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Polish Weekly Review

Authors:

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

Follow us on Twitter:

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Business contacts:

Department of Financial Markets

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

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

We start on Tuesday with balance of payments data for December. A drop in current account balance, itself a result of sharply lower trade balance, can be traced back to the structure of GDP at year's end and previous releases. On Wednesday CSO will release preliminary GDP estimates for Q4'17. We expect an acceleration to 5.3% from 4.9% in Q3. When it comes to the structure of the growth, consumption remained strong (+4.5% y/y), while investment finally rebounded (+11.5% y/y) – the details of the release will be published later this month. CPI data will be published on Thursday (reminder: there was no flash release for January). Yearly growth rate should drop slightly to 1.9% from 2.1% in December, as a result of lower food prices growth, which balanced the seasonal spike in heating costs. Core inflation should stay at +0.9% y/y, dragged by lower import prices (strong PLN), but we need to wait for official NBP data until March. Finally, Friday brings monthly labour market data. Average wage accelerated slightly (from 7.3% to 7.6%) fuelled by calendar effects and pay raises in retail trade. When it comes to employment data, we expect strong growth at 4.8% y/y after yearly update of CSO's population of "9+" enterprises.

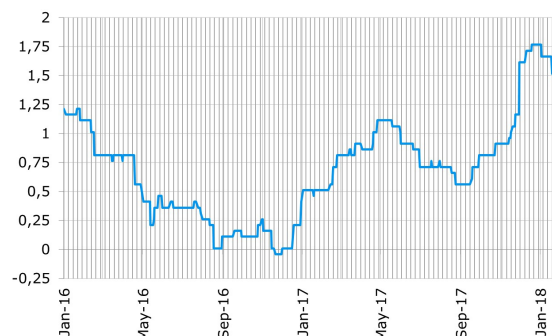
Polish data to watch: February 9th to February 16th

Publication	Date	Period	mBank	Consensus	Prior
Current account (mio EUR)	13.02	Dec	-500	-230	233
Exports (mio EUR)	13.02	Dec	15400	16690	18243
Impots (mio EUR)	13.02	Dec	15900	16530	18134
GDP y/y flash (%)	14.02	Q4	5.3	5.1	4.9
CPI y/y (%)	15.02	Jan	1.9	1.8	2.1
Average wage y/y (%)	16.02	Jan	7.6	6.9	7.3
Employment y/y (%)	16.02	Jan	4.8	3.1	4.6

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 OK0720	2/22/2018	800	1.813	2/8/2018
5Y T-bond PS1023	2/22/2018	1500	2.772	2/8/2018
10Y T-bond WS0428	2/22/2018	700	3.515	2/8/2018
30Y T-bond WS0447	-	125	3.720	10/25/2017

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



Comment

Unchanged, there were no releases to move the index. Next week bring plenty of opportunities to surprise with CPI, preliminary GDP and labour market data.

* 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 2018 Polish GDP is set to grow by 4.6% (with upside risks). 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 2017. 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. In our view, as long as inflation stays within the target band and 5% remains a ceiling for GDP growth, the MPC will keep its rhetoric in place. Our current forecast reflects this reality – no change in interest rates in 2018.
- Fiscal situation continues to be very comfortable. 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

- Political issues moved into the background and the markets are clearly unconcerned with local risks, making the PLN a star performer in the region.
- The key reason for the recent PLN strength is the dollar's weakness. The latter shields Polish currency from repricing along with rising risk-free rates. Moreover, since EM assets survived the equity selloff bravely as a group, they have become much more balanced as a whole of late. In such an environment, PLN remains strong with robust growth and only a hint of higher inflation to come.
- Such an equilibrium is unlikely to persist for long, though. Something has to give in and in either scenario (strong growth and inflation, leading to higher rates globally, or lower growth, higher risk aversion and outflows from EMs) negative real interest rates and dovish MPC will become a liability. Thus, before Zloty strengthens again due to cyclical factors, we might see some weakening in the meantime (to 4.20-ish).

mBank forecasts

	2013	2014	2015	2016	2017	2018 F
GDP y/y (%)	1.4	3.3	3.8	2.9	4.6	4.6
CPI Inflation y/y (average %)	0.9	-0.1	-0.9	-0.6	1.9	2.4
Current account (%GDP)	-1.2	-2.1	-0.5	-0.3	0.2	-0.2
Unemployment rate (end of period %)	13.4	11.4	9.8	8.2	6.6	6.0
Repo rate (end of period %)	2.50	2.00	1.50	1.50	1.50	1.50

