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Polish Weekly Review

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Comment on the upcoming data and forecasts

We start the week with balance of payments data for January. We expect the current account deficit to narrow, caused by a return of trade surplus. At the same time core inflation data (for both January and February) will be also released – this should confirm our inflation estimates based on CSO revisions. Labour market data will be announced on Tuesday. In our opinion employment dynamics will hasten slightly (neutral momentum results in only minor monthly employment growth) and wage dynamics would slow (as a result of calendar effects in manufacturing, high base in mining and one-off effects in transport). Another busy day is Wednesday - releases will cover industrial production and retail sales. In both cases we are anticipating the acceleration of annual growth rates because of base effects and positive working day difference. Wednesday's announcement will be accompanied by PPI data, which would be under the influence of two rather offsetting factors: strengthening of Zloty and rise in oil prices. The week will end on Friday with CSO data about consumer and business confidence.

Polish data to watch: March 16th to March 20th

Publication	Date	Period	mBank	Consensus	Prior
Current account (mio EUR)	16.03	Jan	-681	-920	-1005
Exports (mio EUR)	16.03	Jan	13400	12763	11967
Imports (mio EUR)	16.03	Jan	13200	12912	12600
Core CPI y/y (%)	16.03	Jan	0.6	0.7	0.5
Core CPI y/y (%)	16.03	Feb	0.5	0.5	
Average gross wage y/y (%)	17.03	Feb	3.2	3.2	3.6
Employment y/y (%)	17.03	Feb	1.3	1.3	1.2
Sold industrial output y/y (%)	18.03	Feb	4.9	4.0	1.7
PPI y/y (%)	18.03	Feb	-2.7	-2.7	-2.9
Retail sales y/y (%)	18.03	Feb	2.2	0.0	0.1

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	-	1500	1.667	2/12/2015
5Y T-bond PS0720	-	3500	1.987	2/12/2015
10Y T-bond DS0725	-	2000	2.366	3/12/2015
20Y T-bond WS0428	-	20	2.092	3/12/2015

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



Comment

Big negative surprise in CPI data brings the index down by a few points. Next week offers plenty of opportunities for surprises, chiefly IP and retail sales data.

* 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% and we are close to the bottom in terms of annual growth rate.
- Despite regional (Russia, Ukraine) and European headwinds (soft euro zone growth), stable domestic demand lets economy pass through relatively unscathed. The source of strength lies in consumption (both private and public) and relatively good moods among firms 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.
- Momentum of inflation recorded a turnaround and we await higher readings in coming months. However, GDP gap is too wide to generate inflation pressure and therefore inflation is going to stay low (very low).
- MPC did its part delivering 50bps cut in March. Official communication states that the cycle has been concluded and rates are going to stay at 1.5%. At the same time rate hikes are miles away since there is no inflation in sight and the new MPC (starting job in 2016) may be even more dovish.

Financial markets

- We closed our long position in 10y sector and turned neutral/negative. We are still semi-defensive on Polish bonds and prefer the 5Y sectors as we do not believe in prompt monetary tightening, way ahead of the ECB.
- MPC concluded the easing cycle at 1.5% and rate cut expectations can only be fueled by substantial PLN strengthening due to QE-connected inflows, high real interest rates and improving cyclical position of the Polish economy.
- Local story is exhausted with regard to Polish long term bonds. From now on focus shifts to euro zone's reflation trends (higher breakevens, higher swap rates amid credit risk compression in the periphery) and whether or not Fed will normalize rates.

mBank forecasts

	2010	2011	2012	2013	2014	2015F
GDP y/y (%)	3.7	4.8	1.8	1.7	3.3	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	-1.2	-1.8
Unemployment rate (end of period %)	12.4	12.5	13.4	13.4	11.5	10.3
Repo rate (end of period %)	3.50	4.50	4.25	2.50	2.00	1.50

