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Polish Weekly Review

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Comment on the upcoming data and forecasts

Monday is a public holiday in Poland. On Tuesday the NBP will publish its core CPI data – on the basis of today's CSO data we estimate inflation net of food and energy prices to remain at -0.4% y/y in July. Wednesday is all about labor market data – after a very strong June, July is set to bring a bit of a setback. While employment growth likely held steady at 3.1% y/y, wage growth dropped because of working day effects. On Thursday the CSO will publish industry and retail data. Here the impact of the calendar will be overwhelming (difference in working days falls from +1 y/y in June to -2 y/y in July) and this should drag all activity data for July: an annual decline in industrial output, double-digit drop in construction output and slower retail sales growth.

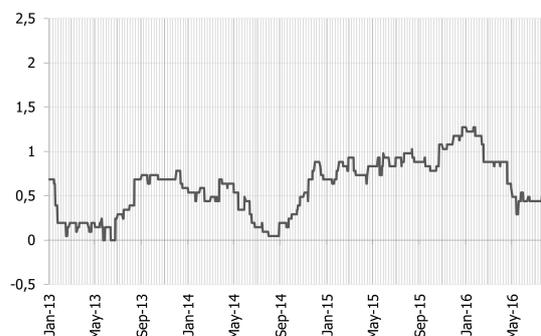
Polish data to watch: August 15th to August 19th

Publication	Date	Period	mBank	Consensus	Prior
Core CPI y/y (%)	16.08	Jul	-0.4	-0.3	-0.2
Average gross wage y/y (%)	17.08	Jul	4.7	4.6	5.3
Employment y/y (%)	17.08	Jul	3.1	3.1	3.1
Sold industrial output y/y (%)	18.08	Jul	-0.5	1.7	6.0
PPI y/y (%)	18.08	Jul	-0.2	-0.3	-0.7
Retail sales y/y (%)	18.08	Jul	3.0	3.6	4.6
Consumer confidence (pts.)	19.08	Aug			

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

Down a notch as flash GDP surprised to the downside (more in the Economics section). Next week should be a bit more interesting as wage, employment, industry and retail data come into view.

* 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. Despite weak Zloty, exports growth ground into a halt. 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 moderate 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 is 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. We expect the MPC to finally acknowledge inflation risks amid temporary weakness in GDP growth and another round of monetary policy stimulation globally. Lower risk premia will certainly help.

Financial markets

- Considerable central bank stimulation petrifies low rate environment. A play for September Fed hike may spoil the picture from some time, though.
- CHF loan conversion bill was trashed, at least for a few months. Bank are obliged to pay back a portion of the the currency spreads instead. Such development takes the pressure off the Polish rating at the moment and lowers the risk premia in Polish bonds.
- However, sustainable downward pressure on yields can be triggered only in case when the door for further rate cuts are opened wide again. This stays off the curret MPC's agenda, at least for now.
- CHF bill affects positively the risk premium in PLN. Increased volume of central bank money puts appreciation pressure on the zloty again. Significant strengthening of the PLN can open the door for rate cuts but as long as they are closed, EURPLN is poised to fall.

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

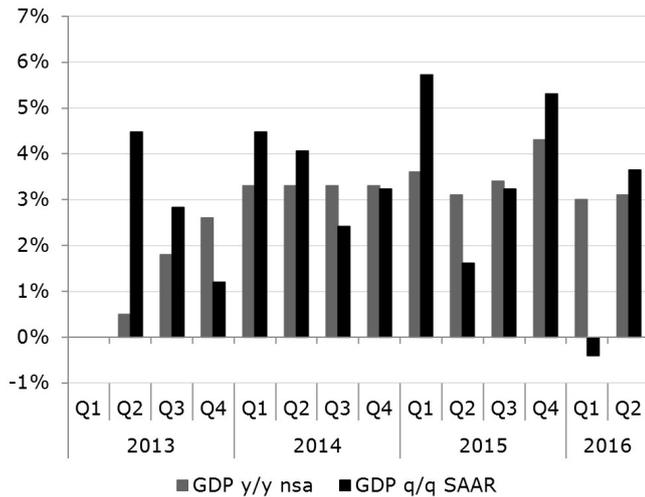
	2015	2015	2015	2015	2016	2016	2016	2016
	Q1	Q2	Q3	Q4	Q1	Q2 F	Q3 F	Q4 F
GDP y/y (%)	3.6	3.1	3.4	4.3	3.0	3.2	3.4	3.5
Individual consumption y/y (%)	3.1	3.1	3.1	3.0	3.2	3.6	4.1	4.4
Public Consumption y/y (%)	1.8	0.8	0.9	8.7	4.4	4.0	4.0	4.0
Investment y/y (%)	11.8	5.8	4.4	4.4	-1.8	-1.0	2.0	3.5
Inflation 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	4.25	4.25
USD/PLN (eop)	3.80	3.76	3.80	3.92	3.73	3.94	3.90	3.94

