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Polish Weekly Review

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Comment on the upcoming data and forecasts

On Tuesday the CSO will release labor market data. For both we expect slower growth on annual basis: wage growth probably declined a bit because of unfavorable working day effects (0 in July vs. +1 y/y in August), while employment growth is predictably decelerating as some key industries lost momentum in recent months. On Wednesday the CSO will publish industry and retail data. The aforementioned calendar effects will work in tandem with high statistical base (September '15 is the beginning of a 4-month streak of strong industrial output releases, associated with spending spree at the end of EU programming period) to depress IP growth. Working day difference will not impact retail sales, though. Boosted by social spending and higher fuel prices, retail sales are bound to accelerate on annual basis. The second half of the week will not be as eventful: MPC minutes will not shed any new light on monetary policy prospects and CSO's sentiment indicators have lagged the PMI recently.

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Polish data to watch: October 17th to October 21st

Publication	Date	Period	mBank	Consensus	Prior
Average gross wage y/y (%)	18.10	Sep	4.4	4.5	4.7
Employment y/y (%)	18.10	Sep	3.0	3.1	3.1
Sold industrial output y/y (%)	19.10	Sep	3.4	3.7	7.5
Retail sales y/y (%)	19.10	Sep	6.5	5.7	5.6
PPI y/y (%)	19.10	Sep	-0.1	-0.2	-0.1
MPC Minutes	20.10	Oct			
Business sentiment indices	21.10	Oct			

Treasury bonds and bills auctions

Paper	Next auction	Last Offer	Yield on the prev auction (%)	Prev auction
(32/37/52) Week T-bills	-	1500	1.350	3/14/2016
2Y T-bond OK1018	-	2000	1.742	10/6/2016
5Y T-bond PS0721	10/21/2016	3500	2.114	8/18/2016
10Y T-bond DS0727	-	4000	3.098	10/6/2016
15Y T-bond WS0428	-	200	3.027	7/7/2016

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



Comment

Final CPI matched the flash release of -0.5% y/y. As a result, Polish surprise index was unchanged during the previous week. Next week brings the important data releases: retail sales, industrial output and wages. Each of them can surprise.

* 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

- 500+ programme is set to support private consumption in 2016. Despite weak Zloty, exports growth ground into a halt. Public infrastructure outlays have shifted towards 2017, and private investment seems to be locally, negatively affected by spillovers from public investment gap, lower absorption of EU funds and political uncertainty. Hence, we expect 2-3 quarters of sub-3% growth.
- Current GDP growth is sufficient to keep inflation and credit risk in check. Globally low to moderate growth amid low commodity prices is set to further underpin deflationary environment. Headline inflation is going to slowly rise only on the back of statistical base.
- Rate cuts are still a possibility (most likely in early 2017). We expect the MPC to finally acknowledge deflation risks amid the on-going weakness in GDP growth and another round of monetary policy stimulation globally.

Financial markets

- Zloty has moved towards the lower bound of its range, thanks to (relatively) hawkish MPC and global easing of monetary conditions. Due to the weakness in exports and country risks still present, we expect Zloty to remain weak for the time being.
- The prevailing event risk for PL assets, the CHF conversion, moved to the background, as its details are unlikely to be announced soon.
- As the expectations for Fed hike moved towards December, market focus is now on US elections and their possible impact on the economy and geopolitics. With the race as tight as it is now, the elections pose a major risk for EM assets, probably higher than Brexit.

mBank forecasts

	2012	2013	2014	2015	2016 F	2017 F
GDP y/y (%)	1.6	1.3	3.3	3.4	2.8	3.2
CPI Inflation y/y (average %)	3.7	0.9	-0.1	-0.9	-0.6	1.7
Current account (%GDP)	-3.7	-1.3	-2.0	-0.1	-0.7	-0.9
Unemployment rate (end of period %)	13.4	13.4	11.4	9.8	8.7	8.1
Repo rate (end of period %)	4.25	2.50	2.00	1.50	1.50	1.25

