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Polish Weekly Review

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Comment on the upcoming data and forecasts

Next week begins with the release of the minutes from the May meeting of the MPC. On Tuesday Statistics Poland will publish its monthly labor market data. We expect (in line with consensus) employment growth to stabilize at 3% y/y, while wage growth likely rebounded from its temporary slump in March (from 5.7 to 6.7% y/y). On Wednesday industrial data will take the center stage. Due to favorable working day difference (up from -1 to +1 y/y) annual industrial output growth is set to surge to 9.5% y/y (above consensus). The accompanying release of PPI data is set to show steady producer price inflation at 2.5% y/y. At the same time Statistics Poland will publish its monthly business and consumer sentiment indicators (for May). On Thursday construction and retail data will be published. Both is set to accelerate considerably due to a confluence of positive factors. The former will be boosted (to 23.5% y/y) by weather conditions, low statistical base and working day count. The latter will accelerate to 11.3% due to late Easter, low base from last year and the abovementioned swing in working day count. Finally, on Friday the NBP will publish M3 data.

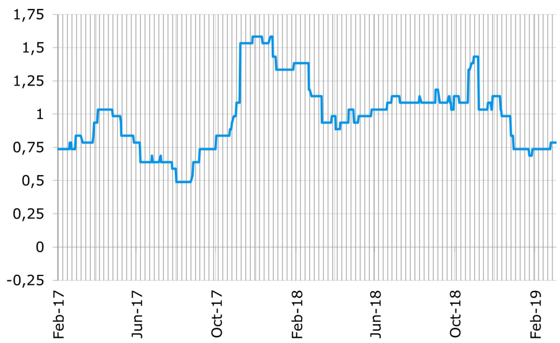
Polish data to watch: May 17th to May 24th

Publication	Date	Period	mBank	Consensus	Prior
MPC Minutes	20.05	May			
Average gross wage y/y (%)	21.05	Apr	6.7	6.5	5.7
Employment y/y (%)	21.05	Apr	3.0	3.0	3.0
Consumer sentiment	22.05	May			
Business sentiment	22.05	May			
Sold industrial output y/y (%)	22.05	Apr	9.5	8.1	5.6
PPI y/y (%)	22.05	Apr	2.5	2.5	2.5
Construction output y/y (%)	23.05	Apr	23.5	15.9	10.8
Real retail sales y/y (%)	23.05	Apr	11.3	8.2	1.8
M3 y/y (%)	24.05	Apr	10.2	10.0	9.9

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 OK0521	6/13/2019	1000	1.598	4/25/2019
5Y T-bond PS0424	6/13/2019	1800	2.224	4/25/2019
10Y T-bond DS1029	6/13/2019	1000	2.890	4/25/2019
30Y T-bond WS0447	6/13/2019	60	3.180	4/25/2019
5Y floater WZ0524	6/13/2019	1000	-	4/25/2019
10Y floater WZ0528	6/13/2019	1000	-	4/25/2019

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



Comment

Q1 flash GDP surprised to the upside, slightly lifting the Polish surprise index. Next week is abundant with macroeconomic data and we expect most of them to beat market consensus.

* 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 below 2.5% (for now) 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	2.4	2.9
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 (%)	5.2	5.3	5.2	4.9	4.6	4.5	4.5	4.4
Individual consumption y/y (%)	4.6	4.8	4.4	4.2	4.2	4.1	4.5	4.9
Public Consumption y/y (%)	4.5	4.5	5.2	4.7	4.4	4.2	4.0	4.0
Investment y/y (%)	9.6	6.0	11.3	8.2	5.0	5.0	4.0	3.0
Inflation rate (% average)	1.5	1.7	1.9	1.4	1.2	2.5	2.8	3.0
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

