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Polish Weekly Review

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Comment on the upcoming data and forecasts

Another batch of monthly macro releases is due next week. On Tuesday the Central Statistical Office will publish labor market data. We expect employment growth to stabilize at 0.9%, while wage growth is set to accelerate from the abysmal June reading. The latter was driven by large downside surprises in mining, manufacturing and construction, and we expect these to at least partly reverse in July. Next day brings trade and industry data. Industrial output has probably decelerated in July owing to high statistical base and unfavorable working day effect. The same factors won't work for retail sales and we expect retail sales growth to hold steady, close to previous month's level. PPI growth ticked down in July due to declines in PLN-denominated commodity prices. The Minutes of July MPC meeting are of purely historical significance.

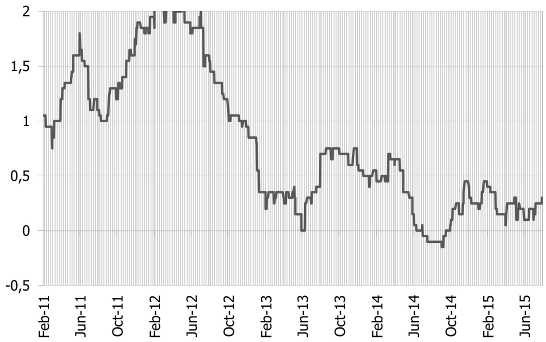
Polish data to watch: August 17th to August 21st

Publication	Date	Period	mBank	Consensus	Prior
Average gross wage y/y (%)	18.07	Jul	3.6	3.3	2.5
Employment y/y (%)	18.07	Jul	0.9	0.9	0.9
Sold industrial output y/y (%)	19.07	Jul	3.6	4.4	7.6
PPI y/y (%)	19.07	Jul	-1.7	-1.6	-1.6
Retail sales y/y (%)	19.07	Jul	3.5	3.0	3.8
MPC Minutes	20.07	Jul			

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	9/10/2015	1500	1.667	6/11/2015
5Y T-bond PS0720	9/10/2015	3000	2.355	7/23/2015
10Y T-bond DS0725	-	2000	3.076	8/6/2015
15Y T-bond WS0428	-	20	2.092	3/12/2015

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



Comment

Unchanged after the week but not without surprises: CPI surprised to the upside, GDP came out below expectations. Next week brings even more opportunities for surprises: industrial output, wages, retail sales and PPI.

* 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).

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Our view in a nutshell

Fundamentals

- GDP growth stabilized around 3.5% per annum.
- 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

- Buy 10Y POLGBs.
- long end rates may be well anchored globally. Due to falling commodity prices and deteriorating Chinese economy, globally, the balance of risks shifted once again towards deflation. On the European front ECB policy is unlikely to be contested by investors and negative net bond supply offers some tailwinds for long end bonds.
- In Poland: 1) we think that political risk has been already digested (see the real life stress test related to the announcement of CHF debt relief bill that had marginal impact on the bond market); 2) inflation will stay low for longer, even a double dip scenario on Polish CPI is likely; 3) investors pay more and more attention to possible modifications of monetary policy in 2016 (rate cuts are an option, more dovish MPC); 4) macro momentum stalled which does not stimulate any expectations for rapid monetary policy normalization; 5) higher post-election credit risk is not obvious for us.
- Polish zloty may move sideways in such an environment (political risk, EM sell-off, lower rates).

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	-0.8
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

