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Polish Weekly Review

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Comment on the upcoming data and forecasts

The next week brings no significant publications. CSO’s data on international trade and car production from SAMAR are of little importance.

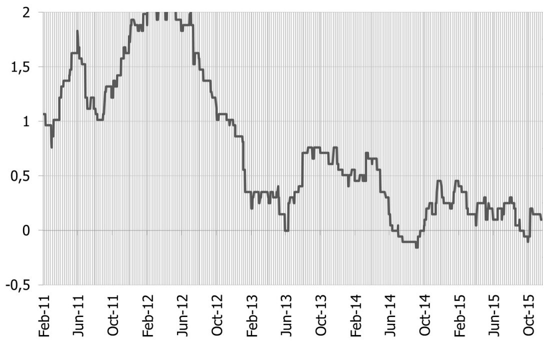
Polish data to watch: December 7th to December 11th

Publication	Date	Period	mBank	Consensus	Prior
NO RELEVANT DATA					

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

One negative surprise - flash CPI. Polish surprise index will remain unchanged next week as no significant releases are scheduled.

* 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 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. In such an environment we stick to cash.
- 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. At the same time, rate cut expectations are set to stay intact. In such circumstances zloty is to remain at the weaker side of the range (4.20-4.40).

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	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 (%)	3.7	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	1.65	1.35	1.35	1.35	1.35
10Y Polish bond yields (% eop)	2.31	3.31	2.84	2.90	2.80	2.70	2.70	2.70
EUR/PLN (eop)	4.07	4.19	4.25	4.30	4.25	4.20	4.20	4.20
USD/PLN (eop)	3.80	3.76	3.80	3.98	4.09	4.12	4.20	4.08

F - forecast

Economics

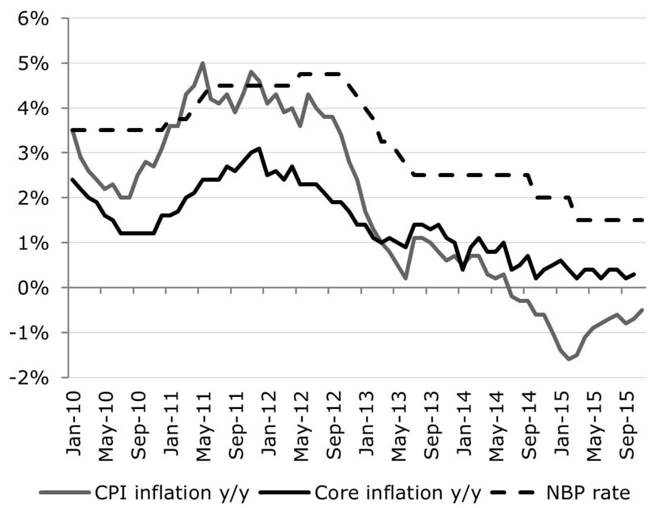
Solid GDP numbers and persistently low inflation. Prepare for monetary and fiscal stimulation next year.

As indicated before and contrary to some expectations, the economy posted yet another quarter of fairly strong growth. Final Q3 GDP numbers released early this week confirmed this picture, even though the relatively high contribution of residual categories might cause some concerns. At the same time, inflation accelerated less than expected, probably on the back of weak core categories. If low core inflation is the best measure of output gap, the the latter is still wide open, making fiscal and monetary stimulation harmless from inflationary perspective. Against this backdrop, the MPC's decision and press conference were of little significance – any changes to NBP policy will be conducted by the new council, bound to be more dovish.

Finally, we have decided to raise our GDP forecasts (2015: from 3.3 to 3.5%, 2016: from 3.1 to 3.6%, 2017: from 3.2 to 3.7%) on the back of higher starting point and upcoming fiscal stimulation (see our comment on GDP figures). Weak currency certainly won't hurt either. After the ECB's underwhelming December decision we also decided to raise our forecasts of EURPLN and bond yields for the next quarters.

