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Polish Weekly Review

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Table of contents

Comment on the upcoming data and forecasts

This Friday, the CSO will publish final CPI data. It will likely confirm the huge disappointment (1.3% y/y vs. 1.7% y/y consensus), but the details of the release will shed some light on its sources. In particular, the decline in core inflation (to 0.6% according to our calculations – to be confirmed officially by NBP data on Monday) will likely be explained. On the same day the NBP will release monthly balance of payments data. The MoF data on EU transfers forced us to revise our forecast of CA balance downwards as we now expect a small deficit instead of a modest surplus. Trade balance likely improved in February. Also on Friday the S&P will publish its review of Poland's rating. We expect the agency to leave ratings unchanged, but upgrade the outlook. Strong growth and fiscal figures, improved external balance as well as possible compromise with the EU suggest a more optimistic assessment from the S&P. On Wednesday the CSO will publish its monthly labor market stats. Wage growth likely declined a bit in March, while employment growth held steady. The former can be attributed to a unfavorable calendar effect. Working days (down from 0 in February to -1 y/y in March) will also weigh down on industrial output growth (Thursday). The slowdown will likely be exacerbated by high statistical base from last year. An even greater base effect (10 p.p.) will drag construction output growth. The accompanying PPI data is set to show a modest rebound in producer prices, driven by higher PLN-denominated commodity prices. Finally, next week will also bring CSO's consumer and business sentiment data for April (on Thursday and Friday, respectively).

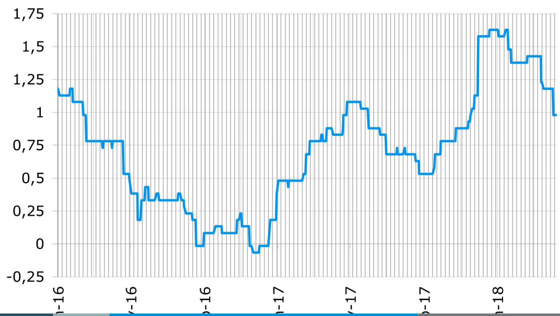
Polish data to watch: April 13th to April 20th

Publication	Date	Period	mBank	Consensus	Prior
CPI y/y (%) *final*	12.04	Mar	1.3	1.3	1.4
Current account (mio EUR)	13.04	Feb	-200	-340	2005
Export (mio EUR)	13.04	Feb	16500	16588	16853
Imports (mio EUR)	13.04	Feb	16700	17101	17057
S&P ratings review	13.04				
Core inflation y/y (%)	16.04	Mar	0.6	0.9	0.8
Average gross wage y/y (%)	18.04	Mar	6.5	6.5	6.8
Employment y/y (%)	18.04	Mar	3.7	3.7	3.7
Sold industrial output y/y (%)	19.04	Mar	4.2	2.9	7.4
Construction output y/y (%)	19.04	Mar	21.4	17.8	31.4
PPI y/y (%)	19.04	Mar	0.2	0.0	-0.2
Consumer confidence	19.04	Apr			
Business confidence	20.04	Apr			

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	4/26/2018	150	1.494	3/27/2018
5Y T-bond PS1023	4/26/2018	800	2.358	3/27/2018
10Y T-bond WS0428	4/26/2018	1400	3.196	3/27/2018
30Y T-bond WS0447	4/26/2018	50	3.764	2/22/2018

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



Comment

Unchanged (lack of important macro releases). Next days are abundant with data, from CPI through labor market and industrial data. The Polish surprise index is bound to change during the upcoming week.

* 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 surprised to the downside in February and March. Base effects suggest that inflation will accelerate in the coming months (until July) and then drop again. The expected path shifted downwards, though. Right now, services prices are the best hope for inflation bulls. The long-run relationship between wages and prices is clear there and we should be seeing a strong signal there in the second half of the year.
- 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	1.8	2.7
Current account (%GDP)	-2.1	-0.6	-0.3	0.3	-0.2	-0.6
Unemployment rate (end of period %)	11.4	9.8	8.2	6.6	5.5	5.0
Repo rate (end of period %)	2.00	1.50	1.50	1.50	1.50	2.00

