

March 14, 2019

Polish Weekly Review

Authors:

Ernest Pytlarczyk, PhD, CFA
chief economist
tel. +48 22 829 01 66
ernest.pytlarczyk@mbank.pl

Marcin Mazurek, PhD
senior analyst
tel. +48 22 829 01 83
marcin.mazurek@mbank.pl

Piotr Bartkiewicz
senior analyst
tel. +48 22 526 70 34
piotr.bartkiewicz@mbank.pl

Maciej Zdrolik
analyst
tel. +48 22 829 02 56
maciej.zdrolik@mbank.pl

Follow us on Twitter:

[@mbank_research](https://twitter.com/mbank_research)

Business contacts:

Department of Financial Markets

Wojciech Dunaj
head of interest rates trading
tel. +48 22 829 07 51
wojciech.dunaj@mbank.pl

Marcin Turkiewicz
head of fx trading
tel. +48 22 829 01 67
marcin.turkiewicz@mbank.pl

Department of Financial Markets Sales

Inga Gaszkowska-Gebska
institutional sales
tel. +48 22 829 01 67
inga.gaszkowska-gebska@mbank.pl

Jacek Jurczyński
head of treasury sales
tel. +48 22 829 15 16
jacek.jurczynski@mbank.pl

mBank S.A.

18 Senatorska St.
00-950 Warszawa
P. O. BOX 728
tel. +48 22 829 00 00
fax. +48 22 829 00 33
<http://www.mbank.pl>

Table of contents

Our view in a nutshell

Economics

- Inflation hits the target in NBP's new staff projections

Fixed income

- Supply looming over the market

Money market

- Stable week behind us

FX market

- Spot: EUR/PLN - stable
- Opts: implied volatility sliding

page 2

page 3

page 4

page 5

page 6

Comment on the upcoming data and forecasts

This Friday, Statistics Poland will publish final CPI for February and we expect it to grow by 1.2% y/y. Food prices likely accelerated on y/y basis (atypical m/m decline happened last year and we expect this year to follow the normal seasonal pattern, i.e. small increase). We expect core inflation growth of 1.2% y/y due to the base effects - to be confirmed on Friday. Finally, residential energy prices most likely remained unchanged. Details of January print will also be released and January inflation is likely to be revised in part due to new weights being introduced. On Monday, apart from core inflation prints, the NBP will publish monthly balance of payments data. After a massive deficit in both CA and trade balances in December, January is set to bring a large swing into CA surplus (due to seasonal EU fund inflows) and a smaller trade deficit. On Tuesday monthly labor market stats will be published. We expect both employment and wages to slow down somewhat, the former due to waning labor demand momentum, the latter due to high base effects. On Wednesday industrial output data will be released. Our below-consensus forecast assumes that last month's surge will be corrected and that weaker industrial sentiment will finally impact output figures. On Thursday Statistics Poland will publish construction output data – we expect it to be boosted by warm and dry weather considerably. Retail sales data, published at the same time, will fail to bring any excitement (flat on y/y constant price basis).

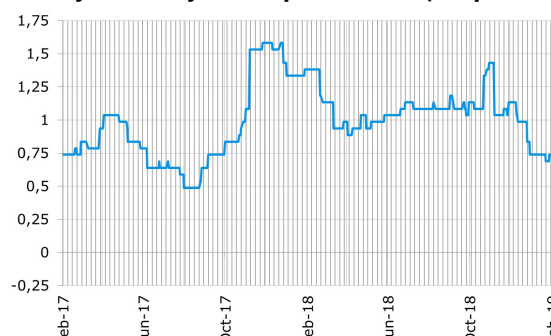
Polish data to watch: March 15th to March 22nd

Publication	Date	Period	mBank	Consensus	Prior
CPI y/y (%)	15.03	Feb	1	1	1
Current account balance (m EUR)	18.03	Jan	2114.0	1560.0	-1400.0
Exports (m EUR)	18.03	Jan	18700	18400	16005
Imports (m EUR)	18.03	Jan	19200	18555	17345
Core CPI y/y (%)	18.03	Jan	1.0	0.6	0.6
Core CPI y/y (%)	18.03	Feb	1.2	0.9	
Average gross wage y/y (%)	19.03	Feb	7.0	7.2	7.5
Employment y/y (%)	19.03	Feb	2.8	2.9	2.9
Sold industrial output y/y (%)	20.03	Feb	3.9	4.7	6.1
PPI y/y (%)	20.03	Feb	3.0	2.6	2.2
Construction output y/y (%)	21.03	Feb	11.0	6.0	3.2
Real retail sales y/y (%)	21.03	Feb	5.3	5.3	5.2
M3 y/y (%)	22.03	Feb	9.2	8.9	8.8

