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Polish Weekly Review

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Comment on the upcoming data and forecasts

This Friday NBP will release the M3 data for October, where we do not expect any noticeable differences, upside trends for main categories will remain unchanged. On Monday Statistics Poland will publish the unemployment rate, which we forecast at the level of 5,7%. This forecast was in line with the flash reading published by the Ministry of Labor.

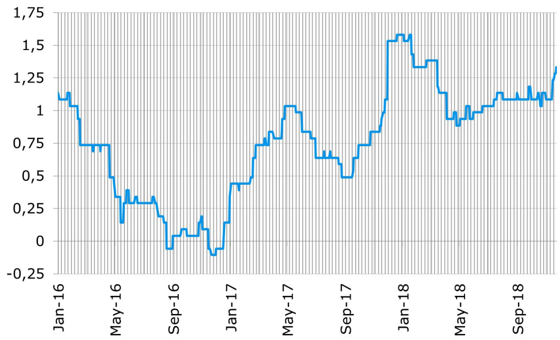
Polish data to watch: November 23rd to November 29th

Publication	Date	Period	mBank	Consensus	Prior
M3 y/y (%)	23.11	Oct	7.7	7.8	7.9
Unemployment rate (%)	25.11	Oct	5.7	5.6	5.7

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	11/15/2018	700	1.456	10/26/2018
5Y T-bond PS0424	11/15/2018	3000	2.604	10/26/2018
10Y T-bond WS0428	11/15/2018	4000	3.179	10/26/2018
30Y T-bond WS0447	11/15/2018	20	3.643	10/4/2010

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



Comment

There were two optimistic surprises this week, which lifted the Polish surprise index. Its increase was due to the wages and retail sales readings which turned out to be above market expectations.

* 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

- Higher Q3 GDP data may imply a level shift in our GDP projections, but not in the trajectory. We await the details of the release to explore the nature of the surprise: a build-up in inventories is going to have different growth implications than an acceleration in private investment.
- (Subject to revision within two weeks) Q2 2018 marked the top of the business cycle. 2018 GDP will fall marginally short of 5% and decelerate further in 2019. We decided to decrease GDP growth forecast in 2019 to 3.6% due to worse consumption prospects. However, the transition towards lower growth is set to be smooth due to substantial potential for fiscal stimulation given currently low and projected GG deficit.
- Core inflation is steadily rising but CPI inflation is most likely to stay low, and even below MPC target in 2019. We do not think that energy prices for households are set to increase substantially given the political calendar. We think that second round effects after surge in electricity costs on the firms' side will be marginal. Current trends in food prices and recent turnaround in oil prices suggest that price developments on these fields at the start of the year are set to be very benign or even at the reverse.
- MPC stays calm even after projecting a substantial rise in inflation in 2019 due to „conservative" high energy prices. Our baseline is now flat rates in 2019. The fate of 2020 hikes is set to be known within the coming 3-4 months. Risks are tilted definitely to the downside.
- Fiscal situation continues to be very comfortable with GG deficits below 1% projected even by conservative bodies (European Commission). 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	4.8	3.6
CPI Inflation y/y (average %)	-0.1	-0.9	-0.6	2.0	1.7	2.0
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	1.50

	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	4.6	4.3	4.3	4.0	3.5	2.9
Individual consumption y/y (%)	4.8	4.9	4.5	4.2	4.0	3.6	3.2	2.8
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	6.0	6.0	6.0	6.0	5.0	4.0
Inflation rate (% average)	1.5	1.7	1.9	1.7	2.0	2.0	1.9	2.1
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	1.50
Wibor 3M (% eop)	1.70	1.70	1.72	1.70	1.70	1.71	1.72	1.73
2Y Polish bond yields (% eop)	1.49	1.63	1.56	1.55	1.60	1.78	2.00	2.20
10Y Polish bond yields (% eop)	3.18	3.22	3.24	3.30	3.40	3.59	3.78	3.95
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

October turned out to be better than expected in most economic aggregates. Positive surprises ranged from wages to industrial production and retail sales. Favorable calendar effects possibly helped across the board and the overal picture is slightly better than we thought. Optimistic industry and retail sales data suggest that GDP will remain strong in Q4 even though it should slow down relative to the third quarter's stunning 5.1% y/y. However, since we are still awaiting the details of the last GDP release (sustainability matters), we are going to present the precise Q4 forecast on Friday next week. One thing seems to be certain even at this point: risks for the consumption in the end of 2018 will probably not realize. Consumption demand will be supported with the coming fuel price cuts and cheap food (which will help the disposable income, especially during the Christmas period).

