

June 10, 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

- No surprises: MPC leaves rates unchanged, offering no new suggestions or ideas for monetary policy. page 2
- Assumptions for the new CHF loan conversion bill are ready. page 3

Fixed income

- Waiting for Brexit? page 4

Money market

- Local risk off page 5

FX market

- Spot – PLN roller-coaster page 6
- Options – EUR/PLN vol spiked

Comment on the upcoming data and forecasts

All the relevant macro releases will happen next week. On Monday the NBP will publish balance of payments data for April. With a modest trade surplus sustained and a seasonal increase in services balance, we expect a modest surplus to appear on the current account. At the same time the CSO will release final CPI data. Although the flash release was -1.0% y/y, we expect - given our assumptions regarding core categories and the path of food prices (confirmed by Czech and Hungarian data) - a small upward revision to -0.9%. On Tuesday the NBP will release M3 data - here the most important factor are the disbursements of child subsidies (around 2 bn PLN in May) which will boost household deposits. On Thursday, the CSO will release monthly labor market data. While employment growth probably remained steady at 2.8%, wages likely accelerated again, boosted by pay raises in retail trade (a byproduct of new child subsidies) and low base in mining. Finally, week ends with retail and industrial data. Industrial output, despite unchanged working day count, likely decelerated due to unfavorable working day arrangement („long weekends”). The aforementioned disbursement of child subsidies boosted retail sales, though.

Polish data to watch: June 13th to June 17th

Publication	Date	Period	mBank	Consensus	Prior
Current account balance (mio EUR)	13.06	Apr	346	372	-103
Exports (mio EUR)	13.06	Apr	15150	15162	15417
Imports (mio EUR)	13.06	Apr	14900	14861	15213
CPI y/y <i>final</i> (%)	13.06	May	-0.9	-1.0	-1.0
M3 y/y (%)	14.06	May	11.8	11.3	11.5
Core CPI y/y (%)	14.06	May	-0.3	-0.3	-0.4
Average gross wage y/y (%)	16.06	May	4.8	4.6	4.6
Employment y/y (%)	16.06	May	2.8	2.8	2.8
Sold industrial output y/y (%)	17.06	May	4.5	4.9	6.0
PPI y/y (%)	17.06	May	-0.9	-1.1	-1.2
Retail sales y/y (%)	17.06	May	4.5	3.6	3.2

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	-	1500	1.708	6/9/2016
5Y T-bond PS0720	7/7/2016	4800	2.219	5/25/2016
10Y T-bond DS0726	-	3000	3.050	6/9/2016
15Y T-bond WS0428	-	20	2.092	3/12/2015

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



Comment

No releases, no surprises. Next week is a different beast, though. With all the publications, one should expect some 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

- 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 fuelled 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 are still negative on POLGBs
- The sentiment towards Polish assets (including bonds) might deteriorate further in the coming weeks amid poll-driven volatility before Brexit vote. Somewhat weaker data from the U.S. may in such circumstances make risk-aversion periods more severe. Low beta EMs (CEE countries) still offer little upside over high beta EMs among investors willing to take on more risk.
- Locally, we are under an impression that the de-escalation of risks is in wishful thinking state. Frictions and negotiations regarding the new CHF loan conversion proposal should support higher risk premium in Polish assets. Stubborn MPC rhetoric makes the issue of rate cuts dead for now (for a few months).
- Zloty may face headwinds because of looming Brexit referendum and noise surrounding negotiations over CHF-mortgage conversion proposals. The balance of risks favour higher volatility and the upside pressure in EURPLN.

