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Polish Weekly Review

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Comment on the upcoming data and forecasts

This Friday, the CSO will release final CPI data. Due to the discrepancy between short-term data on fuel prices and the estimates from the flash CPI reading, we see a strong likelihood of upward revision (to 2.0% y/y). Core inflation (published on Monday) likely rose to 0.6%, as widely expected. The latest NBP's staff projections will be presented on Monday. Also on Monday, the NBP will publish foreign trade data as well. We expect a rebound in current account balance fuelled by the surplus on trade balance. On Tuesday, monthly labour market data are coming up. Employment growth should decelerate on a yearly basis, from 3.7% to 3.6%, after weak performance of retail trade section, while nominal wage growth should stabilize at 7.0% y/y. The latter is currently fuelled by two sections – manufacturing and construction. On the next day real sphere data will be published. On a yearly basis, industrial output accelerated to 7.0%, mainly driven by calendar effects, while construction output stabilized at around 21% – negative impact of labour force shortage could start revealing itself there and prohibiting a stronger rebound. Producer prices grew in June by a staggering 3.8% y/y. Week ends on Friday with retail sales data. Calendar effects (including strong car sales) boosted this category in real terms, allowing to accelerate to 7.3% y/y.

Polish data to watch: June 13th to July 20th

Publication	Date	Period	mBank	Consensus	Prior
Final CPI y/y (%)	13.07	Jun	2.0	2.0	1.9
Core CPI y/y (%)	16.07	Jun	0.6	0.6	0.5
Current account (mio EUR)	16.07	May	406	52	-21
Exports (mio EUR)	16.07	May	17200	17325	17176
Imports (mio EUR)	16.07	May	17000	17410	16862
Employment y/y (%)	17.07	Jun	7.0	7.0	7.0
Average wage y/y (%)	17.07	Jun	3.6	3.7	3.7
Industrial production y/y (%)	18.07	Jun	7.0	6.0	5.4
Construction output y/y (%)	18.07	Jun	21.1	20.4	20.8
PPI y/y (%)	18.07	Jun	3.8	3.7	2.8
Retail sales y/y (%)	20.07	Jun	9.0	8.2	7.6

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	7/27/2018	20	1.637	5/24/2018
5Y T-bond PS1023	7/27/2018	1400	2.481	5/24/2018
10Y T-bond WS0428	7/27/2018	900	3.210	5/24/2018
30Y T-bond WS0447	7/27/2018	150	3.395	4/27/2018

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



Comment

There were no publications, so Polish surprise index remained stable last week. Next days bring plenty of opportunities to surprise: from final CPI, through labour market data to real sphere and retail sales data.

* 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 4.8%. 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, rather benign external environment and stimulation on all fronts.
- Inflation turned around and is set to breach 2% in the summer, before dropping back towards 1.5% towards year end. The key driver are fuel prices and stronger US dollar. Food prices set to decelerate further this year. Those looking for a durable rise in inflation should take a look at core consumer goods (where there is a multi-year upward trend) and services. The pass-through from higher wages has thus far been limited, by we continue to put faith in this time-tested relationship.
- MPC stays calm and waves away any signs of intensifying wage pressure. In our view, as long as inflation stays within the target band, the MPC will keep its rhetoric in place. Weaker PLN has likely no impact on the MPC's discussions, since pass-through effect are seen as negligible. 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 (other than loose monetary policy) 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.
- Thus, we believe that stronger PLN can only be expected over the medium term. In the coming months PLN is set to depreciate further. In addition, weaker PLN will act as a pressure valve on exporters' margins squeezed by rapidly rising labor and commodity costs.

mBank forecasts

	2014	2015	2016	2017	2018 F	2019 F
GDP y/y (%)	3.3	3.8	3.0	4.6	4.8	4.0
CPI Inflation y/y (average %)	-0.1	-0.9	-0.6	2.0	1.8	2.1
Current account (%GDP)	-2.1	-0.6	-0.3	0.2	-0.4	-0.8
Unemployment rate (end of period %)	11.4	9.8	8.2	6.6	5.6	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	5.2	4.7	4.4	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	1.7	2.1	1.7	2.0	2.3	2.0	2.2
Unemployment rate (% eop)	6.6	5.8	5.7	5.6	5.5	5.0	4.9	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	1.70	1.70	1.70	1.71	1.72	1.98
2Y Polish bond yields (% eop)	1.49	1.63	1.55	1.60	1.65	1.85	2.00	2.20
10Y Polish bond yields (% eop)	3.18	3.22	3.35	3.40	3.50	3.59	3.71	3.88
EUR/PLN (eop)	4.21	4.37	4.42	4.40	4.35	4.30	4.25	4.20
USD/PLN (eop)	3.42	3.74	3.78	3.73	3.64	3.55	3.47	3.39

