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Polish Weekly Review

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Comment on the upcoming data and forecasts

Next week only final CPI for February will be published, which we expect to grow by 1.2% y/y. Food prices likely accelerated on y/y basis (atypical m/m decline happened last year and we expect this year to follow the normal seasonal pattern, i.e. small increase). We expect core inflation growth of 1.2% y/y due to the base effects. Finally, residential energy prices most likely remained unchanged. Details of January print will also be released and January inflation is likely to be revised in part due to new weights being introduced.

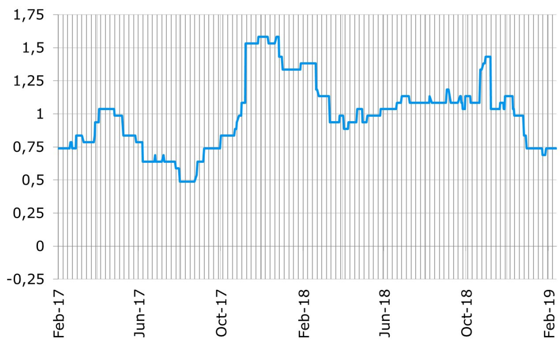
Polish data to watch: March 8th to March 15th

Publication	Date	Period	mBank	Consensus	Prior
CPI y/y (%)	15.03	Feb	1.2	1.2	0.9

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

Manufacturing PMI reading was close enough to the consensus forecasts (47.6 vs 48.4) and did not change the surprise index. Next week only final CPI can move it.

* 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

- Poland will make use of its fiscal space in 2019. The new tax & transfer package is worth 1,0% GDP this year and as much as 1.8% GDP next year. It alters our forecasts of private consumption and GDP materially and we decided to raise GDP forecasts for this year, from 3.7 to 4.1% y/y.
- 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. Fiscal stimulus tilts the balance of risks to the upside.
- General government deficit was likely the lowest in history in 2018. From 2019 onwards deficits are likely to head higher. However, the procyclicality of fiscal revenues ensures a modest increase in the deficit.

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.
- Fiscal stimulation is both a blessing and a curse for the PLN. Over the short term, fiscal stimulus and expectations of a monetary offset should be PLN-positive, as already witnessed in the FX market. However, if no monetary offset arrives and the economy begins to overheat, weaker currency is the only rebalancing mechanism left. As a result, be wary of any strengthening – it might not last.

mBank forecasts

	2015	2016	2017	2018	2019 F	2020 F
GDP y/y (%)	3.8	3.0	4.8	5.1	4.0	3.8
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

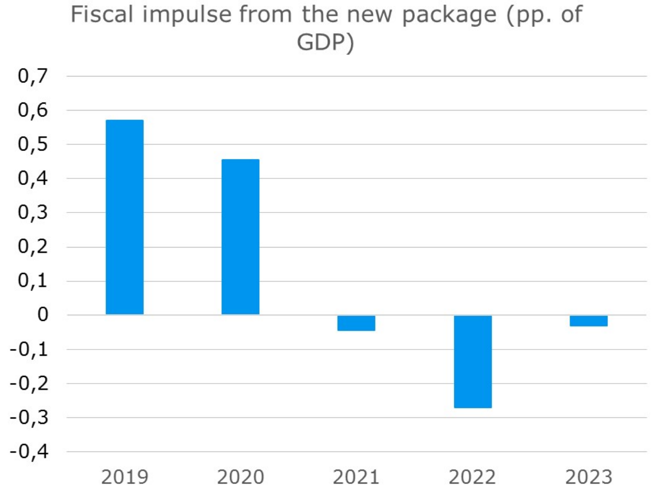
	2018 Q1	2018 Q2	2018 Q3	2018 Q4	2019 Q1 F	2019 Q2 F	2019 Q3 F	2019 Q4 F
GDP y/y (%)	5.3	5.1	5.1	4.9	3.9	4.0	4.0	4.2
Individual consumption y/y (%)	4.7	4.9	4.5	4.3	4.0	3.8	4.2	4.5
Public Consumption y/y (%)	3.0	3.5	3.6	4.0	4.2	4.0	4.0	4.0
Investment y/y (%)	8.2	4.7	9.9	6.7	5.0	5.0	4.0	4.0
Inflation rate (% 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