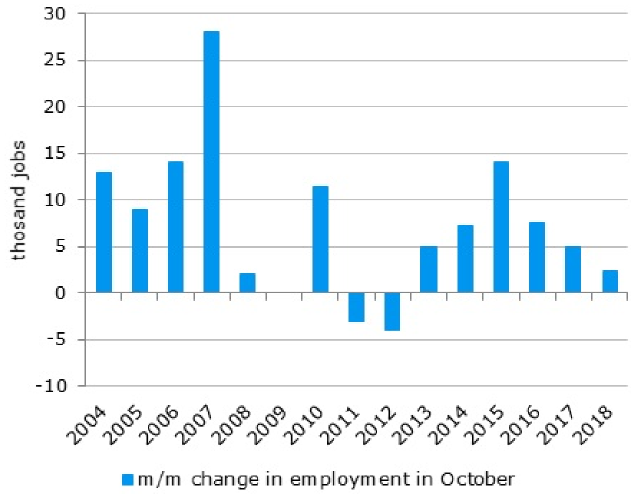
Set of October data is good news for the MPC. Granted, along with Q3 GDP data and latest revisions to H1 national accounts, it indicates that near-term GDP growth projected by the NBP might be too low, but inflation continues to be the key factor. Since the MPC does not believe in a firm link between macroeconomic conditions and inflation, CPI must accelerate considerably to warrant any change in its stance. Neither wages nor PPI data suggest such a scenario. Moreover, latest announcements from the Ministry of Energy concerning the government plan of reimbursements of energy prices to households will most likely end up with no increase in energy bill and cosiderably overshoot NBP's inflation projection.

Below you find our more detailed view on last week's releases.

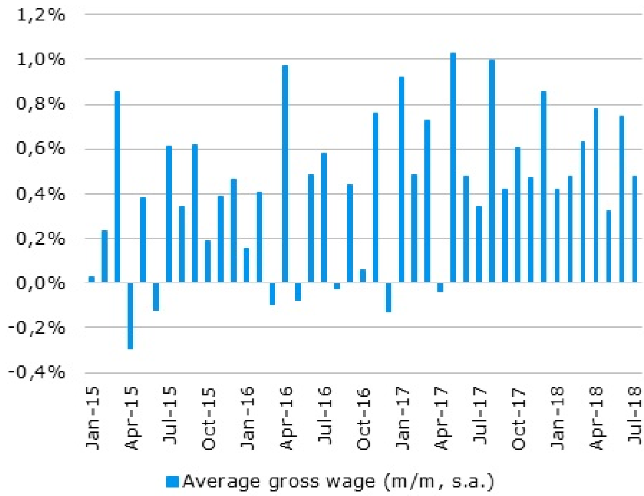
Positive surprise in wages, but employment is still slowing down

Employment in the enterprise sector increased by 3.2% y/y in October, therefore the dynamics remained at the same level as a month before, which was in line with our forecasts and market consensus. In m/m terms there were 2k posts added (which is the weakest result since October 2012). It confirms our hypothesis about the employment slowing down – we can see this trend since 2017 and only due to the seasonal effects October was not another month of decreasing number of employees in absolute terms. It is worth noticing that our idea of weaker labor demand on employment slowdown seems be confirmed in other data sources (PMI, CSO and NBP surveys, job offers availability or alternative employment measures) and by the NBP's staff assessment.

Average gross wage rose by 7.6% y/y, above market consensus (6.5% y/y) and our not optimistic enough forecast (7.1% y/y). As usual, details of the release will be available in a week, so at this point we can only speculate on the sources of the release. We believe that the acceleration was driven by some combination of manufacturing, construction (working day difference matters on both cases) and mining (disbursement of bonuses).



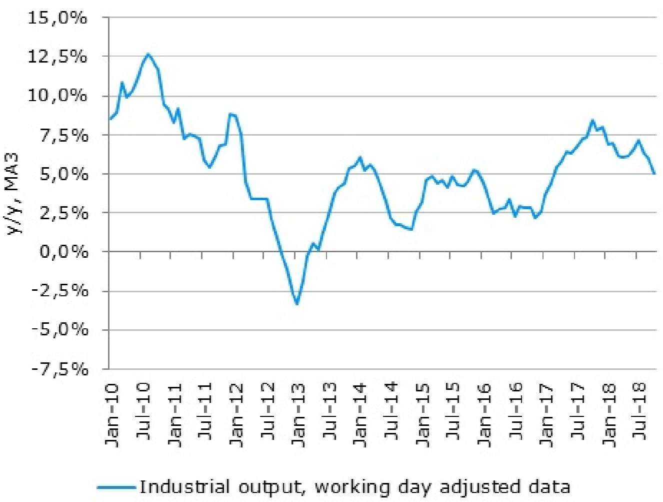
Regardless of the nature of October's surprise, this month was definitely a strong one. In general, not much has changed, though. While corporates continue to report widespread staffing problems, assessments of wage pressure and forecasts of wage hikes have declined somewhat over the last two quarters or so. Taken altogether with weakening labor demand, this suggests a cautious (stable in y/y terms at best) scenario for wage growth in the coming months. In light of current legislation and occupation-specific agreements, prospects of public sector (not included in the enterprise sector) wage growth have brightened, though. It will materialize in 2019 and cushion the expected slowdown in private sector wages.



