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Polish Weekly Review

Authors:

Ernest Pytlarczyk, PhD, CFA
chief economist
tel. +48 22 829 01 66
ernest.pytlarczyk@mbank.pl

Marcin Mazurek, PhD
senior analyst
tel. +48 22 829 01 83
marcin.mazurek@mbank.pl

Piotr Bartkiewicz
senior analyst
tel. +48 22 526 70 34
piotr.bartkiewicz@mbank.pl

Karol Klimas
analyst
tel. +48 22 829 02 56
karol.klimas@mbank.pl

Follow us on Twitter:

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Business contacts:

Department of Financial Markets

Wojciech Dunaj
head of interest rates trading
tel. +48 22 829 07 51
wojciech.dunaj@mbank.pl

Marcin Turkiewicz
head of fx trading
tel. +48 22 829 01 67
marcin.turkiewicz@mbank.pl

Department of Financial Markets Sales

Inga Gaszkowska-Gebska
institutional sales
tel. +48 22 829 01 67
inga.gaszkowska-gebska@mbank.pl

Jacek Jurczyński
head of treasury sales
tel. +48 22 829 15 16
jacek.jurczynski@mbank.pl

mBank S.A.
18 Senatorska St.
00-950 Warszawa
P. O. BOX 728
tel. +48 22 829 00 00
fax. +48 22 829 00 33
http://www.mbank.pl

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Comment on the upcoming data and forecasts

This Friday, the CSO will release June retail sales data. We expect it to accelerate markedly, from 7.6 to 9.0% y/y in nominal terms and from 6.1 to 7.3% y/y in constant prices. The acceleration can be attributed primarly to favorable calendar effects boosting car sales and low statistical base in durables sales. At the same time, the CSO will also release its business sentiment indicators. On Monday, the NBP will publish M3 data for June. Money supply likely surged to 7.7% y/y on the back of FX effects and the rebound in cash in circulation and household deposit growth. On Tuesday, the CSO will release its monthly Statistical Bulletin. Apart from the details of various figures (including employment and wage data), it will contain the final estimate of unemployment rate in June. We expect it to confirm the preliminary reading from the Ministry of Family. It is a notch above our forecast (5.8%), but in line with market consensus (5.9%).

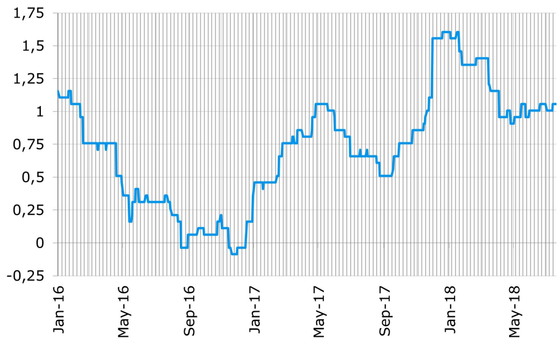
Polish data to watch: June 20th to July 27th

Publication	Date	Period	mBank	Consensus	Prior
Nominal retail sales y/y (%)	20.07	Jun	9.0	8.2	7.6
Business sentiment	20.07	Jul			
M3 y/y (%)	23.07	Jun	7.7	7.3	6.6
Unemployment rate (%)	24.07	Jun	5.9	5.9	6.1

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

Lots of publications, but only one release – final CPI brought a small revision to the flash CPI reading, hence our surprise index has gone up a notch.

* 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 at least 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

