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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 Monday, the NBP will release and present its latest Inflation Report (the MPC has already been briefed on it - see our comment in the Economics section). On Tuesday, the CSO will publish final CPI data for June. We expect it to confirm the flash reading of 1.5% – we believe that the decline is attributable to low fuel and food prices (see the Economics section for a more detailed analysis), with core inflation ticking up a bit. The latter should be officially confirmed on Wednesday. On Friday, the NBP will release balance of payments data for May. We expect a rebound in exports and imports, leading to a modest trade deficit. The overall C/A balance is set to remain slightly below zero.

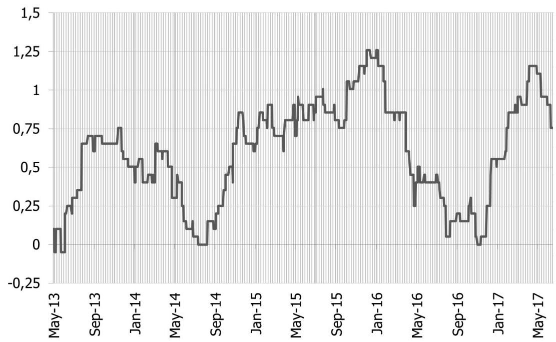
Polish data to watch: July 10th to July 14th

Publication	Date	Period	mBank	Consensus	Prior
Inflation report	10.07	Jul			
CPI y/y *final* (%)	11.07	Jun	1.5	1.5	1.5
Core CPI y/y (%)	12.07	Jun	0.9	0.8	0.8
Current account (mio EUR)	14.07	May	-163	-247	-275
Exports (mio EUR)	14.07	May	15800	16083	15176
Imports (mio EUR)	14.07	May	16200	16182	15090

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	8/3/2017	600	1.859	6/9/2017
5Y T-bond PS0422	8/3/2017	1000	2.587	6/9/2017
10Y T-bond DS0727	8/3/2017	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

Sharply down after last Friday's CPI surprise. Next week brings only final CPI data – it is unlikely that the flash reading will be revised.

* 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	4.0	4.0
CPI Inflation y/y (average %)	0.9	-0.1	-0.9	-0.6	1.9	2.2
Current account (%GDP)	-1.2	-2.1	-0.6	-0.2	-0.9	-1.1
Unemployment rate (end of period %)	13.4	11.4	9.8	8.3	6.8	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	3.8	4.0	4.3	3.8	4.0	4.0	4.0
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	2.0	2.5	3.0	4.0	3.0	3.0	3.0
Investment y/y (%)	-0.4	4.5	7.0	12.0	12.0	11.0	8.0	7.0
Inflation rate (% average)	2.0	1.8	1.9	1.8	1.4	2.1	2.4	2.7
Unemployment rate (% eop)	8.2	7.1	6.6	6.8	6.8	6.0	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	1.90	2.09	2.22	2.41	2.66	2.84	2.97
10Y Polish bond yields (% eop)	3.49	3.32	3.55	3.70	3.92	4.20	4.42	4.57
EUR/PLN (eop)	4.23	4.23	4.15	4.10	4.10	4.10	4.08	4.05
USD/PLN (eop)	3.97	3.70	3.77	3.80	3.80	3.73	3.64	3.55

