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Polish Weekly Review

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Comment on the upcoming data and forecasts

Next Thursday, Statistics Poland will publish flash reading of GDP for 2018, which we expect to increase by 5.1%, with risks to the downside. After 5+ numbers in the last 3 quarters, the final one – with the biggest weight in the GDP numbers – is going to be lower. On Friday Polish manufacturing PMI will be published. As there are no signals of any improvement in the sentiment, it should be close to the last reading.

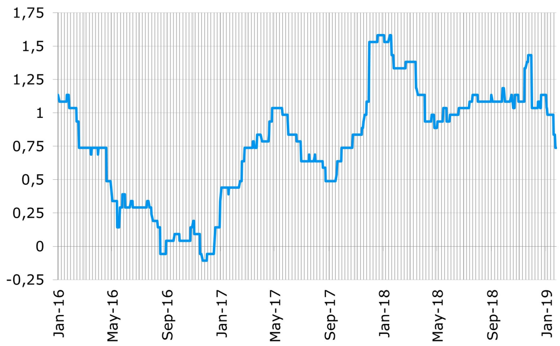
Polish data to watch: January 28th to February 1st

Publication	Date	Period	mBank	Consensus	Prior
GDP *flash* y/y (%)	31.01	2018	5.0	5.0	4.8
Manufacturing PMI (pts.)	01.02	Jan			47.6

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

Poland's surprise index fell significantly by 5 points, due to the all set of categories. Negative surprises came from every side: industry (both industrial output and PPI), wages and retail sales. Next week provides less chances to move the surprise index - only the manufacturing PMI.

* 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: cyclicality, 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

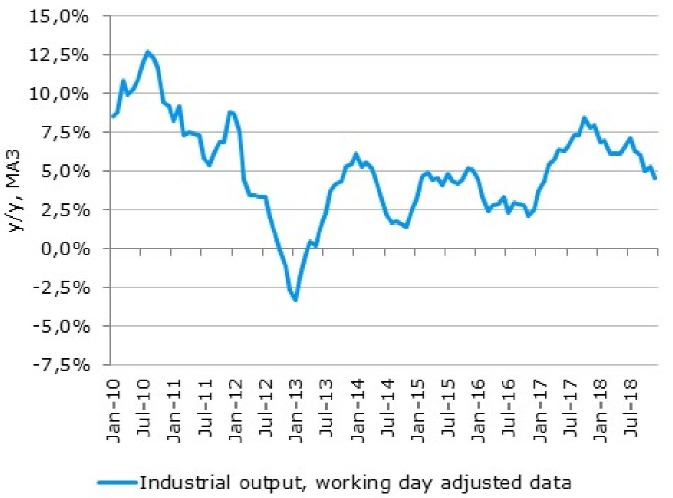
F - forecast

Economics

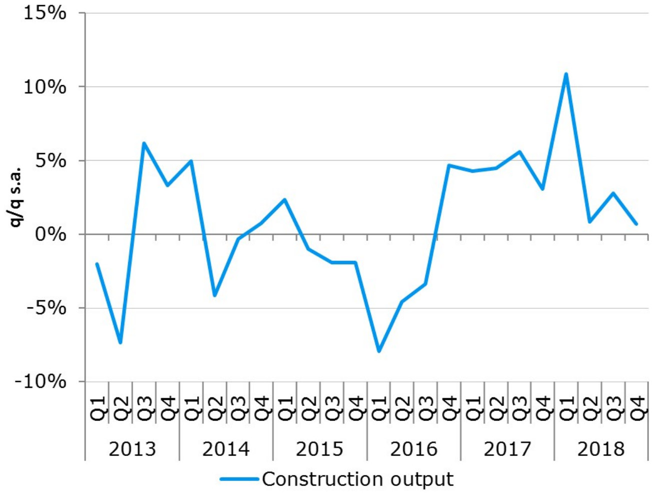
Weak labor market, industry, construction and retail sales data seal the fate of the downtrend in GDP growth

Recent publications were unilaterally disappointing. Whoever had any prejudice regarding the infinite strength of the Polish economy should open her eyes. The weakness in global demand and demand in euro zone in particular is casting shadow and slowly filters through Polish statistical numbers. Below you find the detailed description of the recent data releases. As we learned today, the business activity malaise in euro zone has not gone away therefore – given the negative momentum – we have no other option but to confirm our earlier statements that upcoming GDP numbers for Q1 2019 are in a good way to print substantially below recent ones. We are also awaiting the release for Q4 2018 as a substantial kick from inventory formation may reverse, posing downside risk to our high-frequency-data-based nowcast of 4.8%. We will be able to pick the number from the average 2019 GDP release, scheduled for next Thursday.

