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Polish Weekly Review

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Comment on the upcoming data and forecasts

Next week brings several important macro releases. As December 2012 brought, under any reasonable criteria, disastrous macro figures, there are significant base effects at play, shaping most of this week's figures along with very positive working day effects (December: +1 y/y; November: -2 y/y). Corporate employment, industrial output and retail sales have most likely jumped in yoy terms. The remaining releases likely have not been affected. Corporate wage growth probably edged down on shifts in bonuses in the mining sector (with a positive working day effect at play in manufacturing). Disinflation / deflation on the producers' side probably eased slightly.

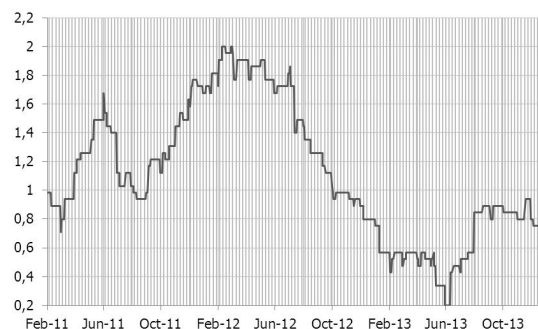
Polish data to watch: January 20th to January 24th

Publication	Date	Period	mBank	Consensus	Prior
Average wage y/y (%)	20.01	Dec	2.8	3.2	3.1
Employment y/y (%)	20.01	Dec	0.4	0.3	0.1
Industrial output y/y (%)	21.01	Dec	9.5	10.5	2.9
PPI y/y (%)	21.01	Dec	-1.0	-1.1	-1.5
MPC's Minutes	23.01				
Retail sales y/y (%)	24.01	Dec	6.6	7.0	3.8
Unemployment rate (%)	24.01	Dec	13.6	13.6	13.2

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 (CPI in line with expectations). Next week brings a series of macro releases with some potential to surprise on the upside (retail sales and PPI being the likely candidates).

* 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 3.5%. 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

- 1) Liquidation of OFE's bond portfolios will change the structure of Polish debt funding (higher percentage of foreign investors and possibly lower liquidity of the market). Thus, Polish bonds will be more than ever exposed to global trends. 2) The mid term upward trend in yields (globally and locally) is not going to be linear, creating at least some possibilities to catch correction/stabilization phases.
- In this vein, at the moment, global investors may use in the short term the mixed (at least in terms of surprises) 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 very 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	13.4	13.0
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	13.4	13.9	12.6	12.4	13.0
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	2.71	2.65	2.65	2.65	3.20
2Y Polish bond yields (% eop)	3.19	3.07	3.06	3.05	2.90	3.00	3.10	3.20
10Y Polish bond yields (% eop)	3.94	4.34	4.48	4.35	4.20	4.60	4.80	5.00
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	3.02	2.99	3.10	3.20	3.25

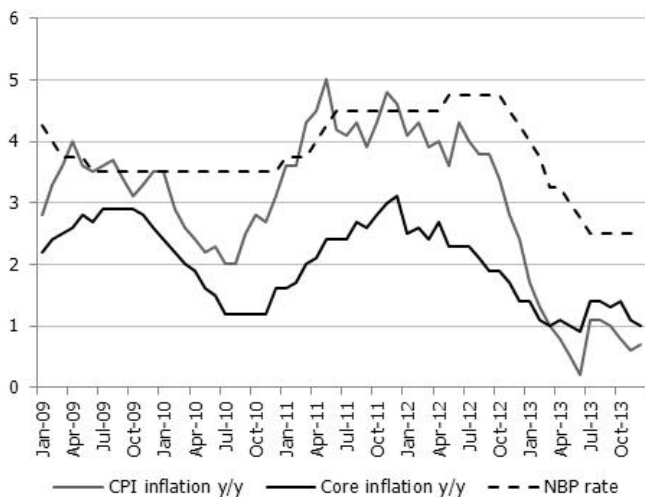
F - forecast

Economics

Inflation remains low

CPI inflation hit our forecast in December: +0.7% y/y. The composition was also unsurprising with moderate food price and fuels price growth leading the way. Core categories are still flattish or even falling. Thereby we estimate core inflation in December to have stayed at 1.1% (November's level).

