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Polish Weekly Review

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Comment on the upcoming data and forecasts

This Friday the Statistics Poland will publish its business sentiment indicators. On Tuesday retail sales data for March will be published. We expect it to grow yearly by 1.8% in real terms. One working day less and late Easter are the negative factors for this reading. In plus one should count buoyant car sales and warm March, resulting in better clothing and footwear sales. On the same day, the NBP will publish M3 aggregate, which we expect to increase by 9.5%. On Wednesday the unemployment rate will be published - we expect it at the level of 5.9%, in line with both consensus and Ministry's of Family, Labour and Social Policy flash reading. Also construction output for March will be published (our forecast 7.2% vs consensus 9.1% y/y). Warm February resulted in shifting some construction works from March to February.

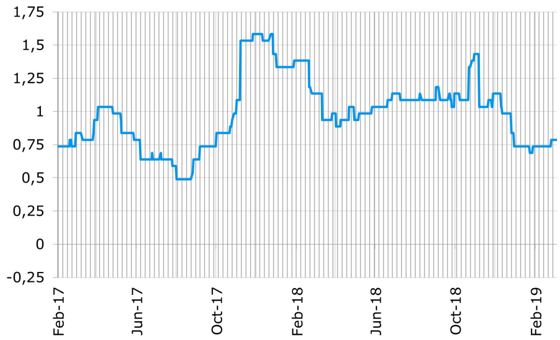
Polish data to watch: April 19th to April 26th

Publication	Date	Period	mBank	Consensus	Prior
Business sentiment	19.04	Apr			
Retail sales y/y (%)	23.04	Mar	1.8	3.3	5.6
M3 y/y (%)	23.04	Mar	9.5	9.7	9.8
Construction output y/y (%)	24.04	Mar	7.2	9.1	15.1
Unemployment rate (%)	24.04	Mar	5.9	5.9	6.1

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	4/8/2019	300	1.561	3/8/2019
5Y T-bond PS0424	4/8/2019	2800	2.200	3/8/2019
10Y T-bond DS1029	4/8/2019	1200	2.841	3/8/2019
30Y T-bond WS0447	4/8/2019	30	3.149	1/25/2019
5Y floater WZ0524	4/8/2019	400	-	3/8/2019
10Y floater WZ0528	4/8/2019	200	-	3/8/2019

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



Comment

Positive surprise from the the CPI release moved the index one point upward, but later the worse than expected wage growth lowered it by 2 points. Over the next several days, Polish surprise index might be moved by retail sales, M3 and construction data.

* 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

- Polish economy continues to show great resilience to global slowdown and Polish consumers seem unfazed by pretty much anything. We are forecasting 2019 growth at 4.5% y/y and 2020 growth at 4.0% y/y. Recent data proved our earlier revisions to be prescient.
- Core inflation is projected to rise steadily. Meat prices (ASF in China; abruptly increased demand for pork), along with considerable increases in fuel prices (May, June) are set to push inflation beyond NBP target already in 2019.
- 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, although the rise in inflation may generate some noise from MPC members.
- Increased government transfers and lower taxes presented in February found new sources of financing (revamp of the pension system) and only moderate GG deficits along with falling debt/GDP ratio are secured. Fiscal story returned to positive path in an unambiguous way.

Financial markets

- 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. New wave of forecast revisions and dovish central banks globally also support PLN strength. However, if no monetary offset arrives and the economy begins to overheat, weaker currency is the only rebalancing mechanism left. For this scenario to play out we need to see inflation. Lots of inflation. With CPI much below 2.5% the story appeals on to speculative minds.

mBank forecasts

	2015	2016	2017	2018	2019 F	2020 F
GDP y/y (%)	3.8	3.0	4.8	5.1	4.5	4.0
CPI Inflation y/y (average %)	-0.9	-0.6	2.0	1.6	2.1	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	5.5	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	4.6	4.5	4.5	4.4
Individual consumption y/y (%)	4.7	4.9	4.5	4.3	4.2	4.1	4.5	4.9
Public Consumption y/y (%)	3.0	3.5	3.6	4.0	4.4	4.2	4.0	4.0
Investment y/y (%)	8.2	4.7	9.9	6.7	5.0	5.0	4.0	3.0
Inflation rate (% average)	1.5	1.7	1.9	1.4	1.2	2.0	2.4	2.8
Unemployment rate (% eop)	6.6	5.9	5.7	5.9	5.9	5.4	5.3	5.5
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	1.72
2Y Polish bond yields (% eop)	1.49	1.63	1.56	1.35	1.69	1.33	1.35	1.37
10Y Polish bond yields (% eop)	3.18	3.22	3.24	2.83	2.84	2.85	2.96	3.12
EUR/PLN (eop)	4.21	4.37	4.28	4.29	4.30	4.30	4.25	4.25
USD/PLN (eop)	3.42	3.74	3.69	3.74	3.84	3.77	3.70	3.66

