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Polish Weekly Review

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Comment on the upcoming data and forecasts

All relevant data releases will be published next week (see the Economics section for more data).

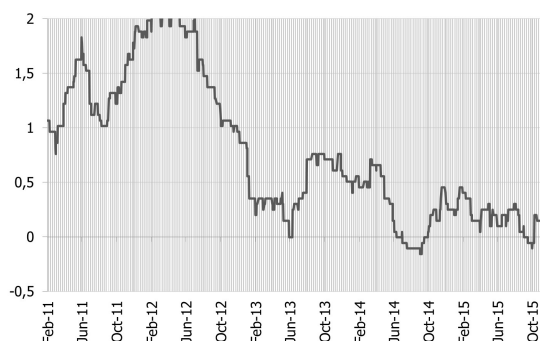
Polish data to watch: December 14th to December 18th

Publication	Date	Period	mBank	Consensus	Prior
M3 y/y (%)	14.10	Nov	9.6	9.2	9.2
Current account (mio EUR)	14.10	Oct	-427	-660	-959
Exports (mio EUR)	14.10	Oct	15450	15383	15059
Imports (mio EUR)	14.10	Oct	15400	15634	14972
CPI final y/y (%)	15.10	Nov	-0.5	-0.5	-0.5
Average gross wage y/y (%)	16.10	Nov	4.3	3.9	3.3
Employment y/y (%)	16.10	Nov	1.1	1.1	1.1
Sold industrial output y/y (%)	17.10	Nov	6.4	5.7	2.4
PPI y/y (%)	17.10	Nov	-2.0	-1.9	-2.3
Retail sales y/y (%)	17.10	Nov	3.5	2.2	0.8

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

No data releases and hence no surprises. All relevant macro releases will be published next week and there'll be plenty of opportunities for surprise.

* 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 perspectives brightened recently.
- 500+ program is set to support private consumption in 2015. At the same time, global headwinds do not seem to be detrimental for Polish exports (see constantly decent business activity in euro zone). Although public infrastructure outlays have shifted towards the latter part of 2016, private investment outlook brightened due to expected faster growth path and burst of consumer optimism.
- Given the current lags of infrastructure spending and constantly fueled consumption growth (child subsidy now, higher tax allowance from 2017), many years of economic expansion are 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.
- Current GDP growth is sufficient to keep inflation and credit risk in check. Globally low to moderate growth amid 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. Polish monetary policy is going to converge with the one run by the NBH. Therefore we expect the newly elected MPC members to be more responsive to low inflation and government financing costs.

Financial markets

- Absent ECB's big bazooka, Polish bonds are exposed on global developments, including December's rate hike in the U.S. Rate cut expectations are being priced out due to financial stability concerns (co-op banks) and weak PLN. In such an environment we stick to cash.
- Polish bonds are now more of EM flavor - higher volatility, wider spreads, more correlation with the broad EM universe.
- Political risks (filtered through changes in valuations of the stock market) and no big bazooka in the euro zone make zloty vulnerable to rising rates in the U.S. In such circumstances zloty is to remain at the weaker side of the range (4.20-4.40). Zloty might strengthen when foreign capital returns to the stock market.

mBank forecasts

	2011	2012	2013	2014	2015F	2016 F
GDP y/y (%)	5.0	1.6	1.3	3.3	3.5	3.6
CPI Inflation y/y (average %)	4.3	3.7	0.9	-0.1	-0.8	0.6
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 (%)	3.7	3.3	3.5	3.5	3.5	3.5	3.7	3.8
Individual consumption y/y (%)	3.1	3.1	3.1	3.2	3.3	3.8	3.6	3.6
Public Consumption y/y (%)	3.7	2.5	2.7	1.2	0.5	2.0	2.0	2.0
Investment y/y (%)	11.5	6.1	4.6	4.0	6.0	7.0	7.5	8.0
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	1.80	1.45	1.45	1.45	1.45
10Y Polish bond yields (% eop)	2.31	3.31	2.84	3.10	3.10	3.00	3.00	3.00
EUR/PLN (eop)	4.07	4.19	4.25	4.40	4.35	4.30	4.25	4.20
USD/PLN (eop)	3.80	3.76	3.80	4.07	4.18	4.22	4.25	4.08

F - forecast

Economics

Gloomy moods & better data.

