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Polish Weekly Review

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Comment on the upcoming data and forecasts

Week kicks in on Monday with final CPI data for November. We stick to our initial forecast at +0.1% y/y, which is higher than the flash estimate, because of regional pattern of food prices and weaker currency. Core inflation (to be published on Tuesday) should remain in negative territory (-0.1% vs. -0.2% in October). Wednesday brings the other NBP data – money supply and balance of payments. We expect M3 money supply to accelerate slightly on a yearly basis in November (a result of extrapolating recent trends, no additional factors in major subcategories). Trade balance should stay negative, amid a slight increase in both exports and imports. The last day of the week is stacked with CSO's labour market data. Employment in the enterprise sector is decelerating towards the end of the year, while annual wage growth should move slightly upwards because of favourable working days pattern.

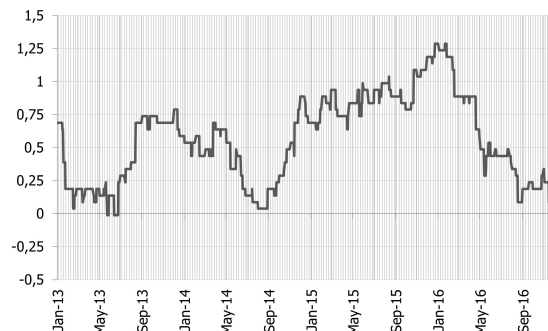
Polish data to watch: December 12th to December 16th

Publication	Date	Period	mBank	Consensus	Prior
CPI y/y (%) <i>final</i>	12.12	Nov	0.1	0.0	-0.2
Core inflation y/y (%)	13.12	Nov	-0.1	-0.1	-0.2
M3 money supply y/y (%)	14.12	Nov	8.8	8.6	8.7
Current account (mio EUR)	14.12	Oct	-1070	-730	-999
Exports (mio EUR)	14.12	Oct	15400	15385	15312
Imports (mio EUR)	14.12	Oct	15900	15480	15512
Average wage y/y (%)	16.12	Nov	3.8	3.9	3.6
Employment y/y (%)	16.12	Nov	3.0	3.0	3.1

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

Poland's surprise index stabilized during a release-free week. This could change soon, since next week brings some opportunities to move the index – final CPI and labour market data for November.

* 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

NBP keeps rates on hold

To no-one's surprise, Polish MPC left interest rates unchanged during its December meeting. The MPC's statement is essentially unchanged – wording was only adjusted to new macroeconomic data. The expected rebound of investment was somewhat postponed but the MPC is as certain of it as before.

During the conference Governor Glapinski dismissed concerns about the deeper-than-expected slowdown in the economy and reaffirmed his belief in a prompt GDP upswing due to accelerating absorption of EU funds. Glapinski was more vocal in expressing its preference for unchanged rates in 2017 and pointed to the ineffectiveness of interest rates in combating lower economic growth. He also indicated that monetary stimulus will happen automatically when inflation rebounds since that is set to bring real interest rates into negative territory.

All MPC member present at the press conference went into great lengths in justifying and arguing for the MPC's credibility. On our view, keeping rates unchanged amid slowing growth and deflation is a means to such an end. The NBP governor sees the central bank's role in macroprudential and regulatory areas, not in monetary policy.

There is little doubt that the NBP will fight tooth and nail against rate cuts. The depth of the slowdown and European inflation trends should decide the fate of Polish rates, though.

