

June 14, 2018

Polish Weekly Review

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Comment on the upcoming data and forecasts

This Friday the NBP will confirm that core inflation fell to 0.5% y/y in May. On Monday the CSO will release monthly labor market data. Due to low statistical base from last year we expect quicker employment growth (3.8 vs. 3.7% y/y), while the slight deceleration in wages (from 7.8 to 7.5% y/y) is a result of unfavorable calendar effect – working day difference dropped from +1 to -1 y/y in May. The same factor contributed to a material slowdown in industrial output in May (data due on Tuesday). However, the arrangement of public holidays (very favorable for 9-day weekends) and high statistical base from last year will dampen it further, hence our below-consensus forecast of 2.3% y/y growth. Construction output, on the other hand, likely rebounded after a meagre April, accelerating modestly on annual basis. The accompanying PPI data, driven by weaker PLN and higher commodity prices, will show significant acceleration in producer prices. On Wednesday the CSO will release consumer confidence data and Thursday will bring May retail sales print. We expect the latter to disappoint as well, mainly due to poor car sales (also an effect of calendar). Finally, on Friday the CSO will release business sentiment data and the NBP will publish money supply and credit data.

Polish data to watch: June 15th to June 22nd

Publication	Date	Period	mBank	Consensus	Prior
Core inflation y/y (%)	15.06	May	0.6	0.7	0.6
Average gross wage y/y (%)	18.06	May	7.5	7.1	7.8
Employment y/y (%)	18.06	May	3.8	3.8	3.7
Sold industrial output y/y (%)	19.06	May	2.3	3.6	9.3
PPI y/y (%)	19.06	May	2.9	2.6	1.1
Construction output y/y (%)	19.06	May	24.1	17.8	19.7
Consumer confidence	20.06	Jun			
Real retail sales y/y (%)	21.06	May	5.3	6.0	4.0
MPC minutes	21.06	Jun			
Business confidence	22.06	Jun			
M3 y/y (%)	22.06	May	6.2	5.9	5.7

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	6/28/2018	20	1.637	5/24/2018
5Y T-bond PS1023	6/28/2018	1400	2.481	5/24/2018
10Y T-bond WS0428	6/28/2018	900	3.210	5/24/2018
30Y T-bond WS0447	6/28/2018	150	3.395	4/27/2018

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



Comment

Unchanged as the CPI was not revised. Next week is quite abundant with data, starting from wage and employment growth on Monday, industrial output and PPI on Tuesday, through retail sales on Thursday.

* 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% 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

	2018	2018	2018	2018	2019	2019	2019	2019
	Q1	Q2 F	Q3 F	Q4 F	Q1 F	Q2 F	Q3 F	Q4 F
GDP y/y (%)	5.2	4.7	4.5	4.5	4.2	4.2	4.0	3.7
Individual consumption y/y (%)	4.8	4.8	4.6	4.2	4.0	3.8	3.8	3.8
Public Consumption y/y (%)	3.6	3.0	4.0	4.0	2.0	2.0	2.0	2.0
Investment y/y (%)	8.1	10.0	10.0	8.0	7.0	6.0	5.0	4.0
Inflation rate (% average)	1.5	1.8	2.0	1.6	2.1	2.7	2.8	2.7
Unemployment rate (% eop)	6.6	5.7	5.5	5.5	5.7	4.9	4.8	5.0
NBP repo rate (% eop)	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.75
Wibor 3M (% eop)	1.70	1.70	1.71	1.72	1.73	1.73	1.73	1.98
2Y Polish bond yields (% eop)	1.49	1.55	1.55	1.60	1.65	1.85	2.00	2.20
10Y Polish bond yields (% eop)	3.18	3.30	3.35	3.40	3.50	3.59	3.71	3.88
EUR/PLN (eop)	4.21	4.30	4.25	4.20	4.15	4.10	4.05	4.03
USD/PLN (eop)	3.42	3.68	3.60	3.51	3.43	3.35	3.27	3.22

