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Polish Weekly Review

mBank Research
(macro/FI/FX analysis)

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Comment on the upcoming data and forecasts

This Friday, the CSO will publish its flash estimate of CPI in September. Due to high food and fuel prices (because of the latter base effect from last year becomes void) and and a bit higher core inflation, inflation is set to accelerate on annual basis, to 2.0%. On Monday, manufacturing PMI for September will be published. Contrary to an optimistic consensus, we expect the index to hold steady close to last month's value. In spite of strong growth in Poland and elsewhere, the effects of supply constraints continue to weigh on the PMI. On Wednesday the MPC will publish its decision regarding interest rates. We expect that the Council will put rates on hold again. The decision will be, just as in the previous months, justified by lack of macroeconomic imbalances, as well as limited wage and inflationary pressures. The NBP governor will likely sound dovish, yet staunchly optimistic regarding the Polish economy.

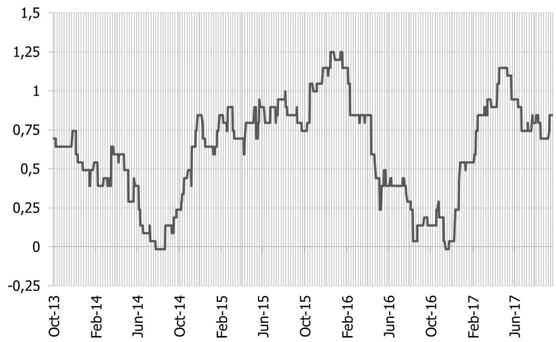
Polish data to watch: September 30th to October 6th

Publication	Date	Period	mBank	Consensus	Prior
Flash CPI y/y (%)	30.09	Sep	2.0	2.0	1.8
Manufacturing PMI (pts.)	02.10	Sep	52.5	53.2	52.5
MPC decision (%)	04.10	Oct	1.50	1.50	1.50

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	10/5/2017	600	1.859	6/9/2017
5Y T-bond PS0422	10/5/2017	1000	2.587	6/9/2017
10Y T-bond DS0727	10/5/2017	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

Unchanged as unemployment rate turned out in line with consensus and below the Ministry of Labour's preliminary estimate. Next days bring two opportunities to surprise: flash CPI (this Friday) and Manufacturing PMI (Monday).

* 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

- After very good set of data for August, we decided to raise our GDP forecasts again. In 2017, Polish economy is set to rise by 4.3% (prev. 3.9%), in 2018 by 4.4% (prev. 4.1%). Let's face it, household consumption is booming, while investment likely finally rebounded in Q3. Poland is entering the upcoming election cycle (local elections in 2018, parliamentary elections in 2019 and presidential elections in 2020) with very tight labor market, favorable external environment and stimulation on all fronts.
- Inflation is fluctuating within the lower half of the target band. Base effects suggest that inflation will drop at the turn of the year and reaccelerate briskly next year. One should look through short-term fluctuations and look at underlying momentum. The case for accelerating core inflation is strengthening. Polish labor market is operating normally and fits regional trends: wage inflation is coming.
- MPC stays calm and waves away any signs of intensifying wage pressure. 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.
- Fiscal situation continues to be very comfortable and GG deficit will fall below 2% of GDP this year. We judge that the increase in VAT revenues is 70% consumption growth and 30% crackdown on tax avoidance. The latter has not ended and the prospects for increases in tax collectibility are very good.

Financial markets

- EURPLN broke through 4.30 on the back of rising local risks (political turbulence, new CHF loan bill and the on-going disputes with the European Commission) and the broader move in EM assets associated with rising risk-free rate globally. Worse still, PLN continues to react asymmetrically to global factors (more likely to weaken than strengthen).
- With rising risk-free rates and slow-but-steady monetary tightening in developed markets, Polish monetary policy is increasingly a liability for the PLN via declining interest rate disparities.

mBank forecasts

	2013	2014	2015	2016	2017 F	2018 F
GDP y/y (%)	1.4	3.3	3.8	2.7	4.3	4.4
CPI Inflation y/y (average %)	0.9	-0.1	-0.9	-0.6	1.9	2.2
Current account (%GDP)	-1.2	-2.1	-0.6	-0.2	-0.9	-1.1
Unemployment rate (end of period %)	13.4	11.4	9.8	8.3	6.8	6.0
Repo rate (end of period %)	2.50	2.00	1.50	1.50	1.50	2.00

