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Polish Weekly Review

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Comment on the upcoming data and forecasts

On Thursday Statistics Poland will publish its final estimate of CPI inflation along with extensive details behind the number. The flash reading (2.0% y/y, compared to market consensus at 1.9% y/y and our forecast of 1.8% y/y) will likely be confirmed, just as our suspicions regarding the source of the surprise will be. Core inflation accelerated markedly in August and final CPI data will shed light on the nature of this development. The NBP's official release of core CPI data is next Friday. Also on Thursday, the NBP will publish monthly balance of payments statistics (for July). We expect CA deficit to widen somewhat due to larger trade deficit. The latter is a result of strong imports and relatively weak exports.

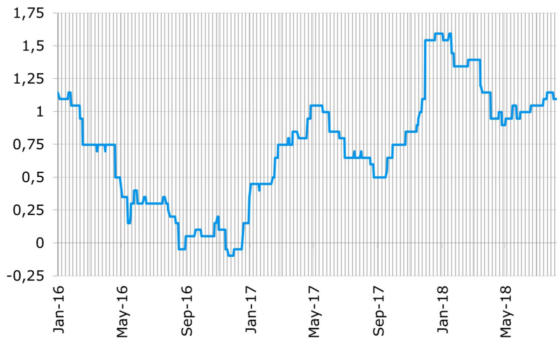
Polish data to watch: September 7th to September 14th

Publication	Date	Period	mBank	Consensus	Prior
Current account (mio EUR)	13.09	Jul	-969	-413	-240
Exports (mio EUR)	13.09	Jul	16700	17129	18071
Imports (mio EUR)	13.09	Jul	17500	17502	18484
CPI *final* y/y (%)	13.09	Aug	2.0	2.0	2.0
Core CPI y/y (%)	14.09	Aug	0.8	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	10/4/2018	250	1.610	9/6/2018
5Y T-bond PS1023	10/4/2018	1500	2.460	9/6/2018
10Y T-bond WS0428	10/4/2018	1000	3.249	9/6/2018
30Y T-bond WS0447	10/4/2018	180	3.495	7/27/2018

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



Comment

Up after flash CPI, but down after the PMI (more information about this surprise can be found in the Economics section), hence Polish surprise index has been unchanged on a weekly basis. Next week brings only one remote possibility of surprise - final CPI 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 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 likely peaked at 2% in the summer months and will drop back towards 1.5% by 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.
- Risk off mood impacted the PLN negatively and better sentiment may only bring a transient relief rally. 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. Therefore, the floor on EURPLN is quite high by historical standards.
- Thus, 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	1.7	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	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	4.9	4.8	4.2	4.0	3.8	3.8	3.8
Public Consumption y/y (%)	3.6	4.4	4.0	4.0	2.0	2.0	2.0	2.0
Investment y/y (%)	8.1	4.5	6.5	7.0	7.0	6.0	5.0	4.0
Inflation rate (% average)	1.5	1.7	2.0	1.5	1.9	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	4.40	4.35	4.30	4.25	4.20
USD/PLN (eop)	3.42	3.74	3.78	3.83	3.75	3.68	3.60	3.51

F - forecast

Economics

MPC: Interest rates and rhetoric unchanged

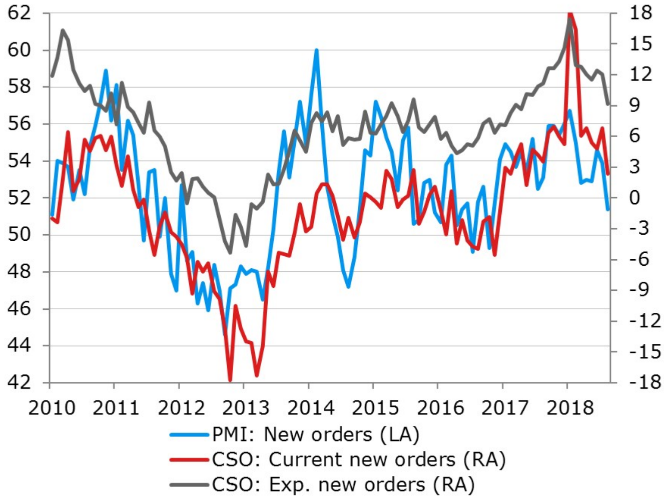
The Monetary Policy Council, during their September meeting, decided to keep the interest rates on hold; also, the press release was barely changed. Its ending still describes the current level of interest rates as ”conducive to keeping the Polish economy on a sustainable growth path and maintaining macroeconomic stability”.

