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Polish Weekly Review

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Comment on the upcoming data and forecasts

On Wednesday, Statistics Poland will publish the flash CPI for October, which we expect to grow by 1.8% y/y, a bit below September’s result. Note that this is a preliminary forecast, subject to revisions, but we expect stable core inflation and slightly higher fuel prices on a monthly basis. Next Friday we will get the Polish manufacturing PMI. According to our preliminary estimates, we expect manufacturing PMI to stay at the same level as in September, indicating low industrial sentiment, compared to several previous months.

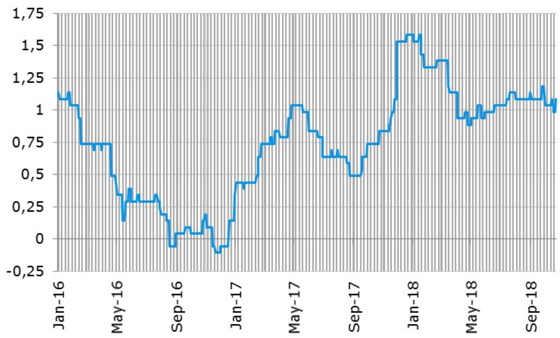
Polish data to watch: October 26th to November 2nd

Publication	Date	Period	mBank	Consensus	Prior
CPI y/y (%) *flash*	31.10	Oct	1.8		1.9
Manufacturing PMI (pts)	02.11	Oct	50.5		50.5

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	10/26/2018	1000	1.517	10/4/2018
5Y T-bond PS0424	10/26/2018	1500	2.732	10/4/2018
10Y T-bond WS0428	10/26/2018	1200	3.303	10/4/2018
30Y T-bond WS0447	10/26/2018	20	3.643	10/4/2010

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



Comment

Surprise index moved one point upward. Retail sales surprised negatively, but more optimistic unemployment data bringed the index back. In the following days, there are two potential index movers – 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).

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Our view in a nutshell

Fundamentals

- Q2 2018 marked the top of the business cycle. 2018 GDP will fall marginally short of 5% and gently decelerate furhter in 2019. 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. Those exogenous factors speak in favor of a smooth transition towards less spectacular GDP growth.
- Recent increases in oil, gas, coal and electricity prices (the latter only in wholesale markets and for corporate & SME clients) are raising the inflation outlook. In particular, base effects in the coming months will not be as strong as previously forecast, inflation will hit the target in early 2018 and there is considerable uncertainty regarding second-round effects of sharply higher electricity prices on consumer goods and services prices. Wages are no longer accelerating, but the wide gap between them and prices should still close if history is a guide.
- MPC stays calm and sees stable rates as having an intrinsic value. 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.
- As a result, 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	4.8	4.8	3.9
CPI Inflation y/y (average %)	-0.1	-0.9	-0.6	2.0	1.7	2.5
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

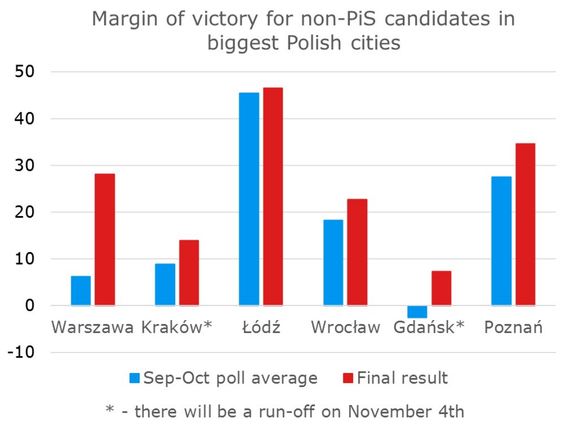
	2018 Q1	2018 Q2	2018 Q3 F	2018 Q4 F	2019 Q1 F	2019 Q2 F	2019 Q3 F	2019 Q4 F
GDP y/y (%)	5.2	5.1	4.6	4.4	4.2	4.0	3.7	3.5
Individual consumption y/y (%)	4.8	4.9	4.5	4.2	4.0	3.8	3.8	3.8
Public Consumption y/y (%)	3.6	4.4	4.0	4.0	2.0	2.0	2.0	2.0
Investment y/y (%)	8.1	4.5	6.0	6.0	6.0	6.0	5.0	4.0
Inflation rate (% average)	1.5	1.7	1.9	1.7	2.2	2.5	2.5	2.6
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	1.72	1.70	1.70	1.71	1.72	1.98
2Y Polish bond yields (% eop)	1.49	1.63	1.56	1.60	1.65	1.85	2.00	2.20
10Y Polish bond yields (% eop)	3.18	3.22	3.24	3.40	3.50	3.59	3.71	3.88
EUR/PLN (eop)	4.21	4.37	4.28	4.40	4.35	4.30	4.25	4.20
USD/PLN (eop)	3.42	3.74	3.69	3.83	3.75	3.68	3.60	3.51

