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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 CSO will release its monthly labor market data. We forecast average wage to have accelerated to 7.1% y/y, due to favorable working day effects (up from -1 y/y in September to +1 y/y in October) 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). On Monday, industrial and retail data will be released. We expect industrial output to accelerate markedly, to ca. 10% y/y due to the above mentioned calendar factors and modest base effect (ca. 1 percentage point). Construction output likely swung even more strongly, reaching new cycle high in y/y terms. PPI likely decelerated a bit in October. Finally, retail sales continued to grow at a rapid pace – with drag from clothing and footwear sales offset by strong car sales and low base in Other category. On Wednesday the CSO will release consumer and enterprise sentiment data for November – this is the earliest measure of economic confidence available. On Thursday, the NBP will publish Minutes from the last MPC meeting and M3 data. We expect neither to impact markets. Next week ends with the release of CSO's Statistical Bulletin along with unemployment data. The preliminary estimate from the Ministry of Family (6.6%) lies between our forecast (6.5%) and market consensus (6.7%).

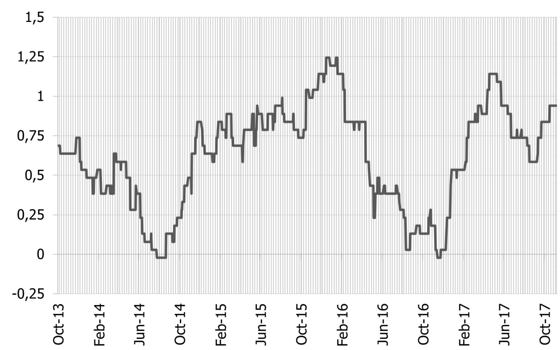
Polish data to watch: November 17th to November 24th

Publication	Date	Period	mBank	Consensus	Prior
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
Sold industrial output y/y (%)	20.11	Oct	10.2	9.9	4.3
PPI y/y (%)	20.11	Oct	3.0	2.8	3.1
Retail sales y/y (%)	20.11	Oct	8.7	8.5	8.6
CSO business sentiment	22.11	Nov			
CSO consumer sentiment	22.11	Nov			
MPC Minutes	23.11	Nov			
M3 y/y (%)	23.11	Oct	5.4	5.5	5.4
Unemployment rate (%)	24.11	Oct	6.5	6.7	6.8

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	11/23/2017	1300	2.000	10/25/2017
5Y T-bond PS0422	11/23/2017	1000	2.813	10/25/2017
10Y T-bond DS0727	11/23/2017	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 flash GDP turned out to have grown faster than anticipated. Next days bring several occasions for surprises: wages, industrial output, PPI, retail sales and unemployment.

* 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).

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Our view in a nutshell

Fundamentals

- 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.
- 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 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

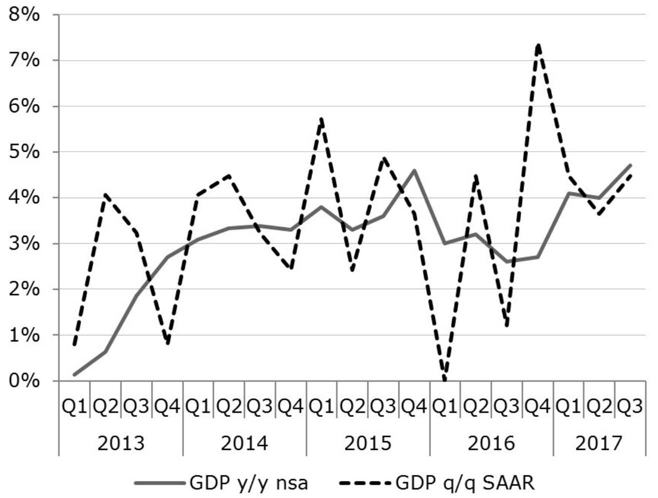
	2017 Q1	2017 Q2	2017 Q3 F	2017 Q4 F	2018 Q1 F	2018 Q2 F	2018 Q3 F	2018 Q4 F
GDP y/y (%)	4.1	4.0	4.7	4.5	4.5	4.5	4.4	4.3
Individual consumption y/y (%)	4.7	4.9	5.0	4.6	4.5	4.2	4.0	4.0
Public Consumption y/y (%)	1.0	2.4	2.5	3.0	4.0	3.0	3.0	3.0
Investment y/y (%)	-0.4	0.8	5.0	10.0	10.0	10.0	10.0	9.0
Inflation 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

