March 21, 2019

Polish Weekly Review

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Comment on the upcoming data and forecasts

Tomorrow NBP will publish the M3 aggregate, which we expect to increase by 9.2% - trends remain unchanged, fluctuations from the beginning of the year were due to the usually volatile Other category. On Monday Statistics Poland will publish the Statistical Bulletin with unemployment rate for February, which should stabilize at the level of 6.1% (our forecast is in line with the market consensus). Finally, next Friday flash CPI data for March will be published. It is too early for a detailed forecast, but inflation will likely remain close to February reading.

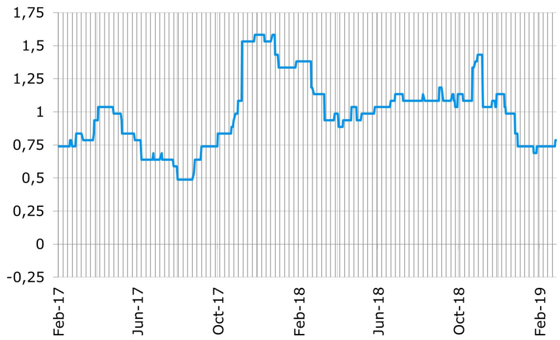
Polish data to watch: March 22nd to March 29th

Publication	Date	Period	mBank	Consensus	Prior
M3 y/y (%)	22.03	Feb	9.2	8.9	8.8
Unemployment rate (%)	25.03	Feb	6.1	6.1	6.1
CPI *flash* y/y (%)	29.03	Mar			1.2

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	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

Series of positive surprises in Polish economy, but only industrial output managed to move the surprise index (1 point higher). Next week flash CPI reading has a potential to change the 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

- Polish economy continues to show great resilience to global slowdown and Polish consumers seem unfazed by pretty much anything. This prompts us to revise our forecasts again, in addition to the effects of the new tax & transfer package (worth 1.0% GDP this year and as much as 1.8% GDP next year). We are now forecasting 2019 growth at 4.5% y/y (prev. 4.1%) and 2020 growth at 4.0% y/y (prev. 3.8%).
- 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. 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. New wave of forecast revisions and dovish central banks globally also support PLN strength. 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	4.5	4.0
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	2019 Q1 F	2019 Q2 F	2019 Q3 F	2019 Q4 F
GDP y/y (%)	5.3	5.1	5.1	4.9	4.4	4.3	4.5	4.6
Individual consumption y/y (%)	4.7	4.9	4.5	4.3	4.2	4.1	4.2	4.4
Public Consumption y/y (%)	3.0	3.5	3.6	4.0	4.4	4.2	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	1.72
2Y Polish bond yields (% eop)	1.49	1.63	1.56	1.35	1.40	1.37	1.39	1.41
10Y Polish bond yields (% eop)	3.18	3.22	3.24	2.83	2.80	2.85	2.96	3.12
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 forecast for 2019 increases to about 4.5%

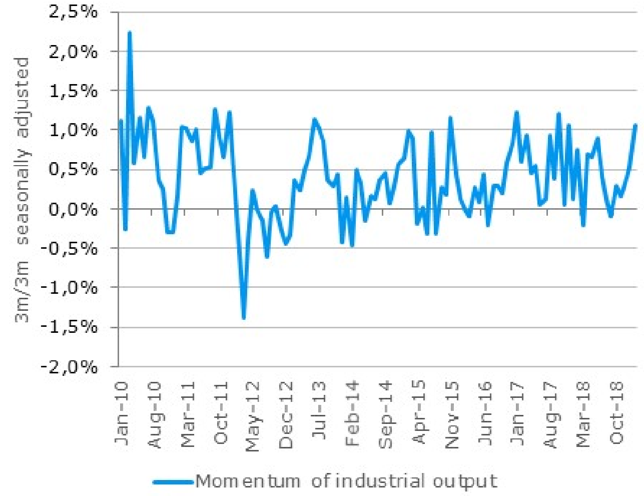
After this week's data we already know that the beginning of the year will not be weak. In terms of household perception, it may be indistinguishable from the fourth quarter and the entire 2018. Good industrial output, retail sales and construction data both in January and February are not an accident - they form a pattern. That is why we decided to raise our Q1 GDP forecasts from 3.9 to 4.5% y/y. It speaks volumes of Polish economy's resilience that the economy barely slowed down in the first quarter – when it should have borne the brunt of adjustment to weak external demand, higher household savings rate and lower public investment growth. As a result, the overall trajectory this year must be adjusted upwards commensurably. Poland will grow by ca. 4.5 y/y this year.

