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Polish Weekly Review

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Comment on the upcoming data and forecasts

A light week ahead of us in terms of macroeconomic data. On Monday the NBP will publish and present its latest Inflation Report. It should shed more light on the detail of the MPC's baseline macroeconomic scenario.

Polish data to watch: July 5th to July 12th

Publication	Date	Period	mBank	Consensus	Prior
NBP inflation report	08.07	Jul			

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	7/26/2019	1000	1.598	4/25/2019
5Y T-bond PS0424	7/26/2019	1800	2.224	4/25/2019
10Y T-bond DS1029	7/26/2019	1000	2.890	4/25/2019
30Y T-bond WS0447	7/26/2019	60	3.180	4/25/2019
5Y floater WZ0524	7/26/2019	1000	-	4/25/2019
10Y floater WZ0528	7/26/2019	1000	-	4/25/2019

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



Comment

Flash CPI surprised to the upside and pushed our Polish surprise index upwards, but the PMI was very close to market expectations. No macro data releases next week, hence no change in the index can be expected.

* 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. Additionally, private investment finally arrived 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 than the 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 through 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 on-going rise in inflation may generate some noise from MPC members, though.
- This year's fiscal deficit is set to widen due to brisk expenditure growth. Nevertheless, revenue growth remains solid and fiscal policy will likely be tightened after the elections. Polish fiscal story remains positive.

Financial markets

- It took the combined might of the two major central banks (the Fed and the ECB) to push the PLN out of its tight annual range. It should not come as a surprise, since global monetary easing tends to favor EM assets. The PLN can be expected to ride the wave of global easing and the subsequent improvement in macroeconomic data.
- As a result, we decided to lower our EUR/PLN and USD/PLN forecasts to account for this appreciation. It will take time for the structural weaknesses of the PLN (negative real interest rates) to reestablish themselves in the eyes of investors.

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	2.3	3.0
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	5.4	5.1
Repo rate (end of period %)	1.5	1.5	1.5	1.5	1.5	1.5

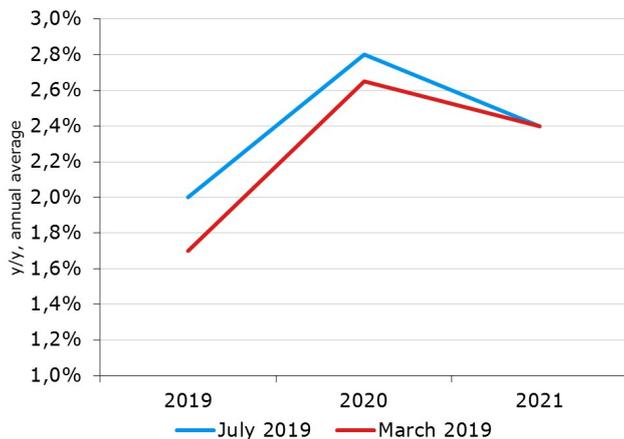
	2018	2018	2018	2018	2019	2019	2019	2019
	Q1	Q2	Q3	Q4	Q1	Q2 F	Q3 F	Q4 F
GDP y/y (%)	5.2	5.3	5.2	4.9	4.7	4.6	5.0	5.3
Individual consumption y/y (%)	4.6	4.8	4.4	4.2	3.9	4.3	4.5	4.8
Public Consumption y/y (%)	4.5	4.5	5.2	4.7	6.4	6.4	6.4	6.4
Investment y/y (%)	9.6	6.0	11.3	8.2	12.6	10.0	8.0	7.0
Inflation rate (% average)	1.5	1.7	1.9	1.4	1.2	2.4	2.6	2.9
Unemployment rate (% eop)	6.6	5.9	5.7	5.9	5.9	5.2	5.2	5.4
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	1.61	1.34	1.36
10Y Polish bond yields (% eop)	3.18	3.22	3.24	2.83	2.84	2.39	2.96	3.12
EUR/PLN (eop)	4.21	4.37	4.28	4.29	4.30	4.24	4.15	4.15
USD/PLN (eop)	3.42	3.74	3.69	3.74	3.84	3.73	3.61	3.58
F - forecast								

