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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

Week begins with the release of monthly labor market indicators. We forecast unchanged employment growth (2.5% y/y) and a slight decline in wage growth. The latter is driven primarily by negative calendar effect that should lower manufacturing wage growth. The same effect (annual difference in working day count drops from +1 to 0) will drag industrial output growth – and we believe it to be the sole driver of this decline. Retail sales growth, on the other hand, is bound to accelerate due to early Easter and strong durable good sales ahead of child subsidy disbursement (from April 1st). Finally, one should take notice of business tendency surveys published next week: first, the NBP's quarterly survey of enterprises, then CSO's monthly surveys of consumers and enterprises.

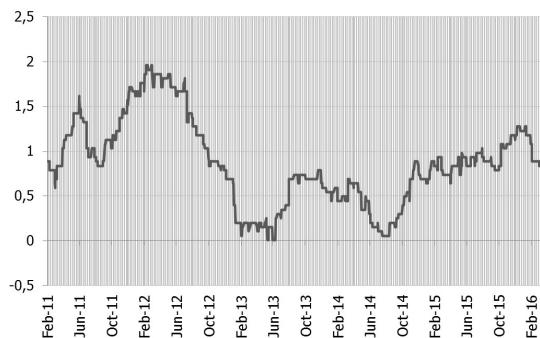
Polish data to watch: April 18th to April 22th

Publication	Date	Period	mBank	Consensus	Prior
Average gross wage y/y (%)	18.03	Mar	3.7	3.4	3.9
Employment y/y (%)	18.03	Mar	2.5	2.5	2.5
Sold industrial output y/y (%)	19.03	Mar	4.0	3.9	6.7
PPI y/y (%)	19.03	Mar	-1.4	-1.4	-1.4
Retail sales y/y (%)	19.03	Mar	5.1	3.5	3.9
NBP enterprise survey	20.03	Q1			
MPC Minutes	21.03	Apr			

Treasury bonds and bills auctions

Paper	Next auction	Last Offer	Yield on the prev auction (%)	Prev auction
(32/37/52) Week T-bills	-	1500	1.350	3/14/2016
2Y T-bond OK1018	-	2700	1.553	3/3/2016
5Y T-bond PS0720	4/21/2016	4800	2.219	2/18/2016
10Y T-bond DS0726	-	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 – final CPI came out unchanged from the flash release. Next week is abundant with data (wages, industrial output, retail sales), so the index might move yet again.

* 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 decided to close our long 10y bonds recommendation and switch to defensive long 2y instead. Switching to 2y allows us to safely take advantage of the expected play on rate cuts in Poland (nobody believes in them which is a mistake in our opinion) and movements associated with the banking tax.
- Local factors temporarily played out and the pendulum may be swinging to the other side at the moment amid greater volatility (great return of CHF conversion programme) while MPC still sticks to stable rates paradigm.
- Globally, we entered the play for Brexit that may be disastrous for all asset classes. Valuations for U.S. rates seem to be at local bottom given the improvement in financing conditions, inflation expectations, weaker dollar and improvement in the data. At this stage further ECB easing play is conceivable but too distant from tactical perspective.
- We see first signs of nervousness on EURPLN. Although it may be only a profit taking after a persistent PLN rally, we think the Zloty may face headwinds because of looming Brexit referendum and return of CHF-mortgage conversion proposals.

