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Polish Weekly Review

mBank Research
(macro/FI/FX analysis)

[@mbank_research](#)

Ernest Pytlarczyk, PhD, CFA
chief economist
tel. +48 22 829 01 66
ernest.pytlarczyk@mbank.pl

Marcin Mazurek, PhD
senior analyst
tel. +48 22 829 01 83
marcin.mazurek@mbank.pl

Piotr Bartkiewicz
senior analyst
tel. +48 22 526 70 34
piotr.bartkiewicz@mbank.pl

Karol Klimas
analyst
tel. +48 22 829 02 56
karol.klimas@mbank.pl

Department of Financial Markets
(business contacts)

Wojciech Dunaj
head of interest rates trading
tel. +48 22 829 07 51
wojciech.dunaj@mbank.pl

Marcin Turkiewicz
head of fx trading
tel. +48 22 829 01 67
marcin.turkiewicz@mbank.pl

Department of Financial Markets
Sales
(business contacts)

Inga Gaszkowska-Gebska
institutional sales
tel. +48 22 829 01 67
inga.gaszkowska-gebska@mbank.pl

Jacek Jurczyński
head of treasury sales
tel. +48 22 829 15 16
jacek.jurczynski@mbank.pl

mBank S.A.
18 Senatorska St.
00-950 Warszawa
P. O. BOX 728
tel. +48 22 829 00 00
fax. +48 22 829 00 33
<http://www.mbank.pl>

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Comment on the upcoming data and forecasts

This Friday, the CSO will release its monthly Statistical Bulletin along with unemployment data for November. The preliminary estimate from the Ministry of Family indicates that unemployment rate remained flat on a monthly basis, in line with market consensus, but above our forecast. The next days will be light in macro releases. At the turn of the year, two important macro releases will be published. On January 2nd, manufacturing PMI will be released – we expect further improvement in business sentiment, in line with German data. On the next day, the CSO will publish its flash estimate of the CPI. Due to strong base effects in food and fuel prices, we will likely see a sharp drop in inflation, from 2.5 to 2.0% y/y.

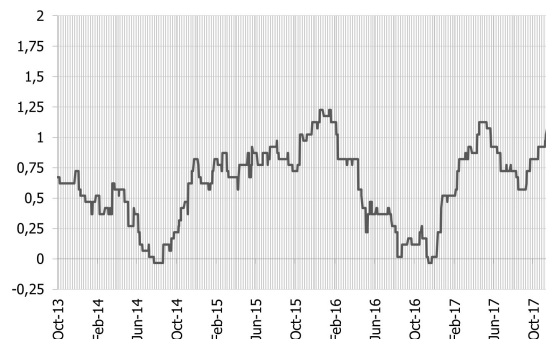
Polish data to watch: December 22nd to January 5th

Publication	Date	Period	mBank	Consensus	Prior
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
Manufacturing PMI	02.01	Dec	54.5		54.2
Flash CPI y/y (%)	03.01	Dec	2.0		2.5

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	1/4/2017	500	1.846	11/23/2017
5Y T-bond PS0422	1/4/2017	750	2.704	11/23/2017
10Y T-bond DS0727	1/4/2017	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

Negative surprise in PPI data was more than balanced by much better than expected retail sales release. All in all, Polish surprise index continues its upward trend. Next weeks bring more opportunities to surprise with publications of unemployment rate, flash CPI and PMI.

