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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
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>

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Comment on the upcoming data and forecasts

On Wednesday the NBP will publish balance of payments data for November. We expect trade balance and current account balance to remain stable. The only material difference is a slight monthly decline in both exports and imports. On Thursday the NBP will release money supply data for December. The mild acceleration we are forecasting can be traced back to low statistical base in household deposits (abysmal returns from the stock market are only helping here). The January meeting of the MPC will also end on Thursday but we do not expect it to bring any surprises - this is the last one in old line-up, before new members are elected by the parliament. On Friday, the CSO will revise its preliminary CPI figures. We expect a slight upward revision, in line with our original estimates. Details should show a decline in fuel prices (not enough to offset the base effect from last year) and extremely low core inflation.

Polish data to watch: January 11th to January 15th

Publication	Date	Period	mBank	Consensus	Prior
Current account (mio EUR)	13.01	Nov	-180	-265	-113
Exports (mio EUR)	13.01	Nov	14900	14761	15344
Imports (mio EUR)	13.01	Nov	14400	14390	14861
MPC decision (%)	14.01	14.01	1.50	1.50	1.50
M3 money supply (%)	14.01	Dec	10.3	9.9	9.8
CPI inflation (%) <i>final</i>	15.01	Dec	-0.4	-0.5	-0.5

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	1/28/2016	1000	1.770	10/29/2015
5Y T-bond PS0720	1/28/2016	3500	2.382	1/7/2016
10Y T-bond DS0726	1/28/2016	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

Slightly down, as flash CPI surprised to the downside. Final CPI data could reverse that decline next 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 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-free 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.
- Rate cuts in 2016 are still a possibility. 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

- Valuations of POLGBS (5Y and longer) look attractive already and credit risk looks overpriced now (Polish assets display very high short term correlation with EMs at the time of stress). Banks substituted NBP bills with short-end bonds, which are exempted from bank tax.
- Wider ASW already improved attractiveness of POLGBs v. IRS. POLGBs cheapened vs. DM and euro peripherals.
- Given the European low-yield environment, rate cuts expectations in Poland should not evaporate completely (although they may be more FX-dependent than previously believed, and the new MPC looks also less willing to cut rates aggressively than before) and a scenario of lower rates for longer should apply to Poland as well (that is why we suggest long end bonds).
- Zloty is to remain in the range (4.20-4.40). It 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	-0.9	0.5
Current account (%GDP)	-5.2	-3.7	-1.3	-2.0	-0.6	-1.1
Unemployment rate (end of period %)	12.5	13.4	13.4	11.4	9.6	8.7
Repo rate (end of period %)	4.50	4.25	2.50	2.00	1.50	1.25