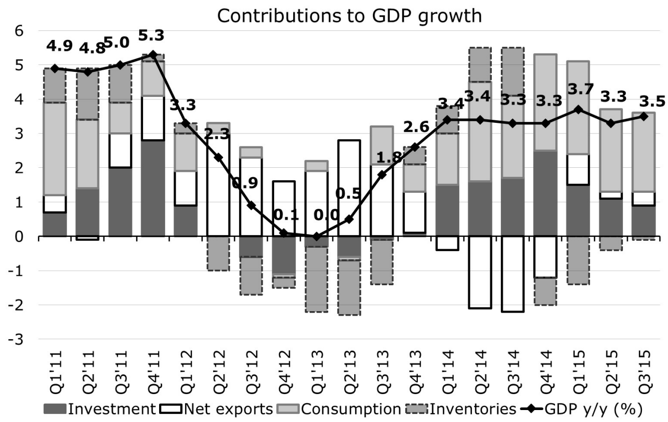
Below is our summary of last week's events.

Inflation keeps surprising to the downside. According to the flash estimate, CPI inflation grew from -0.7% to -0.5% y/y in November, slightly below the market consensus of -0.4%. The preliminary reading indicates that the exit from deflation remains painfully slow. Of course, the underlying details are unknown but we would expect it to be driven by slight increase in food prices, stabilization of core inflation at 0.2% and low statistical base in fuel prices. Trends in fuels, food and the lack of demand pressures suggest the exit from deflation will be longer than initially expected (right now, we expect inflation to turn positive in December or January) and inflation will stay close to zero in 2016.



Gross domestic product grew in Q3 by 3.5% y/y, once again 0.1 pp. higher than the flash reading. Seasonally adjusted data suggest that quarterly growth rate was 0.9% – in the last 7 quarters this rate was very similar – it ranged from 0.7 to 1.0%.

Data is quite consistent which results from models base by higher frequency data (3.2 - 3.3%). However, the composition of this reading is very surprising. Private consumption rose by 3.1% y/y, while we expected is to be lower because of weaker retail sales data. Furthermore, CSO has revised household consumption trajectory downward (also, more variable - ranging from 2.3% to 3.1% y/y in 2014 – 2015); so this is by no means a regular 3% growth. Investment growth came also lower than expected - at 4.6%. Overall, net exports (+0.4%. pp) saved economic growth (however this is a result of previous years revision, because both imports and exports are decelerating on a yearly basis), while contribution of inventories was negative (-0.1% comparing to -0.4%). We are concerned by the fact, that residual categories influence not only contribution but also GDP growth rate.



From the added value side there aren't any highlights, nor does it suggest a slowdown. The economy is accelerating mainly on the back of stronger construction (4.4 vs. 3.5% y/y in the previous quarter), which contrasts with monthly data, and finance and insurance (19.3% vs. 6.8% y/y) – here such volatility is more or less normal. Other sectors are either decelerating or holding steady.

In the coming quarters we still expect GDP growth to remain stable, with upside risks for private consumption starting from Q2 because of the 500+ programme. Preliminary GDP estimates tend to follow remarkably stable trajectories of business cycles. In our view, this means that we are close to the point when investors (yet again) ditch national account data in favor of monthly measures of economic activity. The latter appear to be a better approximation of current activity and national accounts data tend to converge to them with delays and after several revisions.

Against this backdrop, the **Monetary Policy Council** made its decision on Wednesday. Just as all market participants expected, the MPC made no changes in monetary policy. The only significant change in the press release was a part that in fact summarized the Council's term: "the current level of interest rates is conducive to keeping the Polish economy on a sustainable growth path and sustaining macroeconomic balance". Also, during the press conference sustainable growth and fulfillment of central bank mandate (even though inflation is still far from its target) were mentioned. Current MPC is now focusing on such summaries, leaving any changes in monetary policy to its successor. Potential rate cuts were described by governor Belka as ”not needed” but, on the other hand, ”not a tragedy”. Given previous statements, we suspect that this could mean the possible negative influence on banking sector, which in his opinion could withhold monetary easing in Poland.

