March 10, 2017

Polish Weekly Review

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Comment on the upcoming data and forecasts

A very busy week ahead of us. On Tuesday the CSO will publish CPI data for February. Somewhat contrary to market consensus, we expect CPI amount to 1.9% y/y. This is because of modest increases in food and fuel prices on a monthly basis, a cut in gas prices for households and downward revision to January reading (the result of a change in CPI basket weights). On Wednesday the NBP will publish official data on core inflation in January and February – we expect both to come out at 0.3% y/y. On Thursday the NBP will release balance of payments data for January. Here the huge inflow of EU (CAP) funds will foster a record-high current account surplus. This factor dwarfed the modest increase in trade surplus. Labor market data (employment and wages) should be quite stable – slight deceleration in wages is a result of working day effects (-1 vs. +2 y/y a month ago), while employment is set to post a modest gain on a monthly basis. Finally, on Friday the CSO will release industry and retail data. Industrial output likely slowed down due to the aforementioned calendar effect. Its apparent impact on retail sales is bound to be smaller, also because of favorable nominal factors (higher fuel prices on y/y basis).

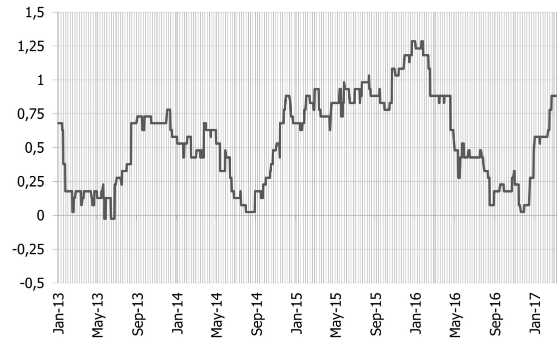
Polish data to watch: March 13th to March 17th

Publication	Date	Period	mBank	Consensus	Prior
M3 y/y (%)	14.03	Feb	8.8	8.4	8.5
CPI y/y (%)	14.03	Feb	1.9	2.1	1.8
Core CPI y/y (%)	15.03	Jan	0.3	0.3	0.0
Core CPI y/y (%)	15.03	Feb	0.3	0.4	
Current account balance (mio EUR)	16.03	Jan	2000	216	-533
Exports (mio EUR)	16.03	Jan	15200	15127	14615
Imports (mio EUR)	16.03	Jan	14900	14850	14766
Average gross wage y/y (%)	16.03	Feb	4.1	4.1	4.3
Employment y/y (%)	16.03	Feb	4.5	4.5	4.5
Sold industrial output y/y (%)	17.03	Feb	2.5	2.8	9.0
PPI y/y (%)	17.03	Feb	4.7	4.5	4.1
Retail sales y/y (%)	17.03	Feb	9.5	8.5	11.4

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 - no data. Next week offers plenty of opportunities for surprises (industry, retail sales, CPI, labor market data).

