



July 26, 2018

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:

[@mbank_research](https://twitter.com/mbank_research)

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

■ Strong June retail sales figure underpins the key role of consumption in Polish GDP growth

page 2
page 3

Fixed income

■ MoF surprised the market with a bigger auction

page 4

Money market

■ Poor liquidity ahead

page 5

FX market

■ Spot – Consolidation continues

■ Options – EUR/PLN vols – a little lower

page 6

Comment on the upcoming data and forecasts

On Tuesday the CSO will publish the flash CPI reading for July. We expect CPI inflation to hold at 2.0% (although this forecast might change as we include more up-to-date information) as core inflation remains flat at 0.6% and the contributions of energy prices and food hold steady. On the next day Manufacturing PMI for July will be published. Based on the available data (CSO's sentiment indicators and European PMIs) we forecast a small decline in the index.

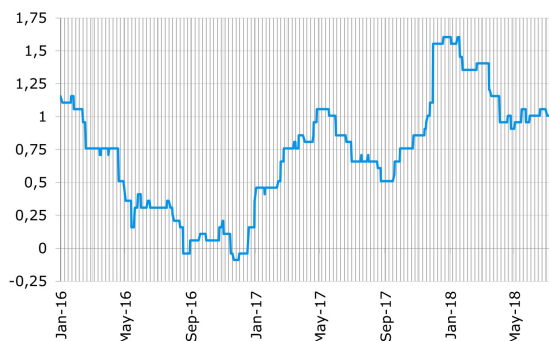
Polish data to watch: June 27th to August 3rd

Publication	Date	Period	mBank	Consensus	Prior
Flash CPI y/y (%)	31.07	Jul	2.0	2.0	2.0
Manufacturing PMI (pts.)	01.08	Jul	54.2		54.2

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

Retail sales trounced expectations and Polish surprise index rose yet again. Next week has exactly two opportunities to extend that trend – 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 at least 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

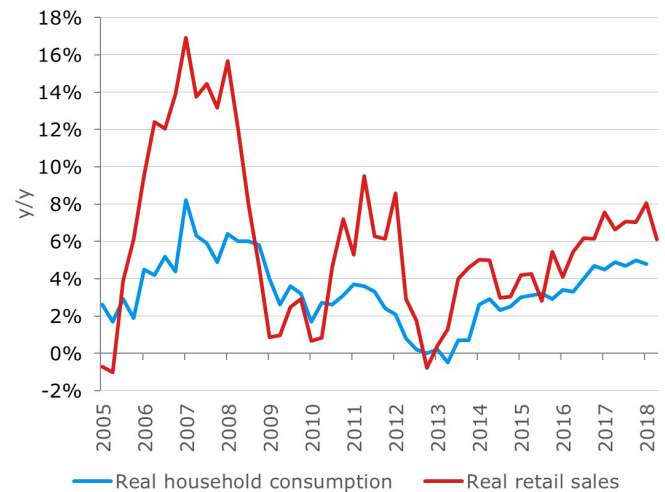
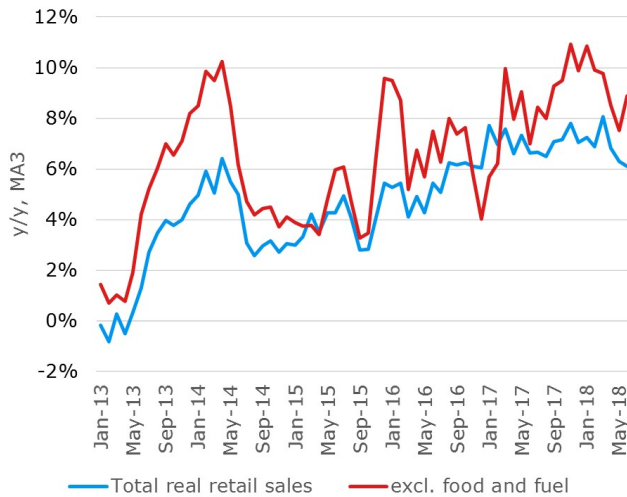
	2018 Q1	2018 Q2 F	2018 Q3 F	2018 Q4 F	2019 Q1 F	2019 Q2 F	2019 Q3 F	2019 Q4 F
GDP y/y (%)	5.2	5.3	4.7	4.4	4.2	4.2	4.0	3.7
Individual consumption y/y (%)	4.8	4.8	4.6	4.2	4.0	3.8	3.8	3.8
Public Consumption y/y (%)	3.6	3.0	4.0	4.0	2.0	2.0	2.0	2.0
Investment y/y (%)	8.1	10.0	10.0	8.0	7.0	6.0	5.0	4.0
Inflation 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

