November 23, 2017

Polish Weekly Review

mBank Research
(macro/FI/FX analysis)

@mbank_research

Ernest Pytlarczyk, PhD, CFA
chief economist
tel. +48 22 829 01 66
ernest.pytlarczyk@mbank.pl

Marcin Mazurek, PhD
senior analyst
tel. +48 22 829 01 83
marcin.mazurek@mbank.pl

Piotr Bartkiewicz
senior analyst
tel. +48 22 526 70 34
piotr.bartkiewicz@mbank.pl

Karol Klimas
analyst
tel. +48 22 829 02 56
karol.klimas@mbank.pl

Department of Financial Markets
(business contacts)

Wojciech Dunaj
head of interest rates trading
tel. +48 22 829 07 51
wojciech.dunaj@mbank.pl

Marcin Turkiewicz
head of fx trading
tel. +48 22 829 01 67
marcin.turkiewicz@mbank.pl

Department of Financial Markets Sales
(business contacts)

Inga Gaszkowska-Gebska
institutional sales
tel. +48 22 829 01 67
inga.gaszkowska-gebska@mbank.pl

Jacek Jurczyński
head of treasury sales
tel. +48 22 829 15 16
jacek.jurczynski@mbank.pl

mBank S.A.
18 Senatorska St.
00-950 Warszawa
P. O. BOX 728
tel. +48 22 829 00 00
fax. +48 22 829 00 33
http://www.mbank.pl

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Comment on the upcoming data and forecasts

The week ends with the release of CSO's Statistical Bulletin along with unemployment data this Friday. The preliminary estimate from the Ministry of Family (6.6%) lies between our forecast (6.5%) and market consensus (6.7%). The bulletin will also contain useful information, e.g. regarding the structure of wage and employment in October, thereby shedding some light on the surprises. On Thursday, the CSO will release the details of Q3 GDP. We expect growth to be driven by household consumption (5.1% y/y) and investment (ca. 5% y/y), with a surprisingly strong contribution from net exports (should be solidly negative at this stage of the business cycle). On the same day flash CPI reading for November will be published. The acceleration in inflation (from 2.1 to 2.4% y/y – this is a preliminary forecast, though) is driven by high fuel and food prices. Finally, next Friday the Manufacturing PMI will be released. Strong readings from the Eurozone and new cyclical highs in CSO's own sentiment indices suggest that the PMI rose again in November.

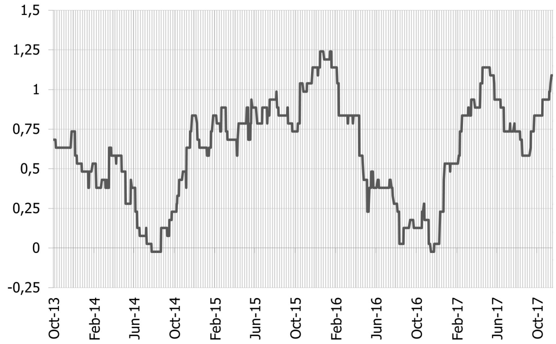
Polish data to watch: November 24th to December 1st

Publication	Date	Period	mBank	Consensus	Prior
Unemployment rate (%)	24.11	Oct	6.5	6.7	6.8
GDP y/y *final* (%)	30.11	Q3	4.7	4.7	4.7
CPI y/y *flash* (%)	30.11	Nov			2.1
Manufacturing PMI (pts.)	01.12	Nov			53.4

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	12/15/2017	500	1.846	11/23/2017
5Y T-bond PS0422	12/15/2017	750	2.704	11/23/2017
10Y T-bond DS0727	12/15/2017	800	3.338	11/23/2017
30Y T-bond WS0447	-	125	3.720	10/25/2017

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



Comment

Up after a strong industrial output reading. The upcoming releases (unemployment rate, CPI and PMI) will likely boost the Polish surprise index further.

