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Polish Weekly Review

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Comment on the upcoming data and forecasts

Next week, the Central Statistical Office will publish flash CPI data for September, for the first time in history (more on that in the Economics section). Other data releases will be of lesser importance - quarterly revision of balance of payments data should show a slightly narrower current account deficit in the second quarter. On Thursday, Poland Manufacturing PMI index will be released. While German data painted a somewhat bleaker picture and CSO's own sentiment indices have shown deterioration in output, order and employment assessment, we believe that September's drop in the PMI can be explained by power outages and logistical problems due to the heatwave. Thus, as the situation normalized and supply chains cleared, sentiment should have rebounded.

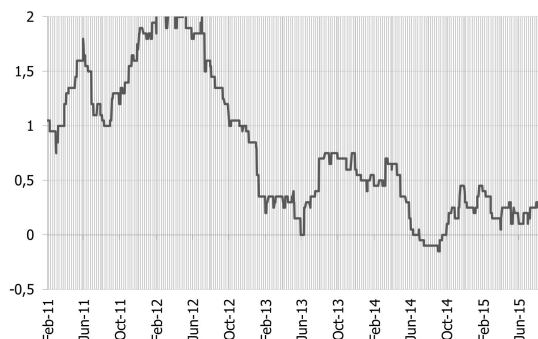
Polish data to watch: September 28th to October 2nd

Publication	Date	Period	mBank	Consensus	Prior
Current account (mio EUR)	30.09	Q2	1505	1505	1676
NBP inflation expectations (%)	30.09	Sep	0.2	0.2	0.2
CPI y/y <i>flash</i> (%)	30.09	Sep	-0.6	-0.6	-0.6
Manufacturing PMI (pts.)	01.10	Sep	53.1	51.9	51.1

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	10/8/2015	1000	1.770	9/24/2015
5Y T-bond PS0720	10/8/2015	3000	2.317	9/24/2015
10Y T-bond DS0726	10/8/2015	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

Unchanged - CSO's unemployment rate data turned out to be identical to the Ministry of Labor's preliminary estimate, hence no surprise here. Next week brings the release of flash CPI and Manufacturing PMI for September - both offer some room for surprise.

* 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

	2011	2012	2013	2014	2015F	2016 F
GDP y/y (%)	4.8	1.8	1.7	3.3	3.5	3.2
CPI Inflation y/y (average %)	4.3	3.7	0.9	-0.1	-0.8	1.5
Current account (%GDP)	-4.9	-3.5	-1.3	-1.2	-0.6	-1.0
Unemployment rate (end of period %)	12.5	13.4	13.4	11.5	10.0	8.9
Repo rate (end of period %)	4.50	4.25	2.50	2.00	1.50	1.50

