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## Polish Weekly Review

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### Comment on the upcoming data and forecasts

On Tuesday the CSO will release its first estimate of 2016 GDP. For obvious reasons, the market is more interested in what the figures will say about the fourth quarter. We expect 2016 growth to come out at 2.7% y/y, with Q4 slightly below 2.5% y/y due to base effects and sluggish machinery & equipment investment in the final months of the year. On Wednesday the Manufacturing PMI for January will be released. Given the on-going manufacturing upswing in Europe, one can expect another good print.

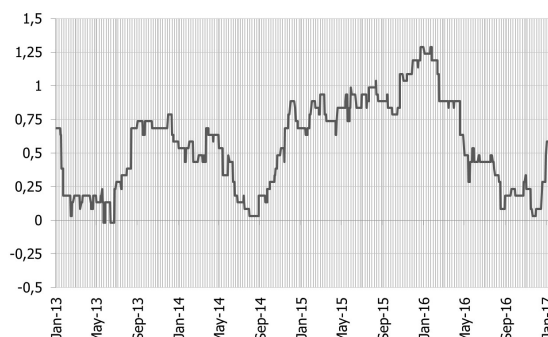
### Polish data to watch: January 30th to February 3rd

Publication	Date	Period	mBank	Consensus	Prior
GDP y/y (%)	31.01	2016	2.7	2.7	3.9
Manufacturing PMI (pts)	01.02	Jan		53.5	54.3

### 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	2/2/2017	1000	2.169	1/23/2017
5Y T-bond PS0422	2/2/2017	1500	3.159	1/23/2017
10Y T-bond DS0727	2/2/2017	3300	3.806	1/23/2017
15Y T-bond WS0428	-	200	3.027	7/7/2016

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



#### Comment

Unchanged as official unemployment figures were in line with preliminary data. Next week offers two opportunities to surprise: GDP 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

- 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 aggressive rate hike bets should lift Zloty later this 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	2.7	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

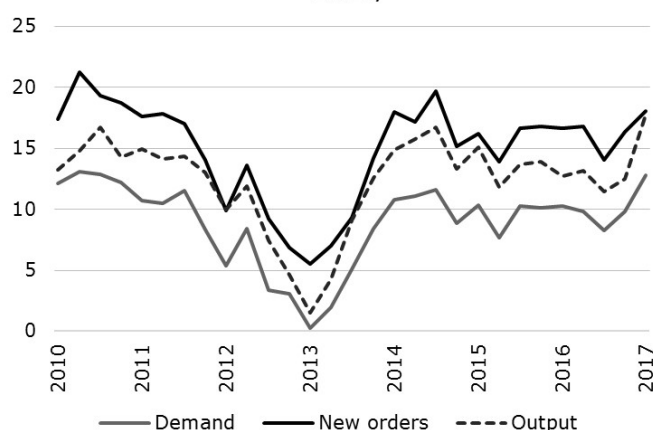
### Some optimism in NBP's enterprise survey

The newest edition of NBP's business tendency survey paints a quite positive, albeit complicated picture of the Polish economy at the turn of the year. As usual, one should look through the overly toned down conclusions and analyze the details of the release.

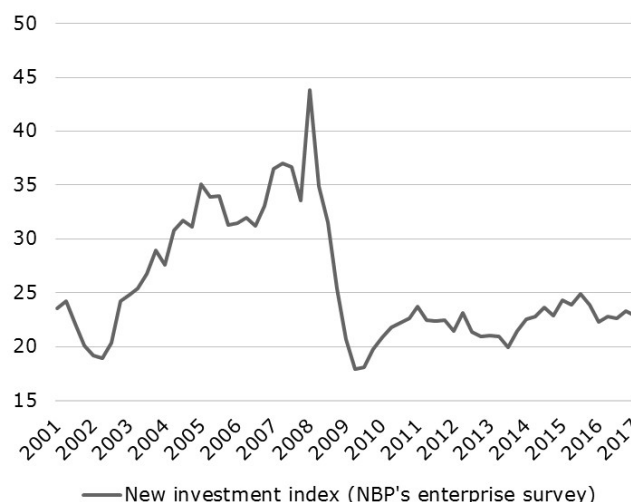
First, the assessment of economic situation in Q4 only marginally improves on the cycle bottom recorded in Q3. With all caveats regarding the loose relationship between sentiment and GDP growth, as well as possibly interesting structure of growth in Q4, this at least suggests that the economy stopped slowing (and strong Q4 data were not a dead cat bounce).

