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Polish Weekly Review

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Comment on the upcoming data and forecasts

On Wednesday the MPC will conclude its two day meeting. We expect rates to remain unchanged and extremely dovish rhetoric to persist at the conference after the recent surprises in inflation. However, it is unlikely that the MPC could become even more dovish than it did a month ago. Final CPI will be released on Thursday. In all likelihood it will confirm the flash reading of 1.3% y/y (down from 1.4% in February). We expect that the decline in core inflation (from 0.8 to to 0.6% y/y) and modestly lower food prices were responsible for the surprise. Detailed core inflation data will be published on Friday by the NBP. At the same time, balance of payments for February will be announced. We forecast a small deficit on the current account (initial forecast was revised lower due to surprisingly small inflow of EU funds in February, as indicated by MoF data), stabilization of exports and slightly lower imports.

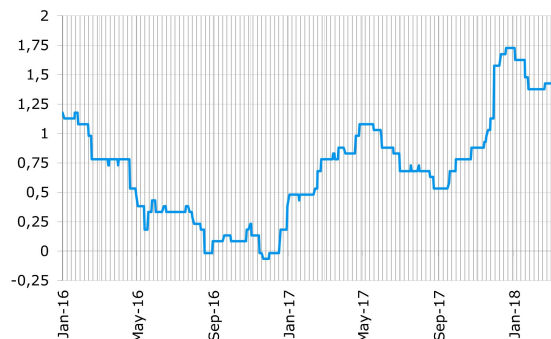
Polish data to watch: April 6th to April 13th

Publication	Date	Period	mBank	Consensus	Prior
MPC decision (%)	11.04	Mar	1.50	1.50	1.50
CPI y/y (%) <i>final</i>	12.04	Mar	1.3	1.3	1.4
Core inflation y/y (%)	13.04	Mar	0.6	0.9	0.9
Current account (mio EUR)	13.04	Feb	-200	-340	2005
Export (mio EUR)	13.04	Feb	16500	16588	16853
Imports (mio EUR)	13.04	Feb	16700	17101	17057

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

Sharply down after another weak CPI print. Next week will be marked by final CPI and core inflation data, both unlikely to move the index.

* 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 surprised to the downside in February and March. Base effects suggest that inflation will accelerate in the coming months (until July) and then drop again. The expected path shifted downwards, though. Right now, services prices are the best hope for inflation bulls. The long-run relationship between wages and prices is clear there and we should be seeing a strong signal there in the second half of the year.
- 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	1.8	2.7
Current account (%GDP)	-2.1	-0.6	-0.3	0.3	-0.2	-0.6
Unemployment rate (end of period %)	11.4	9.8	8.2	6.6	5.5	5.0
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	1.8	2.0	1.6
Unemployment rate (% eop)	8.0	7.0	6.8	6.6	6.6	5.7	5.5	5.5
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	1.49	1.55	1.60	1.70
10Y Polish bond yields (% eop)	3.49	3.32	3.37	3.30	3.18	3.30	3.40	3.50
EUR/PLN (eop)	4.23	4.23	4.31	4.18	4.21	4.20	4.15	4.10
USD/PLN (eop)	3.97	3.70	3.65	3.48	3.42	3.41	3.35	3.31

