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Polish Weekly Review

mBank Research
(macro/FI/FX analysis)

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Comment on the upcoming data and forecasts

On Wednesday the MPC will conclude its two-day meeting, by keeping rates on hold. Due to calendar quirks, only three weeks have passed since the previous meeting and recent data could not have possibly altered the MPC's worldview. The status quo of high growth, stable inflation and balanced economy continues. The press conference after the meeting will likely by marked by dovish comments, with Governor Glapinski reiterating his inclination for stable rates until the end of 2018.

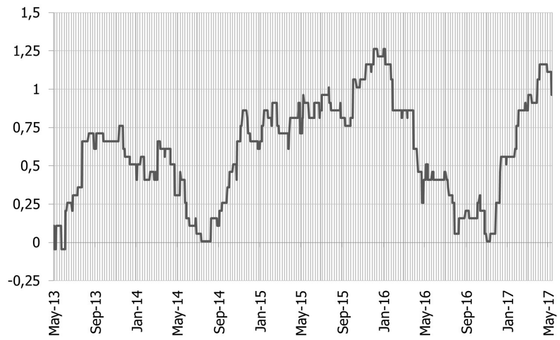
Polish data to watch: June 2th to June 9th

Publication	Date	Period	mBank	Consensus	Prior
MPC decision (%)	07.06	Jun	1.50	1.50	1.50

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	6/13/2017	250	1.905	5/18/2017
5Y T-bond PS0422	6/13/2017	1000	2.734	5/18/2017
10Y T-bond DS0727	6/13/2017	1000	3.289	5/18/2017
30Y T-bond WS0447	-	2100	4.257	2/16/2017

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



Comment

Polish surprise continues its downward move after another negative surprises in flash CPI and manufacturing PMI data. Next week brings no opportunities to a rebound, since MPC will most probably leave rates unchanged.

* 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 proceeding faster than anticipated. Because of this we have decided to raise our growth forecasts (4.0%+ on average in 2017). We have front-run a new wave of forecast upgrades for Poland. Recent data suggest even stronger growth this year.
- 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 benefited in lower rates environment among renewed EM inflows. Substantial improvement in fiscal position seems to be the most important factor for investors (compression of credit risks).
- Stronger GDP growth should underpin the zloty in the mid-term as it stays undervalued in real, effective terms.
- Although a technical correction is due from this levels, zloty-negative factors went to the background for the time being. Remember that Fed hikes were recently a factor discouraging substantial strengthening but not a reason for a weaker zloty per se. Overall it seems that interest rate channel (be it ECB or Fed policy) went to the background for the time being.

mBank forecasts

	2013	2014	2015	2016	2017 F	2018 F
GDP y/y (%)	1.4	3.3	3.8	2.7	4.1	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	2017 Q2 F	2017 Q3 F	2017 Q4 F	2018 Q1 F	2018 Q2 F	2018 Q3 F	2018 Q4 F
GDP y/y (%)	4.0	4.2	4.2	4.2	4.1	3.9	3.8	3.8
Individual consumption y/y (%)	4.7	4.5	4.2	4.0	4.0	3.8	3.8	3.8
Public Consumption y/y (%)	1.0	3.5	3.5	3.5	2.0	3.0	3.0	3.0
Investment y/y (%)	-0.4	6.0	8.0	12.0	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	4.20	4.15	4.10	4.10	4.12	4.14	4.16
USD/PLN (eop)	3.97	3.75	3.77	3.87	3.94	4.00	4.02	4.00

F - forecast

Economics

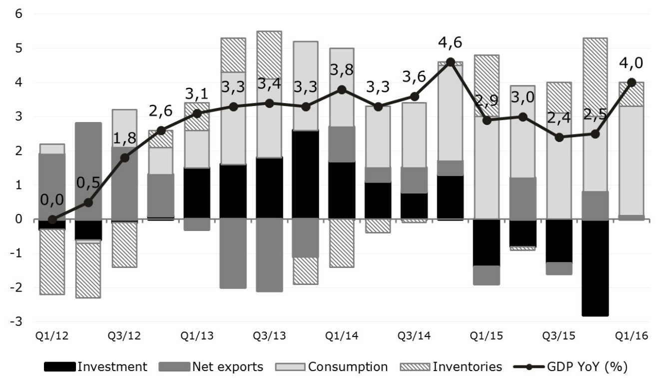
Goldilocks economy is back and supports the MPC's wait-and-see stance.

