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Polish Weekly Review

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Comment on the upcoming data and forecasts

On Wednesday, the NBP will publish balance of payments data for September. We expect both import and export to accelerate, but still keeping the current account deficit low. On Wednesday Statistics Poland will publish preliminary GDP data for the third quarter and final CPI data for October. We expect consumption to slow down to about 4.5%, investment should be around 6% and public consumption should increase because of the local election, but we will not see this until GUS recieves the full set of data and that's unlikely before next year's GDP revisions. Therefore our forecast for Polish GDP is a little below the market consensus (forecast 4.6 y/y vs the consensus 4.7). We also keep our forecast for CPI inflation (1.8% vs the flash reading 1.7%). Next Friday we get the core inflation data, which according to the CPI flash estimate should hit 0.9%.

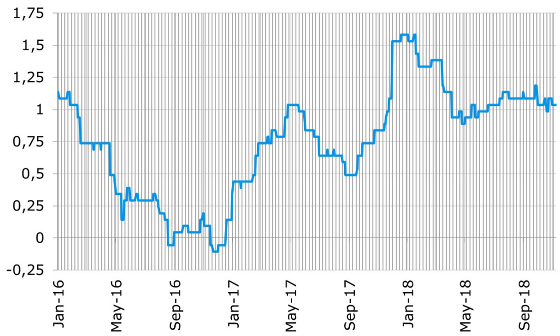
Polish data to watch: October 26th to November 2nd

Publication	Date	Period	mBank	Consensus	Prior
Current Account (m EUR)	13.11	Sep	-285	-376	-549
Export (m EUR)	13.11	Sep	18200	18068	17195
Import (m EUR)	13.11	Sep	18300.0	18029.0	17524.0
GDP y/y (%)	14.11	3Q	4.6	4.7	5.1
Final CPI y/y (%)	14.11	Oct	1.8	1.7	1.9
Core CPI y/y (%)	15.11	Oct	0.9	0.9	0.8

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	11/15/2018	700	1.456	10/26/2018
5Y T-bond PS0424	11/15/2018	3000	2.604	10/26/2018
10Y T-bond WS0428	11/15/2018	4000	3.179	10/26/2018
30Y T-bond WS0447	11/15/2018	20	3.643	10/4/2010

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



Comment

In the previous week surprise index moved one point downward due to the lower than expected CPI flash reading. This week surprise index remained flat because of the lack of Polish data. In the following days, there are few potential index movers – current account data, GDP for third quarter and final inflation readings.

* 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

- Q2 2018 marked the top of the business cycle. 2018 GDP will fall marginally short of 5% and decelerate further in 2019. We decided to decrease GDP growth forecast in 2019 to 3.6% due to worse consumption prospects. However, the transition towards lower growth is set to be smooth due to substantial potential for fiscal stimulation given currently low and projected GG deficit.
- Core inflation is steadily rising but CPI inflation is most likely to stay low, and even below MPC target in 2019. We do not think that energy prices for households are set to increase substantially given the political calendar. We think that second round effects after surge in electricity costs on the firms' side will be marginal. Current trends in food prices and recent turnaround in oil prices suggest that price developments on these fields at the start of the year are set to be very benign or even at the reverse.
- MPC stays calm even after projecting a substantial rise in inflation in 2019 due to „conservative" high energy prices. Our baseline is now flat rates in 2019. The fate of 2020 hikes is set to be known within the coming 3-4 months. Risks are tilted definitely to the downside.
- Fiscal situation continues to be very comfortable with GG deficits projected even by conservative bodies (European Commission) below 1%. 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	3.6
CPI Inflation y/y (average %)	-0.1	-0.9	-0.6	2.0	1.7	2.0
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	1.50

	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	4.3	4.3	4.0	3.5	2.9
Individual consumption y/y (%)	4.8	4.9	4.5	4.2	4.0	3.6	3.2	2.8
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	2.0	2.0	1.9	2.1
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	1.50
Wibor 3M (% eop)	1.70	1.70	1.72	1.70	1.70	1.71	1.72	1.73
2Y Polish bond yields (% eop)	1.49	1.63	1.56	1.55	1.60	1.78	2.00	2.20
10Y Polish bond yields (% eop)	3.18	3.22	3.24	3.30	3.40	3.59	3.78	3.95
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

