April 20, 2017

Polish Weekly Review

mBank Research
(macro/FI/FX analysis)

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Comment on the upcoming data and forecasts

On Wednesday, the CSO will publish its monthly Statistical Bulletin. It should shed some light on last week's surprises, including employment, wages and construction. In addition, the CSO should confirm the preliminary estimate of unemployment in March (at 8.2%). On Friday, the flash CPI for April will be released. We expect inflation to hold close to last month's 2.0% y/y, but our final forecast will be available next week.

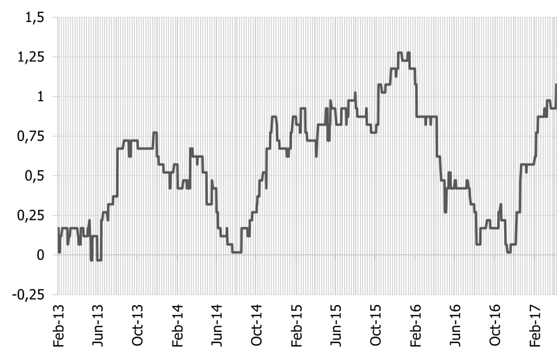
Polish data to watch: April 24th to April 28th

Publication	Date	Period	mBank	Consensus	Prior
Unemployment rate (%)	26.04	Mar	8.2	8.2	8.5
Flash CPI y/y (%)	28.04	Mar			2.0

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

Polish surprise index is back on track after positive surprises from labour market (wages) and real sphere (industrial production). Next week brings two opportunities to move the index – unemployment rate and flash CPI.

* 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

- 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 (4.0% on average in 2017). We have frontrunned a new wave of forecast upgrades for Poland.
- 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, while 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 benefitted 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 (e.g. 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 shifting its view towards ours) it should not change and Zloty may stay stronger.
- CHF risks could come back to the agenda once more as a joint conference of President Duda and NBP governor Glapinski was suggested. 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	4.22	4.20	4.20	4.20	4.20	4.20
USD/PLN (eop)	3.97	4.01	4.02	4.04	4.08	4.12	4.12	4.12

F - forecast

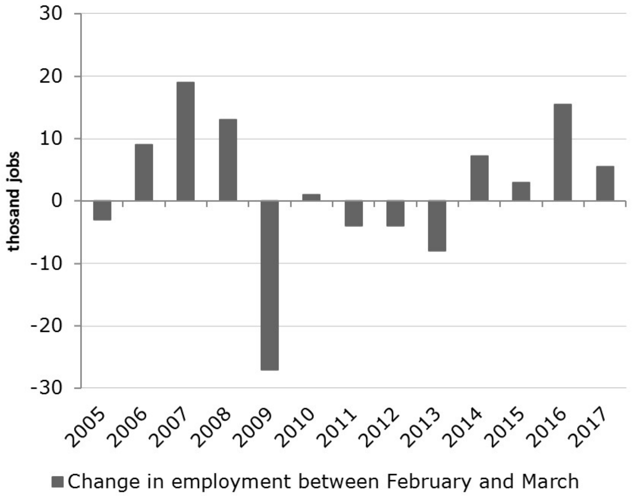
Economics

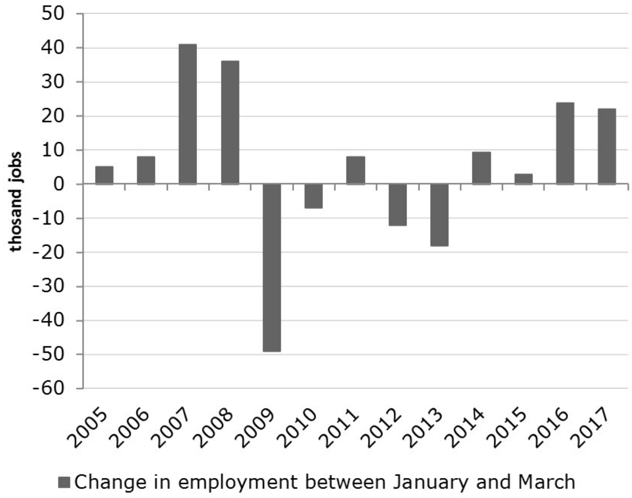
Stellar data behind us. Now we wait for a proper reaction of interest rate markets.

