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Polish Weekly Review

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Comment on the upcoming data and forecasts

March MPC meeting (announcement on Friday) is the only important event next week. While the line-up of the MPC will meet for the first time, no significant changes to monetary policy instruments are expected. First, recent communication from MPC members was cautious and indicated that current policy is adequate. Secondly, weak PLN and excess volatility suggests that markets must stabilize before interest rates can be cut. That said, it is very likely that the MPC will strike a more dovish tone and acknowledge the weakness in the global economy. In addition, the new staff CPI projections are set to be significantly lower than the November vintage.

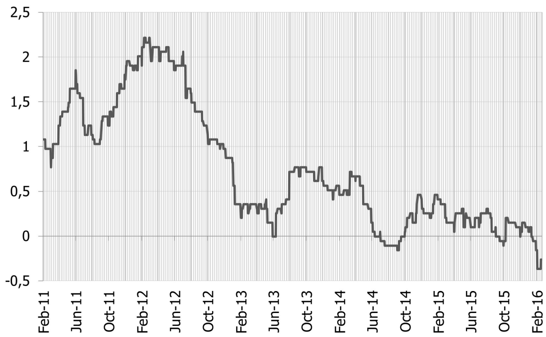
Polish data to watch: March 7th to March 11th

Publication	Date	Period	mBank	Consensus	Prior
NBP rate decision (%)	11.03	Mar	1.50	1.50	1.50

Treasury bonds and bills auctions

Paper	Next auction	Last Offer	Yield on the prev auction (%)	Prev auction
(32/37/52) Week T-bills	3/14/2016	1500	1.290	2/15/2016
2Y T-bond OK1018	4/7/2016	2700	1.553	3/3/2016
5Y T-bond PS0720	4/7/2016	4800	2.219	2/18/2016
10Y T-bond DS0726	4/7/2016	5500	3.014	3/3/2016
15Y T-bond WS0428	-	20	2.092	3/12/2015

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



Comment

Slightly up - final GDP merely confirmed the flash reading of 3.9% but the PMI surprised to the up-side. Next week will be a boring one - no data releases.

* 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).

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Our view in a nutshell

Fundamentals

- GDP growth perspectives brightened recently.
- 500+ programme 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 close CASH recommendation and again turn positive on 10Y POLGBs (meanwhile 10Y bonds moved up by few bps in yield).
- Risk premium looks too high. Polish yield curve is extremely steep. We are keen to use most recent technical setback to re-enter longs in 10Y POLGBs.
- Foreign investors' perception of Polish bonds improved recently (one cannot say the same on equities where sectoral story is still determined by politics).
- Polish zloty lately trades decently which points to fading local risks. Polish bonds may well be supported by expected RRR cut.

mBank forecasts

	2011	2012	2013	2014	2015	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	0.2
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	3.1	3.4	3.8	4.0	4.0
Public Consumption y/y (%)	3.7	2.5	2.7	4.8	0.5	2.0	2.0	2.0
Investment y/y (%)	11.5	6.1	4.6	4.9	5.5	6.0	6.0	6.6
Inflation rate (% average)	-1.4	-0.9	-0.7	-0.6	-0.6	-0.3	0.2	1.3
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	1.50	1.25	1.25
Wibor 3M (% eop)	1.65	1.72	1.73	1.72	1.68	1.68	1.44	1.44
2Y Polish bond yields (% eop)	1.61	1.99	1.76	1.62	1.35	1.35	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	4.35	4.35	4.30	4.25
USD/PLN (eop)	3.80	3.76	3.80	3.92	3.95	3.95	3.91	3.86

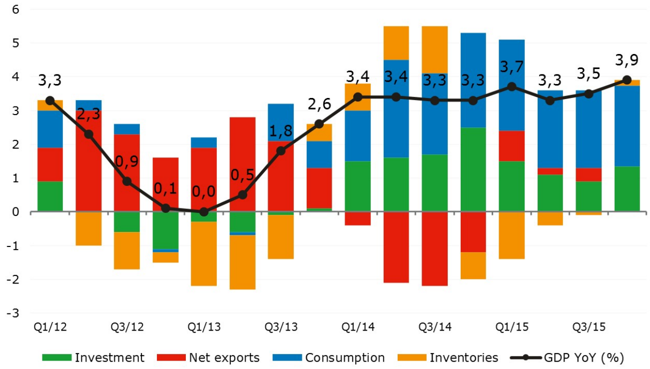
F - forecast

Economics

Solid GDP growth at the end of the year

According to preliminary data, Polish GDP grew by 3.9% y/y in the fourth quarter, in line with our forecast and flash estimate. On a quarterly basis, GDP growth accelerated to 1.1% q/q (seasonally adjusted).