October labor market data, despite the surprisingly strong wage growth, are consistent with the MPC's preferred scenario and most recent NBP staff projections. Furthermore, the widespread skepticism regarding the relationship between wages and prices means that wage growth will not be treated as a leading indicator for inflation. For the MPC to change its stance and market participants to update their forecasts accordingly, a material acceleration in inflation must materialize. We are neither observing, nor forecasting this at this point.

Industrial and construction output accelerated a bit more than expected, no inflation pressure in producer prices.

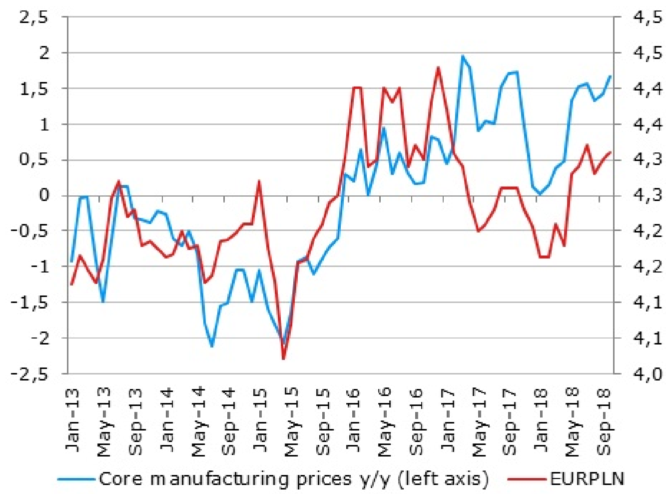
Upside surprise in wage data a day before proved to be a good omen – industry data surprised as well. Industrial output rose by 7.4% y/y in October, beating market forecasts (6.5-6.6% y/y) and our overly pessimistic estimate of 5.5% y/y. The acceleration vis-a-vis September's 2.8% y/y is a result of favorable calendar effect (working day difference rose from -1 to +1 y/y) and therefore not a surprise per se. The momentum has, however, picked up (+1.2% m/m seasonally adjusted) and this part is indeed surprising. A quick scan of the available details of the release indicates that it is not an anomaly easily traceable to any particular industry. Perhaps forecasters failed to appreciate the strength of calendar-related surge (we tend to think there are some non-linearities there). The October result is not strong enough to warrant any change in the overall assessment of trends. Polish industry did slow down, from ca. 8% y/y at the turn of the year to ca. 5% y/y at the moment. The combination of local and global factors (emphasis on the latter) suggests that it will not be re-accelerating in a sustainable fashion anytime soon.



Construction output accelerated in October, growing by 22.4% y/y. The result was higher than both the market consensus (21.0%) and our forecast (19.1%). Such a growth was due mostly to the positive effect of working days and to relatively high temperatures in October. Yearly growth, adjusted for the seasonal effects, increased by 19.6% and remained almost unchanged compared to September. .

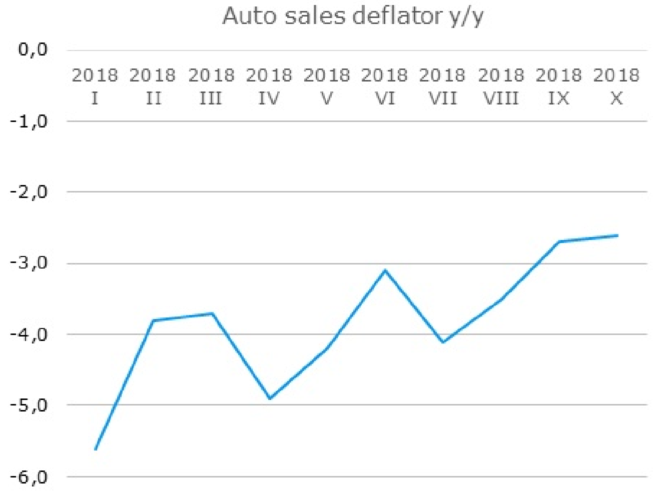
The largest yearly growth was recorded in the construction of buildings (26%), which can be attributed to the working days and weather. Next were civil engineering works (25.2%) and specialized construction activities at the bottom of the pack (12.6%). This result can be considered as an effect of investments finished before the local elections, however it should be the last month when this effect played an important role in construction output. End of local public investments together with supply barriers may affect negatively future readings.

