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Polish Weekly Review

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Comment on the upcoming data and forecasts

This Friday Statistics Poland will publish retail sales data. We forecast retail sales to slow down from 5.6 to 3.0% y/y in real terms, but the downward surprises in wage growth and industrial output data both point to high risk of another disappointment. The deceleration in retail sales will be driven by strongly negative calendar effect, partially attenuated by a rebound in the sales of clothing and footwear as well as furniture and household appliances (after weak May). On Monday business sentiment figures (for July) from Statistics Poland will be published, and the NBP will release June M3 data. Finally, on Tuesday Statistics Poland will publish its monthly Statistical Bulletin along with construction output data. The latter will fit the overall pattern of slowing real activity in June. Unemployment rate (another figure due on Tuesday) declined a bit less than originally forecast, the Ministry of Family's preliminary figures showed.

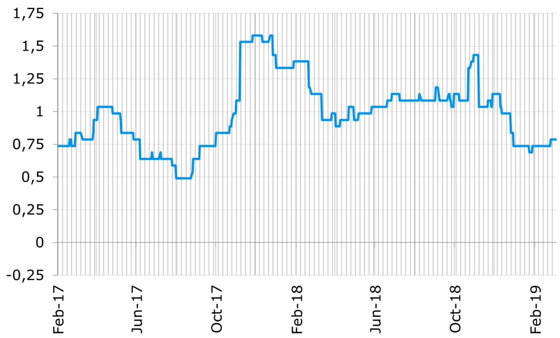
Polish data to watch: July 19th to July 26th

Publication	Date	Period	mBank	Consensus	Prior
Real retail sales y/y (%)	19.07	Jun	3.0	3.9	5.6
Business sentiment indicators	22.07	Jul			
M3 y/y (%)	22.07	Jun	10.2	10.2	9.9
Construction output y/y (%)	23.07	Jun	1.0	3.8	9.6
Unemployment rate (%)	23.07	Jun	5.3	5.2	5.4

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

Wage growth and industrial output disapponted massively, Polish surprise index suffered a significant decline as a result. Publications due next week can extend this sequence of negative surprises.

* 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 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

