July 11, 2019

Polish Weekly Review

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Table of contents

Comment on the upcoming data and forecasts

Next week is full of publications from Polish economy. We start on Monday with final CPI reading – we await confirmation of the flash. The same day NBP publishes current account data (we expect a deficit of EUR 380 mln). On Thursday core inflation will be published – flash estimate suggests the value of 1.9%. Next day Statistics Poland publishes labor market data. We expect the employment growth to remain at the same level as month before (2.7%), while the wage growth should slow down to 5.9% due to the negative difference of working days. Working days are also the main reason of weak industrial production growth (we expect 1.4%), which together with PPI (our forecast of 0.9%) will be published on Tuesday. On Friday retail sales reading sees the light, which also suffered from the negative relation of working days (our estimate of 3.0%).

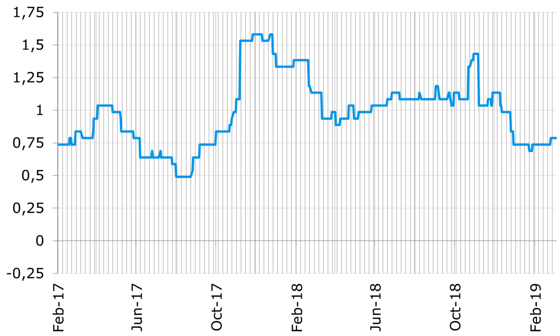
Polish data to watch: July 12th to July 19th

Publication	Date	Period	mBank	Consensus	Prior
CPI *final* y/y (%)	15.07	Jun	2.6	2.6	2.4
Current Account Balance (m EUR)	15.07	May	-290.0	390.0	718.0
Exports (m EUR)	15.07	May	19160.0	19167.0	19440.0
Imports (m EUR)	15.07	May	19650.0	19300.0	19161.0
CPI core y/y (%)	16.07	Jun	1.9	1.9	1.7
Average Gross Wages y/y (%)	17.07	Jun	5.9	7.1	7.7
Employment y/y (%)	17.07	Jun	2.7	2.7	2.7
Sold Industrial Output y/y (%)	18.07	Jun	1.4	4.2	7.7
PPI y/y (%)	18.07	Jun	0.5	0.9	1.4
Retail Sales y/y (%)	18.07	Jun	3.0	3.9	5.6

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

No publications this week resulted in no changes in the surprise index. This situation should change next week, when a range of readings for Polish economy will be published.

* 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	4.9	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

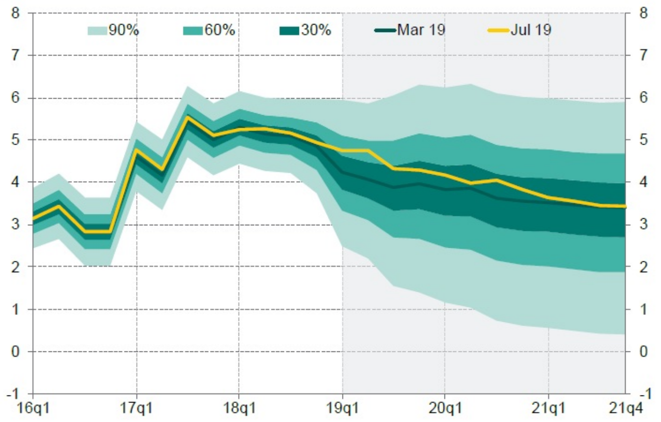
	2018 Q1	2018 Q2	2018 Q3	2018 Q4	2019 Q1	2019 Q2 F	2019 Q3 F	2019 Q4 F
GDP y/y (%)	5.2	5.3	5.2	4.9	4.7	4.6	5.0	5.3
Individual consumption y/y (%)	4.6	4.8	4.4	4.2	3.9	4.3	4.5	4.8
Public Consumption y/y (%)	4.5	4.5	5.2	4.7	6.4	6.4	6.4	6.4
Investment y/y (%)	9.6	6.0	11.3	8.2	12.6	10.0	8.0	7.0
Inflation rate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

