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Polish Weekly Review

mBank Research
(macro/FI/FX analysis)

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Comment on the upcoming data and forecasts

Economic releases begin this week on Wednesday with labour market data. Wage growth should accelerate slightly on calendar effect and another round of wage hikes in retail trade. Employment growth in the enterprise sector should stabilize at 4.6% y/y, which means strong monthly growth (12-16k jobs). On Thursday, the CSO will publish real sphere and retail sales data. Industrial production is set to rebound to 8.0% yearly, fueled by calendar and base effects (weak March last year). When it comes to retail sales, the effect of late Easter will be balanced by positive working days difference and low statistical base. Producer price inflation will also be influenced by statistical effects, which will overbalance weaker commodity prices (oil and copper) and stable exchange rates. Finally, Friday brings MPC Minutes, however they will not have any effect on the market. Also worth noting is the release of the results of CSO's enterprise sentiment survey (also on Friday).

Polish data to watch: April 17th to April 21th

| Publication | Date | Period | mBank | Consensus | Prior |
|---------------------------|-------|--------|-------|-----------|-------|
| Average wage y/y (%) | 19.04 | Mar | 4.6 | 4.3 | 4.0 |
| Employment y/y (%) | 19.04 | Mar | 4.6 | 4.6 | 4.6 |
| Industrial output y/y (%) | 20.04 | Mar | 8.0 | 7.2 | 1.2 |
| PPI y/y (%) | 20.04 | Mar | 4.6 | 4.7 | 4.4 |
| Retail sales y/y (%) | 20.04 | Mar | 7.5 | 8.5 | 7.3 |
| MPC Minutes | 21.04 | Apr | | | |

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 | 4/25/2017 | 900 | 1.992 | 4/6/2017 |
| 5Y T-bond PS0422 | 4/25/2017 | 1500 | 2.872 | 4/6/2017 |
| 10Y T-bond DS0727 | 4/25/2017 | 1600 | 3.439 | 4/6/2017 |
| 30Y T-bond WS0447 | - | 2100 | 4.257 | 2/16/2017 |

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



Comment

Unchanged from previous week, since final CPI release came in line with market expectations and flash release. Next week brings several opportunities to move the index with labour market and real sphere 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).

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 proceeding faster than anticipated. Because of this we have decided to raise our growth forecasts (4.0% on average in 2017). We have frontrun a new wave of forecast upgrades for Poland.
- Boosted by statistical base effects, weak PLN, food price hikes and commodity price spike, headline inflation breached 2% and will fluctuate within the target band. 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, while 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 benefitted in lower rates environment among renewed EM inflows. Although a technical correction is due from this levels, zloty-negative factors went to the background for the time being (e.g. ECB hikes). Remember that Fed hikes were recently a factor discouraging substantial strengthening but not a reason for a weaker zloty per se. With stronger GDP growth (market seems to be shifting its view towards ours) it should not change and Zloty may stay stronger.
- 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 | 2.1 | 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 | 7.2 | 6.6 |
| Repo rate (end of period %) | 2.50 | 2.00 | 1.50 | 1.50 | 1.50 | 2.25 |

