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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 Thursday, the CSO will publish final CPI data, which will explain the surprise in the flash release (2.2 vs. 2.0% y/y expected). There are several suspects: upward deviation of food prices from seasonal pattern, high prices of airline fares, base effects in education textbooks prices or the new list of refundable prescription drugs. On the next day, the NBP will publish core inflation, according to our initial forecast it should accelerate to 0.8 y/y, however this is highly susceptible to the structure of CPI release. If the surprise was driven by core categories, the original core inflation forecast is in doubt.

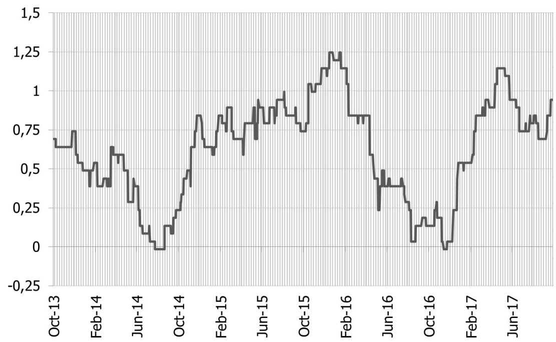
Polish data to watch: October 6th to October 13th

Publication	Date	Period	mBank	Consensus	Prior
CPI y/y (%) *final*	12.10	Sep	2.2	2.2	1.8
Core inflation y/y (%)	13.10	Sep	0.8	0.9	0.7

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	10/25/2017	600	1.859	6/9/2017
5Y T-bond PS0422	10/25/2017	1000	2.587	6/9/2017
10Y T-bond DS0727	10/25/2017	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

Another week without surprises – PMI turned out only slightly above market expectations and NBP rates remained unchanged. This week brings only one opportunity to move the index with final CPI release 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

- 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 4.5% (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 weakened in recent months on the back of 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.
- 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.
- Next year, when the MPC turns around and starts talking rate hikes, while growth continues to be stellar (consensus for a mild slowdown in 2018 is misplaced in our view), zloty should return to its cyclical patterns.

mBank forecasts

	2013	2014	2015	2016	2017 F	2018 F
GDP y/y (%)	1.4	3.3	3.8	2.7	4.3	4.5
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

Rates and rhetoric unchanged at October MPC meeting

Just as expected, MPC did not change rates at its October meeting.

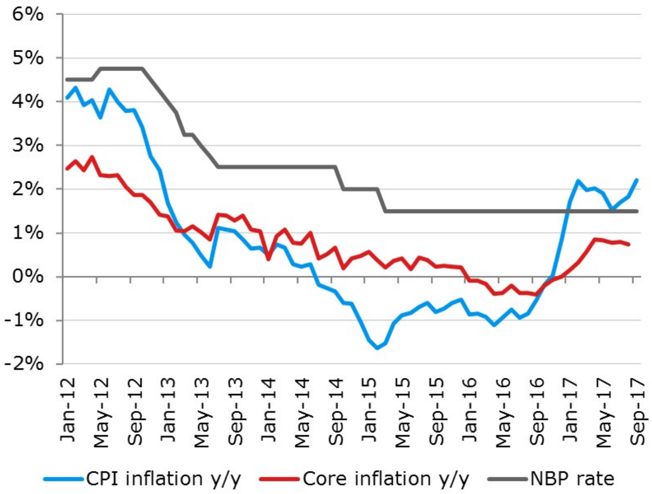
The statement after the meeting also did not change significantly. The ending still contains the key part: "the risk of inflation running persistently above the target in the medium term is limited". Further upswing of Polish economy was noted by adding the reference to a probable rebound in investment after recent rises in construction output. When it comes to inflation, the Council addressed the recent increases in prices of some commodities.

