August 23, 2018

Polish Weekly Review

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Comment on the upcoming data and forecasts

This Friday Statistics Poland (SP) will publish its monthly Statistical Bulletin. As usual, it will contain many details of this month's releases and shed some light on the sources of the surprises in wage and employment data. In addition, the final estimate of unemployment rate is set to confirm the Ministry of Family's preliminary reading of 5.9% (in line with market consensus). Next Friday, the SP will publish flash CPI and final GDP data. The former is set to post a stable or slightly lower y/y reading. In any case, CPI is set to peak this summer and decline towards the end of the year. The latter will likely confirm the flash reading of 5.1% y/y (although odds of a revision are quite high, historically speaking), but the details of the release will be much more interesting. We expect consumption to remains table on y/y basis (at 4.8%) and investment to accelerate slightly, to 9.3% y/y.

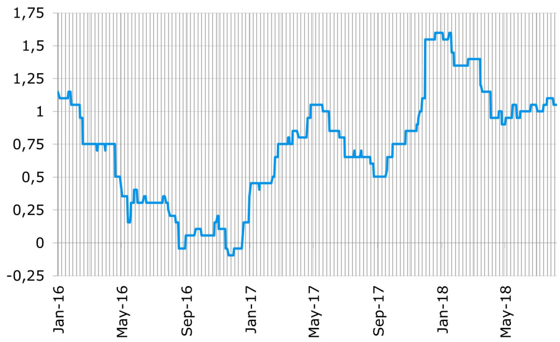
Polish data to watch: August 24th to August 31st

Publication	Date	Period	mBank	Consensus	Prior
Unemployment rate (%)	24.08	Jul	5.9	5.9	5.9
Flash CPI y/y (%)	31.08	Aug		2.0	2.0
GDP y/y (%)	31.08	Q2	5.1	5.1	5.1

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	9/10/2018	1000	1.592	7/27/2018
5Y T-bond PS1023	9/10/2018	2300	2.335	7/27/2018
10Y T-bond WS0428	9/10/2018	1300	3.144	7/27/2018
30Y T-bond WS0447	9/10/2018	180	3.495	7/27/2018

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



Comment

Unchanged – all of last week's macro releases failed to surprise significantly. Next days bring only limited opportunities for surprise. Unemployment rate will likely see the preliminary estimate (in line with market consensus) confirmed. Final GDP and flash CPI can surprise, but one should not treat this as assured.

* 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 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 likely peaked at 2% in the summer months and will drop back towards 1.5% by 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	5.1	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	4.35	4.35	4.35	4.30	4.25	4.20
USD/PLN (eop)	3.42	3.74	3.78	3.78	3.75	3.68	3.60	3.51