mBank forecasts

	2010	2012	2013	2014	2015	2016 F
GDP y/y (%)	3.7	1.6	1.3	3.3	3.6	3.6
CPI Inflation y/y (average %)	2.8	3.7	0.9	-0.1	-0.9	-0.5
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	2015	2015	2015	2016	2016	2016	2016
	Q1	Q2	Q3	Q4	Q1	Q2 F	Q3 F	Q4 F
GDP y/y (%)	3.6	3.1	3.4	4.3	3.0	3.5	3.8	3.9
Individual consumption y/y (%)	3.1	3.1	3.1	3.0	3.2	3.8	4.1	4.3
Public Consumption y/y (%)	1.8	0.8	0.9	8.7	4.4	2.9	4.0	4.0
Investment y/y (%)	11.8	5.8	4.4	4.4	-1.8	2.0	3.0	4.0
Inflation rate (% average)	-1.4	-0.9	-0.7	-0.6	-0.9	-0.9	-0.6	0.6
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	1.50	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	1.60	1.50	1.40
10Y Polish bond yields (% eop)	2.31	3.31	2.84	2.94	2.84	3.30	3.15	3.05
EUR/PLN (eop)	4.07	4.19	4.25	4.26	4.24	4.45	4.35	4.25
USD/PLN (eop)	3.80	3.76	3.80	3.92	3.73	4.05	3.95	3.86

F - forecast

Economics

No surprises: MPC leaves rates unchanged, offering no new suggestions or ideas for monetary policy.

The MPC did not change any monetary policy parameters during its June meeting. Reference rate still equals 1.50%. In the post-meeting statement, which has not changed significantly from the previous one, the MPC once again stated that current level of interest rates is keeping the economy equilibrium. The main theme of the press conference was the looming end of governor Belka's term (11th June) – this was his last meeting. There were no signs of a possible departure from current stance. MPC members still see current interest rate levels as „optimal”. GDP growth slowdown in Q1 (much worse than analysts expected) is viewed as temporary; many reasons for GDP rebound in the upcoming quarters were given.

Governor Belka avoided answering questions about the new CHF conversion proposal (see more in the other text), he left it all for his successor, prof. Glapinski, who was confirmed by the parliament today. To summarize, a relatively good macroeconomic environment as well as worries about financial sector stability distract MPC from persistent undershooting of its inflation target. However, we still see a risk of interest rate cuts – just look at the European environment.

Assumptions for the new CHF loan conversion bill are ready.

This week the assumptions for the new CHF conversion bill (the bill) saw the light. They were prepared by a group of experts commissioned by the Chancellery of the President. The solution's core is still the fair exchange rate (in 4 different forms based on DTI and LTV criteria, among others) accompanied by the reimbursement of currency spreads and an option of walking away from mortgage at the expense of abandoning the property. The solution is expected to become the new bill (or there is one at this stage already, however the remarks at the conference were unclear) that guarantees an option of participation in the proposed scheme for the borrowers but the obligation for the banks.

Although the assumptions have many degrees of freedom (different combinations of partial solutions that finally make up the general solution), a cost of PLN 30-40bn came up during the conference accompanied by the strict promise of neutrality for the public sector deficit. At the same time, the costs for the banks will be spread over time which, in turn, will be ensured by securitization methods (among them setting up a SPV). The latter seems at least controversial at this stage since the final solution has not been exactly shown (former technical proposals stipulating such a possibility ultimately proved to be wishful thinking). The more so, solutions circulating at this stage suggest the crucial question of capital loss in banks and its coverage is still not settled. Presidential experts claimed that the NBP's participation would not be needed. Owing to the constitutional independence of the NBP it is perfectly reasonable. However, if push comes to shove, NBP's participation may be in our opinion necessary to guarantee smooth currency conversion.

As written above, assumptions are set to be written up in the bill (the project already exists or is in the making and advanced). The lack of precision at this stage leaves the door open for negotiations with banks. It may well be an element of pressure amid rather soft proposals already prepared by banks represented by the Polish Banks Association. We think it is reasonable to expect a project of the bill soon, especially if negotiations are deadlocked. We see two main threats at this stage. First of all, the bill can indeed be sent to the Parliament and get stuck for months (it may also evolve in an unpredictable manner). Secondly, even a bill can be a basis for another rating downgrade – the FX mortgage conversion schemes were actually named as a trigger point for such action.

