

December 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](mailto:ernest.pytlarczyk@mbank.pl)

Marcin Mazurek, PhD  
senior analyst  
tel. +48 22 829 01 83  
[marcin.mazurek@mbank.pl](mailto:marcin.mazurek@mbank.pl)

Piotr Bartkiewicz  
analyst  
tel. +48 22 526 70 34  
[piotr.bartkiewicz@mbank.pl](mailto:piotr.bartkiewicz@mbank.pl)

Karol Klimas  
analyst  
tel. +48 22 829 02 56  
[karol.klimas@mbank.pl](mailto: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](mailto:wojciech.dunaj@mbank.pl)

Marcin Turkiewicz  
head of fx trading  
tel. +48 22 829 01 67  
[marcin.turkiewicz@mbank.pl](mailto: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](mailto:inga.gaszkowska-gebska@mbank.pl)

Jacek Jurczyński  
head of treasury sales  
tel. +48 22 829 15 16  
[jacek.jurczynski@mbank.pl](mailto: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

#### Our view in a nutshell

##### Economics

- End of deflation in Poland
- Polish GDP confirmed in Q3 at 2.5% y/y. We expect Q4 figure to come at 1.7% y/y

##### Fixed income

- The sell-off continues

##### Money market

- December liquidity looms

##### FX market

- Spot – EUR/PLN weaker
- Options – EUR/PLN vols consolidating, USD/PLN vols higher

page 2

page 3

page 5

page 6

page 7

### Comment on the upcoming data and forecasts

The MPC will hold rates on next week's meeting. We expect, however, the MPC to tone down its hawkish rhetoric. Recent data have been massively at odds with the NBP's forecasts and doubts regarding next year's growth have emerged. As a result, it is likely that the MPC will at least acknowledge the possibility of rate cuts should the economy slow down further.

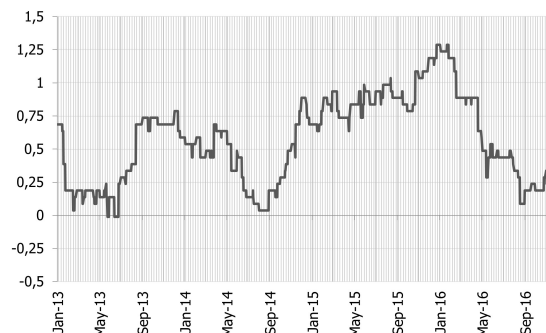
### Polish data to watch: November 5th to December 9th

Publication	Date	Period	mBank	Consensus	Prior
MPC decision (%)	07.12	Dec	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	12/15/2016	2000	1.742	10/6/2016
5Y T-bond PS0722	-	4000	2.499	11/17/2016
10Y T-bond DS0727	12/15/2016	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

Slightly up after the PMI. Next week will bring stabilization to Poland's surprise index as no relevant macro releases are scheduled for next week.

\* 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

- 2016 unfolded as the year of record divergence between investment growth and consumption growth. The latter is the only engine of growth.
- GDP growth will likely bottom at 1.7% y/y in Q4, when investment drought and base effects reach their peaks. Next year growth will accelerate to the average of 3%, as investment returns to growth. It will, however, come no sooner than in mid-year and the effects of 500+ programme will begin to fade by then. The period of lower growth is not over.
- Polish deflation is over. During the next two quarters inflation will be boosted by statistical base effects, weak PLN and commodity price spike (headline inflation to reach 1.5% at the turn of Q1 and Q2). We are skeptical of genuine inflationary pressures in the Polish economy, though.
- Rate cuts are still a possibility (but MPC is very unwilling to ease and global trend is for tightening). We expect the MPC to finally acknowledge downside risks for Polish GDP growth.

### Financial markets

- Global reflation trades weakened the Zloty by raising risk-free rates and encouraging capital outflows from EM assets. 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.
- Stronger dollar and upcoming Fed hike (December) hold in check any strengthening of Polish zloty.