F - forecast

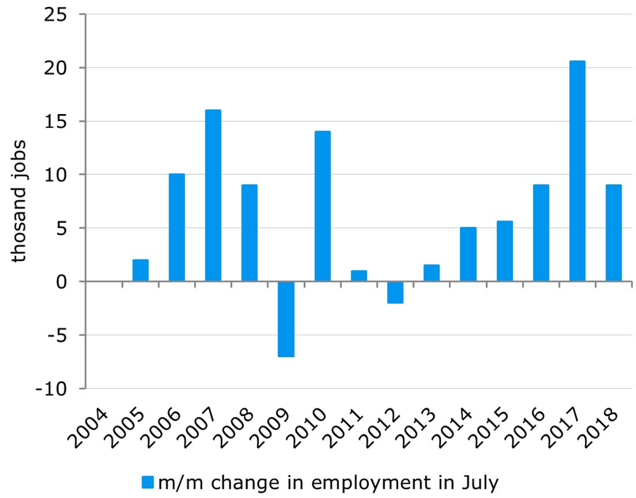
Economics

Strong growth continues

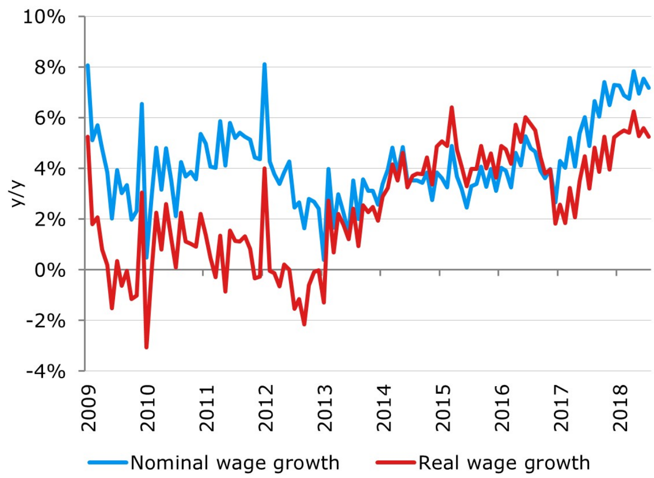
Real activity data for July have more or less come in line with expectations, any surprise must be deemed as insignificant. However, there are several conclusions to be drawn. First, the long-awaited peak in GDP growth most likely occurred in the first half of the year and subsequent readings are set to fall below 5% y/y. The average for the whole year should land at 4.9 or 5.0% y/y. Second, there are no new revelations regarding the structure of growth. Construction output growth, led to some extent by pre-election local government spending and constrained by supply issues, is no longer accelerating. In addition, there is still no evidence of a sustained rebound in machinery spending and investment by private enterprises (recent data on corporate investment for Q2 make this point abundantly clear, in our view). In addition, household consumption continues to be the key engine of growth, with solid consumer spending (including durables and building materials), sky-high sentiment and real wage bill decelerating just barely. At the same time, apart from the spatially correlated surprise in hard data on European industry in Q2, there is no sign of a rebound in economic activity in the euro area in Q3. Export-led expansion it ain't. All in all, the scenario that the vast majority of economy watchers have been expecting for some time now, seems to materializing. The MPC will take note and only resurgent inflation has the potential to upend the dovish status quo in the Council.

As usual, our take on last week's data can be found below.

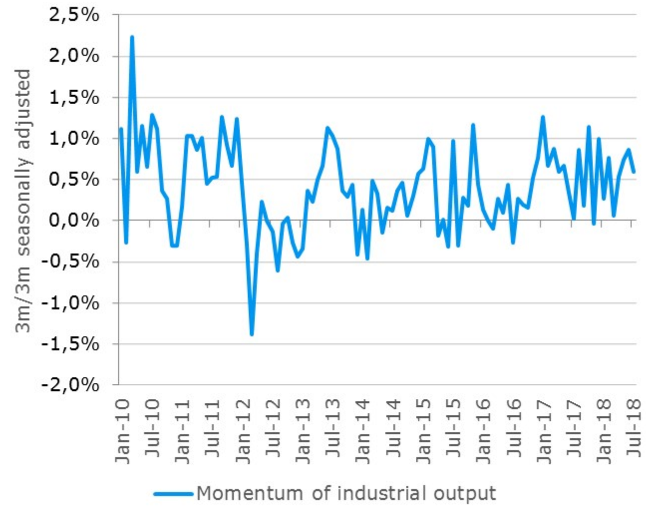
Employment in the enterprise sector rose in July by 3.5%, a tad lower than market consensus and our forecast. On a monthly basis exactly 9k jobs were created, same result as two years ago. It was clear that last year stellar result (growth by more than 20k, an all-time high) will be difficult to repeat, however this release did not live up to temperate expectations. It missed an even lower result (3.4%) by a margin of 1.5k jobs. Details will be published in a week, so we can only speculate about the reasons for this surprise. Momentum in manufacturing could have weakened even more, while last month's surprising growth in sectors like trade and transportation could have been even reversed. We would like also to remind our readers that last year's growth was boosted by a section (administrative and supporting services), which is stagnant this year. General picture remains unchanged. Lack of skilled workers and lower influx of migrants from Ukraine will be prolonging time to fill vacancies, thus dampening employment growth in the following months.



