified). Consumption has already joined and we see no obstacles for further, gradual strenghtening. We expect the support from investment activity to kick in more substantially at the start of 2014. Private investment is to be supported by recedeing uncertainty, public investment is to benefit from new EU co-financed projects.
- Pension reform, along with the political cycle, opens room for fiscal stimulation. We expect significant fiscal stimulus from 2014 onwards, focused mainly on public infrastructure spending and fueled by the relaunch of EU funding. Thus, 2-3 years of solid economic growth are our baseline scenario.
- Inflation stays subdued for the next few months supporting stable NBP rates.
- Inflation target is going to be reached in mid 2014, albeit temporarily. We expect first rate hikes to materialize in late 2014 as we believe that NBP projections of both GDP and inflation for 2014 are too pessimistic and upward sloping inflation path should result in tightening.

Financial markets

- Short term we are constructive on Polish bonds up to the belly of the curve due to current low inflation, carry trades, neutral positioning and determination of global central banks to anchor official rates. For December we also like 5-10 year due to positioning of local investors and possibility of a more favorable global climate. Temporary weakness of the data ahead (at a time when MPC is still in a nirvana state, preocuppied with strenghtening forward guidance instead of searching for signals of improving economy) is also supportive.
- In the mid-term Polish local factors, including economic upturn and liquidation of OFE assets, suggest higher liquidity risk premium on Polish bonds. Global recovery and rising core long term yields will additionally adversely affect Polish bonds.
- Zloty should gradually strenghten on the back of cyclical recovery in Poland.

BRE forecasts

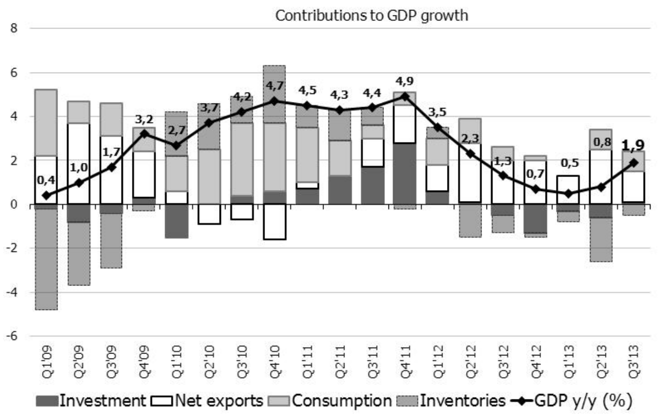
	2009	2010	2011	2012	2013F	2014F
GDP y/y (%)	1.6	3.9	4.5	1.9	1.4	3.2
CPI Inflation y/y (average %)	3.5	2.8	4.3	3.7	1.1	2.2
Current account (%GDP)	-1.6	-4.5	-4.9	-3.5	-1.9	-2.6
Unemployment rate (end of period %)	12.1	12.4	12.5	13.4	13.5	13.2
Repo rate (end of period %)	3.50	3.50	4.50	4.25	2.50	3.00

	2013 Q1	2013 Q2	2013 Q3	2013 Q4 F	2014 Q1 F	2014 Q2 F	2014 Q3 F	2014 Q4 F
GDP y/y (%)	0.5	0.8	1.9	2.4	2.6	3.0	3.4	3.7
Individual consumption y/y (%)	0.0	0.2	1.0	1.9	2.2	2.3	2.3	2.4
Public Consumption y/y (%)	-0.1	4.3	1.7	2.0	0.3	0.3	0.3	0.3
Investment y/y (%)	-2.1	-3.2	0.6	1.0	1.5	2.5	3.5	4.5
Inflation rate (% average)	1.3	0.5	1.1	1.3	1.8	2.2	2.4	2.5
Unemployment rate (% eop)	14.3	13.2	13.0	13.5	14.1	12.8	12.5	13.2
NBP repo rate (% eop)	3.25	2.75	2.50	2.50	2.50	2.50	2.50	3.00
Wibor 3M (% eop)	3.39	2.73	2.67	2.70	2.70	2.70	2.70	3.20
2Y Polish bond yields (% eop)	3.19	3.07	3.05	3.00	3.15	3.30	3.30	3.30
10Y Polish bond yields (% eop)	3.94	4.34	4.43	4.30	4.60	5.00	5.20	5.50
EUR/PLN (eop)	4.18	4.33	4.22	4.10	4.05	3.95	3.90	3.90
USD/PLN (eop)	3.26	3.32	3.12	3.04	2.99	3.10	3.20	3.25