After the final round of March data we can safely say that strong upswing is in the making. Our so far the most optimistic GDP forecast (Q1 3.6% y/y, whole year 4.0%) has clear upside risk attached - we would't at all be surprised by 4.0% growth in Q1 already. It is also possible that strong Q1 in Poland leads global cycle as Poland is deeply rooted in global value chains. All this should lead the market to reconsider its stance towards Polish interest rates. Of course MPC will be trying to talk the data down and „monitor them closely", but solid and unanticipated upswing leads to upward forecast revisions. It is also going to prompt the NBP itself to revise inflation and GDP forecasts (thereby closing the GDP gap earlier). Solid growth makes spectacular employment growth self-sustainable and we await further wage increases. In such circumstances slowly rising core inflation should lead MPC to reconsider its stance. But the market should be quicker and price in more front-loaded tightening in 2018. The first suitable stop for the market to have second thoughts on Polish forward rate curve comes on Monday, after the first round of presidential elections in France. Should the result be benign (as we think), we may play again the normal cycle with higher growth, inflation and monetary tightening.

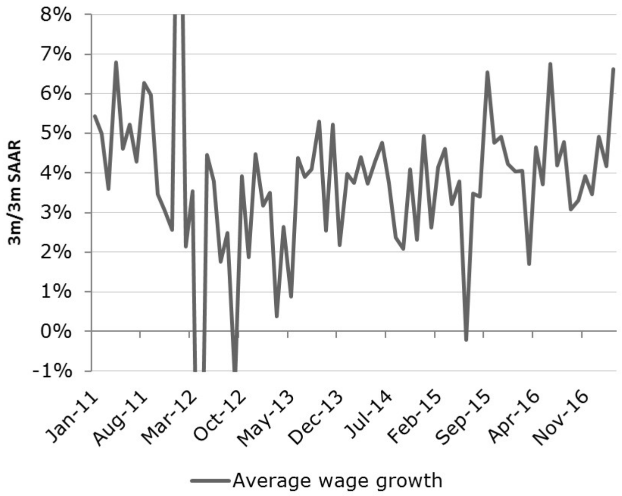
As usual, here's our take on this week's data releases:

Employment in the enterprise sector grew in March by 4.5% – a tad lower than market consensus and our forecast. On a monthly basis only 5.5k jobs were added, whereas we had expected at least twice that much. We will not try to guess the exact reason for this surprise, details will be known by the end of the month when CSO will publish its monthly Statistical Bulletin. This release does not change the broader perspective. It could be treated as a correction after astonishing results in January and February. By now, this year has a record growth in employment and we expect it to stay this way. On the other hand, it is too early associate negative surprises in employment growth with incoming bottlenecks in the labor market (decreasing number of workforce in Poland, lower inflow / outflow of migrant workers from Ukraine).





Average gross wage grew by 5.2% on annual basis, beating market consensus (4.3%) and our forecast (4.6%). As usual, we can only speculate on the sources of the surprise, but the mix of factors influencing wage growth last month was unequivocally positive. The list includes: shifts in mining bonuses, wage hikes in retail trade and positive working day effect (+1 instead of -1 y/y).



Regardless of the reasons behind one surprise or another, one must not doubt that the trend is positive. Taking a broader view, we can reiterate our mantra that structural factors are supportive for higher wage growth. First, the labor market continues to tighten and our favorite tightness indicators (see graph below) have grown further in the first quarter of the year. Secondly, the recent inflation spike was driven by those categories of consumer goods that are essential in the formation of inflation expectations (food and fuels). Those goods are basic necessities with fairly inelastic demand and its prices are both highly variable and observed frequently. As a result, the recent inflation spike probably encouraged wage demands, which in turn, is supporting real wages. Let us not forget that households got used to high real wage growth in the previous few years.

