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Polish Weekly Review

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Comment on the upcoming data and forecasts

On Monday the NBP will publish its quarterly business sentiment report. We are especially looking for any signs of rebound in investment activity, however we do not expect to find many of them. On the next day CSO's Statistical Bulletin for September will be published. Preliminary MFLSP data brought a slight drop in unemployment rate. The Bulletin will also shed more light on recent surprises from the real sphere and labour market data and help to put the finishing touch to GDP forecasts for the third quarter.

Polish data to watch: October 24th to October 28th

| Publication | Date | Period | mBank | Consensus | Prior |
|-----------------------|-------|--------|-------|-----------|-------|
| NBP Enterprise survey | 24.10 | Q4 | | | |
| Unemployment rate (%) | 25.10 | Sep | 8.4 | 8.4 | 8.5 |

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 | 11/3/2016 | 2000 | 1.742 | 10/6/2016 |
| 5Y T-bond PS0722 | - | 4000 | 2.499 | 10/21/2016 |
| 10Y T-bond DS0727 | 11/3/2016 | 4000 | 3.098 | 10/6/2016 |
| 15Y T-bond WS0428 | - | 200 | 3.027 | 7/7/2016 |

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



Comment

Real sphere and labour market data have brought just minor surprises, so the index remains unchanged. We do not expect any change for another week, since preliminary MFLSP unemployment data matches market consensus.

* 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. Hence, we expect 2-3 quarters of sub-3% growth.
- 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.

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 | 1.4 | 3.3 | 3.9 | 2.8 | 3.2 |
| CPI Inflation y/y (average %) | 3.7 | 0.9 | -0.1 | -0.9 | -0.6 | 1.3 |
| 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 | -0.8 | 0.2 | 1.3 | 1.4 | 1.2 | 1.1 |
| Unemployment rate (% eop) | 10.0 | 8.9 | 8.5 | 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 | 1.76 | 1.65 | 1.35 | 1.30 | 1.30 | 1.30 |
| 10Y Polish bond yields (% eop) | 2.84 | 2.91 | 2.92 | 3.00 | 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 | 3.82 | 3.95 | 4.03 | 3.98 | 3.94 | 3.94 |

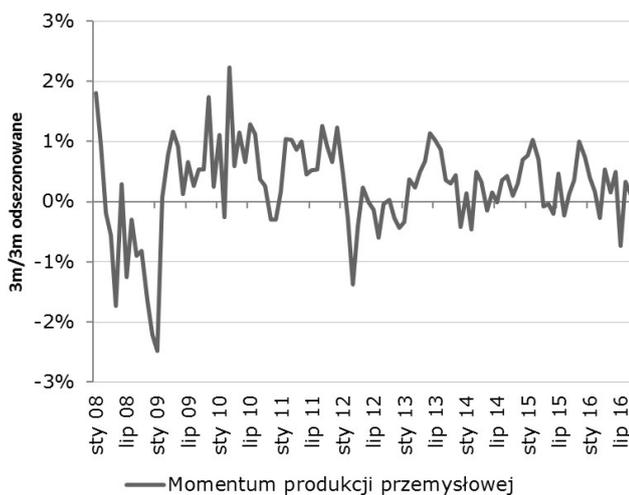
F - forecast

Economics

Full set of Q3 data confirms further slow-down. GDP growth set to fall to 2.6% with strong labour market.

