mBank.pl

January 24, 2014

Polish Weekly Review

Department of Economic Analysis
(research)

Ernest Pytlarczyk, PhD, CFA
chief economist
tel. +48 22 829 01 66
ernest.pytlarczyk@mbank.pl

Marcin Mazurek, PhD
senior analyst
tel. +48 22 829 01 83
marcin.mazurek@mbank.pl

Piotr Bartkiewicz
analyst
tel. +48 22 526 70 34
piotr.bartkiewicz@mbank.pl

Marek Ignaszak
analyst
tel. +48 22 829 02 56
marek.ignaszak@mbank.pl

Department of Financial Markets
(business contacts)

Bartlomiej Malocha, CFA
head of interest rates trading
tel. +48 22 829 01 77
bartlomiej.malocha@mbank.pl

Marcin Turkiewicz
head of fx trading
tel. +48 22 829 01 67
marcin.turkiewicz@mbank.pl

Department of Financial Markets Sales
(business contacts)

Inga Gaszkowska-Gebska
institutional sales
tel. +48 22 829 01 67
inga.gaszkowska-gebska@mbank.pl

Jacek Jurczyński
structured products
tel. +48 22 829 15 16
jacek.jurczynski@mbank.pl

mBank S.A.
18 Senatorska St.
00-950 Warszawa
P. O. BOX 728
tel. +48 22 829 00 00
fax. +48 22 829 00 33
http://www.mbank.pl

Table of contents

Comment on the upcoming data and forecasts

In the forthcoming week the flash GDP estimate for 2013 is to be published on Thursday. According to our forecast the in the fourth quarter of 2013 the GDP growth rate accelerated to 2.5% yoy, which implies 1.5% annual growth rate in whole 2013 – a slightly slower pace than last year's 1.9%.

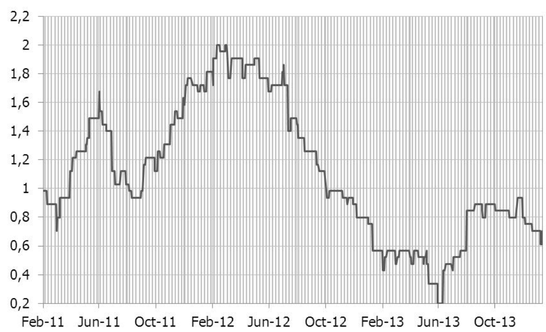
Polish data to watch: January 20th to January 24th

Publication	Date	Period	mBank	Consensus	Prior
GDP y/y (%)	30.01	2013	1.5	1.5	1.9
Inflation expectations	31.01	Jan	0.7	0.7	0.7

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	-	3000	3.087	1/23/2014
5Y T-bond PS0718	-	2400	3.474	1/23/2014
10Y T-bond DS1023	-	4000	4.348	1/23/2014
20Y T-bond WS0429	-	150	3.464	5/16/2013

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



Comment

The industrial output reading moved the index slighlty downward. The forthcoming week brings flash GDP estimate with 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, a 2.5% reading in the final quarter of 2013 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 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. 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

- Correlation of Polish bonds with other EM countries is bound to be much lower than in the past. At the end of the day, Poland should be seen as a satellite state of the euro zone not a typical EM. That is why we see current uptick on yields as artificial and temporary.
- 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. One of them, given already negative positioning among foreign investors, attractive real yields and well prepared for any aberations Polish FinMin we see at the moment.
- Zloty should gradually strengthen on the back of cyclical recovery in Poland. However, current disruptions may temporarily weigh negatively on the Zloty as basket sell-off (all EMs) proceeds. Any depreciation is unlikely to be deep (as in the "Fragile Five") as Poland's fundamentals are comparably strong (record low CA deficit, high real rates, low short-term foreign debt, etc.). Let's not forget about the possibility of NBP interventions should things get out of line with reason.

