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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 Monday, the NBP will publish data on money supply and credit. We expect M3 to decelerate from 5.5% in August to 5.2% y/y in September due to persistent downward trends in both enterprise and household deposits. On the next day, the CSO will publish its monthly Statistical Bulletin, which, apart from the details of latest labour market and real sphere releases, will contains final print of unemployment rate in September. Preliminary data (published by the Ministry of Family, Labor and Social Policy) suggests further drop, from 7.0% to 6.9%, in line with our initial forecast. Finally, MPC Minutes were rescheduled by one week, to next Thursday, but still they should pass unnoticed.

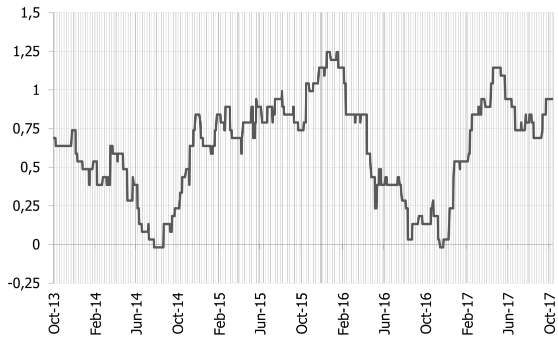
Polish data to watch: October 20th to October 27th

Publication	Date	Period	mBank	Consensus	Prior
M3 money supply y/y (%)	23.10	Sep	5.2	5.5	5.5
Unemployment rate (%)	24.10	Sep	6.9	6.9	7.0
MPC Minutes	26.10	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

Neither of labour market nor real sphere data surprised enough to move the index. Next week should also bring stabilization after preliminary unemployment rate data matched market estimates.

* 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).

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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

- Negative local political factors recently eased with CHF bill possibly shelved for some time and other, controversial government activities postponed to unspecified future. At the same time, the economy shows strength from every angle. However, the MPC still sticks to low rate scenario.
- 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. That is why we do not expect the zloty's performance to be stellar at the moment. 4.20 – 4.40 range seems to be the most loikely scenario for now.
- 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 and apreciate closer to 4.10.

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

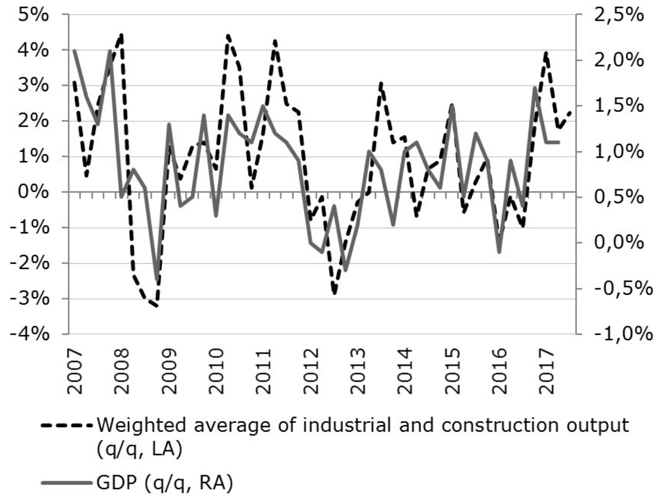
	2017 Q1	2017 Q2	2017 Q3 F	2017 Q4 F	2018 Q1 F	2018 Q2 F	2018 Q3 F	2018 Q4 F
GDP y/y (%)	4.0	3.9	4.6	4.5	4.5	4.4	4.3	4.3
Individual consumption y/y (%)	4.7	4.9	5.0	4.6	4.5	4.2	4.0	4.0
Public Consumption y/y (%)	1.0	2.4	2.5	3.0	4.0	3.0	3.0	3.0
Investment y/y (%)	-0.4	0.8	5.0	10.0	10.0	10.0	10.0	9.0
Inflation rate (% average)	2.0	1.8	1.9	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

The economy accelerated in Q3 amid tightening labor market. The MPC is set to stay put until inflationary signals become undeniable.

