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Polish Weekly Review

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Comment on the upcoming data and forecasts

All relevant releases are clustered on Friday. We will start with the release of Q4 flash GDP. On the basis of annual data we can estimate GDP growth at 3.9% y/y (which implies more than 1% in quarterly terms). Balance of payments data (for December) should show a modest widening in current account balance, mainly due to smaller trade surplus (strong seasonal declines in both imports and exports). At the same time the Central Statistical Office will publish CPI data for January (because of the changes in CPI item weights there was no flash release this time). We expect annual inflation to decline slightly due to very low growth of core categories and a sizeable decline in fuel prices (because of that base effects from the previous year do not work this time).

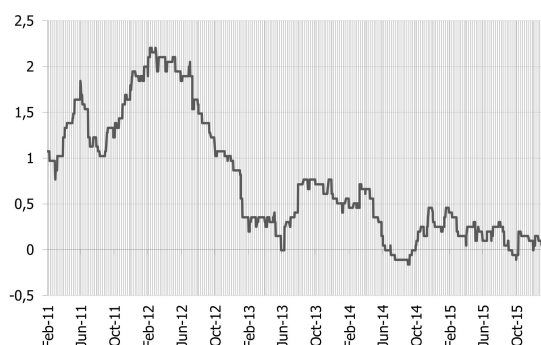
Polish data to watch: February 8th to February 12th

Publication	Date	Period	mBank	Consensus	Prior
GDP (flash) y/y (%)	12.02	Q4	3.9	3.8	3.5
Current account balance (mio EUR)	12.02	Dec	-301	-301	620
Exports (mio EUR)	12.02	Dec	13700	13639	15504
Imports (mio EUR)	12.02	Dec	13400	13683	14748
M3 y/y (%)	12.02	Jan	9.0	9.5	9.1
CPI y/y (%)	12.02	Jan	-0.6	-0.5	-0.5

Treasury bonds and bills auctions

Paper	Next auction	Last Offer	Yield on the prev auction (%)	Prev auction
32 Week T-bills	-	2000	1.365	1/18/2016
2Y T-bond OK1018	-	3000	1.665	2/4/2016
5Y T-bond PS0720	2/18/2016	3500	2.382	1/7/2016
10Y T-bond DS0726	-	3000	3.168	2/4/2016
15Y T-bond WS0428	-	20	2.092	3/12/2015

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



Comment

Unchanged - the only relevant publication (Manufacturing PMI) disappointed only slightly. Next week is all about Friday and GDP & CPI data - some surprises might pop up there.

* 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 perspectives brightened recently.
- 500+ program is set to support private consumption in 2016. At the same time, global headwinds do not seem to be detrimental for Polish exports (exports benefit from better euro zone momentum and weak zloty). Public infrastructure outlays have shifted towards the latter part of 2016 and private investment seems to be locally, negatively affected by political uncertainty. However, positive impulses from consumption and exports are set to encourage private capital formation amid stretched capacity utilization.
- Given the current lags of infrastructure spending and constantly fueled consumption growth (child subsidy now, higher tax-free allowance from 2017), many years of economic expansion are our baseline scenario for the Polish economy. The upswing can be flatter than we historically got used to but longer. Such an outcome almost guarantees that the likelihood of bottlenecks in the economy is small.
- Current GDP growth is sufficient to keep inflation and credit risk in check. Globally low to moderate growth amid low commodity prices are set to further underpin deflationary environment. Headline inflation is going to slowly rise only on the back of statistical base.
- Rate cuts in 2016 are still a possibility. Polish monetary policy is going to converge with the one run by the NBH. Therefore, we expect the newly elected MPC members to be more responsive to low inflation and government financing costs.

