June 21, 2018

# Polish Weekly Review

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## Comment on the upcoming data and forecasts

This Friday the CSO will release business sentiment data and the NBP will publish money supply and credit data. On Monday CSO will publish its monthly Statistical Bulletin. Apart from the details of earlier releases, it will contain final estimate of unemployment rate in May. Preliminary MFLSP estimates indicated a moderate drop, from 6.3% to 6.1% (above our forecast of 6.0%). On Thursday MPC Minutes will be published, however their release will be rather unnoticed by market participants. Both MPC members and investors are waiting for central bank's projection of inflation and GDP growth, which will be published in July.

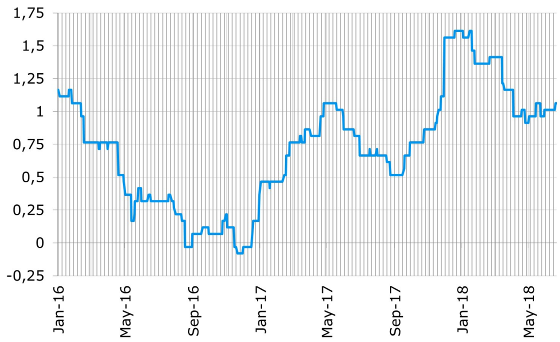
### Polish data to watch: June 22nd to June 29th

| Publication | Date | Period | mBank | Consensus | Prior |
|---|---|---|---|---|---|
| Business confidence | 22.06 | Jun | | | |
| M3 y/y (%) | 22.06 | May | 6.2 | 5.9 | 5.7 |
| Unemployment rate (%) | 25.06 | May | 6.1 | 6.1 | 6.3 |
| MPC minutes | 28.06 | Jun | | | |

### 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 | 6/28/2018 | 20 | 1.637 | 5/24/2018 |
| 5Y T-bond PS1023 | 6/28/2018 | 1400 | 2.481 | 5/24/2018 |
| 10Y T-bond WS0428 | 6/28/2018 | 900 | 3.210 | 5/24/2018 |
| 30Y T-bond WS0447 | 6/28/2018 | 150 | 3.395 | 4/27/2018 |

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




**Comment**

Better than expected industrial production moved the index slightly upward. Next week brings only one opportunity to move it again (unemployment data), but MFLSP estimates – in line with market consensus – suggest that there will be no surprises.

* 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 4.8%. 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 is set to breach 2% in the summer, before dropping back towards 1.5% towards year end. The key driver, albeit a fleeting one, are fuel prices. Food prices set to decelerate further this year. Those looking for a durable rise in inflation should take a look at core consumer goods (where there is a multi-year upward trend) and services. The pass-through from higher wages has thus far been limited, by we continue to put faith in this time-tested relationship.
- 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 until Q4 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 | 4.8 | 4.0 |
| CPI Inflation y/y (average %) | -0.1 | -0.9 | -0.6 | 2.0 | 1.6 | 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 | 1.75 |

| | 2018 Q1 | 2018 Q2 F | 2018 Q3 F | 2018 Q4 F | 2019 Q1 F | 2019 Q2 F | 2019 Q3 F | 2019 Q4 F |
|---|---|---|---|---|---|---|---|---|
| GDP y/y (%) | 5.2 | 5.2 | 4.7 | 4.4 | 4.2 | 4.2 | 4.0 | 3.7 |
| Individual consumption y/y (%) | 4.8 | 4.8 | 4.6 | 4.2 | 4.0 | 3.8 | 3.8 | 3.8 |
| Public Consumption y/y (%) | 3.6 | 3.0 | 4.0 | 4.0 | 2.0 | 2.0 | 2.0 | 2.0 |
| Investment y/y (%) | 8.1 | 10.0 | 10.0 | 8.0 | 7.0 | 6.0 | 5.0 | 4.0 |
| Inflation rate (% average) | 1.5 | 1.7 | 1.8 | 1.4 | 1.9 | 2.3 | 2.4 | 2.6 |
| Unemployment rate (% eop) | 6.6 | 5.7 | 5.5 | 5.5 | 5.7 | 4.9 | 4.8 | 5.0 |
| NBP repo rate (% eop) | 1.50 | 1.50 | 1.50 | 1.50 | 1.50 | 1.50 | 1.50 | 1.75 |
| Wibor 3M (% eop) | 1.70 | 1.70 | 1.71 | 1.72 | 1.73 | 1.73 | 1.73 | 1.98 |
| 2Y Polish bond yields (% eop) | 1.49 | 1.55 | 1.55 | 1.60 | 1.65 | 1.85 | 2.00 | 2.20 |
| 10Y Polish bond yields (% eop) | 3.18 | 3.30 | 3.35 | 3.40 | 3.50 | 3.59 | 3.71 | 3.88 |
| EUR/PLN (eop) | 4.21 | 4.30 | 4.25 | 4.20 | 4.15 | 4.10 | 4.05 | 4.03 |
| USD/PLN (eop) | 3.42 | 3.68 | 3.60 | 3.51 | 3.43 | 3.35 | 3.27 | 3.22 |

