September 13, 2018

Polish Weekly Review

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Comment on the upcoming data and forecasts

Next week, the final batch of Polish data sees the light. Indutrial output slows down on working days whereas retail sales should remain a bright spot as turnaround in dismal, last month's results in food sales is expected and car sales gets propelled by the new EURO norm. Employment slowly losts momentum and labor market as a whole hits the supply wall. However, wage growth decelerated in August on base effects in mining and possible slight turnaround in retail and transport after extraordinary July. Last but not least, producer prices fall a lot on base effects.

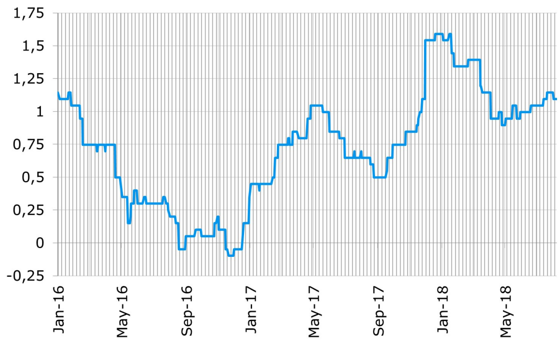
Polish data to watch: September 14th to September 21th

Publication	Date	Period	mBank	Consensus	Prior
Average Gross Wages y/y (%)	18.09	Aug	6.7	7.0	7.2
Employment y/y (%)	18.09	Aug	3.5		3.5
Sold Industrial Output y/y (%)	19.09	Aug	3.6	4.4	10.3
Construction Output y/y (%)	19.09	Aug	22.0		18.7
PPI y/y (%)	19.09	Aug	2.8	3.1	3.4
Retail sales y/y (%)	21.09	Aug	8.3	9.0	9.3

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	10/4/2018	250	1.610	9/6/2018
5Y T-bond PS1023	10/4/2018	1500	2.460	9/6/2018
10Y T-bond WS0428	10/4/2018	1000	3.249	9/6/2018
30Y T-bond WS0447	10/4/2018	180	3.495	7/27/2018

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



Comment
No surprise in final CPI. No surprise in surprise index :)

* 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 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.
- Risk off mood impacted the PLN negatively and better sentiment may only bring a transient relief rally. 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. Therefore, the floor on EURPLN is quite high by historical standards.
- Thus, 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

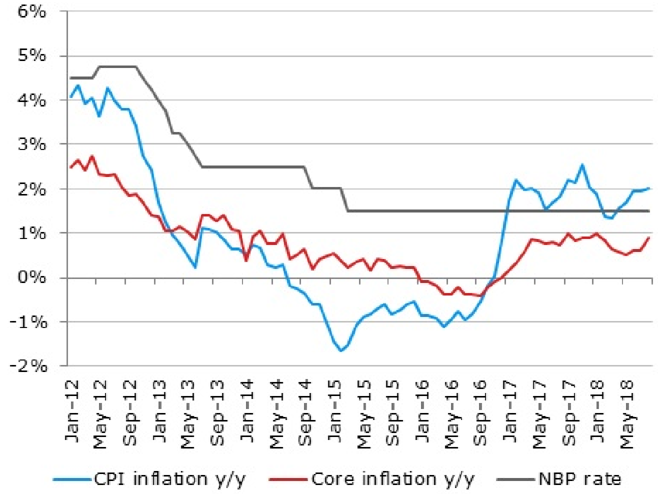
	2014	2015	2016	2017	2018 F	2019 F
GDP y/y (%)	3.3	3.8	3.0	4.6	5.0	4.1
CPI Inflation y/y (average %)	-0.1	-0.9	-0.6	2.0	1.7	2.1
Current account (%GDP)	-2.1	-0.6	-0.3	0.2	-0.4	-0.8
Unemployment rate (end of period %)	11.4	9.8	8.2	6.6	5.6	5.0
Repo rate (end of period %)	2.00	1.50	1.50	1.50	1.50	1.75

	2018 Q1	2018 Q2	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	4.9	4.8	4.2	4.0	3.8	3.8	3.8
Public Consumption y/y (%)	3.6	4.4	4.0	4.0	2.0	2.0	2.0	2.0
Investment y/y (%)	8.1	4.5	6.5	7.0	7.0	6.0	5.0	4.0
Inflation rate (% average)	1.5	1.7	2.0	1.5	1.9	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	4.40	4.35	4.30	4.25	4.20
USD/PLN (eop)	3.42	3.74	3.78	3.83	3.75	3.68	3.60	3.51

F - forecast

CPI inflation marks the top this year, core inflation starts accelerating on somehow higher note.

