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## Polish Weekly Review

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### Comment on the upcoming data and forecasts

Week begins with the release of the latest Inflation Report from the NBP. On Tuesday the monthly marathon of data releases begins with the NBP's publications: balance of payments and M3 data. As for the former – we expect a marked deterioration in current account (small surplus in C/A and trade balance, seasonal drops in services and transfers). The latter should show a slight acceleration in annual growth rate of M3. Inflation increased only marginally in June, with stable food price growth, small increase in fuel prices and high statistical base in communication services. Labor market data will, in our view, show a mixed picture: strong rebound in wage growth (working day and base effects) will be accompanied by slowing employment growth - a new normal for the series. Industrial and trade data (Friday) are bound to accelerate further in June: working day effects (+1 vs. -1 y/y) and base effects in certain trade categories will boost the headlines significantly.

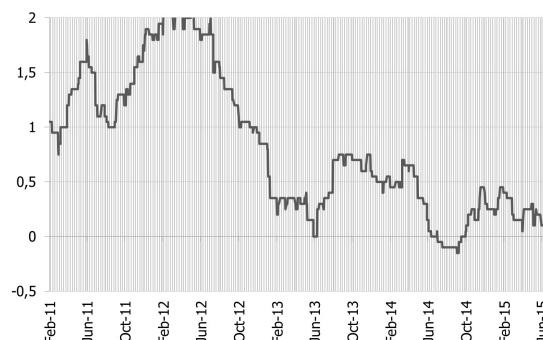
### Polish data to watch: July 13th to July 17th

Publication	Date	Period	mBank	Consensus	Prior
NBP Inflation Report	13.07	Jul			
M3 y/y (%)	14.07	Jun	8.2	7.7	7.7
Current account (mio EUR)	14.07	May	214	383	1138
Exports (mio EUR)	14.07	May	14150	14037	14485
Imports (mio EUR)	14.07	May	14050	14043	14358
CPI y/y (%)	15.07	Jun	-0.8	-0.8	-0.9
Average gross wage y/y (%)	16.07	Jun	4.9	4.1	3.2
Employment y/y (%)	16.07	Jun	1.0	1.1	1.1
Sold industrial output y/y (%)	17.07	Jun	7.0	6.9	2.8
PPI y/y (%)	17.07	Jun	-1.8	-1.9	-2.2
Retail sales y/y (%)	17.07	Jun	3.9	3.5	1.8

### 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

Unchanged (no data releases last week). Next week brings all the relevant data releases: CPI, PPI, industrial output, retail sales, wages. Hard to imagine that there won't be any surprises.

\* 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 until winter.
- Rate cut cycle has been concluded and rates are going to stay at 1.5%. 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 defensive on POLGBs.
- The recent rally was triggered by positioning (local and foreign investors underweight duration) amid pricing out of (unreasonable) interest rate hikes in 2016.
- At the same time local political uncertainty and Greece risks are here to stay.
- Our twist is tactical since problems in Chinese economy are expected to end up in yuan devaluation or/and significant headwinds for consumption due to massively negative wealth effects. Such a scenario should be beneficial for bonds either from deflation side (yuan) or growth side (consumption). This is a developing story at the moment, though.

### 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	4.1
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	8.5	8.5	8.5
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	10.4	9.9	10.0
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	1.72	1.74	1.75
2Y Polish bond yields (% eop)	3.01	2.51	2.00	1.79	1.61	1.99	1.80	1.80
10Y Polish bond yields (% eop)	4.23	3.45	3.05	2.52	2.31	3.31	3.20	3.30
EUR/PLN (eop)	4.17	4.16	4.18	4.29	4.07	4.19	4.10	4.05
USD/PLN (eop)	3.03	3.04	3.31	3.54	3.80	3.76	3.80	3.86

