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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

Karol Klimas
analyst
tel. +48 22 829 02 56
karol.klimas@mbank.pl

Department of Financial Markets (business contacts)

Wojciech Dunaj
head of interest rates trading (acting)
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
head of treasury sales
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

A boring week ahead of us - on Friday the CSO will release monthly figures on international trade (for the period until July).

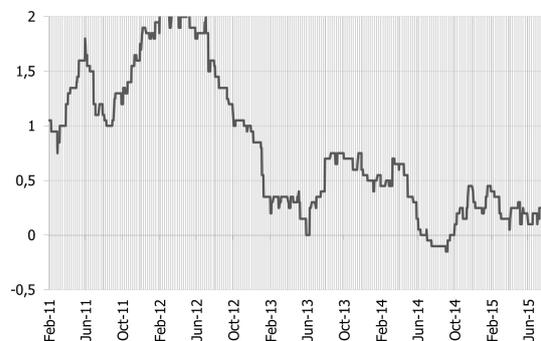
Polish data to watch: September 7th to September 11th

Publication	Date	Period	mBank	Consensus	Prior
International trade (GUS)	11.08	Jul			

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	9/24/2015	1500	1.667	6/11/2015
5Y T-bond PS0720	9/24/2015	3000	2.355	7/23/2015
10Y T-bond DS0726	9/10/2015	2000	3.076	8/6/2015
15Y T-bond WS0428	-	20	2.092	3/12/2015

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



Comment

Sharply down after the PMI. Next week will bring some stabilization as no important data releases are scheduled for the 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

- GDP growth stabilized around 3.5% per annum.
- H2 2015 is expected to bring more (positive) exogenous components to the Polish cycle. Lower costs of financing, generally lower budget deficit and the beginning of a new round of infrastructure spending are expected to give way to expenditures related to political business cycle ahead of general elections.
- Given the schedule of infrastructure spending and stable consumption growth, 2-3 years of economic expansion are our baseline scenario for Polish economy. Upswing phase 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.
- Inflation recorded a slight turnaround and we await higher readings in coming months. However, output gap is too wide to generate inflation pressure and therefore inflation is going to stay low (very low). Prices are going to stay in deflation until winter.
- Rate cut cycle has been concluded and rates are going to stay at 1.5%. Rate hikes are miles away since there is no inflation in sight and the new MPC (starting job in 2016) may be even more dovish.

Financial markets

- We turn constructive on 10y bonds. Although the EM crisis is still ongoing, the focus of investors turned to policy response. ECB acted first promising more accommodation if needed and lowering forecasts; other central banks are set to follow. Play for QE extension is going to support the zloty and break non-favorable correlations with Polish assets.
- Locally, we see more scope for rate cuts being priced in. Drought theme is overdone given the favorable crop worldwide and may lead only to temporary higher prices of vegetables and fruits (no risk for low inflation path whatsoever). Polish bonds recently cheapened versus Hungarian ones while political risk seems to be digested. Among slowing EMs, Polish balanced growth may be seen as a sweet spot reducing credit risk and enabling lower risk free rates to filter through Polish bonds.
- Pro-active ECB stance should be enough to shield the zloty from sharp depreciation in case of higher risk aversion. In such circumstances stable growth story is going to be enough to trigger positive differentiation flows. Local problems remain unsolved, though. The fate of CHF conversion bill is going to be the one of utmost importance in coming days as it returned to the lower chamber of the parliament. That is why we neutralize our outlook for the zloty betting on the middle of interval 4.10-4.30.

mBank forecasts

	2010	2011	2012	2013	2014	2015F
GDP y/y (%)	3.7	4.8	1.8	1.7	3.4	3.6
CPI Inflation y/y (average %)	2.8	4.3	3.7	0.9	-0.1	-0.8
Current account (%GDP)	-4.5	-4.9	-3.5	-1.3	-1.2	-0.6
Unemployment rate (end of period %)	12.4	12.5	13.4	13.4	11.5	10.0
Repo rate (end of period %)	3.50	4.50	4.25	2.50	2.00	1.50

