

October 31, 2014

## Polish Weekly Review

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### Comment on the upcoming data and forecasts

Monday is going to greet us with the fresh PMI reading. We expect more or less flattish reading but above 50 threshold. At first glance, subtle growth seems contradictory to the readings of ESI and local business tendency surveys that presented a real pop in assesment. However, those indicators are usually a lagged representation of PMI. Trend in business activity is at most flat, if not still falling. Two days after MPC is deciding on rates. We think a 50bps cut and a series of fast 25pbs is equally likely (see our comment on the next page). What is important, Belka is not going to point to an end of the cycle since he would like to have a gateway for further easing should economy ails more than currently expected.

### Polish data to watch: November 3rd to November 7th

Publication	Date	Period	mBank	Consensus	Prior
PMI	3.11	Oct	50.1	50.0	49.5
MPC decision	5.11	Nov	1.50	1.75	2.00

### 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	-	2000	1.653	10/23/2014
5Y T-bond PS0719	-	3000	2.007	10/23/2014
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 surprises. We are waiting for PMI readings at the beginning of the next week.

\* 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 post-2013 recovery may not be ultimately derailed, we see important downside risks in coming quarters. In the nearest future we expect economists to cut their growth and inflation forecasts further what may further propel 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 of inflation is already negative and strengthens the impact of high real interest rates.
- MPC drifts towards low inflation, low growth scenario. We see MPC continuing easing cycle, reaching at least 100bps of cuts.

### 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 triggers is an increase in global volatility, centered around EMs. Impatience of the markets regarding ECB's QE announcement may also trigger local bursts of credit risk repricing (contagion from EZ peripherals to Poland), especially if global economy does not pick up (downside growth and inflation surprises across the board).
- EURPLN under counter-balancing forces: expectations for ECB easing and lower rates in Poland amid slowing growth. Zloty is set to stay weaker around 4.20.

### 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	1.50	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	-0.4	0.0	0.4	0.9	1.2	1.2
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	1.50	1.50	1.50	1.50	1.50
Wibor 3M (% eop)	2.71	2.68	2.28	1.60	1.64	1.66	1.70	1.70
2Y Polish bond yields (% eop)	3.01	2.51	2.00	1.53	1.59	1.69	1.81	1.94
10Y Polish bond yields (% eop)	4.23	3.45	3.05	2.53	2.59	2.69	2.81	2.94
EUR/PLN (eop)	4.17	4.16	4.18	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

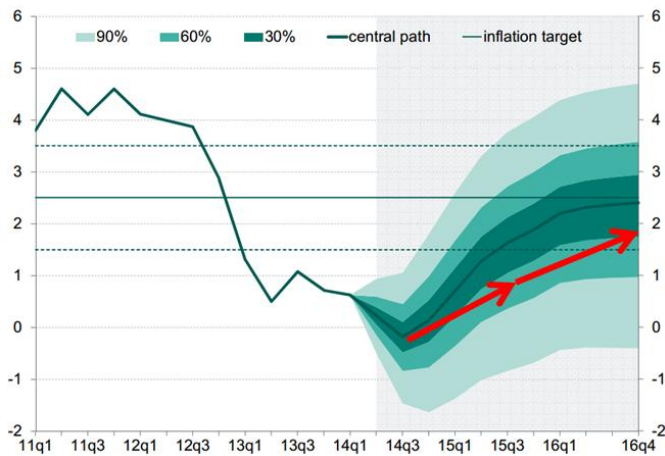
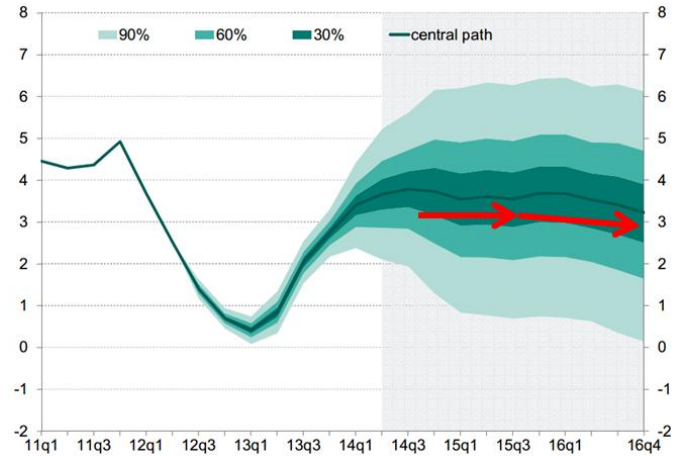
F - forecast