F - forecast

Final GDP data in line in terms of headline growth. Composition surprisingly positive with investment growth and domestic demand finally above zero.

GDP growth amounted to 1.9% y/y in Q3 2013, propelled by rising private consumption (to 1.0% from 0.0% in Q2) and investment (from -3.2% to 0.6%, however, mainly on construction activity as revealed by value added data). It is the latter that constituted the major surprise in the release. At the same time inventory formation pro-cyclically accelerated (to -0.6pp. from -2.0pp) and contribution of net exports fell (from 2.5pp. to 1.4pp.) on statistical base effects as trade balance remained close to historic highs. Such a composition allowed domestic demand to accelerate to 0.5% after 6 quarters of declines.



In the final quarter of the year we expect GDP growth to rise beyond 2.0%, possibly to 2.4%, because of higher consumption and investment (both set to improve towards 2.0%) and supported by inventory cycle. Net exports contribution is set to decline in the coming quarters, however, owing to the structural change in the Polish economy, the usual slide of net exports contribution to negative territory along the cycle is going to be more gradual and the ultimate trough is set be more shallow. Current recovery is propelled both by statistical base effects and rising momentum. Of course cyclically it is the latter factor that matters most. Therefore resulting acceleration in GDP growth is going to be quite spectacular (given the recent standards we recently got used to, 3% growth in Q1 2014 may be seen as impressive).

The data went unnoticed by the fixed income and fx market. Domestic investors are paralyzed by tapering fears. At the same time short end bonds and rates are anchored by dovish ratesettersâ€™ statements and low inflation. Playing for rate hikes seems premature at the moment. However, we advise readers to track the divergence between the growth structure portrayed in NBP projection and the actual data. It can be already seen that transmission of impulses from global to domestic markets is progressing faster than NBP anticipates (see e. g. the divergence in investment growth: NBP projected -2.0%). As we think this divergence may continue, it may put an end to Polish monetary policy nirvana.

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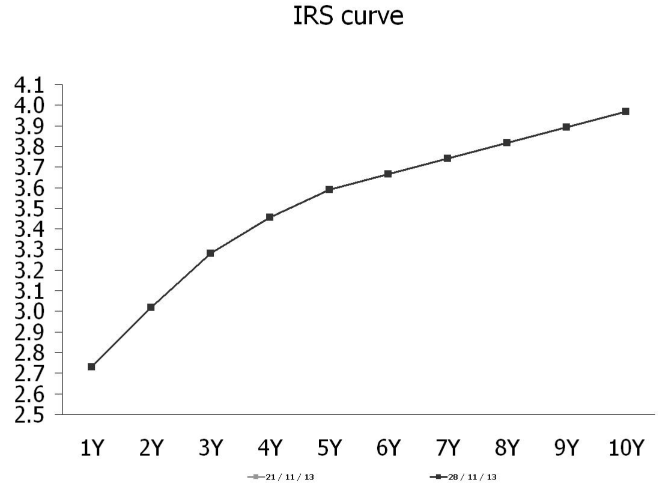
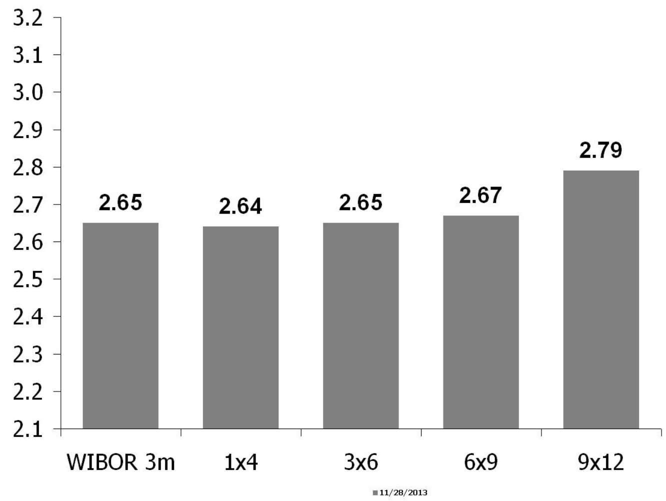
Fixed income

