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Polish Weekly Review

mBank Research
(macro/FI/FX analysis)

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Table of contents

Comment on the upcoming data and forecasts

On Tuesday, the CSO will publish flash CPI data for October. We expect inflation to slow down a bit (it is a bit too early to provide a precise estimate) from cycle high recorded in September due to stable fuel prices and a pullback of clothing and footwear prices which were boosted by cold weather a month ago. Wednesday is a public holiday in Poland. On Thursday, manufacturing PMI for October will be published. We expect the index to stabilize close to last month's value: negative impact of supply constraints should balance the rising demand from abroad and domestic economy.

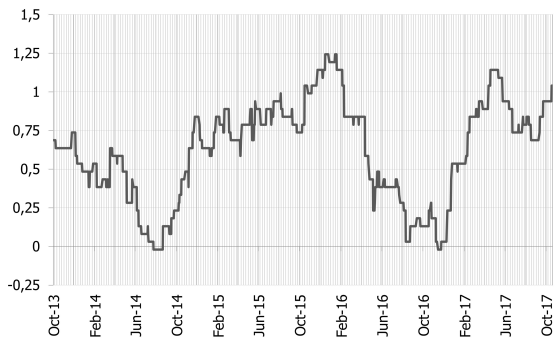
Polish data to watch: October 27th to November 3rd

Publication	Date	Period	mBank	Consensus	Prior
Flash CPI y/y (%)	31.10	Oct			2.2
Manufacturing PMI (pts.)	02.11	Oct	53.8		53.7

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	11/9/2017	1300	2.000	10/25/2017
5Y T-bond PS0422	11/9/2017	1000	2.813	10/25/2017
10Y T-bond DS0727	11/9/2017	2500	3.375	10/25/2017
30Y T-bond WS0447	-	125	3.720	10/25/2017

Reality vs analysts' expectations (surprise index* for Poland)



Comment

Slightly up as final unemployment data showed a tad lower rate than forecast. There are two opportunities to surprise analysts next week: flash CPI and 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

- 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 4.5% (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, especially when inflation temporarily drops on base effects. 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

- Negative local political factors recently eased with CHF bill possibly shelved for some time and other, controversial government activities postponed to unspecified future. At the same time, the economy shows strength from every angle. However, the MPC still sticks to low rate scenario.
- 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. That is why we do not expect the zloty's performance to be stellar at the moment. 4.20 – 4.40 range seems to be the most loikely scenario for now.
- Next year, when the MPC turns around and starts talking rate hikes, while growth continues to be stellar (consensus for a mild slowdown in 2018 is misplaced in our view), zloty should return to its cyclical patterns and apreciate closer to 4.10.

mBank forecasts

	2013	2014	2015	2016	2017 F	2018 F
GDP y/y (%)	1.4	3.3	3.8	2.9	4.3	4.5
CPI Inflation y/y (average %)	0.9	-0.1	-0.9	-0.6	1.9	2.2
Current account (%GDP)	-1.2	-2.1	-0.5	-0.3	-0.9	-1.1
Unemployment rate (end of period %)	13.4	11.4	9.8	8.2	6.8	6.0
Repo rate (end of period %)	2.50	2.00	1.50	1.50	1.50	2.00

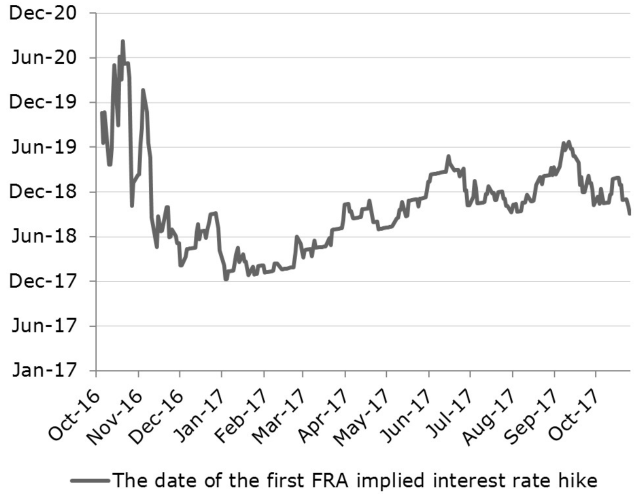
	2017 Q1	2017 Q2	2017 Q3 F	2017 Q4 F	2018 Q1 F	2018 Q2 F	2018 Q3 F	2018 Q4 F
GDP y/y (%)	4.0	3.9	4.6	4.5	4.5	4.5	4.4	4.3
Individual consumption y/y (%)	4.7	4.9	5.0	4.6	4.5	4.2	4.0	4.0
Public Consumption y/y (%)	1.0	2.4	2.5	3.0	4.0	3.0	3.0	3.0
Investment y/y (%)	-0.4	0.8	5.0	10.0	10.0	10.0	10.0	9.0
Inflation rate (% average)	2.0	1.8	1.9	2.0	1.6	2.3	2.5	2.5
Unemployment rate (% eop)	8.0	7.0	6.8	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	1.75	2.04	2.12	2.31	2.66	2.84
10Y Polish bond yields (% eop)	3.49	3.32	3.37	3.69	3.80	4.02	4.40	4.61
EUR/PLN (eop)	4.23	4.23	4.31	4.30	4.25	4.20	4.15	4.08
USD/PLN (eop)	3.97	3.70	3.65	3.68	3.63	3.53	3.46	3.37

