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Polish Weekly Review

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Comment on the upcoming data and forecasts

On Wednesday MPC will make its decision, we expect rates to remain unchanged. MPC members will also acquaint themselves with latest NBP economic projections (central paths for inflation & GDP will be provided in the post-meeting statement). Wording will likely depend on inflation forecast for the next few months. The recent spike in inflation (causing negative real interest rates) is treated by them as temporary and only a prolonged stay above 1.5% mark could encourage members to consider rate hikes. The new projection will have a markedly higher starting point (due to the recent spike in inflation) and should be above the previous one, but the medium-term path will still be slightly below target. However, because of the "wait-and-see" approach, the MPC will not put rate hikes off the table in 2017 definitely. Much less focus will be put on GDP growth, since last releases are in line with MPC expectations (governor Glapinski expects growth to accelerate even more at the turn of second and third quarter).

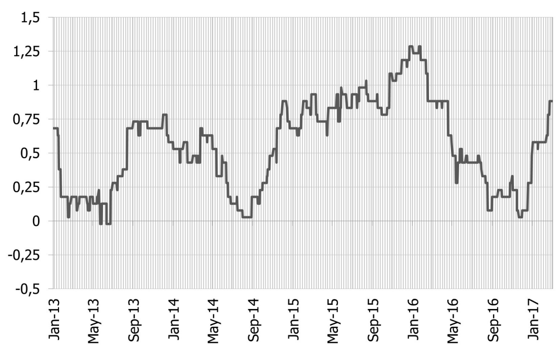
Polish data to watch: March 6th to March 10th

Publication	Date	Period	mBank	Consensus	Prior
MPC decision (%)	08.03	Mar	1.50	1.50	1.50

Treasury bonds and bills auctions

Paper	Next auction	Last Offer	Yield on the prev auction (%)	Prev auction
(29–37/52) Week T-bills	-	700	1.500	2/22/2017
2Y T-bond OK1019	3/23/2017	600	2.183	2/16/2017
5Y T-bond PS0422	3/23/2017	1400	3.177	2/16/2017
10Y T-bond DS0727	3/23/2017	1600	3.854	2/16/2017
30Y T-bond WS0447	-	2100	4.257	2/16/2017

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



Comment

Unchanged from previous week as all releases came more or less in line with market consensus. The index should remain at this level for a longer period of time, since next week has only one important economic release (MPC decision) and there should be no surprises.

* 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

- GDP growth bottomed out at 2.4% y/y in Q3 2016. Momentum is very positive right now; growth picked up on a q/q basis in Q4 already (1.7% q/q). 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 Q2 already and GDP growth to exceed 3% in Q1. With consumption already solid, we expect growth to accelerate over the course of the year, touching 4% y/y in Q4.
- 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. Because of the well-known base effects in oil prices, 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. It is more realistic to place bets on monetary tightening in 2018.

Financial markets

- 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

	2013	2014	2015	2016	2017 F	2018 F
GDP y/y (%)	1.4	3.3	3.9	2.8	3.4	3.5
CPI Inflation y/y (average %)	0.9	-0.1	-0.9	-0.6	2.2	2.3
Current account (%GDP)	-1.2	-2.1	-0.6	-0.6	-0.9	-1.1
Unemployment rate (end of period %)	13.4	11.4	9.8	8.3	7.8	7.3
Repo rate (end of period %)	2.50	2.00	1.50	1.50	1.50	2.25