## Economics

### Waiting for MPC: 50 or 2x25 as equally viable

November is going to be another month with monetary easing in Poland. We see equal probabilities for a scenario of 50bp cut and two consecutive 25bp steps. Both scenarios fall under the condition of a „dense” rate cuts delivery although the former is more interesting e.g. from the economic/political point of view (nothing to be ashamed of, every central bank does it now). What is most important, governor Belka is unlikely to point to the end of the cycle in both scenarios, securing a gateway for further easing should growth disappoints more in the future.

Fresh inflation projection sees the light at November’s meeting. We regard it as a considerable support for monetary easing. We await lower inflation projection (no return to target in monetary policy horizon) and lower growth (structural pessimism over GDP growth becomes deeply rooted in NBP; central bank seems also a bit pessimistic regarding the upswing in 2015 and the prospects of launching big time infrastructure outlays).



Just before the MPC decision, PMI reading is set to see the light - we expect more or less flattish reading, falling far from the optimism conveyed by the business tendency indicators. As soon as the uncertainty over MPC decision fades, we enter a new period of macro publications. They are unlikely to change cyclical picture (almost flat reading in y/y terms). On the other hand, we are likely to see a fresh inflation low accompanied by a substantial fall of core inflation. However, we do not think that expectations for MPC are going to go beyond 1.50% at the moment - we are simply closer and closer to the end of this round of easing. To embark on a new easing episode we see sharp deterioration in real sphere data which we simply do not see (or forecast) right now.

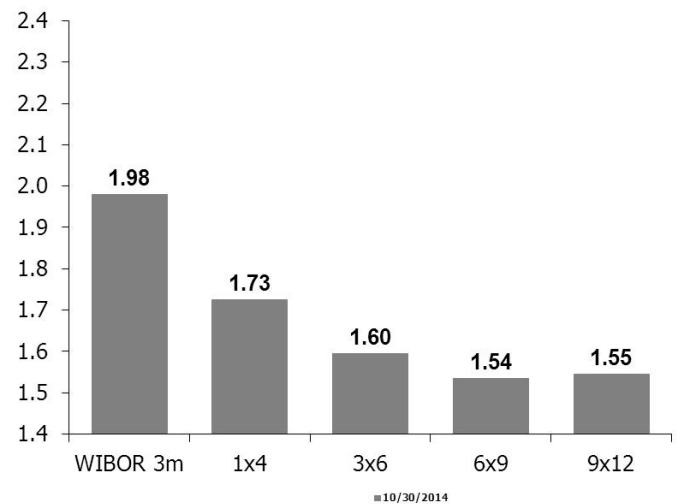
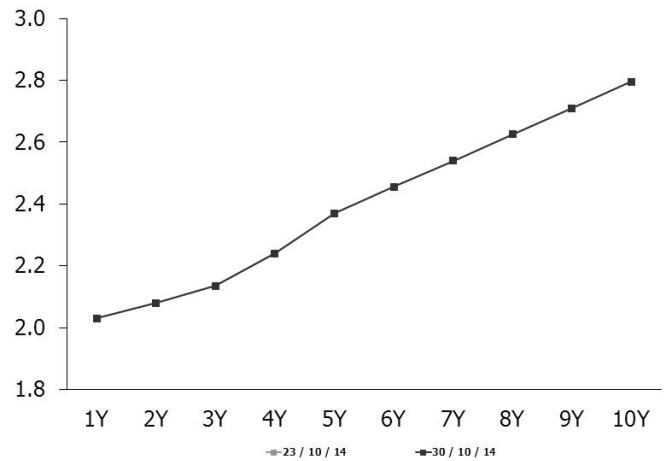
## Fixed income

