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Polish Weekly Review

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Comment on the upcoming data and forecasts

Due to the upcoming holiday period this issue of Polish Weekly Review covers the next three weeks. These, however, will not be very busy. On Tuesday the CSO will publish its Statistical Bulletin along with retail sales and unemployment data. We expect nominal retail sales growth to stabilize at low levels - no obvious statistical bases, unchanged working day effect. Unemployment rate increased slightly in November, the Ministry of Labor and Social Polich reported earlier this month. The last week of the year brings the quarterly revision of current account data and manufacturing PMI, the latter obviously being more important. We expect the PMI to increase slightly on the back of better sentiment regarding the euro area.

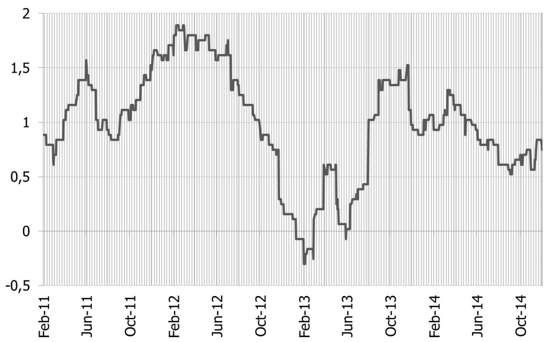
Polish data to watch: December 22nd to January 9th

Publication	Date	Period	mBank	Consensus	Prior
Retail sales y/y (%)	23.12	Nov	1.9	1.9	2.3
Unemployment rate (%)	23.12	Nov	11.4	11.4	11.3
Current account (mio EUR)	30.12	Q3	-1803	-1803	-553
NBP inflation expectations (%)	31.12	Nov	0.2	0.2	0.2
Manufacturing PMI (pts.)	02.01	Dec	53.2		53.2

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	-	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

Three days, three negative, but small surprises: CPI, wages, PPI. The Polish surprise index has thus suffered a setback. Next weeks could bring a few surprises (retail sales, PMI) with the PMI being the most likely to surprise (one of major drivers of our surprise index).

* 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).

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Our view in a nutshell

Fundamentals

- We stick to our view that Poland entered softpatch but recovery will not be derailed. The soft patch, which contrasts with high frequency data, looks shallower than we expected. Growth stalled around 3%. Note that nominal GDP growth is very low.
- Despite regional (Russia, Ukraine) and European headwinds (soft euro zone growth), stable domestic demands lets economy pass through relatively unscathed. The source of strengh lies in consumption (both private and public) and relatively good moods among firms (production continued but so far accumulated as stocks) that commonly used sentiment indices probably understated.
- 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 next 2-3 quarters (longer than NBP projects). Momentum of inflation is already negative and strengthens the impact of high real interest rates.
- MPC got stuck in decision process but the combination of deflation and global factors points to a risk of further easing. The timing is hard to pin down precisely Risk of easing is going to accompany each upcoming meeting.

Financial markets

- POLGBs: We recomend cash near term due to possible negative portfolio effects (EMs nad Russia risks).
- Prolonged disinflation, MPC's easing bias and euro QE are set to support Polish bonds in the mid term.
- Weaker zloty near term on negative portfolio effects (PLN is the cheapest hedge against Russia risks)
- Zloty to strenghten in the mid term on euro QE and high real interest rates (carrry trades).

mBank forecasts

	2010	2011	2012	2013	2014F	2015F
GDP y/y (%)	3.7	4.8	1.8	1.7	3.4	3.5
CPI Inflation y/y (average %)	2.8	4.3	3.7	0.9	0.0	0.0
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	11.9	11.4
Repo rate (end of period %)	3.50	4.50	4.25	2.50	2.00	1.50

	2014 Q1	2014 Q2	2014 Q3	2014 Q4 F	2015 Q1F	2015 Q2F	2015 Q3 F	2015 Q4 F
GDP y/y (%)	3.4	3.5	3.3	3.0	2.8	3.1	3.5	4.4
Individual consumption y/y (%)	2.9	3.0	3.2	3.0	2.8	2.8	3.2	3.4
Public Consumption y/y (%)	0.1	3.7	3.5	2.4	2.0	3.0	3.0	3.0
Investment y/y (%)	11.2	8.7	9.9	7.0	6.0	6.0	7.0	9.0
Inflation rate (% average)	0.6	0.2	-0.3	-0.6	-0.8	-0.2	0.1	0.9
Unemployment rate (% eop)	13.9	12.0	11.5	11.9	12.6	11.8	10.6	11.4
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	1.80	1.61	1.71	1.83	1.96
10Y Polish bond yields (% eop)	4.23	3.45	3.05	2.60	2.50	2.40	2.70	2.96
EUR/PLN (eop)	4.17	4.16	4.18	4.25	4.15	4.05	4.00	4.00
USD/PLN (eop)	3.03	3.04	3.31	3.48	3.46	3.43	3.45	3.51