F - forecast

Economics

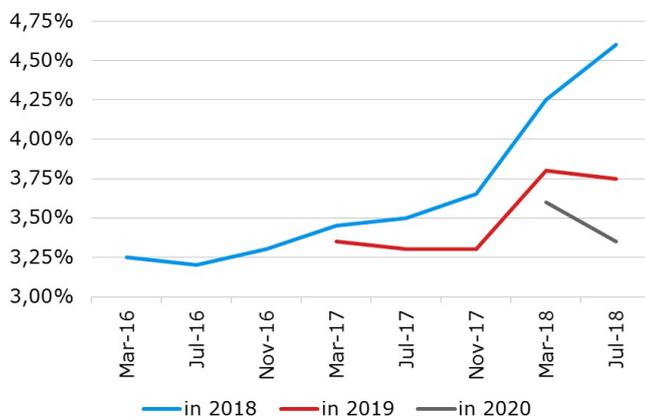
MPC: rates unchanged, wording stays dovish

Yesterday's MPC meeting was rather boring. The rhetoric stayed dovish and the new set of inflation projections looks as if it was tailored to suit the current MPC view. It stays a mystery for us why inflation projection was more or less unchanged or even slightly downgraded within the monetary policy horizon. We look forward to the presentation of the fresh projection on Monday.

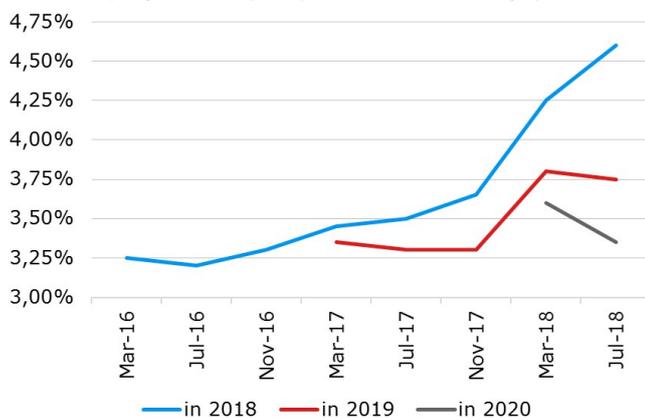
estimates. First of all, not once the economy operated even close to current levels of unemployment rate. Secondly, recent years saw a meaningful fall of prices of tradables which may now come to a halt or even reverse (slowly increasing tariffs in international trade, more inward-oriented China). Thirdly, the pass-through of wages to prices may have been muted as firms had been enjoying relatively high margins that recently began to dwindle. There are also some facts, that cannot be encapsulated in projections since they are still of speculative nature. We see a growing probability of growing prices of electrical energy (judging from energy exchanges, the prices should already been materially higher), water and sewage collection. The rises are temporarily shelved before elections (both municipal in 2018 and general in 2019). At the same time, pork barrel politics may bring some leeway for wage increases in the public sector – those seem to be close to the peak demand right now.

All in all, the wording got a bit softened but forward guidance is stretched to such an extent that it fails to be credible for market participants. Recent increases in market rates seem to be rather of regional nature. Expectations for monetary policy are rather unlikely to be pushed further away without a reversal in inflation and prices should catch some more decent momentum in the coming months.

Average annual GDP growth in subsequent projections (midpoints of 50% range)



Average annual GDP growth in subsequent projections (midpoints of 50% range)



Given the adjustment of inflation projection, governor Glapinski become more confident that rates will stay flat until the end of 2020. It seems a brave call given the macro environment. Easy MPC rhetoric currently rests, in our opinion, on two pillars: current low core inflation and 2020 inflation forecast that is close to target. The latter seems to be based on the former. We feel that the current MPC reasoning may go along the lines quite popular in monetary policy recently. As core inflation stays low, it may reflect not quite its extraordinary nature but biased estimates of output gap. Such rationale would bring the NBP to lower output gap in the future and lesser inflationary pressure.