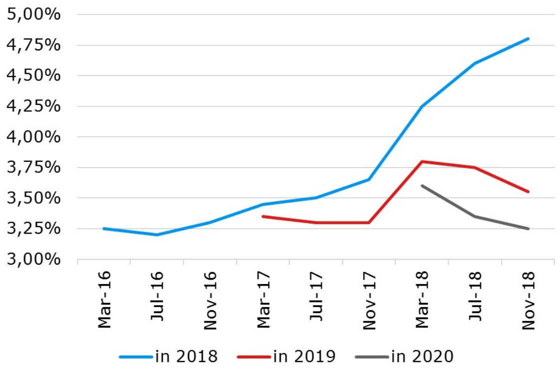
F - forecast

Economics

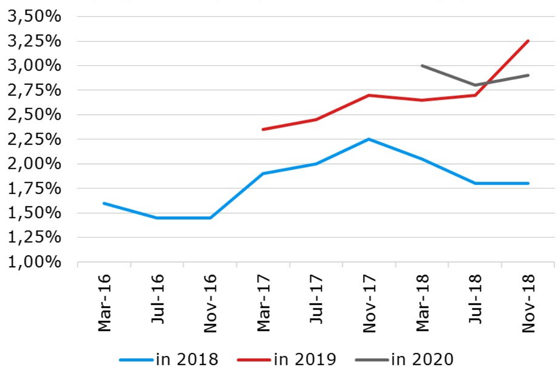
NBP rates and rhetoric unchanged despite higher inflation projections

The November meeting of the Polish Monetary Policy Council did not bring any changes to interest rates - key NBP rate is still at the historic low of 1.5%. The Council's statement has not seen any changes to the key passages – current rate levels are "conductive to keeping the Polish economy on a sustainable growth path and maintaining macroeconomic stability".

Average annual GDP growth in subsequent projections (midpoints of 50% range)



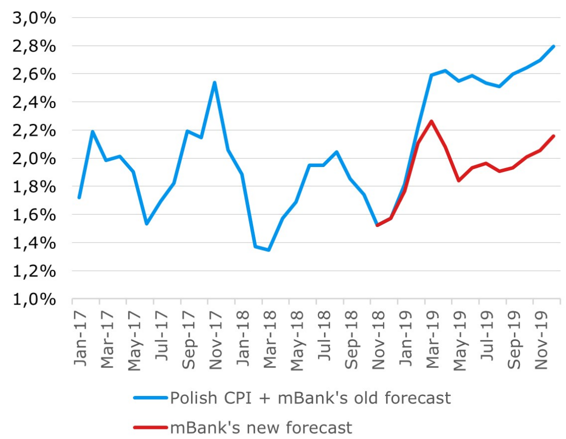
Average annual CPI inflation in subsequent projections (midpoints of 50% range)



As expected, the new NBP staff projections attracted most attention and excitement. However, the changes to CPI and GDP paths have not been entirely consistent with our expectations. GDP forecast is still a no-brainer for the NBP: this year's GDP growth forecast was raised from 4.6 to a very consensual 4.8% y/y; subsequent years have seen a slight downward revision (by 0.1-0.2 p.p.); downward is still the only way forward for Polish GDP growth. This year's inflation forecast is unchanged at 1.8%, but CPI is now projected to grow by 3.25% in 2019 (previously 2.7%) and 2.9% in 2020 (prev. 2.8%). This is the NBP's highest year-ahead inflation forecast since 2011.

