

June 26, 2015

## Polish Weekly Review

### Department of Economic Analysis (research)

Ernest Pytlarczyk, PhD, CFA  
chief economist  
tel. +48 22 829 01 66  
[ernest.pytlarczyk@mbank.pl](mailto:ernest.pytlarczyk@mbank.pl)

Marcin Mazurek, PhD  
senior analyst  
tel. +48 22 829 01 83  
[marcin.mazurek@mbank.pl](mailto:marcin.mazurek@mbank.pl)

Piotr Bartkiewicz  
analyst  
tel. +48 22 526 70 34  
[piotr.bartkiewicz@mbank.pl](mailto:piotr.bartkiewicz@mbank.pl)

Karol Klimas  
analyst  
tel. +48 22 829 02 56  
[karol.klimas@mbank.pl](mailto:karol.klimas@mbank.pl)

### Department of Financial Markets (business contacts)

Bartłomiej Malocha, CFA  
head of interest rates trading  
tel. +48 22 829 01 77  
[bartlomiej.malocha@mbank.pl](mailto:bartlomiej.malocha@mbank.pl)

Marcin Turkiewicz  
head of fx trading  
tel. +48 22 829 01 67  
[marcin.turkiewicz@mbank.pl](mailto:marcin.turkiewicz@mbank.pl)

### Department of Financial Markets Sales (business contacts)

Inga Gaszkowska-Gebska  
institutional sales  
tel. +48 22 829 01 67  
[inga.gaszkowska-gebska@mbank.pl](mailto:inga.gaszkowska-gebska@mbank.pl)

Jacek Jurczyński  
head of treasury sales  
tel. +48 22 829 15 16  
[jacek.jurczynski@mbank.pl](mailto:jacek.jurczynski@mbank.pl)

**mBank S.A.**  
18 Senatorska St.  
00-950 Warszawa  
P. O. BOX 728  
tel. +48 22 829 00 00  
fax. +48 22 829 00 33  
<http://www.mbank.pl>

### Table of contents

#### Our view in a nutshell

##### Economics

- Consumer sentiment is surging but it is doubtful whether consumption would follow suit

##### Fixed income

- Outsiders

##### Money market

- Stable week behind us

##### FX market

- PLN – consolidating
- OPT – vols lower again

page 2

page 3

page 4

page 5

page 6

### Comment on the upcoming data and forecasts

On Tuesday the NBP will publish quarterly BoP data. We expect no significant revision and hence a confirmation that Poland ran a sizable current account surplus in the first quarter. Wednesday brings the release of June Manufacturing PMI. Because of conflicting signals (weaker sentiment in Germany but a slight rebound in industrial sentiment as measured by GUS) we decided on a conservative forecast (unchanged from May).

### Polish data to watch: June 29th to July 3rd

Publication	Date	Period	mBank	Consensus	Prior
Manufacturing PMI (pt.)	01.07	Jun	52.4	52.4	52.4

### 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

No surprises this week, hence Polish surprise index is unchanged. There is only one potential surprise next week - the PMI.

\* 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 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. 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 EGBB.
- 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; the former, however, run currently as high as never.
- 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

