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Polish Weekly Review

mBank Research
(macro/FI/FX analysis)

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Comment on the upcoming data and forecasts

On Tuesday final GDP release for the first quarter will be published. We expect flash reading (4.0% y/y) to be confirmed, much more attention should be put to growth composition. In our opinion consumption growth was solid (4.6-4.8% y/y) with a significant rebound in investment activity (+3-4% y/y after large negative numbers just a quarter before). Net exports should have contributed slightly negatively, while inventories decelerated substantially (from above 2pp. to something just slightly above zero). On the same day CSO will also publish CPI flash release for May, which in April stabilized at 2.0%. On Wednesday Polish manufacturing PMI will be published. Other economic indices (European as well as CSO's business outlook) are reaching all-time highs or levels close to records from the past years, however our final forecast still needs to be tailored. MPC Minutes (published also on Wednesday) should not attract too much attention also because next monetary policy meeting is scheduled only a week after.

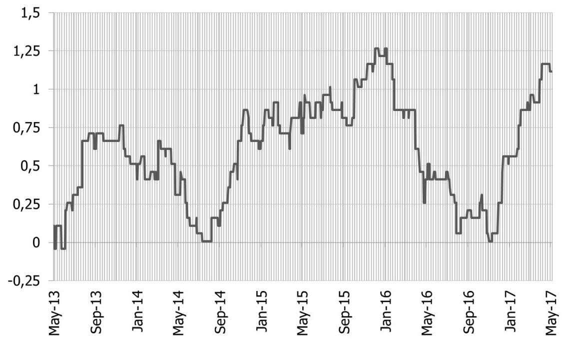
Polish data to watch: May 26th to June 2nd

Publication	Date	Period	mBank	Consensus	Prior
GDP y/y (%) *final*	31.05	Q1	4.0	4.0	2.5
CPI y/y (%) *flash*	31.05	May			2.0
Manufacturing PMI	01.06	May			54.1
MPC Minutes	01.06	May			

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

Polish surprise index moved slightly lower after weaker industrial output data. Next week bring few opportunities to change it with flash CPI and manufacturing PMI 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 front-run 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 benefited in lower rates environment among renewed EM inflows. Substantial improvement in fiscal position seems to be the most important factor for investors (compression of credit risks).
- Stronger GDP growth should underpin the zloty in the mid-term as it stays undervalued in real, effective terms.
- Although a technical correction is due from this levels, zloty-negative factors went to the background for the time being. Remember that Fed hikes were recently a factor discouraging substantial strengthening but not a reason for a weaker zloty per se. Overall it seems that interest rate channel (be it ECB or Fed policy) went to the background for the time being.

mBank forecasts

	2013	2014	2015	2016	2017 F	2018 F
GDP y/y (%)	1.4	3.3	3.8	2.7	4.1	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