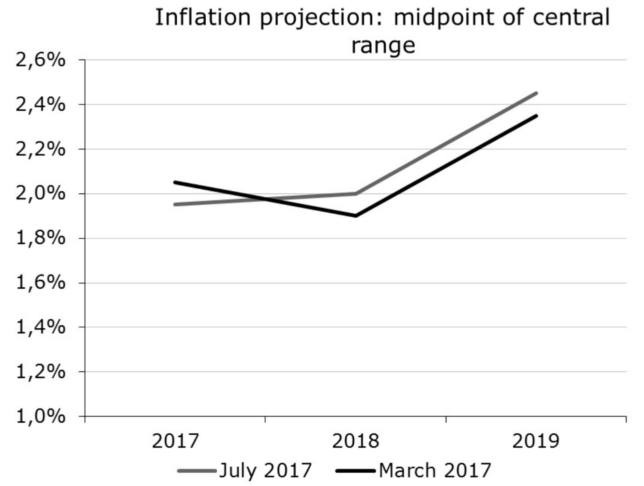
F - forecast

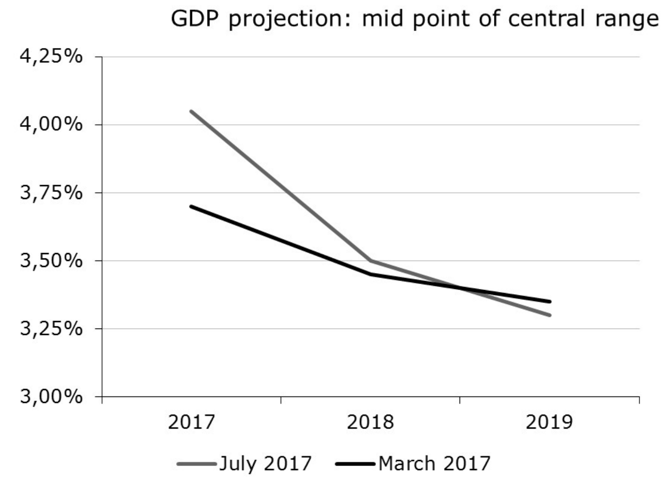
Economics

No surprises from the MPC and still no rush to hike rates, either

July meeting of the Monetary Policy Council brought no changes to interest rates, just as widely expected. The minor alterations to the MPC's post-meeting statement do not change its key message. The Council still maintains that "the risk of inflation running persistently above the target in the medium term is limited".

Governor Glapinski's press conference also unfolded in line with expectations, as it was dominated by comments about lack of macroeconomic imbalances, GDP growth being close to potential, stable inflation and modest growth in unit labor costs. The governor's own forecast of rates stable throughout 2018 was reiterated.



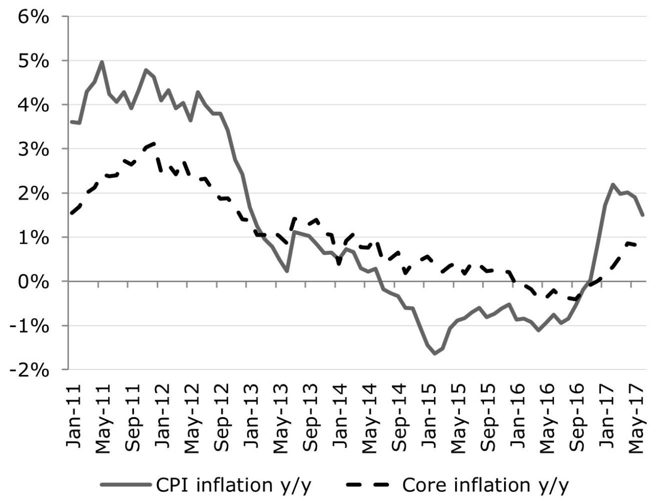


The NBP's latest staff projections support such a view. The NBP raised its 2017 GDP growth forecast substantially, likely due to higher starting point and stronger consumer spending, while 2018 and 2019 forecasts were changed only slightly (up and down, respectively). CPI projections for 2017 were revised down to account for the latest decline in fuel prices, but the 2018-2019 trajectory of inflation was shifted slightly upward. On one hand, this is a tacit admission that core inflation is trending up and growing faster than expected (lower output gap and higher wage growth also feeding into core inflation in NBP's models). On the other hand, by keeping energy and food prices path flat, the NBP signals that it will look through any external supply shocks and focus on domestic inflationary pressures. Regardless of these considerations, the newest projections offer a perfect justification for monetary policy inaction. Inflation will return to target on its own, while growth is set to moderate in 2018 and 2019, reducing the likelihood of higher inflation later on.

Thus, it is of little surprise that governor Glapinski expects the Council to start discussing rate hikes in the latter half of 2018. Markets so far agree with his assessment and price in the first hike at the beginning of 2019. This equilibrium, both in the FI market and in the policymakers' minds, can only be substantially changed if core inflation or its correlates deviate from its forecasted path in the coming months.

June inflation surprised to the downside

According to the flash release, Polish headline CPI dropped on a yearly basis in June, from 1.9% to 1.5%, significantly lower than market consensus (1.7%). As always, we need to wait until final reading for the details, however, we think that food prices are to blame here. We were expecting a rise by 0.8% m/m after the spikes of meat and fats prices (the latter visible also in other European countries), whereas typically for this month one should expect a small drop of around 0.2-0.3%. Core inflation should have risen to 0.9% y/y.



