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Polish Weekly Review

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Comment on the upcoming data and forecasts

This Friday flash CPI data for March will be published, which we expect to increase to 1.6%. Reasons are both in the core inflation (slightly upward trend and higher prices of tourism services) and non-core categories (monthly increases in fuels and food). On Monday manufacturing PMI will be published. Our forecast 48.5 points is based on the slight rebound in a broad spectrum of German indices and possible increase of the optimism after the fiscal package presentation. On Wednesday MPC should not surprise, keeping both interest rate and rhetoric unchanged.

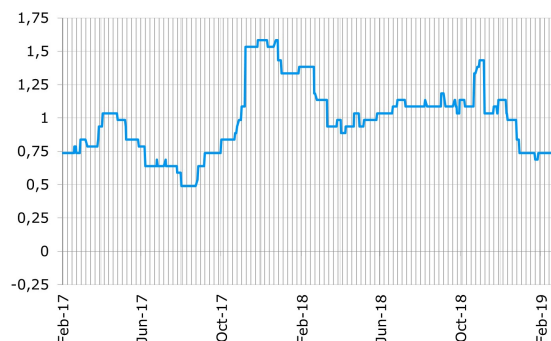
Polish data to watch: March 29th to April 5th

Publication	Date	Period	mBank	Consensus	Prior
CPI <i>flash</i> y/y (%)	29.03	Mar	1.6		1.2
Manufacturing PMI (pts.)	1.04	Mar	48.5		47.6
MPC's decision (%)	3.04	3.04	1.5	1.5	1.5

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

With empty economic calendar, Polish surprise index remains unchanged. Tomorrow flash CPI has a potential to change the index. Next week manufacturing PMI can surprise.

* 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

- 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. For this scenario to play out we need to see inflation. Lots of inflation. With CPI much below 2.5% the story appeals on to speculative minds.

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

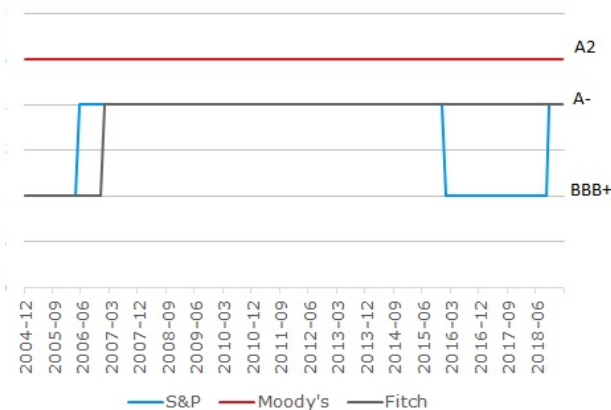
	2018	2018	2018	2018	2019	2019	2019	2019
	Q1	Q2	Q3	Q4	Q1 F	Q2 F	Q3 F	Q4 F
GDP y/y (%)	5.3	5.1	5.1	4.9	4.4	4.3	4.5	4.6
Individual consumption y/y (%)	4.7	4.9	4.5	4.3	4.2	4.1	4.2	4.4
Public Consumption y/y (%)	3.0	3.5	3.6	4.0	4.4	4.2	4.0	4.0
Investment y/y (%)	8.2	4.7	9.9	6.7	5.0	5.0	4.0	4.0
Inflation rate (% 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	4.30	4.25	4.25	4.25
USD/PLN (eop)	3.42	3.74	3.69	3.74	3.81	3.73	3.70	3.66
F - forecast								

Economics

Fiscal package vs rating agencies: too early for hectic moves

The fiscal package, presented a month ago, is still a hot topic. Although we argued in one of the recent issues of Polish Weekly Review that fiscal deficit is going to stay safely below 3%, there are no clear messages from the government on the financing sources or the impact on the Polish fiscal rule. It raises questions how the rating agencies will react. In our opinion they should stay calm. The first answer comes tomorrow from Fitch. Next are Moody's (9.04) and S&P (12.04). We think that agencies are going to stay put.

