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Polish Weekly Review

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Comment on the upcoming data and forecasts

This Friday the CSO will publish labor market data for April. We expect employment growth to hold steady at 3.7% y/y, while wages likely accelerated from 6.7 to 7.5% y/y on the back of base effects and favorable calendar (working day difference rose from -1 to +1 y/y). Similar factors are set to push industrial and construction output growth upwards (to be released on Monday). The former will accelerate from 1.8 to 7.1% y/y (it will no longer be boosted by energy output, though), the latter is set to post a whopping 35% y/y growth rate. The accompanying PPI data will likely show significant acceleration in producer prices, associated mainly with weaker PLN and higher commodity prices. On Tuesday the CSO will publish its report on business sentiment in May. Wednesday is all about the consumer. Retail sales data for April will be primarily influenced by early Easter, hence the deceleration in y/y terms (from 8.8 to 7.0%). Consumer sentiment for May is set to confirm the consumer's strength. Finally, next Friday the CSO will publish its Statistical Bulletin, including unemployment data. We expect the latter to confirm the preliminary reading from the Ministry of Family (6.3%, in line with consensus).

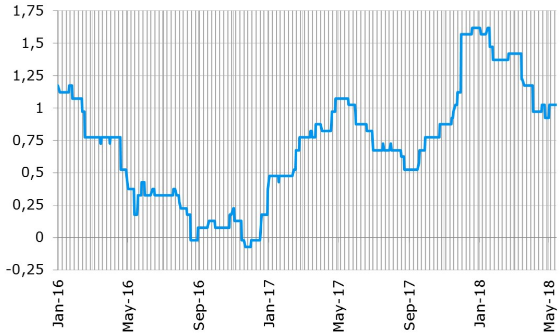
Polish data to watch: May 18th to May 25th

Publication	Date	Period	mBank	Consensus	Prior
Average wage y/y (%)	18.05	Apr	7.5	7.1	6.7
Employment y/y (%)	18.05	Apr	3.7	3.7	3.7
Sold industrial output y/y (%)	21.05	Apr	7.1	8.5	1.8
Construction output y/y (%)	21.05	Apr	35.0	24.5	16.2
PPI y/y (%)	21.05	Apr	0.8	0.9	0.3
Business confidence	22.05	May			
Consumer confidence	23.05	May			
Real retail sales y/y (%)	23.05	Apr	7.0	7.5	8.8
M3 y/y (%)	24.05	Apr	5.8	5.8	5.8
Unemployment rate (%)	25.05	Apr	6.3	6.3	6.6

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	5/24/2018	300	1.504	4/27/2018
5Y T-bond PS1023	5/24/2018	1000	2.322	4/27/2018
10Y T-bond WS0428	5/24/2018	900	3.006	4/27/2018
30Y T-bond WS0447	5/24/2018	150	3.395	4/27/2018

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



Comment

Flash GDP beat expectations and therefore lifted Polish surprise index upwards. Next days are abundant with data: industrial output, PPI, wages, retail sales, unemployment rate.

* 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%. 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 turned around and will accelerate towards 2.3-2.4% in the summer, mainly on the back of higher energy prices. Right now, services prices are the best hope for those looking for a durable rise in inflation. 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, inflation scare, EM asset sell-off and very dovish MPC both contributed to a notable depreciation in the PLN (more 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	3.0	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 (%)	4.4	4.0	5.2	4.9	4.8	4.5	4.5	4.5
Individual consumption y/y (%)	4.5	4.9	4.7	5.0	5.1	4.8	4.6	4.2
Public Consumption y/y (%)	2.1	2.9	3.3	4.8	2.0	2.0	4.0	4.0
Investment y/y (%)	1.4	1.3	3.6	5.4	10.0	10.0	10.0	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

