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Polish Weekly Review

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Comment on the upcoming data and forecasts

This Friday, PMI data see the light. Our models suggest a minor upward correction. Business activity is going to stay much below 50 pts threshold, though. Even with a stabilization of this activity measure, Q1 2019 is heading for a worse reading than Q4 2018. This week MPC holds a monthly meeting. Recent data do not give any reason to abandon prolonged forward guidance on rates (flat until 2021). Therefore we expect this meeting to be rather uneventful. The bias in MPC's reaction function was already revealed in January. Only much higher inflation data would stir the current MPC consensus. Hard to imagine that that as inflation hovers around 1%.

Polish data to watch: February 1st to February 8th

Publication	Date	Period	mBank	Consensus	Prior
PMI (pts.)	01.02	Jan	48.2	48.0	47.6
NBP decision (%)	06.02	Feb	1.50	1.50	1.50

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	1/25/2019	1000	1.547	1/10/2019
5Y T-bond PS0424	1/25/2019	2000	2.251	1/10/2019
10Y T-bond WS0428	1/25/2019	1100	2.821	1/10/2019
30Y T-bond WS0447	1/25/2019	20	3.643	10/4/2010
5Y floater WZ0524	1/25/2019	1000	-	1/10/2019
10Y floater WZ0528	1/25/2019	700	-	1/10/2019

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



Comment

Surprise index remained unchanged because, there was no publication of any reading included in the index. This week only tomorrow's publication of manufacturing PMI can change its behavior.

* 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

- 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.
- The MPC is now talking about holding rates steady until 2021 (the end of most members' term) and – given the overall environment (both global and local factors) – we concur. We don't expect any rate changes in Poland in the foreseeable future.
- 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 upcoming slowdown in demand will be somewhat of a test for the durability of the MoF's fiscal successes.

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: cyclical, 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

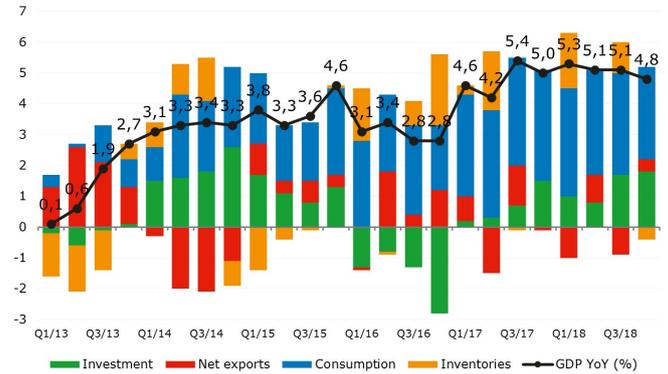
	2015	2016	2017	2018 F	2019 F	2020F
GDP y/y (%)	3.8	3.0	4.8	5.1	3.7	3.3
CPI Inflation y/y (average %)	-0.9	-0.6	2.0	1.6	1.9	2.5
General government balance (%GDP)	-2.7	-2.2	-1.4	-0.2	-0.7	-1.1
Current account (%GDP)	-0.6	-0.5	0.2	-0.6	-1.2	-1.4
Unemployment rate (end of period %)	9.8	8.2	6.6	5.9	5.4	4.9
Repo rate (end of period %)	1.5	1.5	1.5	1.5	1.5	1.5

	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	3.8	3.7	3.5	3.6
Individual consumption y/y (%)	4.7	4.9	4.5	4.0	3.7	3.5	3.4	3.3
Public Consumption y/y (%)	3.0	3.5	3.6	4.4	4.0	4.0	4.0	4.0
Investment y/y (%)	8.2	4.7	9.9	6.9	5.0	5.0	4.0	4.0
Inflation rate (% average)	1.5	1.7	1.9	1.4	1.5	1.8	1.9	2.2
Unemployment rate (% eop)	6.6	5.9	5.7	5.9	6.0	5.4	5.2	5.4
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	1.72	1.72	1.72	1.72	1.73
2Y Polish bond yields (% eop)	1.49	1.63	1.56	1.35	1.40	1.42	1.44	1.46
10Y Polish bond yields (% eop)	3.18	3.22	3.24	2.83	2.80	2.83	2.87	2.91
EUR/PLN (eop)	4.21	4.37	4.28	4.29	4.35	4.30	4.25	4.25
USD/PLN (eop)	3.42	3.74	3.69	3.74	3.85	3.77	3.70	3.66
F - forecast								