Reading was not surprising in the details of the release. Private consumption grew by 3.1% y/y for the fourth time in a row, but we expect that in further revision correlation with retail sales (which accelerated at the end of the year) and household income data will return – just as it happened with 2014 data. Public consumption, which hastened from 2.7 to 4.8% y/y, was the main driver of faster economic growth in last quarter of 2015. This coincides with parliamentary elections, but whatever the true reason for this acceleration is, we should get used to such patterns (e.g. public sector wages unfrozen). Investment rate grew in Q4 by 4.9%, which is a result of a slowdown in public (i.e. at best stagnation on annual basis) and solid rise in private ones. If we factor in almost zero contribution of inventories and net exports, domestic demand grew by 3.9% (fastest in 2015).



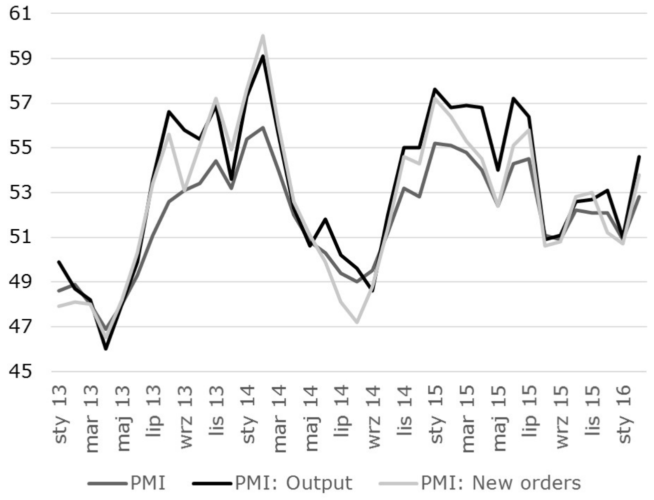
Changes in economic policies will cause a further shift towards the domestic component of growth (private consumption will be boosted by the new child subsidy programme) while exports is bound to make healthy contributions to growth. It is worth noting that Poland, which exhibits a relatively high share of domestic value added in gross exports and a relatively low fx debt, is clearly a net beneficiary of PLN depreciation. This means that it will keep its trade surplus even if imports rebound (just as it did in Q4). On the other hand, sharp cutbacks in local government budgets and a hiatus in EU-financed spending (with the notable exception of road investment) suggest that public investment will decline in 2016. Granted, growth will be supported by private investment, but it won't be enough for investment to retain this year's average growth rate. This is especially true because of the uncertainty shock that negatively affected private investment plans at the turn of the year (a spike in tax- and regulation-related uncertainty as measured by NBP enterprise surveys).

Monetary policy prospects are essentially unchanged. Rate cuts will likely be treated opportunistically by the new MPC and, as such, there won't be any pre-commitment. Measures aiming at increasing liquidity and boosting banks' demand for T-bills (cutting reserve requirement ratio, de-anchoring interbank rates from the reference rate) are probably considered, with the Hungarian central bank as a role model.

