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Polish Weekly Review

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Comment on the upcoming data and forecasts

New series of data releases starts on Thursday with CPI and balance of payments data. We expect a deeper yoy drop in consumer prices, driven by low fuel prices and high statistical base in telecommunication services, which will reduce core inflation. Improvement of current account balance is mainly caused by better mechandise trade balance (set to rebound after a sharp fall in August), which partly offsets seasonal deterioration of primary and secondary income balance. On Friday flash GDP data for 3rd quarter will be announced. We expect, in line with monthly data, a slowdown both YoY and QoQ. On the expenditure side this is driven mainly by consumption and investment weakening (the latter with the addition of high base from previous year). Afternoon M3 data should also show money supply dynamics also decelerating.

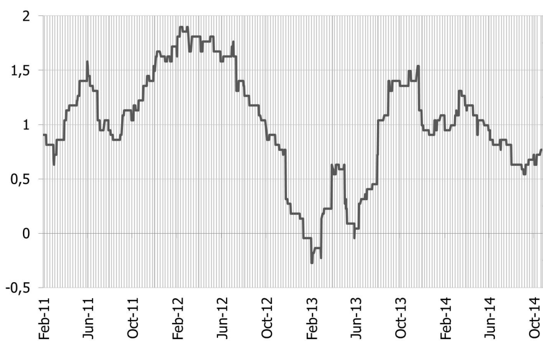
Polish data to watch: November 10th to November 14th

Publication	Date	Period	mBank	Consensus	Prior
NBP Inflation Report	12.11	Nov			
CA balance (mio EUR)	13.11	Sep	-624	-570	-986
Exports (mio EUR)	13.11	Sep	14000	14043	11560
Imports (mio EUR)	13.11	Sep	13800	13586	11624
CPI y/y (%)	13.11	Oct	-0.4	-0.4	-0.3
GDP y/y (%)	14.11	Q3	2.6	2.7	3.3
M3 y/y (%)	14.11	Oct	7.0	7.8	7.8

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	-	2000	1.653	10/23/2014
5Y T-bond PS0719	-	3000	2.007	10/23/2014
10Y T-bond DS1025	-	2000	3.114	9/4/2014
20Y T-bond WS0429	-	150	3.464	5/16/2013

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



Comment

One slight upside surprise in the PMI, so the index inched upwards a bit. Next week brings two opportunities for surprise: CPI and GDP.

* 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

- Polish economy is already in a soft patch. Post-2013 recovery is not going to be derailed.
- Current business tendency indicators suggest that growth momentum, although possibly bottomed out, stays soft and GDP growth is going to be lower in H2 (below 2.5%). External environment (with German economy contracting in Q2 and possibly in Q3) was not so great as well. Recession in Ukraine and Russia add to weaker exports figures, on top of major influence of weaker demand from euro zone. Domestic demand stays relatively firm but downside risks prevail (mostly for investment).
- 2015 is expected to bring more (positive) exogenous components to the Polish cycle. We may see first effects of credit easing in the euro area. Pension reform, along with the political cycle, opens room for fiscal stimulation. We expect significant fiscal stimulus in 2015 onwards, focused mainly on public infrastructure spending and fueled by the re-launch of EU funding.
- 2-3 years of economic expansion are our baseline scenario but growth rates may prove to be more moderate than we expected few months ago.
- Inflation stays very low (negative) for the next few months. Momentum of inflation is already negative and strengthens the impact of high real interest rates.
- After initializing fast rate cut cycle, MPC got stuck in decision process. Stagnation scenario for euro zone, backed up with ultra-low rates and possibility of European QE speak in favor of further monetary easing in Poland, cumulatively by 100bp (including the cut from October). The whole process is going to be messy, though.

