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## Polish Weekly Review

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### Comment on the upcoming data and forecasts

The upcoming week has only one economic release – monetary supply M3 (Friday). We expect it to accelerate to 8.0% y/y in May from 7.2% y/y in April. This is a result of low base effects in household and corporate deposits as well as in cash.

### Polish data to watch: June 8th to May 12th

Publication	Date	Period	mBank	Consensus	Prior
M3 monetary supply y/y (%)	12.06	May	8.0	7.5	7.2

### 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	5/21/2015
5Y T-bond PS0720	-	3500	1.987	5/21/2015
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

Surprise index for Poland fell slightly down toward previous month's minimum. Manufacturing PMI for May came lower than market consensus. Next week brings only one opportunity to move the index – M3 money supply.

\* 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 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 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

- Political risk affects Polish assets. Result of presidential elections is seen as a proxy for general elections' result. Investors see more scope for an increased populism and granulation of parties within the newly elected parliament (foreigners see parallels to discontent movements in Spain and Greece).
- We thus turn defensive on POLGBs. Valuations seem to be quite attractive (especially vs. HGBs). Rally in peripheral euro bonds may well lead to lower rates in POLGBs.
- Zloty should mimic POLGBs dynamics but overall prospects for the currency remain positive (high real rates, monotonic economic recovery).

### mBank forecasts

	2010	2011	2012	2013	2014	2015F
GDP y/y (%)	3.7	4.8	1.8	1.7	3.4	3.9
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	-0.6
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	3.6	3.7	3.9	4.3
Individual consumption y/y (%)	3.0	3.0	3.2	3.0	3.1	3.1	3.1	3.3
Public Consumption y/y (%)	0.5	6.4	5.3	6.4	3.3	3.0	3.0	2.0
Investment y/y (%)	11.4	8.7	9.2	8.6	11.4	9.0	10.0	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	1.68	1.69	1.69
2Y Polish bond yields (% eop)	3.01	2.51	2.00	1.79	1.61	1.70	1.80	1.70
10Y Polish bond yields (% eop)	4.23	3.45	3.05	2.52	2.31	3.00	3.20	2.90
EUR/PLN (eop)	4.17	4.16	4.18	4.29	4.07	4.10	4.10	4.05
USD/PLN (eop)	3.03	3.04	3.31	3.54	3.80	3.87	3.98	4.05

F - forecast

## Economics

### NBP rates unchanged. No new signals from MPC.

In line with expectations, Polish MPC did not change interest rates on June's meeting. Base rate stays at 1.50%. According to the information from the meeting, although inflation rate would be negative in the coming months, the Council (on account of economic recovery) sees a possibility of inflation rate returning back to its target. The latter is consistent with last month's statement, however the word "quarters" was replaced by "months" in it just to reflect a passage of time. Economic outlook is rather optimistic – weaker data for April is viewed as a result of temporary factors. Global economic activity is seen as moderate.

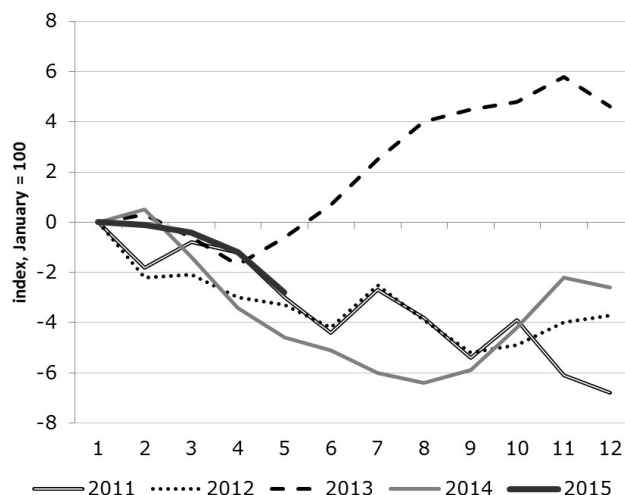
The press conference after the meeting was dominated by political issues and looming end of current MPC's and NBP governor's terms (8 of 9 members end their terms in first two months of 2016, Governor Belka in June 2016). Statements about monetary policy were scarce – summarizing: status quo till the end of term. Governor Belka pointed out, however, that according to forecasts of various institutions, the return of inflation rate to its target could take longer than expected by the inflation projection.

