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# Polish Weekly Review

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## Comment on the upcoming data and forecasts

Week begins with the release of November Manufacturing PMI. While German PMI and Ifo altogether indicate a slight decline in Polish PMI index (and such is the consensus), we are not convinced. Firstly, after two consecutive increases in the PMI it is more likely that the PMI will increase again. Secondly, the PMI has probably overreacted this year, implying a far deeper slowdown in economic activity than it actually happened. If it were to synchronize with other sentiment indices (EC, CSO), it must increase to ca. 53 pts. With (hopefully) a positive surprise in the PMI and with very good GDP data, the MPC's dilemma becomes increasingly more difficult. While we continue to believe that more easing will arrive on the back of European troubles and PLN appreciation, its timing is more or less a random variable now.

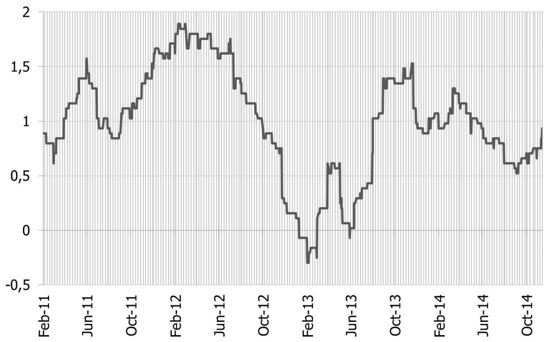
### Polish data to watch: December 1st to December 5th

| Publication | Date | Period | mBank | Consensus | Prior |
|---|---|---|---|---|---|
| Manufacturing PMI (pt) | 02.12 | Nov | 52.0 | 51.0 | 51.2 |
| MPC decision (%) | 03.12 | Dec | 1.75 | 2.00 | 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

Up after better than expected unemployment print and strong GDP release. Polish surprise index seems to have turned around. Next week brings only one opportunity for surprises – the 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).

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## Our view in a nutshell

### Fundamentals

- We stick to our view that Poland entered softpatch but recovery will not be derailed. The soft patch, which contrasts with high frequency data, looks shallower than we expected. Growth stalled around 3%.
- Despite regional (Russia, Ukraine) and European headwinds (soft euro zone growth), stable domestic demands lets economy pass through relatively unscathed. The source of strengh lies in consumption (both private and public) and relatively good moods among firms (production continued but so far accumulated as stocks) that commonly used sentiment indices probably understated.
- 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 in 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 got stuck in decision process but the combination of local and global factors should be enough the break the stalemate and lead to new cuts. The timing is hard to pin down precisely, we see 2x25 (December and January or January and February) and 1x50 bps cut as equally likely. The whole easing cycle will amount to 100 bps.

### Financial markets

- Bearish flattener has run its course. We see significant downside in short end yields (2Y-5Y) due to local (50 bps rate cuts ar even bolder bets to be priced in, very low inflation) and global factors (European QE likely to be centered on the belly of the curve). At the same time, the prospect of Fed normalization should keep the long end more anchored. All in all, bullish steepener is the name of the game now.
- The ECB is firmly on the path towards sovereign QE or at least a broader asset purchase programme. Apparent opposition is kept out of the public and might only slow down the evolution of ECB policy. This makes positive spillovers on Polish markets very likely - offering a lot of support for Polish bonds.
- Expectations for monetary easing proved to be important factor of PLN weakness but the Zloty should be seen as too strong (and both MoF and NBP are encouraging its weakness). There is very little price action and zloty stays at the mercy of carry trades (high real rates) stimulated by structural trades for European QE. At this very moment the real risk if for PLN appreciation. However, appreciation would only make MPC easing case more compelling. All in all, between rock and a hard place – 4,20 is the natural habitat of EURPLN.