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	4/8/2019	300	1.561	3/8/2019
5Y T-bond PS0424	4/8/2019	2800	2.200	3/8/2019
10Y T-bond DS1029	4/8/2019	1200	2.841	3/8/2019
30Y T-bond WS0447	4/8/2019	30	3.149	1/25/2019
5Y floater WZ0524	4/8/2019	400	-	3/8/2019
10Y floater WZ0528	4/8/2019	200	-	3/8/2019

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



Comment

Unchanged (no macro releases). Next days are full of publications and each can move the Polish surprise index. It's a virtual certainty that at least one of them will.

* 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	4.0	3.8
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

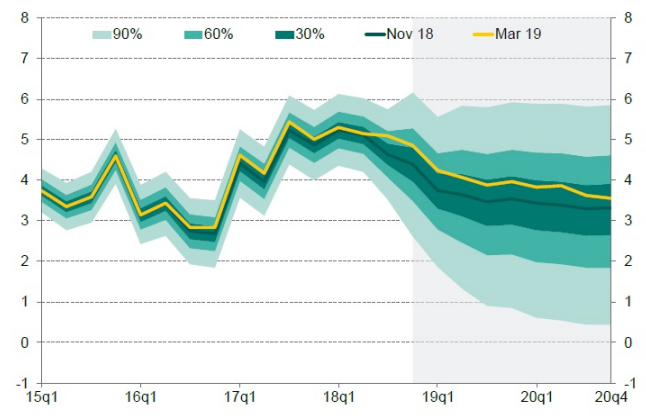
	2018	2018	2018	2018	2019	2019	2019	2019
	Q1	Q2	Q3	Q4	Q1 F	Q2 F	Q3 F	Q4 F
GDP y/y (%)	5.3	5.1	5.1	4.9	3.9	4.0	4.0	4.2
Individual consumption y/y (%)	4.7	4.9	4.5	4.3	4.0	3.8	4.2	4.4
Public Consumption y/y (%)	3.0	3.5	3.6	4.0	4.2	4.0	4.0	4.0
Investment y/y (%)	8.2	4.7	9.9	6.7	5.0	5.0	4.0	4.0
Inflation rate (% 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

Inflation hits the target in NBP's new staff projections

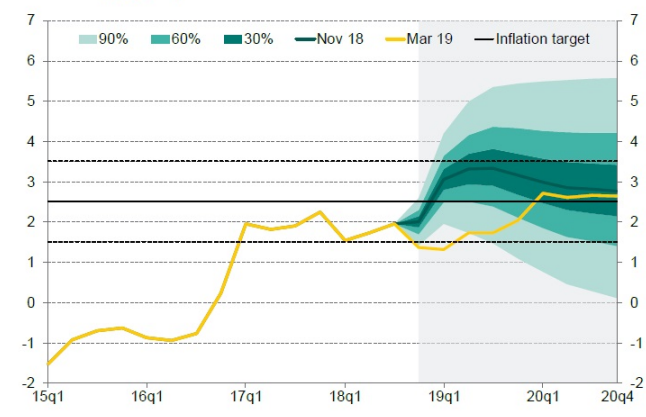
The latest inflation projection ideally hits the inflation target within the monetary policy horizon, which is a strong argument against any change in interest rates. The paths presented (GDP, inflation) are burdened by asymmetric downward risks, which translate into very dovish rhetoric of governor Glapinski. Without a significant surprise in core inflation, such a status quo may last until the end of current MPC's term of office. This projection is not surprising or controversial, also when analyzing the effects of fiscal package. But there are two subjects worthy of attention.

Figure 4.25 March projection versus November projection: GDP growth (y/y, %)



Source: NBP calculations.

