November 20, 2015

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 07 51
wojciech.dunaj@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

Table of contents

Comment on the upcoming data and forecasts

A sleepy week ahead of us. On Wednesday, the CSO will publish its monthly statistical bulletin. It should shed more light on some of this month's publications (employment in particular). The preliminary estimate from the Ministry of Family, Labor and Social Policy indicated a slight decline in unemployment rate – we expect it to be confirmed by the CSO.

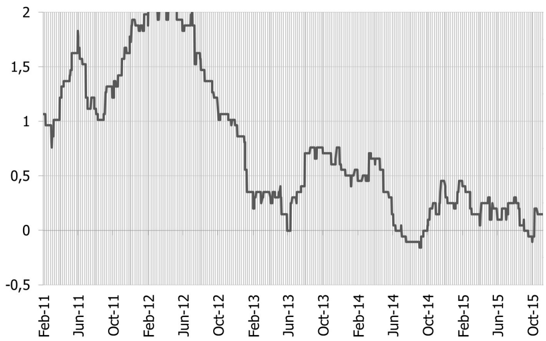
Polish data to watch: November 23th to November 27th

Publication	Date	Period	mBank	Consensus	Prior
Unemployment rate (%)	25.11	Oct	9.6	9.6	9.7

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	11/19/2015	1000	1.770	10/29/2015
5Y T-bond PS0720	11/19/2015	3000	2.317	10/29/2015
10Y T-bond DS0726	11/19/2015	2000	3.076	10/29/2015
15Y T-bond WS0428	-	20	2.092	3/12/2015

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



Comment

There were plenty of opportunities, but neither of the releases was far enough from market consensus, so the index remained unchanged from previous week. It will probably stay at current levels even longer. Preliminary data of the next week's sole publication (unemployment rate), given already by MFLSP, were in line with market consensus.

* 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).

mBank.pl

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 the Polish economy. The upswing 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.
- We expect lower rates in 2016 as the new MPC is set to be more responsive for weaker environment amid global trends for monetary stimulation. Moreover, the new parliament is set to have inclination towards selecting more dovish MPC members.

Financial markets

- Polgbs – near term still neutral (cash). Rate cuts are already priced in, uncertainty surrounding fiscal policy is still an issue, bonds are sensitive to potential monetary tightening in the US.
- We think that POLGBs may still have potential mid-term as monetary stimulus (ECB) is waiting in the wings and the new government is likely to push for easier monetary policy that ultimately will be delivered. Ultimalely, we think fiscal worries will prove overdone.
- Pro-active ECB stance should be enough to shield the zloty from sharp depreciation in case of higher risk aversion. We see zloty stronger mid-term on solid growth story and differentiation flows. Political risk and potential for easier monetary policy may linger for some days. However, as much of it has already been consumed, we neutralize our outlook and opt for more balanced trading around 4.20.

mBank forecasts

	2011	2012	2013	2014	2015F	2016 F
GDP y/y (%)	5.0	1.6	1.3	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	1.00

	2015 Q1	2015 Q2	2015 Q3 F	2015 Q4 F	2016 Q1 F	2016 Q2 F	2016 Q3 F	2016 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	-0.3	0.5	0.6	0.5	0.9
Unemployment rate (% eop)	11.5	10.2	9.7	10.0	10.6	9.4	8.9	9.0
NBP repo rate (% eop)	1.50	1.50	1.50	1.50	1.25	1.00	1.00	1.00
Wibor 3M (% eop)	1.65	1.72	1.73	1.70	1.44	1.20	1.20	1.20
2Y Polish bond yields (% eop)	1.61	1.99	1.76	1.45	1.35	1.35	1.35	1.35
10Y Polish bond yields (% eop)	2.31	3.31	2.84	2.70	2.50	2.50	2.50	2.50
EUR/PLN (eop)	4.07	4.19	4.25	4.15	4.15	4.15	4.15	4.15
USD/PLN (eop)	3.80	3.76	3.80	3.92	3.99	4.07	4.07	4.03