### mBank forecasts

| | 2010 | 2011 | 2012 | 2013 | 2014F | 2015F |
|---|---|---|---|---|---|---|
| GDP y/y (%) | 3.7 | 4.8 | 1.8 | 1.7 | 3.4 | 3.5 |
| CPI Inflation y/y (average %) | 2.8 | 4.3 | 3.7 | 0.9 | 0.1 | 0.2 |
| 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 | 11.9 | 11.5 |
| Repo rate (end of period %) | 3.50 | 4.50 | 4.25 | 2.50 | 1.75 | 1.50 |

| | 2014 Q1 | 2014 Q2 | 2014 Q3 | 2014 Q4 F | 2015 Q1F | 2015 Q2F | 2015 Q3 F | 2015 Q4 F |
|---|---|---|---|---|---|---|---|---|
| GDP y/y (%) | 3.4 | 3.5 | 3.3 | 3.0 | 2.8 | 3.1 | 3.5 | 4.4 |
| Individual consumption y/y (%) | 2.9 | 3.0 | 3.2 | 3.0 | 2.8 | 2.8 | 3.2 | 3.4 |
| Public Consumption y/y (%) | 0.1 | 3.7 | 3.5 | 2.4 | 2.0 | 3.0 | 3.0 | 3.0 |
| Investment y/y (%) | 11.2 | 8.7 | 9.9 | 7.0 | 6.0 | 6.0 | 7.0 | 9.0 |
| Inflation rate (% average) | 0.6 | 0.2 | -0.3 | -0.3 | -0.3 | 0.0 | 0.5 | 0.7 |
| Unemployment rate (% eop) | 13.9 | 12.0 | 11.5 | 11.9 | 12.6 | 11.8 | 10.9 | 11.5 |
| 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 | 2.28 | 1.85 | 1.64 | 1.66 | 1.70 | 1.70 |
| 2Y Polish bond yields (% eop) | 3.01 | 2.51 | 2.00 | 1.68 | 1.61 | 1.71 | 1.83 | 1.96 |
| 10Y Polish bond yields (% eop) | 4.23 | 3.45 | 3.05 | 2.40 | 2.40 | 2.50 | 2.70 | 2.96 |
| 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 |

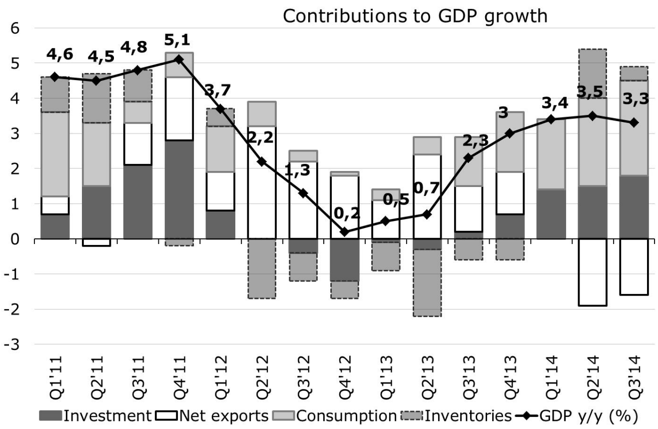
F - forecast

# Economics

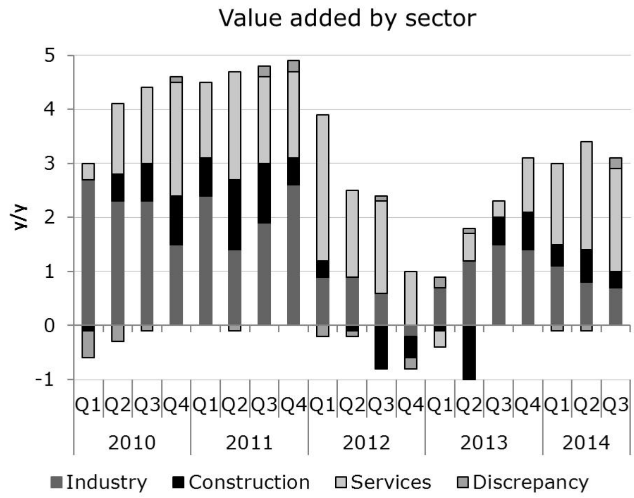
## Q3 GDP growth confirmed at 3.3% with very strong composition.

Q3 growth was confirmed at 3.3% but more than once we indicated that its composition would be far more important, especially given the divergence between GDP and monthly data. Before the release we could only speculate that growth had been boosted by either inventory buildup or public consumption (ahead of local elections). This has not been the case, however, and the details of the release are as stunning as the headline itself was two weeks ago.