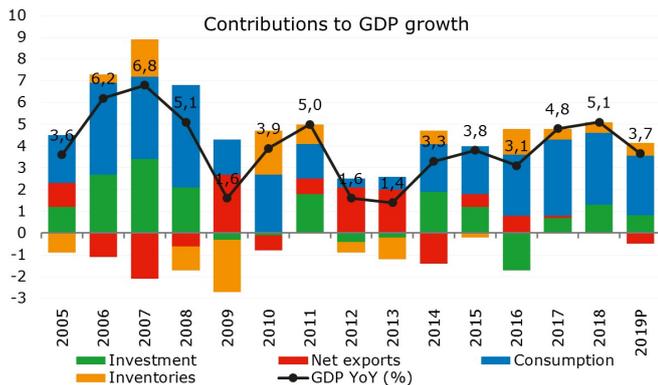
Economics

GDP in 2018 – high numbers are hiding the weak structure of growth

At least those are the implications from preliminary annual data. Because the dynamics of economic processes and the key question regarding the scope of the slowdown in the next quarters are of utmost importance to us, the most important conclusions from today's reading concern its implications for the estimated Q4 results.



Putting numbers aside, composition of growth suggests the slowdown trajectory of GDP and possibilities of bigger jumps in its dynamics. If the smoothing of GDP growth trajectory in 2018 was achieved by inventories and foreign trade, the same factors can imply a more intensive GDP slowdown in 2019. Our base scenario is GDP curbing to about 4% (with risks tilted to the downside) in the 1st quarter. Revision in exports is supported by the weak Eurozone data and Poland's correlations with the German economy, which usually are lagged by one or two quarters.



In our opinion, GDP in 4th quarter grew by 4.8% (the range of possible outcomes is 4.8 – 5.2%), and its structure weakened. According to our calculations, consumption growth decreased to 4% y/y in the last quarter (below expectations of 4.3% y/y, the range 3.9 – 4.1%), which is indicative of a gradual, but lasting slowdown trajectory. Investment growth decreased to about 6.8% (6.8-7.1% y/y range, as compared to the 9.9% y/y in the previous quarter). 2019 seems to be much worse in this category, because of the weaker private investment perspectives (note the declining capacity utilization in recent quarters) and dynamically weaker phase of the EU spending cycle. The situation in Q4 was partly rescued by the public consumption (about 4.4% y/y, range 4.2 – 4.5%), which can be easily connected with the election cycle – but usually it was visible in next revisions of GDP (this timer there should be no exceptions and the estimate of this category can further increase). But the real white knight was net exports. Contribution of inventories corrected strongly to negative territory (about -0.5 p.p., range -0.4 – -0.8%, against +1 p.p. in the 3rd quarter), but net exports in the 4th quarter added about 1 p.p. to GDP growth and it is a moment where true statistical troubles begin. What is a reason of such a huge contribution of foreign trade?

1. CSO has now only a partial information about foreign trade in the 4th quarter, there is still big part of data missing (i.e. December).
2. According to our calculations, net export contribution – keeping trends from October and November unchanged – should be negative. Only extraordinary December's reading (one month's surplus almost equal to the sum of previous two) or unusual behavior of deflators (huge terms of trade improvement) can explain such a strongly positive contribution of net exports in Q4.

Does it mean that the view about 4th quarter can change? It is hard to bet on the exact number, but in our opinion a 0.1-0.3 p.p. revision seems to be a rational approximation.