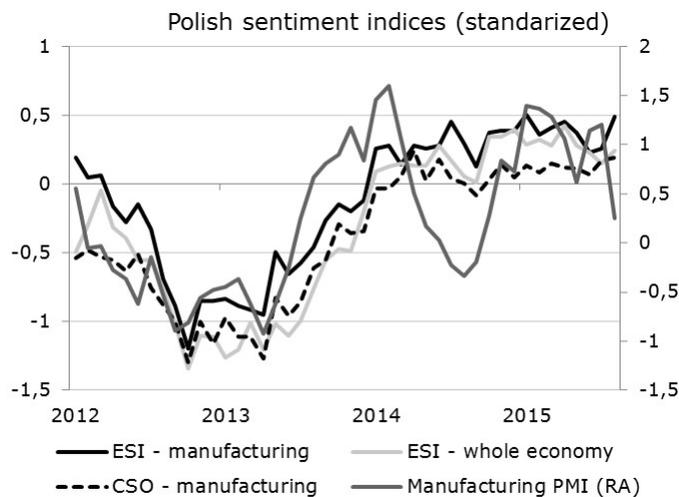
	2014	2014	2014	2014	2015	2015	2015	2015
	Q1	Q2	Q3	Q4	Q1	Q2 F	Q3 F	Q4 F
GDP y/y (%)	3.5	3.6	3.3	3.3	3.6	3.3	3.5	3.8
Individual consumption y/y (%)	3.0	3.0	3.2	3.0	3.1	3.0	3.1	3.2
Public Consumption y/y (%)	0.5	6.4	5.3	6.4	3.3	2.4	2.5	2.0
Investment y/y (%)	11.4	8.7	9.2	8.6	11.4	6.4	8.0	8.5
Inflation rate (% average)	0.6	0.2	-0.3	-0.7	-1.4	-0.9	-0.8	0.1
Unemployment rate (% eop)	13.9	12.0	11.5	11.5	11.7	10.3	9.9	10.0
NBP repo rate (% eop)	2.50	2.50	2.50	2.00	1.50	1.50	1.50	1.50
Wibor 3M (% eop)	2.71	2.68	2.28	2.06	1.65	1.72	1.72	1.72
2Y Polish bond yields (% eop)	3.01	2.51	2.00	1.79	1.61	1.99	1.70	1.70
10Y Polish bond yields (% eop)	4.23	3.45	3.05	2.52	2.31	3.31	3.00	2.90
EUR/PLN (eop)	4.17	4.16	4.18	4.29	4.07	4.19	4.20	4.15
USD/PLN (eop)	3.03	3.04	3.31	3.54	3.80	3.76	3.56	3.67

F - forecast

Economics

Polish Manufacturing PMI unexpectedly cratered in August

Polish manufacturing PMI fell in August from 54.5 to 51.1, massively below expectations (the lowest forecast was only 53.0). At the same time, it is one of the largest surprises in history and third largest one-month drop in the PMI (after October '98 and January '05). It must be noted, though, that the PMI is the only sentiment index that registered such a drop – analogous indices from GUS and the EC were either stable or improved in August. In addition, other readings from the region (Czech Republic, Hungary, Turkey, Germany) do not confirm that a sharp drop in activity has occurred.



Thus, we are leaning towards a different interpretation: the most likely reason for the PMI decline are disruptions in transport and power outages associated with the massive heat wave in the first half of the month. It is of course consistent with a sharp drop in output assessment (from 56.4 to 50.9) but apparently contradicted by the simultaneous decline in new orders (from 55.8 to 50.6). One has to remember, however, that output never declines that much without a parallel move in orders – this is because purchasing managers might have a biased perspective and due to the very nature of lean (just-in-time) production. It is impossible to distinguish orders and production in complicated supply chains. Other subindices of the PMI aren't particularly newsworthy: employment growth held steady in August, while low commodity prices pushed input and output prices down in August (we will see it in PPI data as well).

Regardless of the reasons for the PMI crash, it is important to consider the implications it might hold for hard data. Our analysis of PMI and industrial output data indicated that the correlation between the two series is for all intents and purposes non-existent. For the largest drops in the PMI the correlation is somewhat stronger but doesn't suggest a catastrophe in industrial output data. In our view, especially if one assumes that there is a common factor in the form of power and transport disruptions, the latest PMI reading is consistent with a ca. 2% m/m drop in seasonally adjusted industrial production – our forecast of 5.6% y/y increase already includes such downside risks.

