mBank.pl

September 2, 2016

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

Table of contents

Comment on the upcoming data and forecasts

The MPC meeting is one of two relevant events next week. The Council is reconvening after a two-month hiatus and will have to deal with a large batch of weak data from the real economy, including Q2 GDP. Even though they contradict the MPC's preferred macroeconomic scenario, the Council won't be inclined to react just yet. The positive surprise in the PMI will probably convince the MPC that a rebound is imminent while base effects in fuel prices should work in the MPC's favor soon. Thus, the MPC will make a nod to those developments in the statement but rates will be put on hold. On Friday (evening hours) Moody's will publish its review of Polish sovereign rating. We expect the agency to affirm Poland's A2 rating, with negative outlook. Lack of action will be justified by broadly unchanged legislative situation (CHF resolution less costly but no bill, institutional issues balanced by better tax revenue lately).

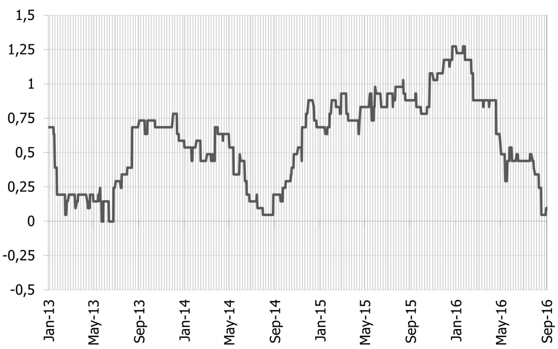
Polish data to watch: September 5th to September 9th

Publication	Date	Period	mBank	Consensus	Prior
MPC decision (%)	07.09	Sep	1.50	1.50	1.50
Moody's rating decision	09.09		A2	A2	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	-	2000	1.647	9/1/2016
5Y T-bond PS0721	9/22/2016	3500	2.114	8/18/2016
10Y T-bond DS0726	-	3000	2.791	9/1/2016
15Y T-bond WS0428	-	200	3.027	7/7/2016

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



Comment

Flash CPI for August surprised on the upside, thus Polish surprise index erased some of its recent fall. Other publications came in line or with just minor surprises. We don't expect any changes next week, because MPC will most certainly leave rates unchanged.

* 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

- Zloty is set to perform well in the near term.
- The details of the CHF conversion are unlikely to be announced soon. Therefore globally easy central bank policy is going to propel all non-zero yielding assets.
- Owing to ultra easy path of Fed funds already priced in, we see the more hawkish Fed as the prevailing risk short-term. We do not expect any moves concerning the possible repricing of U.S. rates to be of such magnitude as the ones we saw at the start of the year. EMs are in a different cyclical position and enjoy higher interest rates.

mBank forecasts

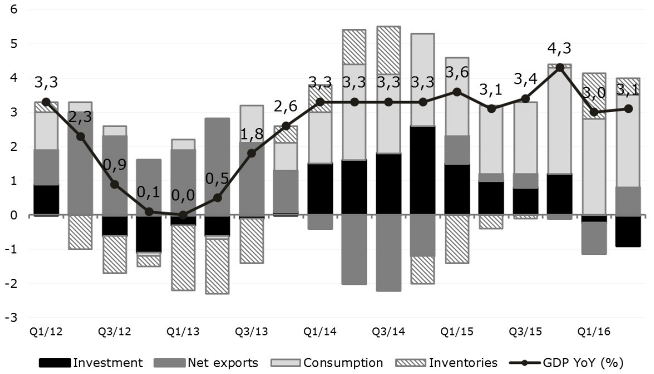
	2012	2013	2014	2015	2016 F	2017 F
GDP y/y (%)	1.6	1.3	3.3	3.4	3.2	3.5
CPI Inflation y/y (average %)	3.7	0.9	-0.1	-0.9	-0.6	1.7
Current account (%GDP)	-3.7	-1.3	-2.0	-0.1	-0.7	-0.9
Unemployment rate (end of period %)	13.4	13.4	11.4	9.8	8.7	8.1
Repo rate (end of period %)	4.25	2.50	2.00	1.50	1.50	1.25

