July 20, 2017

Polish Weekly Review

mBank Research
(macro/FI/FX analysis)

@mbank_research

Ernest Pytlarczyk, PhD, CFA
chief economist
tel. +48 22 829 01 66
ernest.pytlarczyk@mbank.pl

Marcin Mazurek, PhD
senior analyst
tel. +48 22 829 01 83
marcin.mazurek@mbank.pl

Piotr Bartkiewicz
senior analyst
tel. +48 22 526 70 34
piotr.bartkiewicz@mbank.pl

Karol Klimas
analyst
tel. +48 22 829 02 56
karol.klimas@mbank.pl

Department of Financial Markets
(business contacts)

Wojciech Dunaj
head of interest rates trading
tel. +48 22 829 07 51
wojciech.dunaj@mbank.pl

Marcin Turkiewicz
head of fx trading
tel. +48 22 829 01 67
marcin.turkiewicz@mbank.pl

Department of Financial Markets Sales
(business contacts)

Inga Gaszkowska-Gebska
institutional sales
tel. +48 22 829 01 67
inga.gaszkowska-gebska@mbank.pl

Jacek Jurczyński
head of treasury sales
tel. +48 22 829 15 16
jacek.jurczynski@mbank.pl

mBank S.A.
18 Senatorska St.
00-950 Warszawa
P. O. BOX 728
tel. +48 22 829 00 00
fax. +48 22 829 00 33
http://www.mbank.pl

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Comment on the upcoming data and forecasts

This Friday, the CSO will publish its monthly business sentiment indicators - the first reading on enterprise sentiment. At the same time, the NBP will release M3 data. We expect it to slow down on annual basis, mainly due to slower household deposit growth (a direct result of higher consumer spending) and cash in circulation. On Tuesday the CSO will publish its monthly Statistical Bulletin. As usual, it should shed some light on last month's data releases (wages will be of special interest to us this time, because of the surprise - see more in the Economics section). It should also confirm that unemployment rate declined less than forecast, as already indicated by the preliminary data from the Ministry of Family, Labor and Social Policy.

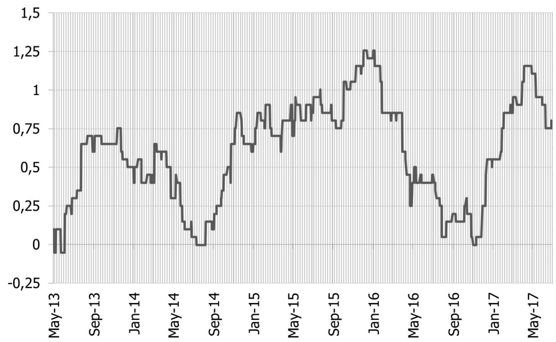
Polish data to watch: July 21st to July 28th

Publication	Date	Period	mBank	Consensus	Prior
M3 y/y (%)	21.07	Jun	5.7	5.9	6.2
Business confidence	21.07	Jul			
Unemployment rate (%)	25.07	Jun	7.2	7.1	7.4

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

Up after wage data, down because of disappointing PPI. All in all, Polish surprise index held steady over the past week. Next week brings only one relevant macro release - unemployment date. If the Ministry of Family's preliminary reading (above market consensus) holds, it will be counted as a negative surprise in our index.

* 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.
- Lower fuel and food prices dragged inflation to the lower bound of the target band. We see it as the local minimum, though.
- 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 rate 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	1.7	1.9	1.5	2.2	2.6	2.6
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	1.93	2.04	2.12	2.31	2.66	2.84
10Y Polish bond yields (% eop)	3.49	3.32	3.38	3.53	3.63	3.85	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	3.67	3.63	3.63	3.60	3.55	3.49