Polish MPC appears to be comfortable with higher inflation

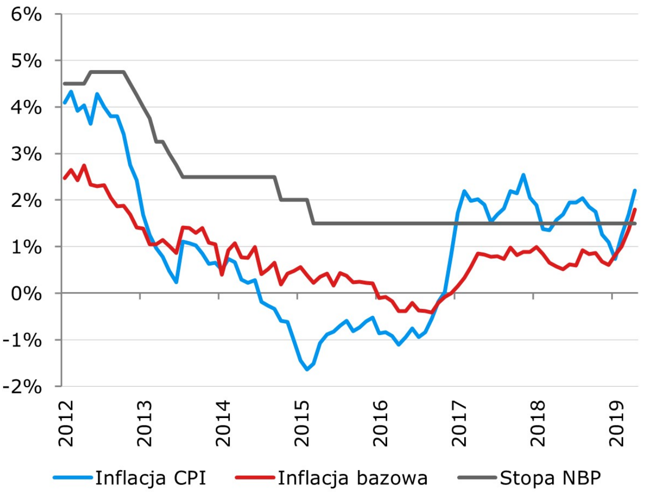
The May meeting of the Monetary Policy Council brought no changes to interest rates or the Councilâ€™s rhetoric. The key passage in the post-meeting statement, describing current interest rate level as optimal, remains in place without any alteration.

The NBP governor's statements during the press conference were dovish, as usual. Predictably, quite a lot of time was devoted to the recent increases in inflation. As we expected the uptick in the CPI was dismissed as modest and caused by factors outside of central bank influence. The rise in core inflation, in turn, is not seen as part of a more durable trend, but rather as normalization after the long period of sub-1% readings. At present, core inflation returned to levels consistent with the state of the real economy. It seems that Mr Glapinski, being aware of further acceleration in the CPI in the following months, is accustomed to the idea of 3-3.5% inflation at the turn of the year. It will not warrant any reaction from the central bank. As for 2020, the governor refrained from any assessment of inflation prospects, highlighting massive uncertainty regarding electricity prices. One should assume that externally-driven electricity price spike will not be enough to shatter the consensus within the Council, though.

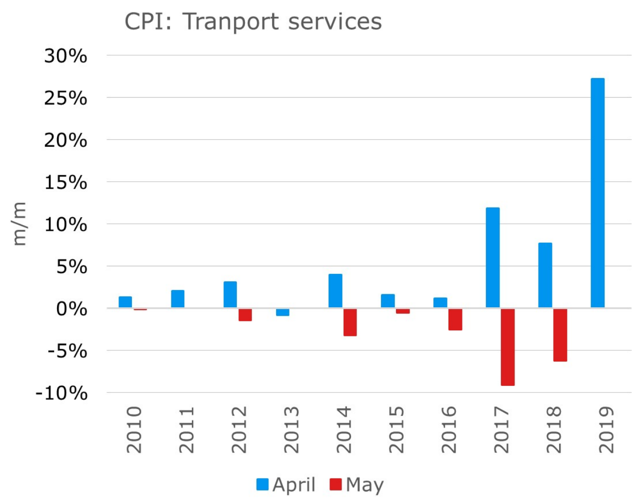
In a way, the MPC's stoic stance is a consequence of the November staff projections which showed a massive upswing in inflation in 2019. It was supposed to be caused by higher electricity prices. While the conservative scenario assumed by the NBP never materialized, the MPC was primed to treat temporary swings in inflation as temporary and see through them. This framework is now being applied in similar circumstances. The MPC is still convinced that GDP growth will decline, following the downturn in Western Europe. Q1's surprisingly strong economic growth did not deter the MPC from this overarching forecast – after all, growth is indeed slowing down.

Polish CPI inflation confirmed at 2.2% y/y

Statistics Poland confirmed April inflation at 2.2% y/y. The main sources of the acceleration vis-a-vis March's 1.7% y/y are: strong food price growth (+1.0% m/m), more expensive fuels (+4.1% m/m) and higher core inflation. The latter was mainly due to transport services (up by a whopping 27.2% m/m!), insurance (+1.4% m/m) and other financial services (+3.6% m/m). While our initial estimate of core inflation (1.8% y/y) is thereby confirmed, the increase is much more concentrated than we initially thought. In other words, core inflation was boosted by one-off factors (in all likelihood the ever-more-volatile airline fares).

