October 7, 2016

Polish Weekly Review

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Comment on the upcoming data and forecasts

On Tuesday, the CSO will publish final CPI release for September. It will shed more light on the surprisingly small increase in inflation (lower food prices is one possibility). On the next day, core inflation will most probably be confirmed at slightly below zero levels. The remaining releases are scheduled to be published on Friday. We expect M3 to decelerate in September, since the rapid build-up of households deposits has ended and base effects in corporate deposits work against the annual growth rate this time. Exports and imports probably rebounded significantly in August after the weak July numbers. Current account balance, driven by weak EU payments, will probably remain much below zero.

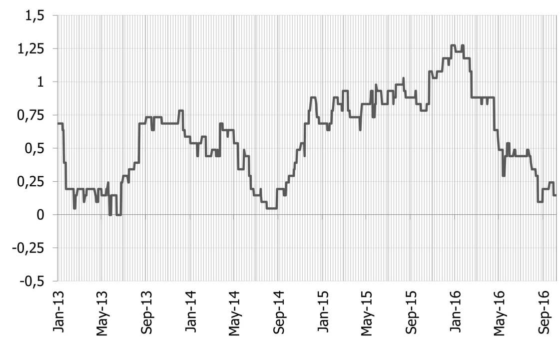
Polish data to watch: October 10th to October 14th

Publication	Date	Period	mBank	Consensus	Prior
CPI y/y (%) *final*	11.10	Sep	-0.5	-0.5	-0.8
Core inflation y/y (%)	12.10	Sep	-0.10	-0.20	-0.40
M3 money supply y/y (%)	13.10	Sep	9.5	9.5	10.0
Current account balance (mio EUR)	13.10	Aug	-550	-318	-802
Exports (mio EUR)	13.10	Aug	14200	13815	13519
Imports (mio EUR)	13.10	Aug	14500	13754	13832

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	-	2000	1.742	10/6/2016
5Y T-bond PS0721	10/21/2016	3500	2.114	8/18/2016
10Y T-bond DS0727	-	4000	3.098	10/6/2016
15Y T-bond WS0428	-	200	3.027	7/7/2016

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



Comment

PMI came in line with market consensus and MPC did not change interest rates, so surprise index remained at the same level. Next week bring only one opportunity to move the index – final CPI for September, published on Tuesday.

* 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. Despite weak Zloty, exports growth ground into a halt. Public infrastructure outlays have shifted towards 2017, and private investment seems to be locally, negatively affected by spillovers from public investment gap, lower absorption of EU funds and political uncertainty. However, over the medium term 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 are still a possibility (most likely in early 2017). We expect the MPC to finally acknowledge deflation risks amid the on-going weakness in GDP growth and another round of monetary policy stimulation globally.

Financial markets

- Zloty has moved towards the lower bound of its range, thanks to (relatively) hawkish MPC and global easing of monetary conditions. Due to the weakness in exports and country risks still present, we expect Zloty to remain weak for the time being.
- The prevailing event risk for PL assets, the CHF conversion, moved to the background, as its details are unlikely to be announced soon.
- As the expectations for Fed hike moved towards December, market focus is now on US elections and their possible impact on the economy and geopolitics. With the race as tight as it is now, the elections pose a major risk for EM assets, probably higher than Brexit.

mBank forecasts

	2012	2013	2014	2015	2016 F	2017 F
GDP y/y (%)	1.6	1.3	3.3	3.4	2.8	3.2
CPI Inflation y/y (average %)	3.7	0.9	-0.1	-0.9	-0.6	1.7
Current account (%GDP)	-3.7	-1.3	-2.0	-0.1	-0.7	-0.9
Unemployment rate (end of period %)	13.4	13.4	11.4	9.8	8.7	8.1
Repo rate (end of period %)	4.25	2.50	2.00	1.50	1.50	1.25