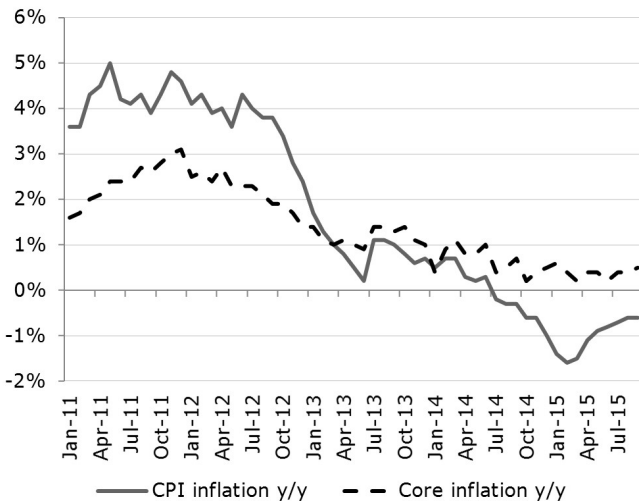
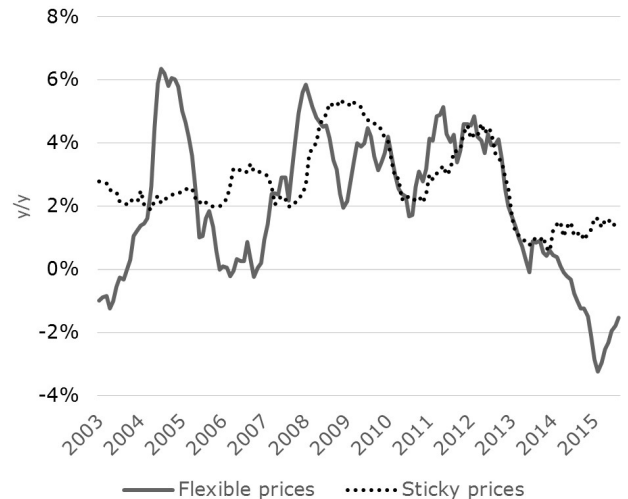
	2015	2015	2015	2015	2016	2016	2016	2016
	Q1	Q2	Q3 F	Q4 F	Q1 F	Q2 F	Q3 F	Q4 F
GDP y/y (%)	3.6	3.3	3.6	3.4	3.0	3.2	3.3	3.5
Individual consumption y/y (%)	3.1	3.0	3.0	3.2	3.2	3.3	3.2	3.0
Public Consumption y/y (%)	3.3	2.4	2.5	1.5	1.5	1.5	1.5	1.5
Investment y/y (%)	11.4	6.4	8.0	7.5	5.5	8.0	8.0	8.0
Inflation rate (% average)	-1.4	-0.9	-0.7	-0.2	0.9	1.0	0.8	1.2
Unemployment rate (% eop)	11.7	10.3	10.0	10.0	10.6	9.4	8.9	9.0
NBP repo rate (% eop)	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
Wibor 3M (% eop)	1.65	1.72	1.72	1.72	1.72	1.72	1.72	1.72
2Y Polish bond yields (% eop)	1.61	1.99	1.70	1.70	1.70	1.75	1.80	1.85
10Y Polish bond yields (% eop)	2.31	3.31	2.90	2.80	2.80	2.90	3.00	3.00
EUR/PLN (eop)	4.07	4.19	4.20	4.15	4.15	4.10	4.00	4.00
USD/PLN (eop)	3.80	3.76	3.65	3.67	3.84	3.90	3.81	3.81

F - forecast

Economics

Flash CPI (published for the first time in Poland) to underscore deflationary tendencies in the Polish economy

Central Statistical Office (GUS) announced recently that flash CPI figures are set to be published prior to the official release. Figures will be released at the end of the month. This way GUS conforms to the publication plan of the Eurostat. However, contrary to European flash figures, Polish publication lacks details on the methodology. Therefore we can only assume – basing on Eurostat methodology – that prices for some categories (food, energy) will be derived from actual statistical data collected from the real economy – possibly for the first half of the month; prices of other goods (and services) will be probably imputed via different SARIMA models (this is the way favored by the Eurostat); the same applies to the missing observations for food and energy.



Using aforementioned assumptions we came up with the figure of -0.6% y/y in September, the same as in August. First of all, we expect somewhat higher than usual growth of food prices (+0,6-1,0% m/m) as a manifestation of higher vegetable and fruit prices in the aftermath of the drought. Fuel prices may have registered a drop of the magnitude of 5-6% m/m and gas tariffs for retail customers had been cut on average by 3-4%. Core inflation may have recorded a mild increase towards 0.5% from 0.4% reported in the prior month.

The reading is not going to change the current status quo. Inflation is running low and the breakdown into sticky (i.e. items with median frequency of price changes below average) and non-sticky (changes more frequent than the average of ca. 6 months) price inflation reveals that nothing is going to change in the coming months/quarters given the outlook for the global economy (including oil prices) and Polish moderate growth around 3-3.5% consistent with still open output gap.

