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Polish Weekly Review

mBank Research
(macro/FI/FX analysis)

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Comment on the upcoming data and forecasts

The week ends with the release of Manufacturing PMI. Out above-consensus forecast is based on the assumption that the index will partly close its sizable gap vis-a-vis euro area business sentiment indicators and CSO's indices. Next week the MPC will convene for a two-day meeting, which will end on Tuesday. We expect the Council to change neither the monetary policy parameters, nor its dovish rhetoric. Governor Glapinski will likely reiterate his positive assessment of economic outlook, skepticism regarding inflationary pressures and his expectations of stable interest rates throughout 2018.

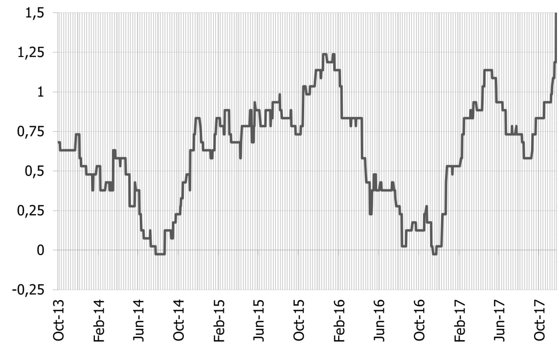
Polish data to watch: December 1st to December 8th

Publication	Date	Period	mBank	Consensus	Prior
Manufacturing PMI (pts.)	01.12	Nov	55.2	54.0	53.4
MPC decision (%)	05.12	Dec	1.50	1.50	1.50

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

Polish surprise index continues to move up. Over the past several days it was boosted by lower-than-expected unemployment rate, upward revision to Q3 GDP and the upward surprise in inflation. Next week will be a lighter one, with PMI being the only opportunity to surprise the markets.

* 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

- 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

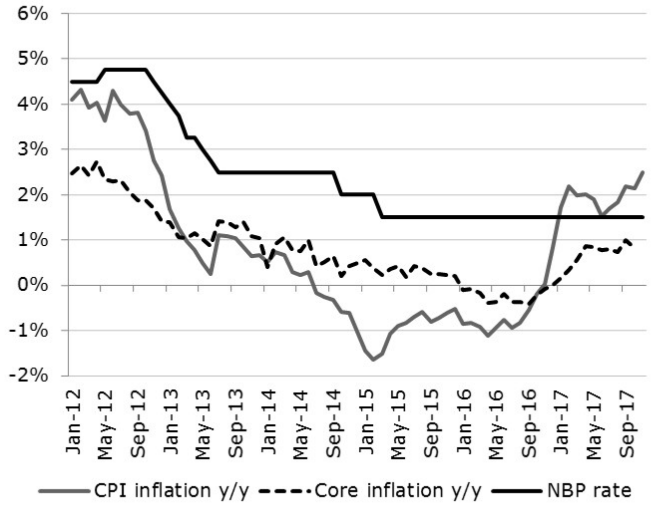
	2017 Q1	2017 Q2	2017 Q3	2017 Q4 F	2018 Q1 F	2018 Q2 F	2018 Q3 F	2018 Q4 F
GDP y/y (%)	4.1	4.0	4.9	4.7	4.7	4.5	4.5	4.5
Individual consumption y/y (%)	4.7	4.9	4.8	4.5	4.5	4.2	4.0	4.0
Public Consumption y/y (%)	0.5	2.1	1.9	3.0	4.0	3.0	3.0	3.0
Investment y/y (%)	-0.5	0.9	3.3	7.5	10.0	10.0	9.0	8.0
Inflation 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

Inflation hit the NBP's target in November, but not for long.

