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Polish Weekly Review

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Table of contents

Our view in a nutshell

Economics

■ GDP rose by more than 5% y/y, while CPI inflation stabilized at 2.0% y/y.

Fixed income

■ Back to school

Money market

■ Not a passenger on the Orient Express

FX market

■ Spot – EUR/PLN bounced from support

■ Options – Implied volatility exploded

Comment on the upcoming data and forecasts

This Friday Statistics Poland (SP) will publish monthly labor market data. While employment growth likely fell a bit, wages have accelerated in July to a new cyclical high in y/y terms (from 7.5 to 8.0%). Next week starts with real sphere data. Industrial production accelerated in July to 11.5% from 6.8% in June fueled by calendar and base effects. Statistical base had the opposite effect when it comes to construction output – yearly index should drop slightly below 20%. Producer prices continue to grow, but higher release (3.9% after 3.7%) is merely a result of upward revision of the previous month reading, while in July itself changes in most categories balance each other. On Wednesday SP will publish data about retail sales. Despite strong car sales, yearly growth rate slowed down slightly both in nominal and real terms. On Thursday NBP will publish M3 money supply data, it should grow at an even faster pace than a month ago driven by households' deposits. Week ends with SP publishing its monthly Statistical Bulletin. According to preliminary data (published earlier this month by MFLSP) unemployment rate stabilized at 5.9%, in line with our initial forecast.

Polish data to watch: August 17th to August 24th

| Publication | Date | Period | mBank | Consensus | Prior |
|-----------------------------|-------|--------|-------|-----------|-------|
| Average gross wage y/y (%) | 17.08 | Jul | 8.0 | 7.7 | 7.5 |
| Employment y/y (%) | 17.08 | Jul | 3.6 | 3.6 | 3.7 |
| Industrial output y/y (%) | 20.08 | Jul | 11.5 | 9.8 | 6.8 |
| Construction output y/y (%) | 20.08 | Jul | 19.6 | 22.4 | 24.7 |
| PPI y/y (%) | 20.08 | Jul | 3.9 | 3.5 | 3.7 |
| Retail sales y/y (%) | 22.08 | Jul | 10.0 | 9.3 | 10.3 |
| M3 money supply y/y (%) | 23.08 | Jul | 7.6 | 7.3 | 7.3 |
| Unemployment rate (%) | 24.08 | Jul | 5.9 | 5.9 | 5.9 |

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 | 8/23/2018 | 1000 | 1.592 | 7/27/2018 |
| 5Y T-bond PS1023 | 8/23/2018 | 2300 | 2.335 | 7/27/2018 |
| 10Y T-bond WS0428 | 8/23/2018 | 1300 | 3.144 | 7/27/2018 |
| 30Y T-bond WS0447 | 8/23/2018 | 180 | 3.495 | 7/27/2018 |

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



Comment

Both flash GDP and final CPI came in line with market expectations, so Polish surprise index remained unchanged. This shouldn't last long since next week brings a plethora of publications from labour market through real sphere to retail sales.

* 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 at least 5%. 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 reach 2% in the summer, before dropping back towards 1.5% towards year end. The key driver are fuel and food prices. The former ceased to grow and base effects are considerable, the latter are 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.
- The relief rally in the PLN is likely over. Either risk off mood returns to the market, or optimism (and – along with it – interest rates) rises considerably. In either case the PLN will be impacted negatively. With the MPC dead-set on keeping rates low, the only path to stronger PLN runs through lower interest rate / easier monetary policy expectations globally.
- 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 | 5.0 | 4.1 |
| 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 |