These hawkish overtones have been immediately softened. First, the statement itself points to higher energy prices (considered "beyond the impact of monetary policy") as the source of higher inflation next year. Second, the NBP governor confirmed this during the press conference. Finally, it should be – according to Glapinski – treated as the worst-case scenario. Given the intrinsic and unresolvable uncertainty regarding the regulator's decision, the NBP staff assumed the worst possible scenario for retail energy prices. Actual hike will be much less pronounced, perhaps one third of the one assumed by the NBP in this projection. The governor's rhetoric was unequivocally dovish and consistent with the previous press conferences. In particular, even in the worst-case scenario of high electricity price hike the governor does not see any need to react and start a tightening cycle in 2019. If "nothing unexpected happens", the same applies to 2020. Thus, the governor's informal forward guidance appears to be extended to end-2020. Core inflation is not a reason for concern and second-round effects of higher electricity costs for corporations are seen as small (we agree with this analysis). There are two major sources of uncertainty for these forecasts: electricity prices and the reaction of immigrant labor force to changes in German labor regulations. As for the latter, the governor is optimistic and does not foresee any major outflow from Poland to Germany.

Taken altogether, the statement, the staff projections and the press conference have shown that the Council is willing to tolerate relatively high (although still within the target band) inflation to the extent its predecessors weren't. Contrary to some comments, the Council projects confidence regarding its baseline scenario, especially as far as the economic outlook is concerned ("GDP slowdown is certain"). By signaling that negative supply shocks will be looked through, the Council has set a very high bar for rate hikes. The unspoken but heavily implied conclusion is that a combination of negative supply shock and negative demand shock does not warrant a rate hike or a more hawkish stance in general. The electricity price hike assumed by the NBP is, in addition, a clear hit to household disposable incomes and any talk of compensation (via tax and transfer system) is in the realm of science fiction, much like the 15% electricity price hike itself.



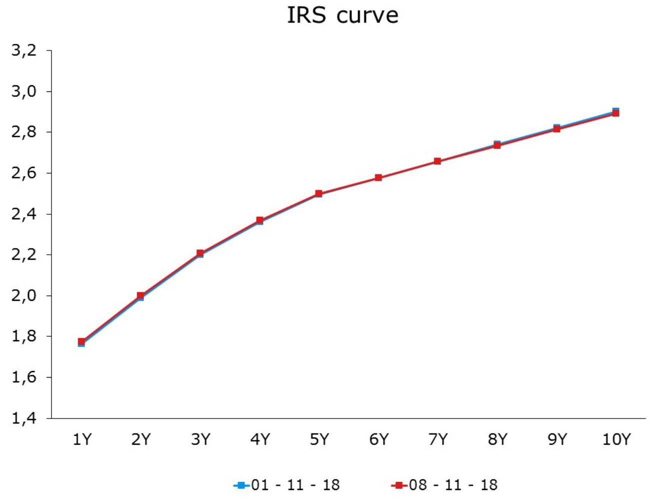
Finally, we believe that the risks to the NBP's inflation outlook are shifted to the downside due to lower electricity price hike, mild scenario for food prices and the decline in energy commodity prices that has already occurred since early October (Brent oil cheapened by 15% in PLN terms). Even if our aggressive core inflation forecast is unperturbed by this, headline inflation is set to oscillate around 2% y/y throughout 2019 (see the graph above). Current market pricing of monetary tightening (start in late 2019) is unrealistic. Our own forecast (early 2020) will also be subject to revisions in early 2019, once the electricity price hike is known and second-round effects seen in year-end pricing decisions measured.