F - forecast

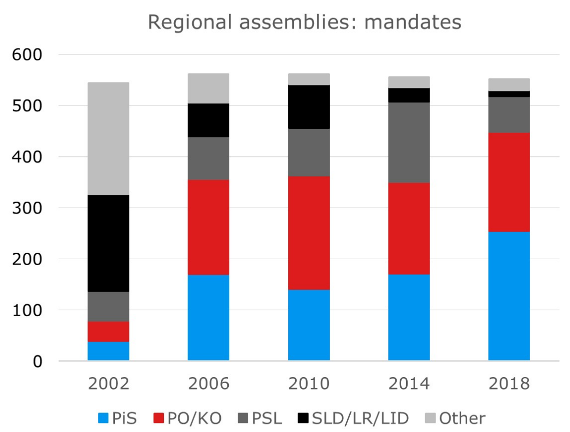
Everyone's a winner after last Sunday's local elections. No immediate implications for Poland's fiscal standing.

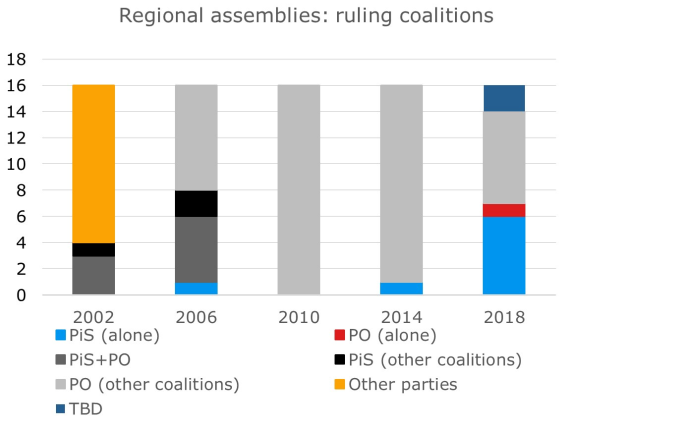
Elections to regional and municipal governments were held last Sunday. Official results were delivered on Thursday. Final results paint a complicated picture, but the national political climate is unchanged and consistent with opinion polls conducted during the campaign that put all major parties close to 2015 parliamentary results. It is also worth to note that the picture differs from the one delivered by the first polls held on Sunday. Therefore, patience was warranted this time.

First, in all major cities the opposition-backed presidential candidates (in many cases, incumbents) won their races easily and with higher margin than indicated by pre-election opinion polls (see the graph above). Several notable races (including Warsaw) were even won in the first round. Arguably, Polish opposition consolidated its hold over the urban electorate.



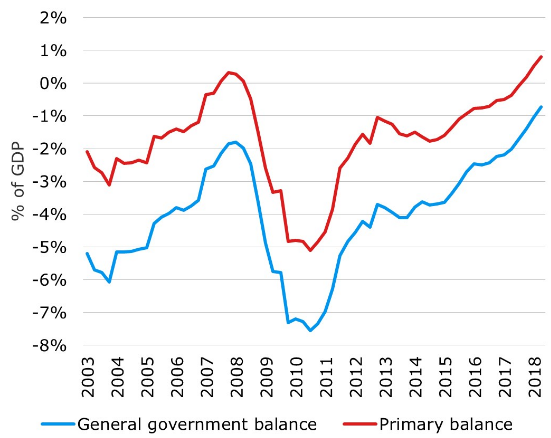
Second, Law and Justice (PiS) made significant gains in elections to regional assemblies. Due to their role in managing EU-financed spending and the vast bureaucratic machinery associated with it, control over regional assemblies was deemed even more important than over biggest municipalities. Based on final results, PiS will control six assemblies outright (up from 1 in 2014 elections) and might sign coalition agreements to control further two. The centre-right opposition will control between eight and ten assemblies (down from 15 in the previous elections), mainly due to significant decline for People's Party (PSL) in rural areas. The overall breakdown of mandates in all assemblies shows significant and broad-based gains for PiS.