Fixed income

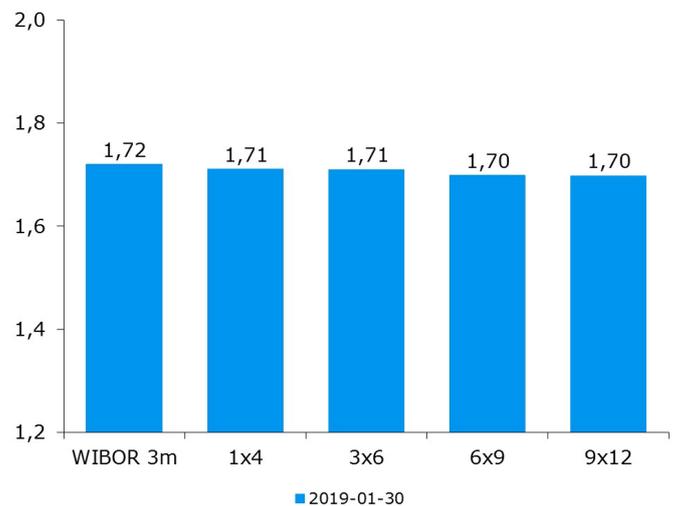
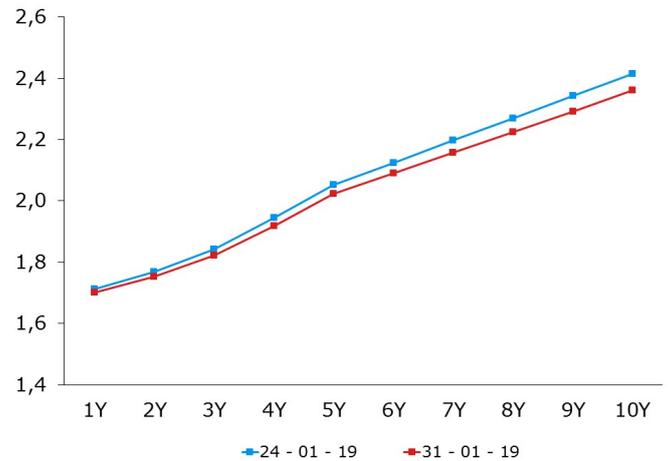
Close to recent lows

Last week the yield curve began to flatten as most bonds sold on the auction had 5y tenor. We are near year yields lows after last Fed meeting, this month a new 10y benchmark will be issued (DS1029).

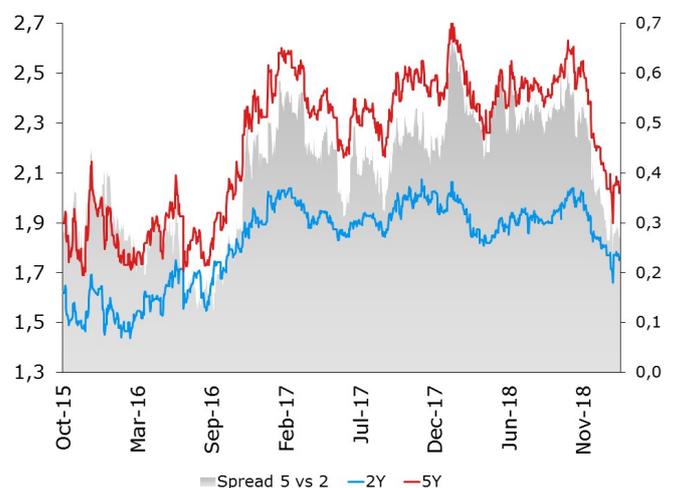
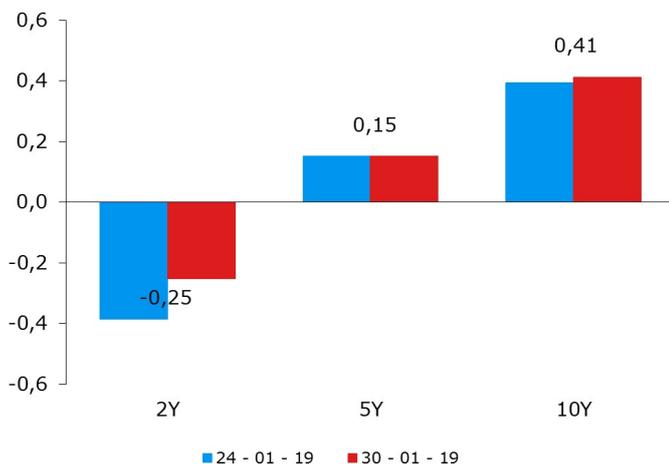
DS1023/5y is 6 bps, WS0428/10y is 44 bps. DS1023/WS0428 is 70 bps. WS0428/Bund is 255 bps.