F - forecast

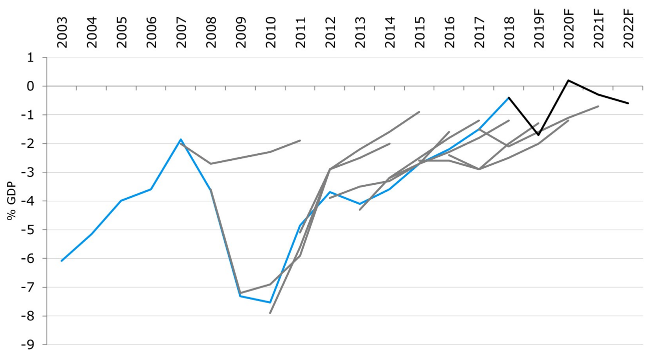
Economics

The Ministry of Finance vows to continue fiscal consolidation

New MYP

This week the new multi-year fiscal plan (MYP) was unveiled by the Ministry of Finance, along with updated Convergence Plan for Poland. Due to the large-scale fiscal stimulus planned for 2019-2020 (ca. 2% of GDP in new spending and tax cuts), many market participants and Polish economy watchers were concerned how it would fit into medium-term budgetary plan and how this would impact fiscal figures going forward. The new MYP does not disappoint. Its macroeconomic assumptions are, as usual, quite conservative. The MoF is forecasting GDP growth at 4.0 and 3.7% in 2019 and 2020, respectively (mBank: 4.5 & 4.0%), while inflation is set to average 1.8 and 2.5% in the two consecutive years (we see inflation exceeding 2% this year and high likelihood of breaching 3% next year).

Multi-year fiscal plans of Polish government (GG deficit)



The MoF is sticking to its fiscal consolidation path, assuming that general government deficit will expand to 1.7% of GDP this year and swing back into a surplus (sic!) of 0.2% of GDP next year. Compared with the previous consolidation plans, this is both a sign of honesty (such a big increase in near-term deficit has never been forecast before) and ambition alike. Poland has never had a GG surplus. The MoF's fiscal plans are radically different from forecasts prepared by private institutions, ratings agencies or international organizations (1.2-1.5% in 2019 and 1.5-2.0% in 2020). In particular, the MoF assumes that GG deficit will decline steeply next year. What are the sources of this divergence?

New revenues

Ministry of finance presented a suite of additional revenue-enhancing measures. The first part comes from recently implemented solutions in VAT and direct taxes. Further VAT collection improvements using banking systems, split payment or online cash registers should provide (according to the plan) additional PLN 4.5 bn in 2019 and 7.6 bn in 2020. Further decrease of CIT and PIT gaps is assumed to provide PLN 2.7 bn this year and 1.1 bn in the next one. The Ministry also presented a new package of tax changes, which can be implemented in the following months. The first one is the so called "entrepreneurship test" whose aim is to distinguish the self-employed who are in fact workers and should work under a typical employment contract (and therefore should pay higher contributions, which could add PLN 1.1 bn in 2020). Moreover, MF proposed a tax on digital companies (0.2 bn), extension of the recycling fee (1.4 bn) and a 3% increase of excise on alcoholic and tobacco products (1.1 bn).

Plan includes also additional revenues from abolishing the cap on social contributions (currently at 30x average wage, previous attempt was reversed by the Constitutional Court for procedural reasons). Its net result is assumed to bring 5.2 bn in 2020. The Ministry also assumes more social contribution revenue from employees on civil contracts (PLN 3 bn). Another new source of revenues is the fee on pension asset transfer (more on that further in the text), assumed to bring ca. PLN 8b in 2020 and 2021. The last source are inflows from CO2 emission allowances (12.3 bn in 2020) and new auctions on telecommunication frequencies (PLN 3.5-5.0 bn).

Summing up, additional tax revenues amount to PLN 13.7 bn in 2020, new social contribution revenues 14.4b (without the pension fee), and one-off flows 27.0 bn (with switching fee).

OFE reform

The reform of private pension funds (so called OFEs) requires a more detailed comment. On Monday, the proposals regarding the last stage of their reform were unveiled. According to the new proposal, current participants will be given a choice between converting their pension assets into voluntary individual retirement accounts (IKEs) or transferring them to the state pension fund within the mandatory part of the system. The former choice will be the default one. In addition, all transfers between pension funds and state institutions will henceforth be abolished. Needless to say, the entire mandatory pension contribution (19.52% of monthly salary) will now be paid into the state fund.

The change is a net positive for public finance in the short term. Transfer of pension assets from OFEs into IKEs will be accompanied by a 15% fee paid to the state in two tranches, amounting to ca. PLN 12 bn each, provided that the vast majority of current OFE participants choose the default options. Reduction of other transfers between pension funds and state institution mitigates this one-off revenue somewhat, but the net effect is close to PLN 8 bn in new revenue in 2020 and 2021.

