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Polish Weekly Review

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Table of contents

Comment on the upcoming data and forecasts

Quite an interesting week ahead of us. On Thursday the NBP will release quarterly data on balance of payments, as well as latest results of inflation expectations survey. Those two certainly don't and won't move markets. On the other hand, the flash CPI (for March) might attract more interest. We believe it will show stable inflation - recent increases in oil prices have not yet filtered into retail prices and core inflation remains extremely low. The release of Manufacturing PMI (also for March) is also notable. We believe that the upside on Polish PMI is limited, given the precarious state of global economy and weak demand from construction-related industries in Poland, therefore the increase in PMI will be a modest one.

Polish data to watch: March 28th to April 1st

Publication	Date	Period	mBank	Consensus	Prior
NBP inflation expectations (%)	31.03	Mar	0.2	0.2	0.2
Balance of payments	31.03	Q4			
Flash CPI (%)	31.03	Mar	-0.8	-0.8	-0.8
Manufacturing PMI (pts.)	01.04	Mar	53.2	52.8	52.8

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	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

Unchanged, as expected. Next week is all about the flash CPI and the PMI releases - there is some scope for surprises.

* 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+ 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 stay 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.
- 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, supported by strong economic fundamentals and ECB stimulus and MPC's communication.

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	4.25	4.25	4.20
USD/PLN (eop)	3.80	3.76	3.80	3.92	3.95	3.86	3.86	3.82

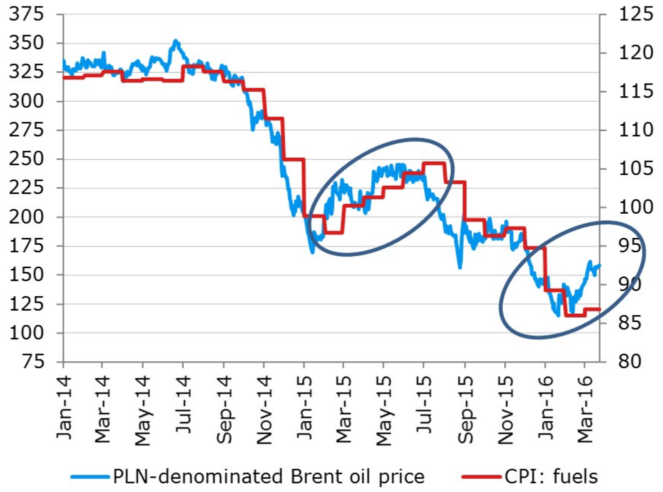
F - forecast

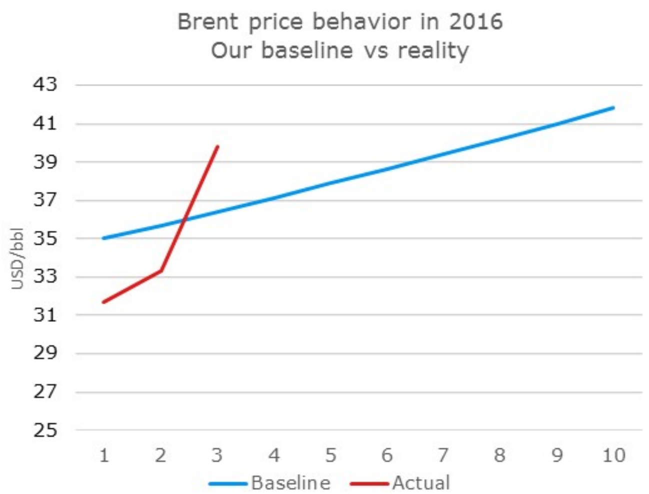
Economics

Let's not overestimate the significance of the latest increase in oil prices

The start of the year brought first a fresh bottom in PLN-denominated Brent oil price and an upward correction afterwards. The upward shift in fuel prices compound to 20% in Fed-Mar period over Jan. As now prices seem to be levelling off, this should translate into 7-8% growth in fuel prices, mostly concentrated in April and May due to normal lags.

Having said that, the price impulse generated by the jump in oil prices is similar to the one generated in 2015 (see the graph). However, the monthly schedule of fuel price increases is going to be different as it starts one month later. Therefore March CPI annual growth is set to be yet dampened by low fuel price growth and Apr-May growth, on the other hand, supported. As far as the whole year is concerned, we are now at the price level assumed for year-end in our baseline scenario (see the other graph).