Fixed income

Less scared

We started this week trading rates higher. POLGBs were sold, with other assets recognized as risky, as coming two day holiday in China has provoked some position clearing. Wednesday's dovish MPC press conference didn't change the blurred picture and we marked the low (in price terms) on Thursday morning – DS0725 traded 101,50 vs Monday's 103,00.

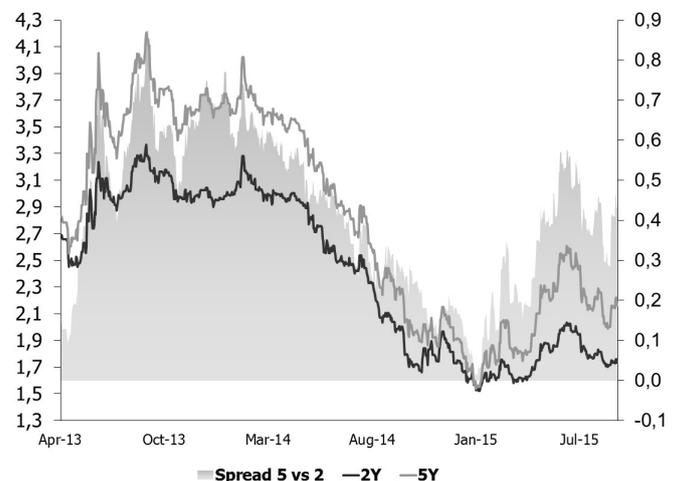
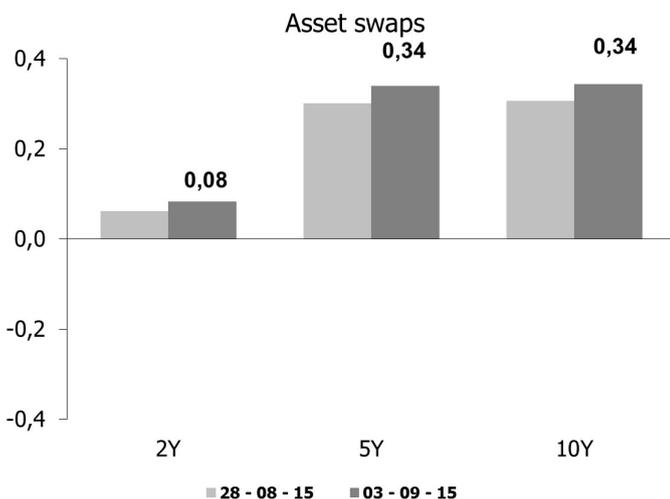
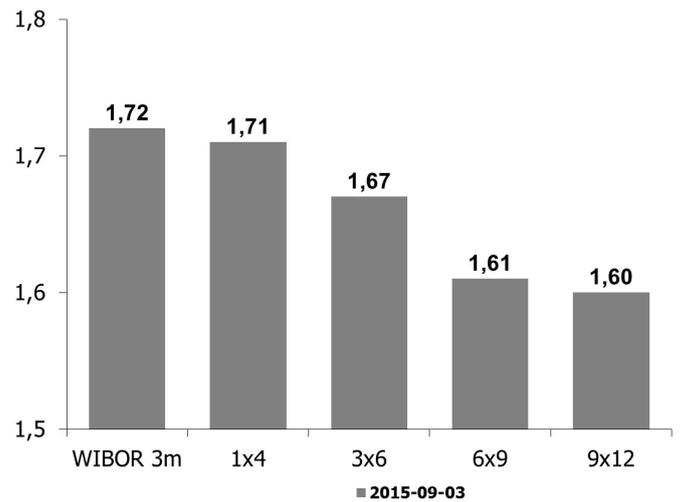
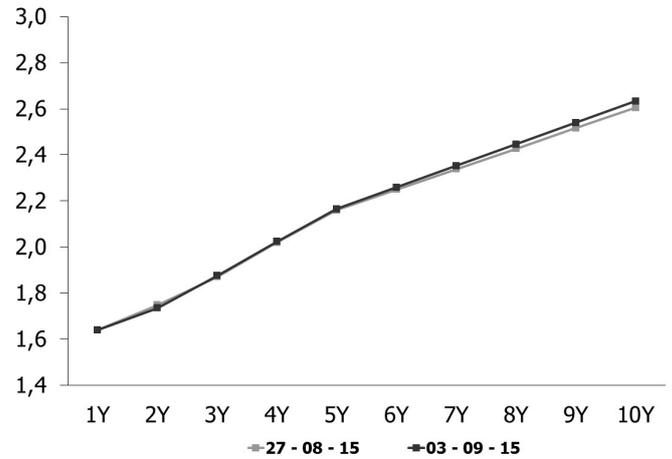
Later that day, after ECB press conference, bonds have rebounded close to Monday's level, trading 102,50/60. The ECB statement, which already supposed to be dovish, exceeded expectations pointing that in current environment increasing the scale of QE is likely. Course correction? Increased disparity with the Fed? Let's wait for Fed.

