mBank.pl

August 5, 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



## Comment on the upcoming data and forecasts

All important economic releases will be published on Friday. We start with preliminary GDP data for the second quarter. After weak Q1 we expect only a slight rebound. Investment activity still remains weak, due to further drop in construction sector. Final figure (3.2% y/y) will be sustained mainly by private consumption. M3 money supply in July will decelerate only slightly (a result of betterment in household deposits and deterioration in corporate). Current account balance for June should drop mainly because weaker EU funds absorption, although final figure will still remain positive (slightly positive trade balance). Last but not least, final CPI release should clarify, where the unexpected drop in the flash release came from.

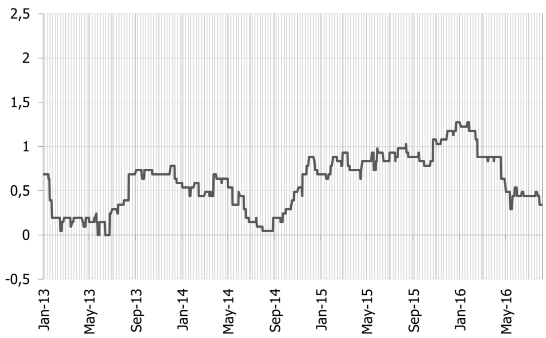
### Polish data to watch: August 8th to August 12th

| Publication | Date | Period | mBank | Consensus | Prior |
|---|---|---|---|---|---|
| GDP y/y (%) *preliminary* | 21.08 | Q2 | 3.2 | 3.3 | 3.0 |
| M3 money supply y/y (%) | 21.08 | Jul | 11.2 | 11.2 | 11.4 |
| Current account (mio EUR) | 21.08 | Jun | 275 | -52 | 495 |
| Exports (mio EUR) | 21.08 | Jun | 14600 | 14753 | 13351 |
| Imports (mio EUR) | 21.08 | Jun | 14250 | 14388 | 13224 |
| CPI y/y (%) *final* | 21.08 | Jul | -0.9 | -0.8 | -0.8 |

### 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 | 8/18/2016 | 1600 | 1.706 | 7/7/2016 |
| 5Y T-bond PS0721 | 9/1/2016 | 5000 | 2.327 | 7/28/2016 |
| 10Y T-bond DS0726 | 8/18/2016 | 2700 | 2.923 | 7/7/2016 |
| 15Y T-bond WS0428 | 8/18/2016 | 200 | 3.027 | 7/7/2016 |

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




**Comment**

Unchanged from the previous week, even though manufacturing PMI surprised to the downside (see the Economics section for more details). Next week brings more opportunities to move the index with preliminary GDP and final CPI data (both published on Friday).

* 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).

mBank.pl

## Our view in a nutshell

### Fundamentals

- 500+ programme is set to support private consumption in 2016. Despite weak Zloty, exports growth ground into a halt. 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 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 and brisk wage growth), many years of moderate 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 is 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. We expect the MPC to finally acknowledge inflation risks amid temporary weakness in GDP growth and another round of monetary policy stimulation globally. Lower risk premia will certainly help.

### Financial markets

- Considerable central bank stimulation petrifies low rate environment. A play for September Fed hike may spoil the picture for some time, though.
- CHF loan conversion bill was trashed, at least for a few months. Bank are obliged to pay back a portion of the the currency spreads instead. Such development takes the pressure off the Polish rating at the moment and lowers the risk premia in Polish bonds.
- However, sustainable downward pressure on yields can be triggered only in case when the door for further rate cuts are opened again. This stays off the curent MPC's agenda, at least for now.
- CHF bill affects positively the risk premium in PLN. Increased volume of central bank money puts appreciation pressure on the zloty again. Significant strengthening of the PLN can open the door for rate cuts but as long as they are closed, EURPLN is poised to fall.

