

November 29, 2018

## Polish Weekly Review

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### Table of contents

#### Our view in a nutshell

#### Economics

- Polish state budget is on a roll

#### Fixed income

- ASW widening has short legs

#### Money market

- False breakout?

#### FX market

- Spot – EUR/PLN – still no fireworks
- Options – EUR/PLN vols – lower

page 2

page 3

page 4

page 5

page 6

### Comment on the upcoming data and forecasts

This Friday Statistics Poland will release final GDP data for the third quarter. Apart from a non-negligible likelihood of a positive revision, details of the release will be of utmost importance. We expect that the surprise (5.1% y/y flash estimate, market consensus at 4.6-4.7% y/y) was driven by higher-than-anticipated inventory buildup, while consumption and fixed investment behaved mostly in line with expectations (our forecasts are 4.5 and 6.0% y/y, respectively). In addition, revised quarterly national accounts data for 2016-2018 will be published along with Q3 GDP. At the same time, flash CPI reading for November will be published. Following the downside surprises in euro area data releases, we expect Polish CPI to dive a little bit deeper than current market consensus forecasts (prev. reading +1.8% y/y, consensus 1.6% y/y, our forecast 1.5% y/y). The decline in inflation is mainly due to low prices of unprocessed food and a base effect in fuel prices – still no sign of recent oil price drops in retail prices. On Monday Markit will publish Polish Manufacturing PMI for November. We believe in a corrective rebound, consistent with the surprising upswing in Statistics Poland's sentiment indicators. Finally, on Wednesday the December meeting of the MPC will end. We expect no change to interest rates and to the Council's rhetoric. Recent declines in inflation will be welcome as evidence that downside risks to NBP's staff CPI forecast are materializing.

### Polish data to watch: November 30th to November 7th

Publication	Date	Period	mBank	Consensus	Prior
GDP y/y <i>final</i> (%)	30.11	Q3	5.1	5.1	5.1
Flash CPI y/y (%)	30.11	Nov	1.5	1.6	1.8
Manufacturing PMI (pts.)	03.12	Nov	51.5	50.5	50.4
MPC rate decision	05.12	Dec	1.50	1.50	1.50

### 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

Unchanged (no data releases). Final GDP, flash CPI and the PMI can all surprise in the coming days.

\* 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 two 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	-0.6	-1.2
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

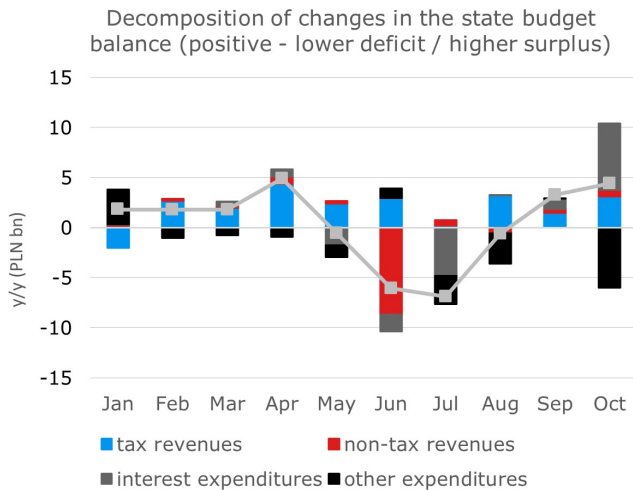
	2018 Q1	2018 Q2	2018 Q3 F	2018 Q4 F	2019 Q1 F	2019 Q2 F	2019 Q3 F	2019 Q4 F
GDP y/y (%)	5.2	5.1	4.6	4.3	4.3	4.0	3.5	2.9
Individual consumption y/y (%)	4.8	4.9	4.5	4.2	4.0	3.6	3.2	2.8
Public Consumption y/y (%)	3.6	4.4	4.0	4.0	2.0	2.0	2.0	2.0
Investment y/y (%)	8.1	4.5	6.0	6.0	6.0	6.0	5.0	4.0
Inflation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

