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Polish Weekly Review

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Comment on the upcoming data and forecasts

In the upcoming week only flash CPI and manufacturing PMI will be published. Absent any major and identifiable shocks, CPI inflation is going to stay more or less unchanged. The series of surprises in food prices is slowly converging towards zero, lower (mom) fuel prices safeguard against upside risks. PMI should slow down, like other European manufacturing indices.

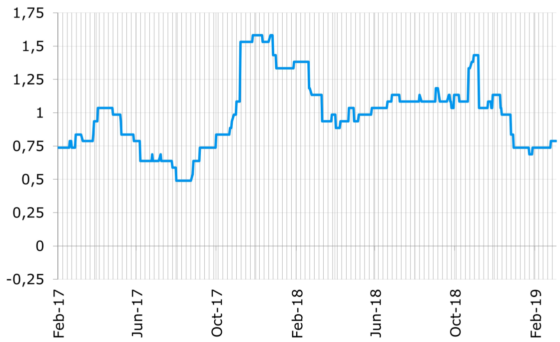
Polish data to watch: July 26th to July 2nd

Publication	Date	Period	mBank	Consensus	Prior
CPI *flash* y/y (%)	31.07	Jul	2.6-2.7	2.6	2.6
PMI Manufacturing (pts.)	1.08	Jul	48.0		48.2

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	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

Last week's readings were close to the market consensus, therefore Polish surprise index remained unchanged. Next week only flash CPI and PMI readings can change it.

* 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

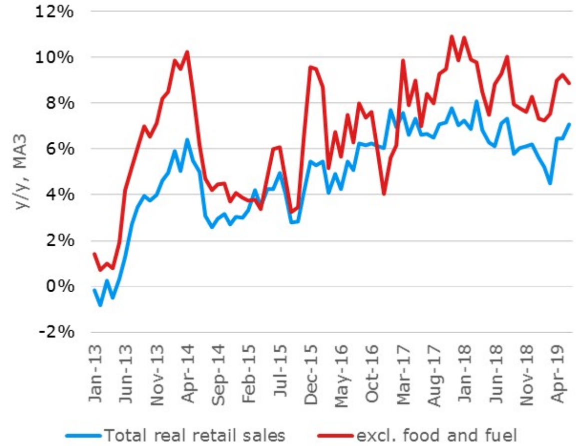
	2018 Q1	2018 Q2	2018 Q3	2018 Q4	2019 Q1	2019 Q2 F	2019 Q3 F	2019 Q4 F
GDP y/y (%)	5.2	5.3	5.2	4.9	4.7	4.6	5.0	5.3
Individual consumption y/y (%)	4.6	4.8	4.4	4.2	3.9	4.3	4.5	4.8
Public Consumption y/y (%)	4.5	4.5	5.2	4.7	6.4	6.4	6.4	6.4
Investment y/y (%)	9.6	6.0	11.3	8.2	12.6	10.0	8.0	7.0
Inflation rate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

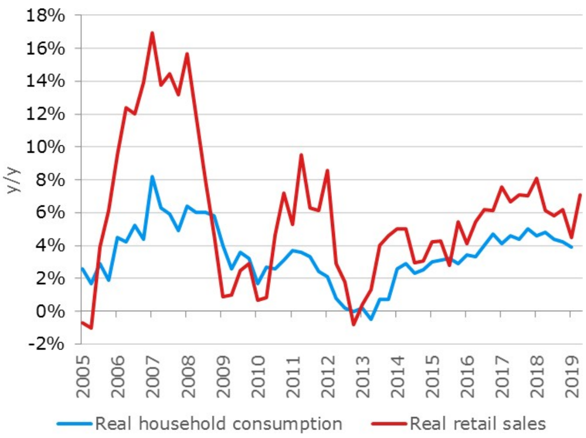
Economics

Polish retail sales slowed down in June, but no surprise this time

Retail sales slowed down in June from 5.6 to 3.7% y/y (in real terms), as expected. Our own forecast (3.0% y/y) was a bit too pessimistic, but the main difference is in the details of the reading. Alas, there is no overarching pattern to the surprises in the categories.



