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Polish Weekly Review

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(macro/FI/FX analysis)

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Comment on the upcoming data and forecasts

Week begins with the release of final CPI data on Tuesday. We expect it to confirm the flash reading of 2.0% y/y, while its details should show a decline in food prices and higher growth in core categories. Official data on the latter will be released on Wednesday and we forecast an acceleration in core inflation from 0.3 to 0.5%. On Thursday the NBP will release balance of payments data. After a stellar January, February will show a pullback in the current account surplus: while the trade balance is set to show a small surplus, EU funds inflows normalized. Finally, on Friday the CSO will publish official fiscal data for 2016 along with a revision of national accounts for 2011-2016 period.

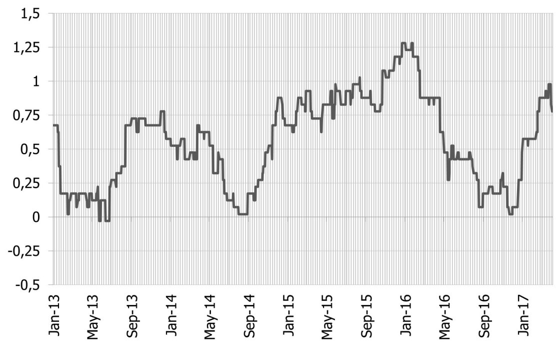
Polish data to watch: April 10th to April 14th

Publication	Date	Period	mBank	Consensus	Prior
CPI *final* y/y (%)	11.04	Mar	2.0	2.0	2.0
Core CPI y/y (%)	12.04	Mar	0.5	0.5	0.3
Current account (mio EUR)	13.04	Feb	245	39	2457
Exports (mio EUR)	13.04	Feb	15300	15265	14976
Imports (mio EUR)	13.04	Feb	15100	15138	14751
M3 y/y (%)	14.04	Mar	9.2	8.5	8.2

Treasury bonds and bills auctions

Paper	Next auction	Last Offer	Yield on the prev auction (%)	Prev auction
(29–37/52) Week T-bills	-	700	1.500	2/22/2017
2Y T-bond OK1019	4/25/2017	900	1.992	4/6/2017
5Y T-bond PS0422	4/25/2017	1500	2.872	4/6/2017
10Y T-bond DS0727	4/25/2017	1600	3.439	4/6/2017
30Y T-bond WS0447	-	2100	4.257	2/16/2017

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



Comment

Negative surprise in PMI was enough to prolong downward correction in Polish surprise index. Next week bring several publications, but only CPI can move 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).

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Our view in a nutshell

Fundamentals

- The economy accelerated in Q4 and at the beginning of the year, suggesting that the recovery in investment is proceeeding faster than anticipated. Because of this we have decided to raise our growth forecasts, to 3.6% in Q1 (prev. 3.1%) and 4.0% on average in 2017 (prev. 3.4%).
- Boosted by statistical base effects, weak PLN, food price hikes and commodity price spike, headline inflation breached 2% and will fluctuate within the target band. While the market and the MPC is focused on base effects and flat CPI in the second half of the year, the case of accelerating core inflation is strengthening. Stellar employment performance shows no respite but wage growth remains moderate. Such equilibrium is unsustainable. If 2007 and 2008 are taken as guidance, wages are ready to take off this year as current demand for labor meets limited supply.
- MPC stays calm and waits rises in headline inflation out carrying steady message of stable rates. Such rhetoric can stay in place for some months. However, as trend in core inflation emerges as evident and labor market strengthen further, the case for rate hikes is set to strengthen as well. All we need is a small change in MPC's wording to make rate expectations wander somewhat more freely.
- Solid labor market performance and prospect for faster growing wages support PIT and VAT revenue from consumption. With much higher headline inflation already in place (deflationary 2016!), further improvements in tax income seem a safe bet for 2017 even without any stringent assumptions on the efficiency of tax collection.

