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Polish Weekly Review

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Comment on the upcoming data and forecasts

This Friday, the CSO will publish real sphere data. In our view, 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 for manufacturing production alone). Recent surprise in December wage data suggests that there is considerable upside risk to our forecast. The latter factor of the two also contributed to a slight slowdown in retail sales. Producer price index, also due this Friday, is set to have declined considerably in y/y terms amid the strengthening of the Zloty and base effects in certain commodity prices. On Tuesday, the NBP will release M3 data. We expect another low (in y/y terms) print since stronger Zloty has negatively affected corporate deposits and household deposit growth remains sluggish due to strong consumption. Finally, on Wednesday the CSO will release its Statistical Bulletin along with unemployment data. The preliminary estimate from the Ministry of Family, Labor and Social Policy came out a tad above market consensus for the unemployment rate (but in line with our forecast).

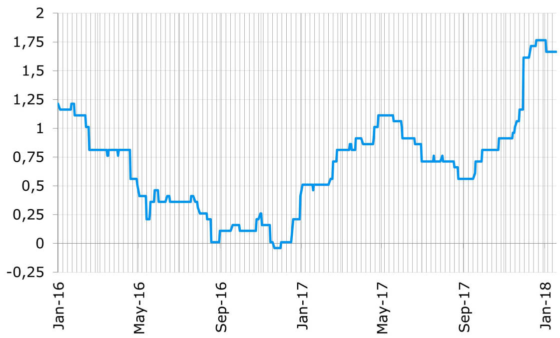
Polish data to watch: January 19th to January 26th

Publication	Date	Period	mBank	Consensus	Prior
Sold industrial output 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
M3 y/y (%)	23.01	Dec	4.5	4.4	4.5
Unemployment rate (%)	24.01	Dec	6.6	6.5	6.5

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	1/26/2018	860	1.863	1/4/2018
5Y T-bond PS0422	1/26/2018	1800	2.561	1/4/2018
10Y T-bond DS0727	1/26/2018	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 – labor market data came broadly in line with market expectations. Next few days are quite abundant with data: industrial output, retail sales and PPI this Friday, unemployment rate on Wednesday.

* 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 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	2.4
Current account (%GDP)	-1.2	-2.1	-0.5	-0.3	0.2	-0.2
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	2.0	2.6	2.6	2.2
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	4.15	4.20	4.15	4.10
USD/PLN (eop)	3.97	3.70	3.65	3.48	3.52	3.50	3.40	3.33

F - forecast

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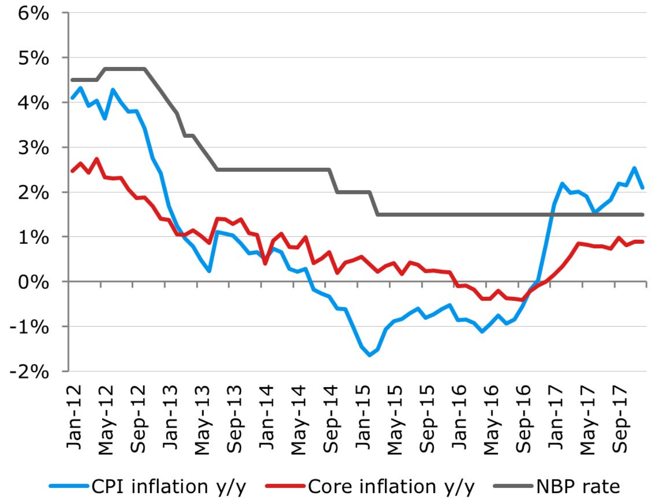
Economics

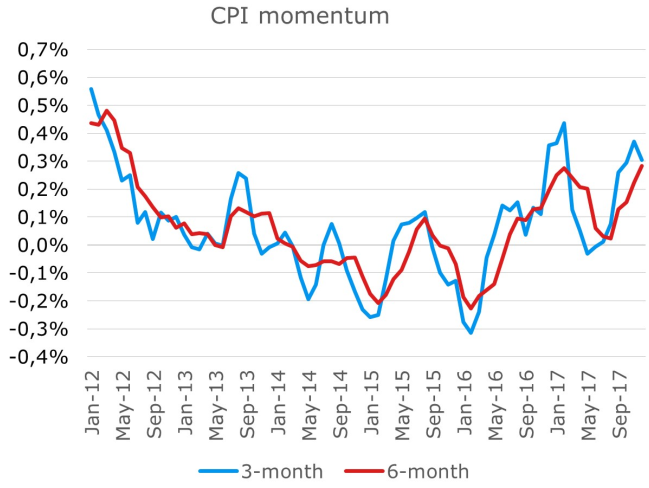
Inflation ends the year at 2.1% y/y due to base effects