Figure 4.27 March projection versus November projection: CPI inflation (y/y, %)

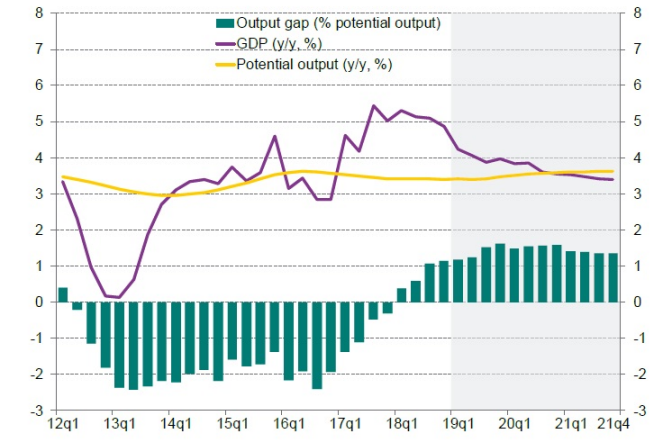


Source: GUS data, NBP calculations.

The first one is the dynamics of potential output. It was re-estimated upward by about 0.5 pp. It implies that the output gap was closed in the 2018. Automatically, it also means that in comparison to Czech Republic and Hungary, where core inflation moved much more around (and above) central banks targets, Polish inflation can actually be very low. Of course, there is a question how much it explains the reality (important in forecasting issues), or only describes it (and ex-post explains the current, low level of core inflation). The reasons for output gap revision seem reasonable (productivity of Ukrainians who are not so numerous neither in Czech nor in Hungarian labor market). The question remains, whether the output gap should explain the be-

havior of core inflation with all categories that are chaotically and acyclically moving (telecoms, air tickets), or rather should focus on the super-core inflation movements, with which it dealt quite well. Anyway, new output gap estimates keep core inflation low.

Figure 4.18 Output gap



Source: GUS data, NBP calculations.

The output gap is a synthetic measure of demand pressure in the economy. It is expressed as a percentage of the deviation of the actual real level of GDP from the level of potential output.

The second subject is energy prices. NBP corrected its earlier assumptions of increases in energy price, hence inflation forecast was lowered significantly. At the same time, they assumed that tariffs will adjust so that there will be no overall energy price increases in 2019. But for now there is a decrease in January. Moreover, the projection assumes market-based energy prices from 2020, thus in line with energy market contracts. It implies energy price increases since 2020, hence within the horizon of the monetary policy. Again, inflation report, at least in terms of energy prices, shows the worse scenario from the point of view of monetary policy. Somehow it answers questions concerning potential output and core inflation. It means that the MPC can comfortably watch the economy and only significant deviations from projection can change their view.

Fixed income

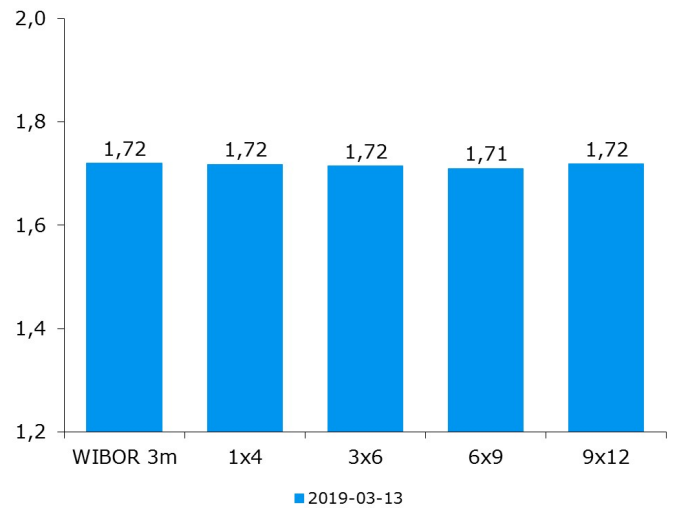
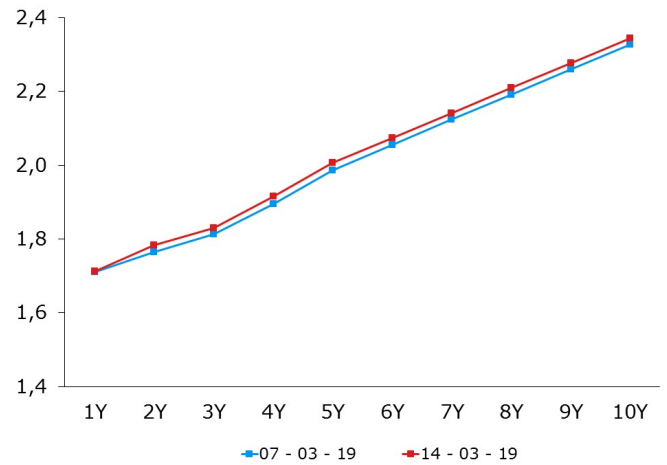
Supply looming over the market

