



April 3, 2015

Polish Weekly Review

Department of Economic Analysis (research)

Ernest Pytlarczyk, PhD, CFA
chief economist
tel. +48 22 829 01 66
ernest.pytlarczyk@mbank.pl

Marcin Mazurek, PhD
senior analyst
tel. +48 22 829 01 83
marcin.mazurek@mbank.pl

Piotr Bartkiewicz
analyst
tel. +48 22 526 70 34
piotr.bartkiewicz@mbank.pl

Karol Klimas
analyst
tel. +48 22 829 02 56
karol.klimas@mbank.pl

Department of Financial Markets (business contacts)

Bartłomiej Malocha, CFA
head of interest rates trading
tel. +48 22 829 01 77
bartlomiej.malocha@mbank.pl

Marcin Turkiewicz
head of fx trading
tel. +48 22 829 01 67
marcin.turkiewicz@mbank.pl

Department of Financial Markets Sales (business contacts)

Inga Gaszkowska-Gebska
institutional sales
tel. +48 22 829 01 67
inga.gaszkowska-gebska@mbank.pl

Jacek Jurczyński
head of treasury sales
tel. +48 22 829 15 16
jacek.jurczynski@mbank.pl

mBank S.A.
18 Senatorska St.
00-950 Warszawa
P. O. BOX 728
tel. +48 22 829 00 00
fax. +48 22 829 00 33
<http://www.mbank.pl>

Table of contents

Our view in a nutshell

Economics

- PMI suggests the upswing in manufacturing continues unabated

Fixed income

- Where are those bonds?

Money market

- Expensive week behind us, cheaper ahead

FX market

- PLN continues its uptrend
- Options – vols kept the bid, Skew sold off

page 2

page 3

page 4

page 5

page 6

Comment on the upcoming data and forecasts

A boring week ahead of us - no data releases scheduled. One can expect that SAMAR data on car output and registrations, as well as GUS data on international trade, will be released. Exact dates are not known in advance, though.

Polish data to watch: April 6th to April 10th

Publication	Date	Period	mBank	Consensus	Prior
NO RELEVANT DATA					

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	4/9/2015	2000	2.366	3/12/2015
20Y T-bond WS0428	4/9/2015	20	2.092	3/12/2015

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



Comment

Unchanged - PMI surprised to the downside but only slightly. Polish surprise index will remain unchanged next week as no important data releases are scheduled for the week.

* 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.
- We see more and more signs of a cyclical upswing driven by better momentum in the euro zone (Poland is highly geared especially towards Germany) and backed by solid domestic demand.
- H2 2015 is expected to bring more (positive) exogenous components to the Polish cycle. Lower costs of financing, generally lower budget deficit and the beginning of a new round of infrastructure spending are expected to give way to expenditures related to political business cycle ahead of presidential and general elections.
- Given the schedule of infrastructure spending and stable consumption growth, 2-3 years of economic expansion are our baseline scenario for Polish economy. Upswing phase can be flatter than we historically got used to but longer. Such an outcome almost guarantees that the likelihood of bottlenecks in the economy is small.
- Momentum of inflation recorded a slight 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). Prices are going to stay in deflation in the next 2-3 quarters.
- 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 are 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.