mBank forecasts

	2010	2012	2013	2014	2015	2016 F
GDP y/y (%)	3.7	1.6	1.3	3.3	3.6	3.8
CPI Inflation y/y (average %)	2.8	3.7	0.9	-0.1	-0.9	-0.1
Current account (%GDP)	-5.4	-3.7	-1.3	-2.0	-0.1	-0.7
Unemployment rate (end of period %)	12.4	13.4	13.4	11.4	9.8	8.7
Repo rate (end of period %)	3.50	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	3.7	3.8	3.9	3.9
Individual consumption y/y (%)	3.1	3.1	3.1	3.1	3.4	3.8	4.1	4.3
Public Consumption y/y (%)	3.7	2.5	2.7	4.8	3.2	2.9	4.0	4.0
Investment y/y (%)	11.5	6.1	4.6	4.9	3.0	3.6	4.0	4.5
Inflation rate (% average)	-1.4	-0.9	-0.7	-0.6	-0.9	-0.5	-0.1	1.0
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	1.67	1.66	1.44	1.44
2Y Polish bond yields (% eop)	1.61	1.99	1.76	1.62	1.45	1.35	1.30	1.30
10Y Polish bond yields (% eop)	2.31	3.31	2.84	2.94	2.84	2.90	2.90	2.90
EUR/PLN (eop)	4.07	4.19	4.25	4.26	4.24	4.25	4.25	4.20
USD/PLN (eop)	3.80	3.76	3.80	3.92	3.73	3.86	3.86	3.82

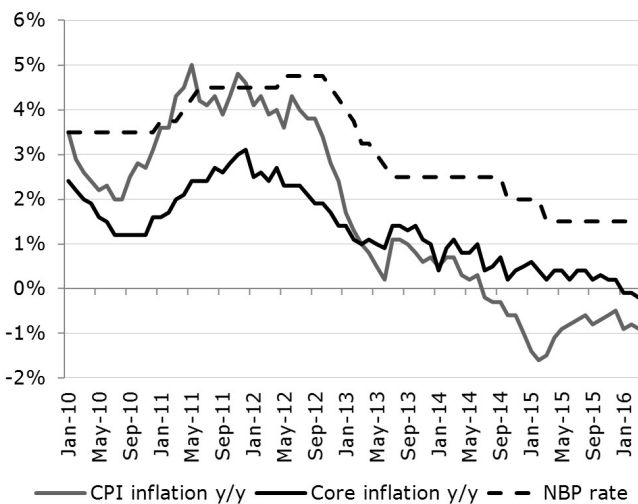
F - forecast

Economics

Deeper core deflation

Final CPI inflation release for March confirmed the flash reading of -0.9% y/y. It was 0.1 pp lower than in February. March was thus the 21-st month in a row with deflation in Poland.

Food prices rose just slightly – by 0.4% on a monthly basis, while fuel while prices grew by 1.3% m/m. Looking into remaining categories we see mainly declines: housing prices were lower, culture and recreation category fell by 1.7% (main reason here was the 9% drop in cable TV prices). As a result, this was the third month in a row with negative core inflation. According to NBP data, annual core CPI rate fell from -0.1% to -0.2%.



Inflation in Poland exhibits zero momentum and at the moment nothing points to a sudden reversal. In the coming months inflation will simply follow the arrangement of statistical bases – compared to the previous year, the increase in fuel prices happened later (biggest increase in April, not in March). In our view, inflation will turn positive only after September.

Persistently low inflation (core inflation in particular) obviously shows how big the room to cut rates really is. That this has not happened yet, is a result of exchange rate volatility and current MPC's communication strategy – the MPC wants to assert itself as an independent body first (which implies waiting with rate cuts – see latest comments from members: Zyzynski, Osiatynski, Ancyparowicz). Monetary easing is supported by both fundamental and market-related reasons. The former are: persistently low inflation and C/A surplus. The latter – global trends and regional easing.

We expect the issue of rate cuts to return to the spotlight soon. It will be preceded by the revision in monetary policy strategy – the new document will allow for unconventional monetary policy tools, similar to those used by the Hungarian central bank.

