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Polish Weekly Review

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Comment on the upcoming data and forecasts

On Tuesday the CSO will publish the second estimate of GDP for the final quarter of 2016. We expect the flash reading of 2.7% y/y and 1.7% q/q to be confirmed this time. Of greater interest should be the structure of growth in Q4 – using annual data we judge that growth was primarily driven by consumption (+4.1% y/y) and inventory buildup (contributing more than 1 pp.). Investment probably rebounded less than initially estimated and our current forecast is -5.5% y/y. On Wednesday Manufacturing PMI for February will be released. We expect another strong release, consistent with the on-going upswing in the European industry.

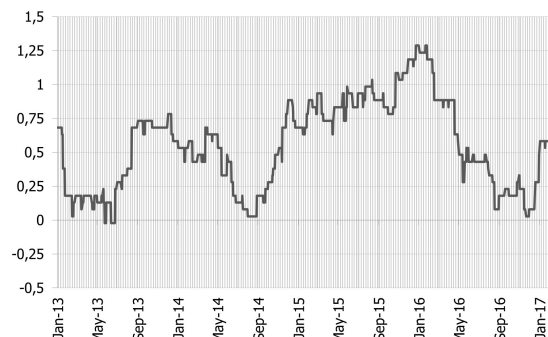
Polish data to watch: February 27th to March 3rd

Publication	Date	Period	mBank	Consensus	Prior
GDP y/y final (%)	28.02	Q4	2.7	2.7	2.7
Manufacturing PMI (pts.)	01.03	Feb			54.8

Treasury bonds and bills auctions

Paper	Next auction	Last Offer	Yield on the prev auction (%)	Prev auction
(29–37/52) Week T-bills	-	700	1.500	2/22/2017
2Y T-bond OK1019	3/2/2017	600	2.183	2/16/2017
5Y T-bond PS0422	3/2/2017	1400	3.177	2/16/2017
10Y T-bond DS0727	3/2/2017	1600	3.854	2/16/2017
30Y T-bond WS0447	-	2100	4.257	2/16/2017

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



Comment

Polish surprise index continues its upward trend – last week it was driven by better than expected unemployment rate. Next week bring two more opportunities to surprise – Manufacturing PMI and GDP data.

* 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

- GDP growth bottomed out at 2.4% y/y in Q3 2016. Momentum is very positive right now; growth picked up on a q/q basis in Q4 already (1.7% q/q). This year, growth will accelerate to the average of 3.4%, as investment returns to growth. Given the upside surprises in construction, one can expect investment growth to turn positive in Q2 already and GDP growth to exceed 3% in Q1. With consumption already solid, we expect growth to accelerate over the course of the year, touching 4% y/y in Q4.
- 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 2.5% 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. Because of the well-known base effects in oil prices, interest should turn to core inflation.
- 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. It is more realistic to place bets on monetary tightening in 2018.

Financial markets

- However, local factors should be positive for the Zloty: faster growth, good fiscal figures and potential for more aggressive rate hike bets should lift Zloty later this year.
- The prevailing event risk for PL assets, the CHF conversion, moved to the background. All known details are relatively benign (no forced conversion).

mBank forecasts

	2013	2014	2015	2016	2017 F	2018 F
GDP y/y (%)	1.4	3.3	3.9	2.8	3.4	3.5
CPI Inflation y/y (average %)	0.9	-0.1	-0.9	-0.6	2.2	2.3
Current account (%GDP)	-1.2	-2.1	-0.6	-0.6	-0.9	-1.1
Unemployment rate (end of period %)	13.4	11.4	9.8	8.3	7.8	7.3
Repo rate (end of period %)	2.50	2.00	1.50	1.50	1.50	2.00

