May 30, 2019

# Polish Weekly Review


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## Comment on the upcoming data and forecasts

This Friday Statistics Poland will publish the details of Q1 GDP. We expect the flash estimate (4.6% y/y) to be confirmed. We forecast that growth in Q1 was driven by household consumption (4.1% y/y) and investment (7.5% y/y). In addition, net exports likely added as much as 1 p.p. to annual growth in Q1. On Monday manufacturing PMI will be published, which we expect to fall slightly, to 48.8 pts. Next day, Statistics Poland will publish flash CPI reading. We are forecasting another increase in annual inflation. The reading will not change the attitude of MPC – it should not surprise, keeping on Wednesday both interest rate and rhetoric unchanged.

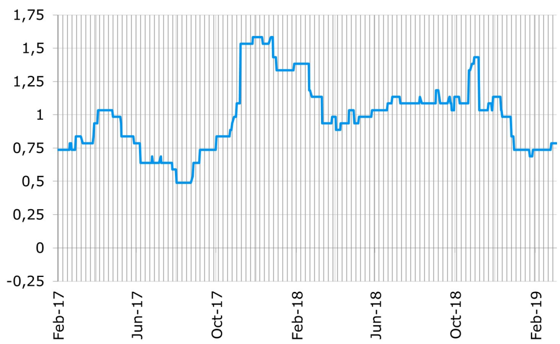
### Polish data to watch: May 31st to June 7th

| Publication | Date | Period | mBank | Consensus | Prior |
|---|---|---|---|---|---|
| GDP y/y *flash* (%) | 31.05 | Q1 | 4.6 | 4.6 | 4.6 |
| PMI (pts.) | 3.06 | May | 48.8 | | 49.0 |
| CPI *flash* (%) | 4.06 | May | 2.7 | | 2.2 |
| MPC's decision (%) | 5.06 | 5.06 | 1.5 | 1.5 | 1.5 |

### 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

Unemployment rate did not surprise, keeping Polish surprise index unchanged. This week the index can move due to the final GDP, flash CPI and the PMI.

* 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. Risks are still tilted to the upside.
- 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) are set to push inflation beyond NBP target already in 2019. The issue of electricity prices will make a comeback in January. Therefore, inflation might accelerate even further in 2020.
- 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 |

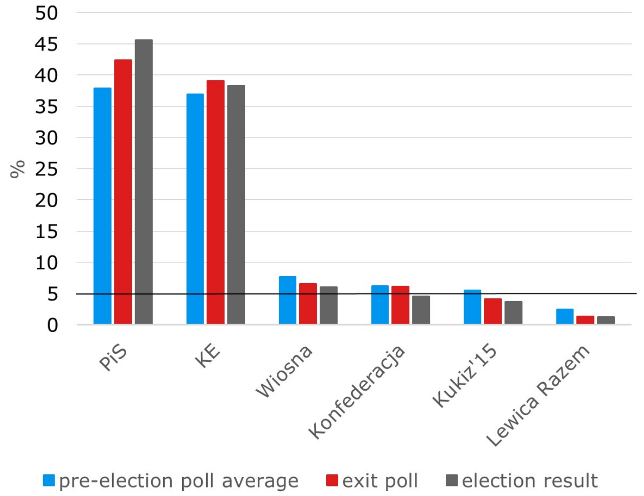
| | 2018 Q1 | 2018 Q2 | 2018 Q3 | 2018 Q4 | 2019 Q1 F | 2019 Q2 F | 2019 Q3 F | 2019 Q4 F |
|---|---|---|---|---|---|---|---|---|
| GDP y/y (%) | 5.2 | 5.3 | 5.2 | 4.9 | 4.6 | 4.5 | 4.5 | 4.4 |
| Individual consumption y/y (%) | 4.6 | 4.8 | 4.4 | 4.2 | 4.1 | 4.1 | 4.5 | 4.9 |
| Public Consumption y/y (%) | 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 | 7.5 | 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

