April 11, 2014

Polish Weekly Review

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Comment on the upcoming data and forecasts

A busy week ahead of us, abundant with macro releases for March. The week begins with Monday's money supply reading. M3 has most likely decelerated in March, again, amid last year's statistical base in corporate deposits and further deceleration of households deposits. Tuesday brings the CPI release. In our view, CPI stood still or ticked down by at most 0.1 pp. in March, pushed down by low food prices. However, the release is subject to high uncertainty being the result of price disturbance caused by an unusually late Easter this year and the uncertain pass-through rate of the hike in excise tax for spirits. The labour market data (Wednesday) will most probably indicate further recovery: continuation of an uptrend in the employment and dynamic wage growth. On the same day the Statistical Office will publish a revision of quarterly national accounts for 2013 and the concurrent information about general government deficits last year. The laborious week ends with Thursday's reading of industrial production and PPI. The latter will exhibit further producers' price deflation driven by declining copper and oil prices. Whereas, the industrial output has been negatively influenced by lower energy and mining production (weather-related in the former, China-related in the latter case), amid impressive increase of manufacturing, amounting to 9% yoy.

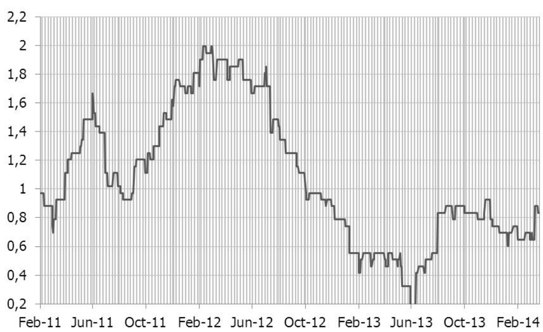
Polish data to watch: April 14th to April 18th

Publication	Date	Period	mBank	Consensus	Prior
M3 y/y (%)	14.04	Mar	4.8	4.8	5.3
CPI y/y (%)	15.04	Mar	0.6 - 0.7	0.8	0.7
Government deficit (% GDP)	16.04	2013			-3.9
Core CPI y/y (%)	16.04	Mar	0.9	0.9	0.9
Employment y/y (%)	16.04	Mar	0.4	0.4	0.2
Wages y/y (%)	16.04	Mar	4.6	3.9	4.0
Sold industrial output y/y (%)	17.04	Mar	6.9	6.3	5.3
PPI y/y (%)	17.04	Mar	-1.3	-1.2	-1.4

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	-	3500	4.261	4/3/2014
20Y T-bond WS0429	-	150	3.464	5/16/2013

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



Comment

Unchanged. Next week brings a lot of opportunities for surprises: CPI, PPI, industrial output, to name a few.

* 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 geografically 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 strenghtening 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 a non negligible risk of a rate cut in Poland (negative spillovers from Ukraine amid strong zloty vs. EM currecies may be seen by the MPC as an excuse to abandon stable rates policy). Although a cut itself is not our baseline, it may draw investors' attention from time to time.
- We are neutral/positive on longer bonds due to conflicting global signals (QE talks at the ECB and inevitable rate normalization in the US due to better data).
- 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 still close to local 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	2.0	1.6	3.5
CPI Inflation y/y (average %)	3.5	2.8	4.3	3.7	0.9	1.0
Current account (%GDP)	-1.6	-4.5	-4.9	-3.5	-1.3	-1.9
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 Q1	2013 Q2	2013 Q3	2013 Q4	2014 Q1 F	2014 Q2 F	2014 Q3 F	2014 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	0.7	1.0	0.8	1.6
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	2.71	2.72	2.72	2.72
2Y Polish bond yields (% eop)	3.19	3.07	3.06	3.05	3.01	3.00	3.10	3.10
10Y Polish bond yields (% eop)	3.94	4.34	4.48	4.35	4.23	4.20	4.60	5.00
EUR/PLN (eop)	4.18	4.33	4.22	4.15	4.17	4.20	4.10	4.00
USD/PLN (eop)	3.26	3.32	3.12	3.02	3.04	3.01	2.96	2.97

F - forecast

Economics

MPC: Rates unchanged, Belka presents a very balanced assessment.

