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# Polish Weekly Review

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## Comment on the upcoming data and forecasts

On Monday the CSO will upgrade GDP data to ESA 2010 methodology. Revisions to GDP growth should not, however, be significant, as the Office already indicated in a press release. On Tuesday, the NBP will publish the results of its monthly survey of household inflation expectations - another drop, following CPI, is expected. On the same day, quarterly balance of payments data will be released, possibly revising monthly figures published earlier. The most important macro release in the coming week is the PMI (Wednesday). After material drops in German business sentiment indices in September, one should expect further worsening of sentiment in Poland as well. We envisage a somewhat larger decline than the market consensus.

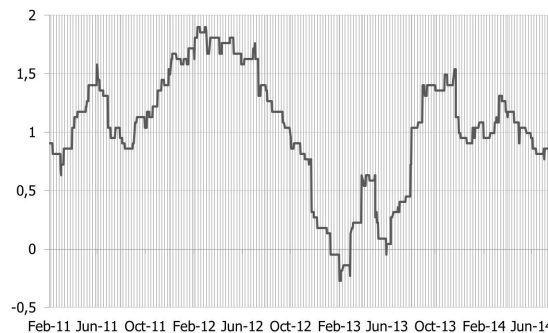
## Polish data to watch: September 29th to October 3rd

Publication	Date	Period	mBank	Consensus	Prior
GDP revision (ESA 2010)	29.09				
NBP inflation expectations (%)	30.09	Sep	0.1	0.1	0.2
Current account balance (mio EUR)	30.09	Q2	650	650	-766
Manufacturing PMI (pts.)	01.10	Sep	48.4	48.8	49.0

## 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

Slightly up, as unemployment rate surprised to the upside. The index seems to be consolidating. Next week brings only one release with the potential to surprise - Manufacturing PMI.

\* 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 H2 (below 2.5%). 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.
- 2015 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

- Our strategic view on Polish bonds is unchanged. Polish fundamentals, along with European factors - including zero inflation, monetary easing and downside risks to GDP (and the fact that Polish economic cycles are becoming more synchronized with European ones), are more than ever supportive to lower rates across the board.
- There is scope for short-term upward corrections to Polish yields. The most likely trigger is an increase in global volatility, centered around EMs.
- 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	3.5
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	1.50

	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	2.5	2.3	2.1	3.1	3.7	4.6
Individual consumption y/y (%)	2.6	2.8	2.4	2.1	1.8	1.8	2.0	2.4
Public Consumption y/y (%)	0.7	0.8	2.0	2.4	3.0	3.0	4.0	4.0
Investment y/y (%)	10.7	8.4	6.4	5.0	4.0	7.5	9.0	11.0
Inflation rate (% average)	0.6	0.2	-0.2	0.3	0.4	0.9	1.2	1.0
Unemployment rate (% eop)	13.9	12.0	11.5	12.4	13.1	11.8	11.3	12.0
NBP repo rate (% eop)	2.50	2.50	2.50	1.75	1.50	1.50	1.50	1.50
Wibor 3M (% eop)	2.71	2.68	2.48	1.97	1.72	1.72	1.72	1.72
2Y Polish bond yields (% eop)	3.01	2.51	1.90	1.80	1.95	2.10	2.20	2.20
10Y Polish bond yields (% eop)	4.23	3.45	3.00	2.80	3.00	3.30	3.40	3.60
EUR/PLN (eop)	4.17	4.16	4.20	4.15	4.10	4.05	4.00	4.00
USD/PLN (eop)	3.03	3.04	3.31	3.32	3.28	3.29	3.33	3.33