	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	1.8	2.0	1.6
Unemployment rate (% eop)	8.0	7.0	6.8	6.6	6.6	5.7	5.5	5.5
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	1.70	1.70	1.71	1.72
2Y Polish bond yields (% eop)	2.01	1.90	1.75	1.72	1.49	1.55	1.60	1.70
10Y Polish bond yields (% eop)	3.49	3.32	3.37	3.30	3.18	3.30	3.40	3.50
EUR/PLN (eop)	4.23	4.23	4.31	4.18	4.21	4.20	4.20	4.20
USD/PLN (eop)	3.97	3.70	3.65	3.48	3.42	3.41	3.39	3.39

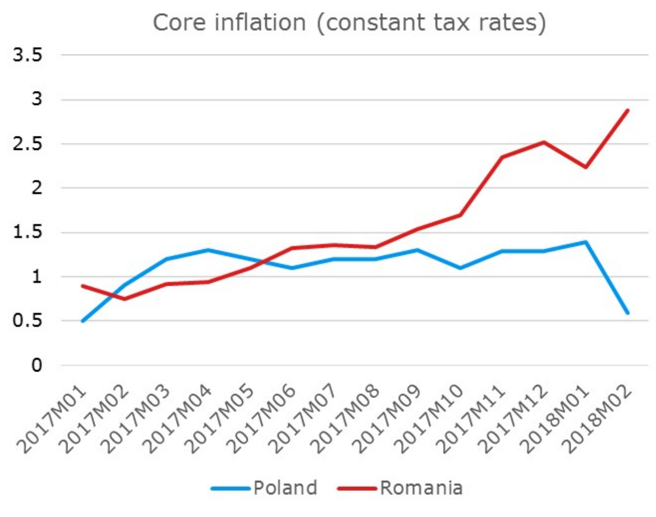
F - forecast

Economics

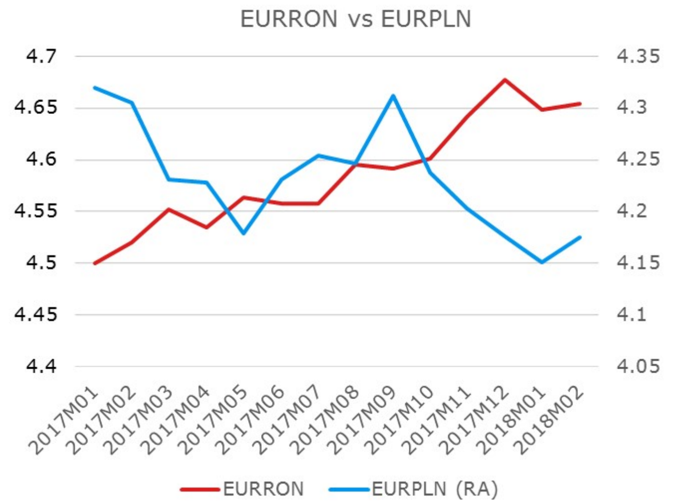
Rates unchanged; dovish rhetoric peaked

As expected, interest rates at the last Polish MPC meeting were left unchanged. The main reference rate stands at 1.5%. The MPC's statement was more or less unchanged, mirroring only new, minor bits of information on many fields. The overall tone was intact. It is tempting to say that the same applies to the conference, but it was a little bit dovish as the governor's specific forward guidance of stable rates was extended to 2020 (2 years from now, to be precise) and the final straw was the talk of possible monetary policy loosening as the next step beyond that horizon. It seems that was the final straw as the market was unable to react on this new information, since much of this has already been discounted. What is striking here, is the fact that governor GlapiĹ„ski was speaking of monetary policy loosening just to inform of the uncertainty that is attached to such long-term thinking. It is also telling that the aforementioned „loosening" was not reduced to simple rate cuts. It seems the hurdle for such a step stays high and it would be truly hard to dip below 1.5% in reference rate without a recession. The reasons are the same as in 2016 when MPC did not deliver a rate cut amidst low growth and persistent deflation. In our opinion, the future monetary loosening is going to be rather non-standard. As we are still in the woods in this field (nothing specific was mentioned), market expectations regarding future rates should have hit the bottom.

