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## Polish Weekly Review

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### Comment on the upcoming data and forecasts

Next week brings only one significant announcement – Polish Monetary Policy Council will decide on interest rates. Most certainly they will remain unchanged. The press conference also should not be surprising, since "Monetary Policy Guidelines for 2016" were published earlier this week.

### Polish data to watch: October 5th to October 9th

Publication	Date	Period	mBank	Consensus	Prior
MPC rate decision (%)	07.10	Oct	1.50	1.50	1.50

### 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

Surprise index went down after two negative surprises: *flash* CPI and manufacturing PMI. We are just few points above last year's minimum. The following week brings no opportunities to move the index.

\* 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 is set to stay close to 3% per annum.
- Downside risks prevail near term. However, until only selected business tendency indicators are decreasing, Poland is expected to escape a deeper slowdown. Exports is going to be weaker due to international developments, investment activity may be negatively affected by the unanticipated fall of future demand. At the same time consumption is to maintain 3% growth (labor market is tight, households have resources to smooth consumption over time). The schedule for infrastructure spending suggests a steep path of outlays from the turn of 2015/2016 onwards. At this stage it is more likely that outlays will be postponed for later part of 2016.
- Given the schedule of infrastructure spending and stable consumption growth, many years of economic expansion are still 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.
- 3% growth is sufficient to keep inflation and credit risk in check. Global headwinds and low commodity prices are set to further underpin deflationary environment. Headline inflation is going to slowly rise only on the back of statistical base.
- NBP rates stable or lower as upcoming MPC may be more dovish and start its tenure in weaker macroeconomic environment.

### 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	3.3	3.1
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

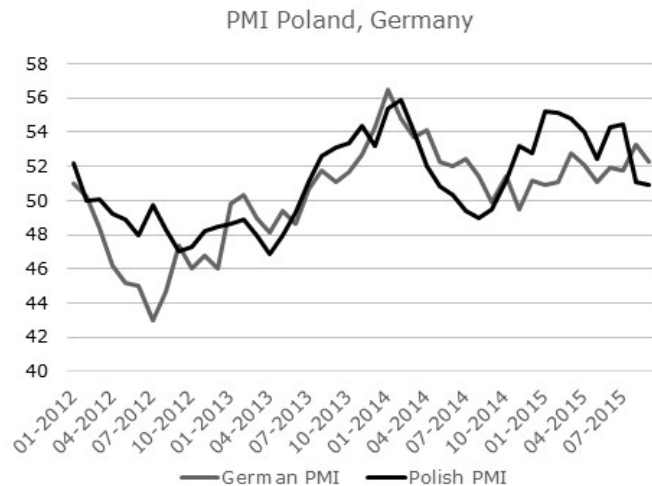
	2015	2015	2015	2015	2016	2016	2016	2016
	Q1	Q2	Q3 F	Q4 F	Q1 F	Q2 F	Q3 F	Q4 F
GDP y/y (%)	3.6	3.3	3.1	3.1	3.0	3.0	3.1	3.2
Individual consumption y/y (%)	3.1	3.0	3.0	3.2	3.2	3.3	3.2	3.0
Public Consumption y/y (%)	3.3	2.4	2.5	1.5	1.5	1.5	1.5	1.5
Investment y/y (%)	11.4	6.4	6.5	5.5	4.5	6.5	7.0	7.0
Inflation rate (% average)	-1.4	-0.9	-0.7	-0.2	0.6	0.7	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	4.24	4.15	4.15	4.10	4.10	4.05
USD/PLN (eop)	3.80	3.76	3.78	3.77	3.84	3.90	3.90	3.86

F - forecast

## Economics

### Polish PMI: Manufacturing business outlook is (already) systematically worsening

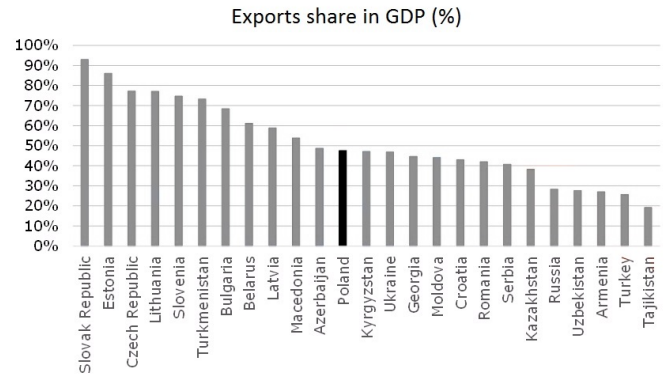
August's release was supposed to be disturbed principally by one-off factors, but there was no improvement of business outlook in September. This development was surprising for both market consensus and our forecast – manufacturing PMI fell from 51.1 to 50.9 p.