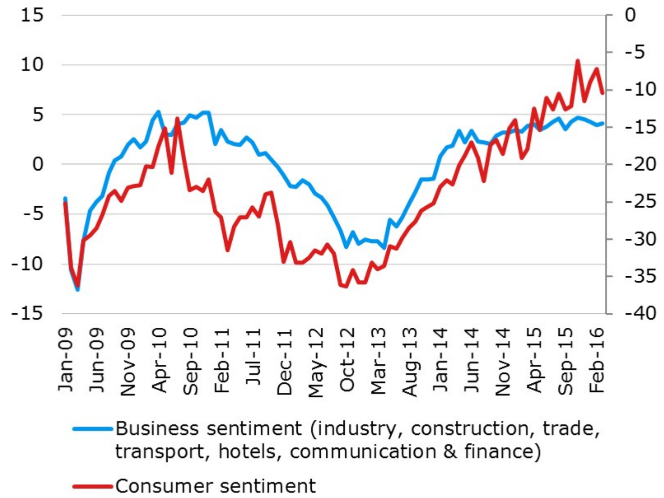




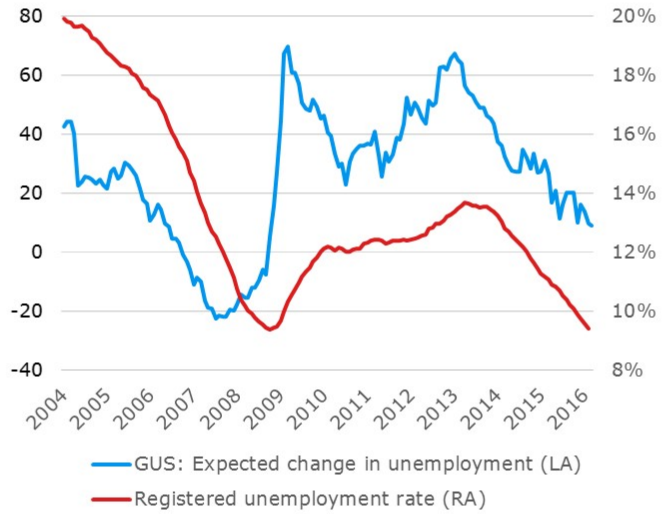
It does not imply that we are heading for a spectacular overshoot, though. Oil price growth is patchy at best. Given the high price-elasticity of onshore U.S. output we do not think that recent momentum can be sustained (we already see some levelling off). We think that oil prices may follow the slight upward trend but in a see-saw manner around the blue line in the graph.

Consumers are in good moods and predict further decline in unemployment

The results of recent business and consumer surveys from GUS were little changed in March. Business tendency indicators seem to be following a see-saw pattern in recent months, suggesting stability in economic activity – the swings in sentiment in various industries mostly cancel each other out.



Consumer sentiment is in an upward trend. While the top was formed after the parliamentary elections and the slight decline ever since can be attributed to political instability, the trend is intact and faster consumption growth is in the pipeline. One reason for this is labor market tightening, seen in various indicators but most consistently – in unemployment figures. Depending on the measure and data source, Polish unemployment rate is either at or close to multi-decade lows. What caught our eye this week, however, is the fact that Polish consumers are actually quite good at predicting future unemployment. And since their expectations are improving, more declines in unemployment are coming.



Tighter labor market means higher wages – this is a possible point of contention between the markets and the NBP. While we firmly believe in the power of the Philips curve, the NBP has just slashed its wage growth forecasts. Labor market tightening is unlikely to be relevant for monetary policy right now and this newfound pessimism should support monetary easing expectations.