Strong June retail sales figure underpins the key role of consumption in Polish GDP growth

Retail sales rose by 8.2% y/y in constant prices and by 10.3% in nominal terms, beating market consensus by a wide margin (6.8 and 8.1% y/y, respectively). Our above-average forecast underestimated the surge in retail sales in June.



Solid June retail sales print still does not compensate for the poor, Easter-driven April numbers, so average Q2 sales have fallen short of Q1. However, this will translate into household consumption statistics only to a limited extent. We believe that consumption will remain the key driver of growth in the second quarter and in H2 as well. Growth in the range of 4.5-5% should be expected in every quarter of this year at least. Thus, the consensus view of the upcoming slowdown in consumption is set to be invalidated again.

The details of the releases indicate that there are three major sources of the surprise. First, car sales growth surprised to the upside, having accelerated from -0.9 to 6.7%, no doubt with high contribution of favorable working day difference. Food sales surprised to the upside, with annual growth matching the previous month's result (5.7 and 5.6% y/y). Finally, sales of furniture and household appliances surged from 6.5 to 15.1% y/y. It would be tempting to ascribe the latter to World Cup related purchases of RTV equipment, but we failed to note similar surges ahead of previous major sports events. Thus, it is more likely that we are observing second-round effects of housing boom as consumers are furnishing their newly received flats (number of completions peaked at the beginning of this year). It would also explain the on-going strength of the Other category, which we believe is driven by strong sales of building materials. Other categories of retail sales behaved in line with our expectations and overall durable goods sales growth has risen to double digits, making June one of the strongest months in the current cycle.

Fixed income

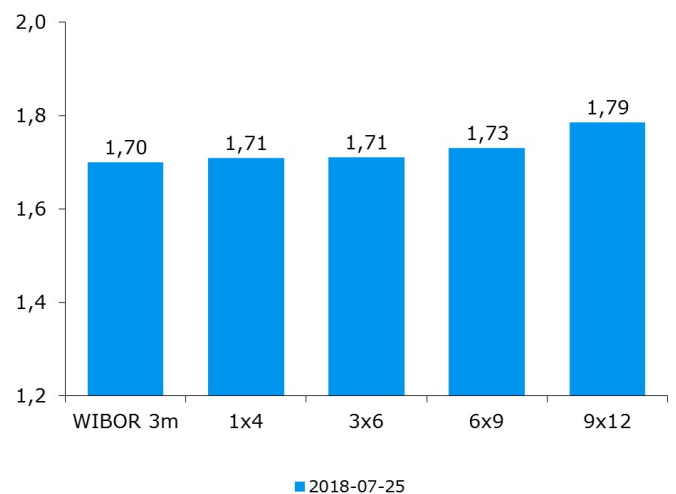
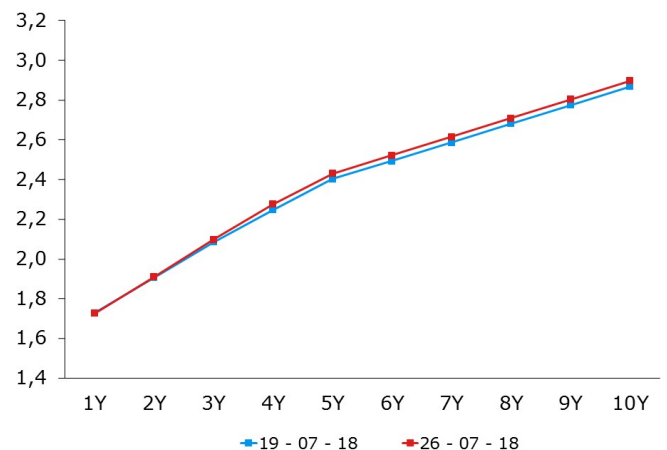
MoF surprised the market with a bigger auction

Yields are lower, but tomorrow there is an auction, with PLN 7 bn on the offer – it's much more than the market expected. Core markets are stable, supply in August will be limited (only one switching auction), investors might look at POLGBs more favorably, but only after the market is saturated with supply after the auction.