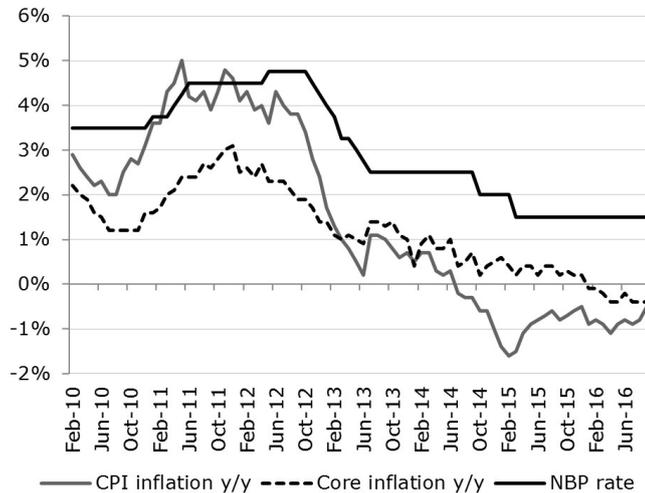
	2016	2016	2016	2016	2017	2017	2017	2017
	Q1	Q2	Q3 F	Q4 F	Q1 F	Q2 F	Q3 F	Q4 F
GDP y/y (%)	3.0	3.1	2.7	2.5	2.7	3.1	3.4	3.5
Individual consumption y/y (%)	3.2	3.3	3.8	4.2	4.3	4.1	3.8	3.5
Public Consumption y/y (%)	4.4	4.4	4.0	1.0	2.4	2.4	2.4	2.4
Investment y/y (%)	-1.8	-4.9	-6.5	-4.0	-2.0	2.0	6.0	6.5
Inflation rate (% average)	-0.9	-0.9	-0.8	0.2	1.3	1.4	1.2	1.1
Unemployment rate (% eop)	10.0	8.9	8.5	8.7	8.9	8.2	7.8	8.1
NBP repo rate (% eop)	1.50	1.50	1.50	1.50	1.25	1.25	1.25	1.25
Wibor 3M (% eop)	1.67	1.71	1.71	1.71	1.44	1.44	1.44	1.44
2Y Polish bond yields (% eop)	1.45	1.65	1.76	1.65	1.35	1.30	1.30	1.30
10Y Polish bond yields (% eop)	2.84	2.91	2.92	3.00	2.80	2.80	2.80	2.80
EUR/PLN (eop)	4.24	4.38	4.30	4.35	4.35	4.30	4.25	4.25
USD/PLN (eop)	3.73	3.94	3.82	3.95	4.03	3.98	3.94	3.94

F - forecast

Economics

September CPI confirmed at -0.5% y/y. Core inflation at all time low.

According to final data, CPI declined by -0.5% y/y in December. Thus, the surprisingly low flash reading was confirmed.



This time, the details of the release are full of surprises. The only certainty, a solid rise in fuel prices, materialized itself. The +3.4% m/m growth, along with low statistical base from last year, decisively contributed to the increase in inflation. Food prices came out below our forecasts (-0.3% vs. +0.2% m/m). Core categories are a mix of typical seasonal readings, e.g. small monthly increases in the prices of clothing, footwear, hotels and restaurants, and solid declines in two big categories: transport and recreation and culture. The former is a result of cheaper transport services (no further details available), the latter is due to lower prices of package holidays and another release of free textbooks for schoolchildren. Inflation net of food and energy held steady at -0.4% for the third time in a row and for fifth time this year. Unrounded, it actually hit an all time low.

In light of September data, inflationary tendencies in the Polish economy are still nonexistent. The expected increase in inflation in the coming months (it should reach ca. 1% y/y at the beginning of next year) is purely due to base effects. Any real acceleration in inflation continues to be out of reach. One should note that the impact of weak zloty is rapidly waning, as seen in the PMI reports and in PPI data. In our view, higher headline CPI prints will not make the MPC more hawkish. On the contrary, weaker GDP data will force the MPC's hand and lead to renewed monetary easing. This will also boost rate cut expectations.

