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Polish Weekly Review

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Comment on the upcoming data and forecasts

Week starts with industrial and retail data. After a disastrous July, when working day effects, auto plant shutdowns and general weakness in demand brought industrial output growth to 4-year low, August brought a strong rebound in output, led by the reversal of calendar effects (difference in working day count jumps from -2 to +1 y/y) and low statistical base (the heat wave in August '15). Retail sales is influenced by the said calendar effect, but we also expect to see some major signs of social spending induced spending (before the beginning of the school year), resulting in retail sales accelerating towards 6% y/y. Wednesday and Thursday are mainly about consumer and business sentiment data (for September), respectively. Finally, the Minutes from the September MPC meeting are unlikely to shed any new light on Polish monetary policy.

Polish data to watch: September 19th to September 23th

Publication	Date	Period	mBank	Consensus	Prior
Sold industrial output y/y (%)	19.09	Aug	6.7	5.1	-3.4
PPI y/y (%)	19.09	Aug	-0.4	0.0	-0.4
Nominal retail sales y/y (%)	19.09	Aug	5.8	4.6	2.0
Consumer confidence	21.09	Sep			
Business confidence	22.09	Sep			
MPC Minutes	22.09	Sep			

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 the previous week (final CPI, wage and employment growth broadly in line with forecasts). Next week is all about industrial and retail sales data (all on Monday) – one should expect some surprises.

* 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

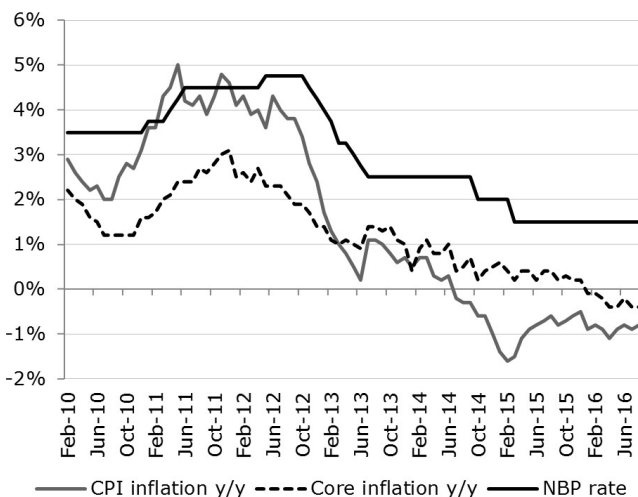
F - forecast

Economics

No revision to flash CPI reading. The uptick in August driven by food prices, after all.

The Central Statistical Office confirmed the flash CPI release for August at -0.8% y/y (pre-flash consensus: -0.9% y/y). Out of two hypotheses we put forward at the time – first suggesting a positive surprise in core categories, second indicating that higher food prices were to blame – the latter turned out to be true.

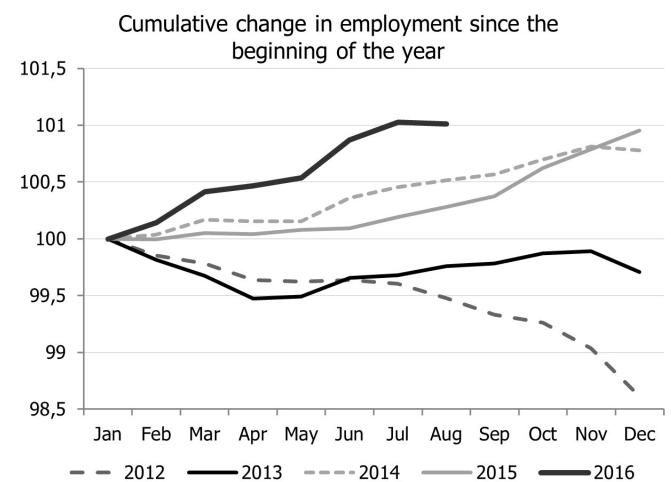
Food prices declined by 0.6% on a monthly basis, much less than marketplace data and regional CPI releases suggested, but in line with a simple rule that adds ca. 0.5 p.p. to last year's reading. Fuel prices declined by 1.4% m/m, while core categories were completely bland, ranging from stagnation to 0.1 or 0.2% increases. All in all, core inflation held steady at -0.4% y/y.



In September, CPI is likely to accelerate to -0.3-0.4 y/y and the following months will be influenced primarily by base effects in fuels (enhanced by the expected slight uptrend in retail fuel prices). In short, one cannot escape the fact that PLN-denominated oil prices are now higher than a year ago.

