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Polish Weekly Review

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Comment on the upcoming data and forecasts

On Monday Statistics Poland will publish monthly labor market stats. After two months of disappointments we expect employment growth to stabilize at 3.2% y/y, while wages likely accelerated a bit, from 6.7 to 7.1% y/y – the latter is mainly due to favorable working day effect (y/y difference rose from -1 in September to +1 in October). The same effect should lift industrial output growth materially (to be released on Tuesday). However, poor energy output due to warm weather and low base will put a brake on y/y growth. Construction output, on the other hand, might be negatively affected by the completions of local government investment ahead of October elections, hence our below-consensus forecast. Producer prices accelerated slightly on the back of higher PLN-denominated energy prices. On Wednesday consumer confidence data for November will be released. Of the three releases next Thursday, retail sales print will be the more important one. We forecast real retail sales to accelerate from 3.6 to 5.8% y/y – below-consensus forecast is the result of poor car sales. Business sentiment indicators and MPC minutes should also be noted. Week ends with the release of M3 data.

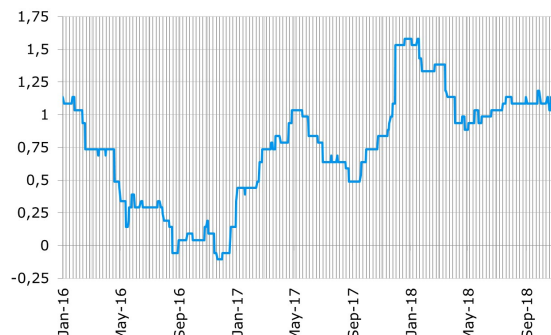
Polish data to watch: November 19th to November 23rd

Publication	Date	Period	mBank	Consensus	Prior
Average gross wage y/y (%)	19.11	Oct	7.1	6.5	6.7
Employment y/y (%)	19.11	Oct	3.2	3.2	3.2
Sold industrial output y/y (%)	20.11	Oct	5.5	6.6	2.8
Construction output y/y (%)	20.11	Oct	19.1	21.0	16.4
PPI y/y (%)	20.11	Oct	3.1	3.0	2.9
Consumer confidence	21.11	Nov			
Real retail sales y/y (%)	22.11	Oct	5.8	6.7	3.6
Business confidence	22.11	Nov			
MPC minutes	22.11	Nov			
M3 y/y (%)	23.11	Oct	7.7	7.8	7.9

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	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

Two surprises last week - flash GDP and final CPI. Both came out above expectations and lifted Polish 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

- Higher Q3 GDP data may imply a level shift in our GDP projections, but not in the trajectory. We await the details of the release to explore the nature of the surprise: a build-up in inventories is going to have different growth implications than an acceleration in private investment.
- (Subject to revision within three weeks) 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 below 1% projected even by conservative bodies (European Commission). 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

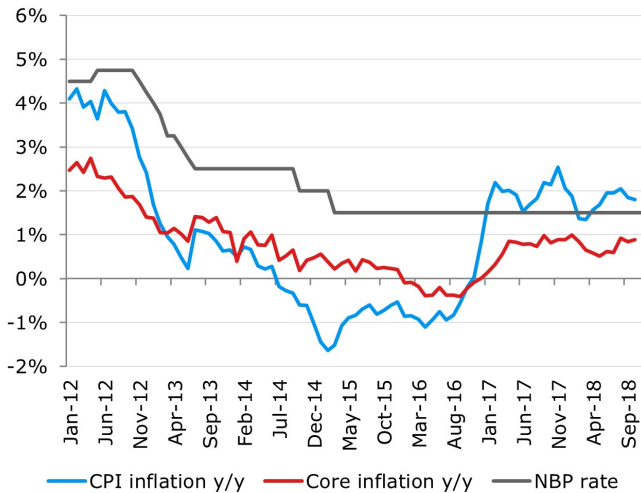
	2018	2018	2018	2018	2019	2019	2019	2019
	Q1	Q2	Q3 F	Q4 F	Q1 F	Q2 F	Q3 F	Q4 F
GDP y/y (%)	5.2	5.1	4.6	4.3	4.3	4.0	3.5	2.9
Individual consumption y/y (%)	4.8	4.9	4.5	4.2	4.0	3.6	3.2	2.8
Public Consumption y/y (%)	3.6	4.4	4.0	4.0	2.0	2.0	2.0	2.0
Investment y/y (%)	8.1	4.5	6.0	6.0	6.0	6.0	5.0	4.0
Inflation 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

CPI inflation at 1.8% y/y in October

For the second consecutive month, the final reading of inflation proved to be a tad higher than the flash release. Inflation in October came out at 1.8% y/y. It was all about rounding, though.