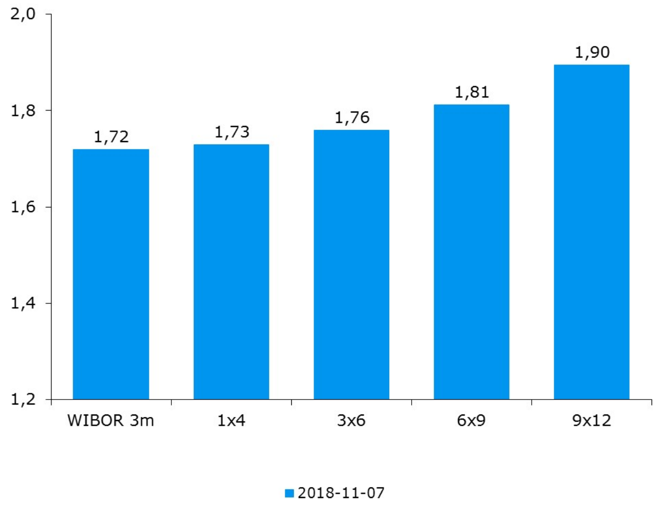
Fixed income

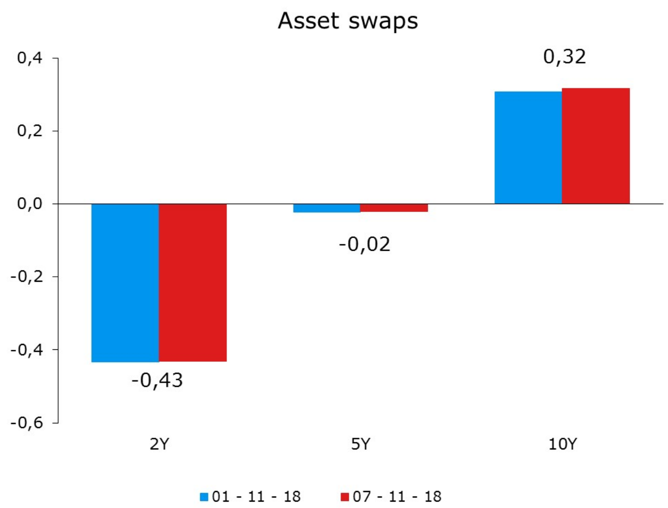
Interesting auction ahead

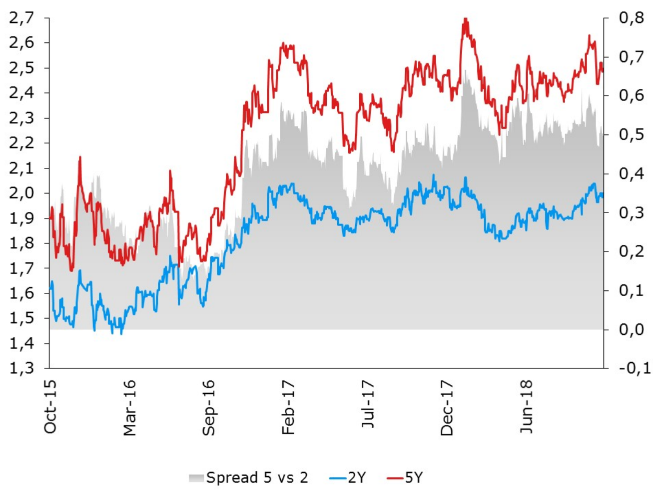
Demand on the last auction exceeded any expectations, most of the bids were placed on long-end bonds. After few days of bullish market, yields began to rise, which was triggered by new inflation projection. It is a week before next auction and, despite high demand on the last auction, we remain cautious as many T-bonds dealers have to make required participation share in primary market.

DS1023/5y is -7bps, WS0428/10y is 28bps. DS1023/WS0428 is 75bps. WS0428/Bund is 277bps. DS1020 is trading at 1,56% (4bps up), DS1023 is trading at 2,48% (6bps up) and WS0428 is trading at 3,23% (7bps up).