F - forecast

Economics

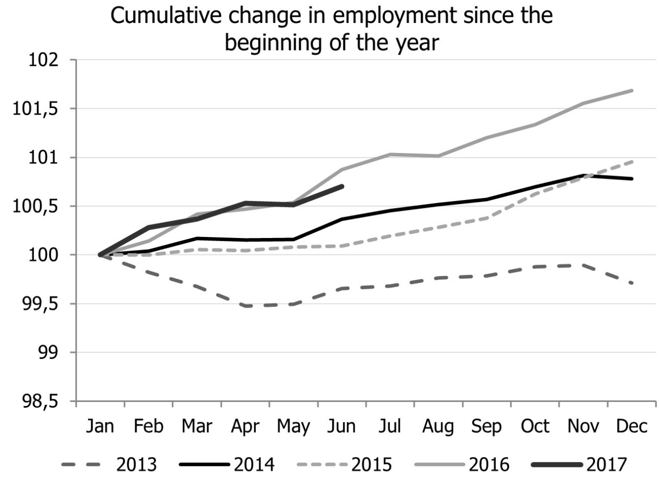
Goldilocks economy

Last week brought important releases from the real sphere, the labor market and the fresh, complex take on survey based business activity prepared by the NBP. After the complete set of data for Q2 it is safe to state that GDP growth decelerated a bit towards 3.8%. Deceleration is not meaningful and economy is on track to generate 4% GDP growth in the next quarters but its composition is going to shift towards larger flow of investment at the cost of consumption. That's a confirmation of the old story rather than a brand new one. What is new, is the possibility that this growth story is likely to be more balanced according to NBP surveys. Compared with the recent reports, wage pressures seem to be a bit lower and enterprises less compelled to raise prices. Such a story resonates well with the Goldilocks economy label that stuck to Poland not only in foreign investors' eyes but also in the MPC's rhetoric.

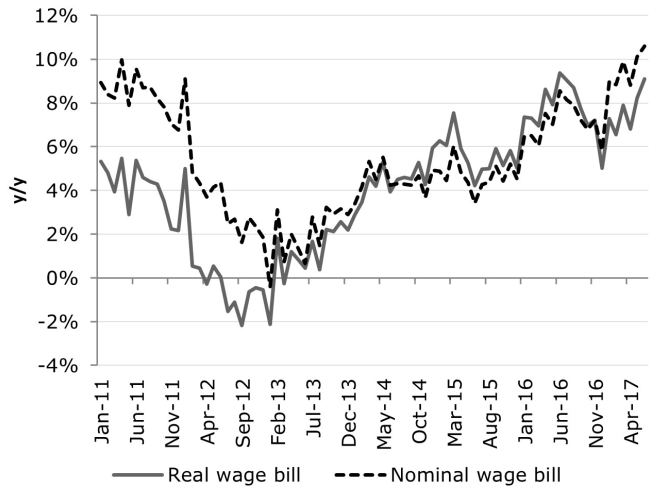
This may be not enough to silence the newfound hawks in the Council (Gatnar, Hardt & Zubelewicz), since their reasoning is not based in labor market prospects, but should cement the consensus view within the MPC. Inflation stabilized at consumers' level and dropped substantially on producers' side. Proposed fuel tax hike had been abandoned hence the odds of inflation running persistently above 2% before 2018Q2 diminished. At first glance economy is perfectly fine and we think that investors are likely to still follow such a line of reasoning. Digging deeper, core inflation gradually but persistently rises along with the demand for labor whereas bargaining position of low-skilled workers improves. Wages already hit 6% growth in enterprise sector and we believe the increases are set to intensify in the coming months. That would constitute a good story to join the more hawkish ECB in 2018 after a possible step back in the very near term. Until then goldilocks economy perception prevails.

Here is our more detailed take on the recent data.

Employment in the enterprise sector disappointed slightly, having grown by 4.3% y/y in June (consensus and our forecast â€“ 4.4% y/y). On a monthly basis employment grew by 11 thousand jobs, below last year's +19k, but close to the usual seasonal pattern of job creation. Nevertheless, it was enough to push total employment over 6 million for the first time in history (5 million was reached in 2007). June data look solid and, coupled with strong employment forecasts from the NBP's business sentiment surveys, suggests that labor demand is growing robustly. As indicated on multiple occasions, labor supply is the major problem. The resulting imbalance might not be corrected at the current wage level.

