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Polish Weekly Review

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Comment on the upcoming data and forecasts

On Tuesday Polish manufacturing PMI will be published. We expect another moderate drop of the index, from 53.7 to 53.3, as indicated by other economic sentiment indices, both foreign (European PMI and German Ifo) and domestic (CSO and EC surveys). On Wednesday, the CSO will release the flash estimate of Polish CPI. It should rebound to 1.7% y/y (in line with market consensus) after marking a local bottom in February (at 1.4% y/y), driven by strong monthly rise of food prices and a small acceleration in core categories.

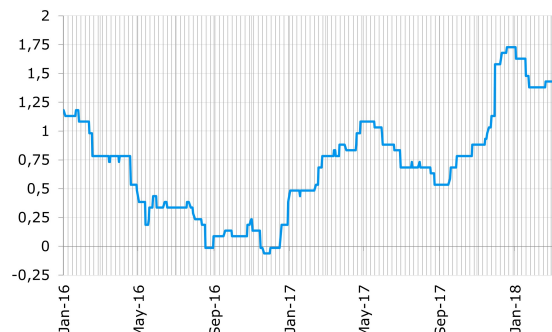
Polish data to watch: March 30th to April 6th

Publication	Date	Period	mBank	Consensus	Prior
Manufacturing PMI (pts.)	03.04	Mar	53.3	53.1	53.7
Flash CPI y/y (%)	04.04	Mar	1.7	1.7	1.4

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	4/26/2018	150	1.494	3/27/2018
5Y T-bond PS1023	4/26/2018	800	2.358	3/27/2018
10Y T-bond WS0428	4/26/2018	1400	3.196	3/27/2018
30Y T-bond WS0447	4/26/2018	50	3.764	2/22/2018

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



Comment

Unchanged - unemployment rate came in line with market expectations and there weren't any more macro releases. Next week will be marked by two publications (PMI and flash CPI) and both might 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%. 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. 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. The signal might be obscured by one-off factors and immediate impact of stronger PLN in 2017.
- 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 and early 2019.
- 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. The impact of PLN-specific factors on the currency has been relatively small.
- Our scenario of an upward correction in EURPLN has finally materialized. Hawkish Fed concerns and (especially) very dovish MPC both contributed to a modest depreciation in the PLN (less than 5%). It seems that the PLN, negatively impacted by easy monetary policy, can only catch a reprieve if global rates move sharply lower and investors readjust their expectations regarding the global economy and global monetary policy in a wholesale fashion.
- Over the medium term, strong GDP growth, low credit risk and purely mechanical (as the expected date of first hike should move closer with each day) drift in interest rate expectations will increase the PLN's relative appeal. Thus, in the second half of the year its cyclical nature should reassert itself.

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	1.70	1.70	1.71	1.72
2Y Polish bond yields (% eop)	2.01	1.90	1.75	1.72	1.50	1.55	1.60	1.70
10Y Polish bond yields (% eop)	3.49	3.32	3.37	3.30	3.20	3.30	3.45	3.55
EUR/PLN (eop)	4.23	4.23	4.31	4.18	4.20	4.20	4.15	4.10
USD/PLN (eop)	3.97	3.70	3.65	3.48	3.41	3.41	3.35	3.31

