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Polish Weekly Review

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Comment on the upcoming data and forecasts

This Friday, the CSO will publish its monthly Statistical Bulletin. As usual, it will shed some light on last month's macro releases, including the labor market data. In addition, the final estimate of unemployment rate will be released along with the Bulletin. We expect the CSO to revise the preliminary reading (published by the Ministry of Family few weeks ago) of 6.9% down to 6.8% due to higher active population as indicated by higher-than-expected employment growth in January. On Wednesday, the details of Q4 GDP will be published. Using annual GDP numbers published a month ago, we forecast GDP growth to be driven by both household consumption (4.5% y/y) and investment (ca. 11% y/y). Positive contribution from net exports and sharply negative contribution of inventory change will complement the reading. Next Thursday the Manufacturing PMI will be released. It is too early for a precise forecast, but we expect it to rise modestly, thereby bridging the gap vis-a-vis European PMIs and CSO's business sentiment indicators. Finally, note that due to the annual changes in CPI basket weights the flash CPI reading for February will not be published.

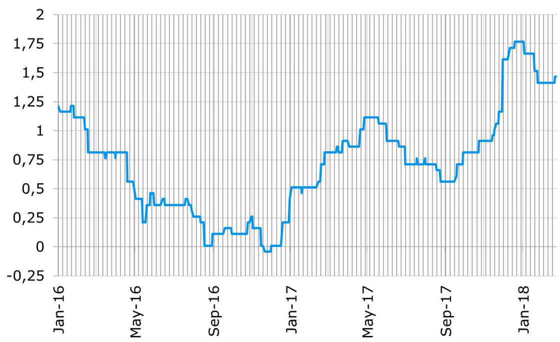
Polish data to watch: February 23rd to March 2nd

Publication	Date	Period	mBank	Consensus	Prior
Unemployment rate	23.02	Jan	6.8	6.9	6.6
Final GDP y/y (%)	28.02	Q4	5.1	5.1	5.1
Manufacturing PMI (pts)	01.03	Feb			54.6

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 OK0720	3/15/2018	200	1.741	2/14/2018
5Y T-bond PS1023	3/15/2018	1000	2.687	2/22/2018
10Y T-bond WS0428	3/15/2018	400	3.430	2/22/2018
30Y T-bond WS0447	3/15/2018	50	3.764	2/22/2018

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



Comment

Up after a buoyant retail sales print. Over the coming days there are three opportunities for surprise: unemployment rate, PMI, final GDP.

* 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 2018 Polish GDP is set to grow by 4.6% (with upside risks). 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. 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 dollar's weakness. The latter shields Polish currency from repricing along with rising risk-free rates. Moreover, since EM assets survived the equity selloff bravely as a group, they have become much more balanced as a whole of late. In such an eivronment, PLN remains strong with robust growth and only a hint of higher inflation to come.
- 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 4.20-ish).

mBank forecasts

	2014	2015	2016	2017	2018 F	2019 F
GDP y/y (%)	3.3	3.8	2.9	4.6	4.6	3.6
CPI Inflation y/y (average %)	-0.1	-0.9	-0.6	1.9	2.4	2.7
Current account (%GDP)	-2.1	-0.5	-0.3	0.2	-0.2	-0.6
Unemployment rate (end of period %)	11.4	9.8	8.2	6.6	6.0	5.8
Repo rate (end of period %)	2.00	1.50	1.50	1.50	1.50	2.25

