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Polish Weekly Review

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Comment on the upcoming data and forecasts

On Tuesday the Manufacturing PMI for August will be released. While a marked acceleration in German industrial sentiment appears to indicate faster growth in Polish industry as well, several factors imply a more modest reading: sentiment indices from GUS and EC were broadly flat in August and heat waves could have disrupted production in some companies.

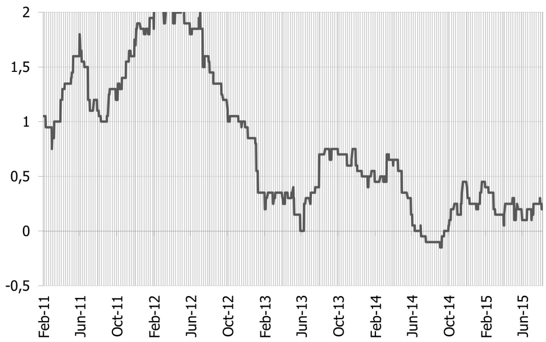
Polish data to watch: August 31th to September 4th

Publication	Date	Period	mBank	Consensus	Prior
NBP inflation expectations (%)	31.08	Aug	0.2	0.2	0.2
Manufacturing PMI (pts.)	01.09	Aug	54.6	54.4	54.5

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 - unemployment rate and GDP growth were not revised, hence no surprises there and the index is stuck in a tight range. Next week brings only one opportunity for surprise - the PMI.

* 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

- 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	3.6
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	3.3	3.5	3.8
Individual consumption y/y (%)	3.0	3.0	3.2	3.0	3.1	3.0	3.1	3.2
Public Consumption y/y (%)	0.5	6.4	5.3	6.4	3.3	2.4	2.5	2.0
Investment y/y (%)	11.4	8.7	9.2	8.6	11.4	6.4	8.0	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

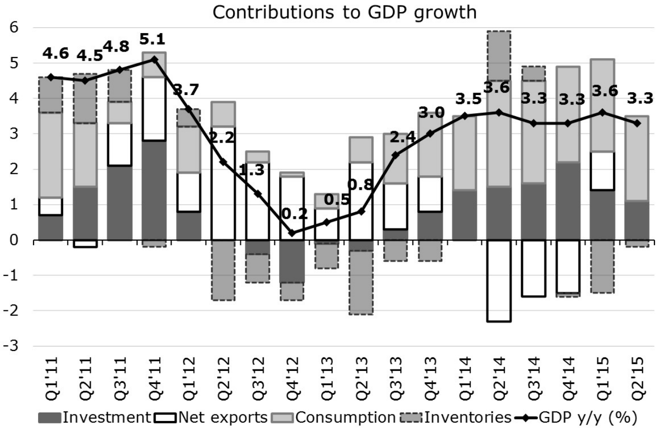
F - forecast

Economics

Q2 GDP growth confirmed at 3.3%. Favorable structure of growth suggest that the economy will continue to grow.

GUS confirmed Q2 GDP growth at 3.3% (down from 3.6% in Q1). On a seasonally and calendar adjusted basis, GDP strangely accelerated from 3.4% to 3.6%; quarterly growth remains stuck in the 0.8-1.0% range.

As it turns out, while our GDP growth forecast was off, predictions for its main components were accurate: private consumption grew by 3% and investment increased by 6.4% (down from 11.4% in the first quarter). Public consumption decelerated from 3.3 to 2.4% – no surprises here, either. As we suspected after the flash release, net exports was the main source of the surprise – slowdown in exports and acceleration in imports resulted in zero contribution of trade. Finally, change in inventories subtracted 0.2% from headline growth.



Poland's economic prospects remain positive. GDP growth should accelerate in the second half of the year, supported by private consumption (household income expectations, further boost from low fuel prices and rising disposable income) and investment. As for the latter, we believe that the Q2 drop is merely a correction of first quarter's spike, driven largely by public investment. A fairly rigid schedule of EU expenditures ensures that public investment will resume its uptrend soon enough. Furthermore, weak inventory buildup in the previous quarters will largely be reversed – and not only due to cyclical reasons – industrial companies may take advantage of low commodity prices and ramp up their purchases. This includes coal, industrial metals, crude oil (refineries are working at full capacity). Net exports, on the other hand, will post negative contributions to economic growth. Imports is set to be supported by strengthening domestic demand, while any slowdown in the global trade will put downward pressure on exports. Nevertheless, one has to remember that consumption-driven growth in the euro area is a certain positive for Polish exports. To sum up – there is no reason to create excessively bearish scenarios. Growth could inch closer to 4% y/y at year end but we believe that it is unlikely that it will accelerate beyond that level.