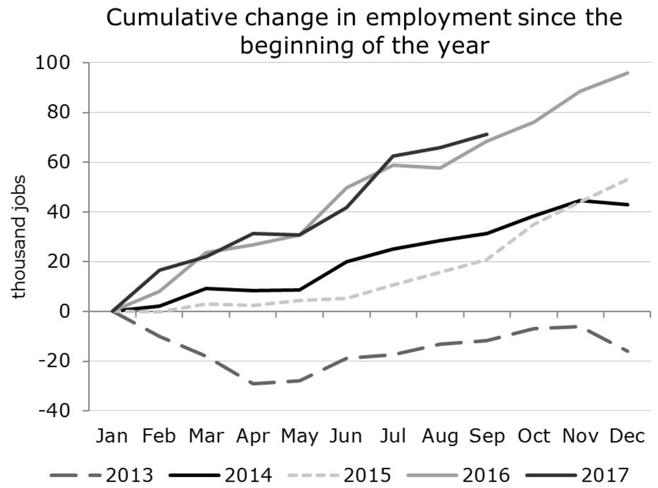
The latest set of monthly data confirmed our view that the economy accelerated materially in Q3. We estimate that GDP rose by 4.6% y/y and more than 1% q/q (see the graph below for illustration of the latter), with both consumption and investment rising by ca. 5% – obviously it's investment rebound that is the most welcome development.



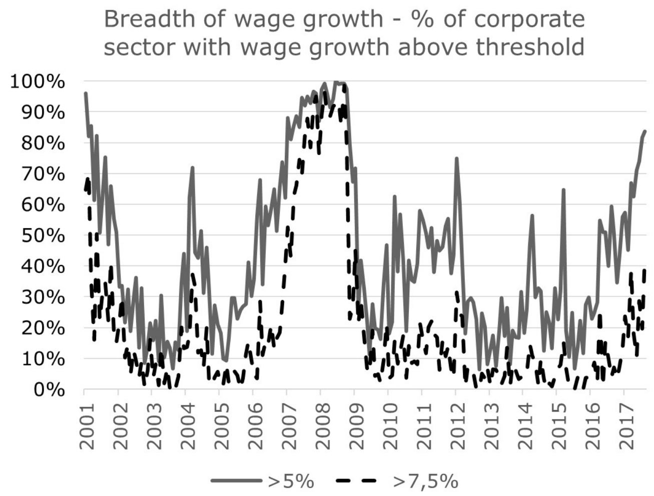
Meanwhile, job growth likely remained solid, which underpins the fact that wage growth has outstripped productivity growth for 5 years now and that gap might even be widening now – the slight setback in September does not change the overall picture of a buildup in wage pressures. By the NBP's book, rising unit labor costs are a prerequisite for domestic inflationary pressures, yet the Monetary Policy Council sticks to its dovish message, as we witnessed two weeks ago. We believe that the MPC will not change course as long as inflation stays within the lower half of the target band. Next year, however, CPI is likely to breach the target and the MPC will react and turn up its hawkishness when this becomes apparent (in mid-2018, that is). Current market pricing, i.e. first rate hike in early 2019, is too optimistic in our view.

As usual, here's our detailed take on last week's releases.