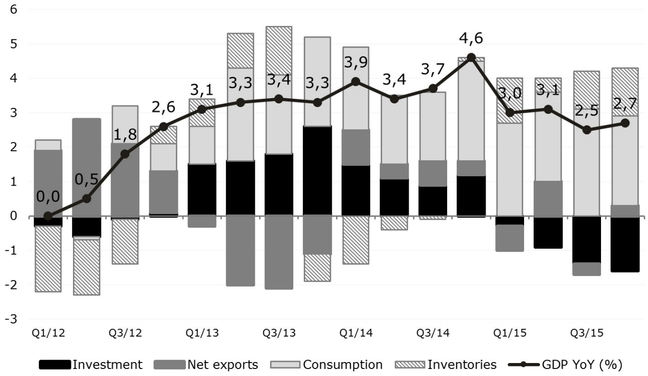
	2017 Q1 F	2017 Q2 F	2017 Q3 F	2017 Q4 F	2018 Q1 F	2018 Q2 F	2018 Q3 F	2018 Q4 F
GDP y/y (%)	3.1	3.4	3.4	3.8	3.8	3.6	3.6	3.6
Individual consumption y/y (%)	4.4	4.2	3.8	3.8	3.6	3.5	3.4	3.4
Public Consumption y/y (%)	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Investment y/y (%)	-2.0	3.5	6.3	7.0	7.3	7.0	6.5	5.5
Inflation rate (% average)	2.1	2.4	2.4	1.9	2.1	2.2	2.3	2.4
Unemployment rate (% eop)	8.5	7.9	7.5	7.8	8.0	7.4	7.1	7.3
NBP repo rate (% eop)	1.50	1.50	1.50	1.50	1.50	1.75	2.00	2.25
Wibor 3M (% eop)	1.73	1.73	1.73	1.73	1.73	1.98	2.23	2.48
2Y Polish bond yields (% eop)	2.15	2.20	2.25	2.30	2.30	2.35	2.40	2.45
10Y Polish bond yields (% eop)	3.90	3.95	4.00	4.05	4.10	4.15	4.20	4.25
EUR/PLN (eop)	4.30	4.25	4.25	4.20	4.20	4.20	4.20	4.20
USD/PLN (eop)	4.06	4.01	4.05	4.04	4.08	4.12	4.12	4.12

F - forecast

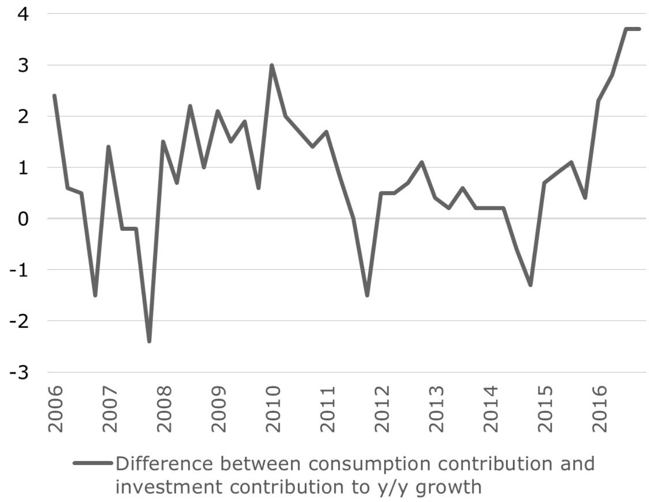
Economics

CSO confirms the acceleration in GDP growth in Q4 and its consumption-heavy composition.

According to the final estimate, Polish GDP grew by 2.7% y/y in last quarter of 2016 (unchanged from the flash estimate). Growth momentum is very impressive â€“ after adjusting for calendar and seasonal effects it equals 1.7% q/q, which is the best result in 9 years, as we already indicated two weeks ago.



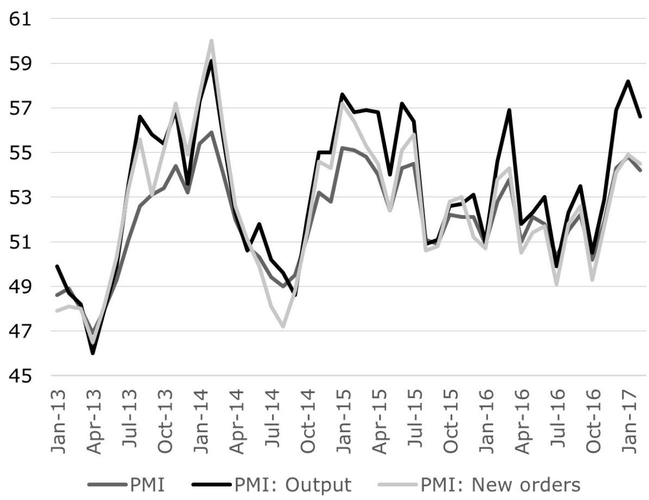
The structure of Q4 GDP growth matches the earlier estimates and our expectations derived from monthly data. Firstly, the rebound in investment is meagre (-5.8% y/y in Q4 vis-a-vis -7.7% y/y in Q3) and can be attributed to the fact that buildings and structures were the only category of investment that 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. Secondly, private consumption barely accelerated, from 3.9 to 4.2% y/y – so far, spending on goods is a reasonably good predictor of overall consumer spending. As a result, the difference between consumption and investment contributions to GDP growth is probably at all-time high. Thirdly, public consumption slowed down in Q4 due to statistical base effects, but not as much as one could have feared (from 4.9 to 2.7% y/y). Moreover, 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. Given the upbeat recent NBP surveys, it should result in acceleration of business sales.