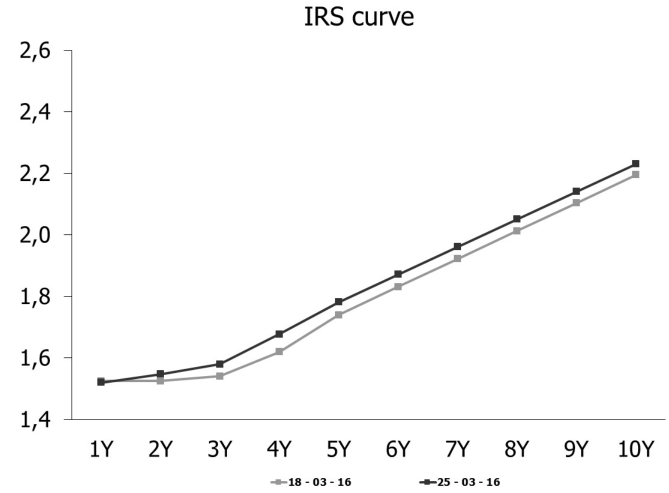
Fixed income

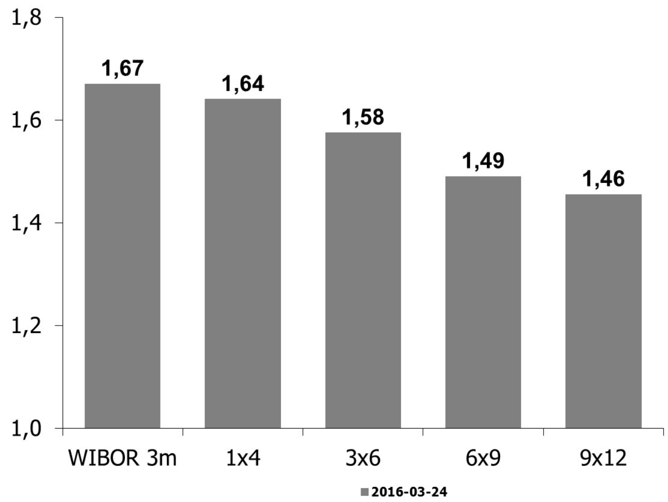
Pre-Easter summary

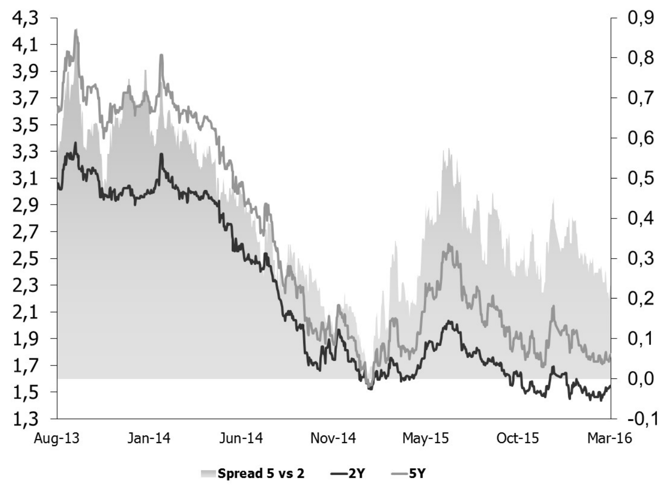
Polish FI market remained surprisingly stable for the last couple of weeks. Although some additional volatility has been added after the central banks' meetings, the overall picture of the yield curve did not change much. It seems like the markets have reached the crossroads and do not recognize any real value to reach for. On the one hand, the global macro mood should favor those who seek higher yields and could take advantage from one of the steepest bond curves among civilized economies but on the other hand they hit the wall of newly elected MPCs persistent denial of any need for further easing. Moreover some of them could feel some sort of inconvenience with both state pro-social spending policies that might adversely affect the budget performance and fx-loan conversion bill program (still suspended bomb) that could lead the whole financial system into real crisis.

The fact is, markets still believe in the necessity of further easing in Poland, trading 9m forward rate agreements 25bp below the current Wibor rate. Granted, the new MPC members look very skeptical of having main interest rate lower in order to stimulate economic growth and they would rather tend to retain some ammo for unpredictable scenarios in the future (the behavior already priced in the curve). The fact is the new government policy has added some risk to the long end of a yield curve resulting in wider asset spreads (over 60bp on 10y).

Concluding, the front end of a yield curve seems not to have any substantial risk to drop much further while the longer end (especially the bond curve) might have a great potential to advance in bond prices if some of the political tensions have vanished. We still believe we would take advantage from paying 2y IRS and buying longer-end bonds as a mid-term strategy.







