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Polish Weekly Review

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Comment on the upcoming data and forecasts

Upcoming week brings real sphere data releases into spotlight and the fresh reading of producer prices. Contrary to dovish surprise in consumer prices, real sphere is set to be more upbeat. Our estimates suggest industrial output growth at 6.9% y/y which was corroborated also by other pieces of information accumulated in the meantime. Also retail sales are expected to accelerate towards 4.3% y/y and given the fresh evidence on car sales consensus seems to be too pessimistic. Last but not least, producer prices are set to stage a minor turnaround towards -2.3% due to higher prices of oil and stronger dollar. On Friday CSO will publish its statistical bulletin for March but it will not bring any new interesting data.

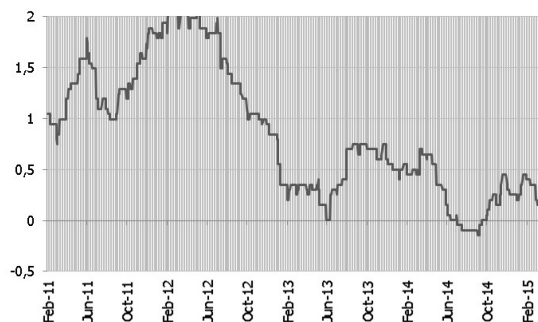
Polish data to watch: April 20th to April 24th

Publication	Date	Period	mBank	Consensus	Prior
Sold industrial production y/y (%)	20.04	Mar	6.9	7.2	4.9
PPI y/y (%)	20.04	Mar	-2.3	-2.5	-2.7
Construction output y/y (%)	20.04	Mar	1.0	2.1	-0.3
Retail sales y/y (%)	20.04	Mar	4.3	1.6	-1.3
Unemployment rate (%)	24.04	Mar	11.7	11.7	12.0

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	4/23/2015	1500	1.667	2/12/2015
5Y T-bond PS0720	4/23/2015	3500	1.987	2/12/2015
10Y T-bond DS0725	-	2000	2.262	4/9/2015
15Y T-bond WS0428	-	20	2.092	3/12/2015

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



Comment

Although this week the index had many opportunities to move, it remained unchanged. Negative surprise in CPI and employment was completely offset by rapid rise in average wage. Next week brings more possible changes: IP, PPI, retail sales (preliminary data for unemployment rate was already released by Ministry of Labour).

* 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	3.4	3.8
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 (%)	3.5	3.6	3.3	3.3	3.3	3.7	3.9	4.3
Individual consumption y/y (%)	3.0	3.0	3.2	3.0	2.8	3.1	3.3	3.5
Public Consumption y/y (%)	0.5	6.4	5.3	6.4	5.5	3.0	3.0	2.0
Investment y/y (%)	11.4	8.7	9.2	8.6	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	3.90	3.80	3.90
USD/PLN (eop)	3.03	3.04	3.31	3.54	3.80	3.68	3.69	3.90

F - forecast

Economics

Rates unchanged. MPC is observing, discussing ...

Just as expected, Polish MPC did not change interest rates on its April meeting. Main reference rate still equals 1.50%. Wording of the statement is in our opinion rather dovish. Inflation diagnosis is straight: there is absolutely no demand pressure (despite improving macroeconomic environment), both deflation and low inflation expectations hold. This was confirmed by latest CPI and base inflation data releases (read more below). The Council has not even mention inflation returning to its target but only focused on reducing likelihood of staying below. The latter best describes MPCs current decision making approach. Last decision to terminate rate cuts cycle resulted not from inflation perspectives but from an inability to constitute long-lasting majority which could react in time to changes in macroeconomic environment.

This schizophrenia revealed itself also during press conference. On the one side there were very cautious comments concerning zloty (however exposing fears of Polish currency strengthening) and statements that getting out of deflation will be sluggish whilst on the other explanations that revising rate cuts will be irresponsible (this is obviously a defense of the latest compromise). When it comes to monetary policy perspectives, governor Belka pointed that rate cuts would be resumed only in face of substantial deterioration of economic situation. At the same time, any rate hikes are so far away from us that they are not even worth discussing.