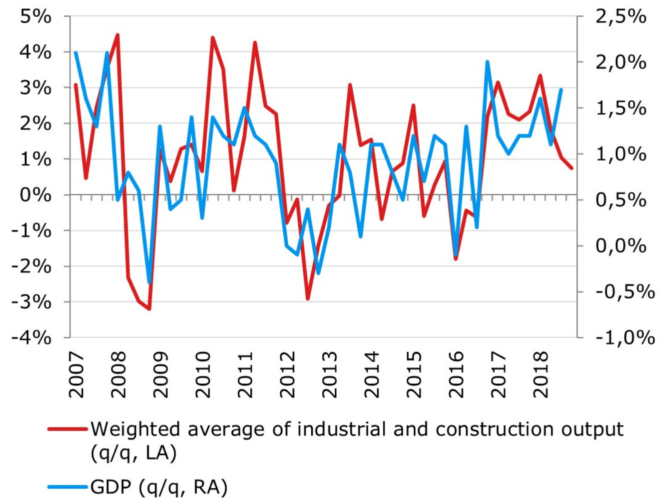
Industrial output rose by 2.8% y/y in December, quite close to our forecast and significantly below market consensus (4.5-5% y/y). This happened despite the lack of calendar effects (zero annual difference in working days for the second month in a row) as the slowdown is the result of weak momentum and high statistical base in manufacturing and mining. The former was a modest -0.4% m/m (seasonally adjusted), the impact of the latter on the whole aggregate we estimate at 2 percentage points. Relatively warm December did not prevent energy output from rising by an impressive 13.4% y/y. Nevertheless, the trend in industrial output remains negative (see the graph below). In hindsight, the surprise is not really that surprising given the very weak PMI print earlier this month. However, current industrial output growth is in no way consistent with PMI output assessment dropping to 2009 levels. Either the PMI is overstating the weakness in the real economy (which we always suspected), or poor sentiment is set to materialize with a lag, in January.



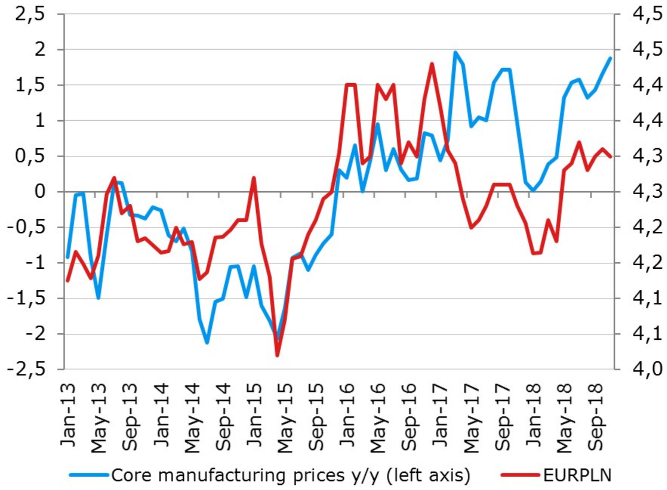
Construction output in December was 12.2% higher compared to the previous year. Such result was below both the market consensus (15.1%) and our more optimistic forecast (17.5%). Output adjusted for the seasonal effects increased by 11.4% annually, but it decreased in monthly terms – by 0.2%. Therefore, the last quarter of 2018 was effectively a period of stagnation in construction (see. graph below). It is also worth to notice that double-digits construction dynamics in 2018 resulted from an excellent beginning of the year – hence it will have also a negative impact for the beginning of the next year (statistical base!). The largest yearly growth was recorded in construction of buildings (24.2%), civil engineering works (11.4%) and specialized construction activities (0.6%). Those last two categories increased slower than the previous month (in November they grew by 20.4% and 18.4%) which could impact the lower than expected reading. In favor of buildings' construction played relatively warm month with low snowfall.



