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Polish Weekly Review

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Comment on the upcoming data and forecasts

Week begins and ends with business surveys - the NBP's quarterly survey results (Q2 with forecasts for Q3) will be released Monday morning, while CSO's consumer and business surveys will be released on Wednesday and Friday, respectively. It will shed some light on the persistence of recent slowdown, particularly in investment. Hard data, on the other hand, is set to come out on a positive note. The arrangement of working days, which depressed output in May, will be very favorable for industrial output and retail sales (to be released on Tuesday), leading to a sharp acceleration in both (similar effect will probably be observed in wage data). The latter should, in addition, be finally boosted by the child subsidy programme (nearly 5 bn PLN disbursed by the end of June).

Polish data to watch: July 18th to July 22nd

Publication	Date	Period	mBank	Consensus	Prior
NBP enterprise survey	18.07	Q3			
Average gross wage y/y (%)	18.07	Jun	5.3	4.8	4.1
Employment y/y (%)	18.07	Jun	2.9	2.9	2.8
Sold industrial output y/y (%)	19.07	Jun	7.7	5.8	3.5
PPI y/y (%)	19.07	Jun	-1.0	-1.0	-0.7
Retail sales y/y (%)	19.07	Jun	5.8	3.7	2.2

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	-	1600	1.706	7/7/2016
5Y T-bond PS0721	7/28/2016	4800	2.219	5/25/2016
10Y T-bond DS0726	-	2700	2.923	7/7/2016
15Y T-bond WS0428	-	200	3.027	7/7/2016

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



Comment

Unchanged as final CPI confirmed the flash reading. In our opinion next week is set to bring a few positive surprises (retail sales, industrial output, wages).

* 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

- 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 fuelled consumption growth (child subsidy and brisk wage growth), 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

- Although the markets escaped thinking of Brexit in terms of really borderline scenarios due to promised central bank interventions, the whole scope and timeline of Brexit repercussions is still unclear. We still think that Brexit is negative for credit risk among EMs and Polish assets are facing other, idiosyncratic risks (rating, pending CHF bill).
- We feel that foreign investors may be reluctant to add Poland to their portfolios due to recent outperformance.
- Zloty to be range bound. Headwinds due to upcoming event risks but fundamentally attractive levels.

mBank forecasts

	2010	2012	2013	2014	2015	2016 F
GDP y/y (%)	3.7	1.6	1.3	3.3	3.4	3.4
CPI Inflation y/y (average %)	2.8	3.7	0.9	-0.1	-0.9	-0.4
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

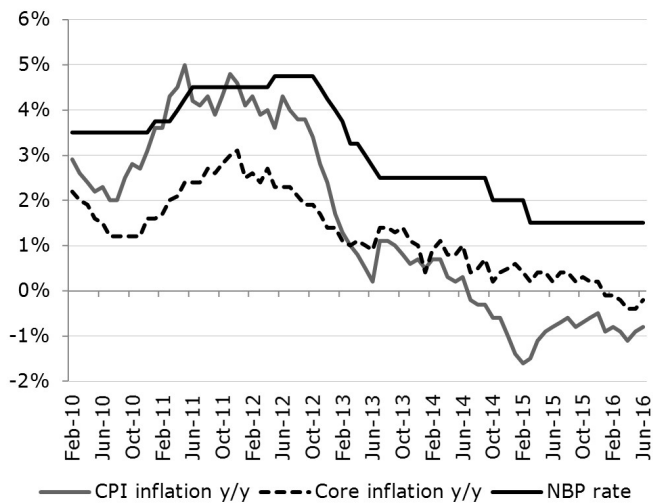
	2015	2015	2015	2015	2016	2016	2016	2016
	Q1	Q2	Q3	Q4	Q1	Q2 F	Q3 F	Q4 F
GDP y/y (%)	3.6	3.1	3.4	4.3	3.0	3.3	3.4	3.5
Individual consumption y/y (%)	3.1	3.1	3.1	3.0	3.2	3.6	4.1	4.4
Public Consumption y/y (%)	1.8	0.8	0.9	8.7	4.4	4.0	4.0	4.0
Investment y/y (%)	11.8	5.8	4.4	4.4	-1.8	0.5	2.0	3.5
Inflation rate (% average)	-1.4	-0.9	-0.7	-0.6	-0.9	-0.9	-0.5	0.6
Unemployment rate (% eop)	11.5	10.2	9.7	9.8	10.0	8.9	8.6	8.7
NBP repo rate (% eop)	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.25
Wibor 3M (% eop)	1.65	1.72	1.73	1.72	1.67	1.71	1.71	1.44
2Y Polish bond yields (% eop)	1.61	1.99	1.76	1.62	1.45	1.65	1.50	1.40
10Y Polish bond yields (% eop)	2.31	3.31	2.84	2.94	2.84	2.91	2.80	2.80
EUR/PLN (eop)	4.07	4.19	4.25	4.26	4.24	4.38	4.35	4.30
USD/PLN (eop)	3.80	3.76	3.80	3.92	3.73	3.94	3.99	3.98

