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Polish Weekly Review

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Comment on the upcoming data and forecasts

On Tuesday the Central Statistical Office will publish the latest Statistical Bulletin. Apart from details on some of the recent macro releases, unemployment data will be interesting. In our view it is likely that the CSO will confirm the preliminary reading from the Ministry of Labor.

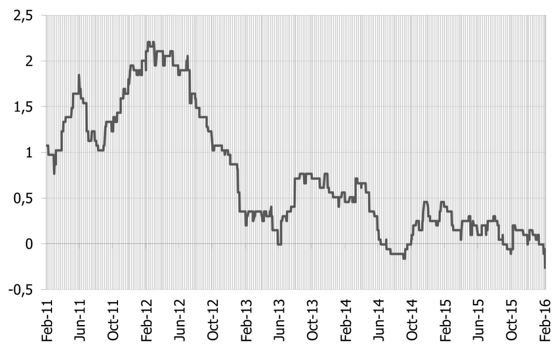
Polish data to watch: February 22nd to February 26th

Publication	Date	Period	mBank	Consensus	Prior
Unemployment rate (%)	23.02	Jan	10.3	10.3	9.8

Treasury bonds and bills auctions

Paper	Next auction	Last Offer	Yield on the prev auction (%)	Prev auction
32 Week T-bills	-	1500	1.290	2/15/2016
2Y T-bond OK1018	3/3/2016	3000	1.665	2/4/2016
5Y T-bond PS0720	3/24/2016	4800	2.219	2/18/2016
10Y T-bond DS0726	3/3/2016	3000	3.168	2/4/2016
15Y T-bond WS0428	-	20	2.092	3/12/2015

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



Comment

Polish surprise index is in a free fall. Small positive surprise in labour data (because of sample change excluding employment) was erased by worse than expected real sphere data, with PPI leading the way. Next week brings only one opportunity for an upward correction (unemployment rate), but preliminary MFLSP data suggests that there won't be any deviation from 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).

Our view in a nutshell

Fundamentals

- GDP growth perspectives brightened recently.
- 500+ programme is set to support private consumption in 2016. At the same time, global headwinds do not seem to be detrimental for Polish exports (exports benefit from better euro zone momentum and weak zloty). Public infrastructure outlays have shifted towards the latter part of 2016 and private investment seems to be locally, negatively affected by political uncertainty. However, positive impulses from consumption and exports are set to encourage private capital formation amid stretched capacity utilization.
- 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

- After a 30 bps rally we decided to close our long 10Y recommendation and turned to a defensive strategy (cash).
- While the compression of credit risk premia in Polish assets indeed happened and rates on core markets fell markedly, we remain sceptical of prompt rate cuts in Poland (contrary to many recent recommendations).
- Above all, there is a lot of uncertainty regarding Fed actions (the dychotomy between tightening financial conditions and firming macro data), the impact of falling oil prices on EM portfolios and volatility. All of this might negatively impact POLGBs.

mBank forecasts

	2011	2012	2013	2014	2015	2016 F
GDP y/y (%)	5.0	1.6	1.3	3.3	3.6	3.8
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	-0.1	-0.7
Unemployment rate (end of period %)	12.5	13.4	13.4	11.4	9.8	8.7
Repo rate (end of period %)	4.50	4.25	2.50	2.00	1.50	1.25

	2015 Q1	2015 Q2	2015 Q3	2015 Q4	2016 Q1 F	2016 Q2 F	2016 Q3 F	2016 Q4 F
GDP y/y (%)	3.7	3.3	3.5	3.9	3.6	3.8	3.8	3.9
Individual consumption y/y (%)	3.1	3.1	3.1	3.2	3.4	3.8	4.0	4.0
Public Consumption y/y (%)	3.7	2.5	2.7	3.8	0.5	2.0	2.0	2.0
Investment y/y (%)	11.5	6.1	4.6	4.8	5.5	6.0	6.0	6.6
Inflation rate (% average)	-1.4	-0.9	-0.7	-0.6	-0.4	0.0	0.5	1.7
Unemployment rate (% eop)	11.5	10.2	9.7	9.8	10.0	9.0	8.6	8.7
NBP repo rate (% eop)	1.50	1.50	1.50	1.50	1.50	1.25	1.25	1.25
Wibor 3M (% eop)	1.65	1.72	1.73	1.72	1.68	1.44	1.44	1.44
2Y Polish bond yields (% eop)	1.61	1.99	1.76	1.62	1.30	1.10	1.35	1.55
10Y Polish bond yields (% eop)	2.31	3.31	2.84	2.94	2.90	2.80	3.00	3.20
EUR/PLN (eop)	4.07	4.19	4.25	4.26	4.40	4.35	4.30	4.25
USD/PLN (eop)	3.80	3.76	3.80	3.92	4.00	3.95	3.91	3.86

