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Polish Weekly Review

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Comment on the upcoming data and forecasts

When it comes to Polish macro data, next Friday is a „super-Friday”. The marathon starts with the release of flash GDP for third quarter. We expect a slight slowdown of GDP growth (from 3.3 to 3.1% y/y), mainly on the back of weaker consumption (as indicated by poor retail sales figures in recent months) and – perhaps – lower net exports contribution. The final CPI for October will probably confirm the flash reading of -0.8% y/y and allow to pinpoint the source of the slight surprise. Data published by the NBP (M3 and balance of payments) are of lesser importance. As for the former, we expect a slight deceleration on the back of high statistical base in social security funds’ deposits. Balance of payments data (for September) will likely show an improvement in both trade and current account balances, due to rebound in exports after a terrible August.

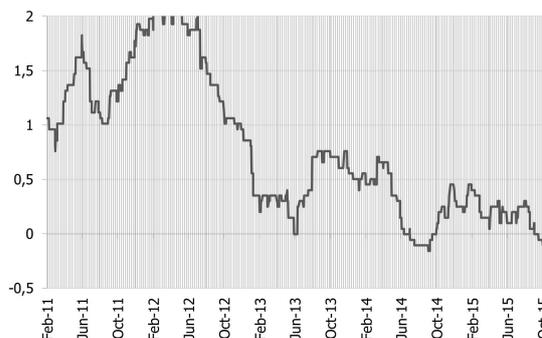
Polish data to watch: November 9th to November 13th

Publication	Date	Period	mBank	Consensus	Prior
Flash GDP y/y (%)	13.11	Q3	3.1	3.3	3.3
M3 y/y (%)	13.11	Oct	8.2	8.5	8.4
Current account (mio EUR)	13.11	Sep	-596	-416	-864
Exports (mio EUR)	13.11	Sep	15000	15053	12764
Imports (mio EUR)	13.11	Sep	14700	14705	12855
Final CPI y/y (%)	13.11	Oct	-0.8	-0.8	-0.8

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 surprised to the downside, thereby allowing for a small correction in Polish surprise index. There is only one publication that can move the index next week: the flash GDP.

* 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 (ECB) 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	-0.3	0.5	0.6	0.5	0.9
Unemployment rate (% eop)	11.5	10.2	9.7	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	1.35	1.35	1.35	1.35
10Y Polish bond yields (% eop)	2.31	3.31	2.84	2.70	2.50	2.50	2.50	2.50
EUR/PLN (eop)	4.07	4.19	4.25	4.15	4.15	4.15	4.15	4.15
USD/PLN (eop)	3.80	3.76	3.80	3.92	3.99	4.07	4.07	4.03

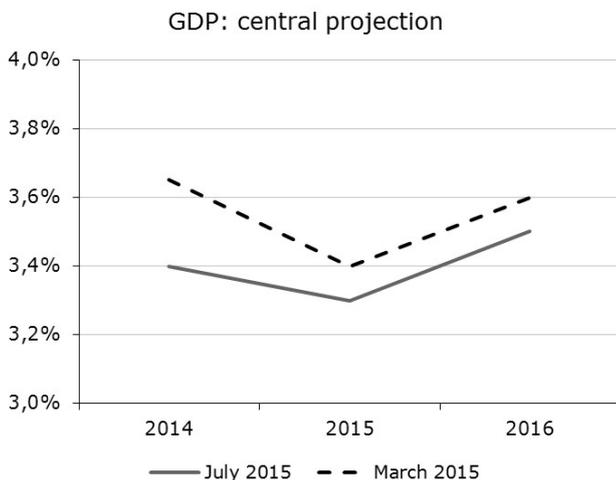
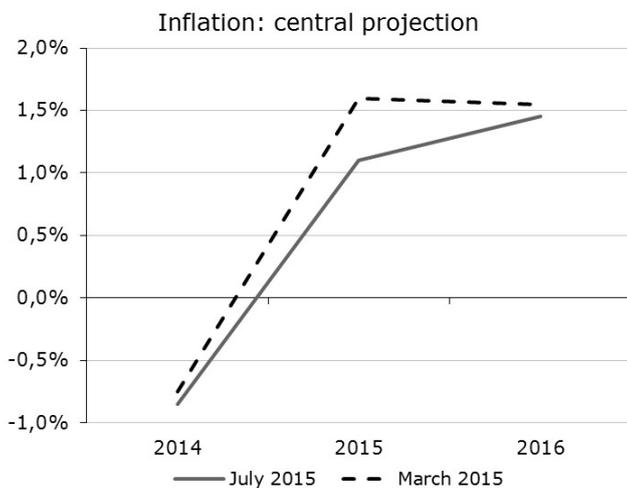
F - forecast