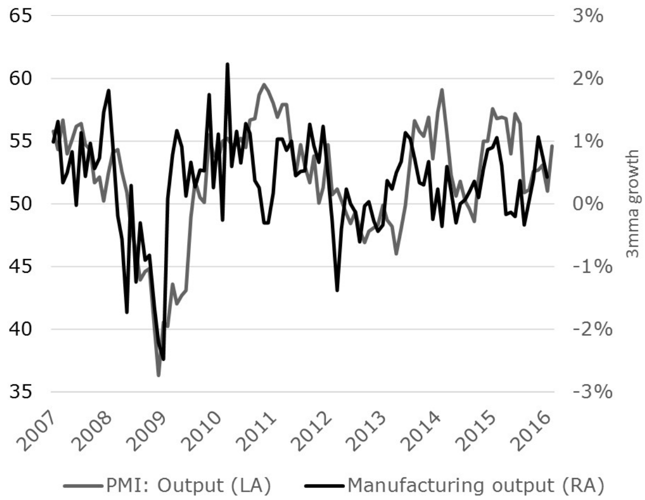
Solid GDP growth is of course good news from the market standpoint. We believe to be yet another reason to price our credit risk in Poland (and this is one of the main reasons for market turmoil at the beginning of 2016). Since growth remains high and supported by domestic components, there is no danger of external imbalances (countries with strong external balance are favored by investors). In addition, recent information on the fiscal side suggests more optimism as tax revenues rebounded at the turn of the year and the government seems determined to bridge the VAT gap. This means that, unless global risks escalate and translate into materially weaker global growth, future budgets become more manageable. All in all, Polish yield curve still seems to steep and Polish long term bonds appear too cheap, not only with respect to regional benchmarks.

PMI at long last surprises positively

In February Polish Manufacturing PMI unexpectedly (consensus and our forecast indicated another fall) rose from 50.9 to 52.9. This was the largest increase since June 2015.



The rebound was driven by two categories: new orders (from 50.7 to 53.8) and production (from 51.0 to 54.6). Both subindices reached their highest values since July 2015. Assessment of labour demand remains strong as well. It is worth mentioning that new export orders category is also improving at a steady pace (it has reached several month maximum). It seems that despite the weakness of export markets (as indicated by disappointing publications of European PMI indices), Polish exporters are performing at least fine. Analogous CSO indices could be lagging – drop in production and new orders category in February's CSO surveys could correspond to weakness of January PMI. We interpret price subindices as a confirmation of a deflationary equilibrium in the Polish economy. For the six time in a row production costs in manufacturing fell and index of factory gate prices is contracting for the seventh time.



While this release is a positive sign for the Polish economy, drawing conclusions about hard data is burdened with uncertainty. Still, we can state with a small margin of error that Polish economy holds its solid momentum (see chart above). Our growth forecast for 2016 looks quite sound. International aspect is much more interesting. Even though, there are serious concerns about economic growth in the euro zone and whole Europe, sentiment among Polish companies is steadily rising without too much worries. This should result in diminishing risk premium in Polish assets and on the other hand, overweighting Polish assets in EM portfolios.

