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Polish Weekly Review

Department of Economic Analysis (research)

Ernest Pytlarczyk, PhD, CFA
chief economist
tel. +48 22 829 01 66
ernest.pytlarczyk@mbank.pl

Marcin Mazurek, PhD
senior analyst
tel. +48 22 829 01 83
marcin.mazurek@mbank.pl

Piotr Bartkiewicz
analyst
tel. +48 22 526 70 34
piotr.bartkiewicz@mbank.pl

Marek Ignaszak
analyst
tel. +48 22 829 02 56
marek.ignaszak@mbank.pl

Department of Financial Markets (business contacts)

Bartłomiej Malocha, CFA
head of interest rates trading
tel. +48 22 829 01 77
bartlomiej.malocha@mbank.pl

Marcin Turkiewicz
head of fx trading
tel. +48 22 829 01 67
marcin.turkiewicz@mbank.pl

Department of Financial Markets Sales (business contacts)

Inga Gaszkowska-Gebska
institutional sales
tel. +48 22 829 01 67
inga.gaszkowska-gebska@mbank.pl

Jacek Jurczyński
structured products
tel. +48 22 829 15 16
jacek.jurczynski@mbank.pl

mBank S.A.
18 Senatorska St.
00-950 Warszawa
P. O. BOX 728
tel. +48 22 829 00 00
fax. +48 22 829 00 33
<http://www.mbank.pl>

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Comment on the upcoming data and forecasts

Heavyweight week. CPI Inflation starts the streak of data on Monday. We expect unchanged reading on still falling food prices; core inflation is set to record an uptick on wearing apparel and recreation and culture (we follow Czech Republic in these categories). Producer prices - to be announced on Wednesday - are going to make up some of recent losses on PLN depreciation. Current account is set to stay roughly unchanged and this applies also to underlying detailed accounts. We expect no significant change in wage growth in August, however, if confirmed, it does mean that recent solid upward trend in manufacturing may have been broken. Employment growth is set to moderately weaken since business tendency indicators are starting to level off. Last, but not least, growth in industrial output fell close to zero. However, given the very weak data on auto production in August (this section generated half of last month's growth) risks are clearly pointing towards negative reading.

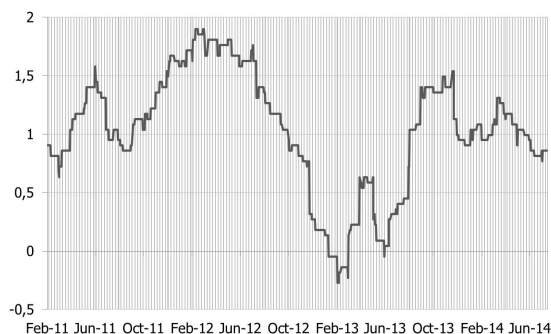
Polish data to watch: September 15th to September 19th

Publication	Date	Period	mBank	Consensus	Prior
CPI Inflation % y/y	15.09	Aug	-0.2	-0.3	-0.2
Core inflation % y/y	16.09	Aug	0.50	0.40	0.40
Current account (EUR mln)	15.09	Jul	-324.0	-512.0	-391.0
Wages % y/y	16.09	Aug	3.4	3.8	3.5
Employment % y/y	16.09	Aug	0.7	0.8	0.8
Industrial output % y/y	17.09	Aug	0.1	0.7	2.3
Producer prices % y/y	17.09	Aug	-1.5	-1.6	-2.0

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 OK0716	-	800	3.024	4/23/2014
5Y T-bond PS0719	-	5000	2.793	7/23/2014
10Y T-bond DS1025	-	2000	3.114	9/4/2014
20Y T-bond WS0429	-	150	3.464	5/16/2013

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



Comment

No releases = no change. We await next week's releases, including the FOMC decision, blushing.