Financial markets

- Regarding the FI market, in the near term bearish flattener is expected due to recent MPC (in)decision and uncertain rate outlook. Structural trade is for lower rates and convergence of Polish rates with the European ones (same inflation patterns but ridiculously high real rates in Poland). Good credit supportive for rating upgrade.
- No strong committment towards exactly QE or/and corporate bonds programme from ECB's side may exacerbate negative local factors, especially amid faster growth in the U.S. and the clear normalization stance of the Fed (however, low inflation prevents longer term yields from a fast move upwards). Steps back in ECB policy (Draghi needs a broader consensus, may proceed more cautiously) may be temporarily seen not only as a barrier for lower rates but also as a trigger for temporary bursts of credit risks.
- EURPLN under counter-balancing forces: expectations for ECB easing and lower rates in Poland amid slowing growth. Zloty is set to stay weaker around 4.20. We see some strength coming in 2015 due to faster growth of the Polish economy and the inflow of fresh money stimulated by further monetary easing in Europe.

mBank forecasts

	2010	2011	2012	2013	2014F	2015F
GDP y/y (%)	3.9	4.5	2.0	1.6	3.0	3.5
CPI Inflation y/y (average %)	2.8	4.3	3.7	0.9	0.1	0.6
Current account (%GDP)	-4.5	-4.9	-3.5	-1.3	-0.9	-1.8
Unemployment rate (end of period %)	12.4	12.5	13.4	13.4	12.2	12.0
Repo rate (end of period %)	3.50	4.50	4.25	2.50	2.00	1.50

	2014 Q1	2014 Q2	2014 Q3 F	2014 Q4 F	2015 Q1F	2015 Q2F	2015 Q3 F	2015 Q4 F
GDP y/y (%)	3.4	3.3	2.5	2.3	2.1	3.1	3.7	4.6
Individual consumption y/y (%)	2.6	2.8	2.4	2.1	1.8	1.8	2.0	2.4
Public Consumption y/y (%)	0.7	0.8	2.0	2.4	3.0	3.0	4.0	4.0
Investment y/y (%)	10.7	8.4	6.4	5.0	4.0	7.5	9.0	11.0
Inflation rate (% average)	0.6	0.2	-0.3	-0.2	0.0	0.4	0.9	1.0
Unemployment rate (% eop)	13.9	12.0	11.5	12.4	13.1	11.8	11.3	12.0
NBP repo rate (% eop)	2.50	2.50	2.50	2.00	1.50	1.50	1.50	1.50
Wibor 3M (% eop)	2.71	2.68	2.28	2.10	1.64	1.66	1.70	1.70
2Y Polish bond yields (% eop)	3.01	2.51	2.00	2.00	1.95	1.94	1.96	2.00
10Y Polish bond yields (% eop)	4.23	3.45	3.05	2.80	2.85	2.94	2.96	3.00
EUR/PLN (eop)	4.17	4.16	4.18	4.15	4.10	4.05	4.00	4.00
USD/PLN (eop)	3.03	3.04	3.31	3.32	3.28	3.29	3.33	3.33