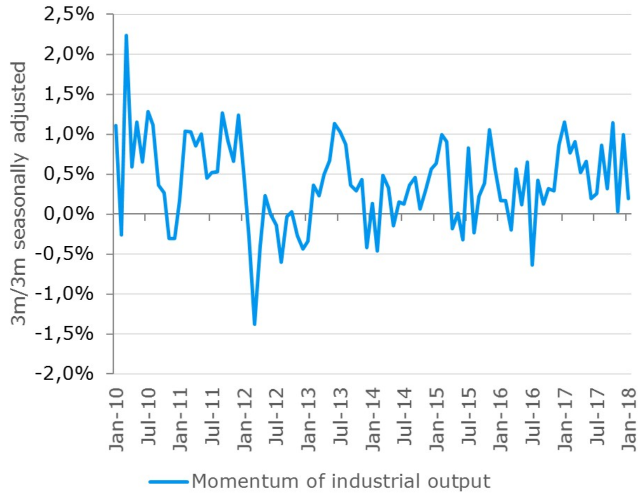
	2017 Q1	2017 Q2	2017 Q3	2017 Q4 F	2018 Q1 F	2018 Q2 F	2018 Q3 F	2018 Q4 F
GDP y/y (%)	4.1	4.0	4.9	5.1	4.8	4.6	4.5	4.5
Individual consumption y/y (%)	4.7	4.9	4.8	4.5	4.6	4.3	4.0	4.0
Public Consumption y/y (%)	0.5	2.1	1.9	3.0	4.0	3.0	3.0	3.0
Investment y/y (%)	-0.5	0.9	3.3	11.5	10.0	10.0	9.0	8.0
Inflation 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	3.40	3.55	3.70	3.80
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

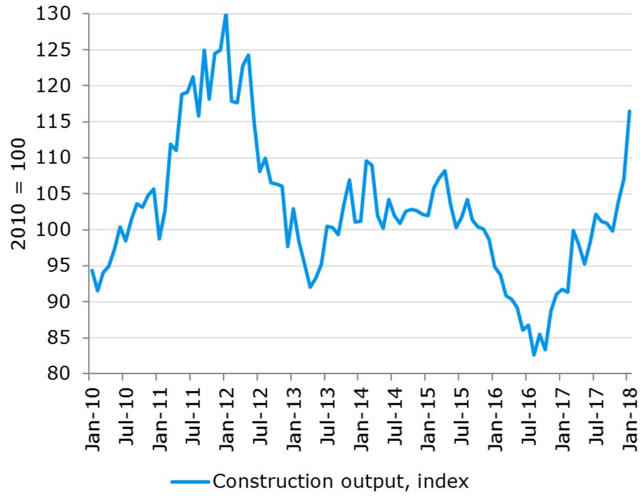
Economics

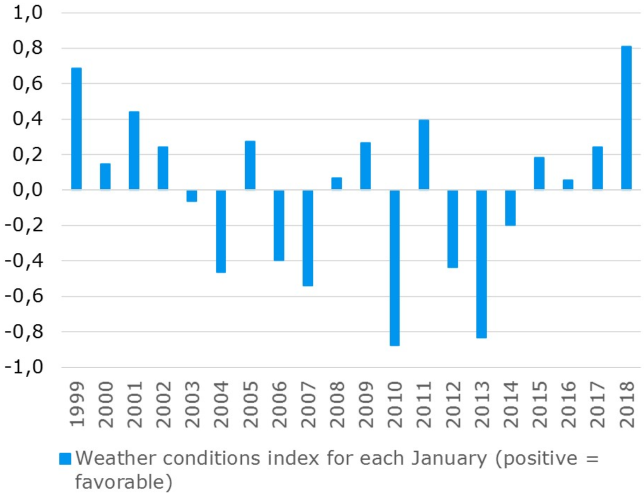
January data confirm the rebalancing of Poland's GDP growth – more investment, slightly less consumption. Producer price growth still very low.

Industrial output rose by 8.6% y/y in January, slightly above market consensus of 8.2% y/y, but below our too optimistic forecast of 11.0% y/y. The acceleration vis-a-vis December's 2.7% y/y is obviously the result of a strong calendar effect (working day difference rose from -2 to +1 y/y), but it masks certain weakness in January data. On a seasonally adjusted monthly basis, industrial output dropped by 0.8% m/m, which suggests that industrial momentum declined at the turn of the year – right now it is close to zero. We do not see it as a meaningful signal, but it should be seen as a sign of flattening uptrend in the sector.

