March 22, 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:
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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

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Comment on the upcoming data and forecasts

This Friday the CSO will release its monthly Statistical Bulletin. Apart from the details of recent publications it contains unemployment data. We expect a slight drop in unemployment rate from 6.9% to 6.8% as indicated by the preliminary estimates from the Ministry of Family. On Wednesday, MPC Minutes from the March meeting will be released, but since most of the changes in perceived stance occurred during the conference, we do not expect this publication to have a significant impact on the markets.

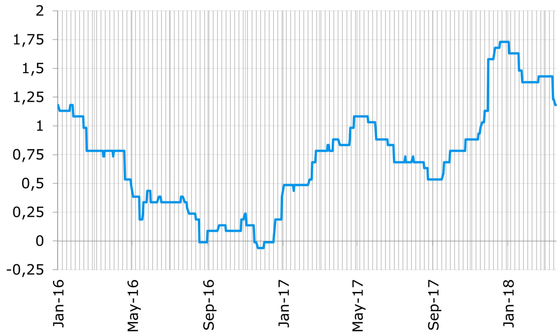
Polish data to watch: March 23th to March 30th

Publication	Date	Period	mBank	Consensus	Prior
Unemployment rate (%)	23.03	Feb	6.8	6.8	6.9
MPC Minutes	29.03	Mar			

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

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



Comment

Disappointment in PPI brought Polish surprise index further down. Next days offer only one opportunity to move the index – the unemployment rate this Friday.

* 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 4.6%. 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 bottom in February 2018. Base effects suggest that inflation will accelerate until summer and then drop again. One should look through short-term fluctuations and look at underlying momentum. The case for accelerating core inflation is as strong as it had been before recent CPI prints. Polish labor market is operating normally and fits regional trends: wage growth is coming. The signal might be obscured by one-off factors and immediate impact of stronger PLN in 2017.
- 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 and early 2019.
- 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. The impact of PLN-specific factors on the currency has been relatively small.
- Our scenario of an upward correction in EURPLN has finally materialized. Hawkish Fed concerns and (especially) very dovish MPC both contributed to a modest depreciation in the PLN (less than 5%). It seems that the PLN, negatively impacted by easy monetary policy, can only catch a reprieve if global rates move sharply lower and investors readjust their expectations regarding the global economy and global monetary policy in a wholesale fashion.
- Over the medium term, strong GDP growth, low credit risk and purely mechanical (as the expected date of first hike should move closer with each day) drift in interest rate expectations will increase the PLN's relative appeal. Thus, in the second half of the year its cyclical nature should reassert itself.

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	2.0	2.1	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	5.8	5.5
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	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	4.9	4.6	4.3	4.0	4.0
Public Consumption y/y (%)	0.5	2.1	1.9	5.4	4.0	3.0	3.0	3.0
Investment y/y (%)	-0.5	0.9	3.3	11.3	10.0	10.0	9.0	8.0
Inflation rate (% average)	2.0	1.8	1.9	2.3	1.9	2.3	2.4	1.9
Unemployment rate (% eop)	8.0	7.0	6.8	6.6	6.8	6.0	5.7	5.8
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	1.65	1.65	1.80	1.75
10Y Polish bond yields (% eop)	3.49	3.32	3.37	3.30	3.30	3.45	3.60	3.70
EUR/PLN (eop)	4.23	4.23	4.31	4.18	4.18	4.20	4.15	4.10
USD/PLN (eop)	3.97	3.70	3.65	3.48	3.48	3.50	3.40	3.33

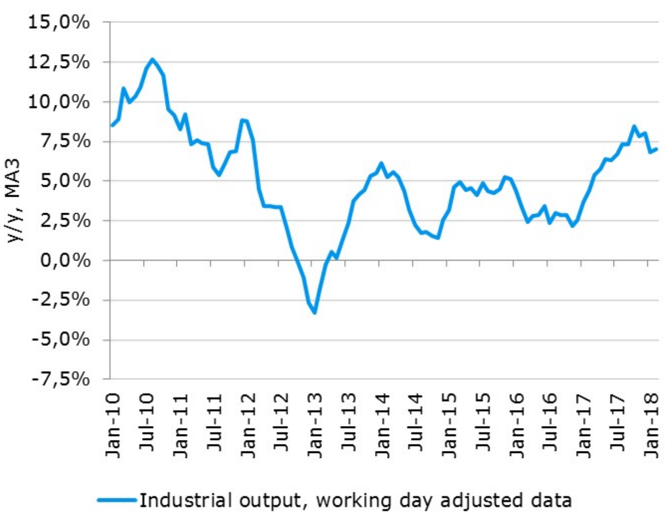
F - forecast

February's figures support strong GDP growth amid deflation in producer prices

Over the past week, we have received most of the relevant data releases for February. While the overall assessment of this data flow must be an optimistic one: GDP growth was sizeable in the first quarter of the year, with strong contributions from both investment and household consumption, while wage growth remains strong. However, beauty is in the eye of the beholder and February data will likely reinforce all the MPC's prior beliefs and its unabashedly dovish rhetoric. First, economic growth remains high, but it likely embarked on a downward trajectory, one that is the cornerstone of the MPC's favored scenario, in which economic growth returns to potential automatically and inflation returns to target, also automatically. Second, the lack of acceleration in current wage prints will vindicate the MPC's long-standing skepticism regarding the labor market. Last but not least, prices pressures are non-existent in the industrial sector (as evidenced by the PPI data) and it will likely be noticed by the MPC.

