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# Polish Weekly Review


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## Comment on the upcoming data and forecasts

This Friday, the CSO will release real sphere data. After a great March, industrial output likely decelerated to 2.2% in April, due to working days difference (-2 vs +1 y/y) and base effects. Despite this strong calendar effect, retail sales probably accelerated above 11% y/y fuelled by late Easter and cyclical effects (strong consumer spending, big deceleration in household deposits). Finally, PPI inflation probably fell slightly because of stronger currency and declines in commodities prices. On Monday, we will see the first gauge of economic activity in May – the CSO's enterprise survey. On Wednesday consumer confidence data for May will also be released. Finally, on Thursday the CSO will publish its monthly Statistical Bulletin, along with unemployment data. We expect the latter to confirm the Ministry of Family, Labor and Social Policy's preliminary estimate of 7.7% (in April).

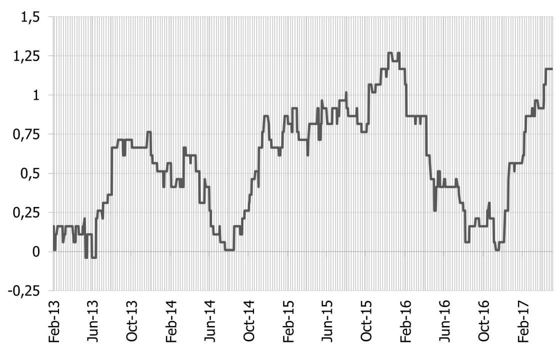
### Polish data to watch: May 19th to May 26th

| Publication | Date | Period | mBank | Consensus | Prior |
|---|---|---|---|---|---|
| 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 |
| Business confidence | 22.05 | May | | | |
| Consumer confidence | 24.05 | May | | | |
| Unemployment rate (%) | 25.05 | Apr | 7.7 | 7.7 | 8.2 |

### 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 | 6/13/2017 | 250 | 1.905 | 5/18/2017 |
| 5Y T-bond PS0422 | 6/13/2017 | 1000 | 2.734 | 5/18/2017 |
| 10Y T-bond DS0727 | 6/13/2017 | 1000 | 3.289 | 5/18/2017 |
| 30Y T-bond WS0447 | - | 2100 | 4.257 | 2/16/2017 |

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




### Comment

Most of April's releases were not able to move the index, since they came more or less in line with market consensus. It could however change rather soon. Tomorrow brings industrial output, retail sales and PPI data, while final unemployment release is due next Thursday.

* 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 |

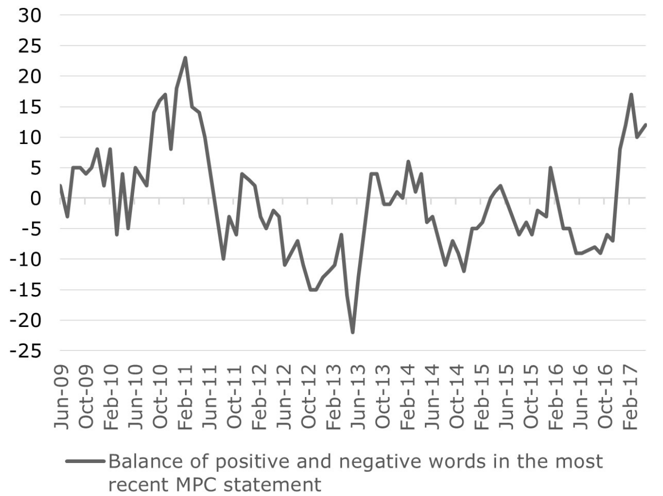
| | 2017 Q1 F | 2017 Q2 F | 2017 Q3 F | 2017 Q4 F | 2018 Q1 F | 2018 Q2 F | 2018 Q3 F | 2018 Q4 F |
|---|---|---|---|---|---|---|---|---|
| GDP y/y (%) | 4.0 | 4.2 | 4.2 | 4.2 | 4.1 | 3.9 | 3.8 | 3.8 |
| Individual consumption y/y (%) | 4.8 | 4.5 | 4.2 | 4.0 | 4.0 | 3.8 | 3.8 | 3.8 |
| Public Consumption 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 | 4.20 | 4.15 | 4.10 | 4.10 | 4.12 | 4.14 | 4.16 |
| USD/PLN (eop) | 3.97 | 3.75 | 3.77 | 3.87 | 3.94 | 4.00 | 4.02 | 4.00 |

