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Polish Weekly Review

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Table of contents

Our view in a nutshell

Economics

- Momentum of Polish industry improves at the end of Q2

Fixed income

- The Test

Money market

- Stable week behind us

FX market

- PLN – consolidating at higher level
- VOL – EUR/PLN stable, USD/PLN higher

page 2

page 3

page 4

page 5

page 6

Comment on the upcoming data and forecasts

The July meeting of Polish MPC will end on Wednesday. The period of tranquility in Polish monetary policy and focus on Greek problems mean that the meeting will probably be a non-event. The statement and the press conference will probably remain optimistic in tone (with questions regarding Greece and possible influence on Polish markets). The only potentially interesting aspect is the new inflation projections. These, in our view, will not bring new signals for market participants (mostly unchanged GDP and CPI paths, CPI won't reach the NBP's target until late 2017).

Polish data to watch: July 6th to July 10th

Publication	Date	Period	mBank	Consensus	Prior
MPC decision (%)	08.07	08.07	1.50	1.50	1.50

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	7/23/2015	1500	1.667	6/11/2015
5Y T-bond PS0720	7/23/2015	3500	1.987	5/21/2015
10Y T-bond DS0725	7/23/2015	2000	2.262	4/9/2015
15Y T-bond WS0428	7/23/2015	20	2.092	3/12/2015

Reality vs analysts' expectations (surprise index* for Poland)



Comment

PMI surprised to the upside (and the index is up on the week). Next week will not change that as no data releases are scheduled.

* 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

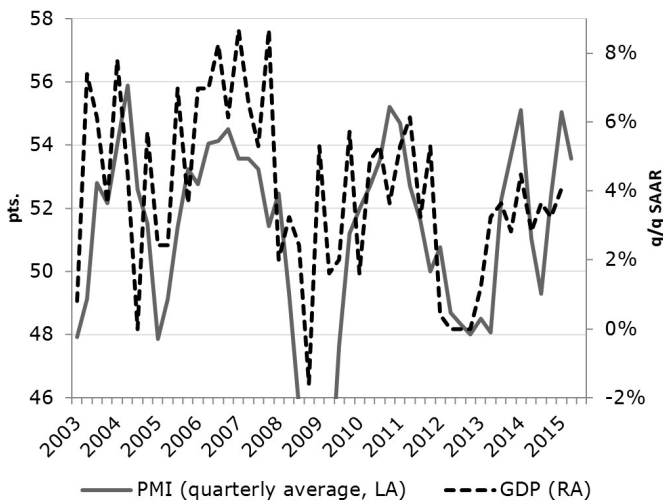
	2014	2014	2014	2014	2015	2015	2015	2015
	Q1	Q2	Q3	Q4	Q1 F	Q2 F	Q3 F	Q4 F
GDP y/y (%)	3.5	3.6	3.3	3.3	3.6	3.7	3.9	4.3
Individual consumption y/y (%)	3.0	3.0	3.2	3.0	3.1	3.1	3.1	3.3
Public Consumption y/y (%)	0.5	6.4	5.3	6.4	3.3	3.0	3.0	2.0
Investment y/y (%)	11.4	8.7	9.2	8.6	11.4	9.0	10.0	10.0
Inflation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

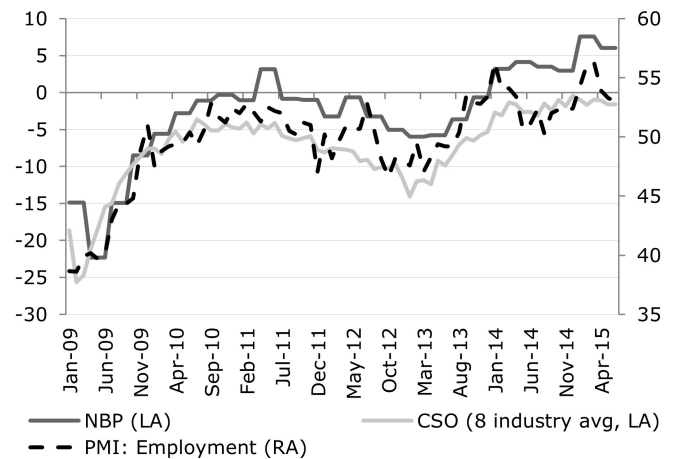
Momentum of Polish industry improves at the end of Q2

Despite our fears, sentiment among Polish manufacturing sector did not deteriorate in June. Manufacturing PMI rose from 52.4 to 54.3, thus breaking the pattern from previous years and is at its highest level since this March. Quarterly average fell only slightly in Q2 (from 55 to 53,6). Fears of economic slowdown, which were dubious before, are now almost impossible. It also suggests that gyrations of quarterly GDP growth will be within statistical error.