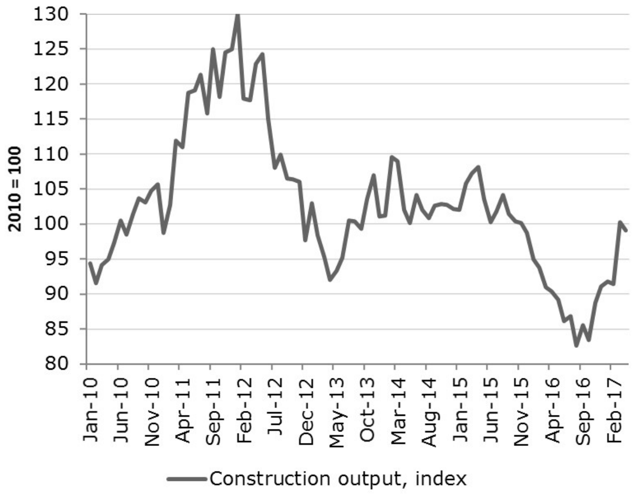
F - forecast

Economics

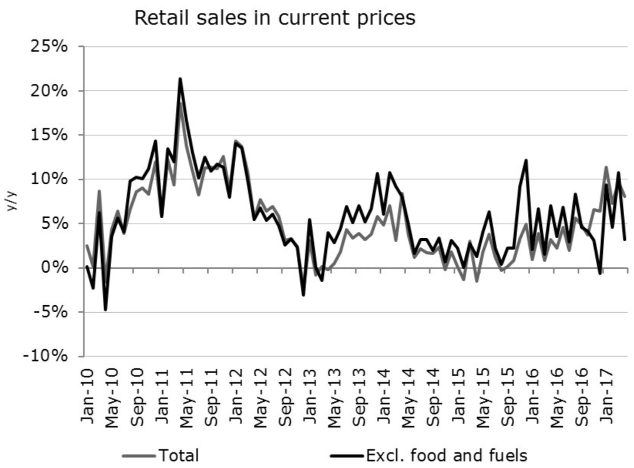
The disappointment in real sphere data is primarily due to underestimated calendar effect. Fast, cyclical upswing is in place.

Industrial output disappointed, having fallen by 0.6% y/y in April (consensus and our forecast – ca. +2% r/r). While the contrast with March's reading of 11.1% could not be greater, it is not a cause for concern. The primary cause of this massive swing is a strong calendar effect (working day count: -2 vs. +1 y/y) and a modest base effect from last year (roughly 1 p.p.). In addition, we feel that large calendar effects are often underappreciated by forecasters and tend to surprise in either direction. After seasonal adjustments, production fell by 1.2% m/m and rose by 4% y/y. Compared to this cycle's average of 3.5% y/y, it can hardly be seen as a bad reading or a major deviation from recent trends. One should remember that calendar effects are volatile – in May they are set to push industrial output to ca. 9% y/y.

Construction output disappointed as well, having grown by 4.3% y/y (consensus: 7%). The impact of working days was probably similar to what we have seen in industrial output data (if not greater), but some influence can also be attributed to weather-related disruptions (cold spells and snowfall in the second half of April). Adjusting for seasonal and calendar effects, we end up with a small decline in construction output (-1.2% m/m), broadly typical for the first month after a spike in output (+9% m/m in March). The next few months are set to bring massive acceleration in construction output due to strong base effects in the first half of 2016 (the decade low in output was noted in August 2016 – see the next graph).

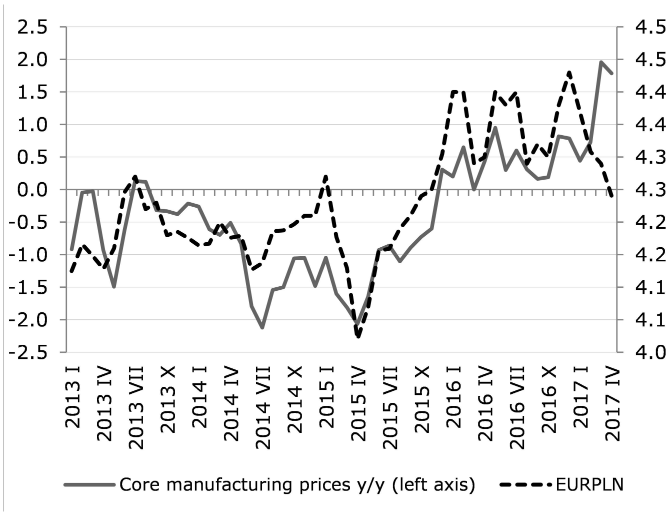


Retail sales rose in April by 8.1% y/y. Given our forecast (11%) it is a disappointment. However, large difference in working days suggests also that a problem with calculation of the stream „value" of one working days was magnified to a considerable extent. It is corroborated by the fact that categories responding more to working days (auto sales, fuel sales, other category) were a source of the biggest surprise. Looking beyond short-term gyrations, sales should normalize in the coming months. Of course we may see some payback given the base effects (500+ cash payouts), but significant pullback in consumption growth is unlikely given the second round effects that popped out since additional cash was disbursed: accumulation of savings (enabling consumption smoothing mechanisms), higher optimism and job security.



