

February 7, 2019

Polish Weekly Review

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Comment on the upcoming data and forecasts

On Wednesday the NBP will publish monthly balance of payments data. Seasonal patterns and the broad-based weakness in output and sales data dictate that both exports and imports drop considerably on a monthly basis. As a result, trade balance is set to widen above 1 bn EUR and only due to a slight improvement in current transfers and services did the overall CA balance not widen beyond 1 bn PLN. On Thursday Statistics Poland will publish preliminary GDP figures for the fourth quarter. The annual data released on January 31st indicates that GDP rose by 4.8% y/y in the fourth quarter, implying a sharp slowdown on a consecutive basis (from 1.7 to 0.4-0.5% q/q). Finally, next Friday January CPI figures will be released. Market consensus converged on a slight slowdown (from 1.1 to 1.0% y/y – equal to our forecast), but uncertainty is high. Main risk factors are: how Statistics Poland recorded the effects of electricity price freeze scheme introduced this year, how various administered prices behaved in January and whether the turn of the year spurred some delayed adjustments of corporate's prices to higher commodity and labor costs.

Polish data to watch: February 8th to February 15th

Publication	Date	Period	mBank	Consensus	Prior
CA balance (m EUR)	13.02	Dec	-1066	-854	-221
Exports (m EUR)	13.02	Dec	16426	16714	20025
Imports (m EUR)	13.02	Dec	17528	17943	20254
GDP y/y (%)	14.02	Q4	4.8	4.8	5.1
CPI y/y (%)	15.02	Jan	1.0	1.0	1.1

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	3/8/2019	150	1.493	2/7/2019
5Y T-bond PS0424	3/8/2019	1500	2.158	2/7/2019
10Y T-bond DS1029	3/8/2019	1500	2.813	2/7/2019
30Y T-bond WS0447	3/8/2019	30	3.149	1/25/2019
5Y floater WZ0524	3/8/2019	600	-	2/7/2019
10Y floater WZ0528	3/8/2019	1000	-	2/7/2019

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



Comment

The PMI was pretty close to market consensus, hence no changes in our surprise index. Next week brings GDP and CPI data, therefore there is some room for the index to start moving again.

* 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 2019, Poland will no longer be able to escape economic gravity. With worse consumption prospects and public investment peaking in annual terms in 2019, we expect GDP to grow by 3.7% y/y this year. Q1 is set to be marked by a major drop in y/y growth and the stable path in the latter quarters is dependent on a rebound in the global economy.
- Core inflation is projected to rise steadily, but CPI inflation is likely to stay low and undershoot the MPC target in 2019. Electricity prices were frozen, but there are many other administered prices that will rise this year. Second round effects after surge in electricity costs on the firms' side will be marginal, though. With low food and fuel prices, the beginning of the year will be marked by low inflation. The uptrend later depends on core inflation accelerating.
- 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. Risks to this forecast are balanced.
- General government deficit was likely the lowest in history in 2018. The name of the game now is fiscal stimulation and we expect fiscal space to be used to cushion the slowdown.

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 EUR/PLN to remain essentially flat within the forecast horizon. Risks are tilted to the upside as market participants are drawing smooth GDP path and underestimate the onset of the slowdown.

mBank forecasts

	2015	2016	2017	2018	2019 F	2020 F
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

Reading between the lines of recent MPC communication

The February meeting of the Monetary Policy Council brought no changes to interest rates, key passages in the Council's statement and governor Glapinski's guidance on future rates.

However, there are several subtle changes in the statement and in Glapinski's rhetoric worth highlighting. First, the Council sees the prospects of global growth as more dismal and that fits the long-cherished narrative of a global downturn we've been hearing from the governor for many months now. Second (now we're starting to read between the lines), while current forward guidance appears to be less dovish (rates "probably" unchanged in 2020 as well as opposed to "until the end of the Council's term"), it wasn't changed on purpose. Instead, it lies well within the natural variability of the Council's rhetoric and it's highly unlikely that the MPC would turn more hawkish in these circumstances. Third, when asked about the direction of the next interest rate change, the governor said that eventually rates will be cut or raised. Contrast this with the way rate cuts were previously framed – this time there was no mention of financial stability, net interest income and reversal rates – in other words, for the governor risks to current rate path are symmetric. Thus, we believe that the Council might be closer to cutting rates than the consensus thinks. It would also make sense to reach the limits of conventional monetary easing first and then use unconventional tools. Finally, we get the impression that the Council, having won the big bet on interest rate hikes with markets and private sector analysts, is still expecting others to ask about rate hikes. This is why all answers regarding the future rate changes are listing the reasons not to hike. The arguments cited (growth prospects, low inflation, balanced economy) are definitely not indicative of a hiking bias. Perhaps it's time to stop asking and start inquiring about future easing.

