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Polish Weekly Review

mBank Research
(macro/FI/FX analysis)

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Table of contents

Comment on the upcoming data and forecasts

Next Friday, the CSO will release final CPI data for April. The flash release (2.0%) has come out in line with market consensus, but above our original forecast of 1.9% y/y. It is highly unlikely for the CSO to revise the flash reading, therefore the breakdown of inflation will be interesting – we continue to bet on low food prices and an upward surprise in core inflation. At the same time, the NBP will publish the M3 data for April. We expect a slight acceleration as last year's odd pattern in corporate deposits is set to repeat itself this year as well and stabilize the annual growth rate.

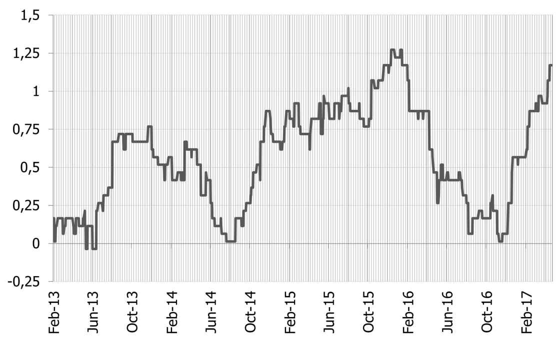
Polish data to watch: May 8th to May 12th

Publication	Date	Period	mBank	Consensus	Prior
CPI y/y (%) *final*	12.05	Apr	2.0	2.0	2.0
M3 y/y (%)	12.05	Apr	7.3	7.1	7.7

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	5/18/2017	1400	1.976	4/25/2017
5Y T-bond PS0422	5/18/2017	2300	2.862	4/25/2017
10Y T-bond DS0727	5/18/2017	2100	3.425	4/25/2017
30Y T-bond WS0447	-	2100	4.257	2/16/2017

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



Comment

Polish surprise index remained unchanged as both flash CPI and Manufacturing PMI came broadly within market consensus. Upcoming days offer only one slim chance for a surprise - final CPI data next Friday.

* 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 (4.0%+ on average in 2017). We have frontrunned a new wave of forecast upgrades for Poland. Recent data suggest even stronger growth this year.
- 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 come back to the agenda. Not only the bill concerning spreads is expected to be voted until summer holidays but also additional measures concerning the easing of CHF burden imposed on some borrowers are being discussed. All in all, things may speed up a bit from this point putting some pressure on the zloty.

mBank forecasts

	2013	2014	2015	2016	2017 F	2018 F
GDP y/y (%)	1.4	3.3	3.8	2.7	4.2	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

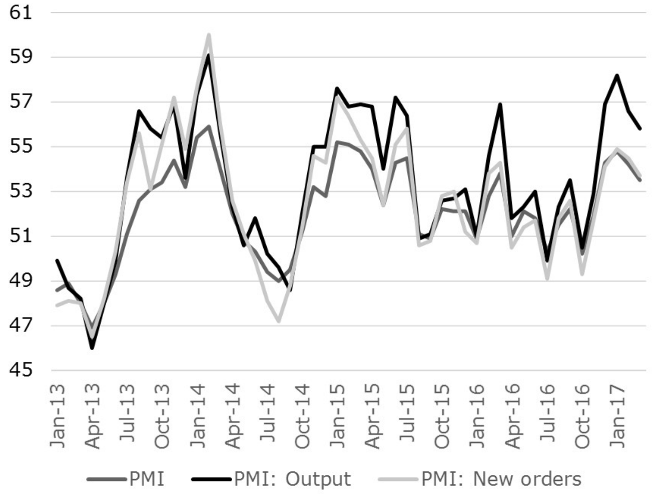
	2017 Q1 F	2017 Q2 F	2017 Q3 F	2017 Q4 F	2018 Q1 F	2018 Q2 F	2018 Q3 F	2018 Q4 F
GDP y/y (%)	4.2	4.2	4.2	4.2	4.1	3.9	3.8	3.8
Individual consumption y/y (%)	4.8	4.5	4.2	4.0	4.0	3.8	3.8	3.8
Public Consumption y/y (%)	3.5	3.5	3.5	3.5	2.0	3.0	3.0	3.0
Investment y/y (%)	3.5	6.0	8.0	12.0	10.0	7.0	5.5	5.0
Inflation 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	4.22	4.20	4.20	4.20	4.20	4.20
USD/PLN (eop)	3.97	4.01	4.02	4.04	4.08	4.12	4.12	4.12

F - forecast

Economics

PMI resumes its uptrend. We are tweaking our GDP forecasts for 2017.

