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Polish Weekly Review

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Comment on the upcoming data and forecasts

A busy week ahead of us. On Monday the NBP will publish balance of payments data for June. Somewhat contrary to the market consensus, we expect a modest current account surplus, driven by trade balance widening its surplus. On Tuesday Poland's statistical office will publish preliminary GDP data for the second quarter and final CPI data for July. In our opinion (again, an out-of-consensus one), the former will show another quarter of acceleration on a yearly basis (to 5.4% y/y), driven by higher net exports contribution and solid consumption and investment growth (4.8 and 9.0% y/y, respectively). CPI will most likely come out at 2.0% y/y, just as the flash release indicated. Wednesday is a public holiday in Poland. On Thursday the NBP will publish its core inflation data and we expect inflation net of food and energy prices to remain flat at 0.6% y/y (we might update it based on the SO's data). Finally, on Friday the SO will publish monthly labor market data. While employment growth likely fell a bit, wages have accelerated in July to a new cyclical high in y/y terms (from 7.5 to 8.0%).

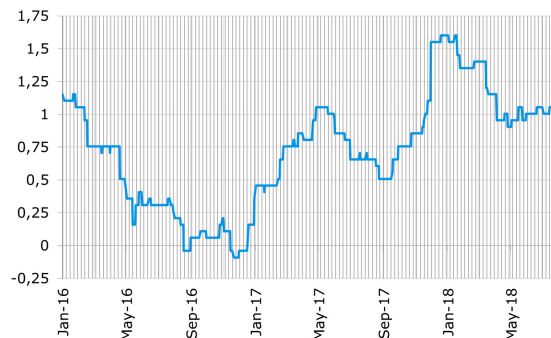
Polish data to watch: August 10th to August 17th

Publication	Date	Period	mBank	Consensus	Prior
Current account balance (m EUR)	13.08	Jun	450	-476	42
Exports (m EUR)	13.08	Jun	18100	17810	17251
Imports (m EUR)	13.08	Jun	17800	17827	17153
GDP y/y (%)	14.08	Q2	5.4	5.0	5.2
Final CPI y/y (%)	14.08	Jul	2.0	2.0	2.0
Core CPI y/y (%)	16.08	Jul	0.6	0.7	0.6
Average gross wage y/y (%)	17.08	Jul	8.0	7.7	7.5
Employment y/y (%)	17.08	Jul	3.6	3.6	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	8/23/2018	1000	1.592	7/27/2018
5Y T-bond PS1023	8/23/2018	2300	2.335	7/27/2018
10Y T-bond WS0428	8/23/2018	1300	3.144	7/27/2018
30Y T-bond WS0447	8/23/2018	180	3.495	7/27/2018

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



Comment

Unchanged (no publications). Next week brings a plethora of macro publications, from GDP through labor market data. Polish surprise index is set to move 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 at least 5%. 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 reach 2% in the summer, before dropping back towards 1.5% towards year end. The key driver are fuel and food prices. The former ceased to grow and base effects are considerable, the latter are 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.
- The relief rally in the PLN is likely over. Either risk off mood returns to the market, or optimism (and – along with it – interest rates) rises considerably. In either case the PLN will be impacted negatively. With the MPC dead-set on keeping rates low, the only path to stronger PLN runs through lower interest rate / easier monetary policy expectations globally.
- 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	5.0	4.1
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

