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## Polish Weekly Review

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### Comment on the upcoming data and forecasts

On Thursday the CSO will publish final CPI for April along with the details of the release. We expect it to confirm the flash reading of -1.1% with a sharp decline in food prices as the main driver. Friday will be a busy day for Poland's economy watchers. The flash GDP for Q1 is likely to show a marked slowdown in economic growth, associated mainly with a drop in public investment and the hiatus in EU spending. NBP's releases, published later that day (M3 and balance of payments) will be treated by the markets with lesser interest. We expect some acceleration in M3 and a slightly negative CA balance (mainly due to fairly weak balance of EU transfers). Finally, on Friday evening Moody's will publish its decision on Poland's sovereign rating.

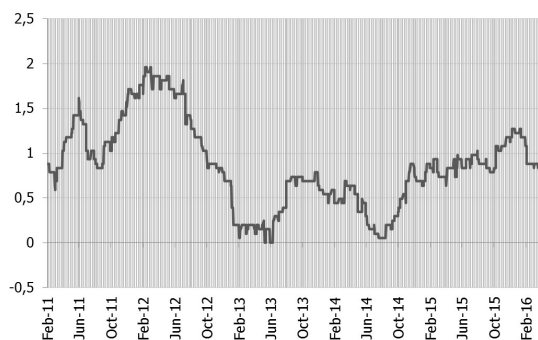
### Polish data to watch: May 9th to May 13th

Publication	Date	Period	mBank	Consensus	Prior
CPI <i>final</i> y/y (%)	12.05	Apr	-1.1	-1.1	-0.9
GDP <i>flash</i> y/y (%)	13.05	Q1	3.6	3.4	4.3
M3 y/y (%)	13.05	Mar	9.9	9.7	9.4
Current account (mio EUR)	13.05	Mar	-184	385	-383
Exports (mio EUR)	13.05	Mar	15500	15421	14466
Imports (mio EUR)	13.05	Mar	15400	15168	14125
Moody's rating decision	13.05	13.05			A2

### 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	-	1500	1.645	5/5/2016
5Y T-bond PS0720	5/26/2016	4800	2.219	4/21/2016
10Y T-bond DS0726	-	3000	3.134	5/5/2016
15Y T-bond WS0428	-	20	2.092	3/12/2015

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



#### Comment

Down after very weak PMI data. There are two major releases next week: final CPI on Thursday and flash GDP on Friday. Plenty of room to surprise.

\* 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 defensive and like 2y bonds. Sticking 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 the MPC is still sticking 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 saw 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

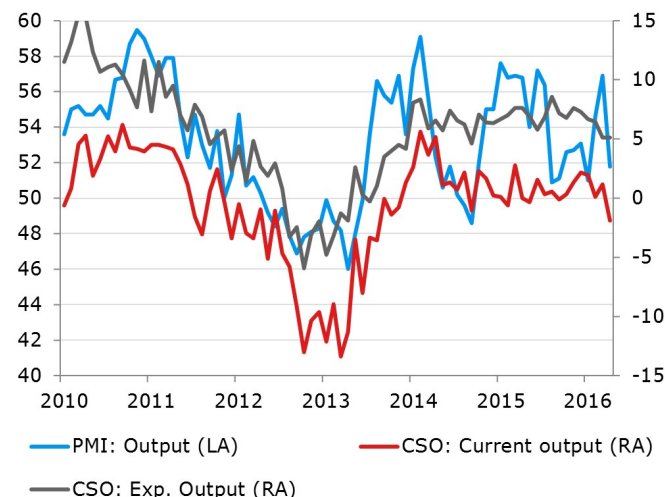
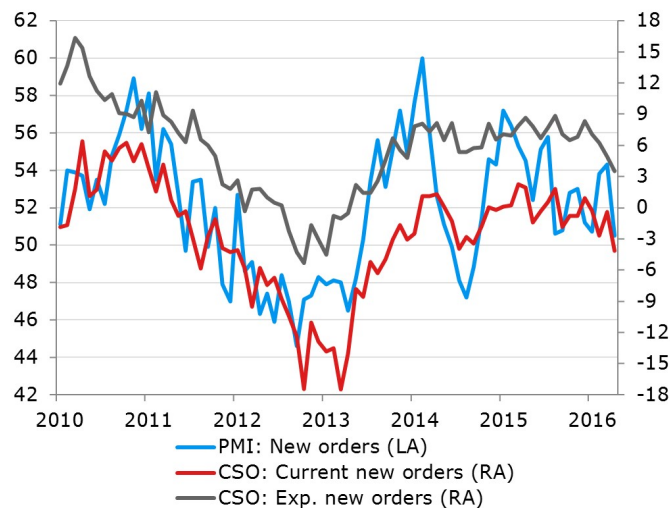
	2015	2015	2015	2015	2016	2016	2016	2016
	Q1	Q2	Q3	Q4	Q1 F	Q2 F	Q3 F	Q4 F
GDP y/y (%)	3.6	3.1	3.4	4.3	3.7	3.8	3.9	3.9
Individual consumption y/y (%)	3.1	3.1	3.1	3.0	3.4	3.8	4.1	4.3
Public Consumption y/y (%)	1.8	0.8	0.9	8.7	3.2	2.9	4.0	4.0
Investment y/y (%)	11.8	5.8	4.4	4.4	3.0	3.6	4.0	4.5
Inflation 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	4.35	4.25	4.20
USD/PLN (eop)	3.80	3.76	3.80	3.92	3.73	3.82	3.79	3.82