Financial markets

- Zloty benefited in lower rates environment among renewed EM inflows. Although a technical correction is due from this levels, zloty-negative factors went to the background for the time being (ECB hikes). Remember that Fed hikes were recently a factor discouraging substantial strengthening but not a reason for a weaker zloty per se. With stronger GDP growth (market seems to be upgrading its view towards ours) it should not change and zloty may stay stronger.
- CHF risks are set to come back to the agenda once more within 2 weeks as joint conference of president Duda and NBP governor Glapinski is looming. However, we expect the conference to be long on words and short on actions. More precisely, rather nothing more than spread regulation and threats of using higher capital weights in SREP process.

mBank forecasts

	2013	2014	2015	2016	2017 F	2018 F
GDP y/y (%)	1.4	3.3	3.9	2.8	4.0	3.9
CPI Inflation y/y (average %)	0.9	-0.1	-0.9	-0.6	2.1	2.3
Current account (%GDP)	-1.2	-2.1	-0.6	-0.6	-0.9	-1.1
Unemployment rate (end of period %)	13.4	11.4	9.8	8.3	7.2	6.6
Repo rate (end of period %)	2.50	2.00	1.50	1.50	1.50	2.25

	2017 Q1 F	2017 Q2 F	2017 Q3 F	2017 Q4 F	2018 Q1 F	2018 Q2 F	2018 Q3 F	2018 Q4 F
GDP y/y (%)	3.6	3.8	4.0	4.4	4.1	3.9	3.8	3.8
Individual consumption y/y (%)	4.3	4.2	4.2	4.0	4.0	3.8	3.8	3.8
Public Consumption y/y (%)	3.5	3.5	3.0	1.5	2.0	3.0	3.0	3.0
Investment y/y (%)	1.5	4.0	8.0	10.0	10.0	7.0	5.5	5.0
Inflation rate (% average)	2.0	2.1	2.3	2.0	2.1	2.2	2.3	2.4
Unemployment rate (% eop)	8.2	7.4	7.2	7.2	7.2	6.6	6.5	6.6
NBP repo rate (% eop)	1.50	1.50	1.50	1.50	1.50	1.75	2.00	2.25
Wibor 3M (% eop)	1.73	1.73	1.73	1.73	1.73	1.98	2.23	2.48
2Y Polish bond yields (% eop)	2.01	2.10	2.20	2.25	2.30	2.35	2.40	2.45
10Y Polish bond yields (% eop)	3.49	3.60	3.70	3.80	3.90	4.00	4.10	4.20
EUR/PLN (eop)	4.23	4.25	4.25	4.20	4.20	4.20	4.20	4.20
USD/PLN (eop)	3.97	4.01	4.05	4.04	4.08	4.12	4.12	4.12

F - forecast

Economics

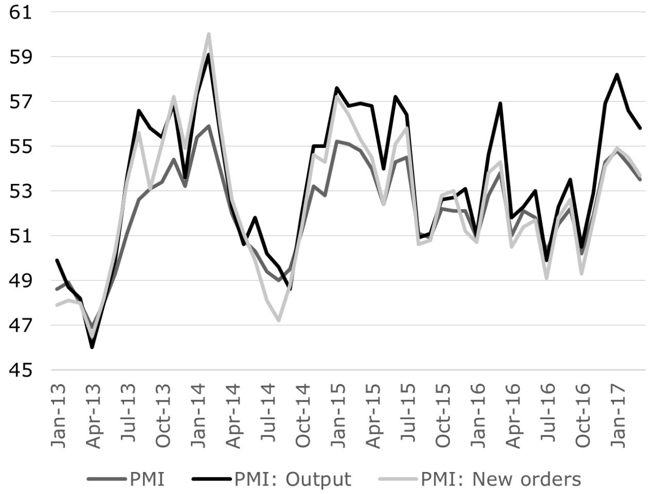
MPC: Interest rates and wording unchanged

Polish Monetary Policy Council did not change interest rates during its April meeting (main rate still equals 1.50%). The statement after the meeting differed only slightly from the previous one. Its most important part, about the limited risk of inflation running persistently above the target over the medium term, remained unchanged. The post-meeting press conference had a dovish and optimistic tone. Long story short, everything is going according to plan and forecasts known by the Council: growth is accelerating, fueled by rebound in investment; CPI has already reached its local maximum and it should gently decelerate as effects of rise in fuel and food prices fade away. Governor Glapinski pointed out that he does not see any need to change interest rates not only till the end of the year but also in 2018.