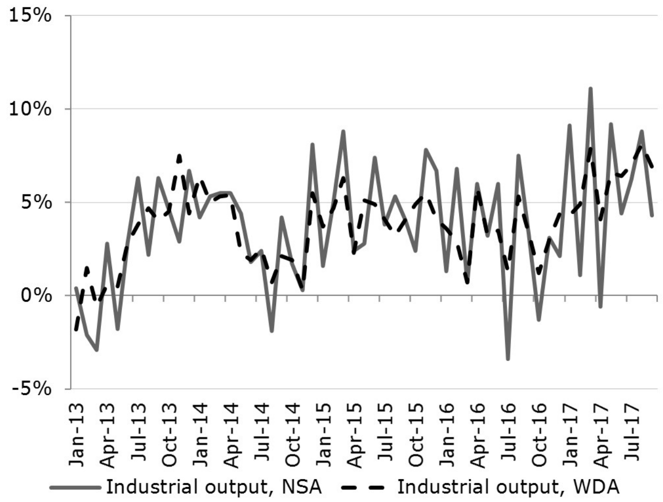
Employment in the enterprise sector rose in September by 4.5% y/y (compared to 4.6% in August), in line with our forecast and slightly lower than market consensus. On a monthly basis, 5.2 thousand jobs were added, only half of last year's growth. As always, we need to wait for the details until the end of the month, however we would like to make some guesses about the structure. We expect that the growth was distributed among manufacturing and some large sectors, where job creation accelerated recently (construction, administrative and support service). Employment in transportation, in our opinion, remained at last month's levels. We do not exclude larger than seasonal drops in sections using seasonal labour (like accommodation and catering), however avoiding those drops would be not enough to lift the final number to 4.6%. All in all, employment is growing in Poland at a great pace, third quarter was poised to do well after stellar July's release. Incoming changes in pension system will not affect significantly this aggregate, while supply-sides bottleneck are revealing themselves currently mostly in survey data (e.g. in the latest NBP report). Eventually, they will be visible in hard data on employment.

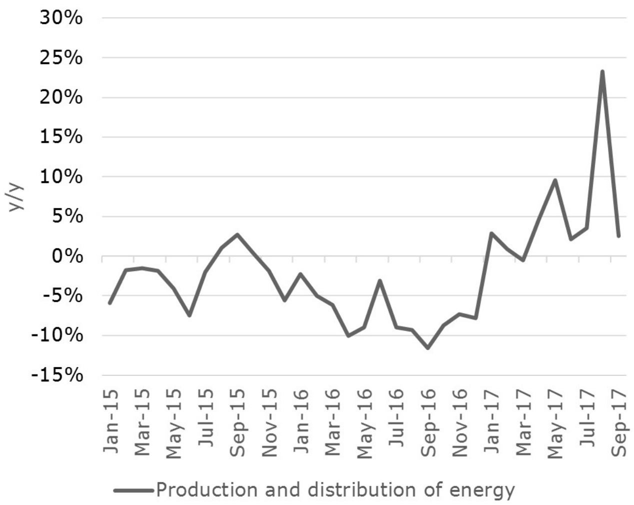


Average gross wage rose by 6.0% y/y, slightly below forecasts (ours 6.4% y/y, market consensus 6.2% y/y). Without a detailed breakdown, we can only speculate as to the source of this slight surprise. Wage growth in September was likely boosted by bonus payments in mining, while calendar effects (working day difference fell from 0 to -1 y/y) depressed wage growth in manufacturing and construction. The effect of each of these factors is uncertain and could easily explain the surprise. Regardless of short-term gyrations in wage growth, trends remain unambiguously positive here. All available information point to further acceleration in wages and increased breadth of this phenomenon (i.e. more enterprises and employees becoming subject to wage growth). According to our calculations, in August 84% of corporate sector exhibited above-5% growth. The results of NBP's enterprise survey published yesterday (English translation is not yet available) underpins our long-held view of strong labor market. In particular, it confirms that staffing problems are mounting, vacancy rates are rising, wage pressures within enterprises are spreading, while wage growth forecasts are trending up. Wage growth is a cyclical phenomenon and arguments about structural weaknesses of Polish labor market are mostly irrelevant here.

