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Polish Weekly Review

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Comment on the upcoming data and forecasts

After a very busy week, one quite calm ahead of us. There is only one significant release – CSO's Statistical Bulletin for August. It will reveal unemployment rate for August, however preliminary data were already given by MLSP (10.0% in line with market consensus and our forecast). The Bulletin will also shed more light on last week's real sphere and labour market data.

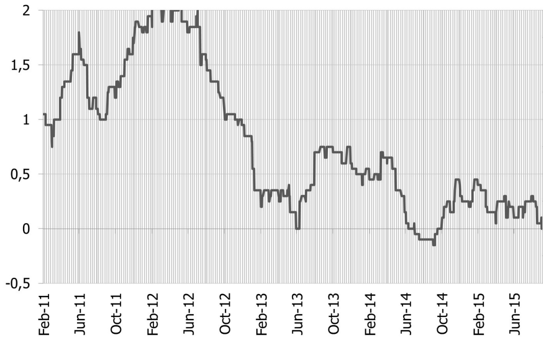
Polish data to watch: September 21th to September 25th

Publication	Date	Period	mBank	Consensus	Prior
Unemployment rate (%)	23.09	Aug	10.0	10.0	10.1

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	9/24/2015	1500	1.667	6/11/2015
5Y T-bond PS0720	9/24/2015	3000	2.355	7/23/2015
10Y T-bond DS0726	-	2000	3.076	9/10/2015
15Y T-bond WS0428	-	20	2.092	3/12/2015

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



Comment

Surprise index went slightly up after higher than expected CPI inflation data, but then fell down on disappointing PPI inflation and retail sales releases. Now the index is at its lowest point in twelve months. Other publications were more less in line with market consensus. Next week brings only one opportunity to move the index (unemployment rate, but it will hardy diverge from market consensus given preliminary data).

* 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 turn constructive on 10y bonds. Although the EM crisis is still ongoing, the focus of investors turned to policy response. ECB acted first promising more accommodation if needed and lowering forecasts; other central banks are set to follow. Play for QE extension is going to support the zloty and break non-favorable correlations with Polish assets.
- Locally, we see more scope for rate cuts being priced in. Drought theme is overdone given the favorable crop worldwide and may lead only to temporary higher prices of vegetables and fruits (no risk for low inflation path whatsoever). Polish bonds recently cheapened versus Hungarian ones while political risk seems to be digested. Among slowing EMs, Polish balanced growth may be seen as a sweet spot reducing credit risk and enabling lower risk free rates to filter through Polish bonds.
- Pro-active ECB stance should be enough to shield the zloty from sharp depreciation in case of higher risk aversion. In such circumstances stable growth story is going to be enough to trigger positive differentiation flows. Local problems remain unsolved, though. The fate of CHF conversion bill is going to be the one of utmost importance in coming days as it returned to the lower chamber of the parliament. That is why we neutralize our outlook for the zloty betting on the middle of interval 4.10-4.30.

mBank forecasts

	2010	2011	2012	2013	2014	2015F
GDP y/y (%)	3.7	4.8	1.8	1.7	3.4	3.5
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

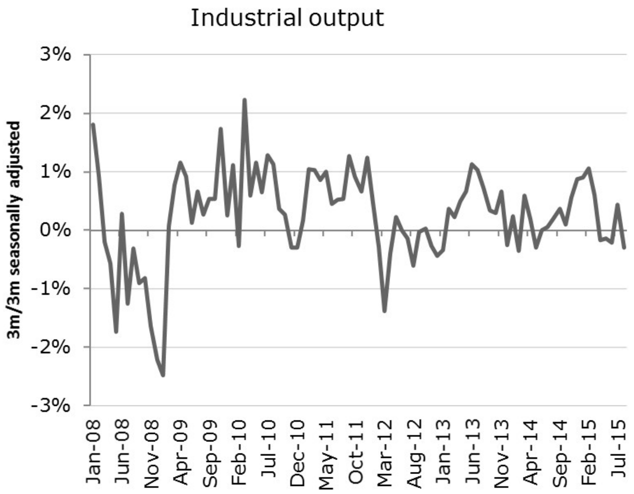
	2014 Q1	2014 Q2	2014 Q3	2014 Q4	2015 Q1	2015 Q2 F	2015 Q3 F	2015 Q4 F
GDP y/y (%)	3.5	3.6	3.3	3.3	3.6	3.3	3.6	3.4
Individual consumption y/y (%)	3.0	3.0	3.2	3.0	3.1	3.0	3.0	3.2
Public Consumption y/y (%)	0.5	6.4	5.3	6.4	3.3	2.4	2.5	1.5
Investment y/y (%)	11.4	8.7	9.2	8.6	11.4	6.4	8.0	7.5
Inflation rate (% 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	10.0	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