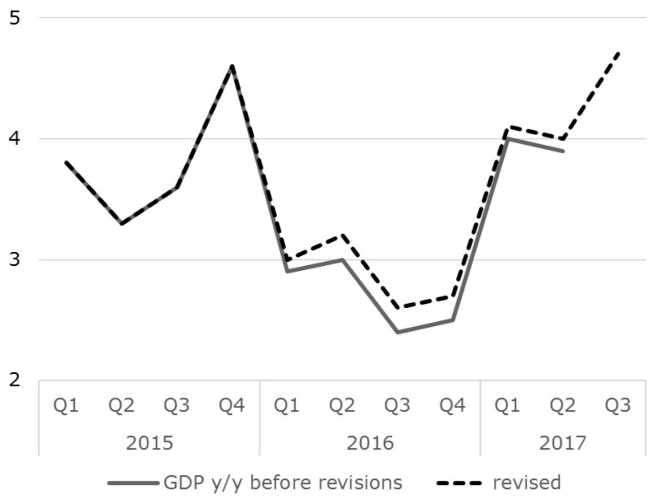
Economics

GDP accelerates again.

According to the flash estimate, GDP accelerated from 4.0 (revised) to 4.7% y/y, above market consensus (4.5%) and close to our optimistic forecast (4.8%). On seasonally adjusted basis, GDP grew by 1.1% q/q and 5.0% y/y.



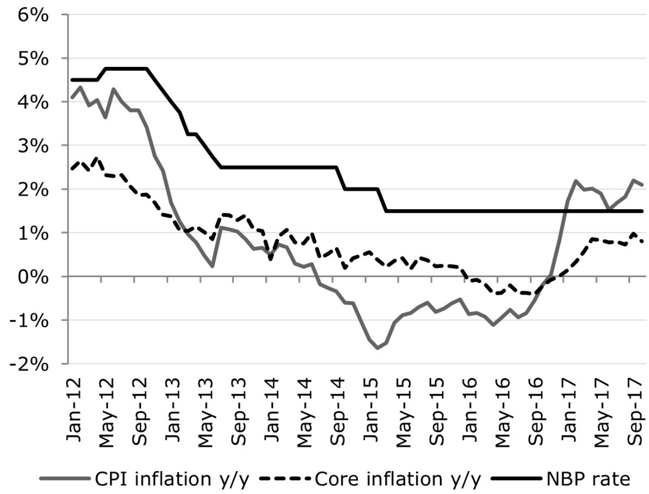
The details of the release will be available in two weeks, but it can be reasonably argued that the acceleration was driven by private consumption (our forecast: 5.1% y/y) and a rebound in investment (to ca. 5% y/y). We also judge that the contribution from net exports might surprise to the upside and be slightly positive, despite very strong consumption growth and the acceleration of investment. Recent NBP and GUS trade data, showing wider trade surplus in Q3, confirm that conjecture. As a side note, one can look at the biannual revision of national accounts data included in the release. It raises the GDP growth path for 2016-2017 by 0.1-0.2 percentage points, but has no material impact on the prospects of growth in the next quarter (no changes to growth structure and arrangement of statistical bases).



Q3 GDP growth makes the NBP's latest inflation projection too pessimistic already. In addition, the revision of national accounts data should, ceteris paribus, reduce output gap and raise projected inflation slightly. Nevertheless, strong GDP data has already been internalized by the MPC and will remain neutral for monetary policy outlook as long as inflationary pressures remain modest. In light of the outcome of the last MPC meeting and the expected decline in inflation at the turn of the year (it might be deeper than the NBP forecasts at the moment), we believe that recent bets on monetary tightening in Poland beginning in Q3'18 are premature.

Inflation still boosted by high food prices, a deeper drop in core inflation.

Final release confirmed the flash CPI reading of 2.1% y/y in October. Its details are, however, very interesting, since they confirm our intuition that a deeper decline in inflation was prevented by higher prices of non-core items. According to our estimates, core CPI decelerated to 0.8% y/y.



Firstly, there has been an unusually high increase in food prices (+0.9% m/m); in addition, residential heating fuel prices rose for the second month in a row, this time by 2.4% m/m. Secondly, there was no seasonal correction in clothing and footwear prices – as a result, this category appears to be accelerating markedly. It is even more interesting in light of international comparisons – in other European countries high readings from September were corrected. Whether it is statistical noise or a beginning in an uptrend, it remains to be seen – it seems implausible to see prices of tradables to rise materially in current circumstances. Thirdly, other core categories paint a mixed picture: there is no correction to the previous month,s upticks in communications, education and hotels&restaurants categories; on the other hand, other goods and services declined in price (namely, financial services and presumably transport insurance).