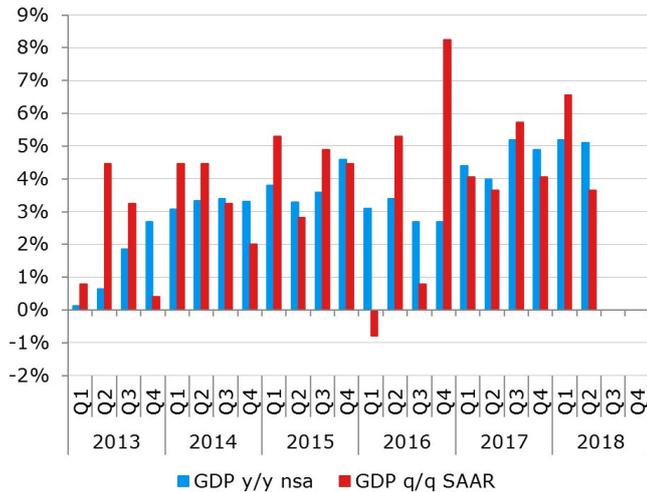
| | 2018 Q1 | 2018 Q2 F | 2018 Q3 F | 2018 Q4 F | 2019 Q1 F | 2019 Q2 F | 2019 Q3 F | 2019 Q4 F |
|--------------------------------|---------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| GDP y/y (%) | 5.2 | 5.1 | 4.8 | 4.7 | 4.4 | 4.2 | 4.0 | 3.7 |
| Individual 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 | 8.9 | 8.5 | 7.0 | 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 | 5.9 | 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 | 4.35 | 4.35 | 4.35 | 4.30 | 4.25 | 4.20 |
| USD/PLN (eop) | 3.42 | 3.74 | 3.78 | 3.78 | 3.75 | 3.68 | 3.60 | 3.51 |

F - forecast

Economics

GDP rose by more than 5% y/y, while CPI inflation stabilized at 2.0% y/y.

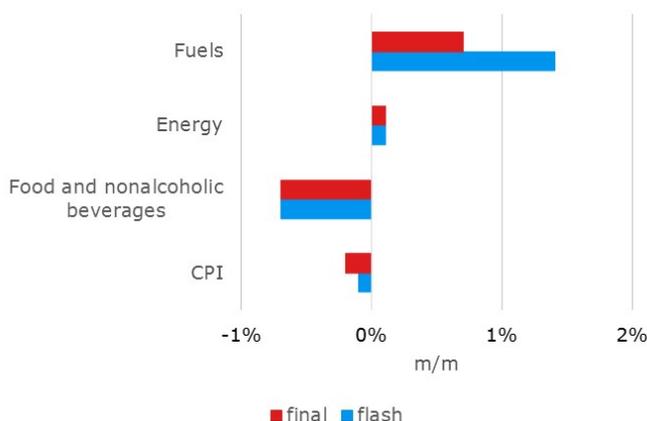
According to the flash estimate, **Q2 GDP** rose by 5.1% y/y, roughly in line with market consensus and below our optimistic forecast of 5.4% y/y. On a sequential basis, GDP decelerated from 1.6 to 0.9% q/q, but its pace remained brisk.



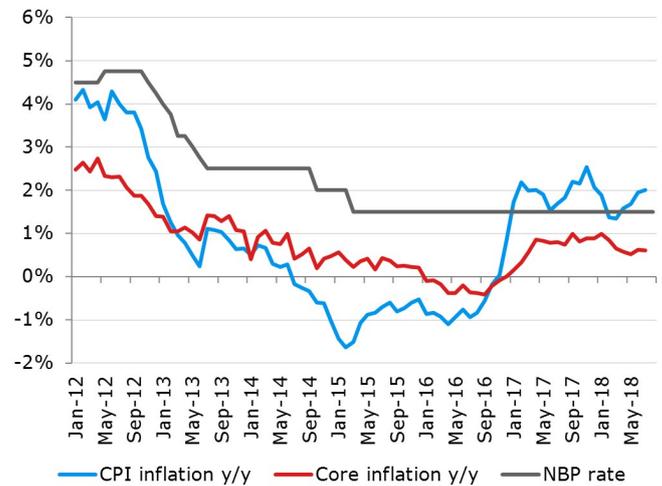
The details of the release will be made available in two weeks, but there are several conjectures to be shared. First, household consumption is unlikely to be the cause of the surprise – historically, the Easter effects that weighed so heavily on Q2 retail sales have not impacted overall household spending. Hence we continue to see 4.8% growth in this category. Second, investment spending likely accelerated a bit vis-a-vis the first quarter (our forecast: 9% y/y). Third, the highly residual categories should be seen as a prime suspect, most of all inventories which remain painfully difficult to estimate on the basis of monthly data.