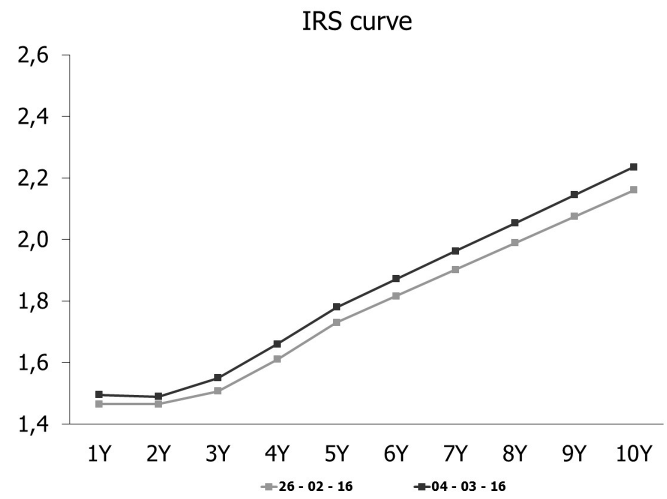
Fixed income

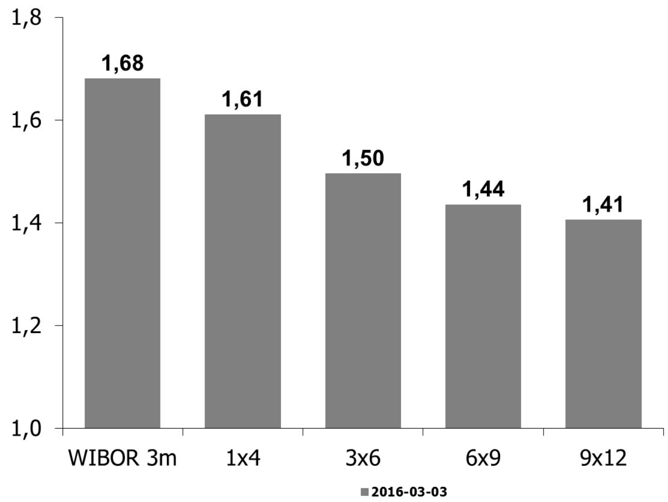
Auction, NFP

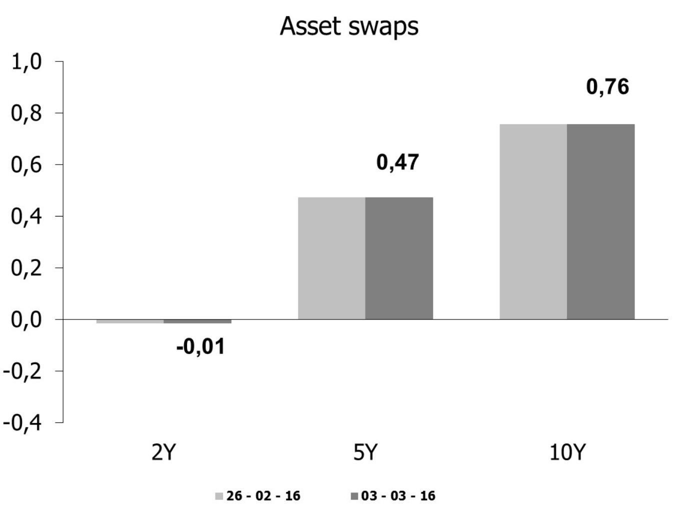
Another successful POLGBs auction was the key event this week. Ministry sold 5.6 bio PLN of DS0726 at 3.014% and 2.8 bio of OK1018 at 1.553% without any problems. Such huge amount of fresh risk injected into market suggests that without Draghi's delivery next week market can be heavy (remember that on 4th FEB MoF sold 4.3 bio of 10yr benchmark).

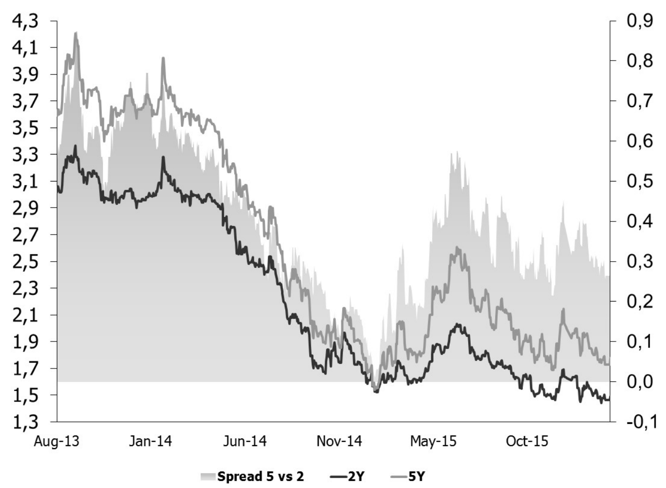
All in all direction of bond market is in Mr Draghi's hands – cut of deposit rate by 20 bps, extension of bonds volume in QE programme or other unconventional measures are on the table. One must say that yields, especially on German curve, are on extremely low levels and that auction results were really strong.

NFP data (242K vs. 195K forecast) pushed yields higher by 2-3 bps (PS0421 2.24%; DS0726 3.03%) – we didn't notice any selling interest after publication. Let's wait for the ECB.