Fixed income

Clear disappointment

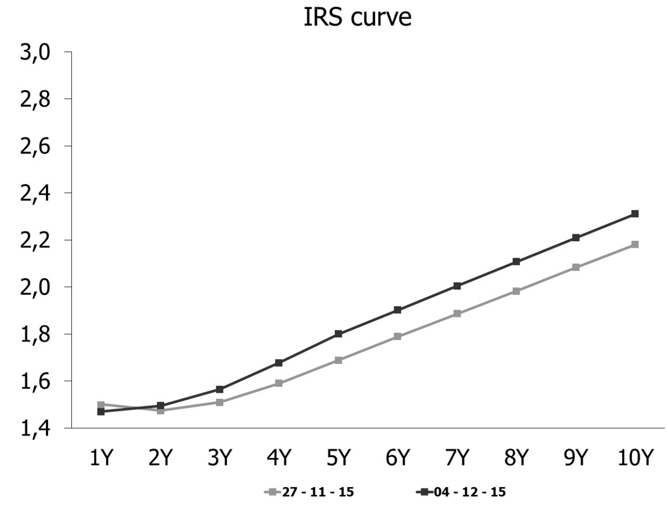
The majority of market participants believed that Mr. Draghi would act decisively and without deposit rate cut by more than 10bps or/and increase in monthly amount of purchases they were strongly dissatisfied. Press conference didn't give more feedback about additional stimulus measures (extension of QE till March 2017, reinvestment of principal payments or purchase of debt instruments of local/regional governments were peanuts compared to what market players had been waiting for).

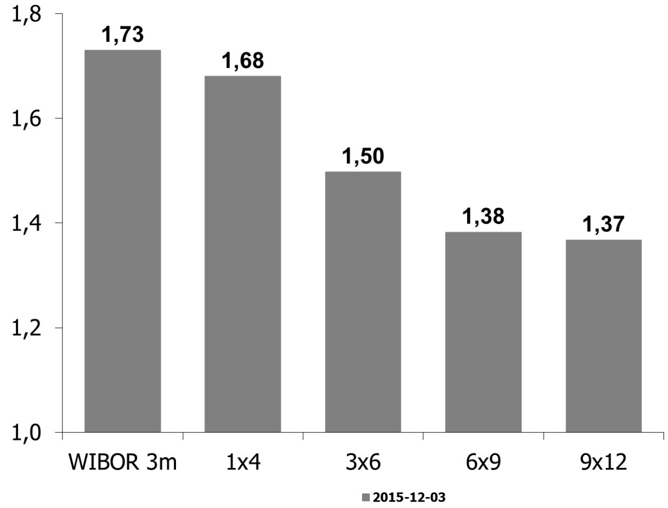
As a result bond tumbled across the world, in Poland as well (OK0717 +4bps 1.60%, PS0421 +23bps 2.44%, DS0725 +27bps 2.94%).

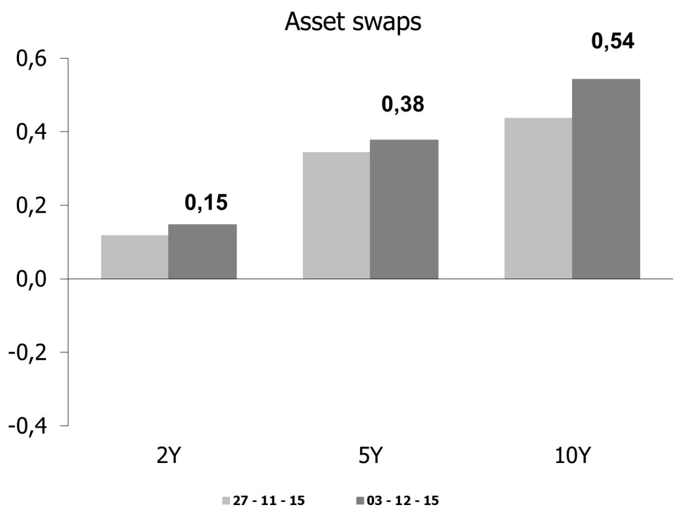
A little higher than expected NFP figure (+211K vs. +200 survey) didn't change the overall bearish picture of the market.

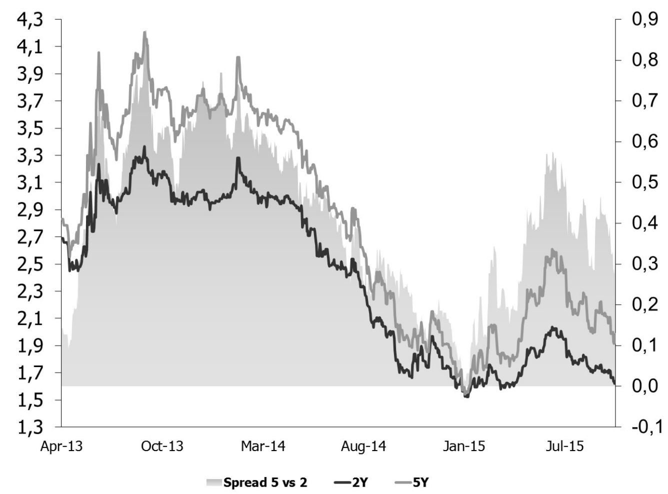
Local story still does not seem important for market players but remember about financial institutions tax as its draft is more and more clear. Bank and insurance assets tax is going to be implemented as of February next year at 0.0325% monthly for banks and 0.05% monthly for insurance.