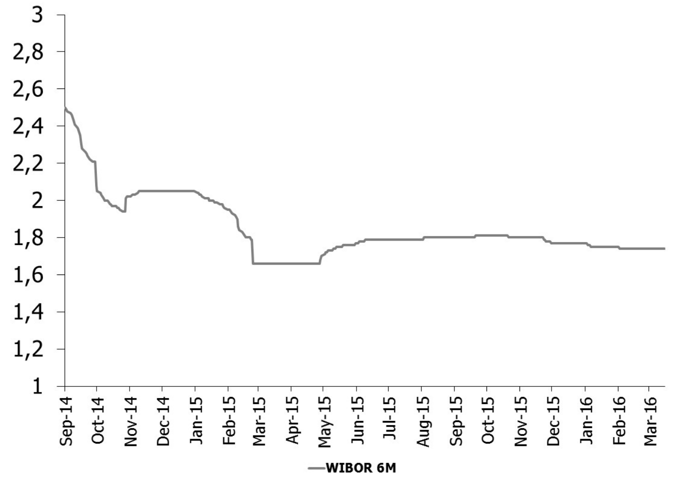
Money market

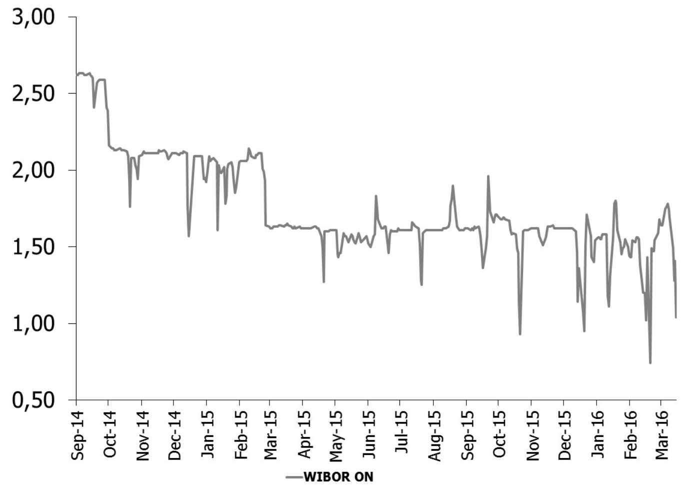
Finally, long awaited cheapness arrived to the market and it should stay with us till the new month.

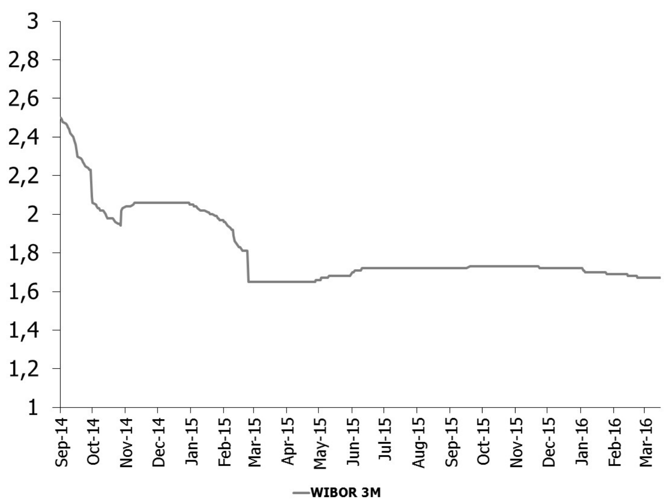
Overnight rates fell below 1% and even the additional OMO wasn't able to drag rates higher. Today we have a regular operation. The central bank is offering 86 bn and our best guess is that this will be underbid as this is the end of the month, end of reserve period and Easter holiday period. Banks should take safe stance and leave some spare liquidity, although we wouldn't try to play that scenario agressively on the cash market as liquidity will be extremely thin.

