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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 Wednesday, the MPC will conclude its two-day meeting and decide on monetary policy. We expect the Concil to hold rates at current levels and keep its dovish rhetoric in place. Even though several members of the MPC have come out in favor of raising rates (provided that certain conditions are met by mid-2018), we believe that they are not indicative of a fundamental shift in the Council's thinking (see our comment in the previous report). Thus, governor GlapiĹ„ski will reiterate the key points about balanced economy, lack of price pressures, optimistic economic outlook and unchanged rates until the end of 2018. It will be underpinned by the latest NBP staff projections. The overall trajectories of growth and inflation will not change - in particular, the NBP still predicts lower growth in 2018 - but the starting point for both CPI and GDP projections will be shifted upward. Next Friday, the NBP will publish balance of payments data for September. We expect a small current account surplus due to the seasonal swing in trade balance (itself an effect of surging exports).

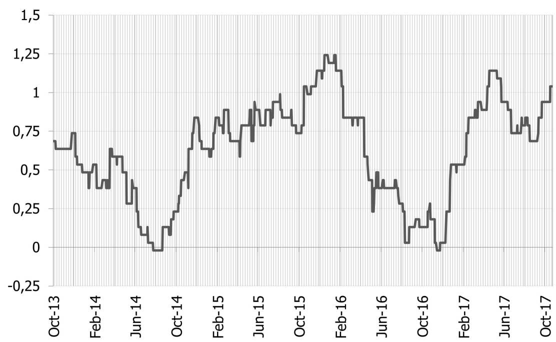
Polish data to watch: November 2nd to November 10th

Publication	Date	Period	mBank	Consensus	Prior
MPC decision (%)	08.11	Nov	1.50	1.50	1.50
Current account (mio EUR)	10.11	Sep	313	-146	-100
Exports (mio EUR)	10.11	Sep	17100	17125	15682
Imports (mio EUR)	10.11	Sep	16300	16684	15384

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	11/9/2017	1300	2.000	10/25/2017
5Y T-bond PS0422	11/9/2017	1000	2.813	10/25/2017
10Y T-bond DS0727	11/9/2017	2500	3.375	10/25/2017
30Y T-bond WS0447	-	125	3.720	10/25/2017

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



Comment

Unchanged as flash CPI and Manufacturing PMI came out in line with expectations. Next week is a light one in terms of macro data (no important releases) and Polish surprise index will remain unchanged.

* 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

- We remain in the vanguard of forecast revision cycle. In 2017, Polish economy is set to rise by 4.3%, in 2018 by 4.5%. Let's face it, household consumption is booming, while investment likely finally rebounded in Q3. Add an unexpected boost from net exports and growth will be very close to multi-year highs 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 likely 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	2.9	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	-0.5	-0.3	-0.9	-1.1
Unemployment rate (end of period %)	13.4	11.4	9.8	8.2	6.8	6.0
Repo rate (end of period %)	2.50	2.00	1.50	1.50	1.50	2.00

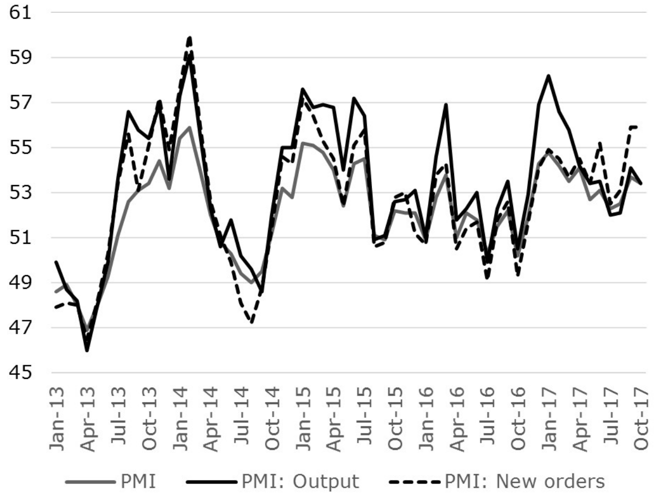
	2017 Q1	2017 Q2	2017 Q3 F	2017 Q4 F	2018 Q1 F	2018 Q2 F	2018 Q3 F	2018 Q4 F
GDP y/y (%)	4.0	3.9	4.6	4.5	4.5	4.5	4.4	4.3
Individual consumption y/y (%)	4.7	4.9	5.0	4.6	4.5	4.2	4.0	4.0
Public Consumption y/y (%)	1.0	2.4	2.5	3.0	4.0	3.0	3.0	3.0
Investment y/y (%)	-0.4	0.8	5.0	10.0	10.0	10.0	10.0	9.0
Inflation rate (% average)	2.0	1.8	1.9	2.0	1.6	2.3	2.5	2.5
Unemployment rate (% eop)	8.0	7.0	6.8	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