Next months are set to bring moderate growth in inflation (in January we expect a small increase towards 0.9%). We do not want to engage in discussions on the effects of changes in inflation basket weights since it is impossible to pin down a directional effect at this stage. Inflation is set to primarily rise on the wave of base effects in the coming months which are going to reverse in the mid-year only to re-accelerate in the end.



It is still too early to link price growth to the upswing in business activity we witness right now. But it will be anchoring bias if we extended this tendency more into 2014. We think that rising economic activity is going to take its toll with slowly accelerating core inflation. At this very moment this possibility is neglected by the market and the MPC as well. We think that the latter would still focus on inflation to sustain its dovish rhetoric and the former is likely to continue the play for low inflation and stable rates. All the more so since the EBC will likely be forced to bolster its credibility, to combat deflationary trends and to loosen Fed-induced tighter monetary conditions to support its dovish rhetoric with real ammunition. In these circumstances falling yields (predominantly longer term bonds) are the most likely scenario. But beware the move still seems tactical whereas the mid-term trend is pointing upwards.

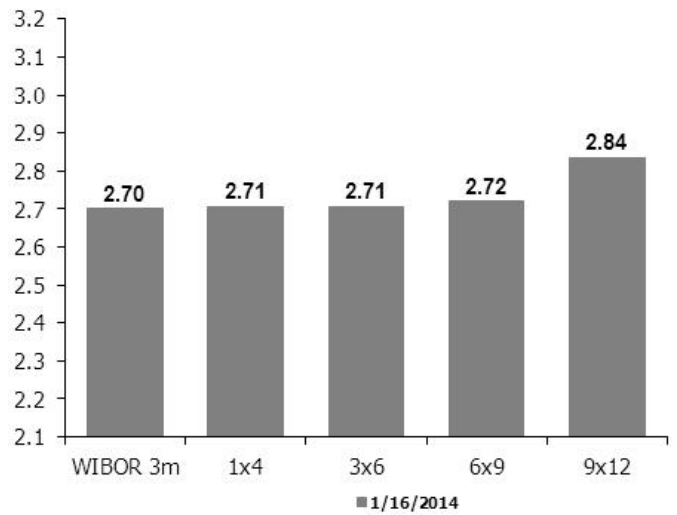
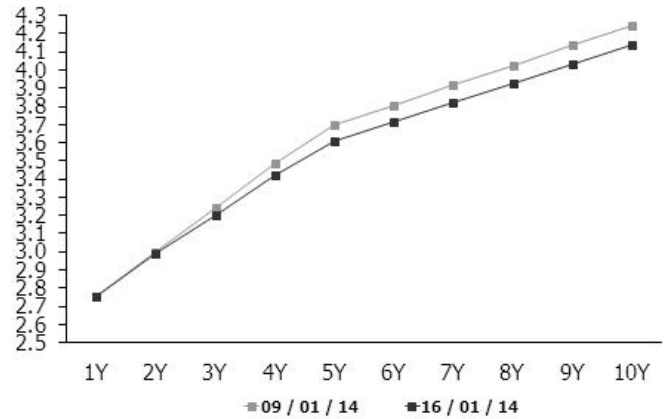
Fixed income

No surprises

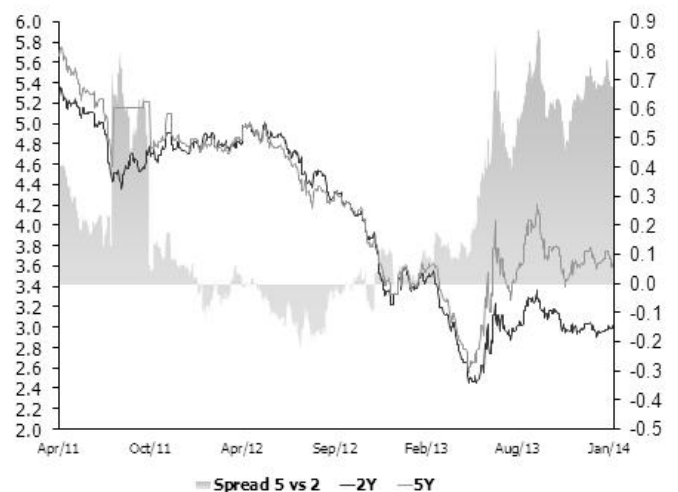
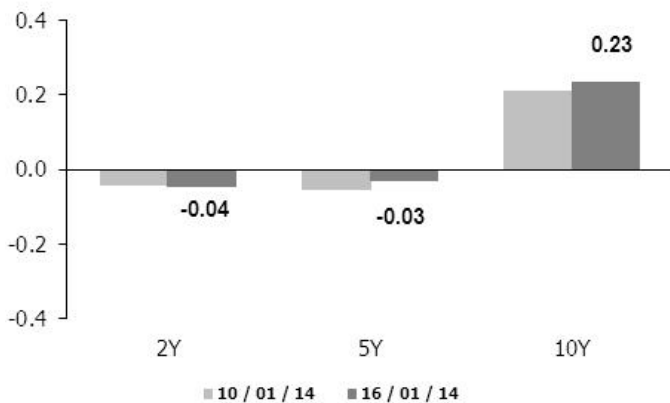
The most important data on our market, CPI inflation, came out at 0.7% YoY, as expected. With no more interesting 'news' from the local economy, investors were following global trends. Yield on DS1023 fell 13bps down to 4.32%. We feel that market expectations for fast GDP growth and ensuing CPI trend are diminishing.