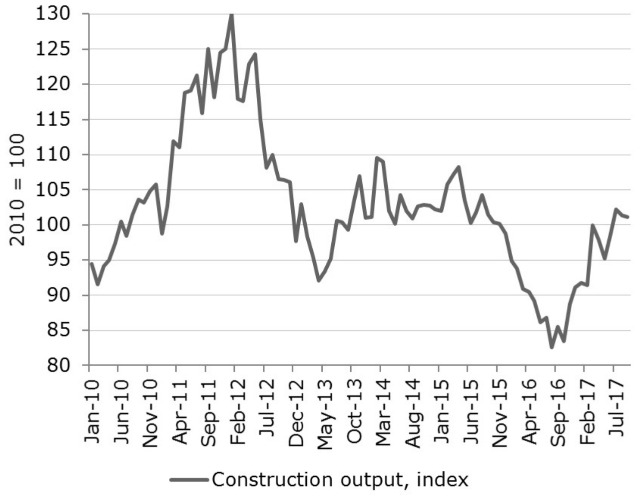


Industrial output rose by 4.3% y/y in September, slightly below forecasts (market consensus 5.2%, our forecast 5.0% y/y). To a large extent, the decline in annual growth rate was expected and can be traced back to calendar effects (working day difference was down from 0 to -1 y/y) and normalization in energy output after a surge in August. The latter (more than 20% y/y) was associated with one-off revenues of energy companies and reversed last month, as expected (see below). In addition, the decline in mining output by 22% y/y – only partly explained by base effects – shaved off 0.8 percentage points from the main aggregate. Manufacturing output did not deviate from recent trends and industry remains buoyant.

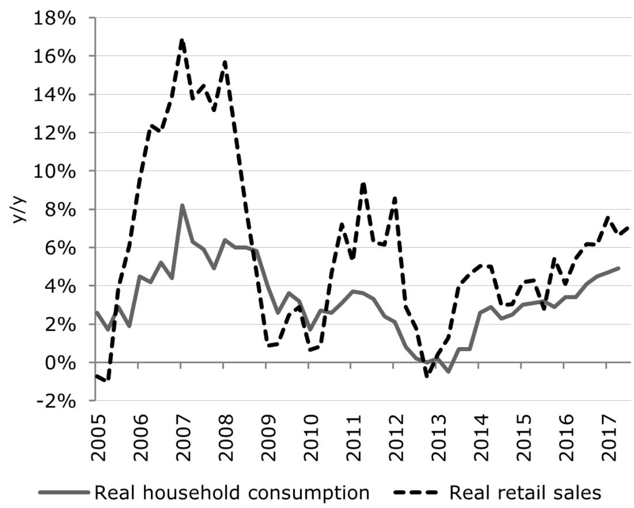




Construction output rose in September by 15.5% on a yearly basis, in line with our forecast and undershooting market estimates. On a monthly basis and after seasonal adjustment, it declined by 0.3%, which means momentum still hasn't come back to this category and base effects are mainly responsible for the moves of the headline figure (in September 2016 construction started rebounding after months of falls). Lack of momentum should also mean confirmation of status quo: privet investments are on the right track, while public sector is still lagging (this will be verified after quarterly data). Even if there are no new signs of incoming revival, the timetable of spending of EU-funds indicates that we will see an acceleration soon. Next month will be boosted by both base and calendar effects and maybe even warmer (so far) month. We should see double-digit yearly growth in the next several months.



Retail sales rose by 8.6% in current prices and by 7.5% in constant prices, slightly above our forecasts, but by betting on an above-consensus print we were on the right track. Most categories of retails sales behaved in line with our expectations. In particular, owing to price effects (higher food and fuel prices on a monthly basis), fuel and food sales barely decelerated on annual basis (from 9.0 to 8.4% y/y and from 8.2 to 7.9% y/y). Durable goods sales remained firmly in their strong uptrends, with one notable exception. Due to unfavorable weather conditions (cold and unusually rainy September), seasonal sales of clothing and footwear began a month earlier, boosting sales of that category from 11.1 to 26.6% y/y. Compared to our forecasts, the only major surprise are nonspecialized stores, but the surprise is not big enough to warrant attention.