DS1020 is trading at 1.36% (no change), DS1023 is trading at 2.02% (4 bps down) and WS0428 is trading at 2.72% (8 bps down).

IRS curve



Asset swaps



Money market

Gloom, but no doom

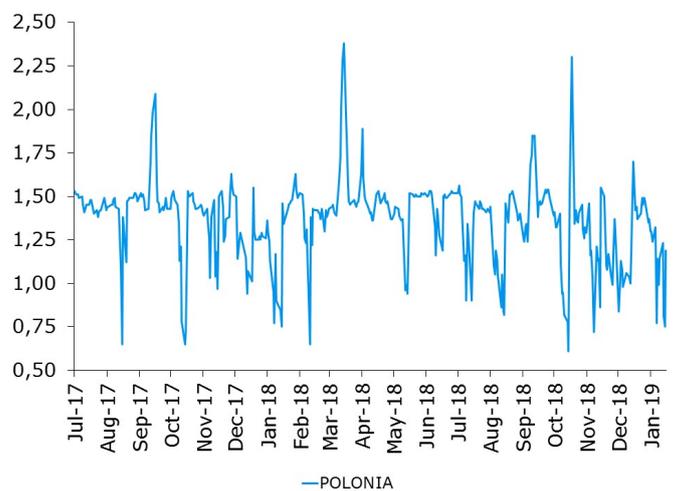
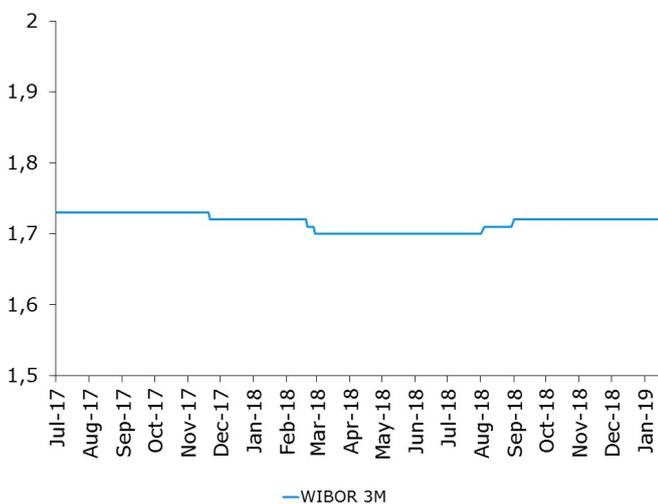
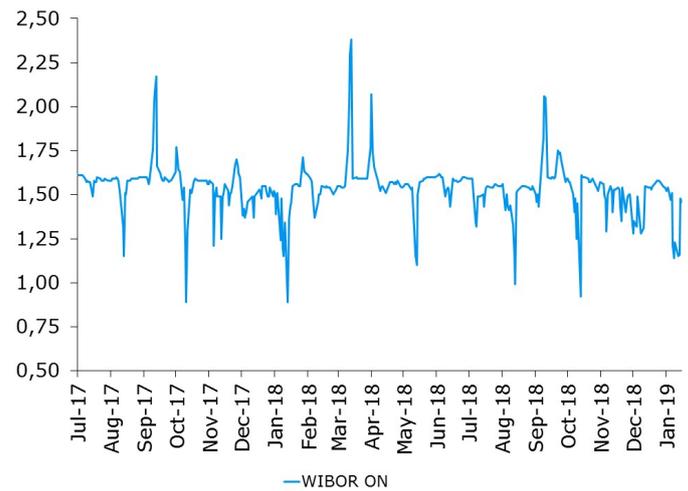
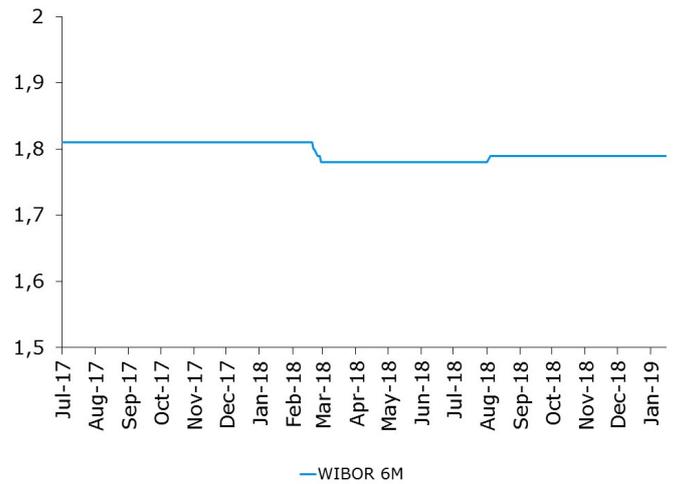
Global mood on rates turned into dovish in the last weeks. The themes of no more rate hikes in the US and gloomy outlook for the economy persist. With a lack of local story we follow this scenario with Polish rates trading on the low side. We see rather limited activity and low liquidity on the market. We should follow global markets in coming days.