According to expectations, president Glapinski, during the press conference, voiced the opinions well-known to all observers of Polish monetary policy: positive perspectives of Polish economic situation, despite the gentle slowdown expected in the next quarters; worsening of the external environment; relatively low inflation within the forecast horizon; lack of any remarkable increase of the core inflation; no-alarming labor market without any impact on the price pressure. Some confusing information was slipped in the MPC’s forward guidance, but we get an impression that fundamentally nothing changed. The ”official” announcement indicates the whole 2019 as a period of interest rates stabilization; the ”personal” preferences of the president included also 2020. The only new and interesting topic concerned the dynamics of investment, and hypotheses, formulated by the MPC members, that reported investment growth could be biased by the changes in financing and bookkeeping. We can expect that those subjects will be more deeply described in the November editions of Inflation Report and Quick Monitoring Survey.

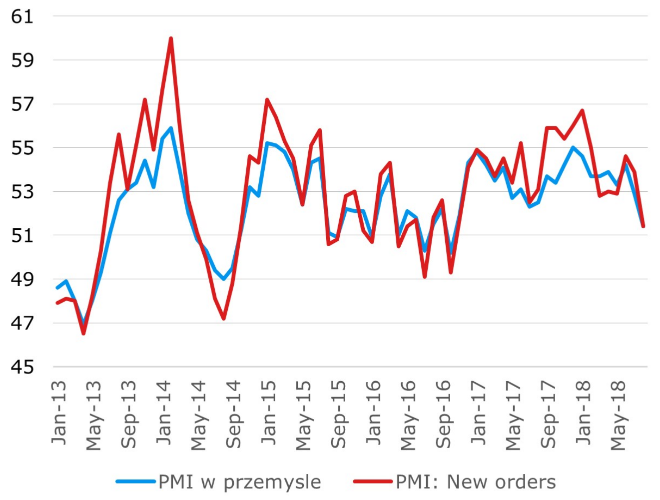
As we stressed many times, the status quo within the MPC can be changed only as a result of an increase in inflation, especially the core inflation. It will change the balance of risks for inflation and strengthen the arguments of ”classical economists” concerning the risk of exceeding the target in case of a negative shock to food or energy prices. It is worth remembering that current MPC did not have any opportunity to make decisions in situation of high core inflation, and we should be aware of the possible dynamic inconsistency (current MPC beliefs about its future reaction function may not be consistent with the actually realized one).

Continuation of the slowdown in Polish manufacturing

In September, the PMI index for Polish manufacturing fell from 52.9 to 51.4. Forecasts assumed that the companies’ sentiment would improve slightly (consensus – 53.0, our forecast – 53.6). Although the Polish PMI did not follow German economic sentiment indexes, it behaved in a similar way to the business tendency indexes released by CSO and EC (declines of sub-indices analogous to PMI components).



Detailed data are alarmingly consistent. Estimates of new orders, output and employment declined. The assessment of employment is at its lowest level for 9 months, new orders and output were estimated so low in September 2016. It is worth noticing that new export orders are at their lowest level since July 2014, the peak of fears concerning the economic troubles of Ukraine and Russia. According to the comment released with the PMI, the positive demand shock has already gone through the Polish industry and the pressure on companies’ production capacity has fallen (more intuitively the hump of new orders from the turn of the year has already been processed). Backlogs of work declined again, and suppliers’ delivery time in September rose at the lowest rate since October 2017. At the same time, wage and cost pressure fell moderately, and corresponding PMI sub-indices are still at a relatively high level (but we cannot see it in the PPI data).