Currently, 1.5% is the lowest value we expect in the upcoming months (except at year end due to uncertainty about fuel prices path). Note that Polish inflation's sensitivity to oil prices goes both ways. We judge that if oil prices rose by 10% from the current levels, inflation would exceed 2.5% in the autumn.

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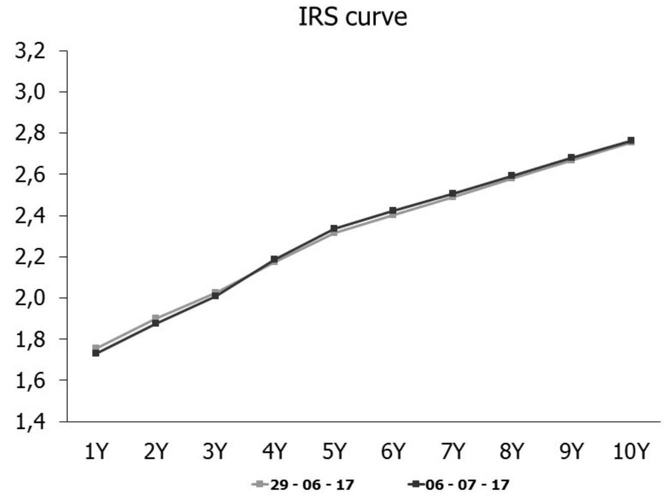
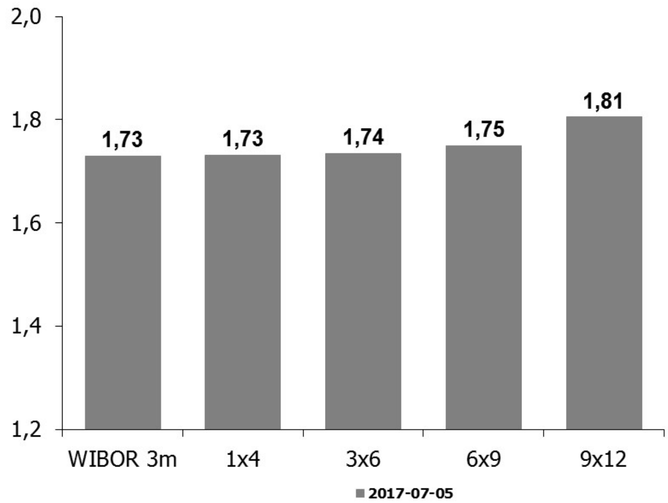
Fixed income

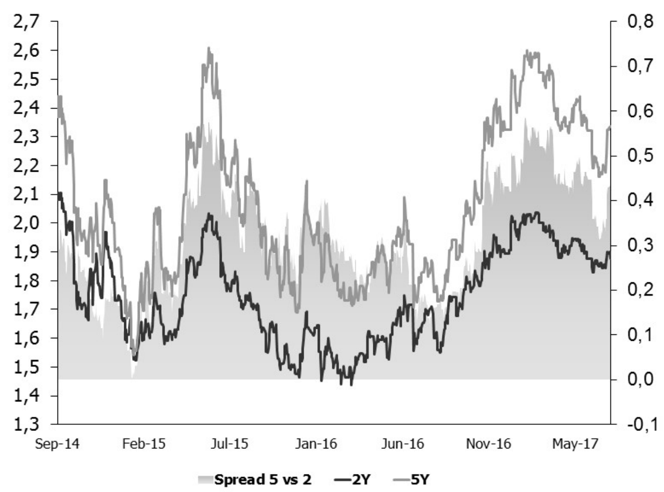
Bears are back

After the ECB suggested it might start some kind of gradual retreat from its market stimulus, the broadly expected run for higher yields in Europe rapidly emerged. Despite the lack of auctions in July, PLN long end of the yield curve went up by around 10 bps in 2 days, following the core markets move. ASWs are tight due to lack of T-bond auctions in July and pretty good budget conditions. The 5y benchmark (PS0422) vs. 5y IRS is around 28 points (huge 10bps move), DS0727 vs 10y IRS is around 48. It is hard to imagine they could tighten further, even though both credit and economic data favor bonds.

Technical analysis indicates that we broke important levels like 2.40 on the 5y swap and 3.85 on 10y. That might suggest reversal of the trend, although it might be a false break so we suggest to be cautious here and stay neutral for few days.







