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Polish Weekly Review

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Comment on the upcoming data and forecasts

Next week starts with publication of balance of payments data for November – we expect current account balance to amount to EUR -600M, with exports at EUR 19200M and imports at EUR 19700M. On Tuesday, final CPI release for December will be published (according to the flash estimate, it increased by 1.1% y/y), followed by core inflation the day after (our updated forecast is 0.6% y/y). Next Friday, Statistics Poland will publish readings from both labor market and industry. We expect stabilization in employment, with its growth at 2.9% y/y, where we expect an increase in trade and transport. We assume that some part of weak last month's reading will be made up in December, but usually weak November means weak December. Gross wages should grow by 7.0% y/y. Weakness of construction, bonuses shifts in mining and high base in the latter category all contribute in minus. Positive for wage growth is the low base in energy sector and shifts of bonuses from January due to the new "solidarity tax" on highest incomes. Industrial output likely slowed down to 2.0% y/y despite lack of difference in working day count (still 0 y/y), because of the high base in manufacturing and mining. Producer prices continued to decelerate due to cheaper oil prices.

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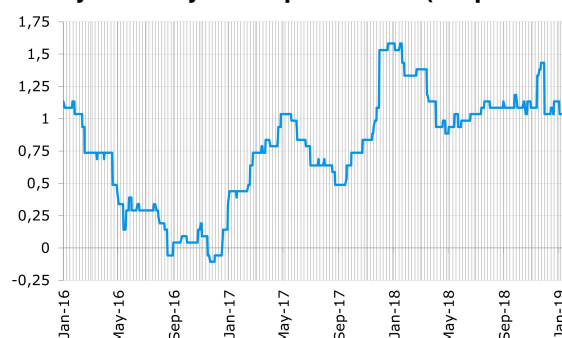
Polish data to watch: January 11th to January 18th

Publication	Date	Period	mBank	Consensus	Prior
Current Account (mio EUR)	14.01	Nov	-600	-479	-457
Exports (mio EUR)	14.01	Nov	19200	19354	20143
Imports (mio EUR)	14.01	Nov	19700	19793	20731
CPI final y/y (%)	15.01	Dec	1.1	1.1	1.3
Core inflation y/y (%)	16.01	Dec	0.6	0.7	0.7
Average Gross Wages y/y (%)	18.01	Dec	7.0	7.3	7.7
Employment y/y (%)	18.01	Dec	2.9	2.8	3.0
Sold Industrial Output y/y (%)	18.01	Dec	2.0	4.8	4.7
Construction Output y/y (%)	18.01	Dec	17.5	14.2	17.1
PPI y/y (%)	18.01	Dec	2.5	2.6	2.7

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	1/25/2019	1000	1.547	1/10/2019
5Y T-bond PS0424	1/25/2019	2000	2.251	1/10/2019
10Y T-bond WS0428	1/25/2019	1100	2.821	1/10/2019
30Y T-bond WS0447	1/25/2019	20	3.643	10/4/2010
5Y floater WZ0524	1/25/2019	1000	-	1/10/2019
10Y floater WZ0528	1/25/2019	700	-	1/10/2019

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



Comment

No surprises in the 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	-0.5	0.2	-0.6	-1.2	-1.4
Unemployment rate (end of period %)	9.8	8.2	6.6	5.9	5.4	4.9
Repo rate (end of period %)	1.5	1.5	1.5	1.5	1.5	1.5

	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	5.9	6.0	5.4	5.2	5.4
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	1.72	1.72	1.72	1.72	1.73
2Y Polish bond yields (% eop)	1.49	1.63	1.56	1.35	1.40	1.42	1.44	1.46
10Y Polish bond yields (% eop)	3.18	3.22	3.24	2.83	2.80	2.83	2.87	2.91
EUR/PLN (eop)	4.21	4.37	4.28	4.29	4.35	4.30	4.25	4.25
USD/PLN (eop)	3.42	3.74	3.69	3.74	3.85	3.77	3.70	3.66
F - forecast								