The extraordinarily good behavior of the economy at the beginning of the year (including exports) implies the possibility of a number of adjustments. First of all, companies will be able to handle wage increases more easily (in this context, supply continues to create its own demand and the consumer remains the driving force for the economy). Secondly, although we expected the decline in investments about 2-3 months ago (because of the decline in production factors used), a more strong economic growth automatically increases the likelihood of a stronger response to capital formation or other forms of increasing production potential. It may not be included directly in the investment statistics, but will contribute to maintaining the low price pressure unchanged, compared to slightly less optimistic scenario of GDP growth.

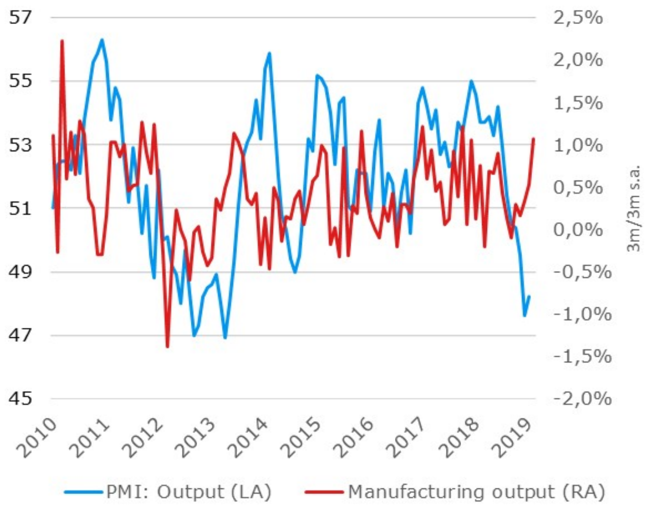
Below you can find the details of published readings.

An industrial miracle in Poland

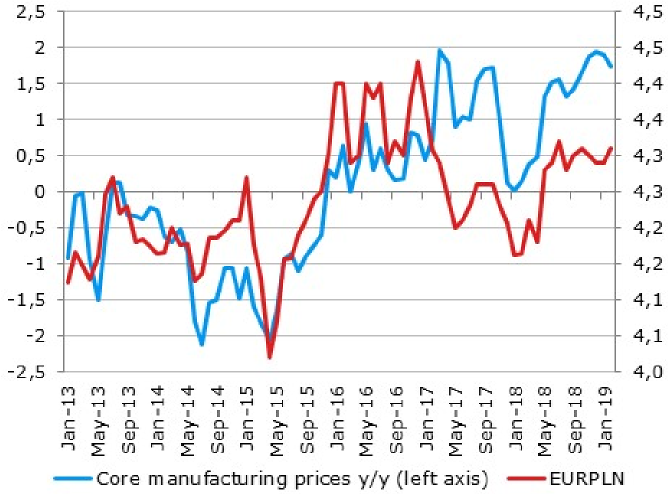
Industrial production grew in February by 6.9% y/y, significantly above forecasts (consensus: 4.7%, our forecast 3.9% y/y). Surprise comes partly from the good mining reading, which accelerated from 0% to about 16% y/y and added 0.8 p.p. to overall production growth. In other words, if not the mining, reading would repeat its previous result, which would have been impressive nonetheless. Manufacturing also posted respectable figures (7.0% y/y). Monthly industrial production increased by 1.7% (adjusted for seasonal and calendar effects), which pushed the momentum to the level around 1% m/m.