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 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	2.5	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	4.10	4.05	4.00	3.95
USD/PLN (eop)	3.26	3.32	3.12	3.02	3.07	3.17	3.24	3.25

F - forecast

Economics

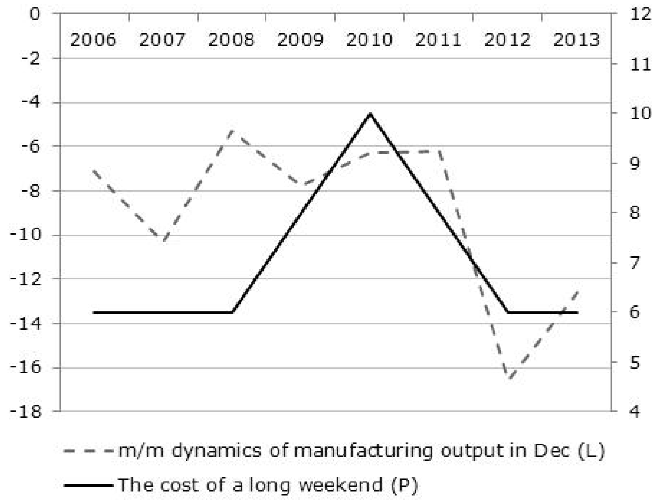
The economy forges ahead, although not without bumps.

The macro figures published last week were a mixed bag. However, we see the economy forging ahead, even though the recovery is plagued with one-off effects which spoil market optimism. A good flavor of the scale of improvement in economic activity can be gleaned from NBP business activity survey released recently - almost all relevant indices shot up decisively upwards after some quarters of meager growth. Upswing is gaining pace. Therefore, when push comes to shove, macro figures will matter, not current (still muted) market expectations. We see that the current consensus within the MPC accepts an economic upswing. However, this upswing is believed to be, contrary the almost every one that occurred in the past, non-inflationary and thereby there is no necessity to lift interest rates. In addition, forward guidance introduced in the autumn successfully blocks any movement of market rates.

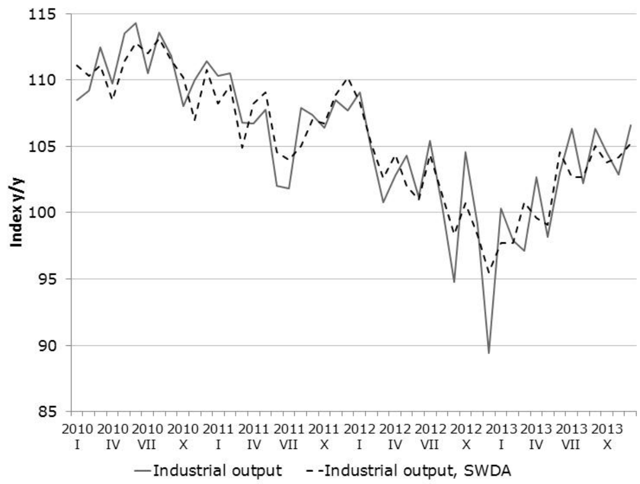
Current situation should become more dynamic in the coming months. Just take a look at the economies that are leading in the cycle, like Great Britain for instance. The strategy the Bank of England is pursuing right now (abandoning forward guidance, looming normalization of interest rates) suggest what may happen in economies where the upswing continues, like Poland. Moreover, it is a global tendency to make monetary policy more discretionary. This way MPC may easily tie interest rates policy more to the cycle and abandon forward guidance for H2 (without notice). We stick to the scenario that GDP acceleration (breaching 4% and upward sloping inflation trend) is going to end up with interest rate hikes in the final quarter of the year. We are not alone in such a scenario - Bratkowski (MPC) recently got it very well too.

Here is what happened last week, in a compact form.