In April, Poland Manufacturing PMI rose from 53.5 to 54.1, broadly in line with market consensus (53.9). The improvement in industrial sentiment was driven by better assessment of new orders (up from 53.7 to 54.5) and employment (rose to 4-month high). Interestingly, output subindex declined further from 55.8 to 54.2 – lowest level since last November). It is a rare occurrence (usually output and new orders move hand in hand) – in the entire 19-year history of Poland PMI this only happened 19 times (including the last one) and it does not appear to have any predictive properties for next few months. Because of this we can only speculate that this is a correction after the major surge in production at the turn of the year. Since production growth outpaced demand / orders, inventories accumulated (as seen in national accounts data for Q4). In the next few months, as inventories normalize relative to sales, the subcomponents of the PMI should behave in a more normal way.



In general, the PMI's details are consistent with our overall macroeconomic scenario for 2017, in terms of both inflation and growth. Apart from solid momentum in the economy, they confirm that the upswing on the labor market shows no signs of stopping (by the way, the recent declines in PMI Employment subindex have not been confirmed by GUS and NBP's enterprise surveys).

An interesting supply constraint seems to be related to the behavior of suppliers who are struggling to meet demand from final goods producers. Such bottlenecks tend to be temporary, though and should be alleviated either by increases in suppliers' capacity (investment and hiring, therefore increasing GDP), or through higher prices (suppliers' margins – a boost to inflation), or a combination of both. It is not a fundamental constraint on economic activity, but might lead to interesting transitional dynamics.

In Q4'16 inventory change posted one of the biggest positive contributions to GDP growth in Polish history (fifth biggest since 2003, to be exact) and if history and our PMI-derived hypothesis on output-inventory behavior at the turn of the year are of any use, then we should see a marked correction in inventory contribution. As enterprises unload their inventory overhand, the contribution should drift to zero in mid-year and turn negative in Q4'17. At the same time, the paths for private consumption and investment are bound to remain slightly downward- and decisively upward-sloping, respectively. Taken altogether, the GDP path for this year appears to be flat, with 4.2% growth on average (previously: 4.0%). This is somewhat unusual, but not impossible, and we will update this forecast after Q1 GDP (flash on May 15th, details on May 31st).

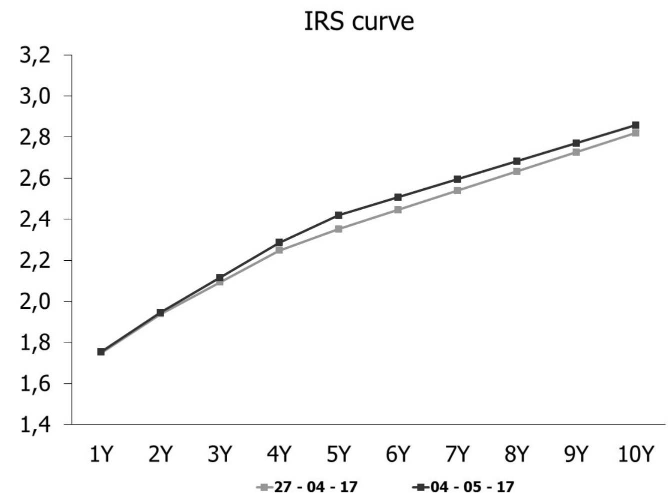
As far as inflation is concerned, the PMI gauge of input prices has decelerated somewhat, while output prices decelerated marginally. Does this herald an end of inflationary impulse on the producers' side? Not necessarily. As the latest NBP enterprise survey shows, there have been major changes in relative roles of various inflation drivers. While commodity prices remained on top, exchange rate is no longer an issue after a few months of appreciation. The latter was overtaken by labor costs and this issue isn't going away anytime soon, as we have reminded our Readers on multiple occasions. Therefore, we are still comfortable with our above-consensus forecasts of core inflation this year.

