June 22, 2017

Polish Weekly Review

mBank Research
(macro/FI/FX analysis)

@mbank_research

Ernest Pytlarczyk, PhD, CFA
chief economist
tel. +48 22 829 01 66
ernest.pytlarczyk@mbank.pl

Marcin Mazurek, PhD
senior analyst
tel. +48 22 829 01 83
marcin.mazurek@mbank.pl

Piotr Bartkiewicz
senior analyst
tel. +48 22 526 70 34
piotr.bartkiewicz@mbank.pl

Karol Klimas
analyst
tel. +48 22 829 02 56
karol.klimas@mbank.pl

Department of Financial Markets
(business contacts)

Wojciech Dunaj
head of interest rates trading
tel. +48 22 829 07 51
wojciech.dunaj@mbank.pl

Marcin Turkiewicz
head of fx trading
tel. +48 22 829 01 67
marcin.turkiewicz@mbank.pl

Department of Financial Markets Sales
(business contacts)

Inga Gaszkowska-Gebska
institutional sales
tel. +48 22 829 01 67
inga.gaszkowska-gebska@mbank.pl

Jacek Jurczyński
head of treasury sales
tel. +48 22 829 15 16
jacek.jurczynski@mbank.pl

mBank S.A.
18 Senatorska St.
00-950 Warszawa
P. O. BOX 728
tel. +48 22 829 00 00
fax. +48 22 829 00 33
http://www.mbank.pl

Table of contents

Comment on the upcoming data and forecasts

On Friday, monthly business sentiment data for June (according to CSO) will be published. On Monday, the CSO will publish its monthly Statistical Bulletin. Among others, it contains final information about the unemployment rate in May. According to preliminary data, unemployment rate fell less than market participants were expecting (from 7.7 to 7.5%, instead of 7.3-7.4%). Details on latest releases from labour market and the real sphere are set to be published. Next week ends on Friday with the flash estimate of CPI in June. Due to the strong drop in fuel prices in June, annual inflation likely fell again.

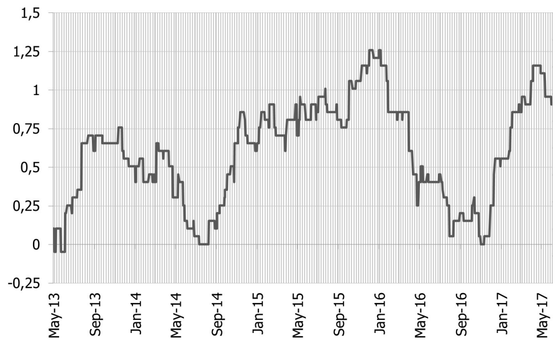
Polish data to watch: June 23rd to June 30th

Publication	Date	Period	mBank	Consensus	Prior
Business confidence	23.06	Jun			
Unemployment rate (%)	26.06	May	7.5	7.5	7.7
CPI y/y (%) *flash*	30.06	Jun			1.9

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	7/6/2017	600	1.859	6/9/2017
5Y T-bond PS0422	7/6/2017	1000	2.587	6/9/2017
10Y T-bond DS0727	7/6/2017	600	3.128	6/9/2017
30Y T-bond WS0447	-	100	3.508	6/9/2017

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



Comment

Only one publication was able to move the index – PPI surprised on the downside. Next week brings two opportunities for surprises: unemployment rate data and flash CPI.

* 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).

mBank.pl

Our view in a nutshell

Fundamentals

- Q1 GDP figures (4.0% y/y) confirmed that the economy is operating on a high gear. However, so far there is little to suggest that it would continue to accelerate. Household consumption will ultimately slow down slightly, as base effects and inflation bite, while the looming acceleration in investment is set to be checked by negative net exports. Therefore, we are comfortable with our current forecast of flat GDP growth path throughout the year. Rapid acceleration in wages or swifter return of private investment are clear, upside risks for 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. The effects of higher domestic seasonal food prices and lower fuel prices will likely cancel each other out. Thus, inflation forecast for 2017 is mostly unchanged so far.
- However, the case for 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 guide, 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 (REER) terms.
- Having said that, there is a constant risk of upward corrections driven either by the repricing of global risk-free rates, or bursts of risk aversion stemming from non-economic news. Heavy positioning (long PLN is clearly a crowded trade) is both a blessing and curse here.

