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## Polish Weekly Review

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### Comment on the upcoming data and forecasts

The only relevant macro releases are due on Friday. The CPI print will probably confirm the flash release of +0.8%, but we will be very interested to see the details (especially to check if core inflation moved up as well). The NBP's data will remain in the background. Balance of payments hardly changed in November, in our view, as trade balance remained nearly balanced, with exports and imports barely moving on monthly basis. Finally, we expect M3 to accelerate, contrary to market consensus of a slight slowdown.

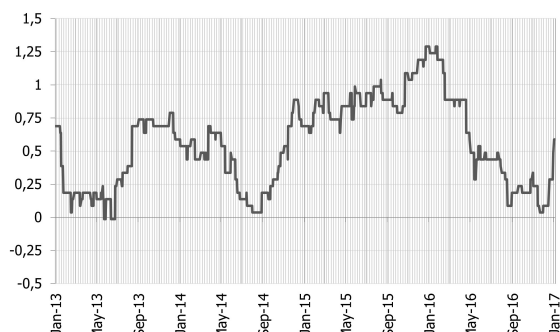
### Polish data to watch: January 9th to January 13th

Publication	Date	Period	mBank	Consensus	Prior
CPI y/y (%) <i>final</i>	13.01	Dec	0.8	0.8	0.8
Current account (mio EUR)	13.01	Nov	-367	-336	-393
Exports (mio EUR)	13.01	Nov	15200	15400	15192
Imports (mio EUR)	13.01	Nov	15200	15306	15162
M3 y/y (%)	13.01	Dec	10.3	9.4	9.7

### Treasury bonds and bills auctions

Paper	Next auction	Last Offer	Yield on the prev auction (%)	Prev auction
(32/37/52) Week T-bills	1/9/2017	1500	1.350	3/14/2016
2Y T-bond OK1019	4/23/2017	1000	2.324	1/5/2017
5Y T-bond PS0422	4/23/2017	3000	3.017	1/5/2017
10Y T-bond DS0727	4/23/2017	1500	3.757	1/5/2017
15Y T-bond WS0428	-	200	3.027	7/7/2016

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



#### Comment

Polish surprise index had another good week after the PMI surged. Next week will be a quiet one – final CPI probably won't surprise and other publications are not relevant.

\* 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

- 2016 unfolded as the year of record divergence between investment growth and consumption growth. The latter is the only engine of growth.
- GDP growth will likely bottom at ca. 2% y/y in Q4, when base effects reach their peaks. Momentum is positive, growth likely picked up on a q/q basis in Q4 already. Next year, growth will accelerate to the average of 3.2%, as investment returns to growth. It will, however, come no sooner than in mid-year and the effects of 500+ programme will begin to fade by then. The period of lower growth is not over.
- Polish deflation has ended. During the next two quarters inflation will be boosted by statistical base effects, weak PLN and commodity price spike (headline inflation to reach 2.0% at the turn of Q1 and Q2). We are still skeptical of genuine inflationary pressures in the Polish economy, though. The fate of inflation in the second half of next year, absent a sustained increase in commodity prices, is by no means certain.
- Rising inflation will prove to be a fertile ground for rate hike bets. It is very unlikely that these will materialize this year, though.

### 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.
- Stronger dollar and more hawkish Fed hold in check any strengthening of Polish zloty. However, inflows to Polish equity market are shifting the balance towards stronger PLN.

### mBank forecasts

	2012	2013	2014	2015	2016 F	2017 F
GDP y/y (%)	1.6	1.4	3.3	3.9	2.5	3.2
CPI Inflation y/y (average %)	3.7	0.9	-0.1	-0.9	-0.6	1.9
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	8.3	7.8
Repo rate (end of period %)	4.25	2.50	2.00	1.50	1.50	1.50