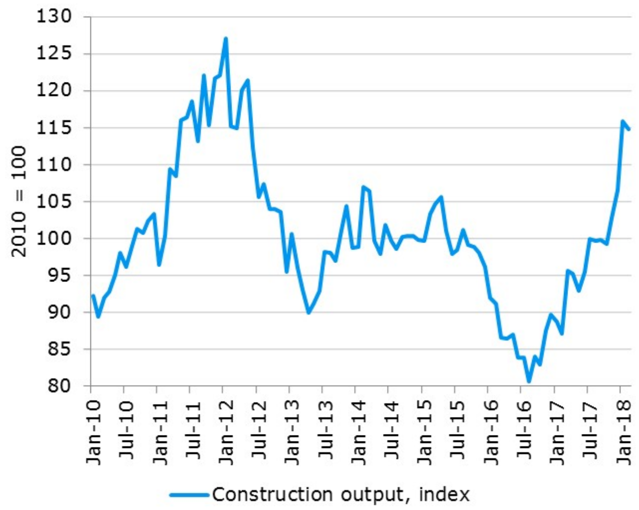
Let's look into details of March publications:

Industrial output rose by 7.4% y/y, below market consensus (8.1%) and close to our forecast (7.5%). The mild slowdown vis-a-vis January is a result of less favorable calendar effect (working day difference dropped from +1 to 0 y/y). The slowdown would have been deeper, had energy production not been ramped up considerably. Due to sharply colder weather (it was the coldest February since 2012), energy output accelerated from 3.7 to 14.1% y/y, boosting total industrial production by 0.9 percentage points. At the same time, this also explains the surprisingly strong momentum (+1.3% m/m seasonally adjusted), which hides a relatively underwhelming performance of manufacturing. All in all, the trend in industrial output has flattened in recent months and industrial output has already peaked in annual terms.

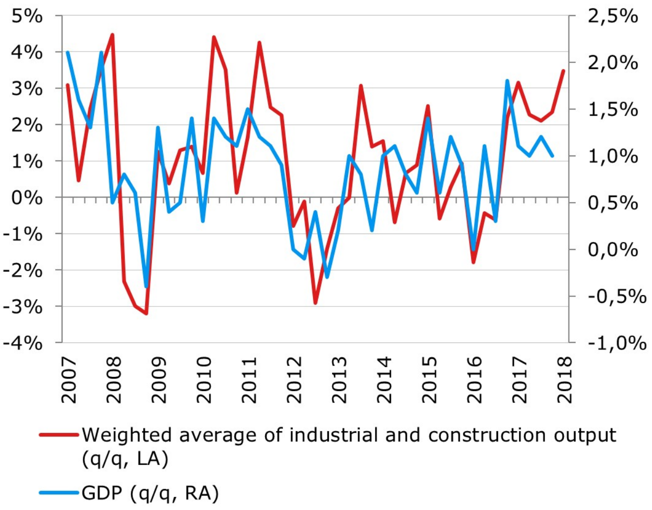


In March, the combination of high statistical base and unfavorable calendar effect is set to drag industrial output growth down to 4% y/y. The next months will be marked by 5-10% growth, a solid performance, to which both external and internal factors continue to point.

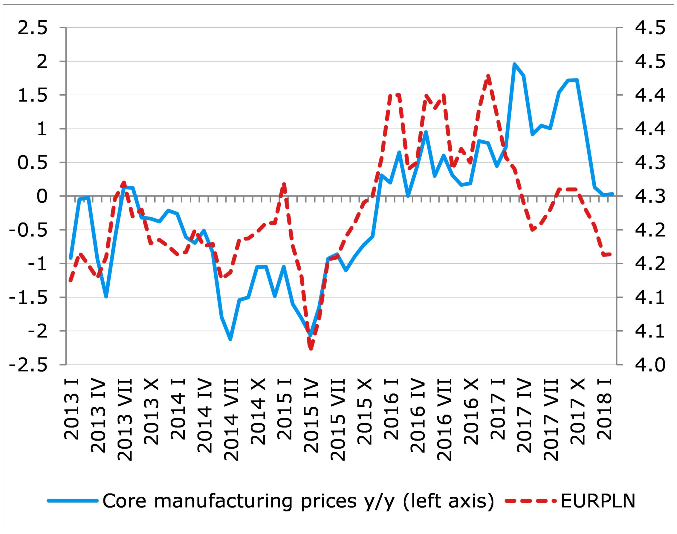
Construction output grew in February by 31.4% on a yearly basis, similar to our forecast and higher than market consensus. However, after seasonal adjustment it fell on a monthly basis by 1% after a stellar release in January. This fall was mainly caused by calendar effects and weather conditions (coldest February since 2012). The scale of the drop is rather moderate, such a pattern with one month's release being boosted by great weather usually has a long and mild correction. General picture remains the same, construction output is being fueled by public investment (mainly rail, but also road). We expect the upward trend to persist, however if low temperatures last longer, we might see a few weaker releases.



