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Polish Weekly Review

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Comment on the upcoming data and forecasts

No relevant data releases are scheduled for the week ahead.

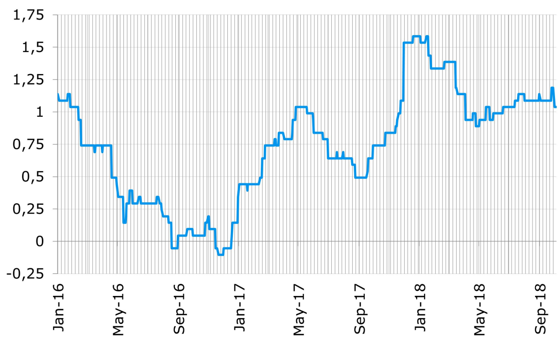
Polish data to watch: October 5th to October 12th

Publication	Date	Period	mBank	Consensus	Prior
NO RELEVANT DATA					

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	10/26/2018	1000	1.517	10/4/2018
5Y T-bond PS0424	10/26/2018	1500	2.732	10/4/2018
10Y T-bond WS0428	10/26/2018	1200	3.303	10/4/2018
30Y T-bond WS0447	10/26/2018	20	3.643	10/4/2010

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



Comment

Due to lower-than-expected PMI and CPI Polish surprise index gave up all its unemployment rate related gains from the previous week. Next week is devoid of any publications, hence the index will remain unchanged.

* 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.
- Recent increases in oil, gas, coal and electricity prices (the latter only in wholesale markets and for corporate & SME clients) are raising the inflation outlook. In particular, base effects in the coming months will not be as strong as previously forecast, inflation will hit the target in early 2018 and there is considerable uncertainty regarding second-round effects of sharply higher electricity prices on consumer goods and services prices. Wages are no longer accelerating, but the wide gap between them and prices should still close if history is a guide.
- MPC stays calm and sees stable rates as having an intrinsic value. 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.
- As a result, 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	4.8	5.0	4.1
CPI Inflation y/y (average %)	-0.1	-0.9	-0.6	2.0	1.7	2.4
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	1.9	1.8	2.2	2.5	2.4	2.4
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	1.72	1.70	1.70	1.71	1.72	1.98
2Y Polish bond yields (% eop)	1.49	1.63	1.56	1.60	1.65	1.85	2.00	2.20
10Y Polish bond yields (% eop)	3.18	3.22	3.24	3.40	3.50	3.59	3.71	3.88
EUR/PLN (eop)	4.21	4.37	4.28	4.40	4.35	4.30	4.25	4.20
USD/PLN (eop)	3.42	3.74	3.69	3.83	3.75	3.68	3.60	3.51

F - forecast

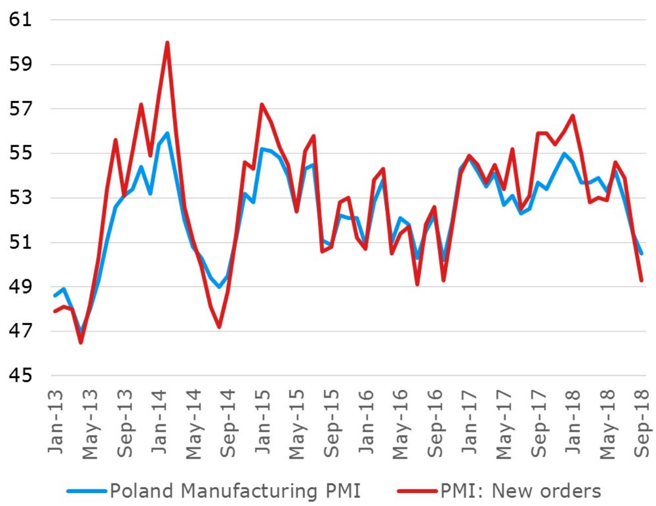
Economics

NBP rates unchanged yet again.

