May 25, 2018

Polish Weekly Review

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Comment on the upcoming data and forecasts

This Friday, the CSO will publish its Statistical Bulletin, including unemployment data. We expect the latter to confirm the preliminary reading from the Ministry of Family (6.3%, in line with consensus). On Wednesday detailed GDP data for the first quarter will be published. We expect confirmation of flash release when it comes to the headline (5.1% y/y), with solid private consumption (also 5.1% y/y), strong investment activity (near 10% y/y) amid negative contribution of net exports and positive of inventories. Also on Wednesday the CSO will publish flash CPI reading. We expect another significant acceleration of annual growth rate, it is too early for a precise forecast, though. Thursday is a public holiday in Poland. On Friday Polish manufacturing PMI for May will be published. On June 6th Polish MPC will holds its next meeting. We expect rates as well as general mood during the conference to remain unchanged. Not much time have lapsed since the last meeting and it will be held just one month before publication of a new set of NBP projections.

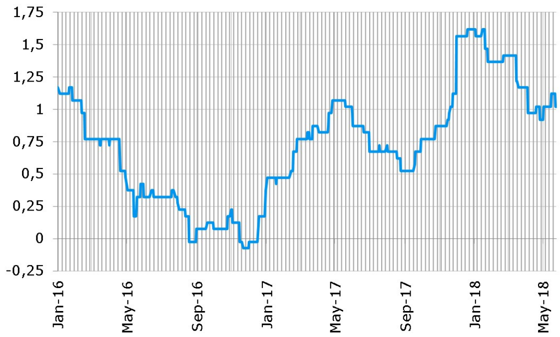
Polish data to watch: May 25th to June 8th

Publication	Date	Period	mBank	Consensus	Prior
Unemployment rate (%)	25.05	Apr	6.3	6.3	6.6
GDP y/y (%) *final*	30.05	Q1	5.1	5.1	4.9
CPI y/y (%) *flash*	30.05	May			1.6
Manufacturing PMI (p.)	01.06	May			53.9
MPC decision (%)	06.06	Jun	1.50	1.50	1.50

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	6/15/2018	20	1.637	5/24/2018
5Y T-bond PS1023	6/15/2018	1400	2.481	5/24/2018
10Y T-bond WS0428	6/15/2018	900	3.210	5/24/2018
30Y T-bond WS0447	6/15/2018	150	3.395	4/27/2018

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



Comment

Polish surprise index dropped after disappointing retail sales data for April. Next two weeks bring few opportunities to move the index: unemployment data, flash CPI and manufacturing PMI.

* 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 turned around and will accelerate towards 2.3-2.4% in the summer, mainly on the back of higher energy prices. Right now, services prices are the best hope for those looking for a durable rise in inflation. 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, inflation scare, EM asset sell-off and very dovish MPC both contributed to a notable depreciation in the PLN (more 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 Q1	2017 Q2	2017 Q3	2017 Q4	2018 Q1 F	2018 Q2 F	2018 Q3 F	2018 Q4 F
GDP y/y (%)	4.4	4.0	5.2	4.9	4.8	4.5	4.5	4.5
Individual consumption y/y (%)	4.5	4.9	4.7	5.0	5.1	4.8	4.6	4.2
Public Consumption y/y (%)	2.1	2.9	3.3	4.8	2.0	2.0	4.0	4.0
Investment y/y (%)	1.4	1.3	3.6	5.4	10.0	10.0	10.0	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

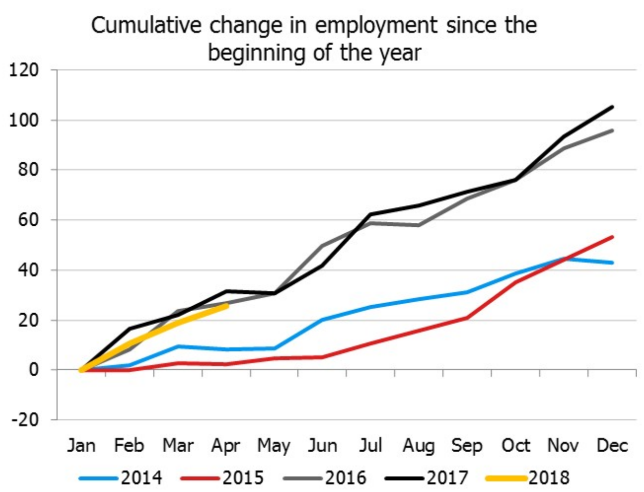
Economics

Easter hangover distorted April data, but the overall scenario for 2018 is unchanged

