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Polish Weekly Review

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Comment on the upcoming data and forecasts

This Friday, Statistics Poland will publish final CPI data for November. We expect it to confirm the flash reading of 1.2% y/y. The details of the release will shed more light on the sources of the surprise and exact core inflation print (official release on Monday). On the same day, the NBP will publish balance of payments data for October. Export models for September data slightly overshot, therefore we expect some revisions of that reading. In October exports should reach EUR 19.2 bn and imports – EUR 20 bn. With bigger trade deficit, current account should widen to EUR -0.8 bn. On Tuesday monthly labor market data will be released. While employment growth is likely to drop from 3.2 to 3.0% y/y due to high base and overall poor momentum (weaker demand meet supply constraints), wages will decelerate only modestly, from 7.6 to 7.1% y/y. The key reason for this is unfavorable calendar (working day count dropped from +1 to 0 or even -1 y/y, depending on how the unanticipated additional public holiday is measured). The same factor pushed down industrial and construction output growth. the former is likely to come out close to 3% y/y, the latter decelerated from 22.5 to 16.4% y/y. PPI data will be influenced by the decline in oil prices. Finally, next Friday brings the publication of monthly Statistical Bulletin along with unemployment and retail sales data.

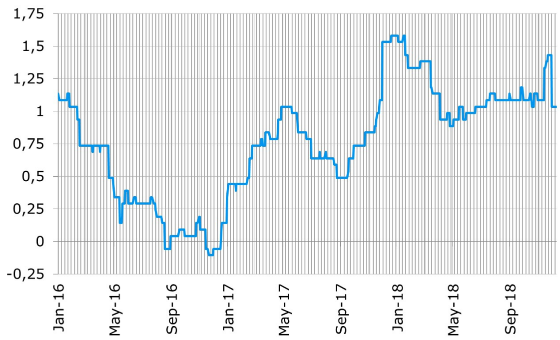
Polish data to watch: December 14th to December 21st

Publication	Date	Period	mBank	Consensus	Prior
CPI y/y *final* (%)	14.12	Nov	1.2	1.2	1.7
Current Account (mio EUR)	14.12	Oct	-850	-472	-547
Export (mio EUR)	14.12	Oct	19200	18724	17683
Import (mio EUR)	14.12	Oct	20000	19040	18132
Core CPI y/y (%)	17.12	Nov	0.8	0.9	0.9
Average gross wage y/y (%)	18.12	Nov	7.1	7.1	7.6
Employment y/y (%)	18.12	Nov	3.0	3.0	3.2
Sold industrial output y/y (%)	19.12	Nov	2.6	3.1	7.4
PPI y/y (%)	19.12	Nov	3.1	4.3	3.2
Construction output y/y (%)	19.12	Nov	16.4	16.5	22.4
Real retail sales y/y (%)	21.12	Nov	5.7	5.7	5.7
Unemployment rate (%)	21.12	Nov	5.1	6.3	7.8

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	1/10/2019	700	1.456	10/26/2018
5Y T-bond PS0424	1/10/2019	3000	2.604	10/26/2018
10Y T-bond WS0428	1/10/2019	4000	3.179	10/26/2018
30Y T-bond WS0447	1/10/2019	20	3.643	10/4/2010

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



Comment

Unchanged (no data releases last week). This will change in the next several days, starting tommorrow. Final CPI, wage growth, industrial output, retail sales and unemployment can all move Poland's surprise index.

* 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 imply a level shift in our GDP projections, but not in the trajectory.
- The turn of 2017 and 2018 marked the top of the business cycle. 2018 GDP will grow at ca. 5% and decelerate considerably in 2019. With modestly worse consumption prospects and public investment peaking in annual terms this year, we expect GDP to grow by 3.8% y/y next year. However, the transition towards lower growth is set to be smooth due to substantial potential for fiscal stimulation given low current and projected GG deficit.
- Core inflation is projected to rise steadily, but CPI inflation is likely to stay low and undershoot the 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 on 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.
- The PLN proved to be exceptionally resilient in recent months: neither the increase in global rates, nor their subsequent decline and violent repricing of monetary policy expectations managed to break it out of the narrow, 2.5% range vis-a-vis the euro.
- While this might be seen as a good omen, the room for PLN to strengthen is not really there: cyclicality, low nominal interest rates, attractiveness of PLN asset markets and worsening terms of trade suggest that PLN strengthening would not be welcome by local stakeholders, big and small. As a result, we expect EURPLN to remain essentially flat within the forecast horizon.