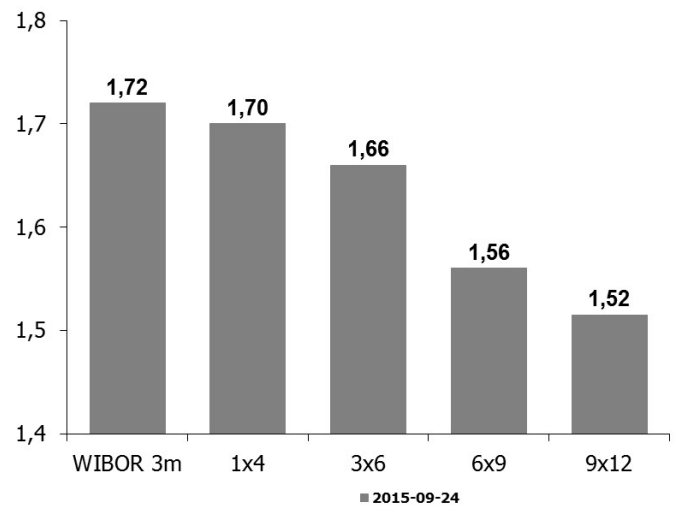
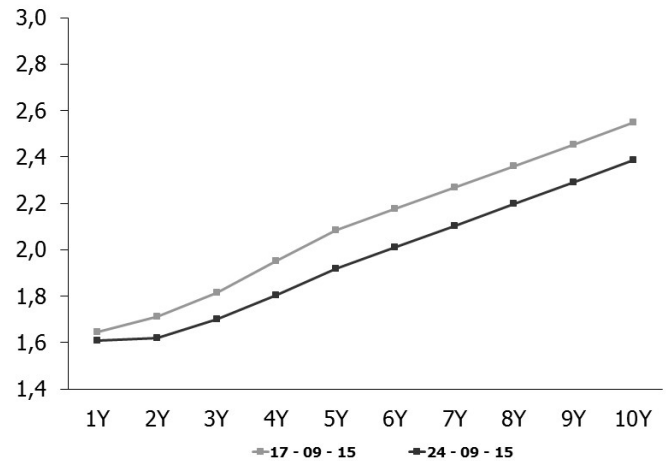
Fixed income

Sell

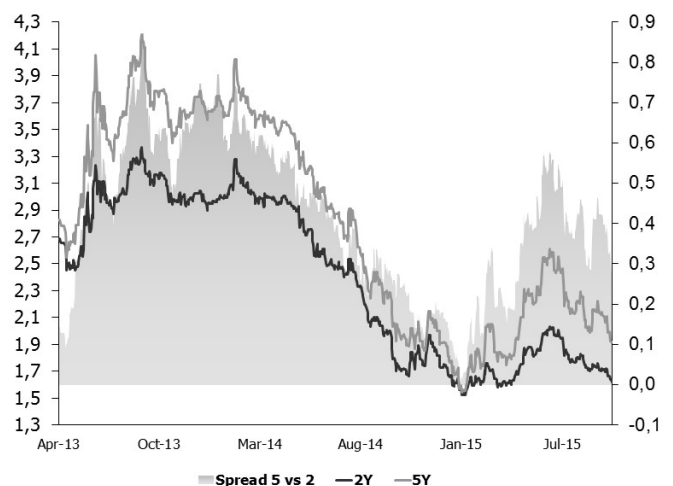
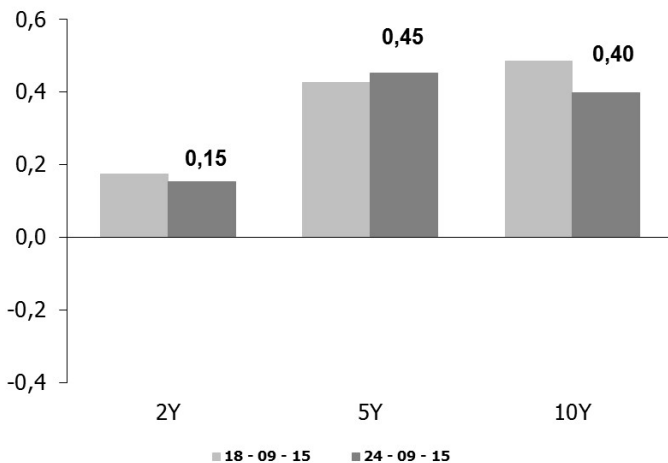
This week we saw nice buying interest, especially in the end of the curve; as a result, DS0725 was trading around 2.75% and PS0420 vs DS0725 narrowed from bps to 46 bps on Thursday. Auction was clearly strong – MoF sold 7.2 bn PLN OK0717 (940 mio) and PS0420 (6.3 bn) with demand 15,2 bn. Stop yields were lower vs. secondary market – OK0717 1.77% and PS0420 2.32%. Such a strong outcome was a surprise and may be related to demand from local banking and trading books; we have to remember that this auction was the last in the primary dealers contest period; moreover, it may be the last issuance of PS0420 as its outstanding amount is close to 30 bio PLN.