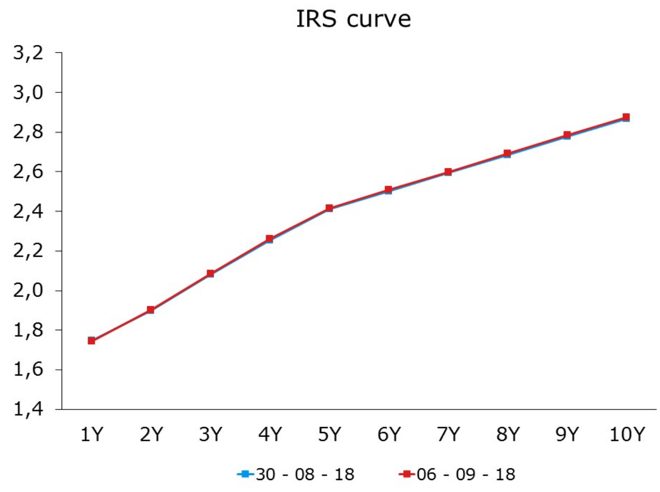
As we noticed many times, forecasting of the GDP using PMI is a pointless effort. PMI is a quite good indicator of short-term manufacturing fluctuations and clearly suggests that its momentum is near zero. This fact, given strong consumption and construction spending is a symptom of weakness in foreign demand (mostly) and machinery and equipment investment (partly). It confirms our hypothesis concerning economic growth in next quarters. GDP, driven by private consumption, will collide with a limited supply from domestic producers. Lack of the working capacity will lead final goods producers to increase the intensity of import in their production, therefore it will widen the trade balance. Negative contribution of net exports will be one of the main reasons for the GDP slowdown in the next half of the year. Interestingly, PMI signals suggest that it can be accompanied by higher inflation, however the impact of higher producer prices on the CPI is small, due to low weight of domestically produced consumer goods in the overall basket.