CPI inflation hit 2.0% y/y in August - just as the flash reading predicted, published at the start of the month. The composition is not surprising. We already knew that food prices fell 0.7% m/m, fuel prices dropped by 0.1% and energy prices were propelled by gas price hikes which translated to 0,5% m/m growth in the whole category. The most interesting are core categories. It seems that y/y upward trend was confirmed in wearing apparel, education, restaurants and hotels. I other category, insurance prices stopped falling y/y trend and we see a nice reversal; the same applied to recreation and culture. Those are price rises we had awaited for long. They lift core inflation to 0.9%.



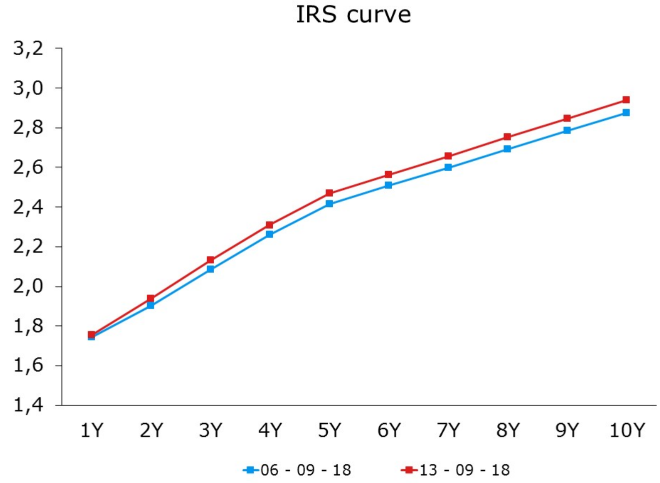
Next inflation reading should be lower at ca. 1.8-1.9%. Base effects in food prices and oil prices are here to blame. The whole year is going to end up even lower (1.4%-1.6%). At the same time, however, core inflation will be marching on, adding 0.1-0.2pp. per month to the annual growth index. We think it is the right time when traditional supply-demand factors (and also to some extent cost factors) should be kicking in. Until core inflation stays relatively low and the headline CPI is expected to fall, MPC has lots of comfort with current rates and accompanying rhetoric. Such a status quo can be maintained for months. At the same time, though, we do not retreat form the call that MPC will start increasing rates in late 2019 since processes causing rises in core inflation rarely die out alone and falling GDP growth can be only a short-term excuse for doing anything since in the reality and in current composition it is still inflationary (widening trade gap). Having said that we have to admit that financial markets rarely skip even short term trends in inflation. Therefore we are rather unlikely to play faster rate hikes until the falling inflation story filters through.