Returning to feasibility, implementation of all parts of the CHF solution and therefore going for a maximum cost for banks is a tricky issue and as such - doubtful. No compromise and a forced solution is going to end up with arbitrage courts and possibly with a blow to budget (lets rewind a bit a point to Eureko case). From this viewpoint, the implementation is far away. Such a reasoning may have been taken up by investors (stronger zloty, a rally in stock exchange and bonds). However, the uncertainty regarding the final shape of the solution (the bill or not), its implementation (via unpredictable legislative process or a compromise firmed by banks) and scope (how many actual solutions presented in the assumption will be finally relevant) shape directly the cost for the banking sector, the mechanism of capital surcharges and the hit for PLN exchange rate. All this is going to support the higher risk premium in Polish assets.

Fixed income

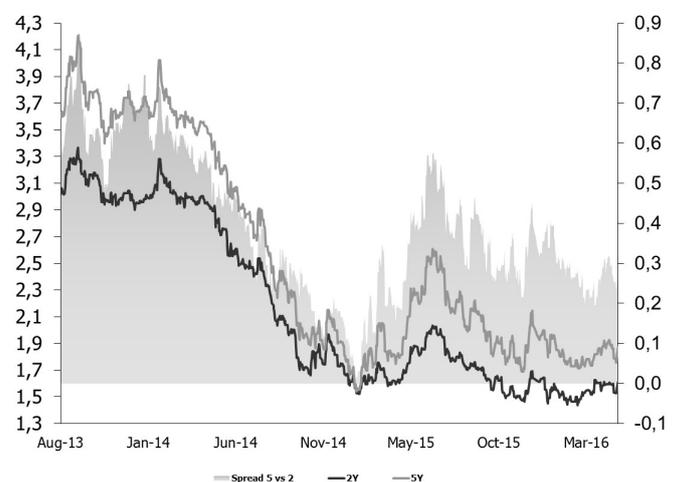
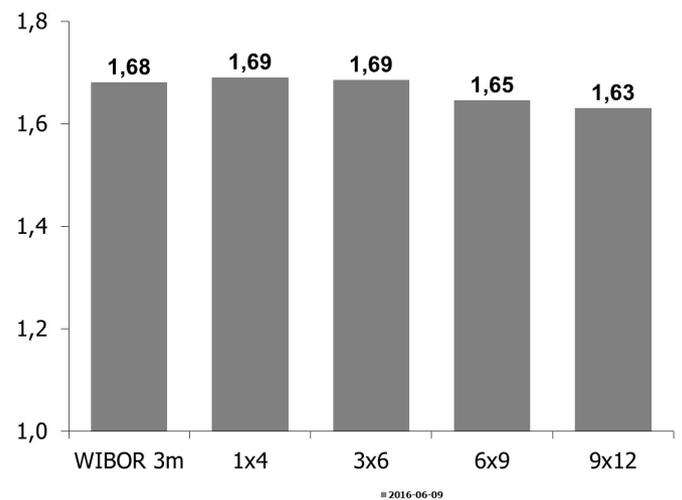
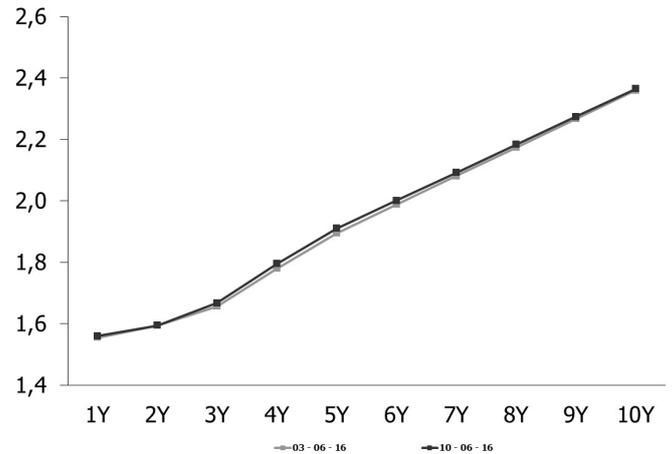
Waiting for Brexit?

