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Polish Weekly Review

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Comment on the upcoming data and forecasts

The upcoming week will be rather quiet. The only major publication is the flash CPI, to be published on Friday. We expect inflation to rise again in March, this time to ca. 2.3-2.4% (our final forecast will be prepared next week) due to base effects and higher core inflation. Quarterly revisions of balance of payments data will not move markets.

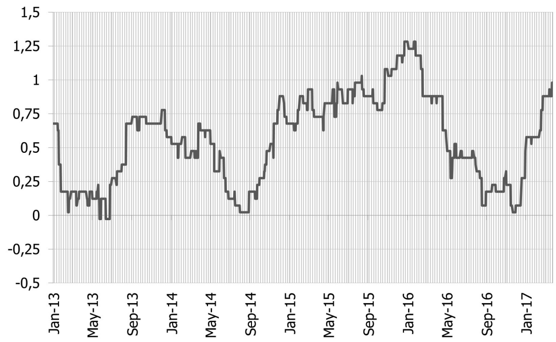
Polish data to watch: March 27th to March 31th

Publication	Date	Period	mBank	Consensus	Prior
Flash CPI y/y (%)	31.03	Mar			2.2
Current account (mio EUR)	31.03	Q4	-1252.0	-1252.0	-2177.0

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	4/6/2017	200	2.049	3/23/2017
5Y T-bond PS0422	4/6/2017	2000	2.945	3/23/2017
10Y T-bond DS0727	4/6/2017	1000	3.568	3/23/2017
30Y T-bond WS0447	-	2100	4.257	2/16/2017

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



Comment

The CSO confirmed the preliminary estimate of unemployment rate (a tad below forecasts), hence another positive surprise from the Polish economy. Flash CPI data can surprise to the upside as well next week – and this is the only potential surprise in a quite boring week.

* 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

- The economy accelerated in Q4 and at the beginning of the year, suggesting that the recovery in investment is proceeeding faster than anticipated. Because of this we have decided to raise our growth forecasts, to 3.6% in Q1 (prev. 3.1%) and 4.0% on average in 2017 (prev. 3.4%).
- Boosted by statistical base effects, weak PLN, food price hikes and commodity price spike, headline inflation probably reached 2.5% in March, hitting the NBP's target head on. While the market and the MPC is focused on base effects and flat CPI in the second half of the year, the case of accelerating core inflation is strengthening. Stellar employment performance shows no respite but wage growth remains moderate. Such equilibrium is unsustainable. If 2007 and 2008 are taken as guidance, wages are ready to take off this year as current demand for labor meets limited supply.
- MPC stays calm and waits rises in headline inflation out carrying steady message of stable rates. Such rhetoric can stay in place for some months. However, as trend in core inflation emerges as evident and labor market strengthen further, the case for rate hikes is set to strengthen as well. All we need is a small change in MPC's wording to make rate expectations wander somewhat more freely.
- Solid labor market performance and prospect for faster growing wages support PIT and VAT revenue from consumption. With much higher headline inflation already in place (deflationary 2016!), further improvements in tax income seem a safe bet for 2017 even without any stringent assumptions on the efficiency of tax collection.

Financial markets

- Zloty should stay above 4.30 in coming weeks. Bets on tighter ECB policy, steady path of rate hikes in the U.S. amid domestic (deepening) negative real interest rate are zloty negative. PLN can be boosted in the latter part of the year as this negative factor will be balanced by better GDP growth, lower fiscal risk and faster rate hikes bets.
- CHF risks are set to come back to the agenda once more within 2 weeks as joint conference of president Duda and NBP governor Glapinski is looming. However, we expect the conference to be long on words and short on actions. More precisely, rather nothing more than spread regulation and threats of using higher capital weights in SREP process.

mBank forecasts

	2013	2014	2015	2016	2017 F	2018 F
GDP y/y (%)	1.4	3.3	3.9	2.8	4.0	3.9
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 (%)	3.6	3.8	4.0	4.4	4.1	3.9	3.8	3.8
Individual consumption y/y (%)	4.3	4.2	4.2	4.0	4.0	3.8	3.8	3.8
Public Consumption y/y (%)	3.5	3.5	3.0	1.5	2.0	3.0	3.0	3.0
Investment y/y (%)	1.5	4.0	8.0	10.0	10.0	7.0	5.5	5.0
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