Polish growth is high enough (and will remain so) that no additional credit risk beyond that stemming from pre-election promises and government change will appear. It is also low enough that no inflationary pressures are emerging in the foreseeable future. Such a scenario favors low interest rates in 2015 and 2016. The probable loosening of monetary policy in the euro area in the coming months (due to lower growth, downside external risks, lower inflation, strong EUR and low commodity prices) seems to be the key trigger market participants will require to have their eyes open to the possibility of further rate cuts in Poland.

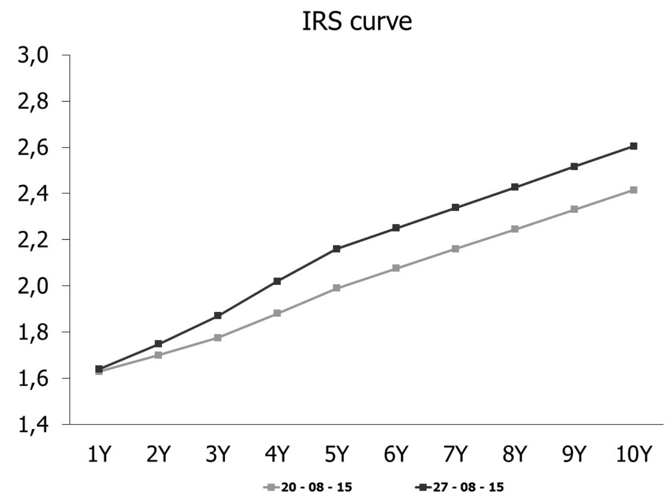
Fixed income

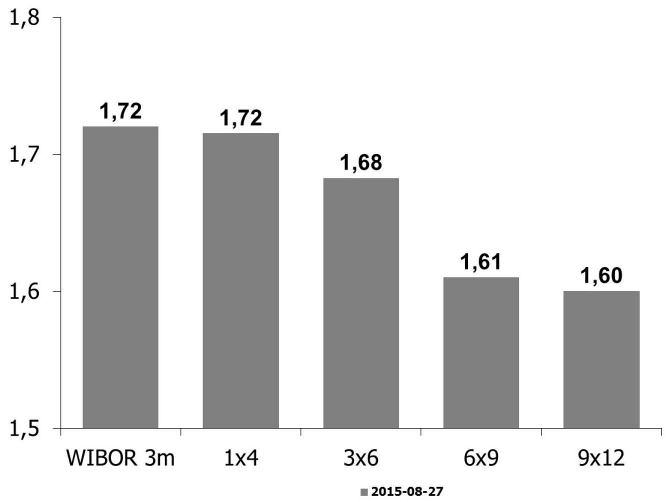
Ambiguous picture

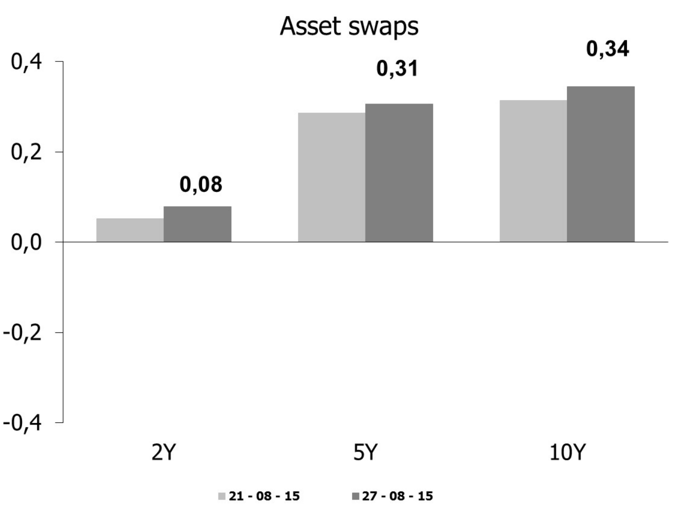
This week began with dynamic sell-off related to stocks' turmoil what pushed yields 20-30 bps higher along the curve (P0420 2.50%; DS0725 3.00%). During second part of the week market became much calmer – yields went down 7-10 bps.

