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Polish Weekly Review

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Comment on the upcoming data and forecasts

This Friday, Statistics Poland will publish December's flash CPI, which we expect to grow by 1.3% y/y, with the core inflation at 0.8%. In detail, flour gets more expensive, as well as fruits (apples and grapes) or vegetables (potatoes, tomatoes, peppers). Dairy and meat remain cheap. Fuel is cheaper by 4% m/m. Core inflation increases (trend in education, recreation and culture, or housing excluding energy). Wednesday's MPC conference should not surprise, keeping both interest rates and rhetoric unchanged.

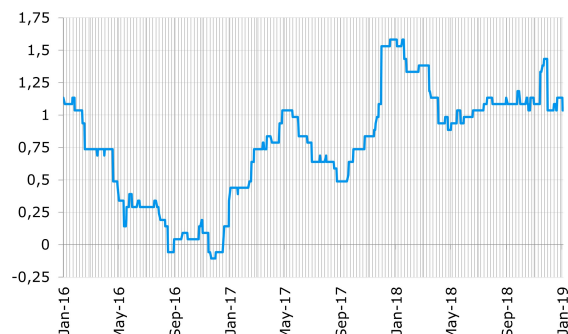
Polish data to watch: January 4th to January 11th

Publication	Date	Period	mBank	Consensus	Prior
CPI y/y <i>flash</i> (%)	04.01	Dec	1.3	1.2	1.3
MPC decision (%)	09.01	Jan	1.5	1.5	1.5

Treasury bonds and bills auctions

Paper	Next auction	Last Offer	Yield on the prev auction (%)	Prev auction
T-bill	-	700	1.500	2/22/2017
2Y T-bond OK0720	1/10/2019	700	1.456	10/26/2018
5Y T-bond PS0424	1/10/2019	3000	2.604	10/26/2018
10Y T-bond WS0428	1/10/2019	4000	3.179	10/26/2018
30Y T-bond WS0447	1/10/2019	20	3.643	10/4/2010
5Y floater WZ0524	1/10/2019	1800	-	10/26/2018
10Y floater WZ0528	1/10/2019	300	-	10/26/2018

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



Comment

Negative surprise from the Polish manufacturing PMI reading (47.6 vs 49.8 points expected) moved the surprise index 2 points lower. In the following days, only tomorrow's flash CPI reading can change Poland's 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 imply a level shift in our GDP projections, but not in the trajectory.
- The turn of 2017 and 2018 marked the top of the business cycle. 2018 GDP will grow at ca. 5% and decelerate considerably in 2019. With modestly worse consumption prospects and public investment peaking in annual terms this year, we expect GDP to grow by 3.8% y/y next year. However, the transition towards lower growth is set to be smooth due to substantial potential for fiscal stimulation given low current and projected GG deficit.
- Core inflation is projected to rise steadily, but CPI inflation is likely to stay low and undershoot the 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 on 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.
- The PLN proved to be exceptionally resilient in recent months: neither the increase in global rates, nor their subsequent decline and violent repricing of monetary policy expectations managed to break it out of the narrow, 2.5% range vis-a-vis the euro.
- While this might be seen as a good omen, the room for PLN to strengthen is not really there: cyclical, low nominal interest rates, attractiveness of PLN asset markets and worsening terms of trade suggest that PLN strengthening would not be welcome by local stakeholders, big and small. As a result, we expect EURPLN to remain essentially flat within the forecast horizon.