Before we wind down for Christmas, yet another busy week is coming. Apart from the super-important Fed decision, all the relevant, high frequency data for the Polish economy see the light. Although they are unlikely to be a game changer, improvement in real sphere figures and a pickup in inflation (regardless of the drivers) fit into the broader picture of improving euro zone economy (as reflected in recent ECB forecasts). With the addition of the ongoing chatter on the ambiguous nature of future rate cuts, we are going to see another chunk of rate cuts expectations being priced out in the run-up to the Fed meeting. After the event, market may be focused more on the ongoing risks regulating the pace of Fed tightening, possible hiccups in the euro zone economy and low inflation after the modest increase of ECB stimulation. The market accepted and factored in the current version of banking tax proposal. We may, however, see some talk on sweeteners for banks veiled under the TLTRO-style arrangements.

Let's have a quick look at the upcoming releases.

Real sphere. Both industrial output and retail sales are likely to stage a recovery. Some positive cyclical behavior of the euro zone, coupled with favorable difference in working days, should give industrial output a modest lift to 6.4% from 2.4% in the previous month. The same applies for retail sales, backed by record-high burst of consumer optimism after the elections, base effect from last year and handsome growth of auto registrations in November. We await acceleration from 0.8% to 3.5% with risks skewed to the upside. Positive developments in industry and retail are unlikely to entail changes in employment growth. Frankly speaking, pressure on labor productivity, shrinking work force and rising wages are set to limit appetite for labor in this cycle. 1% employment growth (give or take +0.2pp) is here to stay for quite a while.

Inflation and wages. Only moderate growth of food prices (the region and Czech Republic in particular seems to be an extreme case, though) and stable fuel prices allow inflation to rise only slowly on the back of base effects from last year. Our base case is a rise of inflation from -0.7% to -0.5% y/y (risks balanced). As for the producer prices, upward force stays the same: base effects connected with lower last year's statistical base in fuels. Absent those, momentum stays flat and competition keeps price policy in check. With weaker zloty and possible new entrants on export and domestic markets, lured by more favorable margins, low producer prices are here to stay for a long time. We see PPI acceleration from -2.3% y/y to -2.0% with risks skewed to the downside. Last but not least, wage growth is set to pick up somewhat to 4.3% from 3.3%. Looking beyond seasonal variation, we see potential for a constant buildup although moderate of wage pressure in the coming quarters.

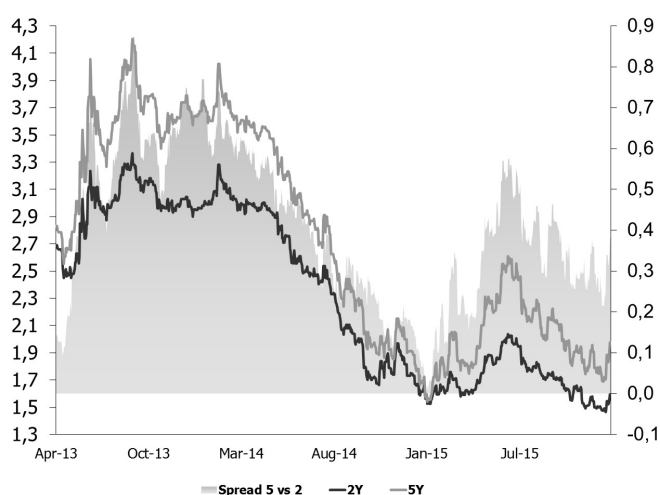
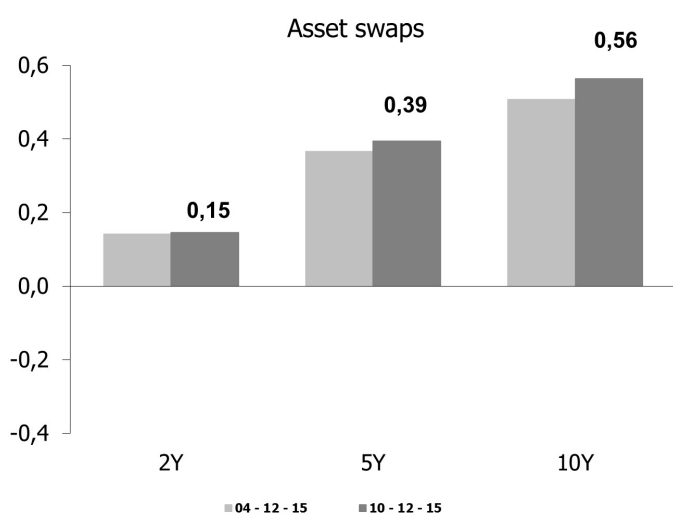
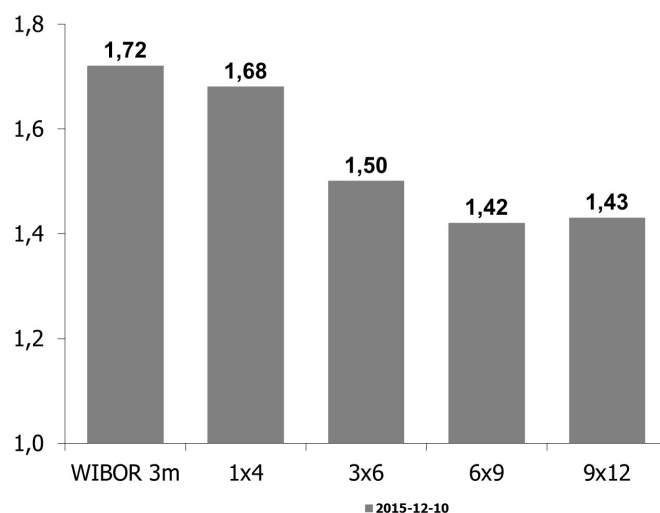
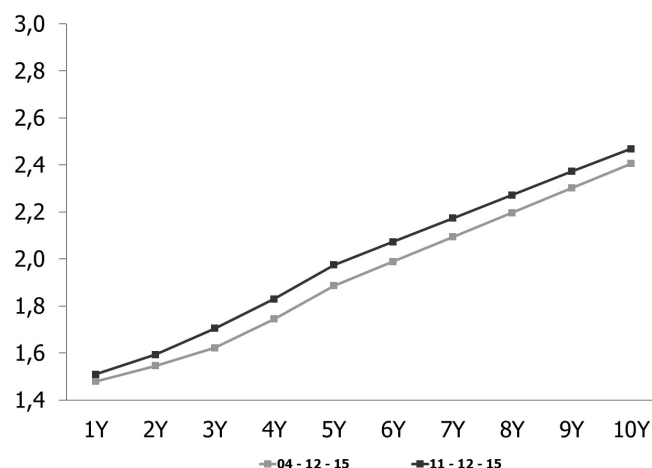
Fixed income