This week was rather calm and we followed core markets. Market participants are increasing duration, which led to 2v5 flattener. On FRNs turnover is limited, as market participants are speculating about huge supply on the upcoming switching auction.

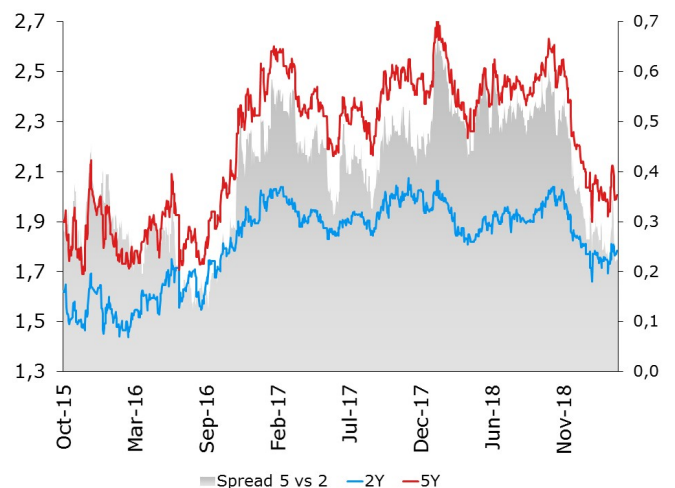
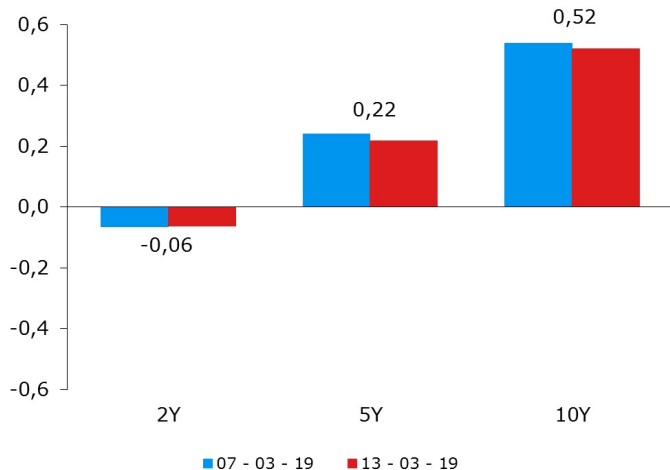
PS0424/5y is 18.5 bps, WS0428/10y is 44 bps. PS0424/WS0428 is 57.5 bps. WS0428/Bund is 272 bps.

DS1020 is trading at 1.54% (3 bps up), PS0424 is trading at 2.21% (no change) and WS0428 is trading at 2.79% (1 bps up).

