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Polish Weekly Review

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Comment on the upcoming data and forecasts

This Friday Statistics Poland (SP/GUS) will publish data on retail sales, which should remain optimistic because of the car sales and very likely adjustment of the last enigmatic declines of food sales and sales in non-specialized stores. On Monday NBP publishes M3 money supply data. It should grow at an even faster pace than a month ago driven by households' deposits. On Tuesday, Statistical Bulletin sees the light containing the official reading of unemployment rate. Despite the preliminary data (5,8% published earlier this month by MFLSP) we expect the unemployment rate at the level of 5.9%, in line with our initial forecast. Keeping things simple, given the number of the unemployed, employment numbers implied by the low estimate of unemployment rate seem rather unlikely given the seasonality and the behavior of the employment in the enterprise sector.

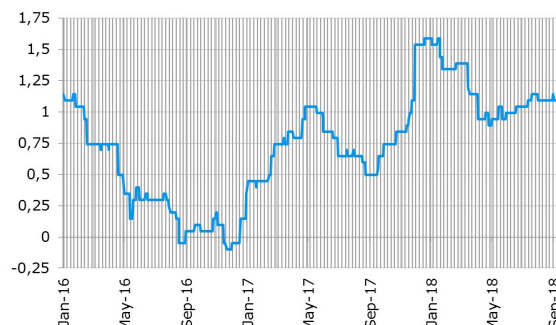
Polish data to watch: September 21th to September 28th

Publication	Date	Period	mBank	Consensus	Prior
Retail Sales y/y (%)	21.09	Aug	8.3	9.1	9.3
Money Supply M3 y/y (%)	24.09	Aug	8.0	7.5	7.3
Unemployment Rate (%)	25.09	Aug	5.9	5.9	5.9

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	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

Neither labor market nor industrial output surprised. Still 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	2018	2018	2018	2019	2019	2019	2019
	Q1	Q2	Q3 F	Q4 F	Q1 F	Q2 F	Q3 F	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

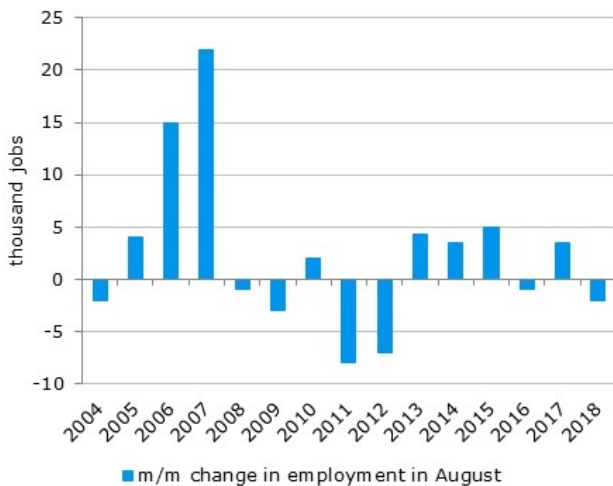
F - forecast

Economics

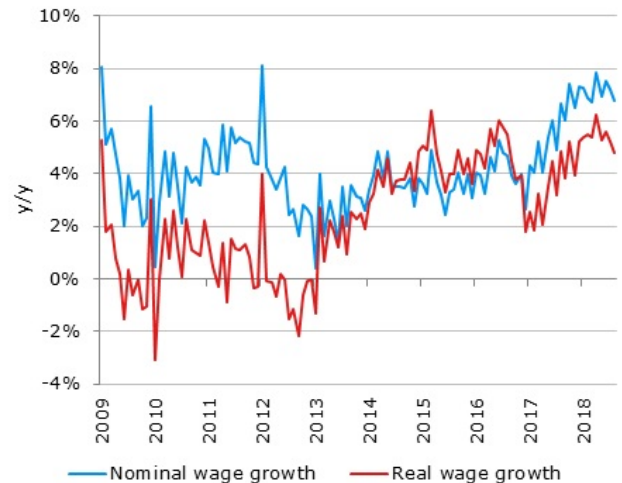
This week's releases mostly hit the consensus. Therefore consensus status quo is maintained. Economy decelerates very gently and MPC has nothing new to digest.

