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Polish Weekly Review

mBank Research
(macro/FI/FX analysis)

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Comment on the upcoming data and forecasts

Busy week ahead of us. This 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. On Monday Ministry of Finance will publish information about budget performance data after June. Unofficial data indicates that the first half of the year ended with significant surplus 2-5 bio PLN, mainly because of payment of historically high NBP's profit. Tuesday brings us labour market data. We expect that wages continue to grow steadily above 5% on a yearly basis, while yearly growth of employment dropped slightly (from 4.5% to 4.4%) due to base effect, monthly change should still be impressive. On Wednesday real sphere data will be published. Our forecasts indicate that industrial production grew in June by 4.4% (huge drop from 9.1% in May), because of base effects and normalization in energy production. Calendar effects influenced retail sales reading, which should drop from 8.4% in May to 6.5% in June on a yearly basis. We expect a rebound in construction production driven by weather normalization. Producer price index is set to fall on a yearly basis once again after a drop in oil prices. Finally, next Friday NBP will publish M3 data, which should decelerate further. Publication of this aggregate has been shifted by few days towards the end of the month.

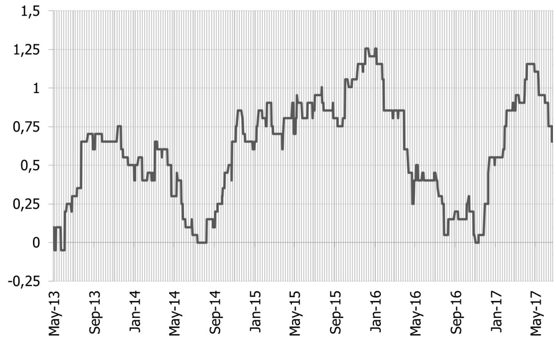
Polish data to watch: July 14th to July 21st

Publication	Date	Period	mBank	Consensus	Prior
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
Average wage y/y (%)	18.07	Jun	5.2	5.0	5.4
Employment y/y (%)	18.07	Jun	4.4	4.3	4.5
Industrial production y/y (%)	19.07	Jun	4.4	3.9	9.1
Retail sales y/y (%)	19.07	Jun	6.5	6.8	8.4
PPI y/y (%)	19.07	Jun	1.9	2.2	2.5
Money supply M3 y/y (%)	21.07	Jun	5.7	5.9	5.2

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	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

Unchanged after final CPI confirmed flash reading. Next weeks brings plenty of opportunities to surprise with labour market and real sphere data.

* 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

- 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	3.9	4.1
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	2.00

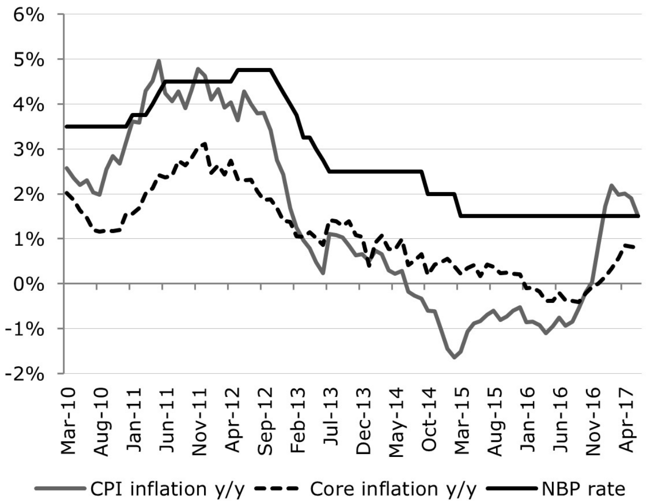
	2017 Q1	2017 Q2 F	2017 Q3 F	2017 Q4 F	2018 Q1 F	2018 Q2 F	2018 Q3 F	2018 Q4 F
GDP y/y (%)	4.0	3.8	3.8	3.9	4.0	4.0	4.2	4.2
Individual consumption y/y (%)	4.7	4.6	4.2	4.0	4.0	3.8	3.8	3.8
Public Consumption y/y (%)	1.0	2.0	2.5	3.0	4.0	3.0	3.0	3.0
Investment y/y (%)	-0.4	3.8	7.0	10.0	10.0	10.0	10.0	9.0
Inflation 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	1.50	1.75	2.00
Wibor 3M (% eop)	1.73	1.73	1.73	1.73	1.73	1.73	1.98	2.23
2Y Polish bond yields (% eop)	2.01	1.90	2.03	2.09	2.22	2.41	2.66	2.84
10Y Polish bond yields (% eop)	3.49	3.32	3.48	3.58	3.73	3.95	4.23	4.45
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

