

February 26, 2016

Polish Weekly Review

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Comment on the upcoming data and forecasts

We start the week on Monday with final GDP growth data for last quarter of 2015. Based on yearly data, we expect the following structure: stable consumption expenditure rise (ca 3.2%), slightly higher investment growth (ca 5.5%) and acceleration of public consumption (to 4.0%) with contribution of inventories and net exports offsetting each other. On Tuesday manufacturing PMI will be published. We expect further drop due to fall in similar CSO indices and deterioration of economic sentiment in Europe.

Polish data to watch: February 29th to March 4th

Publication	Date	Period	mBank	Consensus	Prior
GDP <i>final</i> y/y (%)	29.02	Q4	3.9	3.9	3.9
Inflation expectations (%)	29.02	Feb	0.2	0.2	0.2
Manufacturing PMI (p.)	01.03	Feb	50.4	50.5	50.9

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

Unemployment rate was in line with preliminary data and market consensus, thus Polish surprise index still remains at its low. Next week brings two opportunities to change it: final GDP growth and manufacturing PMI.

* 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 dichotomy 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	2015F	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	2015	2015	2015	2016	2016	2016	2016
	Q1	Q2	Q3	Q4	Q1 F	Q2 F	Q3 F	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

Taking stock of the first 100 days of the new government

In Poland the 100th day of a new government is a traditional milestone – an opportunity to assess the first initiatives and steps taken to fulfill pre-election promises. On this occasion we are updating our readers on the recent changes in fiscal and economic policies.

During the past three months both the government and the parliament have been busy – a total of 43 bills were passed by the parliament (data from NBO watchdogs) – far more than the previous three parliaments as almost as much as the record high of 45 (from the first 100 days of 2001-2005 period). The most anticipated one was the child subsidy programme (called „500+”). At this point we can only repeat the its costs are estimated at 17 bn PLN in the first year and 23 bn PLN in the latter years. While the programme is easily financed this year by the new bank tax and one-off non-tax revenues (LTE auction and NBP profit), the 2017 budget has always been a tough nut to crack and the hope has always been that better tax collection will fill the gap. Recent information gives that hope some credence. First, the government is taking steps to address the issue of tax collection and the effectiveness of tax offices will be raised. Second, tax revenues have been quite strong over the past few months. While no official breakdown was published by the Ministry of Finance, from various comments we learned that January tax revenues are ca. 2 bn PLN ahead of plan. Note that boosting „conventional” tax revenues (CIT, PIT, VAT, excise and other minor taxes) by 1 pp. (to 2012 levels!) of GDP would bridge the gap in financing the 500+ programme and provide some room for the planned gradual increase in tax-free threshold. All in all, fiscal policy appears more and more manageable – the focus on securing stable revenue base for the proposed policies is certainly a positive development.

State government budget revenues (12m sum as % of GDP)





