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Polish Weekly Review

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Comment on the upcoming data and forecasts

This 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 a monthly (albeit small) 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 likely grew by 7.0% y/y. Weakness of construction, shifts of mining bonuses 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. On Tuesday retail sales figures for December will be released. We expect it to slow down vis-a-vis November (in real terms from 7.4 to 5.3% y/y) due to the on-going trend of shifting Christmas purchases from December to November. On the same day Statistics Poland will release business sentiment data for January. On Wednesday January consumer confidence will be released – it will be interesting to see whether December's drop was permanent. For Thursday, the release of the Statistical Bulletin along with unemployment data is scheduled. The Ministry of Family's preliminary estimate of 5.9% is above our forecast and market consensus of 5.8%.

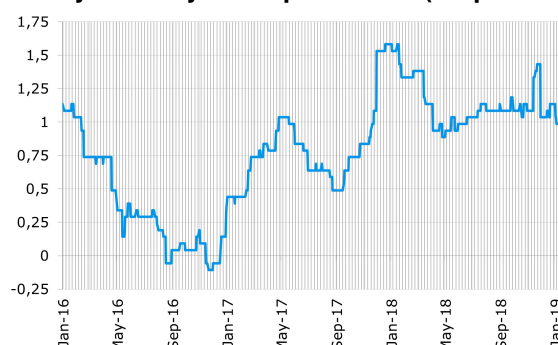
Polish data to watch: January 18th to January 25th

Publication	Date	Period	mBank	Consensus	Prior
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
Business sentiment	22.01	Jan			
Real retail sales y/y (%)	22.01	Dec	5.3	7.4	6.9
Consumer sentiment	23.01	Jan			
M3 y/y (%)	23.01	Dec	8.8	8.6	8.8
Unemployment rate (%)	24.01	Dec	5.8	5.8	5.7

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. Next week will surely end the period of tranquility – among the publications scheduled, many have surprised forecasters before.

* 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

- 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.
- The MPC is now talking about holding rates steady until 2021 (the end of most members' term) and – given the overall environment (both global and local factors) – we concur. We don't expect any rate changes in Poland in the foreseeable future.
- 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 upcoming slowdown in demand will be somewhat of a test for the durability of the MoF's fiscal successes.

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

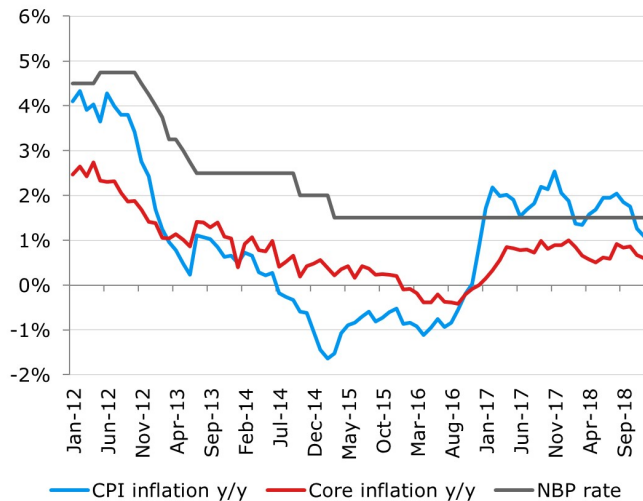
	2015	2016	2017	2018 F	2019 F	2020F
GDP y/y (%)	3.8	3.0	4.8	5.1	3.8	3.3
CPI Inflation y/y (average %)	-0.9	-0.6	2.0	1.6	1.7	2.5
General government balance (%GDP)	-2.7	-2.2	-1.4	-0.2	-0.7	-1.1
Current account (%GDP)	-0.6	-0.5	0.2	-0.6	-1.2	-1.4
Unemployment rate (end of period %)	9.8	8.2	6.6	5.9	5.4	4.9
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

Inflation finishes the year at 1.1% y/y

December CPI grew by 1.1% y/y, just as the flash estimate indicated but below our original forecast (1.3% y/y) and market consensus (1.2% y/y).



Detailed price data do not bring any major surprises. Food prices rose by 0.7% m/m (unchanged from the flash release), fuels cheapened by 3.3% m/m (flash: -3.2% m/m), residential energy prices rose slightly as higher heating and natural gas prices offset cheaper solid fuels. The second source of the surprise was the weak core inflation print – it fell from 0.7 to 0.6% y/y in December. Looking through the categories, we see that seasonal increases in the prices of airline fares, books, newspapers and package holidays indeed occurred, but were offset by cheaper insurance prices, relatively low alcohol prices and generally small increases in large categories such as hotels and restaurants and education.