F - forecast

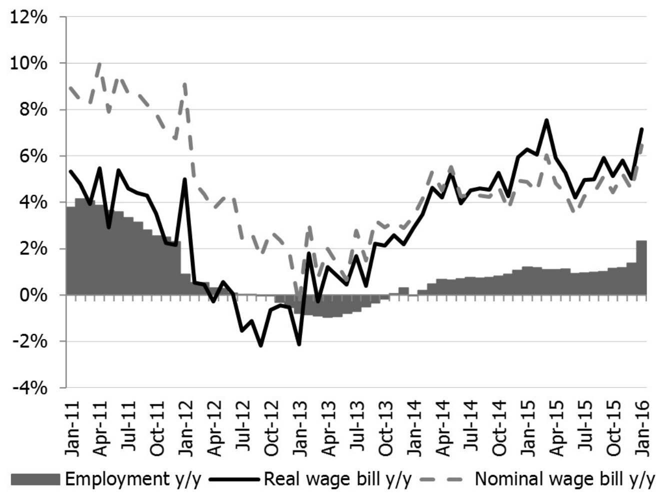
Economics

A week full of surprises but the Polish growth story is intact. Credit risk was clearly mispriced in Polish assets.

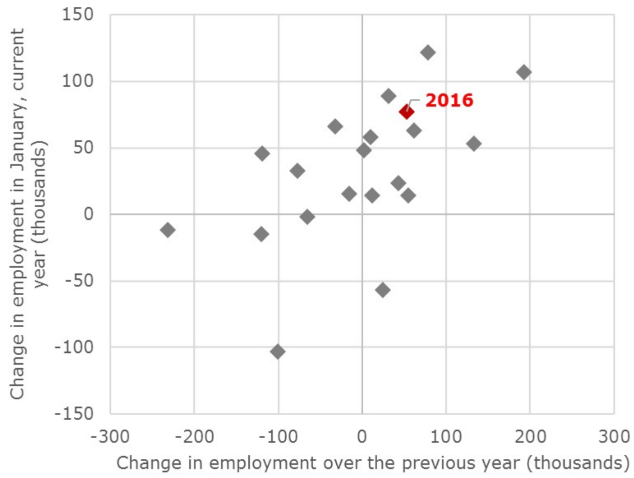
The final set of January data managed to upset consensus forecasts in every possible way: while labor market data came out firmly on the upside, real activity data (industrial and construction output, retail sales) surprised to the downside across the board. A closer look at the data reveals multiple distortions and January quirks that influenced the data. The underlying trend is probably still very positive and unlikely to change materially in the coming weeks. Moreover, even though no hard data has come out yet, there are positive signals from the fiscal sphere and the government seem determined to bridge the VAT gap as soon as possible. With strong growth and high likelihood of positive surprises in tax collection, there is no reason to price in high credit risk.

As usual, we discuss this week's data in greater detail below.