Money market

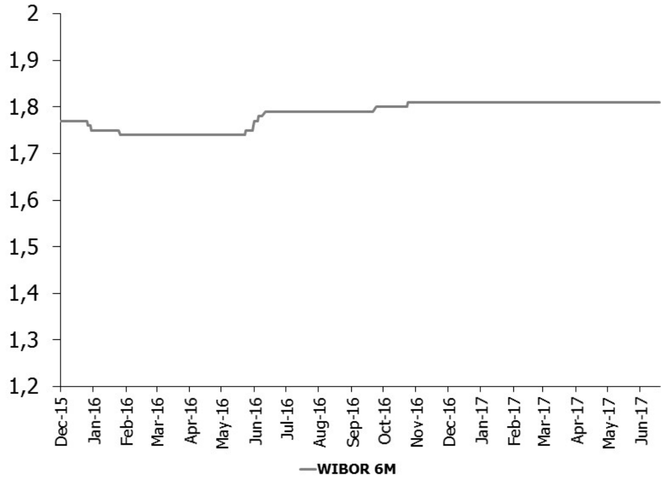
MPC overshadowed by global and local stories

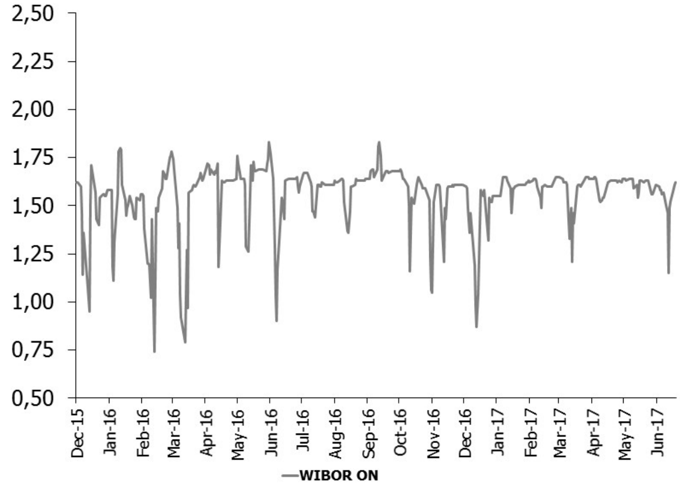
NBP left rates unchanged, which was widely expected by market paticipants. At the press conference governor Glapinski reitaraited, that in his personal opinion rates should stay flat until the end of 2018. More important, though, were other participants, who stated their concerns about leaving rates too low for too long. They raised concerns about negative real rates causing bubbles and encorauging people to withraw deposits from banks in a hunt for riskier assets. Looks like the discussion over rates in the MPC started. Governor Glapinski emphasized that leaving rates flat until end of 2018 is his personal view and other members might have different opinions.

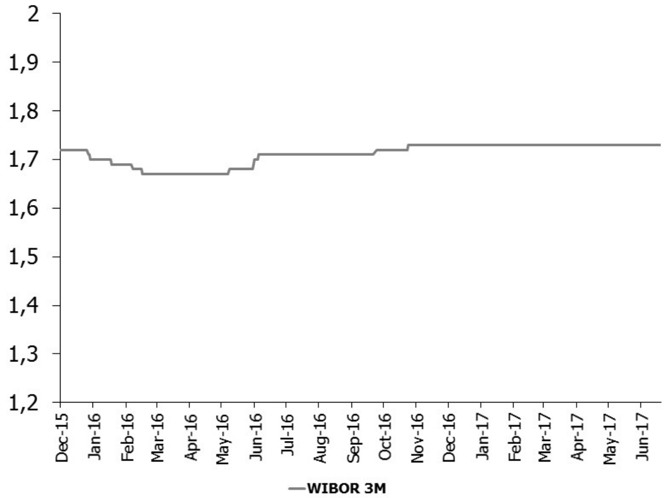
On the core markets we have a major rise in yields, with Europe leading the sell-off. Yield on the 10y Bund reached highest levels since January 2016, breaking through recent range. Polish bonds are being also dragged down with by the huge steepening tendency. There is a story on the market regarding short bonds. It states that local banks will be forced to replace July redemptions on secondary market until the end of the month.