Producer prices rose by 3.2% y/y, a bit above our forecast (3.1% y/y) and market consensus 3.0% y/y). From our point of view, the surprise is purely the matter of upward revisions in September numbers. Absent that, we would have nailed both the headline and the breakdown of PPI inflation in October. In particular, strong m/m growth (0.5% headline, 0.6% in manufacturing) is due to a sizable increase in the prices of coke and oil refining products – itself an echo of early-October surge in oil prices. Since the latter factor has all but reversed since then, PPI is likely to decelerate in the months ahead. Core manufacturing prices accelerated a bit (see the graph below), but perfectly in line with what could be expected given weaker PLN.



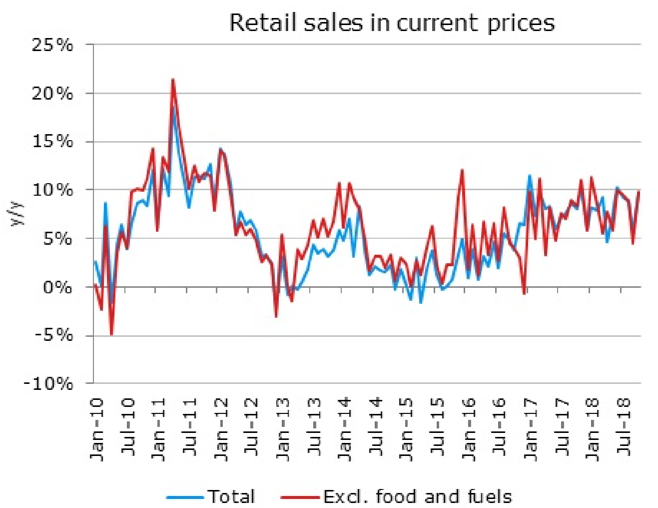
Retail sales beats expectations. Auto sales finally surprises to the upside.

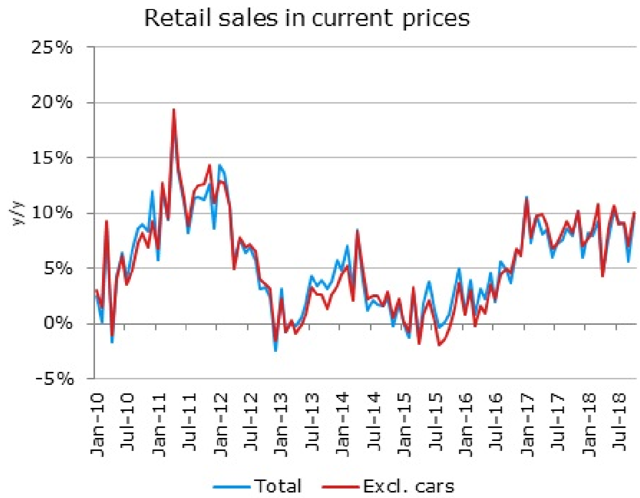
October retail sales increased by 9.7% y/y in nominal terms. It seems auto sales is the main driver of surprise. Results of this category beat model estimate by a substantial amount. After the regulatory driven surge in car registrations in August that immediately found their way only to dealer's parking lots, increased demand took them finally home. It was possible even without prices concessions: from the start of the year, price decreases are losing intensity (see the graph), which can indicate that the demand is strong.



A positive surprise came also from the category "other", however it remains within the typical volatility. Other categories also presented better results, but in this case – as in the industrial production – it can be the working days arithmetic, which with big changes is not so obvious, or linear.

The graphs below summarize well this situation. Last weakness was covered by the current good reading.





Our interpretation of September's retail sales reading turned out to be true, but we did not appreciate the demand's strength. High car sales was realized without more price discounts. Therefore strong demand is here to stay. However, in the end of the year we can see another effect connected with changes in the amortization law for enterprises. New limits suggests that it will more profitable to buy an expensive car now (more than 150k PLN) and postpone buying cheaper cars into the next year. Taking into account disproportions in their market shares, it should have a negative effect on the car sales. But the strength of the demand encourages a cautious approach.

