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Polish Weekly Review

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Comment on the upcoming data and forecasts

On Monday CSO publishes its Statistical Bulletin which, among others, contains data on unemployment rate for June. Preliminary MFLSP data were quite surprising (much lower than market expectations). This would suggest stronger correlation with other labor market data – spike in employment. NBP's inflation expectations (published on Friday) should not bring any surprises.

Polish data to watch: July 25th to July 29th

Publication	Date	Period	mBank	Consensus	Prior
Unemployment rate (%)	25.07	Jun	8.8	8.7	9.1
NBP inflation expectations (%)	29.07	Jun	0.2	0.2	0.2

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	-	1600	1.706	7/7/2016
5Y T-bond PS0721	7/28/2016	4800	2.219	5/25/2016
10Y T-bond DS0726	-	2700	2.923	7/7/2016
15Y T-bond WS0428	-	200	3.027	7/7/2016

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



Comment

Great labor market data as well as better than expected producer prices erased fall from previous week. Monday could move Polish surprise index again, since CSO will then publish unemployment rate for June.

* 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 and brisk wage growth), 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

- Although the markets escaped thinking of Brexit in terms of really borderline scenarios due to promised central bank interventions, the whole scope and timeline of Brexit repercussions is still unclear. We still think that Brexit is negative for credit risk among EMs.
- Despite the possibility of a renewed play for a rate hike in the U.S. in September, Polish assets are facing other, idiosyncratic risks (pending CHF bill).
- We feel that foreign investors may be reluctant to add Poland to their portfolios due to recent outperformance.
- Zloty to be range bound. Headwinds due to upcoming event risks but fundamentally attractive levels.

mBank forecasts

	2010	2012	2013	2014	2015	2016 F
GDP y/y (%)	3.7	1.6	1.3	3.3	3.4	3.4
CPI Inflation y/y (average %)	2.8	3.7	0.9	-0.1	-0.9	-0.4
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	2016 Q2 F	2016 Q3 F	2016 Q4 F
GDP y/y (%)	3.6	3.1	3.4	4.3	3.0	3.3	3.4	3.5
Individual consumption y/y (%)	3.1	3.1	3.1	3.0	3.2	3.6	4.1	4.4
Public Consumption y/y (%)	1.8	0.8	0.9	8.7	4.4	4.0	4.0	4.0
Investment y/y (%)	11.8	5.8	4.4	4.4	-1.8	0.5	2.0	3.5
Inflation rate (% average)	-1.4	-0.9	-0.7	-0.6	-0.9	-0.9	-0.5	0.6
Unemployment rate (% eop)	11.5	10.2	9.7	9.8	10.0	8.9	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	1.71	1.71	1.44
2Y Polish bond yields (% eop)	1.61	1.99	1.76	1.62	1.45	1.65	1.50	1.40
10Y Polish bond yields (% eop)	2.31	3.31	2.84	2.94	2.84	2.91	2.80	2.80
EUR/PLN (eop)	4.07	4.19	4.25	4.26	4.24	4.38	4.35	4.30
USD/PLN (eop)	3.80	3.76	3.80	3.92	3.73	3.94	3.99	3.98
F - forecast								

Economics

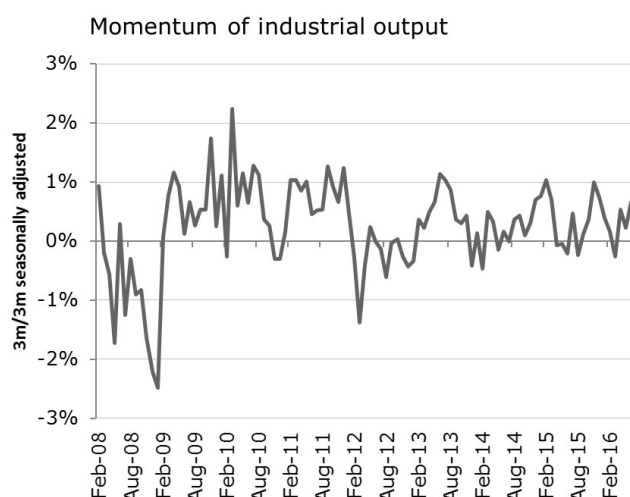
MPC will remain unimpressed by decent real sphere and great labor market data

Data on retail sales and industrial output are consistent with 3.3-3.4% GDP growth in Q2. Growth is set to be biased towards consumption whereas investment activity is expected to stay subdued. Labor market stays in perfect shape. Not only employment is increasing swiftly (+3.1% y/y) but also wage growth is creeping higher (+5.3% y/y). Owing to such positive developments, real labor fund is close to double digit growth. It is a positive sign for consumption (supported also by 500+ child benefit program) which makes up for investment slump and meagre exports performance in Q2.