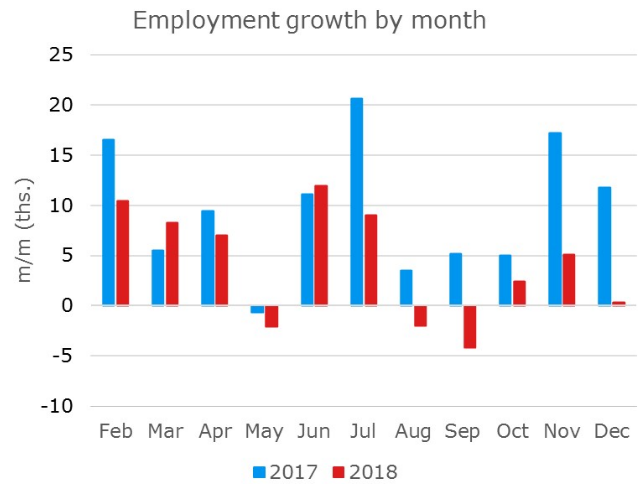
Weak December shifts our GDP nowcasts slightly. We now expect GDP to have grown by 4.8% y/y in the fourth quarter and this forecast is subject to downside risks due to uncertain behavior of inventories at the end of the year. One has to note, in addition that high annual GDP growth rate is masking a serious deterioration in the momentum of the two key cyclical sectors of the economy. In sequential terms, GDP has not been this weak since mid-2016.



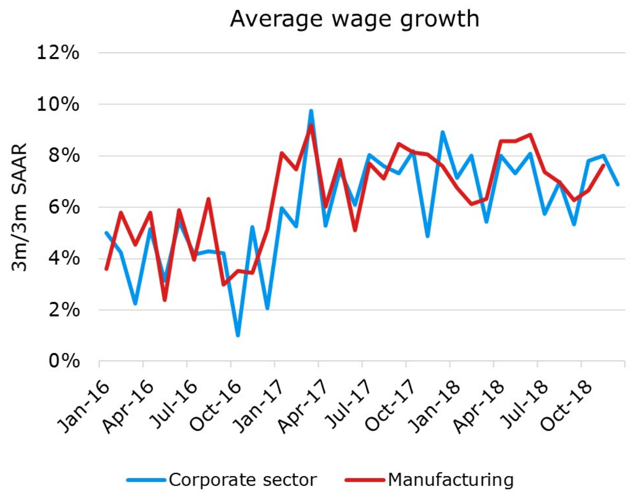
Producer prices printed 2.2% y/y in December, below market consensus and 2.8% previous reading (after upward revision). Much of it stems from coke and oil refining products (-11% m/m), but prices in mining also disappointed (probably the same factors as in coke and oil refining played a role here). Energy distribution came back to normal growth pattern (+0.1% m/m in December after +0.6% in November) therefore the issue of possible transmission of higher energy prices may be dying. The recent bill freezing energy prices makes it almost certain. The most interesting highlight of the report are core manufacturing prices. Despite the weakness of the headline and a slight appreciation of the zloty they went up from 1.9% to 2.1% defying worse business climate. It demands close monitoring whether this trend is continued. For such a mixture of higher core PPI and GDP slowdown would be something knew to crunch for monetary authorities.



Employment in enterprise sector literally ground to a halt in December recording 0% m/m growth. That reduced annual growth to 2.8%. We learned that poor November reading was not (as usual) made up in December. The weakness of seasonal factor is the symptom of the weakness of the overall indicator. We still think it is a mix of demand and supply problems. The former is going to gain strength given the mature character of the cycle and several symptoms of business climate cooling. The latter is going to be relaxed a bit but record low unemployment rate suggest the problems are here to stay; the more so since the influx if migrant workers is coming to a halt in dynamic terms. Weaker employment and labor market favor lower consumption growth in 2019. However, with still high growth of wages and high optimism, expecting something more than a normalization of growth (not 5% but 3-4%) may be exaggeration.