In line with expectations, the MPC left interest rates unchanged during this week's meeting. Thus, the main reference rate stands at 2.5%. The tone of the statement and the press conference were, however, less dovish than we anticipated (and contrary to some investors' expectations). It must be noted that it wasn't hawkish either, some market participants were apparently too enthusiastic about the lack of a cut (a theoretically impossible move). As for the tone, several issues must be raised.

First, forward guidance was not extended. This runs against recent comments made by Belka and several other MPC members, which suggested that the period of interest rate stability should be extended towards the end of the year. During the conference, however, Belka almost pledged to do that in July, when new projections are available.

Second, Belka refrained from presenting precise estimates of the impact of Ukrainian / Russian situation on the Polish economy. Please note that this is a step back from last month's meeting when some numbers were given to the press. The governor merely indicated that the impact will be negative. Belka, just as we do, does not expect this situation to derail the Polish recovery – all references to the state of the economy suggested that the recovery is proceeding in a lively fashion. We stand firm by our forecast of 3.5% growth in 2014. Our estimates of negative fallout from Ukraine / Russia (0.6-0.8% of GDP) are static and do not include feedback effects, e.g. related to lower prices of unsold exports stimulating domestic demand. Therefore, we are probably overestimating the impact.

Third, when asked about further rate cuts, Belka replied that they would be pro-cyclical in light of current economic forecasts. He indicated that rate cuts were not discussed during the meeting only to withdraw and point that cuts were not referred to in the statement. Conclusion – there is probably some support for further easing within the Council. This is exactly how we consider the issue of rate cuts. This is neither ours, nor the Council's baseline scenario (nevertheless, some members are open to it). The likelihood of such scenario is very low (but definitely not zero) but would have enormous payout for market participants if materialized. This would require several events to occur. The list includes: events that are both likely and whose impact can reasonably be assessed by the MPC (if the ECB embarks on a QE programme, sharp appreciation of PLN would occur); events outside our baseline scenario (risks to economic growth materialize to such an extent that the recovery itself is threatened – it would take several months to recognize, verify and include that in NBP staff projections).

Why shouldn't we describe the tone of the meeting as hawkish? One, no warnings of rising inflation (risks are balanced, though). Two, no references to monetary tightening, either. In fact, while discussing inflation targeting, Belka suggested that current policy of low interest rates is good for consumers and should not be abandoned.

Our scenario for monetary policy expectations in Poland (similiarly to the global one) divides the year into two parts. In the first half there is still room for surprises stemming from low inflation and unconventional actions taken by the central banks (for that reason bond yield increases have consistently been premature). Factors that were not anticipated (Ukrainian crisis) tip the balance of risks in favor of a delayed start of monetary tightening and note that the cut is not necessary for the downward drift in Polish bond yields to continue for some time. However, low yields during a maturing recovery are anomalous. We believe that the recovery will not be derailed and, through the labor market, rising wages and prices of services, the second half of the year will be marked by rising core inflation (similiar developments in the US should be coincident). As a result, of course, expectations of momentary tightening will be reinvigorated.

Fixed income

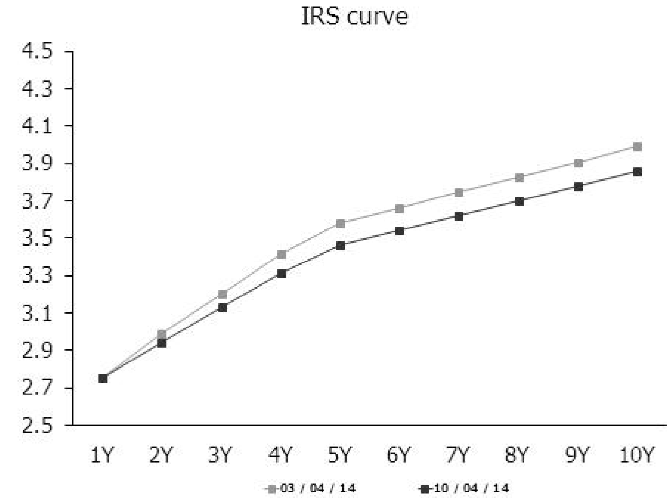
Wait...