F - forecast

## Economics

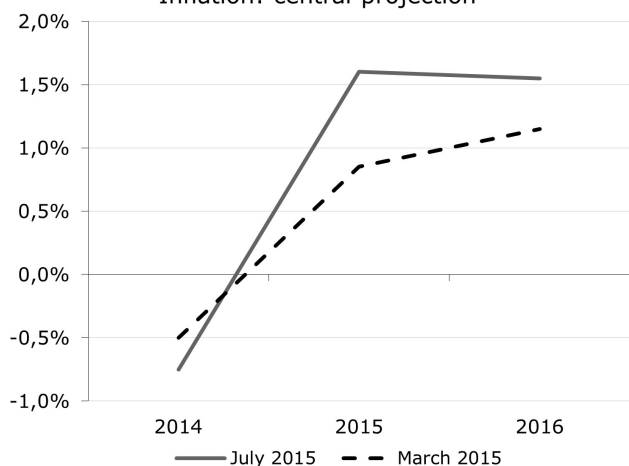
### The MPC keeps rates unchanged. The paradigm of positive real interest rates might be abandoned.

The July meeting of Polish MPC was an unsurprising one. The MPC stood firm by its earlier commitment of unchanged monetary policy. The post-meeting press release clearly states that „expected stable economic growth, amidst recovery in the euro area and good situation in the domestic labour market, reduce the risk of inflation remaining below the target in the medium term”. Nevertheless, negative inflation is set to stay with us for the next few months, which – as Belka clearly stated – delays any normalization in monetary policy. The new inflation projections cited in the statement are only slightly more optimistic than the ones from March as the CPI still remains below target throughout the forecast horizon.

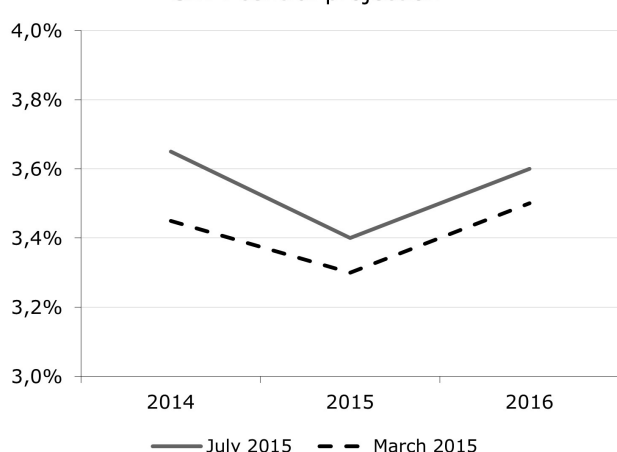
mid-year) because of precisely the same rationale.

Our assessment that the (new) MPC will not be in a rush to raise interest rates and that rates will remain unchanged in 2016 is thus reinforced. Any significant lead on the ECB will result in a marked strengthening of the Zloty and would cool the economy too fast. It is even more likely that the NBP will launch additional easing measures aiming – by changing the monetary policy strategy – at boosting bank demand for short-term government debt (instead of NBP bills).

Inflation: central projection



GDP: central projection



The dovish tone of the meeting is attested, in addition, by the following arguments put forth during the conference: 1) GDP growth barely accelerates after the first quarter of 2015; 2) inflation is set to remain negative for months; 3) negative real interest rates are possible in 2016 (if current projections are true) and even welcomed as it would increase the monetary stimulus. The last argument is clearly contradicting the current paradigm of monetary policy and demolishes the logic employed by those analysts who forecast rate hikes in 2016 (as early as