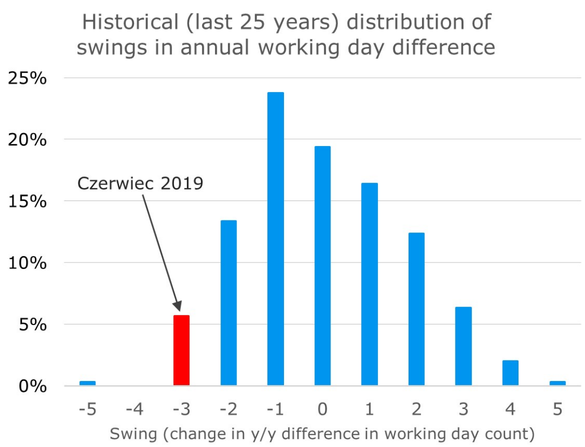
F - forecast

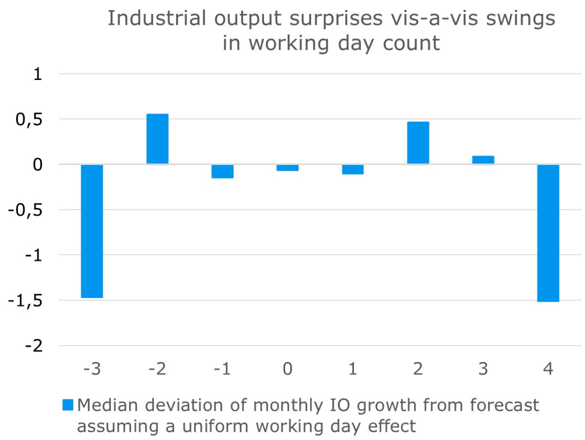
Economics

First decline in Polish industrial output since April 2017

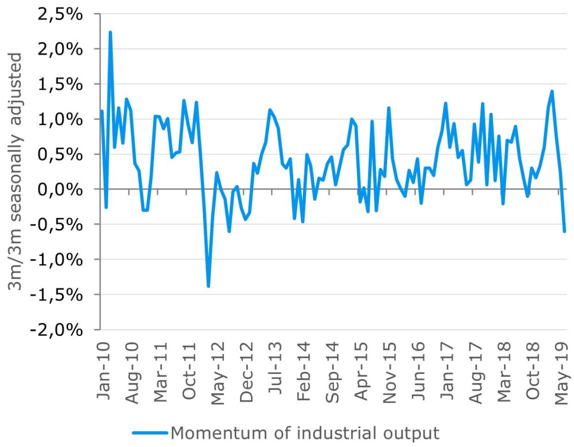
Industrial output surprised to the downside in June, having fallen by 2.7% y/y. Expectations were massively overstated (ca. 3%) and our already pessimistic forecast (1.4% y/y) fell short of the actual retrenchment in industrial output. In our view, several factors contributed to the disappointment.

First, the calendar effect (we've already blamed the surprise in wage growth on it), which was the primary driver of the deceleration in output, was massive and therefore difficult to pin down precisely. To remind our Readers – working day count declined by 3 m/m and the swing in annual terms was a whopping -3 (from +1 to -2 y/y). It was obviously known in advance, but the impact is not as straightforward to calculate as it seems. Average effects might not equal marginal effects and there is some potential for nonlinearity there. Historically, industrial output tended to overreact to these swings and the median surprise vis-a-vis a simple model based on average calendar effects was a respectable 1.5 p.p. In other words, whenever working days swung by 3 p.p. downward (as they did last month), the decline in industrial output was much greater than anticipated. We also suspect that seasonal adjustment fails to adequately correct for this effect and therefore the sequential decline in output (-2% m/m in seasonally adjusted terms) might be somewhat overstated.

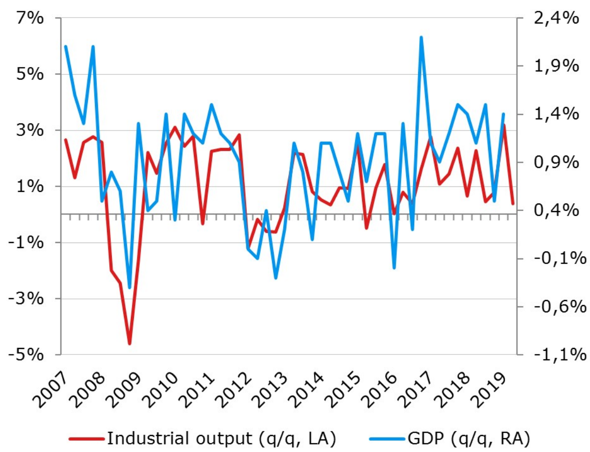




Second, even though the Polish industry proved to be exceptionally resilient to external factors in the previous months, it was bound to end one month. With the benefits of hindsight, we can note that the adjustment to weaker sentiment (and we are not talking about the Polish PMI) was inevitable. If one is looking for a particular factor, we can point to the end of pre-Brexit stockpiling. Finally, lack of reaction of energy output to record-breaking temperatures in June was the icing on the cake (worth at maximum 0.5 p.p.). It remains to be seen if manufacturing production was negatively impacted by the weather. Regardless of the reasons, lost output is loss output and the IP momentum took a deep dive in June (see the graph below).

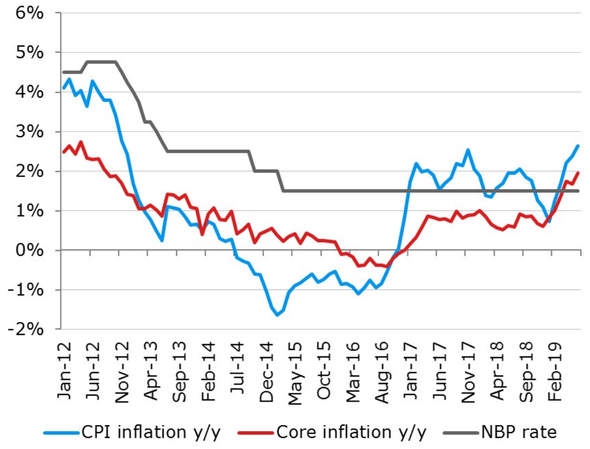


July is set to bring a reversal in the said calendar effect and industrial output growth will return to the 7-8% territory. However, the shift in output between the two quarters has important implications for near-term GDP forecasts. The June industry figures are shifting our GDP nowcasts downward, from 4.6-4.7% y/y to 4.4% y/y. As a result, there is no longer any discrepancy between estimates based on soft and hard data. Both point to GDP slowing down from 4.7 to 4.4% y/y. There is no point denying that our full year forecast of 5.0% is now in danger. For it to be realized, GDP would have to accelerate considerably in the second half of the year. Such atypical behavior of the business cycle is not impossible, but basic arithmetic is working against the 5% figure. We are waiting for the full set of June data (due on Friday and Tuesday) to make a decision about revising the forecasts.