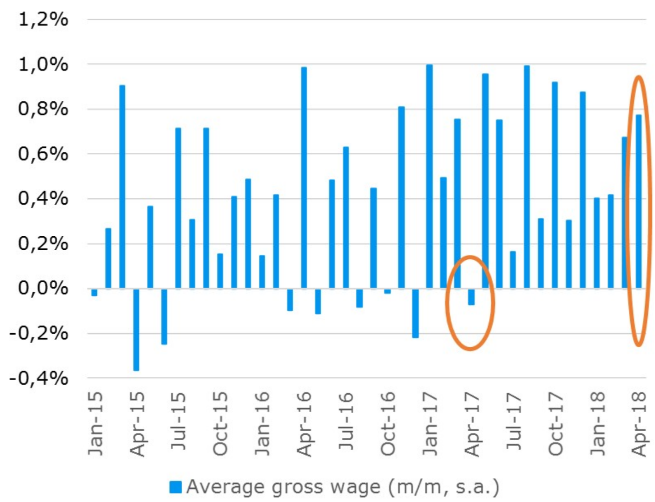
Easter is a difficult time for economists. Its timing can affect economic activity statistics to an often surprisingly high extent and this tends to distort economic figures in March and April. Therefore, it is important to cut through such noise and extract the signal regarding the actual underlying pace of the economy. We judge that nothing really changed after April – the economy is set to grow at a brisk pace in Q2, albeit short-term momentum seems to be waning. Household consumption is still in the driver's seat, with annual growth north of 5% y/y. Investment growth, based on both macroeconomic figures and amassed anecdotal evidence, might already be constrained by supply issues, but this needs to be closely watched going forward. Finally, with waning employment growth and accelerating wage growth, labor market is still looking red-hot. All this comes against the backdrop of limited price pressures – PPI is reflecting the immediate impact of higher commodity prices and lower PLN, while retail prices are little changed if food and fuel prices swings are stripped. It will reinforce the MPC's perception that the economy is perfectly balanced and no adjustment to interest rates is needed in the foreseeable future.

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

Employment in the enterprise sector grew in April by 3.7% y/y, in line with our forecast, market consensus and last month's reading. On a monthly basis exactly 7k jobs were added, which means that the pace of job creation from the beginning of the year has slightly eased. The structure of growth will be known at the time when the CSO's Statistical Bulletin is published, however we expect that all major sections contributed. We interpret this result not as pure stabilization but rather a beginning of a gentle drift towards monthly changes close to zero (and even negative readings in some months). This will be a result of labour market tightening, where insufficient labour supply could be visible through e.g. longer time needed to fill vacancies.

