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Polish Weekly Review

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Table of contents

Our view in a nutshell

Economics

■ Higher fuel prices boosted inflation, core CPI likely stable in April

Fixed income

■ It's bad, but really how bad is it?

Money market

■ May started with an earthquake, will it be followed by rising tension?

FX market

■ Spot – Volatility rules

■ Options – Volatility higher again

Comment on the upcoming data and forecasts

Next week starts with balance of payments data for March. We expect current account deficit to continue to widen after meagre EU-fund transfer inflow and negative trade balance. On Tuesday, CSO will publish final CPI data for April and flash GDP estimate for first quarter of 2018. We expect confirmation of CPI flash release at 1.6% r/r, while GDP growth should decelerate slightly to 4.8% y/y from 4.9% posted in Q4'17. The latter is a result of stronger consumption and investment growth outweighed by negative net exports. On Wednesday, the MPC will decide about interest rates. We do not expect any changes. The Council will be focused on low inflation and strong growth (Goldilocks economy), thus the wording and mood during the conference will remain dovish. Also on Wednesday, the NBP will publish core inflation data, details of CPI flash release suggest that our initial forecast (0.6% y/y) is correct. Finally on Friday labor market data for April will be released. Employment is set to grow at a steady pace (3.7% y/y, same as in March), while wages will accelerate towards 7.5% y/y fueled by base and calendar effects.

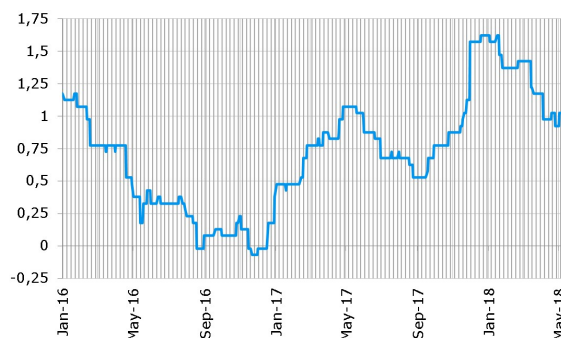
Polish data to watch: May 11th to May 18th

Publication	Date	Period	mBank	Consensus	Prior
Current account (mio PLN)	14.05	Mar	-1543	-1074	-1017
Exports (mio PLN)	14.05	Mar	17800	18141	16271
Imports (mio PLN)	14.05	Mar	18600	18465	16844
CPI y/y (%) <i>final</i>	15.05	Apr	1.6	1.6	1.3
GDP y/y (%) <i>flash</i>	15.05	Q1	4.8	4.8	4.9
MPC decision (%)	16.05	May	1.5	1.5	1.5
Core inflation y/y (%)	16.05	Apr	0.6	0.4	0.7
Average wage y/y (%)	18.05	Apr	7.5	7.1	6.7
Employment y/y (%)	18.05	Apr	3.7	3.7	3.7

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	5/10/2018	300	1.504	4/27/2018
5Y T-bond PS1023	5/10/2018	1000	2.322	4/27/2018
10Y T-bond WS0428	5/10/2018	900	3.006	4/27/2018
30Y T-bond WS0447	5/10/2018	150	3.395	4/27/2018

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



Comment

Flash CPI surprised on the upside, pushing Polish surprise index slightly higher. Next week bring more opportunities to move the index with final CPI, flash GDP and labour market 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%. 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	3.0	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

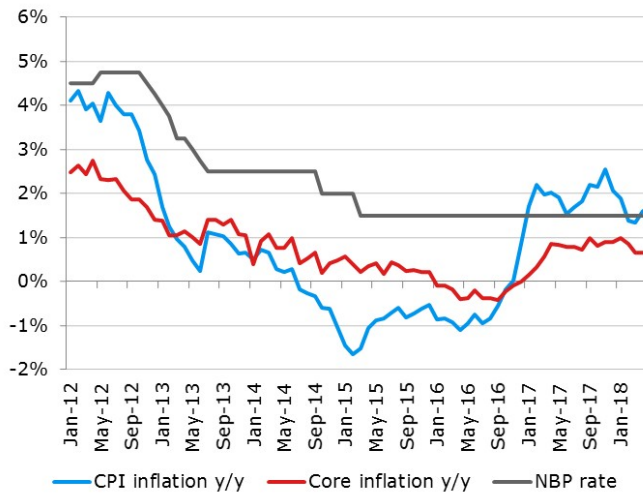
	2017	2017	2017	2017	2018	2018	2018	2018
	Q1	Q2	Q3	Q4	Q1 F	Q2 F	Q3 F	Q4 F
GDP y/y (%)	4.4	4.0	5.2	4.9	4.8	4.6	4.5	4.5
Individual consumption y/y (%)	4.5	4.9	4.7	5.0	4.6	4.3	4.0	4.0
Public Consumption y/y (%)	2.1	2.9	3.3	4.8	4.0	3.0	3.0	3.0
Investment y/y (%)	1.4	1.3	3.6	5.4	10.0	10.0	9.0	8.0
Inflation 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

