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Polish Weekly Review

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Comment on the upcoming data and forecasts

January's MPC meeting will not bring any upheaval in Polish monetary policy: the benchmark interest rate will remain unchanged and the MPC's vow to keep the rates untouched till the mid-2014 will be confirmed again. Low inflation and replacement of prof. Gilowska with dovish prof. Osiatyński will be both contributing to the loose monetary stance of the MPC.

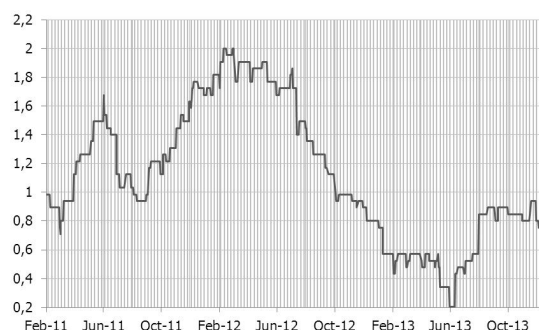
Polish data to watch: January 6th to January 10th

Publication	Date	Period	mBank	Consensus	Prior
MPC decision (%)	08.01	Jan	2.50	2.50	2.50

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 OK0716	1/9/2014	3000	2.983	11/7/2013
5Y T-bond PS0718	1/9/2014	4000	3.589	11/7/2013
10Y T-bond DS1023	1/9/2014	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

For once, PMI surprised to the downside. Thus, our surprise index is down again and will remain unchanged in the coming week as no macro releases are scheduled.

* 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, a 2.7% 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%. Consensus view has been converging to our bullish scenario.
- The upswing has recently been driven by exports that behaves much better than in previous upswing episodes (Polish economy is more competitive and more geographically diversified). Consumption has already joined and we see no obstacles for its further, gradual strengthening. 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. We see potential for upside surprises in 2014, though.
- 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

- Price action on Polish bonds was probably distorted by local investors at the end of the year. 5-10 year sector looks rich now.
- 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 long end bonds.
- Zloty should gradually strengthen on the back of cyclical recovery in Poland.

mBank forecasts

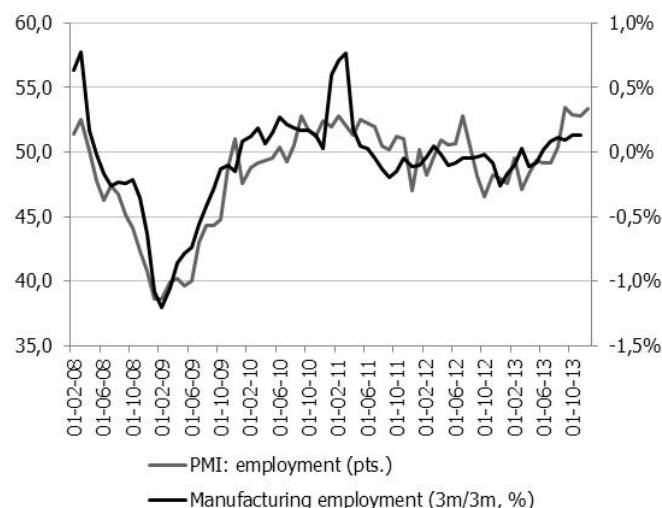
	2009	2010	2011	2012	2013F	2014F
GDP y/y (%)	1.6	3.9	4.5	1.9	1.5	3.3
CPI Inflation y/y (average %)	3.5	2.8	4.3	3.7	0.9	1.7
Current account (%GDP)	-1.6	-4.5	-4.9	-3.5	-1.7	-2.3
Unemployment rate (end of period %)	12.1	12.4	12.5	13.4	13.6	13.2
Repo rate (end of period %)	3.50	3.50	4.50	4.25	2.50	3.00