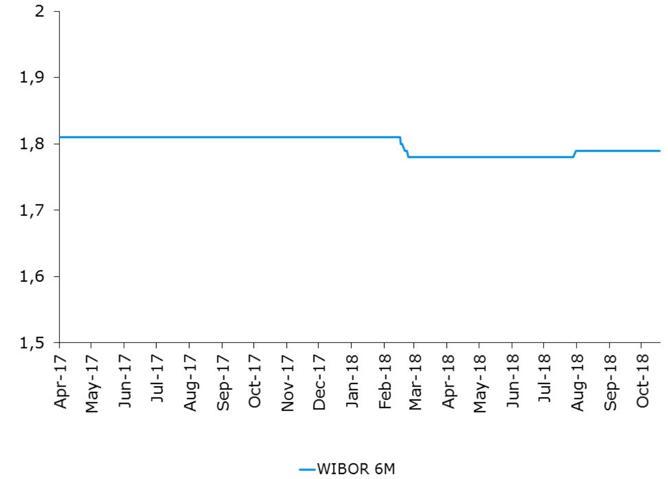
Money market

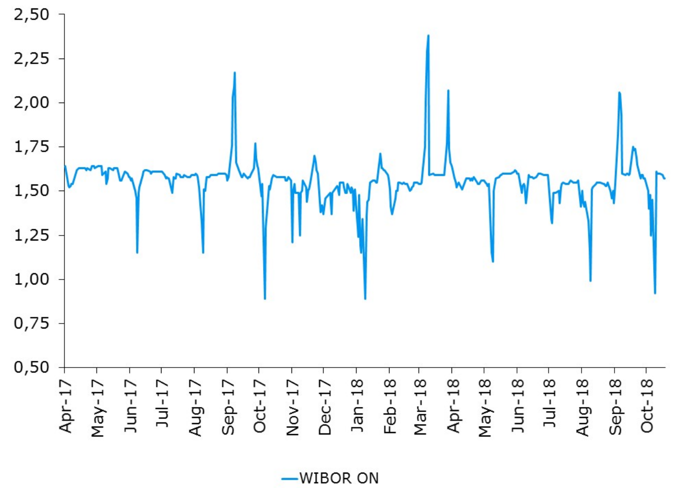
High inflation projection gives plenty of leeway for the MPC

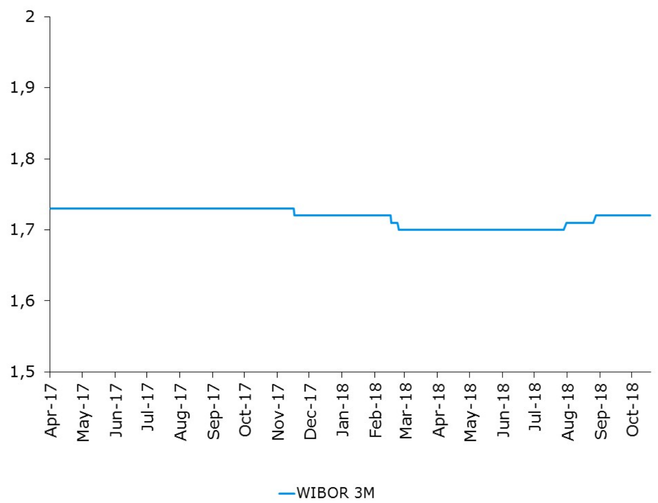
Yesterday's MPC meeting meant to be a non event again, yet It was different this time. All because of new NBP staff projections and especially higher CPI path for 2019. Their new projection shows medium CPI for 2019 at 3.25% versus 2.7% in previous one. That's a huge change and highly exaggerated in our opinion (see the entire macroeconomics section). The market reaction was obvious and the front end rates moved sharply higher. Whole curve rose about 3-6 bp. We are confused because NBP shows shocking upward CPI projections and on the other hand they say there is no need to change rates. Some believe that the new projections are just the worst case scenario and from now on MPC will have huge room for downside surprises in the CPI figures. The message then would be that we are well below the projections and therefore we are not forced to do anything.

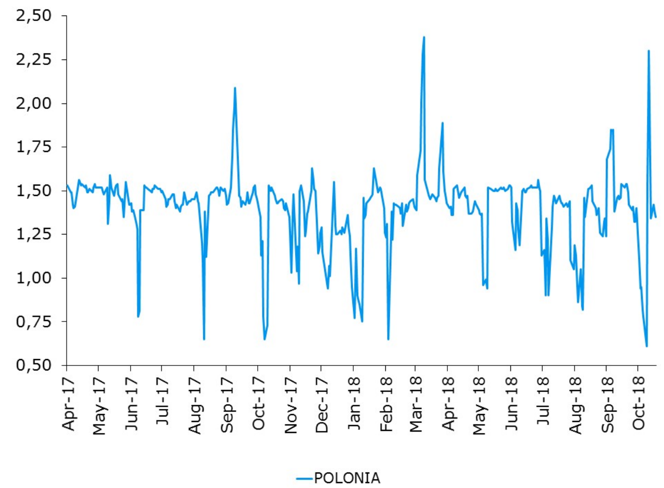
Cash stays rather cheap again. Beginning of the new month stabilizes overnight rate.:

30 day 18 bp
90 day 15 bp



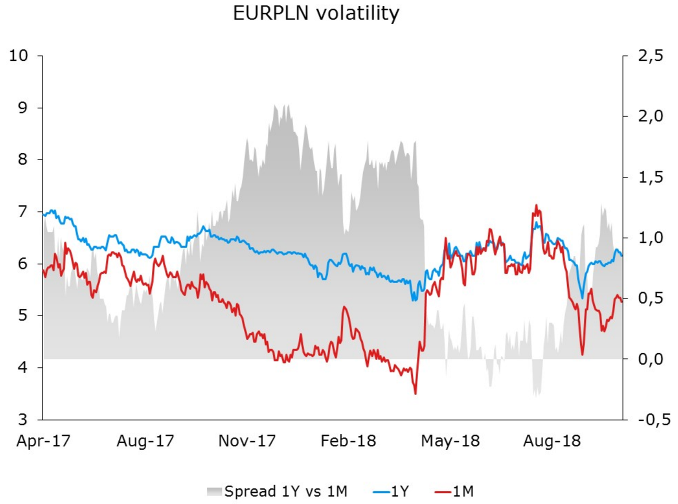




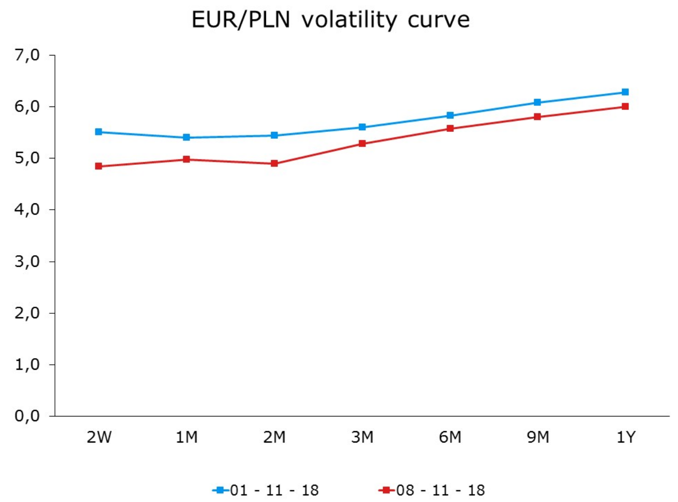


Forex

Spot – EUR/PLN – held in the range Most of the week the Zloty was on the rise, due to the better risk sentiment EUR/PLN slide was halted at 4.2860 level. Fundamentally, EM world is currently pushed and pulled around by USD fluctuations, and PLN is no exception. At the beginning of the week USD was losing ground both before and after the mid-term elections in USA but now, a minute before the Fed meeting, the dollar slightly recovered. Additionally the Zloty has not received any support from MPC, which is still convinced that will keep rates unchanged over a longer horizon. So generally we are still firm in 4.26 - 4.34 range and our strategy is still to play that range.



Opts: EUR/PLN vols – lower Stronger Zloty and low realized returns are to blame for undisturbed slide of EUR/PLN vol curve. 1 month EUR/PLN ATM mid is this Thursday at 4.6% (0.8% lower than a week ago), 3 months are 4.85% (0.55% lower) and 1 year is fixing 5.85% (0.35% lower). The skew was at the same level as week before. The currency spread (difference between USD/PLN and EUR/PLN) moved lower by around 0.4%.

