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April 24, 2015

Polish Weekly Review

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Comment on the upcoming data and forecasts

Upcoming week brings no relevant economic releases.

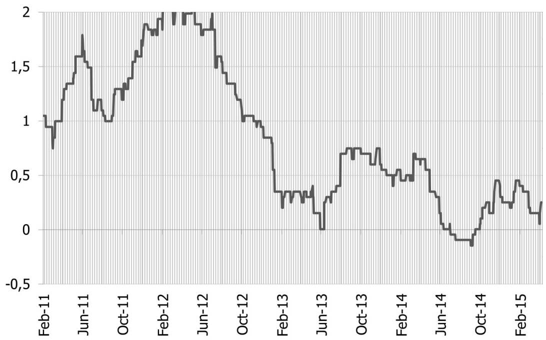
Polish data to watch: April 27th to May 1st

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	4/23/2015
5Y T-bond PS0720	-	3500	1.987	4/23/2015
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

Series of releases from real shpere moved the index few points higher. Both industrial production and retail sales came quite better than expected (read more in economics section). PPI, though also being slightly better than market consensus, did not contribute to this rise. Surprise index is slowly moving up, but it is still far from this years maximum. Next week brings no opportunities to move the 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 see more and more sings 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. Growth accelerates.
- 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.
- 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

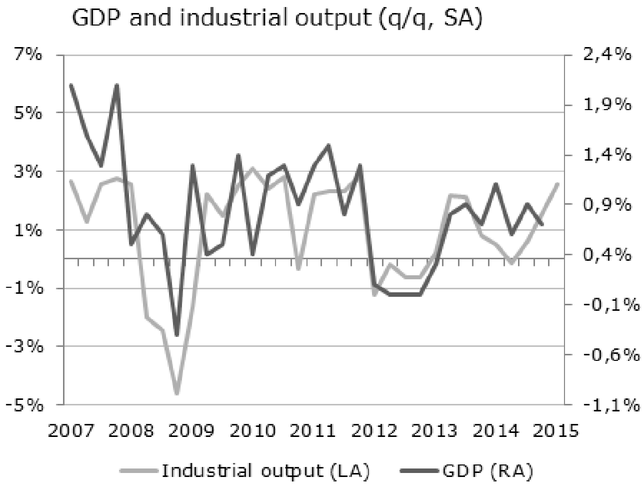
	2014 Q1	2014 Q2	2014 Q3	2014 Q4	2015 Q1 F	2015 Q2 F	2015 Q3 F	2015 Q4 F
GDP y/y (%)	3.5	3.6	3.3	3.3	3.3	3.7	3.9	4.3
Individual consumption y/y (%)	3.0	3.0	3.2	3.0	2.8	3.1	3.3	3.5
Public Consumption y/y (%)	0.5	6.4	5.3	6.4	5.5	3.0	3.0	2.0
Investment y/y (%)	11.4	8.7	9.2	8.6	6.0	7.5	8.5	10.0
Inflation 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

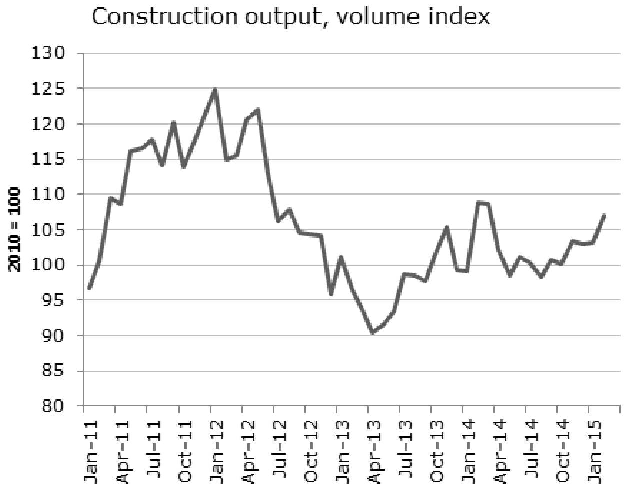
Strong real sphere data (albeit influenced by one-off factors)

In March Polish **industrial output** grew by as much as 8.8%. One has to note, however, that this surprise is solely due to a mammoth acceleration in mining production. The latter accelerated from -11.3 to 15.6% y/y (largest positive swing on record) and added ca. 2 percentage points to the headline. It is reasonable to assume that catching up after several weeks of strikes and outages is to blame for this result. Regardless of its cause, it will be reversed next month. Intensive mining activity completely explains the earlier surprise in wages: in mining alone wages rose by 14% y/y after dropping by 10% in the prior month). Manufacturing production behaved in line with expectations but a 9.6% y/y growth is the fastest in this cycle nevertheless.