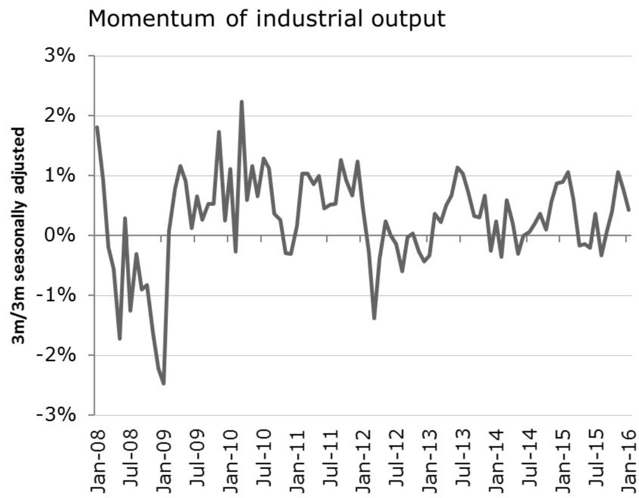
Average gross wage increased by 4.0% y/y in January, beating estimates of 3.1-3.5%. As usual, we are unable to comment on the sources of the surprise – our best guesstimate is that it lies in manufacturing and construction (the latter has erratic seasonal patterns and could easily repeat last year's jump). Regardless of the nature of the surprise, January's reading is consistent with recent trend of 3.5-4.0% annual growth in wages. We believe that this trend will steepen later this year as labor market tightening begins to bite as a result of demographic changes and the negative impact of the upcoming child subsidy programme on labor supply (especially in the lowest decile of wage income distribution). As a result, wage growth will accelerate to 5% this year.



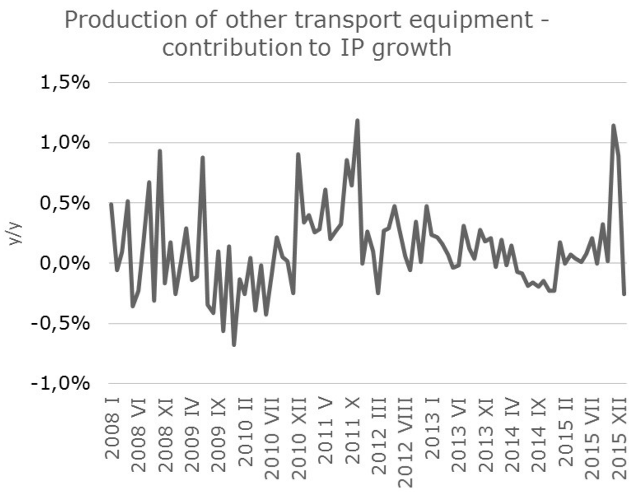
Employment growth was, of course, the bigger surprise of today's release as it grew by as 2.3% on annual basis, much above forecasts (market consensus: 1.5%; our forecast: 1.6%). However, this jump in employment has little to do with actual hiring in January and almost everything with annual resampling done by the Central Statistical Office. While the impact of this procedure on the level of employment is positively correlated with net employment growth over the previous year, the relationship is not precise enough to make accurate forecasts. Therefore, even taking into account all the drawbacks this measure exhibits, unemployment rate seems to be a better gauge of labor market strength. There is no acceleration here – only a steady downward trend. Next months' releases as well as LFS data will allow us to cross-check today's jump in employment with more reliable data sources.



January **industrial output** rose by 1.4% y/y vs. 6.7% recorded in December. January outcome was close to our forecast but significantly below market consensus of 3%. Lower than expected growth rate may be attributed to one-offs including lower working days number (-1 y/y vs. +1 in December) and lower orders from Polish railways (corrected after a surge in December).

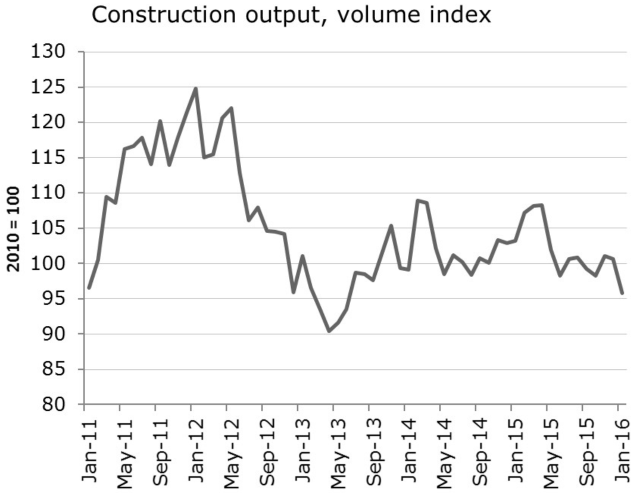


Positive annual growth rates were recorded in 21 out of 34 sections and were mainly driven by exports orders. Negative yearly dynamics were most striking in production of remaining transport vehicles pointing to correction of a surge recorded in December (see the graph below).

