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Polish Weekly Review

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Comment on the upcoming data and forecasts

This Friday, the CSO will publish business sentiment data for April. On Monday retail sales data will be published. We expect an acceleration on a yearly basis, from 7.9% in February to 8.4% in March. This will be fuelled by calendar factors (earlier Easter), despite cold weather. On the next day, the NBP will release about M3 money supply data, which should continue its upward trend – our estimates indicate that it rose in March by 5.4% y/y. On Wednesday CSO will publish it's monthly Statistical Bulletin. It contains, among others, data about unemployment rate in March. Preliminary MFLSP estimates confirmed our forecast of 6.5%. Publication of MPC Minutes (Friday) won't catch the market's attention.

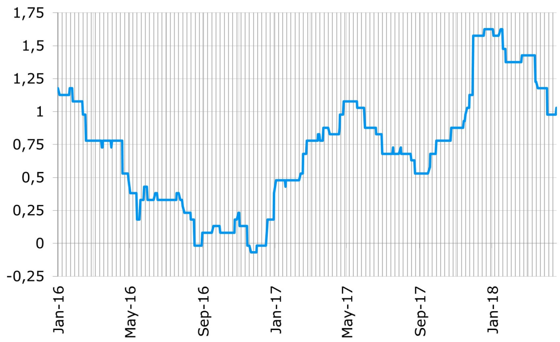
Polish data to watch: April 20th to April 27th

Publication	Date	Period	mBank	Consensus	Prior
Business confidence	20.04	Apr			
Retail sales y/y (%)	23.04	Mar	8.4	8.1	7.9
M3 money supply y/y (%)	24.04	Mar	5.4	5.2	4.9
Unemployment rate (%)	25.04	Mar	6.6	6.5	6.8
MPC Minutes	27.04	11.04			

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

A small upward move index was driven by better than expected PPI data. Next week brings two opportunities to move the index: 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).

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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	2.00

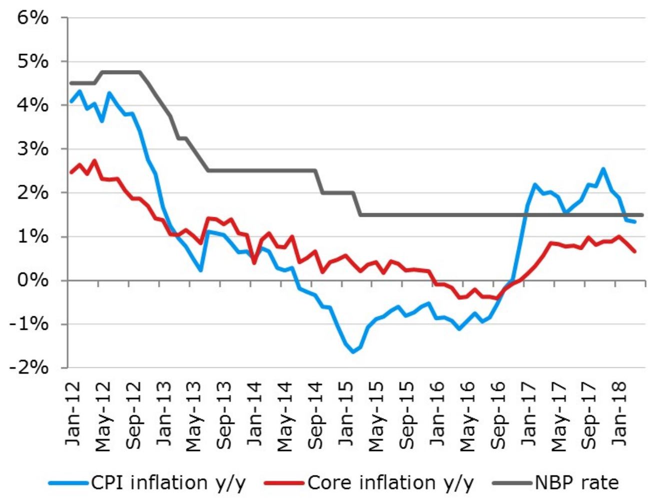
	2017 Q1	2017 Q2	2017 Q3	2017 Q4	2018 Q1 F	2018 Q2 F	2018 Q3 F	2018 Q4 F
GDP y/y (%)	4.1	4.0	4.9	5.1	4.8	4.6	4.5	4.5
Individual consumption y/y (%)	4.7	4.9	4.8	4.9	4.6	4.3	4.0	4.0
Public Consumption y/y (%)	0.5	2.1	1.9	5.4	4.0	3.0	3.0	3.0
Investment y/y (%)	-0.5	0.9	3.3	11.3	10.0	10.0	9.0	8.0
Inflation rate (% average)	2.0	1.8	1.9	2.3	1.9	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	4.20	4.20
USD/PLN (eop)	3.97	3.70	3.65	3.48	3.42	3.41	3.39	3.39