The composition of Fed rate hike in December and ECB monetary policy is clearly bonds negative but after such strong sell-off we think that this move is a little overdone and therefore we decided to take profit and close our short bond position. For the time being we stay on the sidelines, waiting for opportunity to re-sell. In this not favourable environment Ministry of Finance is going to conduct switching auction on Thursday 10th Dec.









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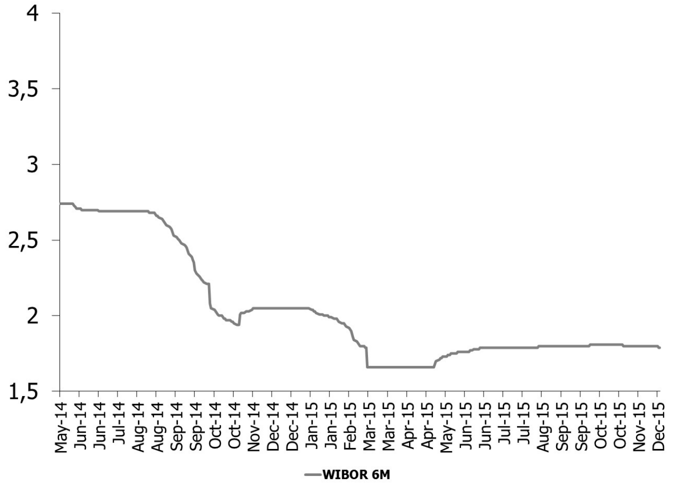
Money market

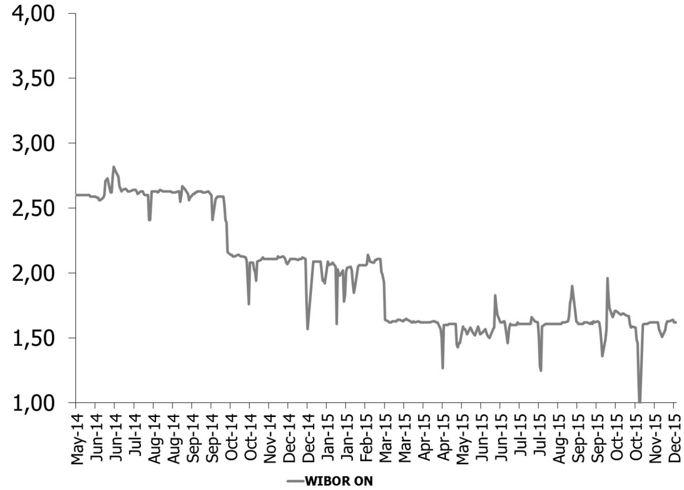
Bills, ECB and taxes

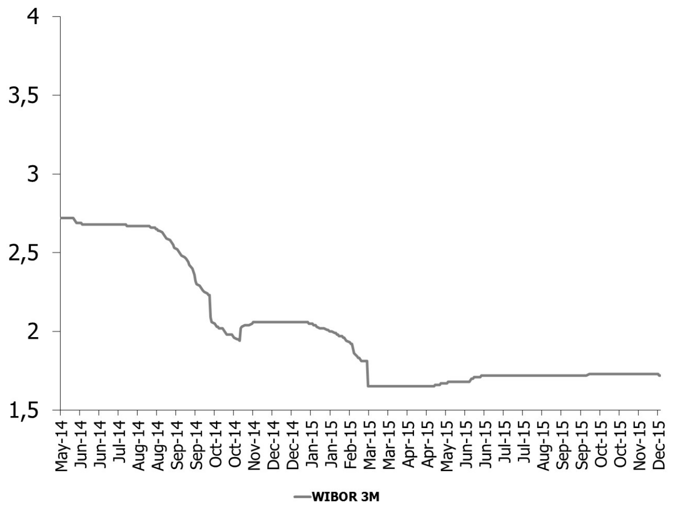
NBP sold today PLN 90.5 bn 7-day bills out of 94.5 offered. That's what should square the market, so nothing exciting is going to happen next week in terms of short cash. Liquidity stays thin going into year end.