When looking into details, the picture remains positive. Categories that improved are: output and, for the first time this year, new orders (it is worth mentioning that the drivers for this advance are domestic orders, because foreign orders grew at a very sluggish pace). On the other hand, employment subindex deteriorated for the third month in a row. This fall is in line with other surveys (NBP, CSO, Randstad and Manpower) and indicates that industry will be adding jobs at a very moderate rate. Maybe just when investment, which are being planned since beginning of 2014, starts, we will see significant increases in this category. Price processes did not change in June – weakening of the zloty brought only a slight rise of input prices, while falls of finished goods prices are not as rapid as at the turn of the year, yet they remain consistent with significant annual decline in the PPI.

Employment forecasts in enterprise surveys



From a wider perspective, Polish economic indicators (CSO, ESI, NBP, PMI) are moving in a narrow range. This suggests that economic growth should not decelerate any time soon. Loss of momentum seen in higher frequency data (monthly industrial production data) should not have significant impact on growth. We see downside risks for 2016 because of households real income slowdown, forced tightening of fiscal policy and possible negative consequences of political uncertainty.

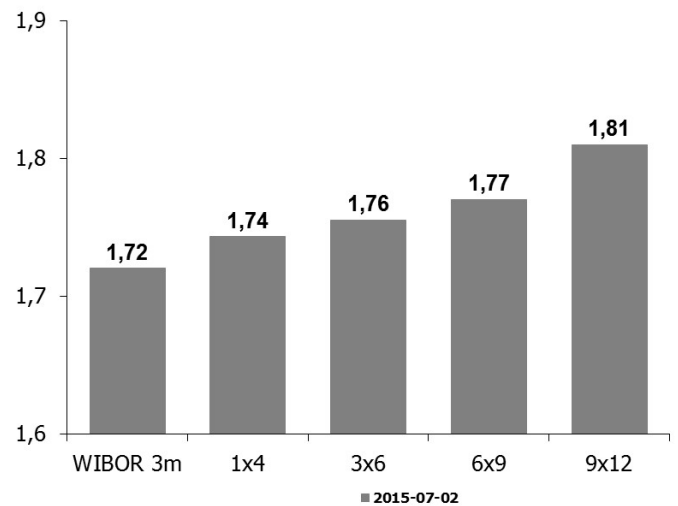
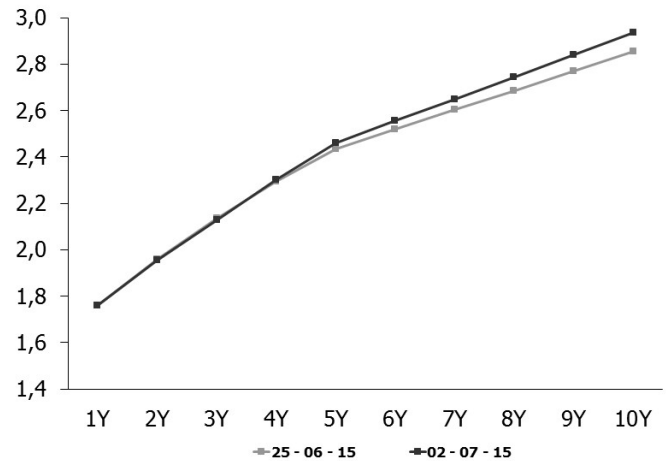
Fixed income