The market puts a lot of faith in the Council and prices in the first rate hike not until the second half of 2018, discarding at the same time the optimism about the economic outlook baked in the Council's own statements. We think that this consensus is very fragile and the expected timing of rate adjustment seems rather late. Moreover, the upward trend in core inflation is underestimated and the effects of rising commodity prices and depreciation of exchange rate (as well as further labour market tightening) have not yet fully revealed themselves in inflation. Just as markets have missed the pullback of fuel and vegetable price rises, they could put too much attention to those effects right now, ignoring more fundamental tendencies in core inflation. As a result, next inflation projections could show higher inflation paths and thus sharpen the MPC's wording, leading finally to start of a new rate hike cycle already at the beginning of the next year.

Polish Manufacturing PMI surprises to the downside

In March Polish Manufacturing PMI dropped from 54.2 to 53.5, contrary to market expectations (consensus expected a slight rise, we were even more optimistic). The fall was a result of worse assessment of output (down from 56.6 to 55.8), new orders (from 54.5 to 53.7) and employment (below 53, five-month low). After looking into details, we do not perceive this release as negative. On the one hand, worsening of aforementioned subindices coincided with higher purchaseing activity (resulting in backlogs reported by suppliers), on the other – respondents have a rather optimistic view and forecasts for the next 12 months haven't been better for more than a year. Moreover, a small correction after a few months of rises need not bring back the index to levels indicating stagnation (50 pts.) – this is what happened in the last few such cases.



In the last several months, we have been putting much attention to PMI subindices connected to price processes. Despite Zloty strengthening and the fall of commodities prices, the upward trend holds strong. Subindex of production costs grew to the highest level since 2011 (67.3 pts.), while after an insignificant fall, output prices index is still near its 6-years high. As a consequence, even if producer prices inflation has stopped accelerating, we expect it to consolidate at currently high levels (4-5%) in the following months. After adjusting for short term swings in food and fuel prices, our fundamental view of price processes remains unchanged – CPI is returning to NBP's target.

In our opinion, details of this publication should not be a reason to be skeptical about our base scenarios for Polish economy (GDP growth at 4%) and CPI (2.1% y/y on average) for 2017.