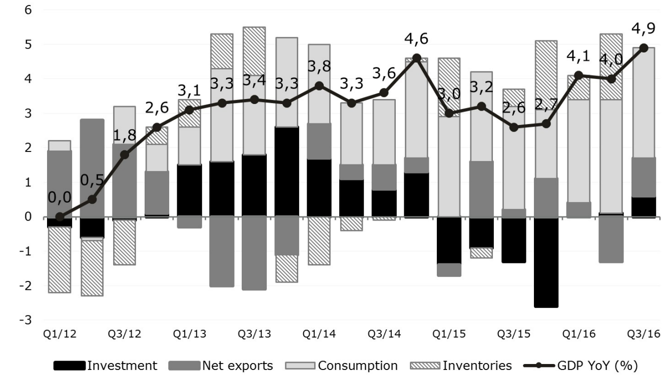
Inflation in Poland hit 2.5% y/y in November, beating our forecast and market consensus (2.4% and 2.3% respectively). A rather unusual jump stems from 2 factors: slightly higher core prices and larger advances in non-core categories. As for the former, we estimate that core inflation accelerated to 0.9% from 0.8%. As for the latter, November saw ca. 3% higher fuel prices, somewhat higher than usual reading of food prices and possible further boost from heating coal prices (propelling housing category).



Due to statistical base effects and forecast stabilization/fall in food and fuel prices at the turn of the year, November marks the highest inflation reading for many months forward. Therefore the fact that inflation reached 2.5% is not important as it may seem. The play for MPC moves is going to really begin at the turn of Q1/Q2 when headline inflation accelerates amid substantial GDP growth and further tightening of the labor market.

GDP accelerates even more.

GDP growth accelerated towards 4.9% y/y in Q3. In sequential, seasonally adjusted terms, growth rate was lifted from 0.9% to 1.2% q/q.



Despite the better headline reading, investment activity was disappointing. 3.3% y/y falls short of the usual investment growth recorded at this very stage of the upswing. Private investment activity growth was close to zero this time. Investment outlays are propelled by local state entities (without this item the growth of the whole investment would be close to zero), central government investment seems to be still shelved. All this should change over the course of the coming quarters. The profile of investment activity is set to take up an inverted U-shaped form. That bodes well for investment in 2018. Consumption growth was also a bit disappointing vis-a-vis our forecast but given the large base effects from last year (the major boost from 500+ programme occurred in Q3 2016) the overall growth of 4.8% y/y is more than just good. The profile of consumption growth is set to fall slightly in the coming quarters, but this should be compensated by better investment activity.

A real positive surprise was generated by net exports. 1.1 pp contribution of this category is quite unusual in this phase of the cycle. Only a part of the extraordinary result can be attributed to weak investment activity. It is in major parts exports that is responsible for quite a substantial trade surplus in goods and services. It is true that the upswing in euro zone helps Polish exports. But it is also true that the lionâ€™s share of trade surplus in generated by services. It falls nicely into the picture where manufacturing is complaining over its competitive powers within the EU whereas services sector is not. One is certain, huge surplus in services (EUR 4 bn quarterly) is expected to be rock solid and provide cushion for net exports in coming quarters.

It is fair to say that – at this very stage – GDP growth composition is pro-inflationary. It is also fair to say that lack of investment is going to generate problems over the coming years as economy is operating close to capacity limits (of course that does not impact 2018 results, that can easily be EU-funds driven). So far the MPC seem to quite aware of the possibility of the slowdown in coming years. However, it does not seem to fully recognize the potential of the economy to surprise upwards in the meantime. At this stage recent NBP projection misses GDP growth by more than just a bit. It may entail correction in March along with more positive GDP gap and higher core inflation profile. It may nicely coincide with the end of temporarily lower headline inflation period (Q1) and generate a hawkish twist in MPC.