F - forecast

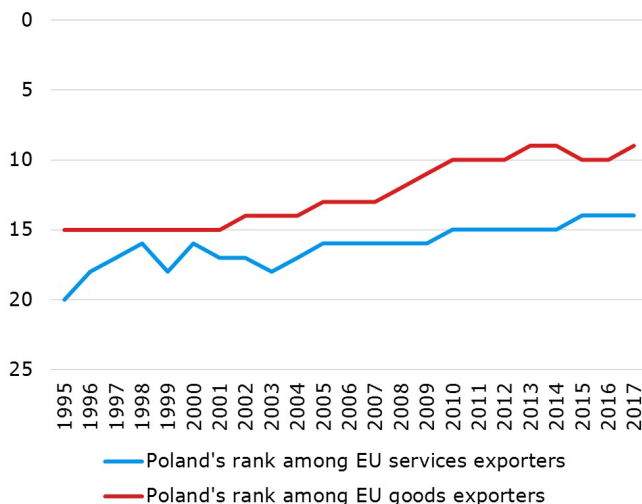
Economics

On Poland's competitiveness from a different angle

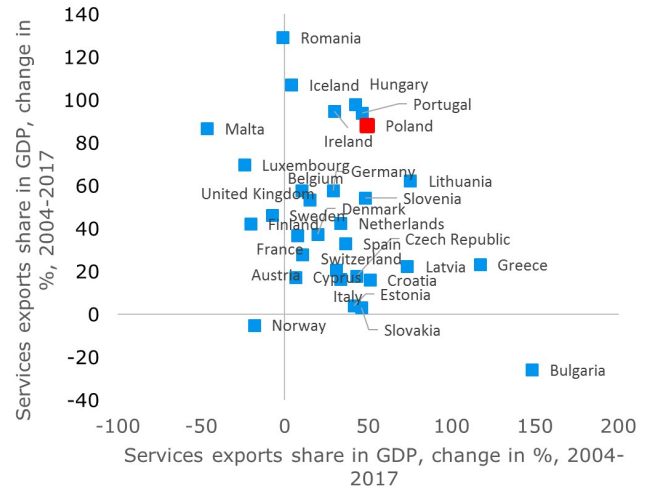
A lot has been said on competitiveness of Polish companies basing on comparative advantages in various fields. As they are numerous, it is really hard to come up with the best measure of competitive advantage; otherwise you may land with composite indices that bear threats of data comparability between countries. Our lazy nature helped us to come up with much simpler solution based on a simple notion. If a country improves its exports (of services and goods) shares, specializes in it (higher share of GDP) and does not hamper its external balance at the same time, then it makes perfect sense. Goods and services delivered by firms are competitive and their growth does not pose a threat to overall economy.

Our framework was simple. We look at the nominal exports data over the 2004-2017 time span (in cases the data from 2017 was not available – only a few – we extrapolated using naive forecasts). We turned to nominal data as we think that real data have no advantage over nominal data over longer time spans when used to compare exports between countries as exchange rates, wages and prices in any country have sufficient time to adjust. In such a way differences in nominal exports values reflect differences in competitiveness no worse than real data. We investigated EU countries with the addendum of some closely related satellite countries (Iceland, Switzerland, Norway).

First, trivia. During the last 20+ years Poland improved its share in total EU exports in goods and services a lot – the graph speaks for itself. One aspect is worth a comment, though. The growth in services seems to be more persistent than in goods. The proportion of those in trade statistics has also been changing over time.

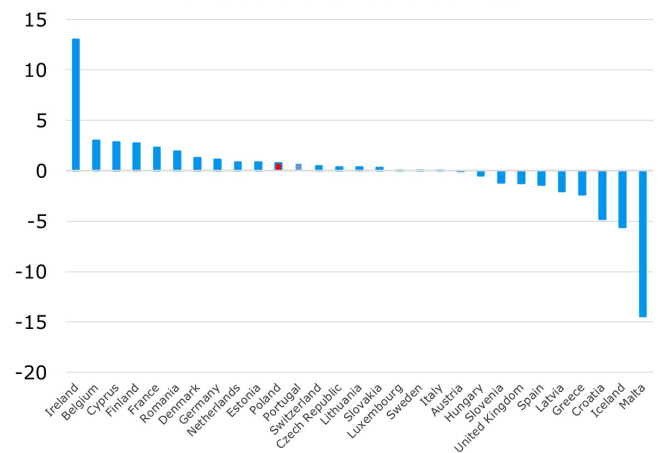


Second, specialization. As the proportion of exports of goods and services changed over time, also did their share in Polish GDP. We treat it as evidence of specialization. The graph below presents how those shares evolved over time in individual countries. The presentations follows on the scatter plot below, so we can observe how the shares in individual countries evolved and how they were biased. Polish growth in exports share was biased towards services but overall the specialization pattern was quite diversified among EU countries.

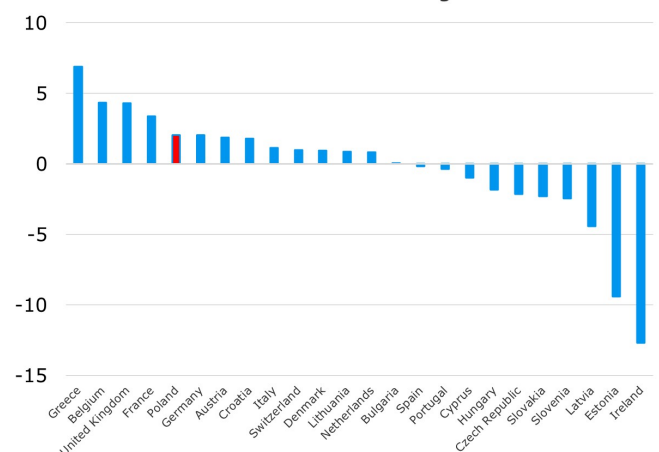


Third, losers and winners. As said, individual countries pursued their individual exports-diversification strategies (or in other words: firms pursued growth based on different comparative advantages). Since we follow this simplistic approach, we do not judge. We let trade balances to decide. Successful diversification should not entail trade balance worsening. We picked countries that increased exports share (in goods and services separately) and investigated their respective trade balances. Results show winners and losers. Poland is in the first category in both services and goods.