F - forecast

# Economics

## Rates unchanged yet again

The MPC held interest rates unchanged during the unusually late May meeting, in line with market expectations. The post-meeting statement was little changed, with minor alterations related to the last few weeks of data and policy releases. The MPC continues to see the economic environment as favorable (see our measure of its sentiment based on statement wording), praise the economy as balanced. Finally, the key sentence was left in place "the risk of inflation running persistently above the target in the medium term is limited".

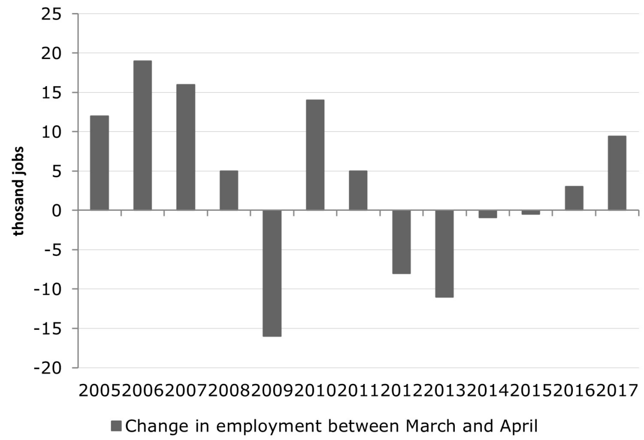



The press conference was unambiguously dovish, even more so than the previous ones. The fast Q1 growth was acknowledged and governor Glapinski expects even better figures in the coming quarters, but this has no impact on monetary policy. Recent inflation developments, as we expected, were seen as confirmation of the MPC's preferred scenario. In the medium term the Council expects inflation to stabilize below target and it is "unimaginable" that it could reach the upper bound of the target band (i.e. 3.5%). Surprisingly dovish were governor Glapinski's statements regarding the labor market: there is no wage pressure and labor shortages are non-existent owing to Ukrainian immigration. With such a diagnosis, it is scarcely surprising that rate hikes are not necessary both in 2017 and likely in 2018.

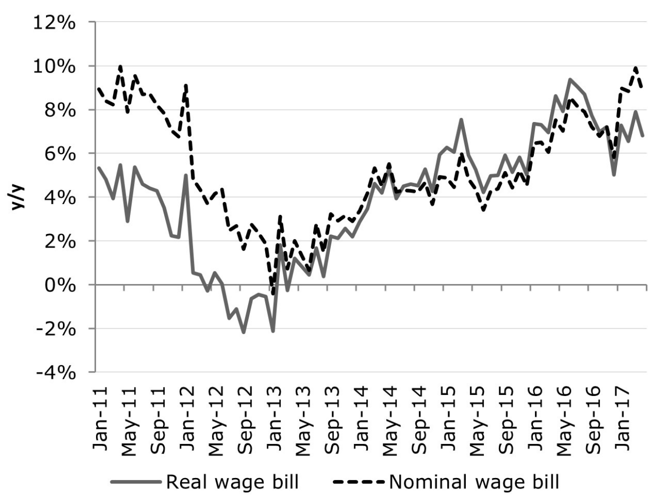
The overall conclusion from the last few meetings is quite self-evident: the faster the GDP growth and the steeper the inflation path (note that recent increases in core inflation were completely ignored), the more dovish the MPC has become. While forecasting stable rates for the next 18 months might be a result of straightforward extrapolation of current Goldilocks-like conditions in the economy, it is contradicted both by some current data (core CPI, labor market stats – see our comment on today's release) and future data as dictated by well-established relation between real variables and inflation. Because of this, we see current market pricing of rate path (first hike in very late 2018) is very optimistic and overly conservative.

