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Polish Weekly Review

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Comment on the upcoming data and forecasts

A lighter week ahead of us in terms of economic data. On Tuesday the Central Statistical Office will release the Statistical Bulletin along with revised unemployment data. As usual, it is useful for in-depth analyses of Polish economy. On Friday the revised GDP figure for Q2 will be published. Apart from possible upward revision vis-a-vis the flash reading of 3.3% y/y it is worth looking at the details of the release. We expect that consumption growth remained steady (ca. 3%) in Q2, while investment slowed down only modestly due to base effects. The most likely candidate for the slowdown in annual figure is net exports contribution, as indicated by trade and BoP data.

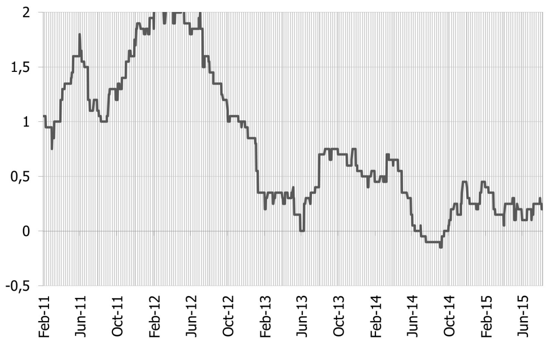
Polish data to watch: August 24th to August 28th

Publication	Date	Period	mBank	Consensus	Prior
Unemployment rate (%)	25.08	Jul	10.1	10.1	10.3
GDP y/y (%)	28.08	Q2	3.3	3.3	3.3

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

Down after weak retail sales print, all other releases came out in line with expectations. Next week is unlikely to move the Polish surprise index - absent a revision in unemployment rate, it will probably stay at current levels.

* 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

- 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

- We turned to cash after closing 10y bond recommendation.
- Although longer end bonds may be prone to downward correction in DM, EM panic may ultimately reach Polish fixed income market as a by-product of EM investment funds withdrawals. What is more, it is hard to believe in much lower yields locally without rate cuts being priced in: sufficient conditions are met, but we are still not there yet. Political risk seems digested but technical complications concerning the conversion of CHF credits to PLN without outright central bank commitment to help seem to be a rather scary story. Bonds may suffer thorough weaker zloty in such a scenario.
- Growth only stable, possibility of contagion, aforementioned technical problems with CHF conversion (dominant theme for some time, possibly even until elections) make zloty vulnerable and we expect it to stay on the weaker side of 4.10-4.30 interval.

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	4.20	4.15
USD/PLN (eop)	3.03	3.04	3.31	3.54	3.80	3.76	3.56	3.67

F - forecast

Economics

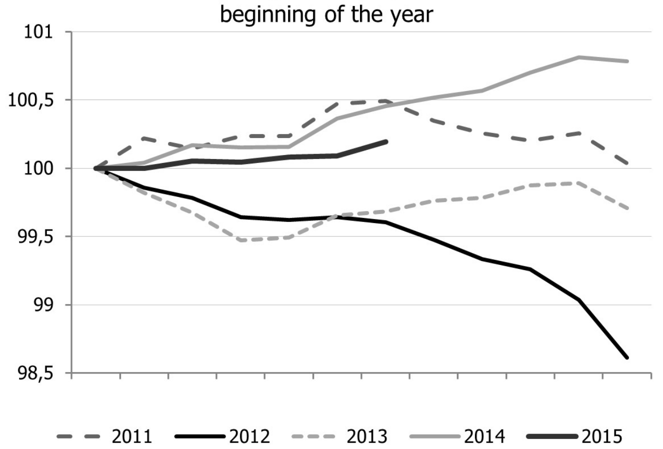
A truly unremarkable set of data underscores the missing rationale for rate hikes in Poland. The market is waking up to the possibility of easing next year.