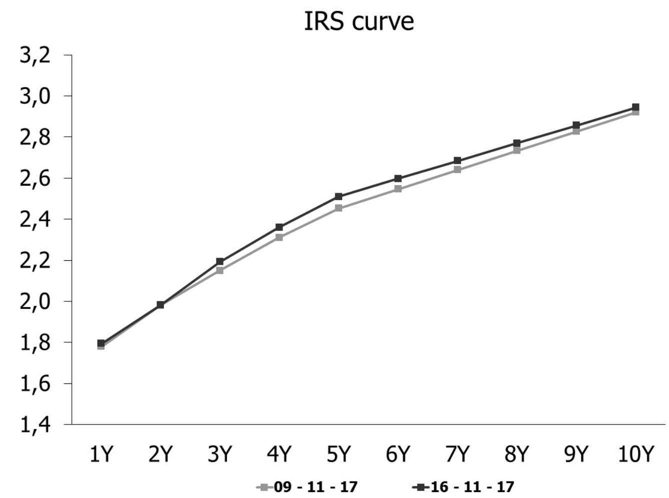
Given our knowledge on oil price trajectory and existing statistical bases, October will likely mark a local top in inflation (2.2-2.3% y/y). Core inflation should remain below 1% in the coming months and will return to uptrend in Spring. This will coincide with a general uptrend in consumer prices, after a hiatus period at the turn of the year. We are betting on a correction in food prices (from already high levels) and a decline in oil prices due to supply response of US shale to the current episode of oil price hikes – both will bring inflation down to 1.5-1.6% y/y. The arrangement of statistical bases is favorable to current MPC rhetoric that emphasizes lack of clear association between wage growth and inflation. The recent shift in market expectations (towards mid-2018) seems premature in these circumstances. It is more likely that the market will move its expected rate path backward, with first rate hike prices in at the beginning of 2019.

