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## Polish Weekly Review

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### Comment on the upcoming data and forecasts

On Thursday the CSO will publish CPI data for February. We expect CPI to slow down modestly, from 1.9 to 1.7% y/y, on the back of lower food and energy prices. Core inflation likely rose to 1.0% in January and remained there in February – official data on core inflation measures will be published by the NBP on Friday. The introduction of 2018 consumer basket weights likely did not impact the January CPI reading. On Friday monthly labor market data will be released. Both wages and employment likely slowed down a bit. The former is mostly related to slightly unfavorable calendar effect (working day difference declined from +1 to 0 y/y), the latter – to base effects from last year. We believe that such strong monthly increases in employment are unlikely to materialize again due to rising labor shortages. Also on Friday the NBP will publish balance of payments data for January. The massive, 2 bn EUR current account surplus is a result of a very high inflow of EU funds at the beginning of the year. Trade balance also likely improved, but remained in a slight deficit.

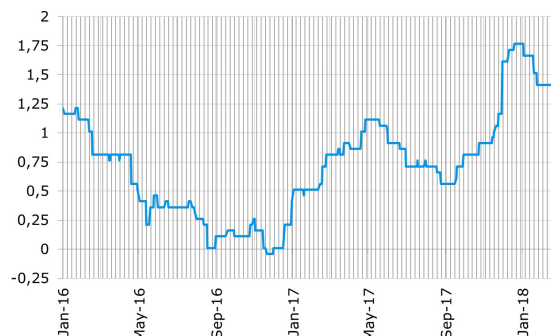
### Polish data to watch: March 9th to March 16th

Publication	Date	Period	mBank	Consensus	Prior
CPI y/y (%)	15.03	Feb	1.7	1.8	1.9
Average gross wage y/y (%)	16.03	Feb	7.0	7.2	7.3
Employment y/y (%)	16.03	Feb	3.7	3.7	3.8
Current account (mio EUR)	16.03	Jan	2150	624	-1152
Exports (mio EUR)	16.03	Jan	16950	16931	15232
Imports (mio EUR)	16.03	Jan	17300	17152	16500
Core inflation y/y (%)	16.03	Jan	1.0	1.0	0.9
Core inflation y/y (%)	16.03	Feb	1.0	1.0	

### 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	3/15/2018	200	1.741	2/14/2018
5Y T-bond PS1023	3/15/2018	1000	2.687	2/22/2018
10Y T-bond WS0428	3/15/2018	400	3.430	2/22/2018
30Y T-bond WS0447	3/15/2018	50	3.764	2/22/2018

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



### Comment

Unchanged from previous week (no data releases). Next week CPI and labor market data offer some room for 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 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

	2014	2015	2016	2017	2018 F	2019 F
GDP y/y (%)	3.3	3.8	2.9	4.6	4.6	3.6
CPI Inflation y/y (average %)	-0.1	-0.9	-0.6	2.0	2.1	2.7
Current account (%GDP)	-2.1	-0.5	-0.3	0.2	-0.2	-0.6
Unemployment rate (end of period %)	11.4	9.8	8.2	6.6	5.8	5.5
Repo rate (end of period %)	2.00	1.50	1.50	1.50	1.50	2.25

	2017	2017	2017	2017	2018	2018	2018	2018
	Q1	Q2	Q3	Q4	Q1 F	Q2 F	Q3 F	Q4 F
GDP y/y (%)	4.1	4.0	4.9	5.1	4.8	4.6	4.5	4.5
Individual consumption y/y (%)	4.7	4.9	4.8	4.9	4.6	4.3	4.0	4.0
Public Consumption y/y (%)	0.5	2.1	1.9	5.4	4.0	3.0	3.0	3.0
Investment y/y (%)	-0.5	0.9	3.3	11.3	10.0	10.0	9.0	8.0
Inflation rate (% average)	2.0	1.8	1.9	2.3	1.9	2.3	2.4	1.9
Unemployment rate (% eop)	8.0	7.0	6.8	6.6	6.8	6.0	5.7	5.8
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	1.65	1.65	1.80	1.75
10Y Polish bond yields (% eop)	3.49	3.32	3.37	3.30	3.30	3.45	3.60	3.70
EUR/PLN (eop)	4.23	4.23	4.31	4.18	4.18	4.20	4.15	4.10
USD/PLN (eop)	3.97	3.70	3.65	3.48	3.48	3.50	3.40	3.33