No changes to the MPC's stance

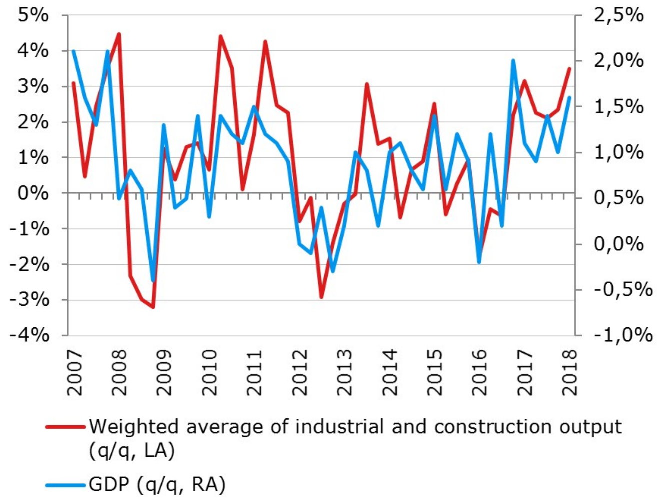
The May meeting of the MPC brought no meaningful changes to Polish monetary policy. Rates were put on hold and the post-meeting statement differs from the previous one only with respect to the discussion of recent data. Key paragraphs on the prospects of GDP growth, inflation and interest rates were identical.

During the press conference President Glapinski reiterated the already known opinions: that there is no wage pressures, that economic growth is „miraculously" without inflationary consequences and that growth prospects for the next quarters are favorable. Forward guidance was also unchanged – current interest rates will remain in place until the end of 2019 and „unless something unexpected happens," in 2020 as well. K. Zubelewicz, the Council's biggest hawk and dissenter confirmed that this is the most likely scenario. The stability of interest rates is seen as a valuable asset and a useful anchor for economic agents in times of uncertainty.

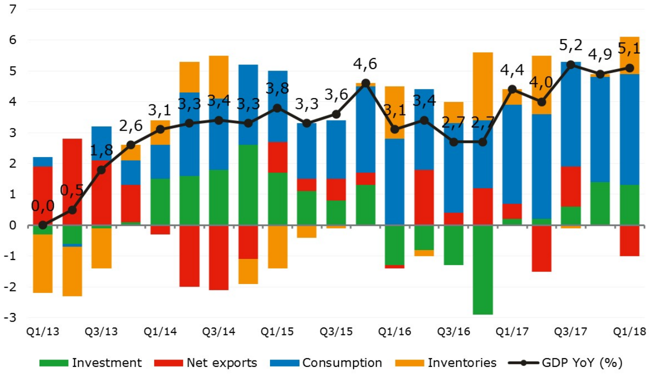
To sum up, the meeting brought no new information relevant for market participants and the expected interest rate path continues to be driven by global developments. We believe that the key local factor to watch in the coming months is core inflation, in particular, its reaction to brisk wage growth and recent PLN depreciation. Its increase might catch market participants off guard. However, the MPC's reaction function ensures that stable interest rates should be seen as a baseline scenario for at least a year.

GDP growth back above 5% y/y. Higher inflation in April confirmed.

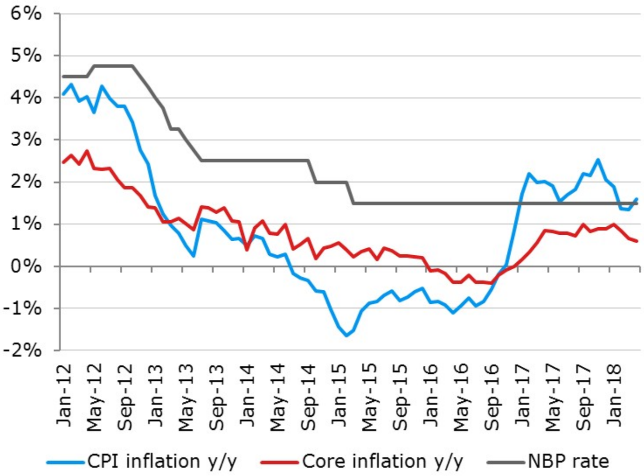
Polish GDP bucked the regional pattern of disappointments and surprised to the upside, having grown by 5.1% y/y in the first quarter (market consensus and our forecast – 4.8% y/y). On a sequential basis GDP rose by an impressive 1.6% q/q (seasonally adjusted) – just as monthly data have indicated for many months.