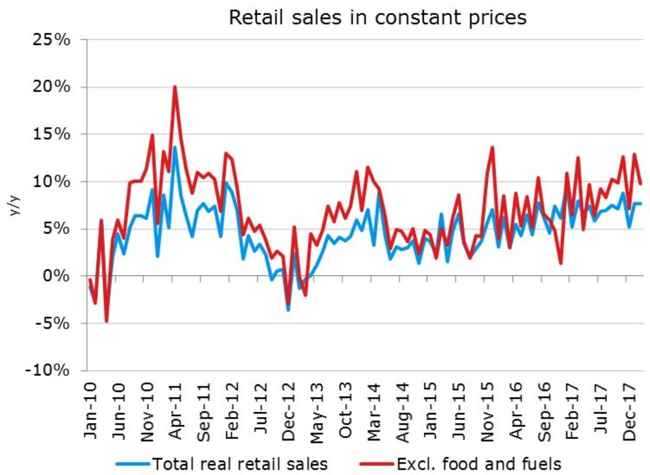
With two months of data behind us, nowcasting Q1 GDP is an easier task. Our initial estimates held pretty well and we continue to forecast that GDP rose by 4.9% y/y in the first quarter. The sequential growth rate is also set to be impressive, with weighted average of quarterly industrial and construction output growth hitting a 7-year high.



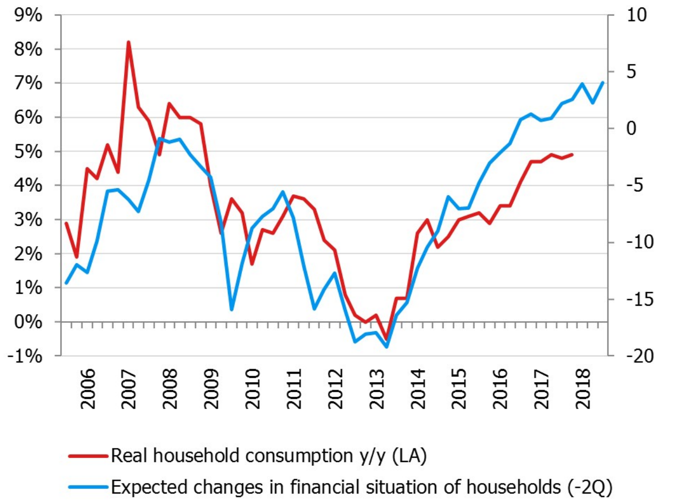
Producer prices returned to negative territory in February. At -0.2% y/y they were lower than market consensus and our forecast, both slightly above zero. Huge drop of prices on monthly basis was generated by oil and coke related prices that dropped by 4.3% m/m. Stripping that, core manufacturing prices stayed flat at precisely 0.0%. It is not a surprise that EURPLN exchange rate also stayed flat over the previous month – the correlation we have exploited for a long time is still holding. We reiterate the hypothesis that current low-price equilibrium in producer prices can only be broken by a spike in exchange rate. Absent such shocks, firm would struggle with rising labor costs. Of course in the aggregate level the effects can be mitigated by a meaningful bank deposit cushion, but on a micro level rising number of bankruptcies is what we should expect. We do not think that this would derail economic expansion. It would be rather a way to sustain it as in such a way misallocated resources would be freed and utilized in a more efficient way. This can only be avoided if prices move. It seems unlikely at this very moment, though.



Retail sales rose by 7.9% y/y in nominal terms and by 7.7% in constant prices, very close to our forecasts and little changed from January's print (8.2 and 7.7% y/y, respectively).

