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Polish Weekly Review

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Comment on the upcoming data and forecasts

Week begins with the release of manufacturing PMI (for April). Given the deterioration in manufacturing sentiment seen in EC and CSO's indicators, we forecast a slight drop in the PMI. Week ends with the NBP's decision on interest rates. We expect the MPC to hold interest rates at the May meeting. The prevailing attitude among the MPC's members is still one of optimal interest rate level. The wording might become a little bit more dovish, though.

Polish data to watch: May 2nd to May 6th

Publication	Date	Period	mBank	Consensus	Prior
Manufacturing PMI (pts.)	02.05	Apr	53.0	53.0	53.8
NBP decision (%)	06.05	May	1.5	1.5	1.5

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	5/5/2016	2700	1.553	4/7/2016
5Y T-bond PS0720	-	4800	2.219	4/21/2016
10Y T-bond DS0726	5/5/2016	5500	3.014	4/7/2016
15Y T-bond WS0428	-	20	2.092	3/12/2015

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



Comment

CPI flash brought down surprise index even more after another negative surprise. Unemployment rate repeated preliminary estimates. Next week has in fact one opportunity to move the index – manufacturing PMI. We do not expect that MPC will make any rate changes.

* 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 defensive and like 2y bonds. Sticking to 2y allows us to safely take advantage of the expected play on rate cuts in Poland (nobody believes in them which is a mistake in our opinion) and movements associated with the banking tax.
- Local factors temporarily played out and the pendulum may be swinging to the other side at the moment amid greater volatility (great return of CHF conversion programme) while the MPC is still sticking to stable rates paradigm.
- Globally, we entered the play for Brexit that may be disastrous for all asset classes. Valuations for U.S. rates seem to be at local bottom given the improvement in financing conditions, inflation expectations, weaker dollar and improvement in the data. At this stage further ECB easing play is conceivable but too distant from tactical perspective.
- We saw first signs of nervousness on EURPLN. Although it may be only a profit taking after a persistent PLN rally, we think the Zloty may face headwinds because of looming Brexit referendum and return of CHF-mortgage conversion proposals.

mBank forecasts

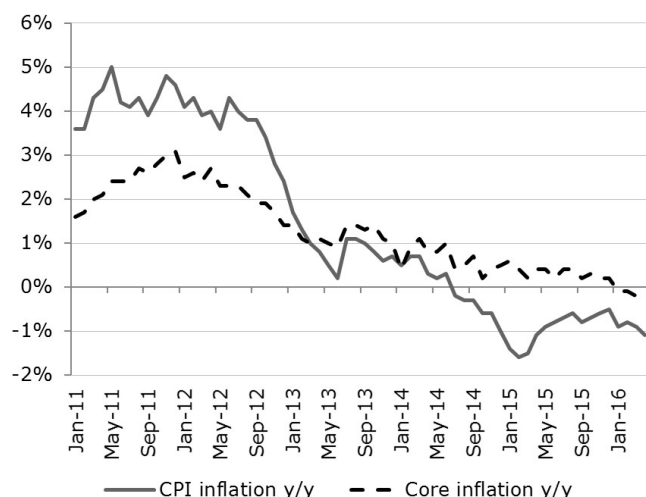
	2010	2012	2013	2014	2015	2016 F
GDP y/y (%)	3.7	1.6	1.3	3.3	3.6	3.8
CPI Inflation y/y (average %)	2.8	3.7	0.9	-0.1	-0.9	-0.1
Current account (%GDP)	-5.4	-3.7	-1.3	-2.0	-0.1	-0.7
Unemployment rate (end of period %)	12.4	13.4	13.4	11.4	9.8	8.7
Repo rate (end of period %)	3.50	4.25	2.50	2.00	1.50	1.25

	2015 Q1	2015 Q2	2015 Q3	2015 Q4	2016 Q1 F	2016 Q2 F	2016 Q3 F	2016 Q4 F
GDP y/y (%)	3.6	3.1	3.4	4.3	3.7	3.8	3.9	3.9
Individual consumption y/y (%)	3.1	3.1	3.1	3.0	3.4	3.8	4.1	4.3
Public Consumption y/y (%)	1.8	0.8	0.9	8.7	3.2	2.9	4.0	4.0
Investment y/y (%)	11.8	5.8	4.4	4.4	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	1.30	1.30
10Y Polish bond yields (% eop)	2.31	3.31	2.84	2.94	2.84	2.90	2.90	2.90
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

Negative inflation for the twenty-second time in a row.