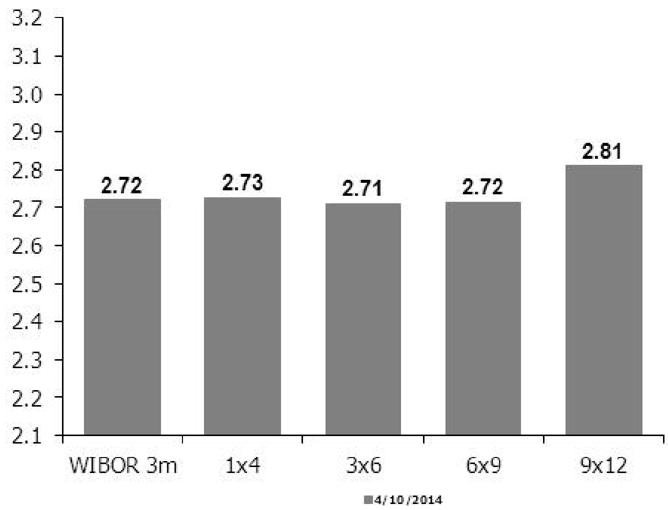
So, a 75 bps rally (since end of January) is behind us. Decent foreign inflows in POLGBs, just slightly netted by local T/P, have took us to the magical 4.00 (DS1023) barrier. Market has taken a deep breath and balanced trading here with rather low (!) volumes.

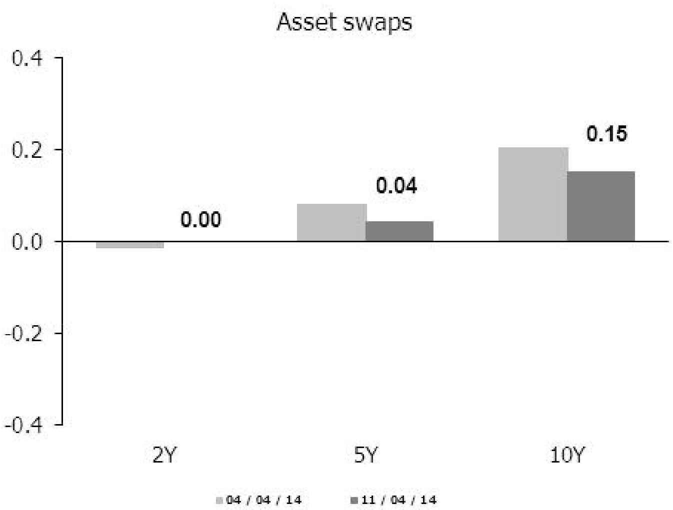
Tapering, accelerating GDP growth, CPI pressures – ideas already forgotten, and so we all accepted low rates regime. Instead of focusing on developments in the US economy, possible ECB QE took power on traders minds.

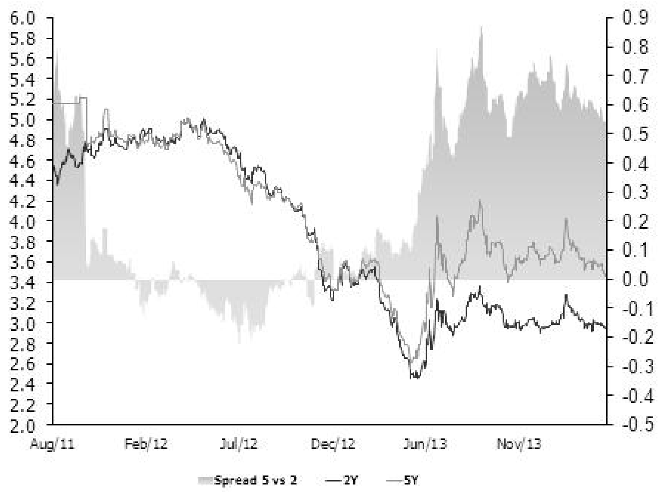
Locally, after the MPC meeting Mr Belka was more eagerly focusing on forward guidance, rather avoiding the word „cut".

Conclusion? We stay away, same as week ago. We find no support here (for now!) from local story to buy bonds, while the global story makes us hesitate between probability of ECB QE and US recovery.









