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Polish Weekly Review

mBank Research
(macro/FI/FX analysis)

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Comment on the upcoming data and forecasts

Tomorrow, the CSO will publish its monthly Statistical Bulletin. It will shed more light on the latest releases from labour market and real sphere. As always, it will also inform us about the unemployment rate in August. Preliminary MFLSP data indicates that the rate stabilized at 7.1%, which is a tick higher than our original forecast and market consensus suggested. Since the same situation happened last month, we expect preliminary data to be confirmed. Next Friday, flash CPI estimate will be published. It is too early to present a specific number, but one can expect CPI to accelerate modestly on the back of higher fuel prices (roughly 3-4% m/m).

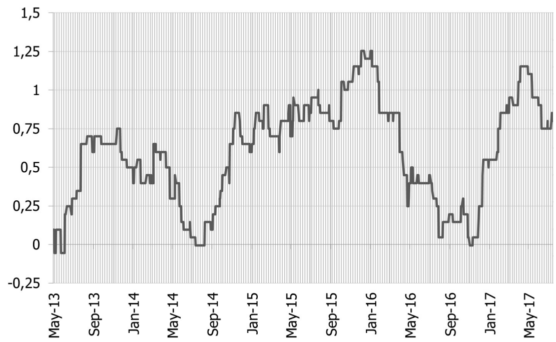
Polish data to watch: September 22nd to September 29th

Publication	Date	Period	mBank	Consensus	Prior
Unemployemnt rate (%)	22.09	Aug	7.1	7.0	7.1
CPI y/y (%) *flash*	29.09	Sep			1.8

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

After few weeks of falls and stabilisation Polish surprise index finally rose after better than expected wage and industrial production data. Next week brings two opportunities to move the index: unemployment rate (this Friday) and flash CPI (next Friday).

* 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

- After very good set of data for August, we decided to raise our GDP forecasts again. In 2017, Polish economy is set to rise by 4.3% (prev. 3.9%), in 2018 by 4.4% (prev. 4.1%). Let's face it, household consumption is booming, while investment likely finally rebounded in Q3. Poland is entering the upcoming election cycle (local elections in 2018, parliamentary elections in 2019 and presidential elections in 2020) with very tight labor market, favorable external environment and stimulation on all fronts.
- Inflation is fluctuating within the lower half of the target band. Base effects suggest that inflation will drop at the turn of the year and reaccelerate briskly next year. One should look through short-term fluctuations and look at underlying momentum. The case for accelerating core inflation is strengthening. Polish labor market is operating normally and fits regional trends: wage inflation is coming.
- MPC stays calm and waves away any signs of intensifying wage pressure. 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.
- Fiscal situation continues to be very comfortable and GG deficit will fall below 2% of GDP this year. We judge that the increase in VAT revenues is 70% consumption growth and 30% crackdown on tax avoidance. The latter has not ended and the prospects for increases in tax collectibility are very good.

Financial markets

- EURPLN returned to 4.25-4.30 range on the back of rising local risks (political turbulence, new CHF loan bill and the on-going disputes with the European Commission) and the broader move in EM assets associated with rising risk-free rate globally. Worse still, PLN continues to react asymmetrically to global factors (more likely to weaken than strengthen).
- With rising risk-free rates and slow-but-steady monetary tightening in developed markets, Polish monetary policy is increasingly a liability for the PLN via declining interest rate disparities.

mBank forecasts

	2013	2014	2015	2016	2017 F	2018 F
GDP y/y (%)	1.4	3.3	3.8	2.7	4.3	4.4
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	4.6	4.5	4.5	4.4	4.3	4.3
Individual consumption y/y (%)	4.7	4.9	5.0	4.6	4.5	4.2	4.0	4.0
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	5.0	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

Accelerating growth with wage pressure would put MPC in a check sooner than later.