* 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

- Polish economy is already in a soft patch. Although the recovery may not be ultimately derailed, we see important downside risks to a forecast of a more dynamic rebound going forward. In the nearest future we expect economists to cut their growth and inflation forecasts further which may stimulate expectations for monetary easing.
- Current business tendency indicators suggest that growth momentum softened and GDP growth is going to be lower in Q3 (3%). External environment (with German economy contracting in Q2) was not so great as well. Recession in Ukraine and Russia do not seem to exert any visible pressure on overall Polish exports for now (exports to the east contracts strongly, though) but Russia's food ban and possible escalation of trade war between EU and Russia suggest a downside risk for Polish exports.
- Final quarter is expected to bring more (positive) exogenous components to the Polish cycle. We may see first effects of credit easing in the euro area. Pension reform, along with the political cycle, opens room for fiscal stimulation. We expect significant fiscal stimulus from 2014/2015 onwards, focused mainly on public infrastructure spending and fueled by the re-launch of EU funding.
- 2-3 years of economic expansion are our baseline scenario but growth rates may prove to be more moderate than we expected few months ago.
- Inflation stays very low (negative) for the next few months. Momentum on inflation is already negative which strengthens the impact of high real interest rates.
- MPC got stuck in a fairly positive GDP growth scenario and is likely to overreact on embargo-related news flow and weaker data releases. We see MPC cutting rates in October by 25bps. We expect a whole easing cycle (around 100bps).

Financial markets

- Geopolitical risks still important for Polish bonds.
- Polish fundamentals, along with European factors - including zero inflation and downside risks to GDP, are more than ever supportive to lower rates across the board.
- Geopolitical risks, increased volatility, ECB easing fatigue and possibility of incoming downward revisions for Polish growth are going to weigh negatively on the zloty. In such circumstances expectation of further easing may do more harm than good to Polish currency. Zloty is set to stay weaker.

mBank forecasts

	2010	2011	2012	2013	2014F	2015F
GDP y/y (%)	3.9	4.5	2.0	1.6	3.0	3.4
CPI Inflation y/y (average %)	2.8	4.3	3.7	0.9	0.2	1.2
Current account (%GDP)	-4.5	-4.9	-3.5	-1.3	-0.9	-1.8
Unemployment rate (end of period %)	12.4	12.5	13.4	13.4	12.2	12.0
Repo rate (end of period %)	3.50	4.50	4.25	2.50	1.75	1.75

	2014	2014	2014	2014	2015	2015	2015	2015
	Q1	Q2	Q3 F	Q4 F	Q1F	Q2F	Q3 F	Q4 F
GDP y/y (%)	3.4	3.3	2.9	3.0	3.0	3.2	3.5	4.0
Individual consumption y/y (%)	2.6	2.8	2.4	1.9	2.1	2.1	2.2	2.2
Public Consumption y/y (%)	0.7	0.8	2.0	2.4	3.0	3.0	3.5	3.5
Investment y/y (%)	10.7	8.4	6.3	7.0	7.0	8.0	9.0	9.0
Inflation rate (% average)	0.6	0.2	-0.2	0.4	0.8	1.2	1.4	1.2
Unemployment rate (% eop)	13.9	12.0	11.5	12.2	13.1	11.8	11.3	12.2
NBP repo rate (% eop)	2.50	2.50	2.50	1.75	1.75	1.75	1.75	1.75
Wibor 3M (% eop)	2.71	2.68	2.48	1.97	1.97	1.97	1.97	1.97
2Y Polish bond yields (% eop)	3.01	2.51	2.00	1.90	1.95	2.10	2.20	2.50
10Y Polish bond yields (% eop)	4.23	3.45	2.80	2.80	3.00	3.30	3.40	3.60
EUR/PLN (eop)	4.17	4.16	4.20	4.10	4.10	4.10	4.05	4.00
USD/PLN (eop)	3.03	3.04	3.28	3.23	3.25	3.24	3.21	3.20

F - forecast



Economics

Coming week is going to be exciting

CPI Inflation starts the streak of data on Monday. We expect unchanged reading on still falling food prices; core inflation is set to record an uptick on wearing apparel and recreation and culture (we follow Czech Republic in these categories). Producer prices - to be announced on Wednesday – are going to make up some of recent losses on PLN depreciation. Current account is set to stay roughly unchanged and this applies also to underlying detailed accounts.

We expect no significant change in wage growth in August, however, if confirmed, it does mean that recent solid upward trend in manufacturing may have been broken. Employment growth is set to moderately weaken since business tendency indicators are starting to level off. Last, but not least, growth in industrial output fell close to zero. However, given the very weak data on auto production in August (this section generated half of last month's growth) risks are clearly pointing towards negative reading.

The upcoming data flow for Poland is going to corroborate the weakness in real sphere and the subdued inflation. No avalanche, though. We feel that in such circumstances, and after announcing a correction, the MPC is going to start cutting rates by 25bps in October. We expect the whole cycle of cuts and at this very moment we do not want to bet on when the cycle is going to end; we feel 100bp is a good starting point. All the data for Polish economy are published until Wednesday. The same day, in the evening, Janet Yellen & the Fed enter the stage. Given the set of likely outcomes, we think this event risk is not going to change our strategic views.