The Test

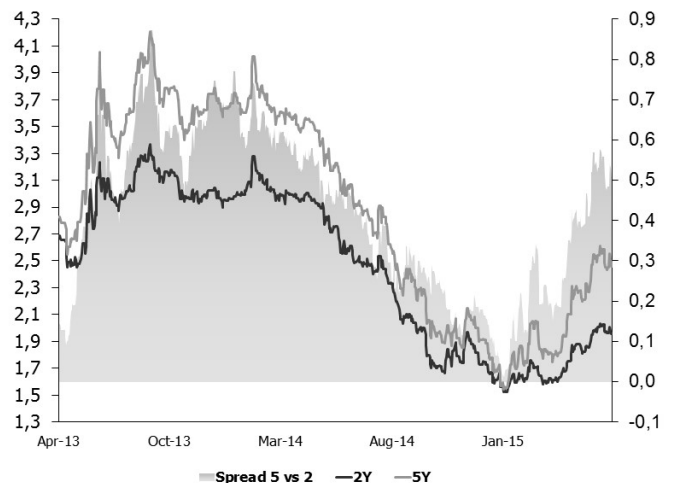
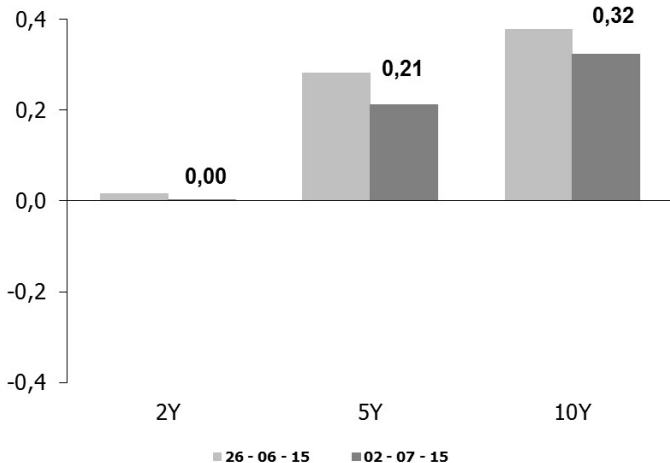
Greece was, once again, the main point of interest for Polish fixed income market. At the beginning of the week, surprising decision about referendum pushed yields higher, to record levels (DS0725 traded around 3.4%). Strong creditors' reaction and not pleasant situation in Greece, caused a reversal worth almost 20bp of earlier weakening. It is clear that for bondholders the most important issue the lack of contagion effect and currently the market is going along this way.

Vote "yes" would be creditors victory and in that scenario much of the pressure on peripheral bonds would diminish. If the referendum results would be "no", we expect strong negative comments from Germany and escalation and isolation of Greece. Either way we expect "Greek tragedy" to have minor impact for Polgbs. With bond supply limited we expect good times for bond holders in coming weeks.

IRS curve



Asset swaps

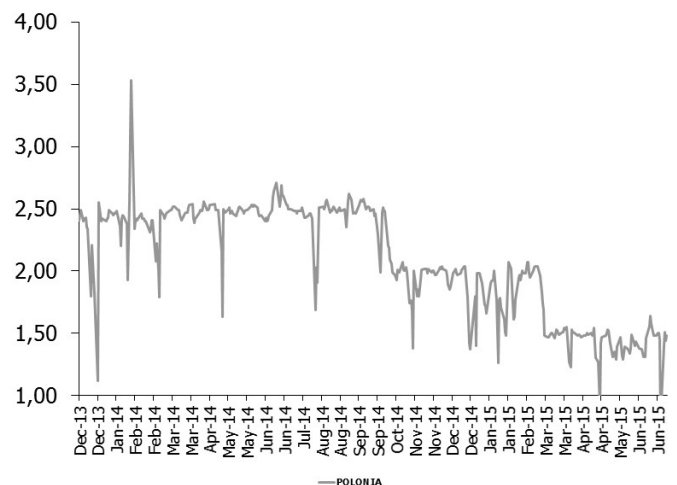
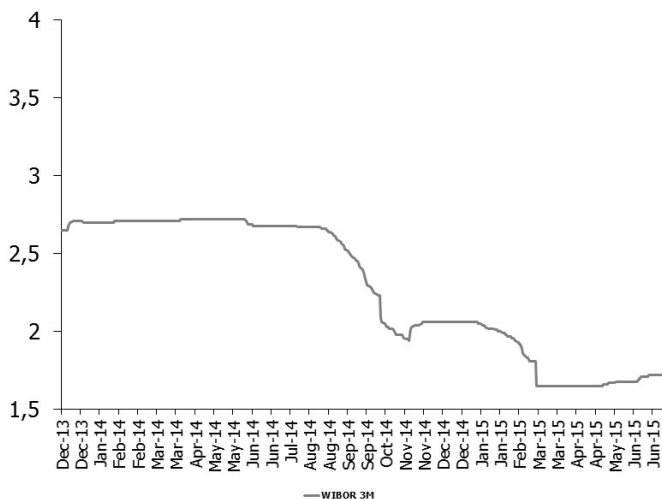
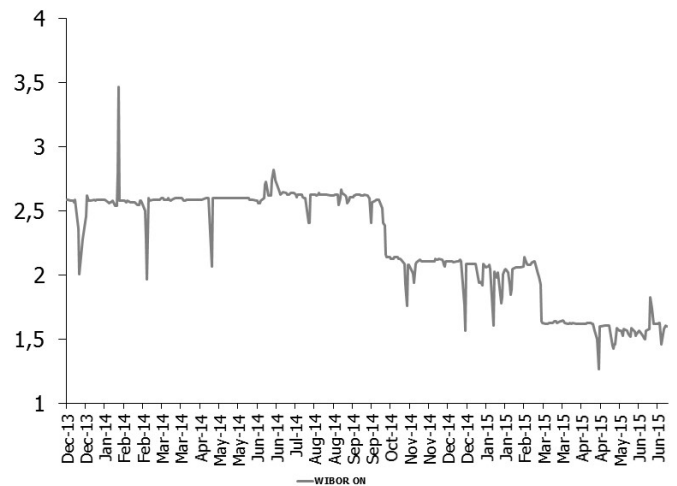
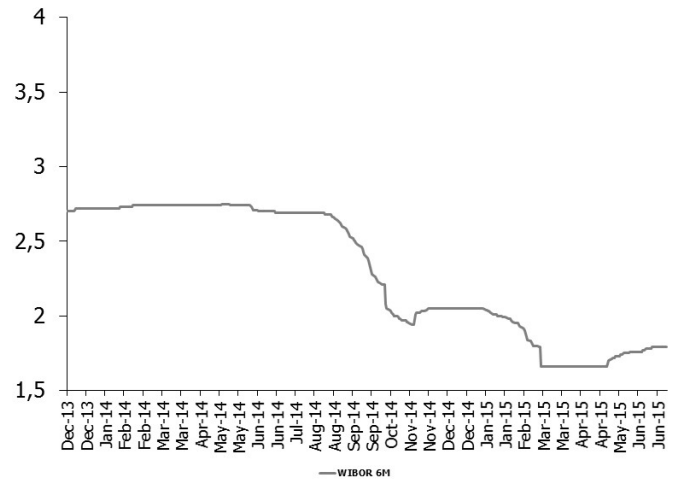


