August 17, 2017

Polish Weekly Review

mBank Research
(macro/FI/FX analysis)

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Comment on the upcoming data and forecasts

This Friday, the CSO will release real activity data. Calendar and base effects are responsible for acceleration of both industrial (to 9.1% y/y) and construction (to 13.1%) output. Growth in retail sales was likely modest in July (our forecast: 6.6% y/y), because the immediate effects of child subsidies ("500+" programme) should start fading away. Last but not least, the expected small change in producer prices index (from 1.8% to 2.0% y/y) is a result of marginal increase in commodity prices and weaker PLN (vis-a-vis the euro). Wednesday will be marked by the release of M3 data (we expect the downtrend driven by the slowdown in household and corporate deposits to continue) and CSO's business sentiment survey. On Thursday, the CSO will release its monthly Statistical Bulleting along with final estimate of unemployment rate. The preliminary data from the Ministry of Family, Labor and Social Policy indicated the unemploment remained flat in July, bucking typical seasonal pattern and all forecasts. Consumer sentiment data due on the same day will likely show consumer confidence close to all time highs.

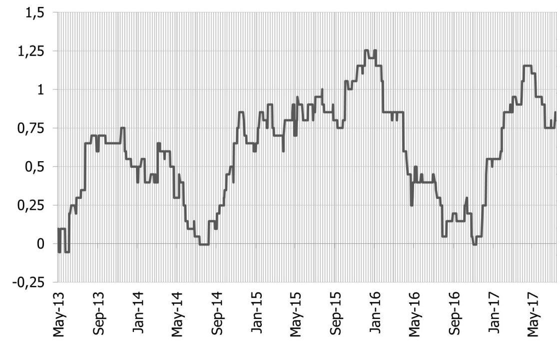
Polish data to watch: August 18th to August 25th

Publication	Date	Period	mBank	Consensus	Prior
Industrial production y/y (%)	18.08	Jul	9.1	8.4	4.5
PPI y/y (%)	18.08	Jul	2.0	2.0	1.8
Retail sales y/y (%)	18.08	Jul	6.6	7.9	6.0
Business confidence	23.08	Aug			
M3 y/y (%)	23.08	Jul	4.6	5.1	5.0
Unemployment rate (%)	24.08	Jul	7.0	7.0	7.1
MPC Minutes	24.08	Jul			
Consumer confidence	24.08	Aug			

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 from previous week, since all economic releases came more or less in line with market consensus. In the following days we will have more opportunities to move the index with real sphere and unemployment 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).

Our view in a nutshell

Fundamentals

- H1 GDP figures (3.9-4.0% 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.
- With stable fuel prices and rising food prices, the local bottom in inflation was set at 1.5% in June.
- 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

- EURPLN rose to 4.30 on the back of rising local risks (political turbulence, new CHF loan bill and the on-going disputes with the European Commission) and the recent uptick in global risk aversion and volatility associated with North Korean tensions. Worse still, PLN appears to react asymmetrically to global factors (it barely benefitted from renewed bets on easy monetary policy globally).
- While PLN appears undervalued in real terms and cyclical factors should underpin its strength, uncertainties, that prevent us from being bullish in the short term, are mounting. These are: geopolitics, the shape and the effects of the new CHF mortgage legislation, as well as Poland's troubles within the EU.

