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Polish Weekly Review

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Comment on the upcoming data and forecasts

On Monday the CSO will publish industry and retail data. Despite a favorable calendar effect (working day difference ticks up from -1 to 0 y/y in November), the acceleration in industrial output will be very meagre due to strong base effects – last year, output was boosted by the EU-financed year end spending splurge (train production added 1 p.p. to IO growth). The accompanying PPI data will show stronger growth in producer prices, owing to weak PLN and higher commodity prices. Retail sales data should come on the stronger side as calendar and base effects (food sales) should boost retail sales growth. On Wednesday the CSO will publish consumer and business sentiment data (the first measure of economic sentiment in December) and on Thursday the Minutes from the last MPC meeting will be released. The latter will not have any impact on markets.

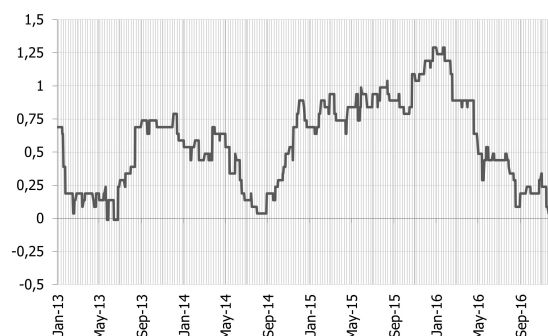
Polish data to watch: December 19th to December 23th

Publication	Date	Period	mBank	Consensus	Prior
Sold industrial output y/y (%)	19.12	Nov	-0.3	1.5	-1.3
PPI y/y (%)	19.12	Nov	1.2	1.0	0.6
Retail sales y/y (%)	19.12	Nov	4.6	4.7	3.7
Consumer confidence	21.12	Dec			
Business confidence	21.12	Dec			
Unemployment rate	23.12	Nov	8.2	8.2	8.2

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	1.742	10/6/2016
5Y T-bond PS0722	-	4000	2.499	11/17/2016
10Y T-bond DS0727	-	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

Unchanged from previous week, since all data came more or less in line with market consensus. Next week brings more opportunities to move the index – real sphere data on Monday and unemployment rate on Friday.

* 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 1.5-1.7% 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 has ended. 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 more hawkish Fed 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

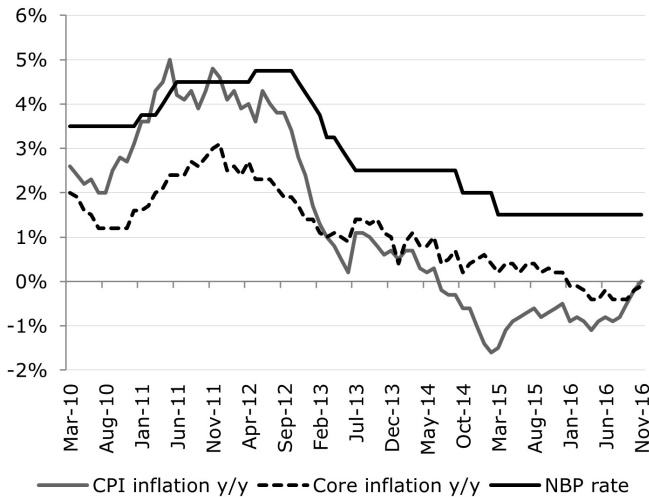
	2016 Q1	2016 Q2	2016 Q3 F	2016 Q4 F	2017 Q1 F	2017 Q2 F	2017 Q3 F	2017 Q4 F
GDP y/y (%)	3.0	3.1	2.5	1.7	2.2	2.8	3.4	3.5
Individual consumption y/y (%)	3.2	3.3	3.9	4.6	4.3	4.0	3.8	3.5
Public Consumption y/y (%)	4.2	3.9	4.9	1.0	3.0	3.0	3.0	3.0
Investment y/y (%)	-2.2	-5.0	-7.7	-4.5	-2.5	3.5	6.0	6.0
Inflation 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

The end of deflation confirmed

According to the final data, yearly CPI index rose in November to 0.0% from -0.2% in October. We expected slightly higher number; without rounding the figure was exactly in between 0.0% and 0.1%. After 28 months statistical deflation ended in Poland. On a monthly basis consumer prices grew by 0.1%.