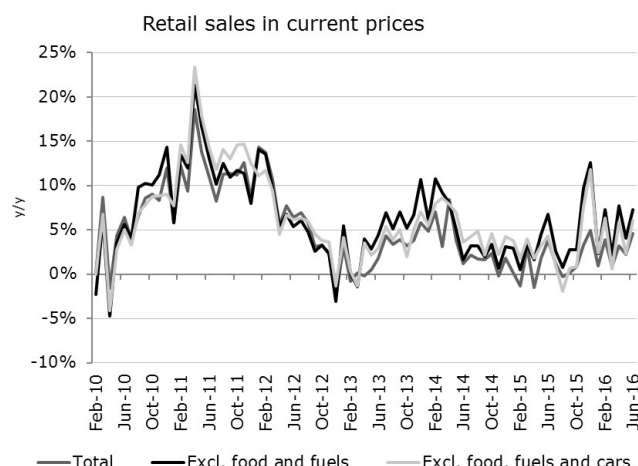
MPC is not going to be much impressed by the data as it seems to be only corroborating their current view of stable rates. It is too early to abandon the possibility of rate cuts, though. Global risks, investment slump, scarce evidence that corporates really increase prices in response to higher labor costs (NBP surveys) suggests that Poland is not out of the woods yet. So we still think that window of opportunity may re-open for rate cuts soon.

Lets look into some of the details:

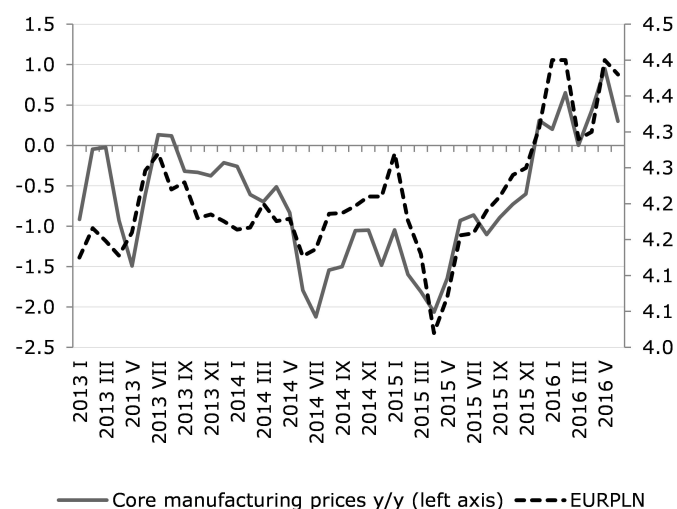
Industrial output grew by 6.0% y/y in June after 3.5% recorded in May. The reading was boosted by working days count whereas seasonally adjusted reading was estimated at 3.6% y/y and 0.7% m/m. This way the momentum stayed close to neutral, consistent with 4% growth in output. It is important to note, though, that May weakness did not extend in June. Therefore the slowdown was probably of one-off nature (as was simultaneous drop in exports and imports). On should also note that despite big decrease in construction, manufacturing fared much better. It may be important disconnection.



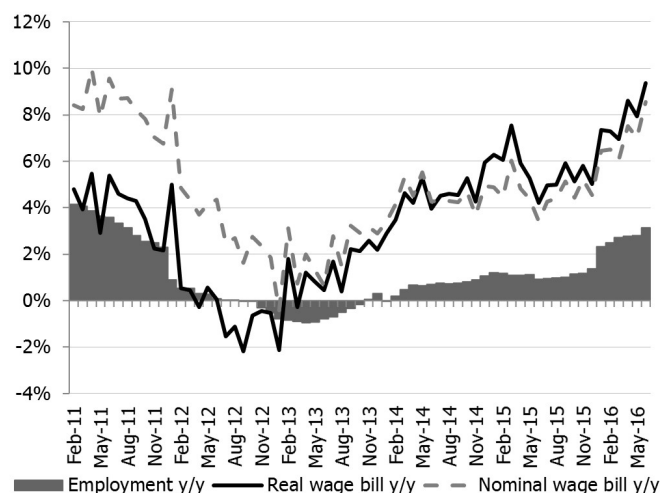
Retail sales grew by 4.6% on annual basis in June. The composition of growth is not surprising. All categories behaved consistently with recent trends and seasonality. Therefore 500+ benefit programme is supporting goods sales only in a minor way. We think that the bulk of expenditures goes to services (such a trend may be exacerbated by the holiday period). We stay optimistic on consumption and we await steeper growth path in coming quarters.