Even more impressive is comparison of hard data with Polish industrial sentiment, which was declining in the last few months. If the old correlations of PMI (especially concerning the production part, which reflected the short-term movements quite well) with actual production held, momentum of production would be even 2 p.p. lower than what was actually registered. This series of positive surprises needs explanation, but to tell the truth – we do not have a good one. It can be a result of export results, which in previous months were high, especially comparing to the poor external environment. Distribution of growth among the categories partly confirms this hypothesis – double-digit dynamics were registered in export-oriented industries.

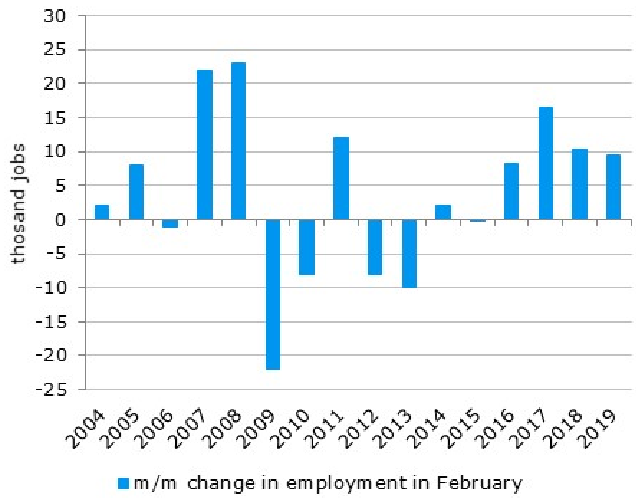


Producer prices once again surprised to the downside. 2.9% y/y translates into 0% growth on monthly, sequential basis in core manufacturing. It is again below the level implicated by the models based on observable data from different sources. It corroborates the fact that pricing powers on producers' side are muted despite cost increases; it seems that efficiency measures prevail (we would be not surprised if, sooner or later, this will mirror itself in economy-wide statistics on productivity). Real sphere of the economy is doing well and price pressures are muted. It is still goldilocks state. No hurry from MPC's side.

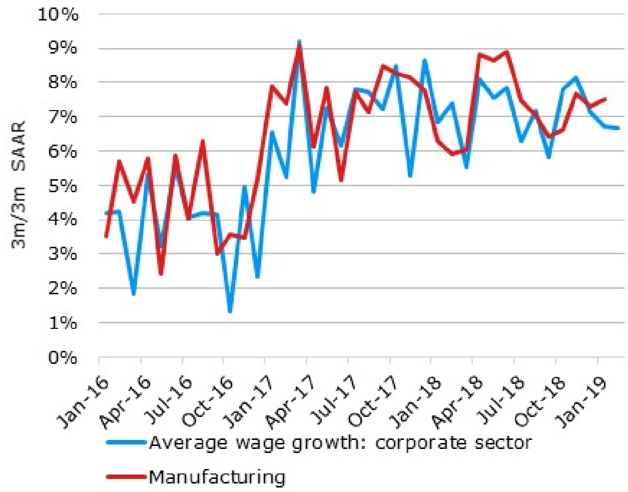


Positive surprise in the labor market data

Employment increased in February by 10 thousand workers in m/m terms. It resulted in the annual employment growth rate of 2.9% y/y, a bit higher than our forecast of 2.8% y/y. It is definitely a positive surprise, especially given that previous months disappointed. However, it is hard to expect any change in the trend, as business cycle indicators are still going down. Probably the better result was generated by traditionally volatile categories like trade or administrative and support services, for sure we will know this with publication of the Statistical Bulletin next week. It's worth exploring the recent slightly stronger wage growth further – perhaps it is the way for firms to attract workers more effectively. A slow decline in GDP growth should decrease labor demand, leading to lower employment growth



