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Polish Weekly Review

Authors:

Ernest Pytlarczyk, PhD, CFA
chief economist
tel. +48 22 829 01 66
ernest.pytlarczyk@mbank.pl

Marcin Mazurek, PhD
senior analyst
tel. +48 22 829 01 83
marcin.mazurek@mbank.pl

Piotr Bartkiewicz
senior analyst
tel. +48 22 526 70 34
piotr.bartkiewicz@mbank.pl

Karol Klimas
analyst
tel. +48 22 829 02 56
karol.klimas@mbank.pl

Follow us on Twitter:

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Business contacts:

Department of Financial Markets

Wojciech Dunaj
head of interest rates trading
tel. +48 22 829 07 51
wojciech.dunaj@mbank.pl

Marcin Turkiewicz
head of fx trading
tel. +48 22 829 01 67
marcin.turkiewicz@mbank.pl

Department of Financial Markets Sales

Inga Gaszkowska-Gebska
institutional sales
tel. +48 22 829 01 67
inga.gaszkowska-gebska@mbank.pl

Jacek Jurczyński
head of treasury sales
tel. +48 22 829 15 16
jacek.jurczynski@mbank.pl

mBank S.A.

18 Senatorska St.
00-950 Warszawa
P. O. BOX 728
tel. +48 22 829 00 00
fax. +48 22 829 00 33
<http://www.mbank.pl>

Table of contents

Our view in a nutshell

Economics

■ June CPI disappointed due to slower fuel price growth

Fixed income

■ Wall of money coming in July

Money market

■ Stable week behind us

FX market

■ Spot – PLN fights back

■ Options – Vols sliding

page 2

page 3

page 4

page 5

page 6

Comment on the upcoming data and forecasts

On Wednesday the two-day MPC meeting will end. Obviously, rates will be put on hold, again. We also believe that the MPC's rhetoric will continue to be dovish, but it is unlikely to become more dovish. In addition, the post-meeting statement will contain the key conclusions from the NBP's latest staff forecasts. In our view, GDP projections will be raised again, especially for 2018. The resulting increase in GDP relative to potential will likely push core inflation higher in the near term and result in CPI inflation returning to target faster. However, the overall shape of projected GDP and CPI trajectories will be unchanged – GDP will converge to potential growth and CPI will stabilize slightly above target. On Friday, the CSO will release final CPI data. Due to the discrepancy between short-term data on fuel prices and the flash CPI reading, we see a strong likelihood of upward revision (to 2.0% y/y). Core inflation likely rose to 0.6%, as widely expected.

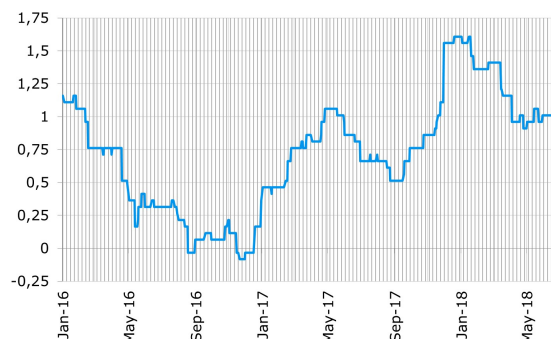
Polish data to watch: June 6th to July 13th

Publication	Date	Period	mBank	Consensus	Prior
MPC decision (%)	11.07	Q1	1.5	1.5	1.5
Final CPI y/y (%)	13.07	Jun	2.0	2.0	1.9

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	7/27/2018	20	1.637	5/24/2018
5Y T-bond PS1023	7/27/2018	1400	2.481	5/24/2018
10Y T-bond WS0428	7/27/2018	900	3.210	5/24/2018
30Y T-bond WS0447	7/27/2018	150	3.395	4/27/2018

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



Comment

Unchanged – CPI surprised to the downside, PMI to the upside and the two releases cancelled each other out. Unless flash CPI is revised, Polish surprise index will be stable next week.

* 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 4.8%. 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, rather benign 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 are fuel prices and stronger US dollar. 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, the MPC will keep its rhetoric in place. Weaker PLN has likely no impact on the MPC's discussions, since pass-through effect are seen as negligible. 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 (other than loose monetary policy) 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.
- Thus, we believe that stronger PLN can only be expected over the medium term. In the coming months PLN is set to depreciate further. In addition, weaker PLN will act as a pressure valve on exporters' margins squeezed by rapidly rising labor and commodity costs.