mBank forecasts

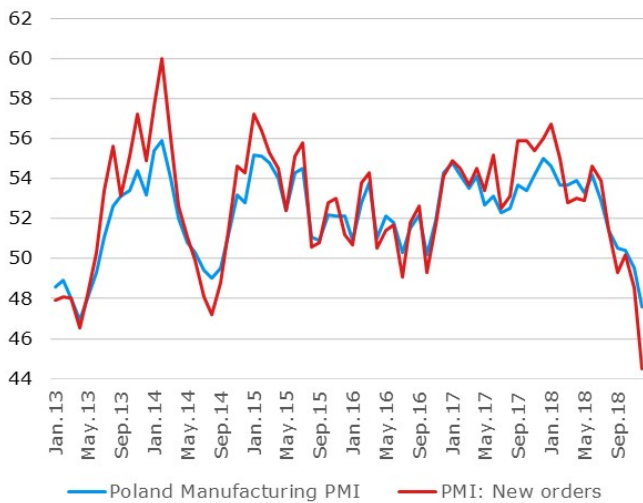
	2015	2016	2017	2018 F	2019 F	2020F
GDP y/y (%)	3.8	3.0	4.8	5.1	3.8	3.3
CPI Inflation y/y (average %)	-0.9	-0.6	2.0	1.6	1.7	2.5
General government balance (%GDP)	-2.7	-2.2	-1.4	-0.2	-0.7	-1.1
Current account (%GDP)	-0.6	-0.3	0.2	-0.6	-1.2	-1.4
Unemployment rate (end of period %)	9.8	8.2	6.6	5.6	5.0	4.9
Repo rate (end of period %)	1.5	1.5	1.5	1.5	1.5	2.5

	2018 Q1	2018 Q2	2018 Q3	2018 Q4 F	2019 Q1 F	2019 Q2 F	2019 Q3 F	2019 Q4 F
GDP y/y (%)	5.3	5.1	5.1	4.8	4.3	4.2	3.6	3.1
Individual consumption y/y (%)	4.7	4.9	4.5	4.3	4.1	3.9	3.5	3.1
Public Consumption y/y (%)	3.0	3.5	3.6	4.0	2.0	2.0	2.0	2.0
Investment y/y (%)	8.2	4.7	9.9	10.0	6.0	6.0	5.0	4.0
Inflation rate (% average)	1.5	1.7	1.9	1.4	1.5	1.6	1.6	2.0
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	3.20	3.30	3.50	3.74	3.96
EUR/PLN (eop)	4.21	4.37	4.28	4.30	4.30	4.25	4.25	4.25
USD/PLN (eop)	3.42	3.74	3.69	3.74	3.71	3.63	3.60	3.56
F - forecast								