We think our bullish trading scenario has become locally exhausted at these levels. Why? We are technically bearish on core markets, stocks seems oversold, general elections are coming, in 2 weeks we will see another auction (next auction – a switching one – is scheduled, DS0726 probably will be on offer) and eventual lift-off in US this year isn't off the table.

IRS curve



Asset swaps



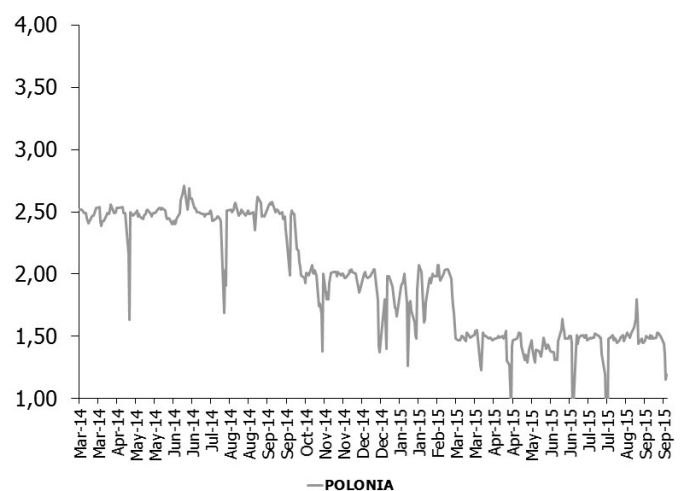
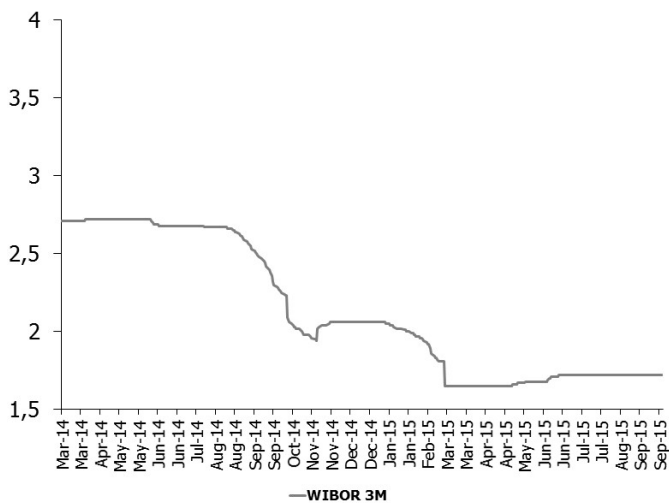
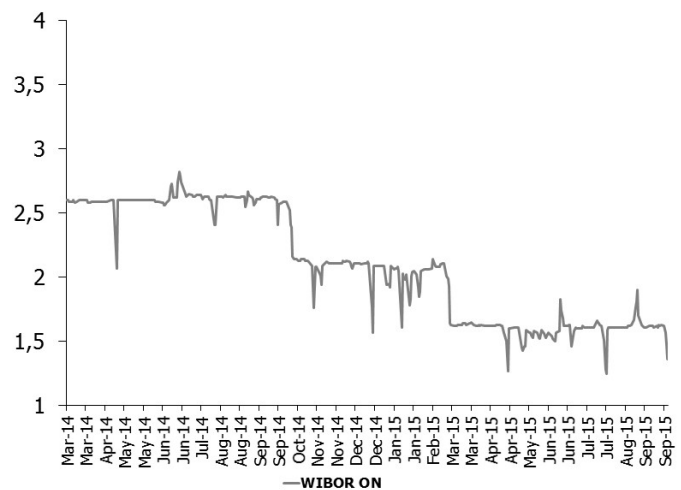
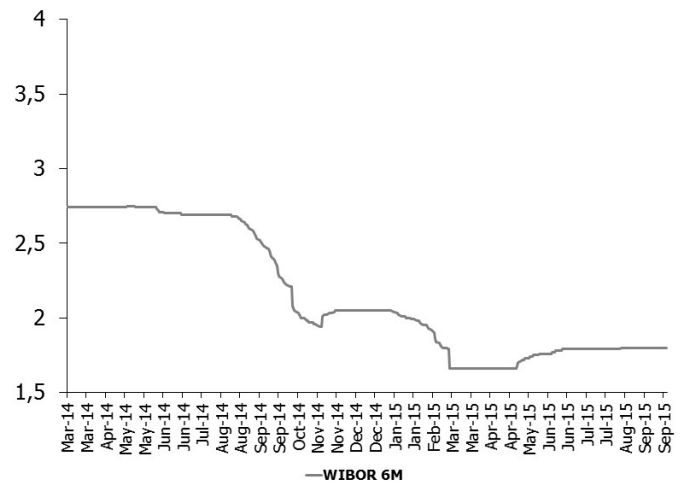


