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Polish Weekly Review

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Comment on the upcoming data and forecasts

Week will begin with the release of flash CPI for October. We expect another month of acceleration in the CPI, primarily due to higher fuel prices (and low statistical base in the category). On Wednesday the Manufacturing PMI index (for the month of October) will be published. We expect a slight improvement, consistent with last month's data from Germany and Poland's other European trading partners.

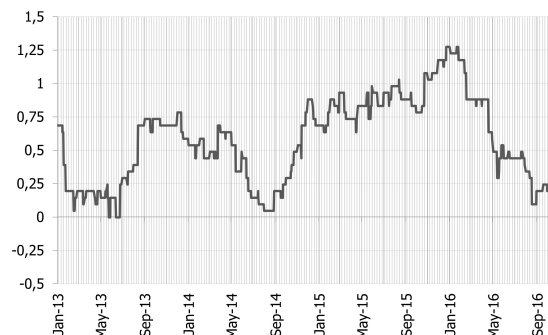
Polish data to watch: October 31st to November 4th

Publication	Date	Period	mBank	Consensus	Prior
Flash CPI y/y (%)	31.10	Oct	-0.2	-0.3	-0.5
Manufacturing PMI (pts.)	02.11	Oct	52.5	52.9	52.2

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	11/3/2016	2000	1.742	10/6/2016
5Y T-bond PS0722	-	4000	2.499	10/21/2016
10Y T-bond DS0727	11/3/2016	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

Unemployment surprised to the upside, lifting our Polish surprise index. Next week offers two opportunities to surprise: flash CPI and manufacturing PMI.

* 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. Hence, we expect 2-3 quarters of sub-3% growth.
- 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 (but MPC is very unwilling to ease). We expect the MPC to finally acknowledge downside risks for Polish GDP growth.

Financial markets

- Global reflation trades weakened the Zloty by raising risk-free rates and encouraging capital outflows from EM assets. 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, 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	1.4	3.3	3.9	2.8	3.2
CPI Inflation y/y (average %)	3.7	0.9	-0.1	-0.9	-0.6	1.3
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	2016	2016	2016	2017	2017	2017	2017
	Q1	Q2	Q3 F	Q4 F	Q1 F	Q2 F	Q3 F	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	0.0	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

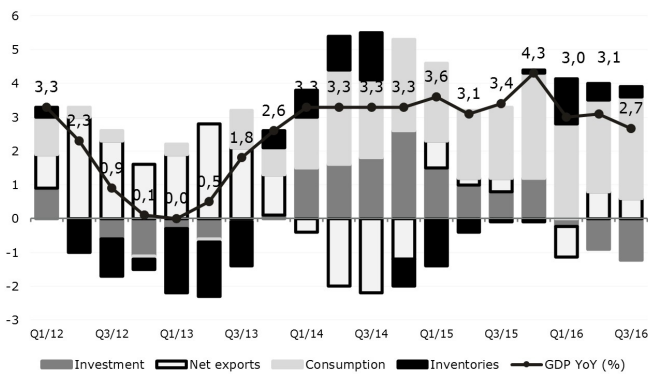
F - forecast

Economics

A month of not-so-spectacular data ahead of us

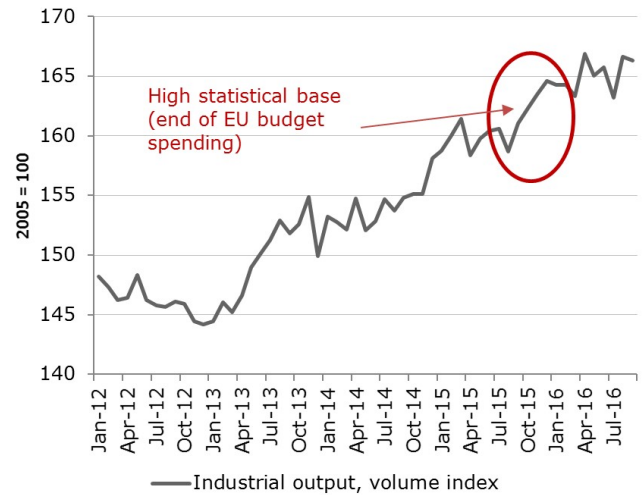
November will bring the release of Q3 GDP data as well as the first hard data for final quarter of the year. We expect them to confirm the on-going slowdown in the economy. Inflation data due next month (CPI and PPI), while up on a month-to-month basis, will not show any material acceleration in underlying inflation. Below you'll find our take on the key data releases to be published in the coming weeks.

