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Polish Weekly Review

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Comment on the upcoming data and forecasts

The upcoming week brings two major releases: inflation and GDP (flash reading); on the side C/A data see the light. Inflation is set to turn less negative on fuel and food prices, but core inflation stays stubbornly low (0.2%). GDP growth accelerates but base effects from last year make the composition look odd (unfortunately, we are not going to get the details until the final reading in the end of the month). Although consumption is set to continue decent growth round 3.0%, investment activity growth can be halved towards 4%. It would be more than compensated by a surge in net exports which contribution swing from deep negative to positive; it was not imports but exports that created the lion's share of trade surplus, a clear signal that cyclical upswing in euro zone is visible. It should be confirmed by C/A data (we are up to a new record surplus) where still high trade balance meets huge inflow of current account registered EU funds.

Polish data to watch: May 11th to May 15th

Publication	Date	Period	mBank	Consensus	Prior
M3 yoy (%)	14.05.2015	Apr	8.1	8.4	8.8
CPI yoy (%)	14.05.2015	Apr	-1.3	-1.3	-1.5
GDP yoy (%)	15.05.2015	Q1	3.5	3.5	3.1
Current account balance (mio. EUR)	15.05.2015	Mar	1911	1080	116
Export (mio. EUR)	15.05.2015	Mar	15000	15036	13720
Import (mio. EUR)	15.05.2015	Mar	14290	14290	12937
Core inflation yoy (%)	15.05.2015	Apr	0.2	0.2	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	-	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

Last week brought no surprises – Polish PMI came just slightly lower than expected and did not move the index. Upcoming week is packed with publications that could change it: M3, CPI (Thursday), GDP and CA (Friday).

* 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

- 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. GDP 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, output 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

- Recent sell-off was triggered by reflation bets (surging oil prices) and dependency of Polish bond market on foreign flows (after OFE revamp there is clear asymmetry in reaction to outflows).
- We turn more constructive and aggressive on POLGBs and suggest buying 10y sector as we have strong reasons to disagree with market valuations. 1) Long term real yields in euro peripherals turn positive which bodes not well for stabilization of debt to GDP ratios, 2) Rising oil prices seem to be driven by speculative factors, not a supply side adjustment 3), Bunds valuations are consistent with JGBs, T-notes etc if adjusted for the time that passed since QE start.
- We also question fast rate hikes. We see them unlikely in 2016 as QE-connected inflows, high real interest rates and improving cyclical position of the Polish economy should translate into stronger PLN offsetting a need for rate adjustment.

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	3.90	3.90
USD/PLN (eop)	3.03	3.04	3.31	3.54	3.80	3.68	3.79	3.90
F - forecast								

Economics

Polish Monetary Policy Council decision - no event

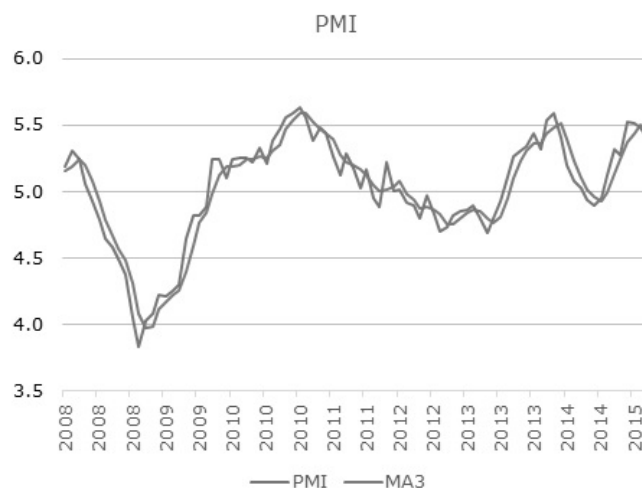
On its May meeting MPC left interest rates unchanged. Wording has changed only slightly - "deflation" was replaced by "negative inflation"; recovery in the euro area was underlined. Conference brought no new conclusions for monetary policy perspectives. The Council acknowledges continuation of economic recovery, but it does not see inflationary pressure. MPC attitude is now neutral. Deflation should be currently uncomfortable for MPC given its mandate, though...but its members do not see reasons to panic because of it, stressing at the same time that inflation and growth in Poland will be in long term lower than their historical values. Such opinion is also shared by ultra-hawkish MPC member J. Winiecki.

During the press conference governor Belka pointed out several times that the Council decided not to change monetary policy parameters till the end of its turn (which is Q1 2016). Such looks seems most probable. At the same time this is a setting that assumes relative stability of the Zloty (which in fact means that it will not appreciate to much).