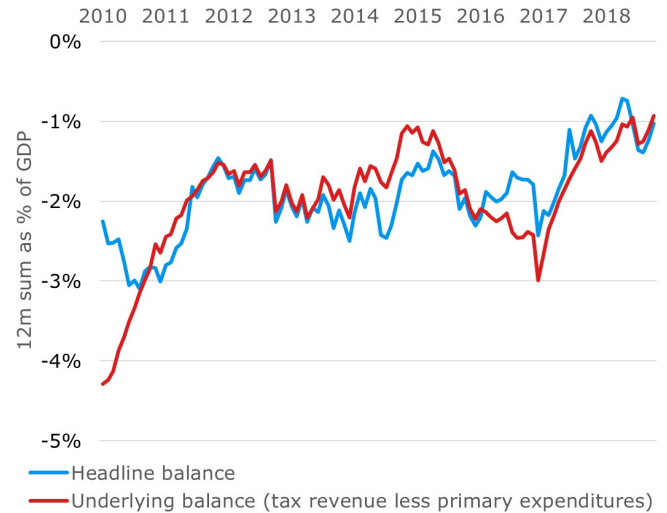
## Economics

### Polish state budget is on a roll

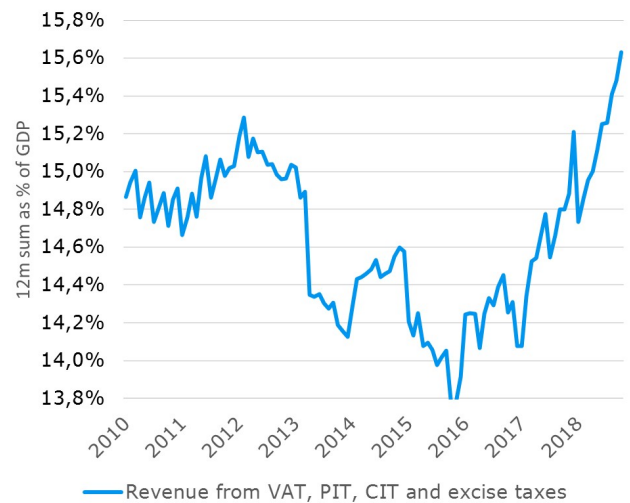
According to latest fiscal statistics, the state budget recorded a PLN 6.5 bn surplus in the first 10 months of the year. During the month of October, the surplus was an impressive PLN 3.3 bn. However, the surplus was significantly boosted by one-off factors whose origin dates back to July data.



As our Readers may recall, July brought an unprecedented deterioration in the fiscal balance – a single-month deficit of PLN 10 bn. This was largely due to unusually high debt service costs that month, which rose by ca. PLN 5 bn on y/y basis, needless to say, without any major move in the exchange rate or other fundamental factors. From the very beginning Polish economy watchers suspected that this had resulted from a shift in interest payments forward in time (from October to July) via swap transactions. Indeed, detailed budgetary statements show a corresponding net acquisition of financial assets of PLN 5 bn in July. To complete the circle, in October, debt service costs were 5 bn below last year's level. As a result, accrual-based budget deficit was inflated in July and understated in October, while actual cash payments are unchanged. This accounting gimmick obviously will not impact full year figures, but was presumably useful as expectations management tool at the time. To wrap up, after a proper adjustment, October figures appear close to last year's. On a 12-month rolling basis fiscal deficit has remained quite stable.



Compared to October 2017, the solid increase in non-interest expenditures (partly due to higher subsidy to social security funds, other sources are unknown at this time) is almost exactly matched by higher tax revenues. Total tax revenues rose by 10.3% y/y in October and excise tax (+6.6% y/y) was the only major category that didn't experience double digit growth (VAT +11.4% y/y, CIT +15% y/y, PIT +11.5% y/y). As a result, tax revenues rose to a new post-credit high a measured against GDP.



Keeping one-off factors aside, one should note that Poland's fiscal situation remains very favorable and general government deficit is set to decline significantly below 1% of GDP (even to 0.5%). The state budget itself will likely end the year with a PLN 15-20 bn deficit, depending on the scale of usual year-end expenditure push. The expected GDP slowdown next year will not be deep enough to materially alter the trajectory of key fiscal figures as output gap will remain decisively positive.