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

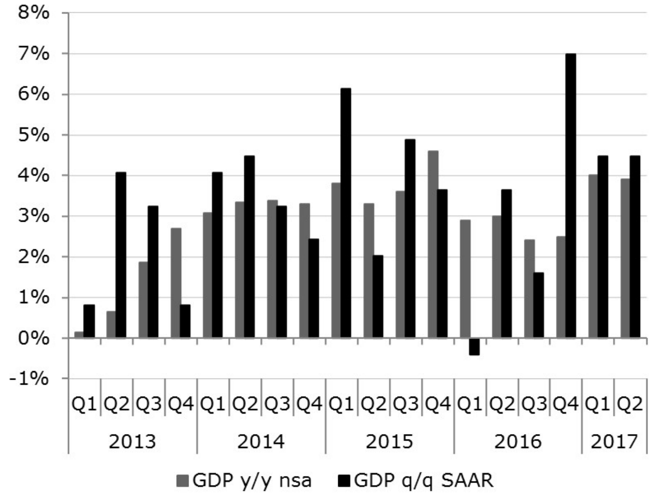
	2017 Q1	2017 Q2 F	2017 Q3 F	2017 Q4 F	2018 Q1 F	2018 Q2 F	2018 Q3 F	2018 Q4 F
GDP y/y (%)	4.0	3.8	3.8	3.9	4.0	4.0	4.2	4.2
Individual consumption y/y (%)	4.7	4.6	4.2	4.0	4.0	3.8	3.8	3.8
Public Consumption y/y (%)	1.0	2.0	2.5	3.0	4.0	3.0	3.0	3.0
Investment y/y (%)	-0.4	3.8	7.0	10.0	10.0	10.0	10.0	9.0
Inflation 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	4.25	4.25	4.20	4.15	4.08	4.05
USD/PLN (eop)	3.97	3.70	3.66	3.63	3.59	3.49	3.40	3.35

F - forecast

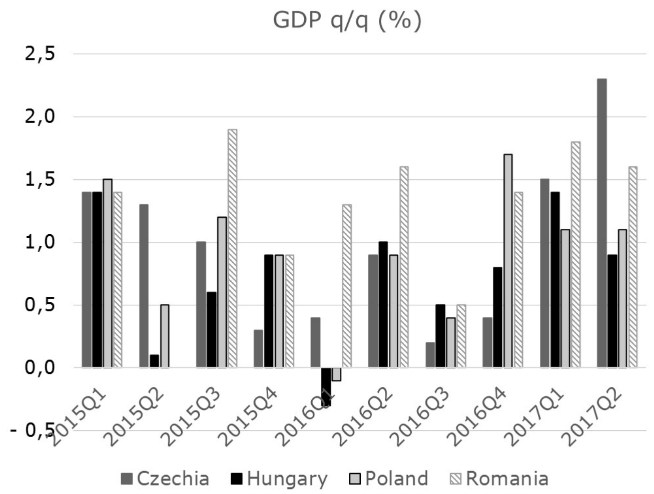
Economics

Solid GDP numbers for Q2 show no signs of Romanian- or Czech-style overheating.

According to the flash estimate, GDP rose by 3.9% y/y in the second quarter, slightly above our forecast and market consensus (both at 3.8%). On a sequential basis, GDP rose by seasonally adjusted 1.1% (unchanged from the previous quarter). Thus, Polish economy has not slowed down vis-a-vis the first quarter.



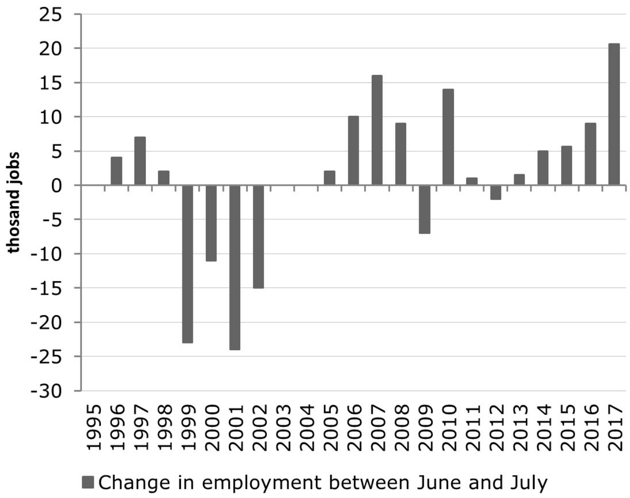
The breakdown of GDP growth will be released on August 31st, we can, however make several educated guesses. We expect consumption to have slightly slowed down (to 4.5% y/y), while investment has likely finally turned positive and accelerated to 4.5% y/y. In the coming quarters GDP growth will remain close to 4% and our baseline trajectories for its main components look accurate (slight deceleration in household consumption and sharp acceleration in investment). The biggest short-term source of uncertainty is inventory formation, as it should be procyclical in normal circumstances.