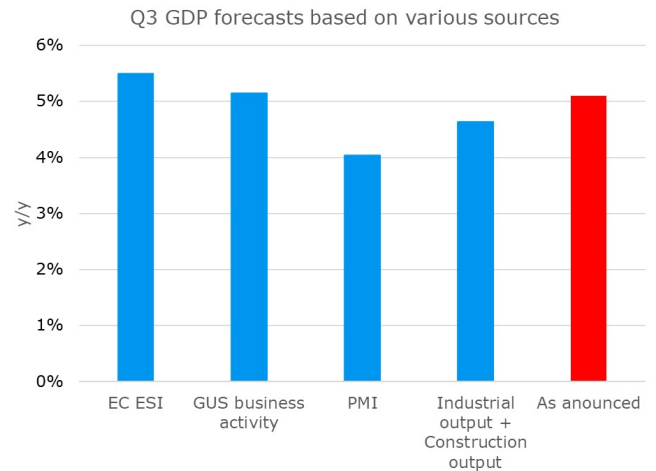
Economics

December's nightmare in manufacturing

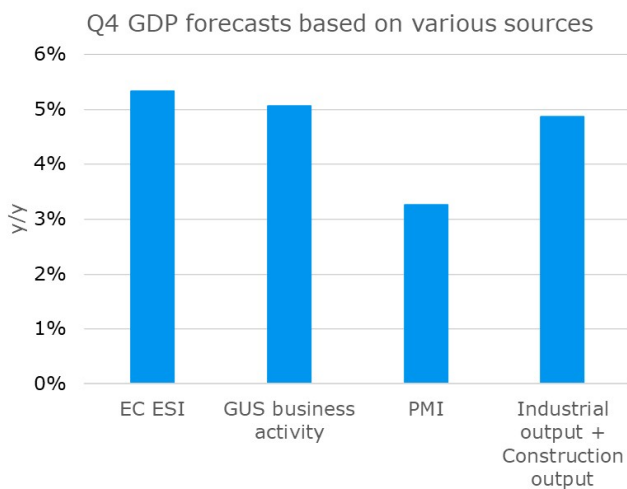
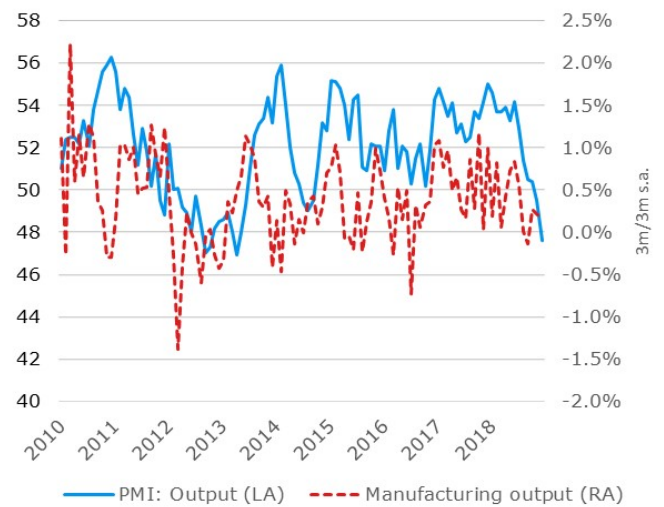
Business activity in December, as measured by the PMI index, fell from 49.5pts to 47.6pts and reached the level last seen in April 2013. Every single subindex disappointed and new orders did it perhaps in the most spectacular way (see the graph). The big drama lies in the fact the drop was unanimously unexpected, and consequently exaggerated in comments that followed and in the market pricing that wiped away all interest rate hikes in Poland till the end of 2020. The amount of pessimism is not justified. At least not in this very moment.



Why? Forecasting on the basis of PMI index is especially cumbersome since it vividly understates the pulse of the economy measured in a standard way via GDP growth. As you can see on the graph, the forecast for Q3 based on PMI should have landed at around 4% whereas other sources of information were more accurate and closer to final reading. The situation painted in Q4 seems more dramatic, but again, other sources of information which are mostly facts at this very moment point to only slight decrease in GDP growth.



It would be interesting to know why PMI paints such gloomy picture. The statistical sample for this indicator is small relative to business activity surveys conducted by GUS and even smaller compared to reports submitted by corporate sector (from where "hard data" come from). At the same time, the structure of the PMI sample is skewed towards enterprises grouped in global supply chains and therefore more correlated with e. g. measures of activity in euro zone. It is fairly straightforward that these types of enterprises are minor part of the whole manufacturing and manufacturing is only a small part of the economy. However, PMI indeed sends a negative signal for the manufacturing itself (see the graph) but – as described – the volatility of PMI is greater than that of manufacturing.