NBP among pessimists on inflation and GDP

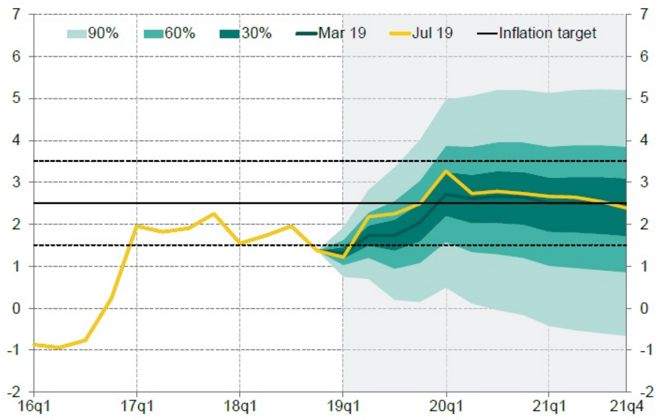
On Monday the latest "Inflation Report" of National Bank of Poland was presented. The overall tone of the new projections remains clear and unchanged compared to previous reports: GDP will almost monotonically slow down to the 3.5% y/y, and the increase in inflation (observed currently and forecasted for the next year), will be temporary. Hence, without any movements in monetary policy, the economy will remain balanced. The main factors guaranteeing the automatic return of inflation to the target are, traditionally, the slowdown in the global economy, the expiration of the EU expenditure cycle and the acceleration of potential output which will reduce the output gap and limit wage growth relatively to labor productivity. As a consequence the core inflation decelerates in mid-2020 and begins to decline slightly in the last quarters of the projection. A constant inflationary impulse from energy prices constitutes a novelty in the report. It is a consequence of the assumptions adopted by the NBP on the extension of energy price increases over three years.

Figure 4.25 July projection versus March projection: GDP growth (y/y, %)



Source: NBP calculations.

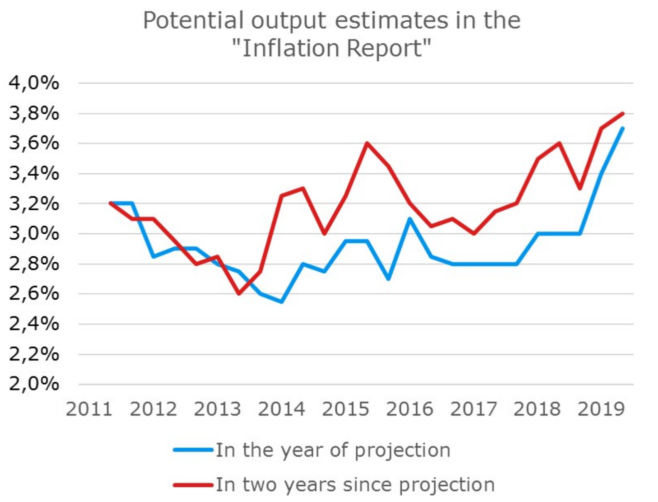
Figure 4.27 July projection versus March projection: CPI inflation (y/y, %)

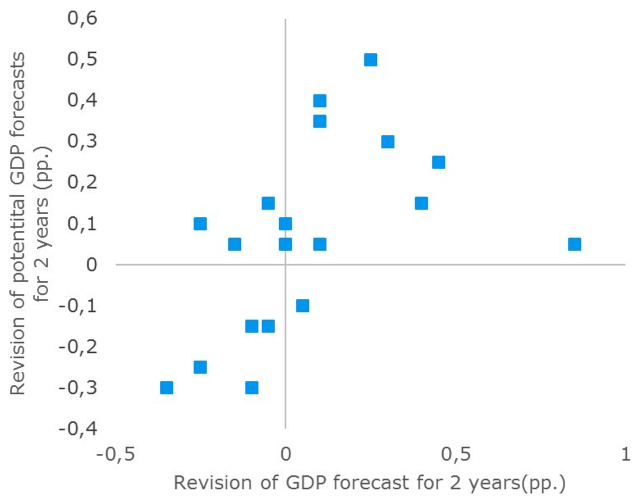


Source: Statistics Poland (GUS) data, NBP calculations.