In January, inflation is likely to drop below 1% due to the decline in fuel prices and the cut in excise taxes on electricity and associated fees coming into effect earlier than other components of the package (after February, overall price of electricity for households will be unchanged vis-a-vis 2018). This and base effects from 2018 will increase CPI's volatility at the beginning of the year. However, inflation is set to remain muted throughout 2019. Our forecast of essentially unchanged annual average is predicated upon slightly higher fuel prices and a sharp acceleration in core inflation. All Polish economy observers are aware how these forecast fared in the previous years. For the NBP the situation remains comfortable and supports the MPC's view of unchanged rates in the next few years (!). In current circumstances the market might disagree and start betting on a proper monetary easing cycle.

Fixed income

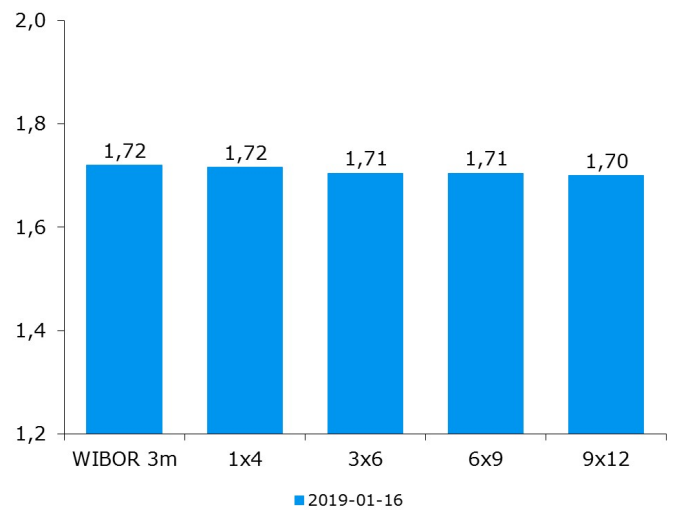
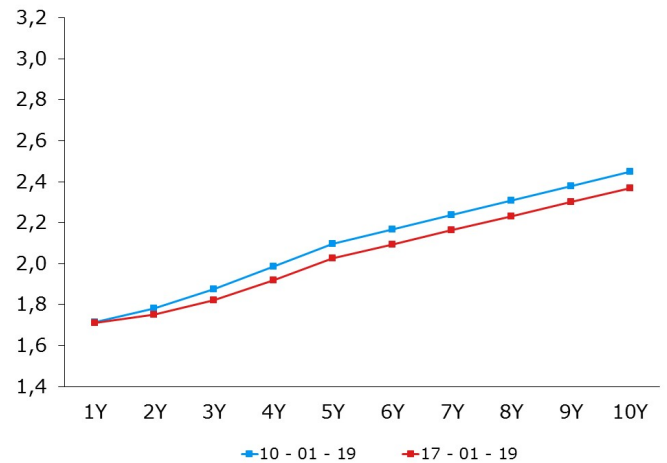
Buying flow dried out

Buying flow dried out, yield on WS0428 reached 2.70% and it all happened this year already. Main flow was on IRS, stop-losses are behind us. 2y was traded at 1.67% (with a rate cut was priced in), now it trades at WIBOR6M (1.79%). ASWs have remained wide despite fairly good GDP prospects and small supply.

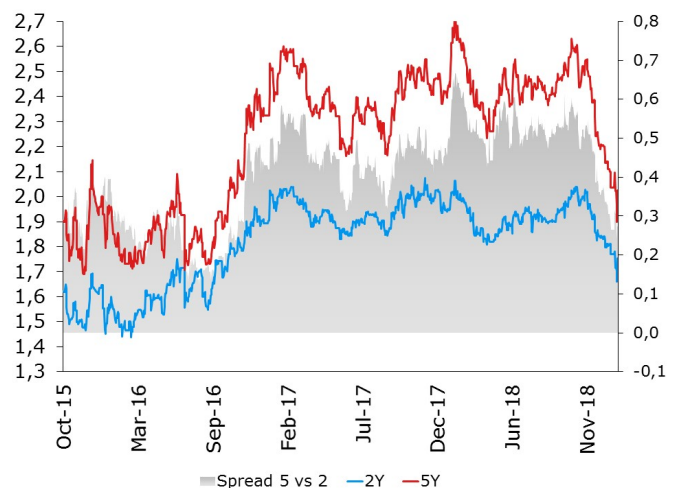
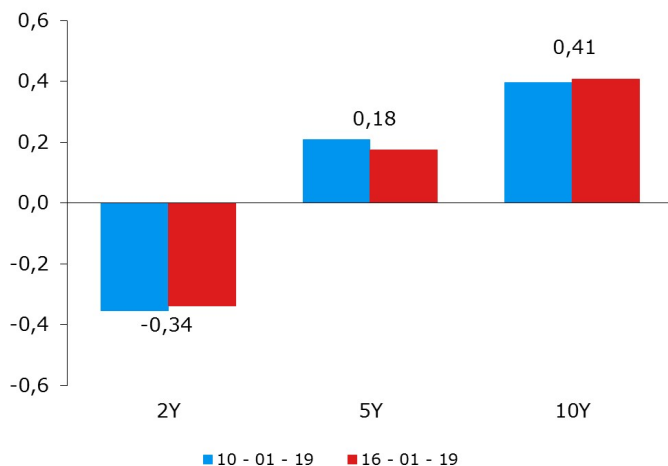
DS1023/5y is 3bps, WS0428/10y is 37bps. DS1023/WS0428 is 72bps. WS0428/Bund is 260bps.