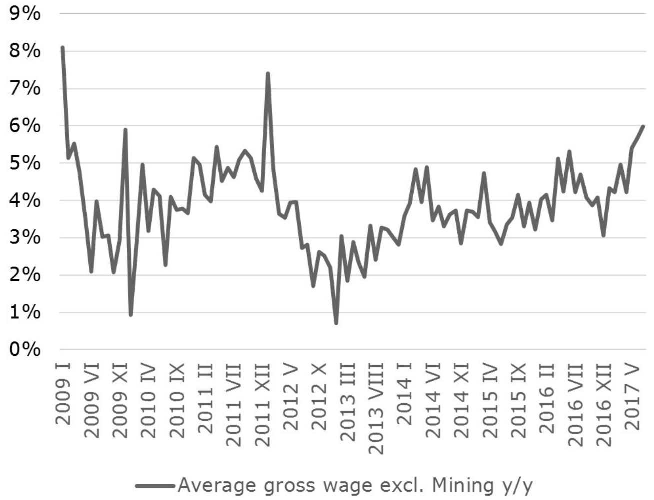
Strong Q2 GDP figures confirm that Polish monetary authorities are in a very comfortable position. Contrary to some CEE economies (Czechia and, especially, Romania), Poland is showing no signs of overheating at the moment. Stable GDP growth, modest inflation and still low core inflation, coupled with entrenched skepticism regarding wage pressures on the NBP's part are key reasons why the Polish MPC is not in a hurry to tighten monetary policy (as compared to its Czech counterpart). With current trajectories of key macroeconomic variables, Poland remains a Goldilocks economy. Moreover, strong GDP growth is conductive for lower credit risk and supportive for long end of the curve at these levels. In these circumstances the curve should be flattening.

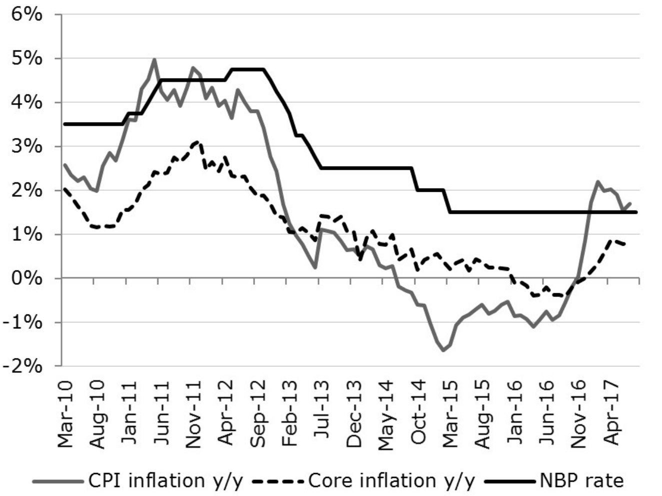
Record-breaking July in employment growth, wages remain in an uptrend.

In July **employment in the enterprise sector** jumped to a record high 6022.1k jobs, which means that it grew by 4.5% on a yearly basis. Such a release is a positive surprise, given not only our forecast and market consensus (4.3%), but also the most optimistic predictions. On a monthly basis this was the best July in recent history (20.1 thousand jobs were added, given recent average below 6k). This means not only a rebound after weaker June, but also another confirmation of labour market being in great shape. Given this stellar data we may even hold off worries about supply constrains at least for some time. Details will be published in next Statistical Bulletin, however we expect that more than one section is responsible for such a large number of created jobs. Acceleration of job creation process in manufacturing is more probable than just a coincidental jump in few smaller but more volatile sections.