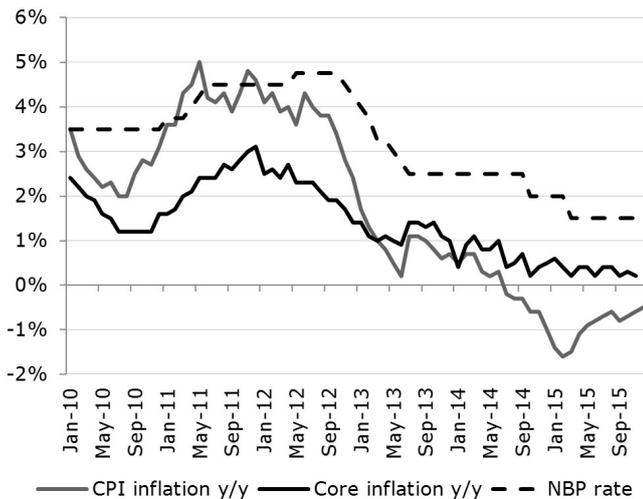
	2015	2015	2015	2015	2016	2016	2016	2016
	Q1	Q2	Q3 F	Q4 F	Q1 F	Q2 F	Q3 F	Q4 F
GDP y/y (%)	3.7	3.3	3.5	3.5	3.5	3.5	3.7	3.8
Individual consumption y/y (%)	3.1	3.1	3.1	3.2	3.3	3.8	3.6	3.6
Public Consumption y/y (%)	3.7	2.5	2.7	1.2	0.5	2.0	2.0	2.0
Investment y/y (%)	11.5	6.1	4.6	4.0	6.0	7.0	7.5	8.0
Inflation rate (% average)	-1.4	-0.9	-0.7	-0.6	0.1	0.3	0.4	1.0
Unemployment rate (% eop)	11.5	10.2	9.7	9.6	9.8	9.0	8.6	8.7
NBP repo rate (% eop)	1.50	1.50	1.50	1.50	1.25	1.25	1.25	1.25
Wibor 3M (% eop)	1.65	1.72	1.73	1.72	1.44	1.44	1.44	1.44
2Y Polish bond yields (% eop)	1.61	1.99	1.76	1.62	1.45	1.45	1.45	1.45
10Y Polish bond yields (% eop)	2.31	3.31	2.84	2.94	3.10	3.00	3.00	3.00
EUR/PLN (eop)	4.07	4.19	4.25	4.26	4.30	4.25	4.25	4.20
USD/PLN (eop)	3.80	3.76	3.80	3.92	4.13	4.17	4.25	4.08

F - forecast

Economics

We do not even bother counting months of deflation in Poland...

In December, according to flash estimate, CPI inflation in Poland amounted to -0.5% y/y. This means that consumer prices were falling only slightly slower than in November. We do not know the details yet, but it is highly likely that its main drivers were: typical seasonal behavior of food prices (a slight rise on a monthly basis) and a large drop in fuel prices (more than 2% m/m). Core inflation fell most likely to 0.2% y/y.

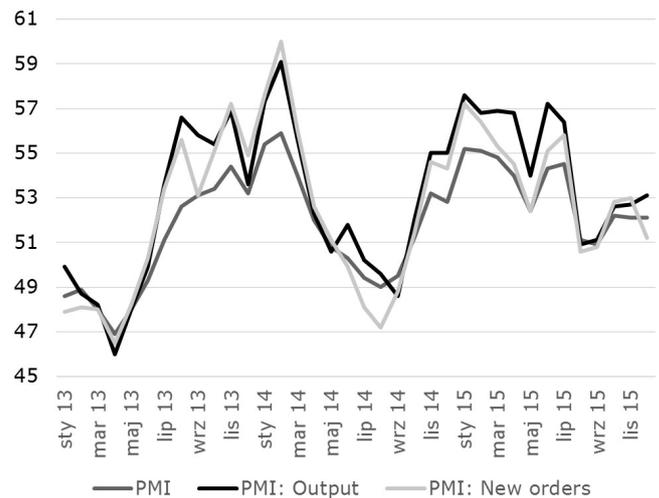


We expect inflation to return to positive values in February / March. January, due to the already announced cut in gas and electricity prices, will probably be another month of deflation. In the second part of 2016 we will probably see a significant change in consumer price momentum because of two reasons. Firstly, domestic factors (higher wages and a shift in equilibrium in the labour market) will move services prices up. Secondly, global commodity markets will be slowly returning to its steady states, which will of course raise inflation also with Eurozone and US rates.

Monday's data still could support monetary policy adjustment. However, the final decision will depend on PLN volatility as well as perception of risk on global markets in the next months. Polish government bonds have already adjusted to final corrections in bank tax and look attractive to us. Higher bond supply will probably occur only in the short end of yield curve and will be bought mainly by banking sector (they are more attractive than bills). Without negative factors (we do not see those in near future) Polish yield curve should be flattening and asset swaps should narrow (this will be the main factor behind the aforementioned move).

