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Polish Weekly Review

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Comment on the upcoming data and forecasts

This 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 this 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. Core inflation likely rose to 1.0% y/y in January and declined to 0.8% y/y in February, as CSO's inflation data shows. Next week starts with industry data. We expect both industrial and construction output to have slowed down in February due to the aforementioned calendar effect and (in the case of construction) sharp deterioration in weather conditions. On Wednesday the CSO will publish retail sales data. We expect little change in the annual growth rate of retal sales, but shifts in its structure are likely (rebound in food sales, correction in Others category after the unusually strong January). Consumer confidence published at the same time will further attest to good prospects of consumption growth. Finally, also on Wednesday, financial and investment data of nonfinancial corporations for 2017 will be published. Next week ends with the release of the CSO's Statistical Bulletin along with unemployment data.

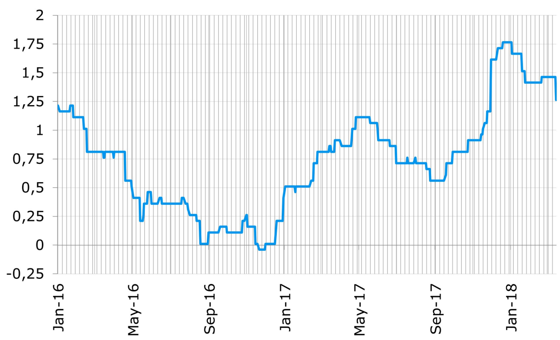
Polish data to watch: March 16th to March 23rd

Publication	Date	Period	mBank	Consensus	Prior
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	0.8	1.0	
Sold Industrial output y/y (%)	19.03	Feb	7.5	8.4	8.6
PPI y/y (%)	19.03	Feb	0.1	0.1	0.2
Retail sales y/y (%)	21.03	Feb	7.6	8.1	8.2
Consumer confidence	21.03	Mar			
M3 y/y (%)	22.03	Feb	4.6	5.0	4.8
Unemployment rate (%)	23.03	Feb	6.8	6.8	6.9

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

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



Comment

Big disappointment in CPI data sends the Polish surprise index tumbling. Next week offers plenty of opportunities to move the index: wages, industrial output, PPI, retail sales and unemployment 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 bottom in February 2018. Base effects suggest that inflation will accelerate until summer and then drop again on base effects. One should look through short-term fluctuations and look at underlying momentum. The case for accelerating core inflation is as strong as it had been before recent CPI prints. Polish labor market is operating normally and fits regional trends: wage growth 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. PLN has remained boxed in a 2% range for may weeks.
- The key reason for the 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 evironment, 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

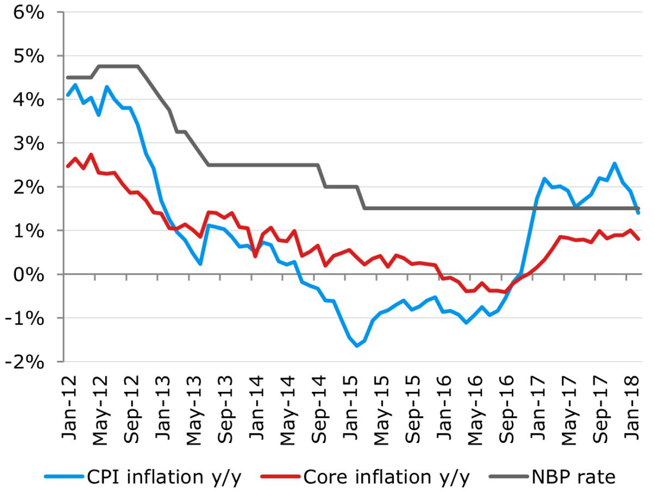
	2014	2015	2016	2017	2018 F	2019 F
GDP y/y (%)	3.3	3.8	2.9	4.6	4.6	3.6
CPI Inflation y/y (average %)	-0.1	-0.9	-0.6	2.0	2.1	2.7
Current account (%GDP)	-2.1	-0.5	-0.3	0.2	-0.2	-0.6
Unemployment rate (end of period %)	11.4	9.8	8.2	6.6	5.8	5.5
Repo rate (end of period %)	2.00	1.50	1.50	1.50	1.50	2.25