In our opinion, rates will remain unchanged through the whole 2016. The rise of inflation would be gradual and economic growth (because of larger expansion of investment) relatively non-inflationary. Moreover, the Zloty will be the disinflationary factor in the medium term. In the next year the new MPC (regardless of realized political scenario) will scale up government's fiscal policy, which is not new taking into account central banks activity in developed economies. The Council is not going to front-load monetary tightening. Quite the contrary, through altering monetary policy strategy it could additionally change the deficit's financing structure (larger involvement of Polish banks in SPW at the expense of foreign investors).

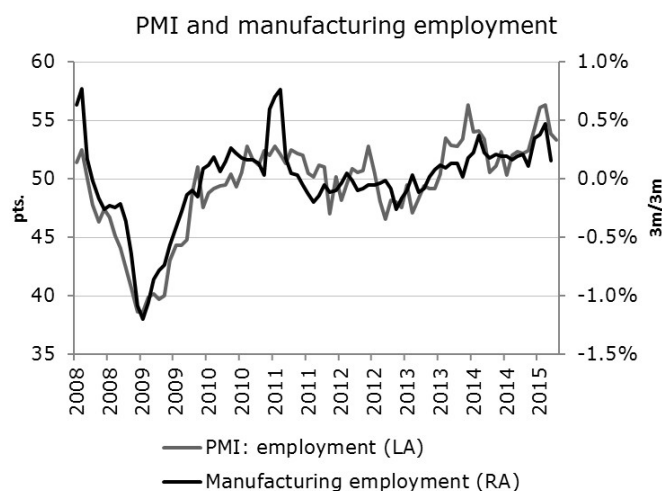
Current changes in the debt market (not only Polish but also global) are results of contestation of new paradigms (secular stagnation etc.) and attempts to price standard yield curve in the long term. We do not think that it has any predictive value concerning NBP rates in 2016.

### Déjà vu: PMI continues to fall

In May Polish manufacturing PMI fell from 54.0 to 52.4 pts., slightly stronger than expected (market consensus and our forecasts 53.5). This way, last year scenario, where PMI established local maximum at the beginning of the year and subsequently was falling towards 50 in the following months, repeats itself almost exactly. As a matter of fact, in last 5 year the index broke out from this pattern only once (see chart below). This could of course be a coincidence and economic activity worsening after great start could have different drivers every time. We do not see the same pattern in other economic activity indices and, what is more important – in real sphere data.



Not surprisingly, Polish PMI fall was driven by all of its components – in May sentiment worsened in: production (from 56.8 to 54.0), new orders (from 54.5 to 52.4) and employment (from 53.9 to 53.3 - here correction coincided with slide in real sphere employment in manufacturing data - see the chart). Decline in new orders category was driven mainly by foreign orders, they are heading now towards 50 pts. line. This was accompanied by worsening in sub-indices of price processes - production costs did not change in May and pace of falls in finished goods prices is the lowest since July 2013.