F - forecast

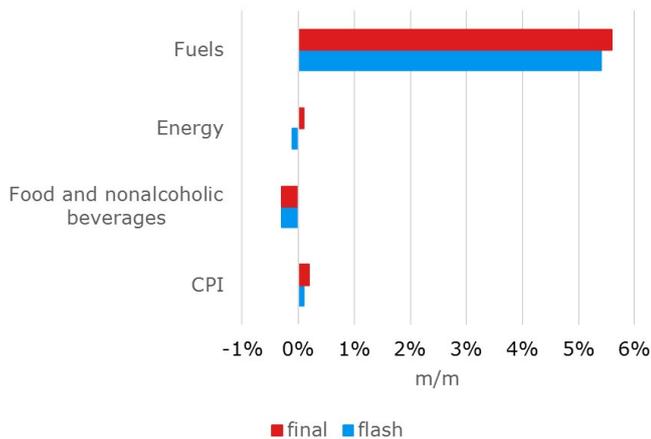
Economics

The May rise in inflation was driven by energy prices only. Core inflation continues to disappoint.

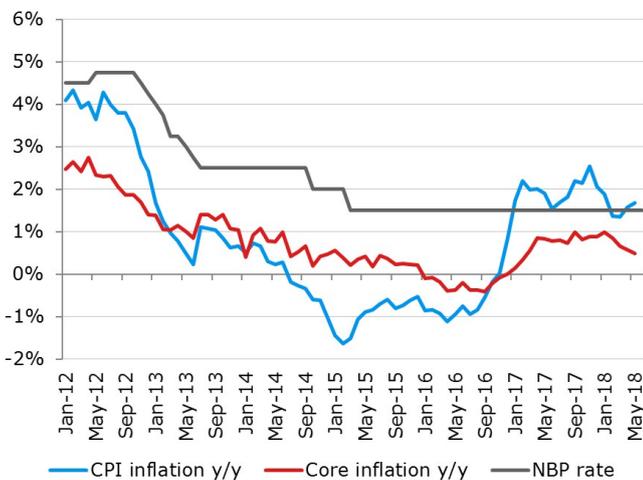
According to the final estimate, inflation rose by 1.7% y/y in May (flash 1.7%, original consensus 1.9%, our forecast 1.8%). Due to rounding, the m/m growth rate was revised upwards (from 0.1 to 0.2%), but this is irrelevant for the bigger picture.

especially now that oil prices have stabilized, will not be enough to push inflation beyond 2% in the summer. Persistently low core inflation will thus allow the MPC to keep its dovish rhetoric even if wages accelerate further. After all, every link between economic activity and inflation appears to be broken in Poland – even services prices ceased to react to higher wages! Thus, neither the central bank, nor market participants will change their expectations regarding monetary policy. Current market pricing (first hike in late 2019), we may add, is conditional on core inflation regaining its usual sensitivity to labor market tightening and positive output gap.

Comparison of flash and final CPI estimates



The breakdown of the figure is only partially consistent with our expectations. The details published along with the flash release did not change materially (see the graph above) – food prices declined by 0.3% m/m, fuel prices rose by 5.6% m/m and residential energy prices rose by 0.1% m/m. However, the devil is in the core this time: some categories rose on a monthly basis (health and communications, the former due to seasonal increase in hospital and sanatorium services prices), others declined. This pertains particularly to Recreation and culture (dropped by 1% m/m due to cheaper package holidays and newspapers) and Other goods and services (down by 0.5% m/m due to insurance services). As a result, core inflation declined to 0.5% y/y in May, much below the market consensus of a slight increase (from 0.6 to 0.7% y/y).