Economics

MPC: no interest rate changes till the end of Council's term

The January meeting of the Polish Monetary Policy Council resulted in flat interest rates. The MPC's statement resembled the previous one, and the focus on lower inflation or the decline in some business cycle indicators was limited. As usual, the press conference was the key to understand the MPC's thinking: governor Glapinski again extended the forward guidance, this time till the "end of the MPC's term" (i.e. until 2021). We expected a move in this vein but a bit later, after the new set of projections. It seems behind-the-scenes talks in the Bank of International Settlements together with the governor's intuition (quite accurate under current conditions) were sufficient to tip the scale earlier. The mix of growth risks and low inflation is enough to close the doors for the increase of interest rates. There will be no hikes: neither in 2019, nor in 2020.

The MPC informed that they do not even consider cutting interest rates (risk for the banking sector). Its equivalent can be (in non-defined distant future) quantitative easing as practiced "in the West", but slightly fitted to the Polish market structure and "simpler". Glapinski informed that a review of possible instruments has been already finished, but we do not know whether any document will be published, or will it just remain an internal report.

What is worth monitoring? Mainly core inflation. Last year, our forecasts indicated much higher core inflation path than the one realized. Analysts from the NBP had exactly the same problem (other central banks – see EBC – did not get much better either). In such situation analysis of the core inflation will be limited to tracking monthly changes. We would not pay too much attention to the oil prices as a catalyst for rate changes. Even if those prices go up, generating CPI increases, the Council will focus on them only in the descriptive part of their statements, but ignore in the decision making since all in all oil prices are beyond monetary policy control (we saw this dynamic in action several times).

Fixed income

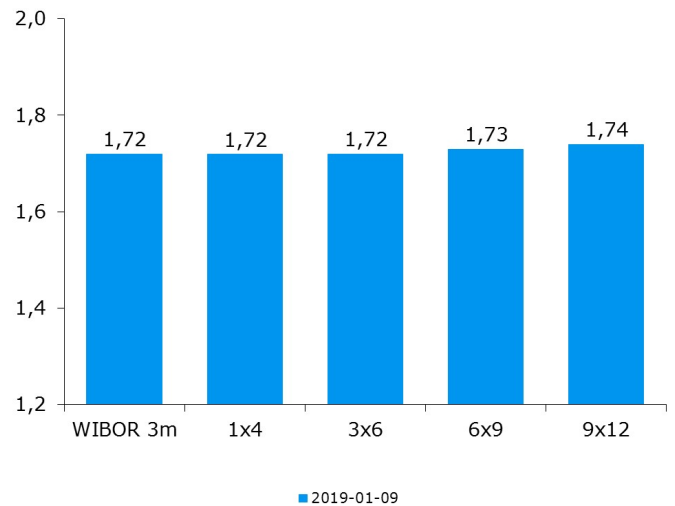
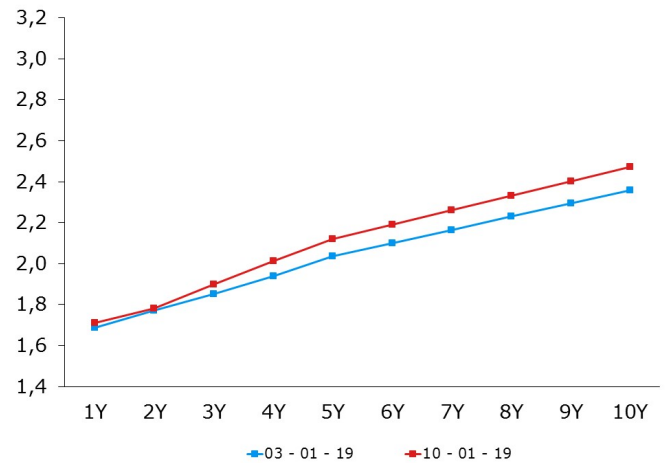
A lot of money is coming back to the market in January

Finally, bond curve began to steepen, after weaker growth projections. Bond supply in Q1 auctions will be relatively low (just as it was today – flow came mainly from international clients). Note that the next auction supply will not exceed January redemptions and coupon payments (WZ0119 + coupons from almost every FRNs and 0123).