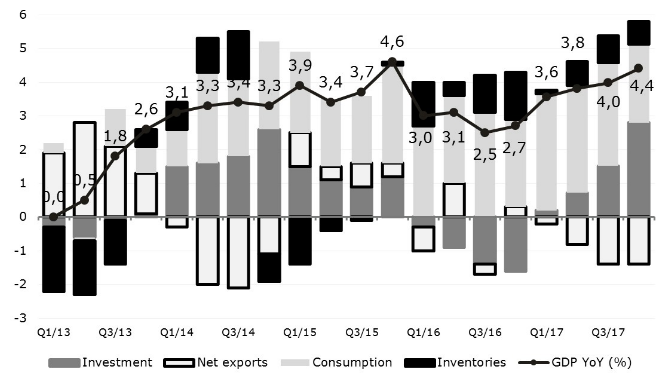
Economics

We are revising upwards our GDP growth forecast for 2017. Farewell to 3.4% and welcome to 4.0%.

2017 began with spectacular performance of manufacturing, construction and retail sales. It was quite obvious for several weeks that Q1 2017 is set to be substantially better in terms of growth rate than Q4.

Our preliminary calculations suggested something too big to be true. Therefore, we inspected them backwards and found that large shifts in GDP growth rates between quarters are nothing unusual. The analysis confirmed that shifts are visible in real-time data (i.e. as published by the Central Statistical Office for the first time) and current CSO numbers (after several revisions); the former tend to be a little bit less substantial, though. Moreover, as growth in Q4 was propelled to a large extent by inventory formation, there was risk that firms may sell more out of stock that could possibly lower the shift of growth rates between Q4 and Q1. We also checked this venue. Large shifts in GDP growth between quarters do no correlate at all with large contributions of the change of inventories. What about NBP projections, then? It is pinned still not far off 3% in Q1. It did not discourage us as well since NBP projections did not catch large, short-term shifts in GDP growth, even when prepared in the quarter in which the shift had took place. They follow the model and smooth such variations over time.

We then finally arrived at the number of 3.6% y/y in Q1. As Q1 sets the tone for the whole year (it is really hard without a large, negative shock to end up with downward sloping GDP growth path during the year that bean with substantial acceleration in Q1), we felt obliged to revise it upwards as well, to 4.0% on average. That means we are mentally prepared to see 4%-plus growth rates in the end of the year. Recently, business activity indicators turned in our way (mind that business activity indicators in major economies shot up as if they truly and finally attained the so called escape velocity central bankers have been yearning for years) corroborating the fact it is unlikely to be a temporary boost but rather a beginning of a sustainable shift upwards.



Of course, the upward path of GDP growth has also its own idiosyncratic flavor: revival of EU and state-sponsored investment activity coupled with higher private outlays. All categories of investment are helped by statistical base but we also observe some new momentum in monthly data on investment goods. Moreover, housing markets stays on the back foot with record high housing starts and permits, supported by the phase of the cycle (still low rates but high consumer confidence). In such circumstances we have no reasons to doubt the investment growth rate presented in recent NBP projections. However, we are slightly more upbeat on private consumption. We think that child benefits may have changed consumer behavior a lot and brought confidence to households (as seen also in consumer surveys). It is going to be seen in both wage bargaining (helped by shrinking labor supply and rising inflation) and spending patterns (more savings, higher likelihood of consumption smoothing, higher propensity to spend out of current income). Therefore we stand in opposition to market consensus and think that episode of lower growth of real incomes in H2 2017 is going to affect private consumption growth in negligible extent: 4% on average stays in focus for the whole 2017.

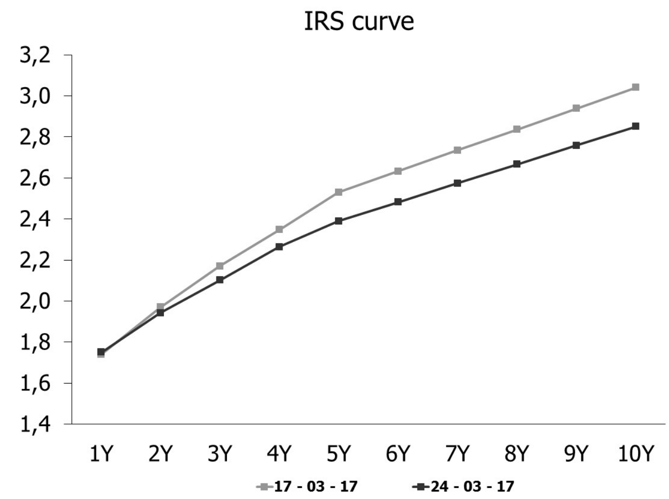
As far as consequences of this revision are concerned, we can think of at least 3 important topics. 1) Reduction of fiscal risk due to brighter prospects for tax base and revenue. 2) Positive surprise for the MPC focusing on 3-4% growth rate as warranting (so far) stable rates; if high Q1 proves to be what we think, NBP projections are set to breach 4% as well due to adjustment of starting point. In such circumstances hawkish camp may become more vocal and it would be easier to take trending core inflation not as a possibility but as a fact. Rate hike bets may be put forward. 3) Solid Q1 growth is going to release a wave of forecast revisions, including the ones applied to stock-valuation models. Rally in equities would gain even more solid footing then.