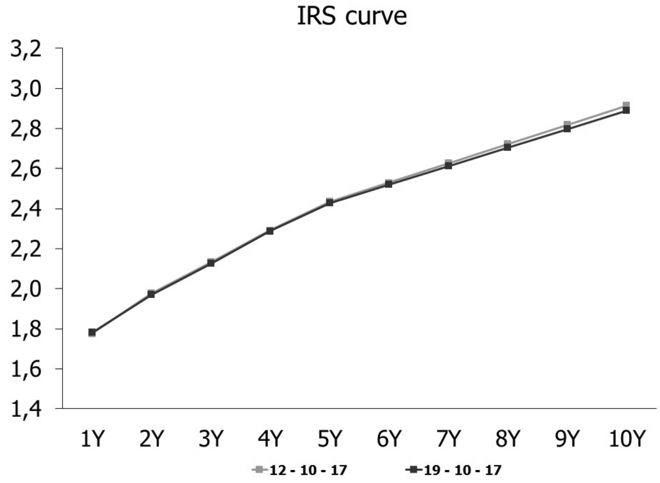


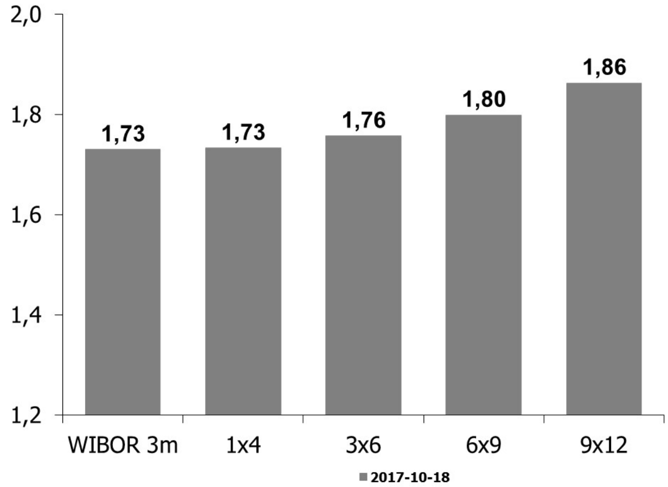
Fixed income

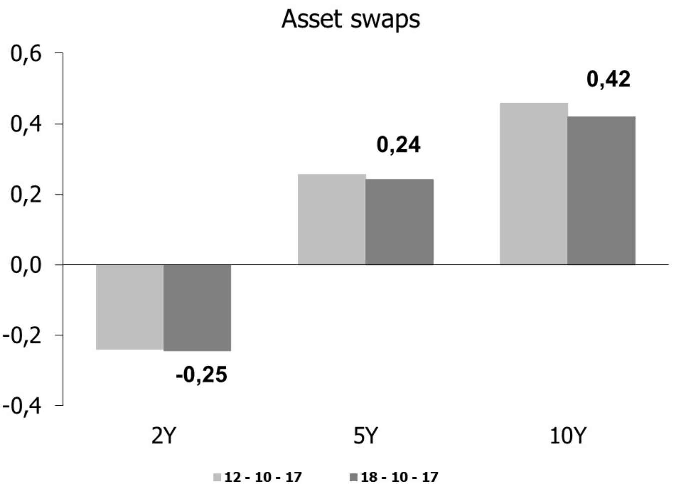
Lower, flatter, tighter

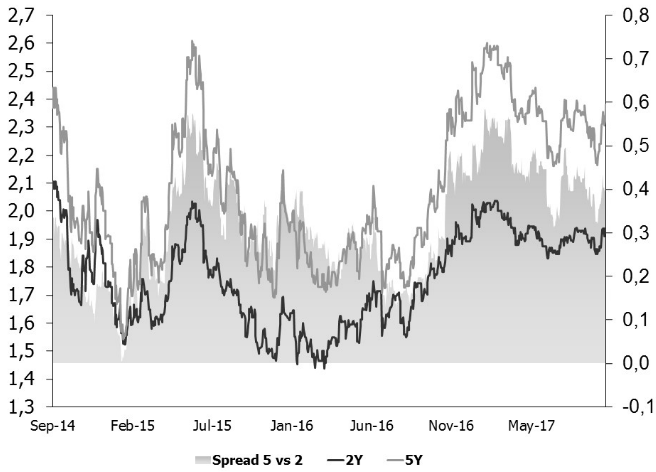
In 2 weeks we have moved from 3,52% to 3,27% on DS0727 and the market deserves some correction. Next week, we have auction: a new 2y benchmark (OK0720) will be issued and there should be good demand here, as DS1017 expires and coupons are paid.