If last week's GDP release was the foot in the proverbial door, the set of real-sphere data published this week is exactly what analysts and market participants needed to retreat from their entrenched positions (by postponing rate hike forecasts or attaching downside risks to them). It's not because the data have a bad flavor – the key takeaway is that they are simply not good enough to support GDP acceleration and stronger CPI prints going forward. In addition, next month's releases might disappoint again due to the severe heat wave in the first half of the month and associated power output problems. The re-pricing of rate expectations is also connected with mounting external risks, concerning (above all) other emerging markets and the impact of on-going Chinese slowdown on the global economy. Weak momentum in Polish data certainly fits that broader picture. And even if current MPC appears unfazed by this development (Minutes of July MPC meeting are mostly about upside risks to growth and inflation), the next one may have other ideas. Also, the only MPC member whose term is not ending this year (Osiatynski) appears open to easing monetary policy in response to CNY depreciation. As ridiculous as this might sound, this is the shape of things to come.

As usual, below you will find our take on last week's data.

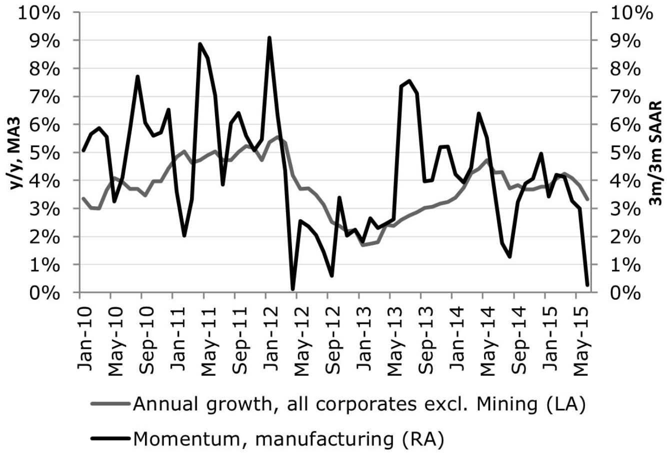
In July, **wage** growth in Poland accelerated from 2.5% to 3.3%. The figure is broadly consistent with both our forecast and market consensus. As usual, any discussion on the details of the release must be speculative as detailed wage data will be published in the Statistical Bulletin in a week. Nevertheless, we suspect that the acceleration in wage growth is a result of a very low statistical base, generated last month by the three most variable sectors: mining, manufacturing and construction. Each of them massively surprised to the downside (in case of manufacturing and construction the ex post forecast error is largest in history, exceeding 2 pp.). As a result, the increase in YoY growth is simply normalization after a disastrous June. Furthermore, one can hardly detect wage pressures in recent monthly data.

Cumulative change in employment since the beginning of the year



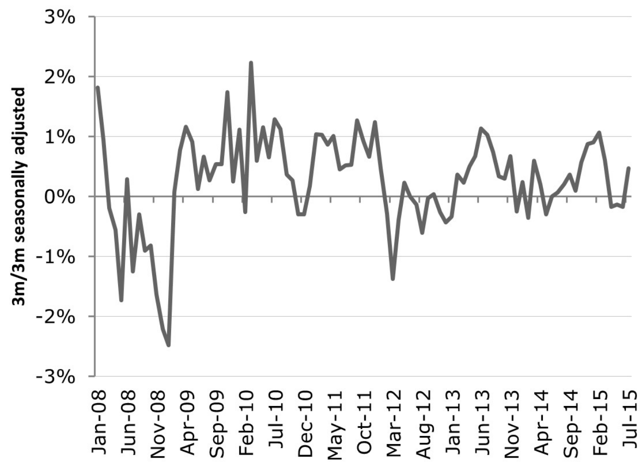
Employment in enterprise sector rose in July by 0.9% matching our forecast and market consensus. Firms did not make up for the weak June, therefore our hypothesis concerning the specifics of this statistic stays intact: firm employing more than 9 workers are not meant to be the workhorse of the employment statistics; smaller firms set to perform the task, however, it is not going to be visible in this very employment indicator. Moreover, since economy (temporarily) lost some momentum, firms may be less eager to expand employment and this moment what makes us think that employment growth in the enterprise sector is unlikely to exceed 1