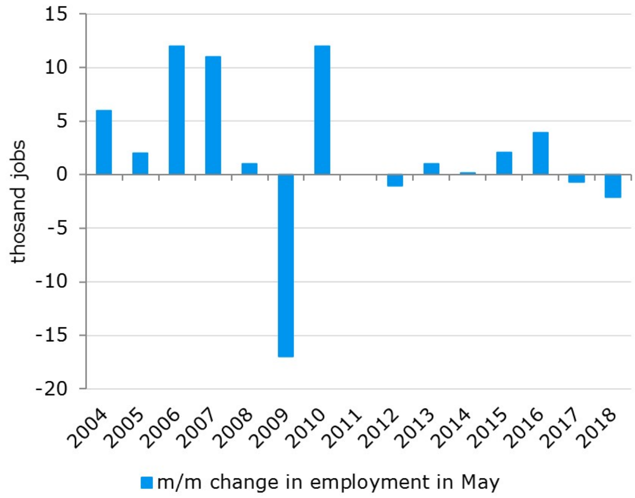
F - forecast

## Everything you always wanted to know about Q2 GDP growth – but were afraid to ask.

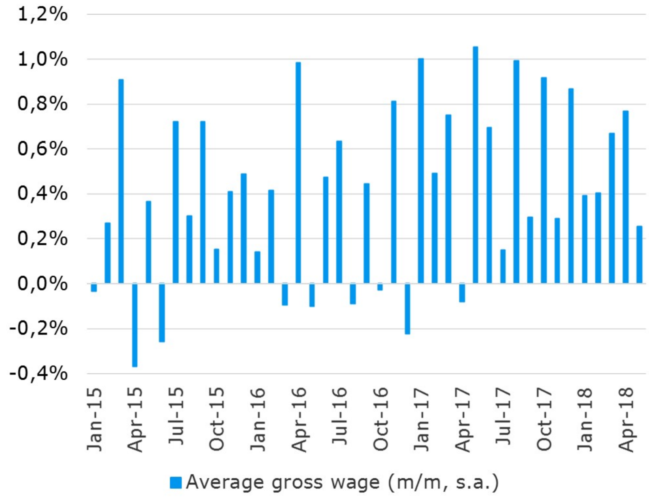
The recent series of macroeconomic data (from labor market stats, to industrial output, construction spending and retail sales) has shown that the Polish economy continues to show resilience and dynamism. Despite a number of negative factors arrayed against them in May (high statistical base, lower working day count, very favorable arrangement of public holidays), the majority of real sphere indicators surprised us to the upside. Based on April and May data, we expect GDP to accelerate to 5.2-5.4% y/y in the second quarter, with low sequential growth, though. As a result, annual forecast must be pushed upwards as well and we are currently aiming at 4.8% (or more) annual average – more updates will be forthcoming as we work out the details. The acceleration in economic activity in Q2 increases the uncertainty regarding the composition of growth. First, consumption likely did not accelerate – Easter effects and deceleration in retail sales are quite suggestive here. Second, until proven otherwise we continue to assume that investment growth is driven by buildings and structures (mainly by local governments ahead of this fall's elections, other public institutions and residential investors), with minimal input from corporate spending on machinery and equipment. Finally, it is unclear whether industry jumped in May on stronger exports, inventory drawdown, higher machinery spending or a combination of all of the above. And just as we repeatedly indicated, all this continues to have no bearing on price developments and – by extension – on the MPC's considerations. According to this week's data (retail sales deflators and the PPI), core consumer goods remain in deflation, albeit there is a very weak upward trend consistent with global tendencies.

As usual below you can find our take on last week's data releases.

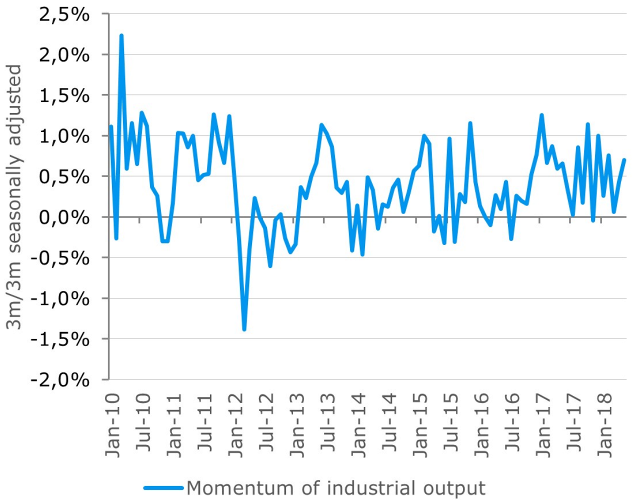
**Employment** in the enterprise sector fell in May by 2.1k jobs on a monthly basis (worst May since 2009), while yearly growth stabilized at 3.7%. Without details, we can only speculate about the reasons for this surprise. Two factors most probably are to blame here. The first one is effect of Sunday trade ban, which revealed itself with a lag as an on-off in retail sales category. The other reason is the general shortage of labor in Polish economy, which would be decreasing momentum in sections which boosted growth in recent months. Previous slowdown in this category (Q3 2017) was most probably a result of longer times needed to fill vacancies, thus growth rates returned to strong monthly growth at the turn of the year. This time it could last longer, so we will not be surprised to see more monthly drops this year.