CPI inflation held steady at 2.0% y/y, just as the flash estimate indicated two weeks ago. However, the monthly change in the CPI was revised downwards, from -0.1 to 0.2% m/m and we calculate that the y/y reading must have come very close to being revised as well.

Comparison of flash and final July CPI estimates



The details of the release bring several small surprises. While the prices of food and nonalcoholic beverages were unchanged from the flash reading (-0.7% m/m) and residential energy prices rose by a small amount (0.1% m/m), fuel price growth was revised downward from 1.4 to 0.7% m/m. Among core categories one should single out slightly more expensive clothing and footwear items as well as alcoholic beverages. However, the two biggest surprises are Recreation and culture as well as the Other goods and services categories (+1.8 and -0.6%, respectively). The former is due to more expensive package holidays (its seasonality is clearly converging to Western European standards), the latter – to cheaper insurance (by 3.3% m/m). All in all, core inflation likely held steady at 0.6% y/y, below consensus and line with our forecast. It should be stressed again that no signs of endogenous price pressures can be detected at present in the Polish CPI data. In the coming months (depending on food prices, August inflation might be similar or slightly lower) inflation is set to fall on strong base effects in fuels and food. We forecast that it will reach 1.3% y/y in December.



The data will be seen as neutral by the MPC. Fast, non-inflationary growth is a confirmation of the Council's enduring optimism, not a cause for concern – even constant surprises vis-a-vis the NBP's projections do not change this. The status quo within the Council can only change if inflation (especially core) surprises to the upside and rises considerably. Despite the near-constant stream of downside surprises in core inflation, we continue to forecast that it will rise later this year and in 2019. Its rise, by pushing the likelihood of overall inflation overshoot, should change the MPC's stance in late 2019 and force it to embark on a gentle tightening cycle, starting with one hike at the end of 2019.

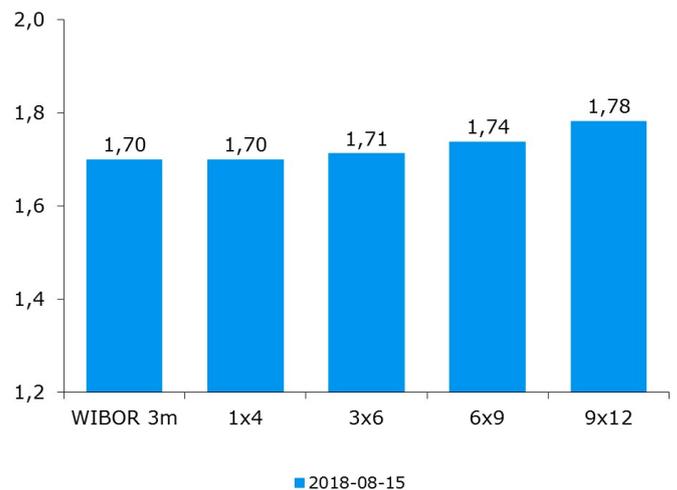
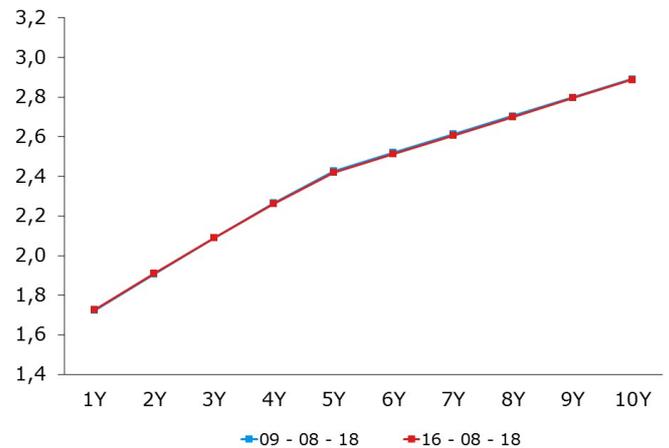
Fixed income