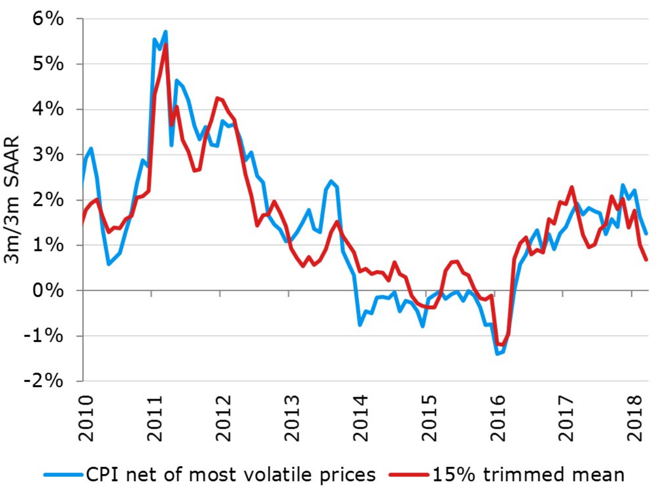
F - forecast

Economics

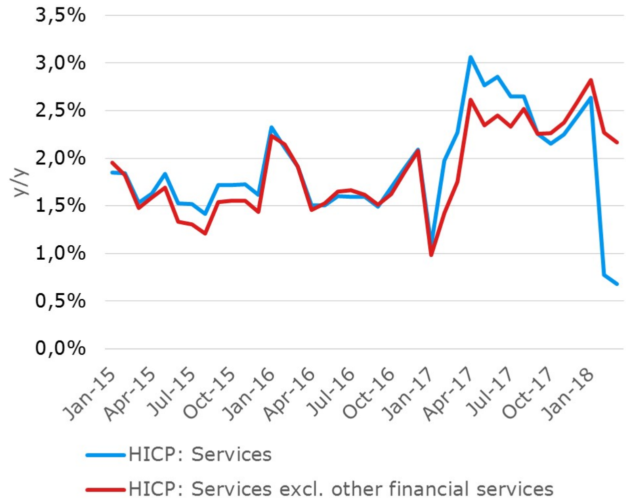
March CPI inflation confirmed at 1.3% y/y, but core inflation is not as weak as it appears

CPI rose by 1.3% y/y in March (flash reading 1.3%; original consensus 1.7%). The details of the release allow us to disentangle the sources of the huge surprise. We already knew that food prices were relatively low in March – the final reading confirms that (-0.1% m/m); fuel prices also declined on a monthly basis (-0.9% m/m – this is somewhat less than could be estimated using high frequency data from gas stations). Curiously, the estimate of residential energy prices was revised downwards (from -0.2% m/m to -0.5% m/m), mainly due to sharp decline in natural gas prices – this comes as a major surprise, since the change was supposed to come into effect starting from April. We will consider this surprise to be a shift between months, not an additional factor.





When it comes to core categories, its composition suggests that the drop in **core inflation** was shallower than we initially guessed (from 0.8% to 0.7% y/y, not 0.6% y/y), It's still a disappointment, though. All measures of core inflation declined on a sequential basis and there is a distinct lack of current momentum in core inflation (see the graph below). We can trace March's decline back to two factors: lower prices of package holidays (Recreation and culture category) and lower insurance fees. At least one of them should reverse itself next month. With higher fuel prices, we should see 1.6% inflation in April (core to tick up to 0.8% y/y). Several commentators noted that core HICP inflation (HICP excluding food, energy, alcohol and tobacco) dipped into negative territory in February. While it is true, the strange behavior of HICP is mainly due to high weight of Other financial services (COICOP 126), whose prices declined by almost 10% in February and March (national CPI is weighed differently). We are unsure how to square this decline with facts on the ground (banks have generally been increasing their fee and commission income to make up for low interest rates), but this category should not be seen as tied to output gap or economy-wide wage growth. If we strip CP126 from services prices, the picture is much clearer (by the way, package holidays are responsible for ca. 0.3 p.p. of the slowdown in services inflation since early 2017) and more favorable to inflation bulls.



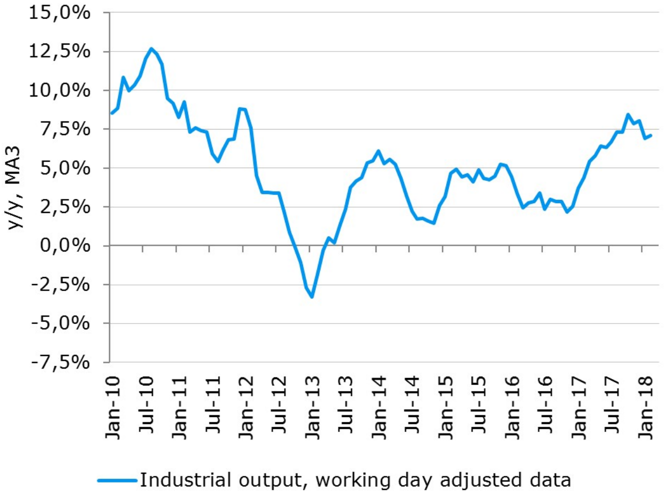
With updated numbers, we forecast core inflation to rise to 1.7-1.9% y/y in December, as the impact of currency appreciation fades and the lagged impact of higher wages is seen in services prices. In our view, the market does not fully discount such a scenario, being anchored at the temporary drop in inflation and its deviation from ”theoretical” levels (unclear what that would mean). We also believe that output gap closed only recently and it is too early to start denying basic economic relationships.

