

April 8, 2016

Polish Weekly Review

Department of Economic Analysis (research)

Ernest Pytlarczyk, PhD, CFA
chief economist
tel. +48 22 829 01 66
ernest.pytlarczyk@mbank.pl

Marcin Mazurek, PhD
senior analyst
tel. +48 22 829 01 83
marcin.mazurek@mbank.pl

Piotr Bartkiewicz
analyst
tel. +48 22 526 70 34
piotr.bartkiewicz@mbank.pl

Karol Klimas
analyst
tel. +48 22 829 02 56
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

Marcin Turkiewicz
head of fx trading
tel. +48 22 829 01 67
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

Jacek Jurczyński
head of treasury sales
tel. +48 22 829 15 16
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>

Table of contents

Our view in a nutshell

Economics

- NBP keep rates unchanged – if it ain't broke, don't fix it

Fixed income

- Surprisingly good auction

Money market

- Risk off

FX market

- Spot – Merely a correction in downtrend or U-turn in EUR/PLN?
- Options – EUR/PLN Vol curve higher

Comment on the upcoming data and forecasts

Next week starts with final CPI data for March. We expect CSO to confirm a *flash* estimate (-0.9%), even given slight rise of fuel and food prices. Core inflation (published the day after) should return to negative territory (-0.1% y/y). On Wednesday CSO will publish foreign trade data for February – our current account forecast (194 mio EUR) is a result of large negative EU balance of transfers. We expect Thursday's M3 monetary supply data to accelerate just slightly (to 10.1% y/y), driven by base (corporate deposits) and calendar effects. Releases end on Friday with budget performance data for March.

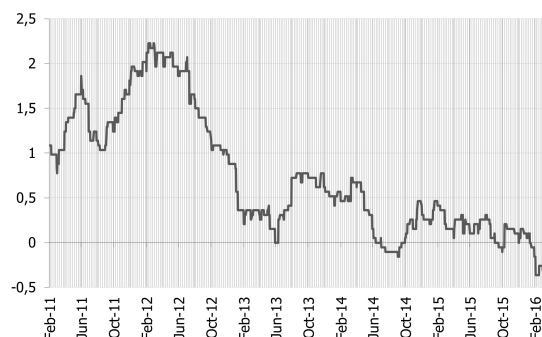
Polish data to watch: April 11th to April 15th

Publication	Date	Period	mBank	Consensus	Prior
CPI y/y (%) <i>final</i>	11.04	Mar	-0.9	-0.9	-0.8
Core inflation y/y (%)	12.04	Mar	-0.1	0.0	-0.1
Current account (mio EUR)	13.04	Feb	194	501	764
Exports (mio EUR)	13.04	Feb	14531	1440	13275
Imports (mio EUR)	13.04	Feb	13768	13673	12699
Money supply M3 y/y (%)	14.04	Mar	10.1	9.9	10.0

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	-	2700	1.553	3/3/2016
5Y T-bond PS0720	4/21/2016	4800	2.219	2/18/2016
10Y T-bond DS0726	-	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 (MPC didn't change rates, just as expected). Next week brings one opportunity to move the index – final CPI data for March, however *flash* estimate was given last week, so it is harder to make a surprise 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+ 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.
- Risk premium looks juicy. Polish yield curve is still very steep. POLGBs are very cheap comparing to Hungarian bonds. Current divergence between monetary policy in Poland and Hungary is not likely to be long-lasting.
- Upcoming round of credit rating revision (13th May – Moody's) resulting in rating / outlook downgrade is to a large extent priced in.
- We see first signs of nervousness on EURPLN. Even with sound economic fundamentals and ECB stimulation Zloty may face headwinds because of looming Brexit referendum and return of CHF – mortgage conversion proposals.