Financial markets

- We turn constructive on 10y bonds and go for an outright long position.
- Although we still wait for the final ruling on CHF conversion programme, domestic risks are well defined now. S&P's rating downgrade was a forward-looking move accounting for possible negative fiscal developments in the months to come. As a consequence, sentiment turned sour. We think it is time to await de-escalation. Macro momentum is quite strong suggesting tighter credit spreads. Deflation will last longer than expected even a month ago. As expected, central banks turned more dovish globally and the next round of global monetary easing is ongoing.
- Polish bonds' valuations are now attractive vs. HU (most accurate benchmark) and euro peripherals. The share of foreign investors decreased over the last 2 months. As the most important uncertainty for the Polish economy is mostly tied to the exchange rate (CHF conversion programme), zloty may be underperforming for some time. As soon as uncertainty fades, we await stronger domestic currency. Breaking 4.44 to the downside can be a trigger for deeper correction.

mBank forecasts

	2011	2012	2013	2014	2015F	2016 F
GDP y/y (%)	5.0	1.6	1.3	3.3	3.6	3.8
CPI Inflation y/y (average %)	4.3	3.7	0.9	-0.1	-0.9	0.5
Current account (%GDP)	-5.2	-3.7	-1.3	-2.0	-0.1	-0.7
Unemployment rate (end of period %)	12.5	13.4	13.4	11.4	9.8	8.7
Repo rate (end of period %)	4.50	4.25	2.50	2.00	1.50	1.25

	2015 Q1	2015 Q2	2015 Q3	2015 Q4	2016 Q1 F	2016 Q2 F	2016 Q3 F	2016 Q4 F
GDP y/y (%)	3.7	3.3	3.5	3.9	3.6	3.8	3.8	3.9
Individual consumption y/y (%)	3.1	3.1	3.1	3.2	3.4	3.8	4.0	4.0
Public Consumption y/y (%)	3.7	2.5	2.7	3.8	0.5	2.0	2.0	2.0
Investment y/y (%)	11.5	6.1	4.6	4.8	5.5	6.0	6.0	6.6
Inflation rate (% average)	-1.4	-0.9	-0.7	-0.6	-0.4	0.0	0.5	1.7
Unemployment rate (% eop)	11.5	10.2	9.7	9.8	10.0	9.0	8.6	8.7
NBP repo rate (% eop)	1.50	1.50	1.50	1.50	1.50	1.25	1.25	1.25
Wibor 3M (% eop)	1.65	1.72	1.73	1.72	1.68	1.44	1.44	1.44
2Y Polish bond yields (% eop)	1.61	1.99	1.76	1.62	1.30	1.10	1.35	1.55
10Y Polish bond yields (% eop)	2.31	3.31	2.84	2.94	2.90	2.80	3.00	3.20
EUR/PLN (eop)	4.07	4.19	4.25	4.26	4.45	4.35	4.30	4.25
USD/PLN (eop)	3.80	3.76	3.80	3.92	4.05	3.95	3.91	3.86
F - forecast								

Economics

MPC keeps rates unchanged

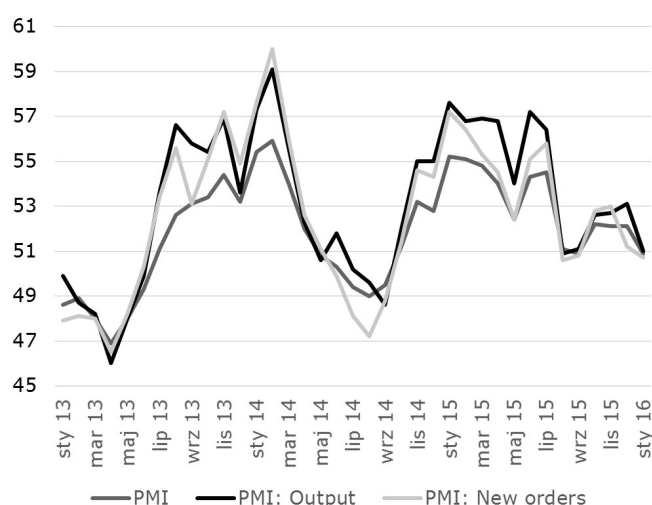
Polish Monetary Policy Council did not change interest rates on February's meeting. This was the first meeting for the three new members appointed by the upper chamber of the Parliament (Chrzanowski, Gatnar and Kropiwnicki), but we were not able to see any novelties in the wording. Comparing to previous document, this one was a little more hawkish. Lot of attention was paid to strong GDP growth for 2015; the phrase about companies being uncertain of future demand was removed. Also, the MPC now claims that deflation is not supposed to have a negative impact on economic activity. Moreover, instead of acknowledging a downward revision of inflation path, the MPC added a passage on slow acceleration of core inflation. The final sentence in the statement did not change – MPC awaits next NBP projections in order to draw further conclusions.