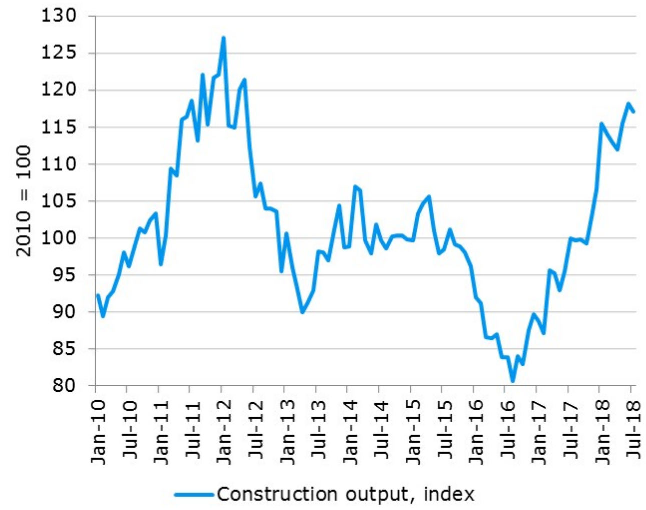
In July **average gross wage** decelerated from 7.5 to 7.2% y/y, below market consensus and our forecast (7.6 and 8.0, respectively). As usual, detail of the release will become available in a week, but we have some conjectures. Our forecast assumed that almost all key sectors saw their wage growth perk up, while mining wage growth remained high after a few months of strong readings. If the latter behaved differently (i.e. swung into negative territory in y/y terms), it would explain most of the surprise. Taking a broader look, one should note that wage growth stabilized (in nominal terms) around 7% y/y. In the coming months real wage growth will be supported by falling inflation, while the decline should also keep inflation expectations and wage demands in check. Solid wage and wage bill growth (the latter is still rising by 11% nominally and 9% in real terms) continue to underpin fast consumption growth. As we have insisted for many months, household consumption will not slow down measurably in the second half of this year.



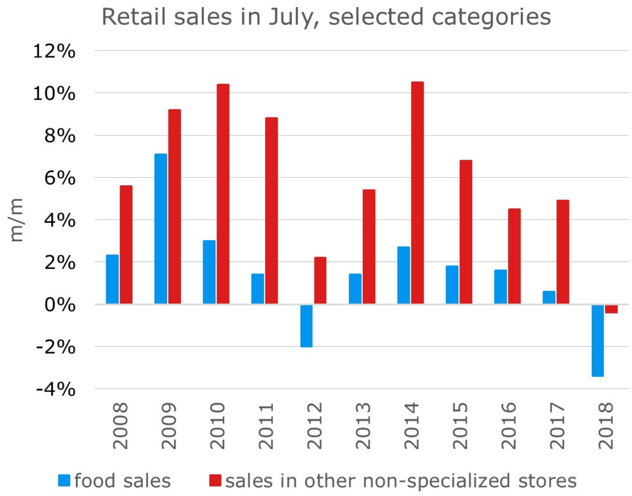
Industrial output rose by 10.3% y/y in July (market consensus 9.6%, our forecast 11.3% y/y). The sizable acceleration vis-a-vis the previous month's reading is a result of favorable calendar (working day count rose from 0 to +1 y/y) and low base – the latter factor's estimated impact is ca. 1.5 percentage points. Adjusted for calendar and seasonal effects, industrial output was unchanged on a monthly basis. The momentum simply isn't there (see the graph below). Furthermore, industrial production continues to be boosted by strong energy output driven by high temperatures – in July it rose by 15.9% y/y. In all likelihood July marks the top in IP growth in annual terms. In the coming months calendar and base effects will drive it lower and lower. From the fundamental side, the looming downtrend in industrial output growth can be associated with weaker demand from Western European trading partners and stabilization of domestic demand – construction output will at best stabilize in y/y terms.