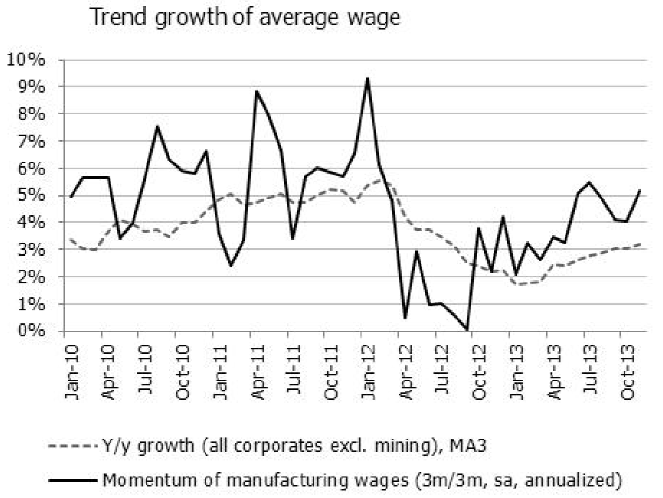
Industrial output hit 6.6% (market consensus 10.5%). Worse reading stems from irregular effects based on possibility to prolong Christmas holidays. We found that it is the ”cost” of prolonging the Christmas holidays (in terms of additional days of leave), not the working days per se that matter for manufacturing readings in December (the picture portrays this regularity quite clearly).



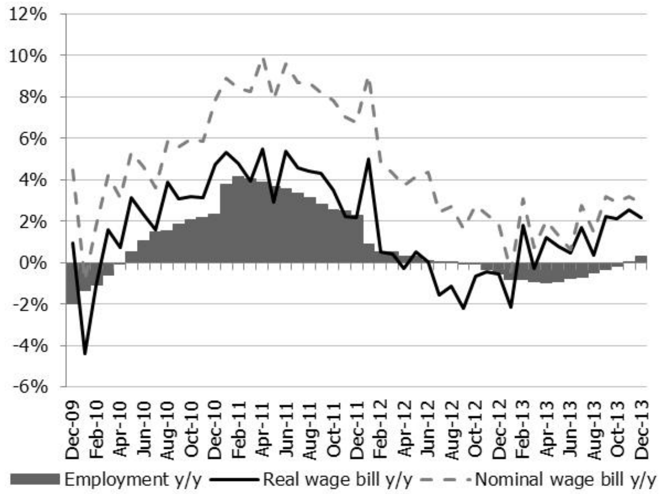
In seasonally adjusted terms industrial output rose from 4.2% to 5.2%. It shows that the upswing is proceeding but we cannot resist saying that mechanical seasonal adjustment is biased downwards as it does not take account of aforementioned, irregular nature of Christmas-related drag. We expect industrial output to rebound in January (despite a huge statistical base effect from the last year a positive reading in annual terms is very likely). This week’s data releases allow us to pin down GDP growth in Q4 at 2.5%.



Labor market. Corporate wages grew in December by 2.7% y/y. Nominal wage growth is obviously low by historical standards, one should however consider the following: (1) the trend is steepening - we estimate that trend growth of wages rose to 3.0% by year end (as compared to 1.5-2% in early 2013); (2) real wage growth is already close to previous cycle highs; (3) Polish labor market is set to tighten this year, which will further accelerate wage growth - we expect a 4.5-5% growth at year end.



Employment in enterprise sector grew by 0.3% y/y, a notch below our forecast of 0.4%. There is no reason to panic, though. It is not a signal of a turnaround in the trend. It is December, and this month is plagued with seasonal effects, always on the downside. Ant it is the size, not the direction of changes which matters for point forecast. This time the seasonal drop was a little bit higher than we thought (10k instead of 7k). However, it was still the best December since 2010 when employment recorded a drop of only 2k. After the seasonal perturbations we are witnessing now, positive tendencies should again take the upper hand but do not look for them already in January. It is a very specific month associated always with a jump in employment (as quoted by the Central Statistical Office) as statistical sample changes to take account of net migration of enterprises in and out from the basket of enterprises with payroll count exceeding 9. Usually the scale and direction of migration is slightly pro-cyclical, but not always. Therefore, January data are often blurred.



