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Polish Weekly Review

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Comment on the upcoming data and forecasts

On Tuesday the Statistical Bulletin containing, among others, unemployment and retail sales data will be published. Preliminary data from the Ministry of Labour and Social Policy indicates a slight, lower than forecast, rise in unemployment rate in December (from 11.4 to 11.5%). On the other hand, retail sales should increase in comparison to negative value in November. This rise will be mainly caused by calendar effects (+1 in working days comparing to previous December).

Polish data to watch: January 26th to January 30th

Publication	Date	Period	mBank	Consensus	Prior
Retail sales y/y (%)	26.01	Dec	1.2	1.7	-0.2
Unemployment rate (%)	26.01	Dec	11.5	11.7	11.4
NBP Inflation expetcations (%)	30.01	Jan	0.1	0.1	0.2

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 OK0717	-	2000	1.653	1/22/2015
5Y T-bond PS0720	-	3000	2.007	1/22/2015
10Y T-bond DS1025	-	1500	2.295	1/15/2015
20Y T-bond WS0429	-	500	2.308	1/15/2015

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

Comment

Big positive surprise in industrial output was partly offset by a small negative surprise in the PPI. Polish surprise index has thus been flat for a month. Next week brings two possible surprises: retail sales and unemployment. Both can surprise to the upside, in our view.

* 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

- 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 demand 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.
- H2 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 negative and strengthens the impact of high real interest rates. GDP growth is too low to close output gap. Inflation is going to stay low.
- MPC got stuck in decision process but the combination of deflation and global factors points to a resumption of further easing. The timing is hard to pin down precisely. Risk of easing is going to accompany each upcoming meeting. In these circumstances betting on anything less than 50bps makes no sense.

Financial markets

- Prolonged deflation, MPC's easing bias and euro QE are set to support Polish bonds in the mid term.
- Zloty to strenghten in the mid-term on euro QE and high real interest rates (carry 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	-0.1
Current account (%GDP)	-4.5	-4.9	-3.5	-1.3	-1.2	-1.8
Unemployment rate (end of period %)	12.4	12.5	13.4	13.4	11.5	11.1
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	-0.9	-0.4	0.1	0.8
Unemployment rate (% eop)	13.9	12.0	11.5	11.5	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	2.06	1.64	1.66	1.66	1.66
2Y Polish bond yields (% eop)	3.01	2.51	2.00	1.79	1.55	1.50	1.64	1.74
10Y Polish bond yields (% eop)	4.23	3.45	3.05	2.52	2.20	2.00	2.50	2.74
EUR/PLN (eop)	4.17	4.16	4.18	4.29	4.25	4.25	4.20	4.10
USD/PLN (eop)	3.03	3.04	3.31	3.54	3.66	3.73	3.75	3.73

F - forecast

Economics

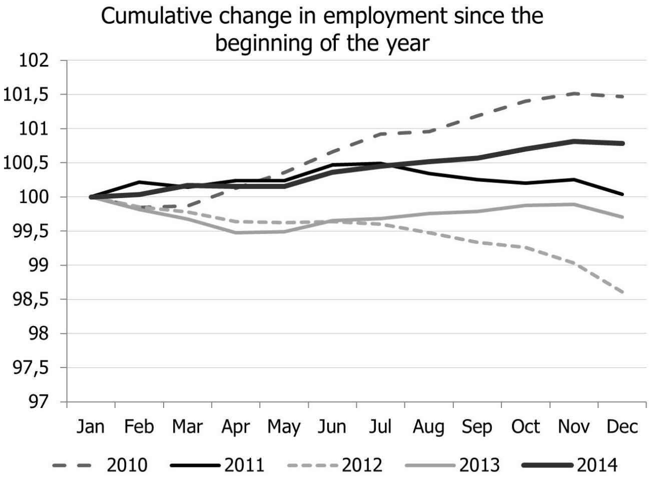
MPC to cut rates even faster despite better data

Recent bout of better data seemed to be a good excuse for the MPC to wait for the new inflation projection before cutting rates again. Only an excuse, though as improvement stays at odds with short-term risks for the economy. Moreover, it is a drop in the ocean as far as evidence on the acceleration of the economy is concerned. It does not alleviate deflationary pressure as well – it does not matter where lower prices come from; they are simply there. Bold quantitative easing program in the euro zone can only stimulate the Polish economy if PLN does not strengthen much. PLN is not going to strengthen much only if MPC is going to actually cut rates. Despite all the informational noise stemming from recent rate-setters' comments we expect them to act fast and cut rates in February.