Slight decline in the PMI in October.

In October, Polish Manufacturing PMI declined from 53.7 to 53.4, a moderate disappointment (consensus 54.0; our forecast 53.8). The decline in the PMI was primarily driven by lower assessment of output (53.4 vis-Ă -vis 54.1 in the previous month), a decline in purchasing activity and less pronounced lengthening in delivery times. On the other hand, stable assessment of new orders (55.9 for the second month in a row) and a modest rebound in employment gauge mitigated the decline in the headline index. In addition, production backlogs rose for the third month in a row. Finally, it is worth noting that October was characterized by the third-highest divergence between New orders and Output indices.

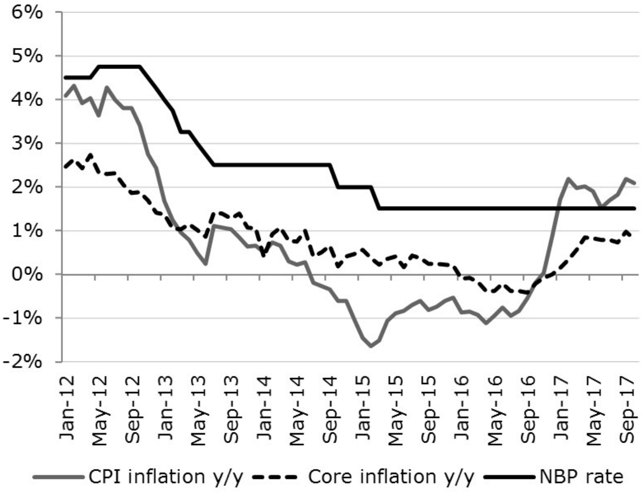


Such a breakdown suggests that manufacturers are still facing supply problems and a significant portion of them is operating at or close to maximum capacity. At the same time, we stand firm by our doubts regarding the relationship between PMI and hard data and between the PMI and other sentiment indices. The marked increase in cost and price pressures should also be noted: input prices have risen at the fastest pace for seven months, while output price gauge was second highest in six and a half years. Again, this is somewhat contradicted by other surveys (EC, GUS, NBP), which are showing much more muted growth. The uptrend is real and common, yet the PMI seems to overestimate the extent to which manufacturing costs and prices rose in 2017. It is not clear, what is behind this divergence, but we would bet on a different industry composition of various samples.

To sum up, Manufacturing PMI for October does not change the overall landscape of the Polish economy at the beginning of the fourth quarter. With all caveats, the PMI is consistent with above-4% growth. From the MPC's point of view, the data is likely to be neutral, as the historical relationships imply moderate growth and balanced economy at current PMI levels.

Inflation turns around, as we expected.

Inflation in October fell to 2.1% y/y, in line with market consensus. We bet on a slightly lower reading, though, on the basis of stabilization of fuel prices, a minor correction in core categories and amid higher than usual food prices. It seems the latter are responsible for the surprise, therefore we leave our original estimate of core inflation (0.8%) intact.