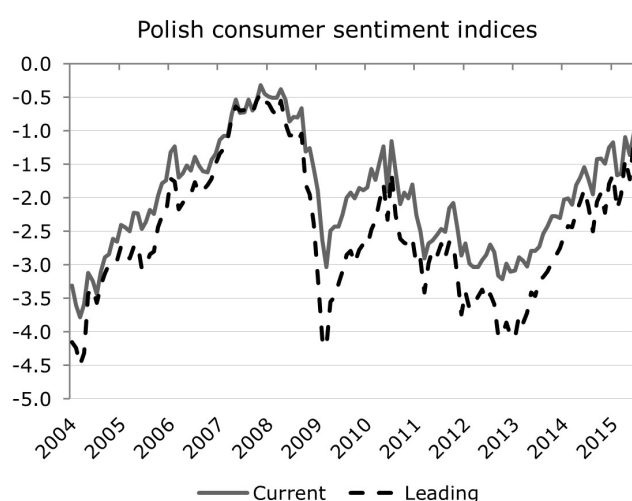
  

	2014 Q1	2014 Q2	2014 Q3	2014 Q4	2015 Q1	2015 Q2 F	2015 Q3 F	2015 Q4 F
GDP y/y (%)	3.5	3.6	3.3	3.3	3.6	3.7	3.9	4.3
Individual consumption y/y (%)	3.0	3.0	3.2	3.0	3.1	3.1	3.1	3.3
Public Consumption y/y (%)	0.5	6.4	5.3	6.4	3.3	3.0	3.0	2.0
Investment y/y (%)	11.4	8.7	9.2	8.6	11.4	9.0	10.0	10.0
Inflation 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

### Consumer sentiment is surging but it is doubtful whether consumption would follow suit

Latest figures indicate that Polish consumer is not concerned with Grexit or changes in the political landscape. On the contrary: both current and leading indices rose to new cycle highs of -10.4 and -11.7, respectively. Also notable are solid increases in the assessment of future household income, economic situation of the country and unemployment risk (lack thereof). On almost all fronts June consumer sentiment is at its highest levels since 2008 and Polish consumer hasn't been that optimistic in years.



Normally, this would herald an acceleration in consumption growth. However, if historical correlations (expected household income tends to lead consumption growth by two quarters, willingness to make major purchases is a nice predictor of current-quarter consumption growth) held, we would have already seen faster growth than the current 3%. Arguably, this is not an aberration, but rather a new normal. First, there is no consumption boom without a major increase in spending on durables. This is unlikely in current situation as Polish households are already fairly saturated with durables (in some cases, i.e. cars, the figures are greater than in many developed countries). Without a major technological breakthrough (e.g. introduction of LCD TV sets) or a housing boom, demand for durables is set to be limited to household formation and durables stock depreciation rates. Incidentally, this seems to be the reason why retail sales continue to disappoint – consumption is shifting towards services. Second, it is unknown whether recent income gains are evenly distributed – and higher income brackets are known to have higher saving rates and substantial mortgage debt burdens (often FX debt). Exact and timely data are scarce but we know that median wages and incomes barely grew since the crisis, as compared to the 2006-2008 period and the poorest have even seen declines in real income.



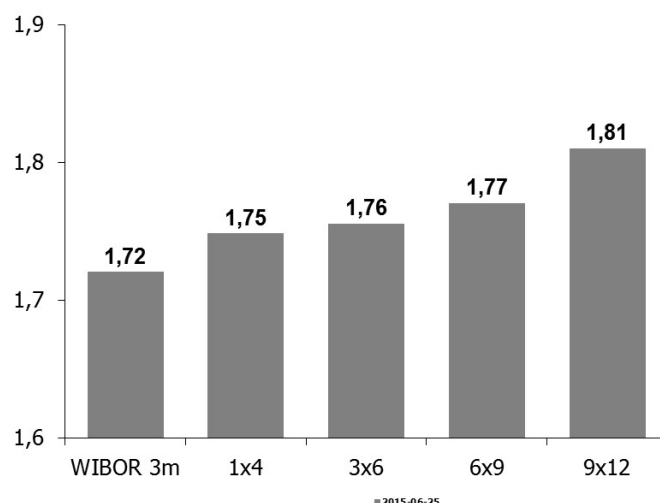
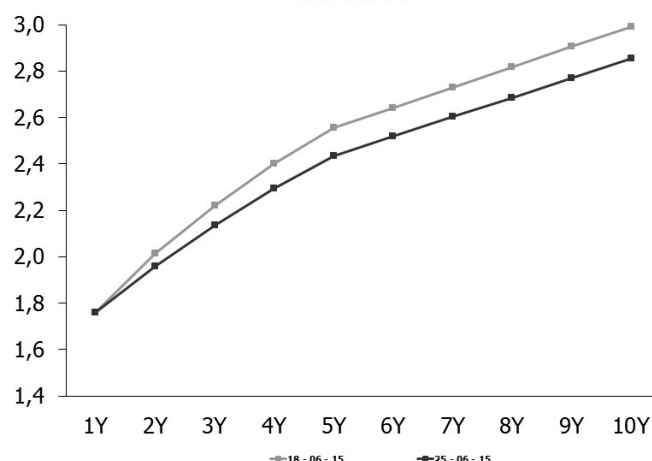
Having said that, we do not deny that consumption will remain a key pillar of Polish economic growth – we only advise against drawing too optimistic conclusions from tentative correlations. As we repeatedly said, this is a balanced recovery, not a boom. Hence, the question of rate hikes next year hangs on the unstated paradigm of positive real interest rates, not on actual inflationary pressures or imbalances.

