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Polish Weekly Review

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Comment on the upcoming data and forecasts

This month's sequence of macro releases begins on Tuesday with money supply data. We expect y/y dynamics to slightly increase due to base effects which mask an on-going weakness in household deposits (very slow growth throughout the entire 2013). On Wednesday the Central Statistical Office will release CPI figures - we expect inflation to tick up due to a slight increase in fuel prices amid stable core inflation (official figure to be released by the NBP on Thursday) and low food prices. Later that day the Ministry of Finance will release preliminary budget figures for the year, confirming a slightly lower deficit. Finally, Friday brings current account data. We expect C/A balance to widen slightly, mainly due to worsened trade balance. The latter is, however, a result of seasonal factors.

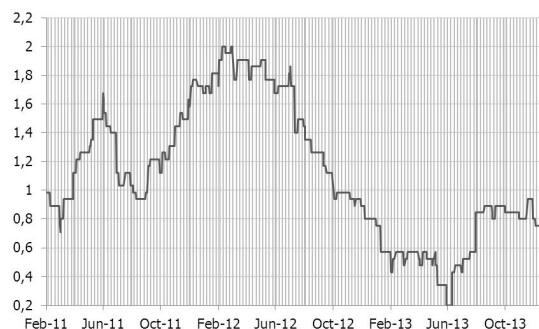
Polish data to watch: January 13th to January 17th

Publication	Date	Period	mBank	Consensus	Prior
M3 y/y (%)	14.01	Dec	5.8	5.8	5.7
CPI y/y (%)	15.01	Dec	0.7	0.7	0.6
Budget performance YTD (%)	15.01	Dec			74.7
Core CPI y/y (%)	16.01	Dec	1.1	1.1	1.1
Current account (mio EUR)	17.01	Nov	-904	-1092	-466
Exports (mio EUR)	17.01	Nov	13240	13636	14622
Imports (mio EUR)	17.01	Nov	13330	13790	14569

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	1/23/2014	3000	2.983	11/7/2013
5Y T-bond PS0718	1/23/2014	3100	3.690	1/9/2014
10Y T-bond DS1023	1/23/2014	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

Unchanged (empty calendar). Next week brings a series of macro forecasts but only headline CPI has any potential to surprise. That being said, we believe that this time there isn't much room for surprises. For a rebound in Polish surprise index we would have to wait until next week.

* 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

- Local factors, including economic upturn and liquidation of OFE assets, suggest higher liquidity risk premium on Polish bonds in the mid-term. This tendency should be backed by globally rising yields. The upward trend in yields is not going to be linear, though, creating at least some possibilities to catch correction/stabilization phases.
- In this vein, global investors may use for short term the mixed data from the U.S. economy (started with NFP) to utilize the recent rise in yields to embark on trades based on steeper curves. This also applies to Polish debt, backed additionally by still dovish MPC, positive budget surprises and low inflation.
- 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	3.5
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	2013	2013	2013	2014	2014	2014	2014
	Q1	Q2	Q3	Q4 F	Q1 F	Q2 F	Q3 F	Q4 F
GDP y/y (%)	0.5	0.8	1.9	2.7	3.1	3.3	3.5	4.0
Individual consumption y/y (%)	0.0	0.2	1.0	1.6	2.5	2.5	2.5	2.8
Public Consumption y/y (%)	-0.1	4.3	1.7	1.2	2.0	2.0	2.0	3.0
Investment y/y (%)	-2.1	-3.2	0.6	4.5	4.5	5.9	7.1	8.0
Inflation rate (% average)	1.3	0.5	1.1	0.8	1.2	1.7	1.6	2.4
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

Rates on hold, forward guidance unchanged

MPC meeting was not an exciting event. Rates were left on hold and indication on future monetary policy (forward guidance) stayed the same, stipulating stability of rates at least until mid-2014.

The statement was merely a repetition of last month's one (incoming signals of economic upswing, low inflation pressure). During the conference the possibility of upward surprise in economic growth was stressed (the dominant theme is still that historical growth rates are out of reach) accompanied by no-risk scenario for inflation and stable rates in the coming months. Belka stressed that a revision of forward guidance may be linked to the publication of fresh inflation projection in March. However, the necessity of revision is not pre-determined.