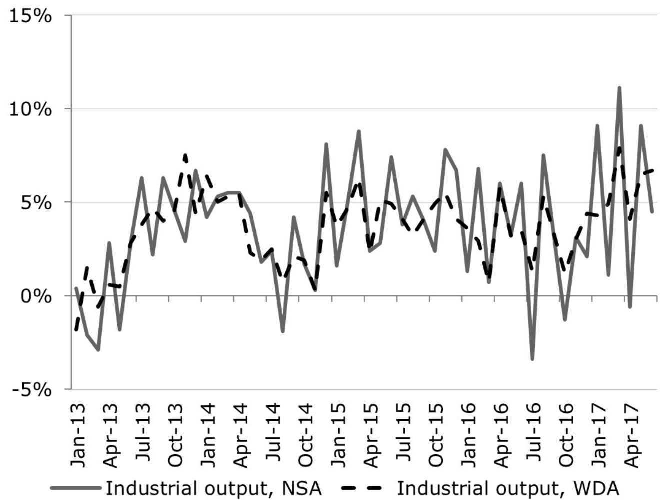


Average gross wage grew by 6% y/y in June, much above market consensus and our forecasts (5.0 and 5.2%, respectively). As usual, the reasons for the surprise are unknown and Poland's economy watchers will have to wait for the Statistical Bulletin (due next week). Regardless of the exact reasons, the 6% increase is the highest reading since 2009, excluding the one-time surge driven by the increase in disability pension contributions in 2012. Our long-held thesis regarding the looming strong acceleration in wages is therefore vindicated to some extent. The factors favoring stronger wage growth are unchanged, with imbalance between labor demand and labor supply in the forefront. In addition, recently Polish press reported that Ukrainian workers have sharply raised their wage demands (by 30% in some sectors). Regardless of the reasons for this (visa-free movement between Ukraine and the EU), this is tantamount to de-anchoring of wages of menial and low-skilled workers.

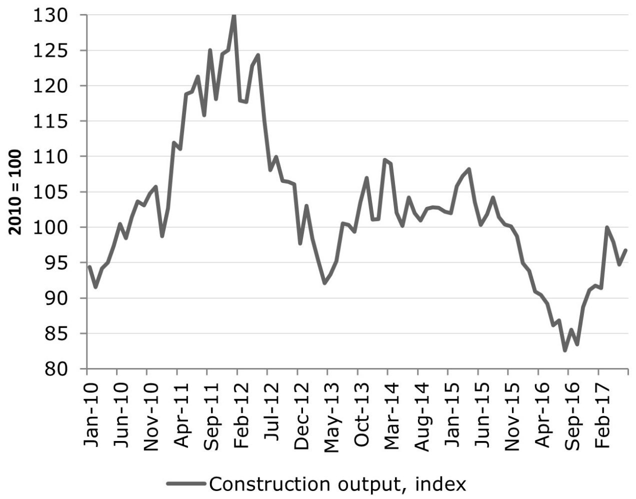


Wage bill grew by 10.6% in current prices and thus set a new cyclical, post-crisis high. Real wage bill is growing by 9.1% y/y, a hair below the deflation-driven surge in 2016. We can only reiterate our conclusion that fears of slower consumption growth this year have been utterly misplaced.

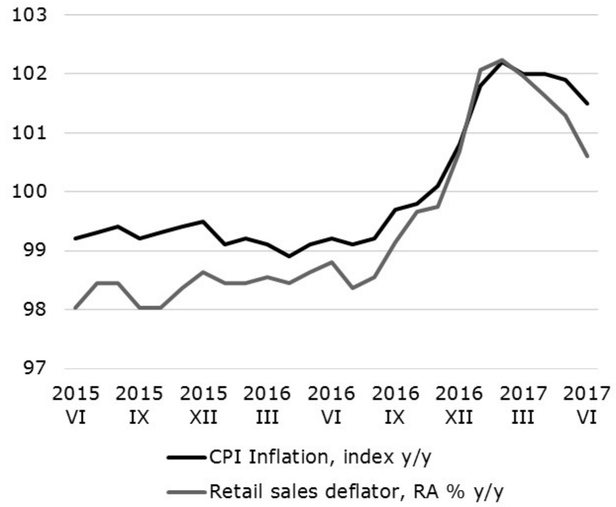
Sold industrial output grew by 4.5% y/y, in line with our forecast and slightly above market consensus. The slowdown relative to May figure is purely a result of less favorable calendar (difference in working day count fell from +1 to -1 y/y). The details of the release have a few positive surprises – weakness in mining and energy production (both in annual and monthly terms) mean that manufacturing performed a bit better than what the headline number would suggest. On a monthly basis, industrial output grew by seasonally adjusted 0.7%, thereby confirming weaker momentum in the second quarter. However, we see this as a necessary correction and adjustment after the stellar Q1, which brought a significant and unsustainable inventory build-up. The overall trend in industrial output is remarkably stable over the medium term (see the graph below).