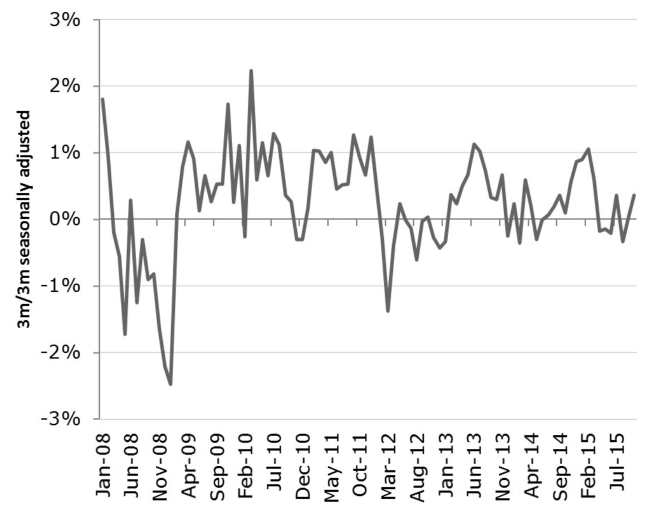
F - forecast

Economics

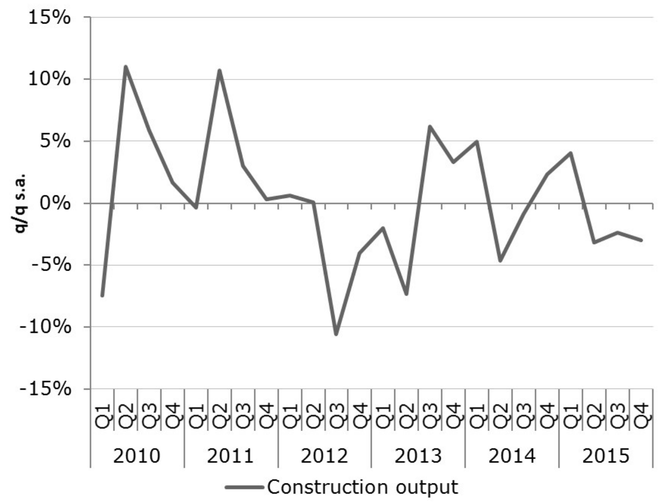
The economy is chugging ahead along a stable and predictable path. Monetary policy will be determined by a paradigm shift, not economic fundamentals.

This week's data confirmed the status quo in the economy. Growth remains stable and signs of weakness pop up in various areas of activity from time to time – this time construction was hit the most but there aren't any signs of acceleration elsewhere. Thus, one cannot draw any new conclusions for monetary policy from these data releases. The status quo in monetary policy embodied in expected rate cuts in 2016. A neutral scenario is being strengthened by the expected desynchronization of monetary policy on both sides of the Atlantic (Fed – rate hikes in December, ECB – further easing). Our opinion remains unchanged – only extreme events could move the market in either side (it is pricing in circa 50bp cuts).

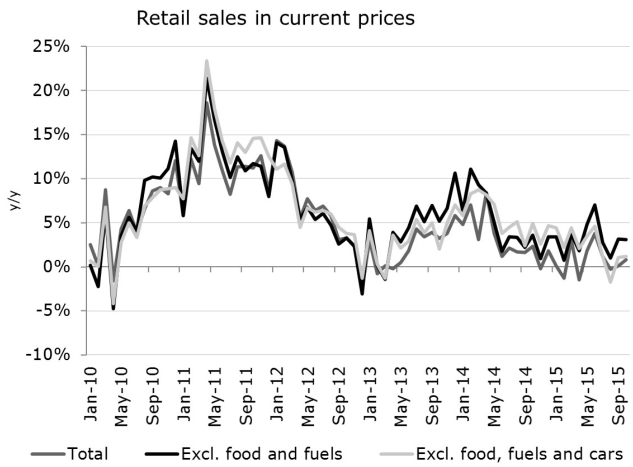
Industrial output grew by 2.4% y/y in October, in line with forecasts and slightly above our prediction. The slowdown relative to September is entirely consistent with unfavorable difference in working days (0 vs. +1 y/y in September). After adjusting for seasonal and calendar factors, monthly increase in production is a modest 0.8%. The momentum of industrial production is thus still quite low, yet high enough to push output to new all-time highs. Bear in mind that this happened in rather challenging environment - fears of fallout from VW scandal and sluggish global economy still persist. At the same time, base effects will drag annual growth rates of IP in the coming months. Thus, any acceleration in industrial output will be quite limited.



