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Polish Weekly Review

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Comment on the upcoming data and forecasts

A very busy week ahead of us. On Monday the NBP will publish money supply statistics for February - M3 is likely to accelerate due to strong growth in household deposit and cash in circulation. On Tuesday the NBP will publish balance of payments data for January. We forecast a large CA surplus, mainly due to a strong rebound in exports and large inflows of EU transfers. On the same day GUS will release CPI data for February along with revised January reading and a new set of basket weights. Our forecast of -0.7% y/y (low fuel prices still to blame) is subject to downside risks after because of other CEE country data. In addition, the change in weights is likely to push the January reading down by 0.1 pp. The underlying inflation is also low, as confirmed by official core inflation data (due on Wednesday) - we forecast two months of stagnation in core CPI. Labor market releases (also on Wednesday) are likely to show stabilization in both wage and employment growth. The former would have been dragged down by the delayed payments of coal mining bonuses but calendar effects probably pushed manufacturing and construction wage growth up, thereby offsetting the drop in mining wage growth. Finally, on Thursday GUS will release industry and trade data. We believe a strong rebound is in the cards for both and retail sales will be boosted by warm weather and consumption smoothing ahead of child subsidy disbursements.

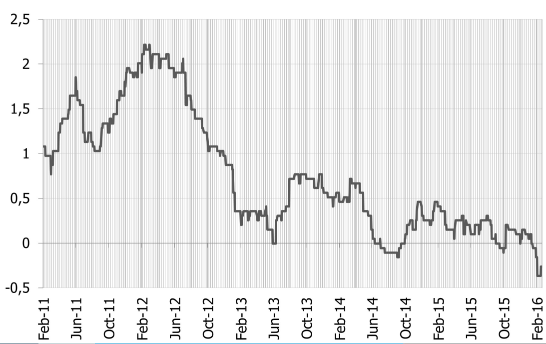
Polish data to watch: March 14th to March 18th

Publication	Date	Period	mBank	Consensus	Prior
M3 (%)	14.03	Feb	10.50	10.10	10.20
CPI y/y (%)	15.03	Feb	-0.7	-0.7	-0.7
Current account (mio EUR)	15.03	Jan	1345	177	-410
Exports (mio EUR)	15.03	Jan	14450	13740	13849
Imports (mio EUR)	15.03	Jan	13300	13015	13476
Average gross wage y/y (%)	16.03	Feb	3.9	3.9	3.9
Employment y/y (%)	16.03	Feb	2.4	2.4	2.3
Core CPI y/y (%)	16.03	Jan	0.0	0.0	0.2
Core CPI y/y (%)	16.03	Feb	0.0	0.1	
Sold industrial output y/y (%)	17.03	Feb	5.5	5.5	1.4
PPI y/y (%)	17.03	Feb	-1.3	-1.2	-1.2
Retail sales y/y (%)	17.03	Feb	5.3	3.6	0.9

Treasury bonds and bills auctions

Paper	Next auction	Last Offer	Yield on the prev auction (%)	Prev auction
(32/37/52) Week T-bills	3/14/2016	1500	1.290	2/15/2016
2Y T-bond OK1018	4/7/2016	2700	1.553	3/3/2016
5Y T-bond PS0720	4/7/2016	4800	2.219	2/18/2016
10Y T-bond DS0726	4/7/2016	5500	3.014	3/3/2016
15Y T-bond WS0428	-	20	2.092	3/12/2015

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



Comment

Unchanged (empty calendar). Next week brings all relevant macro publications, thus offering an excellent change for the index to move in either direction.

* 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

- We stay positive on 10Y POLGBs (meanwhile 10Y bonds moved up by few bps in yield).
- Risk premium looks too high. Polish yield curve is extremely steep.
- Foreign investors' perception of Polish bonds improved recently (one cannot say the same on equities where sectoral story is still determined by politics).
- Polish zloty lately trades decently, supported by strong economic fundamentals and ECB stimulus and MPC's communication.