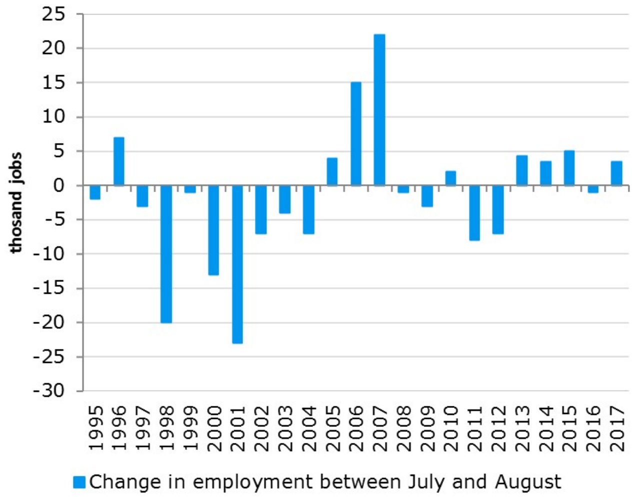
Last month, we were cautiously suggesting that GDP growth could reach 4.5% y/y in the third quarter. Very strong industrial output figures and robust increase in construction output are raising the stakes – at the moment we estimate Q3 GDP growth at 4.5-4.7%. It is too early to offer a definite breakdown, but both investment and household consumption are likely to grow by 5% y/y.

Given the fact, that employment data remain decent and wages are accelerating steadily, one should assess the MPC's assurances about lack of labor market imbalances, limited wage pressures and low unit labor cost growth as wishful thinking. With every month, this internal consensus (shared by the market that is pricing in the first rate hike in H1'19) is looking more and more fragile. It will only be shattered by higher inflation, though – for clear and unambiguous signs of it we will have to wait until next year. In labor market - inflation nexus we trust.

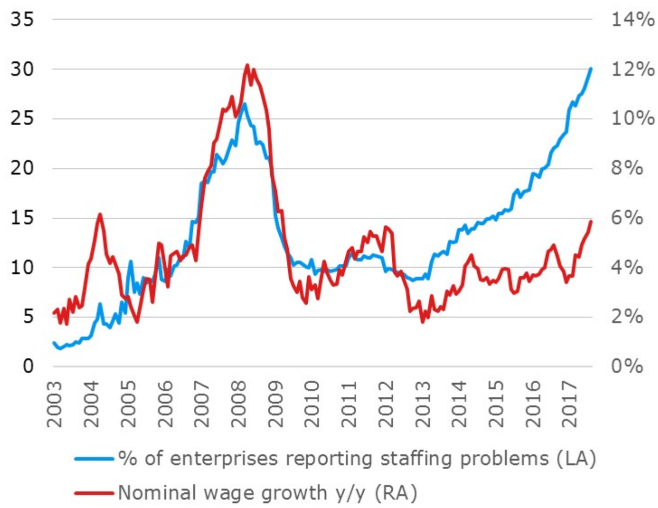
Both releases strengthened the PLN and slightly raised bond yields along the whole curve. Given the extent and the direction of recent data surprises, one can marvel at the market's apparent calm in the face of a clearly accelerating economy. Nevertheless, as we repeatedly indicated, as long as inflation remains below target and core inflation shows little signs of demand-pull pressure, the MPC is unlikely to react and markets will buy its dovish rhetoric completely. Nevertheless, higher GDP growth will mechanically raise the NBP's projection of GDP and, indirectly, core CPI (via smaller output gap). This, along with another stellar month in fiscal data (5 bn PLN surplus this late in the year is unheard of), means that local factors are supportive for Poland's risk premia and bond yields. However, the hawkish turn at the Fed suggests that risk-free rates are set to rise and even become the dominant driver for the Polish mid- and long-end parts of the curve.

Lets go into details of August data:

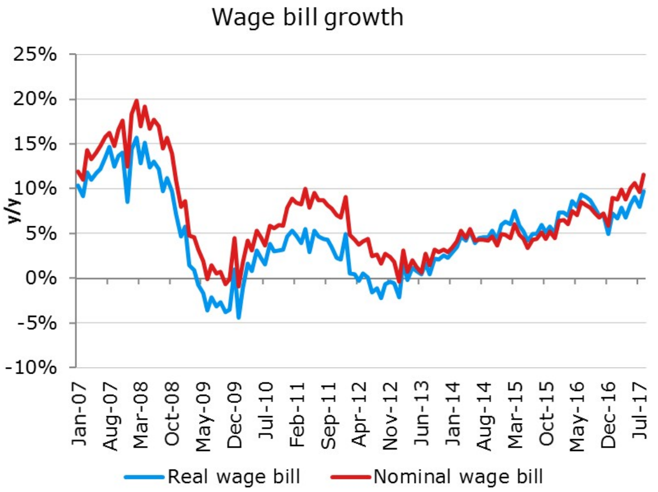
Employment in the enterprise sector rose in August by 4.6% y/y (same as in July), matching both market consensus and our expectations. On a monthly basis 3.5k jobs were added, which does not deviate from a typical results for August. As always, we need to wait until the end of month when Statistical Bulletin will be published, however we do not foresee anything extraordinary there. We expect the minor monthly growth to be distributed among manufacturing and construction, which picked up lately. Bigger picture remains the same – employment in Poland is growing at a remarkable pace. There are no signs of bottlenecks (still stabilization of unemployment rate is intriguing), however this is a great setup for further wage growth.