The local story strikes back

For several weeks we underlined that local story was off the interest for market participants. Finally, it has changed. Political turmoil with Constitutional Court, bank and insurance asset tax introduction, switch auction and rebalancing before FOMC meeting next week - that's why market become so heavy (PS 0421 2.60% +25 bps, DS0725 3.13% +30 bps). Investors realised that risk-premium in Poland is too low, and with the new supply (MoF sold 6.7 bio od OK0717, PS0421 and DS0726) bonds were under strong pressure. Is this move exaggerated? We don't think so.

We believe that the Fed will hike rates next week, but we also believe in dovish statement to calm markets. All in all, we still stay aside as with end year coming liquidity should become much lower.

IRS curve



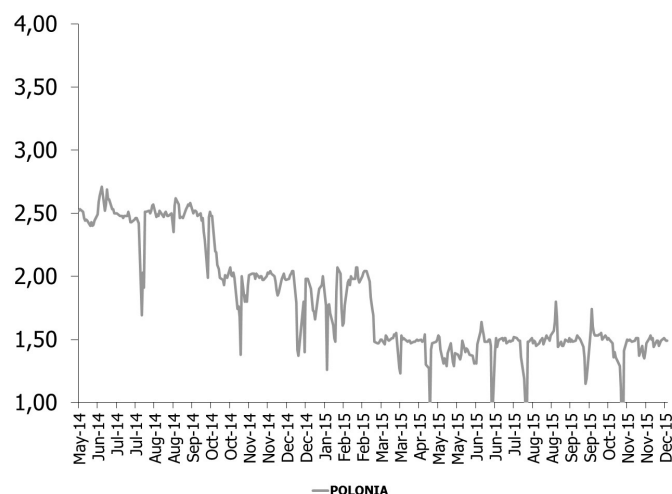
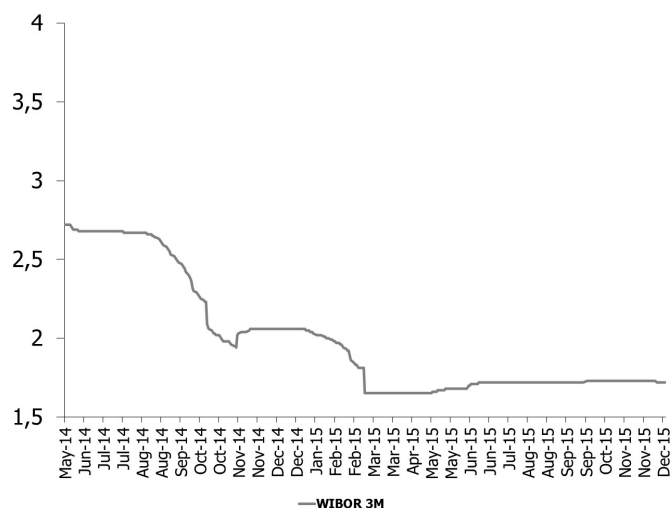
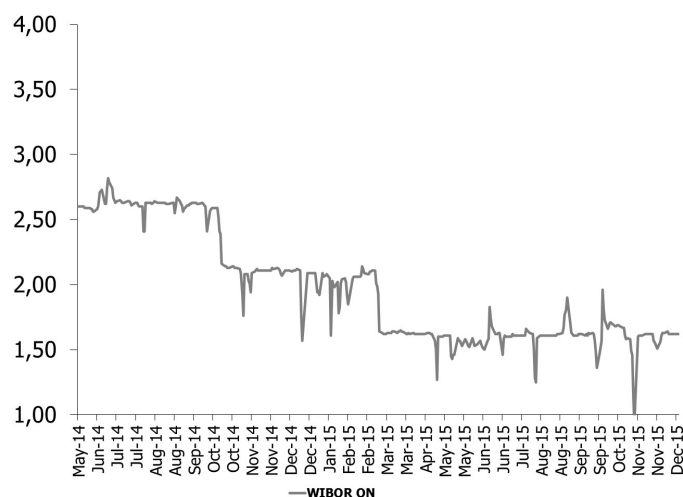
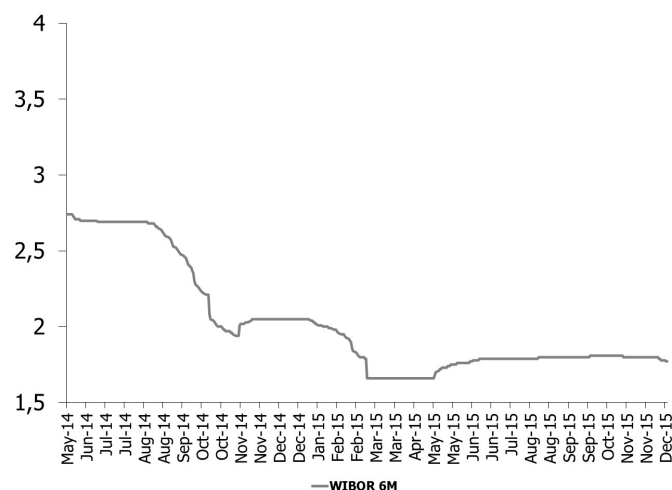
Money market

Stable cash market.

Polonia fluctuated around 1.50 for whole week. Next week should be similar.

FRAs decreased at the beginning of the week to levels where they were before ECB but they rocketed before Thursday auction and now they are still rising. We see two reasons. Firstly, politics caused a big sell-off of bonds (both short and long bonds) and moved the whole curve higher. Secondly, Glapiński statement. He said that rates could be lower by 25 bps but it is not going to meaningfully help the economy.