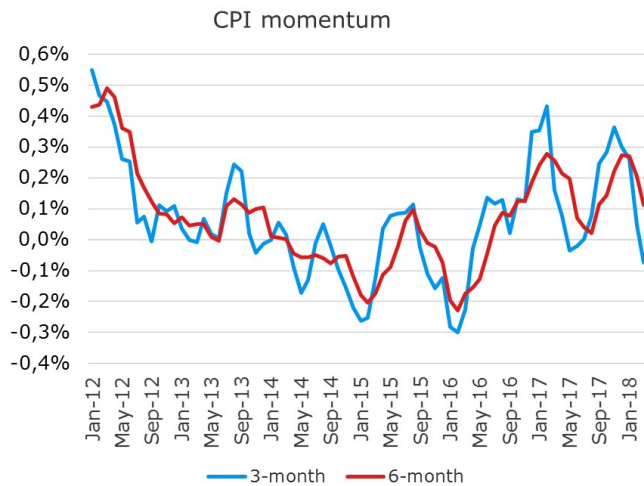
F - forecast

Economics

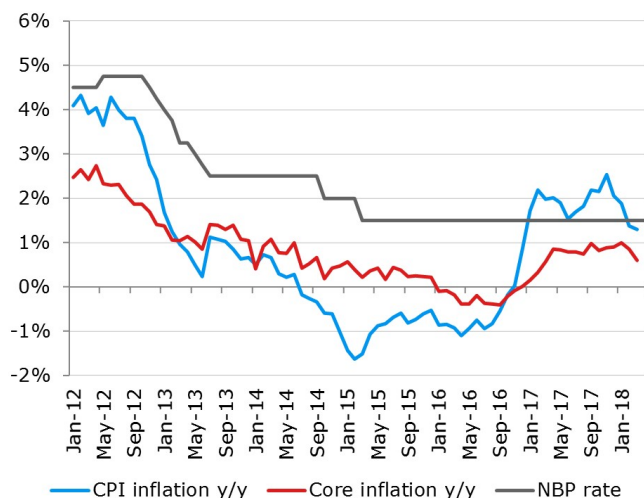
Another surprise in the inflation data – CPI, instead of growing, fell in March

According to the flash estimate, CPI inflation surprisingly fell in March to 1.3% y/y from 1.4% y/y in February. This is a major deviation from both our forecast and market consensus (1.6%-1.7%). Inflation momentum is now firmly in negative territory.

One should not think that it is too early to see the full extent of relation between growing wages and prices of services and markets could be surprised by it. There is also another important factor for markets to consider: looming trade war – China recently announced retaliation tariffs on 50 billion USD of goods imported from the US.



For the first time CSO published some details in the flash release. According to them, food prices remained more or less unchanged (we have expected a significant increase), fuel prices dropped only slightly (contrary to larger drop indicated by usually very reliable data from petrol stations) while heating costs also went down a bit (just as we expected). It seems that we had another surprise in the core categories, whose yearly growth rate could have dropped to 0.6% y/y. Without details we will not speculate whether only one category was responsible for this surprise or was it evenly distributed among several categories.



Markets were betting on a low inflation trajectory, but it had priced-in a rebound already in March. Moreover, lack of core inflation momentum is an invitation to further contest inflation mechanisms based on output gap, wages, etc. We on the other

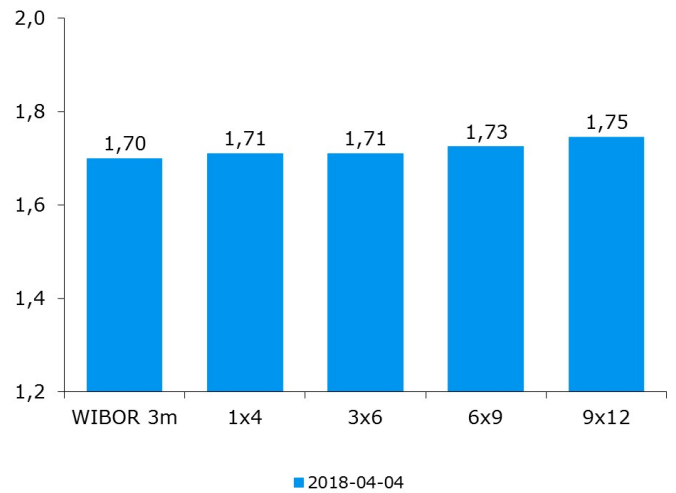
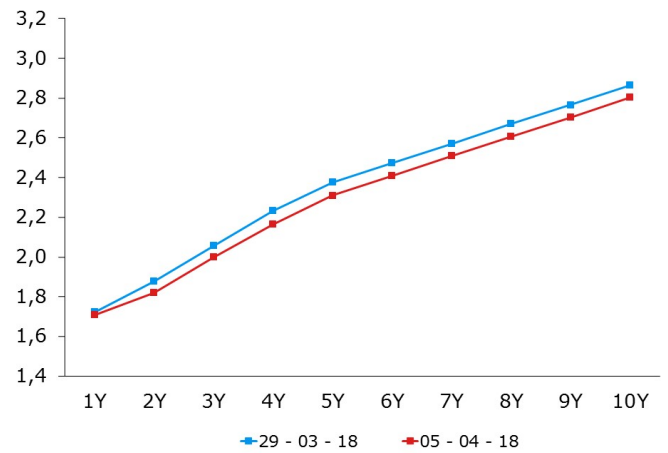
Fixed income

