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Polish Weekly Review

mBank Research
(macro/FI/FX analysis)

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Comment on the upcoming data and forecasts

Week starts on Monday with trade balance data. We expect seasonal growth of both exports and imports, resulting in a smaller current account gap. On Tuesday CSO will publish labour market data. Despite a minor drop in yearly employment growth (from 4.6% to 4.5%), the general picture remains positive. We expect another strong wage growth (6.4% y/y) after few large employers raised significantly wages in September. Real sphere data will be published on Wednesday. After a stellar release in August, industrial production decelerated slightly to 5.5% y/y due to normalization of energy production and calendar effects. Base effects are responsible for worse construction output release than a month ago, however yearly growth should still top 15%. Retail sales should slightly accelerate nominally on a yearly basis, fuelled by car and clothing sales. Finally, PPI is also set to accelerate a bit because of higher commodity prices. Publication of MPC Minutes (Thursday) should pass unnoticed.

Polish data to watch: October 16th to October 20th

Publication	Date	Period	mBank	Consensus	Prior
Core inflation y/y (%)	13.10	Sep	1.0	0.9	0.7
Current account (mio PLN)	16.10	Aug	-623	-651	-878
Exports (mio PLN)	16.10	Aug	16100	15512	14939
Imports (mio PLN)	16.10	Aug	15700	15920	15486
Employment y/y (%)	17.10	Sep	4.5	4.6	4.6
Average wage y/y (%)	17.10	Sep	6.4	6.3	6.6
Industrial production y/y (%)	18.10	Sep	5.0	5.1	8.8
Retail sales y/y (%)	18.10	Sep	8.1	7.9	7.6
PPI y/y (%)	18.10	Sep	3.1	3.1	3.0
MPC Minutes	19.10	Oct			

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

Unchanged after final CPI matched flash estimate. Next week is packed with opportunities to surprise, as labour market and real sphere data will be published.

* 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, especially when inflation temporarily drops on base effects. 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	4.4
CPI Inflation y/y (average %)	0.9	-0.1	-0.9	-0.6	1.9	2.2
Current account (%GDP)	-1.2	-2.1	-0.5	-0.3	-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

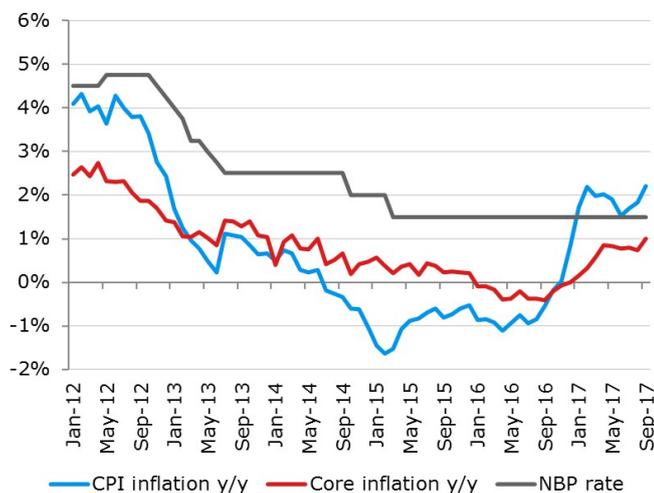
	2017	2017	2017	2017	2018	2018	2018	2018
	Q1	Q2	Q3 F	Q4 F	Q1 F	Q2 F	Q3 F	Q4 F
GDP y/y (%)	4.0	3.9	4.6	4.5	4.5	4.4	4.3	4.3
Individual consumption y/y (%)	4.7	4.9	5.0	4.6	4.5	4.2	4.0	4.0
Public Consumption y/y (%)	1.0	2.4	2.5	3.0	4.0	3.0	3.0	3.0
Investment y/y (%)	-0.4	0.8	5.0	10.0	10.0	10.0	10.0	9.0
Inflation rate (% average)	2.0	1.8	1.9	2.0	1.6	2.3	2.5	2.5
Unemployment rate (% eop)	8.2	7.1	6.9	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	1.75	2.04	2.12	2.31	2.66	2.84
10Y Polish bond yields (% eop)	3.49	3.32	3.37	3.69	3.80	4.02	4.40	4.61
EUR/PLN (eop)	4.23	4.23	4.31	4.30	4.25	4.20	4.15	4.08
USD/PLN (eop)	3.97	3.70	3.65	3.68	3.63	3.53	3.46	3.37