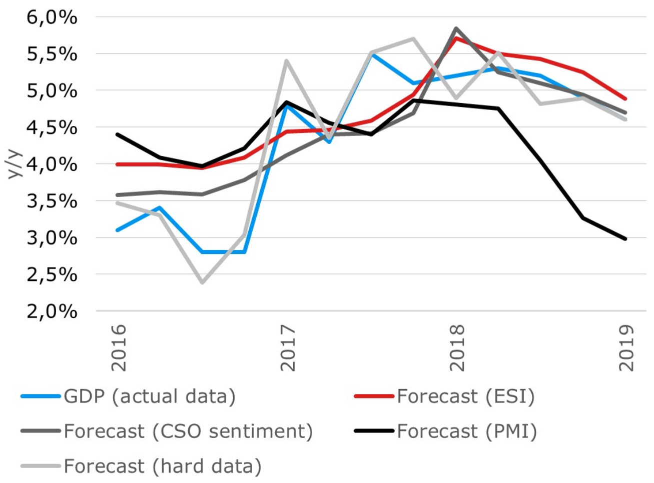


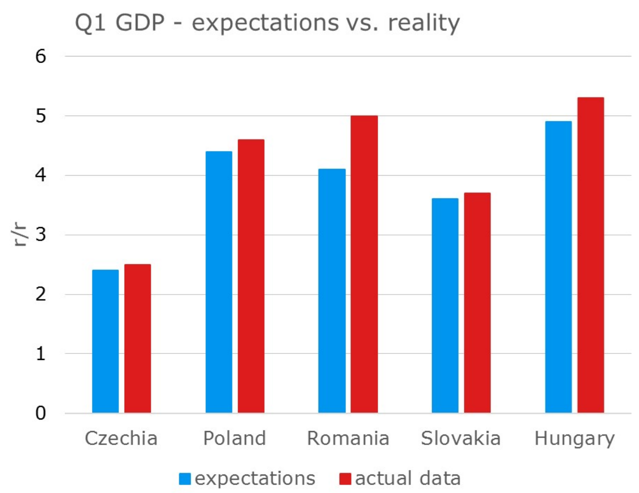
Next month CPI is set to slightly overshoot the NBP's target (rising to 2.5-2.6% y/y), although the exact number will eventually be determined by food and fuel prices. As for the former, higher wholesale pork prices will start impacting retail prices. For the latter – we feel that April's fuel price hike was underestimated and May is likely to compensate for that shortfall. Core inflation will remain broadly stable as April's one off in airline fares is corrected (the historical pattern in April-May is quite clear). Finally, insurance prices are an interesting case. Unless last month's increase was due to higher car insurance premiums, April's increase was due to drought impacting other types of insurance. Since insurers are no longer offering insurance to farmers, there wonâ€™t be any further boost to inflation from that direction. Other financial services are rising as Poland is converging to Western Europe's price levels.



Polish GDP rose by 4.6% y/y in Q1

Polish economy started the year on a firm footing, having risen by 4.6% y/y. The result was better than market consensus (4.4% y/y) and close to our optimistic forecast of 4.7% y/y. Also, this fits higher frequency data phenomenally well (see the graph below). The sequential growth rate (1.4% q/q, seasonally adjusted) is consistent with monthly data – Q1 saw one of the largest q/q increases in industrial and construction output in recent years. Finally, the positive surprise fits the CEE pattern of beating market consensus (see graph below).





The structure of Q1 GDP will be published on May 31st, however, we can make some educated guesses. Our forecasts assume that consumption rose by 4.1% y/y and investment advanced by 7.5% y/y. The missing piece of the puzzle was revealed by yesterday's balance of payment data. Strong exports and a deceleration in overall imports imply that net exports likely added more than 1 percentage point to annual GDP growth.