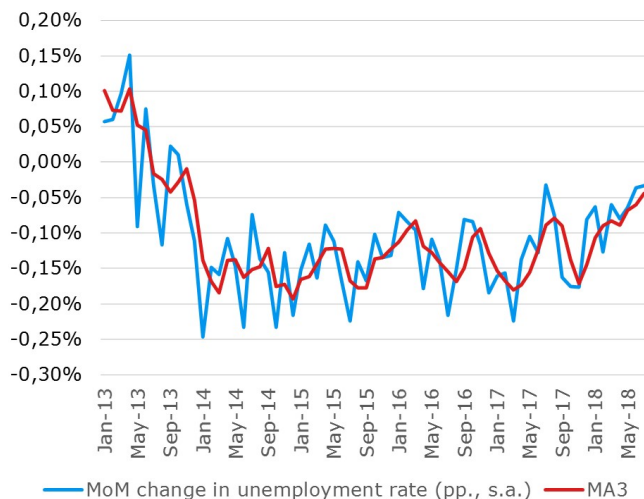
	2018 Q1	2018 Q2 F	2018 Q3 F	2018 Q4 F	2019 Q1 F	2019 Q2 F	2019 Q3 F	2019 Q4 F
GDP y/y (%)	5.2	5.4	4.8	4.7	4.4	4.2	4.0	3.7
Individual consumption y/y (%)	4.8	4.8	4.6	4.2	4.0	3.8	3.8	3.8
Public Consumption y/y (%)	3.6	3.0	4.0	4.0	2.0	2.0	2.0	2.0
Investment y/y (%)	8.1	8.9	8.5	7.0	7.0	6.0	5.0	4.0
Inflation rate (% average)	1.5	1.7	2.1	1.7	2.0	2.3	2.0	2.2
Unemployment rate (% eop)	6.6	5.9	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

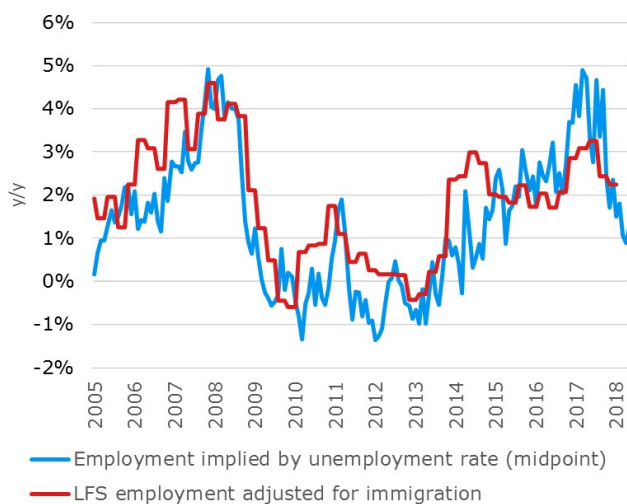
Economics

Unemployment rate appears to be bottoming out

According to the preliminary data published by the Ministry of Family, Labor and Social Policy, unemployment rate held steady in July at 5.9%. In seasonally adjusted terms there was a marginal decline, extending the current period of falling unemployment rate to 57 months. However, the downtrend in the unemployment rate has slowed down considerably this year (see the graph below) and there are two culprits.



First, the number of unemployed has not changed (in seasonally adjusted terms) since February. Second, the contribution of rising employment dropped to zero. Note that the latter number is not directly observed, but imputed from the rate and the level of unemployment. It has unclear origins (it is presumably based on both LFS and corporate employment statistics), but it has historically tracked broad-based employment growth quite well (see the graph below). Interestingly, the decline in employment growth seems to be real and associated with demographic issues and with a slowdown in immigration (it peaked in y/y terms in 2017, although it is still growing at a solid pace) – we use the Social Security Fund statistics on nonresidents' social security contributions to adjust LFS-based employment upward.



While employers have been scratching the bottom of the barrel for quite some time now, it seems that labor supply constraints

are increasingly binding for them. We remain skeptical of natural unemployment rate estimates due to its procyclical nature, but it should be obvious that the more employable an unemployed person is, the sooner he or she will be hired (therefore, there is negative selection). Some frictional unemployment must also exist and Poland has already one of the lowest unemployment rates in the EU and the OECD. As a result, further declines will be more modest. It coincides with another wave of wage acceleration, as seen in last month's numbers and the upcoming figures for July.