The week was closed by payrolls data release – mixed, though decent number.

Conclusion:

Overall we like bonds – disinflation, decent carry, ECB support. We know the risks, though – CHF loans bill, elections, Fed meeting, coming auctions. Especially, the last one seems quite important. Given the Fed meeting, it's rather unlikely to foresee decent demand for bonds, especially from the long end. Auction supply will probably cap market till Fed decision – we see 102,00-103,50 range as most likely and will fade boundaries if so.

IRS curve



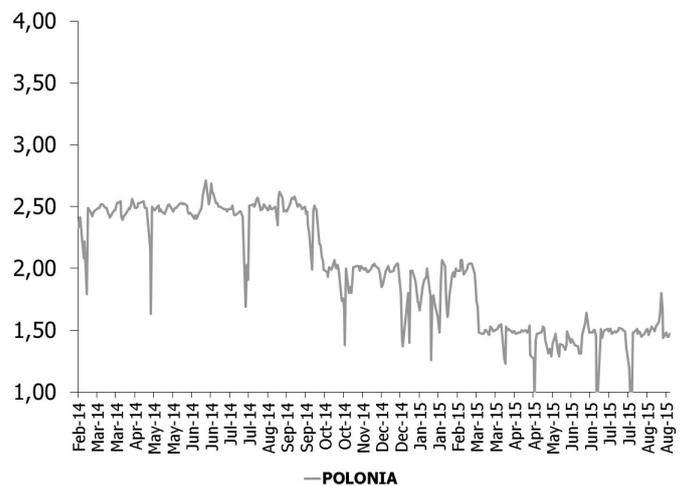
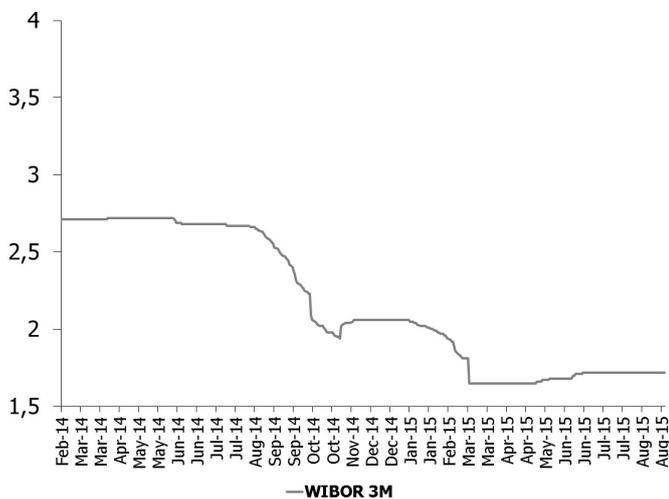
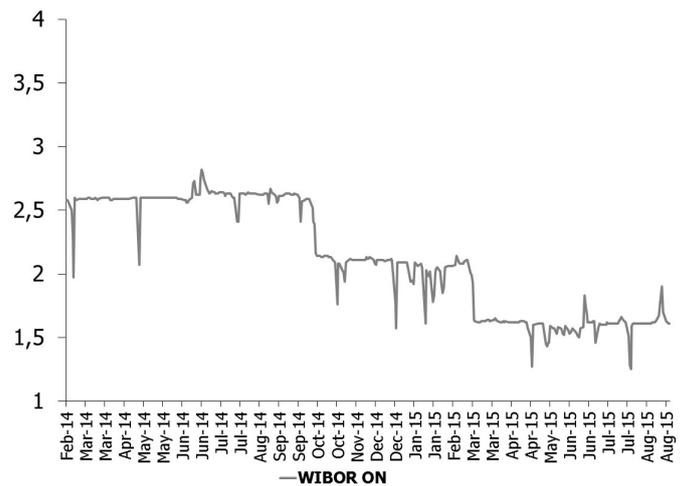
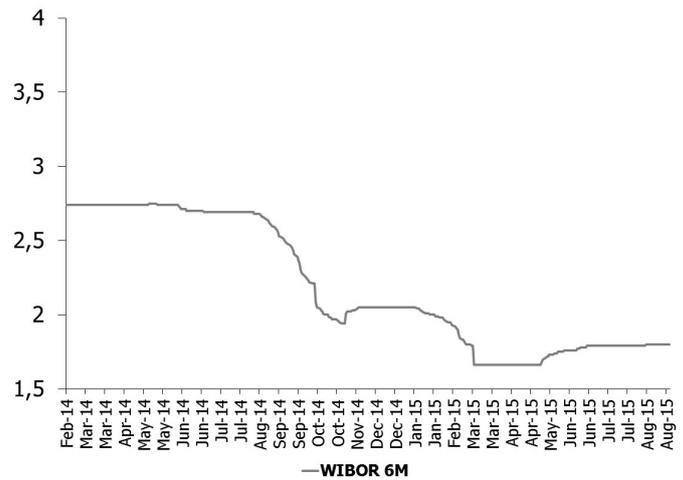
Money market

