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Polish Weekly Review

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Comment on the upcoming data and forecasts

On Wednesday NBP will publish trade balance data for April. We expect current account balance to return above zero (+150 mio EUR) after several months of negative readings. Both exports and imports most probably dropped after stellar March. On Thursday final CPI estimate for May will be published. We forecast a repetition of the flash release at 1.7% (which was a negative surprise given market consensus). The week ends with NBP data about core inflation. Details of flash CPI reading suggest that core inflation stabilized at 0.6% in April.

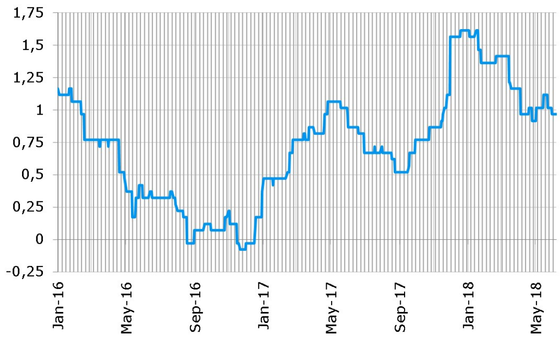
Polish data to watch: June 8th to June 15th

Publication	Date	Period	mBank	Consensus	Prior
Current account (mio PLN)	13.06	Apr	150	-253	-317
Exports (mio EUR)	13.06	Apr	17500	17255	18117
Imports (mio EUR)	13.06	Apr	17700	17343	18434
CPI y/y (%) *final*	14.06	May	1.7	1.7	1.6
Core inflation y/y (%)	15.06	May	0.6	0.7	0.6

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	6/15/2018	20	1.637	5/24/2018
5Y T-bond PS1023	6/15/2018	1400	2.481	5/24/2018
10Y T-bond WS0428	6/15/2018	900	3.210	5/24/2018
30Y T-bond WS0447	6/15/2018	150	3.395	4/27/2018

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



Comment

Flash CPI surprised to the downside, GDP came slightly higher than flash release suggested. All in all Polish surprise index dropped a bit. Next week brings in fact only one tru opportunity to surprise: final CPI reading.

* 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 turned around and will accelerate towards 2% 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 until Q4 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	4.0
CPI Inflation y/y (average %)	-0.1	-0.9	-0.6	2.0	1.7	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	1.75

	2017 Q1	2017 Q2	2017 Q3	2017 Q4	2018 Q1	2018 Q2 F	2018 Q3 F	2018 Q4 F
GDP y/y (%)	4.4	4.0	5.2	4.9	5.2	4.7	4.5	4.5
Individual consumption y/y (%)	4.5	4.9	4.7	5.0	4.8	4.8	4.6	4.2
Public Consumption y/y (%)	2.1	2.9	3.3	4.8	3.6	3.0	4.0	4.0
Investment y/y (%)	1.4	1.3	3.6	5.4	8.1	10.0	10.0	8.0
Inflation rate (% average)	2.0	1.8	1.9	2.3	1.5	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	1.55	1.60
10Y Polish bond yields (% eop)	3.49	3.32	3.37	3.30	3.18	3.30	3.35	3.40
EUR/PLN (eop)	4.23	4.23	4.31	4.18	4.21	4.30	4.25	4.20
USD/PLN (eop)	3.97	3.70	3.65	3.48	3.42	3.68	3.60	3.51

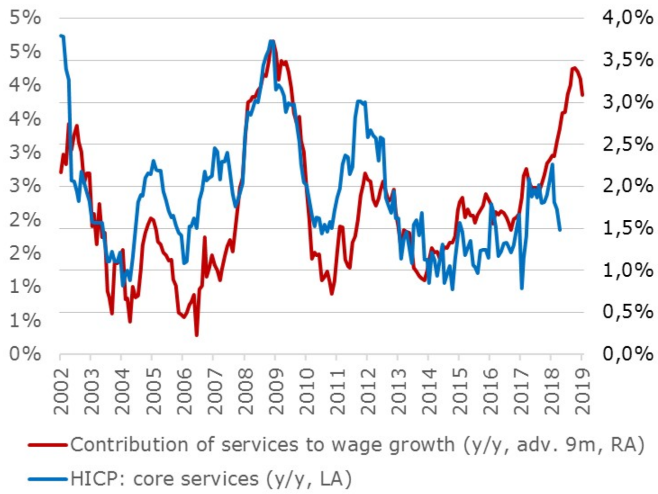
F - forecast

Economics

MPC. Rates unchanged. Guidance unchanged.