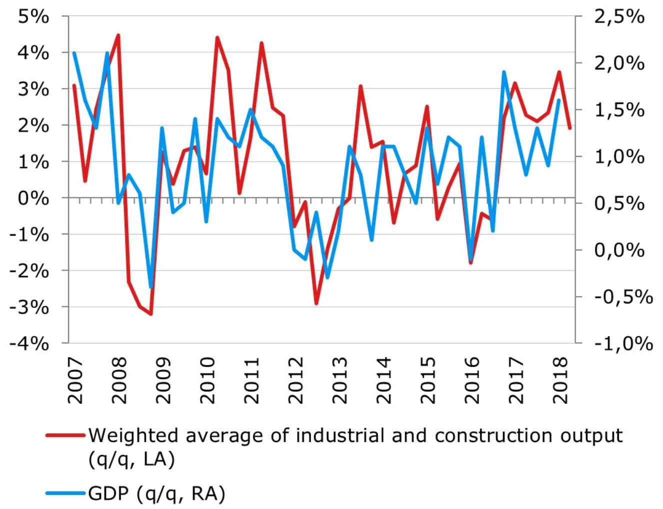
	2018 Q1	2018 Q2 F	2018 Q3 F	2018 Q4 F	2019 Q1 F	2019 Q2 F	2019 Q3 F	2019 Q4 F
GDP y/y (%)	5.2	5.2	4.7	4.4	4.2	4.2	4.0	3.7
Individual consumption y/y (%)	4.8	4.8	4.6	4.2	4.0	3.8	3.8	3.8
Public Consumption y/y (%)	3.6	3.0	4.0	4.0	2.0	2.0	2.0	2.0
Investment y/y (%)	8.1	10.0	10.0	8.0	7.0	6.0	5.0	4.0
Inflation 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

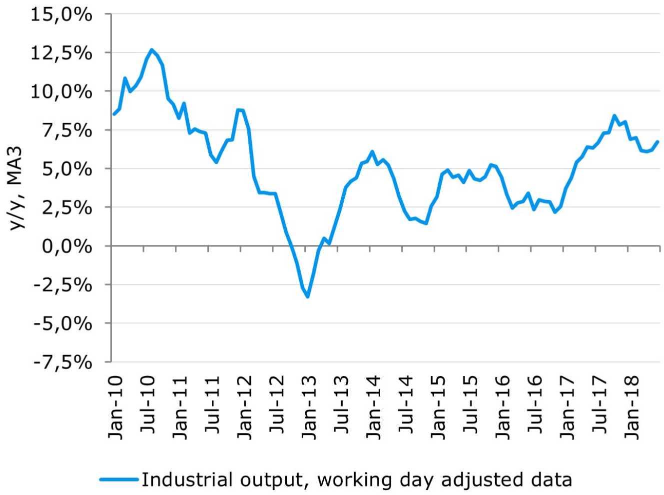
Economics

Polish economy ends Q2 on a high note

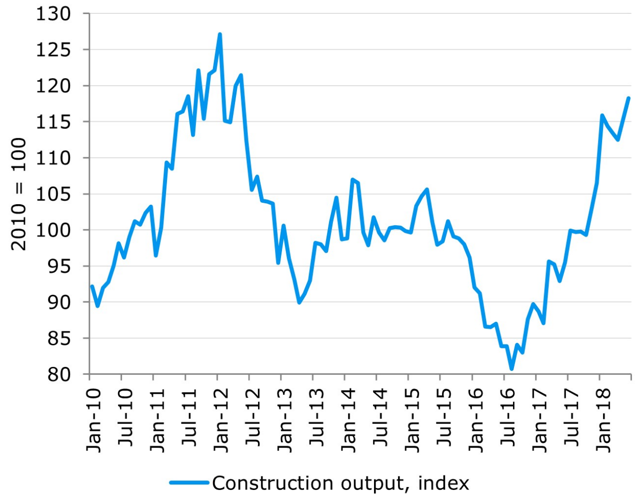
In light of June data, we decided to slightly upgrade our GDP forecast for the second quarter of the year. We now believe that GDP growth will fall in the 5.3-5.4% range (y/y), making it the best quarter since 2008 and an improvement over Q1 (5.1% y/y). The upgrade is mainly due to better than expected construction spending figures, but industry remained fairly strong recently, bucking European trends to some extent. In addition, over the past three months, the economy has maintained solid momentum, which strengthens the case for acceleration. On the other hand, there is still considerable uncertainty regarding the structure of growth and, for the benefit of our readers, we will be delving into this issue in the upcoming weeks. One should, though, be certain that household consumption had a decisive contribution to GDP growth, as indicated this week by solid wage bill and employment growth (see our comment on labor market stats) and buoyant consumer sentiment.



