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Polish Weekly Review

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Comment on the upcoming data and forecasts

The forthcoming week begins with inflation expectation and revised Q4 current account readings, both publication of mere importance for the markets. The former tends to follow closely the low and stable CPI readings, whereas the latter isn't expected to diverge much from what is implied by monthly figures (deficit of approx. 2 bn EUR). Tuesday brings manufacturing PMI for march. The index is expected to decline slightly amid disappointing readings for Germany and tensions between Ukraine and Russia.

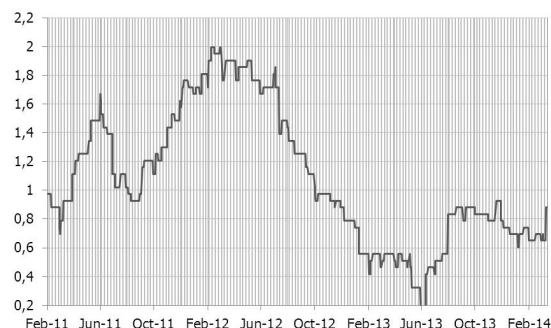
Polish data to watch: March 10th to March 14th

Publication	Date	Period	mBank	Consensus	Prior
Inflation expectations y/y (%)	31.03	Mar	0.7	0.7	0.6
Current account (m EUR)	31.03	Q4	-2013	-2013	-2072
PMI manufacturing (pts.)	01.04	Mar	55.4		55.9

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	-	3500	3.066	3/6/2014
5Y T-bond PS0718	-	2000	3.882	2/13/2014
10Y T-bond DS1023	-	2000	4.541	2/13/2014
20Y T-bond WS0429	-	150	3.464	5/16/2013

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



Comment

Sharply up after lower-than-expected unemployment rate. The index is thus back to its December highs. Next week brings only one opportunity for surprise - the PMI.

* 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 2013. The upswing is going to be continued.
- However, the events in Ukraine made us put a slight downside risk to our near term forecasts in a form of a short soft patch. We therefore flattened GDP growth path in H1 and assume a catch up thereafter. Therefore we are still bullish on 2014 and expect the Polish economy to grow by 3.5% (4% in the final quarter). 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 re-launch of EU funding. Thus, 2-3 years of solid economic growth are our baseline scenario.
- Inflation stays subdued (or even very low) for the next few months supported by a possibility of lower meat prices and deflating tradables basket.
- The MPC has already acknowledged low inflation and possible negative spillovers from Ukraine events. As a consequence forward guidance has been strengthened – that practically means stable rates till the end of the year. We feel the MPC is focused on strengthening low rates environment and stay very dovish (this includes a risk of a rate cut). Although we await normalization of monetary policy in 2015, low inflation, strong zloty (vs EM basket) makes discussion of rate hikes non-existent at the moment.

Financial markets

- Local factors still speak in favor of Polish bonds including a continuation of positive credit story and Poland's status a regional safe haven. Poland is seen as a satellite of euro zone, not a typical EM. Therefore it can absorb part of funds originally re-directed from EMs to Europe (cross-over investors). We are bullish on Polish short term bonds due to non negligible risk of a rate cut in Poland (negative spillovers from Ukraine amid strong zloty vs. EM currencies may be seen by the MPC as an excuse to abandon stable rates policy).
- We are neutral/positive on longer bonds due to conflicting global signals (QE talks at the ECB and rate normalization in the US).
- Polish fundamentals (low CA deficit, high real rates, low short-term foreign debt, accelerating GDP growth) speak in favor of the zloty in mid-term on cyclical basis and as far as potential differentiation among EMs is concerned. Short-term, however, Ukraine events and ensuing risk aversion changes dynamics against the zloty that may be trading weaker. The more so since the PLN is at highs towards its peers in CEE, tempting to be the first best solution to limit investors's exposition on the region.

mBank forecasts

	2009	2010	2011	2012	2013	2014F
GDP y/y (%)	1.6	3.9	4.5	1.9	1.6	3.5
CPI Inflation y/y (average %)	3.5	2.8	4.3	3.7	0.9	1.4
Current account (%GDP)	-1.6	-4.5	-4.9	-3.5	-1.5	-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	2.50