The apparent moves in the endpoint of Glapinski's forward guidance is introducing some volatility to the expectations of future rates (as seen in analysts' recent comments). As a result, market pricing can easily move 25 bps in both directions, despite the fact that flat rate path is still the most likely scenario.

Fixed income

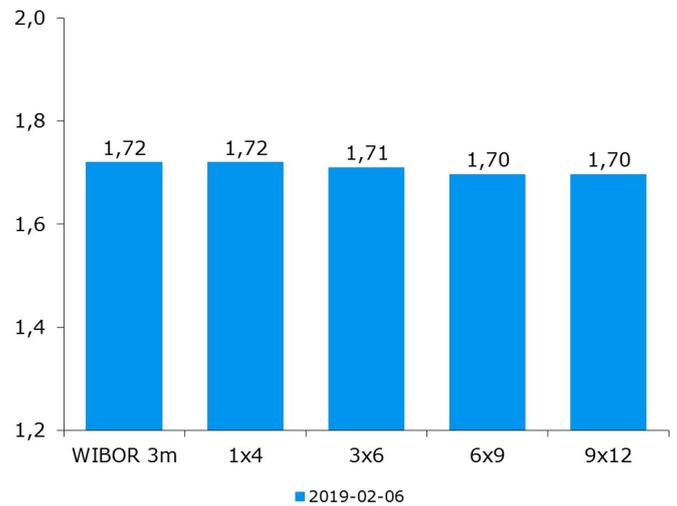
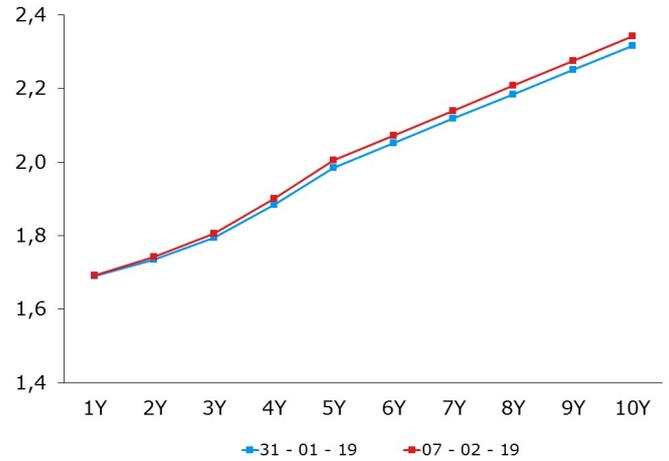
New 10-year benchmark in high demand

Today's auction had bid/cover ratio of 2, most of the demand went to the new 10y benchmark, which was issued at 8bps vs 0428, the old one. Market went down just after auction, as usual, when primary dealers want to sell some of the bonds bought. The latest flattener left the belly of the curve relatively untouched.

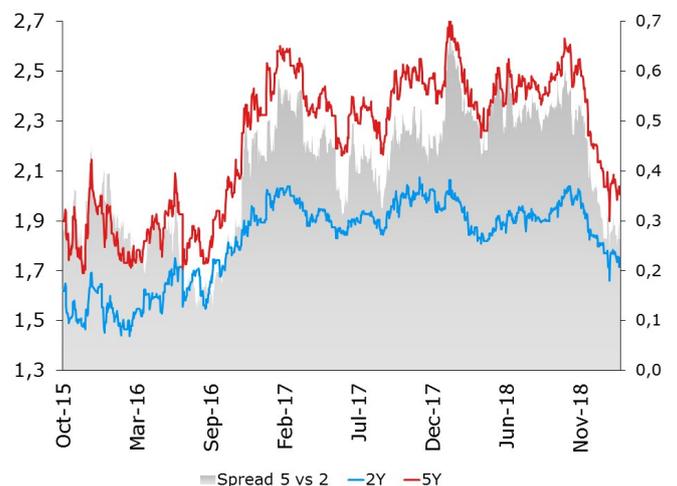
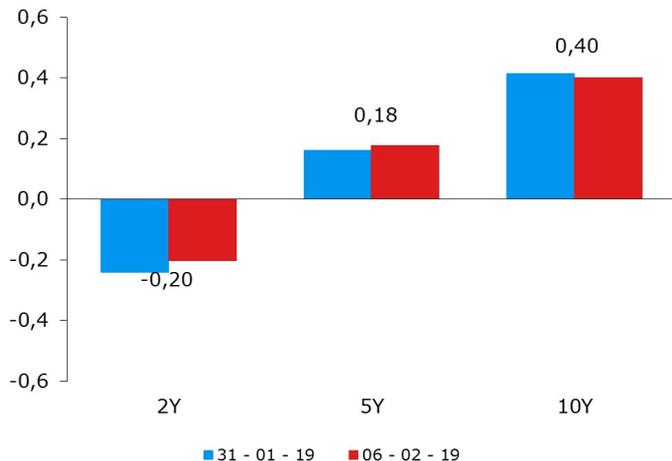
DS1023/5y is 6 bps, WS0428/10y is 39 bps. DS1023/WS0428 is 66 bps. WS0428/Bund is 261 bps.