Fixed income

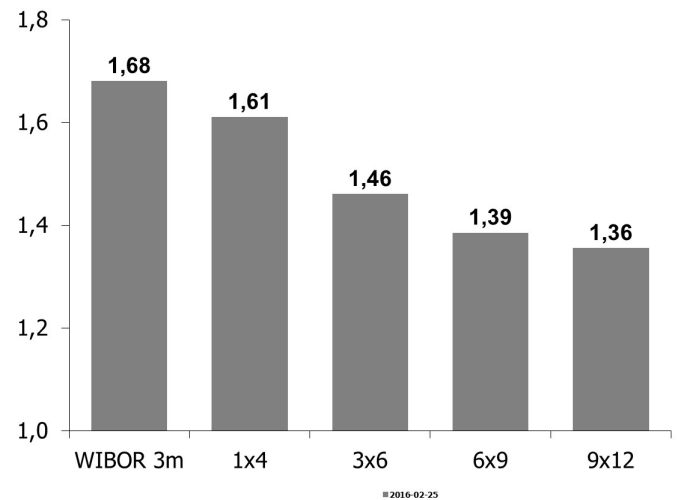
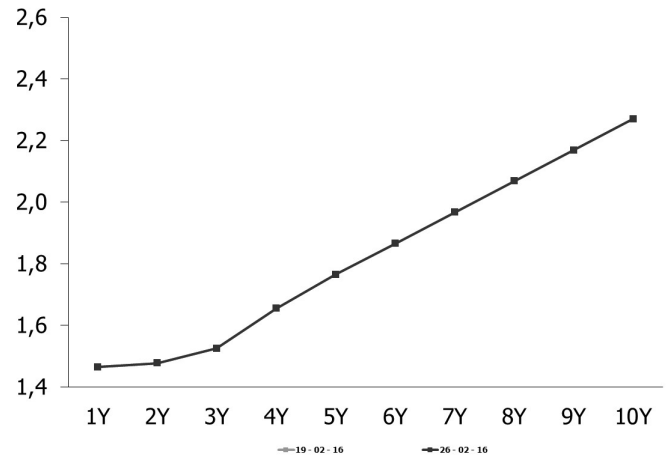
Global story

With no domestic story this week, POLGBs just followed core markets (currently OK1018 1.58%; PS0421 2.21% -2bps; DS0726 2.93% -2bps).

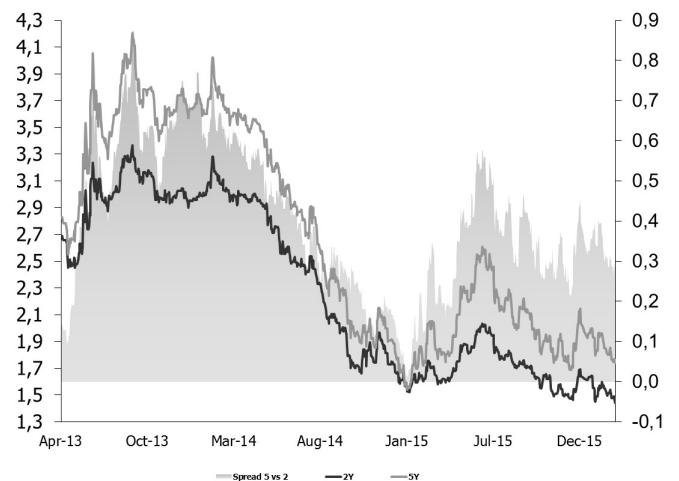
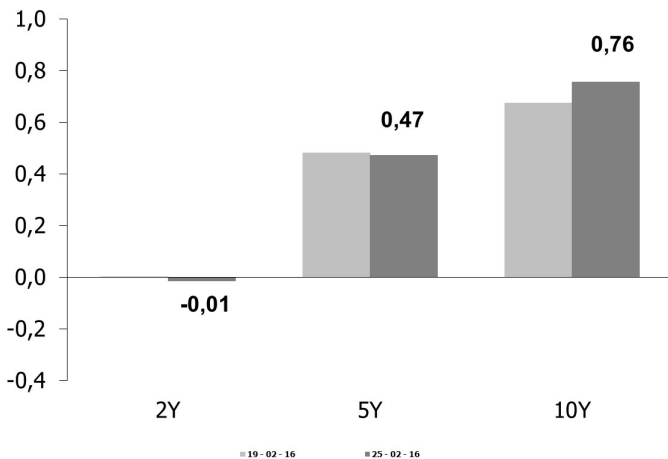
We became slightly bearish as levels are decent, Draghi's dovishness is more and more priced in as well as practically no hike in US through 2016. We expect correction before NFP data next Friday.

Remember about the auction next Thursday (details to be published on Monday – supply for March).

