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Polish Weekly Review

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Comment on the upcoming data and forecasts

On Thursday the NBP will publish balance of payments data for April. We do not expect any significant changes compared to the previous month's publication, with the current account slightly higher than market consensus (our forecast 619 m EUR vs consensus 518 m EUR). Next day Statistics Poland will publish final CPI reading for April. Flash estimate surprised and amounted to 2.3% y/y – lower than both our forecasts and market consensus, mostly due to low dynamics of fuel prices.

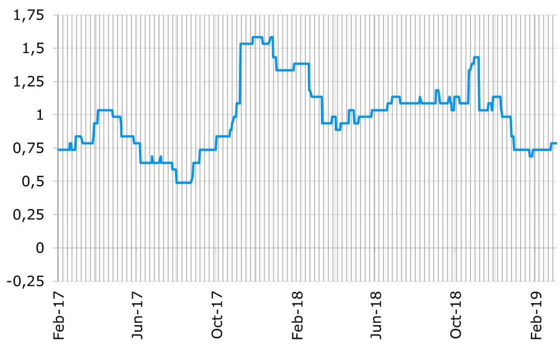
Polish data to watch: May 31st to June 7th

Publication	Date	Period	mBank	Consensus	Prior
Current account (m EUR)	13.06	Apr	619	518	589
Exports (m EUR)	13.06	Apr	19000	19243	19654
Imports (m EUR)	13.06	Apr	18500	18980	19065
Final CPI y/y (%)	14.06	May	2.3	2.3	2.2

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

Last week Polish surprise index moved one point upward due to the higher, than the flash estimate, final GDP for 1st quarter (4.7% vs 4.6%), but later it came back to the previous levels as a result of lower than expected flash CPI reading (2.3% vs 2.4%). This week the index can move due to the balance of payments and final CPI 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).

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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. Additionally, private investment finally arrives and public spending cycle seems to be stronger than we expected. It changes the starting point and the durability of investment activity going forward. Therefore we are upgrading GDP forecast to 5.0% in 2019 and 4.0% in 2020 (with upside risk).
- Core inflation is projected to rise steadily. The combination of food prices and base effects are set to push inflation above target in the year's end. The issue of electricity prices will make its comeback in January. Therefore, inflation might accelerate even further at the onset of 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. The rise in inflation may generate some noise from MPC members, though.
- 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	5.0	4.0
CPI Inflation y/y (average %)	-0.9	-0.6	2.0	1.6	2.0	2.8
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

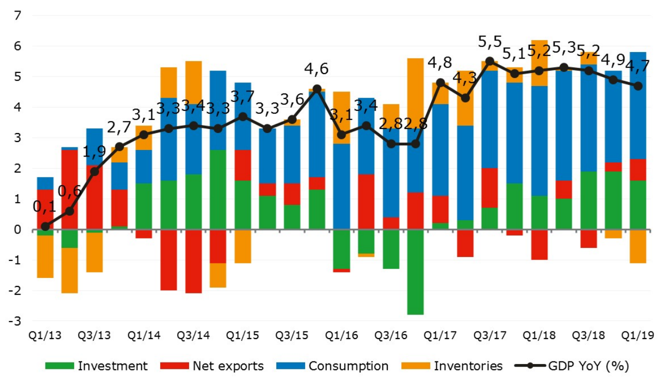
	2018 Q1	2018 Q2	2018 Q3	2018 Q4	2019 Q1 F	2019 Q2 F	2019 Q3 F	2019 Q4 F
GDP y/y (%)	5.2	5.3	5.2	4.9	4.7	4.9	5.0	5.3
Individual consumption y/y (%)	4.6	4.8	4.4	4.2	3.9	4.3	4.5	4.8
Public Consumption y/y (%)	4.5	4.5	5.2	4.7	6.4	6.4	6.4	6.4
Investment y/y (%)	9.6	6.0	11.3	8.2	12.6	10.0	8.0	7.0
Inflation rate (% average)	1.5	1.7	1.9	1.4	1.2	2.3	2.1	2.5
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

Following Q1 details, we are raising our forecast of Polish GDP in 2019 to 5%.