Curve is much flatter now, PS0422/DS0727 is trading at 67 bps, spreads are low: PS0422/5y is at 17 bps, DS0727/10y is at 39 bps and DS0727/Bund is 291 bps. DS1019 is trading at 1,66% (4 bps down), PS0422 is trading at 2,62% (2 bps down) and DS0727 is trading at 3,29% (8 bps down).

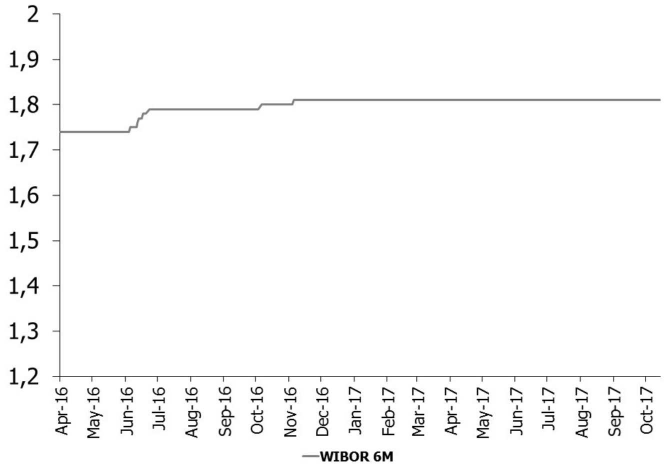








Money market

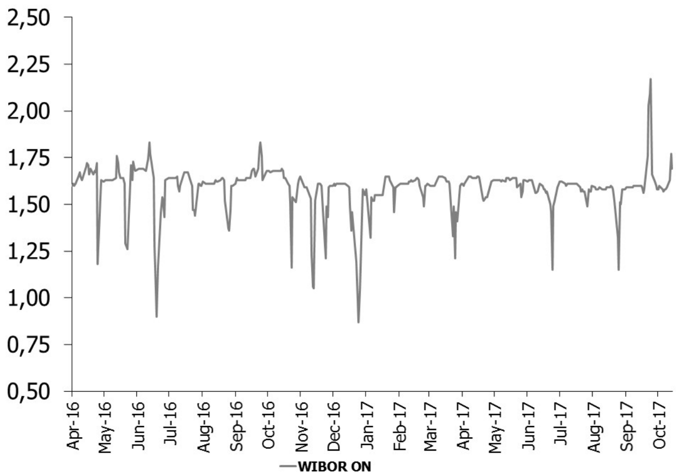


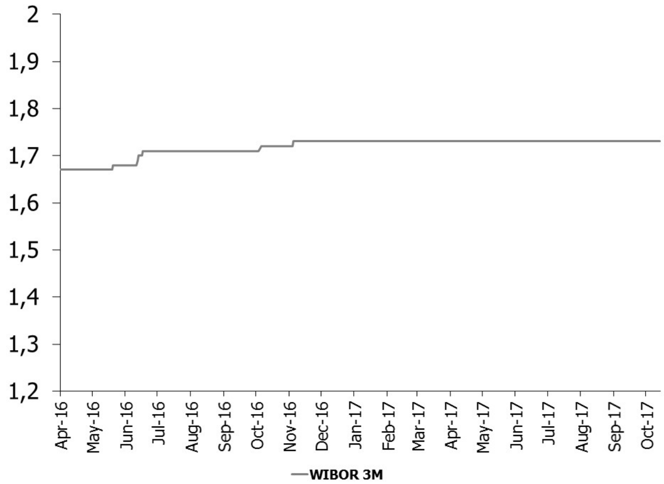
Is this the real hike? Is this just priced in?

