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Polish Weekly Review

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Comment on the upcoming data and forecasts

A quiet week ahead of us. The PMI is the only macro publication due next week. We expect it to post a modest increase, in line with how CSO's sentiment indicators behaved in July and consistent with the general resilience of European sentiment in the immediate aftermath of Brexit.

Polish data to watch: August 1st to August 5th

Publication	Date	Period	mBank	Consensus	Prior
Manufacturing PMI (pts.)	01.08	Jul	52.3	51.6	51.8

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	8/18/2016	1600	1.706	7/7/2016
5Y T-bond PS0721	9/1/2016	5000	2.327	7/28/2016
10Y T-bond DS0726	8/18/2016	2700	2.923	7/7/2016
15Y T-bond WS0428	8/18/2016	200	3.027	7/7/2016

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



Comment

Slightly down as flash CPI surprised to the downside (see the Economics section for more details).

* 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. 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 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 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. We expect the MPC to finally acknowledge inflation risks amid temporary weakness in GDP growth and another round of monetary policy stimulation in euro zone.

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.
- Aside from the possibility of a renewed play for a rate hike in the U.S. in September, Polish assets are facing other, idiosyncratic risks (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

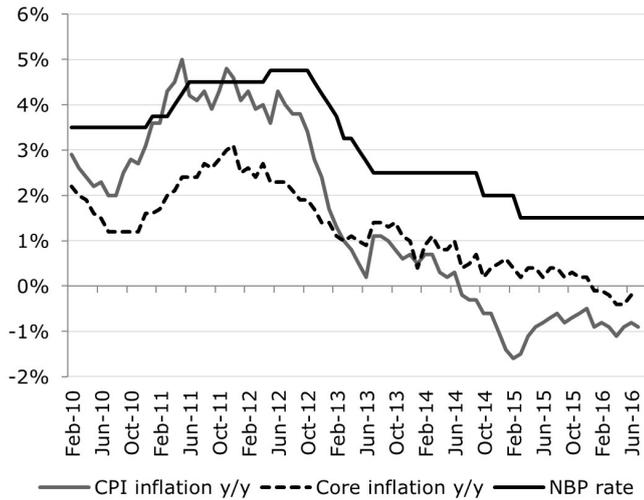
	2015	2015	2015	2015	2016	2016	2016	2016
	Q1	Q2	Q3	Q4	Q1	Q2 F	Q3 F	Q4 F
GDP y/y (%)	3.6	3.1	3.4	4.3	3.0	3.3	3.4	3.5
Individual consumption y/y (%)	3.1	3.1	3.1	3.0	3.2	3.6	4.1	4.4
Public Consumption y/y (%)	1.8	0.8	0.9	8.7	4.4	4.0	4.0	4.0
Investment y/y (%)	11.8	5.8	4.4	4.4	-1.8	0.5	2.0	3.5
Inflation rate (% 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	8.8	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

July's inflation a tad lower

Flash estimate of inflation suggests it moved a tad lower in July, to -0.9%. We opted for a higher reading, although purely on the basis of higher food prices. It seems those are governed by strong seasonal tendencies rather than actual situation on the food market (as we see it). We think core inflation stayed at -0.2%.



Next month is going to push inflation even lower as the decrease in oil prices kicks in; deflation thrives. Price growth is set to accelerate in the end of the year, although it would be purely statistically driven. 0.5% y/y is feasible but that increase does not mean that inflation momentum is high this year but rather reflects the doldrums that occurred a year ago.

The prolonged period of deflation is not comfortable for the central bank. However, it prefers to sit idle, even though GDP growth is heading for a disappointment (note that their preferred scenario for this year is 3.6-3.8% whereas 3.4% would be quite an achievement given the poor performance in Q2). We think that such inactivity can last for a few months from now. However, we still see rate cuts as a possibility as political and regulatory uncertainty fades away and another round of central bank stimulation kicks in (=stronger zloty). In such environment, growth risks and low inflation will be more biting.