While some of those changes have a more hawkish tone, the conference after the meeting was dovish as always. Governor Glapinski reassured everybody that Polish economy is balanced, inflation is close to the NBP's target, and current monetary policy is optimal. Acceleration of wages and other signs of labour market tightening (enterprise surveys) were disregarded, in part because there are more severe in other EMEA countries (Czechia and Hungary) or are symptoms of Poland being a developed economy. The Council remain sceptical when it comes to the relation of wages and prices, as it has become less pronounced of late throughout the world. Those views were supported by forecasts of CPI and GDP growth for 2018 (at first glance, similar to those from latest NBP projections), indicating the inflation should stabilize and growth rate will be slightly lower.

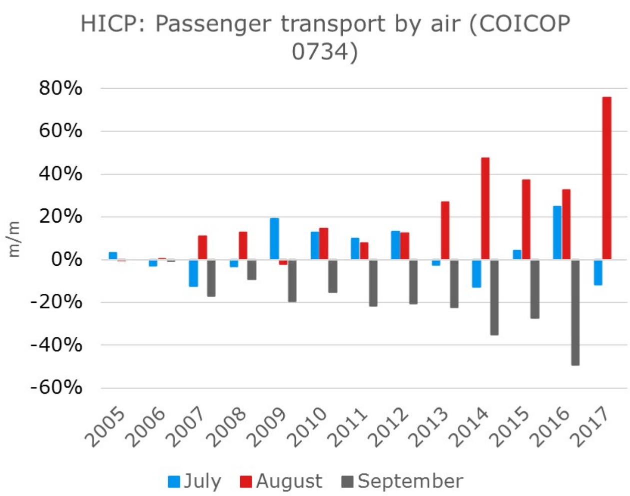
Given such rhetoric, it is not surprising that Governor Galpinski repeated that rates should remain unchanged until the end of next year. Market currently is pricing in such a scenario (first hike should happen at the turn of 2018/2019 and rates are set to rise by a total of 100 bps by the next 5 years). As we mentioned before, taking into account well-established economic relationships among labour market condition, wage growth and core inflation, such statements are too optimistic. On the other hand, the MPC will react only to measured and unambiguous price pressures, thus we expect that rates in Poland will be raised in the third quarter of 2018.

Major surprise in the CPI in September

Latest inflation reading in Poland is a major surprise. Annual growth of 2.2% y/y is close or above the cycle high (2.19% in February). Our estimates and market consensus both pointed to a more muted acceleration in the CPI, from 1.8 to 2.2% y/y. Until the details of the release are published in two weeks, our subsequent analysis is pure speculation. Granted, there is a lot of room for speculation this time.



The first suspect is, as usual, food prices. An increase in food prices in the +0.7-0.9% range (m/m) instead of +0.3-0.6% we assumed in our forecast would be sufficient to push CPI to 2.2%, yet we had considered such as result to be unlikely due to the long-lasting tendency of econometric models to overestimate food prices in September and lack of confirmatory signal in European data published already. The second suspect is airline fares (part of transport services), that have become increasingly more volatile in summer months. A smaller-than-assumed drop in September would also be sufficient to push core and headline inflation upwards. Third suspect resides in the Recreation and culture category and its name is educational textbooks (big m/m drops in the previous years due to the government's programme to introduce free textbooks to primary schools). Fourth suspect is the new list of refundable prescription drugs. The latter two tend to be unpredictable. Obviously, any combination of those factors could be behind the surprise and there is no reason to revise our core inflation forecast (0.8%) yet.



