February 3, 2017

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

Table of contents

Comment on the upcoming data and forecasts

On Wednesday, the MPC will decide on interest rates. We do not expect any changes in monetary policy. MPC members will acknowledge the rapid rise in the CPI (driven by base effects and commodity prices), but January's release (our forecast 1,7%, market consensus 1,6%) won't be published until after the meeting. Just as the Council stayed put during the prolonging deflation, it will not overreact to higher inflation and allow for negative real interest rates. When it comes to economic growth, MPC will be optimistic, pointing out that GDP growth has already bottomed out in Q3 2016 and that the following quarters should bring acceleration above 3% y/y. We think that NBP rates will remain unchanged for at least a year. However, with continuing trend of positive surprises in publications from Polish economy, market participants could start pricing earlier rate hikes.

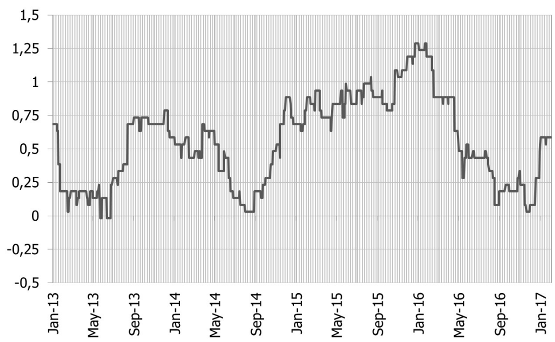
Polish data to watch: February 6th to February 10th

Publication	Date	Period	mBank	Consensus	Prior
NBP rate decision (%)	08.02	Feb	1.50	1.50	1.50

Treasury bonds and bills auctions

Paper	Next auction	Last Offer	Yield on the prev auction (%)	Prev auction
(32/37/52) Week T-bills	2/6/2017	2000	1.540	1/16/2017
2Y T-bond OK1019	2/16/2017	500	2.168	2/2/2017
5Y T-bond PS0422	2/16/2017	1500	3.122	2/2/2017
10Y T-bond DS0727	2/16/2017	2100	3.809	2/2/2017
15Y T-bond WS0428	2/16/2017	200	3.027	7/7/2016

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



Comment

Unchanged from previous week – both GDP and PMI surprised only slightly. Next week's releases also shouldn't move the index, since MPC will most certainly leave rates unchanged.

* 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 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	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	-1.2	-2.1	-0.6	-0.6	-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

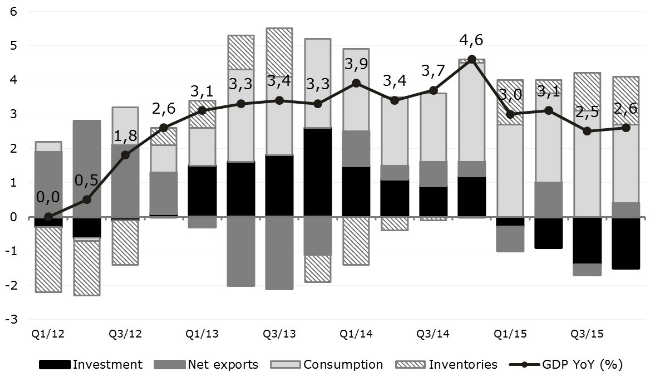
	2016 Q1	2016 Q2	2016 Q3	2016 Q4	2017 Q1 F	2017 Q2 F	2017 Q3 F	2017 Q4 F
GDP y/y (%)	3.0	3.1	2.5	2.6	3.1	3.2	3.6	3.8
Individual consumption y/y (%)	3.2	3.3	3.9	4.1	4.3	4.0	3.8	3.5
Public Consumption y/y (%)	4.2	3.9	4.9	1.2	3.0	3.0	3.0	3.0
Investment y/y (%)	-2.2	-5.0	-7.7	-5.5	0.0	4.0	7.0	7.0
Inflation 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

Annual GDP surprised to the upside, but its structure did not.