Final CPI for December came out a tick higher than the flash reading (2.1% vs 2.0% y/y). This was only the third time we had such a revision, as the flash estimates are usually very precise. Compared to November (the local top at 2.5%), the drop is strictly the result of base effects in food and fuel prices.



Firstly, we want to remind that difference between 2.0% and 2.1% is merely a rounding problem, without further implications. Trend in food prices is not as strong as we expected earlier, but matched our estimate derived from the flash reading (0.5% m/m). Larger than expected drops in clothing and footwear (-1.4% m/m) were balanced by higher prices in the recreation and culture category (+0.3% m/m). Higher transport prices (airline fares) were, however, the straw that broke the camel's back and set CPI in December at 2.1% and core inflation at 0.9%.

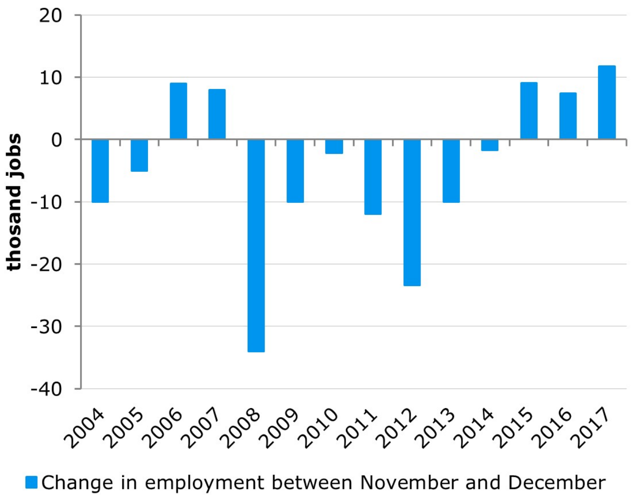
Next two months will be under strong base effects from previous year (mainly food prices), which – combined with the latest corrections in trend of Polish inflationary basket (meat, dairy) – will drive CPI under 2%. Those are still exogenous factors, core inflation should steadily accelerate as GDP continues to exceed its potential. The turn of the year will also be an occasion for some enterprises to adjust its prices to higher labour costs or generally great economic growth and thus demand for their products. Even though there will be strong base effects, the inflationary processes will continue to accelerate rapidly: 3m and 6m moving average will remain around 0.3%. This is the highest pace of inflation growth in years, adjusting by specific periods with extraordinary moves in energy or food prices.



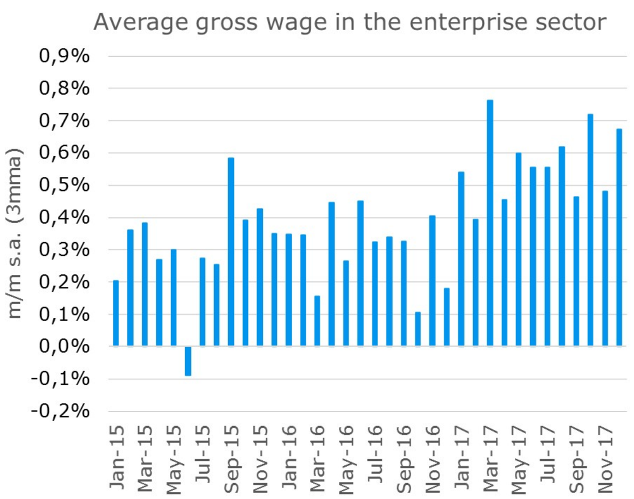
As MPC treats inflation target symmetrically, the recent rise in inflation was not a cause for concern. Not only is the discrepancy between the inflation projection and reality going to be rather ignored, but some members even stated during last conference that they are satisfied with last inflation projection. MPC's rhetoric stays dovish and pins down market expectations. We do not think that the expected temporary drop in inflation is likely to put off those expectations. One issue is the discrepancy between current inflation and projection which me already mentioned (current inflation is running higher), another – are cyclical factors which inevitably should lead to higher rates.