Although such wording could bring forward rate hike expectations, MPC members taking part in the conference definitely put away such a scenario. Governor Belka said directly that MPC did not change its view on possibility of rate cuts / hikes since January's meeting and that he does not believe that the moment when the Council starts a rate hike cycle is near. On the other hand, when asked about rate cuts he pointed out tense situation on financial markets (high Zloty volatility in last weeks) and possibly bad timing for such an action.

Next meeting will be held in an even more updated lineup. The three new members, appointed by the lower chamber of the Parliament this time, will also participate, but we do not think that market situation will allow for rate cuts. Those are more probable in the second quarter when PLN is expected to strengthen. We hold our call about opportunistic character of monetary policy easing.

PMI touches 16-month minimum

Polish manufacturing PMI fell in January from 52.1 to 50.9 pts., below both our forecast (51.5) and market consensus (51.8). In contrast to previous releases, PMI was not saved by better production outlook – this subindex fell for the first time since September 2015. New orders category also performed poorly - it dropped to 50.7, worst reading since last August. Only thanks to stellar new foreign orders this category was able to withstand further drop. Other elements of the report did not change since December: employment rose at a stable pace (confirming NBP and CSO indicators) and there in no sign of price or cost pressures (both indices signalled further falls).



In our previous PMI comment we pointed out the divergence between PMI and similar CSO indices which made unambiguous conclusions difficult to draw. However, this factor has just disappeared (CSO data shows a deterioration in not only general climate but also in new orders and production assessment). Taking into account positive domestic growth perspectives (including private consumption) and high competitiveness of exports (thanks to weak currency), the easiest way to explain the latest drop in PMI is to pin it down on heightened business uncertainty associated with changes in economic policy, legal system and taxation. These factors appeared in earlier NBP researches on the major sources of uncertainty and could be in fact the real reasons here.

Since we do not see a permanent decline in demand in PMI data but only higher uncertainty, it is hard to find its confirmation in the real sphere data. Most probably (following aforementioned NBP's conclusions) this could be realized as a temporary shock to private investment. This coincides with our forecast – GDP growth in 2016 will stabilize, while its structure will move towards private consumption and exports.