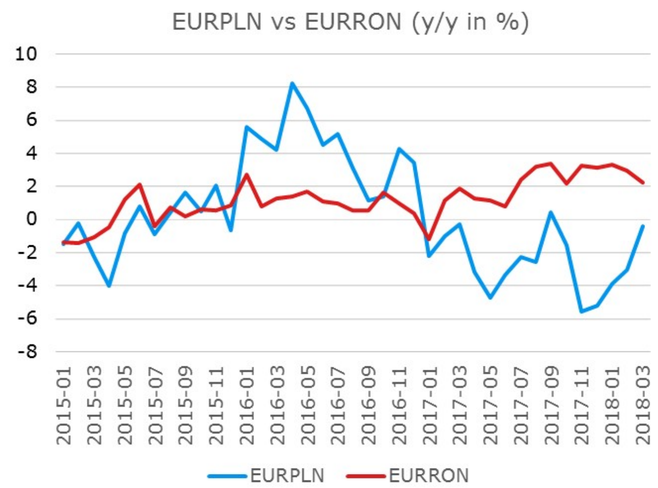
Dovish MPC, very low core inflation, strong PLN. Can we really have a more dovish environment? We do not think so as we still believe in rising core inflation on the basis of tightening labor market. The latter is proceeding more or less in the same speed as in Romania (the CEE country with the highest inflation at the moment), but with quite different outcome as far as core inflation is concerned. We used constant tax core HICP rates to account for any tax changes in both countries and decided to focus on readings after 2017 to get rid of simplest relative price movements (the indirect effects, the comparability of first round outcomes is assured by looking at flat tax HICPs) that accompanied tax increases in Romania in 2016. Such filtered tax readings look almost the same for the majority of 2017 – see the graph below.



But then something happened and core in Romania went sharply up. Some may say that it was because standard economic effects connected with closing the output gap jump-started. That may be part of the story but measured only by labor market, cyclical position of both countries is not much different. We think it was the exchange rate that made the difference – see the next graph (whether one uses EUR crosses or effective exchange rates does not really matter).



Of course, the speed at which the difference occurred may stand in contrast to standard models implying quite long delays between prices and exchange rate changes but our thesis survives also taking account the broader, dynamic view. Look at y/y exchange rates with little more perspective.



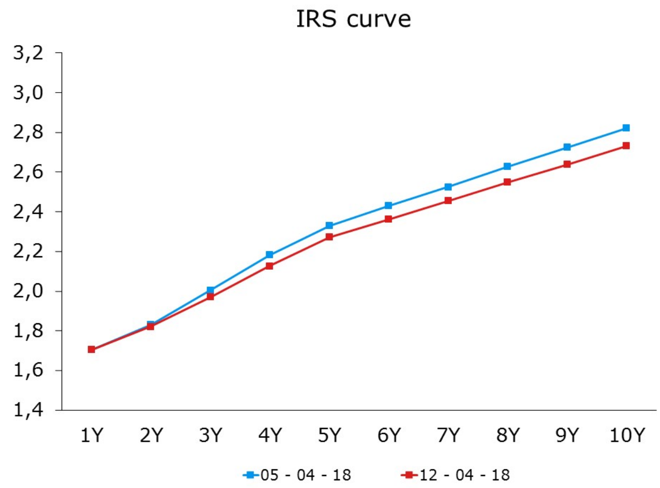
We think it is still the exchange rate that shields Polish core inflation from rising. The base effects generated on exchange rate in 2017 suggest, however, that the honeymoon period is over. Zloty would be increasingly exposed to rate differentials and much of the positive news regarding the economy had been already priced in. Pressure stemming from tight labor market should then translate into core inflation. If Romania was the guide, 1.5 pp. increase in core inflation is possible in 6-8 months. Coincidentally, that is not far of our current estimates. Core inflation is going to triple by the year's end with all consequences for interest rate expectations.

