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Polish Weekly Review

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Comment on the upcoming data and forecasts

On Monday Manufacturing PMI (for September) will be released. We expect the index to inch up a bit, consistent with the behavior of German manufacturing index during the same period. On Wednesday the MPC meeting will end with a vote to leave interest rates unchanged. The statement and the press conference afterwards will be dominated by the usual rhetoric about solid economic growth, accelerating consumption and optimal level of interest rates. Despite negative surprises from the real sphere and the upcoming slowdown in growth (which is heading sub-3% due to the decline in investment), the MPC is not ready to change its mind on rates. This moment will arrive early next year, when growth figures for Q4 will be known.

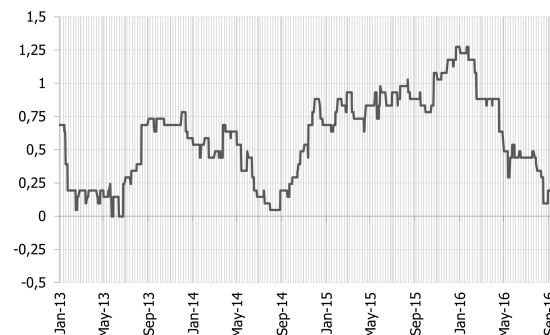
Polish data to watch: October 3rd to October 7th

Publication	Date	Period	mBank	Consensus	Prior
Manufacturing PMI (pts.)	03.10	Sep	52.4	52.1	51.5
MPC decision (%)	05.10	Oct	1.50	1.50	1.50

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	10/6/2016	2000	1.647	9/1/2016
5Y T-bond PS0721	-	3500	2.114	8/18/2016
10Y T-bond DS0726	10/6/2016	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

Slightly down as CPI surprised to the downside. Next week, Manufacturing PMI can move the Polish surprise index in either direction.

* 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 2017, and private investment seems to be locally, negatively affected by spillovers from public investment gap, lower absorption of EU funds and 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 are still a possibility (most likely in early 2017). We expect the MPC to finally acknowledge deflation risks amid the on-going weakness in GDP growth and another round of monetary policy stimulation globally. Lower risk premia will certainly help.

Financial markets

- Zloty has moved towards the lower bound of its range, thanks to (relatively) hawkish MPC and global easing of monetary conditions. Due to the weakness in exports and country risks still present, we expect Zloty to remain weak for the time being.
- The prevailing event risk for PL assets, the CHF conversion, moved to the background, as its details are unlikely to be announced soon.
- As the expectations for Fed hike moved towards December, market focus is now on US elections and their possible impact on the economy and geopolitics. With the race as tight as it is now, the elections pose a major risk for EM assets, probably higher than Brexit.

mBank forecasts

	2012	2013	2014	2015	2016 F	2017 F
GDP y/y (%)	1.6	1.3	3.3	3.4	2.8	3.2
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

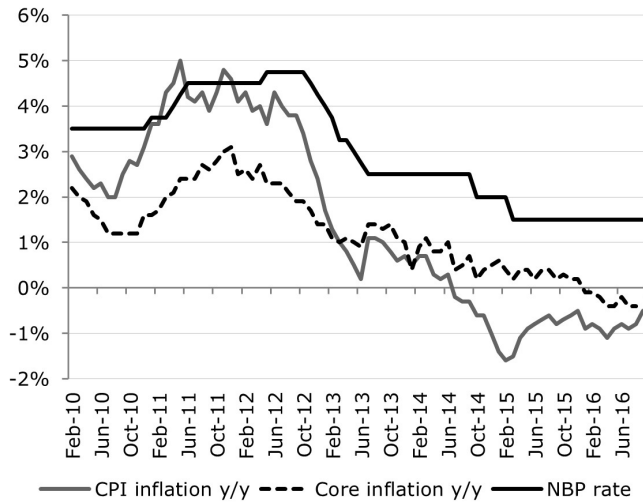
	2016	2016	2016	2016	2017	2017	2017	2017
	Q1	Q2	Q3 F	Q4 F	Q1 F	Q2 F	Q3 F	Q4 F
GDP y/y (%)	3.0	3.1	2.7	2.5	2.7	3.1	3.4	3.5
Individual consumption y/y (%)	3.2	3.3	3.8	4.2	4.3	4.1	3.8	3.5
Public Consumption y/y (%)	4.4	4.4	4.0	1.0	2.4	2.4	2.4	2.4
Investment y/y (%)	-1.8	-4.9	-6.5	-4.0	-2.0	2.0	6.0	6.5
Inflation 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	1.71	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	4.30	4.35	4.35	4.30	4.25	4.25
USD/PLN (eop)	3.73	3.94	3.84	3.95	4.03	3.98	3.94	3.94

F - forecast

Economics

CPI

September growth of consumer prices was lower than our forecast and the market consensus. At -0.5% y/y, deflation eased modestly from -0.8% recorded in August. It is only a flash reading, therefore we can only make some conjectures as for the composition of the price index.



