January 11, 2018

Polish Weekly Review

Authors:

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

Follow us on Twitter:

@mbank_research

Business contacts:

Department of Financial Markets

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

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

Table of contents

Comment on the upcoming data and forecasts

Next week is abundant with data. We start on Monday with trade balance data, where we expect current account balance to drop below zero with exports and imports consolidating. At the same time, the CSO will release final CPI data, which should confirm the flash release of 2.0% y/y. In our opinion, lower food prices are responsible for the initial surprise. On the next day NBP will publish data about core inflation (we expect it to stay at 0.9% y/y). Wednesday brings labour market data. Our forecasts indicate that wage growth reached a local minimum (due to unfavorable working day difference and base effects in manufacturing wages) in December, while employment grew on a yearly basis at previous month's pace. Last but not least, real sphere data will be published next Friday. Industrial production decreased on a yearly basis last month because of calendar (working day difference drops from +1 to -2 y/y) and base effects (around 2 percentage points). The latter factor also contributed to a slight slowdown in retail sales. Producer price index also fell amid the strengthening of the Zloty.

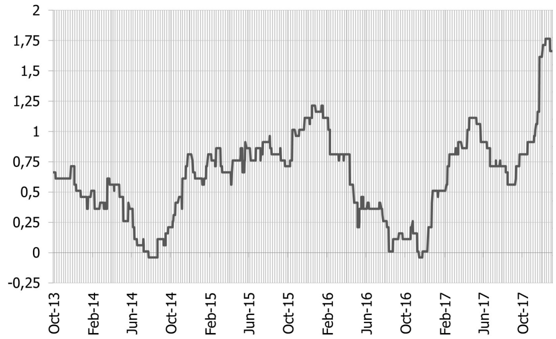
Polish data to watch: January 12th to January 19th

Publication	Date	Period	mBank	Consensus	Prior
CPI y/y (%) *final*	15.01	Dec	2.0	2.0	2.5
Current account (mio EUR)	15.01	Nov	-123	385	575
Exports (mio EUR)	15.01	Nov	17650	17763	17914
Import (mio EUR)	15.01	Nov	17600	17298	17317
Core inflation (%)	16.01	Dec	0.9	0.8	0.9
Average wage y/y (%)	17.01	Dec	5.8	6.9	6.5
Employment y/y (%)	17.01	Dec	4.5	4.5	4.5
Industrial production y/y (%)	19.01	Dec	-1.0	3.1	9.1
Retail sales y/y (%)	19.01	Dec	7.4	6.9	10.2
PPI y/y (%)	19.01	Dec	0.7	0.8	1.8

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	1/30/2018	860	1.863	1/4/2018
5Y T-bond PS0422	1/30/2018	1800	2.561	1/4/2018
10Y T-bond DS0727	1/30/2018	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

Unchanged after MPC has not changed rates (just as expected). Next week brings plenty of opportunities to move the index from final CPI, through labour market to real sphere data.

* 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).

mBank.pl

Our view in a nutshell

Fundamentals

- In 2018 Polish GDP is set to grow 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 reached a local top in November 2017. Base effects suggest that inflation will drop at the turn of the year and reaccelerate briskly from Q2 on. 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. In our view, as long as inflation stays within the target band and 5% remains a ceiling for GDP growth, the MPC will keep its rhetoric in place. Our current forecast reflects this reality – no change in interest rates in 2018.
- 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

- Political issues moved into the background and the markets are clearly unconcerned with local risks, making the PLN a star performer in the region.
- The key reason for the recent PLN strength is the Goldilocks economy, both in Poland and abroad. Strong growth amid low inflation and range-bound global risk free rates is a recipe for inflows and appreciation of EM assets across the board. In such an evironment, PLN remains strong.
- Such an equilibrium is unlikely to persist for long, though. Something has to give in and in either scenario (strong growth and inflation, leading to higher rates globally, or lower growth, higher risk aversion and outflows from EMs) negative real interest rates and dovish MPC will become a liability. Thus, before Zloty strengthens again due to cyclical factors, we might see some weakening in the meantime (to 4.30).