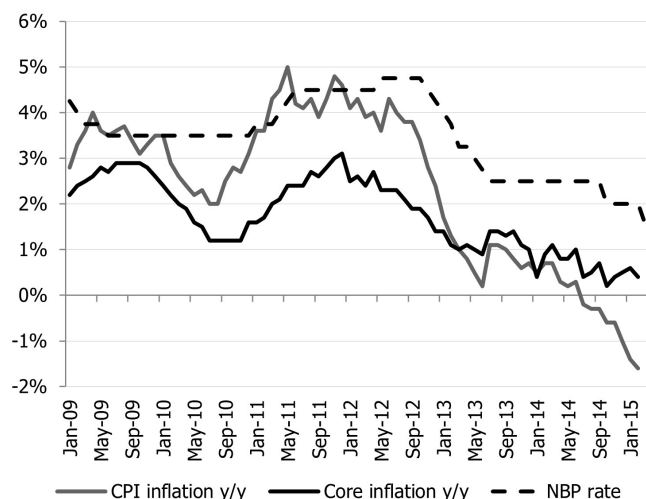
	2014 Q1	2014 Q2	2014 Q3	2014 Q4	2015 Q1 F	2015 Q2 F	2015 Q3 F	2015 Q4 F
GDP y/y (%)	3.4	3.5	3.3	3.1	2.8	3.1	3.5	4.4
Individual consumption y/y (%)	2.9	3.0	3.2	3.1	2.8	2.8	3.2	3.4
Public Consumption y/y (%)	0.1	3.7	3.5	3.7	2.0	3.0	3.0	3.0
Investment y/y (%)	11.2	8.7	9.9	9.0	6.0	6.0	7.0	9.0
Inflation rate (% average)	0.6	0.2	-0.3	-0.7	-1.4	-0.9	-0.4	0.5
Unemployment rate (% eop)	13.9	12.0	11.5	11.5	12.1	11.0	10.2	10.3
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	1.60	1.60	1.60	1.70
10Y Polish bond yields (% eop)	4.23	3.45	3.05	2.52	2.20	2.20	2.30	2.50
EUR/PLN (eop)	4.17	4.16	4.18	4.29	4.10	4.05	4.05	4.05
USD/PLN (eop)	3.03	3.04	3.31	3.54	3.66	3.68	3.75	3.86

F - forecast

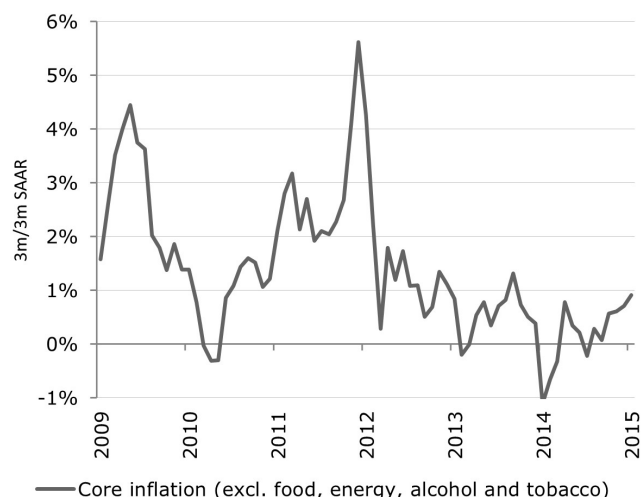
Economics

Deflation hits a new record

CPI inflation in February dropped to -1.6% and January was revised downwards from -1.3% to -1.4%. Compared to 2014, new inflation basket brought some unexpected changes (we opted for an upside revision and we were proven wrong). The share of food, transport (possibly owing mainly to fuels) and housing (we feel that a major downward blow to weighting was generated by cheap energy) fell. On the other hand, importance of core categories in consumer spending rose: recreation and culture, restaurants and hotels, clothing and footwear. The change in weights seems to be consistent not only with substitution and income effects but also a longer, evolutionary shift to services and away from basic goods. The major source of CPI changes in recent months were fuel prices (massive drops) and steadily low food prices. This tendency replicated itself in February. Core categories remained stable but it was sufficient to lower core inflation towards 0.4-0.5% y/y (from 0.6%).



Inflation did make its lowest print and is poised to rise slowly in the coming months. Food prices are set to remain calm, March and April are set to bring an upward adjustment in fuel prices and this tendency is going to be continued, although in lesser magnitude. Core categories, so far contributing to lower inflation readings, have also reached a trough as we already see momentum building (USDPLN rises, inflation trough in non-fuel tradables in EMU). Having enumerated the reasons for a turnaround in CPI, it is fair to say that inflation is going to stay low/very low. Deflation is going to dwell in Poland until Autumn, average CPI for 2015 is set to stay negative.