F - forecast

## Economics

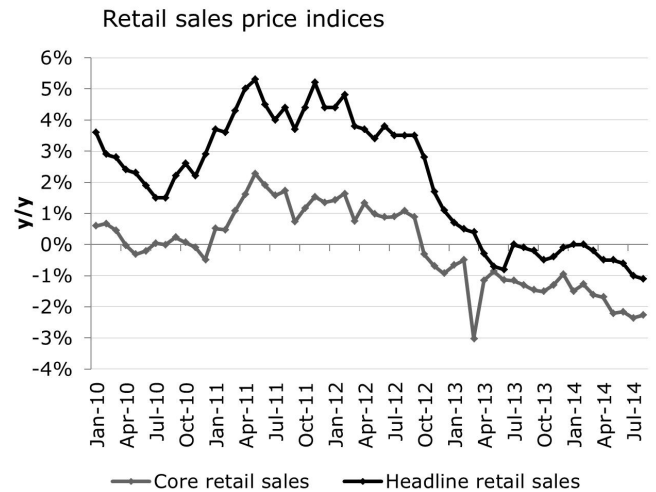
### Retail sales growth stabilizes at low level.

Retail sales hit market consensus in August and was higher than our forecast (0.0%). At 1.7%, however, the reading is still a tad below the previous month when 2.1% growth was recorded. Two facts are worth mentioning: 1) This time lower reading on industrial output was not correlated with retail sales (the odds for such an outcome are worse than a flip of a coin; maybe the structure of manufacturing is the clue: large drag on industrial output was generated by auto sales); 2) we were too pessimistic with regard to retail categories with high volatility (auto sales, home appliances, wearing apparel). Our favorite retail indices with several exclusions (see the graph) stabilized, although at low growth levels.



Real disposable income growth is flattening, high real interest rates encourage to save and uncertainty regarding the future situation dampens spending plans. All this speaks in favor of a flatter consumption growth path and retail data confirm this view. We do not envisage sharp drops, although a growth rates closer to 2% are set to be achieved at the turn of the year when worse sentiment is going to be backed by unfavorable statistical base effects. We stress that this slowdown is not peculiar with regard to the so called stylized facts: consumption is going to stay the pillar of growth and volatility is going to be caused by investment activity and exports.

Retail sales deflator stayed deep in the negative territory (headline at -1.1% and core one at -2.2%). It is worth to note that - maybe for the first time ever - MPC took notice of this fact in the „Minutes”. We think the message is clear: deflationary forces are still deeply rooted in the economy and there is no turnaround in sight.



The data is MPC neutral. Recent speeches and interviews of various rates-setters suggest the October cut is treated as a done deal. Therefore a more interesting bet is on the depth and scale of the cycle (it is still an issue without consensus among MPC members but recent comments from Bratkowski indicate that our scenario might be more likely than most analysts suppose) since with current momentum MPC is going to have hard time to pick a target and the end date of easing. We see a start with 25bps and the cycle of 100bps.

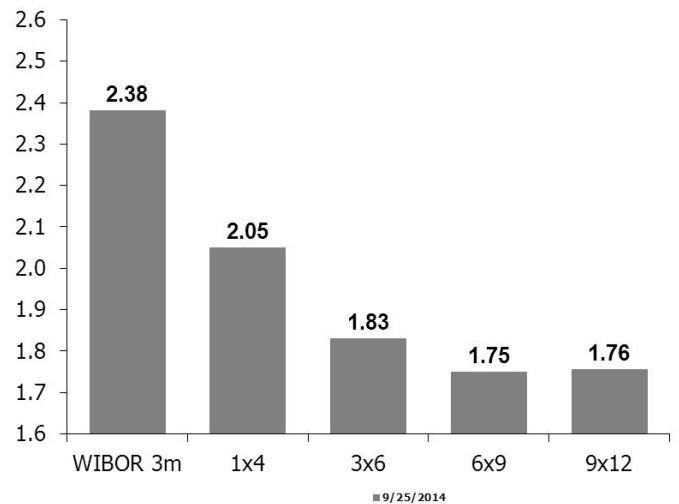
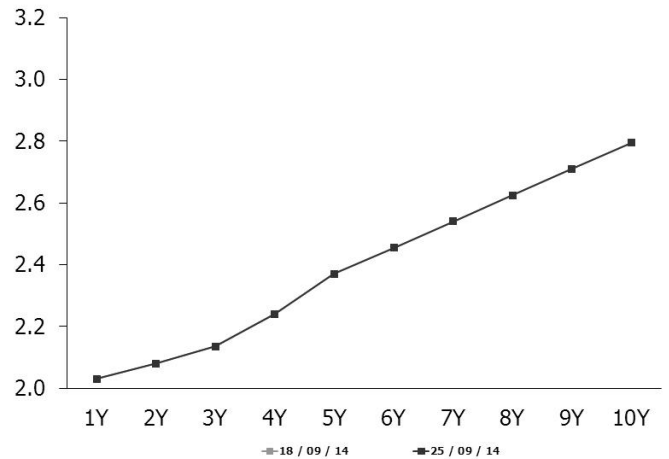
## Fixed income