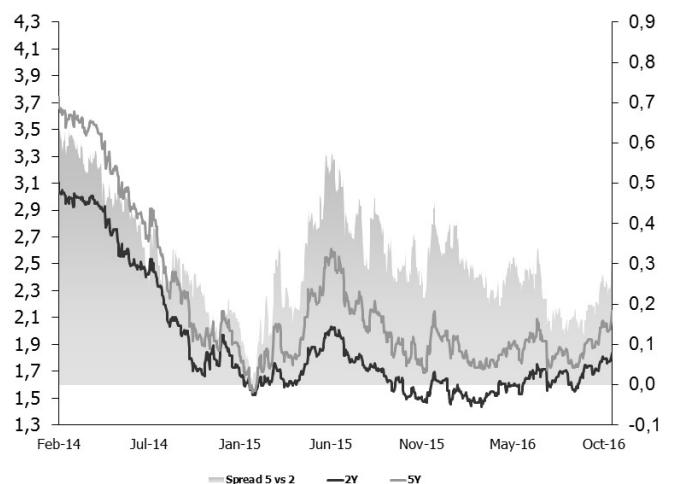
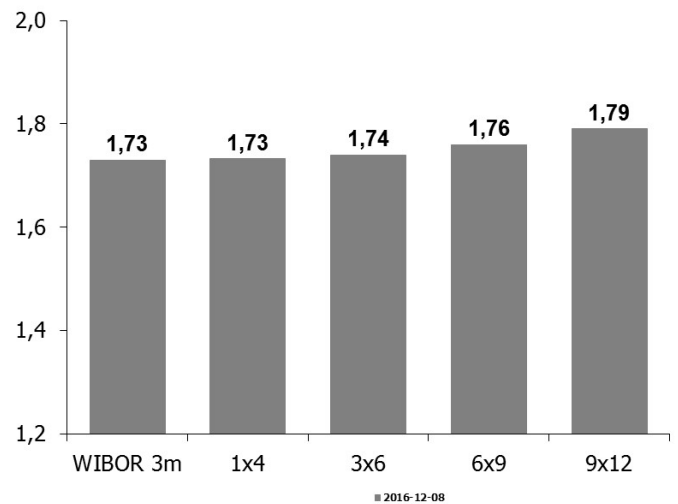
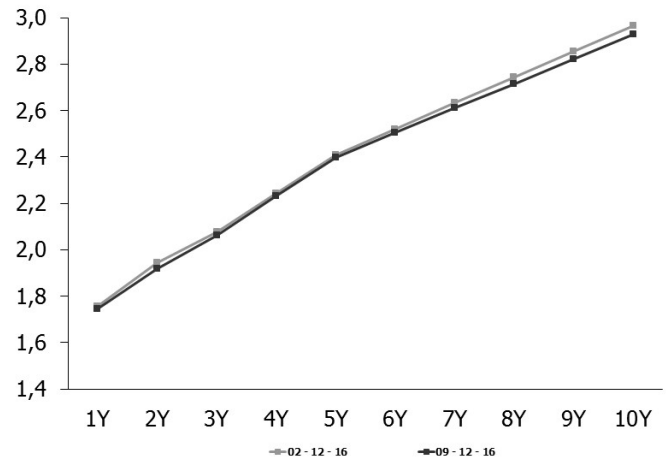
Fixed income

Rebound ...

After a huge sell-off on global fixed income markets we are having a rebound since last Monday. DS0726 yield fell from 3.77% to 3.57%, PS0721 went down from 2.92% to 2.76% and OK1018 yield has frozen at 1.94%. The PS0721/DS0726 spread narrowed from 88 bps to 79 bps; DS0726/DS0727 from 8 to 4. ASW PS0721/5y is trading at 37 bps, DS0726/10y at 63 bps now. Liquidity is currently much worse than last week. Volatility looks really high on the bond market.

Next week Ministry of Finance will announce a switching auction, at the same day FOMC will decide on rates.