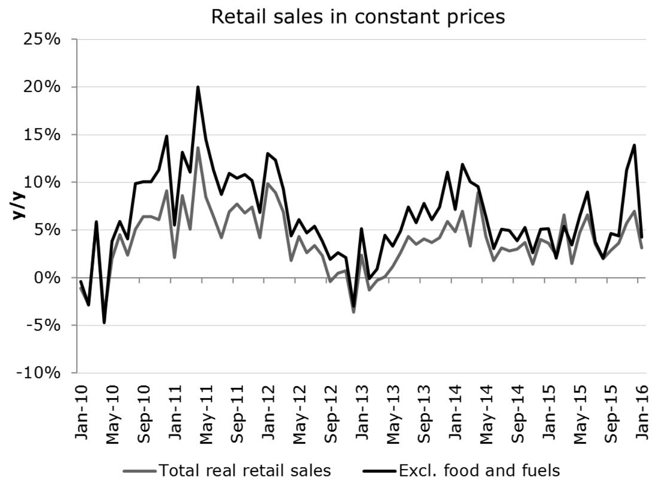


We should expect more of exports driven industrial output growth in the months to come (see weaker zloty boosting competitiveness of Polish exporters). Weaker German data, definitely under spell of VW scandal, may affect Polish numbers to some extent. Notwithstanding this, the momentum of industrial output in Poland should be sustained. February headline number may be boosted by working day effect and come in close to 7% y/y.

Construction output fell by 8.6% y/y in January, much below market consensus (-3.9%) and closer to our forecast of -5.4%. We caution not to overinterpret this figure – the typical range of variation of January output growth is very large and has an outsized impact on annual growth figures (1 pp. of m/m growth translates into more than 3 pp. of y/y growth). Monthly growth rates, even though correlated with weather and calendar effects (both negative) should be treated as largely random. Thus, even the seasonally adjusted figure (-4.8% m/m) might be overestimating the weakness in construction. Nevertheless, there's no reason for optimism either. Construction is dragged down by a deep contraction in local government investment (by 25%) and a slowdown in office and retail investment. Strong growth in road and residential investment is merely compensating the above-mentioned sources of weakness.



Retail sales also surprised to the downside, growing by 0.9% y/y (market consensus and our forecast hovered around 3%). Several factors contributed to the slowdown: softer car sales (from 16.7% to 2.2% y/y – this was expected by us), weaker fuel sales (from -4.2 to 7.3% y/y, chiefly a price effect) and slow growth in books and newspaper sales (from 22.9 to 4.2% y/y). In keeping with previous months' tradition, food and supermarket sales went in opposite directions (the former rebounded from 5.9 to 3.2% y/y, the latter decelerated from 31.8 to -0.6%). Due to structural changes in the sector, the two categories are now notoriously difficult to predict. We'll finish on a positive note – most durable goods categories showed no signs of slowdown. Thus, our view on consumption remains unchanged – due to strong nominal income growth we expect consumption to accelerate to 4% y/y this year.