Employment astonishes once again, wages continue to grow at a rapid pace

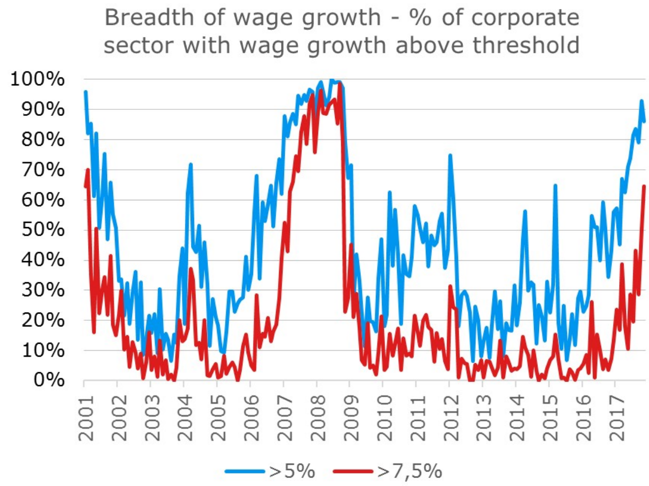
Employment in the enterprise sector grew in December by 4.6% on a yearly basis, once again beating both market consensus and our forecast (4.5% y/y). On a monthly basis almost 12k jobs were created, which is probably the best result since the beginning of transition. Previous records were noted in 2006 and 2015 (at ca +9k jobs). Even without knowing the structure of the growth, this is an impressive result. This should mean that weaker growth between August and October was a result of prolonging time needed by companies to find employees rather than bottlenecks in labor market. Nevertheless, the later started revealing themselves in wages.



Average gross wage rose by 7.3% y/y, close to market consensus and above our forecast. The acceleration from November's 6.5% occurred despite the strong potential drag from base and calendar effects (working day difference dropped from +1 to -2 y/y). That we find no sign of them in the aggregate wage growth is a clear reflection of strong momentum in this series (see the graph below).



As usual, we need to wait for the release of the Statistical Bulletin to get a closer look at the details, but we suspect that wage growth was driven by a combination of mining bonuses as well as manufacturing and construction wages (very warm weather likely helped the latter). It is also worth noting that wage growth is very broad-based right now. As of November, 65% of the enterprise sector experienced wage growth in excess of 7.5% y/y (see the graph below).



Accelerating wages, faster employment growth and lower inflation all pushed wage bill growth to new post-crisis highs. In nominal terms, wage bill rose by 12.2% y/y, while real wage growth accelerated to 10.1% in December. This supports our bullish view on consumption and stands in contrast to many pessimistic forecasts regarding private consumption in 2018.

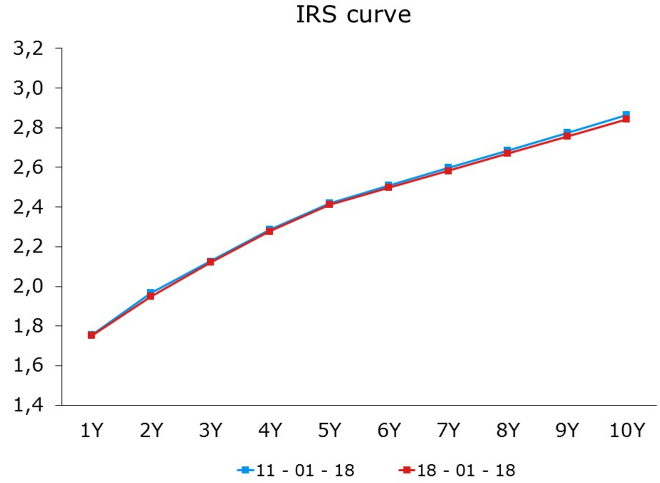
From the MPC's point of view, this is a monetary policy neutral set of data. While strong wage growth contradicts the Council's mellow view of wage developments, it is more or less matched by the acceleration in labor productivity in the past few quarters. Labor market data alone cannot upset the status quo in Polish monetary policy – it can only be caused by inflation development. Since the MPC is willing to consider the inflation target as symmetric, only a sustained rise of inflation above 3% will force a change in the MPC's stance. We are not expecting this in the months ahead.