According to CSO's flash estimate, CPI inflation in Poland fell from -0.9 to -1.1% y/y, in line with our forecast and slightly below Bloomberg consensus (thus surprising to the downside for the sixth time running).



As usual at this stage, we are unable to comment on the nature of this decline in any other way than on the basis of our own assumptions. In our view, the principal reason for the decline in inflation are low food prices (probably fell on a monthly basis). Wholesale prices and a fading effect of currency depreciation imply that we might as well see the repeat of Spring of 2014 (strong decline in food prices). The modest increase in fuel prices failed to compensate for the above mentioned decline. Core inflation probably held steady at -0.2% y/y and this is the best measure of how nonexistent inflationary pressures really are.

We believe that deflation will last until October – base effects will then push inflation back into positive territory, but below 1%. The NBP's goal is still miles away. We also believe that the conventional wisdom on Polish deflation – i.e. that is completely benevolent and 100% external in nature – is utterly wrong. We will merely state that domestic factors are also at play here and even if they weren't, a case for a more active monetary policy can still be made. The general assumption that deflation is irrelevant for the new MPC is also unfounded and the market is overestimating its determination to keep interest rates at present levels. With the current state of inflationary processes, regional trends and low rate environment globally, the NBP is set to take a more active role in the second half of the year (i.e. cut rates and expand its toolbox).

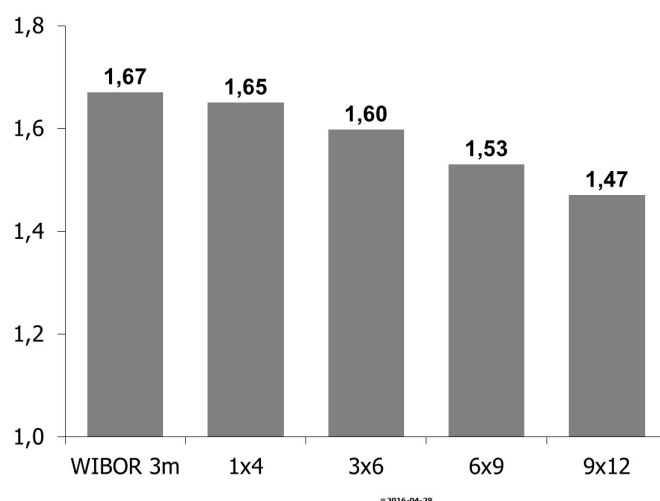
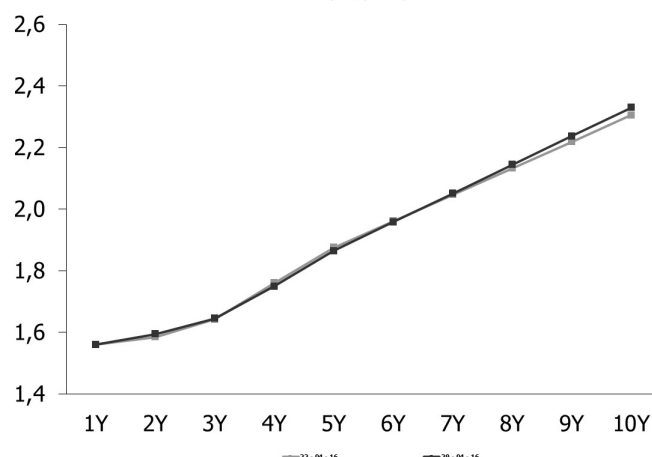
Fixed income

Good old risk...