### Volatile week ahead

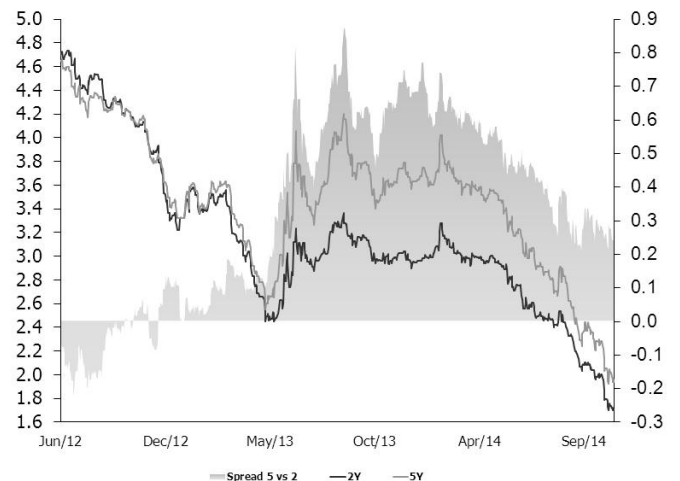
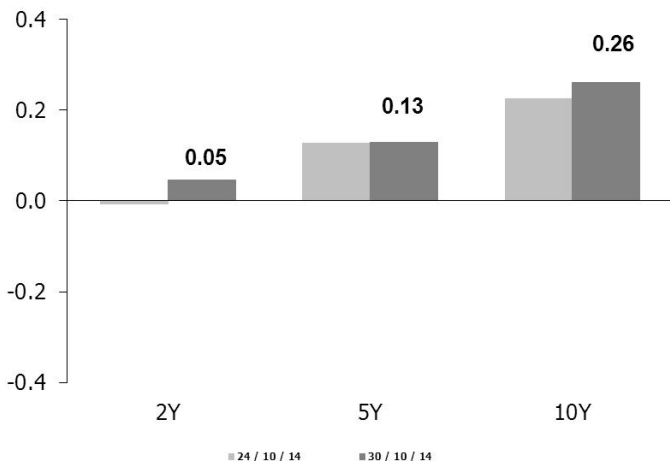
With the Fed decision to finish third round of quantitative easing programme and BoJ surprising extension of its bond purchasing programme this week, we are about 10 bps lower on the middle and long end of the curve (PS0719 1.98%; DS0725 2.52%). Next week seems as interesting as this one as all eyes are on ECB and MPC. Depending on what Mr Draghi is going to say (market players expect dovish statement - its crucial as the Fed decision was quite disappointing) and what scope of rate cuts is going to be delivered by the MPC (expectations are divided between 25 and 50 bps cut) - market will find its direction.

We are on highs and expect higher volatility next week.