Fixed income

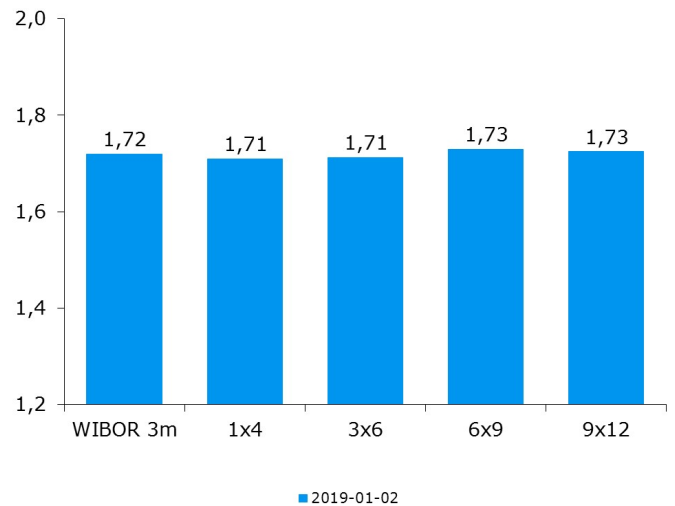
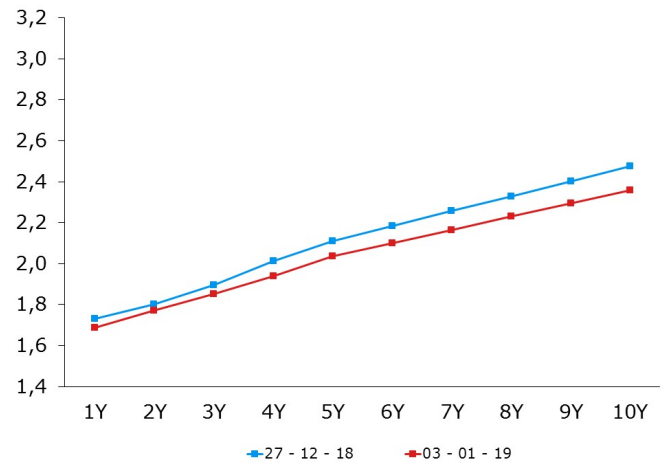
New Year starts with lower yields

Happy New Year! Local clients are buying, internationals are on the offer. Yields touched ridiculousness levels, WS0428 was traded at 2.70%. Liquidity is still poor, real trading should start on Monday. Curve is very flat, even after recent negative surprise in PMI.

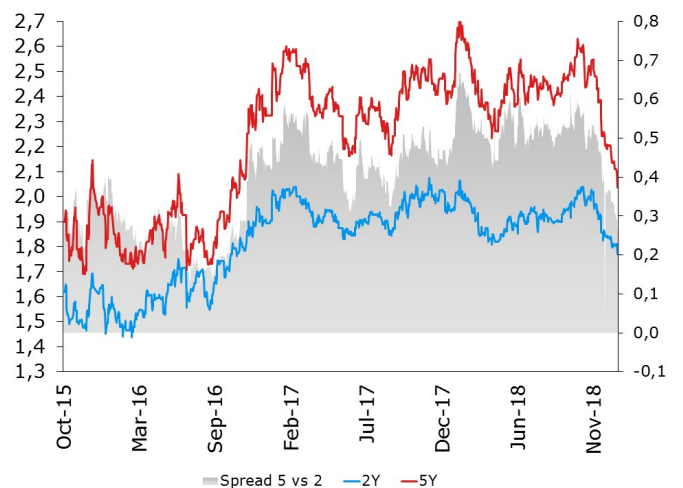
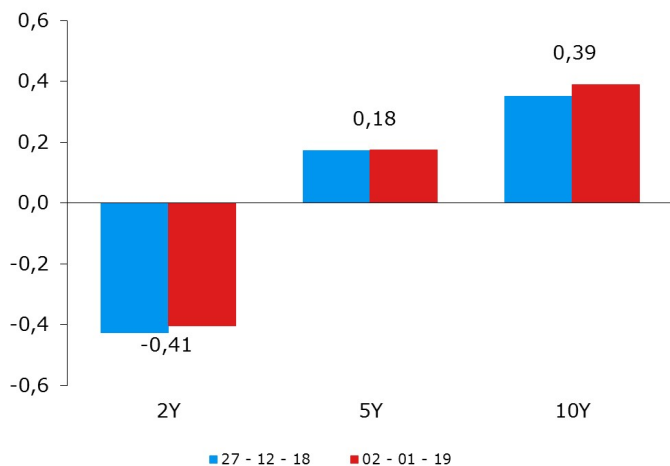
DS1023/5y is 5bps, WS0428/10y is 32bps. DS1023/WS0428 is 63bps. WS0428/Bund is 257bps.