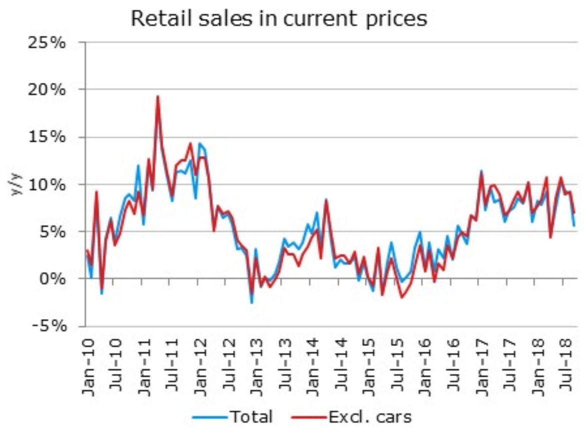
Third, if local elections are treated as a huge opinion poll ahead of next year's parliamentary elections, then the status quo appears to be maintained. Adjusted vote shares and shifts vis-Ă -vis the previous elections are quite similar to the shift that occurred in 2015. Thus, the game is on and PiS appears to be on track to win the 2019 parliamentary elections with very similar support. Whether a coalition partner will be needed depends on a multitude of factors.

Finally, macroeconomic and market implications are almost non-existent in light of these elections. We indicated on several occasions that PiS' poor result might raise Poland's credit and political risk premia, and that investors might start betting on fiscal stimulation ahead of 2019 elections. The likelihood of that has not increased yet. A clearer change in national opinion polls could trigger such a response, but so far none is evident. Finally, fiscal stimulation might still occur (e.g. to soften the expected slowdown in the Polish economy), but will not spook markets. After all, Poland has fiscal space, as seen on record low general government deficit figures.



Weak retail sales, evidently lower because of the weak car sales

Retail sales grew in September by 5.6% nominally (3.6% in real terms), which was lower than both the consensus (7.6%) and our forecast (7.3%). Stronger slowdown is mostly a result of low car sales (it is definitely the worst September in history), which was responsible for deviating by 2pp from our forecast. Growth of this category slowed from 7% y/y in August to -7% y/y in September. In addition, we noted much lower dynamics of the category "Furniture, radio, TV and household appliances", but it is a marginal case because of its low weight in the sales overall. Excluding cars, retail sales rose by 7% (see graph). It does not change the fact that inflection point was achieved, as seen also in other demand aggregates.



The poor reading of the retail sales is definitely the result of the car sales category. The strength of this slowdown suggests that it is not a macroeconomic adjustment caused by the change of consumers' or firms' expectations, or the difference in financing conditions. It is also against the huge increase in new cars registration in August, which should be spread in sales in next months by car sellers. But for a realization of such a scenario we need stronger price incentives and the difference between the nominal and real car sales in August suggests only a 3% discount. At the same time there are problems with availability of some models of new cars, which meet new norms (it is in most cases not the scale of emission that matters, but the method of calculating it). It should help selling the inventory and perhaps this effect will extend to the next months. In the end of the year we can see another effect resulting from tax changes for firms' cars. New amortization limits support buying expensive cars by the end of this year and postponing buying the cheaper ones to the next year. Taking into account disproportions in their market share it should have a negative impact on car sales in the next months of this year.

Analysis above suggests the downward risks for consumption estimates (maybe also investment) in the end of the 2018. However it does not mean that we should extrapolate the path of consumption to the 2019 based on the current pace of its slowdown. Macroeconomic conditions, with a strong labor market and wages, support only the marginal slowdown of consumption in 2019, especially that consumption credit plays an increasingly important role in smoothing the consumption cycle.