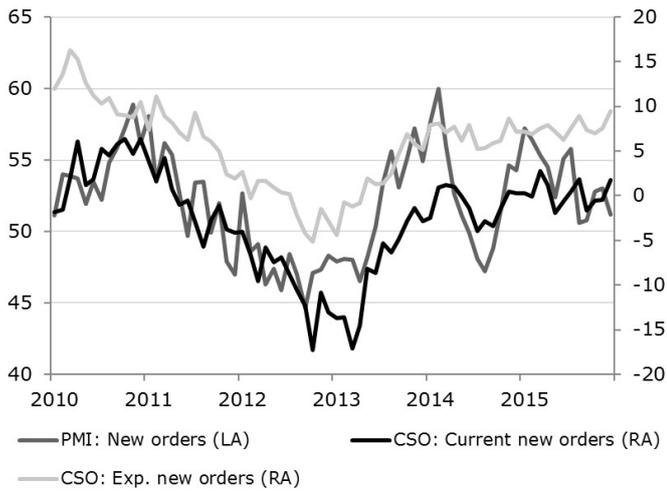
Polish PMI stagnates in December

Polish industry closed last year with a slight disappointment - manufacturing PMI, which was supposed to rise, remained unchanged in December (52.1). This adds up to the general picture of stable PMI readings in Q4 (once 52.2 and twice 52.1 compared to the Q3 average of 52.2). It is worth mentioning that although latest release was unsatisfactory, it was still broadly consistent with other business tendency indicators.



The December's release is an amalgam of slightly better-than-expected estimates of both production (from 52.7 to 53.1) and employment and a decline in new orders component (from 53.0 to 51.2). The slide in the latter subcomponent was driven mainly by the weakness in domestic orders, as export orders showed decent growth. However, there is no breakthrough in either of those categories; the same applies to price processes. In December low commodity prices (including metals) resulted in a declining production costs among surveyed firms for the fourth time in a row; final goods prices dropped at a solid pace as well.

Taking into account the high resilience of Polish economy to external shocks in recent months, it is unlikely that we will see unambiguously negative economic indices. Recent PMI readings imply stable economic growth (as it could sound odd, in last two years micro-cycles in economic growth were only 0.5 pp. apart). Significant deterioration in new domestic orders category should be seen as noise rather than expression of political uncertainty (as some are suggesting) and lower expectations concerning economic growth - the corresponding CSO new order indices climbed in December (see the chart below). This year should bring slight acceleration of economic growth, driven mainly by consumption (e.g. government child support program „500+“).



Fixed income

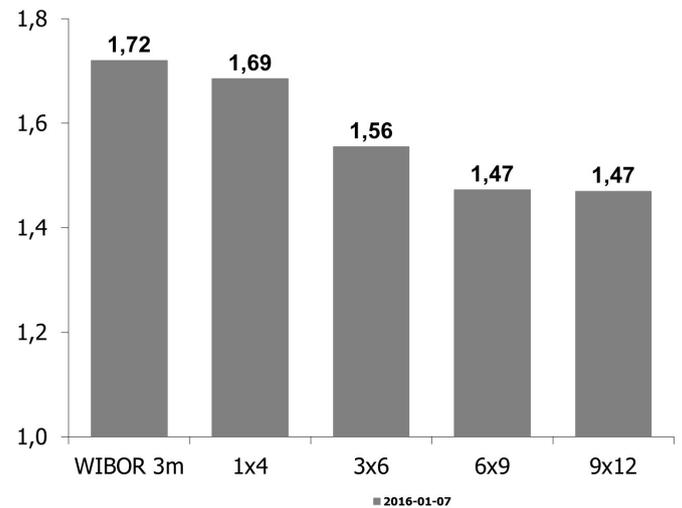
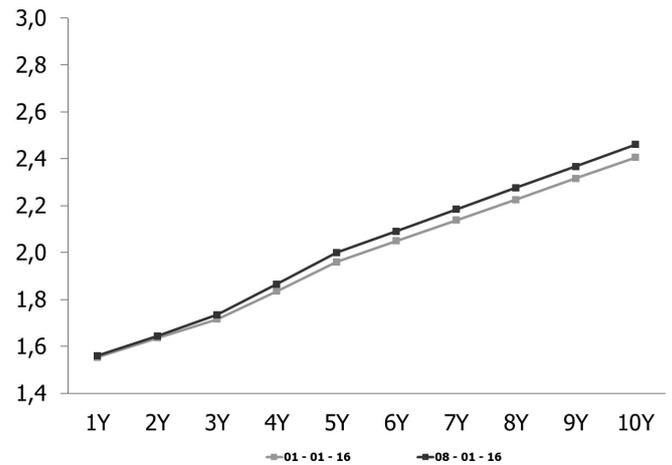
Happy New Year?