mBank forecasts

	2014	2015	2016	2017	2018 F	2019 F
GDP y/y (%)	3.3	3.8	3.0	4.8	5.1	3.8
CPI Inflation y/y (average %)	-0.1	-0.9	-0.6	2.0	1.7	1.7
Current account (%GDP)	-2.1	-0.6	-0.3	0.2	-0.6	-1.2
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

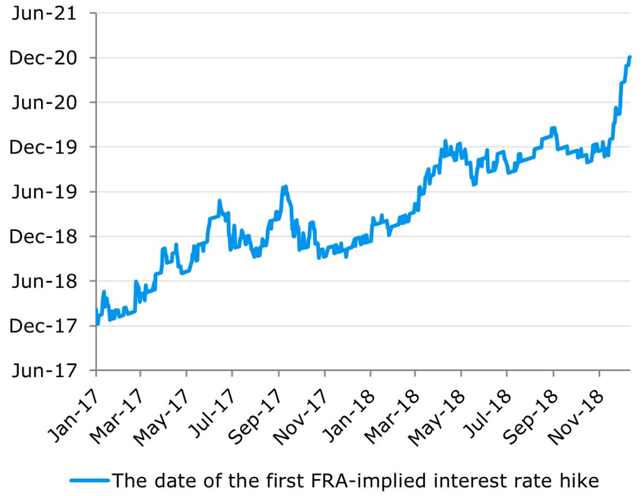
	2018 Q1	2018 Q2	2018 Q3	2018 Q4 F	2019 Q1 F	2019 Q2 F	2019 Q3 F	2019 Q4 F
GDP y/y (%)	5.3	5.1	5.1	4.8	4.3	4.2	3.6	3.1
Individual consumption y/y (%)	4.7	4.9	4.5	4.3	4.1	3.9	3.5	3.1
Public Consumption y/y (%)	3.0	3.5	3.6	4.0	2.0	2.0	2.0	2.0
Investment y/y (%)	8.2	4.7	9.9	10.0	6.0	6.0	5.0	4.0
Inflation rate (% average)	1.5	1.7	1.9	1.7	1.6	1.7	1.6	2.0
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	3.20	3.30	3.50	3.74	3.96
EUR/PLN (eop)	4.21	4.37	4.28	4.30	4.30	4.25	4.25	4.25
USD/PLN (eop)	3.42	3.74	3.69	3.74	3.71	3.63	3.60	3.56

F - forecast

Economics

First rate hike no sooner than late 2020, really?

In just two weeks, the market-implied interest rates moved to extent that hardly matches the changes in macroeconomic scenario. Over that period, the date of the first rate hike was moved outward by a whole year. The balance of risks for inflation and GDP paths currently priced in, favors expectations of earlier hike.



Part of the rally was driven by the global correction in rates (in our opinion also overdone), but part happened on the basis of local developments: low inflation reading for November. It is true that the surprise was heavy (1.2% vs 1.5-1.6% expected), but part of it stems from food prices and the remaining part possibly was driven by low prices in usually "jumpy" core categories. It is also true that currently low core inflation does not imply the low core in the future (2019, 2020). After the certain point is breached (i. e. level of output gap) we may see acceleration that is both unexpected and non-linear and ruling this out at his stage is foolish. We still look for a meaningful acceleration in core inflation in 2019. Low headline is going to mask these developments and encourage MPC to wait but it is hardly possible that the same is going to be true for market expectations. After the recent mess with energy prices, market consensus for headline CPI moved downwards, closer to our forecast (<2% in 2019). With core running above 2% even a minor shock from food (already low) or fuel prices (already very low) can be devastating for such low inflation path. The balance of risks suggests caution with current low path of interest rates.

On the real sphere front... nothing changed. Or one should rather say that the most likely scenario improved. High GDP growth for Q3 mitigated some of the risks that could have been thought of earlier on the basis of falling PMI readings. Moreover, carryover effects imply that GDP growth should be close to 4% and most of the GDP components do not carry substantial risks, possibly besides exports, but part of the deceleration already happened and was masked by solid domestic demand – situation unlikely to change in 2019. Zloty remains a real wildcard as being stable for so many months, it can now cushion any deficiencies in foreign demand. GDP growth presented in recent NBP inflation projections is again too low, starting from Q3, and this is not a forecast but a fact.