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	-0.1
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	3.7	3.8	3.9	3.9
Individual consumption y/y (%)	3.1	3.1	3.1	3.1	3.4	3.8	4.1	4.3
Public Consumption y/y (%)	3.7	2.5	2.7	4.8	3.2	2.9	4.0	4.0
Investment y/y (%)	11.5	6.1	4.6	4.9	3.0	3.6	4.0	4.5
Inflation rate (% average)	-1.4	-0.9	-0.7	-0.6	-0.9	-0.5	-0.1	1.0
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	1.67	1.66	1.44	1.44
2Y Polish bond yields (% eop)	1.61	1.99	1.76	1.62	1.45	1.35	1.35	1.55
10Y Polish bond yields (% eop)	2.31	3.31	2.84	2.94	2.84	2.80	3.00	3.20
EUR/PLN (eop)	4.07	4.19	4.25	4.26	4.24	4.25	4.25	4.20
USD/PLN (eop)	3.80	3.76	3.80	3.92	3.73	3.86	3.86	3.82
F - forecast								

Economics

NBP keep rates unchanged – if it ain't broke, don't fix it

Wednesday MPC decision was not a surprise. It kept rates unchanged and wording also remained the same. Decision makers still do not see the need to change rates and are stuck in preparation phase for different scenarios in the future. Of course not only those which require cutting rates, but also for those entailing rate hikes. However, both scenarios were most probably not diligently discussed during the meeting, because governor Belka mentioned them only in general terms. This did not change since previous meeting, when MPC also was not very specific in this field.

Changes in the statement issued after the meeting were very cosmetic. Possible negative risk still prevails in economic outlook. One difference is that the term "slow core inflation growth" disappeared. Existence of this statement was very bizarre, given long lasting and systematic drop in core inflation rate. During the press conference governor Belka confirmed that various inflation measures are "pinching" MPC. This most probably convinced him to say that NBP and CSO should meet and thoroughly analyze weighing of inflation basket.

We think that MPC could change its attitude if financial markets stabilize. Very important factor is the incoming change at the Governor seat (Mr Belka ends his term on 11th June). All this coincides with a new attitude towards possibility of easing. MPC would rather now consider a single large rate cut in response to materialization of negative risks rather than starting the whole new rate cut cycle. One important question needs to be asked: Isn't it better and even more convenient to open door for possible rate adjustment instead of making occasional and somehow forced reactive adjustments to a dynamic environment?

Fixed income

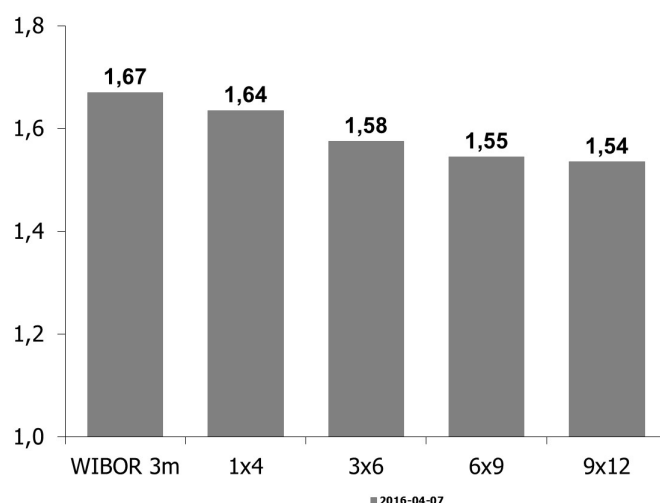
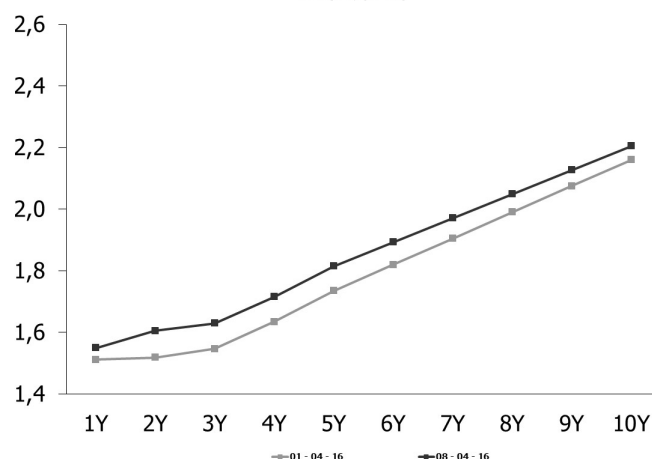
Surprisingly good auction

Finally some more volatility has been added to PLN curve. Just as we expected, the front end of the curve moved up rapidly due to quite hawkish MPC. 2Y IRS increase to 1.64, FRAs moved less aggressive (9x12 rise by just 8 bps). Looks like MPC is less likely to cut rates in the near future than the market expects. As we can't see any sight of it we still see some small potential for front end to rise (some risk of potential easing will be priced in the curve anyway within next quarters).