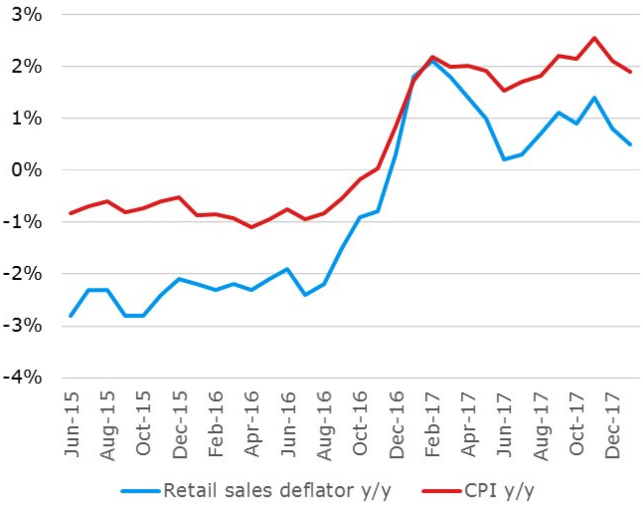


In January **construction output** skyrocketed, growing by 34.7% on a yearly basis (our forecast and market consensus were around 20%). After seasonal adjustment, monthly growth rate rose to 8.8%, more than twice as much as recent trend, thereby elevating the volume index to boom year levels (2011-2012H1). In our opinion, such a stellar release is not only a result of external factors (first and foremost warm and dry month, which means best weather conditions for any January in XXI century – see chart below; secondly, favourable calendar), but also the enduring rebound in investment activity. We expect that main drive were public investments (mainly rail but also road), which are catching up after lags between EU-fund installments. As always we need to wait a few months for the details, they will be revealed with quarterly construction data.



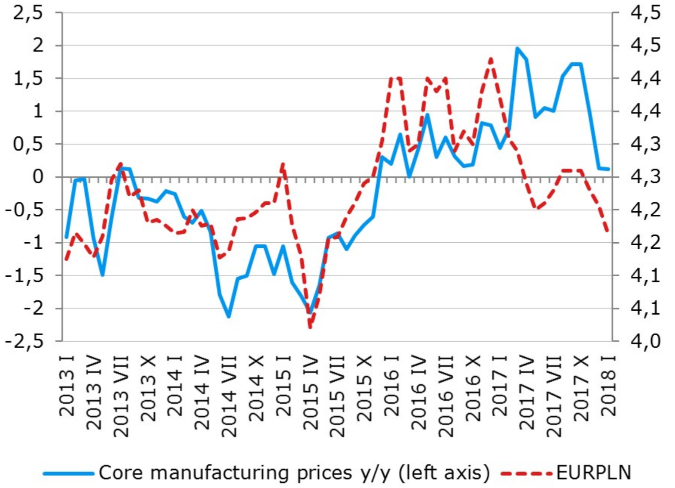


Retail sales rose by 8.2% in January, close to our forecast. In real terms sales increased by 7.7%. It implies that **retail sales deflator** scored a meaningful fall in January (see the graph). At the same time the gap between CPI inflation and retail deflator widened. Is should become a common trend in the coming months and quarters since the dominant pro-inflationary force stems from higher prices of services.

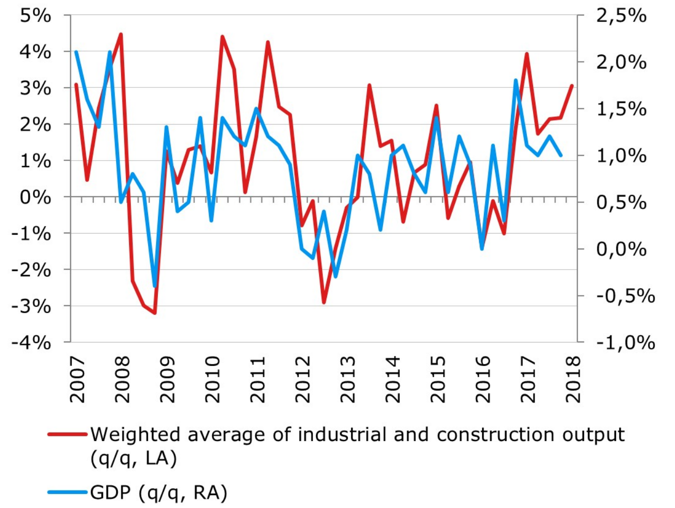


Looking at retail sales composition, 1 pp. was added by really high increase in "other" category that is an especially volatile retail sales component. We also see that growth of sales in food prices slowed. In durables and semi-durables, high growth rates were maintained but some softening is also visible but with no sharp turnaround in sight. We think this supports slow but inevitable normalization of consumption growth. Having said that we would like to remind the readers that consumption growth would stay above 4% and this mild deceleration will be offset by much higher investment growth.