New month starts, so cash should go back to normal.

Ref rate vs Polonia averages:

30 day 20 bp

90 day 23 bp



Forex

Spot – Consolidation continues. It was another week of the extremely tight range for EUR/PLN. The high of last 5 trading sessions was 4.2980, as the result of hard Brexit woes. The move was quickly faded, and we have reached the low at 4.2770 after the Fed meeting. All these moves are well inside the wider range, 4.26-4.34, that has dominated the market for weeks. Local politics (i.e. Kaczyński tapes) are not a market factor at all.

Opts: Implied volatility slightly lower. Realized volatility is still declining, but implied volatility seems to have found its equilibrium at current levels, as the curve has not changed much from last week. 1 month EUR/PLN atm is today at 3.75% (unchanged from last week), 3 months is at 4.15% (0.1% lower than week ago), 1 year is at 5.1% (0.1% lower). The currency spread (difference between USD/PLN and EUR/PLN) and the skew are at the same level as week ago.

Short-term forecasts

Main supports / resistances:

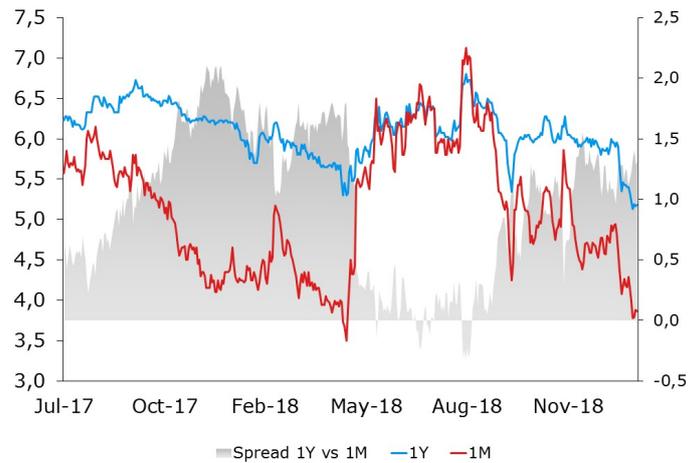
EUR/PLN: 4.2400 / 4.3200

USD/PLN: 3.6000 / 3.9000

Spot: Current position: Long EUR/PLN

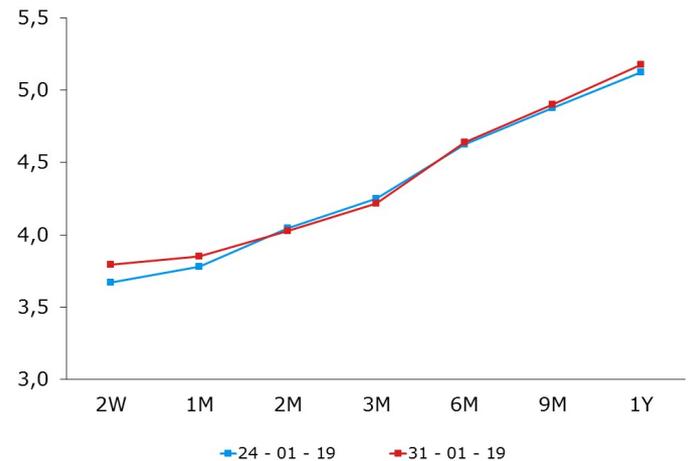
Our strategy is roughly unchanged, we still believe in rangy nature of EUR/PLN. We are going to play that range with a slight PLN negative bias. That makes us long EUR/PLN at 4.2750 with a room to add at 4.2600, and the stop at 4.2400 with hopes to see another try at 4.29+.