### 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 | 3.2 | 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 | -1.0 | 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 | 4.25 | 4.25 |
| USD/PLN (eop) | 3.80 | 3.76 | 3.80 | 3.92 | 3.73 | 3.94 | 3.90 | 3.94 |

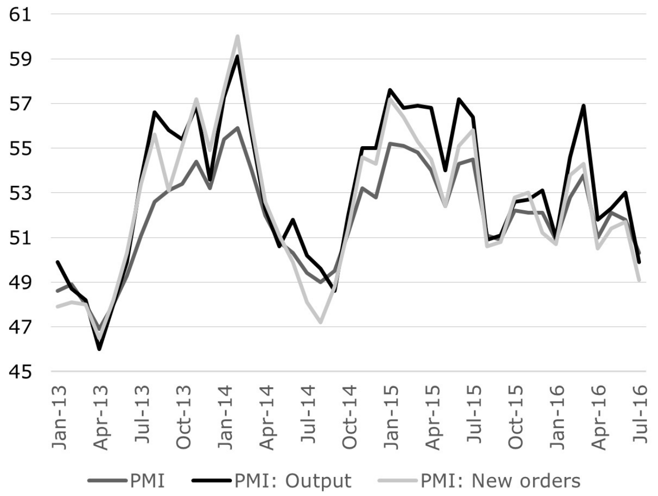
F - forecast

mBank.pl

# Economics

## Manufacturing on the verge of stagnation

In July Polish manufacturing PMI fell from 51.8 to 50.3, decisively below forecasts (ours: 52.3, market consensus: 51,6) and marking the worst reading since September '14. Contrary to the previous month's data, when the slight decline in the headline masked improvements in new orders and output, the are no silver linings this time. In July, output assessment fell from 53.0 to 49.9, while new orders subindex tumbled from 51.7 to 49.1 - needless to say, those are the 2-year lows as well.




In search for the causes of this deterioration in business sentiment, most analysts immediately blamed the most obvious culprit – Brexit referendum. Uncertainty regarding the trajectory of the British economy and demand in other EU economies was supposed to weigh on export orders, the explanation goes. In fact, export orders fell below 50 pts. after a few months of outperformance over domestic orders. We do not see this as a complete explanation. First, analogous GUS data do not point to a significant drop in export orders in July. Second, the European data itself does not corroborate that story, since business sentiment worsened only in selected countries (EZ periphery, Ireland, Czech Republic, not to mention dismal readings from the UK itself). Thus, there is no evidence that a single external uncertainty / demand shock hit European economies at the same time. In any case, Polish exports to other EU countries has been falling for the past few months, completely oblivious to the ups and downs of PMI export orders.

Why, then, has manufacturing sentiment soured? We believe that there is still a domestic component to the decline in sentiment. Cutbacks in public (local governments) and quasi-public (SOEs, mainly utilities and energy) investment, as well increased regulatory uncertainty weighing on private investment plans have been an enduring drag on economic activity this year. In this environment, any rebound in economic growth in the second half of this year will be rather unspectacular – in the contest of official forecasters, closer to NBP's projections rather than the optimistic views of the MoF and the MoED. Apart from the weak demand, the July PMI report also points to a waning inflationary impulse: input prices (driven by weak zloty and commodity prices, both of which have already turned south) are growing slower and slower, while output prices resumed their downward trend. Both trends are pressuring margins but the key message is that deflation will not solve itself. Interest rates could well be cut in such an environment - now that the risk premia are declining and PLN is strengthening, we reiterate our long-held view of rate cuts in Poland.

## Today the FX spreads...

The new CHF loan conversion bill (for clarity we use this simplistic term, but the bill applies to all FX loans, regardless of currency and the nature of the contract) was significantly softened by the Chancellery of the President. The new bill sent to the Parliament foresees only a refund of excessive FX spreads (higher than 0.5% of NBP's fixings and only for the first 350k PLN of original loan size) to the borrowers in the form of principal reduction. This will cost the banking sector around 3.5 bn PLN and should be passed in the Autumn.

The subsequent steps in the CHF loan saga are voluntary but the supervisory authority will provide incentives for banks and borrowers to proceed. The supervisor will adjust risk weights for FX loans on the level of individual banks (SREP – Supervisory Review and Evaluation Process) in order to increase the economic cost of capital to such an extent that banks would convert FX loans on their own. Because of heavy FSA participation in this process, we expect it to happen only after the appointment of a new chairman (i.e. in October). The framework for negotiations between banks and borrowers will probably be built around the famed "fair exchange rate" concept (conspicuously absent during the press conference). At this juncture we believe that conversion will not be mandated by a bill but such a possibility will never be officially abandoned (working as a leverage on banks). It is, however, not a coincidence that the Chancellery dropped forced conversion now and that the new solution was backed by the NBP president (indirectly confirming that the price tag for a forced conversion would be just as big as the NBP judged). Prof. Glapinski's presence also indicates that the NBP, the FSA and the envisioned Systemic Risk Board will work together to solve the CHF loan bill issue without a risk of litigation in arbitrage courts.