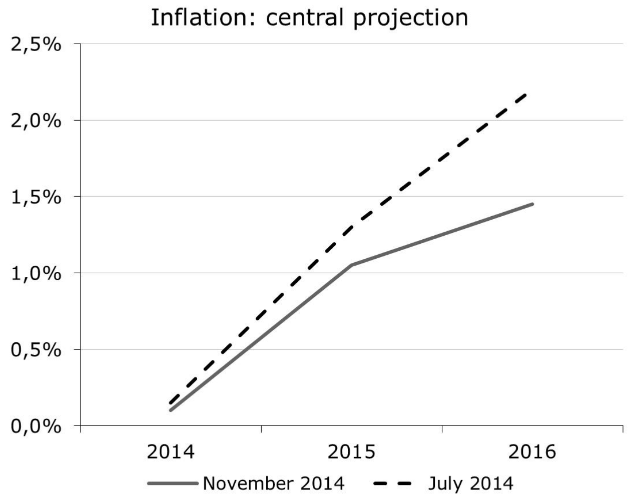
F - forecast

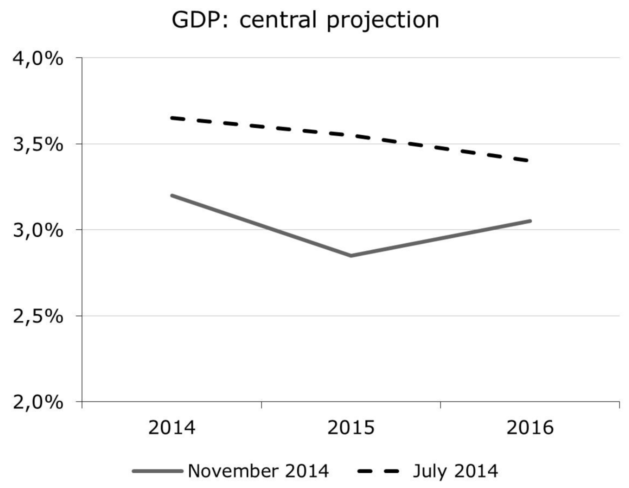
Economics

MPC delivers a major surprise. Rates unchanged in November.

Contrary to market consensus (25bp cut) and market expectations (50bp cut) MPC decided to sit on its hands and left rates unchanged. The decision stays at odds with communication from the last month, including the significance of inflation projection (lower across the board, with downside risks prevailing).

The statement stays dovish and almost completely unchanged since October - it is worth to note that better publications (construction, industrial output) were ignored. Fresh inflation projection points to lower CPI in the whole forecast horizon (1pp in the end of the path, thereby a substantial move down). Inflation only returns to the 1.5%-3.5% interval and fails to recover to 2.5% target. Downside revision was imposed upon GDP growth forecast as well. Polish economy is now seen rising at 2.8% rate in 2015. Both GDP and inflation projections are subject to downside risks. Applying some back-of-the-envelope calculations based on Taylor rule to the numbers provided by the projections yields a scope for further 50-100bps of easing. What the hell is the break for, then?





We think there is a decision stalemate in the MPC. It was quite obvious during the conference that Belka, who once had controlled the working majority in the body, was outvoted by Chojna-Duch. Motivations for such a move are unknown at this stage. Chojna-Duch cited some vague explanations based on better PMI reading and the need to wait for the effects of recent easing.

What comes next, then?

The decision process and communication of the MPC have become unpredictable and messy. Intentions of governor Belka to adjust rates to deflationary-stagnationary environment in Europe were undermined. Chojna-Duch pointed that easing cycle can be resumed if growth falters (by the way, in some twisted way it found its way into the statement: „the Council does not rule out further adjustment of monetary policy, should the incoming data point to a risk of deterioration in economic growth outlook"). Although the condition seems not really fierce, such reasoning stands in contrast with the current view backed by the governor Belka as his assessment of the economy is unambiguous: inflation is not going to return to target (it is an undisputable fact, in his opinion) and there is room for monetary easing. It is a ray of hope that easing might be resumed, especially given the high likelihood of launching European QE. We may see a cut in December. Conditional is at the right place, though, as the decision process has detached from economics and become so chaotic that - out of the blue - easing may actually, this time, find support of the majority in December.

Market-wise, we see a potential for the development of bearish flattener. Opaque monetary policy is not going to support ongoing buying of Polish debt. However, low inflation and low growth are going to prevent the market from definitely forgetting about monetary easing (or worse: from penciling in a definite end-of-cycle scenario).

Fixed income

Minimum sentence

It was an eventful week. So in a chronological order:

It all has started with the MPC meeting... While market argued between 25 or 50bps cut, MPC surprised all of us and did nothing. Lack of action was explained by Mrs Chojna-Duch (not Mr Belka) by a „temporary nature of current slowdown". Bit shocking while both prints (CPI and GDP QoQ) close to zero. In reaction bonds and IRS were repriced by 10-15bps. One may say a light one, but we all got used to the fact that the MPC deals with the present, not the future. We are waiting for GDP numbers then.