Market impact

Broadly speaking, both events have shown that the Polish Ministry of Finance is not out of ammunition when it comes to raising fiscal revenues and even though the entire suite is unlikely to bring the assumed revenue, keeping in line with expenditure rule and with EU fiscal limits is not endangered by the fiscal stimulus. However, the fiscal MYP is likely underestimating future expenditures: (1) the pension bonus (PLN 11 bn) was assumed to be one-time payment even though the political declarations were quite clear that it will be repeated; (2) there are no new public sector wage hikes factored into the plan and total wage bill is assumed to fall as % of GDP; (3) total spending on education and health care is essentially flat, despite the well-established pattern of higher relative prices of public goods and higher provision influenced by population ageing; (4) another energy price freeze is still on the table and the MYP does not influence that.

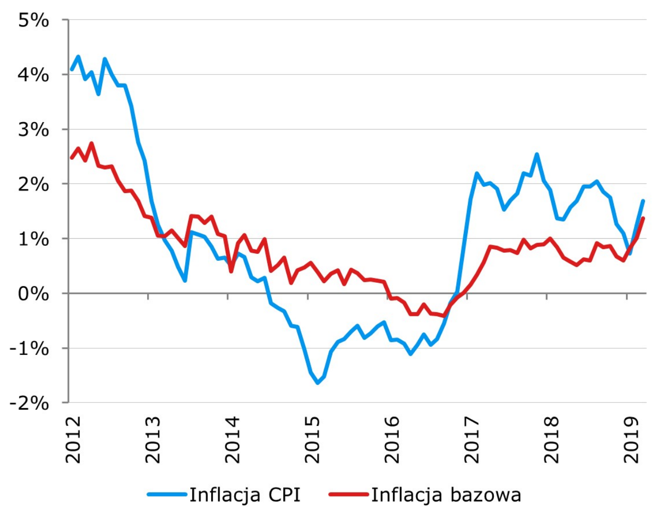
Nevertheless, GG deficits must be assumed to be smaller as a result, reducing bond supply as well. The pension reform also matters for two reasons. First, it reduces uncertainty (there were various proposals flying around) and attempts to reorganize the private pension industry. Second, the asset allocation of private pension funds differs from the one used in individual retirement accounts. The managers of the latter will have to gradually reduce their equity holdings (by 2.5 p.p. per year) and purchase government bonds.

Assessment

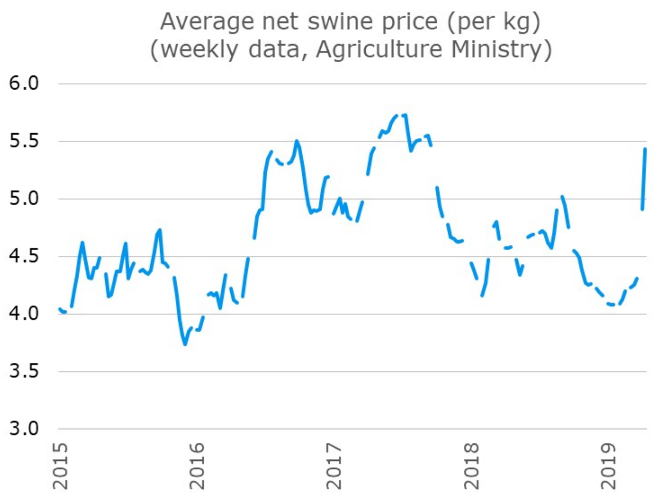
The Ministry of Finance has one more ace in the hole: the procyclicality of fiscal indicators related to the behavior of tax revenues and their relation with the business cycle (they tend to surprise to the upside when output gap is positive). It is likely that GG deficit this year and in 2020 will fall somewhere between the market's original expectations and the Ministry's ambitious path. As noted, both the expenditure rule and the EU fiscal limits will be respected. Finally, it should be noted that in current circumstances (absent a major negative shock which we are not anticipating) it is very difficult to achieve an increase in debt-to-GDP ratio in Poland. For instance, with a 1% GG deficit, nominal GDP growth rate of 2% is enough to stabilize the debt.

Polish inflation confirmed at 1.7% y/y.

Statistics Poland confirmed the flash CPI reading of 1.7% y/y. We might have been wrong about core inflation, though. Based on today's data, we can estimate it at 1.3-1.4% y/y with risks tilted to the upside. When details were not available, we suspected that the surge in core inflation was attributable to one of the highly variable categories such as communications or package holidays. In reality, it was spread out over multiple categories, many of which are exhibiting a clear upward trend. These are: others, hotels and restaurants, clothing and footwear, alcoholic beverages. It should be noted, however, that some of the price hikes (housing, in particular, refuse collection) are administrative in nature and will not accelerate further in the coming months.