F - forecast

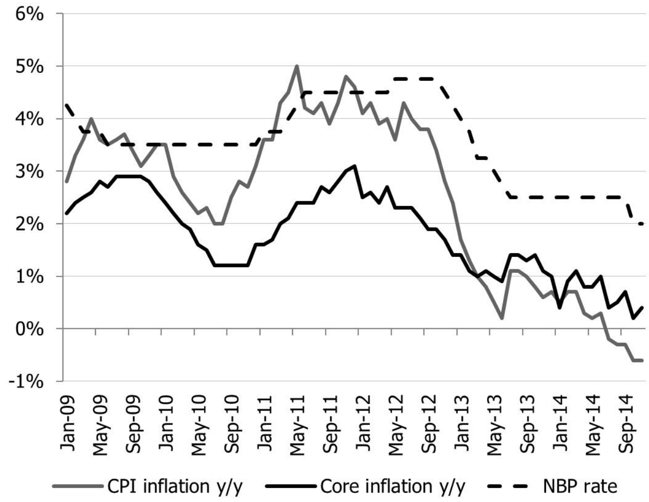
Economics

Polish economy continues to show neutral momentum, total absence of inflationary pressures will eventually trigger another round of monetary easing

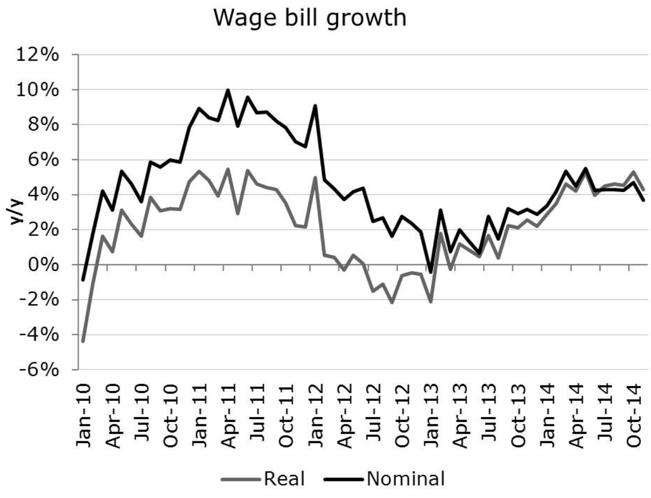
Last week's data confirmed the well-known picture: inflation surprised to the downside and is set to drop to ca. -1% in the first quarter, while real sphere data remain consistent with neutral momentum. In addition, the financial meltdown in Russia is set to have negative economic consequences over the coming quarters as the country falls into a deep recesion; the full extent of damage is still unknown. Against such a backdrop, recent statements and releases from the MPC seem encouraging (Hausner might be joining the doves' camp, four MPC members supported a 50bps cut in November). We still think that monetary easing will be resumed because growth is still modest and the new condition set by prof. Hausner, i.e. deflation for longer and deeper than the NBP believed, will be met. Timing is uncertain as the MPC's decision process remains chaotic and a rate cut could happen at any meeting. However, current market situation (fears of financial crisis in Russia, weaker PLN due to portfolio sell-off, Fed-related risks) should move rate cut expectations to March (the moment new inflation projections are published) or even Spring.