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	6.6	6.0
Repo rate (end of period %)	2.50	2.00	1.50	1.50	1.50	1.50

	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	6.6	6.8	6.0	5.7	6.0
NBP repo rate (% eop)	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
Wibor 3M (% eop)	1.73	1.73	1.73	1.72	1.72	1.72	1.73	1.73
2Y Polish bond yields (% eop)	2.01	1.90	1.75	1.72	1.73	1.73	1.79	1.97
10Y Polish bond yields (% eop)	3.49	3.32	3.37	3.30	3.20	3.35	3.50	3.60
EUR/PLN (eop)	4.23	4.23	4.31	4.18	4.20	4.20	4.15	4.10
USD/PLN (eop)	3.97	3.70	3.65	3.48	3.50	3.50	3.43	3.39

F - forecast

MPC got even more dovish

MPC celebrated the New Year with stable rates. The statement was more or less unchanged. GDP growth is set to slow down a bit, inflation is going to stay close to inflation target and current level of rates is favorable for the economy. However, as in October, there was a dovish insert in the text concerning the coexistence of higher wage growth and stable core inflation.

We got used to dovish rhetoric. Therefore, statements on the lack of wage pressure, the expected moderation of GDP growth and claims that NBP inflation goal is symmetric (indeed it is) make no impression. However, due to the sheer passage of time. this rhetoric seems more and more dovish. In the meantime GDP gap was absorbed (or even widened in the opposite direction) and the economy embarked on a path where inflation pressures should be awaited. Yet, erstwhile hawk Gatnar turns much more dovish and Glapinski paints his forward guidance even more broadly stating the possibility that rates may stay flat even in early 2019.

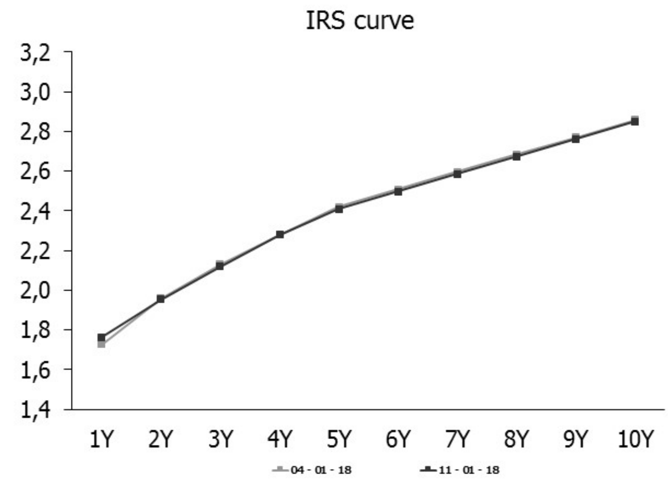
MPC is and wants to be perceived as utterly dovish. We are not going to argue and are joining the no hike camp for 2018. The symmetry of inflation target is the crucial point of MPC communication. It looks as if MPC turned to price level targeting. In such regime the recent deficiencies in reaching inflation target have to be somewhat made up by allowing inflation to run higher for some time (it is what the Fed allows in its policy right now). Such an attitude gives economy and inflation much more leeway. MPC seems to be perfectly hedged on all fronts at this very moment. Not only does it treat inflation target symmetrically, but also expects GDP growth to moderate and inflation to stay relatively low (judging by past standards). If the latter fails to realize, it is still the former the MPC may resort to. All in all, it would take much higher and accelerating GDP growth (on a sequential basis) and inflation substantially breaching 3.0% to make MPC reconsider its stance. We expect strong GDP growth in 2018 and inflation slightly above target. Neither does meet the reconsideration criteria, though.