mBank forecasts

	2013	2014	2015	2016	2017 F	2018 F
GDP y/y (%)	1.4	3.3	3.8	2.7	4.0	4.0
CPI Inflation y/y (average %)	0.9	-0.1	-0.9	-0.6	2.0	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	6.7	6.0
Repo rate (end of period %)	2.50	2.00	1.50	1.50	1.50	2.25

	2017 Q1	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	3.8	4.0	4.3	3.8	4.0	4.0	4.0
Individual consumption y/y (%)	4.7	4.5	4.2	4.0	4.0	3.8	3.8	3.8
Public Consumption y/y (%)	1.0	2.0	2.5	3.0	4.0	3.0	3.0	3.0
Investment y/y (%)	-0.4	4.5	7.0	12.0	12.0	11.0	8.0	7.0
Inflation rate (% average)	2.0	1.9	2.1	2.1	2.1	2.2	2.3	2.4
Unemployment rate (% eop)	8.2	7.0	6.5	6.7	6.9	5.9	5.7	6.0
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	2.00	2.09	2.22	2.41	2.66	2.84	2.97
10Y Polish bond yields (% eop)	3.49	3.25	3.37	3.53	3.75	4.03	4.24	4.40
EUR/PLN (eop)	4.23	4.20	4.15	4.10	4.10	4.10	4.08	4.05
USD/PLN (eop)	3.97	3.75	3.77	3.80	3.80	3.73	3.64	3.55

F - forecast

Economics

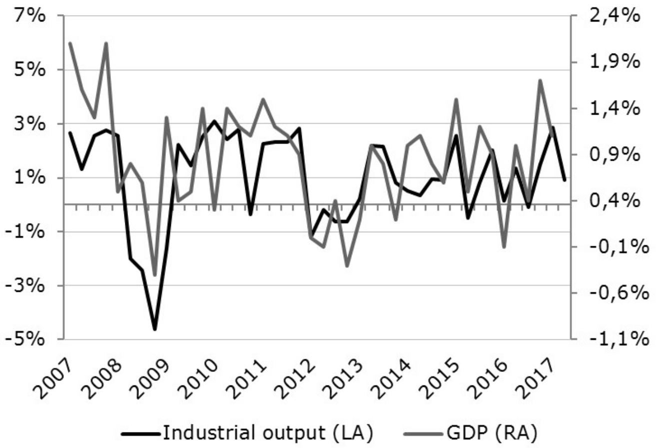
Positive scenario for 2017 remains unthreatened, but price pressure looms large.

May data are consistent with partly weaker soft data in the previous months and imply softer momentum in Q2 (as seen in visibly lower quarterly growth rates of both industrial output and construction spending). A purely arithmetic nowcast would put Q2 GDP growth at 3.8% y/y, but one should remember that this is not materially different from the Q1 figure of 4% y/y. Furthemore, medium-term growth prospects are not impacted by this set of data and we continue to see 4%+ growth this year, owing to the rebound in public investment and strong consumer spending. From the MPC's point of view, those releases are neutral. Current pace of economic growth is sitting in MPC's comfort zone, and is a sign that the Council's optimistic scenario for the year is fulfilling itself. In our opinion, much larger impact on rates hike expectations (the Council is expecting not to adjust the rate until the end of 2018) will result from rising inflation and general price pressures, which are by far underestimated. All these considerations suggest that future inflation in Poland might be underestimated and interest rate expectations (first rate hike priced in at the beginning of 2019) are – let's be frank, given today's knowledge and forecasts – too distant. However it is still too early to spot bets to the contrary in the Polish yield curve.