As usual, here's our short take on last week's releases:

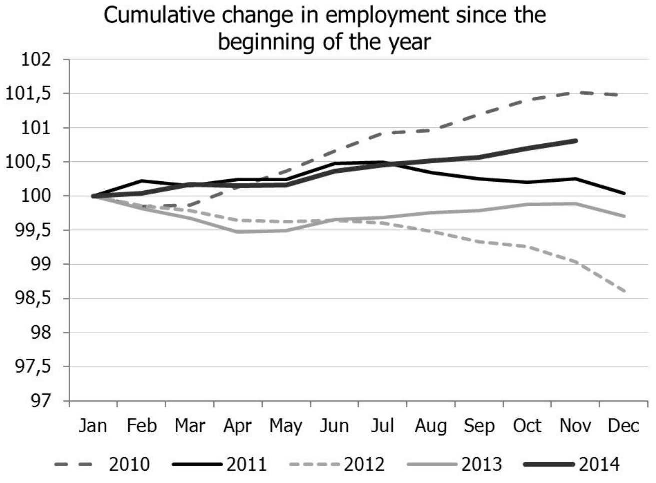
In November **CPI inflation** held steady at a record low of -0.6%, close to analysts' expectations and our forecast (both at -0.5% y/y). The low reading is a result of a fall in food prices (the downward trend in this category is still very strong). Fuel prices declined by 3.2% m/m. Prices in other categories remained broadly unchanged. Communications prices decreased slightly due to lower fees for internet services, which was partly offset by a meagre increase in prices of recreational and cultural services. All in all, core CPI accelerated from 0.2% to 0.4% but only due to statistical base in telecommunication prices (large cut in telecom fees last November). We can only repeat our mantra - there are no signs of a reversal in downward trends in prices - various measures of momentum are at or close to all-time lows. Moreover, the recent declines in oil prices have not been fully reflected in retail gasoline prices - we can expect them to decline by a further 6%. In our view, inflation has not bottomed out yet, as CPI is set to fall by ca. 1% in the first quarter of the year.

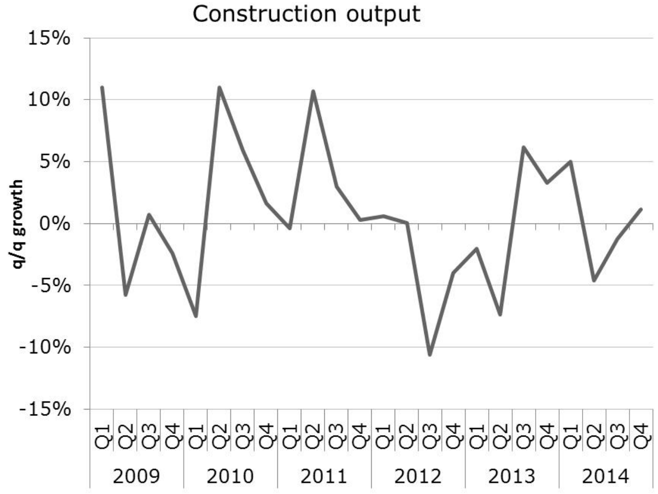


Average wage grew by 2.7% y/y in November, compared to 3.8% noted in October. The deceleration is much stronger than anticipated but close to our forecast. In our view, the drop can be traced back to shifts in mining pensions (multiple press releases pointed to financial problems coal mining was suffering from) and high statistical base in manufacturing wages. Some negative payback in construction and hotels & restaurants could also be expected. Regardless of the nature of the surprise, the trend in wages is still above 3%, a fairly solid number. Current growth rates are thus consistent with neutral momentum in most sectors of the economy (industry, construction).

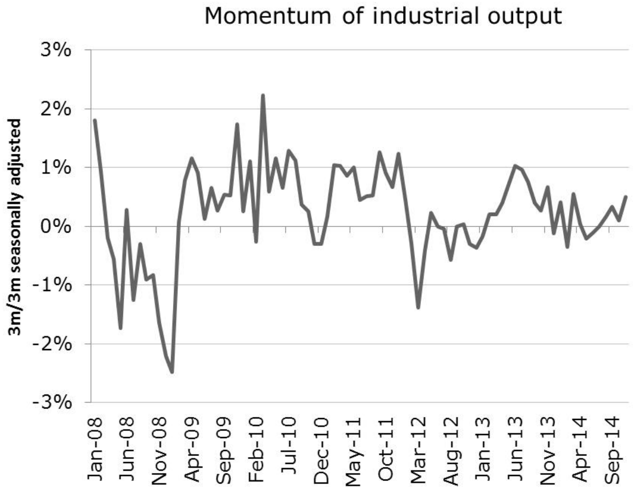


Employment in November grew by 6.2 thousand jobs which translated into an acceleration from 0.8 to 0.9% y/y (in line with both our forecast and market consensus). This is also the best result since November 2007, much above typical seasonal pattern. As usual, industry breakdown of employment is unavailable at this point but we suspect that such a good result is a combination of job growth in manufacturing and services (note that support and administrative services, typically leading overall job growth, hit an all-time high in October). Even though the labor market remains one of the brightest spots in the Polish economy, current growth momentum in the environment of various risks should be sufficient to bring a 1-1.5% annual employment growth next year.