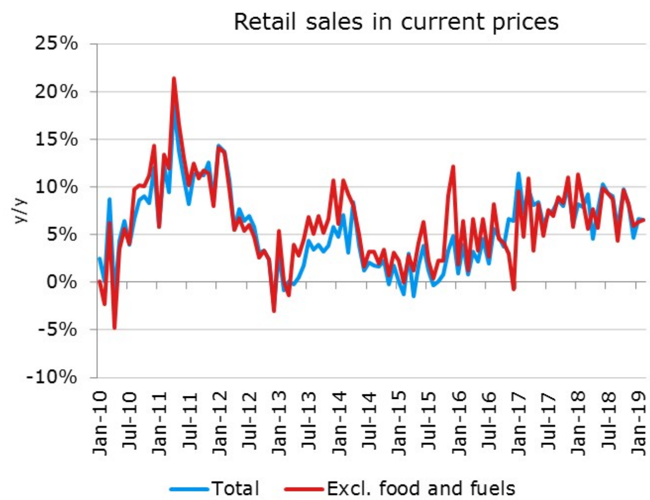
Average gross wage increased yearly by 7.6%, slightly above both last month's result (7.5% y/y) and expectations (our forecast: 7.0%, market consensus: 7.2% y/y) Positive surprise can have many reasons – first hypothesis is unrealized high base in mining and energy supply – but once again for more details we need to wait for the Statistical Bulletin. Wage data do not show any signs of their further acceleration. In fact, the result around 7% has been the anchor for nominal wages dynamics for about 2 years.



Dynamics of total wage bill, both in nominal (10.7% y/y) and real terms (9.5% y/y) were on the relatively high level, suggesting solid growth of household disposable income and keeping consumption dynamics around 4% in the Q1. From the MPC's point of view, today's reading supports the scenario presented on the MPC's press conferences or in the last projection. Growth of the average wage, if it does not translate into inflation, will not be treated as a cause for concern or a sign to change the monetary policy stance.

Retail sales, as all other categories, surprised positively

Retail sales increased in February nominally by 6.5% y/y (5.6% in real terms). The January reading was revised in real terms to 6.1%, due to the revision of CPI inflation (prices from this reading are also used to deflate sales data). Better reading of retail sales perfectly fits the set of other surprises in the real sphere. However, it is difficult to provide clear conclusions from the details of last retail sales reading.



We were surprised negatively by car sales (the dynamics of this category is close to the previous month) and clothing and footwear (it is better than a month ago, but this category will not increase significantly until March, when the higher temperatures arrive). The positive surprise is primarily sales in non-specialized stores (here, an almost 10 p.p monthly acceleration makes an impression). At first glance, it looks like the next blow from the store chains (which include stores with more than 9 employees) to smaller sellers. Of course, without exploring micro-data, it is difficult to provide such a conclusion as an absolute truth, but the acceleration of food prices in February and the still present perception of high prices left a lot of space for pre-Sunday price promotions. Positive surprise comes also from the category of furniture, electronics and household appliances. The return of consumer optimism to the tops and no signs of weakening housing demand will support strong increases of this category this year.