	2016 Q1	2016 Q2	2016 Q3 F	2016 Q4 F	2017 Q1 F	2017 Q2 F	2017 Q3 F	2017 Q4 F
GDP y/y (%)	3.0	3.1	2.7	2.5	2.7	3.1	3.4	3.5
Individual consumption y/y (%)	3.2	3.3	3.8	4.2	4.3	4.1	3.8	3.5
Public Consumption y/y (%)	4.4	4.4	4.0	1.0	2.4	2.4	2.4	2.4
Investment y/y (%)	-1.8	-4.9	-6.5	-4.0	-2.0	2.0	6.0	6.5
Inflation rate (% average)	-0.9	-0.9	-0.8	0.2	1.3	1.4	1.2	1.1
Unemployment rate (% eop)	10.0	8.9	8.5	8.7	8.9	8.2	7.8	8.1
NBP repo rate (% eop)	1.50	1.50	1.50	1.50	1.25	1.25	1.25	1.25
Wibor 3M (% eop)	1.67	1.71	1.71	1.71	1.44	1.44	1.44	1.44
2Y Polish bond yields (% eop)	1.45	1.65	1.76	1.65	1.35	1.30	1.30	1.30
10Y Polish bond yields (% eop)	2.84	2.91	2.92	3.00	2.80	2.80	2.80	2.80
EUR/PLN (eop)	4.24	4.38	4.30	4.35	4.35	4.30	4.25	4.25
USD/PLN (eop)	3.73	3.94	3.82	3.95	4.03	3.98	3.94	3.94
F - forecast								

Economics

Rates unchanged again

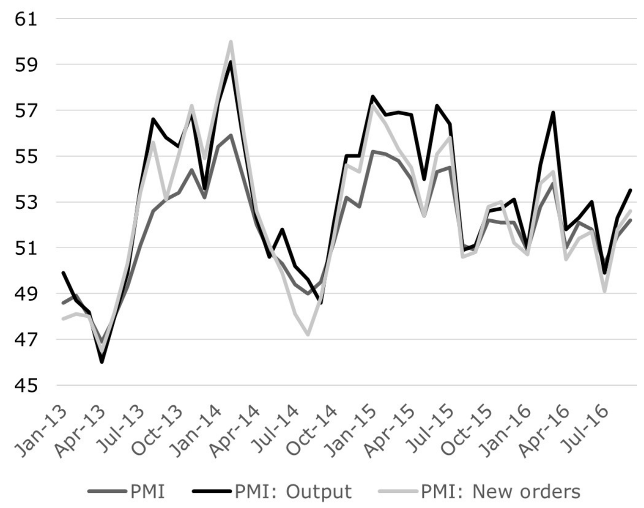
This week's MPC meeting brought no changes to Poland's key interest rates. The key passage in the MPC's statement was not changed as well – current interest rate level "is conducive to keeping the Polish economy on the sustainable growth path and maintaining macroeconomic balance". The tone of the conference was slightly more hawkish, though. The issue of rate cuts has barely appeared at all and governor Glapinski raised the possibility of rate hikes in 2018 several times, whose aim would be to prevent the economy from overheating. Needless to say, its current state is "very good" and there's no reason to consider a negative scenario.

The rationale for shifting the discussion towards risks of overheating was strong labor market and household consumption, as well as stellar exports and temporarily lower investment growth. Supposedly the NBP has sliced investment data and concluded that current contraction is driven by the lack of EU funds. Therefore, it is transitory. Given this, the economy will accelerate in 2017. Inflation is definitely not in this picture: it is poised to stay subdued next year and current deflationary environment is not relevant for monetary policy as it remains completely benign.

