December 20, 2018

Polish Weekly Review

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Comment on the upcoming data and forecasts

This Friday, Statistics Poland will publish monthly Statistical Bulletin along with unemployment and retail sales data. We expect another month of stabilization in unemployment with 5.7% rate, contradicting the Ministry of Family, Labour and Social Policy who published a preliminary estimate of 5.8%. Retail sales likely increased by 5.1% y/y, after very good October we will not see another increase of car sales this month, but there should not be also noticable effect of additional non-working day in November on food sales or other non-specialized stores categories. Warm weather could affect weaker clothing sales in the first part of month. However, data on car registrations suggest another strong month in this category and a non-negligible risk of a higher reading. On Monday NBP will publish M3 aggregate which we expect to increase by 8.7% y/y, due to the low base and current good growth. Because of the holiday season there will be no weekly report next week (we are coming back on January 3rd), therefore it is worth to notice the publications of manufacturing PMI and flash CPI in the first week of January. The former likely saw a small rebound in sentiment, while the latter will probably bring a small decline in inflation, marking the 1.1-1.2% y/y reading the local bottom in inflation.

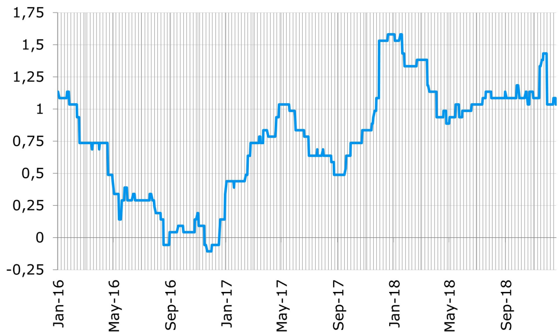
Polish data to watch: December 21st to January 4th

Publication	Date	Period	mBank	Consensus	Prior
Unemployment rate (%)	21.12	Nov	5.7	5.7	5.7
Real retail sales y/y (%)	21.12	Nov	5.1	6.3	7.8
M3 y/y (%)	24.12	Nov	8.7	8.4	8.3
Manufacturing PMI (pts.)	02.01	Dec			49.5
CPI y/y *flash* (%)	04.01	Dec			1.3

Treasury bonds and bills auctions

Paper	Next auction	Last Offer	Yield on the prev auction (%)	Prev auction
T-bill	-	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
5Y floater WZ0524	1/10/2019	1800	-	10/26/2018
10Y floater WZ0528	1/10/2019	300	-	10/26/2018

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



Comment

Final CPI turned out 0.1 pp. higher compared to the flash reading and moved the surprise index one point higher, but PPI reading was below the market consensus and moved the index back. Tomorrow, retail sales and unemployment can change Poland's surprise index, for more changes we need to wait until the beginning of January, when PMI and flash CPI will be published.

* 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).

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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

	2015	2016	2017	2018 F	2019 F	2020F
GDP y/y (%)	3.8	3.0	4.8	5.1	3.8	3.3
CPI Inflation y/y (average %)	-0.9	-0.6	2.0	1.6	1.7	2.5
General government balance (%GDP)	-2.7	-2.2	-1.4	-0.2	-0.7	-1.1
Current account (%GDP)	-0.6	-0.3	0.2	-0.6	-1.2	-1.4
Unemployment rate (end of period %)	9.8	8.2	6.6	5.6	5.0	4.9
Repo rate (end of period %)	1.5	1.5	1.5	1.5	1.5	2.5