## Labor market remains in great shape

In April, 9k jobs were added in the enterprise sector, equivalent to 4.6% y/y (slightly above consensus and our forecast – both 4.5%). This was the best March-to-April growth since '10, which is another proof that labour market is in great shape. We suspect that this small surprise was a result of a rebound in the administrative and support services, which performed rather poorly in March. However, in order to verify it, we have to wait for the release of the Statistical Bulletin. From a broader perspective there is no difference, whether employment is growing by 4.5% or 4.6% y/y. Bottlenecks have been balanced by the inflow of Ukrainian migrants (number of vacancies is extremely high, though) and we do not expect it to reverse any time soon. Incoming visa-free travel for Ukrainians will not allow them to work there and is only valid for 90 days during half a year. Still, we could see some outflows because of grey economy.

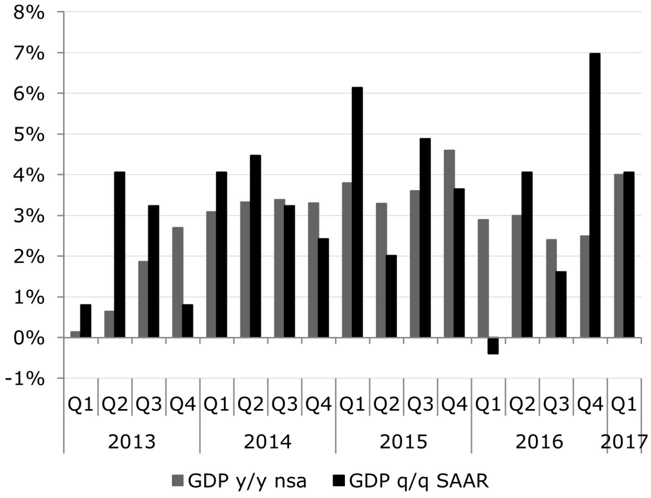



Average wage grew by 4.1% y/y in April, slightly below market consensus and our forecast (4.4 and 4.5%, respectively). As usual, definitive answers regarding the source of the surprise will be provided after the release of the Statistical Bulletin next Thursday. Nevertheless, we know that the last month's acceleration in wages was broad-based. In particular, manufacturing wages grew strongly. We believe that this category was negatively impacted by calendar effects this month (working day difference -2 vs. +1 y/y) – and that explains the deceleration in average wage. Our general view on wages is unchanged – the uptrend is firmly entrenched and supported by demographic, cyclical factors and possibly wage demands formulated during and after the fuel and food price spike at the turn of the year.



## Q1 GDP suggests 4%+ growth in 2017

Growth numbers for Q1 were upbeat: 4.0% y/y and 1.0 q/q (s.a.). The reading was more or less in line with the current market consensus. However, the latter has drifted upwards a lot in a quite short period of time and almost converged with our forecast (4.2%) that was formulated quite early.



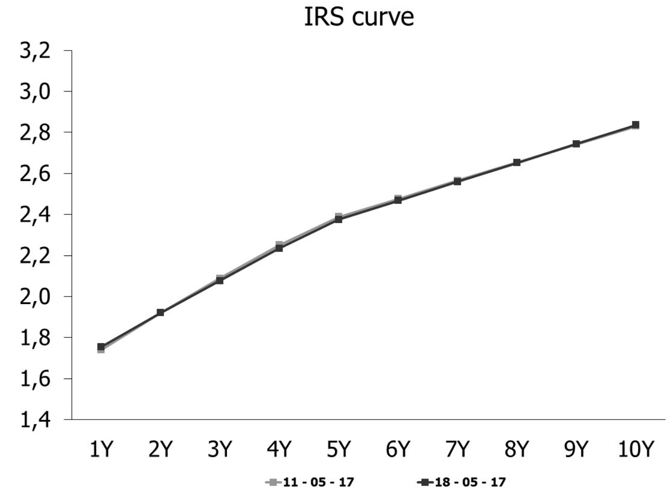

Flash reading is published without a detailed breakdown, set to be published in the end of the month. Therefore, we speculate that such substantial GDP acceleration stems mostly from still elevated consumption (4.6-4.8% r/r) that recently got a backing from investment (acceleration towards +3-4% r/r from negative growth in Q4). Net exports contribution was slightly negative. Change of inventories was only a bit above zero.