Employment decelerates on supply factors. Wages growth decrease a one-off event.

Employment growth decelerated in August to 3.4% y/y, below our forecast and market consensus (both 3.5%). In absolute terms, enterprise sector lost 2k jobs over July. August is usually a month of lower employment growth. However, current reading fits nicely into a broader picture of negative surprises in employment. We think the reason is on the supply side as a friction part of the unemployment is very low. Therefore filling a vacancy takes more time than usual and average monthly growth of employment falls. Path to equilibrium requires higher wages and we still expect them to grow more vigorously.

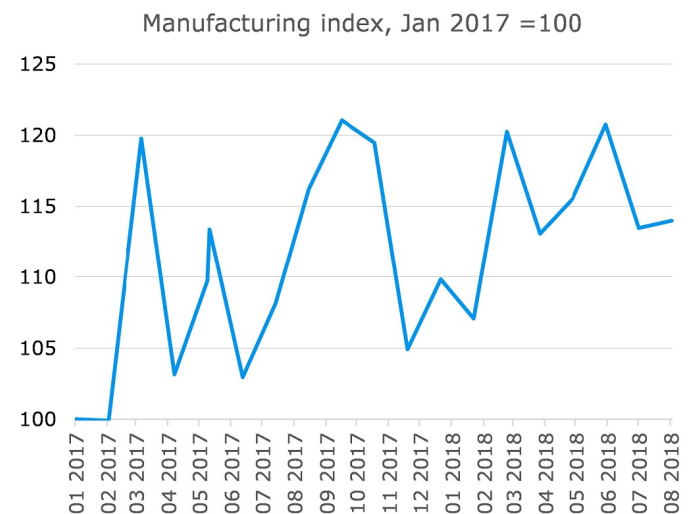


August reading on wages at 6.8% y/y constitutes a contradiction but only in a naive way. July's wage reading was extraordinarily boosted by trade and transportation. August is a pay-back in these sections – although we do not know the detailed breakdown yet, we are quite sure these are the right surprise-generating candidates – accompanied by a base effects in mining. Last but not least, the surprise over consensus is small (0.2pp.) and would not spoil the broader picture even if its source was truly unknown.



Industrial output and producer prices decelerate in line with market consensus.

Industrial output grew by 5.0% y/y in August. The result beat our expectations based on the difference in working days and some base effects. However, it would be hard for the output to escape the same factors in September, when we can expect another drop in annual growth.

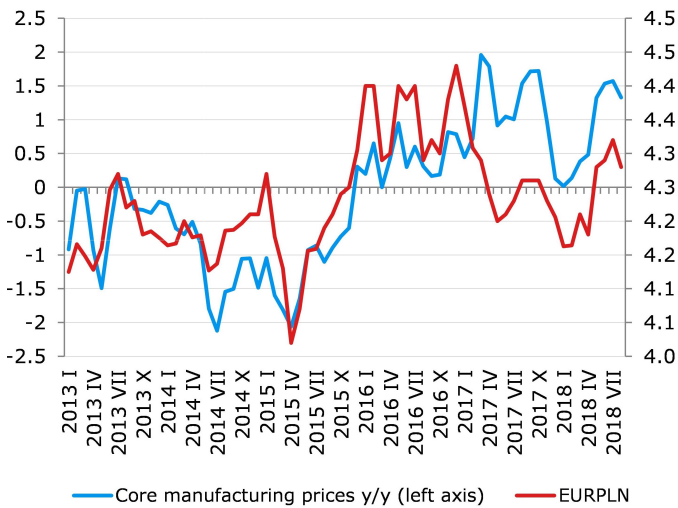


The data corroborates that GDP growth is slowly drifting downwards. Still, the best point estimate for Q3 stays close to 4.8% y/y. Next months are set to be decisive for industrial output. There still remains the issue of capacity utilization in manufacturing (still, no acceleration private investment in this field) and forthcoming minor disruptions in supply chains expected with respect to recent new duties in international trade and general imports-substitution implemented by the Chinese government. Euro area is in the doldrums wherein the lion's share of Polish manufacturing is still attached.

