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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

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Comment on the upcoming data and forecasts

On Wednesday, the CSO will publish the Statistical Bulletin, which (as always) will shed more light on macro releases published earlier in January. It will contain information about unemployment in December as well. Preliminary MFLSP data suggest that unemployment rate rose in December by 0.1 pp. On Thursday, the Minutes from the last MPC meeting will be published, however they should not contain any new important information regarding Polish monetary policy.

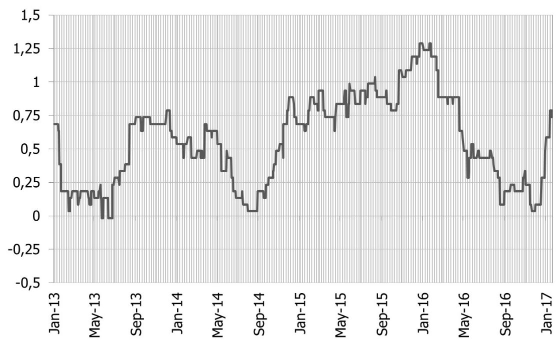
Polish data to watch: January 23th to January 27th

Publication	Date	Period	mBank	Consensus	Prior
Unemployment rate (%)	25.01	Dec	8.3	8.3	8.2
MPC Minutes	26.01	Jan			

Treasury bonds and bills auctions

Paper	Next auction	Last Offer	Yield on the prev auction (%)	Prev auction
(32/37/52) Week T-bills	-	2000	1.540	1/16/2017
2Y T-bond OK1019	1/23/2017	1000	2.324	1/5/2017
5Y T-bond PS0422	1/23/2017	3000	3.017	1/5/2017
10Y T-bond DS0727	1/23/2017	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

Negative surprise in wage data was offset one day later by higher than expected producer prices. All in all, Polish surprise index remained at last week's level. Next week should not change it, since preliminary MFLSP data about unemployment rate were in line with market expectations.

* 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).

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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 likely bottomed at ca. 2.5% y/y in Q4, when base effects reached their peaks. Momentum is very positive right now, growth likely picked up on a q/q basis in Q4 already. This year, growth will accelerate to the average of 3.4%, as investment returns to growth. Given the upside surprises in construction, one can expect investment growth to turn positive in Q1 already. With consumption growth already solid, we expect growth to accelerate over the course of the year.
- 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 2.5% 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. Interest should turn to core inflation.
- Rising inflation will prove to be a fertile ground for rate hike bets. It is very unlikely that these will materialize this year, though. We see the MPC's reaction function as symmetrical – see the Glapinski's comments on allowing real rates to run negative.

Financial markets

- Zloty began the new year on a weak note and that should remain so for the time being. With Trump trades put into doubts and high selectivity among EM investors, inflows into EM currencies remain tepid.
- However, local factors should be positive for the Zloty: faster growth, good fiscal figures and potential for more aggresive rate hike bets should lift Zloty later his year.
- The prevailing event risk for PL assets, the CHF conversion, moved to the background. All known details are relatively benign (no forced conversion).

mBank forecasts

	2012	2013	2014	2015	2016 F	2017 F
GDP y/y (%)	1.6	1.4	3.3	3.9	2.8	3.4
CPI Inflation y/y (average %)	3.7	0.9	-0.1	-0.9	-0.6	2.2
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	2.5	3.1	3.2	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	-2.0	0.0	4.0	7.0	7.0
Inflation rate (% average)	-0.9	-0.9	-0.8	0.2	2.1	2.4	2.4	1.9
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	2.05	2.10	2.15	2.20
10Y Polish bond yields (% eop)	2.84	2.91	2.92	3.63	3.90	3.90	3.90	3.90
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	3.91	3.91	3.94	4.04