POLGBs – large demand, small auction

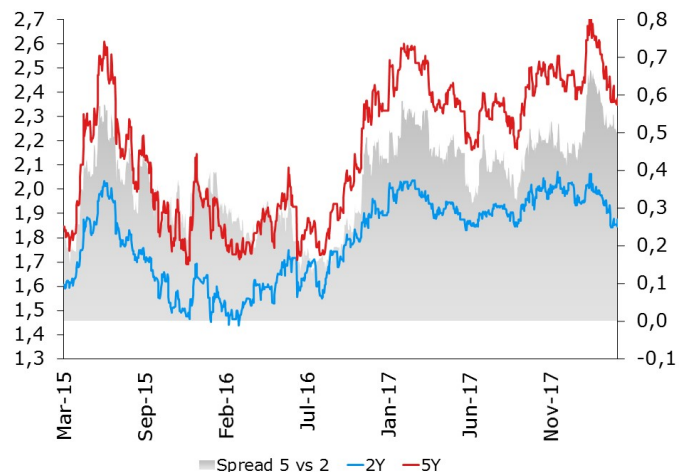
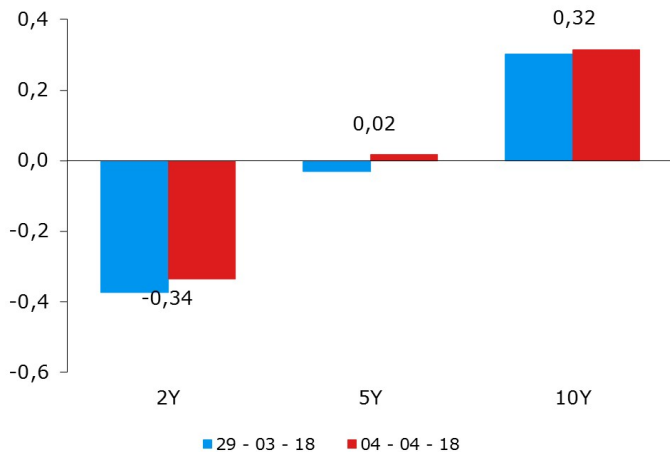
It is a bullish month! PS0418 expires, coupons are paid, small auction today, it is one way market. Curve should have flattened, but it didn't. Looks like market is short in BPV.