Construction activity returned to solid growth. 20% y/y growth is a little bit higher than market consensus. The largest monthly acceleration (>10%) was recorded in infrastructure-related construction activity and much of it can be attributed to political calendar. The issue of higher costs, falling margins and inconclusive tenders is going to cast shadow on this sector's activity in coming months.



Producer prices increased by 3.0% y/y in August. The falling trajectory is clearly visible. However, so far it has not been the case for core prices in manufacturing when we expected (finally) some price pressures to build. Yet, nothing happened and good-old correlation between core producer prices and exchange rate trumped everything else (see the graph).



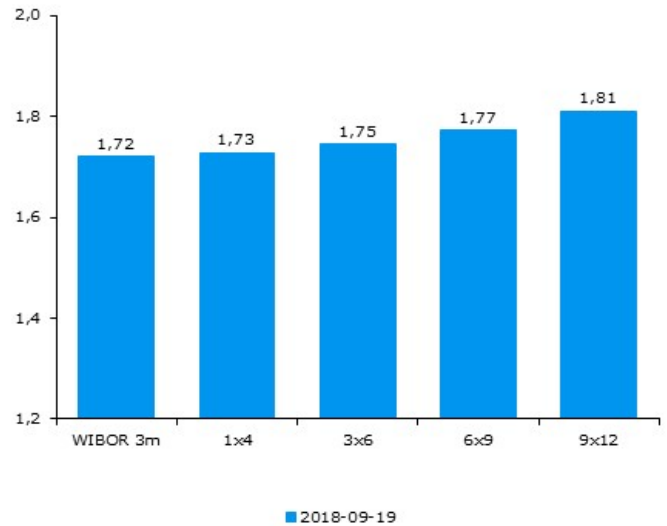
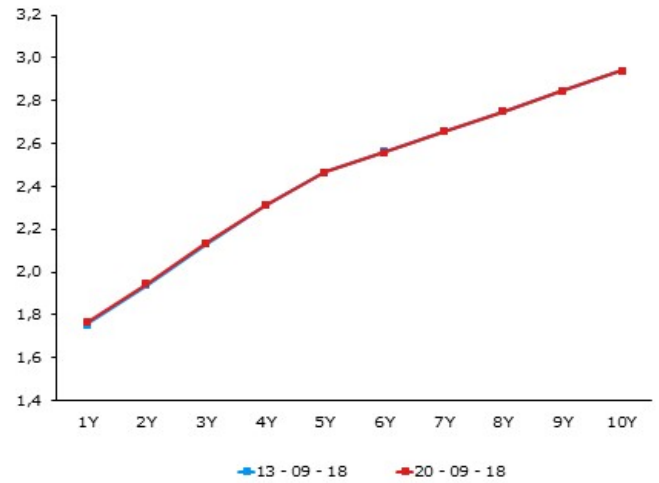
Fixed income