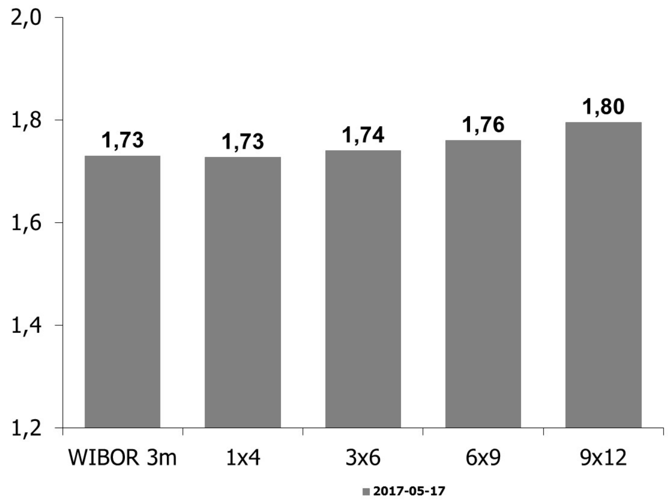
Acceleration of GDP growth resonates well with recent high frequency data and VAT receipts. It comprises a nice summary of the processes that had led to compression of credit risk (40 bps in ASW terms). Next quarter is set to be similar in terms of growth rate. As Q1 is slightly lower than we thought, it would be fairly possible to maintain a gently upward sloping GDP growth profile for the whole 2017, leading to the average reading of 4%+.