Mixed real sphere data for August

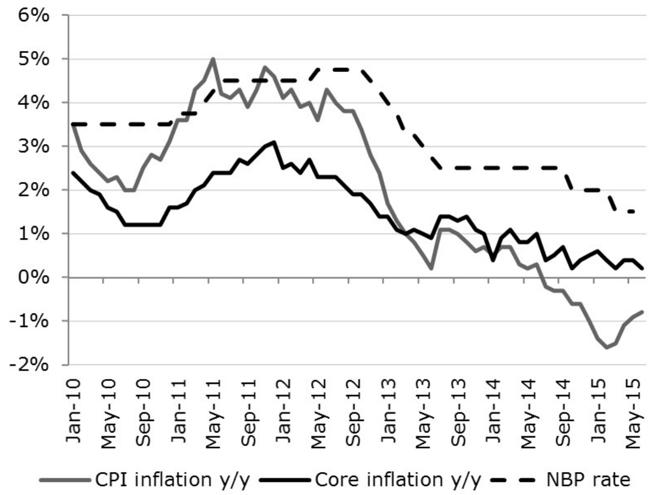
This week's data could be summarized as mixed, with domination of bad information. All releases together brought surprise index for Poland (see page 1) to its lowest level in one year – historically supportive for lower bond yields. GDP growth is flattening. There are new risks of economic slowdown. There is no price pressures and producer prices falls will end in consumer prices going further down. Let's forget about interest rate hikes and get used to risk of cuts in 2016. However, they are dependent on G3 central banks' policy - NBP will not go against the tide. Divergent monetary policy could cause higher exchange rate volatility, which is not liked by policymakers if they still want to deal with CHF mortgages.



In August Polish sold **industrial production** grew by 5.3% y/y, lower than market consensus (6.4%). In the previous month, the annual growth rate amounted to 3.8%. After seasonal adjustments, industrial production increased by 3.6% y/y, which means that the growth impulse is slowly fading. Cyclical categories like metals or computers are responsible for this weak release. We do not see direct influence of heat waves (yearly growth rate of energy production was only slightly higher that in July). However, indirect effects, like lower worker efficiency or power outages are possible.

In our opinion, trajectory of industrial output is flattening. Upcoming months could bring further effects of deteriorating economy of our main trade partners (Germany will be affected by weakening orders from China). There is also a possibility of negative influence from price competitive imports from Russia (mainly semi-finished products).

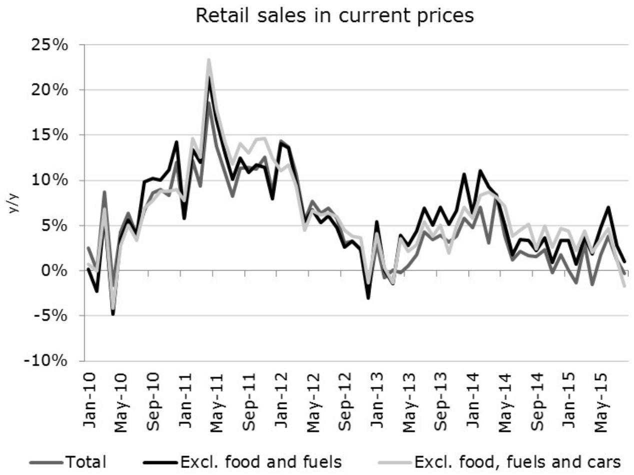
August was the fourteenth month of **deflation** – annual rate of inflation in Poland moved up from -0.7% to -0,6%. This was fourteenth month of deflation in a row. Slightly higher than expected release (market consensus assumed same value as in July: - 0.7%) was caused mainly by higher food prices (-0.7% m/m fall in this category was lower than seasonal patterns).