As we indicated repeatedly, sequential Q1 growth rate has the largest weight in annual average GDP growth. Hence, last quarter's result bodes well for this year's economic growth and for our optimistic forecast of 4.5% y/y. The distribution of quarterly growth rates is likely to be U-shaped, though. Weaker business sentiment across the board in April (no hard data has yet been published) implies further deceleration in GDP, this time to 4.4% y/y. The second half of the year will be shaped by the fiscal stimulus and growth will likely firm up.

There are two considerations for the markets. First, today's surprise will not shift the expected NBP rate path in any meaningful way. Polish MPC has already shown that it was capable of becoming more dovish when growth was accelerating, it only makes sense to expect more dovishness as the economy is slowing down (albeit gently). Second, judging from consumer sentiment or labor market stats, one can confidently argue that there is no practical difference between 5.5 (this cycle's peak) and 4.6% GDP growth. This, in turn means, that credit risk premia should be low.

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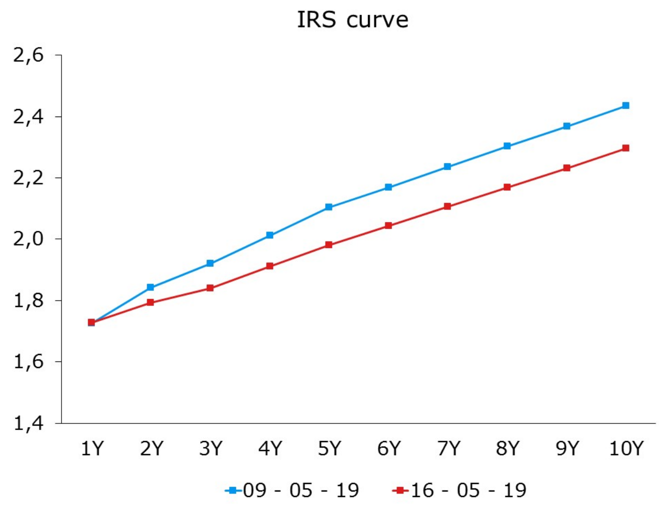
Fixed income