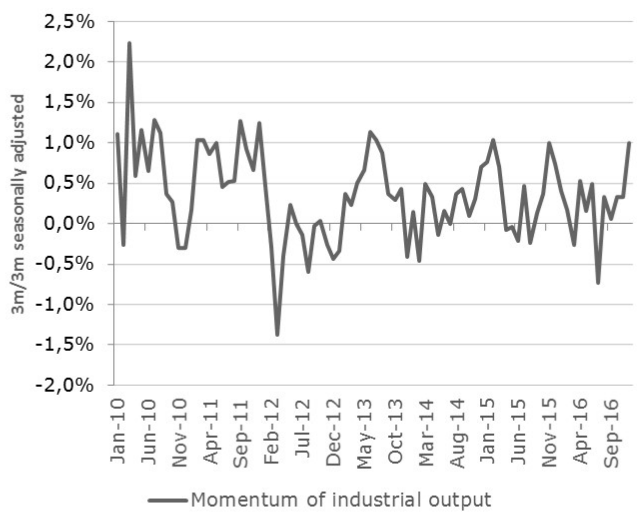
F - forecast

Economics

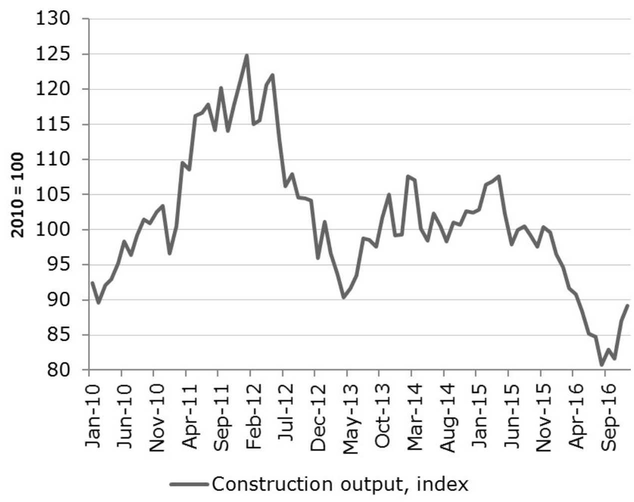
December data confirm that the economy has passed its turning point and is ready to accelerate.

With a full set of monthly economic indicators (except December international trade data), we are estimating Q4 GDP at 2.5% y/y with q/q growth exceeding 1%. On one hand, the data confirms that the economy has already passed its turning point. On the other hand, it should diminish fiscal risks in Poland. For the MPC, let us be clear, it merely the realization of its optimistic view of the Polish economy – no impact on the Council's current thinking on interest rates. Here are the details of last week's publications:

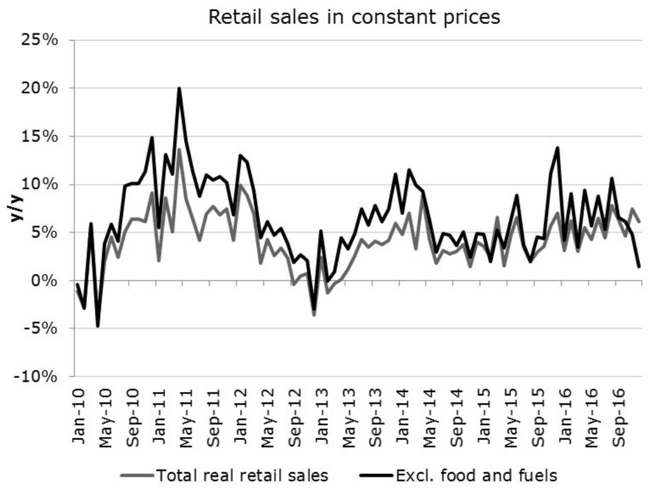
Industrial output grew by 2.3% in December, after 3.3% growth in November. This happened despite negative difference in working day count and various statistical bases (on a monthly and annual basis). After seasonal adjustments, growth amounted to 3.9% y/y and 1.6% m/m. The momentum of industrial output is thus markedly positive and close to various highs seen in the previous years, thereby confirming our expectations that GDP growth forecasts should be now be revised upwards (and upward revisions we will be seeing). The structure of production growth suggests, just like in the previous month, higher exports and positive spillovers from construction.