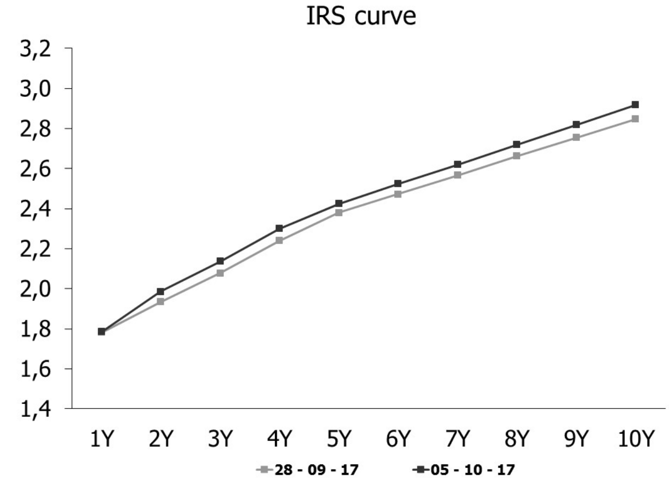
As noted above, the reasons for the surprise might have little to do with the state of the economy. Nevertheless, will form the basis of future inflation expectations of households and as such as relevant for the inflation outlook. They will fall on fertile ground, with underlying inflationary pressure rising due to labor costs. Next few months (until December – that's when base effects kick in – this is conditional on oil price developments) will be marked by a series of 2%+ readings.

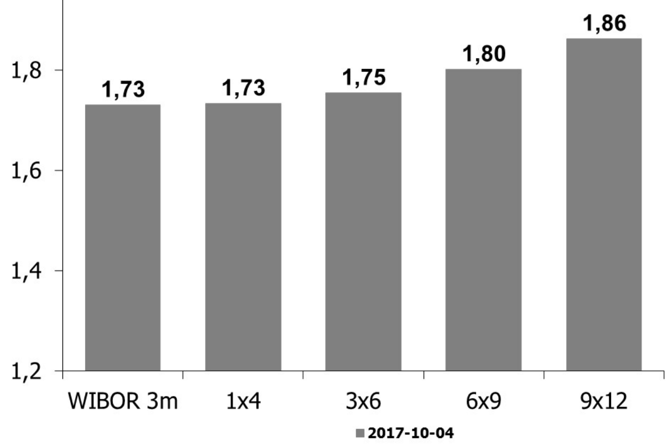
Fixed income

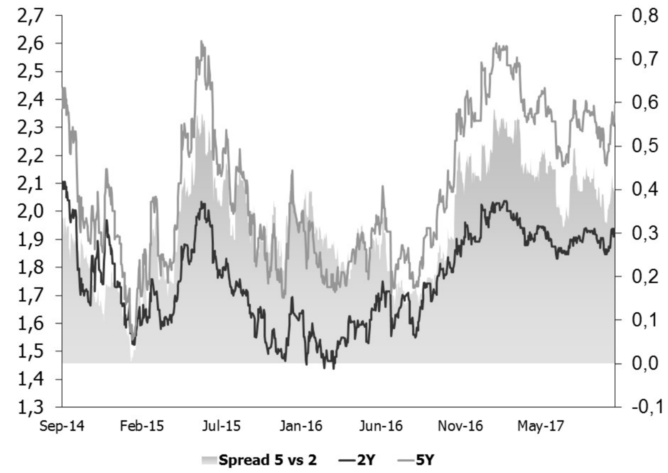
Another auction, but still a switch

Today we had a switching auction. Good demand, there was a lot of bids on 10y bonds. Ministry sold almost 7 bio and after that market is higher. It looks like all the bad news are priced in but market is still short. ASW are narrow PS0719/2y is -34 bps, PS0422/5y is at 20 bps and DS0727/10y is at 45 bps. PS0422/DS0727 is trading at 73 bps, DS0727/Bund is 293 bps. DS1017 expires soon so s/e bonds will be on the bid.

PS0719 is trading at 1.65% (3 bps up), PS0422 is trading at 2.65% (2 bps up) and DS0727 is trading at 3.38% (1 bps up).