Average gross wage rose by 4.9% y/y, slightly below consensus and our forecast (5.4% each). As usual, we will have to wait a week for the release of CSO's Statistical Bulletin to comment on the sources of the surprise. However, we see mining wages as the most likely culprit. Last month, this sector added almost 0.4 p.p. to overall wage growth; negative payback and strong base effects there could easily shave off 0.7-1.0 p.p. from the headline. If we are correct, ex-mining wage growth might even have accelerated vis-a-vis June.





Wage bill growth changed little from the previous month. In nominal terms, wage bill rose by 9.6% y/y (down from 10.6% in June), while real wage bill decelerated to 7.9% y/y from 9.1% in June. These growth rates are consistent with 4%+ consumption growth and support our view that consumption will not slow down materially this year.

Reasons for fast wage growth and the case for further acceleration have for long been a topic of interest for us and we have commented on it several times. Thus, we will skip it this time and simply state that the current behavior of key labor market variables is rather normal, even though the sensitivity of wage growth to labor market tightening is smaller than before the crisis. In particular, wage pressures start at the bottom of the income ladder, in low-pay industries. Mechanisms are similar to the 2007-2008 boom phase on the labor market, but things appear to be proceeding more gradually than before.

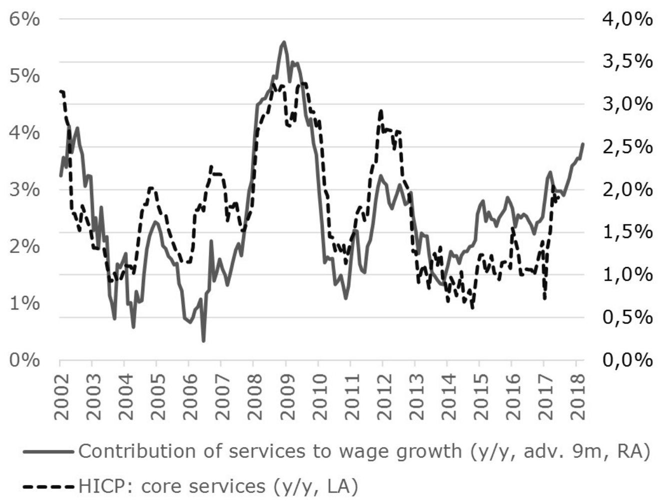
Stable wage growth coupled with fast GDP growth and a surprising decline in wage demands reported in NBP's last enterprise survey are sufficient reasons for the MPC to be confident about its outlook and skepticism regarding wage growth. The Council will also find comfort in the fact that Poland shows no signs of overheating, like Romania or Czech Republic do. Nevertheless, we still feel that current pricing of interest rate path is too optimistic (i.e. first hike too late).

Inflation rose to 1.7% y/y in July on the back of higher food prices.

According to final release, consumer prices in Poland rose in July by 1.7% y/y (in line with the flash estimate of 1.6% y/y), up from 1.5% y/y in June. Just as we suspected, growth was driven by food price behavior. This July, food prices declined by a mere 0.2% m/m (for comparison: -0.9% in 2016 and -1.2% in 2015), which can be traced back to a slight decline in vegetable and fruit prices, an increase in meat prices and stable prices of fats (we are still impressed by the disconnect between stable prices recorded by GUS and the sharp increase in wholesale and shop prices). In general, by breaking typical seasonal patterns, Polish data replicated the behavior of Czech and Hungarian prices. Fuel prices declined by 1.7% m/m – just as we forecast.

Core inflation stayed at 0.8% y/y, with no clear pattern in its details: healthcare prices rose by 0.6% m/m (mainly due to pharmaceuticals); transport services slightly declined in price; package holidays prices rose by over 4% – we have already commented on the fact that this category began to behave similarly to Western Europe. In general, core services accelerated slightly, while core goods decelerated for the third month in a row.

Further months will be marked by above-average readings of food prices, stabilization in fuel prices, base effects and the uptrend in core categories. Among the latter, services prices will be an increasingly more visible element, since they are following labor costs in this sector (see the graph below). As a result, inflation will likely rise towards the end of the year, while the strong base effects at the turn of 2017 and 2018 should not be taken for granted. Even a few $ increase in oil prices could, at these levels, easily match the abovementioned base effect.

