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Polish Weekly Review

mBank Research
(macro/FI/FX analysis)

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Comment on the upcoming data and forecasts

Week begins with the release of labor market data. Employment growth probably held steady at 4.6% y/y in May, consistent with hiring intentions from various enterprise surveys. Wage growth, on the other hand, surged to 5.6% y/y, due to calendar effects (working day difference swung from -2 to +1 y/y) and low statistical base in manufacturing and construction. The same calendar effects likely boosted industrial output and retail sales growth (to be released on Tuesday). The former likely accelerated to above 9% y/y due to calendar effects and strong energy production. The latter was likely boosted by the rebound in car sales. We judge that base effects from the launch of child subsidy programme (May '16 was the first full month of disbursements) are negligible at this point. First data for June, consumer and business sentiment, will be released on Thursday and Friday, respectively.

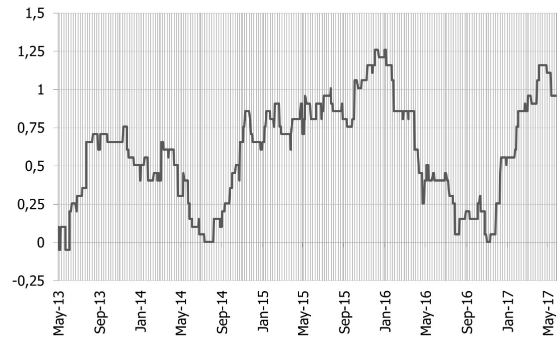
Polish data to watch: June 19th to June 23rd

Publication	Date	Period	mBank	Consensus	Prior
Average gross wage y/y (%)	19.06	May	5.6	4.9	4.1
Employment y/y (%)	19.06	May	4.6	4.6	4.6
Sold industrial output y/y (%)	20.06	May	9.2	8.3	-0.6
PPI y/y (%)	20.06	May	2.7	2.9	4.3
Retail sales y/y (%)	20.06	May	10.2	9.4	8.1
Consumer confidence	22.06	Jun			
Business confidence	23.06	Jun			

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	7/6/2017	600	1.859	6/9/2017
5Y T-bond PS0422	7/6/2017	1000	2.587	6/9/2017
10Y T-bond DS0727	7/6/2017	600	3.128	6/9/2017
30Y T-bond WS0447	-	100	3.508	6/9/2017

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



Comment

Unchanged – no major data releases. Next week brings plenty of them: wages, industrial output, PPI and retail sales. Thus, Polish surprise index will likely move next week.

* 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

- Q1 GDP figures (4.0% y/y) confirmed that the economy is operating on a high gear. However, so far there is little to suggest that it would continue to accelerate. Household consumption will ultimately slow down slightly, as base effects and inflation bite, while the looming acceleration in investment is set to be checked by negative net exports. Therefore, we are comfortable with our current forecast of flat GDP growth path throughout the year. Rapid acceleration in wages or swifter return of private investment are clear, upside risks for 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. The effects of higher domestic seasonal food prices and lower fuel prices will likely cancel each other out. Thus, inflation forecast for 2017 is mostly unchanged so far.
- However, the case for 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 guide, 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 (REER) terms.
- Having said that, there is a constant risk of upward corrections driven either by the repricing of global risk-free rates, or bursts of risk aversion stemming from non-economic news. Heavy positioning (long PLN is clearly a crowded trade) is both a blessing and curse here.

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	2.0	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	6.7	6.0
Repo rate (end of period %)	2.50	2.00	1.50	1.50	1.50	2.25