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	1.8	2.1
Current account (%GDP)	-2.1	-0.6	-0.3	0.2	-0.4	-0.8
Unemployment rate (end of period %)	11.4	9.8	8.2	6.6	5.6	5.0
Repo rate (end of period %)	2.00	1.50	1.50	1.50	1.50	1.75

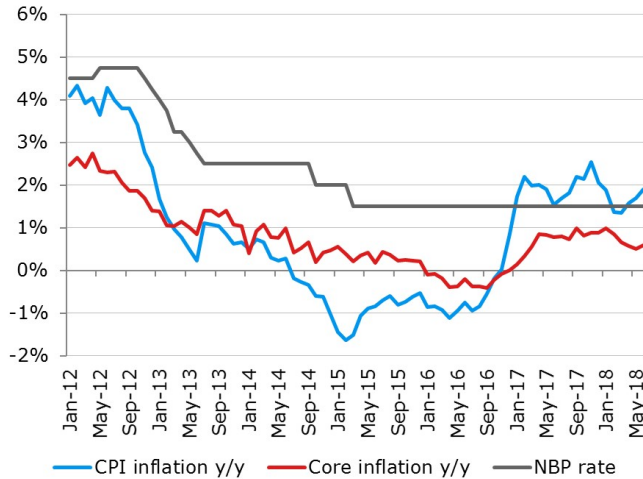
	2018	2018	2018	2018	2019	2019	2019	2019
	Q1	Q2 F	Q3 F	Q4 F	Q1 F	Q2 F	Q3 F	Q4 F
GDP y/y (%)	5.2	5.2	4.7	4.4	4.2	4.2	4.0	3.7
Individual consumption y/y (%)	4.8	4.8	4.6	4.2	4.0	3.8	3.8	3.8
Public Consumption y/y (%)	3.6	3.0	4.0	4.0	2.0	2.0	2.0	2.0
Investment y/y (%)	8.1	10.0	10.0	8.0	7.0	6.0	5.0	4.0
Inflation rate (% average)	1.5	1.7	2.1	1.7	2.0	2.3	2.0	2.2
Unemployment rate (% eop)	6.6	5.8	5.7	5.6	5.5	5.0	4.9	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	1.70	1.70	1.70	1.71	1.72	1.98
2Y Polish bond yields (% eop)	1.49	1.63	1.55	1.60	1.65	1.85	2.00	2.20
10Y Polish bond yields (% eop)	3.18	3.22	3.35	3.40	3.50	3.59	3.71	3.88
EUR/PLN (eop)	4.21	4.37	4.42	4.40	4.35	4.30	4.25	4.20
USD/PLN (eop)	3.42	3.74	3.78	3.73	3.64	3.55	3.47	3.39

F - forecast

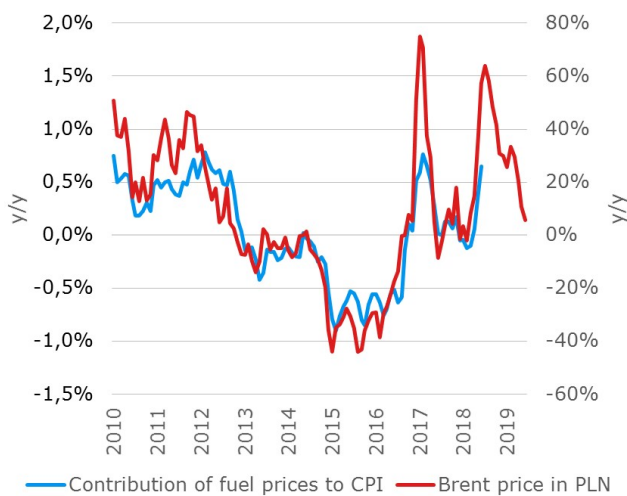
Economics

June CPI disappointed due to slower fuel price growth

In June CPI inflation rose from 1.7 to 1.9% y/y, a tad below market consensus and our forecast, both at 2% y/y.



Based on the details provided, the sole source of the surprise is slower fuel price growth. Instead of 2% m/m, as indicated by high-frequency data from gas stations, fuel prices rose by a mere 1.1% m/m. That this category surprised to such an extent, is a surprise itself. Historically, it was the easiest part of the CPI basket to forecast, and June's surprise is roughly 2.2 sigmas. Perhaps we're seeing payback after last month's print (which was above our proprietary fuel price gauge). Finally, if June print is revised closer to our forecast, headline inflation might be revised to 2.0% y/y. Other categories behaved almost precisely as expected: food prices declined by 0.2% m/m, while residential energy prices stayed flat on a monthly basis. Core inflation likely rose to 0.6% y/y, as expected (range derived from today's details is 0.5-0.7% y/y).