	2016 Q1	2016 Q2 F	2016 Q3 F	2016 Q4 F	2017 Q1 F	2017 Q2 F	2017 Q3 F	2017 Q4 F
GDP y/y (%)	3.0	3.1	3.3	3.4	3.5	3.6	3.6	3.8
Individual consumption y/y (%)	3.2	3.3	3.8	4.2	4.3	4.1	3.8	3.5
Public Consumption y/y (%)	4.4	4.4	4.0	2.0	4.0	4.0	4.0	4.0
Investment y/y (%)	-1.8	-4.9	-3.6	-1.5	2.0	3.0	6.0	6.5
Inflation rate (% average)	-0.9	-0.9	-0.7	0.3	0.9	1.3	1.5	1.6
Unemployment rate (% eop)	10.0	8.9	8.6	8.7	8.9	8.2	7.8	8.1
NBP repo rate (% eop)	1.50	1.50	1.50	1.50	1.25	1.25	1.25	1.25
Wibor 3M (% eop)	1.67	1.71	1.71	1.44	1.44	1.44	1.44	1.44
2Y Polish bond yields (% eop)	1.45	1.65	1.65	1.55	1.35	1.30	1.30	1.30
10Y Polish bond yields (% eop)	2.84	2.91	2.90	2.85	2.80	2.80	2.80	2.80
EUR/PLN (eop)	4.24	4.38	4.35	4.30	4.25	4.25	4.25	4.25
USD/PLN (eop)	3.73	3.94	3.99	3.98	3.97	4.05	4.05	4.05

F - forecast

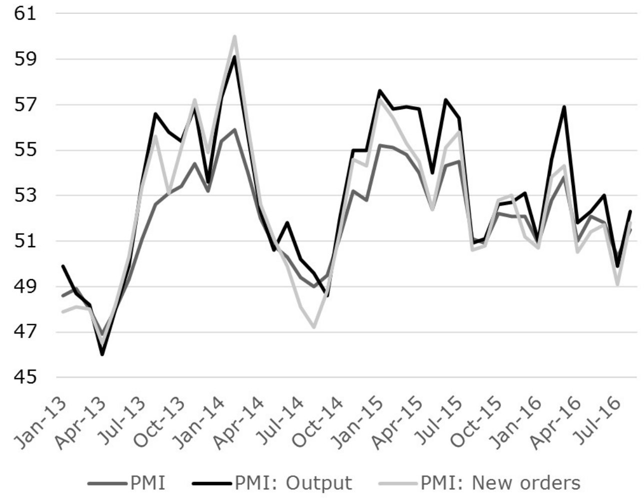
Q2 growth confirmed at 3.1% y/y with very poor details, while PMI returned to June levels

The flash release of Q2 GDP was confirmed at 3.1% y/y and seasonally adjusted 0.9% q/q.



The details of GDP growth in this period must be seen as both surprising and negative. First, despite the launch of the child subsidy programme (granted, disbursements started in May but it hardly matters for y/y growth rates) and the relentless uptrend in wages, household consumption accelerated only marginally, from 3.2 to 3.3% y/y. Second, investment growth surprised to the downside and dropped to -4.9% y/y (market consensus indicated at a small positive number, for reasons unclear to us, we were betting on a modest -1.0% y/y). Such a collapse in investment is perfectly analogous to what happened in years 2012-2013 (and L- or at best U-shaped recovery, not a V-shaped rebound) and stands in contrast to what could be gleamed from monthly indicators. In particular, with only marginal deterioration in construction output, these figures suggest that the drop in investment is not limited to construction and that machinery and equipment purchases also stalled. It indicates that private investment also suffered. Whether it is due to spillovers from EU funding hiatus, or from political uncertainty, it does not matter. Third, with public consumption growth steady at 4.4% y/y and lower inventory buildup (contribution down to 0.5 pp. from 1.3 in Q1), growth was supported by net exports, whose contribution swung from -0.9 to 0.8 pp. and hit a 3-year high.