DS1020 is trading at 1.39% (5bps up), DS1023 is trading at 2.12% (6bps down) and WS0428 is trading at 2.75% (13bps down).

IRS curve



Asset swaps



Money market

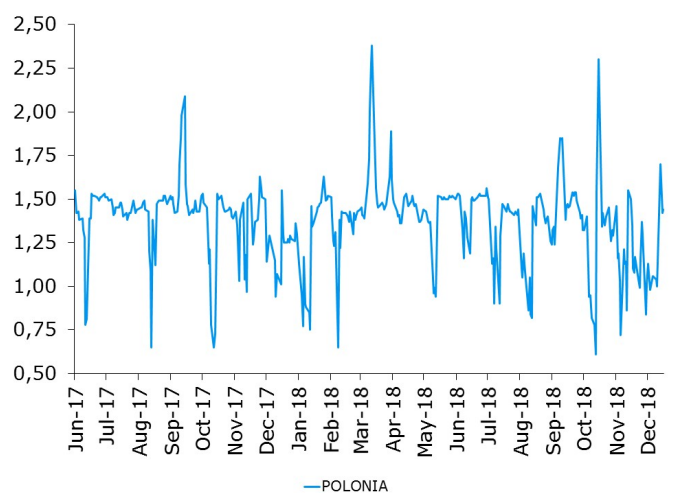
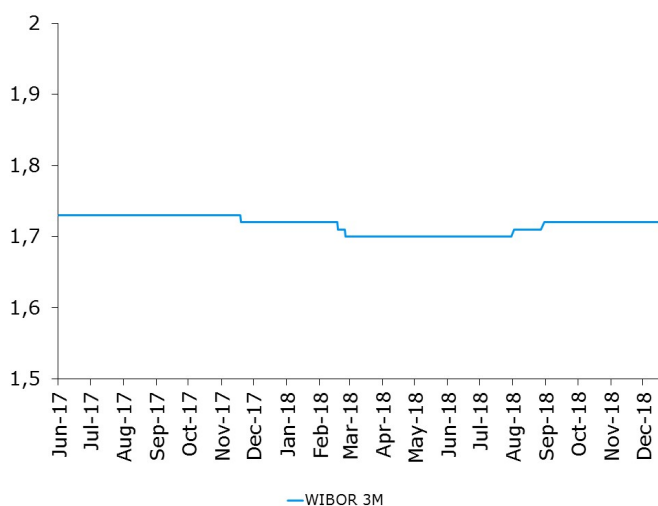
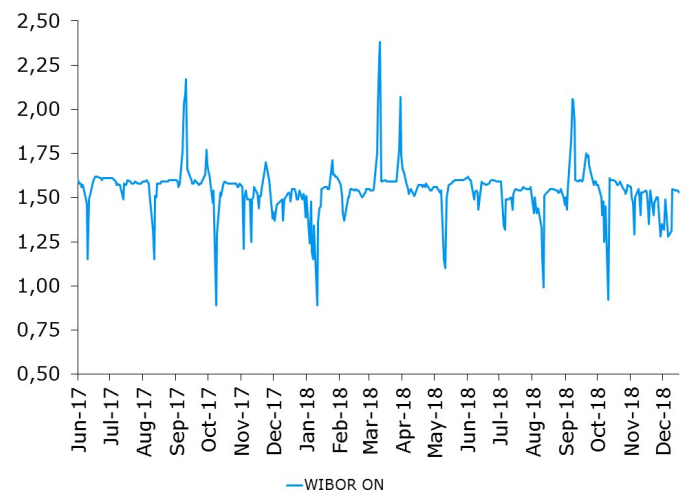
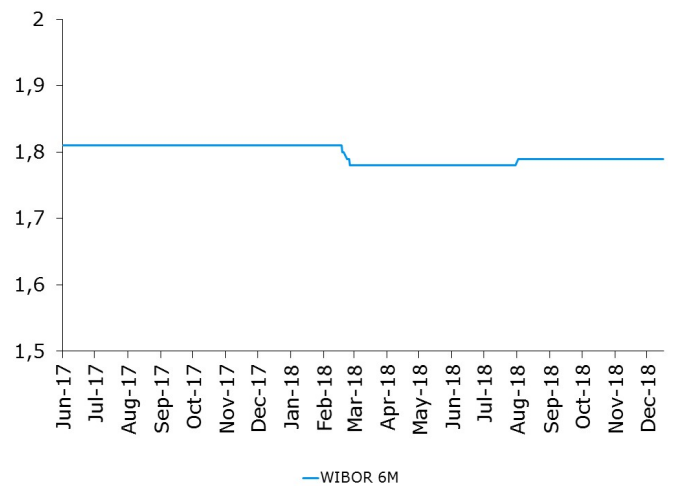
Two years with no hikes?