Producer prices went up by 0.2% y/y in January, close to our forecast of +0.3%. On a monthly basis, prices grew by 0.1% and 0.2% in manufacturing alone. It is the latter that constitutes the most cyclical part of the release. Stripping energy, producer prices in manufacturing rose by 0.1%. That's a really slow growth in prices. The failure of producer prices to go even further south along with the exchange rate should be regarded as a success in these circumstances. However, we are miles away from any inflation pressure here.



It is too early to estimate **Q1 GDP** accurately, but January data offer first hints regarding its composition and direction. First, weaker industrial momentum was more than matched by the stellar construction data. Secondly, there is no indication that the economy slowed down on a sequential basis in Q1 – on the contrary, some acceleration can be expected. Thirdly, investment growth might even top the Q4 result (close to 11%). It should be clear that Q1 GDP will likely match the result from the final quarter of 2017, coming at close to 5%. The entire 2018 should see slight acceleration vis-a-vis 2017.



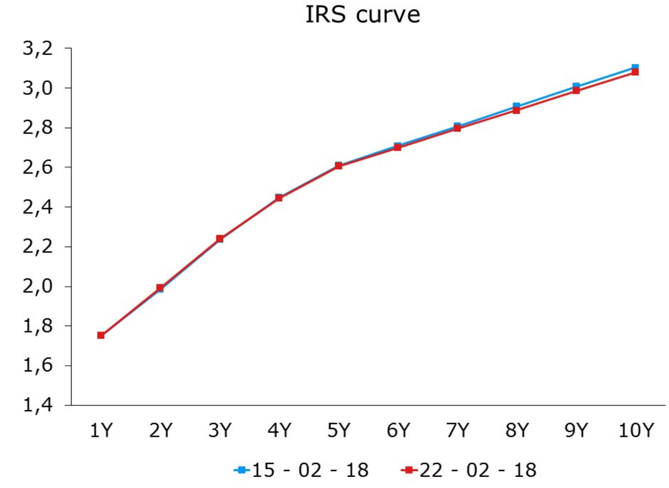
From the MPC's point of view, the data should be seen as neutral. As long as inflation remains in the Council's comfort zone, every data release will confirm both the doves and the hawks' preconceptions. This time weaker industrial momentum and low PPI favor the latter, while high GDP growth is cannon fodder for the latter. In such circumstances the consensus within the MPC will be unchanged and the Council will not want to act preemptively. The MPC's reaction to the upcoming inflation projection will be interesting to watch.