The **flash GDP** reading contains no detailed breakdown, we are thus forced to speculate on the sources of the surprise. In our view, consumption rose by 5.1% y/y in Q1, but record-high consumer sentiment and strong retail sales growth (boosted by early Easter) are consistent with higher readings as well. The impressive surge in construction output in Q1 pointed to 10% growth in investment, but there are clear downside risks to this forecast. First, machinery and equipment spending is notoriously difficult to forecast with monthly data. Second, smaller construction companies (unaccounted in monthly construction output figures) are likely disproportionally squeezed by higher labor costs and their performance is uncertain. Sharply lower contribution from net exports and positive impact of inventory change mostly canceled each other out. If we were to bet on a single source of the surprise, net exports would be the most likely culprit.



April **CPI inflation** was confirmed at 1.6% y/y, but the details of the release brought some surprises. While food and fuel prices rose just as we forecast (+0.4 and +2.8% m/m, respectively), core categories remained surprisingly low. Even if communications prices (-0.6% m/m) were excluded, core inflation would have failed to rise above 0.6% y/y (insurance fees and airline tickets are two items that stand out). Core inflation came out a hair below 0.6%, just as we forecast.



Inflation would have barely moved, had it not been for higher fuel prices (1.4-1.5% excluding first-order effects). It is of little surprise that this category will drive inflation higher in the coming months as well, for instance, May CPI is set to come at 1.9-2.0% y/y. Unless clear evidence of second-round effects is noted, the MPC is likely to dismiss such increases in inflation as exogenous and even harmful for consumer spending. In our view, the red hot labor market implies that any noticeable rise in prices (and fuel prices are extremely conductive for inflation expectations) will swiftly translate into higher wage demands to keep income and consumption growth steady. Core inflation, even though extremely low today, is set to double by the end of the year. Another important near-term factor for inflation is the exchange rate pass-through (from weaker PLN). May and June inflation readings are a natural laboratory of sorts in this respect.

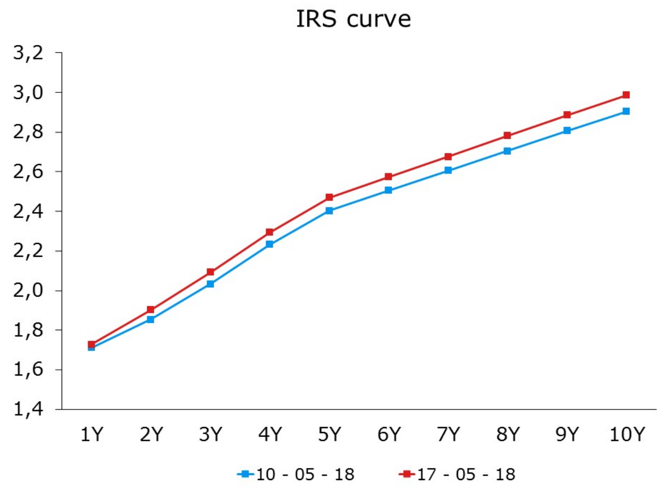
Strong GDP growth (our full-year forecast is unchanged, at 4.6% y/y) is primarily good news for fiscal policy. Without knowing how strongly investment grew in Q1 and what its structure was, it is not advisable to celebrate just yet. The sharp downward revision to Q4 numbers should serve as a good warning here. At the same time, inflation has already rebounded from its local bottom and is set to increase in the coming months. In these circumstances local factors are likely to keep risk premia depressed. Interest rate expectations are not in danger at the moment, but it is not a stable equilibrium.