On the horizon there are other risks to the inflation outlook. The solid increases in oil prices imply that the next two months will be marked by strong increases in fuel prices (7-10% over April and May). In addition, the ASF in China story deserves more attention. It occurred on a cyclical low in swine herds and has already raised pork prices considerably (see the graph below). We expected pork prices to contribute positively to inflation due to cyclical factors but Chinese demand is a factor of a completely different magnitude. It is a classic negative supply shock which will raise food prices growth by 0.5-0.8 p.p., pushing CPI upwards toward the NBP target. One should not that this might be too conservative of an estimate. Due to consumer demand strength, margin compression and potential for substitute product (poultry, beef) prices to be raised in reaction to the pork price shock, higher impact on food prices can be imagined. This is a developing situation and high-frequency data must be monitored.



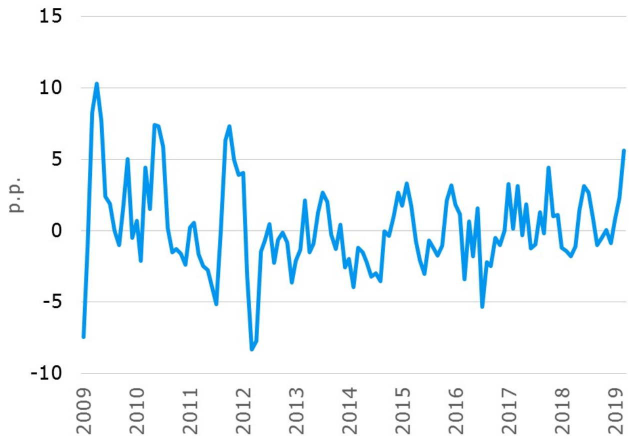
In April **producer price** growth declined from the 2.9% in the previous month to 2.5% y/y (our forecast 2.6%). There are generally three reasons for this. First, low base from the previous year determined the direction of the yearly dynamics. But more interesting events in base effects are still before us – in May oil prices increases from last weeks can offset its effects (see below). Second reason is low price growth in mining. Third – weak price increases in manufacturing and another monthly stagnation in core prices together with its strong decline in annual terms (see chart below). Strictly theoretically, oil prices have negligible impact on core prices in manufacturing. Although one can expect a certain rebound of producer prices in a broad aggregates in May and June, the similar movement in core prices is less likely, although macro conditions are favorable for this.

CPI will reach 2% y/y in April and might hit the NBP target in the summer. This path will overshoot the latest staff projection and might impact the MPC's rhetoric. The hawks (Gatnar, Zubelewicz, Hardt) will feel compelled to argue for a rate hike as soon as the pork supply story hits the wires. The rest of the Council is likely to shrug this off, though. After all, it is a negative supply shock and secondary impact through higher inflation expectations (which are completely adaptive anyway) will appear to be a weak argument. Without a clear price-wage-price transmission channel, the supply shock will work largely through lower household disposable income and lower consumption path. Such an adjustment (through real variables) will favor keeping interest rates at present levels. In addition, agricultural markets are cyclical in nature and there will be oversupply and lower prices somewhere down the road. The latter effect might even coincide with cyclical economic downturn and the

Council has already shown that it is prone to thinking about the economic outlook for 2021, 2022, 2023, etc. The market might have other ideas, though, remembering that Polish MPCs have raised rates in reaction to negative supply shocks. As a result higher rate expectations might be built on the basis of said inflationary story.

Polish industry maintains strong momentum

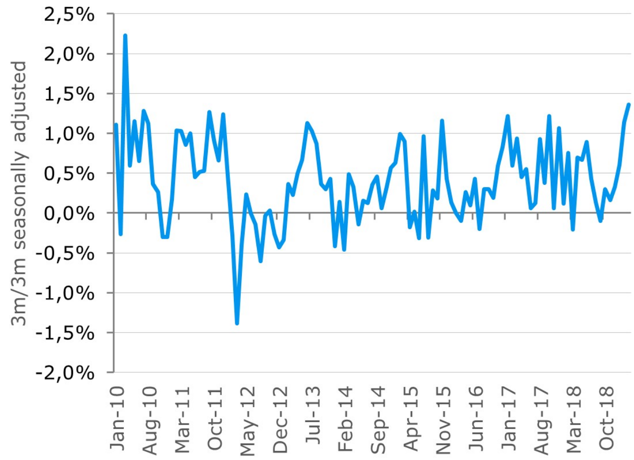
Industrial output rose in March by 5.6% y/y, surprising for the third time in a row (our forecast 4.9% y/y, market consensus 4.4% y/y). This is the best three-month sequence of surprises since late 2011.