* 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%. 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

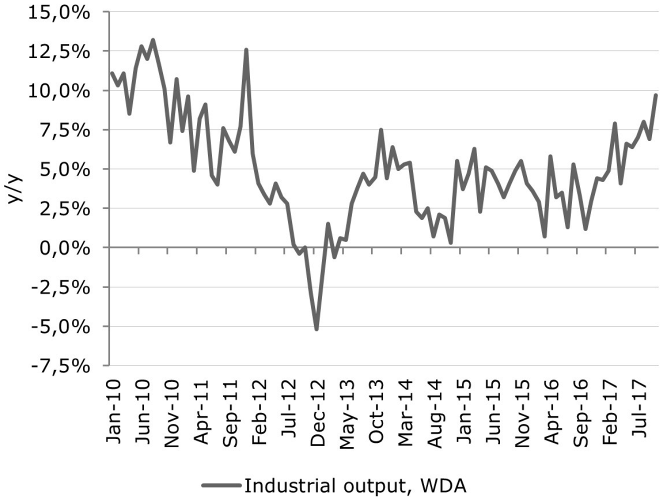
	2017 Q1	2017 Q2	2017 Q3 F	2017 Q4 F	2018 Q1 F	2018 Q2 F	2018 Q3 F	2018 Q4 F
GDP y/y (%)	4.1	4.0	4.7	4.5	4.5	4.5	4.4	4.3
Individual consumption y/y (%)	4.7	4.9	5.0	4.6	4.5	4.2	4.0	4.0
Public Consumption y/y (%)	1.0	2.4	2.5	3.0	4.0	3.0	3.0	3.0
Investment y/y (%)	-0.4	0.8	5.0	10.0	10.0	10.0	10.0	9.0
Inflation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

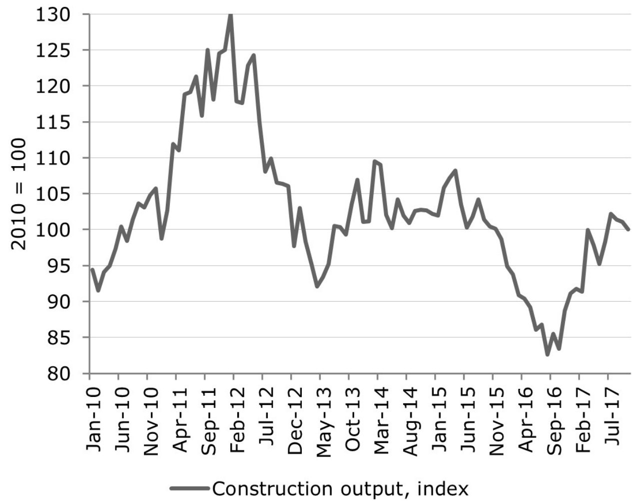
Economics

Real sphere still booming (except for construction). We are still waiting for faster producer price growth.

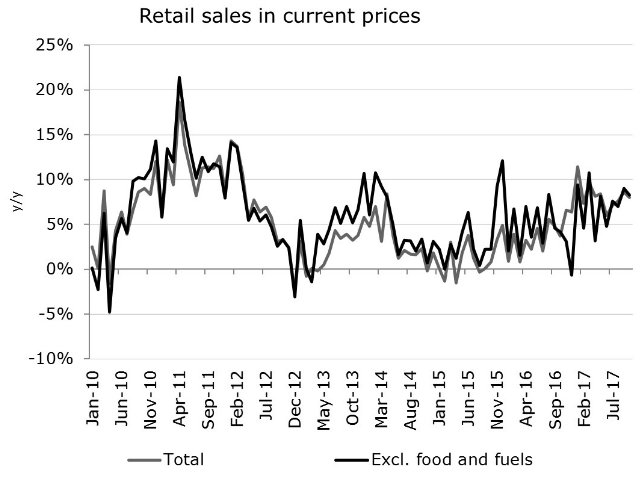
Industrial output rose by 12.3% y/y, beating market consensus and our forecast (9.9 and 10.2%, respectively) – in fact the figure managed to beat even the most optimistic forecasts. The reasons for such a big acceleration in output should be clear in retrospect: favorable calendar effect (working day difference leaped from -1 to +1 y/y), base effects and clear momentum in the previous month. On a seasonally adjusted basis, industrial output rose by 1.7% m/m. Due to the arrangement of statistical bases and working days, output is likely to slow down materially in the coming months. Nevertheless, the uptrend in industry is very steep and the final quarter of 2017 is likely to bring at least as high y/y growth, as the previous one.



