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Polish Weekly Review

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Comment on the upcoming data and forecasts

All relevant macroeconomic releases are due on Friday. Very small current account deficit is a direct result of relatively smaller negative income balance, the return of EU transfers (leading to a surplus in transfer balance) and another strong trade surplus. CPI probably ticked up in November but inflationary pressures are still nonexistent. Low food and fuel prices, along with stable core inflation all attest to that. Money supply continues to grow along with recent trends, thus the main reason for the increase in y/y dynamics is a base effect in the notoriously chaotic 'Other' category.

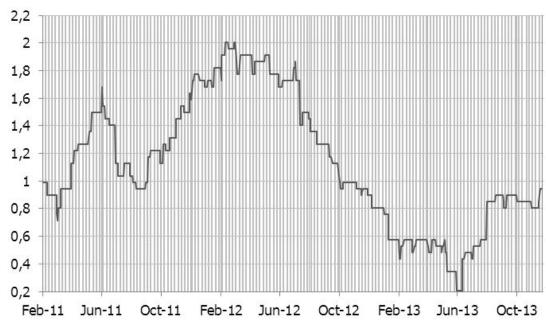
Polish data to watch: December 9nd to December 13th

Publication	Date	Period	mBank	Consensus	Prior
Current account (m EUR)	13.12	Oct	-41	-449	-1024
Export (m EUR)	13.12	Oct	15450	14868	13896
Import (m EUR)	13.12	Oct	14650	14318	13223
M3 y/y (%)	13.12	Nov	6.4	6.2	5.9
CPI y/y(%)	13.12	Nov	1.0	0.9	0.8

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

Slightly up after above-consensus PMI release. In the forthcoming week only CPI offers some opportunity for a surprise.

* 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 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 recently been 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 its 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 receding 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 an upward sloping inflation path should eventually 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 a perceived cheapness of the Polish curve. 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.

mBank forecasts

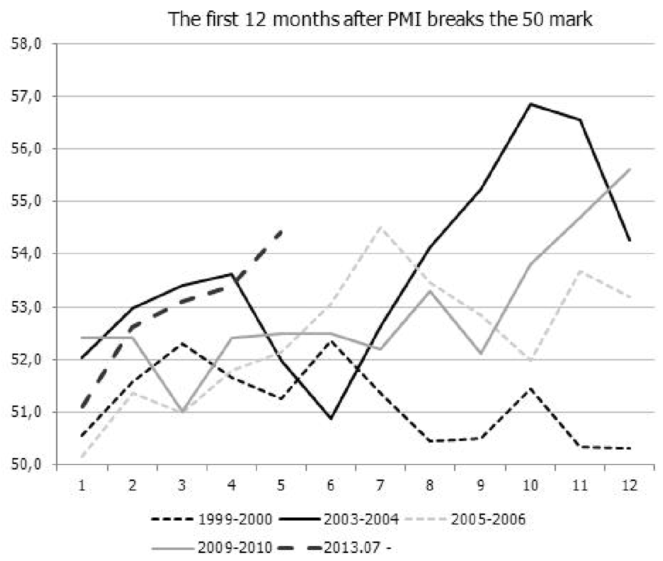
	2009	2010	2011	2012	2013F	2014F
GDP y/y (%)	1.6	3.9	4.5	1.9	1.4	3.2
CPI Inflation y/y (average %)	3.5	2.8	4.3	3.7	1.1	2.2
Current account (%GDP)	-1.6	-4.5	-4.9	-3.5	-1.9	-2.6
Unemployment rate (end of period %)	12.1	12.4	12.5	13.4	13.5	13.2
Repo rate (end of period %)	3.50	3.50	4.50	4.25	2.50	3.00

	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	3.06	2.80	3.00	3.30	3.30	3.30
10Y Polish bond yields (% eop)	3.94	4.34	4.48	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