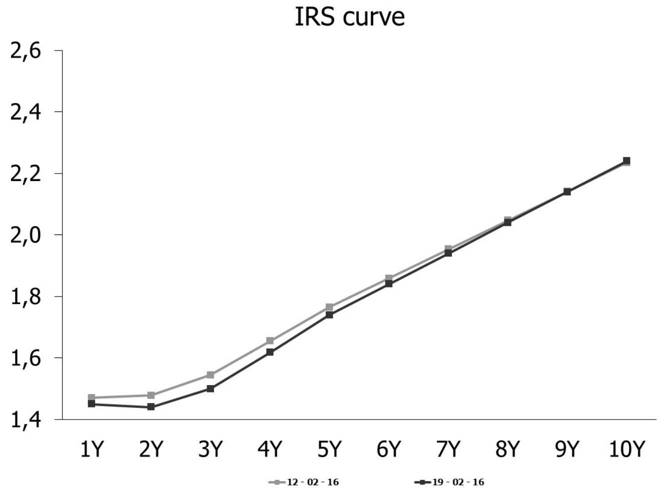


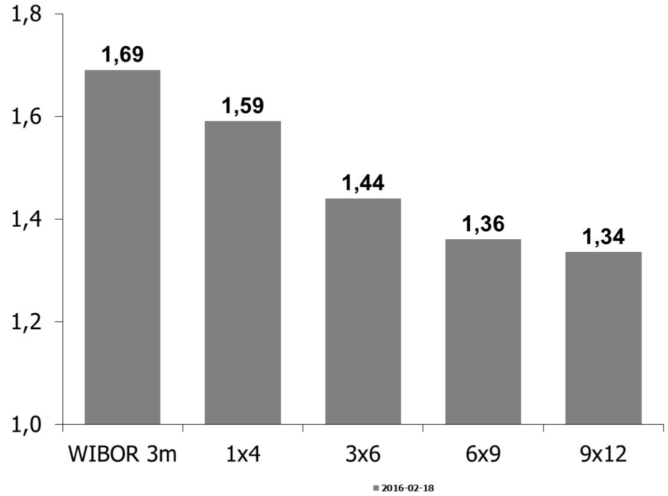
Fixed income

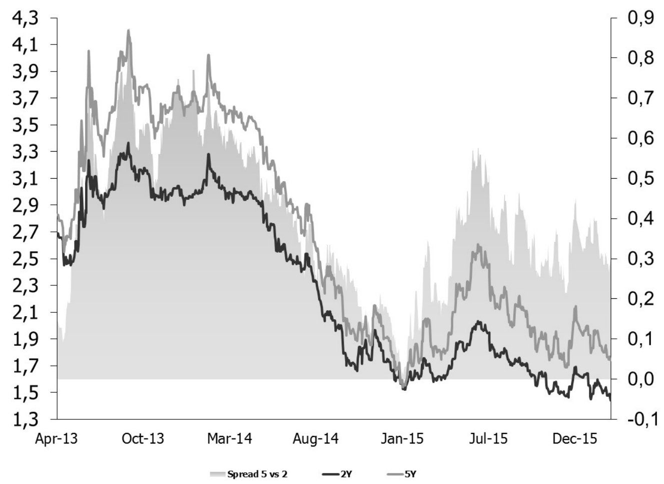
Another strong auction

This week the key event on domestic FI market was Thursday's auction of PS0421 and WZ0120. Before it POLGBs were quite stable with lower yield direction, especially on the long end of curve. The results were maybe not tremendous but quite impressive as 7.2 bio supply was sold with lower ytm vs. secondary market (PS0421 2.219%; WZ0120 SFL 22bps) and bid/cover ratio at 2.08. Bonds were clearly supported by published figures (IP, PPI, retail sales), which were worse than expected. With no value on short end instruments, investors focused on longer bonds; especially DS0726 was the winner. We broke 3% level on DS0726 (currently 2.92% -12bps this week) and still see flattening tendency, however we do not see current levels as an opportunity to go long bonds as levels on core markets are overdone.

We stay sidelined for a while.