DS1020 is trading at 1.37% (2 bps down), DS1023 is trading at 2.1% (3 bps down) and WS0428 is trading at 2.82% (1 bps down).

IRS curve



Asset swaps





Money market

What goes down, must go up

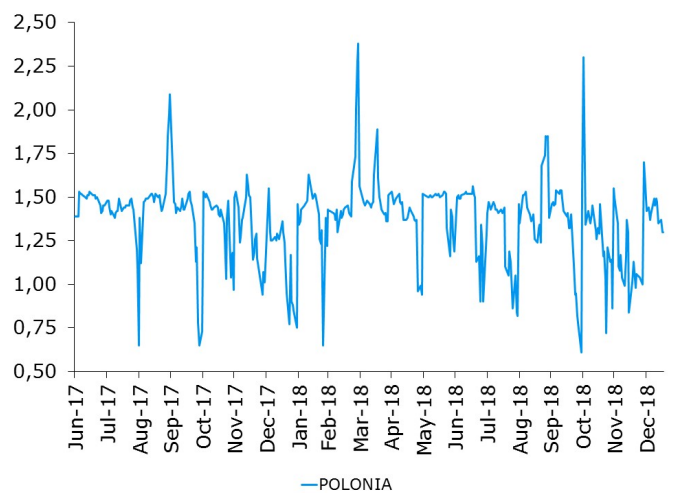
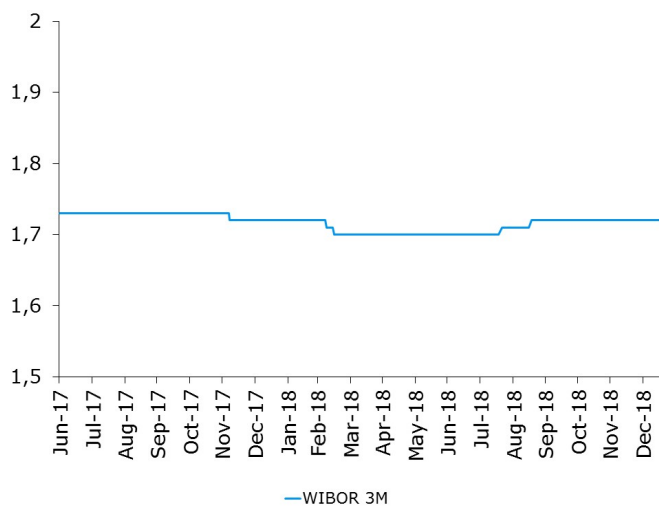
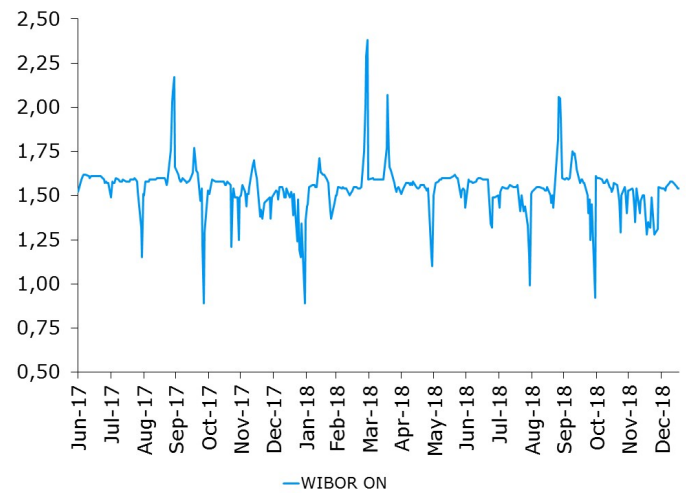
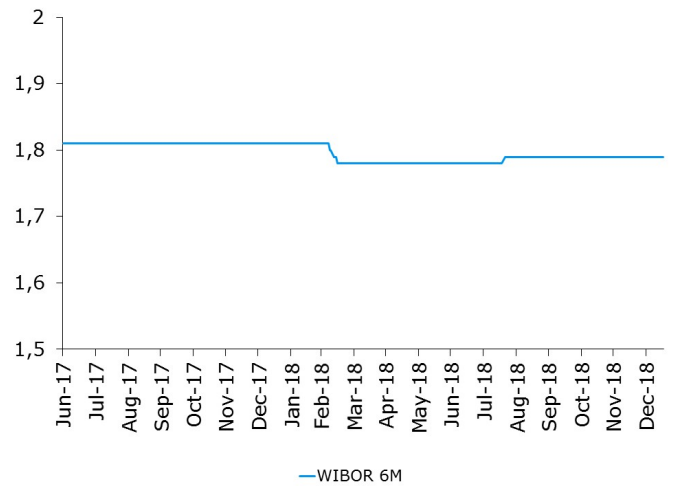
The rollercoaster on Polish yields brought them as low as 1.67% on the 2y swap. We were pricing as much as a 30 bps cut down there and now we are back to more or less 0 priced in. The positioning is lighter this time for sure. Rates are expected to stay on hold for a long time by the NBP governor, but remember that market expectations may vary from -50 to +50 bps change regardless.