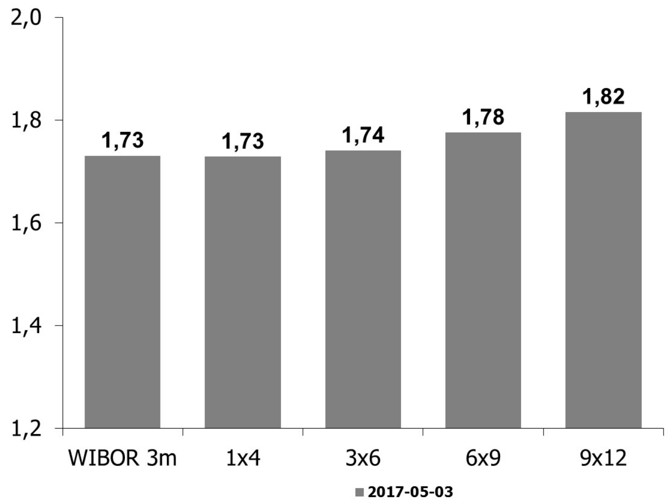
Fixed income

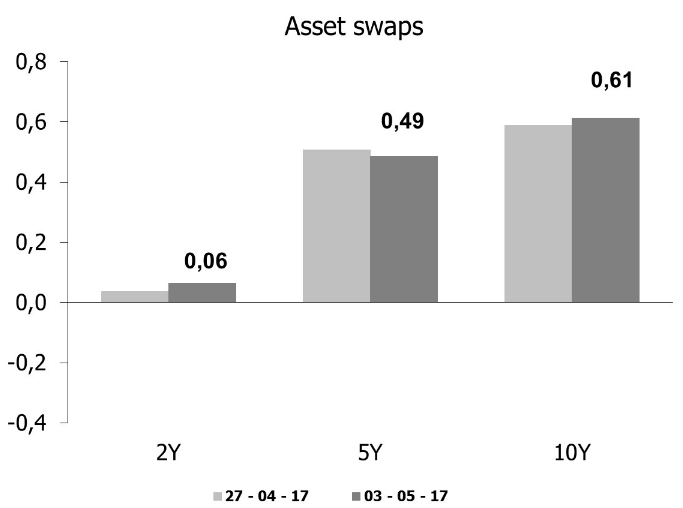
Boring week. Minor drift up in yields continues.

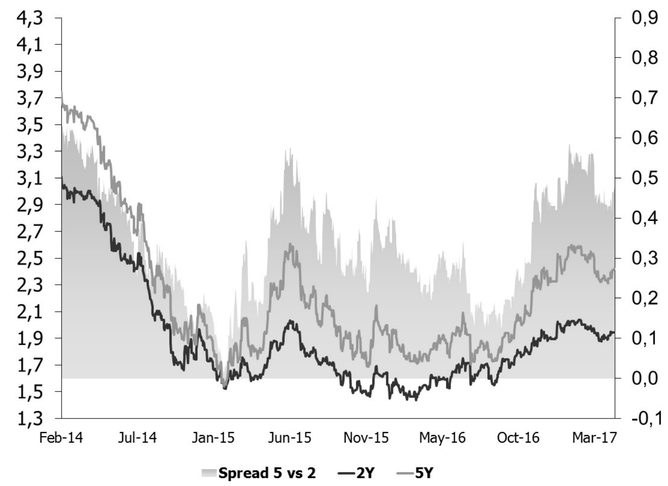
As we had two additional days off, it wasn't an exciting week. The Fed is behind us and a hike in June is certain. French election and Korea still generate some risk for Polish market. Yields are very low, curve is very flat, Bund/DS0727 spread is 310 bps. It is unlikely it will last forever.