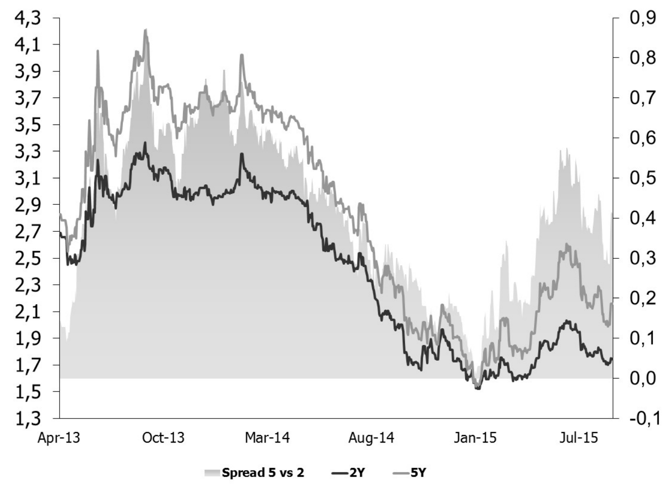
Investors are confused: Yuan devaluation, low energy prices highlight disinflation story; September lift-off in US is practically off the table and ECB next week can be more dovish than previously anticipated. On the other hand, some reports show that China was selling USTs to get USD to defend its currency and uncertainty related to swiss loan Bill vote in the Senate (scheduled on 2nd September) is going to rise.

All in all we think market picture is not unambiguous enough to build aggressive long bond position, therefore we will stay aside for a while. Watch conference in Jackson Hole this weekend, ECB on Thursday and NFP data on Friday.