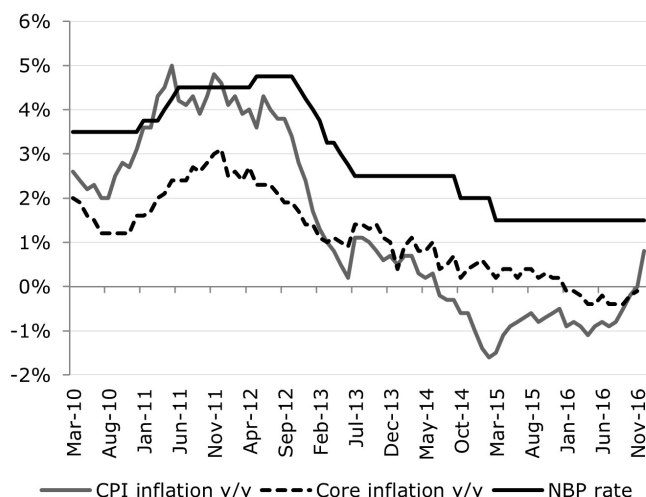
	2016 Q1	2016 Q2	2016 Q3 F	2016 Q4 F	2017 Q1 F	2017 Q2 F	2017 Q3 F	2017 Q4 F
GDP y/y (%)	3.0	3.1	2.5	2.0	2.3	2.9	3.6	3.8
Individual consumption y/y (%)	3.2	3.3	3.9	4.6	4.3	4.0	3.8	3.5
Public Consumption y/y (%)	4.2	3.9	4.9	1.0	3.0	3.0	3.0	3.0
Investment y/y (%)	-2.2	-5.0	-7.7	-3.5	-1.5	4.0	7.0	7.0
Inflation rate (% average)	-0.9	-0.9	-0.8	0.2	1.8	1.8	1.8	2.0
Unemployment rate (% eop)	9.9	8.7	8.3	8.3	8.5	7.9	7.5	7.8
NBP repo rate (% eop)	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
Wibor 3M (% eop)	1.67	1.71	1.71	1.73	1.73	1.73	1.73	1.73
2Y Polish bond yields (% eop)	1.45	1.65	1.76	2.03	2.00	2.00	2.00	2.00
10Y Polish bond yields (% eop)	2.84	2.91	2.92	3.63	3.80	3.70	3.50	3.50
EUR/PLN (eop)	4.24	4.38	4.30	4.40	4.38	4.30	4.25	4.20
USD/PLN (eop)	3.73	3.94	3.82	4.19	4.09	4.10	4.13	4.08

F - forecast

## Economics

### CPI set to accelerate in the following months

In December Polish CPI skyrocketed from 0.0% to +0.8% y/y, much higher than market consensus (+0.5%) but close to our forecast (+0.7%). There were several reasons for this outcome: statistical base in fuel category from previous year, high monthly jump of fuel prices itself (+5%) and rapidly rising food prices (around 1% monthly, close to seasonal highs). We expect core inflation to record -0,1-0,0% y/y growth.

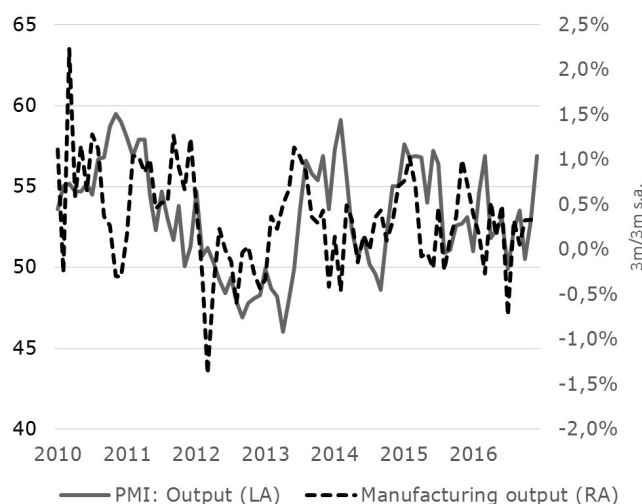
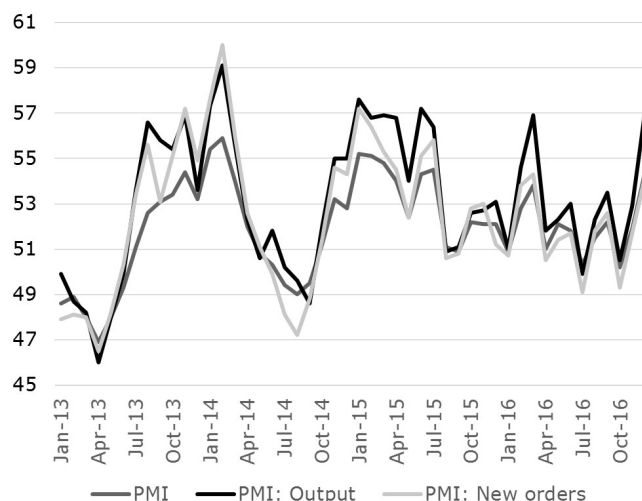