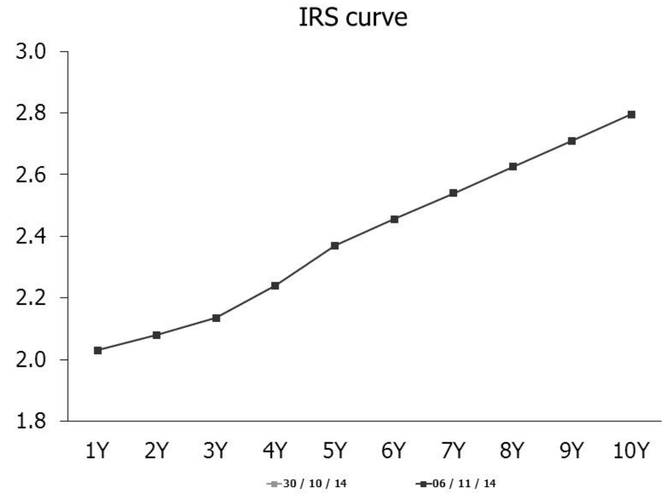
For the next day MF had planned auction on long end bonds – 2-4 yrds of 10Ys. Despite a lack of support from MPC, auction went relatively well – MF sold 4.5 PLN yrds of bonds. While market seemed to balance on a thin rope, helping hand was given by the ECB on press conference - ECB is ready to act and supply more cash. We rebounded by 8 bps (!) especially on long end which made the auction a lucky buy.

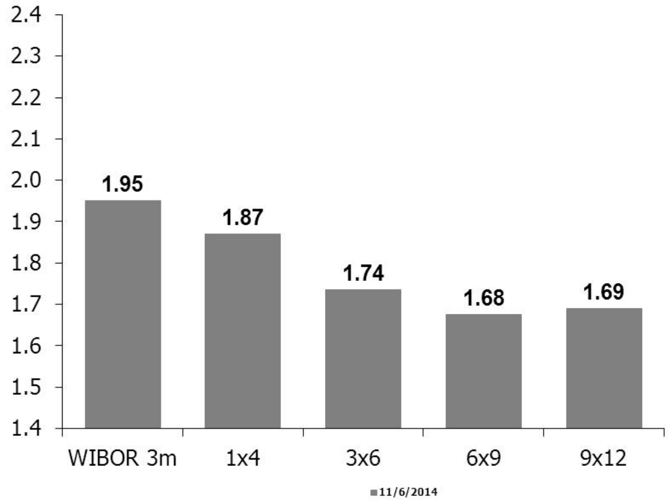
Disaster came by night... or rather late afternoon. Risk off through all bond markets provoked a sell-off by about 12 bps! Which summed up is about 20 bps from pre-MPC levels.

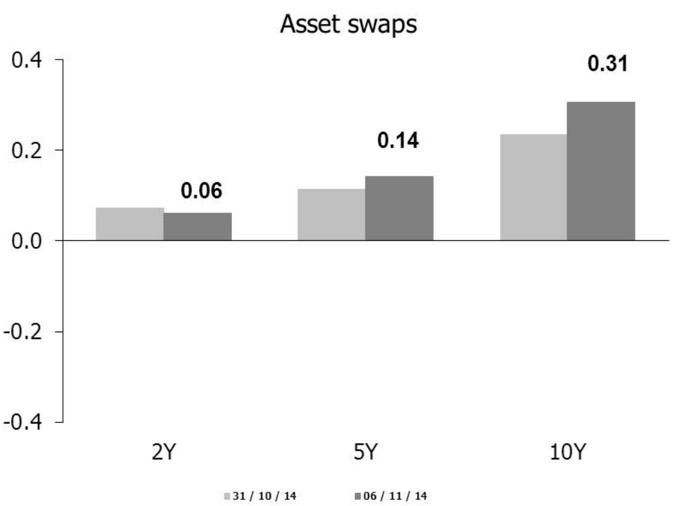
Is it much? Not much?