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

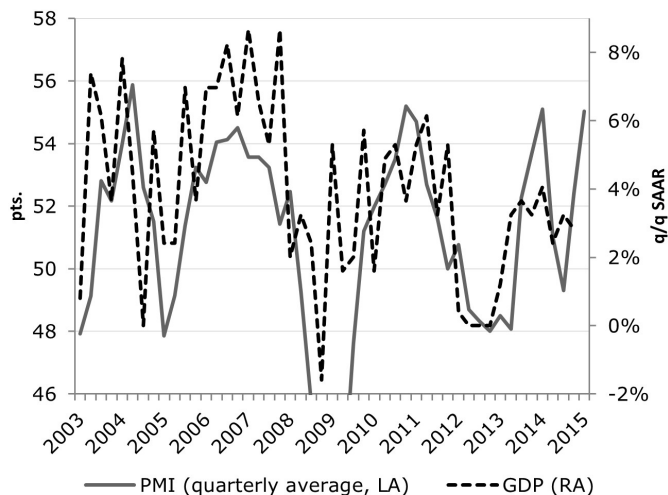
	2014	2014	2014	2014	2015	2015	2015	2015
	Q1	Q2	Q3	Q4	Q1 F	Q2 F	Q3 F	Q4 F
GDP y/y (%)	3.4	3.5	3.3	3.1	3.1	3.5	3.7	4.1
Individual consumption y/y (%)	2.9	3.0	3.2	3.1	2.6	2.8	2.8	2.8
Public Consumption y/y (%)	0.1	3.7	3.5	3.7	2.0	3.0	3.0	2.0
Investment y/y (%)	11.2	8.7	9.9	9.0	6.0	7.5	8.5	10.0
Inflation 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	11.7	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	1.65	1.65	1.65	1.65
2Y Polish bond yields (% eop)	3.01	2.51	2.00	1.79	1.61	1.60	1.60	1.70
10Y Polish bond yields (% eop)	4.23	3.45	3.05	2.52	2.31	2.10	2.30	2.40
EUR/PLN (eop)	4.17	4.16	4.18	4.29	4.07	4.05	4.00	4.00
USD/PLN (eop)	3.03	3.04	3.31	3.54	3.80	3.82	3.88	4.00

F - forecast

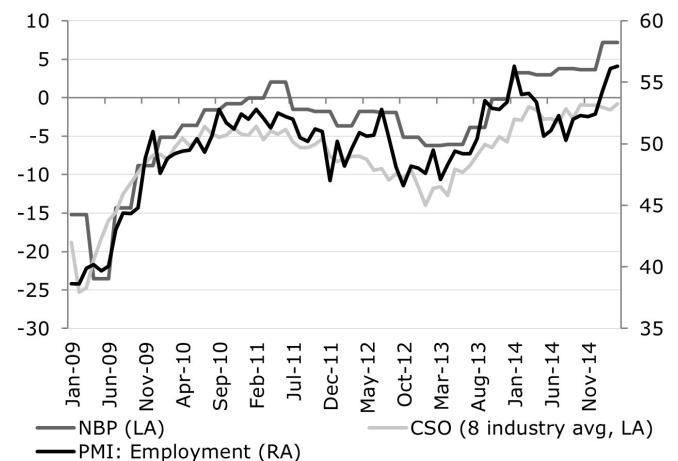
Economics

PMI suggests the upswing in manufacturing continues unabated

Although PMI index fell slightly from 55.1 to 54.8, it stays deep in expansionary territory and normal volatility of the index allows us to claim that business activity in manufacturing stabilized at a high level. Quarterly average is almost equal to multi-year highs recorded in Q4 2010 and Q1 2014 (see the graph below).



Employment forecasts in enterprise surveys



We think that PMI is the first of the better string of data to be published this month, from industrial output and retail sales to higher CPI and PPI (both turning around from deeply negative readings). Such a mixture is going to support stable rates for several months. However, appreciation of the zloty (including a possible break of 4.00 level in EURPLN) is set to be working in favor of reigniting rate cut expectations. The closer to the pain threshold for exporters (currently 3.80-90), the more dynamic this revision of expectations will be.

Characteristics of the manufacturing sector barely changed since last month. High level of output was maintained. Assessment of new orders fell a bit due to domestic factors; orders from abroad improved. Interestingly, actual quotes from surveyed firms suggest that high levels of USDPLN rate are beneficial for exporters. This group is unlikely to be sizable given the small share of USD-denominated exports and overall (basket) PLN strength. All in all export orders are visibly weaker than in 2013/2014 when price competitiveness of Polish goods was at highs.