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



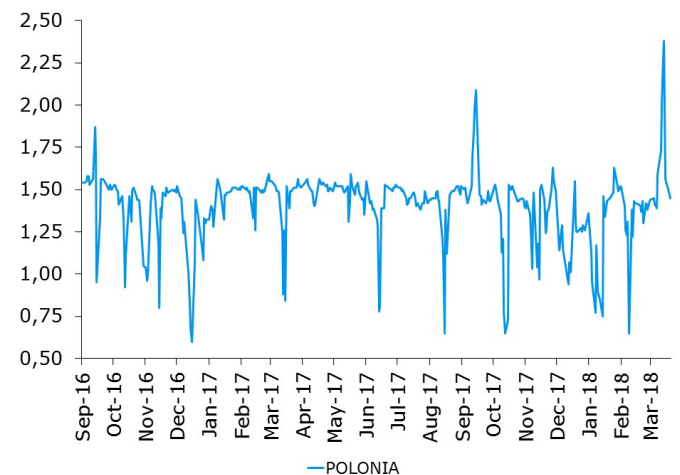
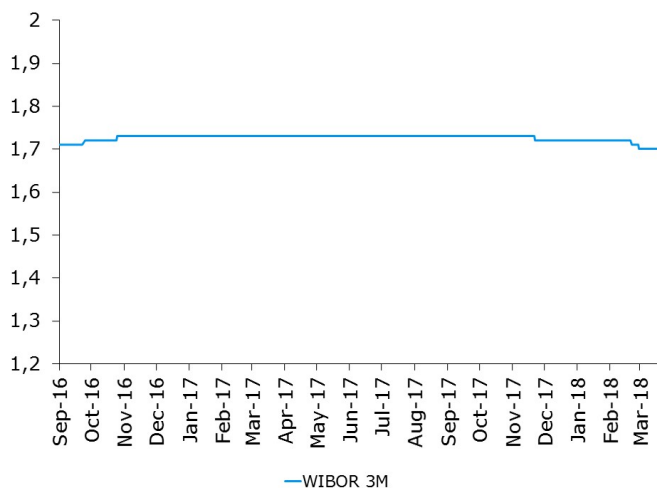
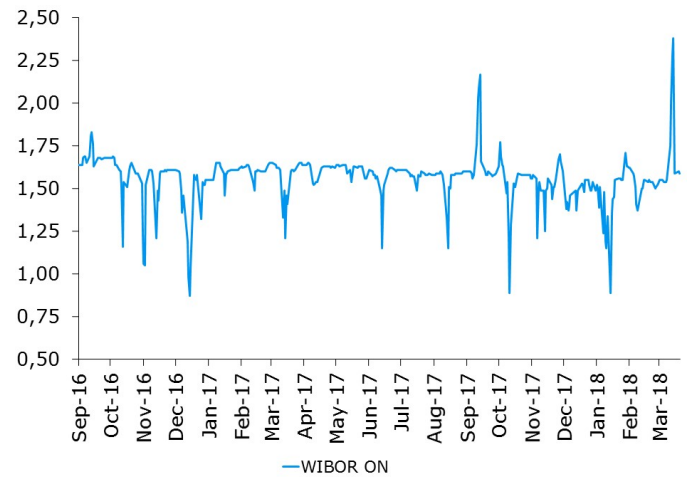
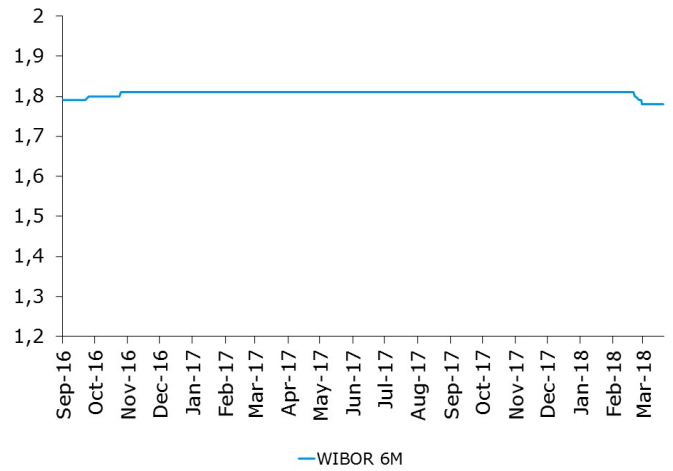
Asset swaps



Money market

What a bullish market

Polish bonds continue to trade in a bullish mood. A surprise in the CPI reading (1.3% vs 1.7% expected) added more fuel to this sentiment and we set multi-month lows in yields. Next week we have the MPC meeting. It is really hard to expect anything more dovish than what we heard after the previous meeting. On the other hand, we thought so already last month too and governor Glapinski still managed to surprise us. Short bonds (DS1020) are being traded at around 1.5% which is the current base rate. With no prospects for change in the MPC consensus we will follow core rates, especially Eurozone.



Forex

Spot – EUR/PLN – flirting with 4.20 It was another uninspiring week for EUR/PLN, with directionless price action in a tight 4.1920-4.2190 range. Low CPI on Wednesday triggered a small spike, but it faded a few hours later. We expect the 4.1900 – 4.2400 range play to continue and we are going to play it with a small PLN-negative skew. We will stick to this skew, unless we see a convincing daily close below 4.1700.

Options – EUR/PLN vols – stable The tight range in EUR/PLN says it all! Both realized volatility measures (daily and high frequency) are still on a downward trend. However, the whole EUR/PLN implied volatility curve is quite stable, as we are at the multi-week lows. 1 month ATM mid is 3.9% today (unchanged), 3 months are at 4.4% (unchanged) and, finally, 1 year fixed at 5.65% (unchanged). 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