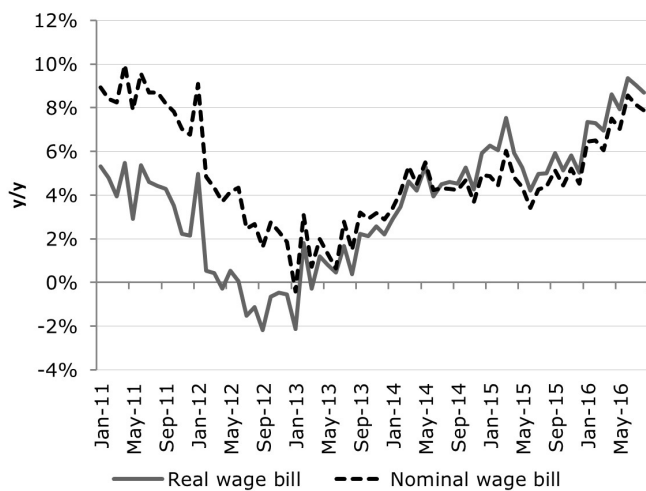
Labor market loses a bit of its dynamism.

Employment in the enterprise sector rose by 3.1% y/y (3.2% consensus). Even though worse than forecast, the deceleration of employment does not seem alarming. Firstly, we expected a deceleration in job creation on a monthly basis (it proved to be a little more pronounced). Secondly, employment in Poland recently posts quarterly jumps and the next is awaited in September. Should that month prove weak, then we will be worried at least a bit. Thirdly, recent changes in employment resulted to some extent from movement in sections that were so far stable. Experience shows that after such a section gains or sheds employment abruptly (due to rounding, GUS posts only changes >1k), it may be or may not be sustainable (it is a toss of a coin). Summing up, we are more worried about demand side of the economy (condition of exports and investment) than labor market itself (and consumption in turn).



Average nominal wage rose in August by 4.7% y/y, below both market consensus (5.0%) and our forecast (5.4%). We still need to wait for details until the end of the month, when the CSO publishes its Statistical Bulletin. This is (albeit by a small margin) the second month in a row with slower wage growth. Last month, slowdown surprise was driven by sections vulnerable to calendar effects, this time the favorable working days pattern has not contributed to better outcome. Taking into account the reduction in corporate employment, this could be a result of further deterioration of economic situation in construction sector (we thought that this category would contribute, along with manufacturing, to acceleration of nominal wage growth). More light will be shed on this topic after Monday's real sphere data.

Further conclusions should not be drawn from this publication, even if there are inconsistent with wage pressure in Polish economy. Looming decrease in labour force participation driven by government "Family 500+" program will still be a significant reason for enterprises to raise wages. Private consumption remains prone, fueled by decent wage fund, and is growing by 7.9% y/y in nominal and 8.7% y/y in real values.



This week's data has still no impact on monetary policy. MPC is focused on the upcoming end of deflation and a rebound of growth in second quarter (by a minimal 0.1 pp). Solid employment and enterprise growth are in line with its current stance. However, some market participants, having seen negative surprises in labour market data, could remain themselves about formerly strong correlation between investment activity and employment growth as well as rising wages' impact on enterprise financial results with deflation. Also European environment still favors low rates in Poland and will prevail over other arguments if: (1) PLN strengthens significantly; (2) GDP disappoints again in Q3 or Q4. Thus, we still see possibility of downward rate adjustments in the next 6 month.