Average gross wage rose by 6.6% y/y in August, topping market consensus (5.7%) and our forecast (6.4%). Just as every month, we are forced to speculate on the details of the release. We believe that wages accelerated due to a combination of several factors: normalization in mining wages (it swung by tens of percentage points in the previous months); high base effects in manufacturing and construction; strong uptrends in several types of services (for instance, wages in NACE N section, i.e. administrative and support services, probably rose by more than 8% in August). Those details are of secondary importance, though. The key takeaway from today's data is that wage growth is at 8 year high and the imbalances evident on the labor market imply much faster wage growth. In our view, wage growth could reach 8% at year end.

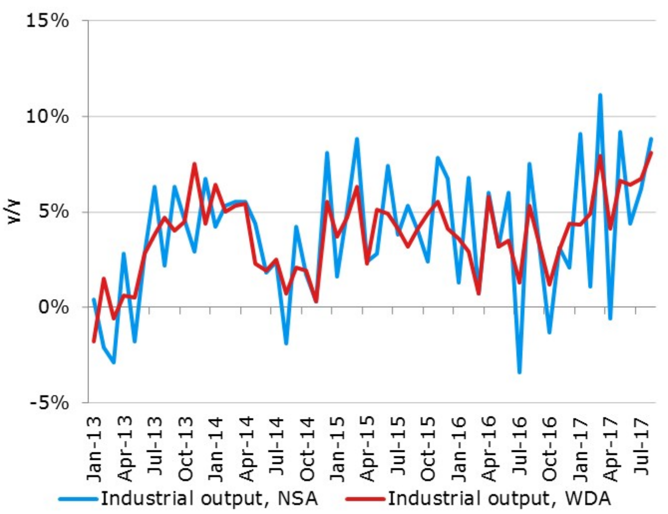


Stable employment growth and acceleration in wages pushed wage bill growth to fresh cyclical highs: it accelerated from 9.6 to 11.6% y/y in nominal and from 7.9 to 9.8% y/y in real terms. One should not bet on any meaningful slowdown in consumption in these circumstances.

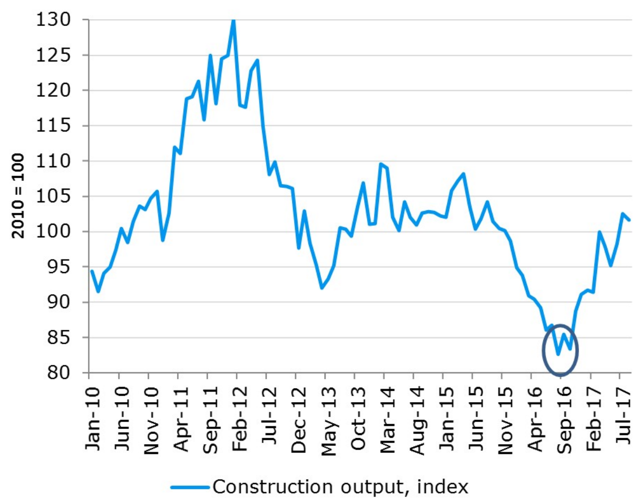


At this stage of the business cycle and with the extent to which labor demand is misaligned with labor supply, one should not be surprised by fast wage growth. The on-going acceleration in wages is also consistent with regional trends. Note, that when we compare apples to apples and adjust for the effects of minimum wage increases, the differences between Polish, Czech and Hungarian wage growth are consistent with the differences in unemployment rates and cyclical positions. This, in turn, suggests that Polish labor market is operating normally and it is unrealistic to expect labor market tightening without wage growth and wage growth without inflation.