Economics

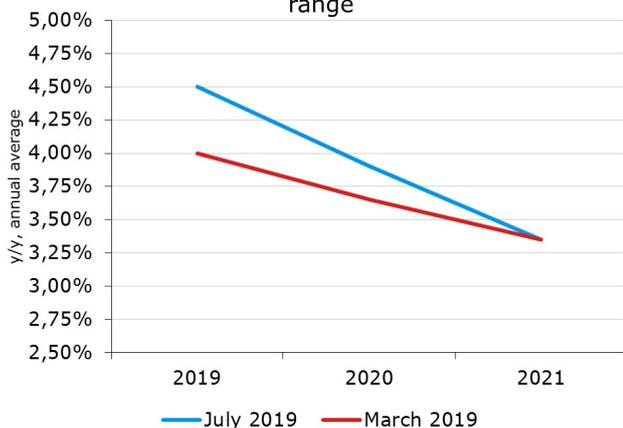
All quiet in the National Bank of Poland

During its July meeting the Monetary Policy Council held interest rates for the 52nd time in a row. Their current levels (main reference rate at 1.5%) is still considered to be "conducive to keeping the Polish economy on a sustainable growth path and maintaining macroeconomic stability". During the press conference governor Glapinski reiterated his "personal opinion" that interest rates will be kept at present levels until the end of 2021, i.e. the end of this Council's term.

CPI projection: midpoint of central range



GDP growth projection: midpoint of central range

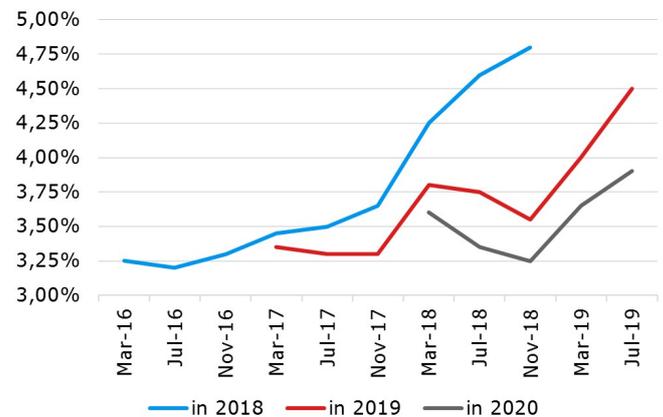


The unwavering faith in optimal nature of current monetary policy is supported by the latest NBP staff projections. As we expected, the NBP was forced to substantially raise its forecasts of GDP growth and CPI inflation, especially for the current year (see the graphs above). It should not come as a surprise, though, that the overall direction of both variables was not changed. GDP growth is set to slow down and gradually glide down to its potential growth rate, presumably due to weaker global growth and the cyclical downturn in public investment. According to the projections, CPI will peak in 2020 and then by late 2021 will have returned to target without any intervention. In keeping with tradition, hours after being briefed on the latest set of staff projections, MPC members started talking about the need to wait for the next projection. One interesting issue raised during the conference was the impact of parliamentary elections on fiscal policy stance and monetary policy considerations – it

should however be clear that the MPC will be able to assess the impact of any political developments in early 2020 at the earliest.

For quite some time we have been insistent that the bar for interest rate changes in Poland was set prohibitively high and the last meeting only strengthened that case. This is due to a combination of several factors: (1) MPC members are anchored in 2017 experience – that uptick in inflation proved to be temporary and the MPC budgeted market expectations of tightening; MPC members are still relishing on that "win" over the markets; (2) apparent lack of interest in the more intricate details of inflation data – it is not an accident that several minutes of the press conference were devoted to food prices and CPI methodology, while the core inflation received no airtime whatsoever; (3) strong faith in the accuracy of the NBP's forecasts and the acumen of the bank's research staff (again, justified by previous experiences); (4) the mechanics of NBP's projection models which are essentially unable to forecast inflation not returning to target on its own. In other words, the inability to forecast a durable rise in inflation is the reason why the NBP is becoming more and more dovish even when it is consistently surprised to the upside by the strength of the economic expansion (see the graph below). The change in paradigm might only be ushered by higher inflation. Breaching the upper limit of the target band (3.5% y/y) is possible in Q1'20 and that might force the MPC to reevaluate its stance. Until that happens, even market plays on changes in NBP policy are not likely to gain traction.

