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Polish Weekly Review

mBank Research
(macro/FI/FX analysis)

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Comment on the upcoming data and forecasts

This Friday, the Manufacturing PMI for August will be published. Contrary to widespread market expectations of a rebound, we forecast a small decline in the PMI. Our forecast is based on the structure of recent declines, not on European PMIs and CSO's own sentiment indicators - both have offer little predicitive value recently. On Tuesday the MPC begins its two day meeting. Obviously, we do not expect interest rates to change on this meeting and we see the post-meeting statement and press conference as similar in content and tone to the previous ones. In particular, it is likely that the NBP governor will strike a dovish tone and remain both optimistic about the economy and skeptical regarding inflation.

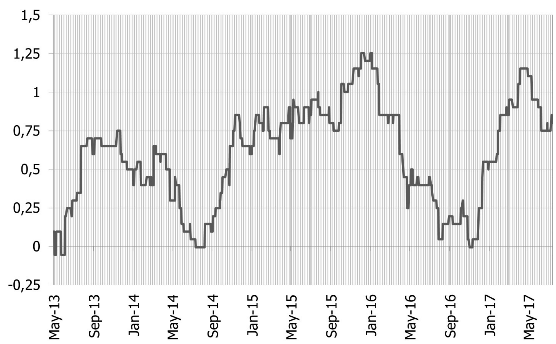
Polish data to watch: September 1st to September 8th

Publication	Date	Period	mBank	Consensus	Prior
Manufacturing PMI (p.)	01.09	Aug	51.9	53.1	52.3
NBP interest rate decision (%)	06.09	Sep	1.5	1.5	1.5

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	9/8/2017	600	1.859	6/9/2017
5Y T-bond PS0422	9/8/2017	1000	2.587	6/9/2017
10Y T-bond DS0727	9/8/2017	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 as both final GDP and flash CPI met market expectations. Next week brings only one opportunity to move the index – tomorrow's manufacturing PMI.

* 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

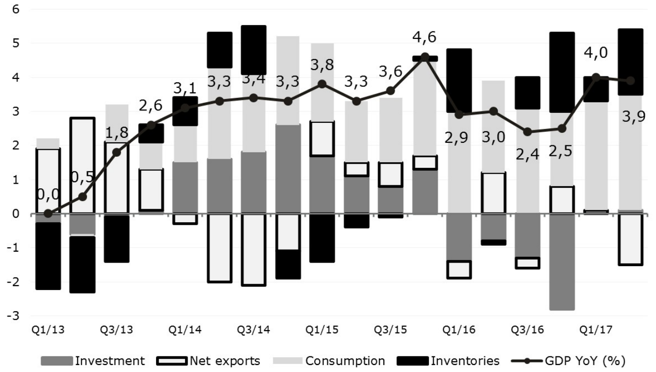
	2017 Q1	2017 Q2	2017 Q3 F	2017 Q4 F	2018 Q1 F	2018 Q2 F	2018 Q3 F	2018 Q4 F
GDP y/y (%)	4.0	3.9	3.8	3.9	4.0	4.0	4.2	4.2
Individual consumption y/y (%)	4.7	4.9	4.2	4.0	4.0	3.8	3.8	3.8
Public Consumption y/y (%)	1.0	2.4	2.5	3.0	4.0	3.0	3.0	3.0
Investment y/y (%)	-0.4	0.8	7.0	10.0	10.0	10.0	10.0	9.0
Inflation 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

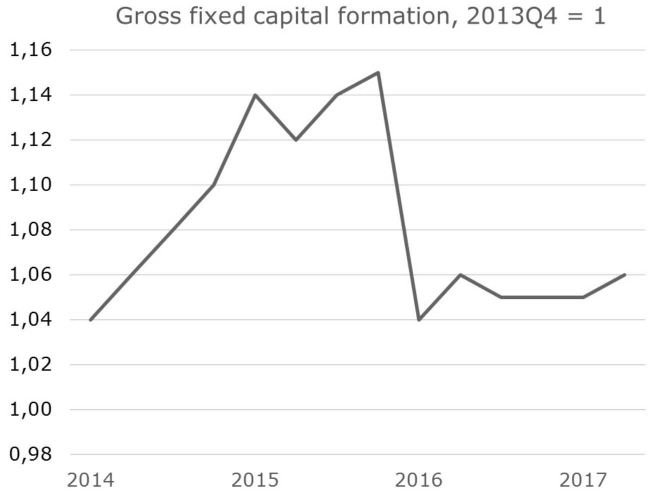
Economics

Q2 growth confirmed at 3.9% y/y. Consumption is driving growth while investment remains in stagnation.

