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## Polish Weekly Review

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### Comment on the upcoming data and forecasts

The upcoming week is abundant in economic publications and starts on Monday with final CPI data for August. We expect CSO to confirm the flash release at -0.8% y/y. Tuesday brings NBP data – core inflation would most probably stay at record low -0.4%, while M3 money supply should accelerate a bit, driven by base effects in corporate deposits. July's current account balance probably plummeted due to poor exports and robust import growth, which resulted in larger trade balance deficit. Divergent surprises in industrial production and retail sales last month strongly imply such an effect. The week ends on Friday with labour market data. We predict average wage growth to accelerate from 4.8% to 5.4% because of sections sensitive to calendar effects (which reversed the very unfavorable July arrangement of working days), while employment probably rose at July's annual pace – the spike in seasonal employment has already happened.

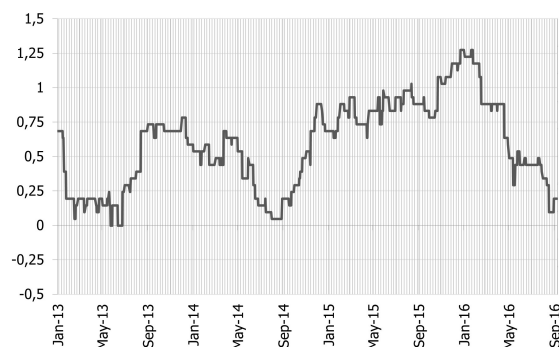
### Polish data to watch: September 12th to September 16th

Publication	Date	Period	mBank	Consensus	Prior
CPI y/y (%) <i>final</i>	12.09	Aug	-0.8	-0.8	-0.9
Current account (mio EUR)	13.09	Jul	-903	-397	-203
Exports (mio EUR)	13.09	Jul	13800	13910	15218
Imports (mio EUR)	13.09	Jul	14000	13950	14814
Core inflation y/y (%)	13.09	Aug	-0.4	-0.4	-0.4
M3 money supply y/y (%)	14.09	Aug	11.4	10.7	10.7
Average wage y/y (%)	16.09	Aug	5.4	5.0	4.8
Employment y/y (%)	16.09	Aug	3.2	3.2	3.2

### 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	-	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

Unchanged from previous week, since (just as expected) MPC has not make any changes in monetary policy. Next week brings lot of opportunities to change it with inflation and labour market data.

\* 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, over the medium term 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 still 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	2016	2016	2016	2017	2017	2017	2017
	Q1	Q2 F	Q3 F	Q4 F	Q1 F	Q2 F	Q3 F	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



## Economics

### **MPC left rates unchanged (for quite some time)**

Just as expected, MPC did not make any changes in monetary policy during its September meeting: base rate still equals 1.50%. The statement after the meeting once again contains the phrase: "the current level of interest rates is conducive to keeping the Polish economy on the sustainable growth path and maintaining macroeconomic balance". It also points out that business outlook is stable and there are no negative effects of deflation. Thus, it is preferable for the MPC to keep interest rates at current levels for some time.

Central banks sometimes have optimism bias when interpreting economic data. An excellent example of this was Governor Glapinski praising acceleration of GDP growth in Q2. In fact, it was higher by only 0.1 pp, which is much below measurement error for such figures in Poland. Mr. Glapinski was focusing on "huge optimism" in Polish economy, completely putting aside the fact that expectations towards GDP growth were significantly lowered (from 3.6-3.8% to 3.1-3.2% for the current year). This line of rhetoric culminated with comments about interest rates. MPC still hopes that the next move will be a rate hike, however, this time Governor Glapinski for the first suggested when it could happen (late 2017). To summarize, MPC has built its strategy on the stability of Polish economy, which Governor Glapinski described as "boredom". Current rates and other monetary policy parameters are thus seen by MPC as optimal (this has not changed for a long period of time).