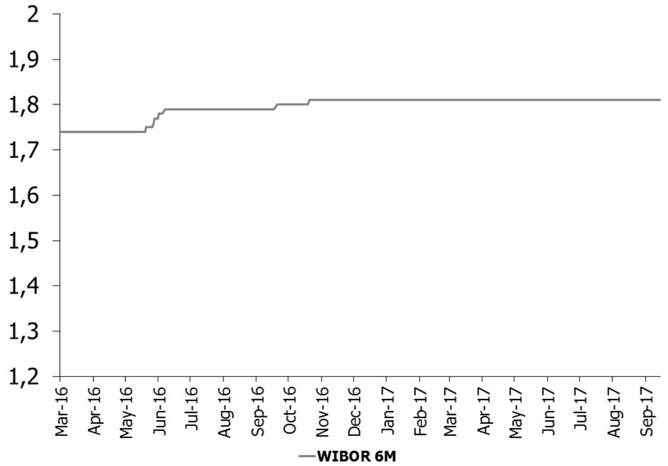
Money market

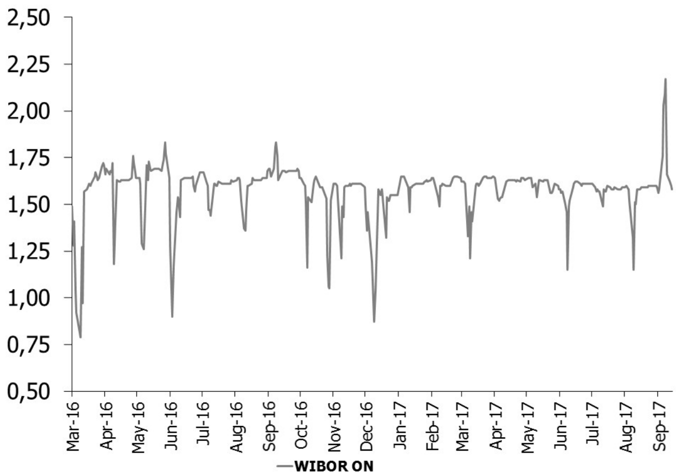
Stable week behind us

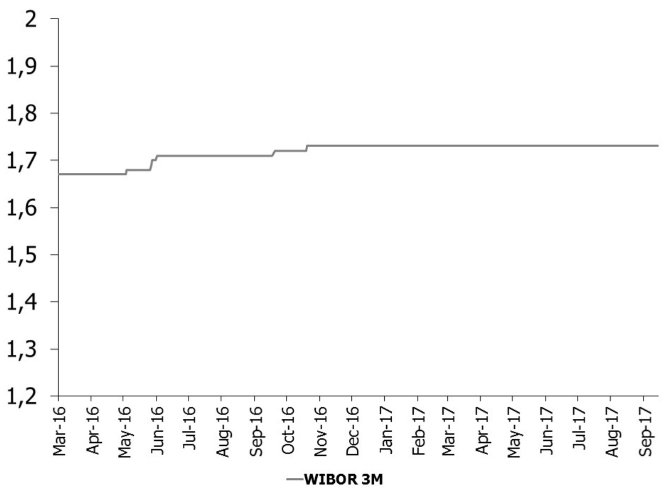
MPC meeting was a non-event again. Governor Glapinski reiterated that in his opinion rates should stay on hold until the end of 2018.

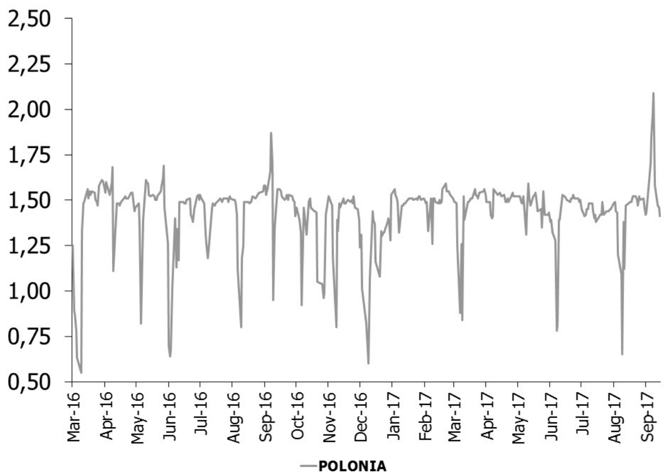
Today we had a switching auction, finally providing some liquidity into 2, 5 and 10-year bond sector.