GDP grew by 2.8% in 2016, slightly above market forecasts of 2.7% growth. Of course, economic analysts are more concerned with Q4 data, which could be calculated with reasonable precision on the basis of annual figure.

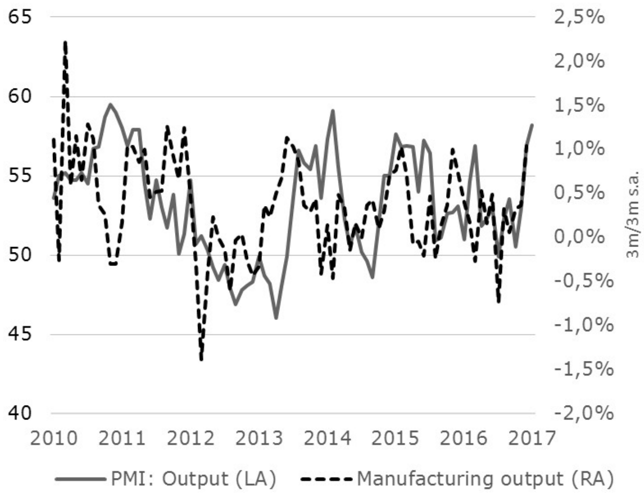


And so, GDP probably grew by 2.6% y/y in Q4 (range of possible outcomes is 2.5-2.8%). The rebound in investment is meagre (-5.5% in Q4 vis-a-vis -7.7% in Q3) and can be attributed to the fact that buildings and structures were the only category of investment that improved its performance in the last quarter. Spending on machinery and equipment remained flat on y/y basis, as industrial output figures show, which also fits output-based nowcasts of GDP we also rely on. Private consumption barely accelerated, from 3.9 to 4.1% y/y – so far, spending on goods is a reasonably good predictor of overall consumer spending. Public consumption slowed down in Q4 due to statistical base effects, but not as much as one could have feared. Our original forecast (+1% y/y) is close to what can be calculated from annual data (+1.2% y/y). Net exports added a few percentage points to growth in Q4 and the trump card was inventory formation. The latter category added a whopping 1.4 p.p. to growth and it seems that firms ramped up production, but haven't sold it completely yet. This should not be seen as a negative development, but rather a result of better sentiment.

Although the composition of GDP growth was rather unusual, we stay positive on 2017 GDP growth. Subsequent GDP reading is going to exceed 3.0% y/y and the whole 2017 is going to top 3.5%. Such a positive notion is going to be corroborated by the next batch of high frequency data, to be published in February. Acceleration of GDP growth and inflation proceeding in the same time is bond negative information. As for the short end of the yield curve, the effect is straightforward as investors may play for a rate hike in 2017 (although the increase in NBP rates was not and still is not our baseline scenario). In the l/e the play is more subtle as better GDP data limit credit risk and improve fiscal position of the government (less supply) amid global trend for higher risk free rates. We think that the latter effect is going to take the upper hand for now.

Another solid PMI report

2017 started with another good PMI release – headline index rose from 54.3 in December to 54.8 in January, while market consensus was expecting a slight fall. Looking into details, a decline in subindex for labour demand (from 55.5 to 53.4) was more than offset by further acceleration of new orders (from 54.1 to 54.9, a 18-months high) and foremost output (from 56.9 to 58.2, a 35-months high) subindices. Purchasing activity also remained at decent levels. All in all January's PMI is almost at a two-year high.