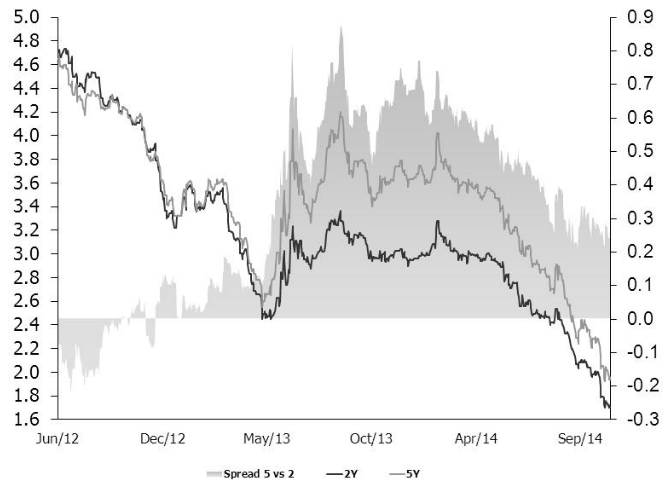
Long end trades fragile but let's take 5Ys into consideration. We priced off 20 bps, less than one regular cut. In that case answer is no. Bonds trade pretty strongly. Bias is for easing, both in Poland and EU. With just another 25bps priced in bonds still looks attractive.

We use current boosted volatility and buy dips – buy at 2,25 5Y bonds.