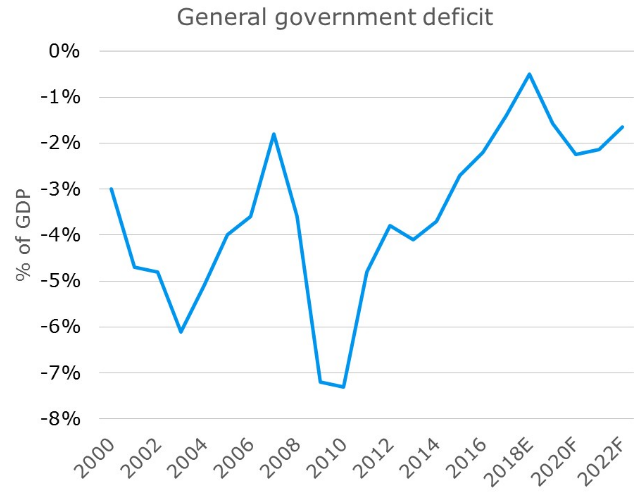
The impact of the new stimulus package on fiscal indicators

Last week we described the new fiscal package proposed for Poland. To remind our readers – fiscal stimulus will amount to 1.1% of GDP in 2019 and 2.1% GDP in 2020 and decline steeply thereafter. It amounts a to a large fiscal impulse of ~ 0.5% of GDP this year and next year (fiscal impulse is defined as change in net expenditures relative to GDP, marginal savings rate of 50% is assumed). The package will consist of both tax cuts and new social spending – the full breakdown of the package is presented in the table below. There have been some clarifications on the government's part (changes in the PIT will be effective starting from 2019Q4), hence the small changes in the table vis-a-vis the previous one.

Measure	2019 cost (PLN bn)	2020 cost (PLN bn)
extending 500+	9.5	19.0
lowering PIT rate by 1 pp.	2.0	8.0
doubling PIT deductibles	0.9	3.5
0% PIT for <26	0.6	2.5
pension bonus	11.0	11.0
local transport	0.0	1.5
Gross expenditure	**24.0**	**45.5**
Additional revenue (-)	4.8	9.1
Net expenditure	**19.2**	**36.1**



This time, however, we want to focus on the implications for fiscal stability. First, let us consider the baseline trajectory for fiscal deficit. Judging from partial data, we can confidently estimate that the general government deficit dropped to all-time low in 2018, reaching a mere 0.5% of GDP. This can be attributed to strong increase in revenues and stable expenditures (higher public investment was perfectly offset by lower expenditures elsewhere). Going forward, one should assume that overall fiscal expenditures should remain stable, close to 41% of GDP as the sharp slowdown in public investment this year is likely to be offset by higher public wage growth. Future revenues are essentially a function of the output gap and the baseline scenario, with GDP growth drifting towards 3% of GDP by 2021) implies output gap stabilizing firmly in the positive territory. As a result, a certain lock-in effect is to be expected on the revenue side. We also assume that some further decline in VAT gap will occur this year. Overall, general government deficit is essentially flat in the baseline scenario.



As we argued extensively last week, the new fiscal package is likely to have smaller multipliers than the previous one. On a net basis (including revenues from increased aggregate demand), the fiscal package will thus expand the deficit by 0.9 pp. of GDP this year and by 1.7 pp. of GDP next year. Deficit is thus likely to reach 2.3% of GDP in 2020, well below the key EDP threshold of 3%. While PM Morawiecki suggested that the new package will be financed by further improvements in tax collections (worth between 0.9 and 1.3% of GDP, according to the PM's presentation), it is very difficult to estimate the potential these new measures have. It is entirely possible that their impact has already been factored in the current budget or in widespread assumptions of positive surprises in fiscal data this year. In any case, new revenues are uncertain, while new expenditures have a pretty definite price tag. This year, the deficit will likely be financed by NBP profit and intragovernmental shifts, leading to no new bond supply, but there are no magic bullets for 2020 and fiscal deficit is likely to go up.