Fixed income

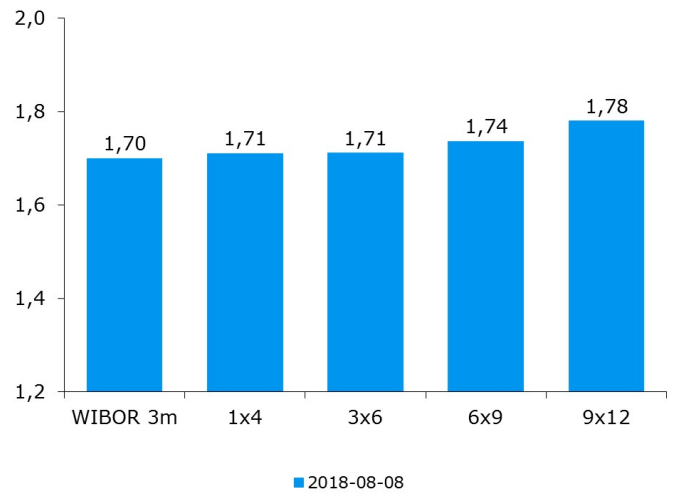
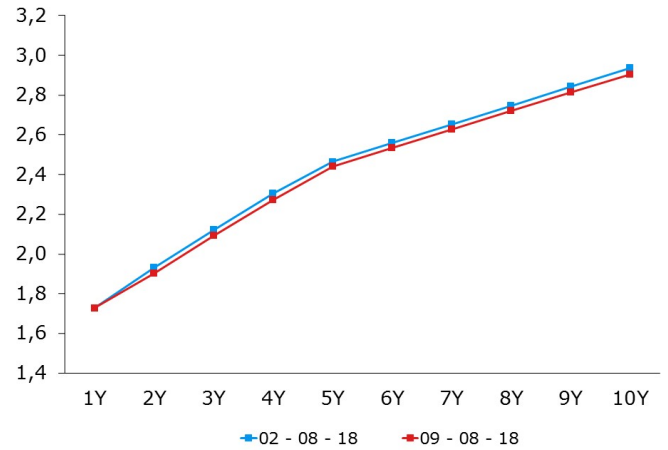
Grass is greener on this side

Polish bonds are in holiday mode. Turkey and Hungary are the main concern for EMs now. Poland is somewhere between EM and core markets, so it's completely quiet. ASWs are tight, curve is steep, FRNs have not kept up with ASWs, we are still close to 3% on UST (a crucial point for global markets).

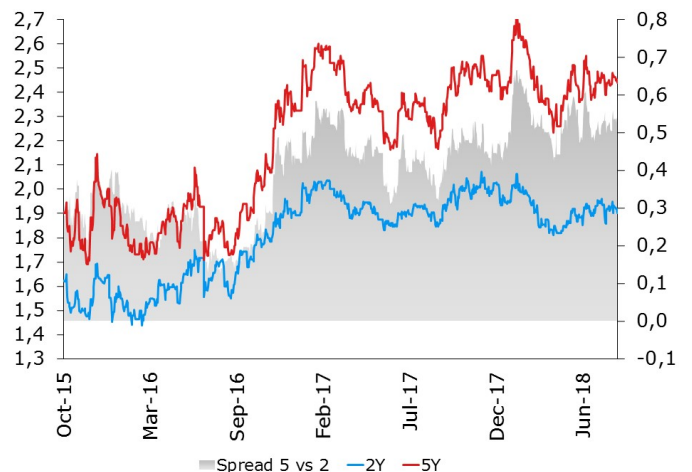
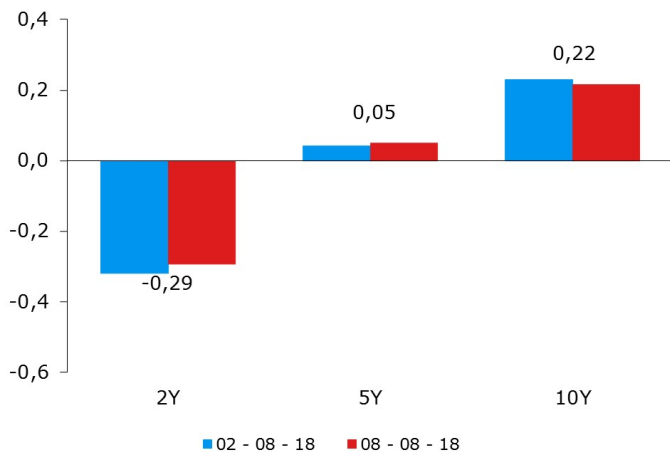
PS0123/5y is -14 bps, WS0428/10y is 17 bps. PS0123/WS0428 is 78 bps. WS0428/Bund is 269 bps.