Construction output, on the other hand, disappointed severely, by declining by a solid -5.2% in October, much below market consensus and our forecasts (-1.1 and -2.6%, respectively). After seasonal adjustments, monthly growth rate amounted to -2.3%, extending a disastrous series of readings this year. If November and December do not bring a significant rebound in construction activity, the fourth quarter is bound to see another quarterly decline in production, third in a row (hasn't happened since the turn of 2012/2013). We already covered the sources of weakness in construction last month - let's just repeat that this is a likely result of delays in public investment (new projects financed by the EU) as well as weakness in office and commercial construction. Relatively solid data on housing confirm that.



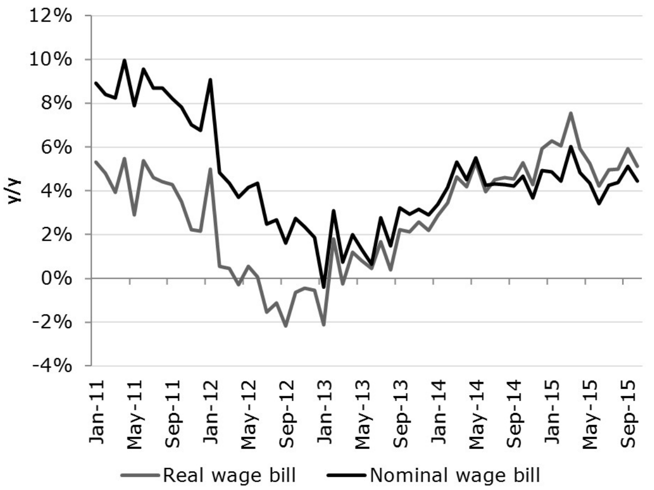
Retail sales went up by 0.8% y/y in October. We were wrong betting at 0.8% contraction. However, the difference stems mostly from seasonal items (textiles, up 12.7% on year) and volatile items (food sales, + 4.2% on year). Stripping those, we would indeed end up in minus. But we unfortunately did not. Other categories behaved more or less as we had expected supporting near zero sales growth. Our favored measures stripping various categories suggest flat momentum and horizontal trend.



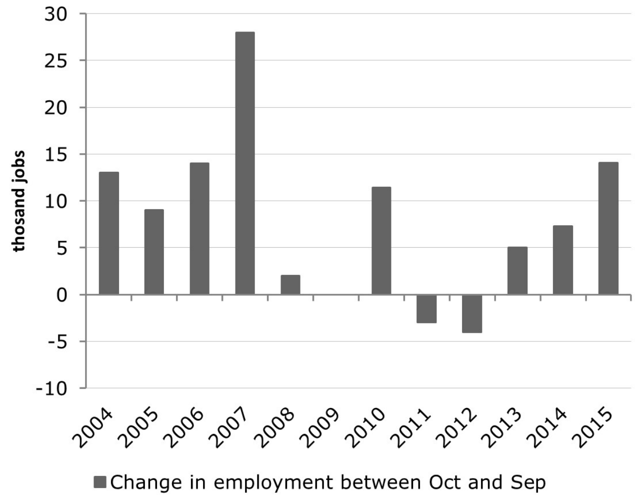
The doldrums seem to be somehow inherent in the Polish economy lately. Although wages (nominal and real) are running high and fuel prices stay low, consumers prefer to forego consumption of goods and consume more services or save for a rainy day instead. As a consequence, consumption is growing close to 3% regardless of growth of retail sales. We think that the policy of the new government can offer consumption a boost: 500+ program and some planned changed in accounting standards with regard to investment activity (100% amortization in one year) can offer a boost to consumption. Therefore, private consumption is going to stay not only the pillar of growth but it can be responsible for maintaining flat profile of GDP growth in the coming months.

Producer prices fell in October by 2.3% y/y, in line with our forecast and slightly above market forecast (2.5% y/y). Just as in September, one category was especially responsible for this fall - mining and quarrying, but decrease of its momentum somehow eases. However, on a monthly basis this category rose at a quite decent pace (1.7%). Other categories changed only slightly on a monthly basis (from -0.3% to 0.1%) We are entering a period where, because of statistical base, yearly index will rise without significant change of monthly momentum. Polish companies do not have enough market power to raise prices. Stable EURPLN exchange rate and negative correlation of the dollar and commodity prices will probably result in low producer prices volatility.