Q2 GDP growth was confirmed at 3.9% y/y and 1.1% q/q – thus, there is no material slowdown vis-a-vis the first quarter. As usual, the details of the release are far more interesting. Just as in the previous quarters, the structure of GDP surprised, and basically in the same fashion.



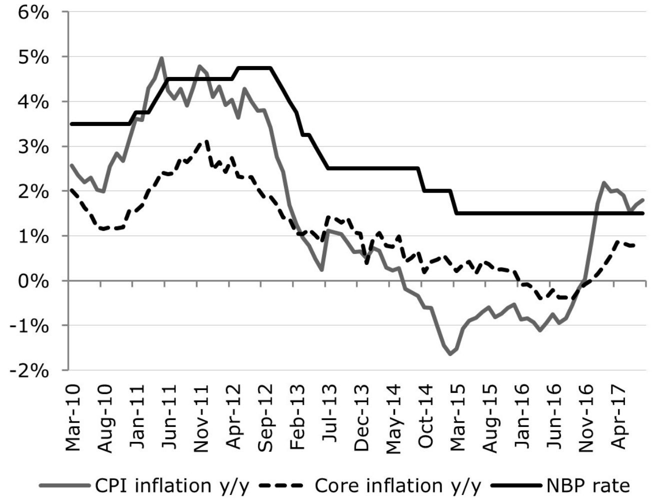
First, household consumption accelerated from 4.7 to 4.9% y/y, beating estimates (most forecasts were 4.5% or lower). At the moment, consumer spending is not deterred by stable retail sales growth (implying an on-going shift towards services), slowing real disposable income growth and base effects associated with the launch of the child subsidy programme last year. If anything, consumption could accelerate further in the second half of the year, as indicated by stellar consumer sentiment data. Second, while investment growth finally turned positive, it was meagre at best (+0.8% y/y, consensus +2.5%, our forecast +4.5%). All signs on heaven and earth suggest that this streak of disappointments is a result of on-going retrenchment in public investment. Private investment has grown steadily since mid-2016 at a pace typical for previous expansions. On a quarter-to-quarter basis, there has been no recovery in investment. Third, the biggest risk factor we had identified, namely inventories, went out with a bang. Inventory change added 1.9 percentage points to growth, while net exports substracted 1.4 percentage points – both categories returned to their usual cyclical patterns. A quick look at historical statistics reveals that the four quarter change in inventories is close to its 2007 peak. Procyclical behavior of inventories suggests that there is no significant danger of a sudden destocking and inventory-related slowdown in GDP. Contribution of net exports will continue to be negative in the next quarters.



Markets did not react to GDP data. Its structure is consistent with our first estimate of Q3 growth (ca. 4.5% y/y). Very fast consumption growth, prospects of a rebound in public investment and procyclical behavior of inventories all point to marked acceleration in GDP in the third quarter. In addition, such breakdown of growth is clearly proinflationary, but that might not impact the MPC's consideration in the next few meetings. However, higher growth means higher starting point for the new projections and lower output gap, thereby shifting CPI projection upward, all else equal. Finally, Q2 GDP data should be conductive to lower credit risk premia and explain (partly) stellar VAT revenue growth in the first half of the year.

Inflation is rising, albeit slowly.

According to the flash estimate, CPI rose by 1.8% y/y in August, in line with consensus, but below our forecast of 1.9%. We were betting on slightly smaller than usual decline in food prices (-0.8-0.9% m/m) and a modest increase in fuel prices (by 2.7% m/m). Labor intensive core categories likely accelerated following faster wage growth, while prices of clothing and footwear probably declined less than last year due to high temperature (correlation is quite high).