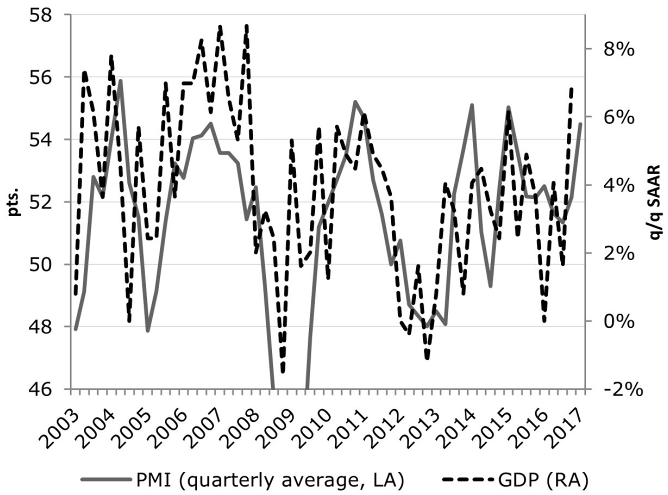
Detailed GDP data for the fourth quarter do not affect our view of the Polish economy. So far, the acceleration in growth has not led to higher expectations for monetary tightening in Poland (no small part due to dovish stance adopted by the MPC). Stronger growth is, however, conductive to lower country risk (as measured by ASW spreads for instance) – we have claimed that it would happen for some time now. This might not help long-end bonds, though, as this part of the curve is at an asymmetric risk of higher yields after the recent declines in risk-free rates globally (which are likely to reverse as the synchronized upswing in major economies reasserts the uptrend in yields).

Polish manufacturing PMI fell slightly in February.

In February Polish manufacturing PMI fell from 54.8 to 54.2, slightly lower than market consensus (54.6). This drop was mainly fuelled by lower assessment of output (fall from 58.2 to 56.6), inventories (fall from 54.6 to 52.9) and a slight decline in new orders (from 54.9 to 54.5). On the other hand, employment subindex grew (from 53.7 to 53.4).



From a broader perspective this slight fall in PMI is just an outlier – the changes in its subindices are not synchronized, have different direction and sizes. For the most part, the drop was caused by the correction in the already stretched production estimates. Its adjustment towards new orders levels means lower inventories growth but is not an indicator of further falls. Conclusions about correlation between PMI and macroeconomic data should be drawn very cautiously. Even though the high momentum of industrial production in February should be sustained, GDP growth was in recent period was a rather leading data for PMI indices, not the opposite.



Thus, we should look into most interesting part of this publication – indices related to prices. In February we saw the continuation of previous months' trends: another record high growth in production costs (a result of both higher commodity prices and "exchange rate volatility") and output prices. The latter rose for the fourth month in a row, which has not happened since 2012. February's PMI confirms foremost the present economic outlook and forecasts further rise in producer prices (we think that yearly PPI could reach 4.7% in February). This data is MPC-neutral.