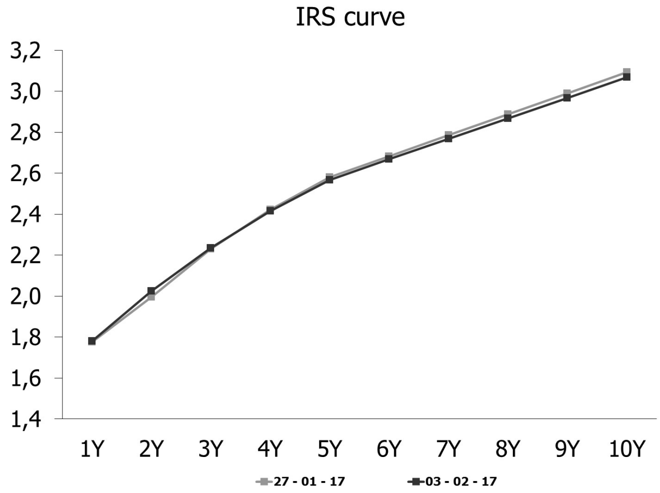
The main conclusion from this release is not a surprise – Polish industry has already entered a phase of rapid expansion. Solid momentum in last month's IP data also confirms it and the upcoming publication of manufacturing production for January could put the seal on it. Boosted by strong calendar effects yearly growth of this category could reach 10% – highest value since the turn of 2011 and 2012. In our comments on recent PMI releases we put much attention to subindices connected to price processes. Those fell slightly in January, thus adding yet another piece of evidence on the rapid consumer inflation comeback. Producer price pressure will hold (especially if companies will treat latest shocks as permanent), unless there is be a deeper correction on global commodities markets. Recent Zloty weakening, which appears to be quite permanent, was one of main drivers of the spike in production costs, after all.

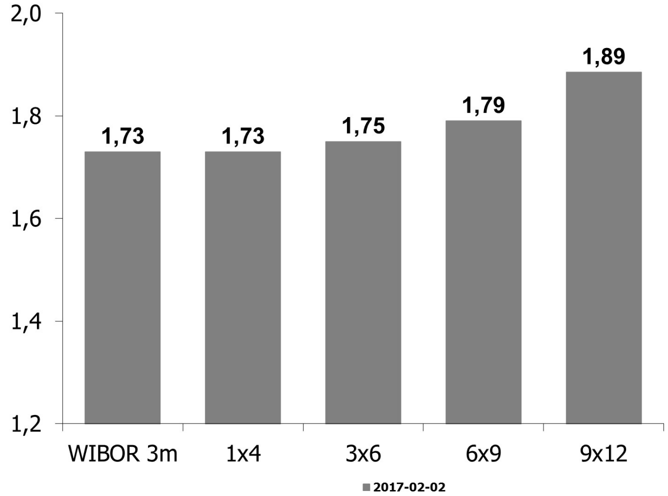
As always we should not jump to far into conclusions regarding hard data, especially since the PMI is not a leading indicator. However, given the widespread improvement in economic sentiment (among main Poland's trade partners and in light of other Polish business indicators), we see this release as a confirmation of economic revival. The character of this rebound will be, in the first quarters, driven largely by base effects and the rebound in construction investment. After few quarters, when other engines of economic growth start, we should see GDP yearly growth exceeding 3%. We stick to our GDP forecast for 2017 (3.4%).