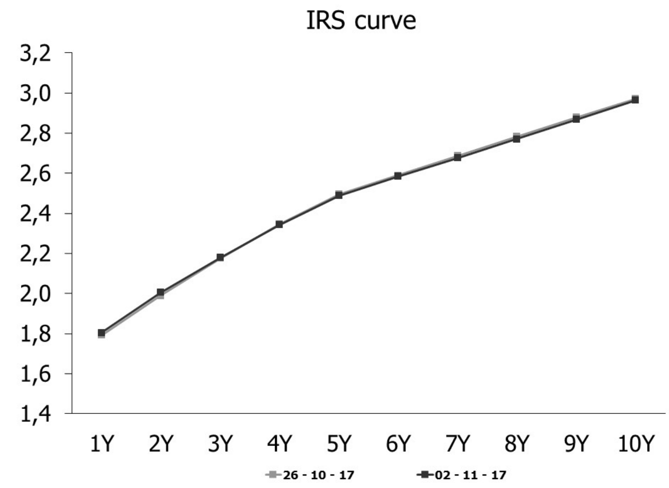


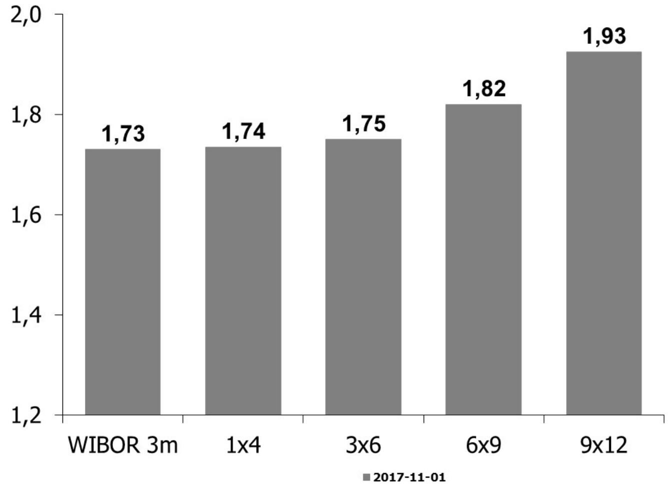
Last month we signaled that CPI inflation marked a local top at 2.2%. October reading only confirms this announcement. Due to base effects inflation is unlikely to return to 2.2-2.3% for more than one month before the mid-2018. It should exert downward pressure on rate expectations. Moreover, it may also temper recently more hawkish MPC members.

