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## Polish Weekly Review

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### Comment on the upcoming data and forecasts

Next week kicks in on Monday with manufacturing PMI for October. We expect just a minor rise of the index after a slight improvement of German indices and stabilization of analogous CSO indicators. Few hours later CSO will publish *flash* CPI for October. Given low food and fuel prices, we see only symbolic rise driven by base effects. On Wednesday MCP will announce its decision about interest rates - they will certainly remain unchanged. However, we could see more dovish wording supported by lower inflation and GDP trajectories in November inflation projection. Current MPC could also acknowledge the possibility that the next Council will be leaning towards monetary policy easing.

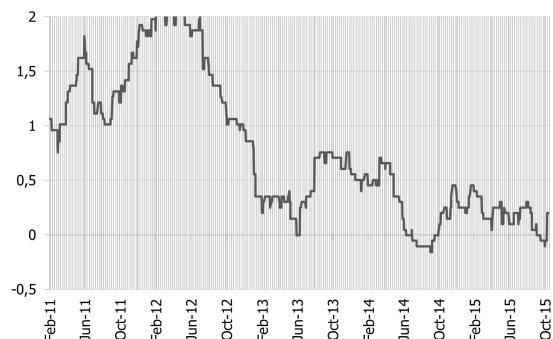
### Polish data to watch: November 2nd to November 6th

Publication	Date	Period	mBank	Consensus	Prior
Manufacturing PMI (p.)	02.11	Oct	51.6	51.1	50.9
Flash CPI y/y (%)	02.11	Oct	-0.7	-0.6	-0.8
MPC decision (%)	04.11	Nov	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	11/19/2015	1000	1.770	10/29/2015
5Y T-bond PS0720	11/19/2015	3000	2.317	10/29/2015
10Y T-bond DS0726	11/19/2015	2000	3.076	10/29/2015
15Y T-bond WS0428	-	20	2.092	3/12/2015

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



### Comment

*Flash* CPI release was postpone on upcoming Monday, so there were no publications to move surprise index this week. Next week brings, besides aforementioned CPI, manufacturing PMI. Both of those releases could move the index in a significant matter.

\* 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 the Polish economy. The upswing 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.
- We expect lower rates in 2016 as the new MPC is set to be more responsive for weaker environment amid global trends for monetary stimulation. Moreover, the new parliament is set to have inclination towards selecting more dovish MPC members.

### Financial markets

- Near term still neutral (cash) and expecting yield curve steepening (rate cuts already priced in, uncertainty surrounding fiscal policy, bonds sensitive to potential monetary tightening in the US).
- We think that POLGBs may still have potential mid-term as monetary stimulus is waiting in the wings and the new government is likely to push for easier monetary policy that ultimately will be delivered.
- Pro-active ECB stance should be enough to shield the zloty from sharp depreciation in case of higher risk aversion. We see zloty stronger mid-term on solid growth story and differentiation flows. Political risk and potential for easier monetary policy may linger for some days. Therefore we expect the weaker side of the range (4.25-4.40) to be dominant near term.

### mBank forecasts

	2011	2012	2013	2014	2015F	2016 F
GDP y/y (%)	5.0	1.6	1.3	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	1.00

	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	1.25	1.00	1.00	1.00
Wibor 3M (% eop)	1.65	1.72	1.73	1.70	1.44	1.20	1.20	1.20
2Y Polish bond yields (% eop)	1.61	1.99	1.76	1.45	1.30	1.20	1.20	1.28
10Y Polish bond yields (% eop)	2.31	3.31	2.84	2.50	2.40	2.30	2.30	2.38
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	3.92	3.99	4.02	4.02	3.93

F - forecast

## Economics

### Update on Polish elections: decisive PiS victory

According to official tally, PiS won the parliamentary elections (confirming the exit polls) and is set to form a unified government without the need for a coalition partner. The final result of the elections was rather close to our forecast with the exception of United Left party which unexpectedly dropped below the threshold of 8% and allowed for a different distribution of mandates. The Sejm will consist of five parties, while the Senate elections have seen an even more crushing victory for PiS (61 out of 100 seats).