F - forecast

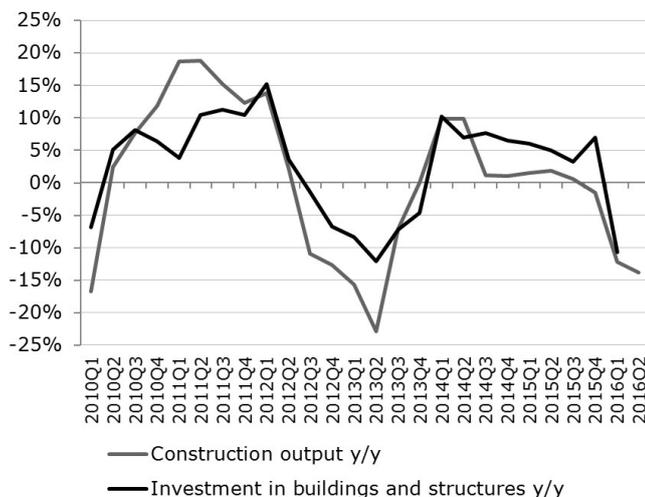
Economics

Growth barely accelerated in Q2

According to the flash estimate, Polish GDP rose in second quarter only by 3.1% y/y (market consensus – 3.3%, our forecast – 3.2%). However, quarterly dynamics was a solid +0.9%.



Interestingly, this was a deviation from the regional pattern of positive surprises (Slovakia, Hungary), which confirms our suspicions voiced in comments to earlier PMI reports. Not only was weaker exports (CSO data were also published today) the cause this time, as the main reason for unsatisfactory growth rate lies in sluggish investment. We still need to wait till the end of the month for details, but we think that investment could have remained in the negative territory in the second quarter (see disastrous situation in construction sector). Final outcome was most likely balanced by strengthening consumption, which was driven by government's "500+" programme and tightening labour market.

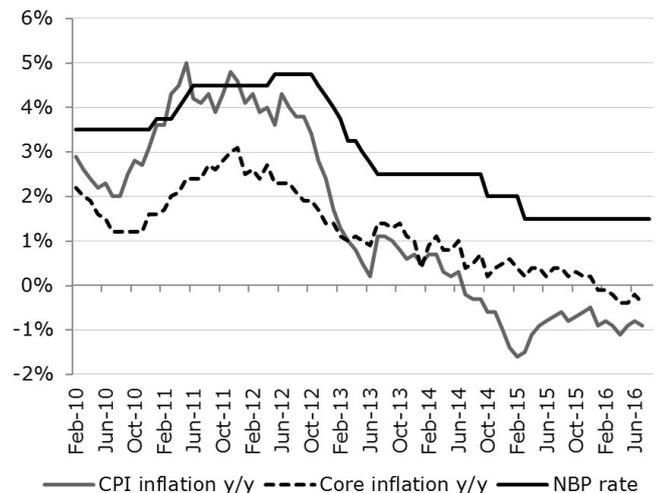


Low GDP print is challenging the unwavering belief in high overall growth this year held by the MPC as late as during the latest meeting. To accelerate to 3.8% annual average, the second half of the year would have to bring ca. 4.5% growth, which seems completely out of reach at the moment. Another batch of higher frequency data (industrial output, construction), should merely

confirm this. As a result, we think that the Council will return to cutting rates this year – by the way, we didn't have to wait long for first dovish comments (Zyzynski). The market is still pricing in only a small chance of rate cuts this year. However, stronger zloty, low inflation and further declines in interest rates throughout the world should favor more aggressive bets regarding Polish rates in the coming weeks. Finally, in current circumstances (hunt for yield, EMs back in vogue) lower GDP growth should not impact Polish credit risk, especially now that tax revenue continues to grow unabated and the most controversial aspects of the government's economic policy have already been publicized. . .