Private consumption growth increased from 3.1% (revised up from 2.6%) to 3.3% y/y, despite a marked deceleration in real retail sales and at best stable growth of real disposable income. Secondly, investment accelerated again after a pothole in Q2, reaching 9.9% y/y. This is a big positive surprise as it runs against all monthly correlates of investment (construction output, vehicle sales, production of capital goods). Without detailed data on investment we are unable to comment on the nature of the surprise but we are fairly certain that pork barrel spending is not to blame (no impact of local elections on construction output which should have reacted if that had been the case). The two categories that had been blamed for the surprise actually remained stable: public consumption grew by 3.5% y/y (just as in Q2), which suggests very little pre-election stimulus; inventories added a mere 0.4 pp. Finally, domestic demand grew by a solid 4.9% y/y, with net exports thus substracting more than 1.5 pp. from the headline for the second quarter in a row.




For markets and for monetary policy the data is ancient history and prospects for the future are much more important. Nevertheless, the revisions in GDP data not only change the starting point for forecasts but also (unfortunately) our way of thinking about the drivers of Polish economy. The structure of growth suggests that the economy can run in high gear even if two most cyclical sectors (industry and construction) are mired in stagnation. This is because the shortfalls on that front are miraculously compensated by the „immaterial economy" (i.e. services). Stable momentum in GDP data (not a whiff of weakness in q/q growth rates) and the lack of one-off factors that could be reversed suggest that solid growth rate will be maintained in Q4, of course everything is conditional to negative statistical base effect that make y/y numbers slightly less upbeat. 2015, despite undeniable global risks, should eventually bring more positive impulses for the economy (oil shock, infrastructural investment, possible acceleration in the euro area due to aggressive easing on the ECB's part).



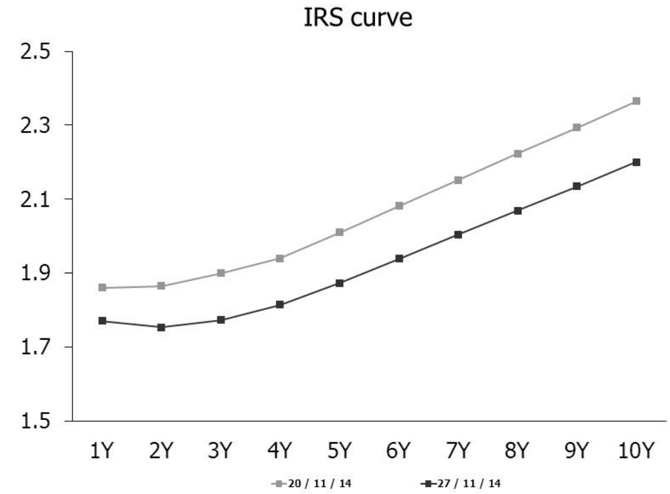

The mix of fast GDP growth and its healthy structure with CPI target going farther and farther away (at this point it is fair to assume that CPI will be negative until mid 2015) clearly clouds the prospects for monetary policy. The MPC will either react to weaker macro data (monthly releases still point out to neutral momentum in the economy), or to the risk of stronger PLN - here the European context comes into the forefront. It is well-known that the decision hangs on one MPC member's vote, it is therefore difficult to predict the timing.