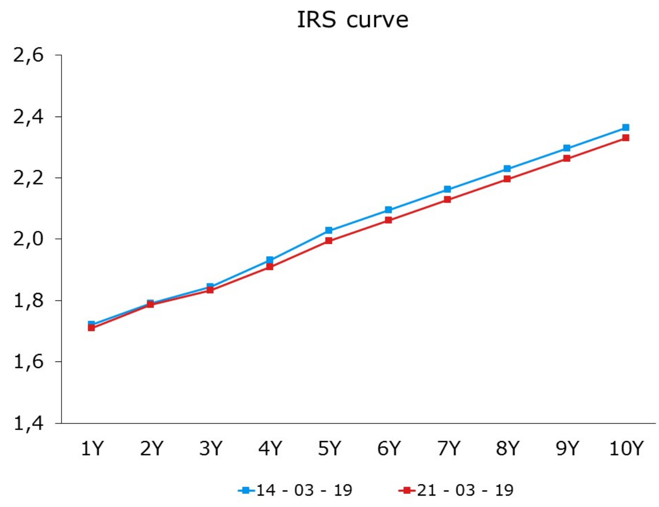
Fixed income

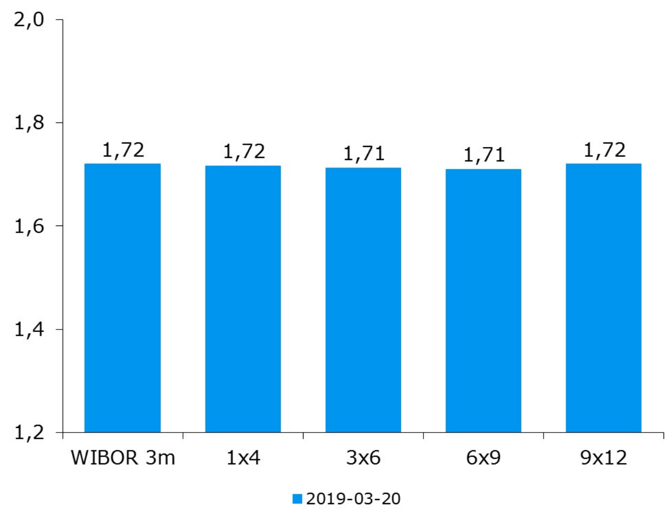
Eerily quiet market

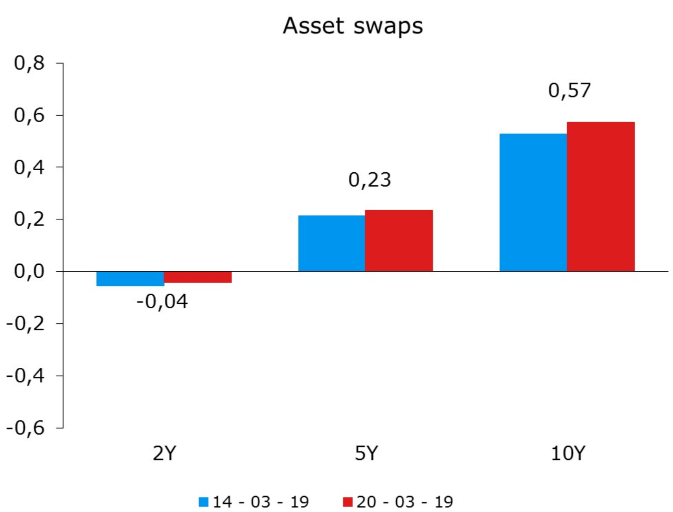
This week should have been a rollercaster, rumors from the Ministry of Finance, Brexit, new Fed policy and an auction. But it has been very quiet, volatility is massively low. Today, the Ministry sold 7.2 bn with demand over 8.8 bn, shorts where covered, but market is not moving. Curve is steep and ASW are wide.

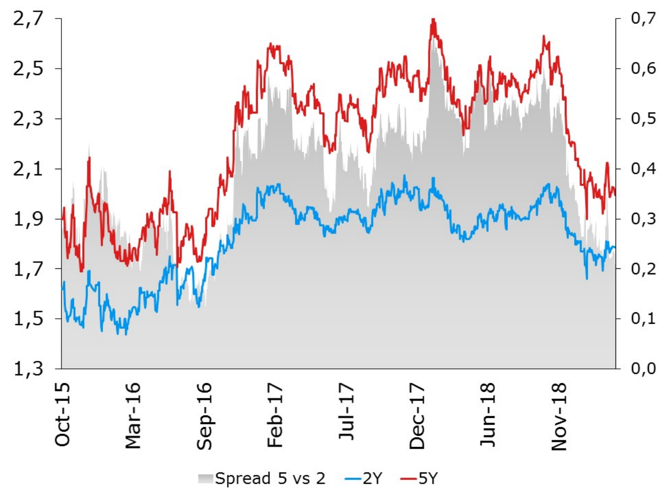
PS0424/5y is 23 bps, WS0428/10y is 46 bps. PS0424/WS0428 is 58 bps. WS0428/Bund is 274 bps.

DS1020 is trading at 1.55% (1 bps up), PS0424 is trading at 2.20% (1 bps down) and WS0428 is trading at 2.78% (1 bps down).