Overnight rate was rather low last week. Next week we have floating bond coupon payments.

Ref rate vs Polonia averages:

30 day 34 bp

90 day 23 bp



Forex

Spot – EUR/PLN – lower, but still in the range Market is immune to the Brexit story. EURPLN keeps on sliding, the move is painfully slow, but we briefly touched the 4.2790 low, before correcting slightly higher. Technically, we are still in 4.26-4.34 range, and we don't expect it to break out of that range any time soon. Generally, market sentiment has improved on heightened expectations that the Federal Reserve will slow the pace of raising rates this year due to a slowdown in global growth.

Opts: EUR/PLN vols – sliding The EUR/PLN implied volatilities were sold hard. The realized volatility is nos-diving and the market was hunting for bids, any bids. 6 month EUR/PLN was given at 4.7% in good amount, 1 year was traded at 5.2%. Spot is really calm and there is no certain volatility trigger on the horizon: 1 month EUR/PLN ATM mid is 4.1% (0.6% lower), 3 month EUR/PLN is 4.5% (0.5% lower) and, finally, 1 year is fixing at 5.25% (0.55% lower). The currency spread (difference between USD/PLN and EUR/PLN) is at the same level as week ago. Skew was offered, especially in the front of the curve.

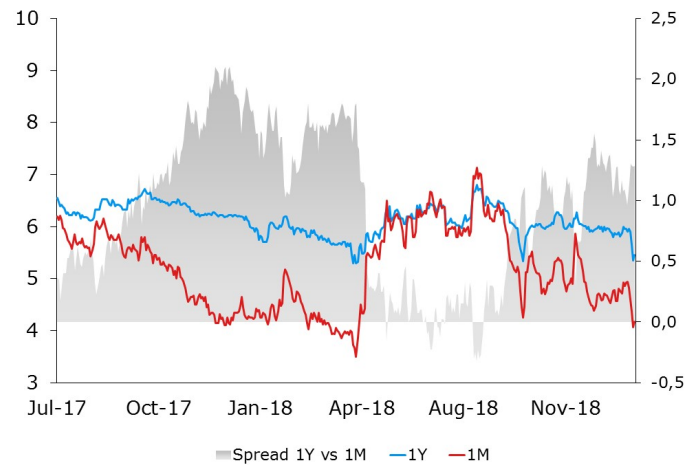
Short-term forecasts

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

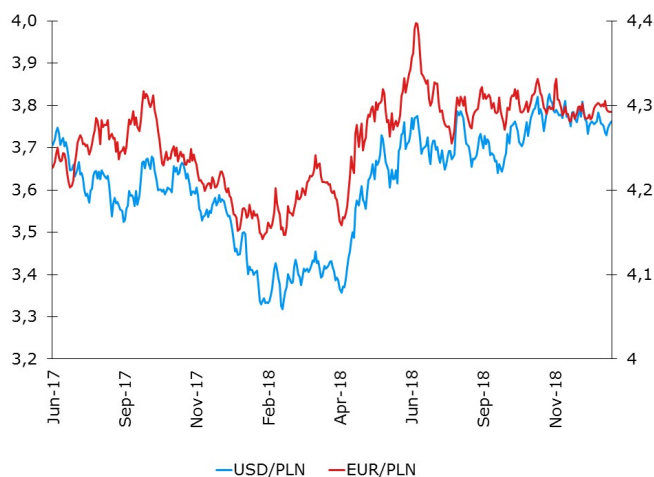
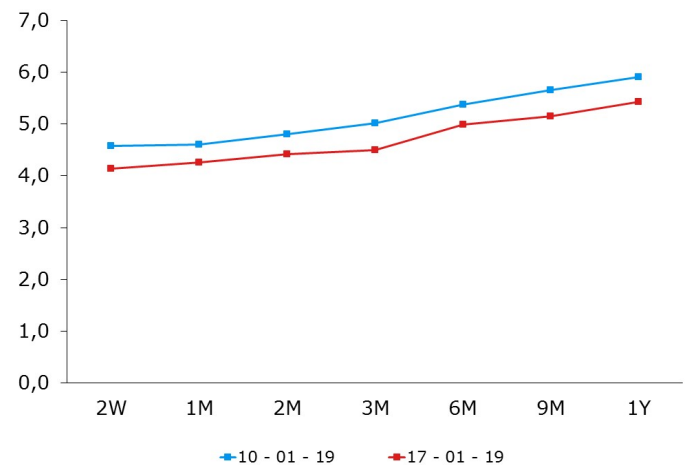
Spot: Current position: None