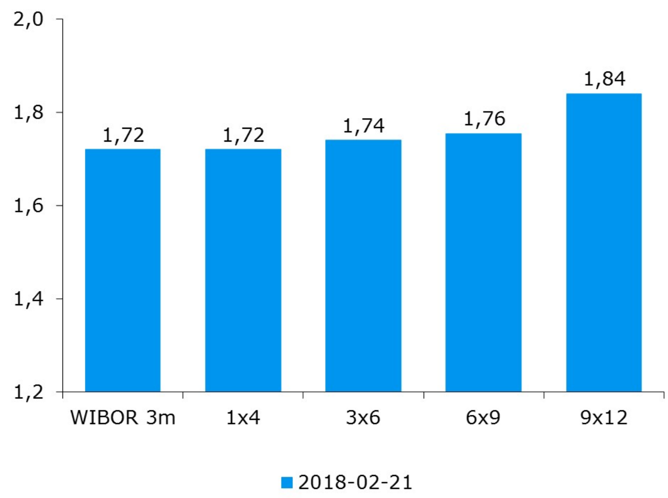
Fixed income

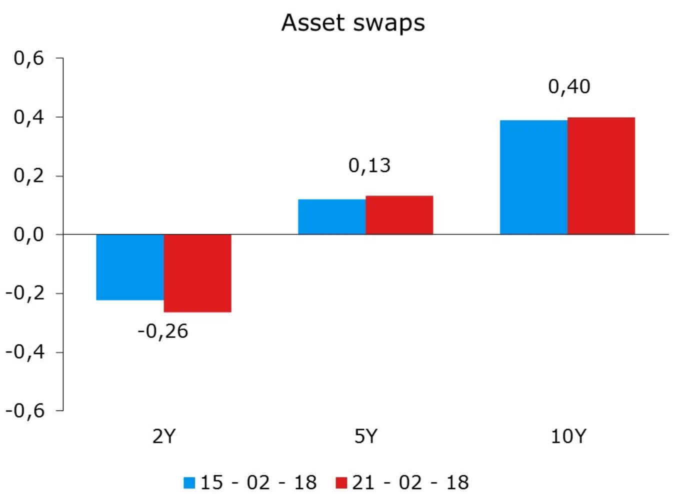
What a bullish market...

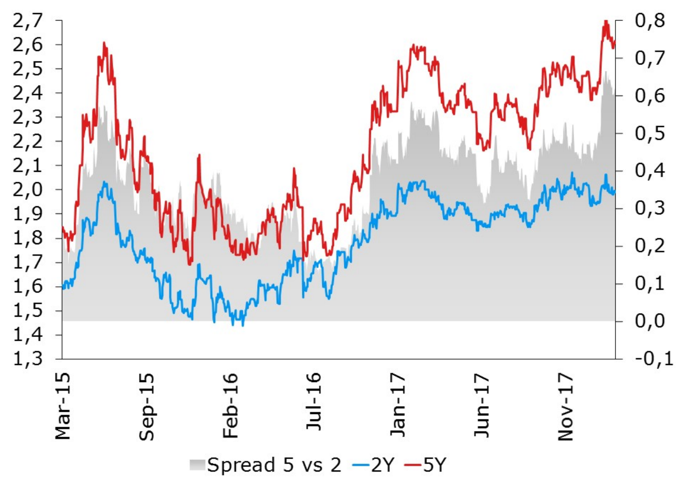
Today, on a regular auction the Ministry of Finance sold 4 bio of Polish bonds: OK0720 (at 1.741%), PS0123 (at 2.687%), WS0428 (at 3.43%), WS0447 (at 3.764%), WS0524, WZ0528. On the supplementary auction, additional 807 mio. Demand was 13 bio and 2.3 bio, respectively. The Ministry of Finance has financed 46% of 2018 borrowing needs as of this moment.

After yesterday's FOMC Minutes, Treasuries moved again to 2.94%, but the Polish market looks really strong. Many traders are not asking whether Treasuries will go through 3%, but when. The market seems to be looking for an opportunity to buy POLGBs. ASW are very tight, PS0123/5y is 5 bps and DS0727/10y is 25 bps. DS0727/Bund is 272 bps. PS0123/DS0727 is 67 bps. DS1019 is trading at 1.51% (1 bps down), PS0123 is trading at 2.69% (6 bps down) and DS0727 is trading at 3.36% (8 bps down).