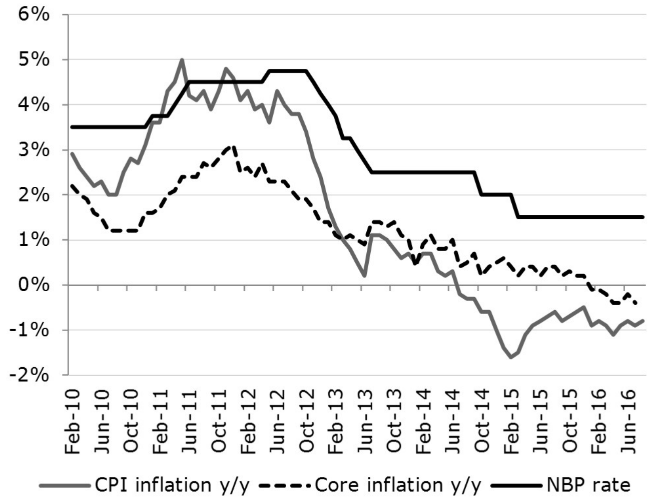
Poor GDP growth and unfavorable structure not only put in question the MPC's optimistic scenario (3.6-3.8% was the preferred forecast), but also indicate that recent revisions from official forecasters were not enough. Poor July data earlier this month merely confirmed that GDP growth will take a flat path this year. Despite the slight upward surprise (51.5 vs. 50.7 expected), the Manufacturing PMI for August confirms this picture. First, barring the inherent imprecision of such comparisons, current levels of the PMI are only a hair above stagnation and consistent with 3% GDP growth. Second, the August rebound has not been confirmed by other similar indicators (CSO and EC) – the correlation is not perfect but one has to be at least wary of the persistent downward trend in CSO / EC's indicators. More importantly, the PMI subindices related to price formation (input and ourput prices) have deteriorated further, suggesting that there is the impact of weaker PLN is already fading.



In these circumstances we see a return to monetary easing as likely this year. Even though individual MPC members either insist that monetary easing is not needed or that it is impotent, the sum of subsequent negative surprises is bound to reach critical mass soon. The markets still see a slim chance of rate cuts this year but this might change: low inflation and flat interest rate trajectories throughout the world should support more aggressive bets on NBP easing. Finally, slower growth can be contrasted with encouraging fiscal data and that should be credit risk positive. After all, most controversial aspects of government's economic policies have already been published.

Poland still in deflation, but this time an upward surprise happened.

According to preliminary data, deflation eased to -0.8% y/y in August (as compared to -0.9% in July and our forecast of -1.0% y/y). At this point we can only speculate as to the nature of the surprise. On one hand, fault may lie in ”Communications” and ”Recreation and Culture” categories, known for one-off surprises in either direction. We can also arrive at -0.8% y/y when we keep our assumptions regarding core categories and assume higher food prices (by adjusting last year’s growth rates by +0.2%).



In September, CPI growth should be less negative (-0.4 to -0.5%), mainly because of base effects, but higher fuel prices might also contribute. The MPC will use that as an argument for keeping rates constant. In our view, it us useful to look at downside risks in the real sphere. For one, Polish growth is kept afloat by consumption and mysteriously high net exports. If consumers suddenly decide to save more (like in 2012) or if, on the contrary, net exports declines to align with a higher consumption-induced imports (accelerating exports, as portrayed in national accounts, is dubious at least), GDP growth can easily drop below 3% y/y. It is not our baseline scenario but the MPC might look at it on a risk management basis, especially if hard data continue to disappoint after the calendar-related rebound in August.