### mBank forecasts

	2012	2013	2014	2015	2016 F	2017 F
GDP y/y (%)	1.6	1.4	3.3	3.9	2.5	3.0
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

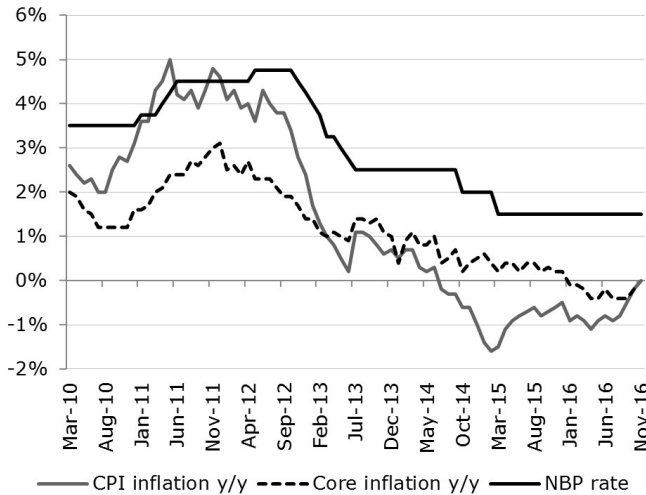
	2016	2016	2016	2016	2017	2017	2017	2017
	Q1	Q2	Q3 F	Q4 F	Q1 F	Q2 F	Q3 F	Q4 F
GDP y/y (%)	3.0	3.1	2.5	1.7	2.2	2.8	3.4	3.5
Individual consumption y/y (%)	3.2	3.3	3.9	4.6	4.3	4.0	3.8	3.5
Public Consumption y/y (%)	4.2	3.9	4.9	1.0	3.0	3.0	3.0	3.0
Investment y/y (%)	-2.2	-5.0	-7.7	-4.5	-2.5	3.5	6.0	6.0
Inflation rate (% average)	-0.9	-0.9	-0.8	0.2	1.3	1.4	1.2	1.1
Unemployment rate (% eop)	9.9	8.7	8.3	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	1.80	1.70	1.60	1.60	1.70
10Y Polish bond yields (% eop)	2.84	2.91	2.92	3.60	3.50	3.40	3.50	3.50
EUR/PLN (eop)	4.24	4.38	4.30	4.50	4.45	4.35	4.25	4.25
USD/PLN (eop)	3.73	3.94	3.82	4.21	4.20	4.14	4.05	4.05

F - forecast

## Economics

### End of deflation in Poland

After 28 months, annual CPI growth in Poland came back from its long journey into negative territory. According to the flash estimate, inflation grew from -0.2% in October to 0.0% y/y in November. On a monthly basis consumer prices grew by 0.1%.

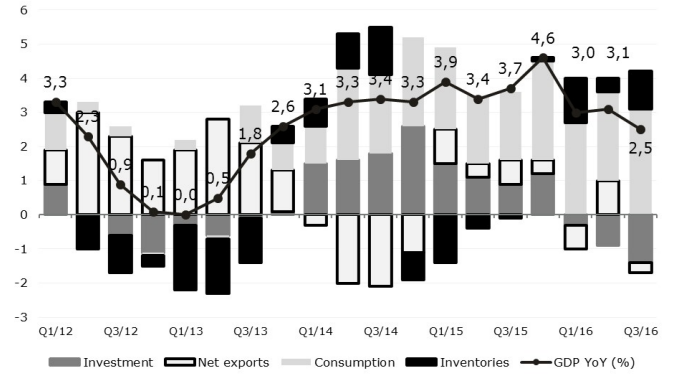


As always, we need to wait until the middle of the month to know the details, but some patterns can already be ascertained from known data. We see risk of higher food prices (0.4% m/m) and stabilization of fuel prices. Other categories should remain more or less unchanged. According to our forecasts, core inflation moved slightly up, from -0.2% a month ago to -0.1% y/y. Price pressure is still very fragile not only in Poland but also in Europe and yearly indices are rising only because of base effects in energy prices.