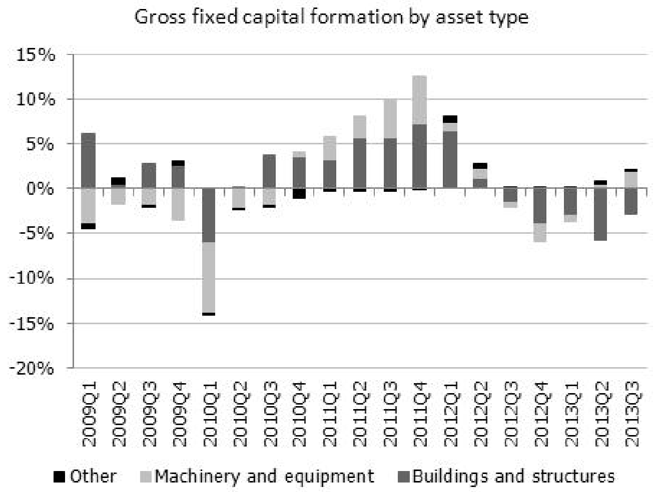
F - forecast

PMI marching upwards. MPC on hold

PMI index for the Polish economy increased from 53.4 to 54.4 generating – once again – an upward surprise. It is the fifth consecutive reading above 50 threshold which makes the current expansion phase the steepest in history (at least in PMI metrics). Current PMI levels are consistent with GDP growth at 2.4-2.5% y/y and this is our forecast for Q4 2013. Growth accelerates, inflation stays low - it's a Goldilocks economy. In such circumstances MPC did not change rates at the last meeting. Moreover, the wording from the statement – additionally to forward guidance that was left intact in its previous form – suggests rate setters feel that the current stance of the monetary policy is adequate and it would take a really serious surprise to change this point of view.



We think such a surprise will be generated in coming months in small but incremental steps. The structure of GDP is going to show that impulses stemming originally from exports are passed on to domestic demand. The transmission mechanism relies partly on record low NBP rates and is mostly visible (at the moment) in rotation of household assets away from term deposits. We await more public investment and positive influence of lower uncertainty on private investment activity (the fact that Q3 investment was above zero is not only attributable to construction; also equipment and software investment accelerated substantially). GDP growth is likely to exceed 3.2% in 2014 with the steepest acceleration occurring at the turn of 2013/2014. Faster growth is going to be accompanied by wage pressure (already visible within the blue collar workers' universe) and a natural upward trend in prices of services. Not once we indicated that core inflation is already not so low. With historical troughs in food and energy prices, any negative supply shock can substantially change the CPI trajectory.



But it will be stealth evidence, as we already indicated, easy to miss out. Therefore, for now we do not expect any significant expectations for monetary policy tightening to arise. ECB once again embarked on easing (expectations that it will be forced into further easing very soon are slowly mounting), global inflation stays low. Also the aforementioned wages pressure and upward CPI trajectory are not going to be obvious for market participants. Only at the end of 2014 GDP growth is going to be strong enough to trigger thoughts on higher inflation within monetary policy horizon. Moreover, the new UE budget perspective may fuel further speculation of steepening GDP trajectory in forthcoming years (at the moment we expect 4% in 2015) and this would only provide more vivid colors to the aforementioned thinking. In such circumstances MPC is going at least to normalize interest rates regardless of the shape of reaction function after Gilowska's departure and implementation of the new NBP bill (more rotation within MPC but temporarily also more members in the body).

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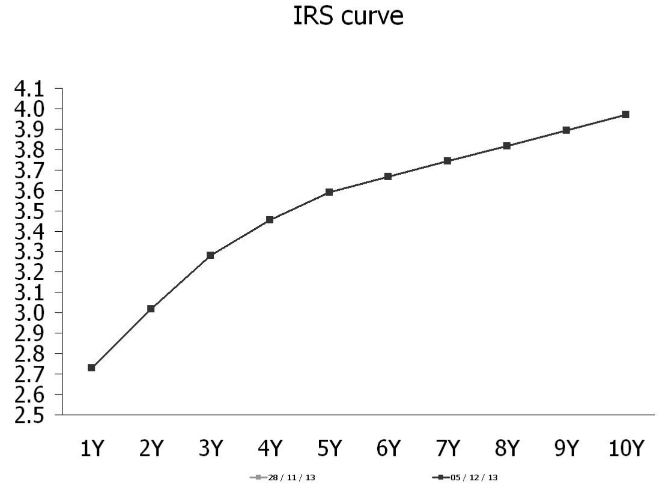
Fixed income