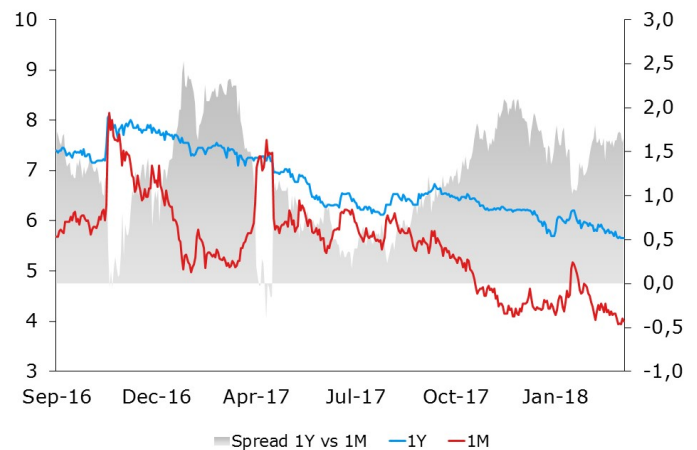
USD/PLN: 3.3500 / 3.6000

Spot Current position: Long EUR/PLN at 4.2050.

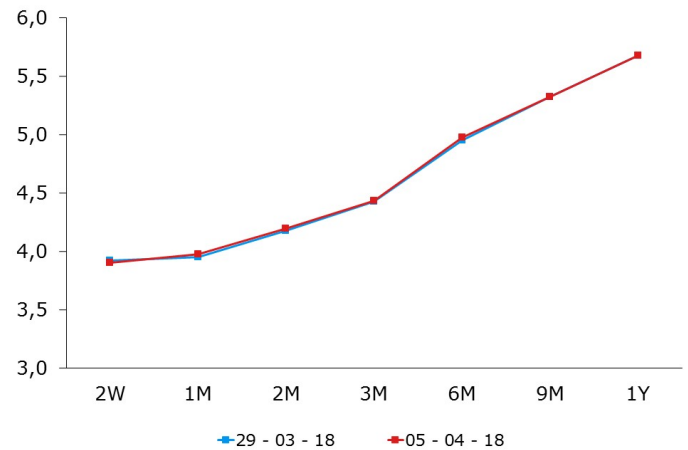
We are long at 4.2050, ready to add at 4.1800 with stop below 4.1600 and hopes to see 4.25+.

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
3/29/2018	1.61	1.70	1.71	1.68	1.86	1.72	1.70	1.71	1.72	1.75	1.80	1.79
4/1/2018	1.77	1.70	1.85	1.68	1.89	1.72	1.70	1.71	1.72	1.75	1.80	1.79
4/2/2018	1.63	1.70	1.71	1.68	1.74	1.72	1.70	1.71	1.72	1.75	1.80	1.79
4/3/2018	1.55	1.70	1.67	1.68	1.82	1.72	1.71	1.71	1.73	1.76	1.81	1.79
4/4/2018	1.63	1.70	1.71	1.68	1.74	1.72	1.71	1.71	1.73	1.75	1.79	1.79

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
3/29/2018	1.720	1.342	1.875	1.502	2.375	2.345	2.865	3.167
4/1/2018	1.720	1.342	1.875	1.502	2.375	2.345	2.865	3.167
4/2/2018	1.720	1.342	1.875	1.502	2.375	2.345	2.865	3.167
4/3/2018	1.720	1.345	1.870	1.554	2.373	2.387	2.870	3.191
4/4/2018	1.720	1.329	1.820	1.484	2.310	2.327	2.802	3.117

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1Y	
3/29/2018	3.95	4.43	4.95	5.68	5.68	1.20	0.54	
4/1/2018	3.94	4.41	4.95	5.65	5.65	1.20	0.54	
4/2/2018	4.05	4.44	4.95	5.65	5.65	1.20	0.53	
4/3/2018	4.00	4.45	4.95	5.65	5.65	1.15	0.54	
4/4/2018	3.98	4.44	4.98	5.68	5.68	1.10	0.53	

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
3/29/2018	4.2093	3.4201	3.5728	3.2073	1.3468	0.1655
4/1/2018	4.2085	3.4139	3.5812	3.2149	1.3473	0.1659
4/2/2018	4.2085	3.4139	3.5812	3.2149	1.3473	0.1659
4/3/2018	4.2094	3.4177	3.5832	3.2212	1.3474	0.1661
4/4/2018	4.2065	3.4224	3.5719	3.2226	1.3482	0.1661

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