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Polish Weekly Review

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Comment on the upcoming data and forecasts

Everything you want to know on the Polish economy in September (and August) sees the light next week. Data are going to be mixed with descending industrial output growth (driven by working days) and retail sales. Labor market is going to suggest stabilization, both in terms of growth in employment and wages. At the same time core inflation is set to falter towards 0.8%. Construction activity is set to be an useful gauge on EU-sponsored investment; it seems we are close to the top in dynamic terms there. Last but not least, producer prices are expected to stay more or less unchanged but the presence of base effects from last year suggest that prices were backed up in sequential terms this year in September; it remains to be seen whether there is more transmission to the core manufacturing sections. C/A balance improved in August and it applies to the trade balance as well. Our forecast so far survived the cross-check with the GUS data published this week. However, it seems only a correction we should await worse trade balance and worse C/A overall in the coming months as demand leaks abroad.

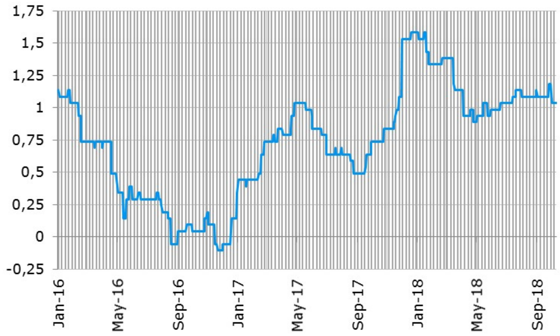
Polish data to watch: October 15th to October 19th

Publication	Date	Period	mBank	Consensus	Prior
CPI y/y *final*	15.10	Sep	1.8	1.8	2.0
Current Account (mio EUR)	15.10	Aug	-300	-357	-809
Export (mio EUR)	15.10	Aug	17100	17023	17115
Import (mio EUR)	15.10	Aug	17300	17288	17547
Average Gross Wages y/y (%)	16.10	Sep	6.6	7.0	6.8
Employment y/y (%)	16.10	Sep	3.4	3.4	3.4
Core inflation y/y (%)	16.10	Sep	0.8	0.9	0.9
Sold Industrial Output y/y (%)	17.10	Sep	3.9	4.3	5.0
Construction Output y/y (%)	17.10	Sep	17.2	18.0	20.0
PPI y/y (%)	17.10	Sep	3.0	2.9	3.0
Retail sales y/y (%)	18.10	Sep	7.4	8.3	9.0

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
The index remained unchanged as this week was devoid of any publications.

* 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

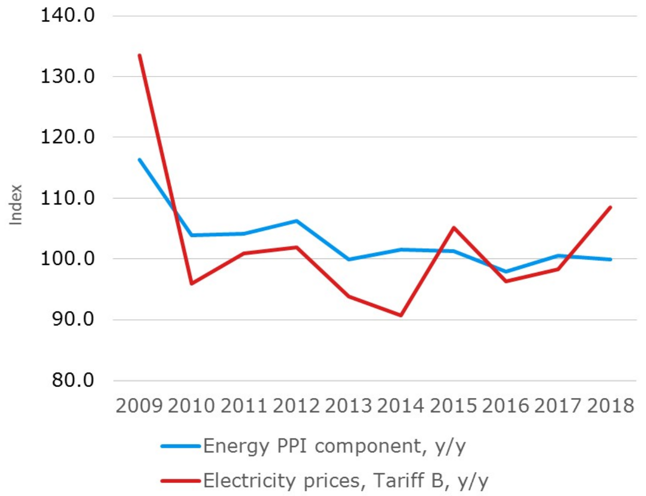
	2018 Q1	2018 Q2	2018 Q3 F	2018 Q4 F	2019 Q1 F	2019 Q2 F	2019 Q3 F	2019 Q4 F
GDP y/y (%)	5.2	5.1	4.8	4.7	4.4	4.2	4.0	3.7
Individual consumption y/y (%)	4.8	4.9	4.8	4.2	4.0	3.8	3.8	3.8
Public Consumption y/y (%)	3.6	4.4	4.0	4.0	2.0	2.0	2.0	2.0
Investment y/y (%)	8.1	4.5	6.5	7.0	7.0	6.0	5.0	4.0
Inflation 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