F - forecast

Economics

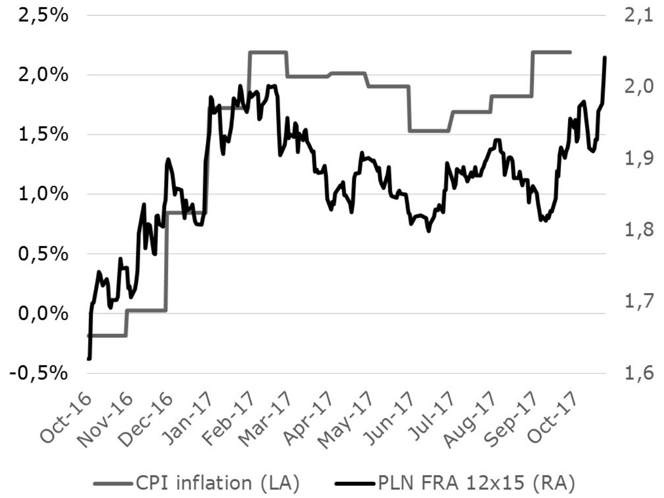
MPC: is it really closer to the hike? Not really, maybe later.

As you may see on the graph below, recent months have brought the date of the first hike substantially forward. Reasons are multiple, but higher inflation, rising wages and push in global rates are among strong candidates for being important. The market also got the impression that the MPC is not as monolithic as it had seemed for a long time: there are now 6 MPC members (Zubelewicz, Gatnar, Ancyparowicz, Hardt, Kropiwnicki and Osiatynski) claiming that a rate hike might be needed before before the end 2018. That stands in contrast with the view of the MPC Governor. Technically, it means that the governor can be outvoted. Is it really a game changer or just noise?



Taking a closer look, only two MPC members base their view on a strong conviction (Zubelewicz, Gatnar), driven by labor market developments and the necessity to act sooner rather than later. The rest seems to be backing a conditional hike (Ancyparowicz, Hardt, Kropiwnicki, Osiatynski) on the back of various assumptions, mechanisms and stories (to be confirmed by the data or NBP projections). Therefore, their statements should be treated in a softer way. That should bring us to conclusion that what we see is what we get: noise.

Having written that, we would like to remind the Readers that we mostly agree on the mechanisms posted by MPC members that may ultimately lead to a hike, but rather in the late 2018. Namely, we think that wage pressure is mounting and core inflation is on upward path. However, we also think that the link between labor market and inflation weakened after the financial crisis (pretty much everywhere). Hence, we do not really buy the necessity of pre-emptive hikes (the majority of central banks globally does not, either). Moreover, with investment activity still mostly flat (and, apart from housing, EU driven) and under-leveraged consumption (compared to 2007-2008), hikes would really need to be substantial to make a difference. Hence, small hikes – delivered for the sake of hiking – do not make much sense. It seems the dominant paradigm in central banking (apart from the Fed) is rather based on assumption that recovery is fragile, inflation uncertain and in such circumstances later rate hikes may be optimal (later delivered after inflation starts to rise substantially). Bank of Hungary is pursuing (successfully!) such a path focused on lowering financing costs for economic entities for longer horizon. So far the markets seem to be quite relaxed with such policy.