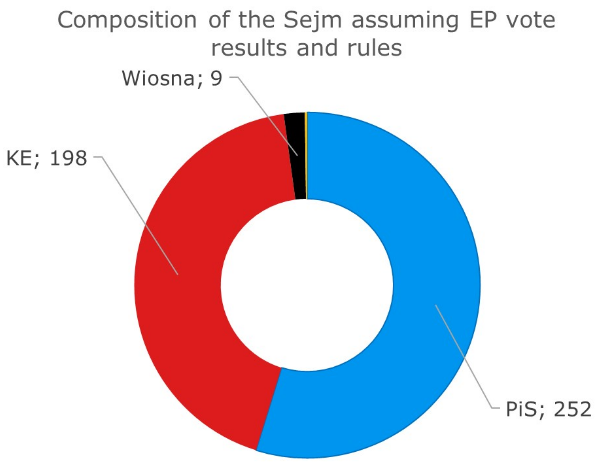
# Economics

## European Parliament elections – status quo maintained

The EP elections surprised observers in two important ways. First, the turnout was enormous and reached 45% (double the 2014 figure and close to values typical for national parliamentary elections). Second, the results of the vote turned out to be more favorable for the ruling party than both pre-election poll averages and exit polls suggested (see the graph below). The final count indicated that Law & Justice (PiS) got ca. 45.5% of the votes (27 seats), while the opposition coalition (KE) got 38.5% (22 votes). The remaining three went to left-wing Wiosna party. We won't comment on the sources of the surprise, focusing on economic and market implications instead.




All parties involved treated this election as a dress rehearsal before the autumn elections to the national parliament. If last Sunday's votes were to be recalculated using national election rules, PiS would expand its majority from 238 to 252, but would fall short of the veto-proof majority (276 seats) or the constitutional majority (309 seats). In the Senate, where seats are decided by winner-takes-all rules, the breakdown would have been 53:47.

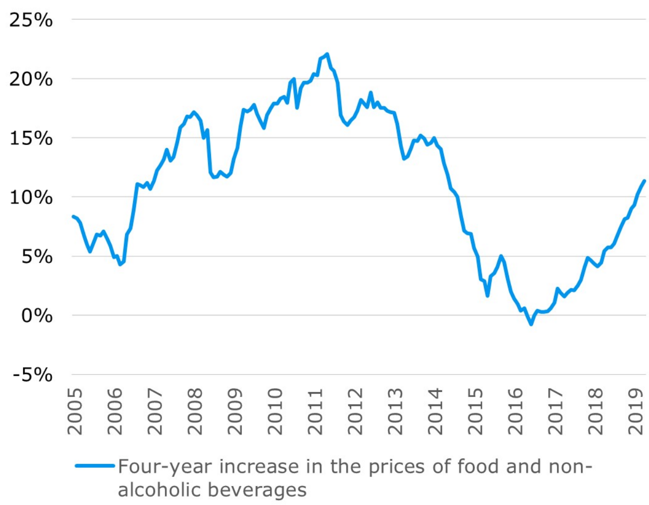



Therefore, the EP election results can be seen as a strong support for the status quo. Apart from reducing the election-related uncertainty, it suggests (on balance) tighter fiscal policy since the need to expand social spending ahead of the autumn election will be smaller. This, in turn, means that the government's fiscal consolidation plans are more likely to materialize. Risk premia in the Polish assets should therefore be smaller and correlations with global trends – tighter. Actual result of the national elections (will likely be held in the second week of October) will depend on many factors, most importantly turnout and the shape of the coalitions, and last Sunday's vote count cannot be treated as an unbiased forecast. We will be reporting on this regularly. For now, the status quo is maintained in every relevant way.