In the following month we will probably see inflation gradually increasing. At the turn of first and second quarter in 2017 CPI could come close to 1.5% on the back of weak PLN and higher commodity prices. This (global) trend keeps in check pricing of any rate cuts in Poland. Only after several months we will see, if inflation will run out of „statistical” steam and accustom us to positive and stable (but still much lower than NBP target) growth. This will not be a significant change.

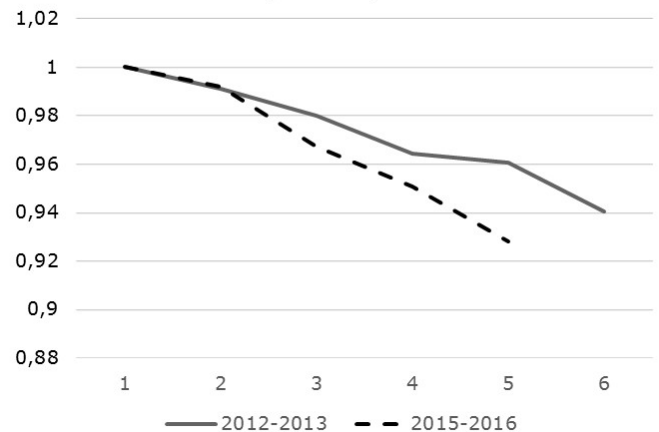
### Polish GDP confirmed in Q3 at 2.5% y/y. We expect Q4 figure to come at 1.7% y/y

Second release confirmed Q3 GDP growth at 2.5% y/y. Looking into details, we see that government’s „Family 500+” programme contributed to consumption not as much as it was initially expected (this category accelerated only from +3.1% at the beginning of the year to +3.9% – remember that early forecasts pointed to 5% growth), even though this programme accounted for 40% of the increase in real household disposable income. Investment (-7.7% y/y) fell more than market consensus and even our down-to-earth forecast. This category’s retrenchment is quite similar to the soft patch noted in 2012-2013, however this one is by now deeper (see chart below). The difference is widening, last quarter would bring only a slight improvement.



GDP got a huge boost from inventories (+1.1 pp) and relatively small setback from net exports (-0.3 pp). The former implies that inventories have already adjusted to the production drop. The upcoming quarters should show more regular, procyclical changes in inventories. The latter category’s behavior is a deviation from other measures of foreign trade (NBP and Eurostat data, industrial production) and could be revised in near future, producing a favorable base for second half of 2017. Moving to next quarters, we see an acceleration of consumption in Q4 and a rebound in investment activity in 2017. However, those would be tempered by weaker exports and negative net exports contribution. Moreover, latest revision of 2015 data (Q4 went up from 4.3% y/y to 4.6%) has created a negative base in Q4 (in public consumption). To summarize, we expect GDP growth to decelerate in Q4 to 1.7% on a yearly basis.