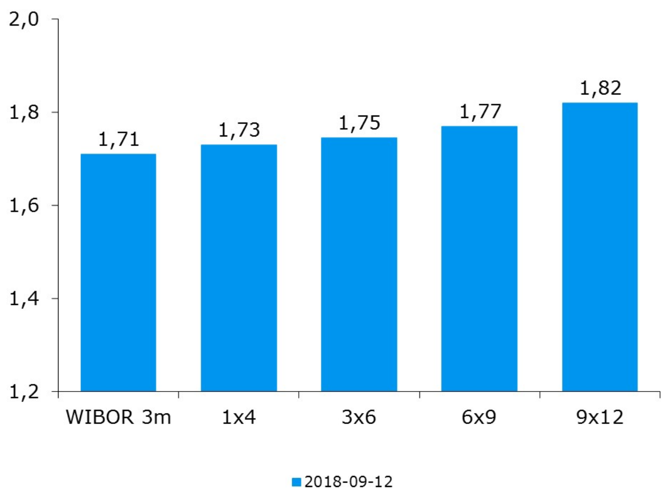
Fixed income

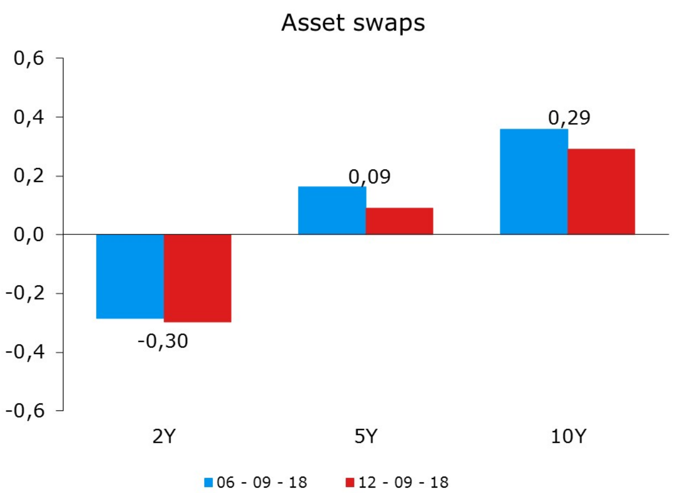
Local sell-off stopped

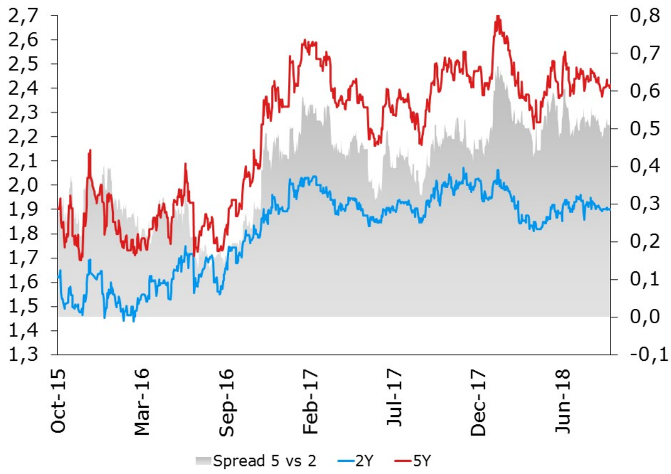
We touched 3.3% on WS0428 and it was a good support. The biggest story is switch auction, as Ministry said it might be canceled. Italy and Turkey are tiny issue again.

ASW were extremely wide but after bonds sell-off from local funds had finished we narrowed 10bps across the curve. DS1023/5y is 5bps, WS0428/10y is 24bps. DS1023/WS0428 is 68bps. WS0428/Bund is 280bps. DS1020 is trading at 1.6% (3bps down), DS1023 is trading at 2.54% (7bps down) and WS0428 is trading at 3.22% (6bps down).