Lower CPI inflation in July confirmed

Final CPI estimate confirmed the flash release at -0.9% y/y. On a monthly basis, food prices fell by 1.0% – exactly as one year ago. This is a significant deviation from regional pattern (Hungary and Czech Republic). Fuel prices fell by 1,1% monthly. Moving into core categories, we saw weaker growth than a year ago (except recreation and culture, where package holidays prices rose sharply). As a result, core inflation fell once again to -0.4% y/y.



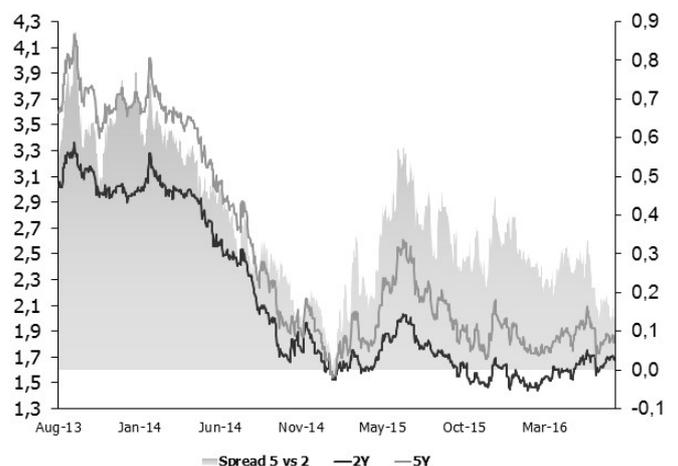
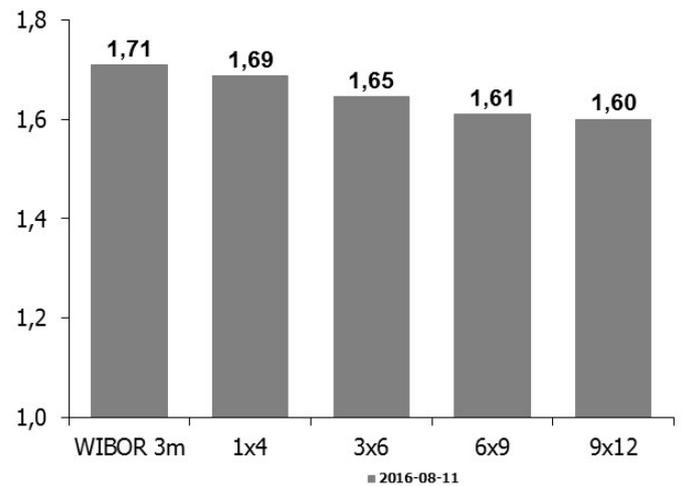
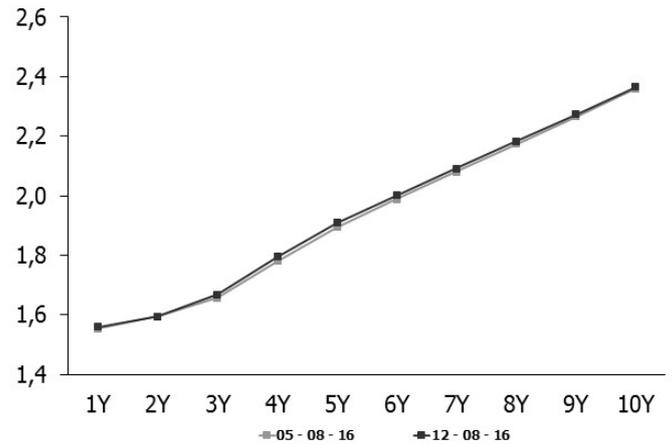
Due to declines in fuel prices and (likely) depressed food prices, August will bring another decline in CPI inflation. By year end, it should move back into positive territory (0.5 – 0.6% y/y) but only because of base effects. We have the constant feeling of deja vu, in which CPI target (or worse, positive CPI prints!) is constantly moving away. Neither the lower GDP growth, nor stronger PLN or deflationary global environment are conducive for a sustained rise in inflation.