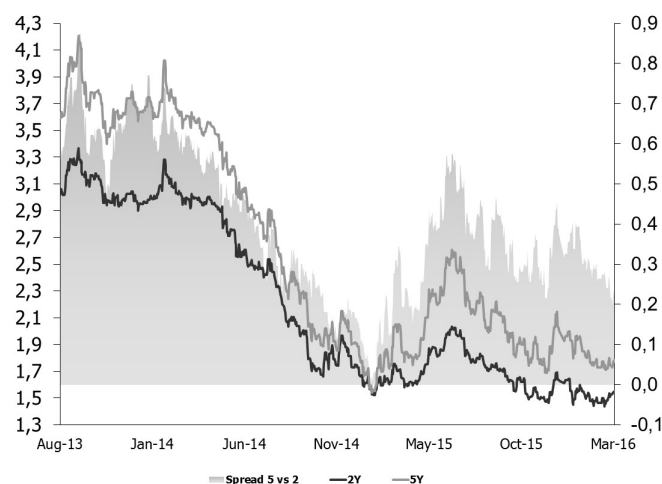
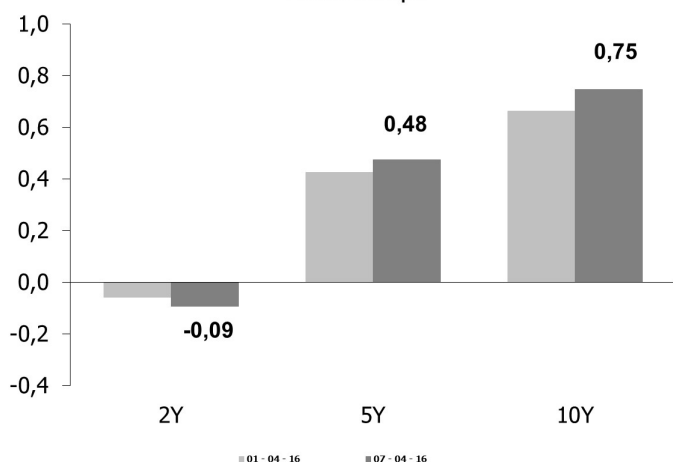
T-bonds auction performed surprisingly well. MinFin sold 6,4bn of long and short term bonds (4,5 of DS0726 and 1,9 of OK1018). Demand exceeded 9bn. Unfortunately, we faced an unexpected sell-off just after the auction reaching lowest levels on Friday morning. As a result of 10Y swap being stuck around 2.23 ASW widened to 68 bps.

The swaps curve has flattened strongly. 2Y vs 10Y IRS is now at 58 bps – lowest since May 2015. We recommend to buy this spread as PLN curve is even flatter than EUR and USD.