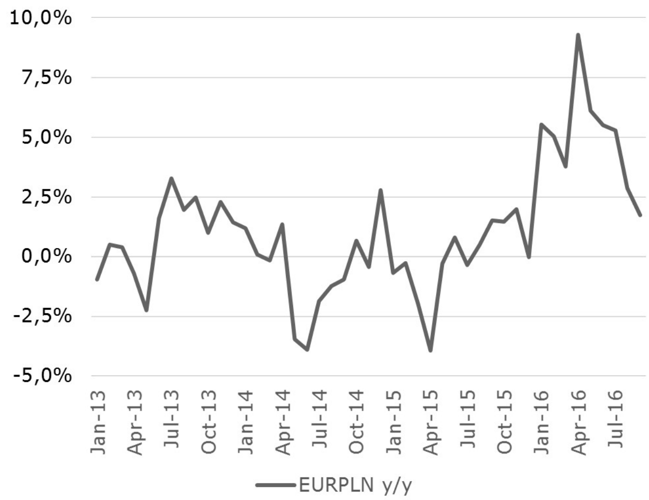
While the rosy view of the labor market supporting consumption is not controversial, our diagnosis of exports and investment prospect differs from the one shared by the NBP. Exports is growing strongly only in national accounts data (unclear why the discrepancy vis-a-vis other measures). Poor growth prospects for the global economy, Germany and Eurozone included, do imbue us with confidence that exports will accelerate. All the more since the impulse from weak Zloty seems to be waning. As far as investment is concerned, the slowdown can certainly be attributed to a large extent to the EU funding hiatus. This does not mean that there is pent-up demand ready to bounce back once funding reappears. Road investment is looking fine, railway investment will eventually return but local governments are constrained by debt limits and the need to keep general government deficit below 3% of GDP. Moreover, the new tranche of enterprise support (focus on innovation) poses a big challenge to potential beneficiaries and thus any analogies with the previous programming period might be misplaced. We believe that H2 growth will fall below 3% and the NBP will be unable to assess whether it really is temporary. The issue of rate cuts will come back with a vengeance next year.

PMI improved slightly

In September Poland Manufacturing PMI increased from 51.5 to 52.2, in line with market consensus and our forecast. The increase was consistent with the behaviour of manufacturing sentiment in Europe and, in particular, among Poland's key trading partners.



The improvement was driven by better assessment of output (from 52.3 to 53.5) and new orders (from 51.8 to 52.6) – in both cases, however, it is still just a return to this year's averages, not a breakout. The employment subindex is the only one that failed to follow this pattern, as it dropped from 53.6 to 51.7, a 2.5-year low. Finally, another month of output price declines and input price stagnation (despite higher commodity prices) complements the deflationary picture of Polish industry. It should be clear that the impulse from weaker zloty is fading fast.



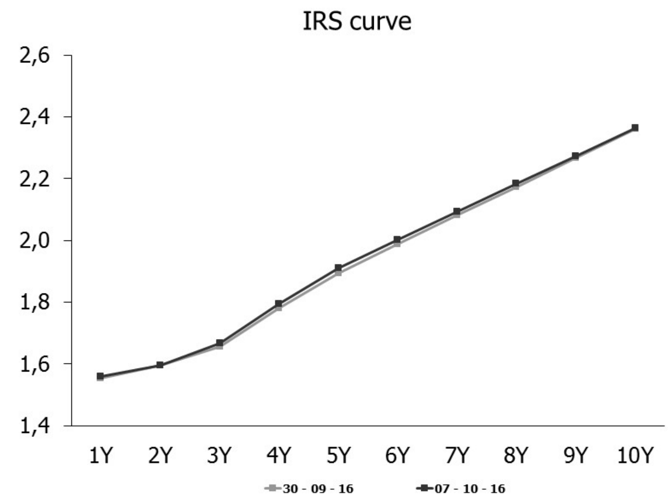
Taken as a whole, the PMI indicates stabilization in Polish manufacturing and remains consistent with small, but positive momentum. It is, however, consistent with different scenarios regarding the overall economy. Key factors for economic growth in H2 are: the on-going decline in investment and base effects resulting from the accumulation of public expenditures (investment and consumption) at end-2015. Both will prevent the economy from accelerating and will push growth down to 2.5-2.7% in the two quarters. The decline in the employment subindex, however worrying, is not consistent with other indices of hiring intentions / labor demand (NBP, CSO, Manpower, Randstat). Nevertheless, one can hypothesize that in an environment of declining boost from weak zloty and on-going pressure on margins from higher wages, the only immediately available form of closing the gap between wages and productivity might be a reduction in employment. This, in turn, means that economic growth – if investment drought is taken into account – can't add up to 3% or more from the output side.