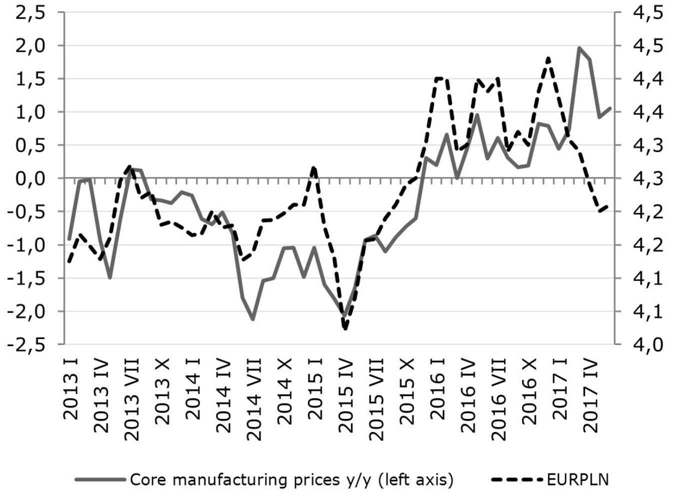
Construction output rose by 11.6%, a bit above market consensus and our forecasts. On a monthly basis, growth amounted to +2.1% after calendar and seasonal adjustments – however, this does not compensate for the previous two monthly declines. The rebound can be traced back to the normalization in weather conditions, but we are unable to verify this hypothesis anyway. We also suspect that the lack of momentum in industrial output results from cautious behavior of private investment (except for housing). With big statistical base effects until August, momentum is not required to maintain double-digit growth in construction output. Later on, base effects will be (in our view) supported by the gradual launch of EU-financed public investment projects.



Retail sales decelerated to 6% y/y in June, as we expected. The decrease was broad-based and we can link it with the difference in working days. So far the negative, statistical base effects connected with the last year's launch o 500+ support programme are muted, but we expect them to be gradually more visible in the next months. Having said that, it has to be noted that overall consumption weakness is an impossible scenario, since households are well-supported by record high growth of nominal incomes and still low inflation. The latter fact is driven primarily by the goods inflation whereas prices in services are on the rise due to increasing costs of labor (see the difference between CPI and retail sales deflator, as depicted below). We expect only slight deceleration of consumption growth towards 4.0-4.2% in H2 2017 and only minor, further step down afterwards. What has been penciled in in the form of tighter labor market and consumer optimism is here to stay affecting (positively) consumer behavior.



Producer prices decelerated to 1.8% y/y in June, as we expected. The fall was driven by prices in mining and energy related industries. Therefore core producer prices in manufacturing were even able to increase a bit. We used to track the correlation between exchange rate and growth of core producer prices. Although we still think there will be high correlation between changes in both variables, there is a growing gap in levels (see the graph). We would link this with the falling profitability of enterprises (as stated with the recent NBP surveys) amid rising labor costs. First line of defense is still concentrated on price increases and this process is ongoing, however, it stays at the same time muted due to statistical effect and global developments (energy). The story of core producer prices is similar to the one characteristic to core inflation. The process of growth is ongoing, but stays at the same time constantly offset by other factors keeping at bay any reaction of monetary authorities.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2016 VII
2016 X
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2017 IV
Core manufacturing prices y/y (left axis)
EURPLN