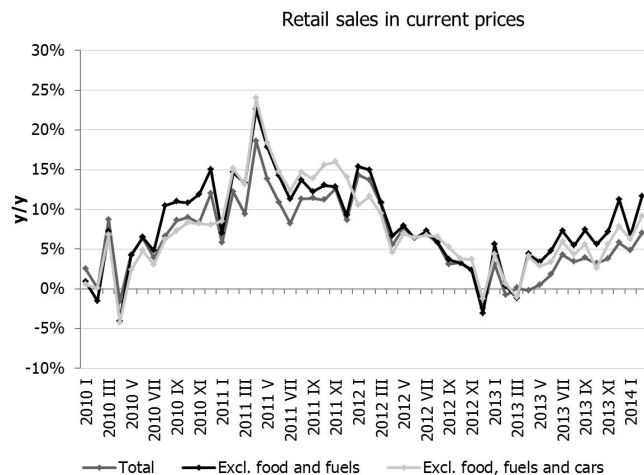
	2013	2013	2013	2013	2014	2014	2014	2014
	Q1	Q2	Q3	Q4	Q1 F	Q2 F	Q3 F	Q4 F
GDP y/y (%)	0.5	0.8	1.9	2.7	3.0	3.1	3.6	4.3
Individual consumption y/y (%)	0.0	0.2	1.0	2.1	2.3	2.6	2.8	3.1
Public Consumption y/y (%)	-0.1	4.3	1.7	2.1	2.0	2.0	2.0	3.0
Investment y/y (%)	-2.1	-3.2	0.6	1.3	3.8	5.3	7.5	8.5
Inflation rate (% average)	1.3	0.5	1.1	0.8	1.0	1.5	1.2	2.0
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	2.50
Wibor 3M (% eop)	3.39	2.73	2.67	2.71	2.65	2.65	2.65	2.65
2Y Polish bond yields (% eop)	3.19	3.07	3.06	3.05	3.00	3.00	3.10	3.10
10Y Polish bond yields (% eop)	3.94	4.34	4.48	4.35	4.30	4.30	4.80	5.00
EUR/PLN (eop)	4.18	4.33	4.22	4.15	4.20	4.20	4.10	4.00
USD/PLN (eop)	3.26	3.32	3.12	3.02	3.04	2.99	2.94	2.97

F - forecast

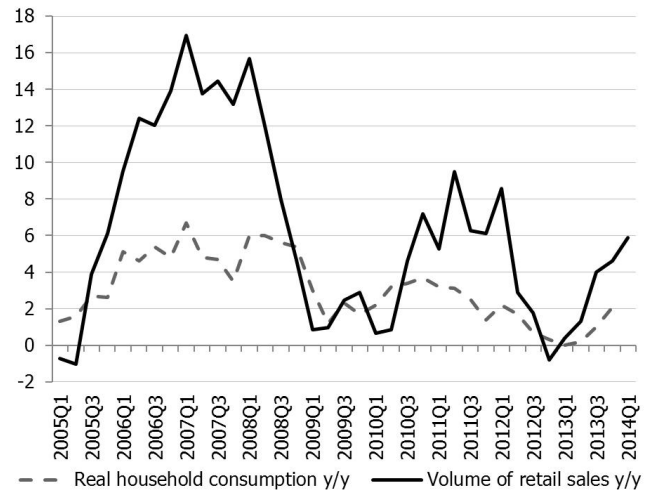
Economics

Poland: Retail sales remain in uptrend. Strong data releases overshadowed by low CPI and Ukraine concerns.

In February, retail sales grew by 7% y/y (market consensus 6.0%, our forecast 6.1%) as compared to 4.8% recorded in January. The surprise was primarily driven by slightly higher than expected automobiles sales (+24.9% y/y) and a surge of sales in "others" category, containing mainly specialized retailers. The latter can be attributed to extraordinarily good weather in February, which boosted construction and renovation works. This time food sales behaved in line with expectations, while it was a factor weighing down on aggregate retail sales recently. Our favorite measures of core sales also surged to new heights: retail sales excluding food and fuels surged from 6.7% to 11.7% y/y; if one excludes cars as well, the acceleration is still impressive - from +6.2% to 9.1% y/y. By all measures, February was the best month for retailers since two years.



A boost in automobile sales can be attributed to the VAT discount window at the beginning of the year. As this opportunity ends in March, second-quarter retail sales will probably be brought down by softer car sales. Nevertheless, the reading comes in line with our scenario of accelerating growth of Polish economy, in which the domestic demand will begin to play an increasingly important role. In addition, the reading implies further acceleration in household consumption in the first quarter of the year and is broadly consistent with our forecast of +2.3% y/y. In the forthcoming months we expect to observe a continuation of uptrend in all aggregates related to the domestic demand and, in the second half of the year, significant surge of capital and infrastructural investments.