Let's now look into details of most important May's releases:

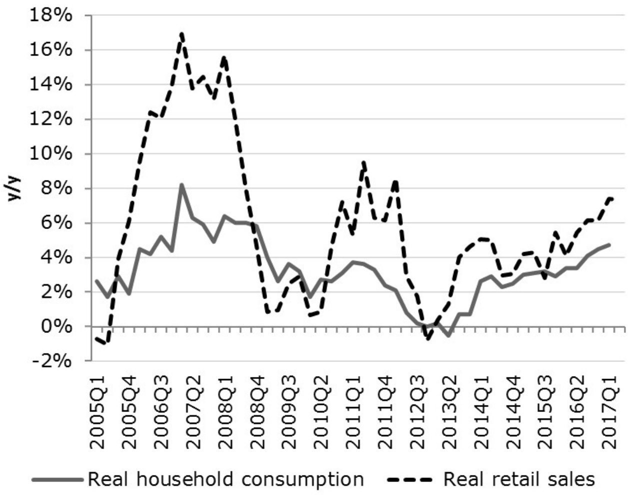
Industrial output grew in May by 9.1% y/y, slightly above market consensus and in line with our forecast. Two major factor contributed to such a number. Firstly, strong calendar effect (working day count swung from -2 to +1 y/y) boosted manufacturing production. Secondly, unusual weather conditions (cold start and hot end of month) raised energy production to 9.6% y/y. After adjusting for seasonal and calendar effects industrial output rose by 1.2%, thus erasing the drop in April. However, the jump in energy production means that momentum in manufacturing in May is weaker than for the whole aggregate. In fact, this is consistent with PMI readings and our thesis that companies are reducing inventories, which peaked at the turn of the year. In June calendar effects would hinder industrial production reading, but we still expect a comfortably positive reading.

GDP and industrial output (q/q, SA)

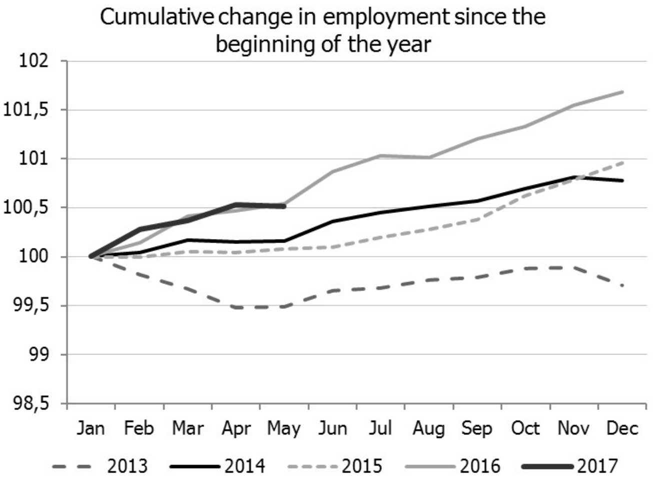


For the second time in a row, **construction output** surprised to the downside. On a yearly basis it grew by 8.4%, whereas market participants expected much higher reading (13.0%). After adjusting for seasonal and calendar effects, the number drops to 6.2% y/y, and on a monthly basis the aggregate fell just as it did in April (this time by 3.2% m/m). We will not speculate now about the reason for this surprise, it could be a result of overestimating base effects. Lower than usual temperatures at the beginning of the month could also contributed to this surprise. As a result, the expected massive acceleration in construction output due to strong base effects in the first half of 2016 is delaying itself a bit.

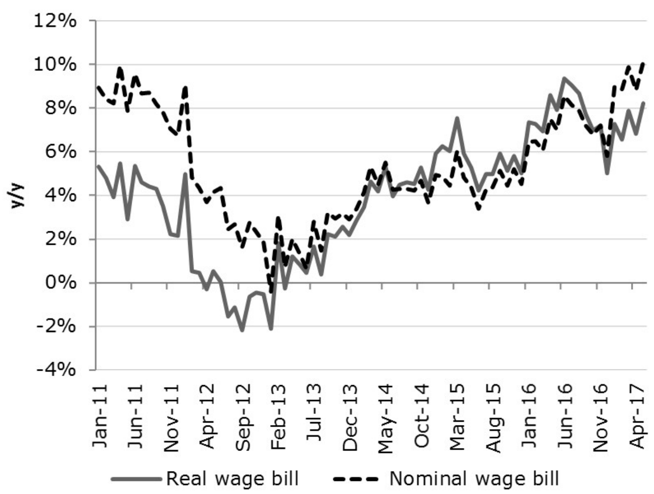
Retail sales disappointed again, having grown by 8.4% y/y (consensus: 9.0%; our very optimistic forecast at 10.2%). The key source of the surprise was the weak performance of food and beverages sales (after Easter-related slump, this category accelerated to a mere 3.5% y/y), as well as smaller than expected increase in fuel sales (14.8% – perhaps the impact of crackdown on tax fraud is waning from retail sales statistics). Other categories behaved more or less as expected and maintained their previous growth rates – in particular, car sales rebounded just as registration figures implied. On average, real retail sales growth in Q2 so far marches the Q1 average, suggesting that there is no material slowdown in consumption. In the following months retail sales might suffer from base effects related to disbursements of child subsidies, but one should not overestimate this effect. This is due to consumption smoothing and because of accelerating wage growth.