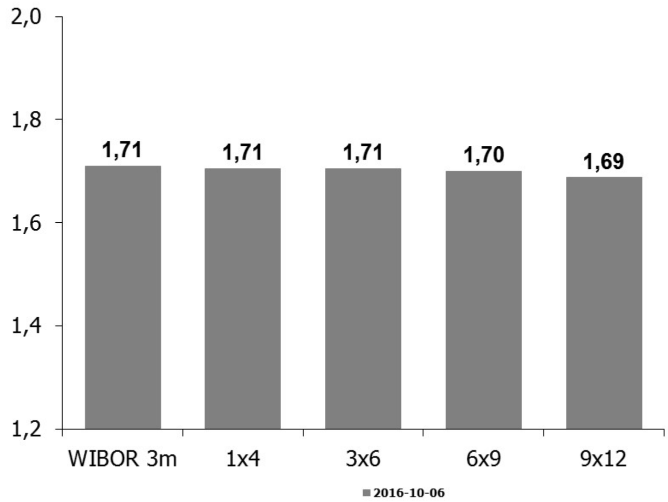
Fixed income

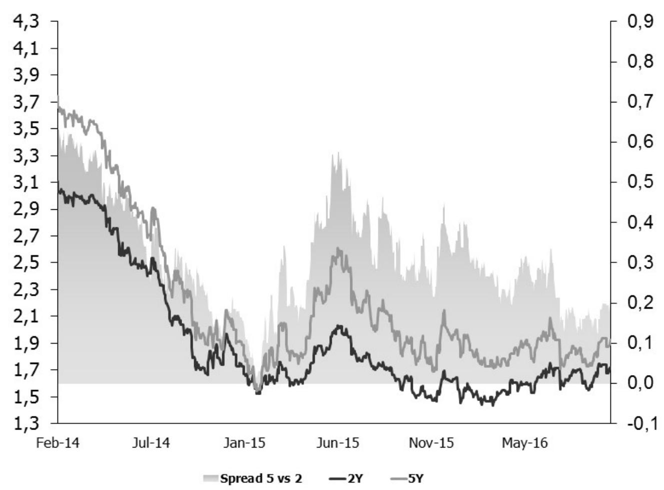
Old bonds mature, new ones are sold...

We had an auction this week, 4.5 bn of NEW DS0727 was sold at 3.1%. Spread between DS0727 and DS0726 was 13bps, which was too flat in our opinion. Market looks very heavy now, everyone is short in BPV.

Long end of the curve should remain unchanged. On the other hand, long end should move downward in yield, till end of month. PS1016 expires and some coupons are paid, this should be supportive for 1-2y bonds.