Flash GDP will be released on November 14th (details on November 29th). We expect GDP to decelerate further on the back of weaker industrial and construction data. All available information regarding the performance of services in Q3 (business services turnover, tourist arrivals, transport revenues) suggests that these sectors are very unlikely to offset the lower contributions from the former two sectors. On the expenditure side, we expect a material acceleration in private consumption (to 4.1% y/y) and further drop in investment (-6.0% y/y).

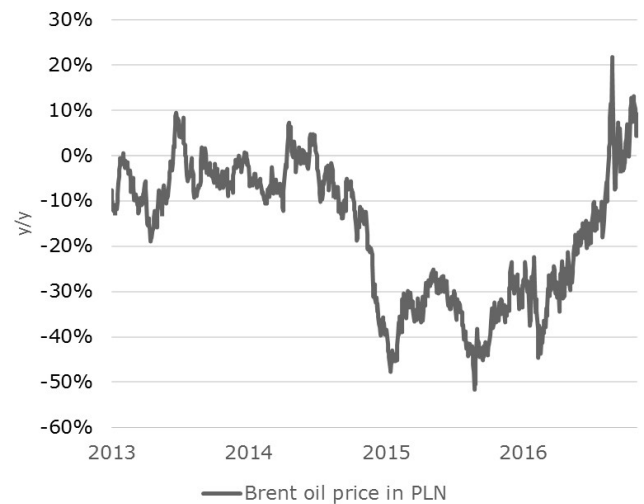


The latest Statistical Bulletin shed some light on the source of the surprises in labour market data. The acceleration in employment was not caused, as we suspected, by the reversal of a surprising drop in communication services one month earlier, but by random fluctuations in several industries. Neither do those industries exhibit a strong trend, nor is it confirmed by hiring intentions as measured by GUS and the NBP. As a result, we expect that October will bring a marginal decline in annual growth rate (from 3.2 to 3.1%). Wages, on the other hand, will decelerate slightly (from 3.9 to 3.7%) because of working day effects.

Real activity data for October will exhibit neutral momentum. While construction output probably stabilized, there is no fundamental reason to suspect strong acceleration. Industrial output will be negatively impacted by high statistical base and working day effects – the end result is a drop from 3.2 to -0.1% y/y. Finally, retail sales figures should come on the stronger side this month. The pothole in durable and semi-durable goods sales in September is unlikely to last – in particular, cold and damp October probably boosted the sales of clothing and footwear. Our forecast for retail sales is 5.4% y/y (6.6% in constant prices).



October will be another month of higher inflation. This time CPI is set to accelerate from -0.5 to -0.2% y/y on the back of higher food and fuel prices. Core inflation, a much better measure of inflationary pressures right now, will tick up to -0.3% y/y.



Last but not least, on its November meeting, MPC will not change interest rates. However, MPC's information set will include latest NBP projections. Those will reveal temporary deceleration in GDP growth in 2016, confirming sub 3% growth in Q3. Inflation projection will display only gradual CPI increase in 2017, slightly above 1% – still undershooting inflation target.