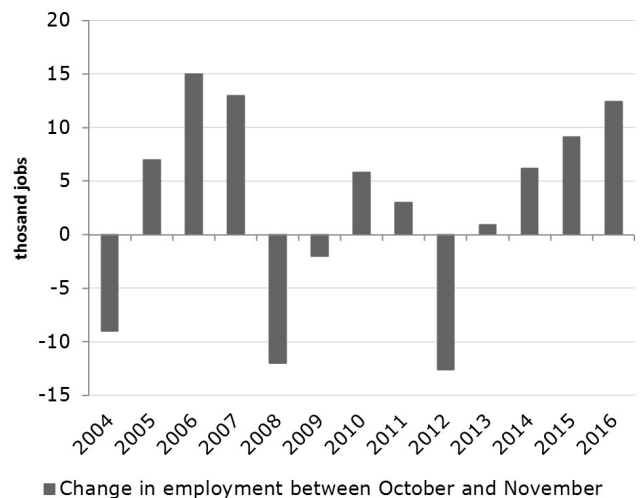


Looking into details, we were able to forecast food (+0.4% m/m) and fuel (-0.1% m/m) prices correctly. There were no surprises in other categories. Solid drop in the transport category is a result of lower transportation services prices (-2.4% m/m), while other products and services prices grew by 0.5% due to higher insurance prices (by 1.4% m/m). Core inflation accelerated a bit but its annual growth rate stayed in the negative territory (-0.1% y/y). Price pressure in Poland is still very weak, same as in Europe, and the recent upward movement of CPI index is a result of low base in energy prices.

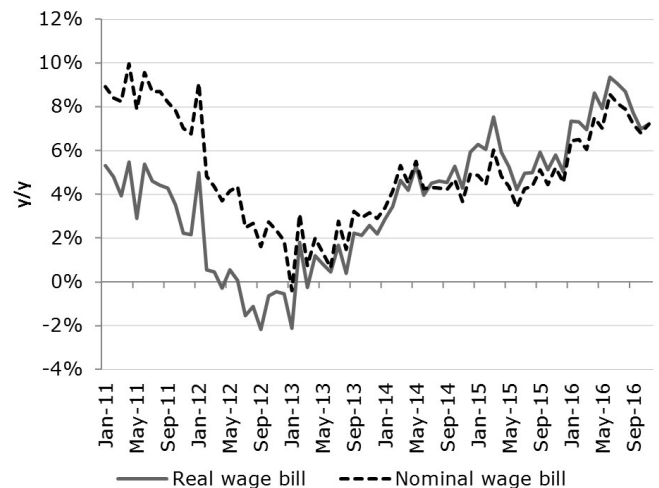
We expect to see CPI gradually increasing in the following months. Because of a surge in oil prices (in January by ca. 80% y/y in PLN), inflation should reach 1.5% in 3-4 months (lower range of inflation target). This (global) trend keeps in check pricing of any rate cuts. Only after several months we will see, if inflation will run out of "statistical" steam and accustom us to positive and stable (but still much lower than NBP target) price growth. This will not be a significant change.

Labor market retains its strength

In November, employment in the enterprise sector grew by 3.1% y/y, higher than both market consensus and our forecast have indicated. October's yearly momentum was thus sustained. On a monthly basis, 12.5k jobs were created and we haven't had such a great November since 2006. As always, we need to wait for the details of the release until the end of the month. It is however likely, that another jump in information and communication section was responsible for this surprise, just as it "saved" last month's release from falling to 3.0% y/y. No matter, where exactly the surprise lies, the overall image remains unchanged. 2016 was one of the best year for employment growth in recent Polish history.



Average gross wage grew by 4.0% y/y in November, close to our forecast and market consensus (both at 3.8% y/y). As usual, we can only speculate on the structure of growth at this point. In our view, the most likely explanation is a simple calendar effect (difference in working days ticked up from -1 to 0 y/y) that boosted manufacturing and construction wages. In the coming months we expect wage growth to stay high due to increasingly more binding labor supply constraints (demographic trends and possible flows out of labor force due to 500+ programme). Anecdotal evidence suggests that the pace of wage growth e.g. in retail trade will be sustained next year.