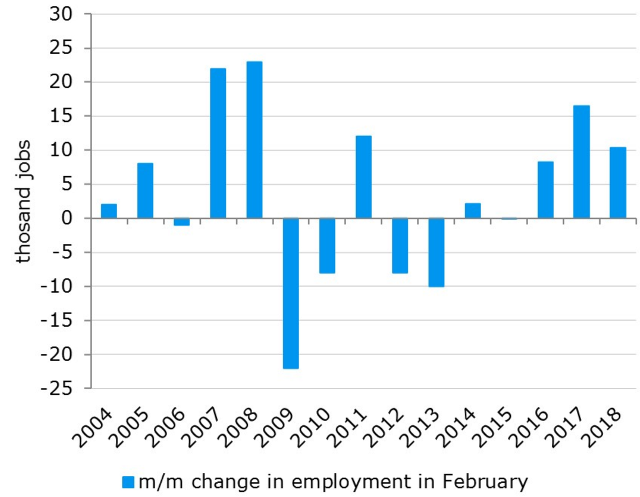


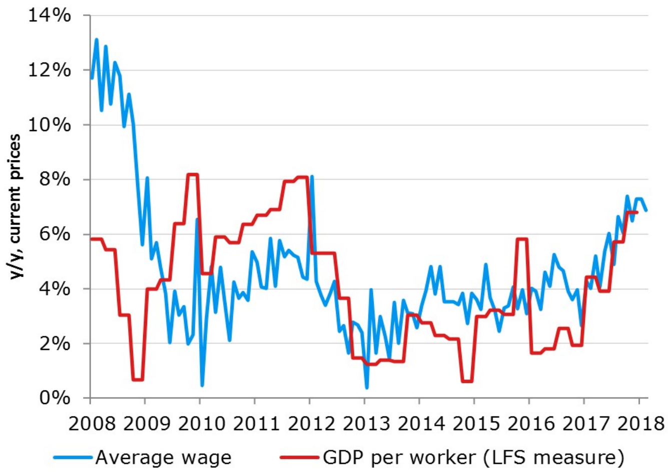
While the aggregate number did not surprise at all, there are several surprises in the details of the release. Those, however, cancelled each other out and do not impact the bigger picture of strong retail sales and – by extension – household consumption growth in Poland. Let's review them in greater detail. Car sales decelerated from 12.5 to 3.1% y/y, likely suffering from the combination of lower working day count and unfavorable weather conditions. Fuel sales accelerated briskly (from 3.5 to 9.5% y/y), while food sales managed to only partially offset the weak January (having risen by 5.6% y/y in February vis-a-vis 4.0% y/y a month ago). Most core categories behaved as expected (double-digit growth rates maintained), with one notable exception. The Others category, where building materials account for the majority of sales, surprised to the upside for the second month in a row. Perhaps this is the result of the on-going housing boom, but this hypothesis is virtually impossible to confirm using aggregate data.



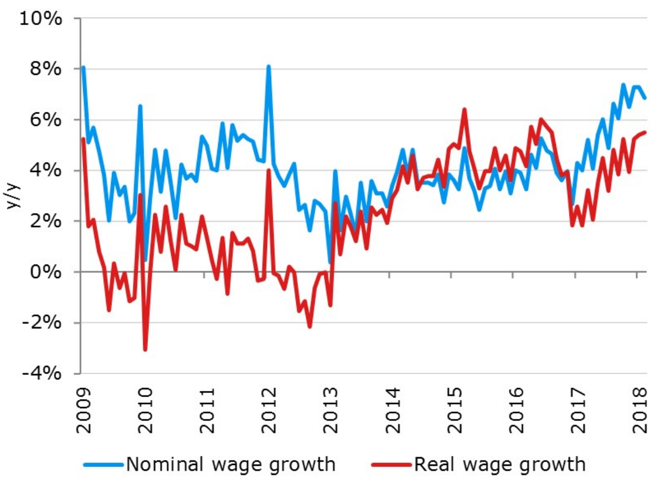
The solid retail sales print bodes well for household consumption growth in the first quarter. Current disposable income flow is sufficient to keep household consumption growing at 1-1.2% q/q and ca. 4.5-5% y/y for the foreseeable future. The more so, since consumer sentiment is still hovering near all-time highs and there is no sign of a reversal given current labor market situation. Finally, household spending remains relatively unlevered, which suggests that its high level could be supported even if incomes decelerate.

Employment in the enterprise sector rose by 3.7% y/y, in line with our forecast. This translates in to a 10k gain in employment on a monthly basis, below last year's result. Employment growth appears to be slowing down, which is consistent with lengthening employee search time and on-going tightening of the labor market. It is normal in current phase of the business cycle and should be reflected in fast wage growth. This labor market imbalance is mitigated to some extent by rising participation among older age groups and higher immigration – both should be monitored closely. However, their impact is limited in the short term and until all reserves are used, somewhat lower employment growth and higher wage growth should be seen as a baseline scenario.