F - forecast

Economics

Inflation at local top due to exogenous factors

Statistical Office confirmed flash inflation reading at 2.2% in September. However, the composition is more surprising than we thought. Food prices rose slightly more than usual (+0.4% m/m) whereas energy prices shot up by 0.7% m/m. The latter seems purely exogenous and of one-off nature. Moreover, wearing apparel prices beat seasonal pattern by 1pp. on monthly basis. Such a behaviour fits well with regional readings and we connect it with cool weather in September. It seems exogenous as well and as such should reverse in October. Other categories reflect seasonal and regulatory factors: package holidays, new free handbooks for school pupils. Core inflation rose to 1.0% y/y from 0.7% in August.



We stick to the view that Polish economy is poised to generate inflationary pressure stemming from higher demand and cost pressure. This should reflect itself in steady rising core inflation. However, recent reading seems to be too much biased with exogenous factors to proclaim it an example of inevitable inflation pressure. Therefore we think it would be looked through by the market and the MPC. Moreover, as it seems that inflation recorded a local top, MPC is unlikely to change its rhetoric while inflation is falling on annual basis. All in all we stick to the view that MPC is going to raise rates in H2 2018. However, rate expectations are set to reverse in the coming months before they finally settle on a proper date of a hike. Combination of lower inflation, expected pull-back of rate hike expectations and sound fiscal performance is positive for Polish bonds.

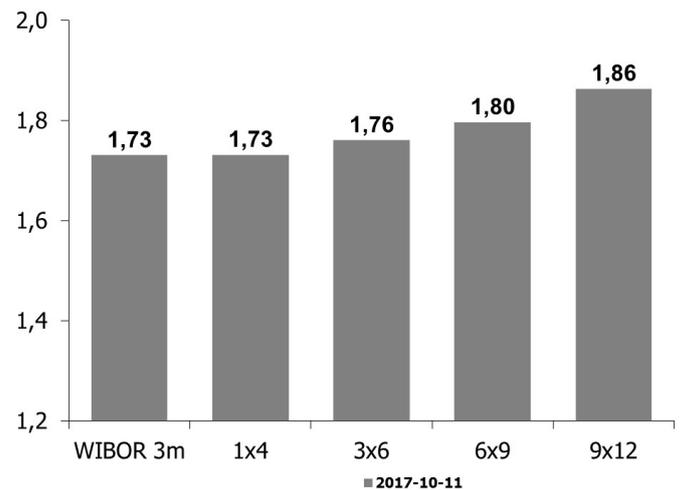
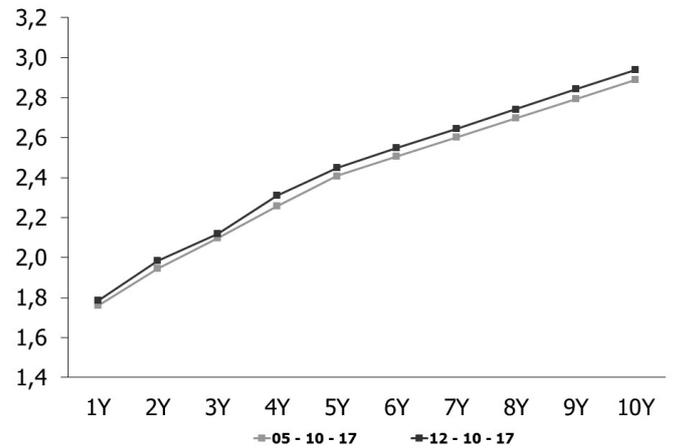
Fixed income