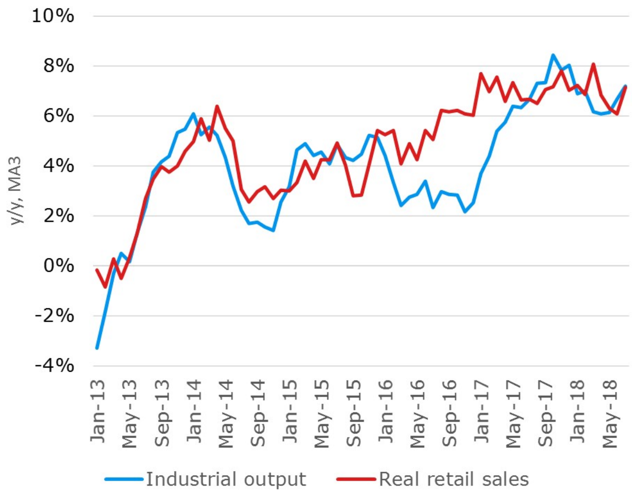


Construction sector grew by in July 18.7% on y/y, below market consensus (22.3%), but close to our forecast (19.6%). On a monthly basis, after seasonal adjustment, it contracted by 1%, thus ending two-months period of solid growth (ca 2.5% m/m). However, two factors are here mainly to blame. Firstly, statistical basis after a stellar release last July (ca. 5 pp.) and secondly election calendar. Incoming local government elections boosted previous releases, leaving a hole afterwards. This could be inhibiting growth in the next few months. We still need to remember that growth in the next months could be retracted also by bottlenecks – labor shortages and failed tenders for public investment (due to unrealistically low prices). In addition, residential construction appears to be peaking as well, with both housing starts and permits coming off its decadal highs considerably in recent months.



Retail sales growth amounted to 9.3% y/y in July, a bit off the official consensus (9.7%) and a bit more off our forecast (10%). The disappointment is small, though, as the downside surprise in food sales (and hypermarket sales) was balanced by higher growth of auto sales (>10% y/y). Overall, core retail sales (see the graph) stayed unchanged that supports expectations of high consumption growth in the quarters to come. Strong labor market, rising consumer sentiment and low leverage are still the same arguments in favor of such development. Digging a bit more, food retail sales drop coincided with the same behavior in hypermarket sales. It seems the driver is the same (yet unknown). It is tempting to blame trade-free Sundays as GUS monitors only entities with staff exceeding 9 persons but it is rather unlikely that the lost sales went under the radar in small local stores given the widespread stories of their worsening condition and the fact that the "other" category (including hypermarkets dealing with building materials) behaved rather in a normal way (and those entities were also closed on trade free Sundays). It is more likely than not that surprising drop in food-related retail sales in only an outlier, carries no additional information and will be made up in August. We'll see. As written, strong car sales even more than offset the described surprise elsewhere. It seems a better gauge of consumer sentiment. What is more, due to European car norm changes starting from September, we may see retail sales of cars to be artificially pumped up in August since car dealer are forced to buy cars complying with older norms themselves, register them and then re-sell. Dealerships are usually employment more than 9 people and such sales will be registered by GUS.