IRS curve



Asset swaps



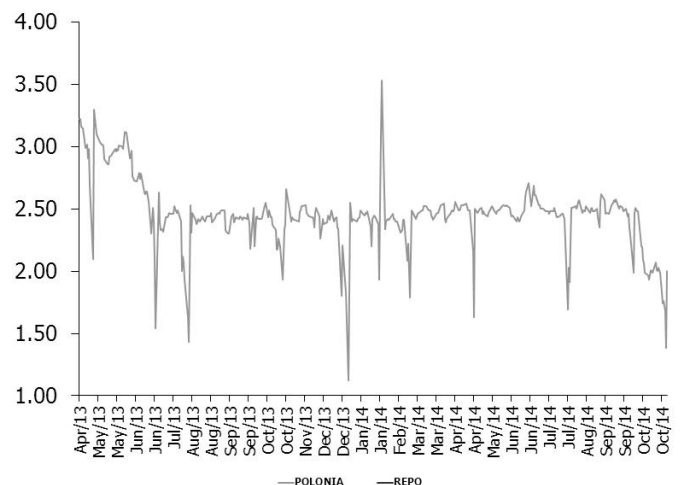
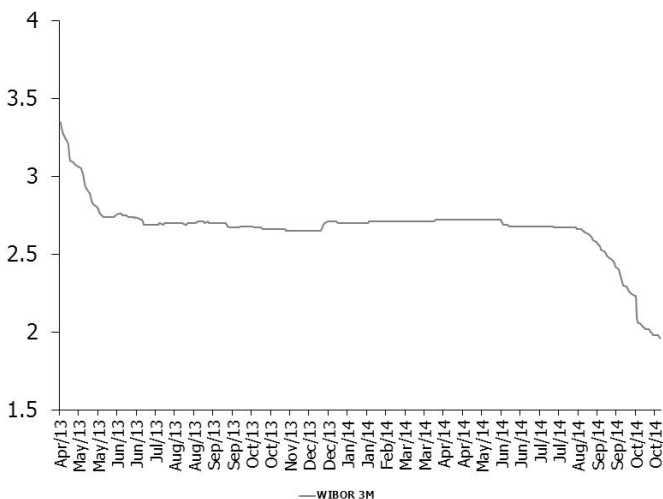
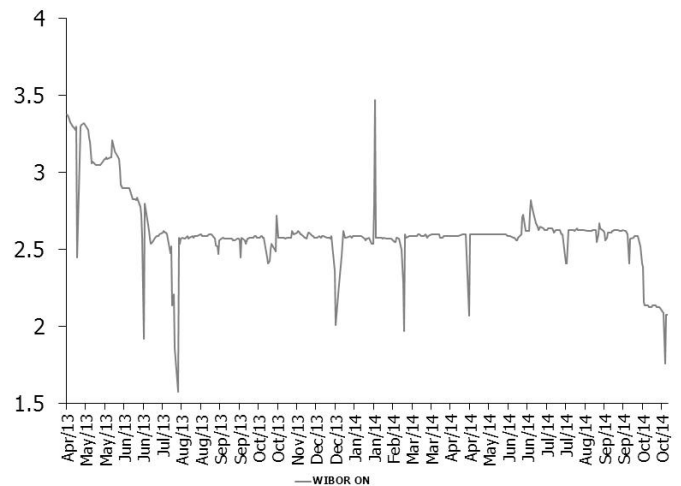
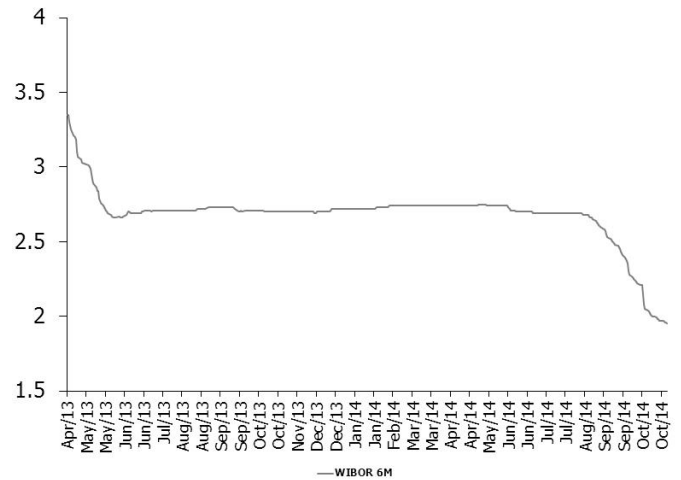
## Money market

### This time BoJ fuelled (short-term?) rally. We enter a week with MPC and PMI.

Muted reaction on the Fed but not so much for BoJ. After unexpected QE in Japan market regain strength to continue rally. In our opinion it might be short term and after the weekend all eyes will be turned on local PMI and MPC meeting. There is a lot in the curve already priced in. 50 bps cut is strongly reflected in front end prices and even some more in further parts of the curve. We think there is plenty of room for disappointment (25 bps cut now with some bullets for December is much more rational than 50 bps for the wording during the conference, however this body has a decent record of strange behaviour). The ECB can also be less dovish than market expects.