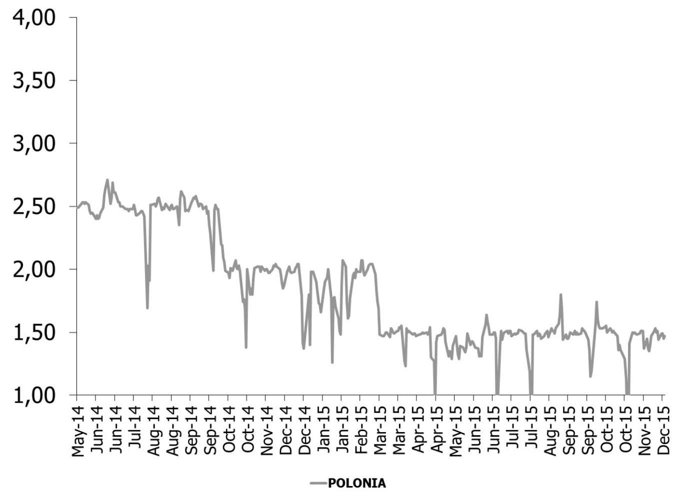
On rates we had a major disappointment at the ECB meeting. Market expected a lot from Mr Drahi and those expectations where not met. Market got caught wrong positioned and we had a major selloff on all bonds. Curve steepened a lot and the very front moved only marginaly around 3-5 bp. The move on Polish assets was a reaction to global selloff not connected to local story.

A project of banking tax which was published today. It assumes monthly payments of 0.0325% wich gives 0.39% tax annualy. We are still trying to figure out what the influence for the local market would be.









Forex

EUR/PLN – higher Short EUR/PLN trade was considered as one of consensus trades on the market and, as it often happens, it did not work quite as planned. What ECB finally has delivered was not enough for the market. As a result, EUR/EM got a nasty squeeze higher. Looking at things from basket perspective (EUR and USD with the same weight), PLN hardly changed. We expect there is still some upside potential to 4.35/37, where we would ideally like to fade the spike. We are firm believers in the rangy nature of EUR/PLN, and see the current range as roughly 4.23/4.35.

Options – calm week In EUR/PLN Vols it was relatively calm week. 1 month EUR/PLN ATM mid is this Friday 6.2 (0.3% lower), 3 months are 6.5% (unchanged) and finally 1 year also unchanged at 7.1. The USD/PLN vols were completely another specie, dropping hard by roughly 1% – 1.5%, as USD/PLN corrected lower. Skew was also better offered, with 1 year RR offered at 1.9% (last week mid).

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 the average of 4.2925 was stopped out at 4.3300.

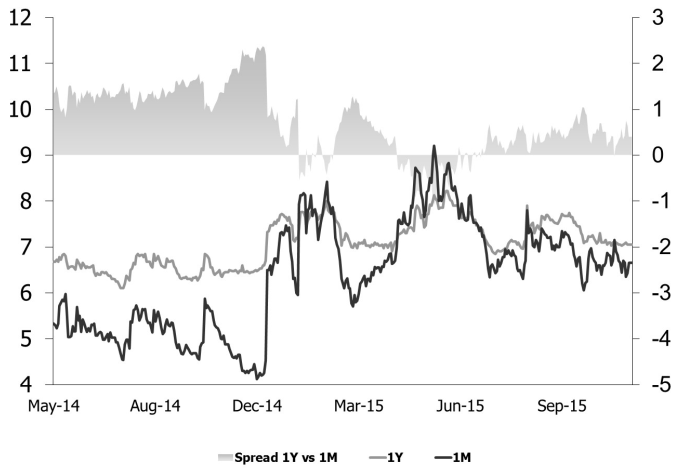
Current position – EUR/PLN short at 4.3350.

We have decided to sell again at 4.3350 and we are ready to add at 4.3600 with stop above 4.3800 and hopes to see move to 4.2500. Position-wise the market is now much cleaner and we think the risk/reward ratio is now much better. The market is disappointed with the last ECB decision, but they are still printing a lot of money that should eventually support PLN.