This week's releases have largely underscored the economic status quo in Poland: growth accelerated as the drag from investment faded (as seen in final Q1 GDP), while inflation stabilized around 2%. Thus, the Goldilocks economy returned after a few quarter hiatus. Polish assets are clearly benefitting from this development, as risk premia have been destroyed over the past few months. MPC is going to stay unimpressed by the data. Discussion is dominated by the current state of affairs and what MPC sees now is what you get in wording. As GDP growth stays strong and inflation stays low, confirmation bias leads still to thinking about impaired Phillips curve and flat (flattening?) expectations concerning the future interest rate path fuelled by MPC comments (mind that the first full 25bps hike is priced in 2019). This is non-standard, going counter to traditional economic theory. It is possible that high liquidity in the global markets is responsible. It is really hard to find a trigger to reverse it. So far, so good.

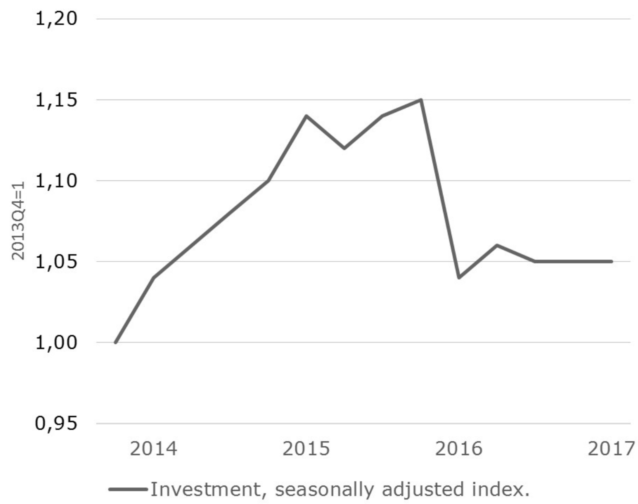
Below you will find our detailed take on this week's releases:

Q1 GDP confirmed at 4.0% y/y, with some surprises in its composition.

Final release of GDP data only confirmed the flash reading. Polish economy grew by 4.0% y/y in the first quarter of 2017. Sequential, seasonally adjusted growth topped 1.1%.



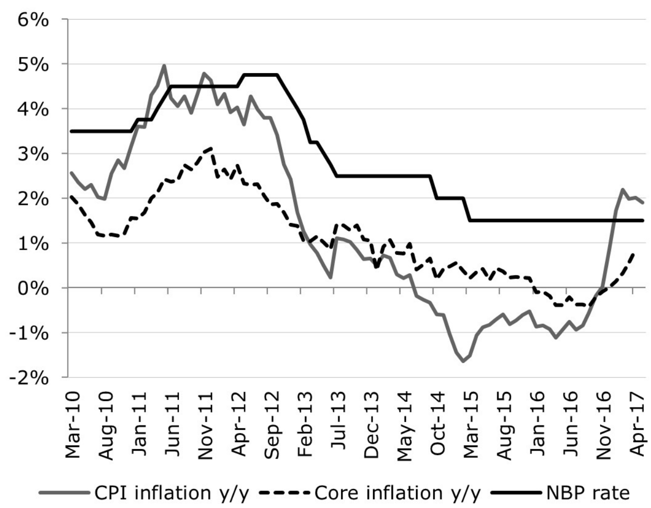
Growth composition carries no major surprises, but seems a bit non-standard. Private consumption matched our estimates (4.7% y/y). 500+ effects proved to be a bit lagging, but relatively strong. 2018 benchmark GDP revision is likely to bring even higher consumption growth profile (5%?) since at this stage the growth of services is probably underestimated. Investment activity disappointed, having generated another dip of 0.4% y/y (a L-shaped recovery – see the graph below). Strong upswing signals from construction activity proved to be a bit too optimistic, therefore we may have witnessed another poor quarter of private investment activity (mostly machinery & equipment). As for residual components of GDP growth, we saw surprisingly strong net exports (resonates well with lower investment) and quite substantial contribution from inventories: distribution of inventory hoarding from Q3 and Q4 proceeds in a gradual manner.