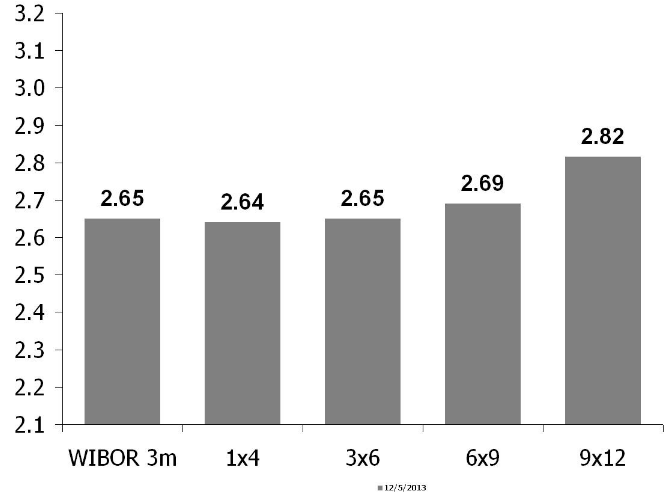
Fantastic numbers

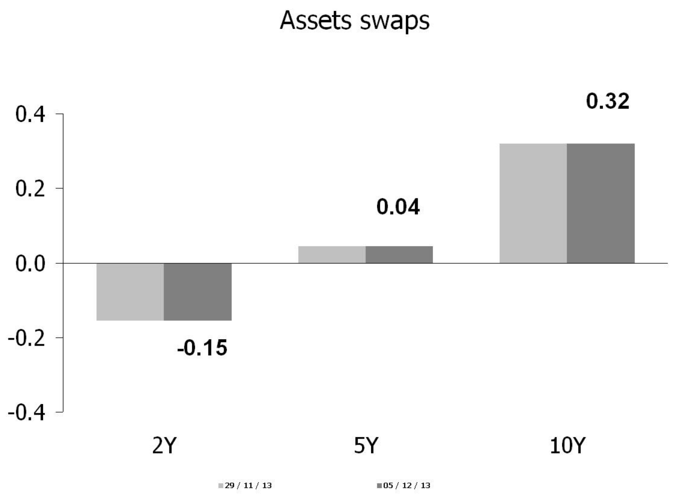
This week on Fixed Income market we were surprised by impressive data from the US economy: ADP, GDP, unemployment, payrolls - it all shows that Fed's stimulus worked out well and we are closer and closer to tapering. The question is if and when this booming US economy is going to influence our growth. It seems that investors doubt that because despite all good data, we barely see paying interest on swaps.

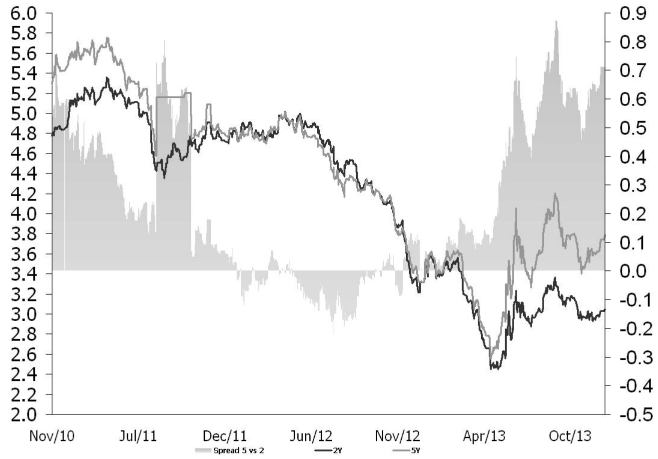
Meanwhile we had strange switching auction here. Instead of usual benchmarks, MinFin decided to offer old one: PS0416. Auction was relatively successfull, but size sold was not so impressive. It seems that investors are waiting for the Fed's meeting this month. Current bond yield levels are attractive and we believe that there is still a chance for 'Santa's rally'.