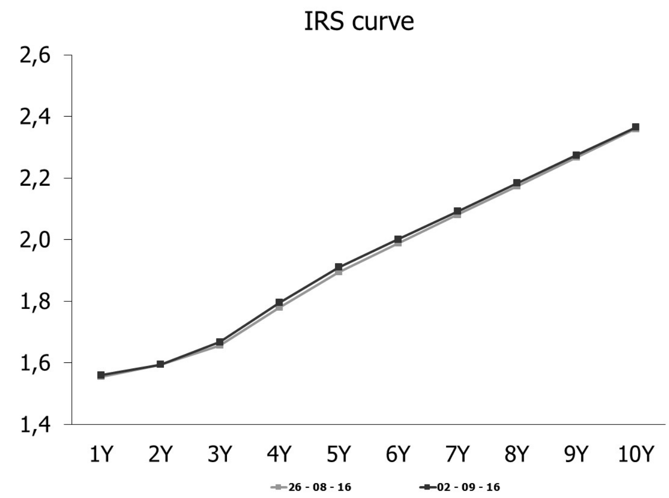
Fixed income

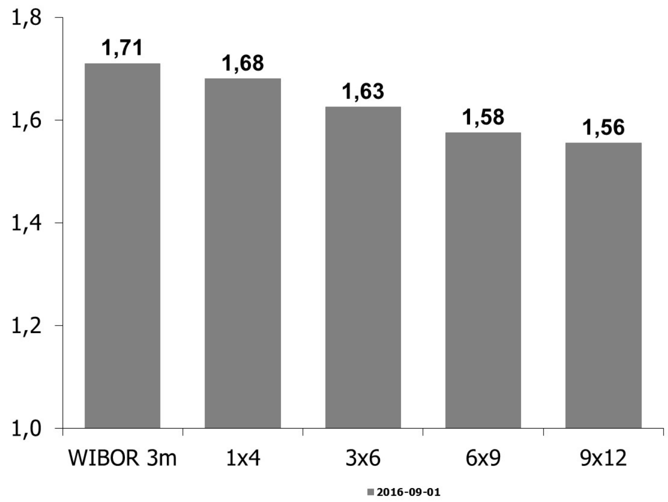
Bull steepener ahead

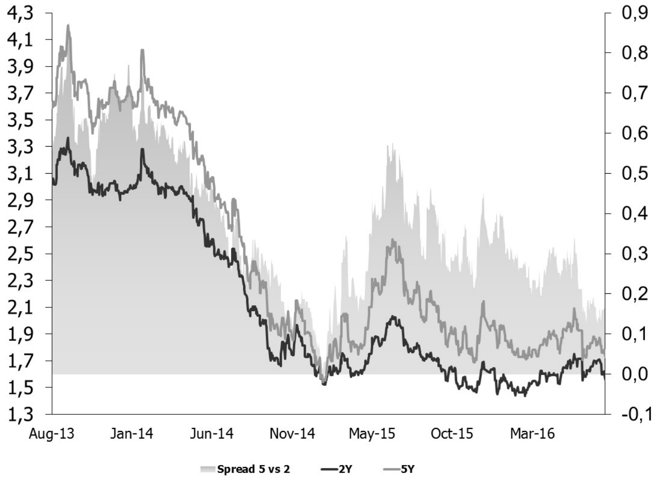
As we expected, steepening of PS0721/DS0726 moved the spread from 59bps to 61,5bps, target 65bps. We still think the spread will be most driven by PS0721. Today's Payrolls at 151k (est. 180k), lower ISM and next week ECB meeting should drive a bull steepener.

ASWs moved, 5y PS0721 from 33/31 to 43/41, 10y DS0726 59/27 to 67/65, and are still under Moody's pressures.

Yesterday we had a very good auction, fully covered. Ministry of Finance sold 7,6 bio bonds, OK1018 at 96,57 (1,647%), DS0726 at 97,50 (2,791%) and WZ0122 at 97,45.