Let's get ready for a big flow

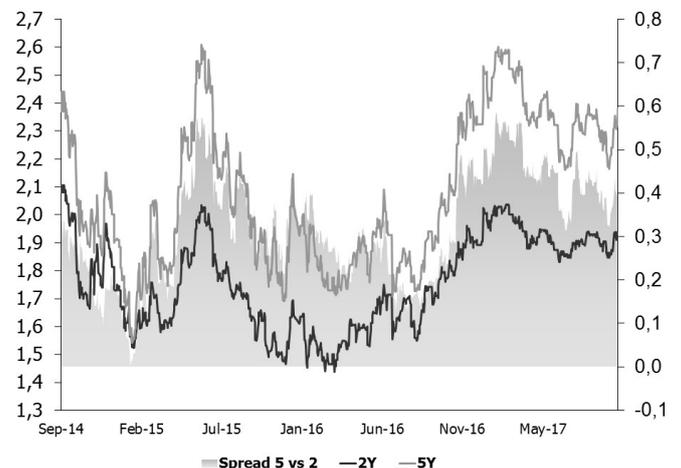
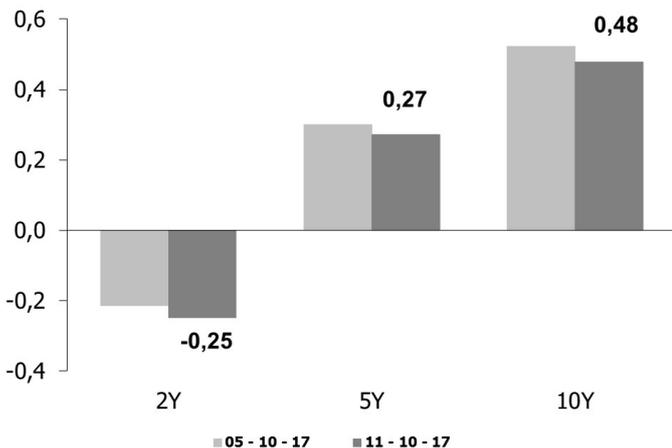
We touched 3.52% on DS0727 and came back to 3.4%. Banking books are buying 2-5y bonds to get into tax protection trade, DS1017 expires (13 bio) and some coupons (5 bio) are paid this month, it will be a massive flow on s/e bonds and ASW. WZ1122 will be the biggest gainer here.

PS0719/2y is -36 bps(!!!), PS0422/5y is at 19 bps and DS0727/10y is at 42 bps. PS0422/DS0727 is trading at 73 bps again, as we saw 78 bps here few days ago, DS0727/Bund is 296 bps. PS0719 is trading at 1.64% (1 bps down), PS0422 is trading at 2.64% (1 bps down) and DS0727 is trading at 3.37% (1 bps down).

