June 27, 2019

Polish Weekly Review

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Comment on the upcoming data and forecasts

Statistics Poland will publish flash CPI reading for June tomorrow. We see a delicate rise in inflation driven by lower than usual drop in food prices, stable fuel prices and somewhat higher core inflation. Next week starts with Polish manufacturing PMI, which we forecast at the level of 49.2 – slight rebound in European PMIs can transpose also to Polish index. This week MPC will have its last meeting before the holiday break. We do not expect any changes, neither in the decision nor its rhetoric. The MPC members will also see the new NBP staff projections and references to GDP and inflation forecasts will be found in the post-meeting statement. One should expect higher GDP growth and slightly higher inflation, but the overall trajectory of both variables will not change (CPI to stabilize close to the target, GDP will gradually drop to potential).

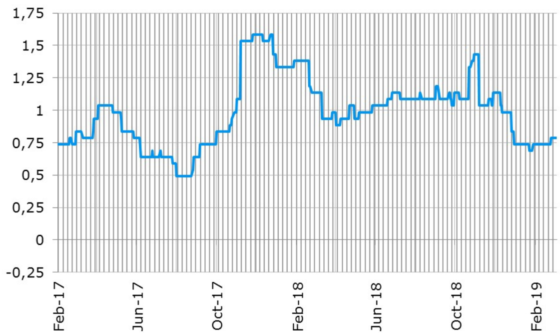
Polish data to watch: July 1st to July 5th

Publication	Date	Period	mBank	Consensus	Prior
CPI *flash* y/y (%)	28.06	Jun	2.5	2.4	2.4
PMI (pts.)	01.07	Jun	49.2	49.0	48.8
MPC decision (%)	03.07	03.07	1.50	1.50	1.50

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

Final inflation for May surprised (2.4% vs flash estimate of 2.3%), which moved the surprise index one point higher and no other surprise was recorded. This week possible surprises can come from June flash CPI and PMI readings.

* 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, our GDP forecasts are higher tha current market consensus – we are forecasting the Polish economy to grow by 5.0% in 2019 and 4.0% in 2020.
- 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 beginning 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.
- Therefore, the PLN is set to follow a reverse J-curve: appreciation first and depreciation much later.

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

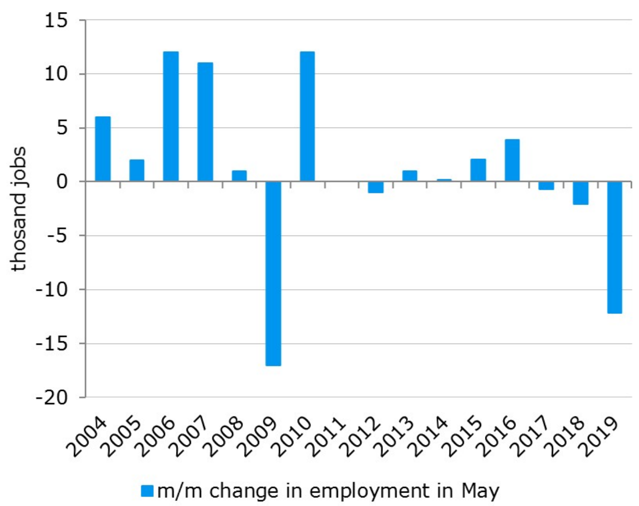
Economics

Over the past two weeks all the major Polish data for May were published. Employment disappointed (growth of 2.7% vs expected 2.9%), but wages surprised positively (7.7% vs 7.1%). Industrial output increased as market consensus expected (7.7%). Negative surprise came from the construction data, which has risen only by 9.6%. Retail sales also slightly disappointed (5.6%). Details of those readings are described below.