Cummulative decline in investment since cyclical top



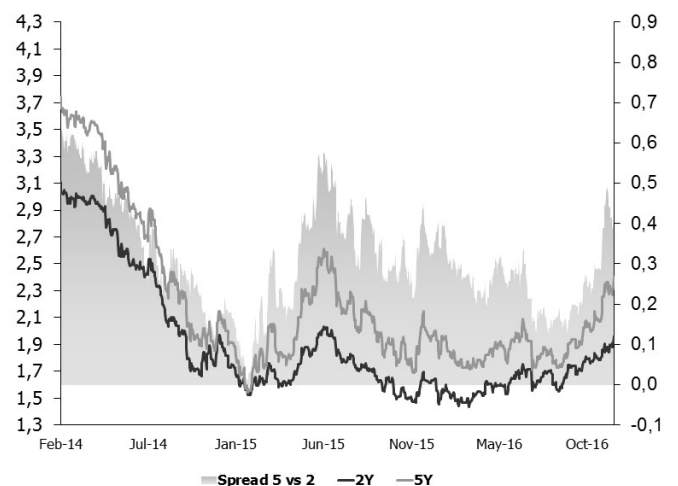
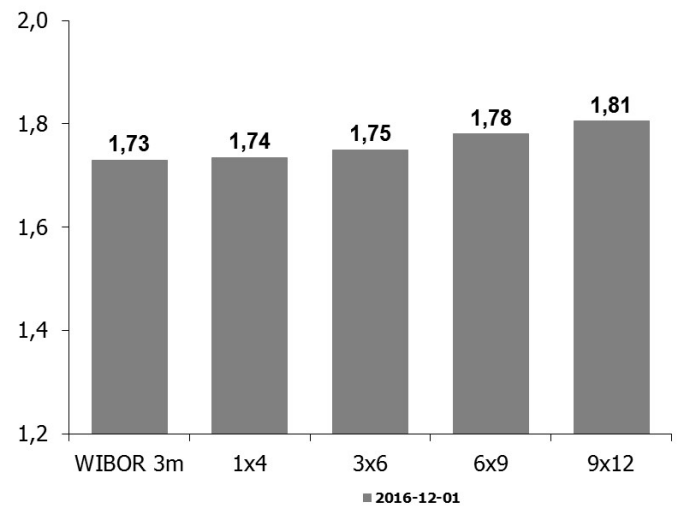
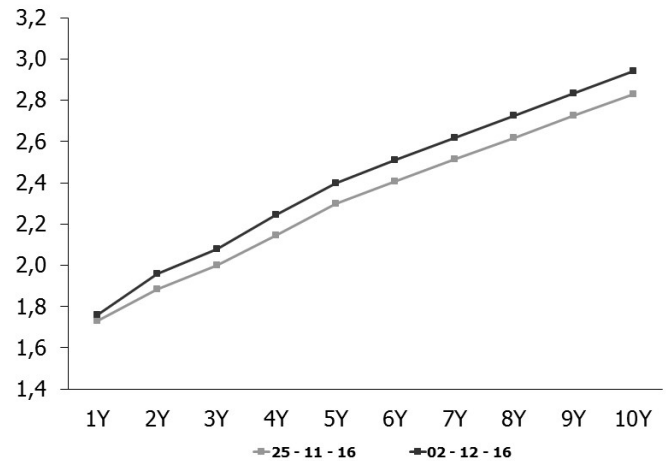
The slowdown is much deeper than analysts expected. We think that investment rebound would be sufficient to drag growth back above 3%, however outlook does not look so bright. Deflationary processes in Europe are hindering imports from Poland and possible escalation of EM problems (higher cost of dollar financing) could hamper diversification of Polish exports, which makes creating genuine inflationary pressures impossible in the medium term. Any rate hikes are thus off the table, even if some are currently priced in. We expect the MPC to stop making overoptimistic comments about state of Polish economy, eventually resulting in much more dovish statements. We are looking forward to further reactions, since investment decline was twice what NBP projected.

## Fixed income

### The sell-off continues

Last week showed the weakness of the market. Global sell-off hit POLGBs as well. DS0726 yield jumped from 3,56% to 3,77%, PS0721 went from 2,83% to 2,92% and OK1018 yield grew from 1,89% to 1,94%. Today yields are 3 bps higher and the curve is still steepening. The PS0721/DS0726 spread is currently traded at 88 bps. Liquidity is getting wider and volatility increases every day. The market doesn't want to take any position, just to skip this year as fast as they can.