Recommendation: Yes, we still like our long 5 year bond positions.









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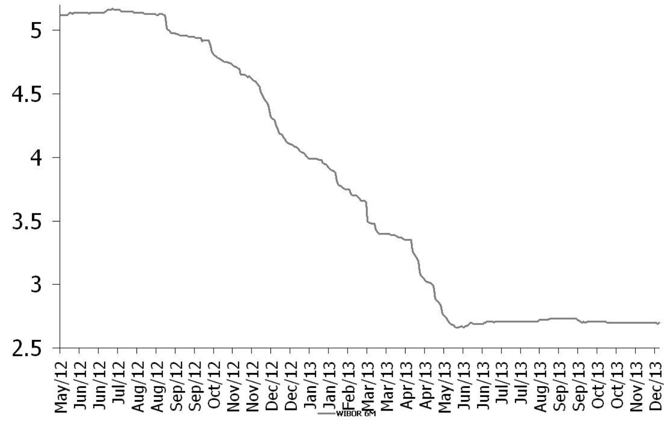
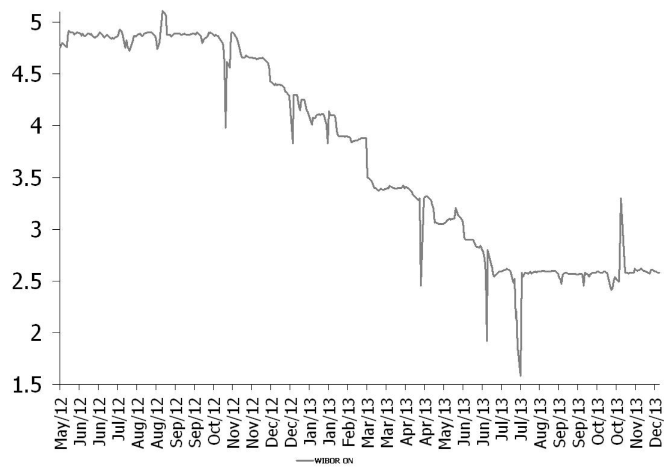
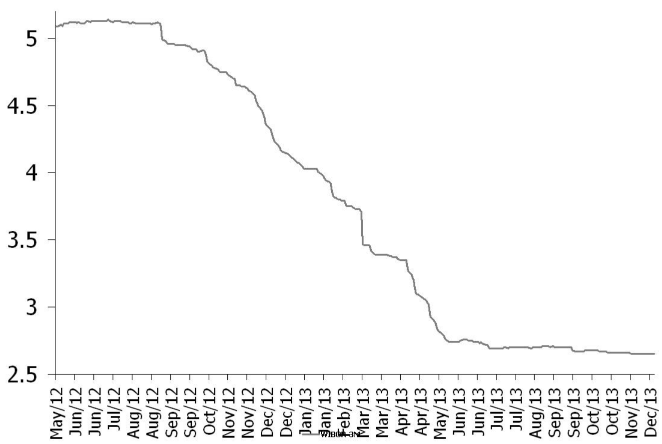
Money market

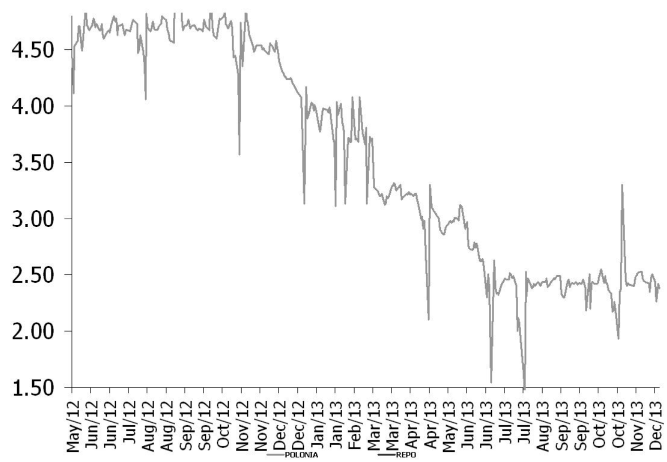
Stable week for Polonia Stable week for Polonia fluctuating around 2.40. Just as we thought central bank made additional OMO. They did it on Tuesday, but demand was lower than supply (12.8 vs 21.5). That's why Polonia was at reasonable levels. Today's OMO was also under bid (125 vs 129 offered) so in next week cash shouldn't be very expensive.