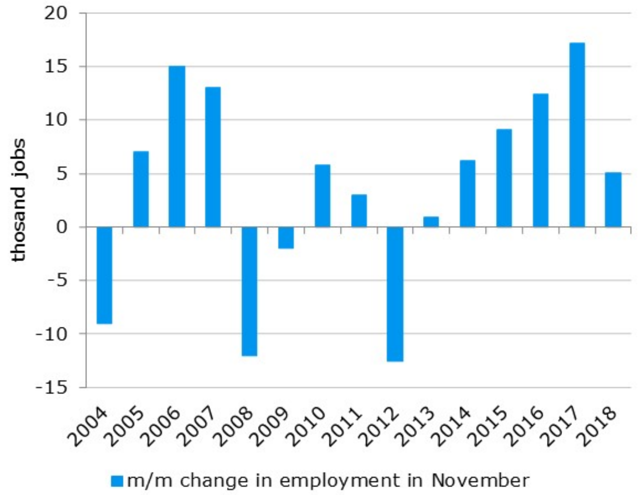
	2018 Q1	2018 Q2	2018 Q3	2018 Q4 F	2019 Q1 F	2019 Q2 F	2019 Q3 F	2019 Q4 F
GDP y/y (%)	5.3	5.1	5.1	4.8	4.3	4.2	3.6	3.1
Individual consumption y/y (%)	4.7	4.9	4.5	4.3	4.1	3.9	3.5	3.1
Public Consumption y/y (%)	3.0	3.5	3.6	4.0	2.0	2.0	2.0	2.0
Investment y/y (%)	8.2	4.7	9.9	10.0	6.0	6.0	5.0	4.0
Inflation rate (% average)	1.5	1.7	1.9	1.4	1.5	1.6	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

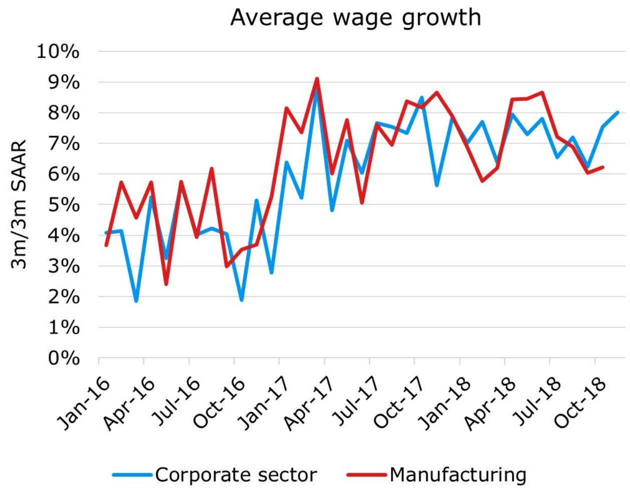
Economics

Uninterrupted slowdown in employment, but wages surprised to the upside again.

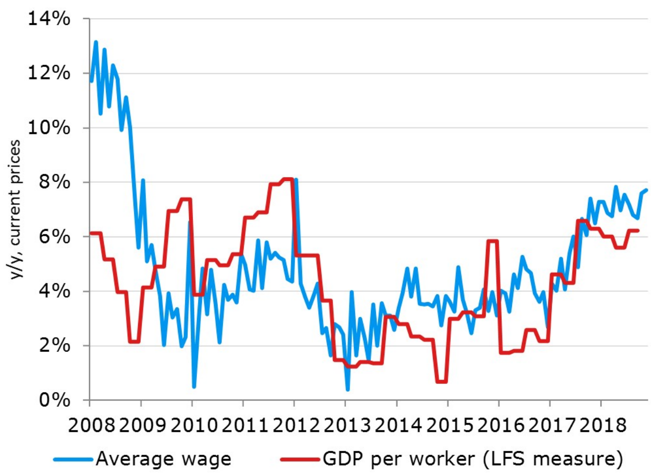
Employment in the enterprise sector increased by 3% y/y in November, in line with our expectations and market consensus. Lower employment dynamics resulted from the base effect from previous year (record-high increase in employee count in November 2017) and in trend of employment slowing down which has been seen for many months. In absolute terms there were 5 thousand posts added, which was the worst result since November 2013. Slowdown of the employment dynamics is a consequence of both supply and demand factors. First ones can be seen in increasing problems with finding workers and extending searching time, second reasons can be confirmed in a whole cross-section set of macro indices.



Average gross wage rose by 7.7% y/y in November, slightly up from October's 7.6% and above market expectations (7.1-7.2% y/y). The reasons for the surprise are unknown at this point, but Friday's release of monthly Statistical Bulletin should be of considerable assistance. Note that there were good arguments in favor of a slowdown in wage growth in November: unfavorable calendar, since working day count dropped from -1 to 0 y/y or even -1 y/y if the extra holiday on November 12th was (somewhat unrealistically) treated as a full-blown one; shifts of mining bonuses, whose disbursement started in October already. While any of the abovementioned factors could be at play, another culprit is also possible – some bonus payments might have already been frontloaded ahead of the imposition of additional "solidarity tax" on highest incomes in January. In any case, Friday's data will be helpful in determining the reasons.