Diagnostic part includes many subjects we already indicated in our analysis. NBP analysts agree with the positive impact of private investment growth in 2019. The investment demand of enterprises was the main driver of the revision of GDP forecasts for the upcoming quarters. In case of inflation, NBP focused (again) on food prices, while increases in core inflation were characterized as temporary and driven by one-off factors and base effects (here we do not fully agree). An interesting point was the opinion on the reasons of relative strength of Polish exports. Poland is relatively strongly connected to consumer goods supply chain while the global trade slowdown mostly affected investment (intermediate goods and consumer demand in developed economies is still growing at a solid pace). Nevertheless, the GDP growth rate at the beginning of the year in the euro zone and in Poland was driven by the one-off factors and the subsequent quarters will bring first stabilization and later a systematic slowdown. In the opinion of NBP, at the beginning of 2021, GDP growth will decline below the potential.

Potential output traditionally behaves in the opposite way than traditional wisdom (based on demographic processes and insufficient investments) suggests. NBP forecasts the potential output growth in the end of the forecast horizon (in 2021) at the highest level since the crisis. The potential growth of about 3.7% in 2021 is also the highest forecast in history, at least since the estimates of potential GDP and its decomposition have been published in the "Inflation Report". Taking into account the potential output estimates for 2018-2020, the NBP has never been more optimistic about the pace at which the Polish economy can develop in a sustainable way. It is worth noting that this optimism lasts for a long-term and this change mostly resulted from systematic revaluation of core inflation in 2013-18. Ex post, the National Bank of Poland admitted in the current "Inflation Report" that the latest research indicates a lower sensitivity of inflation to changes in the domestic economy indicators. More formally, according to the economists of the National Bank of Poland, the Philips curve is more and more flat and its flattening is asymmetrical (applies more to the situation when the unemployment rate drops). Its reasons are structural changes in the labor market, globalization and changes in the behavior of commodity markets in recent years. Of course, this does not directly explain the changes in potential output estimates – they are the result of changes in thinking about inflation.





The key issue was addressed at the end of the conference. What would need to happen to make the projection show inflation permanently near the upper bound of the target? In other words, what assumptions would lead the NBP to forecast the permanent inflation growth? In the opinion of NBP representatives, the macroeconomic scenario and the situation in the global economy would have to improve significantly. The second option is strong negative supply shock. It is not clear whether such assumptions would actually lead to a permanently higher CPI forecasts path. Firstly, the period of a higher growth of major trade partners (2017 and beginning of 2018) did not affect the projection, also the improvement of the economic situation abroad was considered as temporary. Secondly, the forecasts of slowdown abroad are consistent with the expectations of other institutions and low estimates of potential output growth there. It makes the optimistic scenario for the global economy unlikely. Thirdly, the change in the nature of supply shocks globally (structurally lower demand, flexible supply of oil) makes forecasting this kind of shocks as permanent unjustified. Fourthly, for the above reasons, the ex post observed shocks will be considered as temporary, as happened many times in the past.

In the last comment on the MPC conference, we questioned whether the MPC members are able to imagine a permanent increase in inflation, and whether the NBP can predict such a trajectory. Latest "Inflation Report" confirms those doubts. The low inflation and low GDP growth has been internalized by central banks and the NBP does not differ in this category.