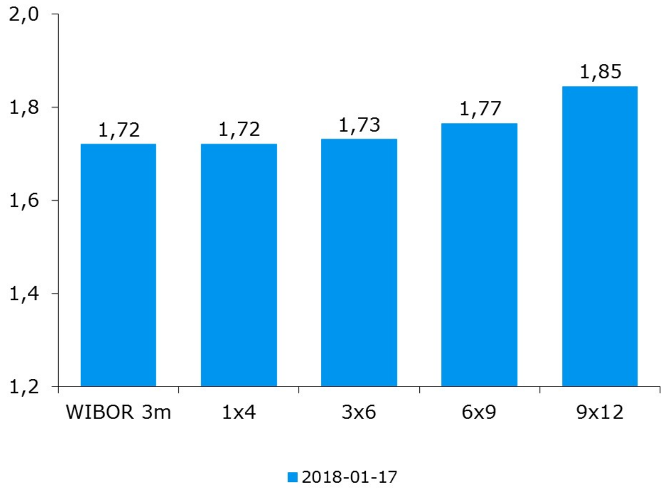
Fixed income

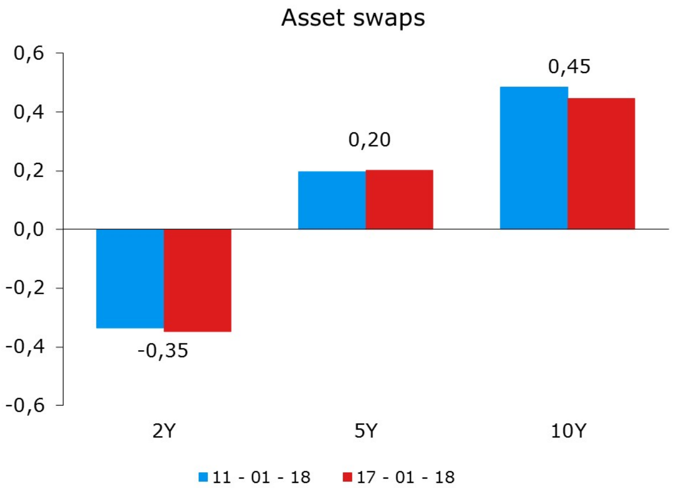
Auction and maturity incoming

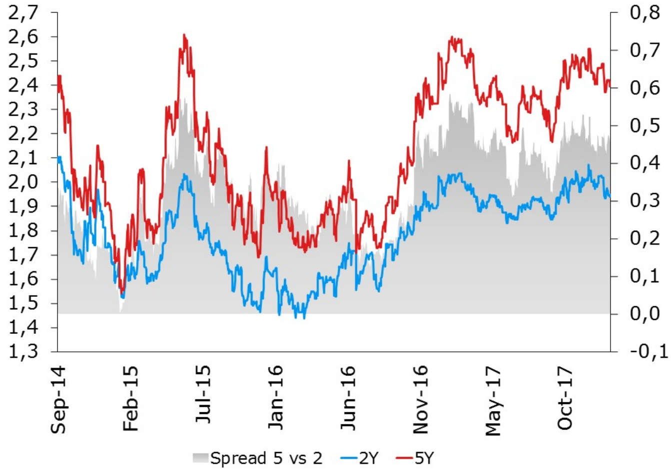
Next week WZ0118 expires and coupons are paid, so 11 bio will come back to the market. Most of it has already been covered, short-end bonds are being massively bid. Next auction is on 26.01, 6-8 bio will be sold, this should help covering the rest of short positions before the end of the month.

PLN curve is steep, PS0123/DS0727 is 67bps. DS0727/Bund is 273bps, PS0123/5y is 17bps and DS0727/10y is 42bps. DS1019 is trading at 1.57% (4bps down), PS0123 is trading at 2.64% (8bps up) and DS0727 is trading at 3.31% (7bps up).