Higher fuel prices boosted inflation, core CPI likely stable in April

Consumer prices rose by 1.6% y/y (March: 1.3% y/y, consensus: 1.5% y/y, our forecast 1.6% y/y).



Similarly to the previous month, the flash reading comes with some additional details. Thus, we know that prices of food and nonalcoholic beverages rose by 0.3% m/m (just as we forecast), while residential energy prices stagnated on a monthly basis (marginally below our forecast of +0.2% m/m) and fuel prices rose by a solid 2.8% m/m. Base effects from last year ensured that both fuel and food prices contributed significantly to the acceleration in CPI in y/y terms. Using the abovementioned details, we estimate that core inflation amounted to 0.5-0.7% y/y in April, in line with our forecast of 0.6% growth. The key factor here was likely the base effects in the prices of airline tickets, whose prices rose by 150% (!!!) in April 2017.

In the coming months the combined effect of higher oil prices at present and base effects related to last year's Spring declines will push inflation above 2% by July. Cheaper food prices and the waning of last year's shocks will only mitigate this trend, but not reverse it. Core inflation should cross the 1% threshold in July and accelerate towards 1.5-1.6% by year end. The upcoming acceleration in core inflation will be linked to wage growth already realized and we stand firm to this forecast. In our view, the potential for surprises in Polish CPI data is still asymmetric (positive surprises more likely than negative ones) and this might both upset MPC's current rhetoric and encourage bets on earlier start to monetary tightening in Poland.

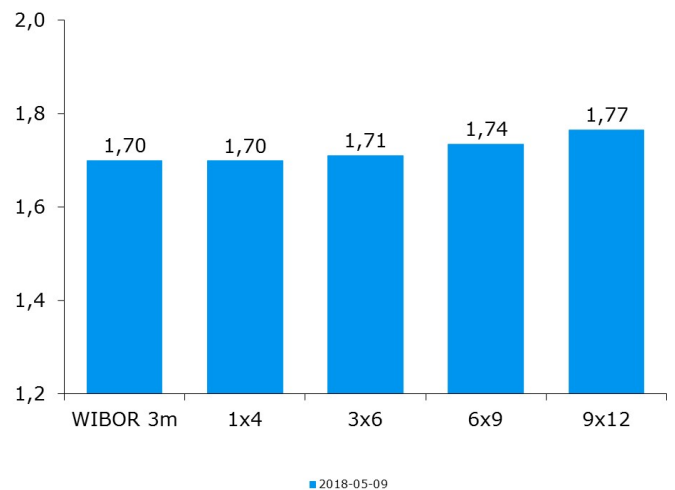
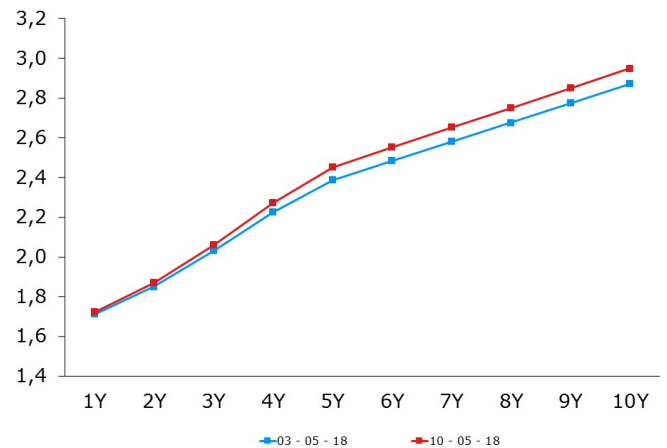
Fixed income

It's bad, but really how bad is it?