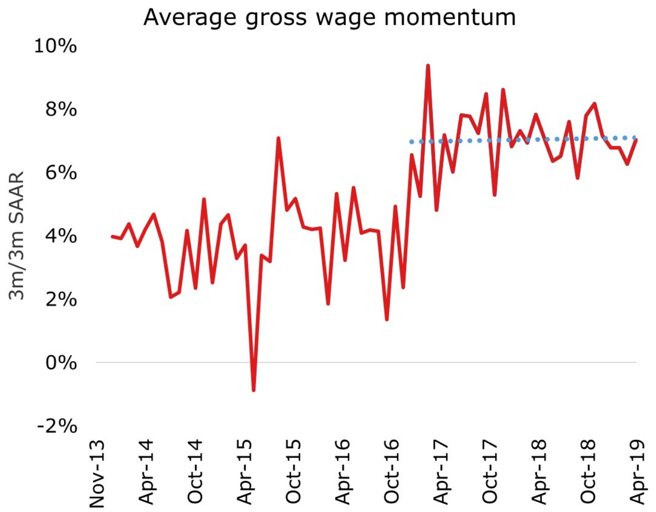
Summing up, a full set of May data lowers our estimate of Q2 GDP growth to 4.6% y/y (prev. 4.8-4.9% y/y). The data remains neutral for the MPC. They prove that the economy is gently slowing down amid temporary (or so the MPC is destined to believe given the staff models and the overall framework) elevated inflation. Such scenario was for long consistent with stable rates and nothing changes on that front.

Disappointing employment growth, strong wage gains in May.

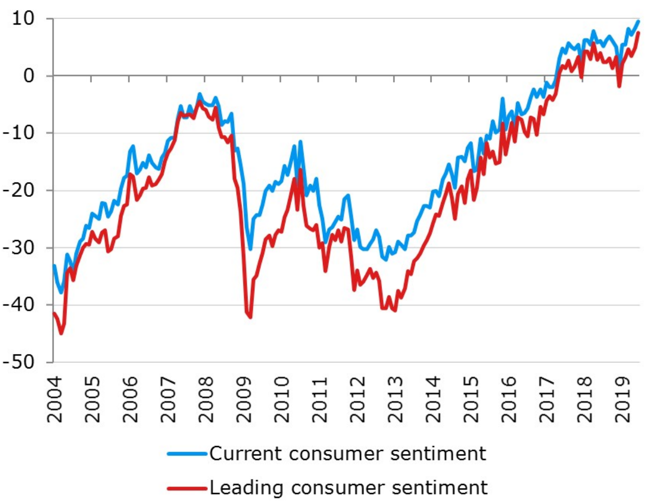
Employment growth in May disappointed, at 2.7% y/y, with expectations at 2.9%. In comparison to April, there were 12 thousand jobs less, which classifies this month as the second worst May in history (only 2009 was worse). Weaker employment growth together with still solid wage dynamics indicate that supply constraints are getting stronger. Reasons can be found in expiring inflow of labor force from abroad, or even outflow of migrants to better developed economies (it can intensify when Germany opens its market the next year). Supply constraints are also consistently indicated by business surveys, where problems with finding employees are still highly reported, despite the lower labor demand from last few quarters. In consequence, week employment growth can become a norm in upcoming months as the result of lack of workers.



Average wage surprised positively in May with yearly growth at 7.7%, which is a higher result than both our forecast and market consensus (respectively, 6.7 and 7.1% y/y). Reasons of this surprise can be found in manufacturing, construction and mining which rose respectively by 7.9%, 8.8% and 7.5%.