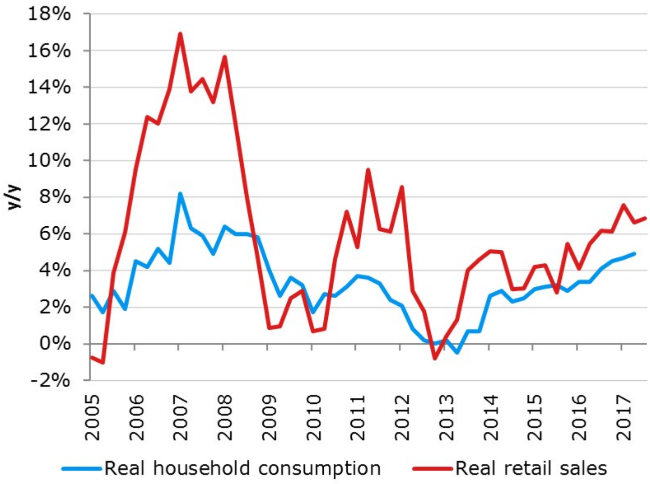
Industrial output rose by 8.8% y/y in August, crushing all forecasts (market consensus 5.9%, our forecast 5.7%). The surprise is mirrored by a very strong monthly increase in output – the seasonally adjusted +3.2% m/m make last August the best single month for industry since March 2010. Our cautious forecast were predicated on a not-so-spectacular manufacturing PMI and an assumption of weak car production. None of our fears materialized and as much as seven industries recorded double-digit growth rates in August. On the coming months one can expect robust figures as well – after all, the current trend is steeper than it was at any point of current economic upswing (i.e. since 2012).



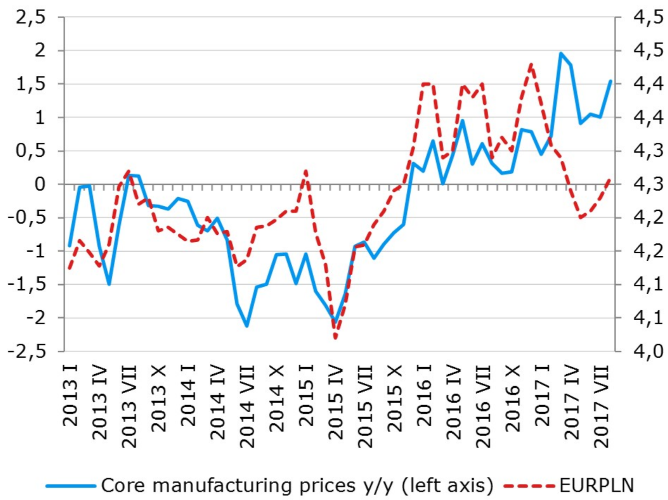
Construction output rose in August by 23.5% on e yearly basis, matching market estimates (our forecast was a bit more optimistic). However, after seasonal adjustment, it fell slightly on a monthly basis (by 0.8%), which means that yearly growth was driven mainly by base effects. Positive momentum from July could not sustain itself and earlier signals of revival (MinFin data) were not confirmed this time. We need to wait one month for CSO Statistical Bulletin with quarterly construction data to say more about the structure of construction spending in Q3. Nevertheless, we know that private investment is in a good shape (it is growing on a quarterly basis) and public sector is lagging here. Its share in GDP fell on the turn of 2016 and 2017 to pre-EU accession levels (ca. 3%). This low base (and a 2% GDP gap comparing to peaks resulting from previous EU-fund accumulation periods) coupled with the timetable of spending of EU-funds mean that we should get used to yearly growth rates exceeding 20%.



Retail sales rose by 7.6% y/y in nominal terms in August. It beat our expectations by a full percentage point. It can easily be noise in the series, but it also can be treated as a cautionary tale for the future. The very first fiscal impulse (500+ expenditures) went through the economy and with a little bit of better business activity worldwide generated second round effects that tightened labor market an lifted consumer confidence to all-time highs. At the moment it is highly possible that consumption growth in Q3 (therefore with a substantial negative base effect connected to 500+ expenditures from the last year) will be still hovering only a bit short of 5%. Nothing really points to a serious deceleration of consumption expenditures afterwards. The story for 2018 is therefore highly positive since such substantial growth of consumption has been achieved with little credit leverage (compared to 2006-2008).



Producer prices went up by 3.0% y/y in August. Half of acceleration stems from energy prices but the other half constitutes a genuine core price growth, as usual correlated well with exchange rate (see the graph). Given the current tendencies in commodity market and recent exchange rate developments, another leg up in producer prices is waiting in the wings in September. One also has to take into consideration that producers would like to compensate more of labor and material costs in their prices of final products. It is a sign of a vivid price pressure and another factors suggesting upward trajectory in producer prices in the future.