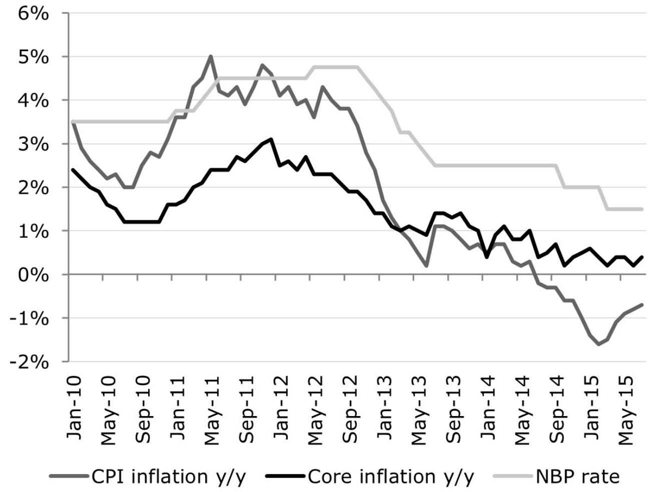
	2014 Q1	2014 Q2	2014 Q3	2014 Q4	2015 Q1	2015 Q2 F	2015 Q3 F	2015 Q4 F
GDP y/y (%)	3.5	3.6	3.3	3.3	3.6	3.7	3.9	4.1
Individual consumption y/y (%)	3.0	3.0	3.2	3.0	3.1	3.1	3.1	3.3
Public Consumption y/y (%)	0.5	6.4	5.3	6.4	3.3	3.0	3.0	2.0
Investment y/y (%)	11.4	8.7	9.2	8.6	11.4	8.5	8.5	8.5
Inflation rate (% average)	0.6	0.2	-0.3	-0.7	-1.4	-0.9	-0.8	0.1
Unemployment rate (% eop)	13.9	12.0	11.5	11.5	11.7	10.3	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	1.72	1.72
2Y Polish bond yields (% eop)	3.01	2.51	2.00	1.79	1.61	1.99	1.70	1.70
10Y Polish bond yields (% eop)	4.23	3.45	3.05	2.52	2.31	3.31	3.00	2.90
EUR/PLN (eop)	4.17	4.16	4.18	4.29	4.07	4.19	4.15	4.10
USD/PLN (eop)	3.03	3.04	3.31	3.54	3.80	3.76	3.84	3.90

F - forecast

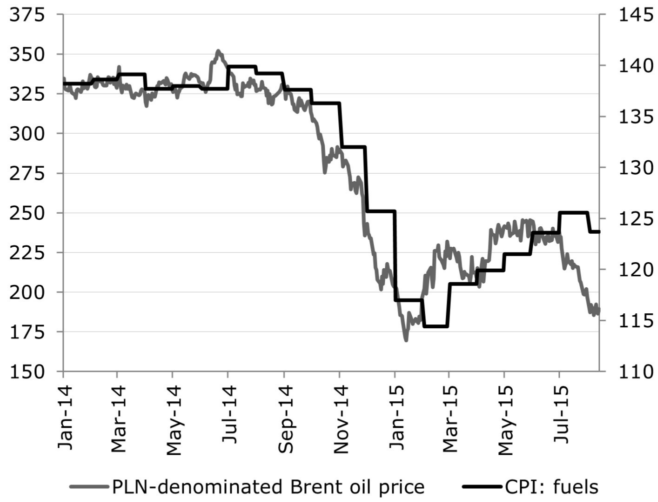
Economics

Thirteenth month of deflation. Low fuel and energy prices will prolong it.

Annual rate of inflation ticked up in July from -0.8 to -0.7%, marking the thirteenth consecutive month of deflation in Poland. The upside surprise is the result of higher prices of medical goods (drugs) and communication services (which, historically speaking, tended to surprise forecasters). Food prices fell by 1.1% m/m (in line with our revised forecast and with regional patterns of cheap foodstuffs). Clothing and footwear prices registered typical, seasonal declines, while most core categories remained stable. The aforementioned increases in health and communication prices lifted core inflation from 0.2 to 0.4% y/y.



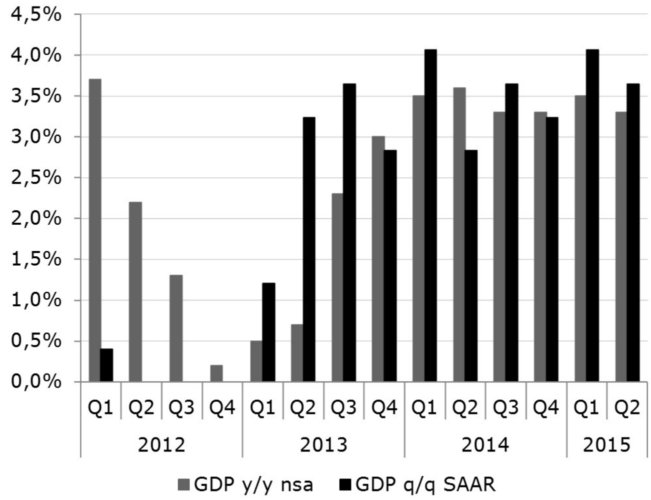
In the coming months we expect core CPI to continue to hover just above zero. CPI could drop in August and September on the basis of lower fuel prices – it is likely that the extremely elevated margins on gasoline and other fuels will be reduced, partly because of parliamentary elections. In addition, a 3.5-4.5% cut in retail prices of natural gas was announced just yesterday. Any meaningful increase in inflation will only occur at year end due to strong base effects (fuel). CPI, in our view, still exhibits neutral momentum.