Strong dollar boosts production costs (input price index went high to 53.6 from 50.4) but so far, given the overall PLN strength, a modest increase in costs does not influence final goods prices. Hence, deflation is still running fast and still deeply negative annual growth rate of producer prices offers a good description of the current state of nominal processes in Poland.

Last but not least, labor market recorded another good month. Employment index climbed to historically highest level (56.3) previously recorded in January 2014. Our above-consensus forecast calls for 1.2% y/y employment growth. After this PMI reading we would normally feel confident but this time it may well be that 1k of workers can tip the scale towards 1.1. Regardless of the final reading we feel the labor market is visibly on the mend and downside surprises should be treated as one-offs or noise.

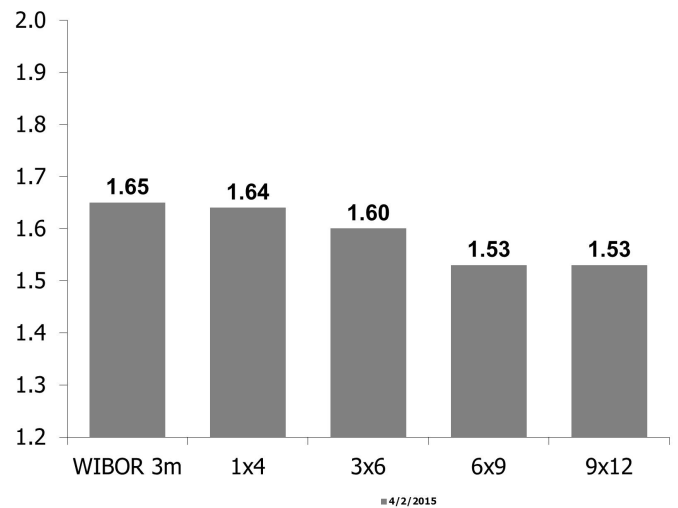
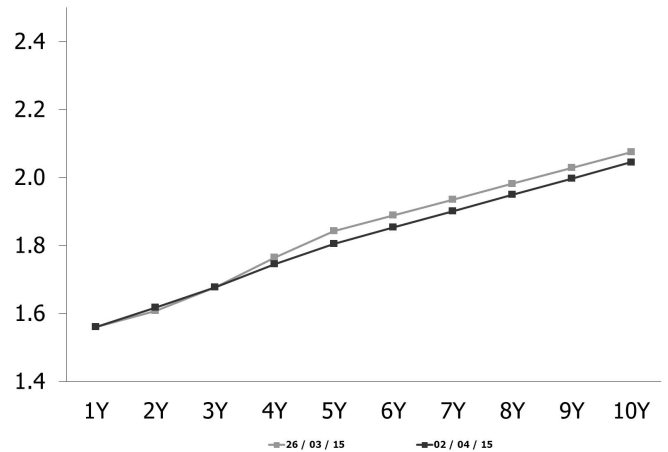
Fixed income

Where are those bonds?