Any nowcast of Q2 GDP would not be a particularly precise exercise. Yet, we can draw some general conclusions regarding the overall trajectories of both industrial and construction output. First, industry likely slowed down slightly on annual basis vis-a-vis the first quarter. Second, construction will accelerate significantly – enough to balance the slight (and uncertain) deceleration in industrial output. This suggests that the conventional fears of "base effect" in Q2 GDP might be misplaced. The investment upswing might just be enough to keep GDP growth above or at 4% in Q2.

Producer prices rose by 4.3% in April, a bit less than we forecast. The deceleration stems from base effects, a decrease of prices in manufacturing (0.2% m/m) and mining (solid 2%, possibly of one-off nature). Given the upward trend in core producer prices, April's deceleration remains a mere blip. Substantial PLN appreciation caused correlation between the zloty and producer prices to come back (see the graph). May is going to be an important checkpoint: should correlation disappear with another, solid leg down in EURPLN, then we may safely say that economy is strong enough to generate constant, inflationary pressure.



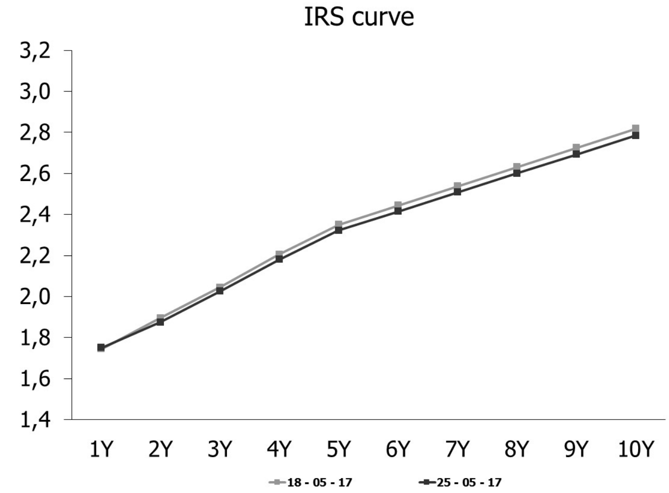
From the MPC's point of view, April data are neutral. The Council remains in a comfortable position and treats high GDP growth as confirmation of its own optimistic stance and not a harbinger of faster inflation down the road. As long as inflation path does not deviate from the current projections in a significant way, the market will believe the MPC's suggestions of another 18 months of interest rate stability. The fate of the long end of the curve will, on the other hand, be determined by the global risk-free rate – credit risk premium probably reached its local minimum in current circumstances.