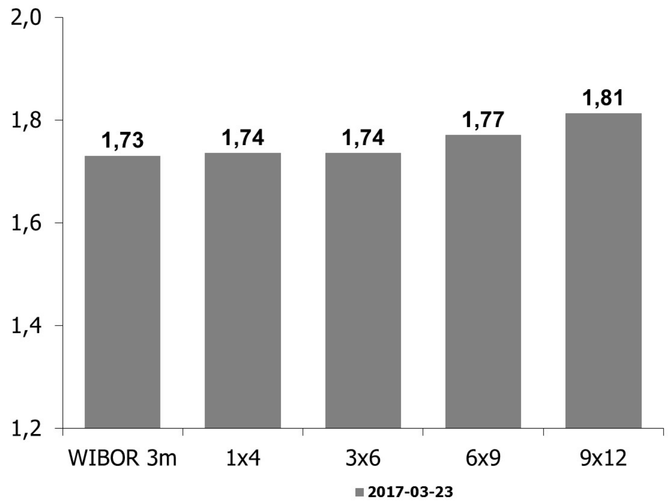
Fixed income

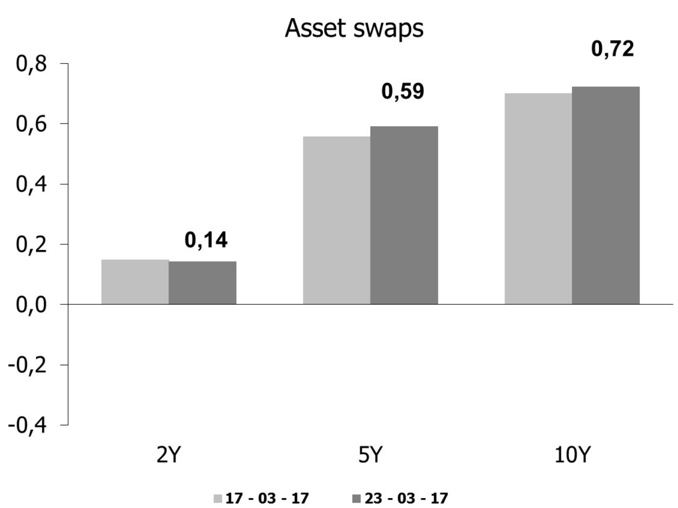
Too flat

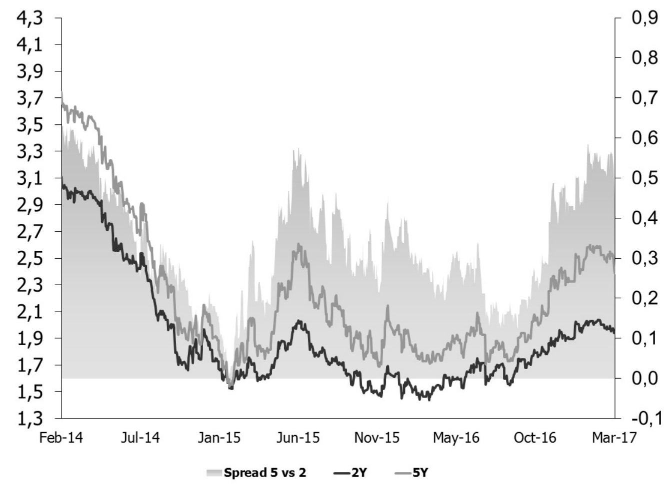
This week we had an auction. The Ministry of Finance sold 5 regular bonds: OK0419 (yield 2.04%), PS0422 (2.95%), DS0727 (3.57%), WZ1122, WZ0126. The total supply was 5 bn with good demand (8.1 bn). All short positions were covered.