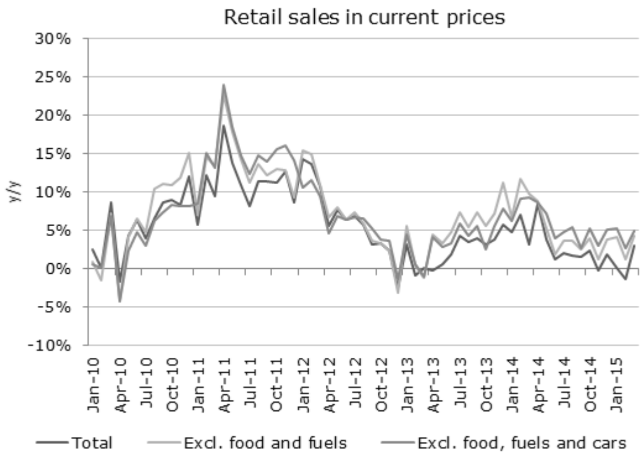


After seasonal adjustments output grew by 0.8% and it might be considered as disappointing given the enormous contribution from mining. Nevertheless, the momentum in industry remains strong and Polish output has just completed its best quarter since 2011. We expect GDP growth to hold steady at 3.3% y/y in Q1 but this is just due to base effects. Subsequent quarters should be even better, provided that the euro area continues its upswing and that infrastructure investment arrives on time.

Construction output in Poland rose in March by 2.9 y/y. After excluding seasonal and calendar factors it fell by 0.5% y/y and rose 0.6% m/m. This result is solid and consistent with newest seasonal pattern in construction - the consequence of warm and dry winters. In the following months construction will benefit from both base effects (significant slide in spring of 2014) and from increase in demand. We have been expecting the latter for months as a result of infrastructure tenders schedule as well as the results of the latest NBP's economic sentiment survey. As a result we predict two-digit growth rate of construction next month, while in summer it should even exceed 20% y/y.

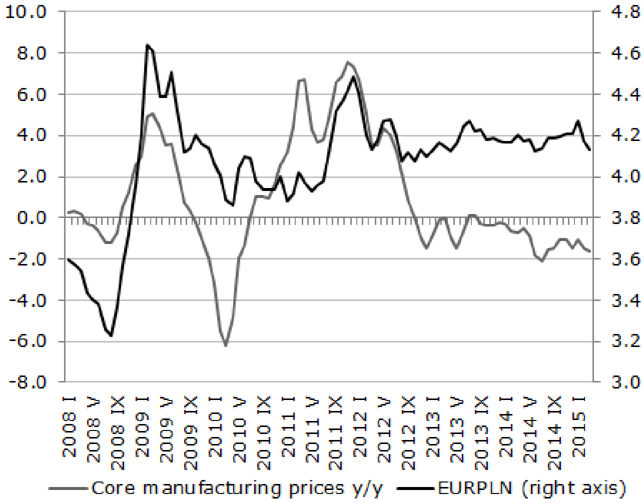


Nominal **retail sales** staged a turnaround towards 3% growth in March on 3 factors: 1) Easter sales, 2) some statistical base effects on auto sales, 3) positive static effects of higher fuel prices. Looking at categories stripping food, fuel and auto sales, we see only local turnaround whereas for at least a year the trend is horizontal. One has to be overly optimistic to see a great comeback of consumption after this very reading (true it was higher than market consensus but we had noted that the market was overly cautious). Sales of goods is flat and consumption is generated via services. We continue to see flat, but relatively solid growth of consumption this year.



More interesting than nominal and real figures for sales itself are sales deflators. The headline one recorded a slight rebound on higher fuel prices. The core one keeps falling and largely reflects the strength of the zloty. Given the underlying trend of the currency, core retail prices seem to have one direction.

Producer prices went down by 2.4% on annual basis in March. Although there is a turnaround (-2.8% previously) it takes place at solidly negative territory and – to be honest – stripping fuel prices there is no turnaround (manufacturing prices excluding coke and oil refining keep on falling on monthly basis). Deflationary equilibrium is firmly entrenched and strong zloty can only exacerbate the problem. Normally, diversified producers are able to make up with domestic sales on the fall of foreign margins. At current juncture, when competition is fierce, no firm has pricing power. We see PPI negative for a long time.