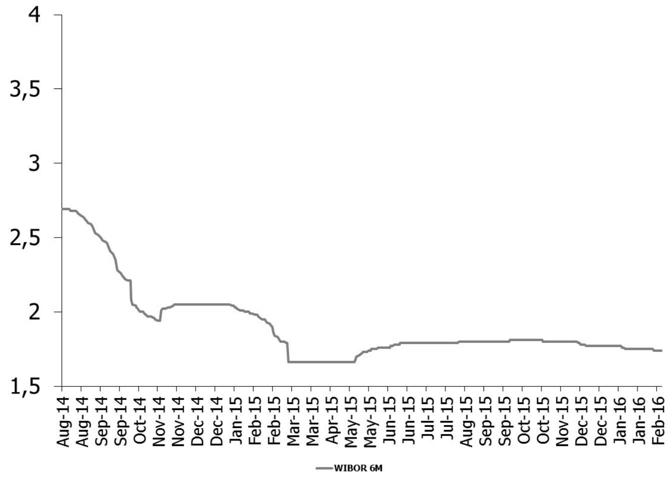


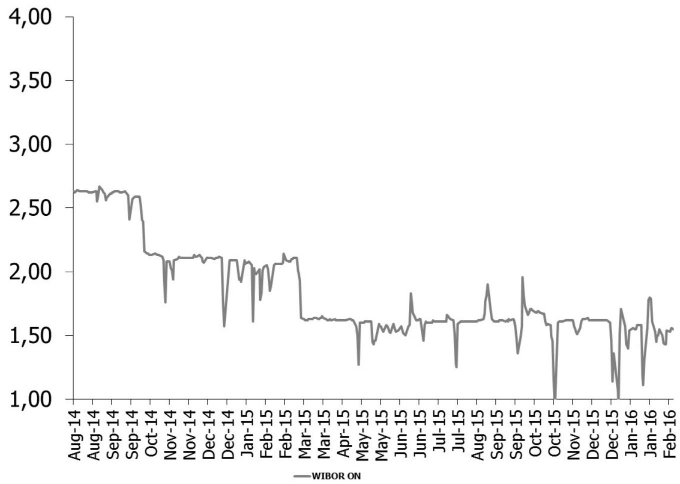
Money market

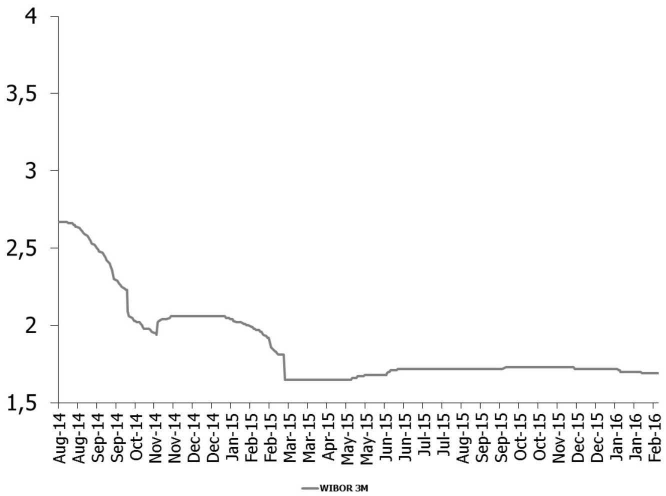
T-bills auction

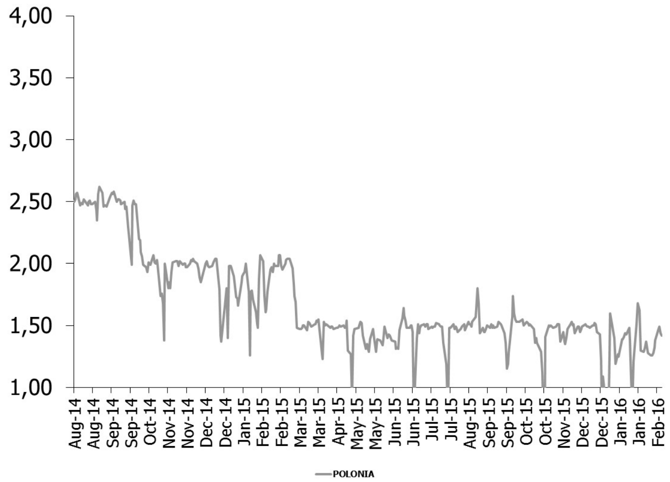
On Monday MinFin sold 2.4 bio of 32wk T-bills. Yield was at 1.29% (360 basis), which is close to where bonds of a corresponding tenor trade.

Market held stable during the whole week, despite some bullish bias on derivatives. We are still happy to possess those short bonds. Low CPI reading, weaker than expected retail sales and industrial output should keep rate cuts on the table. On the other hand, longer periods of cheap funding should help financing Your portfolio.