GDP likely slowed down marginally in Q1

There were no positive surprises in the March set of monthly data and several of them surprised to the downside. While labor market data show a slower pace of hiring and strong wage growth, industry and construction data weakened somewhat in March. For the MPC, these are not game-changers. On the contrary, the negative surprises might be seen as confirmation of the downward-sloping trajectory of GDP growth foreseen by the NBP. With current inflation subdued, some members of the MPC might even start thinking of future easing – likely this was what Mr. Kropiwnicki meant when he declared that easing was more likely than tightening. Nevertheless, before the MPC starts implementing Hungarian-style unconventional instruments, it will likely be surprised by core inflation. Labor market developments as well as waning PLN impact and second-round effects from the current commodity price spike all point to higher core inflation down the road. Meanwhile, the Council adopted a radically different paradigm...

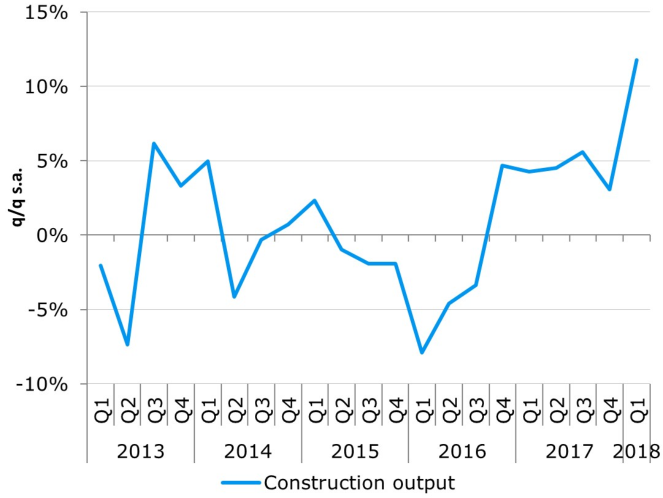
As usual, the detailed comments to last week's data releases can be found below.

Industrial output rose by a mere 1.8% y/y in March, below market consensus and our forecast (3.0 and 4.2% y/y, respectively). The slowdown vis-a-vis February's 7.4% y/y is a result of several factors. The high statistical base (1.5-2.0 p.p. of negative impact) and unfavorable working day difference (down to -1 from 0 y/y) were taken into account by forecasters. The true source of the surprise is the behavior of manufacturing that rose by 0.6% y/y. Had it not been for the massive increase in energy output 19% y/y (effect of very cold weather), industry aggregate would have grown just by 0.2% y/y.

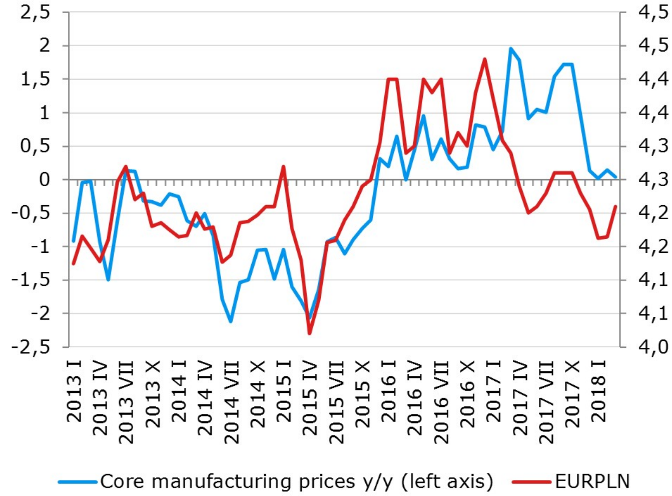


This behavior of Polish industry is consistent with very modest levels of the PMI (which has proven itself to be much more useful than CSO's sentiment indicators) and with the on-going sharp slowdown in euro area industry. Even though the latter is likely due to several temporary and supply-related factors, Polish industry is suffering from similar problems and is not positioned for outperformance. Hence, the slowdown in industrial output (or, perhaps, flattening of the uptrend) is here to stay.

Construction output rose by 16.2% y/y on annual basis. This translated into stagnation on a seasonally adjusted m/m basis. Thus, the slowdown can entirely be attributed to calendar effect and a massive statistical base from the previous year (10 percentage points!). Deterioration in weather conditions might have also been responsible. Nevertheless, the first quarter was one of the best in history in terms of q/q growth. The data on the structure and sources of growth will be available in a week – we will pay close attention to them. All in all, the rebound in investment this year suggests that double-digit growth in construction will be maintained in the coming months.