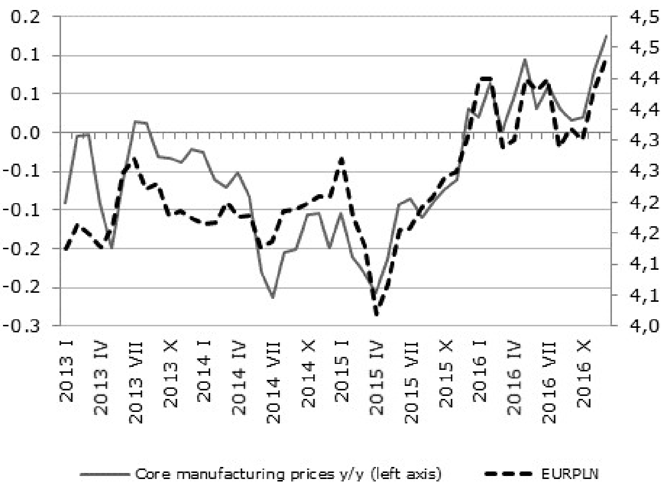
December brought another positive surprise in **construction production**. On a yearly basis the index fell by 8%, whereas market participants expected deeper fall (by more than 12%). This means that monthly index rose (for the second time in a row) by 2.5%. Extrapolating trend from November (almost 7% m/m) suggested even higher outcome, however the revival in investment activity is already a fact. Details of this rebound are still unknown (they will be published in Statistical Bulletin), but we expect that local governments could be responsible for it.



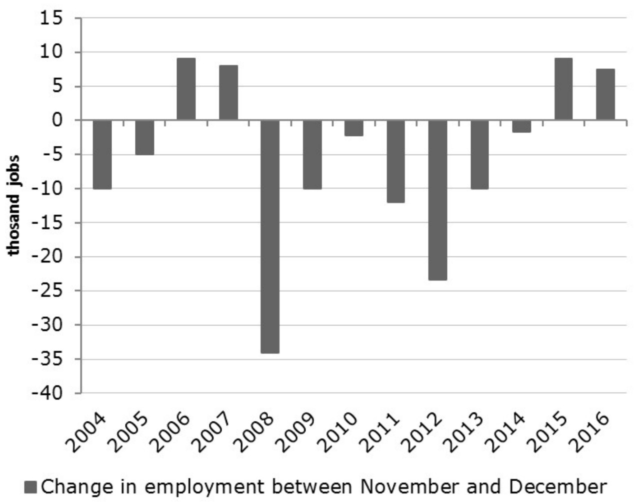
Retail sales rose by 6.4% in December (6.1% in real terms). Everything seems to be following recent trends except retail sales in non-specialized stores where base effects from last years' statistical perturbations kicked in. Our favorite measures excluding more volatile items (see the graph) point to a contraction of sales in December. Do not worry, it is typical for December as it is usually driven by non-durable goods. Therefore the outlook for consumption stays favorable in both 2016 and 2017.



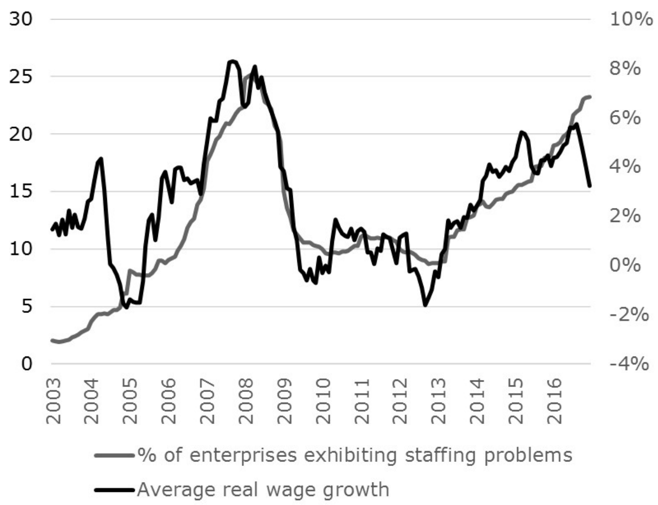
Producer prices grew by 3.0% y/y. Contrary to recent readings, the growth owes much to core categories (+0.9% m/m, highest reading since 2011). As usual their acceleration was nicely matched by exchange rate. The next 3 months are set to lift producer prices further by at least 1bp as base effects kick in.