Fixed income

Long end so high...

As we said last week, the curve was too flat. PS0721 vs DS0726, then at 53bp, moved to @58bp. We still expect steepening towards 65bp. All bonds moved to a new record, OK1018 benchmarks jumped to 1.62% (96.55), PS0721 to 2.07% (98.50) and DS0726 to 2.66% (98.65). Next Tuesday, the Ministry of Finance will announce an auction of 4-8 bio. We expect them to supply DS0726, IZ, and one floater; therefore, market players may bring long end higher in yield just before the auction. ASW looks expensive where 5y PS0721 32/28 and 10y DS0726 56/54.

IRS curve



Money market

Finally out of range

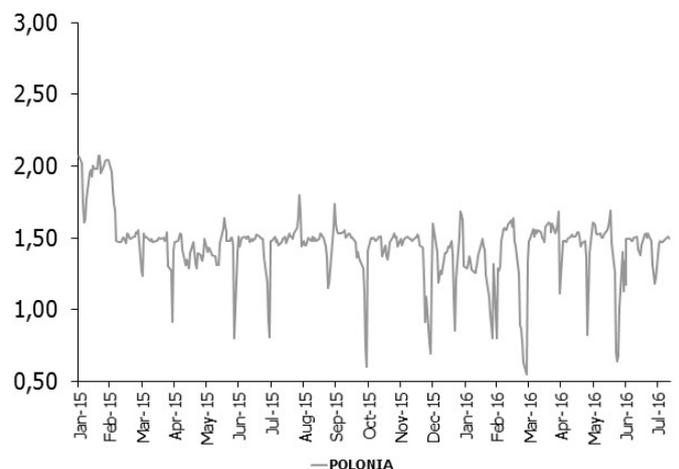
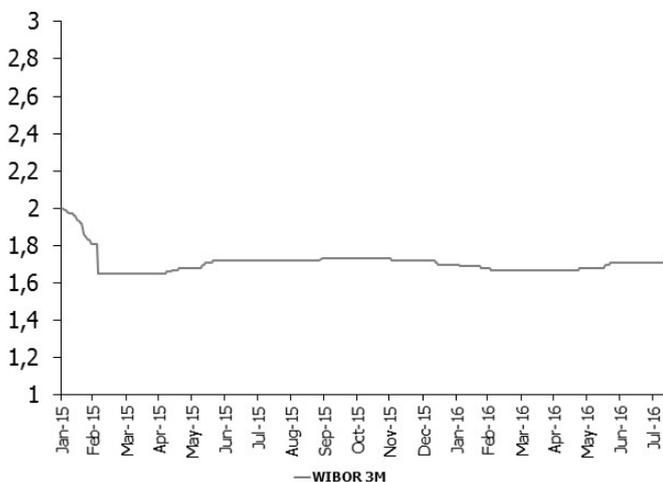
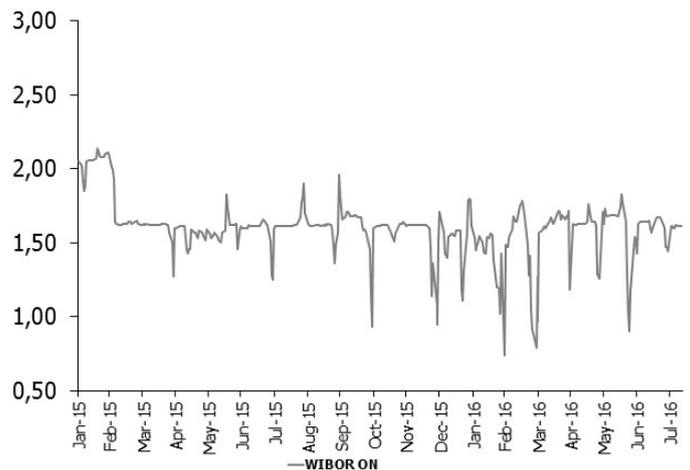
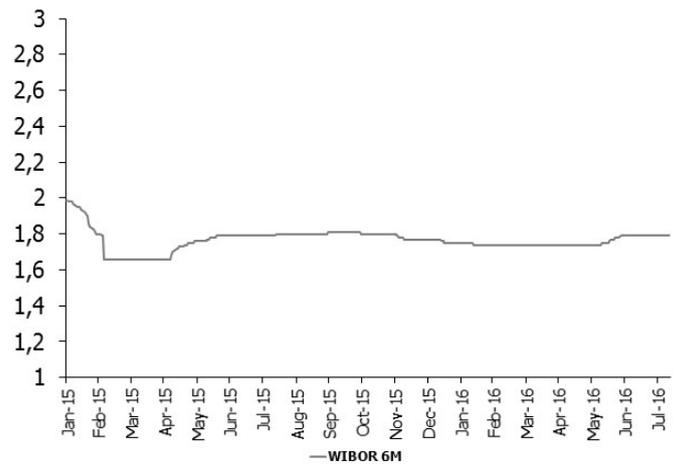
After days of stagnation in the front end we are getting out of range. Trigger came from weaker than expected Q2 GDP print this morning (3.1% vs 3.3% exp) and fresh comments from MPC member Zyzynski afterwards. Polish central banker said he would back cutting interest rates to support investment but if such move would be a threat to banking sector then he wouldn't support that move. In globally bullish environment market players took from the statement only the part that suited them well and moved curve 5-8 bp lower. We do agree the direction for rates is to the downside although pricing in full 25 bp cut in the near future would be enough. 9x12 FRA trades now at 1.53 which is 18bp below current wibor.