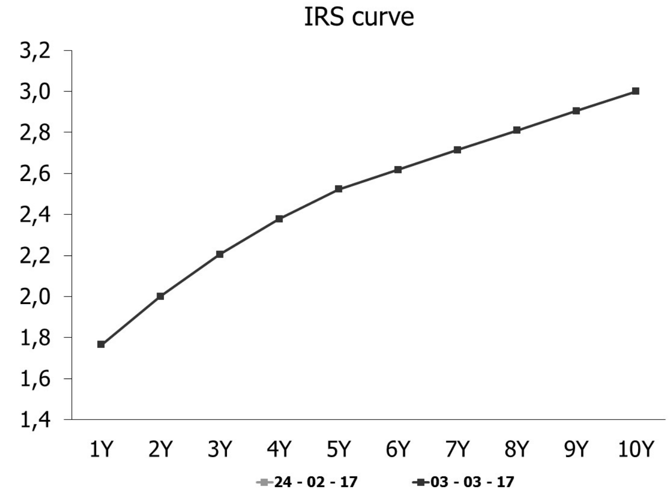
Fixed income

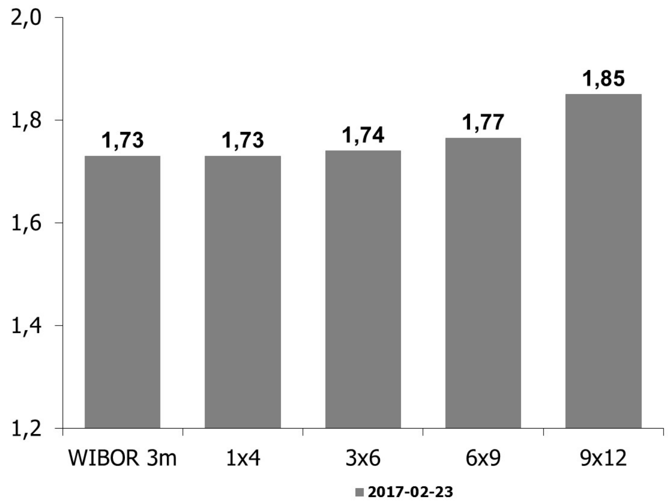
Risk-on

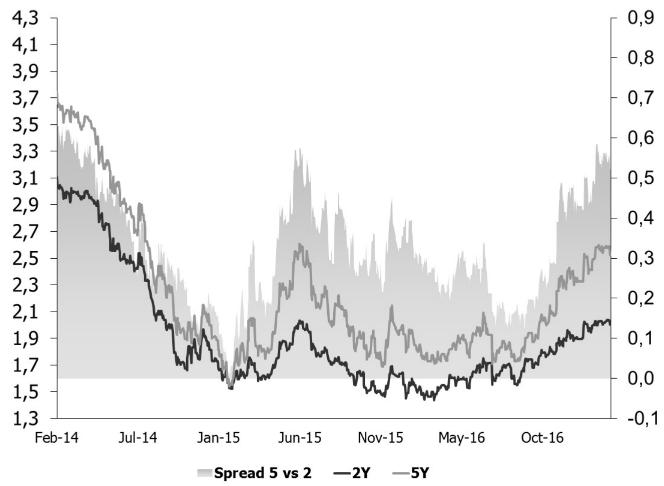
We had a switching auction on Thursday. The Ministry of Finance sold 5.24 bn OK0419/PS0422/DS0727/WZ1122/WZ0126. Not all demand has been covered. We saw stronger buy side on bonds after auction. 2y/5y/10y ASW has narrowed.

Market has switched to risk-on mode. POLGBs have narrowed in spread to the Bund, to 336bp. We had frozen at very important levels on 5y IRS, 2.49-2.51% – a good support for last few weeks. DS0727 is currently stronger – at 3,73-3,70% we can see the trend line there. The PS0422/DS0727 spread is back to 66 bps, ASW PS0422/5y is at 55bps and DS0727/10y is at 76bps. OK0419 is trading at 2.15% (8 bps down), PS0422 is trading at 3.03% (9 bps down) and DS0727 is trading at 3.72% (8 bps down).

The Ministry of Finance won't organize T-bills auction in March.