Second, the forecasts for Q1 are peculiar. While forecasts of general economic situation deteriorated further – note for instance that year-ahead expectations almost dropped to 2012 levels (sic!) – all detailed predictions (output, new orders, demand, exports, employment) surged, e.g. output forecasts increased by most since 2009. It seems that the missing piece of the puzzle is general uncertainty that is driving a wedge between general mood (negative) and facts on the ground (positive). The sources of the uncertainty are both domestic (tax and regulatory policy, as always) and foreign (direction of global economy). The overall level of uncertainty is at its all time high – and this is an unpleasant surprise for us.

Quarterly forecasts from NBP enterprise survey



Third, uncertainty is – as we often reminded our Readers – negative for investment decisions. And predictably, the rise in uncertainty is associated with tepid increases in planned and predicted investment. The risk of renewed declines is negligible, but all indices are below their 2015 highs, indicating slower growth in private investment next year. In fact, only public investment is showing some tentative signs of life, confirming our scenario for 2017.



Finally, the on-going and relentless tightening of labor market (exponential increase in the % of enterprises constrained by a lack of workforce) is translating itself into wage pressure (16% of enterprises reporting such pressure as compared to 25% at the peak of the pre-crisis boom in 2007/8) and higher wage growth forecasts. This isn't exactly news, but it is worth noting that this isn't putting significant pressure on profit margins as the largest and most widespread contribution to company costs comes from commodity prices and exchange rate. The impact of the commodity PLN-denominated price spikes on costs and prices is quite drastic, but we are under the impression that it's mostly rear-view mirror. The spike already happened and ended, after all, but its effects have not been fully reflected in CPI and PPI yet.

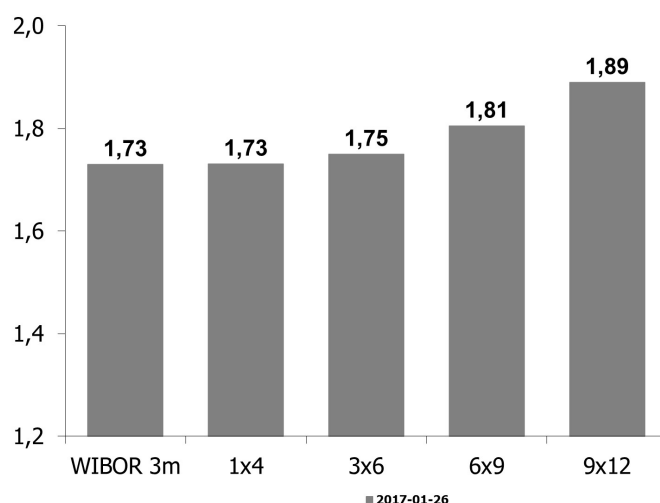
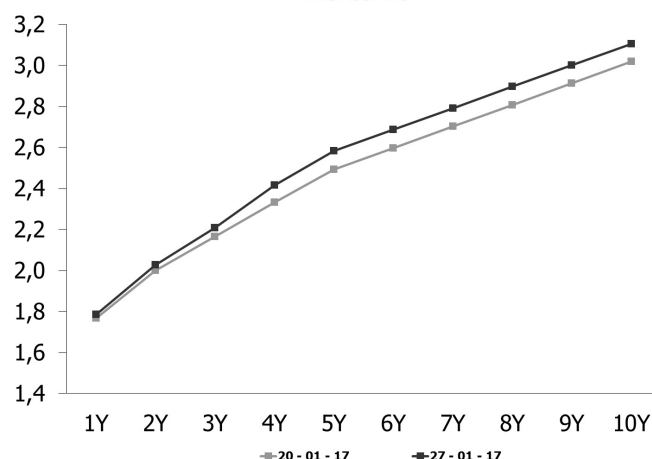
To sum up, quarterly business tendency report is supportive for our overall scenario for the year. It would appear, that the biggest economic risk comes from private investment, but one must remember that private investment hasn't dragged the economy down and won't lift it up. Public investment will.