	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	2.7	2.9	3.0	3.4	3.7
Individual consumption y/y (%)	0.0	0.2	1.0	1.9	2.6	2.5	2.5	2.8
Public Consumption y/y (%)	-0.1	4.3	1.7	1.2	1.0	0.3	1.9	2.5
Investment y/y (%)	-2.1	-3.2	0.6	4.0	6.0	8.0	8.0	8.0
Inflation rate (% average)	1.3	0.5	1.1	0.8	1.4	1.7	1.5	2.1
Unemployment rate (% eop)	14.3	13.2	13.0	13.6	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	2.65	2.65	2.65	2.65	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	4.15	4.05	3.95	3.90	3.90
USD/PLN (eop)	3.26	3.32	3.12	3.07	2.99	3.10	3.20	3.25
F - forecast								

Economics

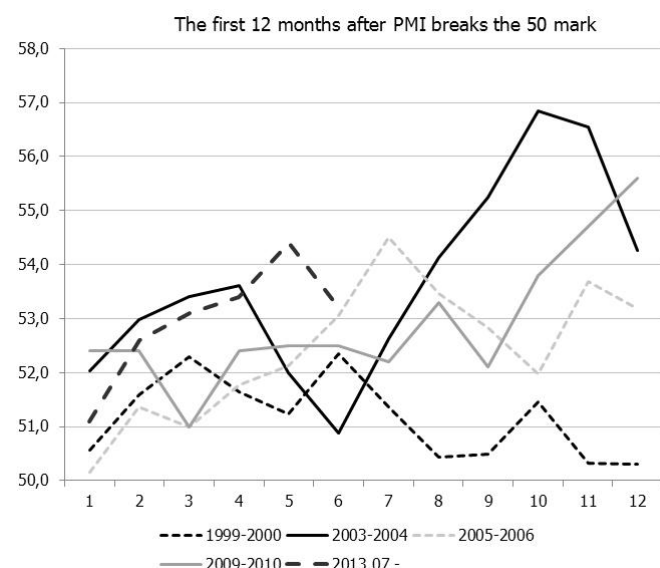
December drop in PMI should be seen as a correction

Polish Manufacturing PMI surprisingly fell in December from November's 54.4 to 53.2. Our forecast and market consensus both indicated a modest increase (55.0 and 54.8, respectively), following very good German figures. It is obviously a disappointment but only vis-a-vis high expectations. After all, 53.2 is still well above the long-term average. Of all episodes in the series, the last six months have been the most dynamic start of an upswing to date.



Survey respondents still see no signs of significant inflationary pressures: input prices have basically been flat and output prices have mostly decreased again (18 months of declines is the longest such sequence in history). Finally, backlogs of work remained below the 50 pts. threshold, although the rising trend in this category is actually more important than current levels. Nevertheless, typical lags between backlogs of work and capacity utilization indicate that current investment cycle only begins now.

To sum up, the drop in PMI should be interpreted as a correction in uptrend, a phenomenon which is inevitable and does not imply a renewed weakness in the economy. We stand firm by our forecast of further acceleration in economic growth in the fourth quarter to 2.7% y/y. Strong fourth quarter implies a 1.5% y/y for the whole year (preliminary yearly figure to be released in late January or early February, flash Q4 GDP on February 14th) and an even better 2014.



The details of the release broadly confirm that conclusion. Output growth eased from November's 56.9 to 53.6 but we would advise not to draw far-reaching conclusions regarding December industrial output figures as they will be propelled mostly by statistical base and calendar effects. New orders modestly declined and another fall away from October's all time high in new export orders suggests that domestic orders continue to flow in at a steady pace. On the other hand, the survey indicates strong job creation in manufacturing (relevant subindex rose from 52.8 to 53.4 – the second best result since July 2007). This sector, highly cyclical in nature, has already seen solid increases in employment (in „hard data“, charted below).