According to the second estimate of Q1 GDP, Polish economy grew by 4.7% y/y in the first quarter, a tad stronger than the initial estimate of 4.6% y/y (historically, this has happened in 1/3 of cases), above market consensus of 4.4% y/y, but in line with our forecast. Compared to the previous quarter, GDP rose by 1.5% q/q, confirming that the economy started the year with strong momentum – we remind our readers that weighted average of industrial and construction output rose by almost 4% q/q in the first three months of the year.

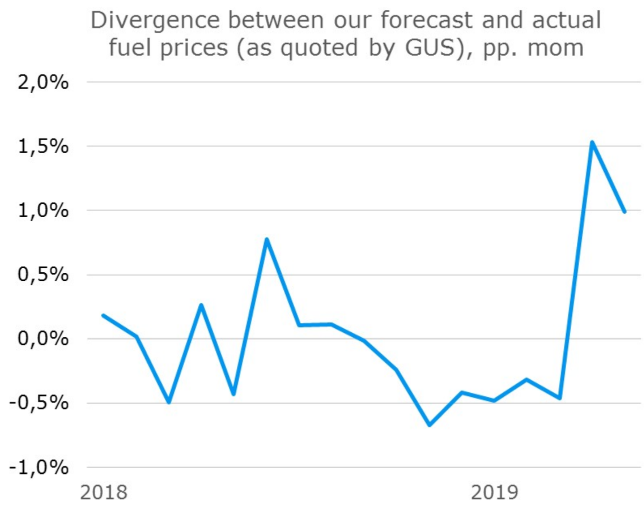


The structure of growth is generally consistent with our expectations, but we were surprised by the extent to which its components accelerated / decelerate. Private consumption slowed down from 4.2 to 3.9% y/y (our forecast 4.1% y/y), which matches the drop in consumer sentiment at the turn of the year and the year-long downtrend in retail sales. The same factors which led to slower consumption growth, should now work in reverse, implying that the Q1's result might mark a local low. The rebound in consumer sentiment, the roll-out of fiscal stimulus and sharply higher retail sales growth in April all suggest that consumption growth is set to return above 4% in Q2 already. Private consumption slowdown was easily offset by public consumption – here we did not appreciate the extent to which higher budgetary expenditures (including public sector wage hikes coming into force in Q1) foreshadowed the acceleration in public consumption. Its final result (6.4% y/y) was above expectations. As for investment, our already optimistic forecast (7.5% y/y) proved to be far too conservative, as investment rose by 12.6% y/y (fastest since 2015Q1). The nature of this acceleration should be obvious given the smashing result of corporate investment (above 20%), driven to a large extent by private investment spending. With public investment slowing down, private companies stepped in to fill the gap. Finally, inventory change subtracted 1.1 p.p. from annual GDP growth, while net exports added 0.7 p.p. The latter has been baked in for many weeks after the release of monthly balance of payments data.

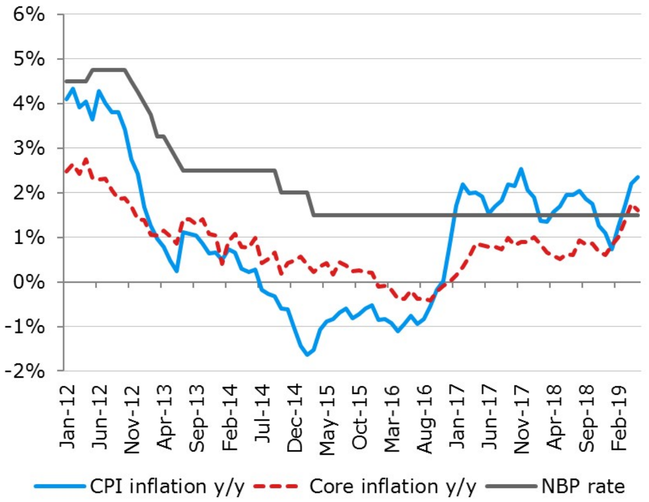
The second quarter is somewhat of a conundrum due to the divergence between hard (implying 5% growth) and soft data (4.4% growth). May data from industry and construction and June business sentiment indices are holding the key to reconciliation of the two numbers. Regardless of Q2 precise figure (we won't know it until August anyway), the structure of Q1 growth should be a basis for another round of forecast upgrades for Poland. To sum up, what disappointed and slowed down growth in Q1 was transitory (individual consumption), what surprised and boosted GDP growth was more permanent (public consumption and private investment). In light of the above we decided to raise our forecasts for 2019, from 4.5 to 5.0% y/y. From the MPC's point of view, this might paradoxically be a comfortable result for the MPC. High investment growth will placate those who saw publically-driven investment cycle as one of lower quality and, through higher potential growth, lower the output gap and core inflation at the end of the forecast horizon. Thus, new NBP projections will show a transitory increase in inflation and slowing core CPI. The hawks might be growing restless due to higher inflation, but consensus is set to remain solid.