Although the reading should be perceived as very positive (the more so since it was accompanied by a sharp and surprising drop in seasonally adjusted unemployment rate), it will have a rather limited impact on the MPC's stance. Growth of 3% magnitude has already been factored in and the Council is more concerned about downside risks than about overheating, especially with the amount of slack in the economy estimated by the NBP staff. The expectations for Polish interest rates are at the moment primarily determined by the perspective of low inflation and negative spillovers from the Ukrainian conflict. Thus, we continue to see some scope for short-end yields to decline.

Fixed income

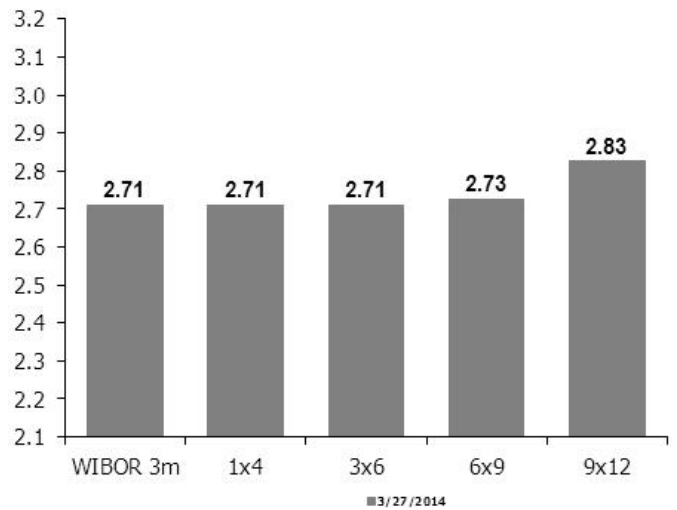
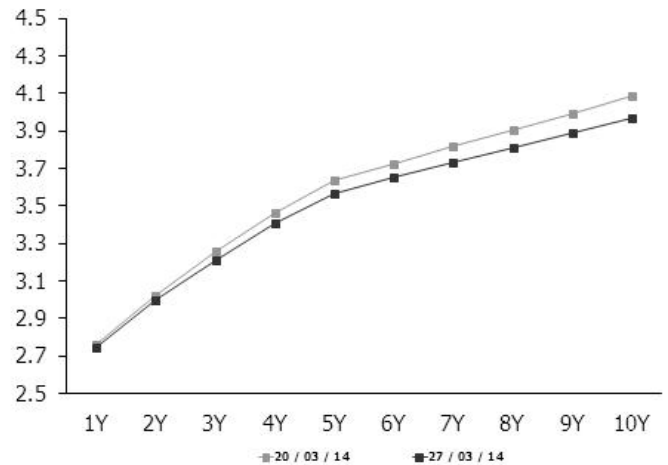
A desired item

POLBGs trade strongly experiencing constant inflows. Locally, bonds are supported by dovish MPC which, despite optimistic GDP scenario even prolonged its forward guidance for low rates. Globally, while US winter soft patch lasts (?), growing market expectations that ECB will be forced to act (cut, QE form?) have added some to this bullish stance. Bond curve, driven by inflows, has flattened a bit - 2Y benchmark trades 8 bps lower, while 10Y 15bps.