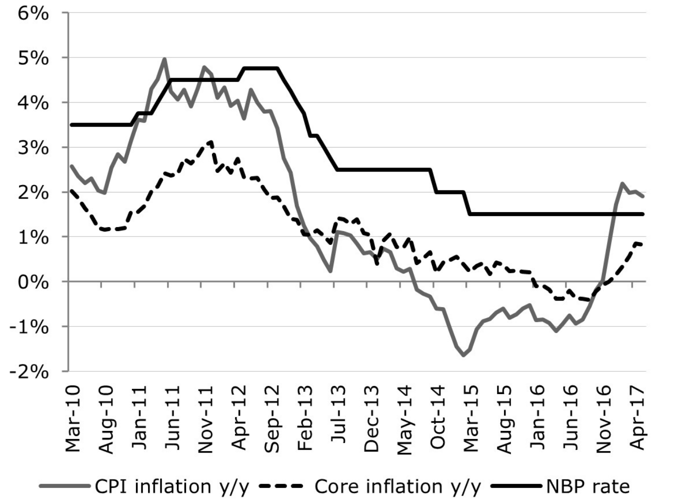
	2017 Q1	2017 Q2 F	2017 Q3 F	2017 Q4 F	2018 Q1 F	2018 Q2 F	2018 Q3 F	2018 Q4 F
GDP y/y (%)	4.0	4.2	4.2	4.2	4.1	3.9	3.8	3.8
Individual consumption y/y (%)	4.7	4.5	4.2	4.0	4.0	3.8	3.8	3.8
Public Consumption y/y (%)	1.0	3.5	3.5	3.5	2.0	3.0	3.0	3.0
Investment y/y (%)	-0.4	5.5	8.0	12.0	10.0	7.0	5.5	5.0
Inflation rate (% average)	2.0	1.9	2.1	2.1	2.1	2.2	2.3	2.4
Unemployment rate (% eop)	8.2	7.0	6.5	6.7	6.9	5.9	5.7	6.0
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

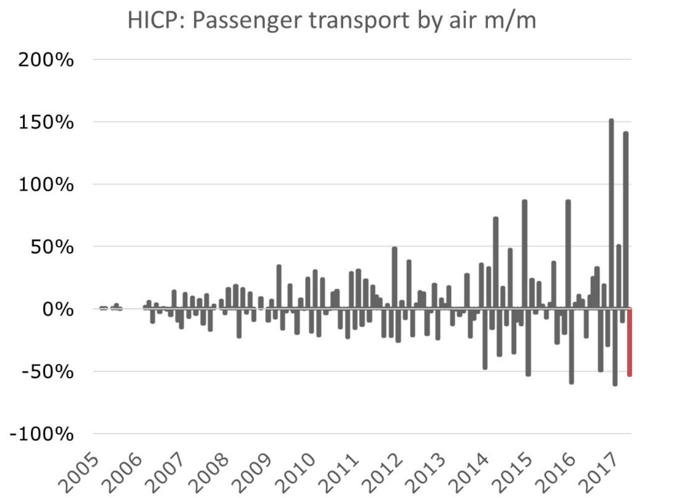
Economics

May CPI confirmed at 1.9% y/y, with curious composition.

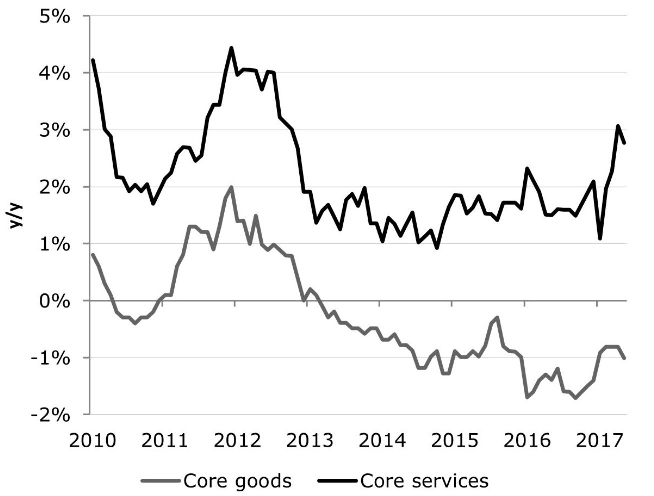
Inflation fell to 1.9% in May, in line with the flash estimate and slightly above our original forecast of 1.8% y/y. In fact, had food prices behaved as we expected, inflation would have fallen to 1.8%. The details of the release are, generally speaking, curious.