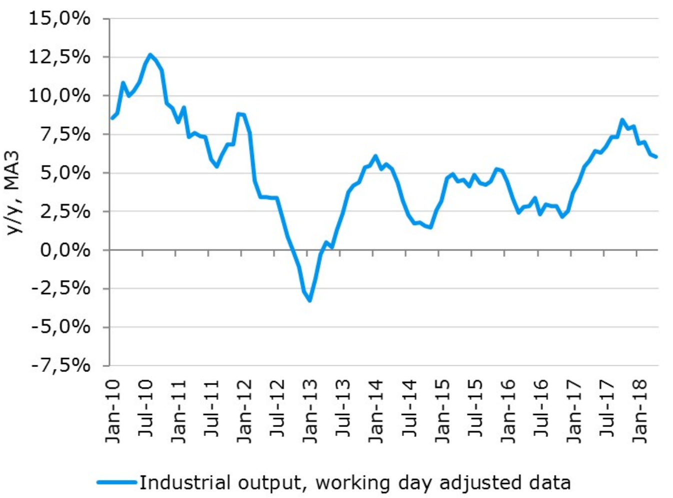


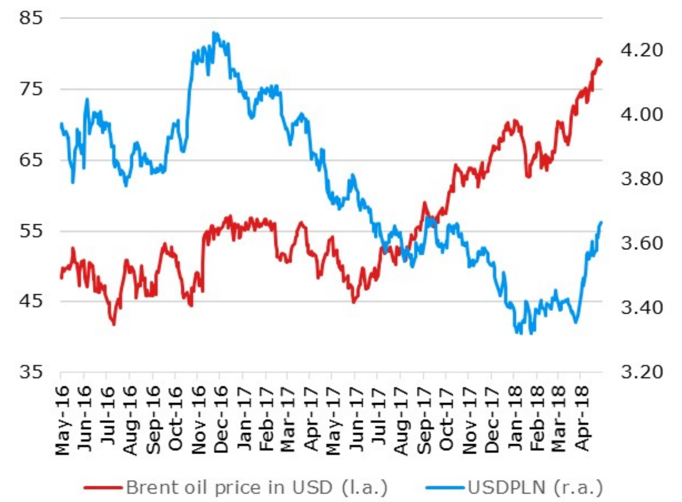
Average gross wage rose by 7.8% y/y, beating estimates and our fairly optimistic forecast (7.2 and 7.5%, respectively). Detailed data from the previous months and our forecasts suggest that April's surge in wage growth is due to several factors: shifts in mining bonuses (and the resulting low base from April 2017), favorable working day count (+1 vs. -1 y/y) and solid uptrends in several industries, mainly services. While the aforementioned statistical base contributed greatly to April's figure, there is tangible evidence that momentum has been building up in recent months.



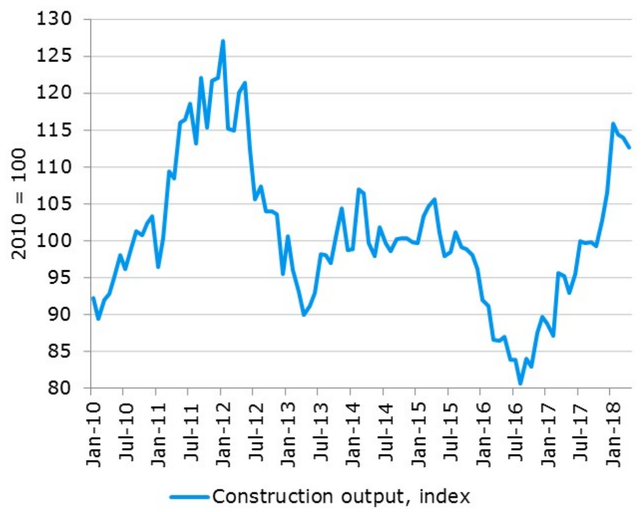
It should not come as a surprise to our readers that we consider the case for faster wage growth to be a well-justified one. In current circumstances one could easily imagine 8-10% wage growth in the second half of the year. In addition, the on-going fuel price spike will likely spark additional wage demands. After all, this category can be considered a good proxy for inflation expectations: demand is price-inelastic over the short term, grabs media headlines and public interest, purchases are often and prices are volatile.

Industrial output rose by 9.3% y/y in April, bearing estimates and our forecast (8.5 and 7.1% y/y, respectively). The upswing was primarily driven by manufacturing production which rose by 9.5% y/y, while mining and energy output posted modest contributions. In particular, the latter was halved due to normalization in weather conditions. Curiously, despite the scale of the surprise, industry showed little new momentum in April, having grown by a mere 0.5% m/m in seasonally adjusted terms. As a result, the trend in Polish industry is still a downward one, with y/y growth reaching one-year lows on a smoothed basis. Therefore, the April surprise seems to be related to capricious seasonality, not a misdiagnosis of economic fundamentals.



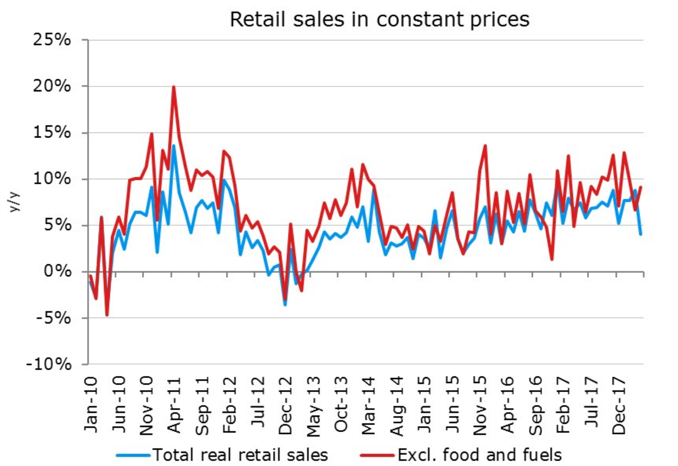


Construction output disappointed, having accelerated from 16.2 to 19.7% y/y (below market consensus of 25% and our optimistic forecast of 35% y/y). The sources of the disappointment are impossible to determine at this point, but construction failed to react to significantly better weather conditions, strong base effect and favorable calendar. Given this and the changes in seasonal patterns in recent years, this is a weak print, as confirmed by seasonally adjusted m/m decline of 1.2%. The pattern of steep, one-time surges in output, intertwined with longer periods of downward drift is still intact.