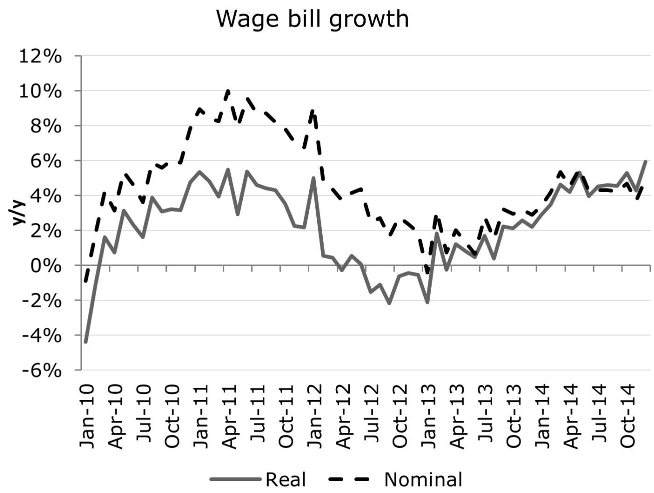
Wages and employment

Average gross wage increased by 3.7% y/y in December, up from 2.7% in November. Every month, we cannot comment on the source of the surprise, as detailed data will be released next week in the Statistical Bulletin. However, the usual suspects „bonuses in mining" are not likely to be the source this time, as multiple signals indicated a sluggish and disappointing level of disbursals in December. Thus, we believe that the surprise could be ascribed to manufacturing and construction, where a more favorable arrangement of working days and holidays offered a significant upside potential.

Employment in the enterprise sector grew by 1.1%. It is a truly positive surprise since employment in December dropped only marginally on November (typical seasonal effects are strong and to the downside). However, it fits rather poorly to business activity indicators (mixed bag) and section-level analysis that suggested most sections hit levels close to their maximal cyclical absorption of workers (mind the overwhelming uncertainty in the economy...). Due to contradictory signals we would rather wait for detailed data before we jump into conclusions.

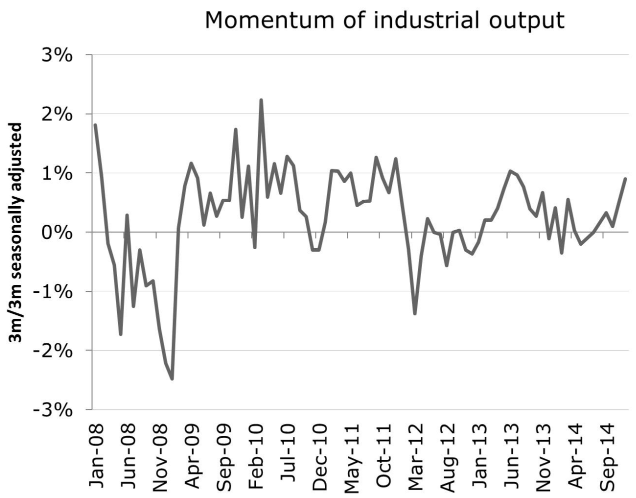


Record low (and negative) inflation, working hand in hand with solid nominal wage growth and stable employment gains led to new highs in real income growth. Real wages grew by 4.8% in December (fastest since October 2008) and real wage bill increased by 5.9% (fastest growth since November 2008). At the moment, real wages are growing faster than at any point during the previous cycle and are nearing pre-crisis growth rates. It is thus worth noting that the current recovery, however bumpy it might seem, is characterized by strong real wage growth, unlike the 2009-2011 period. Obviously, this suggests that strong consumption growth will be maintained in the next quarters and supports our forecast of accelerating growth in 2015. Household consumption is bound to be one of the pillars of this recovery. It does not mean all this has to be inflationary, though.