OK0720 is trading at 1.58% (1 bps up), PS0123 is trading at 2.3% (4 bps up) and WS0428 is trading at 3.08% (4 bps down).

IRS curve



Asset swaps



Money market

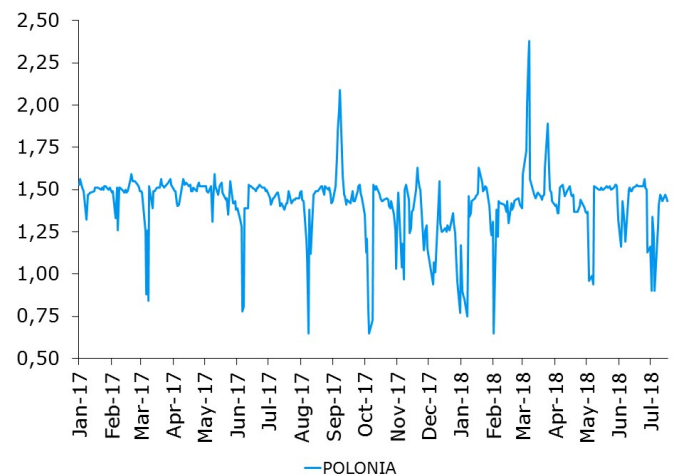
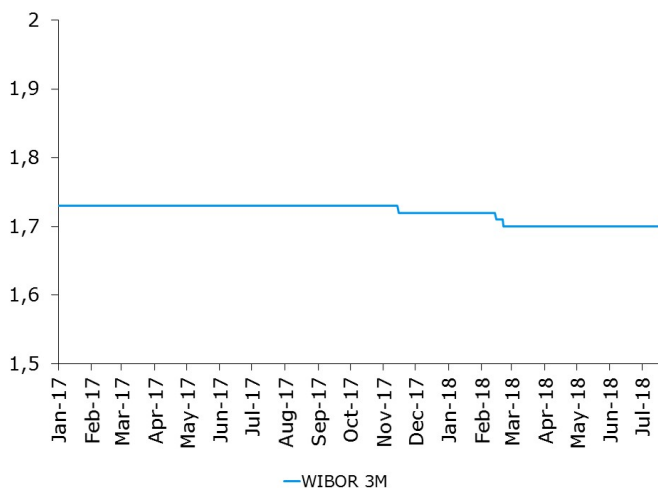
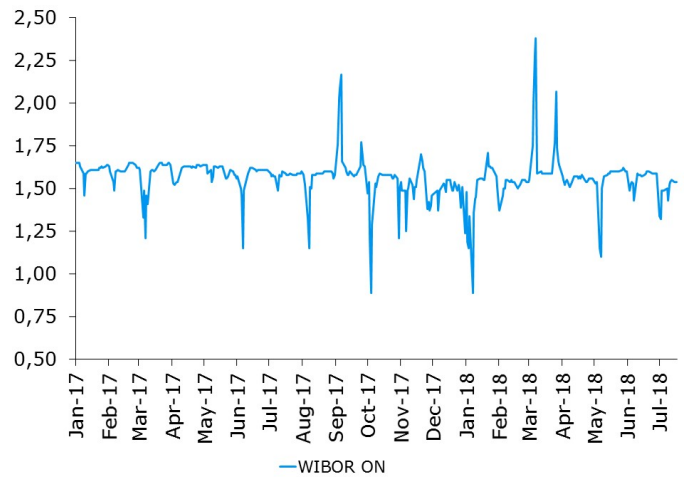
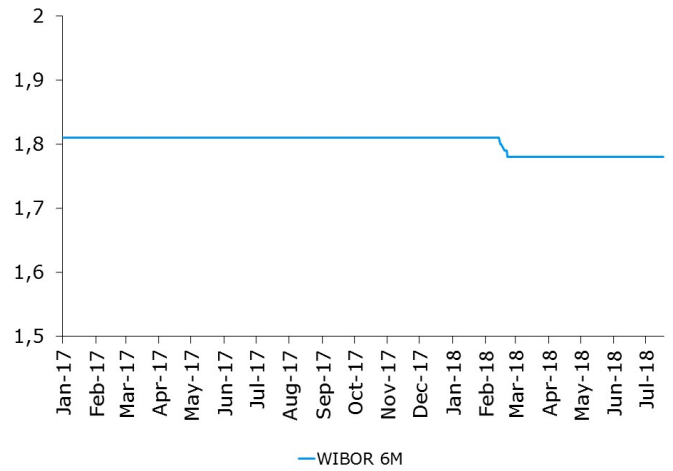
Summertime idleness

