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## Polish Weekly Review

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### Comment on the upcoming data and forecasts

Weak euro area PMIs and a decline in industrial sentiment as measured by Statistics Poland and EC ESI do not bode well for February PMI data (due this Friday) – we expect it to decline further, albeit by a small amount. Next Wednesday the MPC will end its two-day meeting. We expect no changes to interest rates and to the Council's rhetoric. The fiscal stimulus announced last weekend does not seem to have any significant impact on MPC members, as seen in their recent statements. In addition, the new staff projections will likely show lower inflation and higher GDP, reviving the Goldilocks theme and putting the Council in a comfortable position. Flat rates are still the most likely scenario in Polish monetary policy.

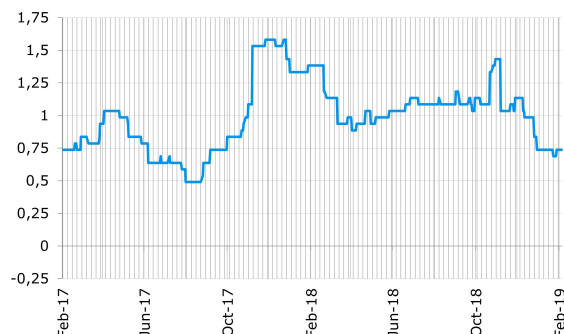
### Polish data to watch: March 1st to March 8th

Publication	Date	Period	mBank	Consensus	Prior
Manufacturing PMI (pts.)	1.03	Feb	48.1	48.4	48.2
MPC decision (%)	6.03	Mar	1.50	1.50	1.50

### 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

Unchanged (no surprises in any of last week's publications). Next few days bring only one opportunity to move the surprise index – manufacturing PMI tomorrow.

\* 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

- Poland will make use of its fiscal space in 2019. The new tax & transfer package is worth 1,0% GDP this year and as much as 1.8% GDP next year. It alters our forecasts of private consumption and GDP materially and we decided to raise GDP forecasts for this year, from 3.7 to 4.1% y/y.
- 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 don't expect any rate changes in Poland in the foreseeable future. Fiscal stimulus tilts the balance of risks to the upside.
- General government deficit was likely the lowest in history in 2018. From 2019 onwards deficits are likely to head higher. However, the procyclicality of fiscal revenues ensures a modest increase in the deficit.

### 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.
- Fiscal stimulation is both a blessing and a curse for the PLN. Over the short term, fiscal stimulus and expectations of a monetary offset should be PLN-positive, as already witnessed in the FX market. However, if no monetary offset arrives and the economy begins to overheat, weaker currency is the only rebalancing mechanism left. As a result, be wary of any strengthening – it might not last.

### mBank forecasts

	2015	2016	2017	2018	2019 F	2020 F
GDP y/y (%)	3.8	3.0	4.8	5.1	4.1	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	2018	2018	2018	2019	2019	2019	2019
	Q1	Q2	Q3	Q4	Q1 F	Q2 F	Q3 F	Q4 F
GDP y/y (%)	5.3	5.1	5.1	4.9	4.4	4.1	3.8	3.9
Individual consumption y/y (%)	4.7	4.9	4.5	4.3	4.0	3.8	3.9	4.0
Public Consumption y/y (%)	3.0	3.5	3.6	4.0	4.2	4.0	4.0	4.0
Investment y/y (%)	8.2	4.7	9.9	6.7	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								