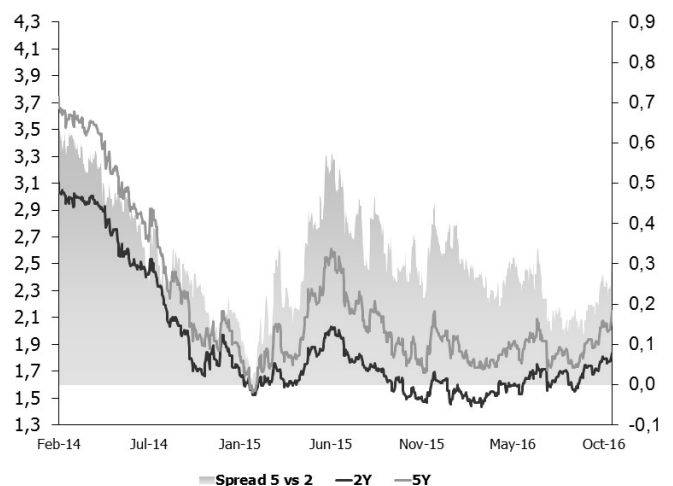
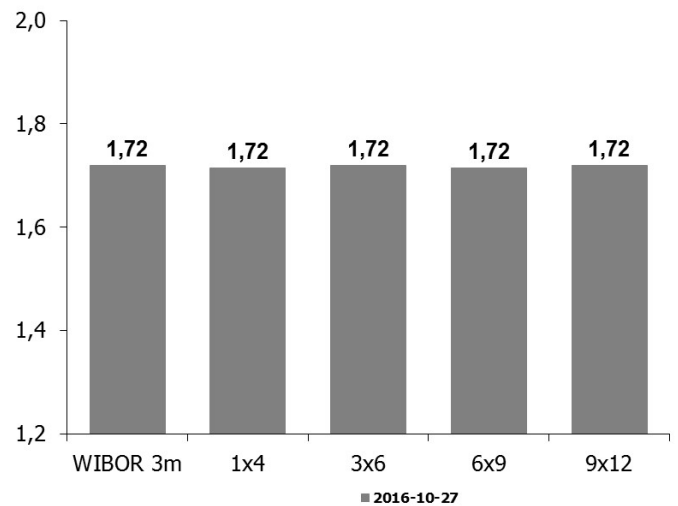
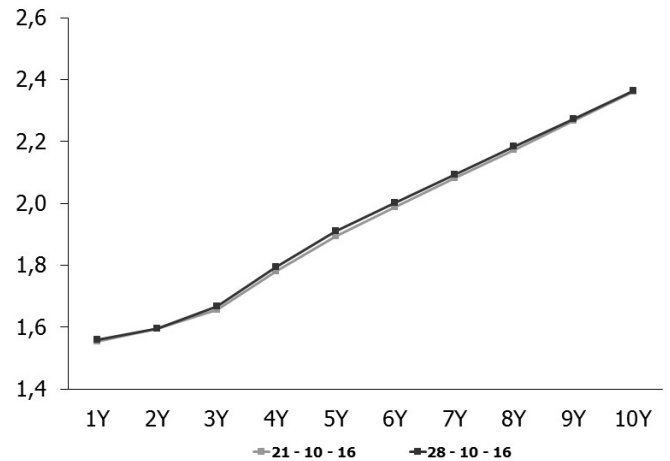
Fixed income

Another auction

PLN curve went steeper, 5y/10y bond spread moved to 61bps.

Next week we have an auction. We expect OK1018 and DS0727. Since its going to be a switch, we expect it to be very heavy. Up to 10bio may be sold. Curve will steepen, long end bonds are being sold by international players and we don't see and inflows to EM funds. ASW on DS0726 are traded at 54bps. S/E bonds and floaters looks very cheap.