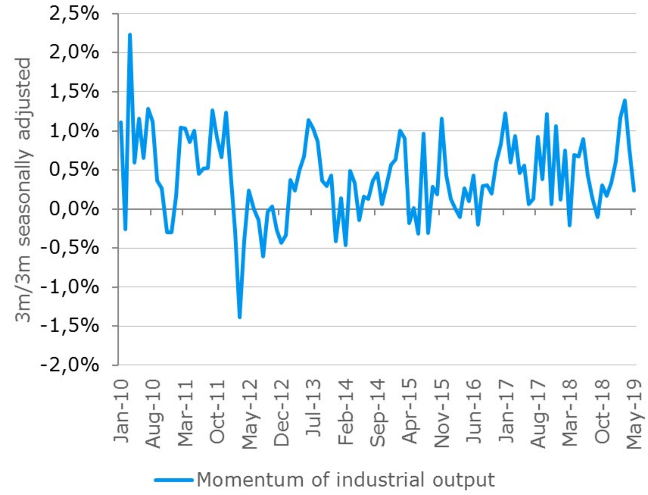
The big picture is unchanged. Since the beginning of 2017, wage growth has been remarkably stable at ca. 7.0% y/y and no statistically significant signs of acceleration or deceleration have been recorded ever since. It would be tempting to assume that 8% constitutes the ceiling for wage growth, but that might not be the case. It seems that the current equilibrium on the labor market is a result of binding supply constraints ameliorated by the slowdown in labor demand. The latter has readily been seen in a variety of soft and hard indicators for a couple of quarters. Nominal wage growth will be impacted by several exogenous factors in the coming months: competition between labor income and social transfers, changes in labor tax wedge (the result of lower PIT rate and higher deductibles), further increases in the minimum wage coming into effect in January and possible rise in inflation expectations in reaction to sustained food price acceleration over the past months.



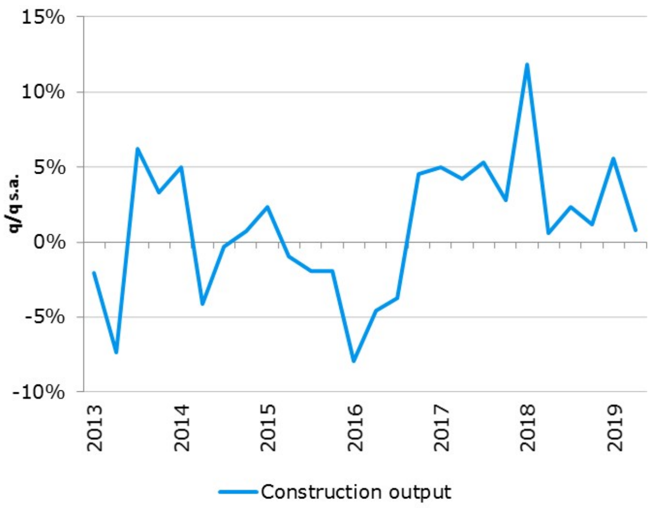
Nominal and real wage bill growth accelerated in May, from 10.2 to 10.6 and from 8.2 to 8.5% y/y, respectively. In conjunction with the disbursement of the pension bonus, this means that real disposable household income accelerated considerably in May. The local top in income growth will occur in the fourth quarter. As a result, household consumption is unlikely to run out of fuel any time soon. Strong consumption growth ahead is also reflected in consumer sentiment – at the same time Statistics Poland published its consumer sentiment indices for June and they rose to new all-time highs (see the graph above). To sum up, optimistic forecasts for the Polish economy will be supported by labor market data releases, while the MPC can look through them and focus on inflation. Inflation outlook is affected, though. In 2019, services prices have regained their sensitivity to wage growth, but should not accelerate much further. The sustained wage growth means, however, that the increase in core inflation this year is not a one off, but will likely persist.

Polish industry is slowly losing steam, construction disappointed.

Industrial output rose by 7.7% y/y in May, in line with market consensus and close to our forecast (7.7 and 8.0% y/y, respectively). The slowdown vis-a-vis the previous month is, in the absence of any calendar effects, purely a result of high statistical base from the previous year. A quick scan of the details of the release does not suggest that a one-off factor was responsible, while growth appears to be evenly distributed between various industries, exports- and domestically oriented alike. High annual growth rate is, however, hiding a marked pullback in short-term momentum (see the graph below), which we already indicated in last month's comment on the data. Note that May was the third consecutive month in which monthly output growth was essentially zero. It is very likely that the entire quarter will end with marginal growth. After the record-high growth in Q1 (likely boosted by stockpiling ahead of the original Brexit date), it should not come as a surprise. European industry is behaving similarly.