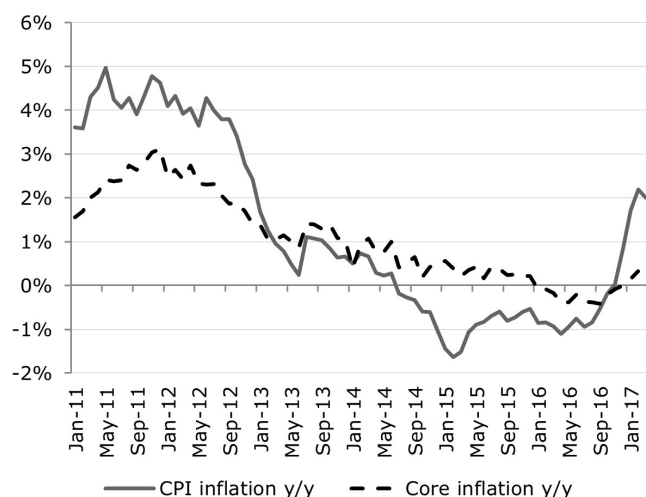
| | 2017 Q1 F | 2017 Q2 F | 2017 Q3 F | 2017 Q4 F | 2018 Q1 F | 2018 Q2 F | 2018 Q3 F | 2018 Q4 F |
|--------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| GDP y/y (%) | 3.6 | 3.8 | 4.0 | 4.4 | 4.1 | 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) | 2.0 | 2.1 | 2.3 | 2.0 | 2.1 | 2.2 | 2.3 | 2.4 |
| Unemployment rate (% eop) | 8.2 | 7.4 | 7.2 | 7.2 | 7.2 | 6.6 | 6.5 | 6.6 |
| 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) | 2.01 | 2.10 | 2.20 | 2.25 | 2.30 | 2.35 | 2.40 | 2.45 |
| 10Y Polish bond yields (% eop) | 3.49 | 3.60 | 3.70 | 3.80 | 3.90 | 4.00 | 4.10 | 4.20 |
| EUR/PLN (eop) | 4.23 | 4.25 | 4.25 | 4.20 | 4.20 | 4.20 | 4.20 | 4.20 |
| USD/PLN (eop) | 3.97 | 4.01 | 4.05 | 4.04 | 4.08 | 4.12 | 4.12 | 4.12 |

F - forecast

Economics

March inflation confirmed at 2.0% y/y with lower food prices and higher core inflation.

In March inflation dropped from 2.2 to 2.0% y/y. As we wrote in our comment to flash data, this was mainly related to the steep drop in food prices (0.5% m/m). The pan-European pattern of food price declines (seen in Polish marketplace prices) have found its way into CSO's price statistics. Fuel prices decreased by 1.3% m/m – no surprises here, either.



Core inflation likely increased from 0.3 to 0.6% y/y, matching the months-old trend. Most core categories either remained stable, or slightly increased in price.

In the coming months food prices might continue to retrace their earlier increases, which will be conducive for stable (around 2.0%) inflation. One must add, however, that fuel and food prices are volatile enough to cause surprises and deviations from the upward CPI trend in both directions. Core inflation is set to continue to accelerate as real sphere factors (labor market, growth) will have an increasing influence over prices.

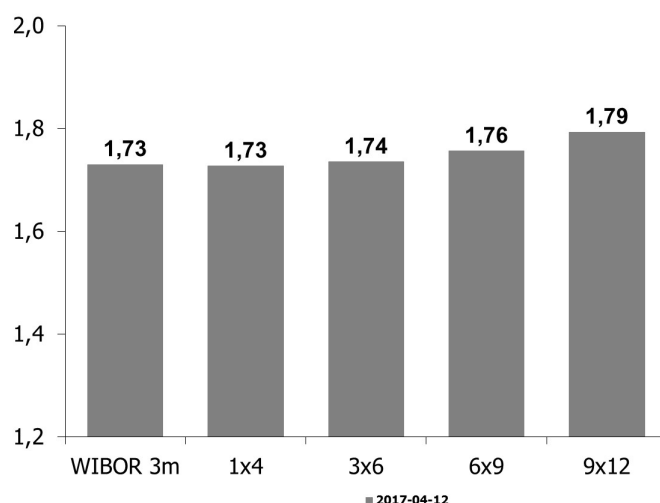
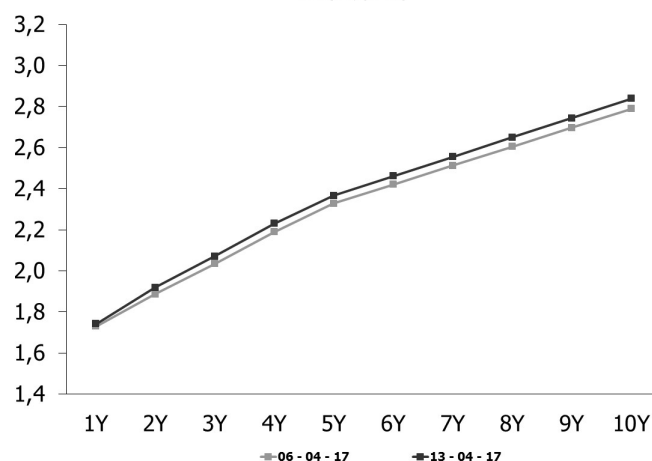
Right now markets are pricing in the first hike around November 2018. This is hardly conservative given EM standards and assumes perfect foresight and high tolerance for negative real rates on the MPC's part. In our view, it is more likely that Poland will not be an exception and that investors start demand higher term premium along the entire yield curve.