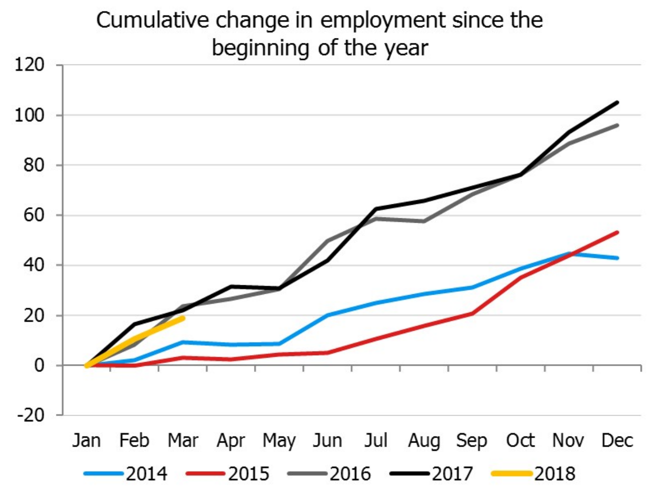


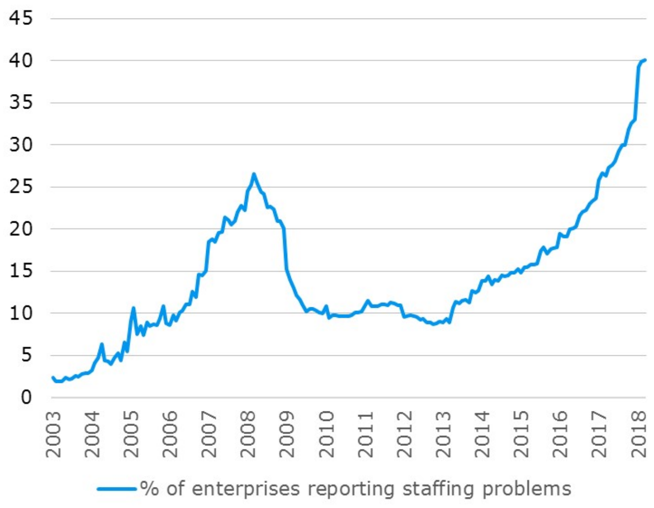
Producer prices rose by 0.3% y/y, beating expectations but coming close to our forecast. To some extent, the surprise might be attributed to higher commodity prices, seen both in mining output prices and in some manufacturing branches (coke and oil refining products, basic metals). Core manufacturing PPI, as we calculate it, stagnated on annual basis, suggesting that Polish industry continues to be trapped in a low-price equilibrium. It remains to be seen whether the recent increases in commodity prices (copper, oil and especially aluminum) translate into higher PPI.



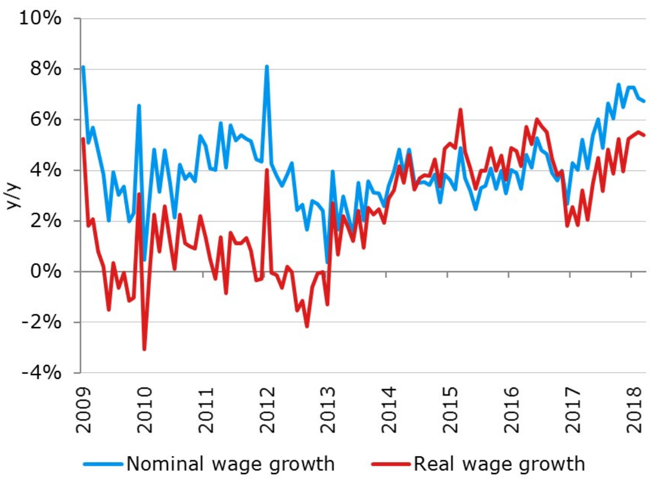
With an almost full set of monthly data, we can confirm our original nowcast – we expect GDP to have grown by 4.9% r/r (and solid 1%+ on a q/q basis) in the first quarter of 2018. It seems that the rebound in construction will mitigate the slowdown in industry.

Employment in the enterprise sector rose in March by 3.7% y/y. Annual growth rates are slowly falling towards new equilibrium facilitated by wages. As we argued several times in the past, it seems that the decrease in employment growth stems from supply factors. As firms find it more and more hard to employ proper workers, recruitment process gets longer and hence every month's employment growth gets weaker. This process is set to continue as unemployment rate is close (or below) the NAWRU level.





Average gross wage rose by 6.7% y/y in March, basically in line with market consensus (6.5% y/y) and barely changed from the February's print (6.8% y/y). Stable annual growth in wages is likely the result of a sharp slowdown in mining wages (high statistical base) and mild deceleration in manufacturing due to unfavorable working day effect, as well as a rebound in utilities and some services sectors. In any case, the detailed breakdown will be available in a week in the upcoming Statistical Bulletin.