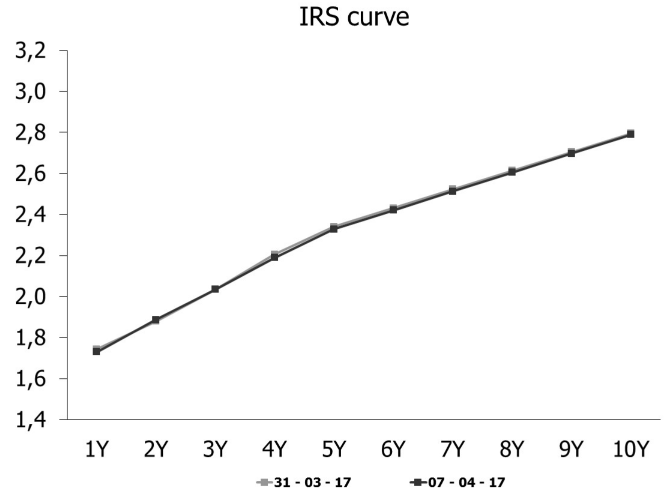
Fixed income

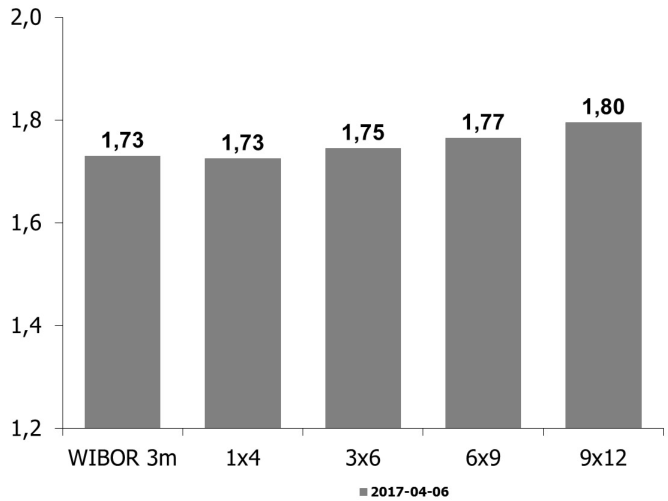
Waiting for a steepener

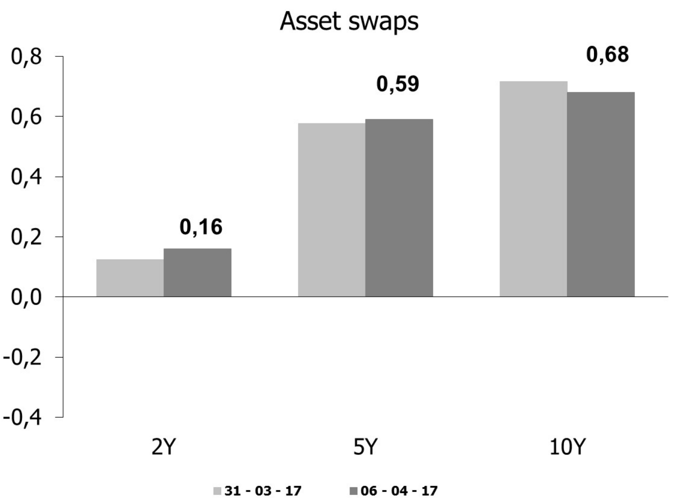
The Ministry of Finance sold 5 bn bonds on Thursday's auction with 9.5 bn demand. The market bought: 1.01 bn OK0419 (yield 1.99%), 1.6 bn PS0422 (2.87%), 1.95 bn DS0727 (3.44%) and two floaters WZ1122: 0.55 bn, WZ0126: 0.53 bn with good demand (9.5 bn). It was quite a strong auction.

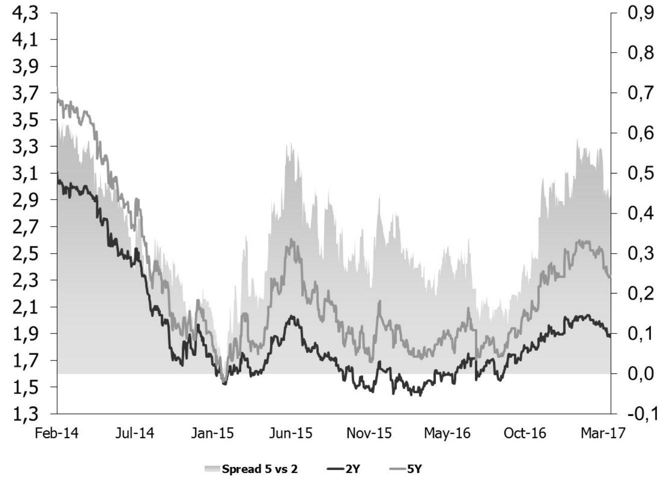
The PS0422/DS0727 spread narrowed from 58 to 56, ASW PS0422/5y has fell to 52 bps and DS0727/10y to 63 bps. OK0419 is trading at 1.99% (no change), PS0422 at 2.88% (4 bps down) and DS0727 at 3.45% (5 bps down). BUND/DS0727 has widened to 321 bps. The curve still looks really too flat. 5y/10y spread is trading at 46 bps.

Poland has financed 56% of 2017 gross borrowing needs after last auction.