IRS curve



Asset swaps



Money market

Risk off

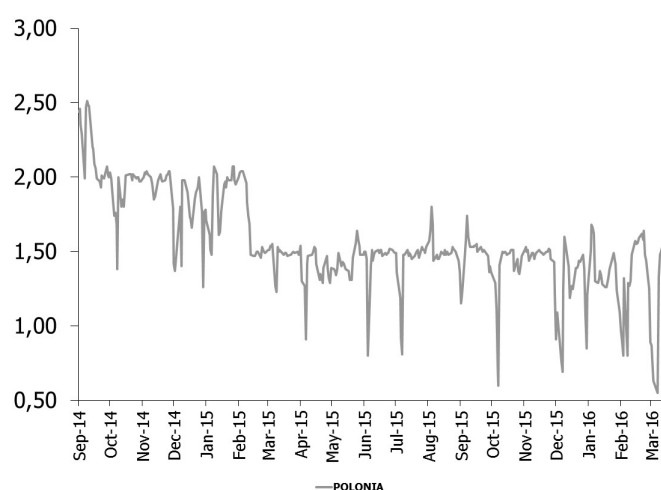
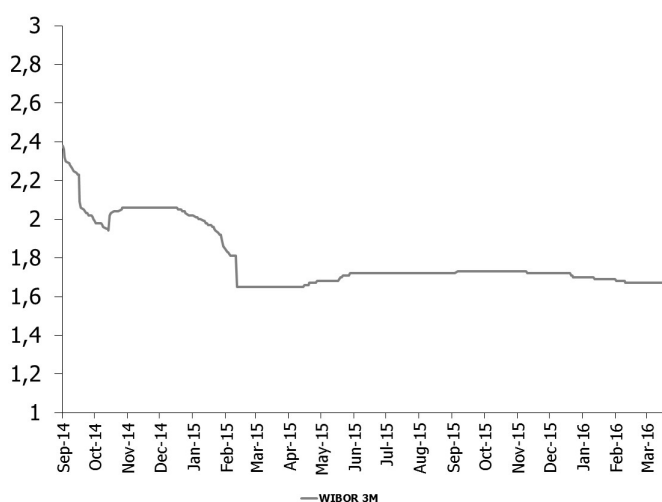
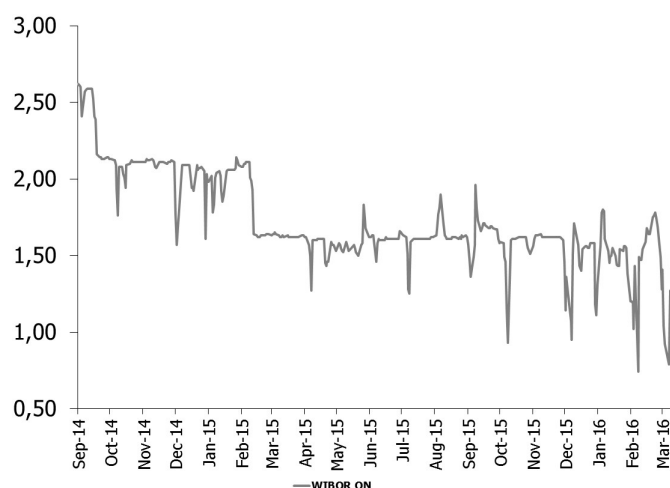
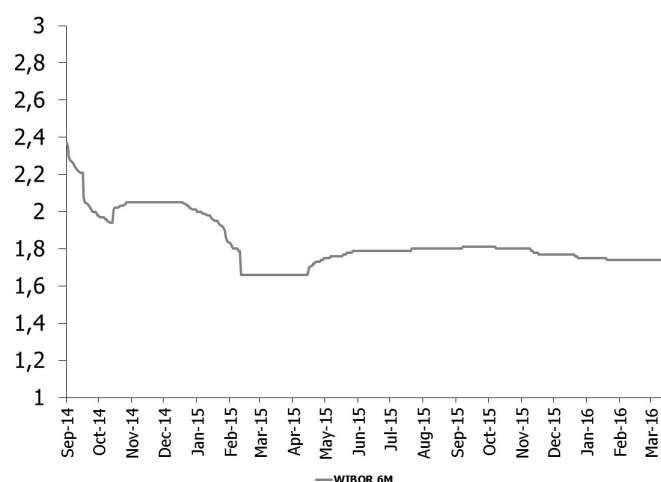
Last week market was driven by two factors: MPC meeting and risk off sentiment on financial markets.

NBP held rates steady and repeated that they don't expect any adjustments in near future. Additionally, there was some selling pressure on risk assets especially on periphery bonds. This triggered further deterioration of rate cuts expectations, front end rates moved around 5-7 bp higher.

We are approaching levels where we are reentering position in short bonds (1016 and 0417). We like to buy those at 1.40 – 35 YTM.

As we hinted in previous week this might be an expensive month. Last week ON held around 1.53 and this week should be similar.

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



Forex

Spot – Merely a correction in downtrend or U-turn in EUR/PLN?