Fixed income

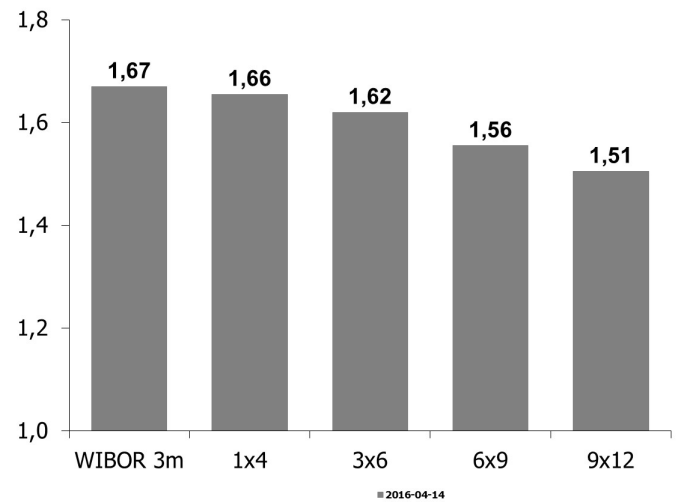
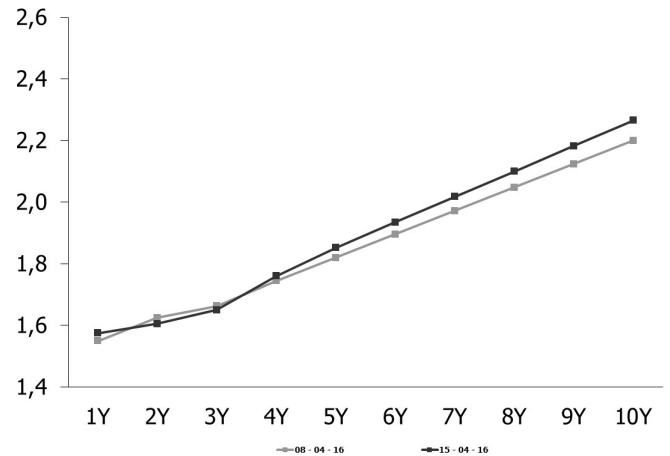
It's high time for steepening

We were right and indeed Polish swap curve was too flat. Since last Friday 2y10y spread widened from 57 bps to 67 bps and it should expand further. Long end of the bond curve remained stable. It rose to 2.98 on the 10y benchmark on Thursday and came back to 2.95 on Friday morning mostly due to the strength in the core markets.

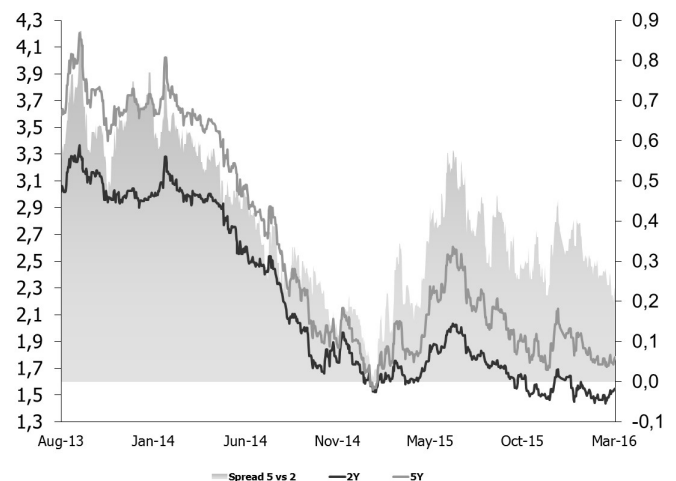
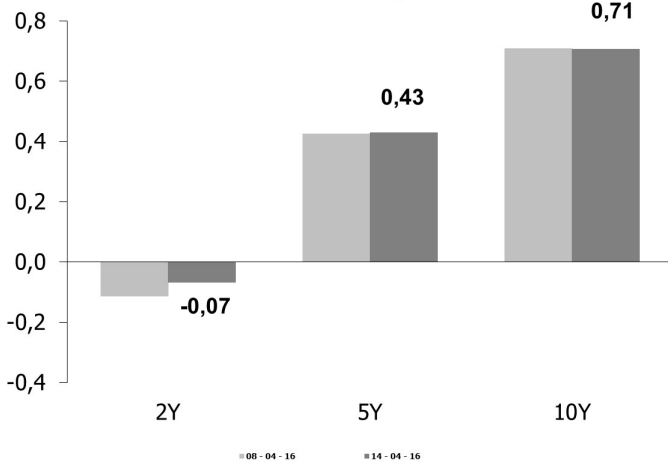
Front end of the curve remained stable. 2Y IRS decreased from 1.65 to 1.62 and in our opinion discounting some small probability of rate cut is fair so we suggest to stay square or receive there, rather than being pay.