The relatively low inflation print and its unfavorable structure are reducing the likelihood of reaching the inflation target even further. In current circumstances the boost from higher fuel prices,

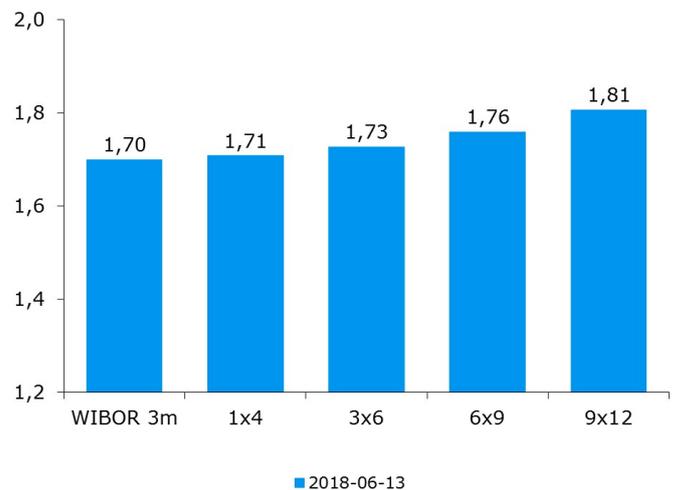
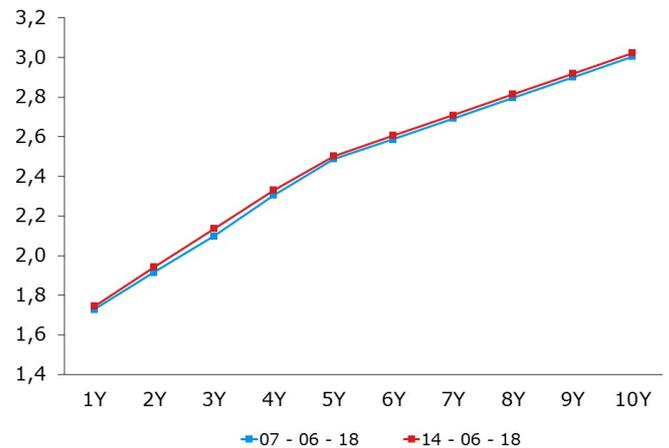
Fixed income

In the shadow of major central banks

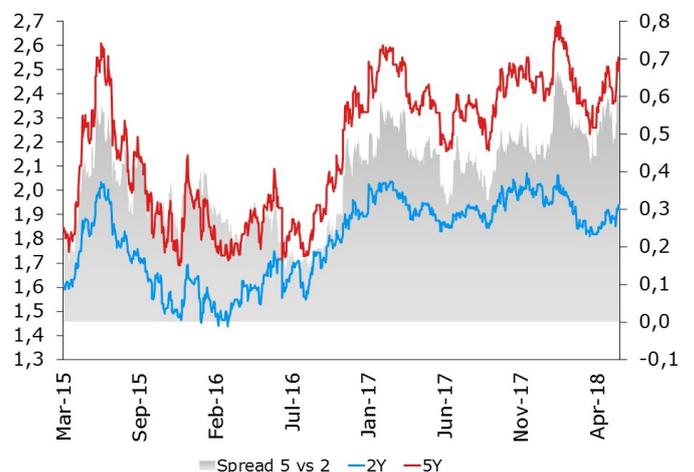
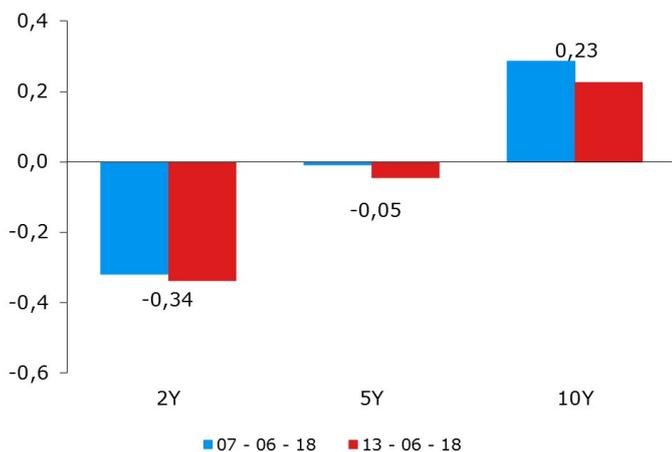
Fed was yesterday, ECB was today, there's too much uncertainty at the moment. If ECB is not a game changer, investors will be eager to bet on lower rates. Timing is everything, though: ECB meeting might bring some volatility to the market. Tomorrow there is an auction in Poland and it's a switching one.