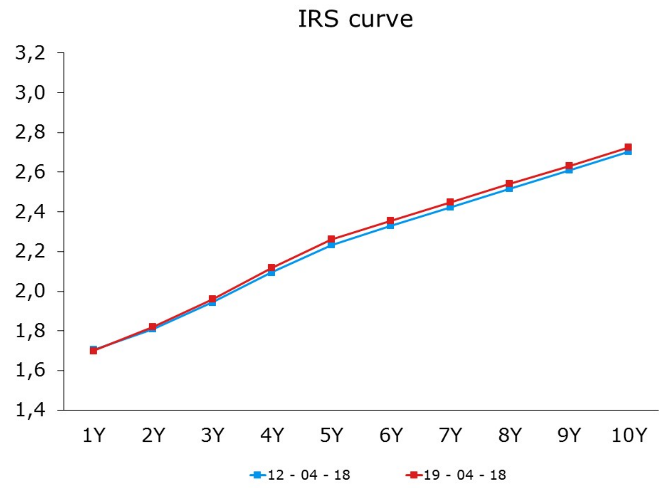
Many observers of Polish economy see the stabilization in wage growth over the past several months as vindication of their benign scenario for the labor market and its impact on price dynamics. We remain unimpressed. First, the uptrend in wages has not yet turned and on a sequential basis wage growth has been stable since the beginning of 2017. Second, labor market imbalances have not yet abated. On the contrary – the share of enterprises reporting staffing problems has continued to grow and the problem spilled over to industries with relatively high wages. All in all, it seems that the market will find its equilibrium at a much higher level of wages.

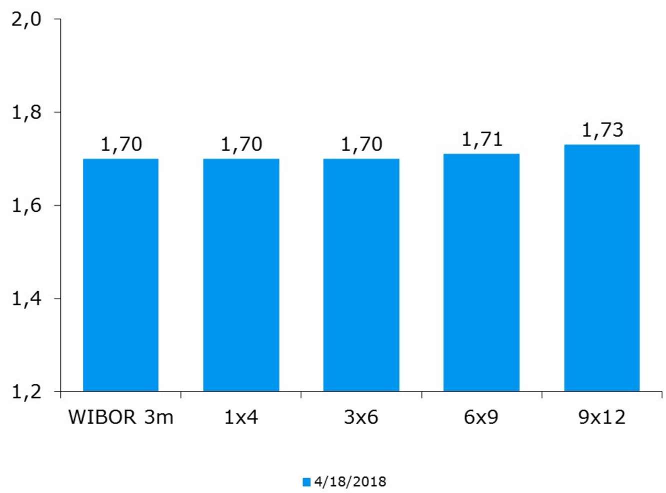
Fixed income

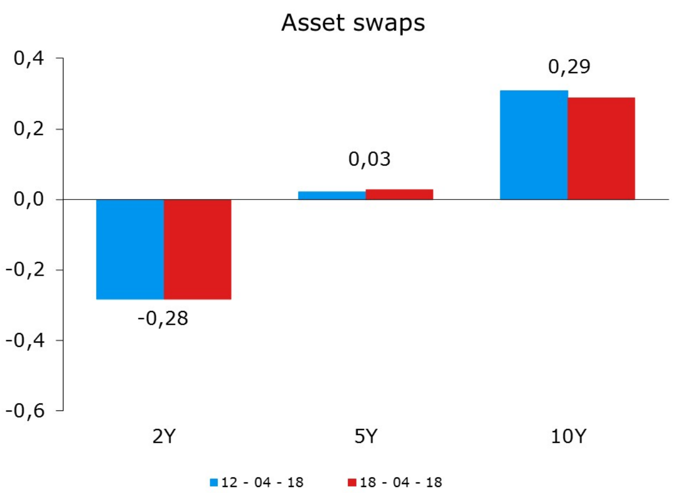
Nihil novi sub sole

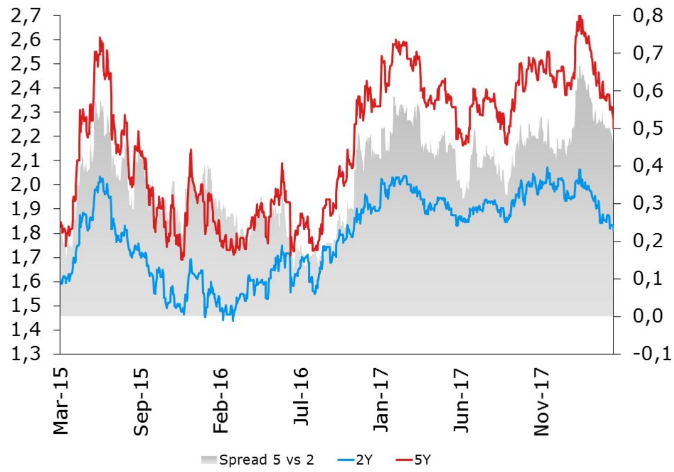
Nothing important changed. It is a bullish month! PS0418 expires, coupons are paid. Additionally, the MPC is talking about QE!? As we said before, this situation could last till the end of the month.