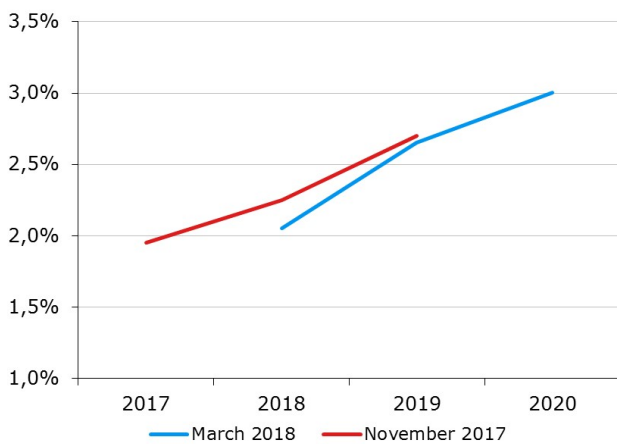
F - forecast

## Economics

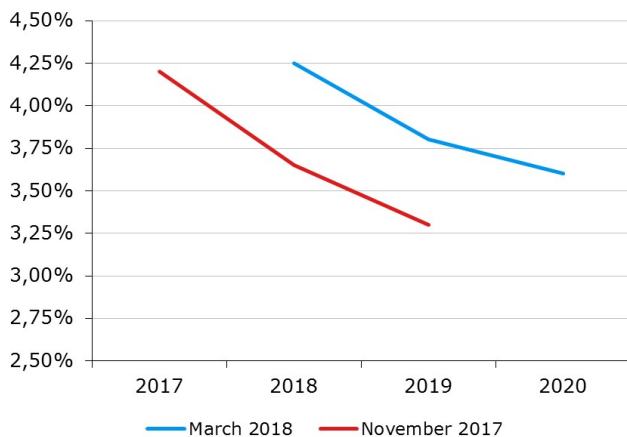
### MPC reached peak dovishness

No change in rates, only slight tweaks in the statement. Projections moved in a way that could be inferred from the earlier comments flowing from the MPC. GDP growth was lifted upwards in the short-term but the overall trajectory (deceleration within the monetary policy horizon) was sustained. Inflation path shifted slightly downwards near term, but hits 3% in 2020. We think that the recent muses on labor productivity may have been the cause for serious revision (downwards) of core inflation path and the reason for confidence that labor costs are unlikely to be passed through onto consumers.

CPI projection: midpoint of central range

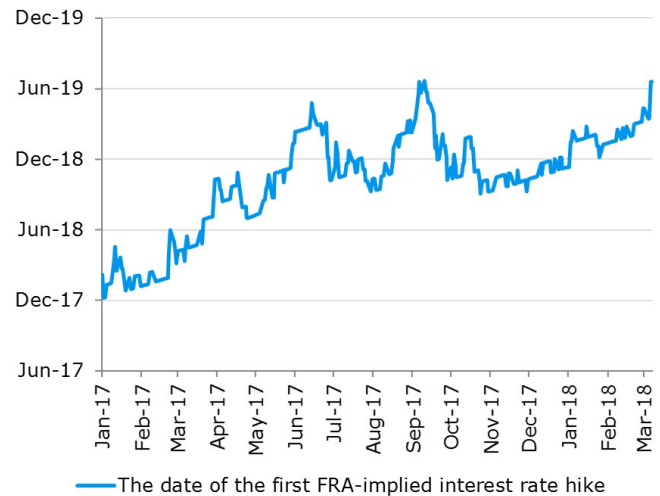


GDP projection: mid point of central range



As usual, the most interesting part of the MPC meeting was the verbal one during the conference. That one was utterly dovish. In short, everything is accelerating in the economy, except for inflation. This way the conditional forward guidance of stable rates was extended through 2018, 2019 and even 2020. What is more, there was a mention that the next MPC move on rates may be down, not up. All those conclusions were drawn from the fact that the economy is going to decelerate a bit in the future, rising labor productivity is to compensate for rising labor costs that are rather unlikely to soar further as part of the recent acceleration stems from the changes in labor contracts and, as such, constitutes only a temporary boost (we have not found the confirmation of the story anywhere so far). Consensus in the MPC shifted to the dovish side and is based upon projections that

have yet to be confirmed.