Party	% of votes	Number of mandates
PiS	37.58	235
PO	25.09	138
Kukiz'15	8.81	42
Nowoczesna	7.6	28
Zjednoczona Lewica	7.55	0
PSL	5.13	16
KORWiN	4.76	0
Razem	3.62	0

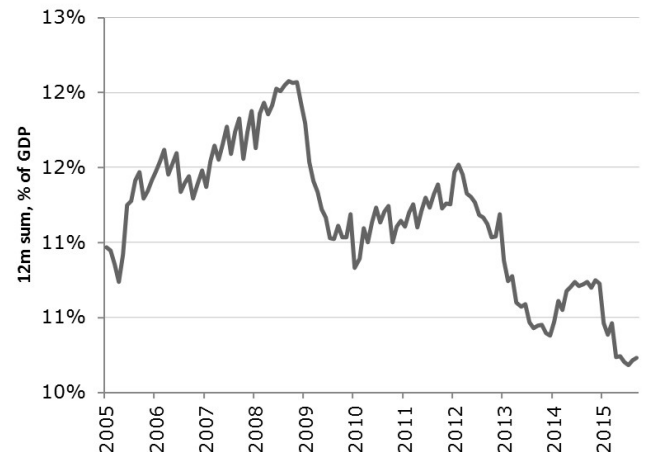
The result of the elections is of course a game changer for the Polish economy and for Polish financial markets but one cannot exaggerate its impacts. For the first time in modern history, single political party took both houses of parliament and the presidency (previously a junior coalition partner was needed to secure the majority in parliament and form a government). Secondly, a new Monetary Policy Council will be selected in January and February, with all the new members being doves. As a result – as we explained in the previous report – rate cuts in 2016 are our baseline scenario: we expect the new easing cycle to amount to 50 bps. Consensus, it seems, will drift towards this view.

Last but not least, fiscal policy will be loosened further in 2016. While this year's budget is likely to come slightly ahead of plan, it is mainly due to historically low debt service costs and a wind-fall profit of 9 bn PLN from the recent LTE telecom auction. The underlying balance is probably quite weak due to poor indirect tax collection (see the graphs below). PiS already indicated that it plans to amend the 2016 budget and even though nothing is set in stone yet (after all, the new government will be sworn in late November), this opens the very real possibility that fiscal deficit will increase markedly as a result. At the very least, fiscal policy is set to become interesting again and we'll be updating our Readers as the situation develops. In particular, if parts of the new government's programme (child subsidy and higher tax free threshold) are put in motion, it will be a major boost to private consumption.

Public debt service cost



Indirect tax revenue



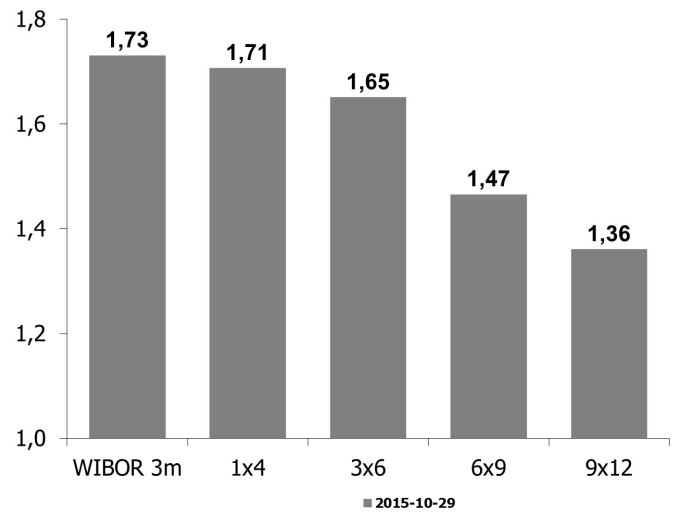
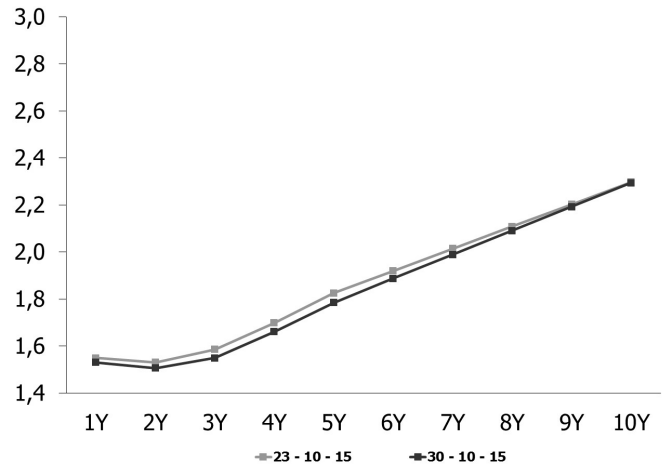
## Fixed income