	2017 Q1 F	2017 Q2 F	2017 Q3 F	2017 Q4 F	2018 Q1 F	2018 Q2 F	2018 Q3 F	2018 Q4 F
GDP y/y (%)	3.1	3.4	3.4	3.8	3.8	3.6	3.6	3.6
Individual consumption y/y (%)	4.4	4.2	3.8	3.8	3.6	3.5	3.4	3.4
Public Consumption y/y (%)	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Investment y/y (%)	-2.0	3.5	6.3	7.0	7.3	7.0	6.5	5.5
Inflation rate (% average)	2.1	2.4	2.4	1.9	2.1	2.2	2.3	2.4
Unemployment rate (% eop)	8.5	7.9	7.5	7.8	8.0	7.4	7.1	7.3
NBP repo rate (% eop)	1.50	1.50	1.50	1.50	1.50	1.50	1.75	2.00
Wibor 3M (% eop)	1.73	1.73	1.73	1.73	1.73	1.73	1.98	2.23
2Y Polish bond yields (% eop)	2.05	2.10	2.15	2.20	2.20	2.20	2.30	2.40
10Y Polish bond yields (% eop)	3.90	3.90	3.90	3.90	3.90	3.90	3.90	3.90
EUR/PLN (eop)	4.38	4.30	4.25	4.20	4.20	4.20	4.20	4.20
USD/PLN (eop)	3.91	3.91	3.94	4.04	4.12	4.12	4.12	4.12

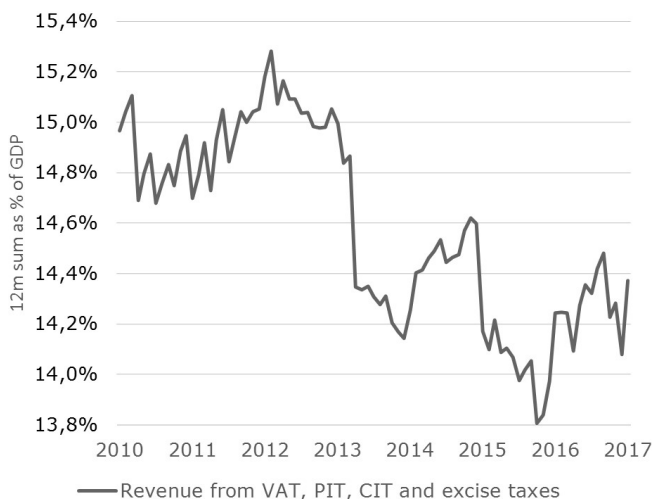
F - forecast

Economics

Fiscal update: the signal and the noise.

Some time has passed since we last dealt with fiscal issues in Poland. With rough estimates for 2016 fiscal year provided by the MoF and preliminary figures for January we can assess Poland's fiscal position and the progress in tax efficiency.

The 2016 budget closed with a deficit of 46.3 bn PLN, below the statutory limit of 54.7 bn PLN, but above the figure implied by January-November performance. In fact, deficit rose by 18.7 bn PLN in December alone, the biggest monthly deficit in Polish history. The biggest source of disappointment was the behavior of VAT revenues which halved on annual basis. The widely cited figure led many observers to draw far-fetching conclusions regarding impact of recent actions aimed at increasing tax collections. However, the poor VAT outturn at the end of the year was a result of accelerated tax refunds, as indicated by the MoF on multiple occasions, and not a sign of poor tax efficiency or earlier manipulations. This view was vindicated by better January figures – VAT revenues increased by 25% y/y, thereby making December a noisy anomaly and marking a return to trend.



And let's make it crystal clear – the trend in tax revenues is still positive. In January revenue from all main types of taxes (VAT, PIT, CIT and excise) increased briskly (by 25.4%, 5.4%, 15.0% and 17.2% y/y, respectively). While total tax revenues are likely to fall somewhat short of the annual goal implied by the 2017 budget, the shortfall will be adequately covered by the record-high payment of NBP profit. Most of the gap will be bridged by additional measures and tools introduced by the Ministry of Finance and by the windfall from higher-than-expected inflation this year. Taking a broader view, there is no question that the general government deficit will increase this year. The main culprit are local governments, who are set to resume investment activity this year. This alone has the potential to swing the GG balance by almost 1 pp. of GDP. The overall balance is likely to be close to 3% of GDP, but will not exceed this threshold. The overall short-term fiscal position of Poland is thus stable. In addition, the NBP profit will reduce gross financing needs this year (net financing needs have already been covered). It will not, however, impact the GG deficit.