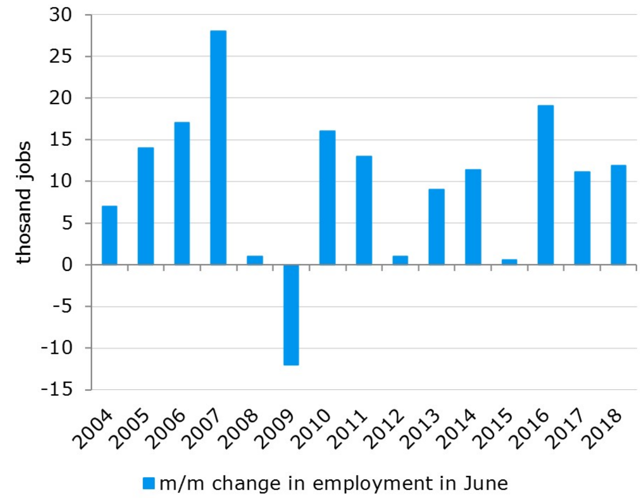
Sold industrial output rose by 6.8% y/y in June, beating market consensus (6.3% y/y), but falling short of our forecast (7.0% y/y). The acceleration vis-a-vis May is a result of more favorable calendar (working day difference rose from 0 to +1 y/y) and warm weather in June – the latter boosted energy output (up from 7.9 to 13.6% y/y). On the other hand, the modest statistical base from last year (ca. 1 p.p.) has put a drag on annual industrial output figures. Given the abovementioned factors and neutral momentum (+0.1% m/m s.a.), we can be reasonably certain that Polish industry has already peaked in annual terms. This, however, is not equivalent to a slowdown, though.



Construction output surprised positively after noting yearly growth of 24.7%, more than our forecast and market consensus suggested (around 21%). What's more important, positive momentum from previous growth was sustained. After seasonal adjustment, monthly growth rate was just slightly lower than the May one (2.5% vs 2.6%). As a result we have a new top on the seasonally adjusted index (see chart below). In June calendar and weather factors were neutral, which confirms a rebound in this category after few weaker readings at the turn of Q1 and Q2. Details will be published with quarterly data later this month, however we will make some guesses about structure of the growth. Incoming local election could boost local governments' spending, which are set to peak at the turn of Q2 and Q3. On the other hand, growth in the next months could be inhibited by bottlenecks – labor shortages and failed tenders for public investment (due to unrealistically low prices).

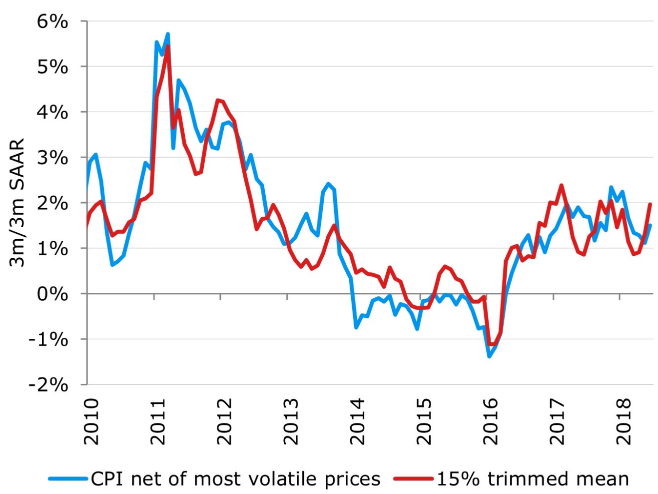


Employment in June surprised us to the upside (3.7% y/y), so did average nominal **wage** growth (7.5% y/y). Despite the surprise we still expect that the growth of employment is set to weaken in coming months due to supply constraints. It is already visible in a broader perspective (Feb-Jul employment growth this year is +36k vs +42k last year) and it is really hard to see any relief in sight since labor pool is very shallow. That is going to translate into higher wages. As usual, we have only headline figures at hand, but we think that manufacturing wage growth hit a new cyclical high in July. Other, more labor intensive sections are set to strengthen further and faster. Wage bill growth ticked up both in nominal and real terms, lending support to consumption growth for another month.