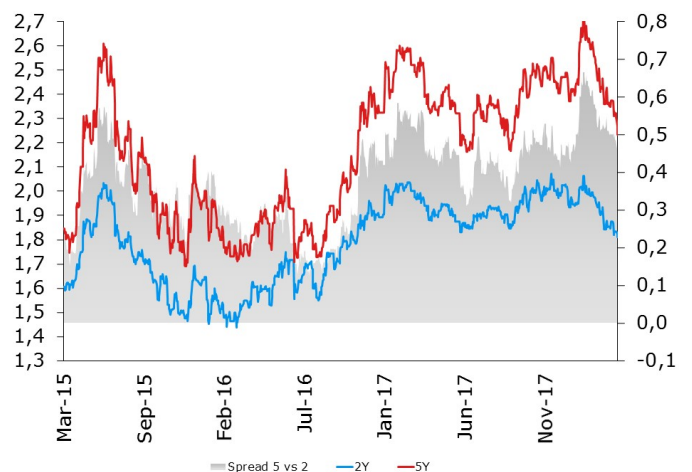
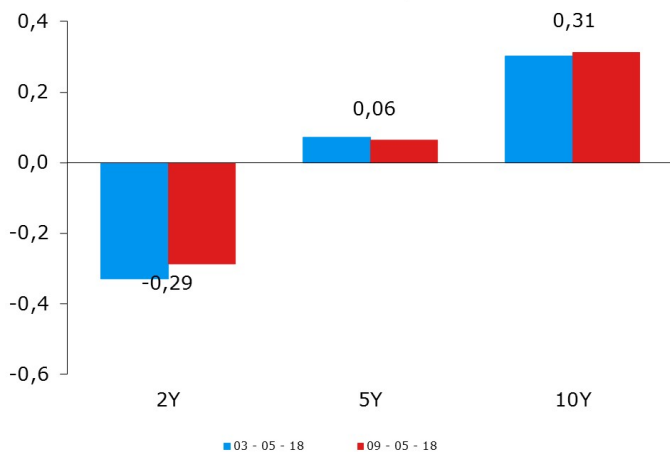
A lot of bad news is already priced in, but there's still a lot of things to look at. EM crisis, Italy election, oil prices, anything can affect POLGBs now. Today we had an auction in Poland and bid/cover was almost 1, so it looks like buyers are full. Now it's time to think about strategy for the next weeks.

Curve has steepened PS0123/WS0428 is 74bps PS0123/5y is 2bps, WS0428/10y is 26bps. WS0428/Bund is 270bps. PS0420 is trading at 1.51% (3bps up), PS0123 is trading at 2.50% (13bps up) and WS0428 is trading at 3.24% (18bps up).

IRS curve



Asset swaps

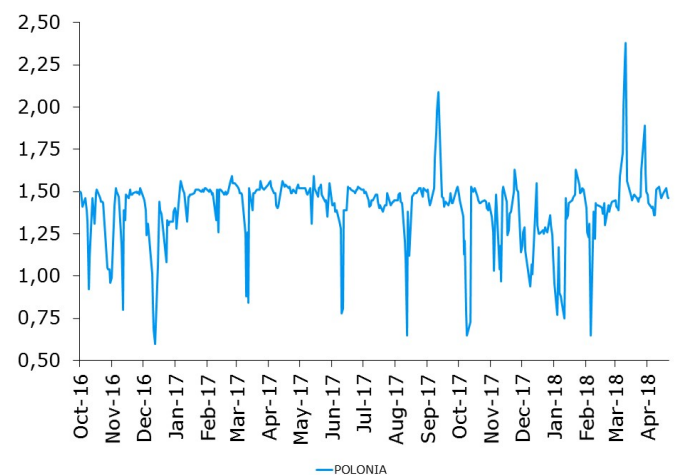
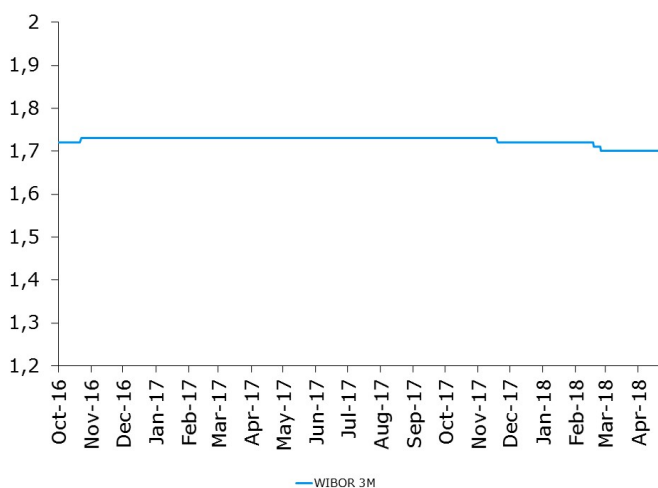
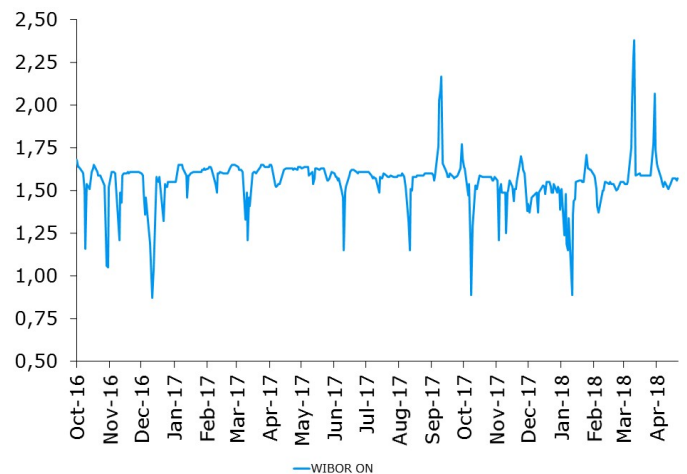
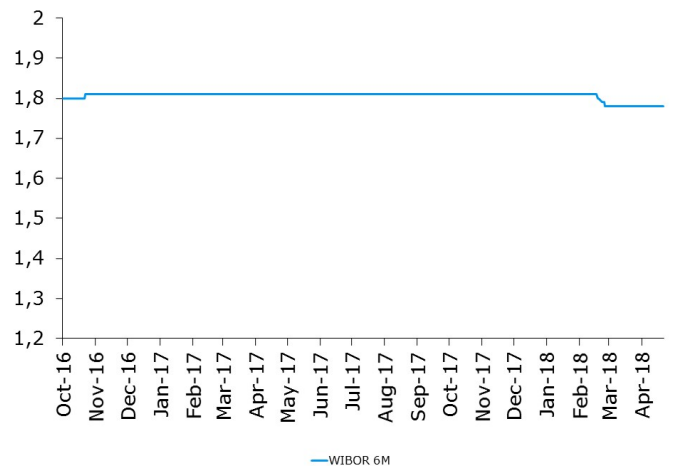