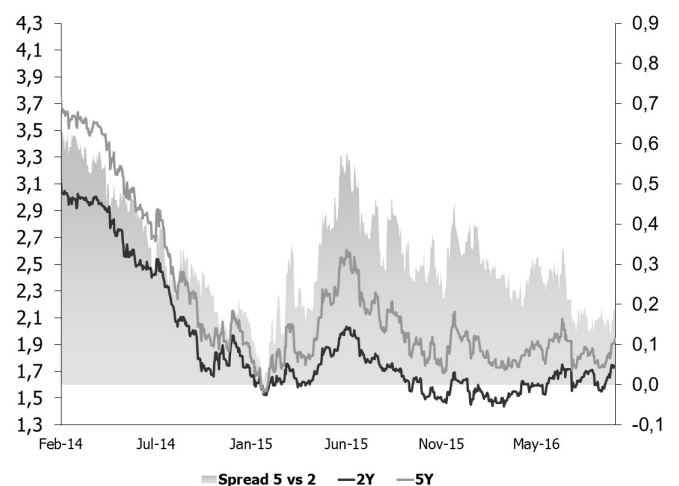
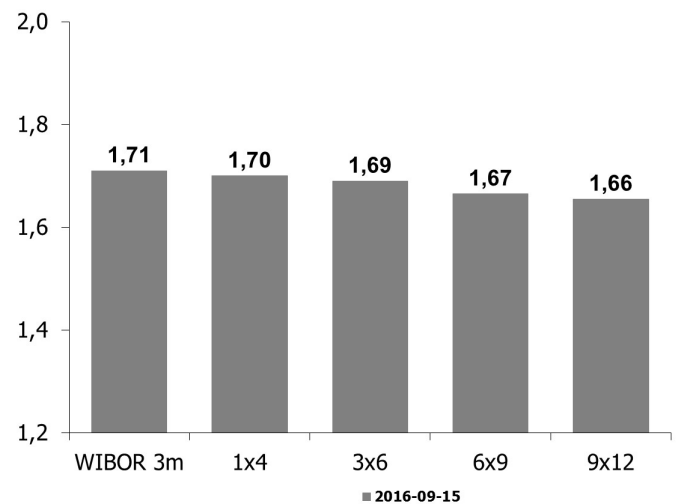
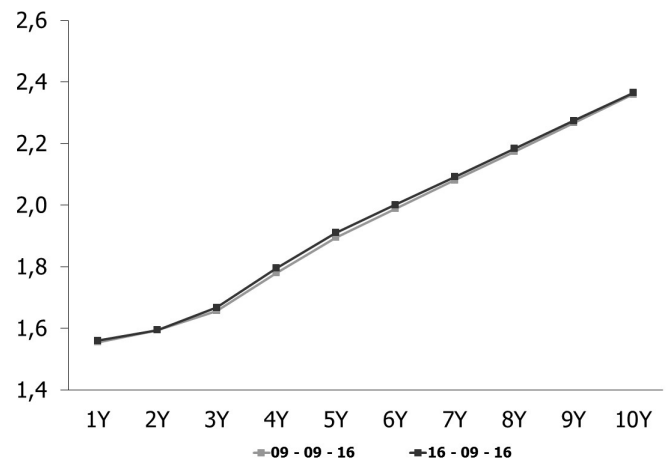


Fixed income

Auction after Fed

Next week we will have a switch auction. We expect PS0721 and WZ0126. This supply protects our curve from steepening, where all other curves go steep. Market expects rate cuts and decrease of I/e bond purchases from BoJ. No one expects any move from Fed so the only surprise may come from rate increase. Fed is on Wednesday and our auction is on Thursday, so it won't be easy to take short position in bonds, since you never know. PS0721 is rich in spreads, the same applies to WZ0126 outright. We see a lot of risks next week, although we still believe in PS0721/DS0726 spread increasing. We believe the level close to 65bps will be hit on Friday, after auction.