## Fixed income

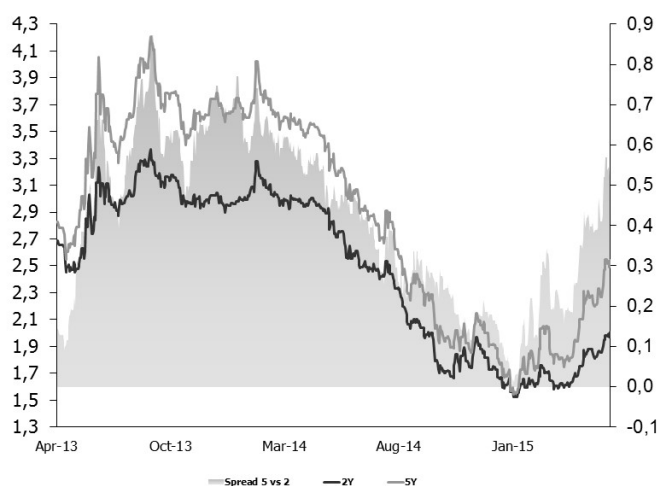
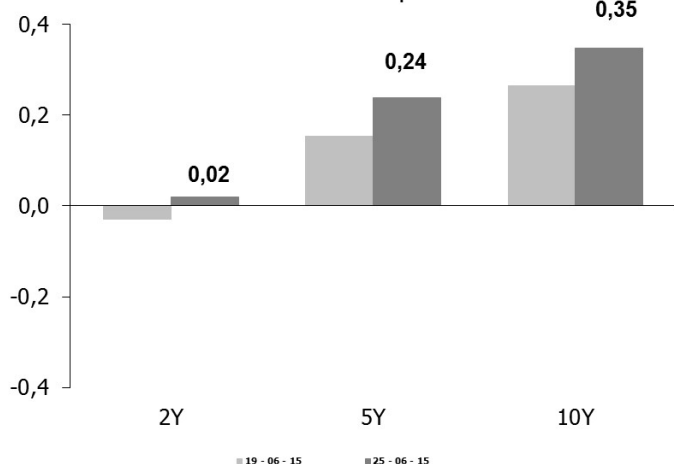
### Outsiders

Polish fixed income market depend more and more on global markets. Endless EU-Greece 'rescue' negotiations put long term investors in defensive stance. Asset swaps widened sharply this week, PS0420 traded 20bp above 5Y IRS, DS0725 30bp above 10Y IRS - both this year highs. While volatility is high, bond auctions in Poland attract less interest despite supportive local economic environment (low CPI, healthy growth). Market reaction for Polish last auction - switching one with 2.5bln demand – was positive because of relatively high prices, but the longer this Greek drama continues, the worse it is for POLGBs. We feel that even negative outcome of this weekend EU-Greece talks is better for Poland (especially in the long end) than being ignored at all by global investors. We hope that any outcome would be able to unveil local story.