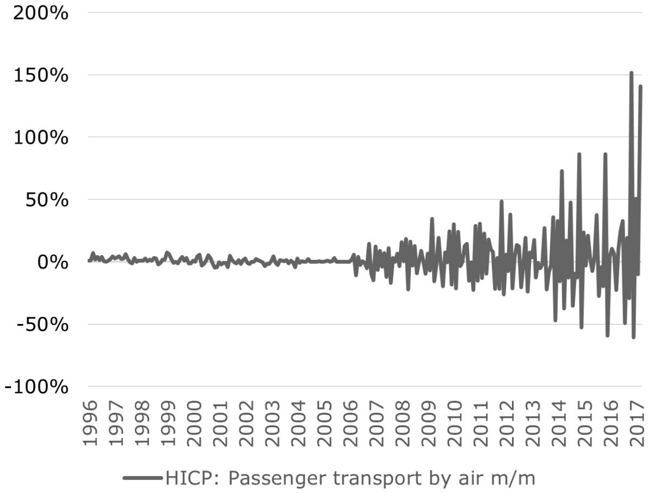
Is poor investment activity a reason for concern? We do not think so. So far, the scenario of investment acceleration in 2017 was based on public activity and base effects. It is far too early to falsify it. Acceleration of investment activity of 3-4 pp. on sequential basis were a norm when EU funding jump-started. According to the volume of EU contracts signed, the biggest flow of investment is going wash over Polish economy in 2018 (with earlier, strong dynamic effects driven by statistical base). With economy rushing at 4% pace and job scarcity growing it is really hard to imagine a continuation of private investment activity doldrums. Therefore, we look for a substantial acceleration of overall investment in Q2 that would allow to sustain GDP growth at 4%.

Inflation down to 1.9% in May.

According to the flash estimate (very likely to be confirmed by the final release in two weeks), inflation fell from 2.0% in April to 1.9% in May (our forecast was one of deeper fall, to 1.8%). As no details are given, we can speculate on the sources of the decline and the surprise.



There are three possibilities (all could be true to some extent). First, it could have been due to low food prices. We are skeptical of this explanation, as we expect a slight increase in food prices in May. Despite much furor about cold spells and weather-related spike in food prices, it is too early to see the impact of weather on domestic fruit production and prices. Second, airline fares are major culprit. The massive increase in air transport prices in April was probably followed by a correction, the magnitude of which is uncertain. Had there been no correction (hence, no decline in transport services prices), one could easily see 1.9% y/y CPI and 1.0% in core CPI. Third, the sharp appreciation of the PLN could have impacted the prices of certain fast-moving consumer goods - again, the impact of PLN appreciation is difficult to nail (could be infinitesimal). A decline in fuel prices (by ca. 2% m/m in May and probably in June as well) is the only non-controversial part of the release.