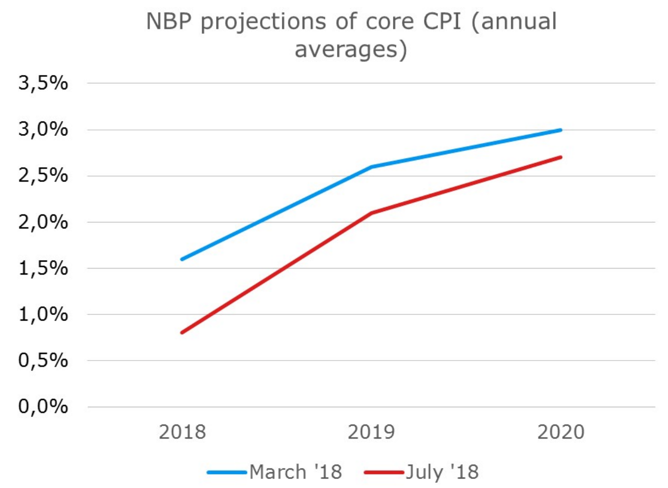


Inflation through the looking glass and what NBP found there

Inflation made modest headway in June. While CPI inflation rose to 2.0% after all (we hinted that a revision is likely in our comment on the flash reading), it was primarily driven by higher fuel prices. Additionally, the same external factor pushed producer price inflation up to 3.7% y/y. Core CPI accelerated to 0.6% y/y and all measures of underlying price pressure remain muted – a far cry from 2017 highs, not to mention the periods of sustained, elevated core CPI growth, i.e. 2007-2009 and 2011-2012. While the breakdown of inflation indicates that services prices re-accelerated a bit, one still should see the current levels as inconsistent with the state of the economy and historical relations between macroeconomic variables.



It was likely the on-going weakness of core inflation that forced the NBP to revise its projected path lower in the latest set of staff projections. It is not a question of lower starting point, though. With higher output gap estimates for 2016 and 2017 and (we are guessing) lower sensitivity of prices to output gap and labor market slack, the actual behavior of core inflation is better explained by NBP's models. Such tweaks readily explain why a clearly pro-inflationary, upward revision to near-term GDP path and higher non-core CPI growth did not make its way into core inflation. However, an old econometric truth is that higher model fit need not translate into better predictive power.



Leaving the arcane nature of core CPI forecasting aside, one should note that even a lower core CPI path implies that Polish monetary policy is set to become even more accommodative within the forecast horizon. It's extremely loose stance in the environment of persistently positive output gap (ca. 1.5% of GDP), high wage growth and new lows in unemployment will likely be called into question. Right now it is contested by two biggest hawks from the Monetary Policy Council (see today's comments from Mr Zubelewicz and Mr Gatnar), but the overall consensus still appears rock-solid. In our view, current MPC stance is to a large extent anchored by low core CPI prints. As soon as it starts rising and the balance of risks for inflation shifts, the MPC's conviction will be tested. Thus, we continue to expect the first rate hike in late 2019.