IRS curve



Asset swaps





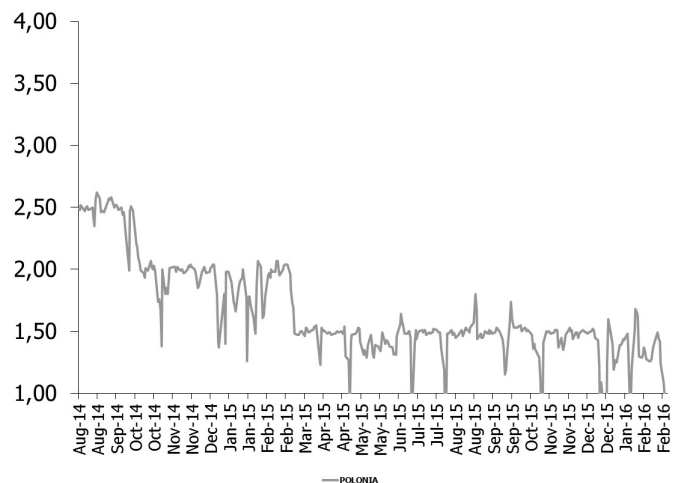
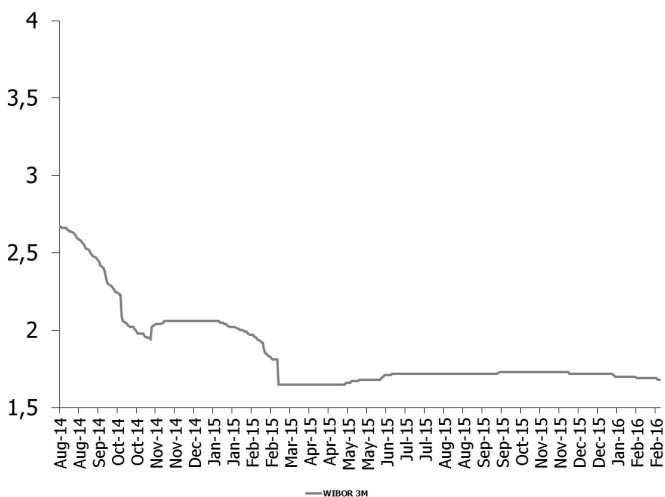
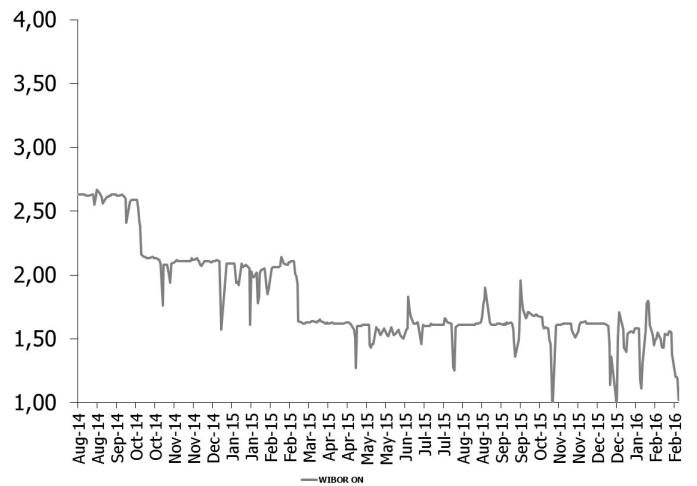
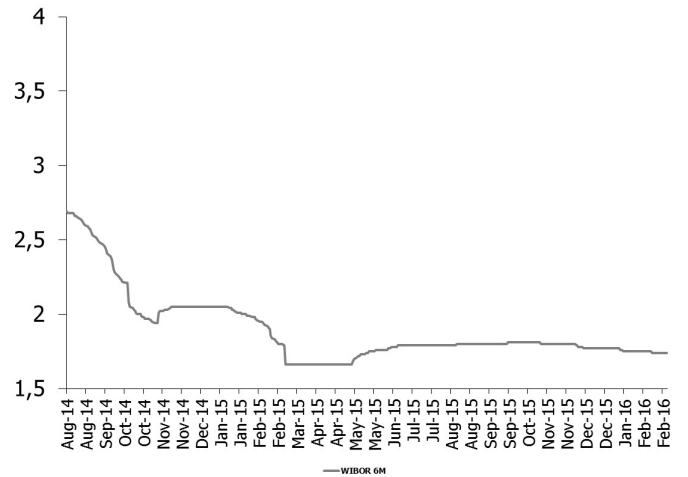
Money market