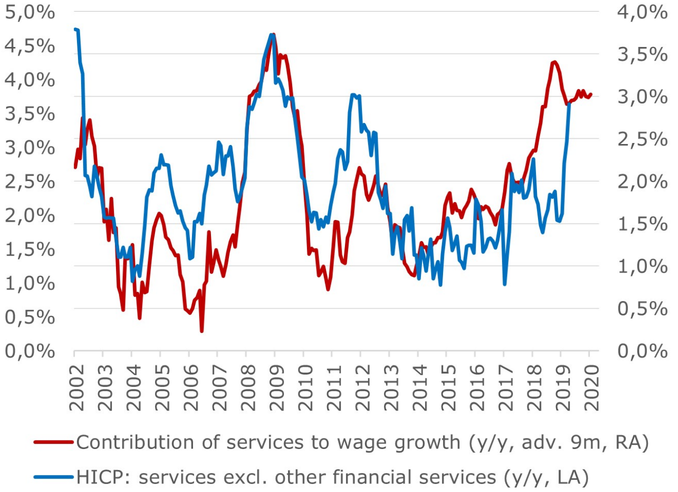
## Taking the lid off of the recent increases in Polish inflation

The inflation story in Poland is one of rapid acceleration – we began the year at many-month low of 0.7% y/y, only to see it rise to 2.2% y/y in April. For May we expect it to accelerate further, to 2.7% y/y, thereby breaching the NBP's target for the first time in years. While the non-core parts of the reading are gathering most of the media hype, the underlying trends are the most pro-inflationary since 2011. Let us delve into the innards of Polish CPI for a couple of moments.

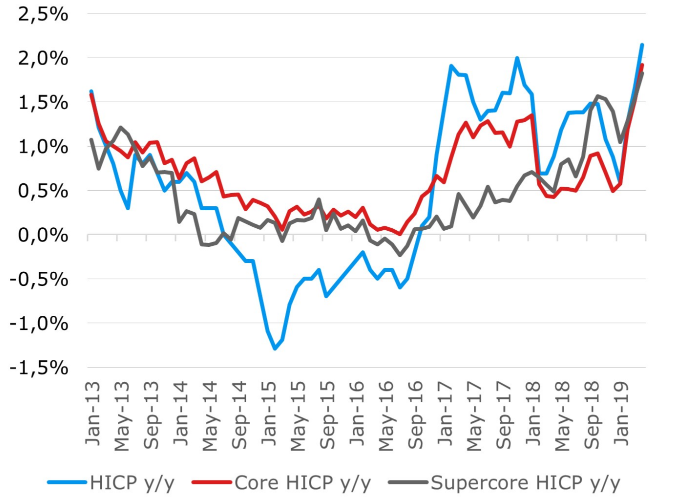
First, the non-core part is driven by energy and food prices. The former, due to electricity price freeze (keep in mind that it won't last forever, though...), is moved mainly by gasoline and other liquid fuels. While May is set to bring another hefty increase (around 3-4% m/m), it will likely mark the local top, if oil prices stay where they currently are. On the other hand, food prices are rising fast and the increase is broad-based, observed in both processed and unprocessed food categories, meat and vegetables, bread products and sugars, etc. May was no exception here and we expect food prices to have risen by a massive 1.8% m/m. In addition, it is far from clear that the inflationary impulse has ended: the rapid switch from drought to flood and the spread of ASF in East Asia are likely to put upward pressure on the prices of many food products this year. Note that public perception is driven by levels more often than by growth rates and the recent string of increases (well above 10% in four years) has put the overall food price index firmly at all-time high.




Second, core inflation has already risen to a 6.5-year high of 1.7% y/y in April (our forecast for May – 1.8% y/y) and this, too, is driven by multiple factors. The overarching theme, it seems, is the rapid acceleration in the prices of services. Consider that services prices were rising by 1-2% y/y throughout the most of the recent low inflation period. In April, they rose by 3.6% y/y (and basically all of the acceleration occurred this year!), closing on 2011 highs. A thorough category-by-category scan reveals that inflation appeared essentially everywhere, with the exception of wage-insensitive categories such as telecommunications and insurance.




Third, the underlying inflationary trends have been positive for some time now, but transitory factors (such as price declines in wage-insensitive categories such as telecommunication and TV fees) held it back. This observation inspired us to compute ”supercore inflation” (see the graph below), which proved to be smoother and more consistent with the macroeconomic environment. Fast forward to 2019 and all measures of core inflation rose considerably and converged. As of April 2019, supercore inflation is telling the same story as core inflation.