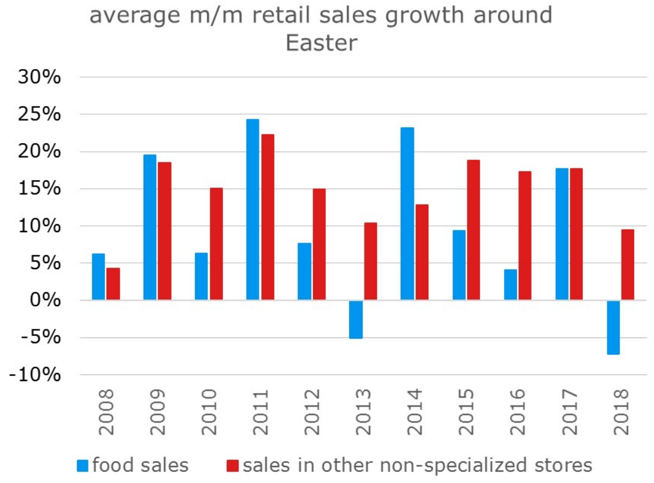


Producer prices surprised to the upside in April. On a yearly basis they rose by 1.1%, higher than market consensus and our forecast indicated (0.8-0.9%). A vast part of this surprise is attributed to revision of last month's reading, which went up from 0.3% to 0.5% y/y. The rest is a result of higher than expected growth in manufacturing prices, only partially balanced by a drop of prices in the mining sector. PPI growth is currently driven by higher commodity prices, mainly oil (on a monthly basis this category rose by a whopping 5.5%). Factoring this growth into oil price in USD and exchange rate (mainly dollar factor, since EURPLN only slightly moved in April), we see that while the former in already contributing to yearly index, the latter will show its full potential only in the second half of the year. Ergo, even if prices and exchange rates will stabilize, PPI will continue to grow.

In April **retail sales** rose by a mere 4.6% y/y in nominal terms, significantly below forecasts of 7-7.5% y/y growth. A quick review of the details of the release indicates that two categories are entirely to blame for the disappointment: food sales and sales in other non-specialized stores (dropped by 8.2 and 2.7% y/y, respectively as compared to our forecasts of +1 and +6.5% y/y). Other categories were little changed compared to our estimates and their overall impact was almost exactly zero – the only notable surprise is the strong car sales (up from -4.3 to 6.8% y/y). As a result, core retail sales accelerated from 5.5 to 7.8% y/y, suggesting that sales of durables and semi-durables remained buoyant.



The massive surprise in the two aforementioned categories requires some explanation, though. We believe that it can be attributed to the timing of Easter, which boosted sales in March and depressed in April (the reverse happened in 2017). It is a known factor, but its impact comes with significant uncertainty, consistent with the observed forecast error. As seen in the graph below, average (Mar-Apr) sales growth around Easter was almost identical in 2018 and 2013 (when Easter happened basically on the same day). It also shows that 2017 sales were rather strong in these two categories. It is also possible that the Sunday trading ban had some effect since shops were closed in four out of five Sundays. In light of all the available evidence on consumer behavior we judge this as a marginal influence.



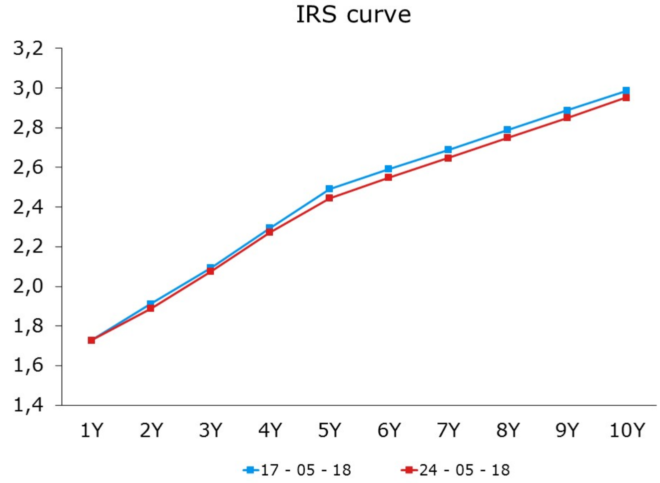
The best retort to weak retail sales figures can be found in consumer sentiment data – Polish consumers sentiment is still at all-time highs. One can expect that retail sales growth will rebound in May and a clear signal of consumer strength will emerge from Easter-related noise.