Calm week

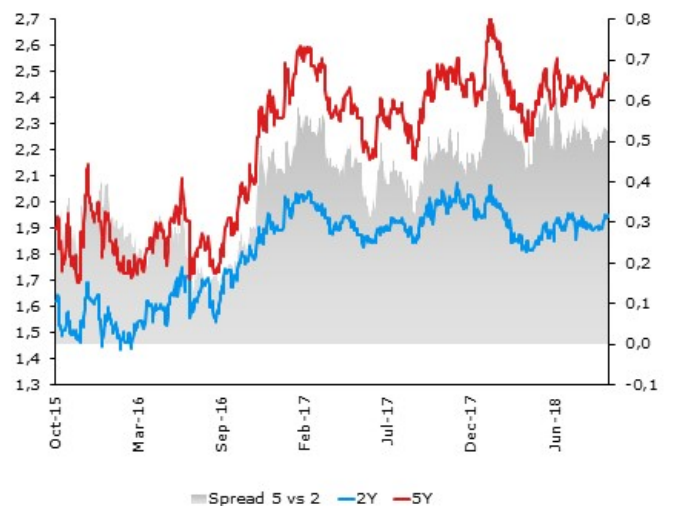
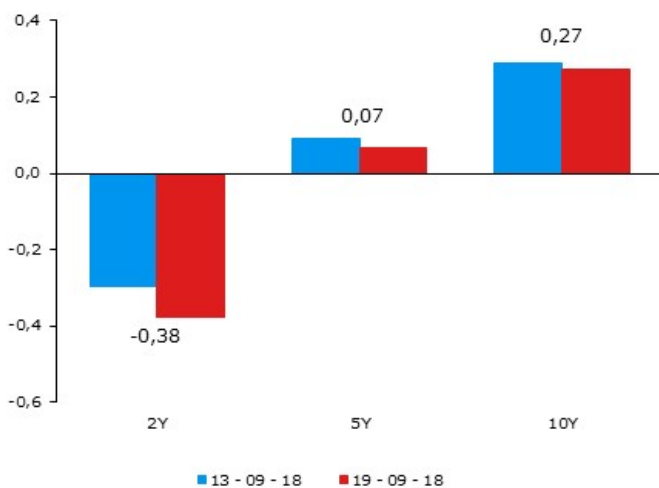
Last week was calm, yield curve flattened further after switch auction was canceled and we saw short-term and mid-term bonds taken.

DS1023/5y is 3.5bps, WS0428/10y is 24.5bps. DS1023/WS0428 is 71bps. WS0428/Bund is 272bps. DS1020 is trading at 1,55% (2bps down), DS1023 is trading at 2,50% (3bps up) and WS0428 is trading at 3,22% (8bps up).