Money market

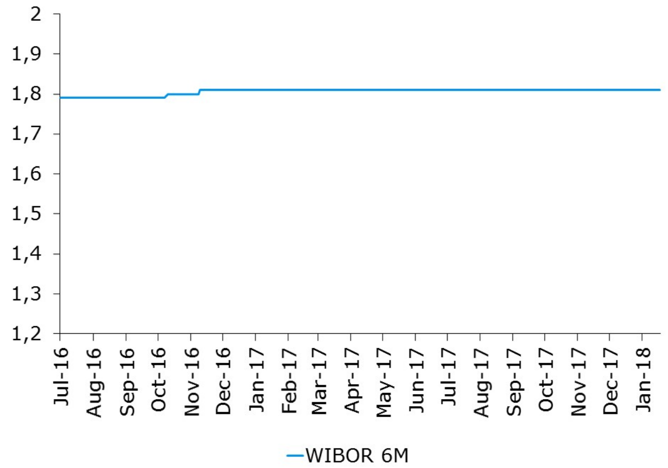
Check out their low, low rates

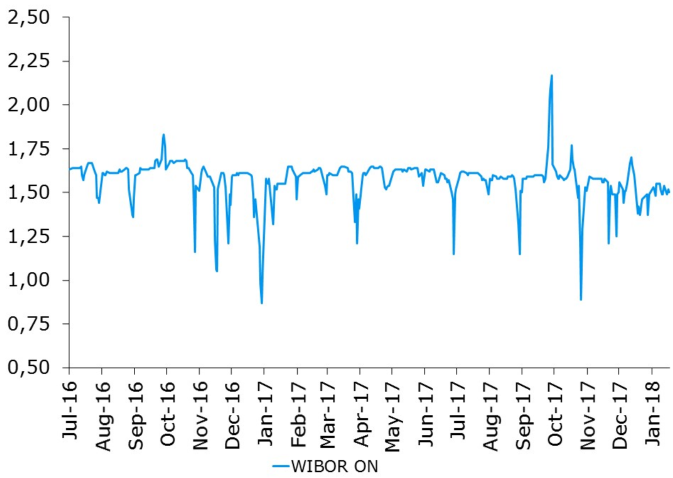
Shortest Polish govies performed quite well despite the recent sell-off on core markets. Bonds up to 3 year tenor were still in demand from local accounts, probably due to January redemptions. Longer end of the curve has performed weeker and followed core rates. It still feels like there is a big conviction in the Polish MPC to stay flat with rates for an extended period.

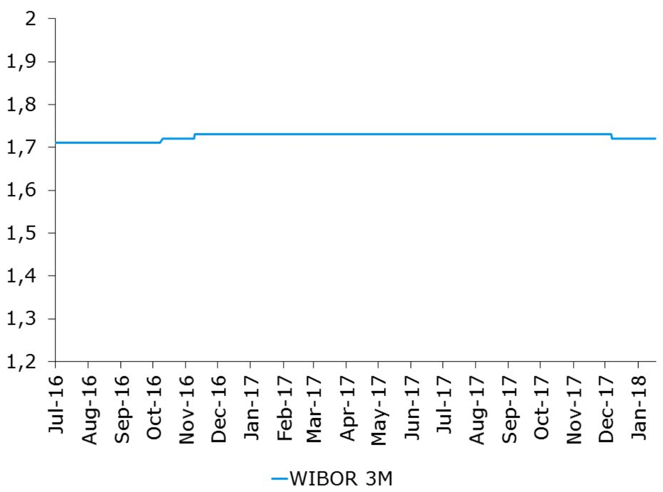
Overnight rate has stayed low for another week.