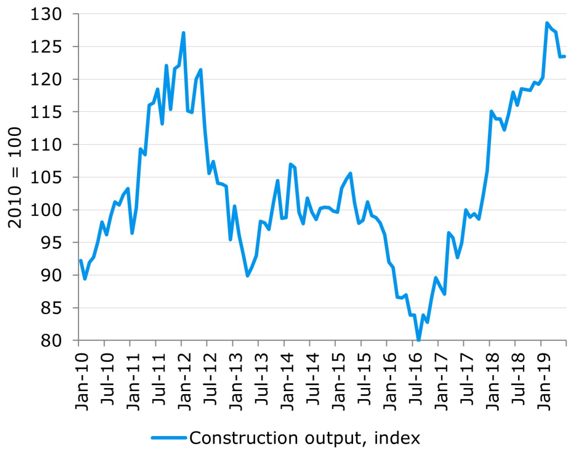
First, while much has been said about the unusually strong and atypical calendar effect in June (we wrote about it in detail in the last weekly comment) its impact has been smaller than expected. The two potentially most susceptible categories, car sales and sales in other nonspecialized stores slowed down less than anticipated or not at all (respectively, from 12.6 to 1.7% y/y and steady at 9.6% y/y). Second, semidurables generally fared much better than expected – sales of clothing and footwear swung from -1.9 to 11.2% y/y, reflecting catching up after weak previous months and perhaps accelerated summer sales due to very high temperatures. Third, there are disappointments in the sales of durable goods – the category of furniture, radio, TV and household appliances did not rebound after weak May and its dynamics dropped from 17.4 to 9.2% y/y. Finally, the Others category disappointed (having declined by 2.3% y/y) and this might be the effect of calendar. This category is worth watching as a measure of second-round effects of housing boom, since sales of building materials are included in it.



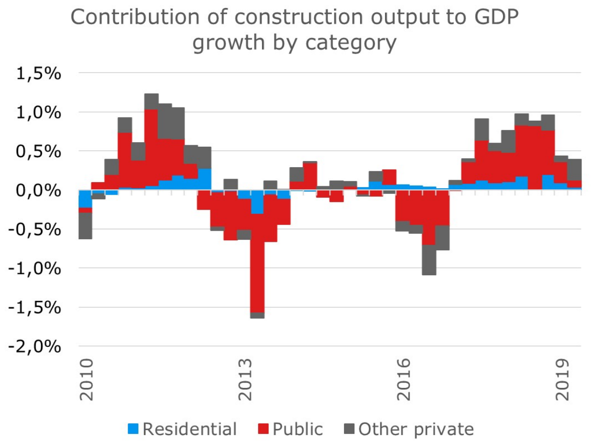
There is no clear-cut story in June retail sales. The entire second quarter, mainly due to the late timing of Easter, brought a material acceleration in total sales (see the graph above). Its impact on household consumption will be positive, but limited – Easter effects tend to be smoothed out in national accounts aggregates. Nevertheless, Q1's figure of +3.9% likely marked a local bottom and consumer spending is set to accelerate further amid record-high consumer sentiment and the on-going disbursement of fiscal stimulus in the coming months. To remind our readers – investment lifted the overall GDP path upwards, but the U-shape is dependent on household consumption accelerating in the second half of the year. This is the key factor to watch this year.

Calendar effect impacted construction output as well

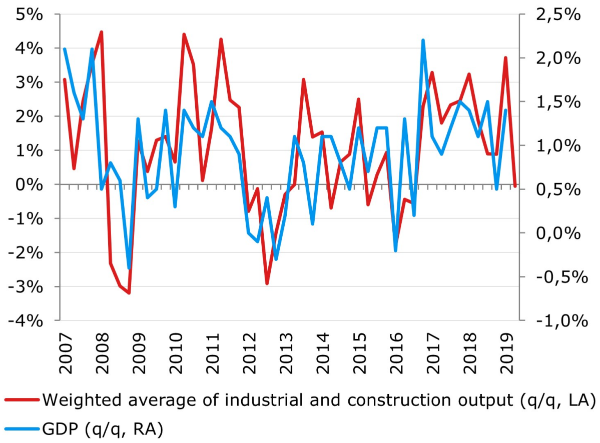
Construction output disappointed, declining by 0.7% y/y, which was below consensus (+4% y/y), but relatively close to our forecast (+1%). If we assume that the whole calendar effect was captured by the seasonal adjustment procedure (and in the case of construction there is no reason to doubt it), this explains the whole slowdown in construction output in June. Construction output, without seasonal and calendar effects, increased monthly by 0.1%. Hence, May remains the worst month for construction this year (see the chart below).