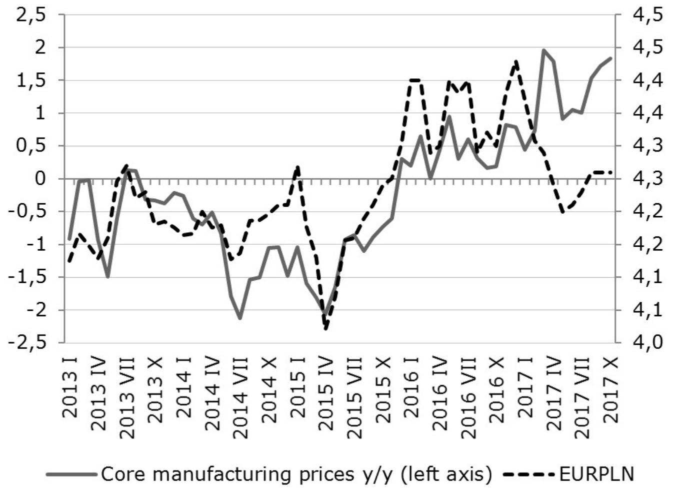
Construction output disappointed yet again, having risen by 20.3% y/y (market consensus 23%, our forecast above 26% y/y) – such a high growth rate is misleading due to base effects, though. On a seasonally adjusted basis, output declined slightly for the third month in a row – thus, there is absolutely no momentum in construction. How can we account for this disappointment? We see this as a sign of enduring weakness in investment, which in current circumstances (i.e. in current business cycle phase and at the beginning of a new EU programming period) should be accelerating briskly already. On the basis of incomplete data we judge that this weakness can be traced back to delays in public investment and supply constraints faced by construction companies (i.e. lack of workforce). Moreover, there is still no evidence that machinery and equipment investment returned to growth and exceeded its 2015 peak. In such circumstances double-digit growth rates of gross investment might not be attainable for more than one quarter.



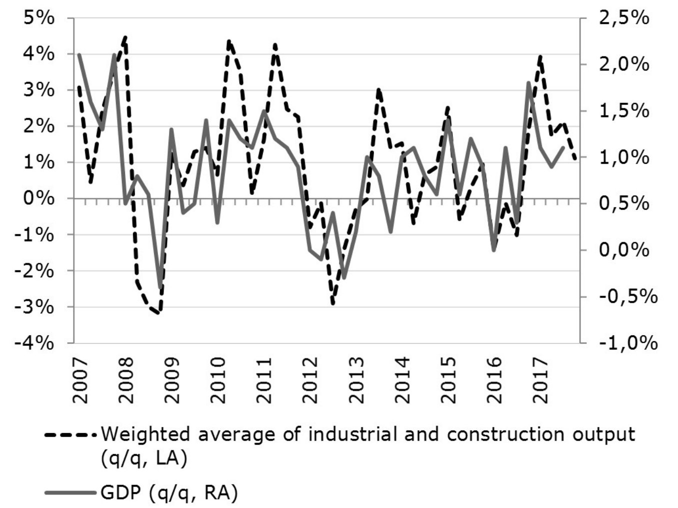
With 8.0% y/y growth, retail sales surprised us to the downside. However, it is not a meaningful surprise. We still think that perspectives for private consumption are bright. First of all, the ongoing change in the pattern of consumption (more services, less goods) should support spending measures relatively to retail sales in coming years. More cyclically, labor market is tight and consumers show high degree of confidence. Last but not least, consumption is not as leveraged as it was in 2006-2008. Conclusions? The solid growth rate of consumer spending should be taken for granted for the upcoming quarters. Consumers got used to some degree of improvement of their consumption. Consumers smooth consumption over time. Therefore, even if anything happens to real disposable income (higher inflation, slower growth due to supply constraints on the labor market) consumption is here to stay as households would ultimately turn to bank credit to compensate for real income loss.



PPI growth (3.0% in October) matched our expectations. The major takeaway from the reading is the fact, that core producer prices are slowly rising (see the graph) despite the stability of the exchange rate. So far we think that firms' pricing power is limited and the described development stems mainly from upward price shock in commodities. However, we will be closely tracking this measure in the coming quarters and this would be the signal that inflation has finally room to accelerate in a sustainable manner.



Accurate nowcasting of Q4 GDP is not feasible at this point, but we expect GDP to slow down slightly on both annual and quarterly basis.