To sum up, from the risk/reward perspective these levels seems to be a good opportunity to take tactical pay positions.

As for liquidity, we had a very cheap end of the reserve and after today's underbid OMO (PLN 109 bn vs 100.5 bln of money bills on the offer) we should also see lower cost of carry at the beginning of the new one. Additional OMO is likely though.



## Forex

**PLN consolidating, still** Another uneventful week for EUR/PLN. 4.20-4.2350 was the trading range. The FOMC or RUB story was influencing main PLN currency pair only marginally. USD/PLN was more lively, with USD/PLN attacking and breaking former 3.3600 resistance. The next resistance is 3.40. Next week will bring ECB and MPC meetings. We expect higher volatility, but not necessarily the break out of current trading range in EUR/PLN.

**Vols – lower** Volatility continues its march lower, 1 month EUR/PLN ATM mid is this Friday at 5.0% (0.4% lower than a week ago), 3 months are 5.2% (0.3% lower) and 1 year is fixing at 6.45% (0.05% lower). There was a decent turnover in the backend, 1 year EUR/PLN EUR/PLN was trading at 6.45% and 6.40% in good amounts, and 1 year USD/PLN was traded at 10.60%. The skew was roughly unchanged, and currency spread (USD/PLN vol minus EUR/PLN vol) was still healthy bid with spot USD/PLN climbing higher.

### Short-term forecasts

SPOT Main supports / resistances:

EUR/PLN: 4.18 / 4.26

USD/PLN: 3.26 / 3.41

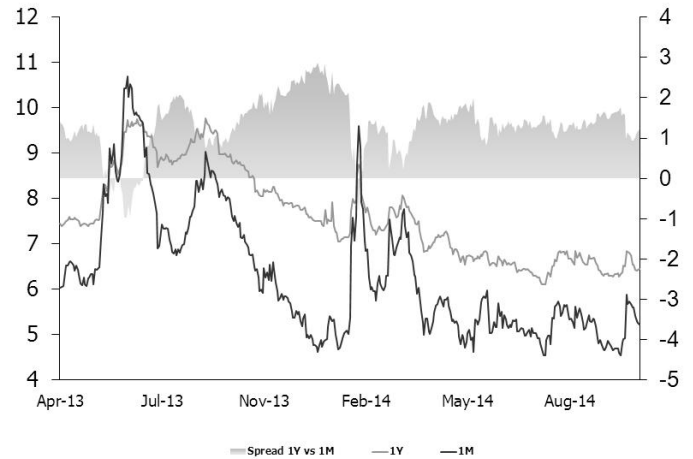
**Spot – Long PLN** We like PLN as our fundamentals are relatively strong. And view current spike as occasion to sell hard currency against PLN.

EUR/PLN short at 4.2300. partially covered at 4.2025, ready to add to at 4.2450 stop still above 4.2600, and we still hope for a move below 4.1800. Core short.