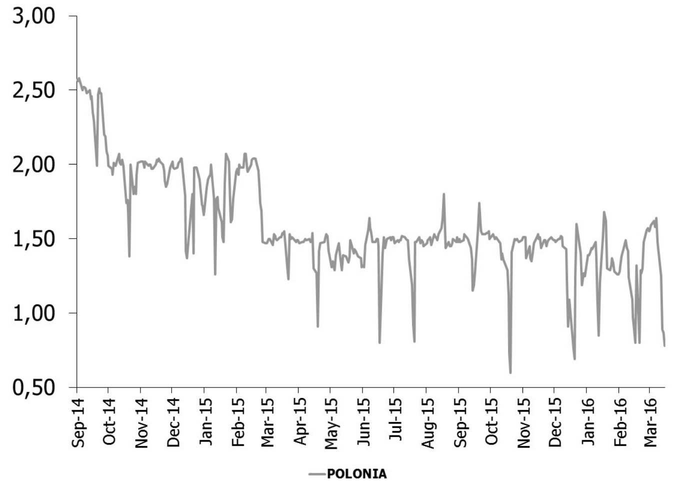
We are taking profit on our short-end bonds. On Thursday the MF held a switching auction which created excellent opportunity to take profit on our bonds. Buy back yields for 0416 0716 1016 were 1.20%, 1.25% and 1.30%, respectively. Regardless of ministry prices, one could have sold the above mentioned bonds 10-15 bp better on the secondary market. ALM desks, as the biggest holders of these bonds, don't want to sell them to other participants as month end is just around the corner and they prefer to hold govies (no tax) over cash.

Polonia vs Ref rate averages: 30 day – 16bp(+2); 90 day – 18 bp(+1)









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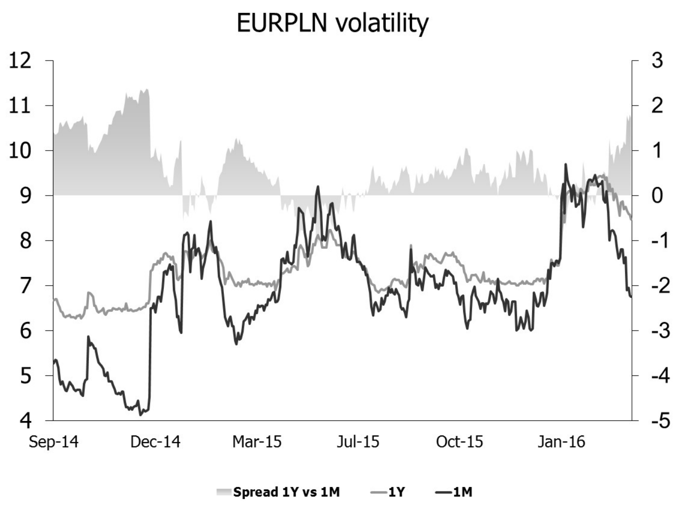
Forex

Spot – PLN still strong EUR/PLN is consolidating just above the 4.23-4.25 support zone, but the pace of PLN march is significantly lower. 4.2250-4.25 is now acting as a support zone, with 4.29-4.32 constituting the resistance layer. We are still skeptical about PLN strength at these levels, most political problems that dragged EUR/PLN to 4.50 are still there. The super dovish cocktail of ECB/FOMC/MPC may fade with time, and could be not enough to push PLN much higher, at least not without prior correction to 4.30+. As usual, we look for ranges in EUR/PLN, currently we see 4.23/4.33 as the most likely one, and we are a little skewed towards buying dips.

Options – EUR/PLN Vol curve weaker by a lot (again)
It was truly a strong opening of the week, with vols landing hard as Easter holiday's week approached. The biggest victim was the front end, with 1 month ATM EUR/PLN mid being 6.8% (0.8% lower than last Friday). The 3 month EUR/PLN mid is 7.7% (0.3% lower) and, finally, 1 year is lower just by 0.2% – to 8.7%. The curve is steep, the skew is offered, and currency spread (difference between USD/PLN and EUR/PLN) is nowhere to be seen (most likely unchanged).