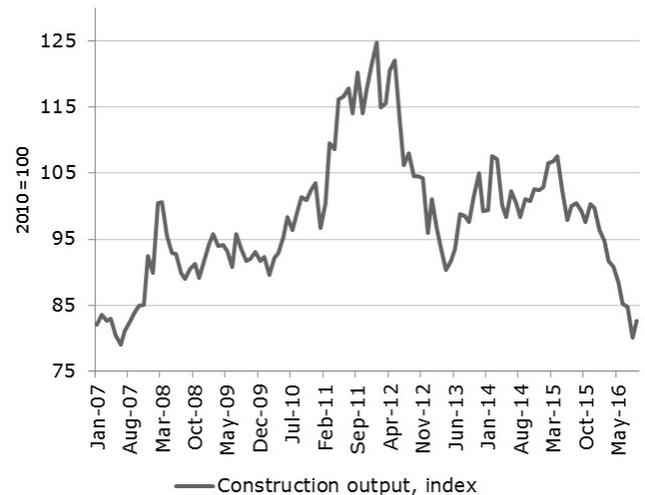
After the full set of September data we reaffirm our forecast of 2.6% growth in Q3. Such a figure (to be released in mid-November) would be an unpleasant surprise for the very optimistic MPC, which is focused on the upcoming end of deflation and regarded GDP growth as stable. Strong labour market will probably not impact the MPC's thinking. Contrary to popular opinions, the relationship between the labour market and inflation is far from straightforward: throughout the world it is definitely weaker than before the crisis (flat Philips curve) and wages have been growing fast (and faster than productivity) since 2013. The latter has had no impact on inflation whatsoever. The market should see Q3 GDP figure (with full extent of the slump in investment quite visible) as a rationale for pricing in at least a risk of monetary easing. Now, lets look into details:

Industrial production grew in September by 3.2% y/y after 7.5% y/y growth in August. Working day difference was disadvantageous: 0 vs. +1. After seasonal adjustment, production grew by 3.3% yearly and fell by 0.2% on a monthly basis. Looking into details, 26 out of 34 sections grew in September, mostly export-oriented ones. As usually, among those which fell were energy production, but also manufacturing of chemical and petrochemical products. Relatively lower rise in production is generally a result of slowdown in German exports (downward trend is visible for several quarters), but also weaker investment in Poland. Rebound in consumption (driven by government children subsidy "500+" programme) is mainly fuelling imports and does not boost local production.

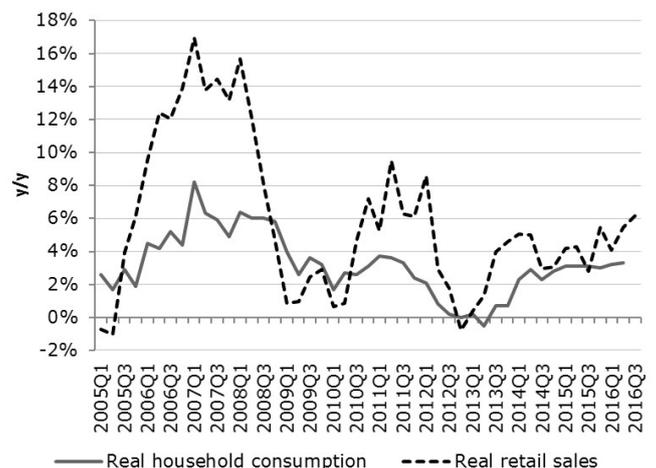


Industrial production momentum is currently only just above zero – it suggest GDP growth below 3% y/y. We are not too optimistic about end of the year, either. Latter months of 2015 brought high statistical base in manufacturing (1.0-1.5% each month – associated with EU-financed spending ahead of the end of the previous programming period), so next three months could exhibit very low IP growth (even negative).

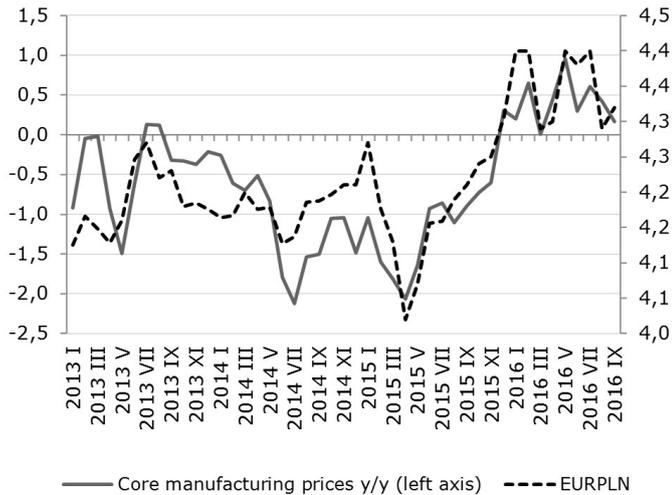
Construction output declined by 15.3% y/y, a bit less than forecast (market consensus and our expectations – ca. -19% y/y). At the same time, it is the first positive surprise from construction and a first monthly increase in construction output (by 3.3%) in a long time. One should not lose the big picture, though. Activity has dropped to 2007 levels and all available information (legislative setbacks related to pipeline construction, lack of ready projects in local governments and railways, softer residential investment) point to a delayed rebound. Double-digit declines are certain until the end of the year or even longer.