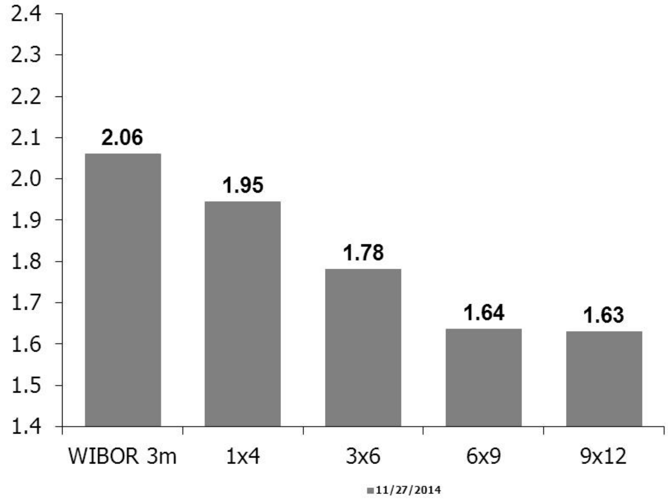
# Fixed income

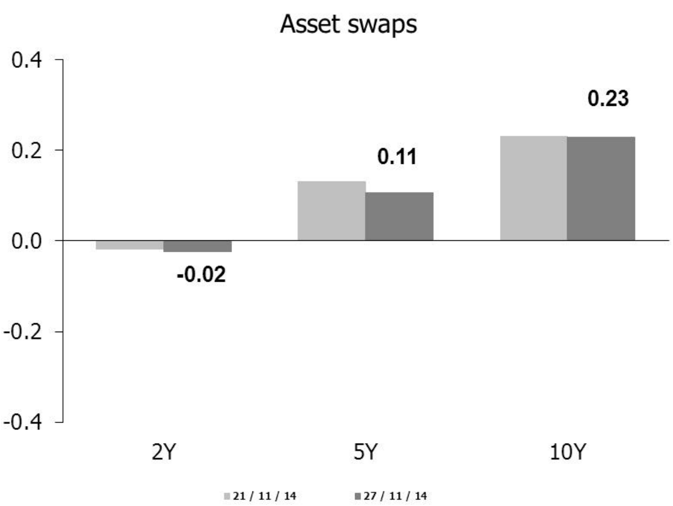
## High Hopes

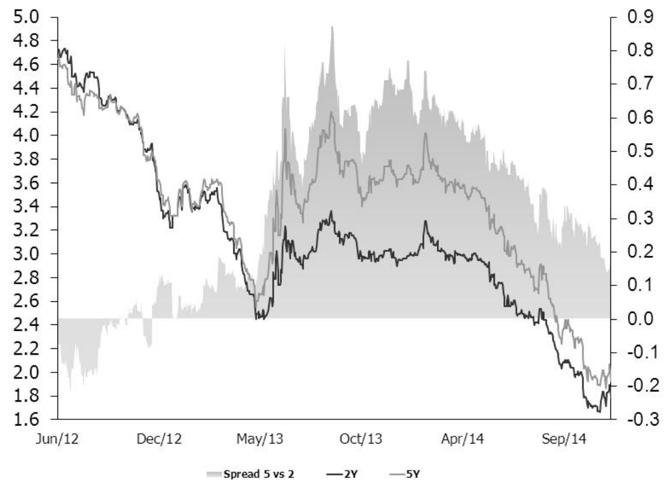
This week, despite the lack of local data and news, yields on Fixed Income market were going down. We were following global trends – hopes for ECB QE next week, disappointing economy growth on main markets (EU, US, China) and sharp drops of oil prices. Yield of DS0725 fall to the all time low of 2.36% (from 2.58% at the end of prev. week), whole curve flattened nicely (2Y IRS – 10Y IRS spread narrowed from +50bp to +41bp).

While we agree with overall direction of the market, there are some risks in the near future, especially considering high hopes for coming events. On the next week's switching auction we can confirm if investors really wants to buy bigger amounts of long end bonds at current levels (turnover on the secondary market is lower because it is the end of the year). Currently we take profit on our long 5Y bond position from previous week.



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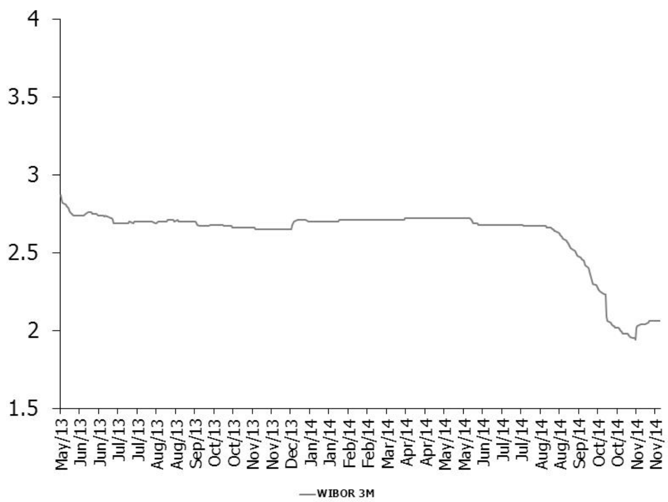
# Money market