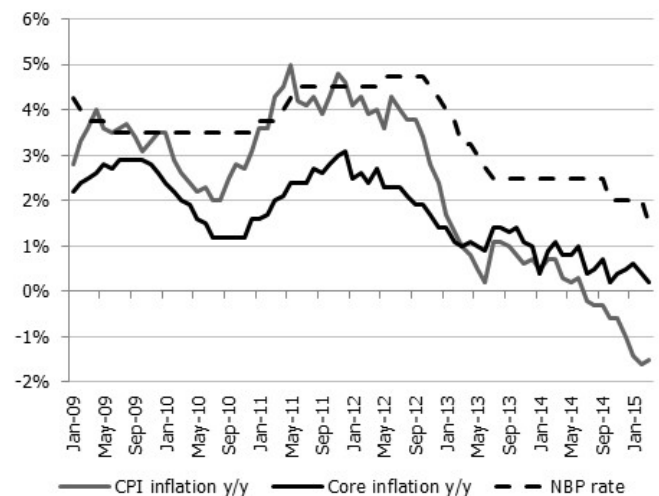
What are the implications for monetary policy? Current MPC setting cannot be ignored - difficulties with reaching latest compromise suggest that there would be no more rate changes. MPC practices very static version of monetary policy which ignores future effects of present events. This was seen already several times: with rate hike in 2012 (when slowdown was already obvious), keeping firmly its line in 2013 and postponing continuation of rate cuts in 2014 (since March 2014 risk for economic growth and inflation were clearly visible).

Present setting: European QE as well as "extravagantly" high real interest rate in Poland can have innumerable consequences in the future. MPC has already noticed (explicitly in statement) that QE could be driving strengthening of Zloty. In our opinion, it is very likely that this is only the beginning of this process. Through capital inflows to Polish stock exchange and carry trades zloty will continue gaining in value. In the case of a small open economy like Poland, this will significantly postpone reaching inflation target.

Thus in our opinion justified are: pricing of rate cuts in Poland, emphasizing personal changes in MPC in 2016 and possible correction of further monetary policy in case of putting further off inflation returning back to its target. In the European context (QE affecting more assets, interest rates in negative territory) it will be very challenging for an open economy like Poland not to share with others its success, driven significantly by price competitiveness - higher economic growth will be offset by capital inflows and strengthening of zloty. In the end we are very skeptical that Poland will raise interest rates ahead of Eurozone. Keep in mind that the latter are priced currently in 4-5 years.

Deep deflation holds. Core inflation aiming zero.

In March inflation amounted to -1.5% yoy, so the rebound is only marginal (only 0.1 pp difference compared to February). This comeback is also significantly slower than expected (much slower than NBP projection as well). Main reason for such sluggish "acceleration" are very low food prices (-0.1% mom) and absolutely no pressure among base categories. If fuel prices had not risen (+3.7% mom) inflation would have been even lower than month before. Core inflation fell to 0.2%, which is its all time low.



Our base scenario is a slow rise of inflation in the following months. However, with even lower starting point the deflation exit moment is moving further down in time. We can easily imagine that with positive surprise from seasonally low food prices (we have been stating for a long time that record low 2014 does not automatically mean expensive 2015) and slowly emerging results of the strengthening zloty (worth now 0.7 pp fall in inflation) we could not yet exit deflation this year and inflation in 2016 could not reach even 1%. With output gap still wide open (even in face of growth acceleration - fast GDP growth in Poland currently works both ways because it also strengthens the currency) will result in MPC not delivering inflation target for longer than anybody had expected. This implies that speculation about further rate adjustments are justified, maybe by the next council, which - contrary to the current one - will not be so divided or entangled.