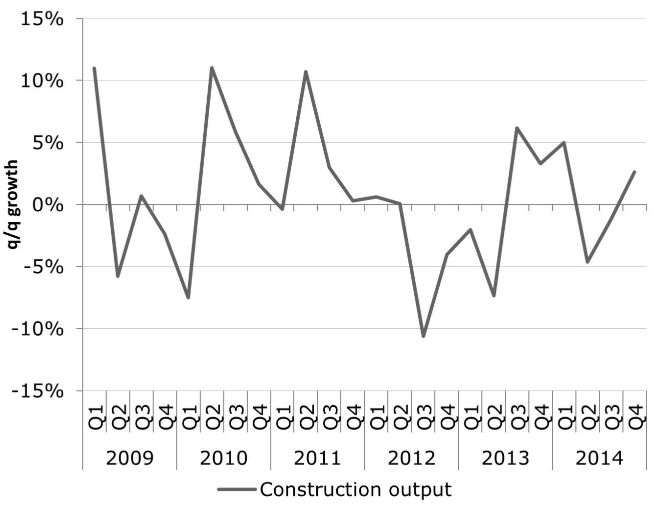


Industrial output and producer prices

Industrial output jumped in December by 8.4% y/y, significantly above forecasts (market consensus oscillated between 4.5 and 5.0%). More than once have we warned that there is a significant upside risk to our forecast but we certainly didn't anticipate such a strong rebound. After adjusting for seasonal and calendar factors, industrial output growth amounted to 2.3% m/m and 5.0% y/y. Even though the figures are impressive, one has to remember about the role working days and their arrangement play for December output (the arrangement of public holidays impact both production shutdowns and vacation schedules). Since December 2013 was among the weakest in history, low statistical base effect boosted latest numbers significantly. Seasonal adjustments are also suspect because of the same factor. IP momentum finally looks as it should in an upswing phase and is close to levels recorded in mid-2013. Next month, statistical base and working day effects will be reversed and IP growth will drop to zero, again. Nevertheless, the starting point for 2015 is much higher than previously thought.



The rebound in construction output was more modest. In December construction output grew by 5.0% y/y (seasonally adjusted 5.3% y/y and 1.0% m/m). Market expectations were also beaten here but the result is not as good as seasonal patterns from previous years implied. Perhaps there is a structural change in the way enterprises are reporting their results, hence smaller increases in December. While warm winter is bound to boost construction in the first quarter (just as it did in 2014), a significant acceleration in construction will probably happen in mid-2015 when all tenders for expressways and motorways are completed and machines start rolling in on construction sites.



Producer prices sank by 2.5% y/y. The sole driver were crude oil prices (15% drop in relevant categories) but even excluding refinery sector producer prices in manufacturing are decreasing in a steady pace of 0.2% per month since Autumn. This is unlikely to change soon as deflationary equilibrium persists. We stick to our theory that only a grand supply shock (higher oil prices) or exchange rate shock can lead to higher producer prices in mid-term; no such thing seems to be on the horizon at the moment. Producer prices are set to stay subdued.

