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Polish Weekly Review

mBank Research
(macro/FI/FX analysis)

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Comment on the upcoming data and forecasts

Polish macro publications return on Monday with the release of corporate employment and wage data. We expect wages to slow down somewhat, from 7.4 to 6.9% y/y. Last month's spike was caused by a broad-based acceleration and we expect it to be partially corrected, in part due to base effects as well. As far as employment growth is concerned, we attribute the forecasted slowdown to labor force dropouts after the retirement age cut and to other labor supply constraints to hiring. On the next day, the CSO will release retail and industry data. Industrial output likely slowed down materially as we enter the period of high statistical bases related to the industrial boom at the turn of 2016 and 2017. Retail sales growth likely remained at a high level as positive and negative factors cancel each other out – we certainly don't see any statistical base related to consumer purchases financed with the 500+ child subsidy programme. Finally, next Friday the CSO will publish its monthly Statistical Bulletin along with unemployment data. The preliminary estimate from the Ministry of Family, Labor and Social Policy was above our forecast (6.6 vs. 6.5%).

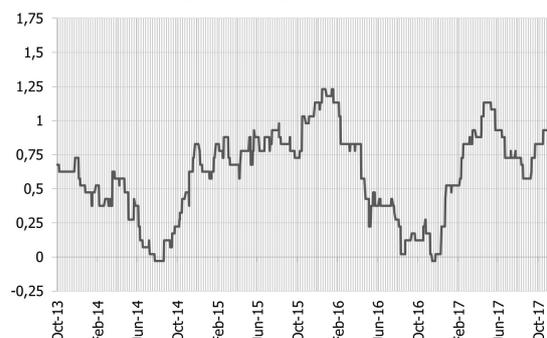
Polish data to watch: December 15th to December 22nd

Publication	Date	Period	mBank	Consensus	Prior
Average wage y/y (%)	18.12	Nov	6.9	6.9	7.4
Employment y/y (%)	18.12	Nov	4.3	4.4	4.4
Industrial production y/y (%)	19.12	Nov	9.6	9.0	12.3
Construction output y/y (%)	19.12	Nov	11.0	14.8	20.3
Retail sales y/y (%)	19.12	Nov	8.1	7.4	8.0
PPI y/y (%)	19.12	Nov	2.6	2.1	3.0
MPC Minutes	21.12	Dec			
Unemployment rate (%)	22.12	Nov	6.6	6.5	6.6
M3 money supply y/y (%)	22.12	Nov	5.0	4.9	5.7

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	-	500	1.846	11/23/2017
5Y T-bond PS0422	-	750	2.704	11/23/2017
10Y T-bond DS0727	-	800	3.338	11/23/2017
30Y T-bond WS0447	-	125	3.720	10/25/2017

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



Comment

Unchanged since final CPI matched the flash estimate. Next week brings important releases from the Polish economy: wages, retail sales, industrial output and the PPI. Plenty of opportunities to surprise.

* 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

- In 2017, Polish economy is set to rise by 4.3%, in 2018 by 4.5%. 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 reached a local top in November. Base effects suggest that inflation will drop at the turn of the year and reaccelerate briskly from Q2 on. 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.
- 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 appreciate 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

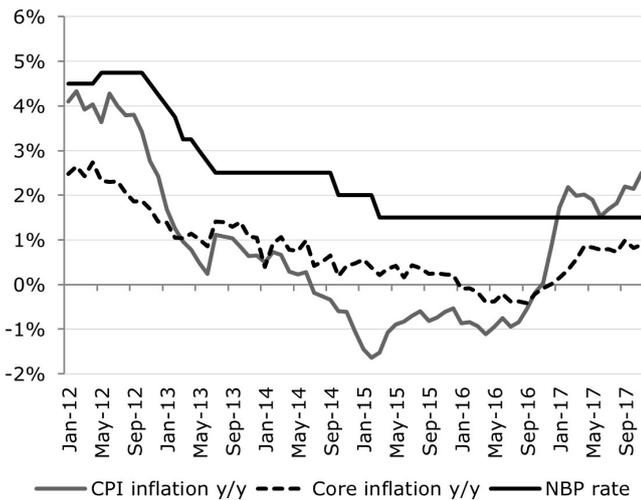
	2017	2017	2017	2017	2018	2018	2018	2018
	Q1	Q2	Q3	Q4 F	Q1 F	Q2 F	Q3 F	Q4 F
GDP y/y (%)	4.1	4.0	4.9	4.7	4.7	4.5	4.5	4.5
Individual consumption y/y (%)	4.7	4.9	4.8	4.5	4.5	4.2	4.0	4.0
Public Consumption y/y (%)	0.5	2.1	1.9	3.0	4.0	3.0	3.0	3.0
Investment y/y (%)	-0.5	0.9	3.3	7.5	10.0	10.0	9.0	8.0
Inflation 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	1.80	1.92	2.11	2.36	2.59
10Y Polish bond yields (% eop)	3.49	3.32	3.37	3.45	3.53	3.68	3.89	4.08
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 marginally above 2.5% y/y, owing to higher food and fuel prices.