Fixed income

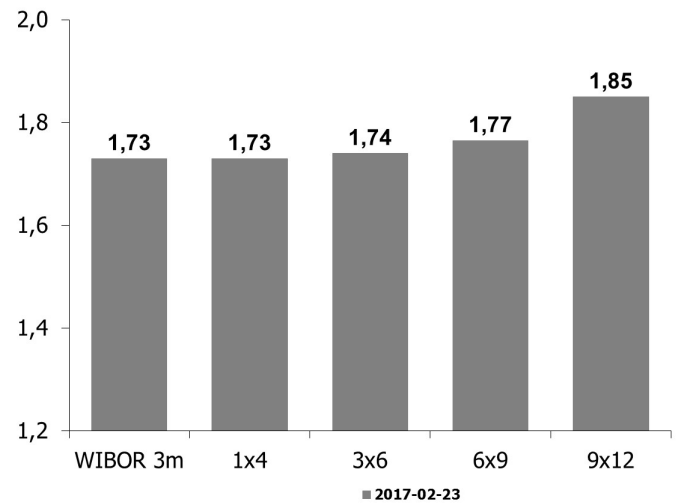
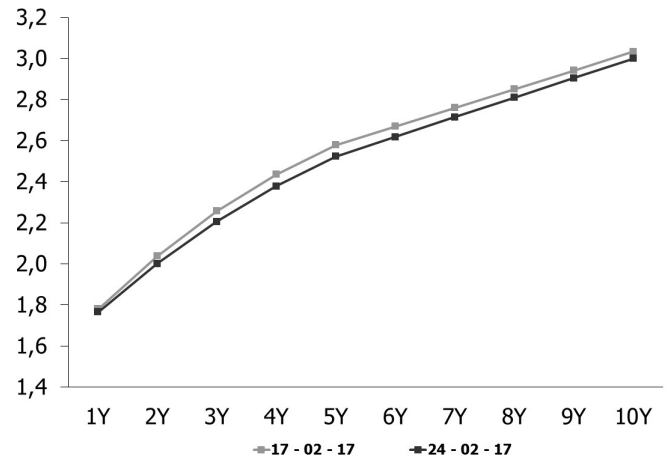
5Y rates at a crucial juncture

Next week we have an auction. The Ministry of Finance is selling OK0419/PS0422/DS0727/WZ1122/WZ0126. We think 4-6 bn will be sold.

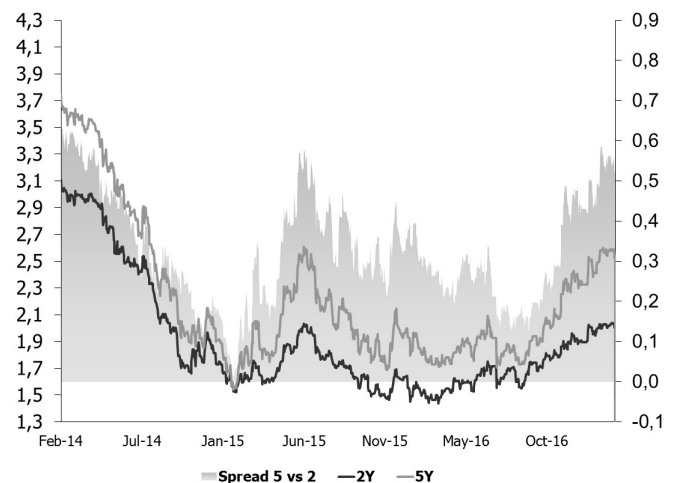
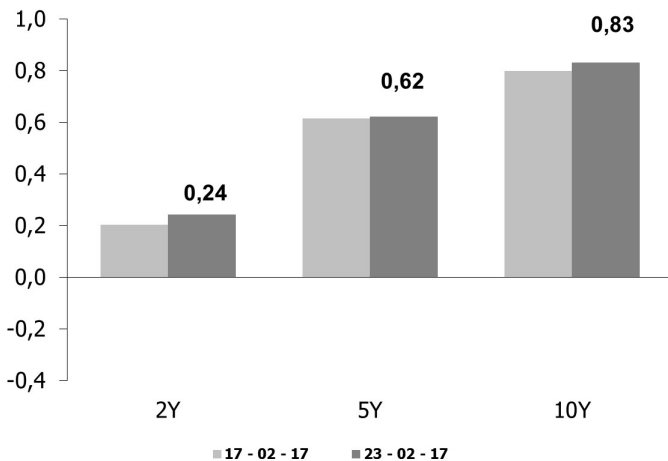
Last week, we were moving in a risk off/risk on mode. POLGBs haven't decided what to follow. We are touching very important levels on 5y IRS, 2.50-2.51% was a good support for last few weeks. On DS0727 we have similar situation, at 3,80-3,81% we can see the trend line.