IRS curve



Asset swaps



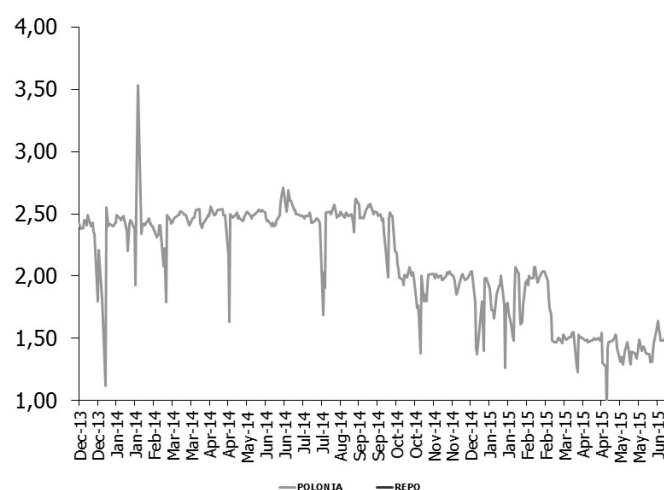
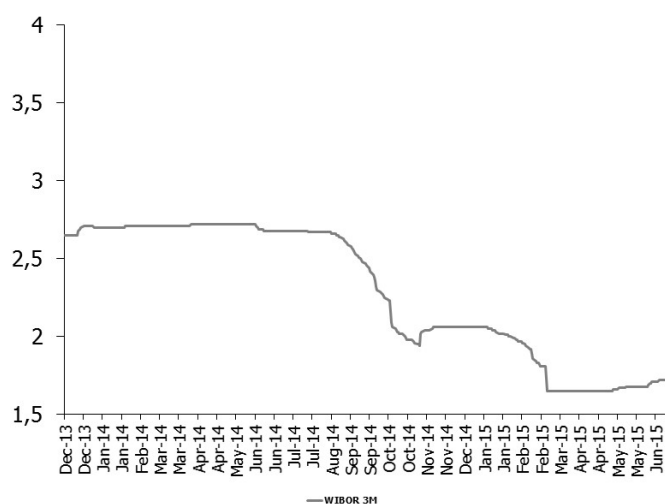
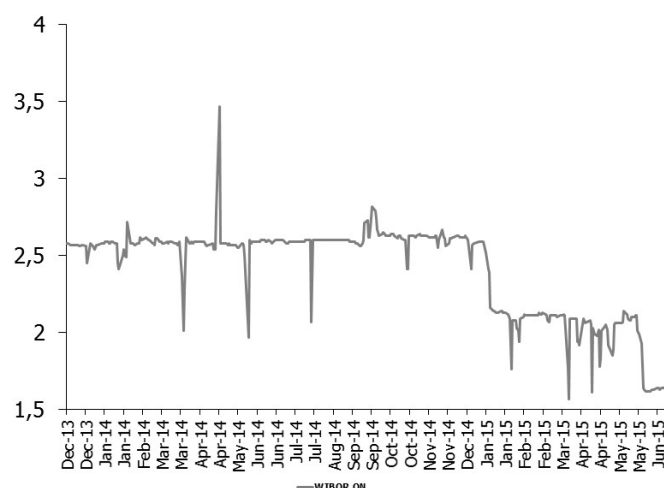
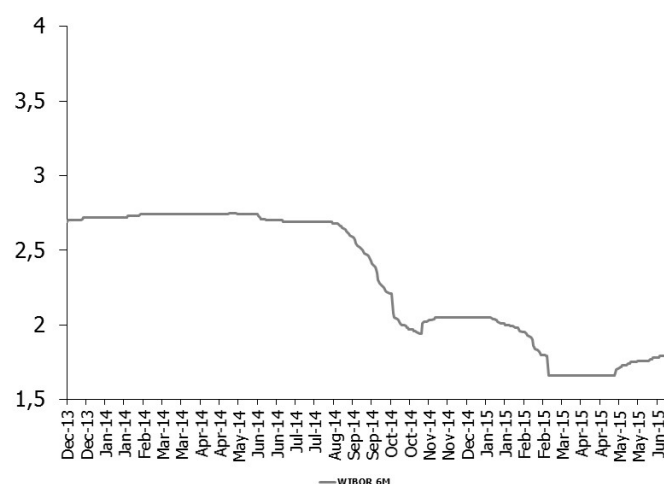
## Money market

### Stable week behind us

Last OMO was almost square, Polonia fluctuated around 1.50. It's the last day of reserve on Monday so today's auction was underbid (by 13 bn PLN) and cash rate fell under 1.0. It won't stay for long as there is additional OMO on Monday.