Markets, however, price in already two rate hikes in 2016, which we see as a too aggressive bet. It would suggest that investors expect the new (probable dovish) Council to substantially front-run the European cycle of monetary policy tightening.

PMI corrects itself down (for the second month)

PMI in Polish industry fell in April to 54.0 pts from 54.8 pts in the previous month. This decline is a result of 1) diminishing pace of new orders inflow (54.5 compared to 55.3) but not foreign ones - those recorded highest growth rate since February 2014, 2) large reduction in employment pace (53.9 after 56.3 in March). The latter was not additionally commented by the surveyed (they still are hiring but at a slower pace). In our opinion, employment rate growth could be lower than in previous periods of upswing because of 1) difficulties with hiring new workers, while training process last longer, 2) change in production's character - going towards higher productivity through more mechanized production (companies explain the fall in backlogs with increased productivity). Production output estimates remained unchanged (56.8), backlogs fell slightly and delivery times got shorter.



Analysis of components indicates that the influence of stronger Euro on export volumes has not shown itself yet. Large amount of export to the euro area is settled directly in Euro, so companies have limited ability to correct prices in foreign currency. As a result, the variable elements are margins in domestic currency, which obviously have to fall due to weaker EUR. In fact, prices of finished goods are still falling (although the tempo is marginally lower). Strong currency influences also costs - they are rising at a lowest rate this year and surveyors gave exchange rate gyrations as a main reason for it. In summary it looks like the result from a stronger exchange rate will be consistent with NBP models: relatively small on GDP but potentially large on prices.

After a very good beginning of the year the industry catches its breath. However there are no reasons to think that momentum in the economy is weakening; we are seeing just a correction of a fast growth from the beginning of the year. Current PMI levels are still in line with 3+ rate of GDP growth. Latest CSO data update moved (up parallel) our estimates of GDP growth path for 2015 - rate of growth will exceed 4% by the end of the year and on average it will amount to 3.8%. According to us it is very important to add that this growth is absolutely noninflationary.

Fixed income

Keep'em all

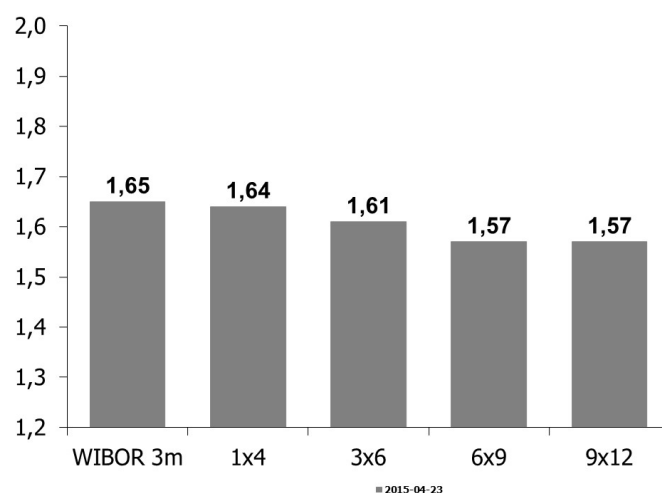
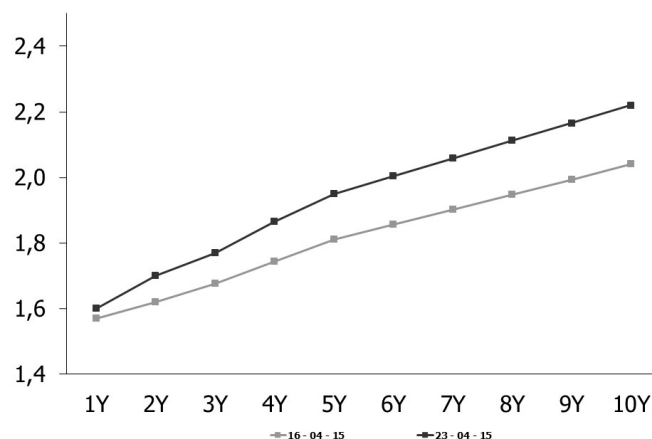
Volatility we have faced this week was uncommon even if we would look a couple of years back.

We began this week trading 10Y benchmark at 2.60, then hit 3.00% on stop loss waves coming through market, all in 48hrs. Where we closed it? 2.70. . .