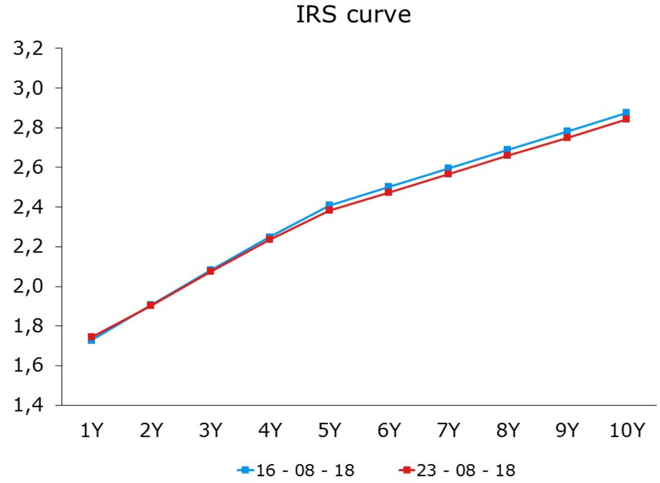


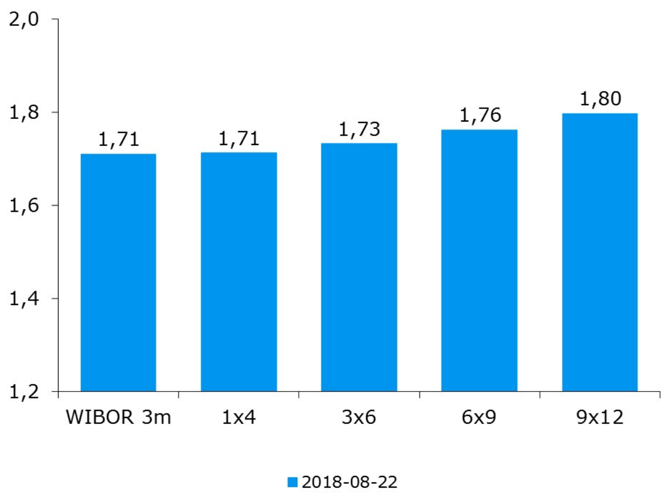
Fixed income

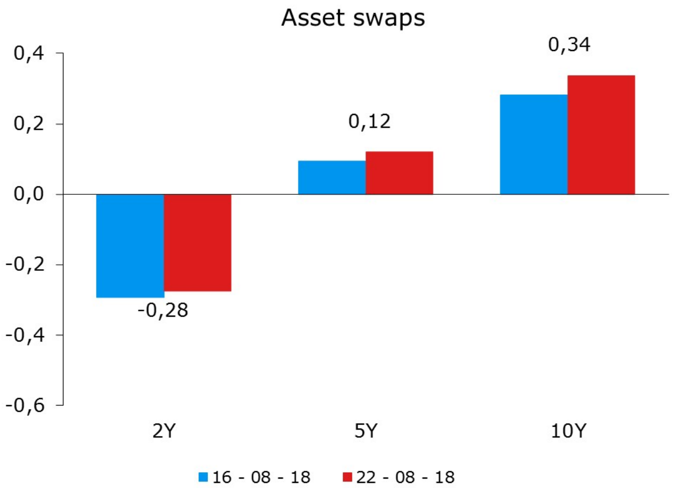
Supply issues coming back into the forefront

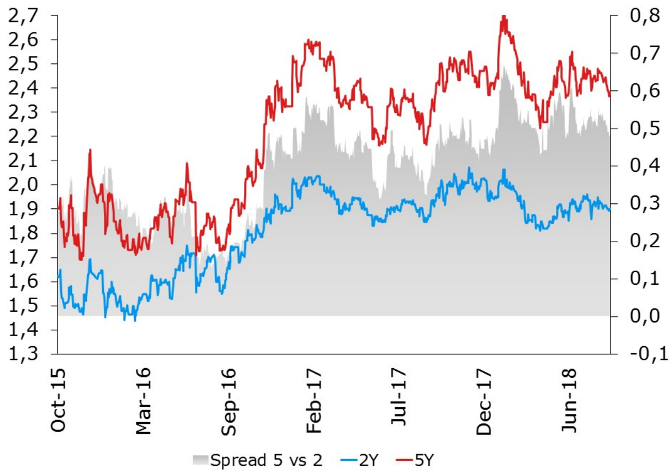
Turkish crisis is over for now. An auction is behind us, the next one is scheduled on September 6th. Supply was only PLN 4.7 bn and after that the market looks stable. Prices have declined in the pre-auction sell-off last week. ASWs have widened, despite the fact that there aren't any credit events on the horizon, and FRNs have sold off as well. OK1018 will expire soon, putting pressure on yields, but not on IRS rates.

DS1023/5y is 7 bps, WS0428/10y is 27 bps. DS1023/WS0428 is 62bps. WS0428/Bund is 280 bps. DS1020 is trading at 1.63% (3 bps down), DS1023 is trading at 2.48% (4 bps down) and WS0428 is trading at 3.15% (4 bps down).