Trend growth of average wage



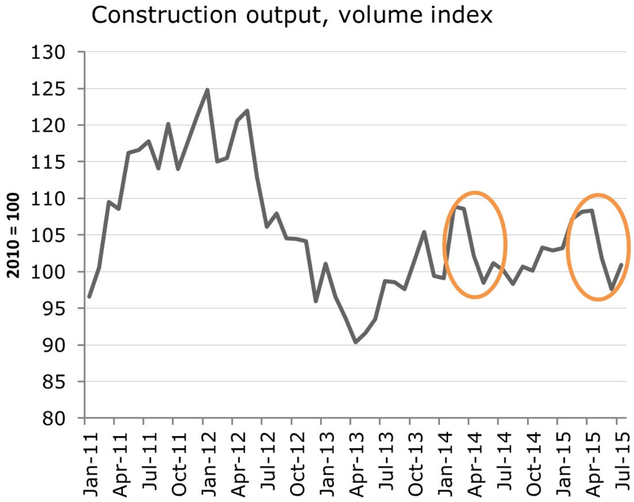
In July **industrial output** grew by 3.8% y/y, in line with our forecast (3.6%) and slightly below market consensus (between 4 and 4.4%, depending on the survey). The decline in y/y growth rate is a result of two factors: unfavorable calendar effect (0 y/y vs. +1 in June) and high statistical base in manufacturing (July â€™14 was the best July in the history of the series). Thus, it is not a worrying sign itself, as the momentum in industry has been low and stable for a few months: after seasonal adjustments industrial output stagnated on a monthly basis and its three-month average (our favorite measure) moved up only because the abysmal April reading dropped out of moving average. It is worth noting that industrial output still remains below its Q1 highs.

Industrial output

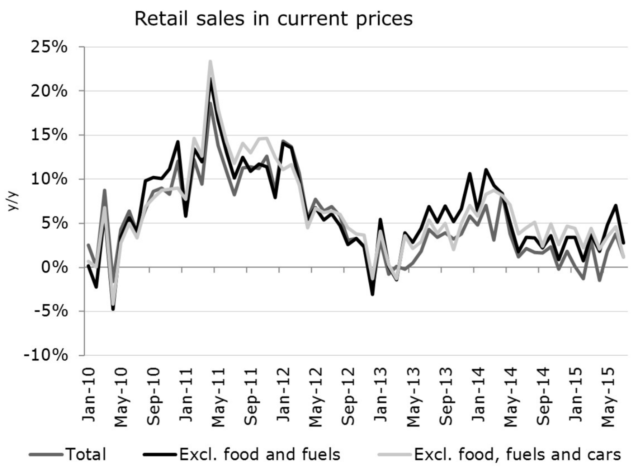


In August industrial output will likely accelerate again to ca. 8%, as implied by calendar factors and base effects. Summer months rarely bring any change in industrial trends because of semi-annual order cycles. This preliminary forecast is, however, subject to downside risks due to the recent heat wave. Industrial output might be negatively affected by power outages, lower efficiency in some plants (a result of forced energy conservation) or longer maintenance periods. This means that industry is unlikely to regain momentum before Autumn.

Construction output barely changed on annual basis (-0.1% y/y), in line with most forecasts, including ours. After seasonal adjustments output grew by 3.4% m/m and herein lies the key to explaining recent volatility in construction activity. As we repeatedly indicated, this year is shaping up to be nearly identical to the previous one: the surge in activity in the first quarter (warm winter and pork barrel cycle in local government investment) is followed by a sharp downward correction of ca. 10%, and then a modest rebound happens in the summer. So far, this playbook is followed down to the letter. In the coming months construction output is likely to embark on an upward trend due to rising road investment. The sector, however, was negatively affected by the recent heat wave as well.



Retail sales grew only by 1.2% y/y. Expansion was substantially slower than expected by us and other analysts. However, there is no need for panic as the divergence was generated by categories that are usually volatile and heavy-weighting: fuel prices dropped by more than we expected, food prices generated a small, downside surprise (rose more slowly than we expected) and there was a substantial drop in „other" category. Durable and semi-durable goods recorded predictable readings consistent with horizontal trend and working days count. We stick to our call that retail sales trends sideways, as is consumption of goods in national accounts. It is nicely pictured by our aggregates excluding some categories. The spike from last month was corrected downwards, there is no new momentum, in one direction or the other.



