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# Polish Weekly Review


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## Comment on the upcoming data and forecasts

Next week brings no significant data. On Thursday CSO will publish its statistical bulletin with, among others, unemployment rate. Preliminary data (in line with market consensus and our forecast) was already given by Ministry of Labour and Social Policy.

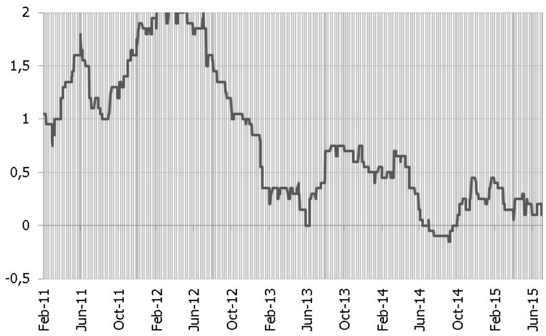
### Polish data to watch: July 20th to July 24th

| Publication | Date | Period | mBank | Consensus | Prior |
|---|---|---|---|---|---|
| NO RELEVANT DATA | | | | | |

### 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

Just as expected, this week's data was full of surprises. Only CPI inflation came exactly in line with market consensus. Labour market data moved the index sharply down, then industrial production (better than expected) erased part of that fall. In the end we are few point lower than 7 day ago. Next week has only one important publication, but preliminary data suggest that the index will not change.

* 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 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 | 10.0 |
| 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

## Big picture still favors low rates

After the passing week all significant releases are already behind us. The big picture is unchanged and favors low rates. Although inflation passed the trough, its march forwards realizes only in small steps amid ultra-low core measures (tracking only 0.2%, a tad above historic lows). After the spectacular Q1, Q2 suggests a slight loss of momentum of the real sphere (only marginal improvement in GDP y/y growth rates), visible also in the labor market. Here is our detailed take on recent publications.

### Real sphere

**Industrial output** grew by 7.6% vs 2.8% recorded in May. The reading was driven by the difference in working days and should be treated at most neutral. In seasonally adjustment terms growth of output stays flat at close to 5% (monthly momentum worsened a bit). It is worth noting that this time the clues form earlier publication of wage growth were leading completely astray.

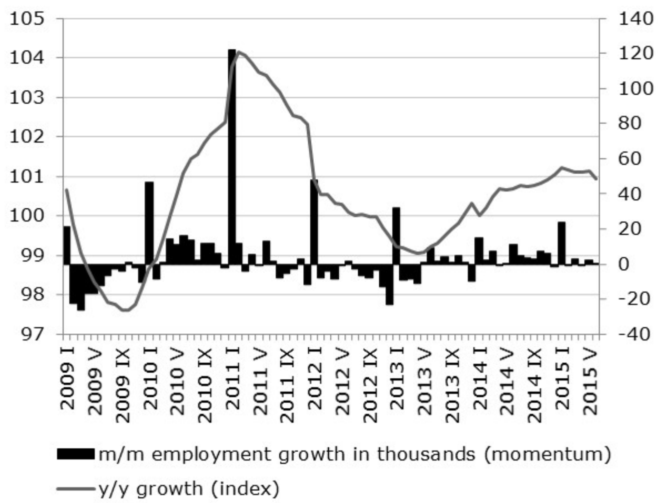
Acceleration of industrial output coincided with decent growth in **retail sales**. June's reading amounted to 3.8% (previous 1.8%) and was driven also by the difference in working days number, some base effects and normal variation among the series. We therefore treat the reading as neutral/normal. It confirms that consumption growth should stay comparable to the one recorded a quarter ago.


### Labor market

June wage growth was depressed from 3.2% y/y to 2.5%, far off the consensus at 4.1%. It possibly reflects weaker momentum (lower number of extra hours worked) versus the stellar Q1. NBP surveys suggest wages pressures stay muted even though labor market slowly turns into the one driven by supply (decent fall in unemployment rate, demographic factors negatively influencing labor force). We may speculate that the reasons lie in negative inflation.