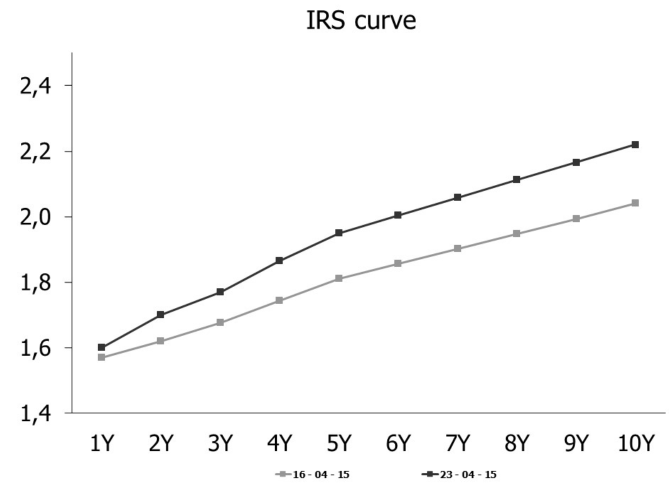
The fixed income market ignored the data but equities rallied massively and EURPLN dropped by more than one figure after the release. There's no point denying that Polish economy is characterized by strong momentum but Poland will be forced to share its success with the outside world. The instrument of sharing is, of course, strong zloty. Its appreciation is facilitated by a plethora of independent factors - we elaborated on that a couple of times. Granted, the scale of recent appreciation is already sizable but overshooting is a very real possibility in a world awash with excess liquidity. Thus, it is easy to imagine EURPLN aiming 3.80. The MPC, despite the recent denials, will have to include exchange rate developments in its monetary policy.

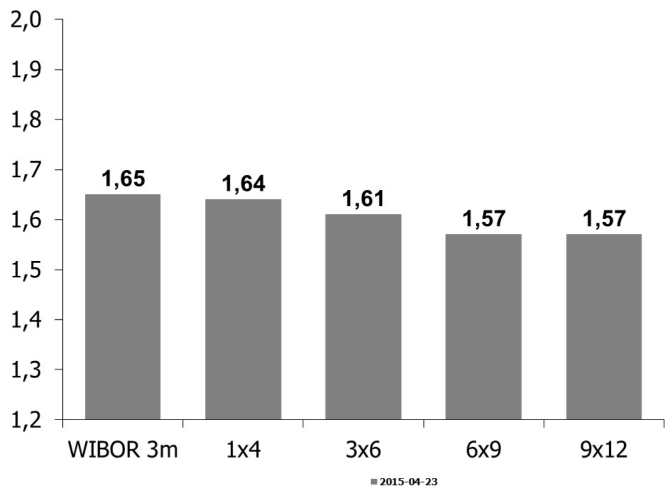
Fixed income

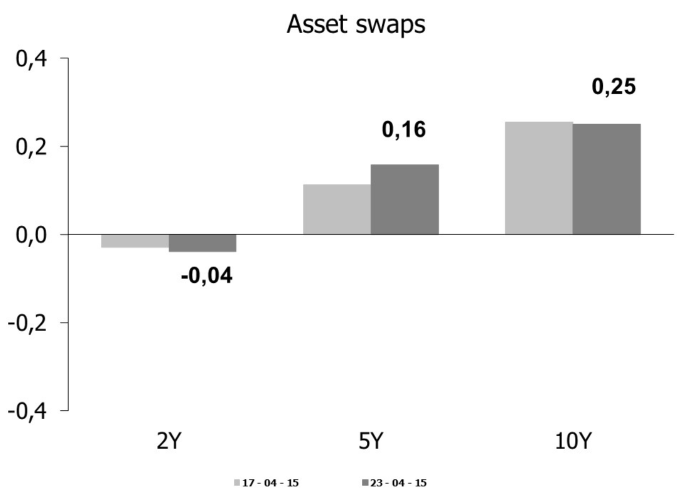
Long of a lifetime?