Fixed income

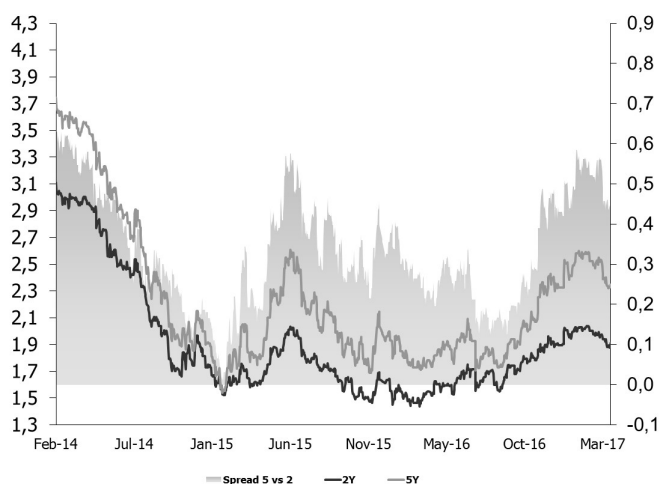
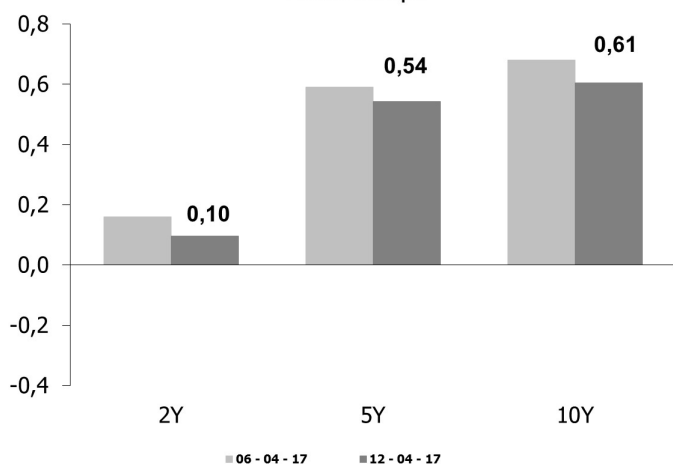
Bonds supported by risk off moods

Tensions are rising all around the world. French elections are coming closer. Core markets are in a risk off mode, yields on the Bund are getting lower and lower. So far, our bonds have followed this trend. BUND/DS0727 is stable, 322 bps, and it hasn't changed since last week. The PS0422/DS0727 spread narrowed from 56 to 52 bps (the lowest we have ever seen on these bonds), ASW PS0422/5y is at 52bps and DS00727/10y is at 59 bps. OK0419 is trading at 1.97% (2bps lower), PS0422 is trading at 2.84% (4 bps lower) and DS0727 is trading at 3.36% (8 bps lower). In our view the rally is about to end soon.