Publication was not positive for Polish bonds. Market participants used the moment (lowest CPI reading in the cycle) to book profits on recent long bonds positions, being additionally afraid of strong correlation of Polish market with other EMs. Neither we see reasons for fast rate hikes in Poland, nor a chance to visibly front-run ECB hikes by MPC. Why? Contrary to Great Britain: 1) Polish economy is not leading the euro zone's cycle, 2) substantial improvement in macro parameters is tantamount to solid PLN appreciation (it is exactly what we see in GB), 3) much of improvement in 2015 GDP growth comes from EU funds that could possibly fade in 2016 (at least in NBP's opinion).

Fixed income

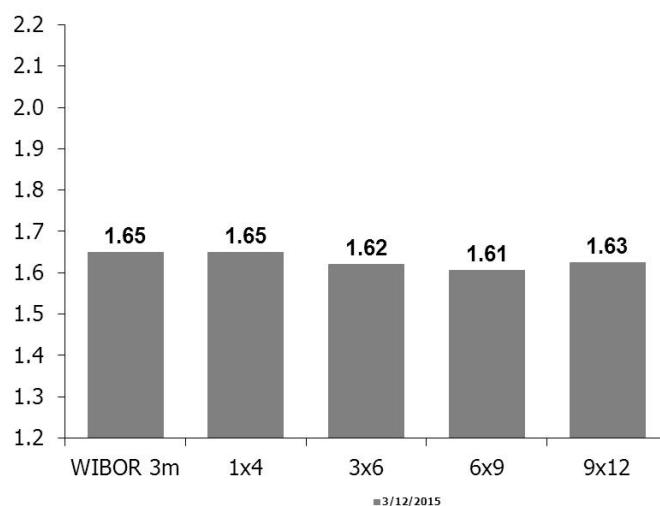
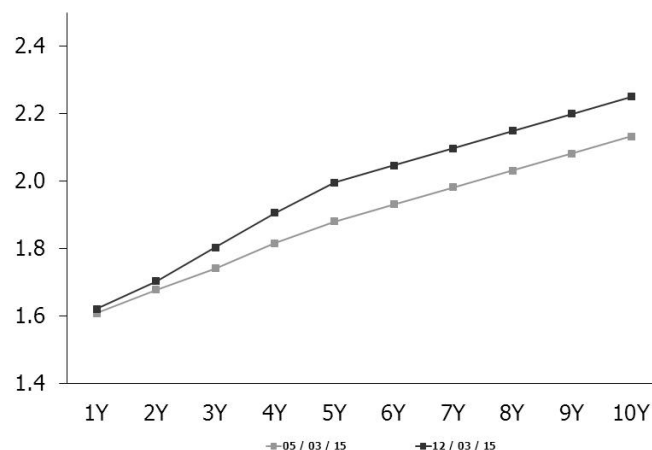
Walking in the shadows

We all live in the shadow of the Fed (tightening) and, as shadows are dark, fears are stronger than hopes. We fear that the Fed will hike rates sooner than later and that the next MPC step will be a hike, too. We see bond sellers hand in hand with EM bonds, we see IRS payers hedging loans. That fear changed perception of PLN market, from converging to emerging basket, and made market vulnerable to any bond selling interest. What may lighten such dark picture? Just dovish Fed crossed my mind, as well as strongly worse performance of US economy. So rather nothing likely, isn't it?