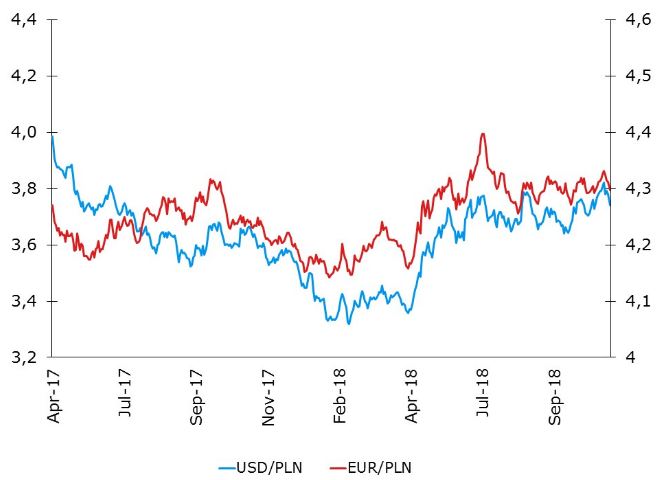


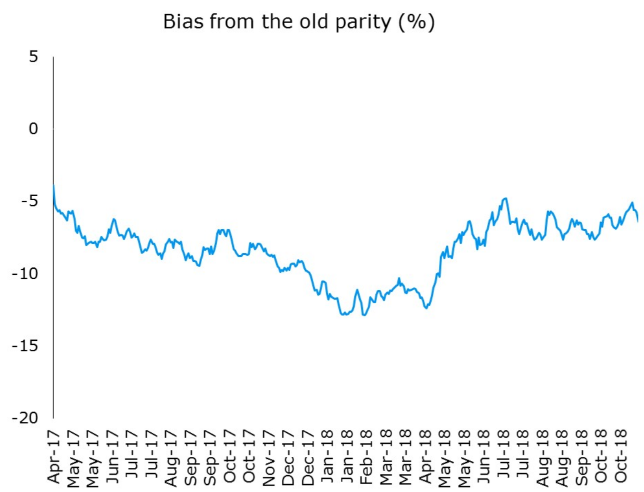
Short-term forecasts

Main supports / resistances:
EUR/PLN: 4.2600 / 4.3400
USD/PLN: 3.6000 / 3.9000

Spot: Current position: Short EUR/PLN at 4.34

We are short EUR/PLN at 4.3400. We are ready to add to short at 4.3550 with the stop at 4.3750. The 4.33/4.35 resistance zone seems to be the pivotal level, and we revisited levels below 4.30 relatively quick. We hope to take profit at 4.2700.





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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
11/1/2018	1.82	1.72	1.94	1.69	2.12	1.77	1.73	1.74	1.77	1.83	1.93	1.86
11/4/2018	1.82	1.72	1.94	1.69	2.12	1.77	1.73	1.74	1.77	1.83	1.93	1.86
11/5/2018	1.82	1.72	1.94	1.69	2.12	1.77	1.73	1.74	1.77	1.83	1.93	1.86
11/6/2018	1.82	1.72	1.94	1.69	2.12	1.77	1.73	1.74	1.77	1.83	1.93	1.86
11/7/2018	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	10/26/2018	7/25/2020	97.52	1.46	700	2600	700
PS0424	10/26/2018	4/25/2024	99.45	2.60	3000	6945	2930
WS0428	10/26/2018	4/25/2028	96.50	3.18	4000	15482	4242

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0720	5Y IRS	PS0423	10Y IRS	WS0428
11/1/2018	1.770	1.314	1.980	1.541	2.503	2.435	2.923	3.177
11/4/2018	1.770	1.314	1.980	1.541	2.503	2.435	2.923	3.177
11/5/2018	1.770	1.314	1.980	1.541	2.503	2.435	2.923	3.177
11/6/2018	1.770	1.314	1.980	1.541	2.503	2.435	2.923	3.177
11/7/2018	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
11/1/2018	4.90	5.13	5.53	6.03	6.03	1.61	0.53
11/4/2018	4.90	5.13	5.53	6.03	6.03	1.61	0.53
11/5/2018	4.90	5.13	5.53	6.03	6.03	1.61	0.53
11/6/2018	4.90	5.13	5.53	6.03	6.03	1.61	0.53
11/7/2018	4.90	5.13	5.53	6.03	6.03	1.61	0.53

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
11/1/2018	0.0000	0.0000	3.7802	3.3509	1.3324	0.1667
11/4/2018	0.0000	0.0000	3.7802	3.3509	1.3324	0.1667
11/5/2018	0.0000	0.0000	3.7802	3.3509	1.3324	0.1667
11/6/2018	0.0000	0.0000	3.7802	3.3509	1.3324	0.1667
11/7/2018	0.0000	0.0000	3.7802	3.3509	1.3324	0.1667

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