IRS curve



Asset swaps



Money market

Following the global story

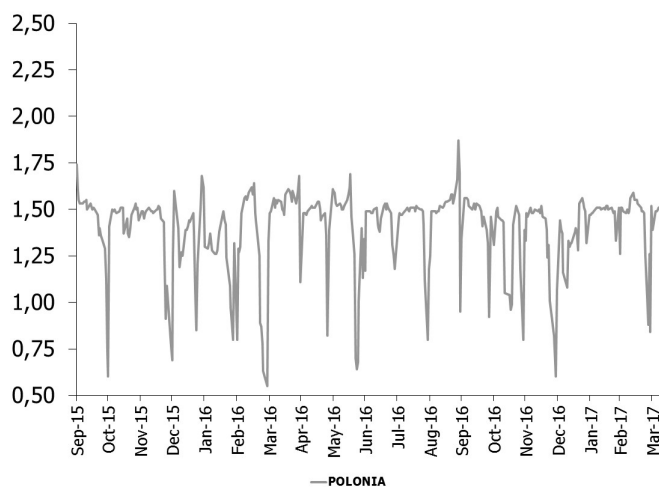
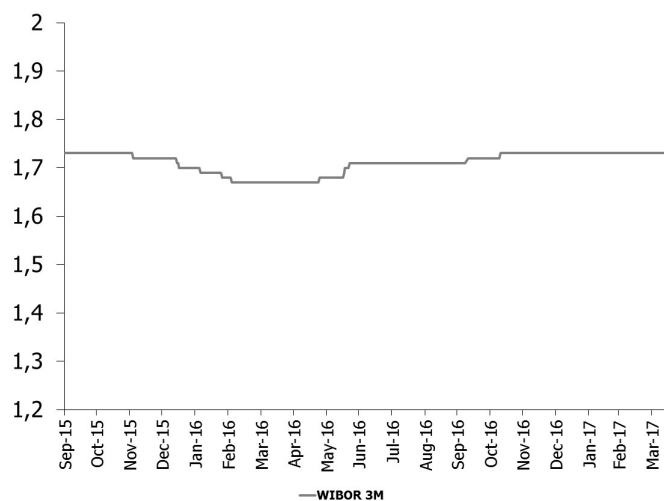
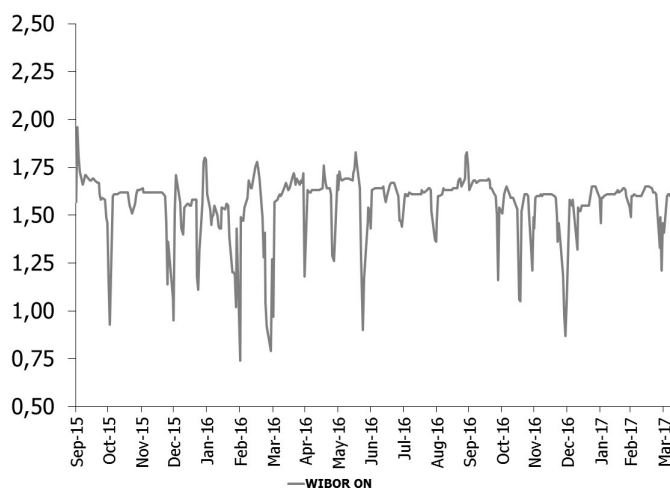
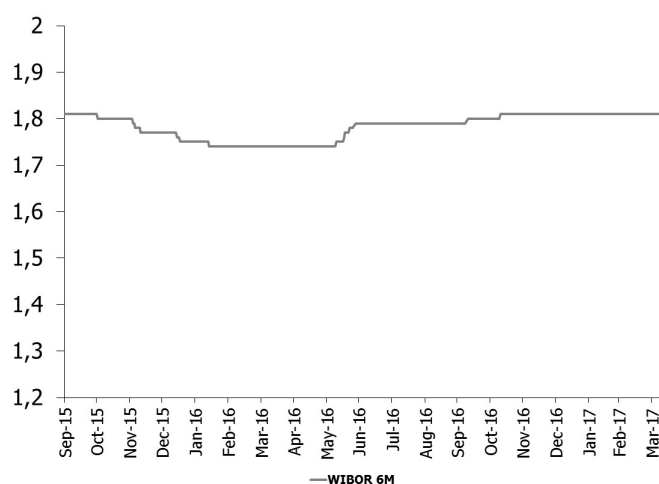
With a lack of local story and stable perspectives for Polish yields we are following global movements. Core markets are rallying and so are we. Curve is flattening with 2y touching 1.91%. It's really hard to play downside on shortest swaps as hardly any rate hikes are priced in...

Tomorrow is a regular OMO and we don't expect any significant change in ON rates during the next, shortened week.

Ref rate vs Polonia averages:

30 day 5 bp

90 day 6 bp



Forex

Spot – PLN: boxed in the tight range For another week in a row, EUR/PLN is meandering inside the 4.21-4.26 range. We have climbed from 4.2225 (week's low) to 4.2520 (week's high) before we dropped back to the middle of the range. Momentum is simply not there. The French election is a clear risk event on the horizon and hopefully it will add some volatility. Even though it is not really clear if one should sell or buy EUR/PLN in the case of a Le Pen victory, we expect slow, trendless price action to continue.