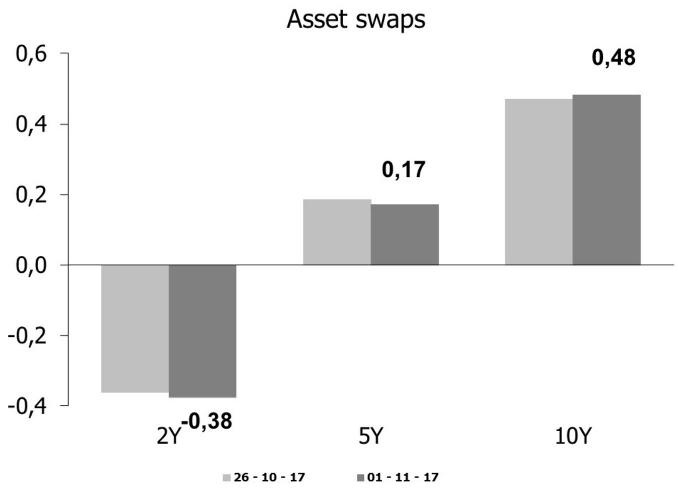
Fixed income

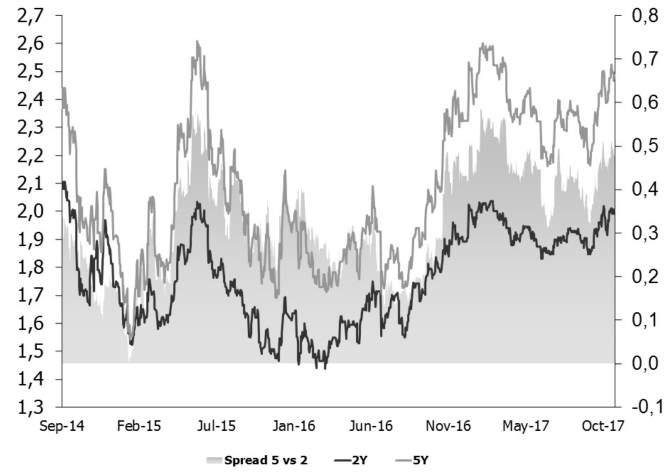
That's a bit steep

New month brought new sellers of long-end bonds. If you want to buy DS0727, don't hurry, as the market is heavily offered. We have two auctions in November, 8 bn both. We touched 3,50% on DS0727 and the long end looks cheap, especially now that the curve is very steep: WS0922/DS0727 spread is 79 bps and DS0727/Bund equals 310 bps. WS0922/5y is 11 bps and DS0727/10y is 48 bps. DS1019 is trading at 1,61% (1 bps up), WS0922 is trading at 2,68% (2 bps up) and DS0727 is trading at 3,47% (6 bps up). In all metrics the curve is extremely steep.









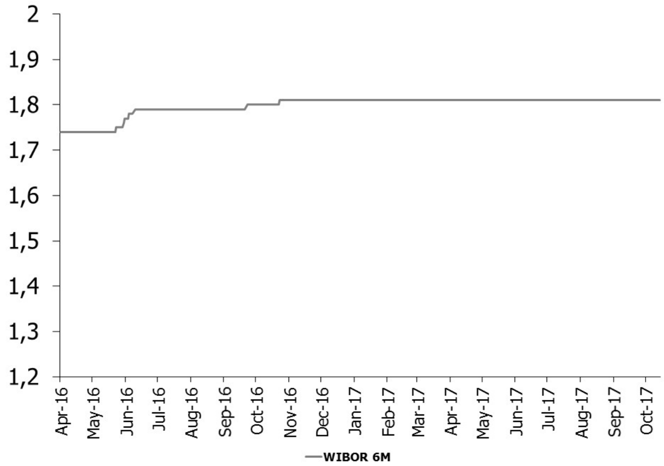
Money market

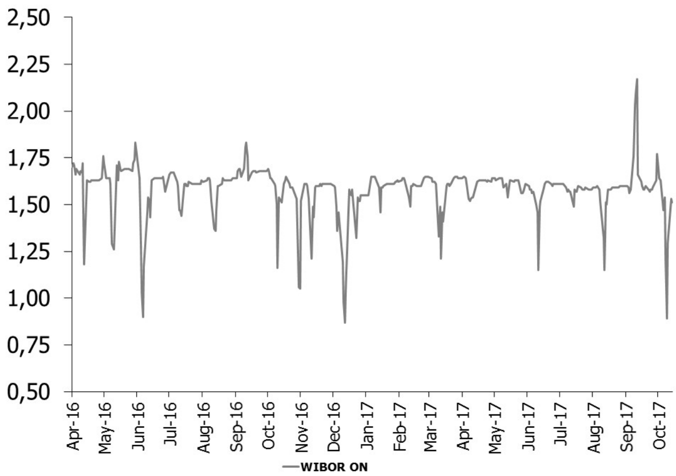
Fear and selling in Warsaw

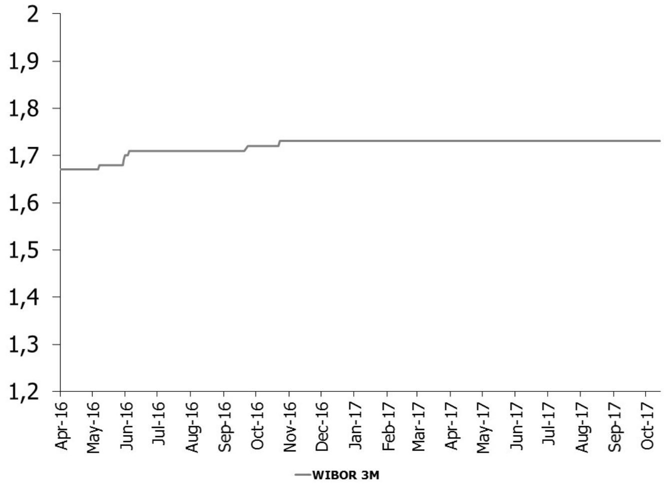
The Polish market has stayed relatively weak for another week. Despite recent relief rally on core markets, Polish yields are grinding higher. Some market research is hinting that a motion for a rate hike can be filed on the November MPC meeting. Although we doubt that, market players seem to be afraid of such an event and front rates set new heights. We had flash CPI print which came out in line with market consensus at 2.1%. Economic analysts predict we may have come lower with the figure in the coming months due to base effects.