* 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

- 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

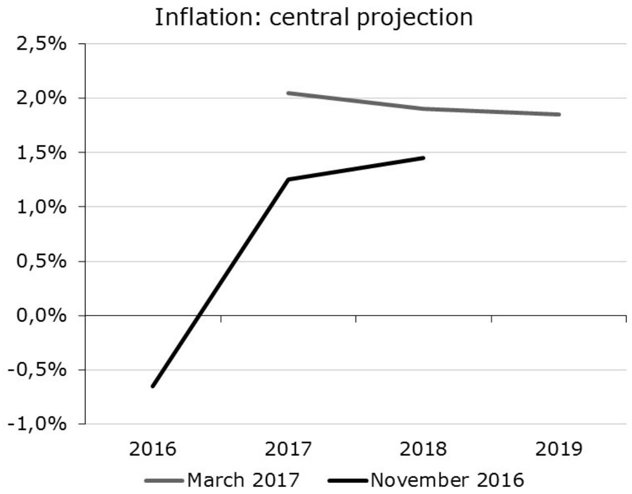
F - forecast

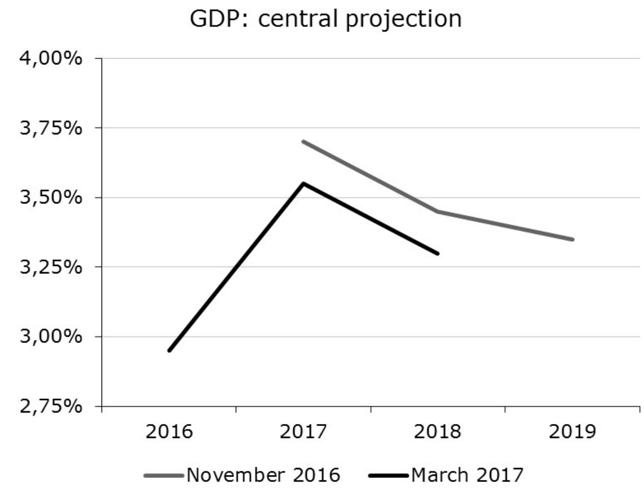
Economics

The MPC keeps rates unchanged and acknowledges the rise in inflation

Polish MPC kept rates on hold during its March meeting, as expected. The post-meeting statement, apart from the usual adjustments to recent data releases, contains one subtle change in the assessment of inflationary tendencies. The Council now assesses that „the risk of inflation running persistently above the target in the medium term is limited”. In February it was „low”, hence there was a slight upgrade.

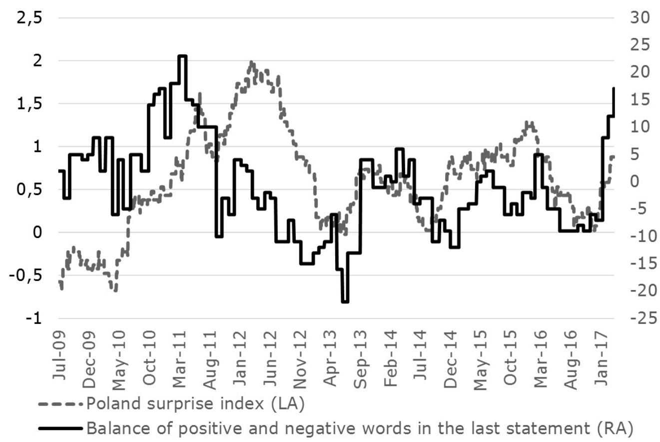
As usual in March, the statement contains the key forecasts from the newest inflation projection. The new forecasts are, just as we anticipated, higher, both in terms of inflation and GDP. Nevertheless, CPI remains below he target and is set to hit a multi-year high this year, only to decline in 2018 and 2019 (thorough readers may find it rather odd since euro zone HICP projection released a day later points to upward inflation path and it is rather straightforward that cyclical position of the EMU is worse than Poland’s). The latter year, included in the bank’s projection for the first time, is expected to see lower growth and inflation. The midpoints of the projections are presented in the graphs below.





The press conference unfolded very much like the previous one: all hawkish accents were in the statement, while the tone of the conference was decisively dovish. As we expected, governor Glapinski belittled the recent increases in inflation as exogenous, transient, driven by commodity prices and irrelevant for monetary policy. Obviously, the scenario for inflation this year has finally arrived at market consensus, as it foresees acceleration until March or April and stabilization later on. Its implications for real interest rates – current projection foresees a record-long period of negative real rates in Poland – are not troubling the Council. Certainly, the MPC is ending the unspoken rule of keeping interest rates above current CPI. While the MPC will monitor inflationary processes carefully, the probability of breaching the target remains low. Comments regarding economic growth and business sentiment were cautious – Mr Glapinski emphasized the lack of imbalances in the Polish economy and voiced skepticism regarding the upswing in developed economies.

Such dovishness stands in stark contrast to both data momentum and the language of the statement. Our analysis of wording (we are counting positive and negative words and treat their difference as a measure of the MPC’s sentiment) suggests that the MPC is most optimistic since April 2011, at which point it remained firmly in a tightening cycle. Interestingly, the recent change in rhetoric happened at the same time macroeconomic data started to surprise positively. History shows that the dissonance cannot last forever and realignment of deeds and words can happen fast. We expect that both aspects of Polish monetary policy will be realigned in early 2018 with the beginning of a tightening cycle. The balance of risks is clearly tilted towards earlier hikes.



The market believes Mr Glapinski’s words and prices in the first hike in the second quarter of 2018. Higher inflation and higher growth might manifest themselves in the back end of the curve, though. Moreover, the MPC seems completely oblivious to the subtle changes in ECB’s policies – any signal from that side would be an important driver of Polish yields. Locally, market players should pay attention to the upcoming inflation prints. Because of the well-known base effects, any acceleration of inflation in the second half of the year will be conditional on core inflation rising further. Here, strong momentum already seen in underlying inflation notwithstanding, the balance of risks is tilted towards higher inflation due to wage growth, currency depreciation and second round effects from the increases in commodity prices.