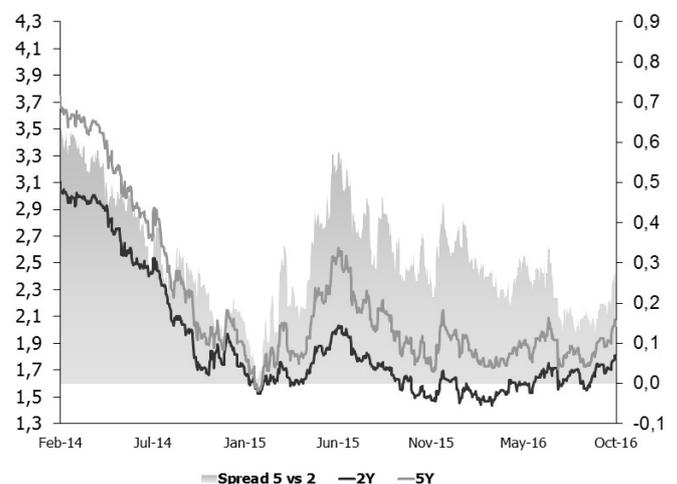
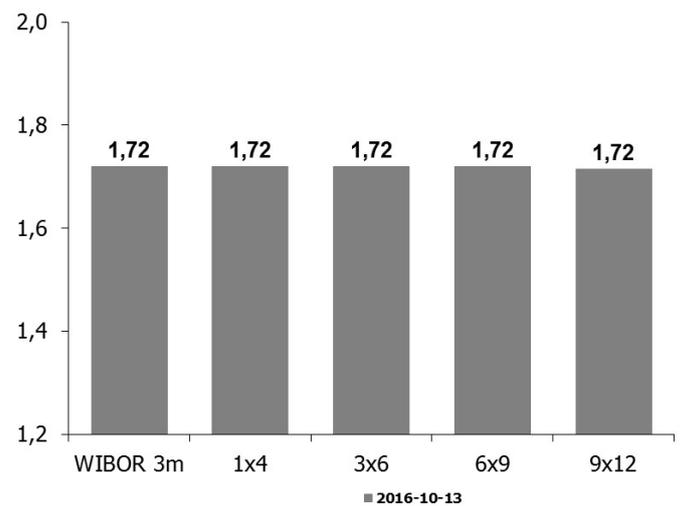
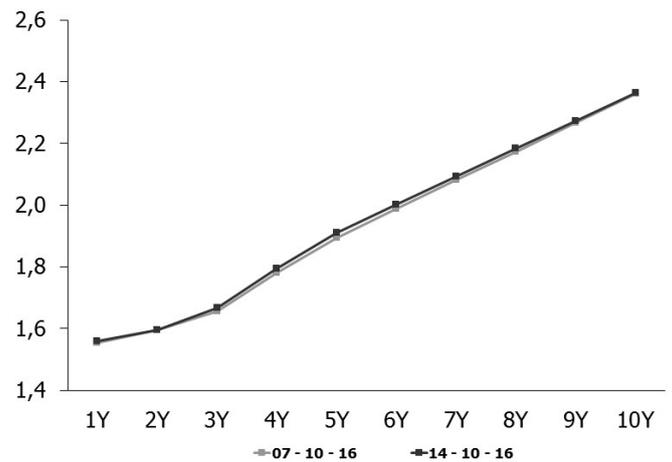


Fixed income

Waiting for the new 5y benchmark...

In October, 15.2 bn PS1016 is maturing and 5.96 bn is paid in interest payments. That's a lot of cash!!! We think most funds and ALM departments will accumulate the short term bond before the end of the month. Even a new 5y benchmark (PS0722) issued by the Ministry of Finance on 21th should find buyers from current levels. Last week ASW was traded in a narrow range 2y/OK1018 @ -6/-8, 5y/PS0721 @ 40/38, 10y/DS0726 @ 60/58. Spread between DS0727 vs. DS0727 moved from 13bps to 15bps and our beloved PS0721 vs DS0726 spread has stuck at 60/58. Market looks heavy on long term bonds, since last auction prices on DS0727 are 80-60gr under the water. The new auction is coming... so the market has to find some room.