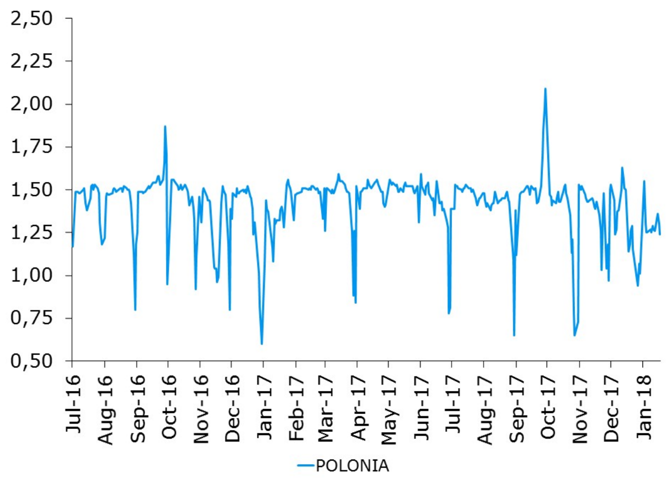
Ref rate vs Polonia averages:

30 day	26 bps
90 day	22 bps









Forex

Spot – EUR/PLN very stable EUR/PLN is still fluctuating in an extremely tight range, 4.1645- 4.1860 covers the weekly range. We have noticed a weak drift towards stronger Zloty, while any move higher towards 4.20 is fading. The strength of the Zloty is most visible against the USD as USD/PLN dropped from 3.52 to 3.3850. The Polish factor is not really in play and we are following the global ”risk on” mood. As a result, we are still in range trading mode, with slightly PL – positive skew.

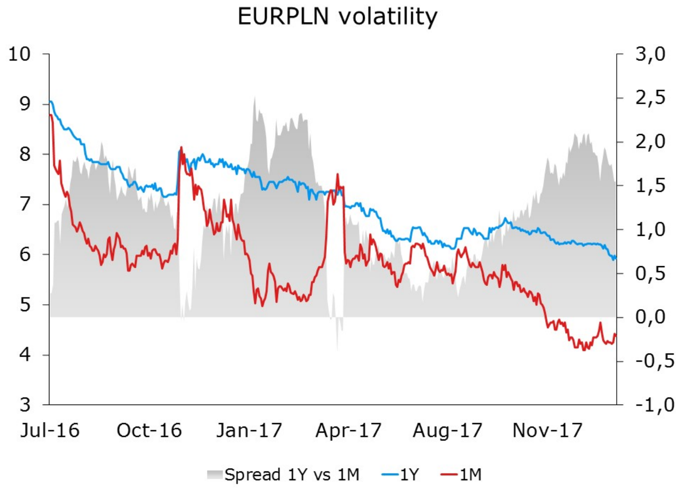
Options – selling pressure in the backend of the curve Realized volatility is still very low. Front end implied vols are already on their historic lows, so the sell-off extended again to the back end of the curve. On Wednesday, 1Y atm EUR/PLN was given at 5.7% and prices moved down to 5.5-5.7%. 1 month ATM mid is 4.3% today (0.2% higher), 3 month is at 4.75% (unchanged) and, finally, 1 year fixed at 5.6% (0.3% lower). The skew was at the same level as a week ago. The currency spread (difference between USD/PLN and EUR/PLN) moved higher by around 0.5%. We noticed buyers of 6m and 1y USDPLN vega.