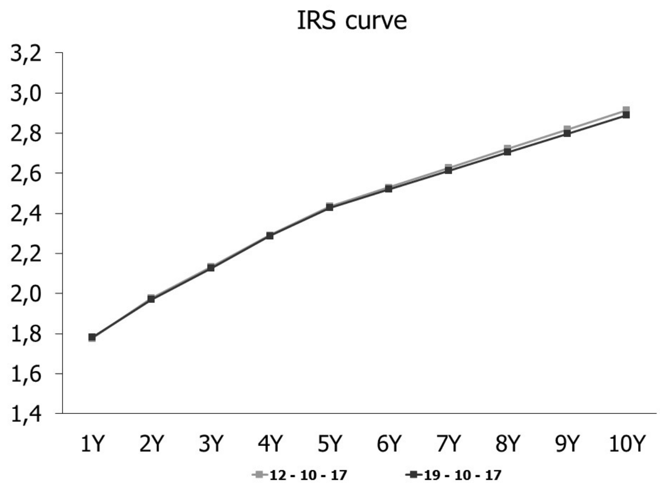
Summing up, we think that MPC would reach for a hike in H2 2018. Until that time inflation is going to be brought down temporarily by base effects and markets should react (see the graph and the link between inflation and expected rate path). Therefore the market pricing seems to be stretched at this very moment. The real and monotonous play for rate hikes will began again shortly, but after market correction.

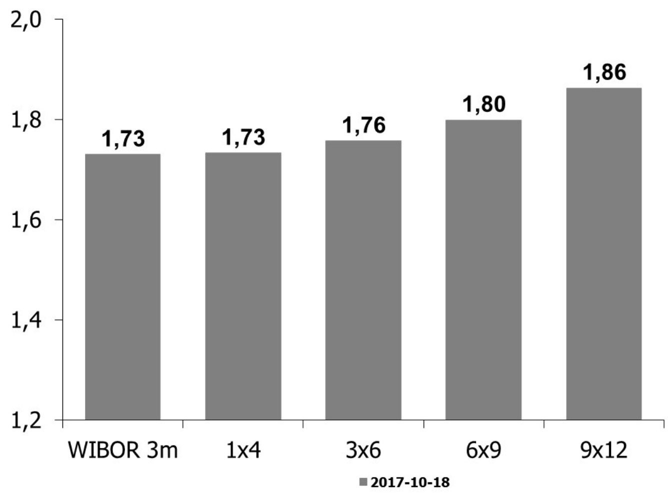
Fixed income

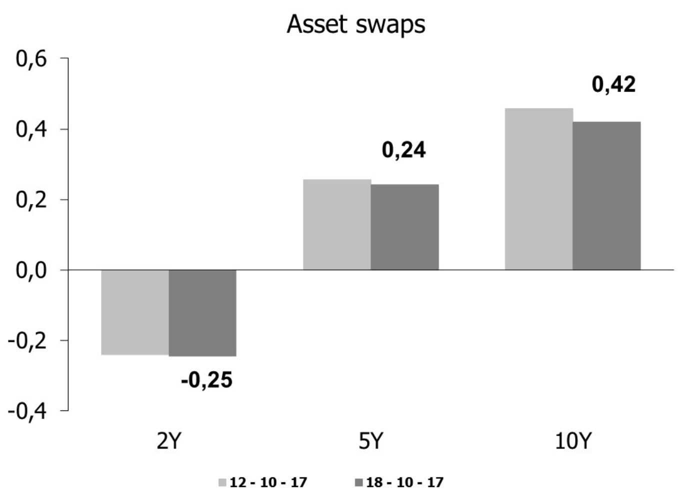
Can I play with steepness?

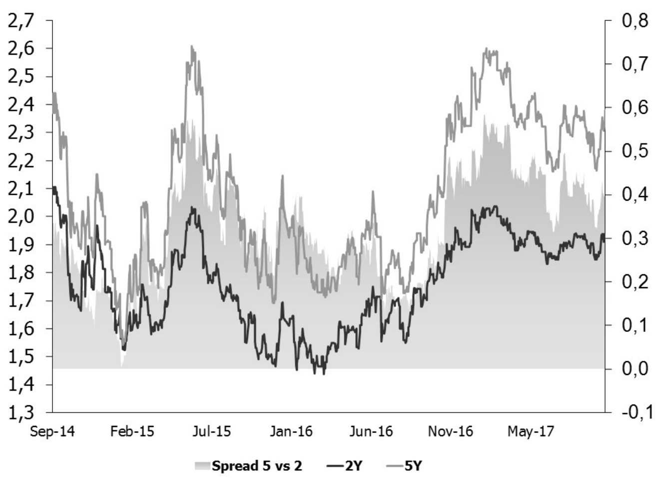
Auction is behind us. Ministry sold 8 bn with demand over 12 bn. Curve is steep again, so there was massive bid on DS0727, over 2.5 bn was sold here. Short bonds are on the bid as we have the end of month and banks don't want to pay banking tax. Yes, it doesn't make sense to buy OK1018 at 1.2%, but since everyone is short...