Fixed income

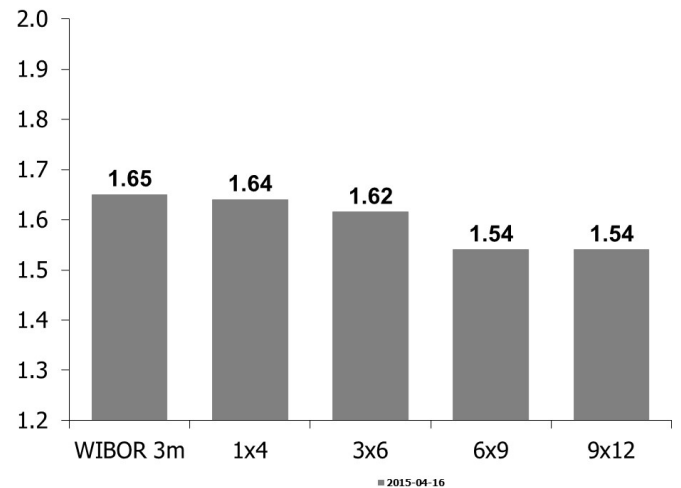
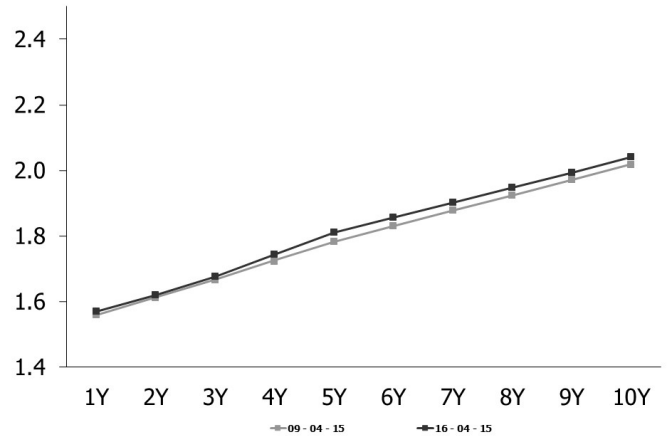
Grexit?

Another boring week on POLGBs with very low turnover and volatility. Market was waiting for CPI data which surprisingly came lower (-1.5% y/y) than estimated (-1.3% y/y); MPC decision – rates unchanged, while governor Belka reiterated that easing cycle is over and current PLN level is not a concern as policymakers were not surprised by, related to ECB's QE program, recent PLN gains.

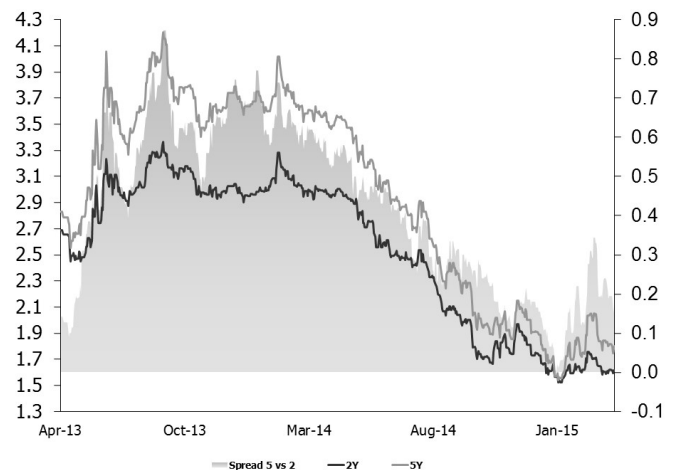
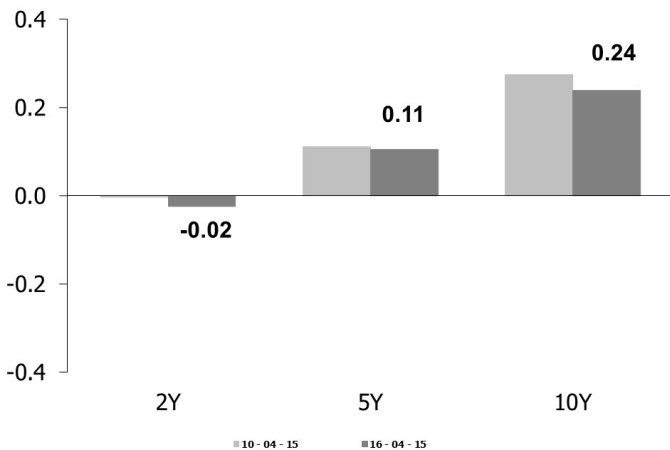
With 10 US Treasuries at 1.85% and 10Y Bund at new yield lows (0.05%) we see dynamic outflows from PIGS's markets (10Y PO 1.98% vs 1.60% last Friday; 10Y IT 1.46% vs 1.27%; 10Y GR 12.5%! vs 11.05%; 10Y SP 1.44% vs 1.20%) due to GREXIT speculations. In fact, current Polish yields aren't so attractive comparing to e.g. Italy or Spain taking into account foreign exchange risk and ECB's QE activity. With poor long end bonds auction last week we focus on next week, when Ministry of Finance will offer shorter ones as we don't see demand from offshore investors on secondary market.