PS0123/5y is -9 bps, WS0428/10y is 20 bps. PS0123/WS0428 is 81 bps. WS0428/Bund is 275 bps. PS0420 is trading at 1.54% (1 bps down), PS0123 is trading at 2.44% (2 bps down) and WS0428 is trading at 3.25% (3 bps down).

IRS curve



Asset swaps



Money market

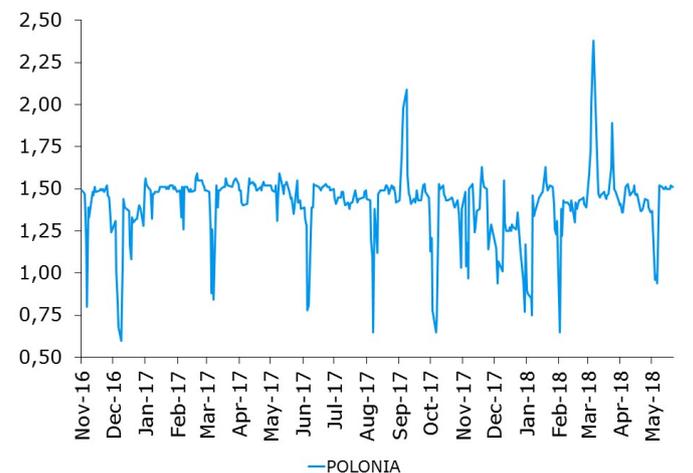
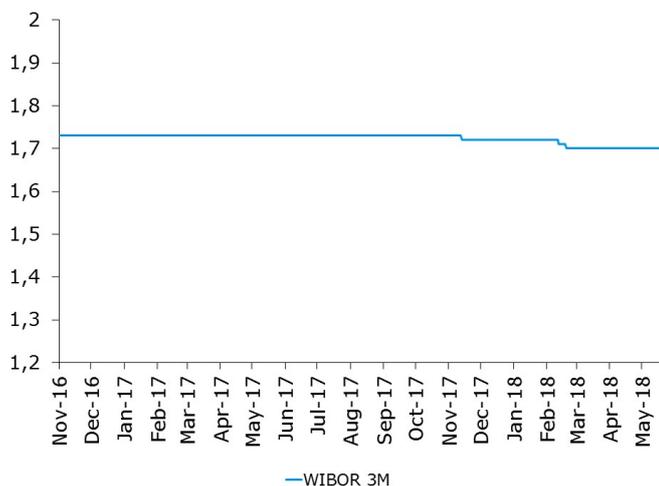
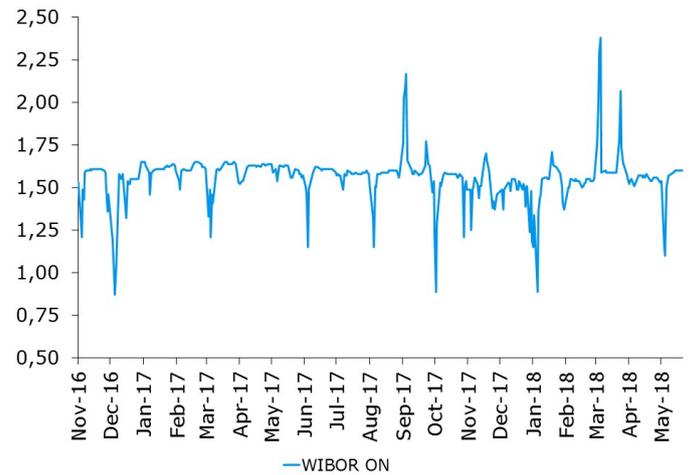
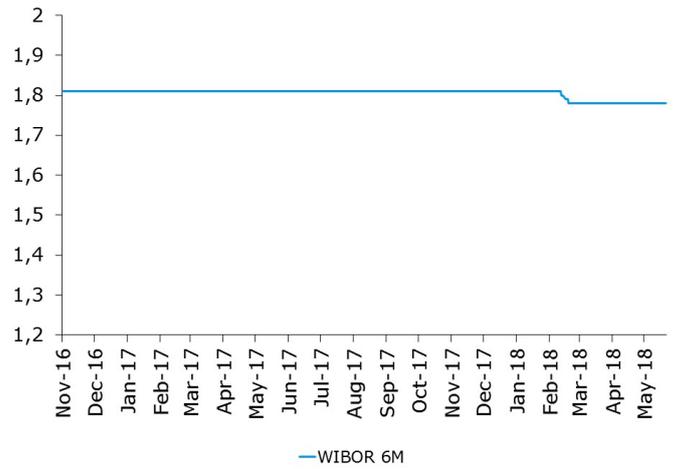
Remarkable resilience