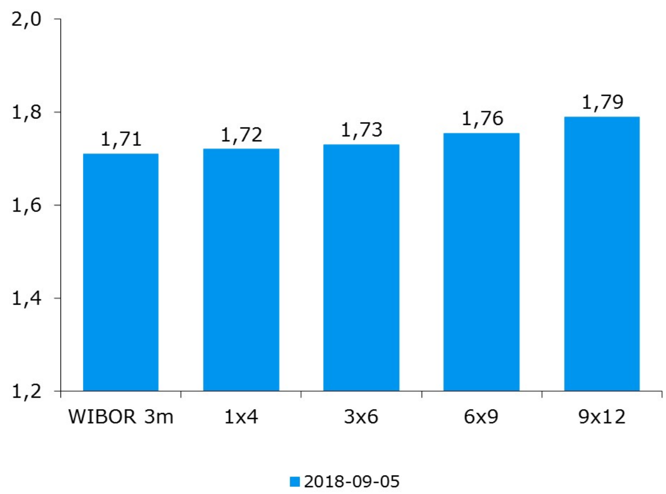
Fixed income

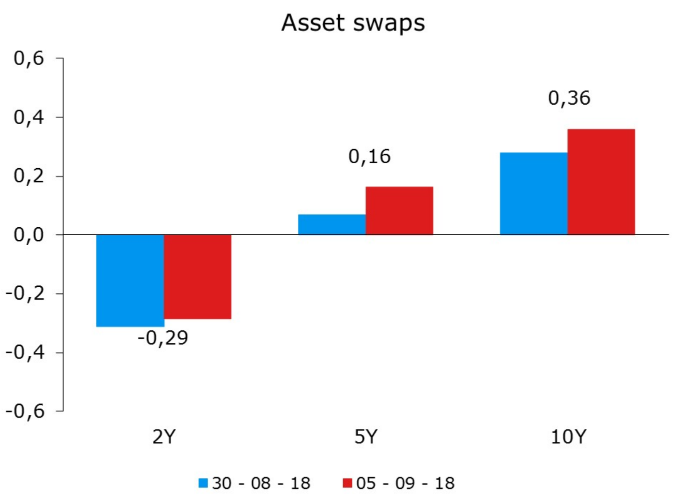
Feel the flow

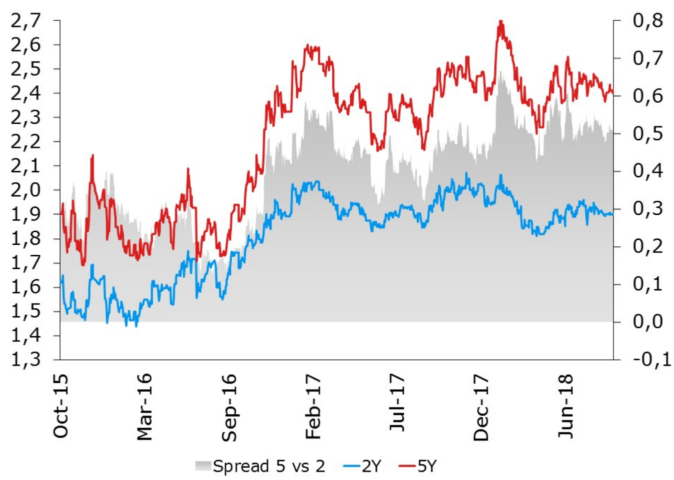
The predicament of some entities on mutual funds market takes it toll. Huge outflows caused a small sell-off, but in the end Ministry added fuel to the fire with its supply. Today, at the auction, Ministry of Finance sold 4 bn of bonds, it's not much, but market was already long in bonds. We touched 3.3% on WS0428 and it proved to be a good support in the past. Last sell-off was driven only by a flow that is over now. ASW are extremely wide, DS1023/5y especially.

DS1023/5y is 15 bps, WS0428/10y is 35 bps. DS1023/WS0428 is 67 bps. WS0428/Bund is 290 bps. DS1020 is trading at 1.63% (6 bps up), DS1023 is trading at 2.61% (14 bps up) and WS0428 is trading at 3.28% (15 bps up).