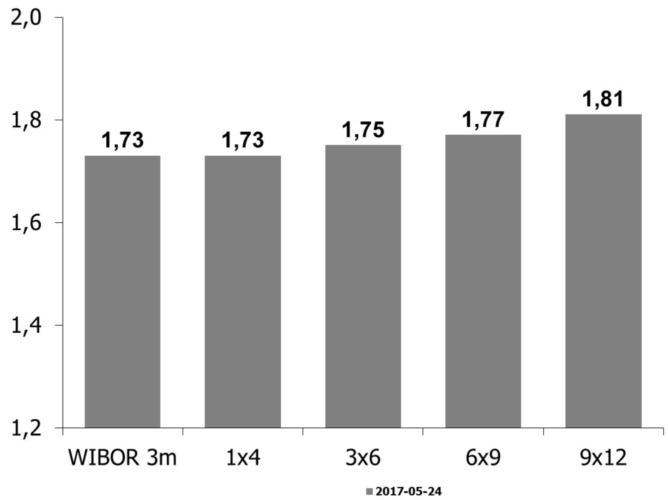
Fixed income

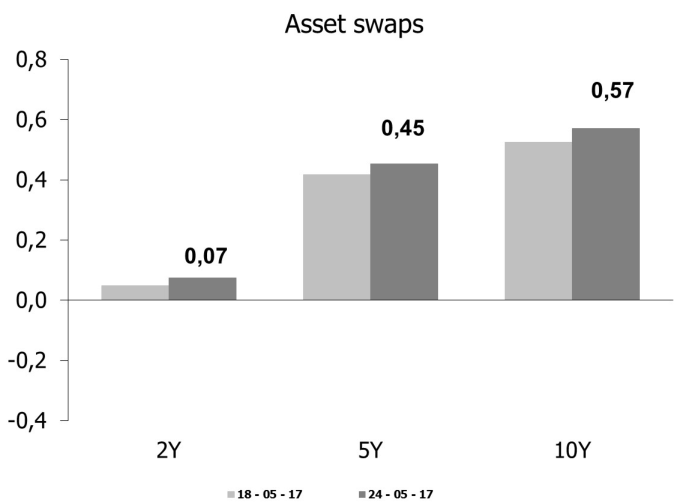
Another week another auction

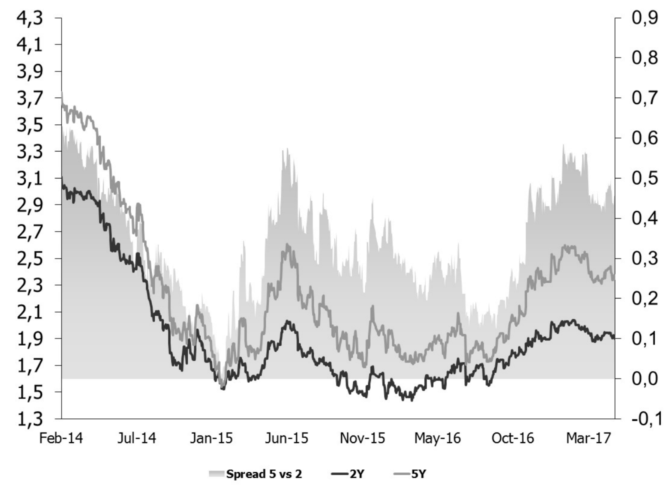
We had an auction this week. 4.3 bio was sold, but bid/cover ratio wasn't so impressive, only 1.35. Every bid was filled, last S/L were taken. Bund/DS0727 spread is at 295 bps today. Polish customers are long, Polish banks are long, internationals went long in march, who else can buy?

The PS0422/DS0727 spread widened from 55 to 57, ASW PS0422/5y is at 40 bps and DS0727/10y is at 52 bps (both widened 1bps). OK0419 is trading at 1.93% (1bps up), PS0422 is trading at 2.74% (4bps down) and DS0727 is trading at 3.31% (2 bps down).









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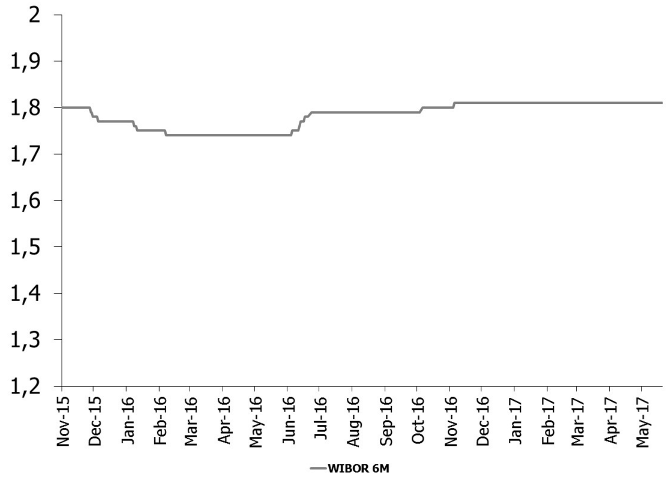
Money market