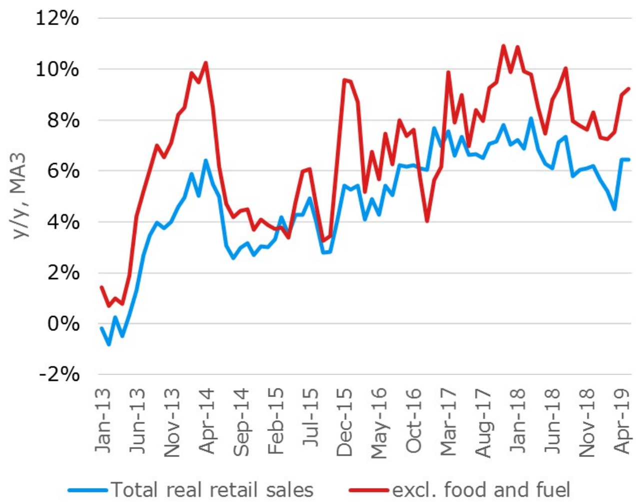


Construction output disappointed, having risen by 9.6% y/y and decreased by 2.7% m/m on a seasonally adjusted basis. Ex post we can trace it to the slowdown in public investment. It is not unexpected – the breakdown of construction output in Q1 hinted at it, the slowing local government expenditures suggested it and our monitoring of highway and motorway tenders foreshadowed it. The exact timing and the extent of the slowdown was, as usual, hard to pin down. With a full set of May data we now expect the economy to have grown by 4.6% y/y in Q2 (prev. 4.8-4.9% y/y). It does not change the overall scenario for this year, since our recent forecast upgrades were primarily based on the rebound in private investment, which is mostly driven by machinery and equipment spending (whose growth is in double digits).



Retail sales surprise to the downside.

Retail sales rose by 5.6% y/y in real terms in May. It is a minor disappointment with regard to market consensus and our slightly more upbeat forecast. However, it is neither time nor the place to jump into conclusions and envision a major slowdown in retail sales and private consumption.



First of all, the unexpected slowdown happened in categories that are usually volatile ("other" category, fuel sales) or the ones that proved to be a bit exaggerated in the prior month (electronics, home appliances). Secondly, consumer optimism has recently marked and all-time high. Thirdly, additional cash injected in the system (pension+ programme, circa PLN 10 bn in May) does not seem to be visible in current data. Due to rather firm budget constraint of beneficiary households it is unlikely that it had already been visible in stellar April's retail sales performance (front-loading of expenditures). Rather, it will be smoothed out in time in coming months. Last but not least, given the real retail sales data alone, private consumption actually accelerated in Q2 vs Q1.