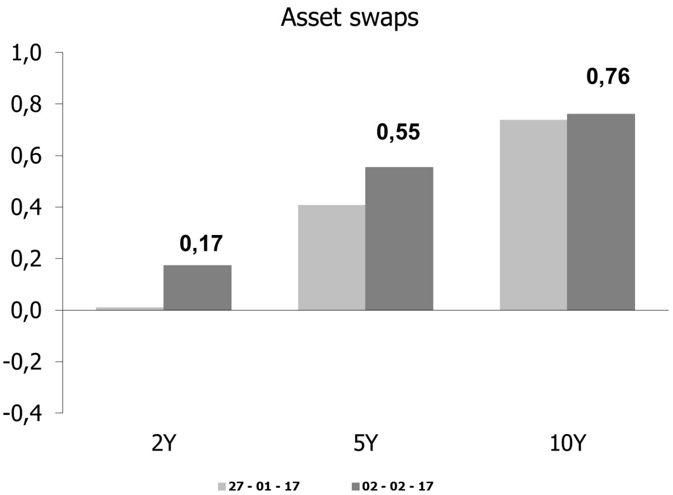
Fixed income

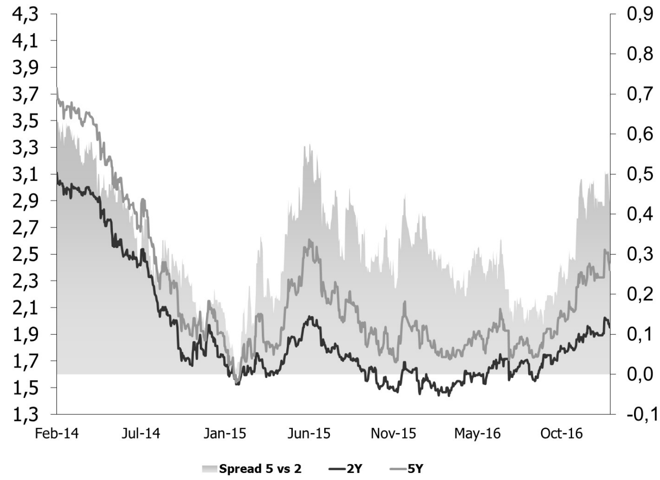
Flattener

Ministry of Finance sold last Thursday PLN 5.9 bn of bonds: OK0419 (yield 2.17%), PS0422 (yield 3.12%), DS0727 (yield 3.81%), and WZ1122 and WZ0126. Demand was almost double that size and not all of it has been covered. We saw bids mostly on s/e and floaters. Spreads are currently traded: PS0721 / DS0726 spread at 77 bps, DS0726/DS0727 at 11 bps. ASW are 55/54 bps in PS0422 / 5y and DS0727 / 10y at 72/69 bps. Next Monday, the Ministry of Finance will offer 1-2bn 29-week T-bills. We expect demand to be fully covered.









