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Polish Weekly Review

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Comment on the upcoming data and forecasts

Next Friday the NBP will publish its monthly balance of payments figures. Contrary to market consensus (which sees a trade deficit in March and a small deficit in the current account), we see a modest surplus on the trade account and a small overall C/A surplus. Higher payment to EU budget was more than offset by trade and services balance. On Monday final CPI data will be published. The flash reading showed an above-consensus surge in inflation (from 1.2 to 1.7% y/y) driven by food prices and higher core inflation (the latter to be confirmed on Tuesday), and we have adjusted our forecasts accordingly. On Wednesday Statistics Poland will publish monthly labor market stats. We expect wage growth to slow down somewhat, from 7.6 to 6.7% y/y due to a combination of factors (high base from last year, downtrends in several categories). Employment growth, on the other hand, is widely believed to have held steady in March, at 2.9% y/y. On Thursday industry data will be published. Lower energy output, high base in mining output and mean-reversion in manufacturing all contribute to a slowdown on y/y basis, from 6.9 to 4.9% y/y. The accompanying PPI data will show a modest slowdown in factory gate prices. On the same day the NBP will publish the Minutes of the last MPC meeting. Finally, next Friday the Statistics Poland's business sentiment indicators will be published.

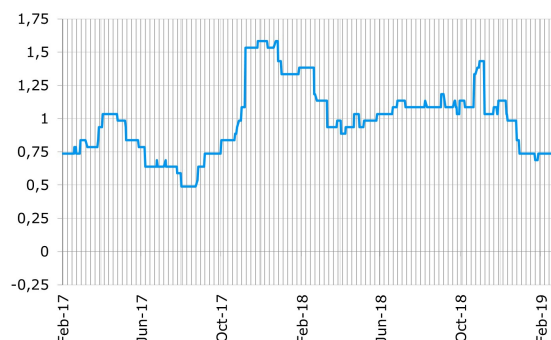
Polish data to watch: April 12th to April 19th

| Publication | Date | Period | mBank | Consensus | Prior |
|---------------------------------|-------|--------|-------|-----------|-------|
| Current account balance (m EUR) | 12.04 | Feb | 376 | -350 | 2316 |
| Exports (m EUR) | 12.04 | Feb | 18600 | 17860 | 18493 |
| Imports (m EUR) | 12.04 | Feb | 18200 | 18084 | 18214 |
| CPI final y/y (%) | 15.04 | Mar | 1.7 | 1.7 | 1.7 |
| Core CPI y/y (%) | 16.04 | Mar | 1.3 | 1.3 | 1.0 |
| Average gross wage y/y (%) | 17.04 | Mar | 6.7 | 7.1 | 7.6 |
| Employment y/y (%) | 17.04 | Mar | 2.9 | 2.9 | 2.9 |
| Sold industrial output y/y (%) | 18.04 | Mar | 4.9 | 4.5 | 6.9 |
| PPI y/y (%) | 18.04 | Mar | 2.6 | 2.6 | 2.9 |
| MPC Minutes | 18.04 | Apr | | | |
| Business sentiment | 19.04 | Apr | | | |

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). Over the next several days, Polish surprise index might be moved by final CPI, wage, employment, industrial output and PPI data.

* 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 | 1.6 | 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 | 5.5 | 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 | 4.5 | 4.5 | 4.4 |
| Individual consumption y/y (%) | 4.7 | 4.9 | 4.5 | 4.3 | 4.2 | 4.1 | 4.5 | 4.9 |
| 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 | 3.0 |
| Inflation rate (% average) | 1.5 | 1.7 | 1.9 | 1.4 | 1.2 | 1.5 | 1.6 | 2.0 |
| Unemployment rate (% eop) | 6.6 | 5.9 | 5.7 | 5.9 | 5.9 | 5.4 | 5.3 | 5.5 |
| 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 | 1.69 | 1.33 | 1.35 | 1.37 |
| 10Y Polish bond yields (% eop) | 3.18 | 3.22 | 3.24 | 2.83 | 2.84 | 2.85 | 2.96 | 3.12 |
| EUR/PLN (eop) | 4.21 | 4.37 | 4.28 | 4.29 | 4.30 | 4.30 | 4.25 | 4.25 |
| USD/PLN (eop) | 3.42 | 3.74 | 3.69 | 3.74 | 3.84 | 3.77 | 3.70 | 3.66 |
| F - forecast | | | | | | | | |