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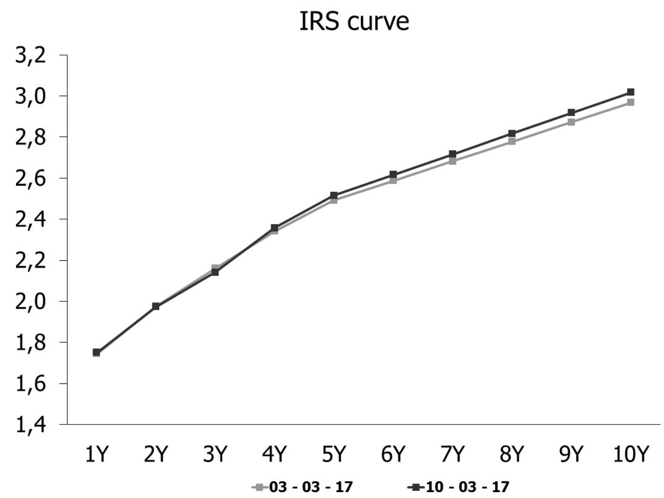
Fixed income

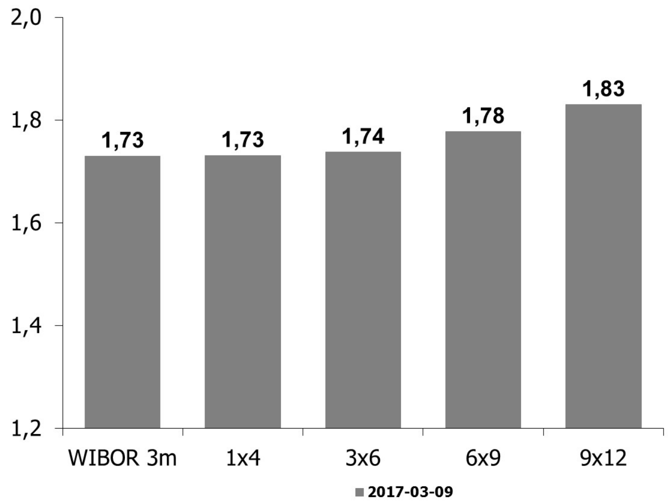
Ahead of the Fed

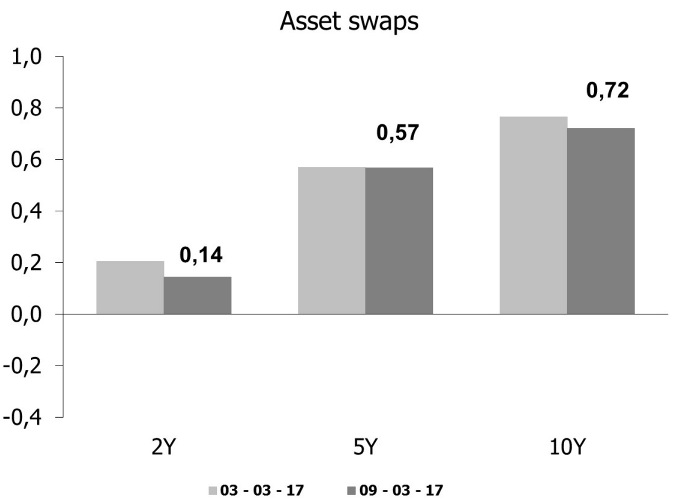
Next week we have the Fed. They must do something.

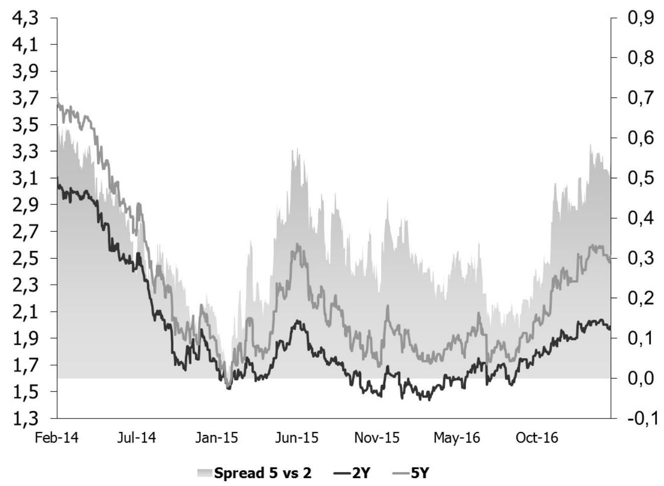
For the whole week we saw bid from internationals. BUND/DS0727 is 329bps and it narrowed 35bps from tops. For 5y IRS 2,50-2,51% was good support for last few weeks and it looks as rebound for now.