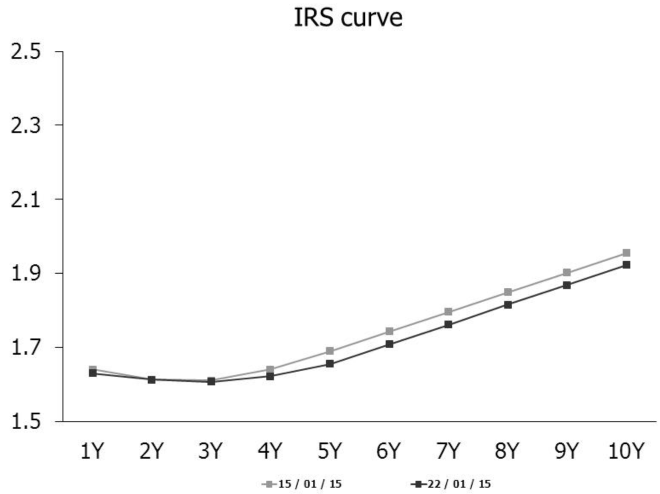
Fixed income

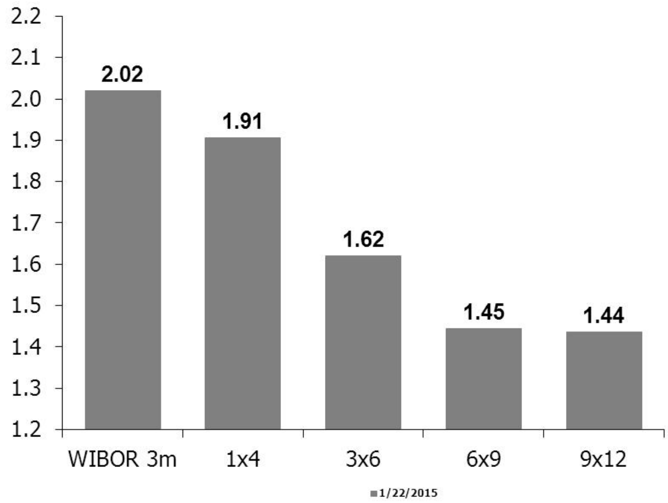
Crossing the Rubicon

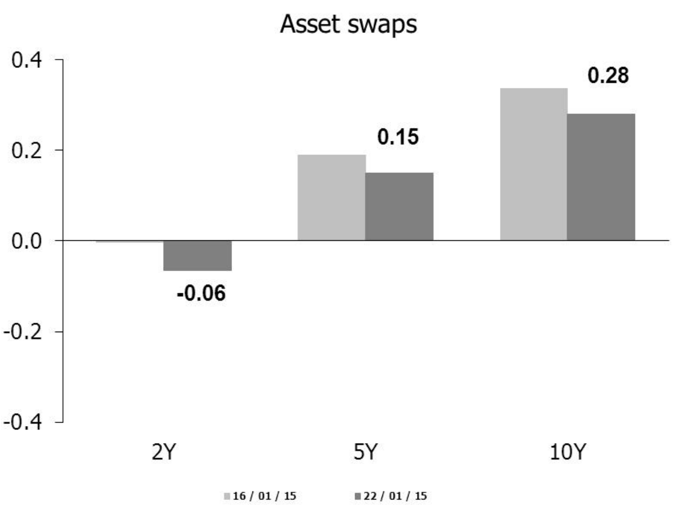
The key event this week was EBC and expected decision on quantitative easing programme. After last week's SNB decision to cut rates and to abandon 1,20 EURCHF floor Mr Draghi also surprised markets with the scale and duration of QE (60 bio EUR purchases per month till September 2016) which is bullish especially for riskier assets like POLGBs. As a result, Polish bonds breached lows on yields on every part of the curve (OK0716 1,57%, PS0719 1,71%, DS0725 2,05%); 2y10y flattened 10 bps to 25 bps and it seems a matter of time when 10y POLGBs hit 2% level.

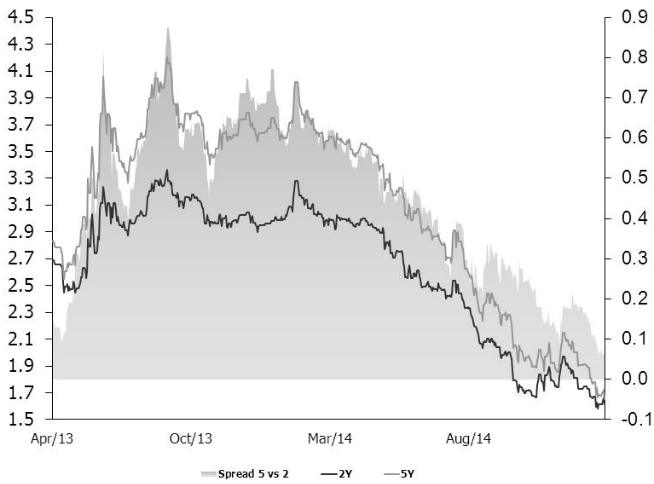
This week the Ministry of Finance issued two new bonds (OK0717 and PS0420), however, because of timing (just before ECB decision) auction was bid mainly in the 2y sector (MoF sold 4,25 bio OK0717 at 1,734% and 2,76 bio PS0420 at 1,98%) and taking into consideration the structure of bonds sold in January (little duration) one can expect much bigger long end issuance in February.

It's difficult to recommend short position in this environment however bear in mind that levels are decent and from technical point of view taking profit on longs is quite reasonable idea.