Bullish beginning of the week. Because of information about banking tax and govies, which will be excluded from it, prices of shortest bonds just skyrocketed - moving the from 1,70 to 1,40% (OK0717) in one week. That's due to the rate of banking tax – 0,44%. It is simply more profitable to buy bonds (short especially) than NBP bills or to keep cash as banks will have to pay tax from these assets.

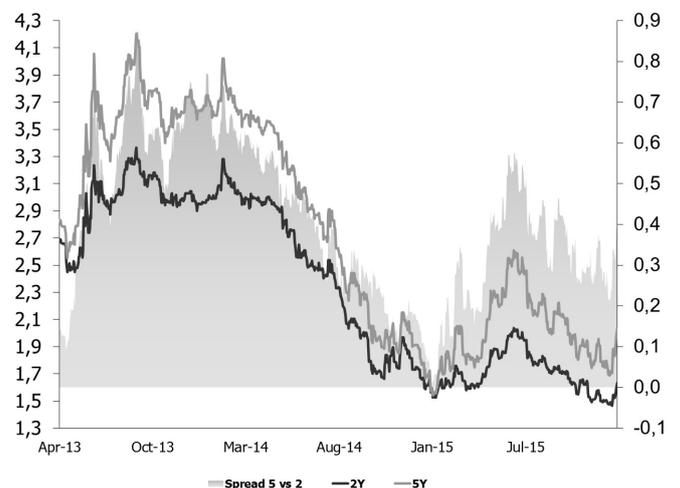
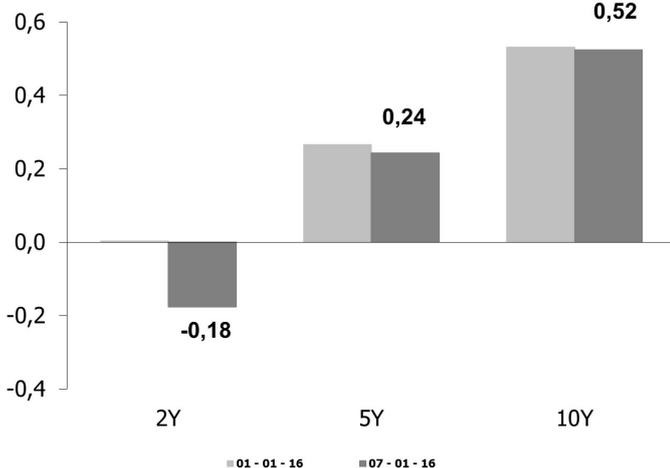
New year opened 5bps higher on the long end and then fell to the levels they were before year end. MF conducted 5 year bond auction on Thursday, selling 4.5 bn bonds.

We are bearish on the longer end. In our opinion expenses of Polish government look huge, while collection of all additional revenues is not certain. It is uncertain how additional levies will affect bank lending and economic growth, as well.