Whatâ€™s in the cards as the source of surprise then? Lower food prices (but it would stand in stark contrast with recent month's readings and general trend; nevertheless, such abrupt changes happened in the past), much lower prices in the Health category (prices of prescription drugs), higher prices in recreation and culture (no effects of 500+ programme). It may also be the case that such a low reading emanates from the lack of any inflation pressure across many categories. Details will be published on October 11th.

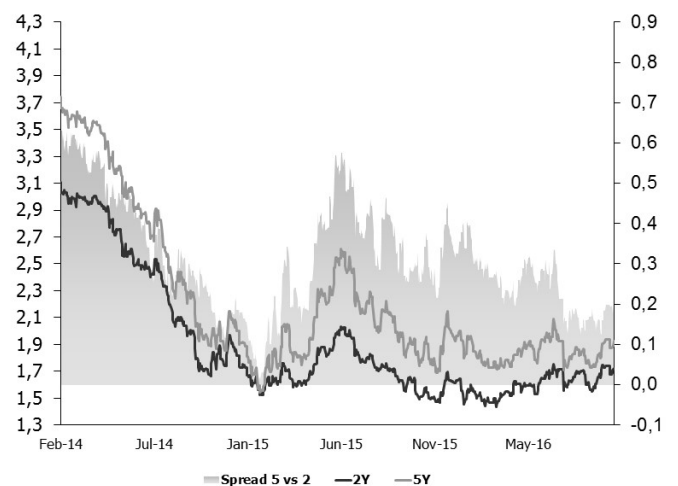
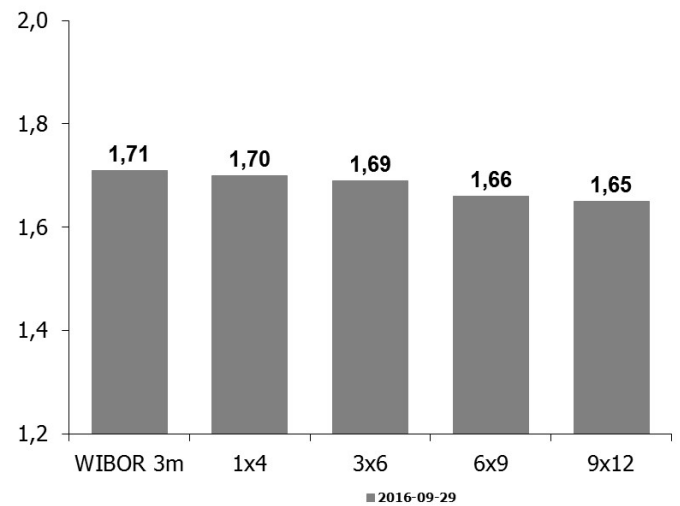
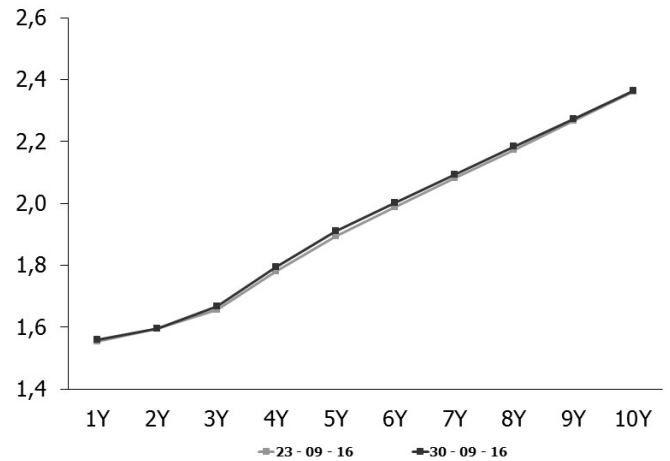
Next months are determined by statistical base. Inflation in October/November is going to be positive. Momentum stays low, though. It should not be an excuse for the MPC to utter more hawkish signals then. Let's wait for a few months to see how the monetary body reacts to lower growth statistics. History shows that 3% realized growth rate may be regarded as an important decision threshold. As we see the next quarters of GDP growth below 3%, we also think such a mechanism may stimulate expectations for monetary easing in Poland.