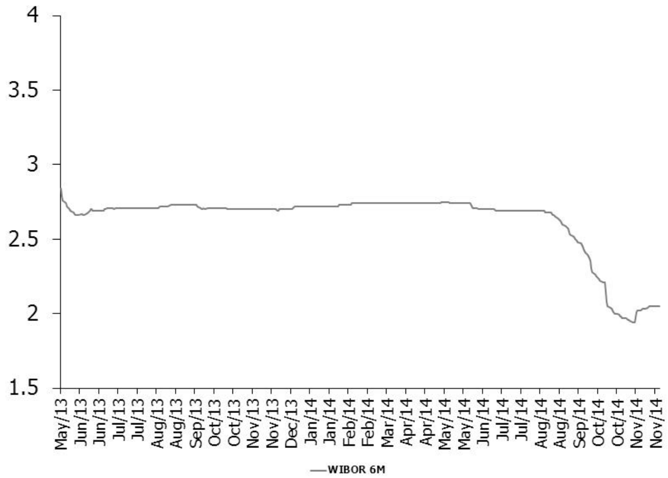
## Expensive week behind us

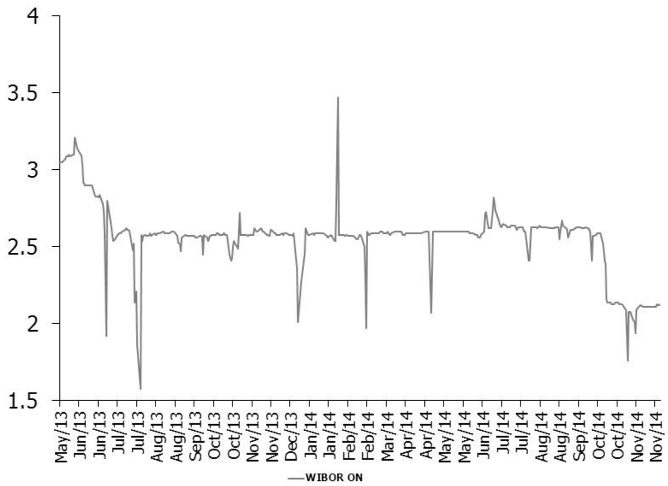
As that was the last week of the reserve with Friday as the last day, whole market was square. Today's OMO was underbid by 14 bn PLN as extra one will be at 15.30.

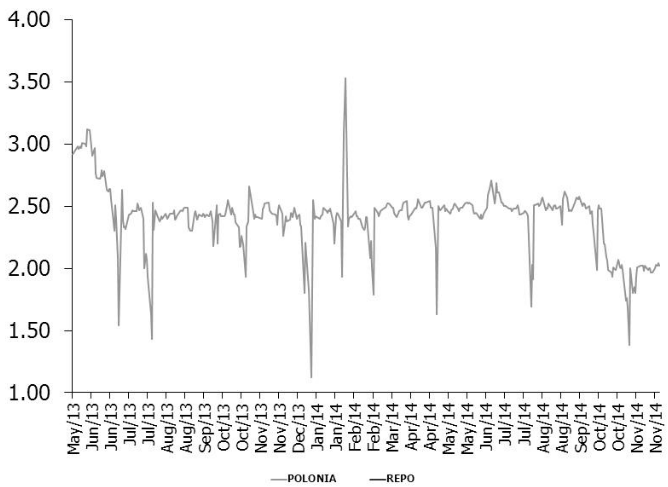
Next week is MPC meeting on Wednesday, so it should be a bit cheaper as it was in October and November. In our opinion is 50/50 chance for a rate cut. Apart from that the whole curve is flattening as market discount 50 bps rate cuts next year. 6x9 FRA is now 1.62/1.67. Spread btw 9x12 and 2Y IRS is just 13 bps now.

We noticed big rally on the shortest bonds (WZ0115 and PS0415) as these bonds are switching papers. Floater was deal at 1.2%.



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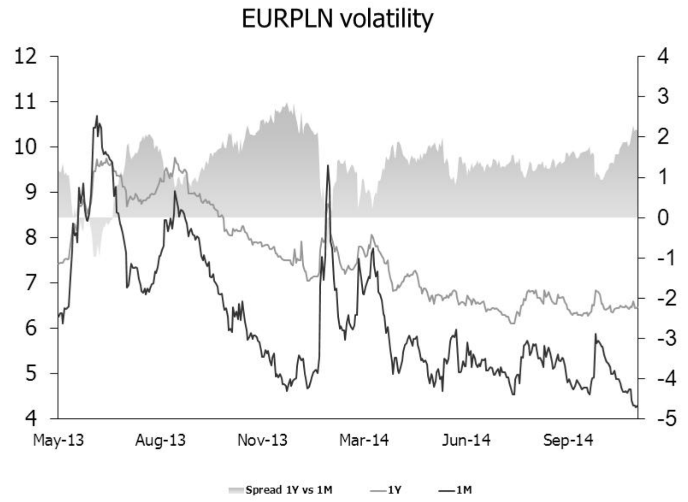
# Forex

