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Polish Weekly Review

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Comment on the upcoming data and forecasts

Tomorrow, CPI figures for January will be released. Market consensus converged on a slight slowdown (from 1.1 in December to 1.0% y/y – equal to our forecast), but uncertainty is high. Main risk factors are: how Statistics Poland recorded the effects of electricity price freeze scheme introduced this year, how various administered prices behaved in January and whether the turn of the year spurred some delayed adjustments of corporates' prices to higher commodity and labor costs. On Tuesday Statistics Poland will publish data from the labor market. We expect wages to accelerate to 7.1% y/y, mostly due to a low base effect in manufacturing. However, there is no clear, upward momentum in wages. Concerning employment, January is a month of significant jumps in this aggregate due to annual resampling of corporate census. We estimate about 75k new positions were added (less than one month before, hence the slowdown in y/y terms). Next day, industrial production data will be released. We expect it to grow by 3.1% (below the market consensus of 3.8%). Concerning PPI, there remains the question of how expectations on the energy tariffs translated into prices. Because of the beginning of the year there is a likely jump in core manufacturing prices. On Thursday CSO will publish both construction output and retail sales figures. Our forecast of the former is significantly below the market consensus (2.0 vs 7.5%), but this month is characterized by high uncertainty anyway. We estimate retail sales to grow annually by 4.4%, there should be a strong price effect in fuels, and categories that disappointed last month can rebound. We end this week with publication of M3, there should not be any significant changes, we estimate it to increase by 9.0% y/y.

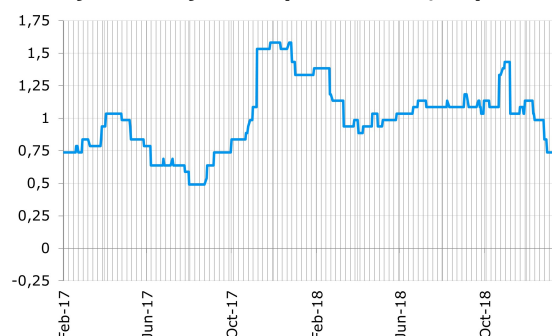
Polish data to watch: February 8th to February 15th

Publication	Date	Period	mBank	Consensus	Prior
CPI y/y (%)	15.02	Jan	1.0	1.0	1.1
Wages (%)	19.02	Jan	7.1	6.9	6.1
Employment (%)	19.02	Jan	2.0	2.0	2.8
Industrial production (%)	20.02	Jan	3.1	3.8	2.8
PPI (%)	20.02	Jan	2.5	2.1	2.2
Construction output (%)	21.02	Jan	2.0	7.5	12.2
Retail sales (%)	21.02	Jan	4.4	5.5	3.9
M3 (%)	22.02	Jan	9.0	9.4	9.2

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	3/8/2019	150	1.493	2/7/2019
5Y T-bond PS0424	3/8/2019	1500	2.158	2/7/2019
10Y T-bond DS1029	3/8/2019	1500	2.813	2/7/2019
30Y T-bond WS0447	3/8/2019	30	3.149	1/25/2019
5Y floater WZ0524	3/8/2019	600	-	2/7/2019
10Y floater WZ0528	3/8/2019	1000	-	2/7/2019

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



Comment

GDP data were close to the market consensus, therefore it did not change the index. Next week is full of publications, both from the production side (industrial and construction output), labor market (employment and wages) and prices (CPI and PPI), all of which can move 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

- In 2019, Poland will no longer be able to escape economic gravity. With worse consumption prospects and public investment peaking in annual terms in 2019, we expect GDP to grow by 3.7% y/y this year. Q1 is set to be marked by a major drop in y/y growth and the stable path in the latter quarters is dependent on a rebound in the global economy.
- Core inflation is projected to rise steadily, but CPI inflation is likely to stay low and undershoot the MPC target in 2019. Electricity prices were frozen, but there are many other administered prices that will rise this year. Second round effects after surge in electricity costs on the firms' side will be marginal, though. With low food and fuel prices, the beginning of the year will be marked by low inflation. The uptrend later depends on core inflation accelerating.
- 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. Risks to this forecast are balanced.
- General government deficit was likely the lowest in history in 2018. The name of the game now is fiscal stimulation and we expect fiscal space to be used to cushion the slowdown.