Money market

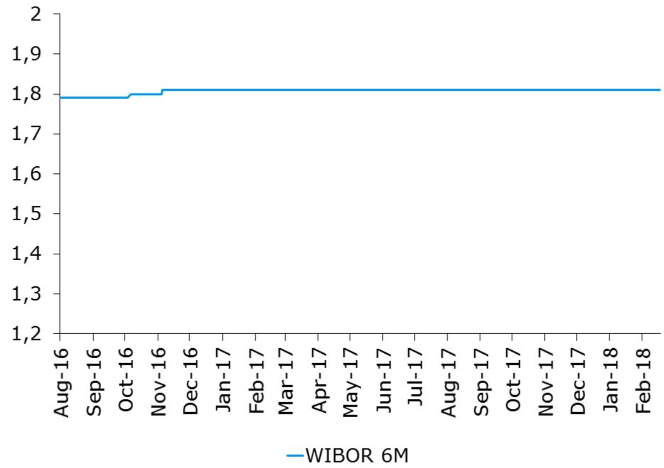
Floaters are surging

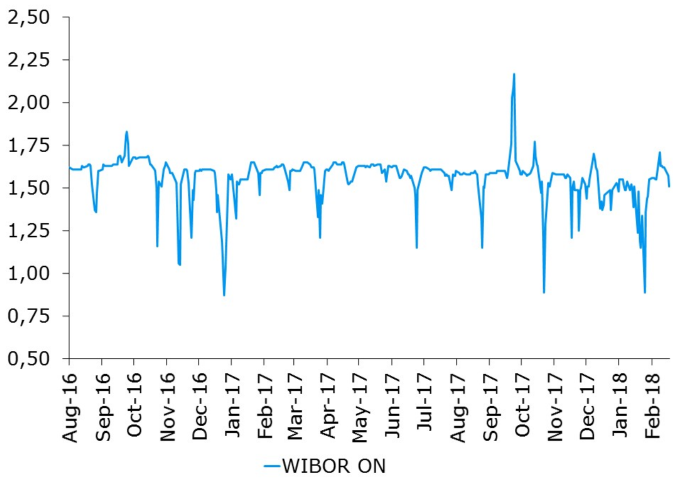
For another week Polish bonds showed strong resilience to global rout. With US yields rising to new records, Polgbs have gained last week, with 10y bond yield falling to 3.45%. It feels like demand comes mainly from local investors as floating rate notes are sky-rocketing. At the moment WZ1122 price is approaching 100.00, meaning that the 5y tenor is trading flat to 6m Wibor. ASWs are trying to keep up with 10y tenor, trading today as tight as 26 bp (!). Front end of the curve is pretty stable with broad consensus about rates starting to rise only in 2019.

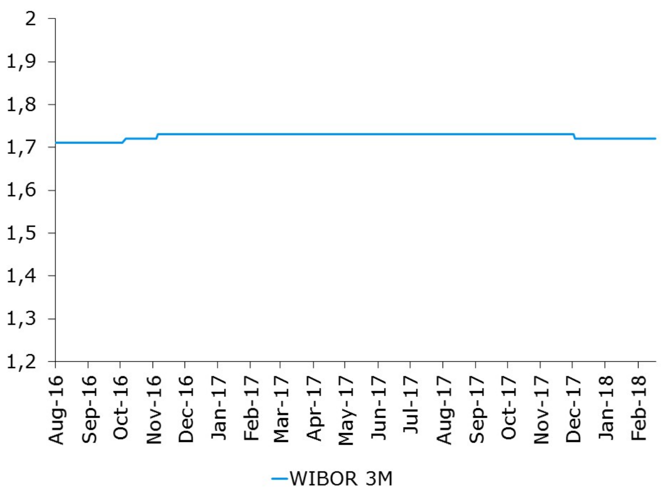
We are approaching month end, so cash will be lower again. Our spreads are continuing to tighten from December/January cheapness.

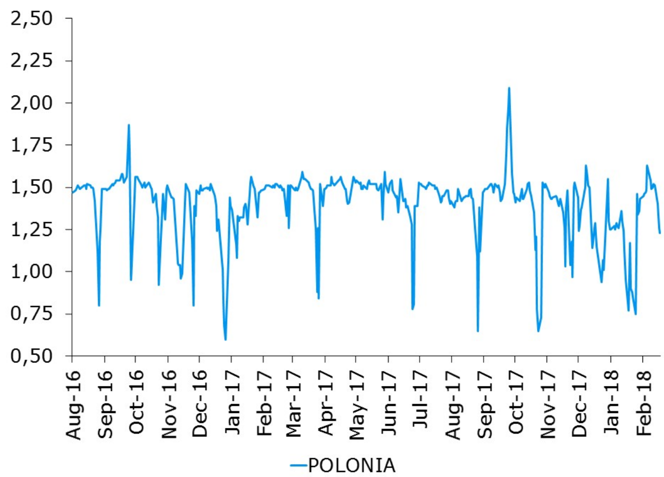
Ref rate vs Polonia averages:

30 day	27 bps
90 day	22 bps



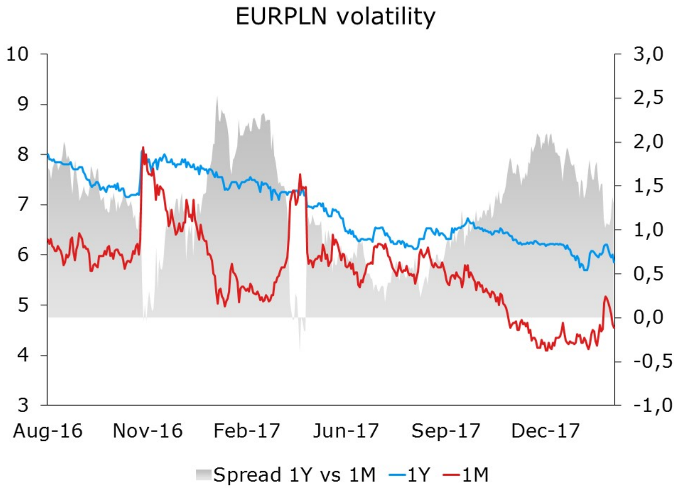






Forex

Spot – Weaker in the range The really strong selling interest in EUR/PLN has run of steam just above the 4.1300 support (the 4.1315 was the low in EUR/PLN). Looking at it, from a purely technical point of view, it has formed a double bottom formation, which could provoke another test at 4.200 and a deeper correction (lower PLN). EUR/PLN reached 4.1880 (high) so far. Whether the momentum will take us above 4.20, is still to be decided. As a result, our baseline scenario is still the 4.14-4.20 range and we will try to play that range.



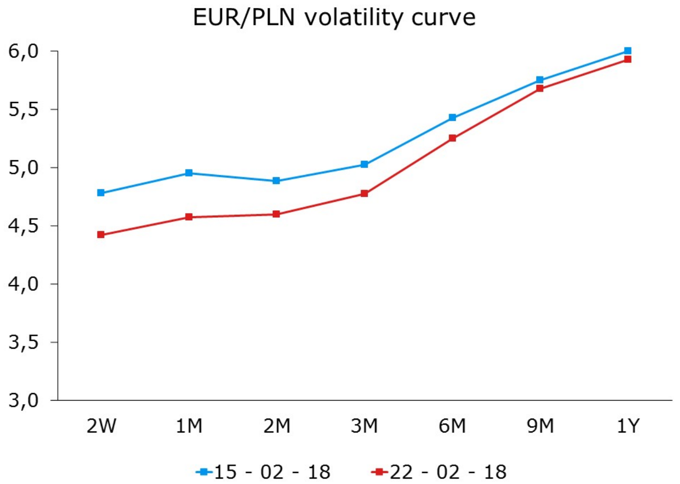
Options – EURPLN vols lower The vols are slightly lower, mostly because of decreasing realized volatility and improving global investment sentiment. 1 month ATM mid is 4.6% today (0.2% lower), 3 months are at 4.75% (0.35% lower) and, finally, 1 year fixed at 5.95% (0.1% lower). The skew is roughly unchanged. The currency spread (difference between USD/PLN and EUR/PLN) was better offered.