## Fixed income

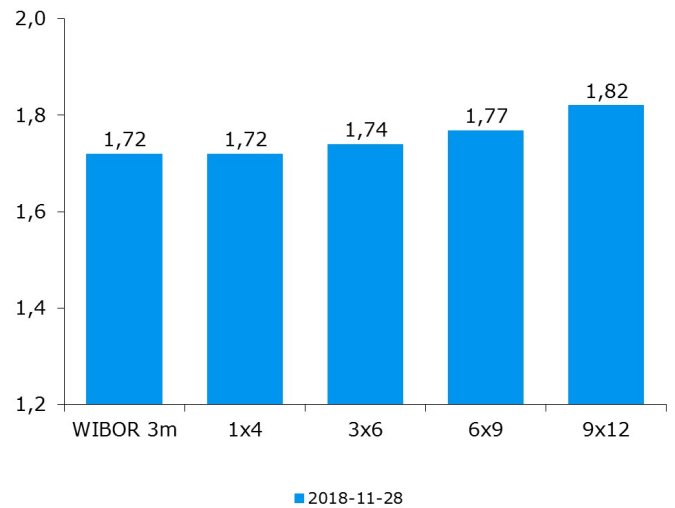
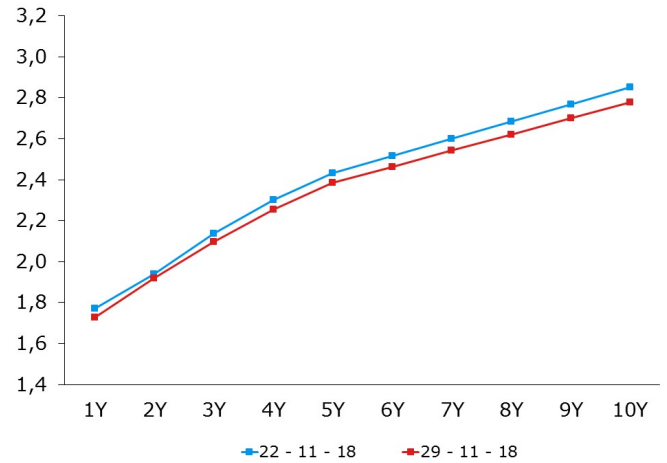
### ASW widening has short legs

The end of year is coming, liquidity is poor, most trading desks are closed or don't want any risk, so maybe it is time to do the opposite... Today demand was covered on the auction, so the secondary market may lose its appeal. We see massive flow on IRS, some internationals are receiving 5y. The consequence is that ASWs spreads are getting wider and wider every day. However, since supply will be rather small in December, this doesn't make much sense, especially in the belly of the curve (PS0424/5y is 20 bps!).

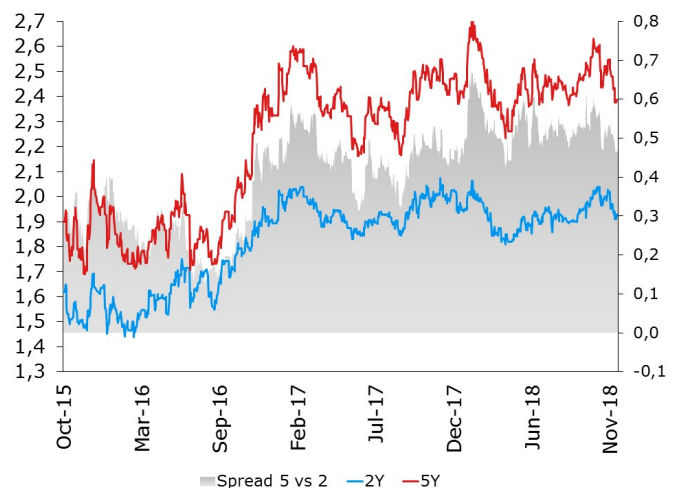
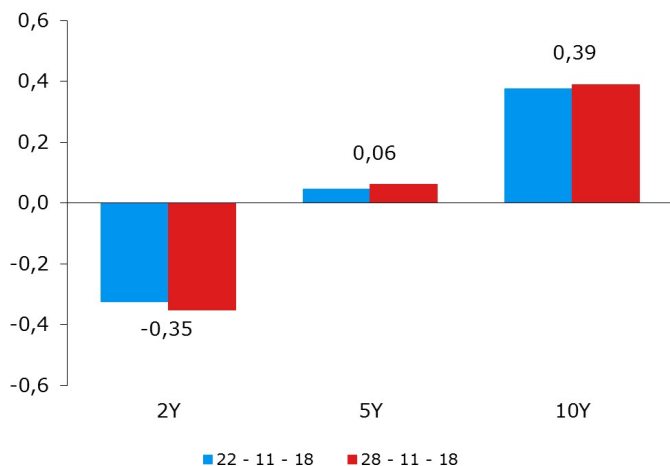
DS1023/5y is 5 bps, WS0428/10y is 40 bps. DS1023/WS0428 is 75 bps. WS0428/Bund is 282 bps.