As there was no important data from Polish economy, front end of the curve remained the same. 1Y OIS is 1.49/1.52, 9x12 FRA 1.79/1.82.

We recommend to buy shortest bonds (PS0416, OK0716) and sell 1Y OIS as we see now chances for rate hikes.



## Forex

**PLN – weaker** While the Greek tragedy went on last week, EUR/PLN was suspended in tight range 4.1560-4.1760. The cacophony of contradicting information's makes the market immune to react but the tensions rises. Generally PLN was an underperformer relative to its peers probably due to growing concern about political risk (general election in autumn). We still are prone to look at EUR/PLN from the 4.10/4.20 range perspective, but it is the upside that could potentially produce fireworks.

**OPT – vols lower, again** Lower realized volatility was the reason why the vols kept on sliding lower the consecutive week. 1 month EUR/PLN ATM is this Friday 7.4% mid (0.3% lower). 3 months EUR/PLN are 7.55% (0.25% down) and finally 1Y is fixing 7.6% (0.2% lower). The Skew was also offered and now is approx. 0.1% lower then week ago. The currency spread (difference between USD/PLN vol and EUR/PLN vol) slid by roughly 0.5%, especially in the frontend.

## Short-term forecasts

Main supports / resistances:

EUR/PLN: 4.09 / 4.19

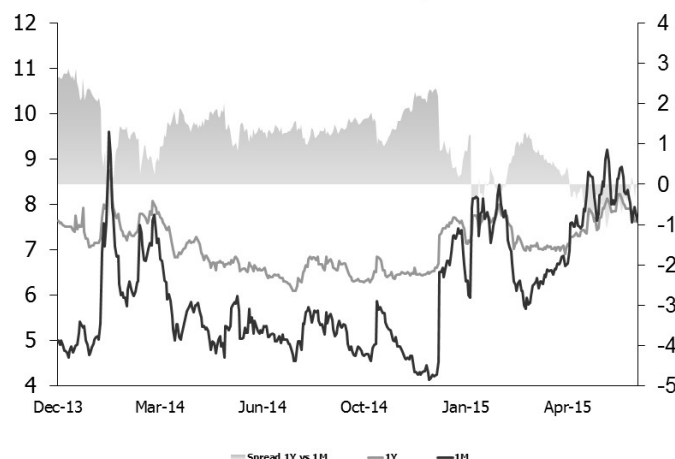
USD/PLN: 3.50 / 3.80

**Position** Still sidelined in EUR/PLN.

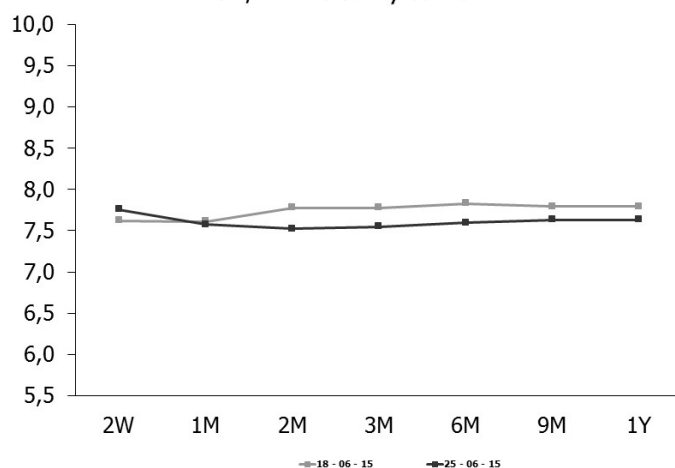
USD/PLN – Unchanged from last week. It was worth to be patient – our long position at 3.66 is finally in-the-money. We are ready to add at 3.6300 and set the stop below at 3.6100. We would like to take profit at 3.8000.