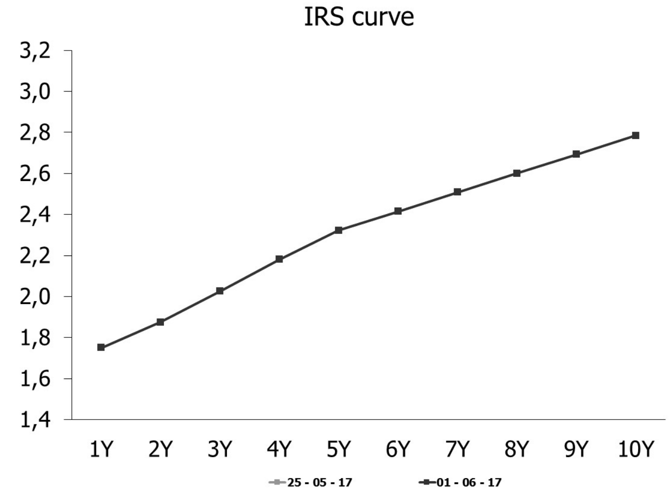


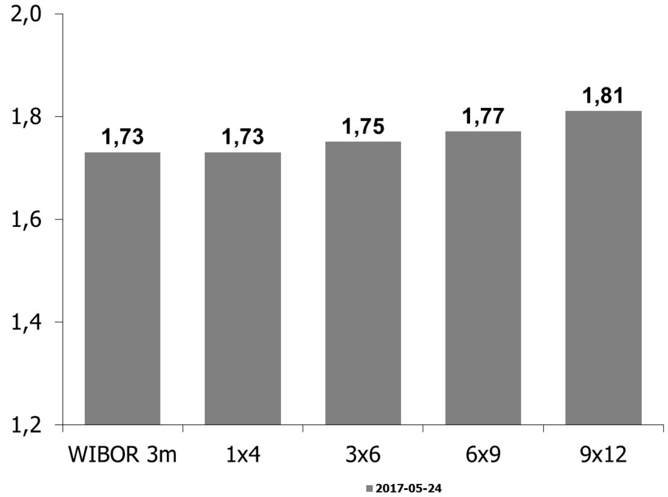
Fixed income

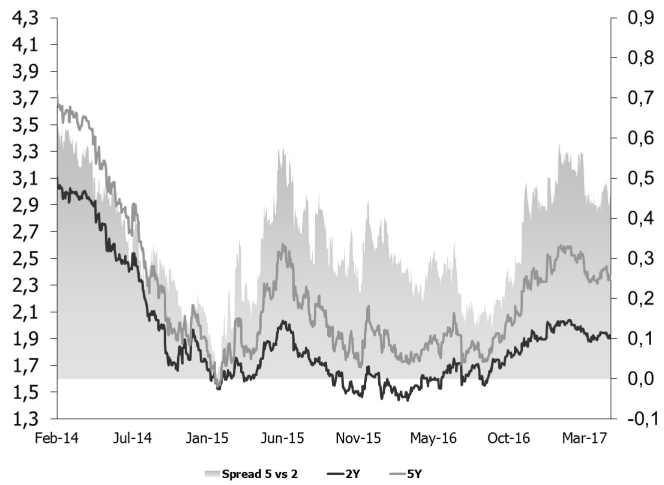
Bull market till the end of world?

Since last auction we have been drifting lower and lower in yields. MPC won't hike until 2020, auctions will be limited, Polish economy looks great, there is happy buying. It looks like Polish bonds are the most wanted in the world. No one is short! There's no way we will finish this year at this levels, someone will take profit.

Bund/DS0727 is 292 bps today. The PS0422/DS0727 widened from 57 to 58, ASW PS0422/5y is at 37 bps and DS0727/10y is at 49 bps (both narrowed 3 bps). OK0419 is trading at 1.89% (4 bps down), PS0422 is trading at 2.66% (8 bps down) and DS0727 is trading at 3.24% (7 bps down).







