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## Polish Weekly Review

**mBank Research**  
(macro/FI/FX analysis)

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### Comment on the upcoming data and forecasts

Next week begins with the release of the latest Inflation Report from the NBP. On the same day, the CSO will release final CPI data for October - we expect the surprise (flash 2.1%, our forecast 2.0%) to be associated with higher food prices. The monthly balance of payments data releases at the same time should show a small current account surplus driven by a surge in exports and resulting improvement in the trade balance. On Tuesday, flash GDP data for the third quarter will be released. We expect a material acceleration vis-a-vis the second quarter (from 3.9 to 4.8% y/y), due to higher contributions from investment, consumption and net exports. The busy week will end with monthly labor market prints from the CSO. We forecast average wage to have accelerated to 7.1% y/y, due to favorable working day effects (from -1 to +1 r/r) and strong uptrend in many services sections. Employment growth, on the other hand, is set to drop a little due to the effects of lower retirement age (small, but meaningful for employment figures).

### Polish data to watch: November 9th to November 16th

Publication	Date	Period	mBank	Consensus	Prior
CPI final y/y (%)	13.11	Oct	2.1	2.1	2.2
Current account (mio EUR)	13.11	Sep	313	-146	-100
Exports (mio EUR)	13.11	Sep	17100	17125	15682
Imports (mio EUR)	13.11	Sep	16300	16684	15384
NBP Inflation Report	13.11	Nov			
GDP flash y/y (%)	14.11	Q3	4.8	4.5	3.9
Core inflation y/y (%)	14.11	Oct	0.8	0.9	1.0
Average gross wage y/y (%)	16.11	Oct	7.1	6.5	6.0
Employment y/y (%)	16.11	Oct	4.4	4.5	4.5

### 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	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

Unchanged (no data). Next week, labor market data, CPI and GDP offer some room for surprise.

\* 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

- We remain in the vanguard of forecast revision cycle. In 2017, Polish economy is set to rise by 4.3%, in 2018 by 4.5%. Let's face it, household consumption is booming, while investment likely finally rebounded in Q3. Add an unexpected boost from net exports and growth will be very close to multi-year highs 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 likely 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 appreciate 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

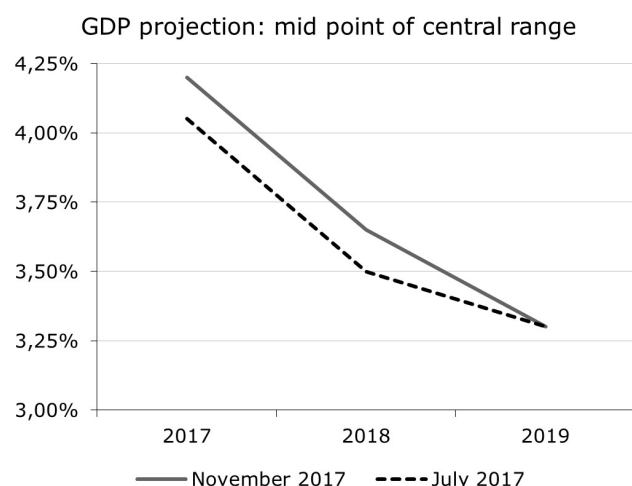
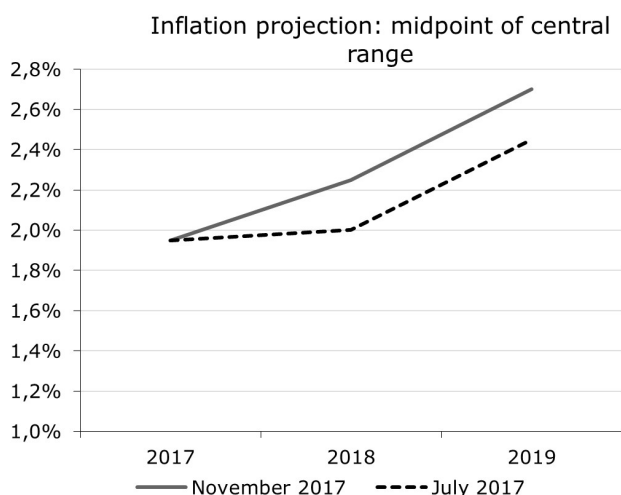
	2017 Q1	2017 Q2	2017 Q3 F	2017 Q4 F	2018 Q1 F	2018 Q2 F	2018 Q3 F	2018 Q4 F
GDP y/y (%)	4.0	3.9	4.6	4.5	4.5	4.5	4.4	4.3
Individual consumption y/y (%)	4.7	4.9	5.0	4.6	4.5	4.2	4.0	4.0
Public Consumption y/y (%)	1.0	2.4	2.5	3.0	4.0	3.0	3.0	3.0
Investment y/y (%)	-0.4	0.8	5.0	10.0	10.0	10.0	10.0	9.0
Inflation 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	1.80	1.92	2.11	2.36	2.59
10Y Polish bond yields (% eop)	3.49	3.32	3.37	3.45	3.53	3.68	3.89	4.08
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