Cummulative (3-month sum) surprise in Polish industrial output data

The slight slowdown on annual basis (February: +6.9% y/y) is entirely attributable to less favorable working day count (-1 vs. 0 y/y), partly mitigated by low statistical base from last year. In addition, headline IP figure understates the strength of Polish industry as both mining and energy output (the latter suffered from relatively good weather) contributed to the slowdown. Manufacturing barely budged – down from 7.0 to 6.3% y/y. The extraordinary (relative to poor external environment) strength of Polish industrial output can be illustrated in several ways, but we will stick with IP momentum, which rose to its highest since 2010 (!).

Why is Polish industrial production so buoyant, is a different question. In our view, there are several independent reasons: (1) the strength of Polish exports and its diversification (whereas exports to Germany flagged at the turn of the year, it accelerated to other destinations); (2) its cost competitiveness; (3) the enduring resilience of Polish domestic demand – the composition of IP growth hints at strong investment.



Momentum of industrial output

Yet another positive surprise from the Polish economy will not impress the MPC much. It is likely that it will be categorized as confirming the Council's optimistic economic scenario and will not be seen as contributing to inflation in any meaningful way. The key issue, as we already stated multiple times, is inflation. Here the potential for surprises is much greater.

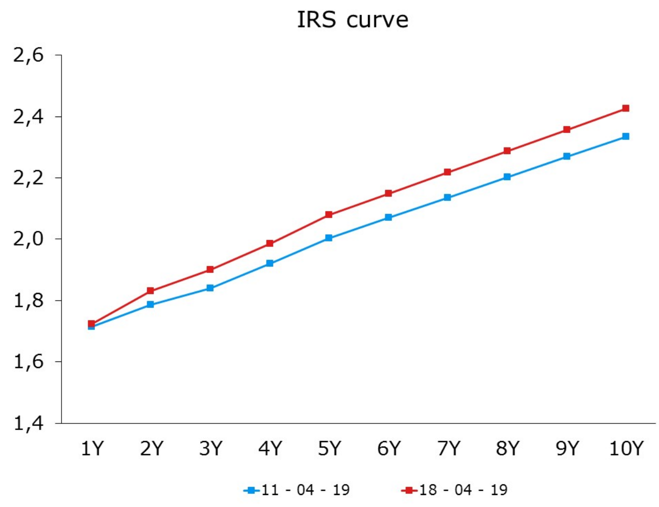
Fixed income

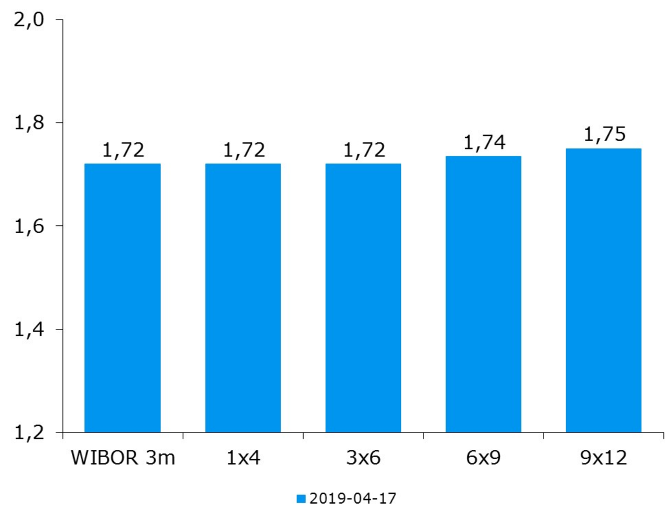
Bonds and swaps reconverging

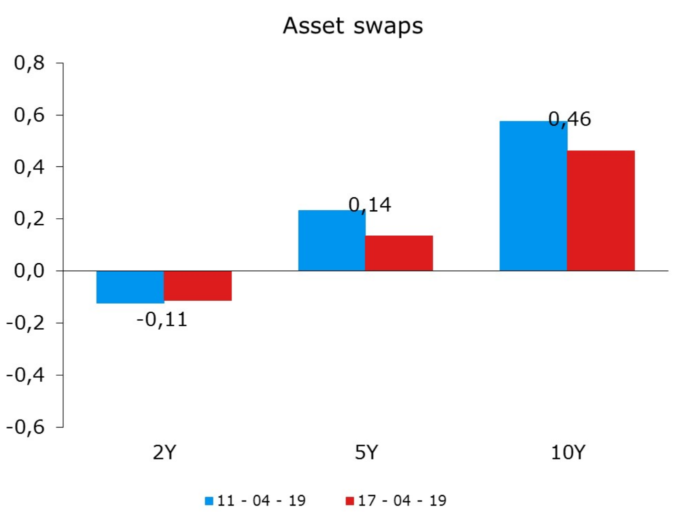
Last week was definitely good for ASWs, which tightened significantly, especially on the long end, as bond curve flattened slightly but irs 5/10y steepened by 4 bps. FRNs also went up, but lagged ASWs a bit – for example WZ0528 lagged 0428/9y by 5bps.