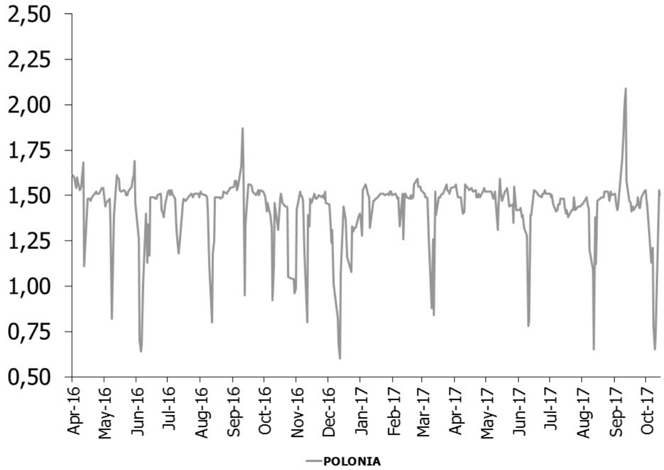
New month started and overnight rate stabilized around 1.50.

Ref rate vs Polonia averages:
30 day 19 bp
90 day 10 bp





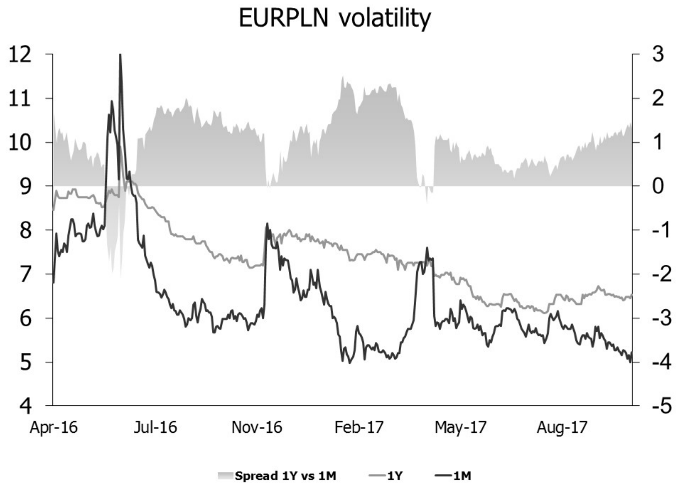




Forex

Spot: EUR/PLN – firmly in range It was another uninspiring week for EUR/PLN, the cross remained firmly in the 4.22-4.27 range. 4.2305 and 4.2640 marked the low and the high of the last 5 trading days, respectively. The Polish factor is nonexistent, we are mimicking the global investment sentiment. The ECB and FOMC are both being closely followed for any clues of potential dovish or hawkish signals. We believe the range is likely to persist and we are going to play that range with a slightly PLN-negative skew.

EUR/PLN vols – roughly unchanged Not much to report, the bank holiday on November 1st depressed realized volatility even further. 1 month ATM mid is 4.85% today (0.1% lower), 3 month is at 5.3% (unchanged) and, finally, 1 year fixed at 6.4% (unchanged). The skew is roughly unchanged. The currency spread (difference between USD/PLN and EUR/PLN) was better offered, and now is 3.25% along the whole curve.