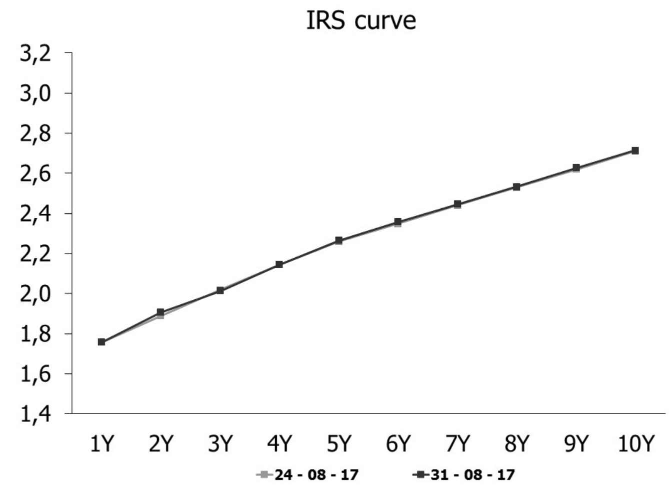


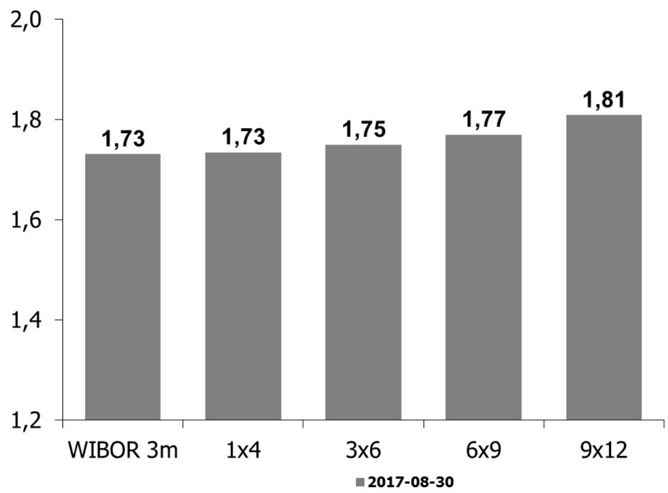
Our forecast was halfway between 1.8 and 1.9% y/y and the surprise could either be caused by core inflation, or food prices. We would be willing to bet on the latter, which would put core inflation at 0.9% y/y and food prices below our initial estimate. The release was unnoticed by the markets and will not affect the MPC.

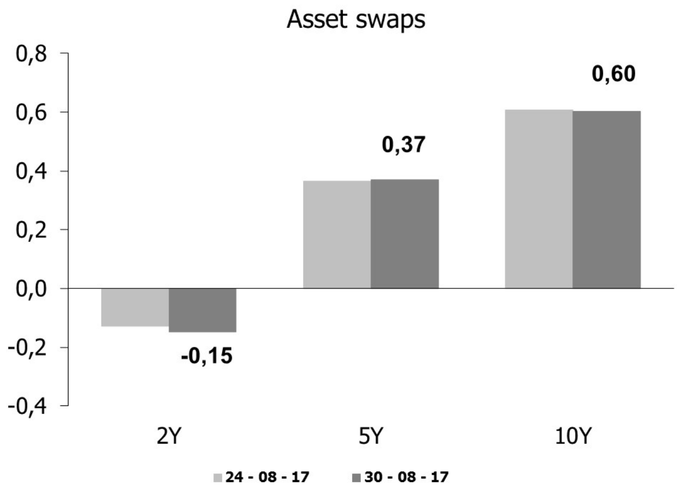
Fixed income

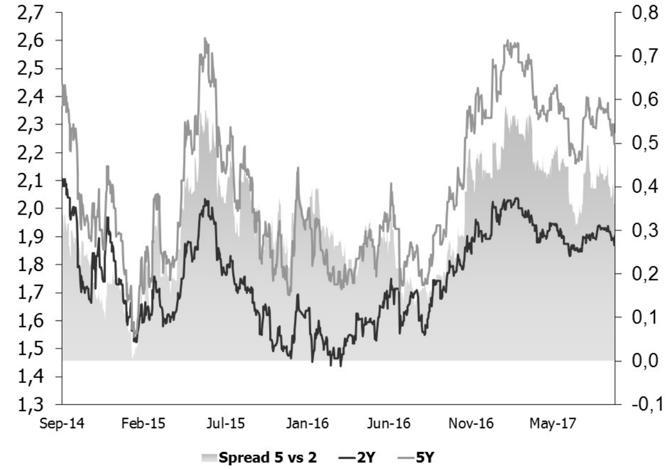
Endless summer? Not on POLGBs!