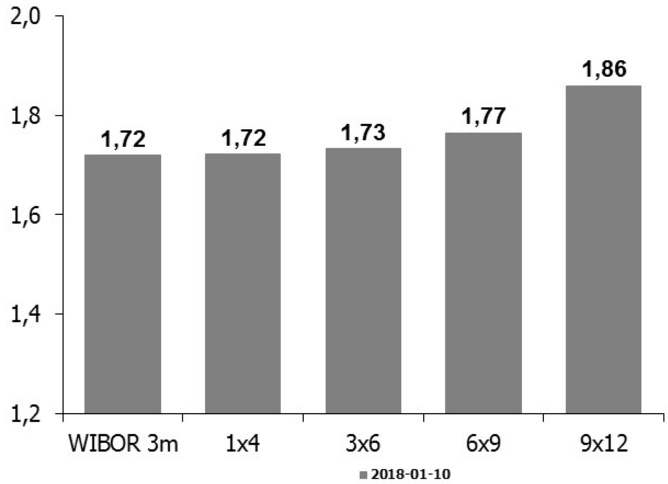
Fixed income

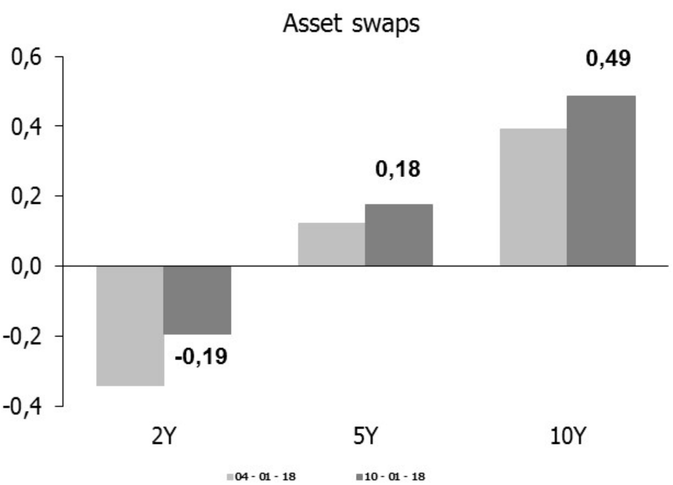
Heavy market

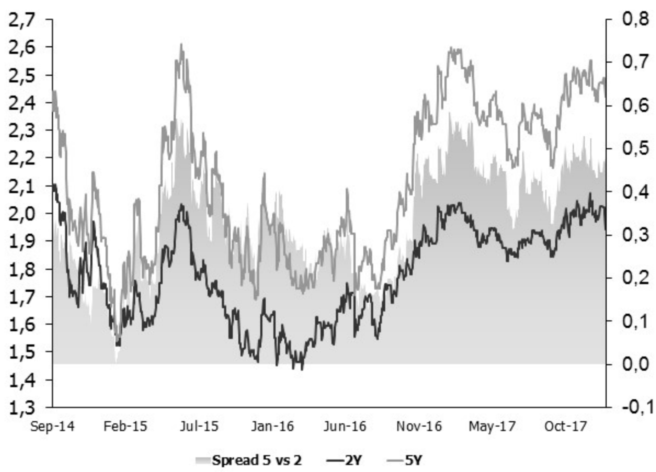
In the last few days Polish market looked heavy, mostly long term bonds. We are definitely following the Bund. Maturing WZ0118 on 25th Jan supported only short term bonds.

The curve is extremely steep again, PS0123/DS0727 is 89 bps. DS0727/Bund is 275 bps, PS0123/5y is 13 bps and DS0727/10y is 45 bps. DS1019 is trading at 1.60% (1 bps down), PS0123 is trading at 2.63% (7 bps up) and DS0727 is trading at 3.34% (10 bps up).