Average planned wage rise
(source: NBP Quick Monitoring Survey)

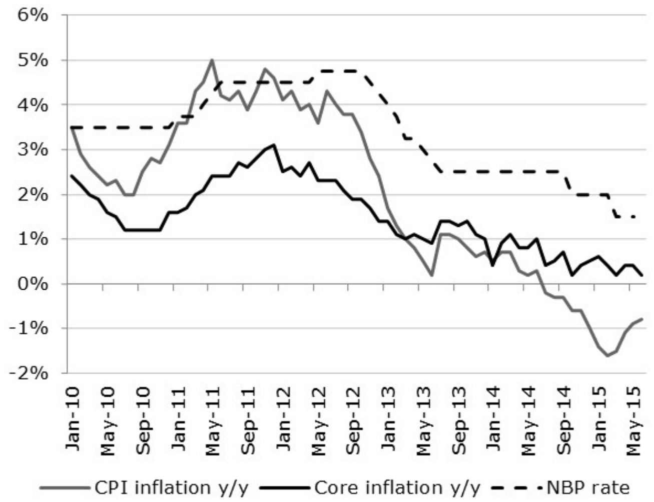
The data soothe concerns over the inflationary developments in the labor market. Although a turnaround in inflation may generate a pick-up in wage demands, such development is so distant that it is hard to be pre-occupied with it.



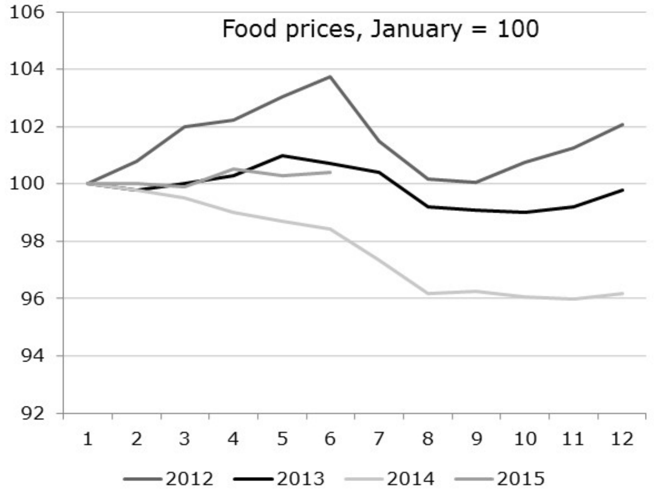

At the same time, employment in enterprise sector rose by only 0.9% y/y in June. Growth in monthly terms was close to zero. For several months we indicated that employment in enterprise sector understates the shape of the Polish labor market. Statistical sample covers only enterprises employing more than 9 workers, and this is also the segment where a progress in productivity is the highest which translates into lower demand for labor. At the same time employment gains reflected in falling unemployment rate are decent. As the focus of financial support from EU shifts towards small enterprises, the rift between the larger ones and the tiny is going to widen. Statistics reflecting only the former are likely to be skewed downwards. Therefore we see only slight acceleration in employment statistics (those we describe in this piece) complemented by decent falls in unemployment rate tracking the whole economy. We also turn to the latter as the proper gauge of the labor market pulse.