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Money market

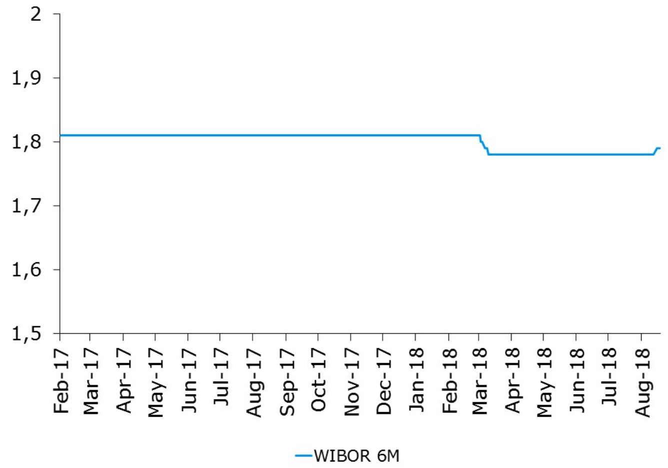
Inexplicable widening in ASW spreads

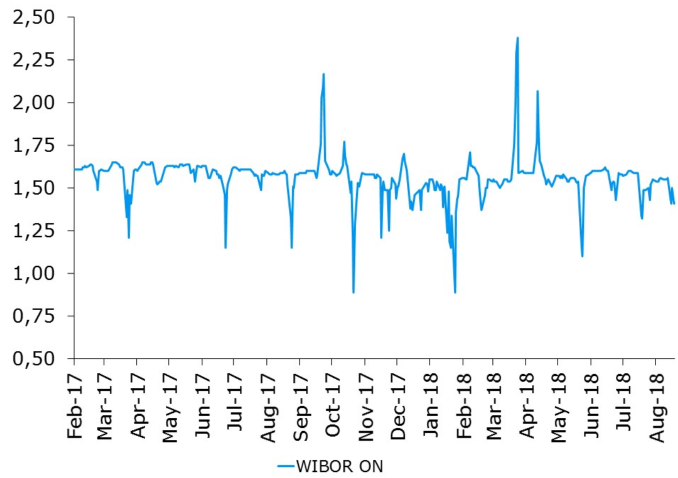
Polish rates hover near the lows with 5y swap trading at 2.38%. It looks slightly weaker on the bond market as we encountered some ASW widening. Asset swap on 5y tenor widened by 8-10 bps. We don't see any story behind that apart from some correction of recent tightening. Muted volatility persists. We are getting close to levels where investors betting on higher yields might find attractive risk / reward ratios.

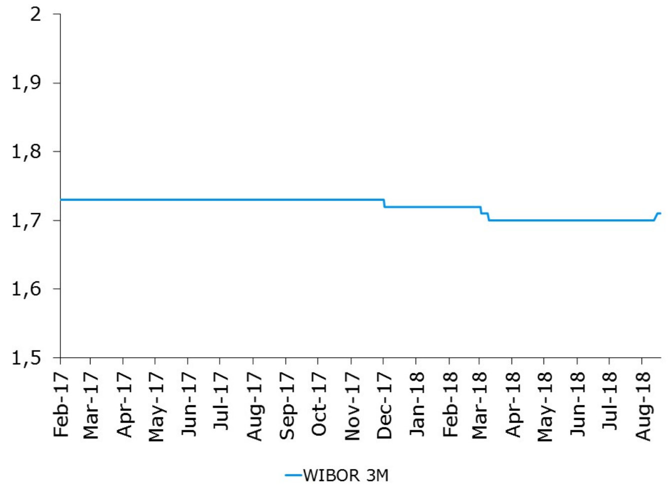
Overnight rate stood very low throughout the whole week, which is quite surprising. Next week, we expect overliquidity to continue due to month end.

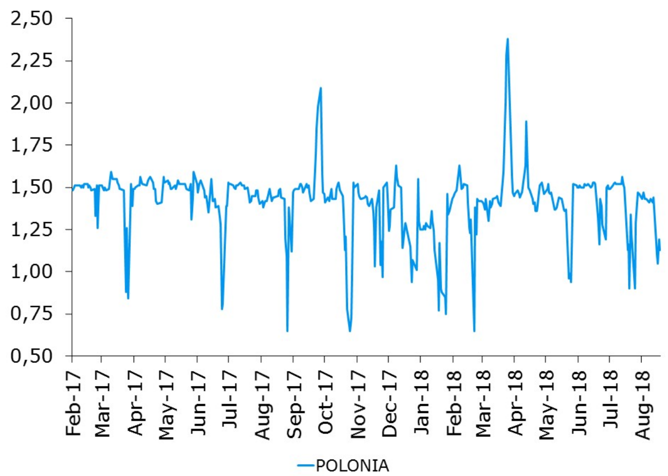
Ref rate vs Polonia averages:

30 day 21 bps
90 day 13 bps



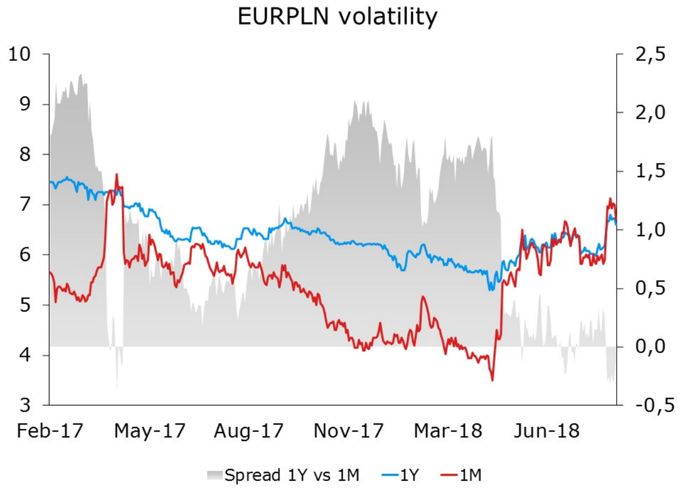






Forex

Spot – Zloty stronger Last week, global risk sentiment improved significantly as the Turkey crisis has come off, while the governments of the US and China have agreed to work together on a framework for trade negotiations. On Thursday the zloty rose for a sixth consecutive day – EUR/PLN kept on sliding, reaching as low as 4.2690, breaking the 4.30 support zone on the way. Of course, USD/PLN was much more interesting with a 3.84-3.68 weekly range, but that was driven purely by EUR/USD. Generally, we are still firmly in wider 4.24-34 range and our strategy still dictates to play that range.



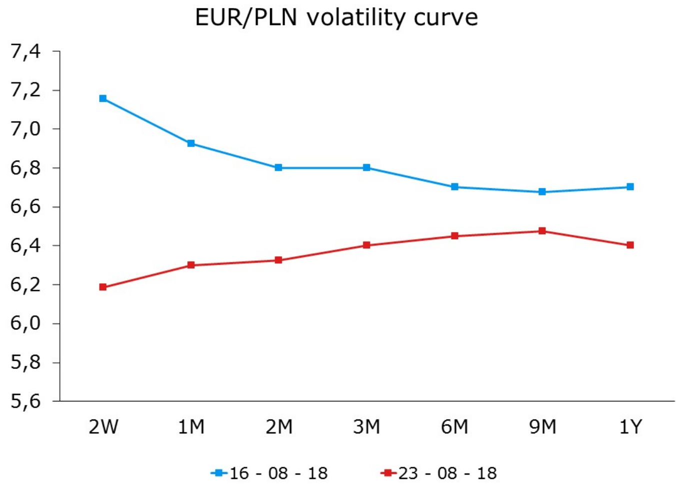
Options – Implied volatility sliding Holding gamma is expensive and this week we saw some offloading – especially in the frontend of the curve. At the beginning of the week EUR/PLN 1 week ATM was even bid on at 7.4% and now is traded at 5.7%. 1 month ATM mid is this Thursday at 6.1% (0.9% lower), 3 months mid are 6.3% (0.7% lower), 1 year is 6.45% (0.3% lower). The skew was also a little lower as well as the currency spread (difference between USD/PLN vol and EUR/PLN vol).