Mean **wage growth** slowed from 4.1 to 3.3%, below market consensus (3.6%) and slightly higher than our forecast (3.1%). This result is a mixture of both base effect from previous year (manufacturing, construction, administration and support services) and lower number of working days (0 r/r vs +1 r/r in previous month). As we mentioned one month ago, nominal wage trend has stabilized at around 3.5-4%. We do not expect this to change in the next months. Structural and demographic changes still are strengthening employees position on the labor market. Economic deceleration is weaker than expected and could be balanced with expansion of fiscal and monetary policy.



Corporate **employment** increased grew by 1.1 on annual basis (above market consensus of 1.0% – forecasters were unanimous this time). On a m/m basis employment grew by 14 thousand jobs and this was the best October since 2007. As usual, it is difficult to comment on a preliminary release, without a detailed breakdown into sectors. Given how sentiment indicators evolved in the past few months - hiring plans and employment forecasts were broadly stable - we believe that one of the more volatile service sectors was behind the surprise. The broader view is unchanged - employment growth will not exceed 1% significantly.



Fixed income

Much ado about POLGBs

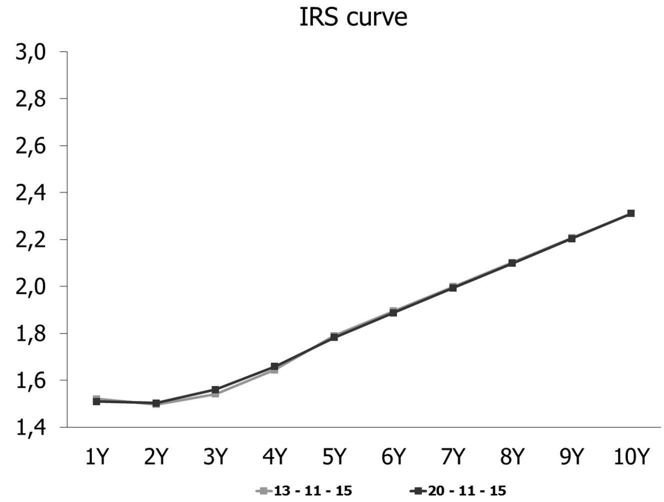
This main event on domestic FI market was Thursday's switching auction. The Ministry of Finance sold 8.3 bio PLN of WZ0120 (WIBOR6M +33bps), PS0421 (2.68%), DS0726 (2.92%) against OK0116 and PS0416 at prices close to the secondary market. What should be noted, is the difference between accepted prices depending on switched bond: OK0116/PS0421 – 98.56; PS0416/PS0421 – 98.65 and OK0116/DS0726 – 96.22; PS0416/DS0726 – 96.326. We read it as MoF's determination to sell as much long-end bonds as the market can accept.

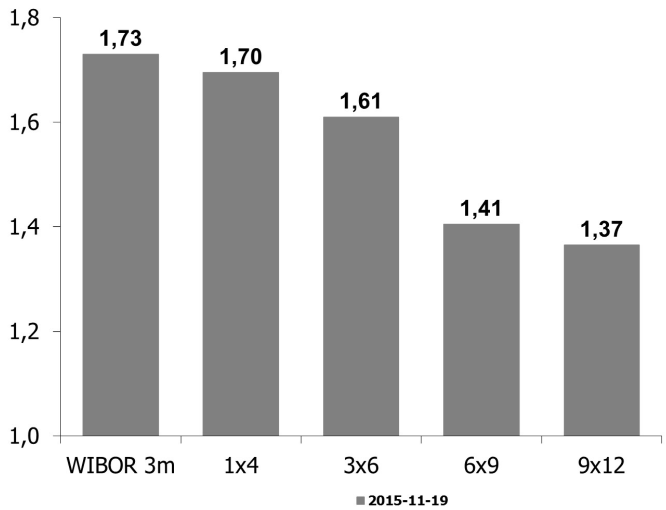
Prime Minister Beata Szydlo presented the her government's programme. She was focused on implementation of all election promises (500PLN monthly child subsidy – budget cost about 20bio PLN, lowering retirement age – 10 bio PLN, increase of tax-free threshold – 20 bio PLN, lower CIT tax – 7 bio PLN) within 100 days. We stick to our view that revenue proposals (improved VAT collection, sector taxes among banks and supermarkets) will not be enough to cover such generous promises and the open question is whether new government will be able to keep budget deficit below 3%.