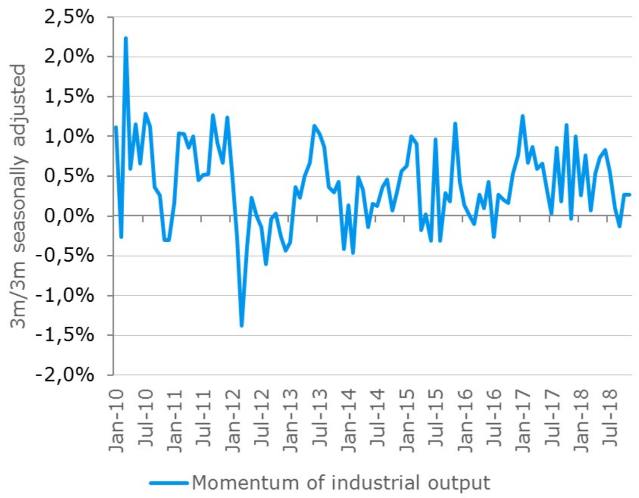
Regardless of the nature of the surprise, wage growth has been holding up surprisingly well in recent months and its momentum looks much more solid than we assessed it only a couple of weeks ago. However, it is still indicative of a stable growth rate (see the graph above), not of significant acceleration. Another wave of wage hikes, pushing its growth rate above 8% is simply not happening. It might change next year, when Germany liberalizes its labor market for Ukrainian workers and the resulting outflow of migrants exacerbates the persistent supply problems in Poland. It will have to be watched closely.



Solid wage growth coupled with markedly lower inflation has boosted real income growth – it should ensure a smooth and gentle deceleration in household consumption. From the MPC's point of view, current labor market data continue to have little significance. In particular, high labor productivity growth allows the Council to wave away persistent positive surprises in wage growth vis-a-vis subsequent staff projections. As we repeatedly claimed, only a significant acceleration in inflation could upend the status quo in Polish monetary policy. The CPI path we are currently forecasting offers no reasons to expect that in 2019.

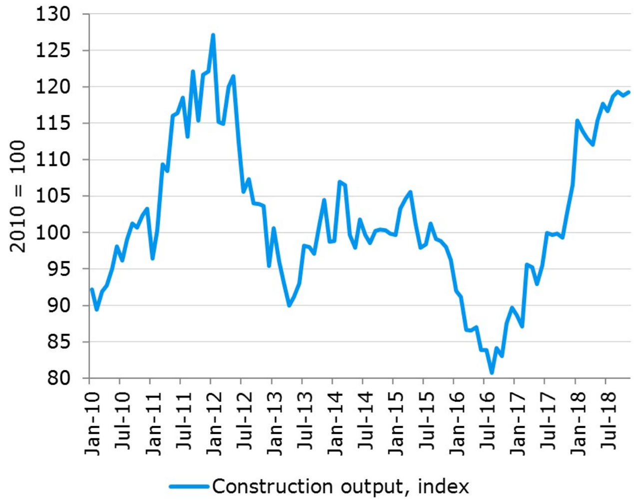
Growth momentum in Poland slowing despite upside surprise in industrial output. PPI dragged by oil prices.

Sold industrial output rose by 4.7% y/y, a bit above market expectations and our forecast (4.0 and 3.1% y/y, respectively). The slowdown vis-a-vis October's 7.4% y/y is a result of less favorable calendar, since working day count dropped from +1 to 0 y/y. The unexpected public holiday on November 12th likely had no measurable impact on output. On a monthly basis, industrial production rose by 0.1% m/m (seasonally adjusted), therefore its momentum is quite low. However, it is still better than what one could have expected on the basis of the PMI. Finally, the trend of slowing down production is still intact and output is now growing at a 5-5.5% clip (down from ca. 8% in Q4'17).