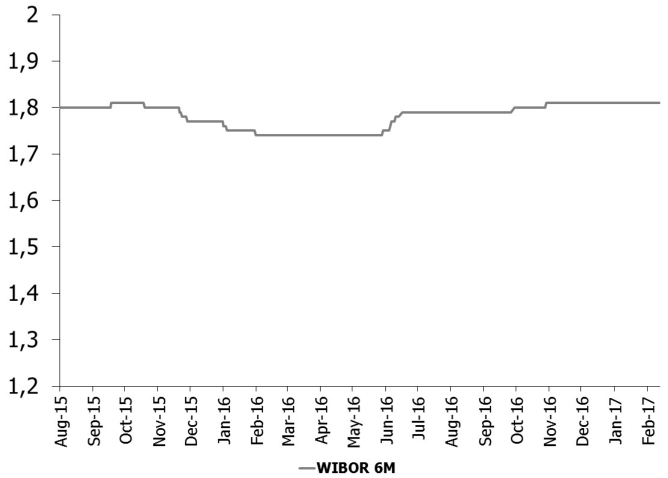
Money market

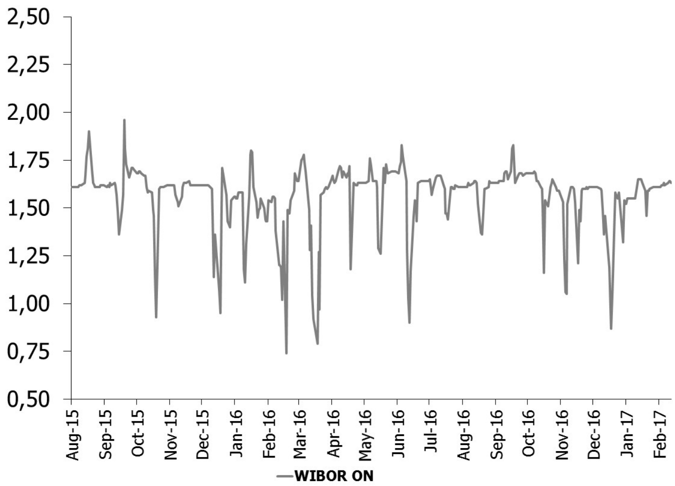
Sell-off

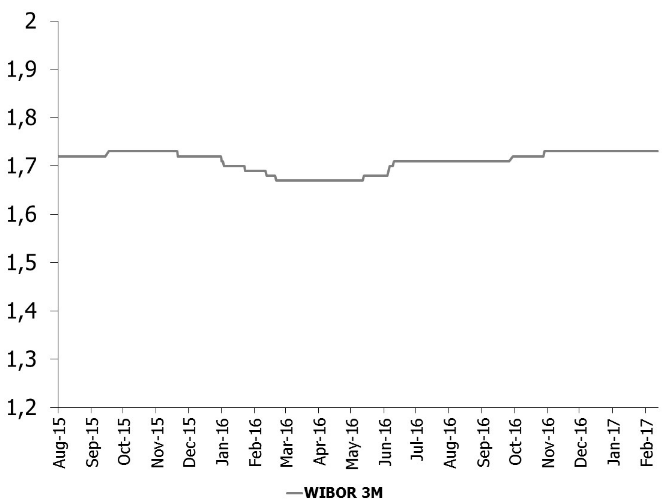
After a recent sell-off in swaps, short bonds are catching up. Two-year govies gained ca. 7-10 bps and reached 2.15%. Comparing with rate hike expectation derived from swaps this yield is not elevated. Next week we have a monetary policy meeting combined with CPI projections. In our opinion there is room for surprises only to the upside as FRA contracts see first rate hikes in 2H 2018.

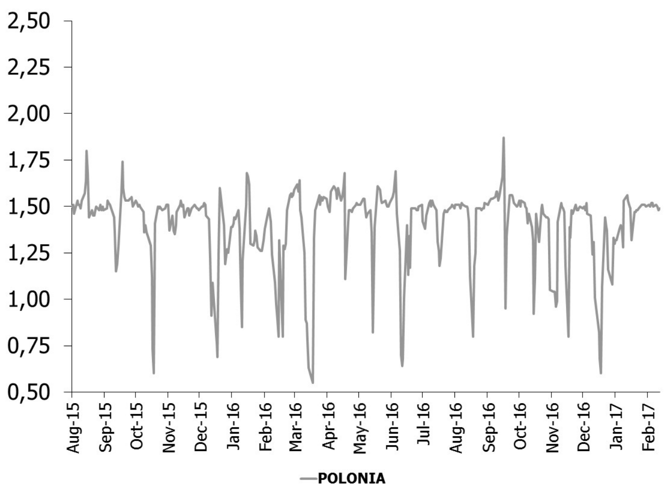
At today's OMO banks bought 70bn out 73.5 bn NBP bills. Theoretically, some spare cash is left on the market, although it's the beginning of the month so O/N rate should hold close to 1.50%.