Composition of the index raises serious concerns about future state of the economy. Production and orders moved up slightly and but both are only slightly above 50 p. threshold. On the other hand, backlog of orders and export orders dropped significantly (the latter even below 50 p. for the first time since many months). A glimpse of an eye on the inventory / orders ratio and comparison with German economic indices suggest that the decline in manufacturing was not anticipated by firm. Stocks of finished goods are growing while just now firms cut the stock of supplies. Falling producers prices (fastest since April 2014) are another problem. For the second time in a row they are being followed by decline in finished goods prices. Employment outlook remained unchanged, which - given the behavior of other categories - should be treated as a positive sign. However, among companies analyzed on a monthly basis by CSO, employment in manufacturing is stuck at almost zero growth, while jobs are being added mostly by service sector.

Last time we were able to keep our nerves. September's data changes the story. Business outlook (measured by PMI) is slowing down and nobody from industrial sector seems to be prepared for it. As for short-term implications, September's industrial production can be worse than expected - our forecast (5% Y/Y) carries thus downside risk. In the long term we could expect further weakening of global demand that poses a risk for Polish manufacturing (Polish economy is not as opened as our CEE peers but may still feel the impact - see the graph). Asia is the center of this process and other EM will be impacted directly by lower commodity prices or indirectly by lower demand for finished goods, depreciation of Asian currencies, deterioration of international payment position and public finance accounts. EU28, as a net commodity importer, is vulnerable to lower export of finished goods while consumers and industrial sector will overall profit on cost basis because of lower commodity prices.

Much bigger problem could be the VW scandal, which may negatively affect not only Germany but also CEE economies. Few days ago we have decided to update our GDP forecasts for the second time this quarter. We have lowered yearly GDP forecast to 3.3% y/y for 2015 and 3.1% for 2016.



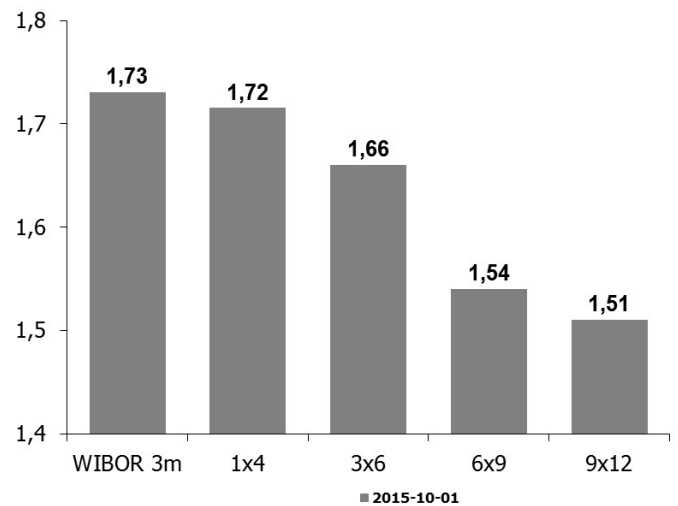
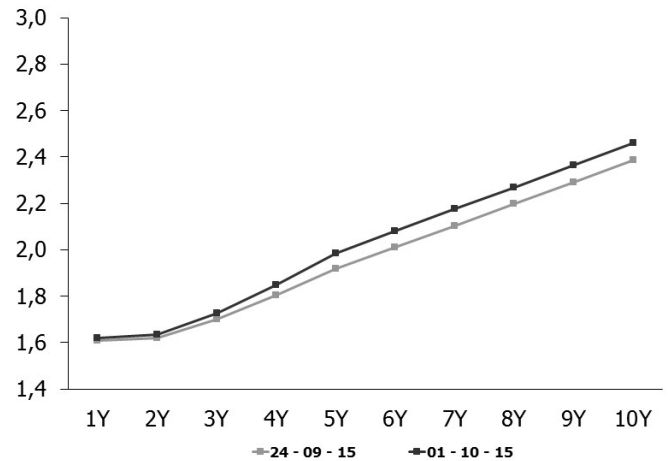
## Fixed income