Of course such a dovish tilt did wreak havoc with interest rates. The market now expects the first MPC move upwards to occur in July 2019. Such market consensus coupled with very strong MPC view opens the room for speculation in the opposite direction. It also opens the MPC itself for surprises in the data as it now put a bet on a very benign economic scenario that yet has to come true. And we doubt – at this very moment – that this is going to be the case. International experience suggests that core inflations (SO FAR) do not accelerate rapidly around full employment. Such reasoning may be the basis for current MPC easy stance. The case is strengthened by the overshoot of core inflation which plagued recent projections. Having said that, this field is still uncharted territory in this cycle and we may see non-linearities as core inflation makes up for the prolonged periods of stability. The argument on strong, lagging correlation between wages and inflation in services is alone sufficient to bring core inflation to around 2% in the year end.

Summing up, by deepening dovish tone, MPC pushed market expectations towards inflation benign scenario. This way, any upward surprise in core inflation is going to shake current consensus fast. We think that market expectations for late rate hikes moved too far. Inflation data would be of utmost importance near term and market reaction is poised to be asymmetric (panic after higher prints, calm after lower).

## Fixed income

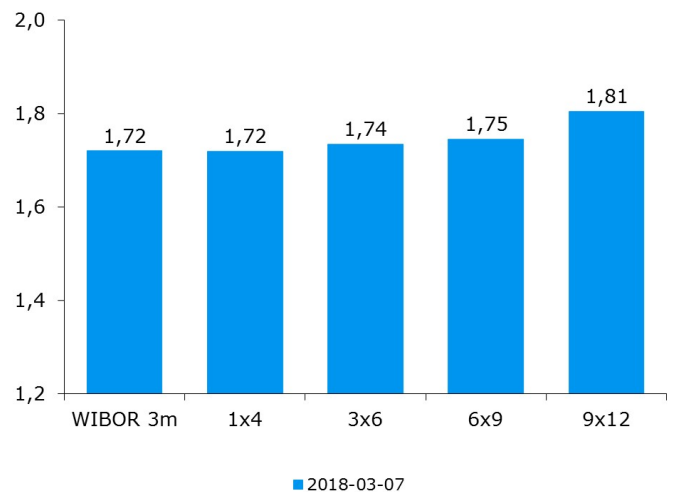
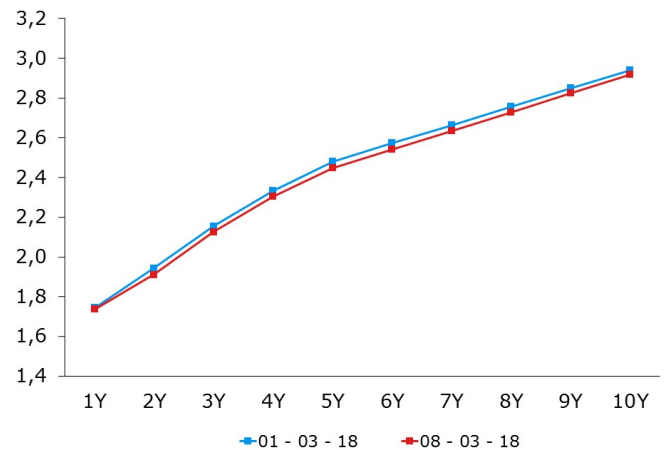
### Headin' down a one way street

We have seen a small correction on POLGBs, DS0727 pulled back to 3.28%, but after the MPC meeting there's only one way again: down. Perhaps the ECB could change it. With DS0727/UST10y spread at 30 bps, investors are trying hard to find value in Polish bonds at these levels.