Inflation in Poland will accelerate rapidly in the following month driven mainly by base effects and is set to reach almost 2% y/y in the next 3-4 months. This is consistent with global trends (see that most publications are surprising positively). The most important question is now – will this trend persist in the second half of the year?

Market reacted vigorously to this surprise (yield curve moved at least several points upward), however part of this move could be linked to low liquidity at the end of the year. This also took back the rest of the pressure from MPC to cut rates, since latest real sphere data have surprised on the positive side. The Council have somehow successfully stayed put through the lion's part of deflation period and through months of weaker economic data. From now on it will be focused on rapidly growing inflation, better macroeconomic data and rebound of investment activity, which will be fuelled by revival in EU funds distribution. Even if the latter was anticipated, a visible proof of it will boost MPC's confidence. Market participants, seeing this shift in MPC wording, would start pricing more interest rate hikes at the turn of 2017 and 2018. Poland as a first country in the region starting monetary tightening could be seen as an attractive bet. Contrary to this view, we think that there would be no hikes in 2017, because: 1) MPC would rather want weak, not strong Zloty, 2) making MPC's independence credible has its limits and rising rates could harm borrowers and would be politically unpopular. However, sometimes markets tend to react stronger to confirmation of expectations than to forecasts themselves. Inflation reaching 2% y/y could thus lead overshooting of market expectations towards interest rate hikes in Poland.

### A strong PMI print at the end of the year

Polish Manufacturing PMI grew from 51.9 to 54.3, beating market expectations (ca. 52.0) and our already optimistic forecast (53.1). The December print put a definite end to the 1.5-year period of stagnation in manufacturing sentiment (as seen in the PMI). As often, the index was boosted by its three main components: output (rose from 52.9 to 56.9), new orders (rose from 51.7 to 54.1, curiously only now have new export orders breached the 50 pts barrier) and employment (rose from 53.9 to 55.5). Needless to say, each of those subindices reached a fresh multi-month high.



The December reading of the PMI is of course consistent with a wide range of outcomes in real sphere data (industrial output can easily drop in annual basis as well as increase by 1.5% y/y). However, if the upturn is sustained, it will translate itself into a major increase in economic momentum. The rebound in industry is old news. The uptick in inflation can still - in our view - influence market pricing. Here the PMI continues to impress - let's list the highlights of the latest report: fastest growth in input prices since January 2012, largest two-month increase in input prices in history, strongest increase in output prices since April 2011, third-largest two-month increase in output price assessment. Coupled with already known facts, i.e. big jump in CPI in December, the surge in the PPI, it paints a clear picture of surging inflation in the first half of the year.