Polish rates remain resilient to global shocks. We still move in a relatively tight range, while our EM peers are suffering from a sell-off. Recent macroeconomic data confirms MPC's view of stable rates although global fears persist. In the last days we saw some paying interest on the very front end of the curve. Contracts 2x5 2x8 were paid 2.5 bps above WIBOR, which is quite odd with current rate outlook. There's really no reason to expect anything but stable rates.

Without a significant cash surplus we trade in a narrow range around 1.53%. Tomorrow's OMO should set up the tone for the next week.

Ref rate vs Polonia averages:

30 day 12 bps
90 day 2 bps



Forex

Spot – Consolidation phase for EUR/PLN The prospect of central bank week, with FOMC, ECB and BOJ on the agenda was the perfect excuse for the EUR/PLN to start the consolidation phase. The new range of roughly 4.25-4.30 is in the making and realized volatility nosedived again. 4.2570 and 4.2950 were the respective EUR/PLN low and high points of the last 5 trading sessions. We expect that rangy game to continue and we don't see much chance for a break out on either side. Especially as the FOMC failed to impress the market, and ECB produced a heat wave for all USD/XXX, but did not influence the EUR/PLN significantly.

Options – Volatility stable The week seemed to be packed with events, including FOMC and ECB, and as a result we started the week with a decent bid for gamma, especially in USD/PLN. So far, both failed to produce any move on EUR/PLN spot and market reverted to selling as realized volatility continues to disappoint. Finally, the whole EUR/PLN curve is a little higher than a week ago. 1 month EUR/PLN ATM mid is at 5.7% (0.1% higher), 3 months are 5.79% (0.15% higher) and 1 year is fixing at 5.95% (no change). 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

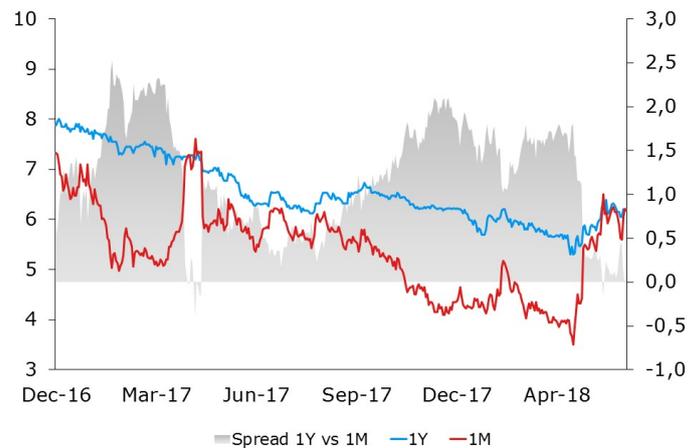
Main supports / resistances:
 EUR/PLN: 4.2300 / 4.3000
 USD/PLN: 3.5000 / 3.7000

Spot Current position: None.