June inflation confirmed at 1.5% y/y. Core inflation stabilized at 0.8% y/y.

June inflation was 1.5% y/y, in line with the flash estimate, but below almost all forecasts (consensus 1.8%). The final release also points to the reasons for this disappointment. In our comment to the flash release, we indicated that low food prices were the most likely culprit and our hypothesis was only partly substantiated by the data. Food prices increased by 0.1% m/m in June, far below our original forecast of +0.8% (no sign of higher meat prices in CSO's data), but somewhat above the typical seasonal reading of -0.2-0.3% m/m. Fuel prices fell by 4.1% – no surprises were noted here.



This means that lower core inflation is also to blame for the surprise in the CPI. Inflation net of energy and food prices stabilized at 0.8% instead of rising to 0.9% y/y, but its structure is (just as in the previous month) messy. In general, consumer services prices increased in June (health, transport, package holidays, hotels, restaurants and miscellaneous categories like hairdressers), while core consumer goods typically declined in price (clothing, passenger cars, various small-weight items). This should not come as surprise – as we indicated multiple times, consumer goods and consumer services are influenced by a different set of factors. The former, over the short term, is driven my exchange rate, global prices and commodity – all of them have been pushing prices downwards. The latter are driven by labour costs and output gap and the fact that most of them are labour-intensive is an indirect confirmation of this.

We reiterate our opinion that June's 1.5% marks the local bottom in inflation. In the coming months inflation will be lifted by higher food prices (the impact of cold Spring will be felt in seasonal fruit and vegetables) and rising core inflation. The new special fee on fuels (0.2 PLN per litre), proposed by the parliament recently, would lift fuel prices by 5%, neutralize the year-end statistical base in that category and push inflation to 2.3-2.4% in October and November.

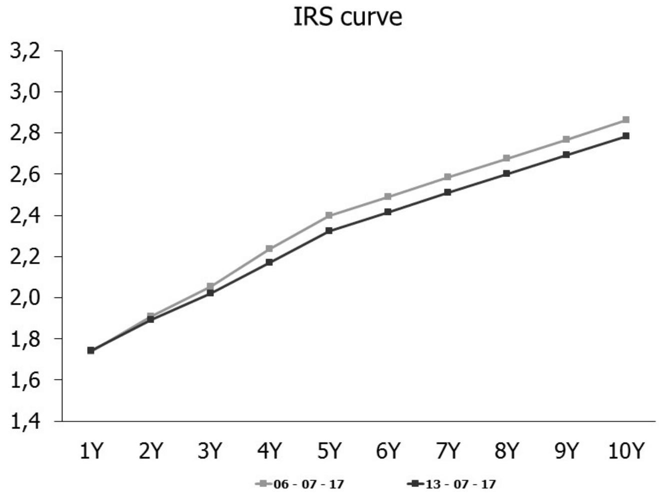
The MPC will see June inflation data as broadly neutral – right now the Council is under the influence of a new inflation projection that fully supports its view of stable rates throughout 2017 and 2018. However, even though the bump in inflation caused by the new fuel fee will largely be ignored (there's a reason why central banks often look at inflation adjusted for the impact of changes in indirect taxes), the market might feel differently and shift its expectations of monetary tightening forward, from today's very optimistic early 2019.