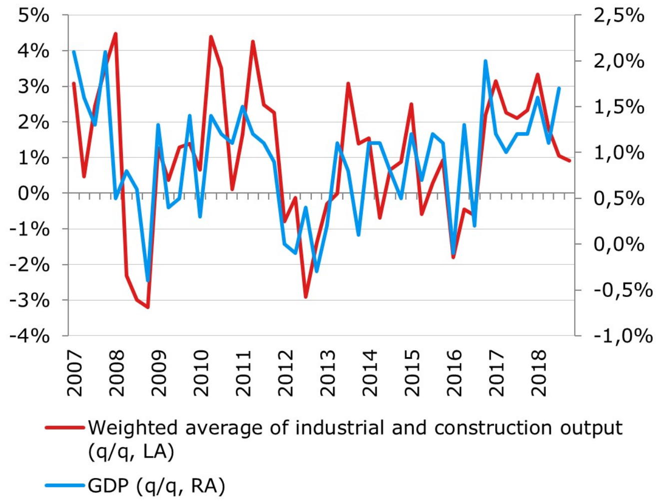


Next months, with calendar being even less favorable and base effects biting, should bring lower growth rates (ca. 2% in December). The fundamentals of Polish industry remain unchanged, though. The world economy has slowed down considerably and the trend shows no signs of abating, let alone reversing. Domestic demand, however, continues to keep Polish industry afloat – whether it will continue, it depends on binding supply constraints.

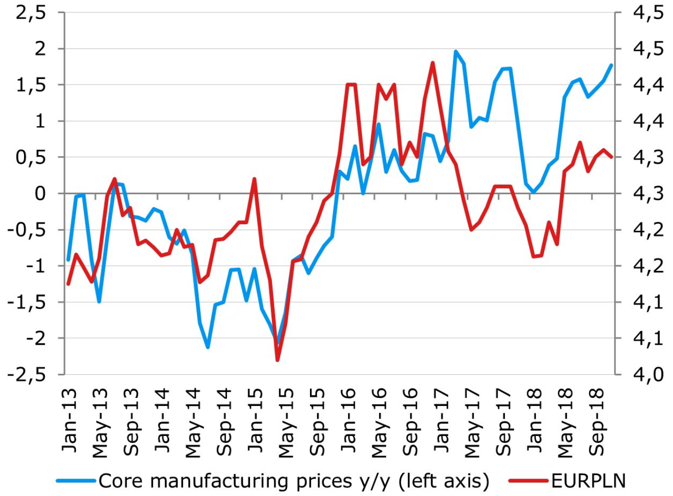
Construction output in November was 17.1% higher compared to the previous year. The result was close to both our forecast (16.4% y/y) and market consensus (16.5% y/y). As in October, in favor of this reading acted good weather (dry and warm month), while it could be limited by additional non-working day and a high base from previous year. Yearly growth, adjusted for the seasonal effects, increased by 15.9 and remained almost unchanged compared to October – in fact November was another month of stagnation. The largest yearly growth was recorded in civil engineering works (20.4% y/y) and specialized construction activities (18.4%) – in those critical infrastructure categories work was continued despite the additional non-working day.



After November data, our **Q4 GDP nowcast** remains essentially unchanged. On the basis of industry and construction data, we estimate Q4 GDP at 4.9-5.0% y/y, but there is considerable uncertainty regarding its composition. In particular, a lot depends on the behavior of inventories after the Q3 buildup. Any correction in that category is likely to push Q4 GDP towards 4.5% and **sold** industrial output will not show this process. Nevertheless, it is worth noting that the economy lost momentum in Q4 and its sequential growth rate is likely to be the lowest since mid-2016.



As we thought, **PPI** dropped considerably in November – to 2.7% y/y (market consensus 3.1%, our forecast 2.6%). There are no surprises: oil-sensitive components dropped like a stone (-6.6% m/m) and core manufacturing prices accelerated a bit to 1.8% y/y from 1.6% y/y a month ago. The latter may not seem an impressive development but it actually is in the context of stable EURPLN (see the graph). It is again a fuel for hope that prices pressure is slowly building (as usual, to be corroborated next month). Another important development are utility prices that are being lifted up by electricity prices for non-regulated customers. We await a slow but steady drift upwards in utility prices, but the cumulative 2019 effect is going to be rather moderate. December reading is going to be again under the spell of low oil prices. Given the more vigorous behavior of core PPI and base effects, the most likely forecast is situated now around 2.5%.



From the MPC's point of view the data continue to be neutral for monetary policy outlook. With short-term data consistent with recent projections and widespread doubts about the link between output gap and inflation, the status quo might only be changed by actual buildup of inflationary (demand-pull) pressures. Based on current data and forecasts, it is highly unlikely that inflation would reach alarming levels in 2019.