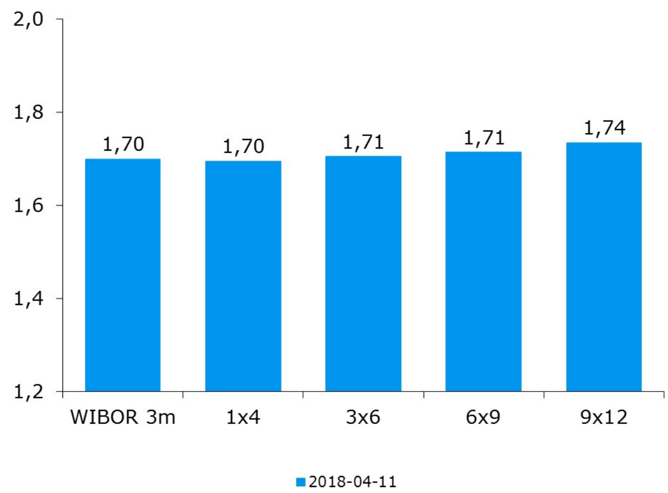
Fixed income

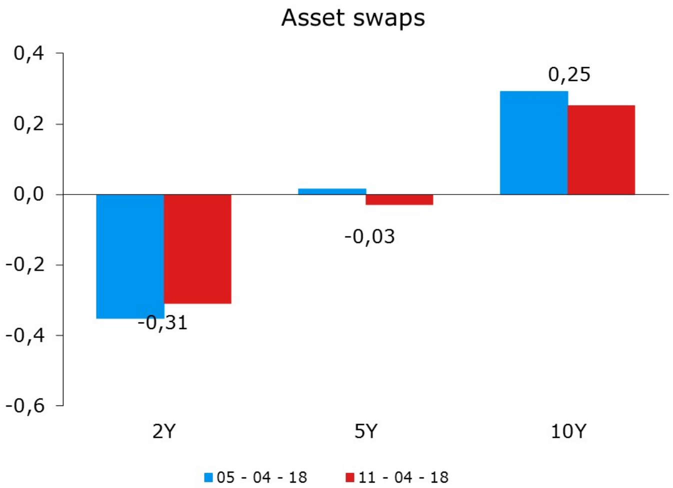
PS0418 expiration will flood the market with cash

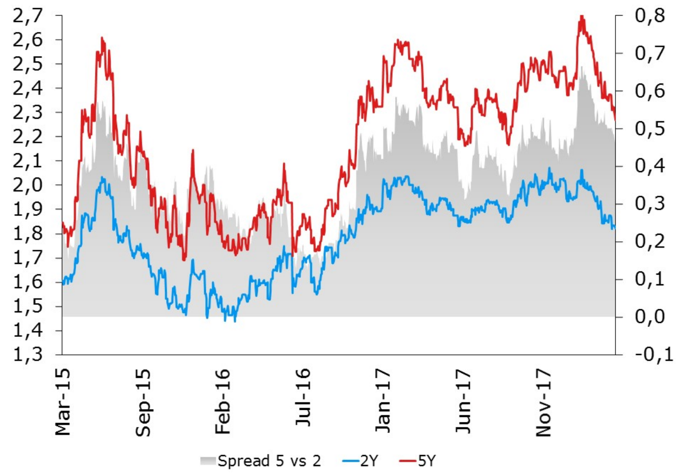
It is a bullish month! PS0418 expires, coupons are paid. Nothing fundamental changed, local banks are short, we see stop losses everyday, yields are lower and lower. If we add low CPI, MPC statement and no supply from the Ministry, there's really no reason to expect higher yields. Usually in such circumstances investors might start taking profits and thinking about a reverse move.

Curve has flattened: PS0123/WS0428 is 74 bps, PS0123/5y is -8 bps, WS0428/10y is 24 bps. WS0428/Bund is 245 bps. PS0420 is trading at 1.48% (3 bps up), PS0123 is trading at 2.22% (10 bps down) and WS0428 is trading at 2.96% (15 bps down).