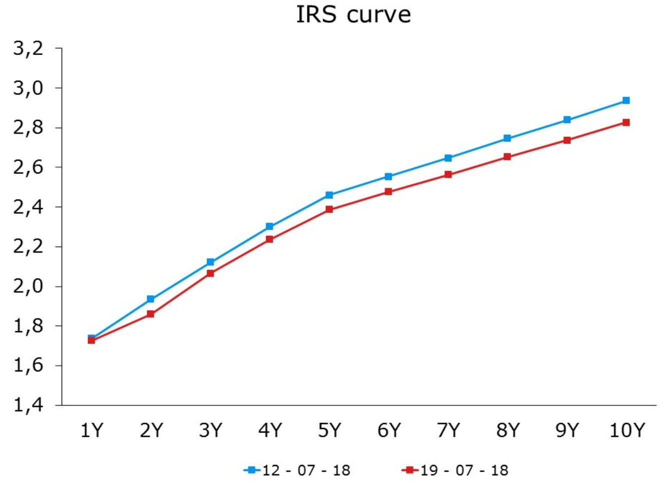
Fixed income

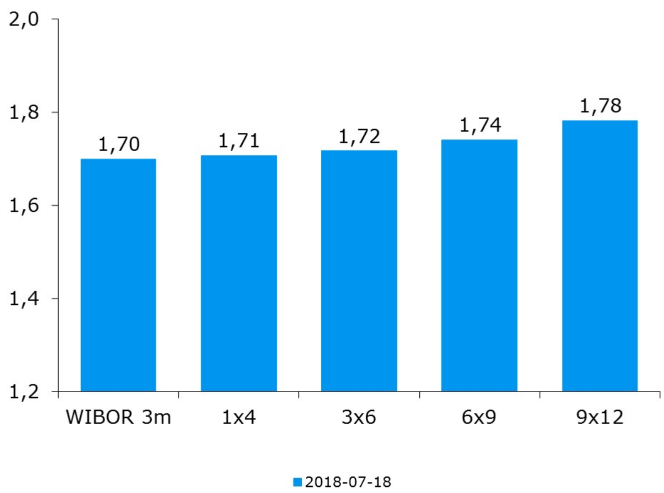
End of the line

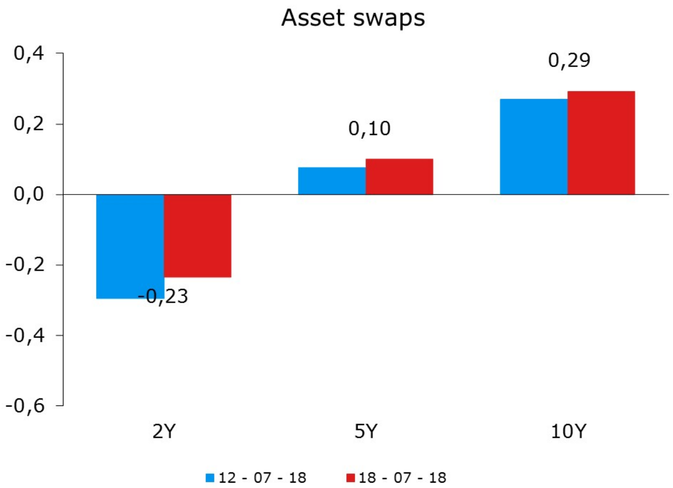
5y IRS touched an important level this week, 2.40%, where many investors might start betting on higher rates. Given that ASW spreads are tight, it should be obvious which instrument would be used. WS0428 is extremely tight in spreads, DS0727/WS0428 is flat, DS0726/WS0428 6.5 bps. Next week we have the PS0718 expiration, it will presumably be rolled into other short end bonds, leading to steepening curve.

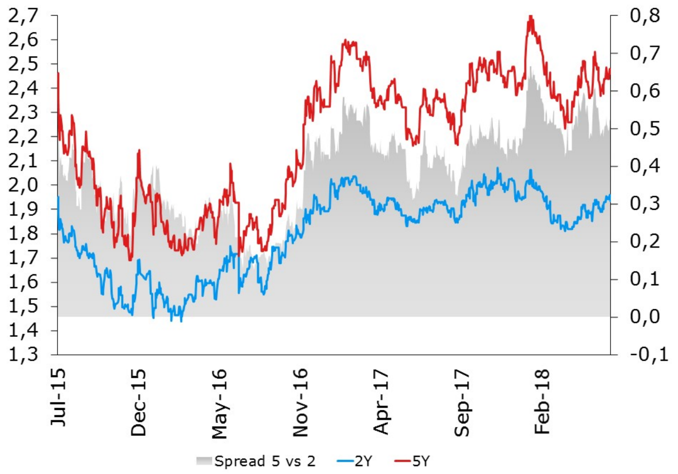
PS0123/5y is -9 bps, WS0428/10y is 22 bps. PS0123/WS0428 is 78 bps. WS0428/Bund is 285 bps.

PS0420 is trading at 1.56% (1 bp up), PS0123 is trading at 2.32% (5 bps down) and WS0428 is trading at 3.1% (7 bps down).









