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Polish Weekly Review

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Comment on the upcoming data and forecasts

Upcoming week brings most of this month's economic releases. We start on Wednesday with M3 money supply data for September and current account data for August. The first should confirm high growth of households deposits. On Thursday CSO will publish *final* CPI inflation for September (read more in Economics section). We will end the week on Friday with core inflation data (should remain at previous month's level) and labour market data. Average wage growth rate should accelerate after weak August. Employment data should reflect recent, flattish trend.

Polish data to watch: October 12th to October 16th

Publication	Date	Period	mBank	Consensus	Prior
M3 y/y (%)	14.10	Sep	7.7	7.6	7.3
Current account (mio EUR)	14.10	Aug	-1502	-1124	-1660
Export (mio EUR)	14.10	Aug	12500	12207	13552
Import (mio EUR)	14.10	Aug	13600	12800	14623
CPI y/y <i>final</i> (%)	15.10	Sep	-0.5	-0.7	-0.8
Budget performance (%)	15.10	Sep			56.1
Core inflation (%)	16.10	Sep	0.4	0.4	0.4
Average wage y/y (%)	16.10	Sep	3.7	3.5	3.4
Employment y/y (%)	16.10	Sep	1.0	1.0	1.0

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 OK0717	10/8/2015	1000	1.770	9/24/2015
5Y T-bond PS0720	10/8/2015	3000	2.317	9/24/2015
10Y T-bond DS0726	10/8/2015	2000	3.076	9/10/2015
15Y T-bond WS0428	-	20	2.092	3/12/2015

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



Comment

Unchanged from previous week – still on this years low. There will be opportunities to move the index in the second part of next week: CPI (final) on Wednesday and labour market data on Friday.

* 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 is set to stay close to 3% per annum.
- Downside risks prevail near term. However, until only selected business tendency indicators are decreasing, Poland is expected to escape a deeper slowdown. Exports is going to be weaker due to international developments, investment activity may be negatively affected by the unanticipated fall of future demand. At the same time consumption is to maintain 3% growth (labor market is tight, households have resources to smooth consumption over time). The schedule for infrastructure spending suggests a steep path of outlays from the turn of 2015/2016 onwards. At this stage it is more likely that outlays will be postponed for later part of 2016.
- Given the schedule of infrastructure spending and stable consumption growth, many years of economic expansion are still 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.
- 3% growth is sufficient to keep inflation and credit risk in check. Global headwinds and low commodity prices are set to further underpin deflationary environment. Headline inflation is going to slowly rise only on the back of statistical base.
- NBP rates stable or lower as upcoming MPC may be more dovish and start its tenure in weaker macroeconomic environment.

Financial markets

- We closed our long 10y bonds recommendation booking 40bp of profit and turn neutral. Once again we decide to step aside mostly to protect profit.
- We think that POLGBs may still have potential mid-term. However, hopes for global stimulus (e.g. fiscal one in China) are flying high while lots of forecasts have been recently downgraded leaving small potential for further downscaling. Locally, one additional cut is priced in in 2016. At this very stage one needs lots of imagination to come up with more and elections are looming fast with some investors eager to take profit just before. That is why we think that it may be wise to stay on the sidelines for a while.
- 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. We neutralize our outlook for the zloty betting on the middle of interval 4.10-4.30.

mBank forecasts

	2011	2012	2013	2014	2015F	2016 F
GDP y/y (%)	4.8	1.8	1.7	3.3	3.3	3.1
CPI Inflation y/y (average %)	4.3	3.7	0.9	-0.1	-0.8	1.5
Current account (%GDP)	-4.9	-3.5	-1.3	-1.2	-0.6	-1.0
Unemployment rate (end of period %)	12.5	13.4	13.4	11.5	10.0	8.9
Repo rate (end of period %)	4.50	4.25	2.50	2.00	1.50	1.50