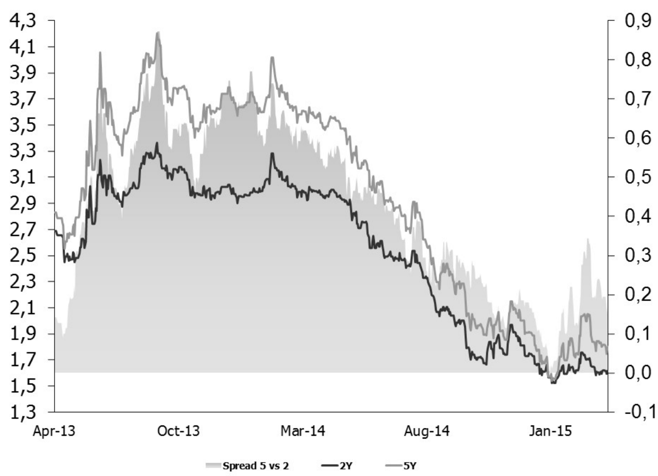
In recent weeks investors were less and less interested in buying PolGBs. Lack of perspective for new rate cut cycle in Poland pushed money flows into other assets (like equities in Euro area). Even QE in Euroland did not help, surprisingly gap between polish 10Y bond and german bund soared 50bp during last 2 months (despite many claiming that Poland is going to benefit from QE the most). Our last 2 auction were not successful (10bln demand this Thursday is less than expected considering more than 15bln cash going into the market from coupons and redemptions) and as a result asset swaps suffered (5Y bonds are 12bp cheaper to swaps than month ago).

While we agree that some kind of this profit taking is justified, current yield levels looks fundamentally attractive. Investors are forward looking, but global economy growth is far from "safe bet". With our CPI near historical lows, easing in Euroland, Japan and recently China and safe Polish budget situation (auctions and be reduced if needed) we feel that 2.50% yield on DS0725 is good enough carry trade. Maybe not "long of a lifetime", but 20bp rally is definitely possible here.