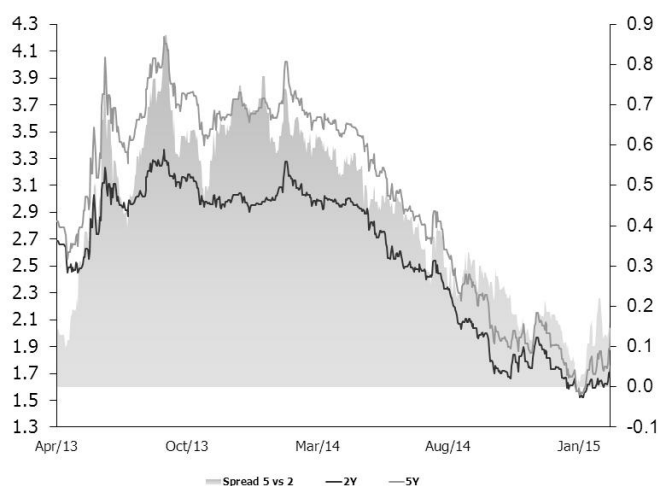
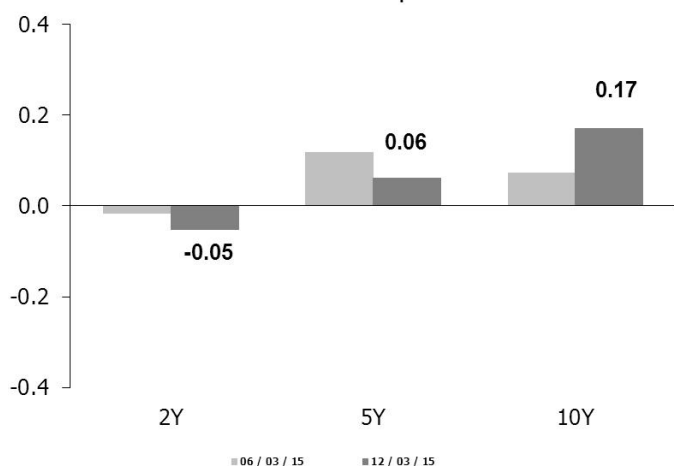
Few words about local point of view. On Thursday MF sold PLN 4 bn of long end bonds on auction. Auction, luckily crossed with US buying interest, went relatively well but made positioning heavier on 10Y. On Friday CPI came surprisingly low, which supports the front end. Seems like selling bonds may be kind of a profitable idea? Well, generally yes, but less attractive given current levels - 5Y trading at 2,10 and 10Y trading 2,50. These are somehow close to historical average values if compared to cash cost (its respectively 60 and 100 bps carry) and therefore creates hardly any relative value.

So buyers then? Level wise we would suggest buying 3-4Y bonds then, with entry levels 1,85-1,90 for 3Y and 1,95-2,00 for 4Y bonds. These bonds are likely to benefit most from cheap cash and CPI staying below 0.0 (or rather close to -1,0) for next few months. And let's wait for better level for selling.