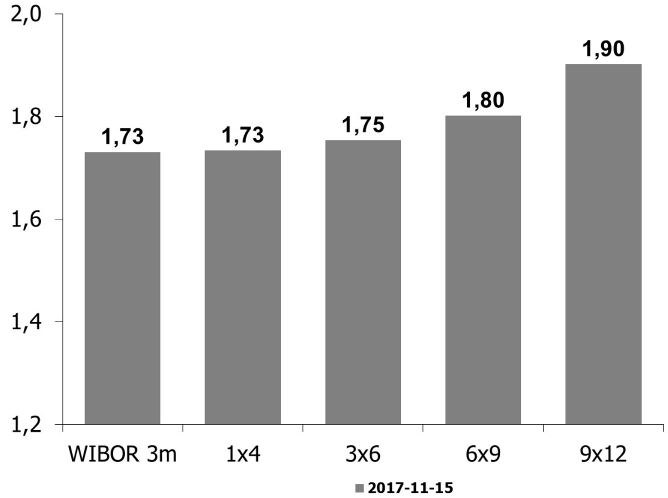
Fixed income

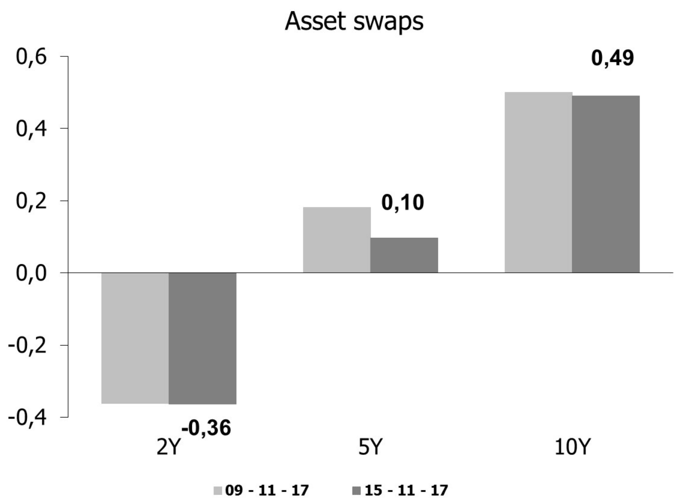
Defying gravity

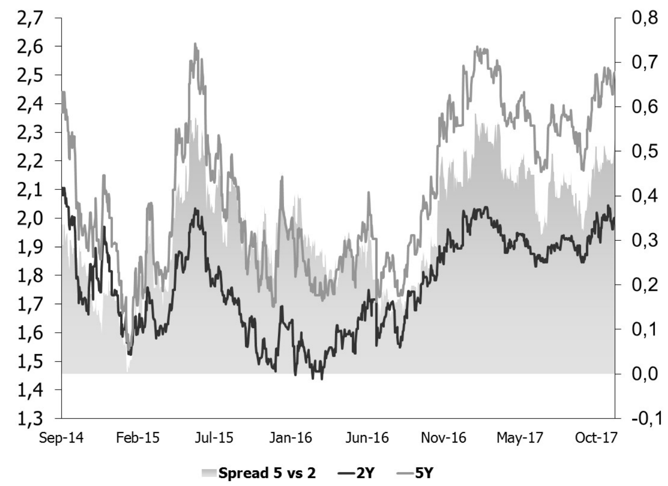
US curve is flatter, EU curves are flatter, but in Poland... no one wants Polish bonds: DS0727 is toxic, WS0922/DS0727 is at 83,5 bps. DS0727/Bund is 303 bps, WS0922/5y is 5 bps and DS0727/10y is 40 bps. Next week, the Ministry will sell 8 bn of bonds again, any bid will be covered in our view.

DS1019 is trading at 1.57% (2 bps down), WS0922 is trading at 2.56% (6 bps down) and DS0727 is trading at 3.41% (1 bps up).