For us it is striking how statically the MPC is looking at the economy. Although Belka mentioned the possibility of a rise in core inflation, he spent more time assuring the market that the MPC is not going to panic when inflation starts to rise in 2014 on statistical base effects. It is therefore clear the MPC is not going to rush for pro-active stance in the coming months (personal changes within the body are set to do nothing but freeze this consensus).

Such an attitude may be a dead end since low inflation cannot last forever. It increases with economic recovery (we believe in steeper GDP path and gradually tightening labor market) in small increments which are not so easy to disentangle from statistical base effects. Therefore we think the theme of rising core inflation is going to return in coming months. Consequently, the upward trend in inflation should – despite changes of MPC composition – result in normalization of monetary policy in the final quarter of 2014.



Fixed income

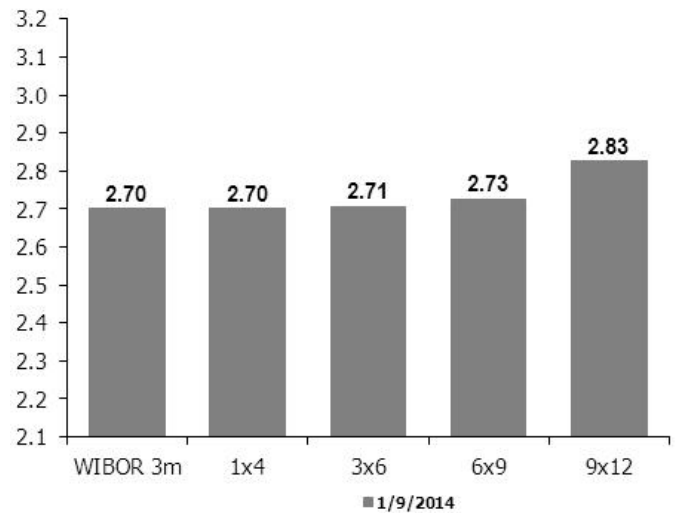
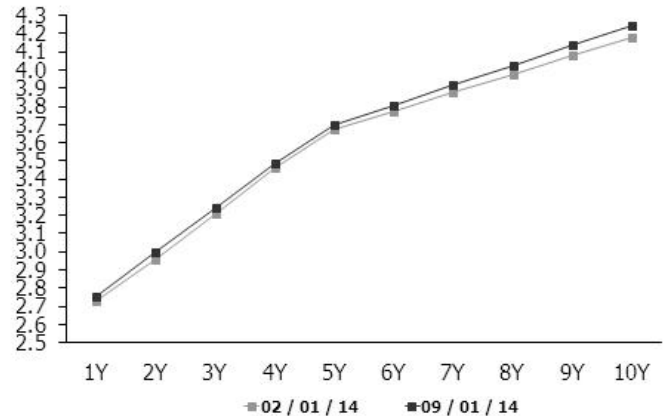
Good level?

Last week we advised to buy DS1023 at 4.50%. It turned out to be highest level traded this week and it looks like that it is currently a good resistance for yields.

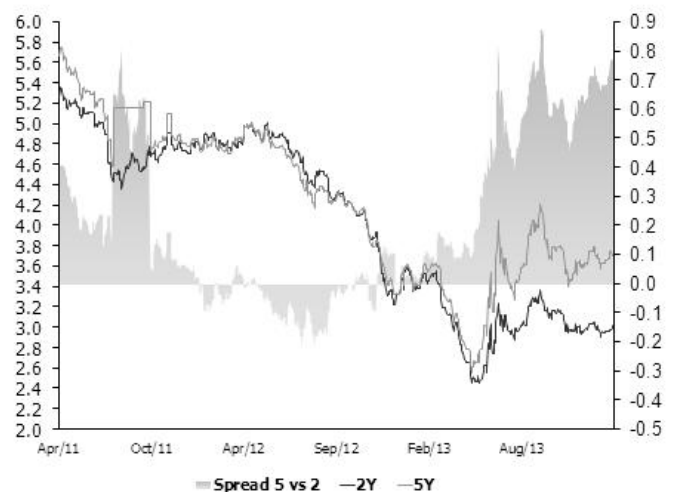
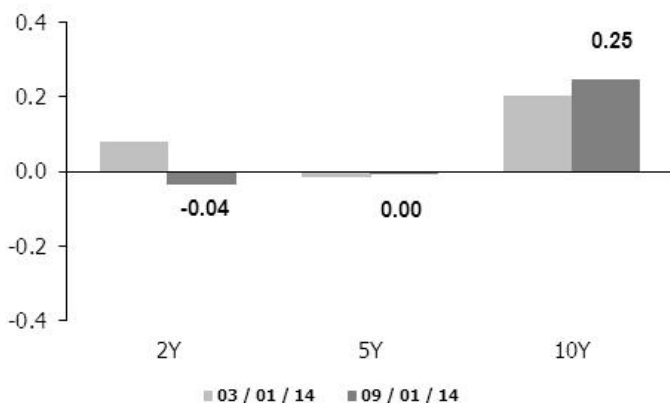
Auction results were relatively good with bid-cover ratio of 1.8. We have a funny situation, where pension funds are buying bonds on the auction only to give them back to MinFin at the beginning of February.