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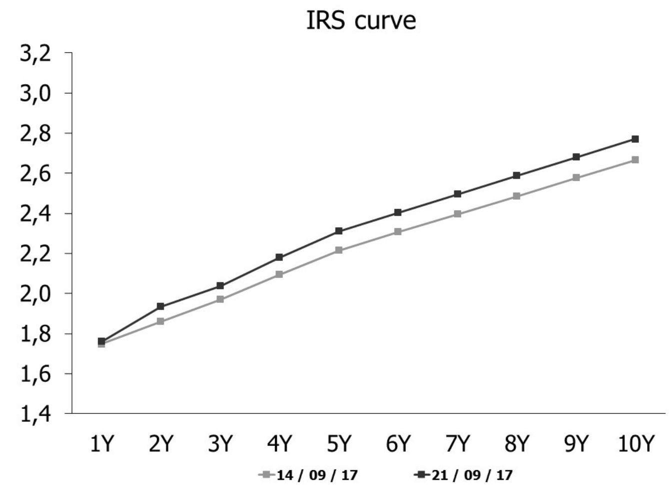
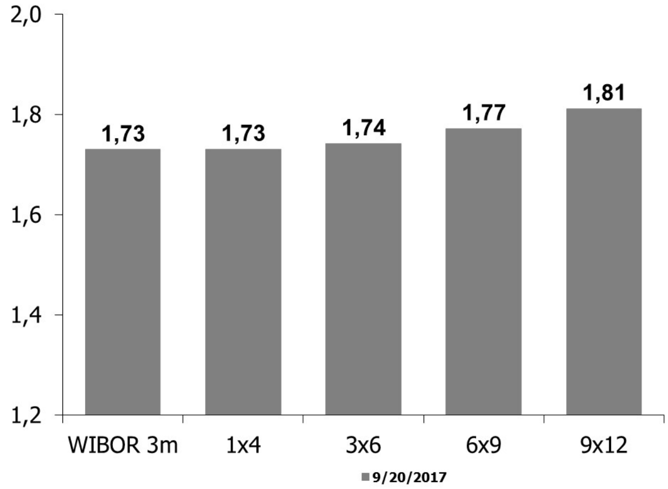
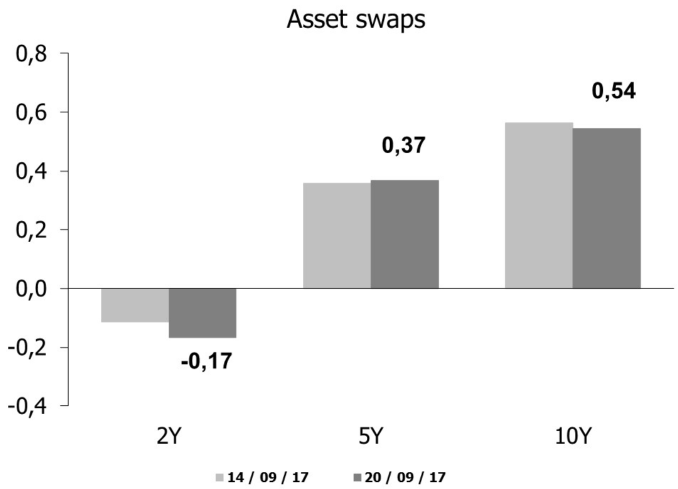
Fixed income

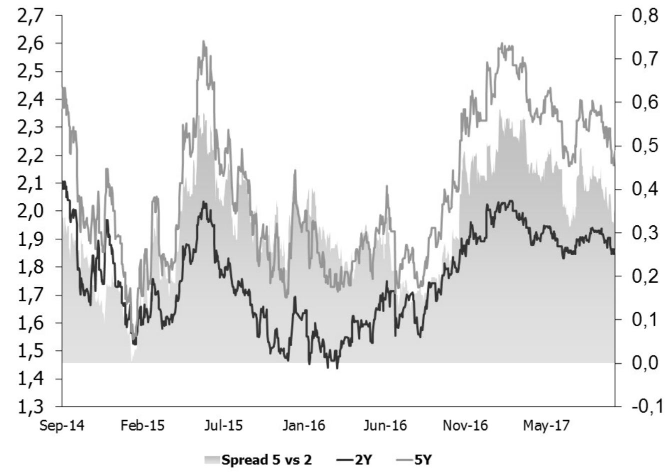
Rolling into deep

Buying flow has finished, auction was huge, internationals are taking profit and now Fed. Customers are long, banks are long, its hard time for POLGBs. DS0727/Bund is at 289 bps, it was at 360 bps in February. Curve is steep again PS0422/DS0727 is trading at 72bps. ASW are narrow, PS0422/5y is at 26 bps and DS0727/10y is at 48 bps. PS0719 is trading at 1.69% (5 bps up), PS0422 is trading at 2.64% (15 bps up) and DS0727 is trading at 3.36% (16 bps up).