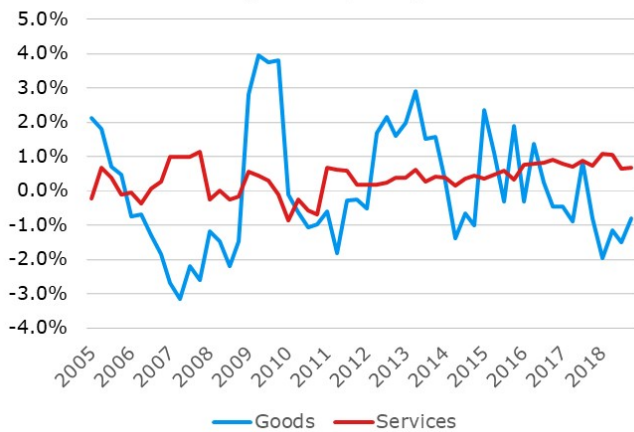
Economics

A short bit on Polish international trade in services

NBP Governor Glapinski is often musing on many traits of the Polish economy that other economies could only envy. It seems that super-stable contribution of international trade in services is one of them. However, there are dark clouds on the horizon and once established champions are being challenged.

When one looks at the breakdown of net exports contribution in GDP (we use current prices in order to capture the breakdown in a more detailed way) you can see that services constitute a fairly stable part, worth 1% of GDP in recent 3 years. It is goods balance that counts at the margin but services generate a safety buffer.

Net exports contribution to GDP growth (current prices) in:

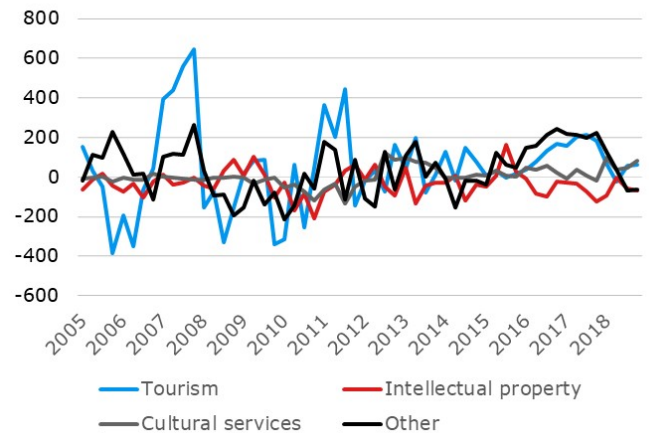


The breakdown of this buffer is very interesting. On one hand we have services that swung from positive to negative growth contribution but are of lesser value: tourism, intellectual property, cultural services. Let's call them swingers. On the other hand, champions (with a trend-like expansion of growth contribution) have emerged: transport, goods for processing (a service in which a manufacturer delegates the enhancement of goods to other manufacturers without any transfer of ownership of these goods), business services, telecommunication services.

Champions: contribution to net exports in services in EUR mln



Swingers: contribution to net exports in services in EUR mln



Both swingers and champions have their own stories in recent quarters. We saw a swift acceleration and then trend-reversion (or maybe something more; to be monitored) in business services and transport (fully compliant with anecdotal evidence that enumerates various competitive hurdles these areas are facing at the moment) whereas some sort of acceleration was experienced by telecommunication services. The same rise and fall story applies to tourism and the whole bunch of lesser services categories grouped in "other" category. On net, international services contribution to GDP decreased a bit. The magnitude of the fall is still negligible, though.