Average gross wage rose by 6.8% y/y in February, slightly below market consensus (7.2% y/y) and our forecast (7.0% y/y). As usual, the details of the releases will be found in the CSO's Statistical Bulletin, due next Friday. We suspect that this mild slowdown in wages (vis-a-vis January's 7.3% y/y) can be attributed to a major swing in utilities and a modest deceleration in construction wages due to unfavorable calendar effect and weather conditions. In addition, retail wages are negatively affected by high statistical base related to the early-2017 wave of wage hikes. Nevertheless, the trend in wage growth is still upward-sloping and the imbalance between labor demand and supply continues to favor higher wages.



Wage bill growth remains exceptionally high: in nominal terms it decelerated from 11.4 to 10.8% y/y, in real terms fell from 9.5 to 9.4% y/y (thanks to the sharp drop in inflation in February). Even if one corrects wage bill growth for the likely upward bias in corporate employment growth, income base for household consumption is not budging. It continues to point to 4.5-5.0% consumption growth in the coming quarters.

As seen in the graph above, wage growth now matches labor productivity growth and this lack of pressure on unit labor costs is a cornerstone of the MPC's dovish rhetoric. In our view, this conclusion is too far-fetched due to the well-known understatement of immigration in LFS data. Had immigration been properly included in the broadest employment figures used to calculate total labor productivity, employment would have been found to grow by 1.8-2.0 p.p. faster than LFS data shows. This, in turn, means that labor productivity growth is overstated by a similar amount and that wage-productivity gap has not closed in 2017. The MPC's rose-tinted glasses might not be an appropriate way of looking at labor market developments.

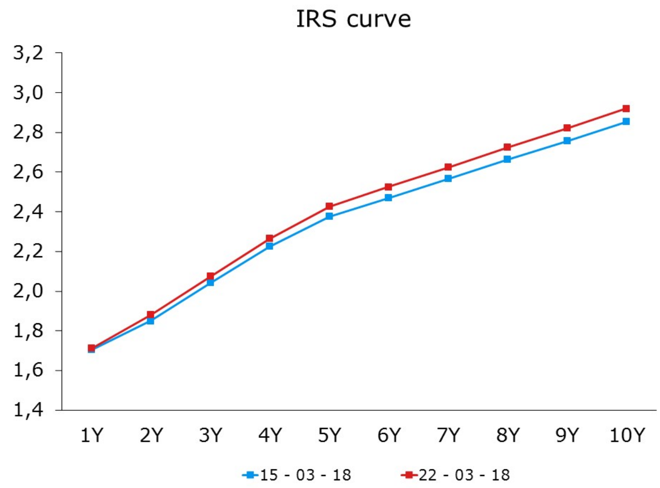
Fixed income

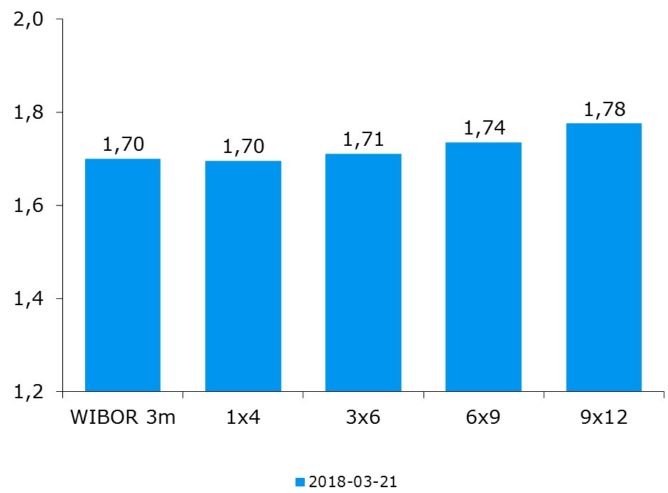
Post-Fed rally

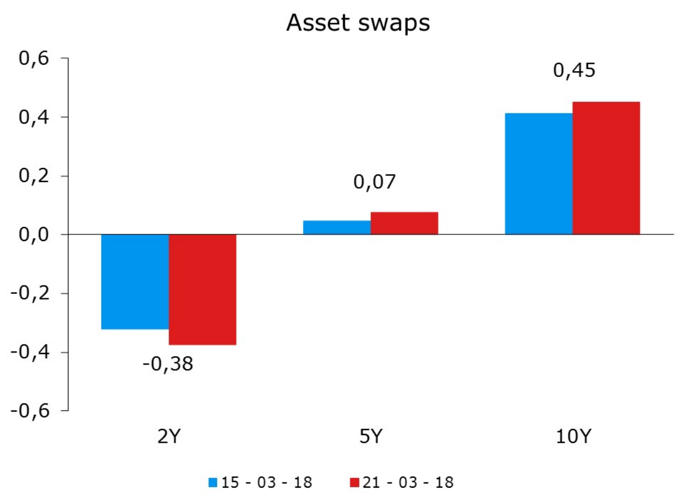
After the FOMC meeting yields are moving lower all over the world, Poland is the biggest winner of them all.