IRS curve



## Money market

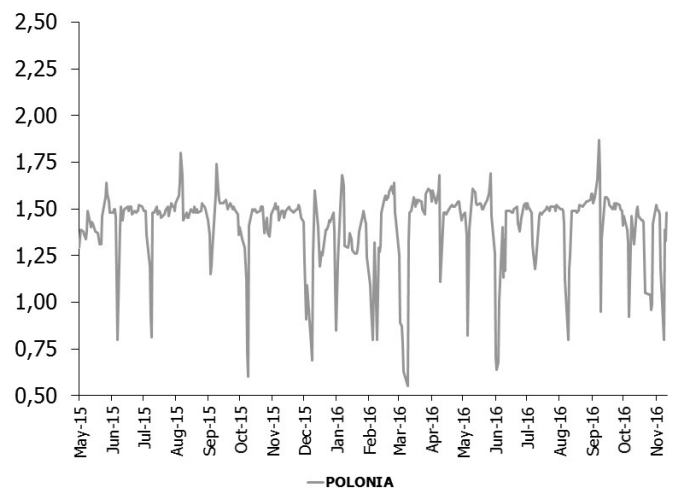
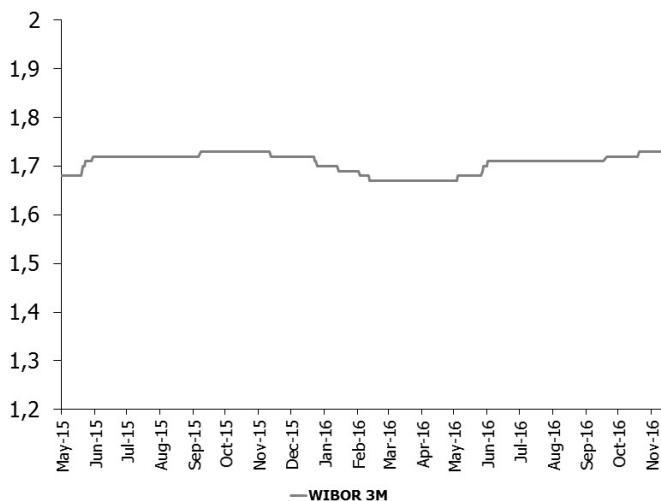
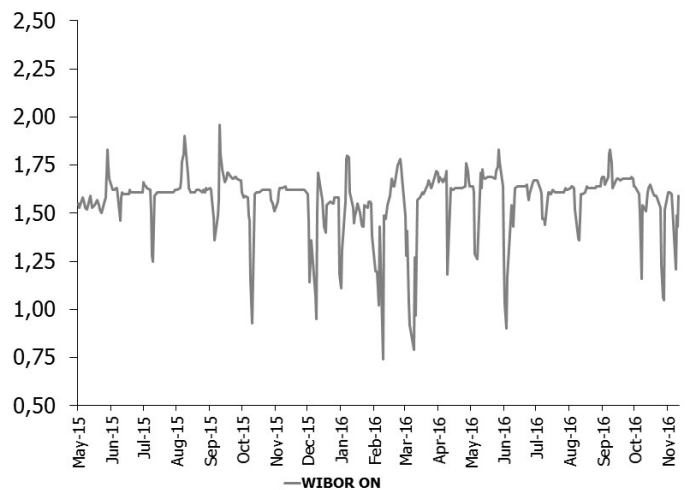
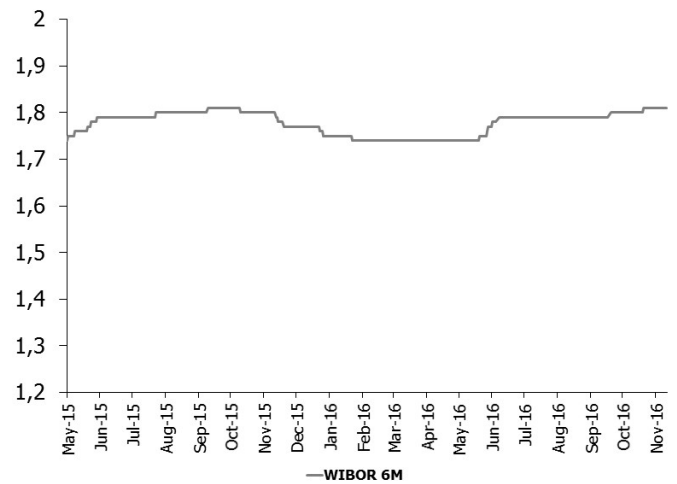
### December liquidity looms

Bond selloff continues all over the world. Polish yield curve grinds higher with 2y swap touching 1,99%. That's nearly a 50 bp hike baked in the 21x24 FRA contract. We can't exclude swaps pricing even more hikes if some SL comes through the very thin December's market. Although we think current 2 year bonds offer very attractive yields (carry), demand may return in January when banks will be able to release their year-end liquidity cushions.