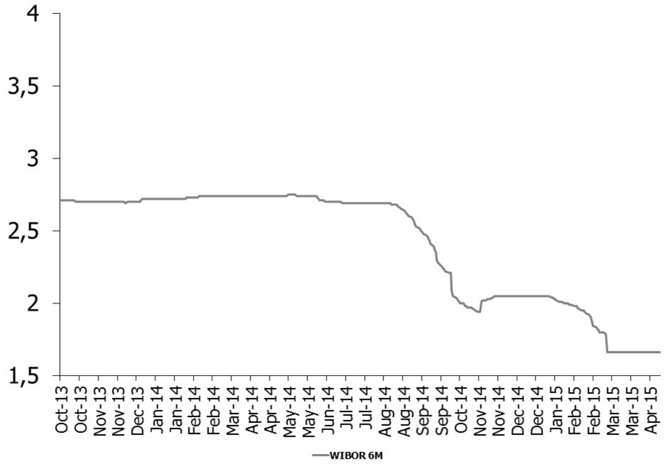


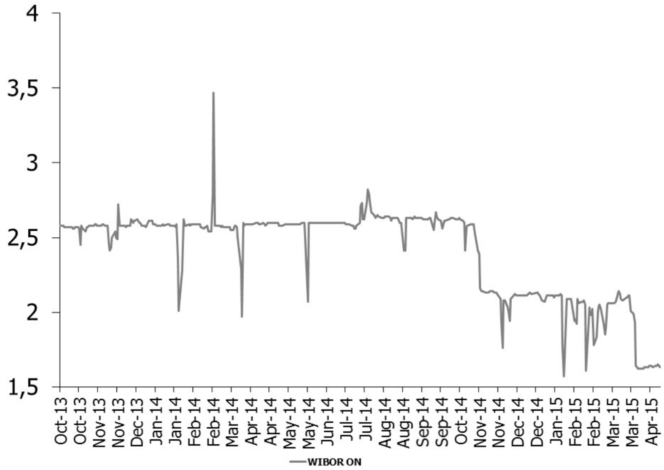
Money market

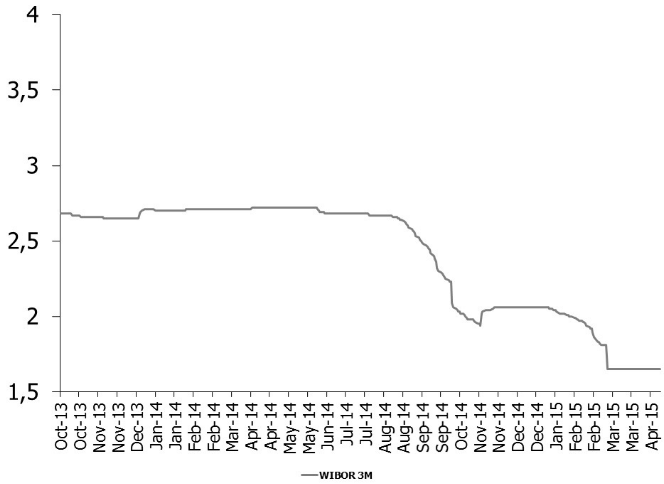
Another boring week for MM

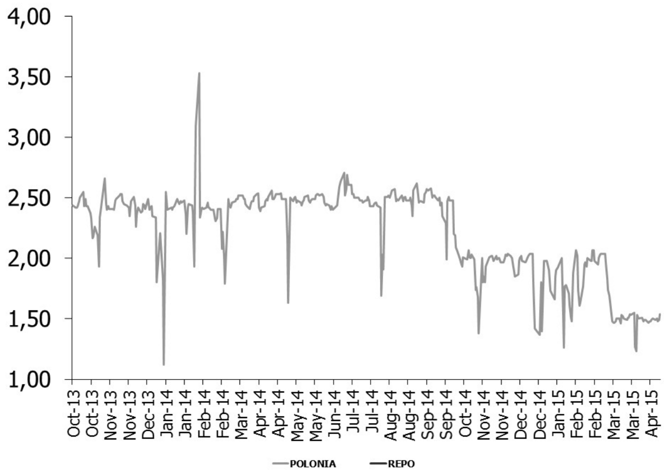
Stable short rates due to balanced system's liquidity. Immune for any figures since for the front end it is obvious that main rate is to remain stable for the foreseeable future. The only volatility hope is for really short rates since we are approaching the end of the reserve requirements settlement period. If we add up maturity of PS0415 bonds plus coupons from other April bonds (net around 18 billion pln inflow, however mostly paired by MinFin's BSB deals via BGK) we can realistically count on a very cheap days next week. Apart from that we would not count on anything thrilling.

We still like buying short bonds like OK0116.







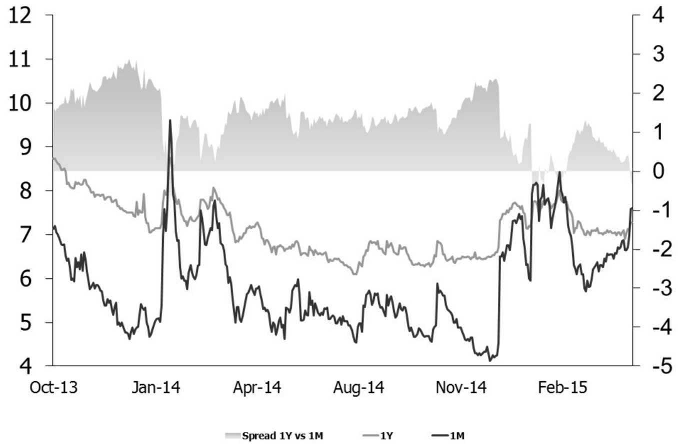


Forex

EUR/PLN (still) consolidating This week we have experienced even a deeper visit below 4.000 in EUR/PLN. We have marked 3.9670 low before, eventually we have managed to drift back above 4.000 (4.0189 high so far). PLN gained most on the day in which we have had lots of Greek, negative news. Which points to using PLN as a safe haven currency in that respect. I even have heard the expression about PLN as "EUR without Greece". We expect more of the rangy, choppy market, roughly 3.95-4.05 . But we also note that US data flow lack strength to guarantee swift rate hikes in the US. And room for disappointment is still big there, that would add extra support for PLN via its USD/PLN leg.

Options – vols higher This week buyers of gamma were very active on the market so especially the beginning of the EURPLN volatility curve is higher than a week ago. 1 week ATM EUR/PLN is this Friday at 8.5% (almost 2.0% higher then week ago), 1 - 3 month ATM mid are at 7.4% (0.6% higher) and finally 1 year is fixing at 7.3% (0.25% higher). Currency spread difference between USD/PLN vols minus EUR/PLN vols) has slid about 0.5% the whole curve and now is at 6.5% (1week) - 6.0% (1year). The skew was little lower than week ago.