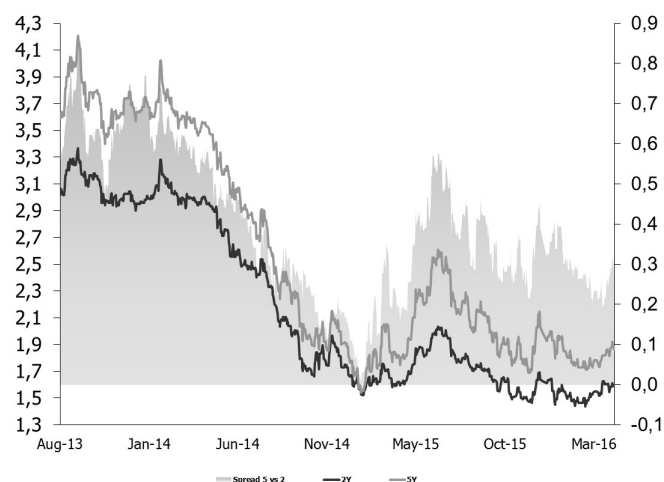
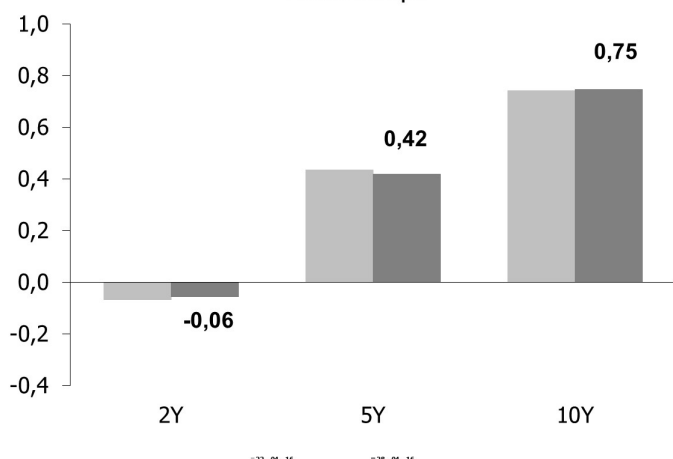
We are on similar levels comparing to last week's close (OK1018 1,60%, PS0721 2,35%, DS0726 3,06%). As the FOMC statement (gradual attitude towards rate hikes), didn't change the overall market picture, it's hard to find a new story on the domestic market. We can't ignore risks coming in May (Moody's review 13th of May, CHF mortgage plan, long end bonds auction on May 5th) but we see the light at the end of the tunnel. We see buying interest in the belly papers and burden in the long end bonds. We expect this situation to last until Moody's review and we will try to build long positions just before the publication. CPI flash release for April at -1,1% y/y was ignored by market participants.

Once again week our 2y10y steepener performed well (+4 bps, 76bps); we want to close it around 80 bps.

IRS curve



Asset swaps



Money market

Incoming change of financial conditions

Expensive month comes to an end. We expected that unfavorable day setup would make cash very expensive throughout the whole April. And so it did.