### Post-elections rollercoaster

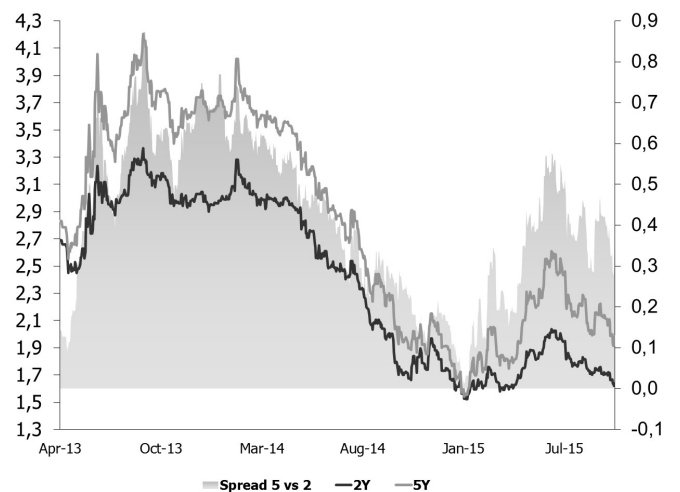
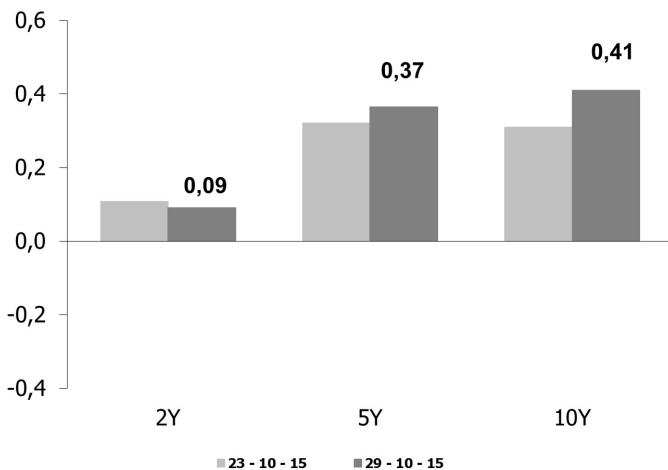
It was a busy week on the fixed income market (elections, FOMC, auction). As polls suggested, Law and Justice won the general elections (37,58%) and has a ruling majority in lower house of Parliament. Market reaction was quite positive (yields went down 7-10 bps: PS0420 now at 1,97%; DS0725 at 2,56%) as coalition with Kukiz'15 committee could be problematic and ECB QE extension story still supports bonds. What does election results mean for the fixed income market? We think that fiscal loosening and monetary stimulus (till March new MPC will be formed) is inevitable. The only question is the timing: when new government will try to introduce election promises?