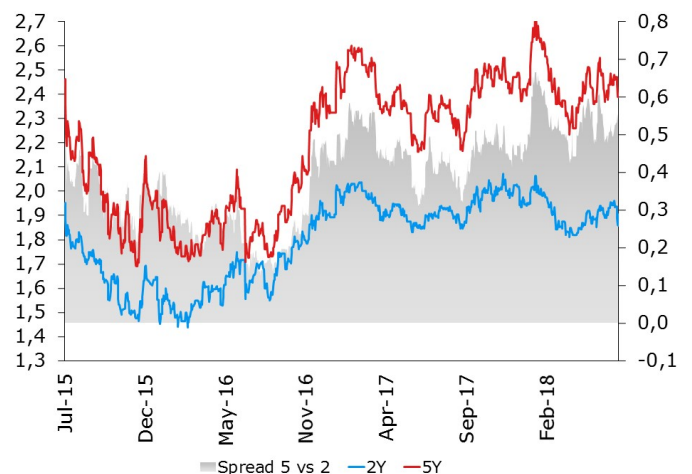
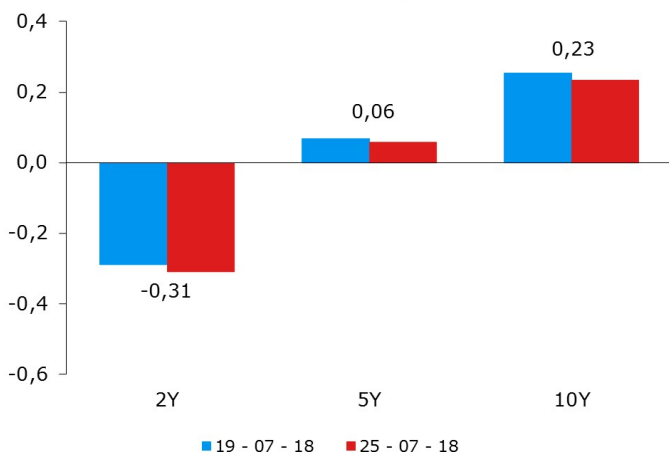
PS0123/5y is -11 bps, WS0428/10y is 22 bps. PS0123/WS0428 is 80 bps. WS0428/Bund is 273 bps.

PS0420 is trading at 1.55% (3 bps down), PS0123 is trading at 2.33% (7 bps down) and WS0428 is trading at 3.13% (9 bps down).

