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Polish Weekly Review

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Comment on the upcoming data and forecasts

A busy week ahead of us – see the Economics section.

Polish data to watch: June 15th to June 19th

Publication	Date	Period	mBank	Consensus	Prior
Current account (mio. EUR)	15.06	Apr	1381	1268	1938
Export (mio. EUR)	15.06	Apr	14400	14582	15322
Import (mio. EUR)	15.06	Apr	14000	13943	14648
CPI y/y (%)	16.06	May	-0.5	-0.7	-1.1
Core inflation y/y (%)	16.06	May	0.5	0.5	0.4
Average wage y/y (%)	17.06	May	3.2	3.7	3.7
Employment y/y (%)	17.06	May	1.1	1.1	1.1
Industrial output y/y (%)	18.06	May	3.8	3.9	2.3
PPI y/y (%)	18.06	May	-2.2	-2.2	-2.6
Retail sales y/y (%)	18.06	May	1.4	1.5	-1.5

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	6/11/2015
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

Unchanged – not a single macro release was published last week. Next week should finally move the index: CPI, PPI, industrial output and retail sales could surprise in either direction.

* 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

- We turn tactically constructive on POLGBs via outright 10y long.
- Globally, the support for higher yields may be waning: elevated valuations in Europe (including full normalization of rates within 5y horizon, rates hikes in 2017) may be unsustainable given the loss of momentum in the real sphere, possible flattening of inflation path (higher EURUSD, loss of upward momentum in oil prices) and looming period of net negative supply of EGGB.
- Locally the story is more or less of the same sort: full normalization is priced in and 2-3 rate hikes come in already in 2016. That's too generous in our opinion whereas the steepness of the curve returned to normal (it is costly to pay rates), local investors seem to be underweight duration and foreign holders reduced long positions of late. Political risk is more or less priced in. Moreover, -ve election story seems to be slowly unwinding given uncertainties what exactly to expect in the Autumn. Last but not least, strong zloty and favorable external position of the economy shields POLGBs (already weak in terms of spread ag bunds and treasuries) from Greek and American risks.
- Zloty should mimic POLGBs dynamics and 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

Upcoming data to show a rebound in both inflation and in crucial short-term activity indicators

Next week brings all the interesting data releases. We start on Monday with the release of CPI data. Because of higher fuel and food prices, as well as low statistical base in the latter category, we expect inflation to jump from -1.1% y/y to as much as -0.5% (above consensus). Core categories should remain in slow upward drift, though. Our forecast is partly influenced by a series of positive inflation surprises in the region (Czech Republic, Hungary, Romania, not to mention the euro area or Sweden). In a similar fashion, producer prices (released on Thursday) should rebound from their April lows, with PPI growth increasing from -2.6% to -2.2%.

Real sphere data will come in two flavors. Labor market data (Wednesday) should not be stellar – we expect wage growth to moderate on the back of working day effects and high statistical base from the previous year, while employment growth is probably stuck at 1.1% y/y. This, however, is an artifact of enterprise sector data, as alternative measures show much faster growth. High reliance on part-time work and short-term contracts is probably to blame. Thursday data (retail sales, industrial production and construction output) are set to show activity growth accelerating in May, despite unfavorable working day effect (-1 y/y vs. 0 y/y in April). This is because one-off effects are set to wane and activity in some areas will return to normal. Note, for instance, that Easter-related decline in food production shaved off ca. 3 percentage points from industrial output growth in April.

Finally, it worth looking at balance of payments data (due to be released on Monday, like CPI). We expect that Poland posts yet another huge CA surplus on the back of very high EU transfers and solid trade balance.

Fixed income

Nothing to fear?