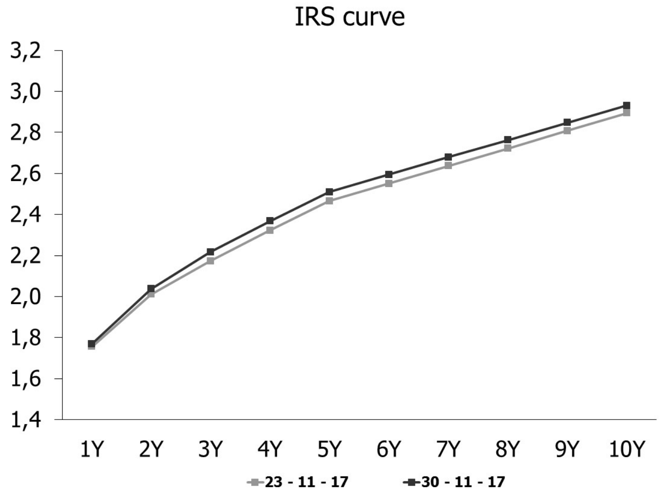
Fixed income

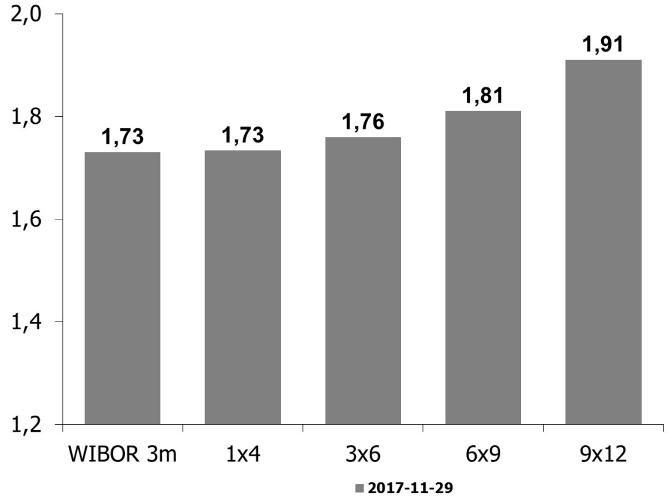
Perfect setup for a flattener

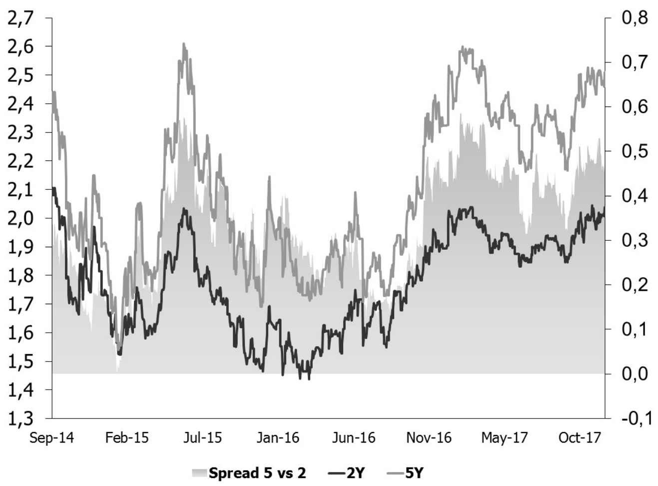
Strong GDP should support a flattener. We have only one auction in December, it should also support curve flattening. Short-end ASW are extremely low, it should support flattener as well. The yield curve is very steep.

WS0922/DS0727 is 77 at bps. DS0727/Bund spread is 295 bps, we moved another 2-3 bps down, but it's still far away from normal levels. WS0922/5y is 2 bps and DS0727/10y is 34 bps.

DS1019 is trading at 1.57% (4 bps up), WS0922 is trading at 2.55% (1 bps up) and DS0727 is trading at 3.32% (1 bps down).