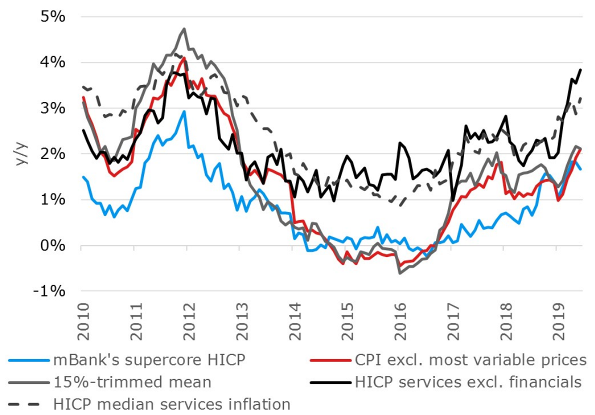


Polish CPI inflation rose to a fresh 6.5-year high

Statistics Poland confirmed the flash reading and CPI rose by 2.6% y/y in June. Core inflation rose from 1.7 to 1.9%, as we originally estimated.



Details of the final reading indicate that there were two main sources of the surprise (original market consensus: 2.4% y/y; our original forecast: 2.5% y/y). First, food prices rose by 0.3% m/m, slightly faster than we forecast. The increases here can be traced back to fruit and vegetable prices (no monthly change in vegetable prices and a slight increase in fruit prices). Over the past year, prices of food and non-alcoholic beverages have already grown by a respectable 5.7% y/y (food alone – by 6.2% y/y). Other noncore items were slightly deflationary - fuel and energy prices have grown a tad slower than we anticipated (+0.1 and -0.2% m/m, respectively). Second, core inflation turned out to be higher than we expected and rose from 1.7 to 1.9% y/y. Its source were communication services and package holiday prices (the summer tendency of price increases was stronger than usual, perhaps due to unusually high temperatures). The upward trend in core inflation itself is a fact too. There are multiple ways we can slice core inflation, but every single one leads to the same conclusion: the uptrend is broad-based and underlying inflation hasn't been that high since early 2012.



A sharp increase in inflation this year has for long been our baseline scenario, but the durability of food price inflation (let us not forget that upside risks remain) and the surge in core inflation are forcing us to upgrade our CPI trajectory upward. At present we expect inflation to reach 3.5% y/y at the beginning of 2020, although the fate of electricity prices is still uncertain (this number assumes flat prices in this category). Without delving into too much detail, one should note that inflation returned to Poland for good and that inflationary pressures have appeared later than in other countries of the region. From the MPC's point of view the key issue right now is not the exact level of inflation, but its "stickiness" or the durability of the surge in core inflation. The Council's instinctive and natural reaction would be to dismiss them as temporary and exogenous.