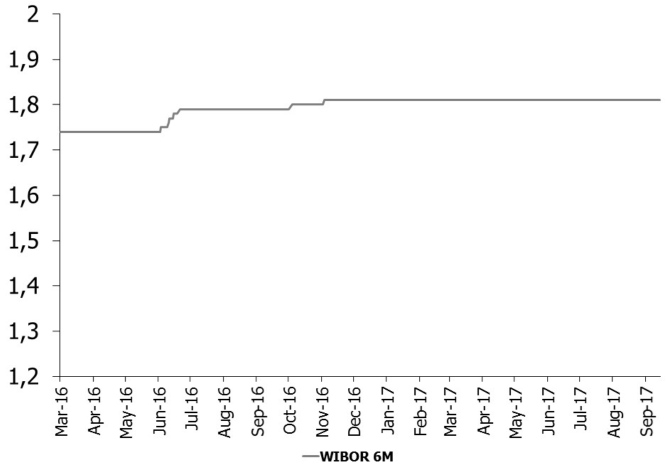
Money market

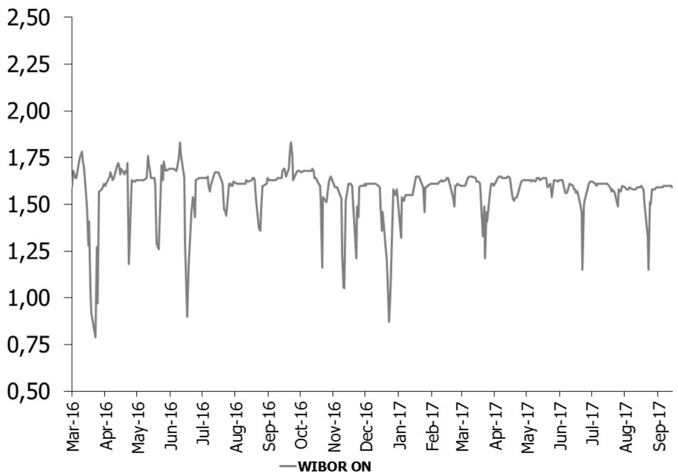
Market not impressed by macro data

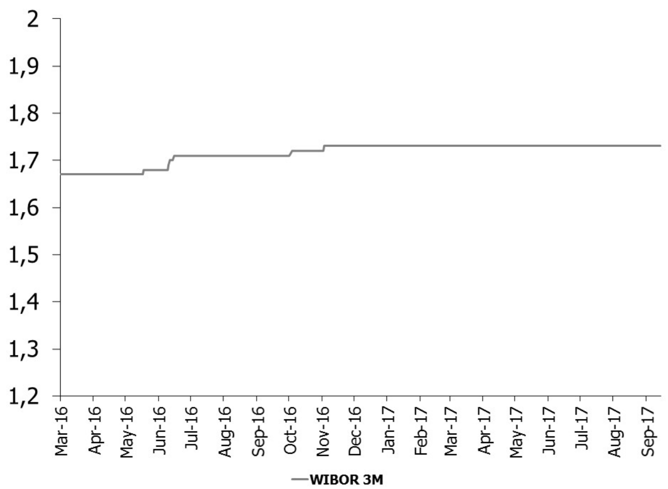
Polish macro data surprised again on the upside showing robust growth at the start of second half of the year. Market analysts are revising GDP forecasts for 2018 to 4.5%+. However market feels 100% confident with NBP commitment to leave rates unchanged for another year or more. Front-end rates move marginally higher probably only due to external factors (bear market on core rates).