IRS curve



Asset swaps

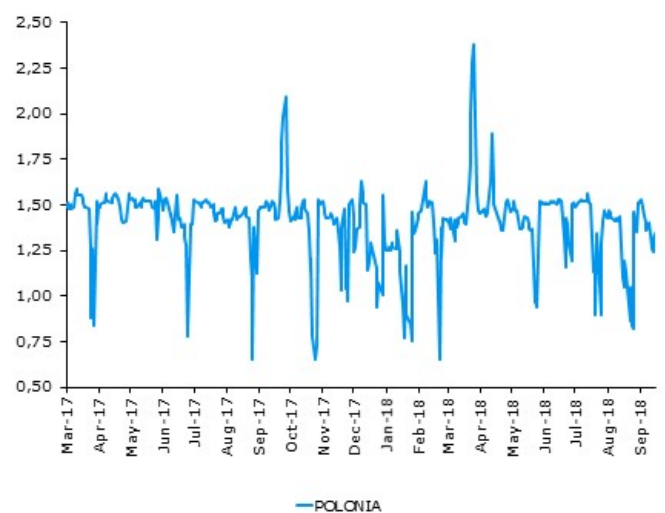
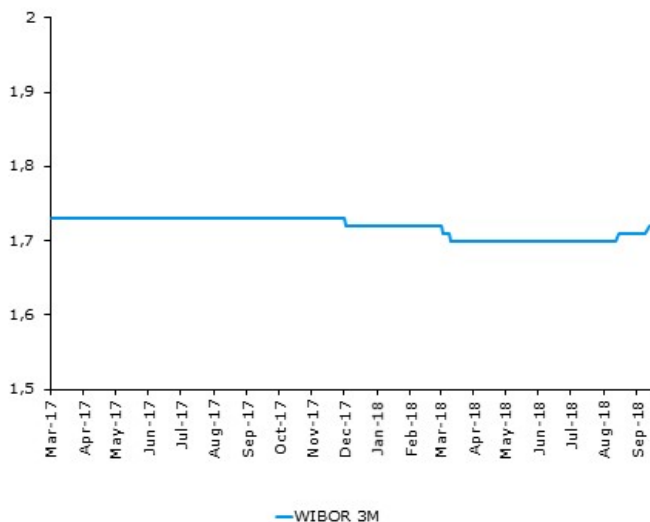
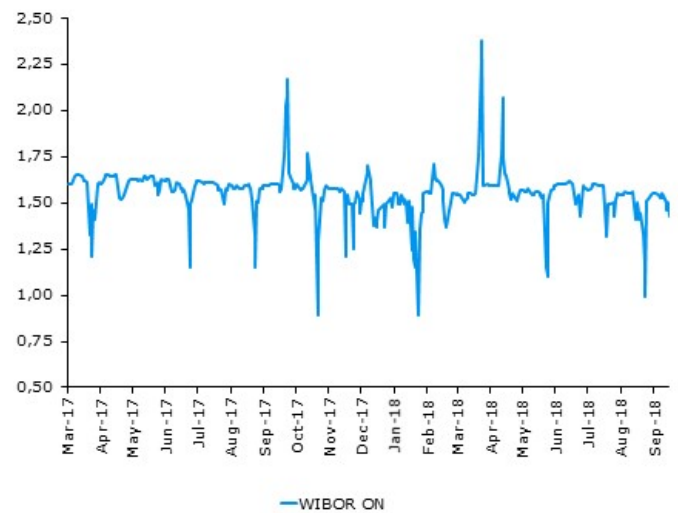
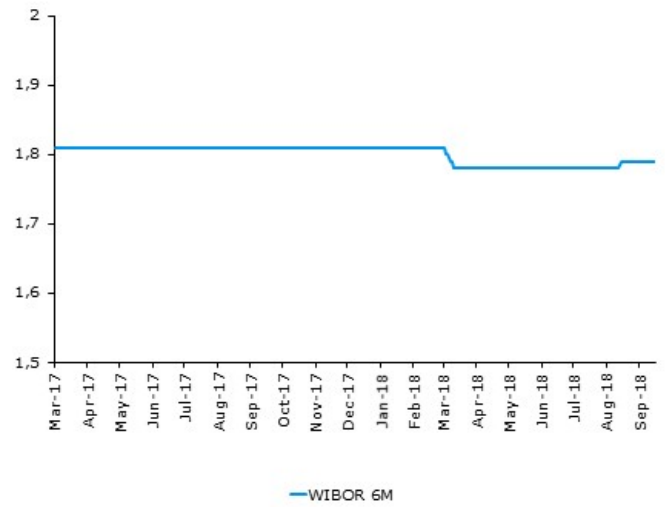




Money market

Cheap week behind us

This week was second cheap week of September. On Friday's OMO banks bought PLN 81.4bn bills out of 88bn offered. Tomorrow we will have regular OMO and we do not expect any special move on next week's founding, especially that upcoming week is the last of mandatory reserve period. In our opinion cash should remain on this week's level with polonia below 1.40.



Forex

Spot – Consolidation phase for EUR/PLN continues.

EURPLN kept on meandering in the extremely tight 4.2850-4.3185 range, it is just in the middle of the wider 4.26-4.34 range. The EM seems to have more relaxed times, the USD is tight in the range as most of G10 crosses. As the consequence, we have a lackluster market with realized volatility at the lows. It is the sign of the times.

Options – EUR/PLN vols dropped as a stone.