Retail sales disappointed this time, having grown by 4.8% y/y in September (6.3% in constant prices). Consensus forecast suggested a slightly bigger figure, ours was even more optimistic. The details of the release are to some extent unsurprising: price and statistical base effects worked in tandem to boost fuel sales (swung from -4.5 to +3% y/y); high statistical base depressed both car sales (down from +15.9 to +3.3% y/y) and the notoriously volatile Other category (from -0.3 to -8.4% y/y). Durable and semi-durable goods sales were the main source of the disappointment, having decelerated significantly. The setback in September suggests that the uptick in retail sales in August was not as meaningful as initially thought. The impact of "500+" programme is definitely real – after all, the upward trend in sales is real, but there is no consumer boom and consumption should accelerate to 4-4.5% y/y in Q3 and Q4.

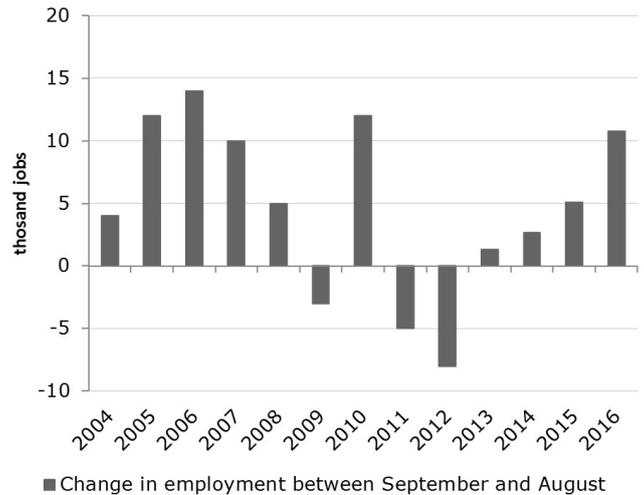


Deflation in **producer prices** finally ended in September. Yearly dynamic grew to 0.2%, after -0.1% in August. On a monthly basis prices grew by 0.3%, but after adjusting by prices set globally, they remained unchanged since last month. Coke and refined petrol product categories recorded solid monthly growth (by 4.2%). Taking into account stable exchange rate, rise in global resources prices had much more significant impact than we have predicted. For the first time in half a year, correlation between exchange rate and manufacturing PPI has reverted. Category that significantly added to overall figure was water supply and sewage.

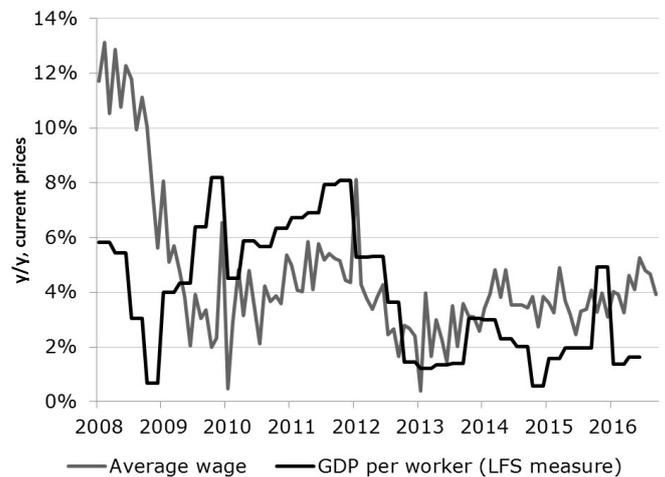


Statistical base lowers risk of return to negative yearly dynamic. However, global deflationary environment with structurally low growth still poses such a risk. Moreover, positive effects of weak PLN are diminishing and according to latest PMI surveys will fade away further. Growing producer prices will not influence consumer prices.