Fixed income

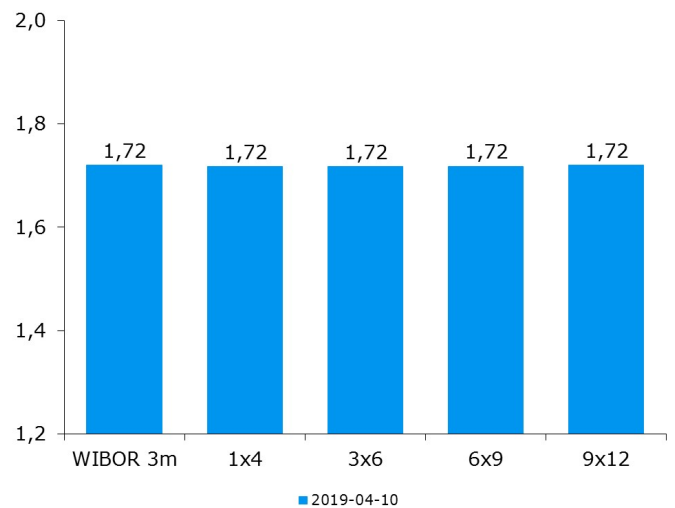
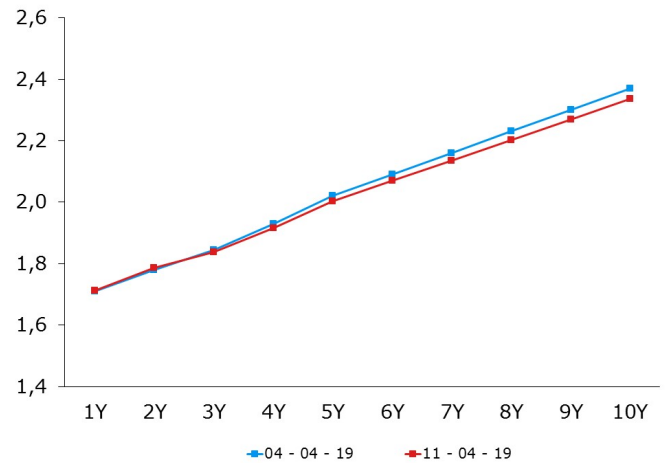
Calm week behind us

Last week was pretty calm, we saw some movers on ASWs, there was interest in buying belly floaters. The long end was rather offered.

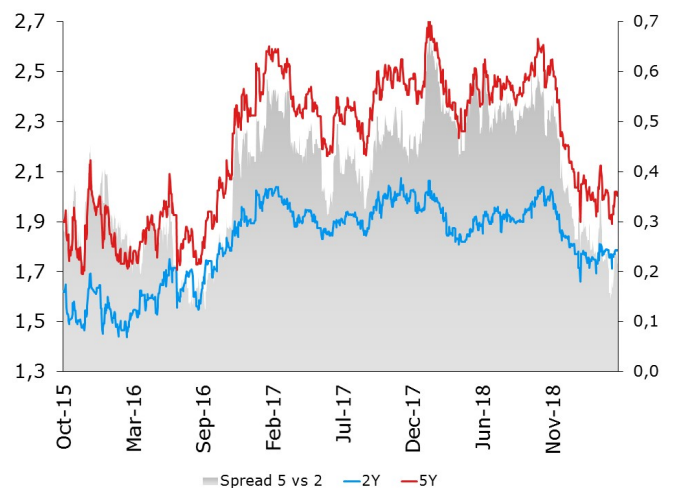
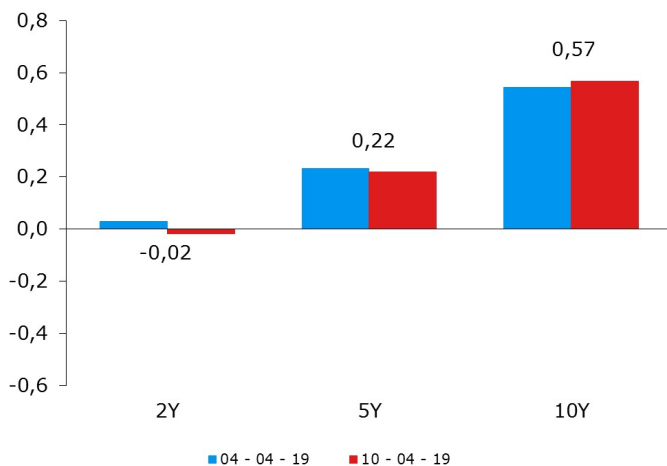
PS0424/5y is 20 bps, WS0428/10y is 43 bps. PS0424/WS0428 is 59 bps. WS0428/Bund is 283 bps.