IRS curve



Money market

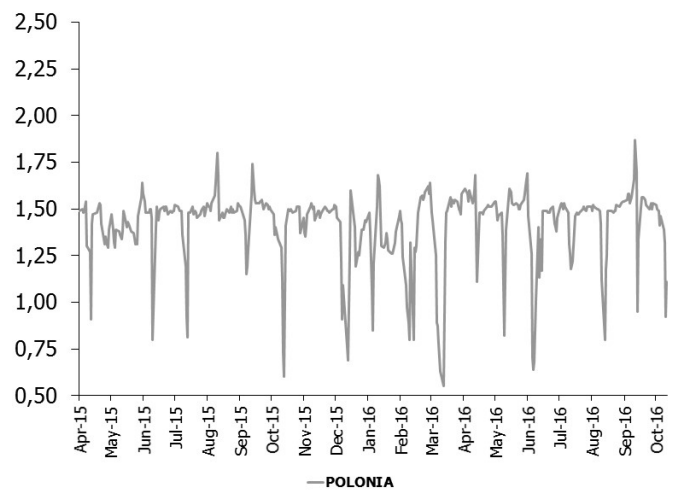
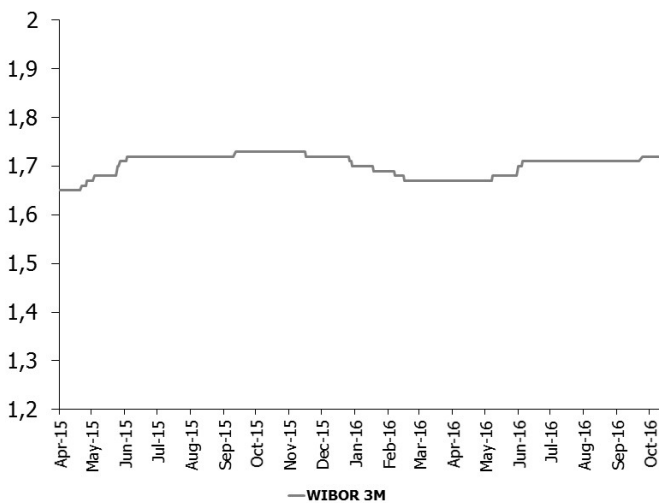
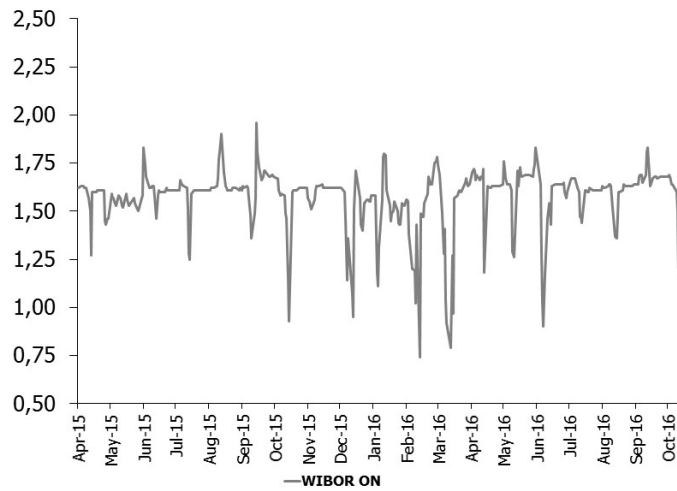
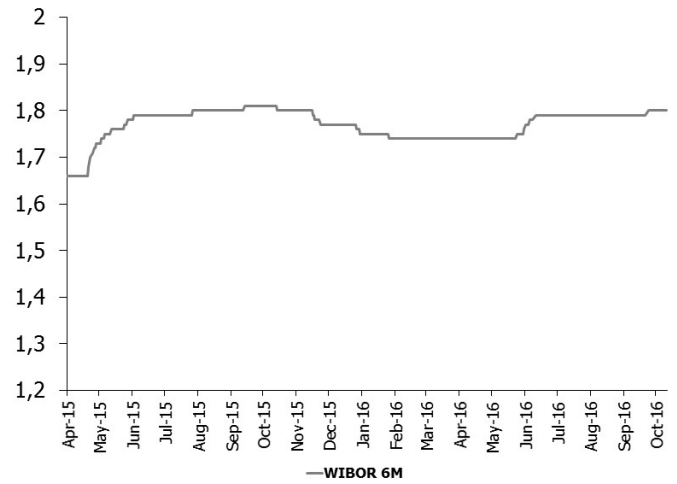
Incoming return of local story