Economics

MPC: rates unchanged

Just as widely expected, Polish MPC did not change interest rates during November's meeting. The reference rate still equals 1.50%. Wording in the press release also did not change significantly. It still suggests that risks to inflation are balanced. On one hand, output gap is closing and, on the other hand, inflation (because of global factors) is consolidating on a low level. While reading the release, Governor Belka pointed out unsatisfactorily low growth in the Eurozone, which indicates how the macroeconomic environment is perceived by at least some MPC members. Just as we had expected, NBP lowered its inflation and GDP projections (see charts below).

ment, should support low interest rates and the new MPC would probably have this kind of bias. As a result, we expect rate cuts in 2016, the earliest in March (market already prices them). However, the biggest change of 2016 will be the use of other monetary policy measures to support fiscal policy targets (e.g. flattening of yield curve, lowering the share of foreign investors in public debt ownership). NBP would probably make use of Hungary's experiences.



We think that the MPC communication is complicated because of the upcoming end of its term as well as significant changes on the political scene. Governor Belka's comments came down to general statements about adequate policy mix in the future (monetary policy adjusted to expected fiscal easing). However, Belka doubts in inflation rebound and remains open to an adjustment of Polish monetary policy to trends in main central bank (Fed and ECB) policies. MPC member Chojna-Duch said outright that the new MPC will decide about interest rates in Poland.

In our opinion MPC statements have low predictive value. Macroeconomic environment, including the external environ-

Fixed income

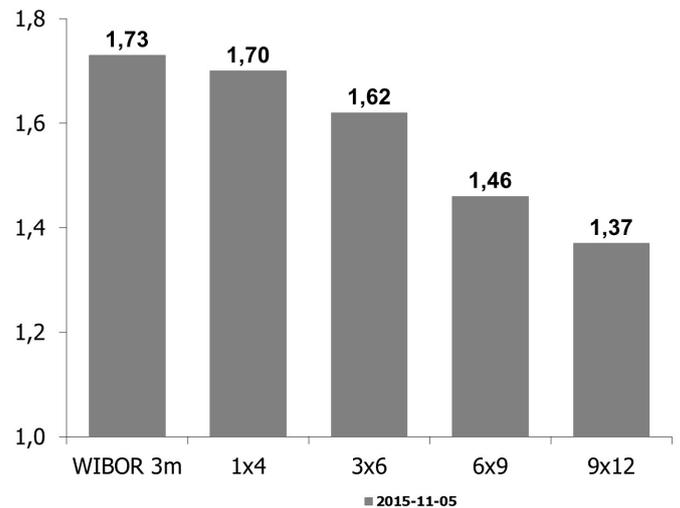
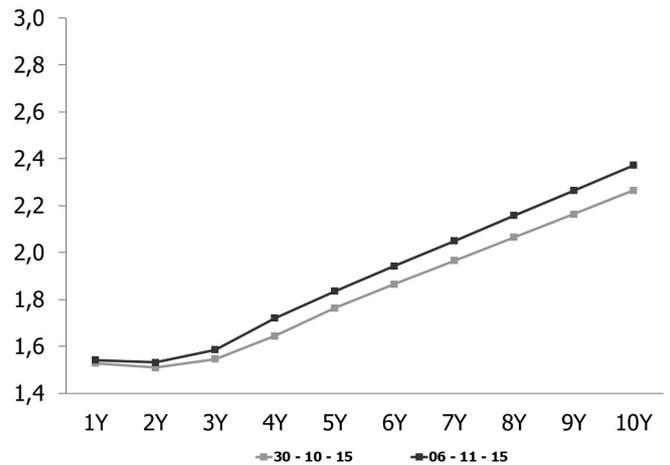
Hike in December

This week long end bonds were under permanent pressure (DS0725 2.85% vs. 2.65% last Friday; OK0717 1.60% vs. 1.56%) as story for December lift-off was fuelled by Janet Yellen, William Dudley and Stanley Fischer – all of them suggested that FED can raise rates at next month meeting. With data-dependent FOMC attitude payrolls data were decisive. Strong NFP outcome (268k vs. 169k forecast) and average hourly earnings +2.5% y/y vs +2.3% y/y forecast pushed yields higher – December hike is almost a done deal.