Nominal and real wage bill both grew by 7.2% y/y, accelerating slightly from the previous month's 6.8 and 7.0% y/y, respectively. Due to the expected uptick in inflation in the coming months,



real household income growth will decline (from May, the effects of 500+ programme will also fade, at least on an arithmetic basis). As a result, consumption growth is expected to moderate in 2017, falling to 3.0-3.5% at the end of the year.

Labor market data are inconsequential for monetary policy. Even the current outlook for GDP growth was not enough to challenge the consensus of unchanged rates. In addition, stable labor market indicators suggest status quo in monetary policy – after all, inflation has barely reacted to labor market developments throughout the world. Current status quo might, however be challenged by the introduction of visa-free regime between the EU and Ukraine (second half of 2017). The possible outflow of Ukrainian workers to e.g. Germany is impossible to estimate but would constitute a drastic tightening of the labor market, especially in the low-skilled spectrum. Higher wage growth and lower labor contribution to GDP would follow.

Fixed income

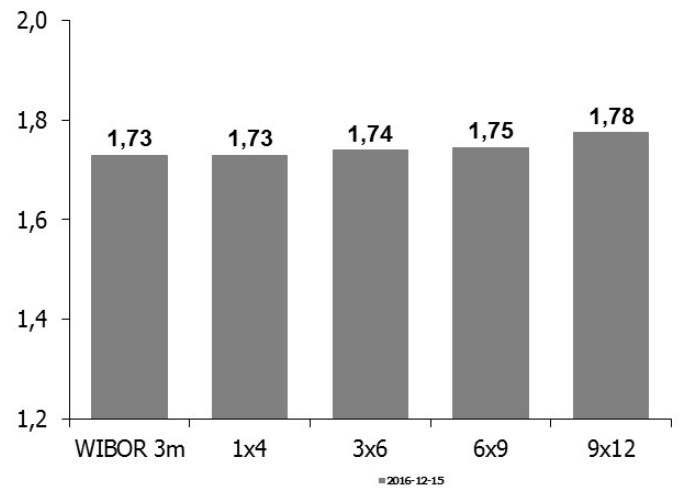
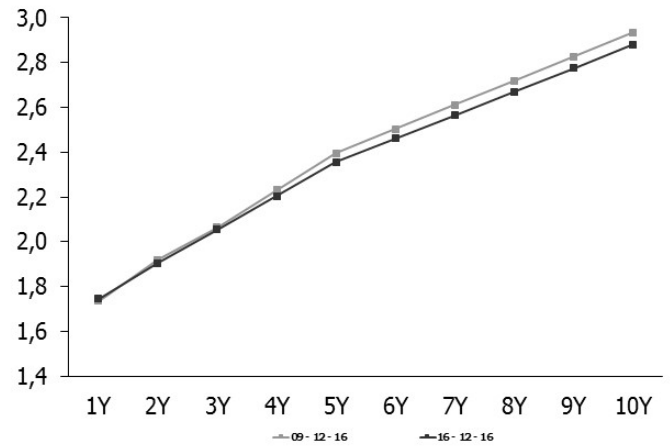
Flattener

Ministry of Finance sold PLN 5.4 bn of a new 2y benchmark, OK0419 (yield 2,14%) on the switch auction this week. Demand was almost fully accepted. Bond market still has high volatility and wide spreads, though. Wednesday's Fed hike and hawkish statement pushed all yield up, then aggressively down in next 2 days.