Back to school

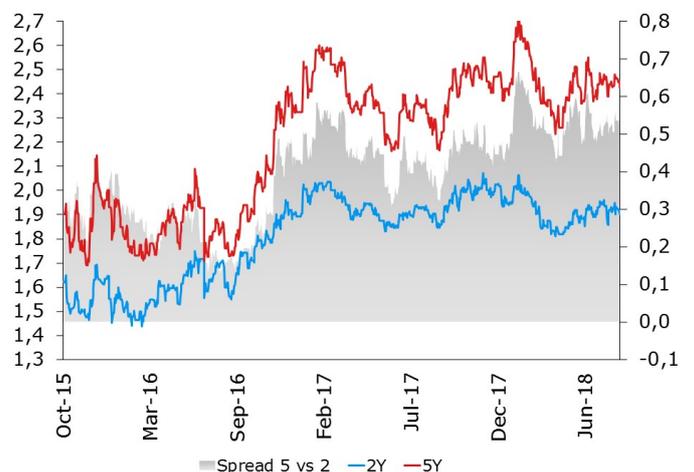
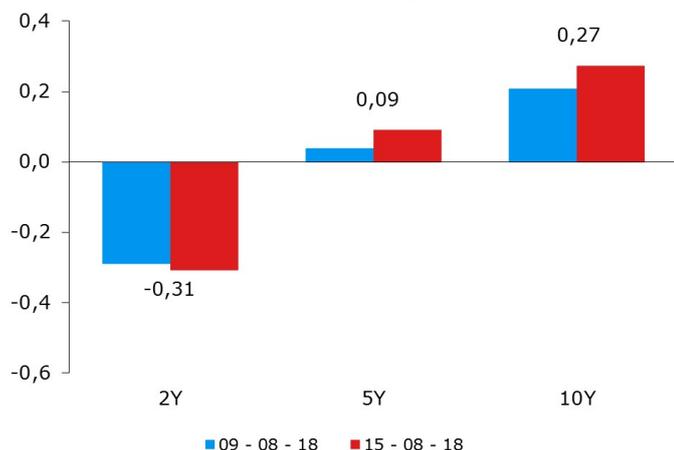
Finally, Polish bonds have moved and holiday mood is over. Everyone is watching TRYUSD, that's the trigger for every move we have seen lately. POLGBs are consequently being traded somewhere between EM and core markets, so sell-off wasn't as aggressive as we expected, but it happened and yields are 5-10bps higher. IRS curve is not moving so ASWs suffered a bit.

PS0123/5y is -4 bps, WS0428/10y is 29 bps. PS0123/WS0428 is 81 bps. WS0428/Bund is 288 bps. OK0720 is trading at 1.6% (2 bps up), PS0123 is trading at 2.38% (8 bps up) and WS0428 is trading at 3.19% (9 bps up).