Summer mood persists on Polish asset markets. Activity and volatility is limited. With Turkish bonds colapsing again, we are trading on the strong side. We are getting closer to lower band of our trading band on swaps. 1y3m is trading as low as 1.74% – that’s very close to the level where no chances for rate hikes are priced in.

Cash remained on the soft side last week. Overnight rate stood around 1.45%. Tomorrow’s OMO will set the tone for next week. We have a bank holiday on the 15th, but that shouldn’t impact rates next week.

Ref rate vs Polonia averages:

30 day 15 bps
90 day 12 bps



Forex

Spot – EUR/PLN still at support Those were very dull 5 trading sessions, with EUR/PLN meandering aimlessly in a tight range (4.2465-4.2850). Technically, as long as EURPLN remains above the 4.24-4.26 support zone, we may expect a rebound to 4.30+, but the momentum is simply not there. Neither to produce the correction higher, nor to break through the support. As a result, the most likely scenario is a continuation of range trading, 4.24-4.30 should cover the price fluctuations for the next few days. By choice we have small PLN negative preference in our range trading strategies.

Options – trading water The realized volatility is still pretty low. However, the whole EUR/PLN implied volatility curve is quite stable. Today there were two big clips of 1 month EUR/PLN traded at 5.7% (in the morning) and at 5.85% (in the afternoon, with weaker Zloty). The curve is still a bit steeper. 1 month EUR/PLN atm mid is today at 5.85% (0.15% higher), 3 months are 5.9% (0.1% higher) and, finally, 1 year is fixing at 6.0% (unchanged). The skew was at the same level as week before. The currency spread (difference between USD/PLN and EUR/PLN) moved higher by around 0.25%. We noticed buyers of 6m and 1y USDPLN vega.