Downward inflation surprise.

Inflation in May amounted to 2.3%, which is lower than the consensus estimate, and only marginally higher than the April reading. Again, the surprise comes from the low and odd estimate of fuel prices: only 1.2% m/m. Cumulative difference between our model and prices presented by Statistics Poland from the last 2 months equals 2.5 pp. We assume that the Statistics Poland might have changed the method of collection or calculation of fuel prices.



Another element of the lower reading is decrease of energy prices (-0.1% m/m) and lower than expected (but still higher than in the last month) food price change (1.4% m/m). Finally core inflation can be estimated at 1.6% y/y, based on the residual. It seems that the reduction in roaming prices was higher than we expected (alternatively a rebound in transport and tourism prices was stronger than assumed). If so, it is hard to expect change in the upward trend in this category, as the decrease in price growth results from categories prone to one-time surprises.



Lower than expected inflation reading makes MPC's situation more comfortable. Council waited the period of higher reading out without any hesitation or change in rhetoric. June meeting did not differ, the Council maintains the paradigm of non-inflationary Polish growth and keeps the path of interest rates expectations flat.

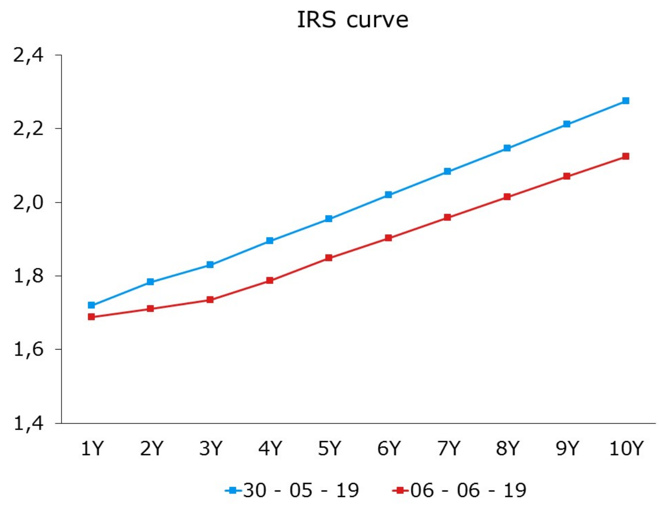
Fixed income

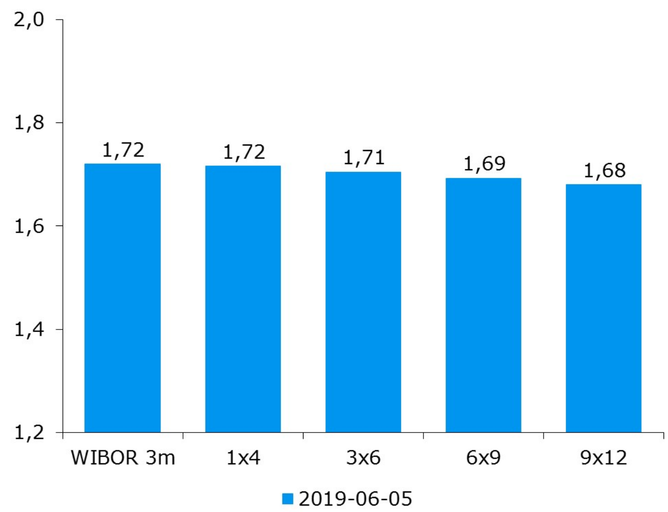
Huge rally on POLGBs.