As it was expected on Wednesday Monetary Council left rates unchanged.









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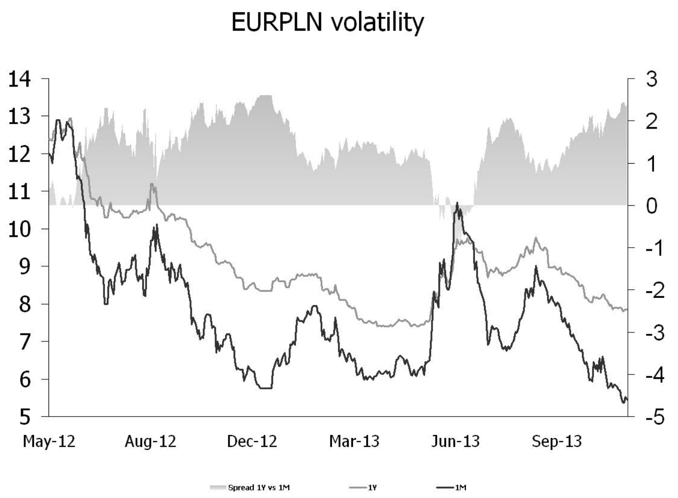
Forex

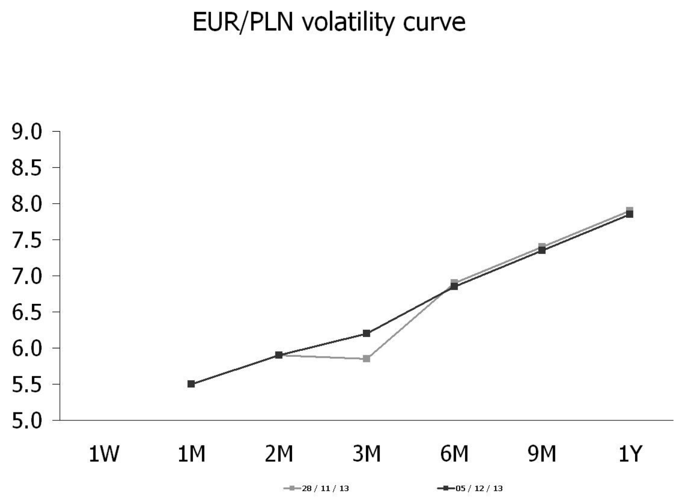
Frozen... 4.18 - 4.21 was this week's range for EUR/PLN. Such was the immunity of EUR/PLN from global shocks. Ukraine turmoil, HUF on fire, nothing was able to push EUR/PLN out of its current 4.17-4.22 range. Even really strong NFP was not enough to move EUR/PLN. Now, we expect market will go back to sleep or, if you prefer, go back into "waiting for the Fed" mode. . . but we doubt we will see fireworks before New Year's Eve.

Vols flattener We had a small bounce in the beginning of the week, with a market buying gamma for what seems to look like eventful week. 3 month EUR/PLN were traded at 6.2%, 6 months at 6.9%, short term options especially with post Fed expiries were in high demand. But the low realized volatility finally took the upper-hand, and we are closing the week with a curve which is just a bit more flat. 1 month EUR/PLN ATM mid fixed this week at 5.25% (0.25% then a week ago), 3 months unchanged at 6%, 6 month 6.7% (0.2% lower) and 1year unchanged at 7.8 %. The currency spread is better bid along the curve, with USD/PLN trailing closely the EUR/USD moves. Skew is roughly unchanged.