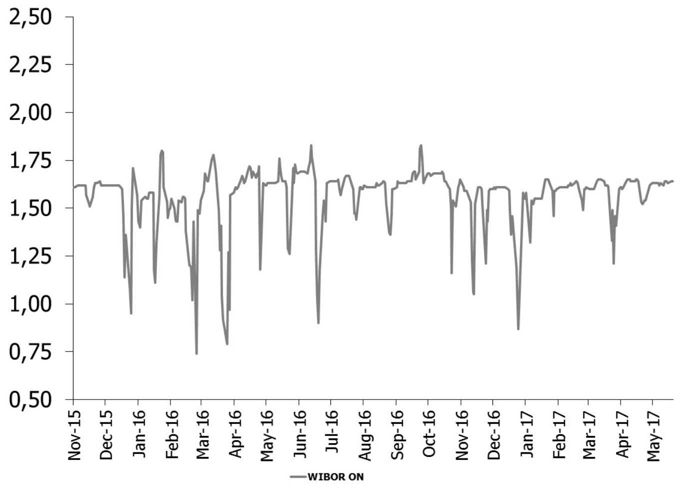
Following global bullish trend

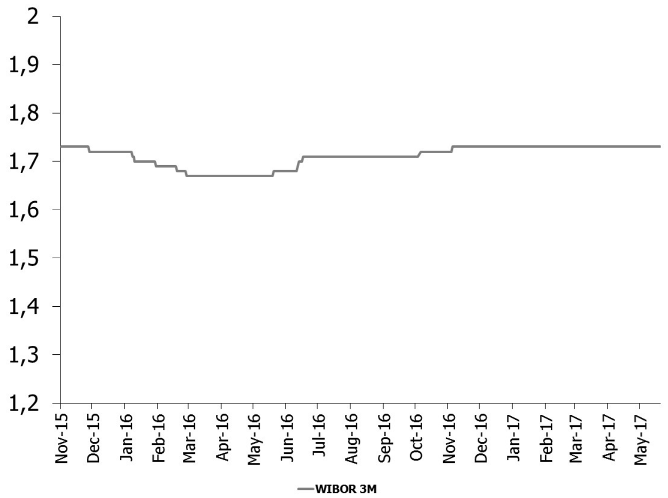
Bullish/risk-on sentiment prevails on global markets. Polish bonds are also benefiting, whole yield curve is drifting slightly lower. We are close to historical lows and getting past them would mean any no rate hikes are priced-in within next two years. Given the phase of economic cycle, such pricing may be regarded as non-standard.

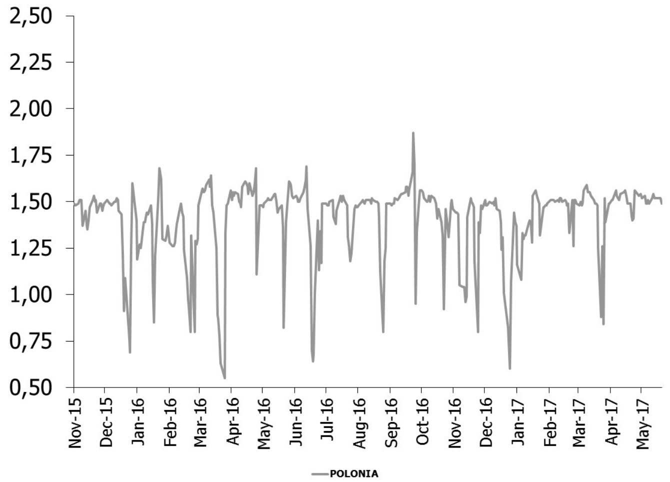
Overnight funding remains in tight range and we don't see it changing soon.