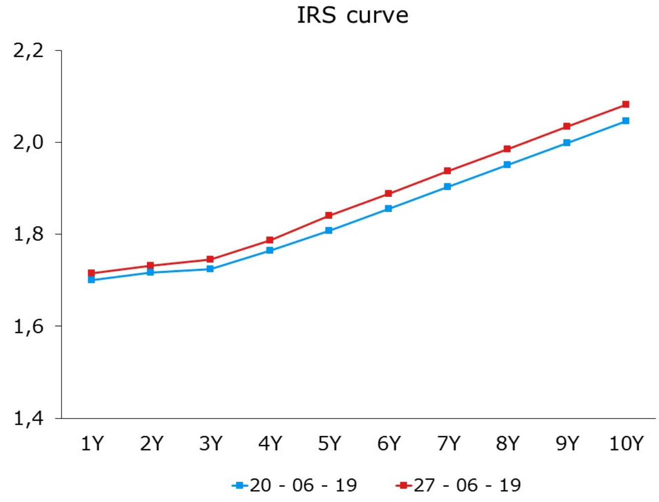
Fixed income

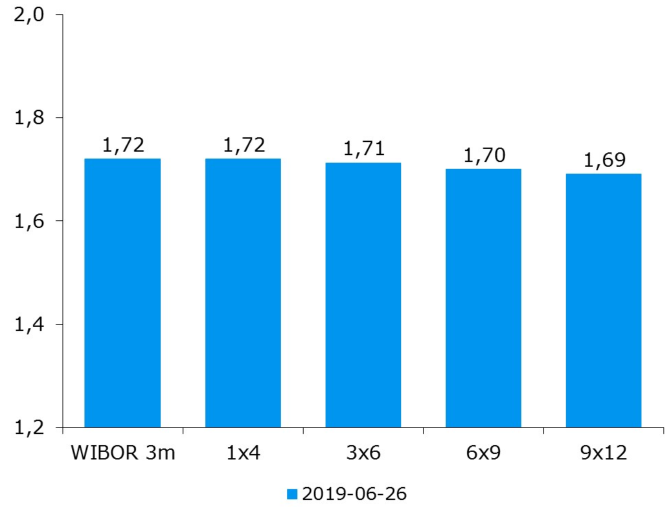
Twisted ASW curve

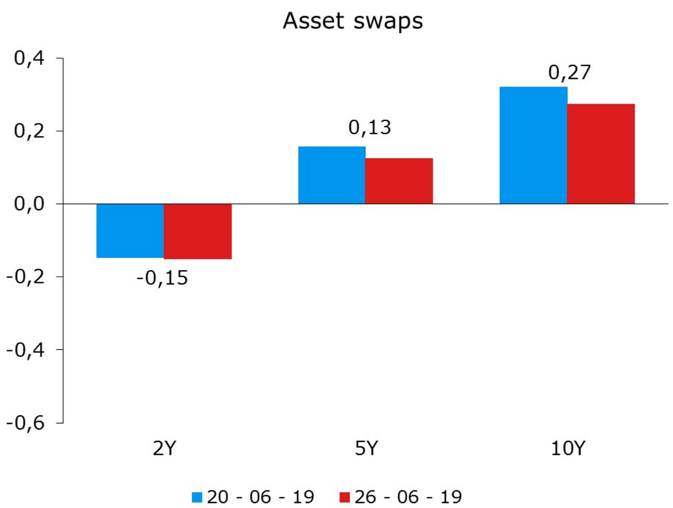
There wasn't a lot of volatility during last week comparing with the previous one, short IRS rates are still below WIBOR. ASWs narrowed step by step and the shortest ASW that has is positive now is PS0123 ASW. Moreover, ASW curve flattened significantly and inverted in the long end, as DS1029 ASW is narrower than DS0726 ASW.

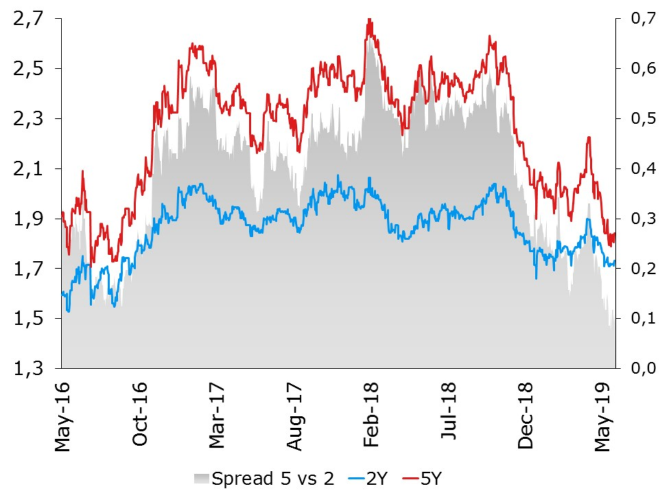
PS0424/5y is 8 bps, WS0428/10y is 22 bps. PS0424/WS0428 is 37 bps. WS0428/Bund is 264 bps.

DS1020 is trading at 1.40% , PS0424 is trading at 1.95% and WS0428 is trading at 2.32%.