As expected, the MPC kept rates unchanged during the October meeting. There were no notable changes in the MPC's assessment of economic conditions and inflation outlook, as well as the Council's rhetoric. In particular, the NBP governor reiterated his 'personal preference' regarding keeping rates on hold until end-2019. The only interesting topic that arose during the press conference was the issue of higher energy prices. Although the discussion was shifted onto the wrong tracks – instead of talking about the impact of higher electricity prices for companies and prices of fuel for residential heating, global oil markets took most of the time – we are under the impression that the MPC will not be perturbed by any direct effects of higher energy prices on the CPI. Second-round effects are a different matter altogether and considerable uncertainty exists there. As we repeatedly indicated, significantly higher core inflation is about the only factor that can upend the status quo within the Council. Thus, we continue to expect the first rate hike to occur in Q4'19.

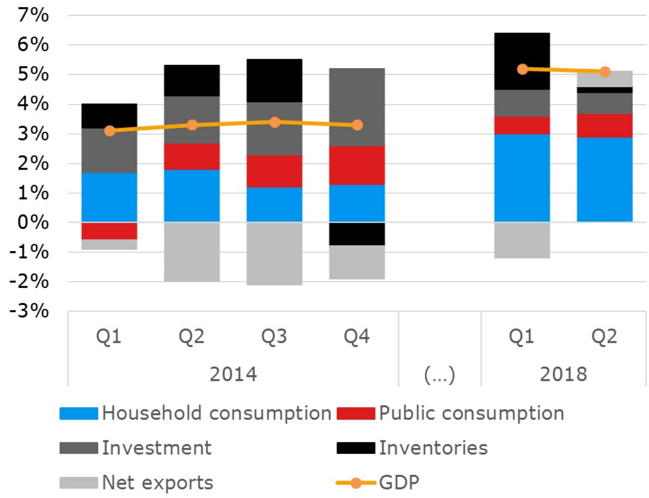
Polish manufacturing slowdown continues.

In September, situation in the Polish manufacturing sector took a negative turn again – the PMI decreased from 51,4 to 50,5 (forecasts suggested its stabilization, we estimated a modest, corrective increase). It is the third decrease in a row and the sequence resembles the last episode of a deep and fast slowdown of polish industry in 2014.



It is not the only resemblance. Just like then, the slowdown of the European manufacturing negatively impacts the Polish industry. In 2014 key factors were economic troubles of Ukraine and Russia and a temporary downturn in the Eurozone; now the main reason of the fall of external demand is the Eurozone manufacturing still slowing down. Similarly as 4 years ago, current episode of PMI declines is associated with both decrease of new orders (subindex was down from 51,4 to 49,3 in September) and strong contraction of export orders (around 46-47 pts). Finally, the details of the reading remain alarmingly consistent (we indicated it also a month ago): lower assessment of production and new orders is associated with weaker labor demand and reduction of production backlogs and lower pressure on suppliers and distribution chains. In consequence, according to the last PMI report, the price pressures seems to decrease as well.

It is worth repeating that manufacturing is not the whole economy, and fluctuations in its activity have not been good predictors of general fluctuations of the economy. It does not mean that PMI says nothing. We can use the analogy with 2014 once again, including the election cycle and its implications on the investment and public consumption. Recall that the drop of the industrial sentiment in 2014 did not translate into any measurable downturn of the GDP – according to both flash and revised data the annual dynamics of the GDP remained stable throughout the year. But, the structure of GDP growth changed drastically in 2014. The decrease in external demand, coupled with solid consumption and investment growth (also the private), translated into a rapid fall of the contribution of net exports, from -0.3 to -2 p.p. by the middle of the year. Higher contribution of inventory change (another deja vu) compensated it fractionally. In this situation, it was the public consumption that turned out to be the knight on a white horse. Its contribution to growth rose from -0.6 p.p. at the beginning of the year to 1.1-1.3 p.p. in the second half of 2014. We cannot fully explain the nature of this acceleration (if it was related to the local and European Parliament elections), however 2014 shows that a strong negative external shock for the manufacturing can be associated with changes of the GDP structure, but does not have to cause a general slowdown in demand.