The effect of the new announcement is undoubtedly positive. The market expected the new bill to be a watered down version of the previous one but restricting the solution to incomplete FX spread refund was more than most hoped. First, the immediate burden on the banking sector falls by a factor of 10-20. Second, the distribution of costs can be (SREP is discretionary) adjusted in such a way that the weakest institutions are not brought underwater. Smaller price tag and a way of spreading costs over time will greatly reduce the pressure on sovereign and bank ratings. How the voluntary conversion process unfolds, is largely unknown. The authorities must first craft the framework and calibrate incentives for banks. It is likely that borrowers with highest DTI and LTV will see their loans converted at the earliest. Still, the costs of conversion will be borne by the banks, albeit spread over years. Also note that it might be sped up ahead of the elections in 2019.

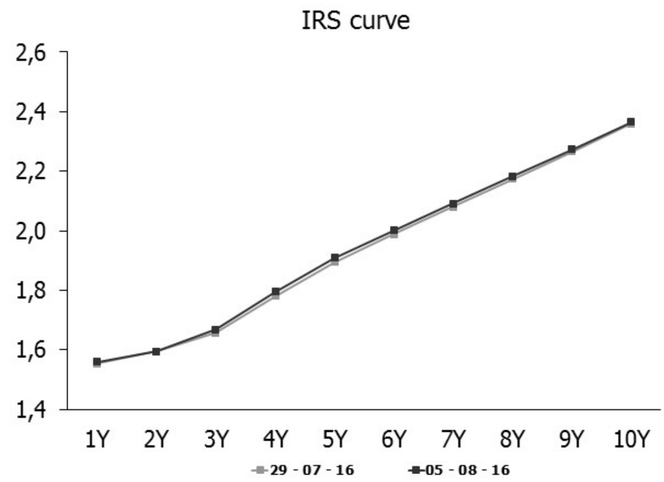
To sum up, the new CHF loan bill should lead to a decrease in risk premium in Polish government bonds (lower pressure on ratings, smaller fiscal costs of the project, lack of a systemic shock). The key to lower bond yields lies, however, with stronger PLN and the fall of stable rates paradigm to which the MPC is so attached right now.

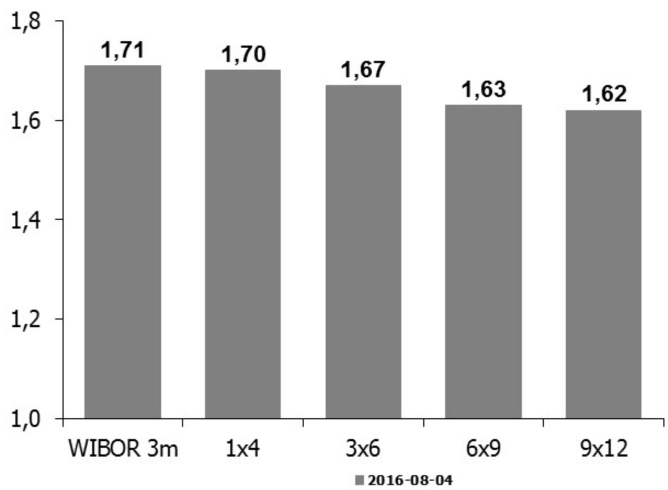
# Fixed income

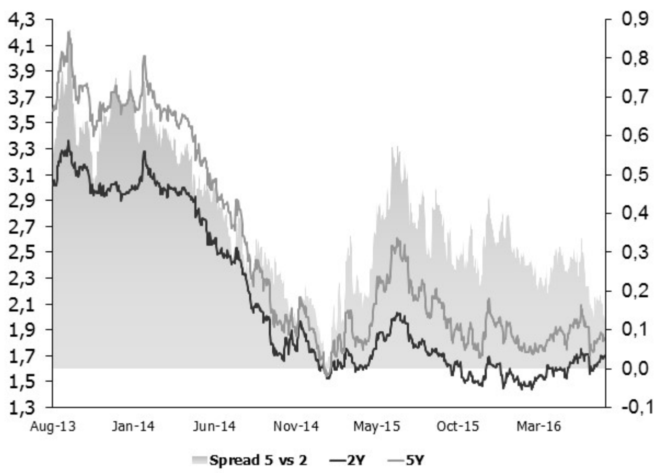
## Enough is enough

Last week we moved to new lows in yield on Polish 10y benchmark (2.72%). Despite that we were quite stable on 5y. Curve is too flat in our opinion, good level to look at PS0721/DS0726 is 53bps as we expect steepening towards 65bps.