Winners and losers in services



Winners and losers in goods



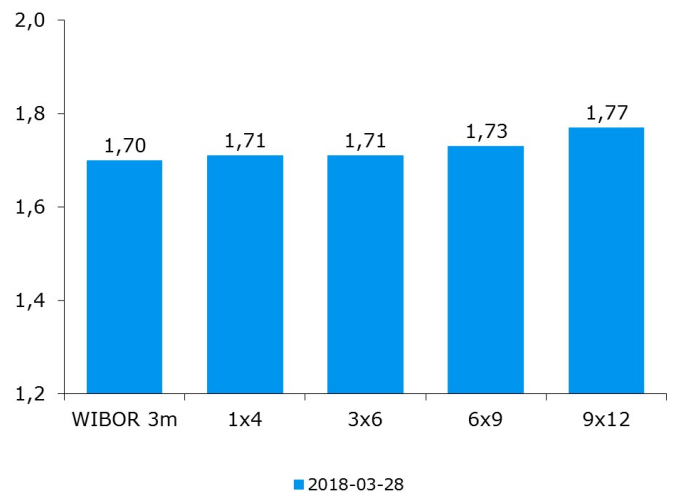
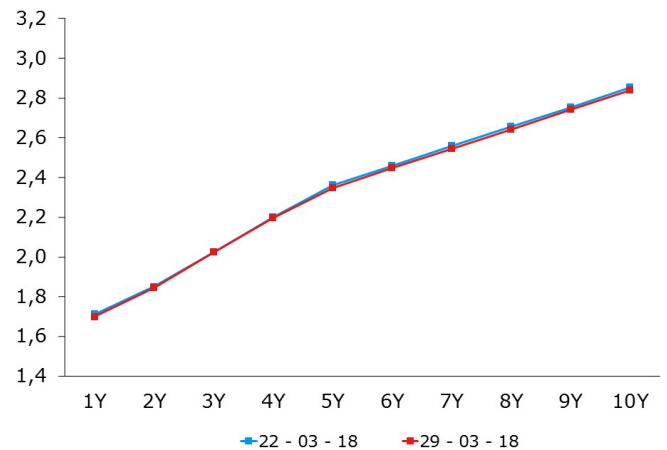
Fixed income

In April there will be a new story on bonds

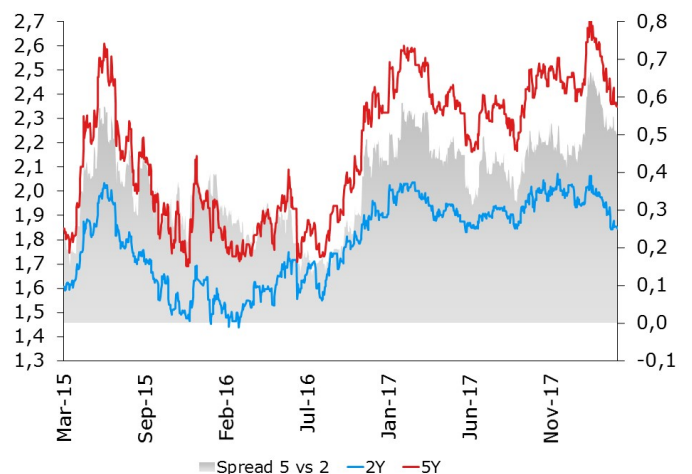
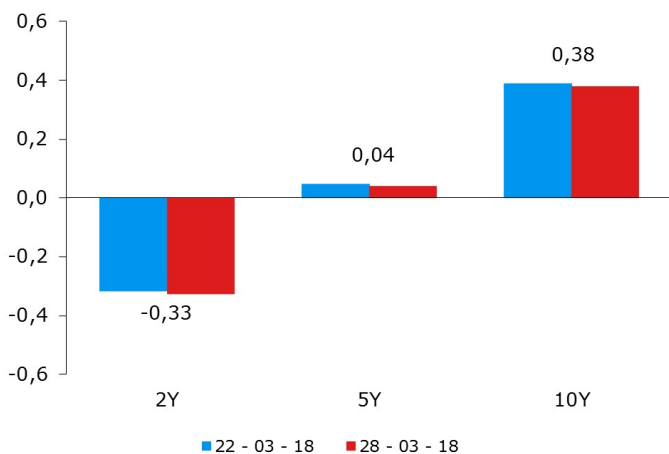
Tomorrow the Ministry of Finance will announce bond supply for April. There will be two auctions, a switching one on April 5th and a regular one on April 27th (the latter's settlement date is May 2nd). PS0418 is expiring, coupons will be paid. There will be cash to spend and bank books will have free space to be filled. It won't be easy for the curve to flatten, though, as long-end bonds are following core market yields.