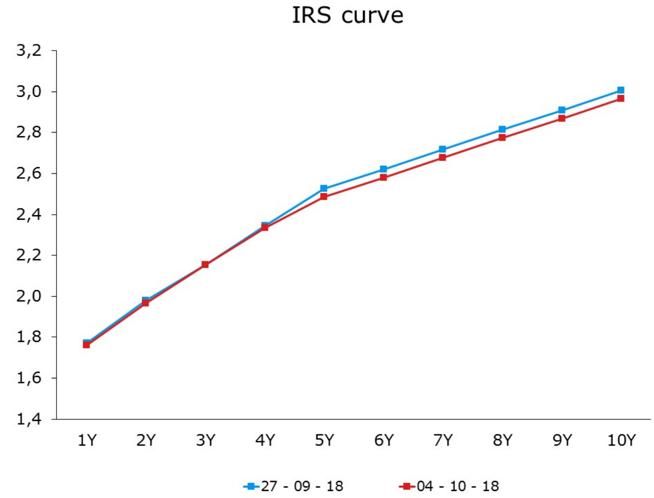
Can such a knight, in context of the electoral cycle, appear once again? Comparisons of the 2018 and 2014 must take into account the completely different cyclical position of the Polish economy. At that time, it barely emerged from a deep and prolonged slowdown in 2012 and in the first half of 2013, the production factors were not fully used (for example, unemployment rate was almost twice as high as today), and firms' inclinations to invest were higher. Now, the economy is struggling with supply constraints and most probably all easily accessible reserves of labor and capital have already been used. Even if a knight on a white horse were to appear, the additional demand would not be absorbed by supply. In a small open economy (which is the Polish case), that operates above its potential, the hypothetical additional demand from public consumption would most probably leak through the current account, lowering the contribution of net export even more sharply than in 2014. In consequence, in our opinion, lower GDP growth in the 2nd half of the year is unavoidable and the PMI simply confirms this scenario. However, it is not a controversial conclusion. Much more interesting question concerns 2019 – whether the growth will be closer to 3% or 4% y/y. The question remains unanswered and the consensus is still optimistic.