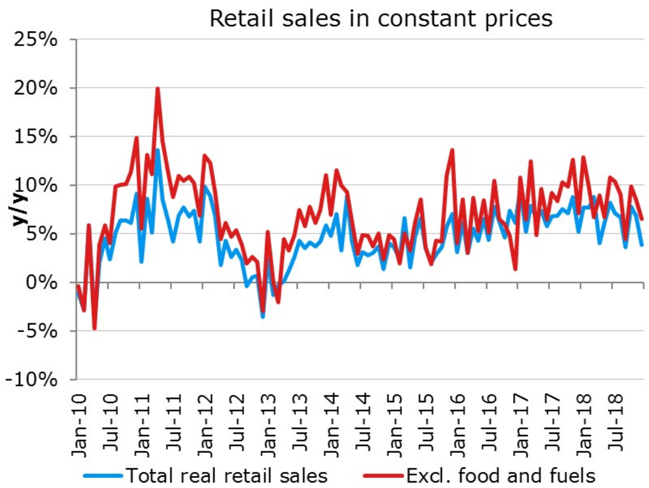


Average gross wage rose by a mere 6.1% y/y, much below market consensus and our forecast (7.3 and 7.0% y/y, respectively). As we know the details now, the weakness extended beyond the shifts in mining's bonuses. Nevertheless, one has to note that December's print is not a turning point. Wages have not accelerated since the beginning of 2017 and based on monthly growth rates one can make the case even for an very gradual slowdown. This process, facilitated by weakening labor demand, will continue this year. Constrained labor supply one should expect wage growth to exceed productivity considerably.

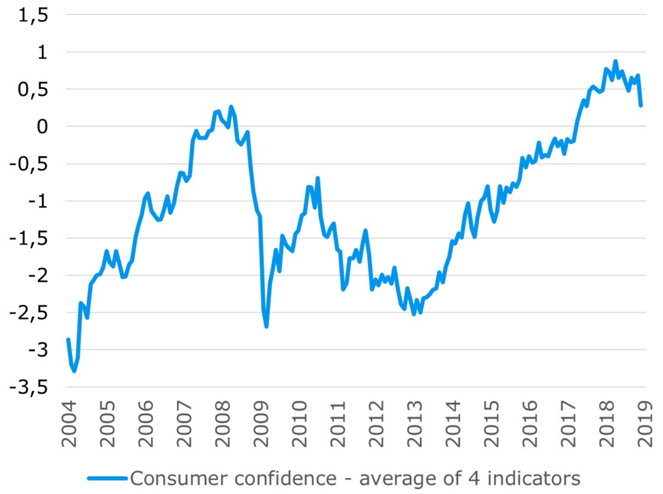


For the MPC, the data should be a confirmation of their preferred scenario and the newly minted consensus of stable rates until the end of current Council's term. The market might have other ideas and start pricing in more aggressive easing scenarios as soon as the global environment allows.

The string of disappointments in December data ends with a weak **retail sales** print. Retail sales grew by a mere 3.9% y/y (in constant prices), much below market consensus 6.9% y/y and our forecast of 5.3% y/y. In current prices sales rose by 4.7% y/y as real and price effects worked in tandem towards the slowdown.



A quick review of the details of the release points to multiple sources of the disappointment. Fuels sales decelerated from 16 to 10.7% y/y due to a strong price effect – this factor will weigh on nominal sales in January as well. Sales of food dropped by 1.4% y/y (from +3.9% y/y in November) – the seasonal uptick in sales was the weakest since 2008 in this category. Even worse results one can see in the highly correlated Other nonspecialized stores category – last December proved to be the weakest one in history. Durables and semi-durables slowed down considerably, but we don't see it as a major surprise. The multi-year trend of shifting pre-Christmas purchases from December to November (due to the spread of Black Friday sales and related events) was in evidence this year. As a result, all categories of durables and semi-durables, except for cars, books and newspapers, slowed down from 12-15 to 4-9% r/r, depending on a category.



However, changes in shopping habits only partly explain the December slowdown in sales. The second piece of the puzzle likely lies in consumer sentiment – its drop by almost 5 pts. was one of the biggest of the series. While month-to-month changes in consumer sentiment have little bearing on short-term dynamics of retail sales, this might not be entirely true for larger drops. Large-scale declines in consumer sentiment correlated with weakness in retail sales in the previous turning points of the consumer cycle – in late 2011 and in 2008. Last December's sales print must be considered in a broader context of slowing economy and turning consumer cycle (likely to be accelerated by the need to rebuild low savings rates). It confirms that household consumption growth is in a downtrend and will drop below 4% in 2019.