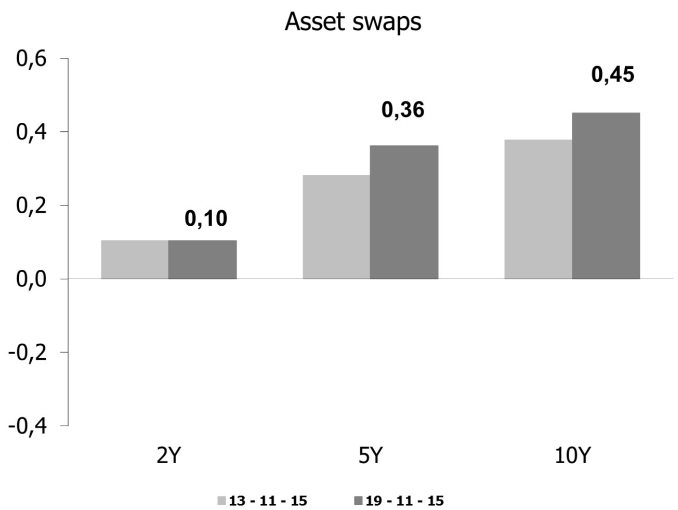
Publication of econ data (read more in economics section) were ignored by market participants.

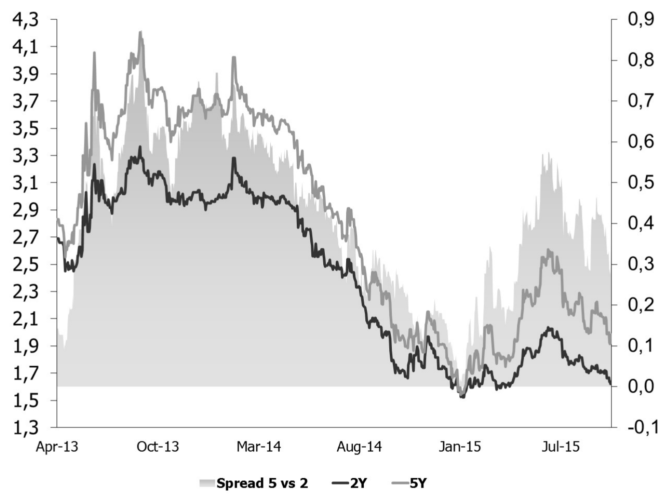
Everybody knows that Mr. Draghi will deliver additional easing – the question is about the scale and scope of instruments he will use. On the other hand, we have the Fed willing to hike rates in December.

Taking it all into account, we still think that current risk-reward scenario looks favourable for paying rates.