### Polish MPC: Rates unchanged, targeted reserve requirement ratio cut.

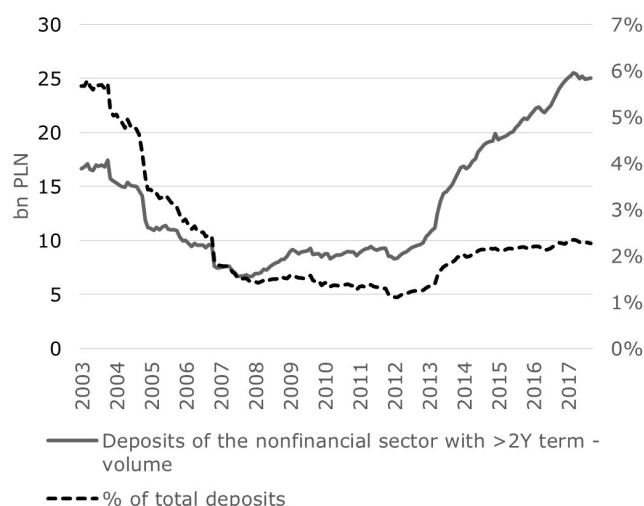
The MPC left reference rate unchanged at 1.50%. However, November meeting continued with a hawkish tilt in the statement accompanied by even more dovish wording during the conference. Recent statement notes that core inflation measures increased of late and the passage referring to doubts over the pass-through of wage growth to inflation was erased. Moreover, the risk of overshooting inflation target is no longer assessed as "limited". Instead, MPC expects inflation to hover close to inflation target in the coming years. Changes seem consistent with the fresh inflation projection (see the graphs below).



GDP growth path was upped due to higher starting point. However, falling trajectory overall in 2017-2019 time span was kept intact. Inflation path shifted upwards in 2018 and 2019 and the central point of projection (calculated as a mean out of quoted min-max interval) is situated slightly above the NBP's target. It may stem either from higher central path of inflation or an (upward) skew in the balance of risks (details are set to be published on Monday). As already mentioned, the conference was utterly dovish. Mr. Glapinski reiterated the will to support stable rate until the end of 2018. Nominal hawk Hardt played down inflation projection quoting uncertainty with regard to mid-term growth perspectives in the euro zone and expected

slowdown in Poland. For the first time since many months the word "deflation" appeared during the conference (Glapinski) as an example of foggy outlook for 2019.

This MPC meeting brought a small change, loosely connected with the usual conduct of the monetary policy. MPC decided to lower the reserve requirement ratio (RRR) to zero for term deposits with maturity over 2 years. Officially, it is claimed that the move had a technical flavor and was aimed at an old legal flaw regarding the unequal treatment of Polish and foreign bank entities (with favor going to the latter). This adjustment restored equality. Of course, the change in RR rate may be also seen as a favor for some MPC members claiming that savings rate is too low. However, the actual significance of the move may be low (or very low) as it frees up only limited stock of funds. Currently, term deposits with >2 years maturity are worth PLN 25 bn (20bn in household sector) and constitute 2.3% of all deposits of non-financial institutions and 2.8% of those from household sector (see the graph below).