### The Test

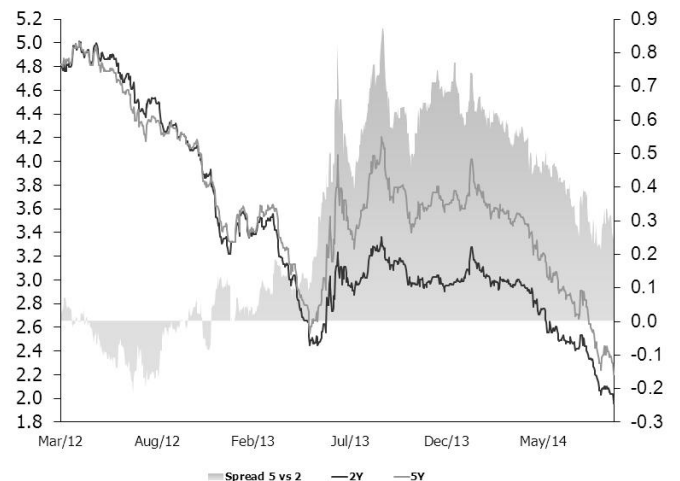
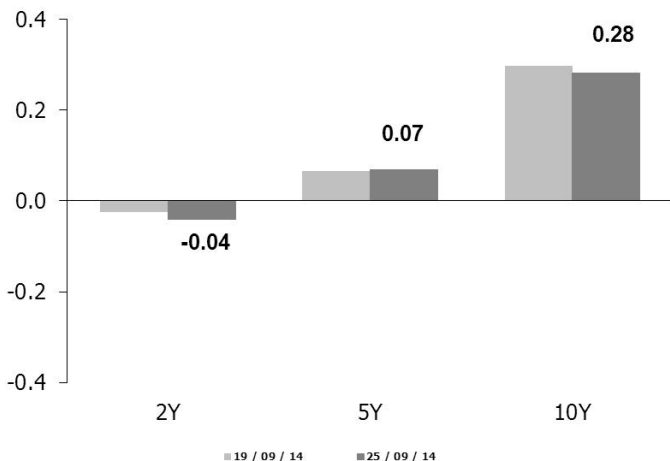
This week on Fixed Income market we have witnessed another impressive bond rally. Main reasons were positive sentiment from core markets, dovish statements from MPC members (Bratkowski mentioned that rate cut cycle could reach 1% in repo rate) and lack of bond supply.

We reached new lowest levels in bond yields and we feel that next auction (held on 2nd October) is going to be an interesting test. Most of this year's rally was caused by foreign investors, but now when rally on bund/treasuries is over, they might refuse to bid Polgbs. Low demand on this auction (if it is going to be the case) can mean the end of this year's bullish trend, just before the beginning of a rate cut cycle.