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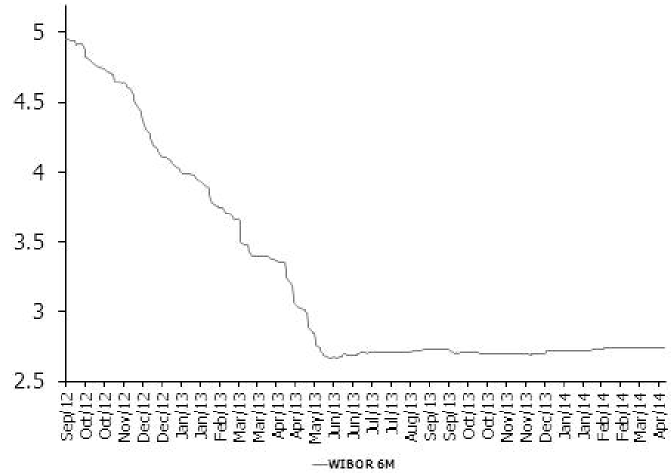
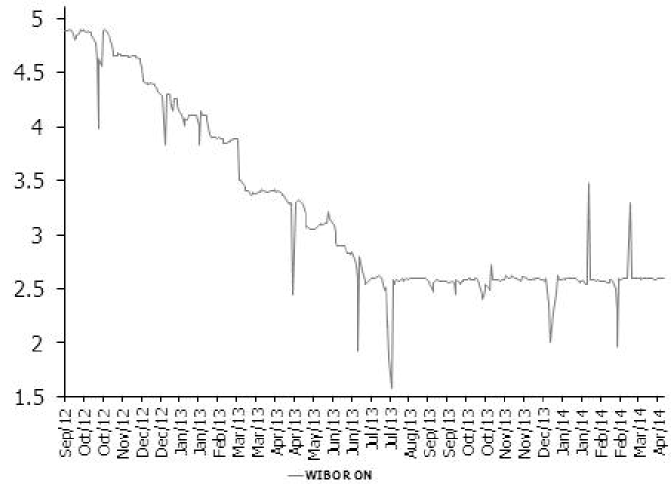
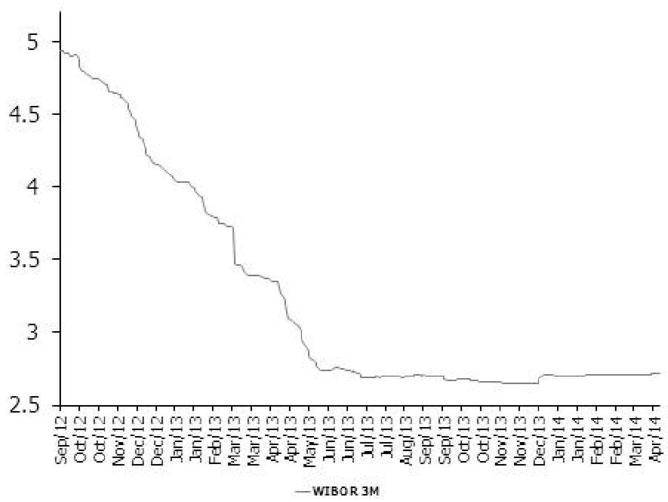
Money market

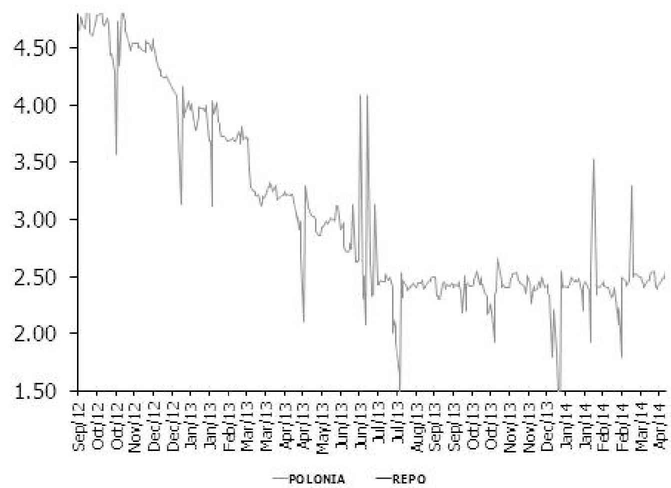
Cheaper week ahead Expensive week behind us. Polonia fluctuated around 2.50 rising on Thursday to 2.56 – what is the point to buy money bills, then? Next week should be a bit cheaper as today's auction was underbid (110.5 vs 111.5).