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	0.2
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	3.1	3.4	3.8	4.0	4.0
Public Consumption y/y (%)	3.7	2.5	2.7	4.8	0.5	2.0	2.0	2.0
Investment y/y (%)	11.5	6.1	4.6	4.9	5.5	6.0	6.0	6.6
Inflation rate (% average)	-1.4	-0.9	-0.7	-0.6	-0.6	-0.3	0.2	1.3
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	1.50	1.25	1.25
Wibor 3M (% eop)	1.65	1.72	1.73	1.72	1.68	1.68	1.44	1.44
2Y Polish bond yields (% eop)	1.61	1.99	1.76	1.62	1.35	1.35	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	4.35	4.35	4.30	4.25
USD/PLN (eop)	3.80	3.76	3.80	3.92	3.95	3.95	3.91	3.86

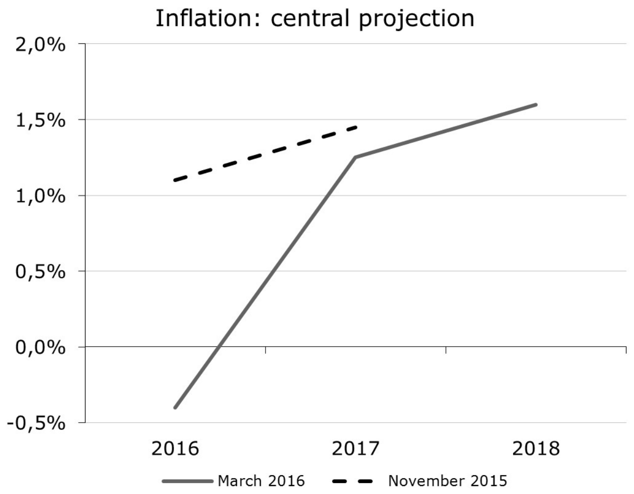
F - forecast

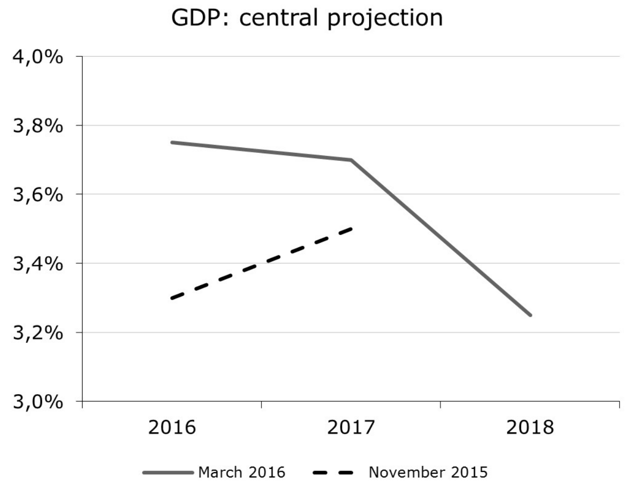
Economics

MPC keeps rates on hold but points out to mounting uncertainties.

MPC left rates on hold at 1.5%. RRR cut was not even considered during the meeting and turned down by Belka as unnecessary in current over-liquidity conditions.

The statement stressed various risks mounting ahead of the global economy, including the contagion of problems from EMs to DMs. At the same time the view on Polish inflation and the real sphere was left intact; in the latter case a new element of social spending was included. Projection sees significantly lower inflation (2016 is on average mired in deflation). GDP growth profile is more or less unchanged.





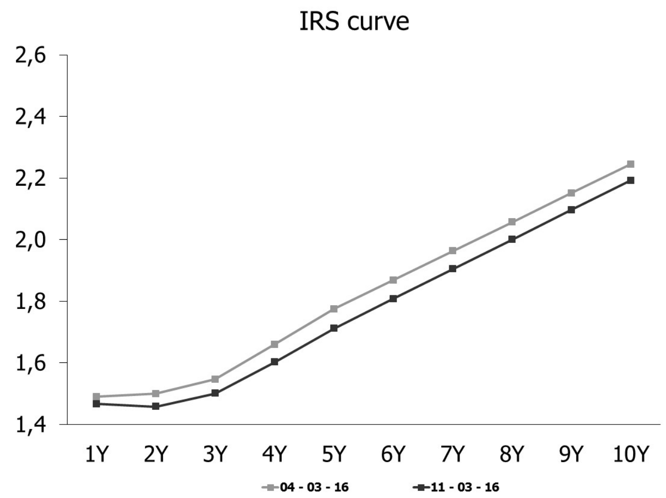
The most favored scenario for now isstable rates. MPC would like to support current status quo as it is safer to operate within the current multi-dimensional set of risks. It is worth asking how long this nirvana can last. Global environment is risky and fragile. ECB is easing monetary policy considerably and rate cuts in Hungary and Czech Republic are in the making. It is no coincidence then that such line of reasoning was considered relatively hawkish by the markets. In such circumstances, demanding global environment may entail strong zloty – a decoction no other central bank would like to face right now. That is why we see a scope for monetary easing. It is not going to happen next month but rate cuts would be constantly in the air. We would not like to thrash RRR cut scenario. It would require changes in institutional setup but – as in Hungarian case – at some stage may seem a natural way of cooperation between the central bank and the government, supporting demand for Polish bonds from commercial banks.