Fixed income

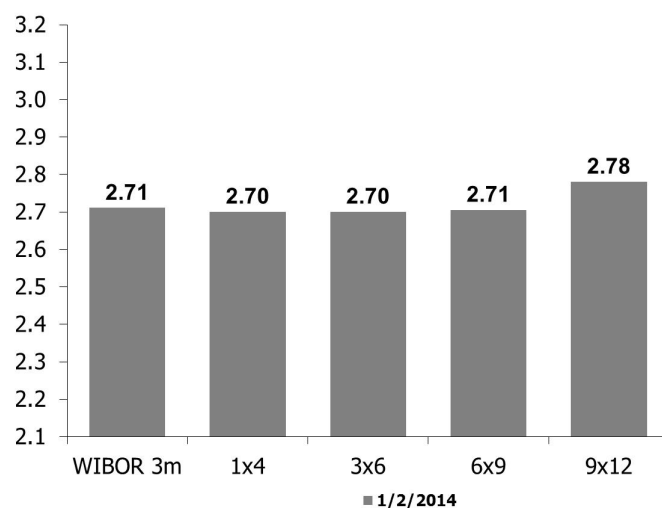
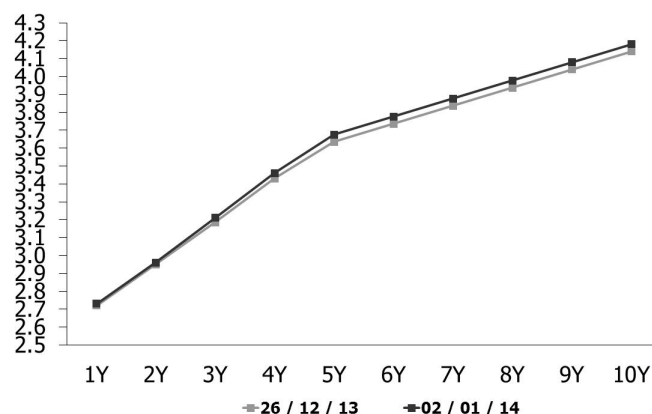
Happy New Trading

New year started quite harsh on Polish Government Bonds. High prices from the year-end fixing got hit and yields of DS1023 rose 15bp up to 4.45%. The market is preparing for an auction on 9th January where 3-6bln of bonds will be offered.

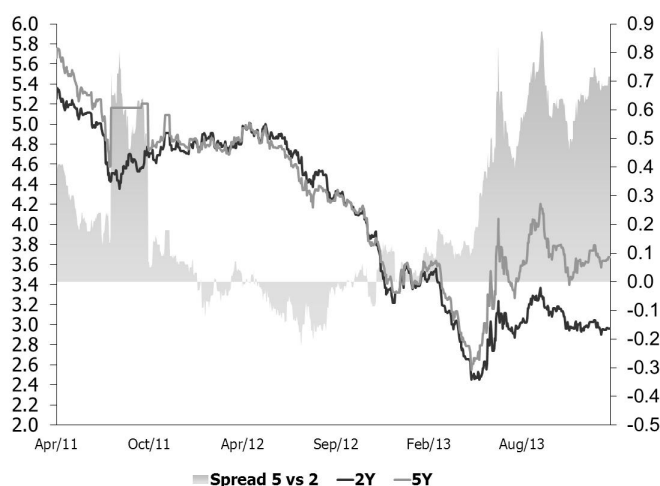
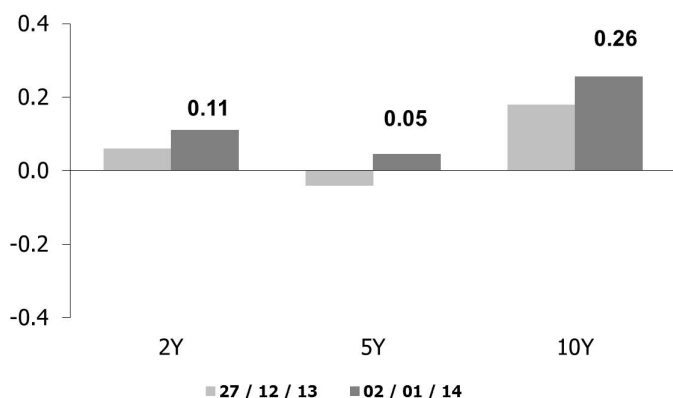
We expect low CPI data this month and pressure from OFE to fix bonds prices high. This is why we are looking for an opportunity to buy bonds and 4.50% yield on DS1023 should be a possible one.