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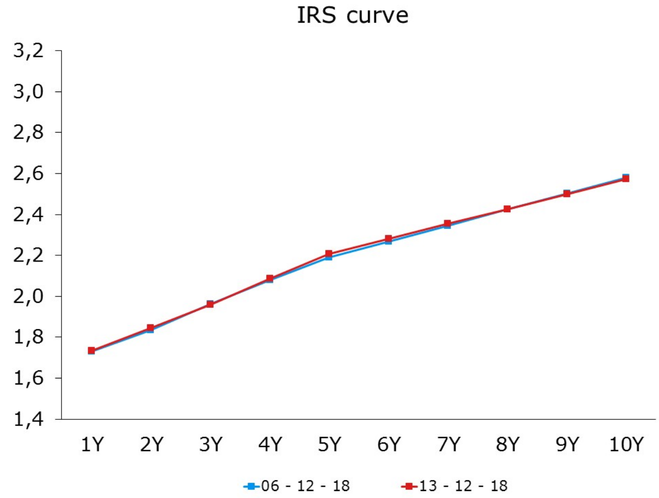
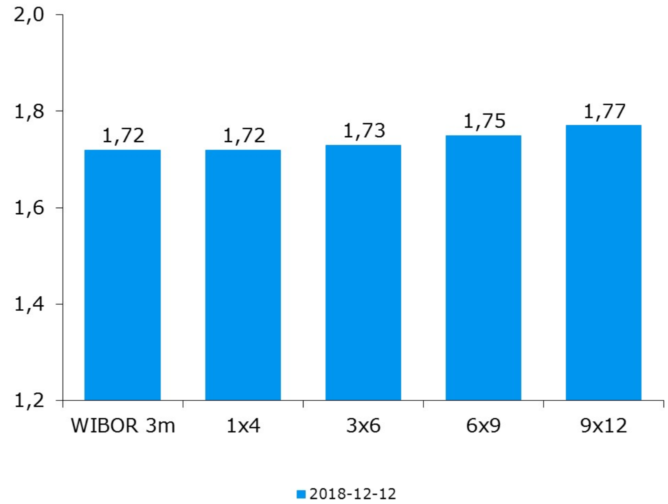
Fixed income

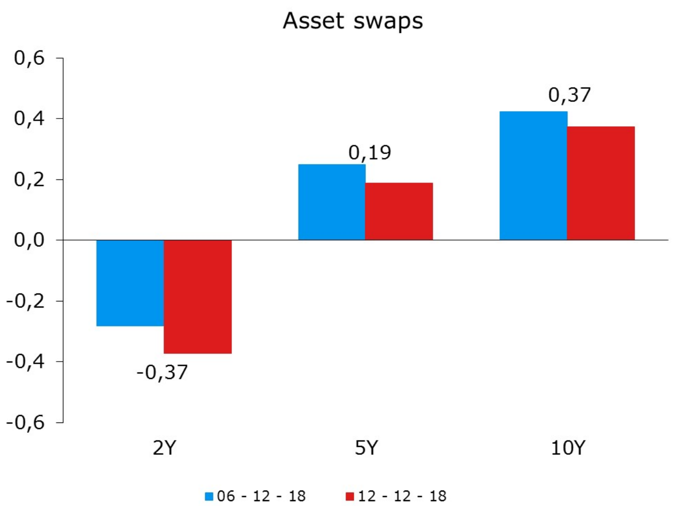
Tighter ASWs, at last

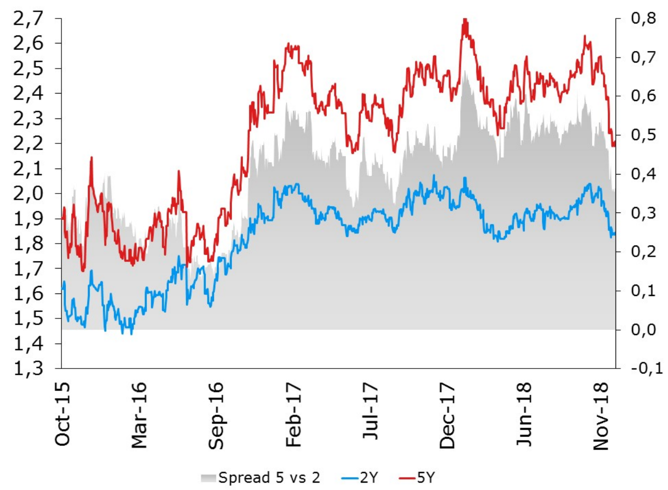
Finally, ASWs began to tighten and we are on the year's lows in terms of bond yields. They are still high compared to recent months. Market is quite vollatile and traders are careful about keeping significant positions, which results in lack of liquidity.