Money market

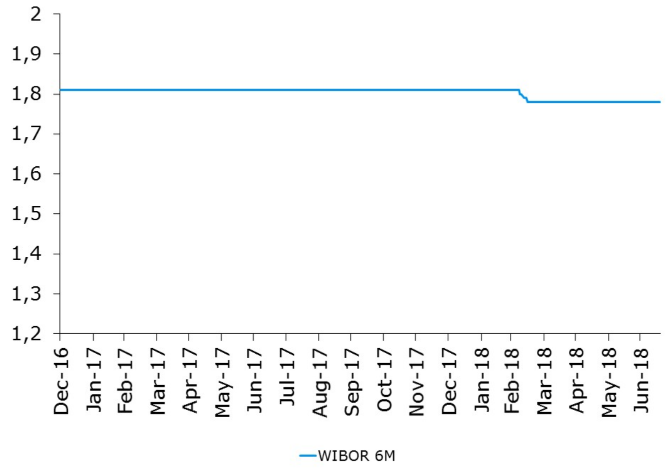
Our almighty range

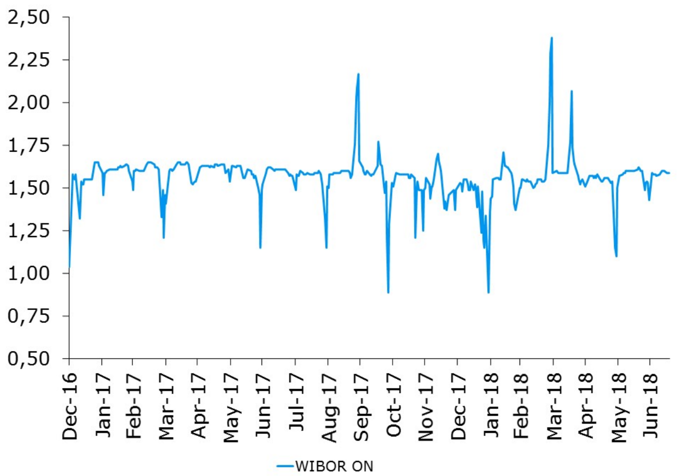
Slightly lower CPI projection plus better sentiment abroad helped to push the Polish yield curve lower. We touched 2.40% on the 5y swap, the "mid" of current range. Yesterday, one of the MPC members (Ancyparowicz) came up with an idea of stable rates until 2022. Contradicting this were today's morning comments from Gatnar and Zubelewicz, stating that MPC should not wait too long with rate hikes. This supports our view about range trading on Polish rates. There is a risk that this range would become very tight encouraging market participants to build enormous positions. Stops in such a scenario would amplify the move.

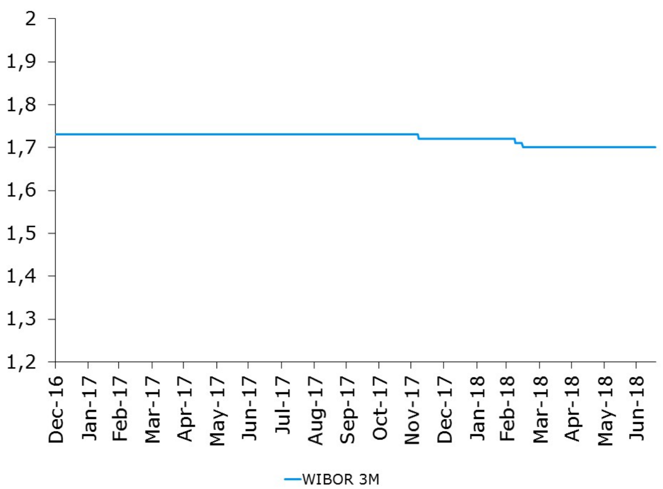
Another boring week on money markets. Cash was stable around 1.50%. Next week we have volatility coming up due to PS0718 redemption and July coupons payment.