Average annual GDP growth in subsequent projections (midpoints of 50% range)



Fixed income

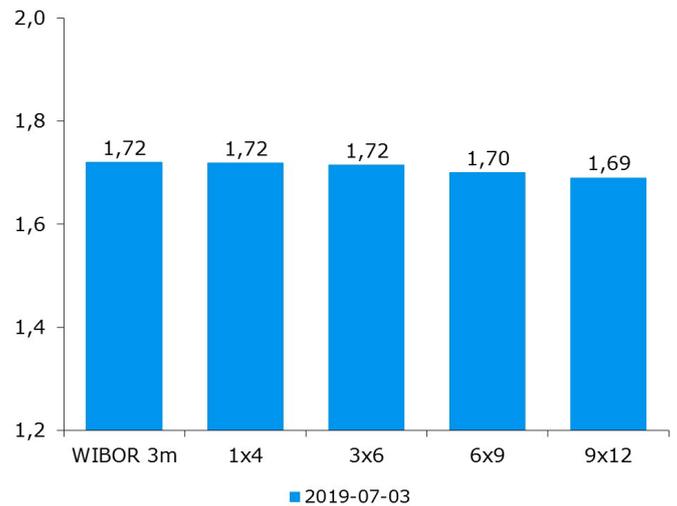
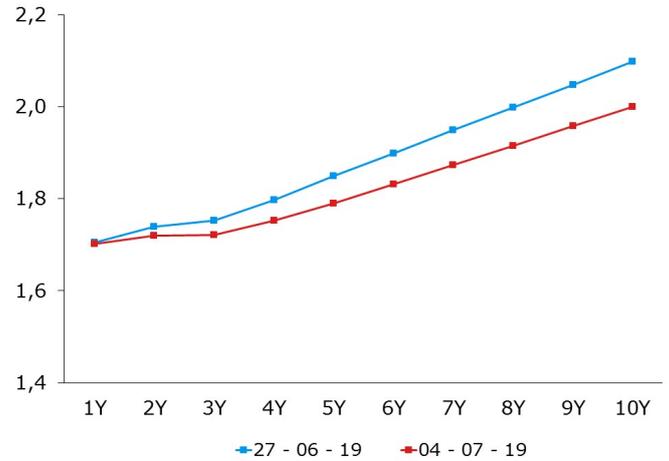
The market is crazy

Market is crazy. POLGBs are mostly driven by core markets, so yields are moving lower and lower. Trend is very strong. Rate cuts and QE are expected everywhere. ASWs are tight, curve is extremely flat. As no one is thinking about higher yields, door for surprises is blown wide open. We will remember this holiday season for a long time.

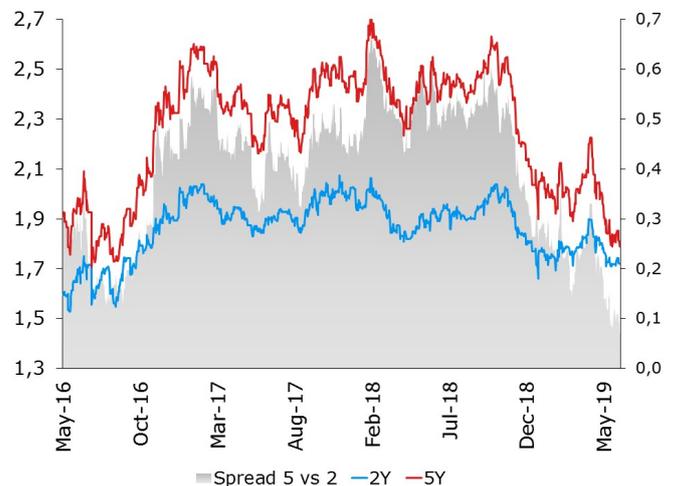
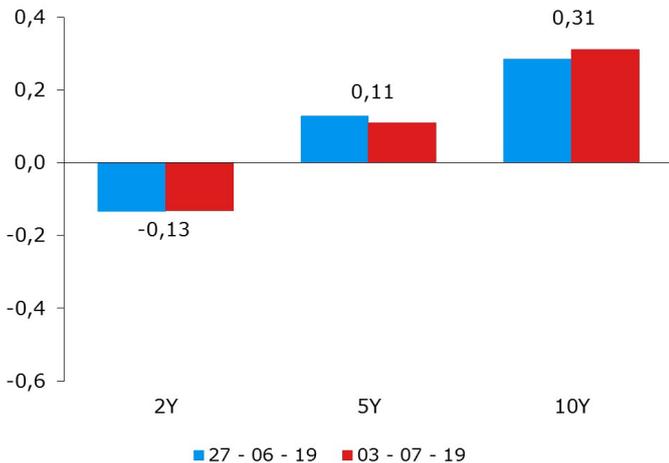
PS1024/5y is 15 bps, DS1029/10y is 28 bps. PS1024/DS1029 is 34 bps DS1029/Bund is 268 bps.