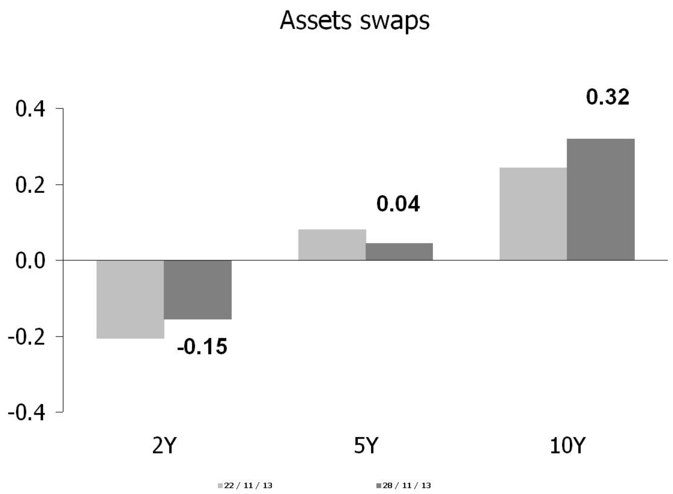
Too obvious

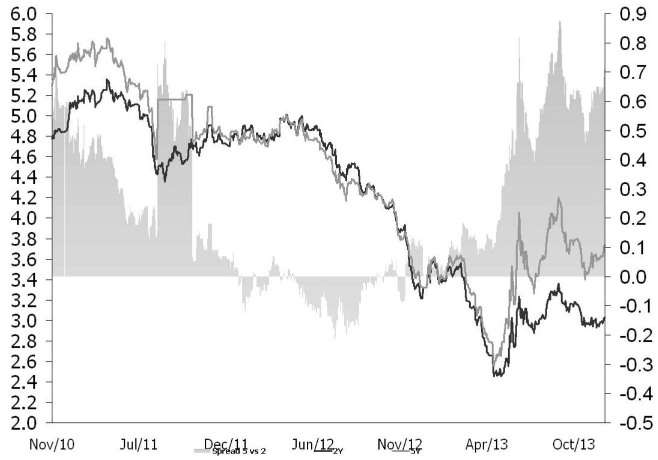
Our previous recommendation (keep 5 year bonds or even switch to 10 year ones) turned out to be... too obvious to be successful. Many investors attracted by good yield at the end of the year bought bonds on the auction and this turned out to be a deadly setup. A little bit worse sentiment on EM market caused a sell-off on our bond market and DS1023 reached 4.55% yield temporarily.

While we underestimated market positioning, our view remains unchanged. Low CPI (both here in Poland and globally), supportive central banks, end of the year - those are the reasons for keeping our 'long 5 year bond' recommendation. Risk factors in comming days are: supply from the switching auction (on December 5th) and possible Fed tapering (December 18th) but market is well-prepared for both those events already.