According to the final release, Polish CPI rose significantly in November to 2.5% y/y from 2.1% y/y in October, more than market consensus (2.3%) and slightly more than our initial forecast (2.4%) indicated. After looking into details, we are of the opinion that 4 main factors were responsible for this growth. Moreover, higher reading (2.6%) was avoided just slightly.



Firstly, food prices grew even faster than we expected (+1.1%). Few categories were responsible for this: further growth of butter prices (even though wholesale prices are already falling) and an enormous rise in egg prices (30%, transmitted 1:1 from the wholesale market). The latter explains entirely our forecast error, since we assumed that price transmission from wholesale to retail would be different. Generally, such a pattern has recently become more likely than it used to be. It is possible that companies raised margins. Secondly, fuel prices rose significantly (+2.9%), this however has been calculated with high precision. Thirdly, we have correctly forecast energy costs for dwellings: the rise by 0.3% is an effect of heating fuel prices (+1.3% m/m). Lastly, core inflation grew from +0.8% to +0.9% on a yearly basis, in line with our forecast.

In the next few months inflation is set to fall on the back of base effects. Core inflation should continue to grow in the background, reflecting the buildup in inflationary pressures. If our suspicions regarding the rise in retail margins are confirmed, there is a case to be made in favor of accelerating core inflation. This, in turn, would be indicative of enterprises adjusting to higher labor costs. The MPC is set to remain staunchly dovish and might ease its rhetoric even further in response to lower inflation print. At the same time, the latest inflation projection will be more and more out of synch with reality due to faster GDP growth and widening output gap (positive this time). It will only be addressed in March, with the newest inflation projection.

Fixed income

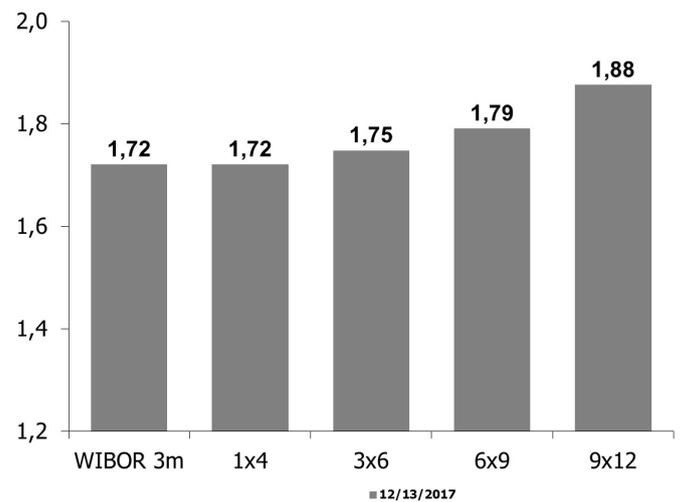
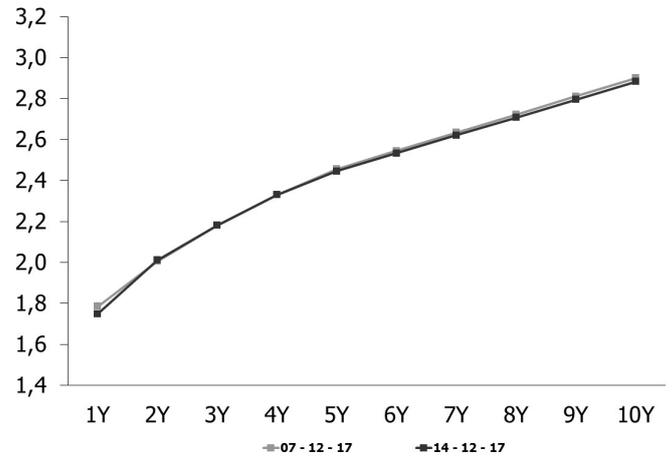
Last (auction before) Christmas

This year's last auction will happen tomorrow, it's the final call for buying bonds from the MoF before Christmas. It will be a switching auction, so supply should be 6-8 bn PLN, the Ministry will sell OK0720/PS0123/DS0727/WZ1122/WZ0126 and, additionally, WS0429.