	2015	2015	2015	2015	2016	2016	2016	2016
	Q1	Q2	Q3 F	Q4 F	Q1 F	Q2 F	Q3 F	Q4 F
GDP y/y (%)	3.6	3.3	3.1	3.1	3.0	3.0	3.1	3.2
Individual consumption y/y (%)	3.1	3.0	3.0	3.2	3.2	3.3	3.2	3.0
Public Consumption y/y (%)	3.3	2.4	2.5	1.5	1.5	1.5	1.5	1.5
Investment y/y (%)	11.4	6.4	6.5	5.5	4.5	6.5	7.0	7.0
Inflation rate (% average)	-1.4	-0.9	-0.7	-0.2	0.6	0.7	0.8	1.2
Unemployment rate (% eop)	11.7	10.3	10.0	10.0	10.6	9.4	8.9	9.0
NBP repo rate (% eop)	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
Wibor 3M (% eop)	1.65	1.72	1.72	1.72	1.72	1.72	1.72	1.72
2Y Polish bond yields (% eop)	1.61	1.99	1.70	1.70	1.70	1.75	1.80	1.85
10Y Polish bond yields (% eop)	2.31	3.31	2.90	2.80	2.80	2.90	3.00	3.00
EUR/PLN (eop)	4.07	4.19	4.24	4.15	4.15	4.10	4.10	4.05
USD/PLN (eop)	3.80	3.76	3.78	3.77	3.84	3.90	3.90	3.86

F - forecast

Economics

MPC: rates unchanged

Just as expected Polish Monetary Policy Council left interest rates unchanged in September. Wording remained relatively optimistic when it came to global growth, however, emerging markets still carry risk. Assessment of domestic business outlook is by all means positive. MPC treats the slowdown displayed by latest indices (PMI) as transitory. Although in such circumstances there is no place for inflationary pressure, MPC expects inflation to grow in next few months and deflation is seen a result of external factors.

The press conference after the meeting unveiled also some details on next inflation projection (it will be published in November). It will most likely show lower path of inflation and flatter trajectory of economic growth; MPC does not attach great importance to the latter development, though. Deflation should still end before the end of the year. It is worth noting that Mr. Osiatyński - one of most dovish MPC members, gave up on rate hikes. He claims that in current market conditions lower interest rates would not help the economy. Governor Belka acknowledged his view and added that he does not see any changes in monetary policy in the near future.

It is clear that MPC does not want to spoil the sentiment with pessimistic visions. Global trends and some aspects of domestic demand (possible lower path of private and public investment) suggest further downward revision of forecasts, though. Financial markets are expecting monetary stimulus with elements of fiscal policy (China) - in countries which are not involved in non-standard monetary policy tools this means lower rates. We uphold our view, that rate cuts in 2016 are likely (50/50 probability). National Bank of Poland should also support deficit financing as well as encourage banks to buy government bonds. The groundwork was laid by Hungarian National Bank, which openly expects yield curve to flatten. HNB also shifted benchmark interest rate to 3M tenor and lowered reserve requirement ratio from 5% to 2%.

Flash CPI reading unlikely to have posted true inflation in September

Flash CPI reading published in the end of September pinned down last month's inflation reading at -0.8%. Given the preliminary character of the publication (our sources in GUS state that it is still work in progress) and some peculiar coincidences suggesting well known problems with fast data processing in GUS (plug last year's monthly variation of prices bar energy and fuels and you will get the flash reading; isn't it really the flash reading?) we would most likely end up with -0.6-0.5% y/y CPI inflation (to be published on Thursday). Food prices are the factor that makes the difference.

In our recent research on drought in Poland (conducted in August) we discovered that extremely arid conditions in summer months can elevate growth of vegetables and fruits prices with one month lag (the effect is not permanent, though, and often limited to one month), as was seen in 2006. We expected this effect to materialize in September. And indeed the price data on vegetables (tomatoes, potatoes and cucumbers) showed a material jump in prices in September that was unusual compared to recent year's seasonal variation.

The regional CPI readings came out rather patchy (vs expectations): much lower in Hungary, higher in Czech Republic. It was food prices that made the difference: low in Hungary, high in Czech Republic. Luckily, the differences can be traced back to the geographic differentiation of agro meteorological conditions (see the report of EC: EDO Drought News, August 2015) in the summer of 2015. In short, Hungary was hotter than Czech Republic and Poland in absolute manner. However, relative to long-term averages, Czech Republic and Poland were regions that recorded much higher temperature anomalies; the same applies to precipitation. Although the sample is very small, we think the drought is the factor that explain the differences in food prices. Therefore we bet on significantly higher growth of food prices in Poland (+ 1.2-1.6% m/m) and consequently higher inflation (lower deflation).