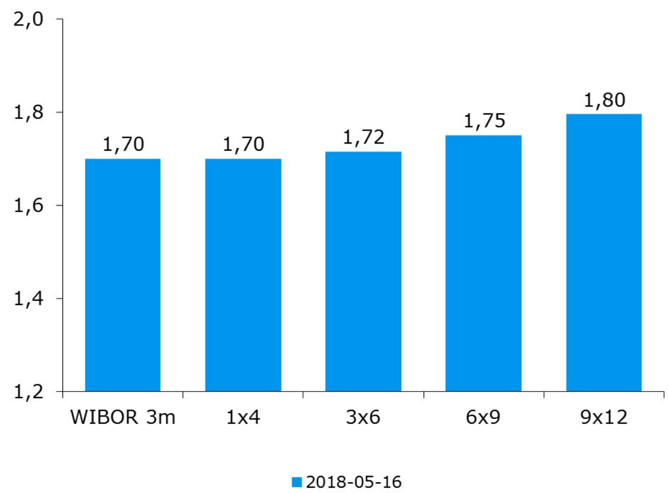
Fixed income

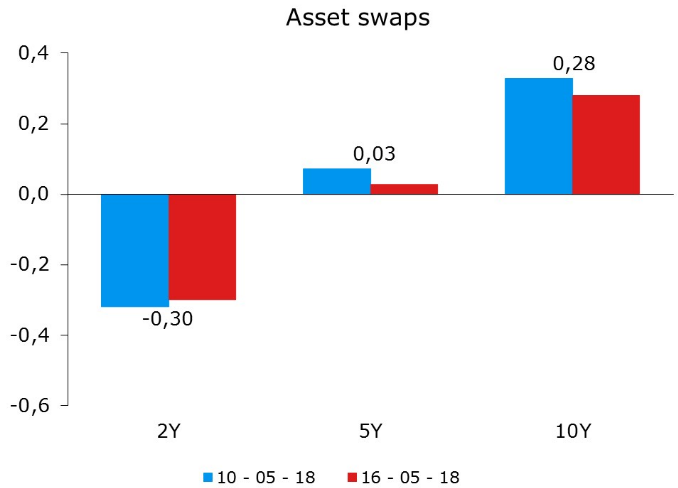
No country for EM bulls

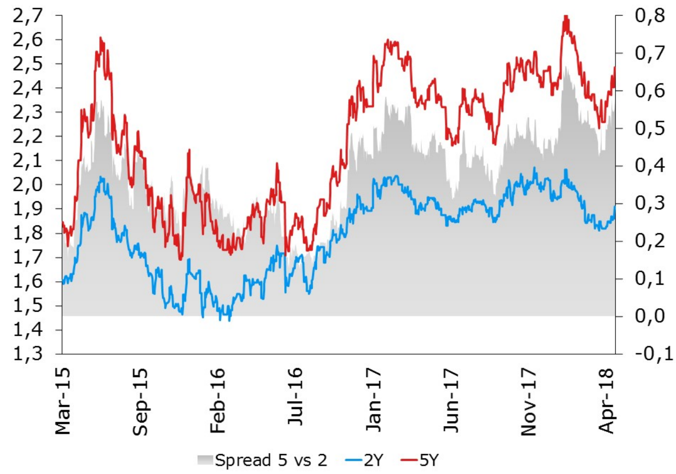
MPC confirmed that they don't want to move rates until 2020 – this will be the key issue for short-end bonds, but longer maturities will be driven by global factors. Oil touched new tops, USD is stronger and stronger, Italian bonds look toxic, Argentina is close to default and Erdogan crisis in Turkey... Its not easy to buy EM assets, but thankfully these crisis stories haven't affected us so far. POLGBs curve is steep, but it dosen't mean it can't get steeper.

PS0123/5y is -1 bps, WS0428/10y is 23 bps. PS0123/WS0428 is 75 bps. WS0428/Bund is 268 bps. PS0420 is trading at 1.6% (9 bps up), PS0123 is trading at 2.53% (3 bps up) and WS0428 is trading at 3.28% (4 bps up).