IRS curve





Money market

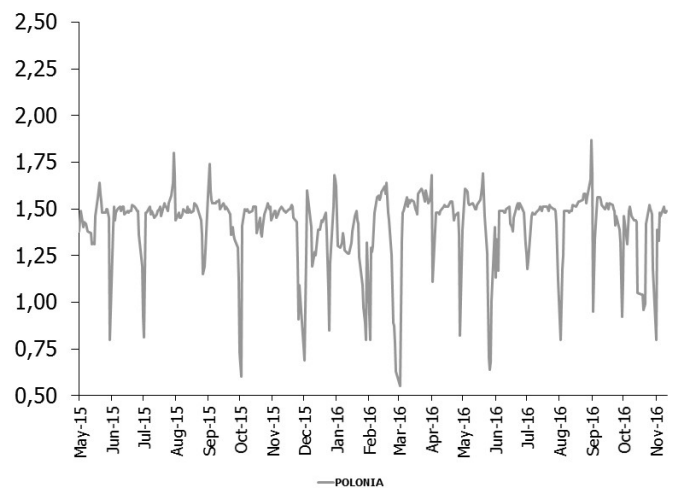
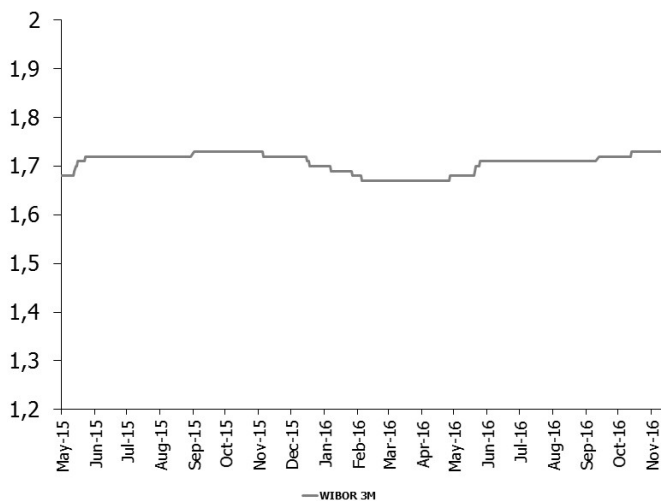
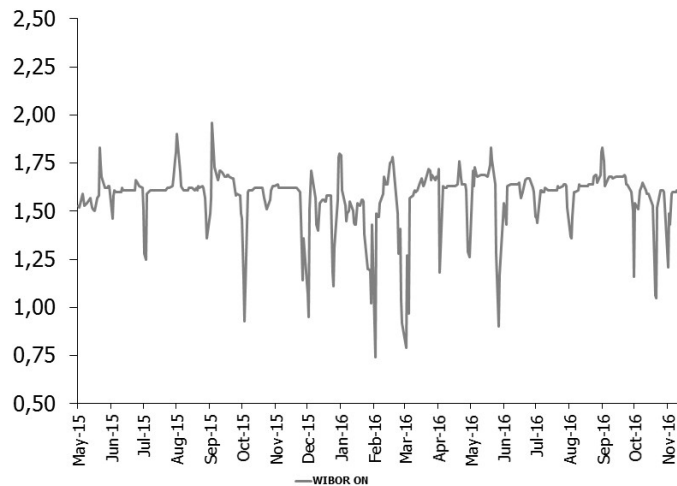
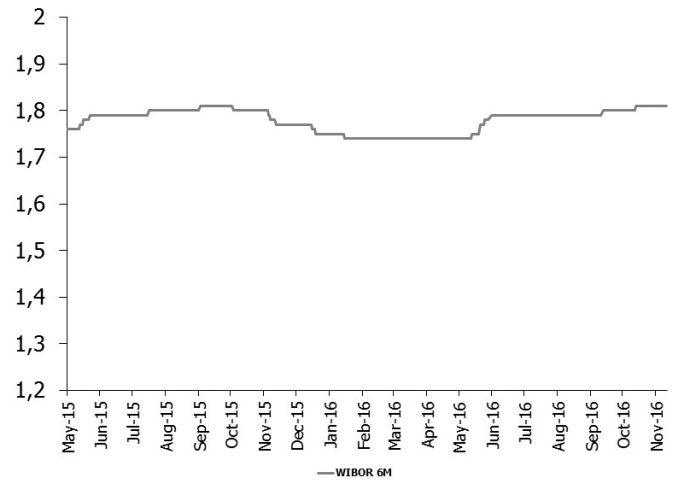
Stable week behind us

MPC meeting proved once again to be a non-event. With some "temporary" economic slowdown and CPI finally reaching positive territory the Council feels comfortable keeping rates at an all-time low. Market still looks fragile, but we would use any sell-off to fill our portfolio with 1-2 year bonds with 40+ bp carry. Ref rate vs Polonia averages:

Stable overnight funding should continue next week.

30 day: 21 bp

90 day: 8 bp



Forex

Spot – Volatile week PLN started on a weaker foot and EUR/PLN breached the 4.50 resistance. But it was lacking momentum and after setting the high at 4.5066, it plunged with a vengeance. EUR/PLN dropped to 4.4199 level within just 2 days! This represents 1% loss per day and it is, with no real news/story, quite impressive and also tells you something about EUR/PLN liquidity. Post-ECB trading was also choppy, but it seems like we are about to stabilize around 4.44, with 4.41-4.51 range as the most likely scenario for the next week.

Options – EUR/PLN vols consolidating / lower The vol traders kept the bids for Gamma, supported by realized volatility and proximity of the ECB meeting. After the meeting, the supply of vol has prevailed (with risk event out of the way), and we are now seeing lower vols as a consequence. 1 month EUR/PLN ATM mid is 6.7% (0.55% lower), 3 months EUR/PLN are 7.1% (0.3% lower) and finally 1 year is fixing at 7.7% (0.15% lower). The currency spread (difference between USD/PLN vol minus EUR/PLN vol) is roughly unchanged / tic lower in the frontend. The skew was offered and, finally, was roughly 0.2% lower than last week.

Short-term forecasts

Main supports / resistances:

EUR/PLN: 4.41 / 4.51

USD/PLN: 4.00 / 4.30

Spot Position: Long EUR/PLN.