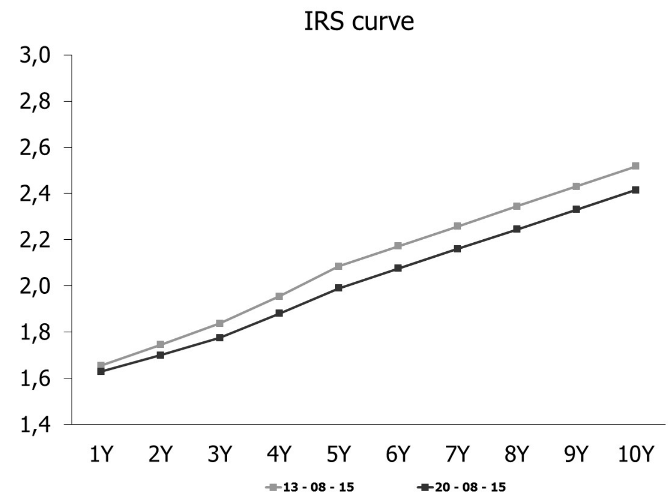
Fixed income

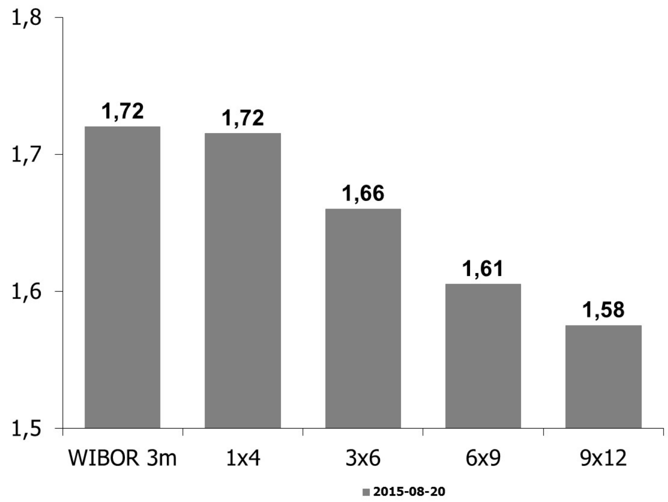
Take profit

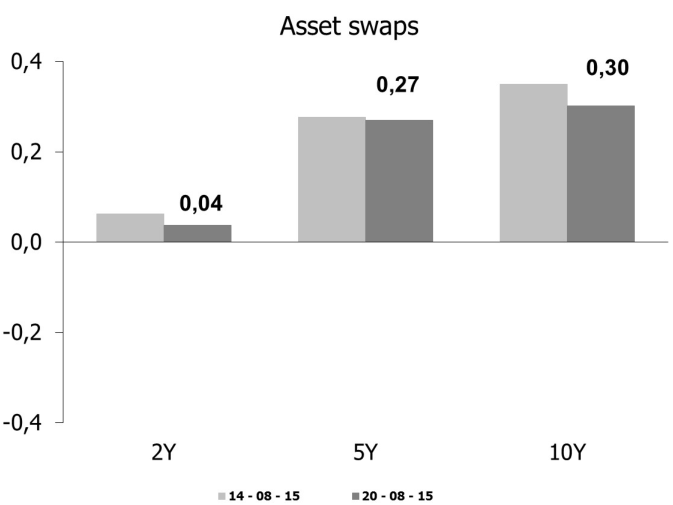
This week POLGBs were traded in the bullish tone (PS0420 2,22%; DS0725 2,69%) which is about 4-7 bps lower comparing to last Friday close. Further drop in oil prices, dovish Fed minutes, worse than expected industrial production (3,8% y/y vs 4,6% y/y survey), retail sales data (3,5% y/y vs 5,0% y/y) and no fresh supply (next auction is scheduled on 10th September) supported domestic fixed income market.

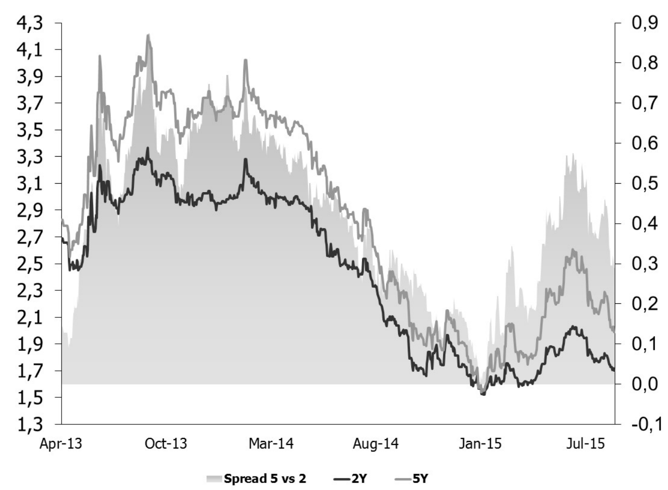
On the other hand, we believe that sharp drop in EMEA market assets in conjunction witch achieving technical supports on the ytm basis may induce some investors to take profit on long bond positions as we are about 40 bps lower vs. last auction on 6th August. We also believe that there are some chances that crude oil will not break $40 level in coming days.