Money market

Stable week behind us

It was first week of reserve so rates remained stable. Polonia fluctuated around 1.50 despite huge cash surplus (10 bn). As today's auction was pretty square, next week will be stable as well.

After Greece announced the referendum, longer end of the curve moved up by 10 bps, front end remained stable. 1Y OIS is 1.48/1.53, 9x12 FRA is 1.79/1.82. We recommend to sell both as we don't believe in any potential rate hike in 2015 and 2016. Partial WIBOR's looks stable now so maybe it's a finally good idea to sell 3x6 at around 1.75 and take 3bps profit.



Forex

PLN – consolidating at higher level Uncertainty on the market rose significantly on Monday, after Greek PM Tsipras called a referendum on whether to accept the creditor proposals. However, the Zloty, after opening this week with 2 figures gap at 4.1925 was traded eminently calm. On Monday EURPLN visited 4.2040 level, only to immediately come back to 4.19 level and finally it stayed there during the rest of the week. We still stick to the "rangy" nature of EUR/PLN, and still think the current trend is slightly up.

OPT volatility – EUR/PLN stable, USD/PLN higher As Hellenic risk has far from receded, this week buyers of gamma was very active on the market, so especially the beginning of the USDPLN volatility curve is higher than week ago. 1w ATM USD/PLN is this Friday at 16.0% (almost 3.0% higher). On EUR/PLN situation was different - quite stable spot and lower realized volatility were the reasons of EUR/PLN volatility curve stability: 1m EUR/PLN ATM is this Friday 7.6% mid (0.1% higher). 3m EUR/PLN are 7.55% and finally 1Y is fixing 7.6% (the same as week before). The currency spread (difference between USD/PLN vol and EUR/PLN vol.) increased especially in the frontend: 1m currency spread is 1% higher, 3m are 0.4% higher.