Rating changes



As we described recently, package consists on both tax cuts (lowering PIT, doubling its deductibles and setting 0% tax level for people under 26) and social spending (extending children benefits and introducing bonus for pensioners). Its cost amounts to almost 20bn PLN this year and about 45bn in the next one, which corresponds respectively to about 1.1% and 2.1% of GDP. First signals from the government suggested that in the first year of the program it will be financed with further improvement in tax collection and some intra-governmental shifts, but last time PM Morawiecki admitted that the program may be financed mainly with debt issuance and deficit expansion. Such a mix was not especially well received by the markets. However, one has to admit that ASW widening has been progressing for some time and the markets were better prepared for bad news and much has already been digested (ASW in 10y moved 40bps in 6 months).

Is there a short-term scope for some indigestion? Are there any triggers? It seems that they are unlikely to come from rating agencies and especially the Fitch which is the first in the line to speak. We think that in favor of keeping the Fitch rating untouched play both the good economy prospects (good readings from the first quarter providing higher GDP estimates), no explicit claims on the aim of exceeding the 3% gg deficit (the intention to keep this indicator in check stays intact) and technical details on rating methodology (fiscal deficit is only one of factors, but much more important is relation of public debt to GDP – with nominal growth around 6-7% this pillar is safe).

In the last note, agency wrote that *any sign that the relevance of the 3% of GDP EU deficit criteria were weakening as a*

fiscal anchor, or failure to stabilise the debt/GDP ratio in the medium term, could be negative for the rating. PM Morawiecki claims that the fiscal package should not result in exceeding the 3% threshold and that the government will try to stay within the fiscal rule. For more details we need to wait until the Convergence Programme – if it does not present exceeding the 3% threshold, or provide unrealistic economic forecasts it is not going to be a game changer. Meddling with fiscal rule can be another trigger. It is not visible in current government rhetorics, though.

The savings approach of the government, which is rumored at the time of preparation of this piece of writing, makes the spending rule issue less urgent/important. Budget amendment is also unlikely at this point. It is after-general-election issue. In the meantime we may see more pre-financing but it is not going to surprise the markets. The degree of preparation is visible (at least to some extent) in current elevated ASW levels.

Fixed income

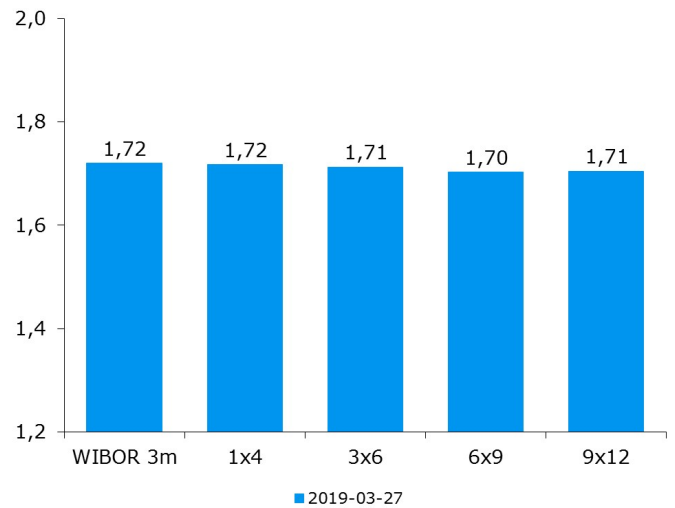
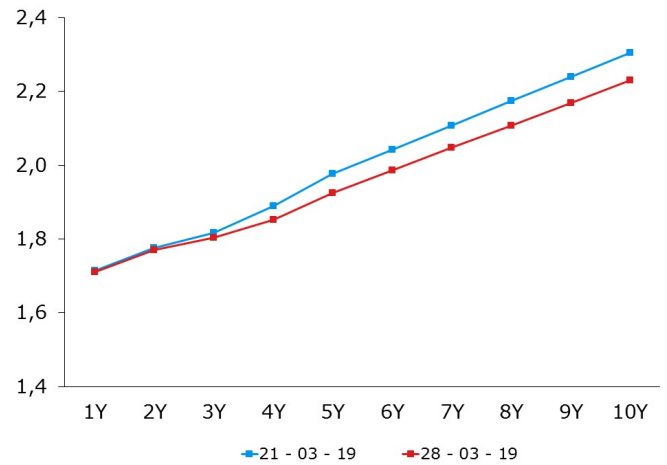
Erily quiet market