**Average gross wage** rose by 7.0% y/y in May, slightly below forecasts (market consensus 7.1%, our estimate 7.5%). Just as it happens every month, we can only speculate on the sources of the surprise, since the details of the release will be published in the Statistical Bulletin in a week. In our view, the most likely cause of the disappointment is unfavorable calendar. Working days were both less numerous (-1 y/y vis-a-vis +1 in April) and arranged in a way that encouraged long weekends at the beginning of the month. As a result, working time-dependent parts of manufacturing and construction wages were sluggish last month. This is reflected in m/m growth rate, which fell below the recent averages and amounted to a mere 0.3% m/m (seasonally adjusted). Fundamentally, there is no turnaround in wage data – imbalances between labor demand and supply have persisted to this day (and arguably deepened) and the uptrend in wages is still solid. Further wage hikes might be facilitated by the spike in fuel prices – a critical factor for household inflation expectations.

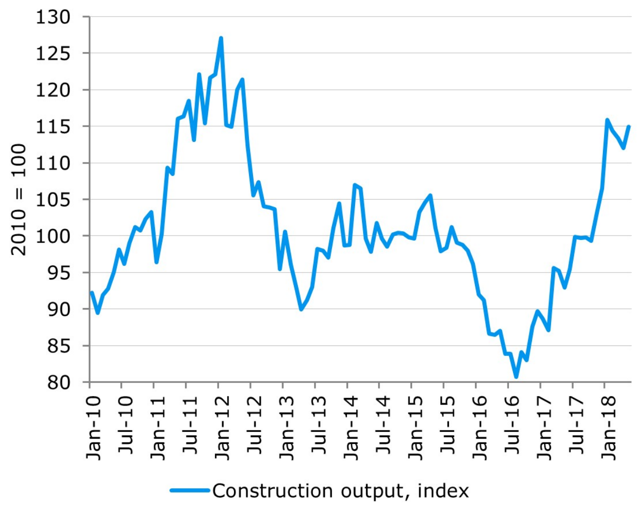



Sold **industrial output** surprised to the upside, having risen by 5.4% y/y in May, above both market consensus and our forecast (3.6 and 2.3% y/y, respectively). Despite a whole array of negative factors potentially weighing on Polish industry in May (working day count dropping from +1 to -1 y/y, their arrangement conductive for long weekends and high statistical base), output held surprisingly well. The strong momentum (+1.6% m/m) was enough to overcome the abovementioned factors. Furthermore, the rebound in industry appears to be broad-based and unrelated to any particular sector.

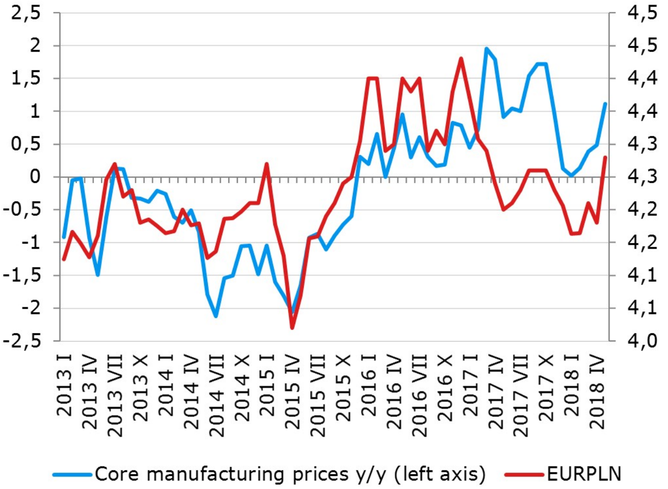



While industrial sentiment (as measured by Polish and German PMIs) remains modest, it is possible that the strong increase in output can be traced back to easing supply constraints on the European level. To confirm or invalidate such a hypothesis, we would have to wait several weeks. Additionally, the strong sold industrial output in May could be a result of manufacturers selling off their elevated inventories (as seen in Q1 GDP, inventory added 1.9 p.p. to GDP growth).

