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## 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>

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### Comment on the upcoming data and forecasts

Week begins on Monday with the release of core inflation data - based on last Friday's GUS data, we estimate it at 0.0% y/y. On Wednesday the CSO will publish monthly labor market statistics. While we are in agreement with market consensus regarding the slight slowdown in employment (high statistical base from last year is enough), our forecast of wage growth is more pessimistic as we see base and calendar effects dragging down wage growth. On Thursday the CSO will release industry and trade data, with interesting developments. Due to base (both an a monthly and yearly basis) and calendar (difference in working days dropped from 0 to -1 y/y) effects, industrial output growth is set to stagnate annually. The accompanying PPI data will surprise to the upside as market consensus is probably underestimating the full impact of energy price spike on producer prices. Finally, the abovementioned calendar and base effects will not deter retail sales from accelerating – we believe that the impact of 500+ programme on Christmas-related spending will prove to be decisive. Week ends with the release of monthly consumer and business sentiment data from the CSO (for January).

### Polish data to watch: January 16th to January 20th

Publication	Date	Period	mBank	Consensus	Prior
Core CPI y/y (%)	16.01	Dec	-0.1	0.0	-0.1
Average gross wage y/y (%)	18.01	Dec	3.4	4.0	4.0
Employment y/y (%)	18.01	Dec	3.0	3.0	3.1
Sold industrial output y/y (%)	19.01	Dec	0.0	0.9	3.3
PPI y/y (%)	19.01	Dec	3.3	2.5	1.7
Retail sales y/y (%)	19.01	Dec	7.6	6.0	6.6
Consumer confidence	20.01	Jan			
Business confidence	20.01	Jan			

### Treasury bonds and bills auctions

Paper	Next auction	Last Offer	Yield on the prev auction (%)	Prev auction
(32/37/52) Week T-bills	1/16/2017	2000	1.550	1/9/2017
2Y T-bond OK1019	1/23/2017	1000	2.324	1/5/2017
5Y T-bond PS0422	1/23/2017	3000	3.017	1/5/2017
10Y T-bond DS0727	1/23/2017	1500	3.757	1/5/2017
15Y T-bond WS0428	-	200	3.027	7/7/2016

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



#### Comment

Unchanged as CPI was not revised from the flash estimate. Next week brings several opportunities for surprises: wages, industrial output, retail sales and PPI.

\* 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 ca. 2% y/y in Q4, when base effects reach their peaks. Momentum is positive, growth likely picked up on a q/q basis in Q4 already. Next year, growth will accelerate to the average of 3.2-3.4%, 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 2.0% at the turn of Q1 and Q2). We are still skeptical of genuine inflationary pressures in the Polish economy, though. The fate of inflation in the second half of next year, absent a sustained increase in commodity prices, is by no means certain.
- Rising inflation will prove to be a fertile ground for rate hike bets. It is very unlikely that these will materialize this year, though. We see the MPC's reaction function as symmetrical – see the Glapinski's comments on allowing real rates to run negative.

### 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. However, inflows to Polish equity market are shifting the balance towards stronger PLN.

### mBank forecasts

	2012	2013	2014	2015	2016 F	2017 F
GDP y/y (%)	1.6	1.4	3.3	3.9	2.5	3.2
CPI Inflation y/y (average %)	3.7	0.9	-0.1	-0.9	-0.6	1.9
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	8.3	7.8
Repo rate (end of period %)	4.25	2.50	2.00	1.50	1.50	1.50