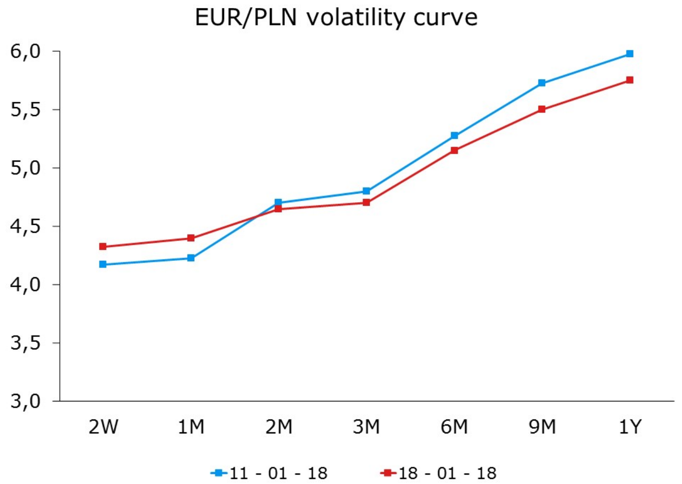
Short-term forecasts

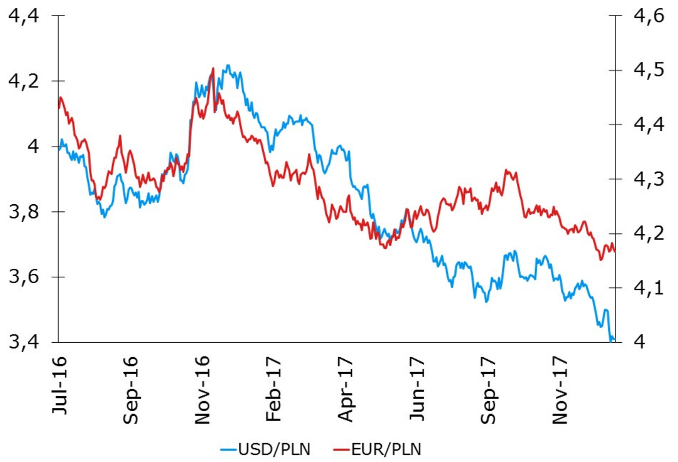
Main supports / resistances:
EUR/PLN: 4.13 / 4.23
USD/PLN: 3.35 / 3.60

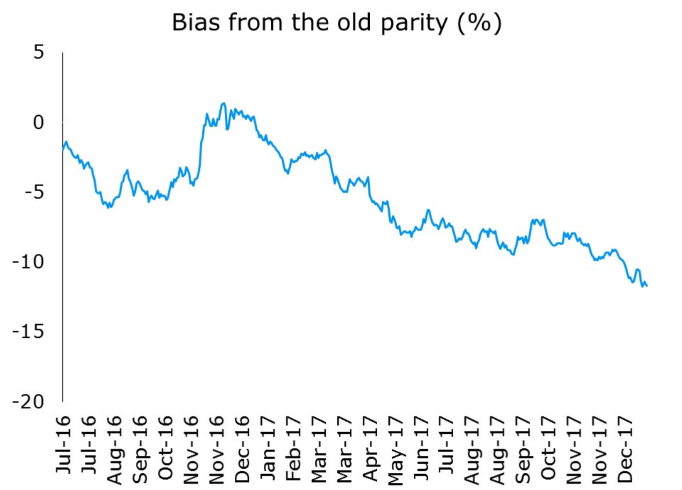
Spot Current position: None.

We are back to our favourite 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
1/11/2018	1.81	1.72	1.89	1.71	2.05	1.75	1.72	1.73	1.76	1.85	1.93	1.83
1/14/2018	1.70	1.72	1.80	1.71	1.95	1.75	1.72	1.73	1.77	1.85	1.95	1.85
1/15/2018	1.71	1.72	1.80	1.71	1.84	1.75	1.72	1.73	1.75	1.84	1.94	1.83
1/16/2018	1.60	1.72	1.71	1.71	1.87	1.75	1.72	1.73	1.75	1.84	1.93	1.83
1/17/2018	1.71	1.72	1.81	1.71	1.99	1.75	1.72	1.73	1.77	1.85	1.94	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
1/11/2018	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
1/14/2018	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
1/15/2018	1.750	1.474	1.635	1.578	1.960	2.232	2.405	2.949
1/16/2018	1.750	1.474	1.635	1.638	1.990	2.290	2.447	2.985
1/17/2018	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
1/11/2018	4.23	4.80	5.28	5.98	5.98	1.35	0.53
1/14/2018	4.25	4.80	5.25	5.90	5.90	1.35	0.53
1/15/2018	4.43	4.83	5.30	5.98	5.98	1.35	0.52
1/16/2018	4.38	4.73	5.23	5.93	5.93	1.40	0.53
1/17/2018	4.40	4.70	5.15	5.75	5.75	1.40	0.54

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
1/11/2018	4.1758	3.4950	3.5683	3.1310	1.3512	0.1635
1/14/2018	4.1669	3.4366	3.5365	3.0929	1.3501	0.1634
1/15/2018	4.1696	3.4010	3.5334	3.0761	1.3482	0.1633
1/16/2018	4.1825	3.4190	3.5428	3.0893	1.3533	0.1639
1/17/2018	4.1739	3.4109	3.5398	3.0801	1.3505	0.1640

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