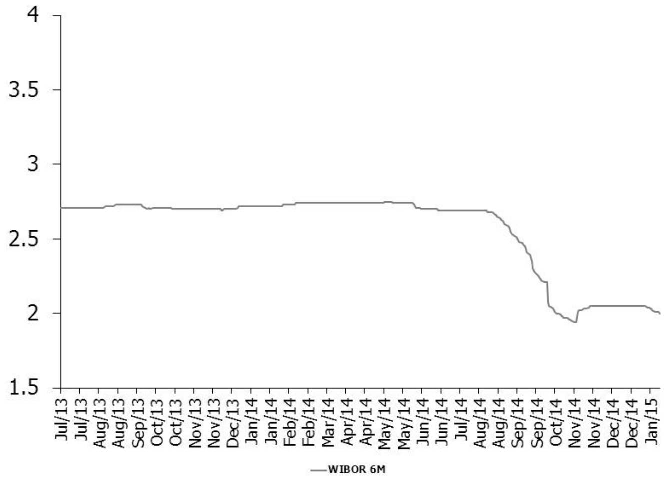


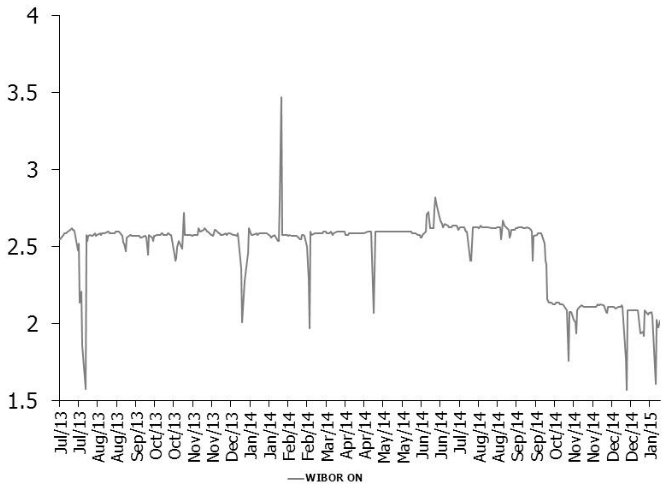
Money market

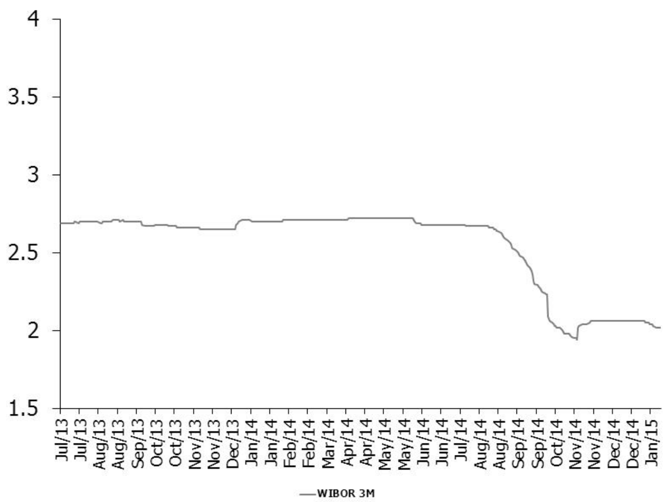
Very cheap week behind us

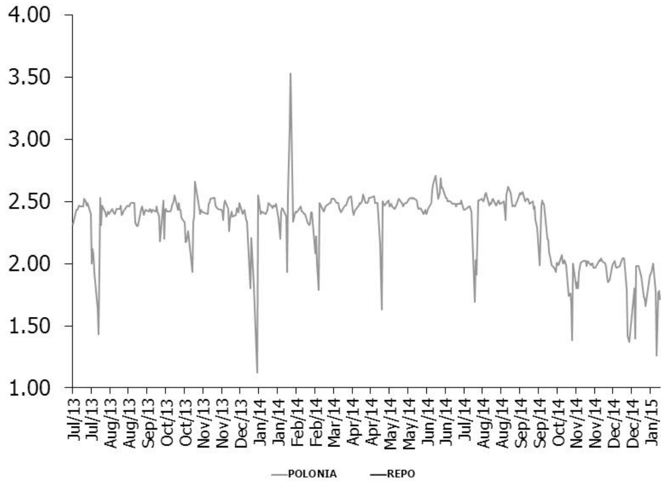
As last week's OMO was underbid by 20 bn PLN (due to CHF turmoil), cash rate fell on Monday to 1.26. NBP carried out an additional OMO on Tuesday and Polonia moved to 1,77. It remained below 1.80 to Friday. As today's OMO was underbid by 6bn next week should be stable with cash rate around 1.90-2.00.