IRS curve



Money market

Switching auction

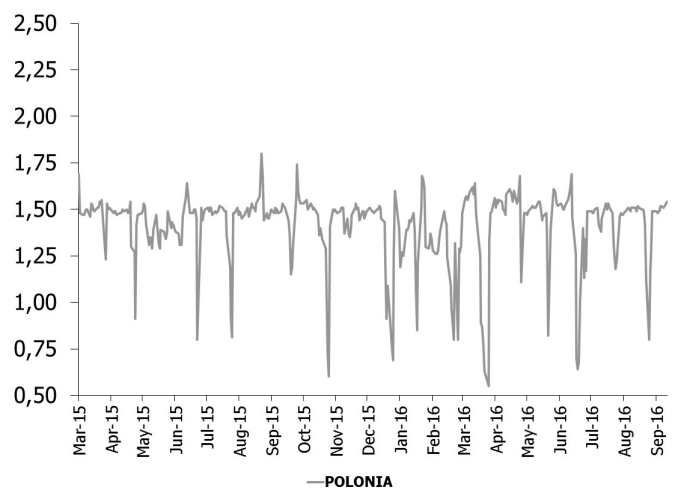
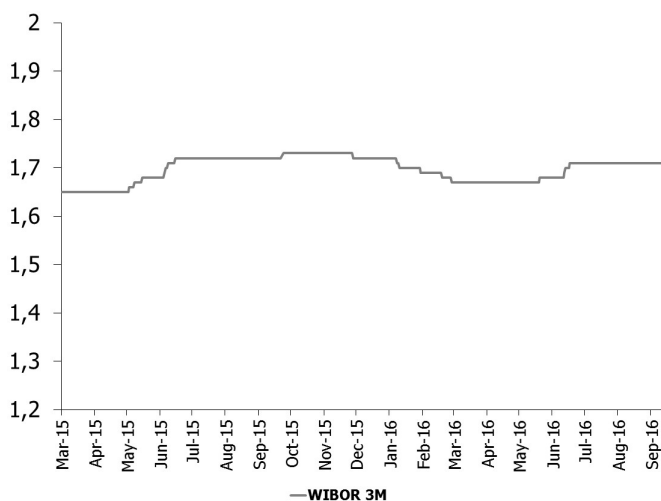
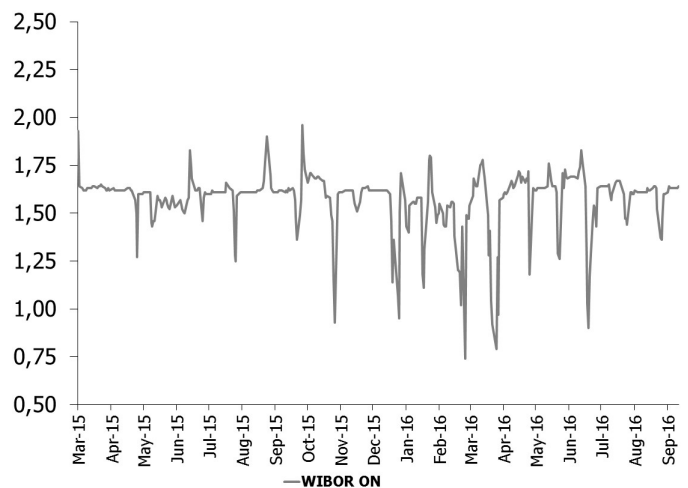
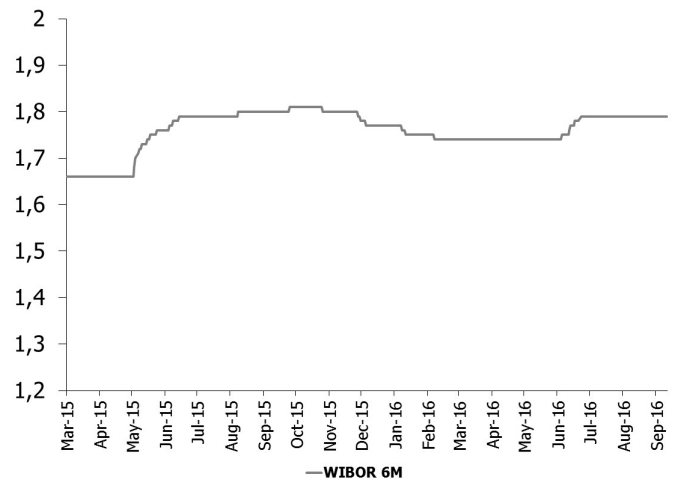
Polish rates peaked last week, with 2y IRS touching 1.77% (1.79% WIBOR). Move up was fueled mostly by bearish sentiment on the global bond market. While there is still a big risk out with the Fed meeting coming next Wednesday, we start to see some value in receiving 2y tenor. Compared to 2y IRS, OK1018 or PS0418 offer decent carry. Bonds should also benefit over swaps due to incoming switching auction and PS1016 redemption. It may make sense to exchange switching bonds (1016, 0117, 0417) to 2y.

Overnight rate should remain around 1.52 throughout the next week. We expect cheaper end of the month as the reserve period ends on Thursday.

Ref rate vs Polonia averages:

30 day: 8 bp

90 day: 10 bp



Forex

Spot – Still no fireworks Moody's decision (last Friday, September 9th) was good for Poland, the current rating was not changed. The threat of imminent downgrade faded, but PLN was not really able to benefit fully from that, as global stock exchanges were all showing red alerts. The mild risk off mood took EUR/PLN to 4.3580 (week's high) before it eventually moved south, reaching 4.3160 (week's low). The price action was slow and disappointing. We assume the range of 4.30-4.39 should hold for the next few sessions, as the market is still looking for a direction. All eyes on FOMC and BOJ meetings.

Options – EUR/PLN vols – higher Time goes on and US presidential elections are approaching quickly. When 2 month ahead date started to include this event, it was like a magic spell. The whole run above 2 months moved to the right. 1 month EUR/PLN ATM mid is at 6,0% (unchanged), 3 months EUR/PLN are 6.7% (0.2% up) and, finally, 1 year is fixing at 7.8% (0.1% higher). The skew was roughly unchanged. The currency spread (difference between USD/PLN vol and EUR/PLN vol) should be in theory better bid, as FOMC may not be that toothless, after all.

Short-term forecasts

Main supports / resistances:

EUR/PLN: 4.23 / 4.35

USD/PLN: 3.75 / 4.00

Spot Position: Long EUR/PLN.