* 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

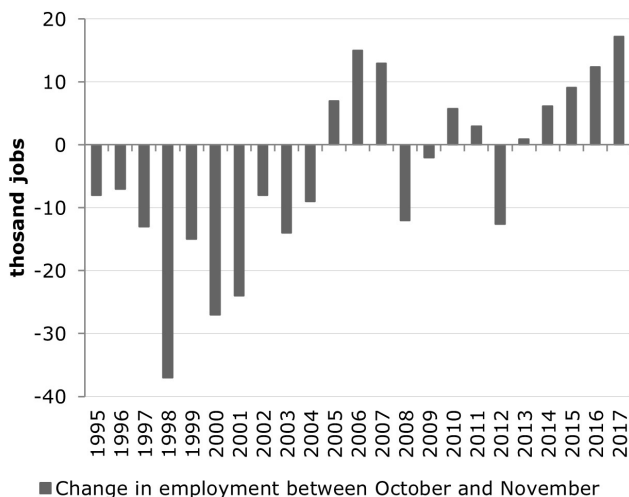
Economics

November numbers confirm Q4 was no worse than Q3. The MPC set to remain dovish.

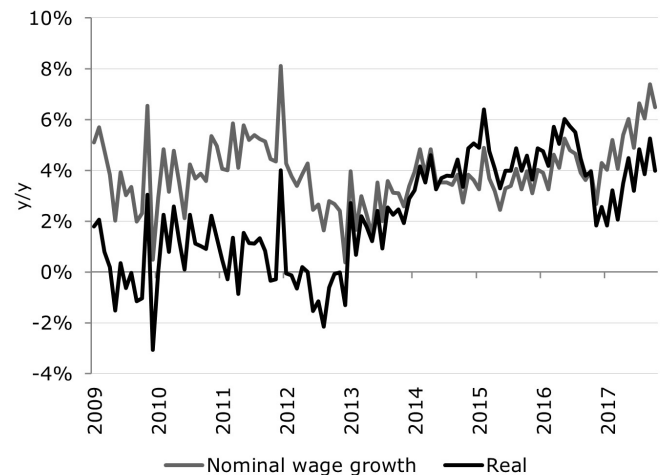
November data continued to come on the positive side. Industrial output is growing at a fast pace, while construction output and retail sales surprised to the upside significantly. Against this backdrop, PPI was a bit underwhelming, but this can be attributed to volatile energy prices. We estimate that GDP rose by 4.8-5.0% in the fourth quarter, with no visible slowdown vis-a-vis the previous one. Meanwhile, the labour market continues to look healthy. The MPC will continue to see the data as confirmation of its optimistic outlook and voice disbelief in its impact on the inflation outlook as long as inflation does not breach the target in a sustainable manner.

As usual, the readers can find our detailed comments on each of this week's releases.

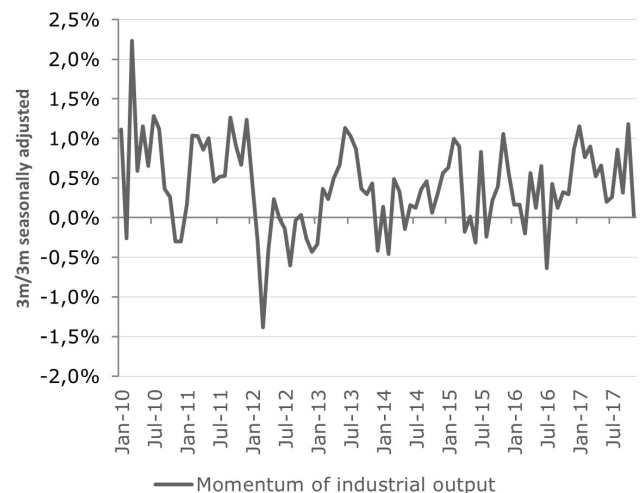
Employment in enterprise sector grew in November by 4.5% on a yearly basis beating both market consensus and our forecast. On a monthly basis more than 17k jobs were added, which is the best result since PKD classification was introduced in 2004. Latest record was noted in 2006 (+15k jobs). Even without knowing the structure of the growth, this is an impressive result. Furthermore, this release puts doubts into the hypothesis that bottlenecks in labour market already started to bite.