PS0123/5y is -2 bps, WS0428/10y is 32 bps. WS0428/Bund is 268 bps. PS0123/WS0428 is 82 bps. DS1019 is trading at 1.34% (flat), PS0123 is trading at 2.37% (4 bps down) and WS0428 is trading at 3.19% (7 bps down).

IRS curve



Asset swaps





Money market

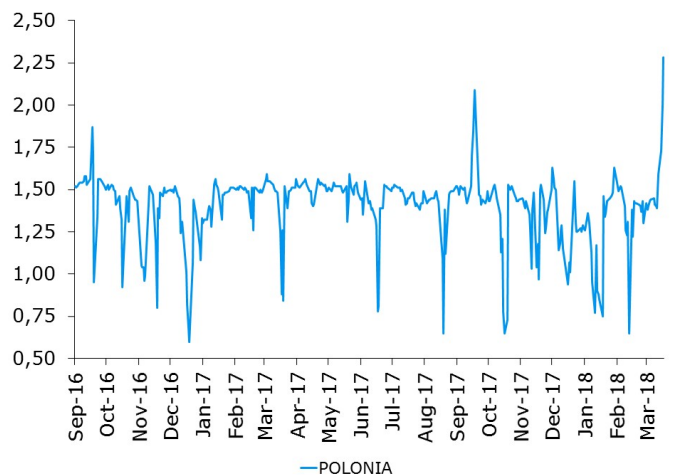
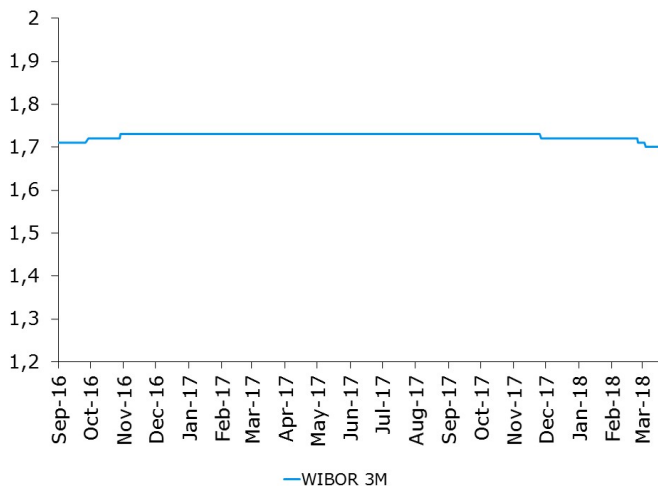
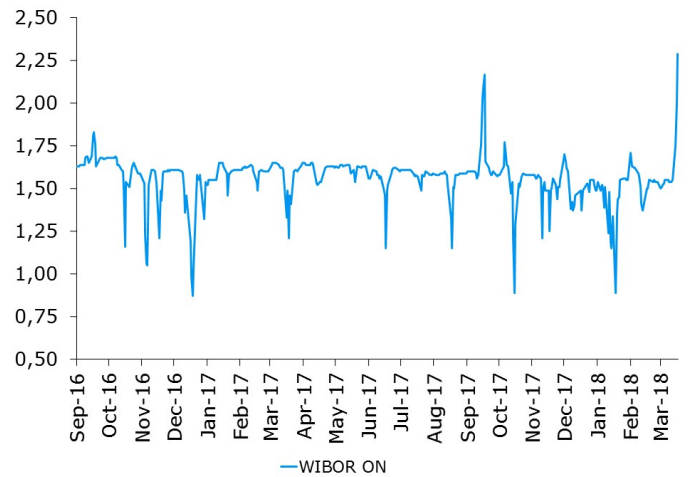
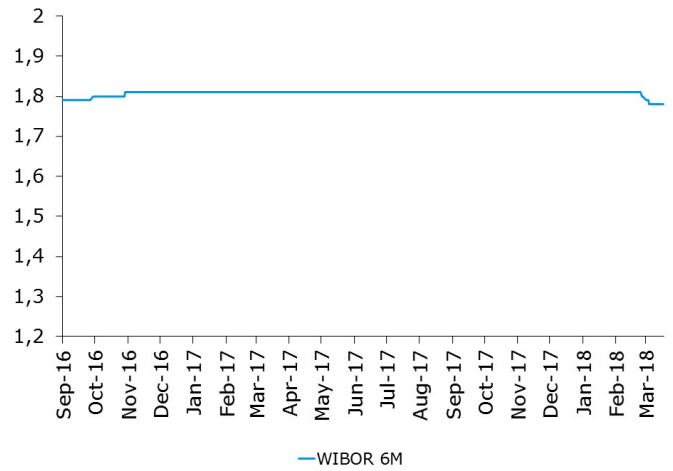
Steady bonds and expensive cash