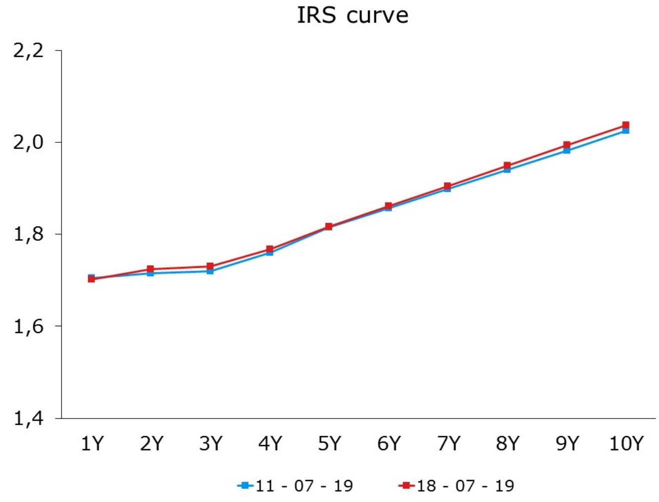
Fixed income

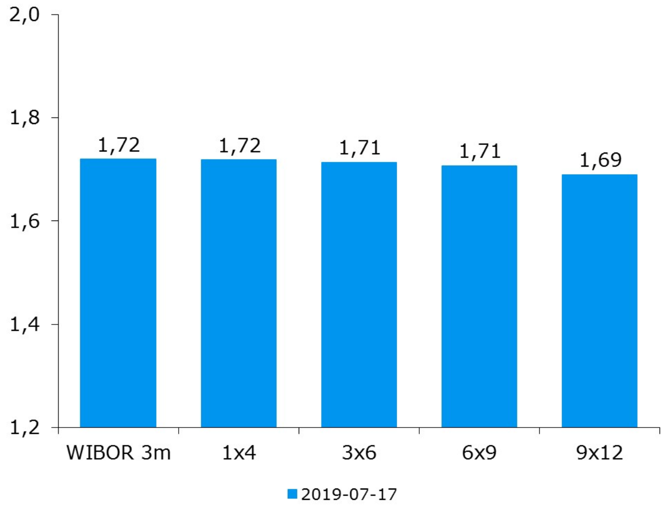
One direction

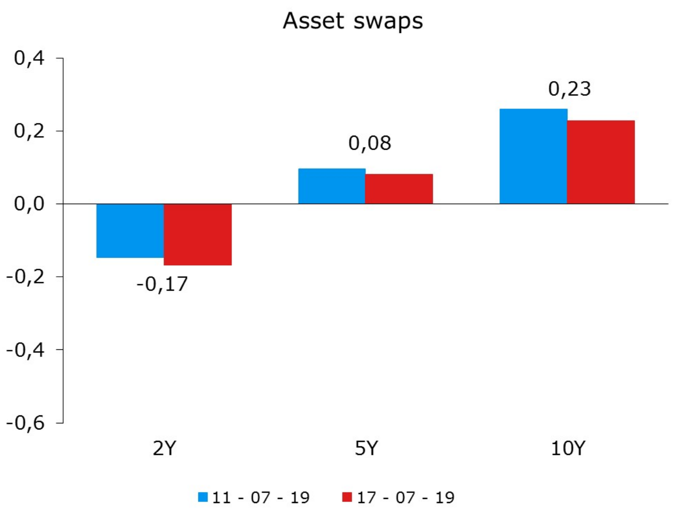
Happy buying continues and there has only been one direction on yields. Everyone believes in the Fed and the ECB, the market is waiting for rate cuts and QE. Curves are extremely flat, ASW are at very low levels. Has all the good news been already priced in? Many investors might start considering whether this rally could continue, 2.20% on DS1029 is a historically low yield.

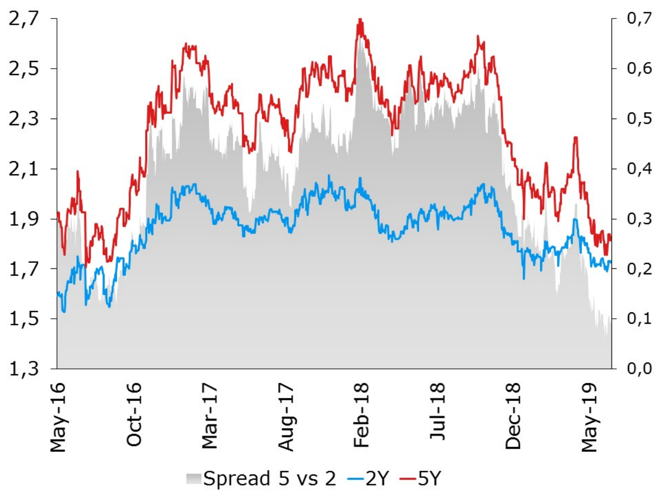
PS1024/5y is 9bps, DS1029/10y is 18 bps. PS1024/DS1029 is 28 bps DS1029/Bund is 252 bps.

DS1020 is trading at 1.28% (1 bps up), PS1024 is trading at 1.93% (3 bps down) and DS1029 is trading at 2.21% (4 bps down).