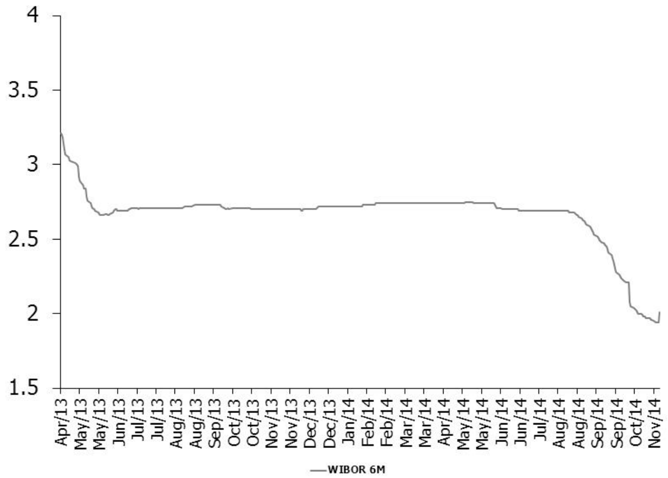


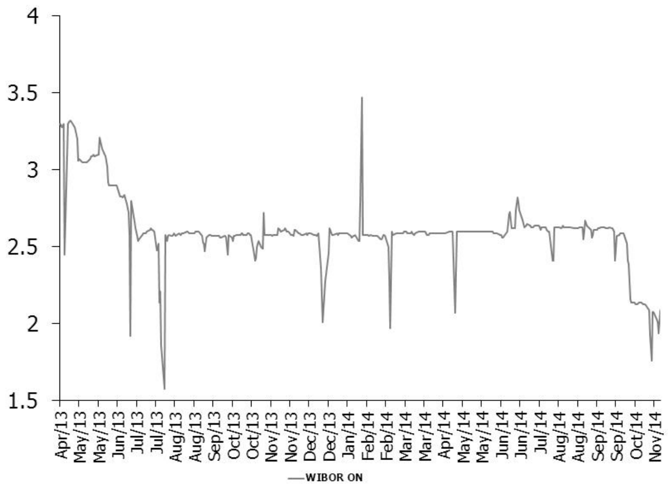
Money market

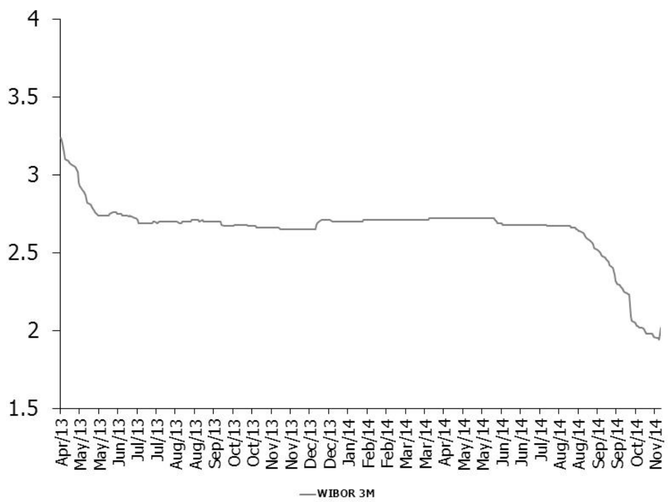
Crazy week behind us.

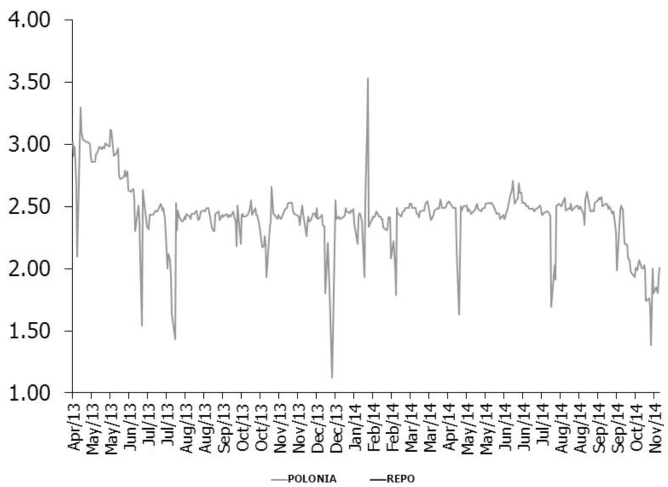
As the whole market expected rate cuts (25 or 50 bps), the beginning of the week was very cheap. Surprisingly, the MPC hasn't changed rates, which moved Polonia back to 2.00 (from 1.80, where it was on Monday and Tuesday). Next week will be stable as last OMO squared the market.

„No rate cut" moved the short end of the curve 20 – 25 bps higher. FRA's under one year are now quoted 20 bps higher than on Wednesday morning. Same happened with OIS. 1Y OIS is discounting now just a 25 bps rate cut in December and a bit more in the beginning of 2015. After the decision 3M WIBOR rose by 8 bps.









Forex

PLN consolidating, still Last week's MPC and ECB meetings could've kicked EUR/PLN out from the 4.20-24 range, but they failed. Generally, the NBP decision about not changing interest rates as well as Draghi's statement being more dovish than expected favoured the PLN. So the lack of pullback towards 4.2 is a little worrisome for EUR/PLN. Today EUR/PLN is traded in the range 4.22-4.23 and all eyes are on NFP today, but I don't believe that the outcome will change much. USD/PLN has continued its march upwards and yesterday it has reached 3.4150. With EUR/USD still tumbling for the ensuing days, we will see levels above 4.45 on USD/PLN...