## Prices

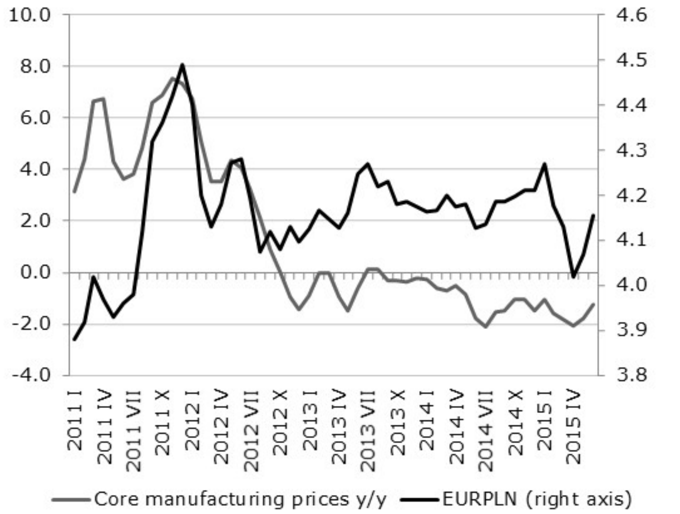
June **CPI inflation** amounted to -0.8% compared to -0.9% previous month. This way coming out of deflation is very slow and, barring normalization of food prices (coming back to still even lower than normal monthly volatility after year of falls - see second chart), deflation could have been even more severe.




Looking into categories, abovementioned food prices rose slightly 0,1% monthly. Difference in this year's and previous food prices path will probably be widening due to drought.




Producer prices jumped in June to -1.6% from previously reported -2.1%. The acceleration stems from exchange rate developments (see the graph) and some catching up in prices connected to commodities and the dollar (mind that in July there was a major change in commodities direction due to developments in China). Barring exchange rate developments, producer prices would stay almost flat on monthly basis. Therefore we think that deflationary environment is still deeply entrenched. One new remark, though. According to NBP surveys, enterprises got used to it and falling margins are not so common anymore.




Fuels rose by 1.8% m/m while vast majority of other categories oscillated around zero (month over month). Falls in communication, education and services prices (together with higher base effects in mobile phone from previous year) moved core inflation down from 0.4% to 0.2% yoy. Core inflation could stay at this level for several months, and escaping deflation would be possible only due to food prices. Fuel and energy prices would play a lesser role - they will consolidate at lower levels because of latest events concerning Iran and weakening demand from China. By the end of the year inflation (principally because of base effects from Q4) should not exceed 1%. Inflation's return to NBP target is still far away.

# Fixed income

## Positioning makes a difference

I am not sure what was more important: we got used to Greece problems and started to treat it as a secondary driver or final agreement in itself.

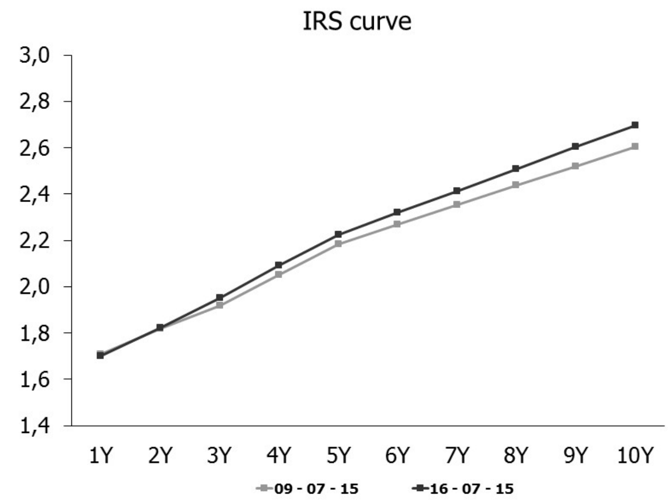
Anyway, market started to neglect Greece story focusing on whether US tightening or China/global slowdown/deflation story will drive yields in its direction.