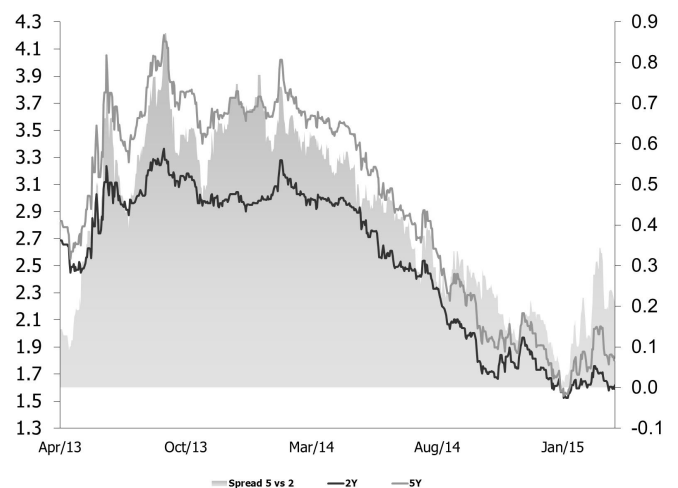
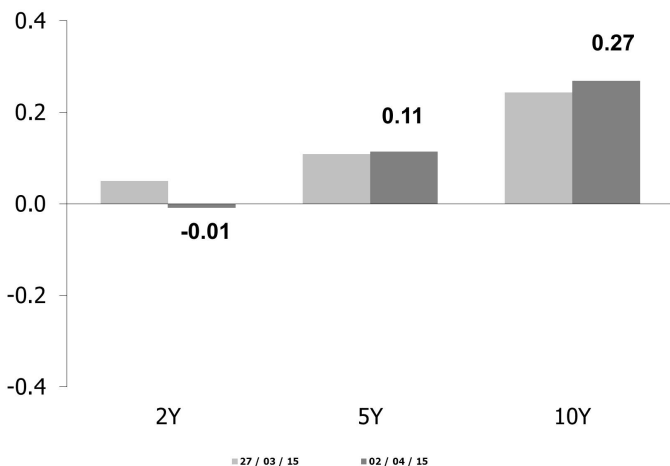
Last week turnover and volatility on Polish fixed income market was below average. Rumors about Greece leaving/staying in the Eurozone do not change sentiment anymore, local data are not exciting either (with local repo rate 'fixed' by the MPC). As we stated in the previous weekly, the main subject of interest is the U.S economy and we just saw surprisingly weak Non-Farm Payrolls data.

This might trigger decent inflows into POLGBs and, considering thin turnover, recently there is a chance for a nervous rally, especially on long end bonds. We expect new range on 10Y bond yield to settle at 2.10%-2.30%.