Since the beginning of the week, we had a sell off in long and belly bonds. The pressure to be short before the primary auction and bad mood of upcoming CHF credit event, put down prices to 94,15 on DS0726 and 96,45 on PS0721. We had believed that strong EURPLN was the right way to show strong demand on Thursday's auction. The Ministry of Finance sold 10y benchmark (DS0726 at 95,255; 3,05%; 3,3 bio) and 2y benchmark (OK1018 at 96,07; 1,708%; 1,05 bio). Extremely high prices on the auction caught short players 3bps in yield on stop losses.

The MPC didn't change rates (1,50%), it was the last meeting of president Marek Belka.

We closed our position, but in our mind we have a bearish view due to coming Brexit event and still unsolved CHF loan conversion issue. Any spikes on bonds, we'll go short.

IRS curve

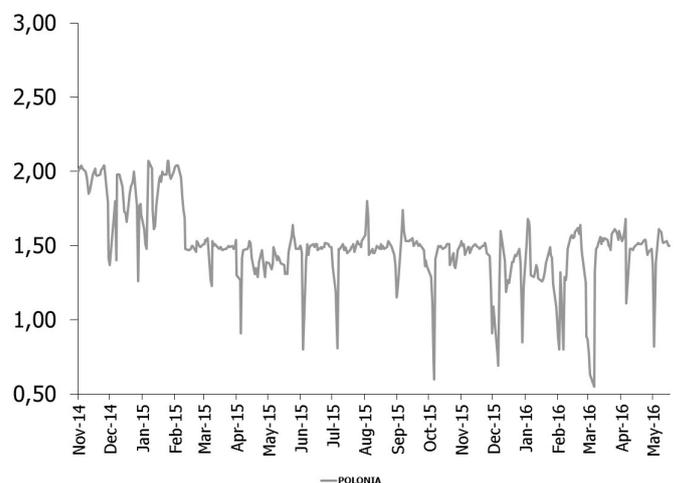
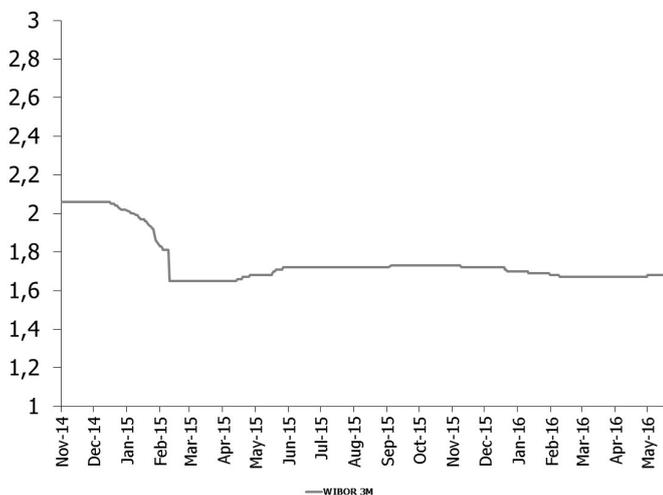
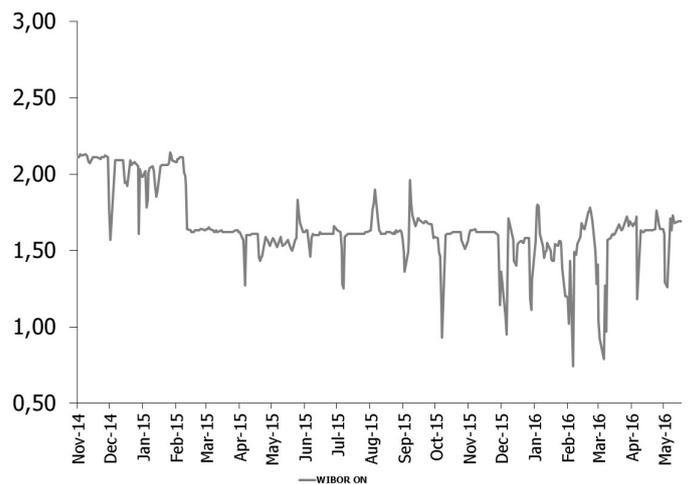
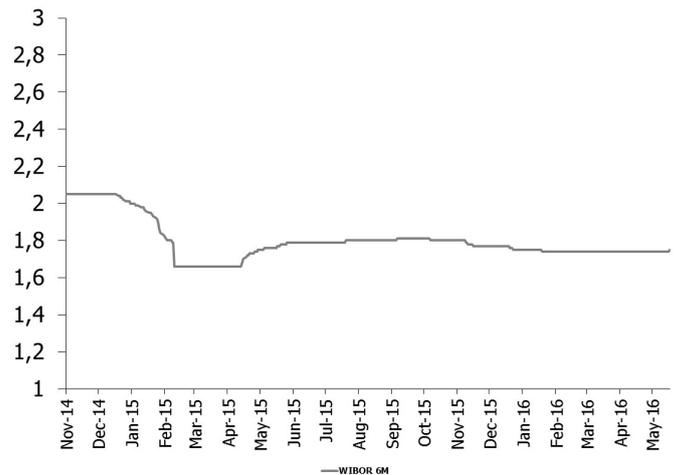