In such risk-off environment we recommend to stay sidelines; watch closely developments in Greece.

IRS curve



Asset swaps



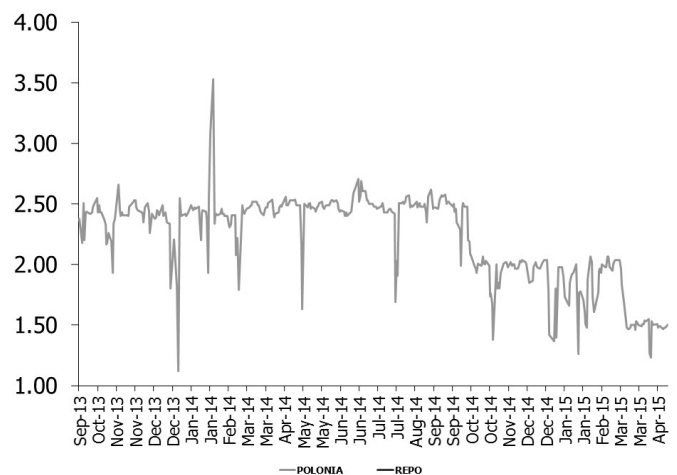
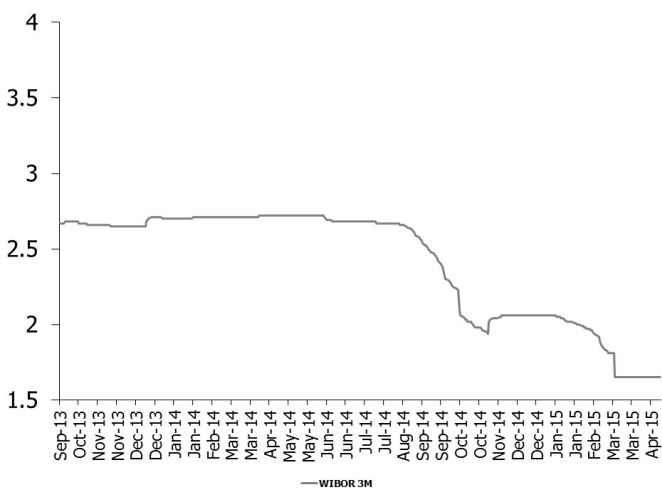
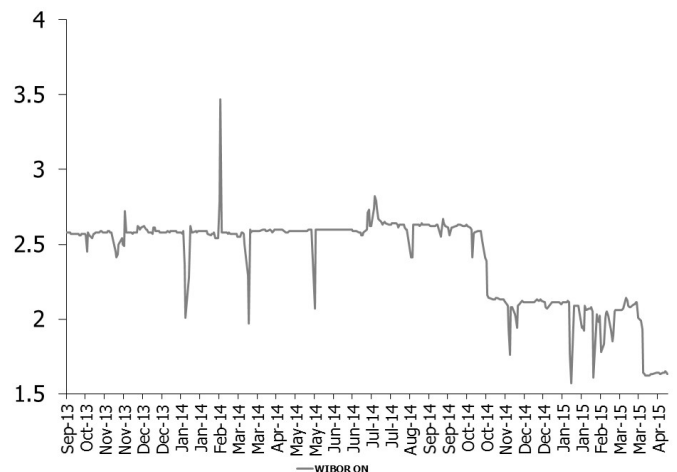
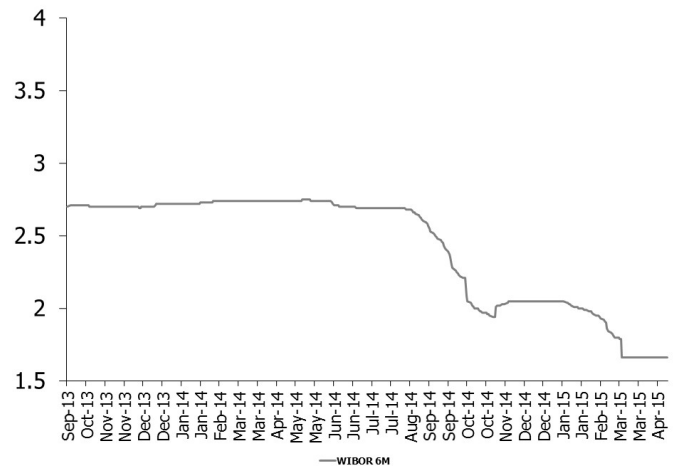
Money market