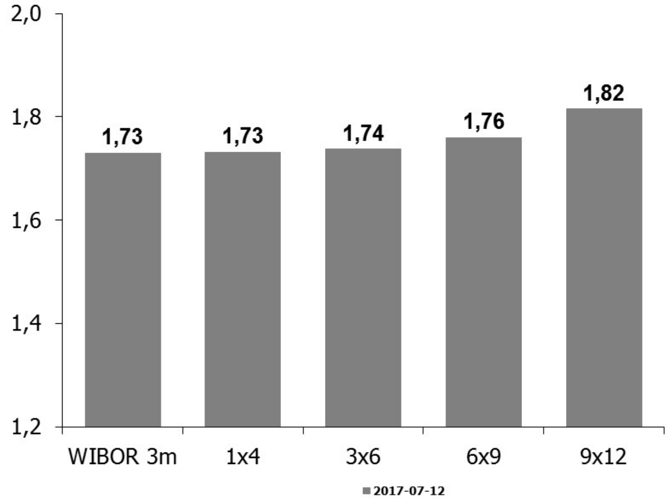
Fixed income

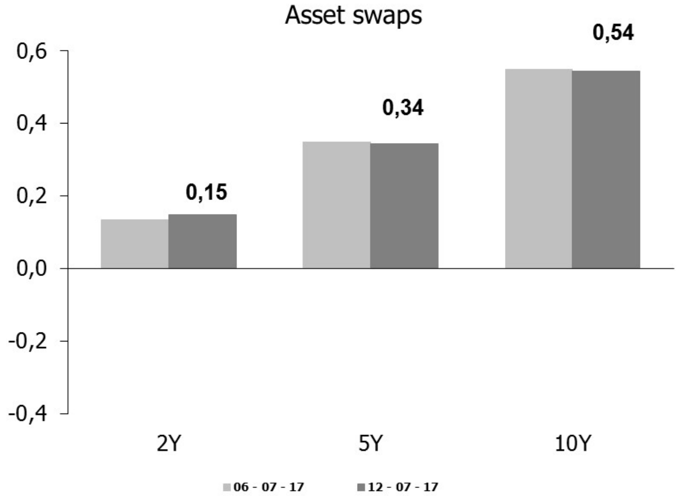
What will the market do?

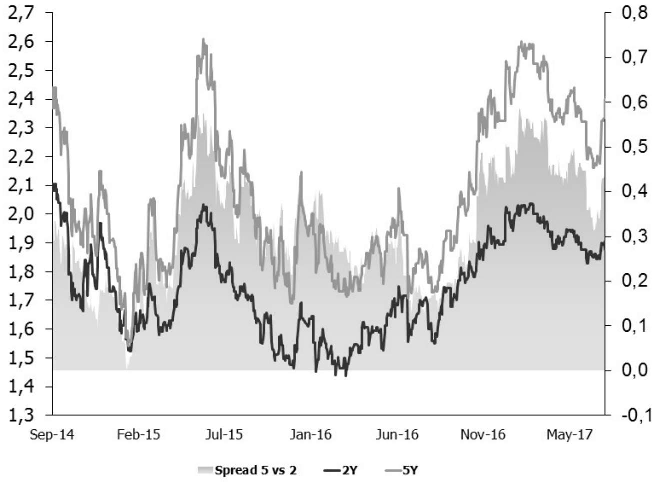
Polish market is following core markets but nothing special has happened on POLGBs. We are trading in a narrow range 30-40bps on the long term. Despite the lack of auctions in July, PLN belly and long-end of the yield has frozen. ASWs are tight due to lack of T-bond auctions in July and pretty good budget conditions. PS0422/5y is trading at 30 bps and DS0727/10y at 52 bps. At the moment it is hard to imagine they could tighten further, even though both credit and economic data favour bonds. 2y benchmark OK0419 is trading at 1.75%, 5y benchmark PS0422 at 2.66% and 10y benchmark DS0727 at 3.33%. The PS0422/DS0727 spread is 66 bps, as curve 2 bps steepened.

Technical analysis indicates that we broke important levels like 2.35 on the 5y swap and 3.80 on 10y, although it might be a false break.