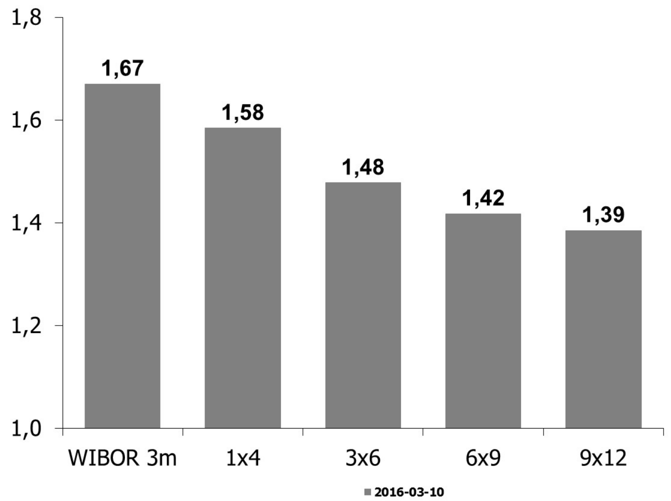
Fixed income

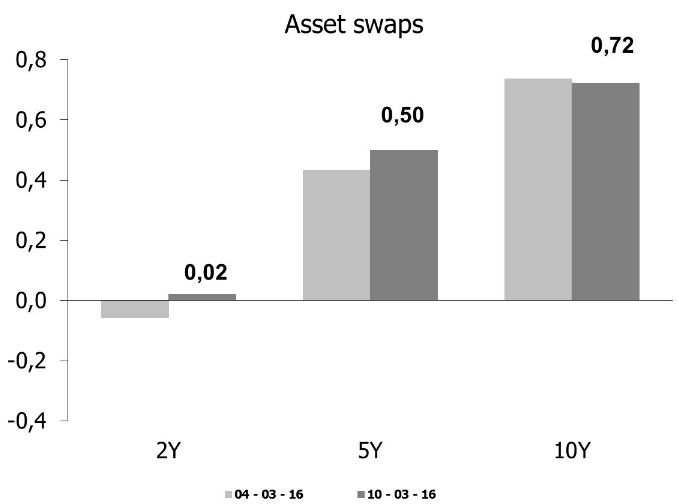
Polish bonds still in demand

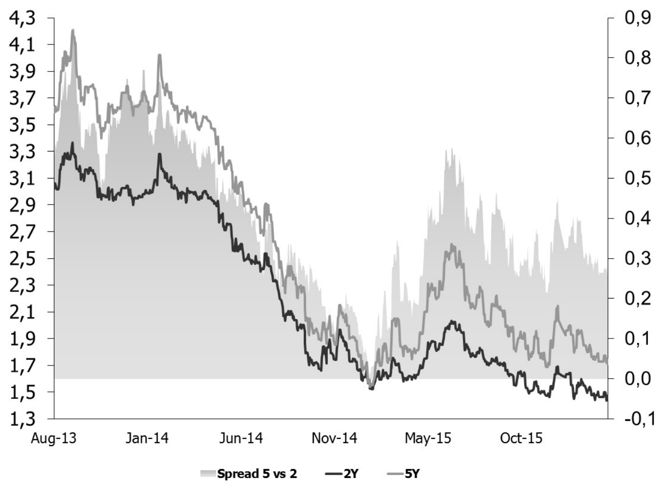
Last week domestic FI market remained in a quite strong risk-on mood. A huge T-bond auction on March 3rd recorded massive demand in 10y sector that resulted in 10bp shift in long end yields. Some more fuel to that downward move has been added by the EBC decision. As a result of lower risk premium the long term asset swaps narrowed by 10bps on the 10Y benchmark (62 bps vs 72 bps last week) mainly due to high foreign investors flows which took place in the last few days. Also, bond curve flattened. The spread between 5y and 10y bonds narrowed to 72 bps (by 5bps) while the shape of the swap curve remained unchanged. 2y-5y is now at 27 bps, 5y-10y is 48 bps.