There is nothing really new in remaining categories (communication prices, housing, services etc.), prices among them have near zero momentum. Yearly core inflation, excluding food and energy, has stabilized at 0.4%.

We do not expect inflation to change its momentum in the upcoming months. On the other hand CPI index could slightly drop in September because of fuel prices (it is possible that oil companies would lower their prices, thus diminishing their huge margins, in the verge of parliamentary elections). This would be also supported by gas price cuts announced in August. Nevertheless, yearly CPI index will rise only in the end of the year, mainly because low base effects (fall of oil prices in last months of 2014).

Retail sales unexpectedly fell by 0.3% on annual basis in August, much below our expectations and market consensus (both around 1.5% y/y). The breakdown of sales by category is quite illuminating this time: car sales held up very well (14.7% y/y); fuel sales decelerated on the back of a price effect; clothing and footwear sales crashed (down from 10.2% y/y to -0.8% y/y) and so did furniture and household equipment sales (decelerated from 5% to -0.4% y/y); finally the usually volatile Other category is nothing short of a catastrophe (from -3.6% to -15.2% y/y!). As a result, our measures of core retail sales all dropped to around zero. Such a structure of retail sales suggests that Polish consumers cut back on discretionary expenditures in the first place, while basic provisioning (food, fuel, pharmaceuticals) was untouched. It is consistent with the discouraging effect of recent heat waves but the strength of this effect is nevertheless surprising. In addition, food and beverage sales failed to accelerate, contrary to expectations - one could expect that heat boosts sales in this group.



In other circumstances the sharp deceleration in durable goods sales would be worrying. However, with consumer sentiment at post-crisis highs and the likely effect of extreme weather, the August retail sales figures are looking like a one-off. As such, it should not impact the trajectory of consumption, largely determined by services. The latter should be affected by the weather to a lesser extent.