Fixed income

Fed-driven market

Within the lack of domestic incentives, the Polish FI market activity last week was strictly driven by the global sentiment. The main driver that determined the rapid pullback of the yield curves in the region was the San Francisco Fed branch analysts' report that suggested the markets seemed to stay far below the anticipated path of future interest rates in US and did significantly undervalue the pace and a scale of the future monetary policy assumptions. After having touched the new local lows in yields on Monday (10y benchmark at 2.95%) the domestic treasury bonds started to trade under the massive downside pressure on Tuesday morning yielding 3.20% within next two days. As the market still believed the Polish MPC would be able to lower the main interest rate by at least 50-75bp within the next few months

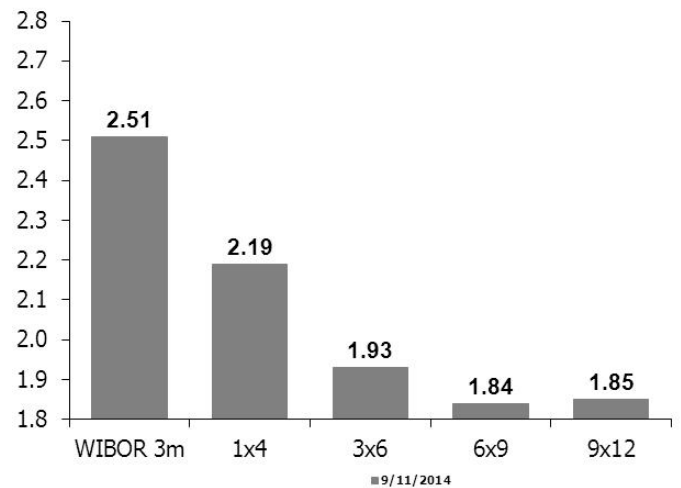
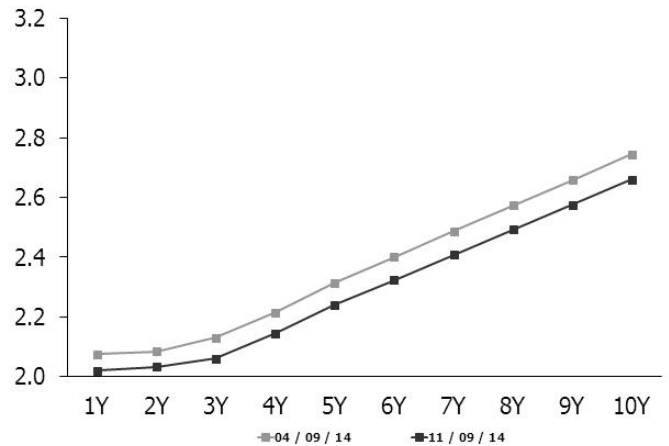
(a monetary adjustment clearly announced and justified) the yield curve steepened by 10-12 points without any action in a short end sector.

We expect quite hectic and volatile market next week within a few quite important incentives.