Market participants would see a reassurance of this rhetoric in the coming return of inflation from negative territory. This would symbolically prevent MPC from making any interest rate or monetary policy adjustments. However, we still see scenarios where interest rate would need to be lowered despite positive inflation: a) significant PLN appreciation or b) another negative surprise in GDP growth (Q3 or Q4). European macroeconomic environment of low interest rates would also support it. Thus, the most probable scenario for Polish monetary policy in the next 6 months is still one of monetary easing.

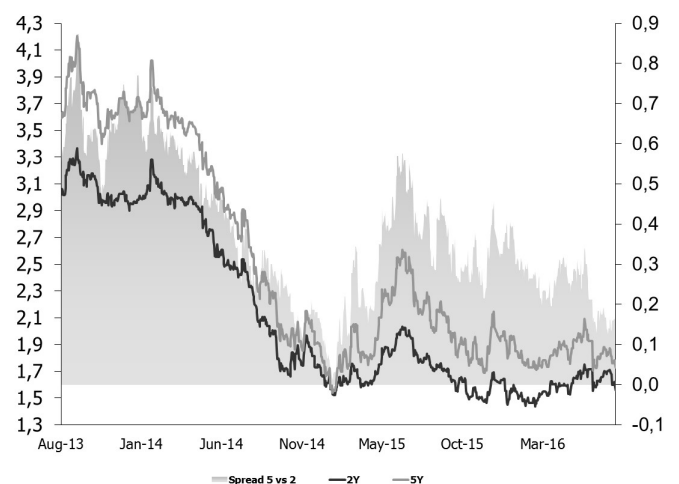
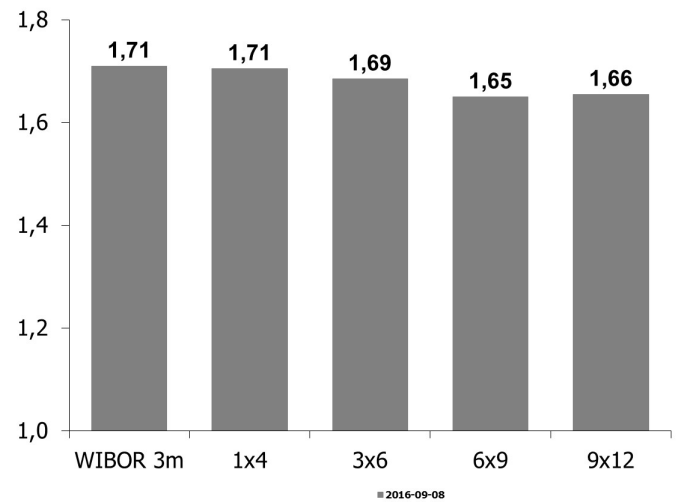
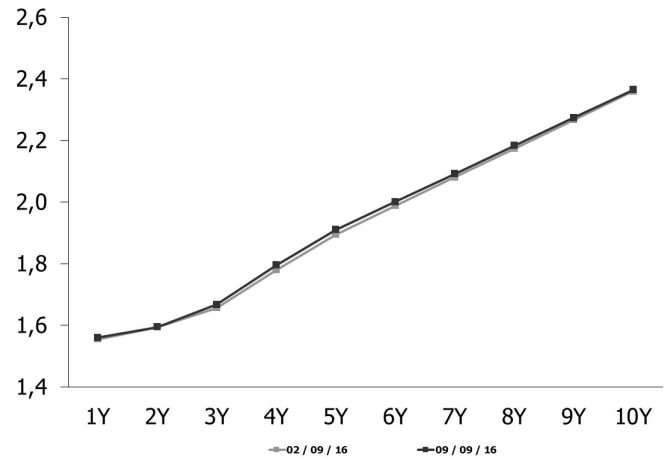
## Fixed income

### Waiting for Moody's

Today Moody's is going to announce its decision about our rating. Market does not expect any change, so it feels like everyone is long in Polish bonds. Risk is asymmetric – if Moody's cuts rating, we will see some selling, if not, market should not move much higher (2-3bps lower in yield).

We had an MPC meeting this week. They don't see rate cuts, so this puts a pressure on s/e bonds, as they moved 10bps higher in yield. This level is good for ALM and MM desks, 1,75% on 2y benchmark should be a good level to go long. 5 and 10y bonds should move higher at the beginning of next week and we think it looks very interesting. Especially PS0721 at 2,4% and DS0726 at 3% would be attractive.