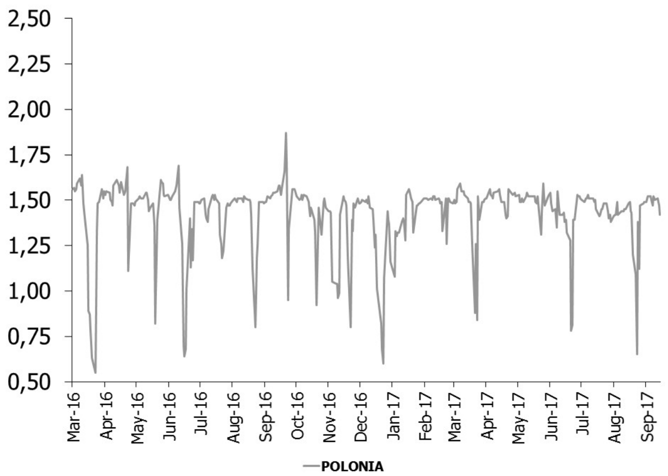
We are getting closer to month's end and overnight rates fell a bit. Tomorrow we have OMO. It is worth mentioning that cash will return to market before end of the reserve period, therefore market participants might be tempted to put all cash into NBP tomorrow.

Ref rate vs Polonia averages:
30 day 11 bp
90 day 9 bp









Forex

Spot: EUR/PLN – range trading continues PLN momentum created by headlines that the European Commission would move to the second stage of EU law infringement procedure against Poland is all gone, yesterday's news. We are one more time at the mercy of the global sentiment. 4.2660 was the low for EUR/PLN this week, and 4.2955 was a respectable high. Range trading in the 4.25-4.30 space still seems to be the most reasonable strategy. We are still skewed to play the market from the short PLN side. More hawkish than expected FOMC, may signal at least a temporary correction in USD/PLN's march lower. Ideal target for USD/PLN correction – 3.7500.

EUR/PLN vols – roughly unchanged The gamma was in demand because of the FOMC meeting, the hawkish outcome prevented vols from prompt melting. There was still buying interest in the backend, reaching 6,5% in 1 year EUR/PLN. EUR/PLN 1 month ATM mid is 5.5% today (0.25% lower vs last week), 3 months are at 5.9% (lower by 0,05%) and finally 1 year fixed at 6.5% (unchanged). The skew was little higher, and the currency spread (difference between USD/PLN and EUR/PLN) at the frontend is also tic better bid.

Short-term forecasts

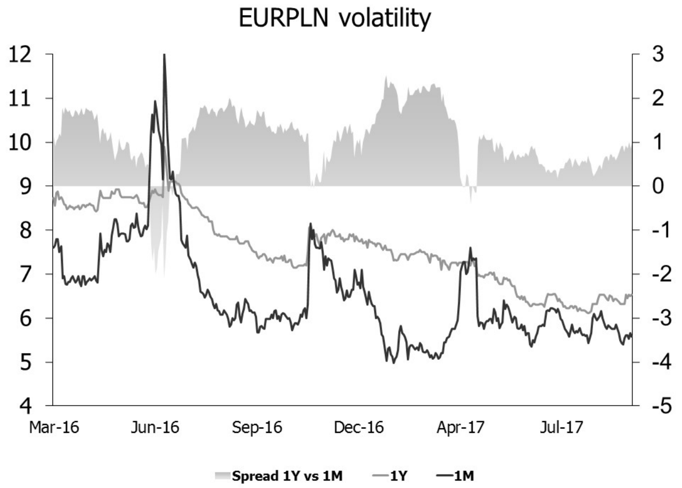
Main supports / resistances:
EUR/PLN: 4.20 / 4.30
USD/PLN: 3.50 / 3.80

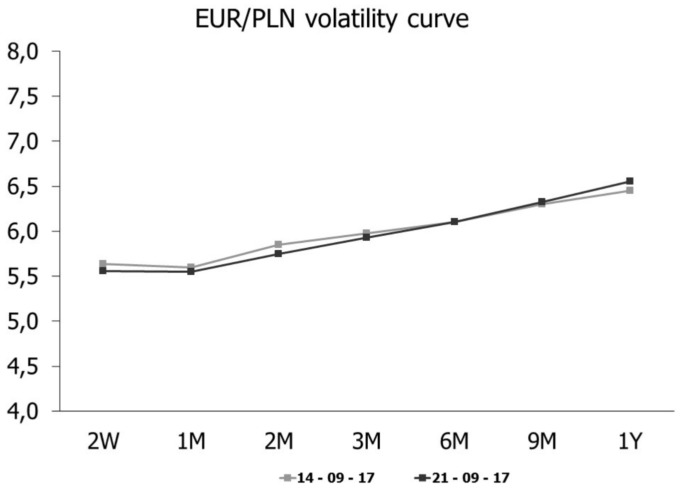
Spot Current position: Still long EUR/PLN at 4.2550.