Fixed income

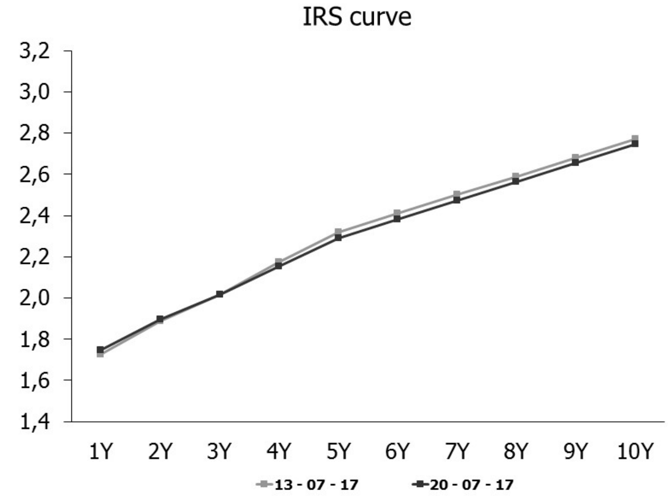
Holiday mood

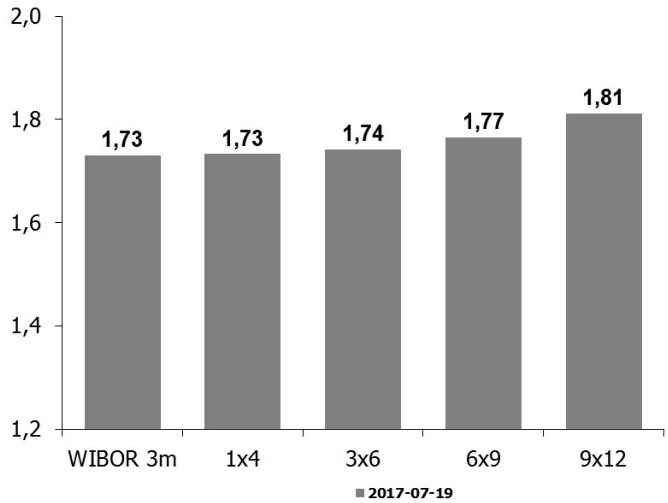
Similary to last week, Polish market was moving in a narrow 30-40 bps range, mostly following core markets. Even positive Polish economic data haven't changed nobody's view on the short curve. The market is definitely waiting for the ECB decision and Dragi's comments. From the clients' point of view, looks like most of them are on the vacation

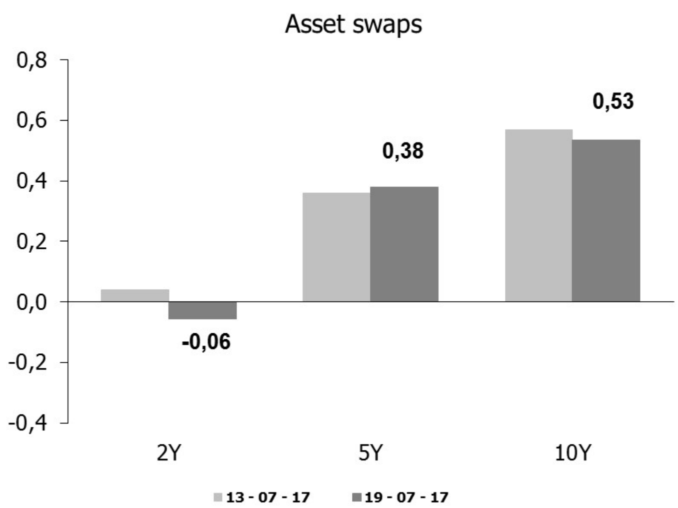
Volatility is low and flow averages show holiday mood. ASWs are tighter due to latest Polish data and lack of T-bond auctions in July. On the other hand, current political situation in Poland can have negative influence on ASW. PS0422/5y is trading at 28 bps and DS0727/10y at 50 bps.

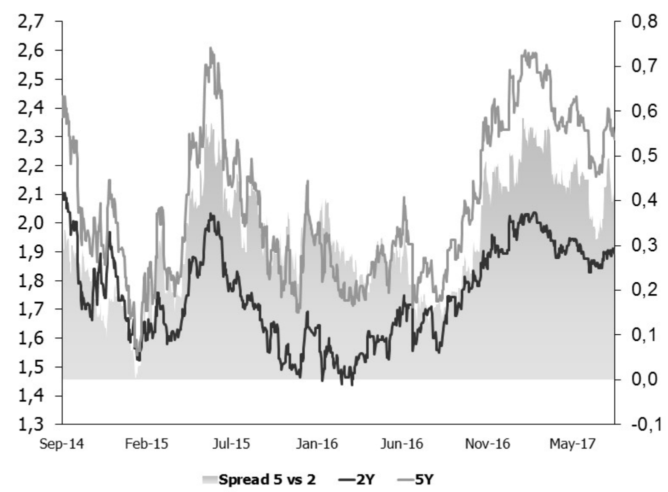
Since last week we are up by 4 bps, 2y benchmark OK0419 is trading at 1.79%, 5y benchmark PS0422 at 2.62% and 10y benchmark DS0727 at 3.27%. The PS0422/DS0727 spread is 66/65 bps, as curve should steepen.

Looks like we are in a bottom at the moment, as indicated by technical analysis on 5y and 10y, and this level can be a good opportunity to pay rates.