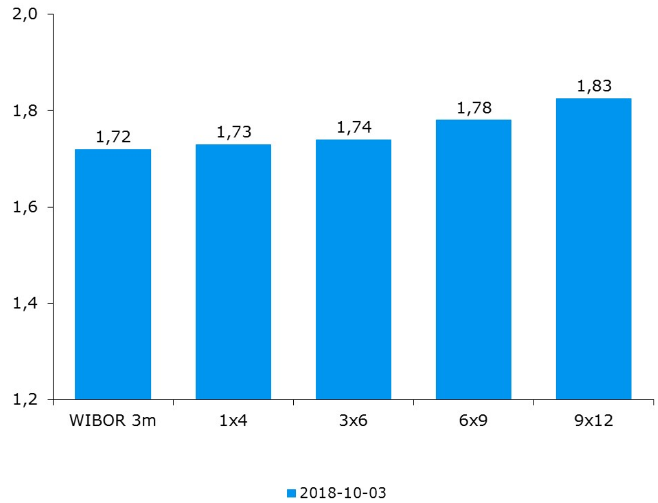
Fixed income

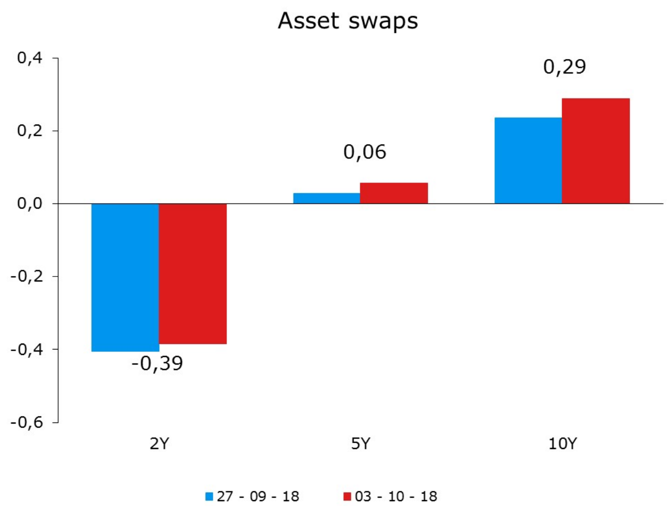
New 5y benchmark

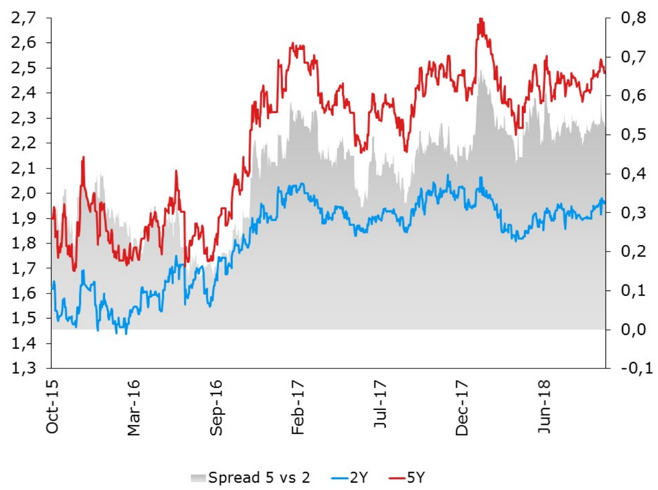
New 5y benchmark was issued at 14bp vs PS1023, demand exceeded supply by circa 40% (8.5 bn demand vs. 6 bn supply). Remaining supply for 4Q is between 5 bn and 16 bn.

DS1023/5y is 1.6 bps, WS0428/10y is 25.4 bps. DS1023/WS0428 is 70.0 bps. WS0428/Bund is 276 bps. DS1020 is trading at 1.57% (3 bps up), DS1023 is trading at 2.57% (5 bps up) and WS0428 is trading at 3.28% (4 bps up).