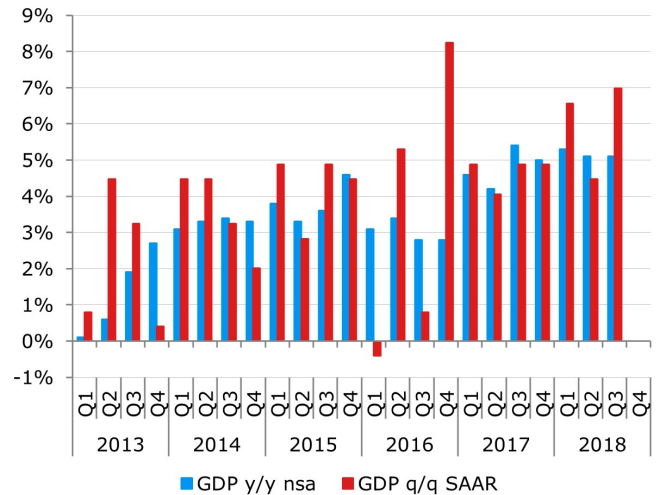


The details of the release stay unchanged in non-core measures: a delicate rises in food and energy prices and moderate growth in motor fuel prices. Core inflation accelerated to 0.9%. If only prices in communications and tobacco products had behaved differently, core inflation would have accelerated to 1.0%. Therefore, the scenario of slowly growing core CPI should be still regarded as a baseline one. We think core inflation may reach 2.4% by the end of 2019. NBP's own forecast of this inflation measure is even higher and this path may be subject to (upward) revision due to higher GDP data published today. Having said that it is worth to bear in mind that MPC takes current inflation path very easy and the described problem of revision is unlikely to shake current inflation path upside down.

Next months are set to bring decreases in CPI inflation that owe much to the dynamics in fuel market. PLN-denominated oil prices moved a lot from this year's top and this should translate into a drop in fuel prices with an usual time lag, possibly cumulating in December. Therefore we look to see CPI inflation close to 1.4-1.5% by the year's end.

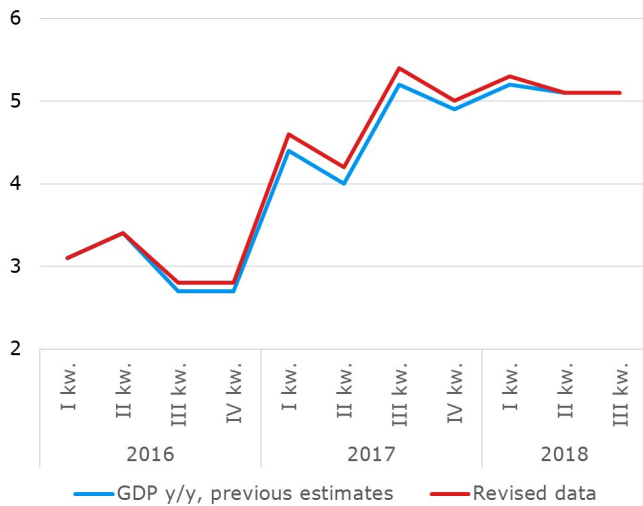
GDP is not slowing down

GDP rose by 5.1% y/y in the third quarter, easily beating market consensus (4.6-4.7% y/y) and our forecast (4.6% y/y). On a sequential basis the figure was also impressive, with 1.7% q/q growth reported by Statistics Poland. As a result, Poland joins Romania, Slovakia and Hungary among countries that defied expectations of a slowdown in Q3.



As usual, no details were given (they are due on November 30th), thus we are forced to speculate on the sources of the release. One possibility is that household consumption failed to slow down as expected (our forecast – 4.5%) if more vigorous spending on consumer services compensated for the deceleration in expenditures on consumer goods (as seen in retail sales data). It seems unlikely given the medium-term downward trend in services value added and deceleration in statistics on tourism and telecommunications. Second possibility is that the notoriously elusive private spending on machinery and equipment accelerated in Q3. The third conjecture (and the most plausible one, in our view) is that higher inventory buildup, in part related to purchases of cars ahead of WLTP introduction in September, boosted Q3 GDP. Our estimates put the number at PLN 1 bn (0.2 p.p. in GDP terms), but we judged it to be completely offset by higher imports. Perhaps national accounts data is not as perfect as we had hoped, perhaps other types of inventories made up the surprise. Finally, pre-election public consumption might have been a factor, but this we continue to be skeptical of this explanation as this type of spending usually fails to show up in initial GDP estimates.