Compared to the previous months, slowdown was mostly a result of weak investments of the public sector: roads, railways, bridges and viaducts, pipelines, waterworks and other transmission lines, and to some extent also sports, cultural and public facilities. Expenditures on commercial construction as well as industrial buildings and structures accelerated in the Q2. But the contribution of housing investments (against the evidence of high activity on construction sites) remains very low. It becomes clear that, besides the overall slowdown of construction, there is also the shift from public (from 0.6 pp of GDP in 2018 to 0.1 pp GDP in 2Q2019) to private investments (from 0.15 p.p. of GDP in 2018 to 0.3 p.p. GDP in Q2'19). If someone wonders why the total investment accelerated in the Q1 despite slower growth in construction, we remind about significantly higher expenditures on machinery and equipment (not included in readings analyzed here).



Despite its optimistic structure, slowdown of construction is a fact. It adds up to the significant slowdown of industrial production in Q2. The total production of these two sectors, after a 3.7% growth in the first quarter, did not change in the second quarter, which is the worst result since 2016. This weakness will be reflected in the lower dynamics of GDP. We have already mentioned (in the last weekly review) that forecasts for the second quarter can be lowered. Now, we can expect slowing down of the economy to 0.5% q/q. In some sense, the second quarter is as weak as the first quarter was strong (good weather and high inventories before the original Brexit date). The second half of the year highly depends on the acceleration of consumption (as discussed above) and keeping high rate of expenditure on machinery and equipment in the enterprise sector (unfortunately, there are no monthly correlates).