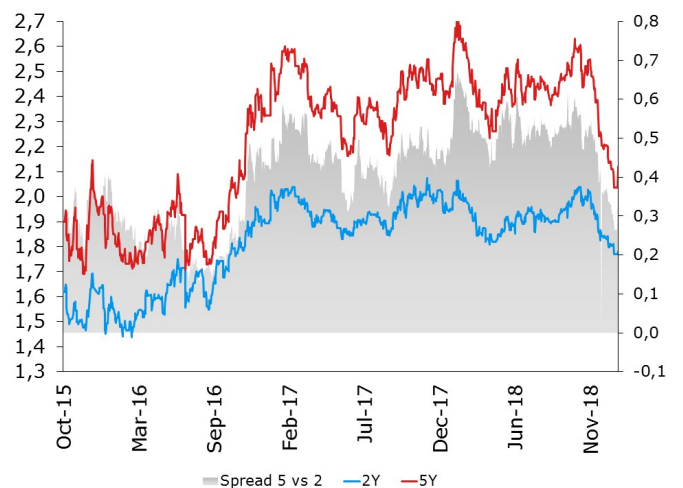
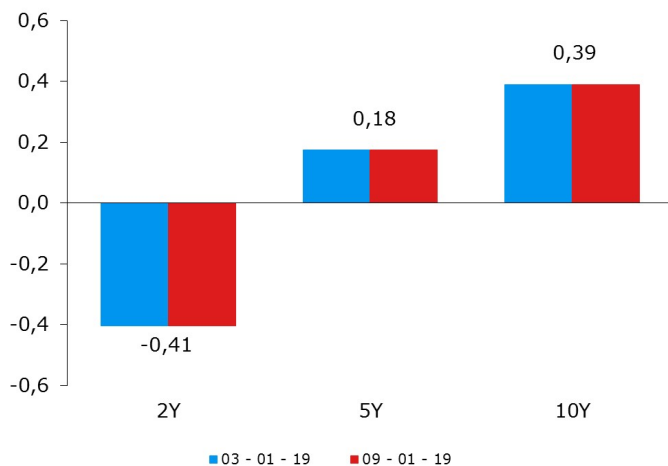
DS1023/5y is 5.5 bps, WS0428/10y is 37 bps. DS1023/WS0428 is 67.5 bps. WS0428/Bund is 258 bps.

DS1020 is trading at 1.41% (2 bps up), DS1023 is trading at 2.15% (3 bps up) and WS0428 is trading at 2.84% (9 bps up).