Don't forget about coming elections and about FX mortgage relief program...





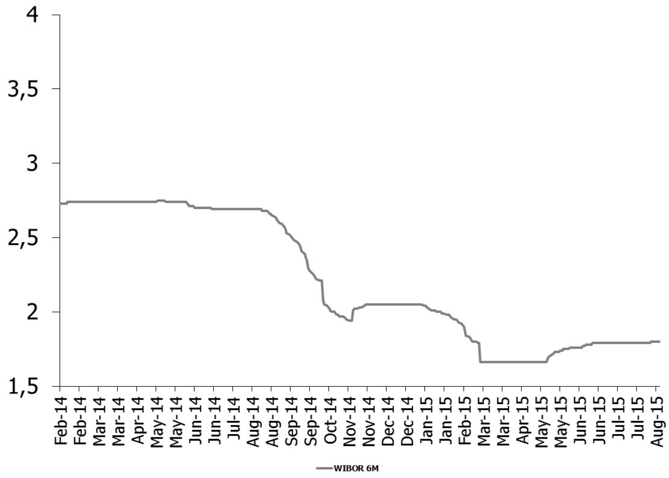


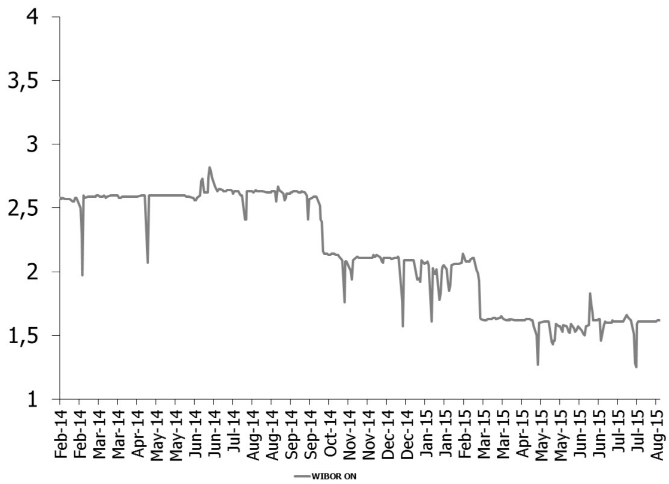


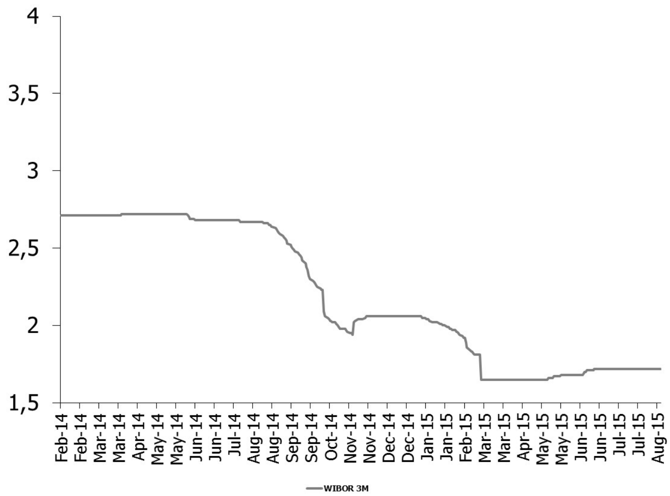
Money market

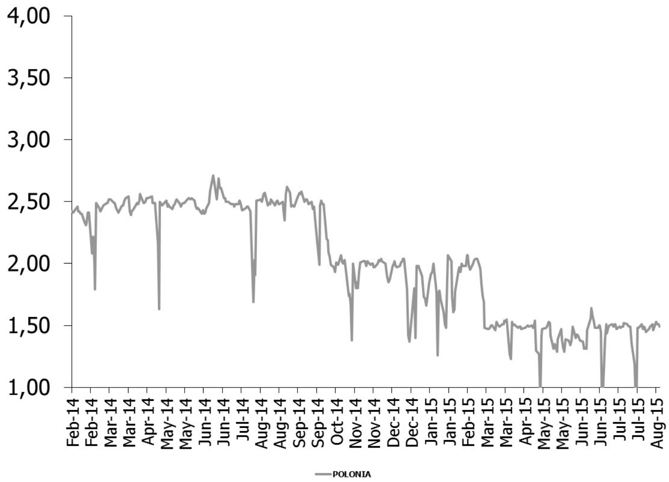
Boring week behind and ahead of us

Quite a boring week on the cash market. Overnight funding hovers around 1,50+ and it seems we will have the same for the rest of the month. What's worth mentioning is that we don't expect excessive liquidity on the month end as last day of reserve comes on Friday. We haven't seen any particular interests on OIS curve wich represents the market's view that any rate movements are far away









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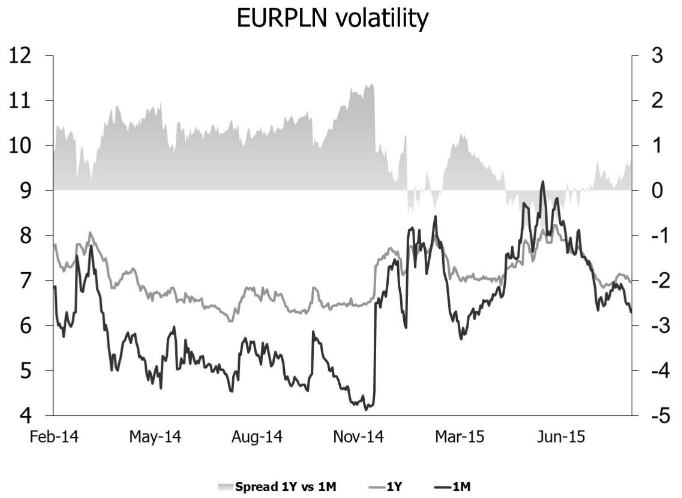