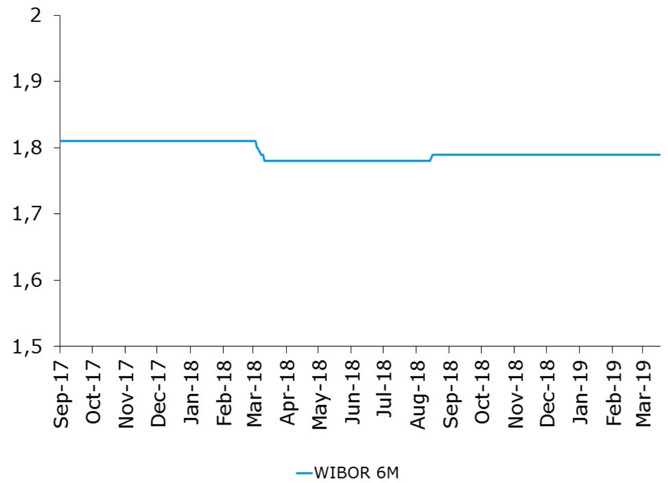
Money market

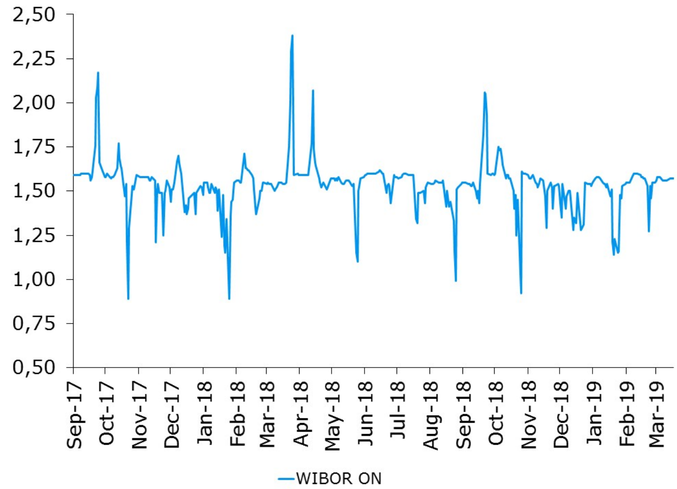
Range trading continues

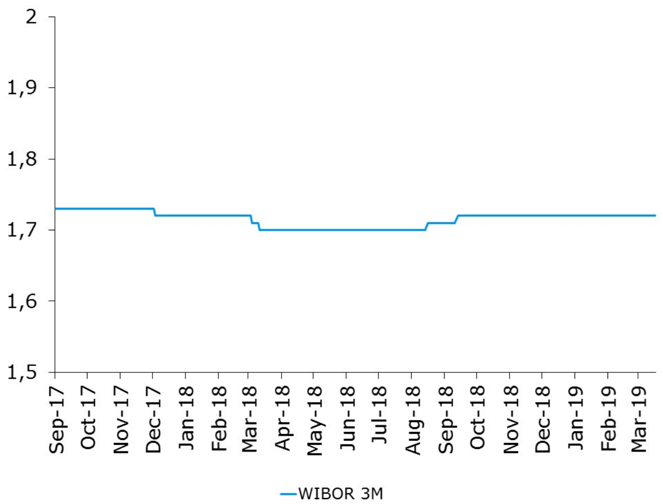
We are back again to chasing the global mood on Polish rates. Local economic data surprised to the upside, our analysts revise growth expectation for this year plus we have a huge stimulus package but that means nothing to investors and we are close to lows in Polish rates. All due to the poor global sentiment with investors expecting a recession around the globe and the need for central banks to step in again with stimulus. No obvious trigger for the market on the horizon.

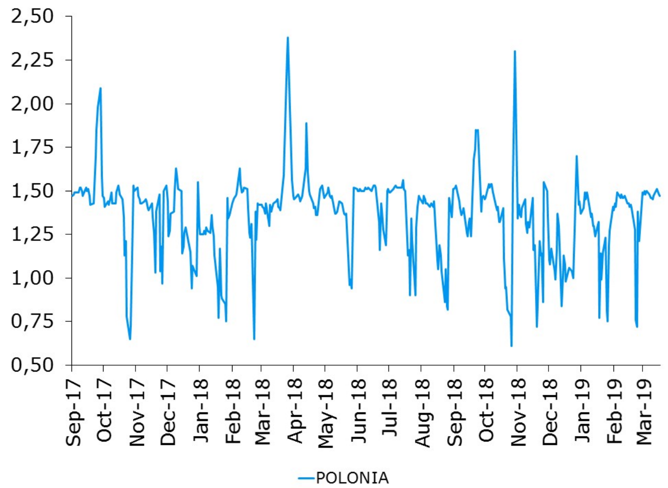
Cash is quite expensive for the whole month. Might be same next week.