DS1020 is trading at 1.39% (3 bps up), DS1023 is trading at 2.07% (5 bps up) and WS0428 is trading at 2.735% (1.5 bps up).

IRS curve



Asset swaps



Money market

Where has all the cheap cash gone?

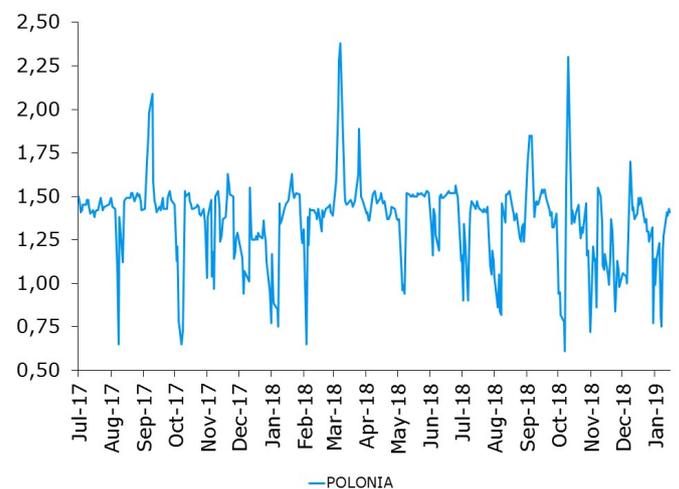
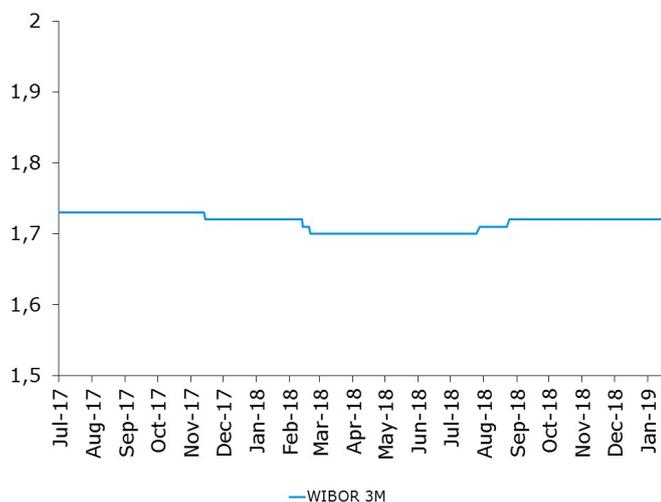
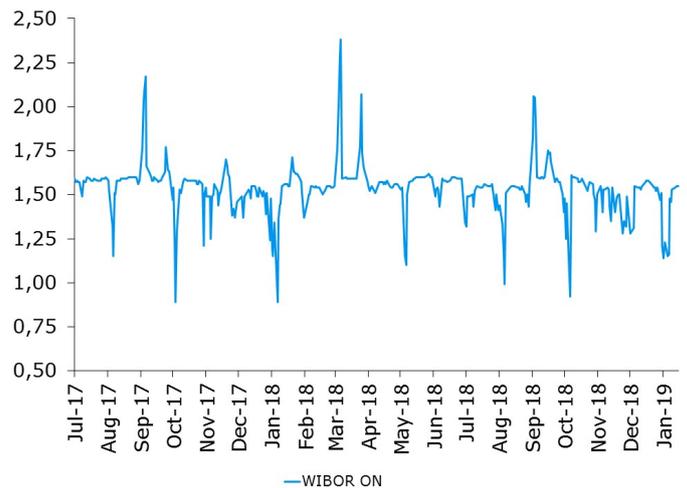
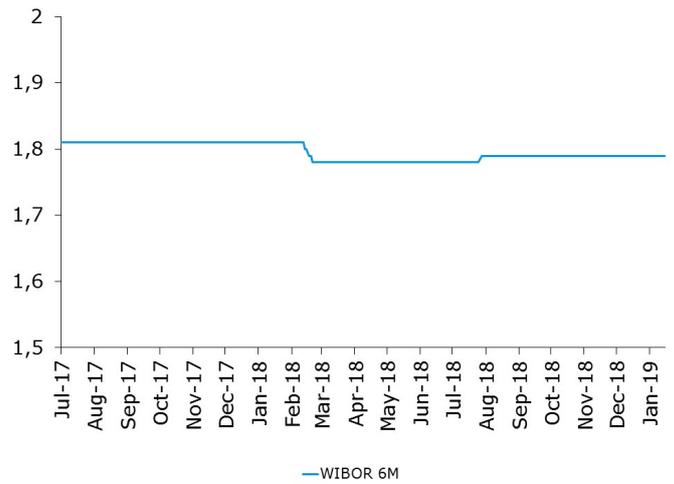
Polish rates remain in the recent tight range. We are slightly below WIBORs on shortest contracts with 2y trading at 1.76%. Yesterday we had the MPC meeting which reassured market about no moves on rates in the coming months. We have a feeling that MPC will do all it takes to leave the rates unchanged for a longer period. They feel relaxed and happy with current developments.