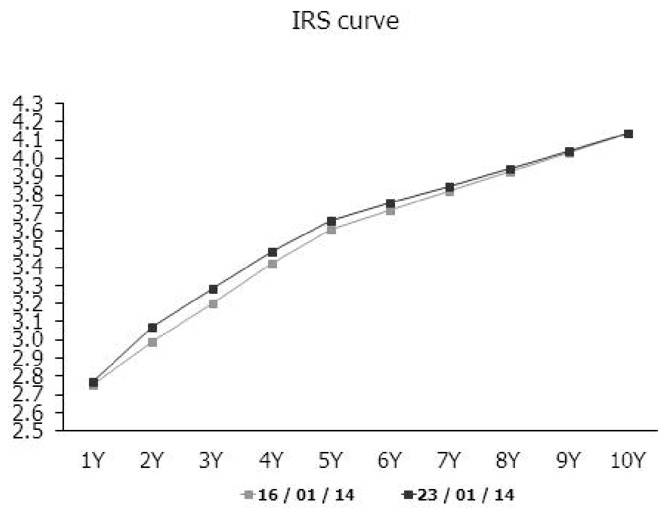
Retail sales growth amounted to 5.8% y/y. It is not a bad figure given the prevailing influence of seasonal factors, whose strength cannot be really tied to the state of the economy. Our favorite measures that exclude the most volatile components are rising substantially: without food and fuels sales growth amounted to 11.2% y/y - the highest number since February 2012. Less seasonal retail items, like car sales, are surprising to the upside and we expect more surprises to come in the coming months since VAT changes (expenses on cars outfitted for goods transport will now be deductible for a few months) encourage firms to make use of this time-limited opportunity. We expect this behavior to be reflected in a broader component of fixed business investment from national accounts. We also sustain our view that strengthening labor market and easy monetary policy (household debt service costs fell decisively throughout last year) are going to lead private consumption higher.