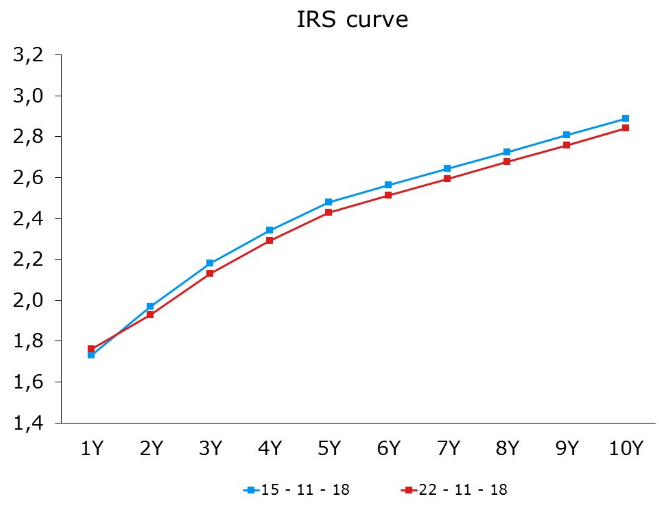
Fixed income

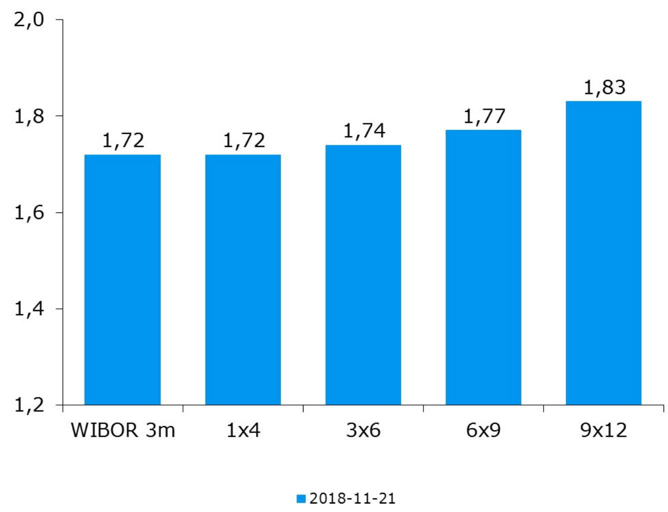
More risk in the market

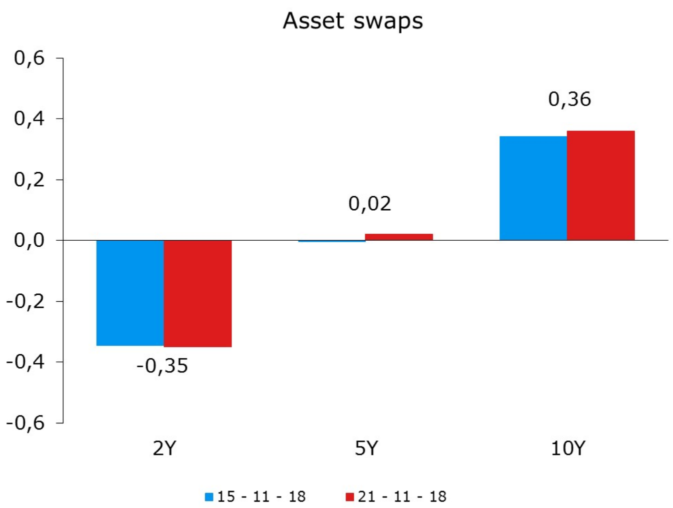
ASW widened last week by 6bps (0424 vs 5y). Last week's sell-off seems to be one-off event as market recovered pretty quickly. As ASW widened, FRNs cheapened. However, these notes are usually first to be hit if risk sentiment turns sour again.

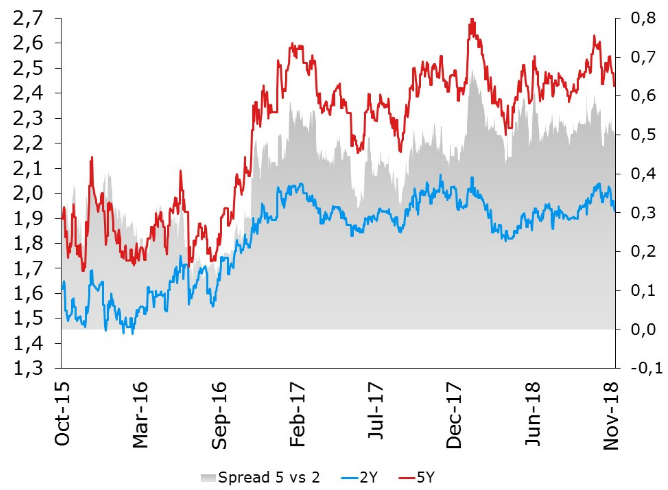
DS1023/5y is 3bps, WS0428/10y is 38bps. DS1023/WS0428 is 75.5bps. WS0428/Bund is 282bps.