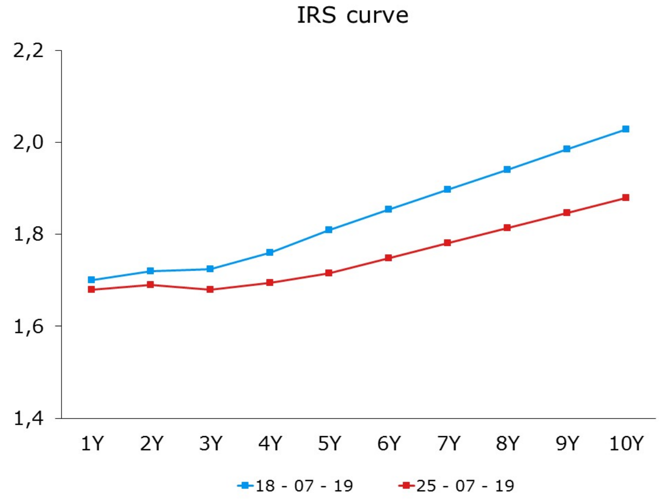
Fixed income

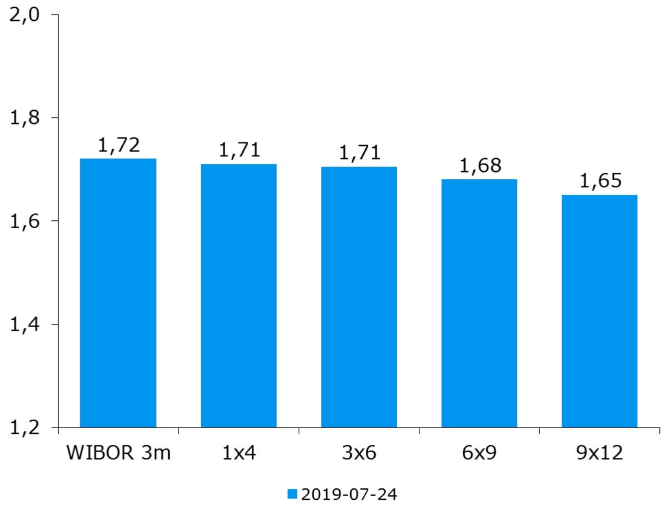
10y yield drops to record low

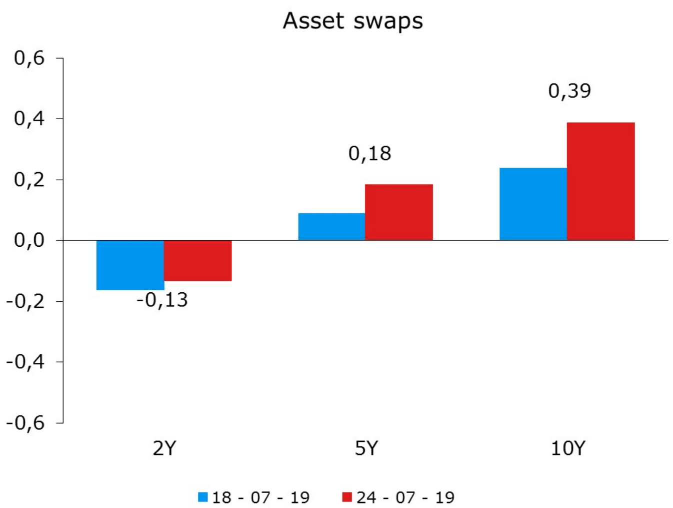
Bullish. We saw new record lows on Polish 10y, it traded at 1.97% minimum. ECB did not deliver anything materially new but the market stays strong. Curve is flat, ASW are narrow. Tomorrow we have auction in Poland with moderate supply.

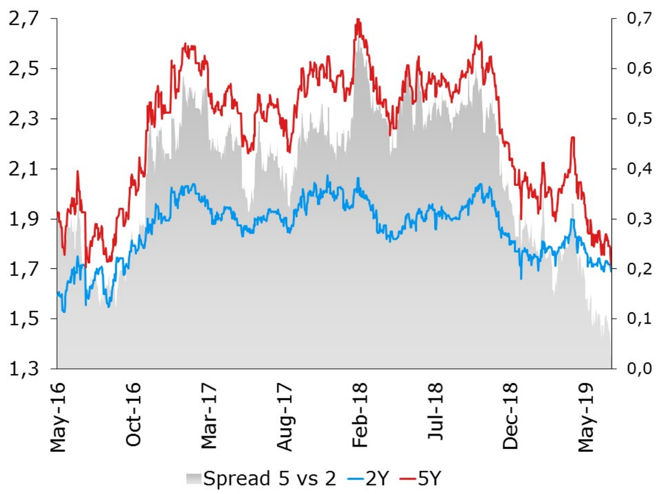
PS1024/5y is 0bps, DS1029/10y is 10bps. PS1024/DS1029 is 23bps DS1029/Bund is 238bps.

DS1020 is trading at 1.25% (3bps down), PS1024 is trading at 1.75% (18bps down) and DS1029 is trading at 1.98% (23bps down).