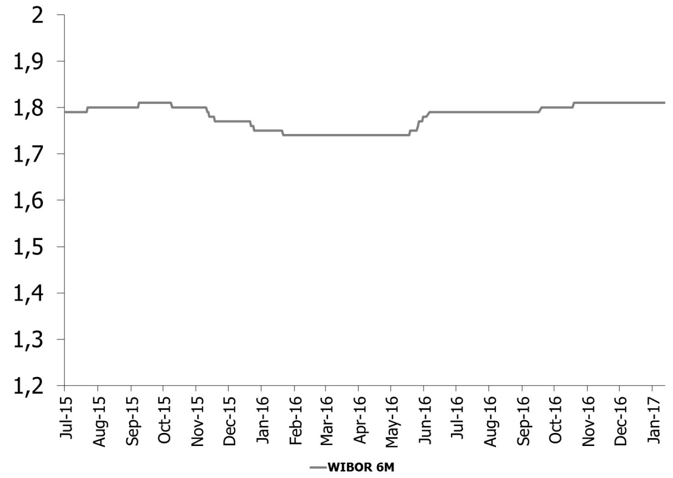
Money market

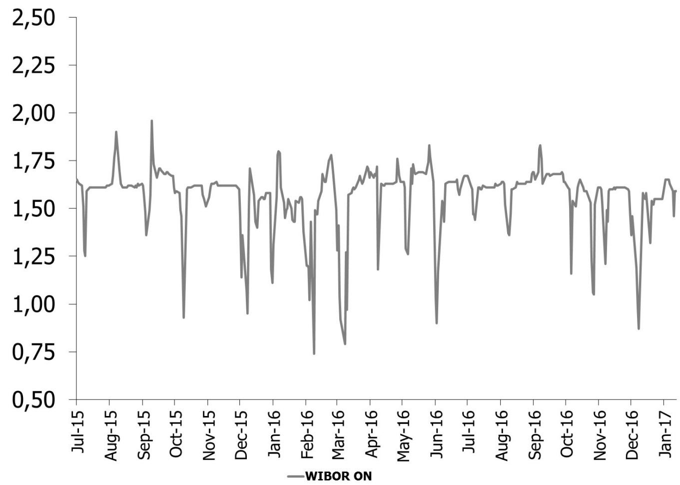
Stable week behind us

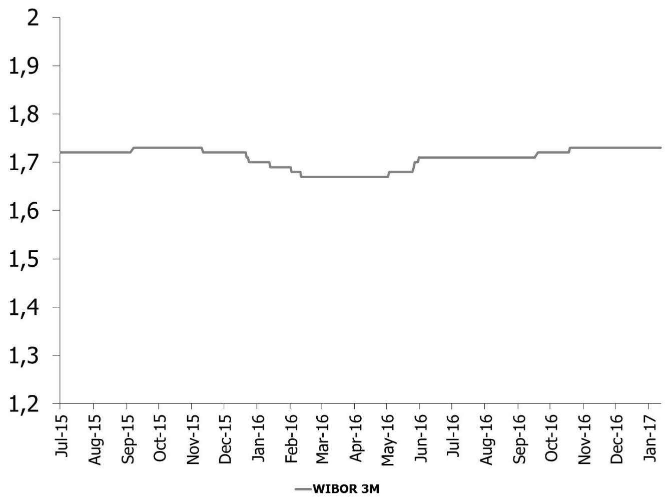
Price action was quite stable on the shortest bonds last week. Demand weakened a bit, although the Ministry of Finance still favours selling long-dated debt. At Thursday's auction they sold only 550 mio of OK0419. Next week we have T-bills auction, which should be cleared at around 1.53% yield. Monetary Policy Council meeting should be a non-event with members reiterating that they feel comfortable with current reference rate for an extended period.

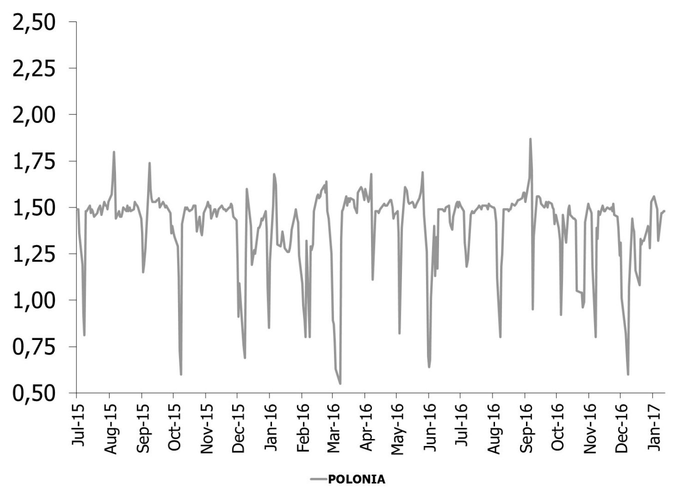
Money market found its equilibrium after the New Year. Overnight cash should hold around 1.50% until month end.

Ref rate vs Polonia averages:
30 day 13 bp
90 day 19 bp









Forex

Spot – The unstoppable Zloty PLN is getting stronger and stronger, even though the pace is really slow. Globally positive investment climate, unwinding of longs in USD/PLN and the fresh highs on Warsaw Stock Exchange – all of the above have contributed to PLN advances. Political picture is also positive, given the assumption that ”no news is good news”. Strong support 4.32-4.35 in EUR/PLN gave way and we even dived below psychological 4.30 support. On USD/PLN we are now grappling with mighty 3.95-3.98 support zone. We are a bit sceptical, whether it has fuel to go much further. We would expect 4.25-4.28 support in EUR/PLN to be much more difficult to be cracked, and we expect at least some correction. Current range will most likely be contained in 4.27-4.35.