Extra liquidity

We are getting into the first end of the month after the introduction of banking tax. Banks took the safe stance and are holding excessive liquidity throughout the whole month. As a result, 30-day average spread between Polonia and the reference rate widened to 23 bps from 5-10 bp seen last year.

What's worth mentioning is that the NBP is not doing any additional operations even with ON below 1%. One could wonder whether that's a temporary distortion or a change in policy stance.

If this persists, we could see some more widening of the spread mentioned above. This should support having bonds on your portfolio or selling OIS.



Forex

Spot – Risk rally continues EUR/PLN has managed to chew through 4.3600 support line, but more powerful support at 4.33 looms not that far. Political risk in Poland is diminishing (at least in the short term), the comments about CHF denomination project are getting more balanced and reasonable. The global sentiment is decent, the ECB is getting closer, and the PLN shorts are being consequently liquidated. It may continue, but a rangy nature of EUR/PLN suggest caution. We see current range at roughly 4.33-4.43 and expect some mean reverting swing.

Options – EUR/PLN Vol curve weaker a bit The frontend was better offered, especially pre - ECB dates. On the other hand the backend kept strong bid with 6 months being healthy bid. 1 month EUR/PLN ATM mid is 8.75% (0.35% lower), 3 months EUR/PLN are 9.1 (0.2% lower) and finally 1 year is fixing at 9.3 (0.2% lower). The skew was a little better offered and currency spread (difference between USD/PLN and EUR/PLN vols) was slightly better bid.

Short-term forecasts

Main supports / resistances:

EUR/PLN: 4.33 / 4.43

USD/PLN: 3.85 / 4.10

Position Spot None

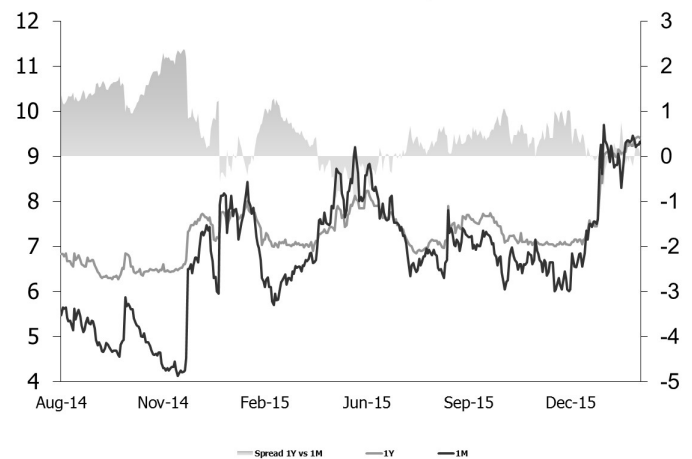
Longs in EUR/PLN at 4.4090, and 4.3890 have been stopped out at 4.3660.

We have been stopped out on our long position. We are ready to reenter long EUR/PLN position at 4.3350 and 4.3150 and S/L bellow 4.2950, with hopes to see 4.43+ again. It is a technical trade based on the mean reverting approach. On the top of it, we wonder if an aggressive action from ECB, will not be counter by some kind of a response from MPC. ECB action is at least partially discounted, the MPC reaction is a big unknown.