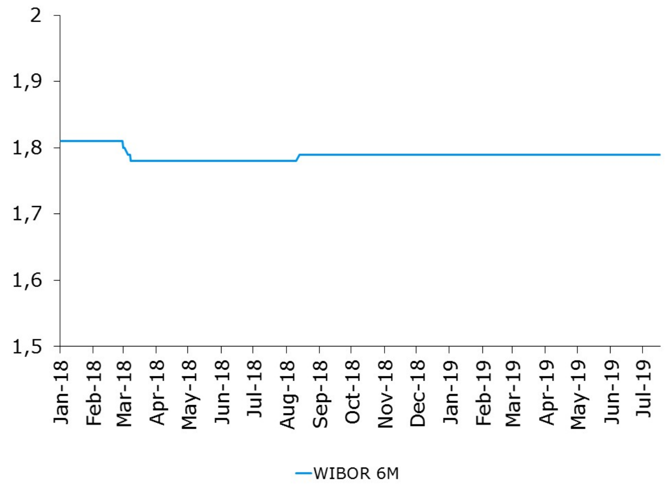
Money market

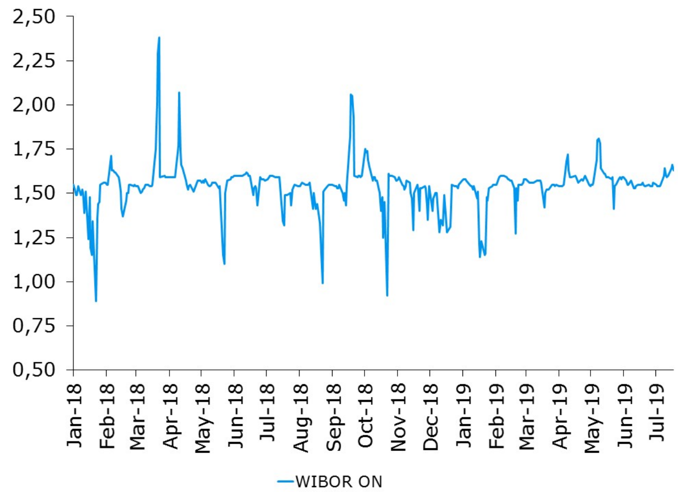
Flattener strikes back

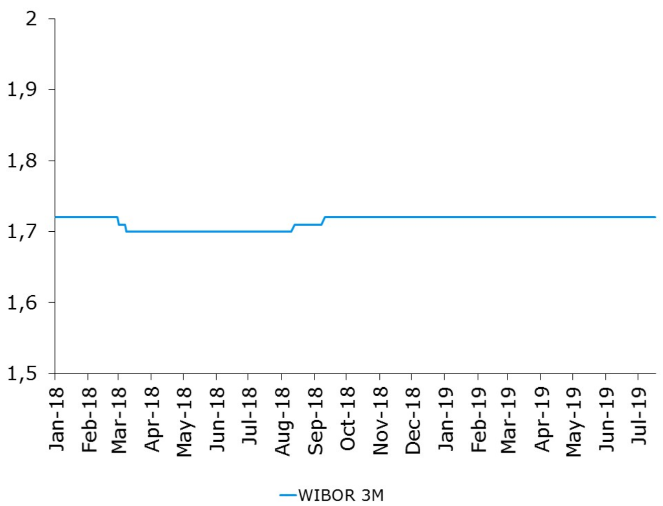
Curve flattened even more last week following global easing story. We are touching levels seen in 2015 when bottoms on the yield curves were established. Full rate cut is priced in a 2 year period. That obviously is flow driven. Spreads are historically tight with 2v5 trading at 1 bp.

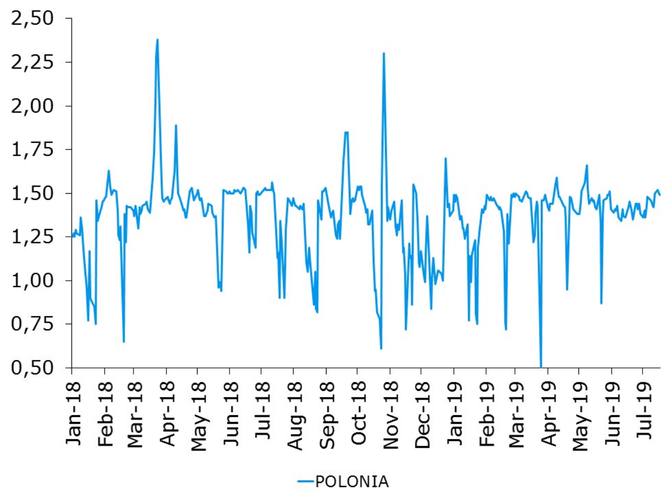
Cash stable around 1.55. End of the month is coming so beware of volatility.

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





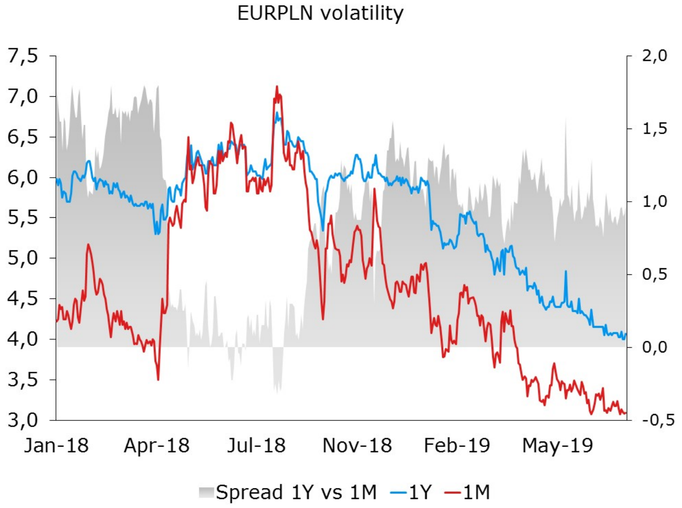




Forex

Spot – EUR/PLN – even stronger Last week EUR/PLN was locked in the narrow 4.2475-4.2600 trading range. We are still waiting for some fresh signal to push us out of the current range. The most obvious candidates are ECB meeting and, later next week, the FOMC meeting – both are expected to dictate the tempo for currencies in coming months. Europe's economic fundamentals have worsened and the EUR/USD has fallen 2.0% this month on expectations that ECB would join other central banks in easing policy. Dovish central banks can push EUR/PLN towards 4.20.