Even a cursory look at wage growth in services and services prices reveals that the once rock-solid correlation first broke down and then reestablished itself. Perhaps the catalyst for price hikes was the looming electricity price spike which was partly arrested by legislation and whose outcome was uncertain for months (while many enterprises received higher bills in 2018 already). Recent news suggest that compensation scheme will be in the ”de minimis” form. This, in turn, means, that electricity prices for medium and large enterprises will be purely market-driven starting this July and enterprises must apply for a partial refund. Electricity prices for corporations were never the problem, though, since energy intensity is very unequally distributed and for most companies it is not a large part of cost structure. The elephant in the room are electricity prices for households. If the template is to be applied to households, the regulator might try to realign them with wholesale electricity prices. This, in turn, implies a massive boost to headline inflation starting from January 2020. This is a space to watch closely and even if there is no change, base effects alone ensure a ca. 0.5 p.p. increase in y/y CPI in January.

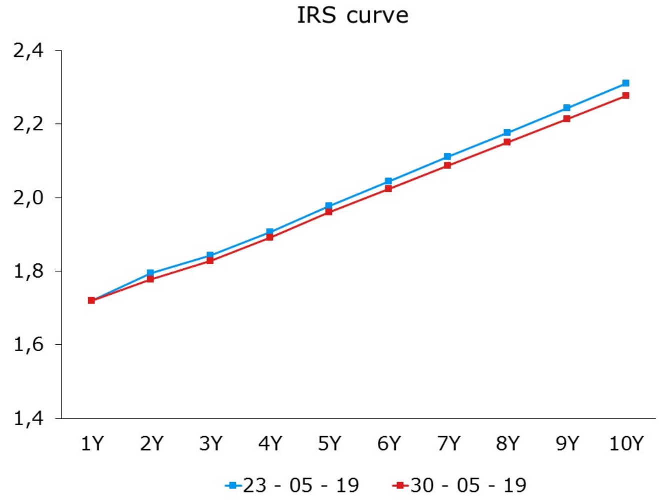
# Fixed income

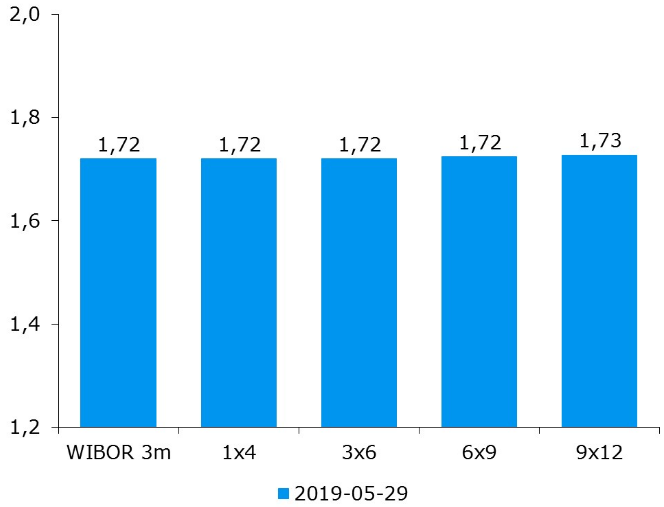
## Post-election calm

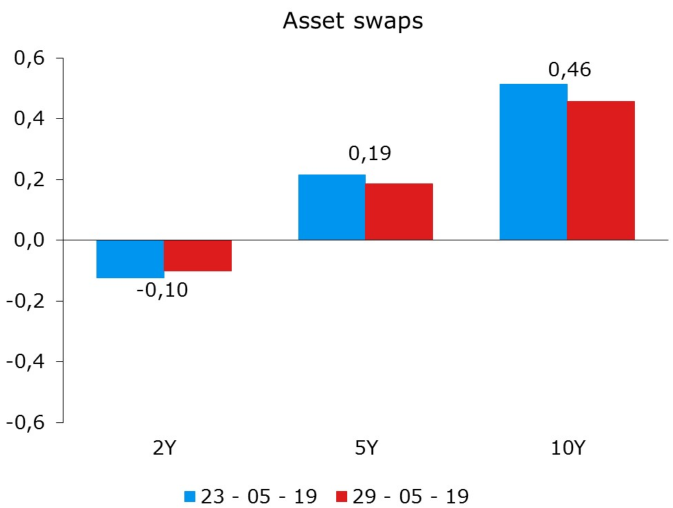
After Law and Justice won in EU Election, the risk of further fiscal stimulation went down. It gave significant boost to ASWs (which narrowed a lot especially in the long end) and floaters. Fixed coupon bonds followed core markets, despite risk of increasing inflation, which led to the significant decrease of yields.