DS1020 is trading at 1.55% (2 bps down), PS0424 is trading at 2.22% (2 bps down) and WS0428 is trading at 2.81% (no changes).

IRS curve



Asset swaps



Money market

Switching auctions on the way

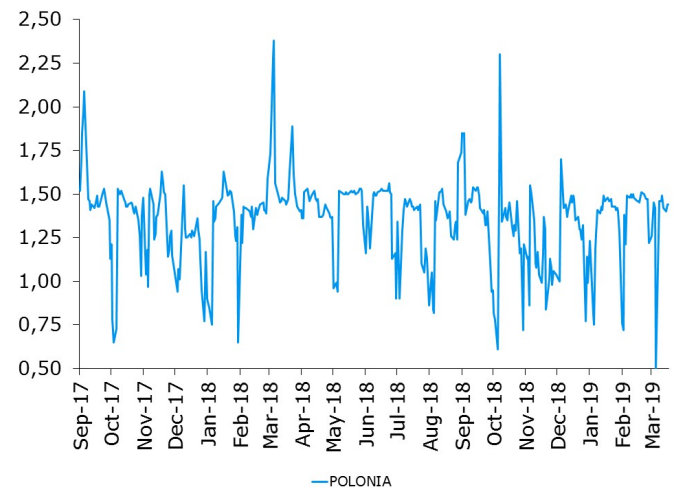
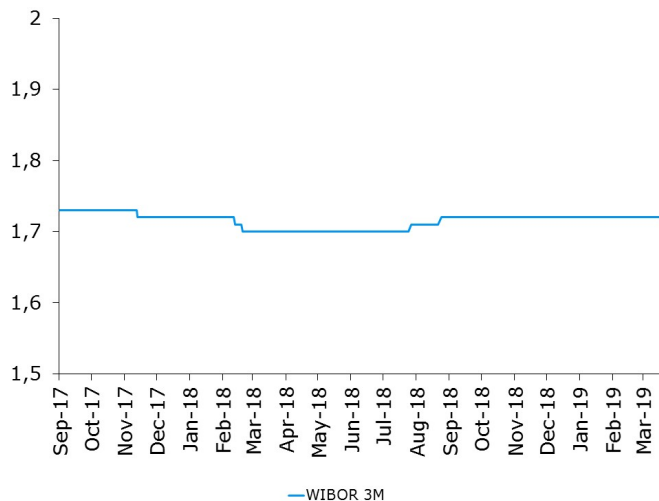
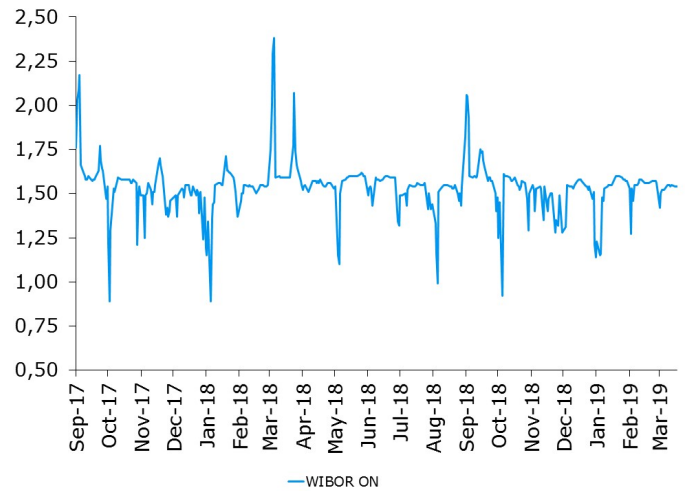
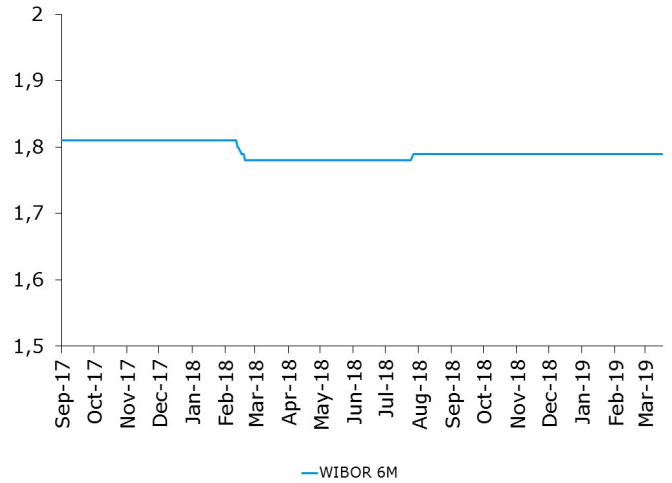
Looks like selling interest on short bonds is gone. Front end of the curve has recovered sharply with 2020 and 2021 bond yields falling by 5-10 bps. There is no bigger story at the moment apart from following global sentiment. We feel that the only factor relevant for the short end right now are the switching auctions on the way.