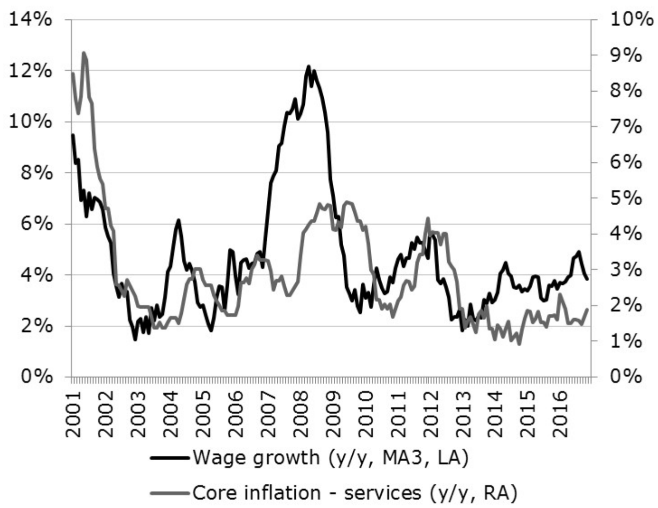
Employment growth in the enterprise sector stayed in December at 3.1% y/y. It was a notch above our forecast but on a sequential basis it was all about rounding since our forecast missed by ca. 1-2k employees, hence something close to model error. Therefore, our view stays the same. We think that employment growth is likely to stay close to 3% y/y but supply problems may start to slowly emerge driving wages higher. We think that an upswing in investment in the latter part of the year is going to boost employment in construction (broad pool of idle workers after last year's layoffs) and related manufacturing sectors (with rather limited supply of labor).



Average gross wage grew by 2.7% y/y in December, much below market consensus and our already pessimistic forecast (4.0 and 3.4% y/y, respectively). As in every month, we can only speculate on the source of the disappointment. We suspect, however, that the surprise was due to low payouts of bonuses in mining and, more importantly, high statistical base in manufacturing and construction. The December reading is this more of an accident than a change in trend – it is also a reminder that in the short term shifts of bonus payouts, calendar effects and statistical bases are more powerful than the overall trend (which is positive).



Our structural view on wage growth remains unchanged – demographic factors are conspiring to tighten the labor market significantly and the resulting imbalance between labor supply and labor demand is raising the cost of labor, i.e. wages. Even now the number of enterprises reporting staffing problems is close to all-time highs, despite the sizable immigration from Ukraine. The key question for 2017, however, concerns real wages, not nominal ones. In our view real wages will slow down somewhat from this year's lofty 4.7% y/y. This is because the expected acceleration in nominal wages (from ca. 4% y/y to 5% y/y) will not keep up with inflation (a swing from -0.6% to 2% on average). Due to high consumer sentiment and consumption smoothing (consumers' cash buffers are simply massive), this might have a limited impact on consumption growth.