Money market

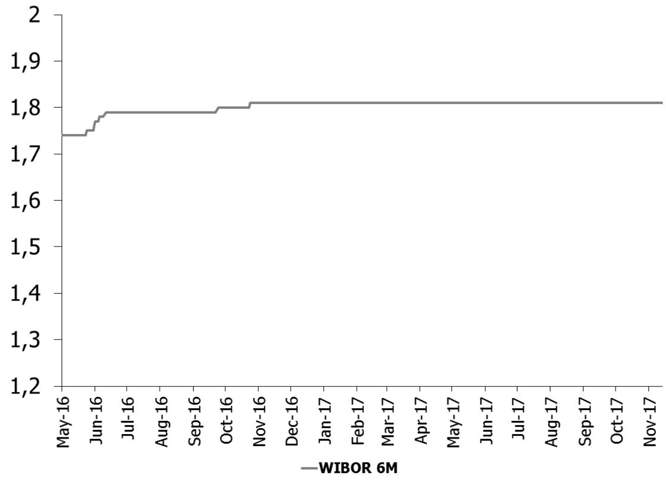
Macro momentum and rate hike bets

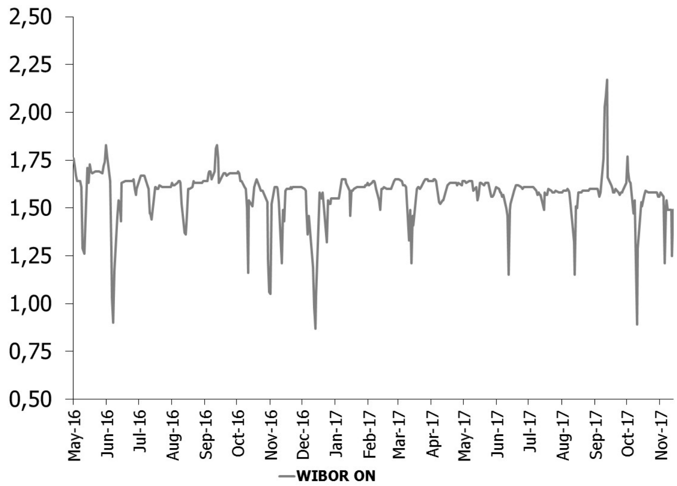
Big news today, flash CPI came out at 2.5%. That's 0.2% higher than market expectations and straight at NBP target. Market reaction is somewhat muted, around +1-2 bp on the IRS curve after the number, but we are close to this year's highs. Apart from CPI we also had GDP, which also came out stronger than market thought (4.9% vs 4.7% exp). To sum up, we have very strong momentum in macroeconomic data, real policy rate is at -1% and what's missing is the MPC's will to do anything with the rates. We will gladly hear what MPC members have to say after CPI reached NBP target.

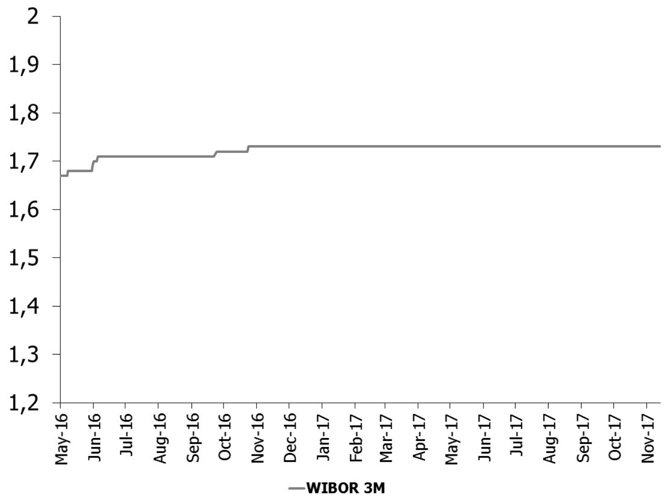
In the next few months we have a base effects kicking in, which will drag CPI a bit lower. FRA contracts are pricing around 31 bps of hikes in 12 months and another 33 bps for next 12 months.

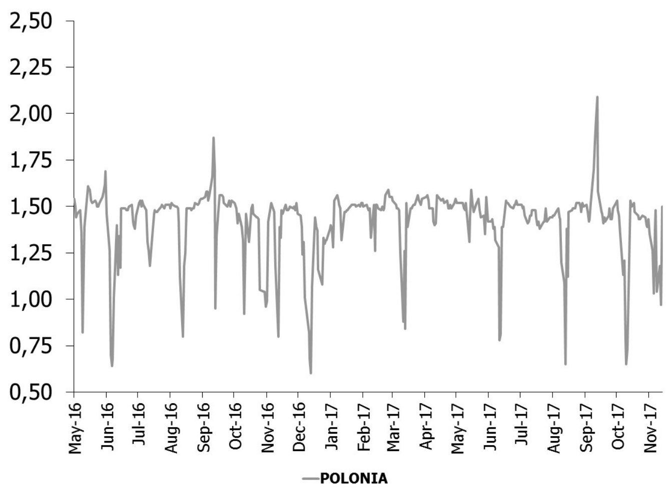
Loose funding conditions persist and we expect that to last until end of the year.