MPC left rates unchanged and after a bullish week we recommend buying 2Y IRS at 2.95 and taking profit at 3.05. Sell short (1-3 W) OIS.



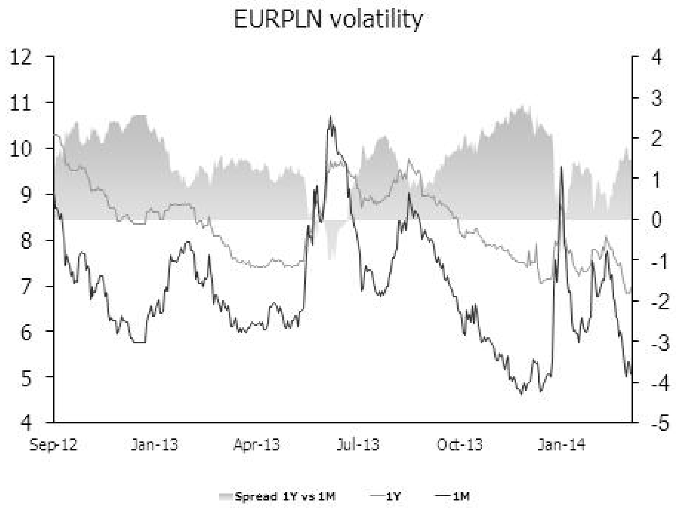






Forex

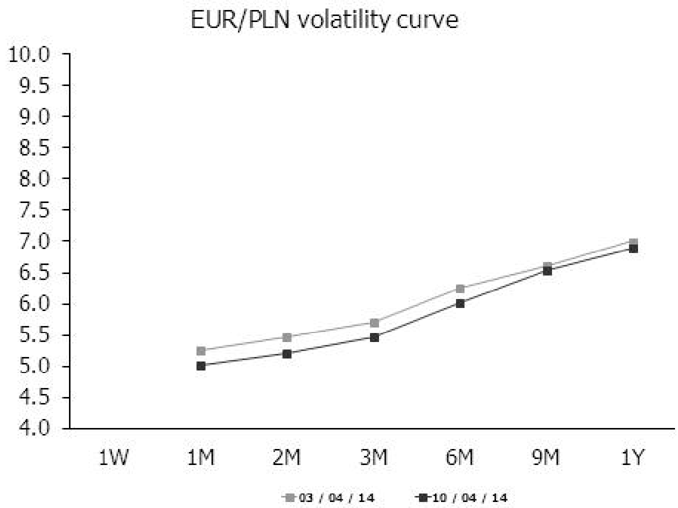
PLN weaker in range FOMC minutes were dovish, Polish MPC on the other hand excluded the possibility of cuts in the nearest future, which altogether should produce the stronger PLN. Unfortunately, it did not, and after the healthy period of consolidation, EUR/PLN is moving back toward the middle of the wider (4.15 – 4.25) range. No obvious trigger, softer stock market plus weaker TRY and ZAR. Or maybe this is all happening because of the positioning in the market... Zloty simply refuses to rise any longer. No need to panic though, even if 4.20 is taken, it is a 4.24/26 resistance zone that really matters.



Vols at the lows Finally the market found its equilibrium and the vols have stopped their slide. And it stopped right on the lows of the year. 1 month is today 4.9% EUR/PLN ATM mid (0.1% lower than last Friday), 3 month are 5.4% (0.35% lower) and finally 1 year is fixing at 6.9% (0.1% lower). The skew was in demand, in both EUR/PLN and USD/PLN, as market participants were anticipating PLN losses. Currency spread (difference between USD/PLN and EUR/PLN) was roughly unchanged.