Along with fresh Q3 data the CSO published revised quarterly growth figures for the 2016-2018q2 period. Overall, they match the annual revisions released in late October and indicate that economic growth in Poland peaked at a higher level in Q3'17 (5.4% y/y as compared to the first estimate of 4.7% y/y). The previous and new estimates are shown on the graph below.



The upside surprise in Q3 and revisions for H1 data will force all economy watchers to raise their 2018 forecasts – also, this comes at a moment when forecasters were getting ready to downgrade them. However, without any handle on the breakdown of the data, we can neither comment on the mid-term implications of the surprise, nor revise our own forecasts. Nevertheless it is clear that this is positive for Poland’s credit risk premia and will force the NBP to raise its staff projections again. Finally, NBP rate expectations will be anchored in Q4’19 in these circumstances.

Fixed income

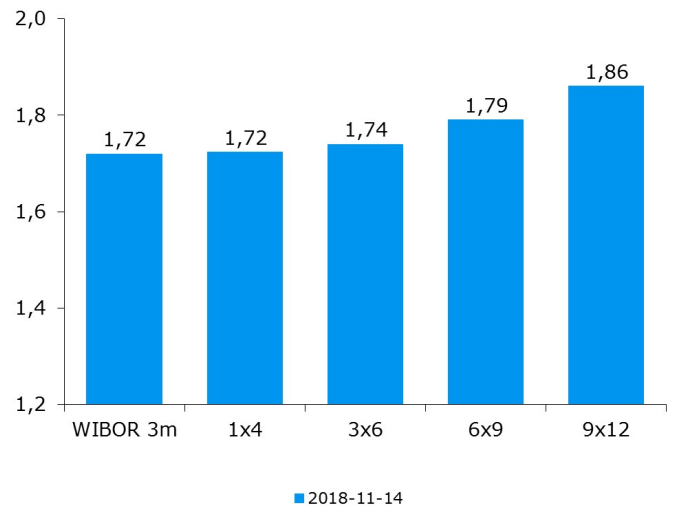
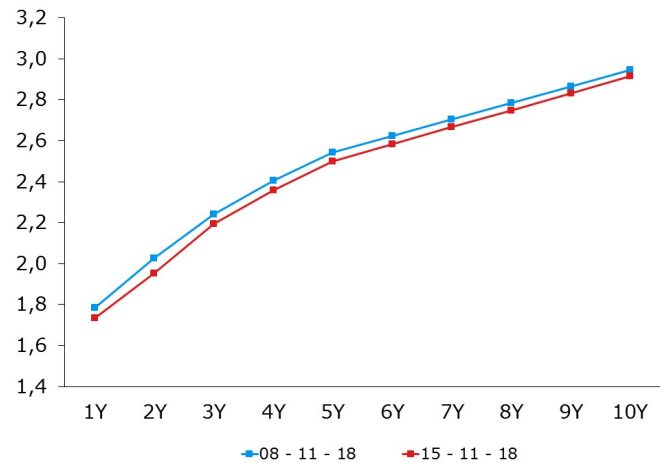
There was something in the air tonight

For the last two days we have seen massive inflows on FRNs and the short end, with investors looking to cash out. Additionally, Ministry sold 8,2 bn on today's auction. It doesn't help, liquidity is poor, market looks very heavy. ASWs are tight, especially relative to FRNs. However, there is a lot of fear on the market, as year-end outflows from banks and leveraged funds are possible. It might be a bumpy December.