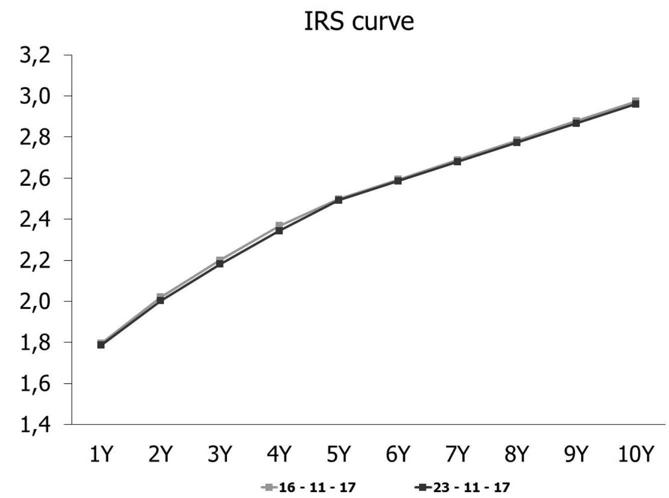
From the MPC's point of view, the data is of the "have cake and eat it too" type. For some MPC members booming industry will be a confirmation of the economy's strength and the optimistic scenario forecast for many quarters by the MPC. Other members, who worry about the state of investment, will see their fears confirmed (we wouldn't exaggerate the impact October print has in mid-term prospects of investment). The status quo in monetary policy depends in inflation data, which will be tricky in the coming months (uptick in November, strong decline at the beginning of 2018 and return to target by mid-2018). Expectation of a hawkish MPC might not last in such circumstances.