Holidays are finally over, flow is coming back. We saw ”tax protection” buying flow that lifted short-end bonds to ridiculous levels. Yields are very low, curve is steep again. PS0422/DS0727 is trading at 71 bps, DS0727/Bund spread is 294 bps, both spreads have widened. ASW stays strong, PS0422/5y is at 29 bps and DS0727/10y is at 54 bps. PS0719 is trading at 1.7% (3 bps up), PS0422 is trading at 2.59% (1 bps down) and DS0727 is trading at 3.30% (1 bps up).









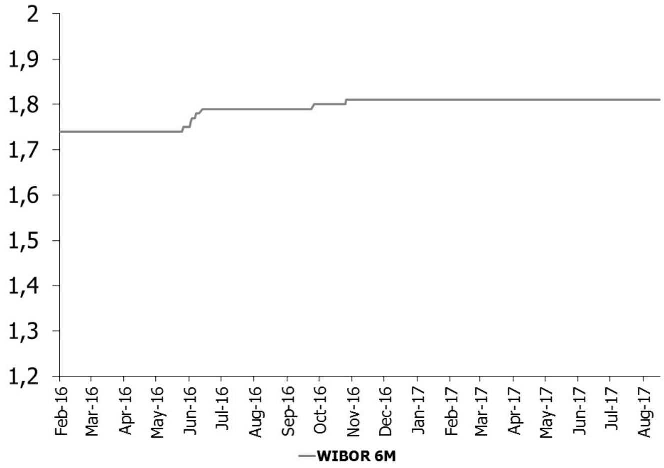
Money market

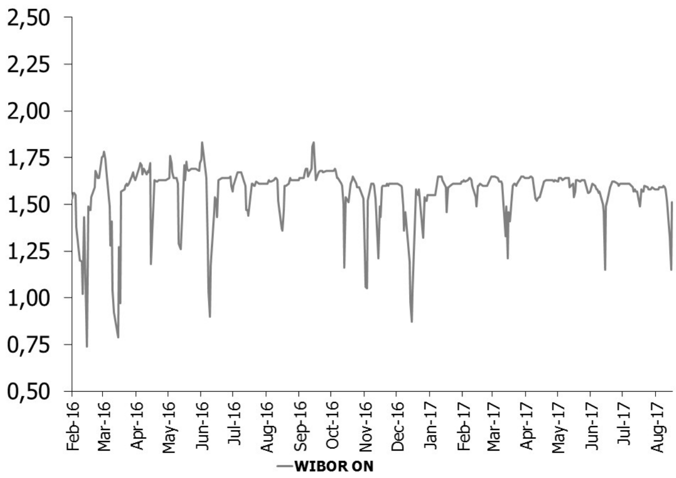
Another week of stability

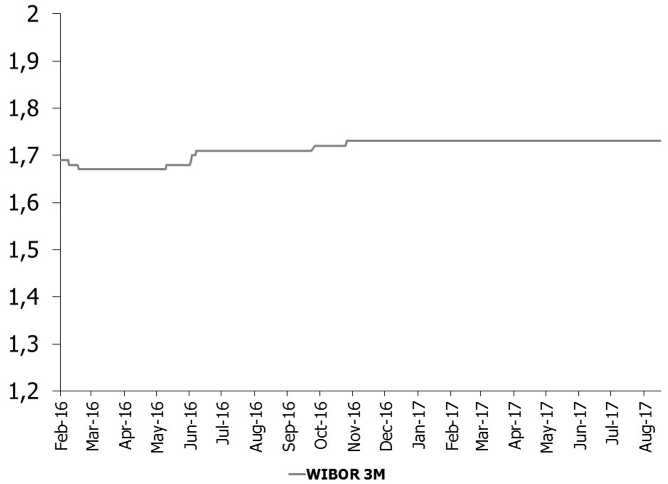
Both GDP and CPI data came out same as market consensus. This supports recent market stability. We still think that Polish yields are rather low. Two year IRS is pricing only a minor 25bp rate hike. We are still in negative real rates territory and some MPC members are raising voices about small rate increase.