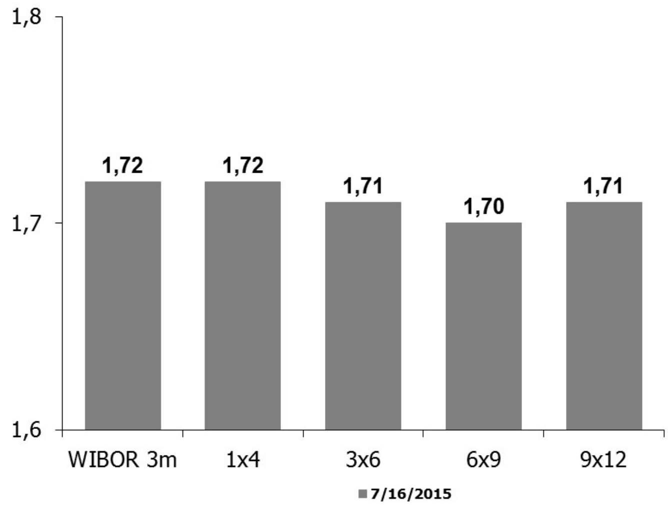
To complete the picture, market positioning was really light, both local and foreign. Greece and local woes made market underweight.

Given the positioning it was clear that bullish direction seemed to be more promising. US rate hikes are likely to have limited impact on both the levels and the region while slowdown threat may spread deflation over the world once again.

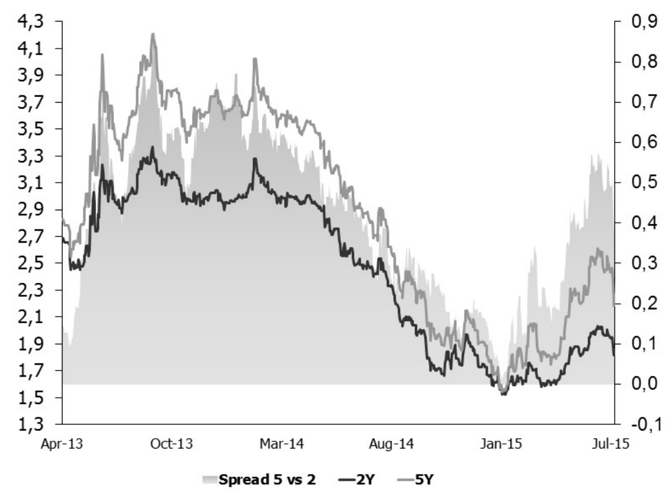
Once inflow started we rallied 55 bps in total and 20bps just this week.

Keeping in mind that local story is neutral on monetary basis and negative on political developments, we see current premium on bonds yield: 20bps on 5Y and 30 bps on 10Y as neutral. We take profit and wait for further developments.