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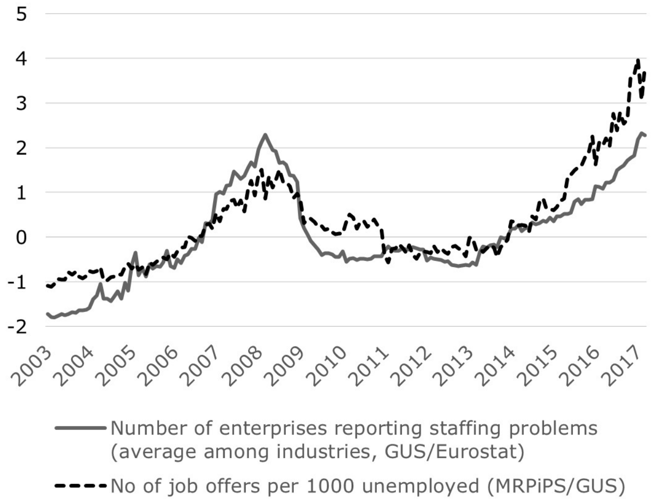
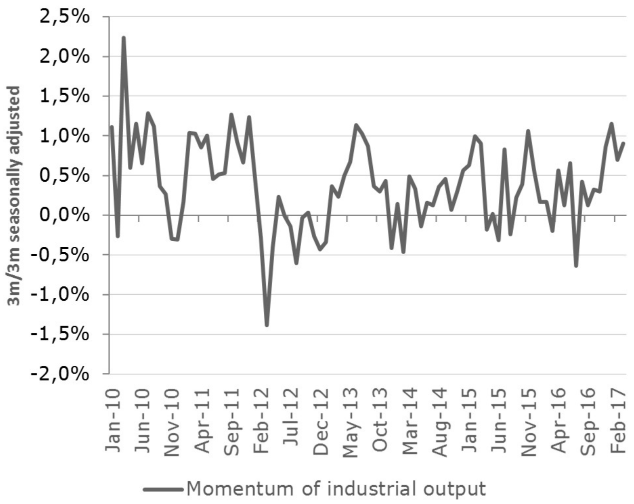
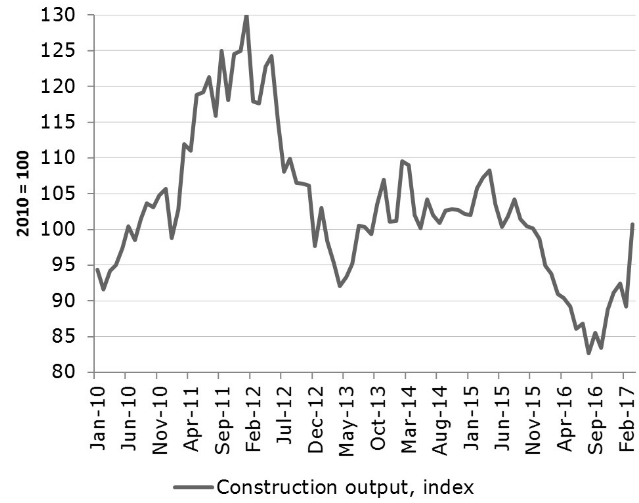


The acceleration in nominal wages should dispel some of the fears regarding real wage and consumption growth this year – we have been skeptical of those for some time now, but it is gratifying to find confirmation of this in hard data. To clarify – we continue to bet on consumption smoothing over time and if real income will be growing even faster, that's even better for consumption in the second half of the year.

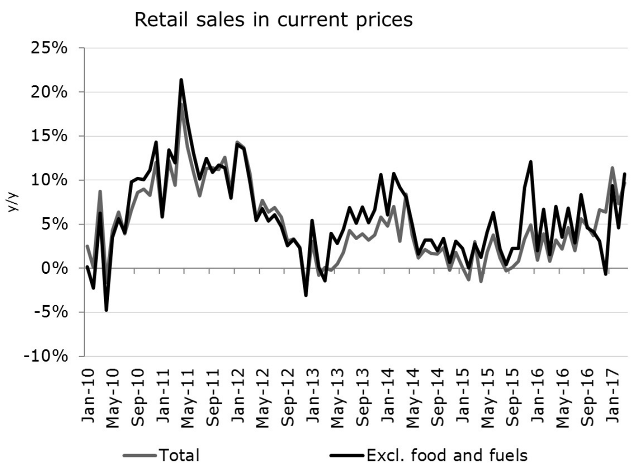
Industrial output grew by a whopping 11.1% y/y in March, beating estimates by a large margin (consensus +7.0%, highest forecast were below 10%). A few facts: this was the fastest annual growth in industrial output since 2010 and the second-best March in the history of the current IO series (after 2010, again). This acceleration is of course partly attributable to working days (+1 vs. -1 y/y in the previous month), but that explains only half of it. After seasonal adjustments, output grew by 8.8% y/y and 2.1% m/m. In some categories output simply exploded, growing by more than 20% (such is the case of misc. machinery and equipment or other non-metallic products – the latter category is strongly tied with construction activity). Their composition strongly suggests that both exports- and domestic-oriented sections are growing at a brisk pace.