Fixed income

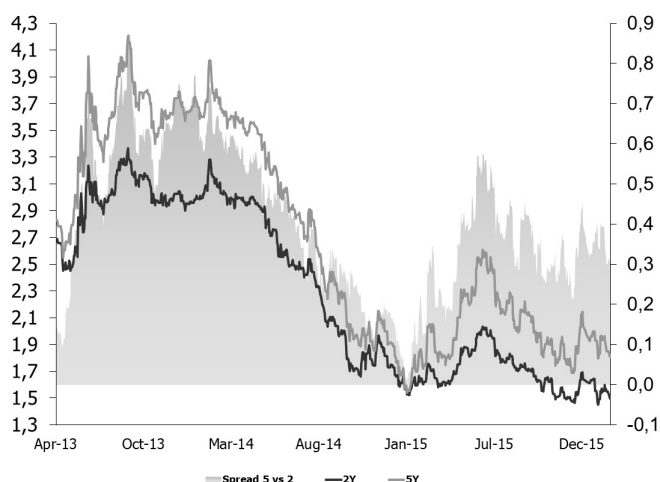
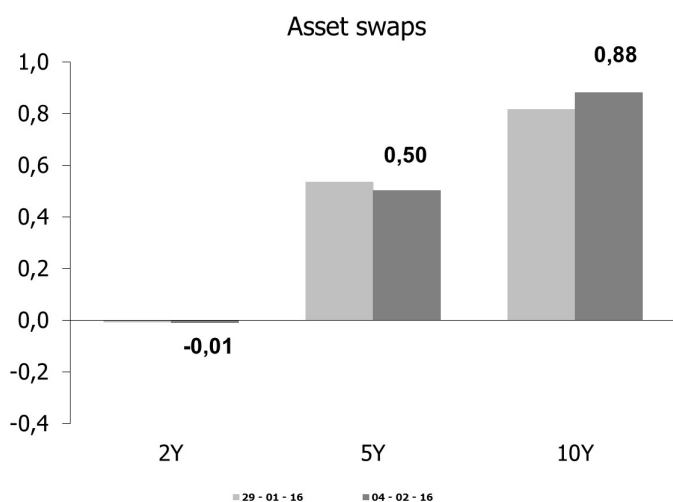
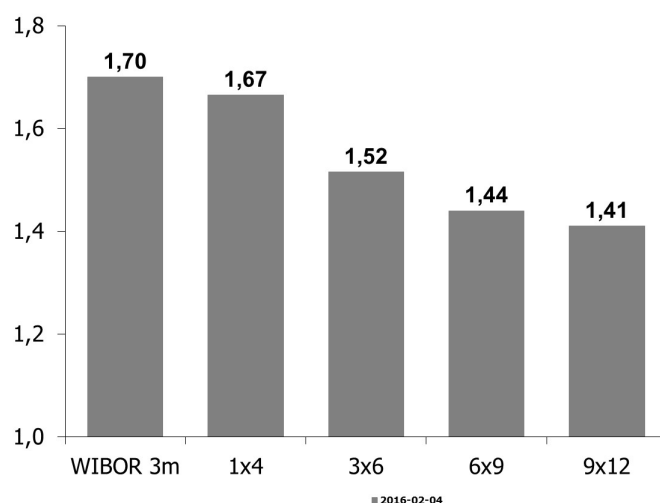
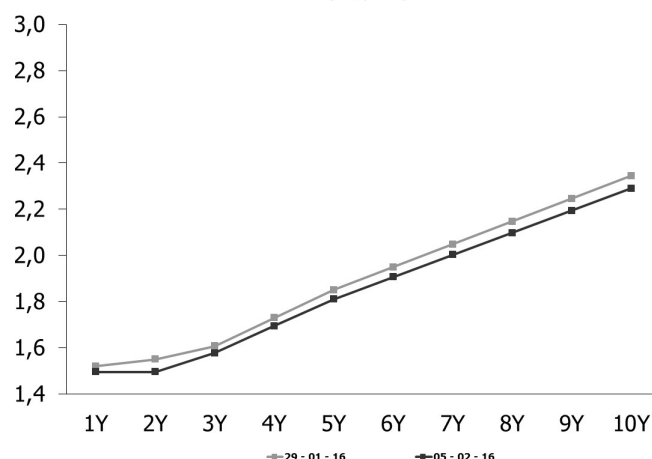
Strong auction

This week all eyes were on Thursday's auction of OK1018 and DS0726. Investors wanted to know if the market is able to absorb long duration at similar to pre-downgrade levels – it absorbed it very well. Auction results were decent (OK1018 1,665% 3,64bio PLN sold vs. 5,96 bio demand; DS0726 3,168% 3,86 vs. 5,66); top-up auction of 1 bio OK1018 and 0,5 bio DS0726 was sold without any problems as well. After auction price action (ytm -3bps) clearly showed that the appetite for POLGBs is still insatiable. Draghi comments, BoJ cut, low crude oil price didn't push yields lower, POLGBs clearly lagged this move as market players weighted Thursday supply after S&P downgrade. As asset swap curve become similar to the Hungarian one, spread of DS0726 against Bund reached 288bps – POLGBs started to attract attention as a cheap investment in 'A-' bonds – demand finally appeared.

Lower than expected NFP data (151k vs. 190k estimated) in conjunction with higher hourly earnings (+2.5% vs. 2.2% y/y) and lower unemployment rate (4.9% vs. 5.0%) were slightly negative for the market (+3 bps.).

We still see some scope for further decline in yields, especially in the long end of the curve.