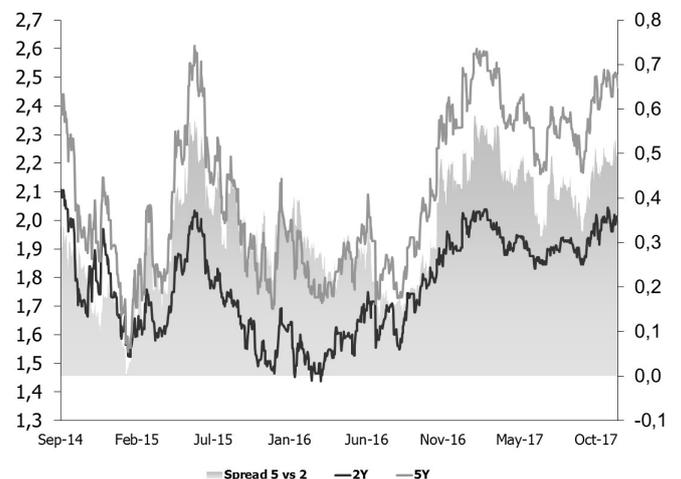
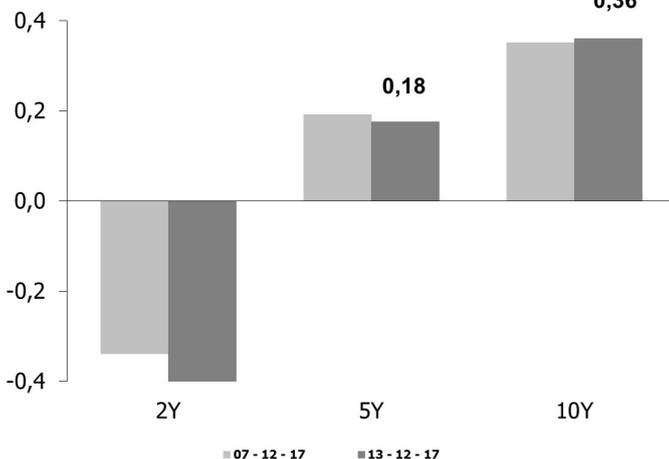
WS0922/DS0727 is 71 bps, DS0727/Bund is 289 bps. WS0922/5y is 8 bps and DS0727/10y is 30 bps.

DS1019 is trading at 1.64% (2 bps up), WS0922 is trading at 2.51% (2 bps down) and DS0727 is trading at 3.22% (2 bps down).