F - forecast

## Economics

### MPC unfazed by the surprisingly deep fall in the PMI.

Although a drop was widely expected, the decline from 53.8 to 51.0 is one of the biggest in the history of the series (5th biggest, to be precise). It was broad-based as well. Output assessment tanked from 56.9 to 51.8, new orders from 54.3 to 50.5 (now the lowest reading since September 2014) and employment from 55.2 to 52.2. The overall pulse of the economy was still supported by still strong new export orders. Additional commentary attached to the publication points to weak zloty as the reason for relative strength of the demand from abroad; we agree. On the nominal side, production costs continued their slump whereas final goods prices recovered to growth territory (it is only the second reading above 50 in the last 4 years, therefore we remain skeptical as far as the sustainability of this development is concerned).



We notice that such a substantial drop in PMI went rather unnoticed, similar to the drops in retail sales and industrial output last month. The dominant theme relates those disturbances to one off factors. Actually, however, recent PMI reading is consistent with other business tendency indices and tells a similar story (one should only make a proper comparison – see the graphs above) of levelling off (if not falling) business activity. We think that such a behaviour of business activity only corroborates the

hypothesis that there is something fundamental in this early slowdown. It may be related to the weakness in construction which generally reveals the hiatus in EU funds disbursement; it weighs on all investment activity. At the same time the center of growth has been shifting towards private consumption. On aggregate it does not make a difference in numbers (although GDP growth slowed a bit to 3.6% in Q1, we expect some more thereafter) but construction and manufacturing may be under pressure for some time.

Friday's monetary policy meeting was a complete non-event. The wording of the statement was not changed at all (some cosmetic, irrelevant alterations notwithstanding). We get an impression that the MPC is stuck precisely at the same stage as a month ago. Although we see the mounting set of risks ahead of the Polish economy (deflation apart – this stays the same), as we write above, the MPC seems to have internalized a better shape of the Polish economy and the risks are put into the background. Currently, the door for policy change is as closed as it was a month ago. However, we still think that the MPC could change its attitude if financial markets stabilize (Brexit, Swiss franc mortgage legislation etc.), widely expected turnaround in the data is weaker than expected and deflation stays entrenched.