Producer prices made a surprise. We opted for softer reading due to base effects. In reality, PPI growth stayed flat as previous reading was revised upwards. All in all producer prices fell 0.7% y/y in June. This is not a breakthrough development though, as each and every higher reading was connected with higher oil prices or/and weaker PLN. This is consistent with NBP surveys as enterprises generally connect higher prices with higher input costs. Excluding most volatile prices of coke and oil, manufacturing prices actually fell in June. Therefore the relation between core producer prices and exchange rate holds. Consequently, stabilization/appreciation of PLN and stabilization of oil prices are supporting lower producer prices ahead.



Labour data is not very abundant with figures to crunch (we are still waiting for CSO Statistical Bulletin to look into details). By now we are impressed by **employment** growth, although only after Q2 data are complete we will be able to verify whether such impressive numbers are sheer statistic effects (a change of legal form of labor contracts) or all this is demand driven. So far NBP surveys suggest that it may be the mixture of the two approaches; in our opinion June employment numbers may overstate the actual labor demand, though.



As for **wages**, it was base effect that lifted wage growth above 5%. More is in the pipeline, though, as labor demand seems to be in solid shape and supply of labor seems to be facing shortages. Situation is tougher because 500+ lifted reservation wage of many workers, the benefits are possibly leading to lower labor force participation of women and, finally, planned changes of pension system may discourage workers that recently contributed positively to labor supply. To recap, 5% growth was only a matter of time and we await more.

Fixed income

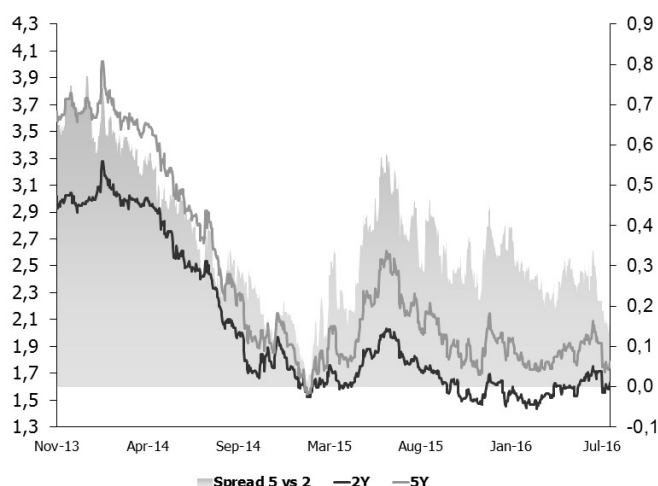
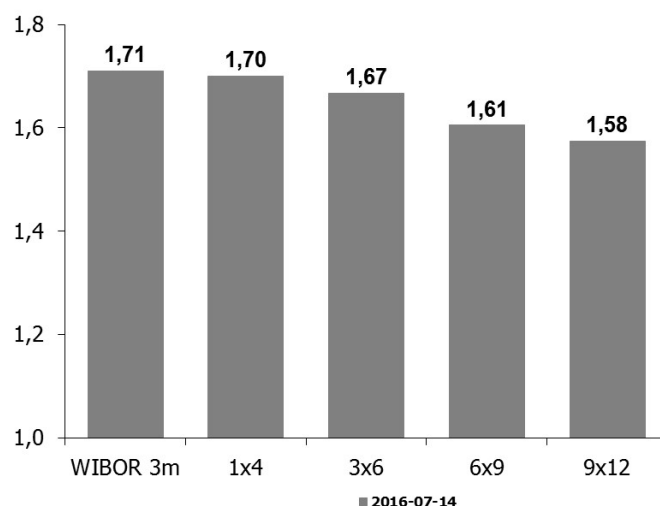
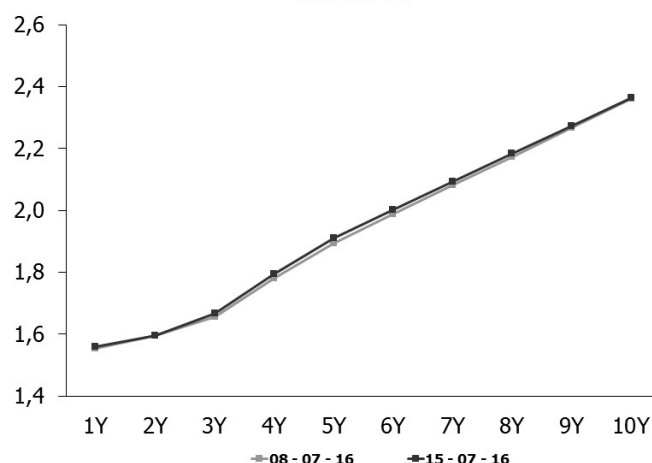
Stable market despite headwinds.