	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	5.3	4.8	4.6	4.5	4.5
Individual consumption y/y (%)	4.7	4.9	4.8	4.5	4.6	4.3	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	11.5	10.0	10.0	9.0	8.0
Inflation rate (% average)	2.0	1.8	1.9	2.0	2.0	2.6	2.6	2.2
Unemployment rate (% eop)	8.0	7.0	6.8	6.6	6.8	6.0	5.7	6.0
NBP repo rate (% eop)	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
Wibor 3M (% eop)	1.73	1.73	1.73	1.72	1.72	1.72	1.73	1.73
2Y Polish bond yields (% eop)	2.01	1.90	1.75	1.72	1.73	1.73	1.79	1.97
10Y Polish bond yields (% eop)	3.49	3.32	3.37	3.30	3.20	3.35	3.50	3.60
EUR/PLN (eop)	4.23	4.23	4.31	4.18	4.15	4.20	4.15	4.10
USD/PLN (eop)	3.97	3.70	3.65	3.48	3.52	3.50	3.40	3.33

F - forecast



Economics

NBP rates still on hold

Recent MPC meeting brought no changes to interest rates. Despite a little more upbeat statement, the overall stance of the MPC stays dovish. We witnessed no meaningful changes in governor's rhetoric. The more so, hawkish camps seems to have been abandoned by Lukasz Hardt who joined the governor's camp, just as Eugeniusz Gatnar did two months before. All this supports our view that rates will be left on hold in 2018.

Turning to details, statement is more upbeat on growth. It is now assessed that global improvement in business activity is meaningful (vs. the version without that adjective last month). In the same vein, the 2018 growth expectation in Poland was upgraded from lower to a bit lower. This may just be semantics, but fully compliant with recent data. The assessment of jump-started investment was derived from recent data on GDP for 2017. It matches our conclusions.

As for the conference itself, the governor's first "forward guidance" on rates seemed to be a less unconditional than before. However, as the conference progressed, the originally a little bit more hawkish reasoning was diluted to the extent witnessed before. We feel that nothing really changed on this field and governor is just trying to get some leeway in case something unexpected happens (so far nothing of this sort is on MPC's radar). It was quite interesting to hear that dominant MPC take on investment is the one linked to future productivity, not current demand. Such a view corroborates our guess that more balanced GDP growth (more investment, less consumption) makes MPC more prone to dovish rhetoric. In this case the structure matters more than the level of growth itself. It is going to slowly translate into inflation projection as (most likely) flattening of core inflation growth 2019 onwards.

Last but not least, the dovish camp is has a new member: Lukasz Hardt. He is another rate-setter, after Eugeniusz Gatnar, who converged in his views to the ones expressed by the governor. It looks as if the appearance on the conference entails a change in mindset. An interesting test of this presumption may come in March. Our calculations show that Kamil Zubelewicz should be absent from conferences for a long time since he more than did his share over the previous months. If he pops up in March, then the dovish camp may greet a new member. Of course these are trivia but once again show that governor's power in the MPC extends far beyond the casting vote he is entitled to in case of a draw.



Fixed income

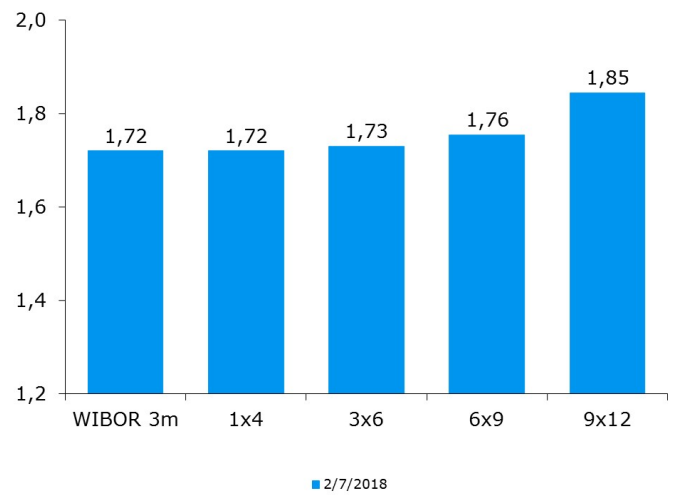
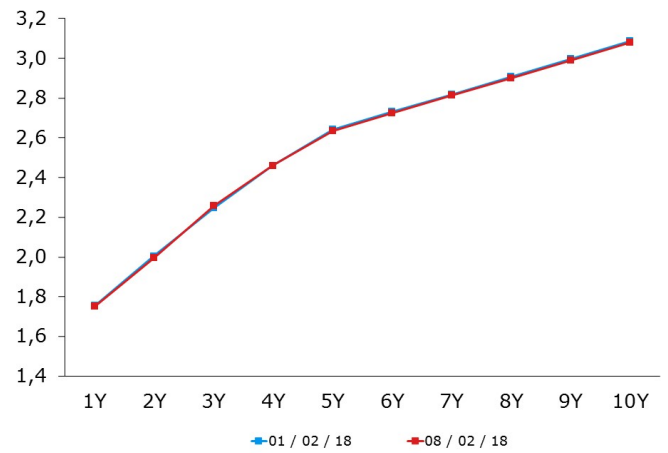
Amazing stability