### Skipping another tightening cycle?

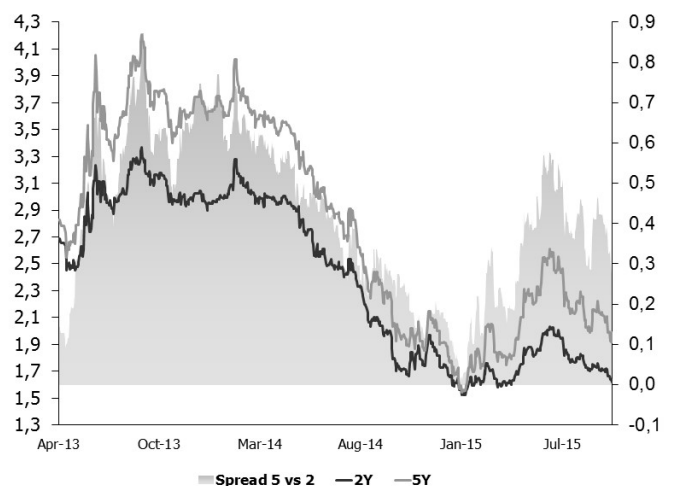
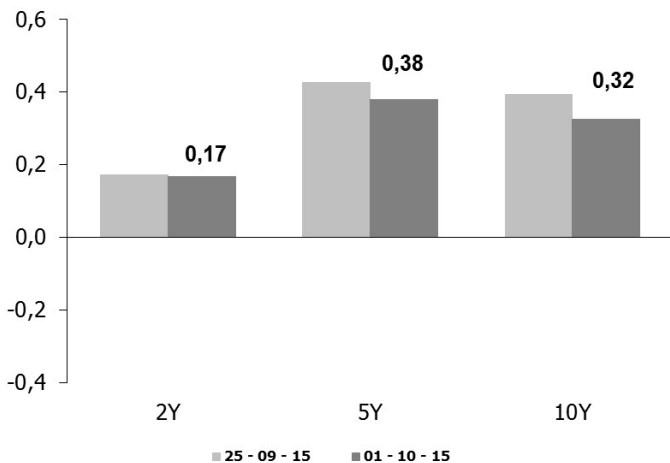
We have a pretty bullish week behind us and bonds are approaching lvl's not seen since 1Q 2015. That's strictly correlated with core yields, especially bunds. When we add to this a certain widening on asset swaps, IRS and FRAs are already pricing nearly 25bp cut next year. That all seems to be justified on the back of the China slowdown, falling commodity prices and some major imbalances around the world. And the only weak spot in this scenario is the Fed which clearly communicates it wants to reduce the stimulus and raise rates.

Levels we mentioned are in 5y benchmark at 2.25% and bund at 0.5% (lows from aug 15). Next week's developments depend on the market's read on Friday's NFP.