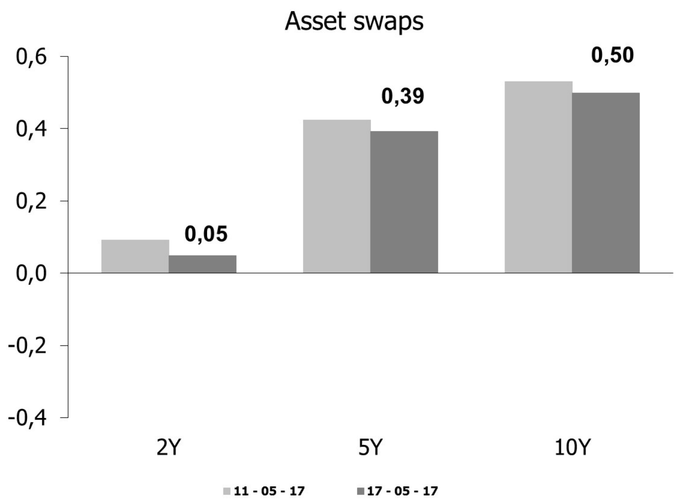
# Fixed income

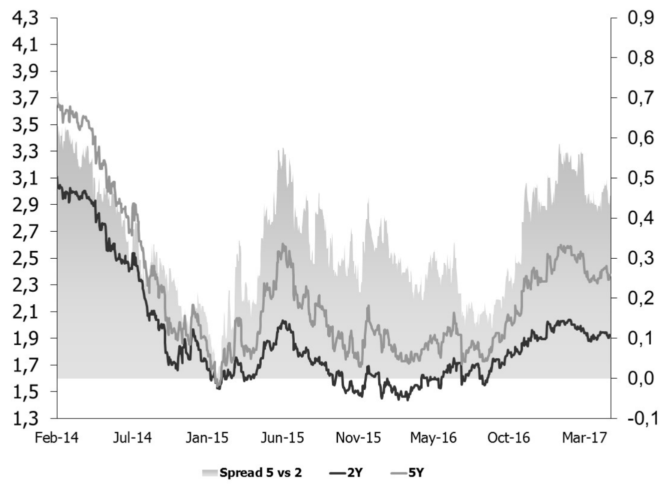
## Polish bonds look very expensive

Yesterday, the Ministry of Finance sold 3 bn of: OK0419, 0.25 bn at 1.905%; PS0422, 1.1 bn at 2.734%; DS0727, 1.35 bn; WZ1122, 0.38 bn; WZ0126, 0.46 bn. All the bids were covered (6,86 bn demand). We saw lowest levels in bond yields: OK0419 at 1.90%, PS0422 at 2.78%, DS0727 at 3.28%. It won't be easy to move yields lower. Next week, the Ministry of Finance will organize a switching auction (8-10 bn). The market can try to close positions before weekend and looks heavy at the moment. The PS0422/DS0727 spread widened from 55 to 56, ASW narrowed 8 bps, PS0422/5y rose to 40 bps and DS0727/10y rose to 50 bps. OK0419 is trading at 1.93% (3 bps down), PS0422 is trading at 2.78% (7 bps down) and DS0727 is trading at 3.35% (7 bps down) compared to last week.



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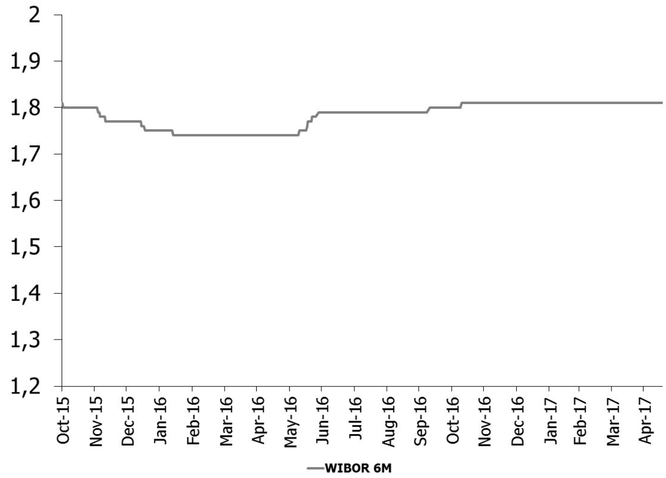
# Money market

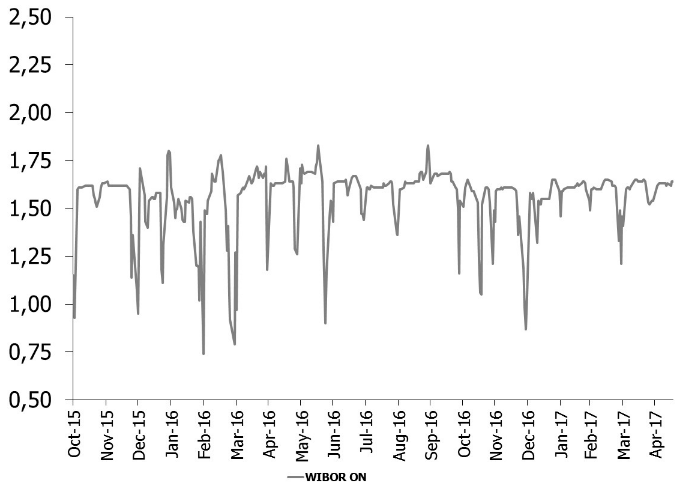
## Hope and disappointment

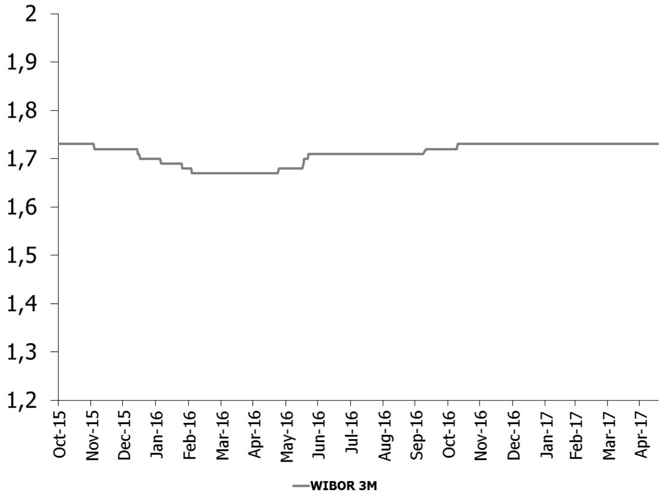
Continuing impressive data from real economy ignited hopes for a change in the MPC's rethoric. Swaps moved higher, with 2y reaching 1.97. Yet again rates where hammered down by the extremely dowish NBP governor. He sounded very bullish on the Polish economy, seeing GDP easly above 4% in 2017, and still reiterated that rates should stay flat even in 2018. Looks like it will be very difficult to surprise him even more. Our attention now turns now to July meeting where new economic projections from the NBP will be released.