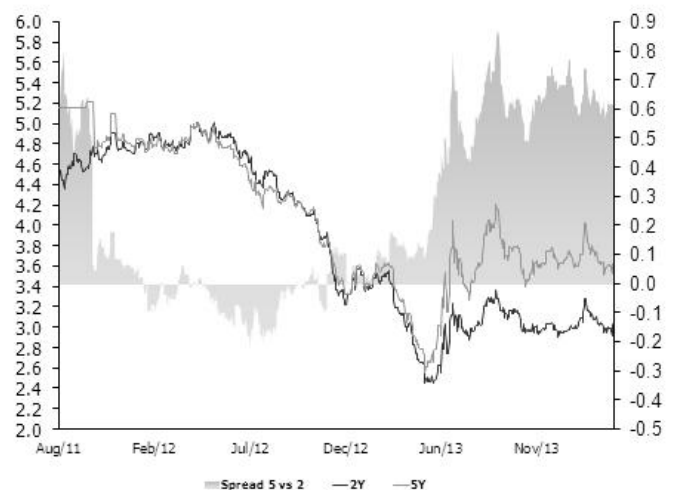
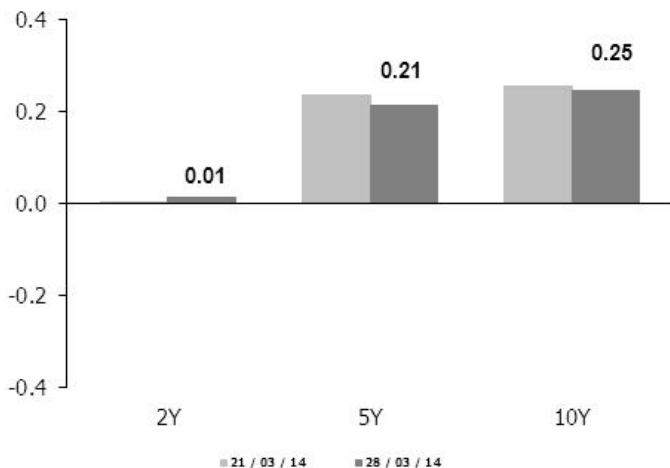
Despite the recent rally we still see value in 2-5Y bonds so we leave our long position unchanged. The long end at current levels we consider as:

- either too vulnerable to any possible risk (Ukraine, pay-rolls);
- or well supplied by MinFin on April auctions (current 'encouraging' levels).

IRS curve



Asset swaps

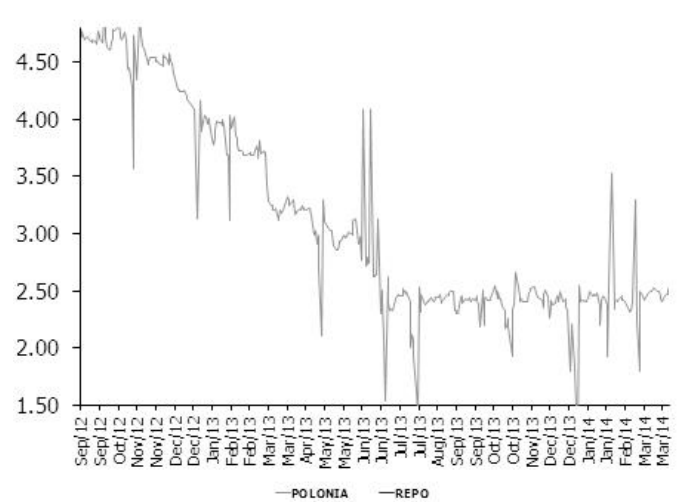
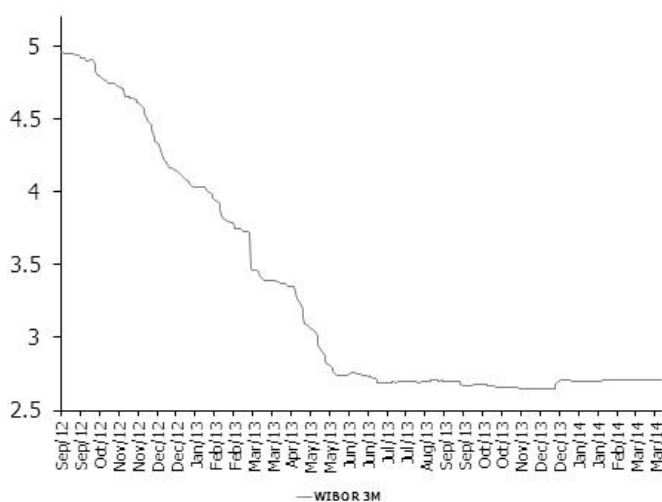
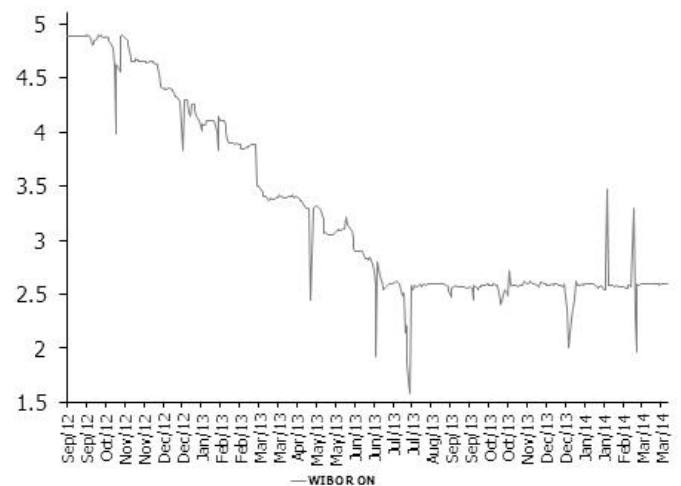
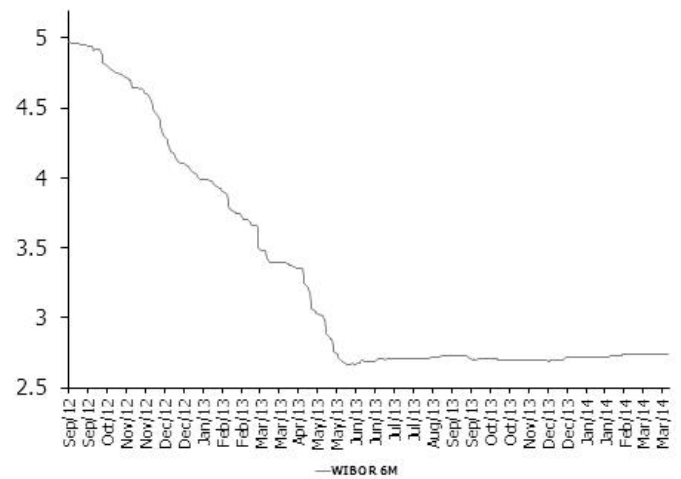