## Fixed income

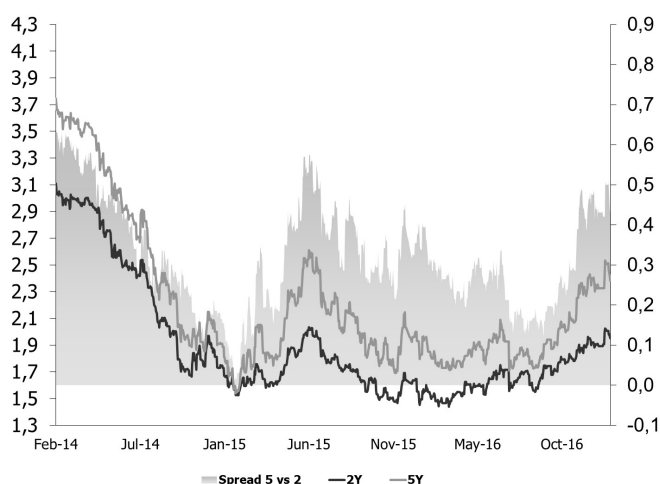
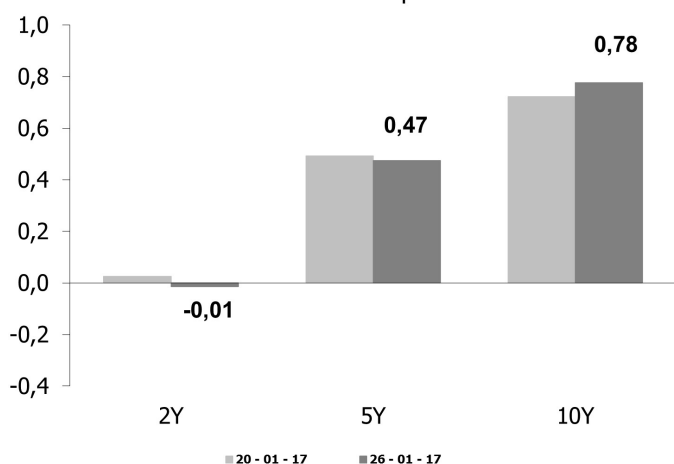
### Another auction

Next week we have another auction. The Ministry of Finance is selling OK0419/PS0422/DS0727/WZ1122/WZ0126. Yields are at this year's high, PS0422 is at 3.23%, DS0727 is at 3.95%, s/e bonds are on the bid as this is the end of the month – therefore banks are buying (OK1018 is at 1,96%). ASW has narrowed, PS0422/5y is 58 bps, OK1018/2y is -7bps. Curve is much steeper – PS0422/DS0727 has moved to 73 from 66 bps since last week. DS0727 is close to 4%, some funds are waiting for these levels.

IRS curve



Asset swaps



## Money market

### Further steepening

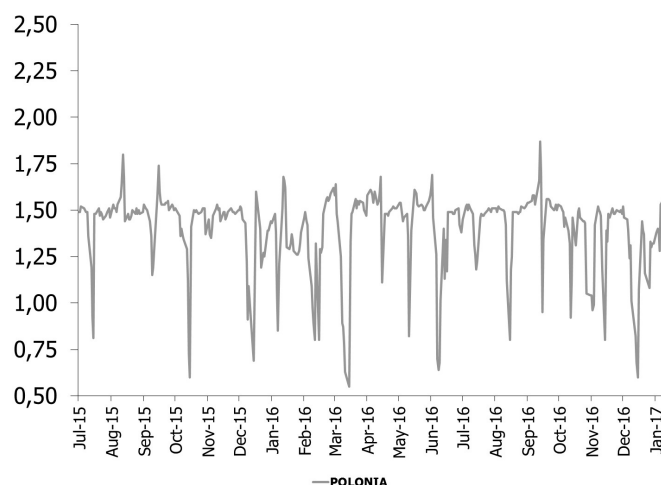
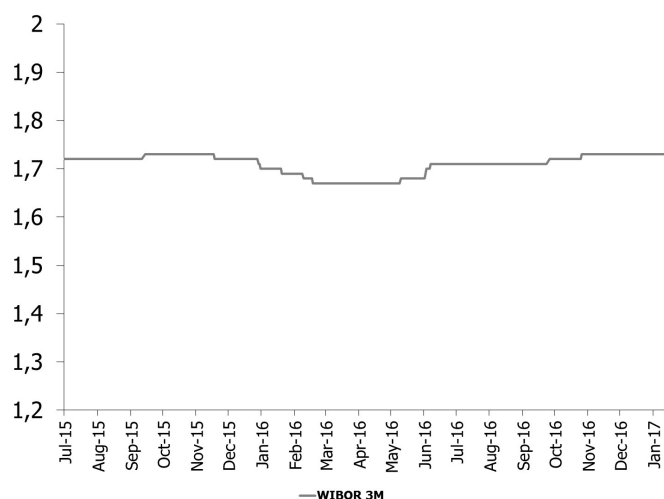
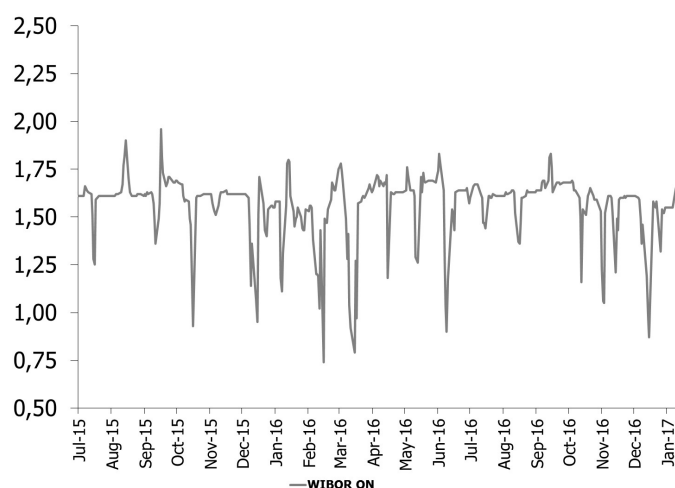
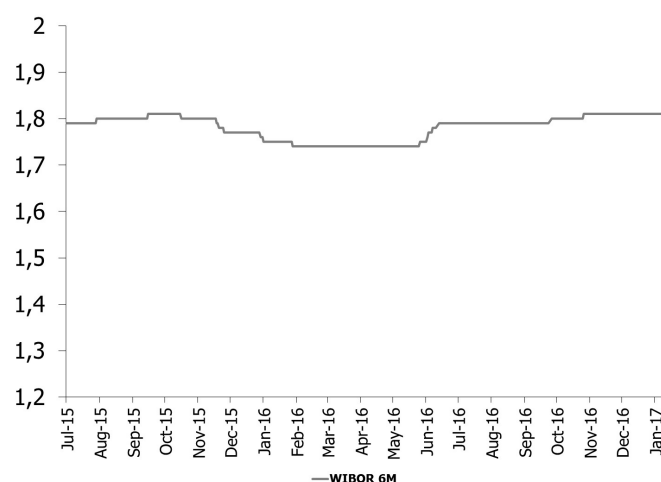
Polish yield curve continued to steepen last week. The move of 2-10Y spread was fuelled by global bond sell-off and brought us to levels not seen for several quarters. That's quite odd, with rate hike expectations being that close (early 2018). Historically the spread wasn't trading higher than 132bp.