IRS curve



Asset swaps



Money market

No local story

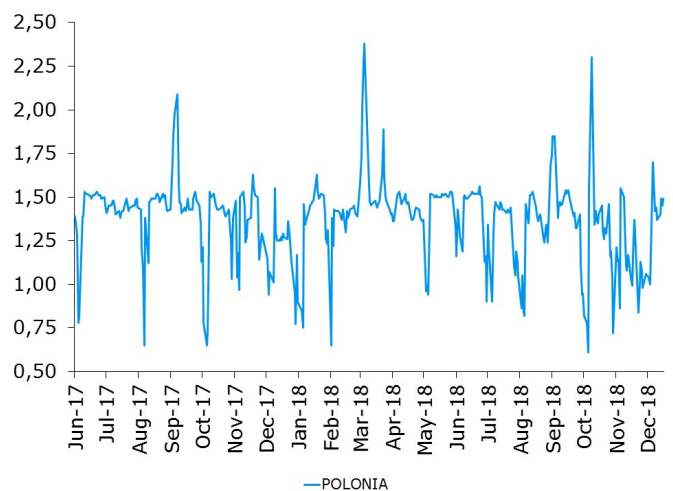
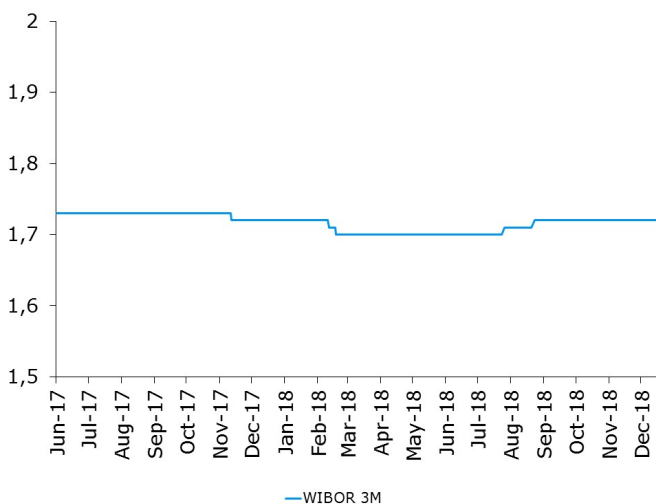
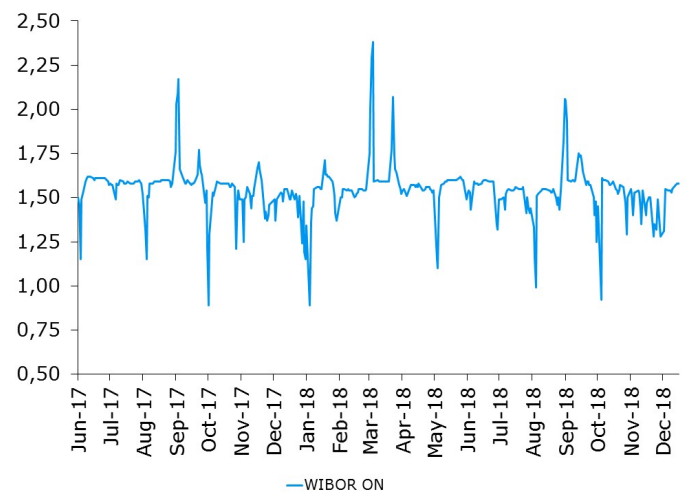
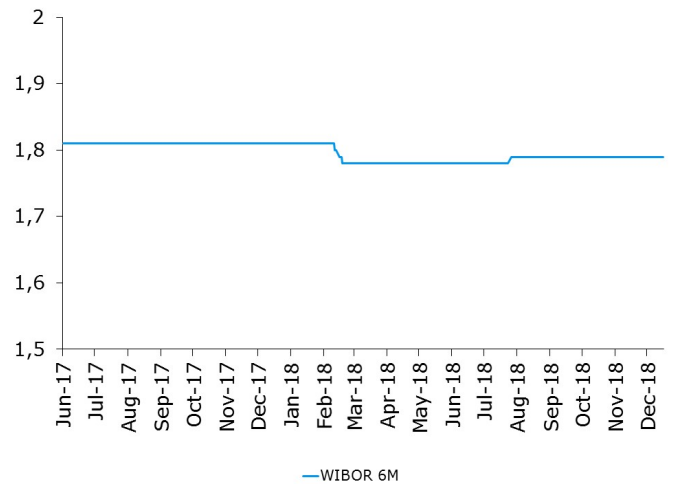
Polish rates bounced back from recent lows. Five year swap moved from 2.04 to 2.16%. We had an MPC meeting during the week which again appeared to be a non event. Polish rates still lack a story and MPC members are happy with this stance. We are following global sentiment which currently is all about the slowdown in United States.

New month stabilizes rates close to 1.50%.