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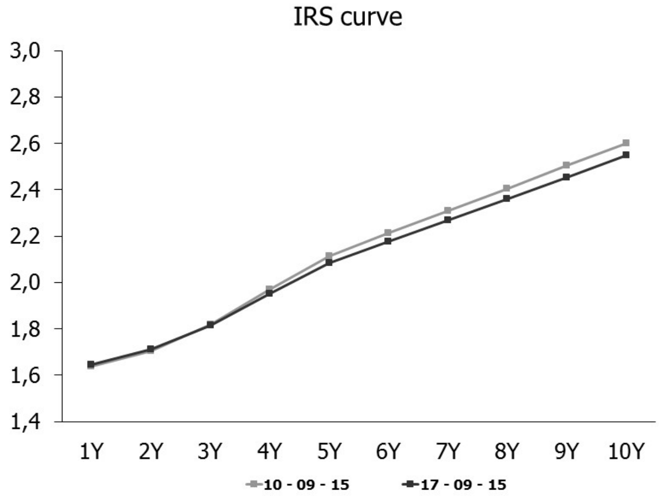
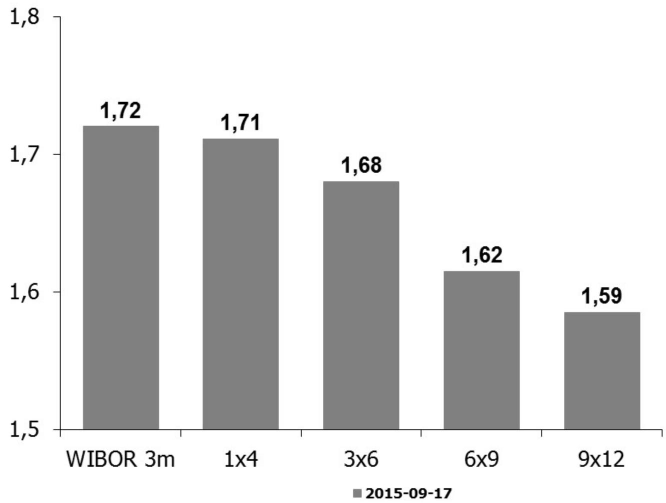
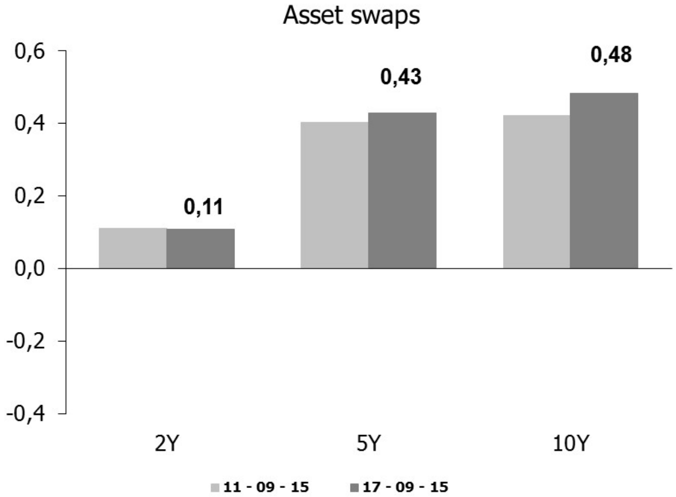
Fixed income

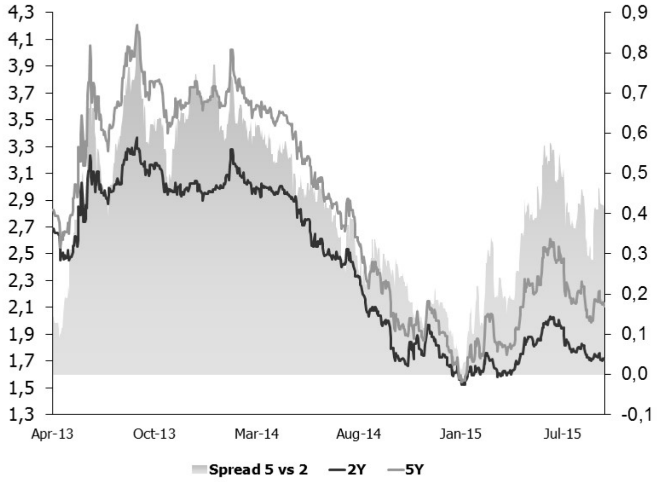
Post FOMC

Happy those who placed hope in Mrs. Yellen prudence. For the last couple of days the FI markets have became quite confused with what might happen to long term yields after the Fed meeting. The bond markets were swinging up and down trying to offset the existing risk exposures. No-hike decision bets would have promoted those who believed the global economy condition did not allow to tighten monetary policy at that stage. Most of bondholders felt a sigh of relief after Fed decided not to hike rates this time. As a result long term yields fell around 10 – 15 bp Friday morning. Surprisingly, PLN curve reported even deeper slump trading 10y from 2.60% down to 2.44%. Is the future bright then? We could expect further rally along the curve in the midterm. Furthermore, we could even try to place some bets on rate cuts in Poland next year. We would like more swaps than bonds as we might see some risk of further asset swaps widening ahead of October general election in Poland.