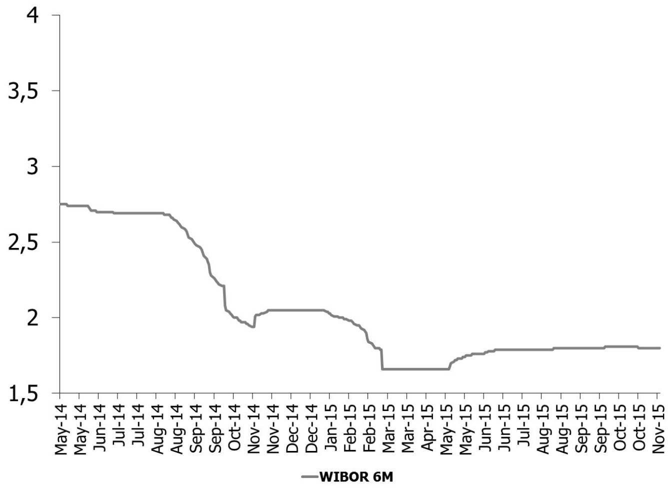
Money market

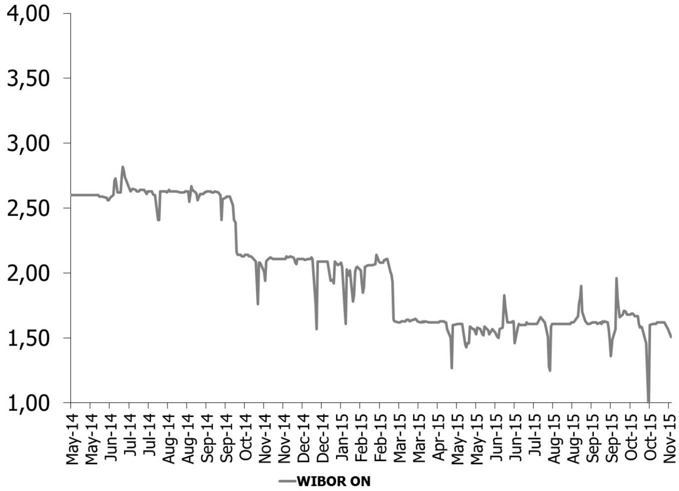
Stable week ahead of us

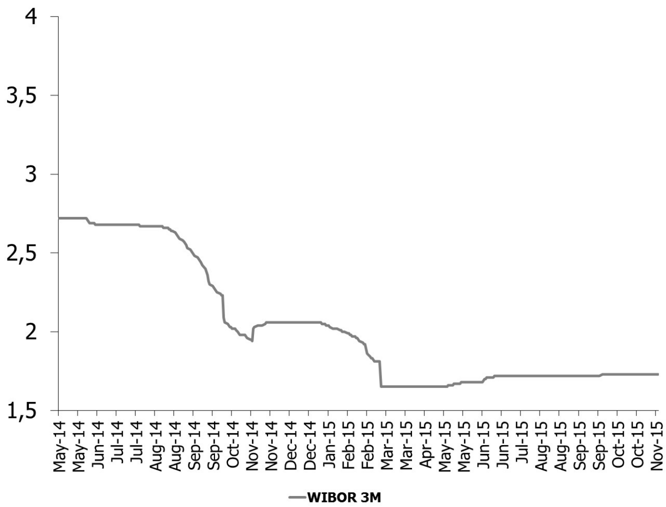
As the last OMO was underbid, cash was cheap. The last day of reserve falls on next Sunday but as today's one squared the market, cash should be stable around 1.50.

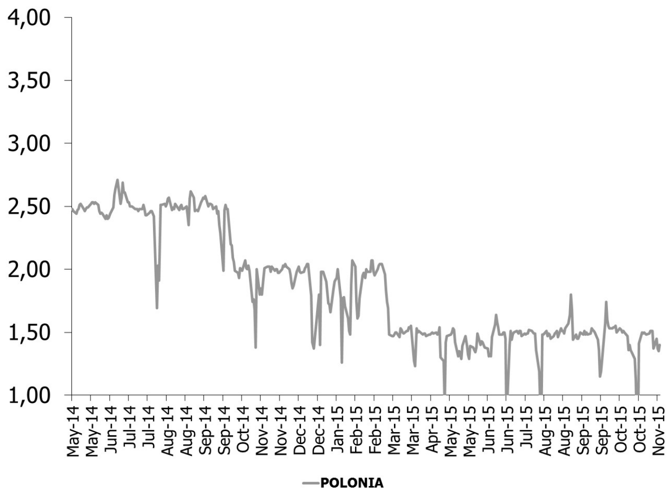
We had a switching auction on Thursday and MF sold 8 bn of medium and long term bonds, buying back OK0116 and PS0416. Our old strategy to buy switching bonds was absolutely right as OK0116 was bought back at 1.39.

FRA and OIS curve remained unchanged for the whole week. We noticed some receiving interest in 6x9 and paying in 8x11 – nothing special then. We recommend to buy 6x9 FRA or 1y3s and hedge it (against potential rate cut) by buying OK0717 at 1.60.