To expect 2% in inflation is one thing (forecasts are catching



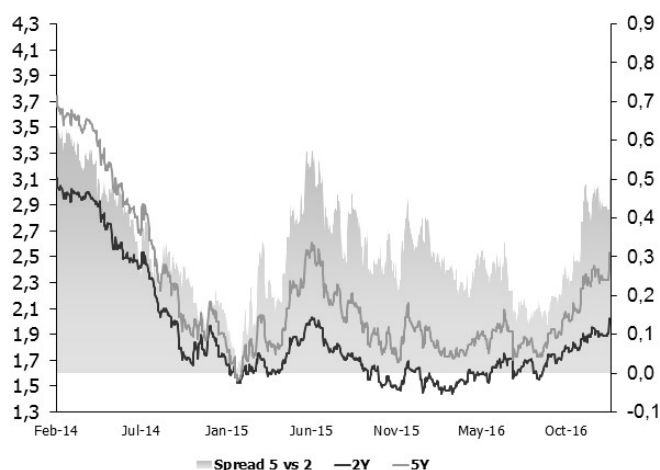
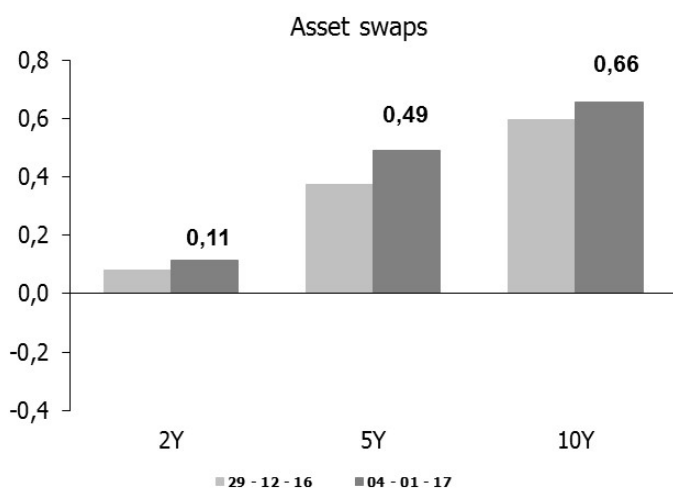
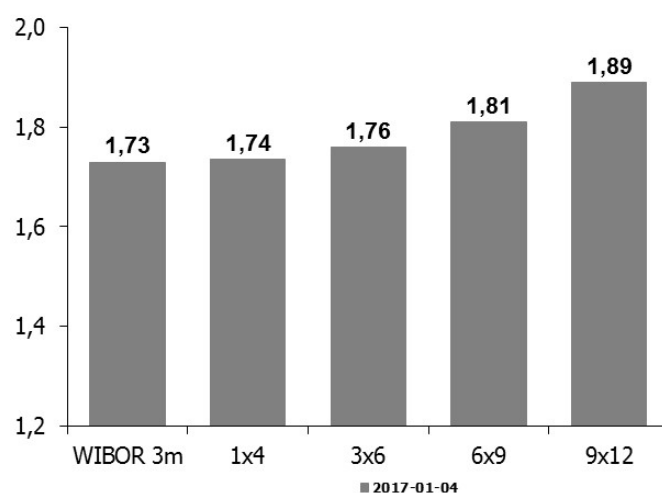
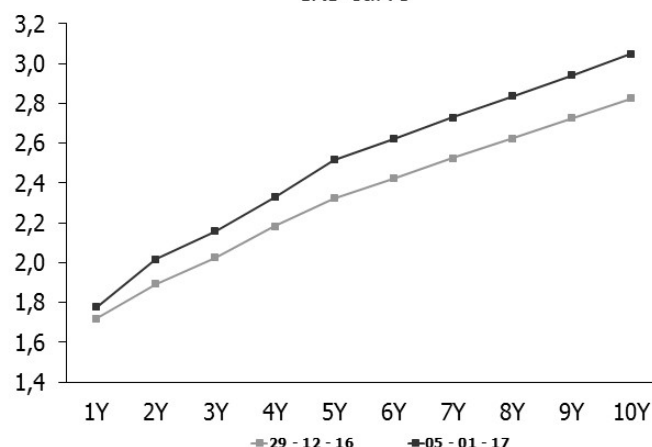
on fast, after all), to see actual releases and surprise is quite another. The stringent stance of the MPC, given both local and global inflationary trends at the moment, is a fertile ground for rate hike expectations to grow. In particular, the "first hike in the CEE region" story has a lot of potential. That being said, the hike itself is unlikely and we see some room for local pushbacks in yields.

## Fixed income

### Challenging week ahead

We had an auction on Thursday. Ministry of Finance sold 5 bonds OK0419/PS0422/DS0727/WZ1122/WZ0126. 5bio found buyers with good bid to cover (2.8/1.8/1.8/5.3/4.5). We have a day off tomorrow and payrolls in USA. Yields are higher this year. The PS0721/DS0726 narrowed from 77 to 73bps, ASW PS0721/5y is at 42bps and DS0726/10y is at 64bps. Next week won't be easy, we have ratings review next Friday and it will be risk off news for POLGBs.