As last OMO was underbid (banks bought PLN 58 bn bills out of 74 bn offered), cash was a bit cheaper with Polonia fluctuating below 1.50 for the whole week.









Forex

Spot: EUR/PLN – lower The momentum in EUR/PLN is already fading. EUR/PLN had one more attempt to break last week's high of 4.3335, but was able to climb only to 4.3250 before correcting lower. The low so far is 4.2935, the 4.2800 is the first technical support of note. Back to our base case scenario, which is range trading, and the current range should be contained in the 4.27-4.34 space. The MPC was a non-event, the NFP are not that crucial for EUR/PLN anymore. Play range with a neutral approach.

EUR/PLN vols – tic lower Stronger Zloty and diminishing realized volatility are behind the reasons, why EUR/PLN vols are sliding again. 1 month ATM mid is 5.35% today (0.45% lower vs last week), 3 months are at 5.6% (0.3% lower) and, finally, 1 year fixed at 6.5% (0.15% lower). The skew and the currency spread (difference between USD/PLN and EUR/PLN) were melting as well.

Short-term forecasts

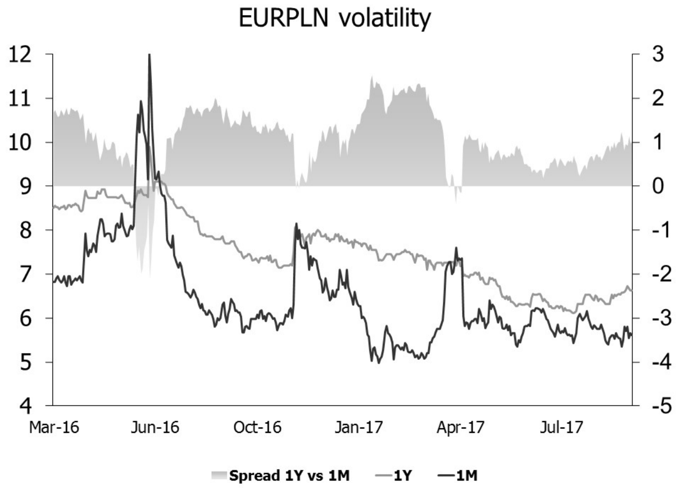
Main supports / resistances:
EUR/PLN: 4.25 / 4.35
USD/PLN: 3.50 / 3.80

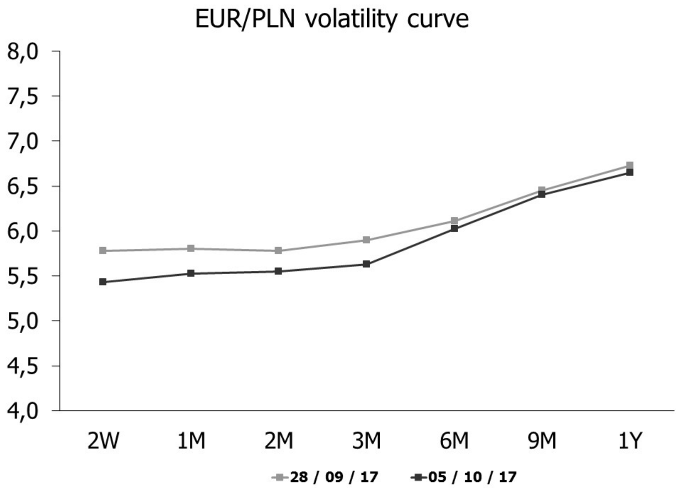
Spot Current position: None.