Ref rate vs Polonia averages:
30 day 2 bp
90 day 13 bp









Forex

Spot – Boxed in the range (still) EUR/PLN has been boxed in the tight 4.27-4.34 range for another week. We had PLN buying flow that took us down to 4.2780 vs EUR, but it was really short lived. As a result we are back above 4.31. There is not much to say about PLN. The rising odds of US rate hike translated into a tic stronger USD/PLN. We are still of the opinion that the rangy nature of EUR/PLN requires at least a peek above 4.35-4.37. Consequently, we are more skewed to fade PLN spikes.

EUR/PLN vols – Tic lower EUR/PLN is moving sideways, and the vols are prone to melting. 1 month EUR/PLN ATM mid is 5.0% (0.25% lower), 3 months EUR/PLN are 6.7% (0.25% lower) and, finally, 1 year is fixing at 7.4% (0.1% lower). The currency spread (difference of USD/PLN minus EUR/PLN) is still steep in the buildup to FOMC meeting. The skew is roughly unchanged.

Short-term forecasts

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

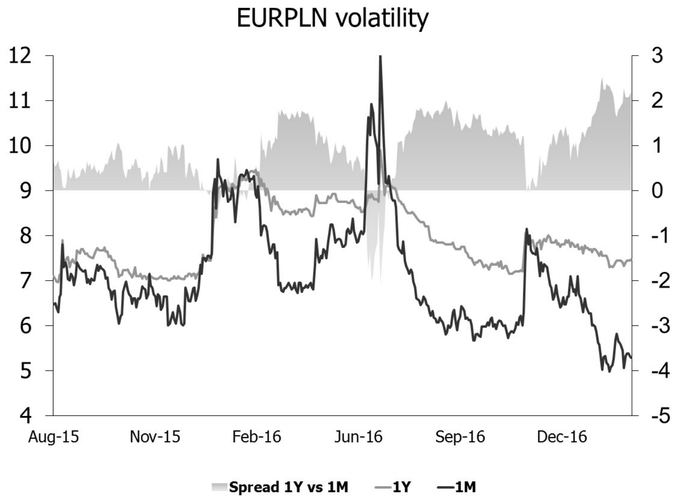
Spot Position: Long EUR/PLN.

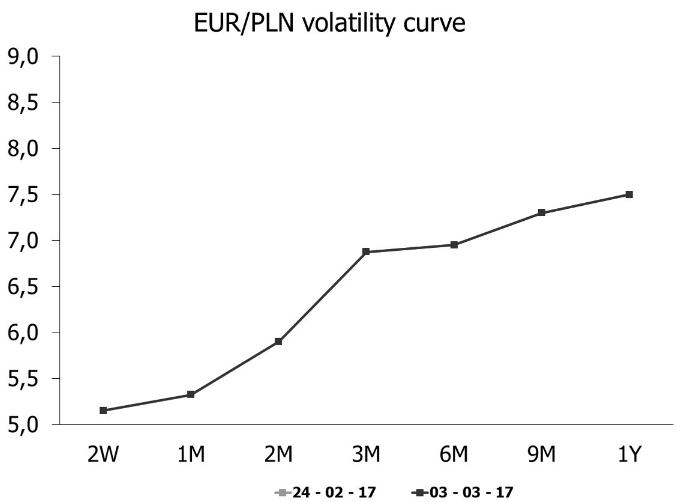
We are long EUR/PLN at 4.2930, we are ready to add at 4.2600 and we have a stop at 4.2350. We are hoping to revisit 4.35 on the way to 4.39.