Money market

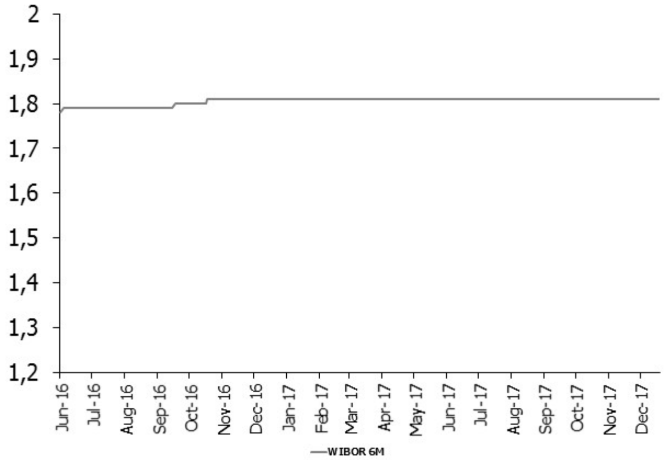
Yield curve is steepening

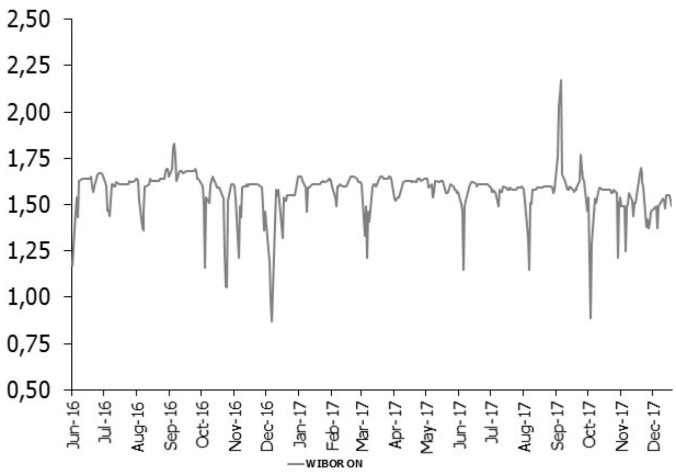
Last week we had MPC meeting with wide market consensus for no change and quite dovish statement (both confirmed). One could however see a slight surprise there. Not only governor Glapinski but also accompanying members reiterated that rates should stay flat till the end of 2018. Additionally they remarked that the last CPI reading was lower than their recent predictions and next NBP projection (March) might show a slightly lower trajectory of inflation. Therefore there might be no need to move rates even in 2019...That's a big difference compared to recent reflection of market expectations in the front end of the yield curve. On the other hand, we there is a strong sell-off that affects the longer part of our curve. Once global environment stabilizes, the curve should become more flat.

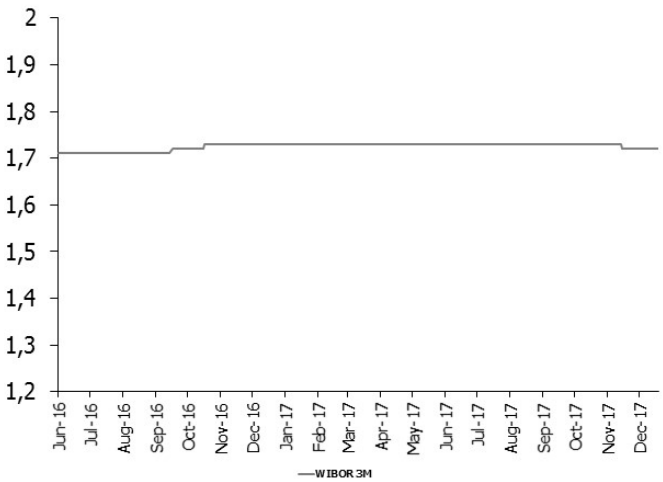
Overnight market is still left with huge over-liquidity. Rates were quite low through the whole week.

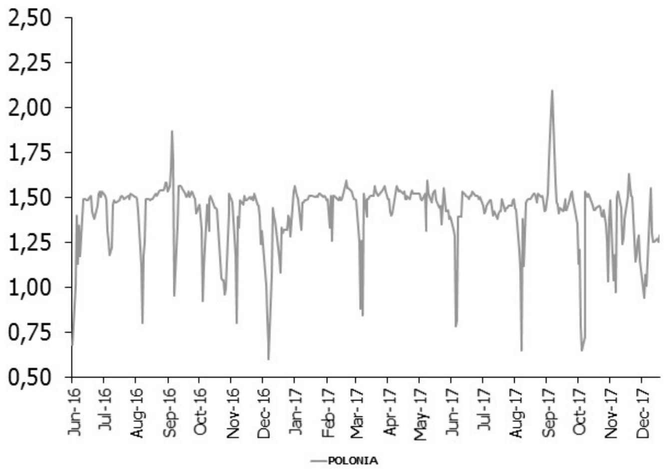
Ref rate vs Polonia averages:

30 day	20 bps
90 day	18 bps









mBank.pl

Forex

Spot – Trend reversal or a mere correction? This week, we have experienced a correction in the PLN uptrend. EUR/PLN spiked from 4.1430 to 4.1930 before correcting lower again to 4,17-ish. It is hard to name an exact reason for the correction, most likely it was a mix of sourer global sentiment, dovish MPC and positioning. The reports advocating reentering PLN longs around 4.19/4.20 are circulating on the market. Is it just a correction in the trend or a trend reversal, it is still to be seen.

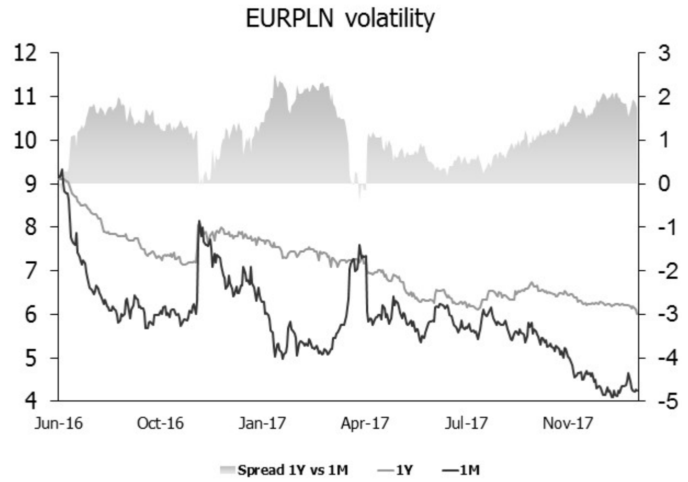
Options – volatility melting further Although the Zloty has lost its value this week, implied EURPLN volatility curve was quite stable. We even observed selling pressure in the backend of the curve. 1 month ATM mid is 4.1% today (unchanged), 3 months are at 4.8% (unchanged) and, finally, 1 year fixed at 5.9% (0.2% lower). The skew as well as the currency spread (difference between USD/PLN and EUR/PLN) were at the same level as a week before.