Money market

End of the reserve without surprises Shortest rates remained stable all week, glued to the main market rate. Today's 2 OMOs are due to the last day of the settlement period. First well underbid reflecting the risk aversion, second will probably square the surplus. Nevertheless, we will enter the new reserve with substantial surplus of cash. Another OMO on Tuesday?

Volatility craving Boring week for longer rates with very narrow range trading. Next week should be more interesting with PMI and ECB. Let us keep fingers crossed for some volatility.

Short bonds look still attractive



Forex

PLN stronger Ukraine is not longer a threat for PLN, as we have reached fresh lows this week with EUR/PLN falling to 4.1640. In our opinion, the mighty range of 4.14 - 4.26 is here to stay. There is really little left of the "PLN factor" in current EUR/PLN price movement, it is global sentiment driven generally. The dual nature of PLN as an emerging or semi-safe-haven is also smoothing its trajectory.

Lower vols Stronger PLN once again forced vol curve lower. The 1 month EUR/PLN ATM is today 5.9% mid (0.8% lower), 3 months are 6.7 % (0.4% lower) and finally 1 year fixed at 7.4% (0.3 % lower). The low realized volatility was also not helping both main curves (EUR/PLN and USD/PLN). The 1 year was given in good amount at 7.6% and 3 month at 6.6%. The skew was better offered across the curve, together with currency spread (USD/PLN vol minus EUR/PLN vol) .

Short-term forecasts

SPOT Main supports / resistances:

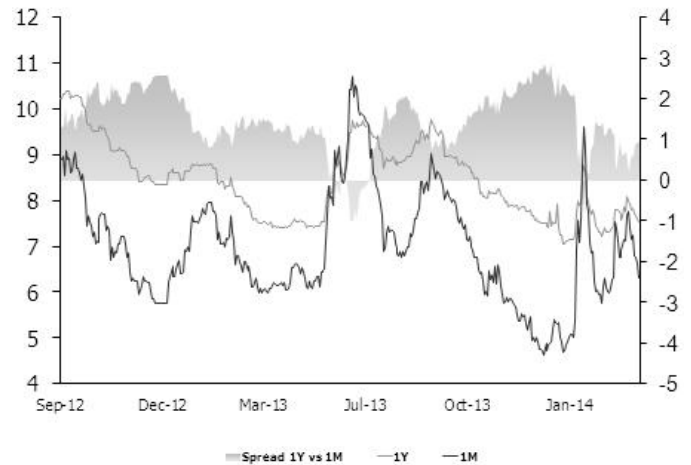
EUR/PLN: 4.1400 / 4.2600

USD/PLN: 3.0000 / 3.1500

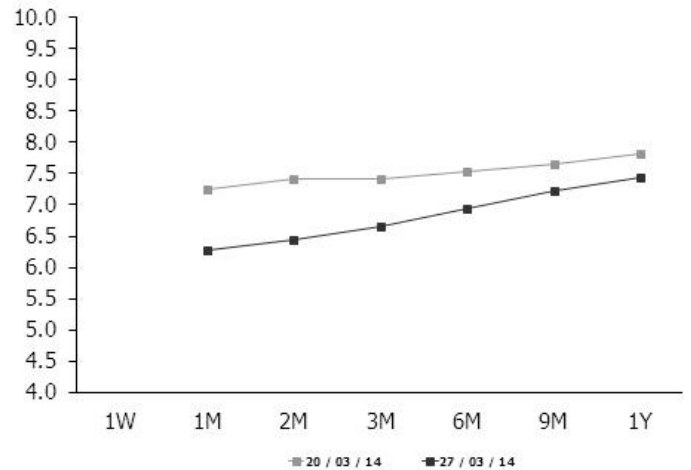
Play range Shorts in EUR/PLN from 4.2350 covered 4.1750. Already long 4.1650 and ready to add 4.1450 with a stop at 4.1300 and hopes for a move above 4.22. Basically we try not to over-think, if that is a range - play it until the market proves you wrong.

Cautious bids We have reloaded our longs in mid/back of the vol curve. No certain trigger, we simply believe in a tight range in vols, which is closely correlated to PLN strength. If the current test of the lower parts of the range, would run off steam, and we would see a move above 4.20, the volatility will dutifully follow higher.

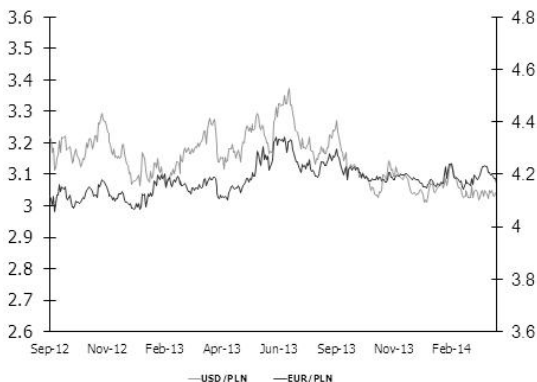
EURPLN volatility



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
3/24/2014	2.55	2.71	2.68	2.64	2.92	2.69	2.72	2.72	2.74	2.83	3.00	2.77
3/25/2014	2.56	2.71	2.70	2.64	2.94	2.69	2.71	2.72	2.74	2.84	3.02	2.82
3/26/2014	2.48	2.71	2.62	2.64	2.86	2.69	2.72	2.72	2.74	2.83	3.00	2.76
3/27/2014	2.86	2.71	2.91	2.64	2.85	2.69	2.71	2.71	2.73	2.83	2.98	2.81
3/28/2014	2.86	2.71	2.91	2.64	2.85	2.69	2.71	2.71	2.73	2.83	2.98	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
OK0716	3/6/2014	7/25/2016	93.07	3.07	3500	6104	3754
PS0718	2/13/2014	7/25/2018	94.45	3.88	2000	4405	2220
DS1023	2/13/2014	10/25/2023	95.80	4.54	2000	3702	1791

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0715	5Y IRS	PS0718	10Y IRS	DS1023
3/24/2014	2.690	2.719	2.990	3.006	3.580	3.802	3.990	4.255
3/25/2014	2.690	2.741	3.000	3.023	3.600	3.827	4.000	4.263
3/26/2014	2.690	2.677	3.000	3.011	3.570	3.812	3.975	4.245
3/27/2014	2.690	2.743	2.995	3.009	3.570	3.783	3.970	4.216
3/28/2014	2.690	2.743	2.995	3.009	3.570	3.783	3.970	4.216

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1Y	
3/24/2014	6.75	7.08	7.33	7.68	7.68	3.15	0.82	
3/25/2014	6.63	6.98	7.25	7.60	7.60	3.15	0.82	
3/26/2014	6.31	6.78	7.10	7.55	7.55	3.02	0.76	
3/27/2014	6.28	6.65	6.95	7.45	7.45	2.97	0.78	
3/28/2014	6.28	6.65	6.95	7.45	7.45	2.97	0.78	

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
3/24/2014	4.1990	3.0483	3.4448	2.9744	1.3411	0.1530
3/25/2014	4.1910	3.0342	3.4365	2.9677	1.3434	0.1527
3/26/2014	4.1835	3.0318	3.4211	2.9633	1.3404	0.1526
3/27/2014	4.1826	3.0401	3.4309	2.9749	1.3400	0.1525
3/28/2014	4.1677	3.0374	3.4194	2.9688	1.3470	0.1522

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