Ref rate vs Polonia averages:
30 day 10 bp
90 day 16 bp





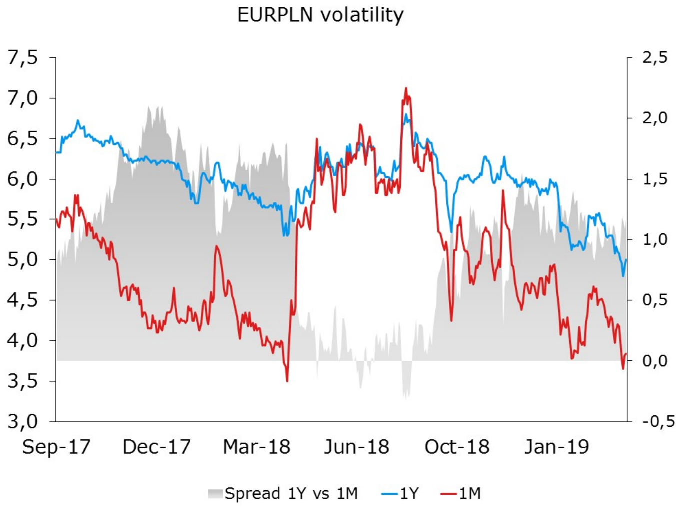


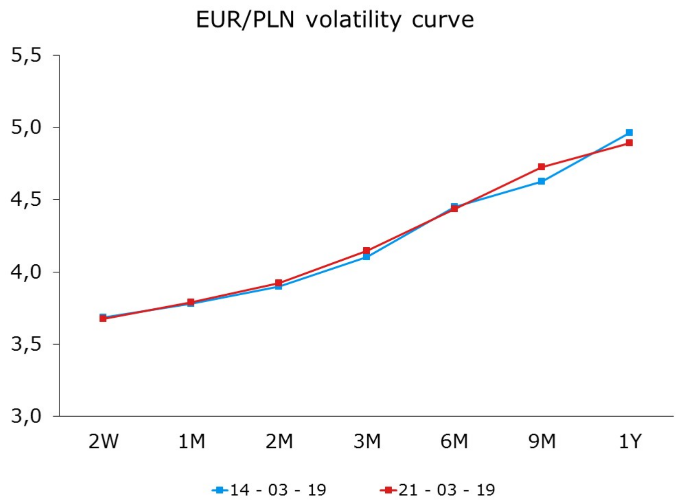


Forex

Spot – EUR/PLN – a bit lower in the range EUR/USD increased almost 0.9% after FOMC expressed its dovish attitude. As ECB and MPC are on the same dovish side, the "risk on" mode in the market should be well supported. EUR/PLN has continuing its sluggish 3 weeks march down from the 4.34 top of the channel, reaching today as low as 4.2780 before a minor rebound (4.29ish). Zloty's strength is the most visible against USD, as USD/PLN dropped from 3.8560 to 3.7420, followed EUR/USD. Healthy Polish fundamentals and generally solid economy favor strong Zloty. On the other hand there are fears of a slowdown in global growth, Brexit uncertainty and trade war worries. Anyway we are still in 4.26-34 range, with slightly PLN-positive skew.

Options: implied volatility sliding It was another very calm week on options market. As a consequence there frontend vol/Gamma was heavily offered on the market. Both volatility curves EUR/PLN as well USD/PLN became more steep. 1 month EUR/PLN ATM mid is fixed today at 3.5% (0.2% lower), 3 months EUR/PLN are 4.0% (unchanged) and finally 1 year is 4.75% (0.2% lower). The skew and the currency spread (difference between USD/PLN vol and EUR/PLN vol) are also lower.