Employment in the enterprise sector fell in May on a monthly basis for the first time this year by 0.7k jobs. On a yearly basis employment is still growing strongly by 4.5%, which is just slightly lower than both market consensus and our forecast: 4.6%. As always, we need to wait till the end of the month for CSO's Statistical Bulletin, which contains details. We were expecting further improvement in Construction category, thus May's fall could have been attributed to correlation of most volatile sections (information and communication, administrative and support service activities). This drop is consistent with preliminary unemployment rate date, which also surprised to the downside (7.5% vs. median forecast ca. 7.3%). However, we do not see those data as first signs of incoming labor market tightening driven by bottleneck and skill mismatch. Positive broader picture remains relatively unchanged – we would need to see several weaker reading, to declare end of boom in this category.



Average gross wage grew by 5.4% y/y in May, slightly above consensus and close to our forecast (5.0 and 5.6%, respectively). As usual, definitive answers regarding the source of the surprise will only be available upon the release of the Statistical Bulletin next week. However, we are reasonably confident that the acceleration was driven by calendar effects (working day difference swung from -2 to +1 y/y) and strong base effects. May ’16 can be remembered as a month of stagnation in manufacturing wages and a big contraction in construction wages. Those one-off effects clearly boosted wage growth, but the uptrend here has long been in evidence – the increasingly tighter labor market will only steepen that trend. Available evidence, i.e. soft and hard labor market indicators as well as employers’ wage forecasts, all point to that.



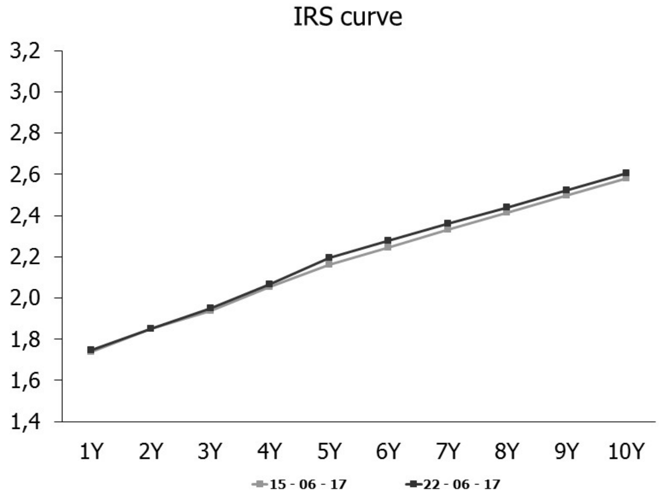
Nominal wage bill grew by 10% in annual terms and this is (rounding errors notwithstanding) probably the new 8-year high. Real wage bill grew by a respectable 8.2% y/y. One should note that wage bill is compensating for the fading statistical effects of ”500+” child subsidy programme (disbursements were first counted to household disposable income in May ’16). At the margin, the impact of faster wage growth on consumption right now is negligible compared to the lagged effects of child subsidies. However, larger and more frequent wage hikes should be another factors keeping consumer sentiment elevated in the coming months.