IRS curve



Asset swaps

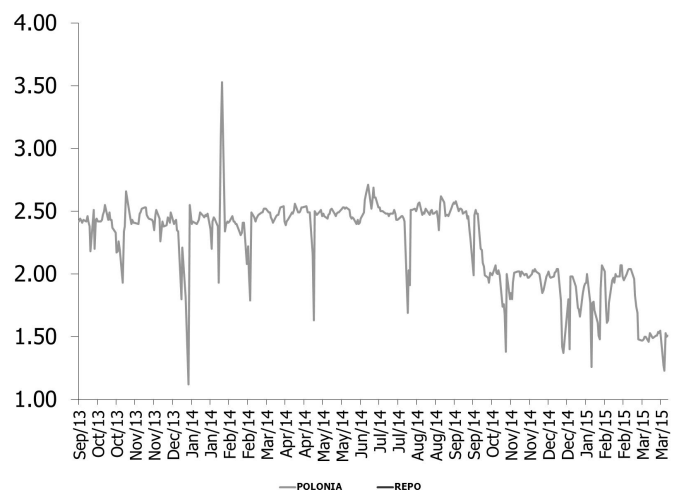
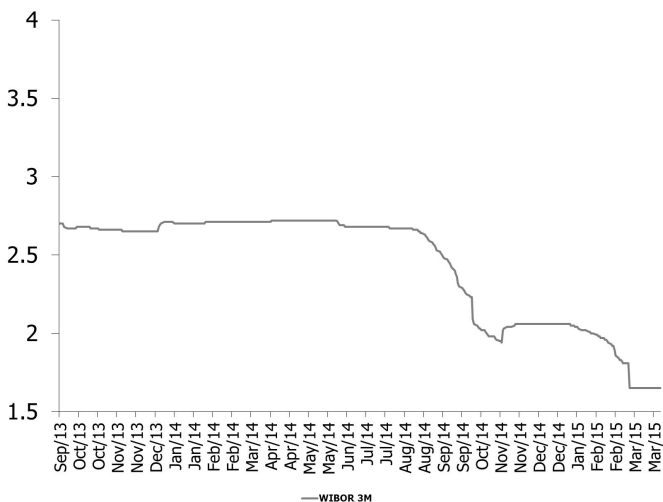
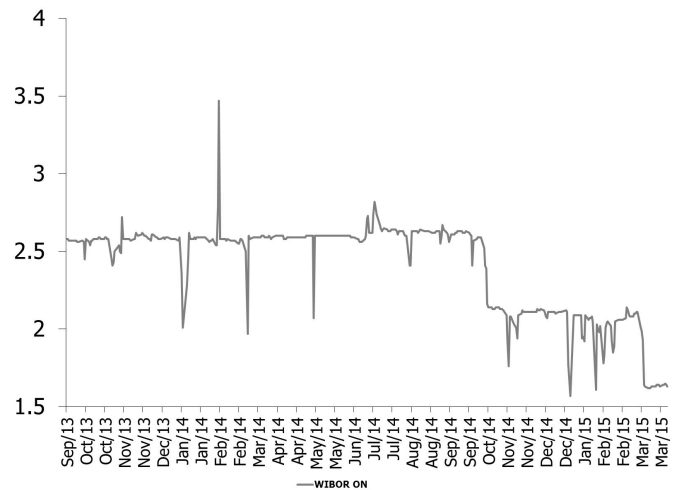
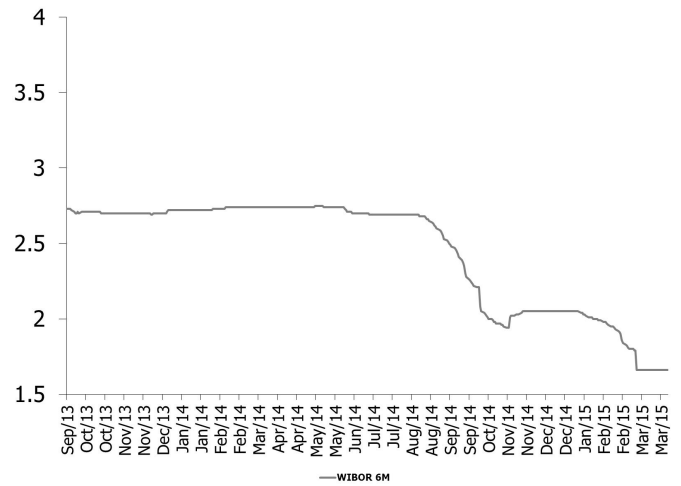


Money market

Expensive week behind us, cheaper ahead

End of reserve was a bit cheaper. Polonia fall to 1.30 in Friday and Monday. The rest of the week was expensive with cash rates over 1.50. Friday's auction was underbid by 3 mld PLN so it might be a bit cheaper after the weekend.

Short end of the curve stayed unchanged. 9x12 FRA is around 1.52 and 1Y OIS around 1.42. On Thursday we noticed quite big sell of OK0116 with 1.57 yield. In our opinion it was a good opportunity to buy it.



Forex

PLN continues its uptrend After the short term upside correction in EUR/PLN to 4.1030, the downturn resumed marking the fresh YTD lows at 4.0530. Then the rate meandered slowly to 4.0750 as market was losing liquidity in this pre-holidays period. The weak NFP gave PLN additional boost. Nevertheless, we are approaching the strong support zone at 4.03/4.05, and we are not expecting it will give way that easy, at least not at the first attempt.

Options – vols kept the bid, Skew sold off. 1 month EUR/PLN ATM mid is fixing this Friday at 6.4 (0.1% higher), 3 months EUR/PLN are 6.5% (unchanged), and finally 1 year is 7.0% (unchanged). The Skew was offered, as the market was trying to buy back the lower strikes in EUR/PLN and USD/PLN by selling RRs in both. As the result the Skew has melted by roughly 0.25%. The currency spread (difference between USD/PLN vol and EUR/PLN) was offered in the frontend as EUR/USD spot calmed a little bit.