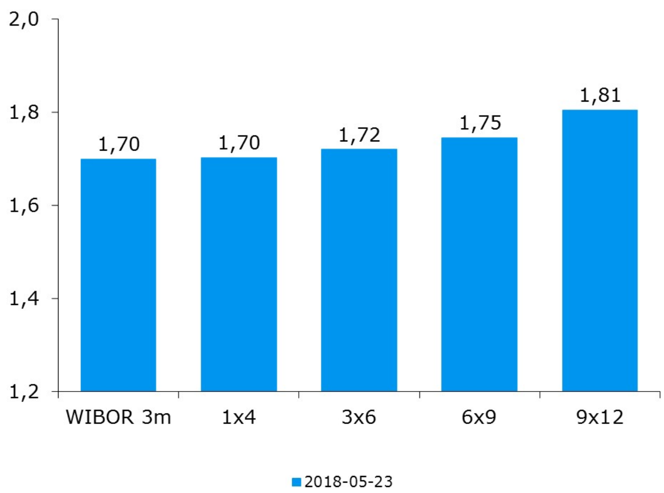
Fixed income

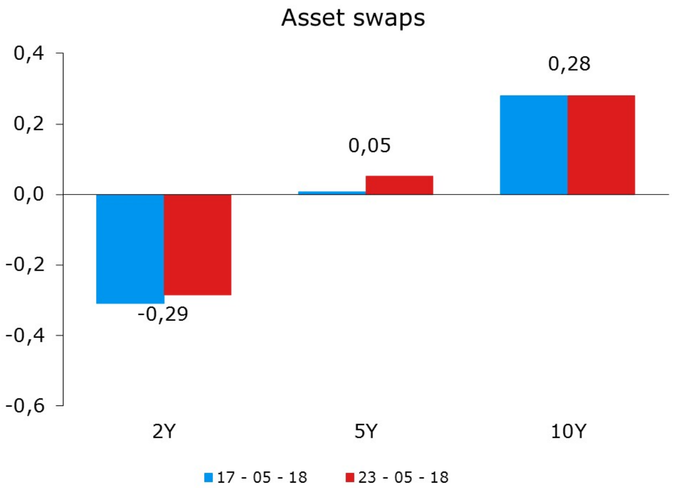
Small auction, robust demand

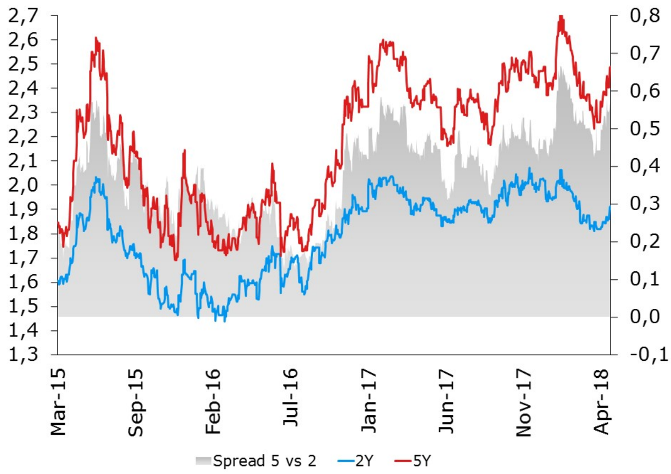
Small auction (3 bio) and good demand (5.2 bio). It feels POLGBs are a "must have" again. We are 10 bps lower from the tops, but it's still a long way to the recent lows. Global markets clearly want to recover after the huge fixed income sell off. We expect only one auction in June which brings about demand/supply factors again on top amid benign local story.

PS0123/5y is -1 bps, WS0428/10y is 21 bps. PS0123/WS0428 is 70 bps. WS0428/Bund is 272 bps. PS0420 is trading at 1.56% (4 bps down), PS0123 is trading at 2.48% (5 bps down) and WS0428 is trading at 3.19% (9 bps down).