IRS curve



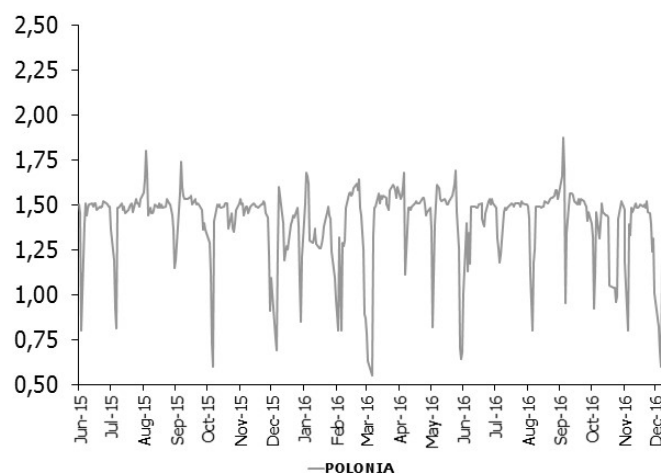
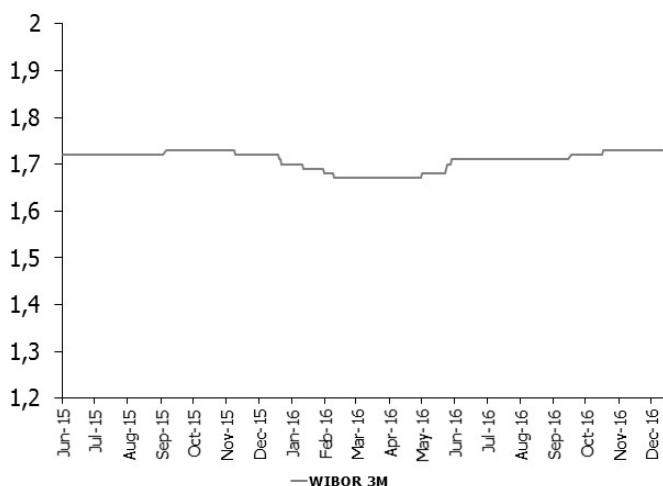
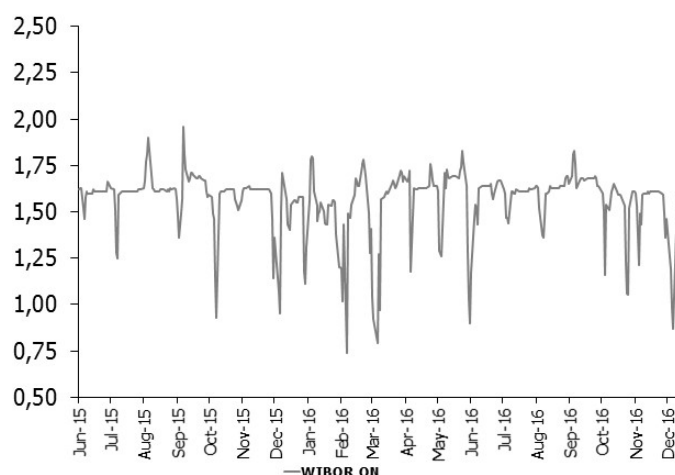
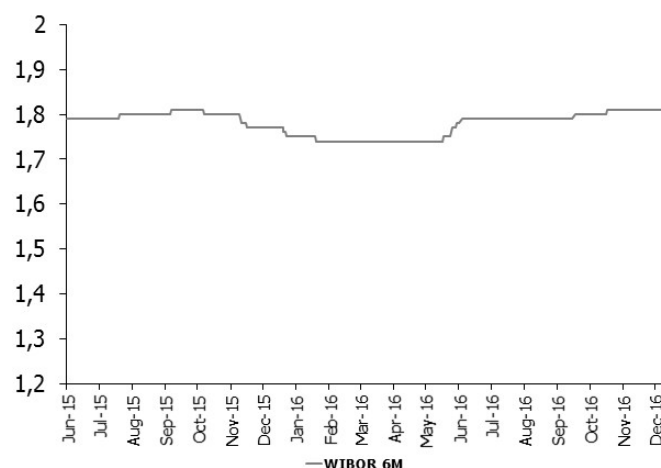
## Money market