DS0727/Bund is 296 bps, WS0922/DS0727 is trading at 74 bps, WS0922/5y is at 12 bps and DS0727/10y is at 41 bps. DS1019 is trading at 1.60% (6 bps down), WS0922 is trading at 2.66% (2 bps up) and DS0727 is trading at 3.40% (11 bps up). The curve is extremely steep.









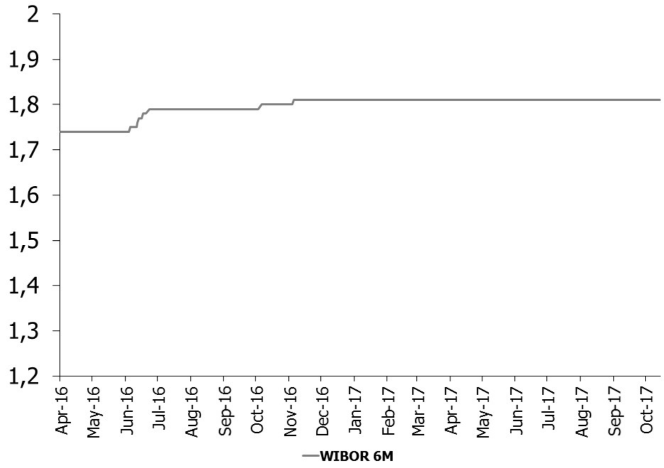
Money market

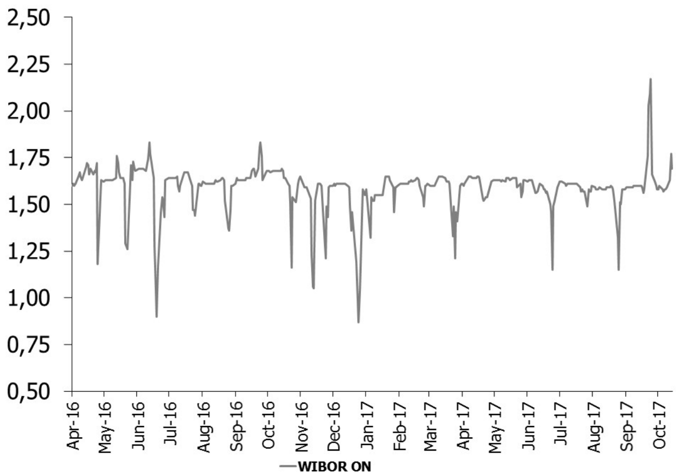
Hikes in the face of lower CPI?

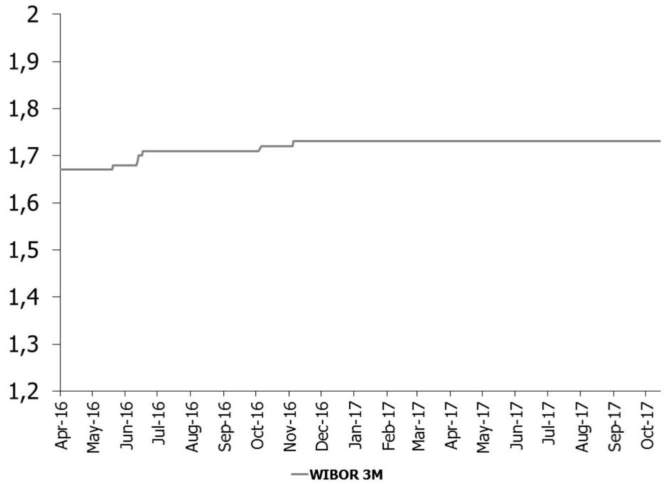
Last week Polish yields continued to rise. That's an outcome of the rise in core yields combined with some hawkish comments from MPC members. Two year swap traded as high as 2.06%, assuming a 60+ bp hike in 2y period. Today, after Mr Draghi calmed markets we are around 3-4 bps off highs. Next week we have flash CPI reading. There is a strong conviction among analysts that we entering a period of high base effects. Some say that CPI may reach 1.5% at the turn of the year. Net shortage of bonds (redemptions vs issuance) pushed ASWs even tighter. Bond curve is divided around 5y tenor. All shorter bonds are in high demand from ALM desks while 5+ year notes are under their radar. Curve steepened again with 5v10 reaching 78 bps.