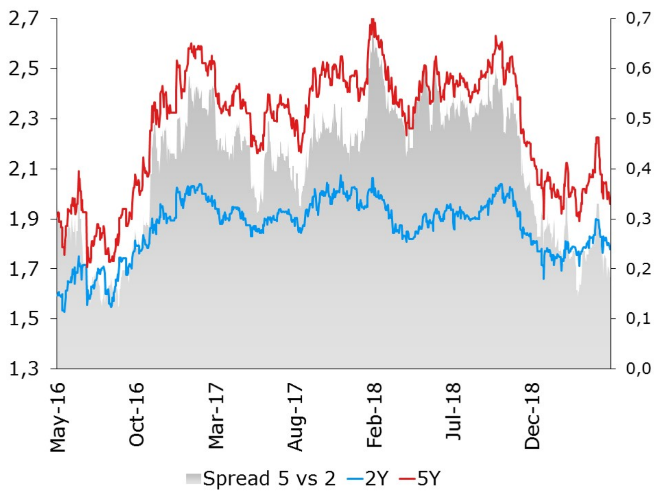
PS0424/5y is 16 bps, WS0428/10y is 36 bps. PS0424/WS0428 is 51 bps. WS0428/Bund is 282 bps.

DS1020 is trading at 1.51% , PS0424 is trading at 2.13% and WS0428 is trading at 2.64%.



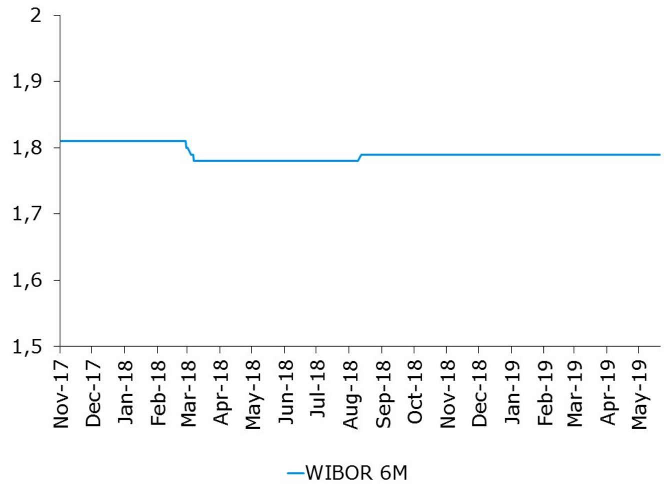
# Money market

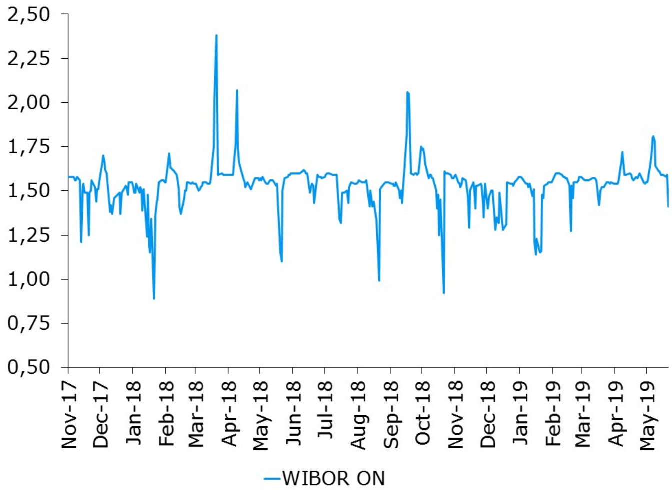
## Global sentiment rules after the elections