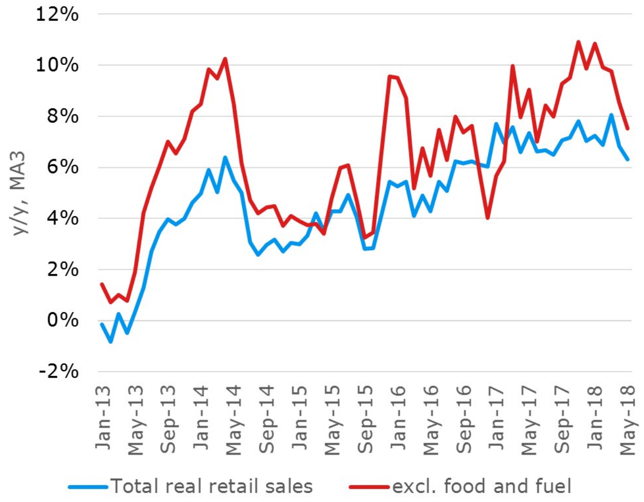
**Construction output** grew in May by a solid 20.8% on a yearly basis, beating market expectations but coming short of our optimistic forecast. Large part of this growth should be attributed to base effect from previous year, but this is not the whole picture. After seasonal adjustment monthly growth reached 2.6%, thus ending 3 months of contraction. As usual, we need to wait for the details until structure of GDP for the second quarter are published, however we can make some guesses. The reason for the rebound could be acceleration of local government investment before incoming local election. However, we expect this effect to cumulate in the third quarter (elections will be held late October or early November). Next month's release will not be boosted by base effects, so another decent figure will confirm upward trend in this category.



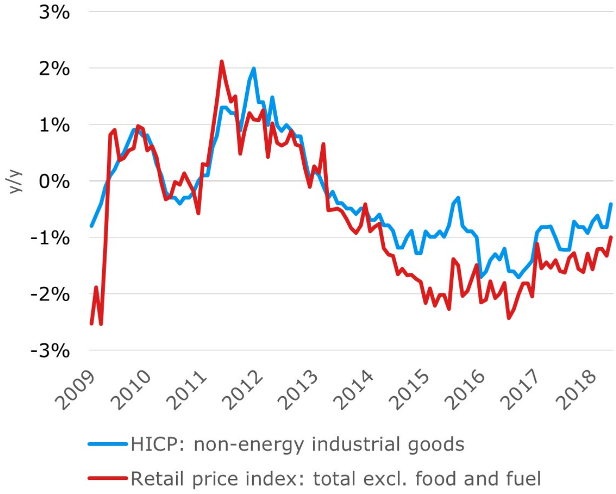

**Producer prices** went up by 2.8% y/y in May. The development was close to our forecast at 2.9% and owed much to energy. Stripping oil and coke prices, manufacturing „core" rose by 1.1% y/y and 0.5% m/m (half of the growth registered by the broader aggregate). We still see that even core prices are driven predominantly by exchange rate developments (see the graph). Next month is set to bring yet the last leg in the current spree of rising producer prices (target 3̃.5%). Afterwards the stabilization/pullback in oil prices and stabilization of exchange rate (especially via the USD) is set to keep the growth in producer prices in check. At least until firms claw back pricing power – so far nothing even close to such development is visibly; all is PLN driven.




**Retail sales** rose by 7.6% y/y in nominal terms and by 6.1% y/y in constant prices – close to market consensus, but somewhat above our forecast (5.3% y/y in real terms).




Quick review of the details of the release shows that the surprise vis-a-vis our forecasts can be traced back to a single category – cars, motorcycles and automobile parts. Instead of declining by a solid 9.3% y/y, it essentially remained flat on annual basis (-0.9% y/y), thereby not showing any outsized negative reaction to unfavorable working day count and arrangement of public holidays. Other categories came out very close to our expectations. Fuel sales accelerated from 13.8 to 18.9% y/y, entirely due to a price effect. Food sales and sales in other non-specialized stores (these two categories were the source of the major surprise in April) rebounded and are on their way towards normalization after the Easter-related slump (currently 5.6 and 7.2% y/y, respectively). Sales of durable goods decelerated a bit, driven by clothing and footwear (down from 13.7 to 4.7% y/y) – this category has likely suffered from high base effect and exceptionally warm Spring weather which pushed seasonal sales forward (to April). Finally, retail price indices accelerated, driven primarily by higher fuel prices and by the gentle uptrend in core retail sales. The latter is entirely consistent with core goods prices as shown by CPI / HICP data.