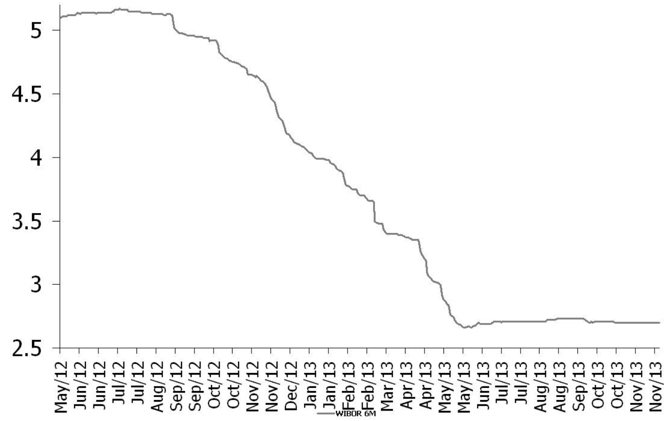


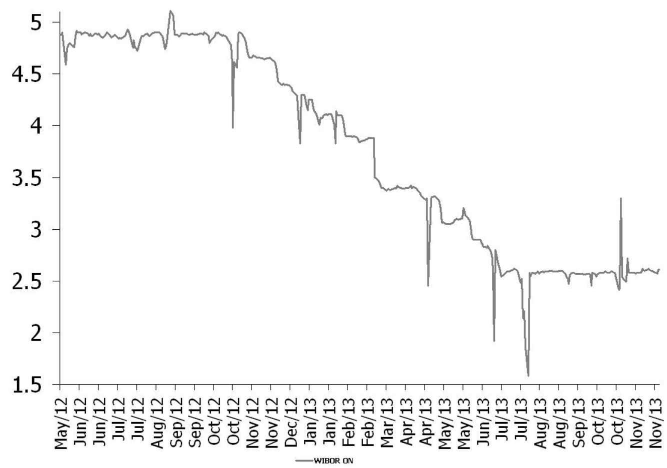


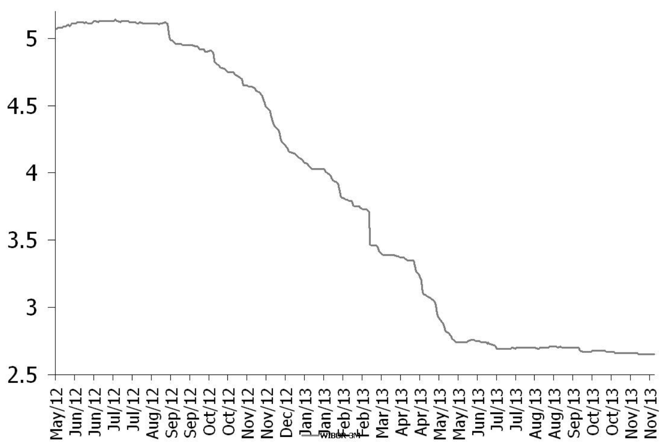


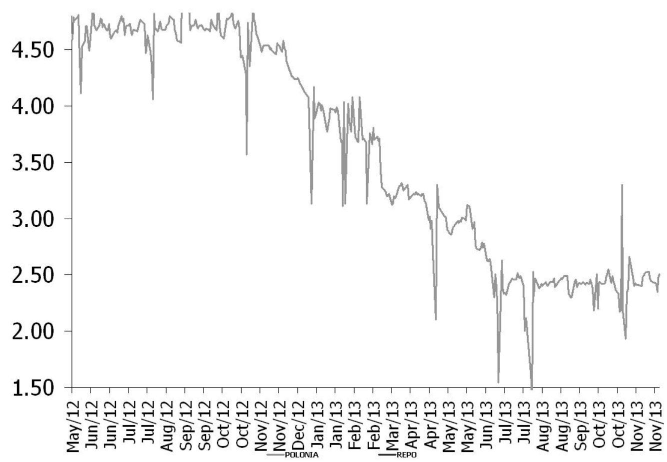
Money market

Additional OMO on Tuesday? Shortest rates were still high last week since liquidity was drained by the regular OMO last Friday and additional one on Wednesday. Today's auction was well underbid (110bln pln vs 130 bln pln on the offer). It should bring some lower rates but additional OMO on Tuesday is also very likely.