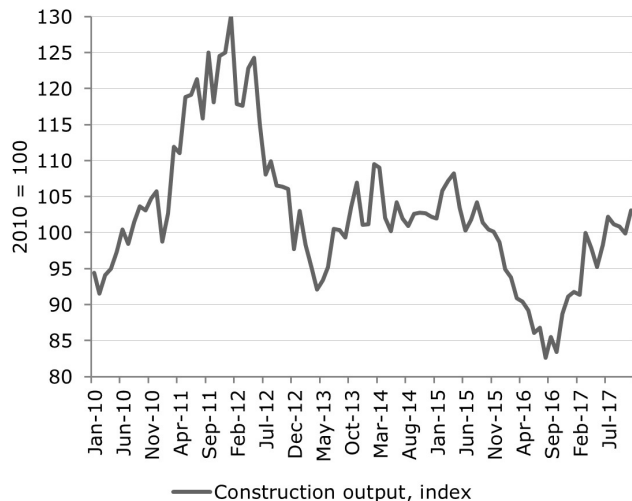
On the other hand, **average wage** grew by 6.5% y/y, missing slightly our forecast and market consensus (both 6.9%). We expected deceleration after stellar growth in October (7.4%, highest result in year), however scope of the drop is slightly greater. As always, we need to wait few days for Statistical Bulletin to examine the structure, but categories which boosted last release are most probably responsible for current drop (manufacturing, construction, real estate activities, trade). Base effects in those categories could have been underestimated. Greater picture on wage processes in Poland remains unchanged: we still see an upward trend. It is still short of what other labor market indicators suggest.



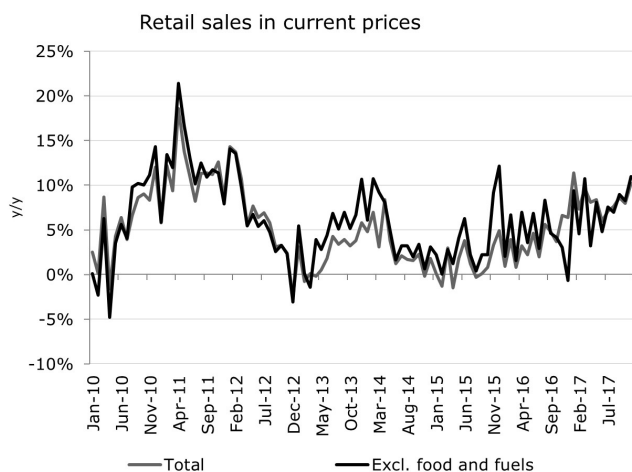
Industrial output rose by 9.1% y/y in November. Our forecast slightly missed on the upside. Lower reading was led by base effects from last year. Momentum remains neutral (ca. 0% m/m on a seasonally adjusted basis). The abovementioned base effects will be a major drag on annual output growth from November on. In particular, the combination of base effects and unfavourable calendar will push headline industrial output growth to zero in December. Looking through these gyrations, we can remain fairly optimistic regarding the outlook for industrial output as both domestic and industrial demand are growing at a fast pace.



Construction output surprised positively after growing by 19.8% on a yearly basis. This is a slightly lower outcome than in October, however the circumstances are completely different (both market consensus and our forecast indicated a growth below 15%). After seasonally adjusting, construction output grew by 3.2% on a monthly basis, thus escaping three month of stagnation (even contraction). We shouldn't be too optimistic yet, since last rebound in this category was temporary. November's release could be a result of changing seasonal pattern for this month, nevertheless it would no explain the whole forecasting error. We need to wait for quarterly data to see the details, but we think that is was driven by catching up with public investment (mainly road infrastructure).



Retail sales rose by 10.2% y/y in November (real +8.8% y/y) beating our forecast. Surprises bloom all over the board with durable, semi-durable and non-durable goods growing faster than forecast. The main takeaway from sales reading should be a positive take on consumption. For many months we have been arguing that perspectives for Polish consumption are bright regardless of base effects on 500+ program. Those should be regarded as inferior versus brilliant consumer confidence, growing incomes and tightening labour market. We also hope for stellar Christmas sales results. We argue that coming X-mas are the first when consumers realized that 500+ is here to stay almost forever. Therefore the whole path of 500+ incomes ranging from now to almost infinity (undefined future) can be discounted as income while planning purchases. X-mas mood can only favour such brave calculations. We think that consumption is going to stay strong onwards and be close in dynamic terms to the results of 2017.