IRS curve



Asset swaps



Money market

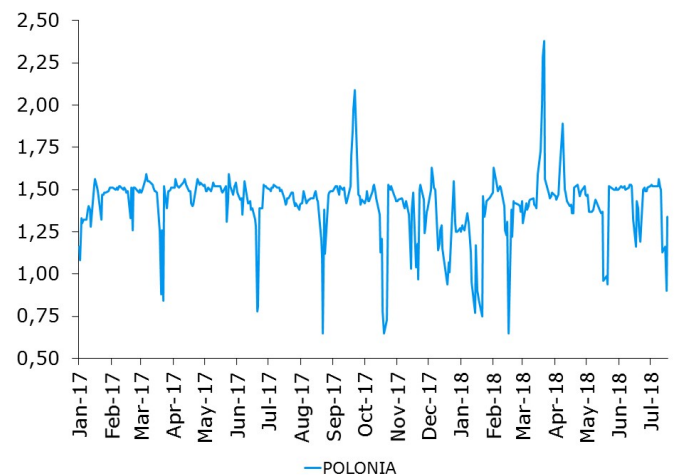
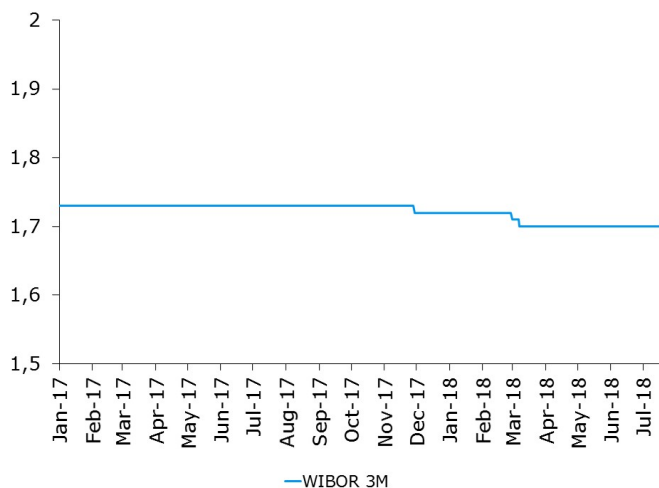
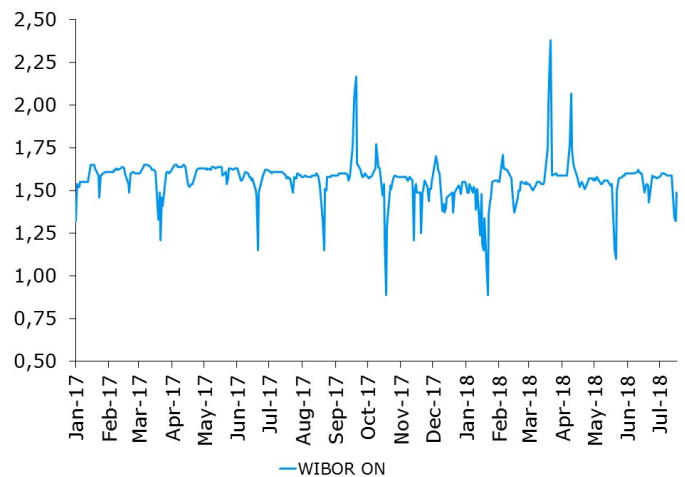
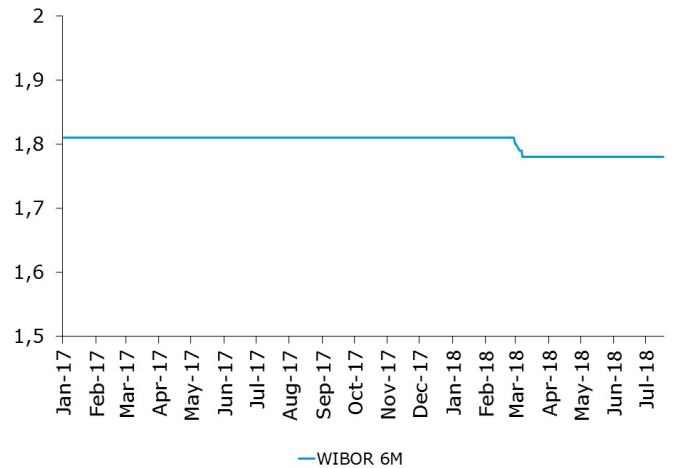
Poor liquidity ahead

Bonds recovered after the small sell-off caused by external factors. The Ministry of Finance announced a PLN 4-7 bn offer on the July 27th auction which feels a bit more than the market expected. Summer mood still persist, prices should stay in a range.

As one should have expected, coupon payments and redemptions distorted short term liquidity. Cash was very cheap until the additional OMO on July 25th. Going into month end, the liquidity will be poor.

Ref rate vs Polonia averages:

30 day 6 bps
90 day 6 bps



Forex

Spot – Consolidation continues During the last 5 trading sessions, we had a spike in EUR/PLN to 4.3515 outside our trading hours, probably fueled by poor liquidity. Later Zloty was on the rise due to better risk sentiment. As a result, EUR/PLN was gradually falling, reaching as low as 4.2850 at the moment of writing this comment. Fundamentally, the EM world is currently pushed and pulled around by USD fluctuations, and PLN is no exception. With USD being tic softer (EUR/USD above 1.17), there is a chance of EUR/PLN chewing through the 4.28-4.30 support zone. As a result, the range may shift lower, to 4.26-4.33, from current 4.29-4.36.