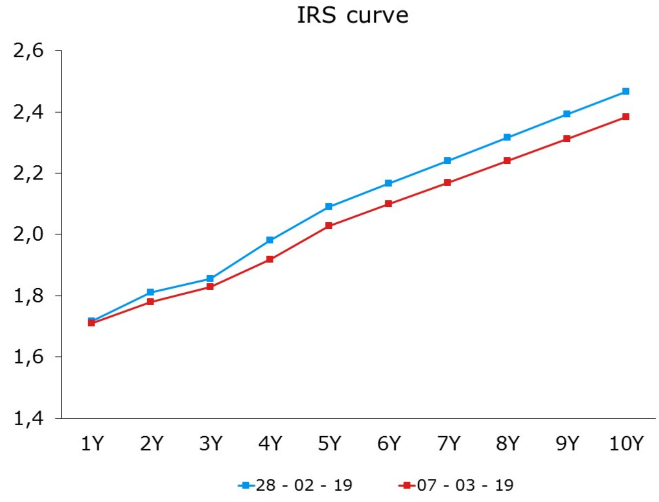
Fixed income

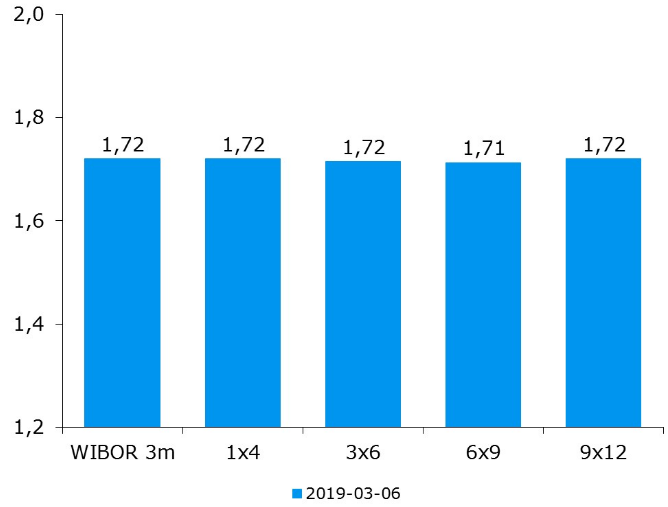
Back from recent highs

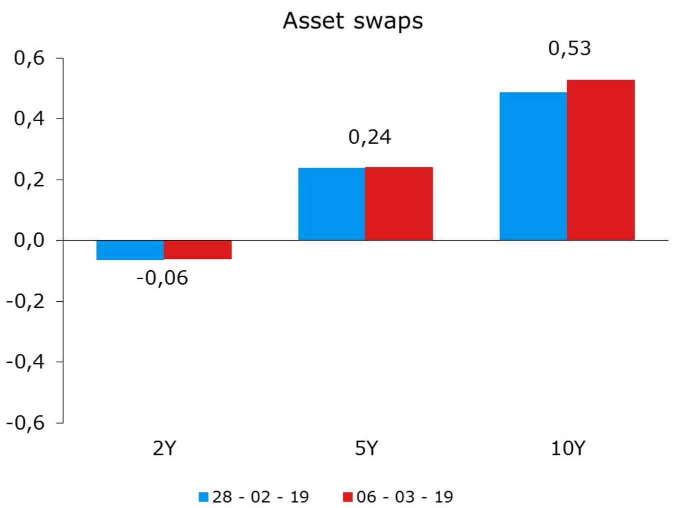
There was a huge recovery this week on the POLGBs, we are closer and closer to the levels before election promises were made. ASWs narrowed a bit and FRNs are few bps lower. There is a pretty small auction tomorrow.

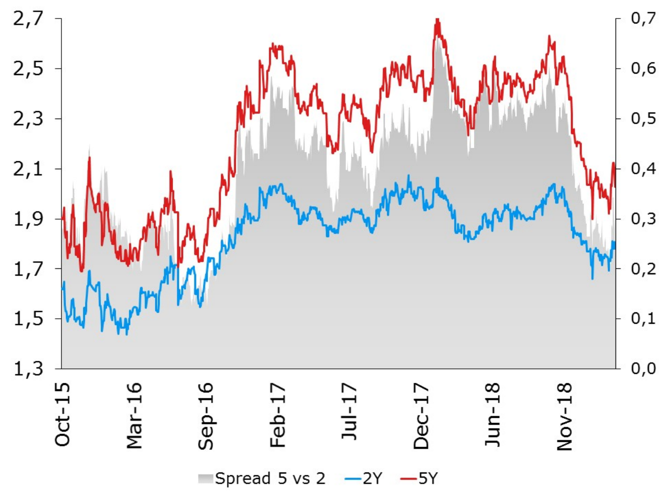
PS0424/5y is 17 bps, WS0428/10y is 40 bps. PS0424/WS0428 is 56 bps. WS0428/Bund is 268 bps.