F - forecast

Economics

Inflation still negative. An uptick in core inflation, though.

June CPI confirmed the flash reading of -0.8% y/y. Our estimates suggested stabilization of food prices (confirmed at +0.2% m/m) and a slight uptick in fuel prices (confirmed at +2.8% m/m). Core inflation rose from -0.4% to -0.2% – the first increase since (sic!) October 2015 – this has to be blamed on higher prices in recreation and culture (more expensive books and package holidays) and other category (insurance premiums). Other items seem to stay flat and/or under the influence of seasonal factors. So far the growth in core inflation should not be regarded as a definitive turnaround; momentum measures barely rose above zero.



Fresh inflation figures do not change the overall picture. Inflation is set to breach zero no sooner than in Q4 and it would stem mainly from base effects. As far as the MPC is concerned, the body is pre-occupied with systemic risks and claims that rates are optimal amidst balanced economy. Such a rhetoric may struggle to survive after Brexit worries sparked expectations for another round of monetary easing. Therefore, we still see a chance for a correction in rates in Poland and meanwhile Poland stands up among EM low yielders.



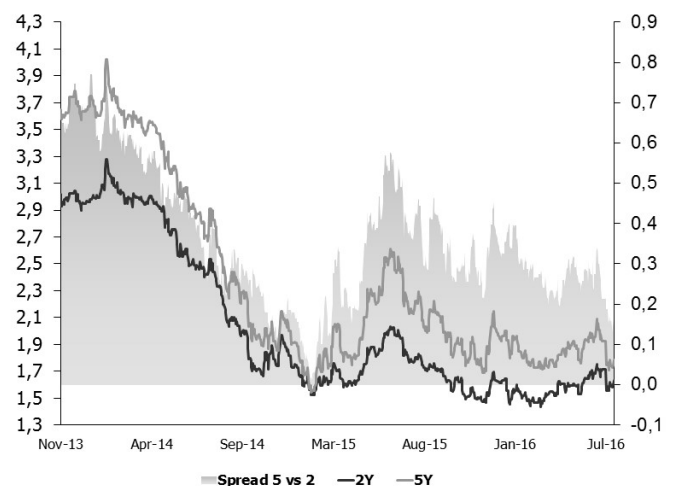
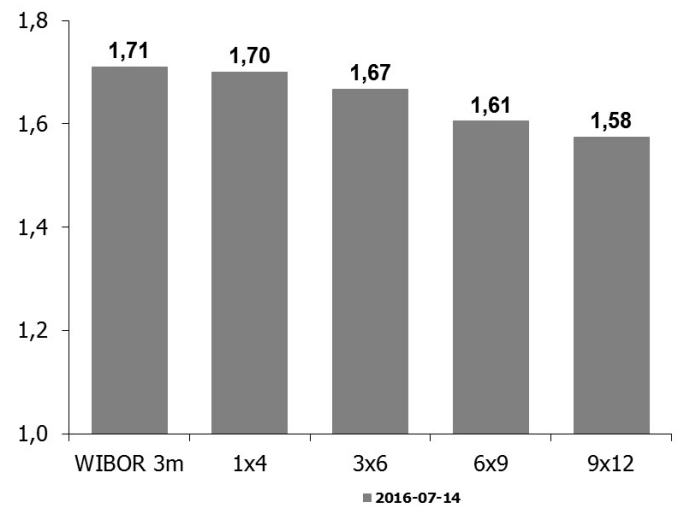
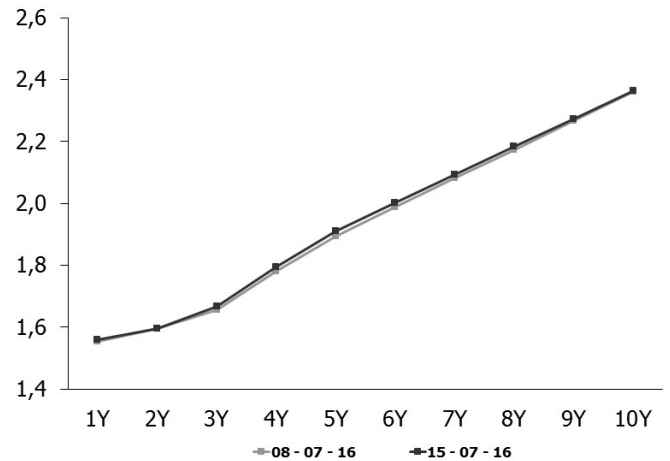
Fixed income