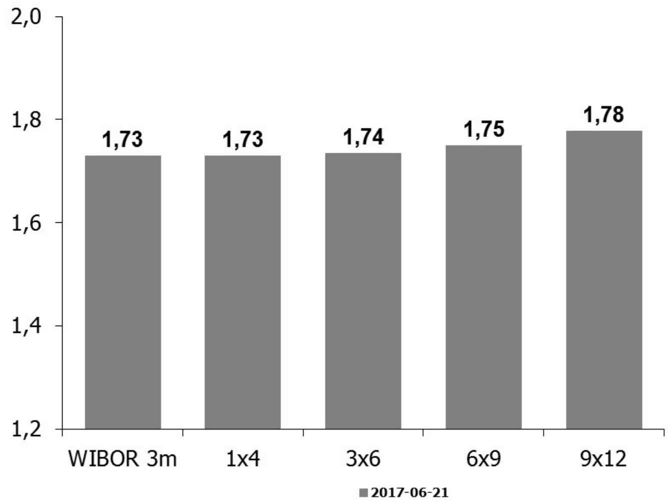
Fixed income

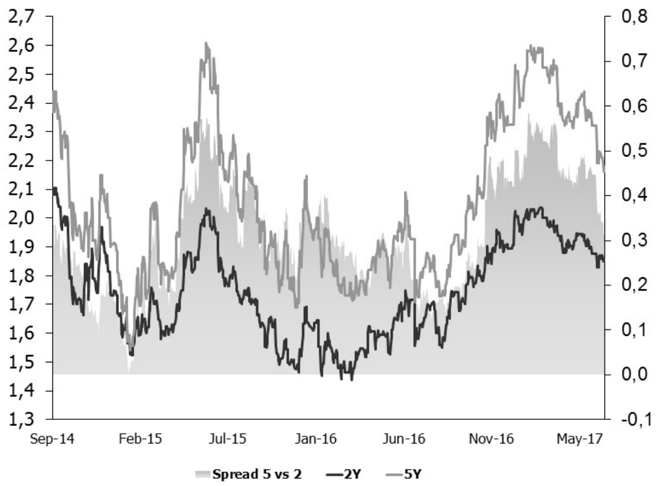
Auctions would be scarcer next quarter

Today we had an auction, bid/cover was 1.25, Ministry of Finance sold 4 bio of bonds, mostly PS0422. No one wants to buy l/e bonds. Finance Ministry promised to cancel 2 auctions in 3Q and sell only 10 bio.

Bund/DS0727 spread is 295 bps today, low was 281 bps. The PS0422/DS0727 is 60bps, as curve is steepening. ASW PS0422/5y is at 37bps and DS0727/10y is at 53bps. OK0419 is trading at 1.87% (3bps up), PS0422 is trading at 2.61% (5bps up) and DS0727 is trading at 3.21% (7bps up). Meanwhile, we touched 3.10% on DS0727 and for now it looks like yields' lows are behind us.