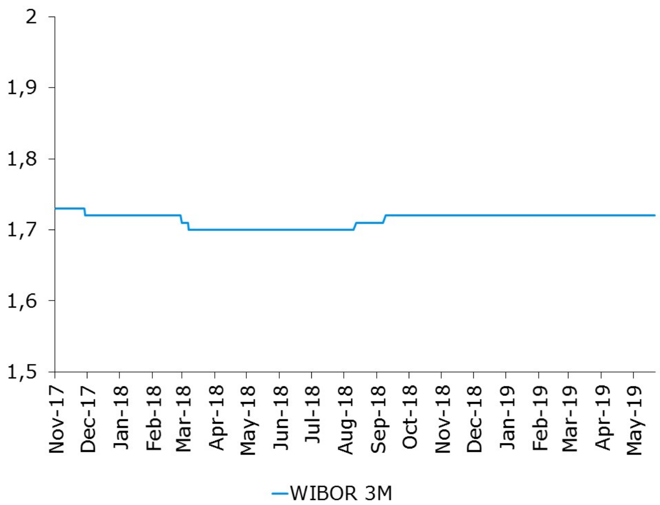
Elections to the European Parliament surprised the market with strong ruling party win over the opposition. In first reaction investors bought bonds as Law & Justice is seen as not forced to set up additional social spending before autumn election. That was followed by strong fall in core yields, which pushed POLGBs even higher. We are still moving within recent range, though. Next week we have CPI print coming which might get closer to NBP target. We will still follow global sentiment in coming days.

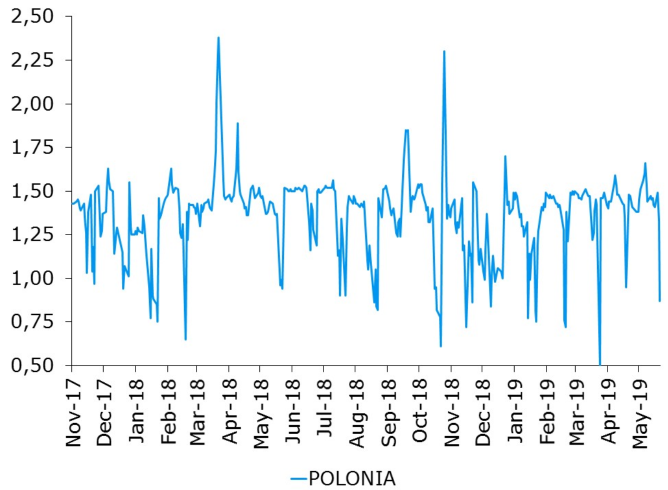
Safe month end with enough spare cash on the market. We start new month so rate will stabilize around 1.50%.

Ref rate vs Polonia averages:
30 day 8 bp
90 day 12 bp



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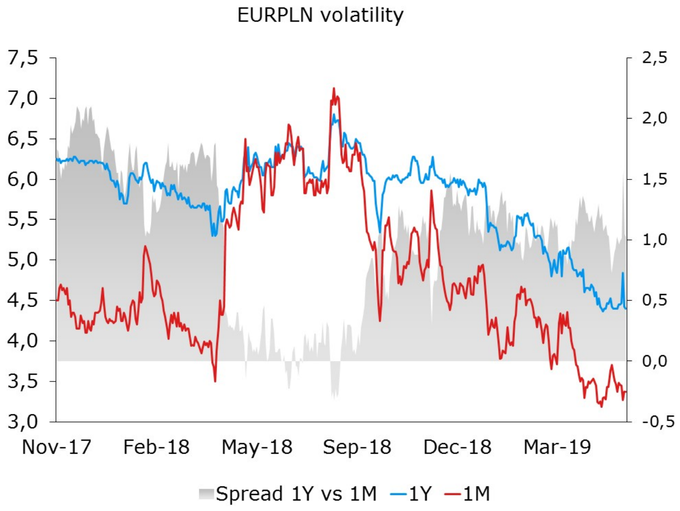
# Forex

**Spot – EUR/PLN – very stable** At the beginning of the week global market sentiment was impacted by the outcome of the European elections and the global mood improvement. The strong result of the Poland's ruling party means lower risk for public finances. The optimism had the impact on the zloty. EURPLN fell to 4.2880 and USDPLN to 3.8280. Unfortunately, optimistic moods after the European election disappeared quickly from the market. In the second part of week we have seen more pessimistic information on growing China-US tensions and the Italy deficit crisis. The EURPLN climbed: to 4.3030 and USDPLN to 3.8620.