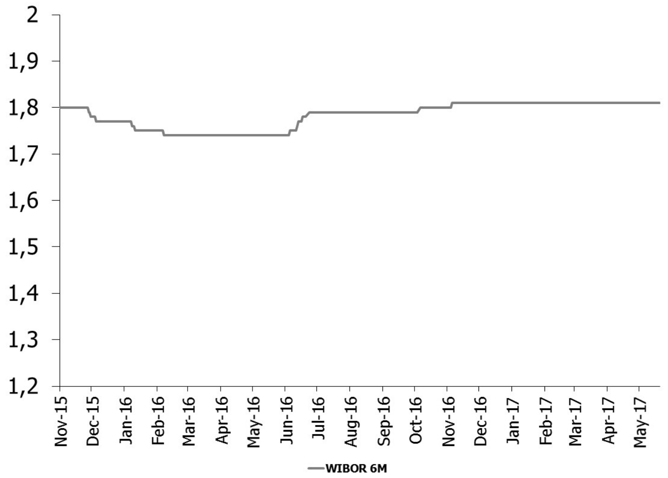
Money market

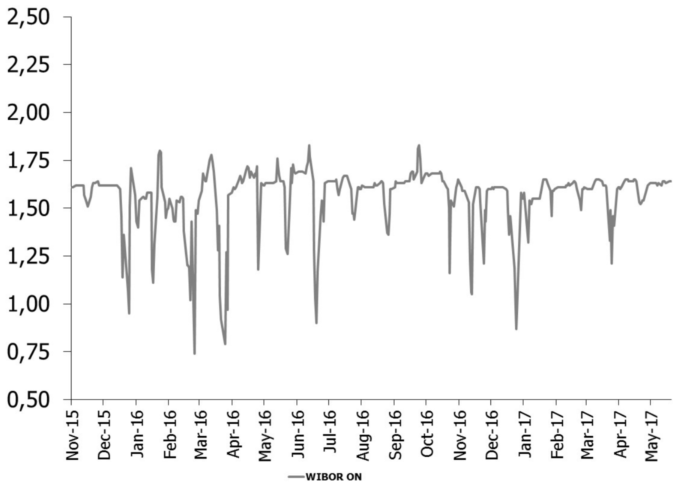
Interest rate expectations on a knife edge

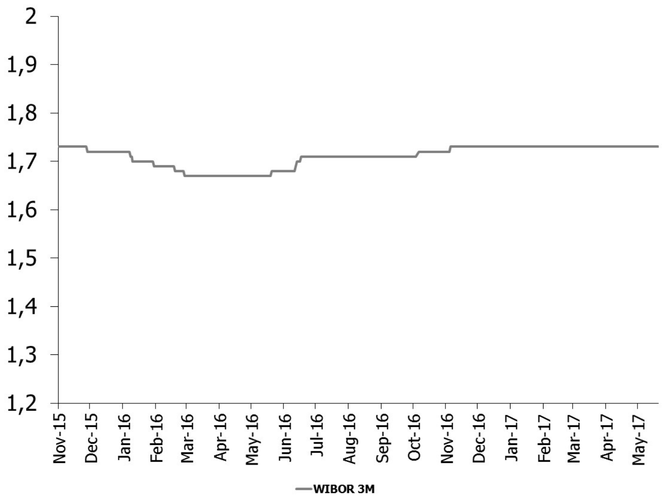
Polish bonds continue to perform well. That's a result of global mood in favor of lower yelds and improving sentiment towards Polish credit. As we wrote last week, we are approaching the levels, where chances for rate hikes and cuts are equal within two year time. That's at least strange in the current economic environment. Positioning-wise we think that local banks already bought enough or even more bonds to avoid paying banking tax for spare cash. Therefore, potential buyers should come either from abroad or from local investment funds to push prices higher. Keep in mind, that we have the Fed decision coming in June. The broad consensus is a hike and they tend to not surprise the market.

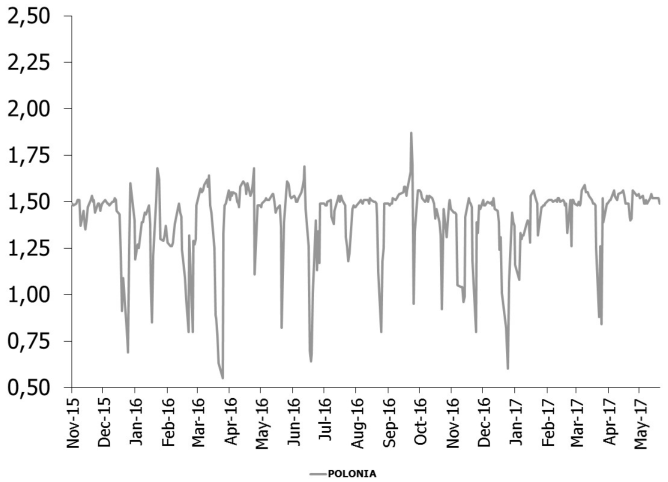
Funding rate stays rather high for another month. We think that this is kind of a structural change, the outcome of banking tax introduction.