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 EUR/PLN to remain essentially flat within the forecast horizon. Risks are tilted to the upside as market participants are drawing smooth GDP path and underestimate the onset of the slowdown.

mBank forecasts

	2015	2016	2017	2018	2019 F	2020 F
GDP y/y (%)	3.8	3.0	4.8	5.1	3.7	3.3
CPI Inflation y/y (average %)	-0.9	-0.6	2.0	1.6	1.9	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

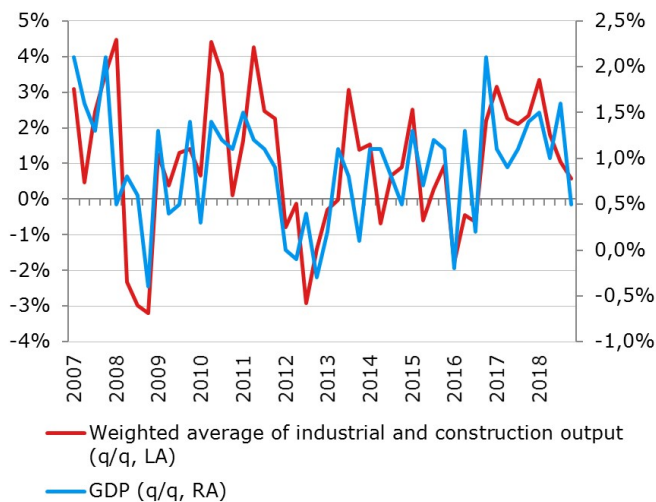
	2018 Q1	2018 Q2	2018 Q3	2018 Q4 F	2019 Q1 F	2019 Q2 F	2019 Q3 F	2019 Q4 F
GDP y/y (%)	5.3	5.1	5.1	4.8	3.8	3.7	3.5	3.6
Individual consumption y/y (%)	4.7	4.9	4.5	4.0	3.7	3.5	3.4	3.3
Public Consumption y/y (%)	3.0	3.5	3.6	4.4	4.0	4.0	4.0	4.0
Investment y/y (%)	8.2	4.7	9.9	6.9	5.0	5.0	4.0	4.0
Inflation rate (% average)	1.5	1.7	1.9	1.4	1.5	1.8	1.9	2.2
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

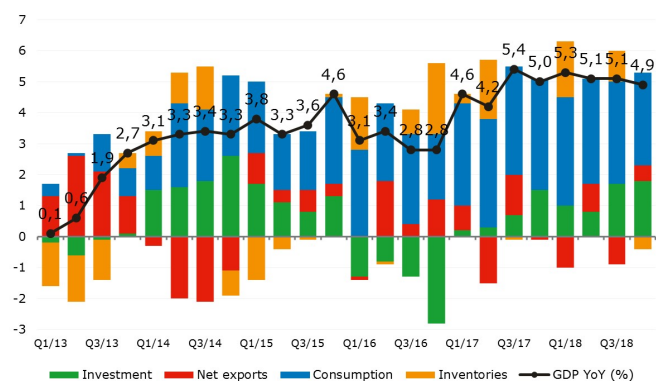
Economics

GDP growth a tad below 5% y/y, but the slow-down is set to continue

According to the flash reading published today, GDP rose by 4.9% y/y in the fourth quarter, close to forecasts and the lower bound of estimates derived from Q1-Q3 data and the annual GDP release we've covered two weeks ago. The high annual growth is, however, mostly a reflection of strong growth in the first nine months of the year. The final quarter was much weaker (+0.5% q/q on a seasonally adjusted basis) and this is consistent with signals sent by monthly activity data.