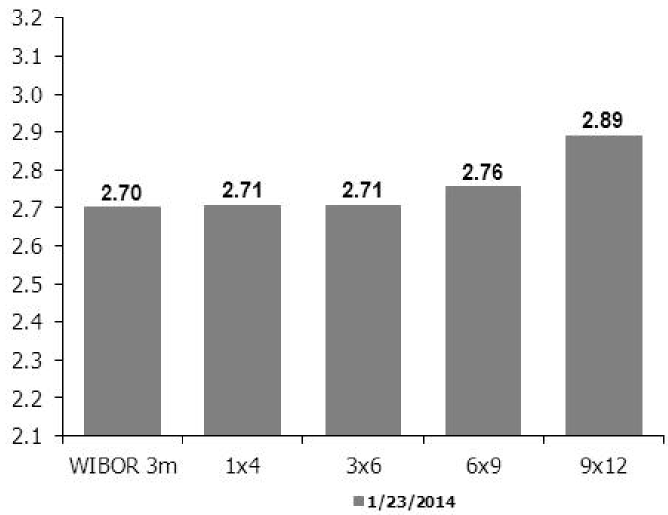
Fixed income

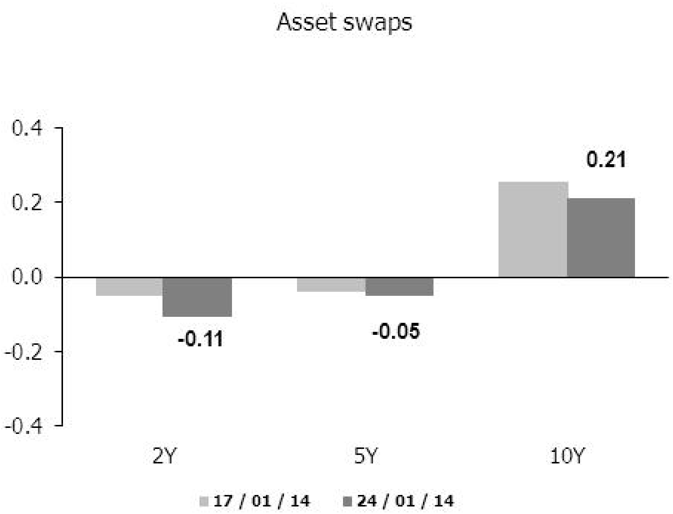
Time to say goodbye

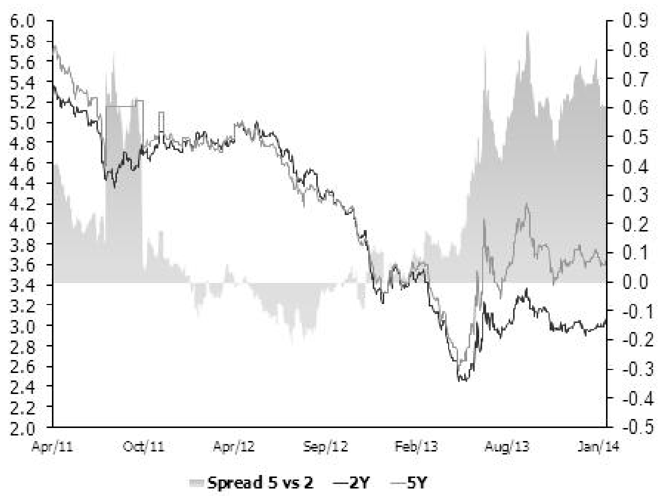
This week sentiment on Fixed Income Market was mixed. From super–optimism before an auction (yield DS1023 below 4.30) to some kind of panic on Friday's EM selloff (yield reached 4.40). Bond traders were preparing for Pension Funds leaving market. One thing is certain - OFE did stablise bond prices a little and now there are fears that the demand for illiquid bonds will decline. We think that the whole process of pension system overhaul is already priced in - whoever were scared about liquidity after 1st Feb, already sold bonds. Decent demand on last auction this Thursday (17bln pln) shows real interest on PolGBs. We believe that corelation of our bonds with bund should remain positive and we suggest to don't panic and keep DS1023 through 1st Feb.

Recommendation: Keep long position on DS1023.