EUR/PLN vols – Front end vols tic higher The bid for Gamma with expiries post first and second election rounds has dragged the frontend vol higher again. As a result, 1 month EUR/PLN ATM MID climbed to 7.1% (0.3% higher), 3 month EUR/PLN is at 6.6% (unchanged), and finally, 1 year is fixing at 7.25% (0.1% higher). The currency spread (difference between USD/PLN and EUR/PLN) keeps on climbing in the frontend, reaching a fresh high at 6.25%! The biggest reported trade was 1 month USD/PLN traded at 13.75 and 13.55. The skew is roughly unchanged.

Short-term forecasts

Main supports / resistances:

EUR/PLN: 4.18 / 4.28

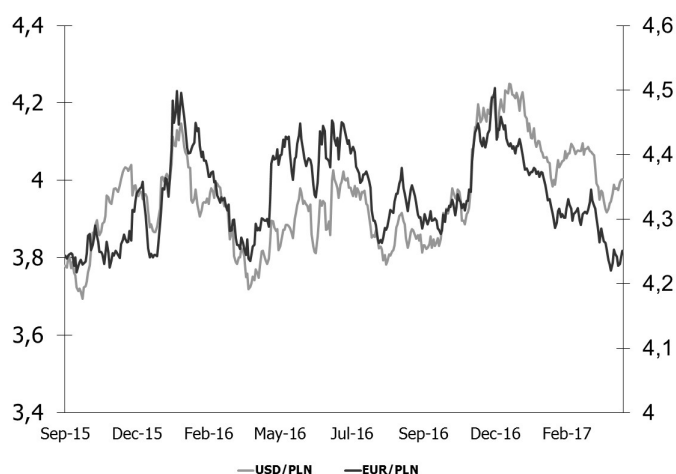
USD/PLN: 3.85 / 4.05

Spot Position: None.

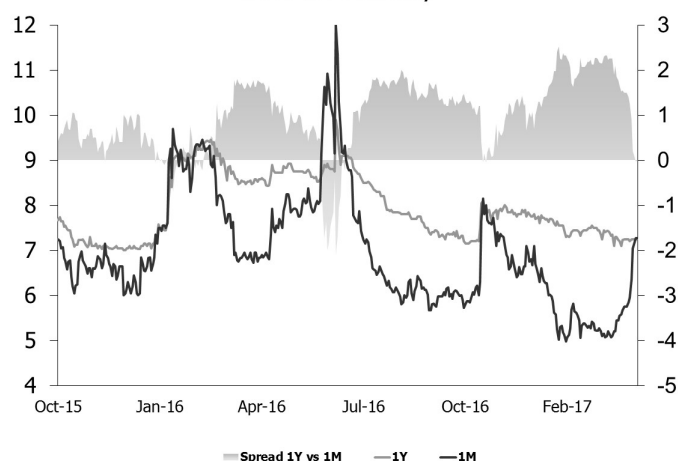
EUR/PLN is still consolidating/trading water in a relatively tight 4.21-4.46 range. There is no "market story" to follow, we are just mimicking the risk/EUR/USD moves. We still think that in the bigger picture the PLN strength might be just a little bit stretched. Anyway, the market is lacking the spark to question current status quo. Sidelined again.

Options Vol – Long 9 month EUR/PLN vol.

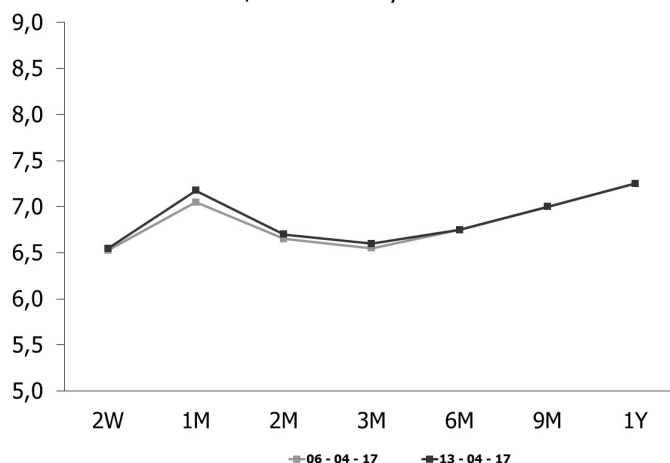
We are keeping the backend long as an outright long position. We see French elections as a good enough reason to be long vol at current levels. We are encouraged by the fact that the backend vols are holding well even with currently low realized volatility.