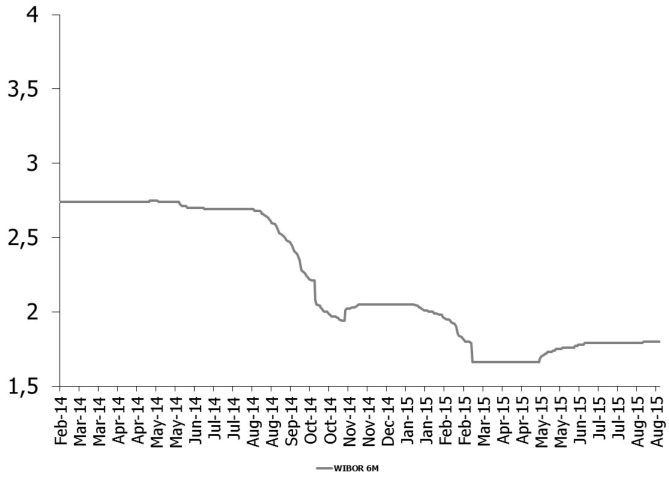


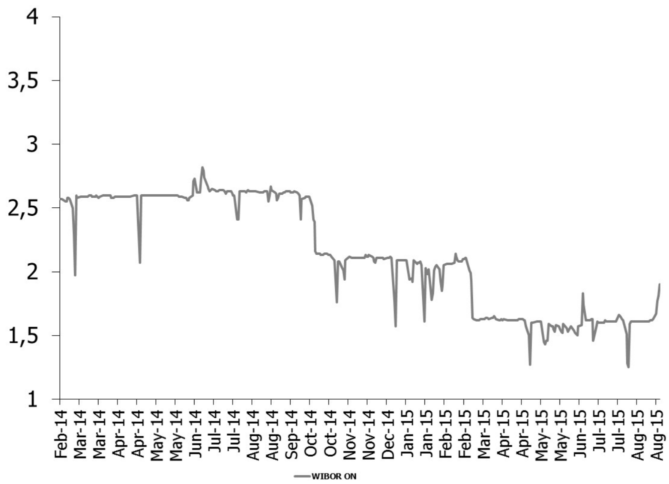
Money market

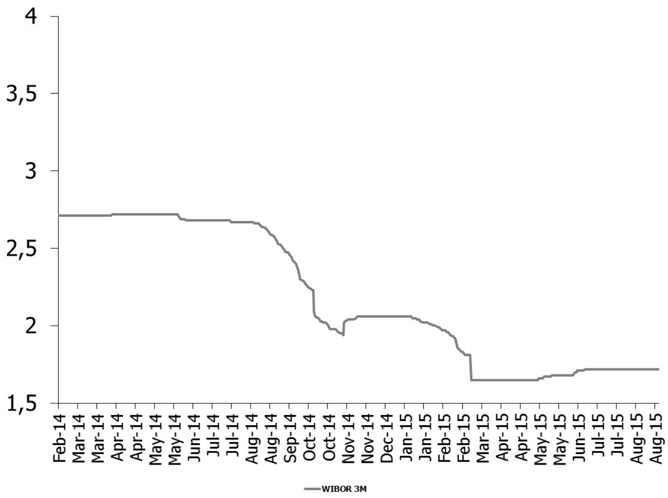
Extremely expensive week behind us

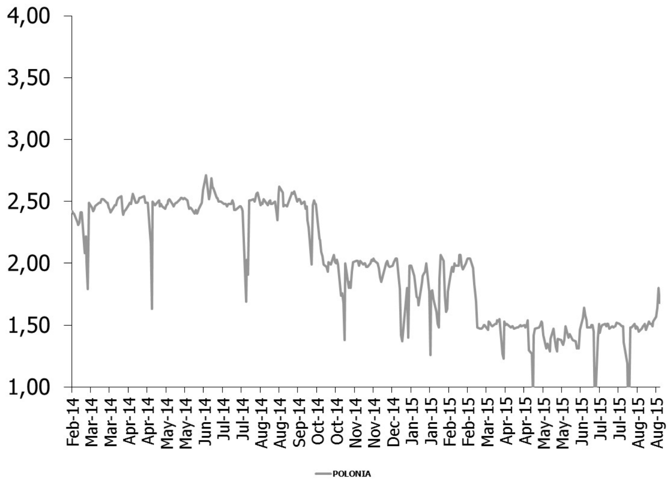
Extremely expensive week behind us. As it was the last week of reserve and market was pretty square, cash rates rose to 1.80 on Wednesday. Today's auction was underbid as it is the last day of reserve and there will be an additional OMO on Friday afternoon.

Front of the curve was stable. FRA strip hasn't changed so 3x6 is 1.67, 6x9 is 1.60 and 9x12 is 1.57. Longer OIS curve is flat. From 6M to 1Y its quoted 1.42/1.47. As WIBORs are stable, we recommend to buy 3x6 and 6x9 as we don't believe in any rate cuts. Shortest bonds aren't so profitable now so we suggest to focus on derivatives.









Forex

PLN - risk aversion's victim The global risk aversion was the spark that pushed EUR/PLN through the 4.20/4.22 resistance zone. The high so far was 4.2660 and we managed to correct lower to 4.2080 meanwhile (week's low), before the bounce back to 4.2200-4.2500, middle of the current 4.2050-4.26650 wider range. We have a full week ahead of us with ECB and NFP being the main events. On the Polish front, we would have the Parliament's upper house debate and vote on CHF loans conversion bill (September 2nd).

In short, we are preparing for a choppy and nervous trading. The liquidity is getting thinner and thinner as market volatility deters market makers. In this environment it is difficult to have a strong view unless one has a really deep pockets and is really convinced. Neither group we do belong, and we are planning to be flexible and opportunistic but with a little PLN bearish tone.

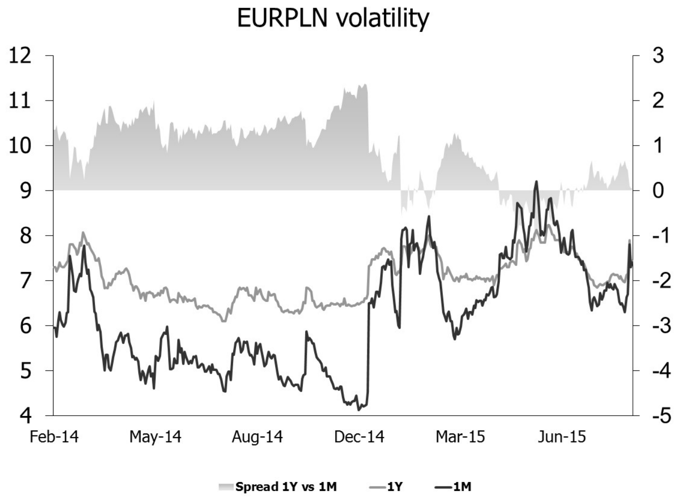
Options – volatility higher The higher realized volatility and weaker zloty were naturally accompanied by the move up in Vols. The biggest spike in vol was of course on Monday when 1M vol jumped from 6.6% to 8.0%, 3M vol increased from 6.8% to 8.0% and 1Y got from 7.15% to 7.6%. After zloty trimmed its losses, volatilities corrected lower. Finally 1M is fixed at 7.0%, 3M are at 7.25% and 1Y is at 7.4%. The Skew is also slightly bid. Currency spread (difference between USD/PLN vol and EUR/PLN vol) is roughly at the same level as week ago – 4.5%.