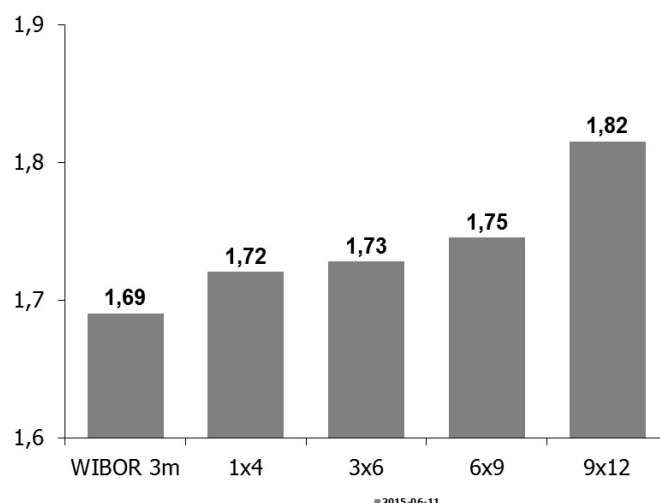
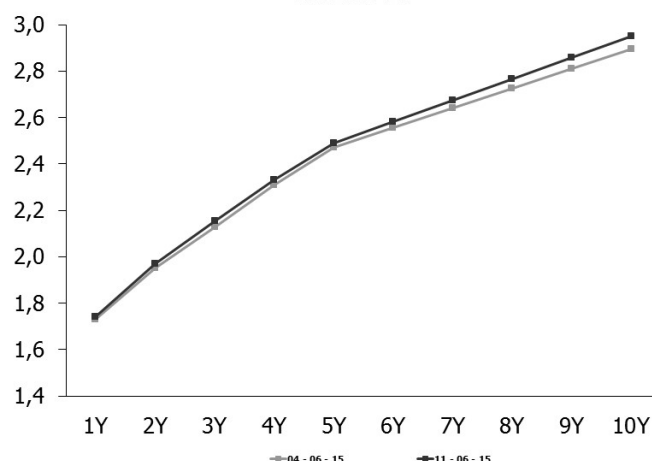
Quiet week for us. 10Y benchmark was traded in 150 ticks range reaching 3,24 after breaking 3.00 support. Data brought nothing new, auction was sold by 4.2 PLN yards cash but only 1,4 yard of fixed bonds (2Y in addition). Demand for bond was weak with selling interests being dominant.

It's pretty hard to define what we fear most these days. Is it higher CPI? Grexit? Political risk? All seem serious. It is almost impossible to find any ray of light in the dark clouds.

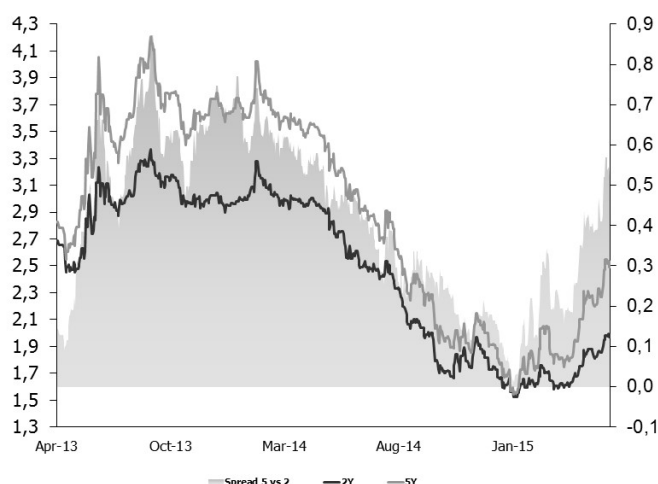
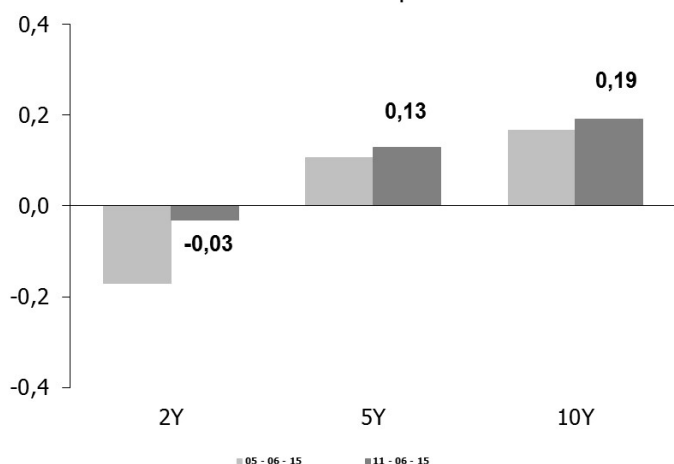
Shall we try nonetheless? Positioning seems fairly light (at least locally). Level wise yields looks attractive, especially on longer end. We already priced in some of mentioned risks. We start to see then some value in rates - 10Y bonds at 3.20 given current CPI level, 1.5% cash cost level seems encouraging. But (again) timing is crucial here. While economic activity and CPI are sloping upwards, while we know nothing about economy plan of new (likely) parliamentary coalition and Grexit still stays likely option - buying bonds seems play only for the brave ones. But - we do feel that current, enhanced economy activity is ripped history. Political risk will set the tone for September or so. Why not try to step in?