We still like long-end bonds, we think carry trades are good when no-one does them. Bond supply will be limited this year, curve is steep and growth/rate hikes fears are mostly priced in. We keep our recommendation to buy DS1023 on dip (in price), but move the level to 4.47% yield (as we don't believe there is a chance to buy at 4.50% anytime soon).

IRS curve

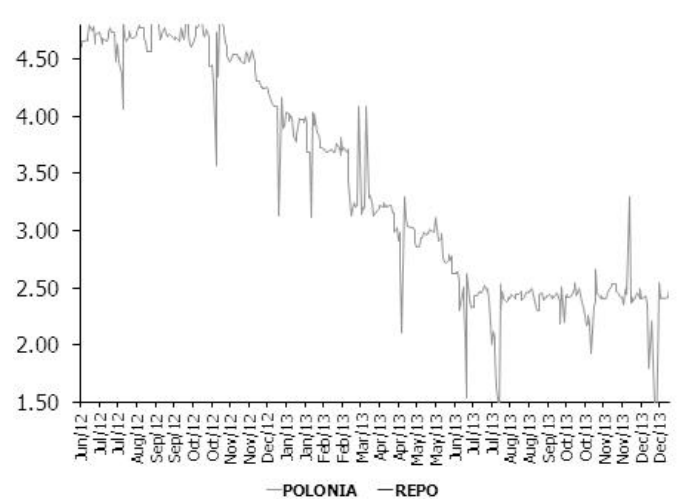
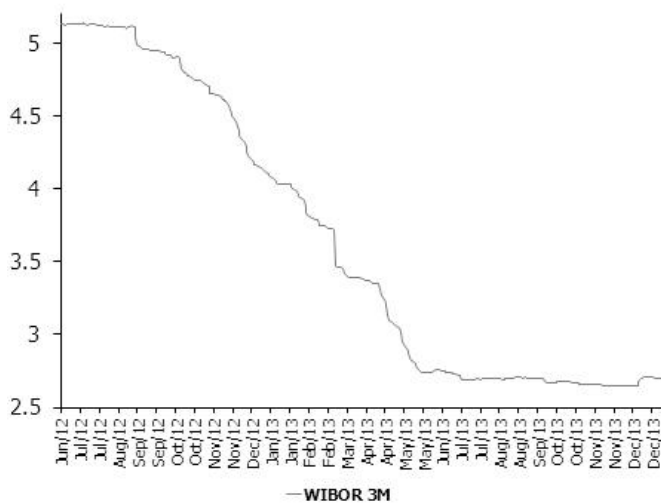
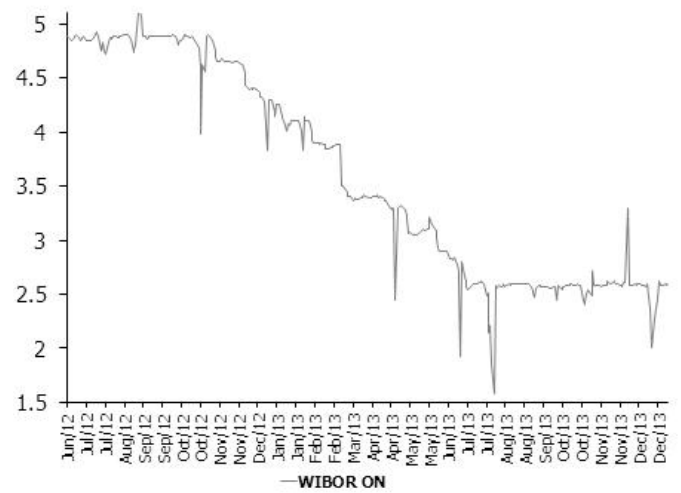
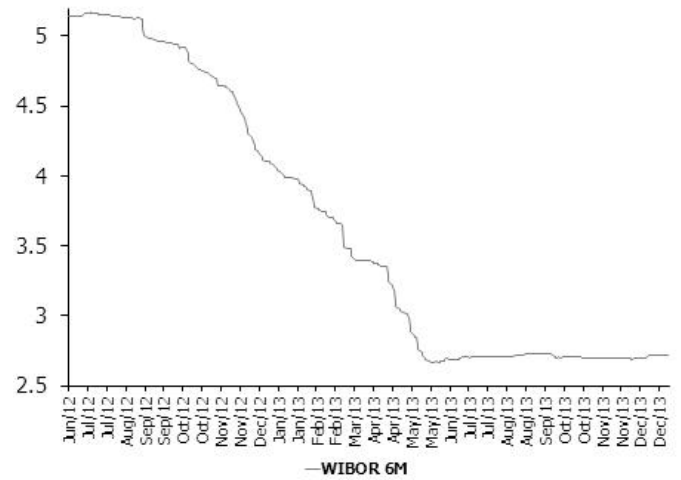