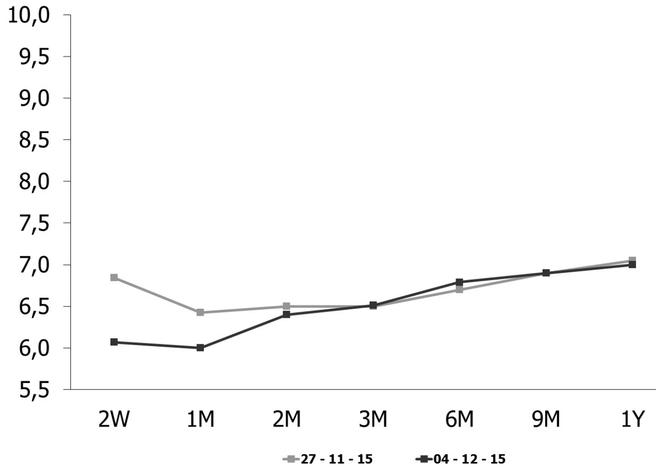
Options – we are long 1 year Vega against 3 months (Vega neutral)

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.

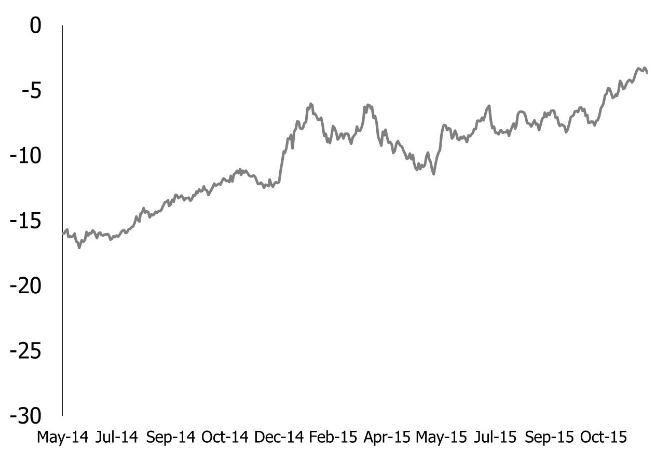
EURPLN volatility



EUR/PLN volatility curve



Bias from the old parity (%)



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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
11/26/2015	1.73	1.73	1.81	1.70	1.70	1.72	1.70	1.59	1.38	1.33	1.34	1.39
11/30/2015	1.60	1.73	1.65	1.70	1.70	1.72	1.70	1.58	1.38	1.33	1.34	1.39
12/1/2015	1.74	1.73	1.79	1.70	1.70	1.72	1.70	1.57	1.37	1.33	1.34	1.38
12/2/2015	1.51	1.72	1.56	1.69	1.59	1.71	1.70	1.54	1.35	1.32	1.33	1.38
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

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
11/26/2015	1.720	1.586	1.476	1.574	1.693	2.039	2.188	2.644
11/30/2015	1.720	1.568	1.490	1.613	1.720	2.082	2.210	2.691
12/1/2015	1.720	1.575	1.475	1.615	1.715	2.073	2.211	2.678
12/2/2015	1.710	1.603	1.465	1.654	1.705	2.058	2.195	2.678
12/3/2015	1.710	1.574	1.495	1.642	1.800	2.177	2.310	2.852

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
11/26/2015	6.35	6.50	6.70	7.10	7.10	1.81	0.60
11/30/2015	6.65	6.60	6.80	7.05	7.05	1.81	0.60
12/1/2015	6.65	6.55	6.75	7.05	7.05	1.70	0.53
12/2/2015	6.65	6.63	6.83	7.05	7.05	1.70	0.53
12/3/2015	6.00	6.51	6.79	7.00	7.00	1.70	0.53

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
11/26/2015	4.2763	4.0298	3.9404	3.2876	1.3687	0.1582
11/30/2015	4.2639	4.0304	3.9099	3.2740	1.3696	0.1578
12/1/2015	4.2651	4.0248	3.9128	3.2694	1.3736	0.1578
12/2/2015	4.2815	4.0305	3.9278	3.2739	1.3721	0.1584
12/3/2015	4.2665	4.0400	3.9461	3.2720	1.3758	0.1579

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