IRS curve



Asset swaps

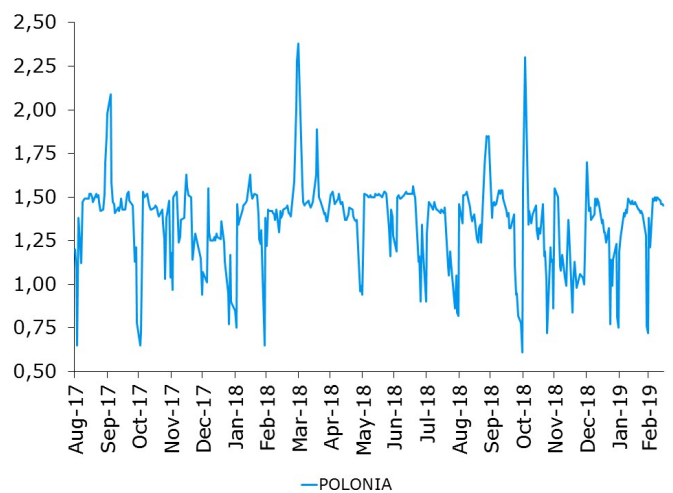
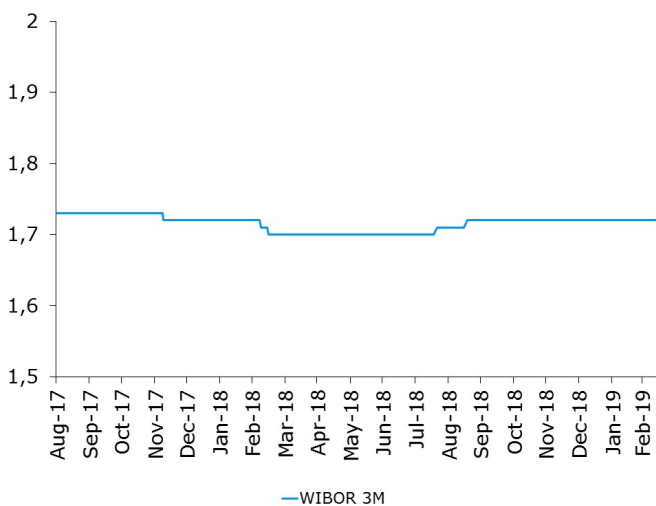
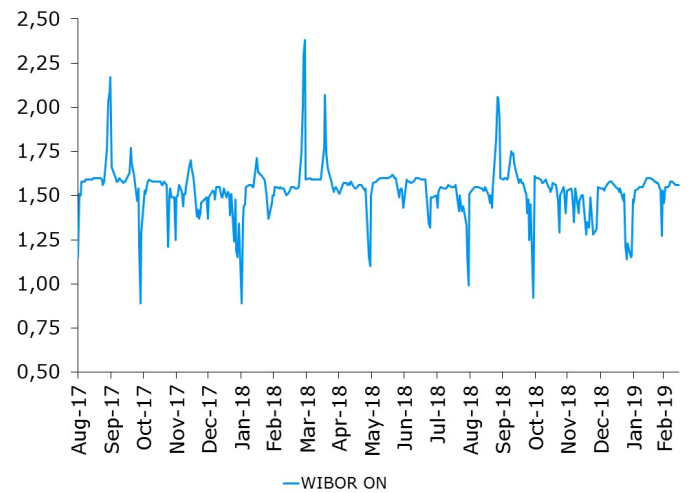
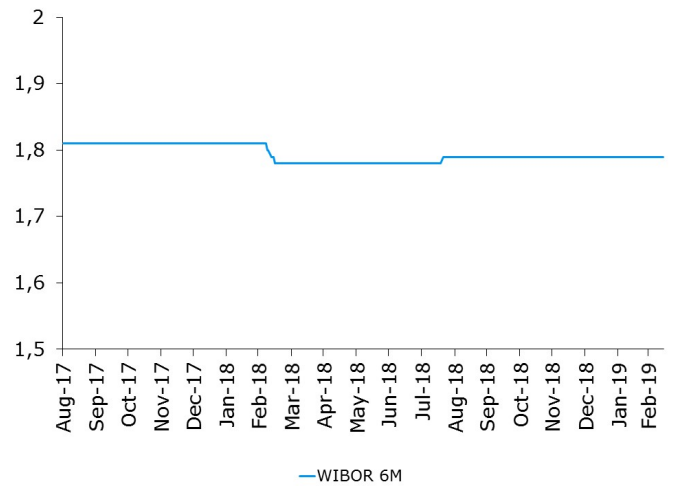




Money market

Stable week behind us

It was second week of mandatory reserve and polonia fluctuated below 1.50% for whole week as we had expected with lowest levels reached on Wednesday 1.44. On Friday's OMO banks bought PLN 72.6bn bills out of 78bn offered. Tomorrow we will have a regular OMO and we do not expect any special move on next week founding, Polonia should remain on this week's level, 1.45/50%.



Forex

Spot: EUR/PLN - stable EUR/PLN has been trading water for another week. Of course USD/PLN was much more interesting with a 3.7920-3.8595 weekly range, but that was driven purely by EUR/USD. Worth noting that we had dovish ECB on the way, which in theory should have given a boost to all EM currencies. The answer, why we have so stable PLN, should the most probably be the ECB's big downgrade of the growth outlook for the euro area, together with the weaker-than-expected Chinese data. This week we could see a real rollercoaster ride on British pound amid a series of parliamentary votes on Brexit options – unfortunately, it has failed to produce any volatility on currency other than GBP.