DS1020 is trading at 1.54% (5 bps down), DS1023 is trading at 2.40% (7 bps down) and WS0428 is trading at 3.15% (6 bps down).

IRS curve



Asset swaps

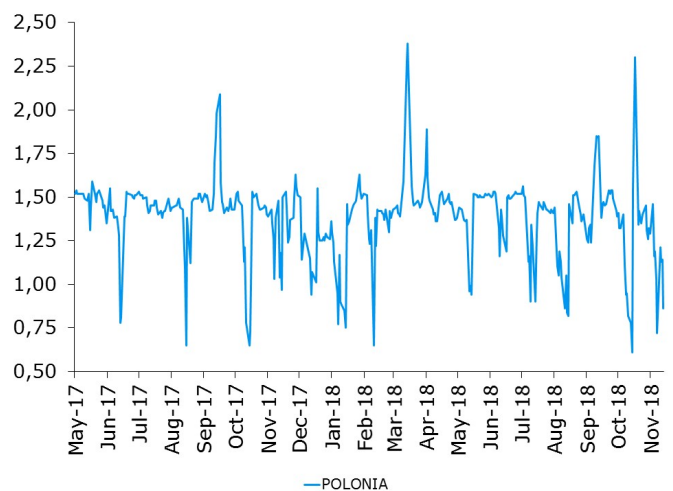
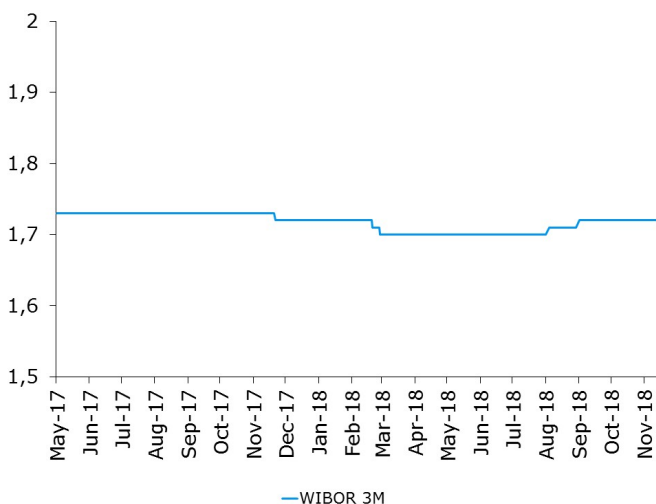
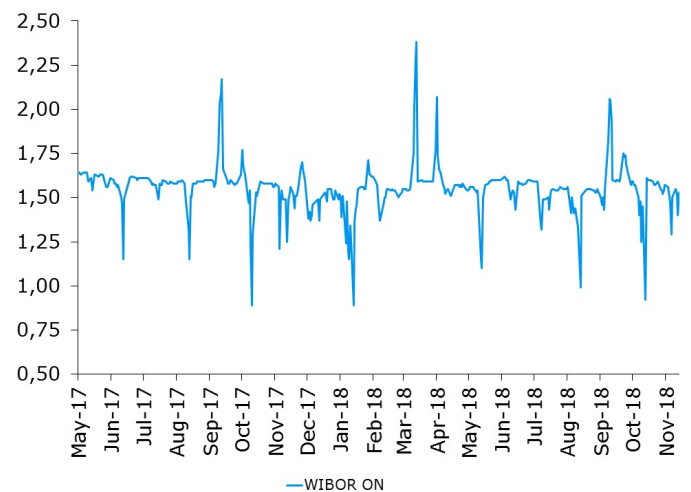
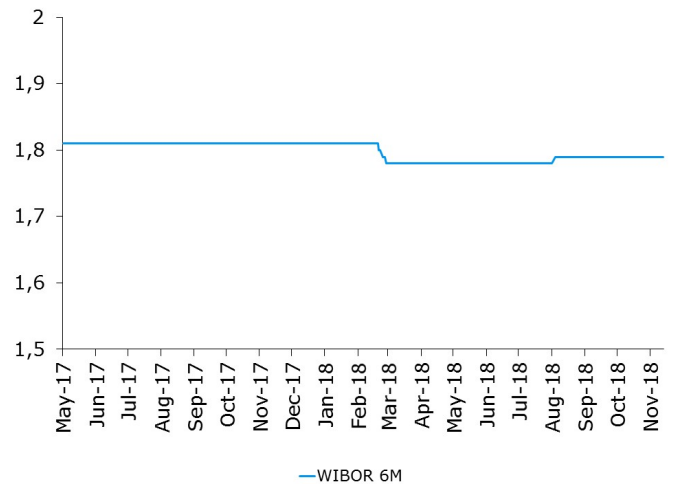