Stable cash rates at the beginning of the month. Next week should be the same. We have big redemptions this month and Easter holiday, so volatility may rise in the second part of the month.

Ref rate vs Polonia averages:

30 day 10 bp

90 day 16 bp



Forex

Spot – EUR/PLN – consolidation in the range. This week broader sentiment in the market remained subdued as the flare-up between the US and Europe added to other potential global flashpoints over trade. Additionally, the IMF downgraded its global economic outlook. On Wednesday the ECB left its ultra-easy stance unchanged and pointed to the weak economic data. Likewise, the minutes from the Fed's last meeting strengthened its recent dovish policy stance with no change to rate hikes this year. Finally the European leaders extended the deadline for Great Britain to leave the Union. All these events seem to be key, but failed to produce any substantial volatility on the spot market. The Zloty was no exception...

Opts: Implied volatility sliding. It was another very calm week on the spot market. We also have mammoth events behind us. As a consequence, the frontend vol/Gamma was heavily offered on the market. Especially USDPLN implied volatility dived, following the fall of EUR/USD volatility. 1w atm USD/PLN fell from 8.0% to 5.75% during last week. Both volatility curves EUR/PLN as well USD/PLN became more steep. EUR/PLN ATM mid is today 3.5% (0.35% lower), 3 month is 3.9% (0.25% lower) and finally 1 year fixed at 4.75% (0.15% lower). The skew was also better offered. The currency spread (difference between USD/PLN and EUR/PLN) decreased by around 0.75%.