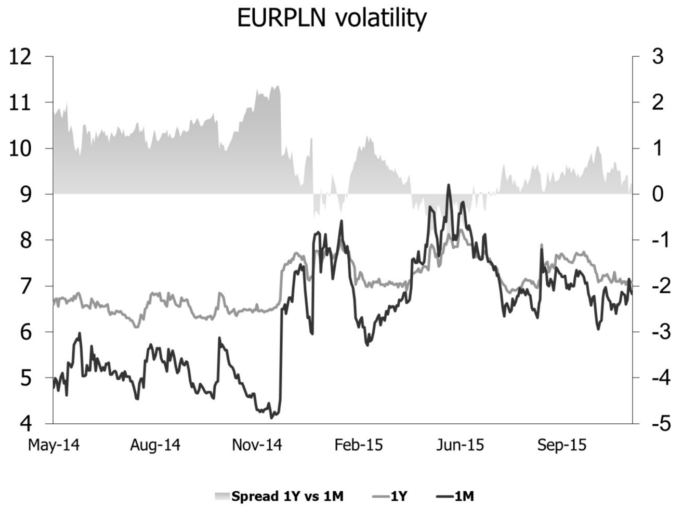




mBank.pl

Forex

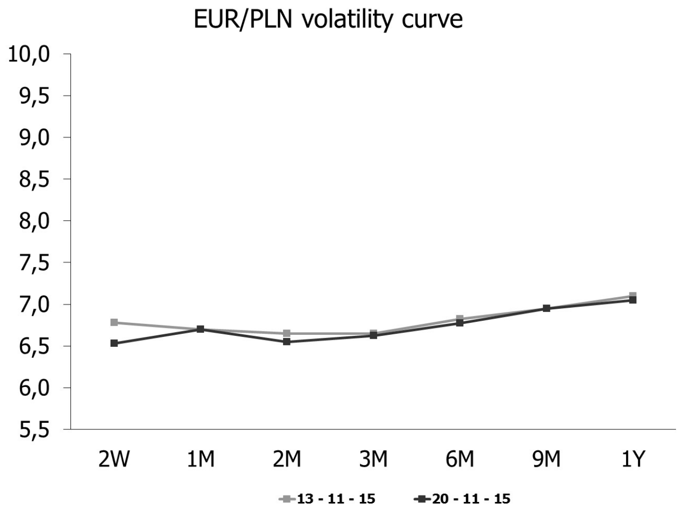
PLN – Boxed in range EUR/PLN is fluctuating in an extremely tight range, around 4.2500 mid of the range. 4.2650 marked a high this week for EUR/PLN, during Prime Minister's expose that rang an alarm bell about fiscal stability. The low so far was 4.2370, on a tic more dovish than expected FOMC minutes. Market is in a wait-and-see mood with regard to the actual decisions of new government. The mammoth-like decisions of ECB and FOMC are also looming on the horizon. As a result, we expect a rangy, choppy market next week.



Options – Consolidation continues It was again a very calm week on the options market. Most of the action was in the longer date skew in EUR/PLN and USD/PLN. Trades reported, 1y 25D RR dealt at 1.7% and 2Y 25D RR at 1.9% (both in EUR/PLN), 2y USD/PLN 25D RR traded at 2.3% and 2.1%. The ATMs were relatively stable. 1 month EUR/PLN ATM mid is 6.7% (0.2% higher, includes EBC and FOMC), 3 months are 6.7% (0.1 higher) and finally 1 year 7.0% (0.1% lower). The currency spread (difference between USD/PLN vol and EUR/PLN vol) is roughly unchanged.

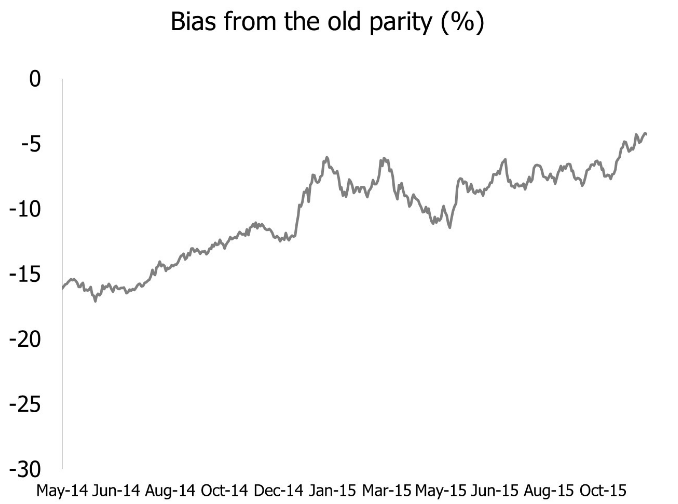
Short-term forecasts

Main supports / resistances:
EUR/PLN: 4.20 / 4.32
USD/PLN: 3.70 / 4.00



Position **Spot** – long EUR/PLN.
We added at 4.22 to our long position from previous week, so finally we are long at average 4.23 with a stop below 4.20 and hopes to revisit 4.28/4.29. Our central scenario is still to play the rangy nature of EUR/PLN. Nevertheless, the political risks are clearly looming on the horizon and that supports short PLN positions.