The PS0422/DS0727 narrowed from 68 to 65, ASW PS0422/5y is at 53bps (narrowed 8bps) and DS00727/10y is at 68bps (narrowed 5bps). OK0419 is trading at 2.06% (10bps down), PS0422 is trading at 3.09% (6bps up) and DS0727 is trading at 3.76% (5bps up).









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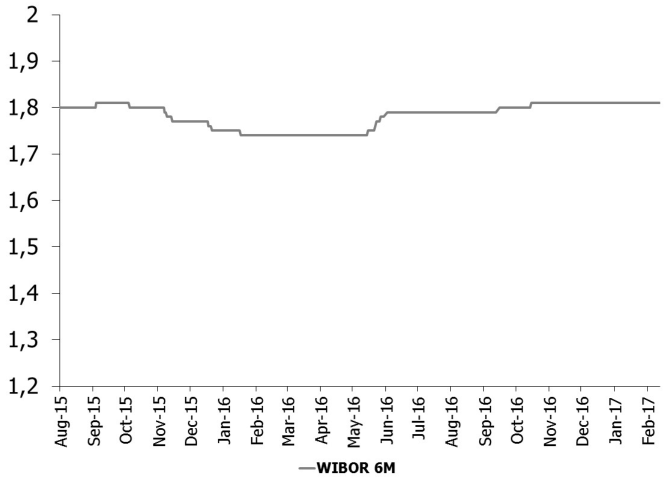
Money market

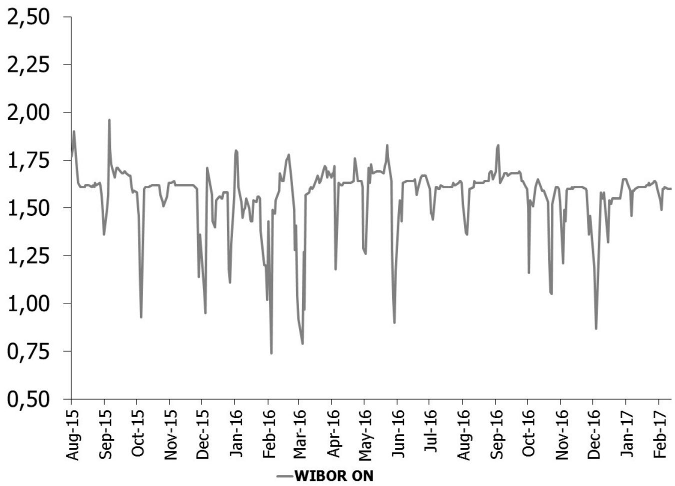
Dovish MPC

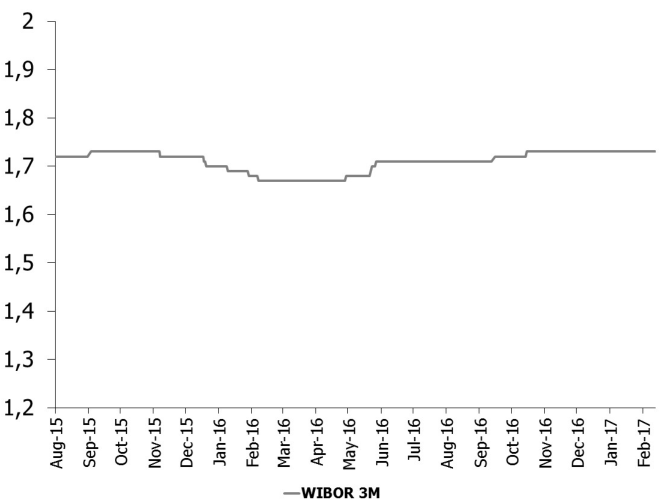
Last week, the main event was the MPC meeting. Governor Glapinski once again sounded very dovish and reiterated that there is no need to change rates for an extended period. He said that CPI will peak in Q3 and turn lower at the turn of the year. If that scenario materializes, rates could stay flat even far beyond 2017. Two year bonds benefited from such comments and yelds fell around 5 bp. Next week we have plenty of economic events: local data including CPI, retail sales, industrial output and the main event, Fed rate decision.