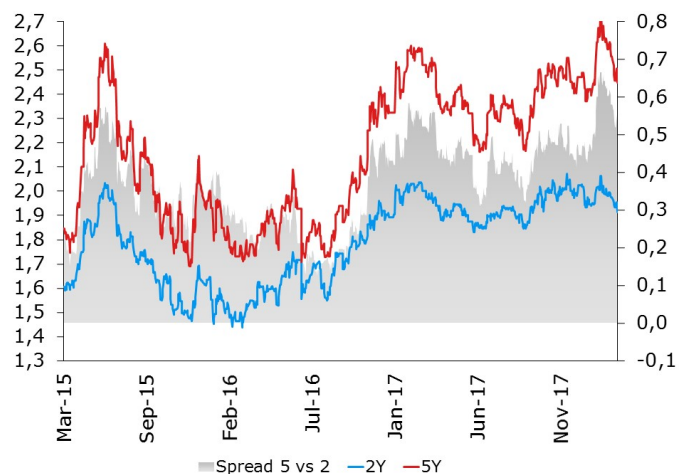
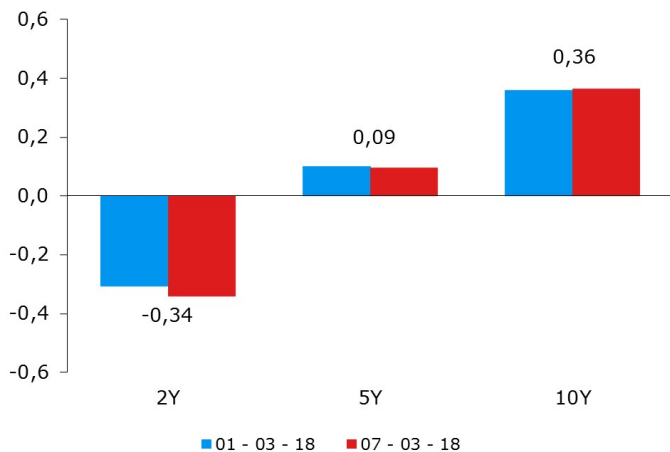
Spreads have tightened considerably: PS0123/5y is 2 bps and DS0727/10y is 25 bps. DS0727/10Y Bund is 250 bps (!), PS0123/DS0727 is 71 bps.

DS1019 is trading at 1.32% (13 bps down), PS0123 is trading at 2,47% (8 bps down) and DS0727 is trading at 3.18% (2bps down).

IRS curve



Asset swaps

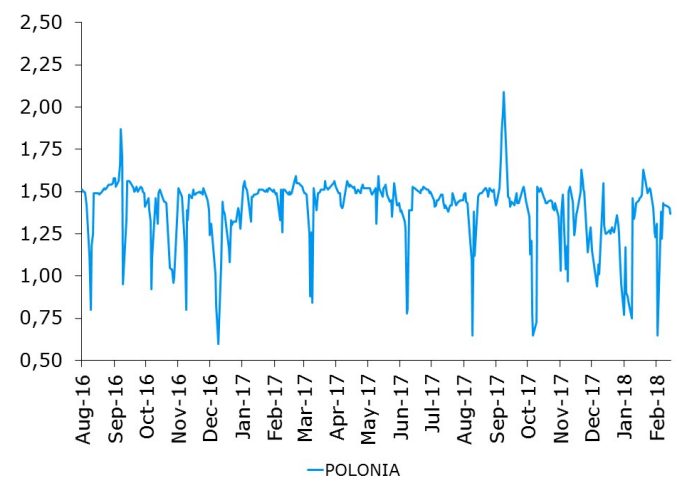
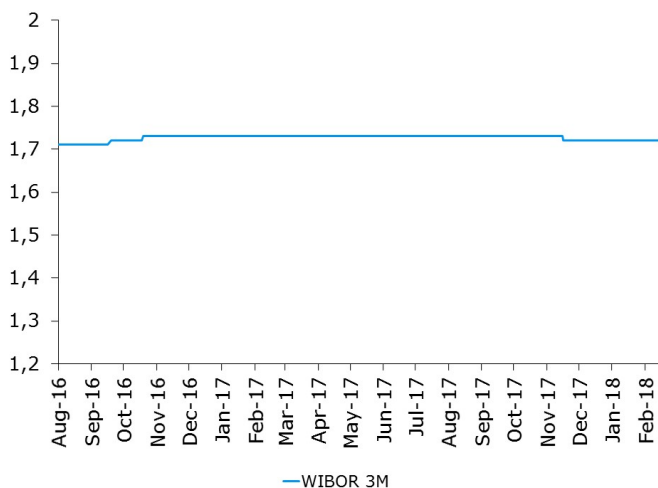
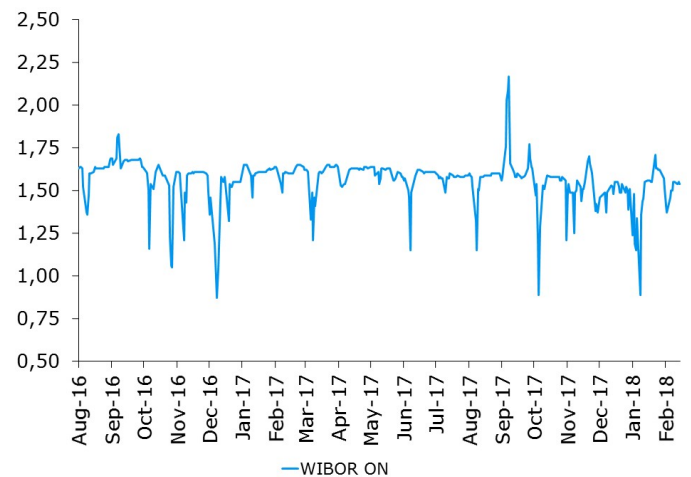
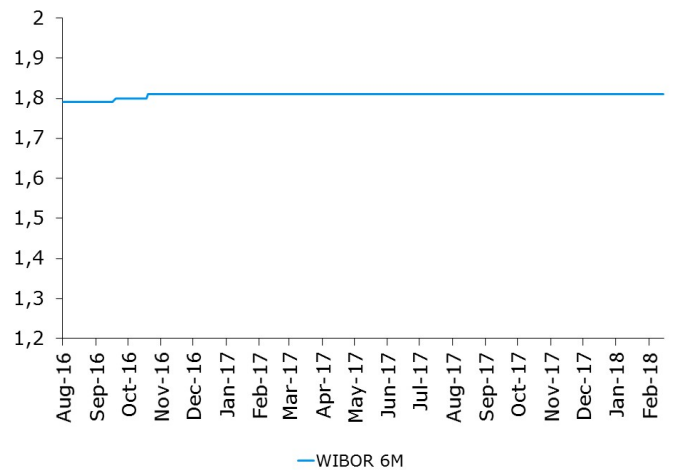