Moving to labour market, **employment** in the enterprise sector rose in September by 3.2% y/y, higher than market consensus and our forecast (3.1%). Yearly dynamics came back from slightly lower number in August (3.1%). On a monthly basis 10k jobs were added, which is the best result since 2010 (see chart below). Details will be known by the end of the month, so we can now only speculate about reasons for this surprise. Even if strong growth trend in some categories (metals, rubber and plastic) had been sustained, it would not have added up to such rise. Missing 5 thousand jobs could come from a rebound in information and communication category, whereas the same number disappeared suddenly in August (without revision this means that one company fell out the sample for one month and returned immediately). Such gyration can also be correlated with order cycles, we haven't studied yet this phenomenon. In general, labour market in 2016 is red hot. However, those releases could be pumped by the on-going shift between different types of employment (from so called junk contracts), NBP estimates this number at 300k.



Average gross wage grew by 3.9% y/y, down from August's pace of 4.7% y/y. As in every month, we are unable to comment on the details of the release – the Statistical Bulletin (due in one week) should shed some light on the subject. After working day effects are included, wage growth probably barely budged vis-à-vis the previous month. Contrary to some leading survey-based indicators of wage growth and the on-going tightening of the labour market, there is no material acceleration in wage growth. It is possible that wage growth is currently constrained by the huge influx of immigrant labour from Ukraine (around 1 million now). Such a hypothesis would explain why services prices have not grown and why the introduction of child subsidy programme did not have a more visible impact on the labour market.





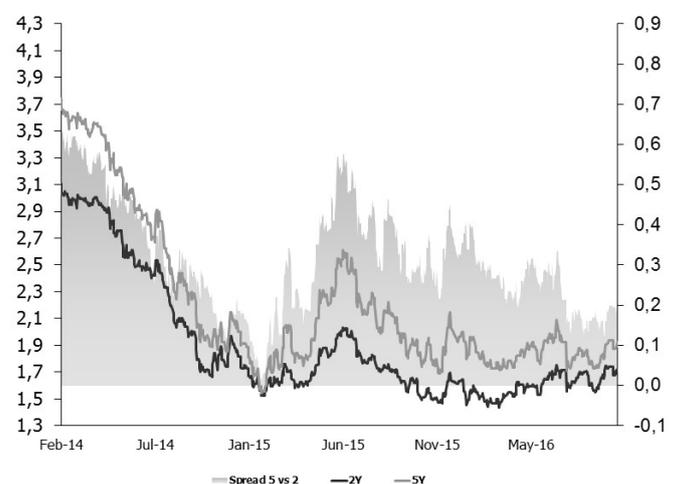
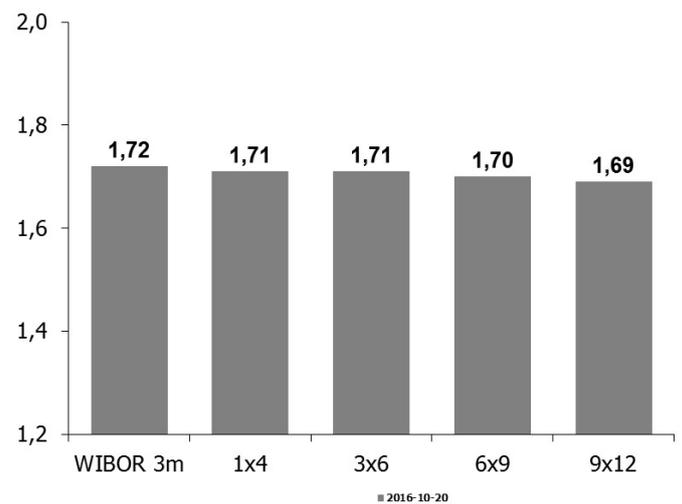
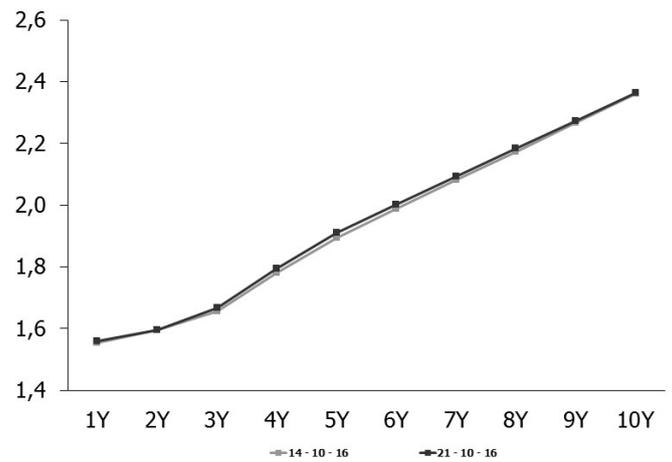
Fixed income