Next week, the mood should be set by speculations/results of an auction. It is going to be last tender with Pension Funds. We expect decent demand for short end bonds from local banks and for longer end bonds from more aggressive foreign investors. We see no signs of lower liquidity/lack of demand for PolGBs, so we suggest keeping long positions in DS1023.

IRS curve



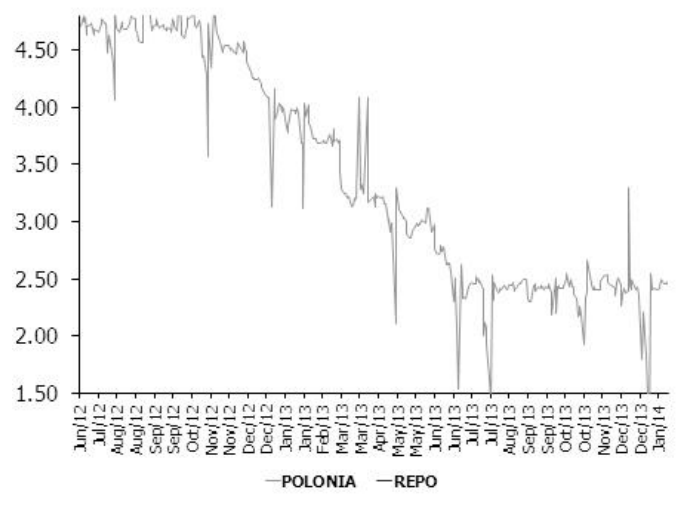
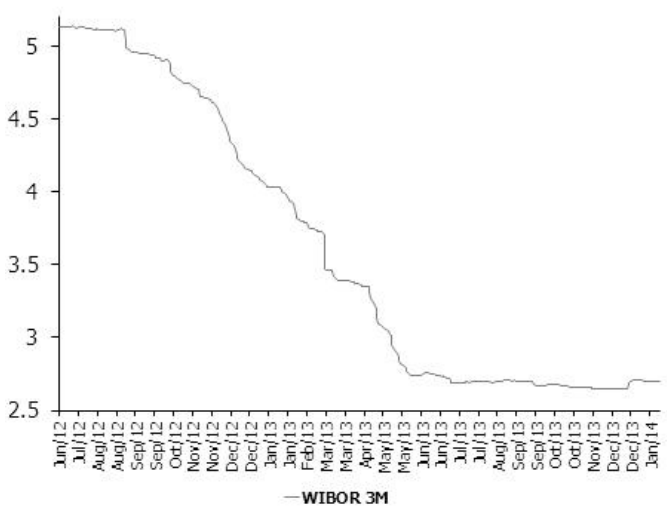
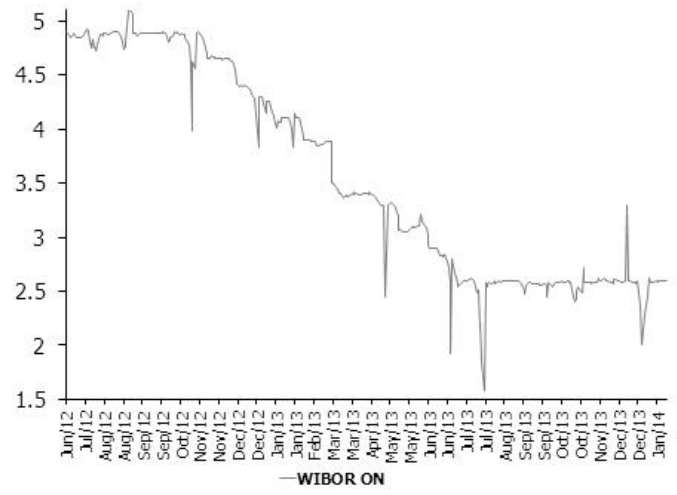
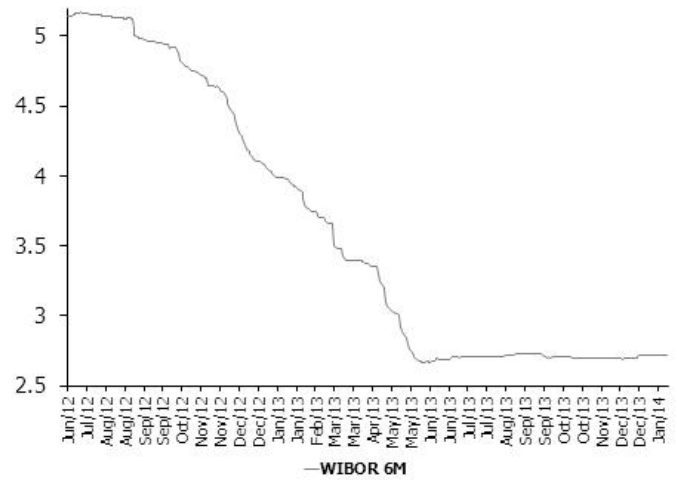
Asset swaps