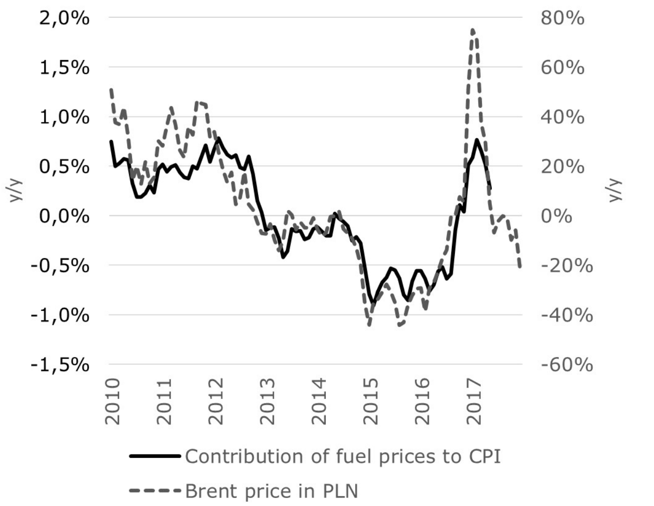
First, food prices increased by 0.8% m/m. Delving into details, our assumptions regarding fruit and vegetable prices were correct (+5.8% and -2.6% m/m, respectively) and the fact that the season begins with higher fruit prices means that this year's overall trajectory should remain high all the way till October. Stronger increases in dairy products, cereals and beverages are surprising and more akin to what we typically see in more volatile Hungarian and Czech data. If those categories behaved as they usually had in Poland, the overall increase in food prices would have been smaller.



Second, core inflation likely fell from 0.9 to 0.8%, but this is an average of a very chaotic set of numbers. Transport services prices fell by 9.1% m/m – the spike in airline fares thus completely reversed itself almost completely (see the graph above). The decline in Healthcare prices (a result of lower drugs prices and slightly higher medical services prices) and Recreation and culture categories also contributed negatively to inflation. On the other hand, communication services prices increased markedly (by 2.4% m/m), followed by Hotels and restaurants, where momentum is slowly but consistently building. Clearly, there is no pattern here, although core services prices are generally rising (except for airline fares), while core good prices are declining. The former, as we've consistently explained, are sensitive primarily to domestic factors, including wage growth and output gap. The latter have come under the disinflationary influence of strong PLN and lower commodity prices.



Third, the decline in fuel prices (by 2% m/m) is not the last in a series. Similar decline will be recorded in June and current trajectory of oil prices suggests that the contribution from fuel prices is set to turn negative in the second half of the year (see the graph below).



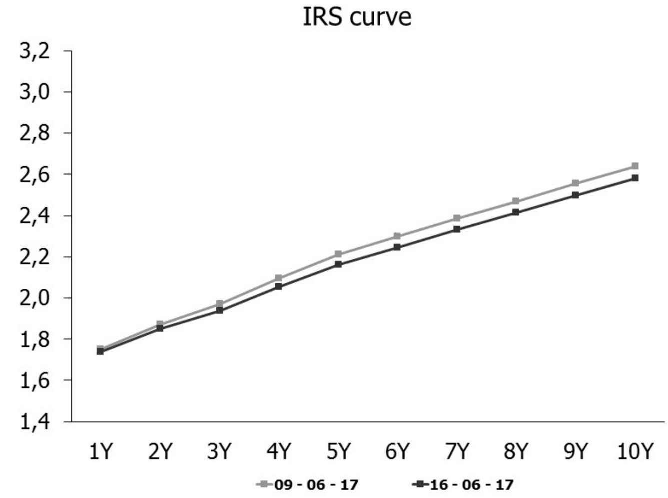
The MPC will see the data as neutral for monetary policy prospects, confirming the long-cherished view of stable inflation within the next few quarters. As long as inflation is not surprising the market to the upside (core inflation in particular – the May reading is clearly a setback here), the market will accept MPC's assurances and price in the first hike in early 2019.