The latest reading does not change the overall picture of sluggish price processes in the Polish economy. Inflation is driven primarily by fuel prices and both July and August are set to post sizable increases, as indicated by current oil prices and USD-PLN. From September on, this category's contribution will gradually decline (see the graph above). We also forecast a gentle uptrend in core inflation, which is – to our surprise – driven mainly

by core consumer goods and not by consumer services. Unless services regain their time-tested sensitivity to wage growth or second round effects of current commodity price spike appear, the scope for acceleration in core consumer prices must be judged as limited. From the MPC's point of view, the data are broadly neutral for the mid-term inflation outlook and inflation is far from the danger zone. Moreover, its structure will likely be interpreted as „safe”, since there is no indication of mounting endogenous inflationary pressures in the Polish economy.

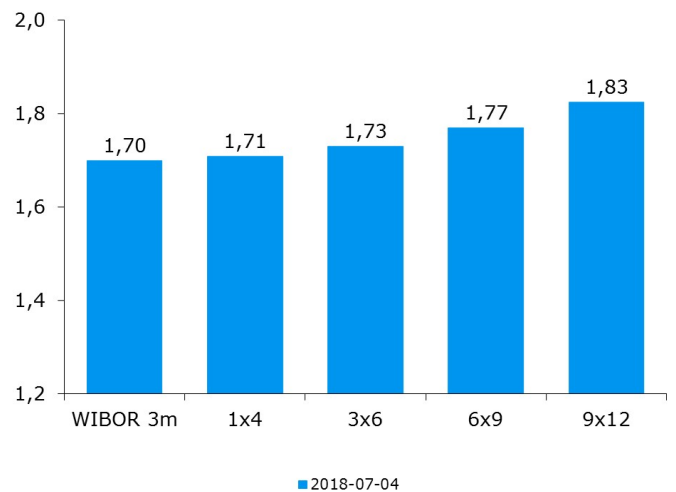
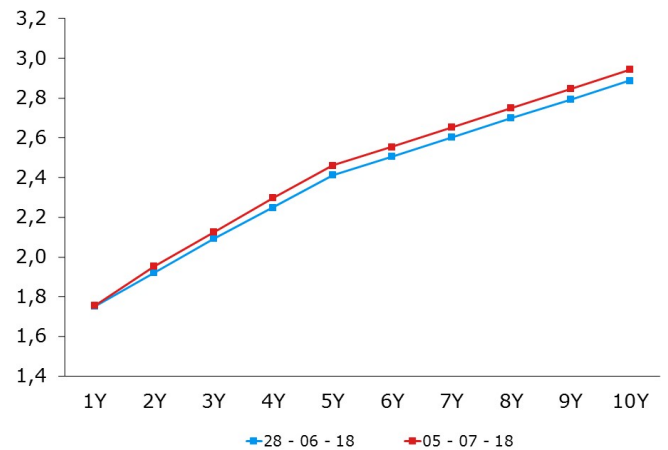
Fixed income