The data offer no new insights into the structure of growth. It is thus worth repeating that, using annual and Q1-Q3 data we estimate that both household consumption and investment slowed down visibly in Q4 (from 4.5 to 4.0% y/y and from 9.9 to ca. 6.8% y/y, respectively). If it wasn't for the surprisingly high contribution from net exports (1 percentage point above values implied by monthly international trade figures), growth would have cratered already in Q4. We await confirmation in two weeks, when the full national accounts data is scheduled for publication.



The implications of today's release for 2019 growth are much more interesting, in our view. First, Q4 figures lay to rest the notion that Poland can be immune to euro area slowdown. Second, the weak q/q print in Q4 reduces the carryover from 2018 into 2019 (hence, slightly lower average 2019 growth can be expected). Third, since the short-term momentum of the Polish economy has shifted from the 1-1.5% range prevalent in 2017 and early 2018 to ca. 0.5, the strong growth recorded

at the beginning of the year constitutes high statistical base. As a result, the consensus might be underestimating the extent to which the Polish economy is set to slow down at the beginning of 2019 and the smooth, gradual trajectories drawn by forecasters seem too optimistic. We believe that Q1 growth will be below 4% y/y already.

From the MPC's point of view, Q1 is still the distant future and the Council will take comfort in still-high Q4 GDP growth and low inflation. Presumably, the March staff projections of GDP growth will be upgraded, as suggested by some members of the Council, including the NBP governor himself. Our view of Polish monetary policy is unchanged – rates will remain flat for the foreseeable future (we do not forecast any hikes) and market pricing can shift, depending on global environment and current data flow, between pricing in a small easing cycle and a small hiking cycle.

Fixed income

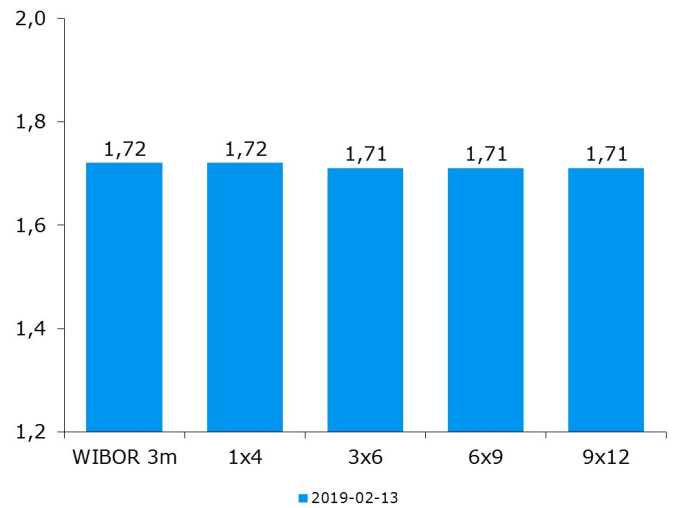
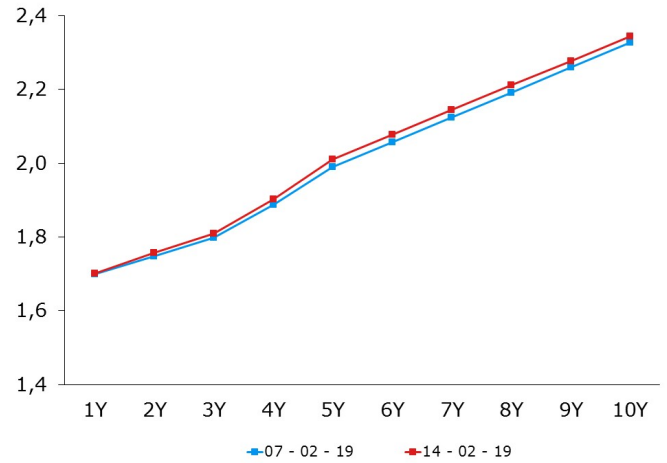
Calm week

This week was extremely calm, market moved in a very narrow range. Some supply was present on floaters, which moved its pricing closer to ASWs.