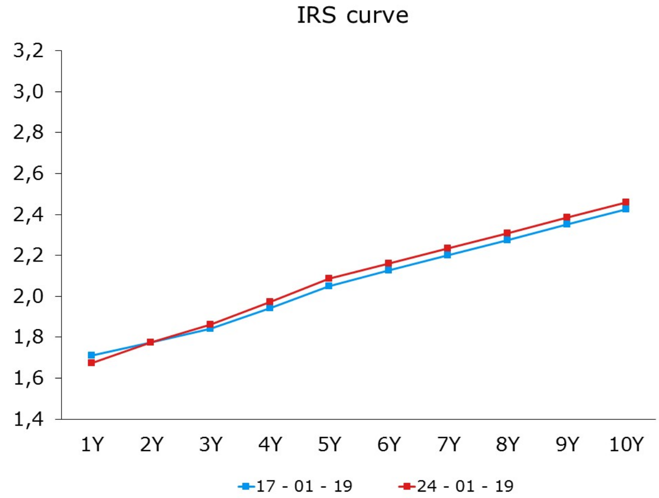
Fixed income

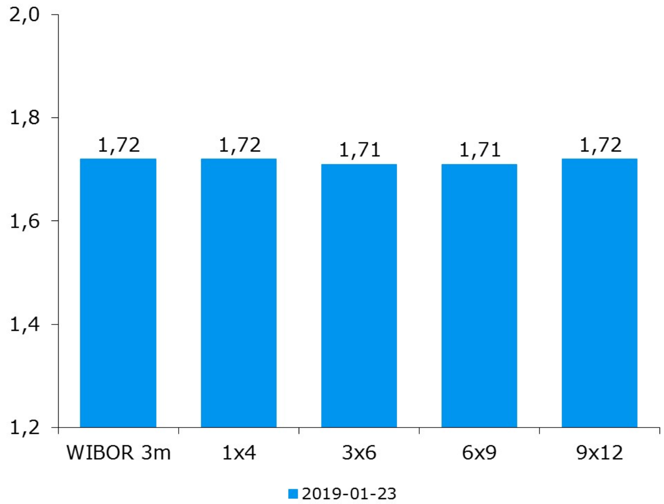
Auction tomorrow

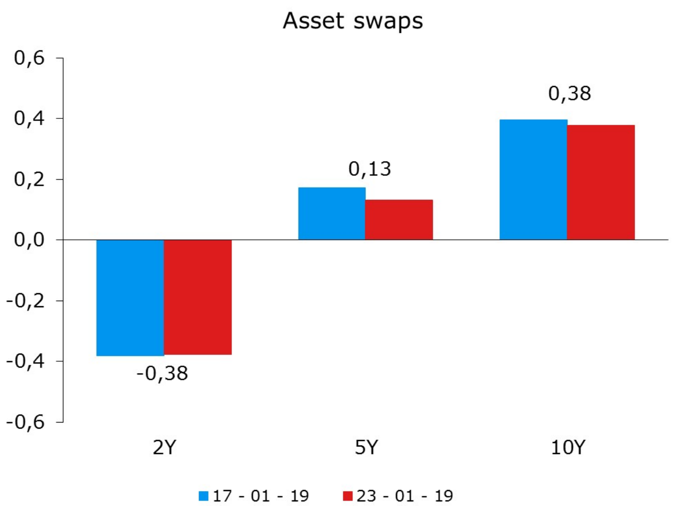
Tomorrow Ministry is selling 5-8bio and – at the same time – 8bio of cash is coming back to the market (WZ0119 expires and coupons are paid). Therefore supply is rather small, so auction should be taken lightly by the market.

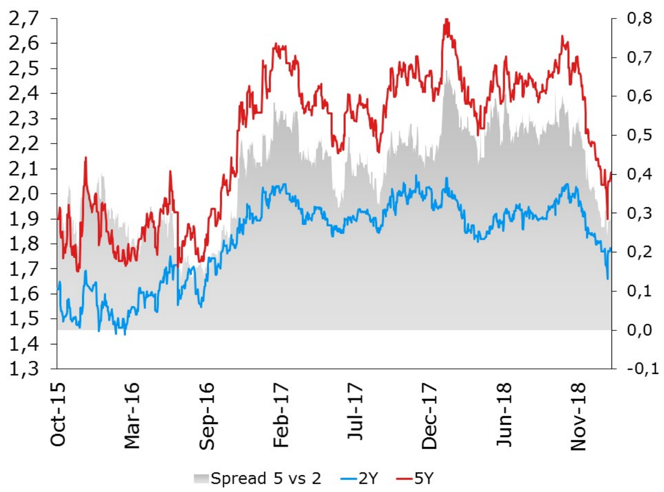
DS1023/5y is -1bps, WS0428/10y is 36bps. DS1023/WS0428 is 74bps. WS0428/Bund is 262bps.