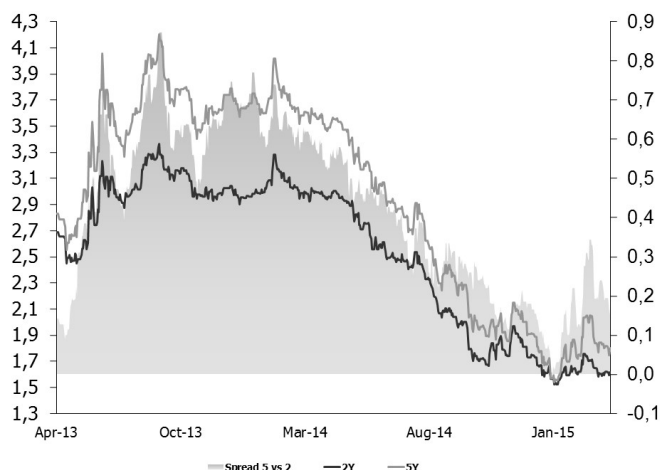
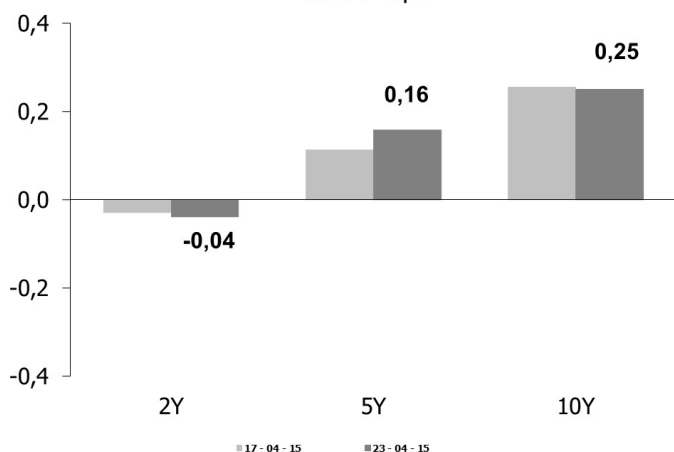
Conclusions? We still suffer for both lack of local story and lack of local liquidity. Neither MPC press conference nor canceling bonds auction by MoF made the difference here. Abandoning POLGBs market by foreign investors made bid side weak and vulnerable for any selling interest. But . . . Change your problems into opportunities they say. Once we hit 2.60 on 5Y and 3.00 on 10Y bonds (respectively 110 and 140 bps over cash level) some buying interest appeared. Initially from bank books (well supplied by depo and retained dividend cash) then followed by foreigners.

Is bullish stance going to stay permanent? Given recent EU and US data, given current UST and bund level we still see risk for downside on yields with natural target on 2.10 on 5Y bonds. Use the dip and buy'em all.