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 / 4.3400

USD/PLN: 3.6000 / 3.9000

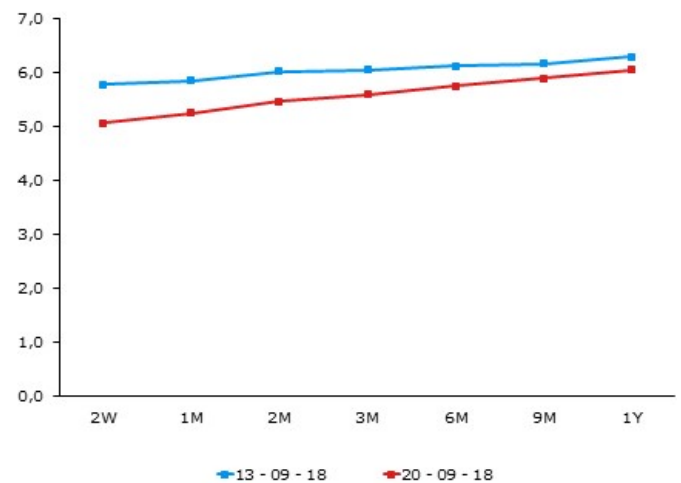
Spot Short from 4.3375 closed at 4.2900. Sidelined.

The risk reward is no longer there. In such a low volatility environment we have decided to close our short in EUR/PLN. We will try to play opportunistically in 4.26-4.34 range.

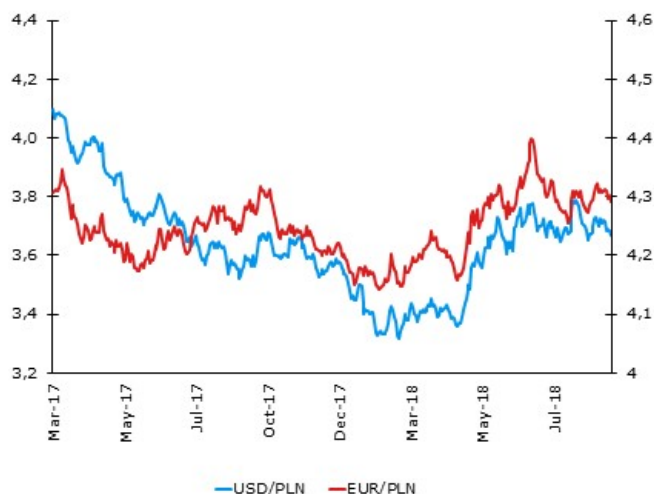
EURPLN volatility



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
9/13/2018	1.68	1.71	1.85	1.69	1.99	1.77	1.73	1.74	1.77	1.81	1.87	1.85
9/16/2018	1.67	1.71	1.81	1.69	1.97	1.77	1.72	1.74	1.76	1.81	1.87	1.85
9/17/2018	1.64	1.72	1.78	1.69	1.95	1.77	1.73	1.75	1.77	1.81	1.87	1.85
9/18/2018	1.54	1.72	1.68	1.69	1.85	1.77	1.73	1.75	1.78	1.81	1.87	1.86
9/19/2018	1.65	1.72	1.81	1.69	1.97	1.77	1.73	1.75	1.77	1.81	1.87	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	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
9/13/2018	1.770	1.385	1.938	1.640	2.467	2.558	2.940	3.230
9/16/2018	1.770	1.398	1.945	1.632	2.472	2.545	2.953	3.237
9/17/2018	1.770	1.395	1.950	1.630	2.478	2.553	2.958	3.223
9/18/2018	1.770	1.386	1.947	1.595	2.475	2.550	2.955	3.227
9/19/2018	1.770	1.382	1.945	1.568	2.465	2.531	2.942	3.216

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
9/13/2018	5.85	6.05	6.13	6.30	6.30	1.60	0.55
9/16/2018	5.58	5.98	6.08	6.25	6.25	1.60	0.55
9/17/2018	5.35	5.68	5.83	6.08	6.08	1.61	0.57
9/18/2018	5.33	5.68	5.80	6.08	6.08	1.61	0.57
9/19/2018	5.25	5.60	5.75	6.05	6.05	1.61	0.57

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
9/13/2018	4.3126	3.7130	3.8264	3.3299	1.3249	0.1688
9/16/2018	4.3093	3.6817	3.8178	3.2914	1.3318	0.1689
9/17/2018	4.2968	3.6876	3.8199	3.2935	1.3229	0.1688
9/18/2018	4.3030	3.6817	3.8327	3.2884	1.3249	0.1690
9/19/2018	4.2929	3.6685	3.8005	3.2647	1.3275	0.1688

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