	2017 Q1	2017 Q2	2017 Q3 F	2017 Q4 F	2018 Q1 F	2018 Q2 F	2018 Q3 F	2018 Q4 F
GDP y/y (%)	4.0	3.9	4.6	4.5	4.5	4.4	4.3	4.3
Individual consumption y/y (%)	4.7	4.9	5.0	4.6	4.5	4.2	4.0	4.0
Public Consumption y/y (%)	1.0	2.4	2.5	3.0	4.0	3.0	3.0	3.0
Investment y/y (%)	-0.4	0.8	5.0	10.0	10.0	10.0	10.0	9.0
Inflation rate (% average)	2.0	1.8	1.7	1.9	1.5	2.2	2.6	2.6
Unemployment rate (% eop)	8.2	7.1	6.6	6.8	6.8	6.0	5.7	6.0
NBP repo rate (% eop)	1.50	1.50	1.50	1.50	1.50	1.50	1.75	2.00
Wibor 3M (% eop)	1.73	1.73	1.73	1.73	1.73	1.73	1.98	2.23
2Y Polish bond yields (% eop)	2.01	1.90	1.93	2.04	2.12	2.31	2.66	2.84
10Y Polish bond yields (% eop)	3.49	3.32	3.38	3.53	3.63	3.85	4.23	4.45
EUR/PLN (eop)	4.23	4.23	4.25	4.25	4.20	4.15	4.08	4.05
USD/PLN (eop)	3.97	3.70	3.66	3.63	3.59	3.49	3.40	3.35

F - forecast

Economics

Poland's labor market – taking a regional perspective

A constant undercurrent in our commentary is the view that Polish labor market is rapidly tightening, which portends an acceleration in wages and, down the line, in consumer prices. Because of this, we tend to bet on higher wage growth and see positive surprises in core inflation. In one of the previous editions of Polish Weekly Review we outlined the general framework we use to think about the labor market and its relationship with inflation.

Since then, wages accelerated (6.6% in the previous month), labor shortages have become more severe and unemployment rate has resumed its routine of monthly declines. However, the MPC's rhetoric remained staunchly dovish, as the NBP governor plainly dismissed concerns of labor market tightening during the last press conference. Not knowing what the labor market thresholds (i.e. levels of key variables that would make the Council worry) are, we decided to take a look at the whole region to see, if the Polish case is in any way special. To summarize our findings:

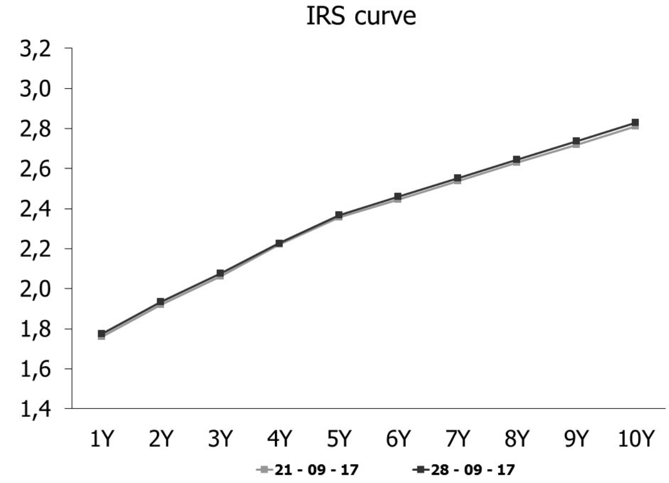
1. It is true that headline wage growth in Poland is lower than in Czech Republic and Hungary, but one should compare apples to apples. Different sector compositions and coverage mean that headline numbers cannot be compared directly. When wage growth in all three countries is measured on a comparable basis, Poland's distance to the two other countries is a bit smaller. For instance, different industry structure accounts for 0.7 percentage point difference in wage growth between Hungary and Poland.
2. Wage growth is impacted by minimum wage hikes and other institutional changes. In particular, the impressive double-digit numbers from Hungary were (starting from January) boosted by the minimum wage hike (by 25% for skilled workers and 15% for all others) and, perhaps, by the cut in social security contributions if the cut was taken advantage of by workers and not fully passed on to net wages. Poland's minimum wage hike amounted to ca. 7% in the same period.
3. Due to general freeze of public sector wages, Poland is clearly lagging in this regard among CEE countries.
4. As impressive as Poland's GDP performance this year and how epic the overall decline in unemployment rate have been, Poland's recovery does not seem to be significantly more advanced than the Czech or Hungarian ones. In fact, Poland's output gap is generally considered (by OECD, EC or national central banks) to be lower than in the other two countries. Conversely, unemployment gap (difference between unemployment rate and NAIRU) is lowest in Hungary.
5. In services, wage growth in all three countries essentially kicked into higher gear at the same time. In manufacturing, curiously, turnarounds happened in the order dictated by unemployment gaps (Hungary first, Poland third) – this is an interesting topic we might return to in the future.