Judge risk appetite by yourself and buy or stay away.

IRS curve



Asset swaps



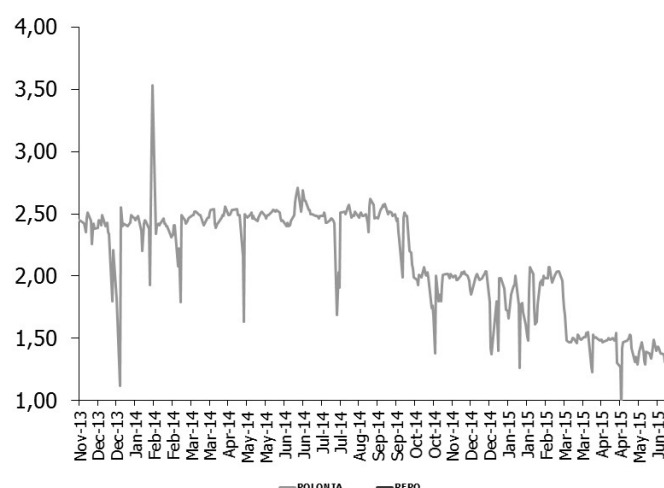
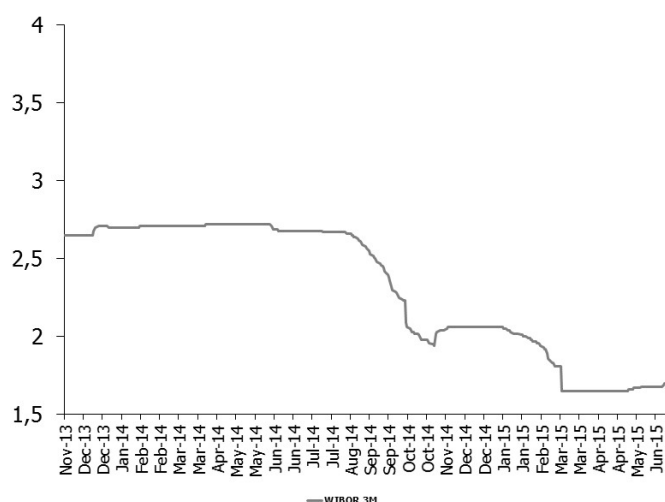
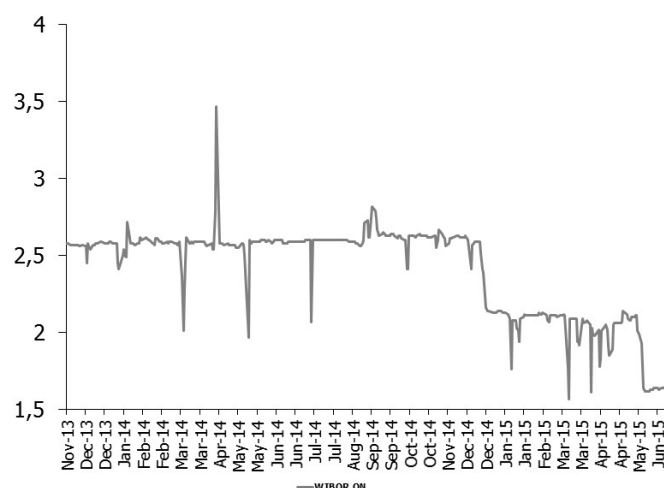
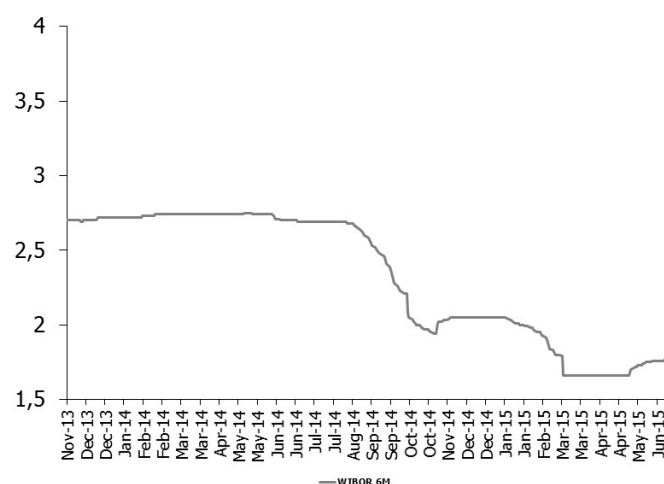
Money market