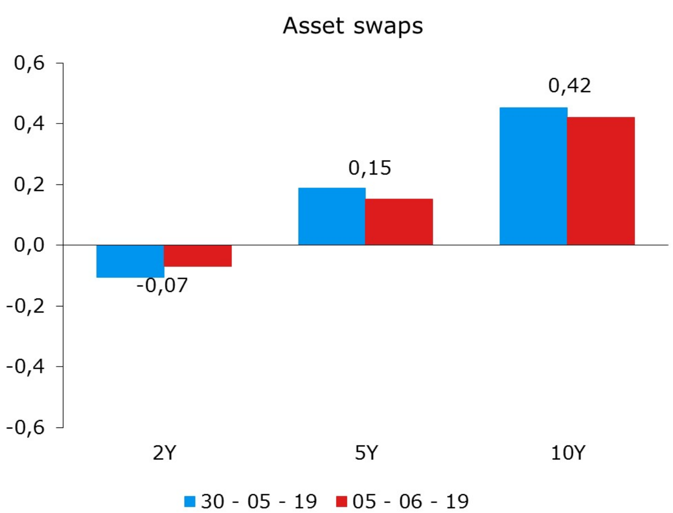
Extremely strong market during whole week. Huge rally on Polish rates (25 bps) was driven mainly by core markets and lower than expected inflation reading in Poland (2.3 vs 2.4 exp). In our opinion market participants expected much stronger reading (more than 2.5) what finally leads to stop loses on the 2Y IRS at 1.72-1.74 and in result we started to discount rate cuts in Poland in the middle of 2020.

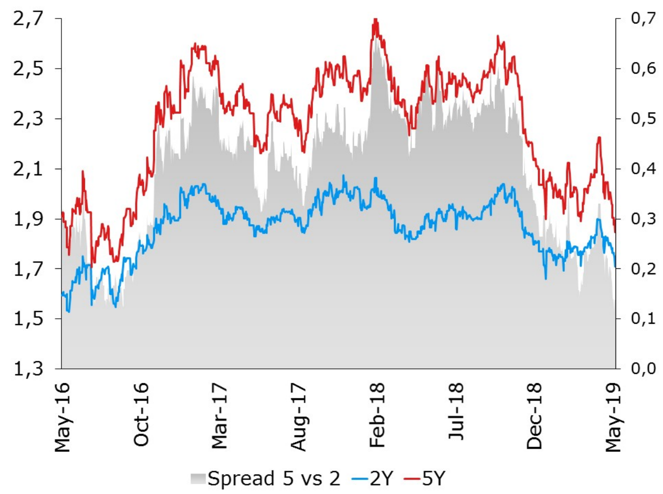
PS0424/5y is 12bps, WS0428/10y is 28bps. PS0424/WS0428 is 45bps. WS0428/Bund is 260bps.

DS1020 is trading at 1.50% , PS0424 is trading at 1.96% and WS0428 is trading at 2.42%.