Ref rate vs Polonia averages:

30 day 34 bp

90 day 23 bp



Forex

Spot – EUR/PLN – still in the range EUR/PLN has been trading water for another week. Still, the dovish rhetoric from the MPC has failed to produce any volatility. USD/PLN was much more volatile and fluctuated in the 3.72 – 3.80 range, as the USD was under pressure of growing expectations that the Fed will pause its rate tightening cycle this year. Generally, the combination of Fed dovishness and optimism about the US-China trade talks supported emerging markets. Of course one should not forget our old set of worries: mainly Brexit uncertainty and global economic slowdown.

Opts: EUR/PLN vols – little lower EUR/PLN was traded in a narrow range and realized volatility has fallen. So there is no surprise that the ATM's volatilities were sold, especially since positive global sentiment was ruling last week. EUR/PLN ATM mid is today 4.7% (0.3% lower), 3 month is 5.0% (0.1% lower) and, finally, 1 year fixed at 5.8% (0.2% lower). The currency spread (difference between USD/PLN vol and EUR/PLN vol) was also offered – now is fixed at ca. 4.25%. Both EUR/PLN and USD/PLN risk reversals are tic lower.

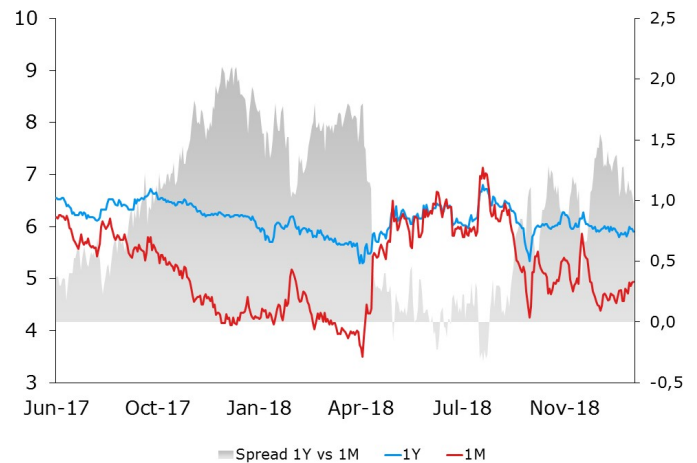
Short-term forecasts

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

Spot: Current position: None

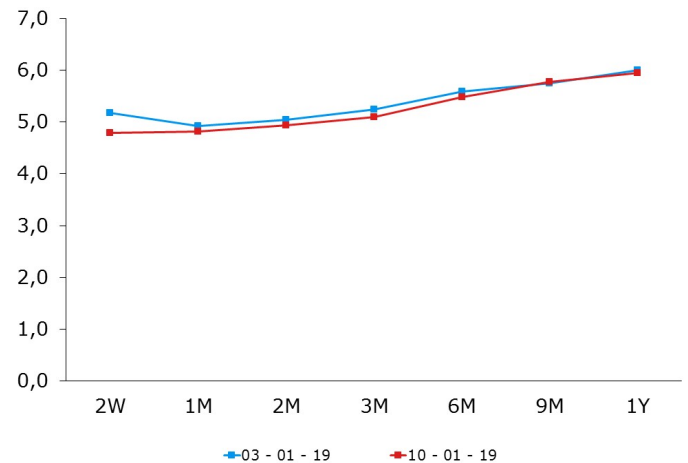
Our strategy is roughly unchanged, we still believe in the rangy nature of EUR/PLN, with a slight PLN-negative bias. Therefore, we are ready to buy EUR/PLN at 4.27 with stop at 4.24 and hopes to see 4.34-35 again.