As expected, MPC left policy rates unchanged. There were only minor tweaks in the statement and the tone of the press conference stayed as dovish as previously: 2018 rates flat, 2019 rates flat with great probability, 2020 rather flat (in our opinion – when economy evolves as expected).

Just to give some details, MPC welcomed more muted response of inflation towards oil prices rises. With respect to wages, the Committee claims (a fact) that the pass through from wages to inflation does not really work. We agree: an allegedly fruitful relation we had found is slowly breaking – see the graph. Moreover, the MPC suggests (opinion) that wages growth is going to be mitigated by the increase of supply of foreign labor, driven by the government actions aimed at simplifying the procedures and broadening the migrant base.

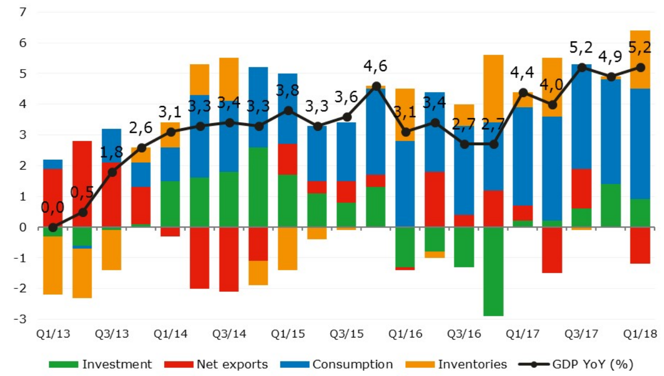


The most interesting part of the conference was related to European QE. MPC is going to closely monitor the influence of tapering the asset purchases (if it finally happens) on monetary policy conditions in Poland. That is something new as previously MPC had been rather concerned by ECB rate hikes. However, we think that all this boils down to the simple monitoring of the zloty strength and does not constitute a viable policy signal at the moment.

Why? Inflation projection in July is going to be decreased. Both the starting point and the sluggishness of transmission can be credited here. It seems the NBP research is observing the same processes as we are. We promised to adjust the expected rate path to expected inflation developments. Core inflation barely moved recently, our favorite relation between wages and inflation in services lost its grip. This is the good moment to soften the expected rate path in Poland. We now think that in 2019 MPC is going to only signal its intentions to tighten monetary policy by a single rate hike (25bps).

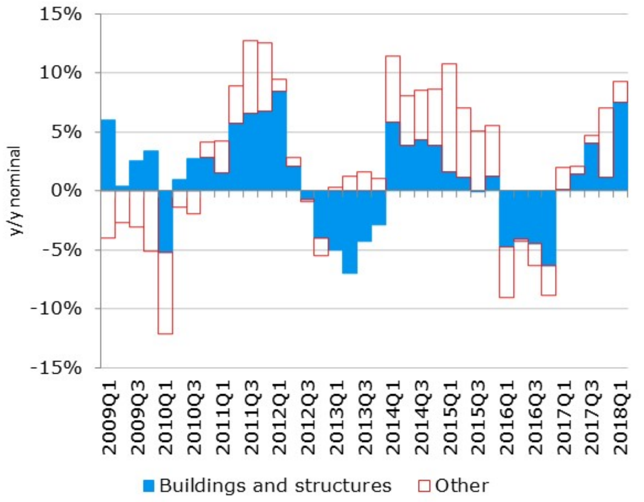
GDP rose by 5.2% y/y, inflation did not live up to expectations in May.

According to the second estimate, **GDP** rose by 5.2% y/y in the first quarter, a notch above the flash reading of 5.1% y/y. On a quarterly basis the strong, seasonally adjusted 1.6% q/q growth rate was maintained.