Industrial output grew in November only by 0.3% y/y after an increase of 1.6% in October. Actual release was worse that consensus forecast and very close to our forecast. On a seasonally adjusted basis, growth was lower than in previous month and amounted to 0.2% y/y comparing to 1.5% in October. We interpret this as confirmation of neutral momentum in the Polish industry. Our favorite measure - moving average of m/m dynamics, is still close to zero.



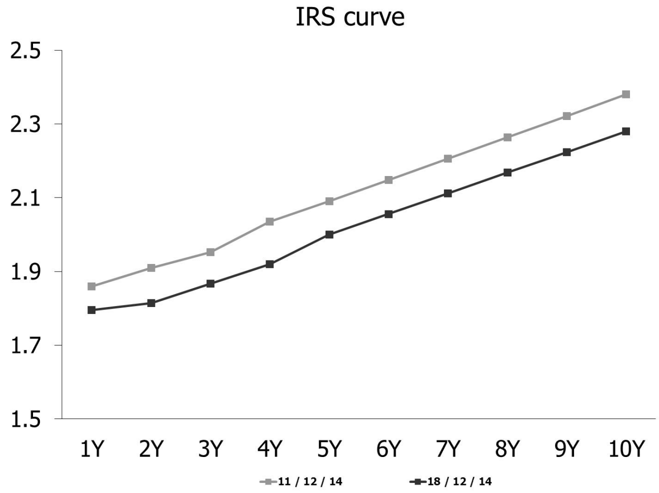
Construction output fell by 1.6% on annual basis (above consensus forecast and our estimates) and even though it decelerated compared to October, the data should be seen as fairly good. On a monthly basis, construction output grew by 2.5% which is not a result of rapid completion of investment ahead of local elections, but rather a consequence of very good weather. Nevertheless, construction output rose only marginally in the fourth quarter and we expect more activity in Spring at the earliest, when construction works on motorways and highways begin (tenders are being systematically completed).

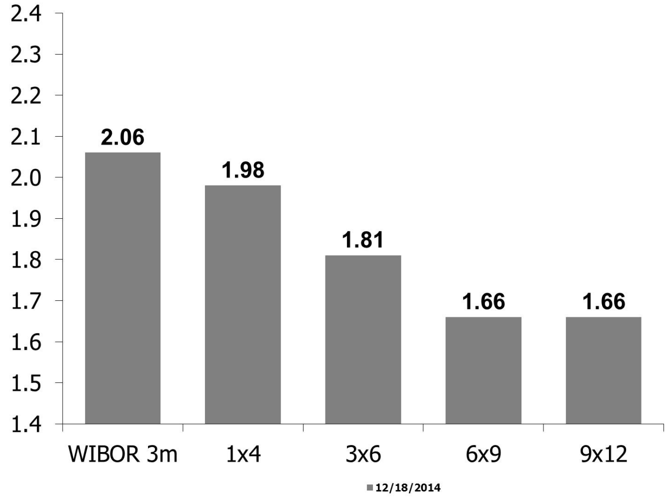
Fixed income

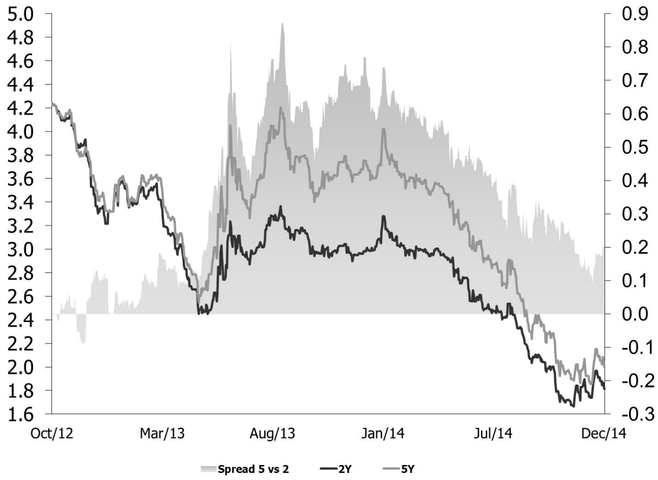
EM again?

