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May 11, 2017

Polish Weekly Review

mBank Research
(macro/FI/FX analysis)

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Comment on the upcoming data and forecasts

A busy week ahead of us. This Friday, the CSO will release final CPI data for April, which should comfirm the flash release (2.0%). Core inflation (published on Monday) should rise to 0.7%. On Monday, the NBP will also release current account data. We expect the balance to move further below zero along with rapid rises in exports (seasonal pattern) and, even more so, imports (strong consumption and investment). Tuesday will bring first estimates of GDP growth in first quarter of 2017. Latest CSOs revision and stellar month data should result in strong acceleration on a yearly basis, from 2.5% in Q4 to 4.2%. On Wednesday, exceptionally late this month, MPC will decide about interest rates, which should remain at the same level. The conference after the meeting should be optimistic as inflation growth has stalled and growth begins to accelerate. Thursday brings labour market data. Wage growth should slightly decelerate on a yearly basis because of less favourable calendar effects, while employment is expected to stabilize at 4,5% y/y. Next week ends on Friday with the release of real sphere data. After a great March industrial output will decelerate to 2.2% in April, due to working days difference and base effects. Despite similiar effects, retail sales should accelerate above 11% y/y fuelled by late Easter and cyclical effects. Finally, PPI inflation probably fell slightly because of stronger currency and declines in commodities prices.

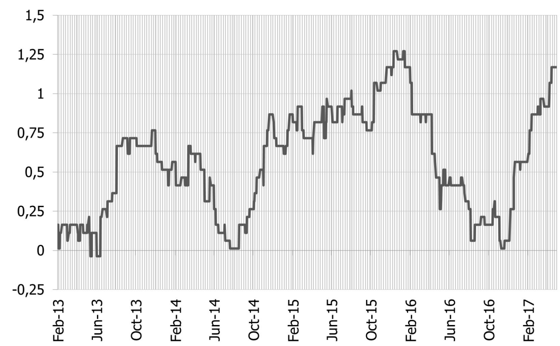
Polish data to watch: May 12th to May 19th

Publication	Date	Period	mBank	Consensus	Prior
CPI y/y (%) *final*	12.05	Apr	2.0	2.0	2.0
Current account (mio EUR)	15.05	Mar	-1200	-368	-860
Exports (mio EUR)	15.05	Mar	17000	17639	15004
Imports (mio EUR)	15.05	Mar	17500	17607	15581
Core inflation y/y (%)	15.05	Apr	0.7	0.7	0.6
GDP y/y (%) *flash*	16.05	Q1	4.2	3.9	2.5
MPC decision (%)	17.05	May	1.50	1.50	1.50
Average wage y/y (%)	18.05	Apr	4.5	4.3	5.2
Employment y/y (%)	18.05	Apr	4.5	4.5	4.5
Industrial production y/y (%)	19.05	Apr	2.2	1.6	11.1
PPI y/y (%)	19.05	Apr	4.5	4.5	4.7
Retail sales y/y (%)	19.05	Apr	11.1	8.9	9.7

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

No publications meant no surprises last week. This would however most probably change as next several days are abundant in economic releases: final CPI, flash GDP and labour 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).