In the absence of local data, Polish market has been following global mood. This wasn't the great for bond holders. Rising expectation for Fed rate hike and fear of ECB signalling only short extension of QE drove global yields to highs not seen since Q2. Two year swap rose 5 bp touching 1.85%. That's still not excessive lvi if some rate hikes would be priced in Poland. Next week we have Polish CPI data, which may impact shortest local yields.

Quite easy last week of the month. Polonia was fixing around 1.30% (average for last 7 days).

Ref rate vs Polonia averages:

- 30 day: -1 bp
- 90 day: 4 bp



Forex

Spot – EUR/PLN testing the 4.34 resistance The sleepy, directionless market continues. 4.3030-4.3450 constitutes the range from Friday to Friday. Zloty is a touch weaker, EUR/PLN had a push to 4.3500, but it failed at the first attempt. No clear reason, it might be because of the rising rates on core markets (probably position tuning before FOMC). The market consensus is that the FOMC will not hike until December. The local Polish flavor is not adding much, with politics being calm. We still see a range of 4.27/4.37 to more or less cover the moves for now. But we see more room to the upside, as that would be more painful for the market.

Options – EUR/PLN vols – touch lower The realized volatility is still at its lows. The frontend was supported by FOMC meeting and fast approaching US elections but in rest of the curve the sellers still prevail. 1 month EUR/PLN ATM mid is at 5.9% (unchanged), 3 month EUR/PLN is at 6.15% (0.1% lower) and, finally, 1 year is fixing at 7.15% (0.15% lower). Skew was roughly unchanged, and currency spread (difference between USD/PLN against EUR/PLN vol is a bit better bid).

Short-term forecasts

Main supports / resistances:

EUR/PLN: 4.25 / 4.37

USD/PLN: 3.75 / 4.00

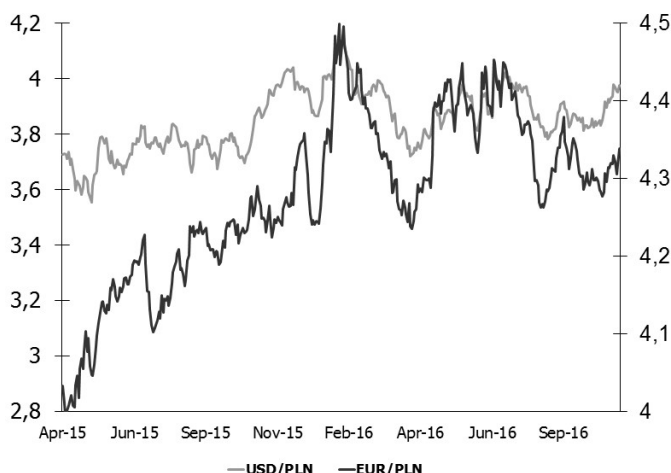
Spot Position: Long EUR/PLN.

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

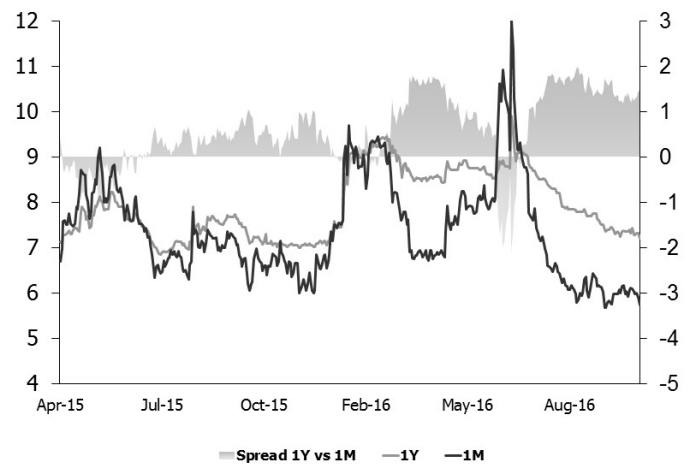
Our position is showing a quite mixed performance, but we are keeping it. The market is lacking momentum, but we think the PLN rally is a bit fatigued. The positioning is also most likely skewed to PLN longs, and all we need is a spark.