Asset swaps



Money market

Stable rates next week Stable week for short rates while Polonia fluctuated around 2.42%. There was no additional OMO and as today's one was just a bit under bid (123.5 vs 125) there shouldn't be any additional one in the next week. Short rates should stay around 2.42%.



Forex

Back in the coma Polish Zloty lost some ground from the beginning of the year. It was viewed by some (ourselves included) as a prelude to something bigger. The reality has disappointed us, one more time. The EUR/PLN is boxed in 4.16-4.19. Shockingly low NFP gave PLN just a little push, EURPLN dropped by a half of the figure. There will be even more head scratching, and in the result EURPLN will probably stay rangy for an extended period of time.

Vols collapsed The spike from last week was really a short lived one. The sellers reemerged with a vengeance and both EUR/PLN and USD/PLN vol curves are lower considerably. 1 month EUR/PLN ATM mid is today 4.7% (0.5% lower than last Friday), 3 months EUR/PLN are 5.5 (0.3% lower) and 1 year is 7.2 (also 0.3 lower). The skew was better offered in both currency pairs. The 1year EUR/PLN 25D rr being given at 2.45%, for USD/PLN same instrument the trading level was 3.3%. With stable EUR/USD and lower EUR/USD vol the currency spread (the difference between USD/PLN and EUR/PLN vol) was massively offered with 1 year currency spread fixing 4.5/5.0 (roughly 0.4% lower than a week ago).

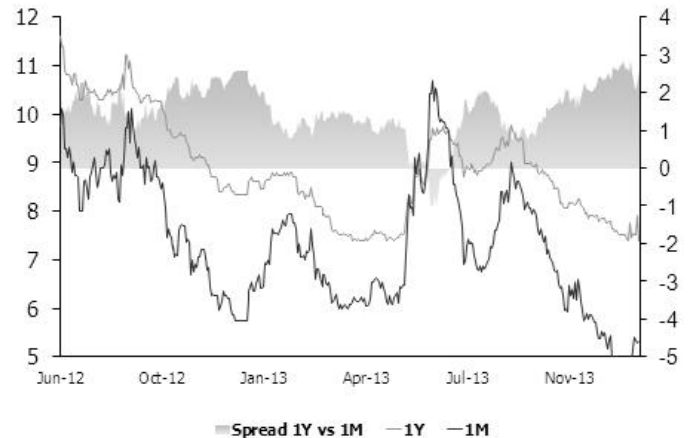
Short-term forecasts

SPOT Main supports / resistances:
 EUR/PLN: 4.1300 / 4.2000
 USD/PLN: 3.0000 / 3.2000