DS1023/5y is 4 bps, WS0428/10y is 37 bps. DS1023/WS0428 is 69 bps. WS0428/Bund is 267 bps. DS1020 is trading at 1.42% (11 bps down), DS1023 is trading at 2.24% (9 bps down) and WS0428 is trading at 2.94% (8 bps down).





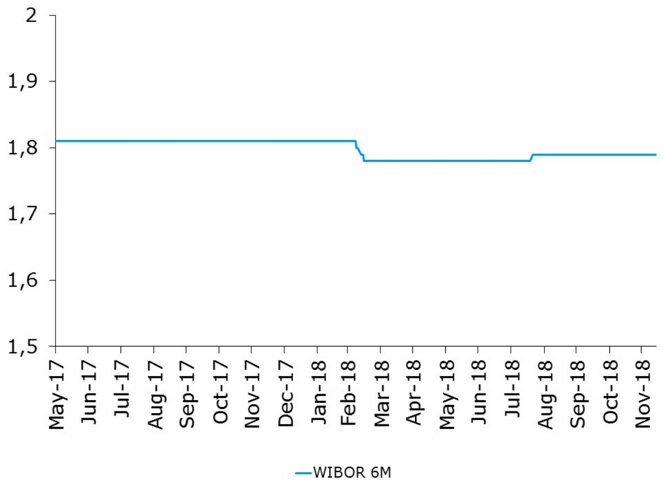


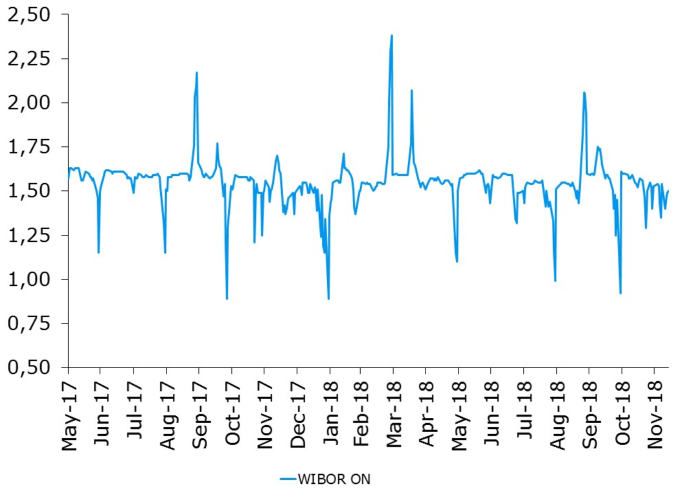


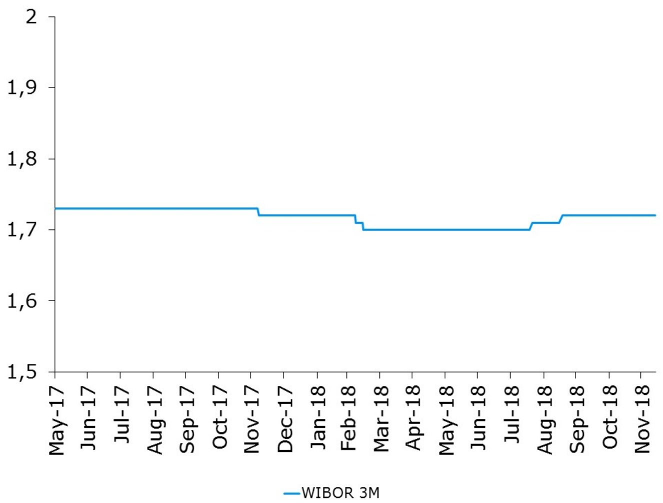
Money market

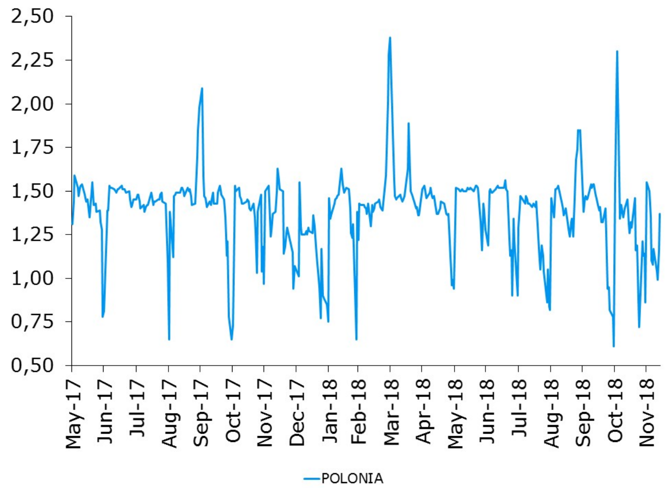
Cheap week behind us

This week was this December's second cheap week. On Friday's OMO banks bought PLN 85.8 bn bills out of 100 bn offered (whereas 96 bln would square the market). Polonia reached the lows on Monday at 0.99% and it caused an additional OMO on Tuesday. NBP offered PLN 15 bn of bills, of which banks bought 9 bn. The rest of the week was also not expensive with Polonia fluctuating around 1.30%. As next week will be the last one before Christmas, we think it will be cheap as liquidity will be secured.





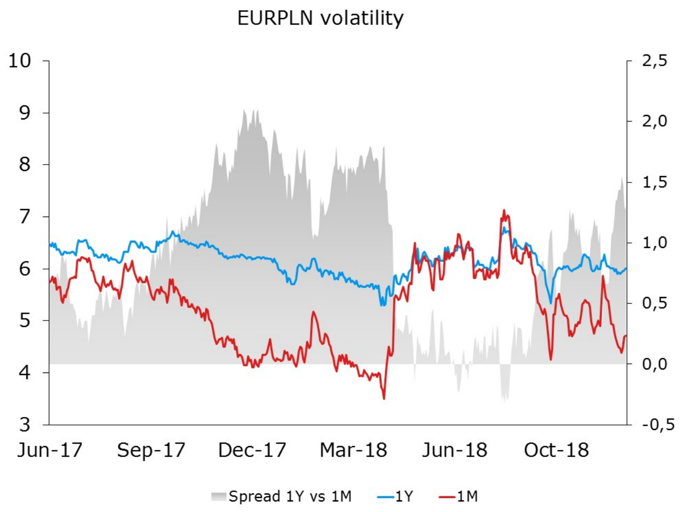




Forex

Spot – EUR/PLN – in the range The range play continues with 4.3035 constituting the high and 4.2760 the low at the last 5 working sessions. We are following the global "risk on – risk off" mood. Last week, the choppy trade on EUR/USD was driven mainly by concerns about Brexit uncertainty – British Prime Minister Theresa May postponed a crucial vote on her Brexit deal, raising the risk of a chaotic exit from the European Union. The situation in France we can also add as new concern to our old list of worries: Italy's budget deficit, downbeat German investor confidence data, the U.S.-Sino trade tensions and an economic slowdown in China. Anyway we are still in range (4.26 – 4.34) trading mode, with slightly PLN-negative skew.

Opts: EUR/PLN vols – treading water The week seemed to be packed with events (mainly ECB) and, as a result, we started the week with a decent bid for gamma, especially in USD/PLN (1 week vol mid is 11.5%). However, the EUR/PLN vol curve is very stable. EUR/PLN 1 month ATM mid fixed today at 4.65% (0.1% higher than a week ago), 3 months EUR/PLN are 5.0% (unchanged) and 1 year is 5.95% (0.05% lower). The skew and the currency spread (difference between USD/PLN vol and EUR/PLN vol) are at same level as week ago.