IRS curve



Asset swaps

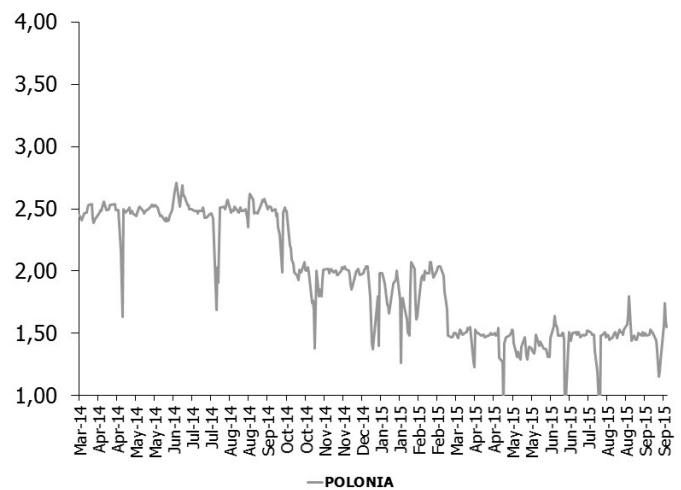
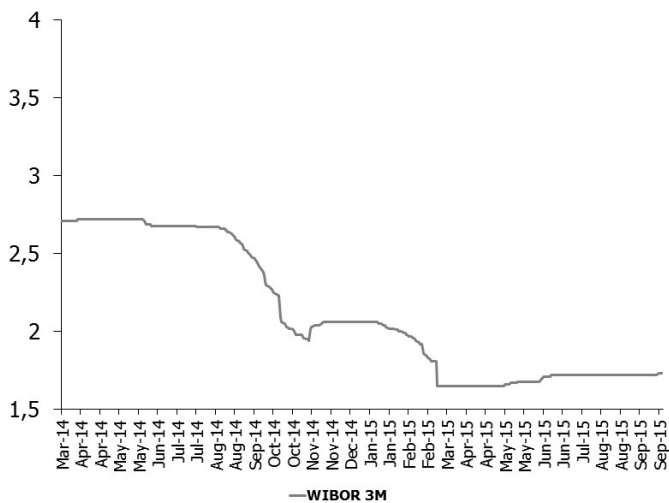
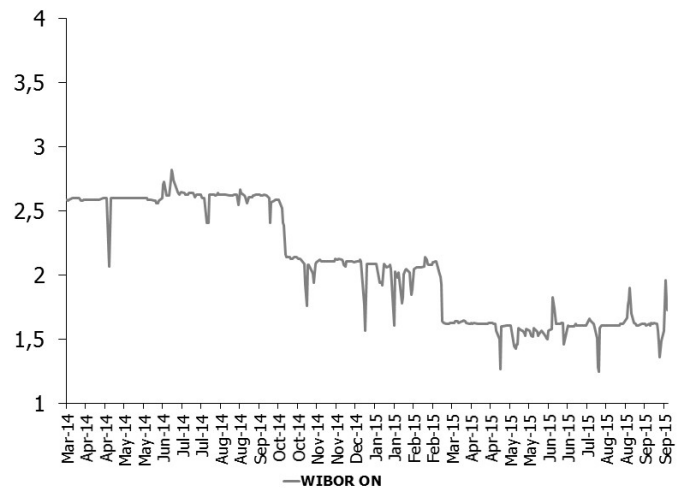
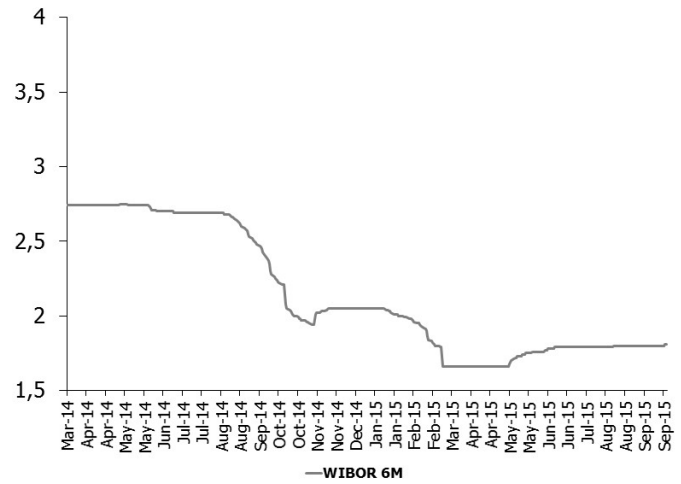


## Money market

### Tough week behind us

As last OMO squared the market and Tuesday was the last day of reserve Polonia rose to 1.74. The rest of the week was also very vulnerable. Next week should be stable.

Short end of the curve going lower and lower. 9x12 is trading at the level of current reference rate and as 3M WIBOR is 1.73 it is discounting almost 25bps rate cut. We recommend to buy it as it too soon to anticipate that move. We also recommend to buy OK0717 at 1.70.



## Forex

**PLN still weak** EUR/PLN is fluctuating in the upper part of the wider 4.17-4.27 range. The global risk off factor is still relatively high and keeping Zloty under pressure. Weak NFP number is also adding weight to this grim picture. The Polish parliamentary elections are getting closer and closer, with market unfriendly Law and Justice firmly in the leader seat. In general we still expect range 4.17-4.27 to hold. We expect all these market turbulence rather to trim PLN strength ( i.e. resulting from ECB s QE), than to cause further weakness.

**Options – unchanged** Not much to say about PLN vols. 1 months EUR/PLN ATM mid is this Friday at 6.9% (0.1% lower), 3 months are 7.25% (0.1% lower) and finally 1 year is fixing at 7.6% (0.1% higher). Skew is roughly unchanged. Currency spread (difference between USD/PLN vol and EUR/PLN vol) should be better offered after the NFP caused USD weakness.

## Short-term forecasts

Main supports / resistances:

EUR/PLN: 4.18 / 4.27

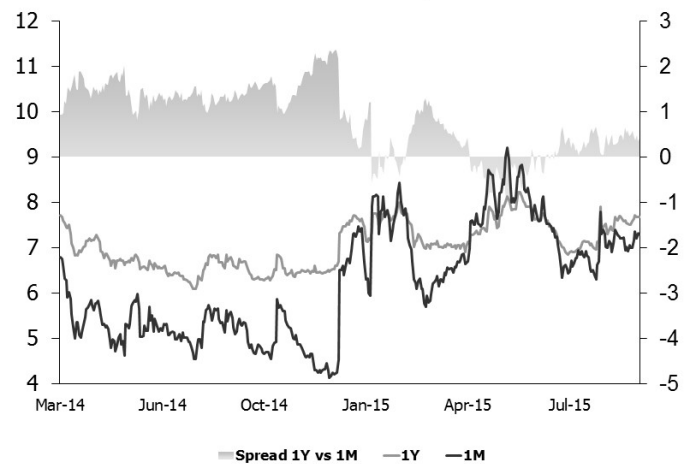
USD/PLN: 3.60 / 3.85

**Position** Spot - Longs EUR/PLN from 4.20 are closed with profit at 4.25

We are now short EUR/PLN at 4.2550 and we are ready to add at 4.2750 with stop above 4.29. We hope to see another move below 4.20. It is purely technical trade, based on our assumption of strong mean reverting feature of EUR/PLN. There is still some time to parliamentary elections, on which we don't want to carry any substantial PLN longs.

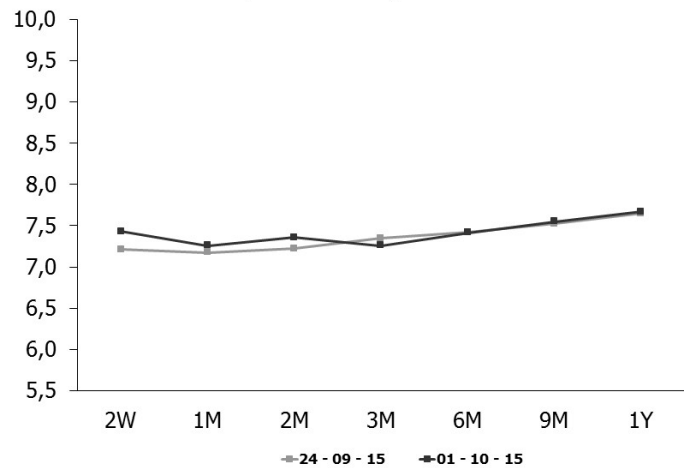
**Options** We are still long Gamma, Vega and Vanna in EUR/PLN and USD/PLN. We think that concerns about global growth, rate hikes in US, and parliamentary elections in Poland will support volatility in the longer term.

EURPLN volatility



— Spread 1Y vs 1M — 1Y — 1M

EUR/PLN volatility curve



— 24 - 09 - 15 — 01 - 10 - 15

Bias from the old parity (%)



— USD/PLN — EUR/PLN

## 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
9/24/2015	1.62	1.72	1.70	1.70	1.73	1.73	1.70	1.66	1.56	1.52	1.53	1.60
9/28/2015	1.63	1.73	1.69	1.70	1.80	1.73	1.71	1.68	1.57	1.53	1.54	1.62
9/29/2015	1.76	1.73	1.69	1.71	1.80	1.73	1.71	1.67	1.56	1.53	1.54	1.59
9/30/2015	1.56	1.73	1.63	1.71	1.73	1.74	1.72	1.68	1.55	1.51	1.53	1.59
10/1/2015	1.71	1.73	1.79	1.71	1.70	1.74	1.72	1.66	1.54	1.51	1.52	1.58

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
9/24/2015	1.730	1.723	1.621	1.775	1.917	2.368	2.385	2.782
9/28/2015	1.730	1.722	1.630	1.819	1.955	2.405	2.422	2.825
9/29/2015	1.730	1.730	1.631	1.832	1.980	2.432	2.450	2.844
9/30/2015	1.740	1.702	1.625	1.794	1.990	2.390	2.455	2.852
10/1/2015	1.740	1.708	1.615	1.781	1.945	2.324	2.445	2.769

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1Y	
9/24/2015	7.18	7.35	7.43	7.65	7.65	2.13	0.57	
9/28/2015	7.21	7.39	7.49	7.69	7.69	2.13	0.57	
9/29/2015	7.33	7.29	7.48	7.68	7.68	2.08	0.53	
9/30/2015	7.28	7.38	7.48	7.68	7.68	2.13	0.57	
10/1/2015	7.25	7.25	7.41	7.68	7.68	2.08	0.54	

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
9/24/2015	4.2200	3.7687	3.8593	3.1391	1.3487	0.1555
9/28/2015	4.2334	3.7861	3.8656	3.1484	1.3438	0.1554
9/29/2015	4.2434	3.7799	3.8909	3.1506	1.3495	0.1559
9/30/2015	4.2386	3.7754	3.8785	3.1402	1.3529	0.1560
10/1/2015	4.2437	3.8005	3.8890	3.1659	1.3548	0.1561

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