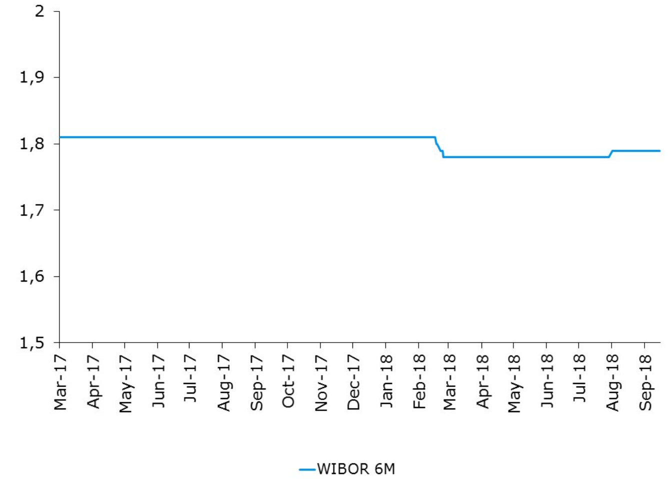
Money market

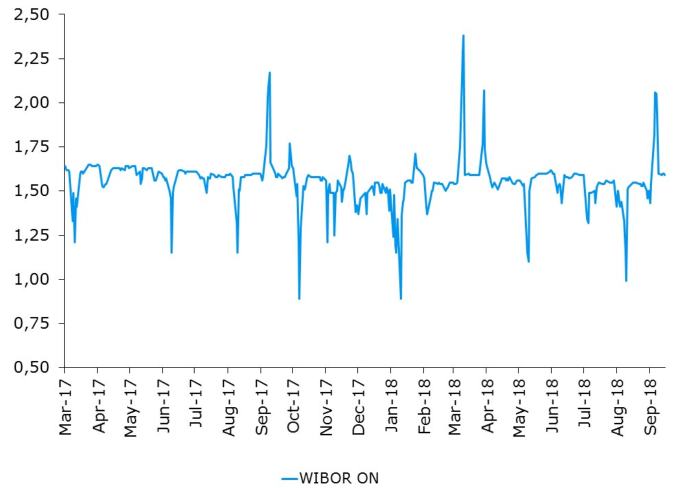
Strong and stable

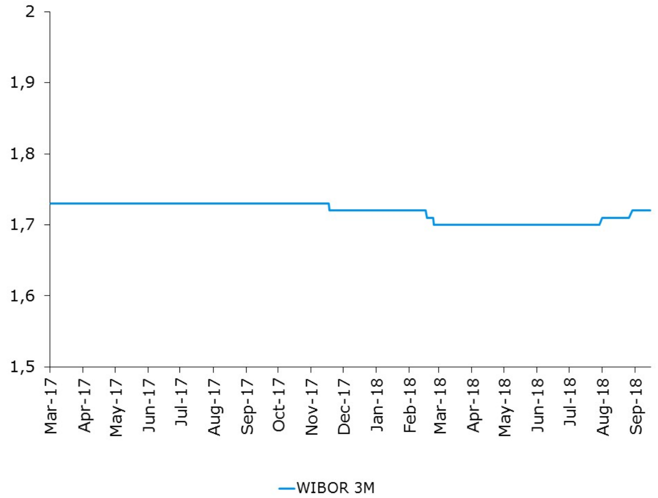
Polish rates are hovering near the maximum of the recent range due to external factors. Polish market feels pretty strong and stable, though. Today the Ministry of Finance sold PLN 6 bn of bonds and this asset class stays higher after the auction.

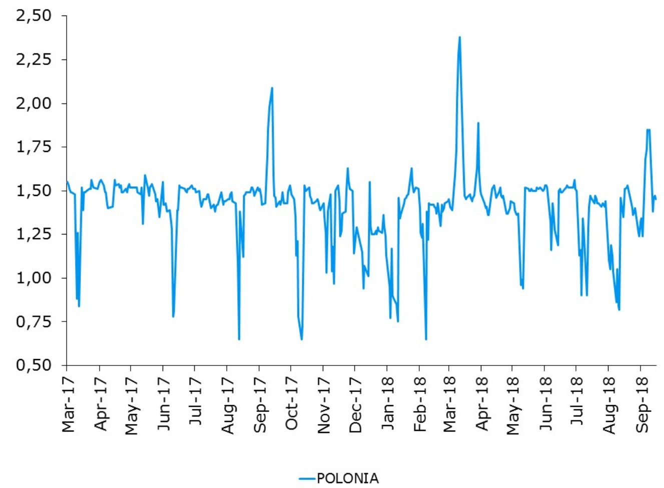
The beginning of the month stabilizes the ON rate. It trades marginally below reference rate.

Ref rate vs Polonia averages:
30 day 8 bp
90 day 15 bp









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Forex

Spot – EUR/PLN – higher. The 4.26-ish support zone held well and has tamed the PLN's advances against the EUR. Stronger USD and Italy's problems have provided the needed spark for PLN to start the weakening spiral. It was the USD/PLN that took the most of the hit, moving from the low of 3.6200 to the high of 3.7550. In case of EUR/PLN the move was much less dramatic, from 4.2660 to 4.3130 so far and it is just in the middle of 4.26 – 4.34 range. No need for panic yet, we are of the opinion that the range mentioned will still dominate.