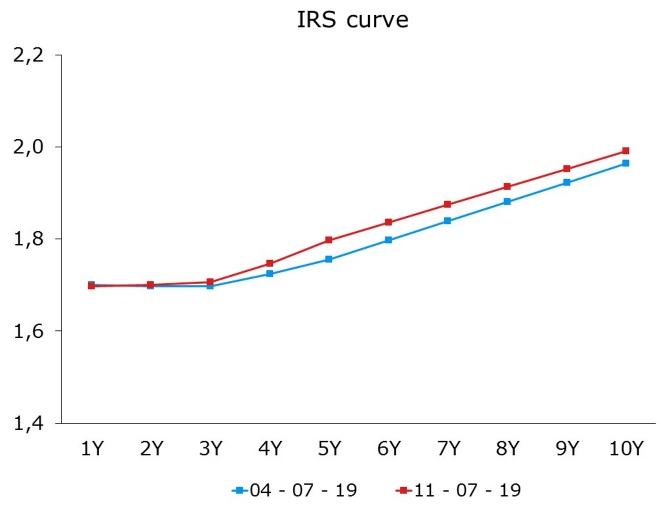
Fixed income

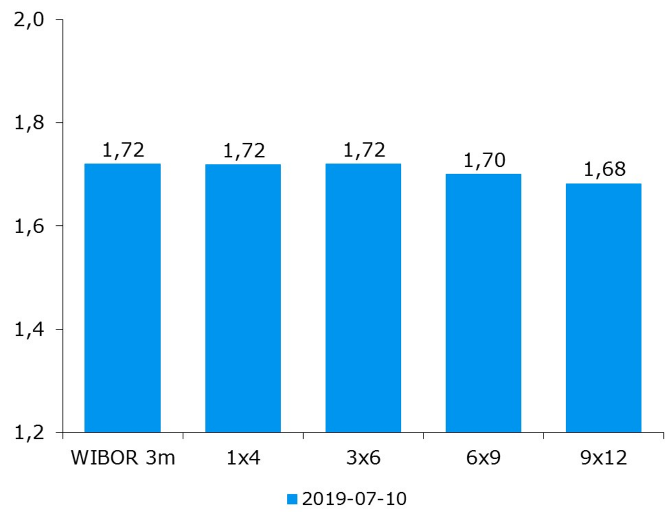
Flat curve. ASW in l/e at 2018 levels.

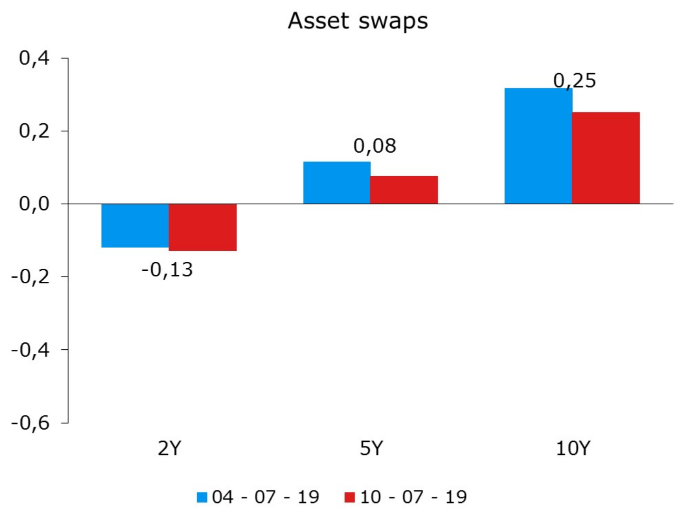
POLGBs are still mostly driven by core markets, but there were some days during last week when Poland was the best performing EMEA market. Curve still struggle to steepen and we reached 5yr lows in 5/10y POLGBs spread. ASWs on L/e are tightened and no further fiscal stimulus is priced in ASW curve (i. e. they are at levels prevailing in 2018).

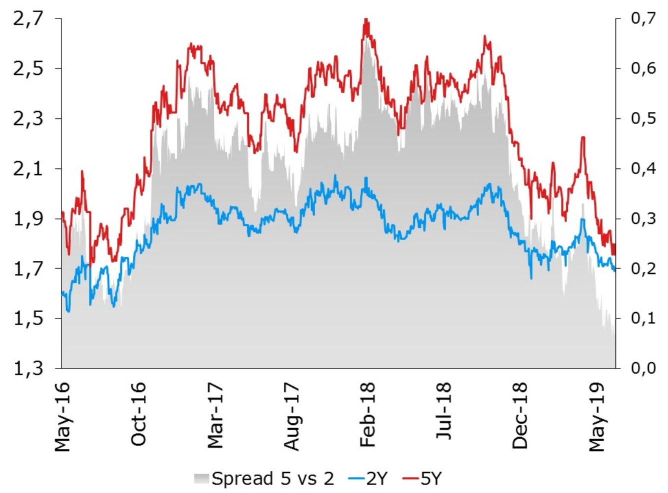
PS1024/5y is 10bps, DS1029/10y is 23bps. PS1024/DS1029 is 31.5bps DS1029/Bund is 248bps.

DS1020 is trading at 1.28% (7bps down), PS1024 is trading at 1.96% (2bps up) and DS1029 is trading at 2.26% (2bps down).