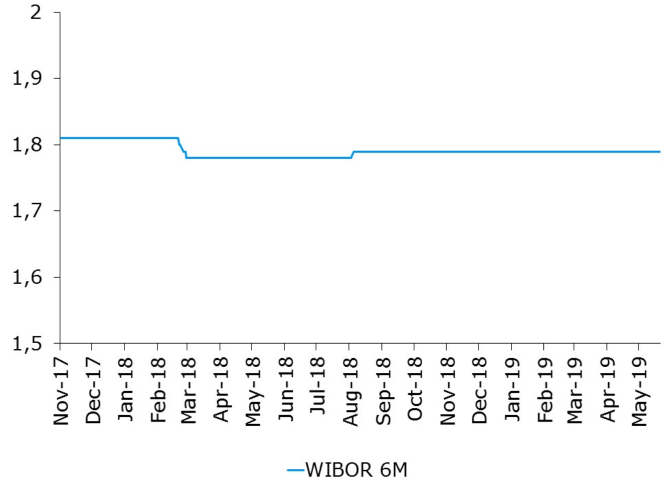
Money market

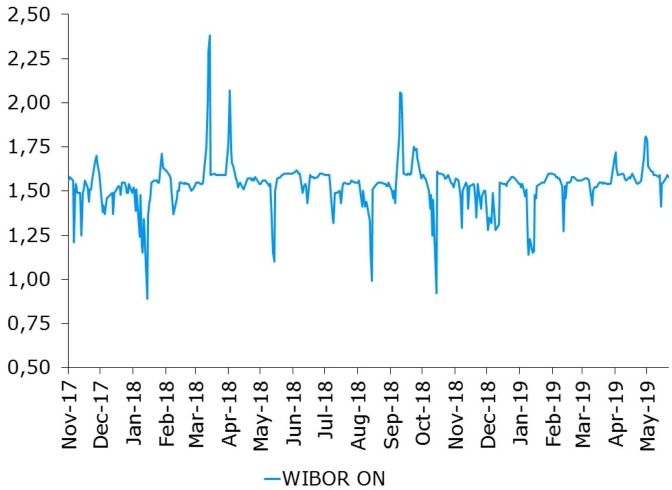
And here we go again: rate cuts expected in Poland.

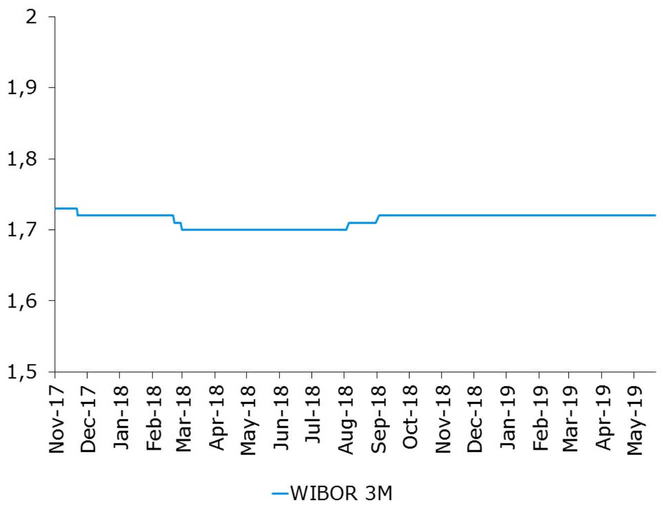
Rally on POLGBs lasted for the whole last week. Slight miss in CPI print added fuel to rally driven by core markets. We took out many month lows on swaps triggering stop losses. Its hard to belive we will see cuts in Poland where GDP is reaching 5% , wages are growing at 7% and CPi is on rising trajectory. Nontheles market is pricing already some with 2y swap trading 7bp below wibor.

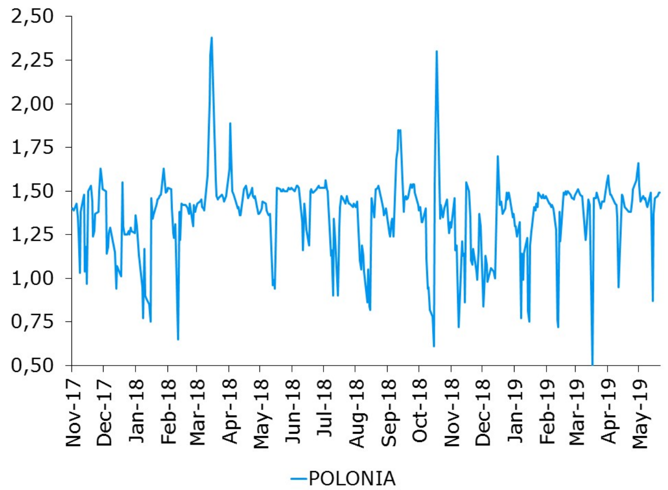
Start of the month stabilizes ON around reference rate. What is worth mentioning, we are seeing more and more interest in longer term REPOs. People are looking for 1-2 month funding.