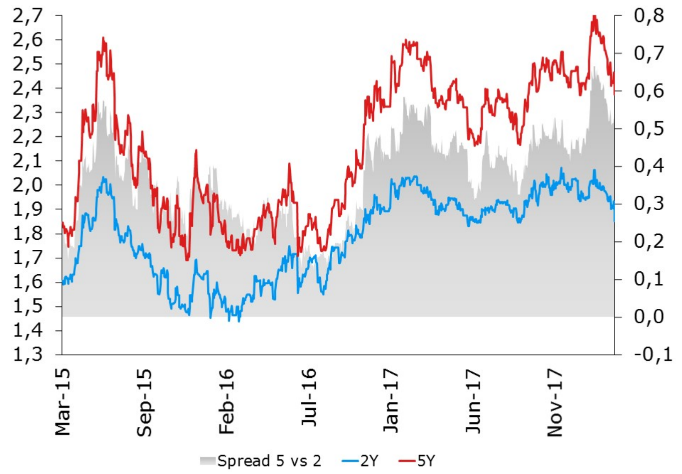
Next week there's an auction in Poland and, as it won't be a large one, hence it will be supportive for the market. End of the month is coming, PS0418 will expire soon, so Polish banks will have to buy bonds.

PS0123/5y is -2 bps, WS0428/10y is 35 bps. WS0428/Bund is 270 bps. PS0123/WS0428 is 85 bps. DS1019 is trading at 1.34% (2 bps up), PS0123 is trading at 2.41% (1 bps up) and WS0428 is trading at 3.26% (2 bps up).









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Money market

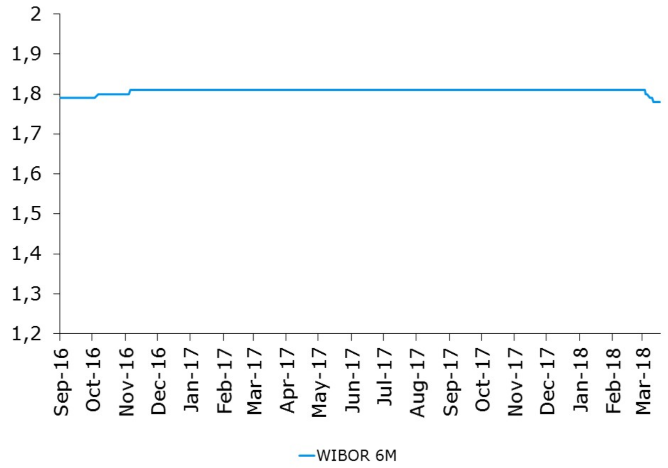
Roller-coaster

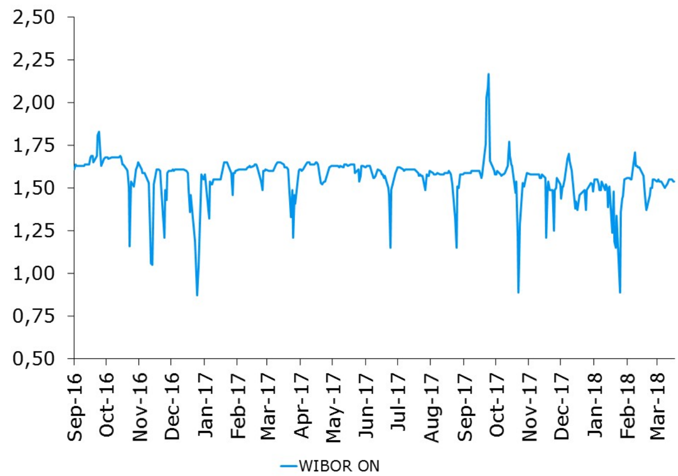
Polish yield curve bounced from lows before Fed meeting. The move ranged from 5 to 12 bp along the curve. Two year swap reached 1.93% and five year was trading as high as 2.48%. Almost whole move was reversed today, investors decided to get back into longs when event risk faded. Fed decision was in our opinion rather in line with expectations, what's driving now the market is rather some positioning. Next week we have POLGBs auction, possibly a small one.

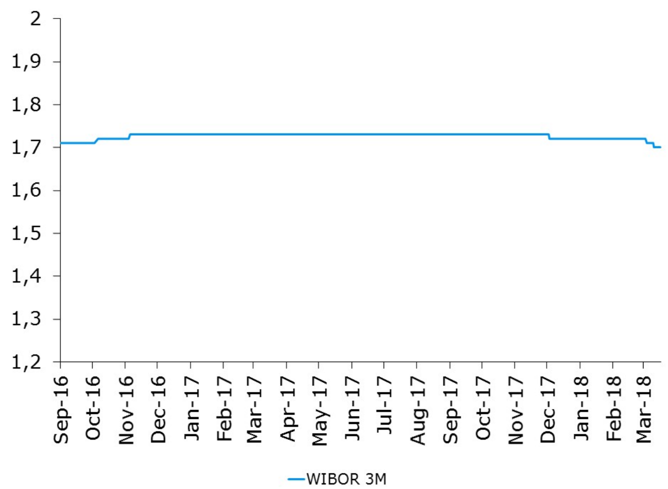
Last week of reserve period comes which tends to be cheap.