IRS curve



Asset swaps

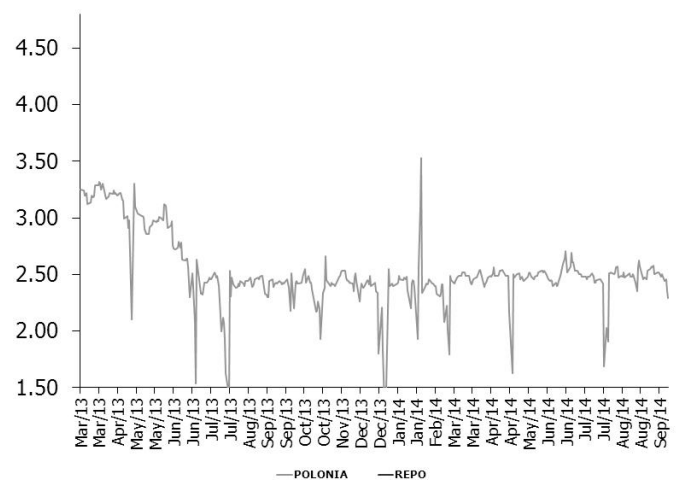
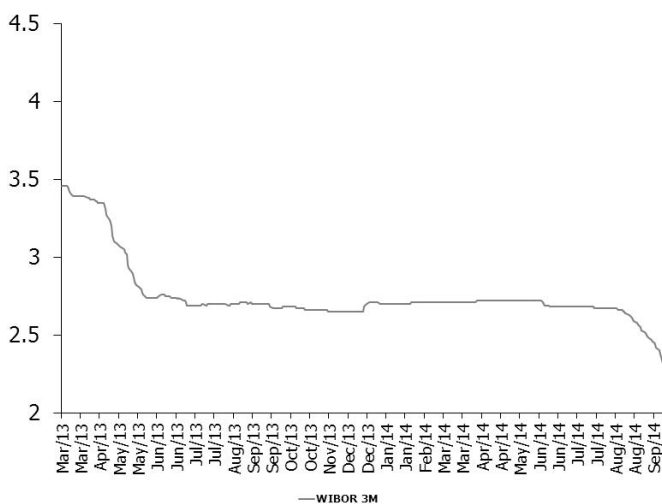
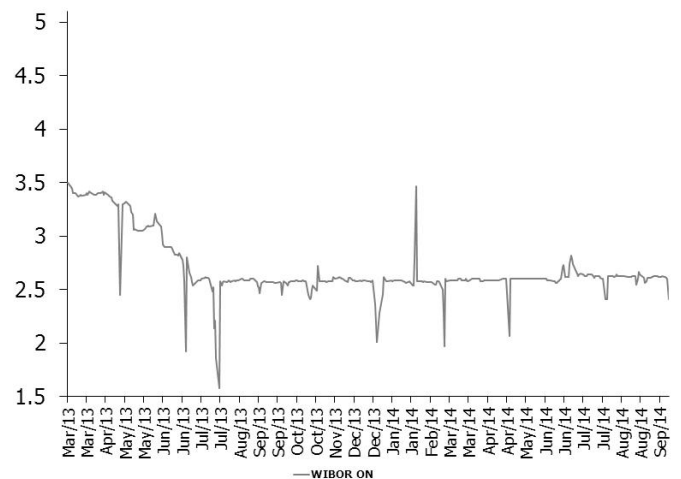
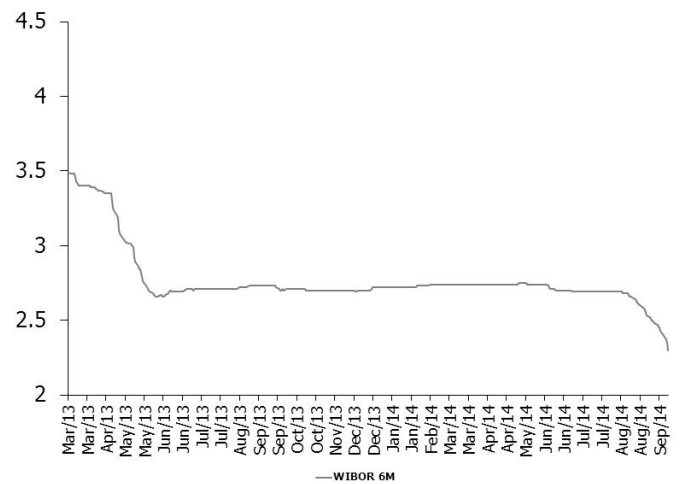


## Money market

**Cheap week behind us.** POLONIA fell to 2.29% on Thursday as banks underbid last OMO. At today's one NBP offered 4 bn PLN bills less than it would square the market. Today POLONIA will fix probably under 2% as there's a huge surplus of cash and Monday is last day of reserve. First week of new reserve should be stable with cash around 2.50%.