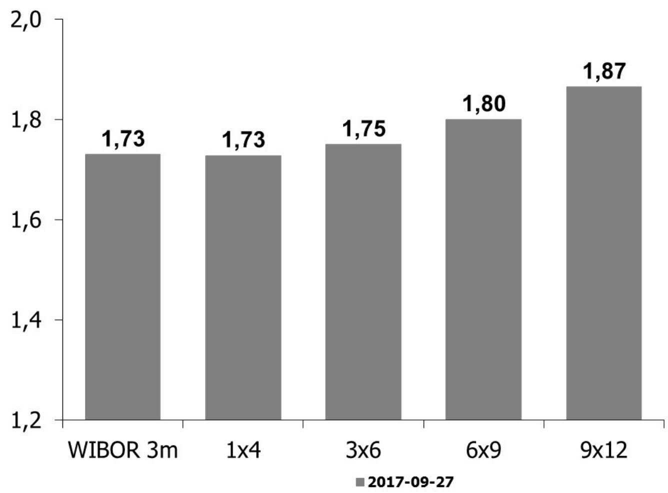
Overall, we get the impression that Polish labor market is operating normally and the differences between wage growth in Poland, Czech Republic and Hungary are perfectly explained by cyclical positions, measurement differences and institutional changes. This also means that monetary policy and market implications cannot be different. In light of this, we see that there are two roads for Poland: to follow Czech Republic's lead and tighten (but earlier than in early 2019, as market pricing suggests now), or try to contain the yield curve at all costs, call it the Hungarian-style. Scenarios are naturally, mutually excludable in terms of their implications for interest rates, the yields curve and its shape and also the exchange rate.