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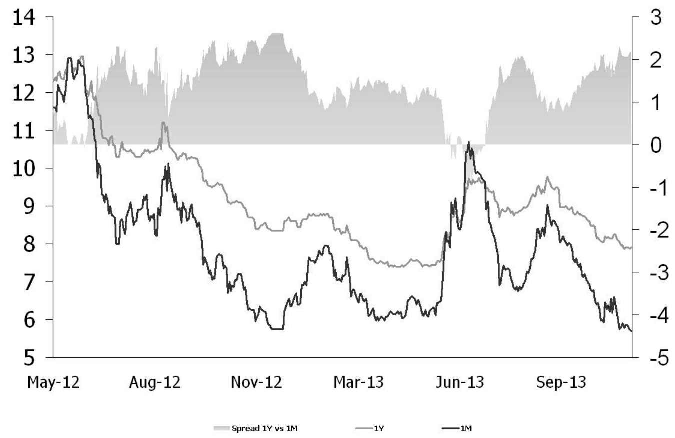
Forex

Frozen... It is the new record. The range for EUR/PLN this week was only 4.1900-4.2080. As a result, realized volatility on 1 week has dropped to the new record low of 2.94% (high frequency hedging) and for daily hedging, it is only 1.81% (source: Bloomberg). The holiday in the US is not helping the market either. We may stay in the coma till the next week's NFP, gauging the next FED move. The government-owned bank is still actively seen on offers in EUR/PLN.

Vols lower We are at the 2013 lows in the EUR/PLN backend vol, in the frontend we actually broke lower. The 1 year EUR/PLN was traded at 7.8%, as extremely low realized volatility is gradually taking its toll on the backend. EUR/PLN 1m ATM mid is 5.1% this Friday (0.4% lower then last week), 3 Months are at 6.0% (0.1% lower) and 1 year is at 7.8% (0.1% lower). The skew is roughly the same, and the currency spread (difference between USD/PLN vol and EUR/PLN vol) is better offered, especially in the frontend, as the market is frantically trying to reduce its Theta bill.

EURPLN volatility



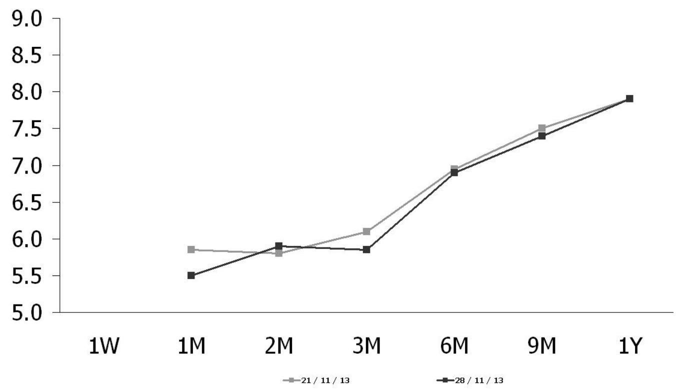
Short-term forecasts

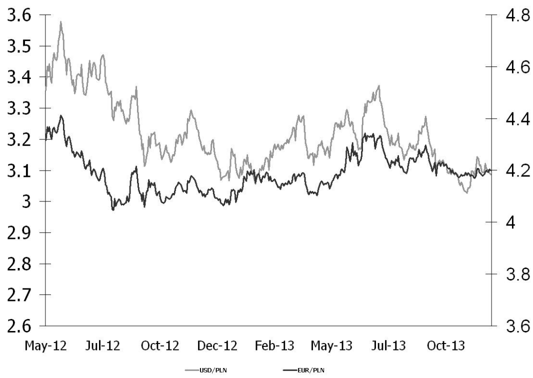
SPOT Main supports / resistances:
EUR/PLN: 4.1400 / 4.2200
USD/PLN: 3.0000 / 3.2000

Stay aside / fade extremes We have decided to change attitude, with such tight ranges and heavy positioning, the market being generally short Gamma. We are square now, as the risk-reward ratio is not really encouraging to be positioned at all. We keep our powder dry and we will likely try to fade extremes if seen. If not, it is almost the end of the year anyway...