EURPLN volatility



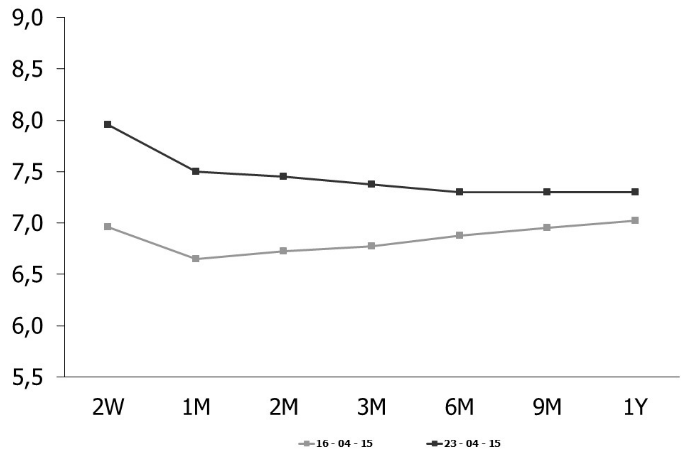
Short-term forecasts

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

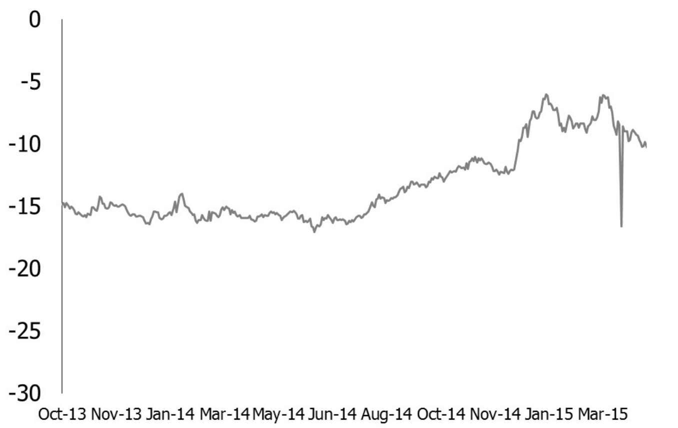
Spot Longs EUR/PLN - stopped out at 3.98. Position- square Timing is everything in FX trading. The EUR/PLN bounced just after our long got stopped. Life. Now on the sidelines. USD/PLN – short. We are small short in USD/PLN at 3.7050 , we are still ready to add at 3.7350 with a stop above 3.7550 and with hopes to see move below 3.60.

Options Strong bids for vols are dominating the market, even though the realized volatility is not impressive. Looks like the vols are just unstoppable in their slow upside bias. It can be related more to low liquidity rather than anything else. 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.

EUR/PLN volatility curve



Bias from the old parity (%)



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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
4/17/2015	1.68	1.65	1.68	1.56	1.58	1.58	1.64	1.62	1.55	1.55	1.59	1.57
4/20/2015	1.65	1.65	1.66	1.56	1.56	1.58	1.66	1.62	1.54	1.54	1.59	1.56
4/21/2015	1.87	1.65	1.93	1.56	1.93	1.58	1.63	1.62	1.57	1.59	1.62	1.59
4/22/2015	1.60	1.65	1.69	1.56	1.81	1.58	1.66	1.62	1.58	1.58	1.63	1.60
4/23/2015	1.69	1.65	1.79	1.56	1.88	1.58	1.64	1.61	1.57	1.57	1.63	1.59

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
4/17/2015	1.580	1.573	1.630	1.602	1.815	1.928	2.040	2.296
4/20/2015	1.580	1.603	1.638	1.637	1.820	1.948	2.065	2.319
4/21/2015	1.580	1.692	1.661	1.651	1.860	2.000	2.092	2.384
4/22/2015	1.580	1.651	1.675	1.691	1.935	2.106	2.175	2.491
4/23/2015	1.580	1.578	1.700	1.661	1.950	2.109	2.220	2.471

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
4/17/2015	6.70	6.85	6.93	7.13	7.13	2.01	0.62
4/20/2015	6.98	6.93	6.95	7.10	7.10	2.01	0.62
4/21/2015	7.58	7.30	7.24	7.28	7.28	2.02	0.63
4/22/2015	7.60	7.33	7.28	7.28	7.28	2.02	0.63
4/23/2015	7.50	7.38	7.30	7.30	7.30	2.04	0.65

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
4/17/2015	4.0330	3.7277	3.9072	3.1355	1.3345	0.1467
4/20/2015	4.0112	3.7302	3.9090	3.1393	1.3310	0.1463
4/21/2015	3.9822	3.7275	3.8828	3.1171	1.3365	0.1451
4/22/2015	4.0015	3.7125	3.9005	3.1086	1.3329	0.1458
4/23/2015	4.0075	3.7371	3.8653	3.1140	1.3282	0.1463

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