This week, all markets were under influence of super rapid moves on RUB and OIL. Global economy slowdown and OIL oversupply pushed it's prices below 60usd/barrel. It was one of the reason of extreme RUB weakness. Implications for Polish Fixed Income market? Some kind of credit risk became real factor here. 5Y Asset Swap (difference between 5Y bond and 5Y IRS) widened from stable +10bp to +20bp this week, which from historical point of view, was a significant move. Investors expect that our GDP is going to be low for a long time (that is why 5Y IRS is still around 2%) but they declined to buy Polgbs with risky Russia/Greece environment. It looks like Poland suddenly became EM again (we are not following Bund prices blindly like in previous weeks).

With even less liquidity in next week we expect market to calm down a little and come back to trade fundamentals (low CPI and downside risk for GDP) but we prefer to sell 5Y IRS over buying 5Y bond.







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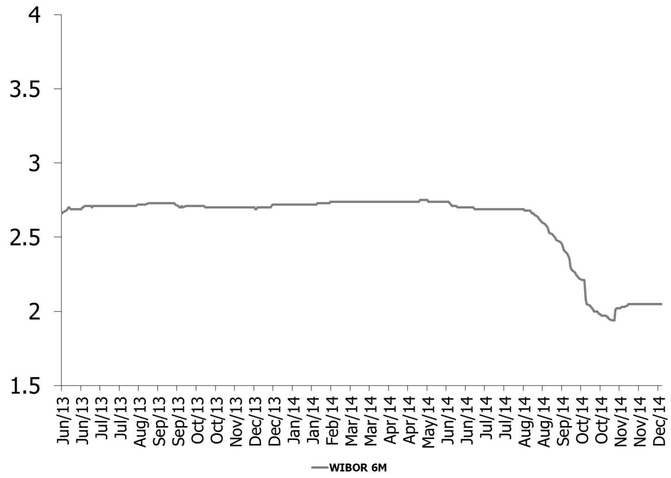
Money market

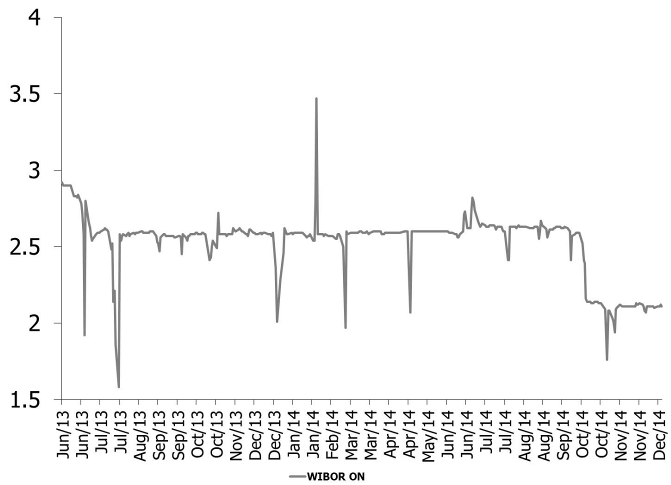
Expensive week behind us

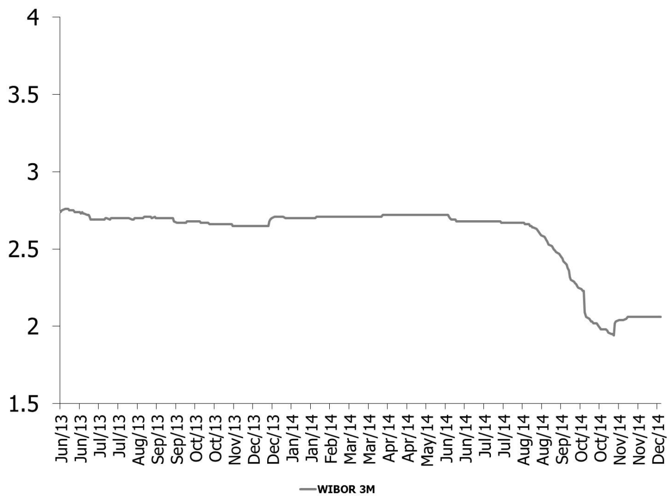
Polonia fluctuated over 2.00% for whole week. Today's OMO was underbid by 8 bn PLN so Christmas week will be cheap.