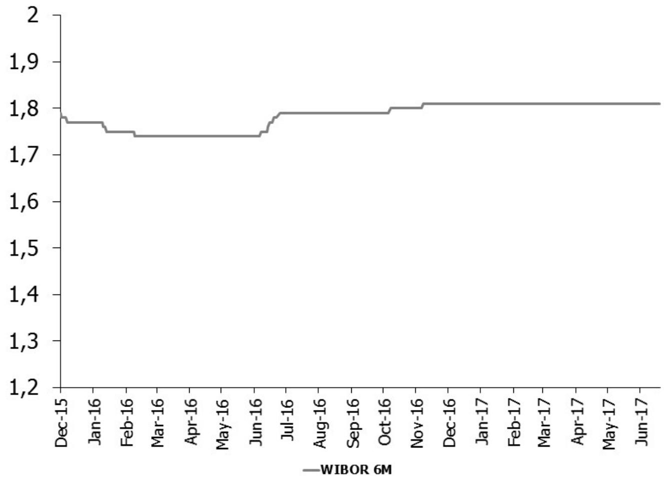


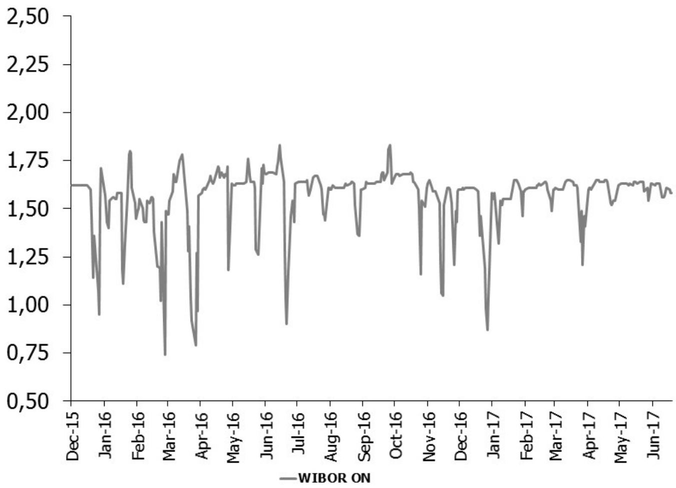


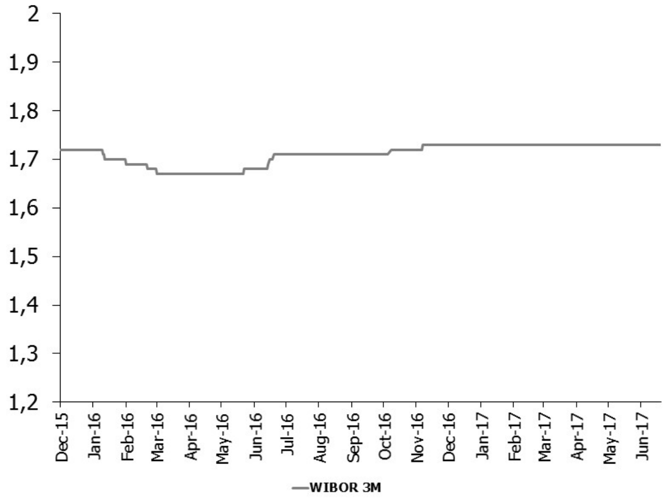
Money market

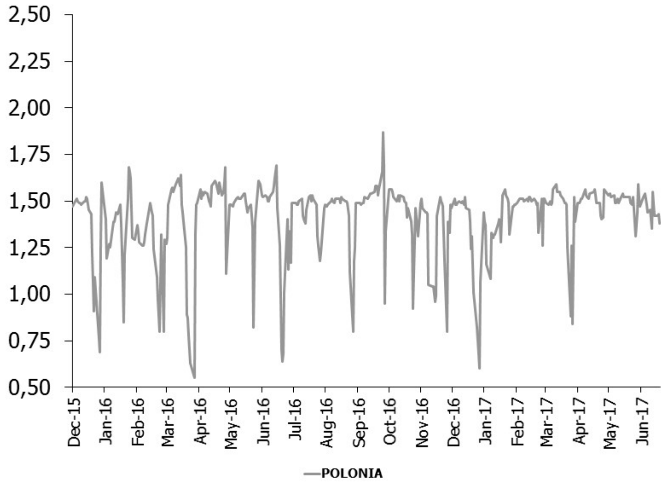
Stable week behind us... cheaper ahead of us

Friday's OMO was underbid (banks bought PLN 69.8 bio bills out of 79.5 bio offered). It caused cheaper cash. Overnight Polonia fluctuated below 1.50 for the whole week. Tomorrow's OMO is likely to be also be underbid as next week is the last week of mandatory reserve period in June. It seems that liquidity will also be secured so we expect quite relaxed funding next week below 1.50%. On the OIS curve we noticed some paying interest on the long-end with 1y Polonia at 1.49 and 9M Polonia at 1.48.









Forex

Spot – PLN – weaker, testing 4.26 The more hawkish then expected tone from Fed is still having its effect on the markets. USD is regaining some of its recently lost territory, and PLN is not an exception. PLN basket (EUR and USD equally weighted against PLN) is weaker as a result. EUR/PLN dropped from its post-Fed spike of 4.2420 to 4.2050 low, and resumed its ascent, reaching as high as 4.2620. We still believe in the rangy nature of EUR/PLN but the current range moved higher to 4.2050-4.2950. PLN longs have been trimmed in last sessions, and we are more balanced in our approach. Fading extremes is the short term trick.

EUR/PLN vols – tic higher in the front end Current spot moves were not enough to impress vol traders to raise the bids. Only the very front end is slightly higher and the backend of the curve has just stopped sliding. 1 month EUR/PLN ATM is at 5.85% (0.35% higher), 3 month EUR/PLN is at 5.85% (0.1% higher) and, finally, 1 year is fixing at 6.40% (unchanged). The currency spread (difference between USD/PLN and EUR/PLN) and the skew is slightly better bid.