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









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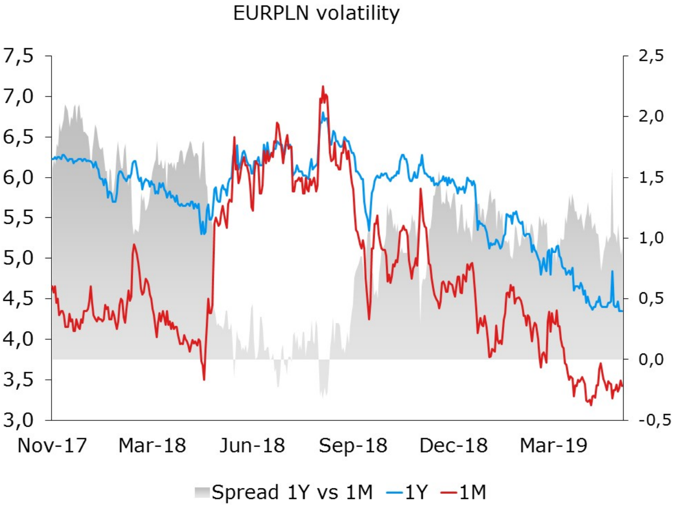
Forex

Spot – EUR/PLN – during the last days the zloty gained The EUR/PLN fell for the sixth session in a row benefiting from stronger than forecasts polish GDP and the rising of EURUSD. These factors were positive for PLN. As a result, EURPLN fell to 4.2725 from 4.2940 and USDPLN to 3.7870 from 3.8570. The meeting of the ECB was not as dovish as expected but still dovish. PLN held to its gains despite higher EURUSD. However, USDPLN did not put 3.85 to test but fell.

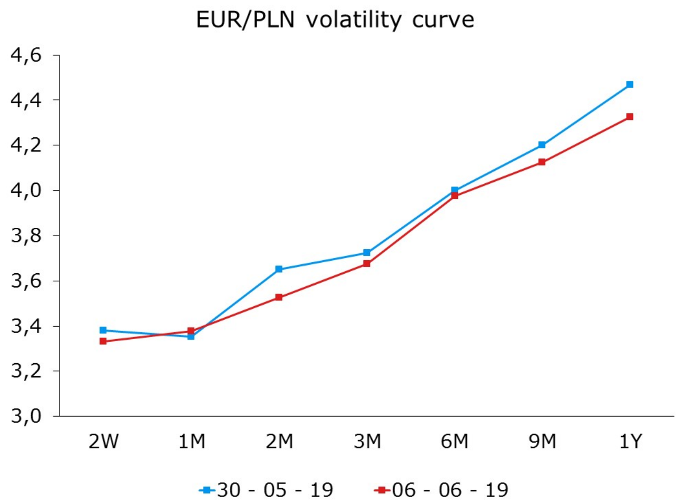
Opts: EUR/PLN vol stable, USD/PLN vol higher Realized volatility of the EUR/PLN is still on the move down, but the implied volatility seems to have found its equilibrium at current levels as the curve has not changed much for weeks. 1 month EUR/PLN atm is today at 3.3% (unchanged from last week), 3 months is at 3.55% (0.1% lower), 1 year is at 4.3% (0.05% lower). Completely different situation is on USD/PLN. The roller coaster on EURUSD causes the demand for USD/PLN gamma and vega, especially in the front end of the curve. The currency spread (difference of USD/PLN minus EUR/PLN) is higher over 1% - 0.25% depending on the maturity.