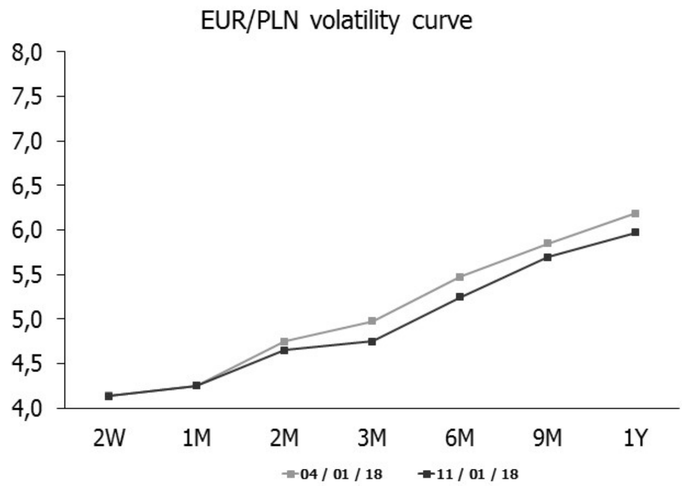
Short-term forecasts

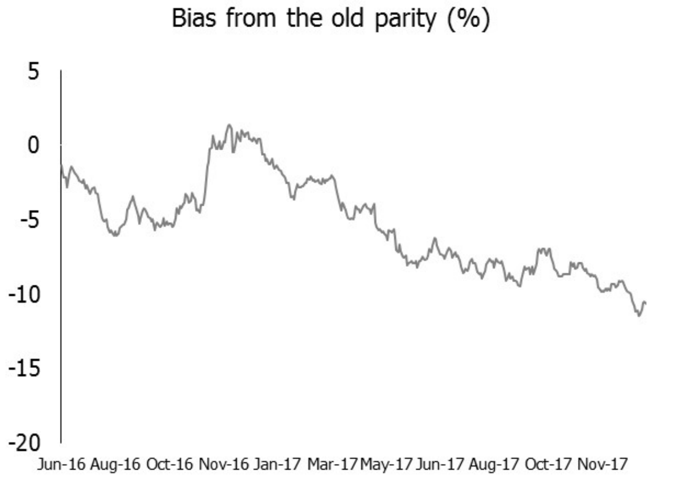
Main supports / resistances:
EUR/PLN: 4.13 / 4.23
USD/PLN: 3.35 / 3.60

Spot Current position: None.

We are back to our favorite game – range playing. We see 4.14-4.19 as the current range, and we are trying to play that range with an open mind.







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
1/4/2018	1.73	1.72	1.86	1.71	2.06	1.75	1.72	1.73	1.77	1.86	1.95	1.85
1/7/2018	1.78	1.72	1.80	1.71	1.89	1.75	1.72	1.72	1.76	1.85	1.95	1.84
1/8/2018	1.70	1.72	1.80	1.71	1.98	1.75	1.72	1.73	1.76	1.86	1.93	1.84
1/9/2018	1.63	1.72	1.72	1.71	1.91	1.75	1.72	1.74	1.77	1.86	1.96	1.85
1/10/2018	1.71	1.72	1.80	1.71	2.01	1.75	1.72	1.73	1.77	1.86	1.95	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
1/4/2018	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
1/7/2018	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
1/8/2018	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
1/9/2018	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
1/10/2018	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
1/4/2018	4.25	4.98	5.48	6.19		6.19	1.39		0.52
1/7/2018	4.23	4.90	5.43	6.13		6.13	1.39		0.52
1/8/2018	4.28	4.93	5.43	6.10		6.10	1.45		0.54
1/9/2018	4.25	4.83	5.30	6.00		6.00	1.40		0.52
1/10/2018	4.25	4.75	5.25	5.98		5.98	1.35		0.54

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
1/4/2018	4.1515	3.4472	3.5308	3.0626	1.3454	0.1628
1/7/2018	4.1544	3.4488	3.5298	3.0457	1.3474	0.1628
1/8/2018	4.1647	3.4735	3.5502	3.0695	1.3481	0.1631
1/9/2018	4.1779	3.4992	3.5622	3.1003	1.3507	0.1637
1/10/2018	4.1784	3.4999	3.5623	3.1314	1.3491	0.1634

Disclaimer

Note that research@mbank.pl is an e-mail address used exclusively for the distribution of mBank's publications. We advise to reply and send feedback directly to their authors.

The document has been drafted at the Investor Relations, Group Strategy and Macro Research Department of mBank S.A. for the purpose of promotion and advertising in line with Article 9 (1) of the Regulation of the Minister of Finance dated 24 September 2012 on the Mode and Conditions of Conduct of Investment Firms, Banks referred to in Article 70 (2) of the Act on Trading in Financial Instruments, and Custodian Banks (Journal of Laws of 2015, item 878, as amended). The document does not constitute investment research or marketing communication within the meaning of Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive. The document does not constitute investment advice, nor is it an offer within the meaning of Article 66 (1) of the Polish Civil Code.

The document has been drafted based on the authors' best knowledge, supported by information from reliable market sources. All assessments herein reflect outlooks as at the date of issue of this material and may be subject to change at the discretion of the authors without prior notification. Quotations presented herein are average closing levels of the interbank market from the previous day, they are obtained from information services (Reuters, Bloomberg) and serve information purposes only. Distribution or reprint of the full text or a part of it is allowed only upon obtaining a prior written consent of its authors.