DS1020 is trading at 1,56% (3bps down), DS1023 is trading at 2,44% (5bps down) and WS0428 is trading at 3.19%. (5bps down).









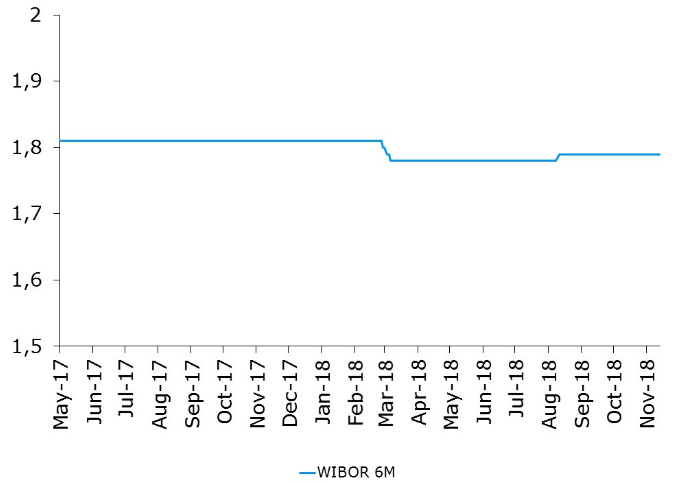
Money market

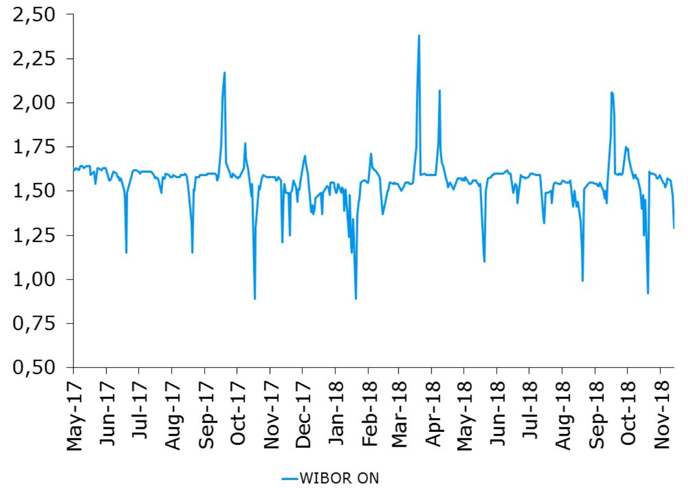
Surpise – first 25bp hike motion since 6 years

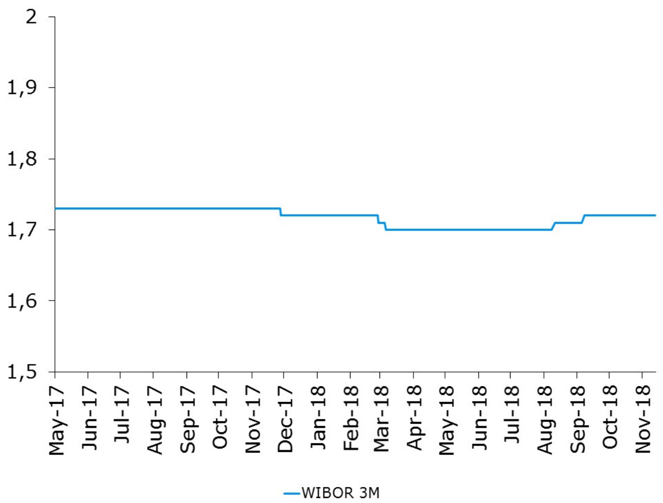
Rates are drifting lower recently in a thin-liquidity market. We are getting closer to the bottom of recent range, so payers may be more active on this levels. It might be an interesting news for them that during the recent MPC meeting there was a motion for a 25 bp hike (turned down of course).