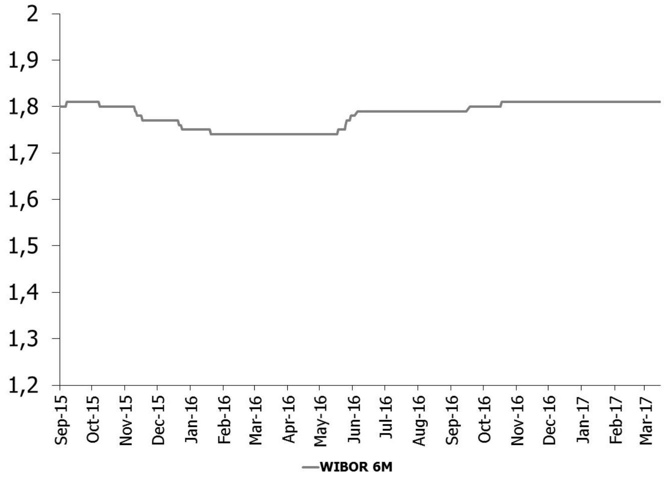
Money market

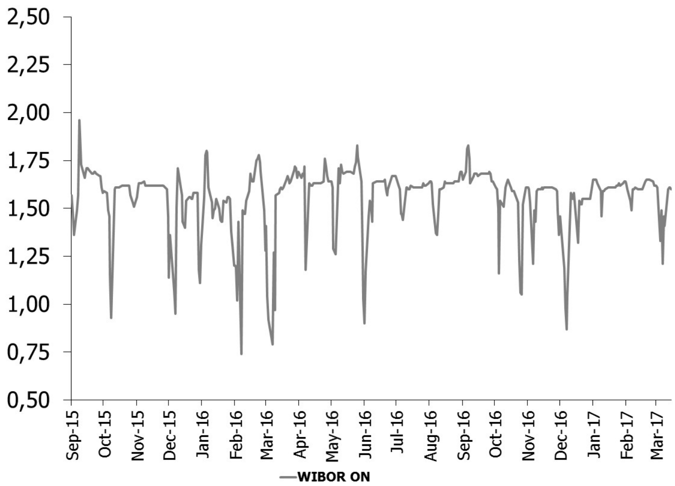
Happy MPC, stable rates

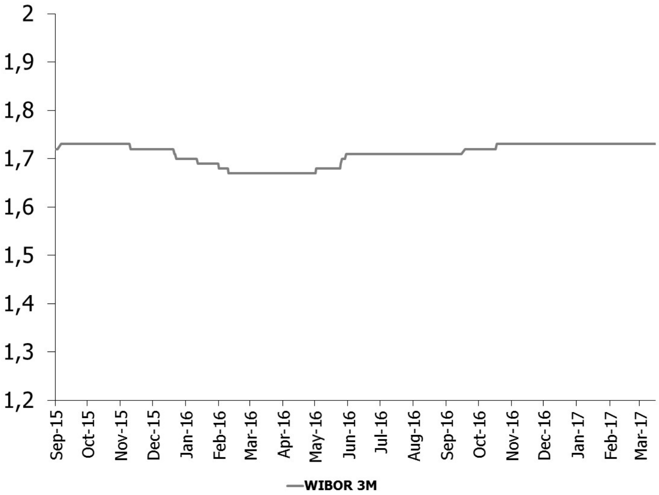
Again, we had a very dull market throughout the week. After weaker than expected CPI (previous week) 2Y swap dipped to 1.90%, but we are now back to 1.925%. The MPC meeting was a non-event again. They are very happy with current economic development in Poland. No price pressure, stable FX and, above all, robust growth. Feels like they just don't want to ruin this perfect equilibrium.

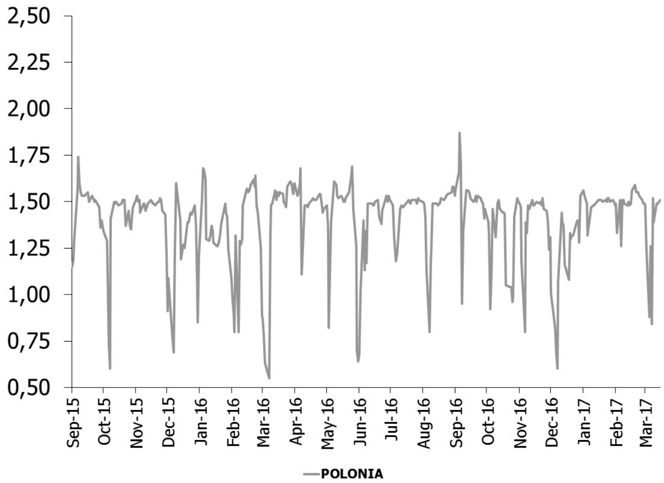
On the money market we have the beginning of the month, which is usually characterized by low volatility and rates around 1.50%.