Is it a merely correction in the downtrend in EUR/PLN or a real U-turn? It is still to be decided. The former is supported by relatively hawkish MPC, the later by negative comments from rating agencies about the fate of Polish ratings. 4.23/4.25 is now a strong, proven support zone and 4.31/4.33 constitutes minor resistance. We 4.3600 pinned as the major and pivotal level. Till then, we have to decisively break above 4.30 and fix there on weekly basis, to gain confidence in a substantial change of pro-Zloty and pro-risk sentiment. It fits well in our rangy perspective of EUR/PLN, we are still expecting at least a test of higher levels in EUR/PLN.

Options – EUR/PLN Vol higher We have seen fresh demand for Vega, especially USD/PLN. 1 month EUR/PLN ATM mid is at 6.9% (0.2% higher), 3 months EUR/PLN is 7.8% (0.2% higher) and finally 1 year is 8.7% (unchanged). Skew is bit better bid, and currency spread (difference between USD/PLN and EUR/PLN) is also trading higher by roughly 1%!

Short-term forecasts

Main supports / resistances:

EUR/PLN: 4.23 / 4.33

USD/PLN: 3.70 / 4.00

Spot Current position: We are long in average 4.2450, moving stop higher to 4.2250 and still hoping to get above 4.32+ .

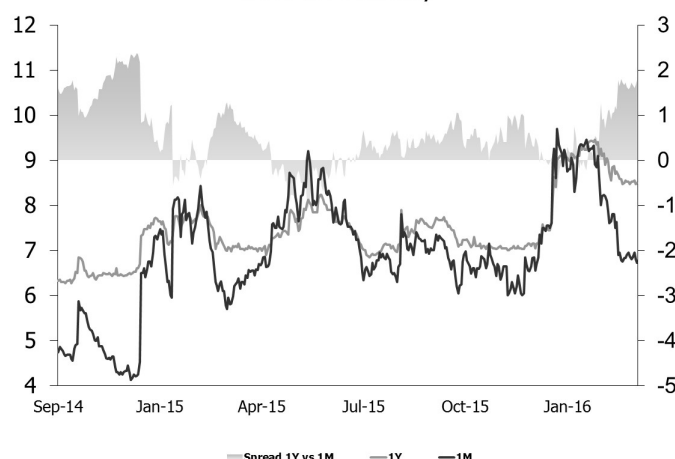
There was no obvious reason for PLN sell-off, it is seems like the positioning might eventually became too crowded in PLN longs. We are watching closely global investment sentiment as it may be a decisive factor in the end. The risk-on train seems to be a bit weary ...

Options

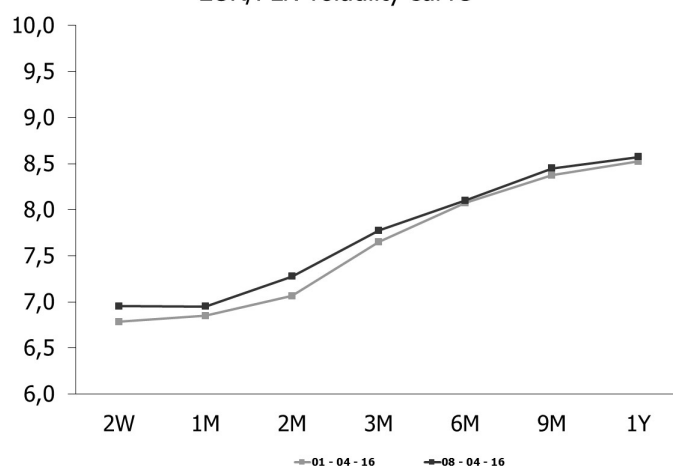
We are now outright long Vega (mostly in backend Vega). We are getting closer to the planned reviews of Poland's ratings by major rating agencies. It's a potential risk factor for Zloty, our long term financial stability is not that guaranteed. We are just a little more pessimistic than the others ... Adding long R/R in 1 Year to the book.