**Options – implied volatility stable** Realized volatility is still on the move down but the implied volatility seems to have found its equilibrium at current levels as the curve has not changed much for weeks. 1 month EUR/PLN atm is today at 3.3% (unchanged from last week), 3 months is at 3.65% (unchanged), 1 year is at 4.35% (0.05% higher). The currency spread (difference of USD/PLN minus EUR/PLN) is roughly unchanged.

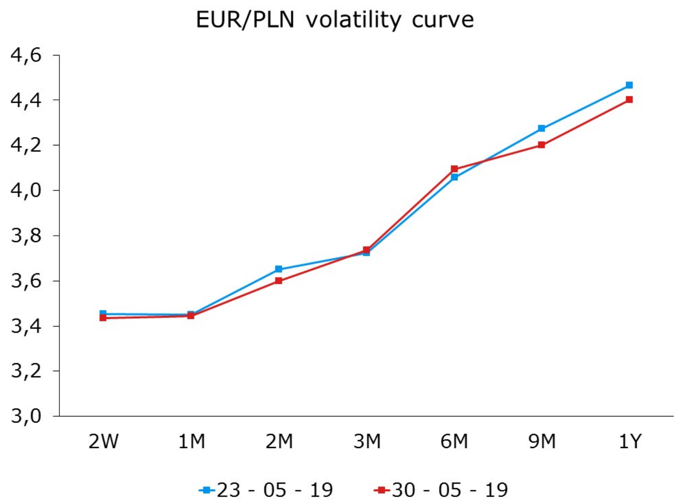


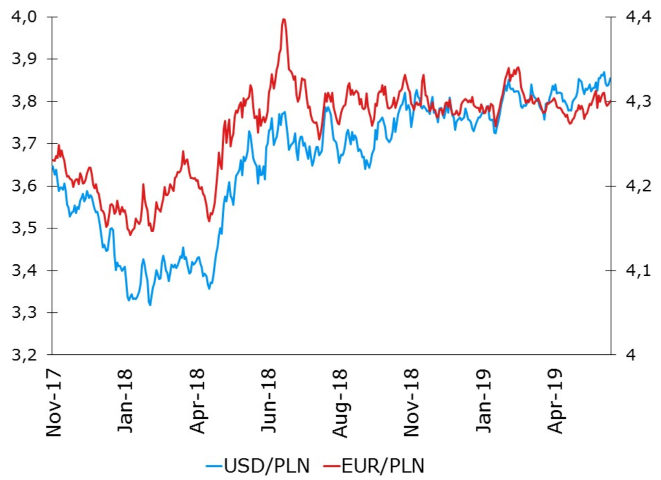

## Short-term forecasts

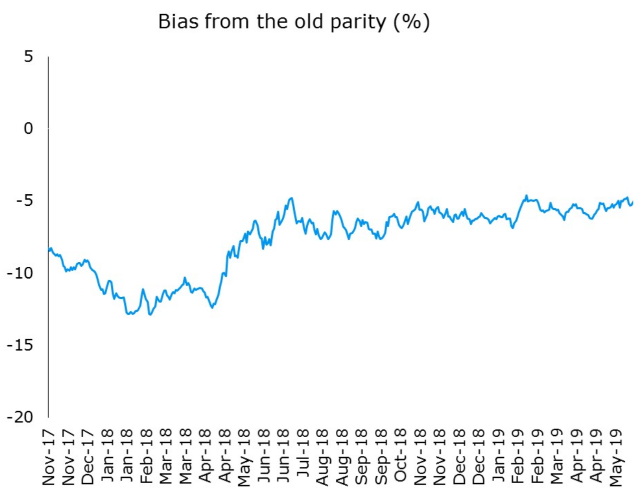
Main supports / resistances:
EUR/PLN: 4.2600 / 4.3400
USD/PLN: 3.6000 / 3.9000