Looks like we should face a further advance of t-bond prices in next days as Polish yields looks very attractive comparing to those in the Eurozone. Moreover we could expect some pressure on Polish MPC to consider action similar to the one delivered by the ECB (though the potential rate cut is already implied in a yield curve). On the other hand, we are a bit afraid of the political tensions in the country that might occasionally disturb the market and lead to greater volatility.









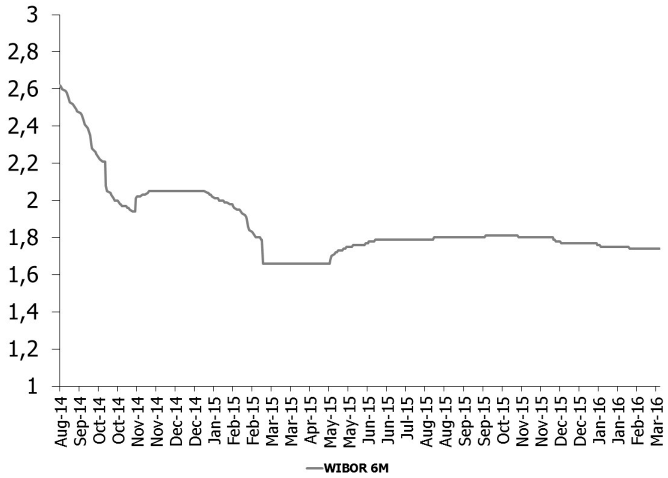
Money market

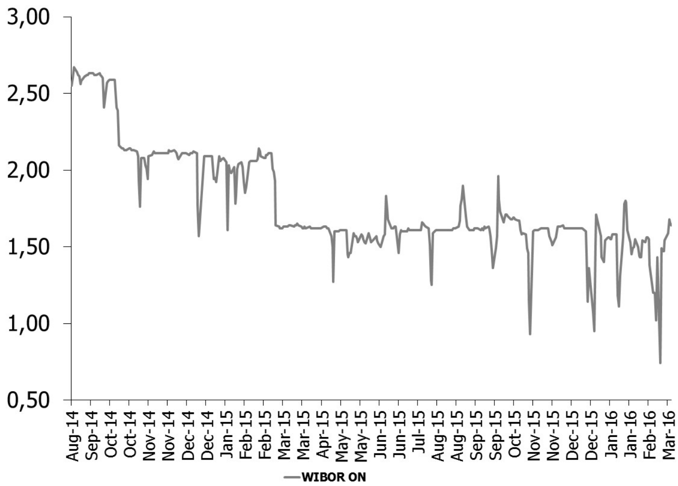
Cash back to normal... for now

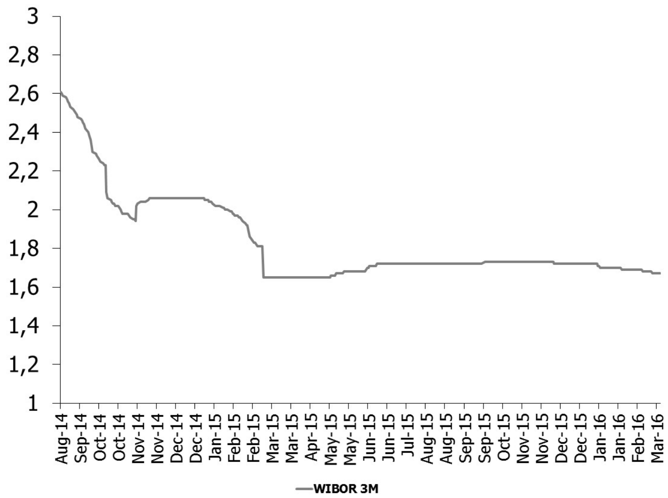
Quite boring week behind us. Market was squared after the last OMO and we had quite stable trading around 1.55%. Today banks also bought all offered NBP bills so the situation should be similar next week.