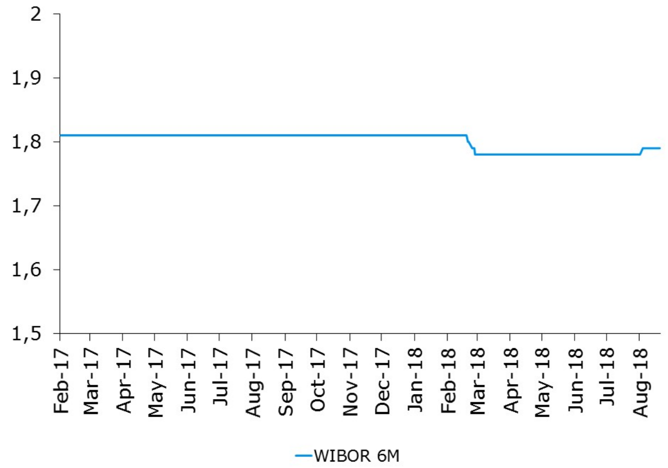


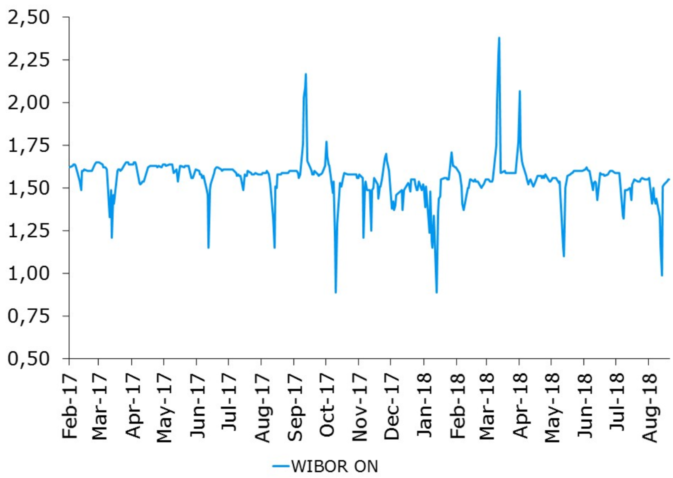


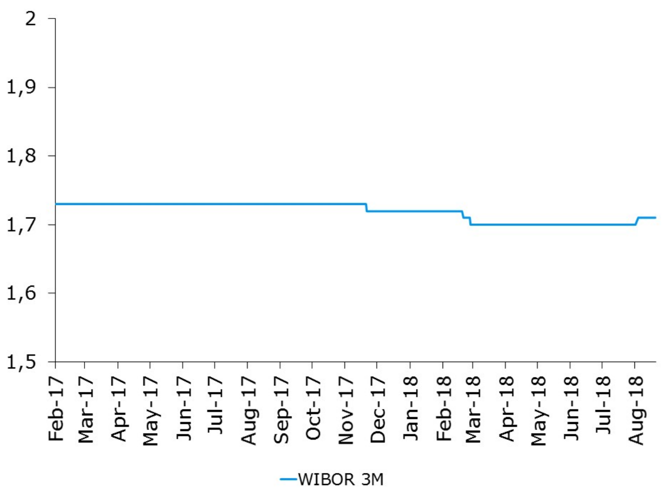
Money market

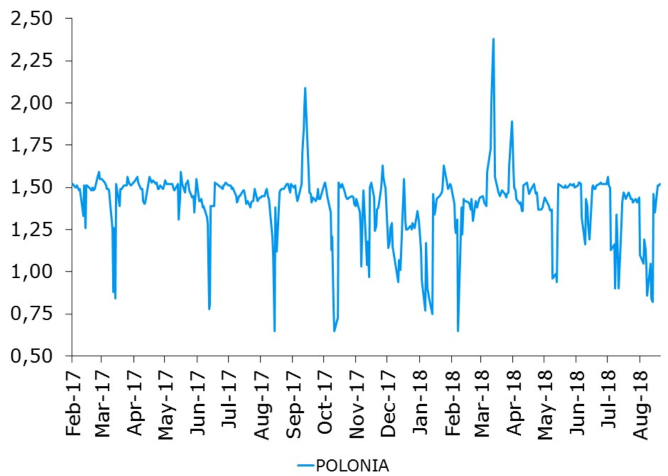
Stable week behind us

It was the first week of mandatory reserve and Polonia rate fluctuated around 1.50% for the whole week, as we had expected. On Friday's OMO banks bought PLN 83.3 bn of bills out of 86 bn offered. Tomorrow we will have a regular OMO and we do not expect any special move on next week founding, Polonia should remain on this week's level of 1.50/53.