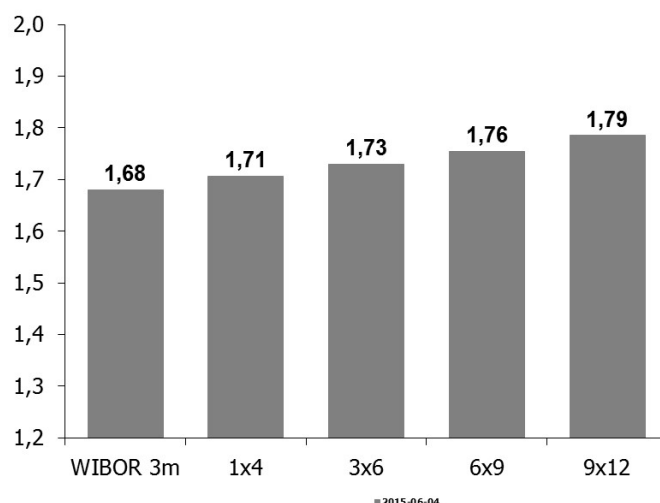
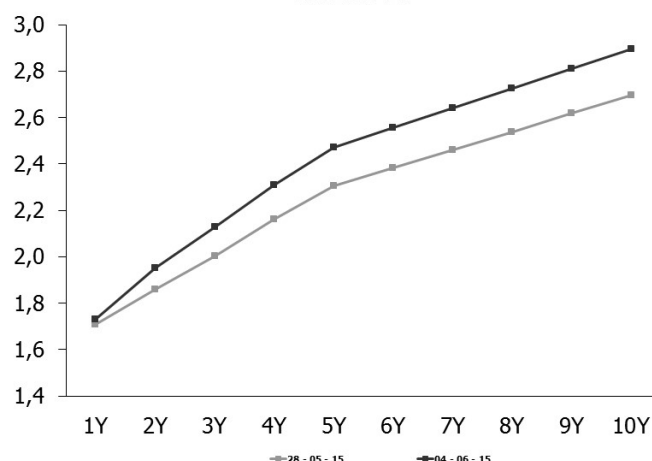
Fourth fall in a row raises questions about usefulness of PMI as a predictor for real sphere data and general economic activity. Taking into account that latest release does not find confirmation in both other economic activity indices (production, employment and new orders sentiment also fell in CSO data but at a much lower pace) and regional data, we do not see those changes as a sign of permanent weakening of the economy. Instead of that we could speculate that those PMI falls were caused by worsening of momentum in German industry in second quarter of 2015 whereas domestic demand in Poland stays healthy. It reminds us at the same time that we observe in Poland normal upbeat (with all local perturbations) and not economic boom that could justify forthcoming monetary tightening.

## Fixed income

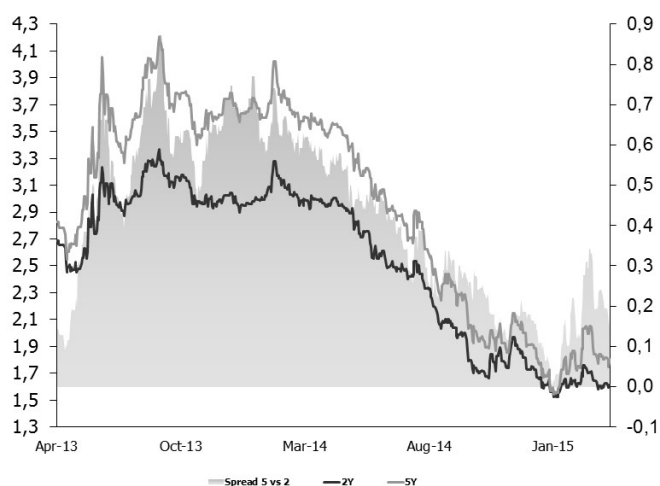
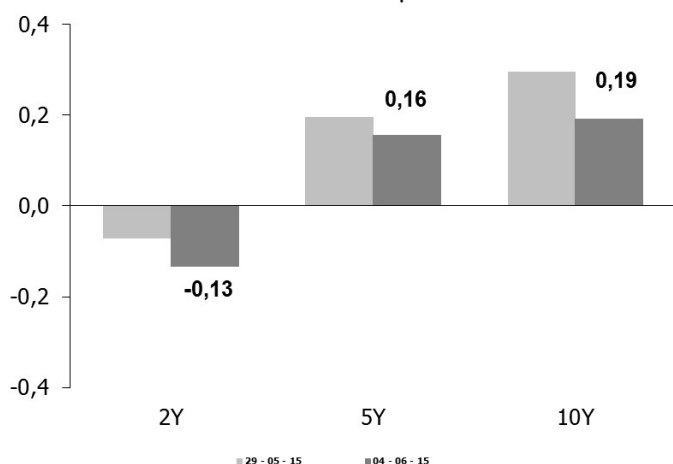
### Risk off