Cheap week behind us

Quite a cheap week due to substantial surplus of the cash in the system. It is caused by the still cautious approach of banks due to current market turmoil (mainly Greece). As we all know liquidity is the best panacea. Polonia rate was around 20 bps lower than the main rate.

Forward rates up to 2Y are discounting 50-75 bps rates hike next year. We do not think these are the true expectations and that the rates are inflated by the longer terms being heavily paid. Therefore we perceive current levels of the front end as a great opportunity to receive. We do not believe in fast hikes both economically and politically (new MPC should be more dovish and government supportive) driven. We see many risks for long end but this short end is overpriced and offering a nice roll down.

Sell 2Y.



Forex

PLN – stronger After setting a top at 4.1800 this week, EUR/PLN turned lower to 4.1270 low. The most likely reason behind better PLN performance is lower Bund yield, which relieved some pressure from EM. Locally, we had a government cabinet reshuffle, which had no visible effect on the market. The tension is gradually rising around Greece, the possible outcome seems to be more and more digital in nature. But the market reaction would be not that symmetrical. The positive outcome (a deal with Greece) is in reality only buying more time, while a technical default or Grexit takes us to a totally new ground. As a result, we expect more volatility to come.

OPT – vols lower Calmer PLN and lower realized volatility were responsible for a offered tone in vols this week. Today 1 month EUR/PLN mid is 8% (0.4% lower than last Friday), 3 month is also at 8% (0.3% lower) and, finally, 1 year is fixing at 7.9% (0.4% lower). 1 year EUR/PLN was given at 7.85% in good amount during the Friday trading. Skew was slightly better offered and currency spread (difference between vols in USD/PLN and EUR/PLN) caught better bids.

Short-term forecasts

Main supports / resistances:

EUR/PLN: 4.0950 / 4.195

USD/PLN: 3.50 / 3.80

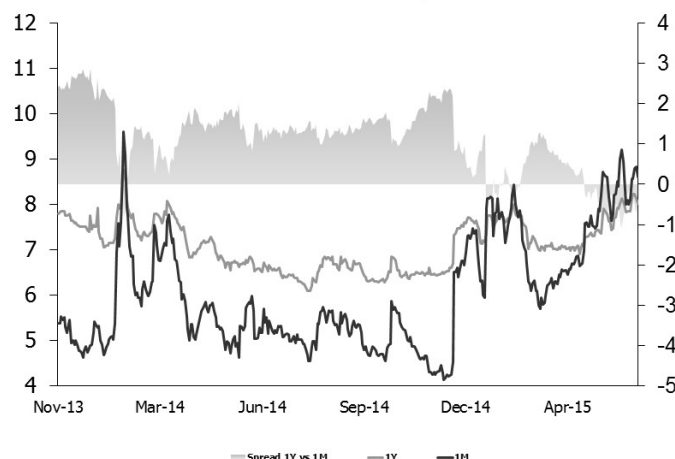
Position Short EUR/PLN from 4.1800 has been closed with profit at 4.1300. We move to the sidelines in EUR/PLN.