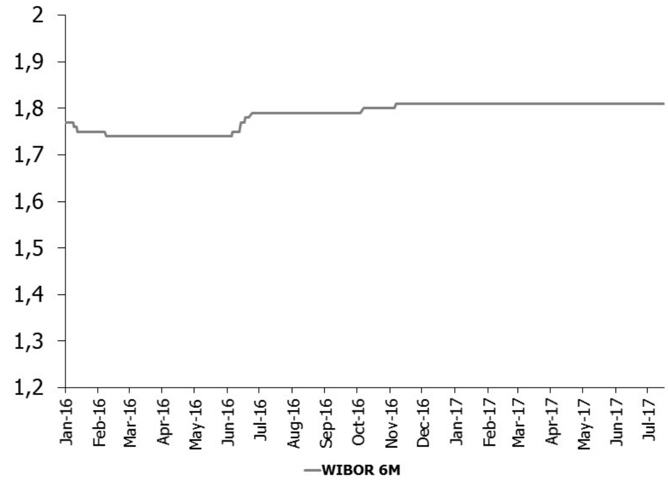
Money market

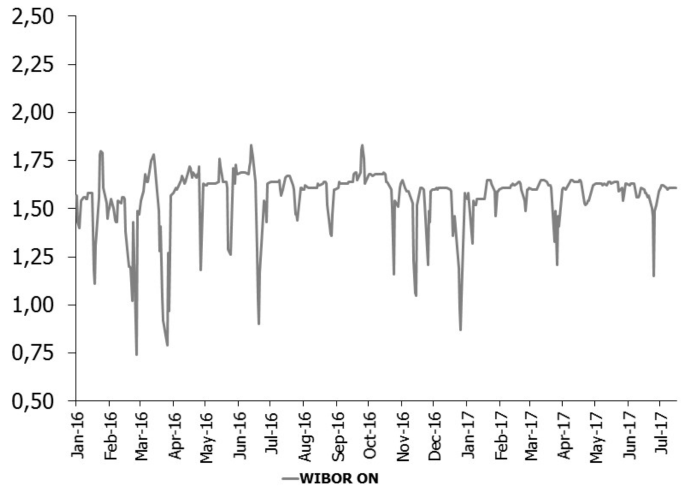
Status quo maintained

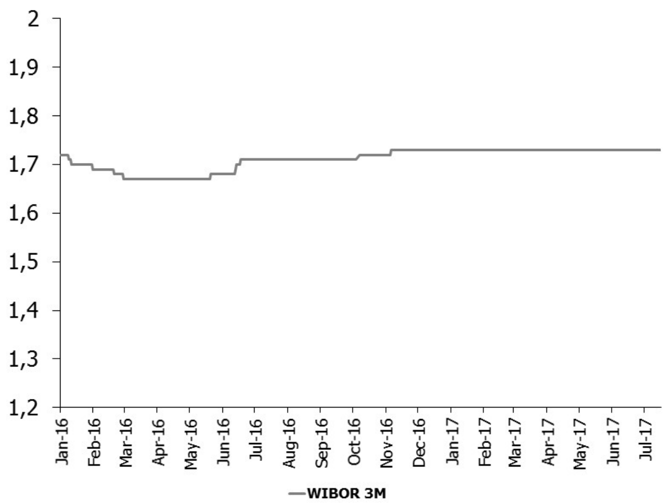
Nothing extraordinary last week. Polish economic data confirmed robust growth, wages surprised on the positive side. Front end rates held stable with slight upward tendency. Long end is following global sentiment. Asset swaps hold quite well. We maintain our willingness to pay front end rate at any dip, hoping for a change in MPC rethoric.

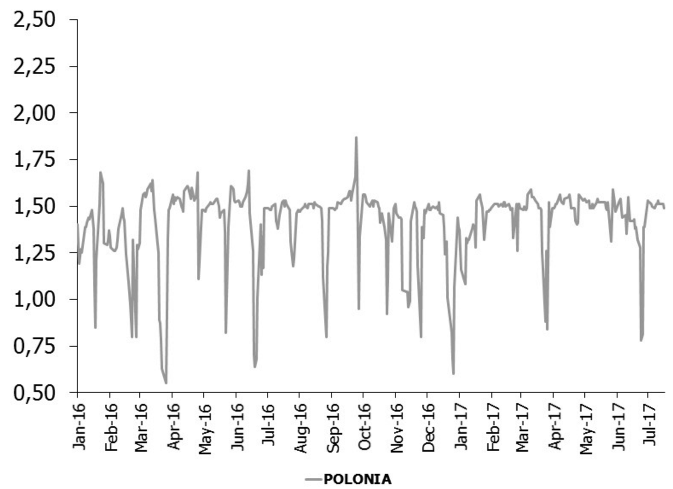
With big redemption on OK0717 and July coupon payments, market lost some liquidity. However, rates stayed in pretty tight range around 1.50%.