The PS0422/DS0727 widened from 55 to 56, ASW PS0422/5y is at 49 bps and DS0727/10y is at 60 bps (both widened by 2 bps). OK0419 is trading at 2.01% (3 bps up), PS0422 is trading at 2.91% (6 bps up) and DS0727 is trading at 3.49% (7 bps up).









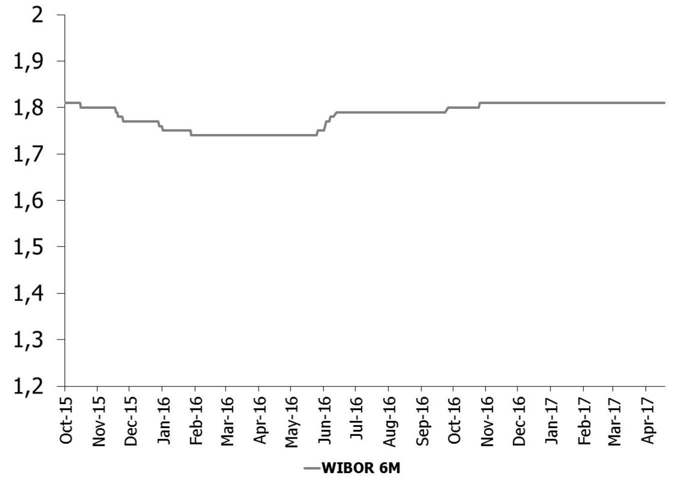
Money market

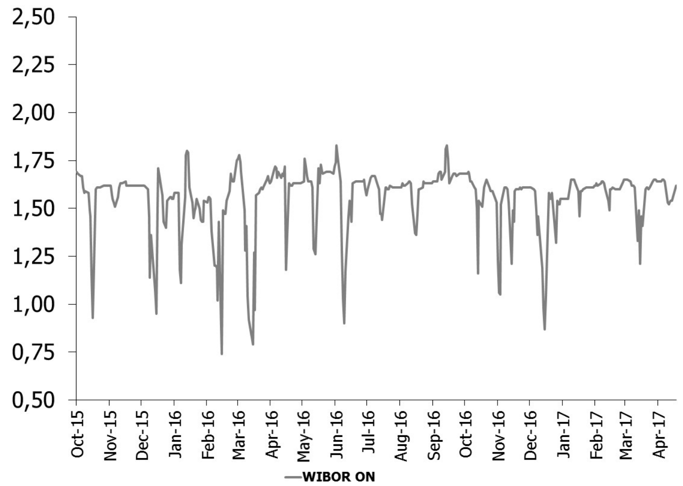
Front end rates at biggest risk if MPC moves

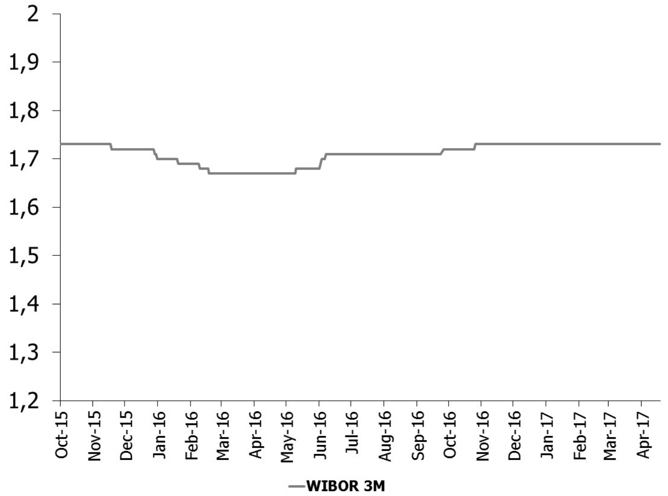
Recent good macroeconomic data combined with fourth month of negative real yields ask for at least some hawkishness from MPC, but they are adamant and don't see any need for rate adjustment. Given that we think that front end rates are at biggest risk for any surprise if MPC tone changes.