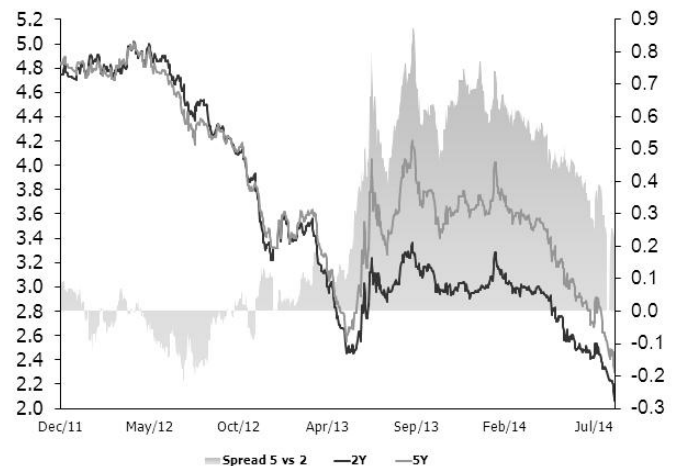
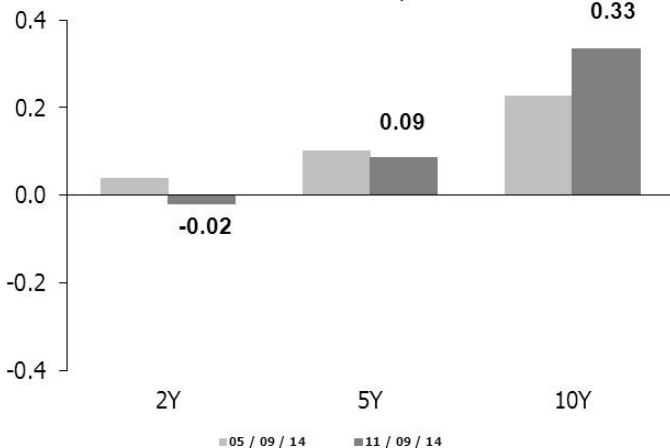
The PLN interest rate players would be very pleased in having both CPI and industrial output data more negative than the analysts' consensus (that's our base assumptions) that might even lead to 50bp cut in the next MPC meeting and could justify what forward rates price at the moment or even push them lower occasionally. On the other hand the Wednesday's Fed meeting would likely speak towards justifying the San Francisco report and could emerge as a major risk into further steepening of a yield curves along the world and lead towards significant weakening of local currencies.

We have no intention to bet on the Fed release although the risk-reward profile on PLN curve and the scale of future policy easing already priced in a yield curve (historic lows) makes the bet dramatically asymmetric.

IRS curve



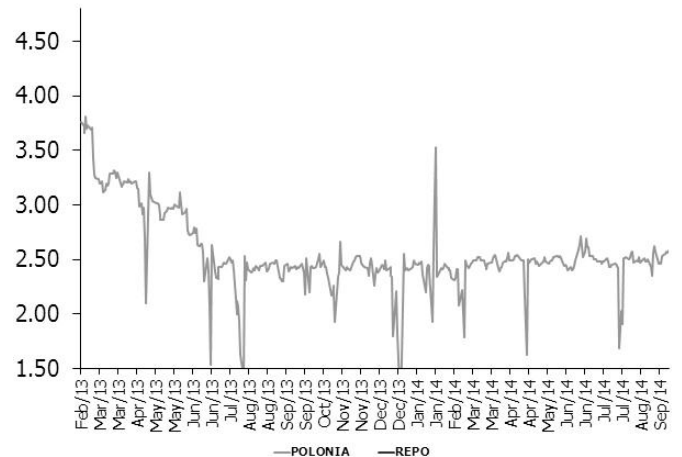
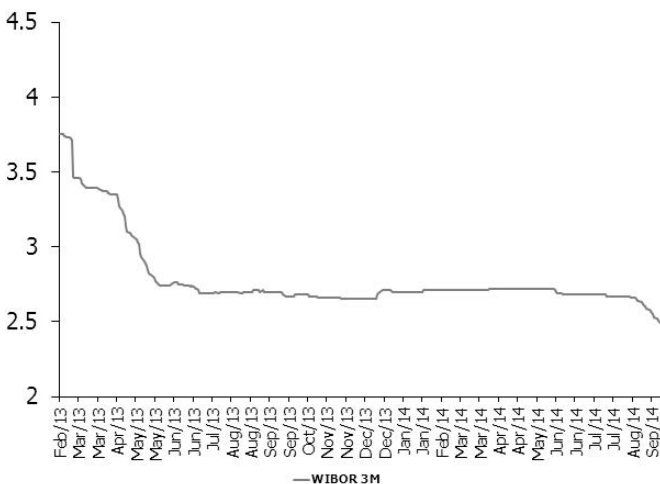
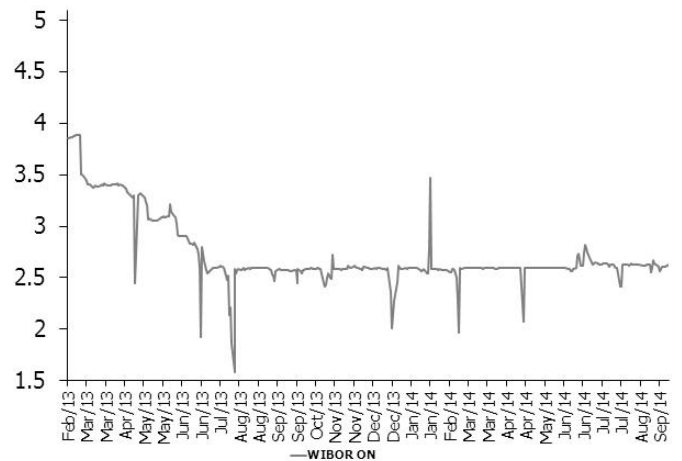
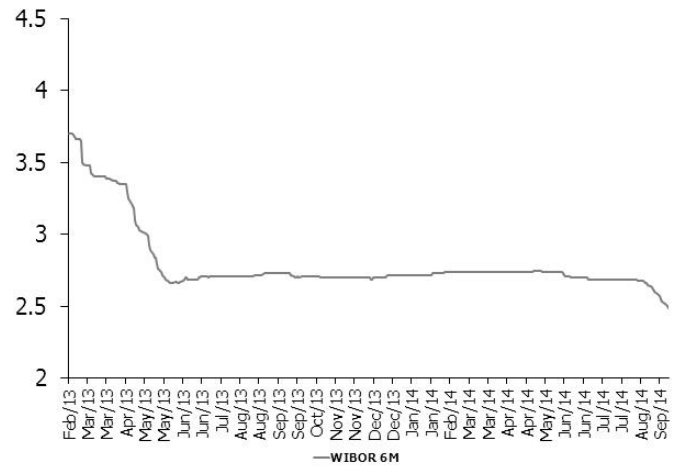
Asset swaps