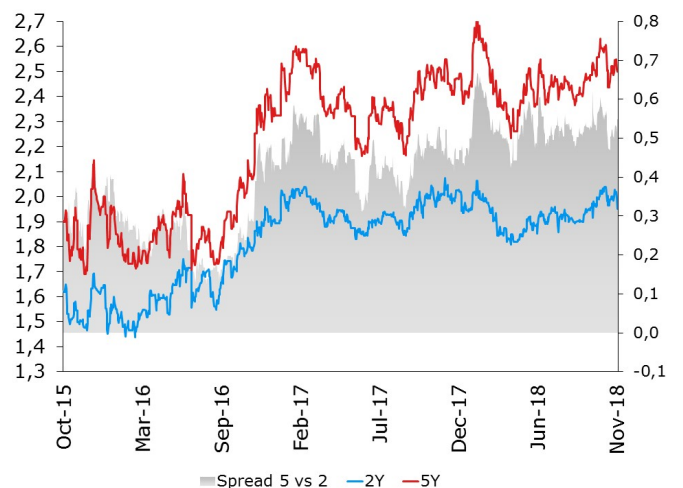
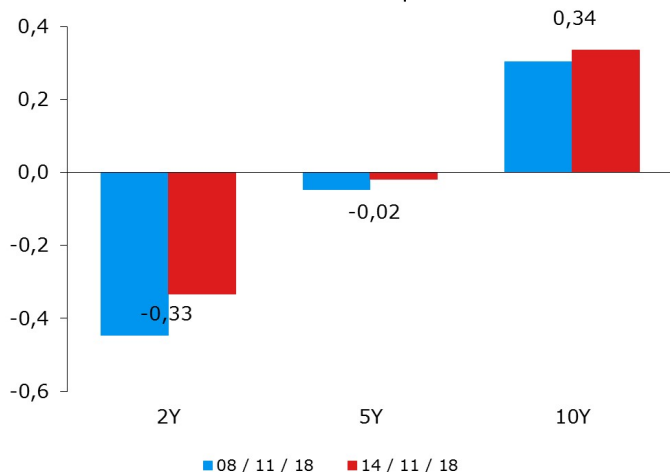
DS1023/5y is -1 bps, WS0428/10y is 34 bps. DS1023/WS0428 is 76 bps. WS0428/Bund is 297 bps.

DS1020 is trading at 1.59% (3 bps up), DS1023 is trading at 2.49% (1bps up) and WS0428 is trading at 3.25% (2 bps up).

IRS curve



Asset swaps



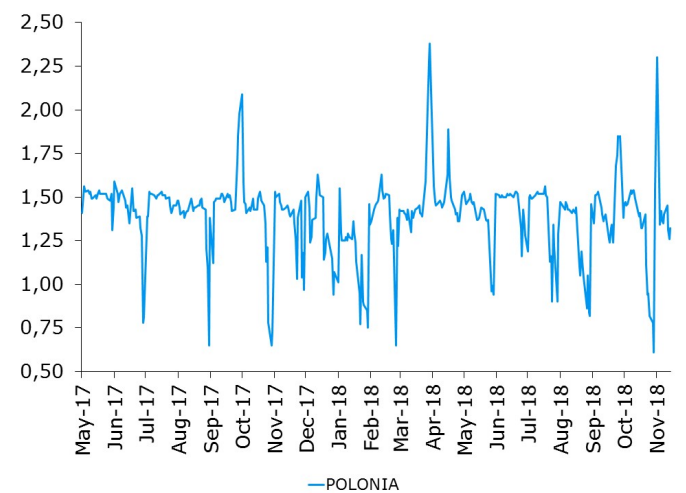
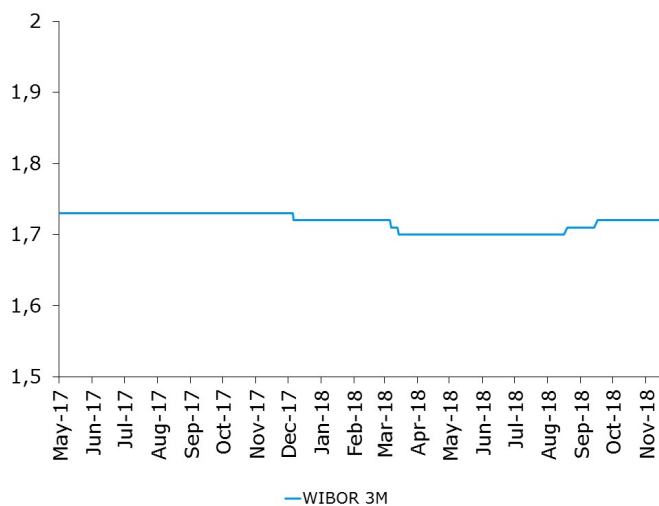
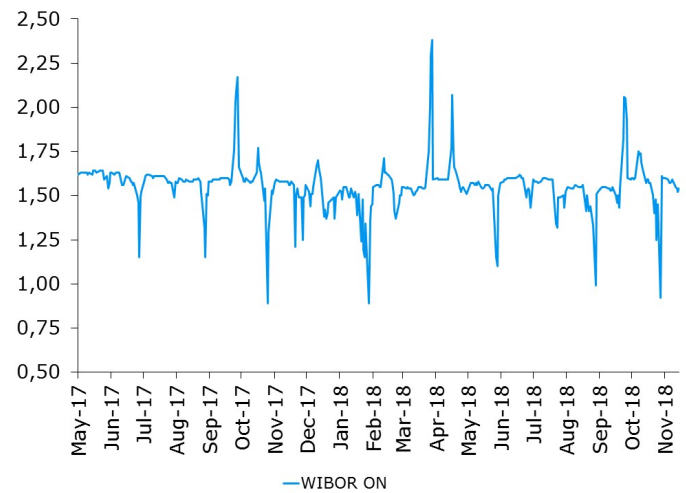
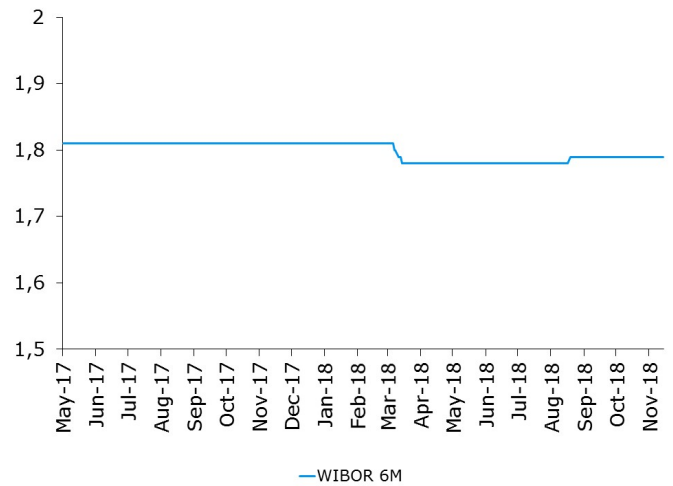
Money market