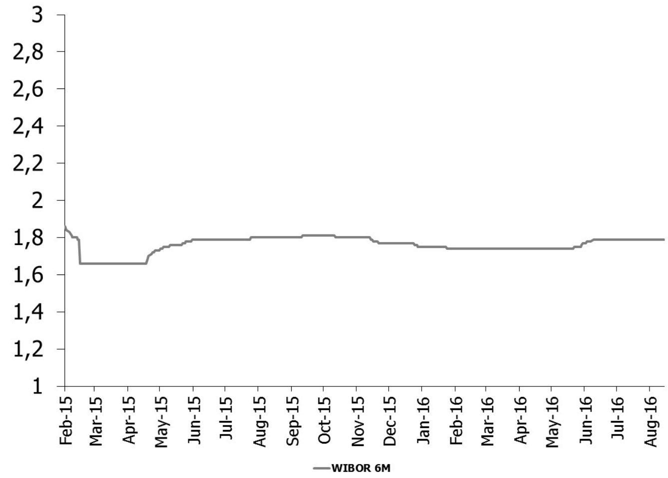
Money market

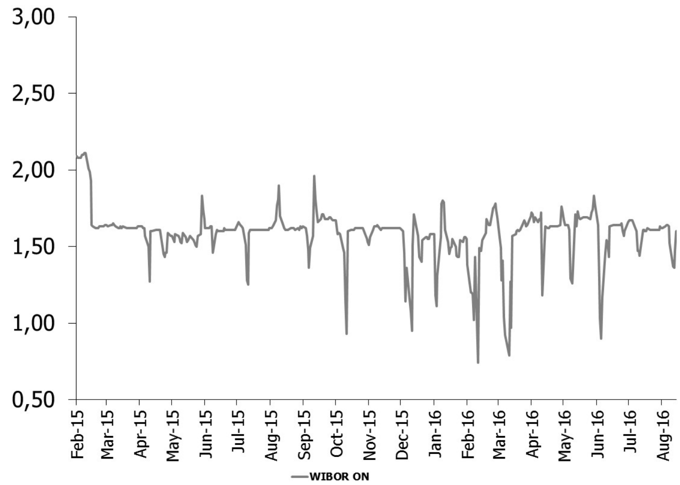
Evaporating rate cut expectations

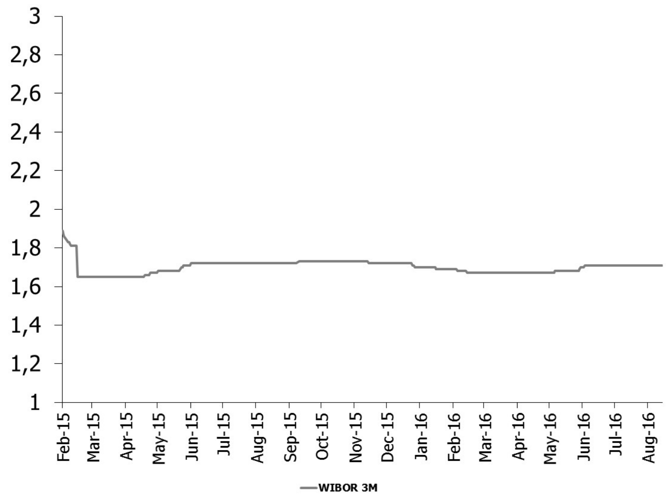
Yields were grinding higher throughout the week with 2y touching 1.68% today. Diminishing rate cut expectations are fueled by higher readings from both CPI and PMI. What's worth mentioning, is the announcement of a switching auction on September 22nd which should support the shortest bonds. We would start gradually receiving rates when we get close to 0 bp cuts priced in.

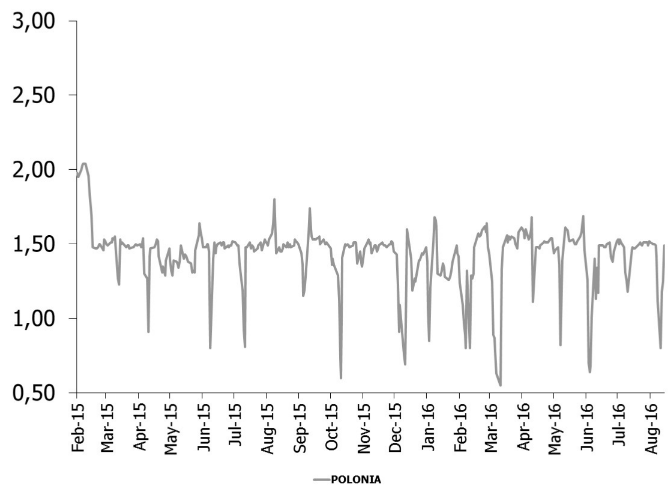
Start of a new month will reduce volatility in overnight rates.