Fixed income

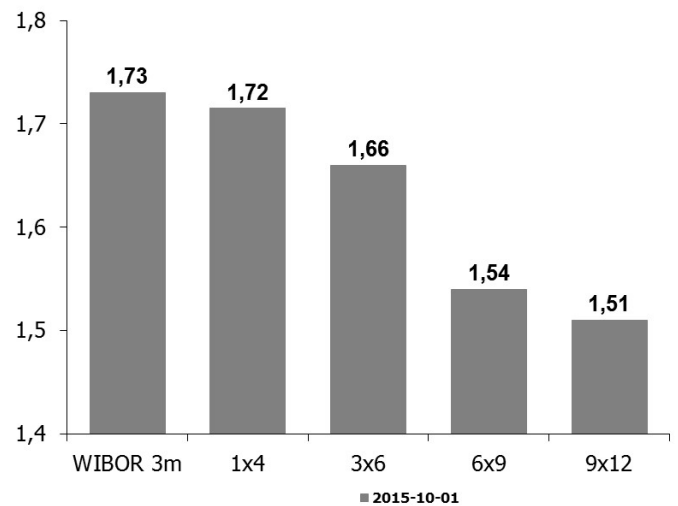
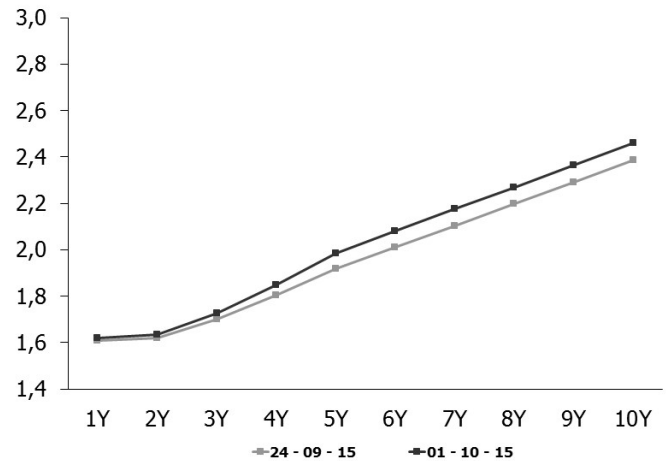
Blurred picture

This week started with post NFP rally as some investors were caught with short bond positions. As a result, yields reached levels not seen since April (PS0420 2.09%, DS0725 2.55%) with several stop-losses triggered. Market position became more balanced and situation on POLGB's more correlated with core bonds; correction reached 8-12 bps (PS0420 2.18, DS0725 2.67%) in the end on a week.

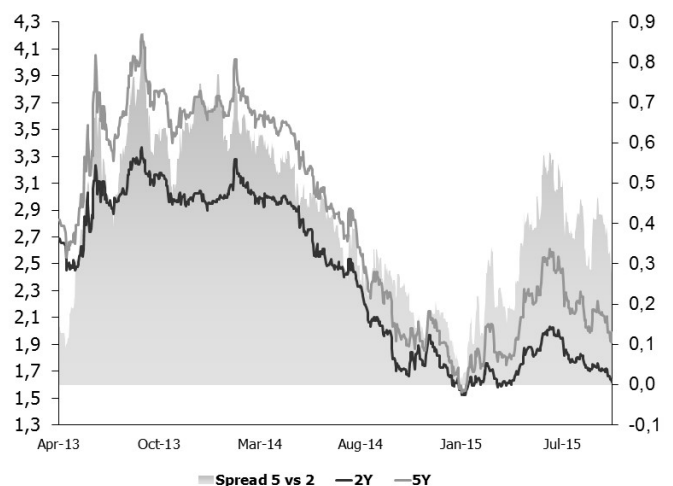
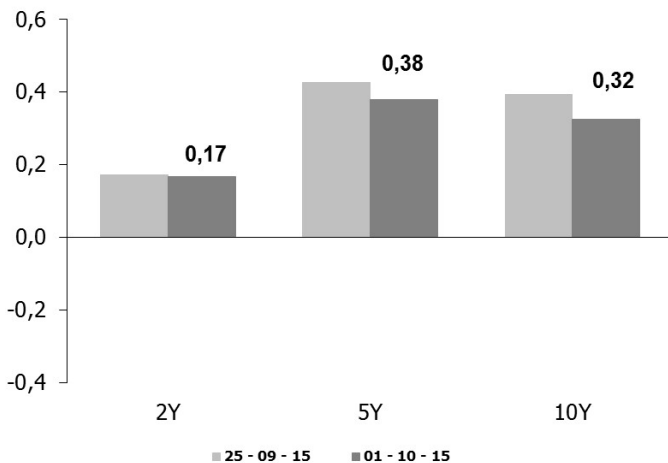
On Thursday Ministry of Finance conducted switch auction - it bought back DS1015 and OK0116 to sell new 5Y benchmark PS0421 and 10Y DS0726. Results were quite positive with demand 6.6 bio against 5.6 bio sold and yields PS0421 2.29% and DS0726 2.78%. It is worth to note that long duration came to the market in the eve of general elections without pressure on the secondary market.