Money market

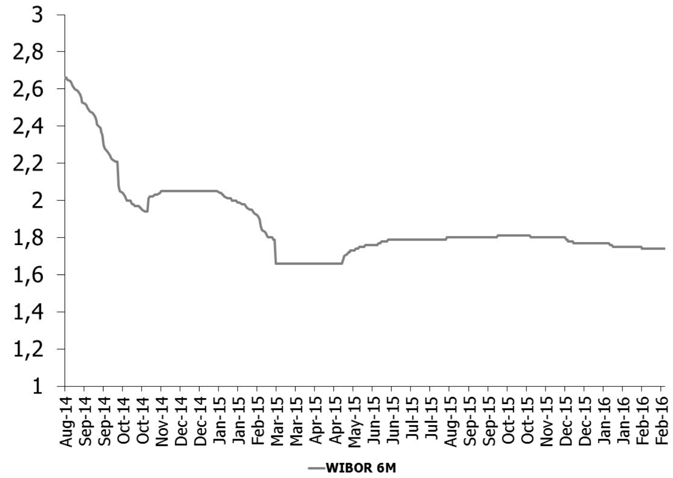
Tax day

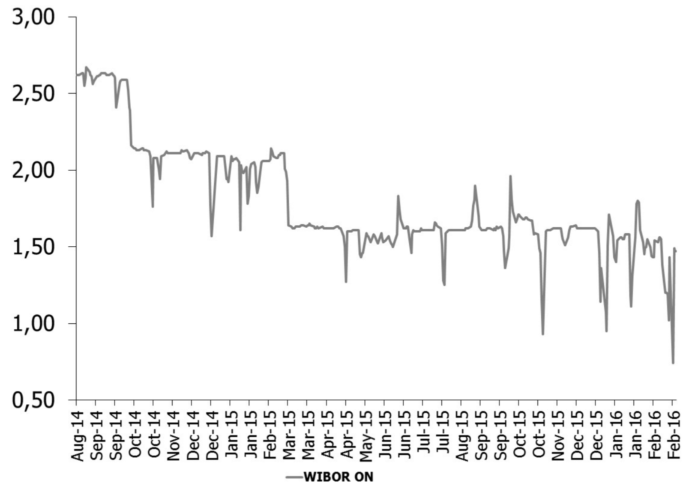
We made through the first end of the month used to pin-down the asset base for banking tax.

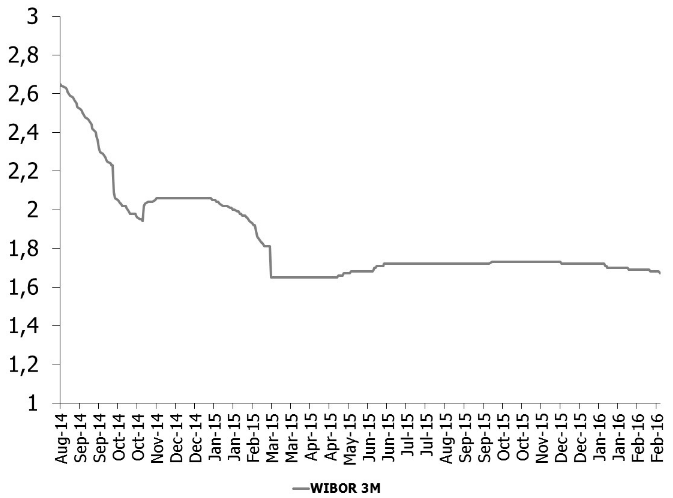
Overnight rates held slightly above deposit rate and polonia fixed at 0.8% that day. Banks shy away from trading ON that day as breakeven spread on 1 day depo was close to 15%. Reported turnover on that day was close to nothing (155 mio). Since then the market came back to normal on the shortest tenors.

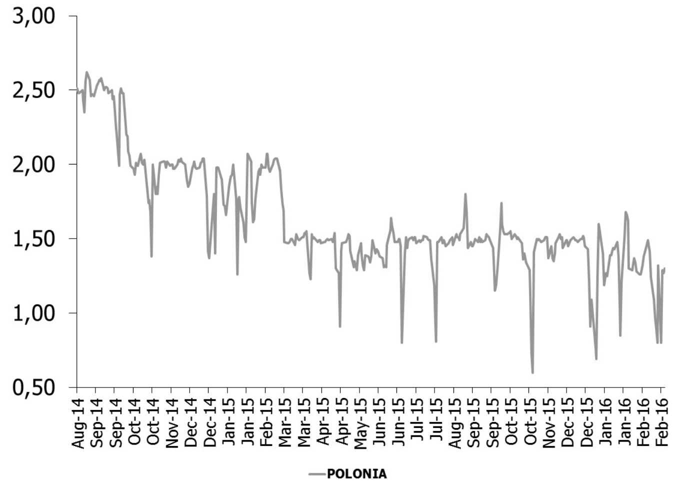
Today banks bought all bills offered by the NBP (84 bio) so the rate should hold around 1.50% next week.