The PS0422/DS0727 spread narrowed from 64 to 62, ASW PS0422/5y has frozen at 53 bps and DS0727/10y at 65 bps. OK0419 is trading at 2.05%, PS0422 at 2.95% and DS0727 at 3.55%. BUND/DS0727 has narrowed to 314 bps. The curve looks too flat as we see positive CPI and GDP figures coming soon. 5y/10y spread fell to 45 bps, level last seen in November 2016.









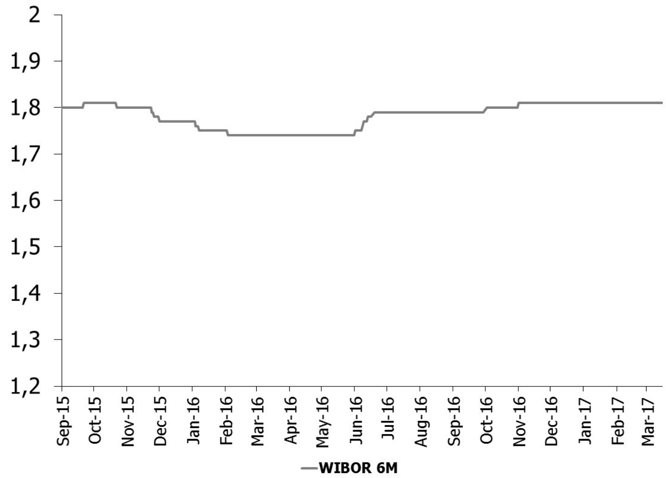
Money market

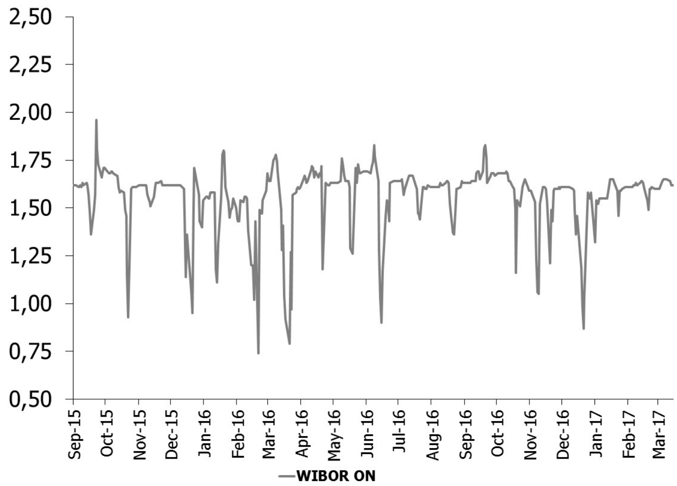
Breakthrough

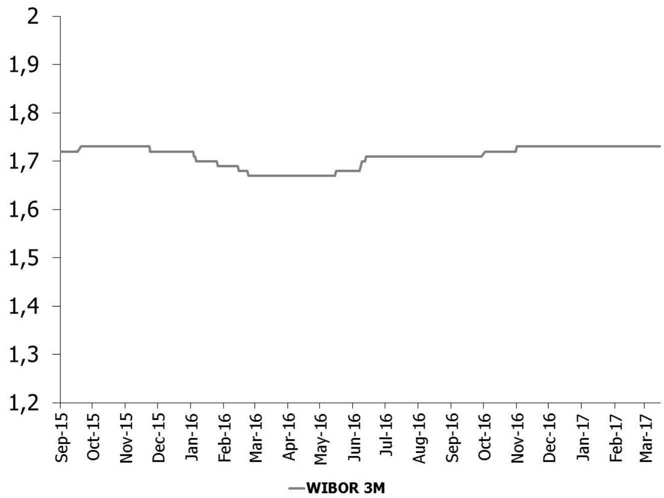
Finally, we broke out of the dull, very narrowly ranged market. Yields fall aggressively by 5 bps (2y) to 15bp (10y). It's hard to name any local factor determining the move. It looks like, after the consolidation, we continue the move lower after breaking the upward trend in rates. While bullish sentiment may continue, we see very little, if any, room on the very front end of the curve. Current levels indicate rates 100% flat through 2017 and only one rate hike in H2 2018. Therefore, if we see another leg lower in rates, the curve should flatten massively.