Demand for Polish bonds is not decreasing. Huge last week's auction (mostly 10y bonds) moved market down by just 4 bps. Next week's auction should be good as well, especially that Min-Fin will offer less risky 5y fixed bonds and floaters. We like buying 2y-10y swap spread (still too narrow) or 10y swap outright.

IRS curve



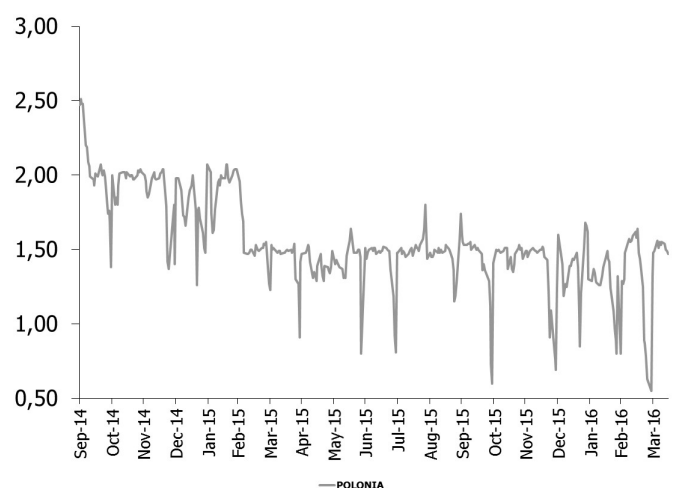
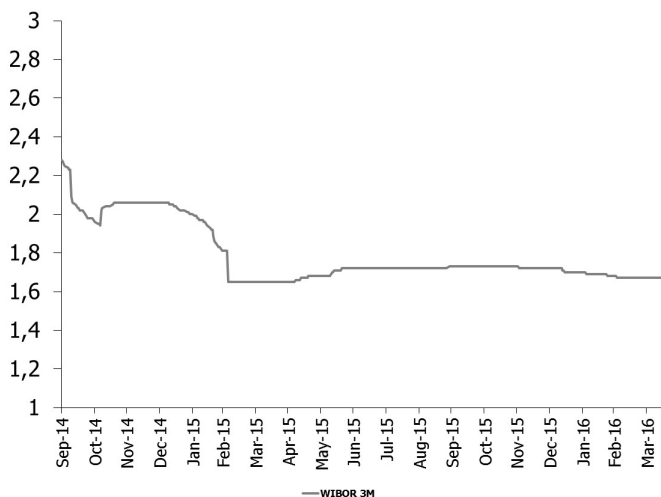
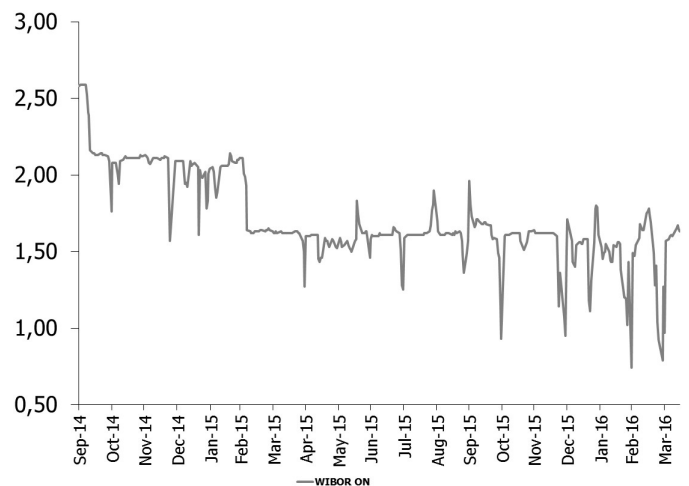
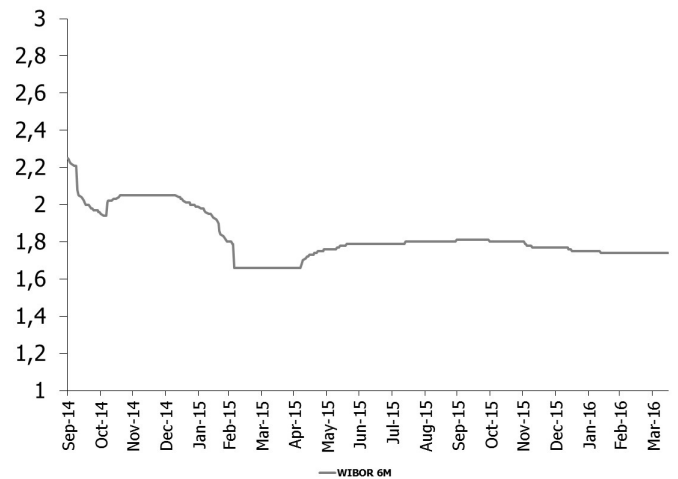
Asset swaps