Ref rate vs Polonia averages:
30 day 5 bp
90 day 6 bp









Forex

Spot – Consolidating EUR/PLN has managed to recover from last week's 4.2100 low to 4.2625 (the high of the week). The spike was short-lived, and EUR/PLN slipped back to 4,22-ish. The PLN was doing so well, partially because of abandonment of EURCZK peg, which produced strong CZK gains. We don't see any reasons behind such a tight correlation, and advice prudence regarding PLN longs. The likely range is 4.21-4.26.

EUR/PLN vols – Front end vols tic higher The realized volatility is still low, but calendar did a trick again. 1 month now includes second tour of French elections. As a result, 1 month EUR/PLN ATM MID climbed to 6.8% (1% higher), 3 month EUR/PLN is 6.6% (0.3% higher) and, finally, 1 year is fixing at 7.15% (0.05% lower). The currency spread (difference between USD/PLN and EUR/PLN) spiked in the frontend, reaching 6%! The skew is roughly unchanged.

Short-term forecasts

Main supports / resistances:
EUR/PLN: 4.18 / 4.28
USD/PLN: 3.85 / 4.05

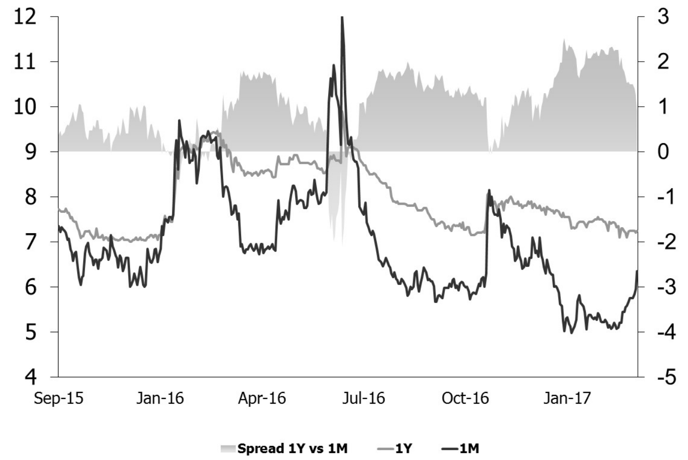
Spot Position: None.

EUR/PLN is still consolidating in a relatively tight 4.21-4.26 range. It is looking quite stable, and we do expect neither side of the range to be breached soon. The momentum is simply not there. We are more likely to fade excessive PLN strength, as the positioning and current levels calls for a weaker Zloty.

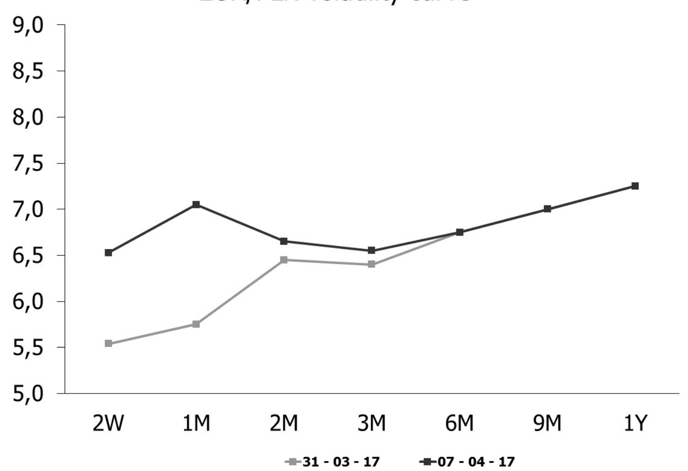
Options Vol – Long 9 month EUR/PLN vol.