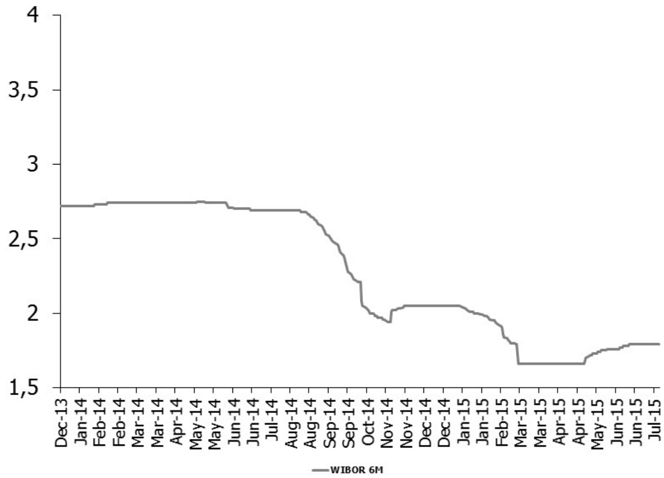
# Money market

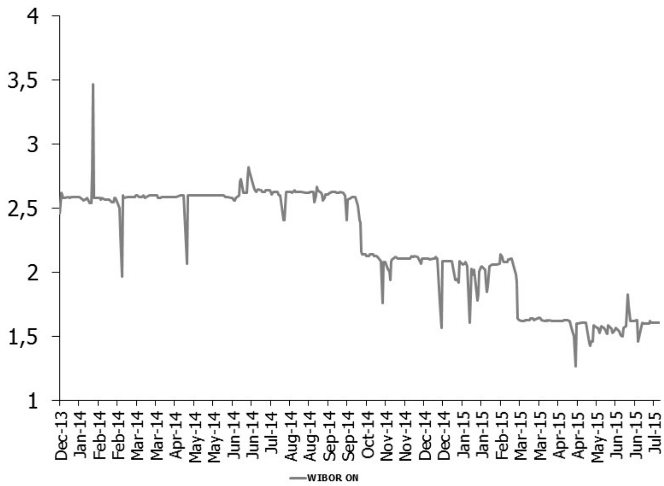
## Stable week behind us...and ahead of us

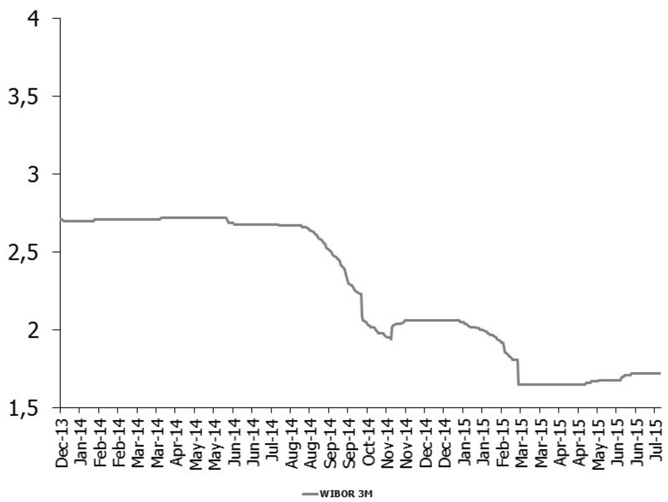
Stable week behind us. Polonia fluctuated under 1.50 for the whole week. Next week should be the same as Friday's auction was just a bit underbid.

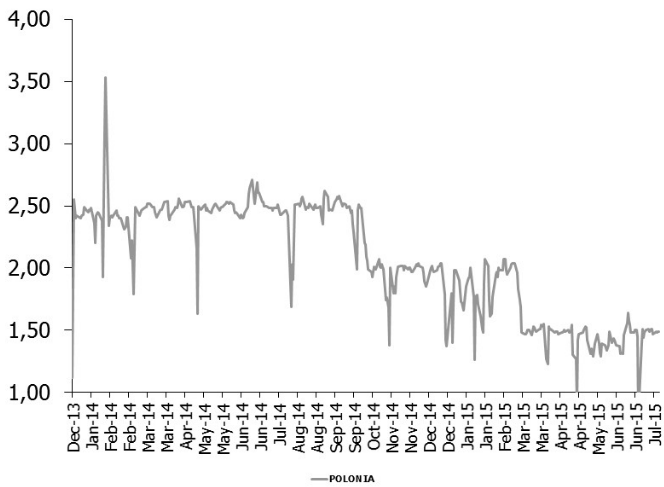
Shortest FRA's are now 6bps under current WIBOR discounting small possibility of rate cuts in near future, but 18x21 FRA is around 1.85 (13 bps over WIBOR) suggesting almost 100% possibility of rate hikes in the beginning of 2017.

We recommend to buy whole front end as we don't believe in any rate cuts. We also don't believe in any rate hikes in 2016 and 2017 so best deal now is to sell FRA spread 6x9 vs 18x21 at 20 bps.



# Forex

**PLN – the ultimate Winner?** Receding Greece fears made the market enthusiastic for PLN. It is probably also the function of liquidity in today's e-managed world. Nevertheless EUR/PLN has experienced the impressive 14 big figure fall within the week, with corrections almost non-existent. Well, impressive, but we believe that 4.07/4.10 support zone will be much tougher to crack at least without prior correction/consolidation.