Despite huge turbulences in Europe, Polish FI market has been quite stable this week. 10Y benchmark fluctuated between 96.20-96.70 so in small 5 bps range. Swaps were moving in the same range, so 5Y traded 1.81-1.86 and 10Y 2.17-2.22. We noticed some paying interest in short end as probability of any rate cut in Poland is rather small now. We also like that idea. It can be played via buying the short end.

What is also interesting is huge demand and lack of offers for the belly and s/e bonds. It looks like Polish liquidity desks are switching from OK0716 into something longer. Buying rather shorter bonds (maturing in 2017) seems more reasonable than in 2018 and 2019 as those look expensive.

We don't have any strong view for the longer end of the curve, maybe except l/e ASW which seems wide. On the one hand Polish yields are quite attractive compared to Western Europe, but aren't they too low there?? On the other hand political situation in Poland is still tricky and government is still working on the law which are rather bearish for our bonds (like CHF bill which should be sent to the parliament next week). The rule of thumb concerning the bill is simple. Unless it is harmful for banks, POL-GBs will be sought as a buy.

IRS curve



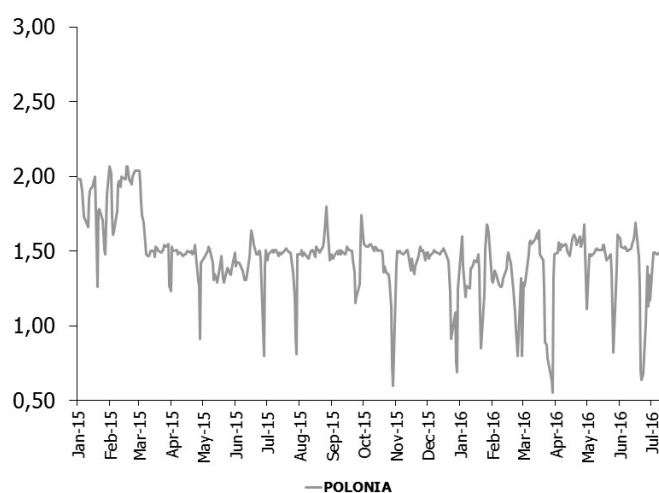
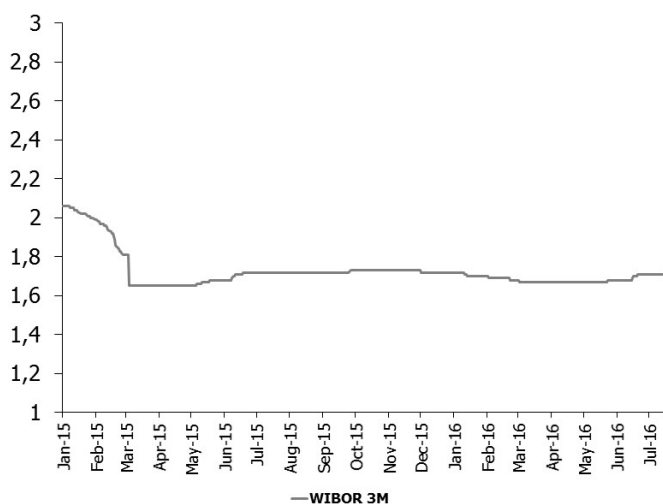
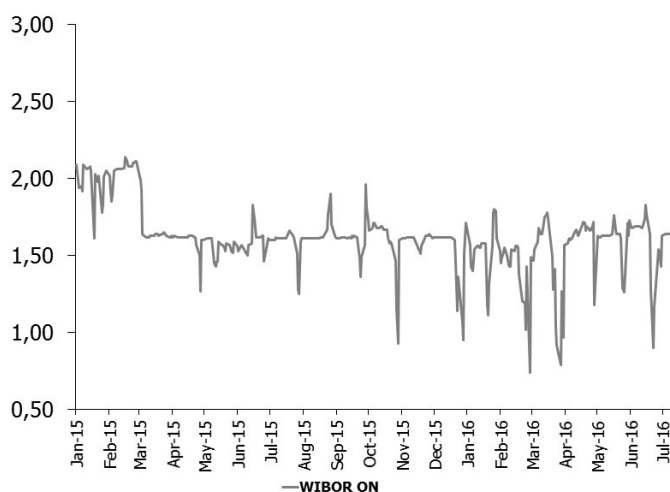
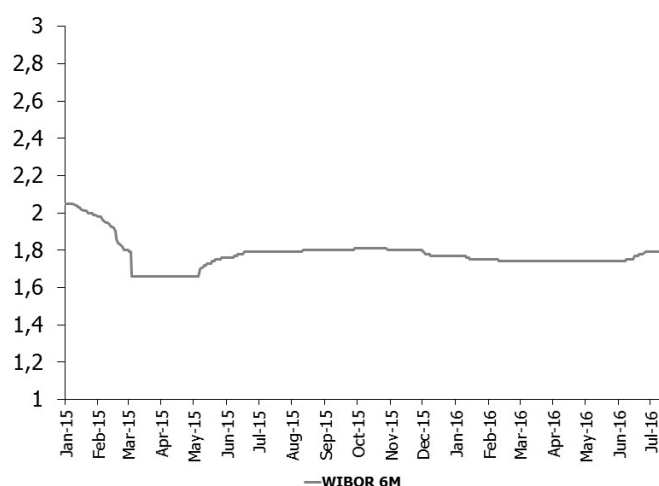
Money market

Stable week behind us... cheaper ahead of us.

Last week was very stable. Polonia fluctuated around 1.50.