As ECB launched QE, whole PLN curve moved down. Shortest end moved down by 5-10. 1Y OIS is now 1.42/1.47. Probability of a rate cut in February is now 50% (discounted in shortest OIS).





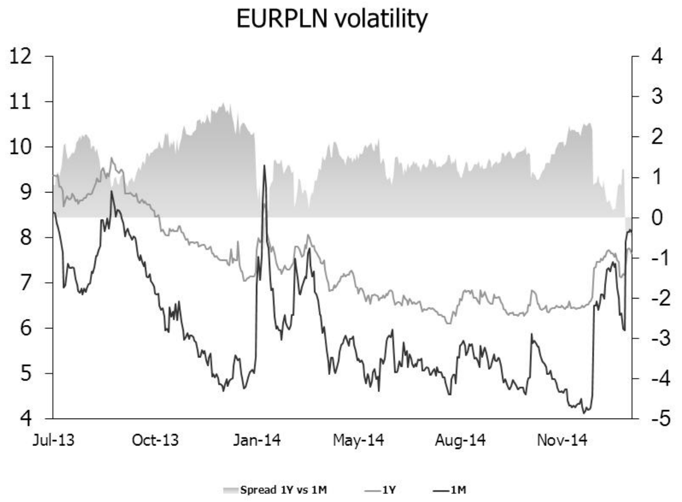




Forex

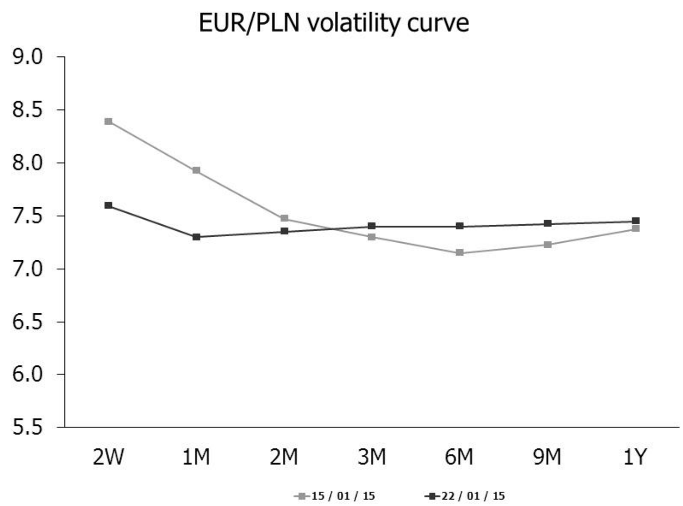
QE has been delivered Mario Draghi has finally delivered a full scale QE, and that was like Prozac injection to the markets. CHF turmoil? Nobody remembers that at the moment, except for CHF debtors. As a result EUR/PLN dropped like a stone from 4.3350 to 4.2190. We still favor range as a baseline and 4.20 - 4.30 is the most likely for now. We will be probably living under the QE spell for a few more days, but it should fade in time. It is interesting to note that EUR/PLN is now positively correlated to EUR/USD, usually it is the reverse.

Vols - all in all bit softer The gamma was really in demand before ECB meeting, and all those who have had paid for Gamma, should not be disappointed. The violent move down from 4.30 to 4.2190 after ECB was more than beneficial for the Gamma owners. Nevertheless, the vols should get softer now, we have big event (ECB) out of the way and PLN is much stronger. 1 month EUR/PLN is now 7.7% (0.3% lower), 3 months are now 7.6% (0.1% lower) and finally 1 year is 7.6% (0.2% lower). We expect the vols to go even lower, when spot stabilizes and Theta bills would get a bit more painful. The Skew was heavily offered especially in the frontend.