Picture of domestic fixed income market is not clear. On the one hand the Fed lift off is more and more likely to be postponed, ECB is in dovish mode and more action is anticipated and off-shore investors seem to be still not interested in political situation. On the other hand we feel that Sep CPI figure can be higher compared to Stat Office's flash estimation -0.8% y/y and rising crude oil prices have just breached 50\$ level. Global story to buy stocks and sell bonds is going to continue and that's why we prefer to pay short rates PLN FRA 6x9 1.54%, 9x12 1.50% and buying 0725 and 0726 spread at 14.5 bps.

IRS curve



Asset swaps



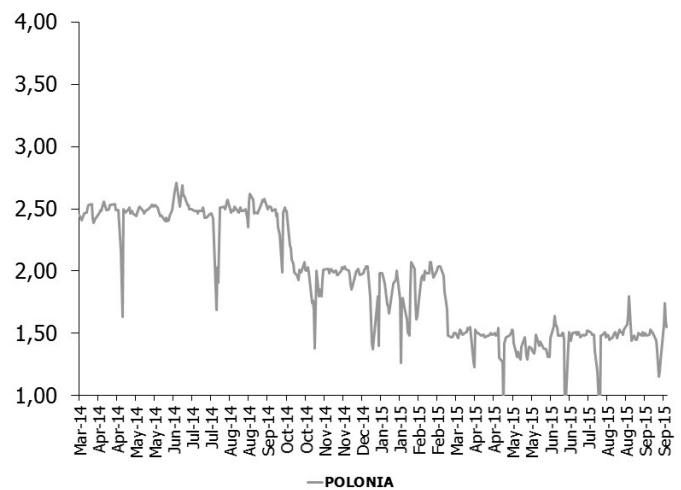
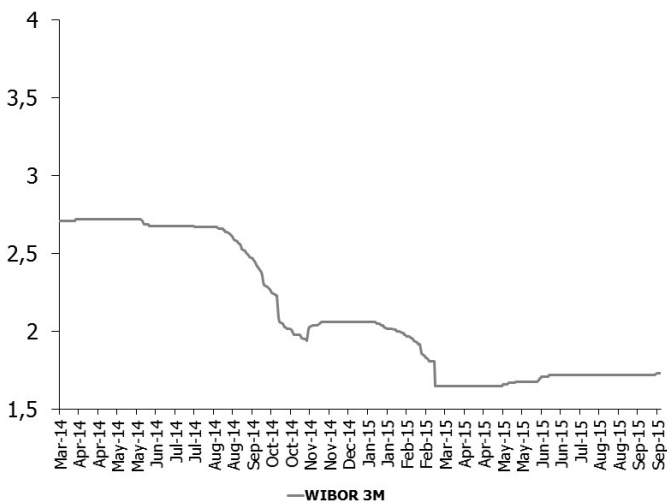
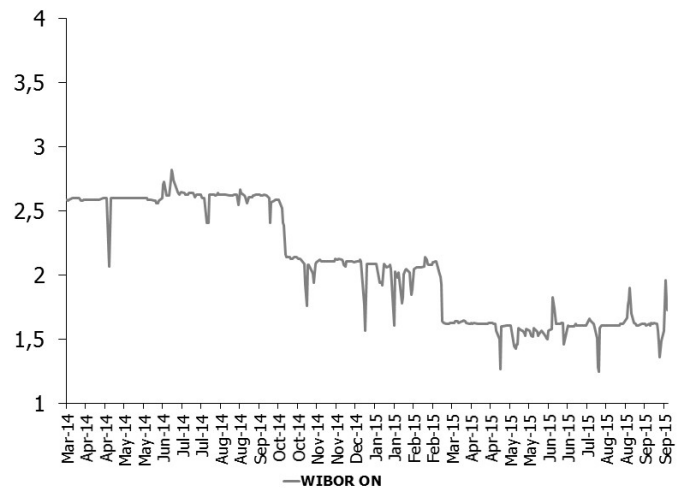
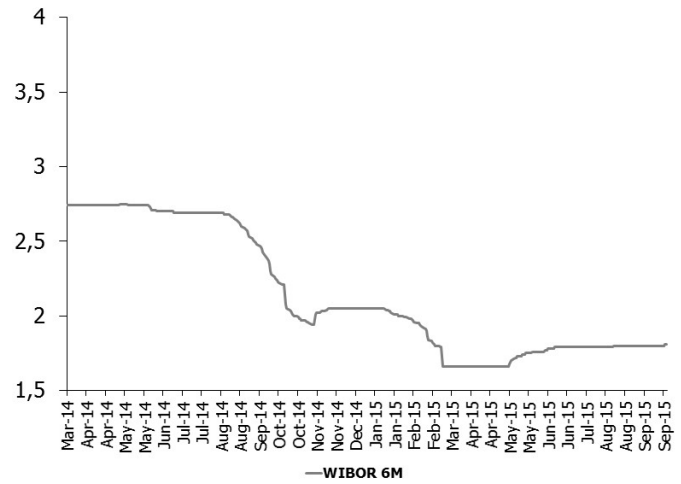