Producer prices rose by 1.8% y/y in November. It is a surprise driven by the prices of coal. Should prices in mining reflected coal prices (cooking coal to be precise) as they did last year, PPI should be only marginally lower than in October. On the contrary, prices in mining were flat m/m what shaved off 1.2pp of the annual PPI reading. Core prices were marginally lower than model-implied. All in all, however, the reading does not look as bad as one may think judging from the headline alone.

Fixed income

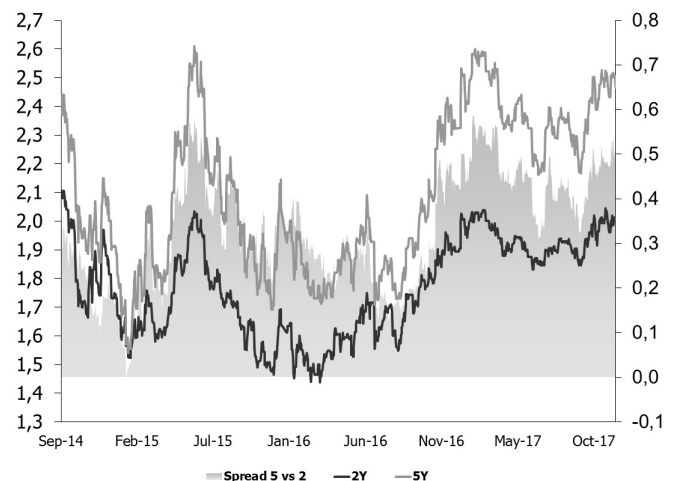
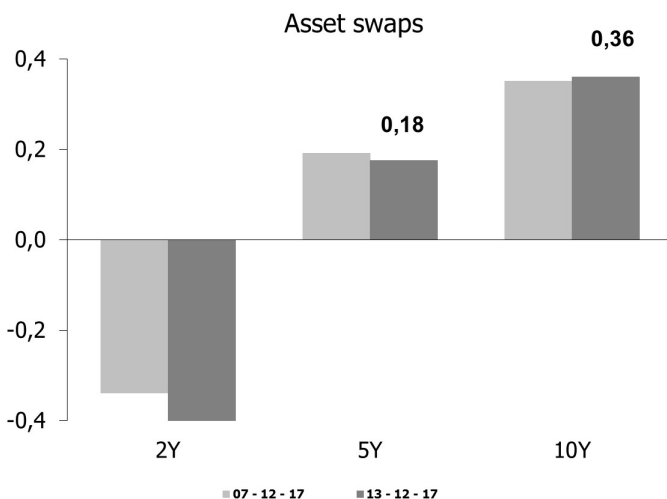
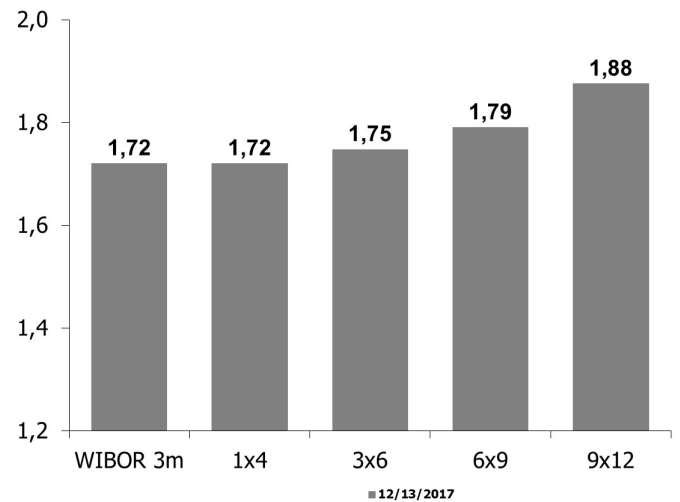
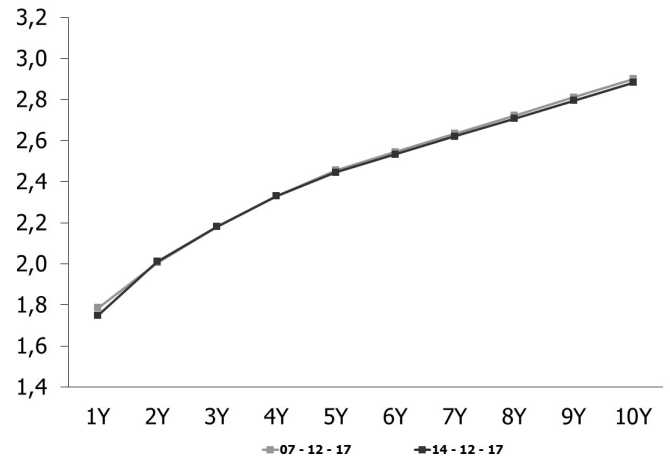
Finally some steepener