Market was a bit surprised with cash rates trading close to 1.50%. People got used to cheap December/January, but this might have come already to an end.

Ref rate vs Polonia averages:

30 day 20 bp

90 day 23 bp



Forex

Spot – EUR/PLN set a six-month low Last Thursday the flow pushed EUR/PLN down and it dived to 4.2585 level, hitting a six-month low. However, it was a matter of hours for EUR/PLN to rise again above 4.275. Afterwards, it was traded around 4.30 throughout the week. In the bigger picture there is no change. EUR/PLN is still trading in a tight range, 4.26 – 4.32. We are following the global "risk-on / risk-off" mood and choppy trade on EUR/USD. The latter last week was driven by concerns about Brexit uncertainty, weaker-than-expected growth and low inflation in the single currency area.

Opts – higher volatility The correlation of weaker PLN and higher Vols is working again. However, the options market reaction was really muted. 1 month EUR/PLN atm is today at 4.2% (0.45% higher than last week), 3 months is at 4.3% (0.15% higher than week ago), 1 year is at 5.2% (0.1% higher). The currency spread (difference of USD/PLN minus EUR/PLN) and the skew are at the same level as week ago.

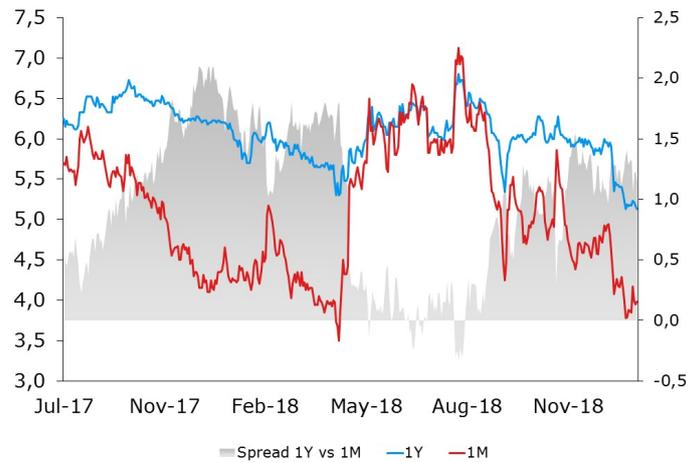
Short-term forecasts

Main supports / resistances:
 EUR/PLN: 4.2400 / 4.3200
 USD/PLN: 3.6000 / 3.9000

Spot: Current position: Long EUR/PLN

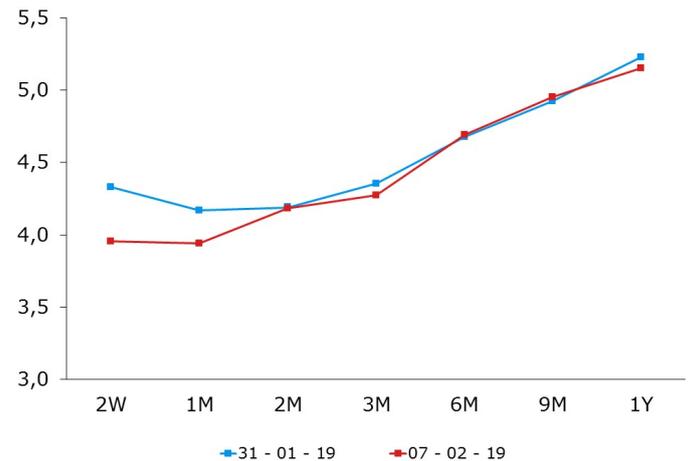
It was a lucky week for our position. We managed to buy EURPLN at the bottom of its trading range at 4.26, so finally we are long on average at 4.2675. Today we have cashed half of our position at 4.30. Still, being long, we are now ready to add at 4.2750 with 4.24 stop for the whole position. The ideal profit taking level is in 4.33-4.34 space. We are aware of the rangy nature of the EUR/PLN and we are not looking for the straight line higher.