Good figures from labor market in USA may move our curve higher. As next auction will be on 10y bonds, we expect it won't be supportive for bonds. ASW also looks rich for us. We don't see any reason for further move down in yields in Poland.



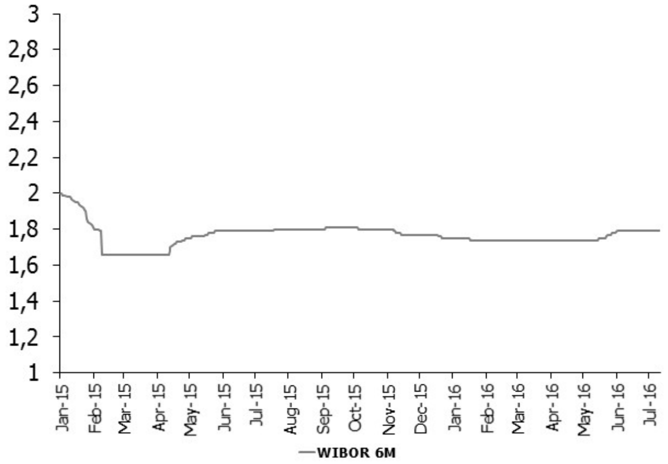



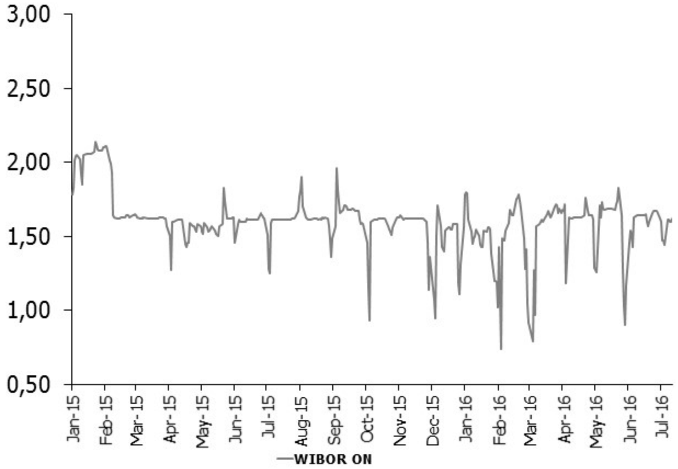
## Money market

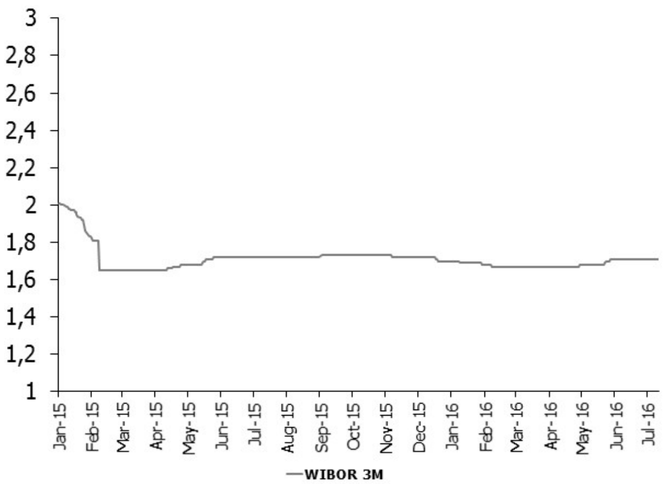
### Stabilization

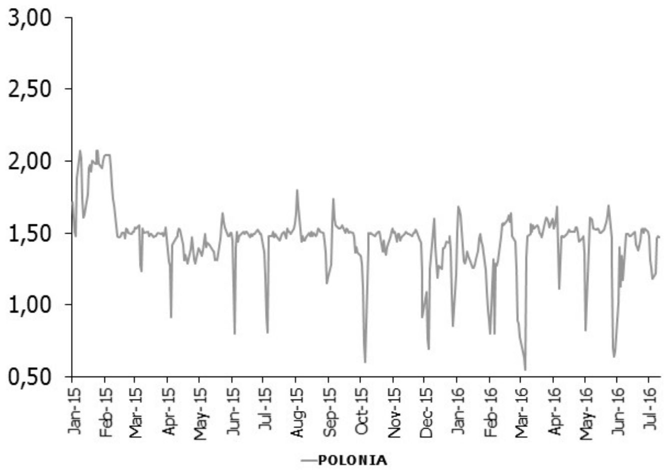
Market stalled last week with FRAs and short IRS well bid despite strong rally on POLGBs. We are pricing now small chances for rate cut within next year with 9x12 FRA holding 9 bp below current WIBOR. Hard to expect any rapid change in that consensus among market participants as new MPC members also favour such stance and reiterate that reference rate will stand at current level in coming quarters.