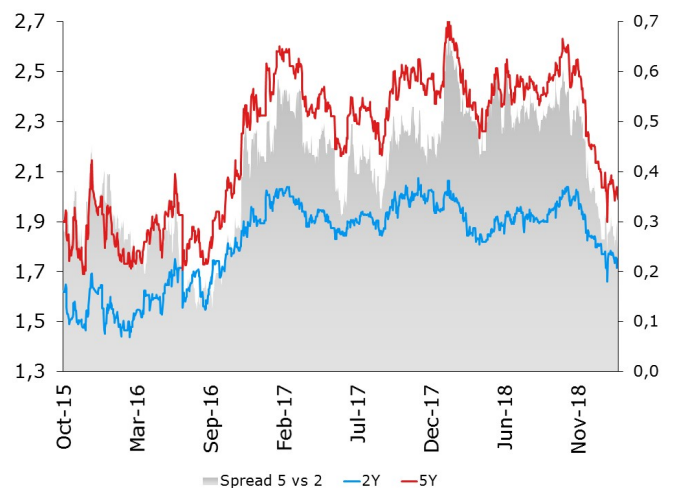
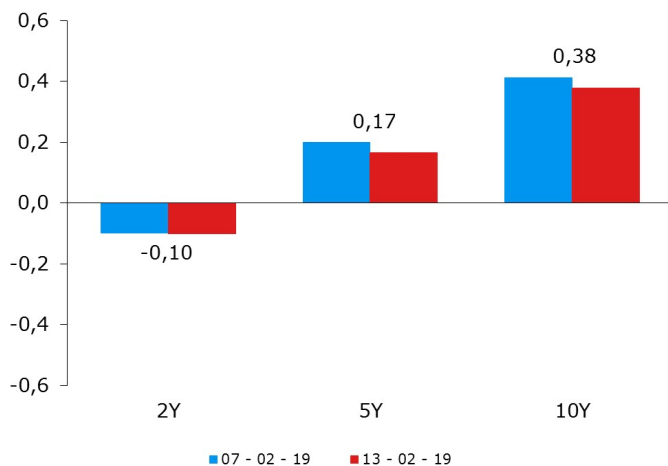
DS1023/5y is 3 bps, WS0428/10y is 34 bps. PS0424/WS0428 is 54 bps. WS0428/Bund is 259 bps.

DS1020 is trading at 1.43% (4 bps up), DS1023 is trading at 2.07% (no change) and WS0428 is trading at 2.70% (3 bps down).