We suggest buying OK0717 and hedge it by 1.5y OIS POLONIA with around 50 bps spread.



Forex

EUR/PLN – creeping higher EUR/PLN is slowly creeping higher, currently wrestling with a strong 4.35/4.37 resistance; the pullbacks are short lived and shallow. The losses of PLN against EUR are partially offset by weaker USD against PLN. The correlation of EUR/PLN with EUR/USD is still relatively weak +0.21% but it is to be noted that in 2012 these pairs were negatively correlated at -0.63%. It is clearly a consequence of EUR being a funding currency. The next big event will be for sure the FOMC meeting but taking into account the positive correlation mentioned above the direct impact for EUR/PLN is not that clear. Liquidity is also questionable at best.

Options – uneventful week 1 month EUR/PLN ATM MID is 6.2% (unchanged from last Friday), 3 months EUR/PLN are 6.5% (also unchanged) and finally 1 year is fixing at 7.1% (unchanged). The decent trade was reported at 1y ATM at 7.00% (50 mio EUR/PLN), but it came back bid. The currency spread (difference between the USD/PLN vol and EUR/PLN vol) seems to be melting with EUR/USD heading north. Skew is roughly unchanged.

Short-term forecasts

Main supports / resistances:

EUR/PLN: 4.23 / 4.35

USD/PLN: 3.90 / 4.15

Position Spot – Short EUR/PLN.

EUR/PLN – The short from 4.3350 was covered at the entry price.

Current position – none.