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

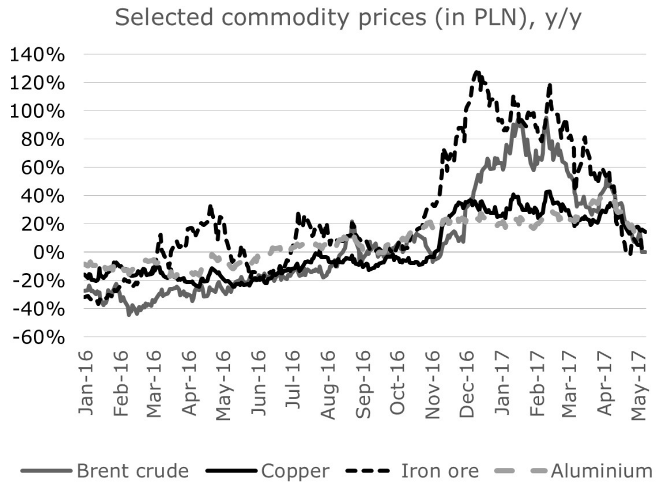
F - forecast

Economics

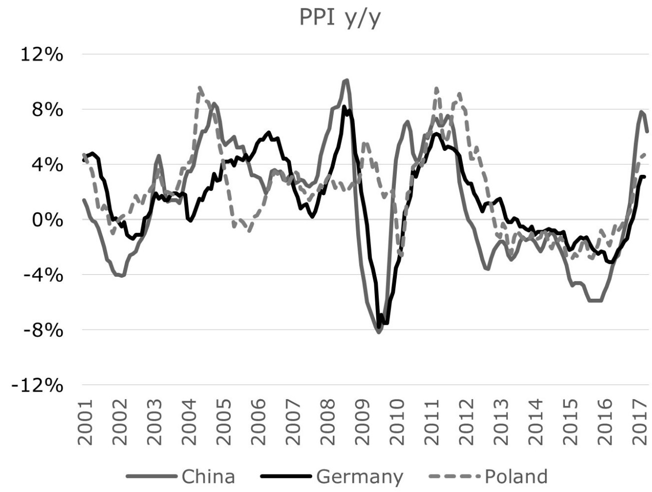
Inflation update: Lets look through the swings in commodity prices.

Tomorrow, the CSO will publish the final estimate of CPI in April. We expect it to grow (in line with the flash reading) by 2.0% y/y. The headline is not that important, though, and Poland's economy watchers should dig into the details of the release.

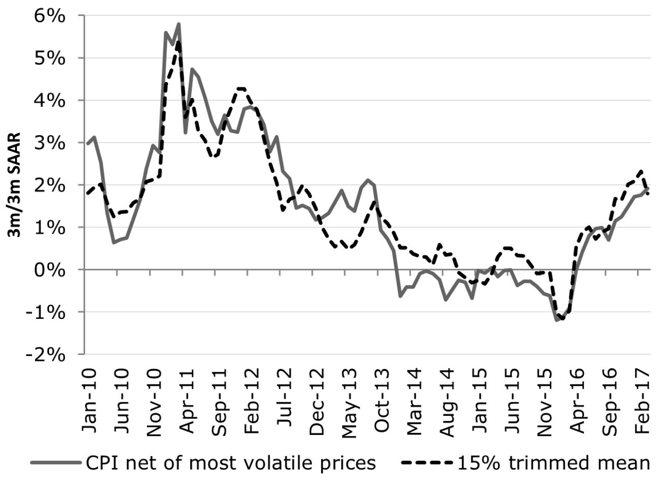
Our original (pre-flash) forecast amounted to 1.9% and was based on the assumption of low food prices. The assumption was later confirmed by Czech and Hungarian CPI surprises (down from 2.6 to 2.0% and from 2.7 to 2.2%, respectively, more than anticipated in both cases) – food price behavior there is consistent with a low reading in Poland. This means that the upward surprise in Poland was most likely caused by core inflation rising further, from 0.6 to 0.7% y/y, thereby confirming the strong momentum in underlying data we've seen for a few months. Food prices, on the other hand, after a few low readings, will probably surprise to the upside due to very cold weather at the turn of April and May (negative for fruit and certain vegetables).



We believe this is a good opportunity to discuss recent inflation developments globally and their impact on Poland's inflation path. The initial impulse from higher commodity prices is rapidly waning and, in some cases (like industrial metals), even reversing. The first signs of this can be seen in Chinese PPI data. Since they appear to lead German PPI and (with even longer delay) Polish PPI, we are paying attention to the deceleration in Chinese PPI. Markets are, of course, also paying attention as this has been an important barometer of global deflation / inflation for many years. Taken at face value, the recent declines in Chinese PPI inflation imply that Polish PPI will at maximum stabilize in the next few months (see the graph below).



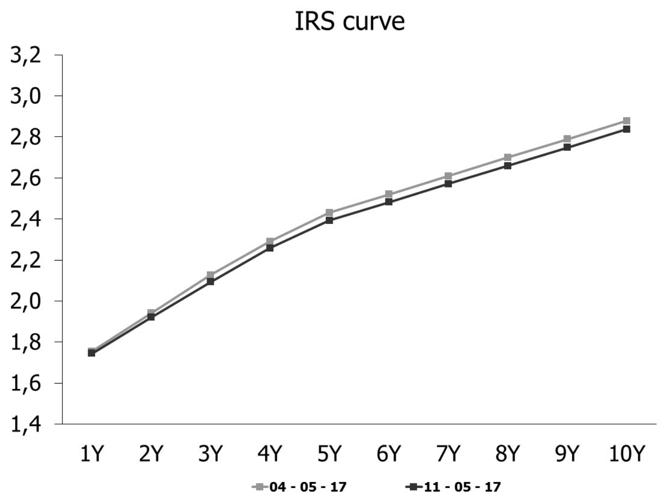
How troublesome is this development for our above-consensus inflation call? Not very much, it turns out. First, the declines in Chinese PPI so far are found only in commodity production and basic processing (production of cement, basic metals, oil refining, etc.). PPI for consumer or investment goods have not ceased to accelerate. Second, the increases in Polish PPI have been broad-based (all major industry groups). Third, the recent upswing in consumer good prices is not even the major contributor to higher core and headline inflation in Poland - services are. The balance of domestic factors supporting acceleration in inflation hasn't changed one bit. On the contrary, labor market tightened and GDP will accelerate far above potential growth this year. While, there will be an immediate, negative impact of lower commodity prices on PPI and CPI inflation, underlying inflation is set to accelerate steadily (see the graph below) and cause more upside surprises to the CPI.