Options Selectively long Vega

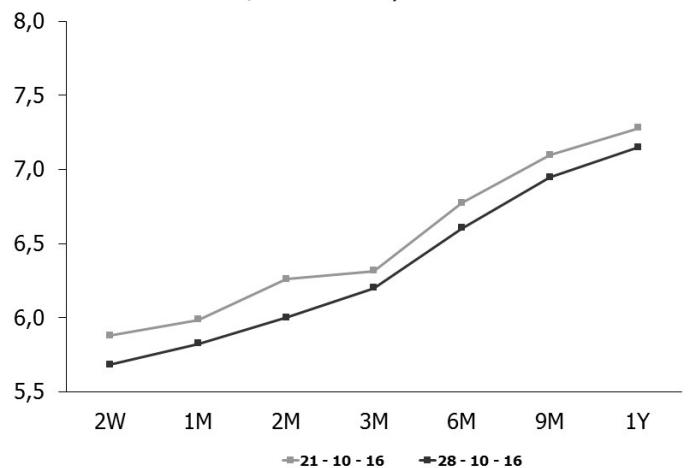
Implied volatilities have come off significantly over the past weeks. There is a lot of uncertainty surrounding the Brexit, postponed decision on forced conversion CHF mortgages, Constitutional Court conflict, U.S. elections, so we stick to our position – we have still selective longs in backend EURPLN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



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
10/21/2016	2.14	1.72	2.22	1.70	1.70	1.74	1.71	1.73	1.70	1.70	1.70	1.78
10/24/2016	2.02	1.72	2.09	1.70	2.14	1.74	1.71	1.71	1.70	1.70	1.71	1.79
10/25/2016	2.16	1.72	2.24	1.70	2.16	1.74	1.72	1.72	1.72	1.71	1.72	1.79
10/26/2016	1.90	1.72	2.00	1.70	2.05	1.74	1.72	1.72	1.71	1.71	1.73	1.79
10/27/2016	2.01	1.72	2.09	1.70	2.13	1.74	1.72	1.72	1.72	1.72	1.75	1.81

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
10/21/2016	1.740	1.474	1.635	1.578	1.960	2.232	2.405	2.949
10/24/2016	1.740	1.474	1.635	1.578	1.960	2.232	2.405	2.949
10/25/2016	1.740	1.474	1.635	1.578	1.960	2.232	2.405	2.949
10/26/2016	1.740	1.474	1.635	1.638	1.990	2.290	2.447	2.985
10/27/2016	1.740	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
10/21/2016	5.99	6.31	6.78	7.28	7.28	2.11	0.61
10/24/2016	6.00	6.33	6.75	7.33	7.33	2.11	0.61
10/25/2016	5.90	6.23	6.64	7.33	7.33	2.17	0.61
10/26/2016	5.73	6.18	6.60	7.20	7.20	2.15	0.68
10/27/2016	5.83	6.20	6.60	7.15	7.15	2.04	0.61

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
10/21/2016	4.3300	3.9800	4.0002	3.8342	1.4065	0.1602
10/24/2016	4.3225	3.9690	3.9933	3.8191	1.4027	0.1599
10/25/2016	4.3058	3.9543	3.9800	3.7860	1.3984	0.1593
10/26/2016	4.3178	3.9517	3.9862	3.7940	1.3967	0.1598
10/27/2016	4.3388	3.9760	4.0039	3.7951	1.4008	0.1606

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