Wall of money coming in July

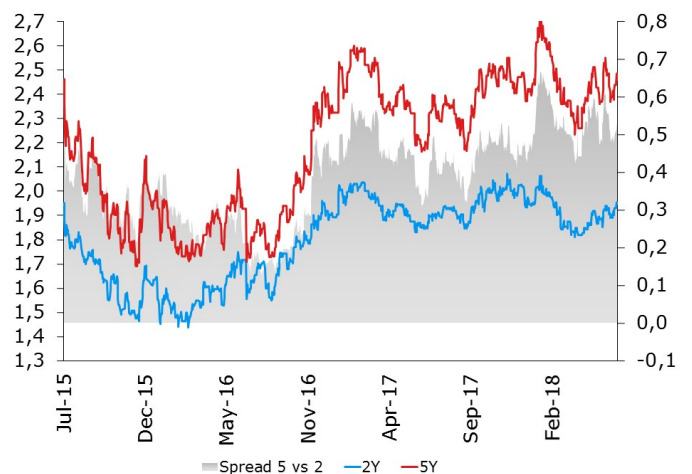
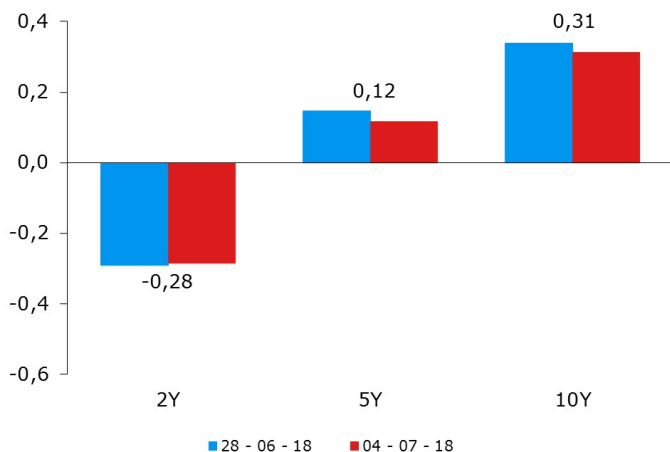
Volatile week behind us, but we finished unchanged. For us it was opportunity to receive some BPV. Supply in Poland will be limited and in July we will see huge cash flows into the POLGGB market, PS0718 plus coupons, PLN 17,1 bn total. ASW tightened, but FRNs didn't rally. It's possible that investors will try to capitalize on this divergence.

PS0123/5y is -8 bps, WS0428/10y is 24 bps. PS0123/WS0428 is 82 bps. WS0428/Bund is 290 bps. PS0420 is trading at 1,58% (1 bps up), PS0123 is trading at 2,4% (1 bps up) and WS0428 is trading at 3,22% (1 bps up).

IRS curve



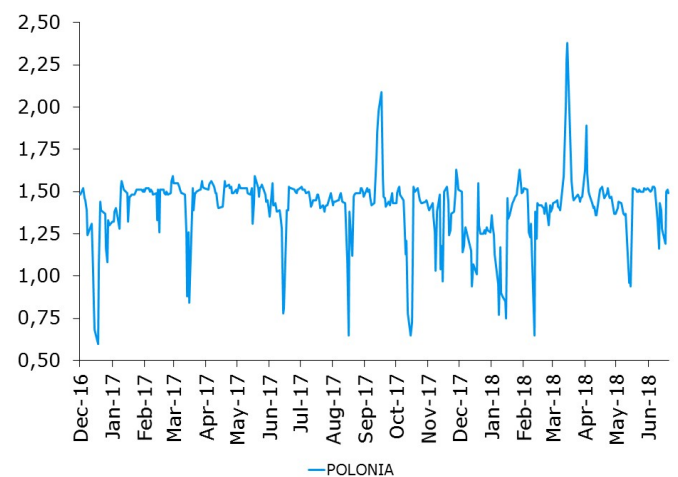
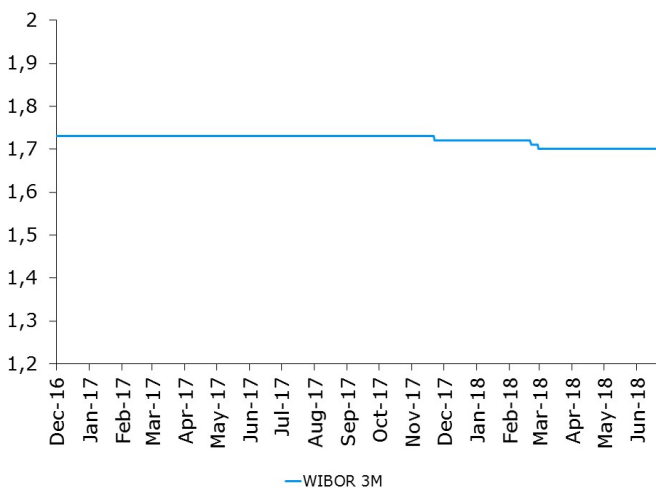
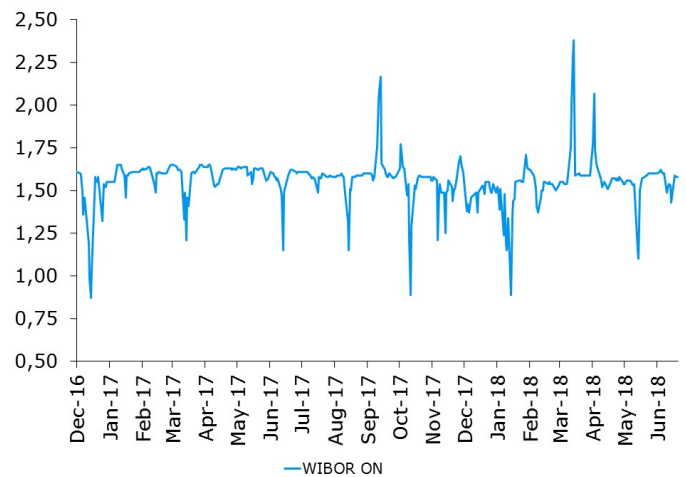
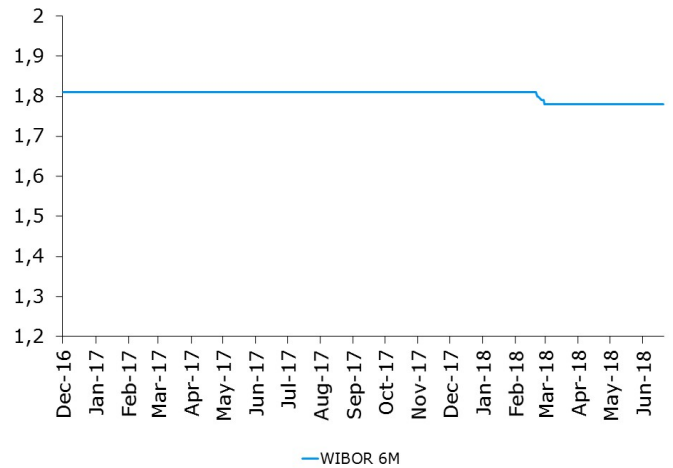
Asset swaps