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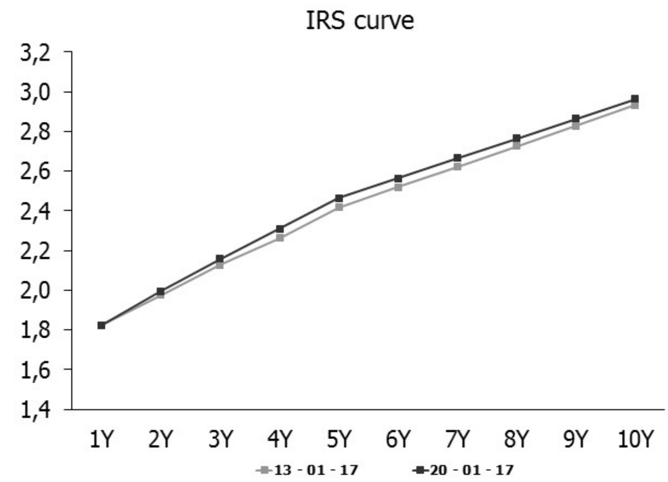
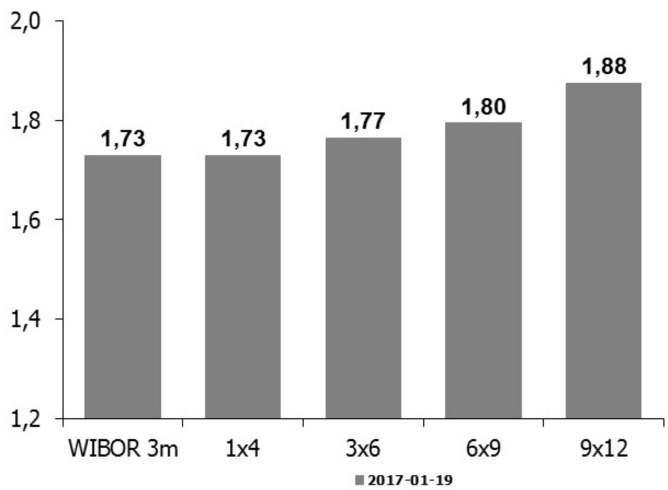
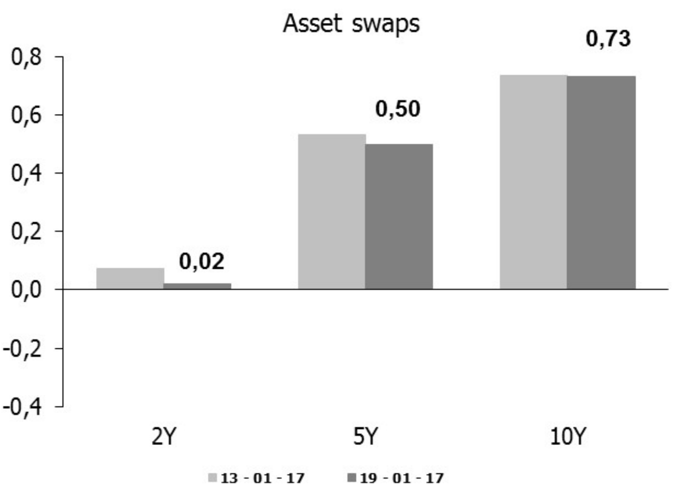
Fixed income

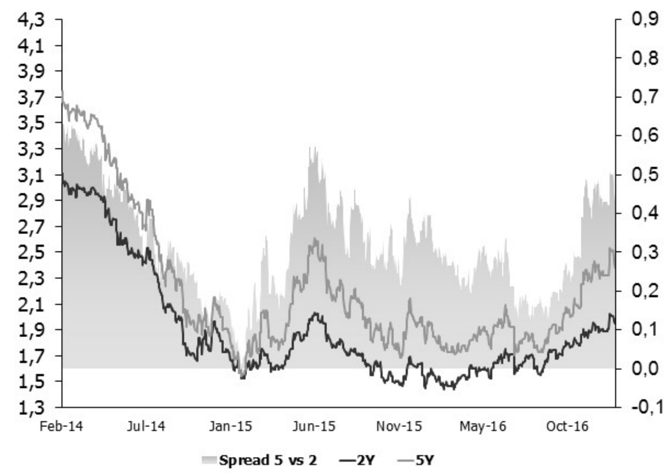
Auction next week

Next week we have an auction. Ministry of Finance is selling OK0419/PS0422/DS0727/WZ1122/WZ0126, 6-9 bn will be on the offer. We saw a lot of good figures this week, so bonds went higher in yields. We saw bids only for s/e bonds, but it's all about expiring WZ0117 (12.5 bn) and coupons from other floaters. PS0721/DS0726 is trading at 80bps, PS0422 10bps and DS0727 12bps higher. OK0419 is at same level 2.20%.