Polish market is the most stable in the world! Core markets don't affect us. We had a small auction today with no impact on the secondary market, bid/cover was 1.7. Poland has financed 43% of 2018 borrowing needs so far.

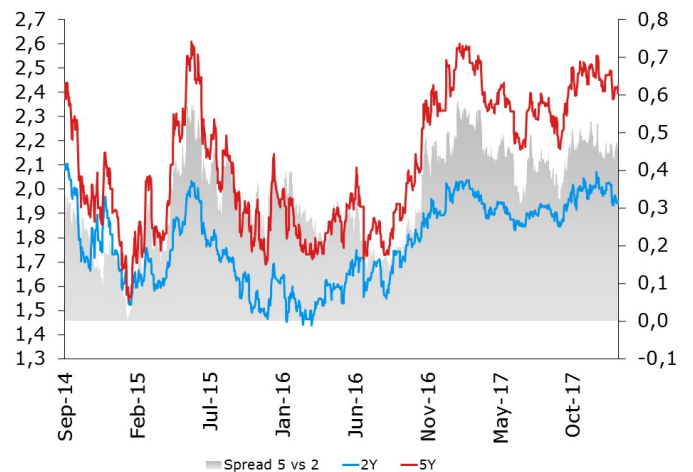
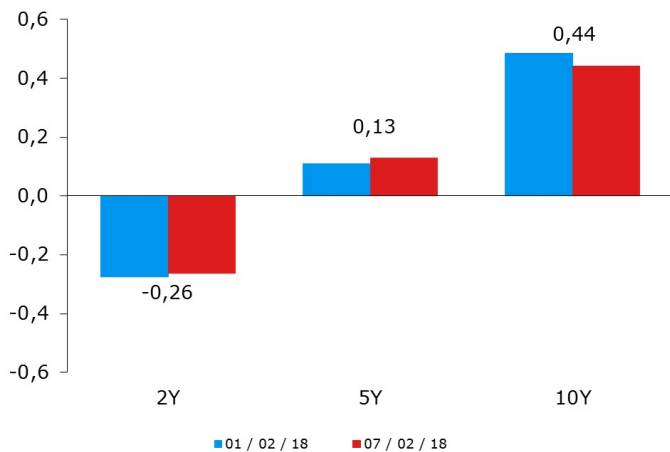
ASWs are very tight, PS0123/5y is 8 bps and DS0727/10y is 29 bps. DS0727/Bund is 267 bps. PS0123/DS0727 is 66 bps.

DS1019 is trading at 1.51% (1 bps down), PS0123 is trading at 2.78% (2 bps up) and DS0727 is trading at 3.44%.