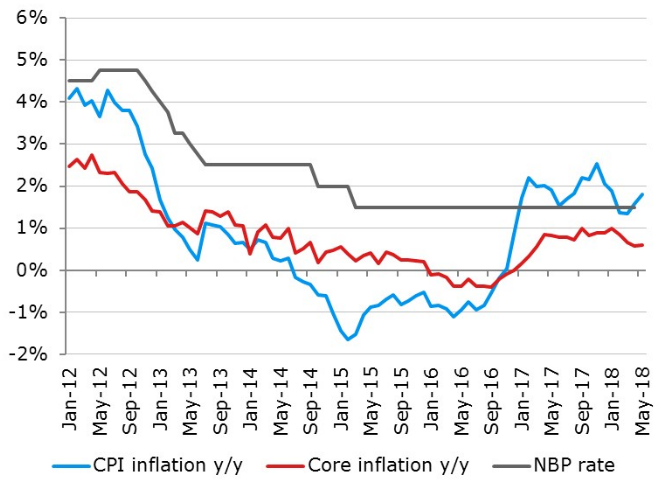


As usual, we like to focus on the details of the release, the more so since our expectations have not completely materialized this time. First, consumption growth which we initially tapped as the main source of the surprise (our original GDP forecast was 4.8% y/y) was lower than anticipated and amounted to just 4.8% y/y. Secondly, while investment accelerated again, to 8.1% y/y, it turned out below our forecast of 10% y/y. The obvious driver of investment demand was construction output which surged in Q1. From the expenditure side, we know that corporate investment was quite muted, while local governments ramped up their expenditures (which rose by a whopping 83% y/y). Thirdly, net exports subtracted 1.1 percentage points from real GDP growth and there are no surprises here – such an outcome was in the cards after the sharp deterioration in external balance as seen in CSO and NBP data. Last but not least, inventory change turned out to be the biggest surprise of the release – this category added a respectable 1.9 percentage points to GDP.

Detailed national accounts data for the first quarter does not change our view on economic growth this year. The economy likely passed its business cycle peak (in y/y terms) and subsequent prints should gradually turn lower. Such a case can be made on the basis of Q1 data as well. First, household consumption failed to accelerate (although it will likely be revised higher in the future). Secondly, there is no evidence of a rebound in machinery and equipment investment and local governments will finish their investment projects by the end of next quarter. This was confirmed by Eurostat data, which indicates that construction sector amounted to 80% of investment growth in Q1 (see next chart). Finally, the increase in inventories might be seen as a bad omen in current economic circumstances (heightened uncertainty, sharp and unexpected slowdown in the euro area). Regardless of the reasons, the contribution of inventory formation will likely be wound down over the coming quarters. All in all, a downward GDP growth trajectory should be expected.



According to the flash estimate, **inflation** rose by 1.7% y/y in May (market consensus 1.9%, our forecast 1.8%). Curiously, this stands in contrast with the surge in Spanish and German inflation – these prints surprised to the upside in a big way. The basic breakdown of Polish inflation is in line with our expectations: food prices dropped by 0.3% m/m, residential energy prices declined by 0.1% m/m and fuel prices went up by 5.4% m/m. We estimate that core inflation was in the 0.6-0.7% range, with the lower band being much more likely – as a result, no acceleration from April's 0.6% can be expected.



Low CPI print means that the likelihood of reaching the inflation target on fuel prices surge alone. We currently forecast inflation to accelerate only modestly above 2% y/y in the summer. In addition, stable core inflation will allow the MPC to remain very dovish even if wages continue to accelerate.

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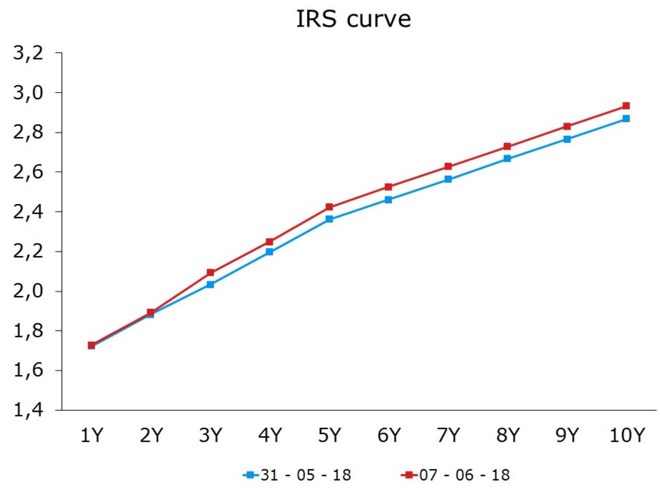
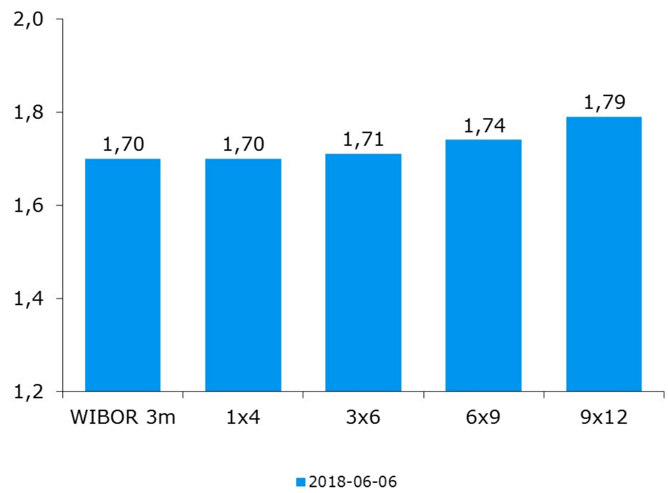
Fixed income