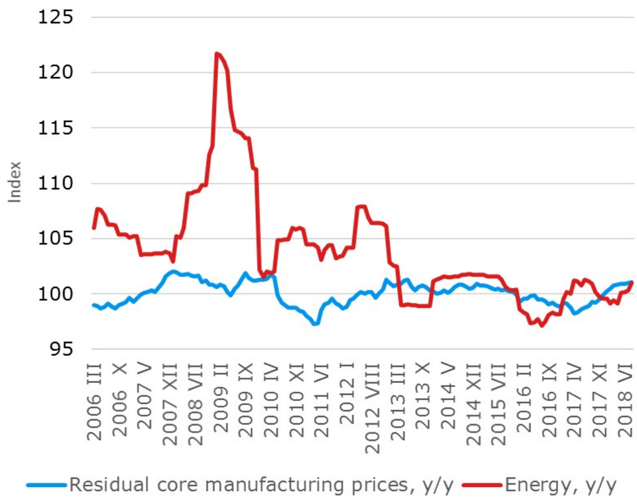
Economics

A quick take on producer prices and electricity prices

It is rather non-controversial to state that energy prices are going to prop-up producer prices as the "electricity, gas, steam and air conditioning supply" section (henceforth energy) constitutes a 6% chunk of the whole industrial output. In addition, energy prices correlate well with electricity prices, especially when the latter jumps substantially (see the graph). Anything happens with energy sector, PPI jumps at once by "anything" times 0.06. However, without second round effects, this direct effect fades quickly and escapes from annual indices after a year generating only a temporary bump (level shift) in prices.



What is really interesting is to look for indirect and second round effects which may reinforce overall pricing and contribute to inflationary pressures at producer's end of the pipe. We decided to use the aforementioned energy PPI component (serves a good proxy for electricity prices and is available as a coherent, monthly time series) to look for its influence over other producer prices, but solely in manufacturing (therefore excluding energy and mining form producer prices reflecting the whole industry). We need even more stripping, though, to see more clearly. As prices in manufacturing are heavily influenced by exogenous pricing in "coke and oil" category, we need to get rid of this as well. Here comes core manufacturing PPI. But still it is fairly easy to also account for changes in other commodities and exchange rates and clean the time series further by analyzing only residuals from (linear) regression equations that do fairly good job in predicting monthly variation of core manufacturing PPI.



Even a cursory inspection reveals that the correlation between residual core manufacturing prices and energy is (very) weak. One may say – correctly to some extent – that these disappointing results may stem form high correlation between energy prices and commodities which we used to explain and bone strip core manufacturing prices. Correlation, especially when commodity prices are expressed in national currency terms, is not overwhelming on average (but sometimes high) and unstable in sign. However, in 2008-2009 commodity prices and energy prices went completely separate ways. We should be then be able to spot the effect of sheer energy in residuals. However, it is not visible.

It would be then tempting to say that electricity prices are unlikely to affect producer price in an indirect manner. It would be a too strong conclusion as 2008-2009 was a very specific period in the global economy, also in terms of market expectations (very gloomy). It does not resemble the current environment. Therefore, what we think we have actually found is a cautionary tale that historical results do not support an upcoming push on producer prices. At the same time, the cost analysis demands a strong assumption that firms would be able to pass on higher costs. The economy is now advanced in the cycle and no such thing happened. Summing up, various numbers which various analysts come up with should be taken with the grain of salt of above-standard size.