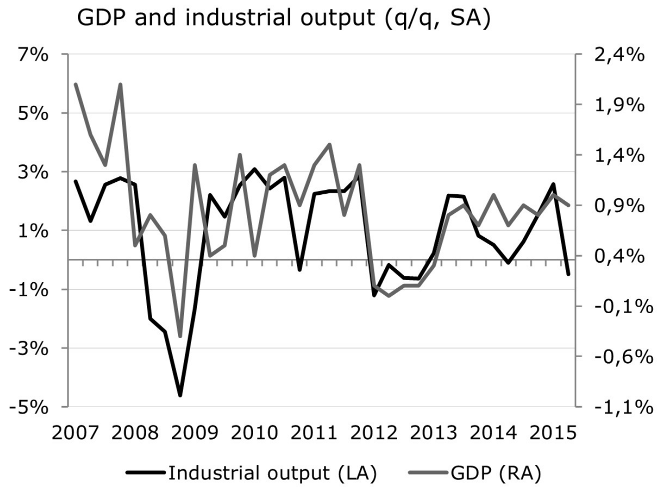
The global factor that has any potential to reverse inflationary trends and their perception (another round of disinflation, especially in Europe) is the further devaluation of the renminbi (we pointed out to this development already in our annual macro outlook in January). Such devaluation (or lower tariffs negotiated by China) should calm growth forecasts in Europe. The market implication of such events is, of course, stronger faith in ultra-low interest rates. Similar mechanisms will work in Poland – cuts are clearly on the table again (see our comment on latest GDP figures).

Negative surprise in GDP data. Growth is clearly flattening.

GDP growth failed to accelerate in the second quarter and amounted to 3.3% y/y as compared to 3.6% in the first quarter (market consensus: also 3.6%). Weaker release could be gleaned from a mixed sequence of monthly data: strongly negative surprises in construction, barely neutral data on industrial output and the lack of acceleration in nominal wages. Only due to massive low base from 2014 have they not declined on annual basis. Interestingly, the GDP release is consistent with Eurozone readings, also indicating a slowdown from the first quarter („euroboom").



As usual, at this point we can only speculate on the structure of growth in Q2 and the sources of the surprise. Our cautious view on consumption seems to vindicated by monthly data (flat trajectory of retail sales and real wages) and by the implied behavior of services. Despite a decline in construction and industrial output on a quarterly basis, GDP barely slowed down when measured as seasonally adjusted q/q growth. This implies that services had a massive positive contribution to GDP and, in turn, to household consumption (largely driven by consumer services these days). In search of a reason for the slowdown, we must turn to investment. A decline from 11.4 to ca. 6%, if not accompanied by a commensurate increase in net exports contribution (weaker trade and BoP data suggest that net exports contribution was smaller than we initially thought), would easily explain the slowdown in headline GDP growth rate.



While we remain constructive on Polish growth, we cannot escape from the profound market implications of today's release. Its importance is due to the fact that the upward trend in GDP growth might be broken. Implications for monetary policy are thus clear – if accelerating GDP growth offered an excuse not to ease policy further, this excuse no longer exists. The constellation of local and global factors is starting to look differently: new MPC (dovish), the risk of further CNY devaluation and new wave of global deflation. In our view, a correction (i.e. cut) of interest rates must be taken seriously now. We have been saying that for a while, at the same time dismissing rate hike forecasts as premature.

Of course, we remain bullish on Polish bonds (the strong down-shift in the yield curve in response to data confirms our view).