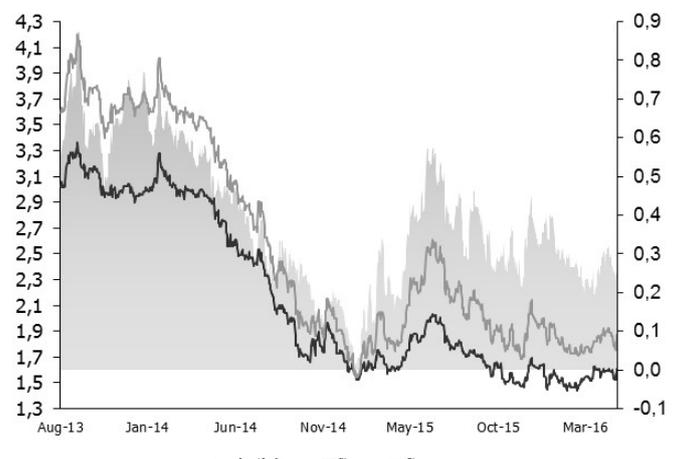
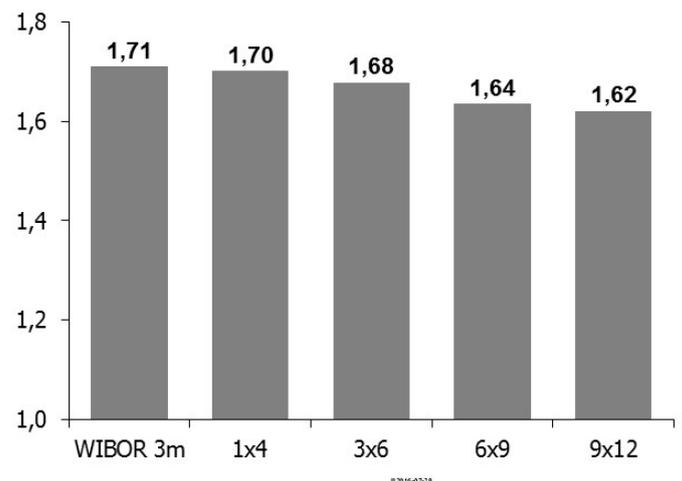
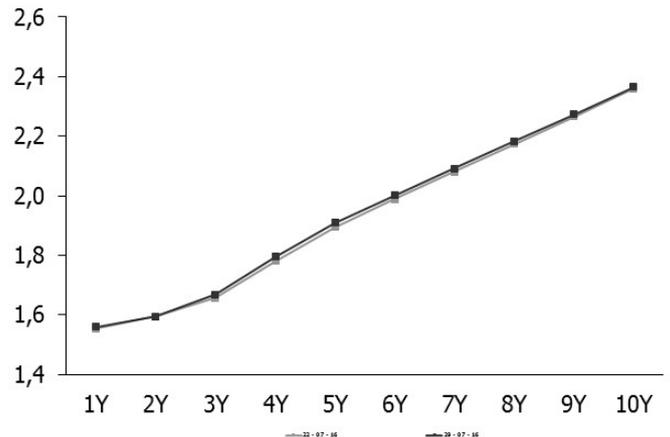
Fixed income

Risk off?

Polish FI market was pretty strong this week. DS0726 has been moving between 96.45 – 96.70 and PS0721 97.25 – 97.45. On Thursday Ministry of Finance sold 5.02 bio 5y benchmark at 97.31 (3.327%) and two floaters WZ1122 1.10 bio at 97.43 (spread for life 42) and WZ0126 1.82 bio at 94.25 (spread for life 64.5). Spread PS0721 against DS0726 at 56/54 was too flat in our opinion; at 60 it would be an extreme we would like to fade. Also asset swaps looks too narrow for us, 10y DS0726 69/67, 5y PS0721 42/40 and 2y OK1018 -2/-4. We have closed our position in 2y asw at -4. We also see some paying interest in short end bonds due to banking tax. Despite holiday, market looks very liquid.

In the upcoming days President Duda is said to announce CHF loan proposal. We think that it will have negative impact on long-term POLGBs.