Today's OMO was underbid as next week is the last week of reserve period. Banks bought 68bn bills out of 73 offered. It should be a bit cheaper next week as on Monday there will be extra cash from OK0716 and coupons from floaters and July bonds.

Shortest bonds were massively bid on Thursday and Friday. Yields below 1.50 is in our opinion a good level to close position.



Forex

Spot – PLN is on the rise. The global risk rally finally got to PLN as well; it was not even disrupted by Turkish events. EUR/PLN is currently grappling with strong 4.34-4.36 support. The ECB was not really eventful, Polish parliamentary holidays are just around the corner, there is not much excitement in the markets. Maybe the FOMC rate decision should get more attention now, with odds attached to a hike possibly underestimated. So far we have not decisively broke to the downside, so we still try to play 4.35-4.45 range.

Options – EUR/PLN vol a tic lower...again. Stronger PLN, low realized returns are to blame for undisturbed slide of EUR/PLN vol curve. The supply is still having an upper hand, with holiday season in full swing. 1 month EUR/PLN ATM mid is 6.8% (0.2% lower), 3 months EUR/PLN are 7.5 (0.4% lower) and finally 1 year is fixing at 8.4 (0.1% lower). The skew and currency spread were also better offered.

Short-term forecasts

Main supports / resistances:

EUR/PLN: 4.35 / 4.55

USD/PLN: 3.80 / 4.20

Spot

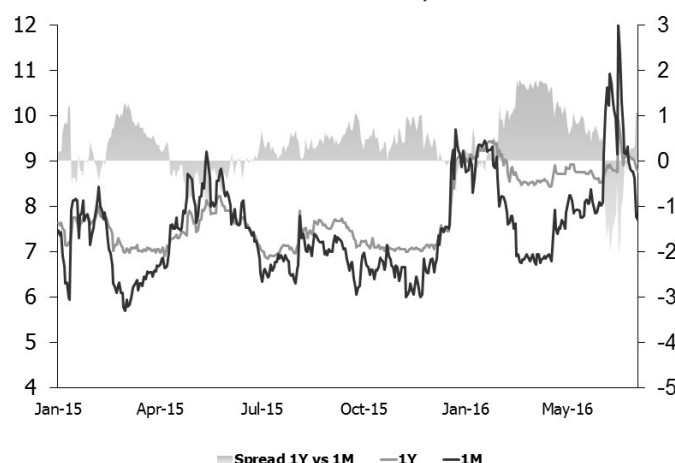
Position: Long EUR/PLN from 4.4050 (and 4.3700) with a stop loss below 4.3375 and hopes to see 4.47 with a possible extension to 4.54.