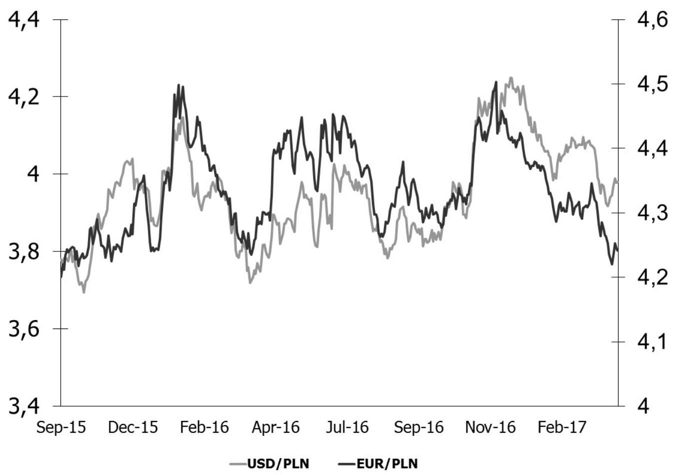
We are keeping the backend long as an outright long position. We see French elections as good enough reason to be long vol at current levels. We are encouraged by the fact that the backend vols are holding well even with currently low realized volatility.

EURPLN volatility

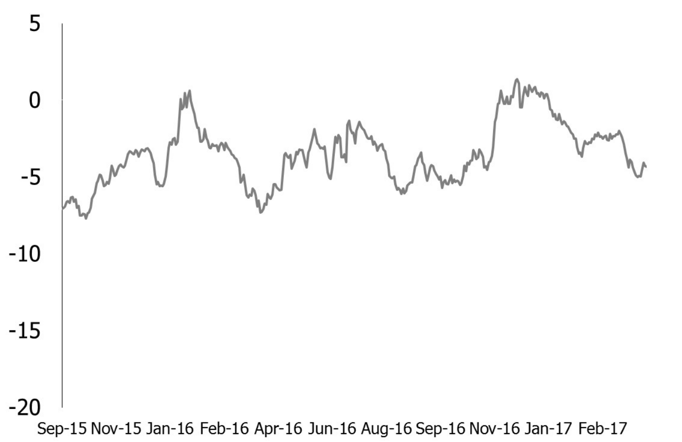


EUR/PLN volatility curve





Bias from the old parity (%)



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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
3/31/2017	1.73	1.73	1.79	1.71	1.82	1.75	1.73	1.74	1.76	1.79	1.84	1.83
4/3/2017	1.63	1.73	1.78	1.71	1.81	1.75	1.73	1.74	1.76	1.78	1.84	1.83
4/4/2017	1.73	1.73	1.81	1.71	1.98	1.75	1.73	1.74	1.76	1.79	1.85	1.84
4/5/2017	1.61	1.73	1.73	1.71	1.89	1.75	1.73	1.74	1.76	1.78	1.84	1.83
4/6/2017	1.63	1.73	1.78	1.71	1.81	1.75	1.73	1.75	1.77	1.80	1.85	1.84

Last primary market rates							
Paper	Au. date	Maturity	Avg. price	Avg. yield	Supply	Demand	Sold
32W TB	3/14/2016	11/30/2016	99.04	1.35	1500	1757	1692
OK0419	4/6/2017	4/25/2019	96.06	1.99	900	2288	918
PS0422	4/6/2017	4/25/2022	97.11	2.87	1500	2255	1437
DS0727	4/6/2017	7/25/2027	91.95	3.44	1600	2552	1693

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0715	5Y IRS	PS0718	10Y IRS	DS1023
3/31/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
4/3/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
4/4/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
4/5/2017	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
4/6/2017	1.750	1.474	1.635	1.525	2.000	2.269	2.460	2.964

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
3/31/2017	5.75	6.40	6.75	7.25	7.25	1.79	0.51
4/3/2017	5.85	6.50	6.75	7.25	7.25	1.79	0.51
4/4/2017	5.95	6.50	6.70	7.20	7.20	1.79	0.51
4/5/2017	6.35	6.55	6.75	7.25	7.25	1.78	0.51
4/6/2017	7.05	6.55	6.75	7.25	7.25	1.78	0.50

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
3/31/2017	4.2198	3.9455	3.9461	3.5272	1.3670	0.1559
4/3/2017	4.2327	3.9664	3.9597	3.5615	1.3690	0.1564
4/4/2017	4.2525	3.9890	3.9804	3.6095	1.3759	0.1570
4/5/2017	4.2464	3.9783	3.9684	3.5906	1.3712	0.1568
4/6/2017	4.2412	3.9792	3.9575	3.5941	1.3666	0.1569

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