Ref rate vs Polonia averages: 30 day – 7 bp; 90 day – 9 bp



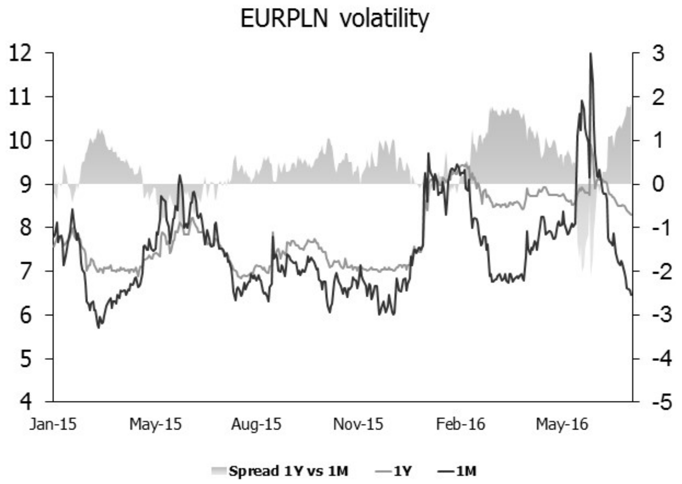



# Forex

**Spot – EUR/PLN broke out lower.** Finally we lived to see the day when a plan to deal with FX loans was presented. The proposals were less onerous compared to the previous version of the plan and costs for banks are significantly lower – at first stage it is only the return of excessive FX spreads. As a result EUR/PLN has beaten its strong support 4.35 and has dropped to 4.28. The story with FX mortgages has not ended yet – the decision on forced conversion was postponed by one year but the whole process is looking so remote and unspecific that we can see further Zloty gains. We are still range players as the base scenario, and 4.23 – 4.35 is the most likely range for now.

**Options – EUR/PLN vols – lower again.** The steady gains of the Zloty helped to push volatilities downside again. Supply is still having an upper hand, with holiday season in full swing. 1 month EUR/PLN ATM mid is 6.3% (0.1% lower), 3 months EUR/PLN is at 7.1% (0.2% lower) and, finally, 1 year is fixing at 8.2% (0.1% lower). The skew and currency spread were also better offered.




## Short-term forecasts

Main supports / resistances:
EUR/PLN: 4.23 / 4.35
USD/PLN: 3.75 / 4.00

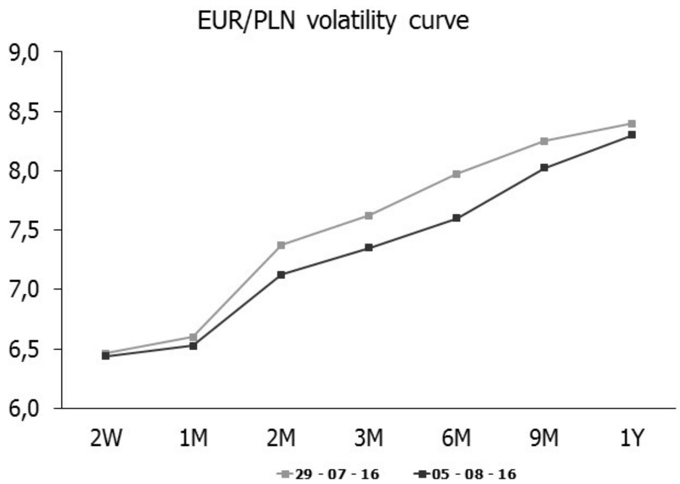
**Spot** New position: Short EUR/PLN.