Construction output grew by 17.2% y/y, again beating all forecasts by a wide margin. Warm March and working day effects explain such the acceleration itself, but not its scale. To account for that, one must go back to the last comparable period, i.e. 2010-2011, when large-scale infrastructural projects were launched and when UE funds began to pour in. It is in this period when such growth rates (+50% m/m n.s.a., +9.7% s.a.) were previously recorded. Detailed data (quarterly) won't be available until the release of the Statistical Bulletin, but we can safely assume that construction output rebound was a broad-based one. We can enumerate some of the factors behind it: base effects in pipeline and energy investment, launch of public investment (including local governments, who are at the beginning of their election-related spending cycles), as well as booming residential investment. As a result, double-digit growth in construction output this year is all but assured.

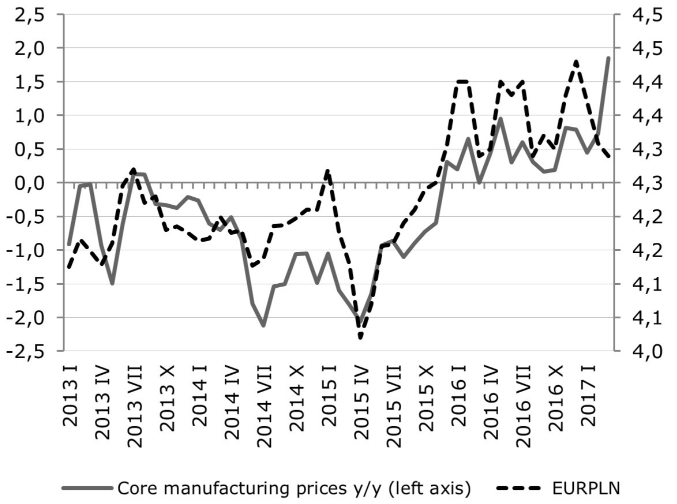


Retail sales accelerated to 9.7% y/y. It is spectacular growth given the shifts in Easter timing. We think that the situation in retail market is best summarized in auto sales together with wearing apparel and home appliances. Such a combo records growth rates clearly above 10% and speaks in favor of our theory that consumers feel a lot more confident while planning purchases. This also corroborates our view that consumption growth rate around 4% (or even more) this year should be regarded as baseline. Consumers not only did get an additional income (500+) they calculate as permanent one but also made some buffer savings to weather the effect of higher inflation in coming months. Moreover, tightening labor market speak is favor of a scenario in which real wages growth falls only marginally as workers renegotiate their nominal contracts seeing growth in prices they observe in highest accuracy (food, fuels).



PPI accelerated to 4.7% in March. The most important thing to note is further acceleration in core manufacturing prices (+0.2%

m/m) and the corresponding rise of annual price index. For the second month in a row we observe a new fact: prices rise despite stable or strengthening zloty (see the graph). It is a blunt evidence that deflationary equilibrium is over. Inflationary equilibrium begins.