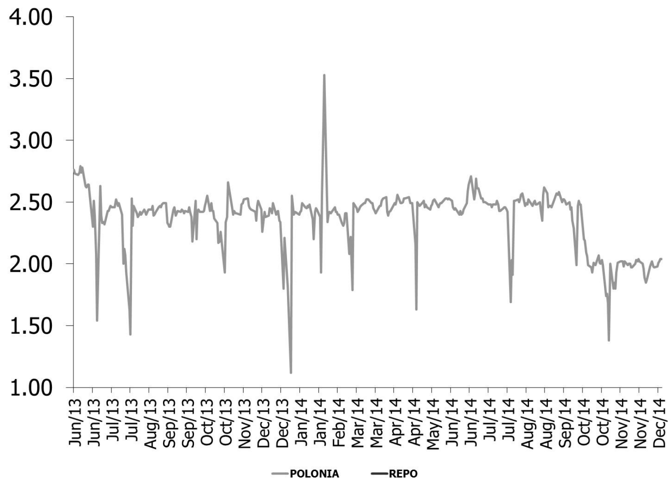
We were wrong with PS0415 last week. This paper can definitely be more expensive. It was traded this week with 1.4 yield.

Last week was very bullish. 1Y3S fall by 5 bps to 1.81, 1Y OIS by 7 bps to 1.67. Spread between 9x12 or 6x9 and 1Y OIS is flat now so we suggesting buying it.





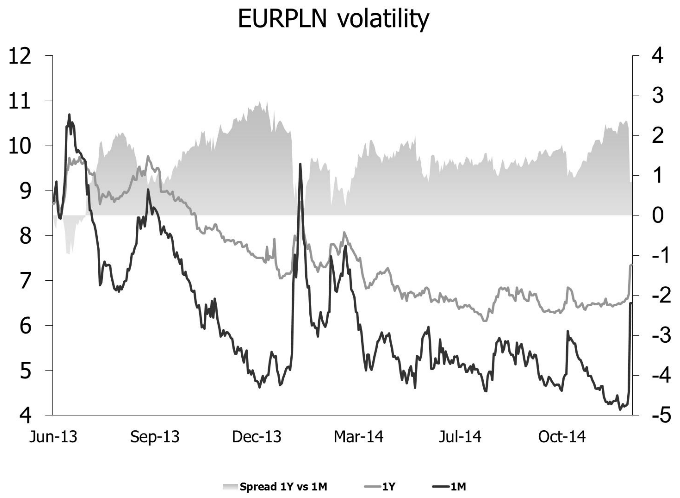




Forex

RUB contagion infects PLN? EUR/PLN shot to 4.2830 on the wave of stop losses, after breaking the former 2014's high at 4.2630. The reasons are unclear. Russia is a big potential credit risk bomb to the world, so some risk adjusting to the currency of its neighbor is prudent. Overcrowded positions and dismissing Christmas' holiday liquidity are also to blame. Fading the spike seems to be logical approach, but the momentum seems to be really against any relief rally. Caution recommended.

Vols exploded The vols gapped higher! 1 month EUR/PLN ATM mid is this Friday at 7% (2.7% higher!), 3 months EUR/PLN mid are 7.25% (2.15% higher), 1 year is 7.6% (1.2% higher). This is a huge move, and not really based on realized volatilities. It looks overdone for PLN trader, but for a RUB trader it hardly moved. Where we belong, it still to be decided. The skew was bid tic better and the currency spread (difference between USD/PLN vol and EUR/PLN vol) was slightly better offered.