IRS curve



Asset swaps



Money market

Cheap weeks ahead of us

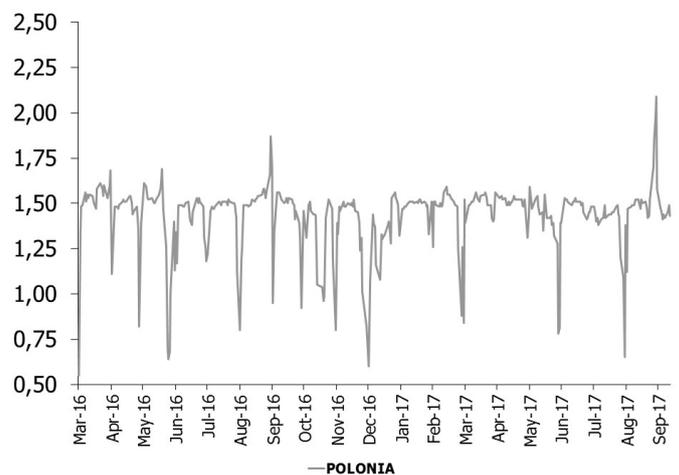
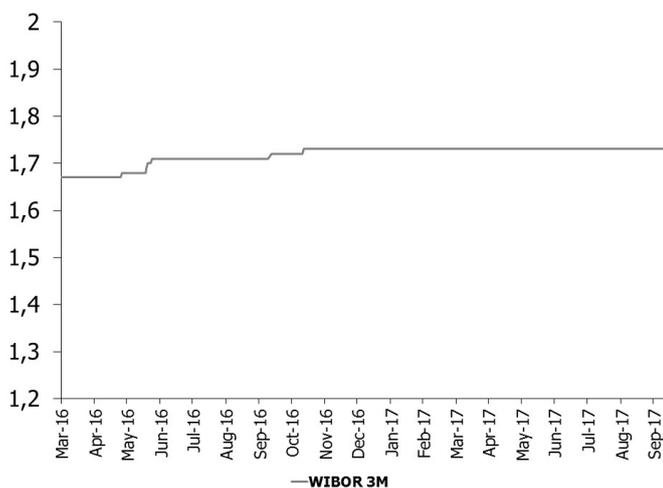
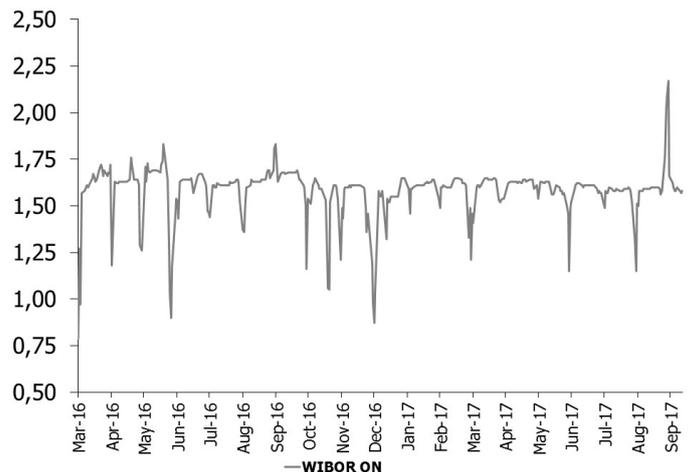
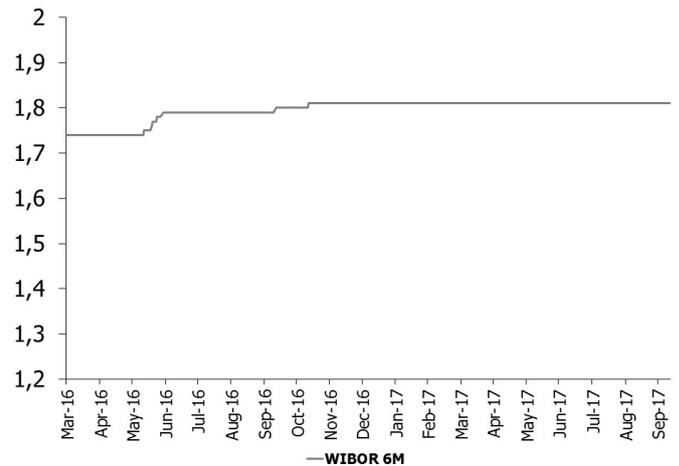
Post CPI surprise rate rally stopped recently with 2y IRS touching 2.03%. This corresponds to roughly 50 bp hike in 2y horizon. With MPC members still sounding dovish that may be it for now. Short bonds held pretty well with ASW tightening further. This month we have DS1017 redemption and October coupon payments, at least some of the cash will be absorbed at the next auction.

This month we expect some overnight rate disruptions due to October maturities and bond auction which have 2 days lag. We would expect a bit cheaper second part of the month.

Ref rate vs Polonia averages:

30 day -4 bp

90 day 4 bp



Forex

Spot: EUR/PLN – at support EUR/PLN is lower, because of dovish FOMC and better risk sentiment after de-escalation of Catalonia tension. The high for EUR/PLN was 4.3180 and the low so far 4.2655. 4.26-4.28 is a support zone, and the obvious resistance in 4.33-4.35 (4.3333 being the recent high). We are of the opinion that playing range is the name of the game in our low β currency pair. Just as we were sceptical of the upside momentum, we are now equally sceptical of the possible Zloty advances. The wider range is now 4.25-4.35, and we will try to play it with a neutral approach.

EUR/PLN vols – tiny tic lower Stronger PLN is usually followed by the lower Vols. This correlation still holds but the pace of the fall diminished. The reason is trivial, we haven't built-in enough risk premium in vols, to have much to unwind. We are just hovering around the lows. 1 month ATM mid is 5.25% today (0.1% lower vs last week), 3 months are at 5.5% (0.1% 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 tic lower as well.