Fixed income

Who wants a new 10y benchmark?

As we expected, market moved our way in spreads. ASW moved 5y/PS0721 from 35/33 to 41/38, 10y/DS0726 from 63/61 to 64/62. The last huge bond auction pushed prices down and the market still looks heavy. Spread PS0721/DS0726 is at 59bps now and looks cheap comparing to the smoothed yield curve. Next Thursday, the Ministry of Finance will offer 3-6bn OK1018 and a new 10y benchmark, DS0727. The market probably will go short in the long end to find some space for a new benchmark. Changes in Polish politics, probability of change in Poland's rating and US presidential elections don't put investors in good mood to buy Polish bonds.

IRS curve



Money market

CPI

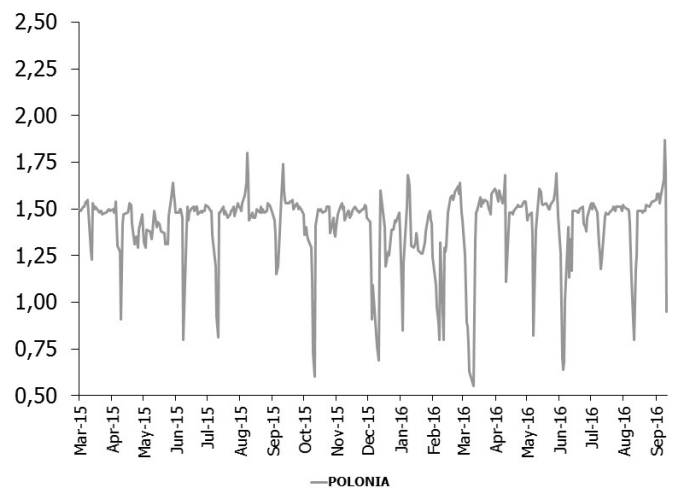
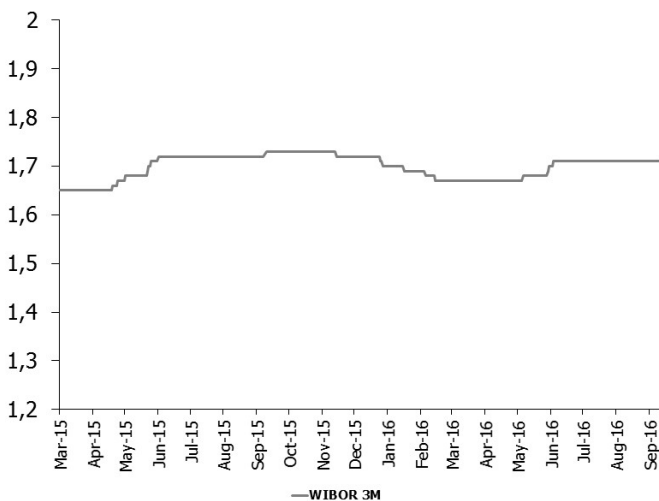
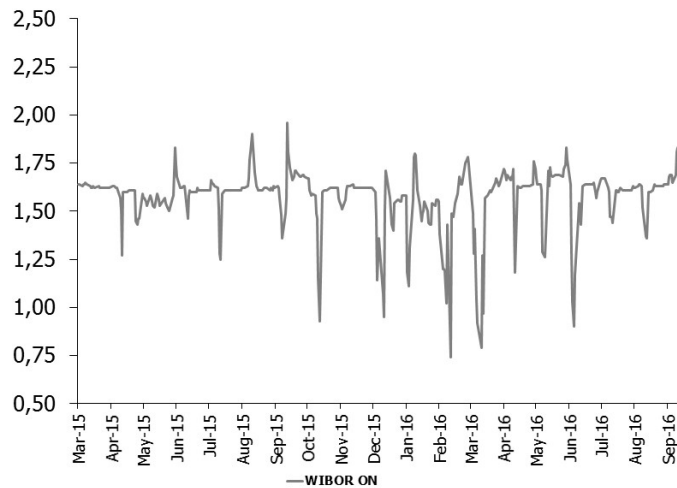
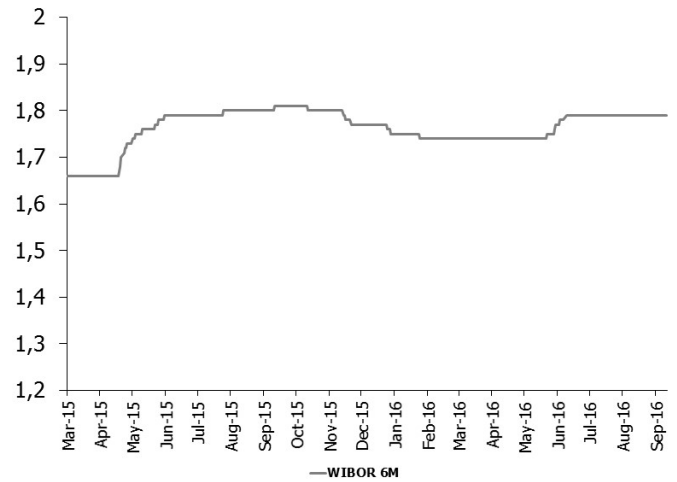
Flash CPI came out lower than market expectations (-0.5% vs. -0.4%). As one could expect, yield curve fell afterwards by 2-3 bps. This somewhat muted reaction might be explained by the MPC rethoric and the overall trend in CPI which should lead us to positive territory in the next few months.