The PS0422/DS0727 spread is back at 68 again, ASW PS0422/5y is at 63bps and DS00727/10y is at 81bps. OK0419 is trading at 2.23% (1 bps up), PS0422 is trading at 3.12% (4 bps down) and DS0727 is trading at 3.80% (1 bps down).

IRS curve



Asset swaps





Money market

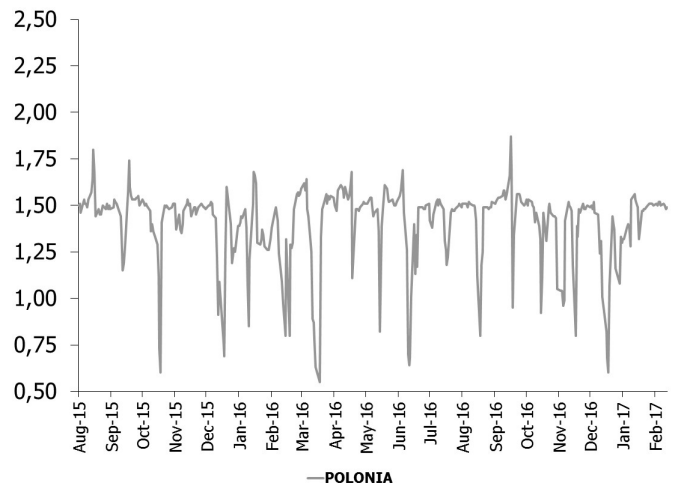
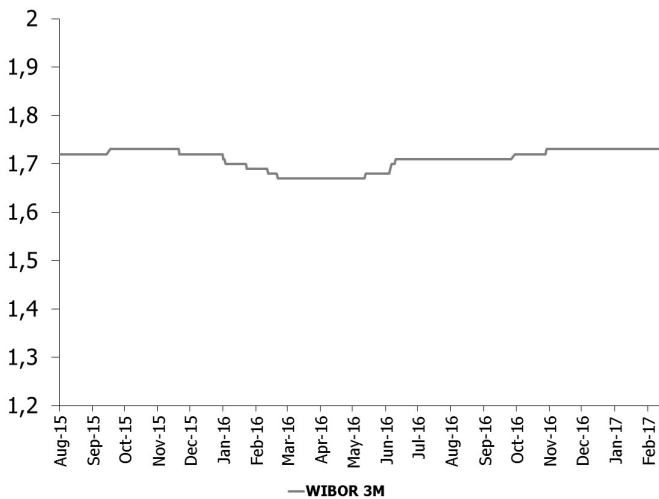
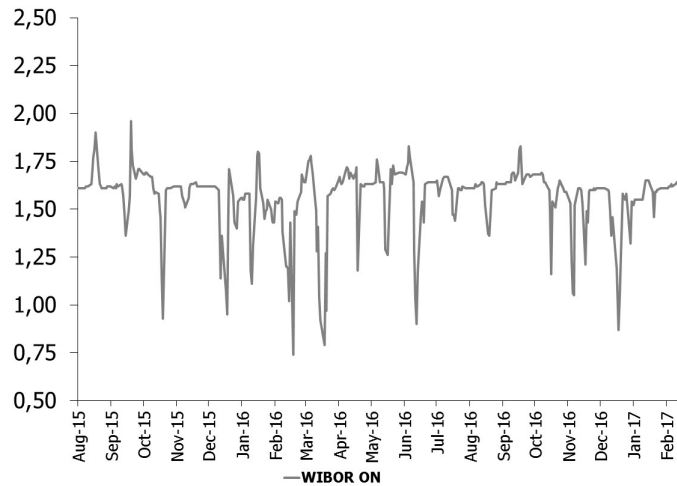
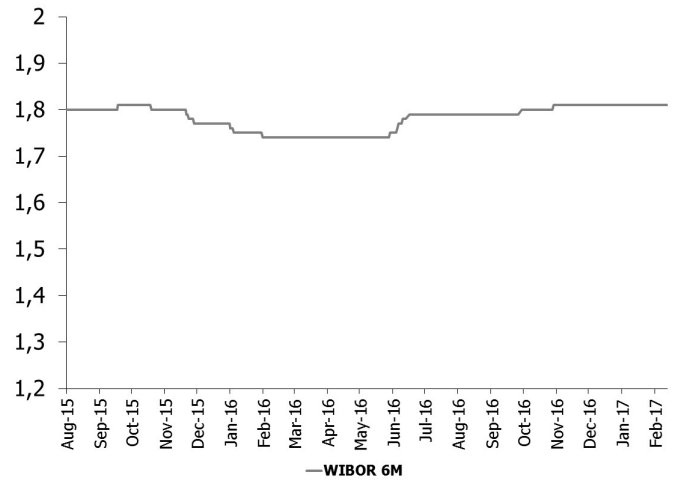
Breakout