EUR/PLN vols – further melting The toxic (vols killing) mixture of stronger PLN and low realized vols is responsible for the continuation of vols melting. As frontend vols are already close to their historic lows, the sell-off extended itself to the middle and backend of the curve. 1 month EUR/PLN ATM mid is 4.8% (0.2% lower), 3 month EUR/PLN is 5.8% (0.2% lower), and finally 1 year is fixing at 7.2% (0.25% lower). The currency spread (difference between USD/PLN and EUR/PLN) was stabilizing as we saw some bids for Gamma before FOMC and NFP. Skew is roughly unchanged.

Short-term forecasts

Main supports / resistances:
EUR/PLN: 4.25 / 4.35
USD/PLN: 3.90 / 4.20

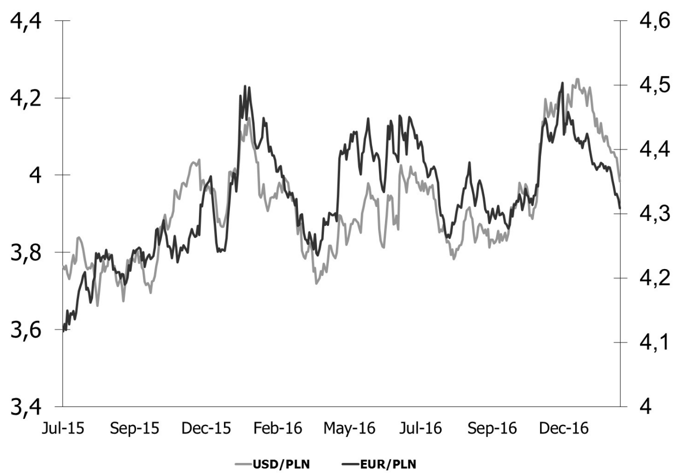
Spot Position: None.

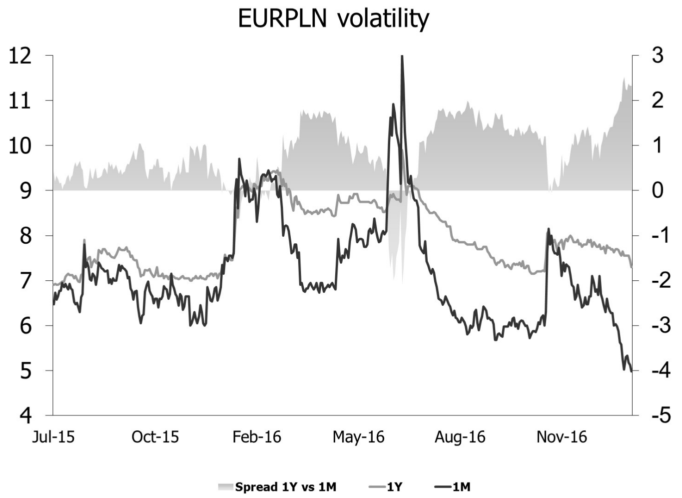
Our longs from 4.36 and 4.33 were stopped out at 4.3050.

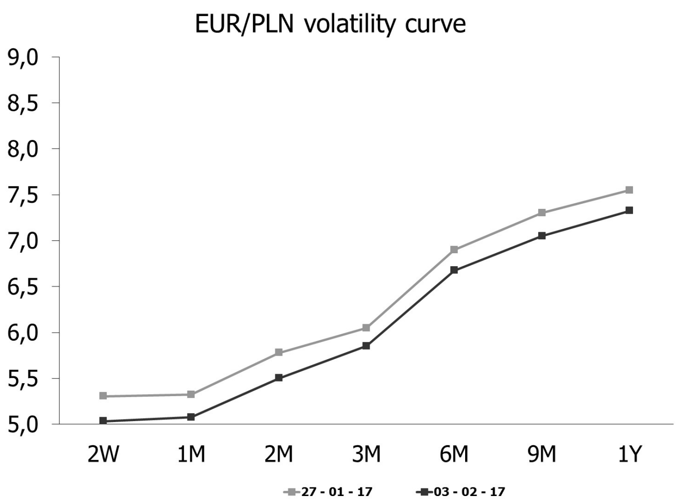
The price action is to be respected. We haven’t changed our view – the rising yields environment and the USD uptrend will eventually translate into weaker PLN. Eventually, with both global yields and dollar stalling/correcting itself at the moment, PLN is gaining value as a result. We have to respect that. We will be trying to roll into PLN shorts again closer to 4.25-4.27 in EUR/PLN and/or at 3.90-3.95 in USD/PLN.