Money market

Tough week behind us

As it was the first week of new reserve, cash was stable with Polonia over 1.50. It should be the same next week. After the last week's US data it decreased to levels where it had been before the last rate cut. 9x12 FRA started to discount more than 25 bps rate cuts in 2016. Now 9x12 FRA is above 1.50, 1Y OIS is around 1.38.

We still think that it is too early to discount any rate cuts so we recommend to buy all front end. Hedge it by buying shortest bonds (OK0716). Also be careful of the next week's CPI.



Forex

PLN back in the middle of the range EUR/PLN is back in the middle of the wider 4.17-4.27 range. The world is not looking that grim anymore. FOMC is more dovish that market had anticipated, EM are not in such bad shape, and stock exchanges may also go up or sideways and not only down. As the result EUR/PLN has dropped from last Friday's high of 4.2595 to 4.21 this Friday low. The scale of the move in USD/PLN is twice as big (3.8050 to 3.7050) respectively. Better global sentiment is evident, but Parliamentary elections in Poland should limit potential PLN gains to current 4.17-4.20 support zone.

Options Old good correlation - stronger PLN = lower vols is back in action. 1 moth EUR/PLN ATM mid is this Friday at 6.4% (0.5% lower), 3 months are 6.7% (0.55% and finally 1 year is fixing at 7.3% (0.3% lower). The skew is bit softer and currency spread (difference between USD/PLN - EUR/PLN vol) is lower because of the EUR/USD creeping higher.

Short-term forecasts

Main supports / resistances:

EUR/PLN: 4.18 / 4.27

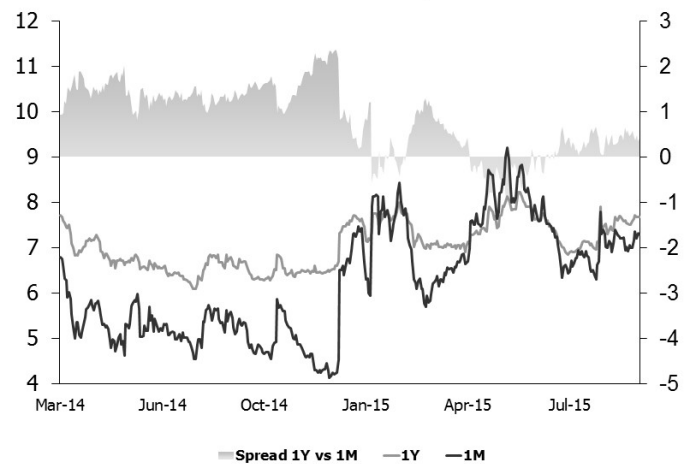
USD/PLN: 3.60 / 3.85

Position Still short EUR/PLN from 4.2550, we have P/T at 4.1900-4.1950 and we lower our stop loss (stop in profit in this case) to 4.25.