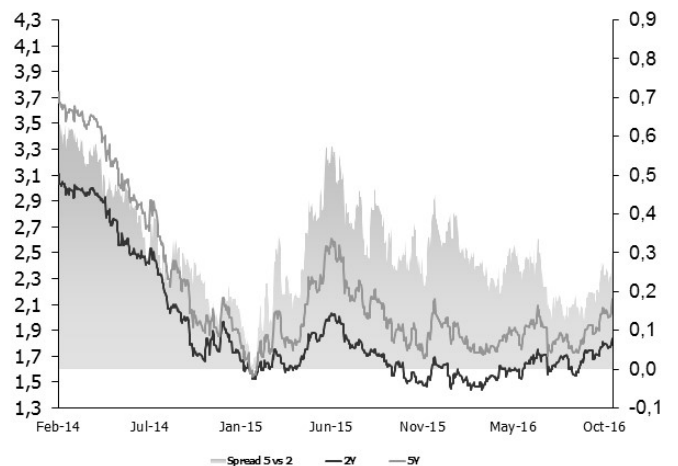
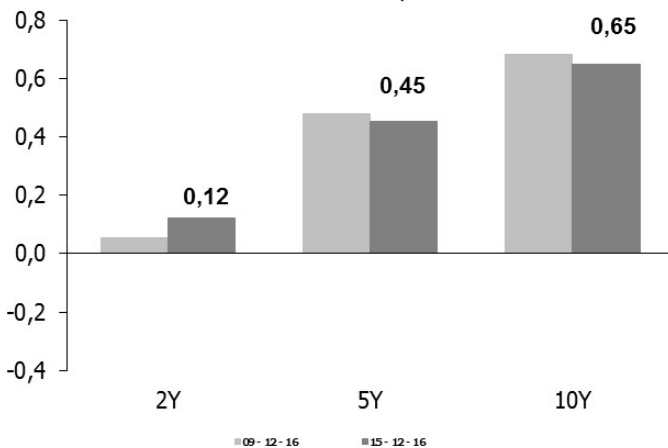
The PS0721 / DS0726 spread has frozen at 72/70 bps, DS0726/DS0727 narrowed to 6/4. DS0726 yield has fallen from 3.65% to 3.42% and PS0721 from 2.90% to 2.70%. ASW were back down, currently to 41/39 bps in PS0721 / 5y and in DS0726 / 10y – to 57/55 bps.

Next week, market should be more quiet due to coming Christmas.

IRS curve



Asset swaps

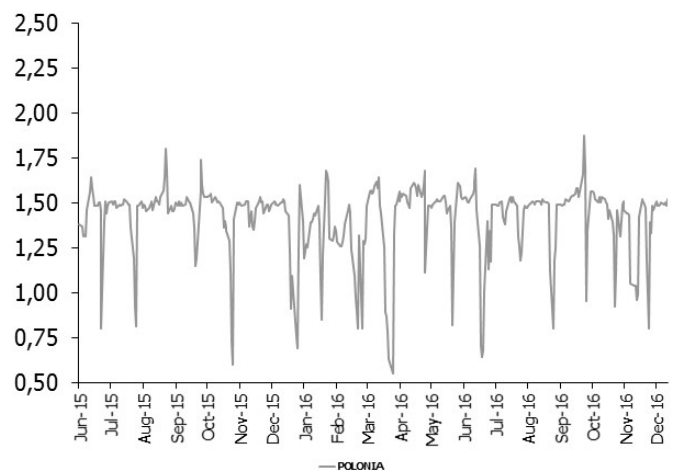
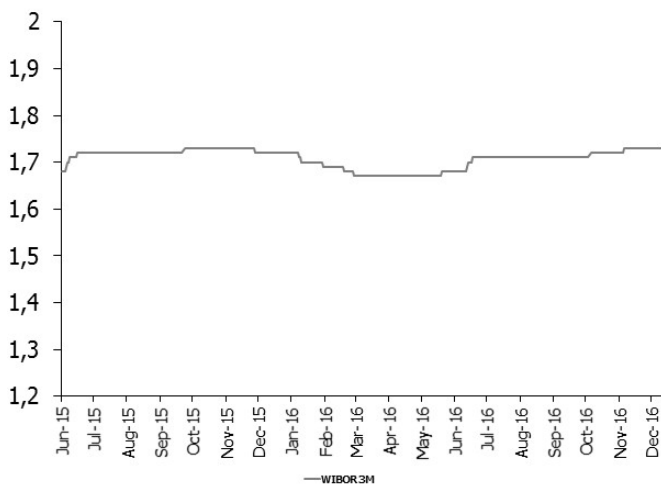
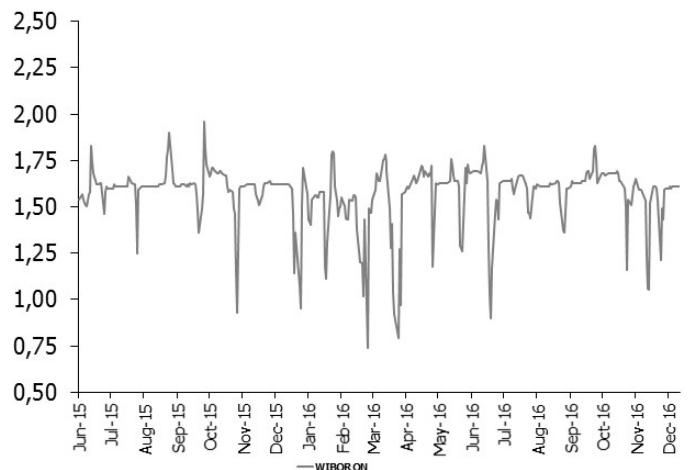
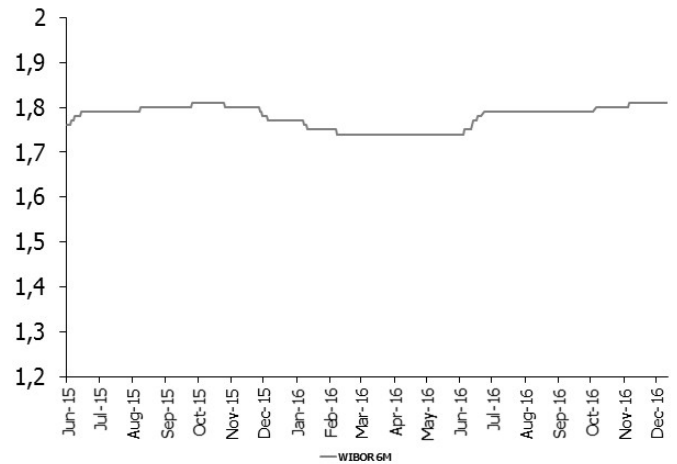