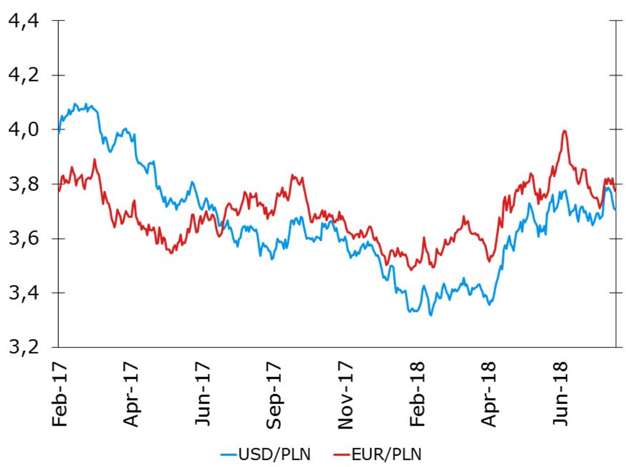
Short-term forecasts

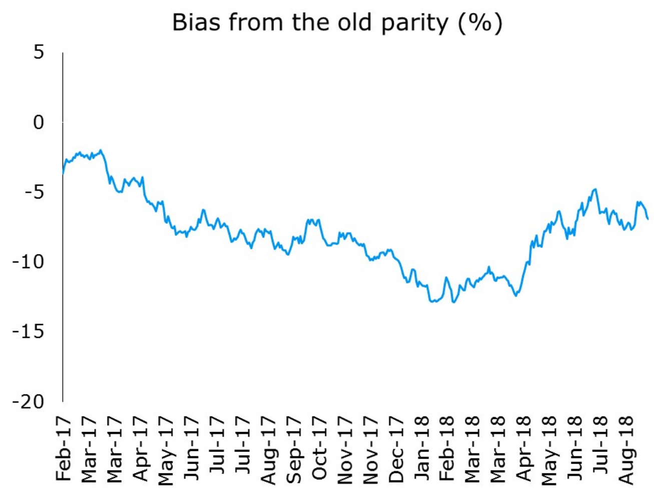
Main supports / resistances:
EUR/PLN: 4.2400 / 4.3400
USD/PLN: 3.6000 / 3.9000

Spot Current position: None.

We think that 4.24-4.34 is the most likely scenario for now. We will try to tactically play that range, we don't have any skew in play. On one hand decent Polish fundamentals may be the reason to get long PLN, on the other hand if contagion continues PLN will not be spared.







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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
8/16/2018	1.81	1.70	1.91	1.68	2.00	1.72	1.71	1.71	1.74	1.79	1.87	1.83
8/19/2018	1.89	1.70	1.99	1.68	2.06	1.72	1.70	1.71	1.73	1.78	1.85	1.81
8/20/2018	1.87	1.71	1.98	1.69	2.05	1.74	1.71	1.72	1.75	1.78	1.84	1.83
8/21/2018	1.68	1.71	1.81	1.69	1.87	1.76	1.72	1.73	1.76	1.80	1.85	1.84
8/22/2018	1.84	1.71	1.92	1.69	1.96	1.77	1.71	1.73	1.76	1.80	1.86	1.85

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
8/16/2018	1.720	1.370	1.905	1.611	2.407	2.501	2.875	3.156
8/19/2018	1.720	1.366	1.898	1.612	2.390	2.493	2.853	3.144
8/20/2018	1.740	1.360	1.892	1.613	2.365	2.457	2.828	3.120
8/21/2018	1.760	1.376	1.900	1.623	2.380	2.492	2.842	3.153
8/22/2018	1.770	1.370	1.900	1.625	2.382	2.502	2.842	3.178

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
8/16/2018	6.93	6.80	6.70	6.70	6.70	1.71	0.56
8/19/2018	7.03	6.83	6.73	6.73	6.73	1.71	0.56
8/20/2018	7.00	6.78	6.70	6.73	6.73	1.69	0.59
8/21/2018	6.70	6.60	6.55	6.60	6.60	1.67	0.59
8/22/2018	6.30	6.40	6.45	6.40	6.40	1.66	0.59

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
8/16/2018	4.3105	3.7871	3.8131	3.4178	1.3313	0.1676
8/19/2018	4.3061	3.7784	3.7926	3.4123	1.3308	0.1674
8/20/2018	4.2997	3.7695	3.7838	3.4065	1.3271	0.1672
8/21/2018	4.3101	3.7375	3.7853	3.3912	1.3330	0.1675
8/22/2018	4.2937	3.7104	3.7705	3.3604	1.3297	0.1669

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