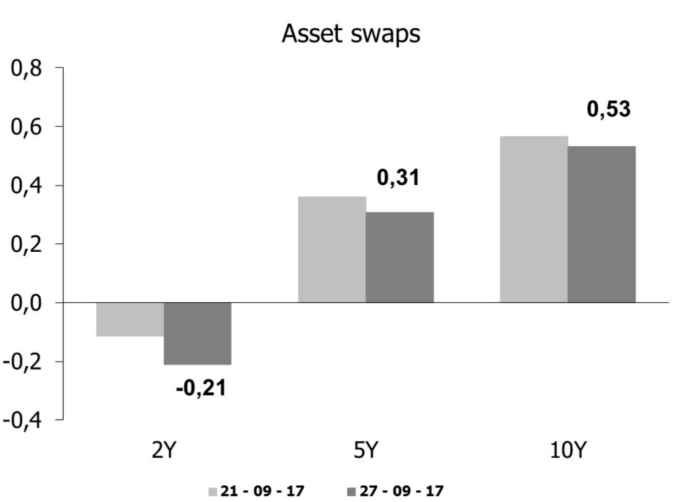
Fixed income

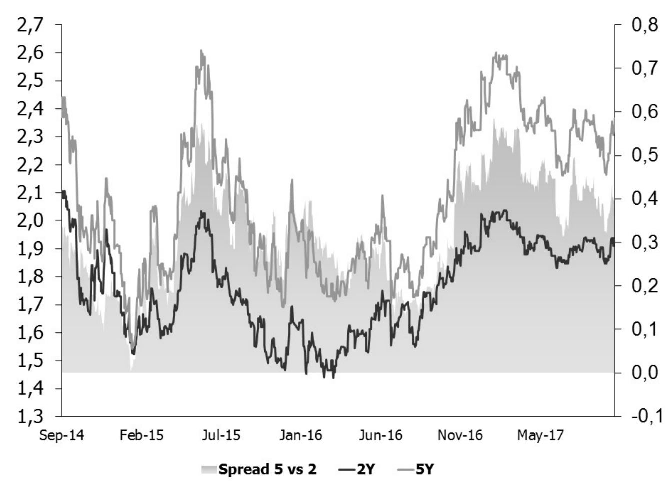
Supply strikes back

End of month is close, everyone wants short end bonds, PS0719/2y is at -35 bps – it doesn't make sense. Curve is very steep, PS0422/DS0727 is trading at 74 bps. In October, supply will come back to the market as we will see two auctions, both 6-8 bn, so it may be a hard month for ASWs. PS0422/5y is at 19 bps and DS0727/10y is at 42 bps, DS0727/Bund is 287 bps. PS0719 is trading at 1,62% (7 bps down), PS0422 is trading at 2,63% (1 bp down) and DS0727 is trading at 3,37% (1 bp up).









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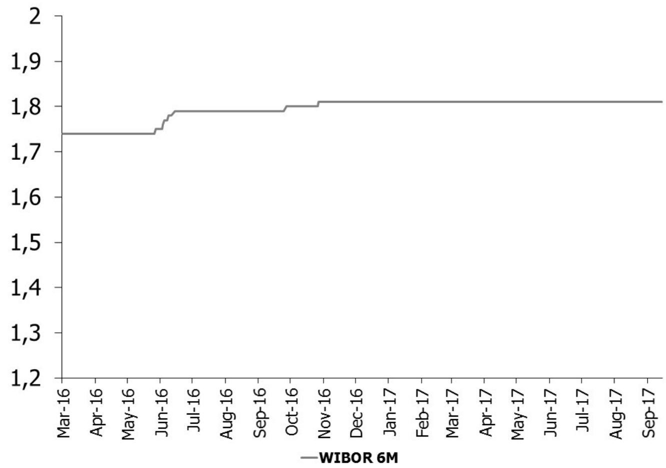
Money market

Great divergence

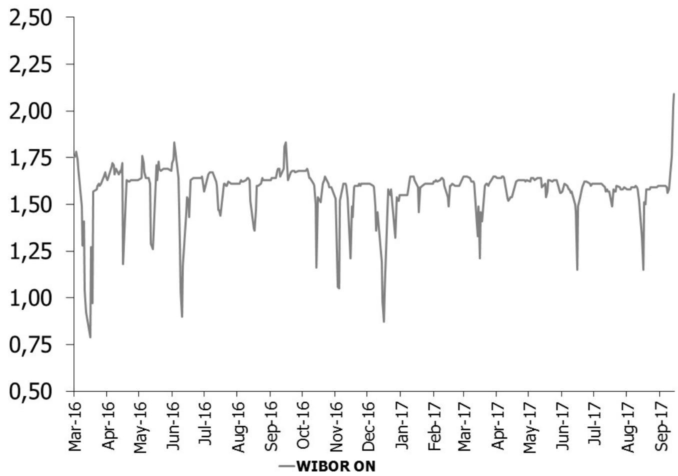


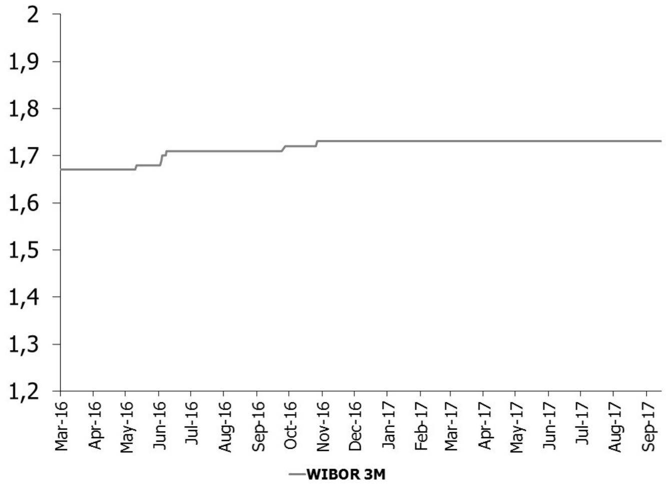
Another month with only one swiching auction amplifies the divergence between bonds and IRS yields. Swaps are moving higher with 2y and 5y touching multi-month highs, while bonds are holding very well with yields on lows. This means that it is very hard for market players to evaluate what real market expectations for future yields are and also difficult to play them due to banking tax.