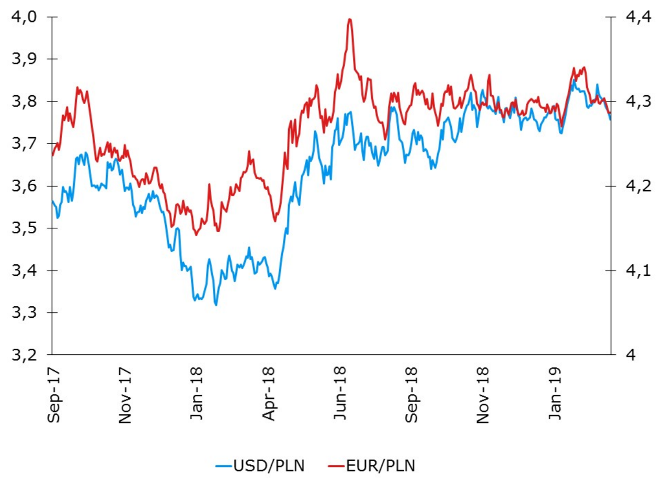


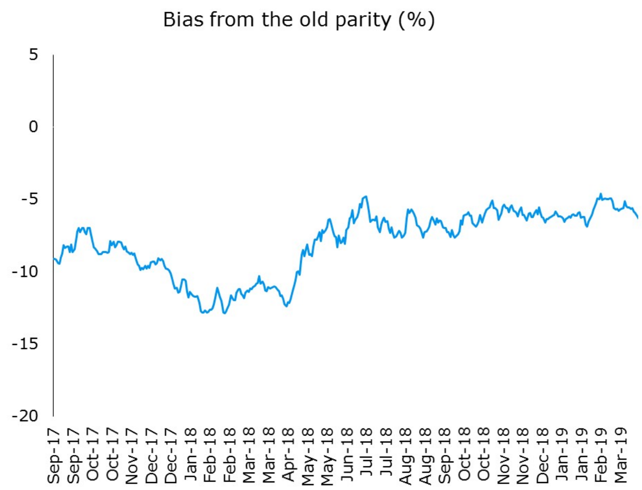
Short-term forecasts

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.





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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
3/14/2019	1.60	1.72	2.05	1.69	2.20	1.77	1.72	1.72	1.72	1.73	1.73	1.79
3/17/2019	1.67	1.72	1.75	1.69	1.91	1.77	1.72	1.72	1.72	1.72	1.73	1.78
3/18/2019	1.60	1.72	1.67	1.69	1.84	1.77	1.72	1.71	1.71	1.72	1.73	1.78
3/19/2019	1.50	1.72	1.58	1.69	1.76	1.77	1.72	1.71	1.71	1.72	1.73	1.78
3/20/2019	1.61	1.72	1.67	1.69	1.84	1.77	1.72	1.71	1.71	1.72	1.72	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
3/14/2019	1.770	1.511	1.790	1.735	2.027	2.240	2.362	2.889
3/17/2019	1.770	1.516	1.790	1.639	2.025	2.242	2.360	2.902
3/18/2019	1.770	1.521	1.787	1.633	2.018	2.229	2.350	2.893
3/19/2019	1.770	1.521	1.787	1.747	2.018	2.251	2.353	2.915
3/20/2019	1.770	1.521	1.785	1.744	1.995	2.229	2.330	2.902

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
3/14/2019	3.78	4.10	4.45	4.96	4.96	1.43	0.51
3/17/2019	3.65	4.05	4.40	4.80	4.80	1.43	0.51
3/18/2019	3.82	4.13	4.48	4.90	4.90	1.43	0.51
3/19/2019	3.84	4.20	4.54	5.00	5.00	1.45	0.51
3/20/2019	3.79	4.15	4.44	4.89	4.89	1.39	0.50

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
3/14/2019	4.3015	3.8018	3.7854	3.4030	1.3679	0.1676
3/17/2019	4.3037	3.8014	3.7863	3.4044	1.3689	0.1677
3/18/2019	4.2993	3.7876	3.7838	3.3973	1.3678	0.1676
3/19/2019	4.2940	3.7823	3.7828	3.3978	1.3689	0.1677
3/20/2019	4.2864	3.7767	3.7781	3.3855	1.3702	0.1671

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