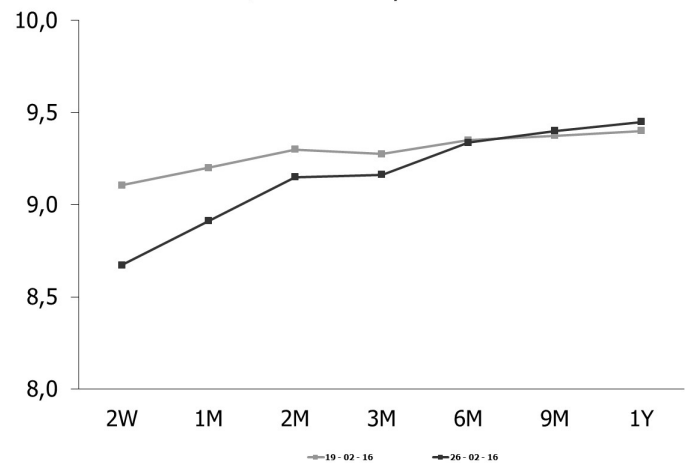
Options Vols

We still keep a small short EUR/PLN Vega in the frontend. The realized volatility still pointing lower, encouraging us to keep the core short Vega/Gamma position. We expect no fireworks till ECB/MPC, with wait and see approach winning more fans.

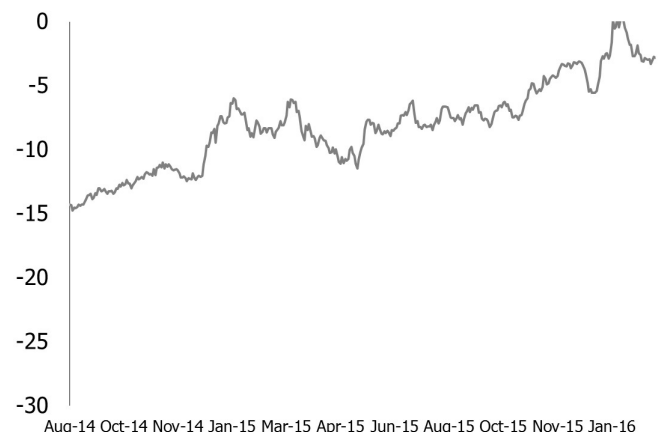
EURPLN volatility



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
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
2/22/2016	1.36	1.69	1.45	1.64	1.51	1.66	1.62	1.47	1.40	1.37	1.34	1.43
2/23/2016	1.24	1.68	1.33	1.64	1.52	1.66	1.61	1.51	1.41	1.37	1.36	1.42
2/24/2016	1.09	1.68	1.20	1.64	1.38	1.66	1.62	1.47	1.41	1.38	1.36	1.43
2/25/2016	1.32	1.68	1.43	1.64	1.48	1.66	1.61	1.46	1.39	1.36	1.33	1.42

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
2/18/2016	1.660	1.474	1.635	1.578	1.960	2.232	2.405	2.949
2/22/2016	1.660	1.474	1.635	1.578	1.960	2.232	2.405	2.949
2/23/2016	1.660	1.474	1.635	1.578	1.960	2.232	2.405	2.949
2/24/2016	1.660	1.474	1.635	1.638	1.990	2.290	2.447	2.985
2/25/2016	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	
2/18/2016	9.35	9.28	9.33	9.38	9.38	2.40	0.56	
2/22/2016	9.25	9.25	9.38	9.43	9.43	2.40	0.56	
2/23/2016	9.25	9.15	9.38	9.43	9.43	2.09	0.57	
2/24/2016	9.33	9.20	9.30	9.40	9.40	2.26	0.56	
2/25/2016	8.91	9.16	9.34	9.45	9.45	2.10	0.56	

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
2/18/2016	4.3902	3.9416	3.9729	3.4634	1.4168	0.1624
2/22/2016	4.3655	3.9391	3.9668	3.4842	1.4159	0.1615
2/23/2016	4.3655	3.9671	3.9835	3.5424	1.4206	0.1613
2/24/2016	4.3720	3.9803	4.0103	3.5566	1.4105	0.1617
2/25/2016	4.3739	3.9705	4.0069	3.5415	1.4107	0.1618

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