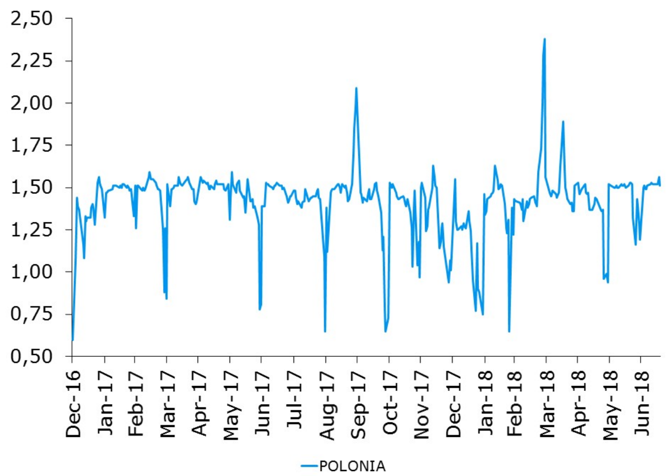
Ref rate vs Polonia averages:

30 day	6 bps
90 day	6 bps



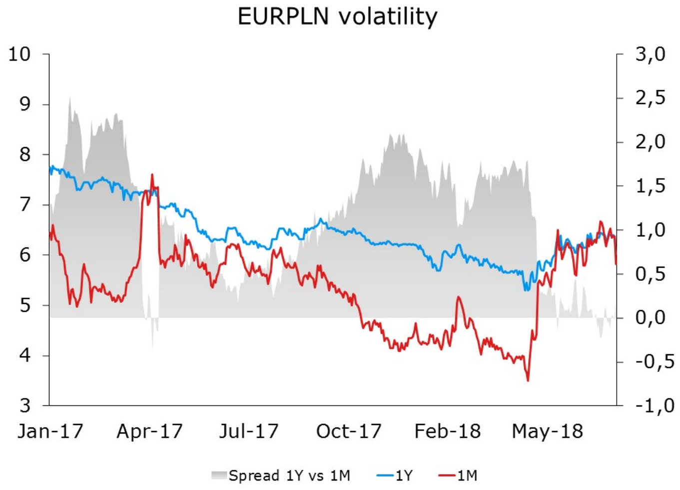






Forex

Spot – Consolidation phase The 4.29-4.31 support zone in EUR/PLN held the initial test. EUR/PLN bounced to approximately 4.32 on the renewed USD strength. The range 4.29â€“4.36 is our base case scenario now, but vigilance on the USD is strongly advised. We expect holiday mood to finally get the upper hand, so that EUR/PLN stays within the range with decreasing realized volatility.



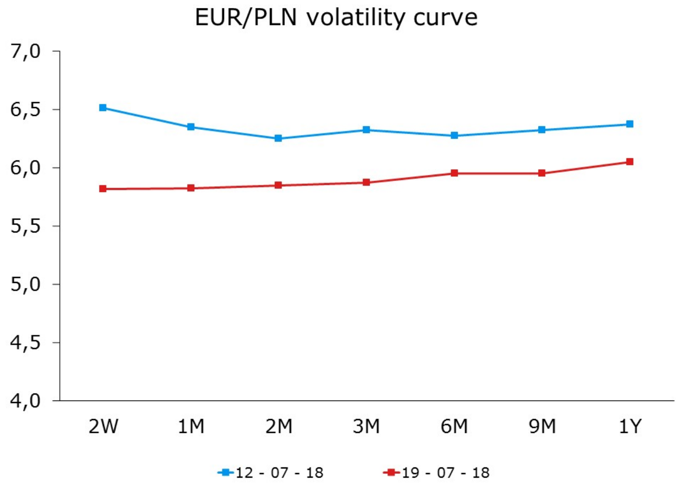
Options – Implied volatilities stable Zloty is stronger than a week ago but implied volatility is not lower – correlation between stronger Zloty and lower volatility isn't working this time. The reason is the really impressive realized volatility – almost every day we see a whipsawing price action – EUR/PLN fluctuated by 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.