USD/PLN - We are long at 3.6600, we are ready to add at 3.6300 and set a stop below, at 3.6100. We would like to take profit at 3.8000. Greece is the reason we have decided to be long USD/PLN. The improving tone of US macroeconomic releases (NFP) is also encouraging.

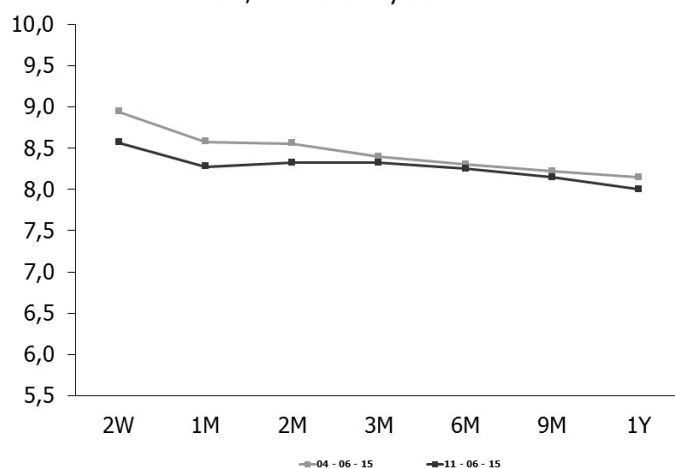
Options We are still long EUR/PLN and USD/PLN Vanna, (in 1:2 ratio in favor of USD/PLN). We are also long longer term Vega in both. Actually, we have added to our long in 1 year EUR/PLN at 7.85% , against our last week sell of 3 months EURPLN at 8.3%. Being long Gamma is also an advisable strategy in our view.



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
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
6/8/2015	1.47	1.68	1.79	1.66	1.95	1.70	1.70	1.73	1.74	1.82	1.92	1.84
6/9/2015	1.71	1.69	1.79	1.67	1.70	1.71	1.70	1.73	1.74	1.82	1.91	1.83
6/10/2015	1.34	1.70	1.51	1.67	1.81	1.71	1.72	1.73	1.75	1.80	1.92	1.84
6/11/2015	1.48	1.70	1.63	1.67	1.93	1.71	1.72	1.73	1.75	1.82	1.90	1.84

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
6/4/2015	1.700	1.674	1.950	1.818	2.470	2.626	2.895	3.086
6/8/2015	1.700	1.710	1.978	1.857	2.515	2.671	2.977	3.187
6/9/2015	1.710	1.699	1.994	1.882	2.535	2.667	3.018	3.210
6/10/2015	1.710	1.689	1.990	1.868	2.535	2.686	3.005	3.228
6/11/2015	1.710	1.767	1.970	1.938	2.490	2.619	2.950	3.142

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1Y	
6/4/2015	8.58	8.40	8.30	8.15	8.15	2.18	0.59	
6/8/2015	8.80	8.50	8.43	8.23	8.23	2.18	0.59	
6/9/2015	8.83	8.50	8.39	8.13	8.13	2.17	0.66	
6/10/2015	8.60	8.45	8.33	8.03	8.03	2.18	0.52	
6/11/2015	8.28	8.33	8.25	8.00	8.00	2.17	0.57	

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
6/4/2015	4.1307	3.7108	3.9690	2.9844	1.3242	0.1503
6/8/2015	4.1559	3.7381	3.9750	2.9808	1.3247	0.1515
6/9/2015	4.1705	3.6975	3.9860	2.9741	1.3337	0.1524
6/10/2015	4.1602	3.6760	3.9655	2.9967	1.3296	0.1522
6/11/2015	4.1481	3.6817	3.9352	2.9801	1.3263	0.1522

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