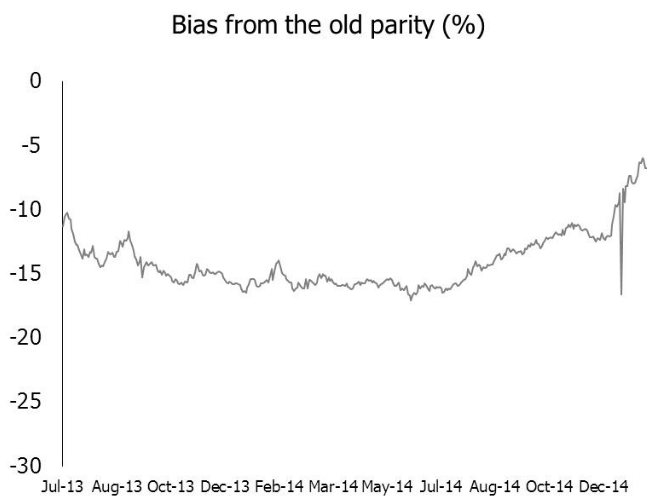
Short-term forecasts

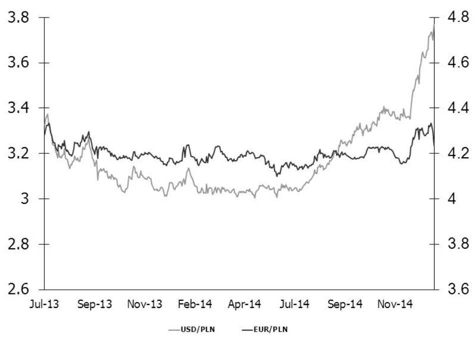
Main supports / resistances:
EUR/PLN: 4.1950 / 4.3150
USD/PLN: 3.60 / 3.90



Spot – long EUR/PLN at 4.3280 Short EUR/PLN at 4.3400 was closed with profit at 4.25. Now we are long at 4.2380, and ready to add 4.2080 with a stop below 4.1930, and profit taking at 4.30+. It is purely tactical, no real fundamental story behind it.

Options – Sidelined We are flat now, but our next move is to buy EUR/PLN Vega, as realized volatility is picking up nicely. All we need are a few days of relative calmness and we should see vols melting . We think the levels to buy are 6.8% 6 months EUR/PLN and 7.2% 1 year. Never theless, it looks like the vols market is back to life.





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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
1/16/2015	1.76	2.03	1.55	1.92	1.38	1.90	1.86	1.63	1.45	1.44	1.45	1.46
1/19/2015	1.78	2.02	1.69	1.91	1.65	1.90	1.89	1.66	1.48	1.51	1.54	1.51
1/20/2015	1.86	2.02	1.77	1.91	1.71	1.90	1.92	1.68	1.49	1.48	1.49	1.50
1/21/2015	1.77	2.02	1.68	1.91	1.62	1.90	1.94	1.69	1.51	1.49	1.51	1.50
1/22/2015	1.84	2.02	1.75	1.91	1.70	1.90	1.91	1.62	1.45	1.44	1.44	1.45

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
1/16/2015	1.900	1.678	1.611	1.609	1.676	1.865	1.940	2.277
1/19/2015	1.900	1.700	1.618	1.604	1.695	1.883	1.960	2.256
1/20/2015	1.900	1.715	1.640	1.641	1.705	1.907	1.975	2.325
1/21/2015	1.900	1.693	1.665	1.628	1.725	1.903	2.000	2.293
1/22/2015	1.900	1.661	1.613	1.548	1.655	1.805	1.922	2.202

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
1/16/2015	8.13	7.80	7.70	7.75	7.75	2.49	0.66
1/19/2015	8.13	7.75	7.75	7.76	7.76	2.49	0.66
1/20/2015	8.18	7.70	7.68	7.75	7.75	2.59	0.69
1/21/2015	8.13	7.50	7.50	7.65	7.65	2.55	0.66
1/22/2015	7.30	7.40	7.40	7.45	7.45	2.52	0.65

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
1/16/2015	4.3220	3.7174	4.2550	3.1931	1.3453	0.1556
1/19/2015	4.3165	3.7176	4.2901	3.1698	1.3565	0.1549
1/20/2015	4.3335	3.7346	4.2697	3.1573	1.3601	0.1557
1/21/2015	4.3218	3.7358	4.3160	3.1731	1.3686	0.1551
1/22/2015	4.2997	3.6994	4.3092	3.1434	1.3628	0.1539

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