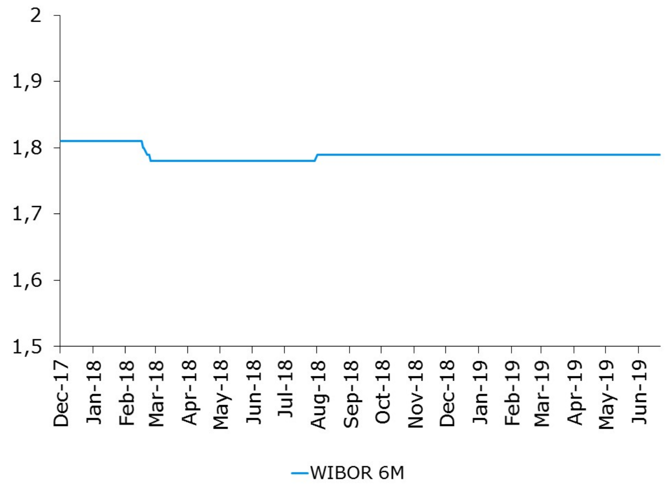
Money market

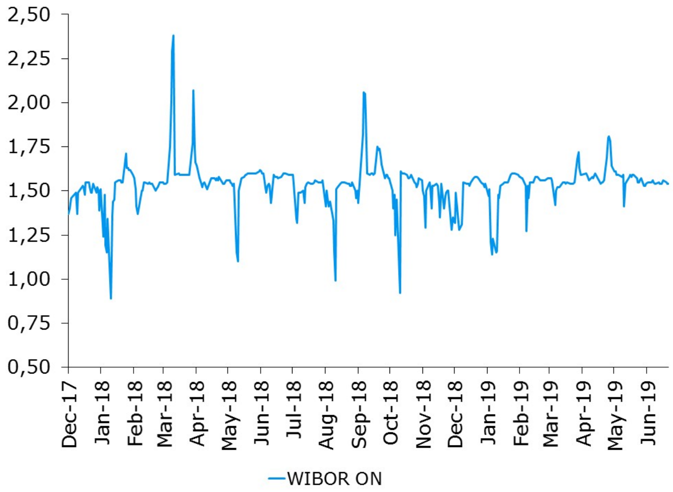
Poland mirred in global low rate bets

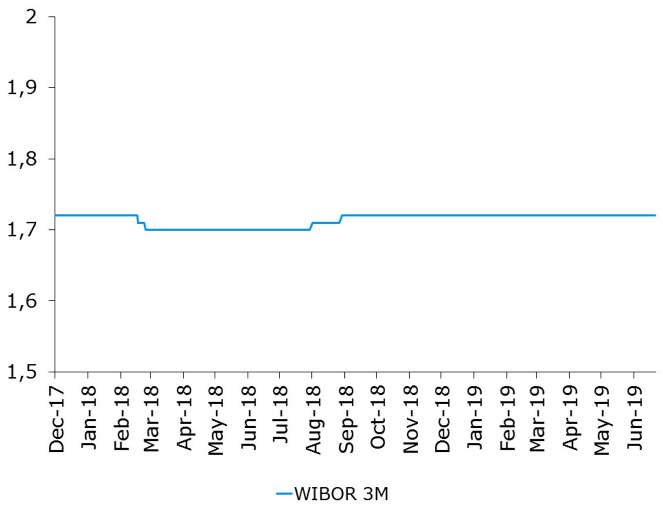
Better than expected job report from the U.S. arrested somehow the scale of easing bets. Polish rates rose 2-6 bp along the curve with 5y IRS trading as high as 1.82%. That is more or less current 6M Wibor. The story for low rates globally for very long period persists.

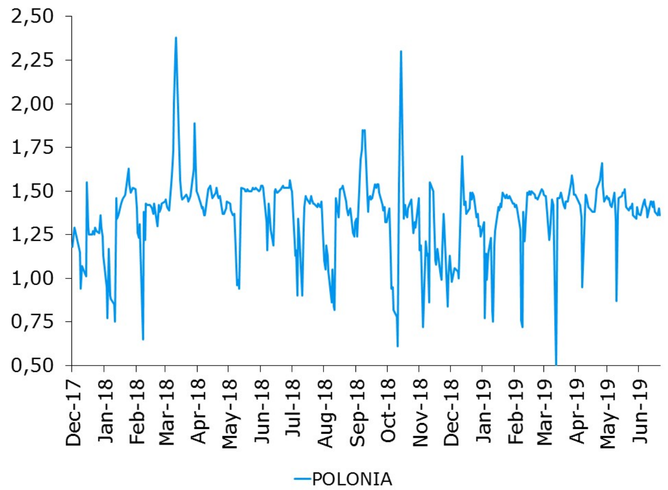
Another "cheap" week. Overnight rate stood between 1.40 and 1.45. Tomorrows OMO will set the tone for the next week.