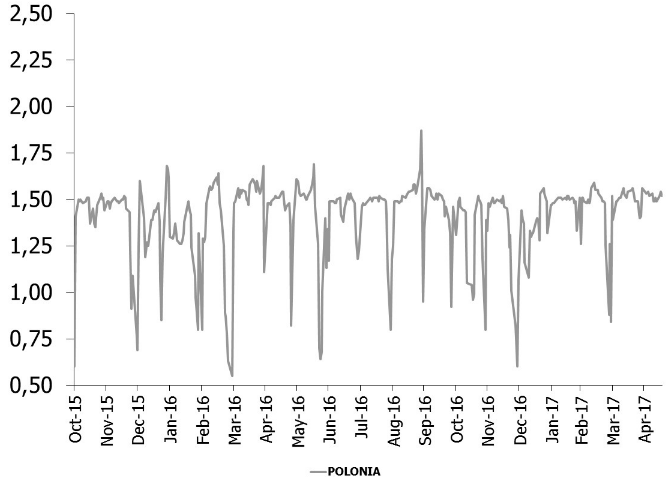
Overnight rates stayed in narrow range for another week. We don't expect that to change next week.

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



## Forex

**Spot – PLN – the wild ride** The week started with positive tone: the Moody's upgrade of Polish rating outlook, the risk-on fever, all forced PLN higher. 4.1850 was the line in the sand, a seasoned EUR/PLN support with stop/losses stocked below that level. As cruel as it is, but routine for the market, these stops were triggered all the way to 4.1615. With EUR/PLN longs already cleared, the market found himself massively long PLN. Dovish MPC, risk off produced because of political risk from Trump – and the mill wheels have changed direction. As a result, EUR/PLN spiked to 4.2300, and next resistance of importance is 4.25/26.

**EUR/PLN vols – tic higher** Softer vol curve from the beginning of the week got support from weaker Zloty. As a result, 1 month EUR/PLN ATM is a bit higher, to 6.1% (0.2% higher), 3 month EUR/PLN are at 6.25% (0.25% higher) and, finally, 1 year is fixing at 6.95% (0.05% higher). The currency spread (difference of USD/PLN minus EUR/PLN) is better bid now, with EUR/USD vols shooting higher. The skew is roughly unchanged.

## Short-term forecasts

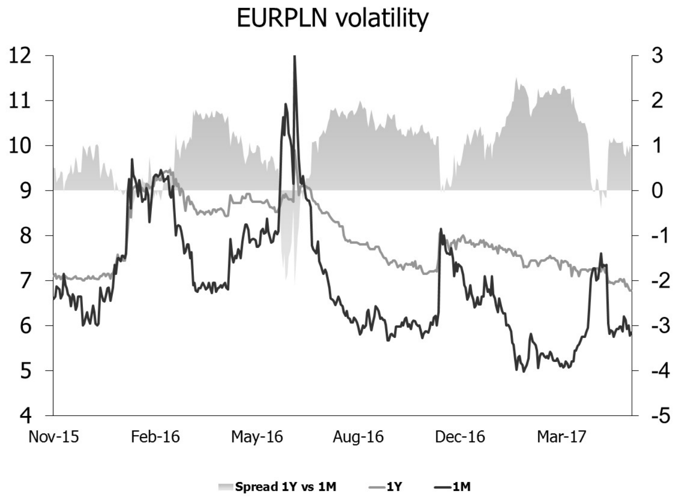
Main supports / resistances:
EUR/PLN: 4.18 / 4.28
USD/PLN: 3.70 / 4.00