## Fixed income

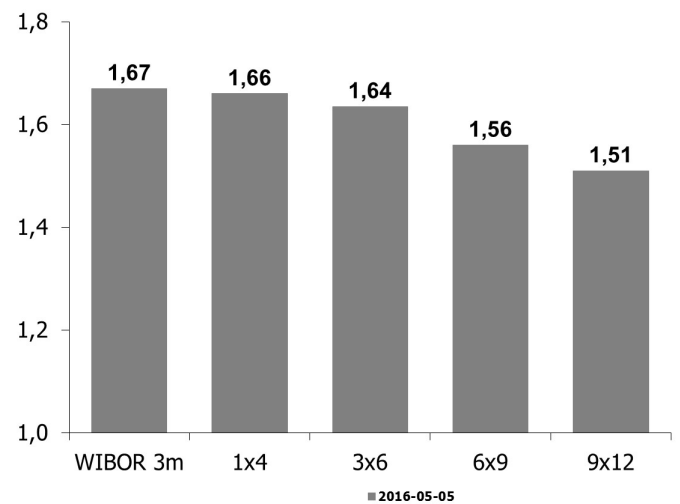
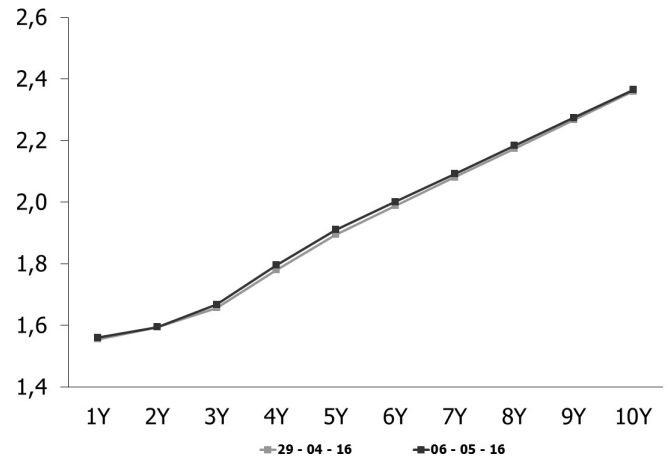
### Waiting for Moody's

The beginning of a shorter week was under (not very aggressive but still) selling pressure, especially in the long end of the curve as primary dealers made some room for bond auction scheduled for 5th May (PS0721 2.38% +5bps; DS0726 3.14% +8bps). The Ministry of Finance sold decent amount of 10y benchmark (2.939 bio PLN at 3.134%) and 2y 1.765 bio PLN at 1.645% without any problem – market was caught short which translated into 5bps yield decline.

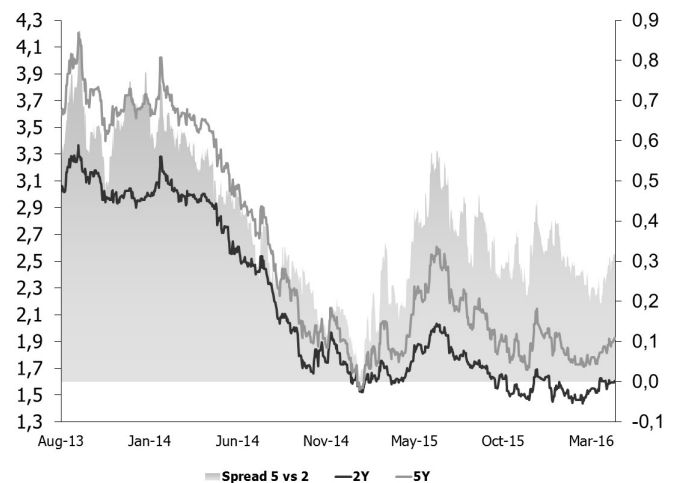
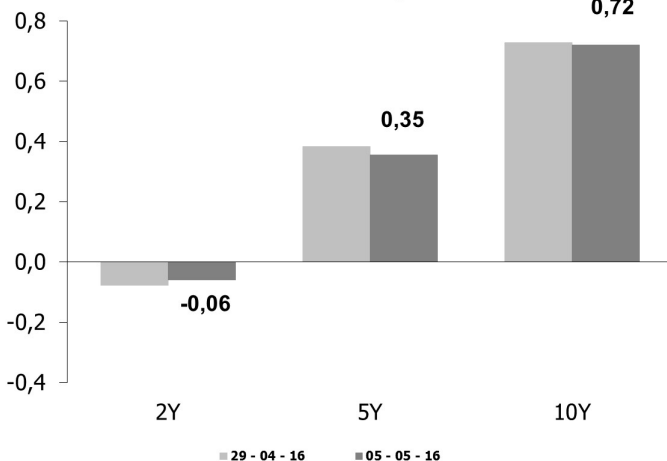
NFP April publication at +160K vs. +200K expected pushed yields to last week levels (PS0721 2.32%; DS0726 3.05%). MPC rate decision (no change) didn't change overall market picture.