We cannot say that fundamentally economy has changed this week. There was no surprising data (in Poland only lower than expected PMI), Greece situation seems similar as week before, QE is going well in Euroland. However, yields on all Fixed Income markets soared massively all over the world. After ECB's press conference yield of DS0725 broke 3% easily and is now around 3.18%. With low turnover investors are trying to reduce risk on most assets and bonds are not excluded from "risky asset category" this time. Does new yield levels look more reasonable? We are in new reality now, liquidity is low, there is less trust in our global village. Next few auctions on PolGBs market are going to be difficult to sell, despite more attractive yields. Caution, defensive strategy is our advice for this week.

IRS curve



Asset swaps

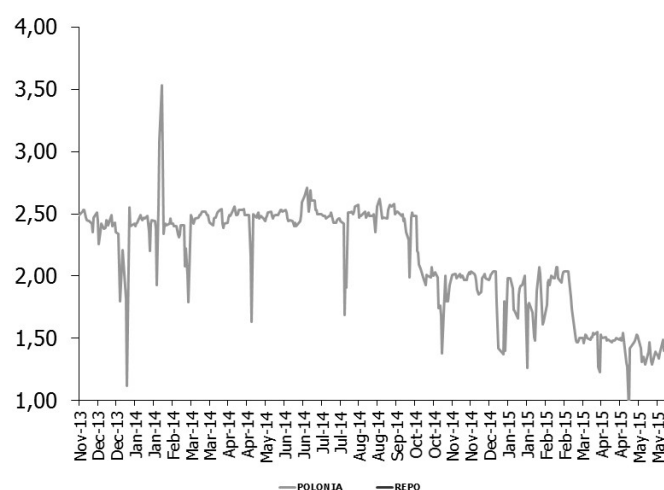
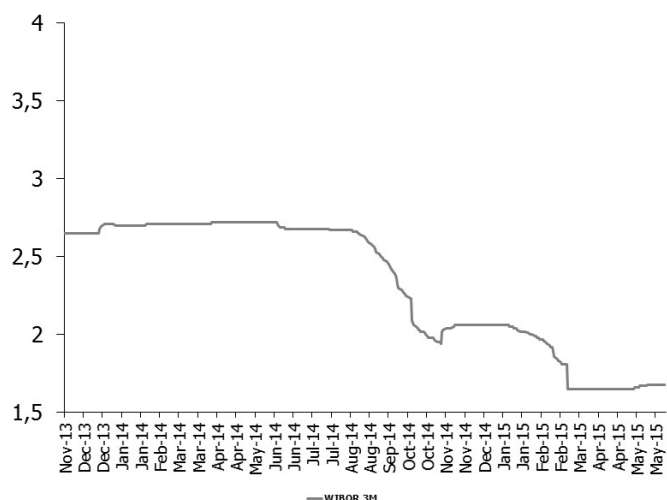
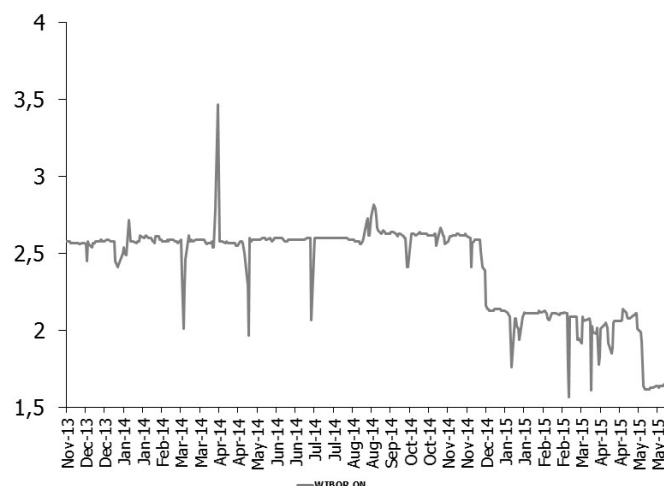
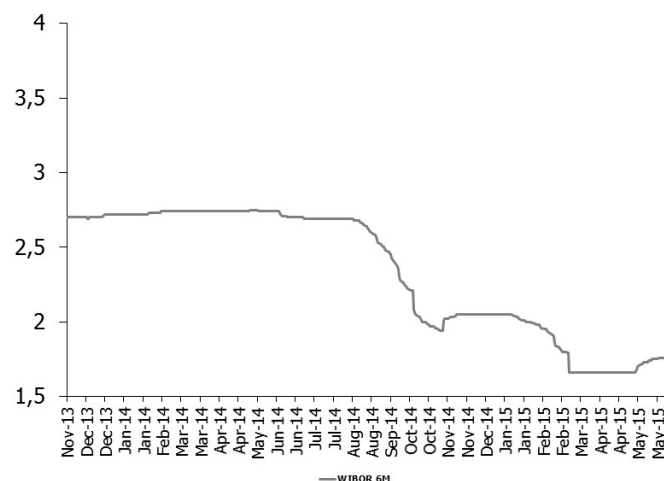