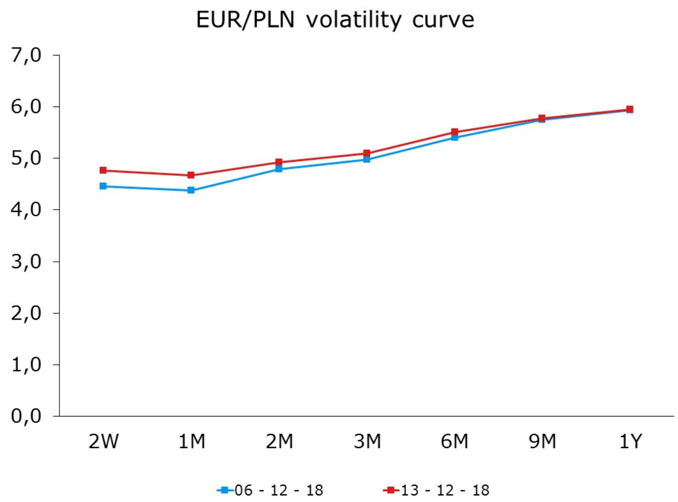


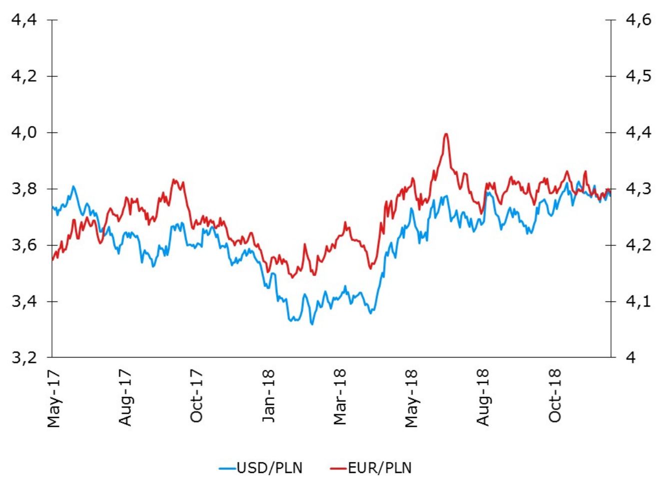
Short-term forecasts

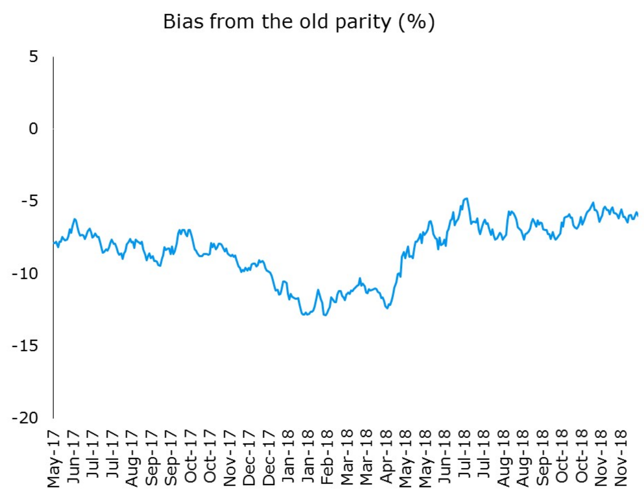
Main supports / resistances:
EUR/PLN: 4.2600 / 4.3400
USD/PLN: 3.6000 / 3.9000

Spot: Current position: None

Our strategy is roughly unchanged, we still believe in the rangy nature of EUR/PLN, with a slight PLN-negative bias. Therefore, we are ready to buy EUR/PLN at 4.27 with stop at 4.24 and hopes to see 4.34-35 again.







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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
12/6/2018	1.90	1.72	1.95	1.69	2.06	1.77	1.72	1.73	1.75	1.76	1.78	1.81
12/9/2018	1.96	1.72	2.02	1.69	2.06	1.77	1.72	1.73	1.75	1.77	1.79	1.82
12/10/2018	1.96	1.72	2.01	1.69	2.12	1.77	1.72	1.73	1.74	1.77	1.79	1.81
12/11/2018	1.78	1.72	1.84	1.69	1.95	1.77	1.72	1.73	1.75	1.77	1.79	1.81
12/12/2018	1.68	1.72	1.78	1.69	1.90	1.77	1.72	1.73	1.75	1.77	1.79	1.81

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
12/6/2018	1.770	1.052	1.835	1.552	2.190	2.439	2.580	3.004
12/9/2018	1.770	1.045	1.840	1.575	2.202	2.468	2.581	3.030
12/10/2018	1.770	1.006	1.840	1.558	2.195	2.446	2.572	3.010
12/11/2018	1.770	0.982	1.835	1.537	2.190	2.435	2.555	3.009
12/12/2018	1.770	0.929	1.845	1.472	2.208	2.395	2.572	2.946

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
12/6/2018	4.38	4.98	5.41	5.93	5.93	1.66	0.54
12/9/2018	4.47	4.97	5.42	5.95	5.95	1.66	0.54
12/10/2018	4.69	5.08	5.43	5.97	5.97	1.70	0.55
12/11/2018	4.71	5.05	5.53	6.01	6.01	1.65	0.55
12/12/2018	4.67	5.10	5.50	5.95	5.95	1.70	0.55

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
12/6/2018	4.2919	3.7844	3.7955	3.3605	1.3261	0.1657
12/9/2018	4.2845	3.7694	3.7924	3.3406	1.3261	0.1656
12/10/2018	4.2911	3.7600	3.7996	3.3356	1.3276	0.1660
12/11/2018	4.2982	3.7763	3.8266	3.3407	1.3289	0.1662
12/12/2018	4.2993	3.7934	3.8191	3.3430	1.3287	0.1662

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