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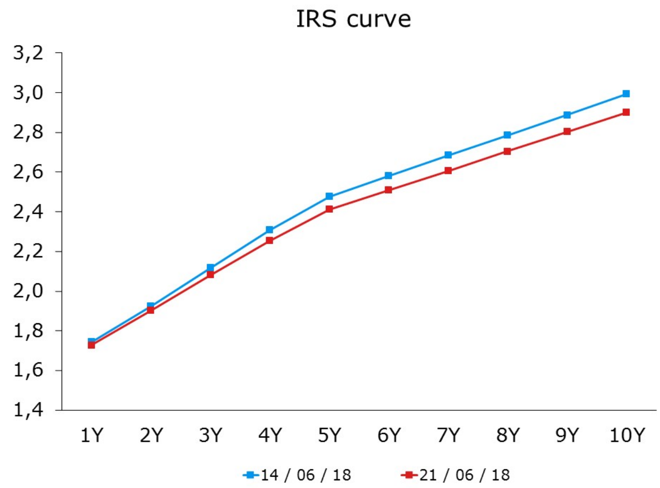
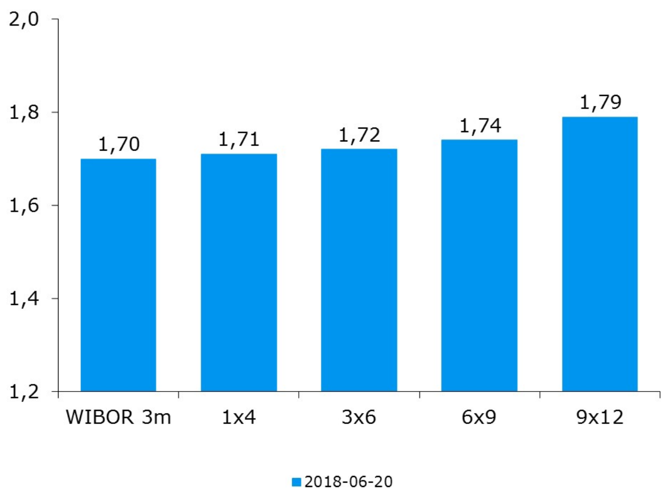
# Fixed income

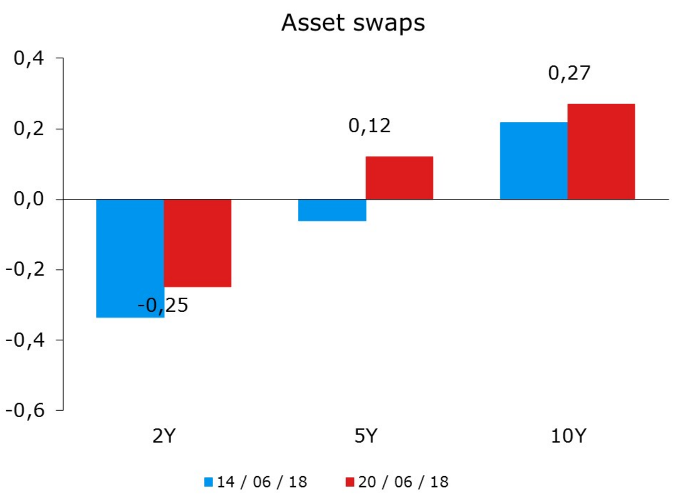
## Risk free assets?

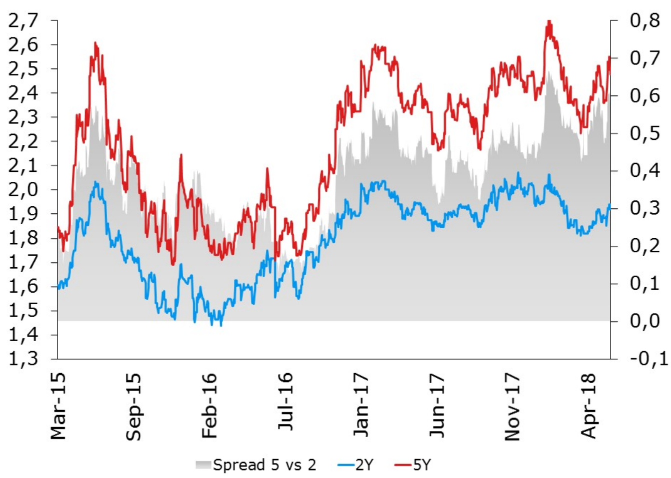
All risks have diminished. Supply in Poland will be limited during holidays, we expect only one auction a month. International players are buying POLGBs again and Polish clients are short. Curve is steep. June auction may be cancelled, so be prepared for it.

PS0123/5y is -6 bps, WS0428/10y is 25 bps. PS0123/WS0428 is 79 bps. WS0428/Bund is 279 bps. PS0420 is trading at 1.56% (2 bps up), PS0123 is trading at 2.35% (9 bps down) and WS0428 is trading at 3.14% (11 bps down).