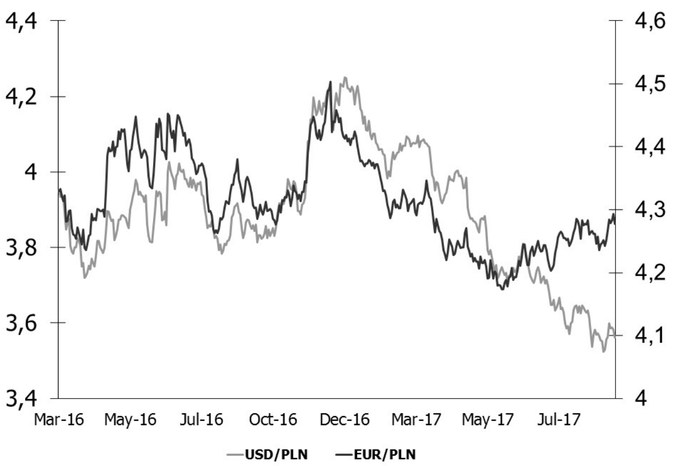
Still long EUR/PLN, 50% of the original position (after partial profit-taking). We are ready to add to the position at 4.2200 with a stop at 4.1900, or to take profit of the remainder at 4.30-ish. We are of the opinion that political risk in Poland is not priced in at current PLN levels. Technically, we see a good chance of EUR/PLN coming back to the middle of the multi months range, namely 4.35-ish.

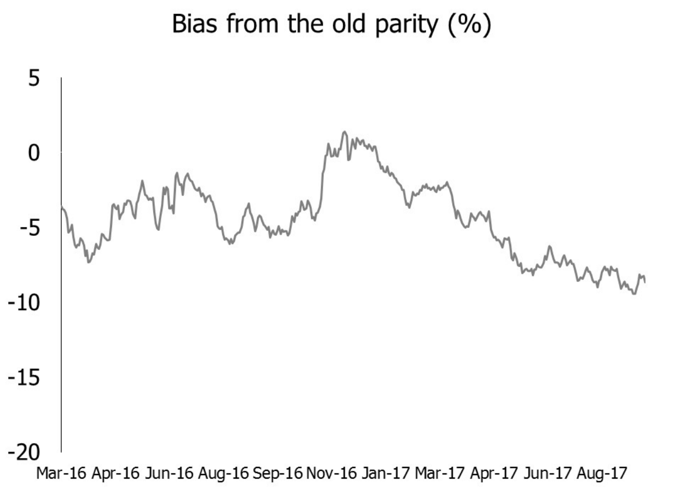
Options Vol – tactical long

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
9/14/2017	1.42	1.73	1.60	1.71	1.74	1.75	1.73	1.74	1.76	1.79	1.83	1.84
9/17/2017	1.40	1.73	1.48	1.71	1.80	1.75	1.73	1.74	1.76	1.80	1.84	1.84
9/18/2017	1.44	1.73	1.51	1.71	1.82	1.75	1.73	1.74	1.77	1.80	1.84	1.84
9/19/2017	1.32	1.73	1.47	1.71	1.67	1.75	1.73	1.75	1.79	1.82	1.87	1.86
9/20/2017	1.77	1.73	1.83	1.71	1.90	1.75	1.73	1.74	1.77	1.81	1.87	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
9/14/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
9/17/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
9/18/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
9/19/2017	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
9/20/2017	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
9/14/2017	5.60	5.98	6.10	6.45	6.45	1.77	0.56
9/17/2017	5.53	5.93	6.10	6.53	6.53	1.77	0.56
9/18/2017	5.65	5.95	6.13	6.50	6.50	1.84	0.58
9/19/2017	5.58	5.91	6.05	6.53	6.53	1.77	0.57
9/20/2017	5.55	5.93	6.10	6.55	6.55	1.79	0.56

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
9/14/2017	4.2837	3.5984	3.7206	3.2594	1.3892	0.1641
9/17/2017	4.2781	3.5863	3.7332	3.2390	1.3852	0.1641
9/18/2017	4.2835	3.5881	3.7376	3.2226	1.3838	0.1642
9/19/2017	4.2930	3.5821	3.7264	3.2109	1.3880	0.1644
9/20/2017	4.2769	3.5619	3.7092	3.1986	1.3866	0.1637

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