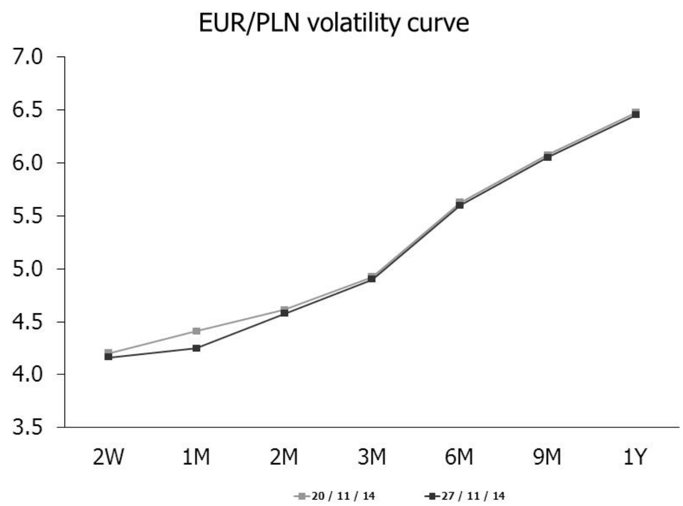
**PLN even stronger** EUR/PLN continued to slide from the 4.24 top of the channel, reaching as low as 4.1715 before a minor rebound (4.18). The 4.16/4.17 support zone is holding from the middle of July so we are expecting that it will also hold at least the first attempt to break it. The risk is getting bit more digital in the next week's mammoth-like events, namely MPC rate decision and ECB. We still believe in the range 4.17/4.22. But the room for disappointment, especially from the side of ECB, is huge.

**Vols – unchanged** The ATM vol curve in EUR/PLN is roughly unchanged. 1 month ATM mid is this Friday at 4.2% (0.1% lower), 3 months are 4.8% (unchanged) and 1 year 6.5% (also unchanged). The curve is quite steep with 3 months vs 1 year spread being at 1.55% (last time seen in December 2013). The skew is roughly unchanged, the real jump was noted on Currency Spread (difference between USD/PLN curve and EUR/PLN) while it rose roughly 0.35% (the frontend even bit more, the backend a tic less). Everything with no evident reason; demand is really strong, though.




## Short-term forecasts

Main supports / resistances:
EUR/PLN: 4.16 / 4.24
USD/PLN: 3.30 / 3.45

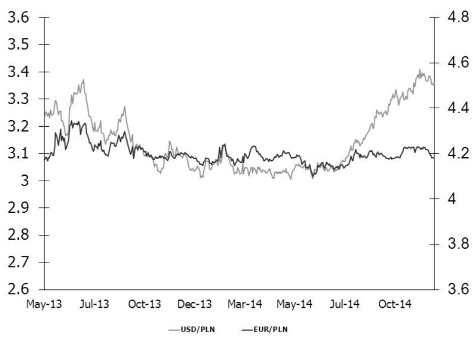


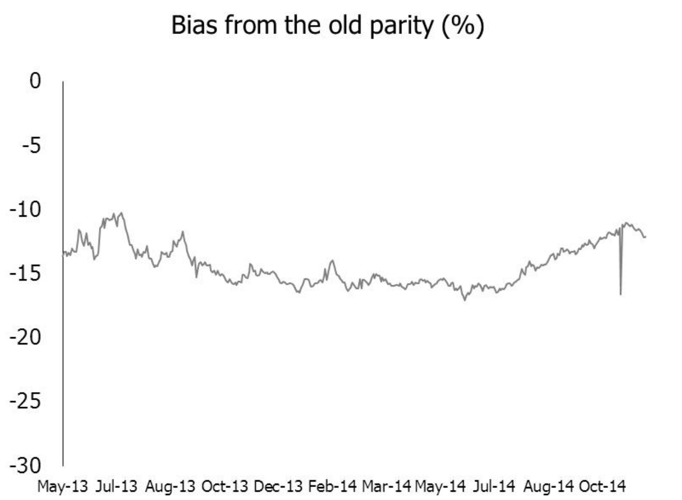

### Spot – long EUR/PLN **We are long at 4.1900 and 4.1750.**

EUR/PLN - we keep our stop below 4.1650 and still have hopes to see 4.22+. It probably will take the rate cut from MPC and disappointment from ECB to get to the profit taking level next week.