## Money market

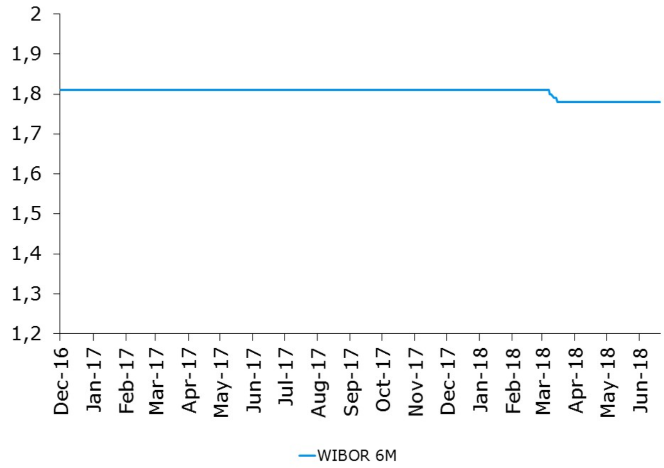
### Rock solid

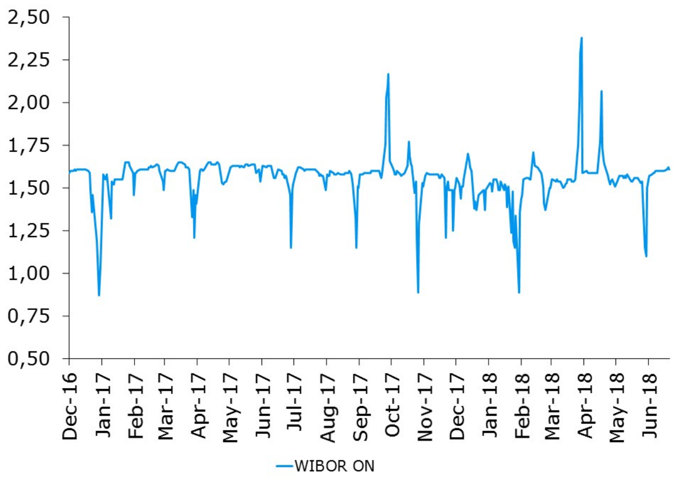
Last week Polish rates dropped in tandem with core rates. It was triggered by comments about trade war escalation between US and China. Polish assets and rates still remain resilient to global shocks and market continues to trade in range. We are currently in the middle of this range.

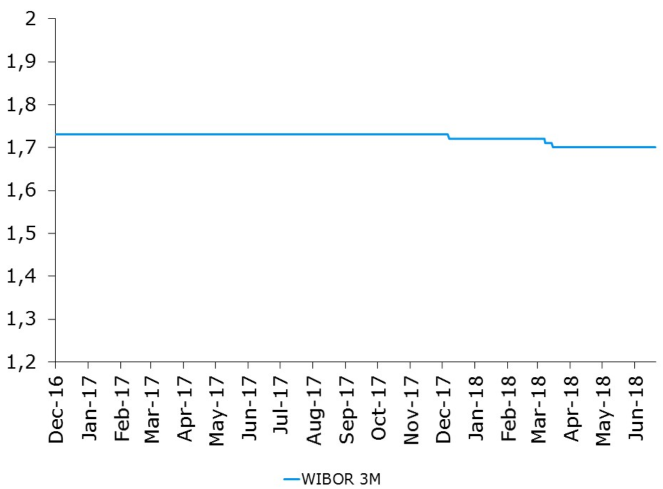
Cash was stable through the whole week. As we mentioned previously, the month's end is a bit tricky this time. We will have another OMO on the last day of the reserve period. This reduces the chances for a cheap end of the month.

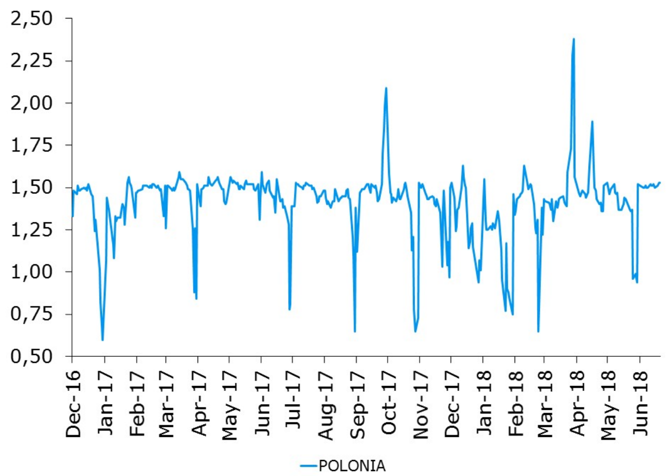
Ref rate vs Polonia averages:

| | |
|---|---|
| 30 day | 10 bps |
| 90 day | 1 bps |



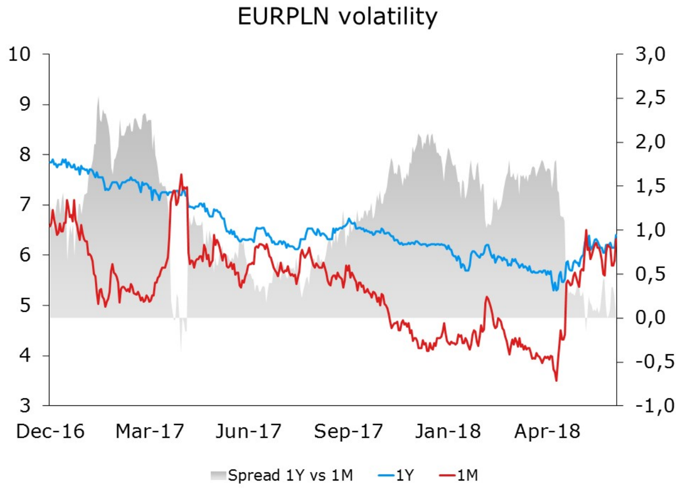



# Forex

**Spot – EUR/PLN higher** A super dovish ECB was not enough to strengthen CEE currencies and PLN was no exception. Strong USD against the EM is the decisive factor at the time. USD/PLN and EUR/PLN were both higher as a result. 4.2645 was the traded low EUR/PLN in the last 5 sessions and 4.3330 the high, for USD/PLN the levels are 3.6060 and 3.7620. We are aware of the rangy nature of EUR/PLN (roughly 4.26-4.34 at the moment), but that does not exclude the option of the range moving higher. EUR/PLN could be challenging the YTD high of 4.3400 and, if broken, potentially targeting next resistance zone around 4.39/4.41.




**Options – Volatility higher** The weaker PLN inevitably led to higher volatilities in EUR/PLN and USD/PLN. The frontend was an obvious winner as market participants rushed to cover their Gamma short. 1 month EUR/PLN ATM mid is at 6.4% (0.7% higher), 3 months are 6.4% (0.65% higher) and 1 year is fixing 6.45% (0.5% higher). The skew and the currency spread (difference between USD/PLN and EUR/PLN) are also higher.

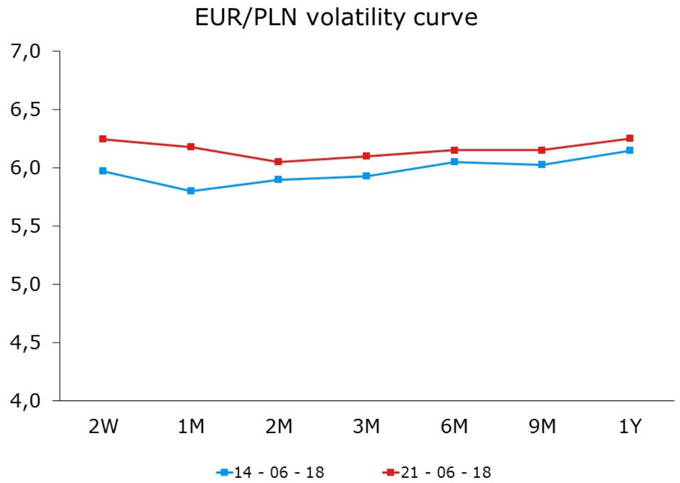
## Short-term forecasts

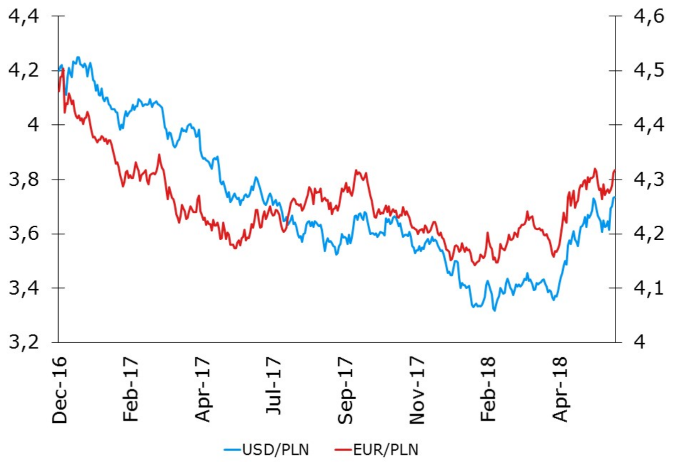
Main supports / resistances:
EUR/PLN: 4.2300 / 4.3500
USD/PLN: 3.6000 / 3.8000