Options – EUR/PLN vols – a little lower The EUR/PLN vol curve melted a little as spot was really calm and there is no certain volatility trigger on the horizon. EUR/PLN ATM mid is today 5.85% (0.05% lower), 3 month is 5.9% (0.1% lower) and, finally, 1 year fixed at 5.9% (0.1% lower). The skew is at the same level as a week ago. The currency spread (difference between USD/PLN and EUR/PLN) is also lower and fixed at 3.75-4.25% (USD/PLN vol is higher).

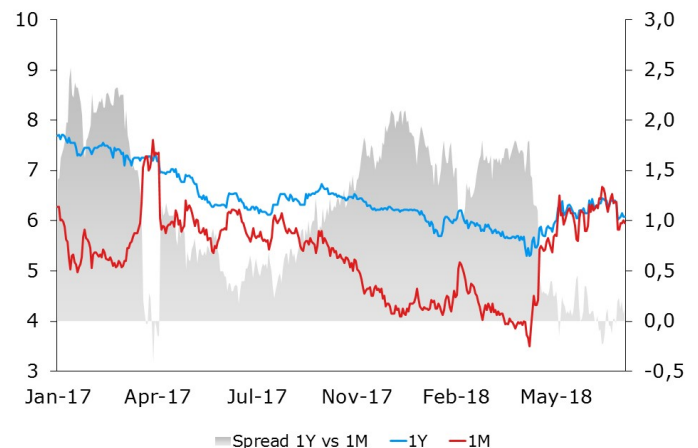
Short-term forecasts

Main supports / resistances:
 EUR/PLN: 4.2600 / 4.3600
 USD/PLN: 3.5500 / 3.8500

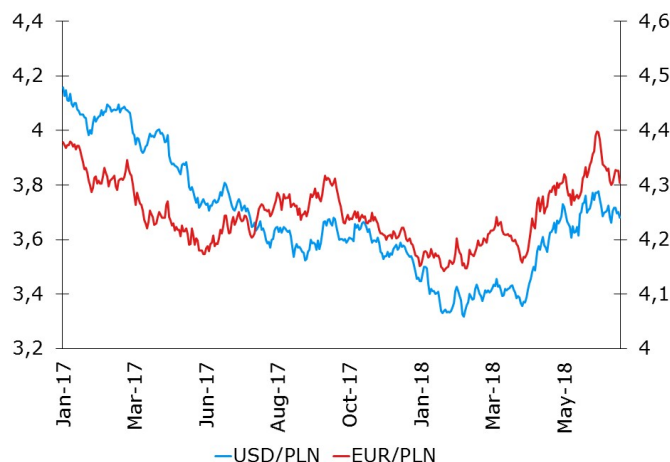
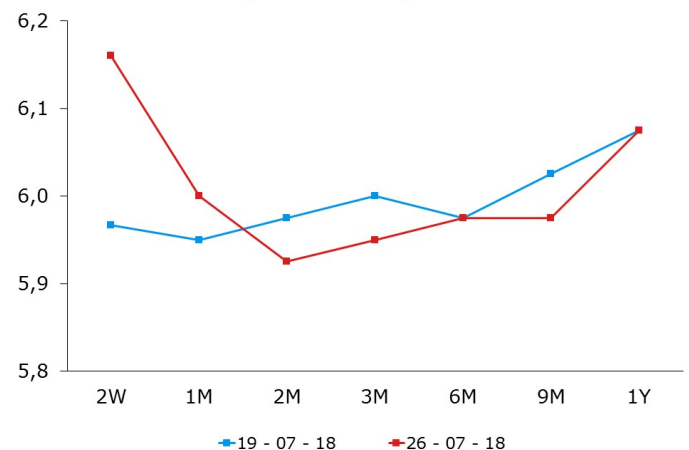
Spot Current position: None.

We still keep our agile/opportunistic trading style, looking for range trading in a wider, 4.26-4.36 range. Fading the spike in EUR/PLN paid off nicely. All eyes on the USD and listening carefully to what Mr. Draghi will have to say at the ECB conference.