Short-term forecasts

Main supports / resistances:

EUR/PLN: 4.05 / 4.15

USD/PLN: 3.60 / 3.95

Spot Long USD/PLN position from 3.72 was partially closed at 3.8050 with profit. The rest was closed at 3.72 (entry level).

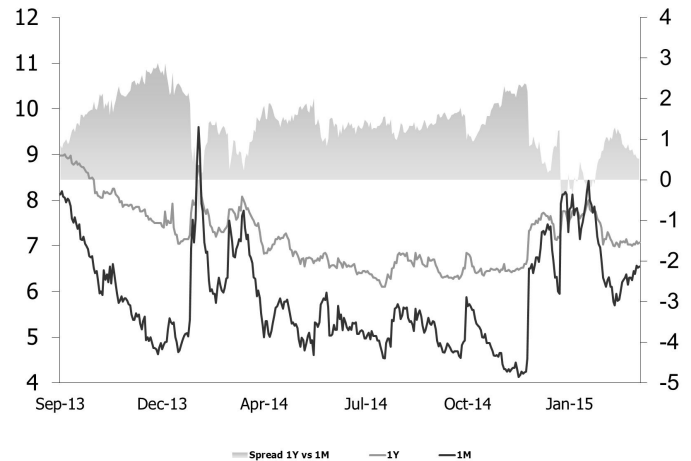
Long EUR/PLN.

We are tactically long EUR/PLN at 4.0585, ready to add at 4.0200 with a s/l below 4.00 and profit taking at 4.1150. It is purely technical/tactical.

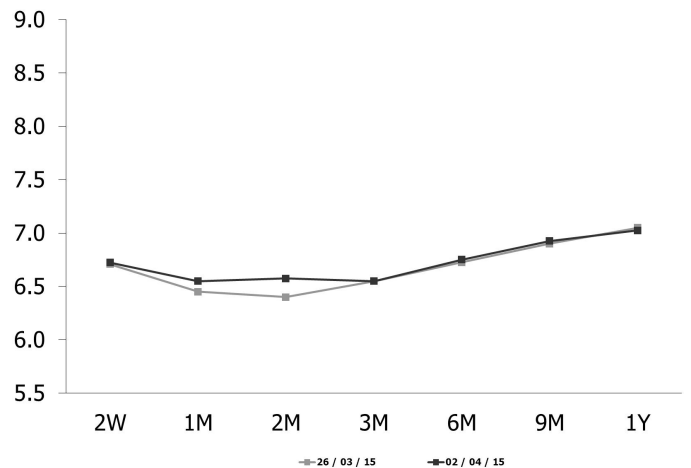
Options The FOMC has created enormous realized volatility, especially in EUR/USD and other USD/XXX crosses. It is very likely that the market will continue to be choppy at best. But in the longer term, the relative nature of the FOMC policy should reduce substantially the heat of the markets. We are trimming our long Vega in the backend but sticking to long Vanna in both EUR/PLN and USD/PLN.