IRS curve



Asset swaps





Money market

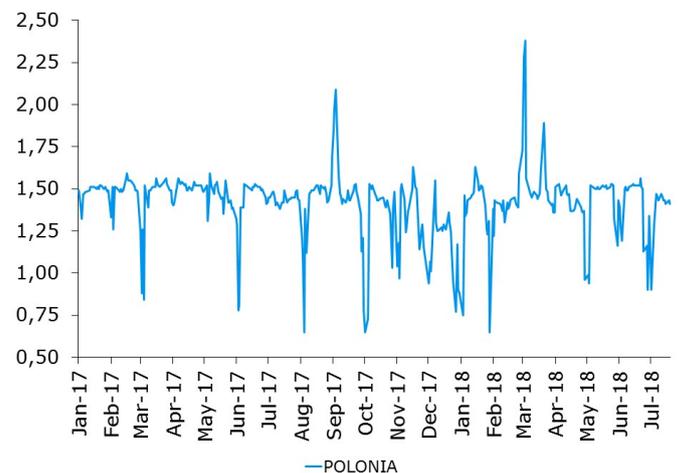
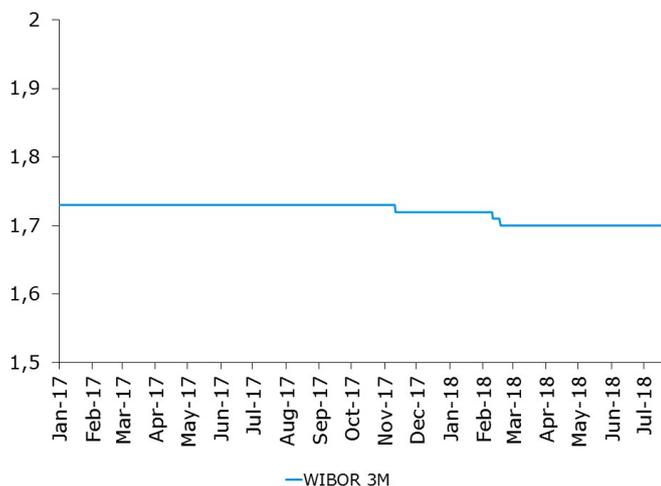
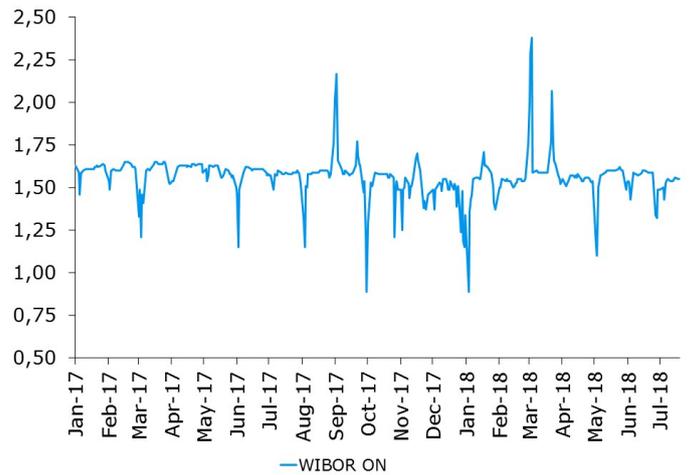
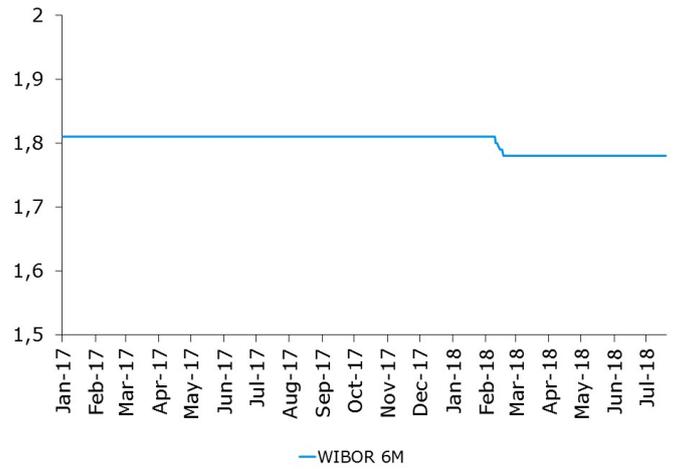
Not a passenger on the Orient Express

Full-on summer mode. Polish rates didn't move while Turkey was collapsing, so they don't move with TRY rebounding neither. Bonds and swaps stayed in a tight range not exceeding 5 bps. We spotted a triangle formation on Polish 5Y swap which should end on the brink of August and September. So keep in mind that Autumn may bring some volatility back.