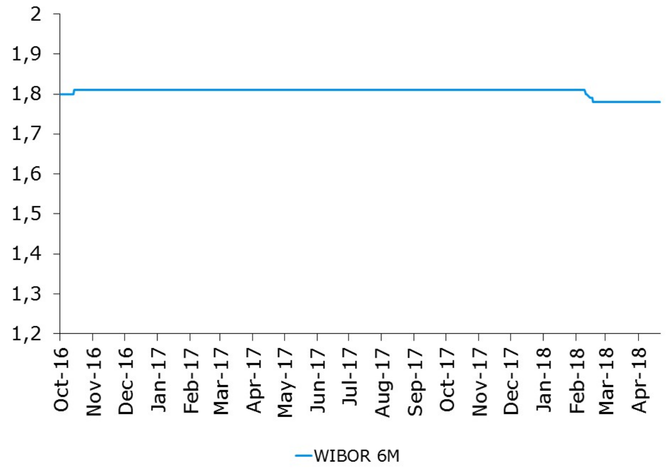


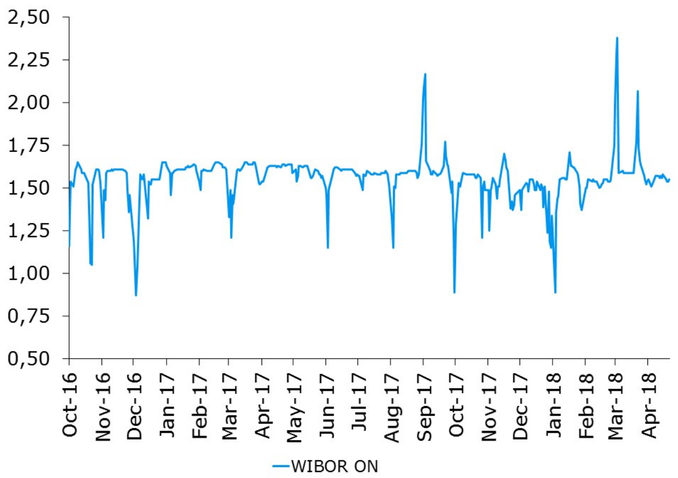
Money market

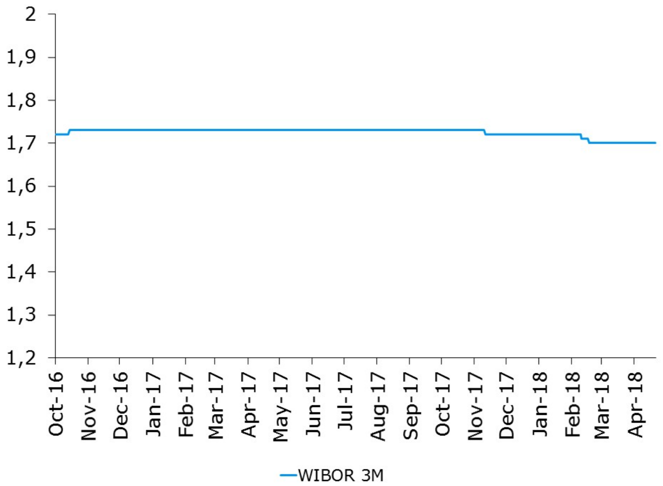
No local story

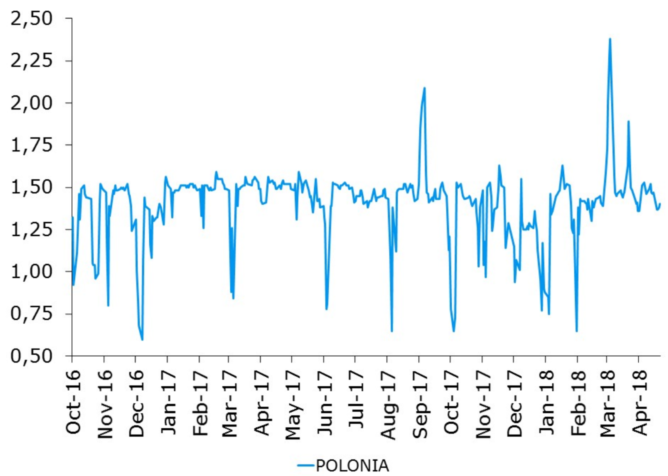
Polish yields conitinue to grind higher with 2y swap rate hitting 1.95%. That's 10 bps off recent lows. That again had nothing to do with the local story. We are following global sentiment with much less volatility. Yesterday, governor Glapinski again reassured that Polish rates should stay at current levels for an extended period unless something extraordinary happens. Our perceptions is that MPC is unwilling to move rates in any direction, including cutting even if the economy slows. With such a strong consensus in the MPC we will follow global trends with those in Europe impacting us the most.

Even though we had PLN 7 bn cash surplus, it wasn't an extraordinary cheap. Tomorrow we have a new OMO which will set the tone for the next week. We don't expect anything extraordinary.