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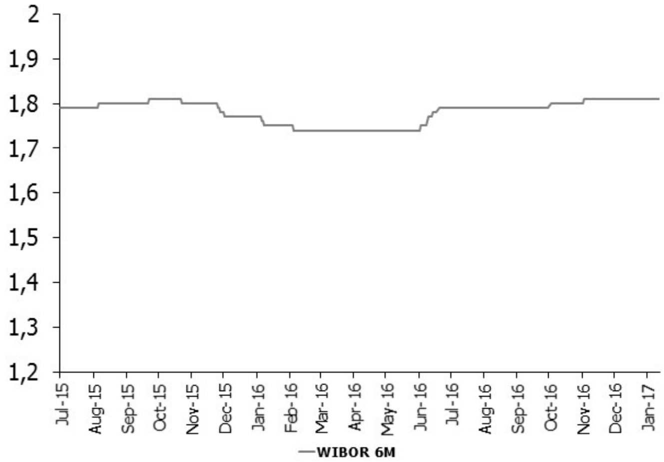
Money market

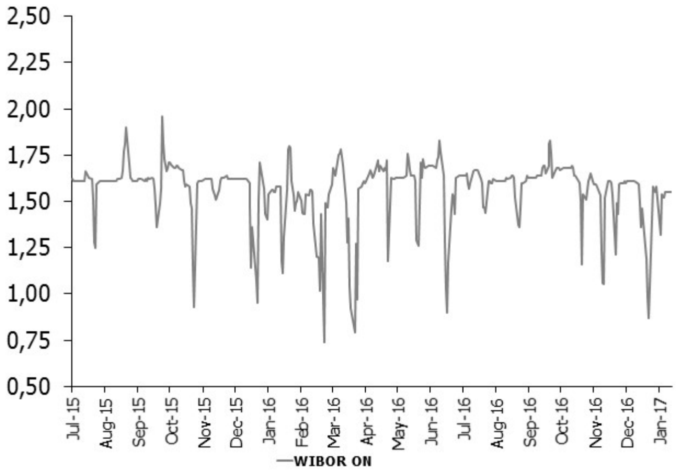
Curve steepening

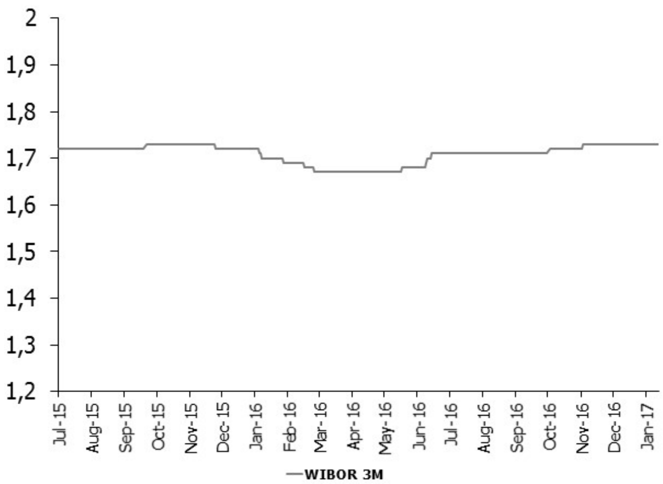
Last week Polish bond curve steepened significantly. Long end was hammered, reaching lower bound of recent range, while shortest maturities retained previous gains. Strong demand for <2 year bonds might be explained by two factors. First of all, WZ0117 was maturing and coupons on all floaters were paid, 15 bio cash will go mostly to local players (banks, funds). Secondly, Financial Stability Committee released recommendations about additional measures for CHF-loan portfolios. Local players assume that the following surge of deposits will be put into risk+tax free short government bonds.

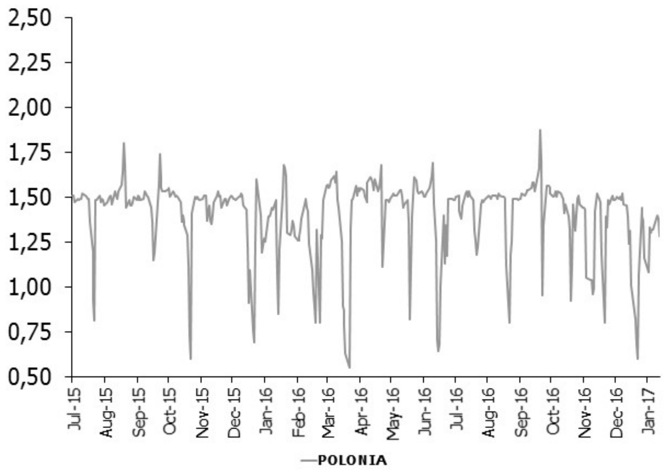
After weeks of cheap cash, the market is going back to normal. At today's OMO banks bought all bills offered by NBP, and that should square the market. Overnight rate should trade close to 1.50% next week.