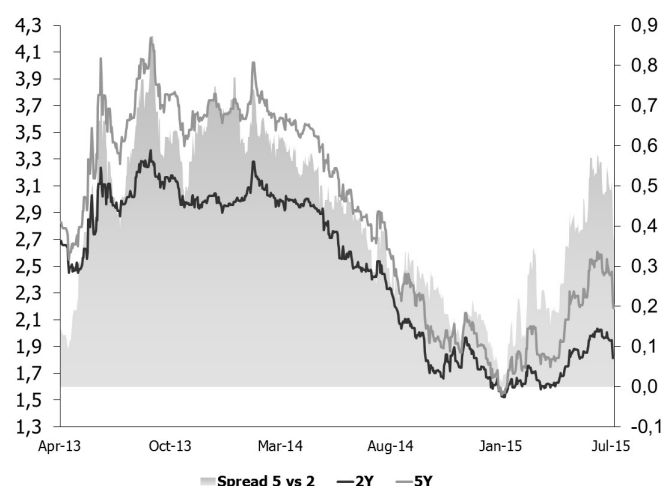
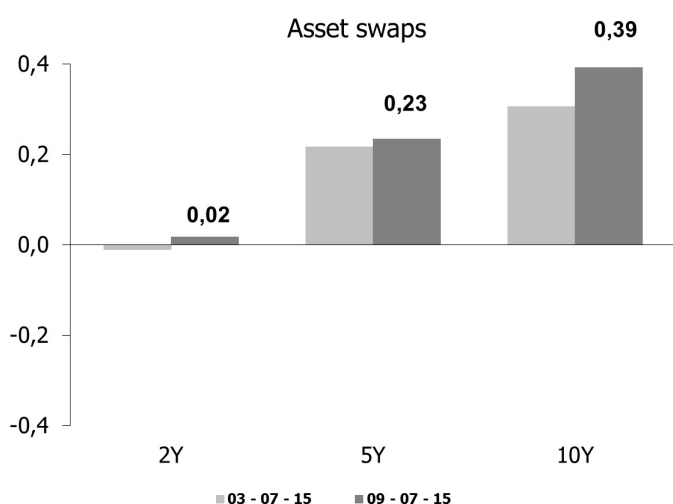
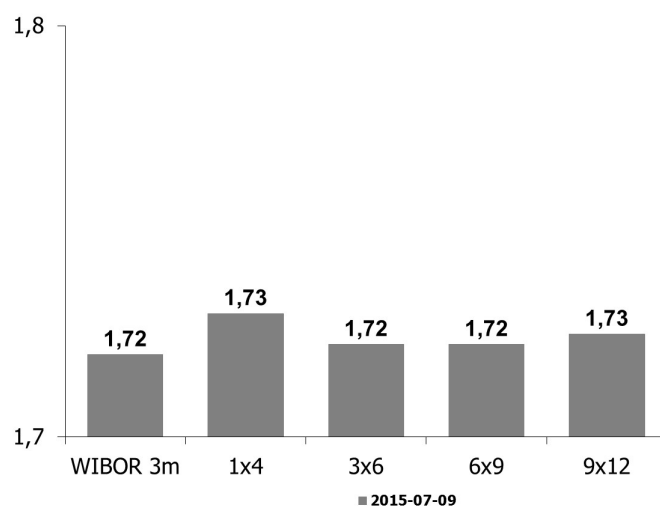
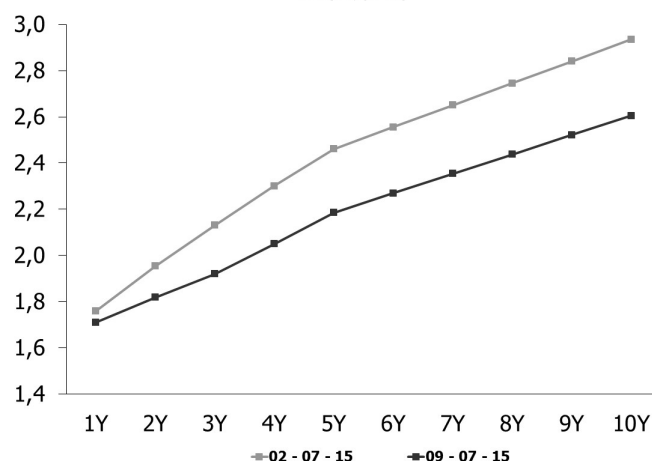
## Fixed income

### China much more important than Greece

Positive sentiment came back to Polish fixed income market. Concerns about global growth (because of slowdown in China) took over Greek problems. As a result 5Y IRS collapsed from 2.55% down to 2.17% and is now trading around 2.27%. Auction of Polish Government Bonds, on Thursday, found moderate demand – MinFin sold 2.5bln of WZ0120 and WZ0124. It seems that investors are now convinced about containing credit risk to Greece only.