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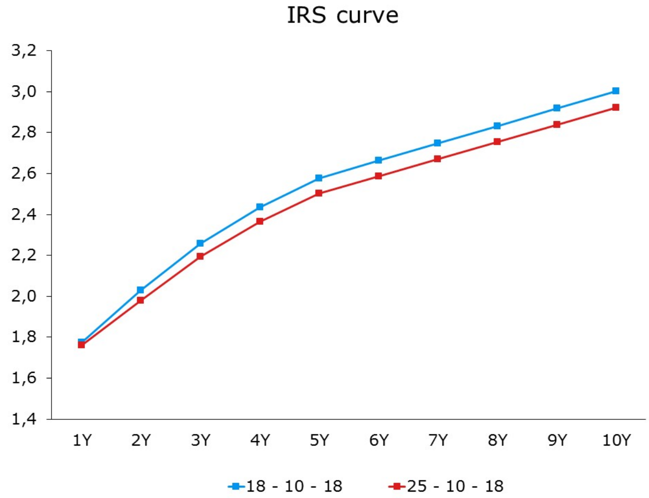
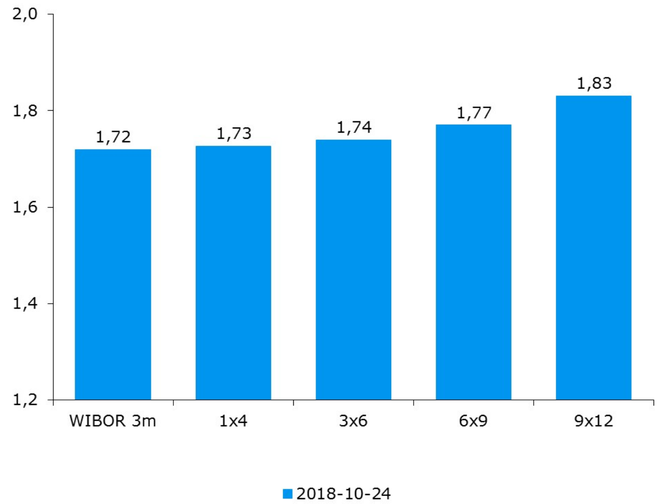
Fixed income

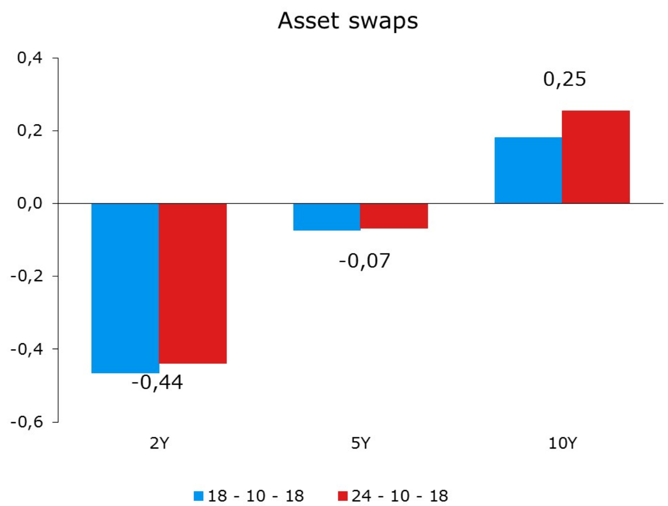
Waiting for the auction

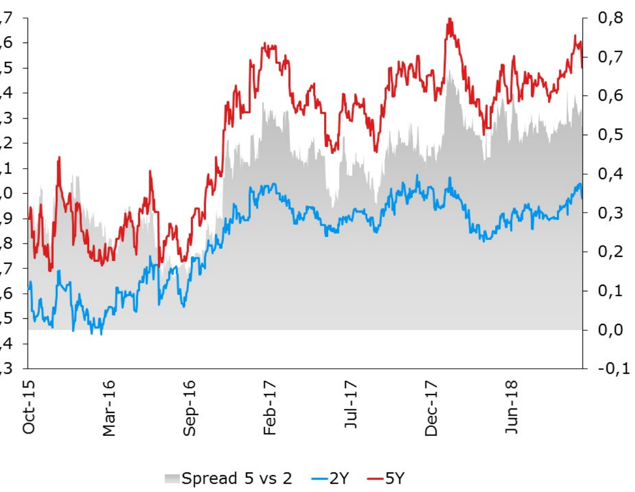
After IDS1018 and OK1018 expired this week, the market is waiting for the auction. Expected supply is 10 bn – not much, but demand should be much higher. ASWs finally reversed from its tops, but they are still extremely narrow.

DS1023/5y is -9 bps, WS0428/10y is 24 bps. DS1023/WS0428 is 74 bps. WS0428/Bund is 276 bps. DS1020 is trading at 1.52% (3bps down), DS1023 is trading at 2.42% (8 bps down) and WS0428 is trading at 3.16% (3bps down).