Money market

Stable week behind us... cheaper ahead of us.

As the last OMO was underbid, cash was a bit cheaper. Polonia fluctuated around 1.50 for the whole week. At today's OMO banks bought PLN 72bn bills out of 79bn offered.

It seems that liquidity is secured, so we expect quite relaxed funding next week – below 1.50%. On the OIS curve we noticed some paying interest on the longer end with 1y Polonia at 1.45 and 9m Polonia at 1.43. Also, short-term bonds with yields around 1,90 look very attractive, especially when cash rate is a bit lower than it used to be.



Forex

Spot – Consolidation It was a much calmer week for EUR/PLN, which was consolidating in a relatively tight range, 4.4040-4.4600. USD/PLN was much more volatile thanks to the FOMC, with 4.1700 – 4.2790 trading range. We haven't seen USD/PLN here since the beginning of this century. As a result, we have weaker PLN against the basket. In general, we think, PLN and the rest of EM may have only limited appreciation perspectives, because of so hawkish FOMC. As usual, we see room for range trading, 4.41-4.51, and we will be a bit more skewed to buy dips rather than sell the spikes.

Options – EUR/PLN vols consolidating Calmer markets, diminishing realized volatility has managed to push lower vols only in the frontend. With the FOMC out of the way, we have no event risks until next year. However, the rest of the run is holding firmly. 1 month EUR/PLN ATM mid is 6.3% (0.4% lower), 3 month EUR/PLN is at 7.1% (unchanged) and, finally, 1 year is fixing at 7.75% (0.05% higher). The currency spread (difference between USD/PLN vol minus EUR/PLN vol) is still creeping higher as dollar advances. Skew is roughly unchanged.

Short-term forecasts

Main supports / resistances:

EUR/PLN: 4.41 / 4.51

USD/PLN: 4.00 / 4.30

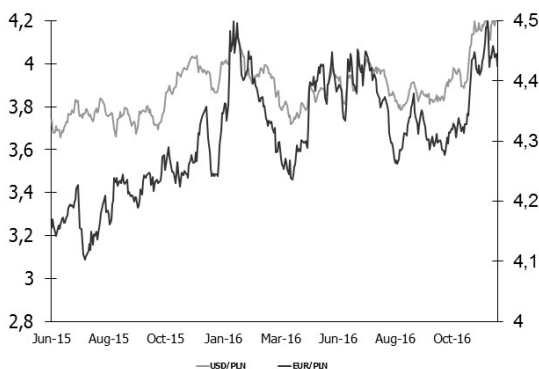
Spot Position: Long EUR/PLN.

We are long EUR/PLN at 4.4400 and we are ready to add at 4.3950 with stop at 4.37 and hopes to see a break of this year's high of 4.5390.