**Options** We are still long EUR/PLN and USD/PLN Vanna and long longer term Vega. We are ready to add to long Vega in back. We think that Greece, rate hikes in US, and parliamentary elections in Poland will support volatility in the longer term. To at least partially cover the Theta bills of quickly approaching holidays, we are short 2 month EURPLN Vega.

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
6/18/2015	1.71	1.71	1.79	1.69	1.70	1.72	1.73	1.75	1.77	1.84	1.94	1.87
6/22/2015	1.58	1.72	1.66	1.69	1.70	1.72	1.75	1.75	1.77	1.82	1.91	1.86
6/23/2015	1.44	1.72	1.59	1.69	1.87	1.72	1.73	1.75	1.77	1.83	1.90	1.86
6/24/2015	1.35	1.72	1.49	1.69	1.78	1.72	1.74	1.75	1.77	1.82	1.91	1.86
6/25/2015	1.42	1.72	1.60	1.69	1.87	1.72	1.75	1.76	1.77	1.81	1.91	1.85

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
6/18/2015	1.720	1.793	2.013	1.997	2.554	2.771	2.993	3.300
6/22/2015	1.720	1.745	1.975	1.956	2.485	2.687	2.935	3.202
6/23/2015	1.720	1.740	1.970	1.959	2.450	2.664	2.877	3.179
6/24/2015	1.720	1.783	1.973	1.977	2.455	2.679	2.880	3.211
6/25/2015	1.720	1.758	1.960	1.980	2.435	2.674	2.855	3.202

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1Y	
6/18/2015	7.61	7.78	7.83	7.80	7.80	2.21	0.59	
6/22/2015	7.95	7.70	7.70	7.63	7.63	2.21	0.59	
6/23/2015	7.75	7.60	7.65	7.65	7.65	2.21	0.56	
6/24/2015	7.60	7.58	7.63	7.63	7.63	2.15	0.55	
6/25/2015	7.58	7.55	7.60	7.63	7.63	2.19	0.58	

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
6/18/2015	4.1615	3.6556	3.9817	2.9761	1.3390	0.1527
6/22/2015	4.1724	3.6799	3.9985	2.9903	1.3390	0.1534
6/23/2015	4.1637	3.7040	3.9884	2.9955	1.3469	0.1532
6/24/2015	4.1640	3.7103	3.9891	2.9960	1.3420	0.1531
6/25/2015	4.1737	3.7305	3.9820	3.0157	1.3377	0.1530

## Disclaimer

Distribution and use of this publication The review note is based on the information available to the public. This review creates exclusively a marketing information as defined in Paragraph 9 Section 1 of the Decree of Minister of Finance dated November 20, 2009 on procedures and conditions to be followed by investment firms and banks mentioned in Article 70 Section 2 of Law on Trading in Financial Instruments dated July 29, 2005 as well as by custody banks. This review note is provided to you for information purposes only and is not intended as advice on any particular matter or as recommendation, offer or solicitation for purchase of sale of any financial instrument and should not be taken as such. mBank SA, its directors, officers, executives, managers, servants or agents expressly disclaim all liability to any person in respect of any-thing, and in respect of the consequences of anything, done or omitted to be done, wholly or partly, in reliance upon the whole or any part of the contents of this review note. The opinions and estimates contained herein reflect the current judgment of the author(s) on the date of this document and are subject to change without notice. The opinions pointed in review do not necessarily correspond to the opinions of mBank SA. The past performance of financial instruments is not indicative of future results. No assurance can be given that any financial instrument or issuer described herein would yield favourable investment results. mBank and/or its principals or employees may have a long or short position or may transact in the financial instrument(s) and/or securities referred to herein or may trade in such financial instruments with other customers on a principal basis. No client or other reader should act or refrain from acting on the basis on any matter contained in it without taking specific independent professional advice on the particular facts and circumstances in issue. Copyright protection exists in this publication and it may not be, even partially, reproduced of distributed without the prior written agreement with mBank SA.

©mBank 2013. All rights reserved.