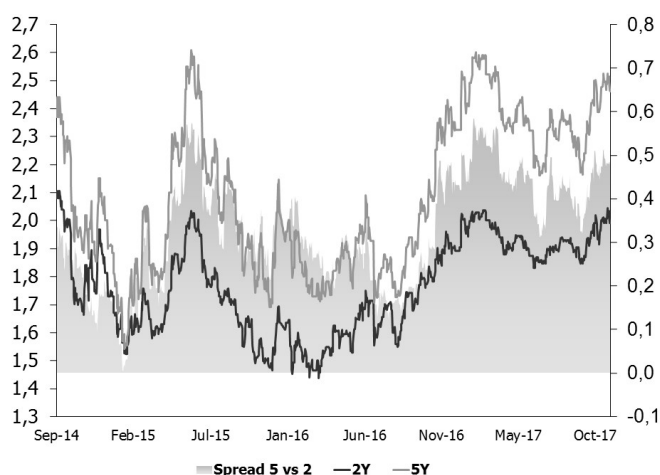
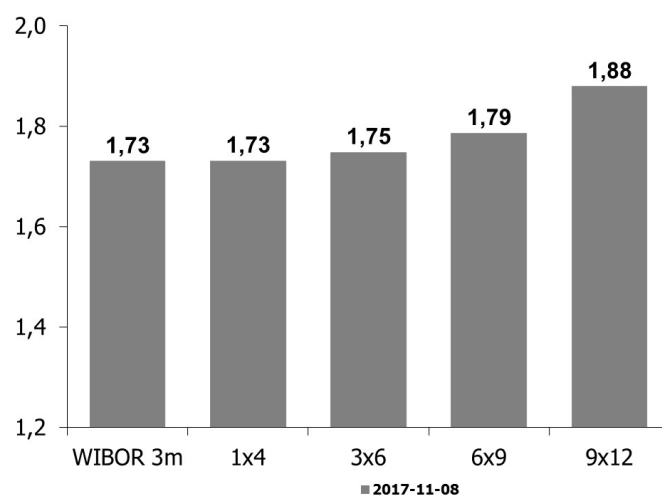
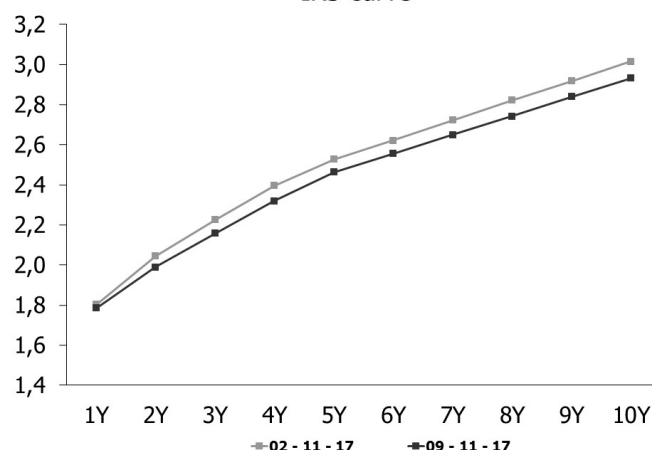
As we expected, the market was caught off guard. Interest rates went down along the whole bond and swap curve, the most in the short end. We warned that the play for the more hawkish MPC was premature on the basis of only some hawkish comments from various MPC members. We think that dovish MPC rhetoric should trigger a shift in expectations and looming lower inflation readings (especially at the turn of the year) are going to exacerbate the move. The play for MPC is going to come back in 2018 when signals of inflation pressure become more obvious.

## Fixed income

### Flatter

Ministry sold over 8 bn bonds on today's switching auction. Most of the supply we saw on the new WZ0528 and WZ1122, so it shouldn't harm fixed bonds. Afterwards the auction curve is steeper, WS0922/DS0727 at 79 bps and DS0727/Bund is 303 bps. ASW spreads are: WS0922/5y at 13 bps and DS0727/10y at 45bps. DS1019 is trading at 1,59% (2 bps down), WS0922 is trading at 2,62% (6 bps down) and DS0727 is trading at 3,40% (7 bps down).