Short-term forecasts

Main supports / resistances:

EUR/PLN: 4.25 / 4.35

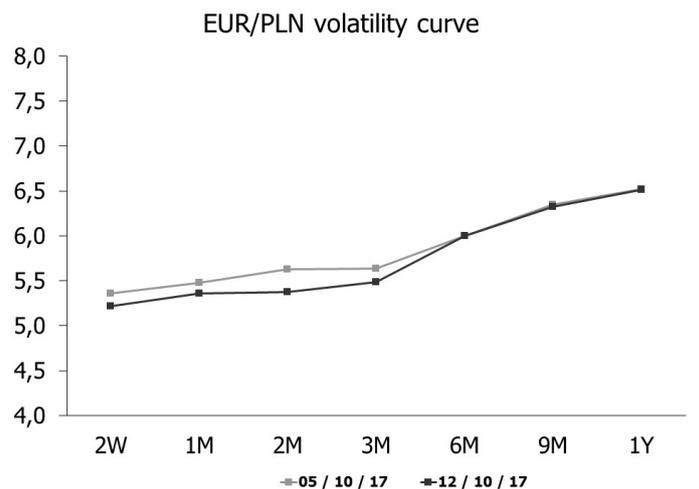
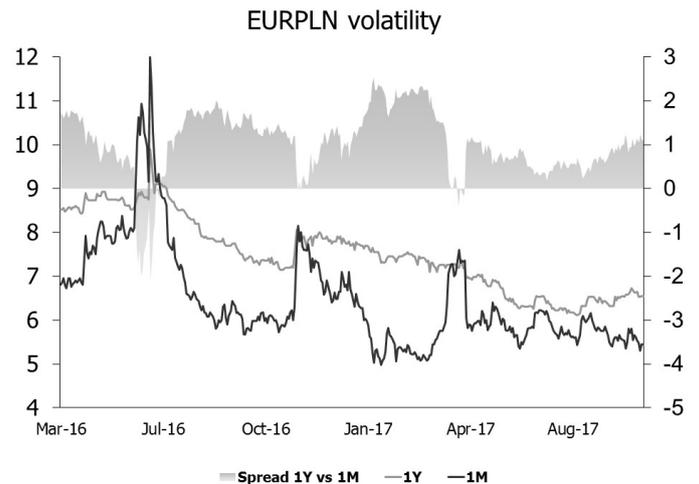
USD/PLN: 3.50 / 3.80

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.



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
10/5/2017	1.63	1.73	1.80	1.71	1.96	1.75	1.73	1.75	1.79	1.86	1.93	1.88
10/8/2017	1.79	1.73	1.82	1.71	1.97	1.75	1.73	1.76	1.82	1.90	1.97	1.92
10/9/2017	1.73	1.73	1.82	1.71	1.97	1.75	1.73	1.76	1.82	1.89	1.98	1.90
10/10/2017	1.56	1.73	1.64	1.71	1.79	1.75	1.73	1.76	1.81	1.88	1.96	1.90
10/11/2017	1.70	1.73	1.76	1.71	1.81	1.75	1.73	1.76	1.80	1.86	1.94	1.88

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
10/5/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
10/8/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
10/9/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
10/10/2017	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
10/11/2017	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
10/5/2017	5.48	5.64	6.00	6.53	6.53	1.74	0.56
10/8/2017	5.30	5.55	5.98	6.53	6.53	1.74	0.56
10/9/2017	5.45	5.60	5.98	6.55	6.55	1.73	0.54
10/10/2017	5.45	5.65	6.03	6.55	6.55	1.74	0.57
10/11/2017	5.36	5.49	6.00	6.51	6.51	1.74	0.57

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
10/5/2017	4.2985	3.6502	3.7435	3.2419	1.3807	0.1665
10/8/2017	4.3042	3.6799	3.7567	3.2559	1.3814	0.1666
10/9/2017	4.3121	3.6743	3.7541	3.2617	1.3804	0.1667
10/10/2017	4.2952	3.6468	3.7306	3.2444	1.3813	0.1660
10/11/2017	4.2836	3.6219	3.7144	3.2271	1.3821	0.1655

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