## Money market

### False breakout?

Polish rates have been setting multi-month lows last week. That's mainly globally driven. We still lack a local story and the outlook for lower yields globally is pushing us lower in a thin market. Five year swap is trading as low as 2.345%, which is breaking the lows of the range. This might pull out some SL and drag rates a bit lower. Many players will see this as a good opportunity to bet on higher rates, especially in the short end, with 1y1y trading at less than 25 bps premium to current 3m wibor.

Cash rates stay low as we predicted. Market is really thin due to month end. Market should get back closer to reference rate as new reserve period starts.



## Forex

**Spot – EUR/PLN – Still no fireworks** Emerging market currencies regained their strength as dovish remarks from the U.S. Federal Reserve Chairman Jerome Powell put the dollar on the back foot. However, Zloty underperformed its peers in the region over worries about the banking sector and involvement of the NBP President in this affair. Additionally, the disputes between our government and the European Commission are still weighing on Zloty – yesterday the European Justice Commissioner made comments that the infringement procedure against Poland on the Supreme Court issue will still go through. All in all, it was another week with EUR/PLN slowly drifting lower in the range 4.26 - 4.34.

**Opts: EUR/PLN vols – lower** It was a rather calm week on the spot market, so implied volatility curves have melted. Volatilities are lower across the curve in both main currency pairs, EUR/PLN and USD/PLN. EUR/PLN 1 month ATM mid fixed today at 4.8% (0.55% lower), 3 month EUR/PLN is at 4.9% (0.45% lower) and, finally, 1 year is 5.95% (0.115% lower). The skew and the currency spread (difference between USD/PLN vol and EUR/PLN vol) are at same level as week ago.

### Short-term forecasts

Main supports / resistances:

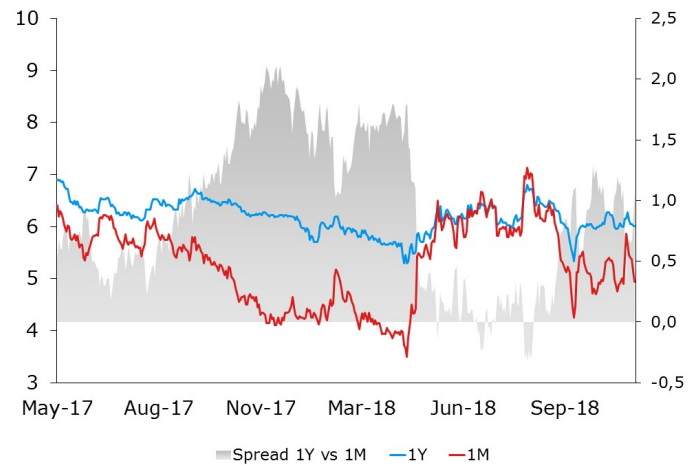
EUR/PLN: 4.2600 / 4.3400

USD/PLN: 3.6000 / 3.9000

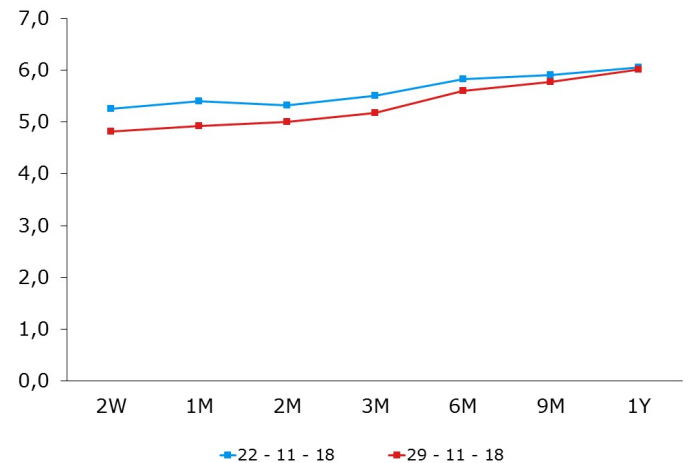
### Spot: Current position: None

Our strategy is roughly unchanged, we still believe in the rangy nature of EUR/PLN, with a slight PLN-negative bias. Therefore, we are ready to buy EUR/PLN at 4.27 with stop at 4.24 and hopes to see 4.34-35 again.