Land of confusion

Market pulled back from post-MPC heights. Swaps are down by about 5-8 bps along the curve with 2Y trading at 2.00%. Market is confused with recent low CPI prints and high projections for 2019 printed by the NBP. Recent information regarding the (now former) head of Polish Financial Supervision Authority only adds to the uncertainty. Within 2 days ASWs widened around 8 bps. However, the broader picture is that the market is still pretty stable and the moves are within range.

Cash rates stay rather low. In current environment banks may take a cautious approach and leave spare liquidity in coming days.

30 day 20 bp
90 day 15 bp



Forex

Spot – EUR/PLN – in the range The range play continues with 4.3050 constituting the high, and 4.2760 the low at last 5 working sessions. The Polish factor is not really in play – upbeat domestic economic data as well as political turmoil seems to be ignored. We are following the global "risk on", "risk off" moods and choppy trade on EUR/USD, which during last week was driven by concerns about Brexit, Italy's budget proposals, downbeat German investors' confidence data, the U.S.-China trade tensions and economic slowdown in China. Taking into account this number of worries, PLN behaves quite stable.

Opts: EUR/PLN vols – higher Vols were on the rise with worsening market sentiment – the main driver was the uncertainty over Britain's Brexit deal with the European Union, which has spooked investors. We saw this week a decent bid for gamma and vega. 1 month EUR/PLN ATM mid is this Thursday at 5.0% (0.4% higher than a week ago), 3 months are 5.05% (0.2% higher) and 1 year is fixing 6.0% (0.15% 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 0.6%.