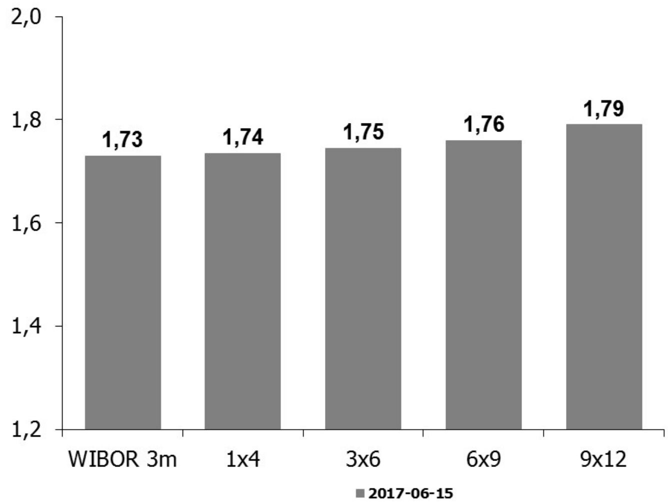
Fixed income

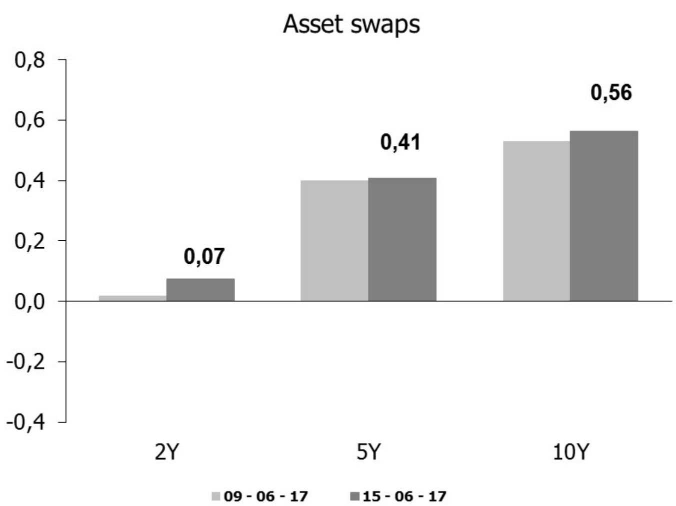
It's all about the (central) banks

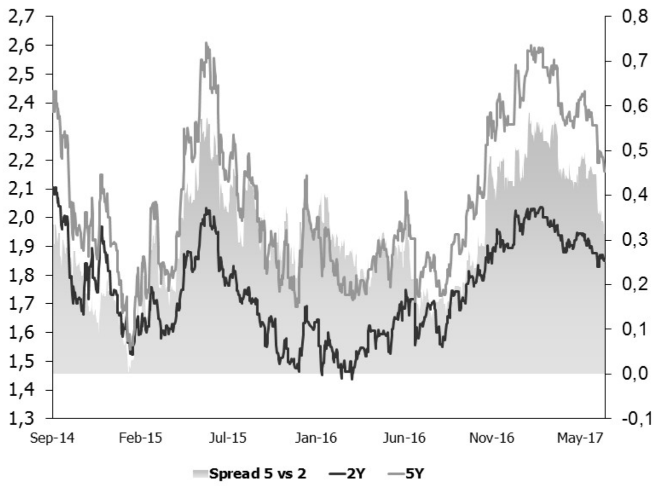
June's Fed decision is behind us and it was hawkish. At the last BoE meeting 3 voters were saying hike. Next week we have a switching auction and it can't be small, if Ministry of Finance doesn't want to cancel any auction during holidays, they need to sell 4 bio at least. If they want to start prefinancing 2018 borrowing needs this year they will have to sell much more. In spite of this, Polish yields are at this year lows.

Bund/DS0727 is 285 bps today, it narrowed 7 bps. The PS0422/DS0727 hasn't moved and is 58 bps, ASW PS0422/5y is at 37 bps and DS0727/10y is at 51 bps. OK0419 is trading at 1,84% (5 bps down), PS0422 is trading at 2,56% (6 bps down) and DS0727 is trading at 3,14% (6 bps down).









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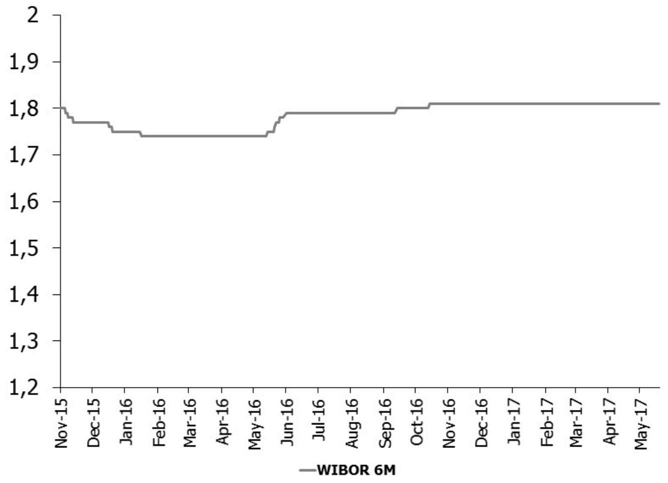
Money market