Today Fitch is announcing rating for Poland, any cut in rating will be negative for POL-GBs.

The curve still looks very flat, PS0721/DS0726 touched 64bps last week and now it should come back to 70bps. As we see the world hunting for yield, we keep a constructive view on POLGBs, although shorter bonds (2,5y) seem to offer better valuations. Important levels to watch are 2.30% on PS0721 and 3.00-3.05% on DS0726

On 25.07, OK0716 expires and some bonds will pay coupons. There will be PLN 15 bn of new cash on the market which is positive news for 2-5y segment as well.

IRS curve

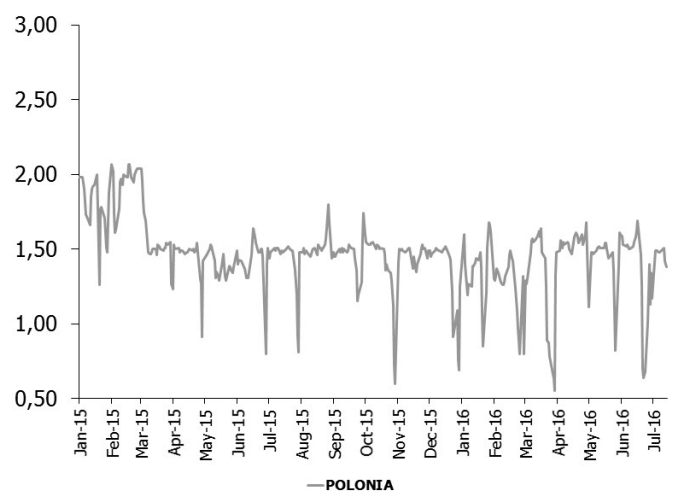
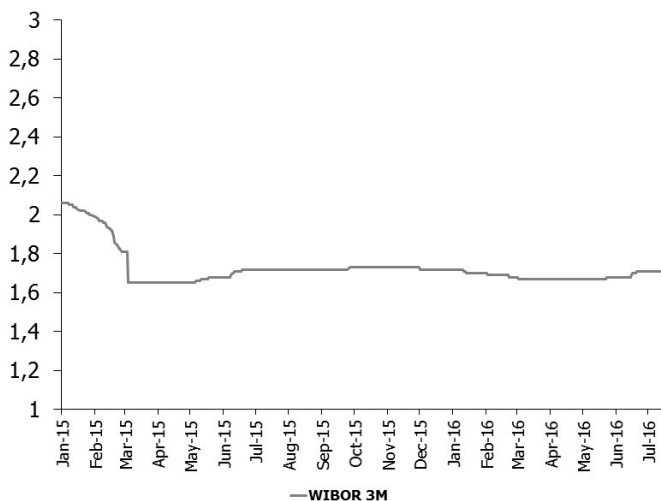
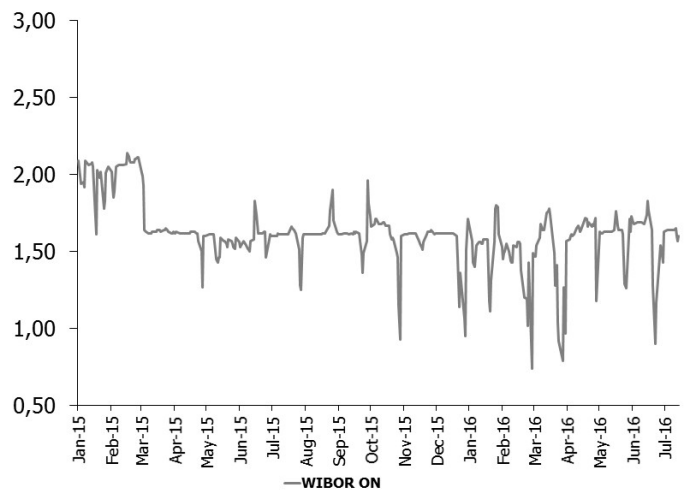
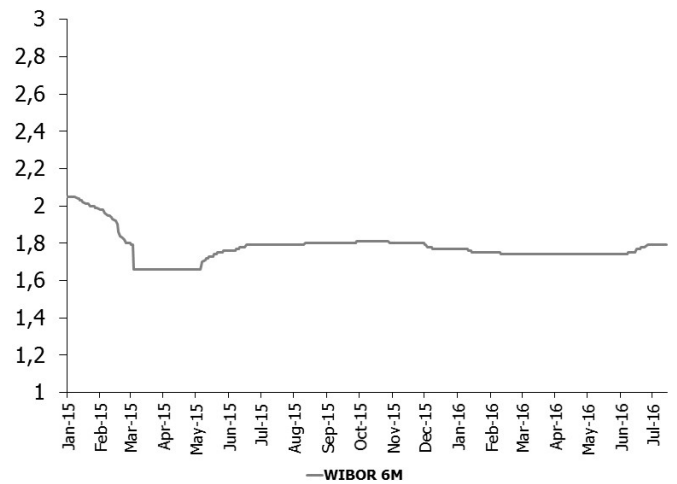