Money market

Quite boring week behind us

Market was squared after the last OMO and we had quite stable trading around 1.52–1.55%. Today banks also bought all offered NBP bills (74.5 bln) so the situation should be similar next week. We can see good opportunity to build up our long position in short bonds (PS1016, PS0417) with levels 1.38–1.40%. We expect increase in demand for that papers as PS0416 is going to maturity. T-bills were quoted at 1.35–1.28%. OIS remained unchanged with 1Y Polonia at 1.18/1.22, 9mth 1.19/1.23 and 6mth 1.22/26.



Forex

Spot – Zloty weaker After wild swings of a last week, this week was in comparison quite uneventful. On Monday we saw some downside correction on EURPLN that came back from 4.30 to 4.27 level. Later EURPLN was inching higher consistently to retest 4.3090 on Thursday. Generally, last week Zloty stood out negatively from its peers. After good data from China, global sentiment improved further but nonetheless Zloty was losing its value. There are reasons behind it: the tensions between EU and PIS government, new presidential project for CHF loans, negative implications of possible Brexit. So if it's not a real U-turn on EURPLN, than at least for sure the range moved higher and we may now expect 4.2750 – 4.36 to be in play.

Options – EUR/PLN Vol curve stable We even have managed to ease a bit in the frontend, mostly because realized volatility was very low (last days Zloty was creeping higher but very slowly). 1 month EUR/PLN ATM mid is at 6.7% (0.2% lower), 3 months EUR/PLN is 8.0% (0.2% higher) and finally 1 year is 8.6% (0.1% lower). The skew is roughly unchanged, and currency spread (difference between USD/PLN and EUR/PLN) is also trading water.

Short-term forecasts

Main supports / resistances:

EUR/PLN: 4.2750 / 4.36

USD/PLN: 3.70 / 4.00

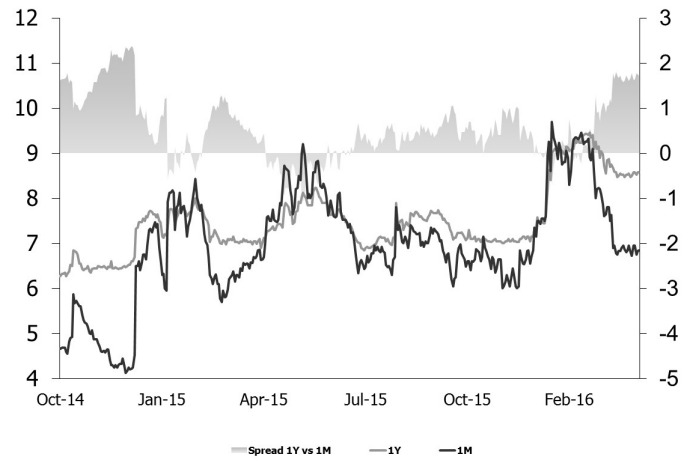
Spot Current position: We are still long on average 4.2450, moving stop higher to 4.2750 and still hoping to get above 4.32+. Lately, the global investment sentiment is quite good but probably domestic factors hang over Zloty... We just still think the better risk/reward is for being long EUR/PLN at current levels.