IRS curve



Money market

Huge redemptions and pessimistic expectations

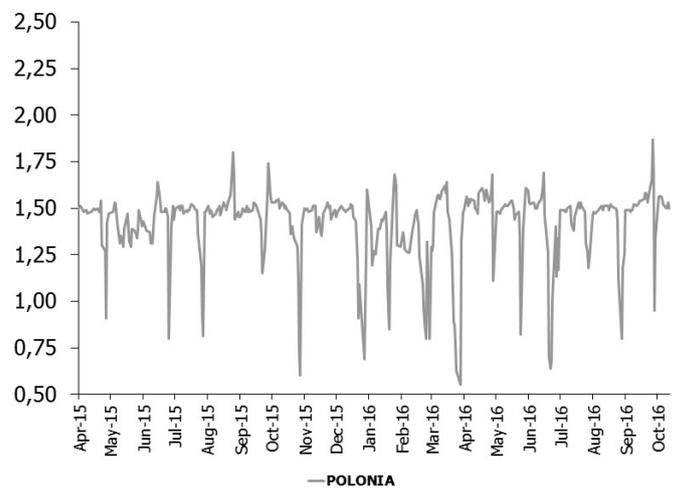
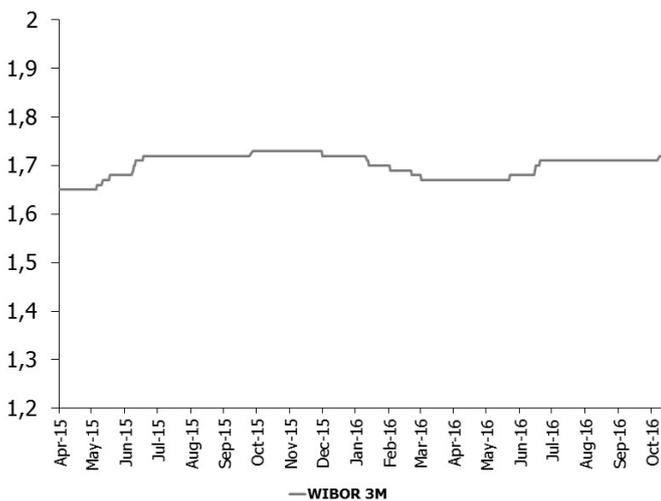
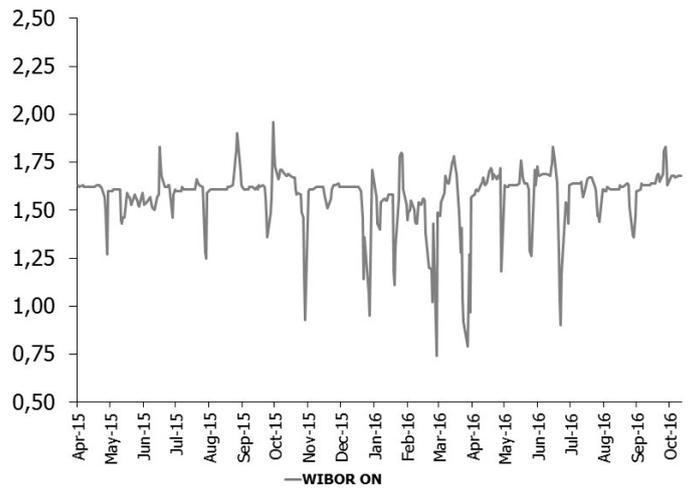
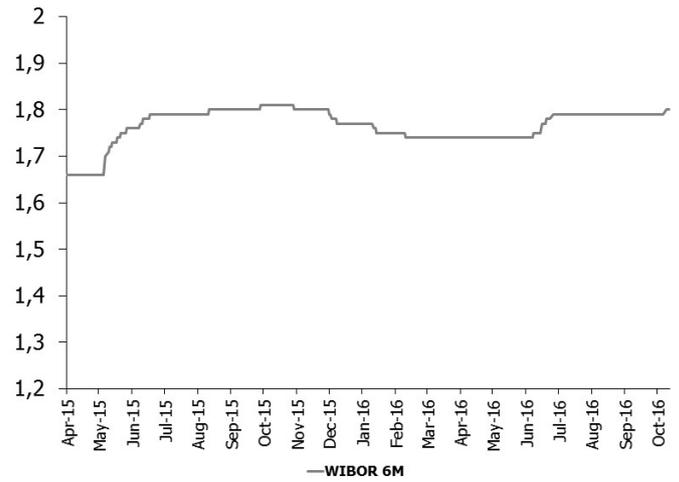
Weaker sentiment still prevails on the bond market. Main reasons for higher yields came from abroad, these are rate hike expectations in the U.S. and some rumors about ECB preparing a taper plan. On the local front, we have falling Polish Q3 GDP forecasts and huge October redemptions. Market pays special attention to these big payments from the Ministry of Finance and hopes this will lift two year bonds up. Although the market is really thin in the 2y sector, spreads are wide and its hard to buy anything with decent yield.