Money market

Cheap week behind us

As last OMO was underbid, Polonia fell on Wednesday to 1.15. Today's OMO square the market so next week should be stable with cash rates around 1.50.

Shortest swaps and FRAs have been falling since Monday. 9x12 FRA is now the lowest point on the curve discounting almost 25bps rate cut in first half of 2016. Also, 1y OIS moved downwards but just by 2bps. It is good a option to buy 9x12 vs. sell 1Y OIS at 10 bps spread. It may be also interesting to buy bonds up to 2Y with 30 bps above cash rates.



Forex

PLN weaker Global risk aversion was the spark that has pushed the EUR/PLN again through the 4.22 level. The high this week was 4.2350 and we managed to correct lower to 4.2070, before the bounce back to 4.22, the middle of the current 4.185-4.2550 wider range. Markets expectations for this year's Fed hike are reinforced and there are still concerns over China's growth. Of course one should not forget the quickly approaching parliamentary elections scheduled for 25th of October. All this should keep PLN with a little bearish tone.

Options – volatility in selective demand The PLN losses and uptick in EUR/USD vols generated selective demand for PLN vols with prices moving cosmetically higher. 1 month EUR/PLN ATM mid is fixing this Friday at 7.0% (0.4% higher), 3 months are also 7.35% (0.1% higher) and finally 1 year is 7.5% (0.1% higher). Skew is roughly unchanged. The currency spread (difference between USD/PLN vol and EUR/PLN vol) is relatively stable at 4.6-4.0.

Short-term forecasts

Main supports / resistances:

EUR/PLN: 4.16 / 4.26

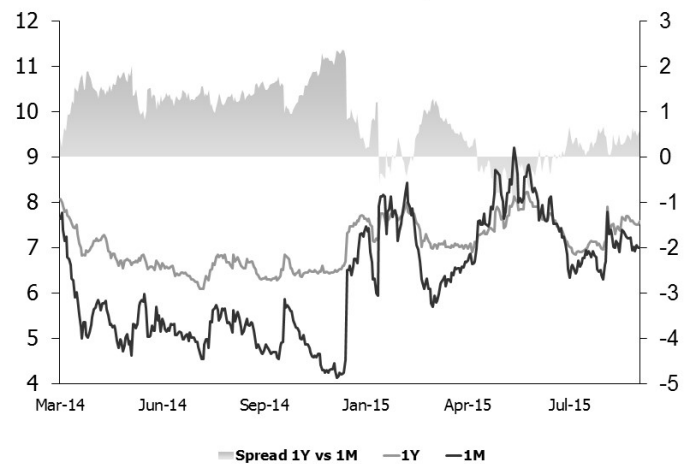
USD/PLN: 3.60 / 3.85

Position Spot - Long EUR/PLN

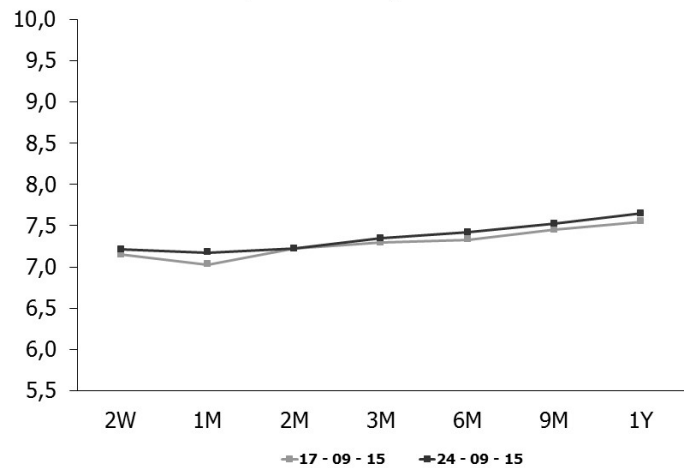
Short from 4.2280 closed and reversed at 4.20. We are ready to add at 4.1800 with a stop below 4.1650 and hopes to revisit levels above 4.2400. We agree that it is not a clean trade and there are possibly also good reasons for stronger PLN (dovish ECB, no hike from FOMC), but these factors are more or less good in current market rate. We are more afraid of the political developments in Poland. They are much more difficult to predict and we assume that being short PLN offers better risk / reward scenario.

Options We are still long Gamma, Vega and Vanna in EUR/PLN and USD/PLN. We think that concerns over global growth, rate hikes in US and parliamentary elections in Poland will support volatility in the longer term.

EURPLN volatility



EUR/PLN volatility curve



Bias from the old parity (%)



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
9/17/2015	1.78	1.72	1.72	1.70	1.75	1.73	1.71	1.68	1.62	1.59	1.65	1.67
9/21/2015	1.75	1.72	1.83	1.70	1.73	1.73	1.71	1.69	1.59	1.55	1.57	1.65
9/22/2015	1.78	1.72	1.85	1.70	1.75	1.73	1.70	1.66	1.57	1.55	1.55	1.62
9/23/2015	1.48	1.72	1.62	1.70	1.60	1.73	1.72	1.68	1.58	1.54	1.55	1.63
9/24/2015	1.62	1.72	1.70	1.70	1.73	1.73	1.70	1.66	1.56	1.52	1.53	1.60

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
9/17/2015	1.730	1.748	1.713	1.821	2.085	2.514	2.547	3.030
9/21/2015	1.730	1.691	1.665	1.831	1.998	2.408	2.432	2.907
9/22/2015	1.730	1.679	1.636	1.764	1.925	2.338	2.382	2.823
9/23/2015	1.730	1.708	1.640	1.823	1.915	2.372	2.375	2.818
9/24/2015	1.730	1.723	1.621	1.775	1.917	2.368	2.385	2.782

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1Y	1Y
9/17/2015	7.03	7.30	7.33	7.55	7.55	2.08	0.56	0.56
9/21/2015	7.05	7.15	7.23	7.51	7.51	2.08	0.56	0.56
9/22/2015	7.00	7.13	7.20	7.50	7.50	1.97	0.53	0.53
9/23/2015	7.00	7.18	7.25	7.58	7.58	2.05	0.54	0.54
9/24/2015	7.18	7.35	7.43	7.65	7.65	2.10	0.57	0.57

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
9/17/2015	4.2065	3.7129	3.8368	3.0720	1.3485	0.1553
9/21/2015	4.1896	3.7080	3.8359	3.0825	1.3509	0.1548
9/22/2015	4.1924	3.7438	3.8522	3.1219	1.3515	0.1550
9/23/2015	4.2007	3.7801	3.8632	3.1431	1.3546	0.1550
9/24/2015	4.2200	3.7687	3.8593	3.1391	1.3487	0.1555

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