Although it seems a good explanation for current state of affairs and current forecast, it neglects some basic features of the cycle that – historically – seem to be hardly captured by NECMOD

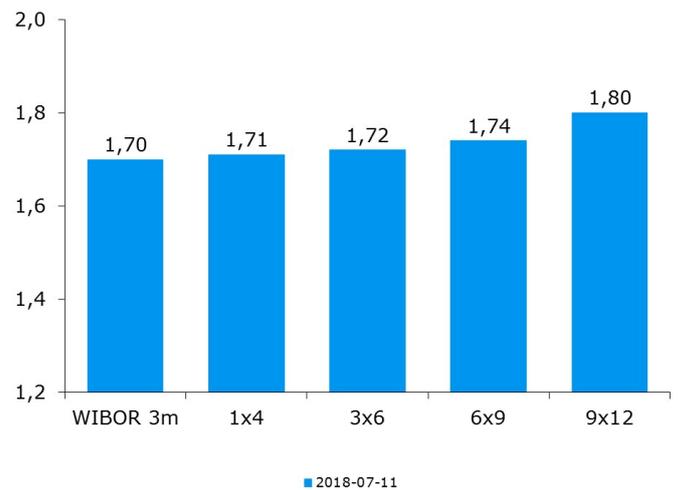
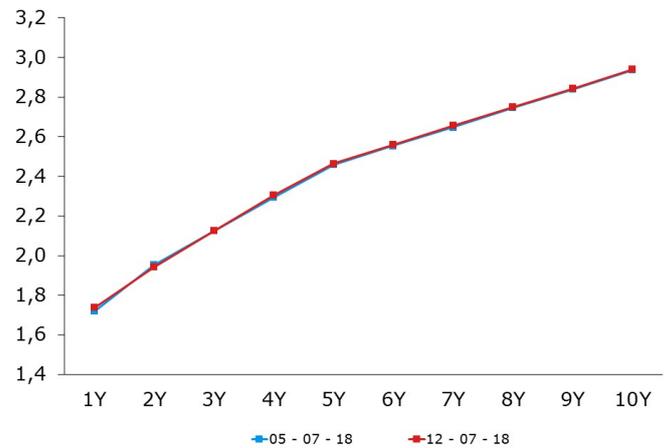
Fixed income

Uneventful week behind us

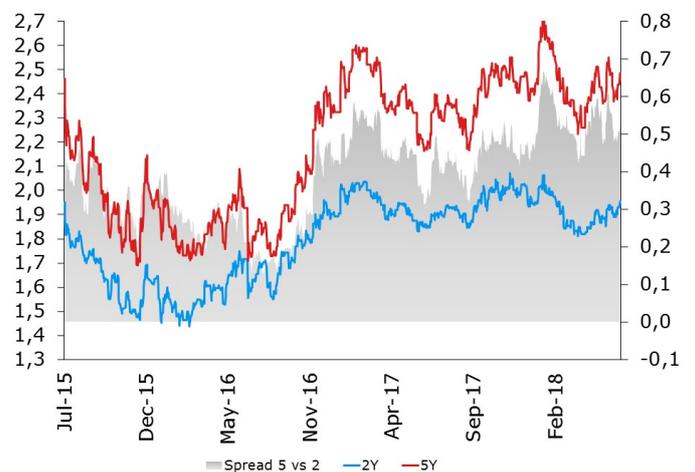
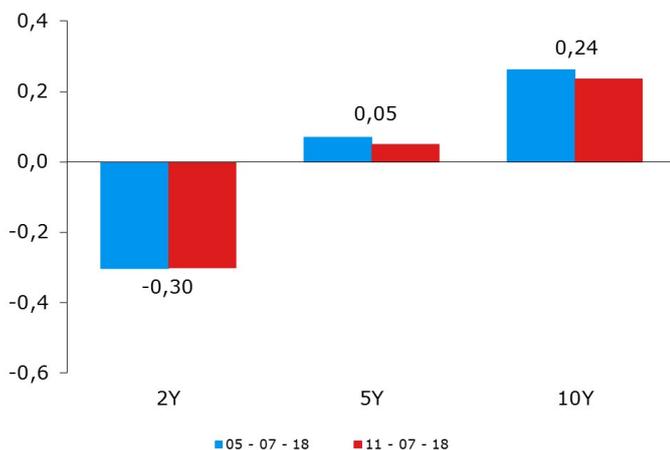
Today, the Ministry of Finance sold PLN 6 bn of POLGBs on the switch auction. Bid/cover was only 1.25, not much, but market remained rock solid. The next big case is PS0718 expiration, 15 bn of fresh cash will flow into the market. MPC was dovish once again. With EURPLN stable in the 4.30-35 range, the choice between fixed and floating coupon bonds in the long end is quite obvious.