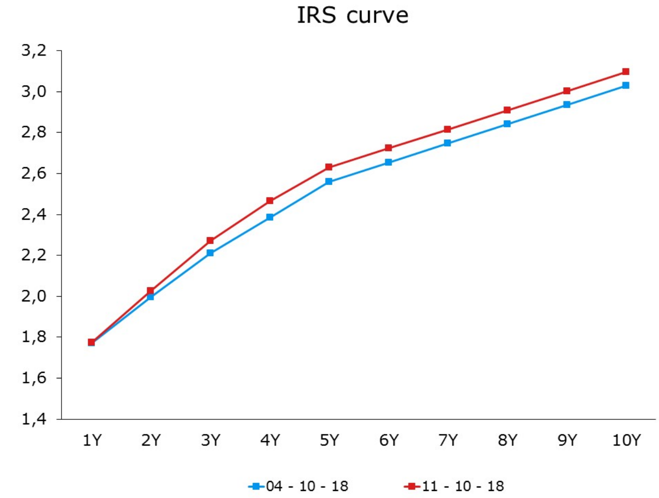
Fixed income

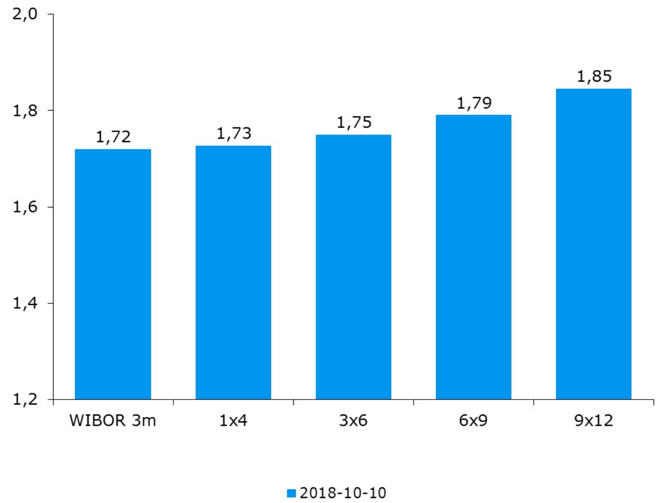
Market went crazy

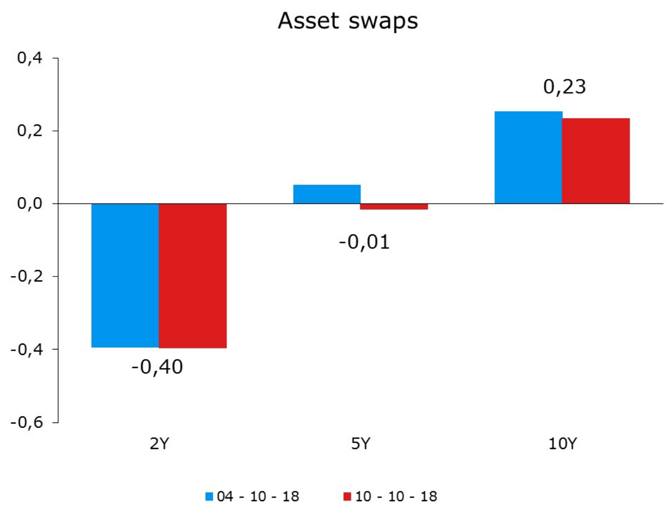
Market went crazy. We see many risks, we see many bullish news. Levels seem attractive but there are many conflicting currents. ASW are extremely narrow, but FRNs don't follow this trend. We see risks from Italy, Brexit, elections in Poland, rising yields all over the world. On the other hand, OK1018 (15bio) and IDS1018 (12bio) are expiring soon.

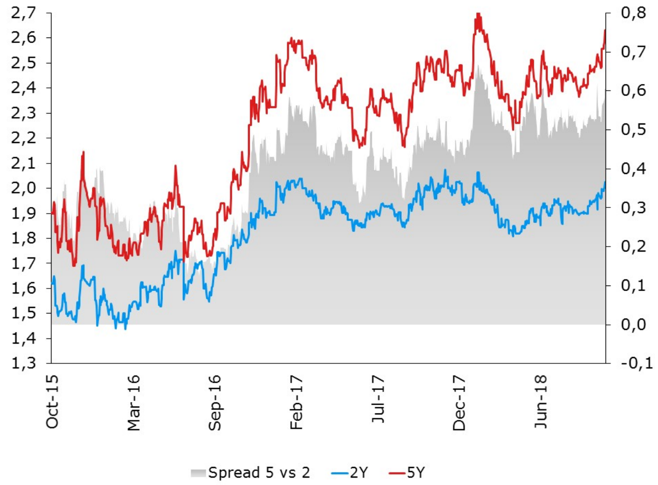
DS1023/5y is -5bps, WS0428/10y is 17bps. DS1023/WS0428 is 69bps. WS0428/Bund is 274bps.

DS1020 is trading at 1.59% (2bps up), DS1023 is trading at 2.58% (1bps up) and WS0428 is trading at 3.27% (1bps down).