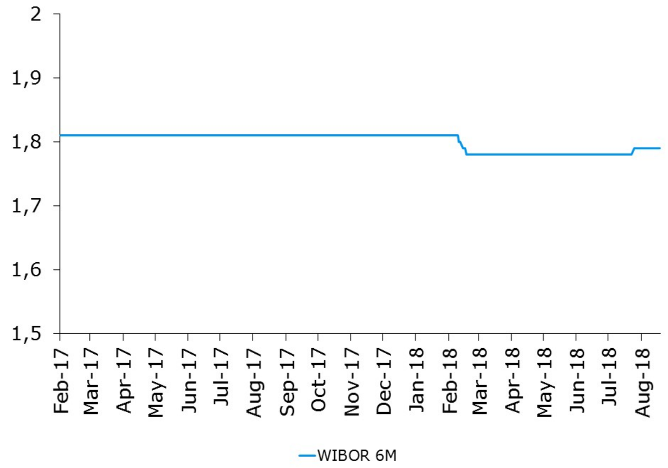
Money market

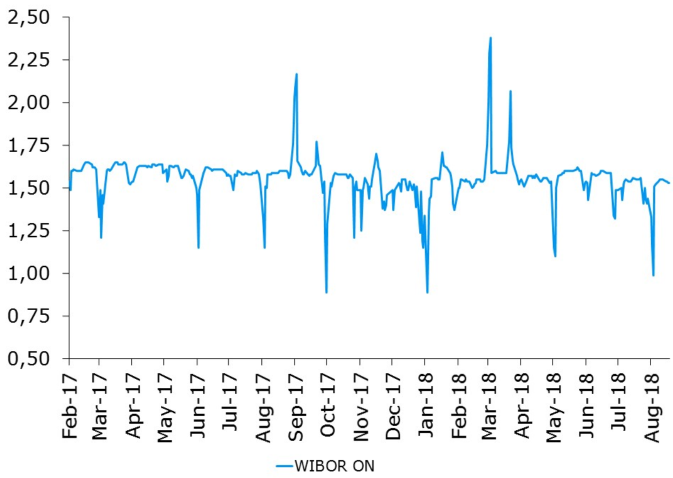
Cheap start of the month

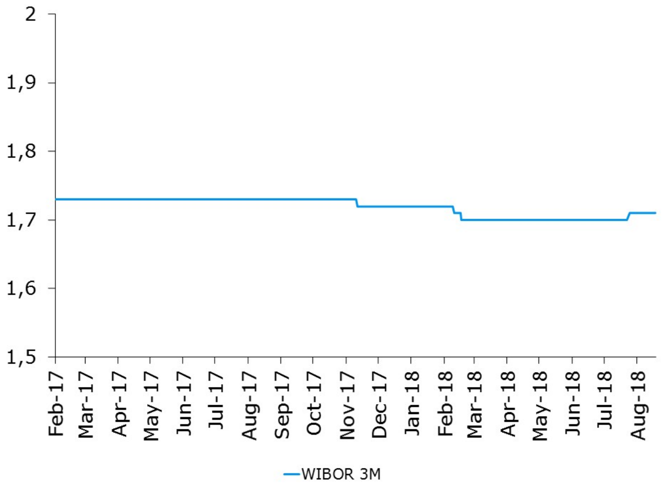
Recently we had local story on polgb's. The affair with one of the biggest local fund put bonds under pressure. At most ASW widened around 10-15 bp along the curve. We see this factor fading already with major flow already gone through the market. Swaps and bonds are caching up, ASW tightening and people are taking more about global situation. Summer is ending so volatility may pick up, especially with ECB and Fed meetings in September.

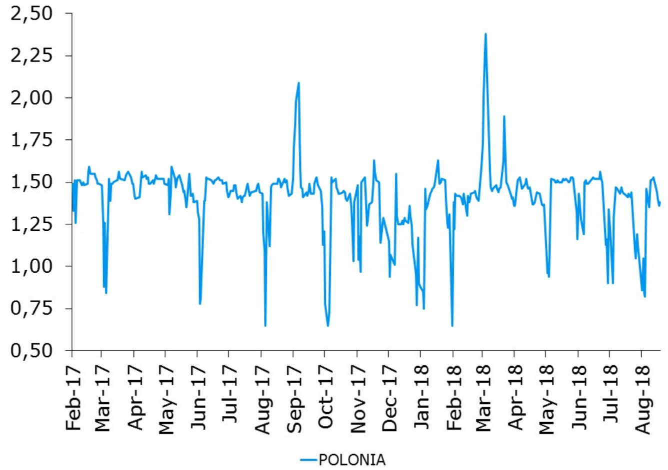
Market is full of cash for some time. Beginning of the month with rate close to 1.40 is really cheap. Apart from mysterious overliquidity we have no major events this month.