It's Christmas time. Shorts have to be covered, books are closed.

On the last auction, the Ministry sold 6 bn PLN of bonds, as we expected, and after that the market is heavy. The heaviest sector was long-end, so as liquidity is extremely low, the curve is very steep again. WS0922/DS0727 is 80 bps, DS0727/Bund is 295 bps. WS0922/5y is 8 bps and DS0727/10y is 30 bps.

DS1019 is trading at 1.71% (7 bps up), WS0922 is trading at 2.53% (2 bps up) and DS0727 is trading at 3.33% (11 bps up).

IRS curve

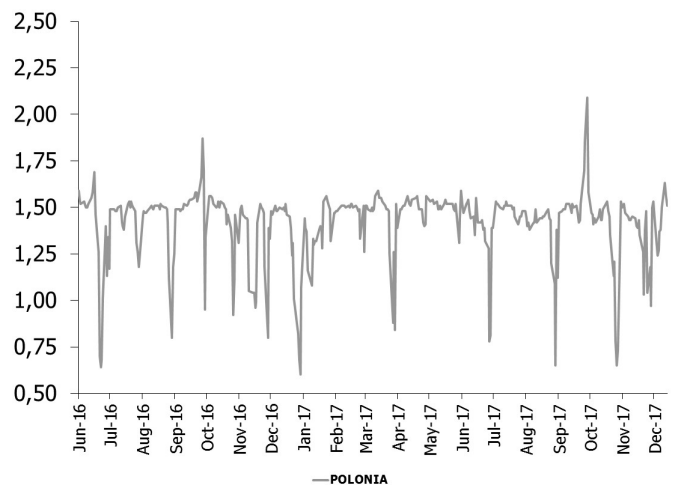
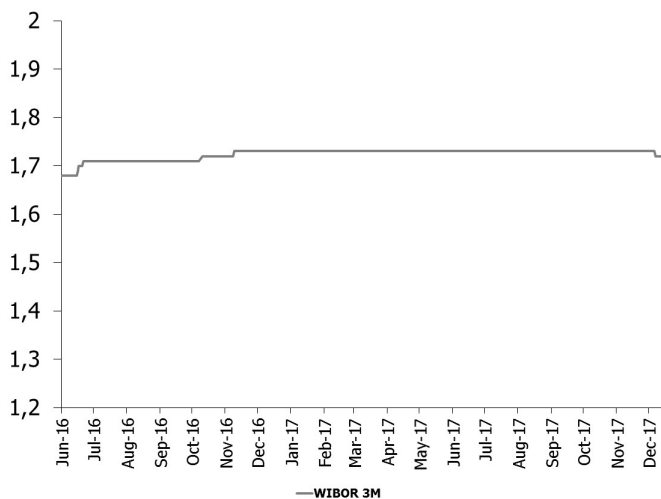
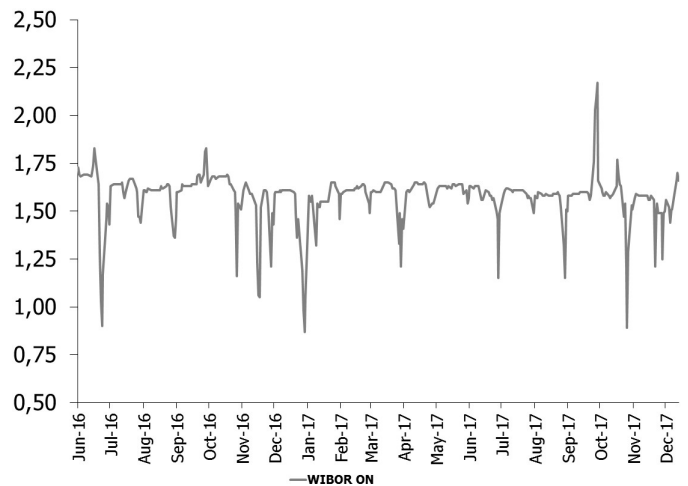
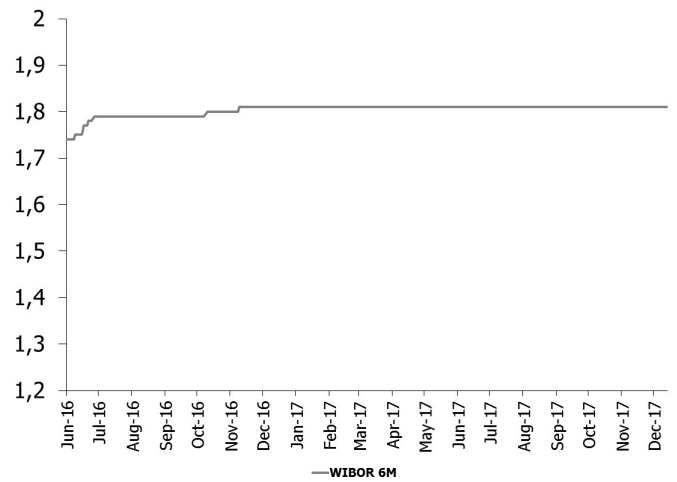




Money market

Last week of the year ahead of us

Polonia has been fluctuating below 1.50% for whole week with lowest levels reached on Monday at 1.18 and on Tuesday at 1.26%. Friday's OMO was underbid, banks bought ca PLN 78 bio bills out of 87 bio offered (when 87 bio would square the market). End of the year is coming and we expect the last (and short) week of the year will be cheap as liquidity will be secured. On the OIS curve we noticed some selling interest on the shorter end with 1W Polonia at 1.32% and 2W Polonia at 1.35%.



Forex

Spot – EURPLN – firmly in range EUR/PLN is still fluctuating in extremely tight range, 4.1955- 4.2255 covers the weekly range. We have noticed a weak drift to stronger PLN, but it was more visible in basket terms (equally weighted EUR and USD ag. PLN). The only distraction was the news of EU triggering article 7 against Poland. In the past we would think it would produce a devastating effect on the Zloty. Now it produced merely 1 figure spike, that quickly faded. As the result, we are still in range trading mode, with slightly PLN-negative skew.