Short-term forecasts

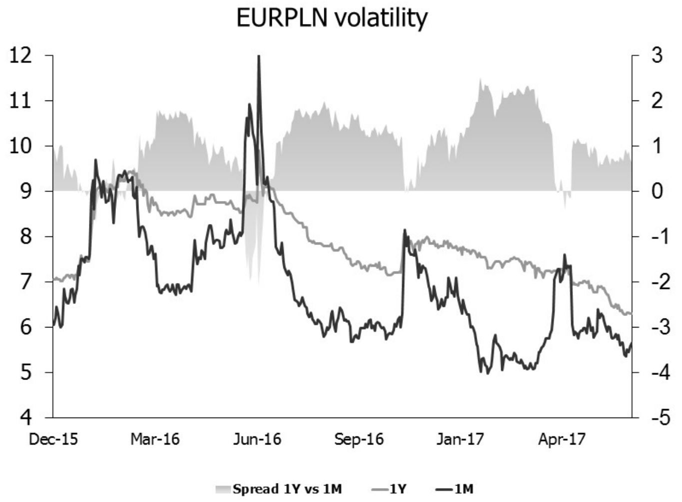
Main supports / resistances:
EUR/PLN: 4.20 / 4.30
USD/PLN: 3.70 / 4.00

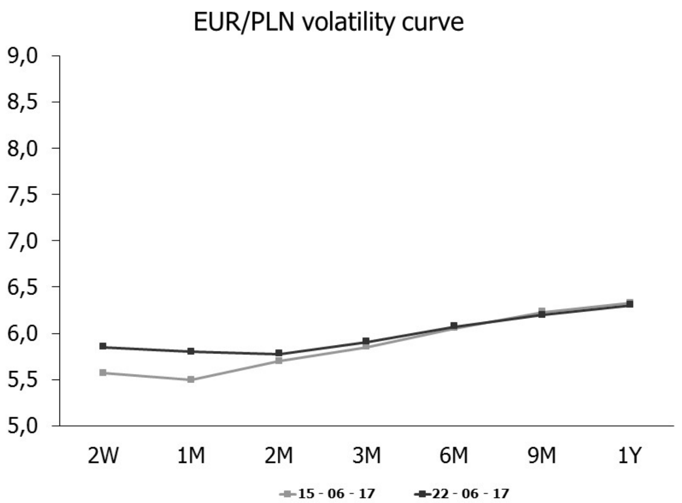
Spot Current position: Long EUR/PLN at 4.2150.

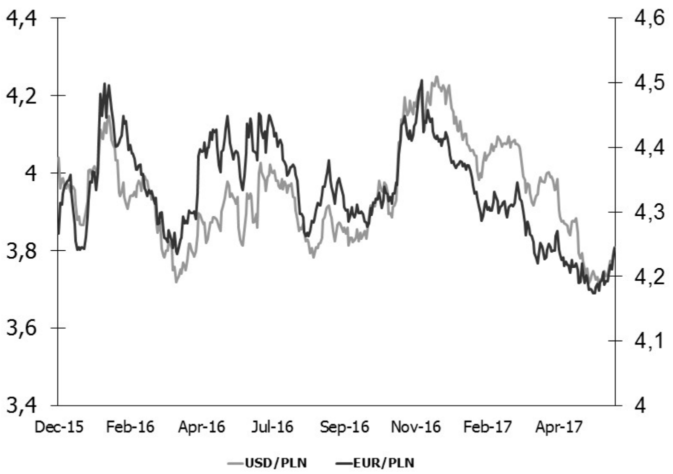
We have reestablished our long at 4.2150, we are ready to add at 4,1850 with 4,1600 stop, hope to see 4.26+ and, eventually, 4.30. We have decided to deep our toe again in the water, the logic is unchanged: dovish MPC, and historically attractive entry level.