In comparison to last week, we moved stop loss roughly 1 figure lower, as our mindset is still firm to fade PLN strength. We still see fundamental risks (mainly political). Even stronger move to the downside should be viewed as corrective only.

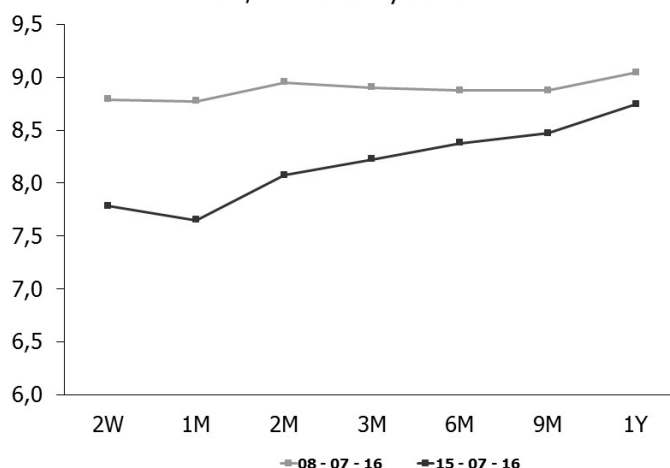
Options Vols – Long Vega in the backend

We are still long Vega in the backend of EUR/PLN vols. The vols spike was really short lived and vols melted as a result. It is frustrating but we think that our view has received a fundamental back up. There is a lot of uncertainty surrounding the Brexit and it will have its footprint on Poland as well. The local future is also looming not that bright with potential deterioration for ratings, constitutional tribunal argument or the biggest worry of it all: CHF denominated loans conversion. We stick to our position.

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
7/15/2016	2.16	1.71	2.09	1.69	1.92	1.71	1.70	1.68	1.60	1.58	1.56	1.66
7/18/2016	2.04	1.71	2.11	1.69	1.93	1.71	1.70	1.66	1.59	1.56	1.54	1.66
7/19/2016	1.78	1.71	1.78	1.69	1.65	1.71	1.70	1.66	1.60	1.57	1.56	1.65
7/20/2016	1.53	1.71	1.59	1.69	1.64	1.71	1.69	1.66	1.60	1.58	1.58	1.68
7/21/2016	2.18	1.71	2.08	1.69	2.03	1.71	1.70	1.67	1.62	1.58	1.58	1.67

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
7/15/2016	1.710	1.474	1.635	1.578	1.960	2.232	2.405	2.949
7/18/2016	1.710	1.474	1.635	1.578	1.960	2.232	2.405	2.949
7/19/2016	1.710	1.474	1.635	1.578	1.960	2.232	2.405	2.949
7/20/2016	1.710	1.474	1.635	1.638	1.990	2.290	2.447	2.985
7/21/2016	1.710	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	
7/15/2016	7.60	8.18	8.30	8.70	8.70	2.29	0.59	
7/18/2016	7.88	8.20	8.35	8.70	8.70	2.29	0.59	
7/19/2016	7.43	7.98	8.20	8.60	8.60	2.29	0.60	
7/20/2016	7.33	7.93	8.10	8.55	8.55	2.27	0.59	
7/21/2016	7.23	7.80	8.08	8.50	8.50	2.26	0.59	

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
7/15/2016	4.4121	3.9598	4.0432	3.7394	1.4020	0.1632
7/18/2016	4.4032	3.9853	4.0499	3.7703	1.3970	0.1629
7/19/2016	4.3811	3.9582	4.0280	3.7315	1.3914	0.1620
7/20/2016	4.3776	3.9790	4.0283	3.7375	1.3917	0.1621
7/21/2016	4.3706	3.9685	4.0180	3.7421	1.3897	0.1617

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