2W OIS passes weekend after potential rate cut (25 or 50 bps?) so be cautious with quotation.

1Y OIS discounting nearly 100 bps rate cut in near future.



## Forex

**PLN bit stronger** It was a really uneventful week, with PLN slightly stronger, but still in a well-defined tight 4.16/4.21 range for EUR/PLN. The EUR/PLN is between the rock and the hard place, on one hand ECB printing press and on the other: the MPC will start its easing cycle already in October, and USD is continuing its march higher. The range is still the most likely scenario, with wider range of 4.14/4.24 containing the EUR/PLN moves in the weeks to come. Long USD/PLN is an interesting substitute to short EUR/USD (offers bit of protection if EUR/USD squeezes on risk aversion).

**Vols – sell-off continues** There is not much more downside in the short term curve, it is already so low (ECB meeting and NFP looming on the horizon). As the result, the sell-off continues for the longer end of the curve. EUR/PLN 1 month ATM ended the week unchanged at 4.7%, 3 months are 5.0% (0.2% lower than last Friday) and 1 year fixed at 6.25% (0.15% lower). Skew was roughly unchanged, and currency spread (difference between USD/PLN vol and EUR/PLN vol) was slightly better offered.

### Short – term forecasts

SPOT Main supports / resistances:

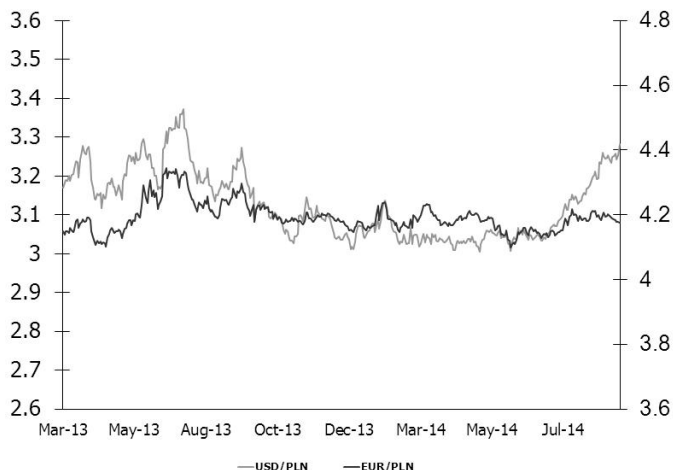
EUR/PLN: 4.16 / 4.21

USD/PLN: 3.18 / 3.32

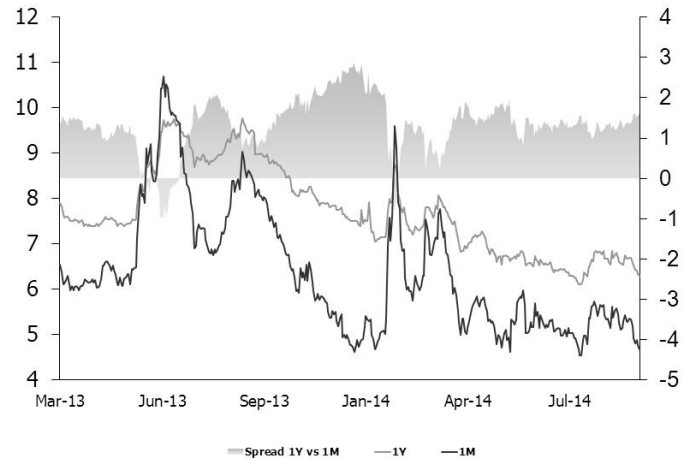
### Spot – short from 4.2025 reversed to long at 4.1700.