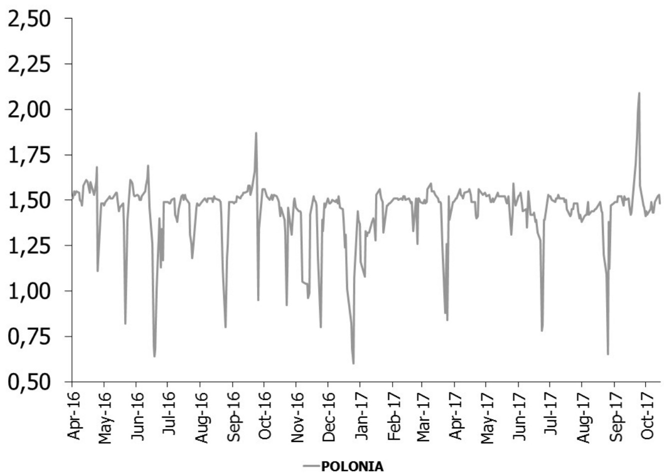
Just as we expected: auction, redemption and coupon payments were too much for market players to square themselves. Since last OMO, we have seen huge overliquidity, even additional operation wasn't able to square the market. When new month starts, everything should be back to normal.

Ref rate vs Polonia averages:
30 day 3 bp
90 day 6 bp



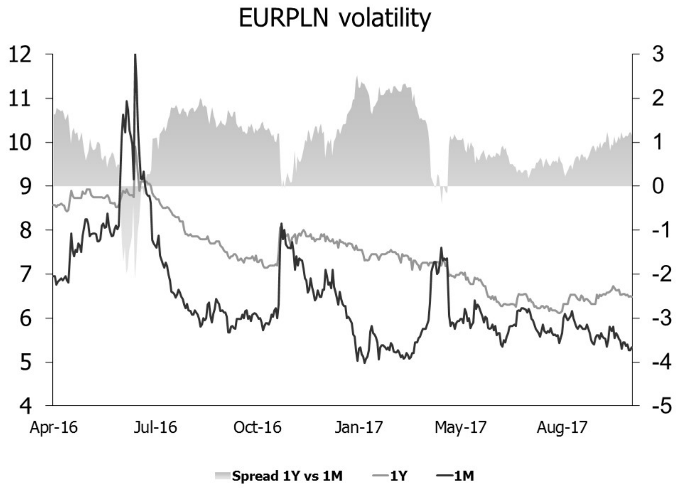






Forex

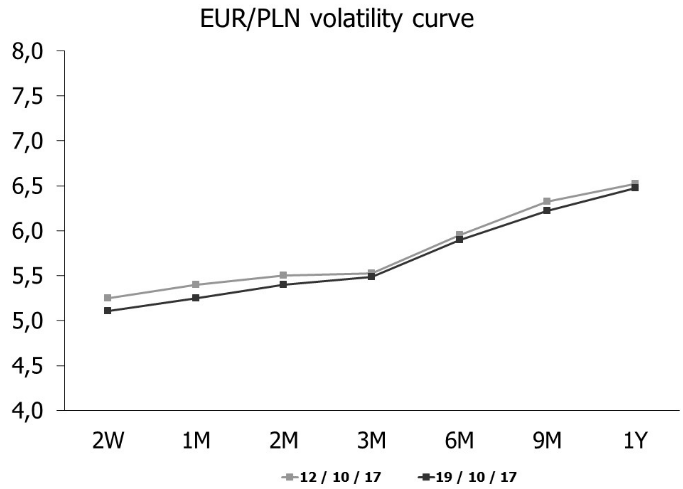
Spot: EUR/PLN – hovering above main support
There is not much to report, EUR/PLN is still hovering above 4.21-4.23, the main support zone. Technically, one might say, it is a double bottom formation and that may provoke the move to 4.26-4.28 resistance zone. The momentum is really weak. There was no change of Poland's ratings from Standards and Poor's last Friday. We believe that the 4.22-4.27 range is a likely scenario for the next following sessions. We are going to play that range with a PLN negative skew.