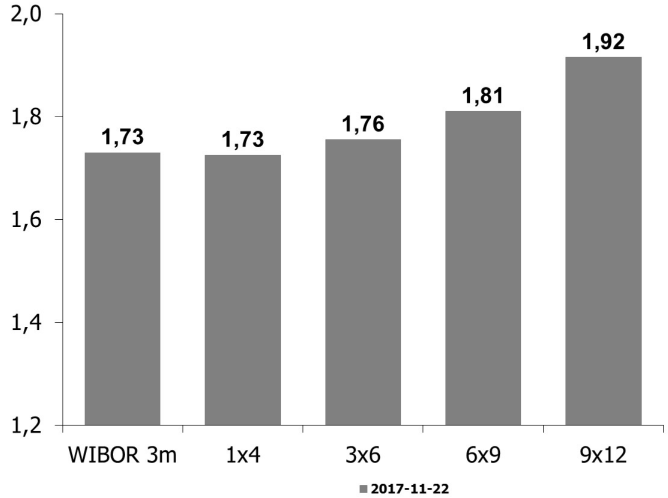
Fixed income

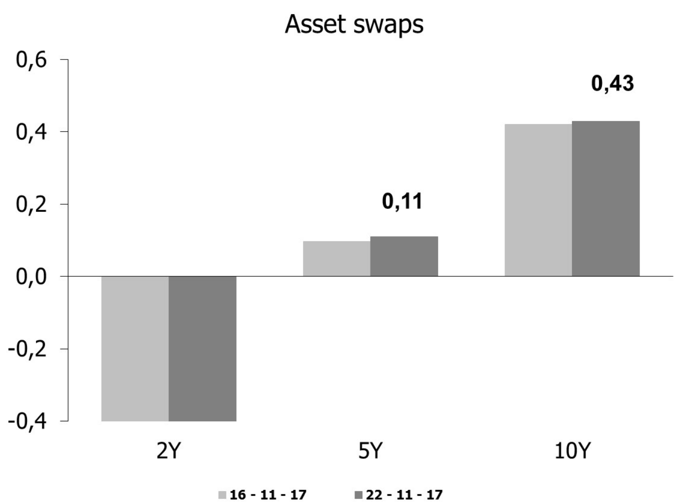
Demand ramping up

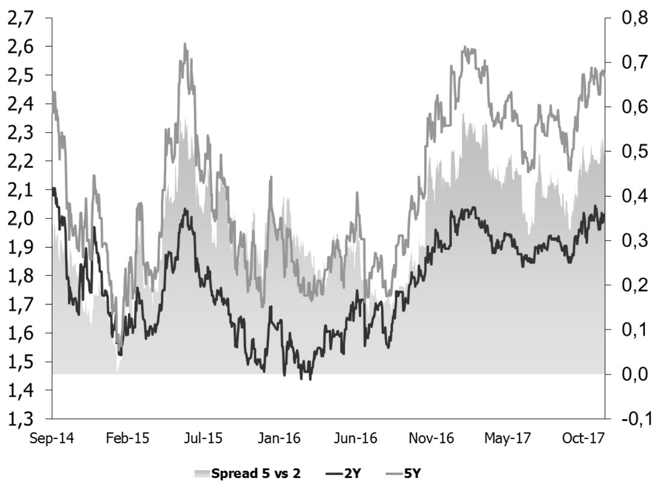
Massive auction in Poland. The ministry sold only 4 bn PLN, bid/cover ratio was 3,5. Market is short, easiest way to cover it is to buy long end bonds. The curve remains steep, but it will change soon. WS0922/DS0727 is 79 bps. DS0727/Bund is 298 bps, we moved 5 bps down but it’s still far, far away from normal levels. WS0922/5y is 5 bps and DS0727/10y is 39 bps.

DS1019 is trading at 1.53% (4 bps down), WS0922 is trading at 2.54% (2 bps down) and DS0727 is trading at 3.33% (8 bps down).









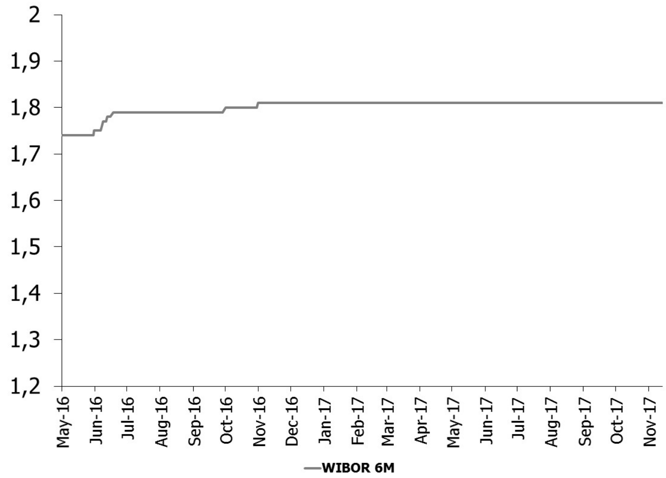
Money market

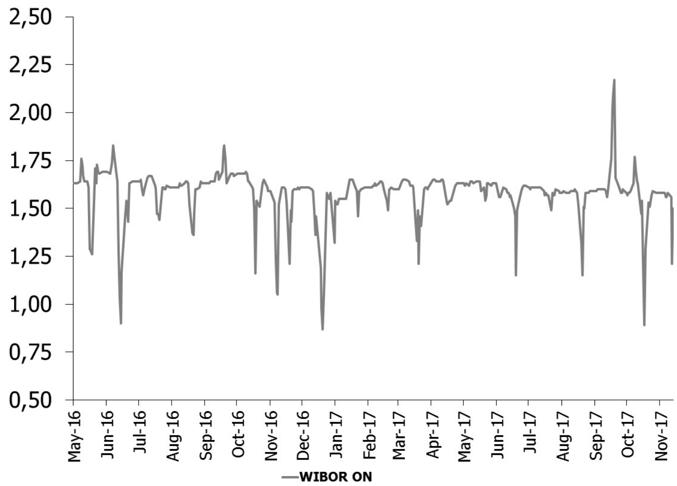
Like watching paint dry

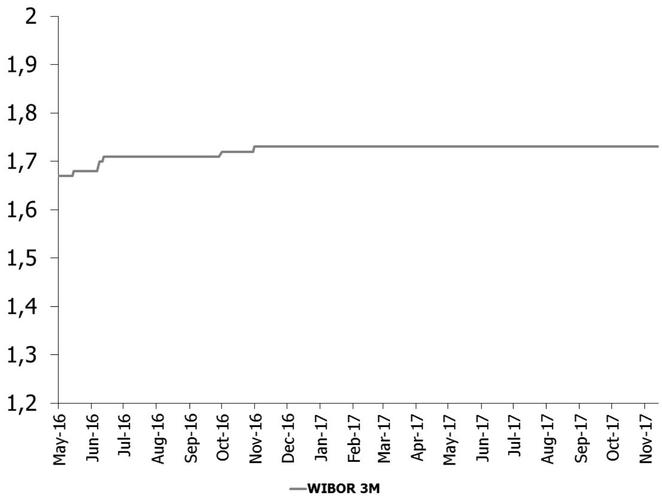
Polish market seems very boring comparing to other nations. Volatility is very limited with 2Y IRS staying in the 2.02-2.05% range. We need some major change either in the MPC's stance or the macro situation to break out of this medium term range. Next week we will have the flash CPI – this should be last high reading, then the base effects should start dragging it lower. The end of the year is coming closer and closer, therefore liquidity will get poorer.