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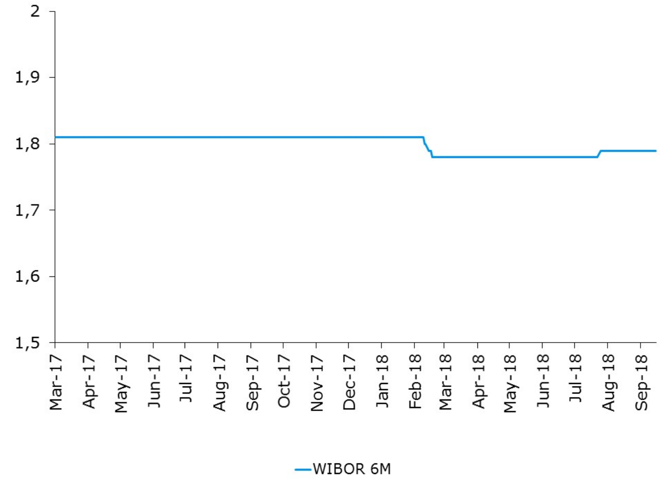
Money market

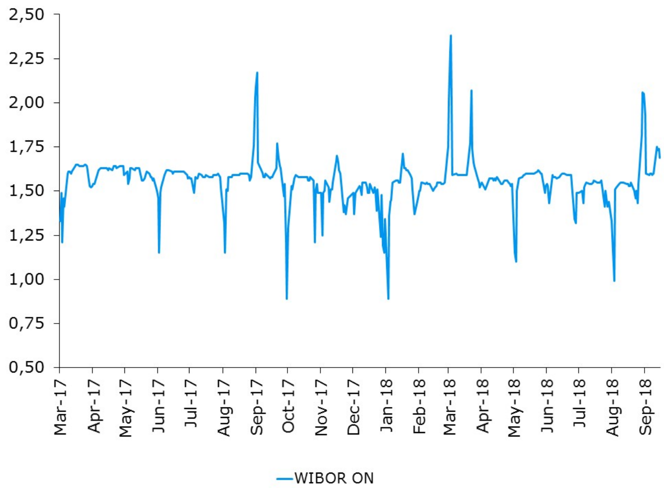
ASW strong and stable

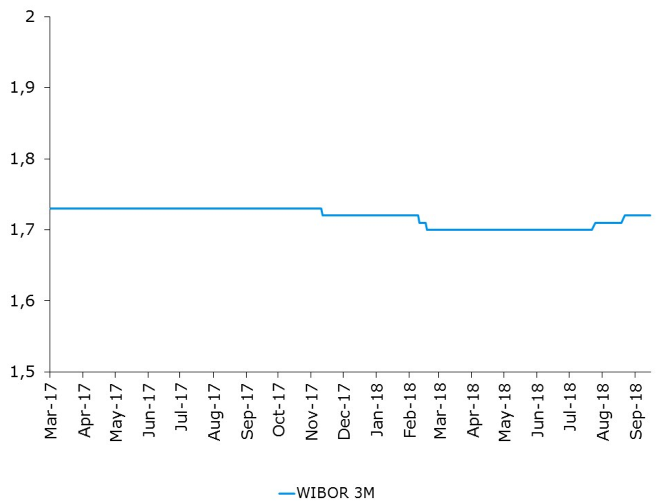
With the lack of local story, Polish yields follow global trends again. Swaps are trading at lvls last seen in q1 and they broke recent highs. Although there is not even a trace of panic on the market. Bonds are very well bid, ASW are tightening again. Any other upside in 2y swaps to 2.08-2.10% lvl would mean tha 100 bp hike is priced until H1 2020. Seems way too much given current MPC rhetoric.