Money market

Stable week behind us

This week was the first of mandatory reserve period and was very stable. As the last OMO was underbid, cash was a bit cheaper. Polonia fluctuated around 1.50% for the whole week. At Friday's OMO banks bought PLN 88,3 bn bills out of 106 bn offered (whereas 93 bn would have squared the market).



Forex

Spot – PLN fights back After hitting the 4,4130 top in EUR/PLN, the well-deserved correction lower is finally taking place. The 4.4100 level was tested twice, and both attempts ended in failure. The correction started with the slight improvement of the investment sentiment. Same applies to other asset classes, CEE currencies included, that regained some of its shine. The pace of the move was surprisingly fast, as liquidity is not good at all, and we touched 4.3490 low in the moment of writing. We think 4.32-4.39 should constitute the fresh range for the next few trading sessions.

Options – Vols sliding The spike in spot to 4,41+ was not really helping vols get any higher. 1 year EUR/PLN was given at 6.4% on the very same day, the skew was also immune to PLN deterioration. The 1 Y rr 25D was never any higher than 1.3% / 1.5%. In the end, 1 month EUR/PLN mid fixed at 6.25% (0.35% lower), 3 months are at 6.2% (0.2% lower) and 1 year is 6.3% (0.1% lower). The supply of vols is quite impressive, but on the other hand the holiday mood is slowly starting to get the upper hand.