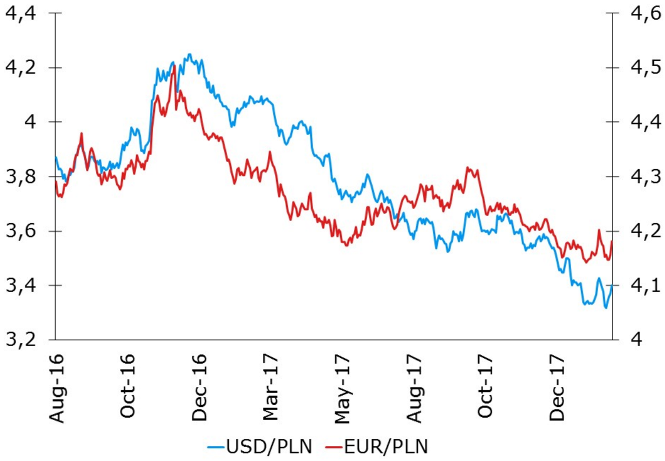
Short-term forecasts

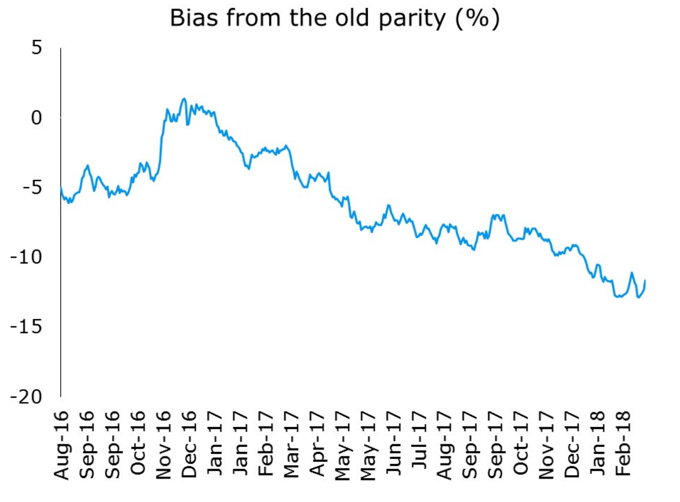
Main supports / resistances:
EUR/PLN: 4.13 / 4.23
USD/PLN: 3.35 / 3.60

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.







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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
2/15/2018	1.71	1.72	1.72	1.71	1.98	1.75	1.72	1.74	1.75	1.83	1.97	1.85
2/18/2018	1.60	1.72	1.70	1.71	1.87	1.75	1.72	1.74	1.76	1.85	1.95	1.83
2/19/2018	1.65	1.72	1.77	1.71	1.95	1.75	1.72	1.74	1.76	1.85	1.98	1.85
2/20/2018	1.45	1.72	1.59	1.71	1.79	1.75	1.72	1.73	1.76	1.84	1.97	1.85
2/21/2018	1.59	1.72	1.72	1.71	1.95	1.75	1.72	1.74	1.76	1.84	1.97	1.86

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
OK0720	2/14/2018	7/25/2020	95.93	1.74	200	656	206
PS0123	2/22/2018	1/25/2023	99.14	2.69	1000	3070	1036
WS0428	2/22/2018	4/25/2028	94.22	3.43	400	1017	473

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0720	5Y IRS	PS0423	10Y IRS	WS0428
2/15/2018	1.750	1.378	1.985	1.763	2.610	2.729	3.105	3.494
2/18/2018	1.750	1.381	1.982	1.728	2.585	2.712	3.055	3.462
2/19/2018	1.750	1.402	1.995	1.735	2.605	2.745	3.090	3.515
2/20/2018	1.750	1.405	1.995	1.736	2.615	2.754	3.095	3.513
2/21/2018	1.750	1.409	1.990	1.726	2.605	2.736	3.080	3.477

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
2/15/2018	4.95	5.03	5.43	6.00	6.00	1.35	0.57
2/18/2018	4.81	4.93	5.40	5.95	5.95	1.35	0.57
2/19/2018	4.63	4.90	5.35	6.00	6.00	1.36	0.54
2/20/2018	4.55	4.78	5.20	5.85	5.85	1.36	0.54
2/21/2018	4.58	4.78	5.25	5.93	5.93	1.38	0.57

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
2/15/2018	4.1530	3.3259	3.5940	3.1250	1.3328	0.1638
2/18/2018	4.1559	3.3173	3.6049	3.1290	1.3357	0.1638
2/19/2018	4.1467	3.3411	3.6013	3.1338	1.3320	0.1638
2/20/2018	4.1472	3.3597	3.5967	3.1345	1.3298	0.1637
2/21/2018	4.1562	3.3697	3.5978	3.1351	1.3317	0.1640

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