We closed our 2y10y steepener at 80bps (opened at 58bps 8th April). We will try to find opportunity to build long bond position just before Moody's decision as global environment is supportive for govies and we see scope for short-term relief rally. Bear in mind that presidential CHF conversion proposal is to be published till the end of May.

IRS curve



Asset swaps



## Money market

### MPC meeting

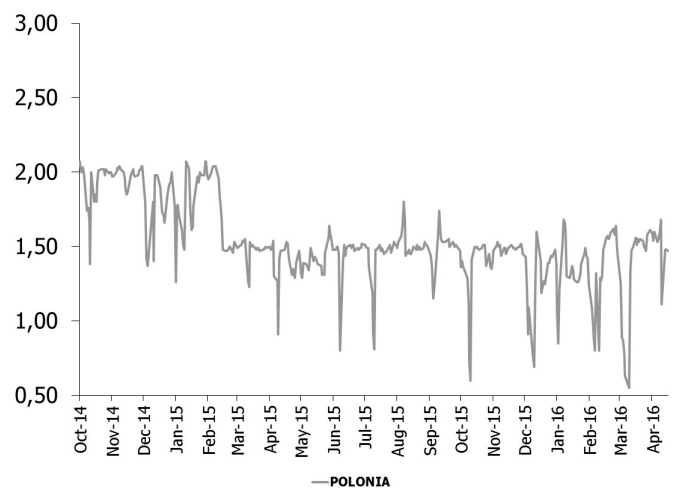
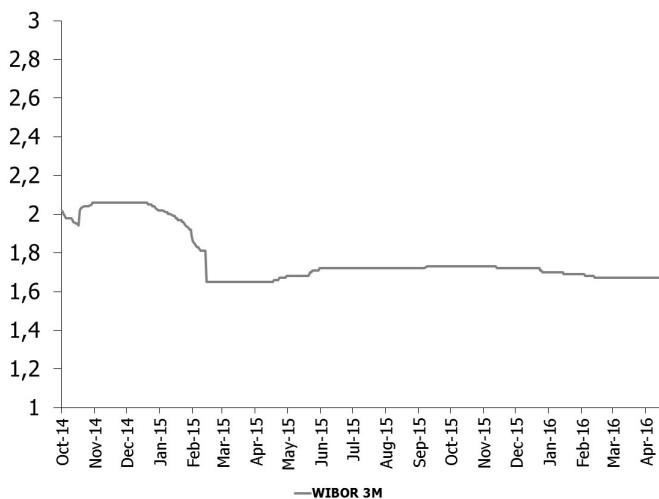
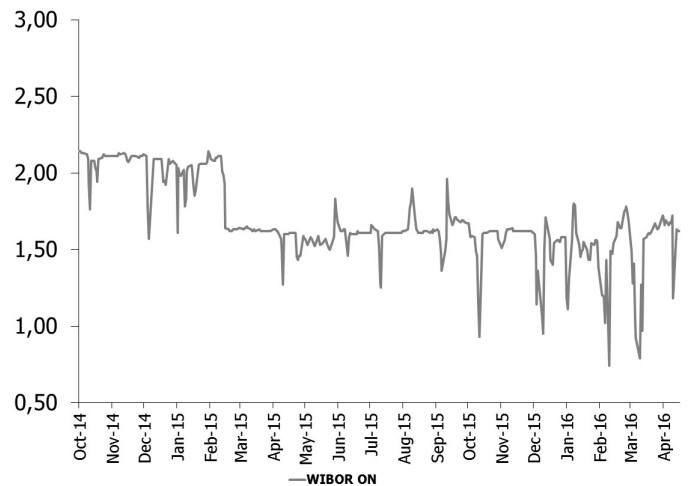
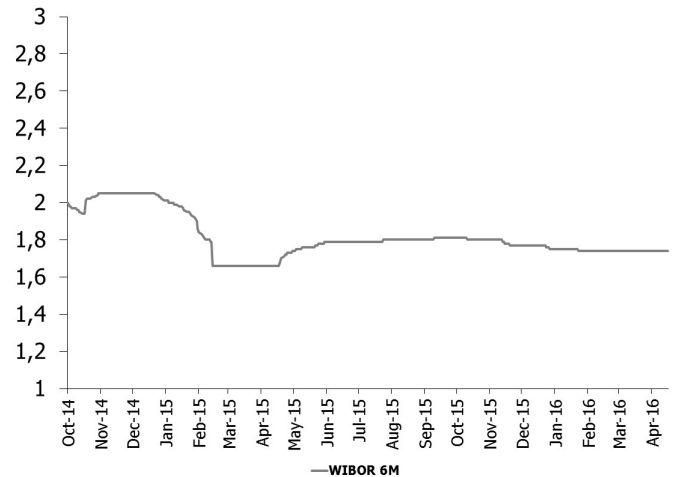
We just had another "boring" rate decision with members happy to leave rates unchanged. Also, no signs of any adjustment in the near future. This stabilizes front rates at current levels, pricing just a small chance for rate cuts in the upcoming months.