Stable short rates

Cash market stabilized this week after the expensive previous one. Polonia fell under 1.50 as market was overliquid. Today's OMO was underbid by 5 bn PLN. As it is the beginning of the reserve period, rates will be stable with cash rate around 1.50.

FRA rates rose a bit since last Friday. 9x12 is now 1.56/1.61, 6x9 2 bps higher. OIS Polonia remained on the same levels. 1Y OIS is 1.42/1.47.

Shortest bonds are heavily offered. OK0116 was given at 1.64 and regular offer is at 1.60. 1Y longer bonds are much more attractive (OK0717 yield is 1.76/1.80) so investors are switching into them as probability of any rate hike is minimal.



Forex

PLN - consolidating EURPLN was boxed in the 4.1990 – 4.2595 range. The latter was hit on risk aversion caused by softer stock markets, the former because of dovish ECB. The polish CHF bill rejection in Senat, also allowed PLN to regain some shine. The NFP which surprised at the headline, but were positive in revisions (close to consensus overall), did little to push PLN either way. We think the balance of risks became a little more positive for Zloty, but we are still hostage to global sentiment.

Options – volatility lower Calmer Zloty, lower realized volatility were the reasons behind lower vols. 1 month EUR/PLN ATM sold off to 6.5% from 8%, 3 months are fixing at 7% (1% lower), and 1 finally 1 year is 7.3% from 7.15%. The vol curve has steeped significantly. The skew was roughly unchanged, so the Currency Spread (difference between USD/PLN and EUR/PLN).

Short-term forecasts

Main supports / resistances:

EUR/PLN: 4.18 / 4.28

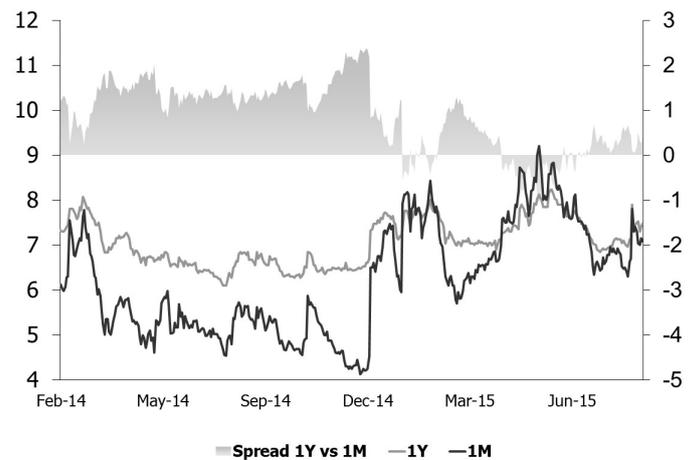
USD/PLN: 3.60 / 3.85

Position Spot – Long from 4.2200 closed/reversed at 4.2280. We are currently short at 4.2280 and we are ready to add at 4.2500 with a stop above 4.2600 and hopes to revisit levels below 4.1700.