Local market is extremely calm comparing to core markets. Market participants are cautious as most of them expects significant bond supply on upcoming auctions. It led to the wider ASWs and bearish on floaters. Next auction (switch) is planned on 04/04/2019, MinFin will offer the same bonds as on the previous auction (OK0521, PS0424, DS1029, WZ0524, WZ0528).

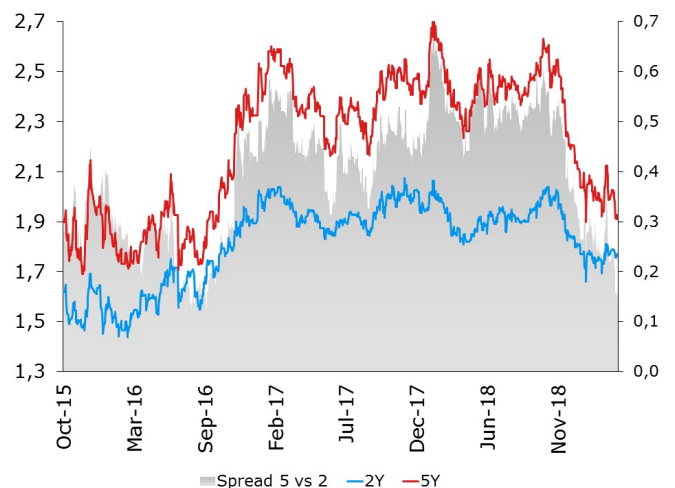
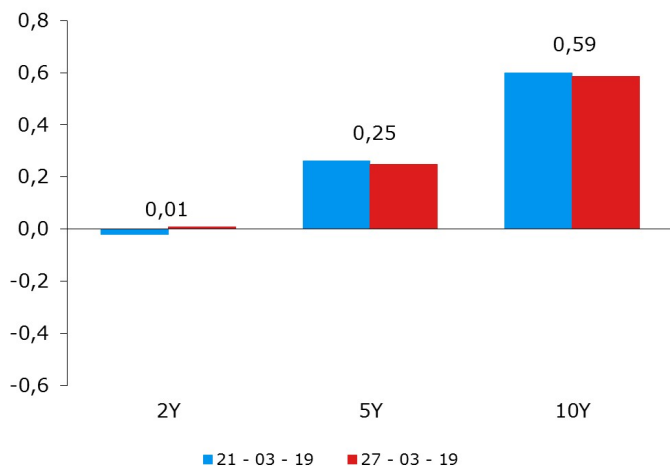
PS0424/5y is 24bps, WS0428/10y is 50bps. PS0424/WS0428 is 54bps. WS0428/Bund is 278bps.

DS1020 is trading at 1,58% (3bps up), PS0424 is trading at 2,16% (4bps down) and WS0428 is trading at 2,71% (7bps down).