December is usually characterized with high volatility in overnight rates. Banks will try to secure spare liquidity for the year's turn.

Ref rate vs Polonia averages:

- 30 day: 21 bp
- 90 day: 8 bp



## Forex

**Spot – EUR/PLN weaker** Last week EUR/PLN scrambled to its new high. It has easily broken the 4.45 – 4.47 resistance zone and spiked to 6 month high of 4.4940. The probability that we will revisit the Brexit spike of 4.5390 is big. The global sentiment is not encouraging. The Polish factor is not really helping, with fiscal position looking worse going forward. Generally, investors are cautious ahead of today's S&P decision about Poland's rating and U.S jobs report, as well as the looming result of Italian referendum that could set the market's tone in the coming days.

**Options – EUR/PLN vols consolidating, USD/PLN vols higher** Weaker Zloty did not take EURPLN vols higher, as the move up was slow and realized volatility finally decreased. 1 month EUR/PLN ATM mid is 7.25% (0.15% lower), 3 month EUR/PLN is at 7.4% (0.1% unchanged) and, finally, 1 year is fixing at 7.85% (0.15% higher). USD/PLN one-week implied volatility has risen for five straight days and climbed to 20% on Friday, its highest level since the Brexit vote in June. The rest of the curve was also higher – the currency spread (USD/PLN vol minus EUR/PLN vol) has grown by roughly 0.4%. We observed big demand on 25RR EUR/PLN as well as on USD/PLN – mid term skew is approx. 0.4% higher.

## Short-term forecasts

Main supports / resistances:  
 EUR/PLN: 4.42 / 4.60  
 USD/PLN: 4.00 / 4.30

**Spot Position:** None.

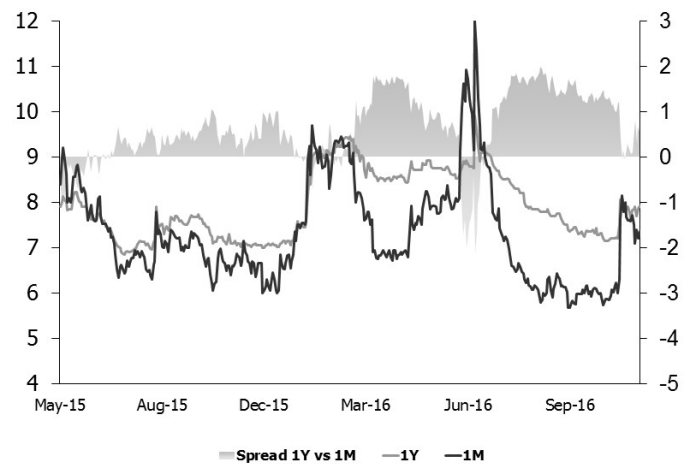
View unchanged from the last week. We are still skewed to the upside (Zloty downside), as Polish fundamentals and global sentiment deteriorated. Ideally, we would like to buy EUR/PLN at 4.44 and we are ready to add at 4.40 with stop loss at 4.37. On the other hand, the move on the EURPLN last month was systematic and amounted to 20 big figures – so we are awaiting some retracement. We would sell EUR/PLN at 4.54 and at 4.57 with a stop above 4.60.