PS0123/5y is -8 bps, WS0428/10y is 24 bps. PS0123/WS0428 is 82 bps. WS0428/Bund is 290 bps. PS0420 is trading at 1.58% (1 bps up), PS0123 is trading at 2.4% (1 bps up) and WS0428 is trading at 3.22% (1 bps up).

IRS curve



Asset swaps





Money market

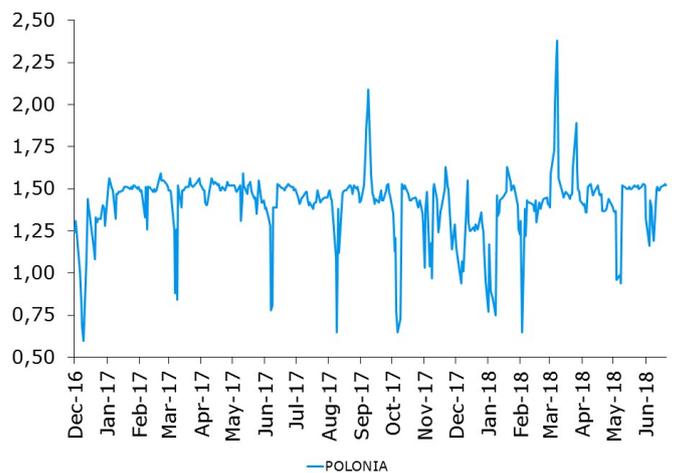
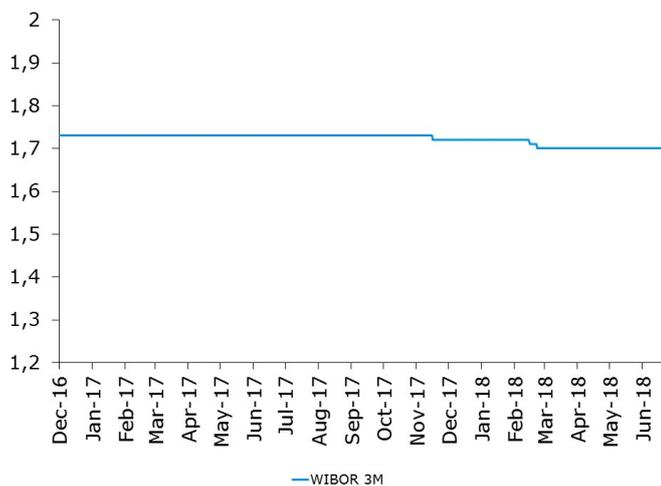
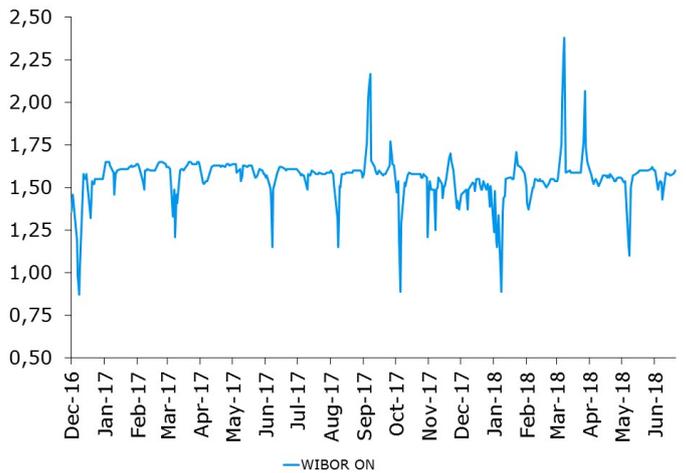
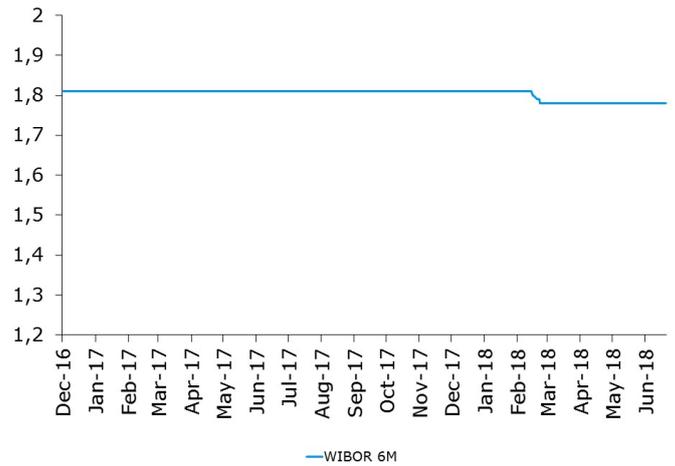
Solid as a rock