IRS curve



## Money market

### A hike too far

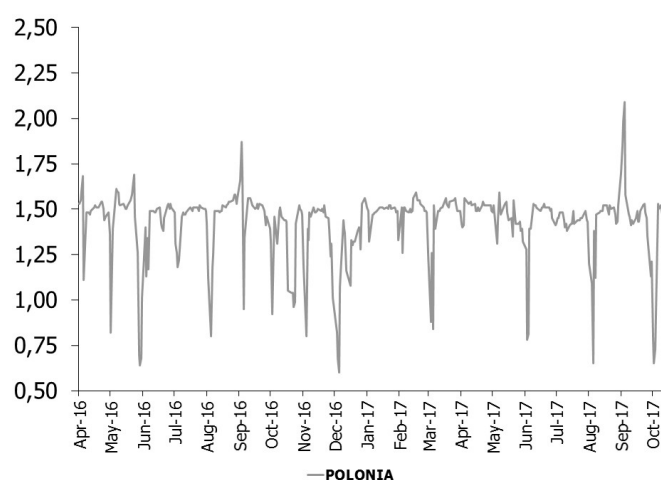
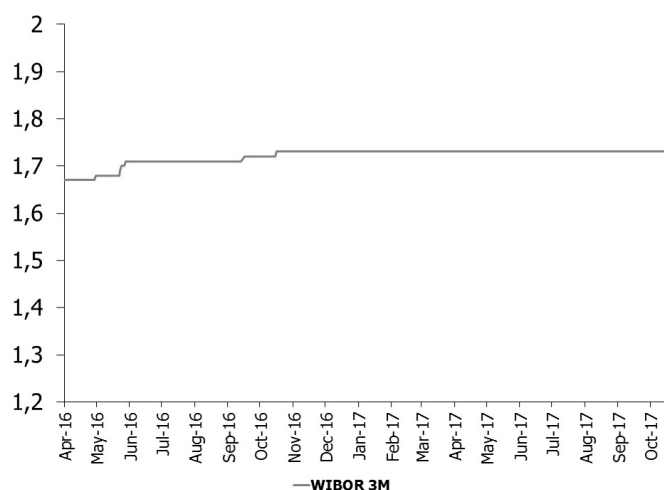
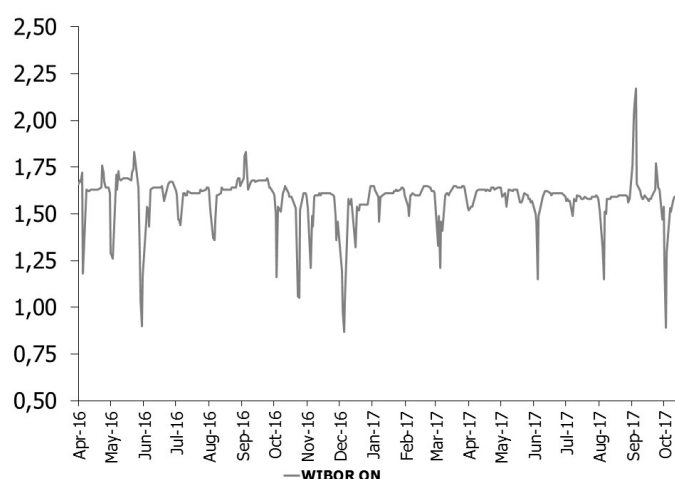
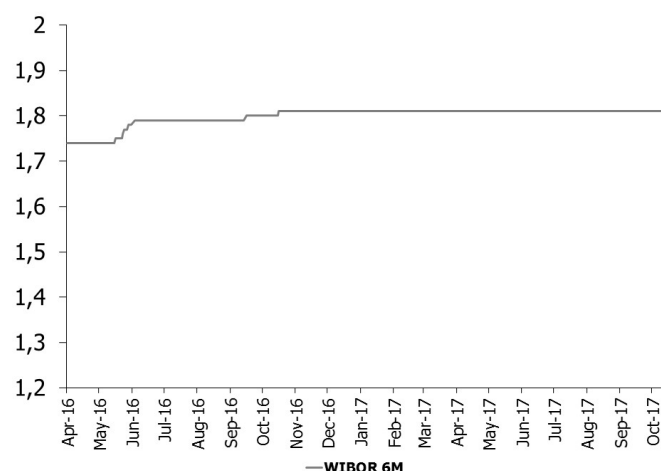
Surprisingly, this month's MPC meeting was a big event for the market. That's mainly due to the buildup in market expectations for a first motion for hike. Short end rates held quite high with some nervousness until the conference. Governor Glapinski and Mr Hardt "surprised" the market by sounding very dovish and reiterating that rates should stay flat until the end of 2018. This should push back calls for an early rate hike, especially with some base effects on CPI kicking in next months.

Cash on the soft side last week with Polonia fixings around 1.44%. Tomorrow's OMO will set the tone for the next week. We don't expect any big divergence from 1.50%.

Ref rate vs Polonia averages:

30 day 18 bp

90 day 8 bp



## Forex

**Spot: EUR/PLN – still treading water** It was another week of the tight range trading in EUR/PLN. 4.2285 and 4.2500 were marking the low and high of the last 5 trading days. The MPC conference has failed to increase the Zloty volatility. The dovish MPC message has not negatively influenced PLN so far. The currency is following global sentiment, with no real life of its own. We are still in range trading mode (wider 4.22-4.27 range). We are playing that range, with slightly negative PLN skew.

**EUR/PLN vols – another move lower** The tight range in EUR/PLN says it all! All realized volatility metrics (daily and high frequency) are still on the move down. The daily observation is especially depressed and close to this year's low. As the consequence, the vols, especially in the front end, keeps on melting. 1 month ATM mid is 4.65% today (0.2% lower), 3 months are at 5.2% (0.1% lower) and, finally, 1 year fixed at 6.3% (0.1% lower). The skew was better offered. The currency spread (difference between USD/PLN and EUR/PLN) was lowered by 0.25% to 3% but mostly in the front end.