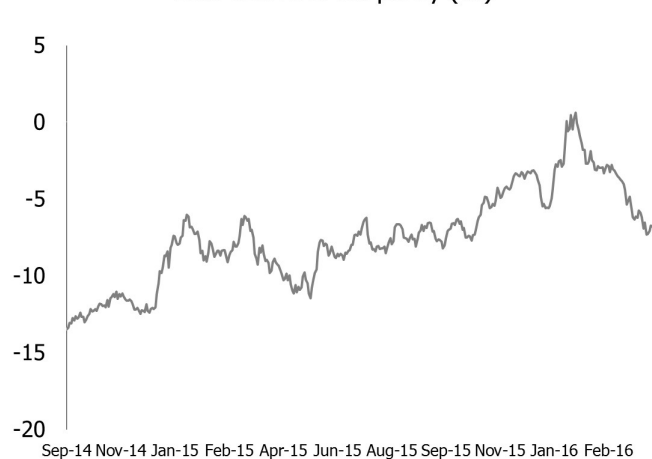
EURPLN volatility



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
3/31/2016	1.46	1.67	1.58	1.64	1.57	1.66	1.64	1.57	1.48	1.42	1.41	1.51
4/4/2016	1.29	1.67	1.40	1.64	1.52	1.66	1.64	1.55	1.47	1.41	1.40	1.49
4/5/2016	1.43	1.67	1.52	1.64	1.51	1.66	1.64	1.55	1.48	1.42	1.41	1.50
4/6/2016	1.51	1.67	1.20	1.64	1.45	1.66	1.65	1.58	1.50	1.46	1.45	1.52
4/7/2016	1.41	1.67	1.53	1.64	1.51	1.66	1.64	1.58	1.55	1.54	1.52	1.60

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
3/31/2016	1.660	1.474	1.635	1.578	1.960	2.232	2.405	2.949
4/4/2016	1.660	1.474	1.635	1.578	1.960	2.232	2.405	2.949
4/5/2016	1.660	1.474	1.635	1.578	1.960	2.232	2.405	2.949
4/6/2016	1.660	1.474	1.635	1.638	1.990	2.290	2.447	2.985
4/7/2016	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	
3/31/2016	6.80	7.73	8.15	8.53	8.53	2.14	0.61	
4/4/2016	6.95	7.78	8.20	8.55	8.55	2.14	0.61	
4/5/2016	6.80	7.66	7.98	8.48	8.48	2.10	0.58	
4/6/2016	6.73	7.60	8.00	8.50	8.50	2.15	0.61	
4/7/2016	6.95	7.78	8.10	8.58	8.58	2.14	0.61	

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
3/31/2016	4.2684	3.7590	3.9040	3.3463	1.3586	0.1578
4/4/2016	4.2355	3.7254	3.8771	3.3386	1.3550	0.1567
4/5/2016	4.2452	3.7337	3.8915	3.3799	1.3573	0.1570
4/6/2016	4.2577	3.7510	3.9042	3.3983	1.3632	0.1575
4/7/2016	4.2601	3.7414	3.9139	3.4516	1.3668	0.1576

Disclaimer

Distribution and use of this publication The review note is based on the information available to the public. This review creates exclusively a marketing information as defined in Paragraph 9 Section 1 of the Decree of Minister of Finance dated November 20, 2009 on procedures and conditions to be followed by investment firms and banks mentioned in Article 70 Section 2 of Law on Trading in Financial Instruments dated July 29, 2005 as well as by custody banks. This review note is provided to you for information purposes only and is not intended as advice on any particular matter or as recommendation, offer or solicitation for purchase of sale of any financial instrument and should not be taken as such. mBank SA, its directors, officers, executives, managers, servants or agents expressly disclaim all liability to any person in respect of any-thing, and in respect of the consequences of anything, done or omitted to be done, wholly or partly, in reliance upon the whole or any part of the contents of this review note. The opinions and estimates contained herein reflect the current judgment of the author(s) on the date of this document and are subject to change without notice. The opinions pointed in review do not necessarily correspond to the opinions of mBank SA. The past performance of financial instruments is not indicative of future results. No assurance can be given that any financial instrument or issuer described herein would yield favourable investment results. mBank and/or its principals or employees may have a long or short position or may transact in the financial instrument(s) and/or securities referred to herein or may trade in such financial instruments with other customers on a principal basis. No client or other reader should act or refrain from acting on the basis on any matter contained in it without taking specific independent professional advice on the particular facts and circumstances in issue. Copyright protection exists in this publication and it may not be, even partially, reproduced or distributed without the prior written agreement with mBank SA.

©mBank 2013. All rights reserved.