Bonds traded steadily, close to recent highs. As we are getting closer to Easter holidays, market activity is fading. Volumes are small and volatility is disappearing. Such mood will persist until next week.

We are having an interesting month's end. Those who played for cheap end of the month got their fingers burned. It happens from time to time, especially when everyone bets on the same side. Cash should be back to normal next week.

Ref rate vs Polonia averages:

30 day 3 bps
90 day 16 bps



Forex

Spot – EUR/PLN – a failed break-out Last week Zloty was supported by positive global sentiment caused by comments from some European Central Bank officials suggesting that the ECB is in no hurry to wind back its stimulus and the fact that trade war fears are receding. Since Monday EUR/PLN has been dropping and there was an attempt to break-out to the downside. The low was 4.2020, which leaves the 4.19-4.20 support zone unscratched. Technically, EUR/PLN looks well supported at current levels. Which nicely translates into our base case scenario of the 4.19-4.25 range for the time being.

Options – EUR/PLN vols – tic lower The EUR/PLN vol curve melted a little as spot was really calm and there was no obvious volatility trigger on the horizon. Incoming Easter also favours lower volatility. 1 month ATM mid is 3.9% today (0.2% lower), 3 months are at 4.4% (0.1% lower) and, finally, 1 year fixed at 5.65% (0.1% lower). The currency spread (difference between USD/PLN and EUR/PLN) and the skew are roughly unchanged.

Short-term forecasts

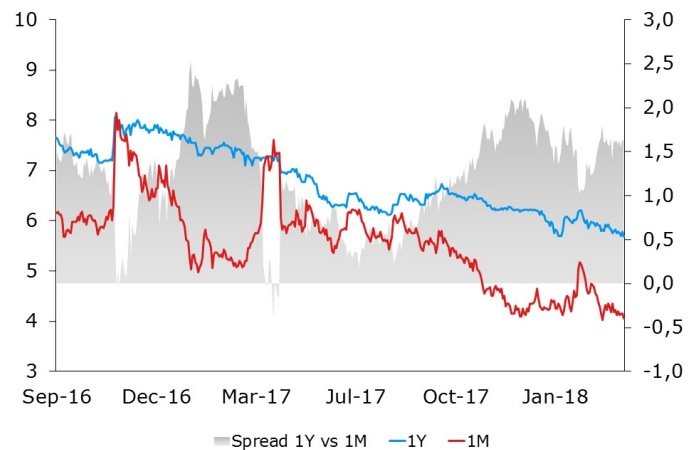
Main supports / resistances:
 EUR/PLN: 4.1900 / 4.2700
 USD/PLN: 3.3500 / 3.6000

Spot Current position: Long EUR/PLN at 4.2050.