	2017 Q1	2017 Q2	2017 Q3	2017 Q4	2018 Q1 F	2018 Q2 F	2018 Q3 F	2018 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

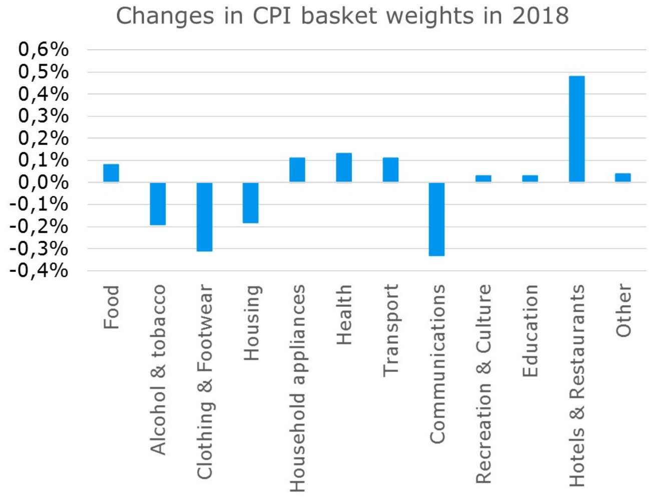
Inflation, where art thou?

CPI inflation declined from 1.9 to 1.4% y/y in February, below market consensus (1.8% y/y) and every forecast, including ours (1.6% y/y).



The deceleration in inflation can primarily be attributed to sharply lower food prices – we were aware of such a possibility due to surprises in regional data release and such a risk materialized – in February food prices dropped by 0.4% m/m. Fuel prices behaved in line with expectations, having fallen by 1.6% m/m and compounding the mild base effect from the previous year. The second source of the surprise lies in core categories. Communications prices (communication services in particular) are the obvious culprit due to the surprising 1.6% m/m decline, but this explains only 0.1 p.p. of the surprise. All major core categories decelerated in February on a sequential basis and there is no sign of imminent acceleration. According to our calculations (to be confirmed tomorrow), core inflation amounted to 1.0% in January (in line with expectations) and 0.8% y/y (we expected stability and most forecasts assumed mild acceleration) in February.

The February CPI release also brought a new set of CPI basket weights, but the revision was broadly neutral for inflation. The share of Hotels and restaurants category rose by 0.5 percentage points, while the shares Clothing and footwear and Communications both declined by 0.3 percentage points. Other changes in basket weights are marginal (see the graph below). Curiously, the increase in nominal spending on Hotels and restaurants is roughly equivalent the increase in spending on food and beverages that one would expect given the major increase in prices last year. We can, half-jokingly, conclude that additional amount of food and beverages was consumed away from home, not at home. Income effects clearly point in this direction, but the abruptness of this shift should be attributed to the impact of child subsidy programme.



The February upset in inflation clearly shifts the path of inflation forecasted for 2018. First, current circumstances stipulate that core inflation will remain below 1% y/y until mid-year (note that this is only due to lower starting point!) and CPI will peak at 2.1% y/y in July. By December strong base effects in food prices will have brought inflation back to 1.5% y/y. Such a scenario seems mostly discounted by the markets and by the MPC itself. This opens some room for upside surprises in future inflation prints, consistent with standard, textbook relations between other macro variables and prices in this phase of the business cycle. Also note that had communications prices not declined, core inflation would not have been far from 1.0% y/y. So, to answer the question, inflation is still there, overshadowed by one-off factors. It would be nihilistic to assume that economic factors will not reveal it once more, to the extent that is not currently expected by investors.