IRS curve



Money market

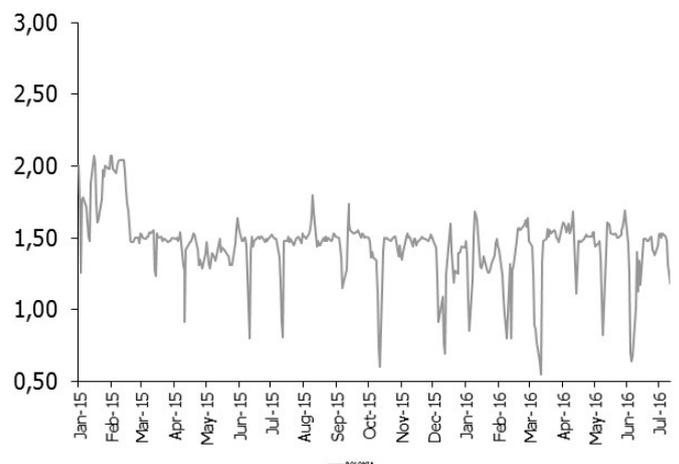
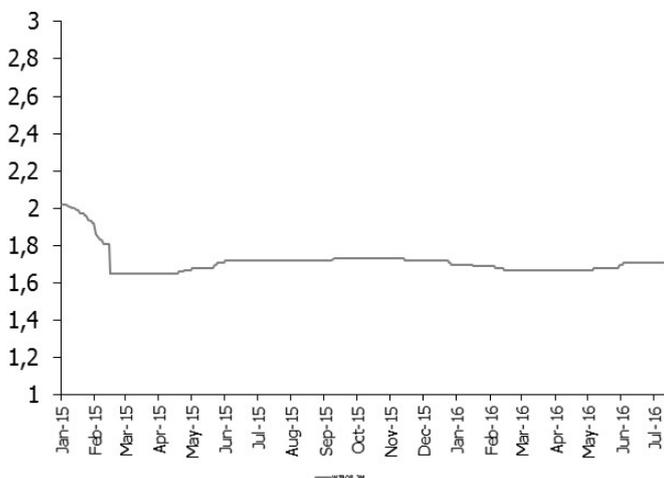
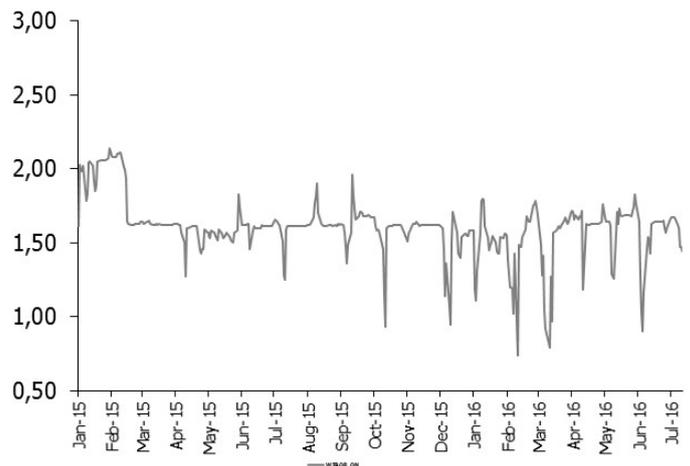
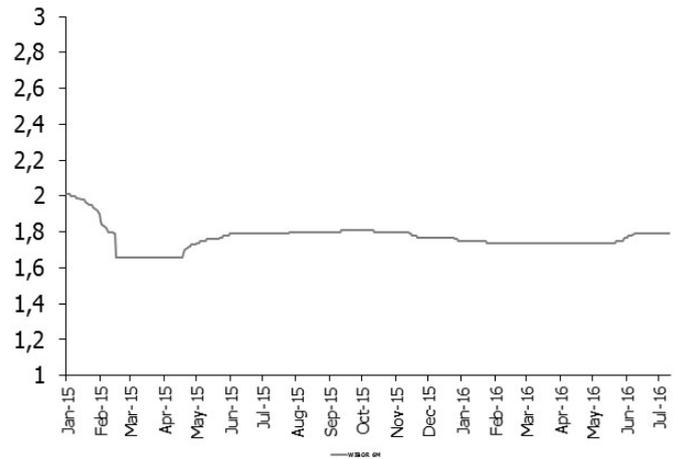
Redemptions

Unusual end of the month. Big cash inflow into the market created substantial demand for shortest bonds. Maturing OK0716 and coupon payments on July bonds, and all floaters flooded banks with fresh cash (around 15 bio). At least part of that amount was reinvested back to tax free government bonds. As a result, we witnessed big tightening of ASW, especially in the 1-2 year segment.