## Short-term forecasts

Main supports / resistances:

EUR/PLN: 4.22 / 4.32

USD/PLN: 3.50 / 3.70

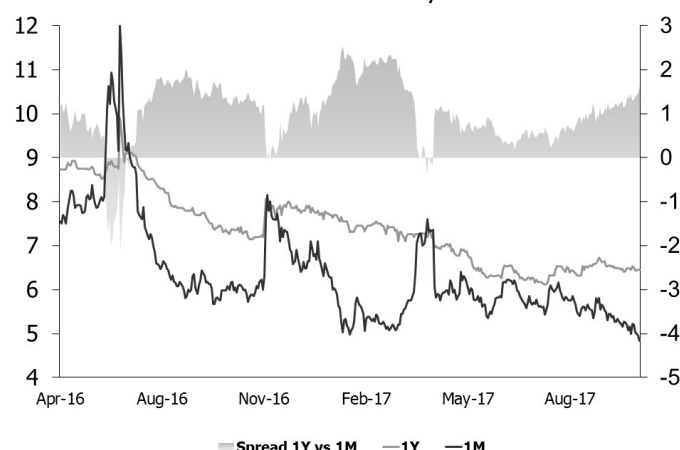
**Spot** Current position: Long at 4.2300 in EUR/PLN .

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 most profitable in the longer run in our low Beta currency.

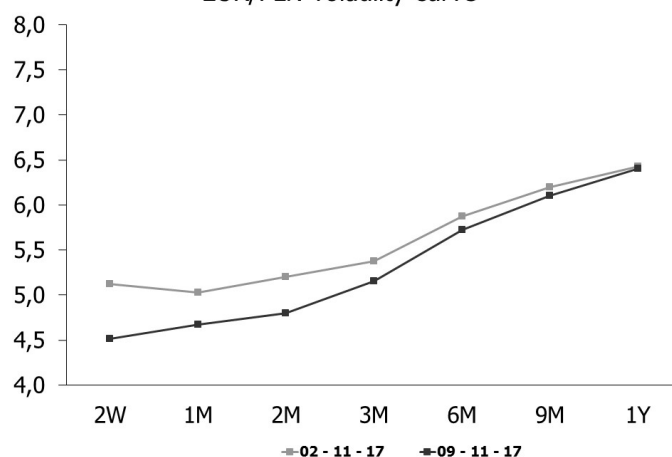
**Options** Vol – sidelined

We don't see much of a value in being positioned in EUR/PLN vol curve. Especially, if one wants to initiate the position by crossing the market spread. The spread in vol vs the realized volatility of the vol curve is not really appealing. We focus on market making, with selling the gamma/vanna being the slightly more preferable strategy.

EURPLN volatility



EUR/PLN volatility curve



Bias from the old parity (%)





## 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
11/2/2017	1.69	1.73	1.79	1.71	1.99	1.75	1.73	1.75	1.82	1.92	2.02	1.92
11/5/2017	1.71	1.73	1.81	1.71	2.00	1.75	1.73	1.76	1.82	1.92	2.01	1.91
11/6/2017	1.63	1.73	1.81	1.71	1.99	1.75	1.73	1.75	1.81	1.91	2.00	1.90
11/7/2017	1.53	1.73	1.59	1.71	1.65	1.75	1.73	1.76	1.81	1.90	1.99	1.91
11/8/2017	1.55	1.73	1.58	1.71	1.61	1.75	1.73	1.75	1.79	1.88	1.97	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
11/2/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
11/5/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
11/6/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
11/7/2017	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
11/8/2017	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	
11/2/2017	5.03	5.38	5.88	6.43	6.43	1.64	0.56	
11/5/2017	5.00	5.35	5.88	6.43	6.43	1.64	0.56	
11/6/2017	4.95	5.30	5.90	6.45	6.45	1.59	0.55	
11/7/2017	4.83	5.28	5.83	6.45	6.45	1.66	0.54	
11/8/2017	4.68	5.15	5.73	6.40	6.40	1.59	0.53	

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
11/2/2017	4.2336	3.6366	3.6368	3.1890	1.3627	0.1656
11/5/2017	4.2406	3.6408	3.6420	3.1900	1.3631	0.1651
11/6/2017	4.2449	3.6585	3.6522	3.2051	1.3649	0.1656
11/7/2017	4.2397	3.6652	3.6617	3.2074	1.3629	0.1658
11/8/2017	4.2423	3.6595	3.6627	3.2181	1.3604	0.1659

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