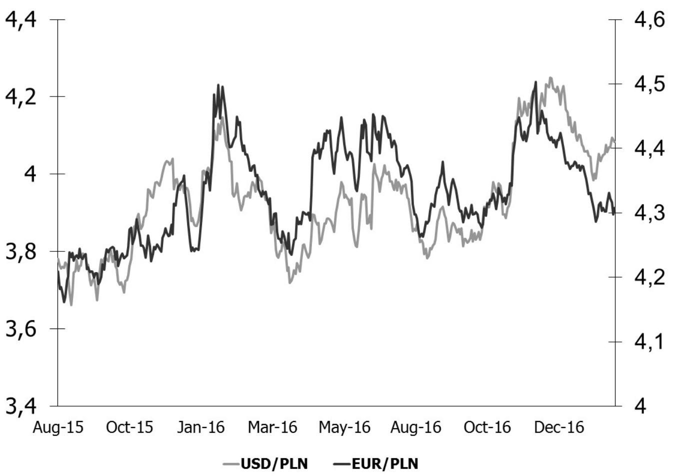
Our hopes are based on the rangy nature of EUR/PLN. Technically, 4.25-4.27 is a mighty support zone, that was not even scratched until now. The PLN seems to be over-owned and hence exposed to possible weakness. The risk on mood has prevailed for weeks already and we have FOMC, French and Dutch elections in front of us.

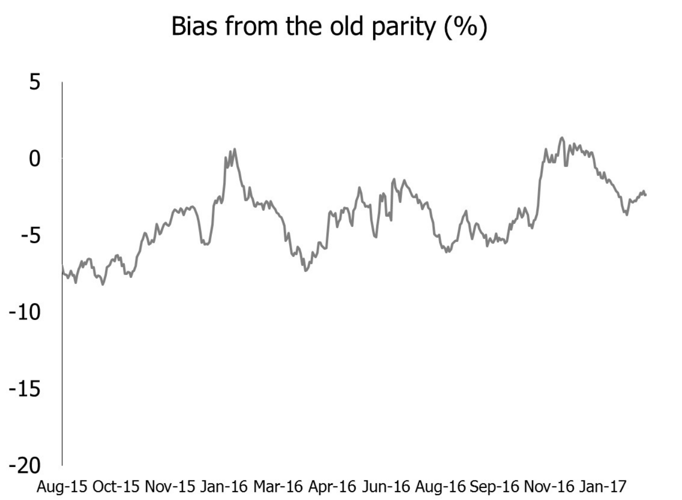
Options Vol – Long 9 month EUR/PLN vol.

We are keeping the backend long as an outright long position. We see French and Dutch elections as a good enough reason to be long vol at current levels. We are encouraged by the fact that backend vols are holding well, even with a current low realized volatility.









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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
2/24/2017	1.95	1.73	2.01	1.71	2.18	1.75	1.73	1.74	1.77	1.85	1.95	1.87
2/27/2017	1.95	1.73	2.01	1.71	2.18	1.75	1.73	1.74	1.77	1.85	1.95	1.87
2/28/2017	1.95	1.73	2.01	1.71	2.18	1.75	1.73	1.74	1.77	1.85	1.95	1.87
3/1/2017	1.95	1.73	2.01	1.71	2.18	1.75	1.73	1.74	1.77	1.85	1.95	1.87
3/2/2017	1.95	1.73	2.01	1.71	2.18	1.75	1.73	1.74	1.77	1.85	1.95	1.87

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
2/24/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
2/27/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
2/28/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
3/1/2017	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
3/2/2017	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
2/24/2017	5.33	6.88	6.95	7.50	7.50	2.04	0.50
2/27/2017	5.33	6.88	6.95	7.50	7.50	2.04	0.50
2/28/2017	5.33	6.88	6.95	7.50	7.50	2.04	0.50
3/1/2017	5.33	6.88	6.95	7.50	7.50	2.04	0.50
3/2/2017	5.33	6.88	6.95	7.50	7.50	2.04	0.50

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
2/24/2017	0.0000	0.0000	4.0411	3.6076	1.3987	0.1594
2/27/2017	0.0000	0.0000	4.0411	3.6076	1.3987	0.1594
2/28/2017	0.0000	0.0000	4.0411	3.6076	1.3987	0.1594
3/1/2017	0.0000	0.0000	4.0411	3.6076	1.3987	0.1594
3/2/2017	0.0000	0.0000	4.0411	3.6076	1.3987	0.1594

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