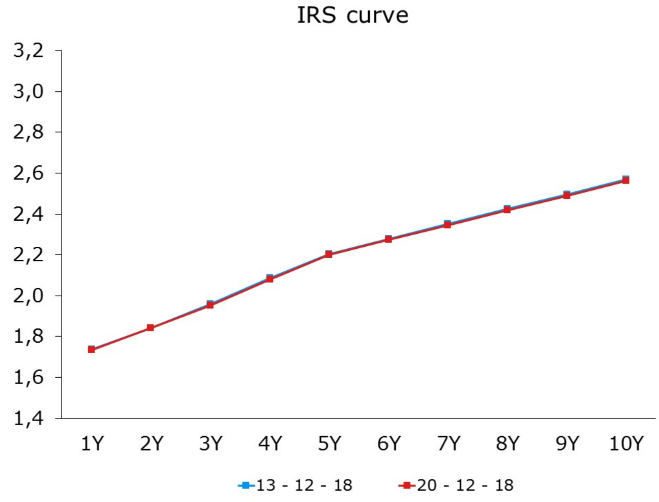
Fixed income

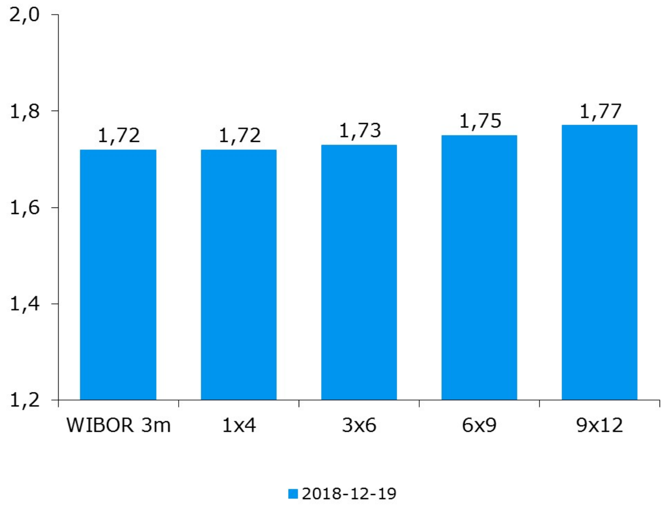
Nothing to see here, move along, wait for next year

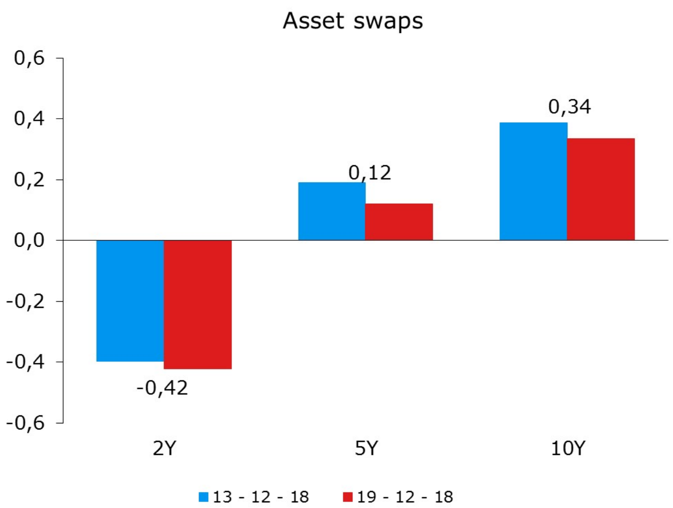
Liquidity is poor, which is typical for the end of year. ASWs tightened a bit further, but still not enough to match credit risk priced by floating rate bonds. The market is strong and had been recently heavily guided by central banks and global developments.