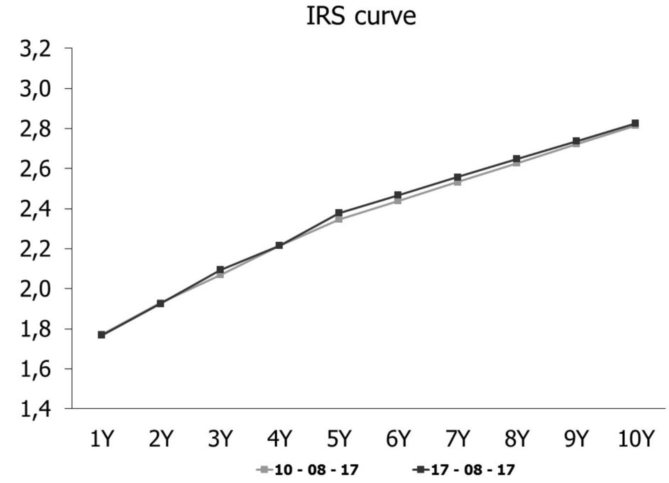


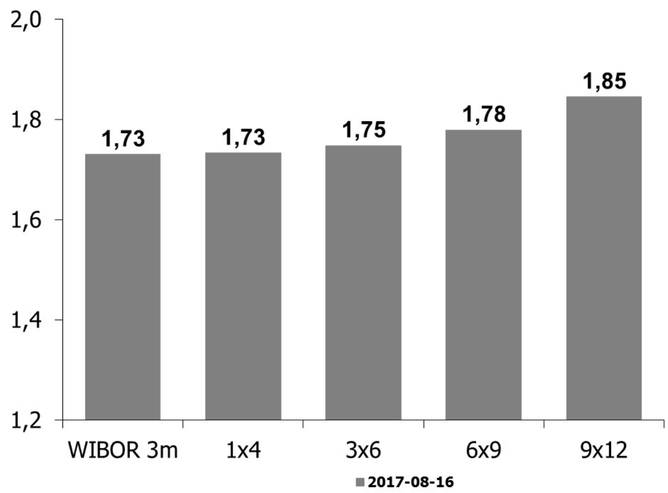
The scenario of higher inflation – regardless of its causes – fits European trends very well. While the MPC is likely to ignore current inflation prints, focusing on medium-term inflation prospects, the market might be less tolerant and start pricing in earlier start to the rate hike cycle. The more so, since bottlenecks on the labor market have become an emerging Polish story.