We are long EUR/PLN at 4.4400 and we are ready to add at 4.40 with stop at 4.37 and hopes to see a break of this year's high 4.5390.

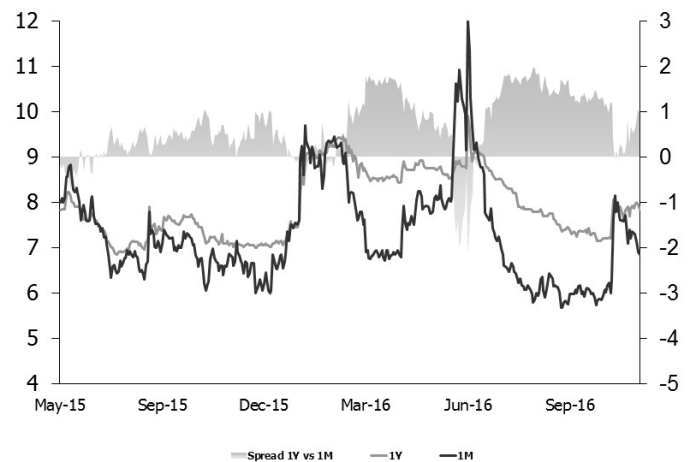
ECB surprised the market on the hawkish side, FOMC's seems like a done deal. It is a bit like coin toss, as we may have a Santa Claus PLN rally, as well. But for a change, we have decided to play it from the long side.

Options Vol – Selectively long Vega

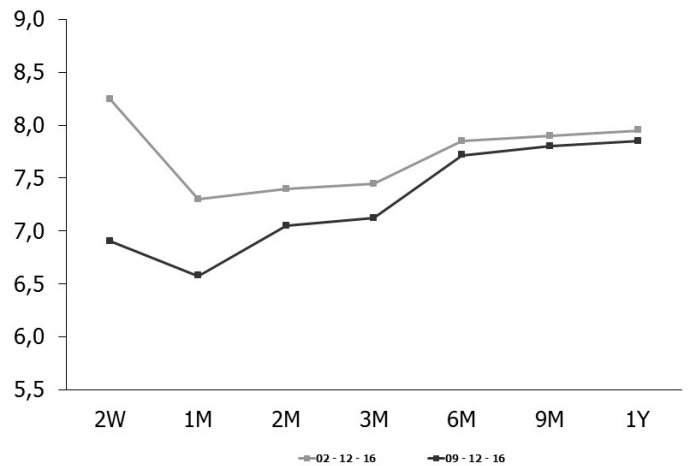
We are keeping our selective long in EUR/PLN Vega (6 months and 12 months) but only in 30% of our risk limits. On one hand, there is the FOMC and the fallout from the Italian referendum, but with Christmas approaching fast, we prefer to keep position light. We would be buyers of backend if that revisits 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
12/2/2016	1.71	1.73	2.15	1.71	2.19	1.75	1.74	1.75	1.78	1.81	1.88	1.87
12/5/2016	2.25	1.73	2.24	1.71	2.27	1.75	1.74	1.75	1.77	1.80	1.87	1.87
12/6/2016	1.79	1.73	2.16	1.71	2.19	1.75	1.74	1.74	1.76	1.79	1.87	1.85
12/7/2016	1.53	1.73	1.97	1.71	1.99	1.75	1.73	1.74	1.76	1.80	1.86	1.84
12/8/2016	1.63	1.73	1.70	1.71	1.75	1.75	1.73	1.74	1.76	1.79	1.86	1.85

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
12/2/2016	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
12/5/2016	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
12/6/2016	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
12/7/2016	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
12/8/2016	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	
12/2/2016	7.30	7.45	7.85	7.95	7.95	2.29	0.62	
12/5/2016	7.13	7.50	7.85	8.00	8.00	2.29	0.62	
12/6/2016	6.90	7.35	7.85	7.95	7.95	2.09	0.63	
12/7/2016	6.85	7.20	7.70	7.85	7.85	1.98	0.62	
12/8/2016	6.58	7.13	7.72	7.85	7.85	1.99	0.62	

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
12/2/2016	4.4885	4.2150	4.1705	3.7077	1.4280	0.1660
12/5/2016	4.4897	4.2213	4.1639	3.6981	1.4319	0.1660
12/6/2016	4.5035	4.1825	4.1551	3.6654	1.4332	0.1665
12/7/2016	4.4232	4.1268	4.0852	3.6210	1.4146	0.1635
12/8/2016	4.4401	4.1107	4.0917	3.6238	1.4158	0.1641

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