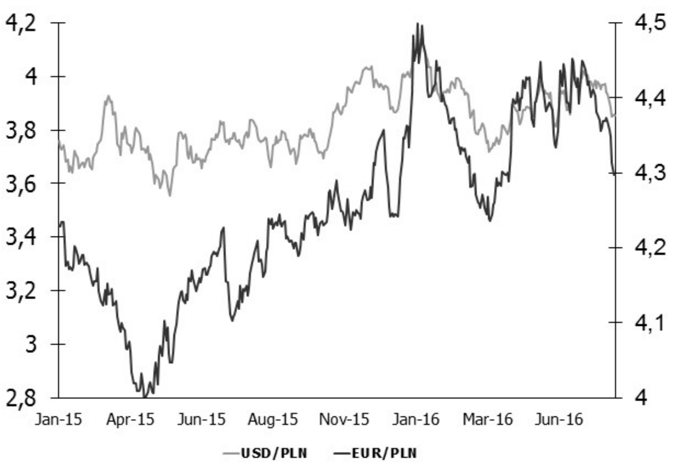
After the release of the FX conversion proposal we closed our long position at 4.35 with 4 figure loss and opened a short position at the same level. So now, we have over 5 figures of profit but we expect the Zloty to extend its gains – we humbly desire to dent the 4.26/4.23 support zone.

The actions of different central banks (ECB, FOMC, BoJ, BoE) were not really eventful, Polish parliament is on holidays. Apart from today's payrolls, there is not much excitement on the markets...

**Options** Selectively long Vega

A long-awaited new draft bill aimed at tackling FX mortgages can have impact only on short term volatility, but in fact it does not really change the bigger picture. There is a lot of uncertainty surrounding Brexit, Constitutional Court row, US elections. Additionally, the current levels of volatility are very low, so we stick to our position – we are still selectively long in backend EURPLN curve.




# 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 |
| 7/29/2016 | 2.12 | 1.71 | 2.15 | 1.69 | 2.02 | 1.71 | 1.70 | 1.68 | 1.64 | 1.62 | 1.62 | 1.70 |
| 8/1/2016 | 2.10 | 1.71 | 2.15 | 1.69 | 2.08 | 1.71 | 1.70 | 1.67 | 1.62 | 1.60 | 1.60 | 1.69 |
| 8/2/2016 | 2.12 | 1.71 | 1.80 | 1.69 | 1.73 | 1.71 | 1.70 | 1.68 | 1.64 | 1.62 | 1.62 | 1.71 |
| 8/3/2016 | 1.51 | 1.71 | 1.75 | 1.69 | 1.75 | 1.71 | 1.70 | 1.68 | 1.64 | 1.62 | 1.62 | 1.71 |
| 8/4/2016 | 2.07 | 1.71 | 2.13 | 1.69 | 2.06 | 1.71 | 1.70 | 1.67 | 1.63 | 1.62 | 1.62 | 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 |
| 7/29/2016 | 1.710 | 1.474 | 1.635 | 1.578 | 1.960 | 2.232 | 2.405 | 2.949 |
| 8/1/2016 | 1.710 | 1.474 | 1.635 | 1.578 | 1.960 | 2.232 | 2.405 | 2.949 |
| 8/2/2016 | 1.710 | 1.474 | 1.635 | 1.578 | 1.960 | 2.232 | 2.405 | 2.949 |
| 8/3/2016 | 1.710 | 1.474 | 1.635 | 1.638 | 1.990 | 2.290 | 2.447 | 2.985 |
| 8/4/2016 | 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 |
| 7/29/2016 | 6.60 | 7.63 | 7.98 | 8.40 | 8.40 | 2.38 | 0.66 |
| 8/1/2016 | 6.58 | 7.48 | 7.88 | 8.35 | 8.35 | 2.38 | 0.66 |
| 8/2/2016 | 6.55 | 7.43 | 7.73 | 8.33 | 8.33 | 2.27 | 0.60 |
| 8/3/2016 | 6.46 | 7.23 | 7.55 | 8.30 | 8.30 | 2.27 | 0.60 |
| 8/4/2016 | 6.53 | 7.35 | 7.60 | 8.30 | 8.30 | 2.27 | 0.66 |

| PLN Spot performance | | | | | | |
|---|---|---|---|---|---|---|
| Date | EURPLN | USDPLN | CHFPLN | JPYPLN | HUFPLN | CZKPLN |
| 7/29/2016 | 4.3684 | 3.9364 | 4.0256 | 3.7925 | 1.3984 | 0.1615 |
| 8/1/2016 | 4.3576 | 3.9040 | 4.0313 | 3.8184 | 1.3974 | 0.1612 |
| 8/2/2016 | 4.3484 | 3.8820 | 4.0190 | 3.8156 | 1.3948 | 0.1608 |
| 8/3/2016 | 4.3135 | 3.8516 | 3.9776 | 3.8078 | 1.3860 | 0.1595 |
| 8/4/2016 | 4.2971 | 3.8588 | 3.9628 | 3.8022 | 1.3817 | 0.1589 |

# 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 of distributed without the prior written agreement with mBank SA.