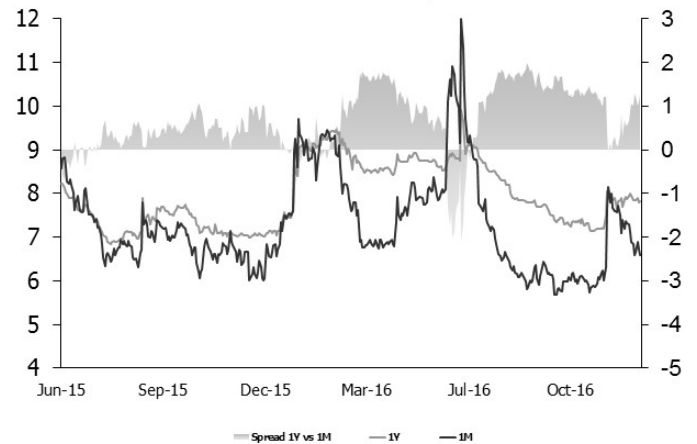
Hawkish FOMC is a supportive factor for weaker PLN. We expect the 4.37-4.40 support zone to hold, but shallow liquidity around Christmas may produce choppy price action. One need to keep some flexibility, and leave room to add on unexpected Zloty strength.

Options Vol – Selectively long Vega

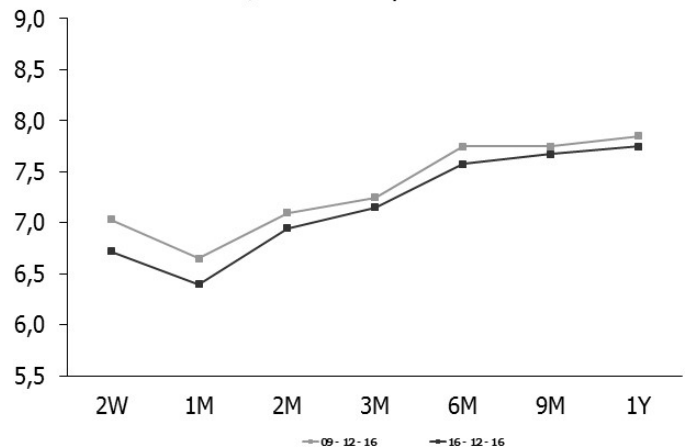
We are keeping our selective long in EUR/PLN Vega (6 months and 12 months) but only in 30% of our risk limits. On one hand, there is the FOMC and the fallout from the Italian referendum, but with Christmas approaching fast, we prefer to keep position light. We would be buyers of backend if that revisits 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
12/9/2016	2.06	1.73	2.07	1.71	2.11	1.75	1.73	1.74	1.76	1.79	1.86	1.85
12/12/2016	2.06	1.73	2.08	1.71	2.13	1.75	1.73	1.74	1.76	1.79	1.86	1.85
12/13/2016	2.14	1.73	2.16	1.71	2.21	1.75	1.73	1.74	1.75	1.79	1.84	1.84
12/14/2016	1.95	1.73	1.97	1.71	2.03	1.75	1.73	1.74	1.75	1.78	1.83	1.83
12/15/2016	2.16	1.73	2.16	1.71	2.21	1.75	1.73	1.74	1.75	1.78	1.84	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
12/9/2016	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
12/12/2016	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
12/13/2016	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
12/14/2016	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
12/15/2016	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
12/9/2016	6.65	7.25	7.75	7.85	7.85	1.99	0.61
12/12/2016	6.90	7.35	7.80	7.90	7.90	1.99	0.61
12/13/2016	6.70	7.10	7.65	7.80	7.80	2.21	0.65
12/14/2016	6.58	7.13	7.65	7.83	7.83	2.00	0.66
12/15/2016	6.40	7.15	7.58	7.75	7.75	2.00	0.61

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
12/9/2016	4.4385	4.1772	4.1120	3.6511	1.4117	0.1642
12/12/2016	4.4583	4.2090	4.1422	3.6336	1.4194	0.1649
12/13/2016	4.4505	4.1905	4.1344	3.6357	1.4154	0.1646
12/14/2016	4.4389	4.1768	4.1302	3.6276	1.4114	0.1642
12/15/2016	4.4453	4.2329	4.1334	3.5909	1.4168	0.1645

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