IRS curve



Asset swaps





Money market

Range trading continues

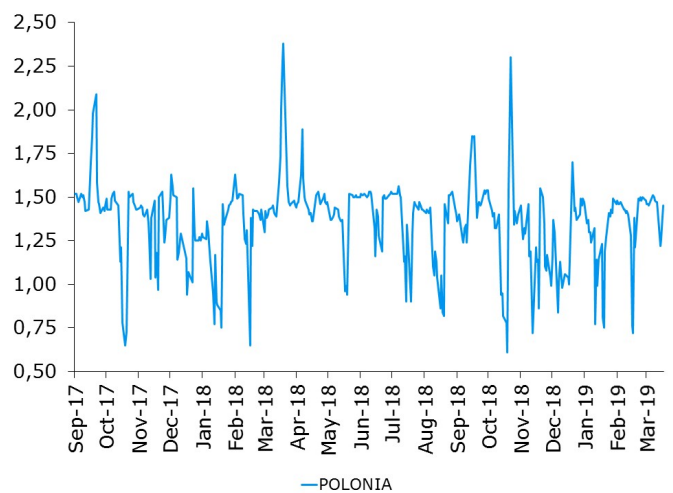
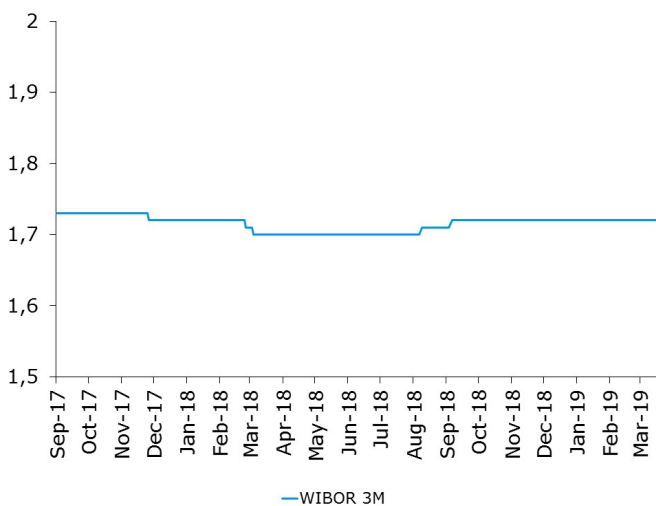
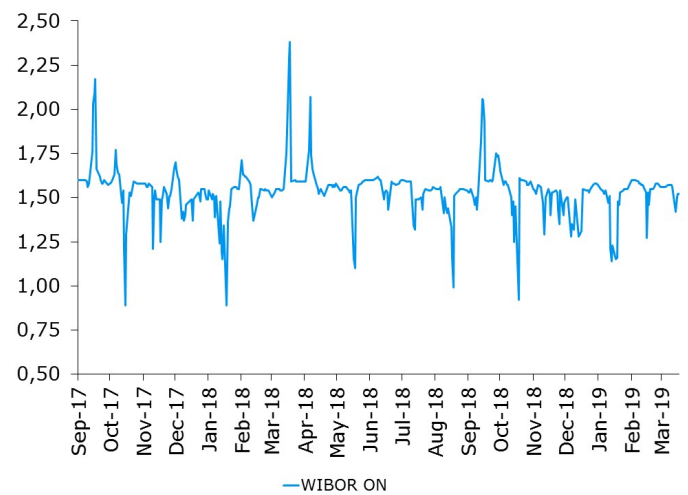
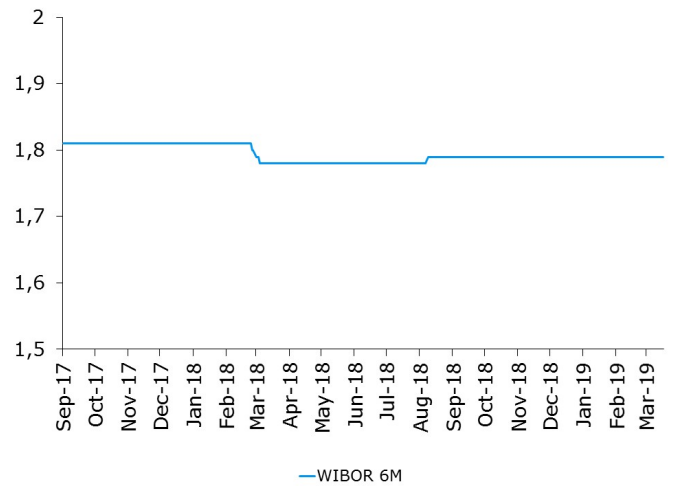
Global rates took another leg lower so we are heading the same way. Move on Polish rates is somewhat muted though. While EUR and USD rates trade at many month lows we ended only on the bottom of recent range. With no reason for MPC to lower rates we should stick to the range.