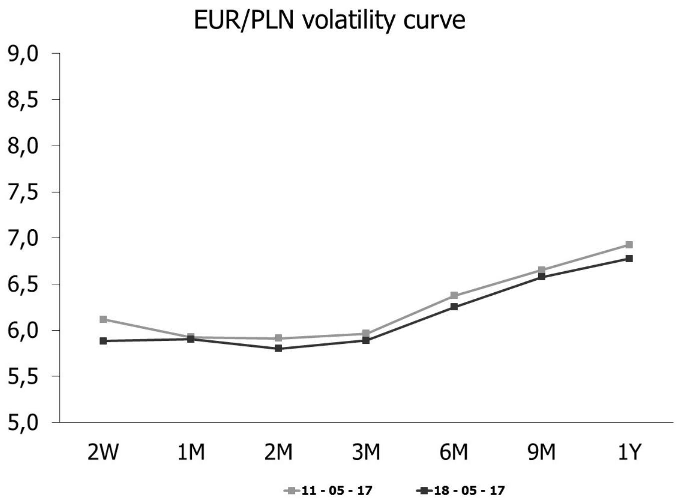
**Spot** Current position: Long EUR/PLN at 4.2250 and 4.1850.

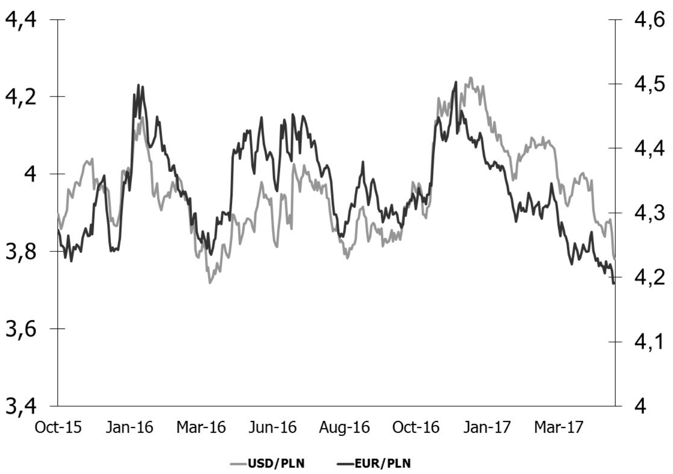
We have added to EUR/PLN long at 4.1850 and the whole position almost got stopped out at 4.1600 (4.1615 was the low). Luckily, our contrarian bet, after a day of consolidation, got back above the water. Whether it is a change in the trend, or just a dead cat bounce, is still to be decided. We moved the stop higher, from 4.1600 to 4.1750, and we still hope to see 4.2650 (partial profit taking level) on the way to 4.3000 - the ideal profit target.

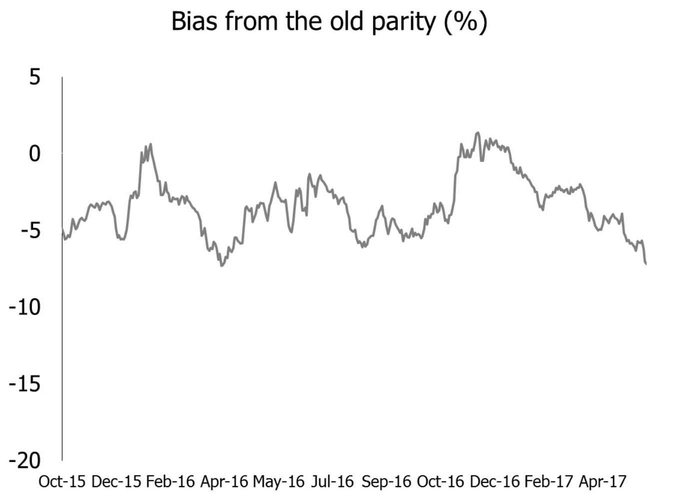
**Options** Vol – long 3 months and 9 months EUR/PLN.

Our long positions in Vega (3 and 9 months) received some support from weaker PLN and moved tic higher. The higher realized volatility makes Theta bills less painful. We still stick to the plan of reducing/liquidating that position before summer vacation begins. All we need is a higher vol.