We cut our bond holdings and will wait for opportunities to refill the portfolio with higher yield again. As the market is still quite nervous (CHF bill, pension reform, Polish rating, Fed, Brexit) opportunities should occur soon. Ideally we would like to have our portfolio full before the end of October when next big redemptions take place.

Start of new month always stabilizes ON rate so we should hold around 1.50 next week.

Ref rate vs Polonia averages: 30 day – 6 bp; 90 day – 9 bp.



Forex

Spot – PLN consolidating. It was a very calm week for the Zloty – it was traded in the 4.3540 – 4.3830 range. The global risk rally finally got to PLN as well. The ECB, FOMC and BOJ were not really eventful, Polish parliament is on holiday, there is not much excitement in the markets. It was not even disrupted by the European Commission (EC) which had imposed its 'recommendation stage' on Poland with respect to the Constitutional Court. Another week of EUR/PLN grappling with a strong 4.34-4.36 support at 4.34-4.36. So far we have not decisively broke to the downside, so we still try to play the 4.35-4.45 range.

Options – EUR/PLN vols – tic lower again. Really low realized volatility of EUR/PLN allowed to push vol to the downside again. Supply is still having an upper hand, with holiday season in full swing. 1 month EUR/PLN ATM mid is 6.4% (0.4% lower), 3 month EUR/PLN is 7.3 (0.2% lower) and finally 1 year is fixing at 8.3 (0.1% 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

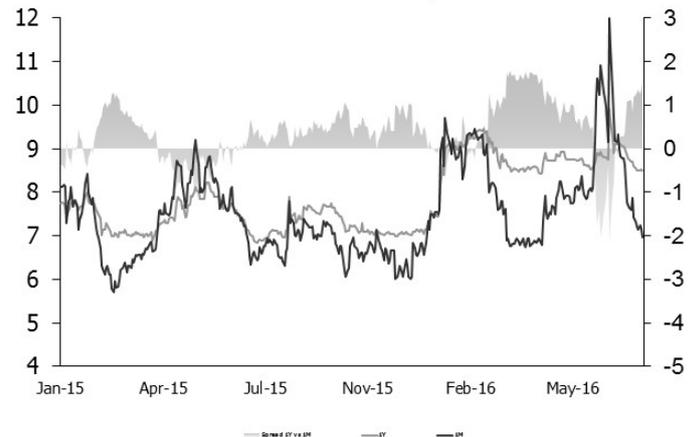
Position: We are still long EUR/PLN with a stop loss at 4.3375 and hopes to see 4.47 with a possible extension to 4.54.

We are expecting to get the draft bill for the CHF/PLN mortgage loans and it might induce further significant Zloty depreciation. We still see fundamental risks (mainly political), and even a stronger move to the downside we view as corrective only.

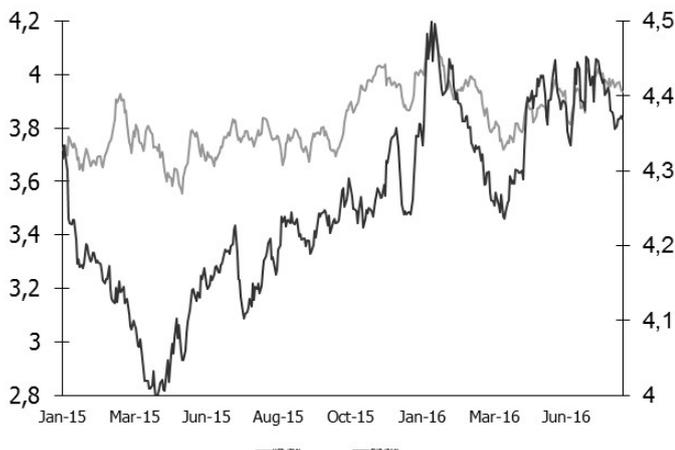
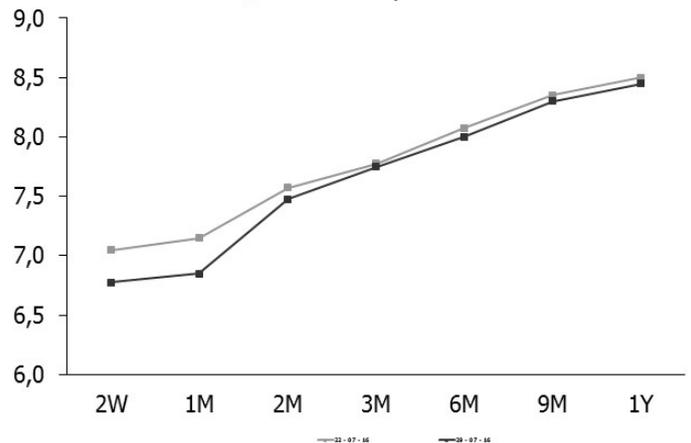
Options Vols – Long Vega in the backend