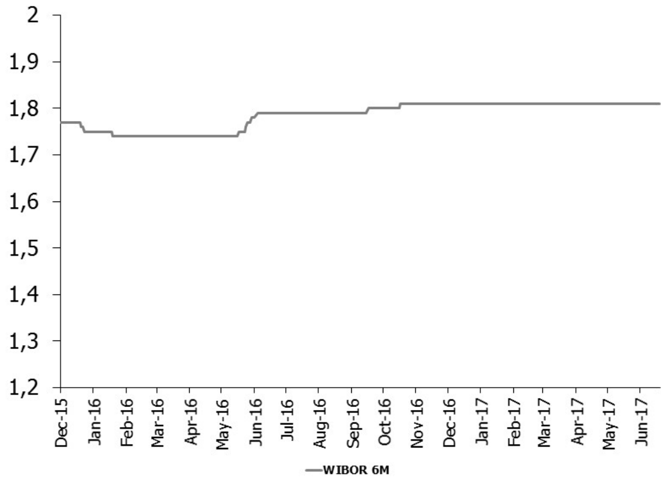
Money market

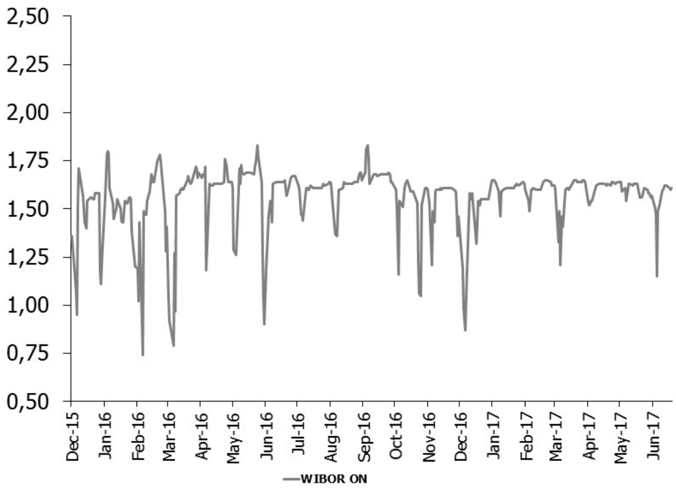
Fearsome negative real interest rates?

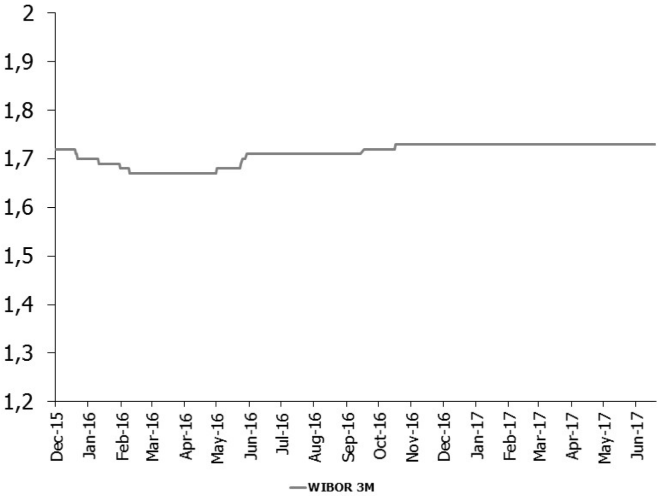
As we wrote last week, a discussion about real rates emerges in MPC. This week two members (Mr Gatnar and Mr Hardt) raised their concerns about negative real rates staying for an extended period of time. They are afraid of potential harmful effect on household deposits and expressed their readiness to hike rates as soon as 2017/2018. Although this scenario has low probability, we think that paying front-end swaps, FRAs close to WIBOR is a very cheap hedge/bet.