## Money market

### Stable week behind us

The MPC meeting surprised on the dovish side, but it wasn't a U-turn, but rather an extension of well-known trends. Governor Glapinski reiterated that in his opinion rates should stay on hold until the end of 2018 or even longer (2019? 2020?).

Polonia fluctuated below 1.50% for whole week with lowest levels reached on Thursday (1.37%). Friday's OMO was underbid, banks bought PLN 88.2 bn bills out of 91.5 bn offered (whereas 91 bn would square the market).



## Forex

**Spot – PLN weaker: EUR/PLN above 4.20** Finally, EUR/PLN has broken 4.20 resistance, reaching 4.2155 high so far. It was the ultra-dovish MPC meeting that finally pushed PLN lower. Technically, it is a strong signal that opens the way to 4.23 and further to the ideal target of 4.29, with 4.18/4.20 now being the support zone. However, our baseline scenario is that EUR/PLN range just moved higher to 4.1850-4.2450. It will be down to global sentiment post-ECB and US numbers that may add fuel to or stop PLN deterioration.

**Options – Volatility higher** The correlation of weaker PLN and higher Vols is working as usual. However, the reaction of option market was really muted. 1 month ATM mid is 4.3% today (0.1% higher than week ago, but 0.5% higher than yesterday), 3 months are at 4.8% (0.1% higher) and, finally, 1 year fixed at 5.95% (0.05% higher). The skew and the currency spread (difference between USD/PLN and EUR/PLN) are roughly unchanged.

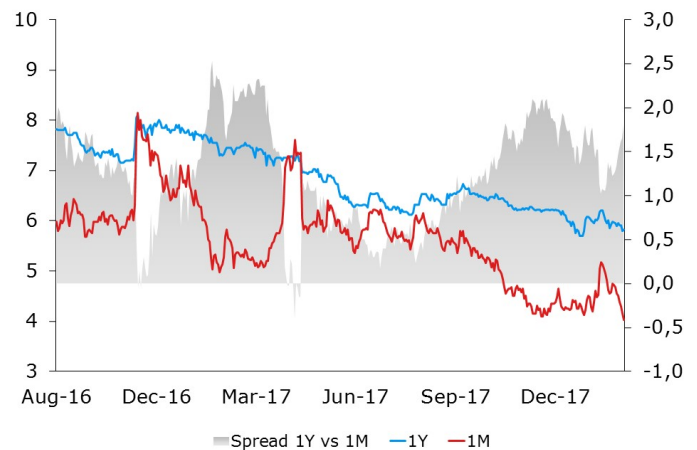
### Short-term forecasts

Main supports / resistances:  
 EUR/PLN: 4.1850 / 4.2450  
 USD/PLN: 3.3500 / 3.6000