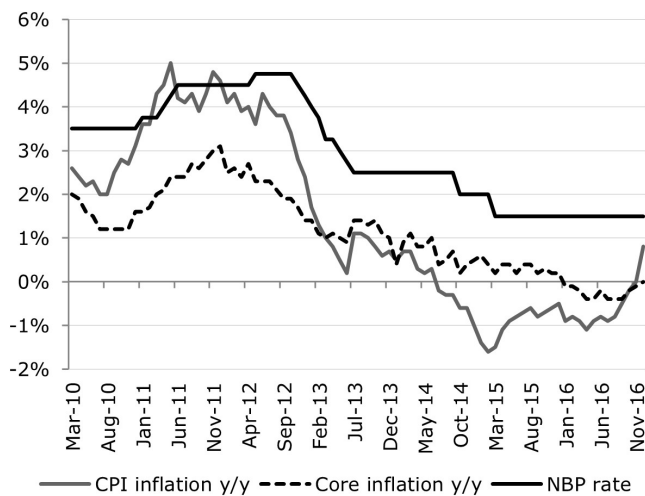
	2016	2016	2016	2016	2017	2017	2017	2017
	Q1	Q2	Q3 F	Q4 F	Q1 F	Q2 F	Q3 F	Q4 F
GDP y/y (%)	3.0	3.1	2.5	2.0	2.3	2.9	3.6	3.8
Individual consumption y/y (%)	3.2	3.3	3.9	4.6	4.3	4.0	3.8	3.5
Public Consumption y/y (%)	4.2	3.9	4.9	1.0	3.0	3.0	3.0	3.0
Investment y/y (%)	-2.2	-5.0	-7.7	-3.5	-1.5	4.0	7.0	7.0
Inflation rate (% average)	-0.9	-0.9	-0.8	0.2	1.8	1.8	1.8	2.0
Unemployment rate (% eop)	9.9	8.7	8.3	8.3	8.5	7.9	7.5	7.8
NBP repo rate (% eop)	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
Wibor 3M (% eop)	1.67	1.71	1.71	1.73	1.73	1.73	1.73	1.73
2Y Polish bond yields (% eop)	1.45	1.65	1.76	2.03	2.00	2.00	2.00	2.00
10Y Polish bond yields (% eop)	2.84	2.91	2.92	3.63	3.80	3.70	3.50	3.50
EUR/PLN (eop)	4.24	4.38	4.30	4.40	4.38	4.30	4.25	4.20
USD/PLN (eop)	3.73	3.94	3.82	4.19	4.09	4.10	4.13	4.08

F - forecast

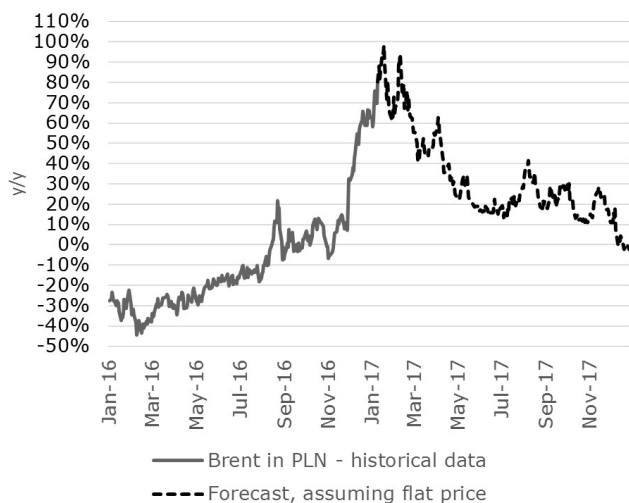
## Economics

### Inflation is accelerating, but so far due to fuel prices, food prices and base effects

Base effects in fuel prices coupled with strong m/m growth in the same category (5.3% in December), as well as higher-than-usual increase in food prices (1.2% m/m) lifted CPI to 0.8% y/y in December. The only core category with non-zero growth was transport goods and services (+2.9% m/m). Elsewhere prices remained flat and core inflation probably ticked up to 0.0% y/y. As we repeatedly claimed, the momentum in core prices is no longer negative, but slightly positive (with emphasis on „slightly“). There are no signs of broad-based price growth or second-round effects from food and fuel price spike.



In the coming months inflation will continue to accelerate due to base effects and commodity price increases – we expect it to top at 2% in 3-4 months. The move is of course part of a global trend (that includes surprises as well as actual releases), but key question remain: will inflation continue to accelerate in the second half of the year or at least maintain its elevated growth rates? To remind our Readers: after Spring, statistical base effects are unfavorable, no upward pressure in core categories, oil prices likely won't grow beyond 55-60\$ per barrel.



### The MPC keeps rates unchanged, explicitly allowing real rates to turn negative

The MPC kept rates on hold during its January meeting, as widely expected. The tone of its statement was also unchanged – current rate level is conducive to keeping the Polish economy on the sustainable growth path and maintaining macroeconomic balance.