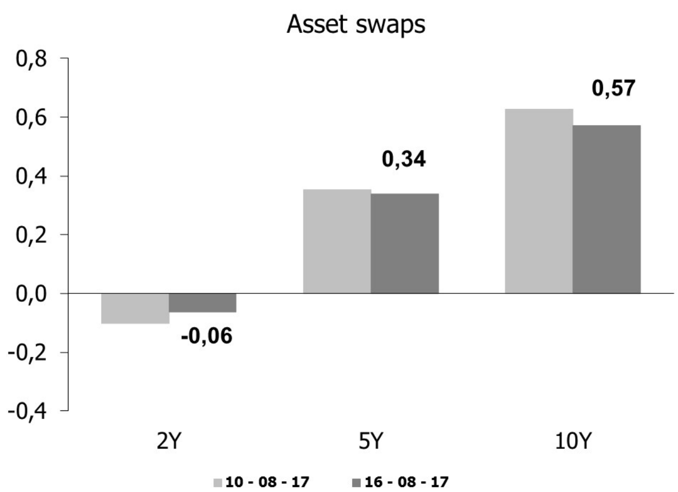
Fixed income

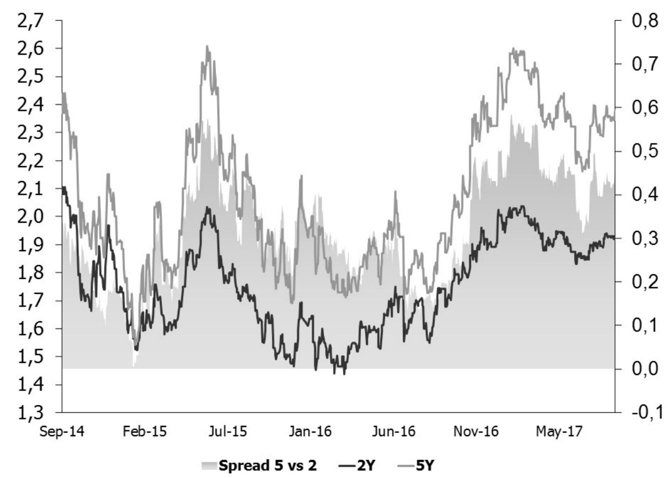
Flatter, faster, quieter

Korean crisis is not important any more, risk on mood is coming back to the market. DS0727/Bund spread is 292 bps as it narrowed 8 bps last week. Polish market is very quiet, we see demand on short end bonds but its only connected with T-Bills expiration. The curve is finally flattening, PS0422/DS0727 spread is trading at 68 bps again, good GDP numbers should help here, we may come back to 62-60 bps levels very soon. ASW PS0422/5y is at 30 bps and DS0727/10y is at 54 bps. OK0419 is trading at 1.76% (3 bps up), PS0422 is trading at 2.68% (2 bps down) and DS0727 is trading at 3.36% (4 bps down).