Fixed income

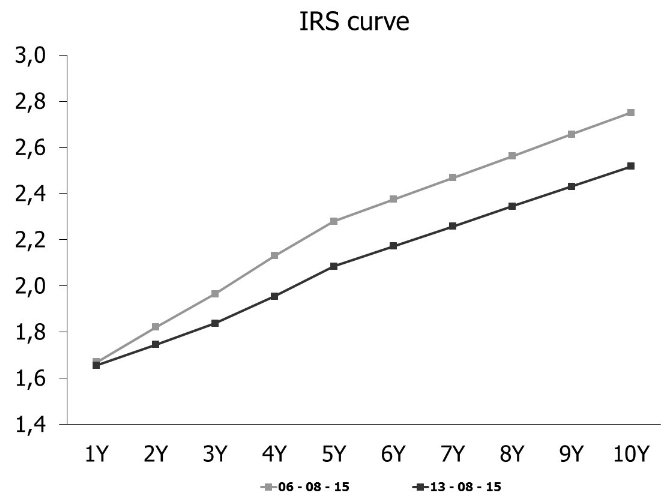
Still long

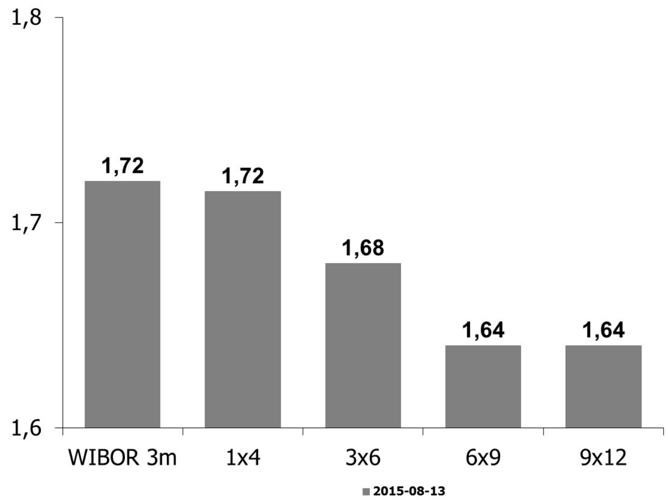
Another interesting week on Polish FI market. We are about 25bps lower vs last Friday close (PS0420 2,26%; DS0725 2,80%) and we think that this rally is going to continue.

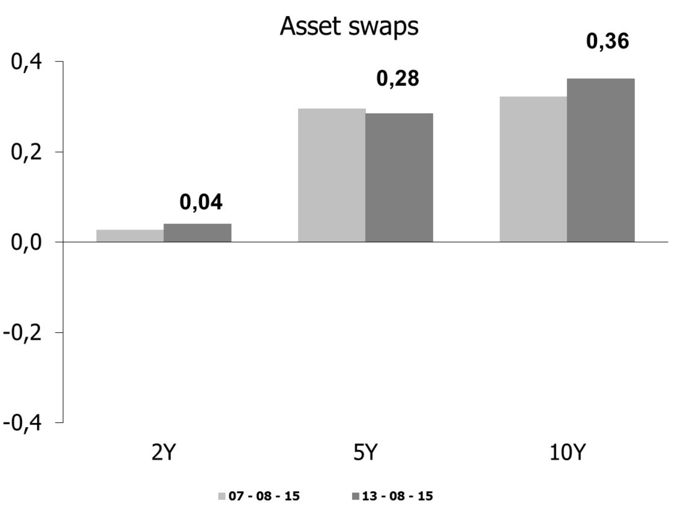
The key driver of stronger market is Yuan devaluation, which underlined global disinflation story. This, in combination with further drop in oil prices, is supportive especially for CEE4 countries' bonds. Furthermore, Q2 GDP figure (3.3% y/y vs. 3.6% forecast) suggests that playing a resumption in rate cuts next year (2x25 bps cuts) isn't a figment of the imagination any more. Worth noting is also lack of fresh supply as next auction is scheduled on 10th September. Market positioning seems encouraging and short squeeze can be expected in coming week.