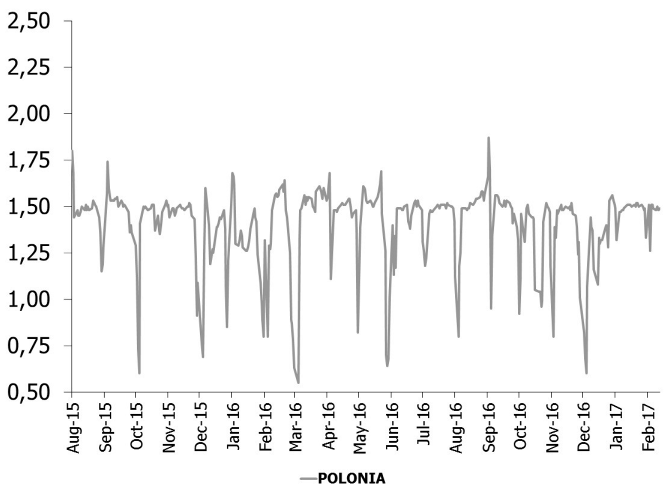
At today's OMO banks bought all bills offered by the NBP. Overnight rate might rise a bit next week.

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





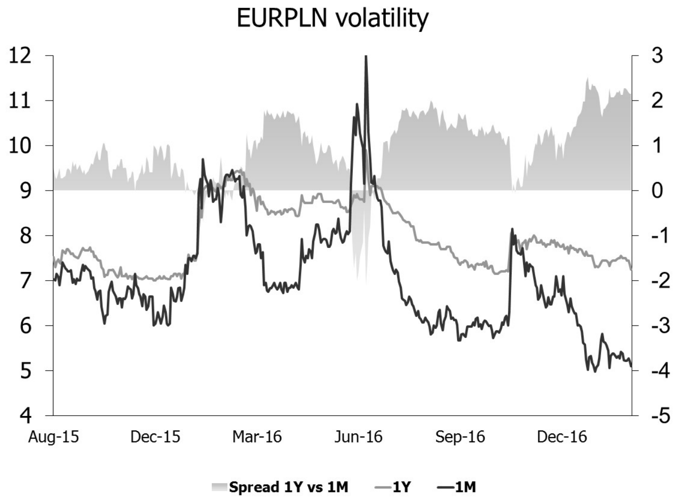




Forex

Spot – Tic weaker EUR/PLN started the week at 4.3010 (week's low) and climbed to 4.3325 (week's high). Also, USD/PLN is a little bit higher now. We are getting closer to FOMC, and after relatively hawkish/less dovish ECB. The odds are slowly tuning in favor of weaker PLN in the near term, as Dutch and French elections are also looming on the horizon. We are skewed to fade PLN spikes, and looking for some headwind for the Zloty.

EUR/PLN vols – sideways The proximity of FOMC meeting pushed the very frontend tic higher. Nevertheless, changes are cosmetic. 1 month EUR/PLN ATM mid is 5.25% (0.25% higher), 3 months EUR/PLN are 6.5% (0.2% lower) and finally 1 year is fixing at 7.4% (unchanged). The currency spread (difference between USD/PLN vol and EUR/PLN vol) is still steep in the build-up to FOMC meeting. Both EUR/PLN and USD/PLN riskies are better bid.



Short-term forecasts

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

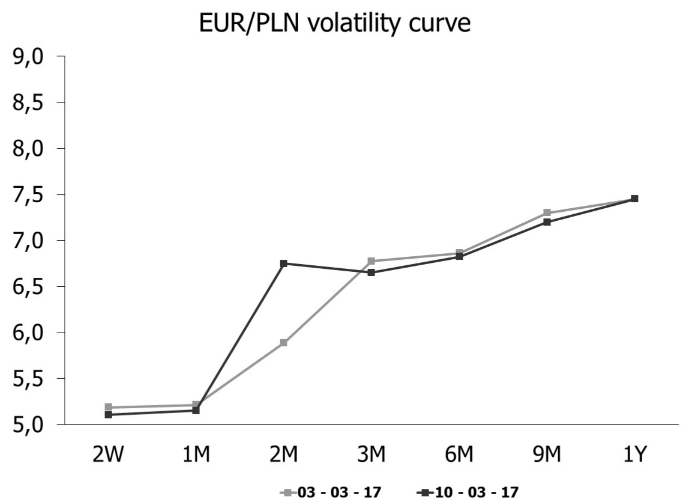
Spot Position: Long EUR/PLN.