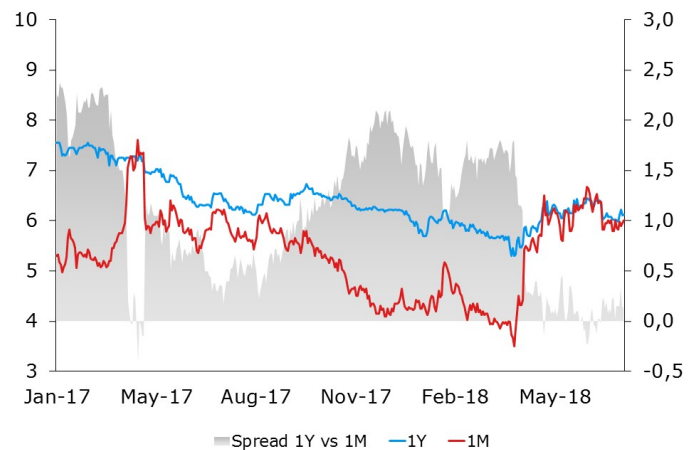
Short-term forecasts

Main supports / resistances:
 EUR/PLN: 4.2400 / 4.3400
 USD/PLN: 3.5500 / 3.8500

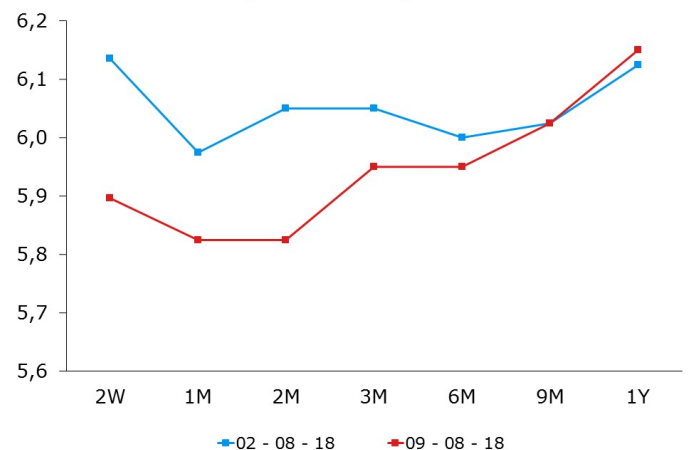
Spot Current position: Long EUR/PLN at 4.2700.

We are ready to add to the position at 4.2400 with 4.2250 stop and hopes to revisit 4.35. It is a technical / opportunistic trade, as we are looking for the 4.26-4.36 range to hold.

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
8/2/2018	1.81	1.70	1.93	1.68	2.00	1.72	1.70	1.72	1.75	1.79	1.86	1.82
8/5/2018	1.83	1.70	1.95	1.68	2.01	1.72	1.71	1.72	1.74	1.79	1.87	1.82
8/6/2018	1.82	1.70	2.01	1.68	2.08	1.72	1.71	1.71	1.74	1.79	1.88	1.83
8/7/2018	1.70	1.70	1.83	1.68	1.90	1.72	1.70	1.71	1.73	1.78	1.86	1.82
8/8/2018	1.78	1.70	1.90	1.68	1.99	1.72	1.71	1.71	1.74	1.78	1.85	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	7/27/2018	7/25/2020	96.91	1.59	1000	1780	1180
PS0123	7/27/2018	1/25/2023	100.68	2.34	2300	3260	2275
WS0428	7/27/2018	4/25/2028	96.71	3.14	1300	2133	1348

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0720	5Y IRS	PS0423	10Y IRS	WS0428
8/2/2018	1.720	1.362	1.930	1.611	2.465	2.507	2.935	3.164
8/5/2018	1.720	1.377	1.925	1.603	2.462	2.482	2.933	3.115
8/6/2018	1.720	1.372	1.920	1.594	2.447	2.494	2.913	3.122
8/7/2018	1.720	1.387	1.920	1.609	2.455	2.528	2.922	3.130
8/8/2018	1.720	1.362	1.900	1.607	2.440	2.490	2.905	3.120

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
8/2/2018	5.98	6.05	6.00	6.13	6.13	1.51	0.56
8/5/2018	5.90	6.00	6.00	6.23	6.23	1.51	0.56
8/6/2018	5.95	5.98	6.00	6.10	6.10	1.51	0.56
8/7/2018	6.00	6.05	6.03	6.13	6.13	1.48	0.56
8/8/2018	5.83	5.95	5.95	6.15	6.15	1.48	0.56

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
8/2/2018	4.2745	3.6783	3.6988	3.2972	1.3295	0.1672
8/5/2018	4.2758	3.6926	3.7118	3.3052	1.3312	0.1664
8/6/2018	4.2672	3.6920	3.7088	3.3196	1.3327	0.1664
8/7/2018	4.2554	3.6722	3.6896	3.3002	1.3316	0.1659
8/8/2018	4.2619	3.6782	3.6908	3.3139	1.3345	0.1665

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