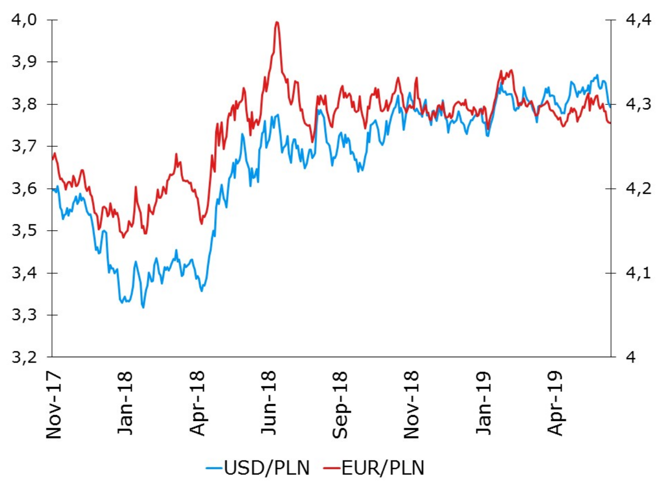


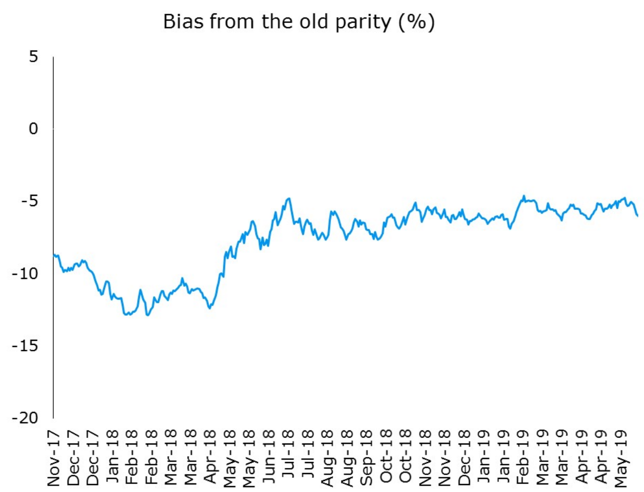
Short-term forecasts

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

Spot - buy on dips
It seems the zloty will be still influenced by signals from the global markets and EURUSD reaction. In our opinion, the space for further increases in EURUSD may be limited and it will affect the zloty. 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
5/30/2019	1.90	1.72	1.78	1.69	1.97	1.76	1.72	1.72	1.73	1.73	1.73	1.79
6/2/2019	1.71	1.72	1.78	1.69	1.97	1.76	1.72	1.72	1.72	1.72	1.71	1.78
6/3/2019	1.68	1.72	1.77	1.69	1.97	1.76	1.72	1.72	1.71	1.72	1.70	1.77
6/4/2019	1.57	1.72	1.80	1.69	1.83	1.76	1.72	1.72	1.73	1.72	1.70	1.78
6/5/2019	1.64	1.72	1.72	1.69	1.91	1.76	1.72	1.71	1.69	1.68	1.66	1.75

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
5/30/2019	1.760	1.535	1.783	1.677	1.955	2.142	2.275	2.728
6/2/2019	1.760	1.536	1.765	1.666	1.905	2.108	2.208	2.649
6/3/2019	1.760	1.531	1.760	1.676	1.878	2.085	2.183	2.630
6/4/2019	1.760	1.525	1.750	1.678	1.895	2.077	2.195	2.623
6/5/2019	1.760	1.536	1.710	1.640	1.848	2.000	2.125	2.547

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
5/30/2019	3.35	3.73	4.00	4.47	4.47	1.45	0.49
6/2/2019	3.40	3.70	3.99	4.35	4.35	1.45	0.49
6/3/2019	3.49	3.70	4.00	4.35	4.35	1.42	0.50
6/4/2019	3.43	3.61	3.99	4.35	4.35	1.40	0.50
6/5/2019	3.38	3.68	3.98	4.33	4.33	1.41	0.50

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
5/30/2019	4.2919	3.8548	3.8196	3.5136	1.3186	0.1661
6/2/2019	4.2916	3.8498	3.8294	3.5387	1.3207	0.1661
6/3/2019	4.2809	3.8292	3.8411	3.5363	1.3198	0.1656
6/4/2019	4.2788	3.8041	3.8267	3.5176	1.3290	0.1661
6/5/2019	4.2782	3.7929	3.8234	3.5038	1.3299	0.1666

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