Money market

Local risk off

Last week's MPC meeting was a non-event. Rates were kept on hold and members reiterated that they feel comfortable with current rate levels. Also, the announcement of chf bill draft turned out with nothing spectacular. Proposals are quite complicated, harmful for banks and still to be discussed.

As fear factor persists, banks are dumping bonds all the way on the curve. Last wave of sales brought us to 1,50% even on the shortest govies. This tempts us to refill our portfolio. Now we look to accumulate 0716 and 1016 around 1,53%+ with intention to sell those at a switching auction later this month.



Forex

Spot – PLN roller-coaster EUR/PLN trended down this week. At first, weak NFP gave EM a strong push, especially against USD. EUR/PLN was on the slide from 4.3920 (week's high), to 4.3150 (week's low), in just three days. On Thursday, the profit taking started, and EUR/PLN bounced back a bit. On Friday we see continuation, which pushed EUR/PLN back above 4.35. The market took the CHF bill conference rather lightly. On the other hand the Brexit fever is flying high and that may affect Poland severely. To have a full market picture, one should add to it poor liquidity. Our usual rangy approach is still valid, 4.32-4.42 it is at the moment, with freshly build PLN longs being the likely target for the market.

EUR/PLN vol spiked The refusal of vol to ease further with PLN advances, was really telling. As the result, Vol really jumped when PLN started to reverse its gains. Realized volatility was also supportive for Gamma buyers. The proximity of Brexit date also forced vols higher. 1 month EUR/PLN ATM mid is this Friday at 8.75% (1.15% higher), 3 months EUR/PLN is 8.1% (0.4% higher) and finally 1 year is 8.50% (unchanged). The skew is bettered bid (especially in the frontend) and Currency Spread (difference between USD/PLN and EUR/PLN vol) soared higher as well.

Short-term forecasts

Main supports / resistances:
 EUR/PLN: 4.31 / 4.44
 USD/PLN: 3.70 / 4.00

Spot Longs EUR/PLN from 4.3900 and 4.3600 were stopped out at 4.3450.

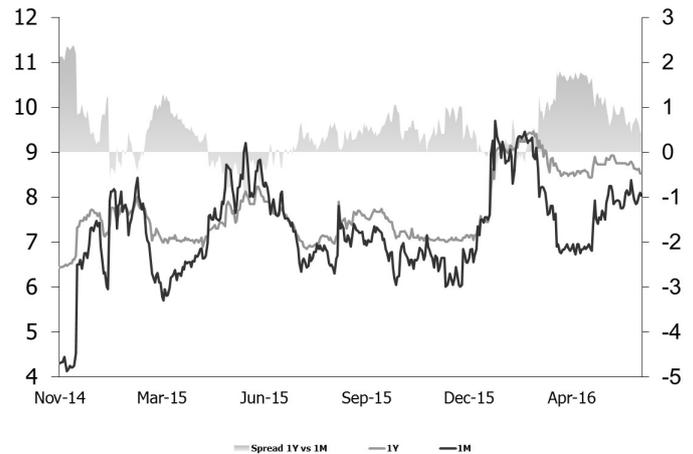
We are long at 4.3235 with stop below 4.2900 and with target at 4.43+.