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









Forex

Spot – PLN – back into a coma The spike in EUR/PLN to 4.2290 from last week turned out to be a one-off event. EUR/PLN kept on sliding since, reaching 4.1716 low, a bit shy of the year's low at 4.1619. The support zone at 4.15-4.17 is currently exposed, but the market momentum is limited. Zloty is stronger in basket terms as well, as USD/PLN is also moving lower, and testing psychological 3.70 support. We are a bit sceptical about current PLN advances, more attached to the rangy 4.17-4.25 scenario. The USD/PLN seems to be the leading cross with PLN keeping the biding tone as EUR/USD still targets north.

EUR/PLN vols – tic lower Stronger PLN usually transforms into the lower vols but with vols already at their lows, the room to the downside is limited. 1 month EUR/PLN ATM is a tic lower at 6.0% (0.1% lower), 3 months EUR/PLN are 6.0% (0.25% lower), and finally 1 year is fixing at 6.85% (0.1% lower). The currency spread (difference between USD/PLN and EUR/PLN) is better offered, as EUR/USD vol melted. The skew is roughly unchanged.

Short-term forecasts

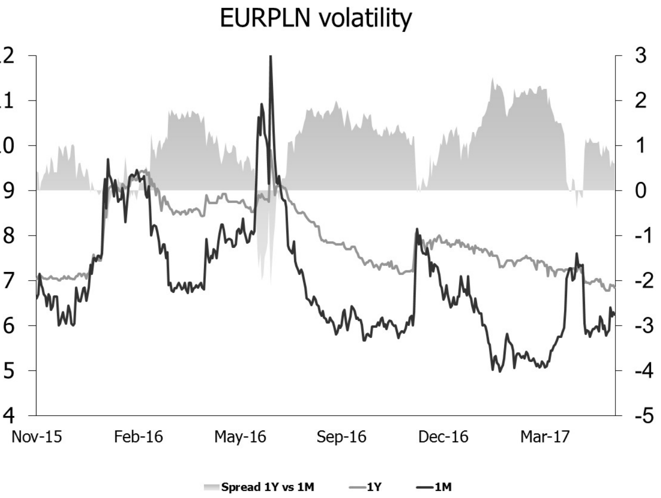
Main supports / resistances:
EUR/PLN: 4.15 / 4.25
USD/PLN: 3.70 / 4.00

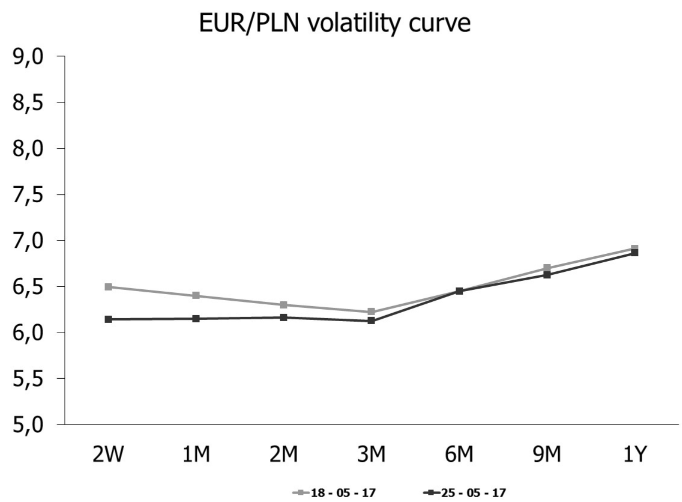
Spot Current position: Long EUR/PLN at 4.2250 and 4.1850.