Stable week behind us

Despite MPC meeting and CPI data last week was extremely boring. Polonia fluctuated a bit under 1.50 with small cash surplus. As today's OMO was a bit underbid next week should be same.

Low inflation (-1.5 vs -1.3 expected) moved just longer end of the curve, shortest remained almost same. So ... 1Y OIS is 1.42 and 9x12 is 1.52. After MPC we noticed some small interest in paying shortest FRA, so 3x6 moved tick higher. As we discounting further cuts in FRAs we recommend to buy it as in our opinion rates will stay stable until end of 2015. Top hedge it buy OK0116.

Next week we have some data (industrial output and retail sales) so they might hopefully move the market and add some volatility.



Forex

PLN consolidating EUR/PLN eventually dipped below 4.0000 (3.9775 low) but PLN was unable to keep to this gains, and we quickly bounced back above 4.000. 3.9975 - 4.0350 constituted the range of the week. We have to allow for some further consolidation, as the market is clearly not ready for clean break off this strong support. The PLN longs are too big, but a potential squeeze to 4.05/4.07 would clean the picture. We still focusing on global factors, as our MPC was nonevent, and the PLN strength subject was in particular avoided. We forecast 3.99/4.07 range for next week.

Options – higher Even the PLN strong and stable, the vols are keeping on creeping higher. 1 month ATM EUR/PLN mid is this Friday at 6.8% (0.2% higher), 3 months are 6.8% (0.1% higher) and finally 1 year is fixing at 7.05% (0.05% higher). The strikes bellow 4.00 are in particular demand, and Gamma in USD/PLN. Skew has stabilized after last week's slide. The market is clearly lacking liquidity, what has devastating effect on bid/offer spreads.