Flash CPI won't be published this month, so we need to wait till final mid-month release.

Ref rate vs Polonia averages:

30 day 21 bp

90 day 19 bp



## Forex

**Spot – Never-ending consolidation** We are still treading water in Zloty. Even though the risk-on mood, stock euphoria finally has reached Warsaw Stock Exchange, and the PLN is stronger as a result. EUR/PLN was sliding slowly, dropping from 4.3790 to 4.3390. Range in USD/PLN was substantially wider, 4.04-4.13, but here we are also ending the week with stronger PLN (thanks to EUR/USD). The "Polish factor" is not being played, with the main market focus being on the likes of TRY, ZAR, RUB... We still like playing the range, moving it bit lower, namely 4.32-4.42.

**EUR/PLN vols – crushed** Vols were sold hard, mimicking the selloff in majors (EUR/USD, USD/JPY). The realized volatility is nosediving, and the market was hunting for bids, any bids. 6 month EUR/PLN was given at 7.0% in good amount, sold on, 1 year was given at 7.5%. 1 month EUR/PLN ATM mid is 5.0% (0.7% lower), 3 month EUR/PLN is 6.0% (0.4% lower and, finally, 1 year is fixing at 7.45% (0.15% lower). The currency spread (difference of USD/PLN minus EUR/PLN) was also being compressed even further. Skew was offered, especially in the front of the curve.

## Short-term forecasts

Main supports / resistances:

EUR/PLN: 4.32 / 4.42

USD/PLN: 4.00 / 4.25

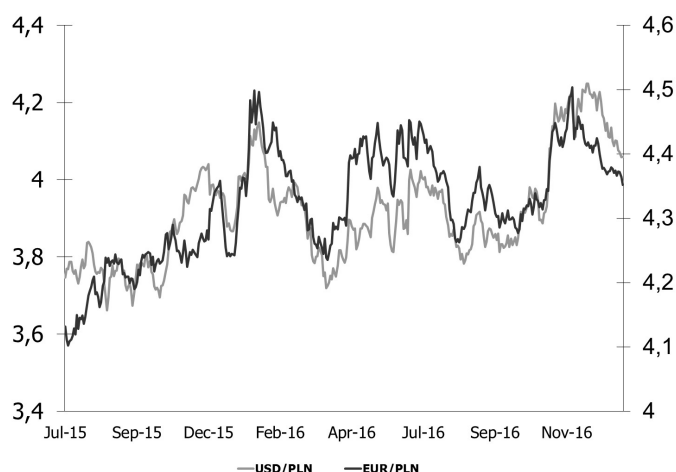
**Spot Position: Long.**

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

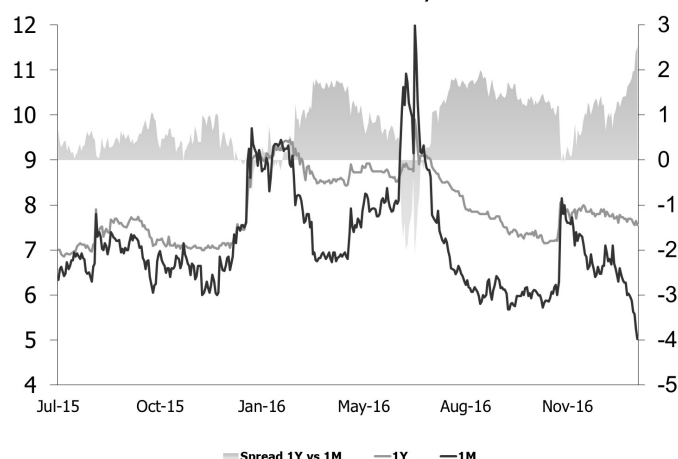
The 4.33-4.36 support is slowly giving way to the downside. We are long, and ready to add at 4.3300. We are (as usual) advocates of the rangy nature of EUR/PLN and hoping for EUR/PLN to revert higher. The beginning of a new year usually transforms into the stronger Zloty, but that effect should fade as time passes.

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

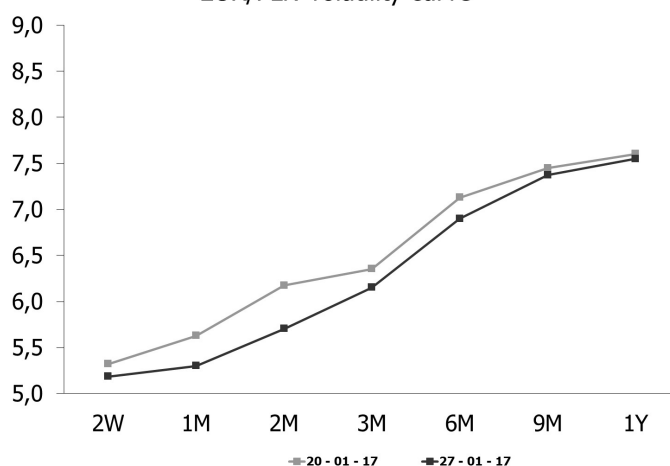
We have sold 3 month EUR/PLN ATM against our long in backend Vol, in Vega neutral terms. It is a positive Theta / slightly short Gamma structure. It expresses our general view, that even though higher vols can be seen due to rising yields, it will be a slow process



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
1/20/2017	1.63	1.73	1.79	1.71	1.83	1.75	1.73	1.75	1.79	1.88	1.97	1.90
1/23/2017	2.06	1.73	2.17	1.71	2.32	1.75	1.73	1.75	1.80	1.88	1.96	1.90
1/24/2017	2.06	1.73	2.15	1.71	2.30	1.75	1.73	1.75	1.80	1.89	1.97	1.90
1/25/2017	1.86	1.73	1.95	1.71	2.11	1.75	1.73	1.75	1.80	1.88	1.97	1.89
1/26/2017	1.99	1.73	2.05	1.71	1.88	1.75	1.73	1.75	1.81	1.89	1.99	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
1/20/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
1/23/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
1/24/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
1/25/2017	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
1/26/2017	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	
1/20/2017	5.63	6.35	7.13	7.60	7.60	1.89	0.55	
1/23/2017	5.58	6.30	7.08	7.55	7.55	1.89	0.55	
1/24/2017	5.25	6.20	7.10	7.65	7.65	1.88	0.54	
1/25/2017	5.03	6.10	6.95	7.55	7.55	1.89	0.54	
1/26/2017	5.30	6.15	6.90	7.55	7.55	1.99	0.61	

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
1/20/2017	4.3658	4.1005	4.0705	3.5632	1.4154	0.1615
1/23/2017	4.3725	4.0760	4.0781	3.5874	1.4119	0.1618
1/24/2017	4.3720	4.0708	4.0744	3.5942	1.4097	0.1617
1/25/2017	4.3636	4.0585	4.0654	3.5748	1.4066	0.1614
1/26/2017	4.3520	4.0590	4.0644	3.5560	1.4008	0.1610

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