Polish fixed income market again shows big resilience to global moves. No matter if it's risk-on or risk-off, moves on Polish yield curve are muted. Yesterday we had an MPC meeting with new projections. They show almost nothing new, just slightly softer path of CPI. This month we have July bond redemptions and coupon payments. ASW have been moving in range formation, but will the inflow of cash into the market change it?

Last week cash stood at higher levels. Tomorrow's OMO will set the tone for next week. We might fall a bit towards 1.50%.

Ref rate vs Polonia averages:

- 30 day 6 bps
- 90 day 6 bps



Forex

Spot – Consolidation phase The EUR/PLN slide was halted at 4.30/4.32 support zone. It should hold for a while and we are expecting range trade in 4.31-4.37 interval. The risk sentiment is somehow better, but the trade war and political tensions are keeping us all on our toes. The summer vacation mood is still not being felt on the market.

Options – Implied volatilities stable Zloty is stronger than week ago but implied volatility are not lower – correlation between stronger Zloty and lower volatility doesn't work this time. The reason is really impressive realized volatility – almost every day we see a whipsawing price action – EUR/PLN fluctuated 3-5 big figures. In the end 1 month EUR/PLN mid fixed at 6.3% (unchanged), 3 months are at 6.2% (unchanged) and 1 year is 6.4% (0.1% higher). The skew is roughly unchanged.

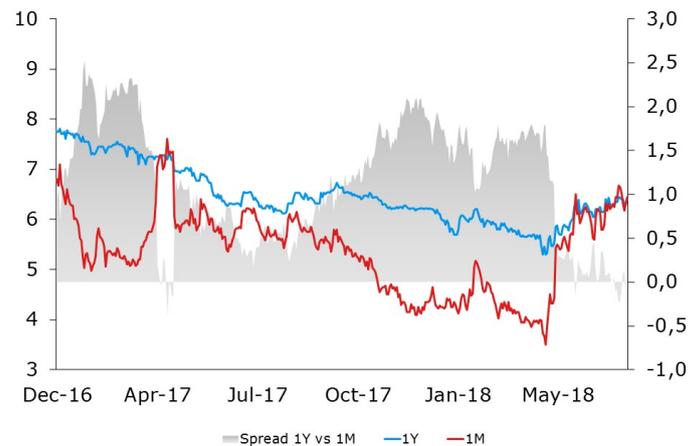
Short-term forecasts

Main supports / resistances:
 EUR/PLN: 4.3200 / 4.3900
 USD/PLN: 3.6000 / 3.9000

Spot Current position: Small long.