On the funding side, we had really calm week with ON holding in tight range around 1.49%. Nothing extraordinary should happen in coming days.

Ref rate vs Polonia averages:

30 day 7 bp

90 day 9 bp



Forex

Spot – PLN even stronger EUR/PLN keeps on sliding gently lower. It set a fresh low this week at 4.2560 (last time seen in April). The worries of the CHF/PLN mortgage bill are out of the way at this moment while global sentiment stays good. It was not even disrupted by the poor Chinese data, as well as disappointing Polish Q2 GDP. We have holiday season in full swing. Even if there are some factors like Constitutional Court conflict, possible rate cuts in Poland, good data from the U.S. economy supporting Fed's normalization policy, U.S. elections... nobody cares about them. We are still more range players and 4.23 – 4.35 is the most likely range for now.

Options – EUR/PLN vols – lower again It was a very calm week on the spot market – realized volatility was really small so implied volatility curves melted. We are lower across the curve in both main currency pairs, EUR/PLN and USD/PLN. 1 month EUR/PLN ATM mid is 6.0% (0.3% lower), 3 months EUR/PLN are 6.5% (0.6% lower) and, finally, 1 year is fixing at 8.0% (0.2% lower). The skew and currency spread were also better offered.

Short-term forecasts

Main supports / resistances:

EUR/PLN: 4.23 / 4.35

USD/PLN: 3.75 / 4.00

Spot New position: Sidelined.

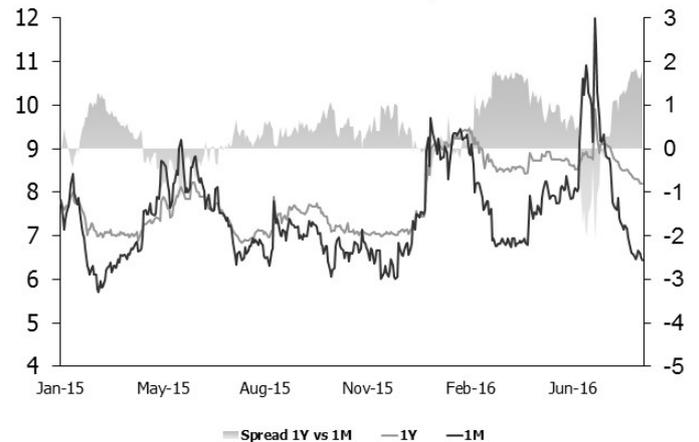
We have closed our short EUR/PLN from 4.35 at 4.2625 and we are sidelined at the moment. As we believe in the rangy nature of PLN, we will try to sell again at 4.28/4.30 with stop at 4.35 and hopes to see 4.23 or buy at 4.23 with stop below 4.20 and 4.30 target.