## Money market

### Stable week ahead of and behind us

First week of the new reserve period was stable with Polonia fluctuating around 1.40. Friday's OMO was underbid by 7 bn PLN so next week should be stable as well.

As a result of bonds sell off, swaps moved higher what finally pushed FRA's higher. 9x12 is traded at 1.80 discounting 50% possibility of rate hikes at the beginning of 2016. We recommend to sell it as none of figures indicate possibility of any rate hikes. Also buying PS0416 with yield around 1.65 looks very attractive especially when cash rate is a bit lower than it used to be.



## Forex

**PLN - victim of the higher yield** We were trading 4.11-4.1450 range in EUR/PLN, consolidating the politically driven spike to 4.1550. It was ECB press conference that pushed global yields higher, and PLN tumbled lower in effect. The losses of PLN were intensified by Polish holiday on 4th, the lack of activity of Polish exporters (usually selling the spikes in EUR/PLN), caused EUR/PLN to reach as high as 4.1931 before correcting lower. The positioning also had its effect, as not that far ago, we were day dreaming about breaching 4.00 and not looking back. As usual we view EUR/PLN as rangy/technical currency pair, the balance of risks currently pushed the cross' range higher. We still look for 4.0950-4.1950 to cover most of the moves. EUR/PLN melted to 4.1470 mid of the range on Friday, before strong NFP took it higher to 4.16 again.

**Options – VOLS higher** The weaker Zloty, volatile bonds markets, all these events were responsible for a spike in Vols. 1 Month EUR/PLN ATM mid is today 8.4% (0.5% higher than last Friday), 3 months are 8.3 (0.4% higher) and finally 1 year is fixing at 8.3% (0.4% higher). There were a lot of turnover in Gamma trades, as market was trying to buy optionality for ECB/NFP. The Skew was also healthy bid.

## Short-term forecasts

Main supports / resistances:

EUR/PLN: 4.0950 / 4.195

USD/PLN: 3.50 / 3.85

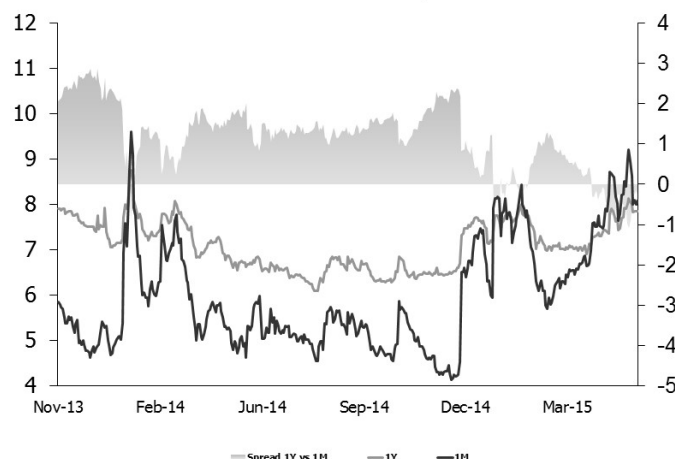
**Position – Short EUR/PLN** We are short at 4.1800 and we are ready to add 4.2050 with S/L at 4.22 and hopes to revisit 4.1200.