Turbulent year-end is history. This time, pain came for payers. Polish rates dropped significantly touching many months lows. Levels are quite decent for someone who believes that hike will be a next move. Two year swap is trading at 1.785% which implicates all corresponding FRA contracts at, or below, current WIBOR. The move is mostly driven by global events. Core rates are dropping like a stone, with US curve pricing next move as a cut. One needs to judge whether it's so bad in the global economy, or it's just flow and bad positioning on a still thin post-December market.

We reached new year and all came back to normality. Liquidity is picking up.

Ref rate vs Polonia averages:

30 day 34 bp
90 day 23 bp



Forex

Spot – EUR/PLN – in the range New Year on financial markets started with risk averse mood. Heightened concerns about global growth, weaker-than-expected data out of China, a revenue warning from Apple and finally FX flash crash on USDJPY – all in the thin holiday liquidity – pushed investors into safe haven-assets. As a result PLN is a tic weaker but still trading in a narrow range. After worse than expected PMI data, sellers of Zloty have moved the rate of EURPLN to almost 4.31. Anyway we are still in 4.26-4.34 range trading mode, with slightly PLN-negative skew.

Opts: EUR/PLN vols – tic higher Slightly weaker PLN and positioning were the reasons why the vols kept on creeping higher. The gains are cosmetic, and we need higher realized volatility and/or weaker PLN to support that gains. 1 month EUR/PLN ATM is traded today at 5.0% (0.7% higher than 2 weeks ago). 3 months EUR/PLN are 5.1% (0.1% higher) and finally 1 year is 6.0 % (no change). The currency spread (difference of USD/PLN minus EUR/PLN) is around 4.5% (USD/PLN vol is higher), the skew is roughly the same as 2 weeks ago.