As we mentioned last week, May has a chance to be quite cheap comparing to the previous month due to favourable calendar and two bank holidays. We still like buying short bonds (1016 and 0417) around 1.40% yield. As time passes, they should be in demand from ALM desks as an alternative to NBP bills which have 1.1% yield (adjusted by tax).

Ref rate vs Polonia averages:

30 day: 0 bp(+5)

90 day: 13 bp(-)



## Forex

**Spot – Zloty’s consolidation continues.** EUR/PLN held the 4.35/4.37 support zone well (4.3675 is the low of the week). The resistance is still at 4.43/4.44 (4.4350 – high of the week), and the series of higher lows is suggesting that pressure is building to the upside. CHF-denominated loan developments is the elephant in the room. The proximity of the Polish ratings revision is another factor to keep a close look at. The bigger picture is unclear, the political risk is tough to estimate. Potential longer term consequences (political, economic) can be quite severe. We are aware of the rangy nature of EUR/PLN but skewed to buy dips in EUR/PLN on good old “buy the rumour, sell the fact” approach.

**Options – EUR/PLN vol higher** Another busy week for option traders. Vols received some support from realized volatility stats (on the rise), as a result 1 month was paid at 8.2% and 2 months at 8.5%. Looks like short Gamma hedges, which had the biggest impact on the frontend. 1 month EUR/PLN ATM mid is this Friday at 8.2% (0.9% higher), 3 months EUR/PLN is 8.5% (0.5% higher) and finally 1 year is 8.85% (0.15% higher). The skew and currency spread (difference between USD/PLN and EUR/PLN vol) is also better bid.

## Short-term forecasts

Main supports / resistances:

EUR/PLN: 4.35 / 4.45

USD/PLN: 3.70 / 4.00

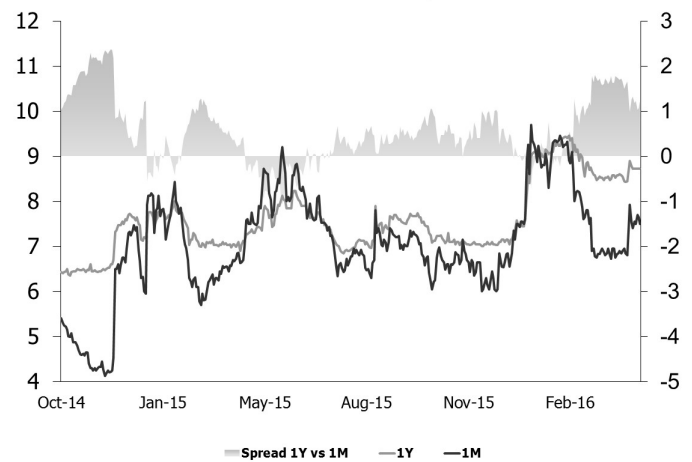
**Spot** Current position: Long EUR/PLN from 4.2405, ready to add 4.3650 with a stop below 4.3450, and hopes to see 4.50+.

It was not an easy call. We have moved a lot from 4.4050 low, and it may as well form a top somewhere around 4.43. On the other hand, it has consolidated nicely above 4.36 and the political tensions (especially around Constitutional Court) are not fading at all. The more agile than usual approach is being advised, any game-changing political solutions, especially in CHF loans conversion project, and this position should be cut.