IRS curve



Asset swaps



Money market

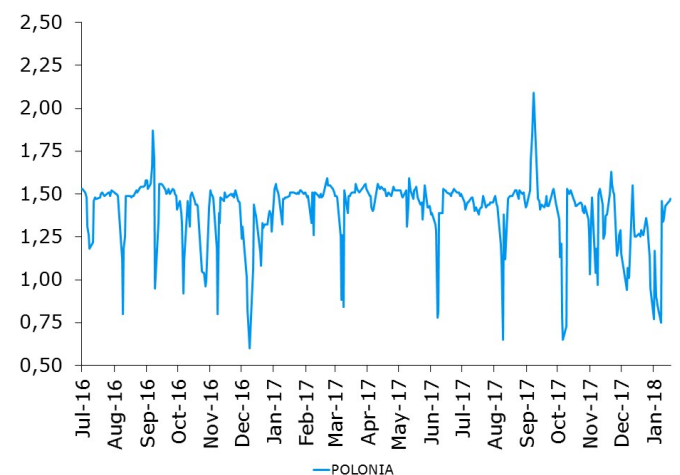
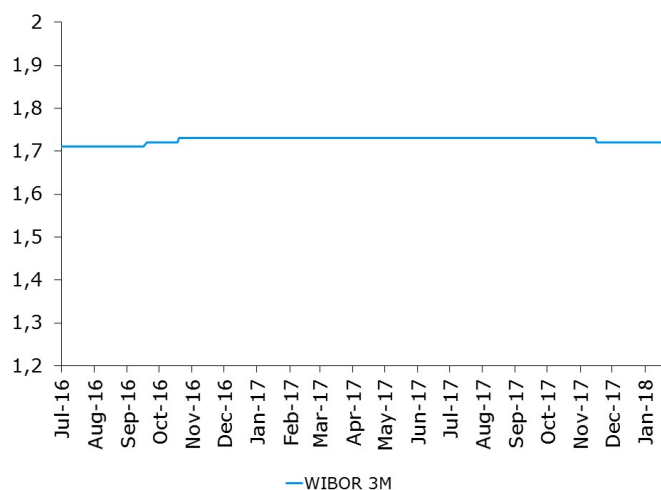
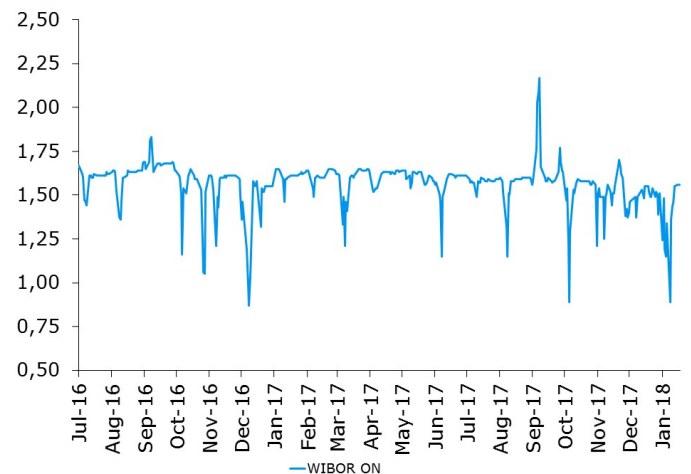
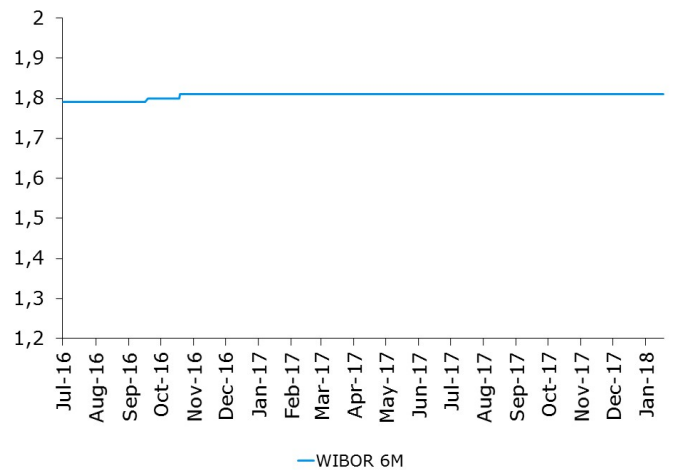
MPC brought stability, market is waiting for CPI release

Polish MPC left rates unchanged yesterday at 1.50%, which was widely expected by market participants. Furthermore, Governor Glapinski reiterated that with his current knowledge rate should stay flat until the end of 2018. MPC members are generally happy with current situation and even hawks accept the governor's view about the rates. This equilibrium supports less volatility on POLGBs in these turbulent times. Next week, Polish CPI will be interesting to watch.

January was a very cheap month. That's a common thing and we think things will start to normalize in February.

Ref rate vs Polonia averages:

30 day 32 bps
90 day 24 bps



Forex

Spot – still boxed in a tight range A sell-off across global stock markets and bets that Fed could hike interest rates at least three times in 2018 have driven the dollar up in recent days. EUR/USD decreased by almost 2.5%. The move in USD/PLN was also substantial as it jumped from 3.3180 (last Friday low) to 3.4135, today's high. EUR/PLN seemed to be invulnerable to any fears, last week it was traded in the narrow 4.1500 – 4.1750 range. Anyway, the investment climate seems to be bit sourer due to the higher core rates. Stretched long Zloty positions might add to this effect. Play the range, 4.14-4.19 is the most likely one.