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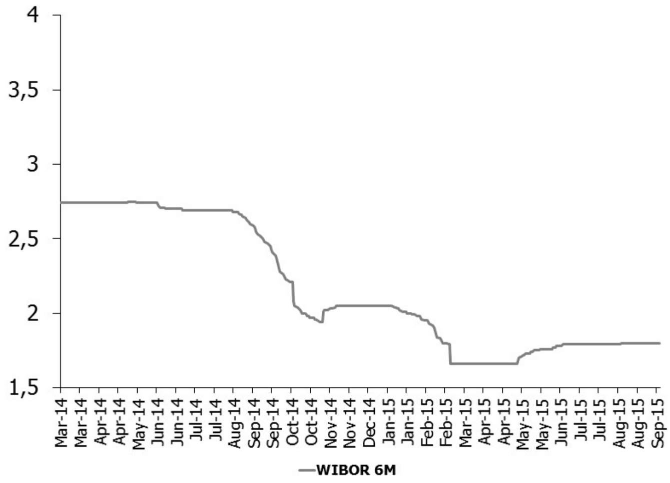
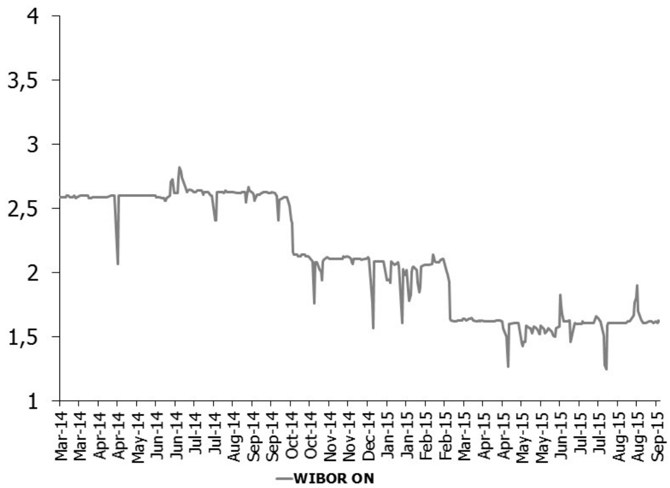
Money market

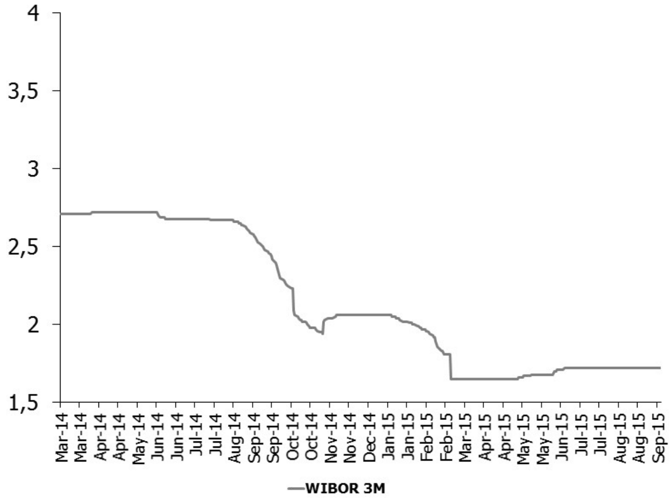
Stable week behind us

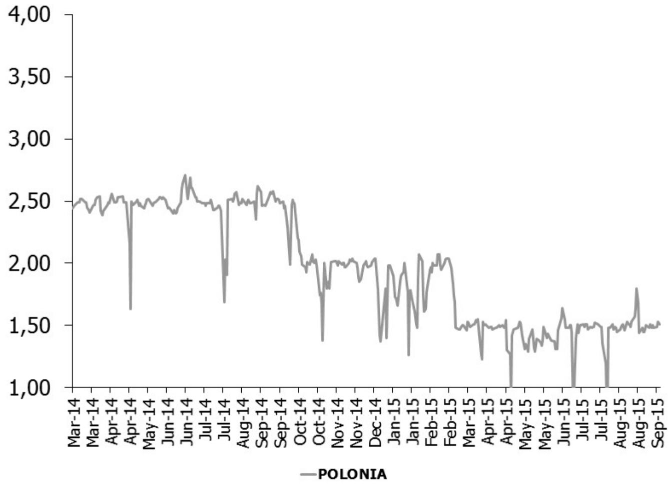
Cash market was stable in last days. Polonia has been fluctuating around 1.50 for the whole week. Next week should be same as todays OMO was underbid just by 3 bn. Before Fed decision we noticed paying interest in shortest FRA so 3x6 was traded at 1.68 and 6x9 at 1.61. Friday started 2 bps lower but without any bigger selling interest.