New 5y benchmark has arrived

Today we had an auction, on which NEW PS0422, WZ0121 and WZ1122 were sold. Demand exceeded 12bio, while supply was almost 10bio. Bid/cover ratio for the new benchmark was 120%. Curve looks very flat, PS0721/DS0726 spread is being traded at 53 bps. Since we expect DS0727 on the next auction, curve steepening seems likely. We expect this part of curve to move up by few bps.

We still see large demand for short end bonds, PS1016 expires next week and some coupons are paid as well. We expect short end bonds to perform well.

IRS curve





Money market

Stable weak ahead of us

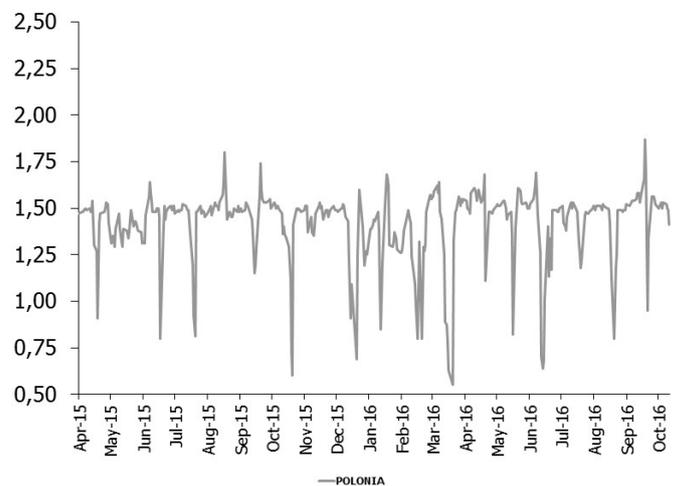
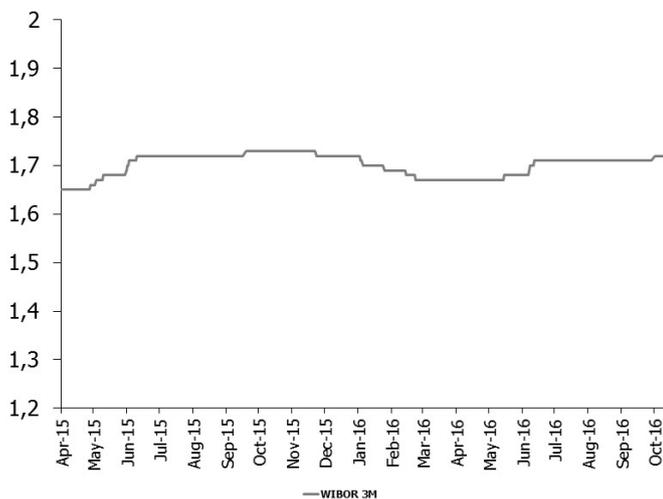
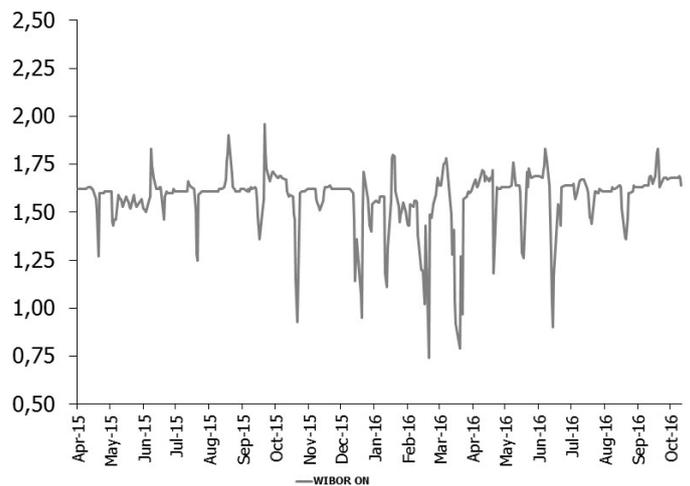
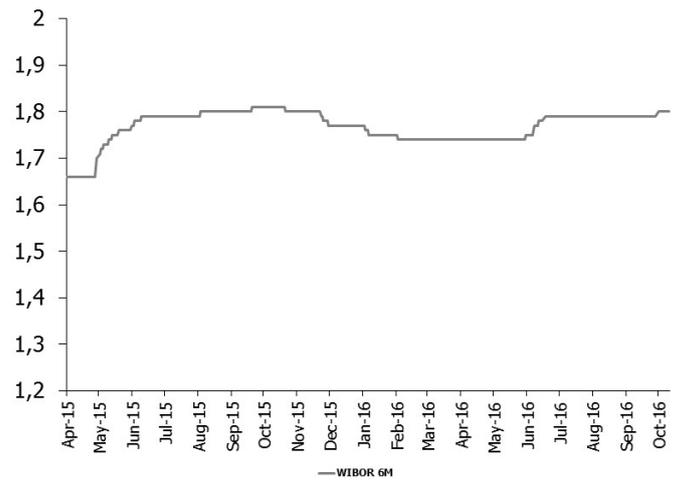
The front end of the Polish curve has stalled, pricing no change in rates for an extended period. Two and one year swaps are trading close to corresponding WIBORs, and it's hard to expect significant deviation from these levels at the moment. With no data due next week we should follow core markets, although the shortest bonds are less responsive to these moves.

Last week of the month should be quite stable. NBP sold around PLN 68 bn, which is enough to square the market and, additionally, we will have cash back from NBP on the last day of the reserve period.

Ref rate vs Polonia averages:

30 day: -1 bp

90 day: 4 bp



Forex

Spot – Still consolidating in the 4.29-4.34 mini-range

It was another boring week for EUR/PLN. PLN is a bit softer, with a trading range of 4.2900-4.3350 (the low and the high of the week, respectively). It was USD/PLN who had all the fun, rising from 3.8750 to 3.9800 (low/high of the week). We felt a bit of the stress, prior to the ECB meeting, as the word tapering was everybody's fear. But once again Mr. Draghi has managed to calm the market with his dovish speech. PLN was not able to benefit from that, as short positions in USD/PLN were squeezed. Our central scenario is still the 4.27-4.37 range.

Options – EUR/PLN vols – consolidating Vols are lower again, and slightly weaker PLN was not able to prevent that. The move was too slow and orderly to make options sellers worry. 1 month EUR/PLN ATM mid is at 5.8% (0.1% lower), 3 months EUR/PLN is at 6.25% (0.05% lower) and, finally, 1 year is fixing at 7.3% (unchanged). Although realized volatility of USD/PLN was quite high, it wasn't reflected in the currency spread (USD/PLN vol vs. EUR/PLN vol), which stayed unchanged.