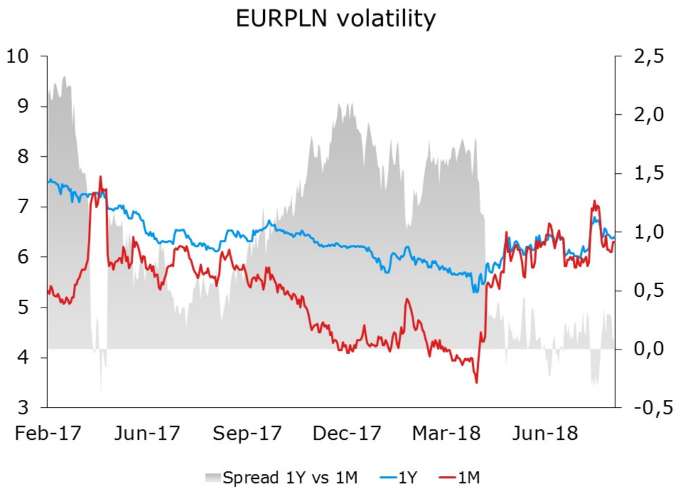




Forex

Spot – at the top of the range The escalating trade tensions between the United States and its trading partners are still casting shadows on emerging markets. The zloty is no exception and the dovish MPC did not provide any support to the PLN. EUR/PLN, from the lazy summer trading just above 4.26 support, spiked to 3.34 before correcting to 4.32-ish. We would expect the PLN losses to at least slow its pace in the near future and the wider 4.26-36 range seems likely.

Options – volatility higher The weaker PLN inevitably led to the higher volatilities in EUR/PLN and USD/PLN. The front end was the obvious winner as market participants rushed to cover their Gamma short. 1W USDPLN was paid at 12.25! This Thursday, 1 month EUR/PLN ATM mid is at 6.5% (0.4% higher), 3 months mid are 6.45% (0.20% higher), 1 year is 6.5% (0.05% higher). The skew was also in demand as well as the currency spread (difference between USD/PLN vol and EUR/PLN vol) The main reason for such a move was higher global risk perception brought by the outflow of funds from emerging markets.