The market is so slow and the range is getting tighter and tighter. That was the reason why we have taken profit earlier than planned. Now long, ready to add 4.1550 with stop at 4.1425. We are hoping for a move higher to 4.20+ , but realistically we are not expecting much.

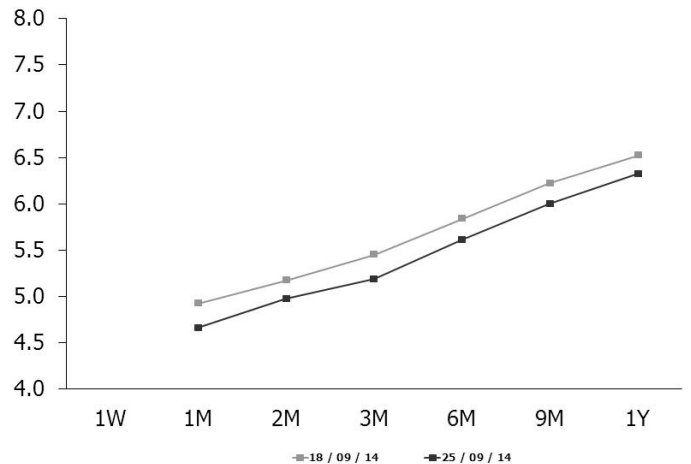
**Options – switched to longer end.** Still core tiny long in the long end. But the general impression is similar to spot performance, one should not expect much. The range for 1 month EUR/PLN ATM is 4.5% - 6.0%, for 1 year EUR/PLN ATM is 6.2% - 6.8%, and this is hardly enough room to play it. One should be trading as the marker, being given at the lows and taken at the highs, to monetize this range. Still skewed to the view that normalization of US interest rates will bring volatility back.



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
9/19/2014	2.28	2.42	2.16	2.31	2.22	2.29	2.13	1.91	1.84	1.84	1.89	1.84
9/22/2014	2.31	2.40	2.18	2.29	2.22	2.27	2.11	1.91	1.84	1.84	1.89	1.85
9/23/2014	2.29	2.38	2.16	2.27	2.21	2.25	2.12	1.92	1.83	1.83	1.88	1.85
9/24/2014	2.05	2.36	1.95	2.25	2.03	2.23	2.06	1.84	1.74	1.75	1.78	1.74
9/25/2014	2.24	2.32	2.15	2.20	2.11	2.18	2.05	1.83	1.75	1.76	1.80	1.74

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
9/19/2014	2.290	2.019	2.040	2.016	2.355	2.420	2.875	3.171
9/22/2014	2.270	1.942	2.040	2.027	2.305	2.376	2.805	3.088
9/23/2014	2.250	2.004	2.038	2.000	2.300	2.390	2.795	3.073
9/24/2014	2.230	1.971	1.975	1.963	2.210	2.329	2.715	2.991
9/25/2014	2.180	1.940	1.960	1.919	2.205	2.274	2.710	2.991

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1Y	1Y
9/19/2014	4.80	5.33	5.70	6.43	6.43	2.25	0.61	
9/22/2014	4.88	5.25	5.70	6.40	6.40	2.25	0.61	
9/23/2014	4.78	5.19	5.63	6.33	6.33	2.26	0.62	
9/24/2014	4.68	5.19	5.63	6.30	6.30	2.26	0.62	
9/25/2014	4.66	5.19	5.61	6.33	6.33	2.25	0.61	

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
9/19/2014	4.1860	3.2507	3.4682	2.9861	1.3451	0.1519
9/22/2014	4.1845	3.2570	3.4650	2.9867	1.3409	0.1520
9/23/2014	4.1775	3.2430	3.4606	2.9919	1.3450	0.1518
9/24/2014	4.1785	3.2525	3.4599	2.9954	1.3464	0.1519
9/25/2014	4.1757	3.2823	3.4577	3.0038	1.3460	0.1518

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