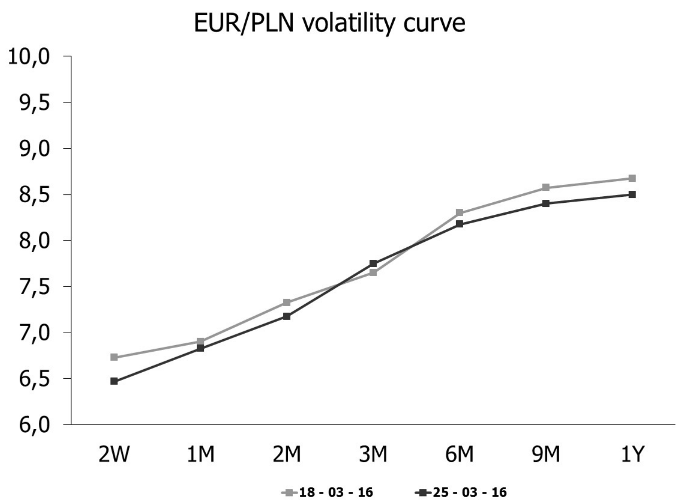


Short-term forecasts

Main supports / resistances:
EUR/PLN: 4.23 / 4.33
USD/PLN: 3.70 / 4.00

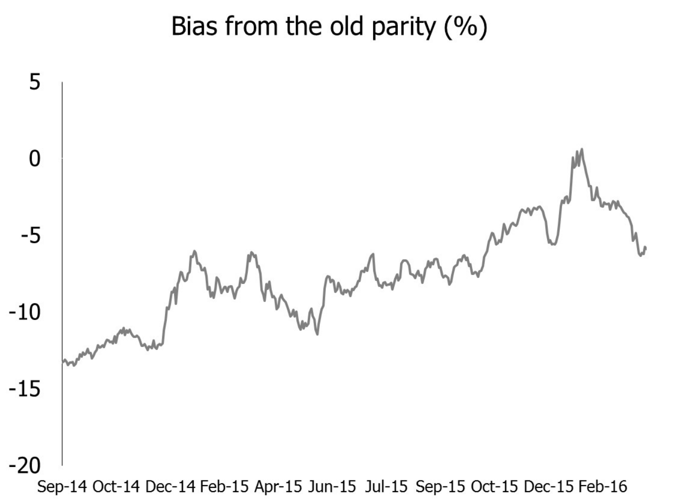
Spot Current position: Long at 4.2550, ready to add at 4.2350, with stop below 4.3150 and hopes to get above 4.32+.

A bit odd feeling to get to long EUR/PLN for the third time, with two prior positions ended with a stop loss. Well, rolling the dice is what we do. We just still think the risk/reward is for being long EUR/PLN at current levels. The downtrend in EUR/PLN is losing momentum, and it may indicate at least same short-term reversal.



Options

We are now outright long Vega (in majority backend Vega), while we were given the 3 month at 7.5% (our level of choice from last week). The magnitude of the drop in vol between last Friday and Monday took us off guard. The Easter adjusted vols were implied with a „single click", as if the market was just one big algorithm. Well, maybe it is.



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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
3/17/2016	1.31	1.67	1.51	1.64	1.52	1.66	1.64	1.55	1.49	1.45	1.43	1.52
3/21/2016	1.39	1.67	1.50	1.64	1.54	1.66	1.63	1.54	1.47	1.44	1.41	1.52
3/22/2016	1.27	1.67	1.39	1.64	1.54	1.66	1.63	1.54	1.47	1.44	1.41	1.50
3/23/2016	1.15	1.67	1.28	1.64	1.44	1.66	1.64	1.55	1.48	1.44	1.42	1.51
3/24/2016	1.38	1.67	1.51	1.64	1.54	1.66	1.64	1.58	1.49	1.46	1.43	1.52

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
3/17/2016	1.660	1.474	1.635	1.578	1.960	2.232	2.405	2.949
3/21/2016	1.660	1.474	1.635	1.578	1.960	2.232	2.405	2.949
3/22/2016	1.660	1.474	1.635	1.578	1.960	2.232	2.405	2.949
3/23/2016	1.660	1.474	1.635	1.638	1.990	2.290	2.447	2.985
3/24/2016	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
3/17/2016	7.63	7.96	8.45	8.75	8.75	2.15	0.57
3/21/2016	6.95	7.53	8.11	8.59	8.59	2.15	0.57
3/22/2016	6.78	7.48	8.15	8.58	8.58	2.20	0.60
3/23/2016	6.75	7.43	8.10	8.48	8.48	2.17	0.61
3/24/2016	6.83	7.75	8.18	8.50	8.50	2.20	0.62

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
3/17/2016	4.2989	3.8037	3.9143	3.4137	1.3839	0.1589
3/21/2016	4.2603	3.7838	3.8994	3.3921	1.3736	0.1576
3/22/2016	4.2590	3.8005	3.9104	3.4019	1.3694	0.1575
3/23/2016	4.2533	3.8010	3.8951	3.3744	1.3590	0.1573
3/24/2016	4.2715	3.8240	3.9201	3.3924	1.3605	0.1579

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