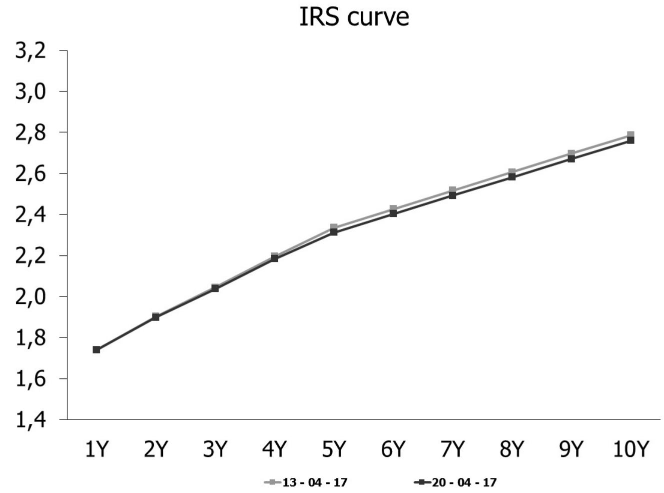


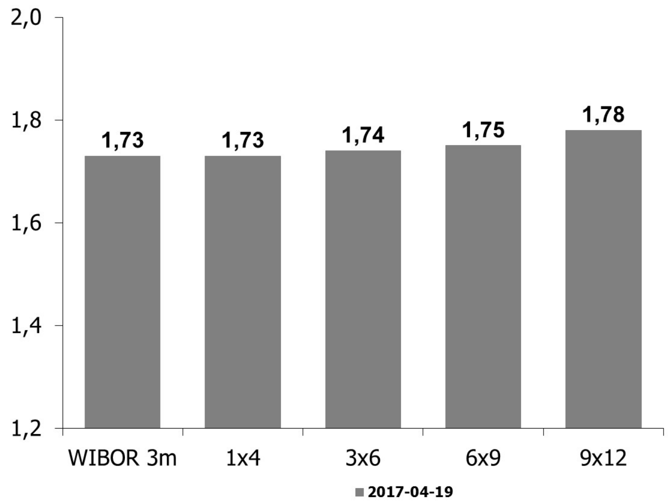
Fixed income

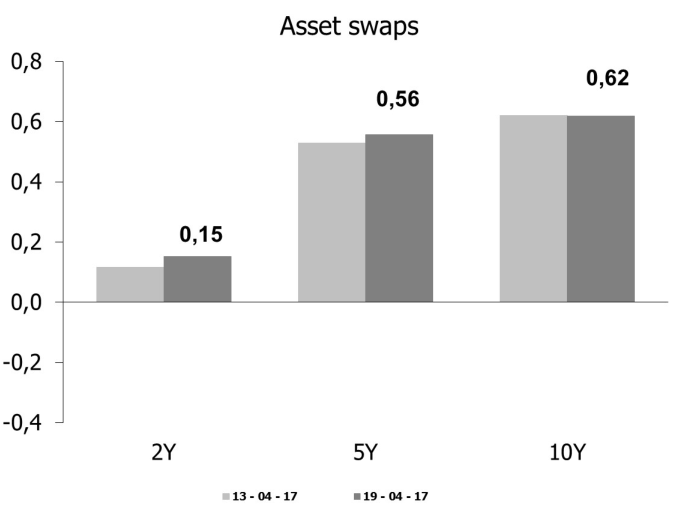
Another bullish week

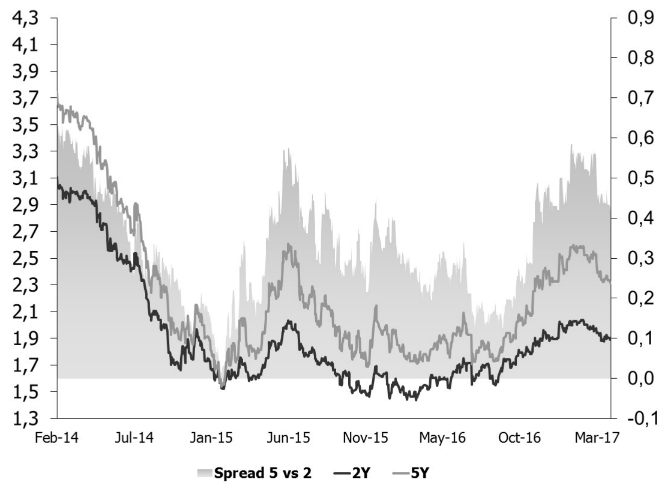
Global bullish on bond market continued last week. We touched low rates levels. Even the incoming (this Sunday) French election doesn't scare the market. Core markets are in a risk off mode, yields on the Bund are getting lower and lower (0.18%). Polish yields have been following this trend, so BUND/DS0727 has narrowed to 317 bps.

The PS0422/DS0727 spread narrowed from 52 to 51 bps (the lowest we have ever seen on these bonds), ASW PS0422/5y is at 52bps and DS00727/10y is at 59 bps. OK0419 is trading at 1.97% (no change), PS0422 is trading at 2.84% (no change) and DS0727 is trading at 3.37% (1 bps higher).