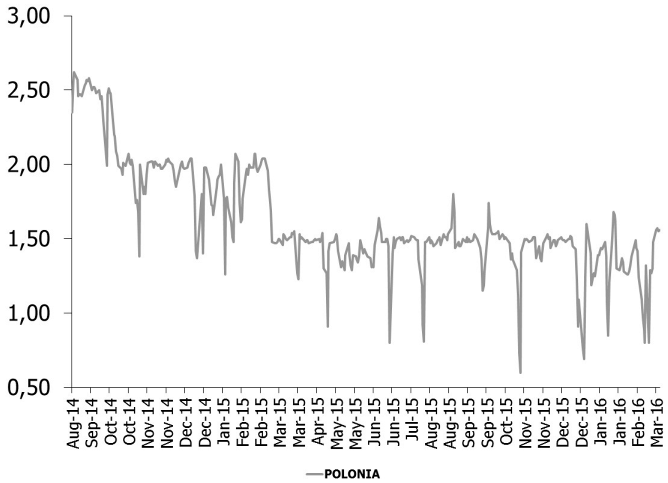
On Monday we have another T-bill auction. The MoF will offer 1-2 bn of 37 week bills and we expect yield to be around 1.30-1.25% on an act/360 basis.

Polonia against reference rate average spread: 30-day – 19bp; 90-day – 18bp.









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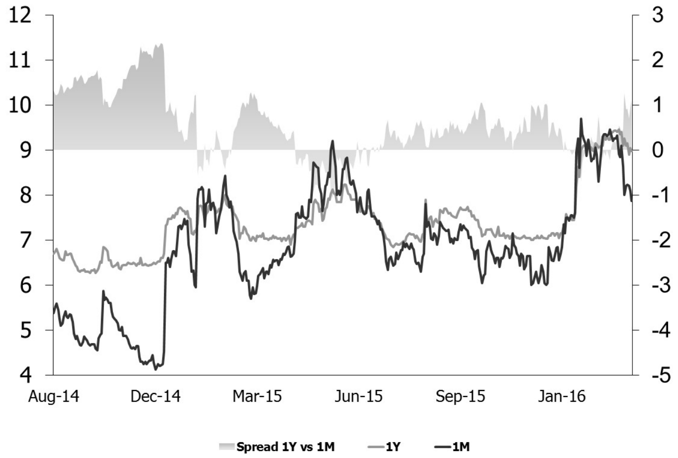
Forex

Spot – PLN at a critical resistance The PLN rally continued for the most of the week, with dovish ECB package pushing it to its low against EUR at 4.2870. Then, the nasty reversal in EUR/USD brought EUR/PLN as high as 4.3460 (high of the week). On Friday, the MPC left rates on hold, which was PLN positive, and we are more in consolidation mode now. We expect a more rangy market, at least untill FOMC meeting. We define current range as 4.2950-4.3650 and expect a slow drift upwards.

Options – EUR/PLN Vol curve weaker (again) Implied volatility is still at a premium to the realized one. Hence, the EUR/PLN vol curve is still on the sliding spiral. 1 month EUR/PLN ATM mid is today at 7.75% (0.50% lower), 3 months are 8.00% (0.4% lower) and, finally, 1 year is fixing at 8.9% (0.3% lower). Skew is roughly unchanged, and Currency Spread (difference between USD/PLN vol and EUR/PLN vol) is tic better offered.

EURPLN volatility



Short-term forecasts

Main supports / resistances:
EUR/PLN: 4.2750 / 4.3750
USD/PLN: 3.8000 / 4.0000

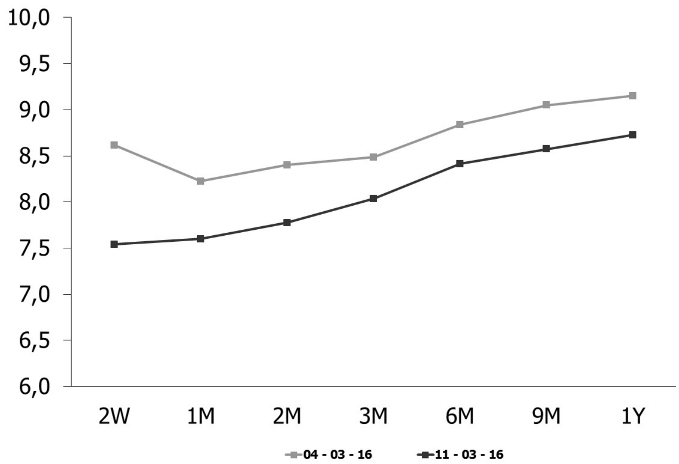
Position **Spot** Current position: Long at 4.3100