IRS curve



Asset swaps

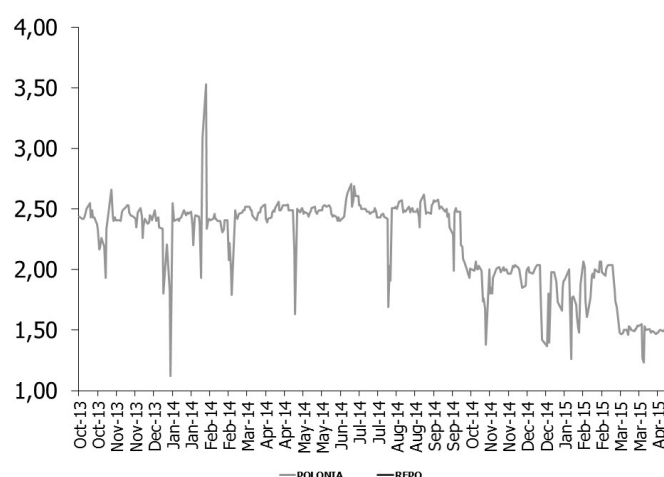
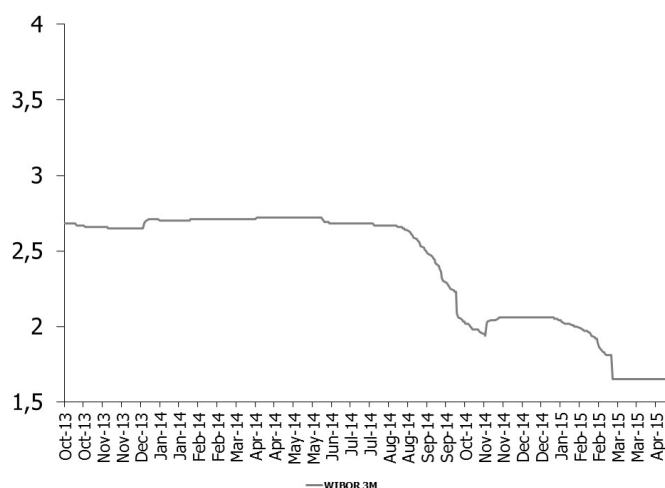
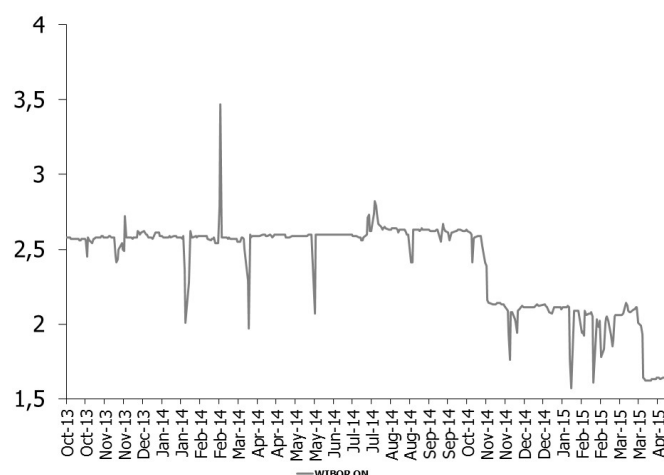
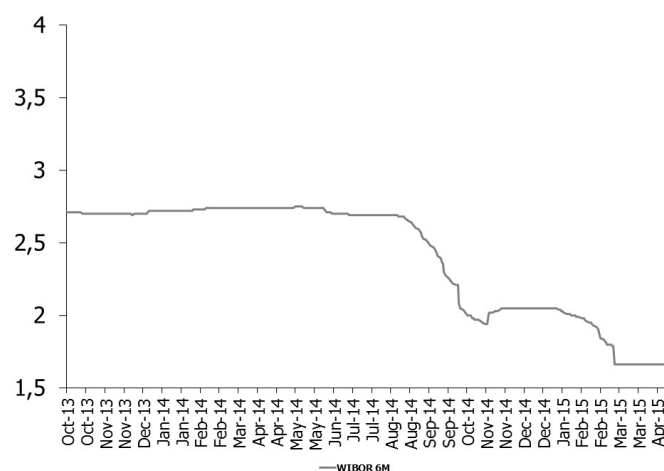


Money market

Rate hike expectations overdone. Cheaper weak ahead.

Last week wasn't boring for sure (despite ON deposit, as Polonia fluctuated around 1.50). Whole curve made massive move upward and we started to discount potential rate hike in Poland. 1Y OIS moved 5bps, 9x12 moved 7 bps. In our opinion rates will remain stable this year so we recommend to sell whole front end (1Y OIS and 6x9, 9x12 FRA) and buy short bonds (like OK0116 at 1.62).

Today's OMO was underbid so next week should be a bit cheaper.



Forex

EUR/PLN higher EUR/PLN is bouncing higher in nervous and choppy trading. This is one of the market consensus trades, that somehow got sour. We had a numerous attempts to break 4.00 but it never really got much of the momentum to seriously threaten 3.95 or lower. With EUR correcting higher against most of the world leading currencies, PLN was no exception. The PLN longs in the market were also adding fuel to this move. We expect more choppy seasons ahead of us, but it is likely that we have a bottom in place for a time being 3.98/4.02 and we may revisit 4.08/4.12 first.

Options The volatile spot and rising realized volatility is helping to support frontend vols. As the result 1month EUR/PLN mid is now 8.5% (1.1% higher than a last Friday), 3 month are 8.2% (0.8 higher) and finally 1 year is today 8% (0.6 higher) . The biggest victims of the current weeks are USD/PLN vols as currency spread (difference between USD/PLN and EUR/PLN vols) was sold with vengeance (roughly 0.7 along the curve). The skew in EUR/PLN got higher, but skew in USD/PLN was better offered.