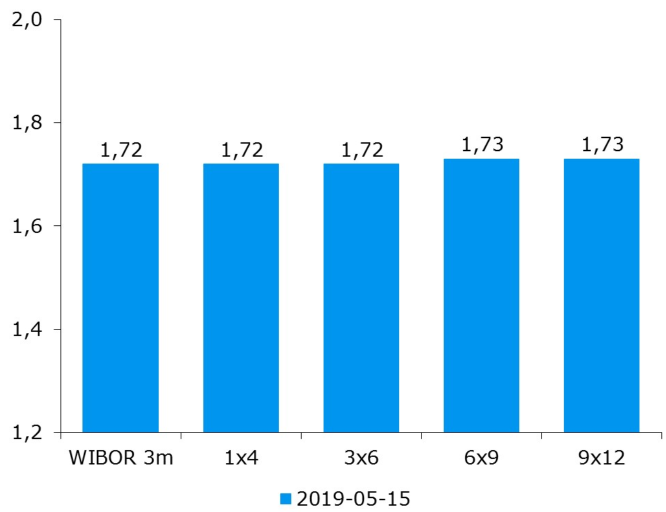
Wider ASWs

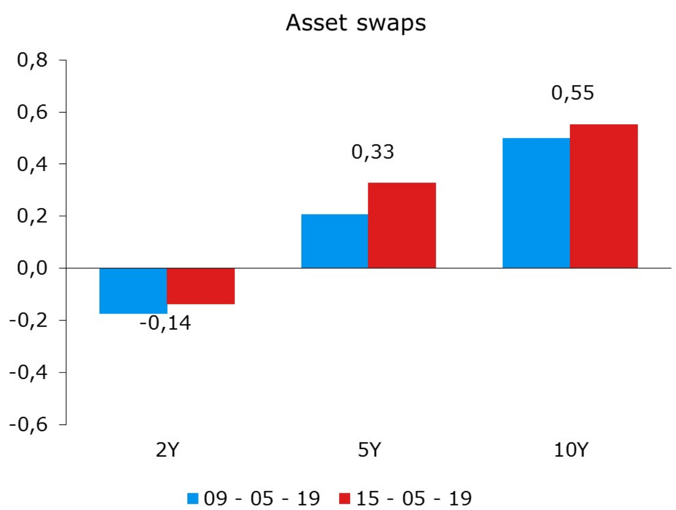
During last week the market was mainly driven by receiving flows on swaps. Even though the bond market just tracked swaps, ASWs still widened significantly. The last bond auction didn't have a high bid to cover ratio, which showed that there was a lack of demand on bonds, which led to significant moves in prices.

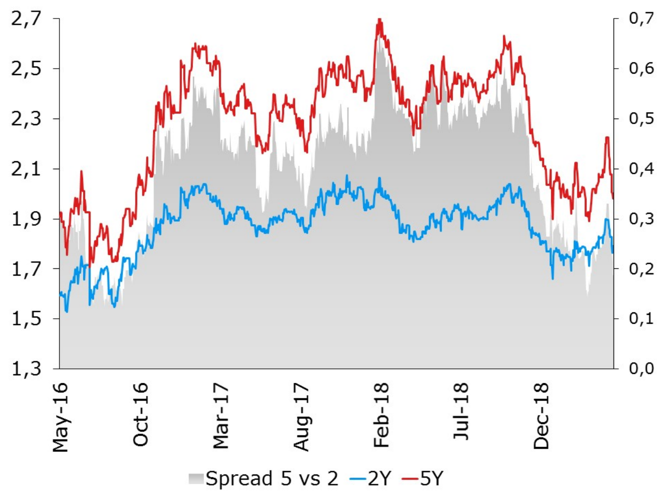
PS0424/5y is 19 bps, WS0428/10y is 42 bps. PS0424/WS0428 is 56 bps. WS0428/Bund is 290 bps.

DS1020 is trading at 1.53%, PS0424 is trading at 2.24% and WS0428 is trading at 2.81%.