IRS curve



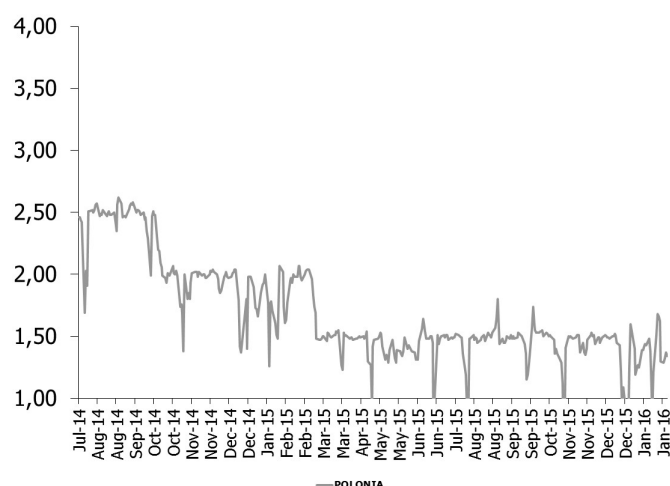
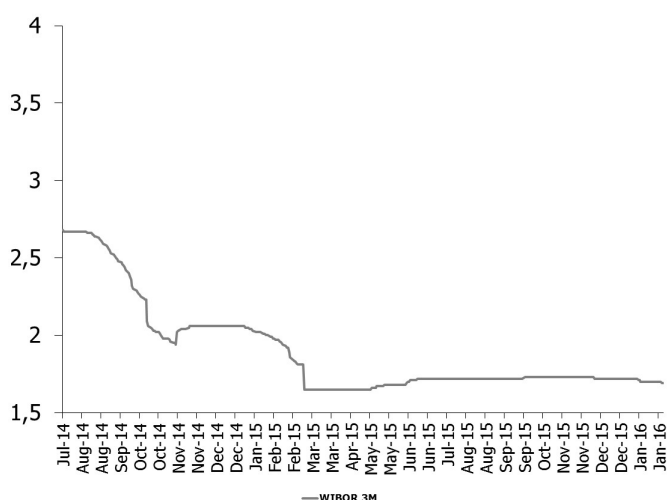
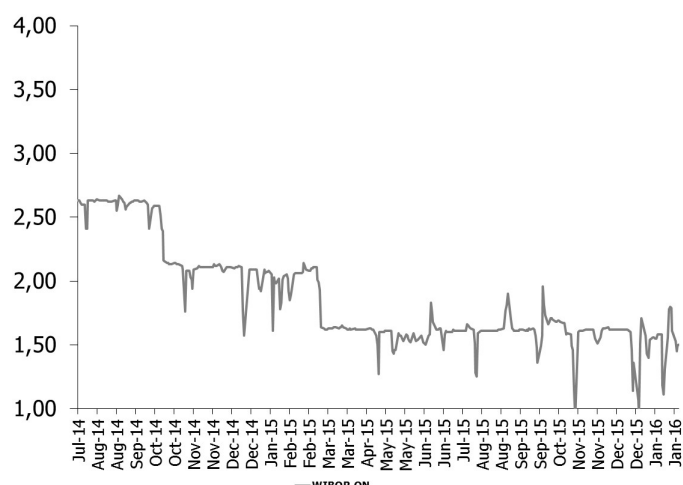
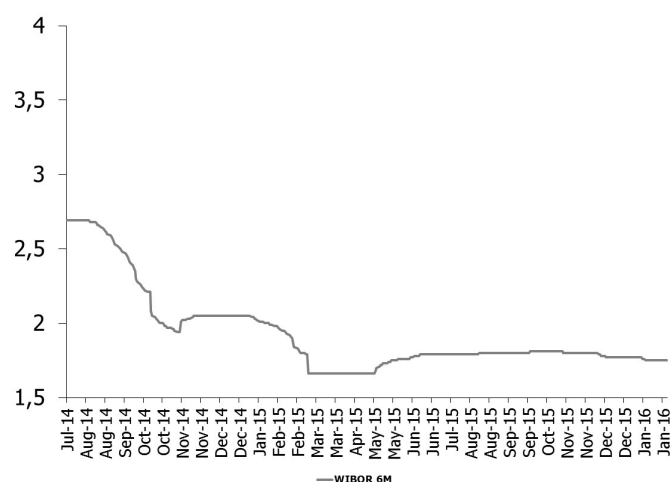
Money market

Heading towards 50bp cut again

As we mentioned a week ago, we had an easy-funding week. Overnight rates hovered around 1,30-1,40% and NPB didn't decide to step in with additional OMO.

Surprisingly, today's OMO was again underbid, banks bought around 7 bio less than what was needed to square off the market. Next week should be quite easy again.

As about OIS and FRA curves go, we are heading down after another wave of easing announcements around the globe. We think this trend may continue, but we are cutting receivers and thinking about paying rates when we reach 50 bp cut expectations. Ideally that would come before ECB meeting.