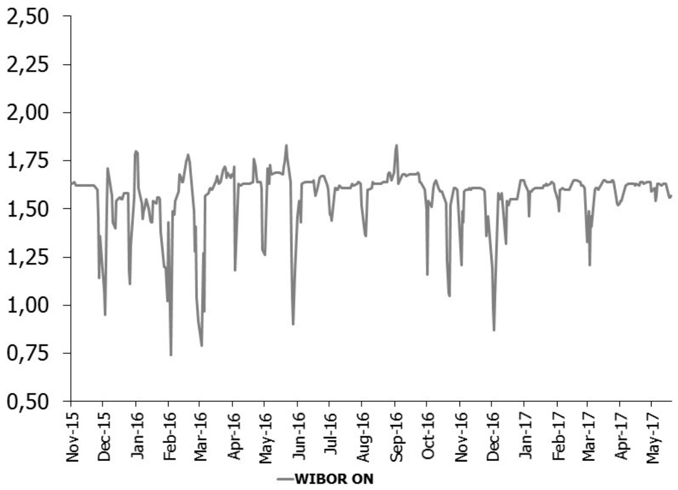
Market believes in stable rates

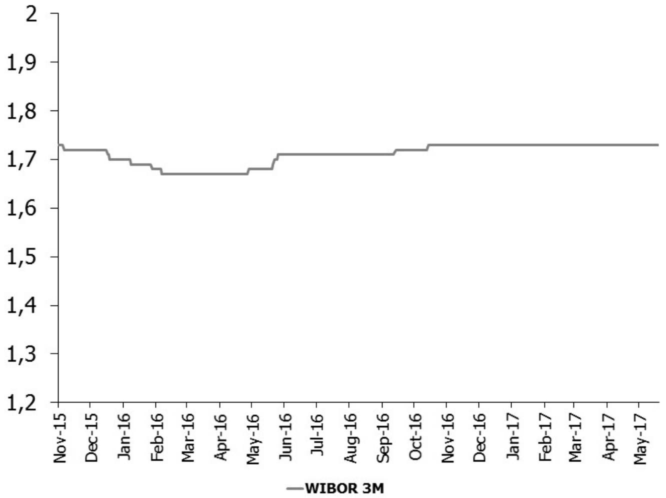
Front end of the curve remains marginally above WIBORs and refuses to move in any direction. That ideally reflects NBP's governor view about stable rates at least till the end of 2018. Globally bullish sentiment pushes bond prices higher via tightening ASW spreads. If bullish sentiment persists, we will see further ASW tightening and curve flattening.

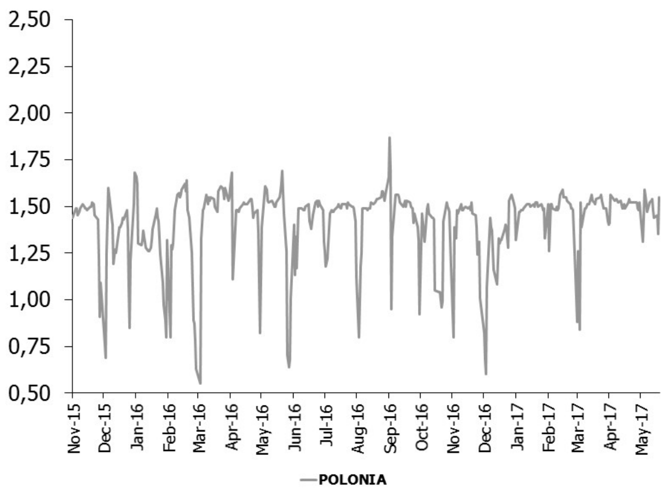
Liquidity stays very thin in overnight. Bank holiday and swings on NBP accounts are to blame. On Tuesday, additional 8 bn PLN suddenly showed up on accounts and smashed Polonia to 1.35. The next day NBP drained the market on an additional OMO sending the overnight rate to 1.55.