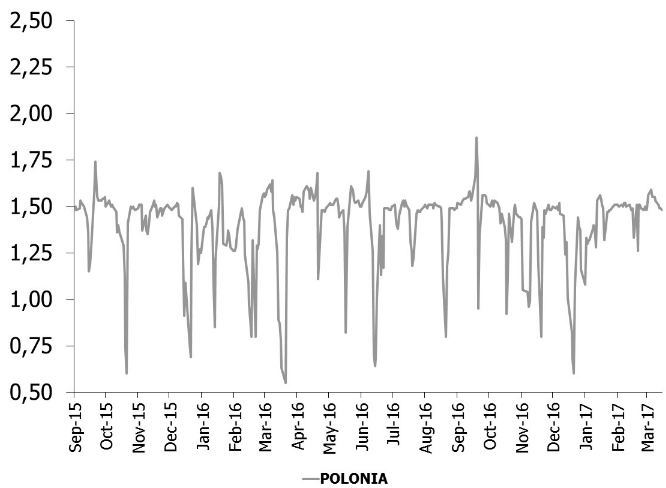
At today's OMO banks bought 73 bn out of 78 bn offered. Finally, we have the long awaited cheaper end of the reserve period.

Ref rate vs Polonia averages:
30 day 1 bp
90 day 11 bp









Forex

Spot – Still strong EUR/PLN is currently testing the 4.25-4.27 support zone. The first line of defense, 4.28-4.30, should be considered broken and EUR/PLN is feeling quite comfortable below 4.30. Zloty was also gaining against the USD, which send the USD/PLN rate to 3.94 low of the week. The Polish factor is not really in play, and we are following the global „risk on" mood. There is little on the horizon (besides possibly crowded PLN longs), to indicate the reversal of the PLN uptrend. Nevertheless, the PLN train is running from 5th of Dec 2016, and it may eventually run out of steam.

EUR/PLN vols – Vols stabilizing The realized volatility is still very low and we don't see the further deterioration in vols only because of the quickly approaching French elections. 1 month EUR/PLN ATM mid is 5.4% (0.4% lower), 3 months EUR/PLN are 6.3% (unchanged), and finally 1 year is fixing at 7.20% (0.05% lower). The currency spread (difference between USD/PLN vol and EUR/PLN vol) is bit higher in the frontend. The skew is roughly unchanged.

Short-term forecasts

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

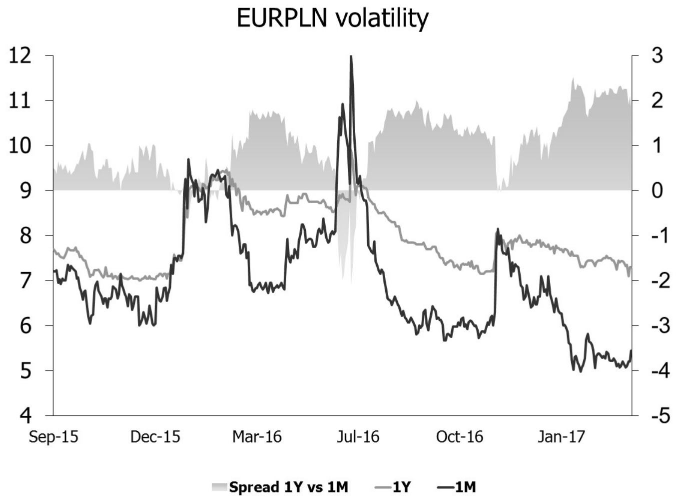
Spot Position: Long EUR/PLN.

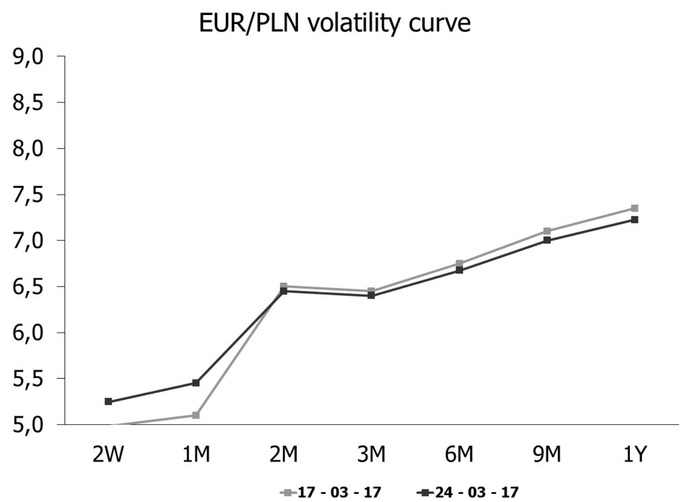
We are long EUR/PLN at 4.2930 and at 4.2600 with a stop at 4.2350. We are hoping to revisit 4.35 on the way to 4.39.