USD/PLN – we are sidelined at the moment.

**Options – Core long 1y Vega** We stick to our core long in Vega in the backend. In 1 month - 3 month sector the vols are looking low, but we are not overall convicted that they are cheap. December with Christmas and New Year's holidays are not really that encouraging to be long gamma.



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# 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 |
| 11/21/2014 | 1.95 | 2.06 | 1.95 | 1.95 | 1.83 | 1.93 | 1.94 | 1.81 | 1.69 | 1.70 | 1.69 | 1.69 |
| 11/24/2014 | 2.07 | 2.06 | 2.07 | 1.95 | 2.03 | 1.93 | 1.94 | 1.79 | 1.66 | 1.70 | 1.69 | 1.66 |
| 11/25/2014 | 2.11 | 2.06 | 2.09 | 1.95 | 1.93 | 1.93 | 1.93 | 1.82 | 1.70 | 1.71 | 1.66 | 1.70 |
| 11/26/2014 | 1.85 | 2.06 | 1.85 | 1.95 | 1.94 | 1.93 | 1.95 | 1.77 | 1.64 | 1.64 | 1.64 | 1.65 |
| 11/27/2014 | 2.07 | 2.06 | 2.06 | 1.95 | 2.05 | 1.93 | 1.95 | 1.78 | 1.64 | 1.63 | 1.64 | 1.64 |

| 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 |
| 11/21/2014 | 1.930 | 1.907 | 1.790 | 1.772 | 1.922 | 2.052 | 2.272 | 2.502 |
| 11/24/2014 | 1.930 | 1.894 | 1.784 | 1.784 | 1.925 | 2.063 | 2.285 | 2.518 |
| 11/25/2014 | 1.930 | 1.882 | 1.780 | 1.772 | 1.925 | 2.016 | 2.265 | 2.472 |
| 11/26/2014 | 1.930 | 1.869 | 1.748 | 1.758 | 1.880 | 1.991 | 2.220 | 2.434 |
| 11/27/2014 | 1.930 | 1.765 | 1.753 | 1.729 | 1.873 | 1.979 | 2.200 | 2.429 |

| EUR/PLN 0-delta stradle | | | | | 25-delta RR | | 25-delta FLY |
|---|---|---|---|---|---|---|---|
| Date | 1M | 3M | 6M | 1Y | 1M | 1Y | 1Y |
| 11/21/2014 | 4.30 | 4.93 | 5.63 | 6.60 | 6.60 | 2.32 | 0.61 |
| 11/24/2014 | 4.30 | 4.85 | 5.63 | 6.45 | 6.45 | 2.32 | 0.61 |
| 11/25/2014 | 4.25 | 4.85 | 5.60 | 6.45 | 6.45 | 2.32 | 0.52 |
| 11/26/2014 | 4.30 | 4.90 | 5.60 | 6.48 | 6.48 | 2.32 | 0.54 |
| 11/27/2014 | 4.25 | 4.90 | 5.60 | 6.45 | 6.45 | 2.32 | 0.54 |

| PLN Spot performance | | | | | | |
|---|---|---|---|---|---|---|
| Date | EURPLN | USDPLN | CHFPLN | JPYPLN | HUFPLN | CZKPLN |
| 11/21/2014 | 4.2088 | 3.3827 | 3.5011 | 2.8734 | 1.3830 | 0.1520 |
| 11/24/2014 | 4.1977 | 3.3842 | 3.4911 | 2.8629 | 1.3781 | 0.1518 |
| 11/25/2014 | 4.1916 | 3.3706 | 3.4859 | 2.8532 | 1.3697 | 0.1518 |
| 11/26/2014 | 4.1800 | 3.3546 | 3.4761 | 2.8478 | 1.3659 | 0.1515 |
| 11/27/2014 | 4.1807 | 3.3528 | 3.4774 | 2.8546 | 1.3613 | 0.1516 |

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