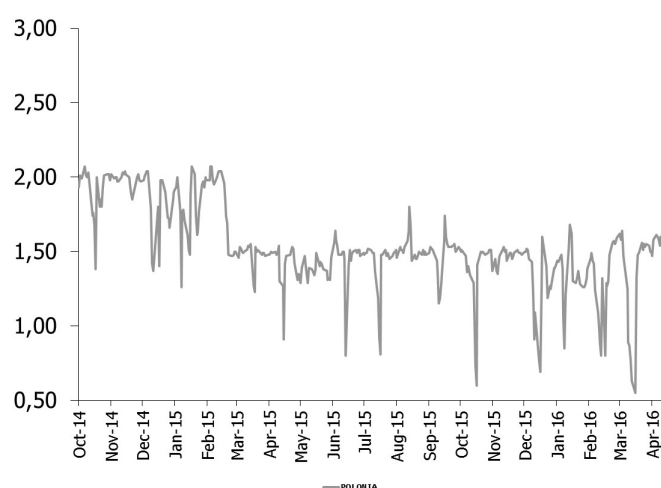
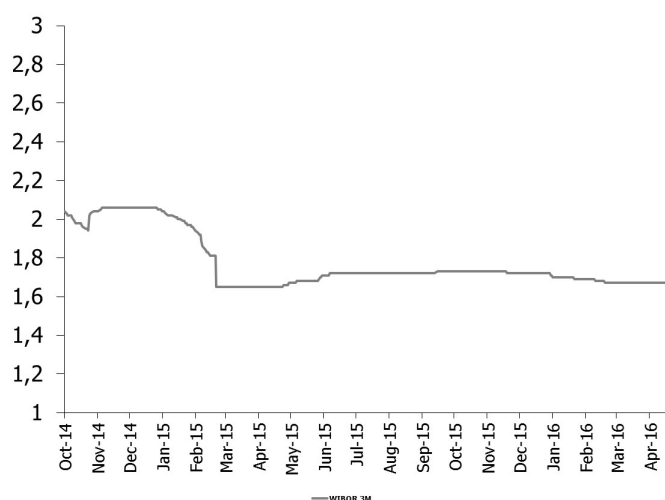
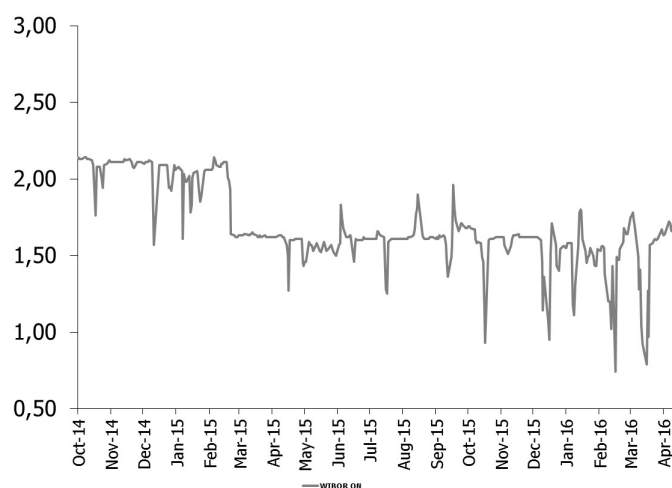
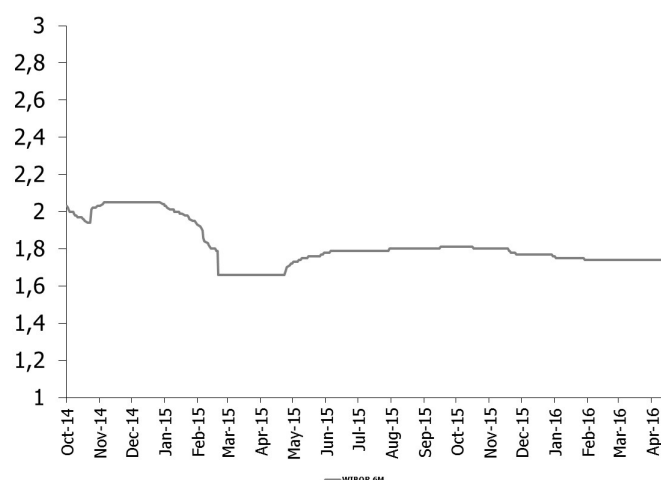
Average Polonia fixing came at 1.55 for the last 30 days. Next month has a chance to be quite the opposite and financing conditions should loosen a bit.

As far as derivatives are concerned, market stabilized, pricing in around 20bp cut in 1 year time.

Ref rate vs Polonia averages:

30 day: -5 bp(-19)

90 day: 13 bp(-1)



Forex

Spot – Złoty consolidating losses The EUR/PLN had reached 4.4275 (the high of the week) before some relief rally took place that moved us to 4.3700, before heading again for 4.40+. The Ministry of Finance was quoted as watching the market carefully (soft intervention thread), some really big bank was advocating the PLN long position. The problem is, that currently the biggest risk for PLN is of political nature (CHF loans, Constitutional Court), one we are not able to quantify/measure. It adds a really binary risk to the picture, and makes us think EUR/PLN should be traded with additional risk premium.

Options – EUR/PLN Vol curve tic higher It was a busy week for option traders. The PLN weakness created the Vega, and Gamma buyers from different type of customers (i.e. 1 year was paid at 8.7%, 3 months traded at 8.4% several times). In the end 1 month EUR/PLN ATM mid is at 7.3% (0.2% higher), 3 months EUR/PLN is 8.0% (0.0% unchanged) and finally 1 year is 8.7% (0.05% higher). The skew is also better bid. We think that, with improved realized volatility, the run in EUR/PLN should be well supported at least in the short term.

Short-term forecasts

Main supports / resistances:

EUR/PLN: 4.29 / 4.39

USD/PLN: 3.70 / 4.00

Spot Current position: Long EUR/PLN from 4.2450 was closed with profit at 4.34 and 4.39. Sideline at the moment.