One step from disaster last week made NBP angry and they refused to host NBP-bills auction on Thursday. Overnight rollercoaster brought Polonia to 0.95% from 1.80% lvls in the previous days.

Ref rate vs Polonia averages:

30 day: 0 bp

90 day: 5 bp



Forex

Spot – PLN rally looks bit fatigued It was again a very calm week for EUR/PLN and we had another attempt to break to the downside. The low was 4.2670, which leaves the 4.25-4.27 support zone intact. Later in the week, the fear around the Deutsche Bank situation, and simply demand for EUR, pushed the rate to the high of the week, 4.3190. Technically, EUR/PLN looks well supported at current levels. Which nicely translates in to our base case scenario of the 4.27-4.37 range for the time being. The government reconstruction was widely ignored by the market.

Options – EUR/PLN vols – lower The realized volatilities are still trading at their lows. Slightly weaker PLN and sourer market sentiment, pushed vols a tic higher. But there is absolutely no rush to buy vols, at least not because of the Gamma performance. 1 month EUR/PLN ATM mid is at 6.0% (0.5% higher), 3 months EUR/PLN is 6.4% (0.2% higher) and, finally, 1 year is fixing at 7.4% (unchanged). The skew and currency spread were roughly unchanged.

Short-term forecasts

Main supports / resistances:
 EUR/PLN: 4.23 / 4.35
 USD/PLN: 3.75 / 4.00

Spot Position: Long EUR/PLN.

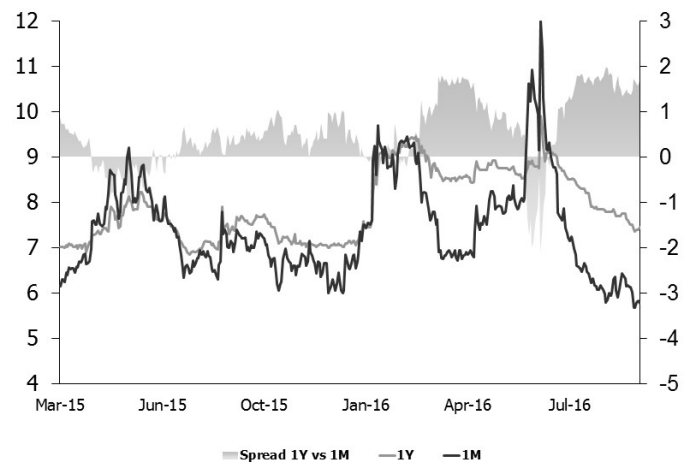
We are long EUR/PLN from 4.3170 and 4.2870. The stop is now at 4.2550 and we are hoping to see 4.38/4.40 and, depending on the momentum, possibly even 4.41/4.43.