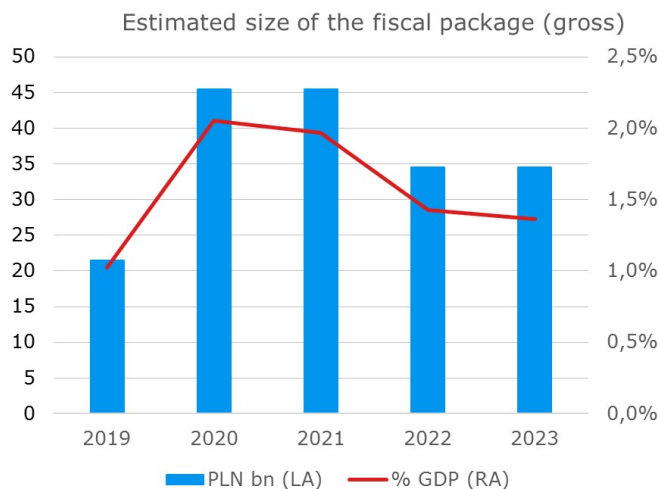
## Economics

### Poland will use its fiscal space and this year's growth prospects have received a sizable kick

Law & Justice party unveiled several fiscal measures during its convention last weekend. The list includes: extending the child subsidy programme to all children, lowering the PIT rate from 18 to 17% in the lower income bracket, doubling PIT deductibles for wage earners, lowering the PIT rate to zero for persons aged less than 26, a one-off pension of PLN 1100 for all pensioners and rebuilding the system of local bus transport in rural areas. The package will be enacted this year and introduced in phases. The pension bonus will be paid before May, the extended child subsidy will be disbursed starting from July and it is still unclear when will the PIT changes come into force.

Measure	2019 cost (PLN bn)	2020 cost (PLN bn)
extending 500+	9.5	19.0
lowering PIT rate by 1 pp.	0.0	8.0
doubling PIT deductibles	1.0	3.5
0% PIT for <26	2.5	2.5
pension bonus	11.0	11.0
local transport	0.0	1.5
<b>Gross expenditure</b>	<b>24.0</b>	<b>45.5</b>
Additional revenue (-)	4.8	9.1
<b>Net expenditure</b>	<b>19.2</b>	<b>36.1</b>

We estimate the gross fiscal cost to amount to ca. PLN 45 bn per year (1.8% of GDP), while the new spending will peak in 2020, when all the elements of the package are disbursed in full amount. We assume that PIT deductibles will be raised this year already, while the lower PIT rates will come into force next year. The trajectory of the fiscal impulse also depends on whether the pension bonus is extended into 2020 and 2021 – this is still unclear to us. The overall size of the package is higher than we anticipated – we expected the government to propose a more measured suite, worth ca. 1% GDP in new social spending, tax cut or a mix of both.



The short-term economic impact is of course positive for GDP growth, boosting it through higher household disposable income and consumption. However, the per-PLN impact will likely be smaller than the last time (i.e. when the first phase of the child subsidy programme was introduced in 2016). First, the new package directs, on balance, more funds to higher-income

households (hence, more will be saved). Second, high wage growth and social spending in 2016-2018 has likely already alleviated liquidity constraints among poorer households and broadened the overall consumption base. These effects will not be repeated this year. Third, despite the slowdown in consumer spending (from 5.0 to 4.3% y/y per latest data), the package is introduced essentially close to the peak of the business cycle. With higher capacity utilization and more binding supply constraints, the additional demand is more likely to leak out through the trade balance / net exports, offsetting the positive impact on consumption to a larger extent. Nevertheless, the package arrives at a point when consumer sentiment has already begun to decline and its sheer size ensures a sizable impact on GDP.

As a result, we decided to raise our GDP forecast for this year (from 3.7 to 4.1% y/y). This also a reaction to today's detailed GDP data which surprised to the upside in terms of consumption growth (4.3 vs. 4.0% y/y estimated using annual data published a month ago). We will be updating the GDP path as we receive new data. Apart from the short-term impact on aggregate demand, there are other implications of the stimulus announced last weekend:

1. While the package is unlikely to change gross savings in the Polish economy, it will shift a sizable chunk of the government's fiscal space to household savings. This suggests higher inflows into equities and asset management, but also into the housing market.
2. Abolishing the income threshold in the child subsidy is likely to raise labor market participation. Might be offset by higher reservation wage.
3. Wage and price expectations will likely determine the impact of the new package on inflation. Public sector wages are the space to watch closely.
4. In our view, there will be no monetary offset and the MPC will keep interest rates at present levels for the foreseeable future. However, the package is likely to squash any rate cut talk and erase expectations of rate cuts. The risks to the baseline rate path (i.e. flat) are asymmetric again.
5. Over the medium term, fiscal stimulus now increases the likelihood of pro-cyclical fiscal policy in the future. However, markets will be primarily concerned with its impact on growth, inflation and bond supply. The latter might not increase materially, especially this year.