Options: implied volatility sliding Holding gamma is expensive and this week we saw some offloading - especially in the frontend of the curve. A week ago EUR/PLN 1 week ATM was even bid on at 4.1% and now is below 3.5%. EUR/PLN 1 month ATM mid has fixed today at 3.7% (0.3% lower), 3 months EUR/PLN are 4.0% (0.3% lower) and, finally, 1 year is 4.95% (0.1% lower). The skew and the currency spread (difference between USD/PLN vol and EUR/PLN vol) are also lower.

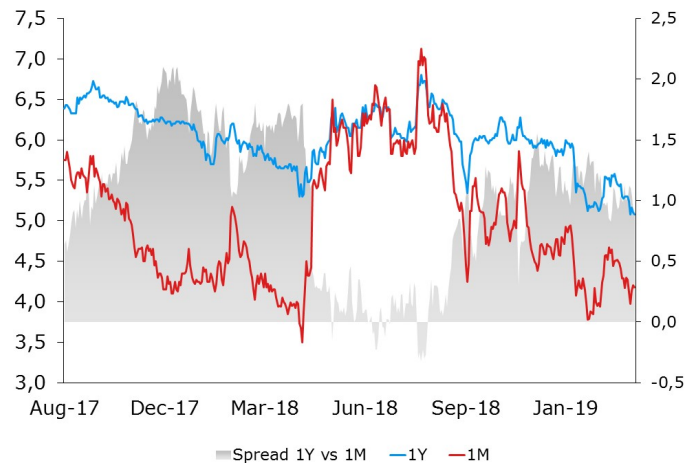
Short-term forecasts

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

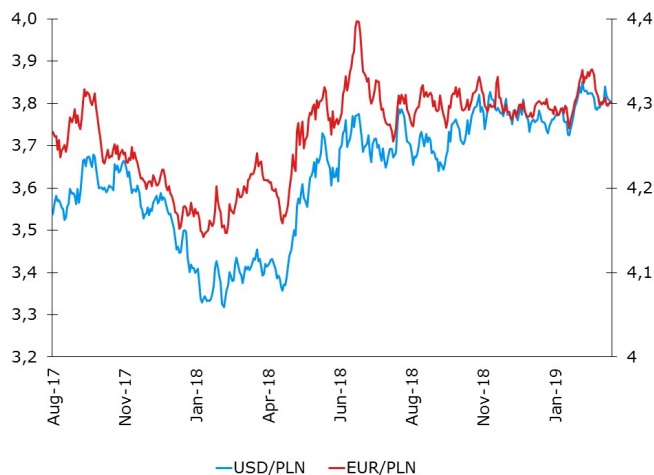
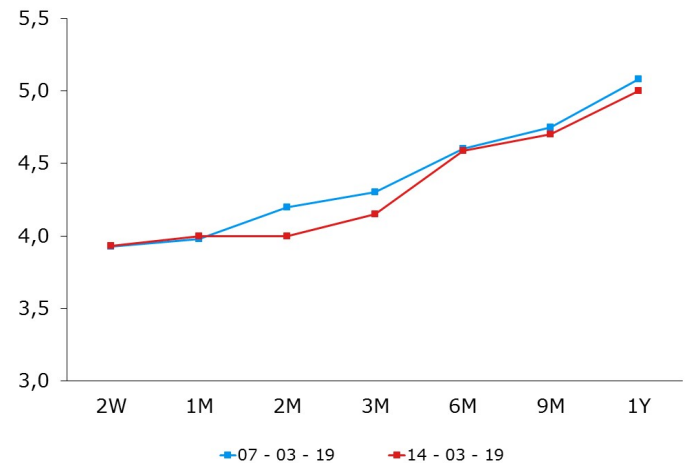
Spot: Current position: Short EUR/PLN

Our strategy is roughly 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 profit taking at 4.2750.