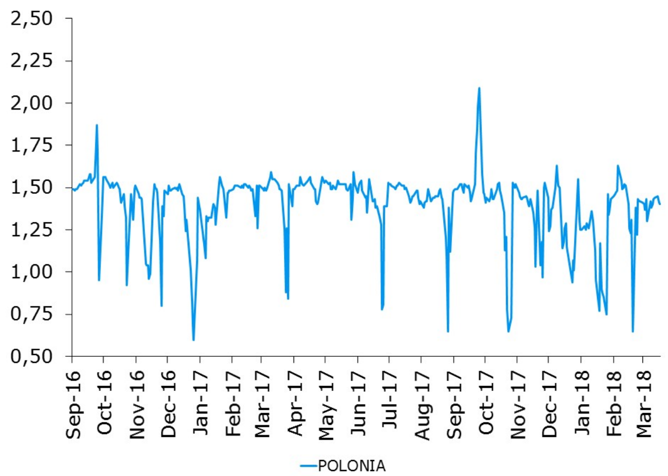
Ref rate vs Polonia averages:

30 day 19 bps
90 day 22 bps









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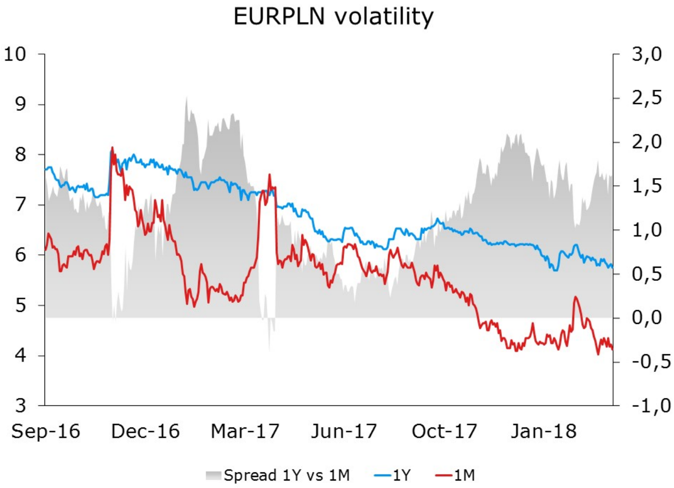
Forex

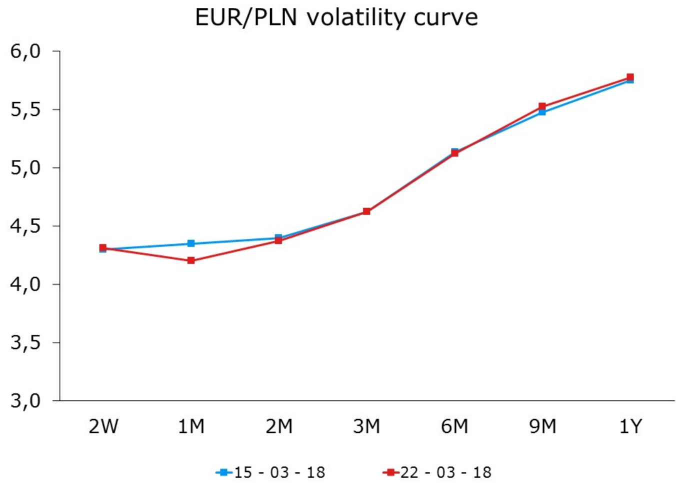
Spot – EUR/PLN – a failed break-out EUR/PLN kept on marching higher, breaching the 4.22/4.23 resistance zone, touching as high as 4.2440 (the week's top). The Zloty's relief rally begun after the FOMC meeting, that was not hawkish enough for the market. As a consequence, EUR/PLN slipped to 4.2170-ish, which in our eyes constitutes the middle of the current 4.19-4.25 range. We stick to our play the range strategy, but this time we apply neutral instead of PLN-negative approach. Nevertheless, while we still are above 4.1900 and in the up-trend, technically speaking, EUR/PLN may eventually reach 4.25/4.27 (an ideal target zone).



Options – EUR/PLN vols – tic lower The EUR/PLN vol curve melted a little as spot was really calm and there is no certain volatility trigger on the horizon. 1 month ATM mid is 4.1% today (0.05% lower), 3 months are at 4.5% (0.1% lower) and, finally, 1 year fixed at 5.75% (0.05% lower). The skew is roughly unchanged. The currency spread (difference between USD/PLN and EUR/PLN) was better offered.