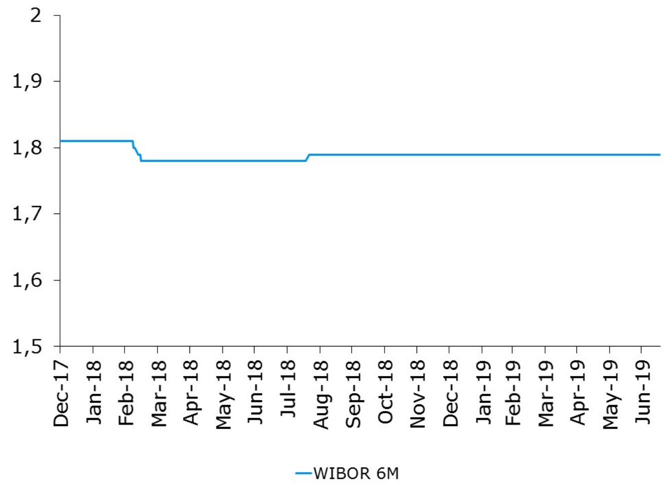
Money market

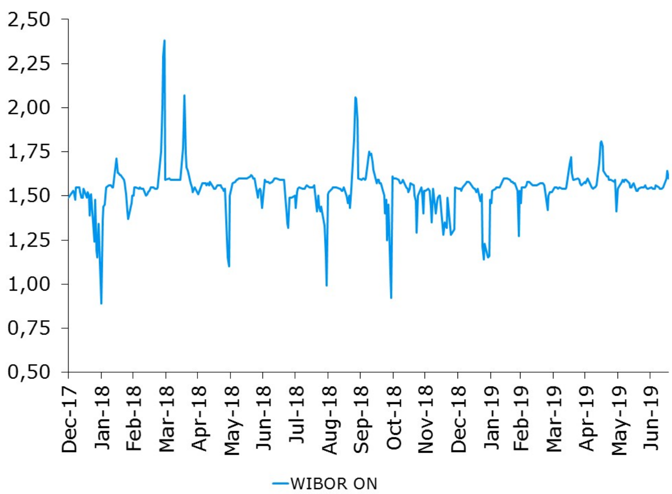
Cash coming back to the market

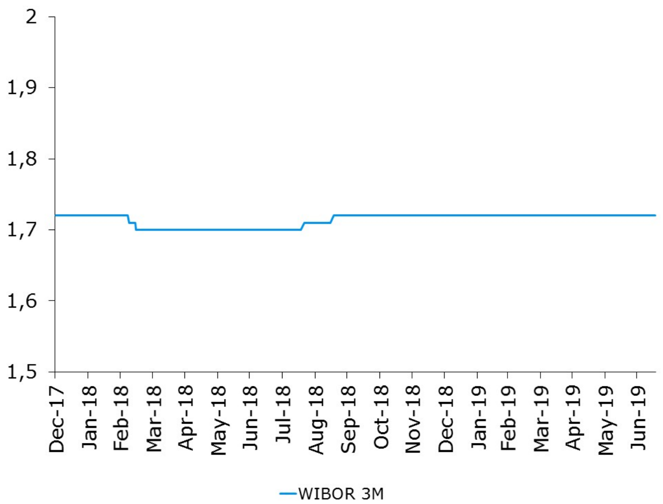
Rates pretty stable along the curve with some small flattening tendency. That's mainly caused by stong demand for 10y bonds. We are still following the global story, and don't expect this to change. We have coupon payments next week for all July bonds and floaters. This is distorting streads between bonds. Some of these weird moves may come to an end once the coupons is paid.