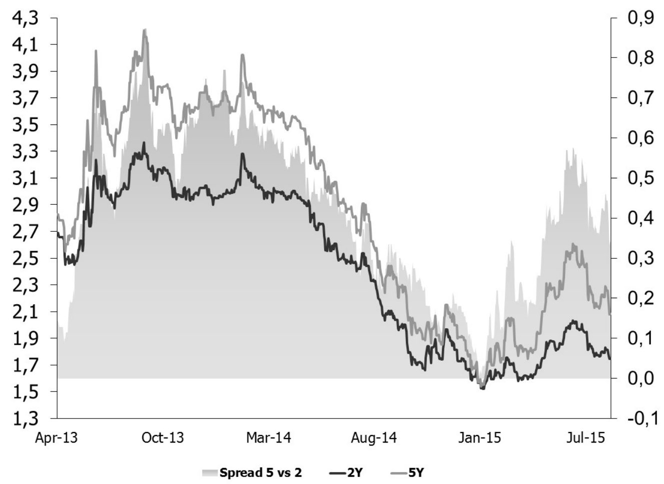
On the other hand, the anxiety related to parliamentary elections diminished a bit and a little higher July CPI figure (-0.7% r/r vs. -0.8% forecast) doesn't change picture.

Target on DS0725 is 2,61% (200 MAVG).







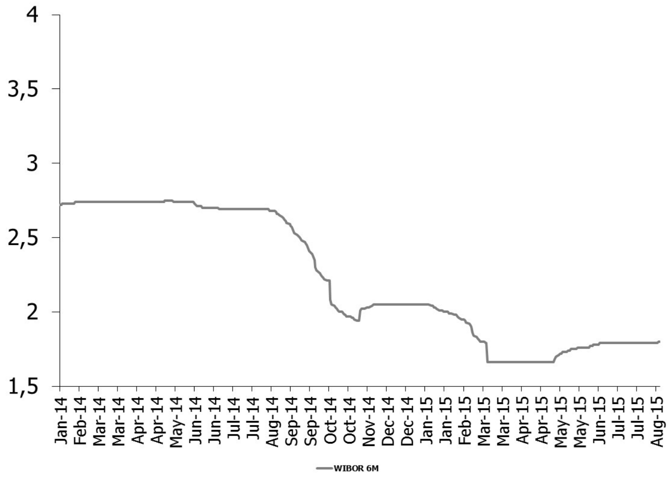


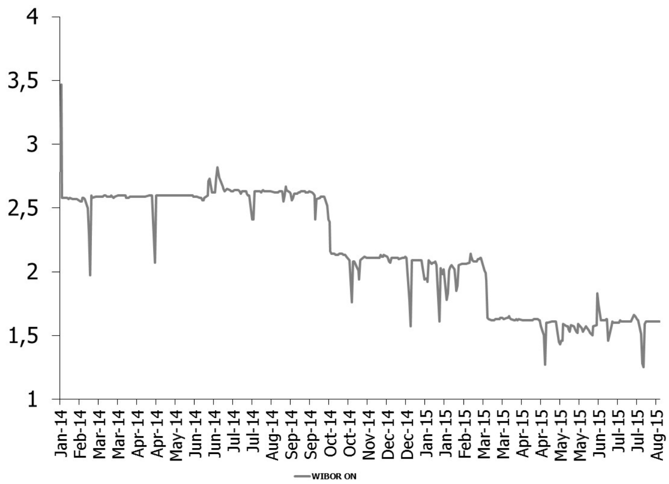
Money market

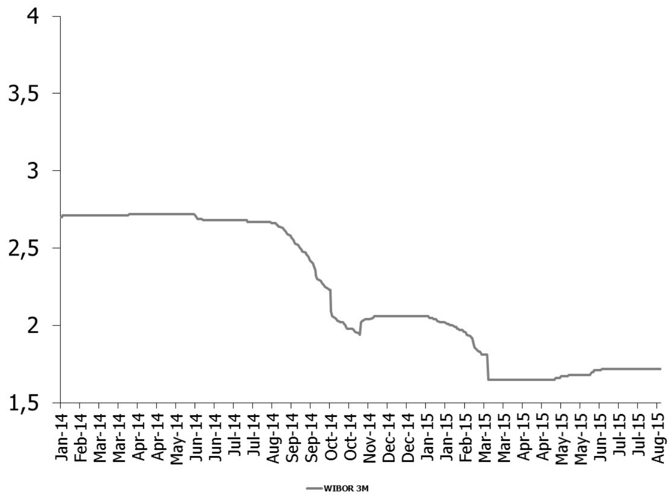
Stable week behind us.