Money market

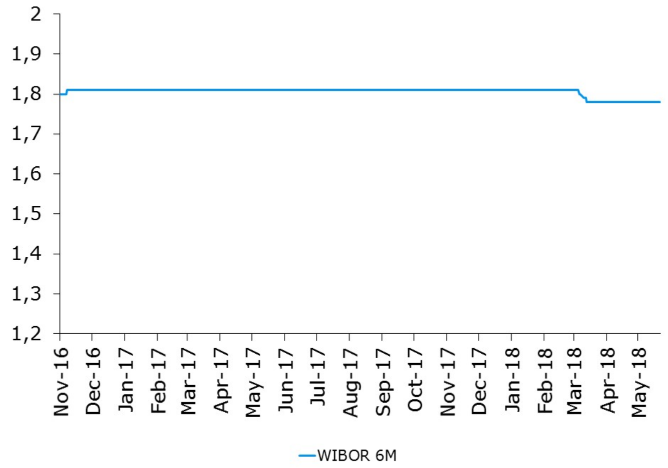
Better than EM?

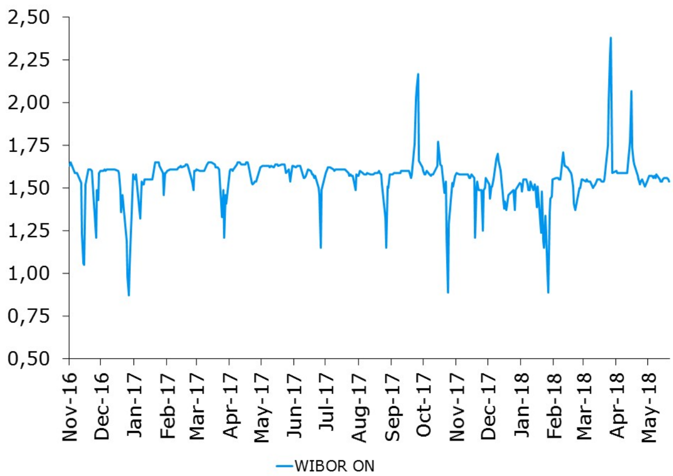
As recent risk-off has strengthened, Polish bonds came out as a winner. It seems to us that we are no longer perceived as a high yield EM. Prices of POLGBs rose in tandem with core markets. Ministry of Finance reduced supply on today's auction to 3 bio from 6 bio initially. Total demand was 5.3 bio and prices are holding above auction levels. There is still lack of local story for POLGBs except for stabilization. Next week is shorter due to bank holiday on Thursday. On Wednesday we have flash CPI reading which is expected at 2.0%.

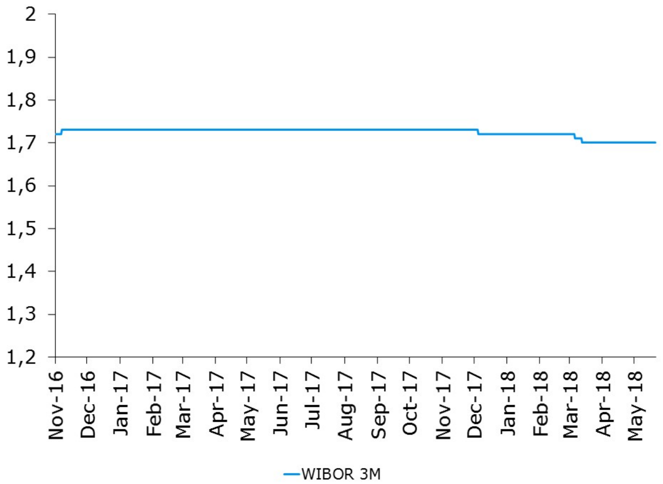
Cash stays slightly below reference rate due to some excess liquidity. We are coming into last week of the reserve period. There is a risk that overnight rate will fall down significantly.

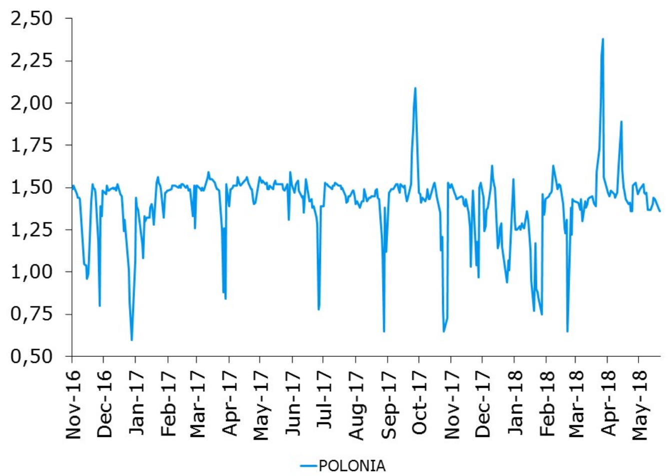
Ref rate vs Polonia averages:

30 day 4 bps
90 day 4 bps









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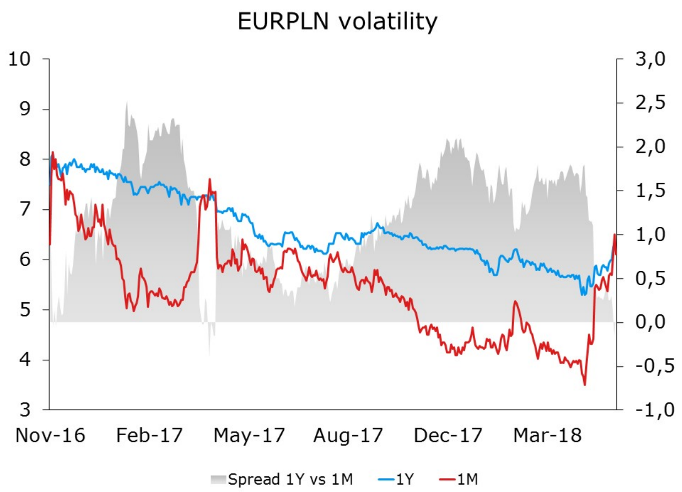
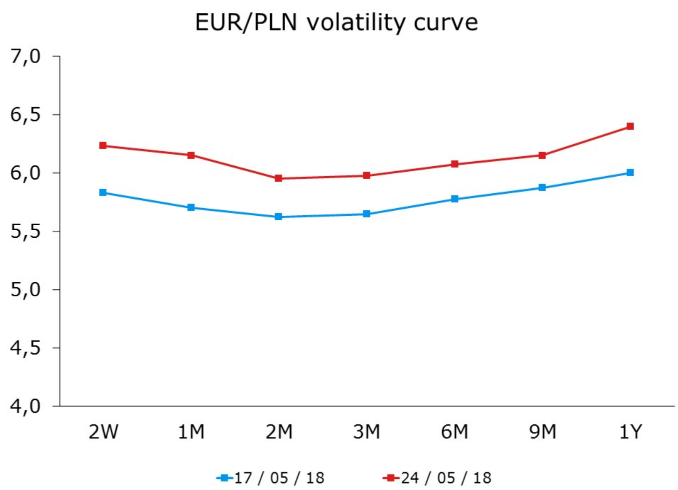
Forex

Spot – High realized volatility persists EUR/PLN is still firmly above 4.25-4.27 support zone, with 4.2710 the low of last 5 trading sessions. On the other hand it has not made much progress to the upside, not a good sign for the new uptrend. The high was 4.3160, only slightly higher than the last week's high of 4.3020. The background of the move was also different. Last week, the rising US Treasury yields seemed to set the tone (with obvious and lasting effect on the PLN), this week it looked more like a TRY driven knee-jerk reaction (short term risk-off effect). As a result, we are still committed to our play the range scenario, currently 4.265-4.3150, but no longer with short PLN preference.

Options – Choppy implied volatility Realized volatility of spot is quite impressive. The buyers of options come back to the market for good. Those were the big trades: 2w EUR/PLN traded at 6.5% in good amount, 1 month was traded at 6.35%, 1y USDPLN traded at 10.35%. During the beginning of this week implied volatility was creeping higher and the mid of the whole EUR/PLN curve was around 6.25%. Today (Thursday) the Zloty is getting stronger and volatility is lower. Finally we are at the same level as week ago. 1 month EUR/PLN ATM mid is at 5.75%, 3 months are at 5.75% and 1 year is fixing at 5.9%. The skew and the currency spread (difference between USD/PLN and EUR/PLN) are at the same level as week ago.