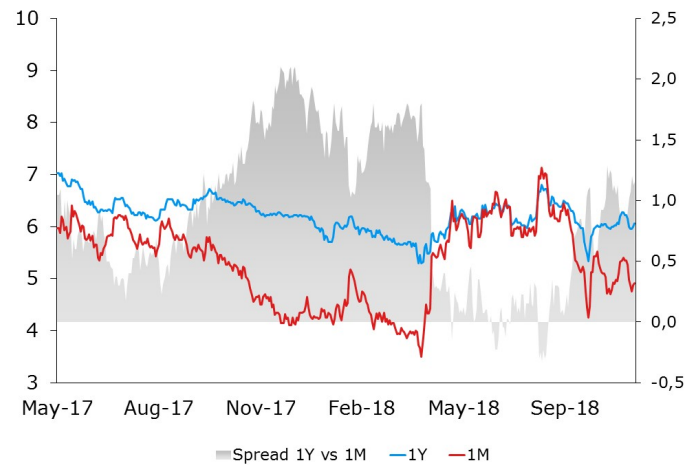
Short-term forecasts

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

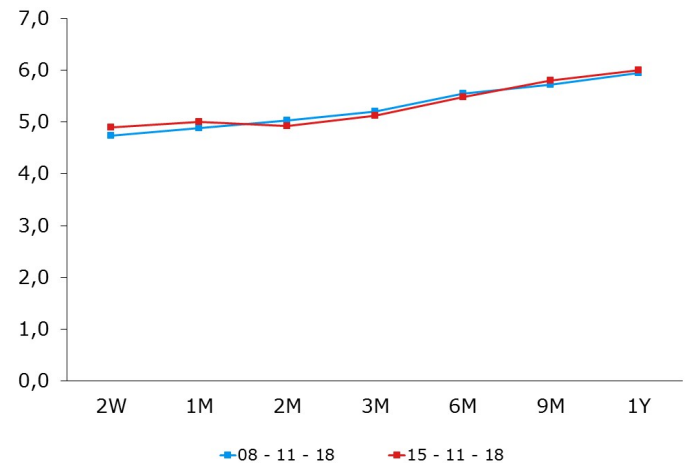
Spot: Current position: Short EUR/PLN at 4.34

We are still 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 (we have missed the purchase by 50 ticks).

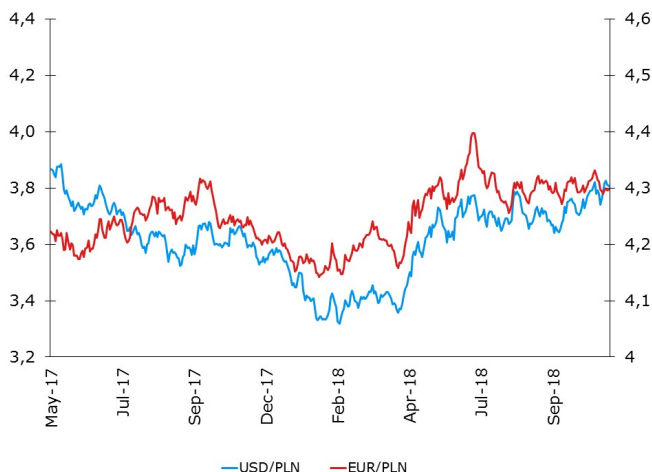
EURPLN volatility



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
11/8/2018	2.00	1.72	1.99	1.69	2.10	1.77	1.73	1.75	1.82	1.89	2.00	1.92
11/11/2018	2.02	1.72	2.07	1.69	2.19	1.77	1.72	1.75	1.81	1.87	1.97	1.90
11/12/2018	2.04	1.72	2.01	1.69	2.11	1.77	1.73	1.75	1.79	2.03	2.00	1.87
11/13/2018	1.92	1.72	1.90	1.69	1.99	1.77	1.72	1.74	1.79	1.87	1.98	1.89
11/14/2018	2.00	1.72	1.98	1.69	2.07	1.77	1.72	1.74	1.79	1.86	1.96	1.89

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
11/8/2018	1.770	1.290	2.027	1.581	2.543	2.496	2.945	3.249
11/11/2018	1.770	1.289	2.015	1.557	2.547	2.458	2.968	3.222
11/12/2018	1.770	1.262	2.019	1.549	2.548	2.451	2.975	3.235
11/13/2018	1.770	1.266	1.994	1.579	2.508	2.457	2.925	3.223
11/14/2018	1.770	1.299	1.951	1.617	2.500	2.481	2.915	3.250

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
11/8/2018	4.88	5.20	5.55	5.95	5.95	1.65	0.55
11/11/2018	4.75	5.10	5.53	5.95	5.95	1.65	0.55
11/12/2018	4.88	5.10	5.50	6.00	6.00	1.63	0.55
11/13/2018	4.91	5.17	5.50	6.06	6.06	1.61	0.55
11/14/2018	5.01	5.13	5.48	6.00	6.00	1.60	0.54

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
11/8/2018	4.2951	3.7599	3.7504	3.3075	1.3358	0.1661
11/11/2018	4.2901	3.7838	3.7535	3.3222	1.3347	0.1653
11/12/2018	4.2962	3.8163	3.7809	3.3497	1.3351	0.1656
11/13/2018	4.2994	3.8268	3.7862	3.3535	1.3326	0.1657
11/14/2018	4.2954	3.8114	3.7747	3.3466	1.3302	0.1654

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