## Fixed income

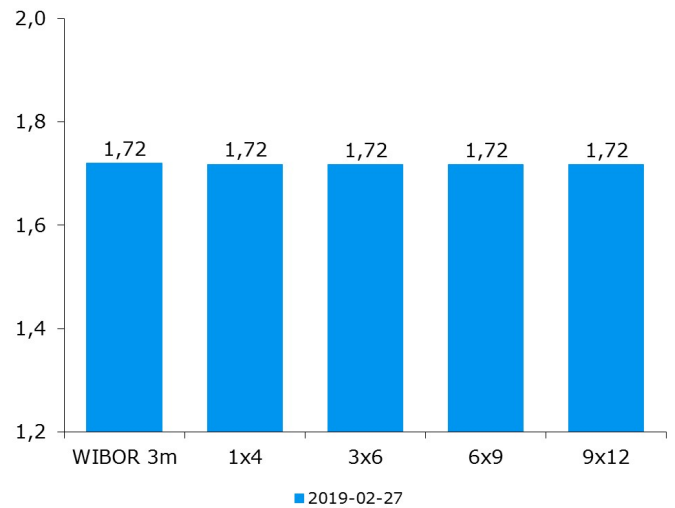
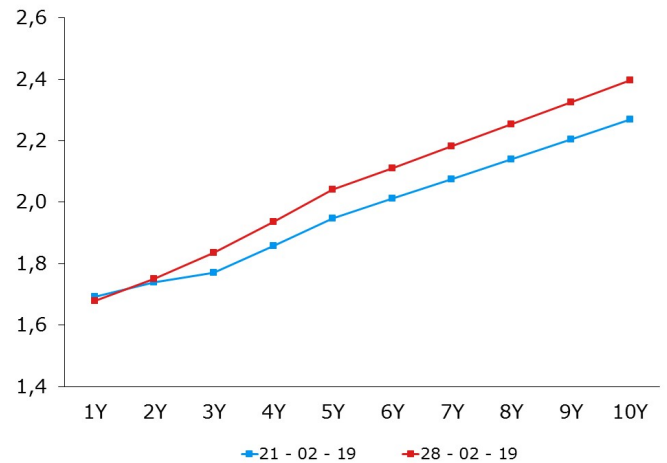
### Next week's auction will test the market's strength

New election promises surprised the market. Investors surmised that Poland will have to issue additional 20B this year and ASW did not like it. The PS0424/5y spread is close to all time highs, but the drivers seem to have changed. Next week's auction will be a big test for our market. March will be a difficult month for everyone anyway, as there's Brexit on the way. Many participants will wait and do nothing.

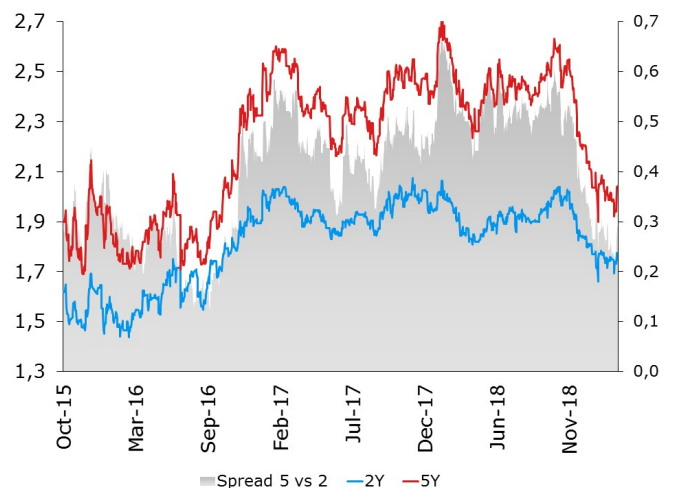
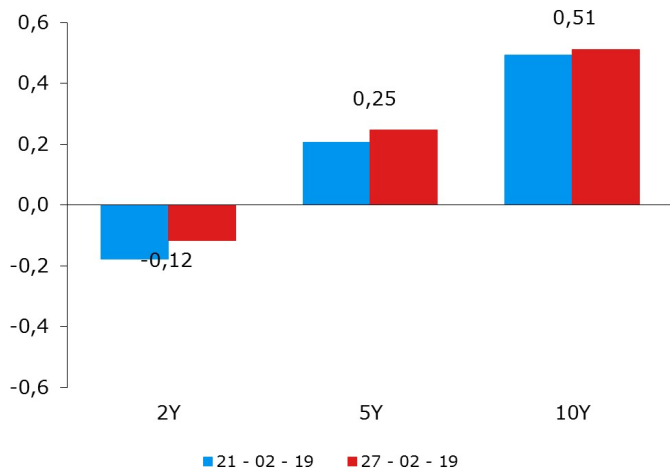
PS0424/5y is 20 bps, WS0428/10y is 38 bps. PS0424/WS0428 is 55 bps. WS0428/Bund is 265 bps.