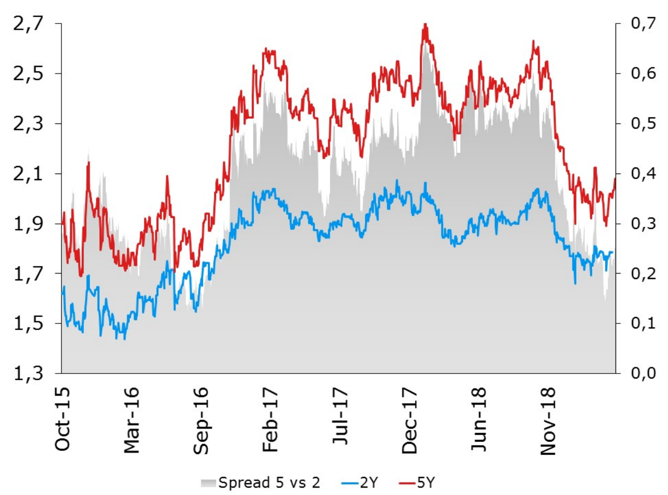
PS0424/5y is 13 bps, WS0428/10y is 36 bps. PS0424/WS0428 is 57 bps. WS0428/Bund is 274 bps.

DS1020 is trading at 1.50% (5 bps down), PS0424 is trading at 2.21% (1 bp down) and WS0428 is trading at 2.79% (2 bps down).









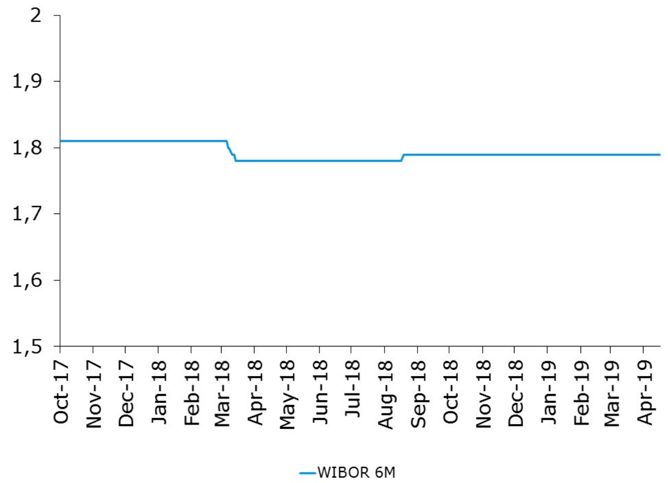
Money market

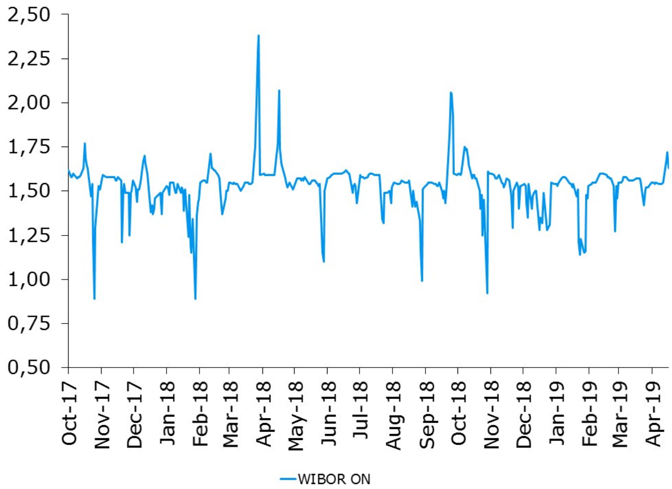
Lots of cash coming back to the market

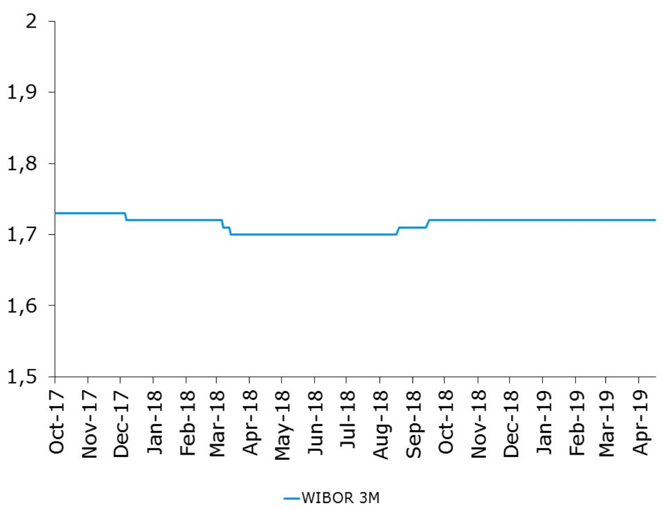
Bonds continue to outperform swaps, so asset swaps are tightening further. The move is quite sharp. Next week we have OK0419 redemption and April coupon payments and these two factors will outweight the auction, where MINFIN will offer PLN 5-8 bn of new bonds. Volatility is still muted and probably will stay there.