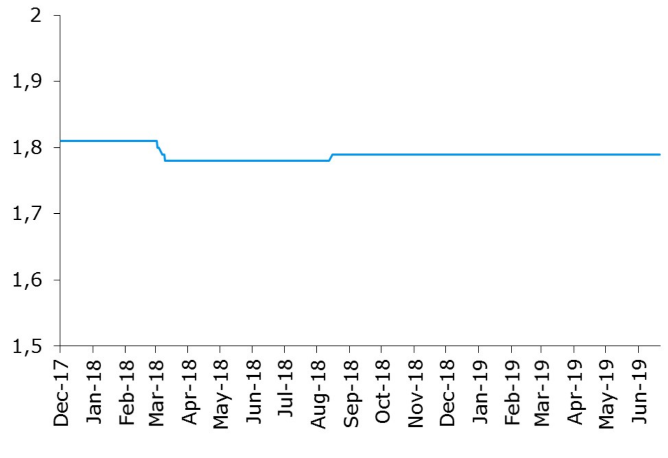
Money market

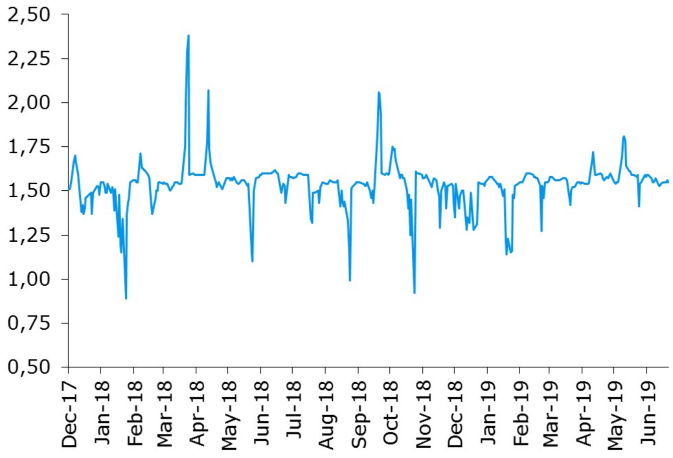
Between the CPI and the G20

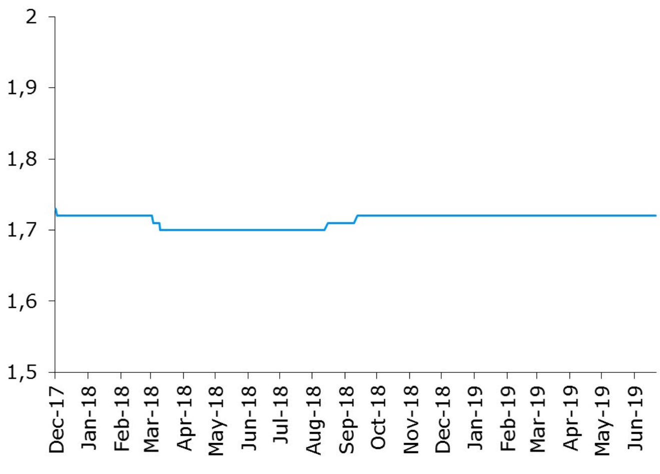
After the Fed "announced" the possibility of a rate cut in the near future, Polish rates stabilized close to recent lows. At the moment the market isn't breaking lower with swaps already pricing some cuts. It's all about the global story now and currently "japanisation" of rates is on the table. Tomorrow we have the flash CPI from Poland and during the weekend the G20 meeting which may bring some news regarding trade war between USA and China.

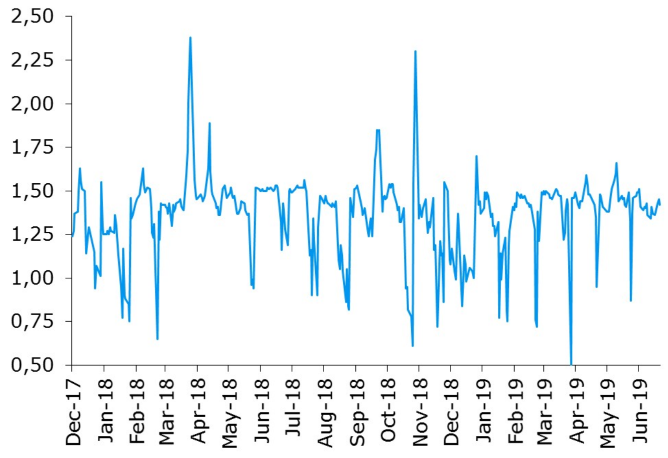
There was sufficient cash left on the market last week to secure funding for everyone. Starting tomorrow rates should get closer to 1.50%.