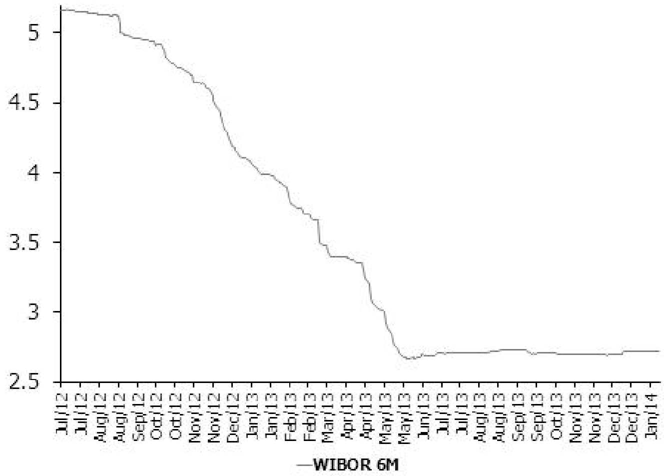


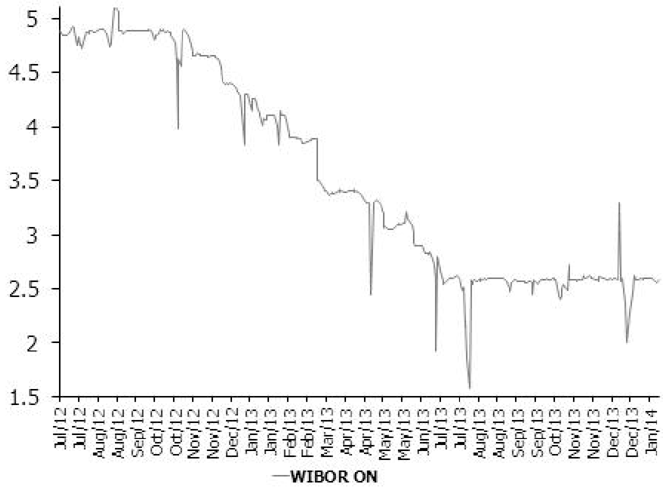
mBank.pl

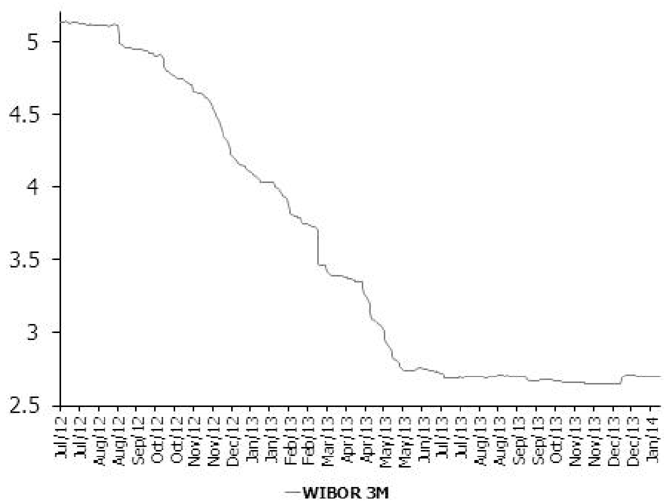
Money market

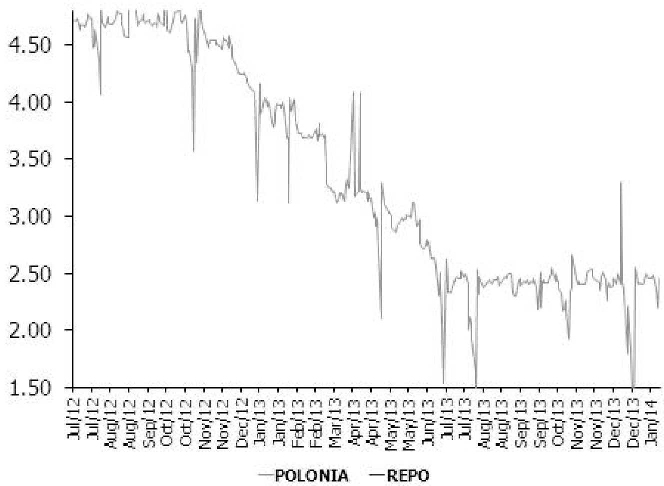
Very strange week for short rates As we expected Friday and Monday was very cheap what resulted in a decline of Polonia rate under 2.40. What was also expected, Central Bank conducted additional OMO on Tuesday. Surprisingly demand at auction was very high (comparing to Fridays OMO) and banks bought 12 bn money bills. Todays OMO was under bid by 3.5 bn what might suggest cheaper next week. That's happened due to end of reserve which will be at January 30th.

Our recommendation is to buy 1Y OIS (at 2.47-2.48 lvl) and sell 9*12 FRA (2.90-2.91 lvl). For short end buy 2W and 3W OIS at 2.39 - 2.41 levels.









Forex

PLN sell-off It was a rude awakening for the whole EM world, and it finally got to PLN as well. EUR/PLN brutally broke out from its sleepy 4.14/4.18 range and we have briefly touched above 4.2250. The TRY/RUB/ZAR were the fire starters, and we still may say that EUR/PLN was treated gently. The next line of defense is 4.23/4.25 and above that we might say that the volatility is back and about to stay because now we still are a bit skeptical...

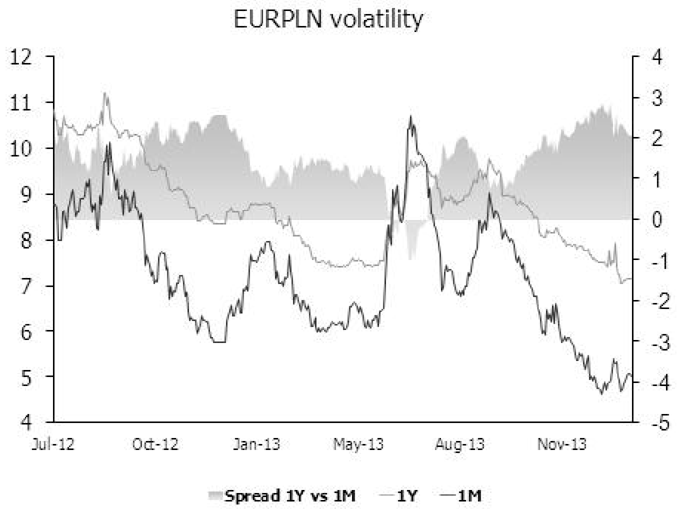
Shot higher It was really an explosion higher today (Friday) on the EUR/PLN vol curve. After the early morning 2 month EUR/PLN ATM paid at 5.9 triggered a vicious run to cover shorts in EUR/PLN and USD/PLN Vega/Gamma. The market lost liquidity and the run from 0.5% spread transformed into 2% spread (nice!). The 1 month EUR/PLN ATM mid is now 7.25% (2.25 higher then a week ago), 3 months are also 7.25% (1.75% up) and finally 1 year is higher by 0.5% to 7.7%. The skew was of course better bid, but currency spread (difference between USD/PLN vol minus EUR/PLN vol) is more less the same as EUR/USD is contradicting EUR/PLN moves. We really need a confirmation for this spike in realized volatility in the future... otherwise it will be simply a dead cat bounce.