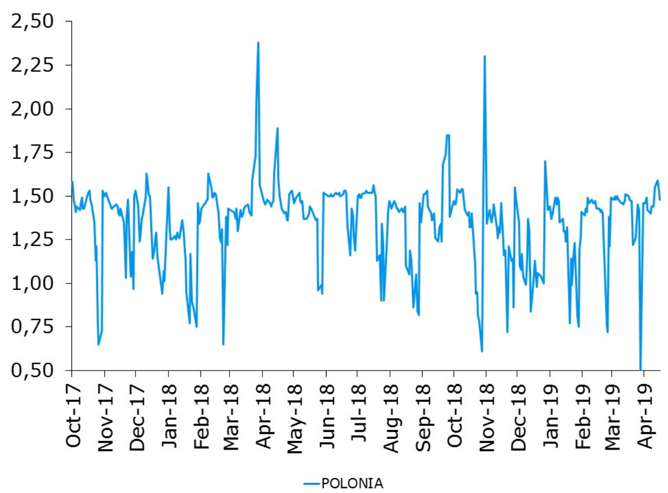
Cash rates were quite high last week. Holiday season plus bond redemptions may add to overnight volatility next week.

Ref rate vs Polonia averages:
30 day 16 bp
90 day 16 bp





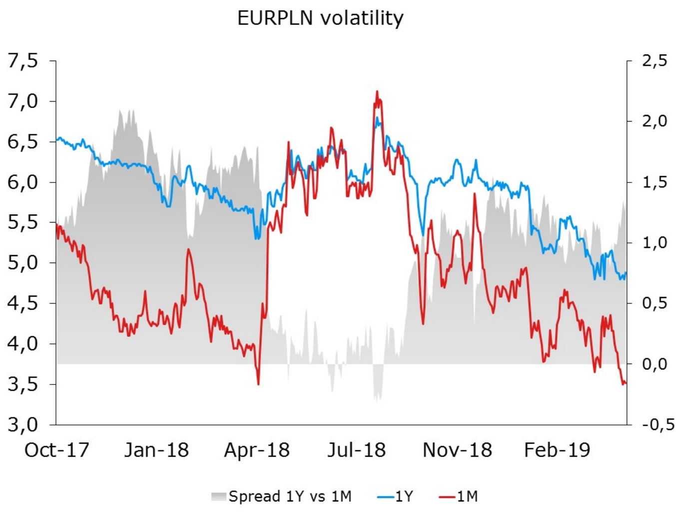




Forex

Spot – EUR/PLN – lower, but still in the range. EUR-PLN – keeps on sliding, the move is painfully slow but we briefly touched 4.27 low, before correcting slightly. Technically we are still in 4.26-4.32 range, and we don't expect to break out that range any time soon. We are following the global "risk on", "risk off" mood, which is changing like in a kaleidoscope. One day investors are excited after excellent economic data from China, defying expectations for a further slowdown. The next day they are spooked by a weaker-than-expected PMI data for the euro zone, renewing concerns that a Europe-wide slowdown may be imminent...

Opts: Implied volatility sliding. It was another very calm week on the spot market. Both volatility curves EUR/PLN as well USD/PLN became more steep. EUR/PLN ATM mid is today 3.35% (0.15% lower), 3 month are 3.65% (0.25% lower) and finally 1 year fixed at 4.55% (0.2% lower). The skew was also better offered. The currency spread (difference between USD/PLN and EUR/PLN) decreased by around 0.25%.