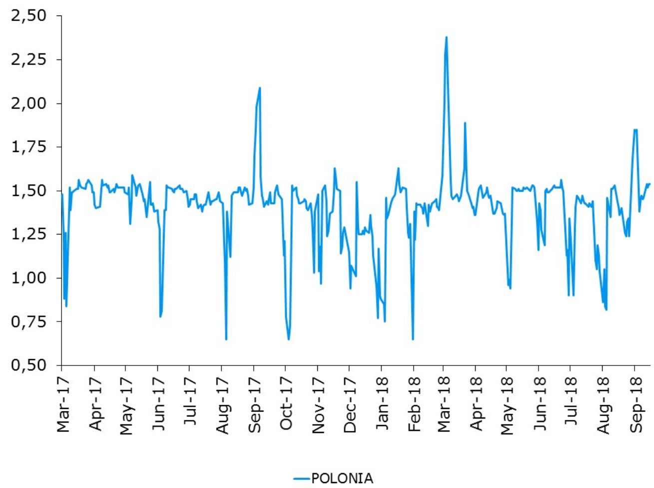
Market was left short cash after last OMO , therefore we where above ref rate for the whole week.

Ref rate vs Polonia averages:
30 day 2 bp
90 day 15 bp



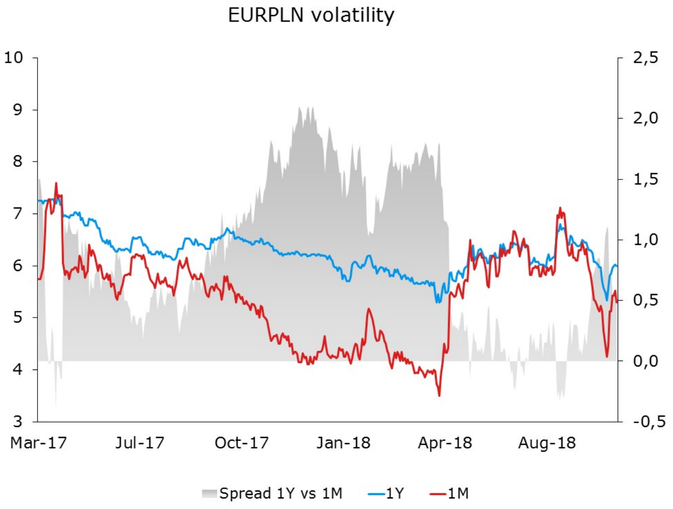






Forex

Spot – EUR/PLN – in the upper part of the range The EUR/PLN is still well contained in the wider 4.26 – 4.34 range. With 4.30ish being the natural magnet for the cross. The risk sentiment is still fragile due to the global exchanges / trade war / Italy, but it does not provide enough momentum to push low Beta currency (as PLN) out of the current range. The range trading continues.



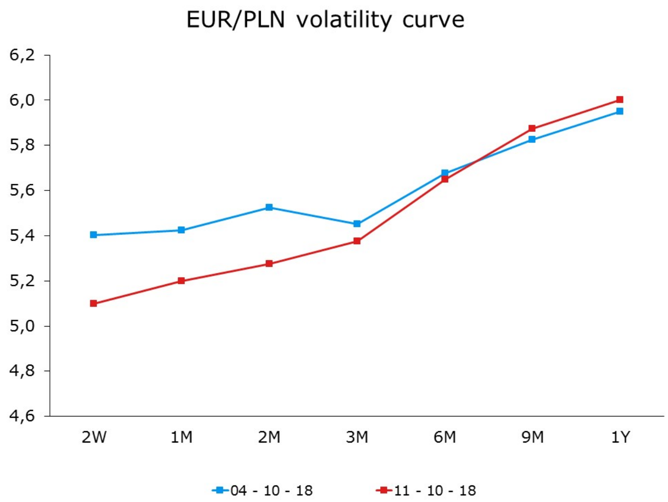
Opts – Volatility lower Last week worries about sustainability of the Italy's public finance faded. Turbulences in the equity market also haven't affected robust risk appetite for currencies yet. As a consequence implied volatility is lower. 1 month EUR/PLN ATM mid is this Thursday at 5.1% (0.5% lower than a week ago), 3 months are 5.3% (0.4% lower) and 1 year is fixing 6.0% (0.1% lower). The currency spread (difference between USD/PLN and EUR/PLN) is at the same level ar. 4.75%. Skew is still in demand.