DS1020 is trading at 1.51% (3 bps down), PS0424 is trading at 2.21% (7 bps down) and WS0428 is trading at 2.68% (5 bps down).









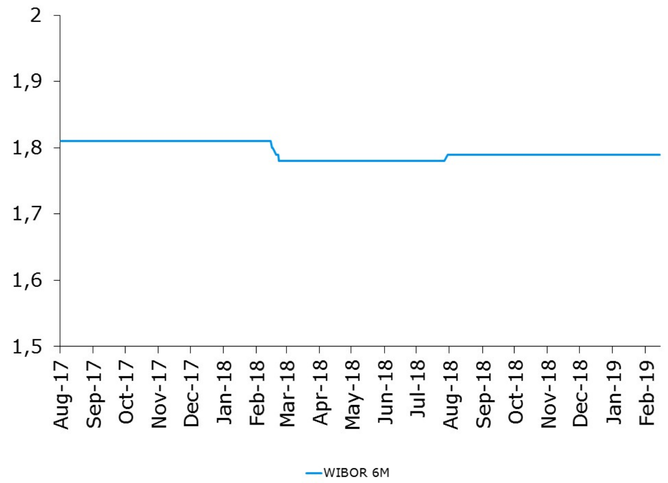
Money market

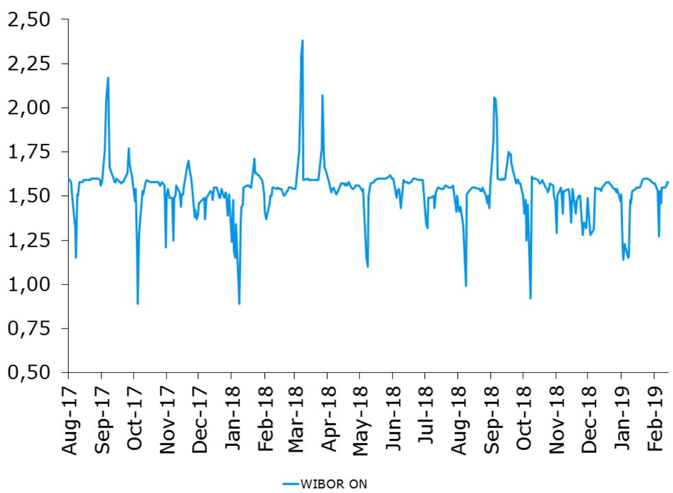
Range trading continues

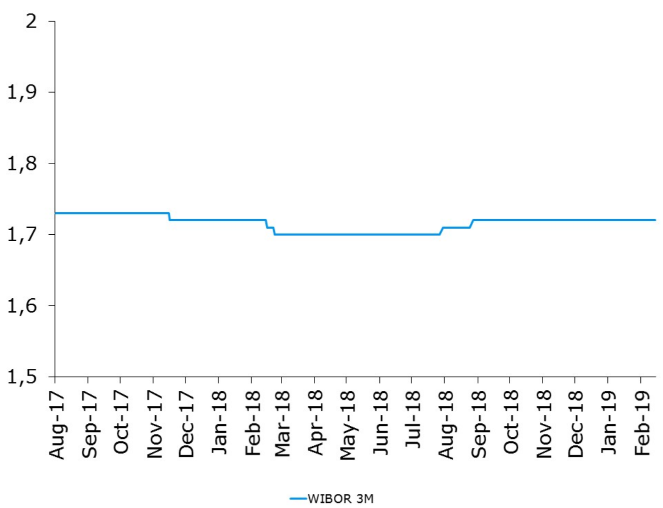
Last week Polish rates made a top with 2y trading at 1.84% and 5y at 2.15%. Following that we had a sharp reversal due with Polish yields tracking down core yields, especially the Bund. As a result, a whole "local stimulus" impact is denied. We are still staying in range, watching global developments closely, especially the condition of our neighbours' economy.