We are breaking out from the recent tight range on Polish rates. The move seems to be going from swaps as ASW are widening strongly. The magnitude of that move can be quite decent as noone would expect such scenario. We might see levels where no rate hike is included and then we would like to pay some rates.

End of the month is approaching and the spread on ON rate will increase. Banks bought 3 bn less bills than the NBP offered today, therefore liquidity should be warranted.

Ref rate vs Polonia averages:

- 30 day 2 bp
- 90 day 14 bp



Forex

Spot – Boxed in the range EUR/PLN is boxed in a tight 4.27-4.34 range. Starting a week around 4.33, it dropped to 4.2880 before correcting to 4.31 again. The value of the equally weighted basket of EUR and USD against ZŁoty hardly changed. This shows a clear lack of momentum, and that we are simply mimicking EUR/USD moves. We still think the air is thin for PLN below 4.30, and as a result we are more skewed to fade PLN spikes.

EUR/PLN vols – The steepener Stronger PLN and low realized volatility is usually a recipe for lower vols. Not this time: the very frontend is a bit softer, but 1 year is 0.1% higher, so looks like the market expects the vols to pick up! 1 month EUR/PLN ATM mid is 5.25% (0.25% lower), 3 months EUR/PLN are 6.8% (unchanged) and, finally, 1 year is fixing at 7.5% (0.1% higher). The currency spread (difference between USD/PLN and EUR/PLN) is also steeper, with post-FOMC dates substantially higher in vols. Skew is roughly unchanged.

Short-term forecasts

Main supports / resistances:

EUR/PLN: 4.25 / 4.35

USD/PLN: 3.90 / 4.20

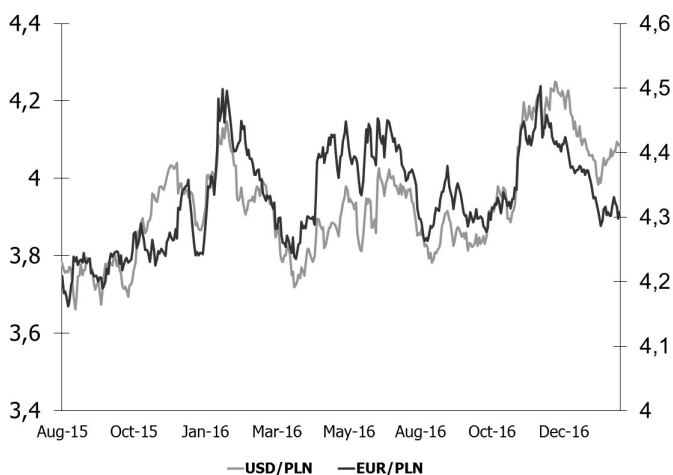
Spot Position: Long EUR/PLN.

We are long EUR/PLN at 4.2930, we are ready to add at 4.2600 and we have a stop at 4.2350. We are hoping to revisit 4.35 on the way to 4.39.