Impact of Greek story is clearly diminishing and we see room for being constructive on bonds.

IRS curve



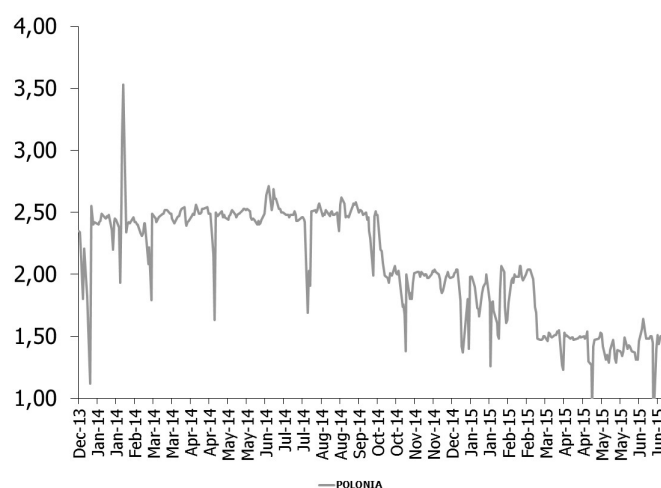
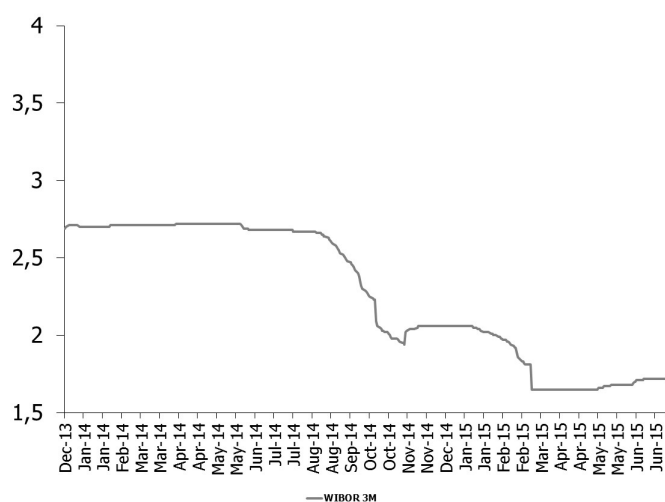
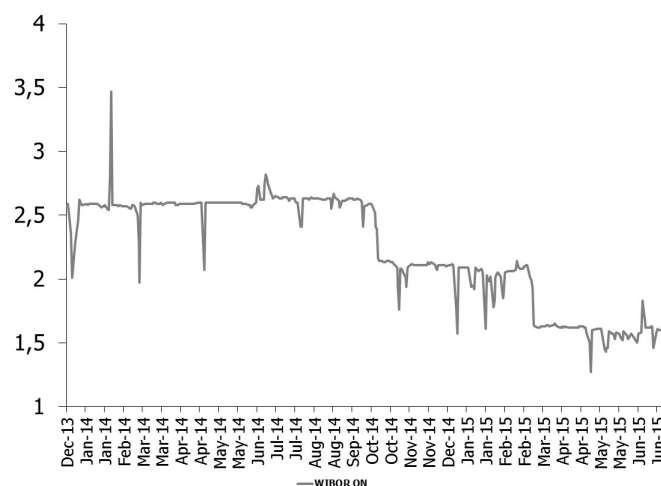
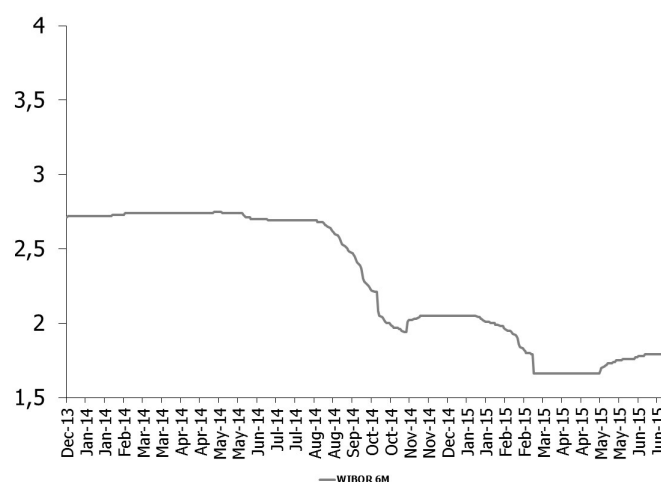
## Money market