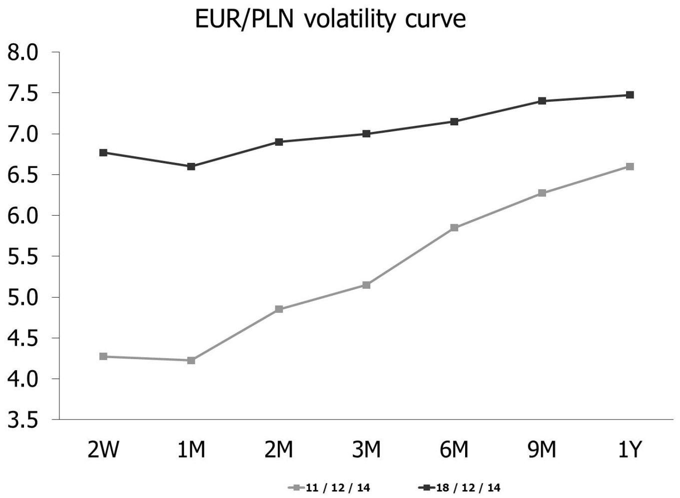
Short-term forecasts

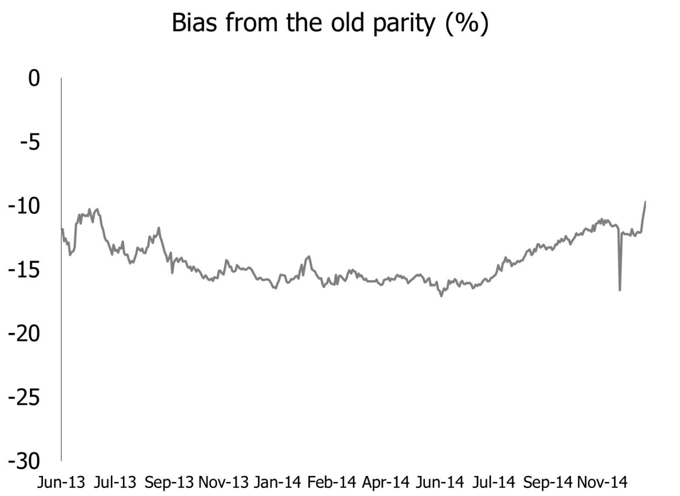
Main supports / resistances:
EUR/PLN: 4.18 / 4.30
USD/PLN: 3.30 / 3.50

Spot – Short EUR/PLN at 4.2700 Luckily, we haven't gone short at 4.2100 (plan from last week), but we eventually have decided to sell EUR/PLN at 4.2700 and are still ready to add at 4.2900 with a stop loss above 4.3050 and P/T at 4.20.

It is a tactical trade, we do agree there are potential risks, diminishing liquidity being just one of them. But on the other hand, the year high form the sell perspective is just too tempting.

Options – Core long 1y Vega We stick to our core Long in Vega in the backend. The move up in vol was really brutal and we think the period of consolidation is ahead of us. The realized volatility trend has to reverse upward, and we need even weaker PLN to eventually see higher levels in vols.





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
12/12/2014	1.93	2.06	1.96	1.95	2.11	1.94	2.04	1.86	1.72	1.72	1.77	1.73
12/15/2014	1.94	2.06	1.95	1.95	2.07	1.94	1.97	1.85	1.70	1.69	1.73	1.70
12/16/2014	1.97	2.06	1.97	1.95	2.08	1.94	1.99	1.88	1.73	1.72	1.77	1.73
12/17/2014	1.88	2.06	1.87	1.95	1.97	1.94	2.01	1.86	1.72	1.71	1.77	1.74
12/18/2014	1.97	2.06	1.97	1.95	2.07	1.94	1.98	1.81	1.66	1.66	1.69	1.67

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
12/12/2014	1.940	1.865	1.880	1.859	2.055	2.205	2.345	2.600
12/15/2014	1.940	1.832	1.845	1.843	2.023	2.158	2.306	2.553
12/16/2014	1.940	1.912	1.870	1.880	2.085	2.263	2.380	2.678
12/17/2014	1.940	1.869	1.860	1.868	2.065	2.245	2.330	2.638
12/18/2014	1.940	1.846	1.814	1.837	2.000	2.206	2.280	2.589

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
12/12/2014	4.25	5.06	5.85	6.60	6.60	2.26	0.53
12/15/2014	4.53	5.38	5.98	6.70	6.70	2.26	0.53
12/16/2014	6.50	6.83	7.05	7.33	7.33	2.60	0.60
12/17/2014	6.50	6.88	7.08	7.35	7.35	2.61	0.59
12/18/2014	6.60	7.00	7.15	7.48	7.48	2.51	0.73

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
12/12/2014	4.1805	3.3639	3.4807	2.8422	1.3527	0.1515
12/15/2014	4.1761	3.3621	3.4768	2.8349	1.3565	0.1514
12/16/2014	4.1935	3.3522	3.4917	2.8764	1.3415	0.1522
12/17/2014	4.2286	3.3928	3.5209	2.8986	1.3507	0.1531
12/18/2014	4.2365	3.4428	3.5190	2.9020	1.3478	0.1537

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