Short-term forecasts

Main supports / resistances:
 EUR/PLN: 4.1250 / 4.22
 USD/PLN: 3.55 / 3.85

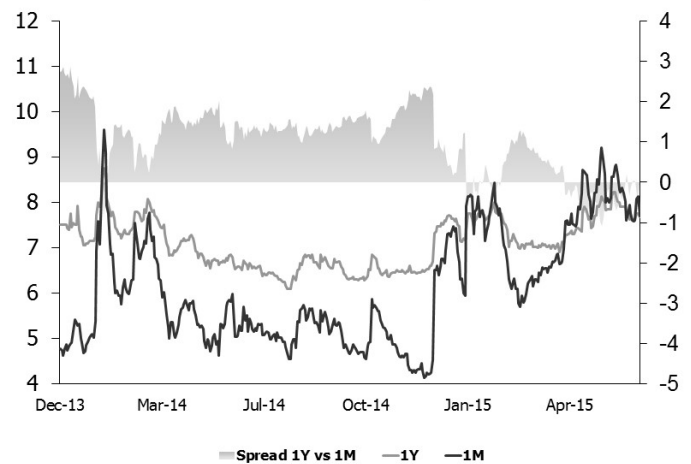
Position Still sidelined in EUR/PLN.

Long USD/PLN – On Monday morning we closed our long position at 3.80 with 14 big figures profit and reopened it again at 3.74 the same day in the evening. The weak US labor data produced some displeased surprise to our position. Nevertheless, uncertainty in Greece as well as inevitable rate hike in the U.S. let us have hope to get USD/PLN back above 3.82. We are ready to add to our long position at 3.66 and set stop at 3.63.

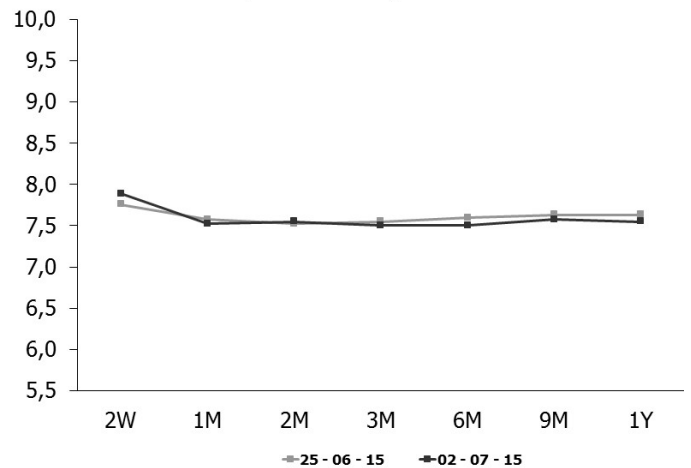
Options We are still long EUR/PLN and USD/PLN. Vanna and long longer term Vega. We are ready to add to long Vega in the back. We think that Greece, rate hikes in the U.S., and parliamentary elections in Poland will support volatility in the longer term. To at least partially cover the Theta bills of quickly approaching holidays we are short 2m 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
6/25/2015	1.42	1.72	1.60	1.69	1.87	1.72	1.75	1.76	1.77	1.81	1.91	1.85
6/29/2015	1.42	1.72	1.60	1.69	1.87	1.72	1.75	1.76	1.77	1.81	1.91	1.85
6/30/2015	1.42	1.72	1.60	1.69	1.87	1.72	1.75	1.76	1.77	1.81	1.91	1.85
7/1/2015	1.42	1.72	1.60	1.69	1.87	1.72	1.75	1.76	1.77	1.81	1.91	1.85
7/2/2015	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
6/25/2015	1.720	1.758	1.960	1.980	2.435	2.674	2.855	3.202
6/29/2015	1.720	1.758	1.960	1.980	2.435	2.674	2.855	3.202
6/30/2015	1.720	1.758	1.960	1.980	2.435	2.674	2.855	3.202
7/1/2015	1.720	1.758	1.960	1.980	2.435	2.674	2.855	3.202
7/2/2015	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	
6/25/2015	7.58	7.55	7.60	7.63	7.63	2.19	0.58	
6/29/2015	7.58	7.55	7.60	7.63	7.63	2.19	0.58	
6/30/2015	7.58	7.55	7.60	7.63	7.63	2.19	0.58	
7/1/2015	7.58	7.55	7.60	7.63	7.63	2.19	0.58	
7/2/2015	7.58	7.55	7.60	7.63	7.63	2.19	0.58	

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
6/25/2015	4.1737	3.7305	3.9820	3.0157	1.3377	0.1530
6/29/2015	0.0000	0.0000	3.9960	3.0204	1.3359	0.1536
6/30/2015	0.0000	0.0000	3.9960	3.0204	1.3359	0.1536
7/1/2015	0.0000	0.0000	3.9960	3.0204	1.3359	0.1536
7/2/2015	0.0000	0.0000	3.9960	3.0204	1.3359	0.1536

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