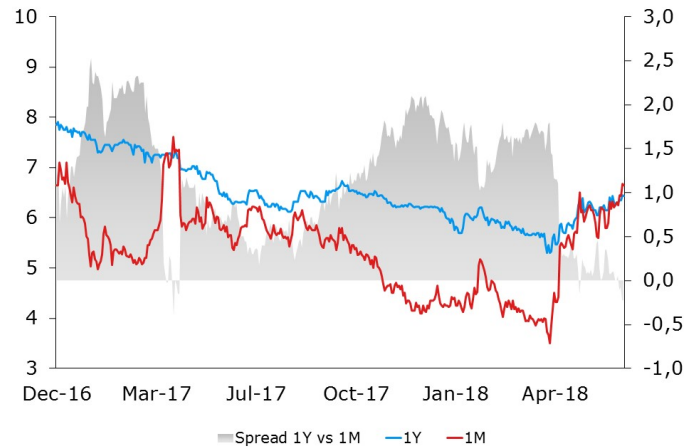
Short-term forecasts

Main supports / resistances:
 EUR/PLN: 4.3200 / 4.3900
 USD/PLN: 3.6000 / 3.9000

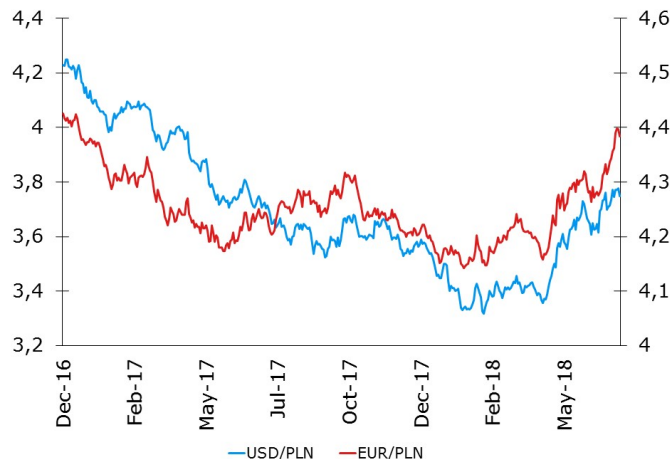
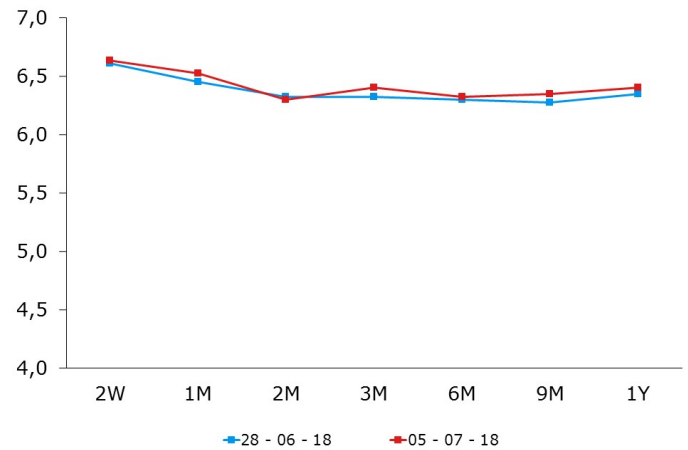
Spot Current position: None.

We keep our agile approach to trading EUR/PLN. The PLN-positive skew worked well, but getting closer to our 4.32 downside target we can even switch into a tactical PLN short. Our base case scenario is a range that will slowly move lower into the vacation period.

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
6/28/2018	1.85	1.70	1.93	1.68	1.97	1.72	1.71	1.73	1.76	1.81	1.87	1.84
7/1/2018	1.82	1.70	1.88	1.68	1.95	1.72	1.71	1.73	1.76	1.81	1.87	1.84
7/2/2018	1.80	1.70	1.86	1.68	1.96	1.72	1.71	1.73	1.77	1.82	1.88	1.86
7/3/2018	1.71	1.70	1.75	1.68	1.87	1.72	1.71	1.73	1.77	1.83	1.91	1.87
7/4/2018	1.83	1.70	1.86	1.68	2.00	1.72	1.71	1.73	1.77	1.83	1.91	1.86

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
6/28/2018	1.720	1.375	1.920	1.630	2.410	2.556	2.888	3.227
7/1/2018	1.720	1.392	1.932	1.631	2.438	2.541	2.918	3.212
7/2/2018	1.720	1.397	1.935	1.635	2.447	2.564	2.932	3.235
7/3/2018	1.720	1.421	1.955	1.666	2.487	2.634	2.978	3.303
7/4/2018	1.720	1.416	1.950	1.666	2.460	2.576	2.942	3.254

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
6/28/2018	6.45	6.33	6.30	6.35	6.35	1.52	0.53
7/1/2018	6.43	6.33	6.25	6.35	6.35	1.52	0.53
7/2/2018	6.68	6.43	6.40	6.45	6.45	1.46	0.55
7/3/2018	6.65	6.38	6.35	6.43	6.43	1.48	0.55
7/4/2018	6.53	6.40	6.33	6.40	6.40	1.48	0.55

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
6/28/2018	4.3566	3.7705	3.7764	3.4180	1.3276	0.1673
7/1/2018	4.3616	3.7440	3.7702	3.3808	1.3272	0.1683
7/2/2018	4.3899	3.7703	3.8019	3.4022	1.3303	0.1690
7/3/2018	4.3978	3.7723	3.7973	3.4002	1.3405	0.1682
7/4/2018	4.3969	3.7759	3.8027	3.4176	1.3469	0.1685

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