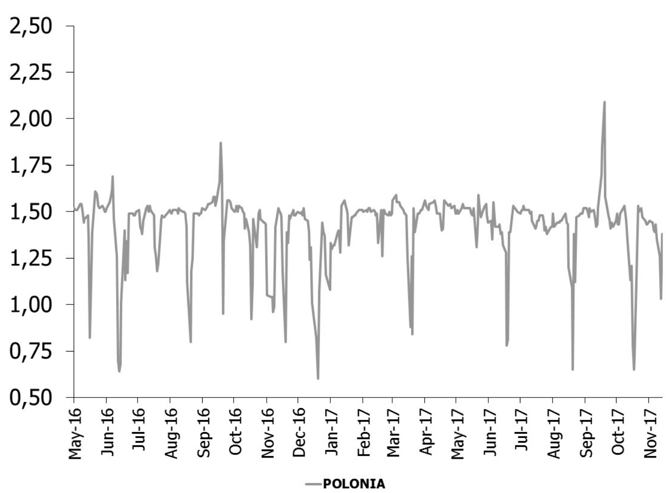
As we wrote in the previous weekly, the closer we get to the end year, the bigger risk of a low overnight rate. We had a cheap week, the next should be similar.

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









Forex

Spot: EUR/PLN – set a four-month low This week Zloty was supported by excellent industrial output, wage and retail sales data, which have fuelled inflation concerns. Anyway, 7 consecutive days of EUR/PLN slide is quite unusual for our market. Finally, EUR/PLN hit four-month low, reaching 4.2050. In the bigger picture, there is no change. EUR/PLN was still trading in a tight range, 4.2050-2.2450. On one hand, we have strong economic data, on the other – concerns connected to the European Union, which has threatened Poland with sanctions. We are still in range trading mode (a wider 4.20-4.25 range). We are playing that range, with slightly negative PLN skew.

EUR/PLN vols – almost unchanged EUR/PLN front end vols were not following EUR/PLN lower, as we are anyway at the multiweek lows – it is probably because of some short covering. The gains are cosmetic, and we need higher realized volatility and/or weaker PLN to support that gains. 1 month ATM mid is 4.50% today (0.1% higher), 3 months are at 4.9% (0.1% lower) and, finally, 1 year fixed at 6.2% (0.1% lower). The skew was better offered. The currency spread (difference between USD/PLN and EUR/PLN) was stable.

Short-term forecasts

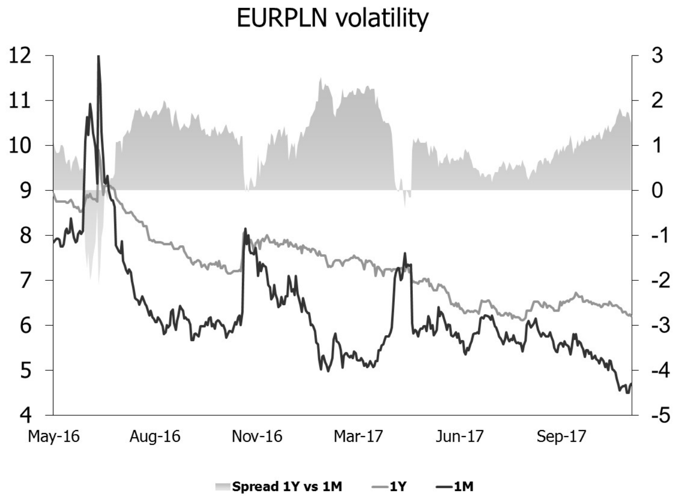
Main supports / resistances:
EUR/PLN: 4.20 / 4.28
USD/PLN: 3.50 / 3.70