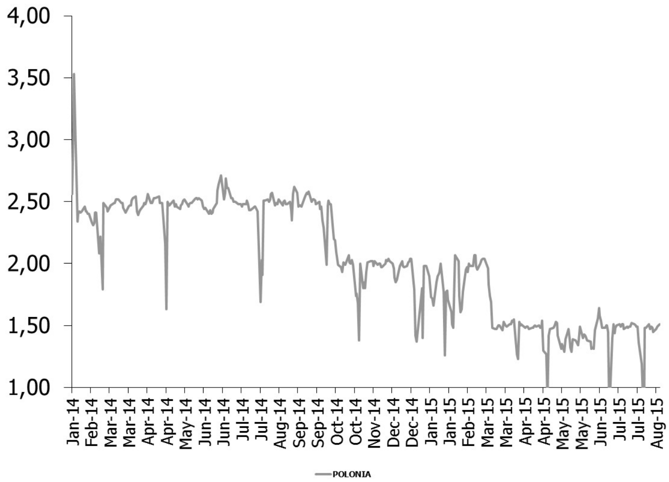
It was second week of reserve so rates remained stable. Polonia fluctuated around 1.50%.

As today’s auction was square (NBP offered 78 bn NBP Bills and 78 bn was bought), next week will be stable as well.





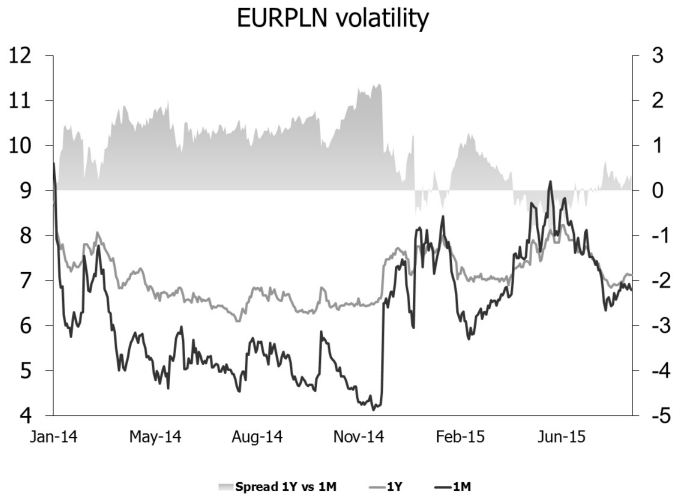




Forex

PLN – consolidating This week EUR/PLN was mostly treading water, it was consolidating in the narrow 4.1700-4.2150 range. The political pressure is lower, there are hopes that CHF denomination project will be rejected by the Senate. It will take place in September, so it has dropped off the markets radar anyway as markets – like animals – live in the present. CNY devaluation and EUR shorts reduction was having its effect on PLN as well. We think we should prepare ourselves for a choppy holiday trading. The big events, namely FOMC September meeting, Polish parliamentary elections are just around the corner, better keep the powder dry for them.

Options – some mixed interests We have seen better bids in the EUR/PLN curve, 1 year was trading at 7.2 in good amount. Later in the week, the sellers took upper hand (but their interest was mostly focused on the front end). The EUR/PLN ATM mid this Friday is 6.4% (0.5% lower), 3 months are 6.7% (0.2% lower) and finally 1 year is fixing at 7.1% (unchanged). The skew is roughly unchanged, the currency spread (difference between USD/PLN vol and EUR/PLN vol) is being sold and fixes are 0.3% lower.