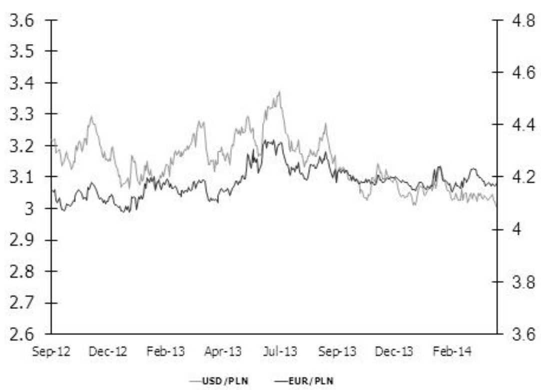
Short-term forecasts

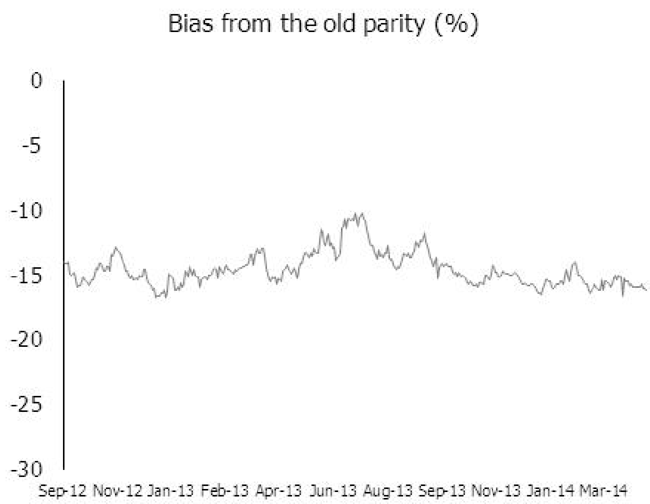
SPOT Main supports / resistances:
EUR/PLN: 4.1400 / 4.2600
USD/PLN: 3.0000 / 3.1500



Play range from the long side Unchanged from last week. 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. The move is painfully slow, so patience is required.

Long vega We have reloaded our longs in mid/back of the vol curve. And the vols seems to have bottomed exactly on the year's lows. With already weaker PLN it seems everything is in place to see at least a mean reverting move. We would love to welcome that, and what is even more important we would love to see pick up in realized volatility. The rise in realized is a crucial factor before option buyers will reemerge on the market, as in the last days we were not able to cover theta bills from Gamma hedging.





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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
4/7/2014	2.86	2.72	2.91	2.64	2.85	2.69	2.73	2.72	2.73	2.82	2.96	2.80
4/8/2014	2.58	2.72	2.72	2.64	2.96	2.69	2.72	2.72	2.73	2.82	2.95	2.76
4/9/2014	2.48	2.72	2.62	2.64	2.85	2.69	2.71	2.71	2.74	2.82	2.96	2.78
4/10/2014	2.72	2.72	2.86	2.64	2.96	2.69	2.73	2.71	2.72	2.81	2.94	2.77
4/11/2014	2.72	2.72	2.86	2.64	2.96	2.69	2.73	2.71	2.72	2.81	2.94	2.77

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
4/7/2014	2.690	2.729	2.955	2.932	3.485	3.538	3.885	4.087
4/8/2014	2.690	2.759	2.943	2.946	3.470	3.510	3.875	4.061
4/9/2014	2.690	2.762	2.953	2.967	3.485	3.549	3.895	4.073
4/10/2014	2.690	2.705	2.940	2.940	3.460	3.503	3.860	4.012
4/11/2014	2.690	2.705	2.940	2.940	3.460	3.503	3.860	4.012

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
4/7/2014	5.35	5.58	6.13	6.85	6.85	2.93	0.73
4/8/2014	5.35	5.64	6.15	6.84	6.84	2.93	0.73
4/9/2014	5.08	5.50	6.08	6.95	6.95	2.76	0.73
4/10/2014	5.01	5.48	6.03	6.90	6.90	2.69	0.70
4/11/2014	5.01	5.48	6.03	6.90	6.90	2.69	0.70

PLN Spot performance

Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
4/7/2014	4.1748	3.0446	3.4178	2.9525	1.3657	0.1521
4/8/2014	4.1684	3.0276	3.4177	2.9506	1.3658	0.1521
4/9/2014	4.1675	3.0221	3.4189	2.9603	1.3692	0.1520
4/10/2014	4.1710	3.0092	3.4262	2.9621	1.3658	0.1521
4/11/2014	4.1784	3.0086	3.4343	2.9590	1.3657	0.1523

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