We stick to our position, which is now back above the breakeven. We had a generally undisturbed risk rally after Brexit, and at least some technical correction should be due. We don't have any idea what a potential risk off trigger would be. We think that Trump risk is not fully discounted. 70% odds of Clinton victory does not seem reassuring. It seems the race is more balanced. Let's learn something from the Brexit lesson.

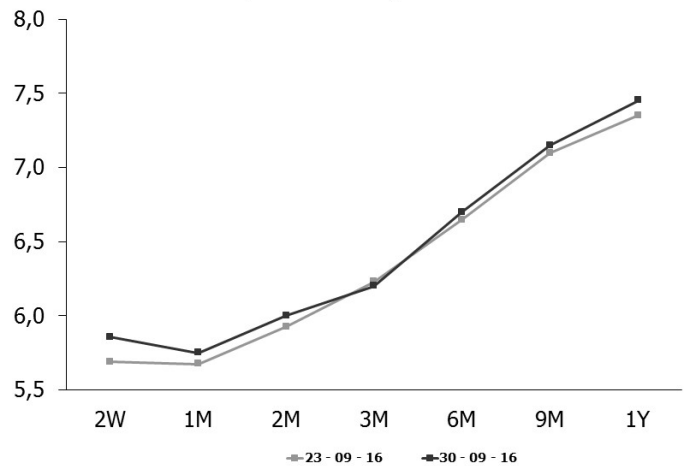
Options Selectively long Vega

Implied volatilities have come off significantly over the past weeks. There is a lot of uncertainty surrounding Brexit, the 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 backend EURPLN curve.

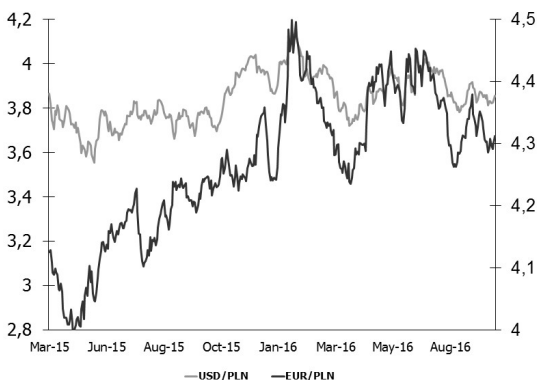
EURPLN volatility



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
9/23/2016	1.82	1.71	1.94	1.69	2.09	1.71	1.70	1.68	1.64	1.62	1.61	1.73
9/26/2016	1.98	1.71	1.96	1.69	2.08	1.71	1.70	1.68	1.65	1.63	1.62	1.73
9/27/2016	2.05	1.71	2.13	1.69	2.11	1.71	1.70	1.69	1.65	1.64	1.63	1.73
9/28/2016	1.79	1.71	1.88	1.69	1.99	1.71	1.70	1.69	1.66	1.64	1.63	1.73
9/29/2016	1.65	1.71	1.65	1.69	1.65	1.71	1.70	1.69	1.66	1.65	1.64	1.74

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
9/23/2016	1.710	1.474	1.635	1.578	1.960	2.232	2.405	2.949
9/26/2016	1.710	1.474	1.635	1.578	1.960	2.232	2.405	2.949
9/27/2016	1.710	1.474	1.635	1.578	1.960	2.232	2.405	2.949
9/28/2016	1.710	1.474	1.635	1.638	1.990	2.290	2.447	2.985
9/29/2016	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	
9/23/2016	5.68	6.23	6.65	7.35	7.35	2.04	0.60	
9/26/2016	5.80	6.23	6.68	7.40	7.40	2.04	0.60	
9/27/2016	5.83	6.25	6.68	7.40	7.40	2.04	0.67	
9/28/2016	5.78	6.25	6.68	7.45	7.45	2.04	0.62	
9/29/2016	5.75	6.20	6.70	7.45	7.45	2.04	0.67	

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
9/23/2016	4.2939	3.8328	3.9495	3.7959	1.4020	0.1589
9/26/2016	4.3075	3.8324	3.9596	3.8081	1.4053	0.1594
9/27/2016	4.2972	3.8227	3.9418	3.8018	1.4006	0.1590
9/28/2016	4.2918	3.8264	3.9398	3.7981	1.3943	0.1589
9/29/2016	4.3014	3.8354	3.9479	3.7798	1.3969	0.1591

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