Polonia against reference rate average spread: 30-day – 24bp; 90-day – 18bp.









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Forex

Spot – Risk rally continues It was another good week for the Zloty. After some consolidation around 4.36 it managed to reach 4.3157 low, not seen from the beginning of January. On Thursday EUR/PLN came back around 4.35 as EUR/USD jumped over 1.5 big figures (correlation between EUR/PLN and EUR/USD is highly positive). Zloty is supported by diminishing political risks in Poland, because comments about CHF conversion project are getting more balanced and reasonable as well as improving global sentiment. The ECB is getting closer and PLN shorts are being consequently liquidated. This trend may continue, but a rangy nature of EUR/PLN suggests caution. We see current range at roughly 4.30 – 4.39 and expect some mean reverting swing.

Options – EUR/PLN Vol curve weaker The gamma was really in demand (but only dates which contains big events approaching: ECB, MPC, Fed) and all those who have paid for Gamma, especially in USDPLN should not be disappointed. The rest of the curve was offered – especially tenors 1M-3M. 1 month EUR/PLN ATM mid is 8.25% (0.5% lower), 3 months EUR/PLN are 8.4 (0.7% lower) and finally 1 year is fixing at 9.2 (0.1% lower). The skew was a little better offered, and currency spread (difference between USD/PLN and EUR/PLN vols) was slightly better bid.

Short-term forecasts

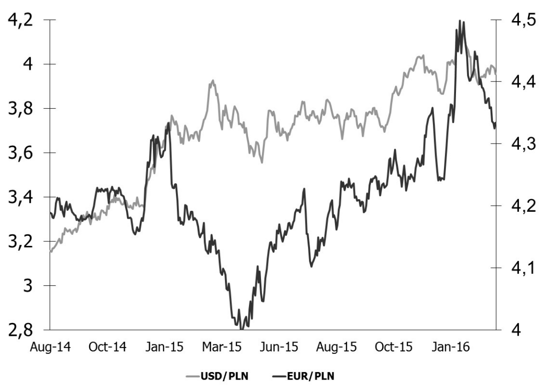
Main supports / resistances:
EUR/PLN: 4.30 / 4.39
USD/PLN: 3.85 / 4.10

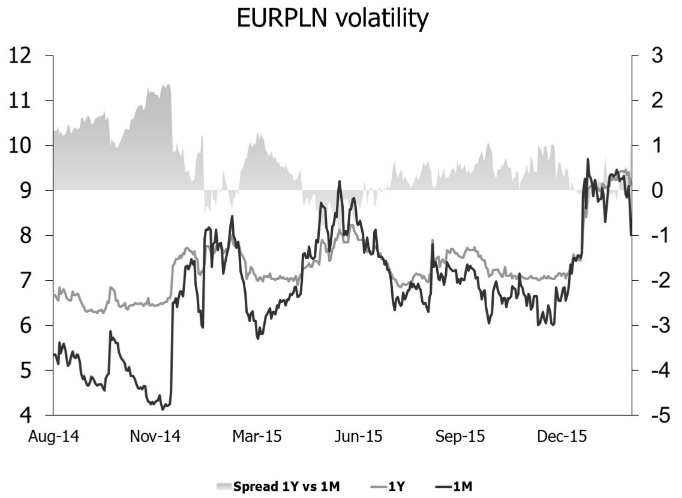
Position **Spot** Current position: Long in EUR/PLN at 4.3250 (average) with S/L below 4.2950 and with hopes to see 4.38+ again.

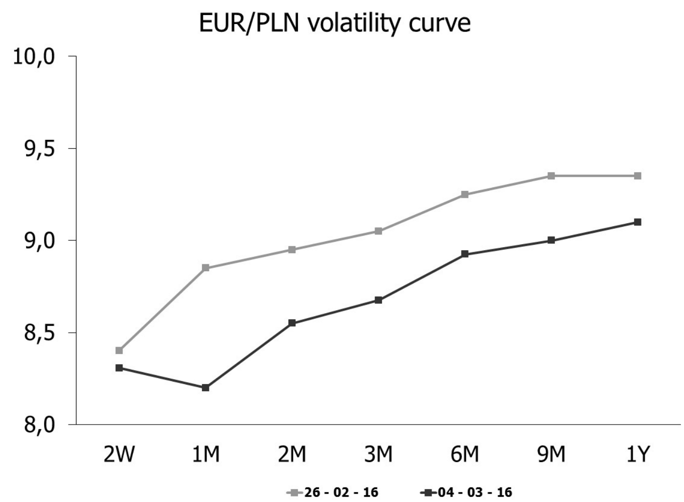
It is technical trade based on a mean reverting approach. On the top of it, we wonder if an aggressive action from ECB is going to be countered by some kind of response from MPC. ECB action is at least partially discounted, the MPC reaction is a big unknown.