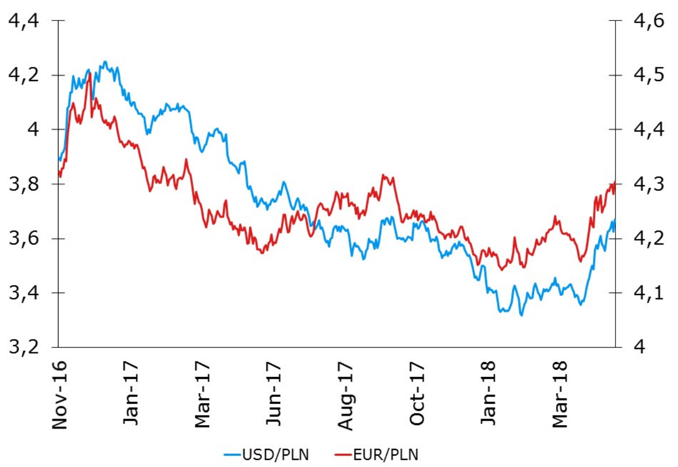


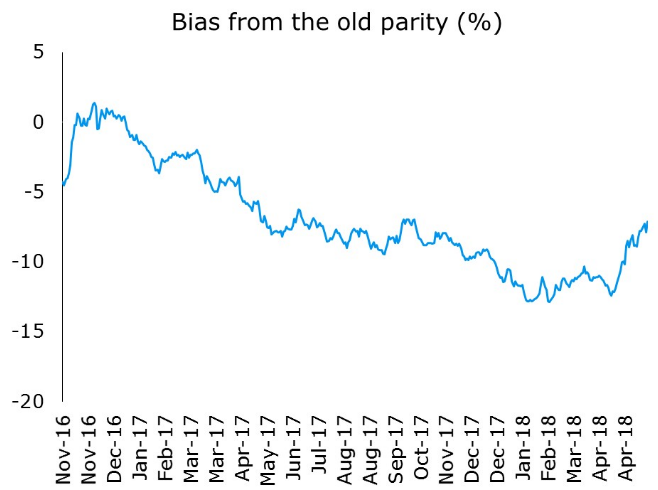
Short-term forecasts

Main supports / resistances:
EUR/PLN: 4.2400 / 4.3300
USD/PLN: 3.5000 / 3.7000

Spot Current position: Small short in EUR/PLN.

We closed our reminding long in EUR/PLN at 4.31 and reversed our position to short EUR/PLN. We are ready to add to the short at 4.3350 with a stop at 4.3550 for the whole position. We are hoping for a move lower in EUR/PLN to 4.2600. The trade is tactical, we are fading, what seems to be a TRY-initiated short term risk-off spike in EUR/PLN. The range play still applies.





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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
5/17/2018	1.78	1.70	1.87	1.68	2.02	1.72	1.70	1.72	1.75	1.80	1.87	1.83
5/20/2018	1.83	1.70	1.87	1.68	2.02	1.72	1.70	1.72	1.76	1.82	1.89	1.84
5/21/2018	1.62	1.70	1.70	1.68	1.74	1.72	1.70	1.72	1.76	1.81	1.88	1.84
5/22/2018	1.69	1.70	1.72	1.68	1.84	1.72	1.70	1.72	1.75	1.79	1.86	1.83
5/23/2018	1.90	1.70	1.94	1.68	2.06	1.72	1.70	1.72	1.75	1.81	1.88	1.84

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	5/24/2018	7/25/2020	96.55	1.64	20	122	22
PS0123	5/24/2018	1/25/2023	100.07	2.48	1400	2440	1389
WS0428	5/24/2018	4/25/2028	96.11	3.21	900	1495	865

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0720	5Y IRS	PS0423	10Y IRS	WS0428
5/17/2018	1.720	1.361	1.912	1.603	2.490	2.497	2.987	3.267
5/20/2018	1.720	1.361	1.918	1.603	2.512	2.497	2.987	3.267
5/21/2018	1.720	1.361	1.920	1.603	2.510	2.497	2.987	3.267
5/22/2018	1.720	1.361	1.905	1.603	2.480	2.497	2.987	3.267
5/23/2018	1.720	1.361	1.889	1.603	2.445	2.497	2.987	3.267

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
5/17/2018	5.70	5.65	5.78	6.00	6.00	1.31	0.56
5/20/2018	6.13	5.95	6.10	6.25	6.25	1.31	0.56
5/21/2018	6.50	6.20	6.25	6.35	6.35	1.33	0.52
5/22/2018	6.10	5.90	6.00	6.13	6.13	1.39	0.56
5/23/2018	6.15	5.98	6.08	6.40	6.40	1.34	0.55

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
5/17/2018	4.2868	3.6283	3.6229	3.2785	1.3550	0.1678
5/20/2018	4.2958	3.6385	3.6413	3.2795	1.3536	0.1679
5/21/2018	4.2991	3.6615	3.6641	3.2895	1.3480	0.1676
5/22/2018	4.2812	3.6252	3.6385	3.2665	1.3521	0.1667
5/23/2018	4.3037	3.6693	3.7007	3.3397	1.3500	0.1675

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