Forex

Spot – Calmer markets After a wild swings during last week, this week was in comparison, quite uneventful. EUR/PLN was slowly sliding from 4.4180 (week's high) to 4.3740 (week's low so far). 4.35-4.37 is a more powerful support, and may provoke some upward correction. Brighter global sentiment and some reassuring comments from Minister Morawiecki about much softer approach towards CHF conversion project, both did the trick. We see current range for EUR/PLN wider, within 4.33 – 4.48, which should be respected, unless something big happens. ECB meeting is already looming on horizon, closely followed by MPC meeting.

Options – Vol curve steeper The challenge of the week was to buy EBC/MPC dates. The spread between 3 week (expiring before ECB/MPC) and some delta expiring after these events, was close to 1%. 1 month EUR/PLN ATM mid is 9.1% (0.1% lower), 3 months EUR/PLN are also 9.3% (0.1% higher) and finally 1 year is fixing at 9.5% (0.1% higher). The currency spread (difference between USD/PLN and EUR/PLN vols) has bettered offered, giving away roughly 0.25% of it's value. Skew was roughly unchanged.

Short-term forecasts

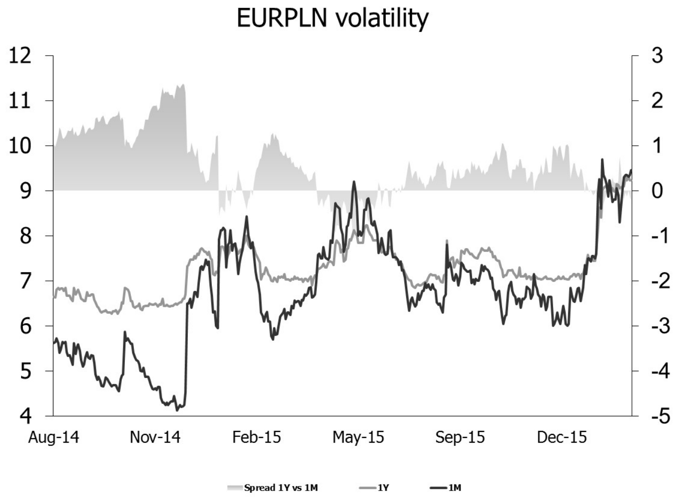
Main supports / resistances:
EUR/PLN: 4.33 / 4.48
USD/PLN: 3.85 / 4.15

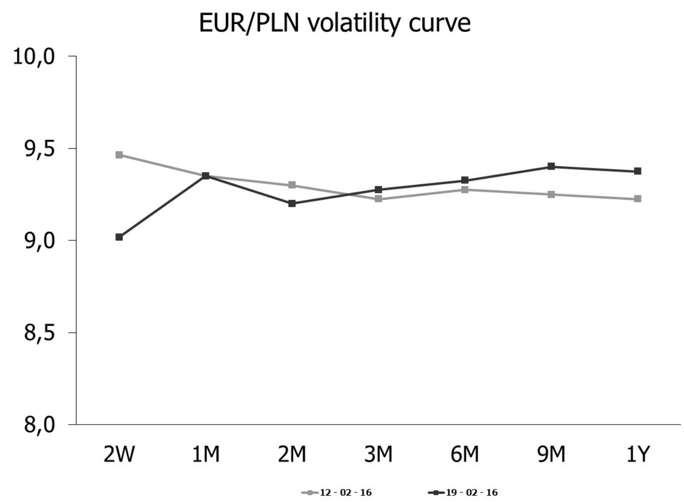
Position **Spot** Long.
We are long EUR/PLN at 4.4090 , and 4.3890 with a stop bellow 4.37 and hopes to see 4.46+ again.

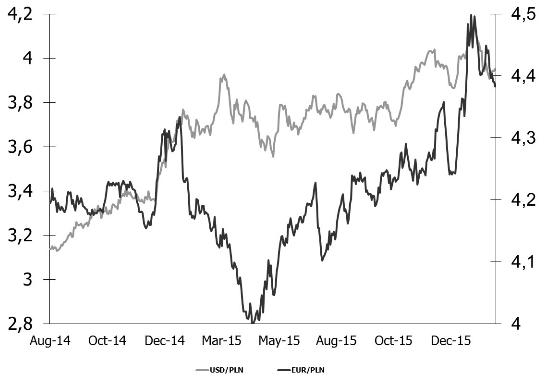
We are close to stop loss, on our EUR/PLN longs. Assuming it will be triggered, it will not change our approach on the rangy nature of EUR/PLN. We would try to scale into PLN shorts at better levels, as close to 4.33 as possible.