DS1020 is trading at 1.35% (5 bps down), PS1024 is trading at 1.94% (6 bps down) and DS1029 is trading at 2.28% (4 bps down).

IRS curve



Asset swaps



Money market

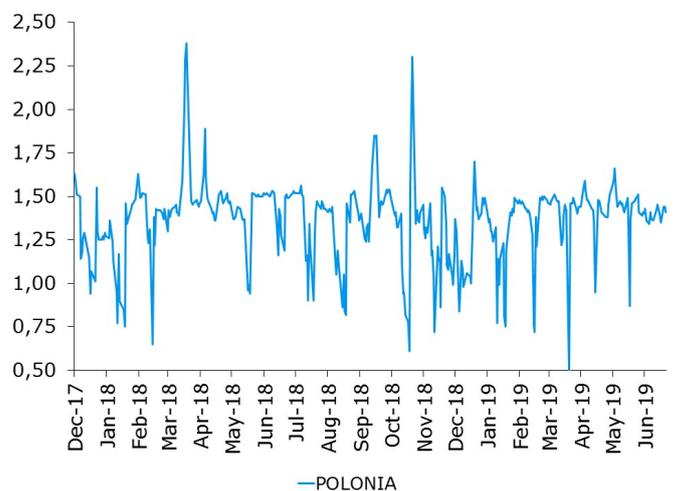
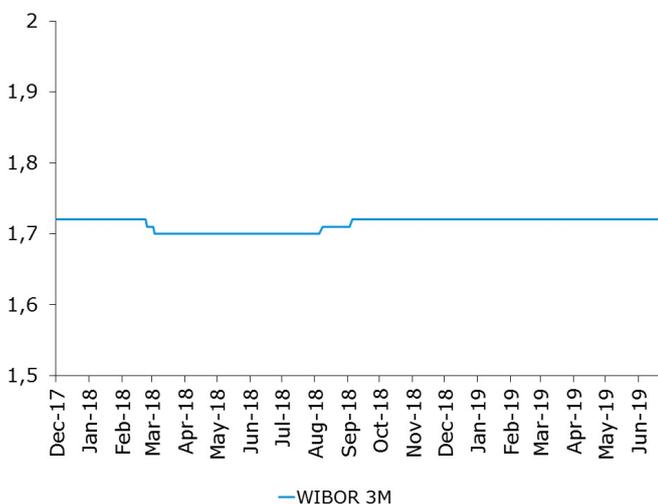
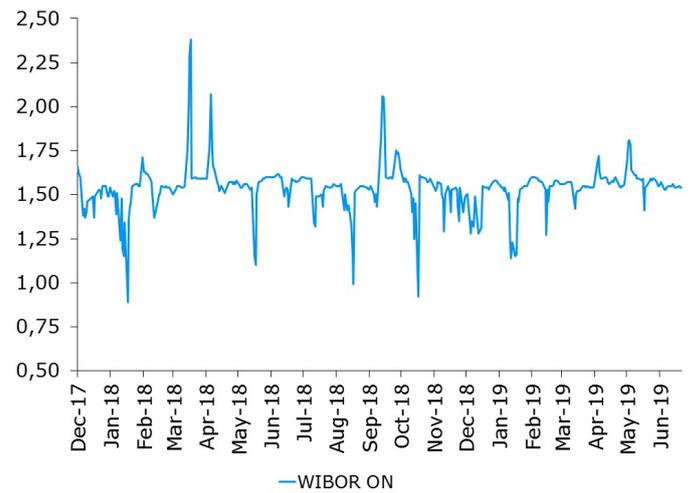
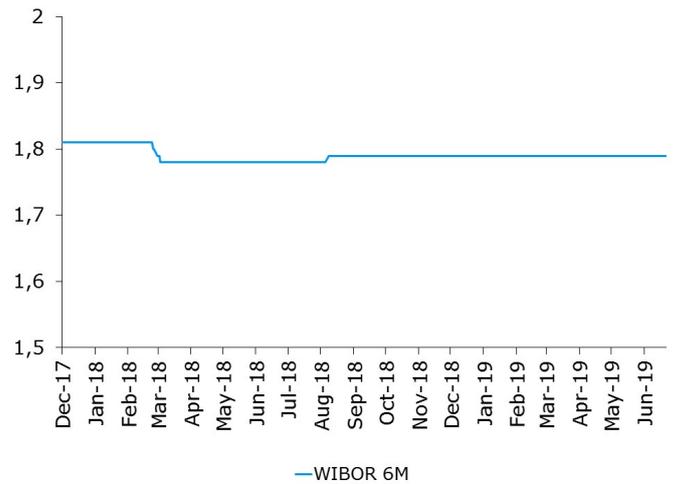
Polish rates - a hostage to global sentiment