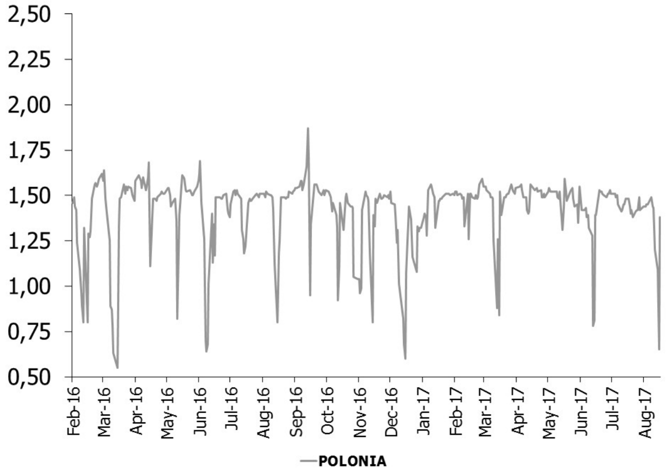
New month and new reserve period will bring overnight rates close to reference rate.

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









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Forex

Spot: EUR/PLN – still boxed in range EUR/PLN has spent another unimpressive week, meandering in 4.24-4.2740 range. It was USD/PLN that contained most of the EUR/USD swings, and setting a much wider 3.5250-3.6000 range. As a consequence, Zloty against the basket (equally weighted EUR/PLN and USD/PLN) was gaining when EUR/USD peaked above 1.20 after dovish Jackson Hole conference. When EUR/USD started a downward correction, PLN against the basket also was losing ground, mostly because of higher USD/PLN levels. We are still in "play the range mood" but for a choice we prefer playing that from short PLN side as political risk looms on the horizon.

EUR/PLN vols – unchanged Not much to report here, 6 months USD/PLN traded at 9.8%. The EUR/PLN and to a greater extend USD/PLN vols were mimicking EUR/USD vols changes and realized volatility is stubbornly low. EUR/PLN 1 month ATM mid is today at 5.7% (unchanged), 3 months are at 6% (0.1% higher) and finally, 1 year fixed at 6.4% (unchanged). The skew was roughly unchanged and the currency spread (difference between USD/PLN and EUR/PLN) frontend is tic better bid due to next week ECB meeting.

Short-term forecasts

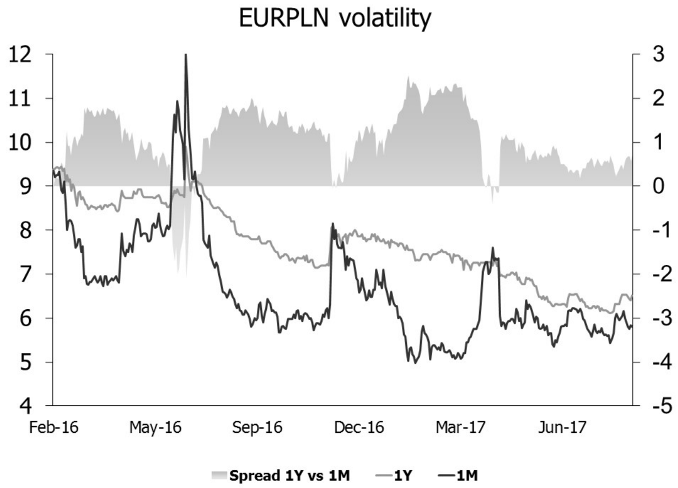
Main supports / resistances:
EUR/PLN: 4.20 / 4.30
USD/PLN: 3.50 / 3.80

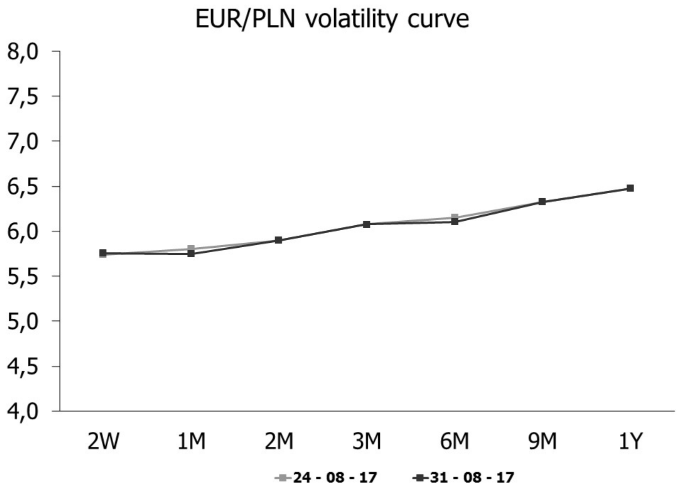
Spot Current position: long EUR/PLN was reinitiated at 4.2550.