Forex

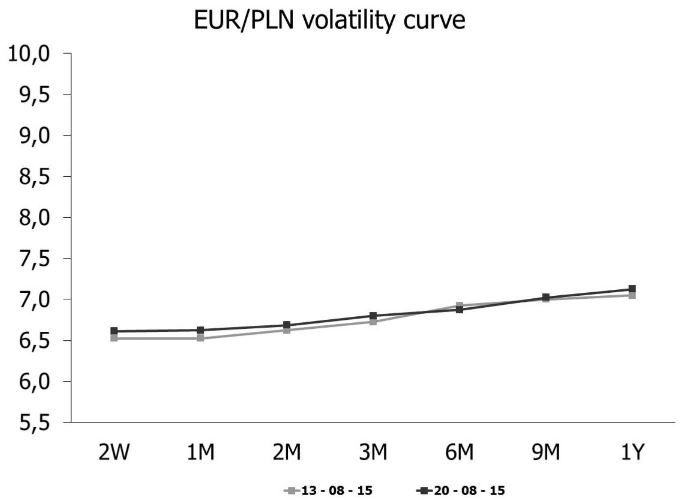
PLN – still in range/ waiting for a breakout EUR/PLN is still in the 4.1550-4.2025 range which set the respective low/high this week. We are still waiting for a breakout from the current range. The fundamental picture is still sound for PLN but political risk from the CHF credit conversion still persist plus we have parliamentary elections just around the corner. The global risk sentiment is also wobbly at best with TRY, ZAR, RUB being the most exposed but that is not helping PLN. The FOMC/ECB meetings are also approaching, adding to this already volatile picture. Seems the summer vacations are over and we are in front of an extremely busy autumn.