Global easing expectations continue to grow worldwide. Each day we set a new record in the number of negative-yielding bonds. The move on Polish rates is muted as Poland is defying global trends with higher GDP growth and rising inflation. Given this equilibrium, we may be unable to move higher in rates unless we see some real change in global sentiment.

Spare cash on the market in the first week of the month resulted in overnight rate trading around 1.45. Tomorrow's OMO will set the tone for the next week.

Ref rate vs Polonia averages:

30 day 8 bp
90 day 12 bp



Forex

Spot – EUR/PLN – The risk appetite continues The zloty has benefited slightly from the good mood on the global markets, after the United States and China agreed on Saturday to resume trade talks. The local currency has remained stable in tight ranges: EURPLN 4.2380-4.25400 and USDPLN 3.7300-3.7650. It was another very calm week on the Polish market.

Opts – EUR/PLN vols – little lower The EUR/PLN vol curve melted a little as spot was really calm and realized volatilities kept on sliding. EUR/PLN ATM mid today is 3% (0.25% lower), 3 month is 3.25% (0.25% lower) and, finally, 1 year fixed at 4% (0.1% lower). The currency spread (difference between USD/PLN vol and EUR/PLN) is roughly unchanged.

Short-term forecasts

Main supports / resistances:

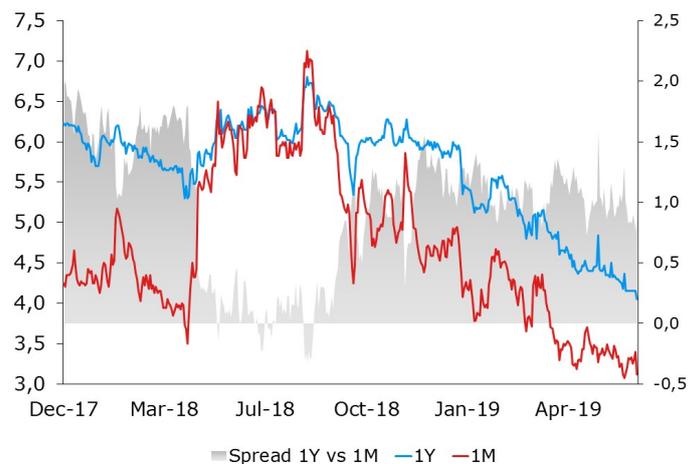
EUR/PLN: 4.2400 / 4.3400

USD/PLN: 3.6000 / 3.9000

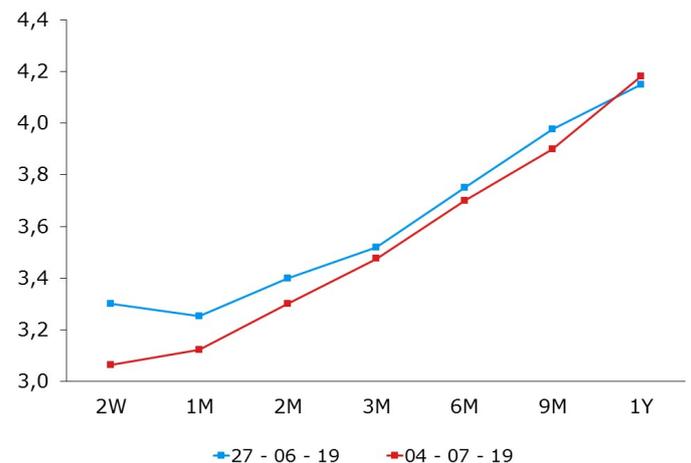
Spot – 4.24 strong support level?

EUR/PLN is trading around 4.24, but PLN strength seems to be running out of steam. The 4.20/4.23 is still holding as the main support zone, with 4.28/4.30 now protecting the upside. We are still in range trading mode, with a slight skew to playing it from PLN short side.