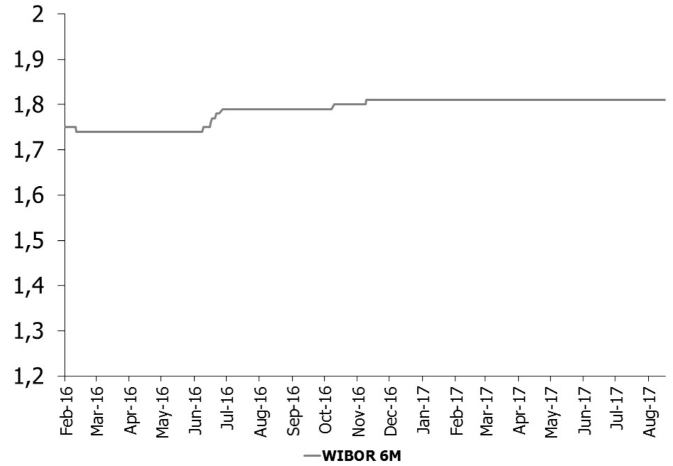
Money market

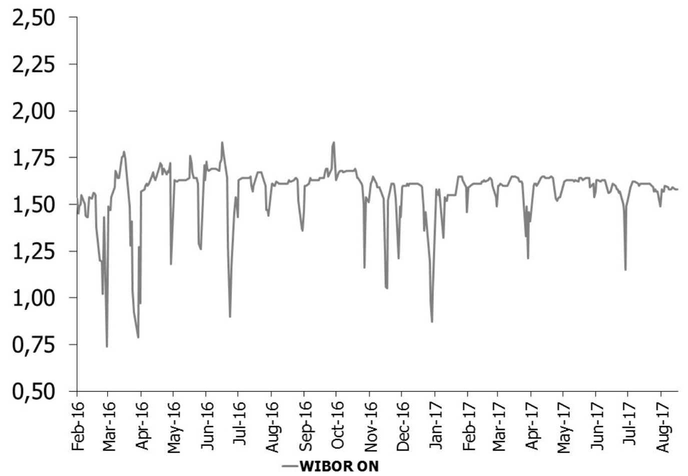
Summertime trading

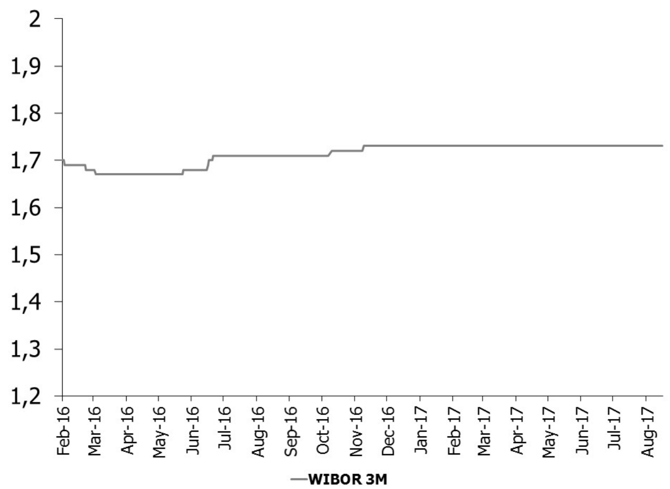
The market slowed down last week. Risk sentiment improved worldwide and sell-off on Polish govies eased. Turnover is very small, short bonds are still in demand as T-bill redemption approaches. This might prevail until Autumn, when the Ministry of Finance returns to the market.

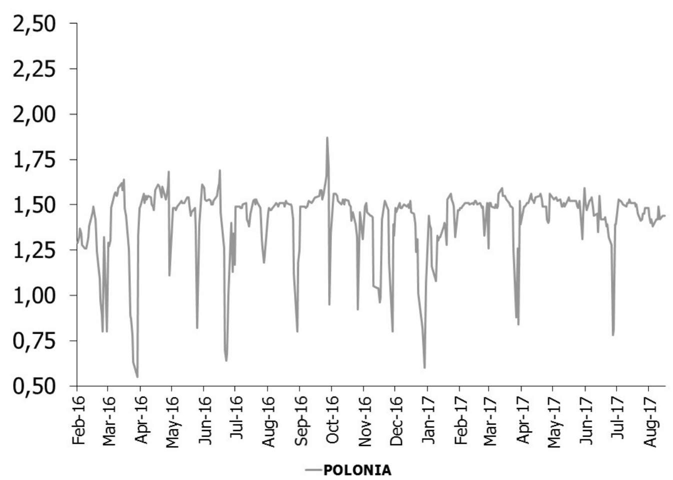
As we signalled last week, cheap cash has already been prevailing for few months. This resulted in widening spreads.