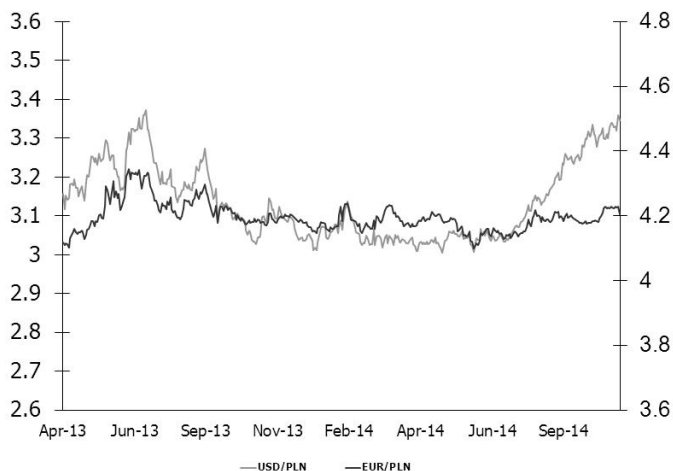
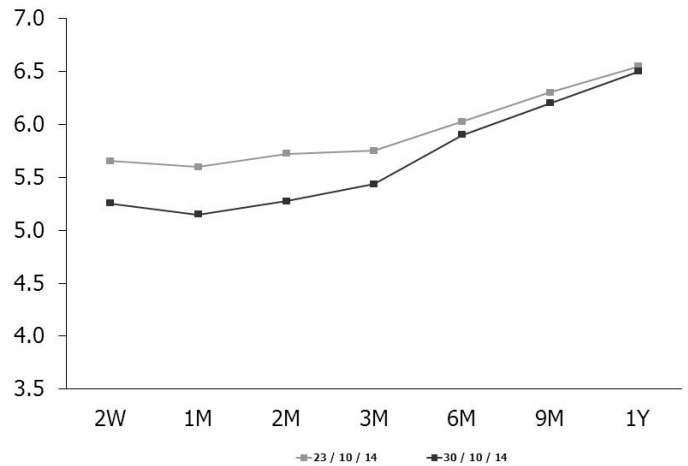
USD/PLN – short at 3.33 has been stopped out at 3.3600. Flat.

**Options – Long 1y Vega** We have bought back 3 month EUR/PLN at 5% , which leave us with naked 1 year outright long. We still think the longer term volatility has bottomed out and we would like to keep that position, waiting for further developments.

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
10/24/2014	1.98	1.98	1.93	1.87	1.88	1.86	1.77	1.58	1.56	1.58	1.63	1.55
10/27/2014	1.99	1.98	1.93	1.87	1.86	1.86	1.74	1.62	1.57	1.58	1.61	1.58
10/28/2014	1.87	1.98	1.93	1.87	1.87	1.86	1.76	1.62	1.56	1.57	1.59	1.57
10/29/2014	1.77	1.98	1.70	1.86	1.78	1.86	1.75	1.60	1.56	1.56	1.59	1.56
10/30/2014	1.86	1.97	1.94	1.86	1.90	1.85	1.73	1.60	1.54	1.55	1.58	1.54

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
10/24/2014	1.860	1.675	1.718	1.711	1.962	2.089	2.422	2.648
10/27/2014	1.860	1.656	1.723	1.742	1.975	2.084	2.425	2.677
10/28/2014	1.860	1.644	1.715	1.727	1.957	2.066	2.407	2.637
10/29/2014	1.860	1.682	1.715	1.712	1.945	2.042	2.375	2.599
10/30/2014	1.850	1.694	1.705	1.751	1.935	2.064	2.360	2.620

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
10/24/2014	5.40	5.58	5.88	6.43	6.43	2.50	0.59
10/27/2014	5.30	5.45	5.88	6.40	6.40	2.50	0.59
10/28/2014	5.25	5.45	5.88	6.43	6.43	2.42	0.59
10/29/2014	5.23	5.50	5.90	6.45	6.45	2.42	0.61
10/30/2014	5.15	5.44	5.90	6.50	6.50	2.42	0.61

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
10/24/2014	4.2245	3.3387	3.5026	3.0861	1.3687	0.1523
10/27/2014	4.2229	3.3288	3.5024	3.0871	1.3680	0.1525
10/28/2014	4.2268	3.3295	3.5035	3.0808	1.3679	0.1523
10/29/2014	4.2248	3.3192	3.5039	3.0708	1.3677	0.1521
10/30/2014	4.2280	3.3592	3.5068	3.0802	1.3656	0.1523

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