IRS curve



Asset swaps



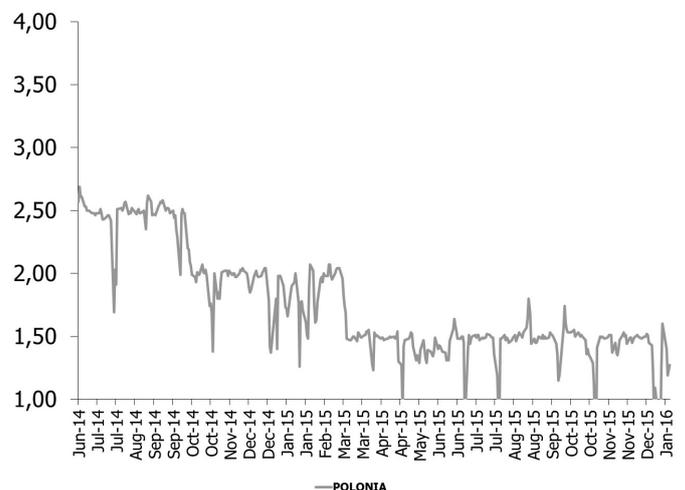
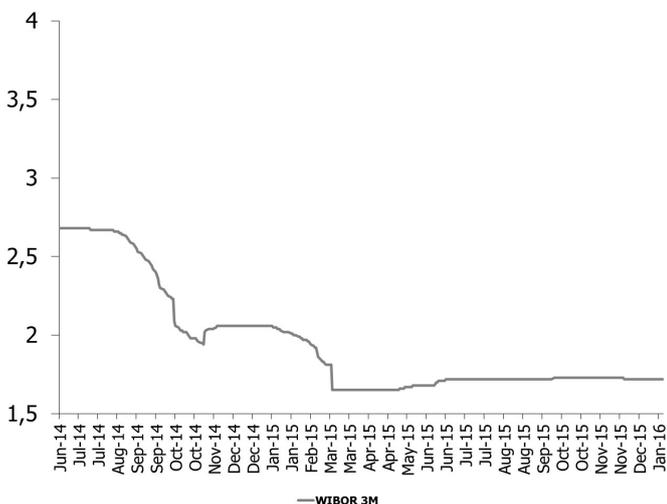
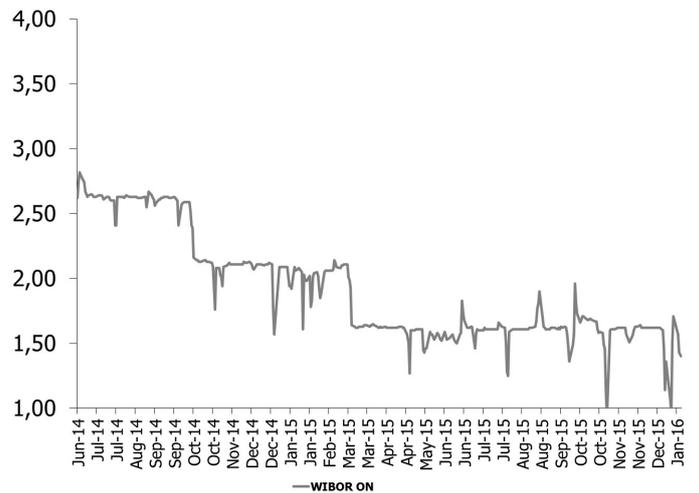
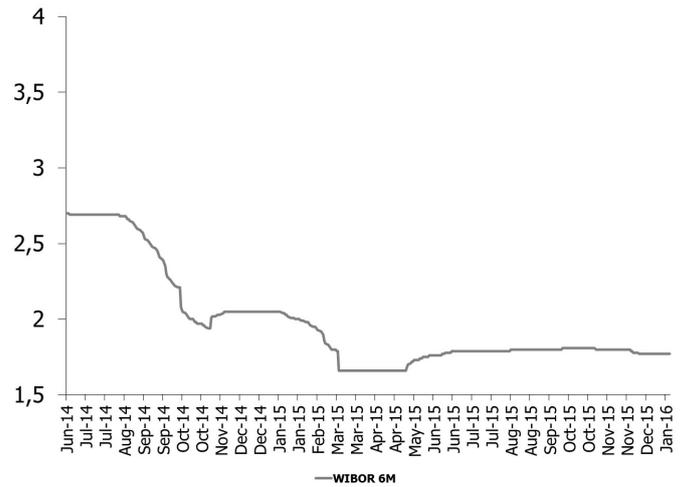
Money market