Ref rate vs Polonia averages:
30 day: 8 bp
90 day: 10 bp





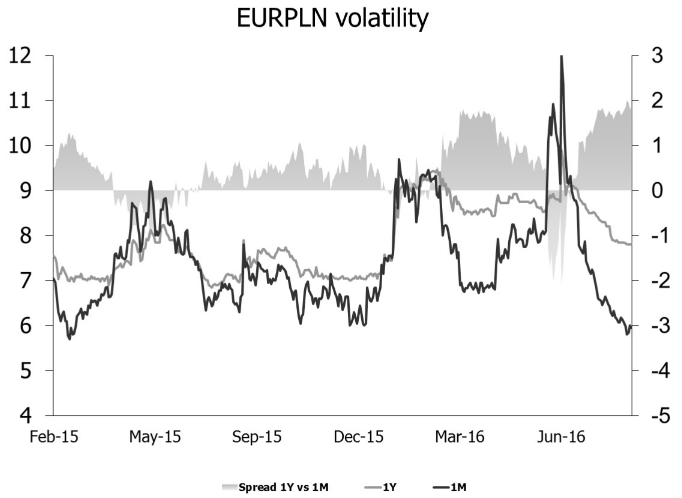




Forex

Spot – PLN depreciated further Zloty continues to weaken. EUR/PLN kept on climbing, reaching as high as 4.3900, breaking on the way the 4.35-4.37 resistance zone. It is quite an achievement (low of the week was 4.3175), if one takes into account the still very slow, holiday market. We are now in the pivotal 4.37-4.39 zone, and if we continue to ascend, the next significant resistance is 4.43-4.45. The squeeze was more likely position liquidation driven, but it seems done for the time being, and we also see some supply on these levels. The main event for next week, will be the Moody's decision, but that's on Friday evening, so we have to wait till next Monday to react. Till then, 4.33-4.41 is the most likely range.

Options – EUR/PLN vols – higher Finally, when some started to lose hope, the freefall of vols stalled a bit, and some buyers emerged. It was nothing significant, but finally we saw some buyers, especially in the frontend (to close Gamma shorts for NFP, September FOMC). 1 month EUR/PLN ATM mid is 6.2% (0.5% higher), 3 month EUR/PLN is 6.5% (0.2% higher) and, finally, 1 year is fixing at 7.8% (unchanged). The skew was roughly unchanged, but the currency spread spiked higher by roughly 1% in the frontend and 0.25% in the backend.



Short-term forecasts

Main supports / resistances:
EUR/PLN: 4.30 / 4.41
USD/PLN: 3.75 / 4.00

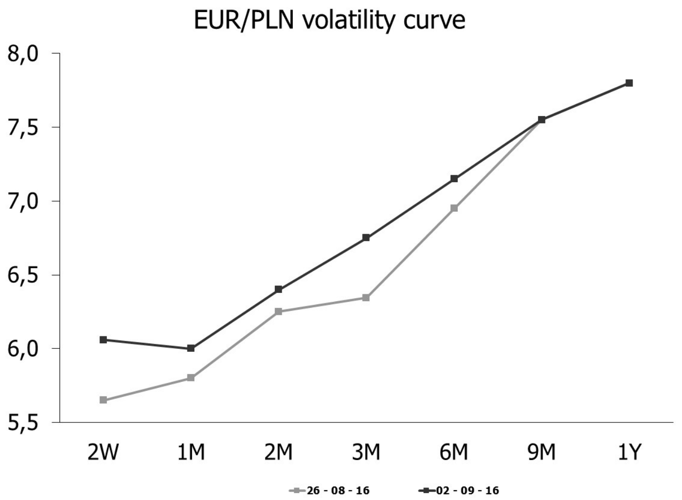
Spot Position: None.

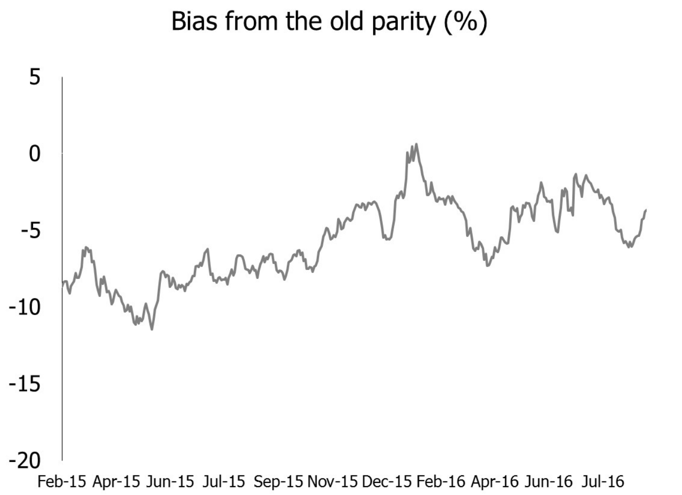
Shorts from 4.29 and 4.32 were stopped out at 4.35.