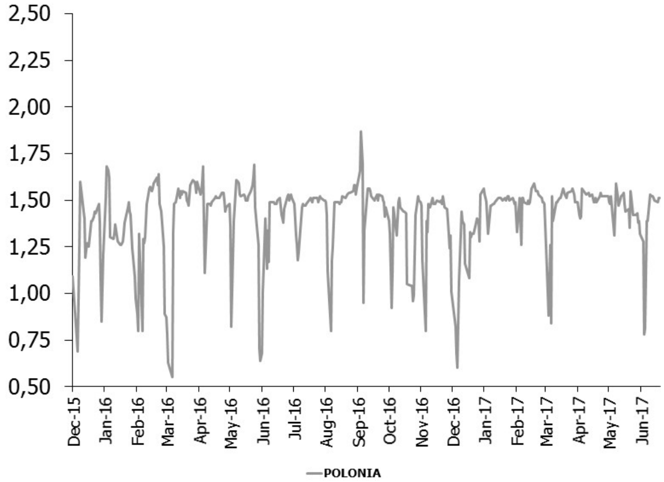
Ordinary week on liquidity. Flows remain small and overnight rate stays in a tight range.

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









Forex

Spot – PLN – range trading continues The testimony from U.S. Federal Reserve chair Janet Yellen, which was taken as dovish, failed to produce much of a volatility in the PLN. EUR/PLN was still treading water, once again the price action was boxed in a tight range, 4.2280-4.2495. We see a bigger risk of breakout from the current range to the upside. Especially in the environment when the Fed is still planning to raise rates and begin winding down its balance sheet as well as there is speculation that the ECB would begin reversing its very easy monetary policy sooner rather than later. Nevertheless, we still believe in the rangy nature of EUR/PLN. We still look for 4.2050-4.2550 to cover most of the moves.

EUR/PLN vols – a little lower The EUR/PLN vol curve melted a little as spot was really calm and there is no certain volatility trigger on the horizon. EUR/PLN ATM mid is today 5.8% (0.45% lower), 3 month is 6.0% (0.3% lower) and, finally, 1 year fixed at 6.3% (0.3% lower). The skew is better offered, especially in the mid curve. The currency spread (difference between USD/PLN and EUR/PLN) is also lower and fixed at 3.0% (USD/PLN vol is higher).

Short-term forecasts

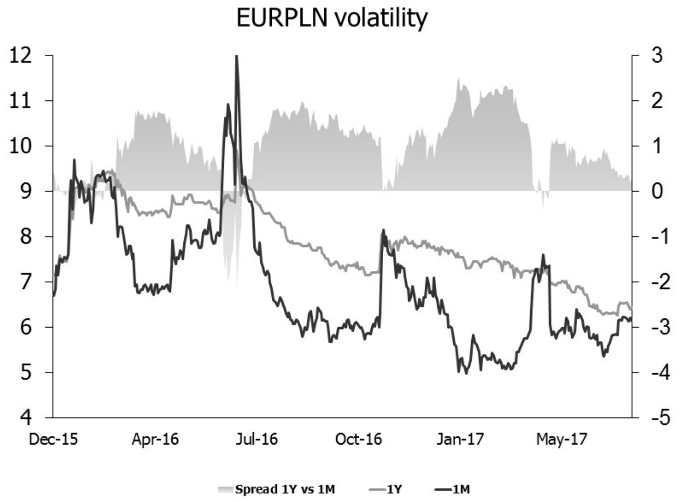
Main supports / resistances:
EUR/PLN: 4.20 / 4.30
USD/PLN: 3.60 / 3.90

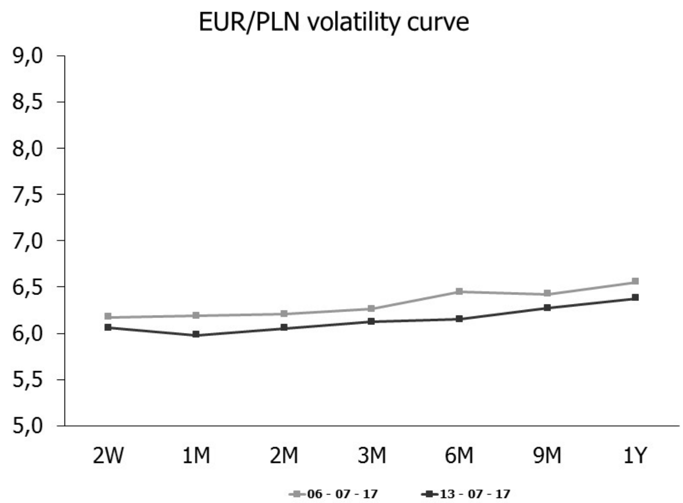
Spot Current position: Long EUR/PLN at 4.2150.