Ref rate vs Polonia averages:
30 day 15 bps
90 day 9 bps



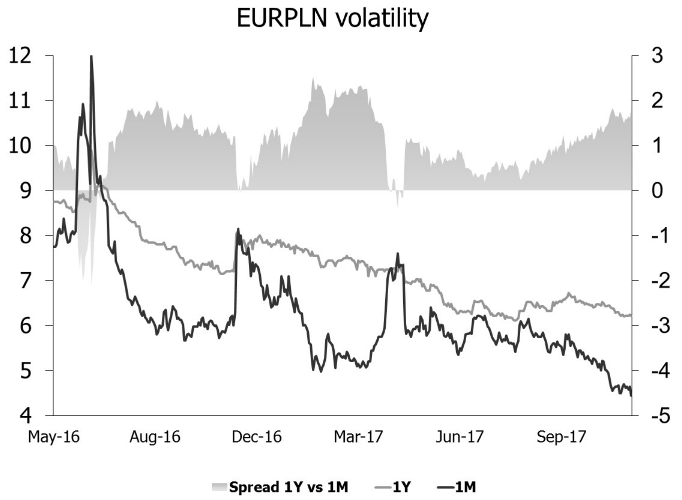






Forex

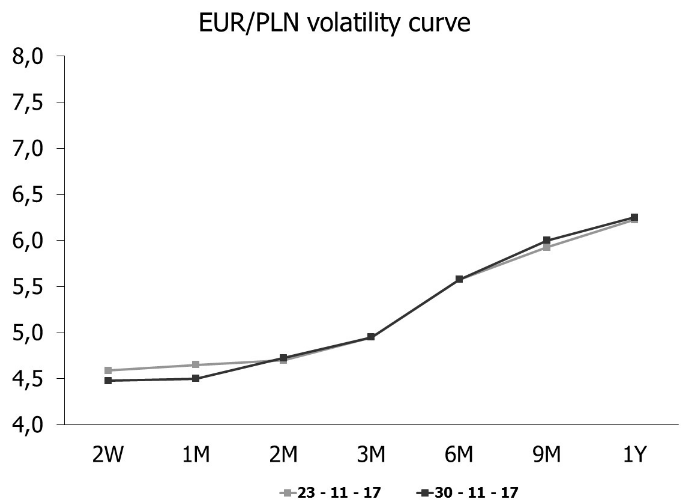
Spot – EUR/PLN – set a new low 4.1875 On Wednesday in the morning, while liquidity was pretty weak, flow pushed EUR/PLN down and it dived to 4.1875 level. However, it was a matter of seconds for EUR/PLN to rise again above 4.19. Afterwards, it was traded around 4.20 during the day. The Zloty is supported by strong fundamentals and expectations for hawkish message from Polish MPC. The market seems to ignore the fact that the parliament is going ahead with the Supreme Court legislation, but this might change if political risks increase due to mass protests or renewed conflict with the EU. We are still in range trading mode (a wider 4.19-4.26 range), with slightly PLN-negative skew.



EUR/PLN vols – almost unchanged Stronger Zloty and diminishing realized volatility are among the reasons why EUR/PLN vols are sliding again. 1 month ATM mid is 4.20% today (0.3% lower), 3 months are at 4.9% (unchanged) and finally 1 year fixed at 6.2% (unchanged). The skew as well as the currency spread (difference between USD/PLN and EUR/PLN) were stable.

Short-term forecasts

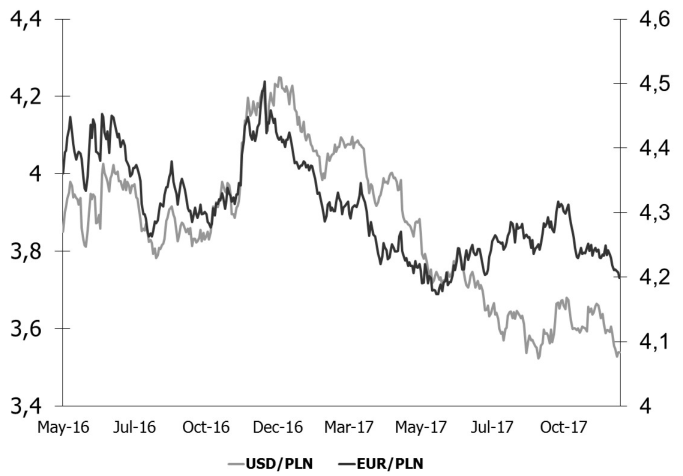
Main supports / resistances:
EUR/PLN: 4.19 / 4.26
USD/PLN: 3.50 / 3.70