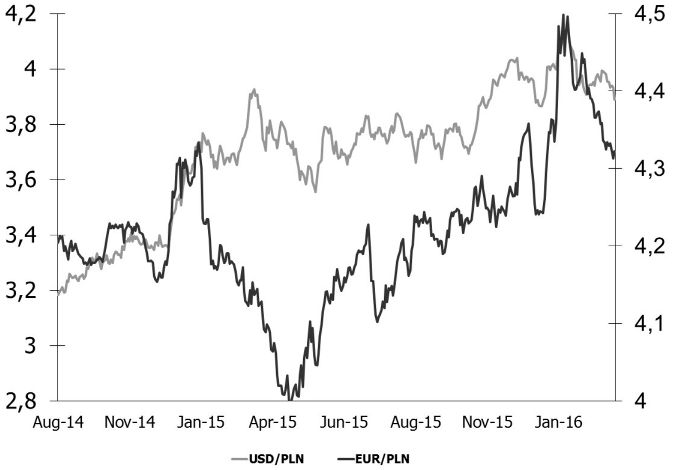
Longs from 4.3250 stopped out at 4.2950. We are long at 4.3100 again, and we are ready to add at 4.29 with a stop below 4.2750. We're hoping to revisit 4.37+. We have not been lucky with placing our stop, it got touched just before spike to 4.3460. Nevertheless we think EUR/PLN is above a strong support at 4.28/4.30, and we are looking for technical correction to the upper part of current range, namely 4.36/4.38.

Options

Realized volatility is still well below the implied one, even with the ECB shockwave included. It encourages us to stick to our short Vega in the frontend (up to 4 months). We are more pessimistic about longer term perspectives for Poland. Current government is a poor guarantee for budget deficit reduction, and political tensions (i.e. Constitutional Court) may build up in the future. As a consequence, we are on bids for longer term Vol. We are hoping for reducing our Vega Short in the frontend, by the backend Vega purchase.

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
3/3/2016	1.38	1.67	1.31	1.64	1.49	1.66	1.61	1.50	1.44	1.41	1.37	1.47
3/7/2016	1.42	1.67	1.46	1.64	1.50	1.66	1.58	1.50	1.40	1.36	1.35	1.40
3/8/2016	1.34	1.67	1.77	1.64	1.52	1.66	1.59	1.48	1.39	1.35	1.32	1.42
3/9/2016	1.47	1.67	1.56	1.64	1.57	1.66	1.59	1.49	1.42	1.38	1.35	1.44
3/10/2016	1.70	1.67	1.35	1.64	1.36	1.66	1.58	1.48	1.42	1.39	1.35	1.43

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
3/3/2016	1.660	1.474	1.635	1.578	1.960	2.232	2.405	2.949
3/7/2016	1.660	1.474	1.635	1.578	1.960	2.232	2.405	2.949
3/8/2016	1.660	1.474	1.635	1.578	1.960	2.232	2.405	2.949
3/9/2016	1.660	1.474	1.635	1.638	1.990	2.290	2.447	2.985
3/10/2016	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
3/3/2016	8.20	8.68	8.93	9.10	9.10	1.95	0.57
3/7/2016	8.20	8.33	8.73	8.90	8.90	1.95	0.57
3/8/2016	8.10	8.34	8.71	9.04	9.04	2.00	0.57
3/9/2016	7.88	8.21	8.63	8.98	8.98	2.10	0.57
3/10/2016	7.60	8.04	8.41	8.73	8.73	2.04	0.57

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
3/3/2016	4.3250	3.9805	3.9891	3.4927	1.3997	0.1599
3/7/2016	4.3292	3.9515	3.9532	3.4816	1.4019	0.1600
3/8/2016	4.3325	3.9333	3.9664	3.4823	1.3925	0.1601
3/9/2016	4.3215	3.9395	3.9468	3.5032	1.3917	0.1598
3/10/2016	4.3131	3.9320	3.9447	3.4678	1.3910	0.1595

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