Curve has flattened: PS0123/WS0428 spread is 74 bps, PS0123/5y is -8 bps, WS0428/10y is 24 bps. WS0428/Bund spread is 245 bps. PS0420 is trading at 1.48% (3 bps up), PS0123 is trading at 2.22% (10 bps down) and WS0428 is trading at 2.96% (15 bps down).









Money market

Different story for each part of the curve

Some volatility appeared on the market due to profit taking. As soon as that ended, we went back higher on POLGBs. The market continues to trade strongly comparing to core markets with Polish 10y yield getting closer and closer to its US equivalent. As offers are thin and bids are strong, we have to wait for the next auction to get some fresh supply. Next week we have PS0418 redemption which should be countered by government auction. The issue is that the auction settlement date is in May and banking books prefer buying in the previous month to save money on tax.

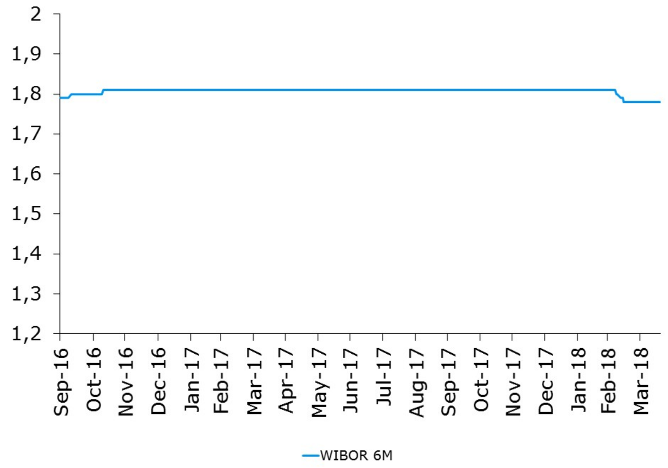
Its worth mentioning current 1Y3Y lvl. It is trading at 1.715 which is more or less current 3M WIBOR. That shows us the extreme strength of the market's conviction about rates staying on hold for the next year.

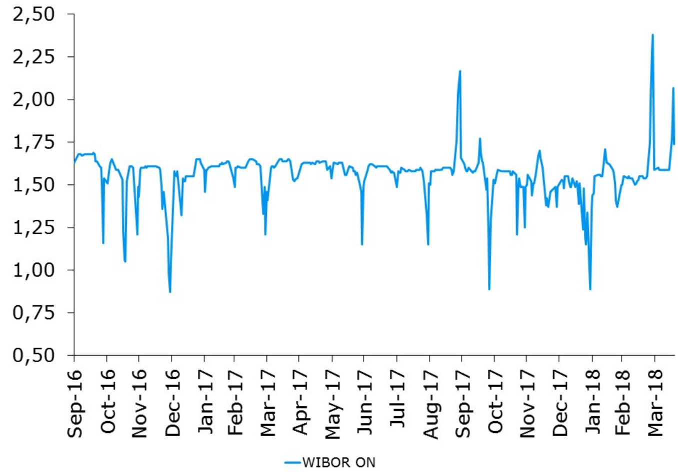
Everyone thought that after one expensive week the next one would be cheap. As a result, we got another expensive week with ON rates trading above 2.00%.

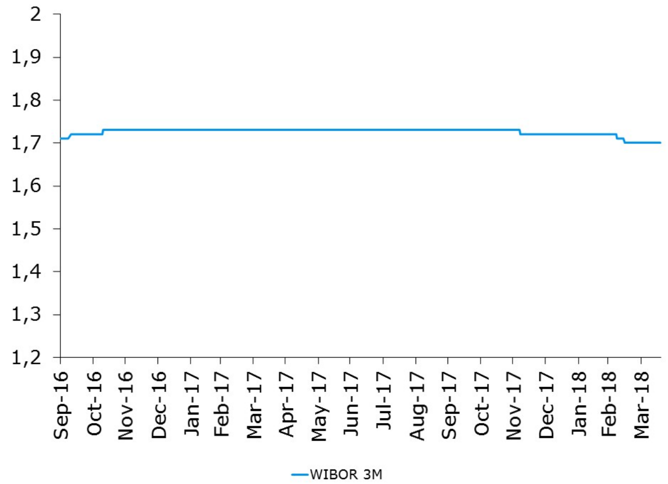
This month's end of reserve period comes on Friday. Banks don't have to be so cautious about buying NBP bills tomorrow as cash will return next Friday on the last 3-day reserve.