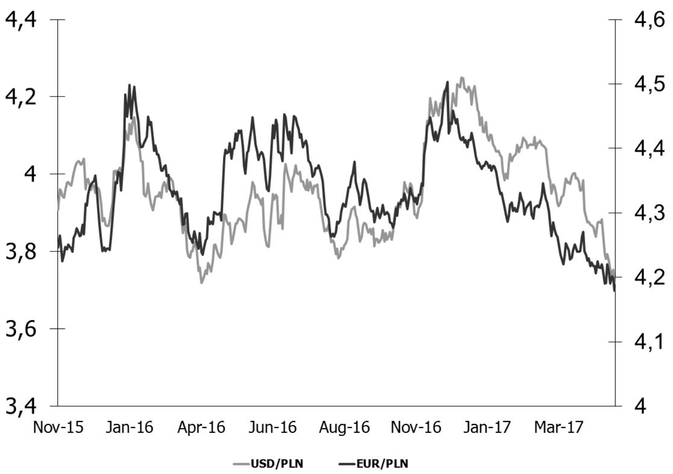
The jury is still out, but the future looks grim for our contrarian long EUR/PLN bet. We have missed the stop loss by 16 pips. We move the stop back and lower to 4.1600 (from 4.1750) and still hope for a move to 4.26/4.30 region.

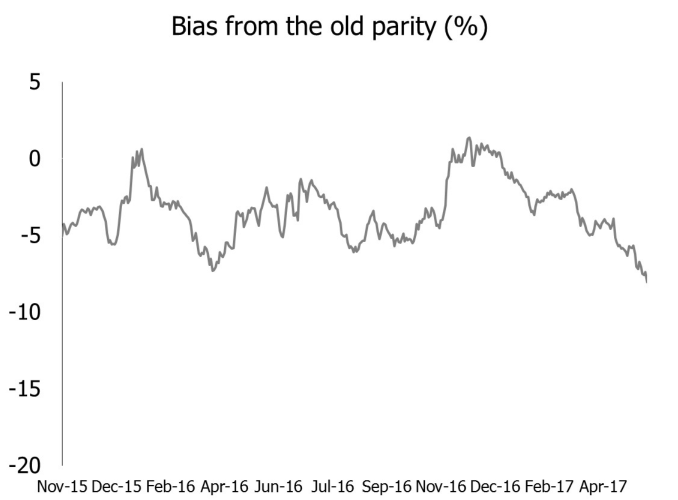
Options Vol – long 3 months and 9 months EUR/PLN.

Stronger PLN, lower realized volatility, lower vol, our long Vega in EUR/PLN was feeling the heat. We are keeping the position for the time being but our favoured time of holding it is shrinking as we wanted to get rid of that position before holidays.









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
5/18/2017	1.88	1.73	1.98	1.71	2.13	1.75	1.73	1.74	1.76	1.80	1.86	1.85
5/21/2017	1.80	1.73	1.92	1.71	2.07	1.75	1.73	1.73	1.75	1.79	1.85	1.84
5/22/2017	1.88	1.73	2.01	1.71	2.15	1.75	1.73	1.74	1.76	1.80	1.85	1.84
5/23/2017	1.72	1.73	1.83	1.71	1.97	1.75	1.73	1.74	1.76	1.80	1.85	1.84
5/24/2017	1.63	1.73	1.71	1.71	1.74	1.75	1.73	1.75	1.77	1.81	1.86	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
5/18/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
5/21/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
5/22/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
5/23/2017	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
5/24/2017	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	RR 1M	RR 1Y	FLY 1Y
5/18/2017	6.40	6.23	6.45	6.91	6.91	1.89	0.56
5/21/2017	6.20	6.14	6.49	6.89	6.89	1.89	0.56
5/22/2017	6.30	6.18	6.48	6.90	6.90	1.89	0.58
5/23/2017	6.25	6.15	6.45	6.85	6.85	1.88	0.54
5/24/2017	6.15	6.13	6.45	6.86	6.86	1.88	0.54

PLN Spot performance

Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
5/18/2017	4.2200	3.7926	3.8678	3.4180	1.3614	0.1583
5/21/2017	4.2069	3.7735	3.8594	3.3838	1.3609	0.1584
5/22/2017	4.1907	3.7526	3.8502	3.3679	1.3582	0.1581
5/23/2017	4.2018	3.7354	3.8448	3.3586	1.3608	0.1583
5/24/2017	4.1985	3.7535	3.8471	3.3560	1.3584	0.1584

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