Overnight market is very illiquid. Market participants stay rather aside.

Ref rate vs Polonia averages:

30 day 18 bps
90 day 12 bps



Forex

Spot – EUR/PLN bounced from support TRY set all EM on fire again. EUR/PLN spiked from the lazy summer trading just above 4.26 support to 4.3440. In fairness, the high on EUR/PLN happened on August 15th, which was a Polish holiday and the thin liquidity was adding fuel to the move. It corrected itself lower on the day after, going back to 4.30ish, which now acts as a support. We are still firmly in a wider 4.26-4.36 range and our strategy is still to play this formation.

Options – Implied volatility exploded The vols gapped higher! 1 month EUR/PLN ATM mid is this Thursday at 7.0% (1.3% higher!), but during the week it was traded even at 7.25% in good amount. 3 months EUR/PLN mid are 7.0% (1.1% higher), 1 year is 6.75% (0.75% higher). This is a significant move and not really based on realized volatilities. The main reason for such move was higher global risk perception brought by the crisis in Turkey. The skew was bid tic better as well as the currency spread (difference between USD/PLN vol and EUR/PLN vol).

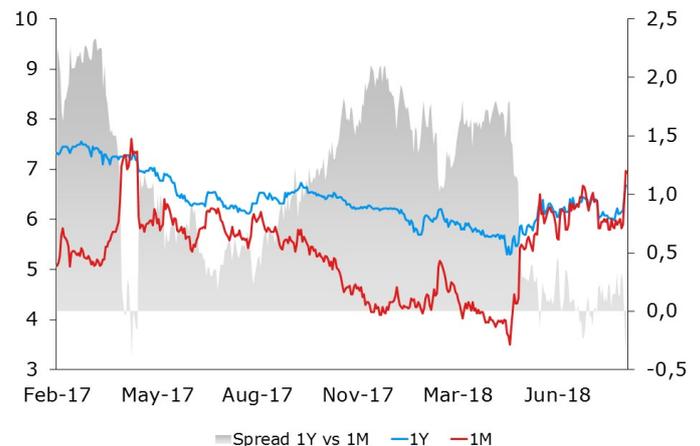
Short-term forecasts

Main supports / resistances:
 EUR/PLN: 4.2600 / 4.3600
 USD/PLN: 3.6000 / 3.9000

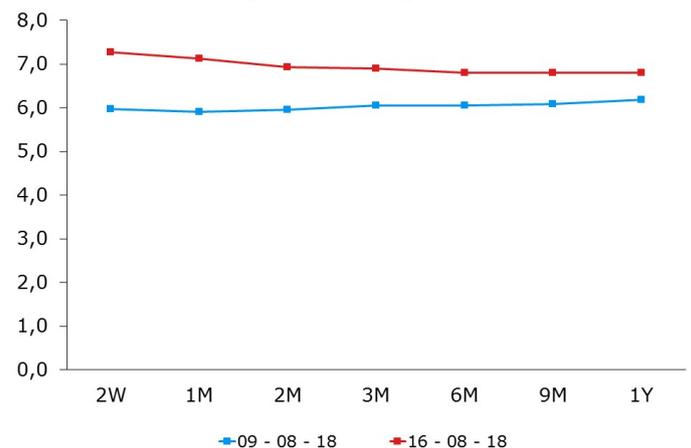
Spot Long EUR/PLN from 4.2700 was closed at 4.3400.
 Current position: None.

We think that 4.26-4.36 is the most likely scenario for now. We will try to tactically play that range, we don't have any skew in mind. On one hand decent Polish fundamentals may be the reason to go long PLN, on the other hand if contagion continues PLN will not be spared.