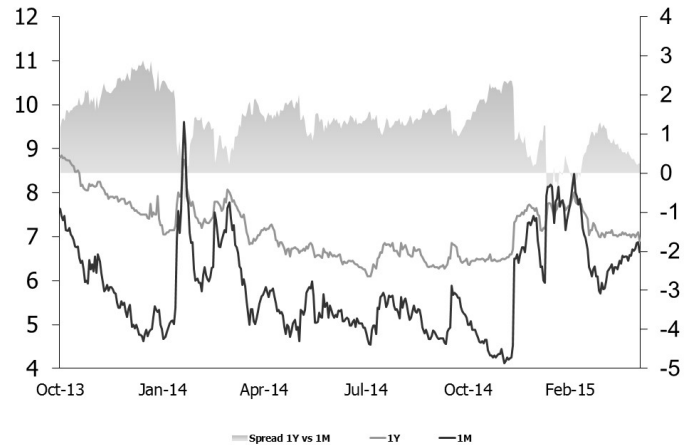
Short-term forecasts

Main supports / resistances:
 EUR/PLN: 4.00 / 4.10
 USD/PLN: 3.60 / 3.95

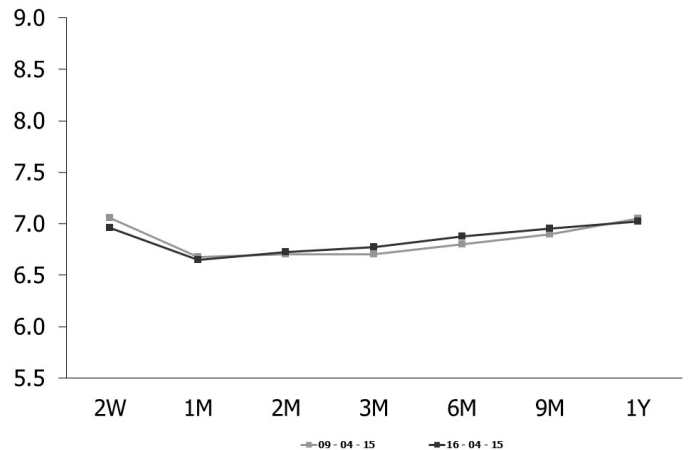
Spot Long EUR/PLN We are long EUR/PLN at 4.0150 ready to add at 3.9950 with a stop bellow 3.9800, and hopes to see 4.06 + for P/T. It is purely technical trade, the ECB QE is still the dominant note, but the PLN longs seems stretched. And we see decent risk/reward on this trade.

Options Still keeping the core long Vanna (long R/R position in both EUR/PLN and USD/PLN). We have even added to this position at current more favorable levels. We still have a preference of being long longer term options against frontend. But current frontend gains are clearly the mimicking moves of the leading currency pairs like EUR/USD.

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
4/10/2015	1.82	1.65	1.77	1.56	1.97	1.58	1.64	1.58	1.52	1.52	1.55	1.54
4/13/2015	1.65	1.65	1.66	1.56	1.56	1.58	1.62	1.60	1.53	1.53	1.56	1.54
4/14/2015	1.85	1.65	1.93	1.56	1.94	1.58	1.64	1.59	1.52	1.52	1.56	1.54
4/15/2015	1.63	1.65	1.70	1.56	1.85	1.58	1.62	1.59	1.52	1.52	1.55	1.53
4/16/2015	1.73	1.65	1.79	1.56	1.92	1.58	1.64	1.62	1.54	1.54	1.58	1.56

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
4/10/2015	1.580	1.576	1.613	1.610	1.803	1.914	2.036	2.311
4/13/2015	1.580	1.539	1.630	1.580	1.829	1.963	2.080	2.343
4/14/2015	1.580	1.530	1.620	1.576	1.810	1.925	2.055	2.301
4/15/2015	1.580	1.521	1.603	1.593	1.790	1.895	2.038	2.262
4/16/2015	1.580	1.494	1.620	1.596	1.810	1.915	2.040	2.279

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1Y	1Y
4/10/2015	6.73	6.70	6.76	6.99	6.99	2.01	0.64	0.64
4/13/2015	6.85	6.73	6.85	7.05	7.05	2.01	0.64	0.64
4/14/2015	6.86	6.78	6.94	7.10	7.10	2.01	0.62	0.62
4/15/2015	6.64	6.61	6.68	6.90	6.90	2.28	0.56	0.56
4/16/2015	6.65	6.78	6.88	7.03	7.03	1.91	0.61	0.61

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
4/10/2015	4.0198	3.7894	3.8715	3.1512	1.3489	0.1467
4/13/2015	4.0198	3.8088	3.8708	3.1522	1.3526	0.1466
4/14/2015	4.0088	3.8001	3.8845	3.1729	1.3523	0.1468
4/15/2015	4.0083	3.7875	3.8801	3.1685	1.3539	0.1465
4/16/2015	4.0140	3.7746	3.8901	3.1655	1.3368	0.1460

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