Ref rate vs Polonia averages:
30 day 25 bp
90 day 16 bp









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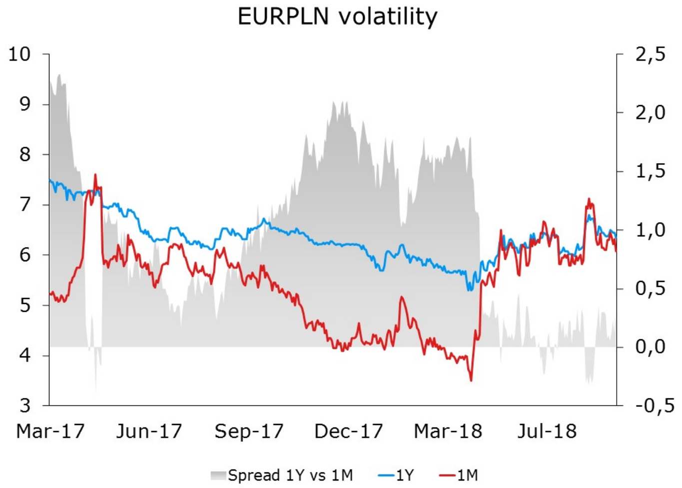
Forex

Spot – consolidation in EURPLN The perspective of "Central banks week" with ECB and BoE on the agenda was the perfect excuse for most of the currencies to start the consolidation phase. The zloty is no exception - EUR/PLN is traded in the narrow range 4.27–4.3250 for four consecutive week, so as a result realized volatility nosedived again. The XXX/PLN are mostly driven by global sentiment. Still, some anxiety over the trade dispute between China and the United States kept many investors on edge.

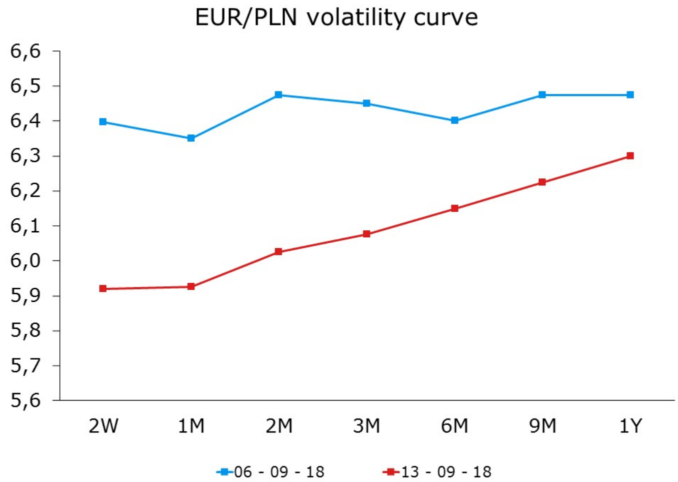


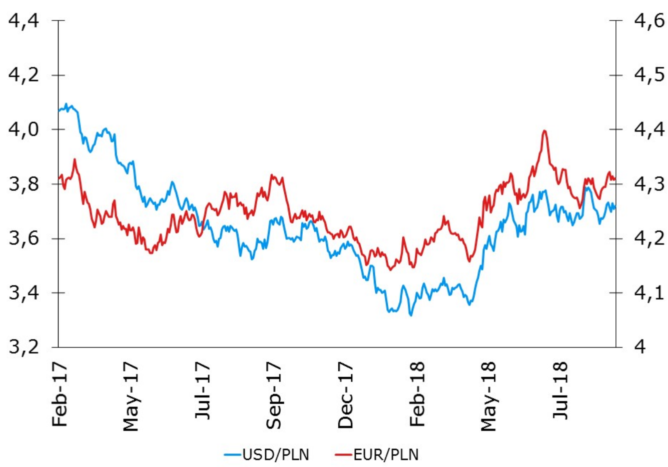
Options – implied volatility sliding The EUR/PLN vol curve melted a little as spot was really calm and there is no certain volatility trigger on the horizon. Holding gamma is expensive and today we saw some offloading – especially in the frontend of the curve. 1 month ATM mid is this Thursday at 5.75% (0.75% lower), 3 months mid are 5.9% (0.55% lower), 1 year is 6.2% (0.3% lower). The skew and the currency spread (difference between USD/PLN and EUR/PLN) are at the same levels as week ago.