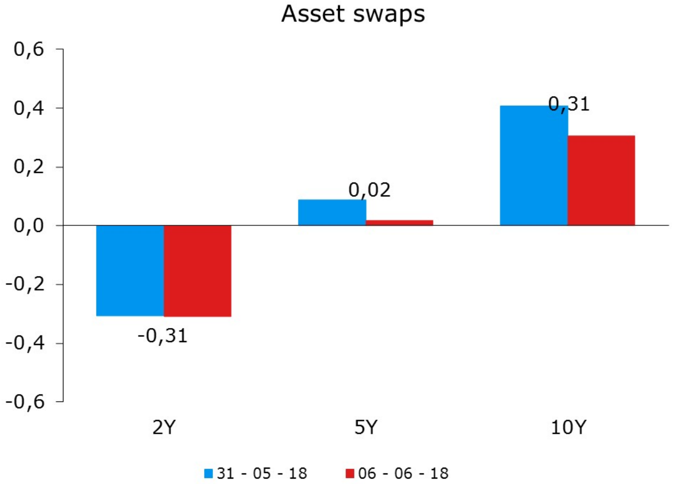
Under Pressure (tam tam tatatam dam...)

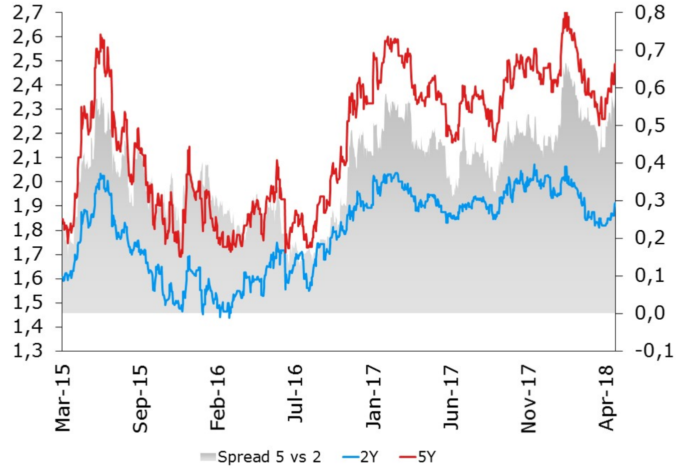
Market recovered but we are under pressure again. Italy looks heavy and ECB is talking about unwinding QE. There is also a local story. Polish MPC said they don't want to change rates till the end of 2020 (possibly). Next week we have a small auction and the curve is very steep. Do your own math.

PS0123/5y is -4bps, WS0428/10y is 29bps. PS0123/WS0428 is 82bps. WS0428/Bund is 280bps. PS0420 is trading at 1.55% (1bps down), PS0123 is trading at 2.46% (2bps down) and WS0428 is trading at 3.28% (9bps up).