IRS curve



Asset swaps



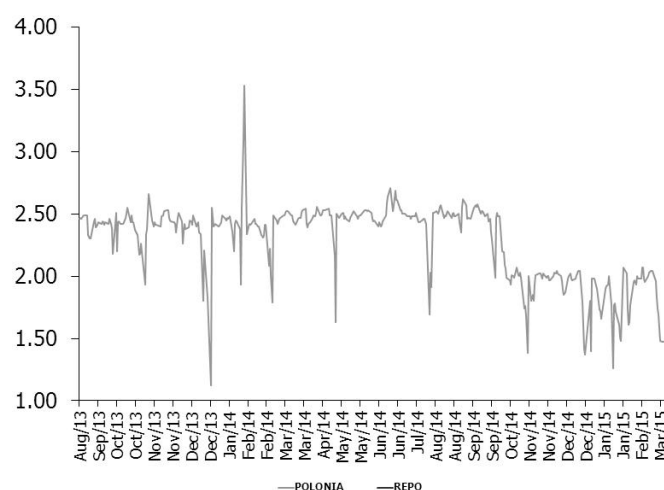
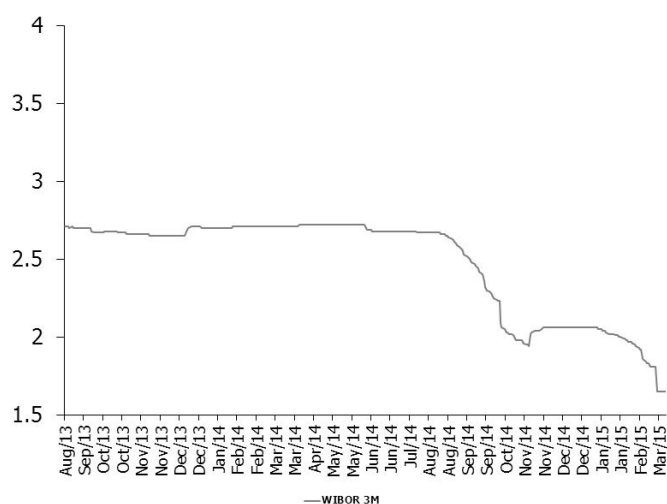
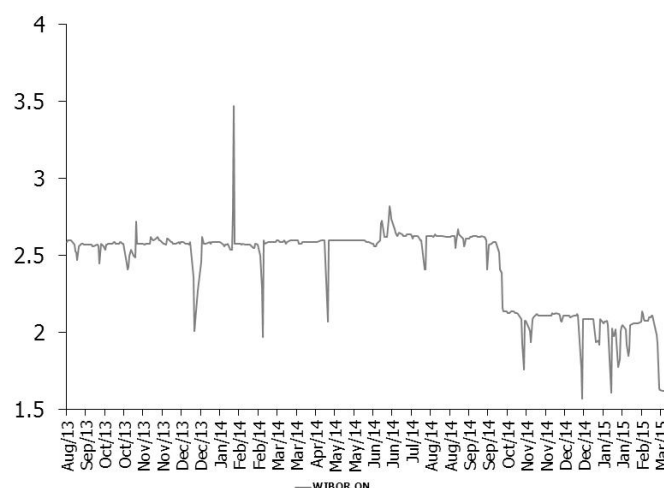
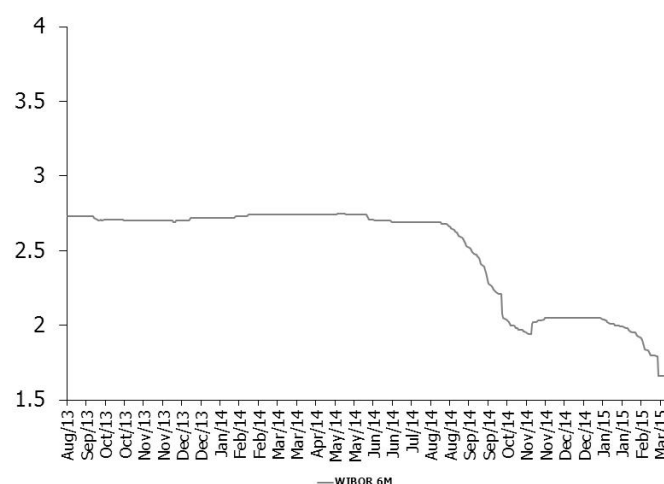
Money market

Expensive week ahead

Polonia fluctuated around 1.50 as banks bought on last OMO just the exact amount to square the market. At today's auction the NBP offered 94 bn money bills (one bn less than it would square the market) and banks bought all of it, so next week might be expensive.

We still recommend:

buy OK0116 at 1,56% buy 1Y OIS and sell 9*12 FRA with spread around 18 – 20 bp.



Forex

PLN consolidating EUR/PLN was consolidating in the current range 4.11–4.17 for the whole week. Looks like the market is a bit puzzled what to do next. Is PLN a synthetic EUR that should be sold due to QE, or it is rather skyrocketing USD/PLN which would put Poland in the ZAR,TRY basket. We think PLN is in majority of cases EUR alike, and only bigger shock would push us into the emerging basket again. We expect 4.12–4.17 range to hold at least till FOMC.

USDPLN vol is a king USD/PLN frontend vols were a real stars of the week. Currency spread (difference between USD/PLN vols minus EUR/PLN vols) climbed from 5.8% to almost 7%. The USD/PLN gamma was in great demand. 1 month EURPLN ATM climbed 0.3% to 5.9%, 3 months EUR/PLN ATM are at 6.2% (the same level as week ago), and 1 year is fixing at 7.2% (0.1% higher). The skew was in demand (6 months EUR/PLN was paid at 1.9%).