IRS curve



## Money market

### Upper bound of the range

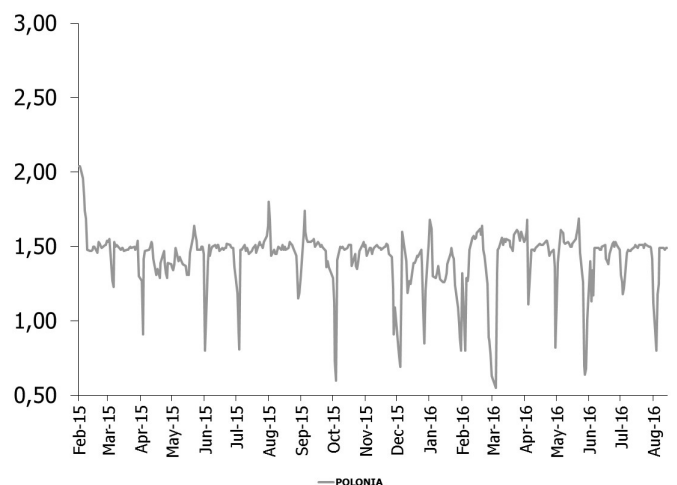
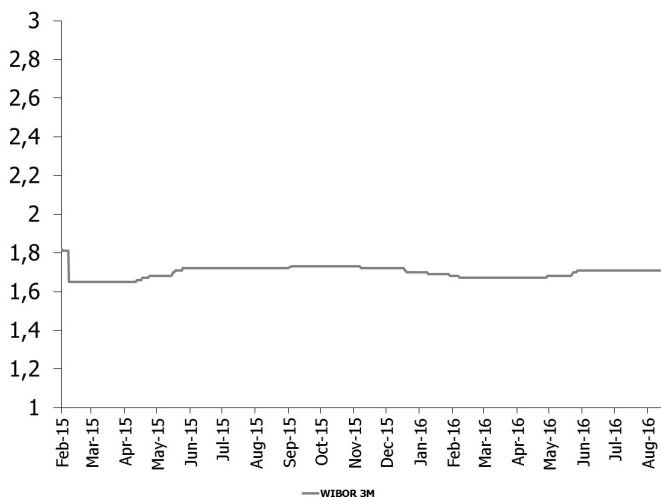
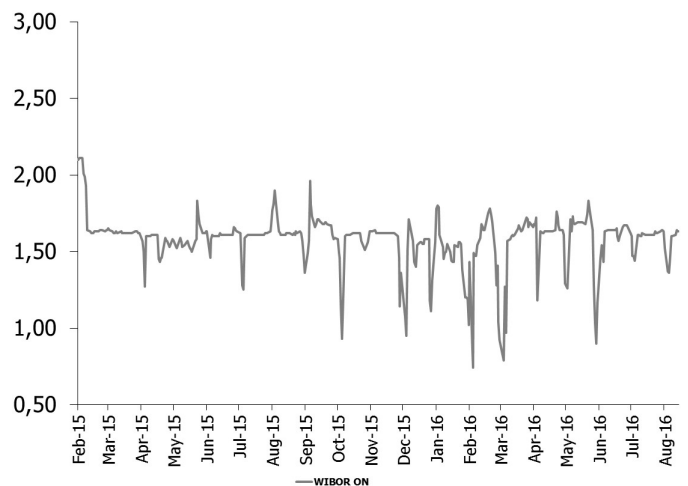
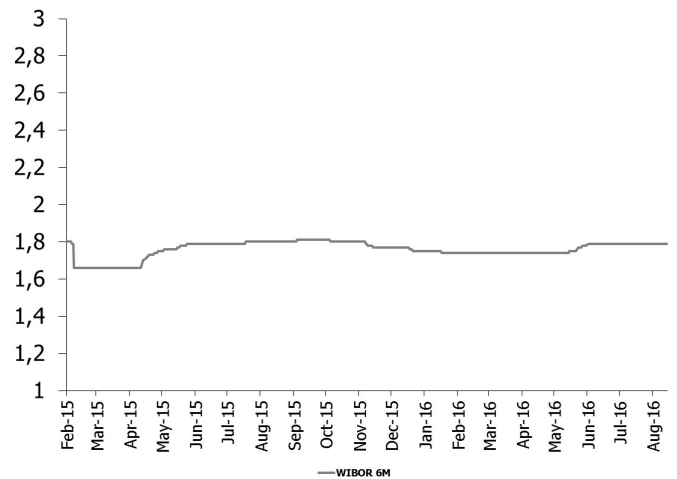
Nothing spectacular came out of MPC meeting this month. While they are still relaxed and happy with current situation, they are reiterating that current level of rates is adequate. With rates seen stable for the next couple of months, we are trading back and forth, either pricing a rate cut or not. Yesterday's "disappointment" from the ECB, upcoming Moody's rating revision for Poland and Fed uncertainty pushed rates to the upper band of that range, therefore we seek an opportunity to receive rates. We might get first chance on Monday if Moody's possible downgrade pushes yields even higher.