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









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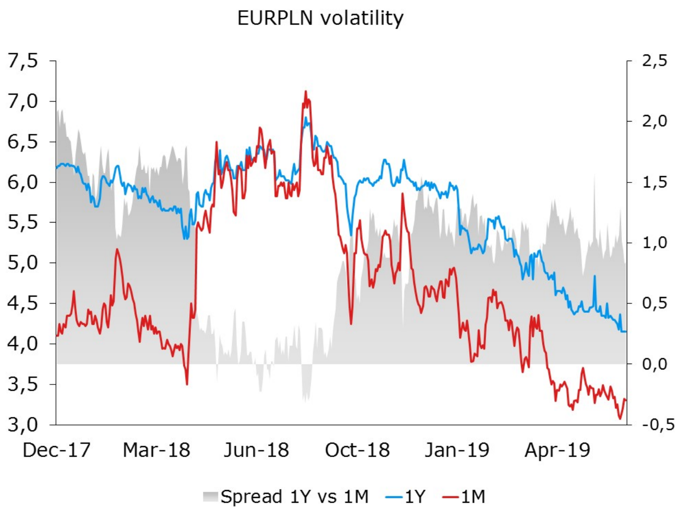
Forex

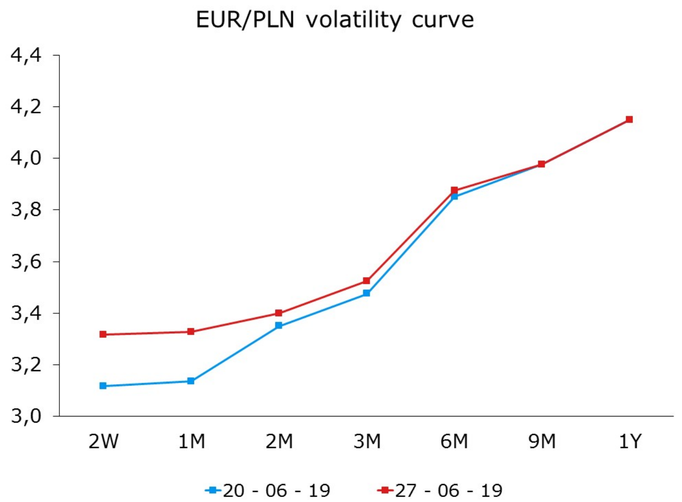
Spot – EUR/PLN – Waiting for G20. The G20 summit at the end of the week and the possible meeting between Trump and Xi are the two main events that may result in a volatility spike. The dovish Fed was the main driver behind the latest zloty gains, but this motor is slowly running out of steam. We are hovering above the crucial EUR/PLN support and barrier level - 4.2500. If it gives way, the next big support is 4.20. If the level holds, the most likely scenario is a slow, crawling move back to 4.28-4/30.

Options – EURPLN vols stable at low levels. The week was eventless in PLN option market. The frontend gamma is still a bit offered due to the really disappointing realized vols. Among EURPLN vols: 1 month ATM mid is this Thursday at 3.25% (unchanged from two weeks), 3 month is 3.5% (unchanged) and 1 year is fixing at 4.1% (0.2% lower). The skew in USD/PLN is slightly lower with EUR/PLN being roughly unchanged.