**Options Vol – Selectively long Vega**

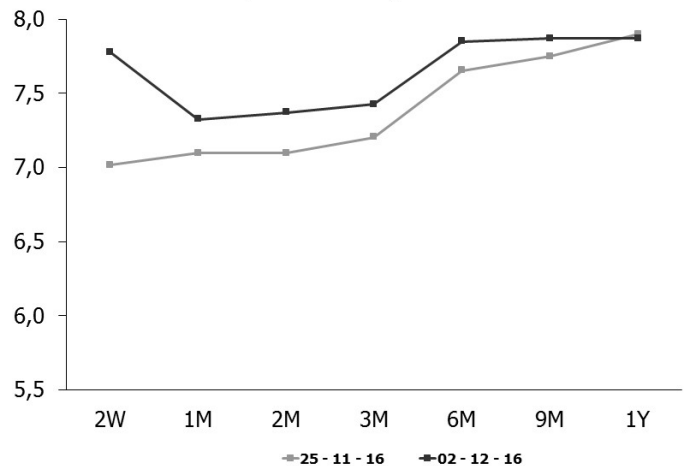
We are keeping our selective long in EUR/PLN Vega (6 months and 12 months) but only in 30% of our risk limits. On one hand, there is the FOMC and the Italian referendum, but with Christmas approaching fast, we prefer to keep position light. We would be buyers of backend if that revisits this year's lows, or sellers of the frontend if some panic / risk off hits the market.



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
11/25/2016	1.79	1.73	1.80	1.71	1.85	1.75	1.73	1.74	1.76	1.76	1.81	1.84
11/28/2016	2.10	1.73	2.10	1.71	2.17	1.75	1.73	1.73	1.74	1.75	1.78	1.84
11/29/2016	2.10	1.73	1.95	1.71	2.00	1.75	1.73	1.75	1.75	1.77	1.81	1.84
11/30/2016	1.89	1.73	1.80	1.71	1.85	1.75	1.74	1.75	1.76	1.78	1.83	1.85
12/1/2016	2.10	1.73	2.11	1.71	2.17	1.75	1.74	1.75	1.78	1.81	1.89	1.87

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
11/25/2016	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
11/28/2016	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
11/29/2016	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
11/30/2016	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
12/1/2016	1.750	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
11/25/2016	7.10	7.20	7.65	7.90	7.90	2.46	0.70
11/28/2016	7.40	7.25	7.63	7.70	7.70	2.46	0.70
11/29/2016	7.20	7.23	7.70	7.87	7.87	2.09	0.62
11/30/2016	7.36	7.30	7.70	7.93	7.93	2.51	0.66
12/1/2016	7.33	7.43	7.85	7.87	7.87	2.31	0.63

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
11/25/2016	4.4106	4.1628	4.1073	3.6821	1.4244	0.1632
11/28/2016	4.4190	4.1521	4.1094	3.7012	1.4246	0.1634
11/29/2016	4.4328	4.1827	4.1235	3.7149	1.4245	0.1639
11/30/2016	4.4384	4.1721	4.1159	3.6908	1.4273	0.1640
12/1/2016	4.4620	4.1987	4.1409	3.6768	1.4248	0.1648

## Disclaimer

Distribution and use of this publication The review note is based on the information available to the public. This review creates exclusively a marketing information as defined in Paragraph 9 Section 1 of the Decree of Minister of Finance dated November 20, 2009 on procedures and conditions to be followed by investment firms and banks mentioned in Article 70 Section 2 of Law on Trading in Financial Instruments dated July 29, 2005 as well as by custody banks. This review note is provided to you for information purposes only and is not intended as advice on any particular matter or as recommendation, offer or solicitation for purchase or sale of any financial instrument and should not be taken as such. mBank SA, its directors, officers, executives, managers, servants or agents expressly disclaim all liability to any person in respect of any-thing, and in respect of the consequences of anything, done or omitted to be done, wholly or partly, in reliance upon the whole or any part of the contents of this review note. The opinions and estimates contained herein reflect the current judgment of the author(s) on the date of this document and are subject to change without notice. The opinions pointed in review do not necessarily correspond to the opinions of mBank SA. The past performance of financial instruments is not indicative of future results. No assurance can be given that any financial instrument or issuer described herein would yield favourable investment results. mBank and/or its principals or employees may have a long or short position or may transact in the financial instrument(s) and/or securities referred to herein or may trade in such financial instruments with other customers on a principal basis. No client or other reader should act or refrain from acting on the basis on any matter contained in it without taking specific independent professional advice on the particular facts and circumstances in issue. Copyright protection exists in this publication and it may not be, even partially, reproduced or distributed without the prior written agreement with mBank SA.

©mBank 2016. All rights reserved.