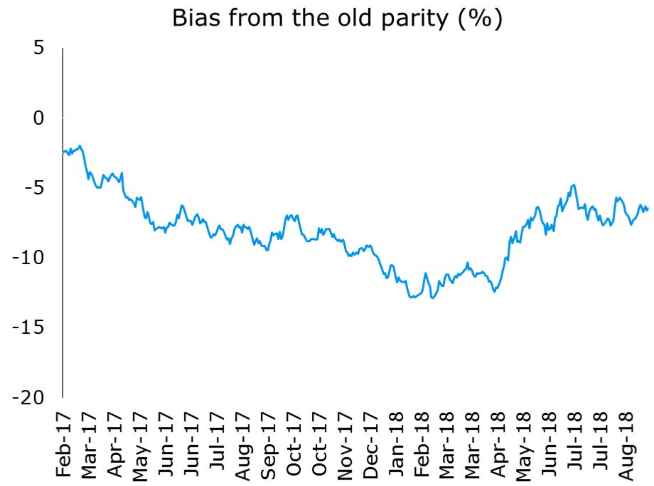
Short-term forecasts

Main supports / resistances:
EUR/PLN: 4.2600 / 4.3600
USD/PLN: 3.6000 / 3.9000

Spot Current position: Still short short EUR/PLN.
We are still short at 4.3375, we are ready to add to short at 4.3550, with the stop at 4.3750. We stick to our view of the rangy nature of EUR/PLN. Unless some risk off scenario reappears, we would like to play 4.24-4.34 range with the open state of mind.







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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
9/6/2018	1.77	1.71	1.88	1.69	2.03	1.77	1.72	1.75	1.79	1.82	1.87	1.86
9/9/2018	1.71	1.71	1.76	1.69	1.90	1.77	1.72	1.75	1.78	1.83	1.86	1.87
9/10/2018	1.65	1.71	1.81	1.69	1.97	1.77	1.72	1.75	1.78	1.82	1.88	1.86
9/11/2018	1.58	1.71	1.75	1.69	2.00	1.77	1.73	1.75	1.78	1.83	1.89	1.87
9/12/2018	1.69	1.71	1.91	1.69	1.99	1.77	1.73	1.75	1.77	1.82	1.88	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	9/6/2018	7/25/2020	97.05	1.61	250	1060	260
PS0123	9/6/2018	1/25/2023	100.14	2.46	1500	2100	1524
WS0428	9/6/2018	4/25/2028	95.90	3.25	1000	1712	1049

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0720	5Y IRS	PS0423	10Y IRS	WS0428
9/6/2018	1.770	1.378	1.900	1.614	2.415	2.577	2.875	3.233
9/9/2018	1.770	1.380	1.928	1.640	2.458	2.608	2.933	3.284
9/10/2018	1.770	1.383	1.938	1.622	2.475	2.594	2.955	3.263
9/11/2018	1.770	1.384	1.952	1.636	2.493	2.600	2.978	3.273
9/12/2018	1.770	1.385	1.938	1.640	2.467	2.558	2.940	3.230

EUR/PLN 0-delta stradle						25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y		1M	1Y	1Y
9/6/2018	6.35	6.45	6.40	6.48		6.48	1.69	0.58
9/9/2018	6.23	6.35	6.33	6.45		6.45	1.69	0.58
9/10/2018	6.33	6.35	6.38	6.45		6.45	1.69	0.57
9/11/2018	6.08	6.13	6.18	6.35		6.35	1.69	0.58
9/12/2018	5.93	6.08	6.15	6.30		6.30	1.69	0.58

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
9/6/2018	4.3218	3.7143	3.8309	3.3355	1.3201	0.1680
9/9/2018	4.3079	3.6995	3.8335	3.3411	1.3277	0.1678
9/10/2018	4.3138	3.7283	3.8384	3.3564	1.3279	0.1682
9/11/2018	4.3077	3.7087	3.8069	3.3292	1.3277	0.1681
9/12/2018	4.3103	3.7198	3.8166	3.3359	1.3277	0.1686

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