EURPLN volatility



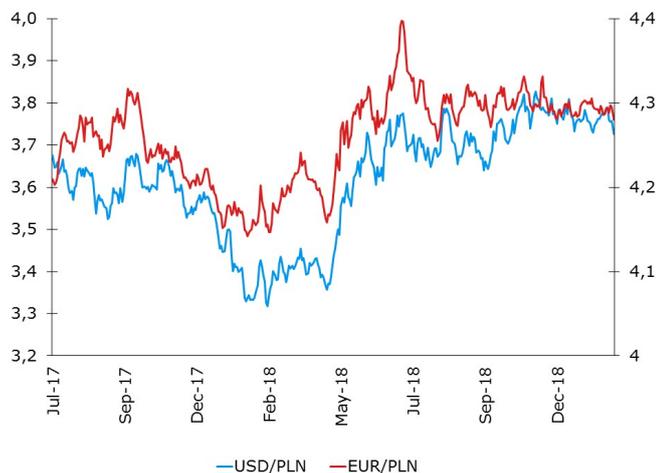
Spread 1Y vs 1M 1Y 1M

EUR/PLN volatility curve



24 - 01 - 19 31 - 01 - 19

Bias from the old parity (%)



USD/PLN EUR/PLN

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
1/24/2019	1.83	1.72	1.94	1.69	2.10	1.77	1.72	1.71	1.71	1.71	1.71	1.77
1/27/2019	1.71	1.72	1.83	1.69	1.99	1.77	1.71	1.71	1.71	1.71	1.71	1.76
1/28/2019	1.82	1.72	1.92	1.69	2.07	1.77	1.72	1.71	1.70	1.71	1.71	1.77
1/29/2019	1.65	1.72	1.74	1.69	1.89	1.77	1.71	1.70	1.70	1.70	1.70	1.76
1/30/2019	1.75	1.72	1.84	1.69	1.99	1.77	1.71	1.71	1.70	1.70	1.70	1.75

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
OK0521	1/10/2019	5/25/2021	96.44	1.55	1000	2836	1100
PS0424	1/10/2019	4/25/2024	101.21	2.25	2000	3453	1915
WS0428	1/10/2019	4/25/2028	99.40	2.82	1100	1967	1145

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0720	5Y IRS	PS0423	10Y IRS	WS0428
1/24/2019	1.770	1.186	1.767	1.380	2.052	2.205	2.415	2.810
1/27/2019	1.770	1.177	1.775	1.382	2.065	2.211	2.422	2.817
1/28/2019	1.770	1.354	1.762	1.376	2.038	2.199	2.393	2.808
1/29/2019	1.770	1.414	1.750	1.511	2.020	2.180	2.357	2.827
1/30/2019	1.770	1.409	1.752	1.500	2.023	2.176	2.360	2.772

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
1/24/2019	3.78	4.25	4.63	5.13	5.13	1.47	0.51
1/27/2019	3.79	4.27	4.65	5.19	5.19	1.47	0.51
1/28/2019	3.88	4.28	4.58	5.16	5.16	1.49	0.52
1/29/2019	3.86	4.31	4.70	5.18	5.18	1.49	0.51
1/30/2019	3.85	4.22	4.64	5.18	5.18	1.46	0.52

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
1/24/2019	4.2942	3.7844	3.8084	3.4482	1.3472	0.1670
1/27/2019	4.2935	3.7893	3.8044	3.4507	1.3484	0.1669
1/28/2019	4.2885	3.7592	3.7896	3.4362	1.3492	0.1668
1/29/2019	4.2974	3.7563	3.7861	3.4317	1.3551	0.1669
1/30/2019	4.2952	3.7577	3.7725	3.4359	1.3544	0.1665

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