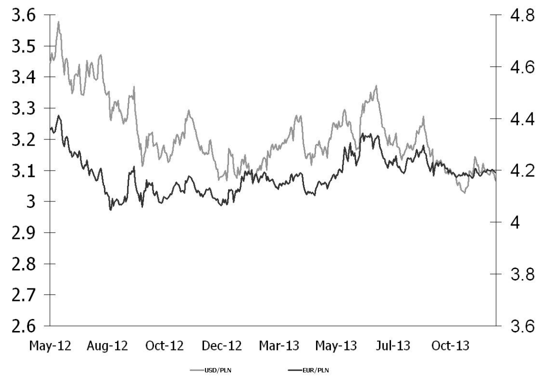
Short-term forecasts

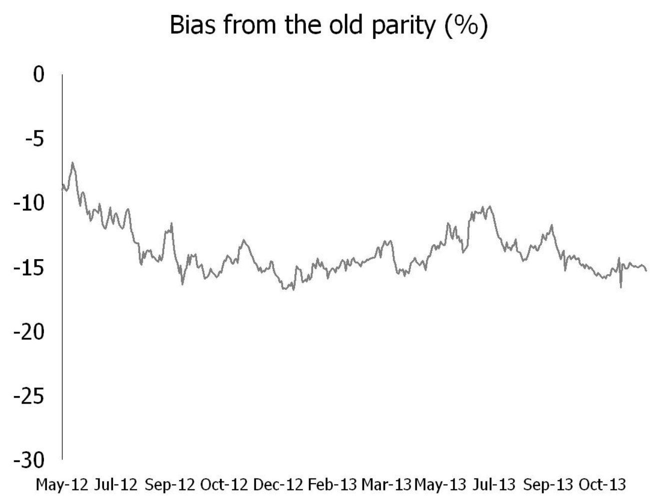
SPOT Main supports / resistances:
EUR/PLN: 4.1400 / 4.2200
USD/PLN: 3.0000 / 3.2000



Stay aside / fade extremes We have decided to change attitude. With such tight ranges and heavy positioning, market is 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 still long backend EUR/PLN. It is still 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 the time being we think the risk reward is skewed to be long backend Vega.





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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
11/29/2013	2.48	2.65	2.61	2.60	2.82	2.65	2.64	2.64	2.69	2.78	2.98	2.78
12/2/2013	2.60	2.65	2.64	2.60	2.65	2.65	2.67	2.66	2.70	2.82	3.04	2.80
12/3/2013	2.47	2.65	2.61	2.60	2.83	2.65	2.65	2.65	2.68	2.80	3.01	2.78
12/4/2013	2.39	2.65	2.53	2.59	2.74	2.65	2.65	2.67	2.70	2.84	3.02	2.79
12/5/2013	2.49	2.65	2.63	2.59	2.84	2.65	2.64	2.65	2.69	2.82	3.03	2.79

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
11/29/2013	2.650	2.477	3.028	2.873	3.740	3.784	4.225	4.544
12/2/2013	2.650	2.477	3.028	2.873	3.740	3.784	4.225	4.544
12/3/2013	2.650	2.477	3.028	2.873	3.740	3.784	4.225	4.544
12/4/2013	2.650	2.477	3.028	2.873	3.740	3.784	4.225	4.544
12/5/2013	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
11/29/2013	5.38	5.85	6.80	7.80	7.80	2.56	0.65
12/2/2013	5.38	6.10	6.80	7.83	7.83	2.56	0.65
12/3/2013	5.53	6.20	6.85	7.85	7.85	2.56	0.64
12/4/2013	5.45	6.20	6.85	7.85	7.85	2.55	0.63
12/5/2013	5.50	6.20	6.85	7.85	7.85	2.56	0.63

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
11/29/2013	4.1998	3.0846	3.4084	3.0163	1.3956	0.1534
12/2/2013	4.1965	3.0965	3.4079	3.0148	1.3875	0.1532
12/3/2013	4.2032	3.0973	3.4179	3.0133	1.3880	0.1530
12/4/2013	4.2011	3.0916	3.4182	3.0145	1.3907	0.1532
12/5/2013	4.1974	3.0870	3.4218	3.0213	1.3892	0.1530

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