Short-term forecasts

Main supports / resistances:

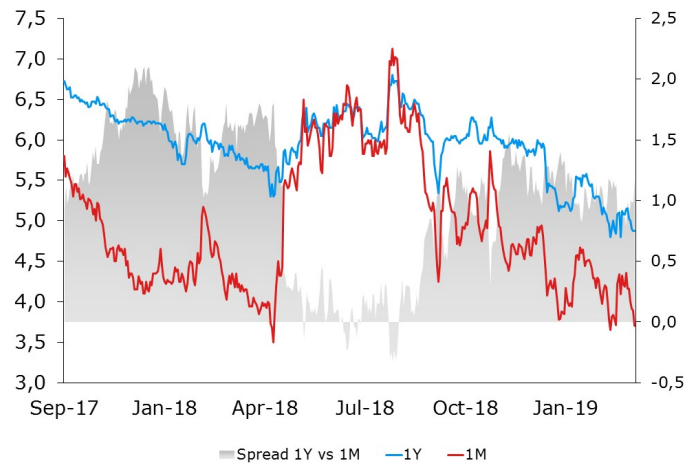
EUR/PLN: 4.2600 / 4.3400

USD/PLN: 3.6000 / 3.9000

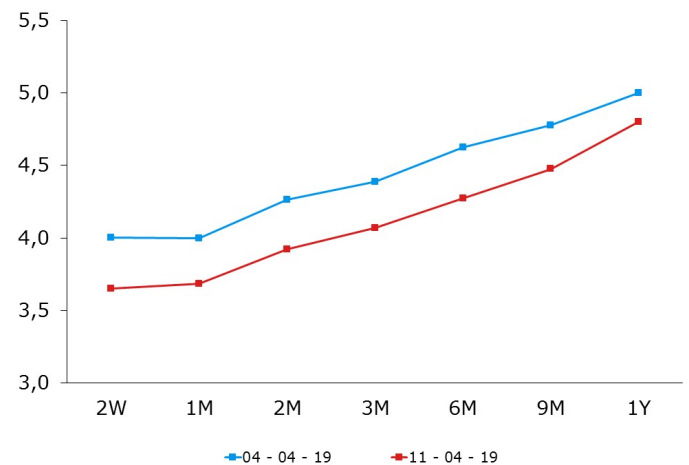
Spot – Buy on dips

The market is so slow, the range is getting tighter and tighter. Since EUR/PLN risks remain skewed to the upsider with the fresh U.S. - Europe story and global growth worries, we prefer to be sideways at this moment. We are ready to buy EUR/PLN at 4.26-27 with stop at 4.24 and hopes for 4.34.

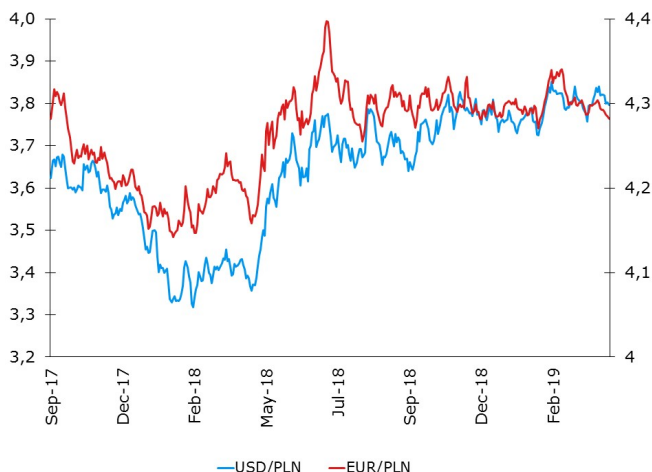
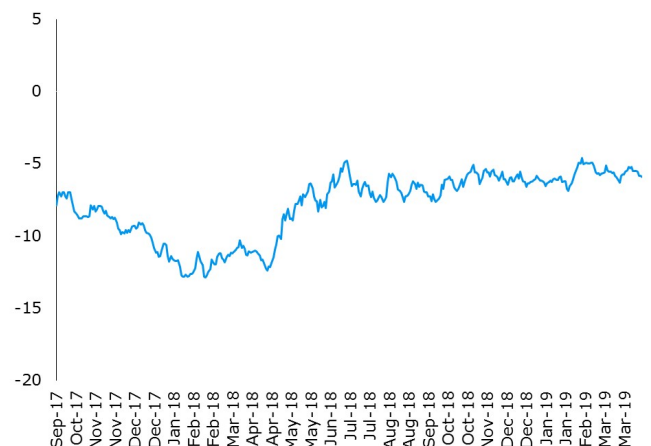
EURPLN volatility