October FOMC statement was much more hawkish than market anticipated. Removing the "recent global and financial developments may restrain economic activity somewhat and are likely to put further downward pressure on inflation in the near term" sentence was a clear signal that the Fed wants the market to believe that hike in December is still on the table. In this unfavourable environment the Ministry of Finance conducted an auction - OK0717, PS0421 and DS0726 were on the offer. MoF sold 8,06 bn of bonds with yields 1,56%; 2,185% and 2,78%. End of the week was in bullish mode – market players weighted Thursday's move as overdone. We maintain our 2y10y steepener recommendation.

IRS curve



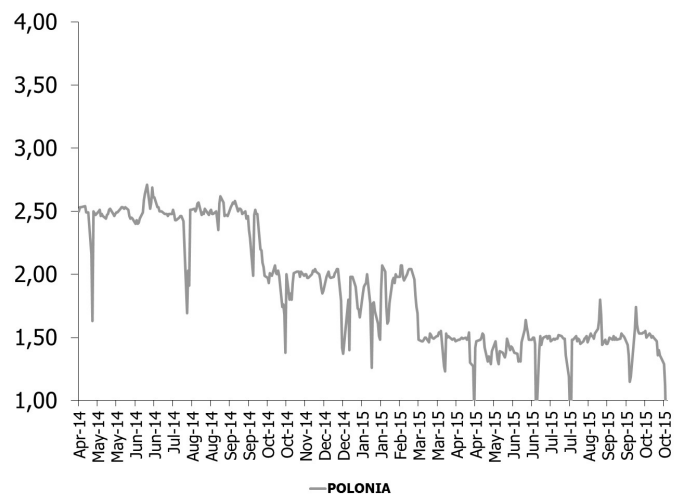
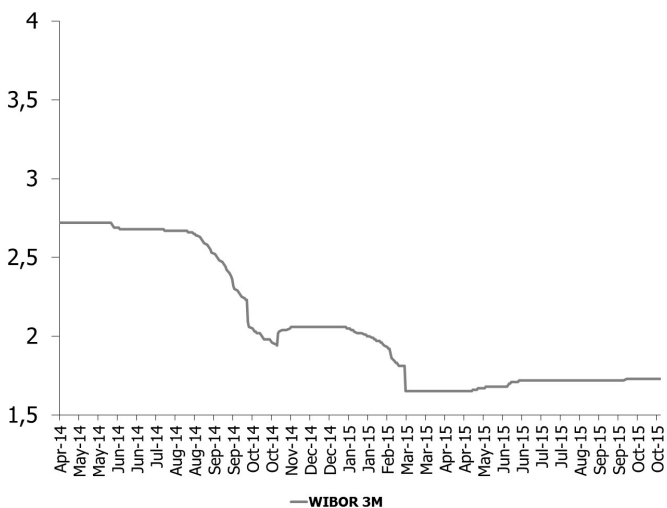
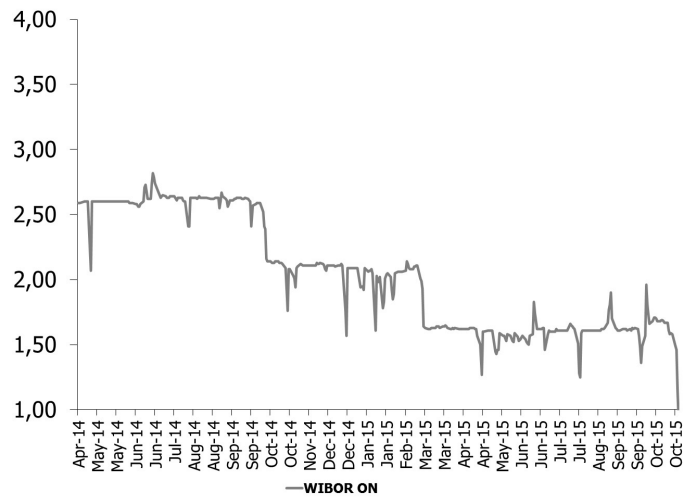
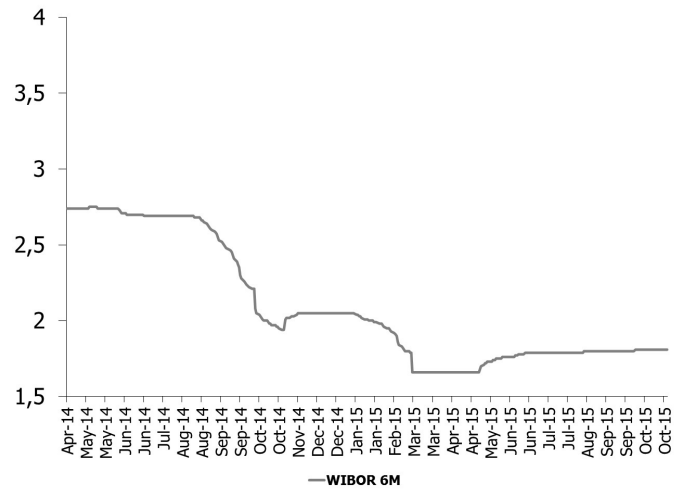
Asset swaps