Ref rate vs Polonia averages:
30 day 32 bp
90 day 20 bp





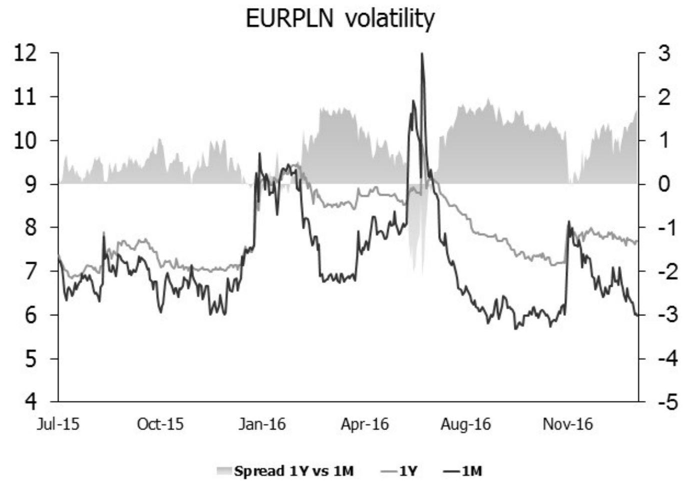




Forex

Spot – Consolidation continues No change in Poland's rating was good news, but the reaction was muted at best. 4.3570 – 4.3920 is an extremely tight weekly range, even for EUR/PLN. Of course USD/PLN behavior was much more interesting, with a 4.0770-4.1440 weekly range, but that was driven purely by EUR/USD. The so called PLN factor, was not really at work. The political scene is relatively calm. As a result, we expect more choppy price action with 4.33-4.44 being the most likely range for EURPLN.

EUR/PLN vols – melting continues The realized volatility is on the slide and both main vol curves are falling as a result. 1 month EUR/PLN ATM mid is 5.7% (0.4% lower), 3 months EUR/PLN is 6.4% (0.3% lower) and 1 year is fixing at 7.6% (0.1% lower). The currency spread (difference between USD/PLN and EUR/PLN) was also further compressed. Skew is roughly unchanged.



Short-term forecasts

Main supports / resistances:
EUR/PLN: 4.34 / 4.46
USD/PLN: 4.00 / 4.30

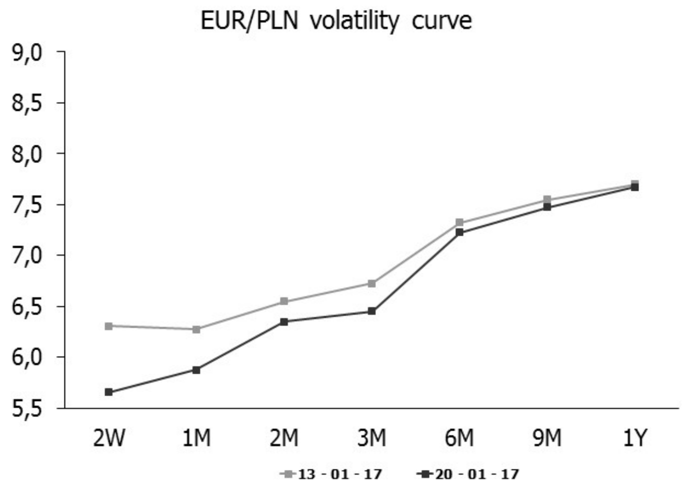
Spot Position: Long.