Short-term forecasts

Main supports / resistances:

EUR/PLN: 4.25 / 4.37

USD/PLN: 3.75 / 4.00

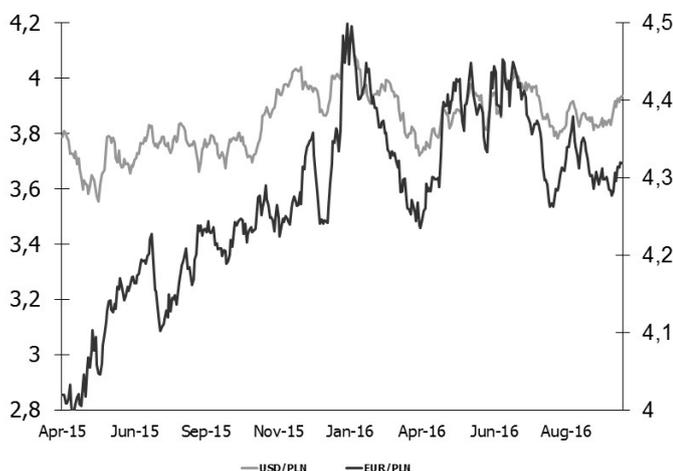
Spot Position: Long EUR/PLN.

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

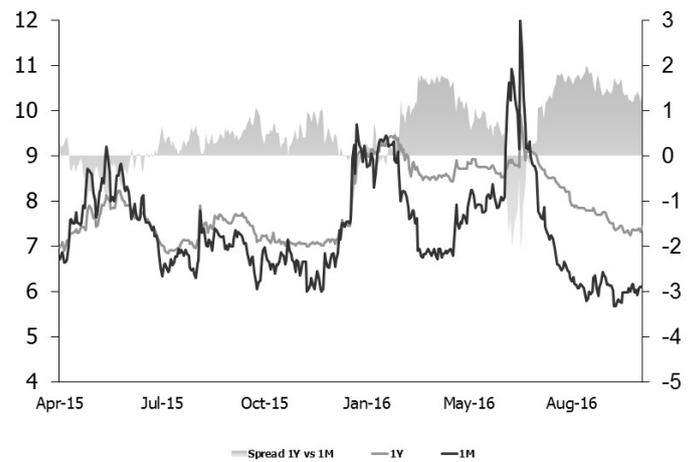
Our position is showing a quite mixed performance, but we are keeping it. The market is lacking momentum, but we think the PLN rally is a bit fatigued. The position is also most likely skewed to PLN longs, and all we need is a spark.

Options Selectively long Vega

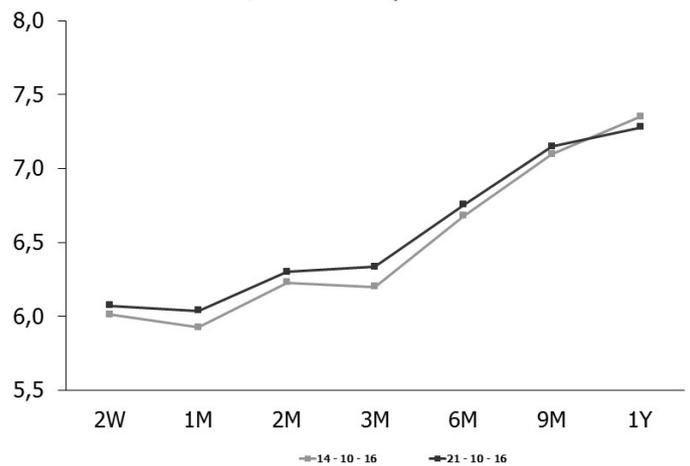
Implied volatilities have come off significantly over the past weeks. There is a lot of uncertainty surrounding the Brexit, postponed decision on forced conversion CHF mortgages, Constitutional Court conflict, U.S. elections, so we stick to our position – we have still selective longs in backend EUR/PLN 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 |
| 10/14/2016 | 2.10 | 1.72 | 2.17 | 1.70 | 2.16 | 1.73 | 1.72 | 1.72 | 1.71 | 1.73 | 1.72 | 1.79 |
| 10/17/2016 | 2.18 | 1.72 | 1.85 | 1.70 | 2.05 | 1.73 | 1.72 | 1.74 | 1.72 | 1.74 | 1.73 | 1.80 |
| 10/18/2016 | 2.13 | 1.72 | 2.19 | 1.70 | 2.13 | 1.74 | 1.72 | 1.71 | 1.71 | 1.71 | 1.72 | 1.80 |
| 10/19/2016 | 1.52 | 1.72 | 1.60 | 1.70 | 1.63 | 1.74 | 1.71 | 1.71 | 1.71 | 1.70 | 1.70 | 1.79 |
| 10/20/2016 | 2.11 | 1.72 | 2.19 | 1.70 | 2.12 | 1.74 | 1.71 | 1.71 | 1.70 | 1.69 | 1.70 | 1.78 |