EURPLN volatility

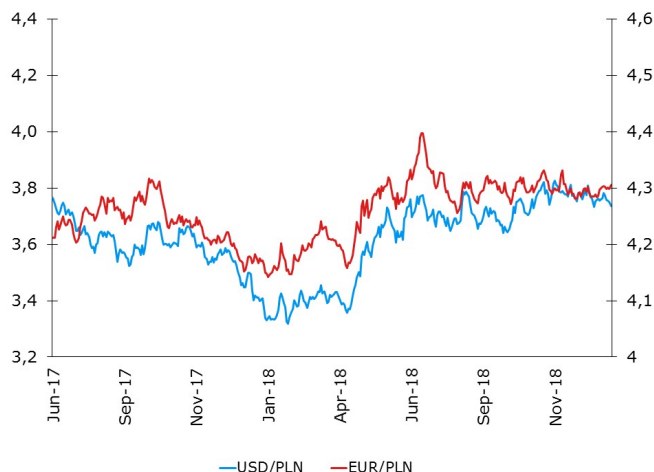


— Spread 1Y vs 1M — 1Y — 1M

EUR/PLN volatility curve

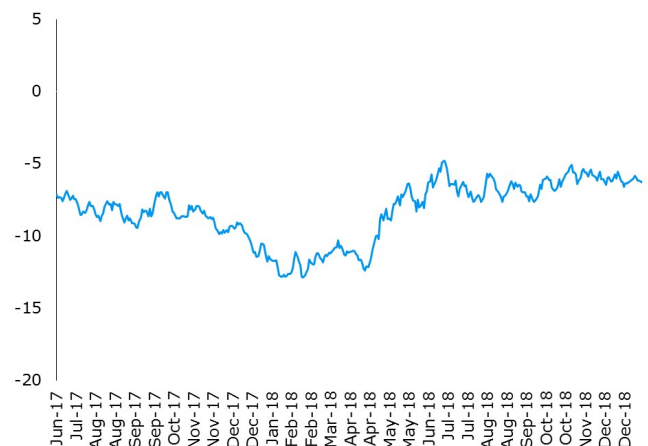


— 03 - 01 - 19 — 10 - 01 - 19



— USD/PLN — EUR/PLN

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
1/3/2019	1.88	1.72	1.94	1.69	2.07	1.77	1.71	1.72	1.73	1.74	1.74	1.79
1/6/2019	1.95	1.72	2.03	1.69	2.16	1.77	1.72	1.72	1.73	1.74	1.76	1.80
1/7/2019	1.60	1.72	1.67	1.69	1.75	1.77	1.72	1.72	1.73	1.74	1.76	1.79
1/8/2019	1.76	1.72	1.85	1.69	1.98	1.77	1.72	1.72	1.73	1.75	1.76	1.80
1/9/2019	1.86	1.72	1.95	1.69	2.10	1.77	1.72	1.72	1.73	1.74	1.75	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
OK0521	1/10/2019	5/25/2021	96.44	1.55	1000	2836	1100
PS0424	1/10/2019	4/25/2024	101.21	2.25	2000	3453	1915
WS0428	1/10/2019	4/25/2028	99.40	2.82	1100	1967	1145

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0720	5Y IRS	PS0423	10Y IRS	WS0428
1/3/2019	1.770	0.960	1.770	1.365	2.035	2.210	2.359	2.747
1/6/2019	1.770	0.960	1.770	1.365	2.035	2.210	2.359	2.747
1/7/2019	1.770	0.960	1.770	1.365	2.035	2.210	2.359	2.747
1/8/2019	1.770	0.960	1.770	1.365	2.035	2.210	2.359	2.747
1/9/2019	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
1/3/2019	4.93	5.24	5.58	6.00	6.00	1.71	0.54
1/6/2019	4.86	5.23	5.57	5.95	5.95	1.71	0.54
1/7/2019	4.92	5.13	5.49	5.96	5.96	1.63	0.55
1/8/2019	4.94	5.13	5.48	5.90	5.90	1.60	0.54
1/9/2019	4.82	5.10	5.48	5.95	5.95	1.65	0.50

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
1/3/2019	4.3030	3.7827	3.8343	3.5132	1.3341	0.1672
1/6/2019	4.3018	3.7720	3.8213	3.4919	1.3390	0.1679
1/7/2019	4.2989	3.7575	3.8245	3.4727	1.3385	0.1682
1/8/2019	4.3013	3.7559	3.8307	3.4497	1.3384	0.1678
1/9/2019	4.2989	3.7509	3.8282	3.4441	1.3362	0.1678

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