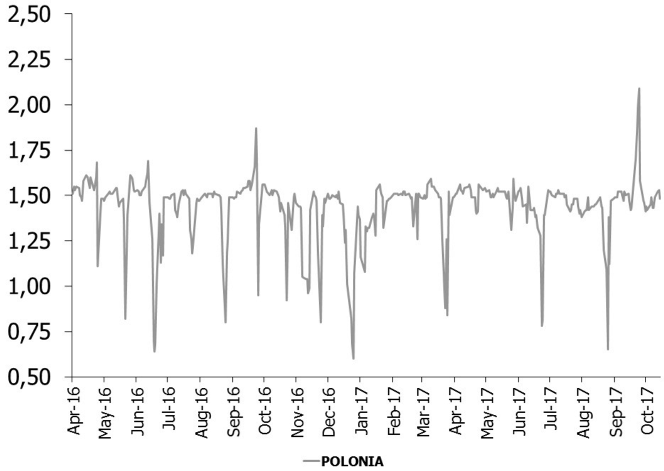
Market stabilized last week with yields hovering few bps below recent heights. Two year swap at 1.97% assumes slightly less than 50 bps hike within this period of time. This isn't a lot in current circumstances, on the other hand MPC confirms their commitment to stable rates for an extended period at any occasion.

As we mentioned last week, this month we might experience some liquidity disruptions. That's due to October redemptions in the second part of the month.

Ref rate vs Polonia averages:
30 day 2 bp
90 day 4 bp







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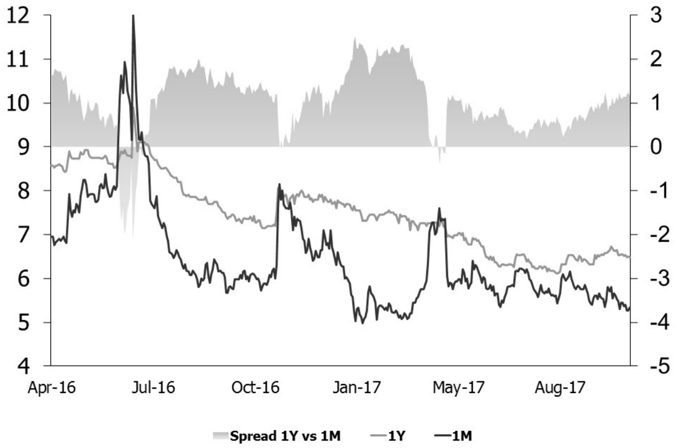
Forex

Spot: EUR/PLN – the slide halts? To be fair, the news flow from the domestic and foreign front was Zloty-positive. Even so, the consecutive 7 days of EUR/PLN slide is quite unusual for our market. There are lots of theories for the reason of the move and such a scale. The one, which is the most convincing in our eyes, is actually quite trivial. It is about liquidity in a world ruled by algorithms: as most of the market makers are no longer taking directional risk positions, the initial flow has created a snowball that kept on rolling down. We will see, if 4.2208 was the actual low, and are we now due for a correction. We are (again) skeptical of EUR/PLN getting higher beta. Range 4.22-4.28 is much more likely for us.

EURPLN volatility



EUR/PLN vols – tiny tic lower The vols were not following EUR/PLN lower, as we are at multiweek lows, anyway. 1 month ATM mid is 5.25% today (unchanged), 3 month is at 5.4% (0.1% lower) and, finally, 1 year fixed at 6.5% (unchanged). The skew was better offered, especially in USD/PLN space. The currency spread (difference between USD/PLN and EUR/PLN) was better bid in the frontend due to the proximity of the ECB meeting.