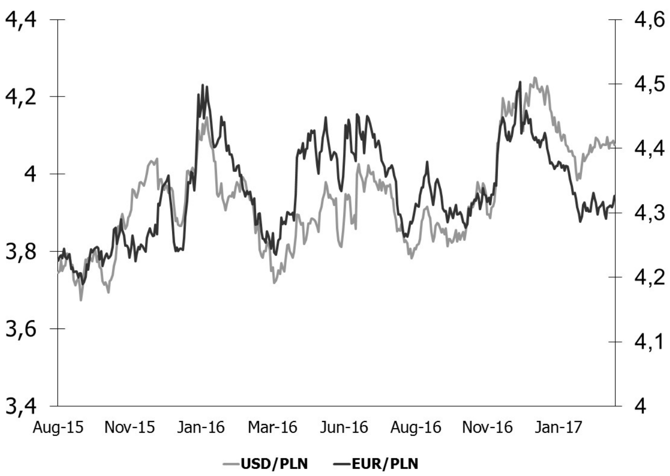
We are long EUR/PLN at 4.2930, we are ready to add at 4.2600 and we have a stop at 4.2350. We are hoping to revisit 4.35 on the way to 4.39.

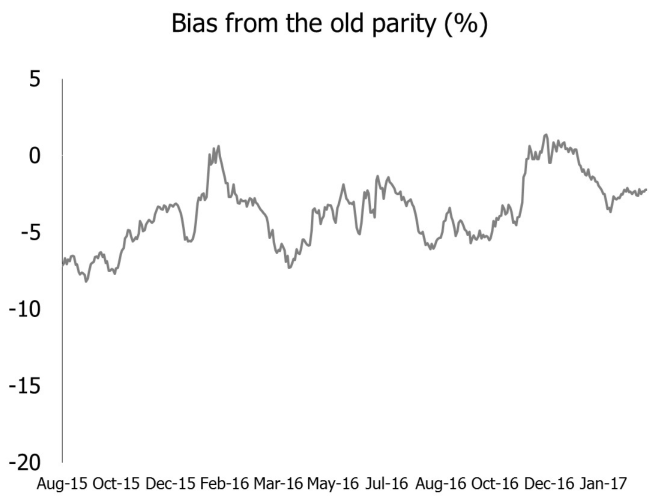
Our hopes are based on the rangy nature of EUR/PLN. Technically, 4.25-4.27 is a mighty support zone, that was not even scratched until now. The PLN seems to be over-owned and hence exposed to possible weakness. The risk on mood has prevailed for weeks already and we have FOMC, French and Dutch elections 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
3/3/2017	1.88	1.73	1.93	1.71	2.15	1.75	1.73	1.74	1.77	1.85	1.94	1.86
3/6/2017	1.89	1.73	1.94	1.71	2.15	1.75	1.73	1.74	1.77	1.84	1.94	1.86
3/7/2017	1.90	1.73	1.85	1.71	1.95	1.75	1.74	1.75	1.79	1.86	1.94	1.87
3/8/2017	1.71	1.73	1.77	1.71	1.98	1.75	1.74	1.75	1.77	1.84	1.94	1.86
3/9/2017	1.79	1.73	1.85	1.71	1.90	1.75	1.73	1.74	1.78	1.83	1.89	1.85

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
3/3/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
3/6/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
3/7/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
3/8/2017	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
3/9/2017	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
3/3/2017	5.21	6.78	6.86	7.45	7.45	2.01	0.54
3/6/2017	5.28	6.63	6.83	7.45	7.45	2.01	0.54
3/7/2017	5.20	6.50	6.70	7.35	7.35	2.08	0.57
3/8/2017	5.10	6.40	6.80	7.25	7.25	2.08	0.57
3/9/2017	5.15	6.65	6.83	7.45	7.45	2.00	0.49

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
3/3/2017	4.3078	4.0955	4.0413	3.5857	1.3901	0.1594
3/6/2017	4.3100	4.0663	4.0290	3.5762	1.3918	0.1594
3/7/2017	4.3115	4.0803	4.0210	3.5811	1.3928	0.1595
3/8/2017	4.3087	4.0818	4.0296	3.5806	1.3898	0.1594
3/9/2017	4.3146	4.0864	4.0252	3.5583	1.3894	0.1596

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