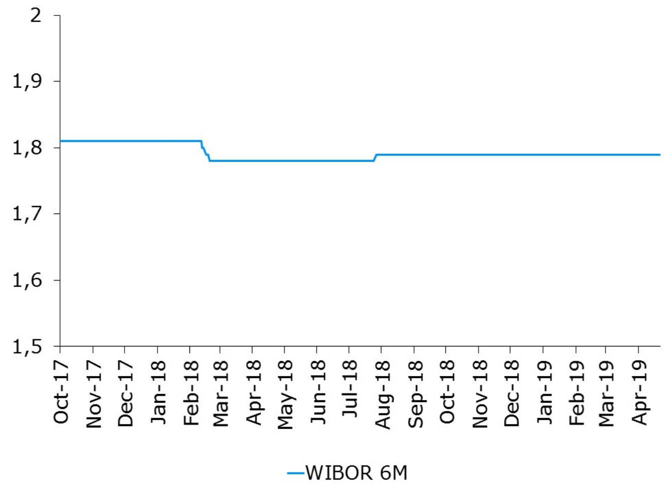


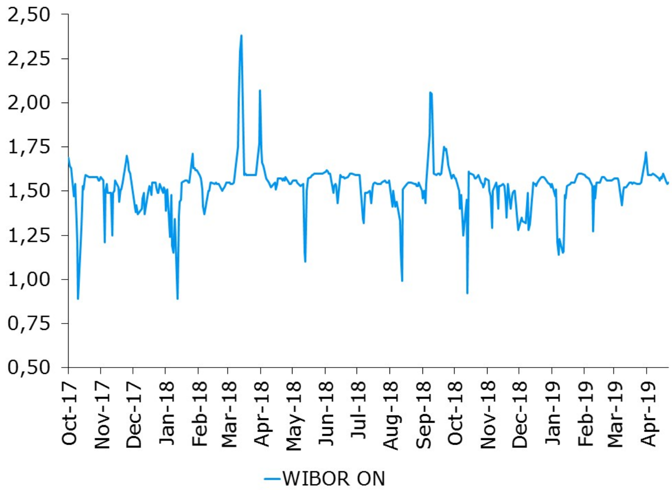
Money market

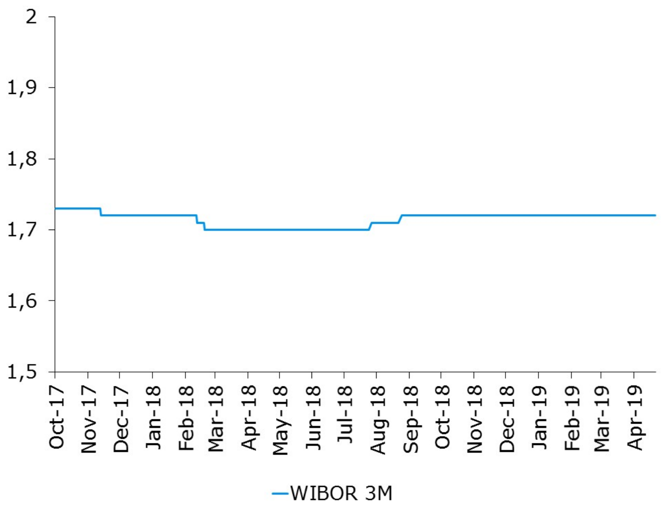
Local story moves into the background

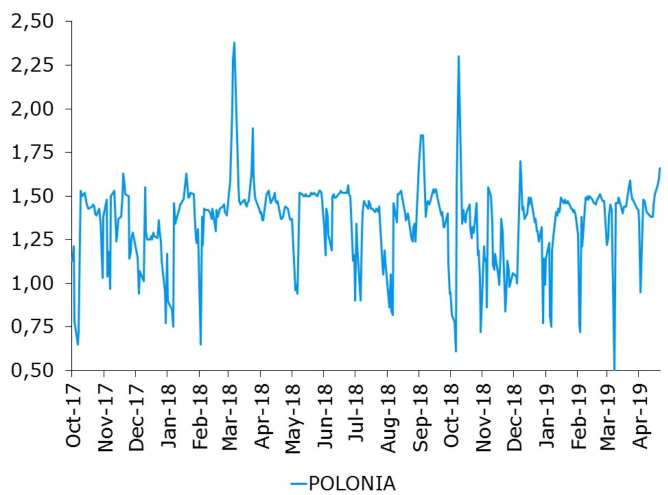
Polish CPI story was forgotten last week and yields where falling rapidly following core markets. All due to President Trump's tweets about tarrifs. Fear of global trade war drove USD and EUR rate to multi-month lows. Yesterday we had a reversal, again after tweets. If it wasn't for the tweets, attention would have been paid to rising Polish CPI.

Very expensive week with O/N trading around 1.80%. All due to slight cash shortage after the recent OMO. Tomorrow's operation will set the tone for next week.