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

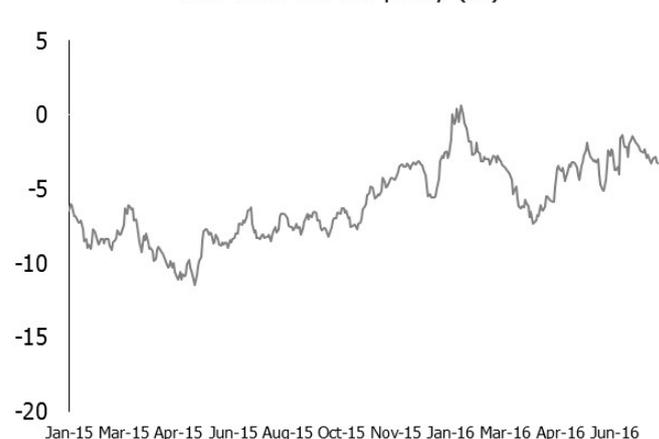
EURPLN volatility



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
7/22/2016	2.15	1.71	2.19	1.69	2.01	1.71	1.70	1.68	1.62	1.58	1.58	1.67
7/25/2016	2.13	1.71	2.17	1.69	2.01	1.71	1.71	1.67	1.61	1.59	1.58	1.67
7/26/2016	2.15	1.71	1.80	1.69	1.80	1.71	1.71	1.68	1.63	1.60	1.60	1.70
7/27/2016	1.91	1.71	1.95	1.69	1.92	1.71	1.70	1.68	1.63	1.62	1.62	1.71
7/28/2016	2.02	1.71	2.04	1.69	2.03	1.71	1.70	1.68	1.64	1.62	1.62	1.71

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
7/22/2016	1.710	1.474	1.635	1.578	1.960	2.232	2.405	2.949
7/25/2016	1.710	1.474	1.635	1.578	1.960	2.232	2.405	2.949
7/26/2016	1.710	1.474	1.635	1.578	1.960	2.232	2.405	2.949
7/27/2016	1.710	1.474	1.635	1.638	1.990	2.290	2.447	2.985
7/28/2016	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
7/22/2016	7.15	7.78	8.08	8.50	8.50	2.28	0.60	0.60
7/25/2016	7.25	7.80	8.08	8.50	8.50	2.28	0.60	0.60
7/26/2016	7.18	7.80	8.10	8.53	8.53	2.28	0.60	0.60
7/27/2016	6.98	7.80	8.08	8.50	8.50	2.27	0.59	0.59
7/28/2016	6.85	7.75	8.00	8.45	8.45	2.27	0.59	0.59

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
7/22/2016	4.3564	3.9504	4.0072	3.7180	1.3887	0.1612
7/25/2016	4.3600	3.9697	4.0275	3.7322	1.3944	0.1613
7/26/2016	4.3694	3.9682	4.0299	3.8048	1.3959	0.1616
7/27/2016	4.3695	3.9739	3.9968	3.7653	1.3944	0.1617
7/28/2016	4.3736	3.9389	4.0038	3.7598	1.3975	0.1617

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