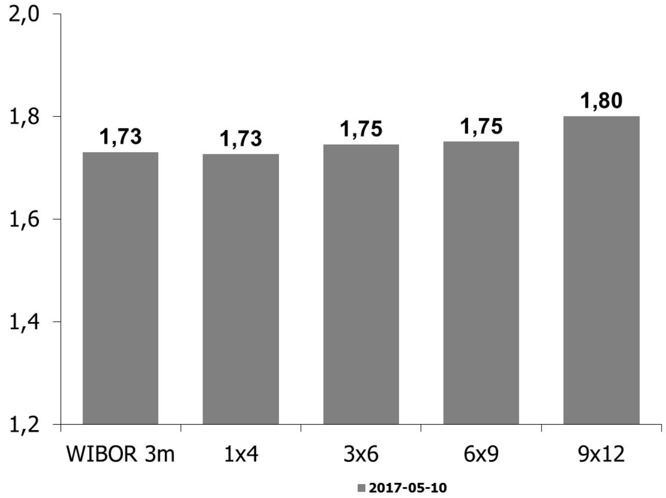


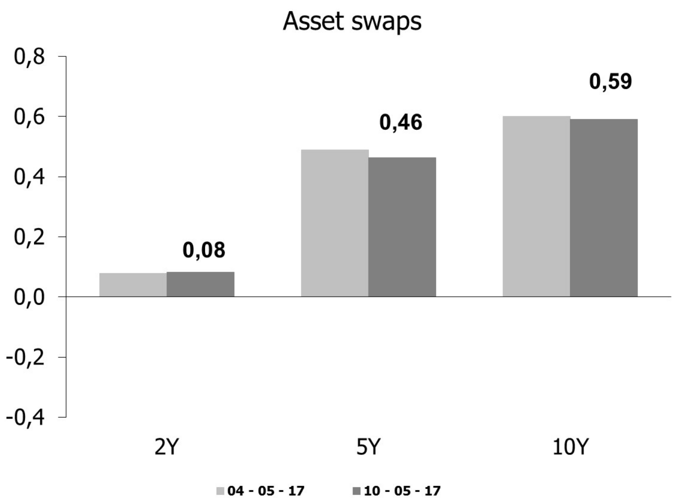
Fixed income

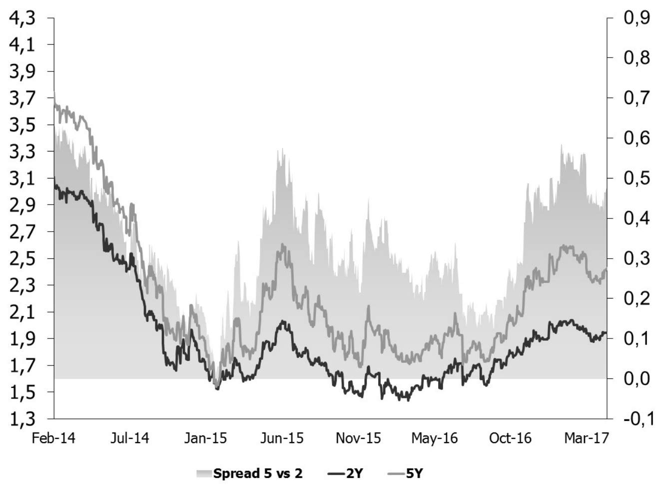
Polish bond are a hot commodity again

Is seems that everyone wanted to buy Polish bonds. Bund/DS0727 spread has moved 15 bps last week and is getting tighter and tighter (295 bps today). The only supply that we see right now is the next week's auction, but it won't bring much (5-6 bio). Still, it should help to cool down buyers. French election is behind us and tension in the Korean peninsula is not a story any more. Curve is flat again, PS0422/DS0727 narrowed to 53 from 55. ASW PS0422/5y is at 44 bps and DS0727/10y at 55 bps (both narrowed ca. 5 bps). OK0419 is trading at 1.97% (4bps down), PS0422 is trading at 2.84% (7bps down) and DS0727 is trading at 3.37% (9 bps down).