The NFP figure was a really wild card and as a consequence we had to execute a stop. Actually we should have triggered stop just after NFP announcement. Next time we will be more agile (hopefully). The bigger picture have not changed that much with political risk still generating a premium. The 4.29-4.31 support zone is in our eyes hardly scratched, and the upside potential persists.

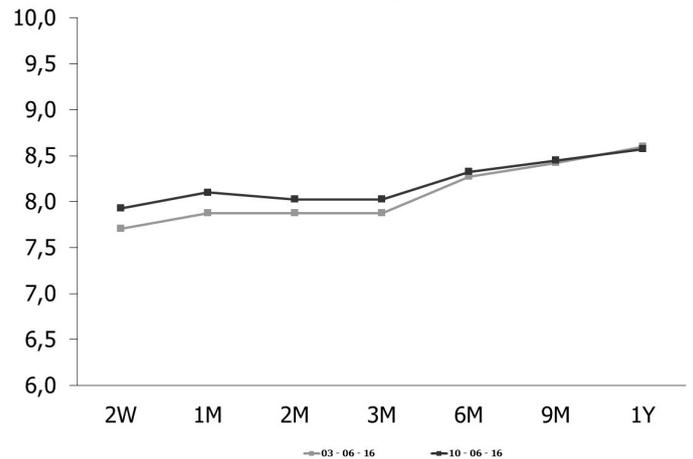
Options Vols – Long Vega in the backend

Our call for long backend still holds. It is a bit less attractive than a few weeks back but we cling to it. The reasons are simple: high bid/offer spread. Illiquid nature of EUR/PLN vols market is not at all in favour of active position adjustments. We still see enough reasons mostly from local politics but also from the Fed. Market structure (increased algorithmic presence) supports holding long Vega in the backend.

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
6/2/2016	1.70	1.68	1.75	1.64	1.64	1.66	1.67	1.67	1.65	1.64	1.64	1.69
6/6/2016	1.75	1.68	1.82	1.64	1.74	1.66	1.67	1.68	1.65	1.64	1.64	1.70
6/7/2016	1.75	1.68	1.82	1.64	1.73	1.66	1.67	1.67	1.65	1.63	1.63	1.70
6/8/2016	1.65	1.68	1.71	1.64	1.69	1.67	1.68	1.68	1.63	1.59	1.60	1.69
6/9/2016	1.86	1.68	1.90	1.65	1.78	1.67	1.69	1.69	1.65	1.63	1.63	1.70

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
6/2/2016	1.660	1.474	1.635	1.578	1.960	2.232	2.405	2.949
6/6/2016	1.660	1.474	1.635	1.578	1.960	2.232	2.405	2.949
6/7/2016	1.660	1.474	1.635	1.578	1.960	2.232	2.405	2.949
6/8/2016	1.670	1.474	1.635	1.638	1.990	2.290	2.447	2.985
6/9/2016	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
6/2/2016	7.85	7.88	8.28	8.63	8.63	2.37	0.63
6/6/2016	8.03	7.95	8.30	8.63	8.63	2.37	0.63
6/7/2016	8.10	8.00	8.28	8.53	8.53	2.33	0.63
6/8/2016	8.03	7.98	8.25	8.53	8.53	2.30	0.63
6/9/2016	8.10	8.03	8.33	8.58	8.58	2.31	0.64

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
6/2/2016	4.3944	3.9204	3.9731	3.5962	1.4014	0.1626
6/6/2016	4.3835	3.8602	3.9598	3.6013	1.4063	0.1623
6/7/2016	4.3533	3.8298	3.9639	3.5549	1.3987	0.1610
6/8/2016	4.3377	3.8150	3.9554	3.5626	1.3967	0.1605
6/9/2016	4.3334	3.8126	3.9703	3.5803	1.3902	0.1604

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 or 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.