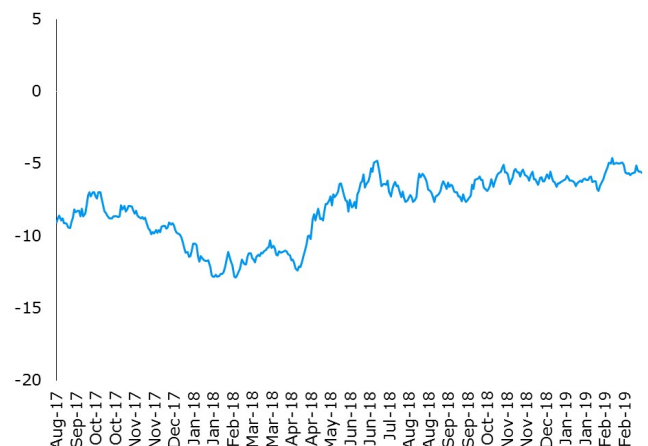
EURPLN volatility



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
3/7/2019	1.60	1.72	1.68	1.69	1.88	1.77	1.72	1.71	1.71	1.71	1.72	1.77
3/10/2019	1.62	1.72	1.69	1.69	1.87	1.77	1.72	1.71	1.71	1.71	1.71	1.77
3/11/2019	1.63	1.72	1.70	1.69	1.88	1.77	1.72	1.72	1.72	1.72	1.73	1.78
3/12/2019	1.50	1.72	1.59	1.69	1.76	1.77	1.72	1.72	1.71	1.72	1.72	1.77
3/13/2019	1.59	1.72	1.67	1.69	1.85	1.77	1.72	1.72	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	3/8/2019	5/25/2021	96.64	1.56	300	555	325
PS0424	3/8/2019	4/25/2024	101.42	2.20	2800	4841	2996
DS1029	3/8/2019	10/25/2029	99.15	2.84	1200	2262	1219

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0720	5Y IRS	PS0423	10Y IRS	WS0428
3/7/2019	1.770	1.435	1.765	1.701	1.987	2.228	2.328	2.867
3/10/2019	1.770	1.453	1.770	1.607	1.990	2.221	2.328	2.870
3/11/2019	1.770	1.475	1.783	1.725	2.007	2.235	2.345	2.883
3/12/2019	1.770	1.512	1.780	1.713	2.005	2.222	2.340	2.879
3/13/2019	1.770	1.511	1.783	1.721	2.006	2.224	2.345	2.865

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
3/7/2019	3.98	4.30	4.60	5.08	5.08	1.43	0.50
3/10/2019	4.14	4.43	4.70	5.17	5.17	1.43	0.50
3/11/2019	4.21	4.40	4.70	5.10	5.10	1.48	0.51
3/12/2019	4.18	4.33	4.68	5.08	5.08	1.46	0.51
3/13/2019	4.00	4.15	4.59	5.00	5.00	1.45	0.51

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
3/7/2019	4.3019	3.8038	3.7867	3.4052	1.3641	0.1681
3/10/2019	4.3068	3.8409	3.8031	3.4571	1.3638	0.1681
3/11/2019	4.2983	3.8199	3.7902	3.4344	1.3617	0.1675
3/12/2019	4.2976	3.8116	3.7813	3.4223	1.3620	0.1675
3/13/2019	4.3006	3.8077	3.7852	3.4201	1.3664	0.1675

Disclaimer

Note that research@mbank.pl is an e-mail address used exclusively for the distribution of mBank's publications. We advise to reply and send feedback directly to their authors.

The document has been drafted at the Investor Relations, Group Strategy and Macro Research Department of mBank S.A. for the purpose of promotion and advertising in line with article 83c of the Act on Trading in Financial Instruments (Journal of Laws of 2017, item 1768, as amended). The document does not constitute investment research or marketing communication within the meaning of Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive. The document does not constitute investment advice, nor is it an offer within the meaning of Article 66 (1) of the Polish Civil Code.

The document has been drafted based on the authors' best knowledge, supported by information from reliable market sources. All assessments herein reflect outlooks as at the date of issue of this material and may be subject to change at the discretion of the authors without prior notification. Quotations presented herein are average closing levels of the interbank market from the previous day, they are obtained from information services (Reuters, Bloomberg) and serve information purposes only. Distribution or reprint of the full text or a part of it is allowed only upon obtaining a prior written consent of its authors.

©mBank 2019. All rights reserved.