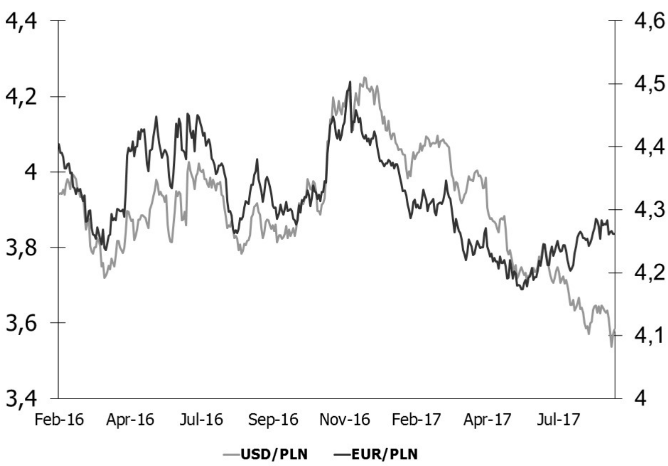
We are ready to add to the position at 4.2200 with a stop at 4.1900, and hope to see 4.3000, possibly on the way to 4.33 +. We are of the opinion that political risk in Poland is not priced in current PLN levels. Technically, we see a good chance of EUR/PLN coming back to the middle of the multi months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

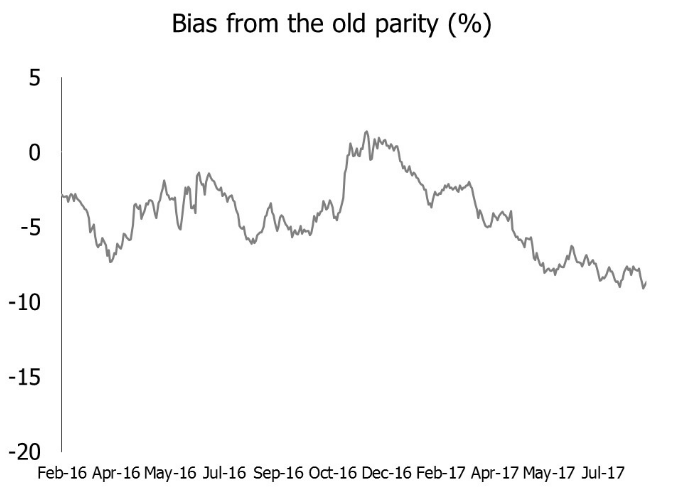
Options Vol – tactical long

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
8/24/2017	1.62	1.73	1.65	1.71	1.91	1.75	1.73	1.75	1.77	1.81	1.86	1.84
8/27/2017	1.60	1.73	1.72	1.71	1.91	1.75	1.73	1.75	1.77	1.81	1.87	1.85
8/28/2017	1.60	1.73	1.65	1.71	1.91	1.75	1.73	1.76	1.78	1.82	1.87	1.86
8/29/2017	1.41	1.73	1.55	1.71	1.73	1.75	1.73	1.75	1.76	1.80	1.84	1.84
8/30/2017	1.53	1.73	1.71	1.71	1.91	1.75	1.73	1.75	1.77	1.81	1.86	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
8/24/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
8/27/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
8/28/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
8/29/2017	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
8/30/2017	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
8/24/2017	5.80	6.08	6.15	6.48	6.48	1.85	0.59
8/27/2017	5.75	6.08	6.05	6.43	6.43	1.85	0.59
8/28/2017	5.84	6.08	6.03	6.40	6.40	1.85	0.59
8/29/2017	5.80	6.08	6.13	6.51	6.51	1.85	0.59
8/30/2017	5.75	6.08	6.10	6.48	6.48	1.83	0.59

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
8/24/2017	4.2827	3.6329	3.7639	3.3221	1.4142	0.1641
8/27/2017	4.2600	3.6112	3.7472	3.2936	1.4001	0.1632
8/28/2017	4.2640	3.5736	3.7501	3.2732	1.4022	0.1633
8/29/2017	4.2661	3.5372	3.7410	3.2612	1.3993	0.1634
8/30/2017	4.2610	3.5678	3.7326	3.2455	1.3935	0.1635

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