DS1020 is trading at 1.36% (1bps down), DS1023 is trading at 2.06% (4bps down) and WS0428 is trading at 2.80% (2bps down).





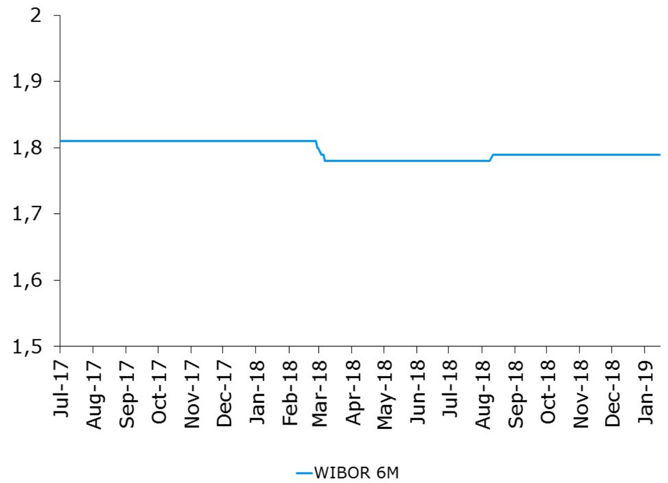


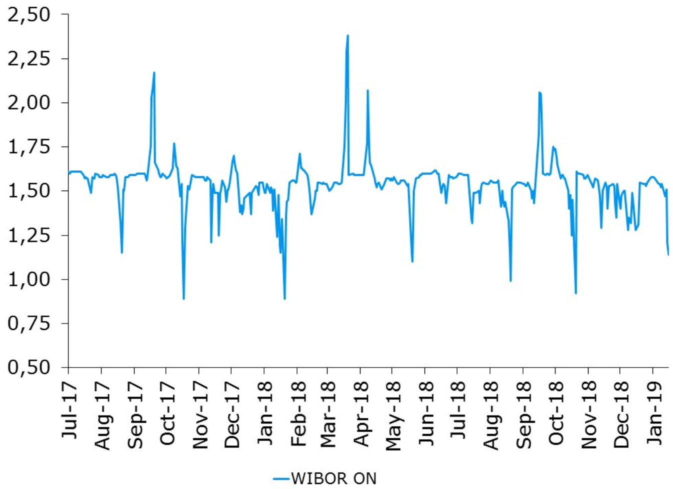


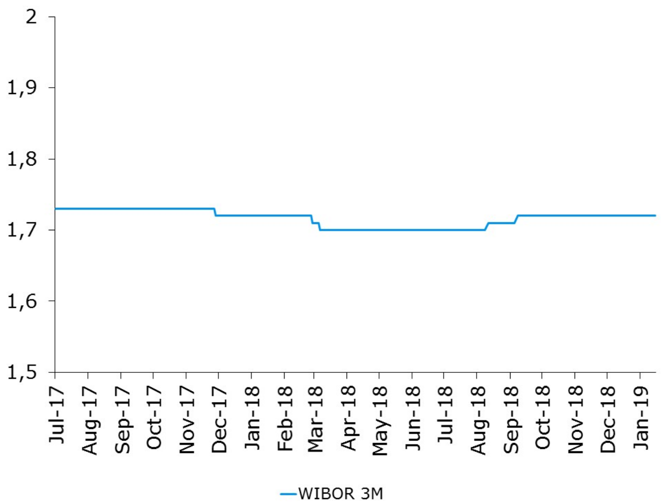
Money market

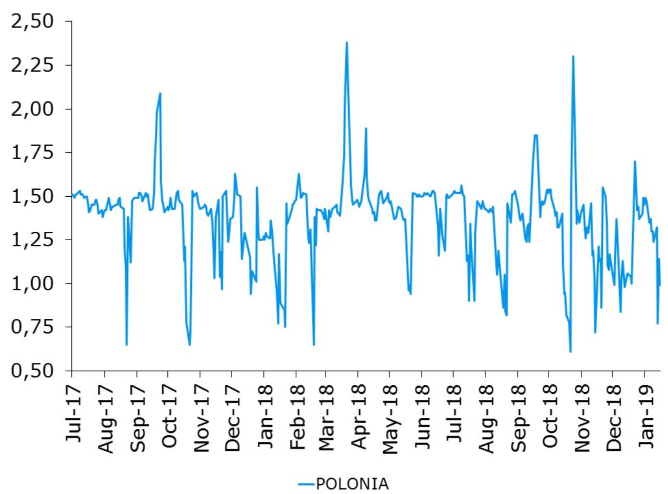
Cheap week behind us

Polonia fluctuated below 1.0% for whole week with lowest level reached on Monday: 0.77. Friday's OMO was underbid, banks bought PLN 82bn bills out of 91bn offered (when 91 bln would square the market). Despite additional OMO on Tuesday (15bln offered vs 10.2bln bought) polonia remains below 1.0%. This week we have floating bonds coupon payment and bond auction on Friday. Next week will be the last of mandatory reserve and we expect that liquidity will be secured so we see quite relaxed funding next week.





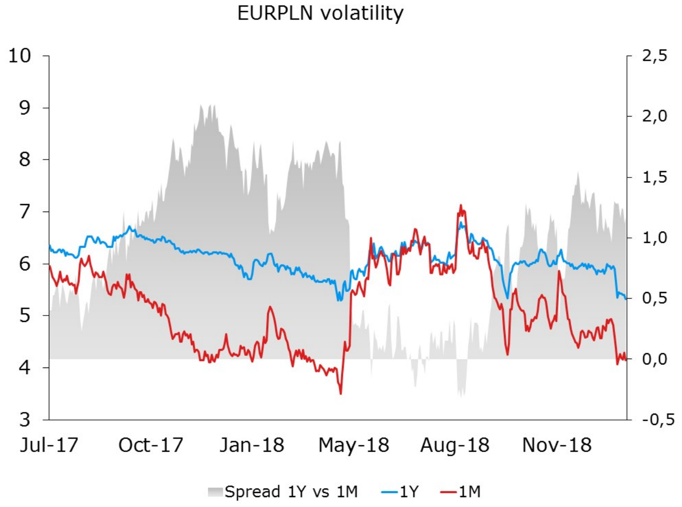




Forex

Spot – Consolidation phase for EUR/PLN The market remains highly focused on Brexit developments and those worries have big impact on the Pound, nevertheless the Euro has not responded too much. EUR/PLN is traded in the narrow range 4.2775 – 4.31 for ninth consecutive week, so as a result realized volatility nosedived again. There XXX/PLN is mostly driven by global sentiment. Still, some anxiety over the trade dispute between China and the United States and concerns over U.S. government shutdown should keep many investors on edge.

Opts: Implied volatility sliding. The EUR/PLN vol curve melted a little as spot was really calm and there is no certain volatility trigger on the horizon. Holding gamma is expensive and we saw some offloading – especially in the front-end of the curve. 1 month ATM mid is this Thursday at 3.75% (0.35% lower), 3 months mid are 4.25% (0.25% lower), 1 year is 5.2% (0.05% 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.