Ref rate vs Polonia averages:
30 day   -1 bp
90 day   2 bp









Forex

Spot – PLN – sideways There is not much to report. EUR/PLN was fluctuating in the extremely tight, 4.1650-4.1900 range. The 4.15-4.17 support zone is holding well, but bulls should not feel encouraged until we don't decisively break above 4.33. Momentum is non-existing, we are being dragged and pushed by random flows. For a choice, we prefer to play that range from the long side. Polish MPC is in no rush to hike rates and our inflation does not provide real reasons for that, either. The drift higher in EUR/PLN is just a bit more likely.

EUR/PLN vols – tic lower The realized volatility in EUR/PLN is at its lows, especially when managed daily. As the result 1 week EUR/PLN ATM is at 4.5% mid. 1 month EUR/PLN ATM is at 5.75% (0.25% lower), 3 month EUR/PLN is at 5.85% (0.15% lower), and finally 1 year is fixing at 6.45% (0.4% lower). The backend vols were in abundant supply, with 6 month EUR/PLN given at 6.1%. The currency spread (difference between USD/PLN and EUR/PLN) and the skew are roughly unchanged.

Short-term forecasts

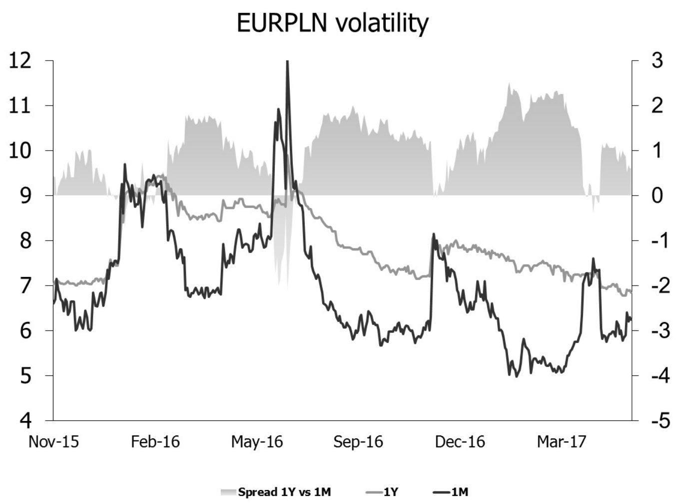
Main supports / resistances:
EUR/PLN: 4.15 / 4.25
USD/PLN: 3.70 / 4.00

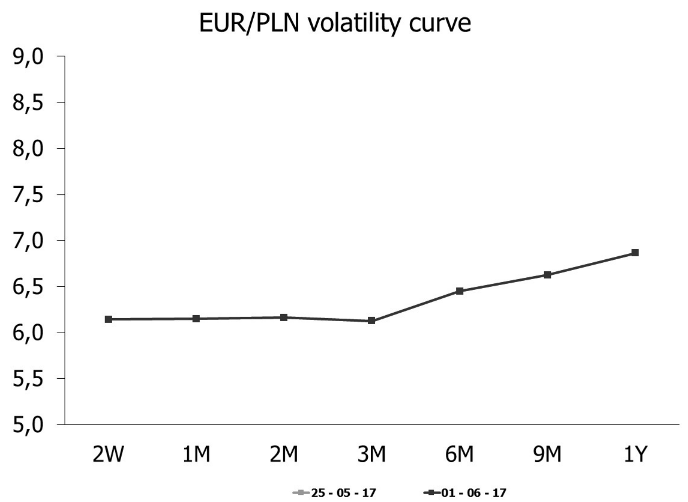
Spot Current position: Long EUR/PLN at 4.2250 and 4.1850.