The yield related shock is supposed to bleed over time. Even the stronger than expected NFP number is about to influence USD/PLN more than EUR/PLN. Falling EUR/USD should drag EUR/PLN lower with time.

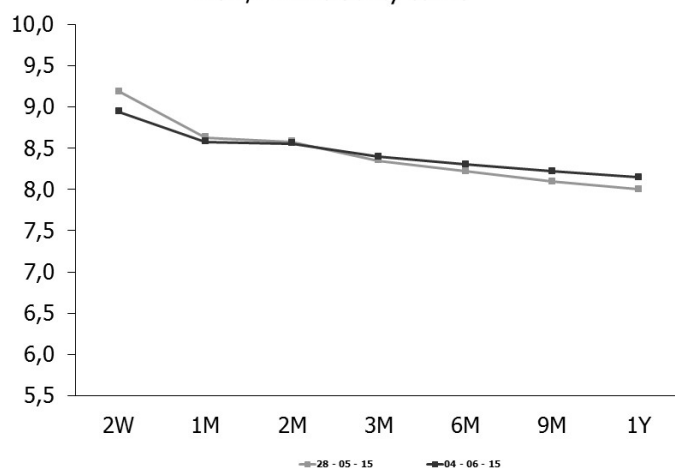
**Options** We are stubbornly long EUR/PLN and to the bigger scale USD/PLN Vanna (long R/R). We are also long Longer term Vega in both. But we sold some 3 month EUR/PLN Vega to at least partially cover the Theta bills of quickly approaching holidays. In our eyes, current high levels of frontend vols are to be faded, especially if PLN stabilizes at current levels.



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
5/28/2015	1.71	1.68	1.85	1.66	1.95	1.70	1.69	1.70	1.72	1.74	1.80	1.79
6/1/2015	1.68	1.68	1.83	1.66	1.94	1.70	1.72	1.73	1.73	1.77	1.83	1.80
6/2/2015	1.48	1.68	1.66	1.66	1.92	1.70	1.70	1.73	1.77	1.80	1.86	1.83
6/3/2015	1.35	1.68	1.55	1.66	1.82	1.70	1.70	1.72	1.75	1.78	1.88	1.83
6/4/2015	1.61	1.68	1.80	1.66	1.92	1.70	1.71	1.73	1.76	1.79	1.88	1.83

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
5/28/2015	1.700	1.634	1.860	1.789	2.305	2.475	2.695	2.961
6/1/2015	1.700	1.701	1.882	1.795	2.310	2.503	2.720	2.990
6/2/2015	1.700	1.703	1.903	1.825	2.355	2.509	2.760	3.001
6/3/2015	1.700	1.674	1.950	1.818	2.470	2.626	2.895	3.086
6/4/2015	1.700	1.674	1.950	1.818	2.470	2.626	2.895	3.086

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1Y	
5/28/2015	8.63	8.35	8.23	8.00	8.00	2.12	0.55	
6/1/2015	8.10	7.93	7.80	7.85	7.85	2.12	0.55	
6/2/2015	8.00	8.00	7.93	7.85	7.85	2.09	0.55	
6/3/2015	8.10	8.05	7.98	7.85	7.85	2.14	0.58	
6/4/2015	8.58	8.40	8.30	8.15	8.15	2.18	0.56	

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
5/28/2015	4.1419	3.7858	4.0014	3.0559	1.3395	0.1509
6/1/2015	4.1260	3.7850	3.9984	3.0521	1.3323	0.1505
6/2/2015	4.1374	3.7676	4.0019	3.0249	1.3373	0.1509
6/3/2015	4.1307	3.7108	3.9690	2.9844	1.3242	0.1503
6/4/2015	4.1307	3.7108	3.9690	2.9844	1.3242	0.1503

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