Options Selectively long Vega

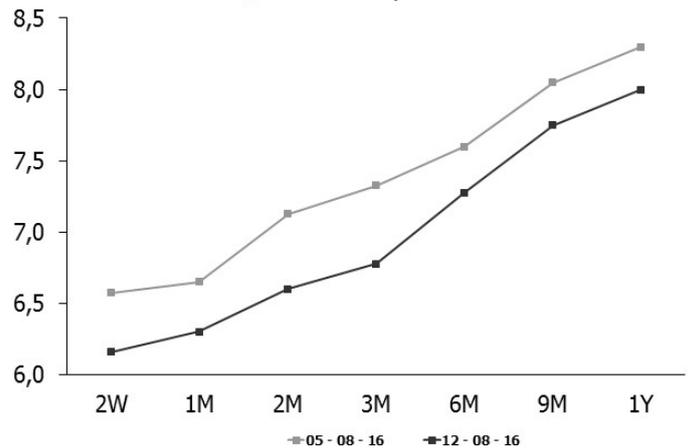
Implied volatilities have come off significantly over the past 2 weeks. For some tenors realized volatilities are significantly higher than implied volatilities (for example 2m 9.7% realized versus 6.4% implied, 3m 8.8% realized versus 6.5% implied). There is a lot of uncertainty surrounding the Brexit, postponed decision on forced conversion of CHF mortgages, Constitutional Court conflict, U.S. elections, so we stick to our position – we have still selective longs in the backend EURPLN curve.



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
8/5/2016	1.73	1.71	1.97	1.69	1.65	1.71	1.70	1.68	1.64	1.63	1.63	1.71
8/8/2016	2.06	1.71	2.12	1.69	2.07	1.71	1.70	1.68	1.64	1.63	1.63	1.72
8/9/2016	1.93	1.71	2.02	1.69	2.10	1.71	1.70	1.67	1.63	1.62	1.62	1.70
8/10/2016	1.86	1.71	1.91	1.69	1.99	1.71	1.70	1.67	1.61	1.60	1.61	1.69
8/11/2016	2.03	1.71	2.08	1.69	2.15	1.71	1.69	1.65	1.61	1.60	1.60	1.69

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
8/5/2016	1.710	1.474	1.635	1.578	1.960	2.232	2.405	2.949
8/8/2016	1.710	1.474	1.635	1.578	1.960	2.232	2.405	2.949
8/9/2016	1.710	1.474	1.635	1.578	1.960	2.232	2.405	2.949
8/10/2016	1.710	1.474	1.635	1.638	1.990	2.290	2.447	2.985
8/11/2016	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
8/5/2016	6.65	7.33	7.60	8.30	8.30	2.27	0.59	0.59
8/8/2016	6.58	7.20	7.48	8.20	8.20	2.27	0.59	0.59
8/9/2016	6.48	7.15	7.45	8.20	8.20	2.27	0.59	0.59
8/10/2016	6.43	7.15	7.45	8.20	8.20	2.27	0.64	0.64
8/11/2016	6.30	6.78	7.28	8.00	8.00	2.24	0.59	0.59

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
8/5/2016	4.2975	3.8542	3.9592	3.8176	1.3799	0.1590
8/8/2016	4.2912	3.8706	3.9423	3.7836	1.3801	0.1588
8/9/2016	4.2693	3.8482	3.9148	3.7603	1.3752	0.1580
8/10/2016	4.2632	3.8250	3.9064	3.7707	1.3735	0.1577
8/11/2016	4.2674	3.8297	3.9242	3.7801	1.3755	0.1580

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