IRS curve



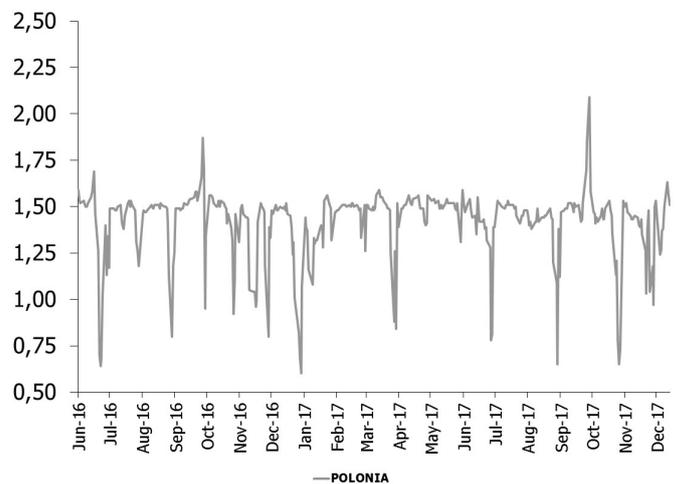
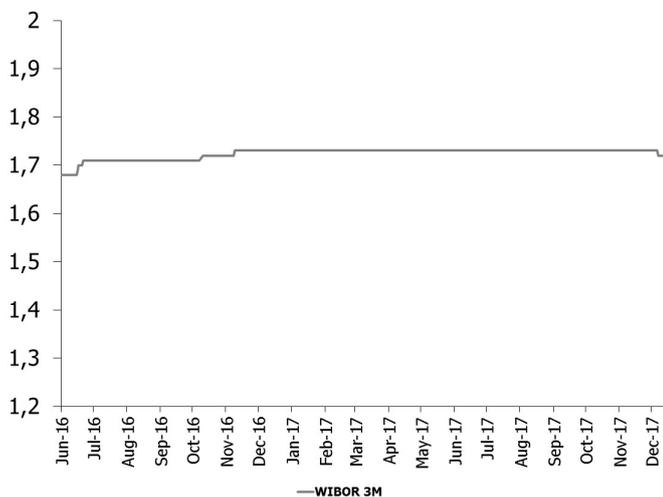
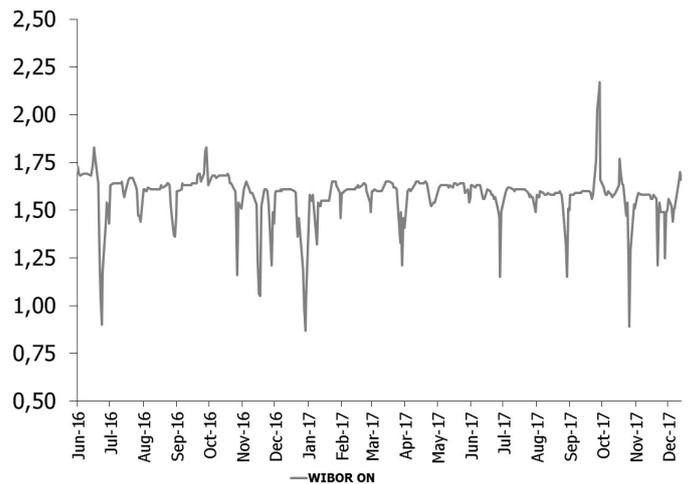
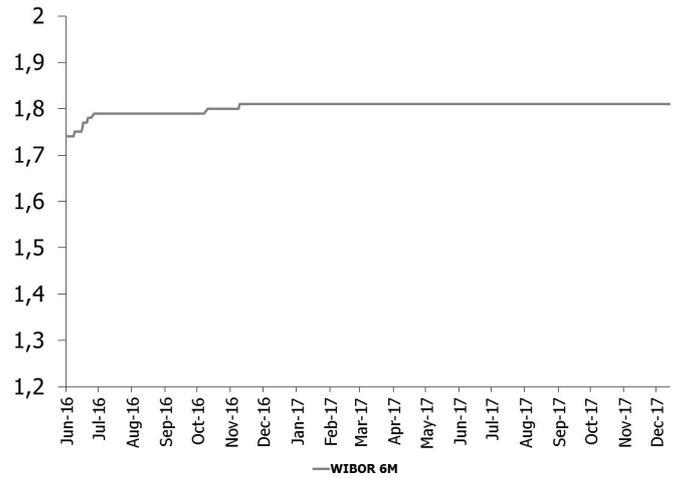
Asset swaps



Money market

Expensive week behind us... cheaper ahead of us

Polonia has been fluctuating around 1.50% for the whole week with highest levels reached on Monday (1.63) and on Tuesday (1.56). Friday's OMO was overbid, banks bought PLN 86 bio bills out of 89 bio offered (when 82.4 bio would square the market). End of the year is coming and we expect that liquidity will be secured, so we see quite relaxed funding next week below 1.50%. On the OIS curve we noticed some selling interest on the shorter end with 2W Polonia at 1.42 and 3W Polonia at 1.43.



Forex

Spot – consolidation The FOMC meeting is already behind us, with 25 bp hike widely expected and dots unchanged. However, the reaction was a dovish one because of the two votes against the hike and Fed's cautious inflation outlook. Hence, markets believe that there could be a longer pause in the rate-hike cycle. In theory, it should be supportive for Zloty but this time EUR/PLN followed EUR/USD and today (Thursday), EUR/PLN is trading higher (above 4.22). We are still waiting for some fresh signal to push us out of the current range (4,19-4.24). The most obvious candidate is the ECB conference today afternoon. In case we get the hawkish message, the 4.24/4.26 resistance zone should be at least tested. If the message is dovish, the move below 4.20 might be seen. However, we are still in range trading mode, with slightly PLN-negative skew.

Options – volatility stable The week seemed to be packed with events, FOMC, ECB, and as the result, we started the week with a decent bid for gamma, especially in USD/PLN. So far, the Fed failed to produce any move on spot and market reverted to selling, as realized volatility continues to disappoint. 1 month ATM mid is 4.2% today (unchanged), 3 months are at 4.8% (unchanged) and finally 1 year fixed at 6.2% (unchanged). The skew as well as the currency spread (difference between USD/PLN and EUR/PLN) were stable.