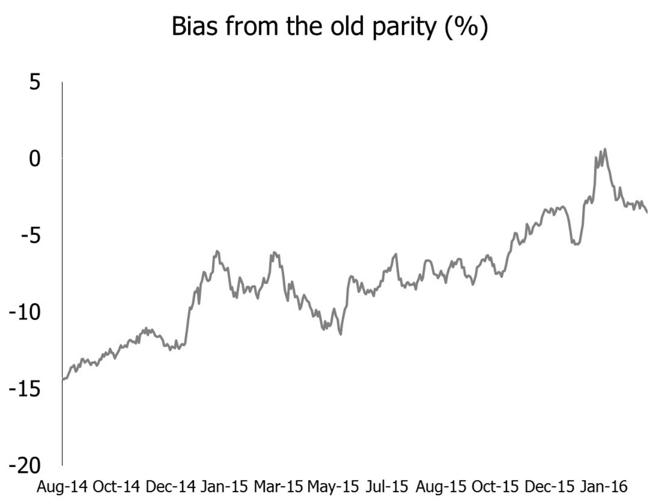
Options Vols

Realized volatility is still pointing lower, encouraging us to keep the core short Vega position – we are short front-end Vega in EUR/PLN (up to 4 months). Everything above 6 months is in our eyes to be long or square because of political risk in Poland and concerns about global recession. But as realized volatility is approx. 1.5% lower than implied vol, we would assume 7.5% for 6 month EUR/PLN or 8.0 % in 1 year, as good re-entry points to get long (longer term) vols.









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
2/25/2016	1.32	1.68	1.43	1.64	1.48	1.66	1.61	1.46	1.39	1.36	1.33	1.42
2/29/2016	1.23	1.68	1.47	1.64	1.50	1.66	1.61	1.47	1.40	1.37	1.33	1.41
3/1/2016	1.19	1.68	1.27	1.64	1.45	1.66	1.61	1.49	1.40	1.37	1.33	1.41
3/2/2016	1.13	1.68	1.20	1.64	1.38	1.66	1.61	1.50	1.44	1.40	1.33	1.46
3/3/2016	1.38	1.67	1.31	1.64	1.49	1.66	1.61	1.50	1.44	1.41	1.33	1.47

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	2/18/2016	4/25/2021	98.93	2.22	4800	9169	5143
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
2/25/2016	1.660	1.474	1.635	1.578	1.960	2.232	2.405	2.949
2/29/2016	1.660	1.474	1.635	1.578	1.960	2.232	2.405	2.949
3/1/2016	1.660	1.474	1.635	1.578	1.960	2.232	2.405	2.949
3/2/2016	1.660	1.474	1.635	1.638	1.990	2.290	2.447	2.985
3/3/2016	1.660	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
2/25/2016	8.91	9.16	9.34	9.45	9.45	2.25	0.55
2/29/2016	9.10	9.13	9.38	9.40	9.40	2.25	0.55
3/1/2016	8.63	8.71	9.03	9.10	9.10	2.25	0.56
3/2/2016	8.00	8.53	8.83	9.25	9.25	2.09	0.57
3/3/2016	8.20	8.68	8.93	9.10	9.10	2.20	0.55

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
2/25/2016	4.3739	3.9705	4.0069	3.5415	1.4107	0.1618
2/29/2016	4.3589	3.9935	3.9922	3.5379	1.4030	0.1611
3/1/2016	4.3365	3.9924	3.9909	3.5298	1.4026	0.1603
3/2/2016	4.3333	3.9861	3.9933	3.4863	1.3988	0.1602
3/3/2016	4.3250	3.9805	3.9891	3.4927	1.3997	0.1599

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