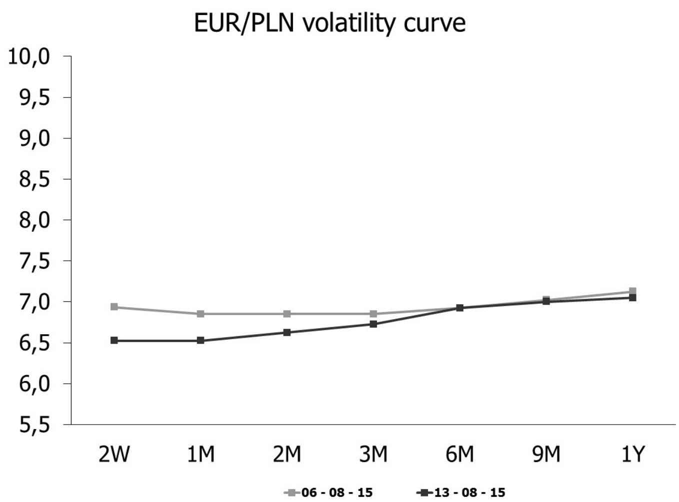


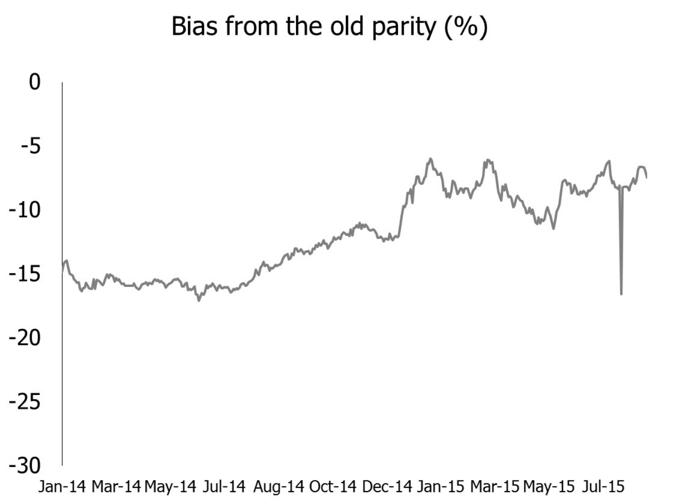
Short-term forecasts

Main supports / resistances:
EUR/PLN: 4.14 / 4.24
USD/PLN: 3.60 / 3.85

Position Our short in EUR/PLN from 4.1775 was cut at 4.2025. We sidelined at the moment. There is risk from Polish political scene, the September FOMC gets more and more binary. There are lots of reasons to sit on our hands, till situation clarifies.

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 backend. We are now covering the shorts in 1-2 months, we are closing PINs. That is leaving us with an outright long Vega and Gamma/Vanna position. The political tension in Poland, the proximity of the crucial FOMC meetings, are in our eyes good reasons for that.





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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
8/6/2015	1.73	1.72	1.82	1.69	1.96	1.73	1.72	1.70	1.67	1.67	1.74	1.73
8/10/2015	1.73	1.72	1.85	1.69	1.94	1.73	1.71	1.70	1.67	1.66	1.72	1.72
8/11/2015	1.77	1.72	1.84	1.69	1.90	1.73	1.71	1.68	1.64	1.63	1.69	1.70
8/12/2015	1.52	1.72	1.61	1.70	1.80	1.73	1.70	1.67	1.62	1.62	1.67	1.66
8/13/2015	1.62	1.72	1.83	1.70	1.73	1.73	1.72	1.68	1.64	1.64	1.68	1.70

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
8/6/2015	1.730	1.732	1.820	1.854	2.280	2.606	2.750	3.108
8/10/2015	1.730	1.742	1.789	1.843	2.200	2.519	2.665	3.035
8/11/2015	1.730	1.709	1.763	1.807	2.140	2.426	2.595	2.952
8/12/2015	1.730	1.730	1.746	1.799	2.077	2.371	2.520	2.875
8/13/2015	1.730	1.735	1.745	1.785	2.085	2.369	2.517	2.878

EUR/PLN 0-delta stradle						25-delta RR			25-delta FLY
Date	1M	3M	6M	1Y		1M	1Y		1Y
8/6/2015	6.85	6.85	6.93	7.13		7.13	1.98		0.54
8/10/2015	6.93	6.85	6.93	7.13		7.13	1.98		0.54
8/11/2015	6.83	6.80	6.88	7.13		7.13	2.06		0.55
8/12/2015	6.79	6.85	6.93	7.13		7.13	2.03		0.55
8/13/2015	6.53	6.73	6.93	7.05		7.05	2.03		0.53

PLN Spot performance

Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
8/6/2015	4.1798	3.8385	3.9033	3.0738	1.3463	0.1546
8/10/2015	4.1933	3.8246	3.8937	3.0667	1.3486	0.1551
8/11/2015	4.2035	3.8087	3.8765	3.0514	1.3494	0.1555
8/12/2015	4.2093	3.7805	3.8575	3.0333	1.3467	0.1557
8/13/2015	4.1822	3.7625	3.8480	3.0197	1.3449	0.1548

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