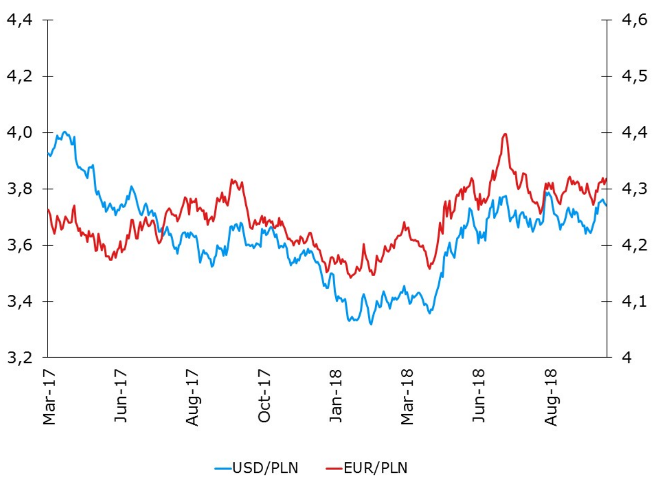
Short-term forecasts

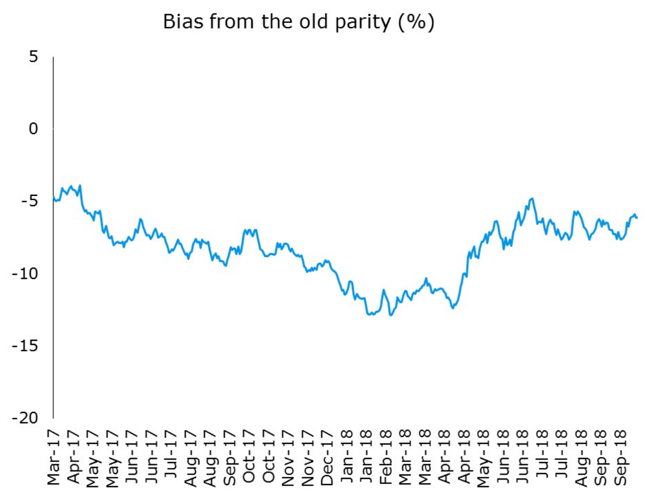
Main supports / resistances:
EUR/PLN: 4.2600 / 4.3400
USD/PLN: 3.6000 / 3.8000

Spot – Sidelined.

We think that 4.26-4.34 is the most likely scenario for now. We will try to tactically play that range, without any bias.







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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
10/4/2018	1.90	1.72	1.94	1.69	2.03	1.77	1.73	1.76	1.80	1.85	1.94	1.89
10/7/2018	1.88	1.72	1.93	1.69	2.10	1.77	1.73	1.75	1.79	1.83	1.94	1.86
10/8/2018	1.88	1.72	1.86	1.69	2.04	1.77	1.73	1.75	1.78	1.84	1.92	1.86
10/9/2018	1.71	1.72	1.75	1.69	1.95	1.77	1.73	1.75	1.78	1.84	1.94	1.87
10/10/2018	1.89	1.72	1.94	1.69	2.12	1.77	1.73	1.75	1.79	1.85	1.96	1.87

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
10/4/2018	1.770	1.378	1.997	1.604	2.558	2.609	3.030	3.283
10/7/2018	1.770	1.379	1.990	1.604	2.558	2.619	3.027	3.308
10/8/2018	1.770	1.383	1.997	1.618	2.572	2.603	3.045	3.313
10/9/2018	1.770	1.358	2.000	1.619	2.583	2.596	3.050	3.297
10/10/2018	1.770	1.345	2.025	1.630	2.630	2.616	3.095	3.328

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
10/4/2018	5.43	5.45	5.68	5.95	5.95	1.55	0.52
10/7/2018	5.43	5.50	5.73	6.00	6.00	1.55	0.52
10/8/2018	5.53	5.53	5.70	6.03	6.03	1.58	0.52
10/9/2018	5.30	5.40	5.65	6.00	6.00	1.55	0.51
10/10/2018	5.20	5.38	5.65	6.00	6.00	1.55	0.51

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
10/4/2018	4.3090	3.7512	3.7816	3.2813	1.3297	0.1671
10/7/2018	4.3117	3.7518	3.7741	3.2954	1.3262	0.1672
10/8/2018	4.3112	3.7574	3.7869	3.3168	1.3242	0.1674
10/9/2018	4.3190	3.7629	3.7861	3.3252	1.3274	0.1674
10/10/2018	4.3082	3.7507	3.7770	3.3136	1.3261	0.1667

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