Rather expensive month on the funding side. End of the month and quarter goes smoothly.

Ref rate vs Polonia averages:

30 day 10 bp

90 day 16 bp



Forex

Spot – EUR/PLN – consolidation in the range The EUR/PLN is still well contained in the narrow 4.2800 - 4.3050 range, with 4.30ish being the natural magnet for the cross. The risk sentiment is fragile due to US curve inversion spooking markets with a pre-2008 reminder and protracted Brexit story, but it does not provide enough momentum to push low Beta currency as PLN out of the current range. The range trading continues.

Opts – Volatility higher The souring in risk sentiment led to the higher volatilities in EUR/PLN and USD/PLN. The frontend was obvious winner as the markets participants rushed to cover their Gamma shorts. 1 month EUR/PLN ATM mid is this Thursday at 4.25% (0.75% higher than a week ago), 3 months are 4.35% (0.35% higher) and 1 year is fixing 5.1% (0.35% higher). The skew was also in demand. The currency spread (difference between USD/PLN and EUR/PLN) moved higher by around 0.4%.

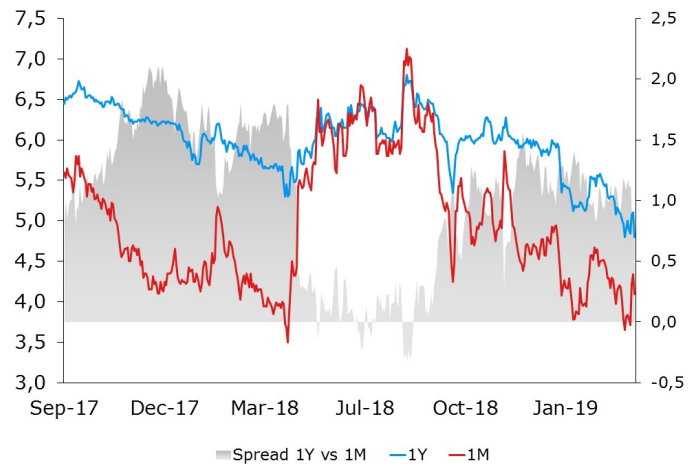
Short-term forecasts

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

Spot – Buy on dips

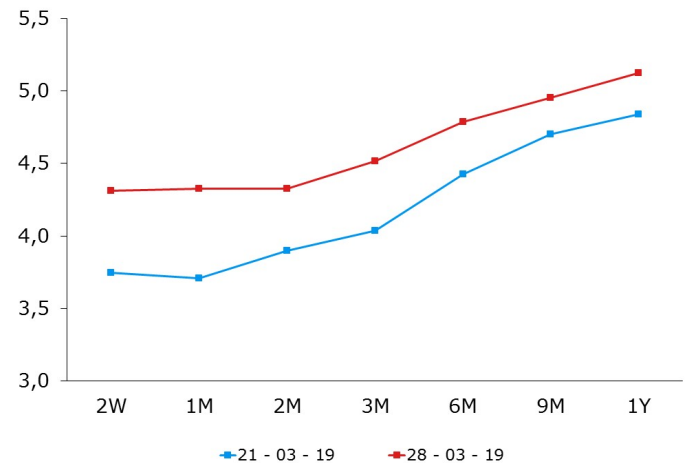
Last week EUR/PLN short we liquidated at 4.2950, with over 4 figures profit. The market is so slow, the range is getting tighter and tighter. However the market is becoming more concerned about global growth conditions, so we have taken profit earlier than planned. Since EUR/PLN risks remain skewed higher with the Brexit story and global growth worries, we prefer to be sideways at this moment. We are ready to buy EUR/PLN at 4.26 / 4.27 with stop 4.24 and hopes for 4.34.