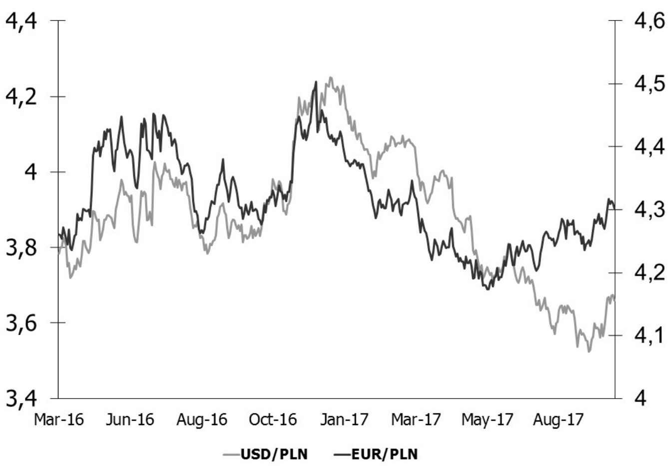
We are ready to reenter the EUR/PLN long at 4.2850 and 4.2450 with a stop loss at 4.2300, with hopes to see 4.35+. That is a purely technical/opportunistic trend-following trade. We can point to reasons, why we should be long PLN (i.e. strong economy). There were several recommendations from the leading global banks to enter long PLN position. We still will place our small contradicting bet in play.

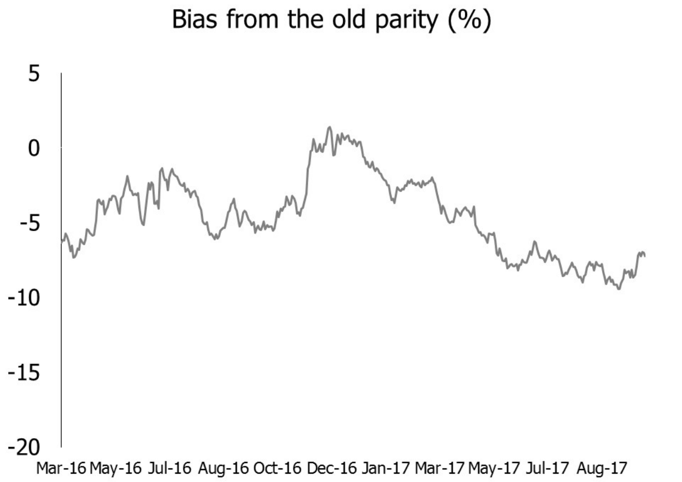
Options Vol – tactical long

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.









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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
9/28/2017	1.69	1.73	1.78	1.71	1.91	1.75	1.73	1.75	1.80	1.86	1.93	1.88
10/1/2017	1.69	1.73	1.77	1.71	1.90	1.75	1.73	1.76	1.80	1.88	1.94	1.90
10/2/2017	1.61	1.73	1.71	1.71	1.75	1.75	1.73	1.75	1.80	1.88	1.94	1.90
10/3/2017	1.50	1.73	1.57	1.71	1.62	1.75	1.73	1.75	1.81	1.87	1.95	1.90
10/4/2017	1.61	1.73	1.70	1.71	1.88	1.75	1.73	1.75	1.80	1.86	1.93	1.89

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
9/28/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
10/1/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
10/2/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
10/3/2017	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
10/4/2017	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
9/28/2017	5.80	5.90	6.11	6.73	6.73	1.79	0.57
10/1/2017	5.55	5.73	6.10	6.68	6.68	1.79	0.57
10/2/2017	5.65	5.65	6.03	6.63	6.63	1.79	0.56
10/3/2017	5.60	5.65	6.03	6.63	6.63	1.73	0.56
10/4/2017	5.53	5.63	6.03	6.65	6.65	1.72	0.57

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
9/28/2017	4.3166	3.6682	3.7668	3.2527	1.3878	0.1657
10/1/2017	4.3091	3.6519	3.7619	3.2439	1.3846	0.1655
10/2/2017	4.3137	3.6726	3.7825	3.2559	1.3864	0.1661
10/3/2017	4.3105	3.6737	3.7618	3.2478	1.3830	0.1662
10/4/2017	4.3025	3.6597	3.7581	3.2504	1.3825	0.1663

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