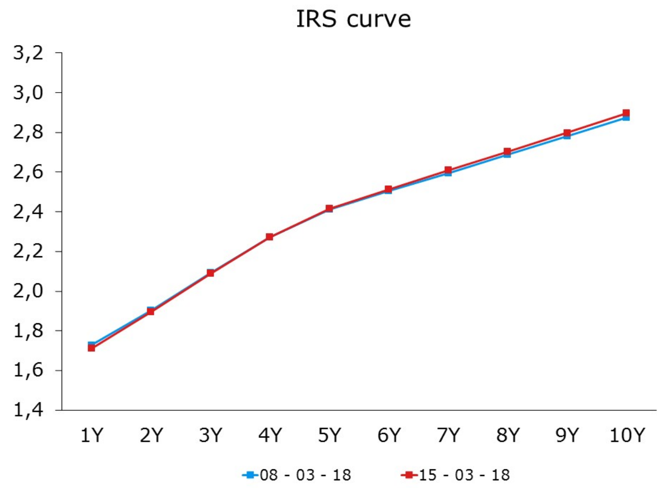
Fixed income

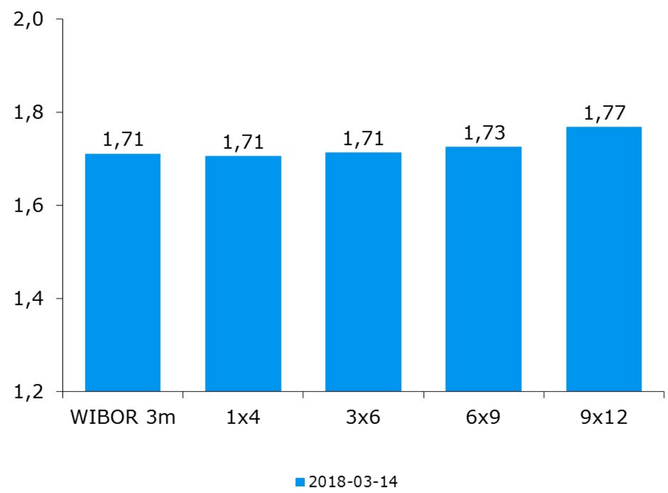
Extremes

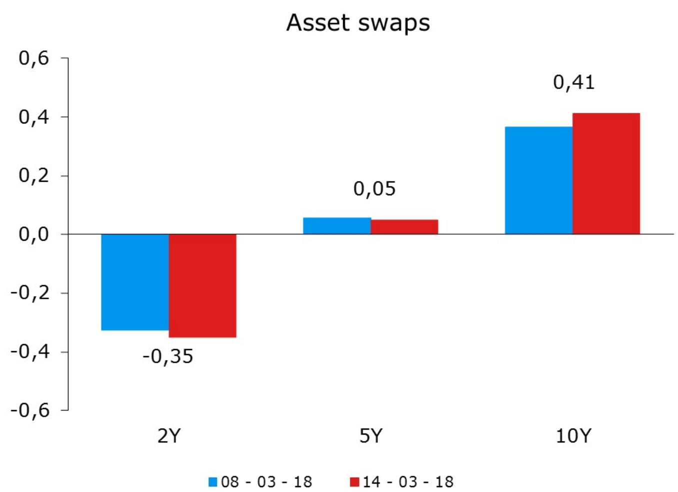
CPI is extremely low, demand on the auction was extremely high... Curve is extremely steep. We have seen international clients buying today. Looks like market is still short on bonds. It's time to switch to a new 10y benchmark, WS0428.

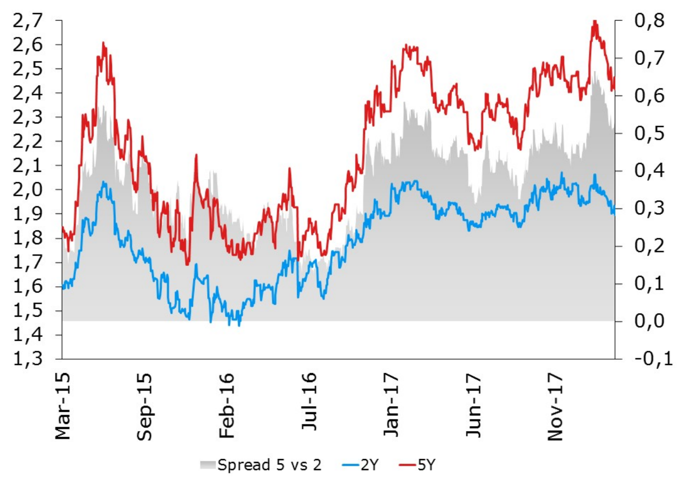
Spreads are tight. WS0428/UST10y is 35bps. Investors will struggle to find value in Polish bonds at these levels. PS0123/5y is 0 bps and WS0428/10y is 35 bps. WS0428/Bund is 267 bps. PS0123/WS0428 is 84 bps.