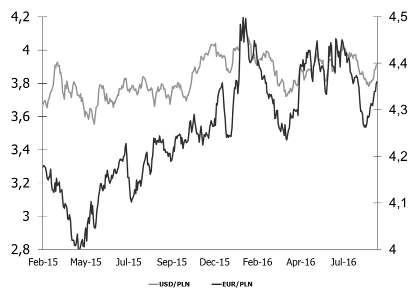
We are at the sidelined at the moment. We are now in the middle of the wider 4.28-4.48 range and we don't have a clear signal either way. Moody's decision is one risk factor, Polish politics coming back from their holidays is also worth watching. The saga of CHF denominated loans is not yet definitely closed. It still will has to be approved by the Parliament, and MPs may add some amendments. Liquidity and volatility are likely to pick up with summer vacations already behind us.

Options Selectively long Vega

Implied volatilities have come off significantly over the past weeks. For some tenors realized volatilities are significantly higher than implied volatilities (for example 2m 9.3% realized versus 6.2% implied, 3m 8.8% realizedversus 6.4% implied). There is a lot of uncertainty surrounding Brexit, postponed decision on forced conversion of CHF mortgages, Constitutional Court conflict, the U.S. elections, so we stick to our position – we have still selective longs in backend EURPLN curve.







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
8/26/2016	2.03	1.71	1.95	1.69	2.10	1.71	1.67	1.59	1.54	1.51	1.49	1.60
8/29/2016	1.93	1.71	2.10	1.69	2.02	1.71	1.66	1.59	1.54	1.51	1.50	1.61
8/30/2016	1.92	1.71	2.09	1.69	2.01	1.71	1.67	1.60	1.55	1.52	1.50	1.62
8/31/2016	1.83	1.71	1.89	1.69	1.94	1.71	1.67	1.62	1.57	1.55	1.53	1.64
9/1/2016	2.02	1.71	2.10	1.69	2.05	1.71	1.68	1.63	1.58	1.56	1.54	1.66

Last primary market rates							
Paper	Au. date	Maturity	Avg. price	Avg. yield	Supply	Demand	Sold
32W TB	3/14/2016	11/30/2016	99.04	1.35	1500	1757	1692
OK1018	8/18/2016	10/25/2018	96.47	1.67	2000	2412	1947
PS0421	8/18/2016	7/25/2021	98.31	2.11	3500	4968	3844
DS0726	8/18/2016	7/25/2026	98.23	2.70	2000	3405	2159

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0715	5Y IRS	PS0718	10Y IRS	DS1023
8/26/2016	1.710	1.474	1.635	1.578	1.960	2.232	2.405	2.949
8/29/2016	1.710	1.474	1.635	1.578	1.960	2.232	2.405	2.949
8/30/2016	1.710	1.474	1.635	1.578	1.960	2.232	2.405	2.949
8/31/2016	1.710	1.474	1.635	1.638	1.990	2.290	2.447	2.985
9/1/2016	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
8/26/2016	5.80	6.35	6.95	7.80	7.80	2.24	0.60
8/29/2016	5.85	6.40	6.95	7.80	7.80	2.24	0.60
8/30/2016	6.00	6.50	7.00	7.80	7.80	2.21	0.60
8/31/2016	5.95	6.50	7.05	7.80	7.80	2.23	0.70
9/1/2016	6.00	6.75	7.15	7.80	7.80	2.22	0.65

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
8/26/2016	4.3270	3.8328	3.9695	3.8160	1.3989	0.1601
8/29/2016	4.3395	3.8789	3.9686	3.7959	1.4031	0.1606
8/30/2016	4.3395	3.8858	3.9654	3.7982	1.4044	0.1605
8/31/2016	4.3555	3.9082	3.9745	3.7895	1.4056	0.1611
9/1/2016	4.3607	3.9116	3.9663	3.7783	1.4061	0.1613

Disclaimer