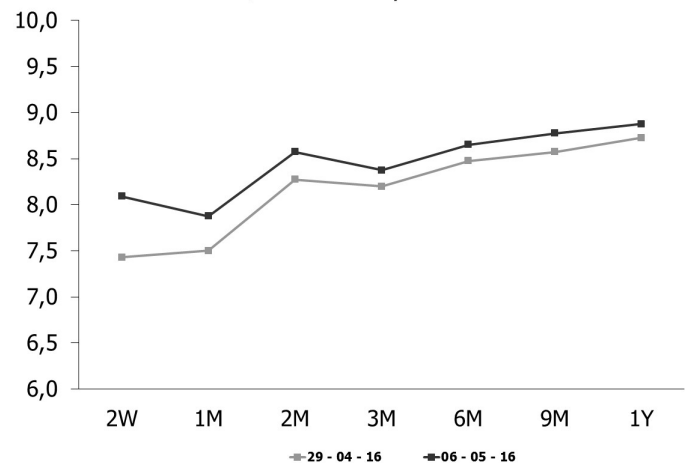
**Options** Vols – Long Vega

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

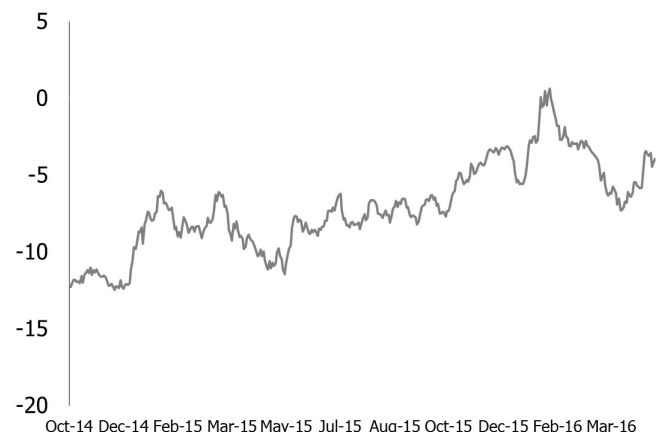
EURPLN volatility



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
4/28/2016	1.77	1.67	1.84	1.64	1.74	1.66	1.65	1.60	1.53	1.47	1.46	1.58
5/2/2016	1.52	1.67	1.69	1.64	1.60	1.66	1.65	1.62	1.54	1.49	1.49	1.57
5/3/2016	1.65	1.67	1.70	1.64	1.62	1.66	1.65	1.61	1.52	1.48	1.47	1.56
5/4/2016	1.42	1.67	1.48	1.64	1.52	1.66	1.66	1.63	1.56	1.50	1.49	1.59
5/5/2016	1.75	1.67	1.84	1.64	1.73	1.66	1.66	1.64	1.56	1.51	1.50	1.60

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
4/28/2016	1.660	1.474	1.635	1.578	1.960	2.232	2.405	2.949
5/2/2016	1.660	1.474	1.635	1.578	1.960	2.232	2.405	2.949
5/3/2016	1.660	1.474	1.635	1.578	1.960	2.232	2.405	2.949
5/4/2016	1.660	1.474	1.635	1.638	1.990	2.290	2.447	2.985
5/5/2016	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	
4/28/2016	7.55	8.18	8.45	8.73	8.73	2.32	0.63	
5/2/2016	7.70	8.25	8.50	8.73	8.73	2.32	0.63	
5/3/2016	7.65	8.23	8.48	8.73	8.73	2.28	0.64	
5/4/2016	7.50	8.23	8.45	8.73	8.73	2.32	0.64	
5/5/2016	7.88	8.38	8.65	8.88	8.88	2.30	0.63	

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
4/28/2016	4.3940	3.8695	4.0020	3.5776	1.4123	0.1625
5/2/2016	4.3842	3.8195	3.9844	3.5873	1.4071	0.1621
5/3/2016	4.3842	3.8195	3.9844	3.5873	1.4071	0.1621
5/4/2016	4.3992	3.8300	4.0078	3.5842	1.4059	0.1627
5/5/2016	4.4003	3.8475	4.0005	3.5853	1.4074	0.1627

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