Money market

May started with an earthquake, will it be followed by rising tension?

Start of May tends to be quite boring in Poland due to bank holidays on 1st and 3rd, but not this year. Risk-off sentiment rolled over markets with Polish assets being treated like EM ones. "Big names" sold Polish govies and yields rose around 5-15 bp around the curve. Sentiment improved yesterday and we are off the lows. Poland recently lacks local story, global mood prevails.

Cash stays in tight range close to ref rate.



Forex

Spot – Volatility rules EUR/PLN spot was on fire in the last two weeks. We had two attempts to break 4.30, both ended in failures setting the high at 4.2975. The downward correction dragged EUR/PLN to 4.2350 low (so far) before consolidating. The fact that Zloty, last year top gainer, is prone to losses at the back of rising yields in US is not a surprise. Equally weighed EUR/PLN and USD/PLN basket, gained 5.9% from low to high. Nevertheless, the outburst of volatility and the pace of PLN weakening was a surprise to many. The realized 1 week volatility spiked to 9.62% from 2.09% (both daily), which was a shock! Is it a game changer or just the one-off it is still to be decided. Anyone who has experienced market turmoil after Lehman bankruptcy may have a little deja vu sensation.

Options – Volatility higher again The Vols are higher and it is not a surprise – realized volatility exploded. Last time buyers of gamma was very active on the market, so especially the front of the EURPLN volatility curve is higher than two weeks ago. The big trades were 2W EUR/PLN traded above 6.0% in good amount, 1 month was traded at 5.7%. Finally 1 month EUR/PLN ATM mid is this Thursday at 5.6% (1.15% higher), 3 months are 5.6% (0.9% higher) and 1 year is fixing 5.8% (0.25% higher). The skew was also traded heavily (i.e. 2 months EUR/PLN 10d RR at 1.9%!) The currency spread (difference between USD/PLN and EUR/PLN) is at the same level as two weeks ago – around 4%.