Forex

Spot – PLN still looks shaky PLN recovery continues. It is modest against EUR, though, as EUR/PLN consolidates in mini range 4.38–4.43 (the low was 4.3750). Zloty strength is the most visible against USD as USD/PLN dropped from 4.07 to 3.93. Nevertheless volatility persists and although political situation is calmer we still have a lot of pending issues (CHF loans conversion to name just one). The global sentiment seems to be improving. The dovish ECB and BOJ are still supporting EM, PLN included. We expect wider 4.33-4.48 range for EUR/PLN until ECB or new political developments push us one way or another.

Options – Vol curve got steeper A little bit of the both side interest in EUR/PLN vols space. 1 month was given at 8.5% in good amount, on the other hand 1 year EUR/PLN traded at 9.2% and 2 years at 9.5%. In general 1 month EUR/PLN ATM is this Friday at 8.3% (0.6% lower), 3 months are 8.8% (0.1% lower) and finally 1 year is fixing at 9.2% (0.1% higher). The currency spread (difference between USD/PLN vol and EUR/PLN vol) was bid vigorously, 1 month C/S was given 1.5% only to be paid at 2.8% later this week. The skew was better offered, down by roughly 0.2%.

Short-term forecasts

Main supports / resistances:

EUR/PLN: 4.37 / 4.53

USD/PLN: 3.90 / 4.20

Position Spot Short EUR/PLN at 4.4775, closed with profit at 4.3975.

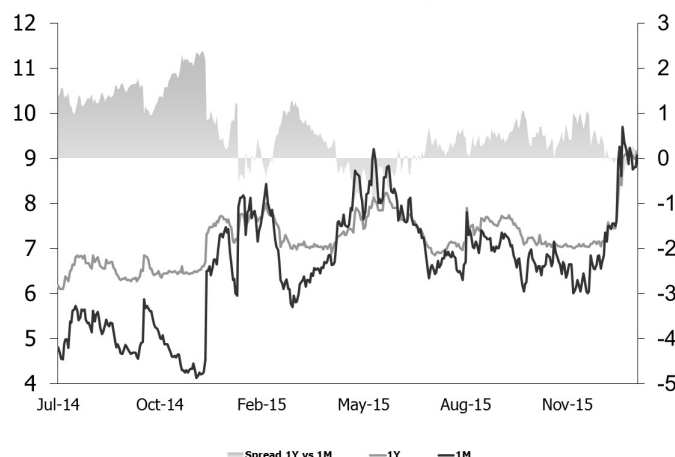
Current position: none.

It is a bit like a toss of a coin. As we seat just in the middle of our predicted middle term range 4.33-4.48, the picture is blurred at best. We are switching to tactical/opportunistic approach.

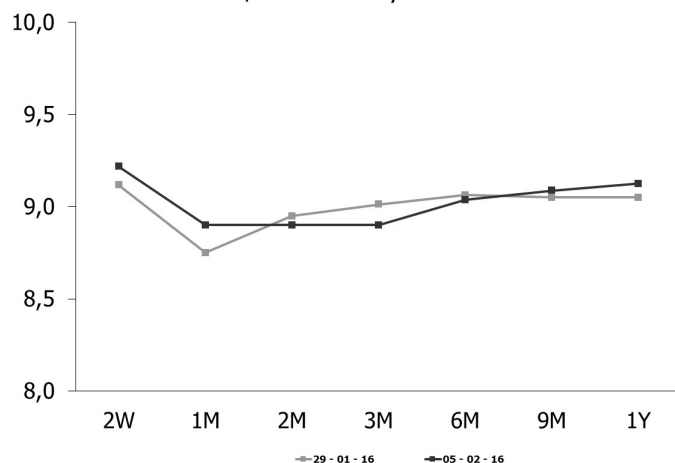
Options Stalemate

We are still short frontend Vega in EUR/PLN (up to 4 months). Even though realized volatilities still are at elevated levels. On the positive side, 1 months was given at 8.5% in good amount. But we need much calmer markets, and possibly stronger Zloty before frontend Vols start to melt more significantly.