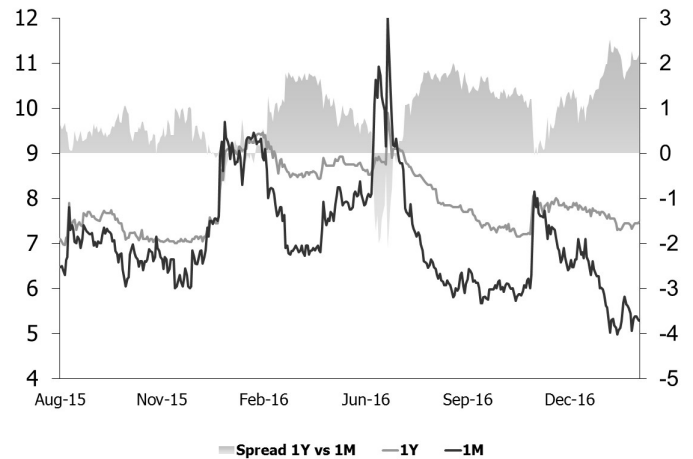
Our hopes are based on the rangy nature of EUR/PLN. Technically, 4.25-4.27 is a mighty support zone, that was not even scratched until now. The PLN seems to be over-owned and hence exposed to possible weakness. The risk on mood has prevailed for weeks already and we have French and Dutch elections in front of us.

Options Vol – Long 9 month EUR/PLN vol.

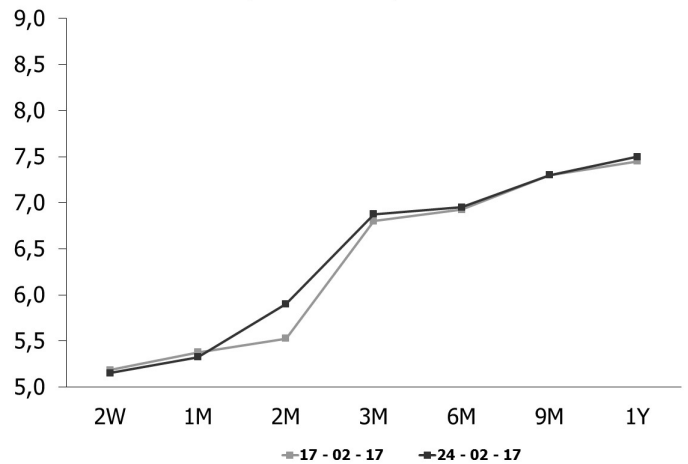
We are keeping the backend long as an outright long position. We see French and Dutch elections as a good enough reason to be long vol at current levels.



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
2/17/2017	1.95	1.73	2.02	1.71	2.18	1.75	1.73	1.75	1.79	1.90	2.00	1.90
2/20/2017	1.95	1.73	2.02	1.71	2.17	1.75	1.73	1.75	1.79	1.88	1.98	1.89
2/21/2017	1.55	1.73	1.58	1.71	1.61	1.75	1.73	1.75	1.79	1.88	1.99	1.90
2/22/2017	1.79	1.73	1.84	1.71	2.01	1.75	1.73	1.75	1.79	1.89	1.98	1.90
2/23/2017	1.95	1.73	2.01	1.71	2.18	1.75	1.73	1.74	1.77	1.85	1.95	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
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
2/17/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
2/20/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
2/21/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
2/22/2017	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
2/23/2017	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	
2/17/2017	5.38	6.80	6.93	7.45	7.45	1.96	0.50	
2/20/2017	5.38	6.90	6.98	7.45	7.45	1.96	0.50	
2/21/2017	5.33	6.83	6.90	7.45	7.45	1.90	0.50	
2/22/2017	5.29	6.80	6.95	7.48	7.48	2.13	0.50	
2/23/2017	5.33	6.88	6.95	7.50	7.50	2.04	0.50	

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
2/17/2017	4.3314	4.0693	4.0711	3.6039	1.4071	0.1603
2/20/2017	4.3227	4.0692	4.0564	3.5979	1.4022	0.1599
2/21/2017	4.3163	4.0942	4.0561	3.5990	1.4031	0.1597
2/22/2017	4.2977	4.0899	4.0375	3.6146	1.3988	0.1591
2/23/2017	4.3076	4.0840	4.0411	3.6076	1.3987	0.1594

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