### CPI

Inflation is coming back at high speed, according to flash CPI. Figure which came out at 0.8 (0.4 expected) surprised everyone and lifted short yields by around 10 bps. According to new estimates, CPI can touch 2% as soon as in the first quarter. We are very curious and cautious how MPC will react to new environment with negative real rates.

Holiday liquidity distortion still persists and overnight rate are holding really low. At today's OMO Banks bought only 70 bio of bills and spare 13 bio cash is left on the market. Probably on Monday NBP will hold additional operation.

Ref rate vs Polonia averages: 30 day 22 bp 90 day 16 bp



## Forex

**Good start.** It is a good start of the year for the Zloty. EUR/PLN has slipped to 4.3612 low yesterday and USD/PLN also retraced from its highs to current 4.1450. As a result, PLN has gained in basket terms from the beginning of the year. Local factor is almost non-existent with Polish politics relatively calm. The signs of inflation are renewing hopes for the next MPC move being a hike. The correction lower in USD (post FOMC minutes) is also PLN positive. As usual we are looking for tradable ranges in EUR/PLN, and now 4.34-4.46 is the most likely one.

**EUR/PLN vols – melting after Xmass spike.** We had a move higher in vols during holiday period, partly because of nonexistent liquidity. This year's opening is more optimistic and we have seen sellers in EUR/PLN and USD/PLN vols 1 month EUR/PLN ATM mid is 6.3%, 3 months EUR/PLN are 6.8% and finally 1 year is fixing at 7.7%. The currency spread (difference of USD/PLN minus EUR/PLN) was finally better offered after weeks of growing. Skew is roughly unchanged.

## Short-term forecasts

Main supports / resistances:

EUR/PLN: 4.34 / 4.46

USD/PLN: 4.00 / 4.30

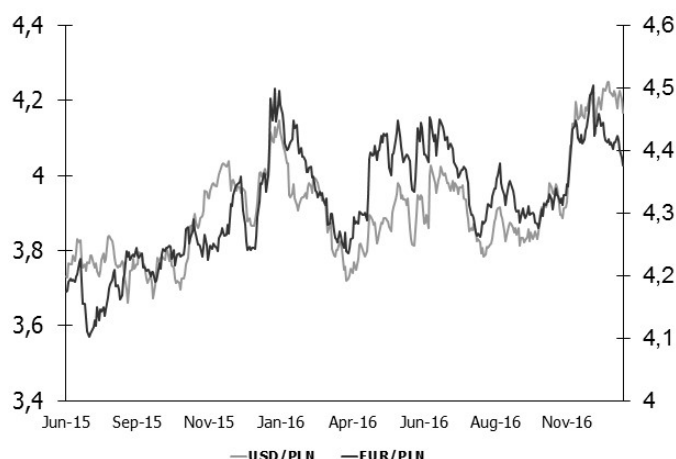
**Spot** Position: None.

We were long EUR/PLN at 4.4400 and 4.3950, and stop loss was triggered at 4.37.

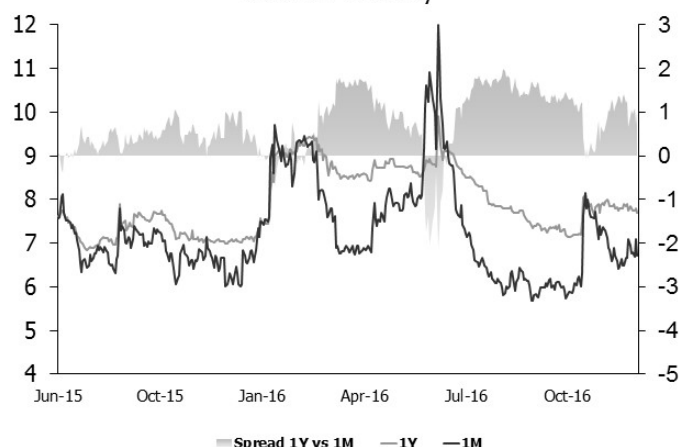
The bigger picture is roughly unchanged. The hawkish FOMC, and possible move higher in core yields will keep all EM currencies exposed to further weakness. We will get to know soon what kind of reaction function towards inflation the new MPC has. Anyway, the possibility of hike/s is looming on the horizon. The political crisis surrounding Constitutional Tribunal is still there, unsolved. We will apply agile/tactical approach, till liquidity will be fully restored and situation clarifies.