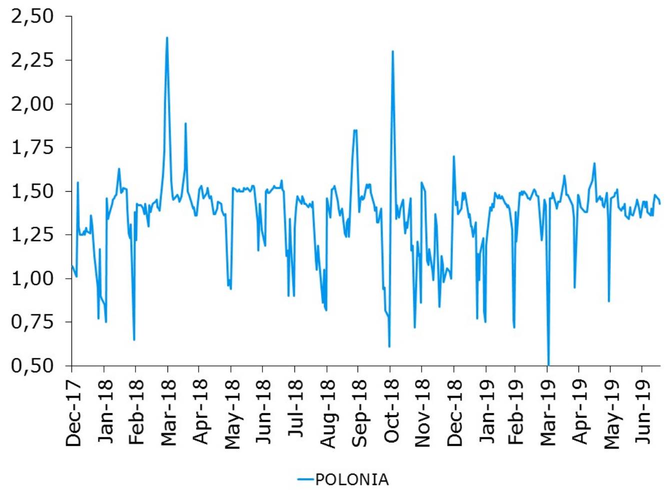
Cash rates stable around 1.50%. Next week might be pretty volatile with July coupon payments, PS0719 redemption and auction coming in.

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





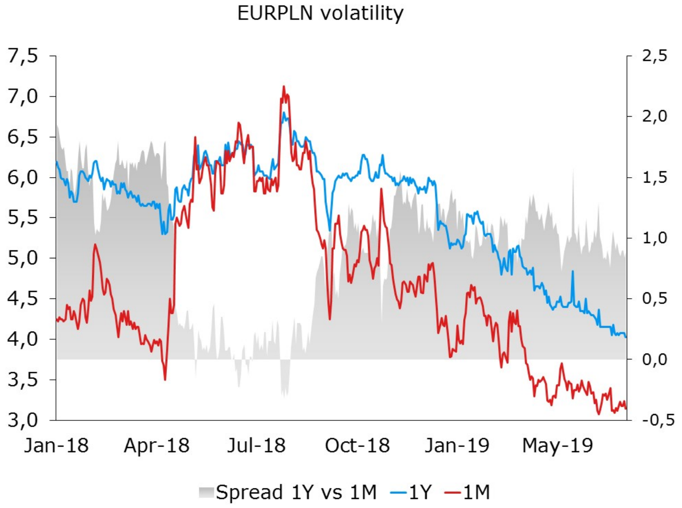




Forex

Spot – EUR/PLN – stable Those were very dull five trading sessions, with EUR/PLN meandering aimlessly in a tight, 4.2550-2700, range. Technically, as long as the PLN is above 4.24-4.25 support zone we may expect the rebound to 4.30+, but the momentum is simply not there. Neither to produce the correction higher, nor to break through the support. As a result, the most likely scenario is a continuation of range trading, 4.24-4.30 should cover the price fluctuations for the next few days. By choice we have small PLN-negative preference in our range trading strategies.

Opts – EUR/PLN vols – treading water Historically implied volatilities are extremely cheap, but the realized volatilities are not really encouraging for any purchases. EUR/PLN ATM mid today is 3.0% (0.1% lower), 3 month is 3.25% (unchanged) and finally 1 year fixed at 3.95% (unchanged). The currency spread (difference between USD/PLN and EUR/PLN vol) is roughly unchanged.