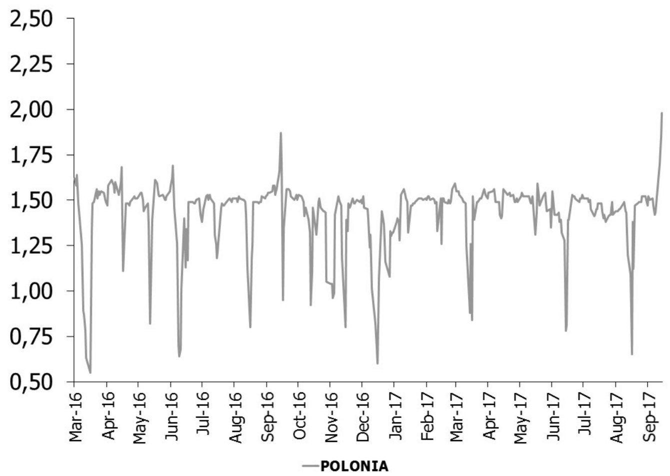
It feels like the economy is really in good shape, if not even overheating. Watch crude oil closely which is breaking highs and will have big impact on the CPI headline.

As we mentioned last week, there was a risk for more expensive cash. This risk materialised with O/N rates trading around 2.00%. Next week it all should go back to normal, around 1.50%. Averages are tightening, looks like ALM desks replaced their bond holdings and cheap cash is gone. At least for now.

Ref rate vs Polonia averages:
30 day 2 bp
90 day 5 bp







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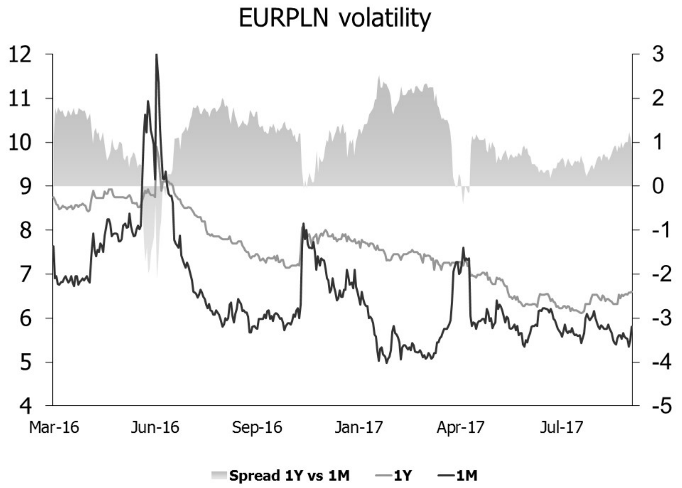
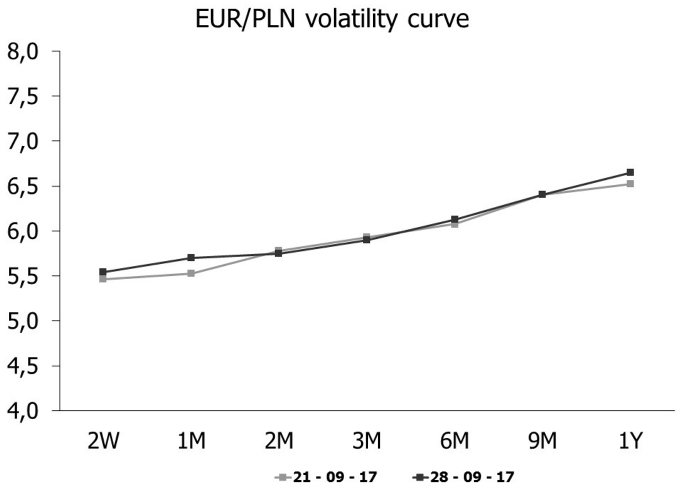
Forex

Spot: EUR/PLN – shot higher The mix of more hawkish FOMC, mild risk off sentiment and, above all, positioning forced EUR/PLN to break 4.30 resistance in style. The high so far was 4.3335 against 4.2610 low in EUR/PLN. USD/PLN moved from 3.55 low to 3.6950 high, before correcting lower. Is it merely a stop loss indicated position trimming or the beginning of the new trend (for weaker PLN), is still to be decided. Our range trading approach stays intact, but we are now moving to neutral from PLN negative skew. We are bit skeptical, if market has legs to run much further from here. Nevertheless, the price action is to be respected. Technical resistance of note for EUR/PLN is 4.3500 and 3.7500 for USD/PLN (our ideal targets).