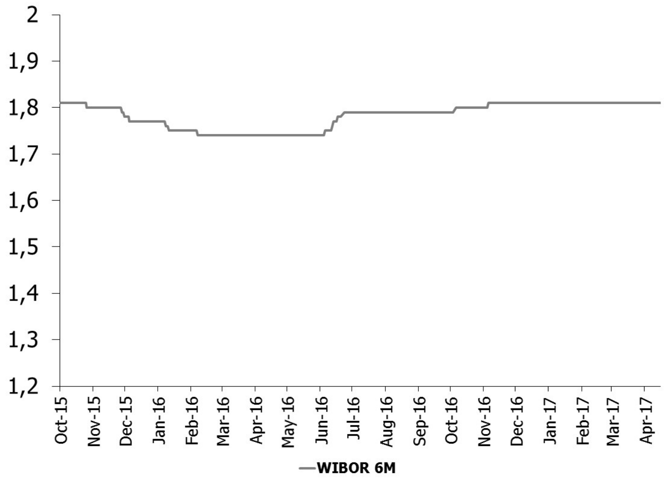
Money market

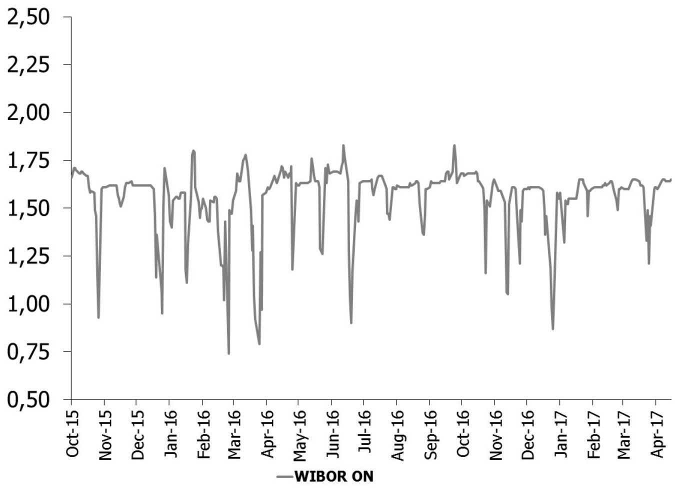
Nihil novi

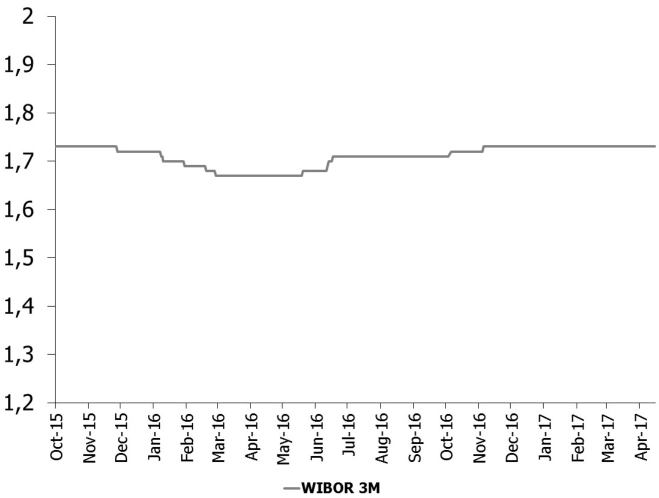
Nothing new happened on the very front end of the yield curve. We are currently in a tight range with hardly any perspectives to move. Market consensus states that rates will be stable for the next year or even longer and MPC members are strengthening that view with their comments. Next week we have a pretty decent bond auction but this comes together with April bond coupons and maturity payments. Market participants will look to replace PS0417 with new bonds. Recent cold weather sparks market rumours about food prices as temperatures have fallen below zero in some parts of Poland.