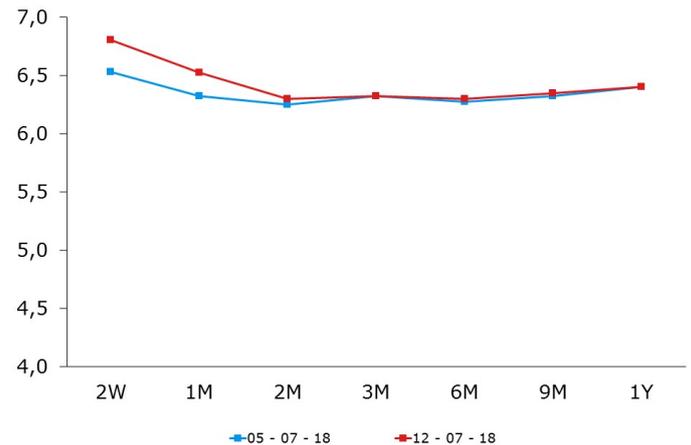
We have a small tactical long which was built at an average price of 4.3140, with 4.3040 stop and hopes to switch into short at 4.35+. The stop is really tight, as we are generally PLN constructive. But the pace of PLN advances was simply too fast and we have to allow some correction/consolidation in what can be Zloty positive summer.

EURPLN volatility

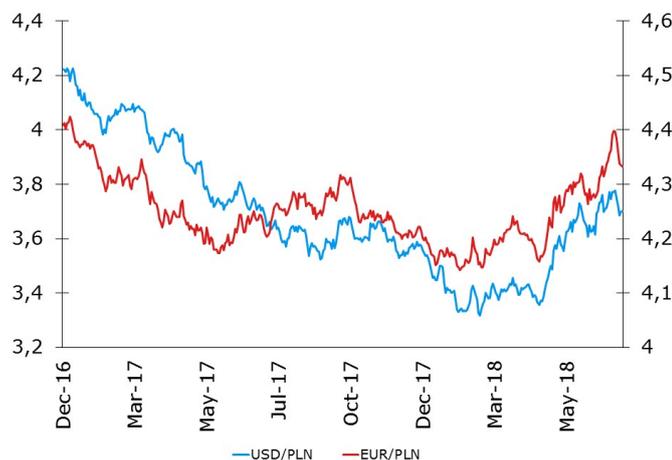


— Spread 1Y vs 1M — 1Y — 1M

EUR/PLN volatility curve



— 05 - 07 - 18 — 12 - 07 - 18



— USD/PLN — EUR/PLN

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
7/5/2018	1.91	1.70	1.95	1.68	2.07	1.72	1.71	1.73	1.75	1.82	1.91	1.85
7/8/2018	1.88	1.70	1.96	1.68	2.01	1.72	1.71	1.73	1.76	1.82	1.89	1.85
7/9/2018	1.88	1.70	1.95	1.68	2.06	1.72	1.71	1.73	1.76	1.82	1.90	1.85
7/10/2018	1.69	1.70	1.76	1.68	1.87	1.72	1.71	1.73	1.76	1.83	1.91	1.86
7/11/2018	1.78	1.70	1.84	1.68	1.96	1.72	1.71	1.72	1.74	1.80	1.88	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	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
7/5/2018	1.720	1.393	1.950	1.647	2.458	2.528	2.935	3.197
7/8/2018	1.720	1.417	1.942	1.643	2.438	2.523	2.914	3.204
7/9/2018	1.720	1.412	1.952	1.650	2.458	2.524	2.930	3.185
7/10/2018	1.720	1.408	1.960	1.653	2.480	2.544	2.955	3.201
7/11/2018	1.720	1.403	1.940	1.638	2.465	2.515	2.938	3.173

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
7/5/2018	6.33	6.33	6.28	6.40	6.40	1.47	0.53
7/8/2018	6.18	6.15	6.18	6.30	6.30	1.47	0.53
7/9/2018	6.33	6.20	6.23	6.29	6.29	1.45	0.55
7/10/2018	6.45	6.46	6.23	6.41	6.41	1.45	0.48
7/11/2018	6.53	6.33	6.30	6.40	6.40	1.48	0.57

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
7/5/2018	4.3833	3.7485	3.7759	3.3891	1.3518	0.1686
7/8/2018	4.3600	3.7222	3.7507	3.3645	1.3450	0.1681
7/9/2018	4.3380	3.6850	3.7334	3.3358	1.3440	0.1676
7/10/2018	4.3356	3.6973	3.7230	3.3264	1.3328	0.1670
7/11/2018	4.3322	3.7000	3.7255	3.3285	1.3345	0.1672

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