Banking Tax

Quite a busy start of the new year. The parliament made an adjustment to the banking tax draft - government bonds are now exempted from taxation. As a result we have seen an enormous rally in short/medium bonds. One year govies moved from 1,65% to 1,30% and two year notes reached 1,40% from 1,75% in December. The move is quite justified, as local banks hold around 80 bio PLN in NBP bills (1.53%) after tax their yield moves to a mere 1,09%. This makes all short term bonds very attractive as long as they are above the mentioned lvl.

There are many more market implications which should to be discussed/solved, for example: how the cash market will look like, how the WIBORs will behave and what will happen during each month end period. As far as ON market is concerned, we don't see any major reasons that cash rates would go lower due to tax as depos are also taxed. However, we should have more frequent and bigger swings and usually when there are bigger movements, banks tend to take a cautious stance, which results in additional liquidity and lower overnight rate. We will get answers to these questions in the coming months for certain.

Good luck.



Forex

PLN weaker China and stocks are to blame for sour investment sentiment at the beginning of 2016. EUR/PLN wasted no time as well, rising from 4.2550 (year-end) to 4.3580 (high YTD). We are now consolidating gains in the 4.32-4.36 zone, but the 4.37/4.40 resistance zone is still in danger, and it is above the 4.40 level where fireworks can potentially start. The influence of political developments in Poland on the PLN are unclear to us. We are still skewed to the opinion about the rangy nature of EUR/PLN, but we have to admit the range is slowly but surely creeping up.

Options – ATMs higher Vols are higher, and it is not a surprise. Weaker PLN is usually dragging vols up.

This Friday the 1 month EUR/PLN ATM is fixing at 7.4% mid (higher by 0.9% in comparison to 31st of December), 3 months are also 7.4% (up by 0.7%), and finally 1 year is 7.4% (0.2% higher). The big trades were 1y EUR/PLN traded at 7.4 in good amount, 2 months were traded at 7.45%. The skew was also traded heavily (i.e. 6 months EUR/PLN 25d RR at 1.45%). The currency spread (difference between USD/PLN and EUR/PLN) was better offer at the year open, only to find buyers and come back above 4.0% in the end.

Short-term forecasts

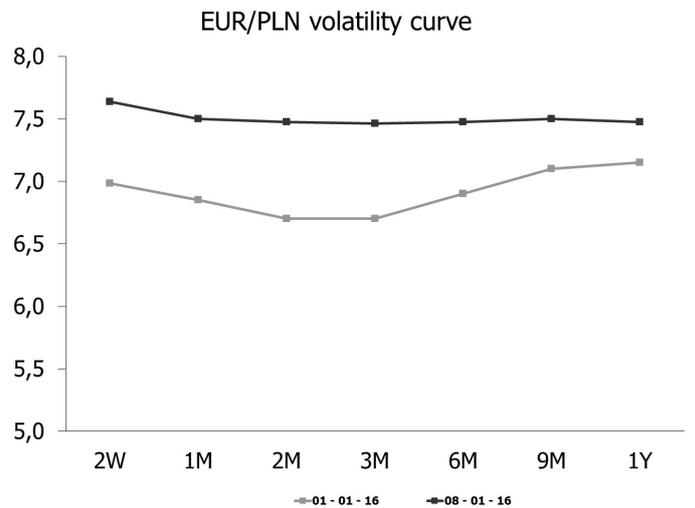
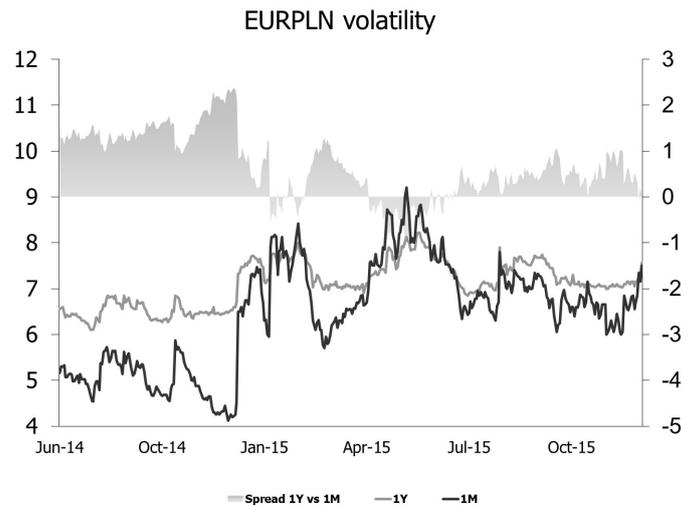
Main supports / resistances:
 EUR/PLN: 4.25 / 4.4250
 USD/PLN: 3.90 / 4.15