## Money market

### It was a very cheap week

ON deposit rate reached 0.5% level (NBP deposit rate) on Thursday. It was triggered by maturity of DS1015 bond plus coupons from other October bonds. Additionally it was the last week of the reserve requirements settlement period. Some market players expected additional OMO and were surprised when NBP did not act despite extremely low deposit rate. 1Y OIS polonia declined by 5bp and was priced 1,26/31. 9x12 FRA fell also by 5 bp to level 1,35/37. Rates in next week as a first of new mandatory reserve period should oscillate around reference rate as banks bought enough NBP-bills offered on today's auction to square off the system.



## Forex

**PLN – Political risk vs ECB and FOMC** Decisive majority for the Law and Justice party in Sunday's election seemed to have caught market a little by surprise and during the first three days all the PLN gains from last week evaporated. EUR/PLN moved from 4.2410 last Friday's low to 4.2955 high this week, where we eventually started to see sellers. We expect the new government to scale back its pre-election (fiscally costly) promises and we think that political risk is already discounted in the current price level. We now should again focus on the global factors. Worth noting that we had hawkish (PLN negative) FOMC on the way, which is somehow offsetting the dovish ECB (PLN positive). Nonetheless, we keep our mantra of rangy nature of EUR/PLN, and expect 4.22/4.29 range for time being, with spikes above 4.30 likely worth fading.

### Options – EUR/PLN vols lower, USD/PLN vols higher

Lower realized volatility, calmer markets, dovish ECB were the reasons why EURPLN vols kept on sliding lower. 1 month EUR/PLN ATM is this Friday at 6.4% mid (0.6% lower). 3 months EUR/PLN is at 6.5% (0.3% down) and, finally, 1y is fixing at 7.0% (0.25% lower). The Skew was roughly unchanged. The currency spread (difference between USD/PLN vol and EUR/PLN vol) was traded higher off the low post FOMC on Wednesday and EUR/USD plunged, as Fed put the December rate hike back on the table.

### Short-term forecasts

Main supports / resistances:

EUR/PLN: 4.22 / 4.32

USD/PLN: 3.70 / 4.00

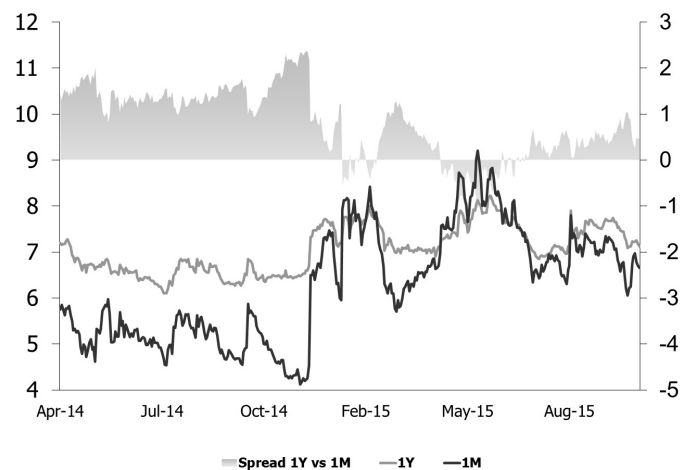
### Position Spot – short EUR/PLN.