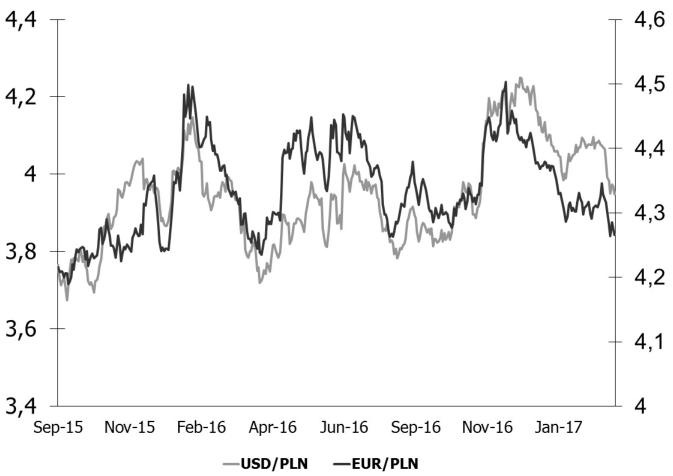
PLN is looking robust, there are reports suggesting 4.18 as a final target. The echo of the dovish FOMC and the less alarming French electoral campaign signals are supporting risk currencies. We are sticking to our strategy, still hoping for a move to the center of the EUR/PLN multi months range roughly 4.35.

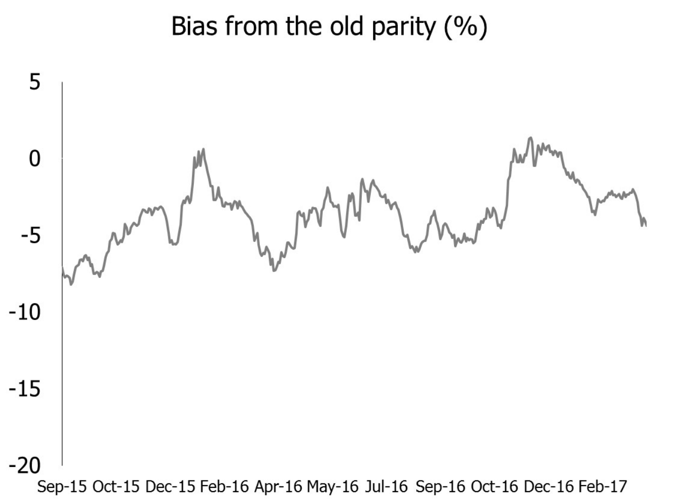
Options Vol – Long 9 month EUR/PLN vol.

We are keeping the backend long as an outright long position. We see French elections as good enough reason to be long vol at current levels. We are encouraged by the fact that the 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
3/17/2017	1.93	1.73	1.97	1.71	2.14	1.75	1.73	1.74	1.78	1.83	1.93	1.86
3/20/2017	1.73	1.73	1.73	1.71	1.73	1.75	1.73	1.75	1.78	1.84	1.93	1.86
3/21/2017	1.88	1.73	1.94	1.71	2.12	1.75	1.73	1.74	1.77	1.83	1.93	1.85
3/22/2017	1.67	1.73	1.75	1.71	1.92	1.75	1.73	1.73	1.77	1.81	1.89	1.85
3/23/2017	1.85	1.73	1.93	1.71	2.09	1.75	1.74	1.74	1.77	1.81	1.87	1.84

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
3/17/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
3/20/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
3/21/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
3/22/2017	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
3/23/2017	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
3/17/2017	5.10	6.45	6.75	7.35	7.35	1.84	0.53
3/20/2017	5.20	6.50	6.80	7.10	7.10	1.84	0.53
3/21/2017	5.20	6.45	6.75	7.30	7.30	1.79	0.50
3/22/2017	5.45	6.50	6.80	7.30	7.30	1.79	0.51
3/23/2017	5.45	6.40	6.68	7.23	7.23	1.88	0.51

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
3/17/2017	4.3013	3.9917	4.0122	3.5255	1.3897	0.1592
3/20/2017	4.2821	3.9821	3.9876	3.5292	1.3870	0.1584
3/21/2017	4.2635	3.9502	3.9670	3.5086	1.3815	0.1578
3/22/2017	4.2855	3.9731	4.0001	3.5687	1.3884	0.1585
3/23/2017	4.2750	3.9687	3.9922	3.5759	1.3837	0.1582

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