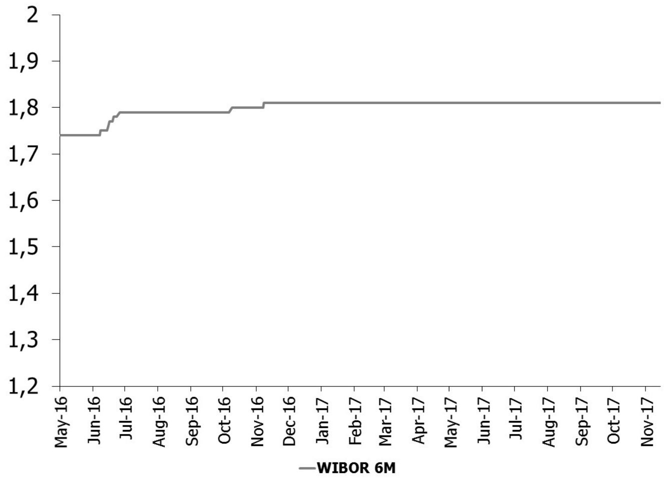
Money market

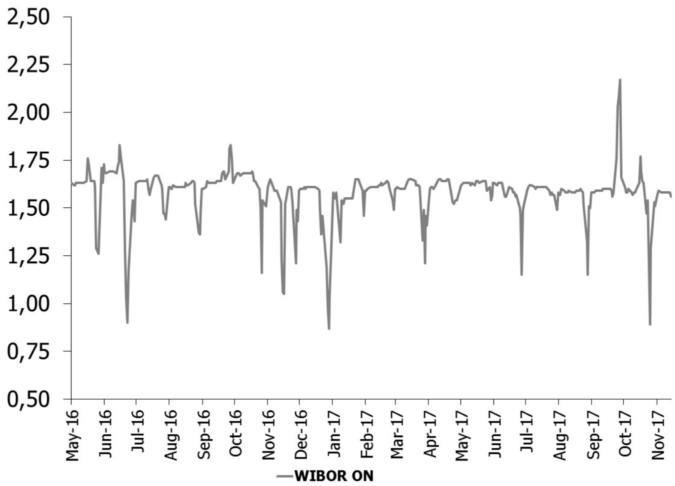
At a crossroads

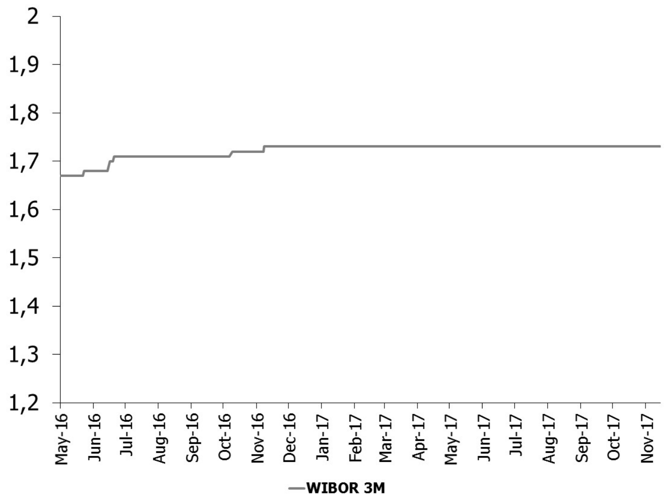
Polish rates reversed their post-MPC meeting declines with 2y moving back toward 2.04%. That's mainly due to risk-off environment on global markets. Polish curve steepened as some pressure on long end bonds has persisted for few weeks. Currently, 9x12 FRA stands at 1.90%, which is 17 bps above current WIBOR level. One may argue that this is too much for August '18 with governor Glapinski saying that rates will stay flat until end of 2018. In current macroeconomic circunstamces some risk of earlier hike should be priced in. GDP growth is quite robust, CPI around 2% and unemployment on multi-year lows. On the other hand, if a return of inflation to 1.5% at the start of 2018 due to base effects materializes, even those few hawks might switch to neutral stance. Given all that we don't have any strong conviction in either direction.

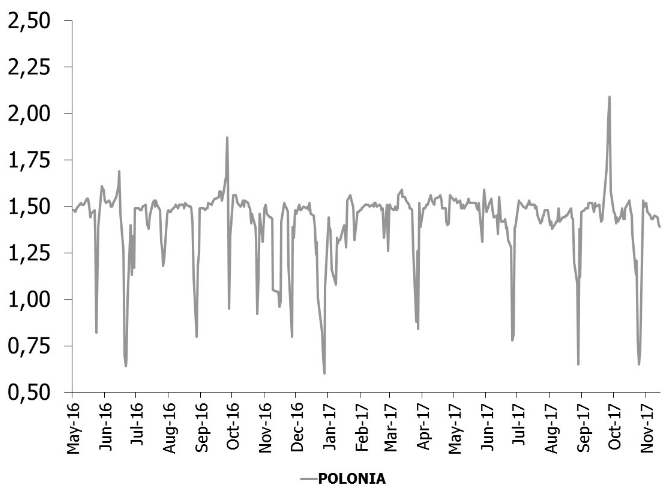
Last week came out to be quite cheap again. Tomorrow we have an OMO, which will set the tone for next week. Going forward into year end feels like loose liquidity policy should be maintained.

Ref rate vs Polonia averages:
30 day 18 bp
90 day 8 bp





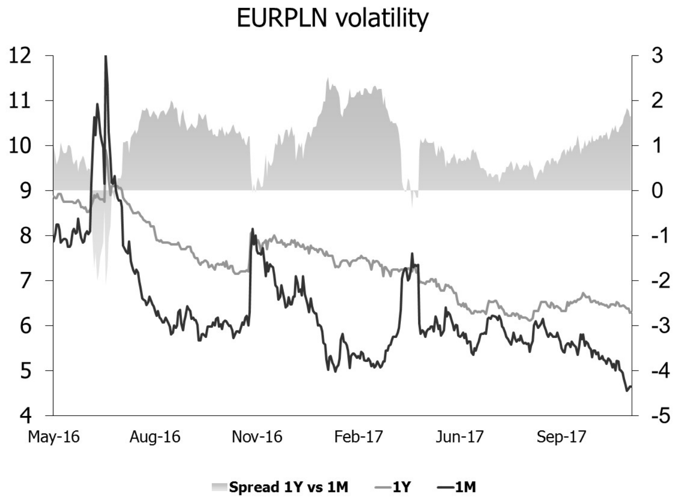




Forex

Spot: EUR/PLN – still boxed in a tight range It was another week of tight range trading in EUR/PLN (we haven't changed that line for 3 weeks already). During the week, EUR/PLN was „spiking" on a mild risk off and some pullback. 4.2230 and 4.2505 marked the low and high of the last 5 trading days. Whether we are one tiny step closer towards launching Article 7 proceedings against Poland or not, it had no effect on the PLN, but the issue has to be noted. We are still in range trading mode (the wider 4.22-4.27 range). We are playing that range with slightly PLN-negative skew.