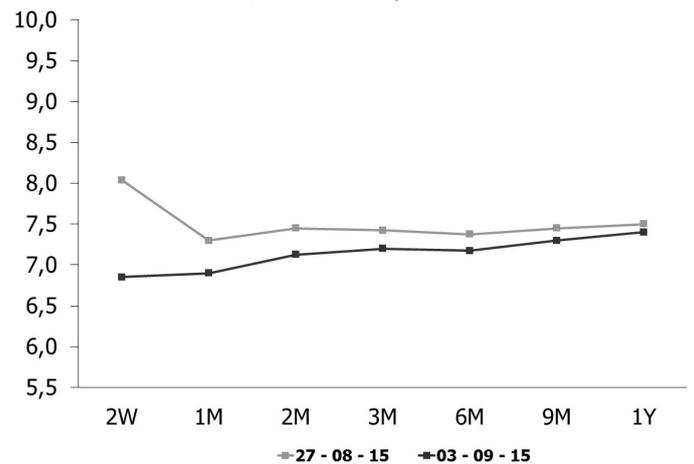
The Senat (upper house of the Parliament) has rejected the CHF bill and, by sending it back to Sejm (lower house of Parliament), it made it quite difficult to pass the bill before elections. In other words the huge systemic risk to PLN was at least postponed if not reversed. The dovish ECB is another strong factor, and reason we became overall PLN positive.

Options We are still long Vega and Vanna in EUR/PLN and USD/PLN. The position was nevertheless reduced last week. The Gamma still covers Theta bills, so we are not really worried. There are still FOMC and polish elections in front of us, and we prefer to be long Gamma/Vega into these events.

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
8/27/2015	1.58	1.72	1.66	1.70	1.82	1.73	1.72	1.68	1.61	1.60	1.64	1.66
8/31/2015	1.65	1.72	1.72	1.70	1.75	1.73	1.71	1.67	1.60	1.58	1.63	1.65
9/1/2015	1.78	1.72	1.85	1.70	1.75	1.73	1.72	1.69	1.63	1.62	1.67	1.67
9/2/2015	1.47	1.72	1.55	1.70	1.69	1.73	1.71	1.68	1.62	1.61	1.66	1.68
9/3/2015	1.78	1.72	1.85	1.70	1.75	1.73	1.71	1.67	1.61	1.60	1.64	1.67

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
8/27/2015	1.730	1.659	1.748	1.827	2.160	2.466	2.605	2.949
8/31/2015	1.730	1.669	1.730	1.871	2.140	2.514	2.590	2.978
9/1/2015	1.730	1.732	1.755	1.851	2.215	2.540	2.670	3.010
9/2/2015	1.730	1.703	1.758	1.826	2.223	2.582	2.683	3.045
9/3/2015	1.730	1.695	1.735	1.817	2.165	2.504	2.633	2.976

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1Y	1Y
8/27/2015	7.30	7.43	7.38	7.50	7.50	2.05		0.54
8/31/2015	7.00	7.13	7.15	7.30	7.30	2.05		0.54
9/1/2015	7.15	7.18	7.20	7.40	7.40	2.05		0.53
9/2/2015	7.09	7.23	7.26	7.48	7.48	2.10		0.57
9/3/2015	6.90	7.20	7.18	7.40	7.40	2.05		0.54

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
8/27/2015	4.2255	3.7450	3.9260	3.1114	1.3465	0.1560
8/31/2015	4.2344	3.7780	3.9238	3.1167	1.3463	0.1566
9/1/2015	4.2297	3.7503	3.8985	3.1307	1.3448	0.1564
9/2/2015	4.2440	3.7626	3.9065	3.1395	1.3481	0.1570
9/3/2015	4.2314	3.7645	3.8840	3.1289	1.3460	0.1566

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