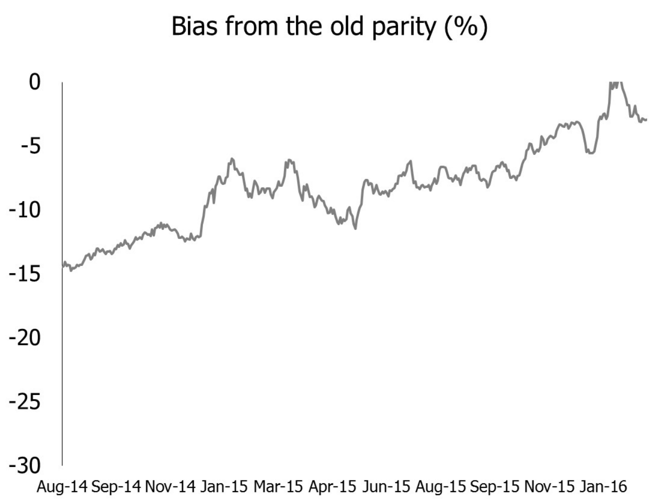
Options Vols

We trimmed our short in EUR/PLN short term (up to 3 months Vega). We still kept part of this short as 1 week realized volatility nose-dived. It should put some weight on the front end of the curve, especially if market decides to sit on his hands till ECB/MPC will fire its bazooka.









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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
2/11/2016	1.70	1.69	1.80	1.64	1.70	1.66	1.65	1.52	1.45	1.42	1.41	1.47
2/15/2016	1.72	1.69	1.65	1.64	1.67	1.66	1.61	1.49	1.41	1.39	1.36	1.43
2/16/2016	1.55	1.69	1.58	1.64	1.55	1.66	1.60	1.48	1.40	1.38	1.39	1.44
2/17/2016	1.25	1.69	1.30	1.64	1.41	1.66	1.57	1.45	1.38	1.35	1.36	1.39
2/18/2016	1.42	1.69	1.50	1.64	1.66	1.66	1.59	1.44	1.36	1.34	1.34	1.37

Last primary market rates							
Paper	Au. date	Maturity	Avg. price	Avg. yield	Supply	Demand	Sold
32W TB	1/18/2016	8/31/2016	99.16	1.37	2000	11765	2400
OK1018	2/4/2016	10/25/2018	95.62	1.67	3000	8160	4645
PS0421	2/18/2016	4/25/2021	98.93	2.22	4800	9169	5143
DS0726	2/4/2016	7/25/2026	94.10	3.17	3000	6661	4366

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0715	5Y IRS	PS0718	10Y IRS	DS1023
2/11/2016	1.660	1.474	1.635	1.578	1.960	2.232	2.405	2.949
2/15/2016	1.660	1.474	1.635	1.578	1.960	2.232	2.405	2.949
2/16/2016	1.660	1.474	1.635	1.578	1.960	2.232	2.405	2.949
2/17/2016	1.660	1.474	1.635	1.638	1.990	2.290	2.447	2.985
2/18/2016	1.660	1.474	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
2/11/2016	9.35	9.16	9.21	9.31	9.31	2.09	0.57
2/15/2016	9.31	9.26	9.26	9.31	9.31	2.09	0.57
2/16/2016	9.35	9.20	9.23	9.23	9.23	2.10	0.58
2/17/2016	9.45	9.23	9.23	9.23	9.23	2.09	0.58
2/18/2016	9.35	9.28	9.33	9.38	9.38	2.10	0.57

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
2/11/2016	4.4407	3.9219	4.0541	3.5220	1.4240	0.1640
2/15/2016	4.3960	3.9220	3.9935	3.4430	1.4222	0.1624
2/16/2016	4.4042	3.9404	3.9938	3.4588	1.4201	0.1629
2/17/2016	4.3905	3.9431	3.9800	3.4575	1.4149	0.1624
2/18/2016	4.3902	3.9416	3.9729	3.4634	1.4168	0.1624

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