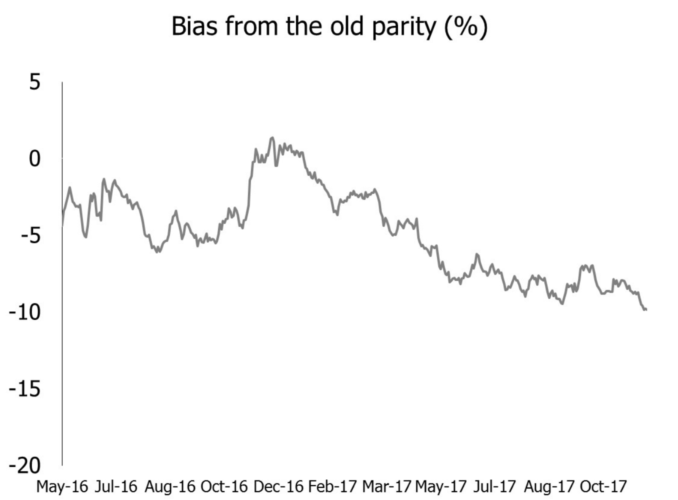


Spot Current position: Long EUR/PLN re-initiated at 4.1970.
Our EUR/PLN long at 4.23 was stopped out at 4.1950. We reentered the long at 4.1970 with a stop at 4.1600 and hopes to see 4.25+. It is purely technical, opportunistic trade. We are of the opinion that mean reverting strategies are the most profitable ones in the longer run with regard to our low Beta currency. We prefer to play the current range (4.19-4.26) from the short PLN side.

Options Vol – sidelined

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. The fundamentals for Poland are still very strong, but the political headlines may lead to further nervousness. As for the bigger picture, we are much more keen to enter bigger long Vega trade but timing is crucial. For now we are sticking to our small tactical long.





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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
11/23/2017	1.80	1.73	1.89	1.71	2.05	1.75	1.74	1.76	1.80	1.90	2.00	1.89
11/26/2017	1.81	1.73	1.91	1.71	2.08	1.75	1.73	1.76	1.80	1.90	2.03	1.93
11/27/2017	1.83	1.73	1.84	1.71	2.01	1.75	1.73	1.76	1.81	1.91	2.03	1.90
11/28/2017	1.50	1.73	1.57	1.71	1.63	1.75	1.73	1.76	1.82	1.91	2.01	1.93
11/29/2017	1.60	1.73	1.67	1.71	1.74	1.75	1.73	1.76	1.81	1.91	2.03	1.91

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
11/23/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
11/26/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
11/27/2017	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
11/28/2017	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
11/29/2017	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
11/23/2017	4.65	4.95	5.58	6.23	6.23	1.51	0.54
11/26/2017	4.58	4.95	5.63	6.23	6.23	1.51	0.54
11/27/2017	4.65	5.00	5.65	6.25	6.25	1.44	0.52
11/28/2017	4.45	4.88	5.53	6.23	6.23	1.44	0.52
11/29/2017	4.50	4.95	5.58	6.25	6.25	1.43	0.52

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
11/23/2017	4.2108	3.5557	3.6245	3.1958	1.3442	0.1652
11/26/2017	4.2116	3.5486	3.6160	3.1845	1.3496	0.1656
11/27/2017	4.2086	3.5276	3.5972	3.1703	1.3535	0.1655
11/28/2017	4.2074	3.5382	3.6005	3.1807	1.3513	0.1654
11/29/2017	4.1991	3.5385	3.5971	3.1743	1.3490	0.1648

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