DS1020 is trading at 1.54% (8 bps up), PS0424 is trading at 2.28% (16 bps up) and WS0428 is trading at 2.83% (18 bps up).

IRS curve



Asset swaps



## Money market

### Finally, a local story

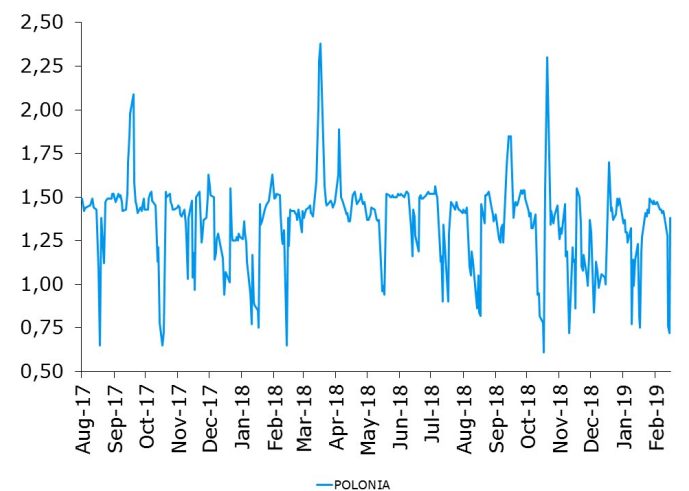
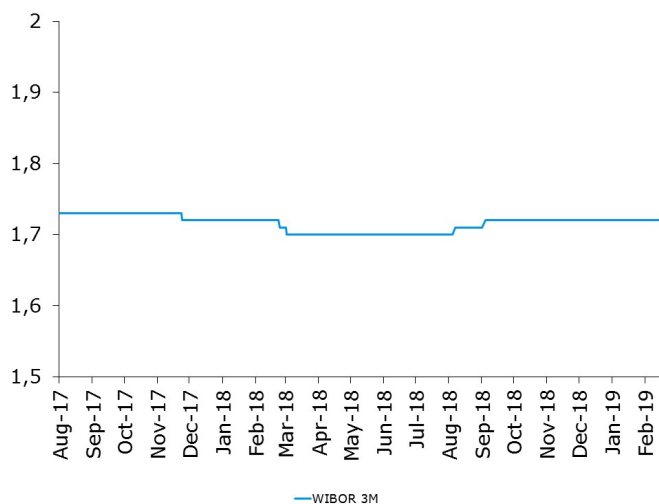
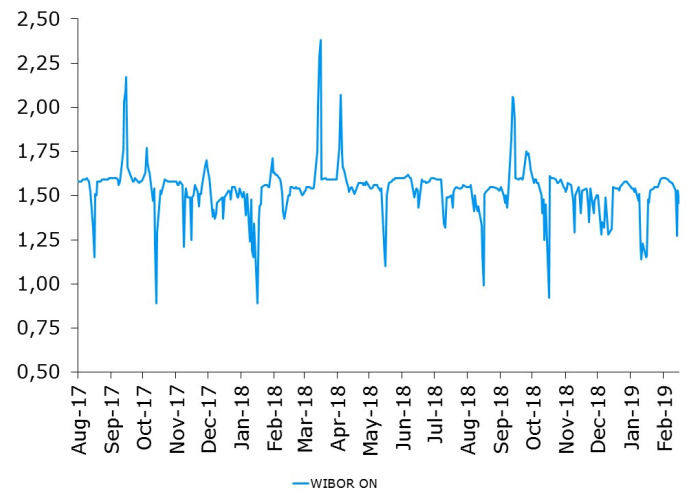
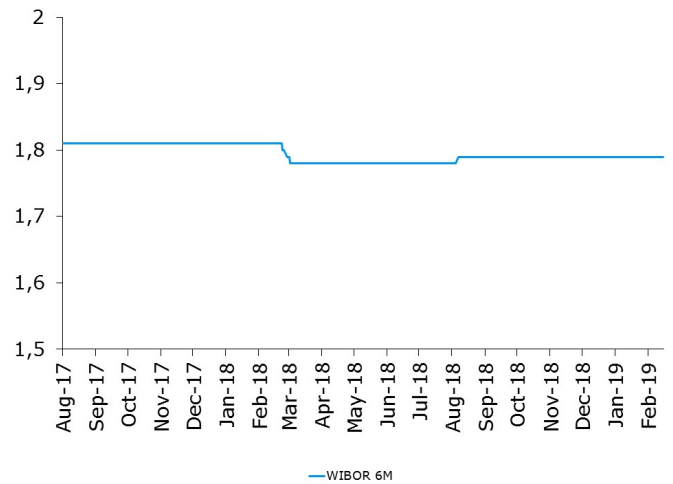
During the weekend the ruling party finally delivered some local story. PiS unveiled a huge social spending plan to enact before next elections. It is worth around 1.5% to GDP, so market participants interpreted this as excluding any rate cuts for now and implying higher borrowing needs. To sum up, we have erased all expectations of lower rates with 2y swap trading at 1.80% and 5y as high as 2.09%. The 2y swap rate is still a bit below its earlier levels.