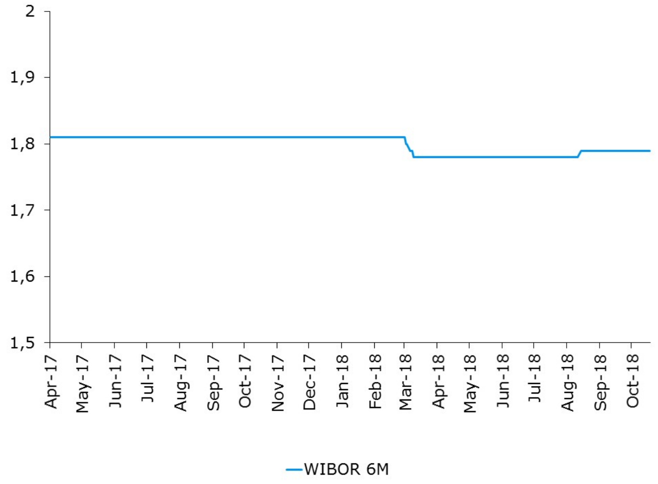
Money market

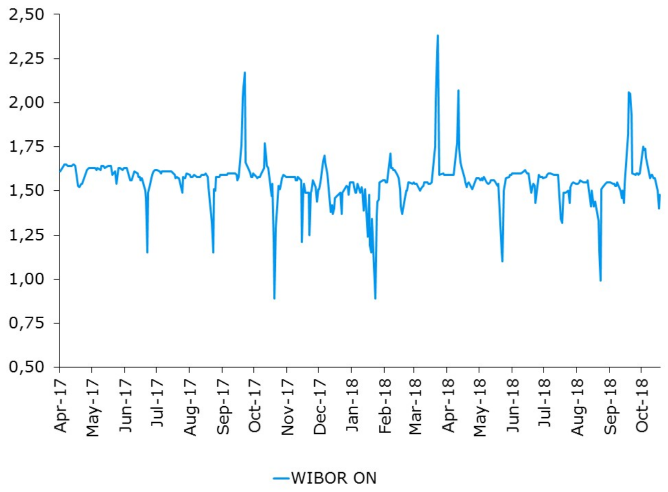
Polish swaps turned lower

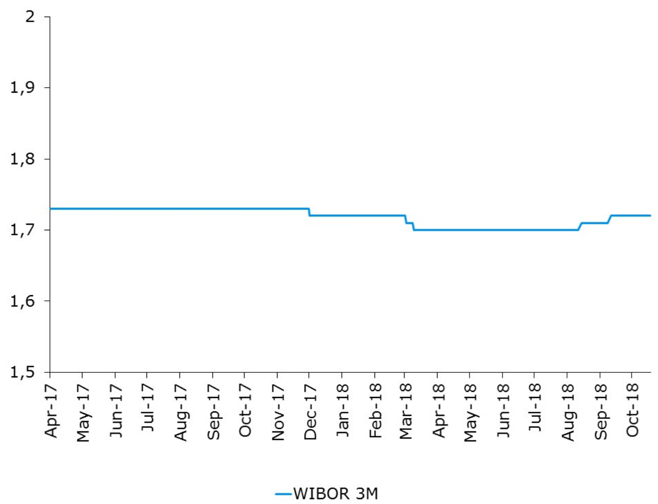
Polish swaps turned lower in recent days. Since beginning of the week it feels like the paying interest has evaporated. 5y swap is trading as low as 2.505% , that's around 15 bp off recent tops. It seems to be in line with recent economic data that came out on the weaker side.

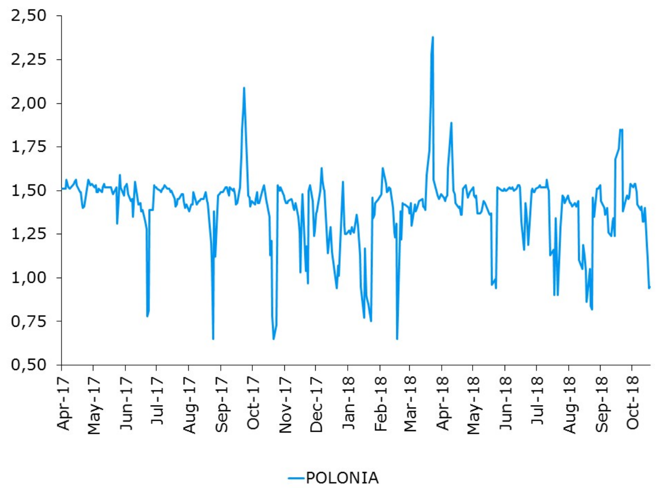
Cash was extremely cheap for the whole week. Even additional OMO wasn't sufficient to push rates higher. We are heading into month end which usually tends to be cheap.