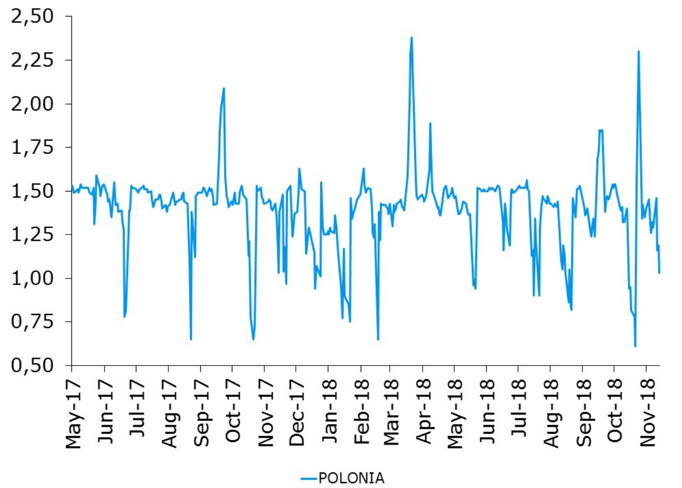
Cash stays very low all the time. That has to do with recent elevated (but at the same time also concentrated) risk in the banking system. Next week should be cheap as well.

30 day   18 bp
90 day   15 bp



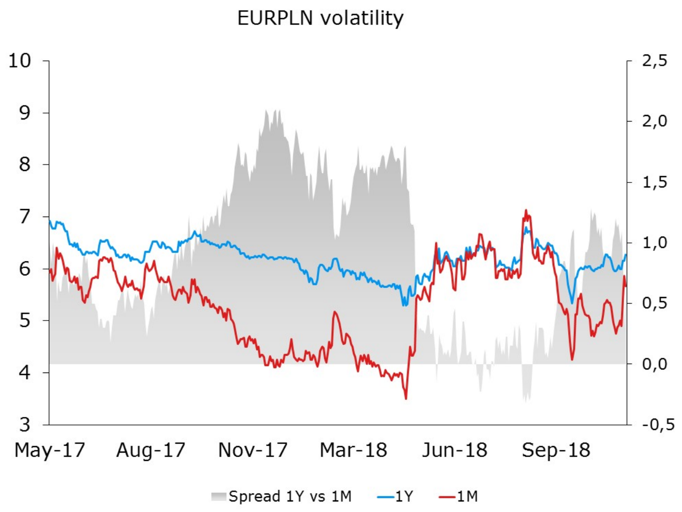




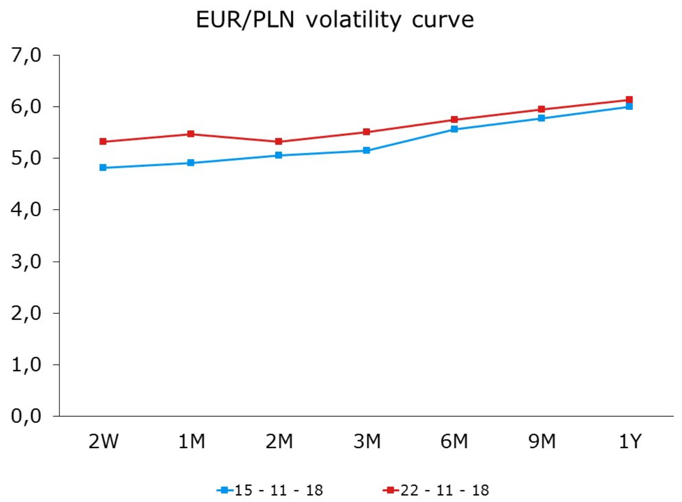


Forex

Spot – EUR/PLN – in the range The pressure on Zloty has been building this week due to local institutional risk concerning the Polish Financial Supervision Authority and the overall stability in some parts of the banking sector. As a consequence, zloty underperformed its peers in the region. After hitting 4.3340 top in EUR/PLN, the correction lower is finally taking place, partly after assurance from NBP about its preparedness for liquidity injections to troubled banks. Generally the risk sentiment is somehow better, but the trade wars, concerns about global growth, Brexit uncertainty and local political tensions are obstacles for the Zloty to get stronger.



Opts: EUR/PLN vols – wobbly The usual pattern. Vols went higher with the weaker Zloty, the frontend was the main beneficiary of the move, the buyers of the skew reemerged. 1M EURPLN was paid on at 5.7%, 3m was traded at 5.8% and the skew curve was bid on 0.2% higher. With the stronger Zloty however, the vols have come down again. On the weekly basis, 1 month EUR/PLN ATM mid is 0.35% higher to 5.35%, 3 months are now also 5.35% (0.3% higher) and 1 year is fixing 6.1% (0.1% higher). The currency spread (difference between USD/PLN and EUR/PLN) is at 4.75%.