Standard end of the month. Cash rate is laying on the floor. Next week rates should get back to 1.50%. Bloomberg reported that repo trades will be tax-exempt. Looks like work is already in progress.

Ref rate vs Polonia averages:

30 day 17 bp

90 day 23 bp



## Forex

**Spot: EUR/PLN lower, but still in the range** During the last days EUR/PLN has kept on sliding, since 4.34-4.35 turned out to be a strong resistance. Technically, we are still in the 4.26-4.34 range and we don't expect to break out of that range any time soon. In general, sentiment on Zloty has improved on the news that British Prime Minister Theresa May offered lawmakers the chance to vote on delaying Brexit, opening up the possibility of avoiding a chaotic no-deal departure from the European Union. Additionally the market seems to ignore local political and fiscal issues after Poland's ruling party pledged more spending ahead of this year's parliamentary elections.

**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 the short volatilities (up to 2M) trend was evidently downward sloping. 1 month ATM mid is this Thursday at 4.1% (0.3% lower), 3 months mid are 4.4% (0.3% lower), 1 year is 5.25% (0.15% lower). The currency spread (difference of USD/PLN minus EUR/PLN) and the skew are also better offered.

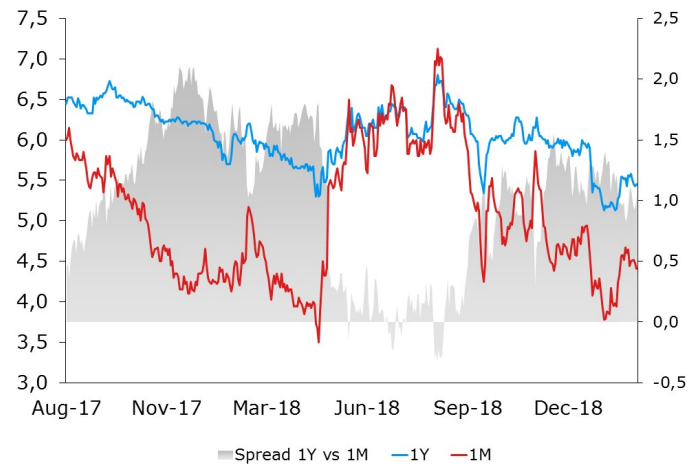
### Short-term forecasts

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

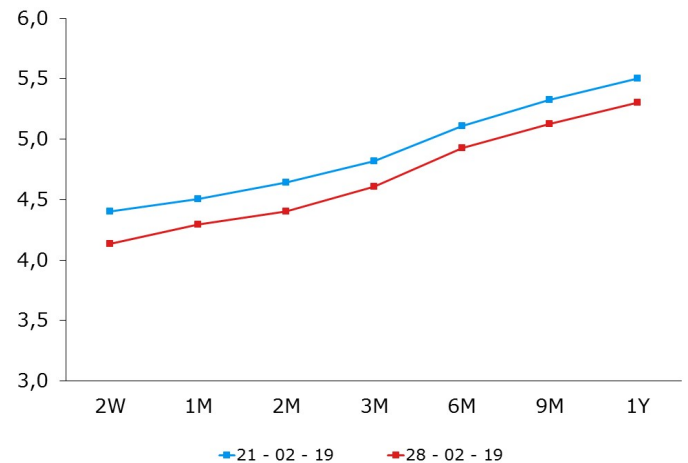
### Spot: Current position: Short EUR/PLN

Our strategy is unchanged. We are still 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.