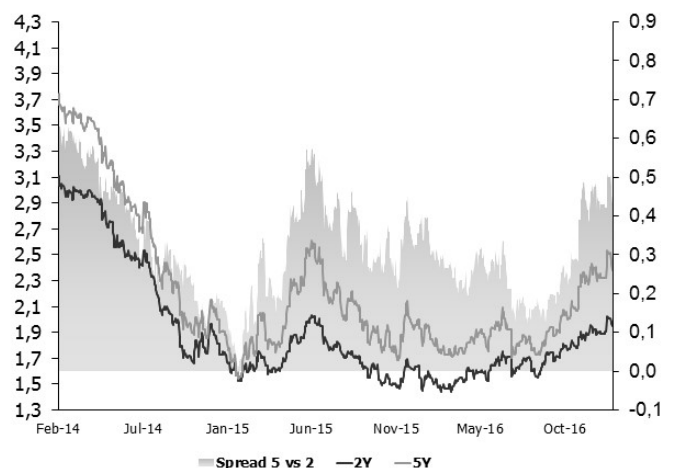
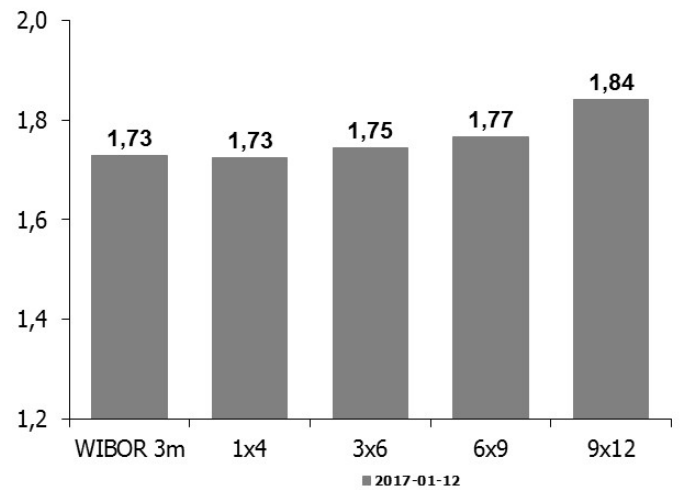
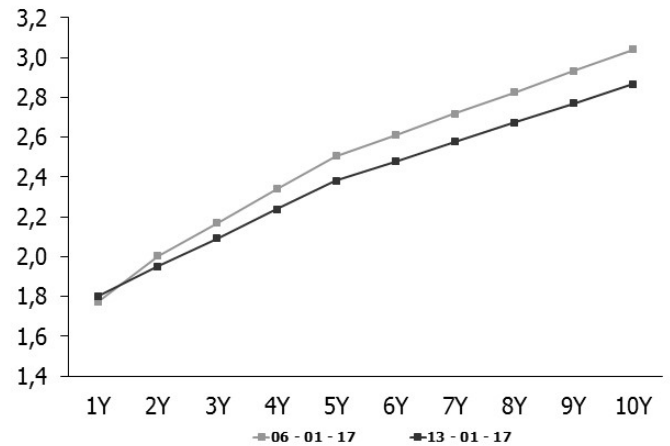
During the conference, the NBP governor treated the risks for inflation as balanced and symmetric. Before the last meeting, the MPC had waited the period of deflation and lower growth out, remaining unwavering in its optimism. Now, that data turned positive, the Council does not suggest that rates should be changed. Recent uptick in inflation is seen as exogenous and the tightening of labor market is welcome, not worrying. Governor Glapinski reiterated his view that, by holding nominal rates constant in the face of higher inflation, the NBP will allow real rates to drift below zero and stimulate the economy. These factors lead us to assess that the conference had a dovish tone. The MPC evidently wants to see through the coming uptick in inflation and refuses to fuel tightening expectations.