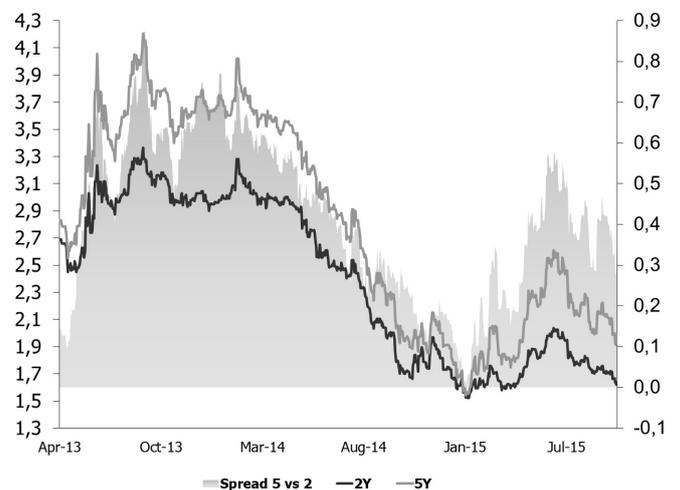
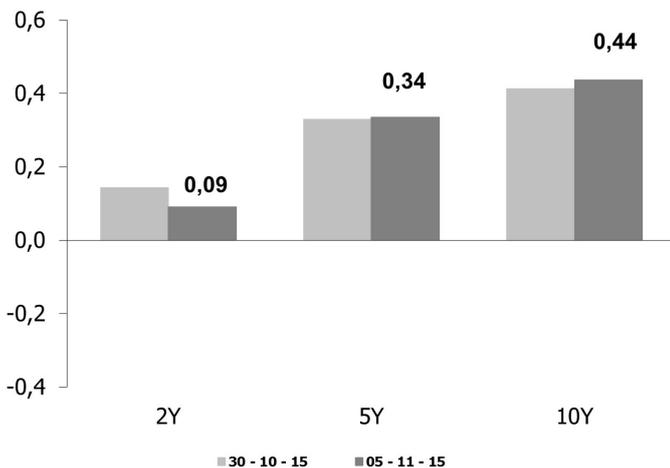
After Law and Justice victory in general elections all eyes are on the government composition and L&J program. As we mentioned in the previous report, fiscal loosening is a matter of time but one more thing is crucial for domestic fixed income market – details of the proposed financial transaction tax or banking tax. Implementation of the first one on the nominal basis can ruin market of short and medium term instruments (OIS, FRA, IRS, bonds). On the domestic side we had also flash CPI, which came a touch below market expectations (-0.8% y/y vs. -0.7% y/y) and MPC meeting (no change as expected).

We maintain our 2y10y steepener recommendation.