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 |
| 8/9/2018 | 1.77 | 1.70 | 1.88 | 1.68 | 1.98 | 1.72 | 1.70 | 1.71 | 1.74 | 1.78 | 1.85 | 1.81 |
| 8/12/2018 | 1.89 | 1.70 | 1.99 | 1.68 | 2.06 | 1.72 | 1.70 | 1.71 | 1.73 | 1.79 | 1.87 | 1.82 |
| 8/13/2018 | 1.81 | 1.70 | 1.93 | 1.68 | 2.00 | 1.72 | 1.70 | 1.72 | 1.74 | 1.79 | 1.85 | 1.83 |
| 8/14/2018 | 1.49 | 1.70 | 1.58 | 1.68 | 1.62 | 1.72 | 1.70 | 1.71 | 1.74 | 1.78 | 1.84 | 1.82 |
| 8/15/2018 | 1.82 | 1.70 | 1.92 | 1.68 | 2.02 | 1.72 | 1.70 | 1.71 | 1.74 | 1.78 | 1.84 | 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 | 7/27/2018 | 7/25/2020 | 96.91 | 1.59 | 1000 | 1780 | 1180 |
| PS0123 | 7/27/2018 | 1/25/2023 | 100.68 | 2.34 | 2300 | 3260 | 2275 |
| WS0428 | 7/27/2018 | 4/25/2028 | 96.71 | 3.14 | 1300 | 2133 | 1348 |

| Fixed income market rates (closing mid-market levels) | | | | | | | | |
|---|----------|-----------|--------|--------|--------|--------|---------|--------|
| Date | 1Y WIBOR | 1Y T-bill | 2Y IRS | OK0720 | 5Y IRS | PS0423 | 10Y IRS | WS0428 |
| 8/9/2018 | 1.720 | 1.367 | 1.905 | 1.616 | 2.425 | 2.463 | 2.893 | 3.100 |
| 8/12/2018 | 1.720 | 1.361 | 1.913 | 1.616 | 2.435 | 2.499 | 2.915 | 3.139 |
| 8/13/2018 | 1.720 | 1.371 | 1.915 | 1.619 | 2.445 | 2.511 | 2.915 | 3.151 |
| 8/14/2018 | 1.720 | 1.372 | 1.910 | 1.602 | 2.418 | 2.508 | 2.888 | 3.159 |
| 8/15/2018 | 1.720 | 1.372 | 1.910 | 1.602 | 2.418 | 2.508 | 2.888 | 3.159 |

| EUR/PLN 0-delta stradle | | | | | 25-delta RR | | 25-delta FLY |
|-------------------------|------|------|------|------|-------------|------|--------------|
| Date | 1M | 3M | 6M | 1Y | 1M | 1Y | 1Y |
| 8/9/2018 | 5.90 | 6.05 | 6.05 | 6.18 | 6.18 | 1.58 | 0.57 |
| 8/12/2018 | 6.45 | 6.45 | 6.45 | 6.48 | 6.48 | 1.58 | 0.57 |
| 8/13/2018 | 6.98 | 6.75 | 6.68 | 6.68 | 6.68 | 1.59 | 0.59 |
| 8/14/2018 | 6.93 | 6.73 | 6.65 | 6.68 | 6.68 | 1.73 | 0.58 |
| 8/15/2018 | 7.13 | 6.90 | 6.80 | 6.80 | 6.80 | 1.78 | 0.59 |

| PLN Spot performance | | | | | | |
|----------------------|--------|--------|--------|--------|--------|--------|
| Date | EURPLN | USDPLN | CHFPLN | JPYPLN | HUFPLN | CZKPLN |
| 8/9/2018 | 4.2715 | 3.6846 | 3.7068 | 3.3156 | 1.3346 | 0.1668 |
| 8/12/2018 | 4.2942 | 3.7481 | 3.7697 | 3.3807 | 1.3310 | 0.1676 |
| 8/13/2018 | 4.3094 | 3.7862 | 3.8054 | 3.4304 | 1.3294 | 0.1678 |
| 8/14/2018 | 4.3001 | 3.7768 | 3.8027 | 3.4012 | 1.3299 | 0.1673 |
| 8/15/2018 | 0.0000 | 0.0000 | 3.8027 | 3.4012 | 1.3299 | 0.1673 |

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