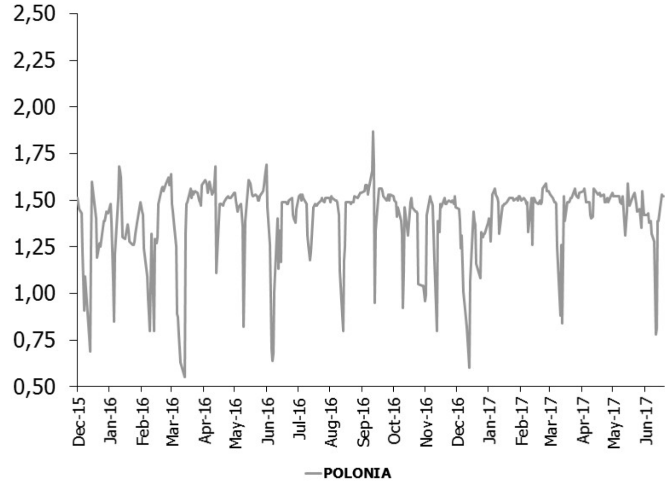
Nothing new on the overnight market. Funding rate stays slightly above reference rate, as usually at the beginning of the month.

Ref rate vs Polonia averages:
30 day 10 bp
90 day 3 bp





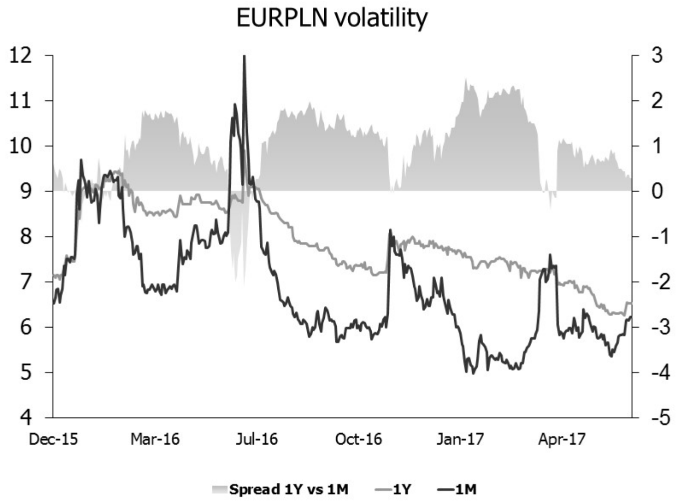




Forex

Spot – PLN – range trading continues EUR/PLN was still treading water, once again the price action was boxed in a tight, 4.22-4.2530 range. We see a bigger risk of breakout of the current range to the upside. Technically, one may point to the higher lows pattern as confirmation of an upside trend. In our view, EUR/PLN needs to decisively breach the 4.25-4.27 resistance zone to confirm that. On the upside, 4.28 is the target and then, 4.30/32. Nevertheless, it would not be a straight line, the rangy nature of EUR/PLN is not to be forgotten.

EUR/PLN vols – tic higher Slightly weaker PLN and positioning were the reasons why the vols kept on creeping higher. The gains are cosmetic, and we need higher realized volatility and/or weaker PLN to support that gains. 1 month EUR/PLN ATM is at 6.25% (0.15% higher), 3 month EUR/PLN is 6.3% (0.2% higher) and, finally, 1 year is fixing at 6.60% (0.1% higher). The currency spread (difference between USD/PLN and EUR/PLN) is around 3.5% (USD/PLN vol is higher), the skew is roughly the same.



Short-term forecasts

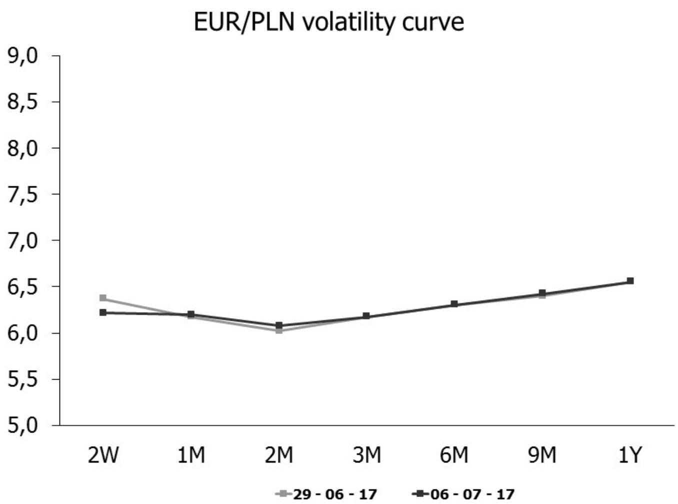
Main supports / resistances:
EUR/PLN: 4.20 / 4.30
USD/PLN: 3.70 / 4.00