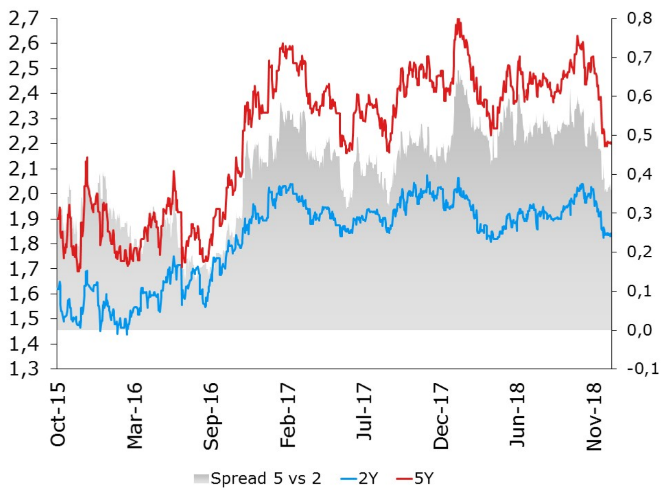
DS1023/5y is 0 bps, WS0428/10y is 32 bps. DS1023/WS0428 is 69 bps. WS0428/Bund is 265 bps.

DS1020 is trading at 1.34% (8 bps down), DS1023 is trading at 2.18% (6 bps down) and WS0428 is trading at 2.88% (6 bps down).









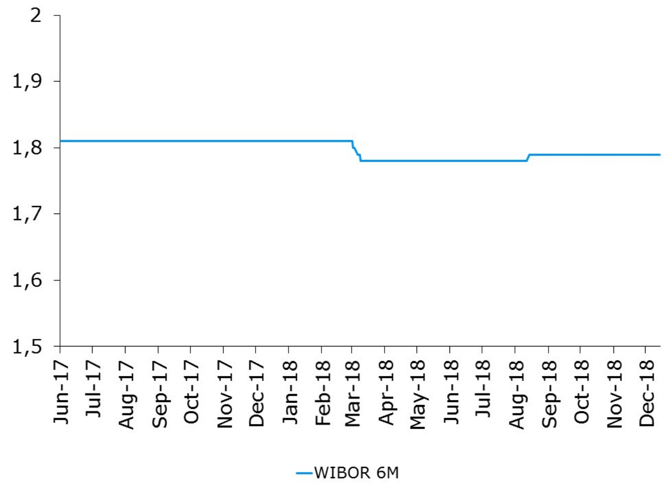
Money market

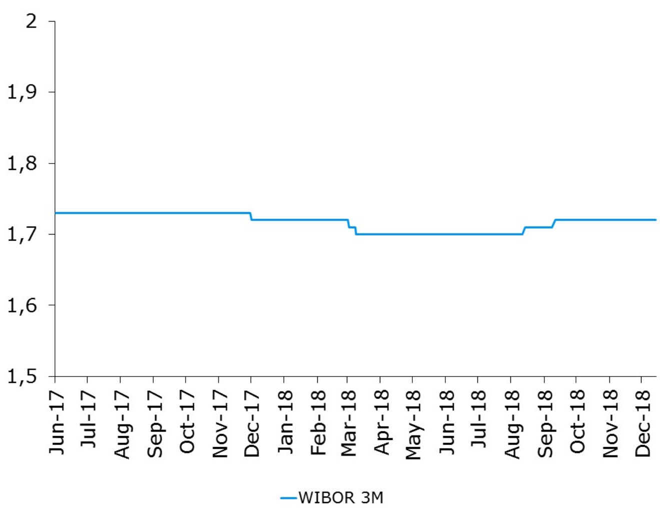
Two years with no hikes?

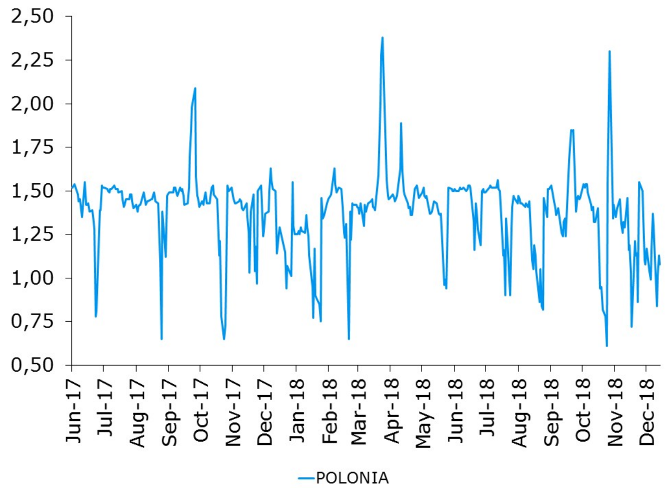
Polish curve stays close to recent lows. Activity is fading due to year end coming. Fed raised rates as expected, but there was no upside on core yields after the decision. Activity and volatility should detiorate further towards the end of 2018. Polish market is pricing no move in the next 2 years at least. We enter 2019 with an important question: are payers, recently allured by potential electricity price hikes and hammered not long after by low inflation, going to be once again tempted by low interest rate path priced in by the market alone?