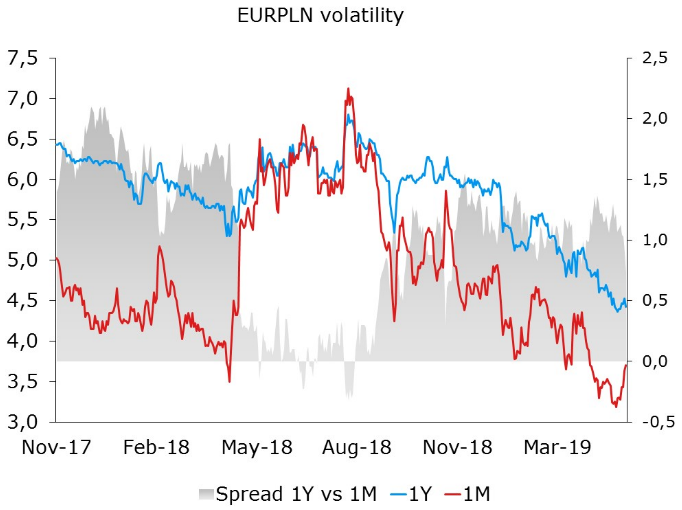




Forex

Spot - EUR/PLN - trade wars weighed on the market sentiment Trade war was the main topic of the week, and still is the crucial factor for global investment sentiment. EUR/PLN reached 4.3150 on the trade war intensification, and retraced quickly below 4.30 on President Trump's tariffs being postponed. USDPLN rose to 3.8550 from 3.8200 thanks to appreciation of USD against EUR. Interestingly, very good Polish balance of payments data (surplus in March and much smaller deficit in February) had little effect on the zloty. We expect the upcoming week will be the another (of already so many) week with EUR-PLN boxed in the tight range of 4.27-4.34

Options - implied volatility stable Both volatility curves (EUR/PLN and USD/PLN) stayed relatively stable and have not changed much for several days. 1 month EUR/PLN atm is today at 3.50% (0.10% higher than a week ago), 3 months is at 3.75% (0.10% higher), 1 year is at 4.3% (0.10% lower). The currency spread (difference between USD/PLN and EUR/PLN) is roughly the same.