Ref rate vs Polonia averages:
30 day 6 bp
90 day 6 bp



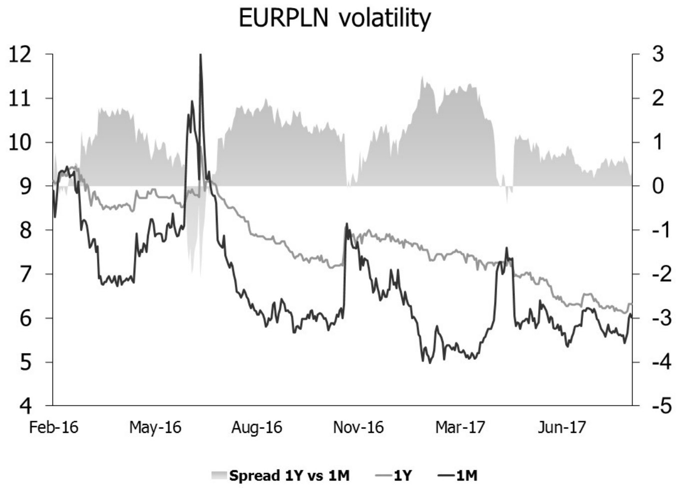






Forex

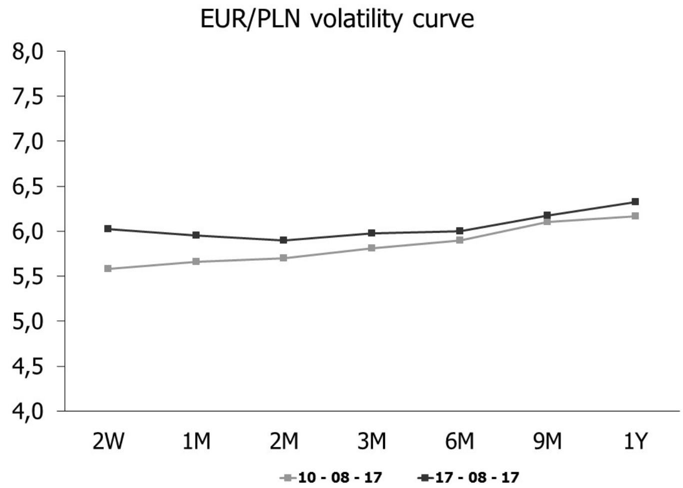
Spot: EUR/PLN – boxed in 4.25-4.30 range EUR/PLN set a high at 4.2960, bit shy of 4.30, before strong PLN recovery took the cross back down to 4.2530. We are still in range with 4.24/4.26 support zone and 4.29/4.31 being the resistance zone. PLN factor is still not really playable, decent/strong fundamentals and growing political uncertainty produce a deadlock. We are still skewed to play the current range from a short PLN side.



EUR/PLN vols – higher The vols were on the rise with weaker Zloty, we even had realized volatility picking up, but we are skeptical if it will last. The frontend vols, gamma, were in high demand (maybe for short covering). EUR/PLN ATM mid is today 6.0% (0.7% higher), 3 months is at 6.0% (0.3% higher) and, finally, 1 year fixed at 6.4% (0.3% higher). The currency spread (difference between USD/PLN and EUR/PLN) is roughly unchanged. The skew as well, 6 months EUR/PLN 25D RR traded at 1.5%.

Short-term forecasts

Main supports / resistances:
EUR/PLN: 4.20 / 4.30
USD/PLN: 3.50 / 3.80



Spot Current position: the remainder of the long EUR/PLN was cashed at 4.2925. A fresh long EUR/PLN was reinitiated at 4.2550.

We are ready to add to the position at 4.2200 with a stop at 4.1900, and hope to see 4.3000, possibly on the way to 4.33+. We are of the opinion that political risk in Poland is not priced in at current PLN levels. Technically, we see a good chance of EUR/PLN coming back to the middle of the multi-month range, namely 4.35-ish.

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.

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
8/10/2017	1.69	1.73	1.82	1.71	1.97	1.75	1.73	1.75	1.79	1.83	1.90	1.87
8/13/2017	1.62	1.73	1.68	1.71	1.72	1.75	1.73	1.75	1.79	1.83	1.91	1.87
8/14/2017	1.64	1.73	1.85	1.71	1.98	1.75	1.73	1.75	1.78	1.83	1.90	1.87
8/15/2017	1.54	1.73	1.67	1.71	1.82	1.75	1.73	1.75	1.78	1.83	1.90	1.87
8/16/2017	1.69	1.73	1.83	1.71	1.98	1.75	1.73	1.75	1.78	1.85	1.90	1.87

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
8/10/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
8/13/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
8/14/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
8/15/2017	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
8/16/2017	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
8/10/2017	5.66	5.81	5.90	6.16	6.16	1.84	0.58
8/13/2017	6.00	5.98	6.05	6.33	6.33	1.84	0.58
8/14/2017	6.10	6.03	6.05	6.33	6.33	1.82	0.58
8/15/2017	6.01	6.01	6.05	6.33	6.33	1.82	0.57
8/16/2017	5.95	5.98	6.00	6.33	6.33	1.82	0.58

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
8/10/2017	4.2709	3.6432	3.7720	3.3132	1.3986	0.1634
8/13/2017	4.2851	3.6449	3.7975	3.3447	1.4008	0.1636
8/14/2017	4.2823	3.6278	3.7559	3.3065	1.4076	0.1637
8/15/2017	4.2823	3.6278	3.7559	3.3065	1.4076	0.1637
8/16/2017	4.2724	3.6435	3.7403	3.2853	1.4059	0.1640

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