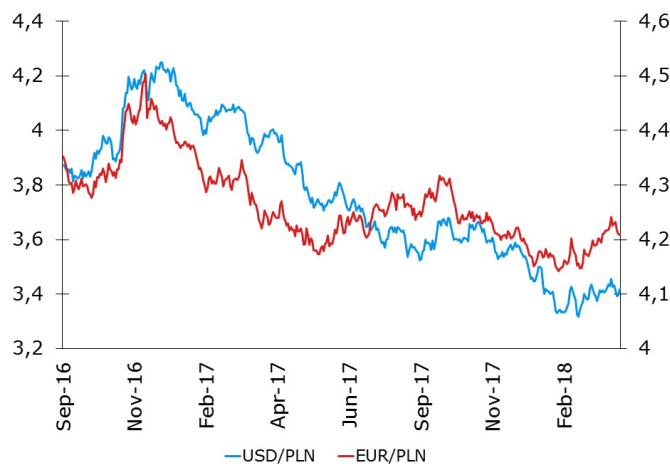
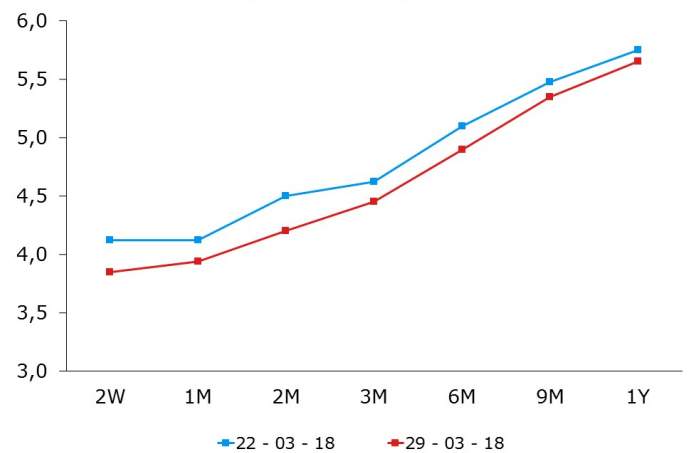
We are long at 4.2050, ready to add at 4.1800 with stop below 4.1600 and hopes to see 4.25+.

As no significant news or political risk is set to arise in the coming week, we think the Zloty will trade relatively stable with slight inclination towards more weakness against the Dollar and the Euro. Yield differentials are set to deteriorate, which combined with dovish monetary stance of the MPC is likely to result in Zloty depreciating gradually.

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
3/22/2018	1.70	1.70	1.79	1.68	1.96	1.72	1.69	1.71	1.73	1.75	1.80	1.79
3/25/2018	1.64	1.70	1.73	1.68	1.89	1.72	1.70	1.71	1.73	1.76	1.81	1.80
3/26/2018	1.62	1.70	1.80	1.68	1.97	1.72	1.70	1.71	1.72	1.75	1.81	1.80
3/27/2018	1.57	1.70	1.63	1.68	1.79	1.72	1.69	1.71	1.72	1.75	1.81	1.79
3/28/2018	1.63	1.70	1.71	1.68	1.74	1.72	1.71	1.71	1.73	1.77	1.83	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	3/27/2018	7/25/2020	96.61	1.49	150	348	148
PS0123	3/27/2018	1/25/2023	100.63	2.36	800	2101	801
WS0428	3/27/2018	4/25/2028	0.00	3.20	1400	2474	1400

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0720	5Y IRS	PS0423	10Y IRS	WS0428
3/22/2018	1.720	1.368	1.850	1.533	2.360	2.407	2.852	3.239
3/25/2018	1.720	1.371	1.855	1.548	2.365	2.394	2.855	3.241
3/26/2018	1.720	1.375	1.855	1.547	2.355	2.389	2.844	3.225
3/27/2018	1.720	1.350	1.850	1.494	2.350	2.389	2.840	3.222
3/28/2018	1.720	1.348	1.845	1.519	2.347	2.387	2.840	3.219

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1Y	
3/22/2018	4.13	4.63	5.10	5.75	5.75	1.25	0.53	
3/25/2018	4.15	4.60	5.05	5.70	5.70	1.25	0.53	
3/26/2018	4.15	4.58	4.90	5.78	5.78	1.25	0.53	
3/27/2018	4.05	4.50	5.00	5.68	5.68	1.15	0.52	
3/28/2018	3.94	4.45	4.90	5.65	5.65	1.20	0.52	

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
3/22/2018	4.2261	3.4264	3.6133	3.2434	1.3565	0.1665
3/25/2018	4.2295	3.4319	3.6211	3.2722	1.3508	0.1663
3/26/2018	4.2316	3.4145	3.6089	3.2533	1.3531	0.1664
3/27/2018	4.2164	3.3921	3.5843	3.2132	1.3486	0.1657
3/28/2018	4.2097	3.3956	3.5731	3.2173	1.3459	0.1653

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