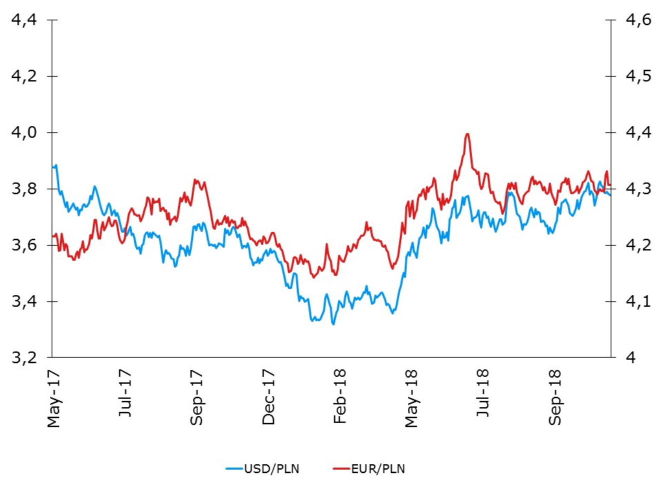


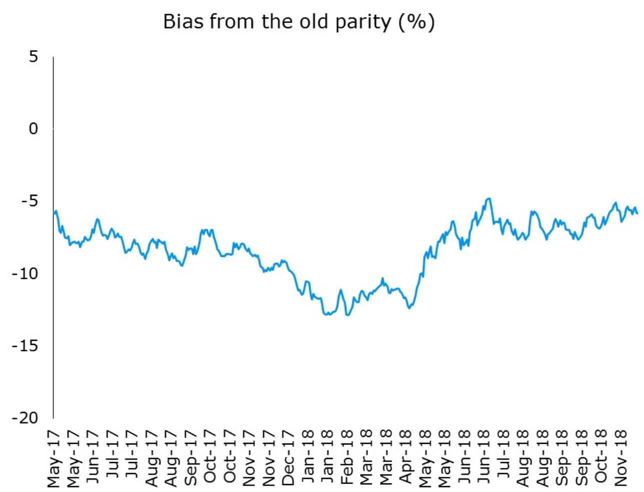
Short-term forecasts

Main supports / resistances:
EUR/PLN: 4.2600 / 4.3400
USD/PLN: 3.6000 / 3.9000

Spot: Current position: None

We closed our short at 4.34 with 4 figures profit. Our strategy is roughly unchanged, we still believe in rangy nature of EUR/PLN, with a slight PLN negative bias. So we are ready to buy EUR/PLN at 4.27 with stop at 4.24 and hopes to see again 4.34 / 4.35.





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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
11/15/2018	1.98	1.72	1.96	1.69	2.04	1.77	1.72	1.74	1.78	1.85	1.94	1.85
11/18/2018	2.01	1.72	1.91	1.69	2.13	1.77	1.73	1.75	1.79	1.86	1.92	1.89
11/19/2018	1.73	1.72	1.78	1.69	1.88	1.77	1.73	1.75	1.78	1.84	1.94	1.86
11/20/2018	1.90	1.72	1.85	1.69	1.97	1.77	1.73	1.74	1.77	1.82	1.89	1.85
11/21/2018	1.98	1.72	1.96	1.69	2.07	1.77	1.72	1.74	1.77	1.83	1.88	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	10/26/2018	7/25/2020	97.52	1.46	700	2600	700
PS0424	10/26/2018	4/25/2024	99.45	2.60	3000	6945	2930
WS0428	10/26/2018	4/25/2028	96.50	3.18	4000	15482	4242

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0720	5Y IRS	PS0423	10Y IRS	WS0428
11/15/2018	1.770	1.289	1.969	1.622	2.480	2.475	2.888	3.230
11/18/2018	1.770	1.352	1.970	1.635	2.480	2.512	2.900	3.273
11/19/2018	1.770	1.338	1.960	1.601	2.470	2.474	2.888	3.236
11/20/2018	1.770	1.317	1.940	1.570	2.427	2.431	2.844	3.199
11/21/2018	1.770	1.309	1.928	1.578	2.430	2.450	2.840	3.200

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
11/15/2018	4.91	5.15	5.56	6.00	6.00	1.63	0.54
11/18/2018	5.40	5.50	5.82	6.16	6.16	1.63	0.54
11/19/2018	5.86	5.73	5.97	6.15	6.15	1.65	0.55
11/20/2018	5.67	5.72	5.96	6.28	6.28	1.71	0.56
11/21/2018	5.46	5.51	5.75	6.13	6.13	1.72	0.55

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
11/15/2018	4.2970	3.8074	3.7814	3.3572	1.3315	0.1653
11/18/2018	4.2950	3.7876	3.7608	3.3399	1.3353	0.1652
11/19/2018	4.3242	3.7840	3.7947	3.3586	1.3448	0.1663
11/20/2018	4.3314	3.7900	3.8171	3.3702	1.3461	0.1663
11/21/2018	4.3070	3.7829	3.8029	3.3490	1.3392	0.1657

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