2Y IRS is now 1.68/1.70 and we recommend buying it and selling 9x12 with 12 bps spread. Whole OIS curve remained stable so 1Y OIS is 1.42/1.47.









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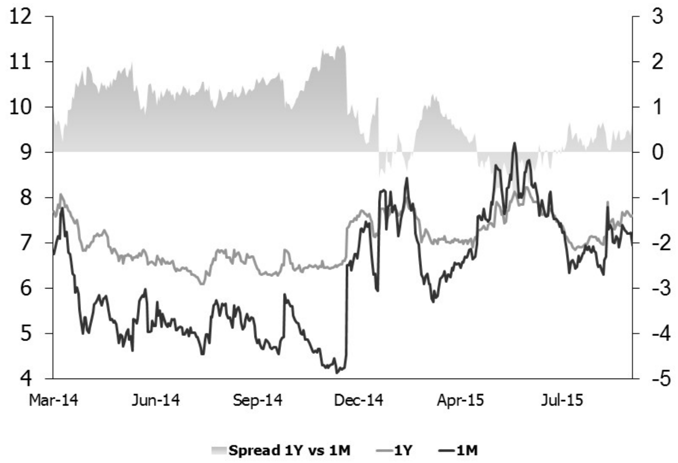
Forex

EUR/PLN – grappling with support FOMC has delivered a dovish message and PLN has gained value noted especially against USD. EUR/PLN is still supported by strong 4.19 – 4.20 zone and commercial demand is being reported at these levels. The bigger picture is being quite constructive for Zloty: dovish ECB and FOMC, the CHF credit legislation being delayed, to mention the most obvious. Of course one should not forget the quickly approaching parliamentary elections scheduled for 25th of October. On the other hand PLN and HUF are probably the best quality emerging currencies available with some safe heaven function as well.

Options The realized volatility was disappointing to all positioned long Gamma in EUR/PLN. As the result EUR/PLN vol curve is fixing bit softer. 1 month EUR/PLN ATM mid is this Friday at 6.6% (0.55% lower), 3 months EUR/PLN are 7.25% (0.1% down) and finally 1 year is 7.4% (0.2% lower). Looks like the middle of the curve that covers elections is still in demand, and represents best value. Skew is roughly unchanged, but currency spread (difference between USD/PLN and EUR/PLN vol) is softer due to spike in EUR/USD and supply in EUR/USD vols.