December usually is cheap and this year is no different. Liquidity is set to stay poor until 2019.

Ref rate vs Polonia averages:
30 day 21 bp
90 day 14 bp



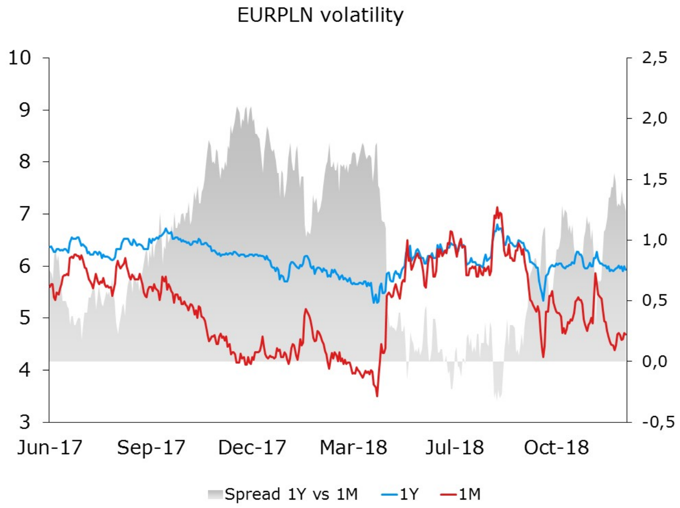


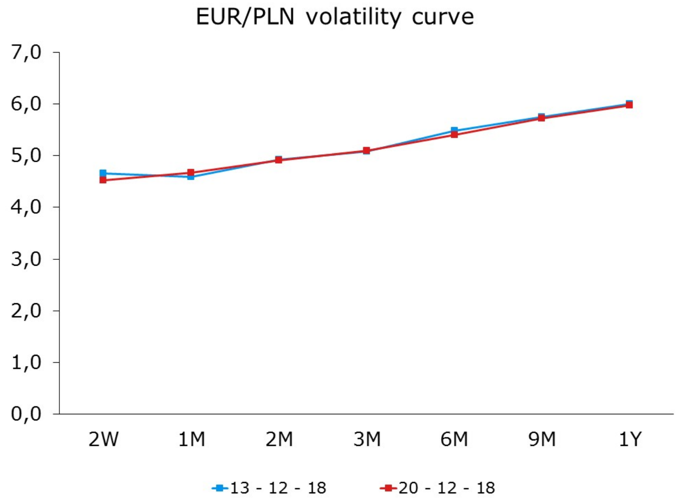


Forex

Spot – EUR/PLN – in the range The FOMC meeting is already behind us, with the expected hike but softening the language of the policy statement and lowering the path of rates implied in the 'dot plot'. However, markets are surprised by the Fed's committment to retain the core of its plan to tighten monetary policy, despite rising uncertainty about global economic growth. As a result there were: a sharp sell-off in equity markets, a fall in Treasury bond yields, a flattening in the yield curve, and weakness of risk sensitive currencies. Nevertheless, the message from the FOMC has failed to produce any volatility on EUR/PLN – we are still in the 4.28–4.31 range trading mode, with slightly PLN-negative skew.

Opts: EUR/PLN vols – the front end lower Fast approaching Christmas, the lack of real thrill and fat theta bills were the reasons why the front end of the volatility curve has collapsed. 1 week EUR/PLN and USD/PLN dived by 1.5% and 3.5%, respectively, and fixed at 4.0% and 8.0%. The rest of the curve is quite stable. EUR/PLN 1 month ATM mid fixed today at 4.3% (0.35% lower than week ago), 3 months EUR/PLN are 5.0% (no change) and finally 1 year is 5.95% (no change). The skew is also touch lower, along with the currency spread (difference between USD/PLN vol and EUR/PLN vol), which decreased by around 0.5% and is now at 4.0–4.5%.