Money market

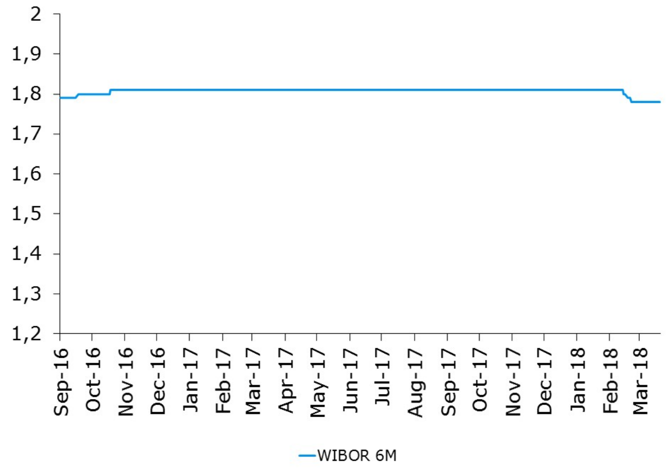
April showers bring May flowers

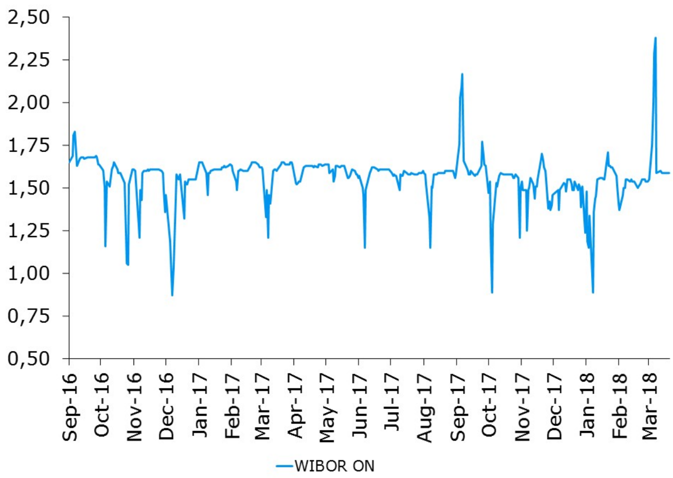
Polish bonds continue to trade on the strong side. We are establishing new highs (in price terms) every day. We belive this time the reason for this move is a local one. We had a really low print on CPI recently plus we have big April redemptions coming. Banking books are replacing PS0418 and the Ministry of Finace cut the supply in April. When April factors disappear and the Ministry returns to the market, the supply situation will reverse sharply.

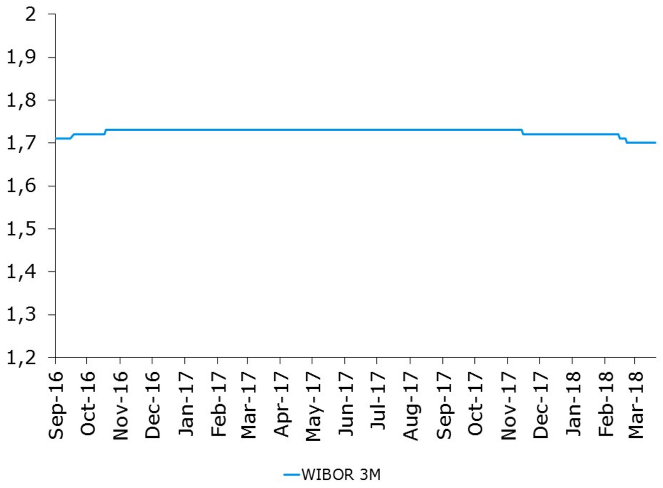
Stable O/N rate around 1.50%. Worth mentioning is that the average for 30 days came out at 1.57. Still looks like market believes that's a one-off as no-one touches 1.40 offers on the 1 month OIS.

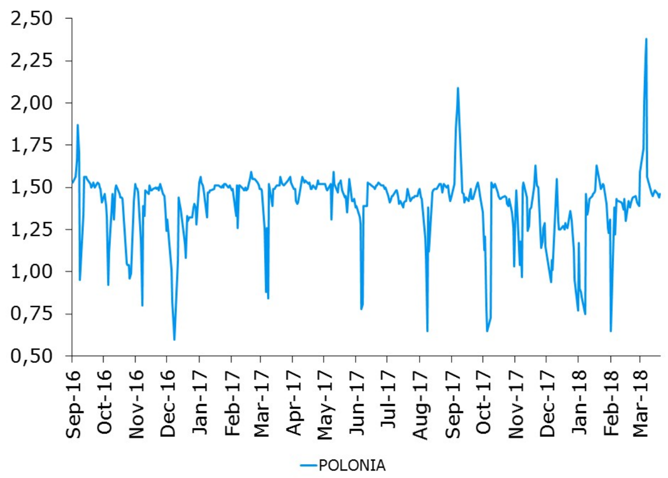
Ref rate vs Polonia averages:

30 day -7 bps
90 day 12 bps









Forex

Spot – EUR/PLN – slightly lower During last 5 working days, EUR/PLN was slowly drifting lower. The 4.16-4.18 support zone still holds, so it is too early to decisively call for more Zloty advances. The range play continues with 4.2080 constituting the high and 4.1808 the low of at last 5 working sessions. Polish MPC meeting ended on a dovish note, but it was not enough to weaken the PLN. On the other hand, there are rumours about ending the Poland-EU conflict over rule of low. Expectations regarding the S&P this Friday (April 13th) are flying rather low, yet an upgrade in the outlook is possible. We still keep to range play approach, with a slight PLN negative skew, unless we see a convincing daily close below 4.17.