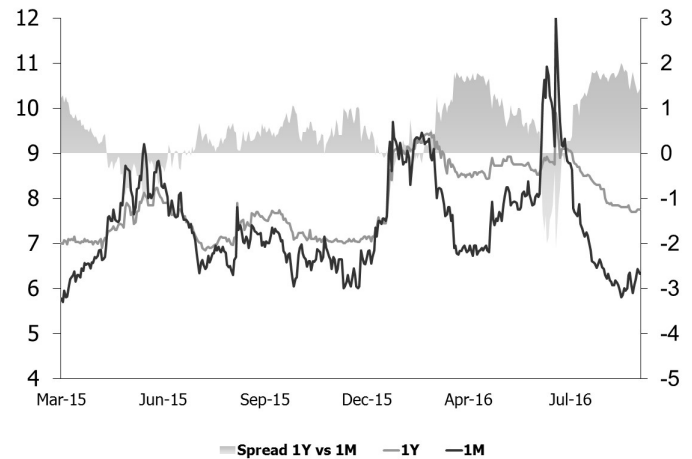
We are long EUR/PLN from 4.3170, ready to add at 4.2870. Stop is at 4.2650 and we are hoping to see 4.38/4.40, or depending on the momentum, possibly 4.41/4.43.

We are still keeping our long EUR/PLN position. 4.27/4.30 is a strong support zone, we still think 4.31-4.39 is a range. The odds for FOMC to surprise on the hawkish side are low, but maybe that is why it is worth keeping this position from pure risk/reward perspective. Polish politics is still a risk.

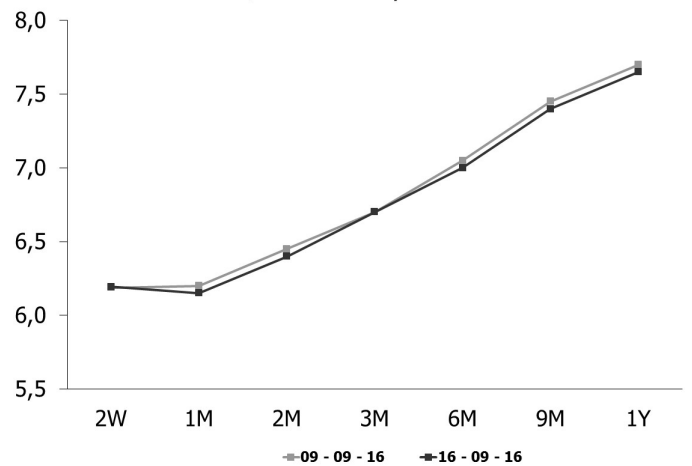
Options Selectively long Vega

Implied volatilities have come off significantly over the past weeks. 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
9/9/2016	1.79	1.71	1.85	1.69	2.00	1.71	1.70	1.70	1.67	1.68	1.65	1.76
9/12/2016	1.78	1.71	1.85	1.69	2.03	1.71	1.70	1.69	1.67	1.68	1.66	1.75
9/13/2016	1.95	1.71	2.04	1.69	2.05	1.71	1.70	1.69	1.66	1.67	1.67	1.74
9/14/2016	1.73	1.71	1.82	1.69	1.95	1.71	1.70	1.68	1.67	1.65	1.65	1.74
9/15/2016	1.97	1.71	2.04	1.69	2.05	1.71	1.70	1.69	1.67	1.66	1.67	1.75

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
9/9/2016	1.710	1.474	1.635	1.578	1.960	2.232	2.405	2.949
9/12/2016	1.710	1.474	1.635	1.578	1.960	2.232	2.405	2.949
9/13/2016	1.710	1.474	1.635	1.578	1.960	2.232	2.405	2.949
9/14/2016	1.710	1.474	1.635	1.638	1.990	2.290	2.447	2.985
9/15/2016	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	
9/9/2016	6.20	6.70	7.05	7.70	7.70	2.19	0.61	
9/12/2016	6.43	6.78	7.10	7.75	7.75	2.19	0.61	
9/13/2016	6.38	6.75	7.10	7.75	7.75	2.21	0.62	
9/14/2016	6.33	6.78	7.10	7.75	7.75	2.21	0.69	
9/15/2016	6.15	6.70	7.00	7.65	7.65	2.14	0.61	

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
9/9/2016	4.3264	3.8385	3.9444	3.7572	1.4014	0.1600
9/12/2016	4.3460	3.8668	3.9695	3.7869	1.3995	0.1608
9/13/2016	4.3520	3.8734	3.9844	3.8065	1.4039	0.1610
9/14/2016	4.3455	3.8716	3.9578	3.7610	1.4028	0.1607
9/15/2016	4.3356	3.8587	3.9575	3.7689	1.3973	0.1604

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