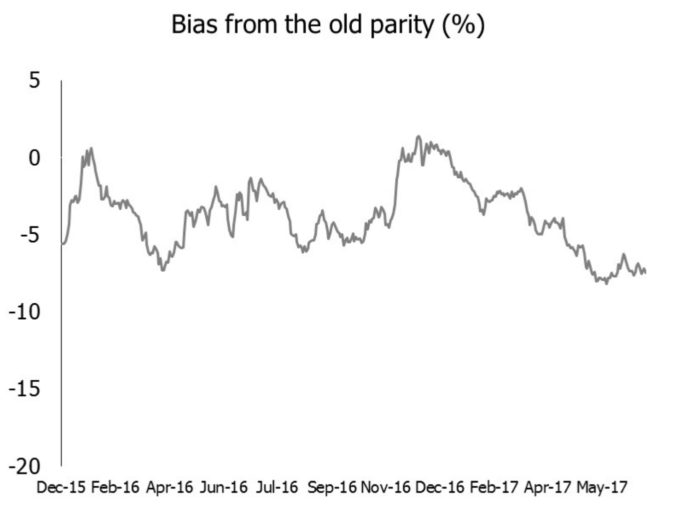
We have reestablished our long at 4.2150, we are ready to add at 4.1850 with 4.1600 stop, hope to see 4.26+ and, eventually, 4.30. We have decided to put our toe again in the water, the logic is unchanged: dovish MPC, and historically attractive entry level.

Options Vol – tactical long

We reduced some vega position but still have small tactical long in mid curve Vega. The market is not really moving, we are in very tight price ranges. In the bigger picture, we are much more keen to enter bigger long Vega trade, but timing is key. For now we are sticking to our small tactical long.







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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
7/6/2017	1.68	1.73	1.80	1.71	1.98	1.75	1.73	1.74	1.75	1.81	1.86	1.84
7/9/2017	1.72	1.73	1.76	1.71	1.79	1.75	1.73	1.74	1.76	1.82	1.89	1.84
7/10/2017	1.72	1.73	1.76	1.71	1.80	1.75	1.73	1.74	1.76	1.82	1.89	1.84
7/11/2017	1.55	1.73	1.68	1.71	1.87	1.75	1.73	1.74	1.76	1.81	1.89	1.84
7/12/2017	1.62	1.73	1.83	1.71	2.02	1.75	1.73	1.74	1.76	1.82	1.85	1.85

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
7/6/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
7/9/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
7/10/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
7/11/2017	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
7/12/2017	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
7/6/2017	6.19	6.26	6.45	6.55	6.55	1.82	0.54
7/9/2017	6.13	6.18	6.25	6.48	6.48	1.82	0.54
7/10/2017	6.21	6.26	6.33	6.39	6.39	1.81	0.54
7/11/2017	6.13	6.23	6.25	6.43	6.43	1.81	0.55
7/12/2017	5.98	6.13	6.15	6.38	6.38	1.81	0.54

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
7/6/2017	4.2388	3.7351	3.8688	3.2994	1.3721	0.1622
7/9/2017	4.2337	3.7068	3.8525	3.2586	1.3732	0.1621
7/10/2017	4.2348	3.7160	3.8521	3.2545	1.3755	0.1622
7/11/2017	4.2435	3.7235	3.8446	3.2573	1.3769	0.1622
7/12/2017	4.2432	3.7034	3.8442	3.2649	1.3793	0.1624

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