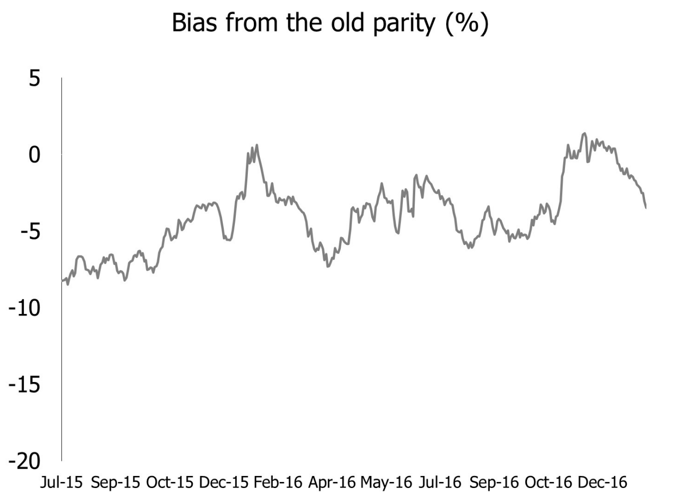
Options Vol – Long 9 month EUR/PLN.

We are buying back our sold frontend in EUR/PLN. It was a profitable trade (Theta-wise), but the vols are substantially lower now. We have dropped to the levels, where we think there is no additional incentive to keep these shorts. We are keeping the backend long as an outright long position.









mBank.pl

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
1/27/2017	1.90	1.73	2.13	1.71	2.20	1.75	1.73	1.75	1.78	1.87	1.97	1.88
1/30/2017	1.73	1.73	2.05	1.71	2.25	1.75	1.73	1.75	1.78	1.87	1.97	1.88
1/31/2017	1.97	1.73	1.86	1.71	1.89	1.75	1.73	1.75	1.78	1.87	1.98	1.88
2/1/2017	1.81	1.73	1.90	1.71	2.05	1.75	1.73	1.75	1.79	1.88	1.99	1.89
2/2/2017	1.78	1.73	2.10	1.71	1.89	1.75	1.73	1.75	1.79	1.89	1.97	1.89

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
1/27/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
1/30/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
1/31/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
2/1/2017	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
2/2/2017	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
1/27/2017	5.33	6.05	6.90	7.55	7.55	2.05	0.55
1/30/2017	5.18	6.08	6.93	7.55	7.55	2.05	0.55
1/31/2017	5.13	6.10	7.00	7.45	7.45	2.03	0.54
2/1/2017	4.98	5.75	6.64	7.30	7.30	1.94	0.52
2/2/2017	5.08	5.85	6.68	7.33	7.33	1.96	0.52

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
1/27/2017	4.3413	4.0595	4.0609	3.5309	1.3924	0.1607
1/30/2017	4.3291	4.0472	4.0529	3.5295	1.3903	0.1602
1/31/2017	4.3308	4.0446	4.0625	3.5514	1.3926	0.1603
2/1/2017	4.3221	4.0071	4.0465	3.5357	1.3915	0.1600
2/2/2017	4.3084	3.9835	4.0307	3.5424	1.3962	0.1594

Disclaimer