Money market

Calm and cheap week ahead of us.

As the last OMO was underbid, cash was a bit cheaper. Polonia fluctuated around 1.40% for the whole week. At today's OMO banks bought PLN 69 bn bills out of 74 bn offered. It seems that liquidity is secured so we expect quite relaxed funding next week at 1.40-1.50%. On the OIS curve we noticed some paying interest on the longer end with 1y Polonia at 1.35.

As cash rate is a bit lower than it used to be, PS1016, PS0417 and OK0717 with yield around 1.6% look cheap.



Forex

Spot – PLN is moving sideways. The Zloty is not really benefitting from the global risk rally. We are trading sideways and it feels like the interest is mixed, even though risk environment is positive. The most likely reason is the risk premium which is required to cover political risk. The issues concerning CHF loan conversion project and the Constitutional Court are still affecting Polish currency. The BoE fell short of delivering a rate cut but the hopes that the ECB will offer some kind of dovish package are still high. We will also have Fitch reviewing Poland's rating (Friday evening). The consensus view is that the outlook can be in danger but the rating itself should be left unscratched. We still see 4.37 – 4.47 range and by choice we are skewed to buy dips.

Options – EUR/PLN vol falling down. On the options market there's not even a trace of worry about Brexit. We had another week of heavy supply, the whole curve was offered quite aggressively – especially tenors below 6M. Now EURPLN curve is even lower than before the Brexit referendum. 1 month EUR/PLN ATM mid is 7.0% (1.6% lower), 3 months EUR/PLN are 7.9% (0.75% lower) and, finally, 1 year is fixing at 8.5% (0.4% lower). The skew and currency spread were also better offered.

Short-term forecasts

Main supports / resistances:
 EUR/PLN: 4.35 / 4.55
 USD/PLN: 3.80 / 4.20

Spot

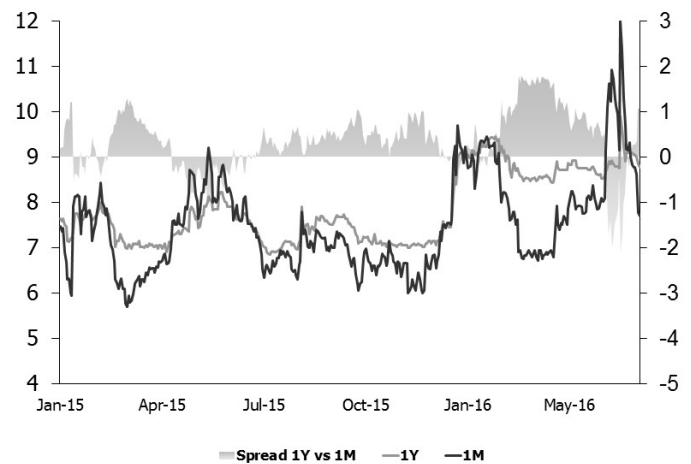
New position: Long EUR/PLN from 4.4050, ready to add at 4.3700 with a stop loss below 4.3475 and hopes to see 4.47 with a possible extension to 4.54.