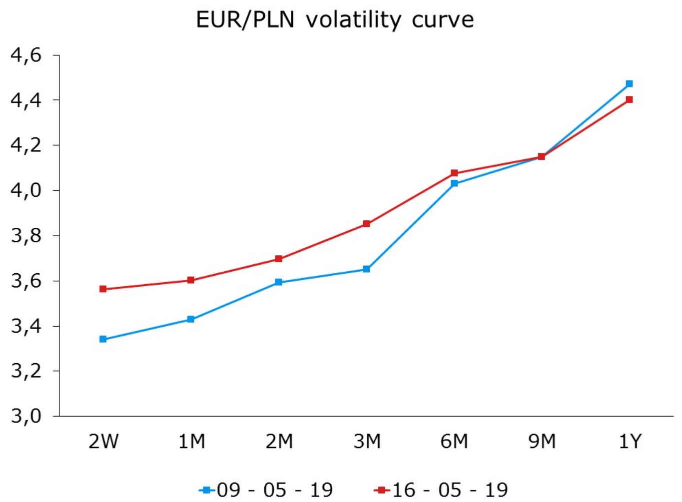


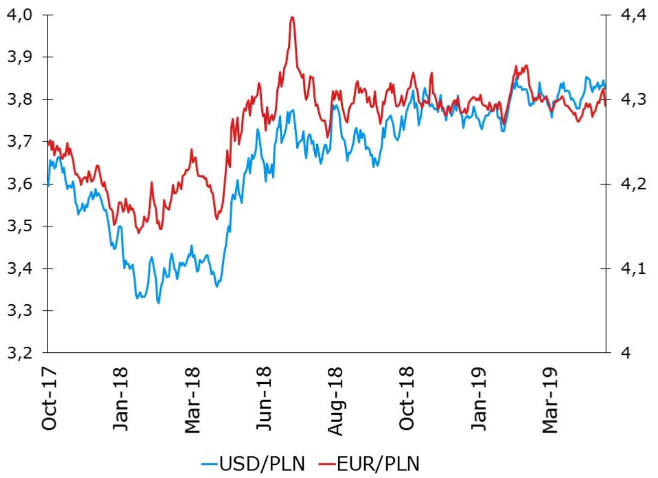
Short-term forecasts

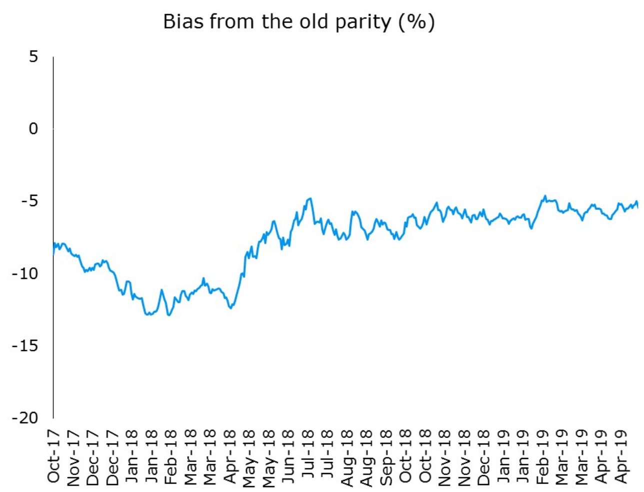
Main supports / resistances:
EUR/PLN: 4.2600 / 4.3400
USD/PLN: 3.6000 / 3.9000

Spot - buy on dips

In this week market has tested local resistance level 4.3150. Generally, we still believe in range trading in EUR/PLN. Our strategy is unchanged, playing the range 4.27-4.32, ideally from the short PLN side.







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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
5/9/2019	1.68	1.72	1.82	1.69	1.99	1.77	1.72	1.73	1.76	1.76	1.80	1.82
5/12/2019	1.68	1.72	1.74	1.69	2.01	1.77	1.72	1.72	1.73	1.75	1.76	1.80
5/13/2019	1.68	1.72	1.84	1.69	1.98	1.77	1.72	1.72	1.74	1.75	1.74	1.81
5/14/2019	1.68	1.72	1.69	1.69	1.87	1.77	1.72	1.72	1.72	1.74	1.74	1.79
5/15/2019	1.68	1.72	1.78	1.69	2.11	1.77	1.72	1.72	1.73	1.73	1.74	1.79

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	4/25/2019	5/25/2021	96.77	1.60	1000	1260	1010
PS0424	4/25/2019	4/25/2024	101.28	2.22	1800	2766	1896
DS1029	4/25/2019	10/25/2029	98.72	2.89	1000	1598	923

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0720	5Y IRS	PS0423	10Y IRS	WS0428
5/9/2019	1.770	1.594	1.842	1.668	2.103	2.308	2.435	2.934
5/12/2019	1.770	1.567	1.827	1.663	2.078	2.308	2.417	2.903
5/13/2019	1.770	1.567	1.792	1.638	2.005	2.308	2.330	2.845
5/14/2019	1.770	1.578	1.763	1.879	2.003	2.308	2.323	2.866
5/15/2019	1.770	1.578	1.793	1.656	1.980	2.308	2.295	2.847

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
5/9/2019	3.43	3.65	4.03	4.47	4.47	1.36	0.47
5/12/2019	3.43	3.63	3.95	4.46	4.46	1.36	0.47
5/13/2019	3.64	3.80	4.08	4.53	4.53	1.40	0.48
5/14/2019	3.70	3.85	4.08	4.43	4.43	1.36	0.48
5/15/2019	3.60	3.85	4.08	4.40	4.40	1.43	0.52

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
5/9/2019	4.2977	3.8410	3.7741	3.5012	1.3249	0.1671
5/12/2019	4.2955	3.8242	3.7734	3.4821	1.3277	0.1670
5/13/2019	4.3029	3.8321	3.7949	3.4942	1.3272	0.1670
5/14/2019	4.3085	3.8323	3.8042	3.4946	1.3297	0.1673
5/15/2019	4.3128	3.8457	3.8244	3.5149	1.3276	0.1675

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