Short-term forecasts

Main supports / resistances:

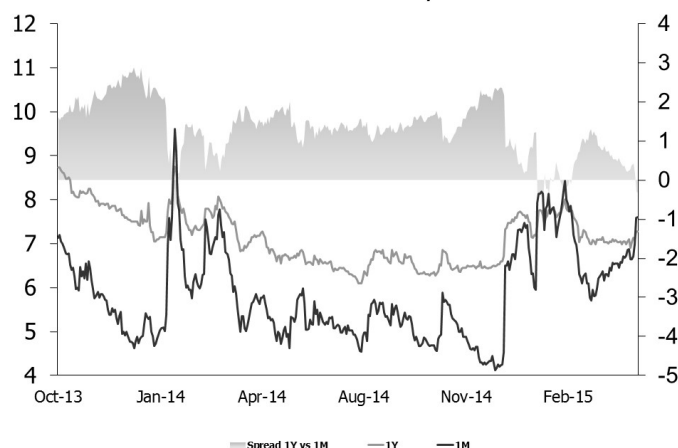
EUR/PLN: 4.00 / 4.12

USD/PLN: 3.50 / 3.80

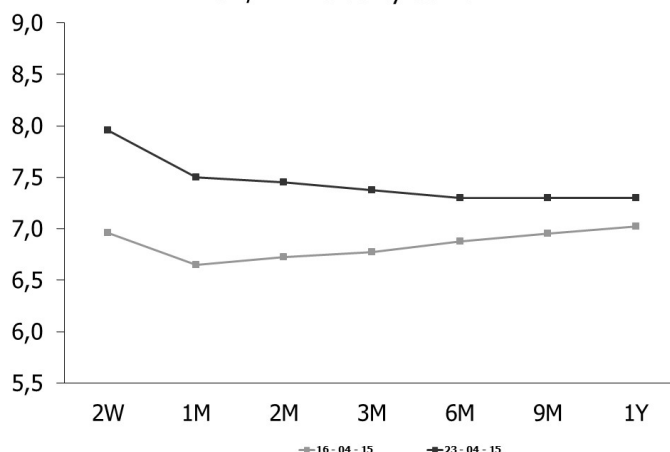
Spot Longs EUR/PLN. Position. We are long EUR/PLN at 4.04, we are ready to add at 4.01 with a stop below 3.99, and hopes to revisit 4.10 +. It is technically driven trade, by a series of higher lows and higher tops. USD/PLN - Short from 3.7050 closed with profit at 3.60.

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. Our conviction to be long Vega is now getting extra support from realized volatility statistics. The curve is reversed so frontend vols are reflecting that, but if that trend in realized volatility will be sustained this should encourage bids in the backend as well.

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
4/30/2015	1.83	1.65	1.91	1.56	1.94	1.58	1.67	1.66	1.63	1.64	1.72	1.64
5/4/2015	1.65	1.65	1.66	1.56	1.56	1.59	1.66	1.65	1.64	1.65	1.72	1.66
5/5/2015	1.81	1.65	1.91	1.56	1.96	1.59	1.65	1.66	1.67	1.73	1.80	1.70
5/6/2015	1.43	1.65	1.44	1.56	1.89	1.59	1.67	1.67	1.67	1.71	1.81	1.72
5/7/2015	1.66	1.66	1.70	1.58	1.61	1.62	1.70	1.69	1.67	1.69	1.79	1.70
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				
4/30/2015	1.580	1.654	1.750	1.695	2.100	2.232	2.370	2.647				
5/4/2015	1.590	1.681	1.758	1.691	2.100	2.241	2.395	2.641				
5/5/2015	1.590	1.656	1.810	1.758	2.175	2.369	2.480	2.776				
5/6/2015	1.590	1.708	1.874	1.828	2.310	2.507	2.600	2.913				
5/7/2015	1.620	1.701	1.825	1.730	2.220	2.371	2.507	2.803				
EUR/PLN 0-delta stradle						25-delta RR		25-delta FLY				
Date	1M	3M	6M	1Y			1M	1Y				
4/30/2015	7.48	7.38	7.38	7.40			7.40	2.00	0.61			
5/4/2015	7.90	7.50	7.48	7.43			7.43	2.00	0.61			
5/5/2015	7.85	7.50	7.45	7.40			7.40	2.01	0.61			
5/6/2015	8.20	7.75	7.60	7.35			7.35	2.04	0.58			
5/7/2015	8.73	8.20	7.98	7.80			7.80	2.14	0.62			
PLN Spot performance												
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN						
4/30/2015	4.0337	3.5987	3.8438	3.0274	1.3312	0.1471						
5/4/2015	4.0465	3.6320	3.8756	3.0235	1.3325	0.1476						
5/5/2015	4.0179	3.6205	3.8619	3.0100	1.3325	0.1470						
5/6/2015	4.0552	3.6116	3.9064	3.0158	1.3311	0.1479						
5/7/2015	4.0685	3.5830	3.9285	3.0017	1.3261	0.1484						

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