Short-term forecasts

Main supports / resistances:

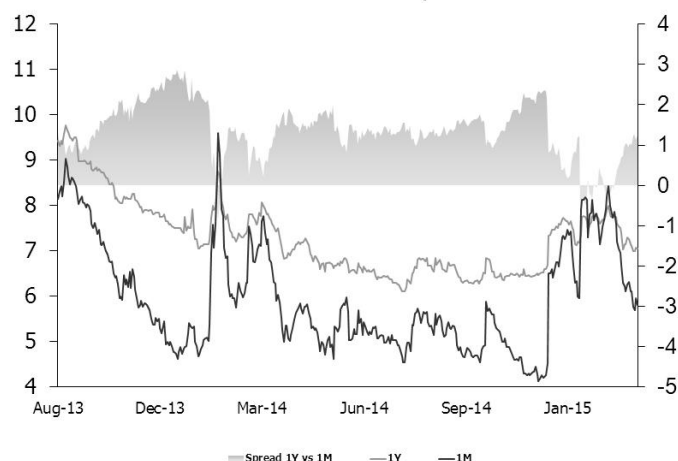
EUR/PLN: 4.08 / 4.24

USD/PLN: 3.60 / 3.90

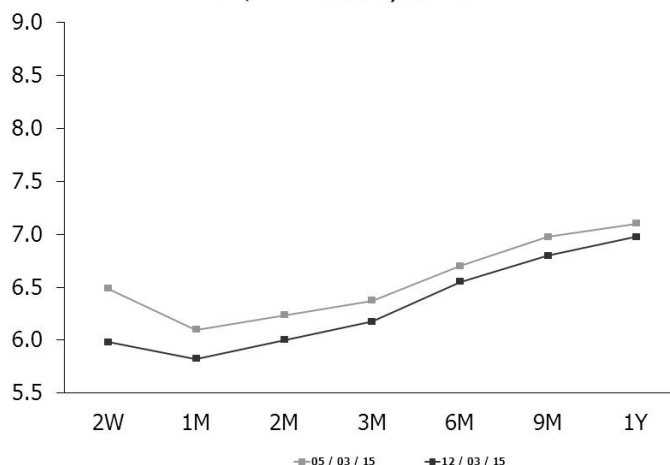
Spot Still sidelined.
No clear signal.

Options We are still long Vega in the backend. We are squaring our longs in USD/PLN in the mid curve as we don't think it will last. We expect more balanced price action until the FOMC. As a consequence we were tempted to use these elevated levels to square USD/PLN longs in the front/mid curve. Still long in Vanna in both EUR/PLN and USD/PLN.

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
3/6/2015	1.68	1.65	1.68	1.56	1.58	1.58	1.64	1.63	1.61	1.66	1.71	1.64
3/9/2015	1.69	1.65	1.76	1.56	1.91	1.58	1.65	1.61	1.60	1.62	1.71	1.63
3/10/2015	1.68	1.65	1.77	1.56	1.92	1.58	1.66	1.64	1.63	1.65	1.72	1.65
3/11/2015	1.53	1.65	1.65	1.56	1.82	1.58	1.61	1.63	1.59	1.63	1.67	1.61
3/12/2015	1.60	1.65	1.71	1.56	1.93	1.58	1.65	1.62	1.61	1.63	1.68	1.63

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
3/6/2015	1.580	1.649	1.758	1.742	2.035	2.153	2.280	2.352
3/9/2015	1.580	1.596	1.738	1.697	2.045	2.134	2.310	2.486
3/10/2015	1.580	1.569	1.740	1.697	2.050	2.136	2.317	2.493
3/11/2015	1.580	1.681	1.720	1.669	2.030	2.054	2.315	2.443
3/12/2015	1.580	1.561	1.703	1.651	1.995	2.057	2.250	2.421

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1Y	
3/6/2015	5.78	6.25	6.70	7.00	7.00	2.26	0.63	
3/9/2015	5.70	6.13	6.50	6.99	6.99	2.26	0.63	
3/10/2015	5.95	6.33	6.68	7.08	7.08	2.29	0.63	
3/11/2015	5.80	6.28	6.63	7.05	7.05	2.16	0.64	
3/12/2015	5.83	6.18	6.55	6.98	6.98	2.29	0.65	

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
3/6/2015	4.1292	3.7649	3.8535	3.1364	1.3578	0.1513
3/9/2015	4.1259	3.7890	3.8531	3.1364	1.3533	0.1513
3/10/2015	4.1233	3.8345	3.8525	3.1448	1.3467	0.1513
3/11/2015	4.1435	3.9091	3.8888	3.2163	1.3563	0.1518
3/12/2015	4.1251	3.8928	3.8781	3.2126	1.3603	0.1513

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