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.

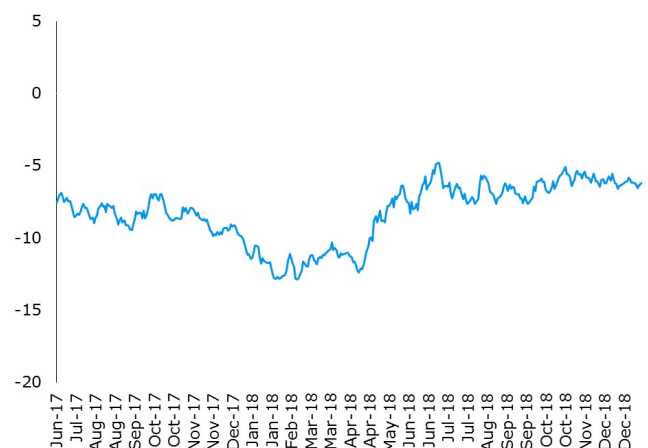
EURPLN volatility



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
1/10/2019	1.96	1.72	2.04	1.69	2.16	1.77	1.72	1.72	1.72	1.73	1.73	1.78
1/13/2019	1.89	1.72	1.96	1.69	2.08	1.77	1.71	1.72	1.72	1.71	1.71	1.78
1/14/2019	1.95	1.72	2.03	1.69	2.16	1.77	1.73	1.73	1.73	1.73	1.75	1.79
1/15/2019	1.76	1.72	1.84	1.69	1.95	1.77	1.71	1.70	1.69	1.67	1.65	1.73
1/16/2019	1.95	1.72	2.02	1.69	2.07	1.77	1.72	1.71	1.71	1.70	1.69	1.78

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
1/10/2019	1.770	1.129	1.780	1.426	2.095	2.303	2.447	2.844
1/13/2019	1.770	1.114	1.716	1.367	2.023	2.195	2.395	2.756
1/14/2019	1.770	1.129	1.705	1.333	1.965	2.161	2.350	2.734
1/15/2019	1.770	1.122	1.660	1.355	1.900	2.170	2.280	2.758
1/16/2019	1.770	1.120	1.752	1.414	2.025	2.200	2.369	2.777

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
1/10/2019	4.60	5.01	5.38	5.90	5.90	1.59	0.51
1/13/2019	4.37	4.80	5.15	5.65	5.65	1.59	0.51
1/14/2019	4.07	4.40	4.85	5.35	5.35	1.56	0.53
1/15/2019	4.18	4.50	4.90	5.46	5.46	1.54	0.52
1/16/2019	4.26	4.50	4.99	5.43	5.43	1.59	0.52

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
1/10/2019	4.3055	3.7360	3.8273	3.4556	1.3381	0.1680
1/13/2019	4.2957	3.7289	3.7945	3.4415	1.3365	0.1679
1/14/2019	4.2936	3.7458	3.8116	3.4633	1.3369	0.1680
1/15/2019	4.2922	3.7542	3.8111	3.4577	1.3338	0.1679
1/16/2019	4.2929	3.7619	3.8066	3.4631	1.3269	0.1678

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