Money market

Cheap week ahead Last week was very expensive while Polonia fluctuated around 2.46%. As today's OMO was underbid (114.5 vs 122.5 offer), next week should be cheap. That has happened due to upcoming payment on floaters (22nd of January). It will be hard to finance position in these securities during ex-dividend period. Additional OMO is very likely on Tuesday but it shouldn't change a lot and cash should be cheap.

Our recommendation for short term is to sell 1W Polonia (at 2.35 – 2.40 levels) as it should be cheap until the end of reserve and for long term buy 1Y Polonia at 2.44 – 2.46 levels. Risk/reward is favourable, especially when MPC hikes rates in Q4.



Forex

In range EUR/PLN marked a week with an unimpressive 4.14-4.1750 range. It was USD/PLN that was doing all the heavy work, the EUR/PLN being the follower. It is logical in the environment where the mighty FOMC is deciding on the future of all markets. The 2.98/3.00 is the main support zone, and 3.13/3.15 is the crucial resistance which need to be cleared, to confirm the stronger recovery and possible losses for PLN.

Mild recovery The sell-off from the last week continued into this week. The 1 month brushed the floor at 4.5% before a mild recovery at the end of the week. Same statistic, EUR/PLN 1 month ATM mid fixed today at 5.1% (0.3% higher then last week), 3 months EUR/PLN are at 5.6% (0.1% higher) and 1 year is unchanged at 7.2%. The Skew and Currency Spread (difference between USD/PLN vol and EUR/PLN vol) was a tic better bid.

We are skeptical about this recovery as realized volatility is not really confirming that, it looks more like a correction, profit taking on shorts for the time being.

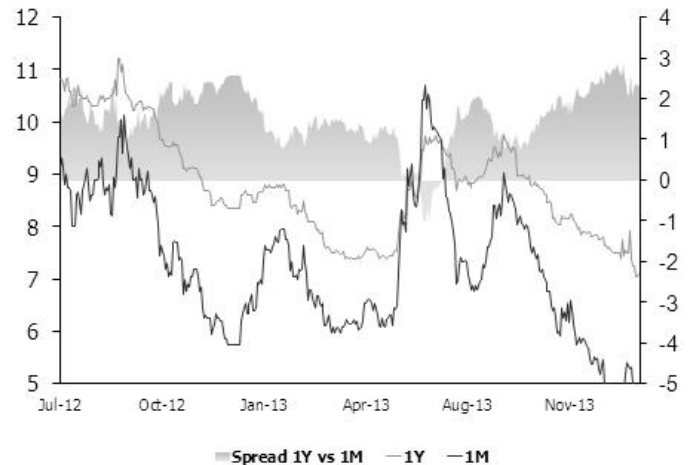
Short-term forecasts

SPOT Main supports / resistances:
 EUR/PLN: 4.1300 / 4.1900
 USD/PLN: 3.0000 / 3.2000