EURPLN volatility



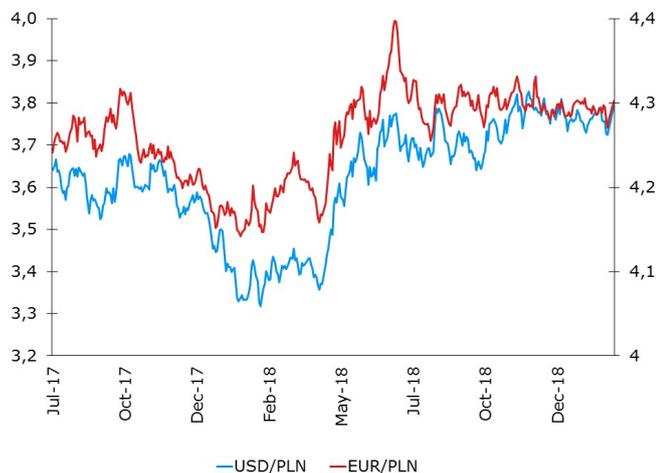
— Spread 1Y vs 1M — 1Y — 1M

EUR/PLN volatility curve



— 31 - 01 - 19 — 07 - 02 - 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
1/31/2019	1.75	1.72	1.91	1.69	2.04	1.77	1.71	1.72	1.70	1.69	1.69	1.76
2/3/2019	1.73	1.72	1.80	1.69	1.95	1.77	1.71	1.70	1.71	1.70	1.69	1.75
2/4/2019	1.66	1.72	1.77	1.69	2.02	1.77	1.72	1.71	1.71	1.71	1.70	1.77
2/5/2019	1.53	1.72	1.65	1.69	1.82	1.77	1.71	1.70	1.69	1.70	1.69	1.77
2/6/2019	1.64	1.72	1.76	1.69	1.91	1.77	1.72	1.71	1.70	1.70	1.69	1.76

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	2/7/2019	5/25/2021	96.67	1.49	150	450	180
PS0424	2/7/2019	4/25/2024	101.65	2.16	1500	3445	1570
DS1029	2/7/2019	10/25/2029	99.40	2.81	1500	1066	1666

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0720	5Y IRS	PS0423	10Y IRS	WS0428
1/31/2019	1.770	1.373	1.735	1.494	1.985	2.147	2.317	2.731
2/3/2019	1.770	1.348	1.757	1.605	2.020	2.178	2.353	2.751
2/4/2019	1.770	1.365	1.750	1.627	2.038	2.218	2.380	2.775
2/5/2019	1.770	1.372	1.716	1.627	2.015	2.186	2.357	2.747
2/6/2019	1.770	1.380	1.742	1.539	2.005	2.181	2.343	2.743

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
1/31/2019	4.17	4.36	4.68	5.23	5.23	1.49	0.51
2/3/2019	3.99	4.32	4.74	5.21	5.21	1.49	0.51
2/4/2019	3.95	4.23	4.63	5.18	5.18	1.48	0.52
2/5/2019	3.98	4.23	4.72	5.13	5.13	1.47	0.52
2/6/2019	3.94	4.27	4.69	5.15	5.15	1.42	0.50

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
1/31/2019	4.2802	3.7271	3.7521	3.4329	1.3551	0.1661
2/3/2019	4.2706	3.7243	3.7509	3.4195	1.3462	0.1658
2/4/2019	4.2813	3.7408	3.7511	3.4043	1.3474	0.1664
2/5/2019	4.2869	3.7542	3.7519	3.4127	1.3493	0.1669
2/6/2019	4.2936	3.7706	3.7680	3.4379	1.3467	0.1667

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