Recommendation: Buy DS1023 on dip.

IRS curve



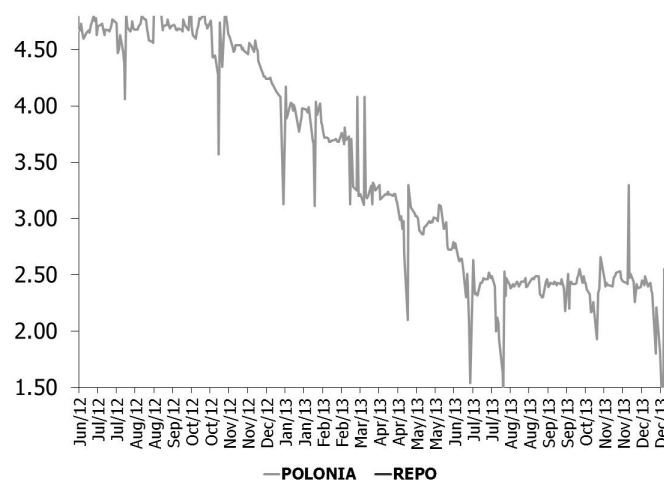
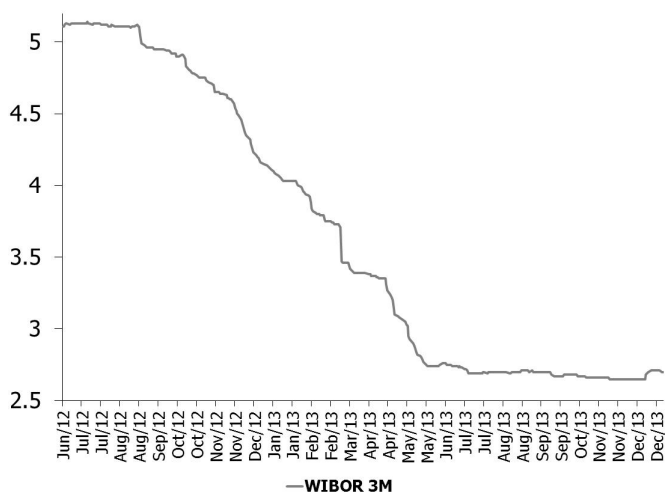
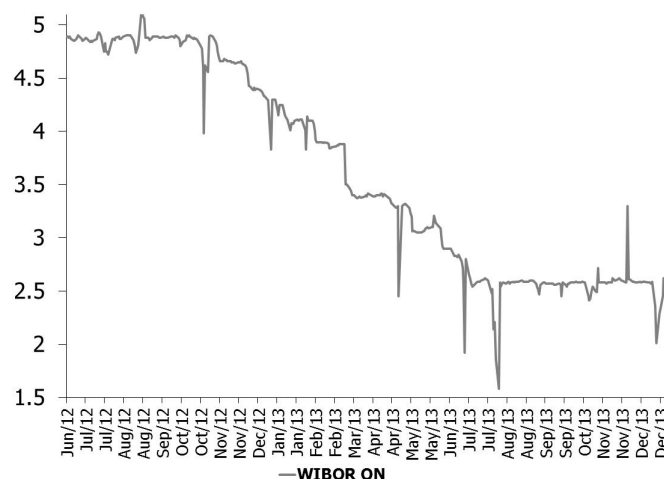
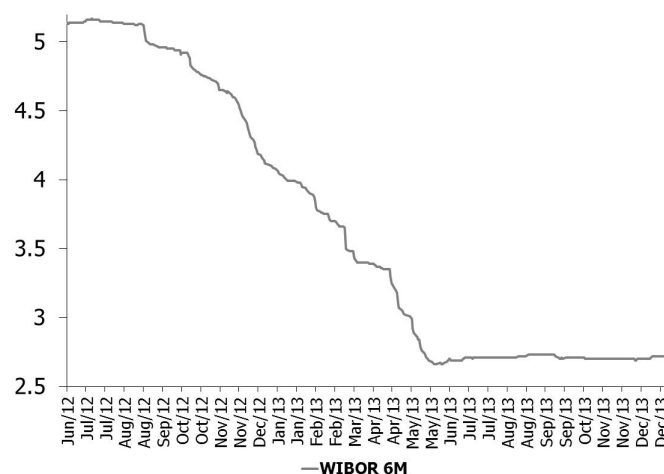
Asset swaps