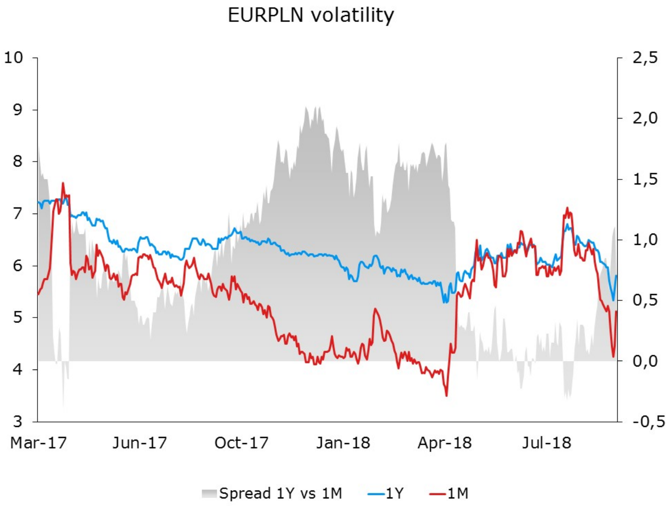
Opts: EUR/PLN vols – volatility exploded. The concerns about Italy's budget plan rattled market sentiment and weighed on the euro as well as emerging currencies. As a result implied volatilities have gapped higher with a vengeance. Especially, buyers of gamma were very active on the market, so the beginning of the EURPLN volatility curve shot up. 1 month EUR/PLN ATM mid is this Thursday at 5.6% (1.5% higher than a week ago), 3 month is at 5.7% (0.8% higher) and 1 year is fixing at 6.1% (0.15% higher). The currency spread (difference between USD/PLN and EUR/PLN) is higher by 0.5%. Skew is also in demand.

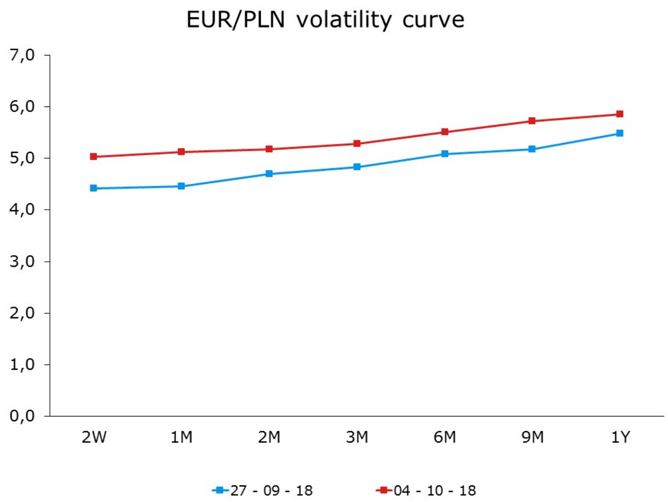
Short-term forecasts

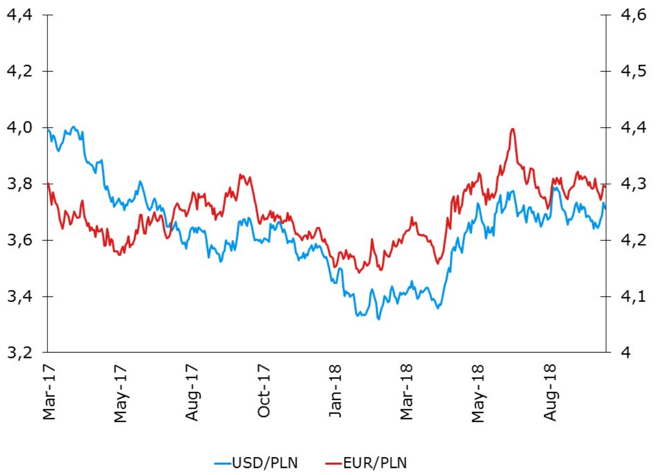
Main supports / resistances:
EUR/PLN: 4.2600 / 4.3400
USD/PLN: 3.6000 / 3.8000