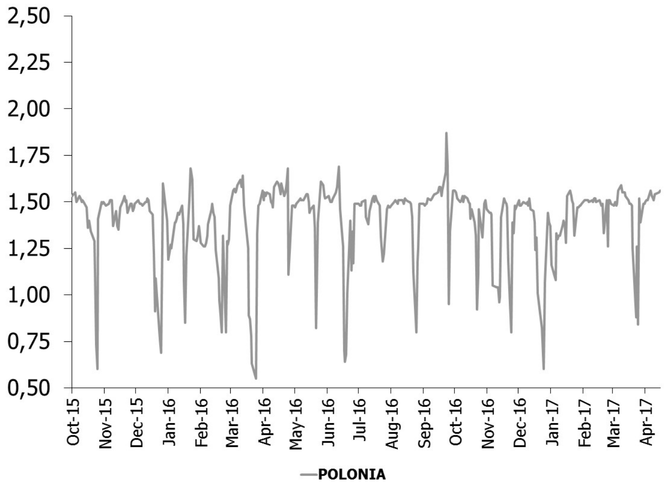
Overnight rates stayed in the upper range last week. Next week we might have some liquidity distortions due to April's coupon period.

Ref rate vs Polonia averages:
30 day 5 bp
90 day 3 bp









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Forex

Spot – PLN: tic higher EUR/PLN has managed to climb further and even breached the 4.2500 resistance zone. 4.2685 was so far the high of the week vs 4.2280 low; hardly an excitement. The value of the Zloty is roughly the same, as USD/PLN is trading similarly lower. We are mimicking EUR/USD, and so called "Polish factor" is not really being played. We have a very mild risk off phase, but all eyes are now on French electoral game. The range is maybe a little stretched, 4.22-4.28 instead of 4.21-4.26, but it is much too early to herald any major trend creation.

EUR/PLN vols – Front end vols tic higher The French electoral calendar is the main driver for the short term vols. As the result, 1 week (which includes first round) and 1 month (now includes second round of French elections) were fairly hunted. 1 month EUR/PLN atm mid climbed to 7.2% (0.4% higher), 3 months EUR/PLN are 6.6% (unchanged), and finally 1 year is fixing at 7.15% (unchanged). The currency spread (difference between USD/PLN and EUR/PLN) spiked in 1w, reaching 7.5%! The skew is roughly unchanged.

Short-term forecasts

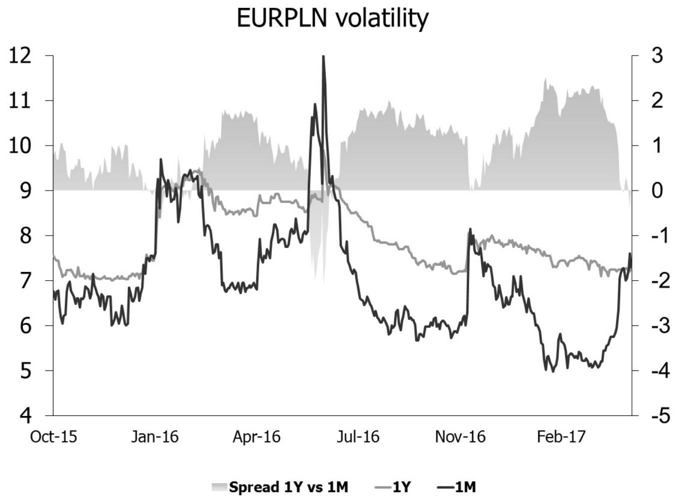
Main supports / resistances:
EUR/PLN: 4.18 / 4.28
USD/PLN: 3.85 / 4.05

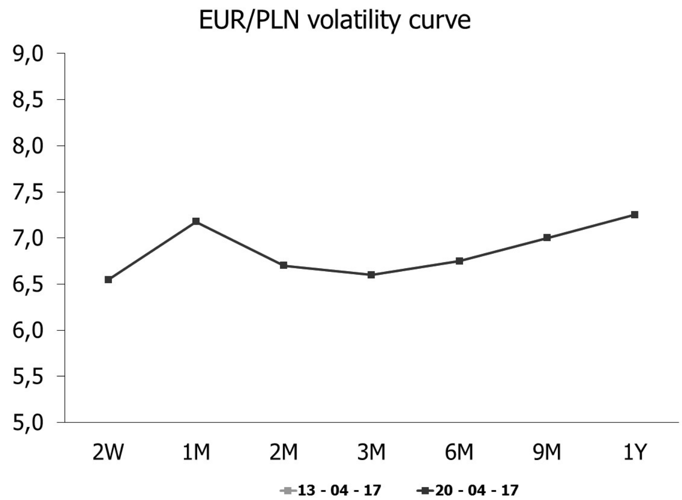
Spot Position: None.