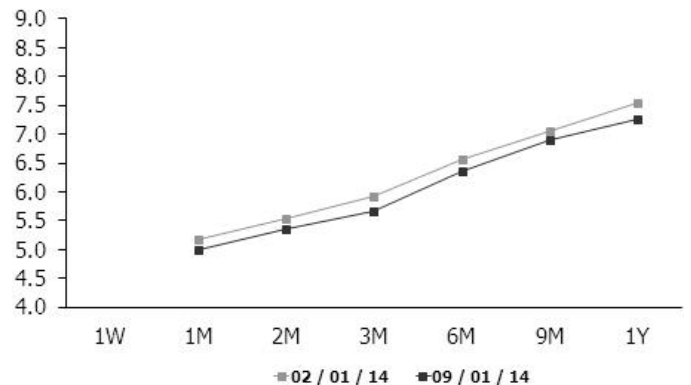
Long EUR/PLN Still long, but the conviction is low. The momentum is simply not there. Long EUR/PLN from 4.1550 with fresh stop 4.1450 and faint hopes for 4.1950. It is purely tactical, meaning we don't have a better idea.

Long backend The logic of better risk/reversal of being long Vega in the backend is still there. But the current price action is proving us wrong. The backend took quite a beating but we have decided to keep it for the time being. The vols are on the lows of the year. The level that should act as support and hopefully provide some correction.

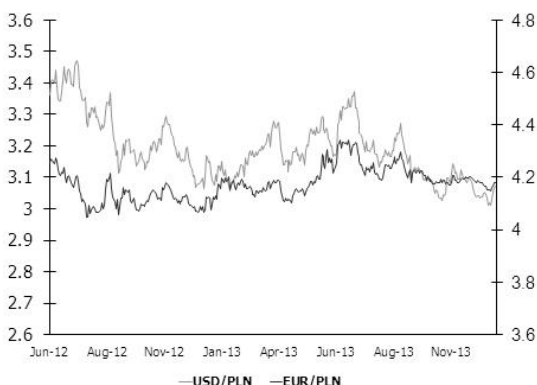
EURPLN volatility



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
1/3/2014	2.54	2.70	2.67	2.62	2.88	2.65	2.71	2.70	2.71	2.81	2.93	2.79
1/6/2014	2.53	2.70	2.65	2.62	2.88	2.65	2.70	2.71	2.73	2.80	2.96	2.81
1/7/2014	2.52	2.70	2.64	2.62	2.87	2.65	2.71	2.71	2.72	2.79	2.95	2.79
1/8/2014	2.50	2.70	2.52	2.62	2.55	2.65	2.71	2.71	2.72	2.81	2.98	2.80
1/9/2014	2.51	2.70	2.64	2.62	2.86	2.65	2.70	2.71	2.73	2.83	2.97	2.81

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	1/9/2014	7/25/2018	95.10	3.69	3100	5697	3147
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
1/3/2014	2.650	2.689	2.980	3.058	3.750	3.738	4.280	4.479
1/6/2014	2.650	2.689	2.980	3.058	3.750	3.738	4.280	4.479
1/7/2014	2.650	2.707	2.995	3.057	3.715	3.739	4.245	4.475
1/8/2014	2.650	2.686	3.013	2.986	3.715	3.712	4.250	4.496
1/9/2014	2.650	2.670	3.000	2.965	3.695	3.690	4.245	4.491

EUR/PLN 0-delta stradle				25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y
1/3/2014	5.41	5.93	6.68	7.50	7.50	2.56
1/6/2014	5.34	5.93	6.68	7.50	7.50	2.56
1/7/2014	5.29	6.21	6.68	7.93	7.93	2.52
1/8/2014	5.33	5.88	6.58	7.40	7.40	2.50
1/9/2014	5.00	5.68	6.36	7.25	7.25	2.64

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
1/3/2014	4.1645	3.0517	3.3884	2.9253	1.3951	0.1514
1/6/2014	4.1645	3.0517	3.3884	2.9253	1.3951	0.1514
1/7/2014	4.1798	3.0688	3.3817	2.9411	1.3907	0.1521
1/8/2014	4.1789	3.0717	3.3765	2.9272	1.3923	0.1521
1/9/2014	4.1776	3.0695	3.3787	2.9240	1.3912	0.1523

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