Money market

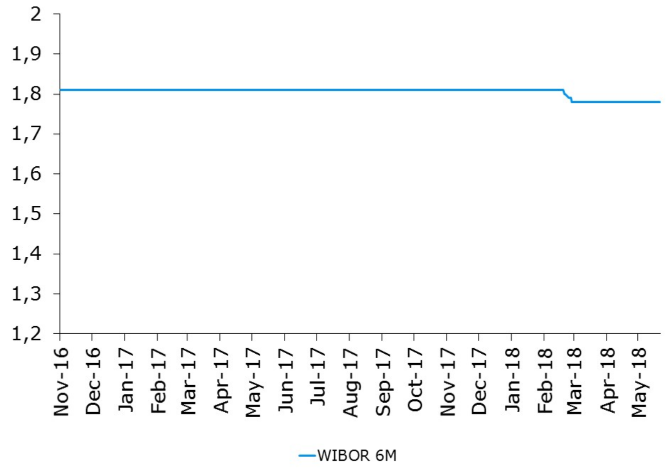
Macro data brought stability

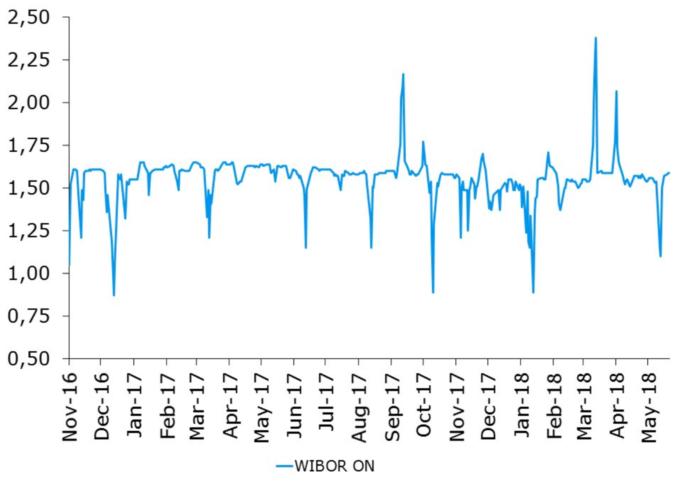
Recent macroeconomic figures confirm stable outlook for Polish rates in the upcoming months. We had a very good GDP print and on the contrary CPI and retail sales disappointed a bit. This should support current rates.

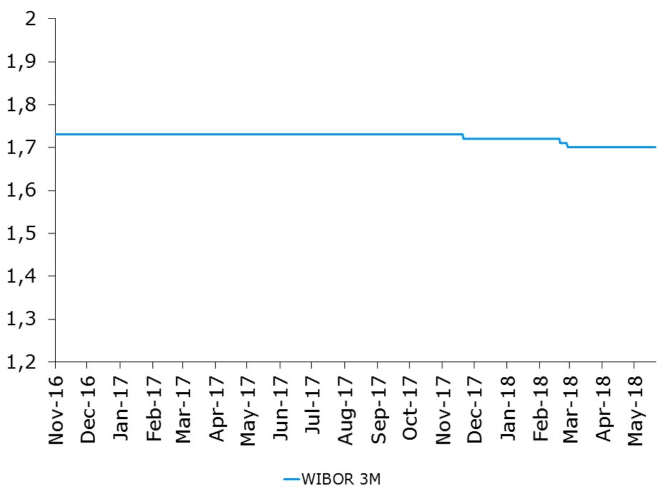
At the start of the month overnight rate stabilizes around 1.50% as always. That should continue through the next week as well. This reserve period ends on Friday, therefore month's end might be expensive.

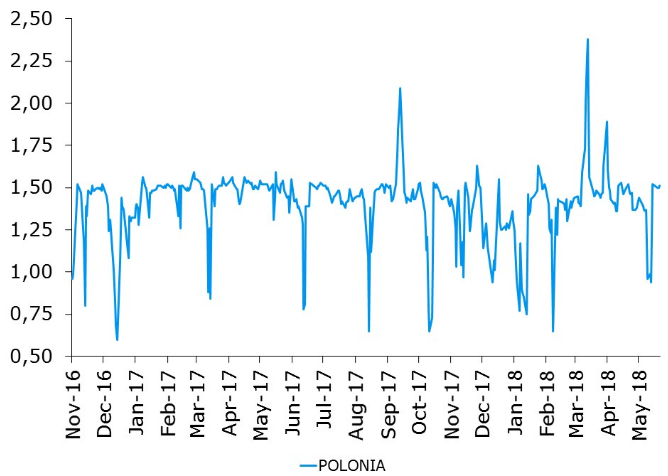
Ref rate vs Polonia averages:

30 day 14 bps
90 day 3 bps



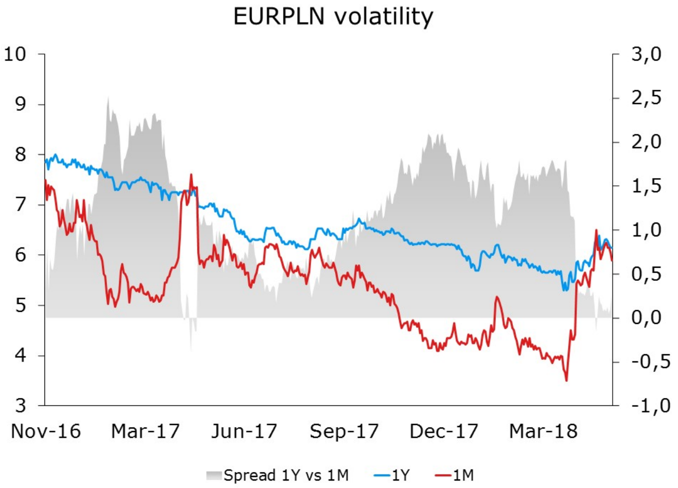




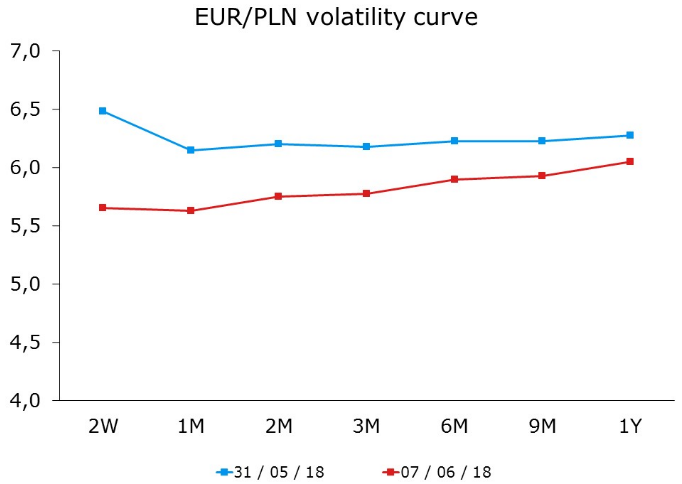


Forex

Spot – PLN is on the rise EUR/PLN high was 4.34 occurred during the the Italy initiated EM panic. After that knee-jerk reaction PLN is back on the rise and that move is eventually getting traction. The 4.30 was supporting the EUR/PLN for a while, but once it gave way, we reached 4.2570 low really fast. We may now expect some consolidation, realized volatility is still elevated. Nevertheless, we believe that the new range will be 4.23-4.30. We are aiming to play that range, preferable from the long PLN side.



Options – Volatility stable During last two weeks the top of the whole EUR/PLN curve was around 6.25% and there were many buying interest of gamma/vega. But now the situation has changed. The Zloty is stronger as easing concerns over Italian politics and trade tension improve risk sentiment. Realized volatility of spot is decreasing so buying volatility pressure has disappeared. Finally we are almost at the same level as two weeks ago. 1 month EUR/PLN ATM mid is at 5.6%, 3 months are 5.75% and 1 year is fixing 5.95%. The skew and the currency spread (difference between USD/PLN and EUR/PLN) are also at the same levels as two weeks ago.