# 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 |
| 5/11/2017 | 1.85 | 1.73 | 1.96 | 1.71 | 2.13 | 1.75 | 1.73 | 1.74 | 1.75 | 1.81 | 1.87 | 1.84 |
| 5/14/2017 | 1.87 | 1.73 | 1.96 | 1.71 | 2.10 | 1.75 | 1.73 | 1.74 | 1.76 | 1.81 | 1.87 | 1.84 |
| 5/15/2017 | 1.87 | 1.73 | 1.75 | 1.71 | 1.90 | 1.75 | 1.73 | 1.74 | 1.77 | 1.80 | 1.88 | 1.85 |
| 5/16/2017 | 1.68 | 1.73 | 1.78 | 1.71 | 1.93 | 1.75 | 1.73 | 1.75 | 1.78 | 1.82 | 1.89 | 1.85 |
| 5/17/2017 | 1.87 | 1.73 | 1.97 | 1.71 | 2.11 | 1.75 | 1.73 | 1.74 | 1.76 | 1.80 | 1.87 | 1.85 |

| Last primary market rates | | | | | | | |
|---|---|---|---|---|---|---|---|
| Paper | Au. date | Maturity | Avg. price | Avg. yield | Supply | Demand | Sold |
| 32W TB | 2/22/2017 | 8/30/2017 | 99.21 | 1.50 | 700 | 1832 | 726 |
| OK0419 | 5/18/2017 | 4/25/2019 | 96.43 | 1.91 | 250 | 990 | 253 |
| PS0422 | 5/18/2017 | 4/25/2022 | 97.75 | 2.73 | 1000 | 2297 | 972 |
| DS0727 | 5/18/2017 | 7/25/2027 | 93.25 | 3.29 | 1000 | 1454 | 990 |

| Fixed income market rates (closing mid-market levels) | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Date | 1Y WIBOR | 1Y T-bill | 2Y IRS | OK0715 | 5Y IRS | PS0718 | 10Y IRS | DS1023 |
| 5/11/2017 | 1.750 | 1.474 | 1.635 | 1.578 | 1.960 | 2.232 | 2.405 | 2.949 |
| 5/14/2017 | 1.750 | 1.474 | 1.635 | 1.578 | 1.960 | 2.232 | 2.405 | 2.949 |
| 5/15/2017 | 1.750 | 1.474 | 1.635 | 1.578 | 1.960 | 2.232 | 2.405 | 2.949 |
| 5/16/2017 | 1.750 | 1.474 | 1.635 | 1.638 | 1.990 | 2.290 | 2.447 | 2.985 |
| 5/17/2017 | 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 |
| 5/11/2017 | 5.93 | 5.96 | 6.38 | 6.93 | 6.93 | 1.88 | 0.55 |
| 5/14/2017 | 6.00 | 6.03 | 6.35 | 6.83 | 6.83 | 1.88 | 0.55 |
| 5/15/2017 | 5.78 | 5.83 | 6.25 | 6.78 | 6.78 | 1.88 | 0.55 |
| 5/16/2017 | 5.85 | 5.88 | 6.25 | 6.78 | 6.78 | 1.89 | 0.55 |
| 5/17/2017 | 5.90 | 5.89 | 6.25 | 6.78 | 6.78 | 1.91 | 0.55 |

| PLN Spot performance | | | | | | |
|---|---|---|---|---|---|---|
| Date | EURPLN | USDPLN | CHFPLN | JPYPLN | HUFPLN | CZKPLN |
| 5/11/2017 | 4.2150 | 3.8744 | 3.8446 | 3.3928 | 1.3571 | 0.1584 |
| 5/14/2017 | 4.2200 | 3.8837 | 3.8534 | 3.4180 | 1.3598 | 0.1588 |
| 5/15/2017 | 4.2096 | 3.8463 | 3.8498 | 3.3862 | 1.3596 | 0.1587 |
| 5/16/2017 | 4.1902 | 3.7932 | 3.8296 | 3.3397 | 1.3566 | 0.1587 |
| 5/17/2017 | 4.1912 | 3.7808 | 3.8390 | 3.3601 | 1.3522 | 0.1583 |

# Disclaimer