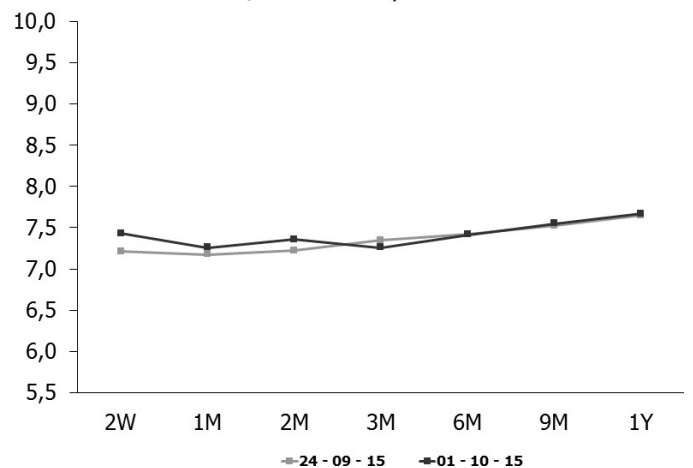
There is still some time before the elections, and we don't think market is that forward looking. If global sentiment really improves, there is still space for PLN to rise. The approach is strictly technical, and we may act opportunistically, and close our position earlier if we will see some PLN negative news.

Options We are still long Gamma, Vega and Vanna in EUR/PLN and USD/PLN. We think that concerns about global growth, rate hikes in the US, and parliamentary elections in Poland will support volatility in the longer term. The both vols curves are lower but we are getting closer to the multi-week support levels what, potentially, creates opportunity to enter into cheap election bet.

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
10/1/2015	1.71	1.73	1.79	1.71	1.70	1.74	1.72	1.66	1.54	1.51	1.52	1.58
10/5/2015	1.62	1.73	1.70	1.71	1.73	1.74	1.69	1.66	1.50	1.44	1.44	1.52
10/6/2015	1.82	1.73	1.88	1.71	1.80	1.74	1.72	1.67	1.52	1.46	1.47	1.55
10/7/2015	1.55	1.73	1.62	1.71	1.64	1.74	1.74	1.70	1.55	1.49	1.51	1.60
10/8/2015	1.63	1.73	1.71	1.71	1.79	1.74	1.72	1.69	1.54	1.50	1.52	1.57

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
10/1/2015	1.740	1.708	1.615	1.781	1.945	2.324	2.445	2.769
10/5/2015	1.740	1.664	1.550	1.647	1.804	2.157	2.271	2.602
10/6/2015	1.740	1.657	1.564	1.769	1.830	2.188	2.295	2.642
10/7/2015	1.740	1.702	1.595	1.708	1.860	2.223	2.325	2.670
10/8/2015	1.740	1.626	1.615	1.751	1.875	2.217	2.335	2.671

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1Y	1Y
10/1/2015	7.25	7.25	7.41	7.68	7.68	2.08	0.53	
10/5/2015	7.05	7.08	7.30	7.65	7.65	2.08	0.53	
10/6/2015	7.08	7.15	7.35	7.65	7.65	2.08	0.54	
10/7/2015	6.83	6.94	7.21	7.53	7.53	2.13	0.57	
10/8/2015	6.76	6.91	7.16	7.55	7.55	2.11	0.53	

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
10/1/2015	4.2437	3.8005	3.8890	3.1659	1.3548	0.1561
10/5/2015	4.2475	3.7730	3.8864	3.1391	1.3618	0.1565
10/6/2015	4.2453	3.7890	3.8873	3.1468	1.3593	0.1566
10/7/2015	4.2272	3.7604	3.8869	3.1315	1.3567	0.1560
10/8/2015	4.2405	3.7543	3.8772	3.1346	1.3558	0.1565

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