Ref rate vs Polonia averages:
30 day 9 bp
90 day 3 bp









Forex

Spot – PLN – range trading continues Zloty received a healthy boost after last Friday's weak reading on US inflation and retail sales, which fanned speculation that the Fed may not be as hawkish as the market had expected. Additionally, Zloty strengthened as the collapse of president Donald Trump's healthcare bill eroded confidence in his ability to legislate to boost growth. Finally the biggest gains were seen against the USD (3.7200 high vs. 3.6240 low), while EUR/PLN was sliding from 4.2350 high to 4.1970 low. Later this week the Zloty weakened slightly as the parliament moved forward with work on a Supreme Court bill that would impact the judiciary in Poland. Nevertheless, we still believe in the rangy nature of EUR/PLN. We still look for 4.1950-4.2550 to cover most of the moves, unless today's ECB catches the market by surprise.

EUR/PLN vols – little lower EUR/PLN was traded in a narrow range and realized volatility has fallen. Therefore, it is not strange that the ATM Volatilities were sold. Fresh optimism is winning. EUR/PLN ATM mid is today 5.6% (0.2% lower), 3 month is at 5.8% (0.2% lower) and, finally, 1 year fixed at 6.2% (0.1% lower). The currency spread (difference between USD/PLN and EUR/PLN) fixed approximately at 3.25% (USD/PLN vol is higher). Both EUR/PLN and USD/PLN riskier are roughly unchanged.

Short-term forecasts

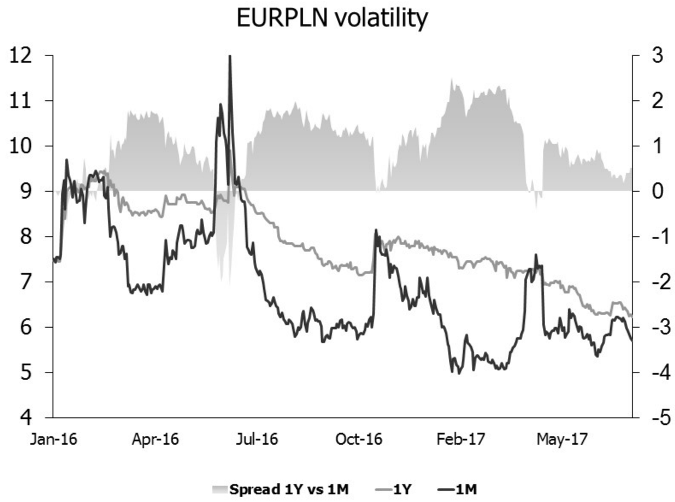
Main supports / resistances:
EUR/PLN: 4.18 / 4.28
USD/PLN: 3.60 / 3.90

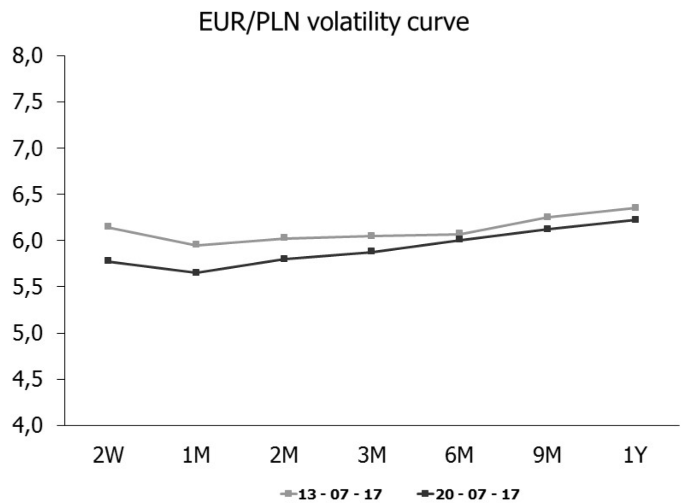
Spot Current position: Long EUR/PLN at 4.2150.