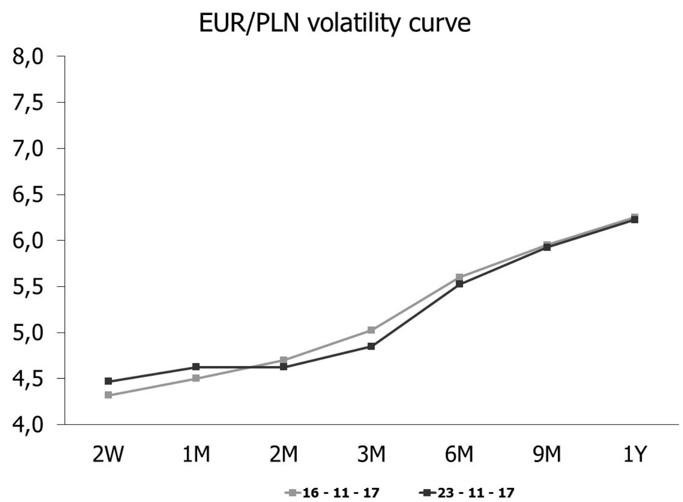
Spot Current position: Long at 4.2300 in EUR/PLN .

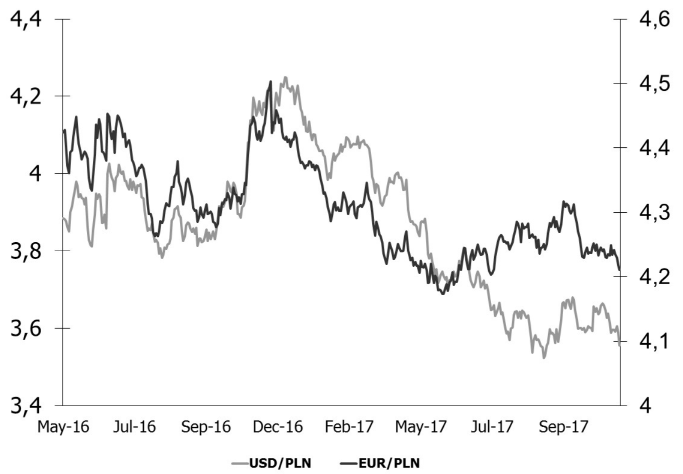
We are long at 4.2300 with a short stop at 4.1950 and hopes to see 4.27+. It is a purely technical, opportunistic trade. We are of the opinion, that mean-reverting strategies are most profitable in the longer run in our low Beta currency.

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.







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
11/16/2017	1.74	1.73	1.83	1.71	2.01	1.75	1.73	1.76	1.78	1.87	2.01	1.89
11/19/2017	1.83	1.73	1.88	1.71	1.98	1.75	1.73	1.76	1.81	1.91	2.01	1.90
11/20/2017	1.76	1.73	1.84	1.71	2.02	1.75	1.73	1.76	1.81	1.91	2.01	1.90
11/21/2017	1.66	1.73	1.75	1.71	1.93	1.75	1.73	1.76	1.81	1.92	2.02	1.90
11/22/2017	1.78	1.73	1.92	1.71	2.08	1.75	1.73	1.76	1.81	1.92	2.02	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
11/16/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
11/19/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
11/20/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
11/21/2017	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
11/22/2017	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
11/16/2017	4.50	5.03	5.60	6.25	6.25	1.61	0.53
11/19/2017	4.50	4.90	5.55	6.23	6.23	1.61	0.53
11/20/2017	4.65	4.95	5.60	6.25	6.25	1.53	0.53
11/21/2017	4.70	4.95	5.50	6.20	6.20	1.49	0.53
11/22/2017	4.63	4.85	5.53	6.23	6.23	1.61	0.53

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
11/16/2017	4.2346	3.5958	3.6266	3.1761	1.3572	0.1657
11/19/2017	4.2419	3.5965	3.6266	3.1958	1.3593	0.1659
11/20/2017	4.2351	3.5909	3.6308	3.2026	1.3560	0.1656
11/21/2017	4.2296	3.6060	3.6313	3.2075	1.3531	0.1656
11/22/2017	4.2183	3.5881	3.6260	3.2008	1.3462	0.1655

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