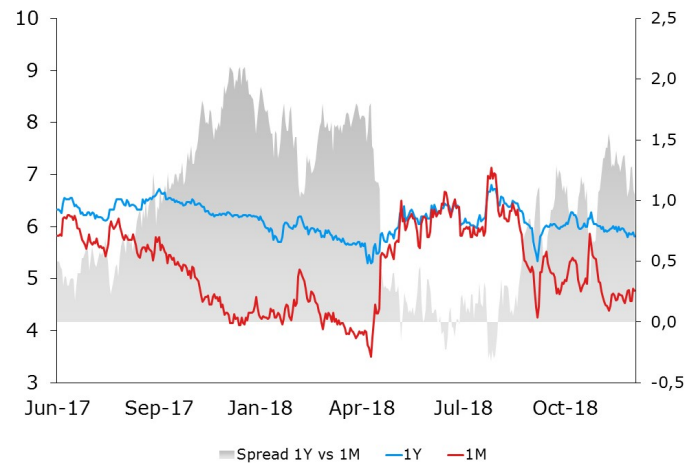
Short-term forecasts

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

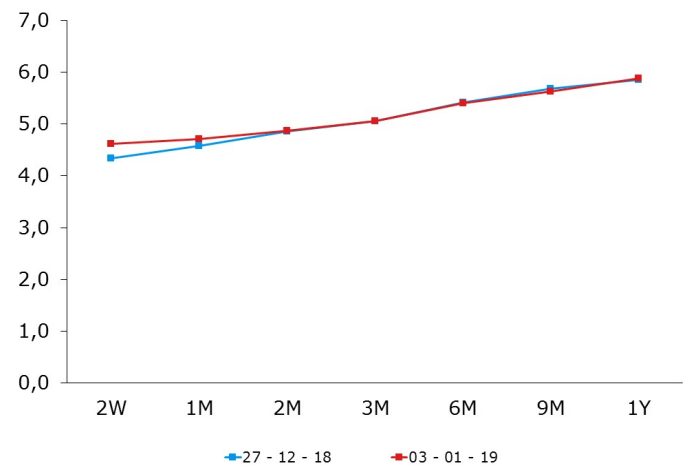
Spot: Current position: None

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.

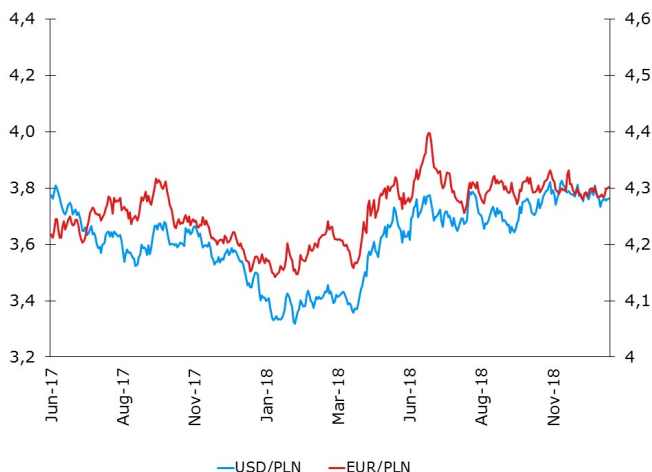
EURPLN volatility



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
12/27/2018	1.94	1.72	1.94	1.69	2.06	1.77	1.72	1.73	1.75	1.76	1.77	1.82
12/30/2018	1.99	1.72	1.94	1.69	2.07	1.77	1.72	1.73	1.75	1.76	1.77	1.81
12/31/2018	1.63	1.72	1.71	1.69	1.74	1.77	1.73	1.73	1.75	1.75	1.77	1.81
1/1/2019	1.53	1.72	1.61	1.69	1.64	1.77	1.73	1.73	1.75	1.75	1.77	1.81
1/2/2019	1.95	1.72	2.38	1.69	2.15	1.77	1.71	1.71	1.73	1.73	1.74	1.79

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
12/27/2018	1.770	1.025	1.802	1.374	2.111	2.283	2.475	2.825
12/30/2018	1.770	0.903	1.805	1.346	2.110	2.294	2.467	2.846
12/31/2018	1.770	0.903	1.810	1.346	2.100	2.294	2.461	2.846
1/1/2019	1.770	0.903	1.810	1.346	2.100	2.294	2.461	2.846
1/2/2019	1.770	0.960	1.770	1.365	2.035	2.210	2.359	2.747

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
12/27/2018	4.58	5.05	5.41	5.85	5.85	1.67	0.54
12/30/2018	4.57	4.98	5.38	5.85	5.85	1.67	0.54
12/31/2018	4.80	5.10	5.45	5.89	5.89	1.60	0.51
1/1/2019	4.76	4.84	5.29	5.81	5.81	1.76	0.55
1/2/2019	4.71	5.05	5.40	5.88	5.88	1.57	0.53

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
12/27/2018	4.2860	3.7616	3.7938	3.3916	1.3344	0.1656
12/30/2018	4.2969	3.7550	3.8115	3.4008	1.3365	0.1666
12/31/2018	4.3000	3.7597	3.8166	3.4124	1.3394	0.1673
1/1/2019	4.3000	3.7597	3.8166	3.4124	1.3394	0.1673
1/2/2019	4.3016	3.7619	3.8242	3.4523	1.3353	0.1671

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