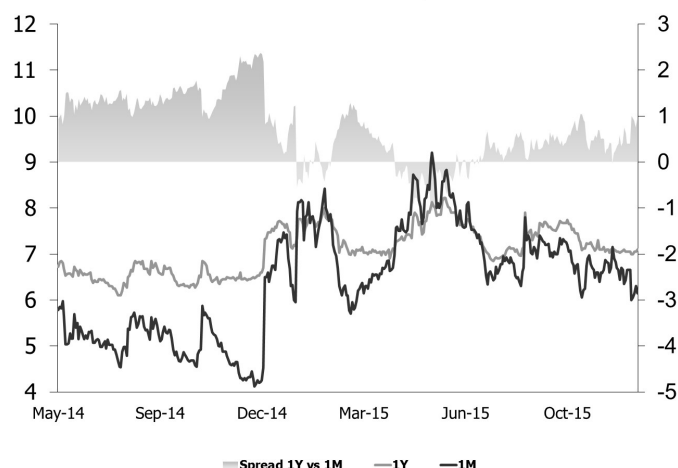
We moved to the sidelines, position wise, because of the fact that 4.30/4.32 support was not even tested properly. The liquidity is getting worse and worse, and the short in EUR/PLN simply is not that rosy anymore.

Options – we are long 1 year Vega against 3 months (Vega neutral)

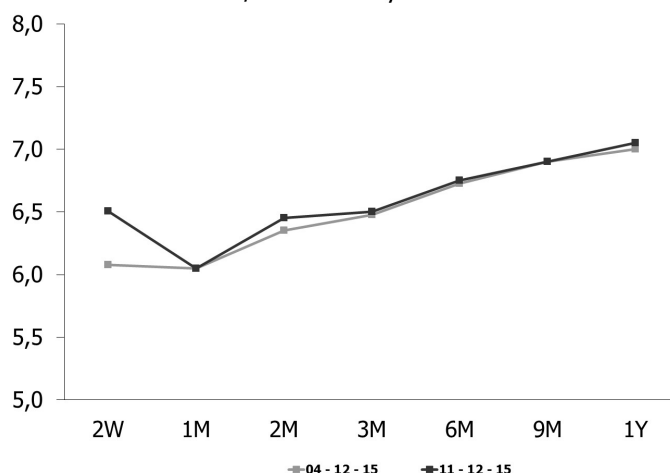
We think that Party that had won the elections would act more prudent while they will be have full responsibility for the country. Hence, it will temper some of its promises and Poland generally healthy fundamentals will prevail. The loosening of fiscal conditions may influence us negatively in the future and that is the reason to be long 1 year ATM.



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
12/3/2015	1.68	1.72	1.58	1.69	1.65	1.71	1.68	1.50	1.38	1.37	1.40	1.39
12/7/2015	1.59	1.72	1.56	1.68	1.62	1.70	1.67	1.48	1.38	1.36	1.40	1.40
12/8/2015	1.60	1.72	1.65	1.68	1.70	1.70	1.68	1.49	1.38	1.36	1.40	1.40
12/9/2015	1.48	1.72	1.46	1.67	1.54	1.69	1.70	1.53	1.42	1.39	1.47	1.47
12/10/2015	1.76	1.72	1.72	1.67	1.55	1.69	1.68	1.50	1.42	1.43	1.48	1.45

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
12/3/2015	1.710	1.574	1.495	1.642	1.800	2.177	2.310	2.852
12/7/2015	1.700	1.555	1.520	1.642	1.830	2.176	2.343	2.836
12/8/2015	1.700	1.584	1.534	1.685	1.855	2.248	2.365	2.913
12/9/2015	1.690	1.610	1.565	1.762	1.920	2.318	2.415	2.987
12/10/2015	1.690	1.655	1.595	1.740	1.975	2.369	2.470	3.033

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1Y	
12/3/2015	6.00	6.51	6.79	7.00	7.00	1.70	0.51	
12/7/2015	6.15	6.40	6.75	7.05	7.05	1.70	0.51	
12/8/2015	6.30	6.53	6.74	7.05	7.05	1.59	0.47	
12/9/2015	6.15	6.59	6.86	7.10	7.10	1.59	0.50	
12/10/2015	6.05	6.50	6.75	7.05	7.05	1.59	0.41	

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
12/3/2015	4.2665	4.0400	3.9461	3.2720	1.3758	0.1579
12/7/2015	4.3111	3.9853	3.9781	3.2293	1.3811	0.1595
12/8/2015	4.3282	3.9877	3.9963	3.2400	1.3809	0.1601
12/9/2015	4.3402	3.9705	4.0030	3.2359	1.3810	0.1605
12/10/2015	4.3440	3.9601	4.0083	3.2523	1.3720	0.1607

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