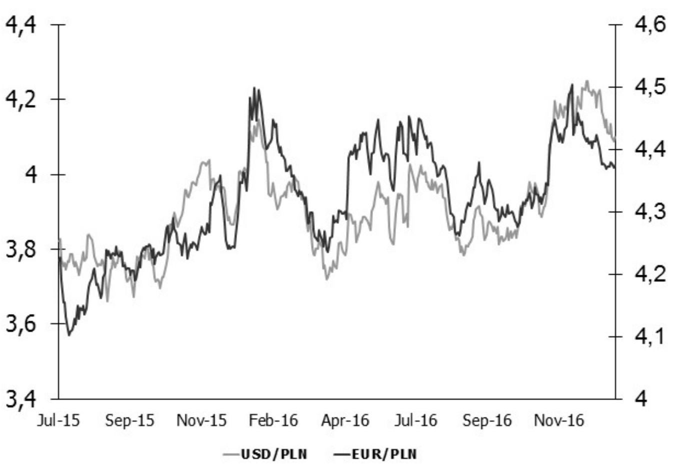
We are long from 4.3600, ready to add 4.3300, with a stop at 4.3050 and hopes to revisit 4.44+.

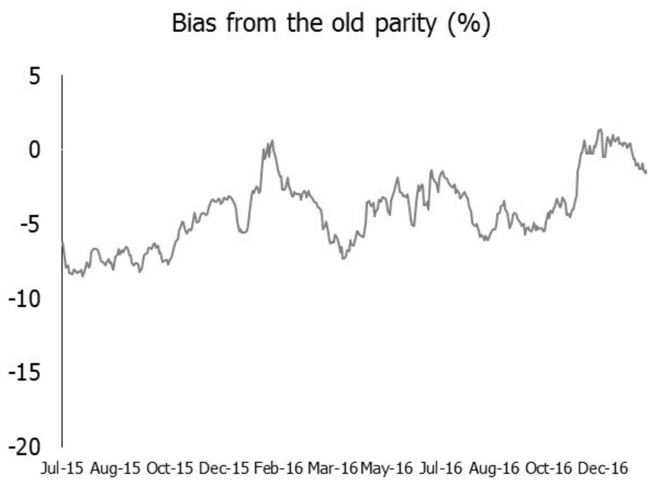
We are still hovering above the 4.33/4.36 support zone, it seems that we are not breaking lower. That gives us hope, that the next leg will reach higher – to the upper band of current range (4.42/4.44). Beginning of the new year usually transforms into stronger Zloty, but that effect should fade as time passes.

Options Vol – We are short 3 month / long 9 month EUR/PLN.

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







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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
1/13/2017	2.03	1.73	2.14	1.71	1.74	1.75	1.74	1.75	1.79	1.86	1.91	1.88
1/16/2017	2.07	1.73	2.15	1.71	2.27	1.75	1.73	1.75	1.80	1.87	1.92	1.88
1/17/2017	2.17	1.73	2.10	1.71	2.39	1.75	1.73	1.75	1.80	1.87	1.91	1.90
1/18/2017	1.95	1.73	2.03	1.71	2.17	1.75	1.73	1.75	1.78	1.86	1.93	1.88
1/19/2017	2.10	1.73	2.20	1.71	2.35	1.75	1.73	1.77	1.80	1.88	1.95	1.90

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
1/13/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
1/16/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
1/17/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
1/18/2017	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
1/19/2017	1.750	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
1/13/2017	6.28	6.73	7.33	7.70	7.70	1.89	0.61
1/16/2017	6.00	6.53	7.23	7.63	7.63	1.89	0.61
1/17/2017	6.03	6.53	7.25	7.70	7.70	2.00	0.61
1/18/2017	5.98	6.53	7.25	7.70	7.70	2.01	0.66
1/19/2017	5.88	6.45	7.23	7.68	7.68	2.05	0.58

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
1/13/2017	4.3730	4.1084	4.0753	3.5835	1.4231	0.1618
1/16/2017	4.3792	4.1354	4.0837	3.6196	1.4252	0.1621
1/17/2017	4.3771	4.0989	4.0843	3.6260	1.4223	0.1620
1/18/2017	4.3705	4.0870	4.0798	3.6089	1.4192	0.1617
1/19/2017	4.3741	4.1014	4.0797	3.5820	1.4199	0.1618

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