We also note that current solution adopted in Greece will most likely kick the can a bit further but risks persists. The black clouds from China are also looming on the horizon. In other words, current PLN euphoria may end quite quickly. We are more inclined to see the 4.08-4.18 range for EUR/PLN in coming week.

**Options – sell off continues** The sell off in vols continues as PLN was getting stronger and EUR/USD vols were still moving south.

1 month EUR/PLN ATM is this Friday at 6.4 % (0.5% lower), 3 months are 6.6% ( 0.6% lower) and finally 1 year is fixing at 7.0% (0.2% down). The skew was also offered, as well as the currency spread (difference between USD/PLN vol and EUR/PLN vol). The lack of liquidity is also evident.

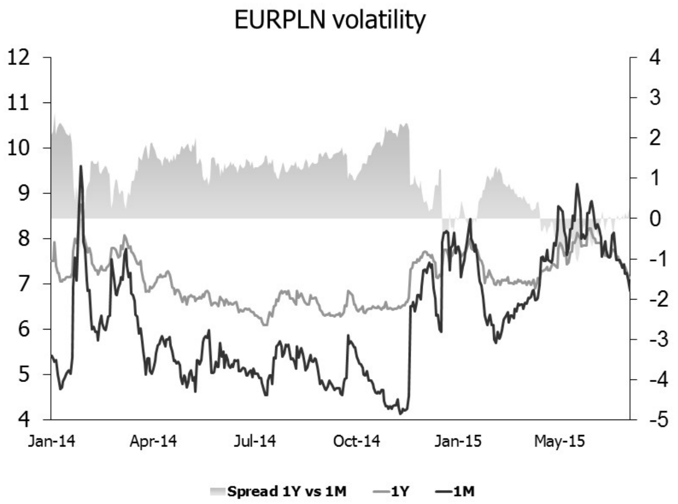
## Short-term forecasts

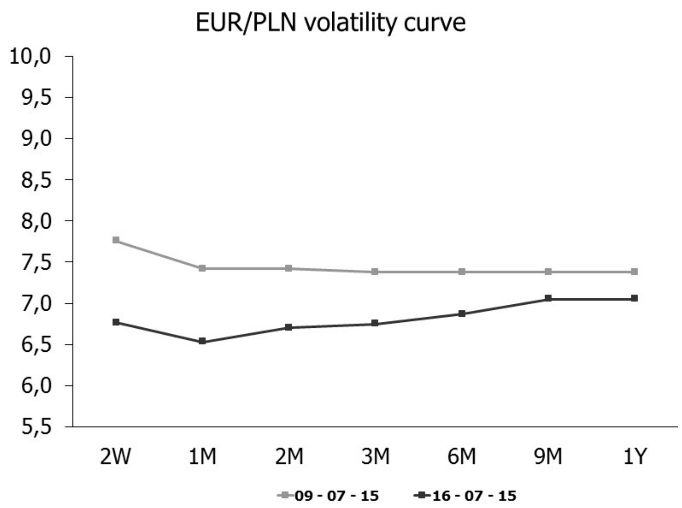
Main supports / resistances:
EUR/PLN: 4.08 / 4.23
USD/PLN: 3.65 / 3.85

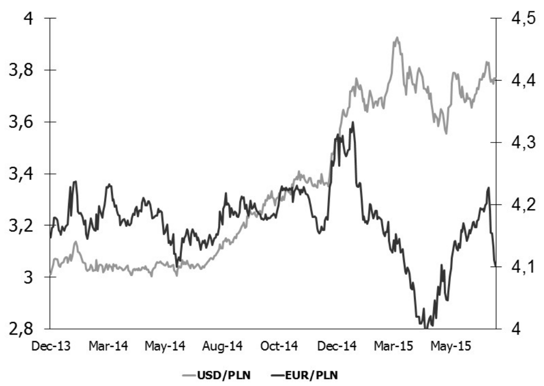
**Position** EUR/PLN - long from 4.15 stopped out at 4.1280.