Options – we are long 1 year Vega against 3 months (Vega neutral)
We are of the opinion that party that have won the elections would act more prudent as they will be taking full responsibility for the country. Hence, that would temper same of its promises and Poland's generally healthy fundamentals will prevail. The looser fiscal conditions may influence us negatively in the future and that is the reason to be long 1 year ATM.



mBank.pl

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
11/12/2015	1.76	1.73	1.83	1.70	1.72	1.72	1.70	1.62	1.42	1.33	1.34	1.43
11/16/2015	1.86	1.73	1.83	1.70	1.73	1.72	1.70	1.61	1.41	1.34	1.36	1.42
11/17/2015	1.65	1.73	1.83	1.70	1.75	1.72	1.70	1.60	1.43	1.34	1.37	1.42
11/18/2015	1.54	1.73	1.59	1.70	1.62	1.72	1.69	1.60	1.40	1.36	1.37	1.43
11/19/2015	1.84	1.73	1.80	1.70	1.72	1.72	1.70	1.61	1.41	1.37	1.38	1.41

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
11/12/2015	1.720	1.623	1.545	1.592	1.905	2.106	2.425	2.755
11/16/2015	1.720	1.606	1.490	1.630	1.755	2.071	2.277	2.697
11/17/2015	1.720	1.555	1.495	1.625	1.755	2.145	2.280	2.751
11/18/2015	1.720	1.593	1.508	1.620	1.793	2.153	2.315	2.770
11/19/2015	1.720	1.592	1.503	1.606	1.782	2.144	2.310	2.761

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
11/12/2015	6.60	6.56	6.83	7.03	7.03	1.93	0.50
11/16/2015	7.15	6.66	6.84	7.13	7.13	1.93	0.50
11/17/2015	6.90	6.61	6.81	7.10	7.10	1.84	0.51
11/18/2015	6.83	6.60	6.85	7.08	7.08	1.82	0.56
11/19/2015	6.70	6.63	6.78	7.05	7.05	1.96	0.58

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
11/12/2015	4.2245	3.9434	3.9263	3.2054	1.3537	0.1563
11/16/2015	4.2472	3.9581	3.9328	3.2210	1.3620	0.1571
11/17/2015	4.2433	3.9775	3.9324	3.2272	1.3596	0.1569
11/18/2015	4.2509	3.9802	3.9264	3.2287	1.3665	0.1572
11/19/2015	4.2477	3.9754	3.9023	3.2257	1.3705	0.1572

Disclaimer

Distribution and use of this publication The review note is based on the information available to the public. This review creates exclusively a marketing information as defined in Paragraph 9 Section 1 of the Decree of Minister of Finance dated November 20, 2009 on procedures and conditions to be followed by investment firms and banks mentioned in Article 70 Section 2 of Law on Trading in Financial Instruments dated July 29, 2005 as well as by custody banks. This review note is provided to you for information purposes only and is not intended as advice on any particular matter or as recommendation, offer or solicitation for purchase of sale of any financial instrument and should not be taken as such. mBank SA, its directors, officers, executives, managers, servants or agents expressly disclaim all liability to any person in respect of any-thing, and in respect of the consequences of anything, done or omitted to be done, wholly or partly, in reliance upon the whole or any part of the contents of this review note. The opinions and estimates contained herein reflect the current judgment of the author(s) on the date of this document and are subject to change without notice. The opinions pointed in review do not necessarily correspond to the opinions of mBank SA. The past performance of financial instruments is not indicative of future results. No assurance can be given that any financial instrument or issuer described herein would yield favourable investment results. mBank and/or its principals or employees may have a long or short position or may transact in the financial instrument(s) and/or securities referred to herein or may trade in such financial instruments with other customers on a principal basis. No client or other reader should act or refrain from acting on the basis on any matter contained in it without taking specific independent professional advice on the particular facts and circumstances in issue. Copyright protection exists in this publication and it may not be, even partially, reproduced of distributed without the prior written agreement with mBank SA.