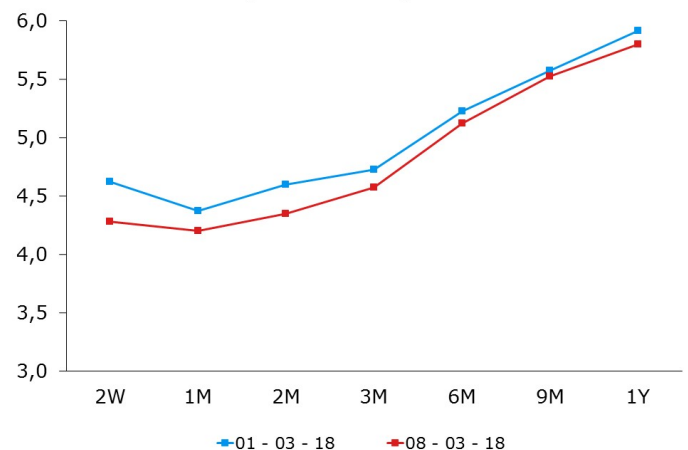
**Spot** Current position: None.

The bigger picture favors 4.1850 – 4.2450 range for EUR/PLN. We would like to play it by selling at 4.2300, adding at 4.2500 with a stop above 4.2650 and hopes for 4.1800. Or, alternatively, buy EUR/PLN at 4.1950, add at 4.1800 with stop below 4.1600.

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
3/1/2018	1.54	1.72	1.66	1.71	1.86	1.75	1.72	1.73	1.76	1.82	1.92	1.83
3/4/2018	1.69	1.72	1.74	1.71	1.80	1.75	1.72	1.74	1.75	1.82	1.92	1.83
3/5/2018	1.58	1.72	1.70	1.71	1.93	1.75	1.72	1.73	1.75	1.83	1.93	1.82
3/6/2018	1.38	1.72	1.51	1.71	1.76	1.75	1.72	1.73	1.75	1.82	1.93	1.82
3/7/2018	1.58	1.72	1.70	1.71	1.96	1.75	1.72	1.74	1.75	1.81	1.89	1.81

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
OK0720	2/14/2018	7/25/2020	95.93	1.74	200	656	206
PS0123	2/22/2018	1/25/2023	99.14	2.69	1000	3070	1036
WS0428	2/22/2018	4/25/2028	94.22	3.43	400	1017	473

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0720	5Y IRS	PS0423	10Y IRS	WS0428
3/1/2018	1.750	1.389	1.945	1.639	2.480	2.579	2.940	3.299
3/4/2018	1.750	1.392	1.935	1.643	2.455	2.539	2.905	3.276
3/5/2018	1.750	1.395	1.951	1.658	2.490	2.565	2.945	3.324
3/6/2018	1.750	1.381	1.955	1.614	2.507	2.572	2.977	3.327
3/7/2018	1.750	1.338	1.912	1.571	2.447	2.542	2.917	3.281

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
3/1/2018	4.38	4.73	5.23	5.91	5.91	1.37	0.54
3/4/2018	4.30	4.68	5.23	5.91	5.91	1.37	0.54
3/5/2018	4.15	4.49	5.10	5.80	5.80	1.37	0.54
3/6/2018	4.03	4.53	5.13	5.83	5.83	1.38	0.53
3/7/2018	4.20	4.58	5.13	5.80	5.80	1.16	0.53

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
3/1/2018	4.1854	3.4356	3.6333	3.2183	1.3338	0.1646
3/4/2018	4.1986	3.4200	3.6470	3.2338	1.3381	0.1653
3/5/2018	4.1895	3.3995	3.6321	3.2202	1.3357	0.1651
3/6/2018	4.1891	3.3936	3.6114	3.2056	1.3348	0.1649
3/7/2018	4.1922	3.3744	3.5992	3.1950	1.3403	0.1648

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