Options – EURPLN vols stable, USDPLN vols higher

Although markets were very volatile this week, with the VIX index – widely considered the best gauge of fear in the market – shooting up from 17 on Friday to 50 on Tuesday, the implied EURPLN volatility curve was quite stable. 1 month EUR/PLN ATM mid is 4.4% (0.2% higher), 3 month EUR/PLN is at 4.8% (unchanged) and, finally, 1 year is fixing at 6.0% (unchanged). The currency spread (difference between USD/PLN and EUR/PLN) rose by 0.75% due to higher EUR/USD vols. The skew was at the same level as a week before.

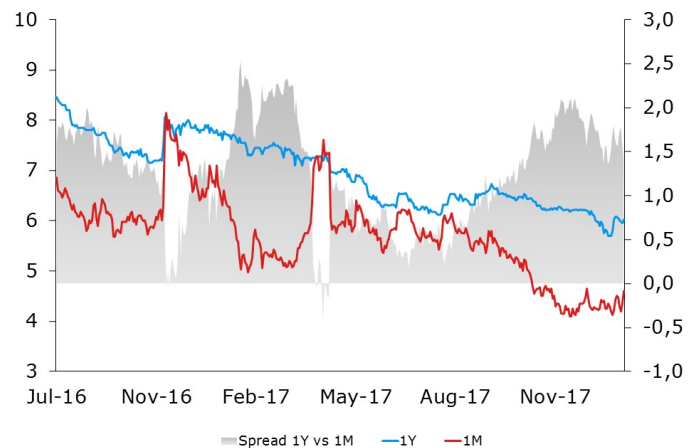
Short-term forecasts

Main supports / resistances:
 EUR/PLN: 4.13 / 4.23
 USD/PLN: 3.35 / 3.60

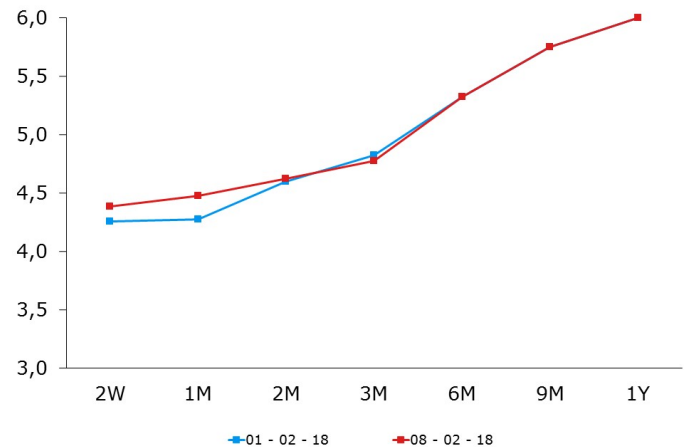
Spot Current position: None.

We are back to our favourite game – range playing. We see 4.14-4.19 as the current range, and we are trying to play that range with an open mind.

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
2/1/2018	1.64	1.72	1.72	1.71	1.77	1.75	1.72	1.73	1.76	1.86	1.98	1.85
2/4/2018	1.66	1.72	1.77	1.71	1.91	1.75	1.72	1.73	1.75	1.83	2.02	1.85
2/5/2018	1.65	1.72	1.85	1.71	1.98	1.75	1.72	1.73	1.76	1.85	1.98	1.84
2/6/2018	1.52	1.72	1.60	1.71	1.64	1.75	1.72	1.74	1.76	1.86	1.97	1.87
2/7/2018	1.63	1.72	1.75	1.71	1.99	1.75	1.72	1.73	1.76	1.85	1.97	1.83

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
2/1/2018	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
2/4/2018	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
2/5/2018	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
2/6/2018	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
2/7/2018	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
2/1/2018	4.28	4.83	5.33	6.00	6.00	1.41	0.53
2/4/2018	4.20	4.76	5.29	5.98	5.98	1.41	0.53
2/5/2018	4.38	4.78	5.33	5.95	5.95	1.38	0.54
2/6/2018	4.60	4.99	5.36	6.03	6.03	1.40	0.54
2/7/2018	4.48	4.78	5.33	6.00	6.00	1.35	0.54

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
2/1/2018	4.1504	3.3346	3.5806	3.0417	1.3383	0.1643
2/4/2018	4.1615	3.3329	3.5886	3.0332	1.3452	0.1649
2/5/2018	4.1585	3.3375	3.5882	3.0370	1.3418	0.1651
2/6/2018	4.1547	3.3498	3.5852	3.0728	1.3395	0.1648
2/7/2018	4.1593	3.3677	3.5904	3.0870	1.3418	0.1648

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