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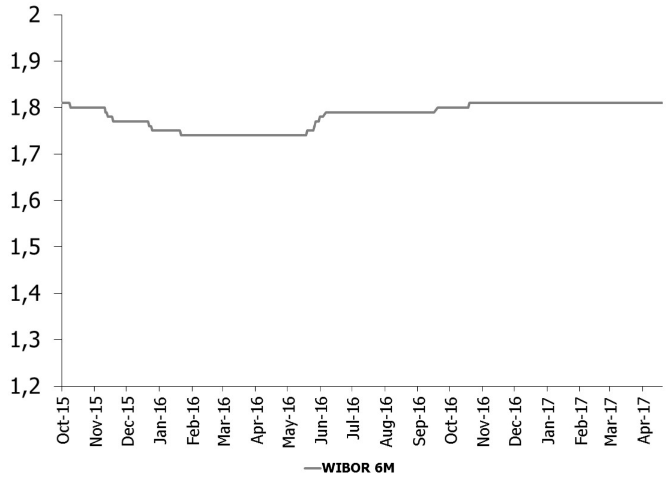
Money market

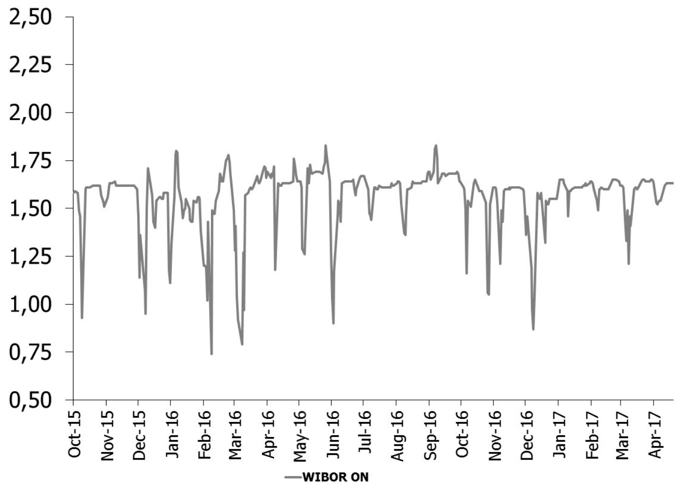
Nothing to talk about except the weather

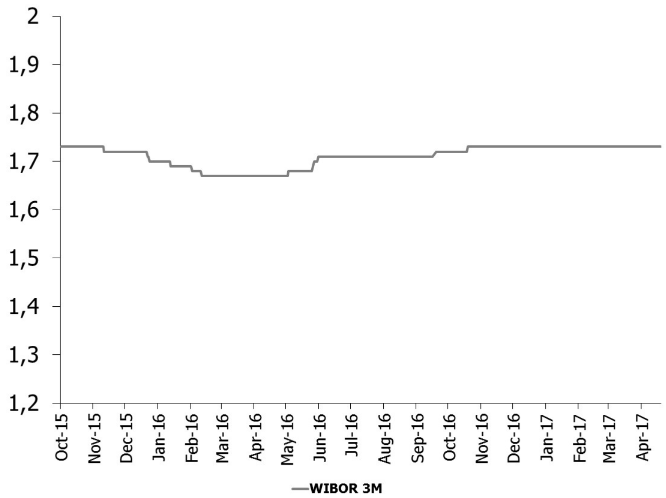
Another boring week on Polish rates. With no prospects of any movement in the near future, we are staying in a tight range on 2y IRS. Next week, the MPC is having a meeting. Market consensus is so unanimous at the moment that both decision and conference are widely expected to be a non-event. Last week, we had another wave of ground frost in Poland. In some regions temperature fell 7 degrees Celsius below zero, which may have a huge impact on this year's crops. As a result, food prices (especially fruits and vegetables) may rise abnormally this year.