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 |
| 4/6/2017 | 1.63 | 1.73 | 1.78 | 1.71 | 1.81 | 1.75 | 1.73 | 1.75 | 1.77 | 1.80 | 1.85 | 1.84 |
| 4/9/2017 | 1.83 | 1.73 | 1.94 | 1.71 | 2.09 | 1.75 | 1.73 | 1.73 | 1.75 | 1.79 | 1.86 | 1.83 |
| 4/10/2017 | 1.81 | 1.73 | 1.90 | 1.71 | 2.04 | 1.75 | 1.73 | 1.74 | 1.76 | 1.80 | 1.87 | 1.84 |
| 4/11/2017 | 1.69 | 1.73 | 1.78 | 1.71 | 1.93 | 1.75 | 1.73 | 1.74 | 1.76 | 1.80 | 1.86 | 1.84 |
| 4/12/2017 | 1.83 | 1.73 | 1.93 | 1.71 | 2.09 | 1.75 | 1.73 | 1.74 | 1.76 | 1.79 | 1.86 | 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 | 4/6/2017 | 4/25/2019 | 96.06 | 1.99 | 900 | 2288 | 918 |
| PS0422 | 4/6/2017 | 4/25/2022 | 97.11 | 2.87 | 1500 | 2255 | 1437 |
| DS0727 | 4/6/2017 | 7/25/2027 | 91.95 | 3.44 | 1600 | 2552 | 1693 |

| Fixed income market rates (closing mid-market levels) | | | | | | | | |
|---|----------|-----------|--------|--------|--------|--------|---------|--------|
| Date | 1Y WIBOR | 1Y T-bill | 2Y IRS | OK0715 | 5Y IRS | PS0718 | 10Y IRS | DS1023 |
| 4/6/2017 | 1.750 | 1.474 | 1.635 | 1.578 | 1.960 | 2.232 | 2.405 | 2.949 |
| 4/9/2017 | 1.750 | 1.474 | 1.635 | 1.578 | 1.960 | 2.232 | 2.405 | 2.949 |
| 4/10/2017 | 1.750 | 1.474 | 1.635 | 1.578 | 1.960 | 2.232 | 2.405 | 2.949 |
| 4/11/2017 | 1.750 | 1.474 | 1.635 | 1.638 | 1.990 | 2.290 | 2.447 | 2.985 |
| 4/12/2017 | 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 | |
| 4/6/2017 | 7.05 | 6.55 | 6.75 | 7.25 | 7.25 | 1.79 | 0.51 | |
| 4/9/2017 | 7.18 | 6.55 | 6.75 | 7.25 | 7.25 | 1.79 | 0.51 | |
| 4/10/2017 | 7.18 | 6.60 | 6.75 | 7.25 | 7.25 | 1.77 | 0.53 | |
| 4/11/2017 | 7.18 | 6.60 | 6.75 | 7.25 | 7.25 | 1.77 | 0.53 | |
| 4/12/2017 | 7.18 | 6.60 | 6.75 | 7.25 | 7.25 | 1.82 | 0.60 | |

| PLN Spot performance | | | | | | |
|----------------------|--------|--------|--------|--------|--------|--------|
| Date | EURPLN | USDPLN | CHFPLN | JPYPLN | HUFPLN | CZKPLN |
| 4/6/2017 | 4.2412 | 3.9792 | 3.9575 | 3.5941 | 1.3666 | 0.1569 |
| 4/9/2017 | 4.2273 | 3.9755 | 3.9519 | 3.5931 | 1.3625 | 0.1586 |
| 4/10/2017 | 4.2301 | 3.9956 | 3.9591 | 3.5899 | 1.3620 | 0.1594 |
| 4/11/2017 | 4.2415 | 4.0009 | 3.9720 | 3.6158 | 1.3616 | 0.1588 |
| 4/12/2017 | 4.2505 | 4.0026 | 3.9774 | 3.6491 | 1.3644 | 0.1593 |

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