Ref rate vs Polonia averages:
30 day 6 bp
90 day 15 bp





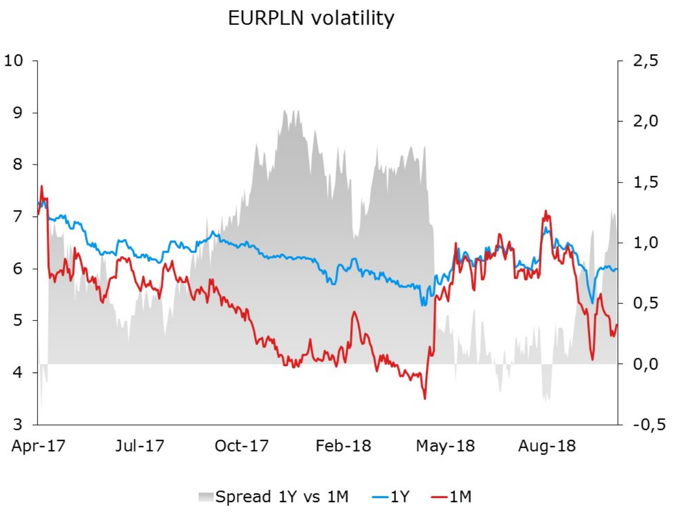




Forex

Spot – EUR/PLN – in the upper part of the range. The rout on Wall Street and weak European and U.S. economic data have dented global risk sentiment. It pushed emerging markets currencies into a weakening spiral. The Zloty, low Beta as it is, still fits into category. In consequence, EUR/PLN is traded above 4.31, but there is no need for panic yet. We are of the opinion that the well-known 4.26 – 4.34 range will still dominate.

Opts – Volatility higher Weaker PLN inevitably led to higher volatilities in EUR/PLN and USD/PLN. The front end was the obvious winner as market participants rushed to cover their Gamma shorts but we also see healthy demand for 9m and 1y vega. 1 month EUR/PLN ATM mid is this Thursday at 5.0% (0.5% higher than a week ago), 3 months are 5.1% (0.2% higher) and 1 year is fixing 6.0% (0.1% higher). The skew was at the same level as week before. The currency spread (difference between USD/PLN and EUR/PLN) moved higher by around 0.4%.