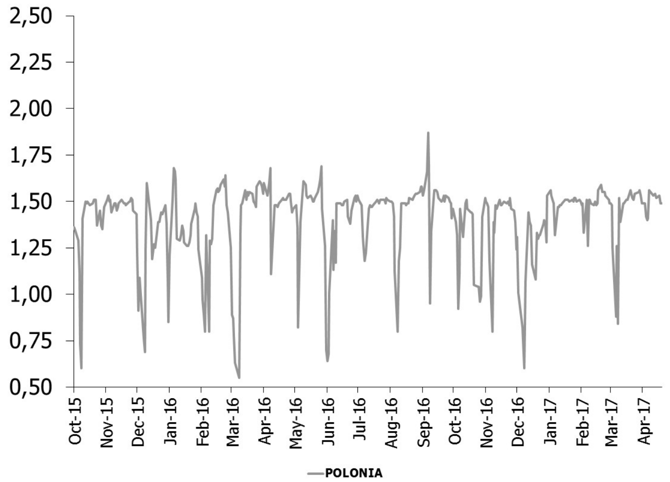
On the funding side also nothing new happened. We still see a very tight market with big banks being on the bid in shortest tenors all the time.

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









Forex

Spot – PLN still consolidating EUR/PLN was retesting the May 3rd low at 4.1875 on May 8th – first trading day after French election results had been known. It actually reached 4.1880 low before retracing once again to the middle of 4.19-4.25 range. The "Polish factor" is not really being played right now. On Friday, May 12th, there could be a Moody's update of Poland's rating, but as we already have negative outlook, there is limited risk attached to this. For choice, we dare to think the low at 4.1880 is already in place, and we will be playing EUR/PLN opportunistically from the long side. To be fair, we need to clearly break above 4.25-4.27 resistance zone to confirm that.

EUR/PLN vols – treading water The EUR/PLN and USD/PLN vols have opened lower on Monday, but later during the week we have slowly crept higher. 1 month EUR/PLN ATM is fixing at 5.9% (0.1% higher), 3 months EUR/PLN are 6.0% (0.05% higher), and finally 1 year is fixing at 6.9% (unchanged). The currency spread (difference of USD/PLN minus EUR/PLN) is bettered offered, due to USD risk event being out of the way. The skew is tic better bid, as current spot levels offer good entry levels for buyers of skew.

Short-term forecasts

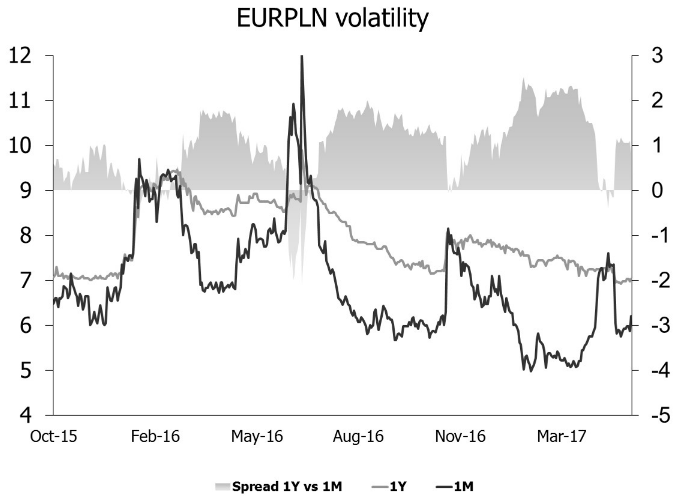
Main supports / resistances:
EUR/PLN: 4.18 / 4.28
USD/PLN: 3.70 / 4.00

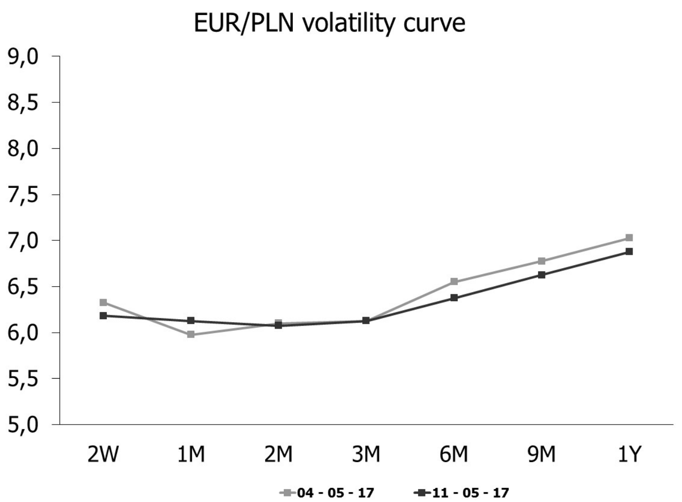
Spot Current position: Long EUR/PLN at 4.2250.