EUR/PLN vols – tick higher The vols were on the rise with weaker Zloty, we even had realized volatility picking up, but we are skeptical if it will last. Last week there was still buying interest in the backend, reaching 6.75% in 1 year EUR/PLN. EUR/PLN 1 month ATM mid is 5.8% today (0.3% higher vs last week), 3 months are at 5.9% (unchanged) and finally 1 year fixed at 6.65% (0.15% higher). The skew and the currency spread (difference between USD/PLN and EUR/PLN) were rather offered.



Short-term forecasts

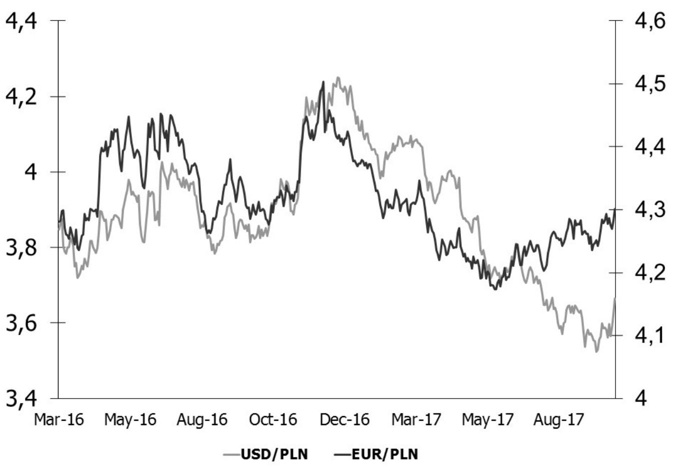
Main supports / resistances:
EUR/PLN: 4.25 / 4.35
USD/PLN: 3.50 / 3.80

Spot Current position: Long EUR/PLN at closed at 4.32. Sidelined.

We have closed the remainder of our EUR/PLN long at 4.3200. It is tempting to sell at the highest level for weeks, but we will keep only a small opportunistic position at the moment. We are not convinced, that we have much more momentum in this negative Zloty move, but the dust will have to settle before we would think about getting our toe in the water again.

Options Vol – tactical long

We reduced some vega position but still have small tactical long in mid curve Vega. The market is not really moving, we are in very tight price ranges. In the bigger picture, we are much more keen to enter bigger long Vega trade, but timing is key. For now we are sticking to our small tactical long.



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
9/21/2017	1.59	1.73	1.66	1.71	1.71	1.75	1.73	1.74	1.79	1.83	1.90	1.87
9/24/2017	1.59	1.73	1.66	1.71	1.71	1.75	1.73	1.75	1.80	1.85	1.90	1.89
9/25/2017	1.63	1.73	1.65	1.71	1.91	1.75	1.73	1.74	1.80	1.84	1.90	1.87
9/26/2017	1.48	1.73	1.59	1.71	1.74	1.75	1.73	1.75	1.80	1.86	1.91	1.89
9/27/2017	1.68	1.73	1.74	1.71	1.79	1.75	1.73	1.75	1.80	1.87	1.91	1.87

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
9/21/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
9/24/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
9/25/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
9/26/2017	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
9/27/2017	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
9/21/2017	5.53	5.93	6.08	6.53	6.53	1.80	0.56
9/24/2017	5.35	5.90	6.13	6.58	6.58	1.80	0.56
9/25/2017	5.50	5.90	6.08	6.58	6.58	1.79	0.56
9/26/2017	5.80	5.90	6.13	6.60	6.60	1.84	0.59
9/27/2017	5.70	5.90	6.13	6.65	6.65	1.78	0.58

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
9/21/2017	4.2863	3.5975	3.7042	3.2035	1.3822	0.1642
9/24/2017	4.2746	3.5651	3.6807	3.1818	1.3795	0.1639
9/25/2017	4.2698	3.5866	3.6887	3.1988	1.3761	0.1639
9/26/2017	4.2820	3.6234	3.7368	3.2428	1.3769	0.1643
9/27/2017	4.3012	3.6650	3.7588	3.2459	1.3792	0.1651

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