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





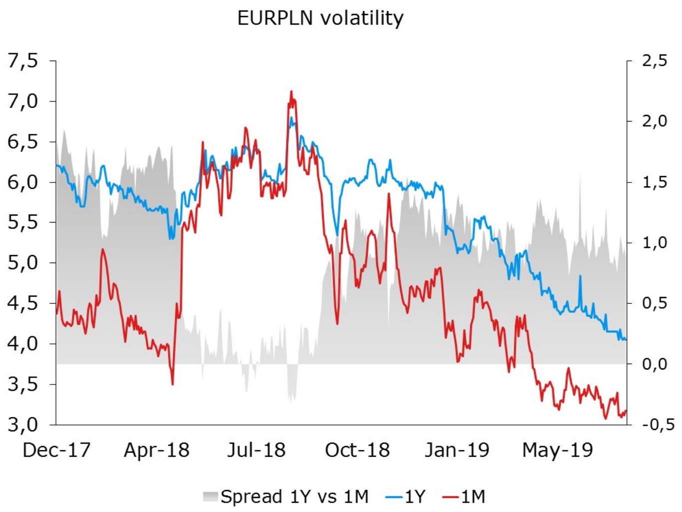




Forex

Spot – EUR/PLN – weaker Last Friday EUR/PLN slide was halted at 4.24/4.25 support zone, at least temporary. Main reason was strength of USD following excellent US labor market report as well as weaker than expected economy data from Germany. EUR/PLN rose above its month high at 4.2750 only to slip off below 4.27 after Federal Reserve Chairman Jerome Powell set the stage for a rate cut later this month. The risk sentiment is somehow better but the trade war and political tensions are keeping us all on our toes. For now we are still firm in 4.24 - 4.30 range and our strategy still applies to play that range.

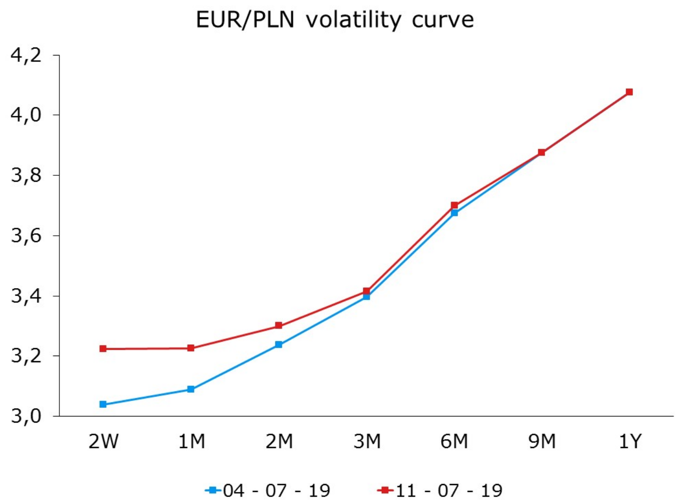
Opts – EUR/PLN vols – treading water Weaker zloty did not take the EURPLN vols higher, as the move up was slow and realized volatility was still low. EUR/PLN ATM mid today is 3.1% (0.1% higher), 3 month is 3.25% (unchanged) and finally 1 year fixed at 3.95% (0.05% lower). The currency spread (difference between USD/PLN vol and EUR/PLN) is roughly unchanged.