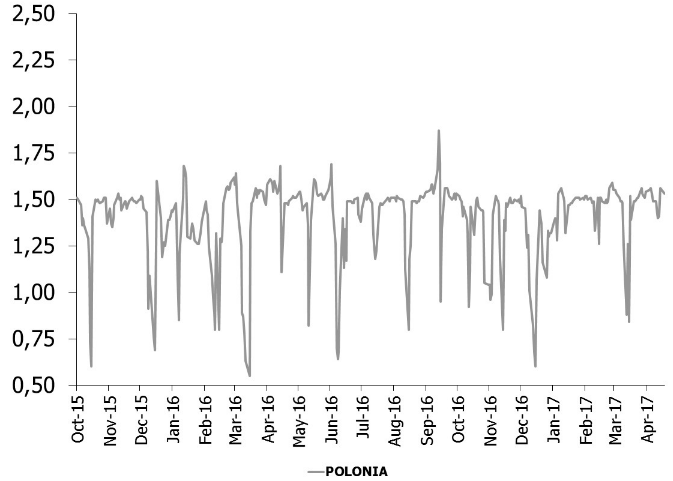
Our financing condition gauge (polonia vs ref rate) reached negative territory for the first time in months. We will monitor this closely. In the meantime please adjust your OIS calculators.

Ref rate vs Polonia averages:
30 day -1 bp
90 day 2 bp









Forex

Spot – PLN strong, but still within the range EUR/PLN was testing the lower band of the current range, getting as low as 4.1875 before reverting to the well-known 4.20-4.25. The low was printed during Polish holiday on May 3rd, so poor liquidity could have been a factor. USD/PLN is also a tic lower, trading in the 3.83-3.87 range. The market now waits for results of second round of elections in France. The final Le Pen defeat is maybe still worth a few figures lower in EUR/PLN. But we are not chasing that. We are rather skewed to fade spikes in PLN, as we assume that current levels are not a good entry point for longs in the Zloty.

EUR/PLN vols – consolidating The realized volatility is still pretty low. 1 month EUR/PLN ATM MID dropped to 5.8% (0.1% lower), 3 months EUR/PLN are 5.95% (0.05% higher) and, finally, 1 year is fixing at 6.9% (unchanged). The currency spread (the difference of USD/PLN minus EUR/PLN) is still better offered, not only in the short term as the market was axed to sell 6 month USD/PLN at 10%. The skew is a tic better offered.

Short-term forecasts

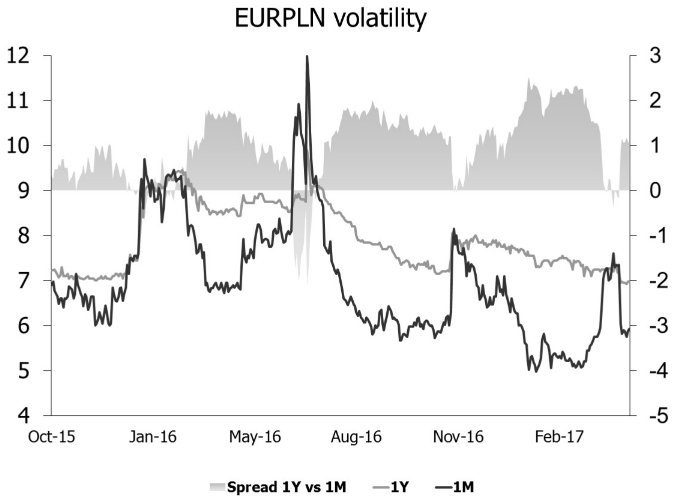
Main supports / resistances:
EUR/PLN: 4.18 / 4.28
USD/PLN: 3.70 / 4.00

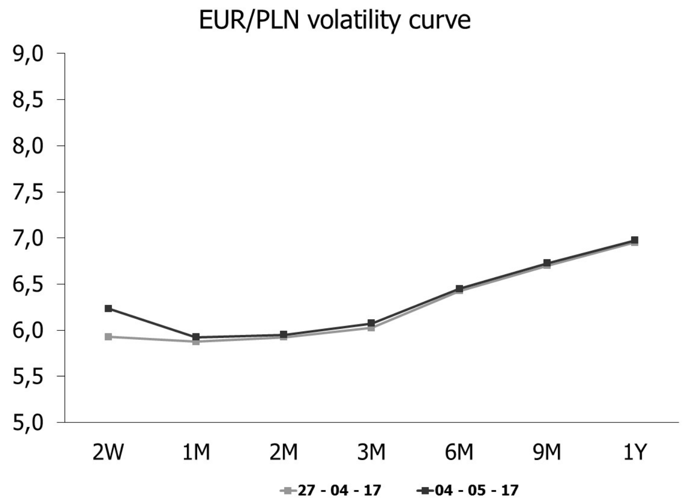
Spot Current position: Long EUR/PLN at 4.2250.