Options – volatility stable The tight range in EUR/PLN says it all! Both realized volatility metrics (daily and high frequency) are still on the move down. However in the middle of EUR/PLN curve we have seen even better bids as we are at the multi-week lows. 1 month ATM mid is 4.20% today (unchanged), 3 months are at 5.0% (0.2% higher) 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

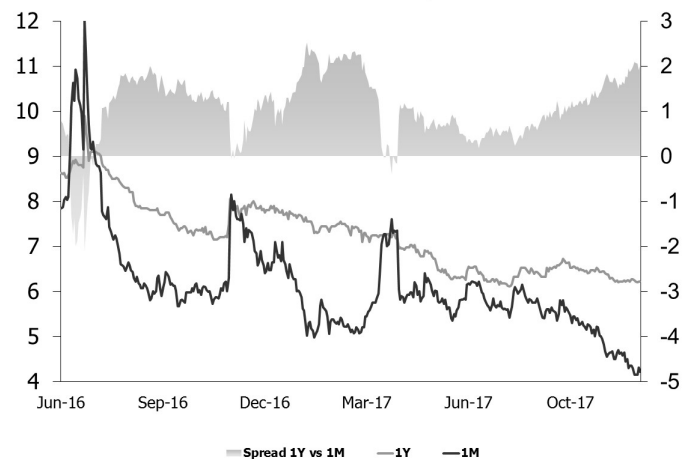
Spot Current position: Long EUR/PLN at 4.1970.

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.

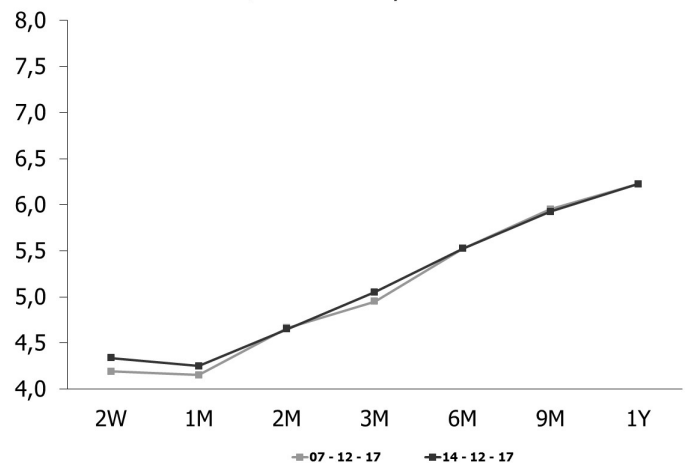
Options Vol – sidelined

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.

EURPLN volatility



EUR/PLN volatility curve



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
12/14/2017	1.72	1.72	1.86	1.71	2.07	1.75	1.73	1.75	1.79	1.88	1.97	1.87
12/17/2017	1.81	1.72	1.94	1.71	2.02	1.75	1.73	1.74	1.78	1.88	1.97	1.87
12/18/2017	1.63	1.72	1.85	1.71	2.05	1.75	1.73	1.74	1.78	1.88	1.98	1.87
12/19/2017	1.45	1.72	1.69	1.71	1.89	1.75	1.72	1.74	1.80	1.90	2.02	1.88
12/20/2017	1.80	1.72	1.93	1.71	2.06	1.75	1.73	1.75	1.79	1.89	2.00	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
12/14/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
12/17/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
12/18/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
12/19/2017	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
12/20/2017	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
12/14/2017	4.10	5.00	5.45	6.18	6.18	1.55	0.52
12/17/2017	4.10	5.00	5.50	6.20	6.20	1.55	0.52
12/18/2017	4.25	5.05	5.50	6.20	6.20	1.56	0.52
12/19/2017	4.15	5.00	5.50	6.23	6.23	1.50	0.53
12/20/2017	4.13	5.03	5.50	6.23	6.23	1.49	0.52

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
12/14/2017	4.2216	3.5716	3.6144	3.1670	1.3436	0.1644
12/17/2017	4.2217	3.5786	3.6227	3.1908	1.3446	0.1644
12/18/2017	4.2134	3.5740	3.6137	3.1730	1.3417	0.1640
12/19/2017	4.2011	3.5583	3.6134	3.1598	1.3415	0.1634
12/20/2017	4.1975	3.5459	3.5925	3.1337	1.3394	0.1635

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