Options – volatility higher The move up in spot was naturally accompanied by the move up in Vols – but the move was half-hearted. 1M vol increased from 6.4% to 6.6%, 3M vol increased from 6.7% to 6.8% and 1Y is at 7.15% (0.1% higher). Correlation between EURPLN and EURUSD is high and positive so currency spread (difference between USD/PLN vol and EUR/PLN vol) is lower and fixes around 4.5%. The Skew was roughly unchanged.



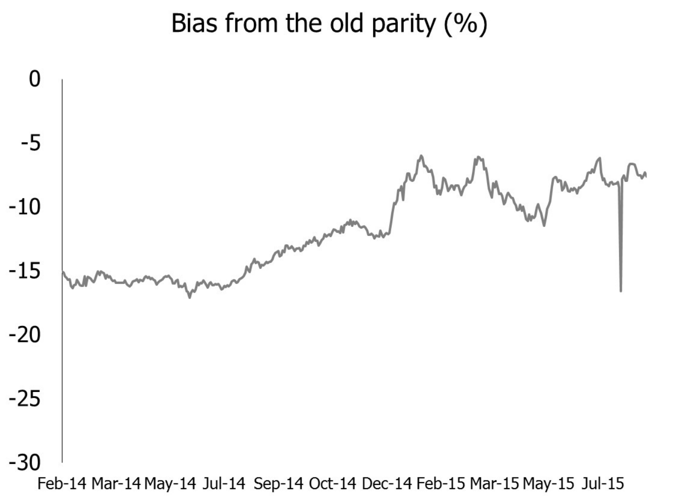
Short-term forecasts

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



Position Spot – we are long EUR/PLN at 4.1750, ready to add 4.15 with a stop below 4.1350. We are hoping for a test/break of 4.2150/4.2400. We agree that it is not a clean trade and there are possibly also good reasons for stronger PLN (even more dovish ECB, no hike from FOMC), but these factors are more less good discounted in current market rate. We are more afraid of the political developments in Poland. It is much more difficult to predict and we assumed short PLN offers better risk reward scenario.

Options We are long EUR/PLN and USD/PLN vol. We have added this position in the backend. This outright long position in Vega and Gamma is from our point of view the prudent one. There are lots of potential market moving events: NFP/FOMC/ECB, Polish elections are the most obvious.



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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
8/13/2015	1.62	1.72	1.83	1.70	1.73	1.73	1.72	1.68	1.64	1.64	1.68	1.70
8/17/2015	1.77	1.72	1.84	1.70	1.85	1.73	1.70	1.66	1.62	1.58	1.63	1.66
8/18/2015	1.71	1.72	1.79	1.70	1.70	1.73	1.71	1.68	1.62	1.58	1.64	1.65
8/19/2015	1.54	1.72	1.61	1.70	1.64	1.73	1.72	1.66	1.60	1.58	1.62	1.65
8/20/2015	1.58	1.72	1.80	1.70	1.82	1.73	1.72	1.66	1.61	1.58	1.60	1.66

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
8/13/2015	1.730	1.735	1.745	1.785	2.085	2.369	2.517	2.878
8/17/2015	1.730	1.723	1.708	1.790	2.002	2.283	2.432	2.771
8/18/2015	1.730	1.728	1.707	1.765	2.030	2.299	2.455	2.777
8/19/2015	1.730	1.666	1.720	1.757	2.030	2.305	2.450	2.757
8/20/2015	1.730	1.670	1.700	1.737	1.990	2.260	2.415	2.717

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
8/13/2015	6.53	6.73	6.93	7.05	7.05	2.01	0.54
8/17/2015	6.50	6.63	6.75	7.03	7.03	2.01	0.54
8/18/2015	6.40	6.55	6.68	6.98	6.98	2.00	0.53
8/19/2015	6.30	6.54	6.71	6.96	6.96	2.00	0.53
8/20/2015	6.63	6.80	6.88	7.13	7.13	2.02	0.55

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
8/13/2015	4.1822	3.7625	3.8480	3.0197	1.3449	0.1548
8/17/2015	4.1775	3.7613	3.8540	3.0216	1.3456	0.1546
8/18/2015	4.1616	3.7578	3.8499	3.0228	1.3474	0.1540
8/19/2015	4.1690	3.7718	3.8724	3.0356	1.3483	0.1543
8/20/2015	4.1946	3.7659	3.9098	3.0381	1.3405	0.1552

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