Position Spot – No position at the moment

Spot We are still sidelined at the moment. Technically, fading a break higher at 4.3750 with room to add at 4.4050 and stop above 4.4250 looks compelling to us. Profit taking would be 4.2750. We will, however, enter this trade only if the PLN weakness would be fueled by external/global factors. If any major political risk materialize, it could be a game changer and we will have to adjust to it.

Options

We start the year with a clean book. But if we look at the market, we think we may have a volatile year ahead of us. The FOMC move, regardless of its pace, China, falling stocks create a lot of market uncertainty. Political risks in Poland beg the question, where are we heading? All that is making us think of not being too short Gamma, Vega as a preferred strategy.



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
12/31/2015	1.71	1.72	1.80	1.67	1.69	1.69	1.70	1.58	1.49	1.49	1.52	1.53
1/4/2016	1.58	1.72	1.76	1.67	1.75	1.69	1.70	1.60	1.49	1.50	1.54	1.53
1/5/2016	1.60	1.72	1.63	1.67	1.76	1.69	1.69	1.58	1.50	1.51	1.55	1.56
1/6/2016	1.55	1.72	1.57	1.67	1.67	1.69	1.69	1.58	1.50	1.51	1.55	1.56
1/7/2016	1.74	1.72	1.79	1.67	1.69	1.69	1.69	1.56	1.47	1.47	1.50	1.51

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
12/31/2015	1.690	1.486	1.635	1.638	1.960	2.226	2.405	2.936
1/4/2016	1.690	1.486	1.635	1.638	1.960	2.226	2.405	2.936
1/5/2016	1.690	1.486	1.635	1.638	1.960	2.226	2.405	2.936
1/6/2016	1.690	1.486	1.635	1.638	1.990	2.290	2.447	2.985
1/7/2016	1.690	1.486	1.635	1.525	2.000	2.269	2.460	2.964

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
12/31/2015	6.70	6.73	6.90	7.15	7.15	1.70	0.48
1/4/2016	7.35	7.05	7.15	7.30	7.30	1.70	0.48
1/5/2016	7.15	7.03	7.15	7.35	7.35	1.70	0.48
1/6/2016	7.50	7.33	7.43	7.58	7.58	1.58	0.41
1/7/2016	7.50	7.46	7.48	7.48	7.48	1.79	0.47

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
12/31/2015	4.2615	3.9011	3.9394	3.2411	1.3601	0.1577
1/4/2016	4.2935	3.9281	3.9526	3.3049	1.3597	0.1588
1/5/2016	4.3176	4.0073	3.9792	3.3658	1.3690	0.1597
1/6/2016	4.3176	4.0073	3.9792	3.3658	1.3690	0.1597
1/7/2016	4.3475	4.0085	3.9979	3.4102	1.3771	0.1609

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