Options Vols – Long Vega

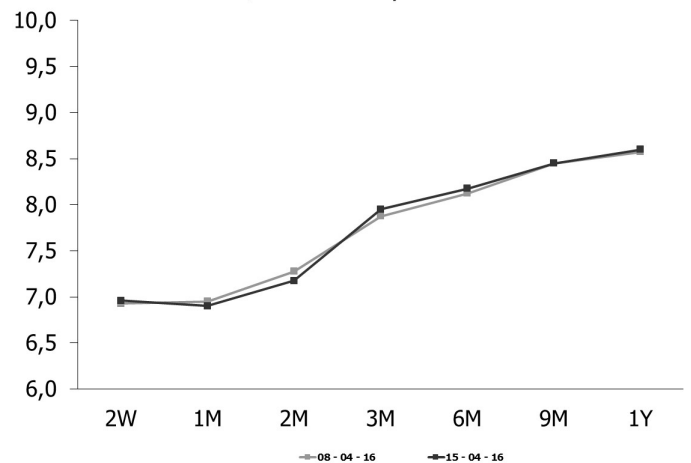
The political situation remains blurred at best, with potential sources of problems firmly in place (i.e. Constitutional Tribunal, EU's resolution, CHF legislation draft). We are getting close to the planned reviews of Poland's rating. It's a potential risk factor for the Zloty, and our long term financial stability is not warranted. In this environment the only thing we can be sure of is increased volatility. We are now outright long Vega (in majority backend Vega). We are just a little more pessimistic than others.



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
4/7/2016	1.41	1.67	1.53	1.64	1.51	1.66	1.64	1.58	1.55	1.54	1.52	1.60
4/11/2016	1.48	1.67	1.35	1.64	1.60	1.66	1.66	1.59	1.56	1.51	1.51	1.58
4/12/2016	1.38	1.67	1.49	1.64	1.56	1.66	1.66	1.62	1.55	1.51	1.51	1.58
4/13/2016	1.32	1.67	1.40	1.64	1.47	1.66	1.65	1.62	1.55	1.52	1.50	1.58
4/14/2016	1.73	1.67	1.82	1.64	1.72	1.66	1.66	1.62	1.56	1.51	1.51	1.59

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
4/7/2016	1.660	1.474	1.635	1.578	1.960	2.232	2.405	2.949
4/11/2016	1.660	1.474	1.635	1.578	1.960	2.232	2.405	2.949
4/12/2016	1.660	1.474	1.635	1.578	1.960	2.232	2.405	2.949
4/13/2016	1.660	1.474	1.635	1.638	1.990	2.290	2.447	2.985
4/14/2016	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	
4/7/2016	6.95	7.78	8.10	8.58	8.58	2.17	0.60	
4/11/2016	6.75	7.75	8.05	8.53	8.53	2.17	0.60	
4/12/2016	6.83	7.93	8.18	8.58	8.58	2.24	0.63	
4/13/2016	6.85	7.88	8.13	8.58	8.58	2.22	0.60	
4/14/2016	6.90	7.95	8.18	8.60	8.60	2.26	0.62	

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
4/7/2016	4.2601	3.7414	3.9139	3.4516	1.3668	0.1576
4/11/2016	4.2826	3.7587	3.9344	3.4759	1.3721	0.1584
4/12/2016	4.2867	3.7490	3.9420	3.4630	1.3743	0.1586
4/13/2016	4.2827	3.7771	3.9343	3.4591	1.3763	0.1584
4/14/2016	4.3016	3.8174	3.9511	3.4955	1.3824	0.1591

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