Vols – lower Although last week was full of events, EUR/PLN volatility curve was persistent. 1 month EUR/PLN ATM mid is this Friday at 5.0%, 3 months are 5.2% and 1 year is fixing at 6.5% (0.05% higher then last week). Again, there was some turnover in the backend: 1 year EUR/PLN was trading at 6.45%. This tedium on EUR/PLN option market was compensated by the increase of demand on USD/PLN gamma (1w atm was trading at 12.75%) and vega. In turn, the currency spread (difference between USD/PLN vol and EUR/PLN vol) has gained 0 0.3 - 0.4% to aprox. 4.6%. So, finally 3 months USD/PLN ATM is now 9.75%, 6m ATM is at 10.45% (0.35% higher then week ago), 1Y ATM is at 11.1% (0.4% higher then week ago).

Short-term forecasts

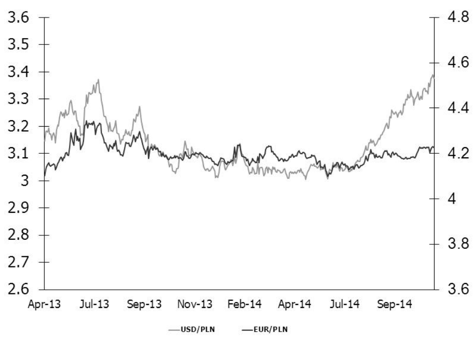
Main supports / resistances:
EUR/PLN: 4.18 / 4.26
USD/PLN: 3.30 / 3.45

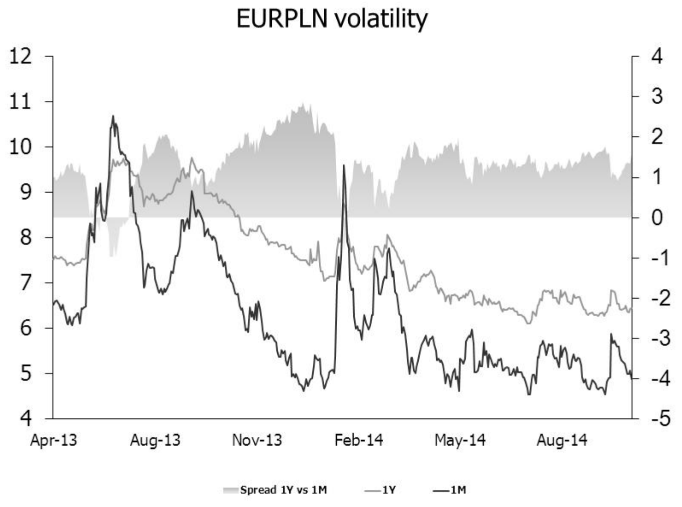
Spot – Long PLN **We like PLN as our fundamentals are relatively strong.**

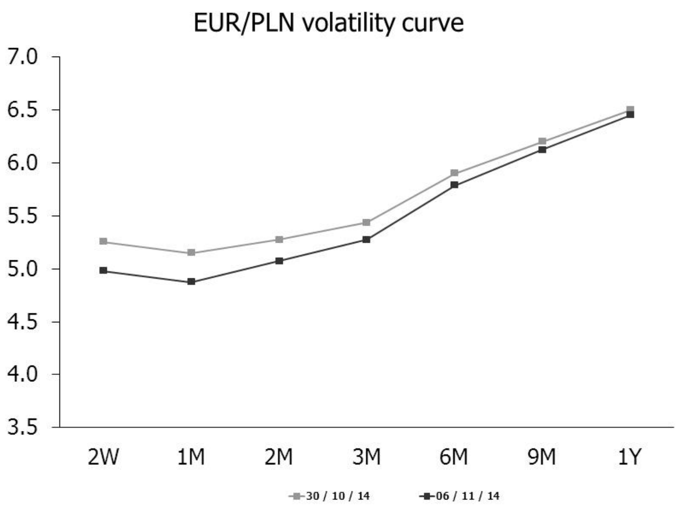
EUR/PLN - on Thursday afternoon we closed our short position at 4.2130 with 170 pips profit. Now, again we are short at 4.2300, ready to add at 4.2450 with stop at 4.2600 and hopes for a slide back to 4.2000.