### Stable week behind us

Last week was stable with cash around 1.50. Next week should be cheaper as today's OMO was underbid by 5bn PLN.

After weeks of sell-off, market became bullish. Longer end fell by 30 bps, front end by 10bps. All FRA under a year are now quoted 1.70/1.74 and some of them are traded under WIBOR.

Also OIS market is stable. Swaps from 6M to 1Y are 1.45/1.50. In our opinion it might be a good time to buy 6x9 and 9x12 under current WIBOR.



## Forex

**PLN – volatile, finally stronger** At the beginning of the week the backdrop remained weak for Zloty with risk aversion high on the back of Greek uncertainty and turmoil in Chinese equity markets. EUR/PLN has breached the strong range boundary of 4.22, and hit its half year high at 4.245. The situation changed in the end of the week whereas global risks sentiment improved after the FOMC minutes were less hawkish and we saw some signs that Greece was making some progress in its efforts to secure fresh funding. Finally EUR/PLN pulled back from 4.24 below 4.18. Is it a comeback to the old well known 4.10-4.20 range? We will see soon...

**OPT – volatility lower** This week Greece provided another impetus for FX volatility but strangely enough implied EUR/PLN volatilities have not reflected that. 1 month EUR/PLN ATM is this Friday 6.9% mid (0.7% lower than week ago). 3 months EUR/PLN are 7.2% (0.35% lower) and finally 1y is fixing at 7.3% (0.3% lower than week ago). It is worth noting that the medium term implied volatilities are traded below realized volatility. For example 3m EUR/PLN realized volatility is at 8.0% (0.8% higher than implied), 6m EUR/PLN realized volatility is at 7.9% (0.6% higher than implied). The currency spread (difference between USD/PLN vol and EUR/PLN vol) increased roughly about 0.4%.

## Short-term forecasts

Main supports / resistances:

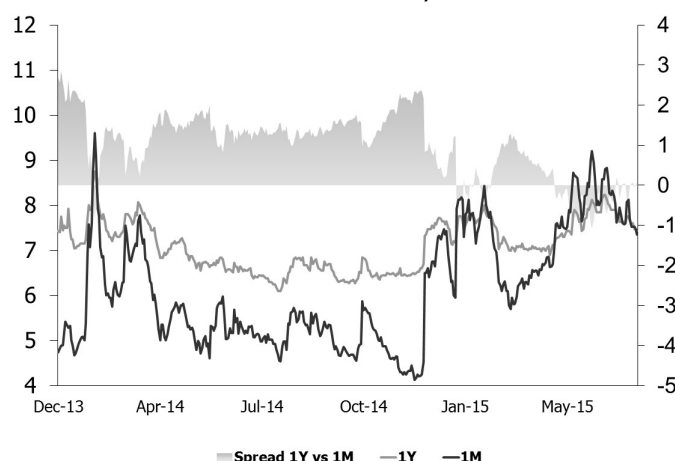
EUR/PLN: 4.1250 / 4.25

USD/PLN: 3.55 / 3.95

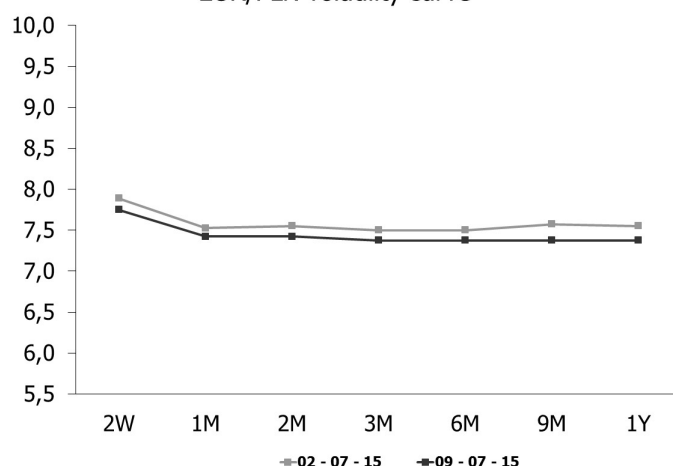
**Position** Position USD/PLN – On Monday we closed our long position at 3.83 with 9 big figures profit and reopened it again at 3.80. Today in the morning we closed it at 3.7750 with 2.5 figures loss. We don't have a position at the moment. Despite the Fed being less hawkish than expected, USD has been on an upward trajectory. Additionally there is still a long struggle ahead for Greece. So we will try to buy again at 3.66 with stop at 3.61 and hopes to see again 3.8. Position EUR/PLN - Sidelined at the moment but we will venture to buy at 4.15 with stop at 4.1280 and hopes to see 4.19.

**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 risks, rate hikes in the US, market turbulence in China and parliamentary elections in Poland will support volatility in the longer term. To at least partially cover the Theta bills, we are short 1-2 months 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
7/2/2015	1.46	1.72	2.03	1.69	2.15	1.72	1.74	1.76	1.77	1.81	1.90	1.85
7/6/2015	1.49	1.72	1.60	1.69	1.87	1.72	1.74	1.75	1.76	1.80	1.90	1.84
7/7/2015	1.76	1.72	1.83	1.69	1.73	1.72	1.74	1.74	1.73	1.78	1.83	1.82
7/8/2015	1.39	1.72	1.80	1.69	2.05	1.72	1.72	1.72	1.72	1.73	1.78	1.78
7/9/2015	1.76	1.72	1.83	1.69	1.73	1.72	1.73	1.72	1.72	1.73	1.76	1.78
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				
7/2/2015	1.720	1.795	1.954	1.957	2.460	2.671	2.935	3.259				
7/6/2015	1.720	1.800	1.950	1.957	2.462	2.687	2.930	3.235				
7/7/2015	1.720	1.785	1.885	1.898	2.360	2.583	2.812	3.144				
7/8/2015	1.720	1.769	1.815	1.859	2.225	2.470	2.657	3.050				
7/9/2015	1.720	1.734	1.818	1.835	2.185	2.419	2.605	2.997				
EUR/PLN 0-delta stradle						25-delta RR		25-delta FLY				
Date	1M	3M	6M	1Y			1M	1Y				
7/2/2015	7.53	7.50	7.50	7.55			7.55	2.16	0.55			
7/6/2015	7.53	7.48	7.48	7.48			7.48	2.16	0.55			
7/7/2015	7.48	7.43	7.40	7.48			7.48	2.16	0.58			
7/8/2015	7.35	7.40	7.38	7.43			7.43	2.16	0.58			
7/9/2015	7.43	7.38	7.38	7.38			7.38	2.16	0.58			
PLN Spot performance												
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN						
7/2/2015	4.1935	3.7859	3.9974	3.0653	1.3345	0.1539						
7/6/2015	4.1990	3.7960	4.0193	3.0968	1.3308	0.1548						
7/7/2015	4.2026	3.8313	4.0443	3.1243	1.3310	0.1550						
7/8/2015	4.2213	3.8225	4.0545	3.1426	1.3292	0.1556						
7/9/2015	4.2277	3.8290	4.0304	3.1528	1.3344	0.1558						

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