Short-term forecasts

Main supports / resistances:

EUR/PLN: 4.19 / 4.26

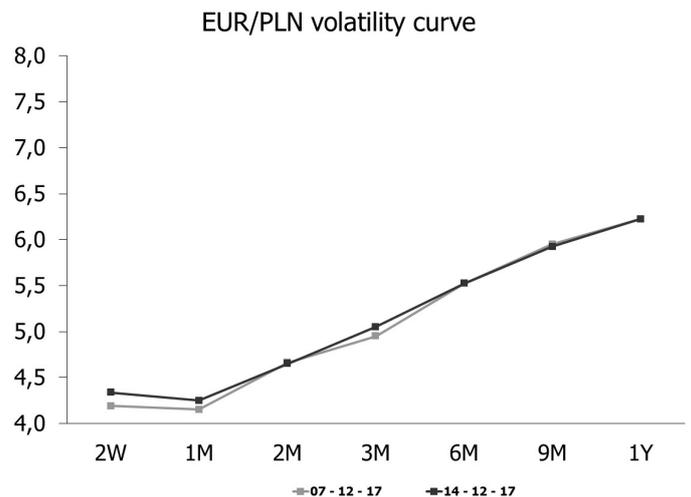
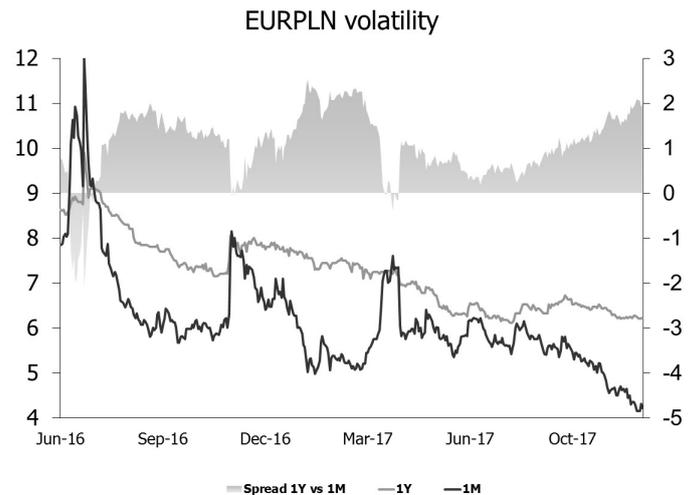
USD/PLN: 3.50 / 3.70

Spot Current position: Long EUR/PLN at 4.1970.

We are long at 4.1970 with a stop at 4.1600 and hopes to see 4.25+. It is a technical trade based on the mean reverting approach.

Options Vol – sidelined

We don't see much of the value in being positioned in EUR/PLN vol curve. The fundamentals for Poland are still very strong, but the political headlines may lead to further nervousness. Historically, vols are extremely cheap, but the realized volatilities are not really encouraging for any purchases.



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
12/7/2017	1.69	1.72	1.76	1.71	1.82	1.75	1.73	1.75	1.79	1.88	2.02	1.91
12/10/2017	1.51	1.72	1.81	1.71	2.03	1.75	1.72	1.75	1.81	1.90	2.01	1.89
12/11/2017	1.70	1.72	1.76	1.71	1.83	1.75	1.73	1.75	1.80	1.89	2.00	1.88
12/12/2017	1.65	1.72	1.70	1.71	1.80	1.75	1.73	1.75	1.81	1.91	2.02	1.89
12/13/2017	1.69	1.72	1.85	1.71	2.08	1.75	1.72	1.75	1.79	1.88	1.98	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
12/7/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
12/10/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
12/11/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
12/12/2017	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
12/13/2017	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
12/7/2017	4.15	4.95	5.53	6.23	6.23	1.56	0.52
12/10/2017	4.15	5.00	5.55	6.20	6.20	1.56	0.52
12/11/2017	4.31	5.04	5.53	6.23	6.23	1.50	0.52
12/12/2017	4.23	5.00	5.51	6.23	6.23	1.50	0.53
12/13/2017	4.25	5.05	5.53	6.23	6.23	1.55	0.53

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
12/7/2017	4.2115	3.5722	3.6028	3.1711	1.3388	0.1645
12/10/2017	4.2026	3.5808	3.5924	3.1532	1.3356	0.1645
12/11/2017	4.2038	3.5633	3.5965	3.1431	1.3374	0.1643
12/12/2017	4.2077	3.5708	3.6085	3.1465	1.3390	0.1641
12/13/2017	4.2155	3.5880	3.6186	3.1642	1.3405	0.1644

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