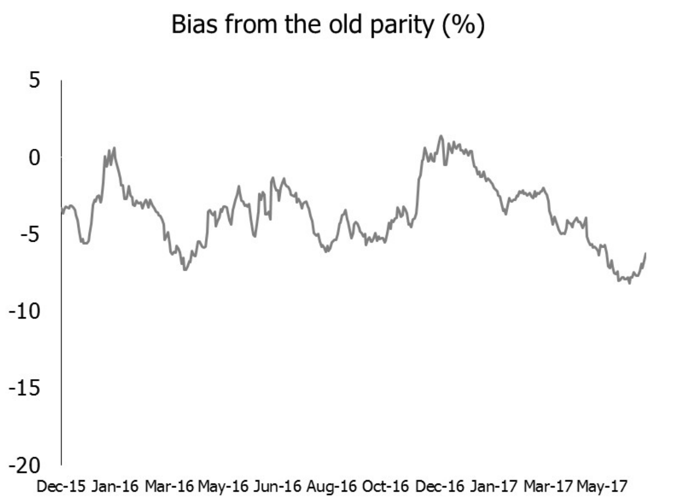
Options Vol – long 3 month and 9 month EUR/PLN.

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









mBank.pl

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
6/15/2017	1.71	1.73	1.84	1.71	2.03	1.75	1.74	1.75	1.76	1.79	1.80	1.81
6/18/2017	1.71	1.73	1.82	1.71	2.01	1.75	1.73	1.74	1.75	1.78	1.81	1.83
6/19/2017	1.69	1.73	1.82	1.71	2.02	1.75	1.73	1.74	1.76	1.80	1.82	1.84
6/20/2017	1.59	1.73	1.73	1.71	1.94	1.75	1.73	1.74	1.75	1.78	1.82	1.83
6/21/2017	1.66	1.73	1.71	1.71	1.75	1.75	1.73	1.74	1.75	1.78	1.83	1.83

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	6/9/2017	4/25/2019	96.62	1.86	600	1505	500
PS0422	6/9/2017	4/25/2022	98.47	2.59	1000	1811	1085
DS0727	6/9/2017	7/25/2027	94.61	3.13	600	944	640

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0715	5Y IRS	PS0718	10Y IRS	DS1023
6/15/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
6/18/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
6/19/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
6/20/2017	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
6/21/2017	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
6/15/2017	5.50	5.85	6.05	6.33	6.33	1.90	0.57
6/18/2017	5.45	5.78	6.00	6.33	6.33	1.90	0.57
6/19/2017	5.58	5.79	6.01	6.30	6.30	1.91	0.59
6/20/2017	5.65	5.83	6.03	6.31	6.31	1.88	0.57
6/21/2017	5.80	5.90	6.08	6.30	6.30	1.89	0.59

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
6/15/2017	4.2025	3.7497	3.8702	3.4031	1.3715	0.1605
6/18/2017	4.2181	3.7749	3.8771	3.3912	1.3706	0.1608
6/19/2017	4.2112	3.7615	3.8711	3.3879	1.3698	0.1607
6/20/2017	4.2248	3.7862	3.8865	3.3929	1.3713	0.1612
6/21/2017	4.2442	3.8090	3.9104	3.4261	1.3714	0.1614

Disclaimer

Distribution and use of this publication The review note is based on the information available to the public. This review creates exclusively a marketing information as defined in Paragraph 9 Section 1 of the Decree of Minister of Finance dated November 20, 2009 on procedures and conditions to be followed by investment firms and banks mentioned in Article 70 Section 2 of Law on Trading in Financial Instruments dated July 29, 2005 as well as by custody banks. This review note is provided to you for information purposes only and is not intended as advice on any particular matter or as recommendation, offer or solicitation for purchase of sale of any financial instrument and should not be taken as such. mBank SA, its directors, officers, executives, managers, servants or agents expressly disclaim all liability to any person in respect of any-thing, and in respect of the consequences of anything, done or omitted to be done, wholly or partly, in reliance upon the whole or any part of the contents of this review note. The opinions and estimates contained herein reflect the current judgment of the author(s) on the date of this document and are subject to change without notice. The opinions pointed in review do not necessarily correspond to the opinions of mBank SA. The past performance of financial instruments is not indicative of future results. No assurance can be given that any financial instrument or issuer described herein would yield favourable investment results. mBank and/or its principals or employees may have a long or short position or may transact in the financial instrument(s) and/or securities referred to herein or may trade in such financial instruments with other customers on a principal basis. No client or other reader should act or refrain from acting on the basis on any matter contained in it without taking specific independent professional advice on the particular facts and circumstances in issue. Copyright protection exists in this publication and it may not be, even partially, reproduced of distributed without the prior written agreement with mBank SA.