This month's funding has gone smoothly from the beginning and this should continue throughout next week. Market participants bought 61.8b NBP bills out of 63.5 offered.

Ref rate vs Polonia averages:

30 day: -1 bp

90 day: 4 bp



Forex

Spot – Still consolidating above the main 4.25/4.27 support zone EUR/PLN was once more trying to break the 4.25/4.27 support zone. The low of the week was 4.2640. Later in the week the global sentiment worsened and FOMC minutes were kind of hawkish. EUR/PLN corrected higher to 4.3140 (high of the week) as a result. The biggest momentum was of course on USD/PLN (from 3.8180 to 3.9225 respectively), and in basket terms, EUR & USD equally weighted ag PLN, the PLN is also softer by roughly 1%. We still see a range of 4.26-4.36 as the most likely scenario. The Polish politics, the biggest risk factor in our eyes, is still relatively subdued.

Options – EUR/PLN vols – consolidating Weaker PLN managed to stop the vol slide, we have seen some Gamma buyers. The realized volatilities are still trading at its lows. 1 month EUR/PLN ATM mid is at 5.9% (0.1% higher), 3 months EUR/PLN are 6.25% (unchanged) and, finally, 1 year is fixing at 7.3% (unchanged). Currency spread (USD/PLN vol vs EUR/PLN vol) was in demand because of USD/PLN advances. The skew was roughly unchanged.

Short-term forecasts

Main supports / resistances:

EUR/PLN: 4.25 / 4.37

USD/PLN: 3.75 / 4.00

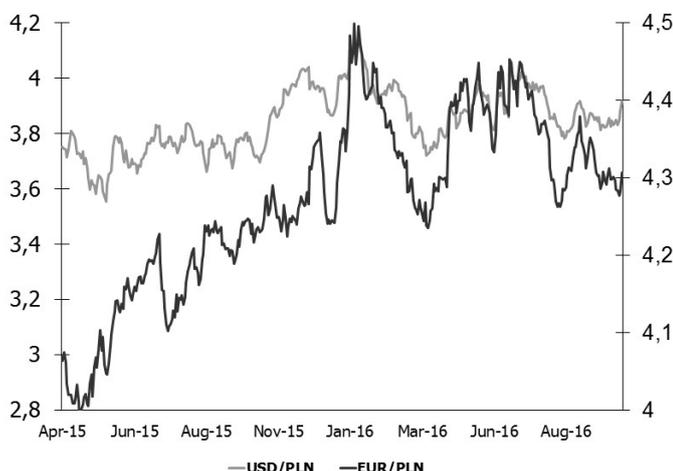
Spot Position: Long EUR/PLN.

We are long EUR/PLN from 4.3170 and 4.2870. The stop is now at 4.2550 and we are hoping to see 4.38/4.40 and, depending on the momentum, possibly even 4.41/4.43.

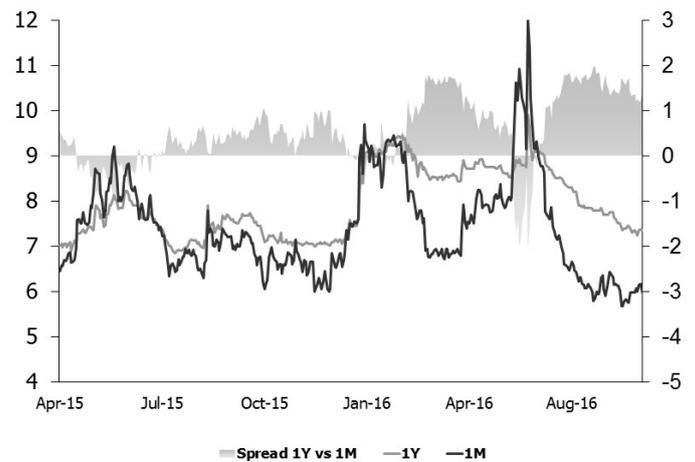
Our position's performance is mixed but we keep it nevertheless. The market is lacking momentum but we think PLN rally is a bit fatigued. The positioning is also the most likely skewed towards PLN longs. All we need is a spark.