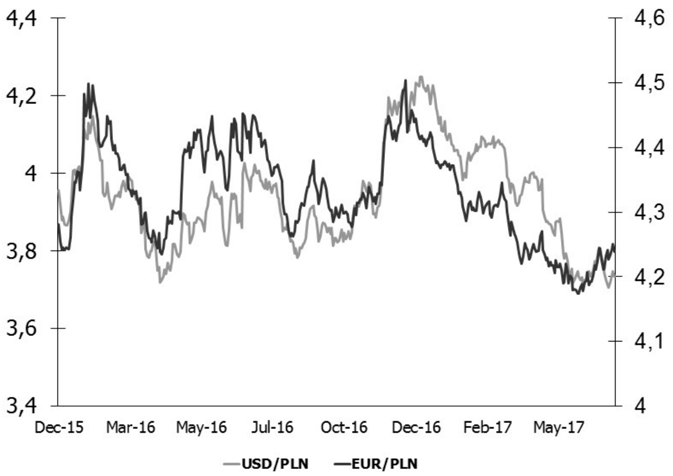
Spot Current position: Long EUR/PLN at 4.2150.

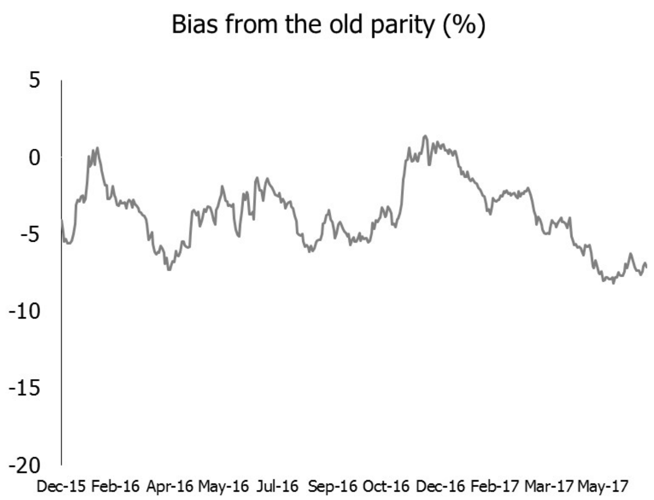
We have reestablished our long at 4.2150, we are ready to add at 4.1850 with 4.1600 stop, hope to see 4.26+ and, eventually, 4.30. We have decided to put our toe again in the water, the logic is unchanged: dovish MPC, and historically attractive entry level.

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.







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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
6/29/2017	1.79	1.73	1.60	1.71	1.80	1.75	1.73	1.74	1.78	1.82	1.89	1.85
7/2/2017	1.73	1.73	1.81	1.71	1.98	1.75	1.73	1.74	1.77	1.83	1.88	1.86
7/3/2017	1.71	1.73	1.81	1.71	1.99	1.75	1.73	1.74	1.76	1.80	1.84	1.83
7/4/2017	1.54	1.73	1.59	1.71	1.63	1.75	1.73	1.74	1.75	1.80	1.86	1.83
7/5/2017	1.76	1.73	1.89	1.71	2.08	1.75	1.73	1.74	1.75	1.81	1.87	1.83

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
6/29/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
7/2/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
7/3/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
7/4/2017	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
7/5/2017	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
6/29/2017	6.18	6.18	6.30	6.55	6.55	1.81	0.54
7/2/2017	6.15	6.13	6.30	6.53	6.53	1.81	0.54
7/3/2017	6.23	6.15	6.30	6.53	6.53	1.80	0.55
7/4/2017	6.23	6.18	6.30	6.53	6.53	1.81	0.55
7/5/2017	6.20	6.18	6.30	6.55	6.55	1.80	0.54

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
6/29/2017	4.2412	3.7122	3.8791	3.2979	1.3679	0.1612
7/2/2017	4.2265	3.7062	3.8667	3.3128	1.3689	0.1611
7/3/2017	4.2331	3.7196	3.8735	3.2951	1.3706	0.1621
7/4/2017	4.2428	3.7372	3.8752	3.3019	1.3764	0.1624
7/5/2017	4.2501	3.7471	3.8780	3.3002	1.3797	0.1625

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