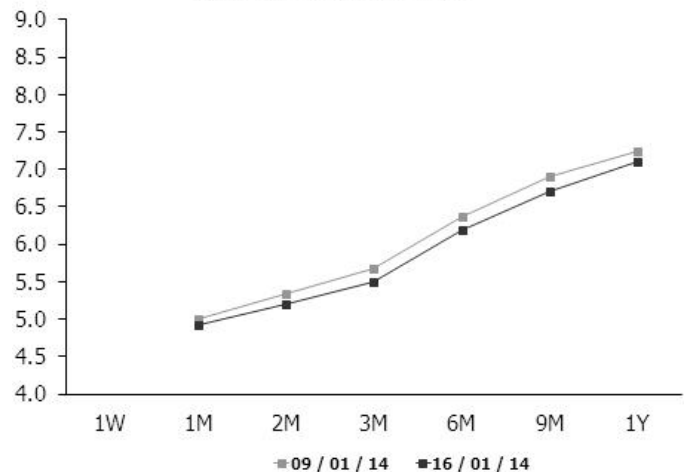
Buy USD/PLN on dips Longs from 4.1550 stopped out at 4.1450 in EUR/PLN. The EUR/PLN trading ranges are so tight, that it is not really tradable anymore. We have decided to switch more interest into USD/PLN instead (it used to be all about USD/PLN in the good old days of PLN trading). We are long USD/PLN at 3.04 we ready to add at 3.0050 with a stop below 2.9850 and with hopes to see 3.10 and above.

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.

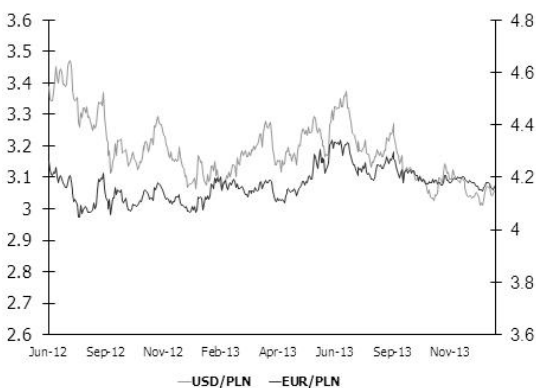
EURPLN volatility



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
1/10/2014	2.60	2.70	2.62	2.62	2.65	2.65	2.71	2.70	2.72	2.83	2.91	2.80
1/13/2014	2.54	2.70	2.65	2.62	2.86	2.65	2.70	2.70	2.72	2.82	2.95	2.81
1/14/2014	2.54	2.70	2.66	2.62	2.87	2.65	2.70	2.70	2.71	2.81	2.94	2.80
1/15/2014	2.42	2.70	2.54	2.62	2.76	2.65	2.71	2.71	2.73	2.86	2.97	2.80
1/16/2014	2.51	2.70	2.62	2.62	2.85	2.65	2.71	2.71	2.72	2.84	2.97	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	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
1/10/2014	2.650	2.687	2.990	2.949	3.670	3.617	4.225	4.435
1/13/2014	2.650	2.683	2.985	2.958	3.588	3.576	4.133	4.374
1/14/2014	2.650	2.652	2.990	2.957	3.605	3.603	4.135	4.366
1/15/2014	2.650	2.701	3.013	2.955	3.630	3.594	4.160	4.399
1/16/2014	2.650	2.629	2.990	2.946	3.610	3.581	4.135	4.366

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
1/10/2014	4.90	5.63	6.33	7.25	7.25	2.21	0.61
1/13/2014	4.68	5.38	6.08	7.05	7.05	2.21	0.61
1/14/2014	4.71	5.38	6.08	7.05	7.05	2.22	0.61
1/15/2014	4.84	5.48	6.13	7.10	7.10	2.21	0.61
1/16/2014	4.93	5.50	6.20	7.10	7.10	2.31	0.69

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
1/10/2014	4.1745	3.0700	3.3818	2.9248	1.3934	0.1525
1/13/2014	4.1600	3.0450	3.3718	2.9449	1.3936	0.1519
1/14/2014	4.1565	3.0400	3.3731	2.9344	1.3861	0.1518
1/15/2014	4.1522	3.0495	3.3614	2.9237	1.3842	0.1513
1/16/2014	4.1647	3.0566	3.3713	2.9191	1.3848	0.1516

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