EURPLN volatility



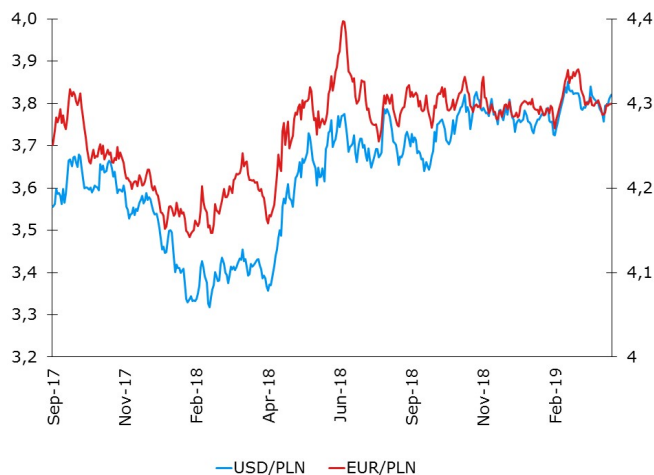
Legend: Spread 1Y vs 1M (grey), 1Y (blue), 1M (red)

EUR/PLN volatility curve



Legend: 21-03-19 (blue), 28-03-19 (red)

Bias from the old parity (%)



Legend: USD/PLN (blue), EUR/PLN (red)

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
3/21/2019	1.61	1.72	1.78	1.69	1.93	1.77	1.72	1.72	1.72	1.72	1.72	1.78
3/24/2019	1.61	1.72	1.77	1.69	1.92	1.77	1.72	1.71	1.69	1.69	1.69	1.75
3/25/2019	1.61	1.72	1.69	1.69	1.90	1.77	1.72	1.72	1.71	1.71	1.71	1.77
3/26/2019	1.53	1.72	1.62	1.69	1.74	1.77	1.72	1.71	1.71	1.72	1.72	1.78
3/27/2019	1.59	1.72	1.77	1.69	1.92	1.77	1.72	1.71	1.70	1.71	1.71	1.77

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
3/21/2019	1.770	1.498	1.775	1.754	1.977	2.238	2.305	2.905
3/24/2019	1.770	1.498	1.755	1.734	1.912	2.182	2.220	2.837
3/25/2019	1.770	1.540	1.767	1.757	1.910	2.201	2.218	2.856
3/26/2019	1.770	1.569	1.770	1.681	1.925	2.215	2.230	2.869
3/27/2019	1.770	1.527	1.770	1.778	1.925	2.174	2.230	2.815

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1Y	1Y
3/21/2019	3.71	4.04	4.43	4.84	4.84	1.43	0.51	0.51
3/24/2019	4.22	4.45	4.70	5.08	5.08	1.43	0.51	0.51
3/25/2019	4.34	4.40	4.70	5.10	5.10	1.45	0.50	0.50
3/26/2019	4.09	4.30	4.69	4.80	4.80	1.38	0.51	0.51
3/27/2019	4.33	4.52	4.79	5.13	5.13	1.46	0.51	0.51

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
3/21/2019	4.2870	3.7581	3.7849	3.4020	1.3640	0.1672
3/24/2019	4.2894	3.7948	3.8079	3.4332	1.3582	0.1669
3/25/2019	4.2978	3.7966	3.8184	3.4446	1.3564	0.1670
3/26/2019	4.2970	3.7969	3.8245	3.4397	1.3585	0.1668
3/27/2019	4.2991	3.8113	3.8373	3.4512	1.3437	0.1669

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