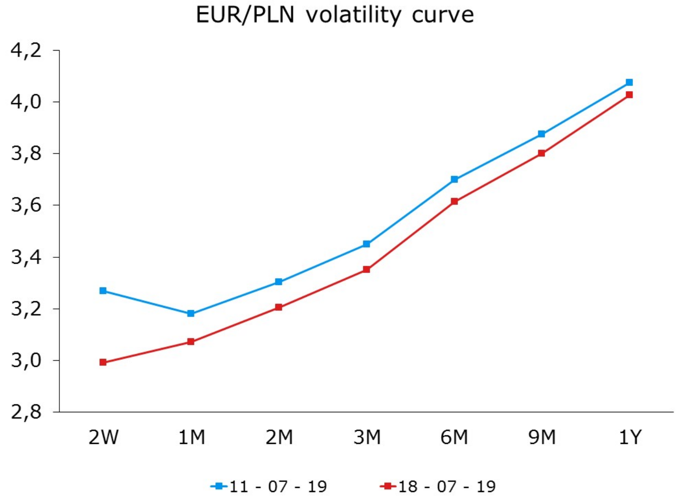


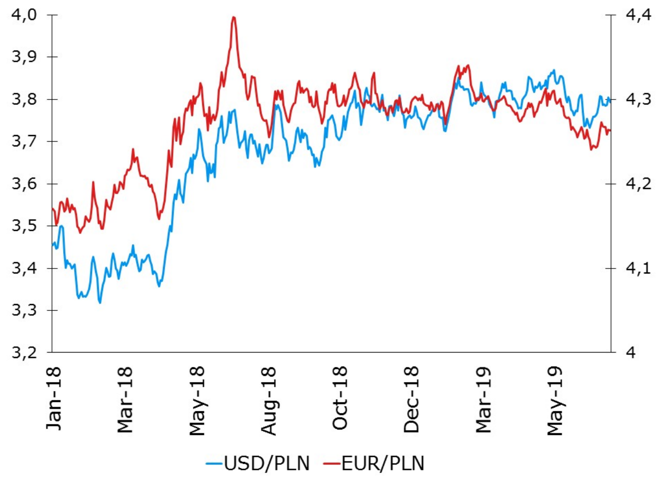
Short-term forecasts

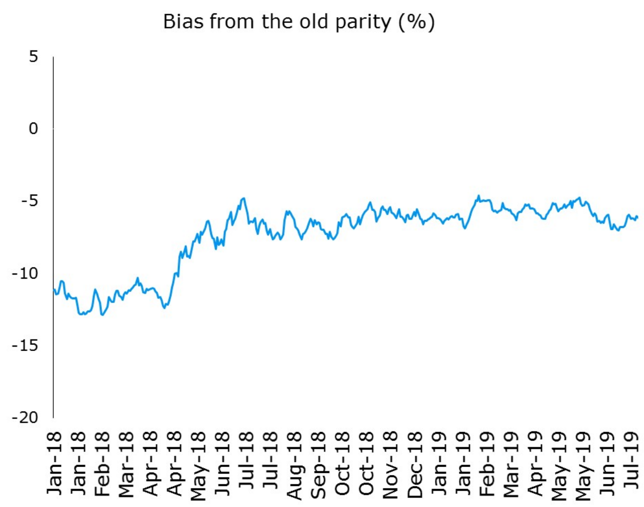
Main supports / resistances:
EUR/PLN: 4.2400 / 4.3000
USD/PLN: 3.6000 / 3.9000

Spot – Long EUR/PLN at 4.2450

We have small tactical long that was built at the average price of 4.2450, with 4.23 stop and hopes to switch into shorts 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 play it from PLN 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
7/11/2019	1.62	1.72	1.81	1.69	1.93	1.76	1.72	1.72	1.71	1.70	1.66	1.77
7/14/2019	1.63	1.72	1.80	1.69	1.93	1.76	1.72	1.72	1.71	1.70	1.67	1.77
7/15/2019	1.69	1.72	1.73	1.69	1.86	1.76	1.72	1.72	1.71	1.70	1.67	1.77
7/16/2019	1.51	1.72	1.56	1.69	1.61	1.76	1.72	1.72	1.71	1.69	1.66	1.76
7/17/2019	1.65	1.72	1.72	1.69	1.79	1.76	1.72	1.71	1.71	1.69	1.66	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
7/11/2019	1.760	1.271	1.715	1.569	1.815	1.912	2.025	2.286
7/14/2019	1.760	1.280	1.730	1.571	1.837	1.933	2.060	2.317
7/15/2019	1.760	1.267	1.725	1.559	1.815	1.893	2.033	2.277
7/16/2019	1.760	1.251	1.730	1.714	1.830	1.977	2.053	2.283
7/17/2019	1.760	1.250	1.725	1.557	1.817	1.899	2.038	2.266

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
7/11/2019	3.18	3.45	3.70	4.08	4.08	1.24	0.47
7/14/2019	3.18	3.42	3.68	4.08	4.08	1.24	0.47
7/15/2019	3.24	3.43	3.71	4.08	4.08	1.21	0.47
7/16/2019	3.14	3.36	3.66	4.03	4.03	1.22	0.46
7/17/2019	3.07	3.35	3.62	4.03	4.03	1.22	0.46

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
7/11/2019	4.2682	3.7859	3.8406	3.5036	1.3112	0.1667
7/14/2019	4.2669	3.7889	3.8397	3.4965	1.3099	0.1667
7/15/2019	4.2673	3.7856	3.8512	3.5084	1.3099	0.1667
7/16/2019	4.2582	3.7867	3.8475	3.5053	1.3085	0.1665
7/17/2019	4.2644	3.8038	3.8434	3.5134	1.3056	0.1666

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