IRS curve



Asset swaps

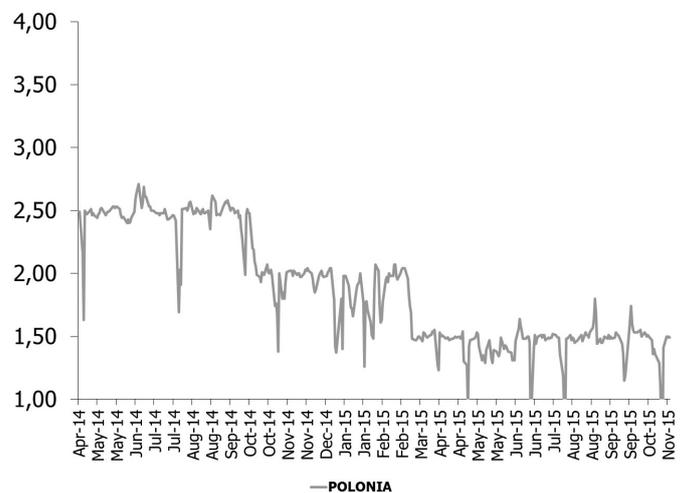
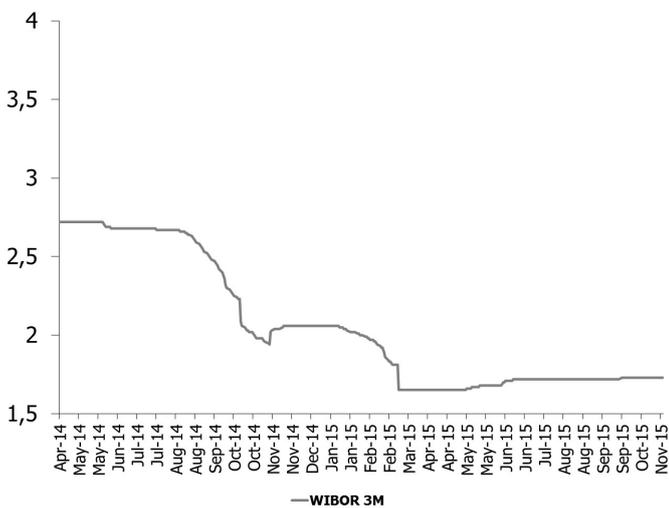
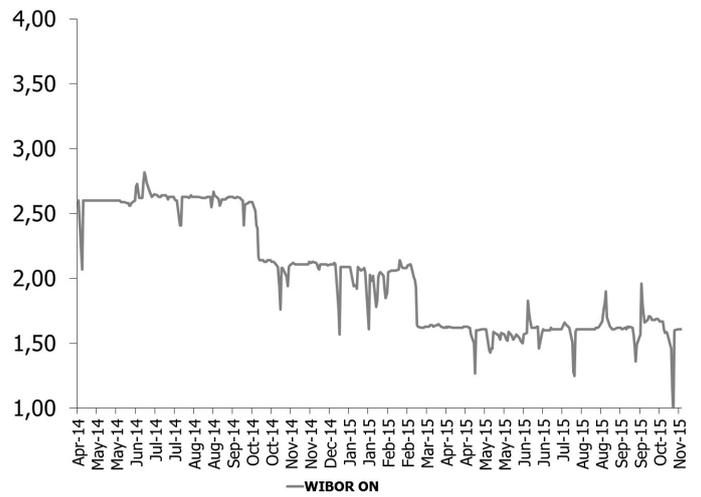
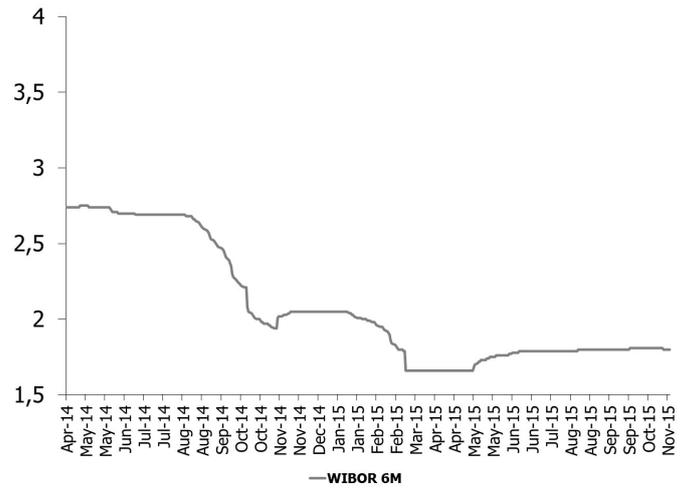




Money market

Stable week behind us

Beginning of the month stabilizes overnight rates while Polonia held steady around reference rate. To give some colour for the next week, banks bought 85 bio NBP Bills out of 91 bio offered. This should result in comfortable funding but we wouldn't expect big fall in funding cost comparing to last week.



Forex

PLN – Mixed performance PLN was moving in a tight range: 4.2230 - 4.2690 against EUR and 3.84-3.92 against USD. One may say, we were simply mirroring EUR/USD moves, with PLN factor being largely ignored for time being. The election has removed some political uncertainty, but we still need to wait and see what the first decisions of the freshly constituted government will be. Some of the projects, like financial transactions tax or presidential project of CHF denominated loans, are quite market shaking. Really strong NFP also does not support PLN. We still believe in the rangy nature of EUR/PLN, currently 4.22-4.32.

Options – Consolidation The vols market is trading sideways, with the bid for short term Gamma against USD (because of NFP). 1 month EUR/PLN ATM is this Friday 6.5% (0.1% higher), 3 months are 6.6% (0.1% higher) and finally 1 year 7.1% (0.1% higher). The USD/PLN vols are generally in demand, with currency spread (difference between USD/PLN vol and EUR/PLN vol) shooting higher by roughly 0.5% – 0.75%.