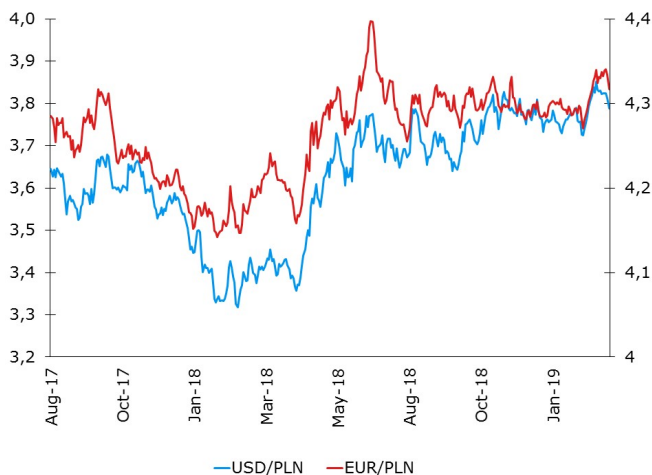
EURPLN volatility



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
2/21/2019	1.61	1.72	1.73	1.69	1.87	1.77	1.71	1.71	1.69	1.68	1.69	1.75
2/24/2019	1.62	1.72	1.72	1.69	1.87	1.77	1.71	1.70	1.69	1.69	1.68	1.75
2/25/2019	1.70	1.72	1.73	1.69	1.87	1.77	1.72	1.71	1.71	1.71	1.71	1.77
2/26/2019	1.51	1.72	1.61	1.69	1.76	1.77	1.72	1.72	1.72	1.72	1.73	1.78
2/27/2019	1.58	1.72	1.68	1.69	1.85	1.77	1.72	1.72	1.72	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	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
2/21/2019	1.770	1.437	1.740	1.562	1.947	2.154	2.268	2.761
2/24/2019	1.770	1.454	1.730	1.571	1.940	2.153	2.257	2.754
2/25/2019	1.770	1.463	1.775	1.618	2.038	2.266	2.377	2.892
2/26/2019	1.770	1.448	1.746	1.617	2.030	2.256	2.342	2.863
2/27/2019	1.770	1.481	1.751	1.633	2.040	2.288	2.396	2.908

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1Y	
2/21/2019	4.51	4.82	5.11	5.50	5.50	1.54	0.51	
2/24/2019	4.52	4.75	5.10	5.45	5.45	1.54	0.51	
2/25/2019	4.48	4.79	5.12	5.43	5.43	1.54	0.51	
2/26/2019	4.41	4.77	5.05	5.45	5.45	1.54	0.51	
2/27/2019	4.29	4.61	4.93	5.30	5.30	1.49	0.50	

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
2/21/2019	4.3322	3.8247	3.8171	3.4547	1.3651	0.1688
2/24/2019	4.3387	3.8242	3.8225	3.4518	1.3651	0.1692
2/25/2019	4.3402	3.8241	3.8267	3.4547	1.3648	0.1692
2/26/2019	4.3338	3.8124	3.8145	3.4394	1.3641	0.1689
2/27/2019	4.3173	3.7886	3.8003	3.4309	1.3645	0.1684

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