Overnight rate should remain around 1,52 next week. We expect the end of the month to be cheaper as reserve period ends on Thursday.

Ref rate vs Polonia averages:

30 day: 8 bp

90 day: 10 bp



## Forex

**Spot – The U-turn** Last week's Deputy Prime Minister Morawiecki's comments about possible Poland downgrade by Moody's set the week's high for EUR/PLN around 4.39. There was only one direction from that point and that was down. Warmer global investment climate (because of softer NFP and ISM from US) was encouraging enough for fresh PLN longs. After marking a low around 4.3060, the touch less dovish ECB poured some cold water. As a result, EUR/PLN has corrected to 4.3300, and here we are, waiting for Moody's rating decision about Poland.

**Options – EUR/PLN vols – higher** It was really quiet for most of the week, the action started on Thursday with 1 week (gamma buying) trades. 1w EUR/PLN got paid at 6.5%, then was offered at 6.00, only to get paid again, this time at 7.00. It is purely short gamma trimming before Moody's, and the rest of the run was unimpressive. We have to see realized volatility really picking up before any substantial pickup in vols. 1 month EUR/PLN ATM mid is at 6.0% (0.2% lower), 3 month EUR/PLN are 6.5% (unchanged) and, finally, 1 year is fixing at 7.7% (0.1% lower). The skew was roughly unchanged but currency spread melted a bit after US rate hike became less likely.

## Short-term forecasts

Main supports / resistances:

EUR/PLN: 4.23 / 4.35

USD/PLN: 3.75 / 4.00

**Spot Position:** Long EUR/PLN.

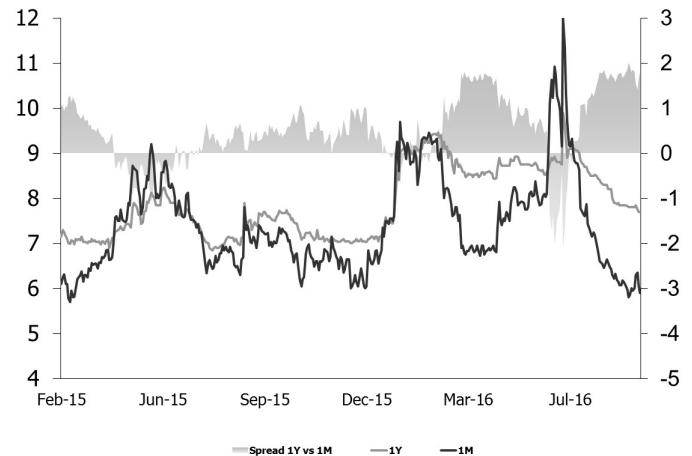
We are long EUR/PLN from 4.3170, ready to add at 4.2870. Stop is at 4.2650 and we are hoping to see 4.38/4.40, or depending on the momentum, possibly 4.41/4.43.