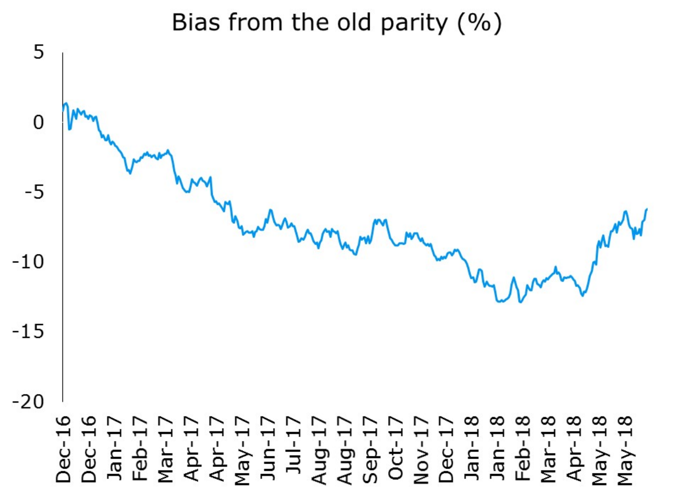
**Spot** Current position: Short EUR/PLN.

We are short EUR/PLN at 4.3050 and 4.3300, with 4.35+ stop loss and profit taking at 4.2600.

The 4.33/4.35 resistance zone seems to be a pivotal level. If it holds, we may revisit the levels below 4.30 relatively quick. On the other hand, a clean upward break-out would indicate possibility an extension to 4.39/4.40. Taking into account our current position, we are hoping for the former.



# 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 |
| 6/14/2018 | 1.58 | 1.70 | 1.64 | 1.68 | 1.67 | 1.72 | 1.71 | 1.73 | 1.75 | 1.80 | 1.88 | 1.83 |
| 6/17/2018 | 1.85 | 1.70 | 1.81 | 1.68 | 1.85 | 1.72 | 1.71 | 1.73 | 1.75 | 1.80 | 1.87 | 1.84 |
| 6/18/2018 | 1.84 | 1.70 | 1.95 | 1.68 | 2.01 | 1.72 | 1.71 | 1.73 | 1.75 | 1.80 | 1.85 | 1.84 |
| 6/19/2018 | 1.71 | 1.70 | 1.84 | 1.68 | 1.91 | 1.72 | 1.71 | 1.73 | 1.74 | 1.79 | 1.85 | 1.83 |
| 6/20/2018 | 1.87 | 1.70 | 1.97 | 1.68 | 2.06 | 1.72 | 1.71 | 1.72 | 1.74 | 1.79 | 1.86 | 1.82 |

| 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 |
| 6/14/2018 | 1.720 | 1.353 | 1.923 | 1.587 | 2.478 | 2.416 | 2.993 | 3.209 |
| 6/17/2018 | 1.720 | 1.357 | 1.930 | 1.576 | 2.485 | 2.439 | 2.995 | 3.239 |
| 6/18/2018 | 1.720 | 1.313 | 1.905 | 1.581 | 2.433 | 2.407 | 2.943 | 3.212 |
| 6/19/2018 | 1.720 | 1.374 | 1.910 | 1.648 | 2.425 | 2.549 | 2.925 | 3.193 |
| 6/20/2018 | 1.720 | 1.405 | 1.900 | 1.652 | 2.410 | 2.531 | 2.900 | 3.169 |

| EUR/PLN 0-delta stradle | | | | | 25-delta RR | | 25-delta FLY |
|---|---|---|---|---|---|---|---|
| Date | 1M | 3M | 6M | 1Y | 1M | 1Y | 1Y |
| 6/14/2018 | 5.80 | 5.93 | 6.05 | 6.15 | 6.15 | 1.45 | 0.53 |
| 6/17/2018 | 5.80 | 5.90 | 6.03 | 6.15 | 6.15 | 1.45 | 0.53 |
| 6/18/2018 | 5.90 | 5.95 | 6.03 | 6.15 | 6.15 | 1.45 | 0.54 |
| 6/19/2018 | 6.33 | 6.20 | 6.23 | 6.40 | 6.40 | 1.43 | 0.53 |
| 6/20/2018 | 6.18 | 6.10 | 6.15 | 6.25 | 6.25 | 1.46 | 0.52 |

| PLN Spot performance | | | | | | |
|---|---|---|---|---|---|---|
| Date | EURPLN | USDPLN | CHFPLN | JPYPLN | HUFPLN | CZKPLN |
| 6/14/2018 | 4.2757 | 3.6155 | 3.6782 | 3.2881 | 1.3304 | 0.1664 |
| 6/17/2018 | 4.2802 | 3.6922 | 3.7056 | 3.3410 | 1.3235 | 0.1663 |
| 6/18/2018 | 4.2887 | 3.7003 | 3.7130 | 3.3479 | 1.3291 | 0.1667 |
| 6/19/2018 | 4.3113 | 3.7316 | 3.7462 | 3.3971 | 1.3294 | 0.1670 |
| 6/20/2018 | 4.3171 | 3.7352 | 3.7470 | 3.3921 | 1.3364 | 0.1671 |

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