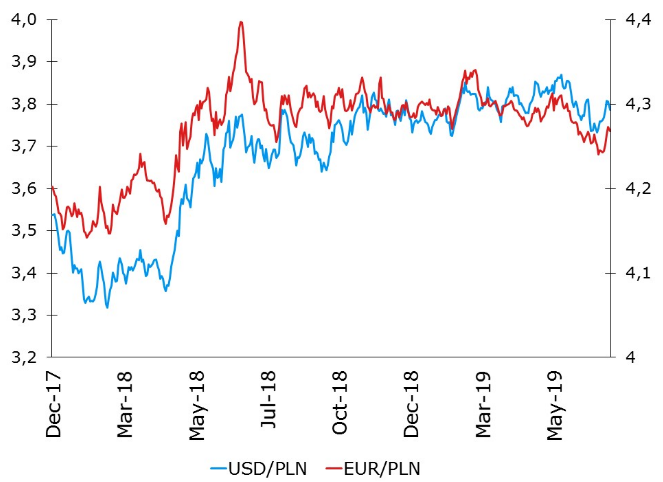


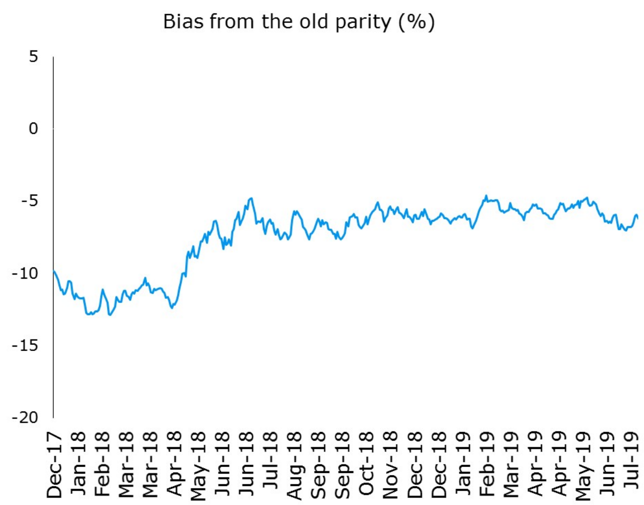
Short-term forecasts

Main supports / resistances:
EUR/PLN: 4.2400 / 4.3400
USD/PLN: 3.6000 / 3.9000

Spot – Long EUR/PLN at 4.2450
We have small tactical long that was built at average price of 4.2450, with 4.23 stop and hopes to switch into short at 4.30+. The 4.23/4.25 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's short 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
7/4/2019	1.63	1.72	1.83	1.69	1.96	1.76	1.72	1.72	1.70	1.69	1.66	1.76
7/7/2019	1.63	1.72	1.71	1.69	1.74	1.76	1.72	1.71	1.71	1.69	1.66	1.77
7/8/2019	1.72	1.72	1.90	1.69	2.02	1.76	1.72	1.71	1.68	1.66	1.66	1.73
7/9/2019	1.54	1.72	1.72	1.69	1.84	1.76	1.72	1.71	1.69	1.67	1.63	1.75
7/10/2019	1.70	1.72	1.89	1.69	2.02	1.76	1.72	1.72	1.70	1.68	1.64	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
7/4/2019	1.760	1.444	1.698	1.579	1.755	1.870	1.965	2.282
7/7/2019	1.760	1.367	1.710	1.714	1.797	1.898	2.010	2.286
7/8/2019	1.760	1.343	1.690	1.714	1.760	1.851	1.955	2.242
7/9/2019	1.760	1.262	1.690	1.563	1.757	1.829	1.942	2.199
7/10/2019	1.760	1.251	1.700	1.573	1.797	1.872	1.992	2.242

EUR/PLN 0-delta stradle						25-delta RR			25-delta FLY
Date	1M	3M	6M	1Y		1M	1Y		1Y
7/4/2019	3.09	3.40	3.68	4.08		4.08	1.27		0.48
7/7/2019	3.15	3.40	3.68	4.05		4.05	1.27		0.48
7/8/2019	3.12	3.36	3.65	4.08		4.08	1.27		0.48
7/9/2019	3.18	3.43	3.68	4.05		4.05	1.29		0.50
7/10/2019	3.23	3.42	3.70	4.08		4.08	1.27		0.48

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
7/4/2019	4.2427	3.7618	3.8125	3.4885	1.3160	0.1667
7/7/2019	4.2445	3.7689	3.8165	3.4888	1.3116	0.1666
7/8/2019	4.2519	3.7857	3.8194	3.4928	1.3095	0.1668
7/9/2019	4.2637	3.8074	3.8282	3.4961	1.3110	0.1671
7/10/2019	4.2729	3.8066	3.8410	3.4939	1.3110	0.1671

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