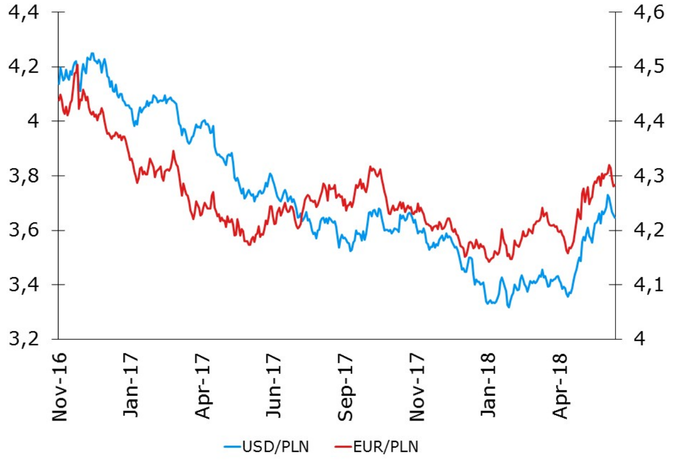


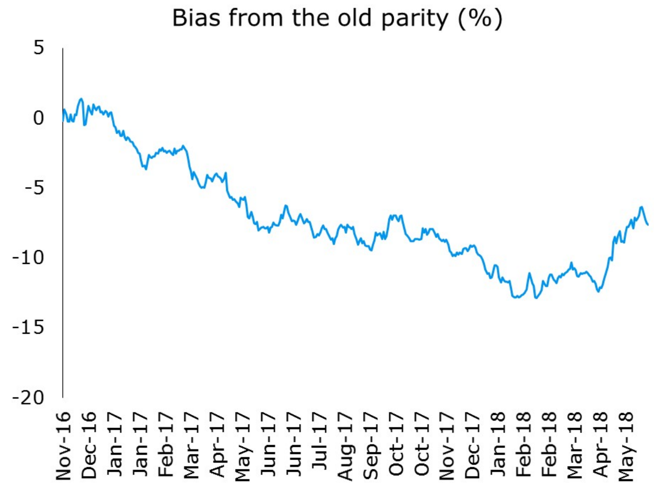
Short-term forecasts

Main supports / resistances:
EUR/PLN: 4.2300 / 4.3000
USD/PLN: 3.5000 / 3.7000

Spot Current position: None.

We closed our short EUR/PLN from 4.3100 and 4.3350 at 4.2600. It paid back to fade the Turkey/Italy sell off in PLN. We stick to our view of the rangy nature of EUR/PLN, we look for new range to be defined (4.23-4.30 our guess). Unless some risk off scenario reappears, we would like to play that range, with an agile set of mind. We may sell 4.2950, add 4.3300 with 4.3450 stop and hopes for 4.2450. Or we may buy EUR/PLN at 4.2400 and 4.2100 with 4.1950 stop, and 4.2950 profit taking. Till then, for choice we still keep small PLN skew preference.





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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
5/31/2018	1.80	1.70	1.88	1.68	1.89	1.72	1.70	1.74	1.74	1.78	1.83	1.82
6/3/2018	1.80	1.70	1.87	1.68	2.02	1.72	1.70	1.73	1.73	1.78	1.83	1.81
6/4/2018	1.78	1.70	1.85	1.68	1.99	1.72	1.70	1.74	1.74	1.78	1.83	1.82
6/5/2018	1.60	1.70	1.68	1.68	1.81	1.72	1.70	1.71	1.73	1.78	1.83	1.82
6/6/2018	1.73	1.70	1.78	1.68	1.88	1.72	1.70	1.71	1.74	1.79	1.84	1.81

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	5/24/2018	7/25/2020	96.55	1.64	20	122	22
PS0123	5/24/2018	1/25/2023	100.07	2.48	1400	2440	1389
WS0428	5/24/2018	4/25/2028	96.11	3.21	900	1495	865

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0720	5Y IRS	PS0423	10Y IRS	WS0428
5/31/2018	1.720	1.364	1.885	1.578	2.360	2.447	2.868	3.275
6/3/2018	1.720	1.333	1.883	1.571	2.370	2.431	2.878	3.233
6/4/2018	1.720	1.349	1.890	1.583	2.368	2.408	2.876	3.205
6/5/2018	1.720	1.353	1.852	1.583	2.380	2.413	2.885	3.219
6/6/2018	1.720	1.357	1.890	1.581	2.423	2.440	2.933	3.239

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
5/31/2018	6.15	6.18	6.23	6.28	6.28	1.49	0.55
6/3/2018	6.15	6.05	6.13	6.20	6.20	1.49	0.55
6/4/2018	6.05	5.95	6.03	6.15	6.15	1.49	0.55
6/5/2018	5.90	5.95	5.95	6.15	6.15	1.45	0.55
6/6/2018	5.63	5.78	5.90	6.05	6.05	1.43	0.54

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
5/31/2018	4.3195	3.7200	3.7577	3.4245	1.3526	0.1672
6/3/2018	4.3146	3.6934	3.7442	3.3821	1.3490	0.1670
6/4/2018	4.2931	3.6665	3.7218	3.3472	1.3453	0.1667
6/5/2018	4.2804	3.6569	3.7087	3.3320	1.3434	0.1667
6/6/2018	4.2829	3.6470	3.7001	3.3140	1.3429	0.1671

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