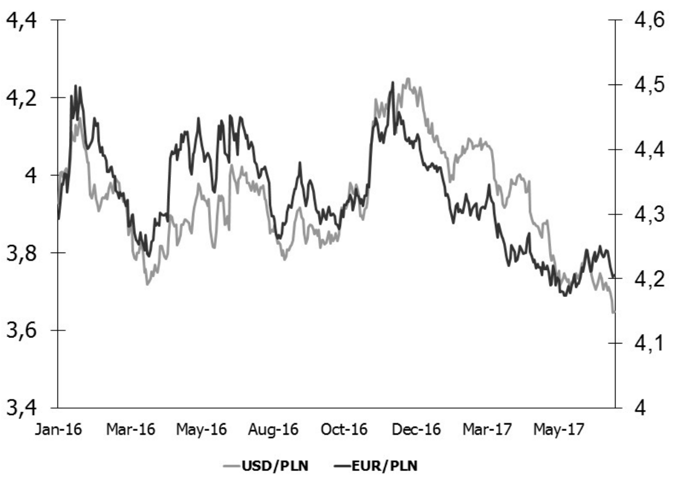
We are still long EUR/PLN. We are ready to add at 4.1850 with 4.1600 stop, hope to see 4.26+ and, eventually, 4.30. It is a technical position based on the mean reverting approach. On the top of it, we wonder if an aggressive action from ECB will not spur a rate hike by the MPC, especially that growth data confirms the strength of the Polish economy.

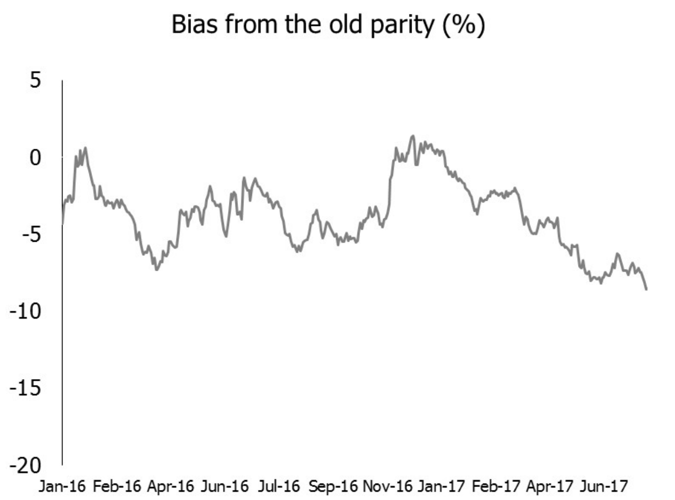
Options Vol – tactical long

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
7/13/2017	1.70	1.73	1.83	1.71	2.03	1.75	1.73	1.74	1.76	1.80	1.86	1.84
7/16/2017	1.62	1.73	1.76	1.71	1.94	1.75	1.73	1.73	1.75	1.80	1.86	1.83
7/17/2017	1.63	1.73	1.77	1.71	1.95	1.75	1.73	1.75	1.76	1.80	1.85	1.84
7/18/2017	1.53	1.73	1.66	1.71	1.85	1.75	1.73	1.74	1.76	1.81	1.85	1.83
7/19/2017	1.69	1.73	1.74	1.71	1.79	1.75	1.73	1.74	1.77	1.81	1.88	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
7/13/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
7/16/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
7/17/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
7/18/2017	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
7/19/2017	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
7/13/2017	5.95	6.05	6.07	6.35	6.35	1.81	0.56
7/16/2017	5.85	6.00	6.13	6.25	6.25	1.81	0.56
7/17/2017	5.75	5.98	6.10	6.28	6.28	1.80	0.54
7/18/2017	5.70	5.93	6.00	6.23	6.23	1.81	0.55
7/19/2017	5.65	5.88	6.00	6.23	6.23	1.82	0.56

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
7/13/2017	4.2345	3.7133	3.8515	3.2831	1.3776	0.1620
7/16/2017	4.2194	3.6986	3.8162	3.2654	1.3765	0.1616
7/17/2017	4.2091	3.6767	3.8148	3.2651	1.3753	0.1612
7/18/2017	4.2032	3.6469	3.8088	3.2473	1.3706	0.1612
7/19/2017	4.2057	3.6486	3.8256	3.2567	1.3734	0.1615

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