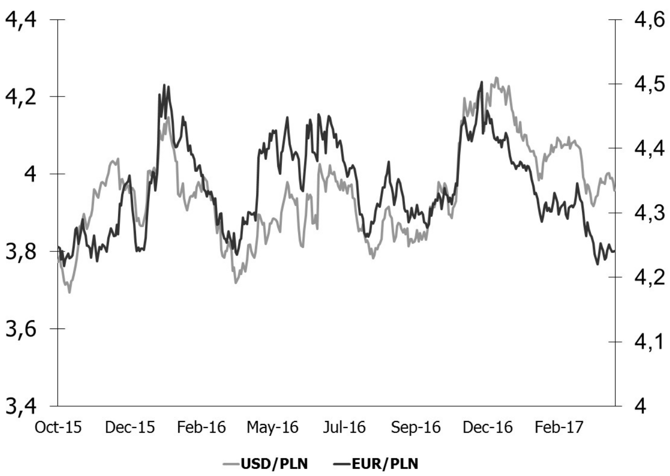
EUR/PLN is still consolidating in a relatively tight 4.21-4.28 range. It looks quite stable and we do not expect neither of the sides of the range to be breached soon. The momentum is simply not there. We are more likely to fade excessive PLN strength, as the positioning and current levels call for a weaker Zloty.

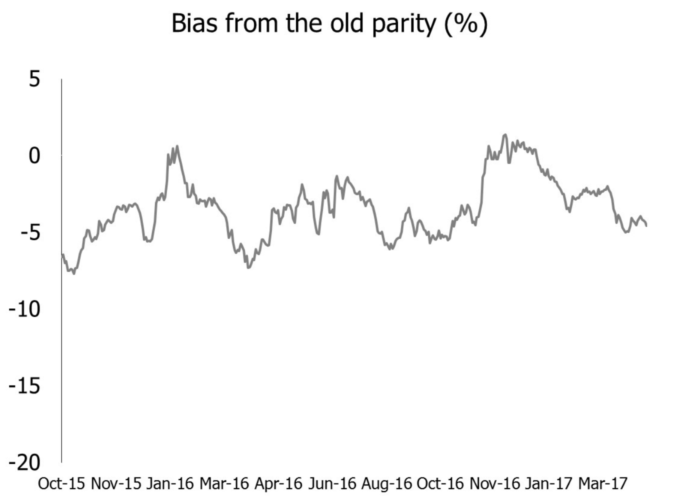
Options Vol – Long 9 month EUR/PLN vol.

We are keeping the backend long as an outright long position. We see French elections as a 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.









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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
4/13/2017	1.86	1.73	1.96	1.71	2.11	1.75	1.73	1.74	1.75	1.79	1.85	1.83
4/16/2017	1.63	1.73	1.71	1.71	1.75	1.75	1.73	1.74	1.75	1.79	1.85	1.83
4/17/2017	1.63	1.73	1.71	1.71	1.75	1.75	1.73	1.74	1.75	1.79	1.85	1.83
4/18/2017	1.66	1.73	1.76	1.71	1.90	1.75	1.73	1.73	1.74	1.77	1.82	1.82
4/19/2017	1.83	1.73	1.93	1.71	2.07	1.75	1.73	1.74	1.75	1.78	1.83	1.83

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
4/13/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
4/16/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
4/17/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
4/18/2017	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
4/19/2017	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
4/13/2017	7.18	6.60	6.75	7.25	7.25	1.82	0.52
4/16/2017	7.18	6.60	6.75	7.25	7.25	1.82	0.52
4/17/2017	7.18	6.60	6.75	7.25	7.25	1.82	0.52
4/18/2017	7.18	6.60	6.75	7.25	7.25	1.82	0.62
4/19/2017	7.18	6.60	6.75	7.25	7.25	1.80	0.60

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
4/13/2017	4.2450	3.9886	3.9730	3.6581	1.3591	0.1588
4/16/2017	4.2395	3.9911	3.9724	3.6649	1.3550	0.1588
4/17/2017	4.2395	3.9911	3.9724	3.6649	1.3550	0.1588
4/18/2017	4.2401	3.9800	3.9688	3.6559	1.3548	0.1584
4/19/2017	4.2404	3.9571	3.9669	3.6351	1.3543	0.1582

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