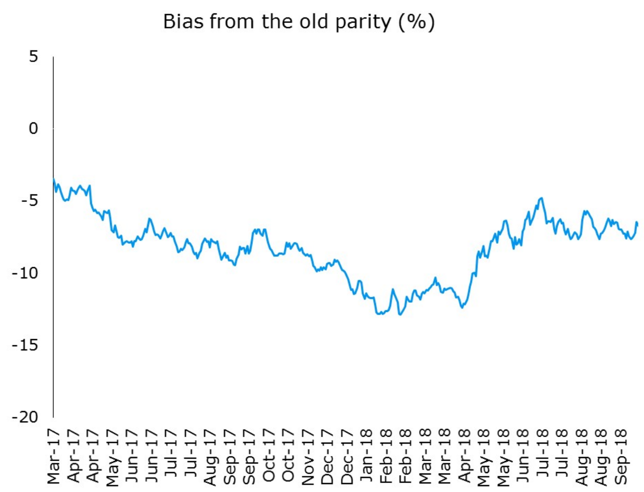
Spot – Sidelined.

We missed the buying opportunity for EUR/PLN in low 4.26-ish. Now, in the center of 4.26-4.34 range, we are trading opportunistically with neutral approach.









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
9/27/2018	1.84	1.72	1.89	1.69	2.04	1.77	1.73	1.75	1.78	1.82	1.90	1.87
9/30/2018	1.93	1.72	1.98	1.69	2.13	1.77	1.73	1.75	1.78	1.83	1.91	1.87
10/1/2018	1.63	1.72	1.71	1.69	1.74	1.77	1.73	1.75	1.78	1.84	1.91	1.87
10/2/2018	1.74	1.72	1.79	1.69	1.95	1.77	1.73	1.74	1.76	1.82	1.89	1.85
10/3/2018	1.73	1.72	1.78	1.69	1.88	1.77	1.73	1.74	1.78	1.83	1.93	1.86

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	10/4/2018	7/25/2020	97.33	1.52	1000	1577	927
PS0424	10/4/2018	4/25/2024	98.80	2.73	1500	3701	2651
WS0428	10/4/2018	4/25/2028	95.50	3.30	1200	1926	1196

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0720	5Y IRS	PS0423	10Y IRS	WS0428
9/27/2018	1.770	1.313	1.980	1.575	2.525	2.553	3.005	3.241
9/30/2018	1.770	1.312	1.970	1.575	2.505	2.550	2.980	3.235
10/1/2018	1.770	1.330	1.962	1.570	2.495	2.532	2.966	3.205
10/2/2018	1.770	1.346	1.960	1.570	2.480	2.541	2.953	3.231
10/3/2018	1.770	1.345	1.965	1.580	2.485	2.542	2.965	3.254

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
9/27/2018	4.45	4.83	5.08	5.48	5.48	1.50	0.74
9/30/2018	4.25	4.68	4.98	5.34	5.34	1.50	0.74
10/1/2018	4.46	4.83	5.18	5.58	5.58	1.45	0.56
10/2/2018	5.13	5.25	5.45	5.81	5.81	1.50	0.57
10/3/2018	5.13	5.28	5.50	5.85	5.85	1.48	0.52

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
9/27/2018	4.2814	3.6557	3.7697	3.2426	1.3228	0.1665
9/30/2018	4.2714	3.6754	3.7638	3.2403	1.3191	0.1664
10/1/2018	4.2795	3.6867	3.7452	3.2351	1.3231	0.1661
10/2/2018	4.2975	3.7326	3.7962	3.2844	1.3268	0.1662
10/3/2018	4.2949	3.7103	3.7650	3.2591	1.3303	0.1665

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