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









Forex

Spot – PLN – weaker but still in range. It was the Federal Reserve's decision to raise interest rates and lay out a plan to unwind its balance sheet that pushed global yields higher and PLN tumbled lower in effect. The losses of PLN were intensified by Polish holiday on 15th and the lack of activity of Polish exporters (usually selling the spikes in EUR/PLN) caused EUR/PLN to reach as high as 4.2413 before correcting lower. The move on USD/PLN was even more spectacular as it shot from 3.71 and hit 3.8035. Now (Friday afternoon), after a corrective move, EUR/PLN and USD/PLN are below 4.22 and 3.78, respectively. As usual, we view EUR/PLN as a rangy/technical currency pair, the balance of risks currently pushed the pair's range higher. We still look at 4.1800-4.2500 to cover most of the moves.

EUR/PLN vols – tic lower Although the realized volatility was quite impressive, it didn't impact implied volatility. Investors are mindful of quickly approaching holidays and don't want to pay the theta bill, so there are no buyers of Vega and Gamma. 1 month EUR/PLN ATM is at 5.5% (0.2% lower), 3 months EUR/PLN are 5.75% (0.1% lower) and, finally, 1 year is fixing at 6.4% (unchanged). The currency spread (difference between USD/PLN and EUR/PLN) and the skew are roughly unchanged.

Short-term forecasts

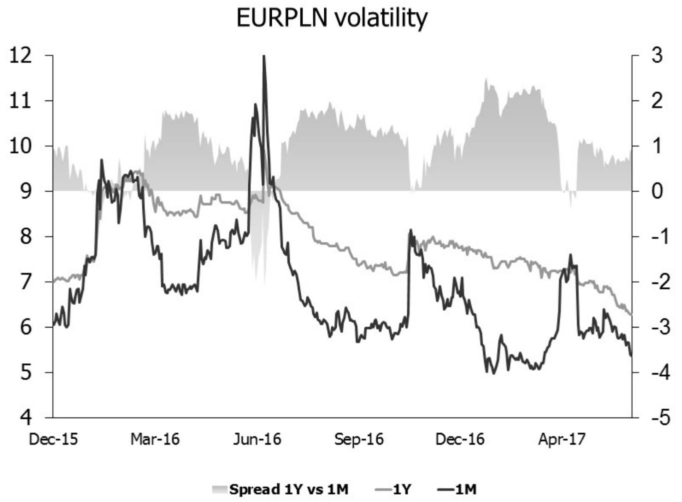
Main supports / resistances:
EUR/PLN: 4.15 / 4.25
USD/PLN: 3.70 / 4.00

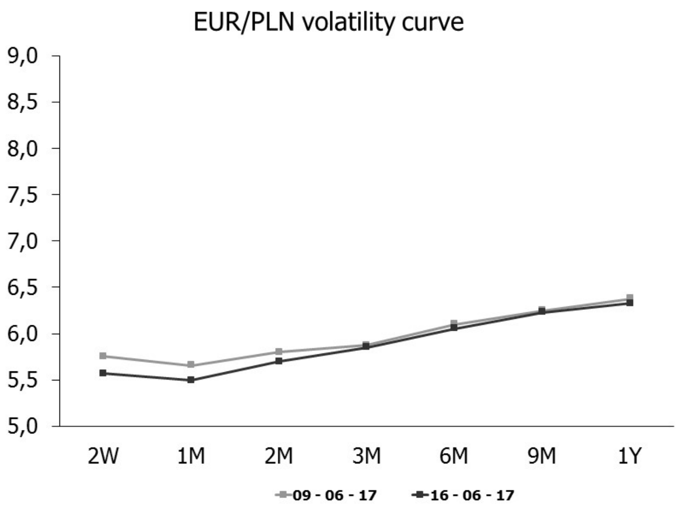
Spot Current position: sidelined.