DS1019 is trading at 1.32% (flat), PS0123 is trading at 2.40% (7 bps down) and WS0428 is trading at 3.24% (1 bps down).







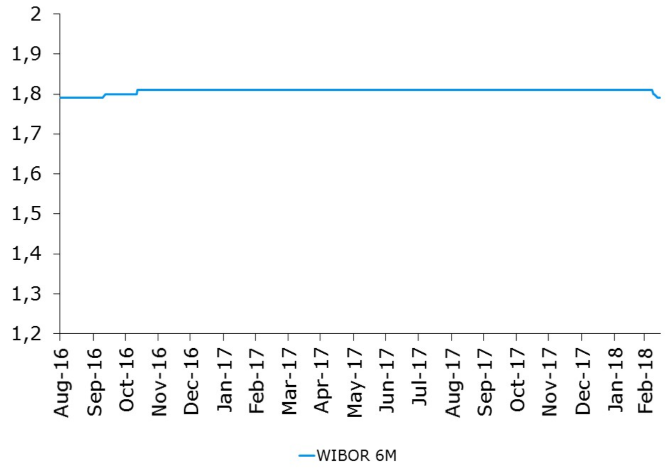


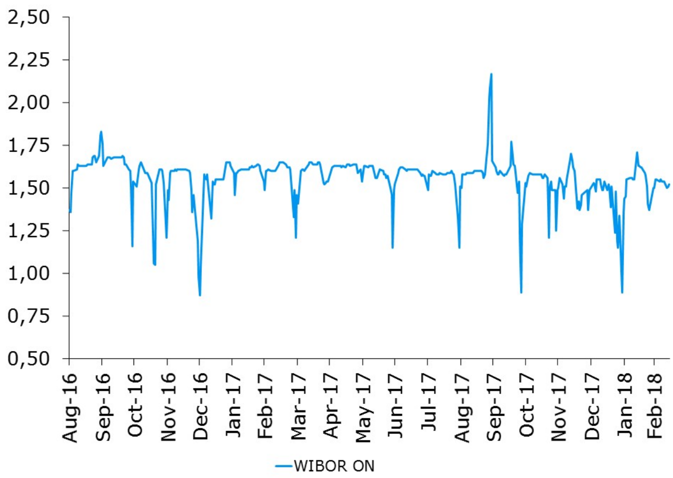
Money market

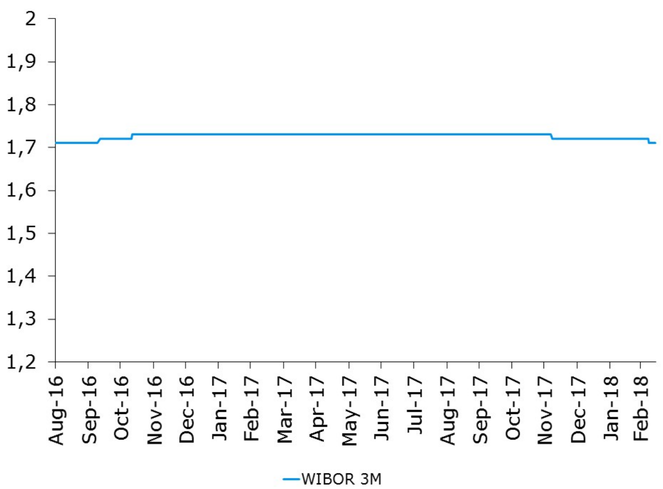
CPI adds fuel to the fire

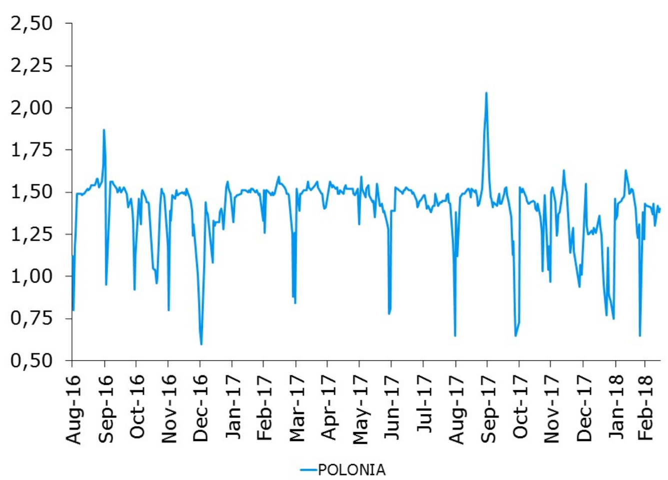
Polish market continues to trade with bullish sentiment. Responsible for that are extremely dovish MPC plus core rates drifting lower. Today's low CPI print adds to that bullish sentiment with bonds (especialy sub 5y) flying high. We are getting to some extremes in yields with 2y benchmark trading at 1.50%. Investors will likely start betting on highier yields from here as the curve almost ruled out any rate change in two years time. Next week we have a Fed meeting to watch, there is a wide consensus for a rate increase.