Short-term forecasts

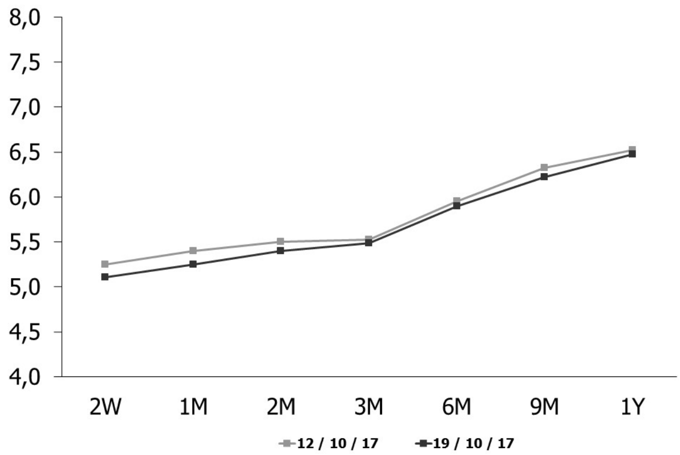
Main supports / resistances:
EUR/PLN: 4.22 / 4.32
USD/PLN: 3.50 / 3.80

Spot Current position: Long at 4.2850 and 4.24450 was stopped out at 4.2280 in EUR/PLN.

We reentered the EUR/PLN long at 4.2300.

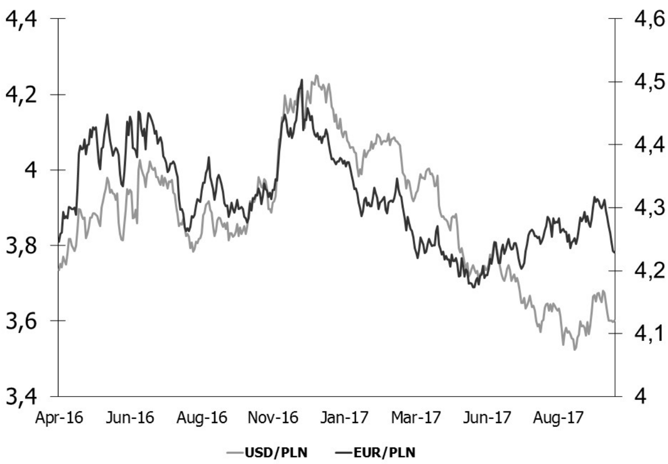
The scale and the pace of the move has taken us by surprise. If our assumption of the liquidity being to a large extent responsible for the move is correct, then we are expecting that EUR/PLN should come back to more neutral 4.26-4.28 zone soon. As a consequence, we reentered the long at 4.2300 with a short stop at 4.2050 and hopes to see 4.2650+.

EUR/PLN volatility curve



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.



Bias from the old parity (%)

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
10/12/2017	1.66	1.73	1.75	1.71	1.97	1.75	1.73	1.75	1.79	1.87	1.89	1.88
10/15/2017	1.63	1.73	1.77	1.71	1.81	1.75	1.73	1.76	1.80	1.85	1.91	1.88
10/16/2017	1.63	1.73	1.73	1.71	1.88	1.75	1.74	1.75	1.79	1.85	1.91	1.87
10/17/2017	1.53	1.73	1.64	1.71	1.80	1.75	1.73	1.76	1.79	1.86	1.92	1.88
10/18/2017	1.63	1.73	1.80	1.71	1.89	1.75	1.73	1.76	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
10/12/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
10/15/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
10/16/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
10/17/2017	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
10/18/2017	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
10/12/2017	5.40	5.53	5.95	6.53		6.53	1.74		0.55
10/15/2017	5.26	5.51	5.84	6.48		6.48	1.74		0.55
10/16/2017	5.28	5.53	5.93	6.50		6.50	1.69		0.58
10/17/2017	5.33	5.39	5.99	6.48		6.48	1.67		0.57
10/18/2017	5.25	5.49	5.90	6.48		6.48	1.56		0.56

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
10/12/2017	4.2705	3.6000	3.6969	3.2066	1.3809	0.1650
10/15/2017	4.2603	3.6010	3.6927	3.2131	1.3817	0.1649
10/16/2017	4.2449	3.6004	3.6914	3.2196	1.3779	0.1646
10/17/2017	4.2313	3.5964	3.6796	3.2053	1.3745	0.1641
10/18/2017	4.2293	3.6006	3.6733	3.1963	1.3726	0.1644

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