It is all about risk/reward. The post Brexit risk rally is getting bit fatigued, hence, prone to correction. Positioning is another factor, as we believe the market is already long PLN. Polish politics is another risk since the Parliament vacations are over. The CHF denominated loans subject may resurface.

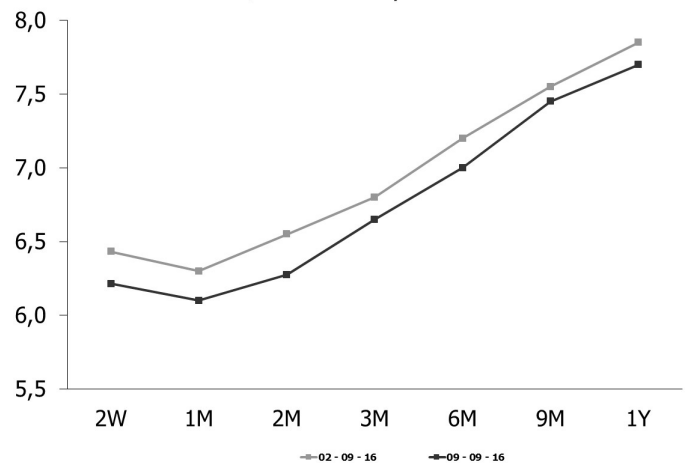
**Options** Selectively long Vega

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% realized versus 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.

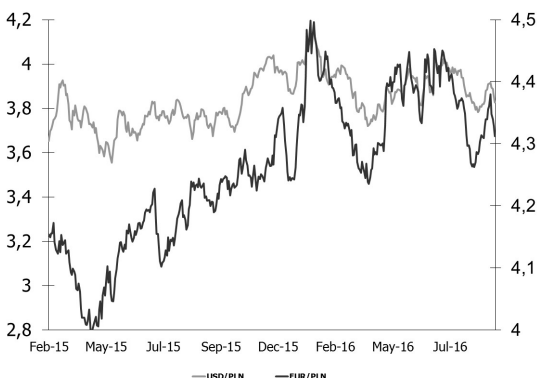
EURPLN volatility



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
9/2/2016	1.88	1.71	1.80	1.69	1.95	1.71	1.69	1.68	1.63	1.60	1.58	1.69
9/5/2016	1.91	1.71	2.00	1.69	2.09	1.71	1.69	1.65	1.62	1.60	1.60	1.69
9/6/2016	1.99	1.71	2.09	1.69	2.06	1.71	1.68	1.64	1.60	1.60	1.55	1.67
9/7/2016	1.73	1.71	1.84	1.69	1.94	1.71	1.69	1.66	1.64	1.61	1.60	1.69
9/8/2016	1.93	1.71	1.85	1.69	2.00	1.71	1.71	1.69	1.65	1.66	1.64	1.72

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
9/2/2016	1.710	1.474	1.635	1.578	1.960	2.232	2.405	2.949
9/5/2016	1.710	1.474	1.635	1.578	1.960	2.232	2.405	2.949
9/6/2016	1.710	1.474	1.635	1.578	1.960	2.232	2.405	2.949
9/7/2016	1.710	1.474	1.635	1.638	1.990	2.290	2.447	2.985
9/8/2016	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
9/2/2016	6.30	6.80	7.20	7.85	7.85	2.21	0.69
9/5/2016	6.35	6.75	7.10	7.75	7.75	2.21	0.69
9/6/2016	6.05	6.60	7.00	7.70	7.70	2.19	0.61
9/7/2016	5.90	6.45	7.00	7.70	7.70	2.19	0.61
9/8/2016	6.10	6.65	7.00	7.70	7.70	2.21	0.69

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
9/2/2016	4.3796	3.9164	3.9949	3.7791	1.4115	0.1621
9/5/2016	4.3480	3.8937	3.9786	3.7661	1.4064	0.1608
9/6/2016	4.3396	3.8869	3.9658	3.7590	1.4007	0.1605
9/7/2016	4.3289	3.8515	3.9727	3.7896	1.3993	0.1602
9/8/2016	4.3122	3.8255	3.9502	3.7671	1.3977	0.1596

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