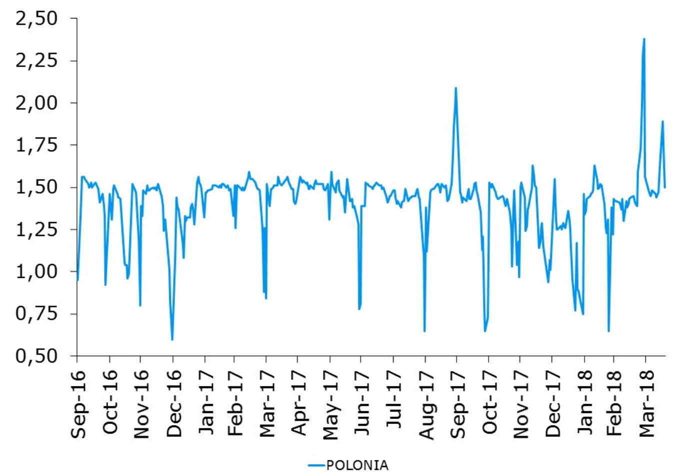
Ref rate vs Polonia averages:

30 day -12 bps
90 day 9 bps









Forex

Spot – EUR/PLN – lower range Global market ignores the increased tensions in the Middle East and concerns about a trade war. Positive investment sentiment still supports risky assets. Additionally, Zloty is supported by strong Poland's economy and S&P decision to revise the outlook on Poland's rating to positive from stable. It was another week with EUR/PLN slowly drifting lower. It even traded briefly below 4.16, but now is back at 4.17-ish level. Our base case scenario is that EUR/PLN range just moved lower to 4.1350-4.1950.

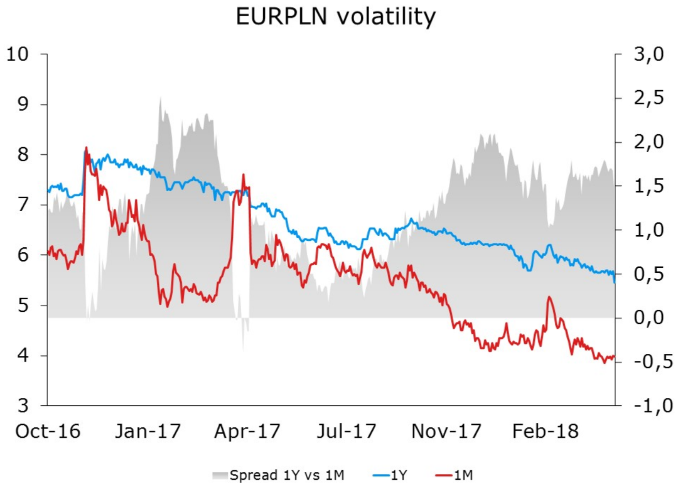
Options – EUR/PLN vols – at lows Volatility continues its march lower. 1 month EUR/PLN ATM mid is this Thursday at 3.65% (0.25% lower than a week ago), 3 months are 4.1% (0.3% lower) and 1 year is fixing 5.25% (0.35% lower). There was decent turnover in the backend, 1 year EUR/PLN was trading at 5.45% and 6m at 4.75% in good amounts. The skew is also better offered. Volatilities are at their all-time lows – in 2008 before financial crisis 1 month ATM EUR/PLN mid was above 5.0%, 1 year ATM mid was at 5.75%. The only thing that explains such a situation are realized volatilities lower than 10 years ago.