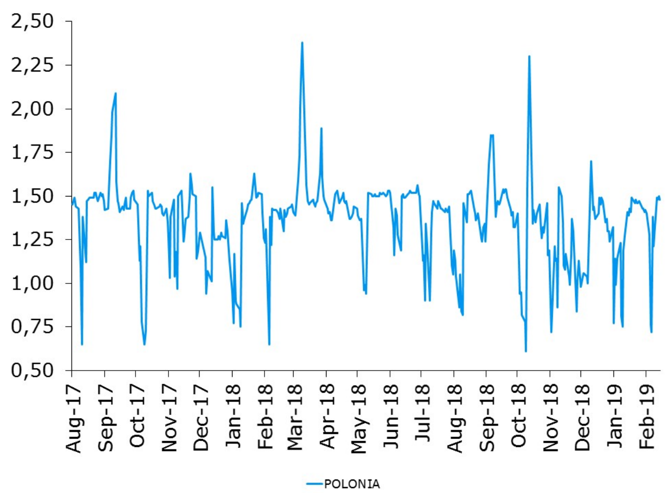
Cash rates were relatively high last week. Overnight rate traded around 1.55%. Tomorrow OMO will set the tone for the next week. But we don't expect any excessive cheapness at the beginning of the month.

Ref rate vs Polonia averages:
30 day 12 bp
90 day 22 bp





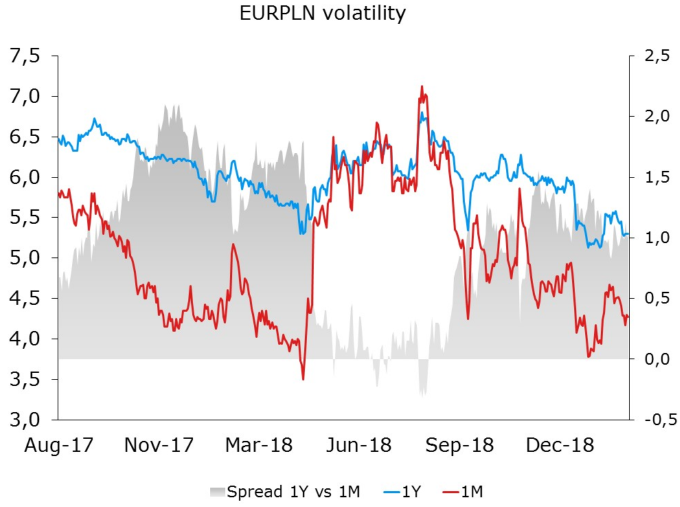




Forex

Spot: EUR/PLN - stable EUR/PLN has been treading water for another week. Still, dovish rhetoric from the MPC failed to produce any volatility. EUR/USD was also stuck in a tight range as traders focused their attention on the European Central Bank's policy review on Thursday afternoon. The bigger picture is blurred. Healthy Polish fundamentals and generally solid economy favor strong Zloty. On the other hand, there are renewed fears of a slowdown in global growth, Brexit uncertainty and new signs of tension between the United States and North Korea. Anyway we are still in the 4.26-34 range, with slightly PLN-positive skew.

Opts: EUR/PLN vols - lower It was a rather calm week on the spot market, so implied volatility curves have melted. Volatilities are lower across the curve in both main currency pairs, EUR/PLN and USD/PLN. EUR/PLN 1 month ATM mid fixed today at 4.0% (0.1% lower), 3 months EUR/PLN are 4.3% (0.1% lower) and, finally, 1 year is 5.05% (0.2% lower). The skew and the currency spread (difference between USD/PLN vol and EUR/PLN vol) are at same level as week ago.