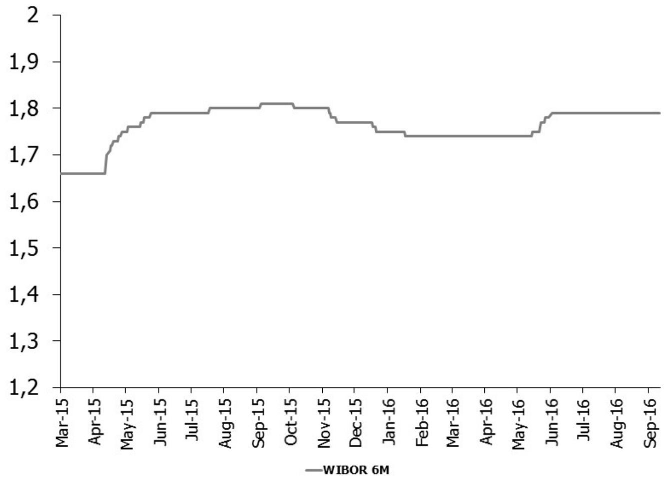
Money market

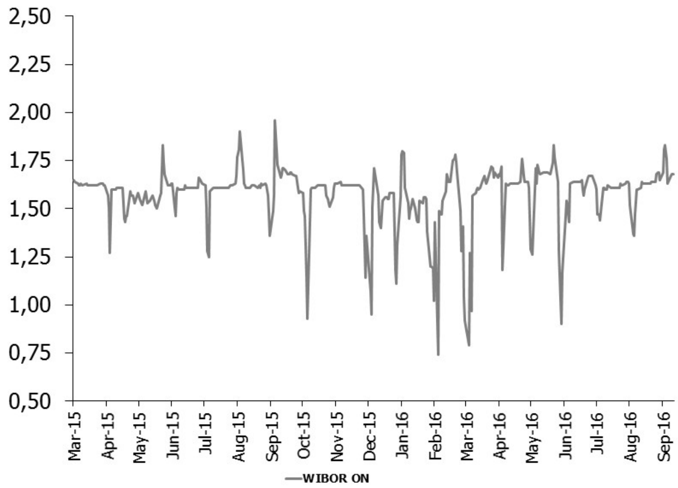
Nothing priced in

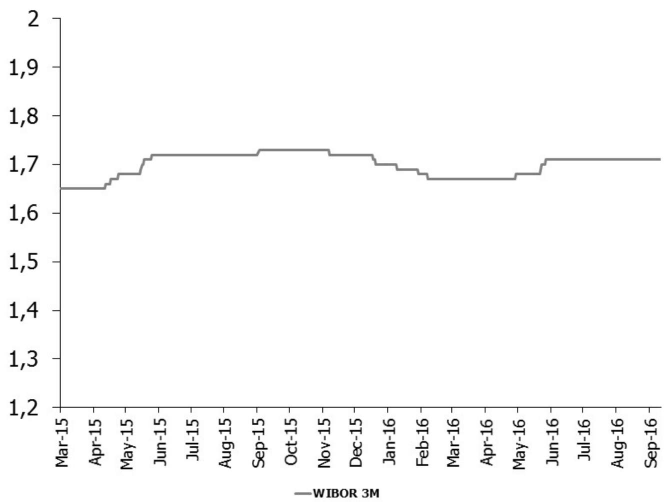
Post-CPI bullish sentiment faded as the overall trend in inflation moved up and MPC reiterated that they see a hike as next move. We are reaching ”interesting” levels as 1y3s is trading at 1.71 and 2y at 1.79. This means that neither rate cuts nor hikes are priced in. Given incoming new low GDP estimates, receiving rates might be tempting.

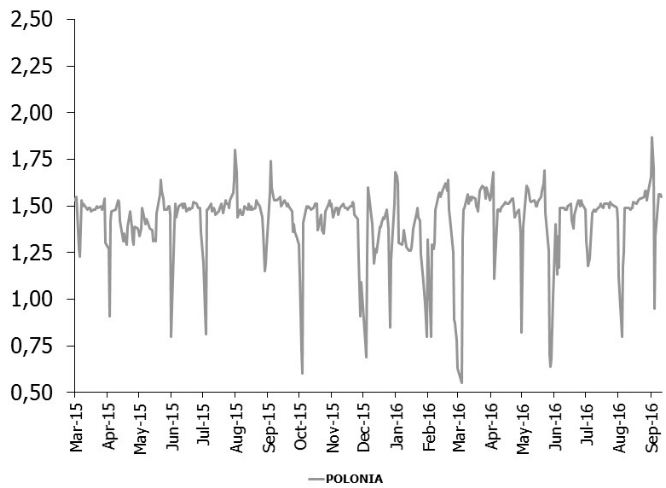
On the funding side, we have a new month which should stabilize rates. Today’s OMO was underbid and rates should persist around 1.53% throughout the next week.