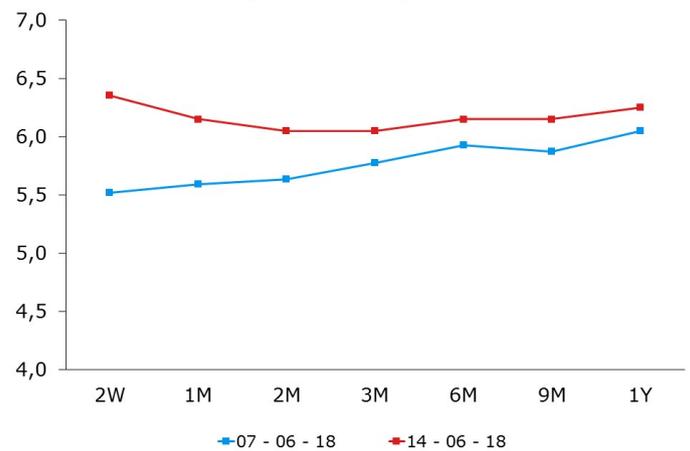
We were close to our sell level at 4.2950, but as that level was touched just briefly, it was not enough to install the position. We still would like to range play the cross and our fine-tuned entry levels are as follows. Sell at 4.3050, add at 4.3300 with stop above 4.3450 and hopes to revisit 4.2550 or buy 4.2550, add 4.2300, with stop below 4.2150 and 4.2950 target in mind. Inside that range, we employ really opportunistic, agile approach with slight PLN positive skew.



EURPLN volatility



EUR/PLN volatility curve



Bias from the old parity (%)



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
6/7/2018	1.78	1.70	1.85	1.68	1.99	1.72	1.70	1.72	1.74	1.79	1.86	1.83
6/10/2018	1.74	1.70	1.87	1.68	1.99	1.72	1.70	1.72	1.75	1.81	1.89	1.84
6/11/2018	1.59	1.70	1.66	1.68	1.88	1.72	1.70	1.72	1.76	1.81	1.89	1.84
6/12/2018	1.61	1.70	1.68	1.68	1.82	1.72	1.70	1.73	1.75	1.80	1.86	1.83
6/13/2018	1.79	1.70	1.87	1.68	2.01	1.72	1.71	1.73	1.76	1.81	1.87	1.85

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
6/7/2018	1.720	1.347	1.915	1.595	2.485	2.477	3.005	3.291
6/10/2018	1.720	1.351	1.925	1.581	2.530	2.492	3.040	3.334
6/11/2018	1.720	1.355	1.940	1.587	2.550	2.483	3.080	3.286
6/12/2018	1.720	1.336	1.920	1.587	2.495	2.439	3.010	3.273
6/13/2018	1.720	1.340	1.940	1.603	2.503	2.457	3.021	3.247

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
6/7/2018	5.59	5.78	5.93	6.05	6.05	1.45	0.54
6/10/2018	6.05	6.00	6.13	6.20	6.20	1.45	0.54
6/11/2018	6.20	6.05	6.13	6.20	6.20	1.45	0.53
6/12/2018	6.18	6.03	6.13	6.20	6.20	1.46	0.52
6/13/2018	6.15	6.05	6.15	6.25	6.25	1.46	0.49

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
6/7/2018	4.2634	3.6062	3.6717	3.2803	1.3437	0.1663
6/10/2018	4.2912	3.6479	3.7136	3.3366	1.3420	0.1661
6/11/2018	4.2717	3.6247	3.6760	3.2964	1.3312	0.1663
6/12/2018	4.2776	3.6271	3.6862	3.2906	1.3295	0.1669
6/13/2018	4.2820	3.6461	3.6874	3.2957	1.3362	0.1665

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