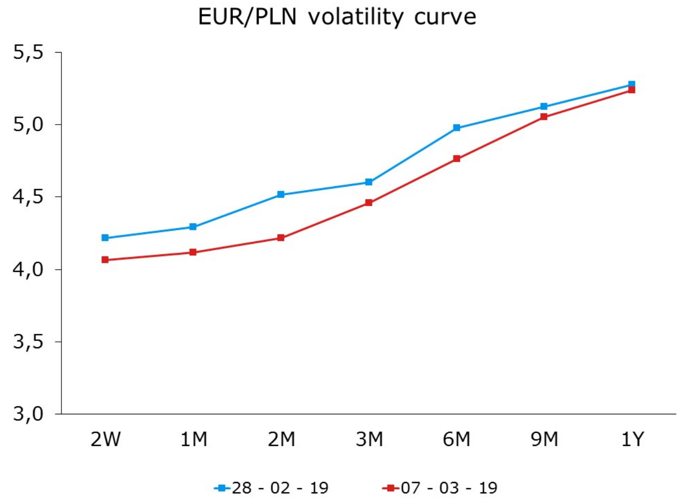


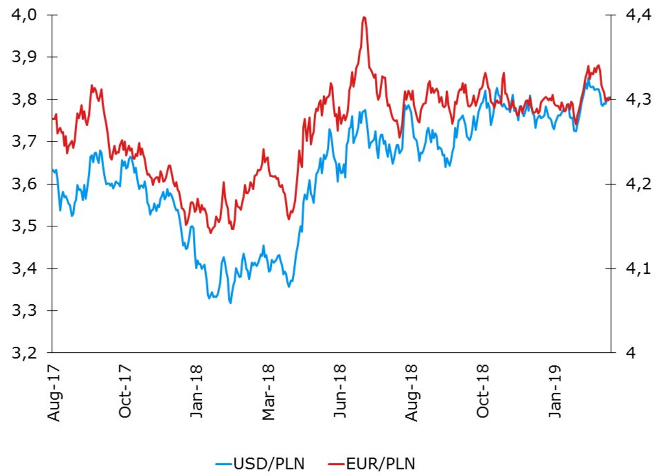
Short-term forecasts

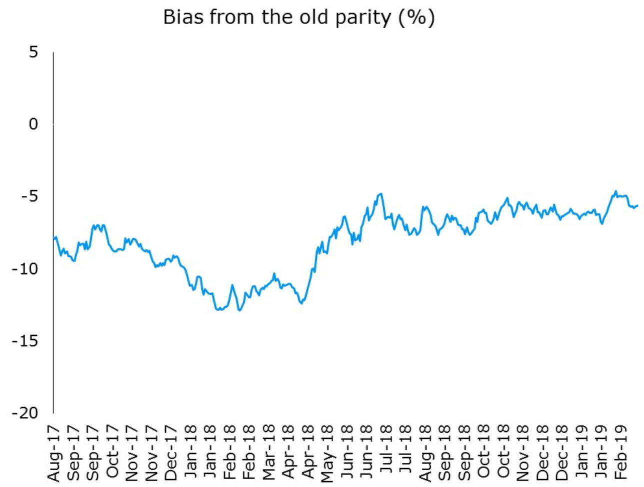
Main supports / resistances:
EUR/PLN: 4.2600 / 4.3400
USD/PLN: 3.6000 / 3.9000

Spot: Current position: Short EUR/PLN

Our strategy is roughly unchanged. We are still short EUR/PLN at 4.34 with a room to add at 4.35, and the stop at 4.37, with profit taking at 4.2750.







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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
2/28/2019	1.57	1.72	1.67	1.69	1.86	1.77	1.72	1.72	1.72	1.73	1.74	1.79
3/3/2019	1.57	1.72	1.75	1.69	1.87	1.77	1.72	1.72	1.73	1.74	1.76	1.80
3/4/2019	1.56	1.72	1.77	1.69	1.88	1.77	1.72	1.72	1.72	1.73	1.75	1.79
3/5/2019	1.46	1.72	1.58	1.69	1.79	1.77	1.72	1.72	1.73	1.73	1.75	1.78
3/6/2019	1.57	1.72	1.67	1.69	1.88	1.77	1.72	1.72	1.71	1.72	1.72	1.78

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
2/28/2019	1.770	1.481	1.810	1.748	2.090	2.328	2.467	2.954
3/3/2019	1.770	1.499	1.781	1.755	2.123	2.325	2.503	2.972
3/4/2019	1.770	1.489	1.807	1.753	2.105	2.311	2.470	2.947
3/5/2019	1.770	1.480	1.800	1.743	2.080	2.291	2.435	2.933
3/6/2019	1.770	1.444	1.780	1.720	2.027	2.266	2.383	2.909

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
2/28/2019	4.29	4.60	4.98	5.28	5.28	1.54	0.50
3/3/2019	4.17	4.52	4.74	5.30	5.30	1.54	0.50
3/4/2019	4.30	4.55	4.88	5.30	5.30	1.51	0.50
3/5/2019	4.27	4.50	4.88	5.30	5.30	1.29	0.52
3/6/2019	4.12	4.46	4.76	5.24	5.24	1.49	0.50

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
2/28/2019	4.3120	3.7853	3.8013	3.4167	1.3628	0.1683
3/3/2019	4.3079	3.7920	3.7907	3.3884	1.3639	0.1682
3/4/2019	4.2984	3.7893	3.7856	3.3880	1.3599	0.1677
3/5/2019	4.3018	3.7977	3.7940	3.3918	1.3633	0.1679
3/6/2019	4.2992	3.8038	3.7845	3.4006	1.3627	0.1678

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