IRS curve



Asset swaps

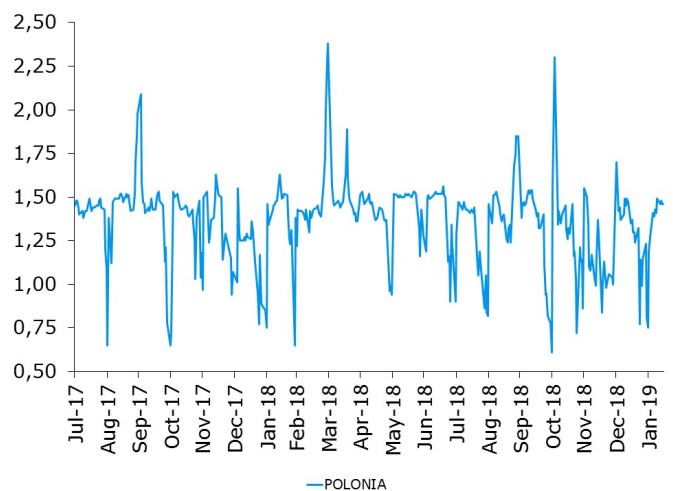
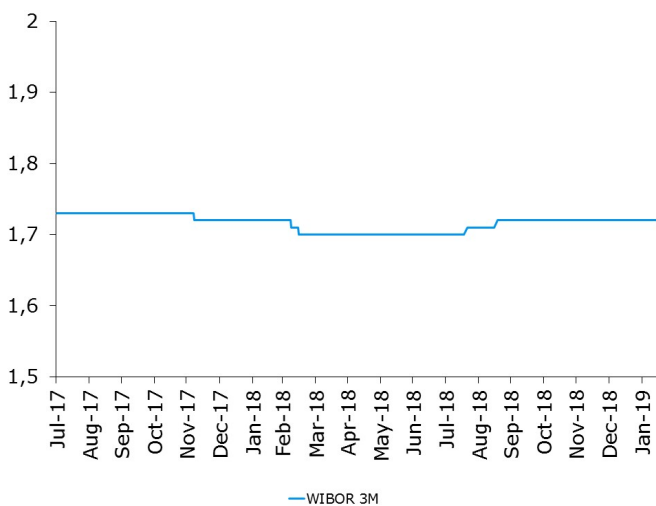
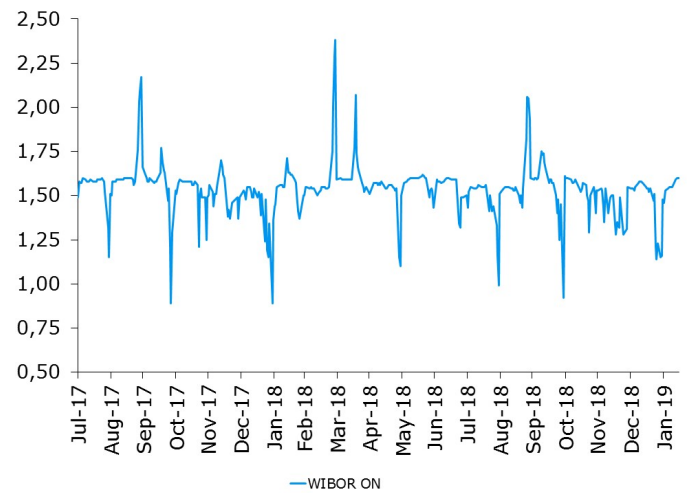
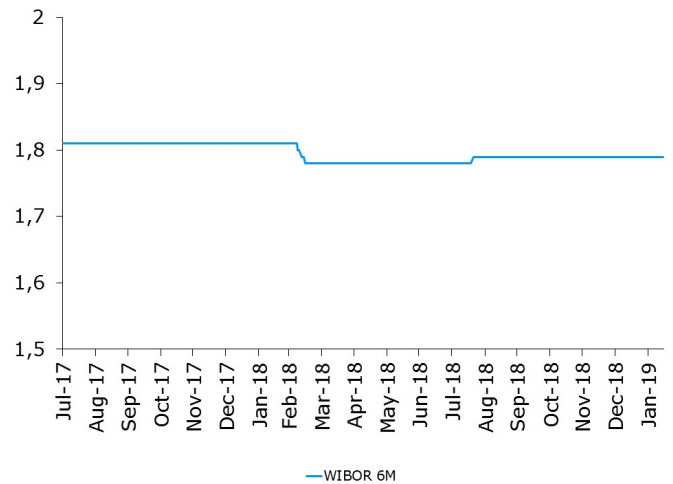


Money market

Volatility continues to decrease

Volatility on Polish rate markets is decreasing further. Swaps are trading in a narrow range with 2y IRS trading around 1.77% and 5y at 2.02%. Tomorrow we have a CPI reading which may insert some volatility into the market. Although it is unlikely to change the MPC's stance (i.e. keeping rates flat for extended period).

Market stabilized around 1.50 in overnight rate. Tomorrow's OMO will set tone for the next week.



Forex

Spot – EUR/PLN – at the top of the range Stronger USD and the prolonged trade tensions between the United States and its trading partners, as well as the Brexit uncertainty, have provided the needed spark for PLN to start the weakening spiral. It was the USD/PLN that took the most of the hit, moving from 3.7200 low to 3.8580, the high of last two weeks. In case of EUR/PLN the move was much less dramatic, from 4.2600 to 4.3420 so far and it is at the top of the 4.26 - 4.34 range. No need for panic yet, we are of the opinion that this range should dominate.