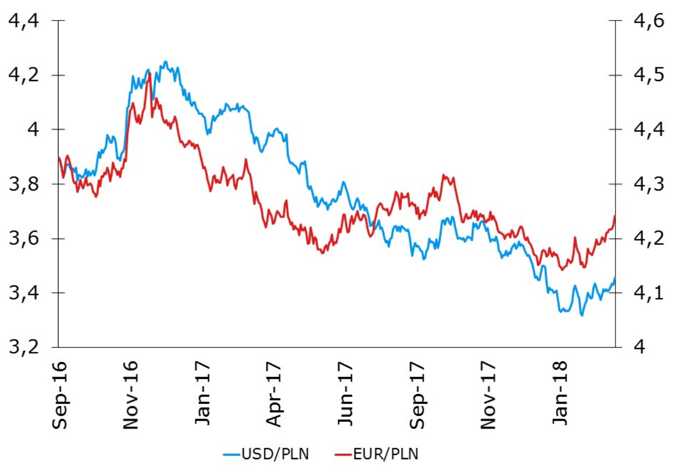
Short-term forecasts

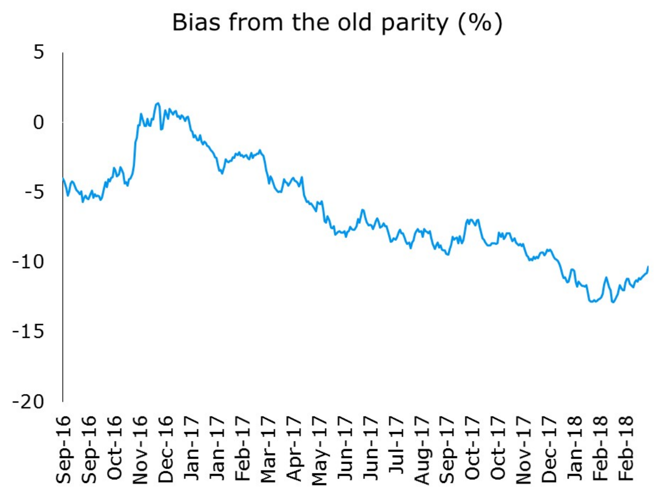
Main supports / resistances:
EUR/PLN: 4.1900 / 4.2700
USD/PLN: 3.3500 / 3.6000



Spot Current position: Sidelined.

Finally, our long EUR/PLN at 4.1950 was in the money. We closed it at 4.2350 and we are sidelined at the moment. As believers of the rangy nature of EURPLN, we are now ready to re-enter the trade at 4.20 with a stop at 4.1650. Or alternatively sell EUR/PLN at 4.25/4.26, with stop above 4.28.





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
3/15/2018	1.53	1.70	1.66	1.68	1.90	1.73	1.70	1.70	1.71	1.75	1.83	1.78
3/18/2018	1.59	1.70	1.67	1.68	1.70	1.73	1.69	1.71	1.72	1.73	1.82	1.79
3/19/2018	1.60	1.70	1.68	1.68	1.91	1.73	1.70	1.70	1.71	1.74	1.80	1.79
3/20/2018	1.46	1.70	1.30	1.68	1.50	1.73	1.69	1.70	1.71	1.75	1.82	1.78
3/21/2018	1.66	1.70	1.76	1.68	1.95	1.73	1.70	1.71	1.74	1.78	1.84	1.80

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
3/15/2018	1.730	1.325	1.852	1.530	2.375	2.422	2.852	3.264
3/18/2018	1.730	1.329	1.843	1.519	2.360	2.404	2.847	3.251
3/19/2018	1.730	1.332	1.843	1.529	2.365	2.428	2.852	3.265
3/20/2018	1.730	1.354	1.864	1.543	2.410	2.468	2.902	3.323
3/21/2018	1.730	1.376	1.879	1.504	2.427	2.502	2.920	3.372

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
3/15/2018	4.35	4.63	5.14	5.75	5.75	1.36	0.54
3/18/2018	4.18	4.65	5.15	5.80	5.80	1.36	0.54
3/19/2018	4.23	4.65	5.05	5.83	5.83	1.33	0.54
3/20/2018	4.13	4.54	5.10	5.75	5.75	1.33	0.54
3/21/2018	4.20	4.63	5.13	5.78	5.78	1.33	0.54

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
3/15/2018	4.2168	3.4117	3.6073	3.2202	1.3550	0.1658
3/18/2018	4.2162	3.4214	3.6028	3.2363	1.3550	0.1659
3/19/2018	4.2176	3.4341	3.6009	3.2392	1.3562	0.1659
3/20/2018	4.2242	3.4296	3.6035	3.2251	1.3573	0.1661
3/21/2018	4.2416	3.4544	3.6205	3.2496	1.3620	0.1668

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