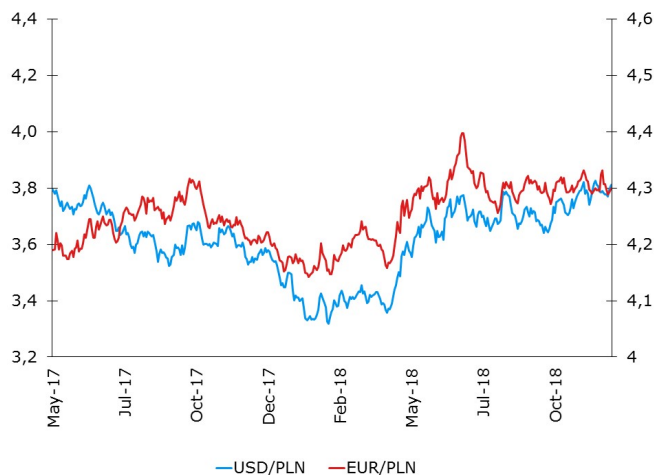
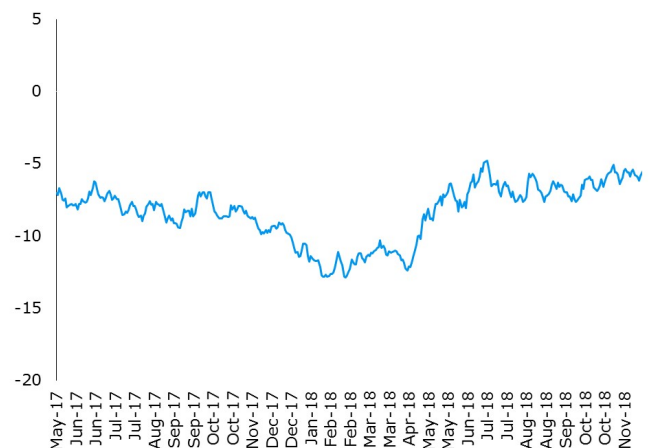
EURPLN volatility



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
11/22/2018	1.97	1.72	1.96	1.69	2.07	1.77	1.73	1.74	1.79	1.84	1.90	1.88
11/25/2018	1.95	1.72	1.96	1.69	2.06	1.77	1.72	1.74	1.77	1.82	1.87	1.84
11/26/2018	2.01	1.72	1.96	1.69	2.08	1.77	1.72	1.74	1.77	1.82	1.88	1.84
11/27/2018	1.53	1.72	1.61	1.69	1.64	1.77	1.73	1.75	1.79	1.85	1.92	1.88
11/28/2018	1.86	1.72	1.94	1.69	2.16	1.77	1.72	1.74	1.77	1.82	1.88	1.84

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
11/22/2018	1.770	1.300	1.940	1.614	2.434	2.480	2.853	3.228
11/25/2018	1.770	1.299	1.910	1.588	2.375	2.425	2.778	3.155
11/26/2018	1.770	1.293	1.917	1.593	2.385	2.441	2.785	3.180
11/27/2018	1.770	1.211	1.928	1.584	2.387	2.430	2.783	3.167
11/28/2018	1.770	1.166	1.920	1.568	2.385	2.446	2.779	3.168

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
11/22/2018	5.40	5.51	5.82	6.05	6.05	1.73	0.56
11/25/2018	5.38	5.42	5.73	6.05	6.05	1.73	0.56
11/26/2018	5.15	5.33	5.65	6.03	6.03	1.70	0.56
11/27/2018	4.94	5.23	5.58	6.01	6.01	1.78	0.55
11/28/2018	4.92	5.18	5.59	6.01	6.01	1.73	0.55

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
11/22/2018	4.3064	3.7764	3.8000	3.3435	1.3386	0.1656
11/25/2018	4.2972	3.7779	3.7949	3.3482	1.3376	0.1654
11/26/2018	4.2883	3.7701	3.7831	3.3297	1.3303	0.1658
11/27/2018	4.2919	3.7948	3.7950	3.3395	1.3247	0.1654
11/28/2018	4.2994	3.8114	3.8137	3.3504	1.3256	0.1659

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