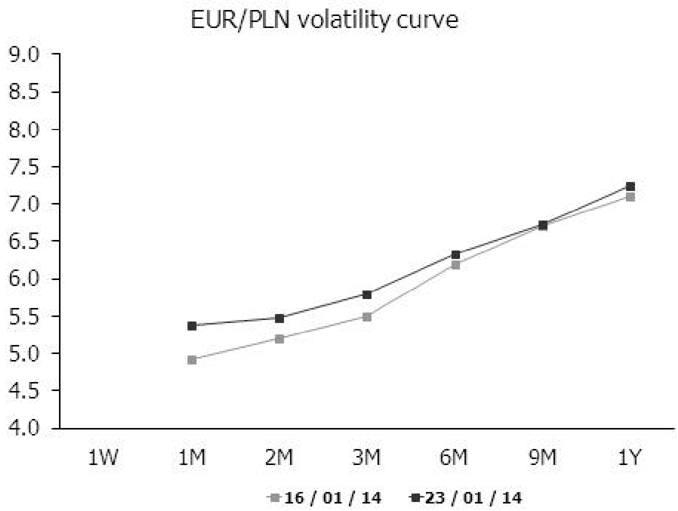
Short-term forecasts

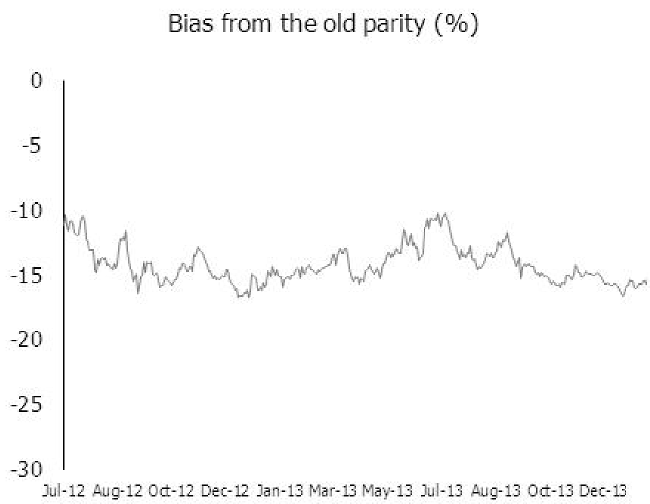
SPOT Main supports / resistances:
EUR/PLN: 4.1800 / 4.2500
USD/PLN: 3.0000 / 3.1000

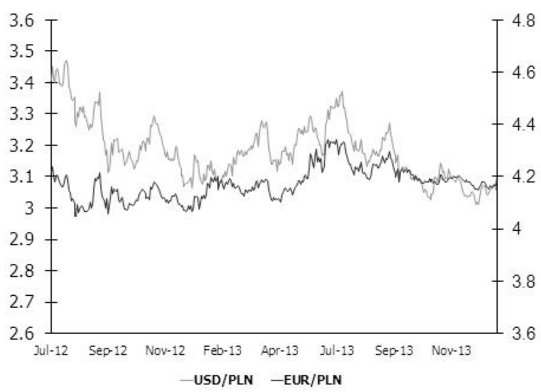
Buy USD/PLN on dips The long on USD/PLN from 3.04 still on, it would work much better. We are moving our stop to 3.03 now and still hoping to see the USD/PLN above 3.10. We are also ready to tactically buy EUR/PLN at 4.19 with stop 4.16 and hopes for 4.25. We are not calling it a "new crisis" at least not yet, but we think the range will move right and simply get wider.