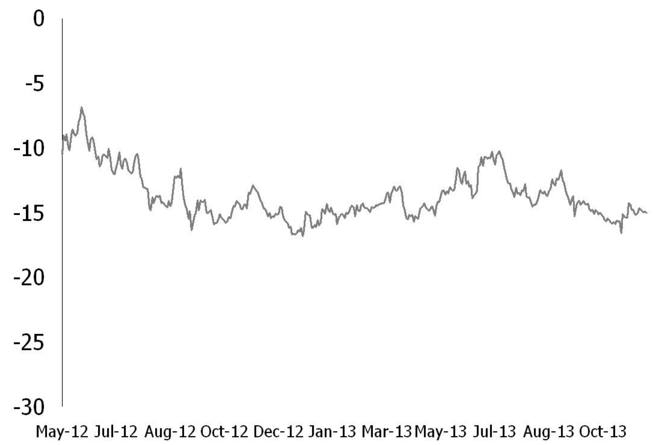
Cautiously long backend We are still long backend EUR/PLN. It is still a modest long, and we also still have some shorts in the frontend. And not to muddle the view, we have to confess that we don't see any obvious volatility triggers on the horizon. The realized volatility is not really encouraging buyers. The vols are cheap and even though they may stay here for time being we think the risk/reward is skewed to be long backend Vega.

EUR/PLN volatility curve





Bias from the old parity (%)



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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
11/22/2013	2.50	2.65	2.62	2.60	2.83	2.65	2.67	2.65	2.67	2.77	2.93	2.76
11/25/2013	2.48	2.65	2.60	2.60	2.81	2.65	2.67	2.65	2.67	2.77	2.94	2.76
11/26/2013	2.47	2.65	3.00	2.60	2.82	2.65	2.67	2.66	2.68	2.78	2.95	2.76
11/27/2013	2.37	2.65	2.52	2.60	2.73	2.65	2.65	2.66	2.67	2.79	2.98	2.77
11/28/2013	2.48	2.65	2.62	2.60	2.84	2.65	2.64	2.65	2.67	2.79	2.99	2.77

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	OK0715	5Y IRS	PS0718	10Y IRS	DS1023
11/22/2013	2.650	2.603	2.990	2.785	3.625	3.706	4.125	4.369
11/25/2013	2.650	2.614	2.970	2.780	3.620	3.705	4.115	4.369
11/26/2013	2.650	2.530	2.985	2.786	3.630	3.725	4.125	4.456
11/27/2013	2.650	2.541	3.013	2.891	3.695	3.795	4.185	4.555
11/28/2013	2.650	2.477	3.028	2.873	3.740	3.784	4.225	4.544

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
11/22/2013	5.85	6.20	6.95	7.90	7.90	2.56	0.66
11/25/2013	5.80	6.10	6.90	7.90	7.90	2.56	0.66
11/26/2013	5.73	6.03	6.90	7.88	7.88	2.57	0.64
11/27/2013	5.70	5.85	6.90	7.90	7.90	2.57	0.64
11/28/2013	5.50	5.85	6.90	7.90	7.90	2.56	0.70

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
11/22/2013	4.1995	3.1077	3.4108	3.0715	1.4083	0.1542
11/25/2013	4.1930	3.1019	3.4073	3.0507	1.4038	0.1539
11/26/2013	4.1935	3.0945	3.4058	3.0531	1.4048	0.1535
11/27/2013	4.2038	3.0899	3.4155	3.0362	1.4066	0.1538
11/28/2013	4.1988	3.0872	3.4101	3.0212	1.4020	0.1536

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