Options – EUR/PLN vols – treading water Realized volatility is still pretty low. However, the whole EUR/PLN implied volatility curve is quite stable, as we are at the multi-week lows. 1 month ATM mid is 3.9% today (unchanged), 3 months are at 4.4% (unchanged) and, finally, 1 year fixed at 5.6% (0.05% lower). The currency spread (difference between USD/PLN and EUR/PLN) crashed in the frontend, falling from 4,5% to 3.5%. The skew was also better offered.

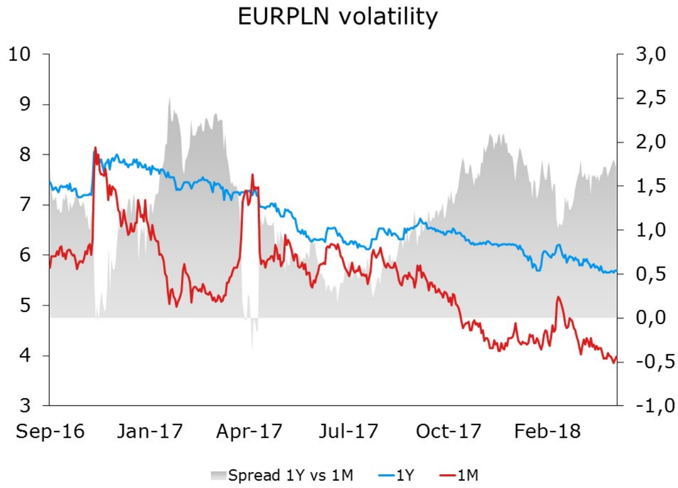
Short-term forecasts

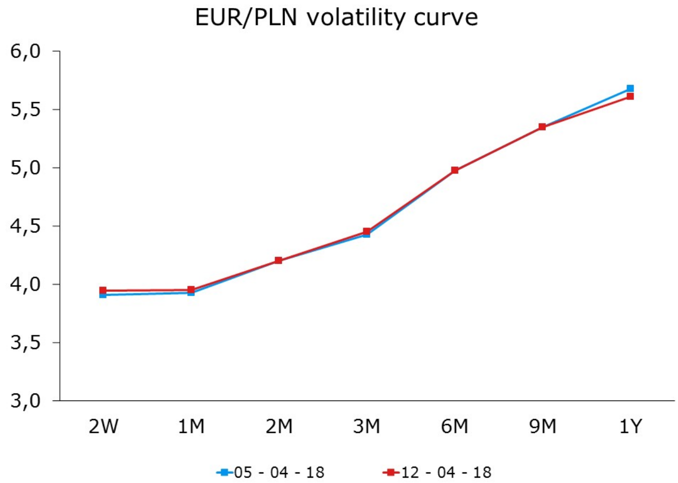
Main supports / resistances:
EUR/PLN: 4.1900 / 4.2700
USD/PLN: 3.3500 / 3.6000

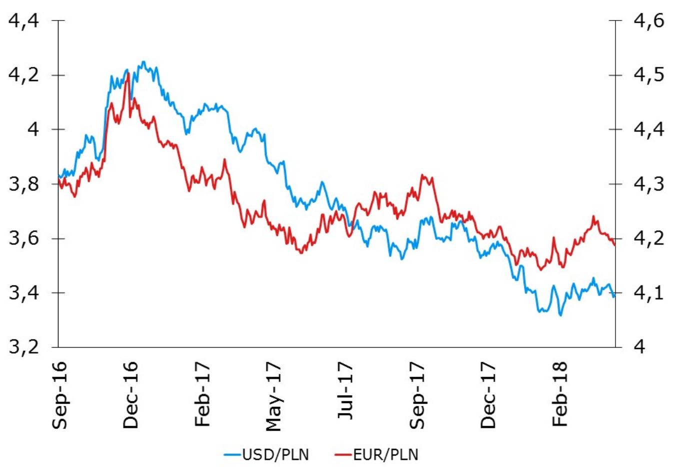
Spot Current position: Long EUR/PLN at 4.2050.