**Options** Vol – We sold 3 month EUR/PLN.

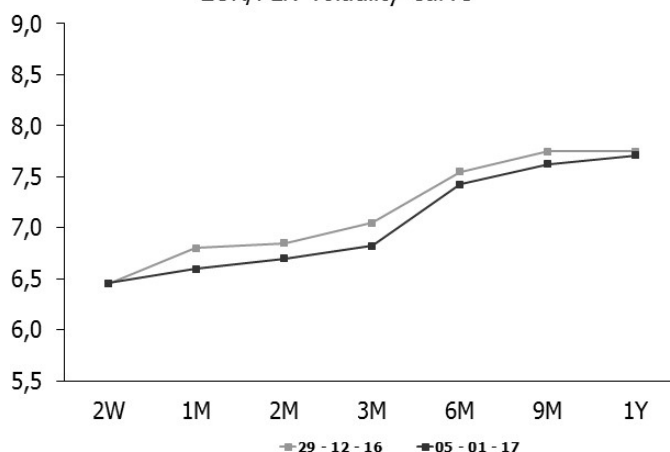
We sold 3 month EUR/PLN ATM against our long in backend Vol, in Vega neutral terms. It is a positive Theta, slightly shot Gamma structure. It express our general view that even though higher vols may be eventually seen due to rising yields, it will be a slow process.



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
12/29/2016	1.64	1.73	1.77	1.71	1.75	1.75	1.73	1.74	1.76	1.78	1.83	1.85
1/1/2017	1.79	1.73	1.84	1.71	1.90	1.75	1.74	1.75	1.77	1.80	1.85	1.86
1/2/2017	2.14	1.73	2.21	1.71	2.19	1.75	1.74	1.75	1.78	1.82	1.86	1.88
1/3/2017	1.53	1.73	2.06	1.71	1.64	1.75	1.74	1.76	1.81	1.88	1.96	1.92
1/4/2017	2.10	1.73	2.23	1.71	2.32	1.75	1.74	1.76	1.81	1.89	1.98	1.93

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
OK0419	1/5/2017	4/25/2019	94.88	2.32	1000	2825	990
PS0422	1/5/2017	4/25/2022	95.62	3.16	1500	2880	1570
DS0727	1/5/2017	7/25/2027	89.20	3.76	1500	2787	1544

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0715	5Y IRS	PS0718	10Y IRS	DS1023
12/29/2016	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
1/1/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
1/2/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
1/3/2017	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
1/4/2017	1.750	1.474	1.635	1.525	2.000	2.269	2.460	2.964

EUR/PLN 0-delta straddle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1Y	
12/29/2016	6.80	7.05	7.55	7.75	7.75	1.98	0.62	
1/1/2017	6.68	7.05	7.55	7.75	7.75	1.98	0.62	
1/2/2017	7.10	7.20	7.55	7.80	7.80	1.91	0.62	
1/3/2017	6.70	6.95	7.50	7.70	7.70	1.88	0.61	
1/4/2017	6.60	6.83	7.43	7.71	7.71	2.00	0.61	

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
12/29/2016	4.4131	4.2161	4.1190	3.6240	1.4267	0.1635
1/1/2017	4.4240	4.1793	4.1173	3.5748	1.4224	0.1637
1/2/2017	4.4157	4.2106	4.1209	3.5858	1.4270	0.1634
1/3/2017	4.4002	4.2271	4.1137	3.5802	1.4226	0.1629
1/4/2017	4.3877	4.2037	4.0978	3.5712	1.4207	0.1624

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