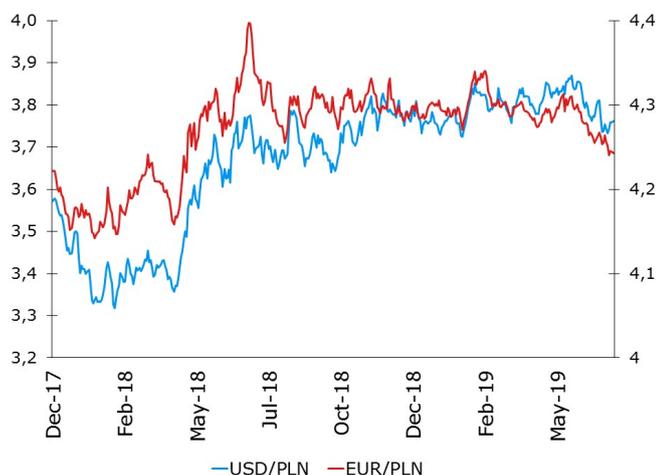
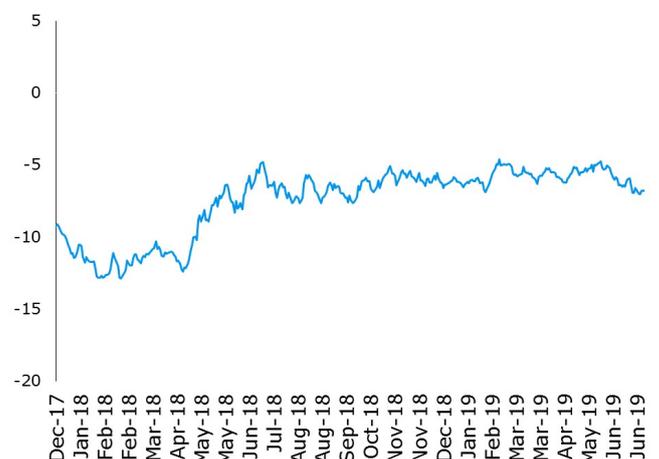
EURPLN volatility



EUR/PLN volatility curve



Bias from the old parity (%)



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
6/27/2019	1.71	1.72	1.94	1.69	2.05	1.76	1.72	1.71	1.71	1.70	1.68	1.77
6/30/2019	1.69	1.72	1.73	1.69	1.80	1.76	1.72	1.72	1.71	1.70	1.68	1.77
7/1/2019	1.68	1.72	1.88	1.69	2.06	1.76	1.72	1.72	1.72	1.71	1.68	1.78
7/2/2019	1.57	1.72	1.77	1.69	1.90	1.76	1.72	1.72	1.70	1.69	1.68	1.77
7/3/2019	1.64	1.72	1.83	1.69	1.97	1.76	1.72	1.72	1.70	1.69	1.66	1.76

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
6/27/2019	1.760	1.391	1.740	1.606	1.850	1.978	2.098	2.382
6/30/2019	1.760	1.401	1.742	1.623	1.852	1.978	2.098	2.394
7/1/2019	1.760	1.383	1.722	1.713	1.815	1.950	2.063	2.367
7/2/2019	1.760	1.458	1.720	1.595	1.810	1.934	2.045	2.358
7/3/2019	1.760	1.380	1.720	1.589	1.790	1.899	2.000	2.312

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
6/27/2019	3.25	3.52	3.75	4.15	4.15	1.27	0.48
6/30/2019	3.31	3.50	3.75	4.15	4.15	1.27	0.48
7/1/2019	3.40	3.53	3.80	4.15	4.15	1.27	0.48
7/2/2019	3.12	3.48	3.74	4.05	4.05	1.27	0.47
7/3/2019	3.12	3.48	3.70	4.18	4.18	1.27	0.48

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
6/27/2019	4.2561	3.7426	3.8238	3.4672	1.3162	0.1673
6/30/2019	4.2520	3.7336	3.8322	3.4673	1.3140	0.1672
7/1/2019	4.2406	3.7430	3.8034	3.4575	1.3139	0.1666
7/2/2019	4.2457	3.7593	3.8056	3.4740	1.3149	0.1669
7/3/2019	4.2442	3.7596	3.8152	3.4912	1.3140	0.1668

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