Money market

Stable rates next week After the cheap Christmas week, when Polonia was under 2% (even with additional OMO on Monday), rates came back to normal levels. As Monday (30th) was the last day of reserve and central bank did an additional OMO, Polonia was at 2.5. Nothing unexpected on short rates happened on December 31st and Polonia was stable to the end of week.

Next week should be stable as well, as today's OMO was just a bit under bid (123.5 vs. 125).



Forex

PLN bit weaker The Polish Zloty is a bit weaker in the new year. Sourer investment sentiment and expectations of BGK ceasing it's protecting offers in EUR/PLN were to blame for the weaker start of PLN trading. The range for the week for EUR/PLN is 4.1325-4.1725, still quite unimpressive. In 2014 PLN will most likely not have much of it's own life, we believe it will rather track global developments. The Fed tapering and possible QE from ECB being ranked as the highest.

Tic higher The frontend is higher on the relief really, once we finally got over with the holiday season. The New Year and the fresh positioning are also an important issue. 1 month EUR/PLN ATM mid is today 5.15% (0.65% higher than on the last day of the year), 2 months EUR/PLN were paid at 5.65% (0.35% higher), the backend is roughly unchanged with 1 year EUR/PLN fixing today at 7.5%. The skew is roughly unchanged. The currency spread (USD/PLN vol minus EUR/PLN vol) is the biggest winner, especially in the frontend. USD/PLN curve rose approximately 1.5% in the frontend, the move up for the backend was far more modest, around 0.25%.

Short-term forecasts

SPOT Main supports / resistances:

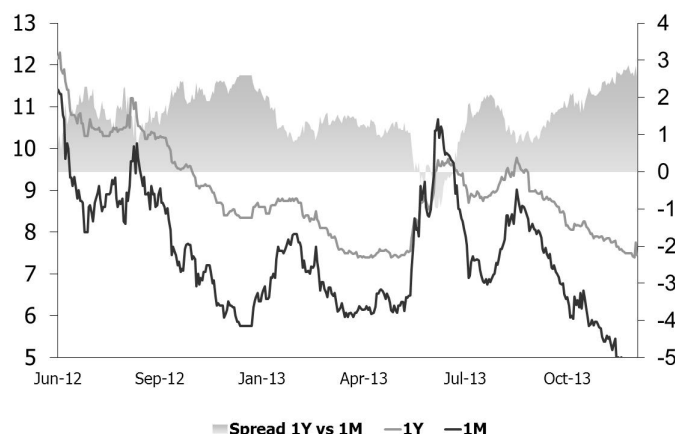
EUR/PLN: 4.1300 / 4.2000

USD/PLN: 3.0000 / 3.2000

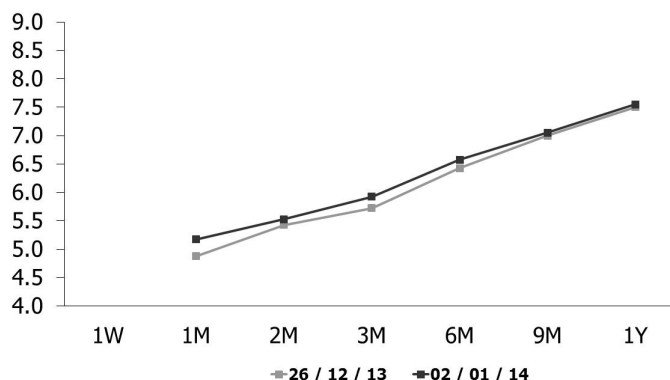
Long EUR/PLN We are tactically long from 4.1550 with a stop below 4.1300 and hopes for 4.20. The idea is a highly educated guess and is based on the well-known wisdom that what is not going up, must go down (it being the PLN in this equation).