Long backend We have a nice bounce in vols finally but we are not jumping in the air yet. We will repeat from the upper paragraph. "We really need a confirmation to this spike in realized volatility in the future... otherwise it will be simply a dead cat bounce". The risk/reward for being long backend vol is still here but it is not confirmed yet by increased realized volatility, over time. Until then, it's just a spike.









mBank.pl

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
1/20/2014	2.54	2.70	2.65	2.62	2.88	2.65	2.71	2.68	2.74	2.86	3.03	2.83
1/21/2014	2.52	2.70	2.65	2.62	2.88	2.65	2.71	2.71	2.74	2.87	3.03	2.83
1/22/2014	2.42	2.70	2.55	2.62	2.78	2.65	2.70	2.70	2.76	2.89	3.05	2.83
1/23/2014	2.54	2.70	2.67	2.62	2.90	2.65	2.71	2.71	2.76	2.89	3.08	2.83
1/24/2014	2.54	2.70	2.67	2.62	2.90	2.65	2.71	2.71	2.76	2.89	3.08	2.83

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
OK0716	1/23/2014	7/25/2016	92.70	3.09	3000	4087	3375
PS0418	1/23/2014	4/25/2018	101.00	3.47	2400	3160	2440
DS1023	1/23/2014	10/25/2023	97.25	4.35	4000	5290	4125

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0715	5Y IRS	PS0718	10Y IRS	DS1023
1/20/2014	2.650	2.698	3.025	2.945	3.605	3.577	4.105	4.341
1/21/2014	2.650	2.786	3.020	2.964	3.600	3.615	4.090	4.374
1/22/2014	2.650	2.605	3.043	2.962	3.630	3.606	4.120	4.363
1/23/2014	2.650	2.750	3.070	2.965	3.655	3.607	4.140	4.350
1/24/2014	2.650	2.750	3.070	2.965	3.655	3.607	4.140	4.350

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
1/20/2014	5.08	5.78	6.23	7.15	7.15	2.35	0.69
1/21/2014	5.09	5.80	6.28	7.15	7.15	2.35	0.69
1/22/2014	5.01	5.61	6.26	7.15	7.15	2.23	0.61
1/23/2014	5.38	5.80	6.33	7.24	7.24	2.46	0.71
1/24/2014	5.38	5.80	6.33	7.24	7.24	2.46	0.71

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
1/20/2014	4.1586	3.0680	3.3719	2.9435	1.3793	0.1516
1/21/2014	4.1647	3.0763	3.3706	2.9395	1.3749	0.1511
1/22/2014	4.1669	3.0761	3.3758	2.9478	1.3789	0.1514
1/23/2014	4.1679	3.0559	3.3843	2.9299	1.3733	0.1516
1/24/2014	4.2014	3.0727	3.4237	2.9871	1.3752	0.1529

Disclaimer

Distribution and use of this publication The review note is based on the information available to the public. This review creates exclusively a marketing information as defined in Paragraph 9 Section 1 of the Decree of Minister of Finance dated November 20, 2009 on procedures and conditions to be followed by investment firms and banks mentioned in Article 70 Section 2 of Law on Trading in Financial Instruments dated July 29, 2005 as well as by custody banks. This review note is provided to you for information purposes only and is not intended as advice on any particular matter or as recommendation, offer or solicitation for purchase of sale of any financial instrument and should not be taken as such. mBank SA, its directors, officers, executives, managers, servants or agents expressly disclaim all liability to any person in respect of any-thing, and in respect of the consequences of anything, done or omitted to be done, wholly or partly, in reliance upon the whole or any part of the contents of this review note. The opinions and estimates contained herein reflect the current judgment of the author(s) on the date of this document and are subject to change without notice. The opinions pointed in review do not necessarily correspond to the opinions of mBank SA. The past performance of financial instruments is not indicative of future results. No assurance can be given that any financial instrument or issuer described herein would yield favourable investment results. mBank and/or its principals or employees may have a long or short position or may transact in the financial instrument(s) and/or securities referred to herein or may trade in such financial instruments with other customers on a principal basis. No client or other reader should act or refrain from acting on the basis on any matter contained in it without taking specific independent professional advice on the particular facts and circumstances in issue. Copyright protection exists in this publication and it may not be, even partially, reproduced of distributed without the prior written agreement with mBank SA.