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 |
| 4/4/2019 | 1.65 | 1.72 | 1.74 | 1.69 | 1.90 | 1.77 | 1.72 | 1.72 | 1.72 | 1.72 | 1.72 | 1.78 |
| 4/7/2019 | 1.67 | 1.72 | 1.75 | 1.69 | 1.91 | 1.77 | 1.72 | 1.72 | 1.72 | 1.73 | 1.73 | 1.78 |
| 4/8/2019 | 1.67 | 1.72 | 1.76 | 1.69 | 1.91 | 1.77 | 1.72 | 1.72 | 1.71 | 1.72 | 1.73 | 1.78 |
| 4/9/2019 | 1.56 | 1.72 | 1.64 | 1.69 | 1.80 | 1.77 | 1.72 | 1.72 | 1.72 | 1.72 | 1.72 | 1.78 |
| 4/10/2019 | 1.65 | 1.72 | 1.73 | 1.69 | 1.87 | 1.77 | 1.72 | 1.72 | 1.72 | 1.72 | 1.72 | 1.79 |

| 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 |
| 4/4/2019 | 1.770 | 1.556 | 1.780 | 1.808 | 2.020 | 2.252 | 2.370 | 2.914 |
| 4/7/2019 | 1.770 | 1.509 | 1.785 | 1.778 | 2.020 | 2.252 | 2.365 | 2.931 |
| 4/8/2019 | 1.770 | 1.533 | 1.785 | 1.783 | 2.020 | 2.251 | 2.365 | 2.925 |
| 4/9/2019 | 1.770 | 1.518 | 1.783 | 1.665 | 2.007 | 2.240 | 2.348 | 2.921 |
| 4/10/2019 | 1.770 | 1.517 | 1.785 | 1.767 | 2.002 | 2.221 | 2.337 | 2.905 |

| EUR/PLN 0-delta stradle | | | | | 25-delta RR | | 25-delta FLY | |
|-------------------------|------|------|------|------|-------------|------|--------------|--|
| Date | 1M | 3M | 6M | 1Y | 1M | 1Y | 1Y | |
| 4/4/2019 | 4.00 | 4.39 | 4.63 | 5.00 | 5.00 | 1.48 | 0.51 | |
| 4/7/2019 | 3.91 | 4.25 | 4.50 | 4.90 | 4.90 | 1.48 | 0.51 | |
| 4/8/2019 | 3.89 | 4.13 | 4.45 | 4.88 | 4.88 | 1.48 | 0.51 | |
| 4/9/2019 | 3.70 | 4.03 | 4.52 | 4.88 | 4.88 | 1.47 | 0.51 | |
| 4/10/2019 | 3.69 | 4.07 | 4.28 | 4.80 | 4.80 | 1.32 | 0.51 | |

| PLN Spot performance | | | | | | |
|----------------------|--------|--------|--------|--------|--------|--------|
| Date | EURPLN | USDPLN | CHFPLN | JPYPLN | HUFPLN | CZKPLN |
| 4/4/2019 | 4.2921 | 3.8215 | 3.8263 | 3.4298 | 1.3417 | 0.1670 |
| 4/7/2019 | 4.2921 | 3.8215 | 3.8222 | 3.4212 | 1.3389 | 0.1674 |
| 4/8/2019 | 4.2897 | 3.8188 | 3.8180 | 3.4260 | 1.3340 | 0.1673 |
| 4/9/2019 | 4.2871 | 3.8003 | 3.8069 | 3.4137 | 1.3354 | 0.1674 |
| 4/10/2019 | 4.2852 | 3.8023 | 3.7984 | 3.4210 | 1.3317 | 0.1673 |

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