| 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 | 10/6/2016 | 10/25/2018 | 96.54 | 1.74 | 2000 | 4838 | 2448 |
| PS0421 | 8/18/2016 | 7/25/2021 | 98.31 | 2.11 | 3500 | 4968 | 3844 |
| DS0727 | 10/6/2016 | 7/25/2027 | 94.57 | 3.10 | 4000 | 5916 | 4359 |

| Fixed income market rates (closing mid-market levels) | | | | | | | | |
|---|----------|-----------|--------|--------|--------|--------|---------|--------|
| Date | 1Y WIBOR | 1Y T-bill | 2Y IRS | OK0715 | 5Y IRS | PS0718 | 10Y IRS | DS1023 |
| 10/14/2016 | 1.730 | 1.474 | 1.635 | 1.578 | 1.960 | 2.232 | 2.405 | 2.949 |
| 10/17/2016 | 1.730 | 1.474 | 1.635 | 1.578 | 1.960 | 2.232 | 2.405 | 2.949 |
| 10/18/2016 | 1.740 | 1.474 | 1.635 | 1.578 | 1.960 | 2.232 | 2.405 | 2.949 |
| 10/19/2016 | 1.740 | 1.474 | 1.635 | 1.638 | 1.990 | 2.290 | 2.447 | 2.985 |
| 10/20/2016 | 1.740 | 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 |
| 10/14/2016 | 5.93 | 6.20 | 6.68 | 7.35 | 7.35 | 2.11 | 0.60 |
| 10/17/2016 | 6.08 | 6.28 | 6.70 | 7.40 | 7.40 | 2.11 | 0.60 |
| 10/18/2016 | 6.11 | 6.30 | 6.78 | 7.31 | 7.31 | 2.06 | 0.60 |
| 10/19/2016 | 6.10 | 6.35 | 6.83 | 7.43 | 7.43 | 2.11 | 0.61 |
| 10/20/2016 | 6.04 | 6.34 | 6.75 | 7.28 | 7.28 | 2.11 | 0.61 |

| PLN Spot performance | | | | | | |
|----------------------|--------|--------|--------|--------|--------|--------|
| Date | EURPLN | USDPLN | CHFPLN | JPYPLN | HUFPLN | CZKPLN |
| 10/14/2016 | 4.2955 | 3.8965 | 3.9457 | 3.7403 | 1.4059 | 0.1589 |
| 10/17/2016 | 4.3142 | 3.9265 | 3.9709 | 3.7697 | 1.4072 | 0.1596 |
| 10/18/2016 | 4.3137 | 3.9148 | 3.9613 | 3.7645 | 1.4064 | 0.1596 |
| 10/19/2016 | 4.3204 | 3.9285 | 3.9730 | 3.7973 | 1.4098 | 0.1599 |
| 10/20/2016 | 4.3189 | 3.9359 | 3.9785 | 3.7970 | 1.4063 | 0.1598 |

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