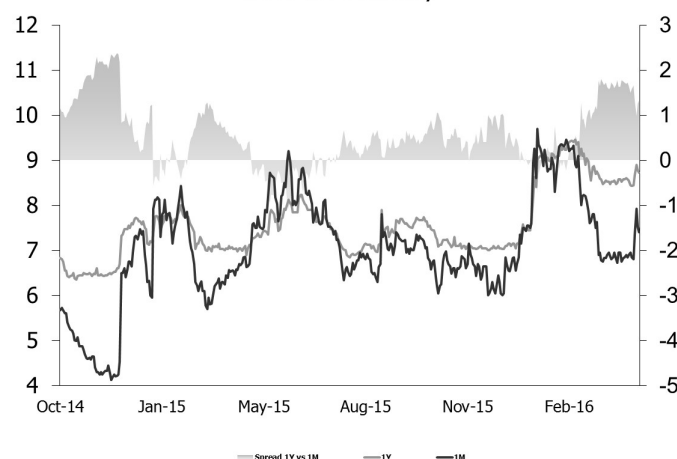
It is a strange feeling that, after weeks of advocating PLN shorts (and 2 stop losses), the market out of the blue agrees to your view and delivers what you were hoping for and more in a few days. Well, we try to keep cool. Technically, one still should be bullish while above 4.35/4.37, breaking 4.4270 may open renewed hopes for 4.50. We are neutral/tactical at this stage. We are still skewed to buying the rumour, (selling PLN) with this unclear political landscape.

Options Vols – Long Vega

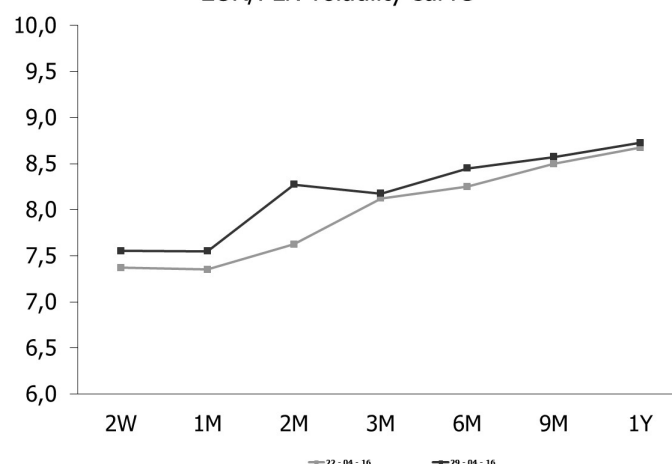
The political situation remains blurred at best, with potential sources of problems firmly in place (i.e. Constitutional Court, EU's resolution, CHF legislation draft). We are getting close to the planned reviews of Poland's ratings by major rating agencies. It is a potential risk factor for the Złoty as our long term financial stability is not that warranted. In this environment the only thing we can be sure of is elevated volatility. We are now outright long Vega (in majority backend Vega). We are just a little more pessimistic than others.



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
4/21/2016	1.46	1.67	1.56	1.64	1.60	1.66	1.65	1.60	1.52	1.46	1.45	1.55
4/25/2016	1.70	1.67	1.75	1.64	1.64	1.66	1.66	1.60	1.55	1.48	1.48	1.57
4/26/2016	1.50	1.67	1.58	1.64	1.68	1.66	1.65	1.61	1.53	1.48	1.48	1.56
4/27/2016	1.39	1.67	1.46	1.64	1.55	1.66	1.65	1.61	1.53	1.48	1.48	1.56
4/28/2016	1.77	1.67	1.84	1.64	1.74	1.66	1.65	1.60	1.53	1.47	1.46	1.58

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
4/21/2016	1.660	1.474	1.635	1.578	1.960	2.232	2.405	2.949
4/25/2016	1.660	1.474	1.635	1.578	1.960	2.232	2.405	2.949
4/26/2016	1.660	1.474	1.635	1.578	1.960	2.232	2.405	2.949
4/27/2016	1.660	1.474	1.635	1.638	1.990	2.290	2.447	2.985
4/28/2016	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	
4/21/2016	6.80	7.88	8.00	8.45	8.45	2.21	0.65	
4/25/2016	7.93	8.58	8.68	8.90	8.90	2.21	0.65	
4/26/2016	7.53	8.23	8.53	8.78	8.78	2.25	0.63	
4/27/2016	7.40	8.20	8.45	8.73	8.73	2.35	0.63	
4/28/2016	7.55	8.18	8.45	8.73	8.73	2.32	0.63	

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
4/21/2016	4.2885	3.7981	3.9102	3.4592	1.3845	0.1586
4/25/2016	4.3860	3.8962	3.9947	3.5043	1.4117	0.1623
4/26/2016	4.3978	3.8935	4.0000	3.5130	1.4088	0.1626
4/27/2016	4.3926	3.8793	3.9896	3.4888	1.4080	0.1625
4/28/2016	4.3940	3.8695	4.0020	3.5776	1.4123	0.1625

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