We are short at 4.2900 and we are ready to add at 4.31 with S/L at 4.33 and hopes to revisit 4.24/4.22. Once the dust settles, we think that the winning party will try to withdraw from most costly pre-elections vows. This can support PLN. Additionally, falling EUR/USD (dovish ECB, hawkish FOMC) should drag EURPLN lower with time.

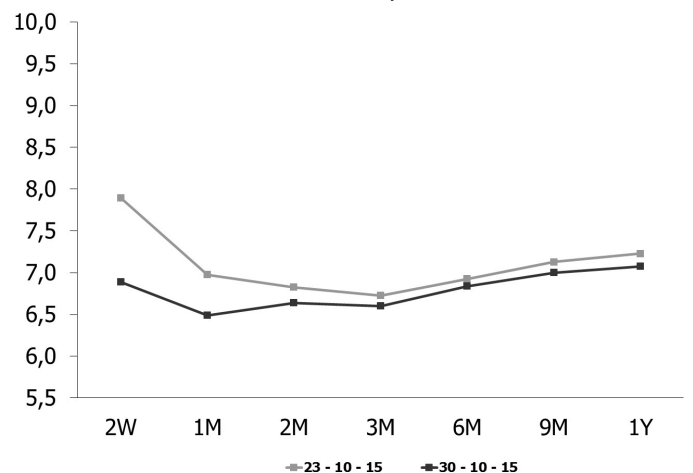
### Options – core 1y long Vega, short mid term

We stick to our core Long in Vega in the backend. Although realized volatility is quite high, we have ventured to sell some mid-term Vega. We expect vols to go even lower, when spot stabilizes and Theta bills would get bit more painful. All we need, is a few days of relative calmness and we should see vols melting.

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
10/22/2015	1.75	1.73	1.83	1.71	1.73	1.74	1.71	1.65	1.48	1.43	1.44	1.51
10/26/2015	1.62	1.73	1.70	1.71	1.73	1.74	1.70	1.65	1.45	1.38	1.39	1.47
10/27/2015	1.62	1.73	1.70	1.71	1.73	1.74	1.71	1.64	1.45	1.36	1.36	1.45
10/28/2015	1.52	1.73	1.60	1.71	1.63	1.74	1.71	1.66	1.44	1.33	1.35	1.43
10/29/2015	1.62	1.73	1.70	1.71	1.73	1.73	1.71	1.65	1.47	1.36	1.36	1.46

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
10/22/2015	1.740	1.660	1.555	1.689	1.847	2.196	2.317	2.650
10/26/2015	1.740	1.616	1.518	1.680	1.850	2.167	2.350	2.701
10/27/2015	1.740	1.566	1.505	1.590	1.785	2.094	2.290	2.618
10/28/2015	1.740	1.567	1.490	1.565	1.742	2.050	2.240	2.584
10/29/2015	1.730	1.584	1.505	1.595	1.785	2.150	2.295	2.704

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
10/22/2015	6.90	6.73	6.93	7.23	7.23	2.09	0.54
10/26/2015	6.78	6.68	6.93	7.25	7.25	2.09	0.54
10/27/2015	6.70	6.70	6.88	7.18	7.18	2.07	0.56
10/28/2015	6.65	6.70	6.88	7.13	7.13	2.07	0.56
10/29/2015	6.49	6.60	6.84	7.08	7.08	2.05	0.53

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
10/22/2015	4.2769	3.7806	3.9357	3.1573	1.3736	0.1580
10/26/2015	4.2605	3.8645	3.9444	3.1913	1.3710	0.1572
10/27/2015	4.2709	3.8669	3.9302	3.2099	1.3691	0.1578
10/28/2015	4.2902	3.8826	3.9459	3.2260	1.3757	0.1582
10/29/2015	4.2732	3.8974	3.9364	3.2276	1.3740	0.1577

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