Options Selectively long Vega

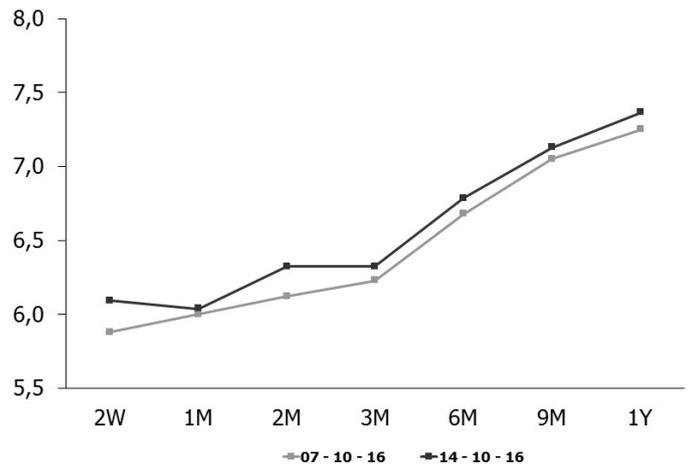
Implied volatilities have come off significantly over the past weeks. There is a lot of uncertainty surrounding Brexit, the postponed decision on forced conversion of CHF mortgages, Constitutional Court conflict, U.S. elections, so we stick to our position – we have still selective longs in backend EURPLN curve.



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
10/7/2016	1.78	1.71	1.78	1.69	1.65	1.71	1.71	1.72	1.70	1.70	1.71	1.78
10/10/2016	1.99	1.72	2.09	1.70	2.10	1.72	1.72	1.73	1.72	1.72	1.73	1.82
10/11/2016	1.88	1.72	1.98	1.70	2.10	1.73	1.73	1.73	1.73	1.73	1.74	1.83
10/12/2016	1.80	1.72	1.91	1.70	2.04	1.73	1.73	1.72	1.72	1.72	1.73	1.82
10/13/2016	1.55	1.72	1.58	1.70	1.61	1.73	1.72	1.72	1.72	1.72	1.73	1.79

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
OK1018	10/6/2016	10/25/2018	96.54	1.74	2000	4838	2448
PS0421	8/18/2016	7/25/2021	98.31	2.11	3500	4968	3844
DS0727	10/6/2016	7/25/2027	94.57	3.10	4000	5916	4359

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0715	5Y IRS	PS0718	10Y IRS	DS1023
10/7/2016	1.710	1.474	1.635	1.578	1.960	2.232	2.405	2.949
10/10/2016	1.720	1.474	1.635	1.578	1.960	2.232	2.405	2.949
10/11/2016	1.730	1.474	1.635	1.578	1.960	2.232	2.405	2.949
10/12/2016	1.730	1.474	1.635	1.638	1.990	2.290	2.447	2.985
10/13/2016	1.730	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
10/7/2016	6.00	6.23	6.68	7.25	7.25	2.15	0.61
10/10/2016	6.15	6.28	6.70	7.35	7.35	2.15	0.61
10/11/2016	6.18	6.30	6.73	7.38	7.38	2.21	0.68
10/12/2016	5.98	6.23	6.70	7.35	7.35	2.14	0.61
10/13/2016	6.04	6.33	6.79	7.36	7.36	2.14	0.60

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
10/7/2016	4.2853	3.8505	3.9234	3.7080	1.4084	0.1586
10/10/2016	4.2835	3.8307	3.9131	3.7153	1.4074	0.1585
10/11/2016	4.2767	3.8487	3.9023	3.7041	1.4053	0.1583
10/12/2016	4.2825	3.8851	3.9240	3.7503	1.4032	0.1584
10/13/2016	4.3065	3.9164	3.9576	3.7629	1.4055	0.1594

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