Technically, EUR/PLN is keeping the bid tone. The supports are 4.3900 and a more serious one can be placed at 4.3600. The 4.47 and 4.54 are the obvious targets. The market is consolidating and this direction may continue for the time being. Nevertheless, we believe that from the risk/reward point of view the shorts in PLN are just more tempting.

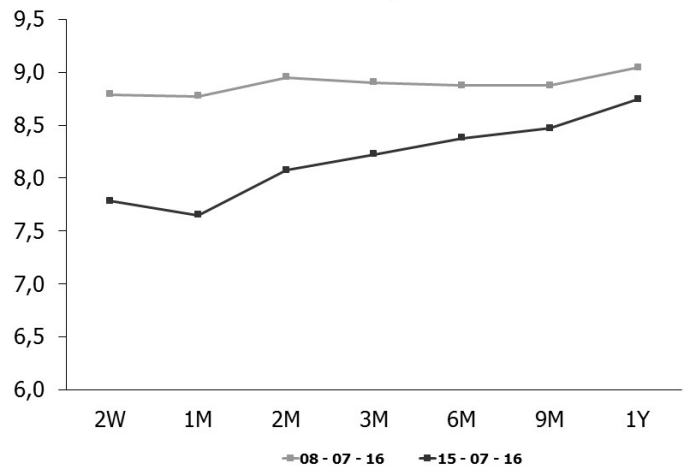
Options Vols – Long Vega in the backend

We are still long Vega in the backend of EUR/PLN vols. The vols' spike was really short lived, and they melted as the result. It is frustrating but we think that our view has received a fundamental back up. There is a lot of uncertainty surrounding the Brexit and it will have its influence on Poland as well. Locally, the future is also looming not that bright with potential rating deterioration, Constitutional Court argument or the biggest worry of them all – CHF loans conversion. We stick to our position.

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
7/7/2016	1.62	1.71	1.69	1.69	1.74	1.71	1.70	1.65	1.57	1.55	1.52	1.63
7/11/2016	2.07	1.71	2.03	1.69	1.87	1.71	1.70	1.64	1.56	1.54	1.51	1.62
7/12/2016	2.09	1.71	2.04	1.69	1.88	1.71	1.69	1.64	1.58	1.54	1.51	1.61
7/13/2016	1.53	1.71	1.59	1.69	1.64	1.71	1.69	1.64	1.56	1.53	1.51	1.61
7/14/2016	1.63	1.71	1.69	1.69	1.74	1.71	1.70	1.67	1.61	1.58	1.57	1.65

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
7/7/2016	1.710	1.474	1.635	1.578	1.960	2.232	2.405	2.949
7/11/2016	1.710	1.474	1.635	1.578	1.960	2.232	2.405	2.949
7/12/2016	1.710	1.474	1.635	1.578	1.960	2.232	2.405	2.949
7/13/2016	1.710	1.474	1.635	1.638	1.990	2.290	2.447	2.985
7/14/2016	1.710	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	1Y
7/7/2016	8.78	8.90	8.88	9.05	9.05	2.31	0.61	0.61
7/11/2016	8.63	8.68	8.73	9.00	9.00	2.31	0.61	0.61
7/12/2016	7.78	8.30	8.45	8.85	8.85	2.41	0.60	0.60
7/13/2016	7.70	8.25	8.35	8.78	8.78	2.29	0.60	0.60
7/14/2016	7.65	8.23	8.38	8.75	8.75	2.29	0.67	0.67

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
7/7/2016	4.4380	4.0036	4.0984	3.9644	1.4024	0.1642
7/11/2016	4.4170	4.0060	4.0657	3.9222	1.4076	0.1634
7/12/2016	4.4224	3.9807	4.0582	3.8496	1.4116	0.1635
7/13/2016	4.4016	3.9809	4.0324	3.8149	1.4027	0.1628
7/14/2016	4.4070	3.9681	4.0450	3.7553	1.4050	0.1631

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