## Fixed income

### Range trading ahead of rating decisions

On Friday evening Moody's and Fitch will announce their rating decisions. We don't expect any changes. Market is dealing in a range: PS0422 96.15-45 and DS0727 89.90-91.50. The curve has slightly steepened, the PS0721/DS0726 spread moved from 73 to 78bps. Asset swaps currently are: PS0721/5y at 42bps and DS0726/10y at 64bps. On Monday, the Ministry of Finance will offer 32 weeks T-bills on an auction, we are expecting their rate at 1,55

IRS curve



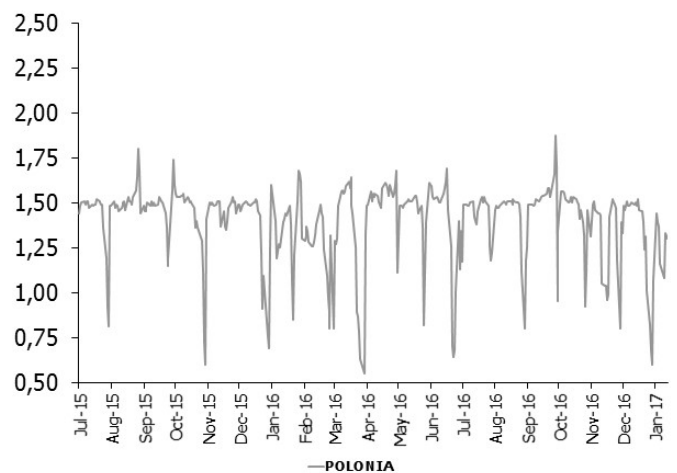
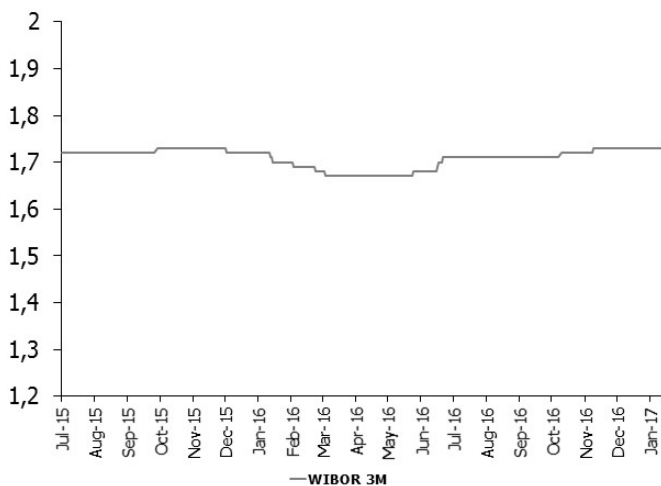
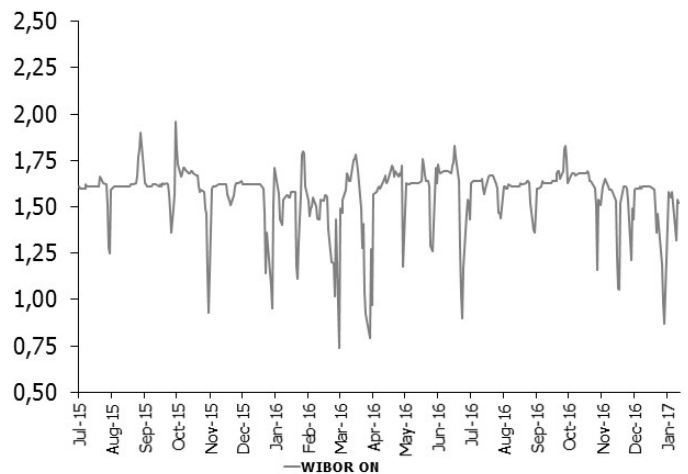
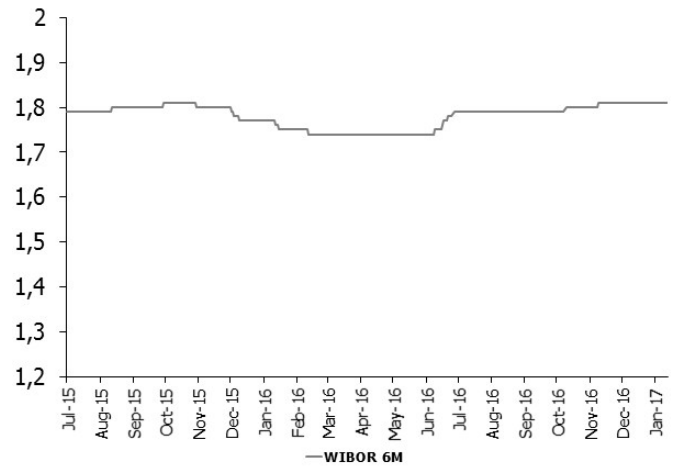
## Money market