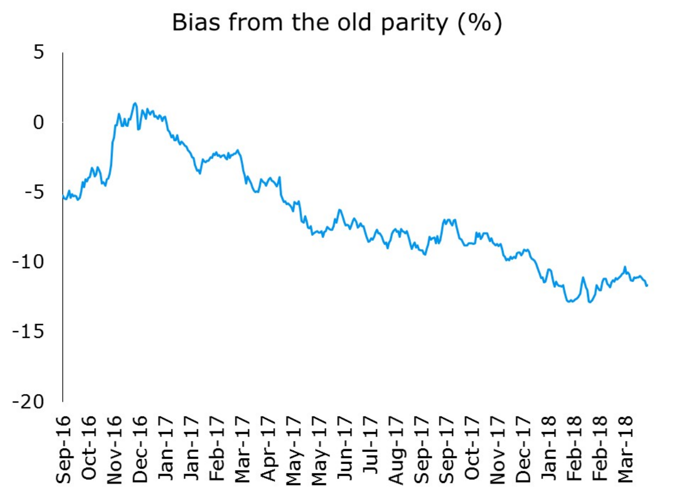
We are long at 4.2050, ready to add at 4.1800 (we have missed the purchase level by 25 ticks) with a stop below 4.1600 and hopes to see 4.25+.

As no significant news or political risk is set to arise in the coming week, we think the Zloty will trade relatively stable with slight inclination towards more weakness against the Dollar and the Euro. Yield differentials are set to deteriorate, which combined with dovish monetary stance of the MPC is likely to result in Zloty depreciating gradually.









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
4/5/2018	1.75	1.70	1.83	1.68	1.97	1.72	1.70	1.70	1.73	1.75	1.77	1.79
4/8/2018	1.63	1.70	1.73	1.68	1.88	1.72	1.71	1.71	1.72	1.75	1.79	1.79
4/9/2018	1.83	1.70	1.88	1.68	1.98	1.72	1.70	1.71	1.72	1.74	1.78	1.78
4/10/2018	1.62	1.70	1.71	1.68	1.81	1.72	1.70	1.71	1.72	1.74	1.79	1.79
4/11/2018	1.76	1.70	1.90	1.68	2.01	1.72	1.70	1.71	1.71	1.74	1.77	1.78

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	3/27/2018	7/25/2020	96.61	1.49	150	348	148
PS0123	3/27/2018	1/25/2023	100.63	2.36	800	2101	801
WS0428	3/27/2018	4/25/2028	0.00	3.20	1400	2474	1400

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0720	5Y IRS	PS0423	10Y IRS	WS0428
4/5/2018	1.720	1.320	1.830	1.479	2.330	2.346	2.822	3.113
4/8/2018	1.720	1.314	1.834	1.489	2.320	2.291	2.807	3.088
4/9/2018	1.720	1.327	1.830	1.454	2.303	2.280	2.785	3.045
4/10/2018	1.720	1.331	1.830	1.523	2.291	2.282	2.767	3.038
4/11/2018	1.720	1.314	1.823	1.513	2.270	2.242	2.730	2.981

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
4/5/2018	3.93	4.43	4.98	5.68	5.68	1.10	0.53
4/8/2018	3.85	4.40	4.98	5.65	5.65	1.10	0.53
4/9/2018	3.93	4.43	5.00	5.70	5.70	1.14	0.52
4/10/2018	3.99	4.25	4.98	5.70	5.70	1.10	0.53
4/11/2018	3.95	4.45	4.98	5.61	5.61	1.10	0.53

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
4/5/2018	4.2070	3.4301	3.5681	3.2022	1.3512	0.1662
4/8/2018	4.1984	3.4315	3.5620	3.1945	1.3465	0.1656
4/9/2018	4.1967	3.4174	3.5618	3.1912	1.3457	0.1655
4/10/2018	4.1990	3.4068	3.5653	3.1844	1.3475	0.1657
4/11/2018	4.1911	3.3859	3.5340	3.1658	1.3450	0.1656

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