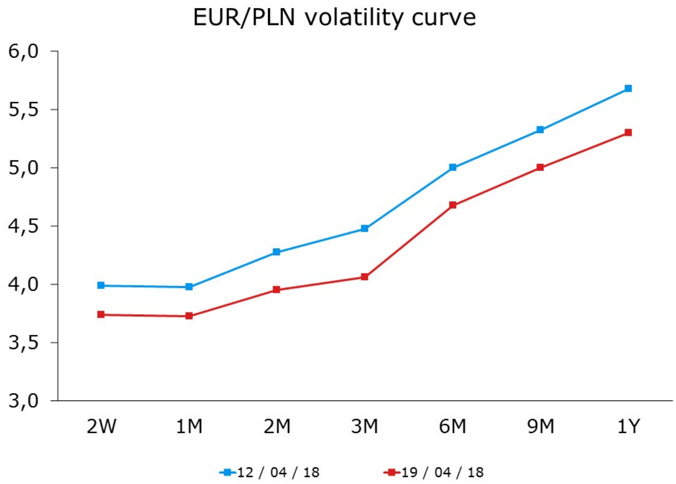
Short-term forecasts

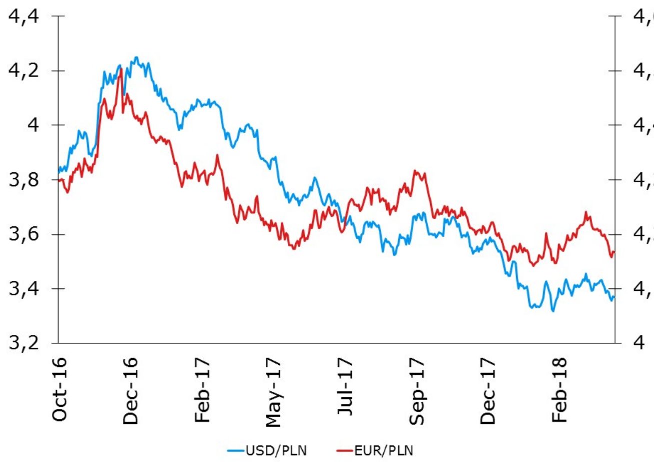
Main supports / resistances:
EUR/PLN: 4.1300 / 4.2000
USD/PLN: 3.3000 / 3.5000

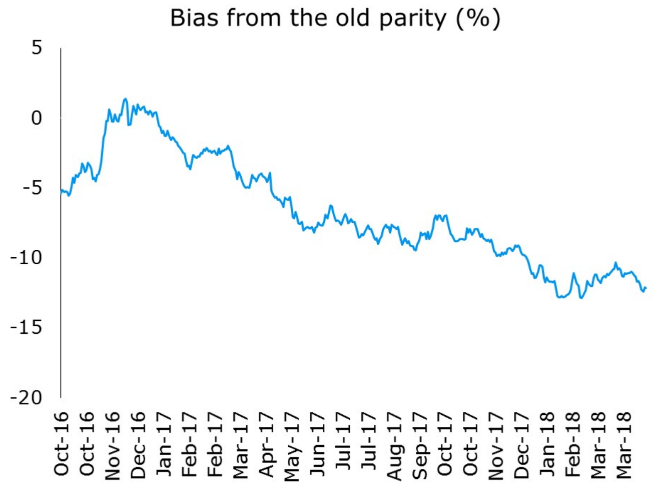
Spot Current position: None, buy on dips.

Our long EUR/PLN position was stopped out at 4.16. We are sidelined at this moment, but we are going to dip our toe again in the water, the logic is unchanged: dovish MPC and historically attractive entry level. We are ready to buy EUR/PLN at 4.13/4.14 with stop at 4.10 and hopes for 4.17/4.19.









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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
4/12/2018	1.75	1.70	1.80	1.68	1.90	1.72	1.70	1.71	1.72	1.73	1.77	1.79
4/15/2018	1.74	1.70	1.84	1.68	1.96	1.72	1.70	1.70	1.72	1.74	1.79	1.79
4/16/2018	1.77	1.70	1.84	1.68	1.96	1.72	1.70	1.71	1.72	1.76	1.78	1.80
4/17/2018	1.65	1.70	1.72	1.68	1.84	1.72	1.70	1.71	1.72	1.74	1.78	1.78
4/18/2018	1.74	1.70	1.84	1.68	1.95	1.72	1.70	1.70	1.71	1.73	1.77	1.78

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
4/12/2018	1.720	1.345	1.809	1.527	2.233	2.255	2.703	3.011
4/15/2018	1.720	1.359	1.849	1.540	2.284	2.291	2.745	3.045
4/16/2018	1.720	1.352	1.837	1.555	2.302	2.366	2.773	3.086
4/17/2018	1.720	1.356	1.828	1.495	2.350	2.317	2.825	3.064
4/18/2018	1.720	1.339	1.818	1.535	2.260	2.287	2.725	3.013

EUR/PLN 0-delta stradle						25-delta RR			25-delta FLY
Date	1M	3M	6M	1Y		1M	1Y		1Y
4/12/2018	3.98	4.48	5.00	5.68		5.68	1.13		0.53
4/15/2018	3.93	4.45	4.95	5.63		5.63	1.13		0.53
4/16/2018	4.00	4.48	5.00	5.68		5.68	1.10		0.53
4/17/2018	3.98	4.40	4.90	5.45		5.45	1.10		0.53
4/18/2018	3.73	4.06	4.68	5.30		5.30	1.10		0.53

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
4/12/2018	4.1882	3.3924	3.5303	3.1755	1.3456	0.1654
4/15/2018	4.1769	3.3862	3.5214	3.1467	1.3433	0.1650
4/16/2018	4.1628	3.3666	3.5054	3.1408	1.3417	0.1647
4/17/2018	4.1582	3.3572	3.4921	3.1384	1.3384	0.1646
4/18/2018	4.1677	3.3721	3.4805	3.1431	1.3428	0.1648

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