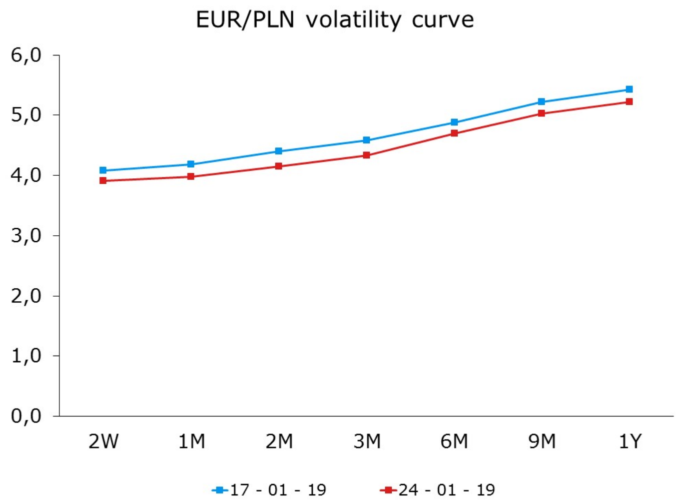


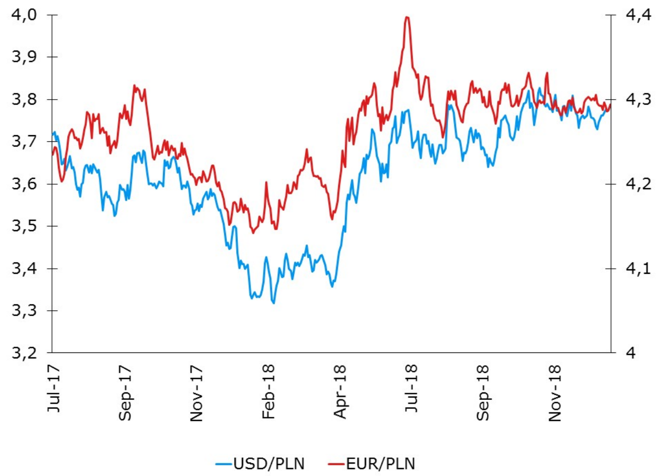
Short-term forecasts

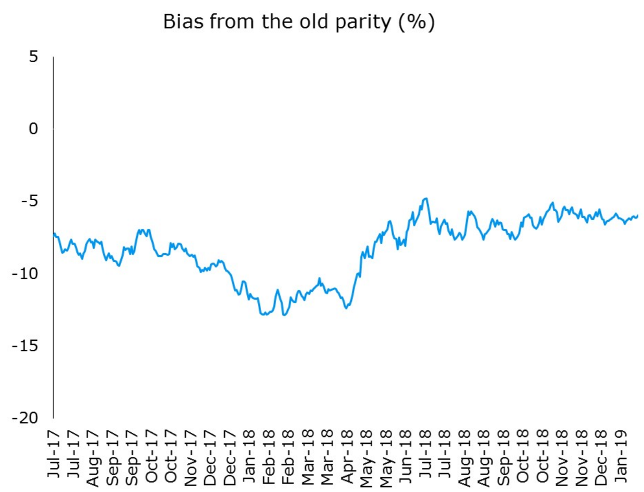
Main supports / resistances:
EUR/PLN: 4.2600 / 4.3400
USD/PLN: 3.6000 / 3.9000

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.







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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
1/17/2019	1.88	1.72	1.95	1.69	2.08	1.77	1.72	1.72	1.72	1.72	1.72	1.77
1/20/2019	1.96	1.72	2.02	1.69	2.17	1.77	1.72	1.71	1.71	1.71	1.70	1.78
1/21/2019	1.87	1.72	1.94	1.69	2.09	1.77	1.71	1.71	1.72	1.72	1.72	1.77
1/22/2019	1.74	1.72	1.83	1.69	1.96	1.77	1.72	1.72	1.70	1.71	1.73	1.77
1/23/2019	1.80	1.72	1.89	1.69	2.05	1.77	1.72	1.71	1.71	1.72	1.73	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
1/17/2019	1.770	1.049	1.773	1.392	2.050	2.222	2.425	2.822
1/20/2019	1.770	1.072	1.770	1.403	2.050	2.241	2.420	2.849
1/21/2019	1.770	1.032	1.773	1.408	2.060	2.251	2.430	2.854
1/22/2019	1.770	1.157	1.783	1.403	2.063	2.239	2.435	2.836
1/23/2019	1.770	1.194	1.775	1.397	2.085	2.216	2.459	2.836

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
1/17/2019	4.18	4.58	4.88	5.43	5.43	1.52	0.51
1/20/2019	4.17	4.56	4.90	5.40	5.40	1.52	0.51
1/21/2019	4.29	4.61	4.93	5.40	5.40	1.52	0.51
1/22/2019	4.15	4.47	4.84	5.33	5.33	1.52	0.51
1/23/2019	3.98	4.34	4.70	5.23	5.23	1.49	0.51

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
1/17/2019	4.2875	3.7615	3.7921	3.4607	1.3340	0.1678
1/20/2019	4.2964	3.7694	3.7917	3.4401	1.3473	0.1681
1/21/2019	4.2928	3.7751	3.7844	3.4421	1.3491	0.1677
1/22/2019	4.2862	3.7727	3.7839	3.4466	1.3478	0.1674
1/23/2019	4.2867	3.7747	3.7817	3.4420	1.3476	0.1672

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