### MPC

As we signalled last week, Polish monetary policy comes to a new reality, where deflation is not a threat anymore. First remarks from the NBP governor are that stabilizing rates is still warranted. Market reacted very optimistically and 2y bonds rallied, reaching levels last seen before the latest CPI reading. We would be very cautious adding to our portfolio at this point. Analysts predict that CPI can reach 2% as soon as first quarter, while governor Glapinski in his interview signaled CPI only gradually moving to the lower band at 1.5%. If analysts' predictions materialize, bonds may offer more attractive yields again.

At today's OMO banks bought 80 bn of NBP bills. That should more or less square the market. Cash might be a touch higher than in the previous week.

Ref rate vs Polonia averages: 30 day 29 bp 90 day 19 bp



## Forex

**Spot – Consolidation** Last week was an extremely quiet one for EUR/PLN. 4.3520 and 4.3850 are the respective low and high of the week. It clearly shows that there is actually no real interest in Zloty at these levels, and that flows are balanced. USD/PLN was much more volatile, as the USD shock absorber (4.09-4.18 being the range). Ironically, the main event for PLN this week, will be seen today (Friday evening), when the fate of Poland's ratings will be decided, outside of PLN trading hours. The majority expects no change in rating, which would be PLN-positive. Our typical rangy approach assumes the current range is 4.33-4.44, and we will try to play that range.

**EUR/PLN vols – melting continues** The diminishing realized volatility, and tic stronger PLN are taking vols lower. 1 month EUR/PLN ATM mid is 6.1% (0.2% lower), 3 months EUR/PLN is at 6.7% (0.1% lower) and, finally, 1 year is fixing at 7.7% (unchanged). The currency spread (difference of USD/PLN minus EUR/PLN) was also better offered due to the falling EUR/USD vols. Skew is roughly unchanged.

## Short-term forecasts

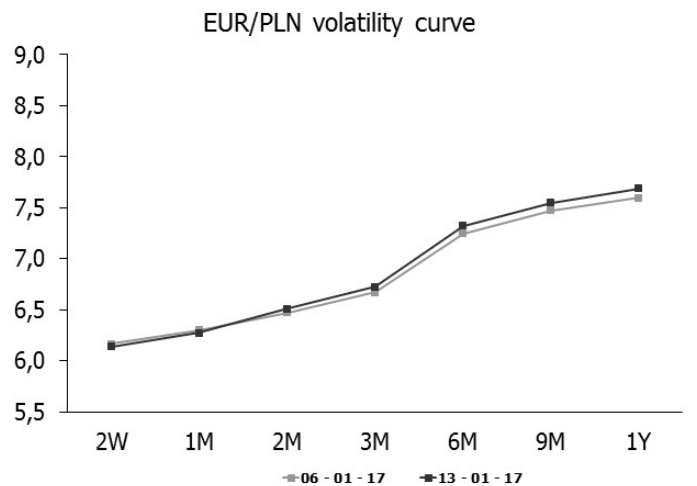
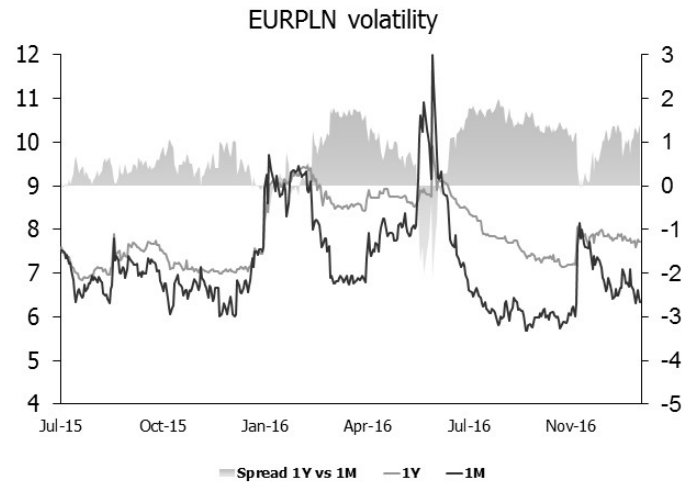
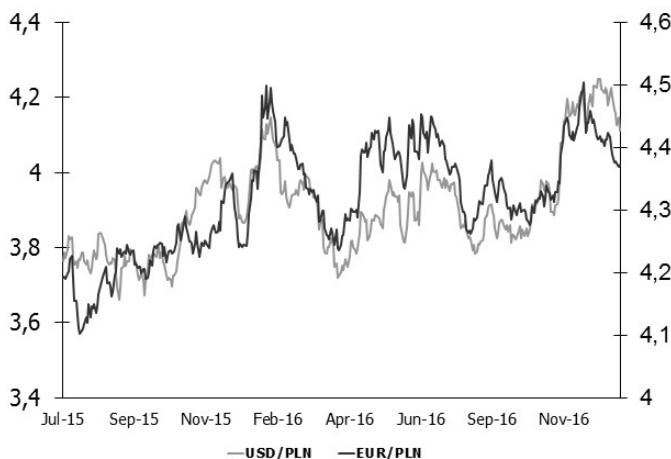
Main supports / resistances:  
 EUR/PLN: 4.34 / 4.46  
 USD/PLN: 4.00 / 4.30