Short-term forecasts

Main supports / resistances:

EUR/PLN: 4.22 / 4.32

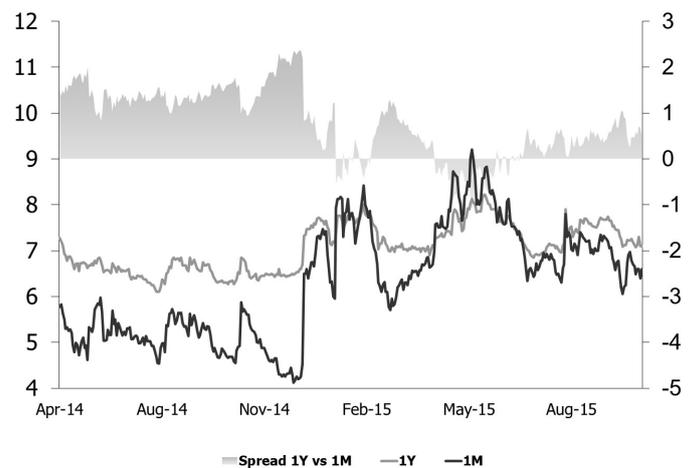
USD/PLN: 3.70 / 4.00

Position Spot – long EUR/PLN .

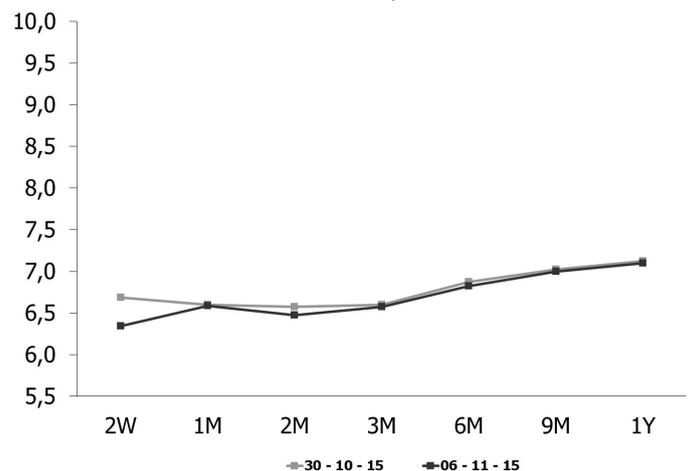
We have closed our short from 4.2900 with profit at 4.2400. We opened long EUR/PLN at 4.2400, and we are ready to add at 4.22 with a stop below 4.20 and hopes to revisit 4.28/4.2900. Our central scenario is still playing the rangy nature of EUR/PLN. Nevertheless, political risk is clearly looming on the horizon and that supports short PLN position.

Options – we are long 1 year Vega against 3 months (Vega neutral) We are of the opinion that party that have won the elections would act more prudent as they will be taking full responsibility for the country. Hence, that would temper some of its promises and Poland's generally healthy fundamentals will prevail. The looser fiscal conditions may influence us negatively in the future and that is the reason to be long 1 year ATM.

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
10/29/2015	1.62	1.73	1.70	1.71	1.73	1.73	1.71	1.65	1.47	1.36	1.36	1.46
11/2/2015	1.78	1.73	1.70	1.70	1.75	1.73	1.71	1.65	1.45	1.35	1.37	1.45
11/3/2015	1.78	1.73	1.70	1.70	1.75	1.73	1.69	1.64	1.46	1.35	1.36	1.44
11/4/2015	1.58	1.73	1.58	1.70	1.62	1.73	1.69	1.62	1.45	1.36	1.38	1.46
11/5/2015	1.78	1.73	1.69	1.70	1.71	1.73	1.70	1.62	1.46	1.37	1.39	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
10/29/2015	1.730	1.584	1.505	1.595	1.785	2.150	2.295	2.704
11/2/2015	1.730	1.583	1.513	1.647	1.800	2.115	2.310	2.716
11/3/2015	1.730	1.676	1.515	1.642	1.787	2.126	2.310	2.747
11/4/2015	1.730	1.585	1.518	1.603	1.797	2.165	2.325	2.793
11/5/2015	1.730	1.612	1.531	1.621	1.835	2.170	2.372	2.808

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
10/29/2015	6.49	6.60	6.84	7.08	7.08	1.93	0.50
11/2/2015	6.60	6.61	6.88	7.30	7.30	1.93	0.50
11/3/2015	6.40	6.55	6.85	7.10	7.10	1.92	0.50
11/4/2015	6.60	6.53	6.78	7.10	7.10	1.92	0.49
11/5/2015	6.59	6.58	6.83	7.10	7.10	1.91	0.50

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
10/29/2015	4.2732	3.8974	3.9364	3.2276	1.3740	0.1577
11/2/2015	4.2490	3.8590	3.9060	3.1998	1.3644	0.1568
11/3/2015	4.2495	3.8678	3.9126	3.2032	1.3551	0.1570
11/4/2015	4.2455	3.8876	3.9234	3.2050	1.3498	0.1568
11/5/2015	4.2306	3.8925	3.9062	3.1940	1.3462	0.1564

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