EUR/PLN vols – melted further in the front end EUR/PLN curve was lower again, but almost exclusively in the front end. This makes the curve quite steep, as a consequence (last time we had the curve that steep was in March). 1 month ATM mid is 4.40% today (0.25% lower), 3 month is at 5.0% (0.2% 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 higher by 0.75%, due to higher EUR/USD vols and the proximity of December FOMC.



Short-term forecasts

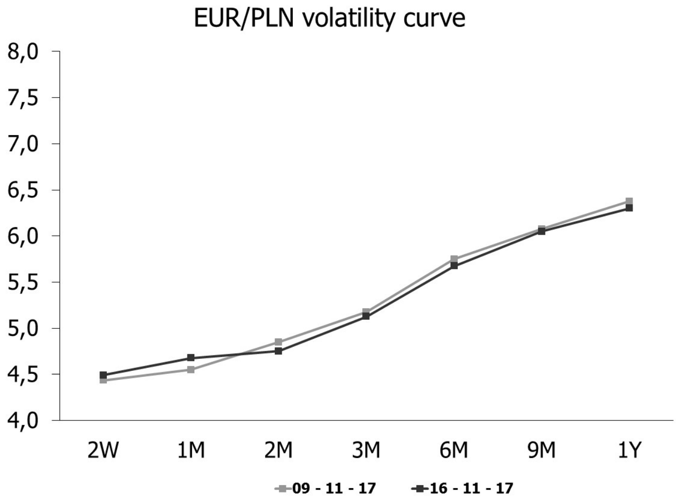
Main supports / resistances:
EUR/PLN: 4.22 / 4.32
USD/PLN: 3.50 / 3.70

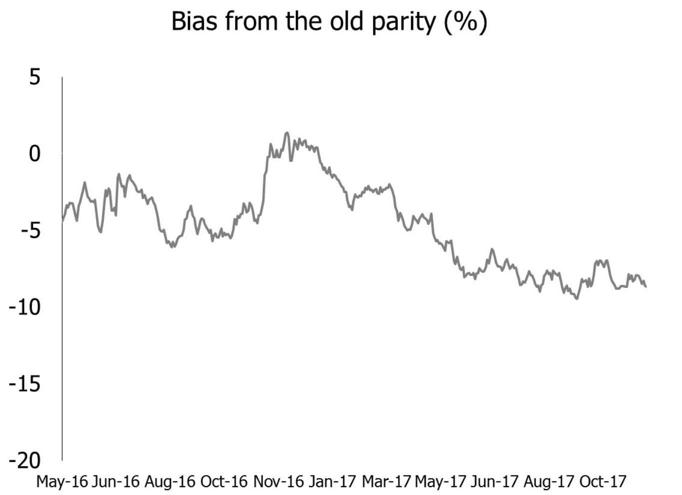
Spot Current position: Long at 4.2300 in EUR/PLN .

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.





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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
11/9/2017	1.63	1.73	1.77	1.71	1.83	1.75	1.73	1.75	1.78	1.89	1.99	1.90
11/12/2017	1.71	1.73	1.78	1.71	1.83	1.75	1.73	1.76	1.79	1.87	1.99	1.87
11/13/2017	1.79	1.73	1.88	1.71	2.04	1.75	1.73	1.75	1.80	1.91	2.02	1.89
11/14/2017	1.60	1.73	1.69	1.71	1.88	1.75	1.74	1.75	1.80	1.90	1.99	1.91
11/15/2017	1.71	1.73	1.81	1.71	1.99	1.75	1.73	1.75	1.80	1.90	2.01	1.89

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
11/9/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
11/12/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
11/13/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
11/14/2017	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
11/15/2017	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
11/9/2017	4.55	5.18	5.75	6.38	6.38	1.59	0.55
11/12/2017	4.60	5.15	5.70	6.38	6.38	1.59	0.55
11/13/2017	4.65	5.10	5.70	6.29	6.29	1.53	0.55
11/14/2017	4.65	5.10	5.63	6.30	6.30	1.49	0.53
11/15/2017	4.68	5.13	5.68	6.30	6.30	1.49	0.54

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
11/9/2017	4.2308	3.6466	3.6427	3.2137	1.3545	0.1658
11/12/2017	4.2299	3.6274	3.6539	3.1997	1.3553	0.1657
11/13/2017	4.2352	3.6382	3.6468	3.2091	1.3574	0.1657
11/14/2017	4.2332	3.6126	3.6313	3.1749	1.3582	0.1655
11/15/2017	4.2487	3.5886	3.6382	3.1811	1.3622	0.1657

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