Long backend Our short term shorts in Vega already expired, we are now long backend EUR/PLN and USD/PLN Vega. We think the tapering year should produce volatility in it's due time. We simply think the risk /reward of being long is better than vice versa.

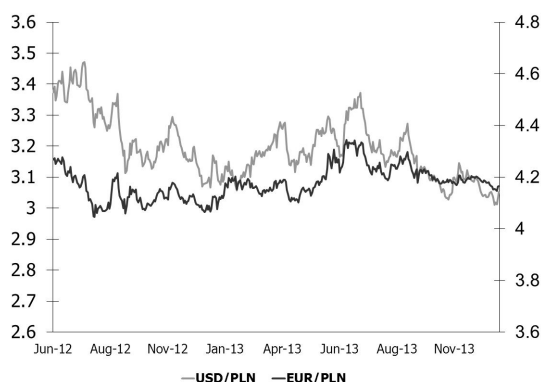
EURPLN volatility



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
12/27/2013	2.52	2.71	2.65	2.62	2.70	2.65	2.71	2.70	2.69	2.75	2.89	2.74
12/30/2013	2.56	2.71	2.70	2.62	2.89	2.65	2.70	2.70	2.71	2.76	2.91	2.78
12/31/2013	2.57	2.71	2.71	2.62	2.90	2.65	2.70	2.70	2.71	2.76	2.91	2.76
1/1/2014	2.47	2.71	2.61	2.62	2.80	2.65	2.71	2.71	2.70	2.76	2.90	2.77
1/2/2014	2.51	2.70	2.60	2.62	2.84	2.65	2.70	2.70	2.71	2.78	2.93	2.78

Last primary market rates							
Paper	Au. date	Maturity	Avg. price	Avg. yield	Supply	Demand	Sold
52W TB	3/4/2013	8/28/2013	98.33	3.49	3000	7324	3084
OK0116	11/7/2013	1/25/2016	93.73	2.98	3000	8542	3178
PS0718	11/7/2013	7/25/2018	95.35	3.59	4000	6129	4787
DS1023	10/22/2013	10/25/2023	97.57	4.30	2000	2376	1416

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0715	5Y IRS	PS0718	10Y IRS	DS1023
12/27/2013	2.650	2.733	2.965	3.025	3.650	3.610	4.160	4.338
12/30/2013	2.650	2.706	2.960	3.028	3.675	3.646	4.180	4.353
12/31/2013	2.650	2.706	2.960	3.028	3.675	3.646	4.180	4.353
1/1/2014	2.650	2.706	2.960	3.028	3.675	3.646	4.180	4.353
1/2/2014	2.650	2.733	2.960	3.070	3.675	3.720	4.180	4.436

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1Y	
12/27/2013	4.74	5.79	6.45	7.43	7.43	2.68	0.71	
12/30/2013	4.84	5.73	6.43	7.40	7.40	2.68	0.71	
12/31/2013	4.89	5.73	6.75	7.75	7.75	2.57	0.65	
1/1/2014	4.90	5.90	6.45	7.45	7.45	2.80	0.64	
1/2/2014	5.18	5.93	6.58	7.55	7.55	2.56	0.70	

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
12/27/2013	4.1538	3.0105	3.3910	2.8721	1.4019	0.1511
12/30/2013	4.1513	3.0180	3.3866	2.8675	1.3963	0.1512
12/31/2013	4.1472	3.0120	3.3816	2.8689	1.3969	0.1513
1/1/2014	4.1472	3.0120	3.3816	2.8689	1.3969	0.1513
1/2/2014	4.1631	3.0315	3.3816	2.8778	1.3979	0.1517

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