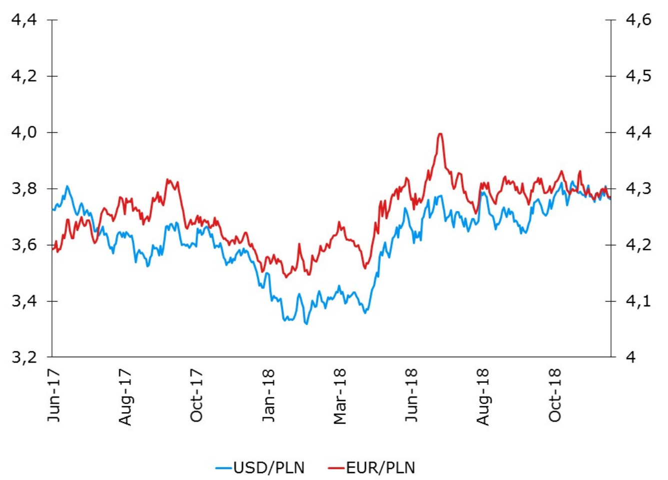


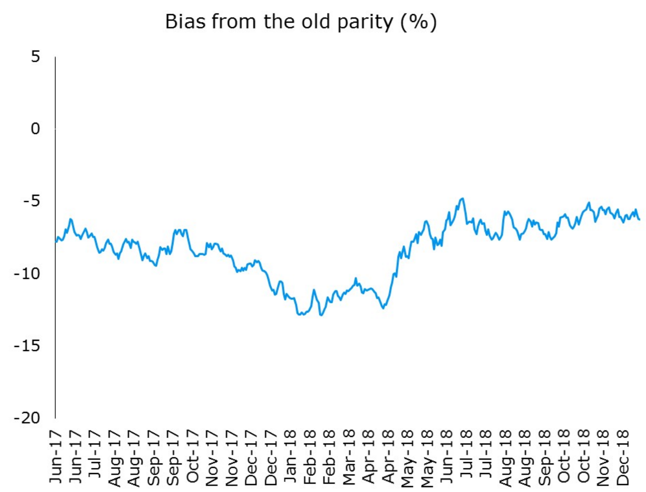
Short-term forecasts

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
12/13/2018	1.65	1.72	1.70	1.69	1.80	1.77	1.72	1.73	1.76	1.77	1.79	1.82
12/16/2018	1.88	1.72	1.95	1.69	2.06	1.77	1.72	1.73	1.74	1.76	1.79	1.81
12/17/2018	1.94	1.72	2.01	1.69	2.11	1.77	1.72	1.73	1.75	1.77	1.80	1.82
12/18/2018	1.78	1.72	1.83	1.69	1.94	1.77	1.72	1.73	1.75	1.77	1.79	1.82
12/19/2018	2.01	1.72	2.05	1.69	2.06	1.77	1.72	1.73	1.75	1.77	1.80	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
12/13/2018	1.770	0.940	1.840	1.442	2.205	2.395	2.570	2.956
12/16/2018	1.770	0.948	1.835	1.423	2.202	2.365	2.567	2.932
12/17/2018	1.770	0.981	1.830	1.413	2.205	2.376	2.580	2.936
12/18/2018	1.770	1.000	1.840	1.408	2.200	2.321	2.565	2.900
12/19/2018	1.770	0.975	1.840	1.418	2.200	2.321	2.563	2.898

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
12/13/2018	4.59	5.08	5.49	6.00	6.00	1.70	0.55
12/16/2018	4.59	5.08	5.48	5.90	5.90	1.70	0.55
12/17/2018	4.71	5.09	5.47	6.00	6.00	1.65	0.55
12/18/2018	4.69	5.05	5.45	5.93	5.93	1.73	0.54
12/19/2018	4.67	5.10	5.40	5.98	5.98	1.65	0.54

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
12/13/2018	4.2937	3.7739	3.8036	3.3257	1.3272	0.1662
12/16/2018	4.3021	3.8095	3.8202	3.3558	1.3287	0.1669
12/17/2018	4.2906	3.7871	3.8025	3.3413	1.3265	0.1663
12/18/2018	4.2853	3.7668	3.7989	3.3513	1.3253	0.1662
12/19/2018	4.2846	3.7619	3.7875	3.3484	1.3287	0.1664

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