**Spot - buy on dips**

The global market sentiment shall continue to play the main role on the local market, we don't expect EURPLN to leave the 4.27.4.34 range anytime soon. Our strategy to play that range still applies. Ideally we are ready to buy EUR/PLN at 4.27-28 with stop at 4.24 and hopes to see again 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 |
| 5/23/2019 | 1.79 | 1.72 | 1.87 | 1.69 | 2.04 | 1.77 | 1.72 | 1.72 | 1.73 | 1.74 | 1.75 | 1.80 |
| 5/26/2019 | 1.68 | 1.72 | 1.71 | 1.69 | 1.78 | 1.76 | 1.72 | 1.72 | 1.73 | 1.73 | 1.75 | 1.79 |
| 5/27/2019 | 1.71 | 1.72 | 1.78 | 1.69 | 1.95 | 1.76 | 1.72 | 1.73 | 1.73 | 1.74 | 1.75 | 1.80 |
| 5/28/2019 | 1.61 | 1.72 | 1.68 | 1.69 | 1.87 | 1.76 | 1.72 | 1.73 | 1.73 | 1.74 | 1.74 | 1.80 |
| 5/29/2019 | 1.71 | 1.72 | 1.78 | 1.69 | 1.97 | 1.76 | 1.72 | 1.72 | 1.72 | 1.73 | 1.73 | 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 |
| 5/23/2019 | 1.770 | 1.542 | 1.795 | 1.670 | 1.978 | 2.192 | 2.310 | 2.823 |
| 5/26/2019 | 1.760 | 1.552 | 1.803 | 1.683 | 2.007 | 2.200 | 2.337 | 2.836 |
| 5/27/2019 | 1.760 | 1.552 | 1.803 | 1.667 | 2.002 | 2.173 | 2.337 | 2.817 |
| 5/28/2019 | 1.760 | 1.553 | 1.793 | 1.656 | 1.985 | 2.163 | 2.310 | 2.788 |
| 5/29/2019 | 1.760 | 1.552 | 1.777 | 1.675 | 1.960 | 2.145 | 2.277 | 2.735 |

| EUR/PLN 0-delta stradle | | | | | 25-delta RR | | 25-delta FLY |
|---|---|---|---|---|---|---|---|
| Date | 1M | 3M | 6M | 1Y | 1M | 1Y | 1Y |
| 5/23/2019 | 3.45 | 3.73 | 4.06 | 4.47 | 4.47 | 1.43 | 0.51 |
| 5/26/2019 | 3.27 | 3.70 | 4.05 | 4.85 | 4.85 | 1.43 | 0.51 |
| 5/27/2019 | 3.38 | 3.70 | 4.08 | 4.43 | 4.43 | 1.40 | 0.51 |
| 5/28/2019 | 3.38 | 3.70 | 4.03 | 4.40 | 4.40 | 1.45 | 0.51 |
| 5/29/2019 | 3.44 | 3.74 | 4.10 | 4.40 | 4.40 | 1.45 | 0.51 |

| PLN Spot performance | | | | | | |
|---|---|---|---|---|---|---|
| Date | EURPLN | USDPLN | CHFPLN | JPYPLN | HUFPLN | CZKPLN |
| 5/23/2019 | 4.3107 | 3.8696 | 3.8343 | 3.5136 | 1.3192 | 0.1669 |
| 5/26/2019 | 4.2989 | 3.8436 | 3.8327 | 3.5083 | 1.3182 | 0.1663 |
| 5/27/2019 | 4.2952 | 3.8374 | 3.8154 | 3.5049 | 1.3192 | 0.1663 |
| 5/28/2019 | 4.2967 | 3.8386 | 3.8249 | 3.5147 | 1.3164 | 0.1663 |
| 5/29/2019 | 4.3007 | 3.8554 | 3.8329 | 3.5289 | 1.3141 | 0.1663 |

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