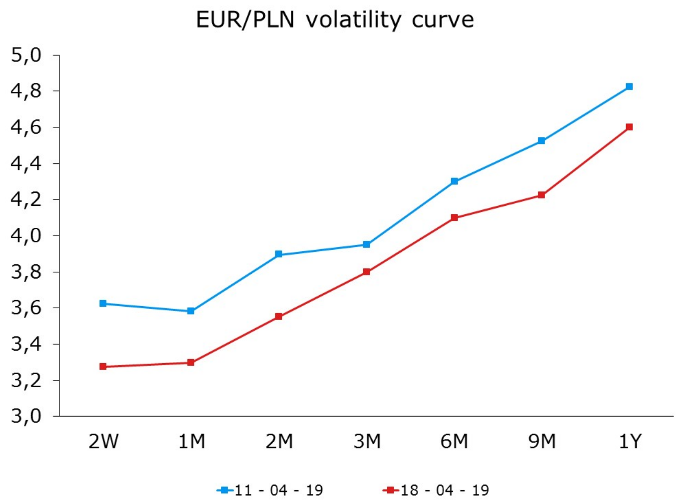


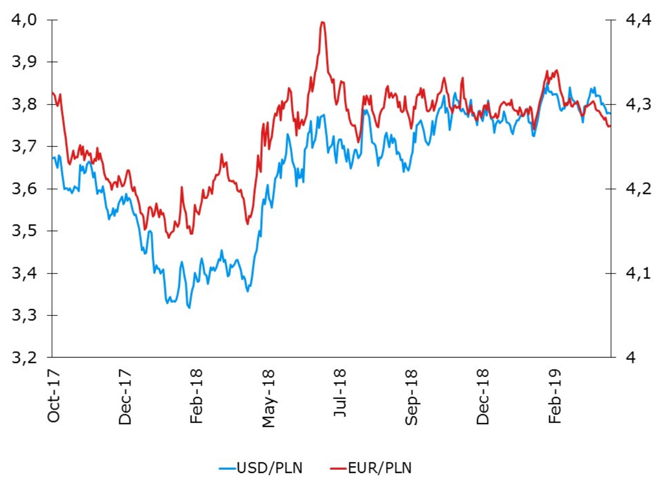
Short-term forecasts

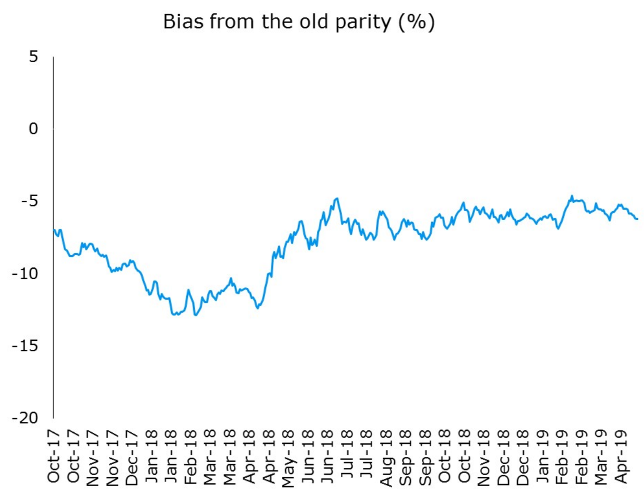
Main supports / resistances:
EUR/PLN: 4.2600 / 4.3400
USD/PLN: 3.6000 / 3.9000

Spot – Buy on dips

The market is so slow, the range is getting tighter and tighter. Since EUR/PLN risks remain skewed to the upsider with the fresh U.S. - Europe story and global growth worries, we prefer to be sideways at this moment. We are ready to buy EUR/PLN at 4.26-27 with stop at 4.24 and hopes for 4.34.







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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
4/11/2019	1.72	1.72	1.72	1.69	1.88	1.77	1.72	1.72	1.72	1.72	1.73	1.78
4/14/2019	1.65	1.72	1.80	1.69	1.96	1.77	1.72	1.72	1.72	1.73	1.74	1.80
4/15/2019	1.75	1.72	1.73	1.69	1.89	1.77	1.72	1.72	1.73	1.74	1.75	1.80
4/16/2019	1.57	1.72	1.64	1.69	1.80	1.77	1.72	1.72	1.73	1.74	1.75	1.80
4/17/2019	1.67	1.72	1.74	1.69	1.91	1.77	1.72	1.72	1.74	1.75	1.77	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
OK0521	3/8/2019	5/25/2021	96.64	1.56	300	555	325
PS0424	3/8/2019	4/25/2024	101.42	2.20	2800	4841	2996
DS1029	3/8/2019	10/25/2029	99.15	2.84	1200	2262	1219

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0720	5Y IRS	PS0423	10Y IRS	WS0428
4/11/2019	1.770	1.528	1.787	1.664	2.003	2.234	2.335	2.910
4/14/2019	1.770	1.538	1.803	1.674	2.032	2.242	2.373	2.913
4/15/2019	1.770	1.528	1.810	1.627	2.040	2.217	2.382	2.893
4/16/2019	1.770	1.513	1.782	1.716	2.050	2.214	2.391	2.873
4/17/2019	1.770	1.518	1.830	1.718	2.080	2.216	2.425	2.886

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
4/11/2019	3.58	3.95	4.30	4.83	4.83	1.41	0.48
4/14/2019	3.50	4.03	4.35	4.85	4.85	1.41	0.48
4/15/2019	3.55	3.90	4.30	4.80	4.80	1.41	0.51
4/16/2019	3.52	3.85	4.23	4.89	4.89	1.41	0.51
4/17/2019	3.30	3.80	4.10	4.60	4.60	1.40	0.51

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
4/11/2019	4.2821	3.7964	3.7913	3.4167	1.3320	0.1673
4/14/2019	4.2847	3.7899	3.7846	3.3858	1.3294	0.1672
4/15/2019	4.2770	3.7789	3.7698	3.3752	1.3337	0.1669
4/16/2019	4.2737	3.7802	3.7612	3.3768	1.3364	0.1666
4/17/2019	4.2750	3.7778	3.7495	3.3736	1.3393	0.1665

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