EUR/PLN vols – tic lower The vols are slightly lower, mostly because of the decreasing realized volatility, and ECB being already behind us. 1 month ATM mid is 4.95% today (0.3% lower), 3 months are at 5.3% (0.1% lower) and, finally, 1 year fixed at 6.4% (0.1% lower). The skew is roughly unchanged. The currency spread (difference between USD/PLN and EUR/PLN) was better offered, also in the backend with USD/PLN ATM 6 months being given at 9.2%.

Short-term forecasts

Main supports / resistances:
EUR/PLN: 4.22 / 4.32
USD/PLN: 3.50 / 3.80

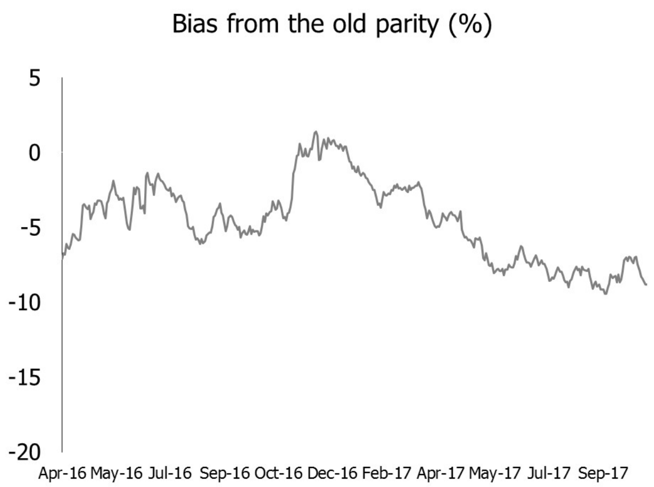


Spot Current position: Long at 4.2300 in EUR/PLN .

We are long at 4.2300 with a short stop at 4.1950 and hopes to see 4.27+. It is a purely technical, opportunistic trade. We are of the opinion, that mean-reverting strategies are the most profitable in the longer run in our low Beta currency.

Options Vol – sidelined

It is time to throw in the towel. We have closed our tactical long in the mid curve of EUR/PLN. First of all, the theta bills are not really being covered by gamma. Secondly, the realized volatility, both daily and higher frequency, is slowly, but steady heading south. As a result, we have neutralized our Vega long, and moved to the sidelines.



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
10/19/2017	1.67	1.73	1.79	1.71	1.94	1.75	1.73	1.75	1.80	1.86	1.93	1.88
10/22/2017	1.65	1.73	1.73	1.71	1.80	1.75	1.73	1.75	1.82	1.89	1.96	1.90
10/23/2017	1.70	1.73	1.80	1.71	1.95	1.75	1.73	1.76	1.81	1.88	1.95	1.90
10/24/2017	1.53	1.73	1.59	1.71	1.64	1.75	1.73	1.76	1.82	1.90	1.99	1.91
10/25/2017	1.64	1.73	1.76	1.71	1.96	1.75	1.73	1.76	1.83	1.94	2.01	1.92

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
10/19/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
10/22/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
10/23/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
10/24/2017	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
10/25/2017	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
10/19/2017	5.23	5.48	5.93	6.45	6.45	1.56	0.56
10/22/2017	5.15	5.35	5.90	6.46	6.46	1.56	0.56
10/23/2017	5.28	5.45	5.93	6.40	6.40	1.56	0.56
10/24/2017	5.25	5.45	5.93	6.41	6.41	1.56	0.56
10/25/2017	5.20	5.36	5.90	6.48	6.48	1.56	0.56

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
10/19/2017	4.2381	3.5896	3.6695	3.1868	1.3736	0.1647
10/22/2017	4.2452	3.5966	3.6601	3.1736	1.3780	0.1650
10/23/2017	4.2359	3.6061	3.6564	3.1679	1.3741	0.1649
10/24/2017	4.2382	3.6031	3.6544	3.1693	1.3739	0.1652
10/25/2017	4.2370	3.6006	3.6293	3.1549	1.3651	0.1657

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