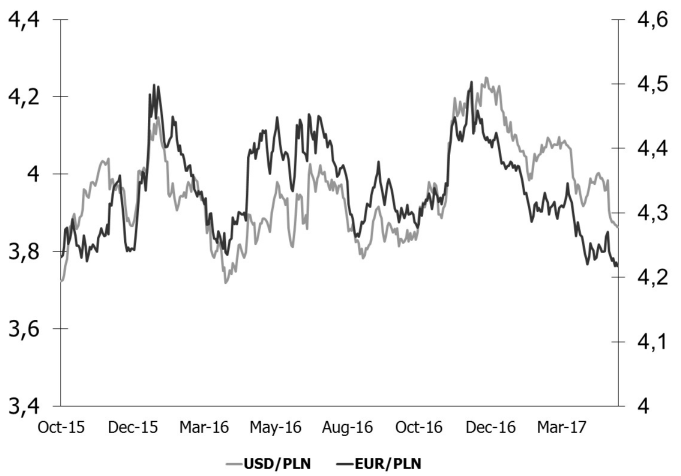
We missed the second purchase of EUR/PLN by 25 tics. The strategy is unchanged. It is all about risk/reward. We don't see any imminent reasons to sell PLN, but the temptation of playing against the trend is rising. We are ready to add at 4.1850 with 4.1600 being a firm stop. The hopes are to go back to 4.30 eventually. After the last set of positive data we think the potential for positive surprises is really limited.

Options Vol – Long 9 month EUR/PLN vol. Unchanged from last week.

Our position got hit hard, when the vols reversed down on the back of market-friendly French election results. Well, the milk has already spilled. The move down in vol was so big, that we are now at bids in 3 month EUR/PLN in the 5.80% region. We find that level attractive, and we would like to add some to our already long Vega exposure.







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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
4/27/2017	1.83	1.73	1.92	1.71	2.10	1.75	1.73	1.74	1.77	1.82	1.88	1.85
4/30/2017	1.88	1.73	1.94	1.71	2.10	1.75	1.73	1.74	1.76	1.81	1.90	1.85
5/1/2017	1.63	1.73	1.71	1.71	1.74	1.75	1.73	1.74	1.77	1.82	1.90	1.86
5/2/2017	1.70	1.73	1.60	1.71	1.75	1.75	1.73	1.74	1.78	1.82	1.90	1.86
5/3/2017	1.87	1.73	2.01	1.71	2.12	1.75	1.73	1.74	1.78	1.82	1.90	1.86

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
4/27/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
4/30/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
5/1/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
5/2/2017	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
5/3/2017	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
4/27/2017	5.88	6.03	6.43	6.95	6.95	1.84	0.56
4/30/2017	5.75	6.08	6.45	6.93	6.93	1.84	0.56
5/1/2017	5.88	6.08	6.45	6.98	6.98	1.82	0.54
5/2/2017	5.93	6.08	6.45	6.98	6.98	1.86	0.55
5/3/2017	5.93	6.08	6.45	6.98	6.98	1.82	0.54

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
4/27/2017	4.2296	3.8776	3.9056	3.4827	1.3528	0.1569
4/30/2017	4.2170	3.8696	3.8951	3.4772	1.3536	0.1565
5/1/2017	4.2170	3.8696	3.8951	3.4772	1.3536	0.1565
5/2/2017	4.2226	3.8675	3.8884	3.4477	1.3528	0.1569
5/3/2017	4.2226	3.8675	3.8884	3.4477	1.3528	0.1569

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