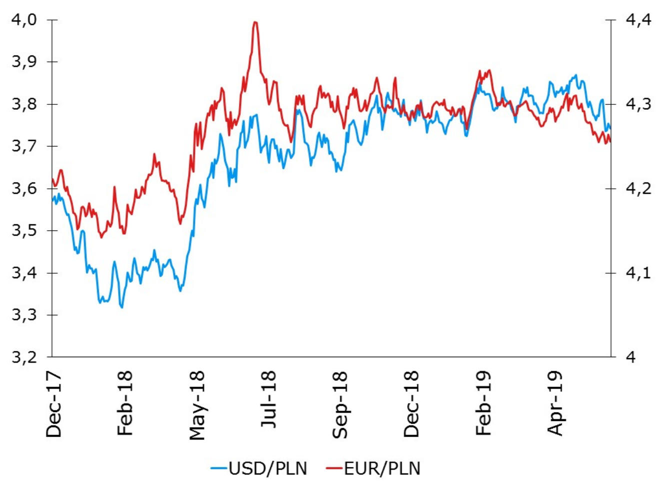
Short-term forecasts

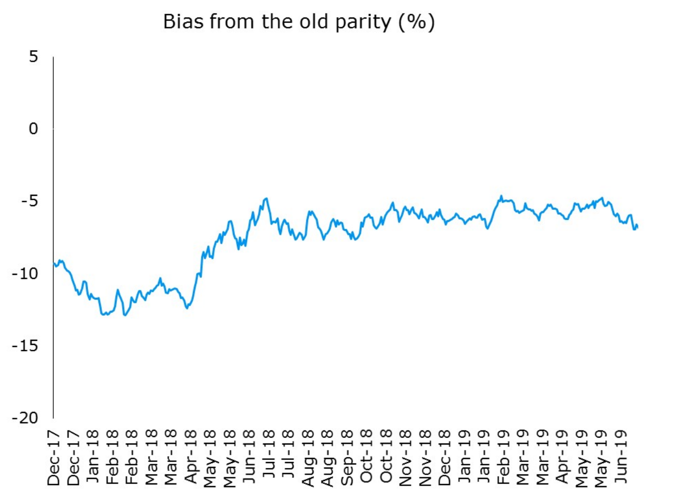
Main supports / resistances:
EUR/PLN: 4.2500 / 4.3400
USD/PLN: 3.6000 / 3.9000



Spot – Buy on dips

Two days ago market tested local EUR/PLN support level at 4.25, and we bought it at 4.2515. We are ready to add again to the position at 4.25, with 4.24 stop and hopes to revisit 4.30. We are looking for 4.24-4.34 range to hold. In our view the situation on EURUSD will remain crucial for the domestic currency in the days to come.





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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
6/20/2019	1.60	1.72	1.98	1.69	2.11	1.76	1.72	1.72	1.70	1.68	1.66	1.75
6/23/2019	1.62	1.72	1.76	1.69	1.97	1.76	1.72	1.72	1.71	1.70	1.67	1.77
6/24/2019	1.70	1.72	1.82	1.69	1.94	1.76	1.72	1.71	1.71	1.70	1.67	1.77
6/25/2019	1.54	1.72	1.66	1.69	1.84	1.76	1.72	1.71	1.70	1.69	1.67	1.76
6/26/2019	1.73	1.72	1.85	1.69	2.05	1.76	1.72	1.71	1.70	1.69	1.68	1.77

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
6/20/2019	1.760	1.424	1.717	1.570	1.808	1.965	2.047	2.368
6/23/2019	1.760	1.471	1.718	1.608	1.835	1.984	2.078	2.403
6/24/2019	1.760	1.428	1.722	1.608	1.830	1.956	2.075	2.359
6/25/2019	1.760	1.410	1.712	1.572	1.805	1.931	2.040	2.317
6/26/2019	1.760	1.394	1.732	1.581	1.840	1.965	2.083	2.357

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
6/20/2019	3.14	3.48	3.85	4.15	4.15	1.27	0.49
6/23/2019	3.21	3.50	3.82	4.15	4.15	1.27	0.49
6/24/2019	3.32	3.56	3.78	4.15	4.15	1.27	0.49
6/25/2019	3.31	3.55	3.85	4.15	4.15	1.27	0.48
6/26/2019	3.33	3.53	3.88	4.15	4.15	1.27	0.48

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
6/20/2019	4.2673	3.8104	3.8157	3.5136	1.3180	0.1665
6/23/2019	4.2622	3.7705	3.8381	3.5100	1.3159	0.1664
6/24/2019	4.2538	3.7360	3.8259	3.4797	1.3127	0.1662
6/25/2019	4.2554	3.7376	3.8308	3.4909	1.3130	0.1665
6/26/2019	4.2642	3.7540	3.8477	3.4941	1.3181	0.1673

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