Cash slightly below the reference rate, as some spare funds were left after the last OMO.









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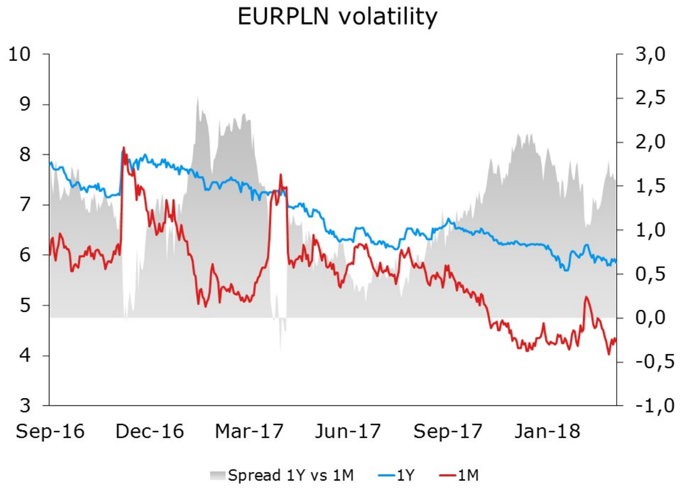
Forex

Spot – Consolidation phase The EUR/PLN upward momentum after the MPC meeting faded relatively quickly. As a result, EUR/PLN corrected lower to 4.1880 (5-day low), before turning higher again to 4.2185 (5-day high). The soft February CPI numbers were behind the fresh PLN weakness, as that makes any hike from the MPC's side even more unlikely. We still are of the opinion that EURPLN is range-bound, currently 4.1850-4.2350, with a slight PLN-negative preference.



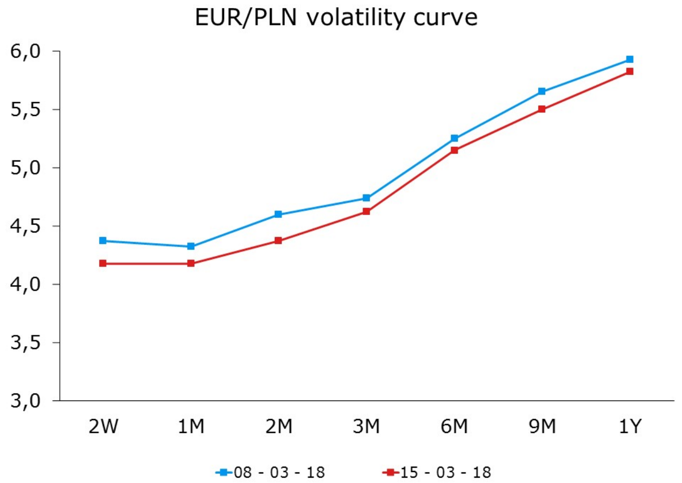
Options – EUR/PLN vols – tic lower The vols are slightly lower, mostly because of the decreasing realized volatility and all big events being already behind us. 1 month ATM mid is 4.15% today (0.15% lower), 3 month is at 4.6% (0.2% lower) and, finally, 1 year fixed at 5.8% (0.15% lower). The skew is roughly unchanged. The currency spread (difference between USD/PLN and EUR/PLN) was better offered.