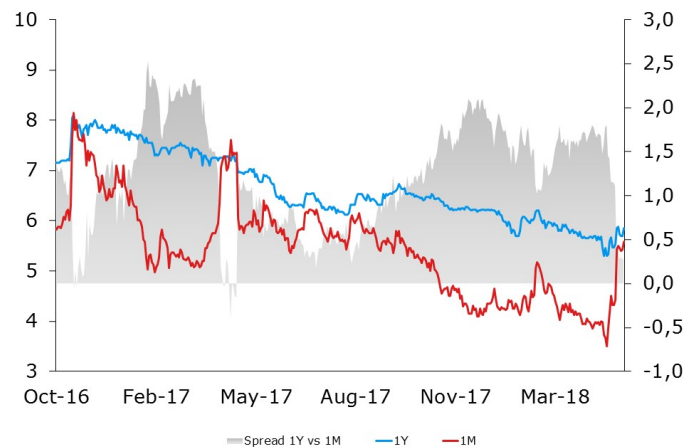
Short-term forecasts

Main supports / resistances:
 EUR/PLN: 4.2250 / 4.2950
 USD/PLN: 3.4600 / 3.6600

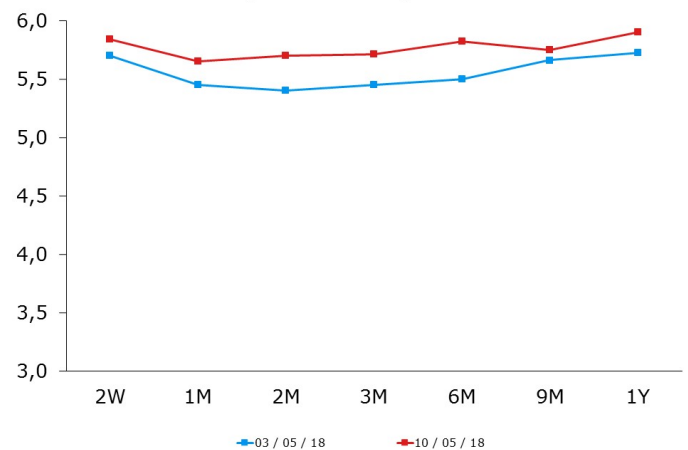
Spot Current position: Long EUR/PLN.

Our strategy is roughly unchanged, we still believe in rangy nature of EUR/PLN. We are going to play that range with a slight PLN negative bias. It is simply because the upside moves in EUR/PLN are usually of more violent nature. That makes us long EUR/PLN at 4.2400 with a room to add at 4.2050. And the stop at 4.1800 with hopes to see another try at 4.29+

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
5/3/2018	1.75	1.70	1.83	1.68	1.96	1.72	1.71	1.72	1.73	2.11	1.79	2.08
5/6/2018	1.67	1.70	1.74	1.68	1.78	1.72	1.71	1.71	1.73	1.77	1.80	1.80
5/7/2018	1.84	1.70	1.93	1.68	2.07	1.72	1.70	1.71	1.73	1.75	1.80	2.08
5/8/2018	1.67	1.70	1.75	1.68	1.88	1.72	1.70	1.70	1.72	1.77	1.83	1.80
5/9/2018	1.75	1.70	1.83	1.68	1.95	1.72	1.70	1.71	1.74	1.77	1.82	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	4/27/2018	7/25/2020	96.72	1.50	300	470	370
PS0123	4/27/2018	1/25/2023	100.78	2.32	1000	1470	1165
WS0428	4/27/2018	4/25/2028	97.80	3.01	900	1070	895

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0720	5Y IRS	PS0423	10Y IRS	WS0428
5/3/2018	1.720	1.319	1.850	1.520	2.385	2.458	2.871	3.173
5/6/2018	1.720	1.344	1.842	1.528	2.375	2.453	2.866	3.158
5/7/2018	1.720	1.326	1.869	1.540	2.372	2.434	2.884	3.140
5/8/2018	1.720	1.352	1.855	1.572	2.420	2.530	2.904	3.257
5/9/2018	1.720	1.334	1.870	1.583	2.450	2.515	2.951	3.264

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
5/3/2018	5.45	5.45	5.50	5.73	5.73	1.25	0.54
5/6/2018	5.40	5.35	5.50	5.70	5.70	1.25	0.54
5/7/2018	5.43	5.35	5.50	5.70	5.70	1.27	0.53
5/8/2018	5.58	5.53	5.65	5.85	5.85	1.28	0.54
5/9/2018	5.65	5.71	5.83	5.90	5.90	1.28	0.54

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
5/3/2018	4.2675	3.5563	3.5731	3.2381	1.3589	0.1667
5/6/2018	4.2771	3.5754	3.5789	3.2781	1.3603	0.1677
5/7/2018	4.2513	3.5634	3.5509	3.2599	1.3546	0.1667
5/8/2018	4.2662	3.5884	3.5744	3.2908	1.3564	0.1672
5/9/2018	4.2790	3.6090	3.5988	3.2881	1.3596	0.1672

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