Ref rate vs Polonia averages:
30 day: 0 bp
90 day: 4 bp





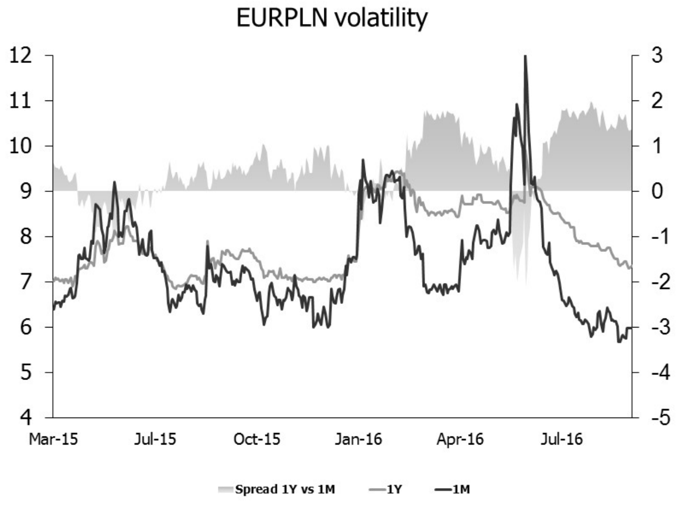




Forex

Spot – Hovering above the 4.25/4.27 support zone The 4.32 resistance proved too tough to crack for EUR/PLN. As a consequence, we headed south, and briefly touched 4.2725, before correcting slightly. In general, we are treading water. The MPC meeting was eventless, the Polish factor is almost non-existent. We are being pushed around by global sentiment, and that seems to be PLN positive. Baseline scenario is trading in the 4.25-4.35 range.

Options – EUR/PLN vols – lower Stronger PLN is usually positively correlated with a lower vol, and this time it has proved true. Realized volatilities are still trading at their lows. 1 month EUR/PLN ATM mid is at 5.8% (0.2% lower), 3 months EUR/PLN are 6.2% (0.2% lower) and, finally, 1 year is fixing at 7,3% (0.1% lower). The skew was roughly unchanged, but currency spread (USD/PLN vol vs. EUR/PLN vol) was healthily bid, because of the proximity of US elections and higher vols in EUR/USD.



Short-term forecasts

Main supports / resistances:
EUR/PLN: 4.25 / 4.37
USD/PLN: 3.75 / 4.00

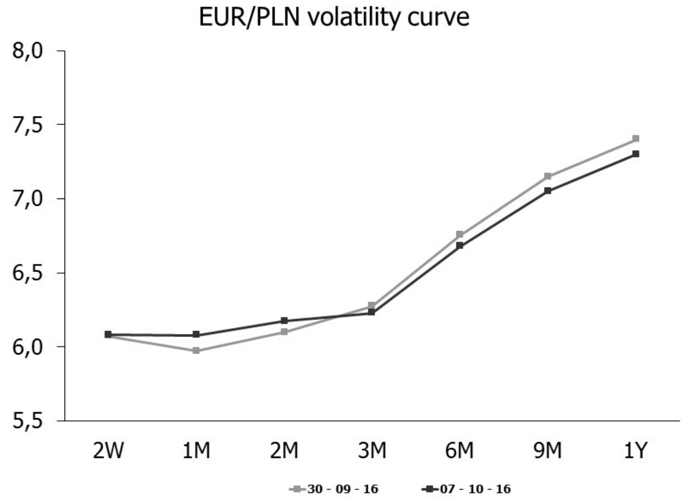
Spot Position: Long EUR/PLN.

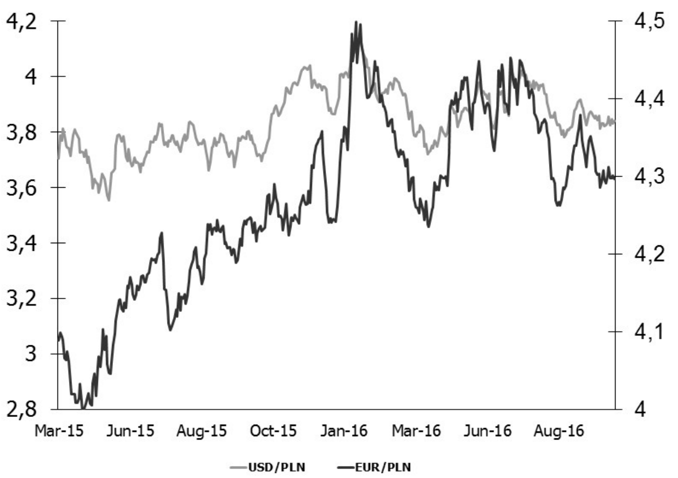
We are long EUR/PLN from 4.3170 and 4.2870. The stop is now at 4.2550 and we are hoping to see 4.38/4.40 and, depending on the momentum, possibly even 4.41/4.43.