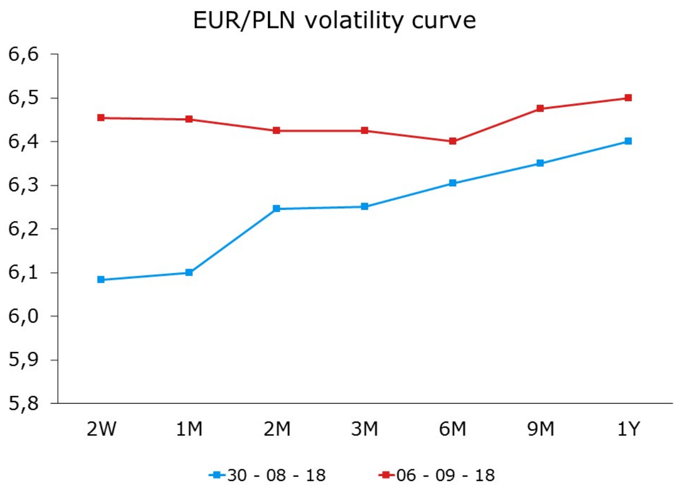


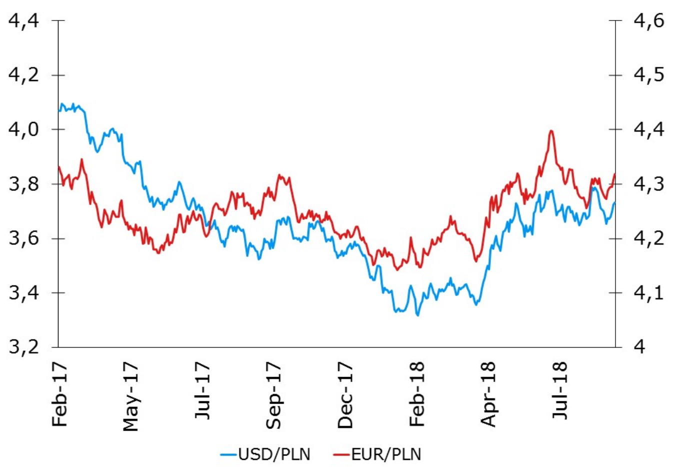
Short-term forecasts

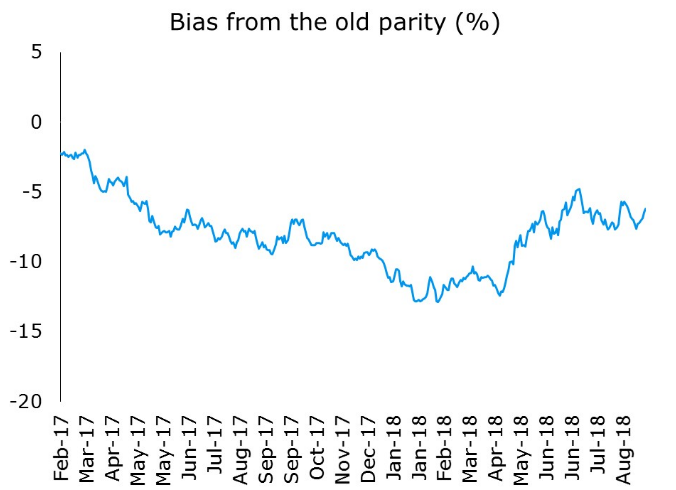
Main supports / resistances:
EUR/PLN: 4.2600 / 4.3600
USD/PLN: 3.6000 / 3.9000

Spot Current position: Short EUR/PLN.

We closed our long in EUR/PLN from 4.2650 at 4.32 and reversed our position to short EUR/PLN at 4.3375. We are ready to add to this short at 4.3550 with the stop at 4.3750. The 4.33/4.35 resistance zone seems to be the pivotal level, so we may revisit the levels below 4.30 relatively quick.







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
8/30/2018	1.65	1.71	1.76	1.69	2.09	1.77	1.73	1.74	1.77	1.80	1.84	1.85
9/2/2018	1.68	1.71	1.76	1.69	1.93	1.77	1.73	1.74	1.77	1.80	1.88	1.85
9/3/2018	1.63	1.71	1.71	1.69	1.74	1.77	1.72	1.74	1.77	1.80	1.84	1.84
9/4/2018	1.53	1.71	1.61	1.69	1.64	1.77	1.73	1.74	1.77	1.81	1.87	1.85
9/5/2018	1.70	1.71	1.81	1.69	1.95	1.77	1.72	1.73	1.76	1.79	1.85	1.84

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	9/6/2018	7/25/2020	97.05	1.61	250	1060	260
PS0123	9/6/2018	1/25/2023	100.14	2.46	1500	2100	1524
WS0428	9/6/2018	4/25/2028	95.90	3.25	1000	1712	1049

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0720	5Y IRS	PS0423	10Y IRS	WS0428
8/30/2018	1.770	1.358	1.898	1.587	2.410	2.479	2.868	3.147
9/2/2018	1.770	1.352	1.902	1.571	2.413	2.523	2.873	3.183
9/3/2018	1.770	1.378	1.902	1.610	2.410	2.561	2.870	3.208
9/4/2018	1.770	1.390	1.898	1.604	2.402	2.554	2.860	3.216
9/5/2018	1.770	1.378	1.900	1.614	2.415	2.577	2.875	3.233

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
8/30/2018	6.10	6.25	6.31	6.40	6.40	1.60	0.56
9/2/2018	6.10	6.25	6.30	6.38	6.38	1.60	0.56
9/3/2018	6.30	6.25	6.28	6.38	6.38	1.66	0.57
9/4/2018	6.30	6.30	6.30	6.40	6.40	1.69	0.59
9/5/2018	6.45	6.43	6.40	6.50	6.50	1.71	0.59

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
8/30/2018	4.2917	3.6724	3.7871	3.2912	1.3140	0.1667
9/2/2018	4.2953	3.6808	3.8033	3.3225	1.3160	0.1669
9/3/2018	4.2954	3.6991	3.8112	3.3322	1.3146	0.1668
9/4/2018	4.3073	3.7241	3.8287	3.3416	1.3143	0.1673
9/5/2018	4.3183	3.7330	3.8301	3.3473	1.3148	0.1677

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