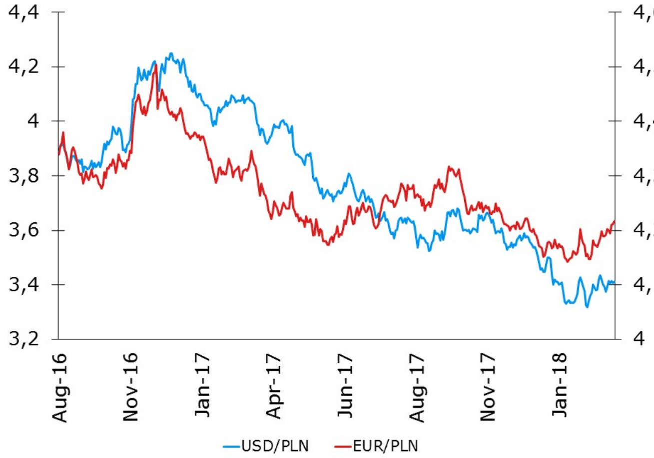
Short-term forecasts

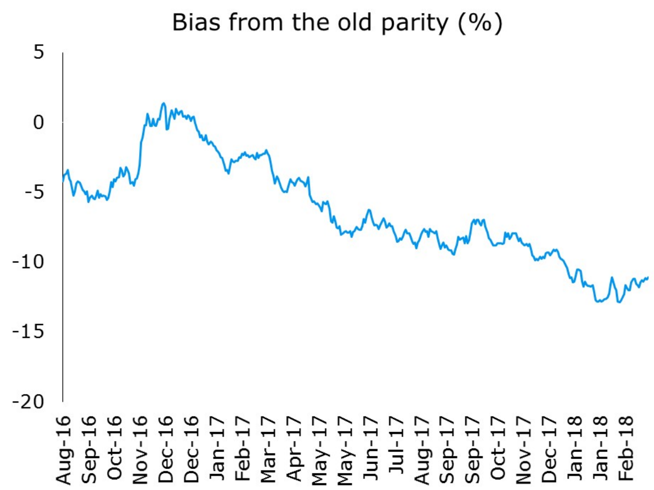
Main supports / resistances:
EUR/PLN: 4.1850 / 4.2450
USD/PLN: 3.3500 / 3.6000

Spot Current position: Long EUR/PLN at 4.1950.

We are long at 4.1950, ready to add at 4.1800 with stop below 4.1600 and hopes to see 4.23+.







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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
3/8/2018	1.59	1.71	1.65	1.70	1.72	1.74	1.71	1.72	1.74	1.79	1.87	1.82
3/11/2018	1.50	1.71	1.61	1.70	1.86	1.74	1.71	1.71	1.74	1.80	1.90	1.82
3/12/2018	1.49	1.71	1.61	1.69	1.93	1.74	1.71	1.72	1.73	1.79	1.89	1.81
3/13/2018	1.39	1.71	1.50	1.69	1.76	1.74	1.71	1.72	1.74	1.80	1.88	1.83
3/14/2018	1.68	1.71	1.74	1.69	1.79	1.74	1.71	1.71	1.73	1.77	1.85	1.80

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
3/8/2018	1.740	1.357	1.902	1.576	2.410	2.466	2.875	3.241
3/11/2018	1.740	1.361	1.915	1.581	2.430	2.523	2.890	3.293
3/12/2018	1.740	1.355	1.905	1.576	2.420	2.511	2.890	3.298
3/13/2018	1.740	1.340	1.935	1.567	2.464	2.512	2.950	3.349
3/14/2018	1.740	1.334	1.895	1.545	2.415	2.465	2.895	3.307

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
3/8/2018	4.33	4.74	5.25	5.93	5.93	1.33	0.56
3/11/2018	4.23	4.68	5.20	5.88	5.88	1.33	0.56
3/12/2018	4.35	4.73	5.28	5.93	5.93	1.41	0.56
3/13/2018	4.28	4.68	5.14	5.85	5.85	1.32	0.55
3/14/2018	4.18	4.63	5.15	5.83	5.83	1.33	0.55

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
3/8/2018	4.2024	3.3935	3.5907	3.1989	1.3480	0.1653
3/11/2018	4.1989	3.4132	3.5923	3.1965	1.3477	0.1650
3/12/2018	4.1942	3.4066	3.5865	3.1970	1.3455	0.1647
3/13/2018	4.2097	3.4143	3.6016	3.1866	1.3508	0.1654
3/14/2018	4.2114	3.4055	3.6009	3.1955	1.3512	0.1655

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