**Spot** Position: None.

We would like to buy EUR/PLN at 4.3600, we are ready to add at 4.3300 with a stop at 4.31 and hopes to revisit 4.44+. With higher core market yields, the low yielding Zloty is exposed to underperformance. Being Poles and living in Warsaw, we are also exposed to the constant noise from Polish political front. It is not really encouraging, and it creates the impression of a political crisis. As a result, we are more keen to fish at the level which seems to be a bottom of the current range rather than fade spikes.

**Options** Vol – We are short 3 month / long 9 month EUR/PLN.

We have sold 3 month EUR/PLN ATM against our long in backend Vol, in Vega neutral terms. It is a positive Theta / slightly short Gamma structure. It expresses our general view, that even though higher vols can be seen due to rising yields, it will be a slow process.





## 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
1/6/2017	2.18	1.73	2.23	1.71	2.26	1.75	1.74	1.75	1.81	1.88	1.95	1.92
1/9/2017	2.20	1.73	2.26	1.71	2.35	1.75	1.74	1.76	1.82	1.90	1.97	1.92
1/10/2017	2.16	1.73	1.78	1.71	2.27	1.75	1.74	1.76	1.78	1.87	1.92	1.89
1/11/2017	1.54	1.73	1.60	1.71	1.66	1.75	1.74	1.75	1.78	1.86	1.91	1.88
1/12/2017	2.12	1.73	2.22	1.71	1.84	1.75	1.73	1.75	1.77	1.84	1.91	1.88

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
OK0419	1/5/2017	4/25/2019	94.88	2.32	1000	2825	990
PS0422	1/5/2017	4/25/2022	95.62	3.16	1500	2880	1570
DS0727	1/5/2017	7/25/2027	89.20	3.76	1500	2787	1544

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0715	5Y IRS	PS0718	10Y IRS	DS1023
1/6/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
1/9/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
1/10/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
1/11/2017	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
1/12/2017	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	1Y
1/6/2017	6.30	6.68	7.25	7.60	7.60	2.11	0.65	0.65
1/9/2017	6.60	6.90	7.45	7.78	7.78	2.11	0.65	0.65
1/10/2017	6.43	6.73	7.33	7.73	7.73	2.11	0.66	0.66
1/11/2017	6.33	6.70	7.30	7.73	7.73	2.11	0.65	0.65
1/12/2017	6.28	6.73	7.33	7.69	7.69	1.89	0.61	0.61

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
1/6/2017	4.3766	4.1667	4.0876	3.5724	1.4175	0.1619
1/9/2017	4.3783	4.1592	4.0863	3.5537	1.4210	0.1621
1/10/2017	4.3735	4.1270	4.0737	3.5580	1.4167	0.1619
1/11/2017	4.3684	4.1465	4.0706	3.5694	1.4124	0.1616
1/12/2017	4.3728	4.1103	4.0791	3.6039	1.4212	0.1619

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