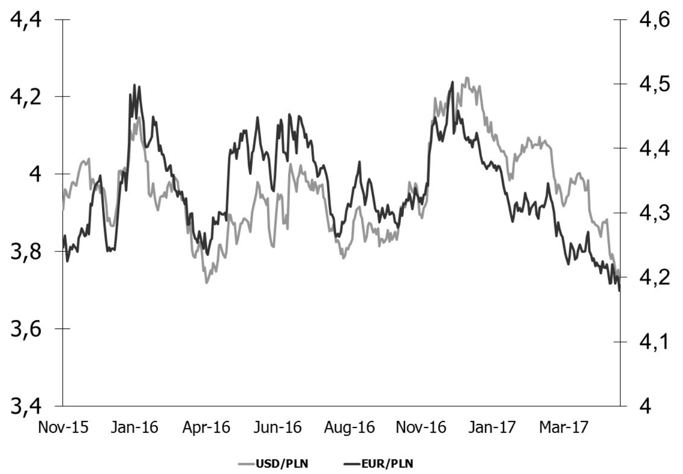
The jury is still out, but the future looks grim for our contrarian long EUR/PLN bet. We have missed the stop loss by 16 pips. We move the stop back and lower to 4.1600 (from 4.1750) and still hope for a move to the 4.26/4.30 region.

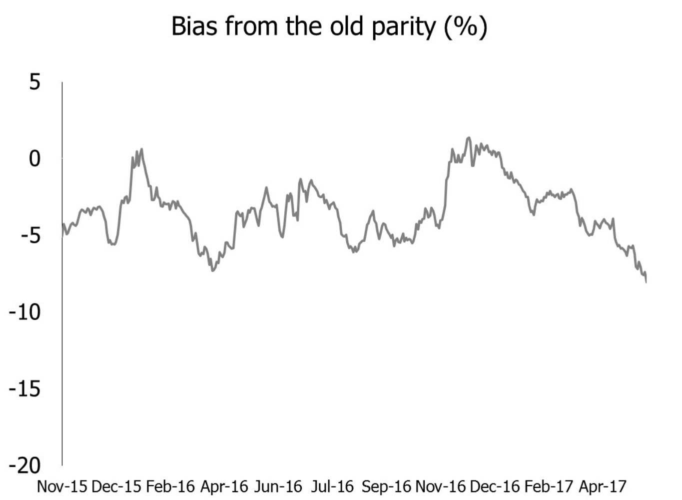
Options Vol – long 3 months and 9 months EUR/PLN.

Stronger PLN, lower realized volatility, lower vol, our long Vega in EUR/PLN was feeling the heat. We are keeping the position for the time being but our favoured time of holding it is shrinking as we wanted to get rid of that position before holidays.









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
5/25/2017	1.63	1.73	1.65	1.71	1.75	1.75	1.73	1.74	1.76	1.80	1.85	1.84
5/28/2017	1.93	1.73	2.02	1.71	2.15	1.75	1.73	1.74	1.76	1.80	1.85	1.84
5/29/2017	1.93	1.73	2.03	1.71	2.16	1.75	1.73	1.74	1.76	1.80	1.85	1.84
5/30/2017	1.75	1.73	1.85	1.71	1.99	1.75	1.73	1.74	1.75	1.79	1.84	1.83
5/31/2017	1.84	1.73	1.94	1.71	2.09	1.75	1.73	1.74	1.75	1.78	1.83	1.82

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
OK0419	5/18/2017	4/25/2019	96.43	1.91	250	990	253
PS0422	5/18/2017	4/25/2022	97.75	2.73	1000	2297	972
DS0727	5/18/2017	7/25/2027	93.25	3.29	1000	1454	990

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0715	5Y IRS	PS0718	10Y IRS	DS1023
5/25/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
5/28/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
5/29/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
5/30/2017	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
5/31/2017	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
5/25/2017	6.03	6.08	6.35	6.78	6.78	1.88	0.54
5/28/2017	5.90	6.03	6.30	6.73	6.73	1.88	0.54
5/29/2017	6.03	6.05	6.33	6.73	6.73	1.90	0.55
5/30/2017	6.00	6.04	6.25	6.58	6.58	1.88	0.54
5/31/2017	5.78	5.88	6.15	6.48	6.48	1.89	0.55

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
5/25/2017	4.1796	3.7177	3.8289	3.3256	1.3567	0.1581
5/28/2017	4.1803	3.7248	3.8381	3.3550	1.3602	0.1581
5/29/2017	4.1794	3.7371	3.8373	3.3563	1.3569	0.1579
5/30/2017	4.1739	3.7471	3.8326	3.3763	1.3551	0.1575
5/31/2017	4.1737	3.7354	3.8338	3.3701	1.3561	0.1578

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