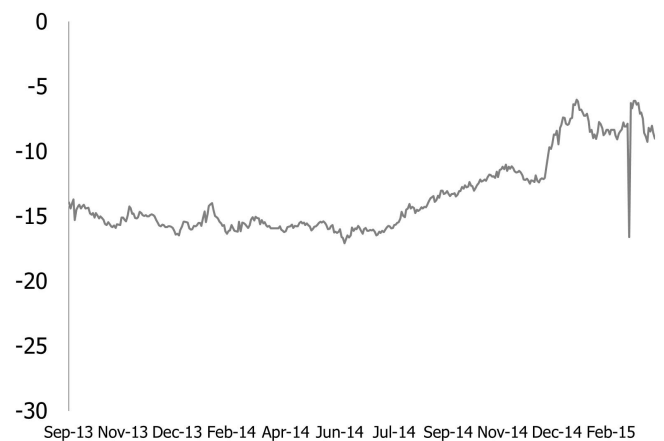
EURPLN volatility



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
3/27/2015	1.84	1.65	1.68	1.56	1.58	1.58	1.64	1.58	1.52	1.52	1.55	1.53
3/30/2015	1.70	1.65	1.80	1.56	1.56	1.58	1.63	1.58	1.51	1.51	1.54	1.53
3/31/2015	1.68	1.65	1.68	1.56	1.58	1.58	1.64	1.59	1.52	1.52	1.55	1.53
4/1/2015	1.63	1.65	1.44	1.56	1.47	1.58	1.64	1.58	1.51	1.51	1.55	1.53
4/2/2015	1.86	1.65	1.97	1.56	1.99	1.58	1.64	1.60	1.53	1.53	1.58	1.55

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
3/27/2015	1.580	1.646	1.605	1.655	1.845	1.953	2.080	2.323
3/30/2015	1.580	1.574	1.590	1.618	1.825	1.943	2.055	2.297
3/31/2015	1.580	1.550	1.608	1.600	1.832	1.943	2.071	2.325
4/1/2015	1.580	1.608	1.592	1.596	1.802	1.935	2.035	2.325
4/2/2015	1.580	1.617	1.618	1.609	1.805	1.919	2.045	2.313

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1Y	
3/27/2015	6.39	6.48	6.66	7.03	7.03	2.16	0.63	
3/30/2015	6.56	6.53	6.78	7.10	7.10	2.16	0.63	
3/31/2015	6.53	6.50	6.75	7.05	7.05	2.11	0.58	
4/1/2015	6.55	6.53	6.75	7.08	7.08	2.07	0.62	
4/2/2015	6.55	6.55	6.75	7.03	7.03	1.94	0.63	

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
3/27/2015	4.0993	3.7890	3.9177	3.1739	1.3635	0.1489
3/30/2015	4.0940	3.7685	3.9097	3.1487	1.3656	0.1490
3/31/2015	4.0890	3.8125	3.9110	3.1744	1.3667	0.1486
4/1/2015	4.0665	3.7890	3.8929	3.1505	1.3597	0.1477
4/2/2015	4.0640	3.7524	3.9028	3.1392	1.3604	0.1475

Disclaimer

Distribution and use of this publication The review note is based on the information available to the public. This review creates exclusively a marketing information as defined in Paragraph 9 Section 1 of the Decree of Minister of Finance dated November 20, 2009 on procedures and conditions to be followed by investment firms and banks mentioned in Article 70 Section 2 of Law on Trading in Financial Instruments dated July 29, 2005 as well as by custody banks. This review note is provided to you for information purposes only and is not intended as advice on any particular matter or as recommendation, offer or solicitation for purchase or sale of any financial instrument and should not be taken as such. mBank SA, its directors, officers, executives, managers, servants or agents expressly disclaim all liability to any person in respect of any-thing, and in respect of the consequences of anything, done or omitted to be done, wholly or partly, in reliance upon the whole or any part of the contents of this review note. The opinions and estimates contained herein reflect the current judgment of the author(s) on the date of this document and are subject to change without notice. The opinions pointed in review do not necessarily correspond to the opinions of mBank SA. The past performance of financial instruments is not indicative of future results. No assurance can be given that any financial instrument or issuer described herein would yield favourable investment results. mBank and/or its principals or employees may have a long or short position or may transact in the financial instrument(s) and/or securities referred to herein or may trade in such financial instruments with other customers on a principal basis. No client or other reader should act or refrain from acting on the basis on any matter contained in it without taking specific independent professional advice on the particular facts and circumstances in issue. Copyright protection exists in this publication and it may not be, even partially, reproduced of distributed without the prior written agreement with mBank SA.

©mBank 2013. All rights reserved.