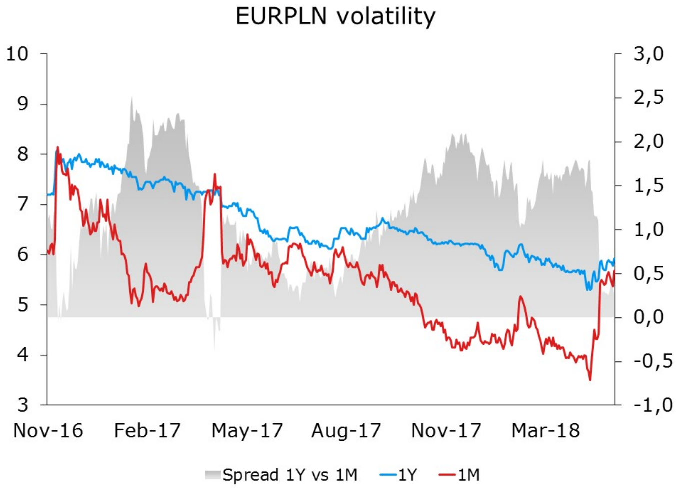




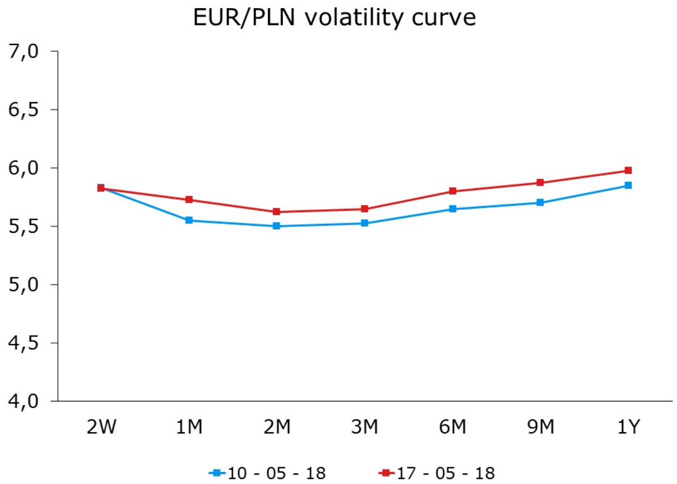


Forex

Spot – Uptrend seems intact The rising UST yields are still casting a shadow on EMs. Zloty is no exception, and the dovish MPC did not provide any support to it. The support zone in EUR/PLN at 4.22-4.24 held well (4.2350 was the low) and the subsequent march higher reached as high as 4.3020. The move quickly lost momentum and the correction brought the rate back to the middle of the range at 4.2750-ish. Technically, we wave the set of higher highs and higher lows that suggests we may have another look at 4.30+ relatively soon. We are still inclined to play the 4.24-4.32 range, preferably from the PLN short side.



Options – Volatility higher again The buyers came back to the market for good. Realized volatility is quite impressive, so no surprise that implied volatilities are higher. 1 month EUR/PLN ATM mid is this Thursday at 5.7% (0.1% higher), 3 months are 5.75% (0.15% higher) and 1 year is fixing at 5.9% (0.1% higher). The skew is also higher – all EUR/PLN curve 25RR above 1.0%. The currency spread (difference between USD/PLN and EUR/PLN) is higher too – around 4.25%.