Opts – Volatility higher Weaker PLN inevitably led to higher implied volatilities in EUR/PLN and USD/PLN. It happened even though realized volatilities are still on their move down. 1 month EUR/PLN ATM mid is this Thursday at 4.6% (0.4% higher), 3 months mid is 4.9% (0.60% higher), 1 year is 5.6% (0.4% higher). The skew was also in demand as well as the currency spread (difference between USD/PLN vol and EUR/PLN vol). The main reason for such move was fresh worries about U.S.-China trade tensions and global growth which caused outflows of funds from emerging markets.

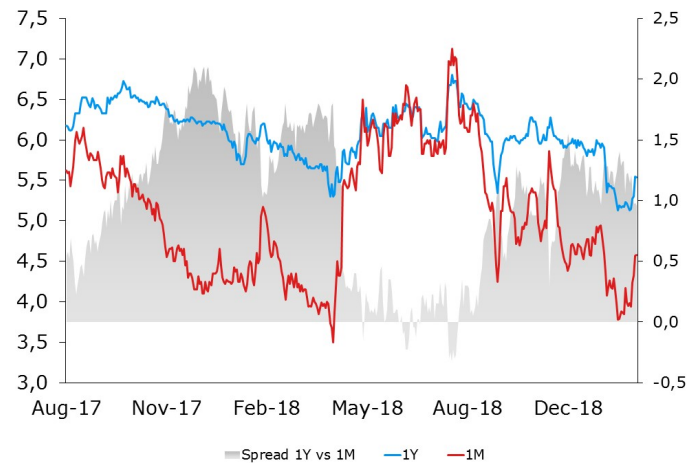
Short-term forecasts

Main supports / resistances:
 EUR/PLN: 4.2600 / 4.3500
 USD/PLN: 3.6000 / 3.9000

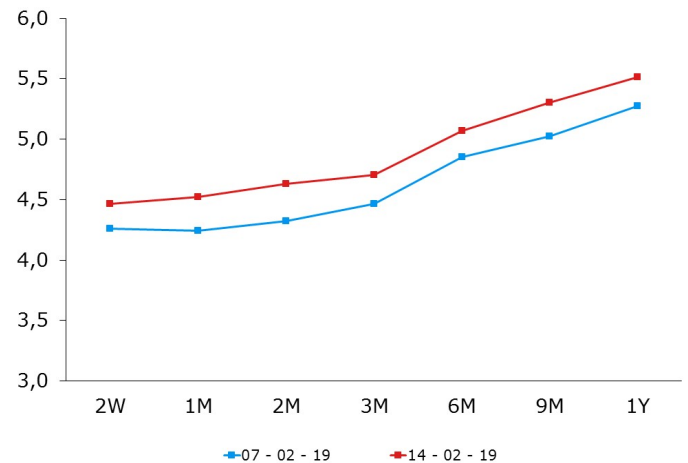
Spot: Current position: Short EUR/PLN

We closed the rest of our long position at 4.33 with over 6 big figures in profit. We stick to our range play strategy, but this time we apply positive, instead of PLN-negative approach. That makes us short EUR/PLN at 4.34 with a room to add at 4.35, and the stop at 4.37 with hopes to see levels below 4.30.