We have reentered EUR/PLN long at 4.1010, and we are ready to add 4.0850 with a stop below 4.07 and hopes to revisit 4.16+. The trade is purely tactical as we like Polish fundamentals. However, we think that current PLN strength was gained a little bit too fast.

**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 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.




# 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 |
| 7/9/2015 | 1.76 | 1.72 | 1.83 | 1.69 | 1.73 | 1.72 | 1.73 | 1.72 | 1.72 | 1.73 | 1.76 | 1.78 |
| 7/13/2015 | 1.75 | 1.72 | 1.82 | 1.69 | 1.72 | 1.72 | 1.72 | 1.72 | 1.71 | 1.72 | 1.78 | 1.77 |
| 7/14/2015 | 1.49 | 1.72 | 1.55 | 1.69 | 1.78 | 1.73 | 1.72 | 1.72 | 1.71 | 1.72 | 1.79 | 1.77 |
| 7/15/2015 | 1.39 | 1.72 | 1.47 | 1.69 | 1.68 | 1.73 | 1.72 | 1.70 | 1.69 | 1.71 | 1.77 | 1.77 |
| 7/16/2015 | 1.50 | 1.72 | 1.57 | 1.69 | 1.78 | 1.73 | 1.72 | 1.71 | 1.70 | 1.71 | 1.77 | 1.76 |

| 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 |
| 7/9/2015 | 1.720 | 1.734 | 1.818 | 1.835 | 2.185 | 2.419 | 2.605 | 2.997 |
| 7/13/2015 | 1.720 | 1.773 | 1.860 | 1.877 | 2.290 | 2.461 | 2.780 | 3.080 |
| 7/14/2015 | 1.730 | 1.742 | 1.843 | 1.863 | 2.268 | 2.485 | 2.753 | 3.095 |
| 7/15/2015 | 1.730 | 1.717 | 1.839 | 1.850 | 2.241 | 2.430 | 2.721 | 3.035 |
| 7/16/2015 | 1.730 | 1.716 | 1.821 | 1.847 | 2.225 | 2.406 | 2.698 | 3.004 |

| EUR/PLN 0-delta stradle | | | | | 25-delta RR | | 25-delta FLY |
|---|---|---|---|---|---|---|---|
| Date | 1M | 3M | 6M | 1Y | 1M | 1Y | 1Y |
| 7/9/2015 | 7.43 | 7.38 | 7.38 | 7.38 | 7.38 | 2.07 | 0.56 |
| 7/13/2015 | 7.25 | 7.15 | 7.20 | 7.28 | 7.28 | 2.07 | 0.56 |
| 7/14/2015 | 7.08 | 7.08 | 7.13 | 7.18 | 7.18 | 2.07 | 0.56 |
| 7/15/2015 | 6.85 | 6.95 | 7.03 | 7.13 | 7.13 | 2.06 | 0.56 |
| 7/16/2015 | 6.53 | 6.75 | 6.88 | 7.05 | 7.05 | 2.01 | 0.52 |

| PLN Spot performance | | | | | | |
|---|---|---|---|---|---|---|
| Date | EURPLN | USDPLN | CHFPLN | JPYPLN | HUFPLN | CZKPLN |
| 7/9/2015 | 4.2277 | 3.8290 | 4.0304 | 3.1528 | 1.3344 | 0.1558 |
| 7/13/2015 | 4.1550 | 3.7543 | 3.9636 | 3.0423 | 1.3395 | 0.1532 |
| 7/14/2015 | 4.1545 | 3.7645 | 3.9911 | 3.0514 | 1.3338 | 0.1534 |
| 7/15/2015 | 4.1319 | 3.7470 | 3.9595 | 3.0319 | 1.3293 | 0.1526 |
| 7/16/2015 | 4.1111 | 3.7694 | 3.9469 | 3.0419 | 1.3310 | 0.1517 |

# Disclaimer