EURPLN volatility



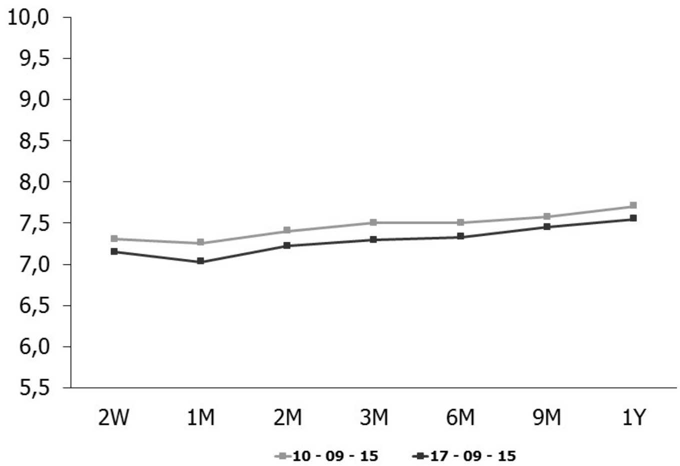
Short-term forecasts

Main supports / resistances:
EUR/PLN: 4.16 / 4.26
USD/PLN: 3.60 / 3.85

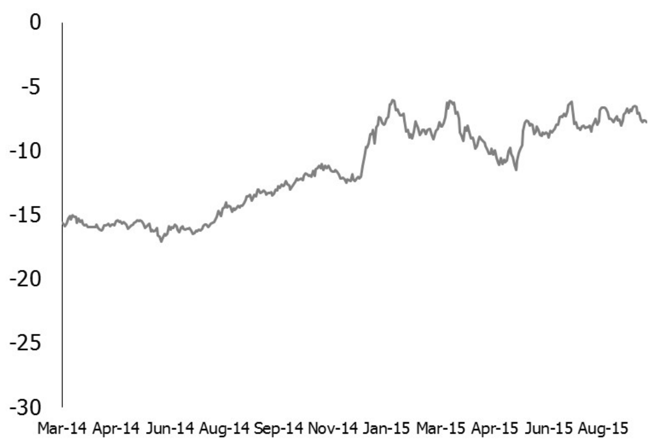
Position Spot – Our position unchanged. We are still short at 4.2280 and we are ready to add at 4.2500 with a stop above 4.2600 and hopes to revisit levels below 4.1700. The Senat (upper house of the Parliament) has rejected the CHF bill, by sending it back to Sejm (lower house of Parliament), what makes it quite difficult to pass the bill before elections. In other words the huge systemic risk to PLN was at least postponed if not reversed. The dovish ECB and FOMC are another strong factors, and reasons we became overall PLN positive.

Options We are still long Vega and Vanna in EUR/PLN and USD/PLN. The positioned was nevertheless reduced in last weeks. The Gamma performance this week was beyond expectations, but we are still small long in Gamma. There are still Polish elections in front of us, and we prefer to be long Gamma/Vega into this event.

EUR/PLN volatility curve



Bias from the old parity (%)



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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
9/10/2015	1.56	1.72	1.62	1.70	1.75	1.73	1.71	1.67	1.59	1.59	1.62	1.65
9/14/2015	1.73	1.72	1.81	1.70	1.81	1.73	1.71	1.68	1.61	1.58	1.62	1.64
9/15/2015	1.73	1.72	1.85	1.70	1.82	1.73	1.72	1.69	1.60	1.59	1.62	1.65
9/16/2015	1.53	1.72	1.60	1.70	1.64	1.73	1.71	1.68	1.61	1.60	1.63	1.68
9/17/2015	1.78	1.72	1.72	1.70	1.75	1.73	1.71	1.68	1.62	1.59	1.65	1.67

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
9/10/2015	1.730	1.649	1.706	1.819	2.115	2.466	2.600	2.963
9/14/2015	1.730	1.732	1.698	1.808	2.065	2.489	2.522	2.959
9/15/2015	1.730	1.750	1.720	1.879	2.090	2.544	2.550	3.036
9/16/2015	1.730	1.731	1.718	1.847	2.110	2.541	2.577	3.056
9/17/2015	1.730	1.748	1.713	1.821	2.085	2.514	2.547	3.030

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
9/10/2015	7.25	7.50	7.50	7.70	7.70	2.12	0.50
9/14/2015	7.20	7.43	7.55	7.65	7.65	2.12	0.50
9/15/2015	7.23	7.30	7.38	7.59	7.59	2.10	0.57
9/16/2015	6.95	7.23	7.28	7.60	7.60	2.12	0.49
9/17/2015	7.03	7.30	7.33	7.55	7.55	2.04	0.53

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
9/10/2015	4.2153	3.7648	3.8570	3.1152	1.3406	0.1559
9/14/2015	4.2090	3.7124	3.8272	3.0896	1.3430	0.1553
9/15/2015	4.2094	3.7238	3.8417	3.1152	1.3454	0.1555
9/16/2015	4.1994	3.7315	3.8361	3.1011	1.3469	0.1552
9/17/2015	4.2065	3.7129	3.8368	3.0720	1.3485	0.1553

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