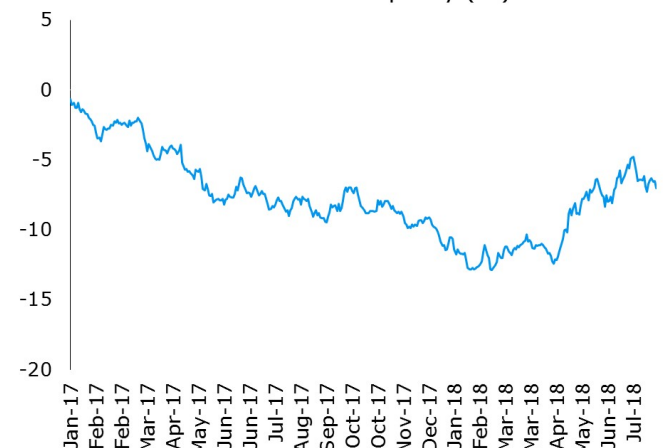
EURPLN volatility



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
7/19/2018	1.84	1.70	1.90	1.68	2.03	1.72	1.70	1.71	1.72	1.77	1.86	1.81
7/22/2018	1.72	1.70	1.81	1.68	1.93	1.72	1.71	1.72	1.75	1.79	1.86	1.84
7/23/2018	1.82	1.70	1.81	1.68	2.02	1.72	1.71	1.71	1.73	1.79	1.88	1.82
7/24/2018	1.66	1.70	1.72	1.68	1.86	1.72	1.71	1.72	1.74	1.79	1.85	1.81
7/25/2018	1.82	1.70	1.90	1.68	2.04	1.72	1.71	1.71	1.73	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
7/19/2018	1.720	1.414	1.905	1.616	2.403	2.471	2.868	3.122
7/22/2018	1.720	1.420	1.920	1.630	2.438	2.529	2.895	3.168
7/23/2018	1.720	1.364	1.930	1.643	2.452	2.539	2.918	3.183
7/24/2018	1.720	1.379	1.920	1.637	2.450	2.528	2.908	3.179
7/25/2018	1.720	1.354	1.910	1.601	2.430	2.487	2.895	3.128

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1Y	1Y
7/19/2018	5.95	6.00	5.98	6.08	6.08	1.48	0.55	0.55
7/22/2018	5.95	5.95	6.03	6.15	6.15	1.48	0.55	0.55
7/23/2018	6.00	5.95	5.98	6.08	6.08	1.50	0.59	0.59
7/24/2018	5.95	5.90	5.98	6.08	6.08	1.49	0.56	0.56
7/25/2018	6.00	5.95	5.98	6.08	6.08	1.48	0.56	0.56

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
7/19/2018	4.3155	3.7163	3.7121	3.2904	1.3272	0.1668
7/22/2018	4.3275	3.7170	3.7199	3.3053	1.3278	0.1672
7/23/2018	4.3262	3.6957	3.7271	3.3263	1.3272	0.1671
7/24/2018	4.3256	3.7020	3.7230	3.3278	1.3236	0.1677
7/25/2018	4.3035	3.6793	3.7070	3.3085	1.3216	0.1677

Disclaimer

Note that research@mbank.pl is an e-mail address used exclusively for the distribution of mBank's publications. We advise to reply and send feedback directly to their authors.

The document has been drafted at the Investor Relations, Group Strategy and Macro Research Department of mBank S.A. for the purpose of promotion and advertising in line with Article 9 (1) of the Regulation of the Minister of Finance dated 24 September 2012 on the Mode and Conditions of Conduct of Investment Firms, Banks referred to in Article 70 (2) of the Act on Trading in Financial Instruments, and Custodian Banks (Journal of Laws of 2015, item 878, as amended). The document does not constitute investment research or marketing communication within the meaning of Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive. The document does not constitute investment advice, nor is it an offer within the meaning of Article 66 (1) of the Polish Civil Code.

The document has been drafted based on the authors' best knowledge, supported by information from reliable market sources. All assessments herein reflect outlooks as at the date of issue of this material and may be subject to change at the discretion of the authors without prior notification. Quotations presented herein are average closing levels of the interbank market from the previous day, they are obtained from information services (Reuters, Bloomberg) and serve information purposes only. Distribution or reprint of the full text or a part of it is allowed only upon obtaining a prior written consent of its authors.

©mBank 2018. All rights reserved.