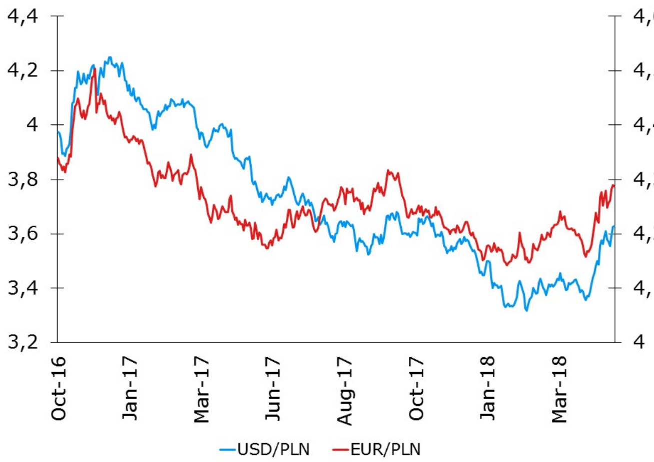


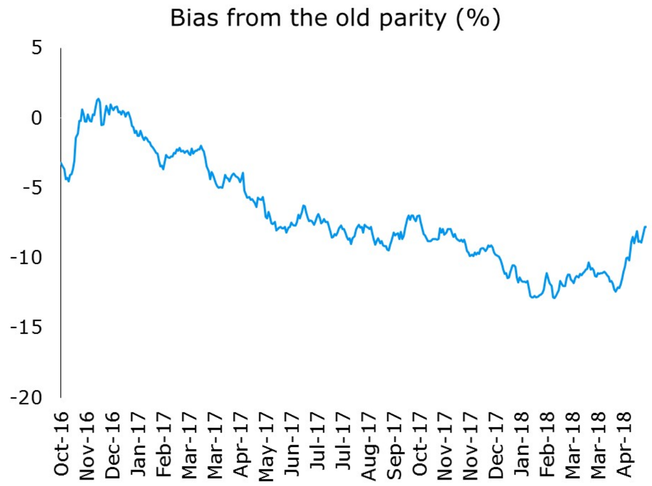
Short-term forecasts

Main supports / resistances:
EUR/PLN: 4.2400 / 4.3300
USD/PLN: 3.4600 / 3.6600

Spot Current position: Long EUR/PLN.

We cashed half of the long EUR/PLN position from 4.2400 at 4.2950. Still being long, we are now ready to add at 4.2500 with 4.2250 stop for the whole position. The ideal profit taking level is in the 4.33-4.35 space. We are aware of the rangy nature of EUR/PLN and we are not looking for a straight line higher. The 7-8 figure EUR/PLN range (currently 4.24 – 4.32), with a slight drift higher is our base scenario.





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
5/10/2018	1.63	1.70	1.71	1.68	1.74	1.72	1.71	1.71	1.75	1.77	1.83	1.83
5/13/2018	1.70	1.70	1.78	1.68	1.91	1.72	1.70	1.71	1.73	1.77	1.83	1.81
5/14/2018	1.67	1.70	1.75	1.68	1.96	1.72	1.70	1.71	1.74	1.77	1.83	1.82
5/15/2018	1.59	1.70	1.69	1.68	1.84	1.72	1.70	1.72	1.75	1.79	1.88	1.84
5/16/2018	1.79	1.70	1.88	1.68	2.03	1.72	1.70	1.72	1.75	1.80	1.86	1.83

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	4/27/2018	7/25/2020	96.72	1.50	300	470	370
PS0123	4/27/2018	1/25/2023	100.78	2.32	1000	1470	1165
WS0428	4/27/2018	4/25/2028	97.80	3.01	900	1070	895

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0720	5Y IRS	PS0423	10Y IRS	WS0428
5/10/2018	1.720	1.335	1.855	1.536	2.405	2.477	2.905	3.234
5/13/2018	1.720	1.339	1.860	1.489	2.405	2.482	2.906	3.223
5/14/2018	1.720	1.332	1.874	1.541	2.425	2.494	2.930	3.234
5/15/2018	1.720	1.368	1.910	1.605	2.487	2.553	3.002	3.285
5/16/2018	1.720	1.361	1.902	1.603	2.470	2.497	2.987	3.267

EUR/PLN 0-delta stradle						25-delta RR			25-delta FLY
Date	1M	3M	6M	1Y		1M	1Y		1Y
5/10/2018	5.55	5.53	5.65	5.85		5.85	1.23		0.53
5/13/2018	5.45	5.43	5.60	5.85		5.85	1.23		0.53
5/14/2018	5.38	5.35	5.53	5.78		5.78	1.20		0.57
5/15/2018	5.68	5.60	5.70	5.93		5.93	1.23		0.54
5/16/2018	5.73	5.65	5.80	5.98		5.98	1.34		0.55

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
5/10/2018	4.2473	3.5773	3.5630	3.2586	1.3509	0.1666
5/13/2018	4.2569	3.5708	3.5643	3.2676	1.3535	0.1671
5/14/2018	4.2615	3.5558	3.5594	3.2457	1.3521	0.1672
5/15/2018	4.2823	3.5931	3.5912	3.2674	1.3497	0.1677
5/16/2018	4.2893	3.6241	3.6278	3.2892	1.3523	0.1680

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