Short-term forecasts

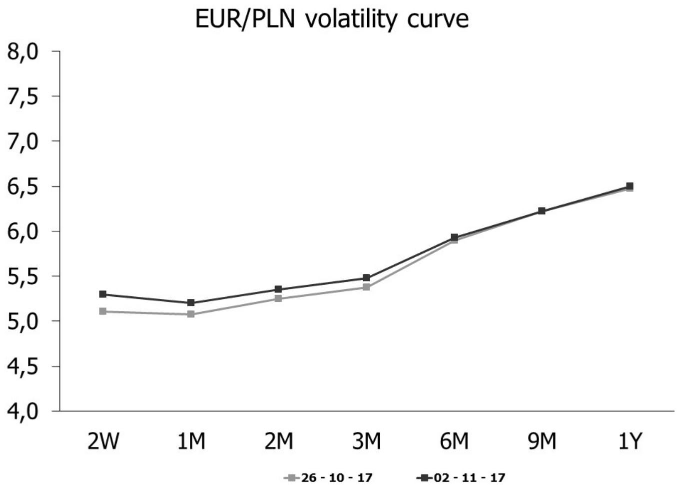
Main supports / resistances:
EUR/PLN: 4.22 / 4.32
USD/PLN: 3.50 / 3.70

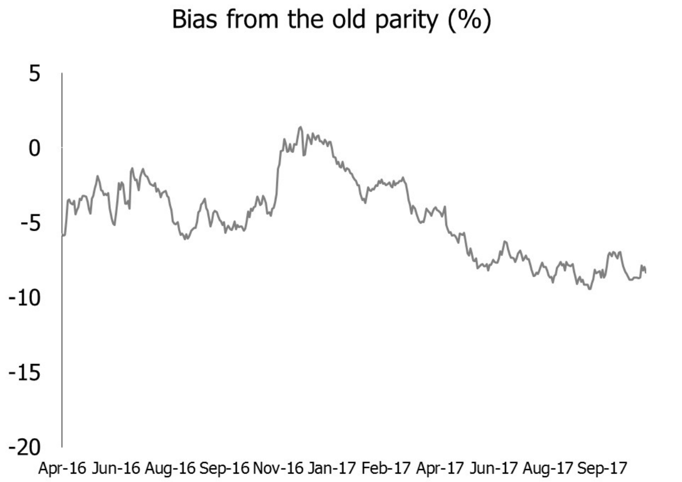
Spot Current position: Long at 4.2300 in EUR/PLN .

We are long at 4.2300 with a short stop at 4.1950 and hopes to see 4.27+. It is a purely technical, opportunistic trade. We are of the opinion, that mean-reverting strategies are the most profitable in the longer run in our low Beta currency.

Options Vol – sidelined

We don't see much of the value in being positioned in EUR/PLN vol curve. Especially, if one wants to initiate the position by crossing the market spread. The spread in vol vs the realized volatility of the vol curve is not really appealling. We focus on market making, with selling the gamma/vanna being the slightly more preferable strategy.





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
10/26/2017	1.72	1.73	1.78	1.71	1.82	1.75	1.73	1.74	1.81	1.89	1.99	1.91
10/29/2017	1.65	1.73	1.75	1.71	1.97	1.75	1.73	1.76	1.81	1.90	1.99	1.89
10/30/2017	1.66	1.73	1.76	1.71	1.98	1.75	1.73	1.76	1.84	1.93	2.01	1.94
10/31/2017	1.52	1.73	1.58	1.71	1.62	1.75	1.74	1.75	1.82	1.93	1.99	1.94
11/1/2017	1.60	1.73	1.70	1.71	1.91	1.75	1.74	1.75	1.82	1.93	1.99	1.94

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
10/26/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
10/29/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
10/30/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
10/31/2017	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
11/1/2017	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
10/26/2017	5.08	5.38	5.90	6.48	6.48	1.56	0.56
10/29/2017	5.15	5.40	5.88	6.48	6.48	1.56	0.56
10/30/2017	5.00	5.48	5.86	6.45	6.45	1.56	0.56
10/31/2017	5.23	5.41	5.98	6.53	6.53	1.71	0.54
11/1/2017	5.20	5.48	5.93	6.50	6.50	1.64	0.56

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
10/26/2017	4.2458	3.5939	3.6318	3.1624	1.3664	0.1657
10/29/2017	4.2520	3.6568	3.6575	3.2072	1.3663	0.1657
10/30/2017	4.2403	3.6430	3.6515	3.2065	1.3673	0.1653
10/31/2017	4.2498	3.6529	3.6603	3.2254	1.3646	0.1657
11/1/2017	4.2498	3.6529	3.6603	3.2254	1.3646	0.1657

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