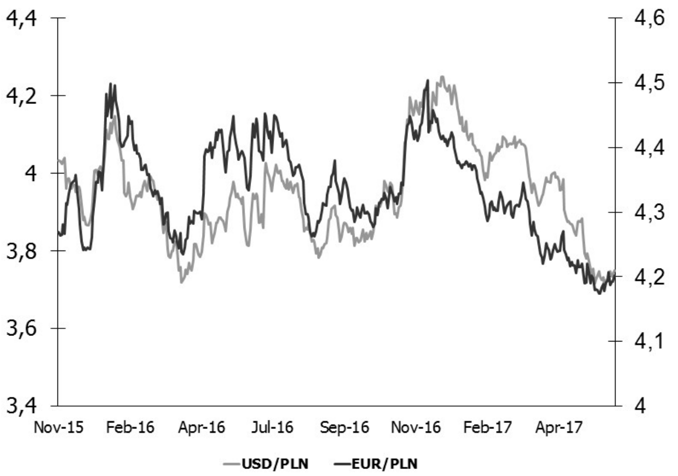
Finally, our long EUR/PLN from 4.2250 and 4.1850 was in the money. Luckily, we have closed it at 4.24 and we are sidelined at the moment. The price action is still not decisive. It is still too early to call it a reversal of the trend. We need convicting weekly close above 4.23/4.25 to make it look more serious. As we believe in rangy nature of PLN, we will try to buy again at 4.18 / 4.20 with stop at 4.1550 and hopes to see 4.24 / 4.26.

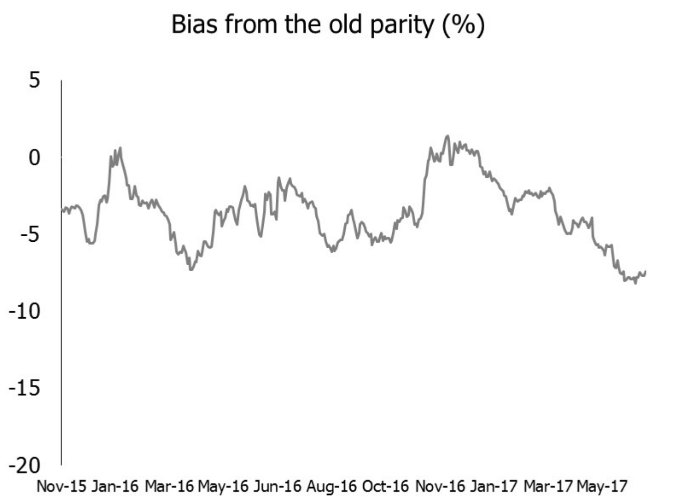
Options Vol – long 3 month and 9 month EUR/PLN.

Our long positions in Vega (3 and 9 month) received some support from weaker PLN. The higher realized volatility makes Theta bills less painful. We still stick to the plan to reducing/liquidating that position before summer vacation begins. All we need is higher vol.









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
6/9/2017	1.63	1.73	1.71	1.71	1.74	1.75	1.73	1.75	1.75	1.79	1.82	1.83
6/12/2017	1.76	1.73	1.89	1.71	2.08	1.75	1.73	1.74	1.75	1.78	1.82	1.83
6/13/2017	1.61	1.73	1.71	1.71	1.75	1.75	1.73	1.74	1.75	1.80	1.82	1.83
6/14/2017	1.56	1.73	1.61	1.71	1.65	1.75	1.73	1.74	1.75	1.77	1.80	1.82
6/15/2017	1.71	1.73	1.84	1.71	2.03	1.75	1.74	1.75	1.76	1.79	1.80	1.81

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	6/9/2017	4/25/2019	96.62	1.86	600	1505	500
PS0422	6/9/2017	4/25/2022	98.47	2.59	1000	1811	1085
DS0727	6/9/2017	7/25/2027	94.61	3.13	600	944	640

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0715	5Y IRS	PS0718	10Y IRS	DS1023
6/9/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
6/12/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
6/13/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
6/14/2017	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
6/15/2017	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
6/9/2017	5.65	5.88	6.10	6.38	6.38	1.90	0.56
6/12/2017	5.65	5.81	6.08	6.33	6.33	1.90	0.56
6/13/2017	5.40	5.78	6.00	6.28	6.28	1.90	0.56
6/14/2017	5.35	5.78	6.00	6.28	6.28	1.88	0.55
6/15/2017	5.50	5.85	6.05	6.33	6.33	1.88	0.54

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
6/9/2017	4.1877	3.7465	3.8566	3.3947	1.3603	0.1597
6/12/2017	4.1927	3.7350	3.8612	3.3954	1.3628	0.1600
6/13/2017	4.1921	3.7379	3.8667	3.3941	1.3651	0.1599
6/14/2017	4.2025	3.7497	3.8702	3.4031	1.3715	0.1605
6/15/2017	0.0000	0.0000	3.8702	3.4031	1.3715	0.1605

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