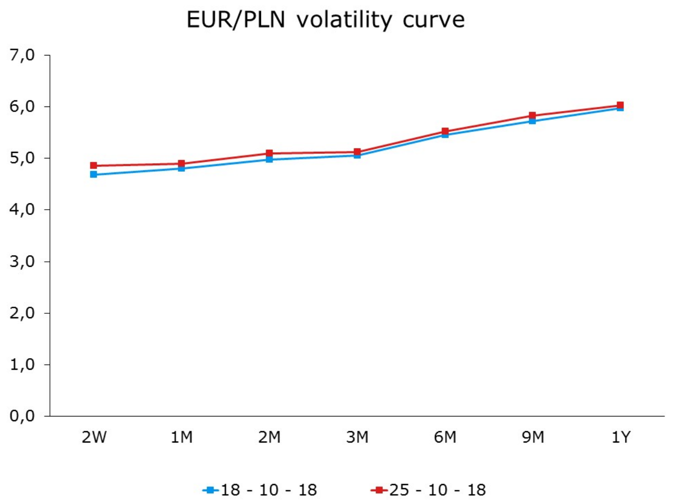


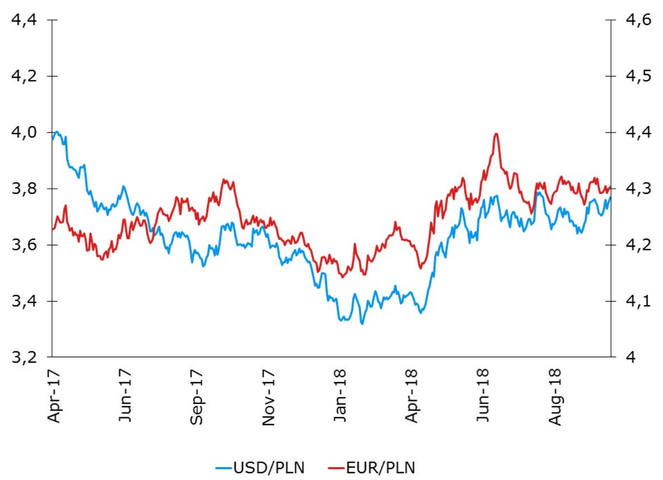
Short-term forecasts

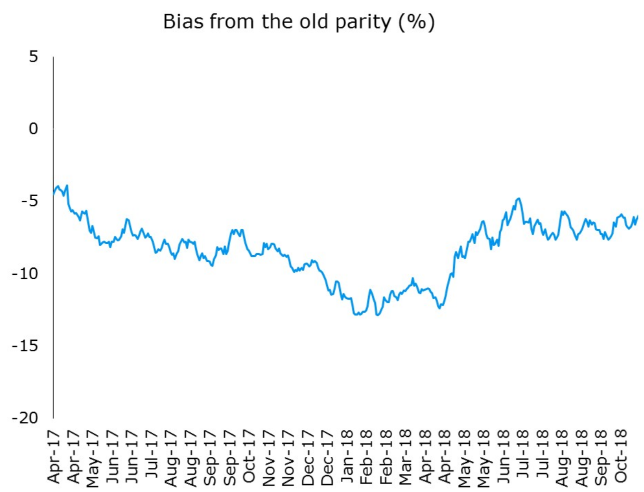
Main supports / resistances:
EUR/PLN: 4.2600 / 4.3400
USD/PLN: 3.6000 / 3.8000

Spot – Sidelined.

We think that 4.26-4.34 is the most likely scenario for now. We will try to tactically play that range, without any bias.







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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
10/18/2018	1.96	1.72	1.98	1.69	2.14	1.77	1.72	1.76	1.79	1.85	1.97	1.89
10/21/2018	2.03	1.72	2.01	1.69	2.18	1.77	1.73	1.75	1.80	1.86	1.99	1.87
10/22/2018	1.93	1.72	1.93	1.69	2.11	1.77	1.73	1.75	1.79	1.85	1.97	1.87
10/23/2018	1.72	1.72	1.74	1.69	1.91	1.77	1.73	1.75	1.78	1.84	1.96	1.86
10/24/2018	1.82	1.72	1.94	1.69	2.12	1.77	1.73	1.74	1.77	1.83	1.93	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	10/4/2018	7/25/2020	97.33	1.52	1000	1577	927
PS0424	10/4/2018	4/25/2024	98.80	2.73	1500	3701	2651
WS0428	10/4/2018	4/25/2028	95.50	3.30	1200	1926	1196

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0720	5Y IRS	PS0423	10Y IRS	WS0428
10/18/2018	1.770	1.318	2.030	1.564	2.577	2.503	3.002	3.183
10/21/2018	1.770	1.318	2.038	1.593	2.597	2.538	3.027	3.253
10/22/2018	1.770	1.321	2.038	1.587	2.607	2.525	3.038	3.256
10/23/2018	1.770	1.327	2.010	1.556	2.565	2.474	2.990	3.200
10/24/2018	1.770	1.314	1.980	1.541	2.503	2.435	2.923	3.177

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
10/18/2018	4.80	5.05	5.45	5.98	5.98	1.56	0.54
10/21/2018	4.70	5.00	5.45	5.95	5.95	1.56	0.54
10/22/2018	4.78	5.00	5.43	6.00	6.00	1.56	0.54
10/23/2018	4.93	5.13	5.50	6.00	6.00	1.61	0.54
10/24/2018	4.90	5.13	5.53	6.03	6.03	1.61	0.53

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
10/18/2018	4.2966	3.7302	3.7543	3.3140	1.3344	0.1662
10/21/2018	4.3049	3.7601	3.7746	3.3444	1.3309	0.1664
10/22/2018	4.2922	3.7273	3.7387	3.3053	1.3283	0.1660
10/23/2018	4.2984	3.7485	3.7667	3.3396	1.3317	0.1664
10/24/2018	4.3036	3.7698	3.7802	3.3509	1.3324	0.1667

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