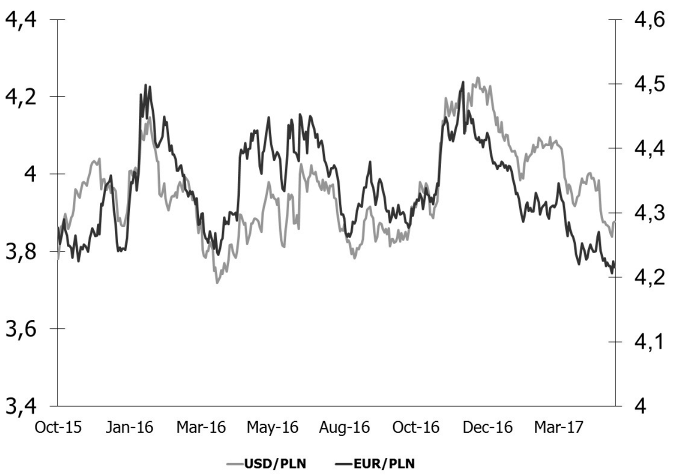
Once again, we have missed the second purchase of EUR/PLN, this time by 30 tic. The strategy is unchanged. It is all about risk/reward. We don't see any imminent reasons to sell PLN, but the temptation of playing against the trend is rising. We are ready to add at 4.1850 with 4.1600 being a firm stop. 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.

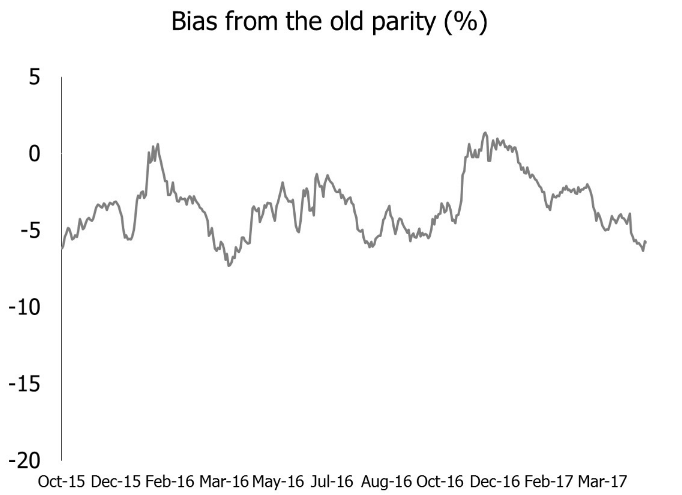
Options Vol – long 3 months and 9 months EUR/PLN.

We had to pay up higher than our ideal entry point to purchase 3 month EUR/PLN (paid 6.15 against 5.80% we hoped for). Currently we are long 3 month and 9 month VOL EURPLN, but we are planning to get rid of that opportunistic long in Vols before holidays.









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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
5/4/2017	1.85	1.73	1.94	1.71	2.11	1.75	1.73	1.74	1.78	1.82	1.90	1.86
5/7/2017	1.85	1.73	1.93	1.71	2.10	1.75	1.73	1.74	1.77	1.82	1.89	1.85
5/8/2017	1.83	1.73	1.93	1.71	2.09	1.75	1.73	1.74	1.77	1.81	1.89	1.85
5/9/2017	1.65	1.73	1.73	1.71	1.92	1.75	1.73	1.74	1.78	1.81	1.89	1.86
5/10/2017	1.85	1.73	2.01	1.71	2.02	1.75	1.73	1.75	1.75	1.80	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	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
5/4/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
5/7/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
5/8/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
5/9/2017	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
5/10/2017	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
5/4/2017	5.98	6.13	6.55	7.03	7.03	1.84	0.55
5/7/2017	5.98	6.13	6.55	7.03	7.03	1.84	0.55
5/8/2017	5.88	6.13	6.55	6.98	6.98	1.84	0.55
5/9/2017	6.20	6.33	6.60	7.03	7.03	1.86	0.55
5/10/2017	6.13	6.13	6.38	6.88	6.88	1.84	0.55

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
5/4/2017	4.2177	3.8630	3.8914	3.4228	1.3509	0.1575
5/7/2017	4.2176	3.8490	3.8928	3.4266	1.3511	0.1572
5/8/2017	4.2059	3.8391	3.8734	3.4088	1.3485	0.1575
5/9/2017	4.2253	3.8741	3.8713	3.4096	1.3549	0.1583
5/10/2017	4.2155	3.8777	3.8524	3.4063	1.3549	0.1580

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