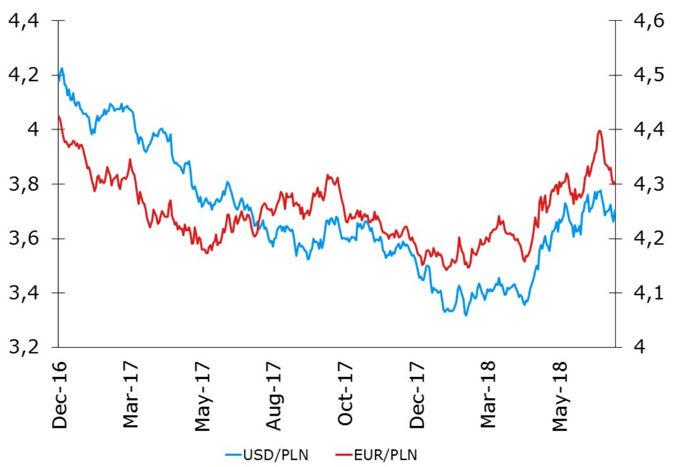
Short-term forecasts

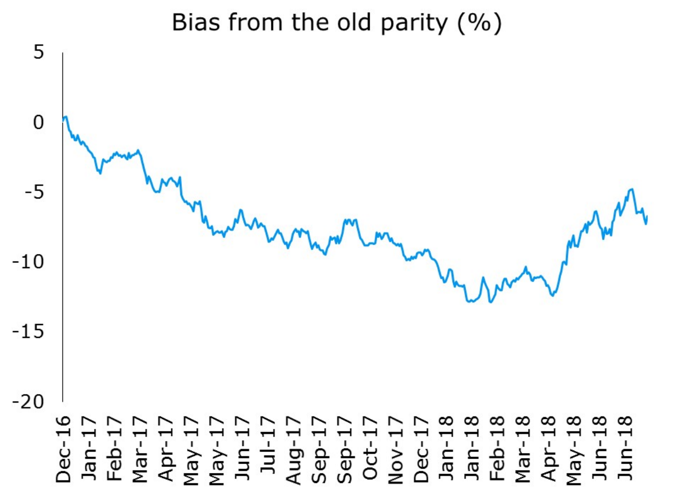
Main supports / resistances:
EUR/PLN: 4.2900 / 4.3700
USD/PLN: 3.6000 / 3.9000

Spot Current position: Neutral.

Our small tactical long from 4.3140 was stopped at 4.3040. Current position – none.







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
7/12/2018	1.79	1.70	1.84	1.68	1.96	1.72	1.71	1.72	1.74	1.79	1.87	1.83
7/15/2018	1.79	1.70	1.82	1.68	1.94	1.72	1.71	1.72	1.75	1.80	1.90	1.84
7/16/2018	1.87	1.70	1.90	1.68	2.03	1.72	1.71	1.72	1.73	1.79	1.86	1.82
7/17/2018	1.49	1.70	1.58	1.68	1.62	1.72	1.71	1.71	1.74	1.77	1.83	1.82
7/18/2018	1.78	1.70	1.83	1.68	1.95	1.72	1.71	1.72	1.74	1.78	1.85	1.82

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
7/12/2018	1.720	1.388	1.935	1.639	2.460	2.537	2.935	3.204
7/15/2018	1.720	1.403	1.938	1.630	2.470	2.526	2.945	3.174
7/16/2018	1.720	1.398	1.886	1.624	2.442	2.526	2.917	3.170
7/17/2018	1.720	1.403	1.860	1.612	2.390	2.456	2.858	3.079
7/18/2018	1.720	1.428	1.857	1.623	2.388	2.487	2.827	3.119

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
7/12/2018	6.35	6.33	6.28	6.38	6.38	1.48	0.55
7/15/2018	6.38	6.28	6.28	6.40	6.40	1.48	0.55
7/16/2018	6.38	6.23	6.25	6.35	6.35	1.46	0.55
7/17/2018	5.83	5.85	5.88	6.03	6.03	1.50	0.56
7/18/2018	5.83	5.88	5.95	6.05	6.05	1.48	0.56

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
7/12/2018	4.3262	3.7055	3.7159	3.2974	1.3302	0.1669
7/15/2018	4.3302	3.7244	3.7118	3.3036	1.3339	0.1670
7/16/2018	4.3076	3.6828	3.6816	3.2741	1.3372	0.1665
7/17/2018	4.2998	3.6619	3.6850	3.2594	1.3318	0.1663
7/18/2018	4.3036	3.7031	3.6941	3.2759	1.3289	0.1665

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