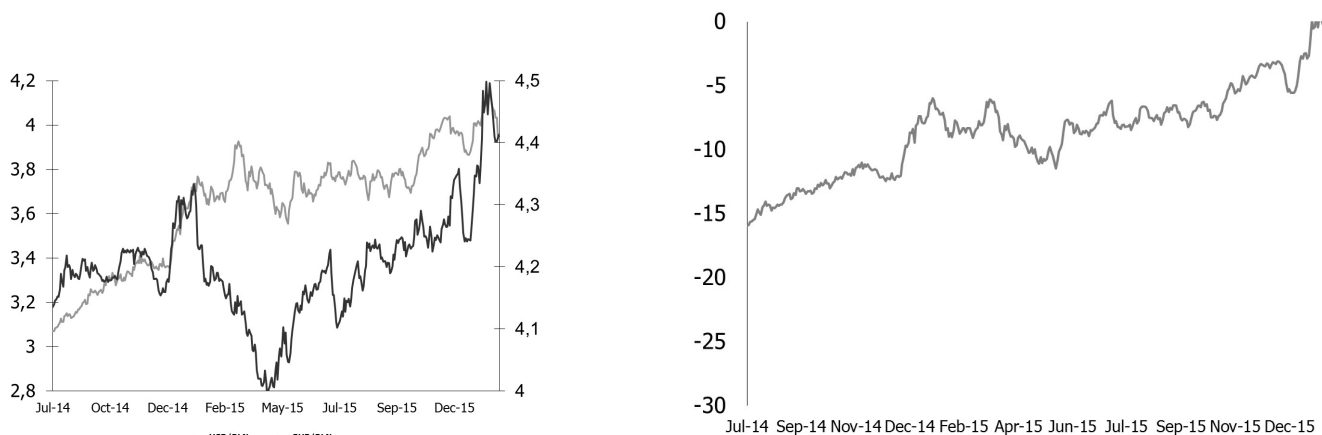
EURPLN volatility



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
1/28/2016	1.55	1.70	1.59	1.65	1.57	1.67	1.68	1.54	1.47	1.45	1.44	1.50
2/1/2016	1.41	1.70	1.41	1.65	1.53	1.67	1.68	1.53	1.46	1.44	1.43	1.48
2/2/2016	1.55	1.70	1.54	1.65	1.49	1.67	1.67	1.52	1.46	1.40	1.41	1.44
2/3/2016	1.32	1.69	1.54	1.65	1.56	1.67	1.67	1.50	1.40	1.38	1.39	1.42
2/4/2016	1.73	1.69	1.78	1.65	1.67	1.67	1.67	1.52	1.44	1.41	1.40	1.46

Last primary market rates							
Paper	Au. date	Maturity	Avg. price	Avg. yield	Supply	Demand	Sold
32W TB	1/18/2016	8/31/2016	99.16	1.37	2000	11765	2400
OK1018	2/4/2016	10/25/2018	95.62	1.67	3000	8160	4645
PS0421	1/7/2016	4/25/2021	98.11	2.38	3500	724	4555
DS0726	2/4/2016	7/25/2026	94.10	3.17	3000	6661	4366

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0715	5Y IRS	PS0718	10Y IRS	DS1023
1/28/2016	1.670	1.474	1.635	1.578	1.960	2.232	2.405	2.949
2/1/2016	1.670	1.474	1.635	1.578	1.960	2.232	2.405	2.949
2/2/2016	1.670	1.474	1.635	1.578	1.960	2.232	2.405	2.949
2/3/2016	1.670	1.474	1.635	1.638	1.990	2.290	2.447	2.985
2/4/2016	1.670	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	
1/28/2016	9.05	9.05	9.08	9.08	9.08	2.08	0.44	
2/1/2016	8.80	8.93	8.93	8.99	8.99	2.08	0.44	
2/2/2016	8.80	8.88	8.88	8.98	8.98	2.09	0.57	
2/3/2016	9.05	9.10	9.15	9.15	9.15	2.09	0.57	
2/4/2016	8.90	8.90	9.04	9.13	9.13	2.10	0.57	

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
1/28/2016	4.4588	4.0872	4.0265	3.4411	1.4235	0.1650
2/1/2016	4.4104	4.0638	3.9730	3.3524	1.4188	0.1631
2/2/2016	4.4015	4.0333	3.9520	3.3419	1.4139	0.1629
2/3/2016	4.4024	4.0325	3.9642	3.3725	1.4159	0.1629
2/4/2016	4.4078	3.9492	3.9431	3.3549	1.4232	0.1631

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