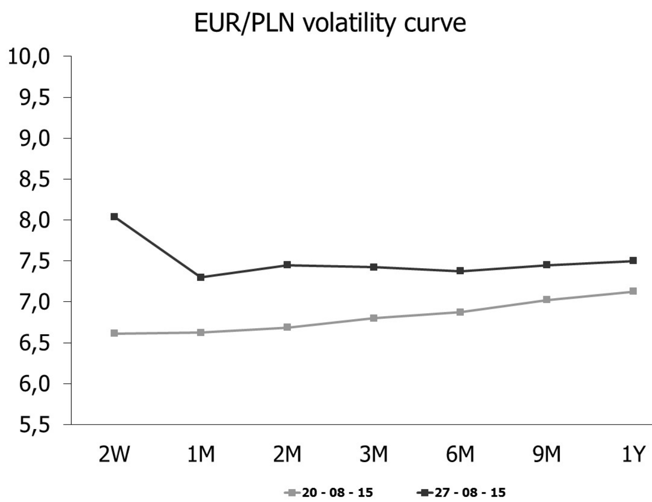
Short-term forecasts

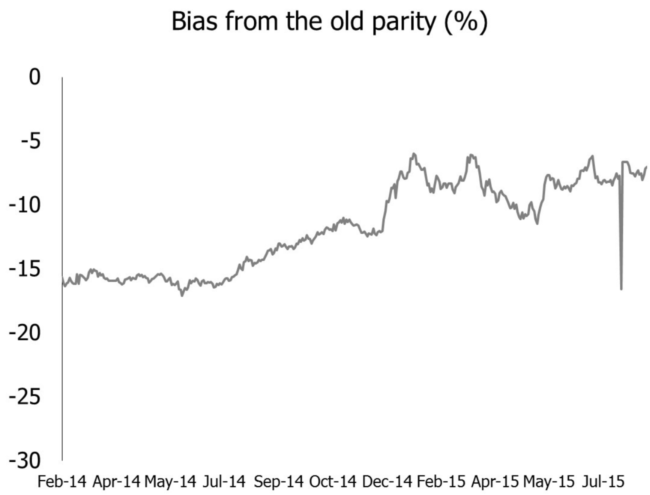
Main supports / resistances:
EUR/PLN: 4.18 / 4.28
USD/PLN: 3.60 / 3.85

Position Long from 4.1750 was closed with profit at 4.2550. We are long again at 4.2200 and we are ready to add at 4.1950 with a stop below 4.1800 with a hope to see 4.29+. It is still purely tactical trade as we think that global risk aversion stemming from situation in China will not be solved by one rate cut or some liquidity injection. We are bit wary about Polish politics, as the election campaign has already started.

Options We have taken profit on the half on our long Vega positon in EUR/PLN. This is purely tactical maneuver to build some protection against Theta bills. Our view is unchanged we are outright long EUR/PLN and USD/PLN Vega/Gamma. 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, with Polish elections the most obvious one.







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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
8/20/2015	1.58	1.72	1.80	1.70	1.82	1.73	1.72	1.66	1.61	1.58	1.60	1.66
8/24/2015	1.75	1.72	1.81	1.70	1.82	1.73	1.71	1.69	1.61	1.59	1.64	1.68
8/25/2015	1.65	1.72	1.72	1.70	1.75	1.73	1.72	1.70	1.63	1.61	1.65	1.68
8/26/2015	1.55	1.72	1.62	1.70	1.65	1.73	1.71	1.67	1.60	1.59	1.63	1.69
8/27/2015	1.58	1.72	1.66	1.70	1.82	1.73	1.72	1.68	1.61	1.60	1.64	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
8/20/2015	1.730	1.670	1.700	1.737	1.990	2.260	2.415	2.717
8/24/2015	1.730	1.668	1.725	1.814	2.090	2.421	2.520	2.880
8/25/2015	1.730	1.696	1.750	1.838	2.160	2.529	2.605	2.982
8/26/2015	1.730	1.678	1.743	1.819	2.160	2.487	2.610	2.947
8/27/2015	1.730	1.659	1.748	1.827	2.160	2.466	2.605	2.949

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
8/20/2015	6.63	6.80	6.88	7.13	7.13	1.98	0.53
8/24/2015	7.80	7.70	7.73	7.90	7.90	1.98	0.53
8/25/2015	7.30	7.20	7.23	7.35	7.35	2.04	0.53
8/26/2015	7.40	7.28	7.35	7.45	7.45	1.98	0.50
8/27/2015	7.30	7.43	7.38	7.50	7.50	1.96	0.49

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
8/20/2015	4.1946	3.7659	3.9098	3.0381	1.3405	0.1552
8/24/2015	4.2390	3.6971	3.9129	3.0624	1.3468	0.1568
8/25/2015	4.2309	3.6613	3.8973	3.0649	1.3524	0.1564
8/26/2015	4.2381	3.6937	3.9180	3.0914	1.3456	0.1564
8/27/2015	4.2255	3.7450	3.9260	3.1114	1.3465	0.1560

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