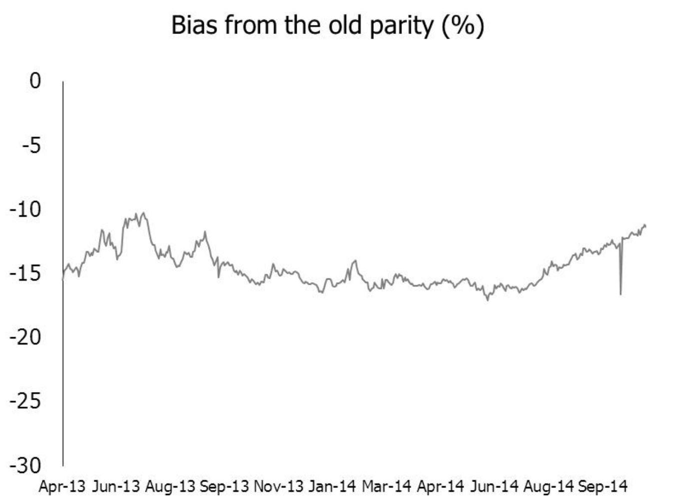
USD/PLN – we are sidelined at the moment.

Options – Long 1y Vega Still small tactical long in backend curve of Vega. The market is not really moving, we are in very tight price ranges. We still think the longer term volatility has bottomed out and we would like to keep that position, waiting for further developments (we also have to consult the deterioration of global sentiment as well as the worries about Russia).









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
10/31/2014	1.86	1.96	1.94	1.85	1.87	1.84	1.70	1.56	1.51	1.51	1.55	1.52
11/3/2014	1.85	1.95	1.80	1.84	1.86	1.84	1.71	1.57	1.51	1.53	1.56	1.52
11/4/2014	1.98	1.95	1.76	1.84	1.83	1.83	1.65	1.55	1.50	1.52	1.55	1.50
11/5/2014	1.67	1.94	1.62	1.84	1.71	1.83	1.81	1.69	1.65	1.66	1.69	1.67
11/6/2014	2.11	2.02	2.11	1.91	1.98	1.89	1.87	1.74	1.68	1.69	1.72	1.68

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	4/23/2014	7/25/2016	93.51	3.02	800	2136	836
PS0719	5/8/2014	7/25/2019	99.25	3.41	4000	5807	4075
DS1025	6/5/2014	7/25/2025	94.90	3.82	2000	2743	1693

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0715	5Y IRS	PS0718	10Y IRS	DS1023
10/31/2014	1.840	1.682	1.675	1.747	1.895	2.009	2.330	2.564
11/3/2014	1.840	1.676	1.670	1.743	1.900	2.048	2.338	2.600
11/4/2014	1.830	1.652	1.663	1.699	1.885	1.998	2.315	2.584
11/5/2014	1.830	1.761	1.758	1.788	1.940	2.083	2.360	2.643
11/6/2014	1.890	1.749	1.788	1.848	1.970	2.113	2.375	2.681

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
10/31/2014	5.00	5.35	5.78	6.38	6.38	2.37	0.54
11/3/2014	4.99	5.25	5.73	6.35	6.35	2.37	0.54
11/4/2014	5.08	5.45	5.75	6.43	6.43	2.40	0.59
11/5/2014	4.88	5.28	5.79	6.45	6.45	2.37	0.57
11/6/2014	4.88	5.28	5.79	6.45	6.45	2.37	0.57

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
10/31/2014	4.2043	3.3459	3.4860	2.9985	1.3687	0.1514
11/3/2014	4.2209	3.3772	3.5017	2.9918	1.3695	0.1519
11/4/2014	4.2253	3.3776	3.5056	2.9788	1.3675	0.1520
11/5/2014	4.2310	3.3887	3.5146	2.9592	1.3685	0.1521
11/6/2014	4.2250	3.3769	3.5083	2.9481	1.3623	0.1521

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