Money market

Expensive week behind us. The next set to be cheaper. As we expected last week was expensive. Polonia fluctuated 6 bps above reference rate. Next week should be a bit cheaper as banks bought a bit less than it will square the market.

We can see some value in short term OIS. As 1M OIS passes through MPC meeting and last week of reserve, we recommend selling it at 2.37-2.39. WIBOR's are still falling and they will probably reach 2.30 before MPC meeting and potential rate cut.



Forex

Fed rate hike looming The fears of the faster than expected rate hike path by Fed, were the main reason behind PLN losses this week. EUR/PLN shot from 4.1765 to 4.2170 before retracing back below 4.20 and consolidated in 4.1875/4.2010 region. The more hawkish Fed is likely, but it should not be a huge surprise to the market anymore. EUR/PLN is still in range 4.17/4.22, as there are reasons for both directions. For the choice, we think that calmer market will support PLN as it is natural gravity.

Vols – choppy The vols went higher with PLN loses, but with spot below 4.20 they began to melt again. In EUR /PLN curve everything is roughly unchanged, 1 month EUR/PLN ATM mid is today 5.25% (0.15 higher than a week ago), 3 months 5.6% (unchanged), 1 year 6.7% (unchanged). The real winner is a USD/PLN curve with a currency spread (difference between USD/PLN and EUR/PLN vol) widened by 0.25%-0.45%. Skew was roughly unchanged.

Short – term forecasts

SPOT Main supports / resistances:

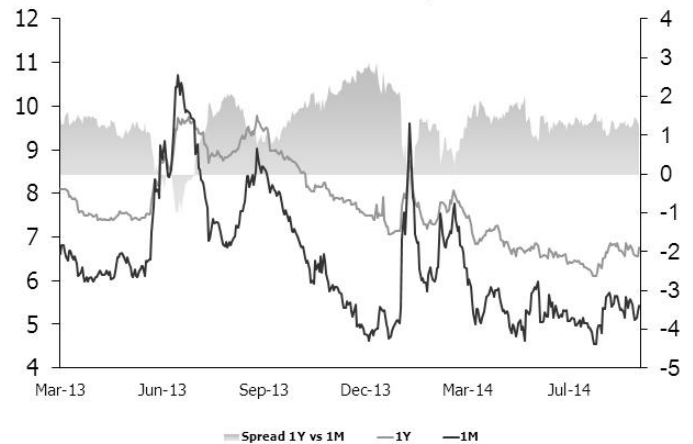
EUR/PLN: 4.16 / 4.25

USD/PLN: 3.15 / 3.30

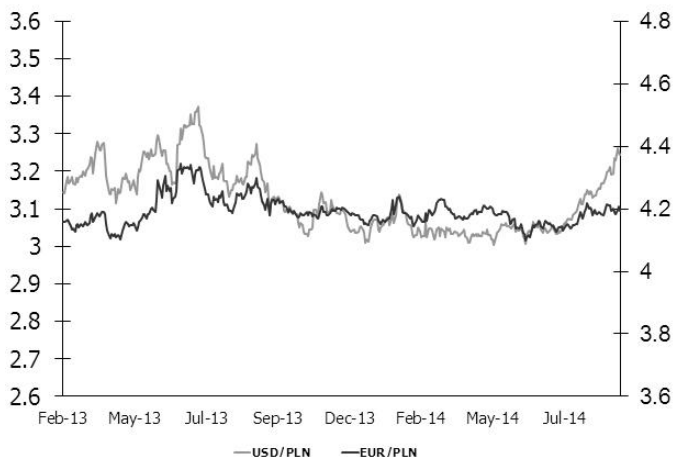
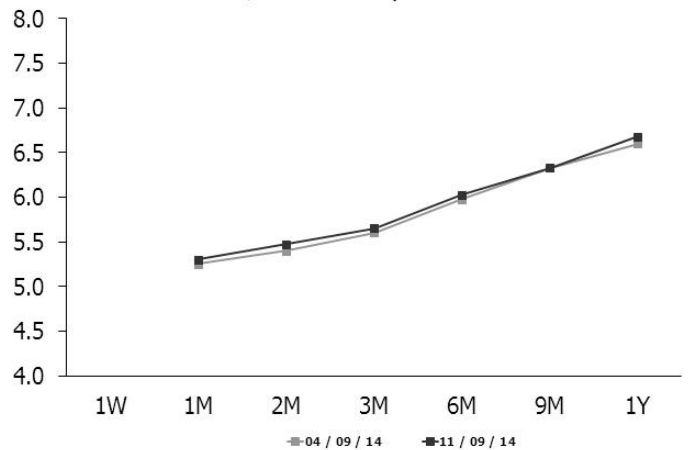
Spot – still short EURPLN We are now average short 4.2025, stop loss 4.2300 and profit taking at 4.1500. The logic is simple: we hope that geopolitical tension in Ukraine already has picked, ECB is a real deal, firmly on truck to deliver more loose policy.

Options – reduced long Unchanged. The disappointing realized volatility made us trim our position by half. We still core Vega in EUR/PLN, but we have to admit the trade lost some of it shine. The EUR/PLN curve is still close to multiyear lows, but it may as well stay here for a longer while.

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
9/5/2014	2.59	2.53	2.58	2.43	2.43	2.42	2.35	1.97	1.86	1.86	1.88	1.86
9/8/2014	2.45	2.52	2.25	2.42	2.28	2.41	2.34	1.93	1.82	1.82	1.84	1.82
9/9/2014	2.41	2.51	2.41	2.41	2.40	2.40	2.19	1.95	1.85	1.85	1.89	1.85
9/10/2014	2.31	2.50	2.14	2.40	2.19	2.39	2.20	1.98	1.87	1.87	1.91	1.89
9/11/2014	2.52	2.49	2.52	2.39	2.38	2.38	2.19	1.93	1.84	1.85	1.90	1.85

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
9/5/2014	2.420	2.049	2.068	2.105	2.295	2.396	2.720	2.947
9/8/2014	2.410	2.115	2.033	2.018	2.240	2.327	2.660	2.839
9/9/2014	2.400	2.061	2.078	2.049	2.350	2.477	2.800	2.996
9/10/2014	2.390	2.012	2.088	2.052	2.360	2.437	2.810	2.991
9/11/2014	2.380	2.018	2.080	2.061	2.370	2.455	2.795	3.128

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1Y	1Y
9/5/2014	5.10	5.53	5.90	6.58	6.58	2.27	0.64	0.64
9/8/2014	5.15	5.50	5.93	6.55	6.55	2.27	0.64	0.64
9/9/2014	5.30	5.58	5.98	6.55	6.55	2.25	0.66	0.66
9/10/2014	5.43	5.75	6.10	6.75	6.75	2.29	0.64	0.64
9/11/2014	5.30	5.65	6.03	6.68	6.68	2.19	0.62	0.62

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
9/5/2014	4.1908	3.2354	3.4748	3.0742	1.3367	0.1518
9/8/2014	4.1824	3.2303	3.4677	3.0729	1.3317	0.1513
9/9/2014	4.1978	3.2605	3.4813	3.0667	1.3266	0.1518
9/10/2014	4.2070	3.2508	3.4825	3.0452	1.3289	0.1517
9/11/2014	4.1935	3.2435	3.4666	3.0320	1.3326	0.1518

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