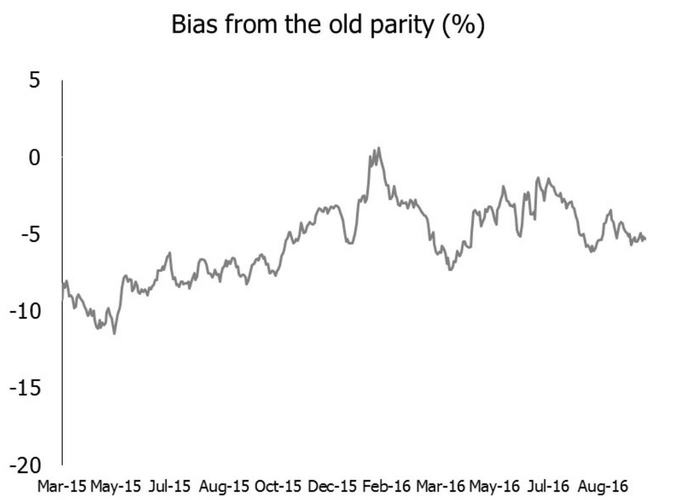
We still clinging to that EUR/PLN long. We had a third attempt to break down through the 4.2700 support, and it failed for the time being. Risk assets are still performing good. Let's see if events in the US (elections) or in the UK (GBP on fire) would translate into weaker PLN.

Options Selectively long Vega

Implied volatilities have come off significantly over the past weeks. There is a lot of uncertainty surrounding Brexit, the postponed decision on forced conversion of CHF mortgages, Constitutional Court conflict, U.S. elections, so we stick to our position – we have still selective longs in backend EURPLN curve.







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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
9/30/2016	2.22	1.71	2.20	1.69	1.70	1.71	1.70	1.68	1.64	1.63	1.62	1.72
10/3/2016	2.07	1.71	2.08	1.69	2.12	1.71	1.70	1.68	1.64	1.62	1.61	1.73
10/4/2016	2.16	1.71	1.81	1.69	1.70	1.71	1.70	1.69	1.65	1.64	1.62	1.74
10/5/2016	1.82	1.71	1.90	1.69	1.97	1.71	1.70	1.72	1.71	1.71	1.68	1.78
10/6/2016	2.02	1.71	1.99	1.69	2.09	1.71	1.71	1.71	1.70	1.69	1.69	1.78

Last primary market rates							
Paper	Au. date	Maturity	Avg. price	Avg. yield	Supply	Demand	Sold
32W TB	3/14/2016	11/30/2016	99.04	1.35	1500	1757	1692
OK1018	10/6/2016	10/25/2018	96.54	1.74	2000	4838	2448
PS0421	8/18/2016	7/25/2021	98.31	2.11	3500	4968	3844
DS0727	10/6/2016	7/25/2027	94.57	3.10	4000	5916	4359

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0715	5Y IRS	PS0718	10Y IRS	DS1023
9/30/2016	1.710	1.474	1.635	1.578	1.960	2.232	2.405	2.949
10/3/2016	1.710	1.474	1.635	1.578	1.960	2.232	2.405	2.949
10/4/2016	1.710	1.474	1.635	1.578	1.960	2.232	2.405	2.949
10/5/2016	1.710	1.474	1.635	1.638	1.990	2.290	2.447	2.985
10/6/2016	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
9/30/2016	5.98	6.28	6.75	7.40	7.40	2.21	0.61
10/3/2016	5.98	6.23	6.68	7.30	7.30	2.21	0.61
10/4/2016	5.98	6.25	6.70	7.33	7.33	2.14	0.61
10/5/2016	5.98	6.25	6.75	7.35	7.35	2.14	0.61
10/6/2016	6.08	6.23	6.68	7.30	7.30	2.20	0.60

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
9/30/2016	4.3120	3.8558	3.9802	3.8171	1.3947	0.1596
10/3/2016	4.2976	3.8252	3.9364	3.7716	1.3935	0.1590
10/4/2016	4.2984	3.8472	3.9303	3.7587	1.3963	0.1591
10/5/2016	4.3014	3.8307	3.9212	3.7240	1.4039	0.1592
10/6/2016	4.2974	3.8405	3.9337	3.7050	1.4086	0.1590

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