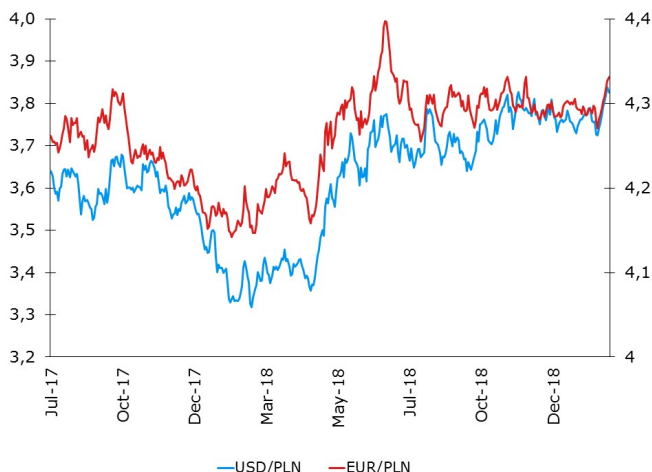
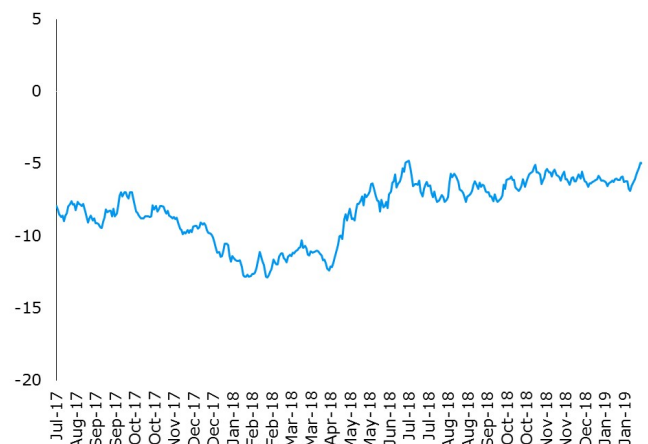
EURPLN volatility



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
2/7/2019	1.66	1.72	1.77	1.69	1.99	1.77	1.71	1.71	1.69	1.70	1.70	1.75
2/10/2019	1.75	1.72	1.85	1.69	1.92	1.77	1.72	1.71	1.70	1.70	1.70	1.76
2/11/2019	1.84	1.72	1.97	1.69	2.05	1.77	1.71	1.71	1.70	1.70	1.70	1.77
2/12/2019	1.66	1.72	1.73	1.69	1.87	1.77	1.71	1.71	1.70	1.70	1.70	1.76
2/13/2019	1.80	1.72	1.96	1.69	2.11	1.77	1.72	1.71	1.71	1.71	1.71	1.76

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	2/7/2019	5/25/2021	96.67	1.49	150	450	180
PS0424	2/7/2019	4/25/2024	101.65	2.16	1500	3445	1570
DS1029	2/7/2019	10/25/2029	99.40	2.81	1500	1066	1666

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0720	5Y IRS	PS0423	10Y IRS	WS0428
2/7/2019	1.770	1.405	1.747	1.648	1.990	2.189	2.327	2.740
2/10/2019	1.770	1.380	1.742	1.644	1.986	2.176	2.323	2.720
2/11/2019	1.770	1.405	1.760	1.657	2.012	2.192	2.348	2.733
2/12/2019	1.770	1.413	1.755	1.655	2.018	2.190	2.355	2.735
2/13/2019	1.770	1.430	1.757	1.656	2.010	2.176	2.345	2.722

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
2/7/2019	4.24	4.47	4.85	5.27	5.27	1.48	0.51
2/10/2019	4.33	4.45	4.83	5.30	5.30	1.48	0.51
2/11/2019	4.57	4.75	5.10	5.55	5.55	1.54	0.51
2/12/2019	4.58	4.81	5.05	5.54	5.54	1.54	0.51
2/13/2019	4.52	4.71	5.07	5.51	5.51	1.44	0.51

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
2/7/2019	4.3019	3.7919	3.7814	3.4463	1.3462	0.1668
2/10/2019	4.3082	3.8040	3.7956	3.4628	1.3494	0.1670
2/11/2019	4.3172	3.8190	3.8082	3.4643	1.3506	0.1671
2/12/2019	4.3268	3.8380	3.8093	3.4714	1.3569	0.1674
2/13/2019	4.3312	3.8261	3.8031	3.4564	1.3626	0.1677

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