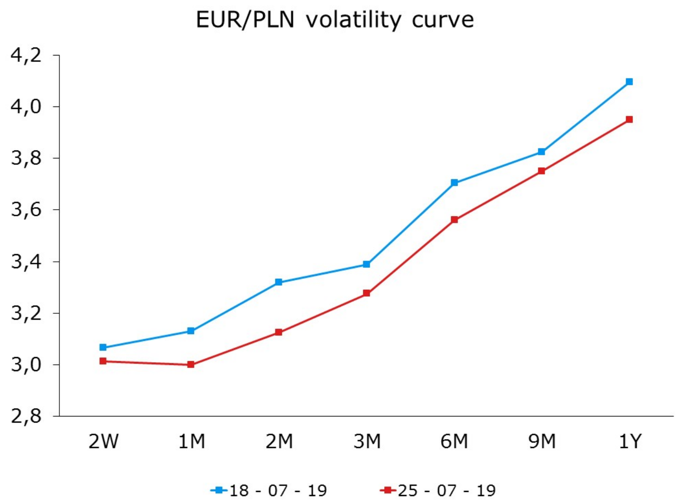
Opts – EUR/PLN vols – frontend water EUR/PLN and especially USD/PLN frontend are higher in anticipation of EBC and FOMC, and probably because of some short covering. USDPLN 1w is fixed today at 8.5% (3.5% higher than week ago!). EUR/PLN 1 month ATM mid is today 3.1% (0.1% higher), 3 months are at 3.4% (0.15% higher) and finally 1 year fixed at 3.95% (unchanged). The skew was roughly unchanged, and the currency spread (difference between USD/PLN and EUR/PLN) is better bid by approx. 0.5%.

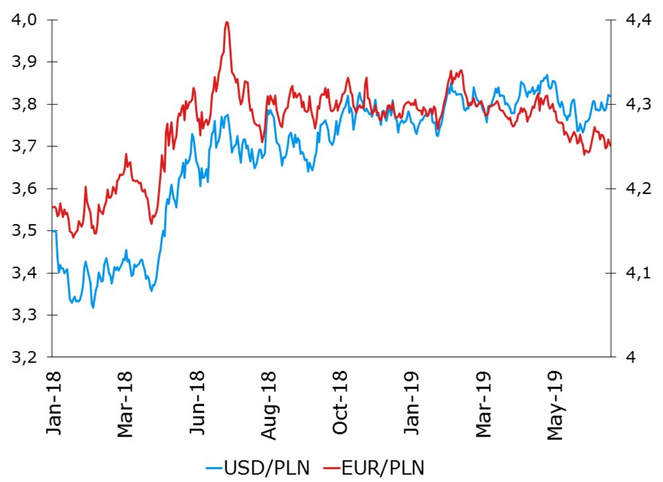


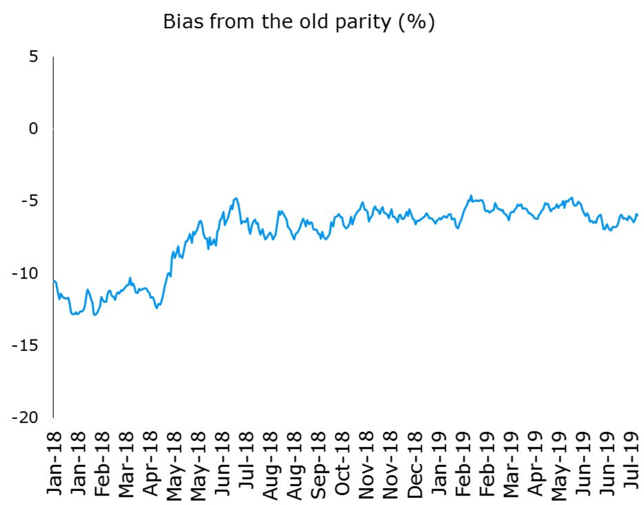
Short-term forecasts

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

Spot – Long EUR/PLN at 4.2450
The ECB and upcoming FOMC decision could trigger Zloty gains. We are skeptical about that rally and still have long position at 4.2450 with 4.23 stop and hopes to switch into short at 4.28+.







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
7/18/2019	1.60	1.72	1.81	1.69	1.92	1.76	1.72	1.72	1.71	1.69	1.66	1.77
7/21/2019	1.71	1.72	1.75	1.69	1.80	1.76	1.72	1.71	1.70	1.68	1.65	1.76
7/22/2019	1.69	1.72	1.80	1.69	1.93	1.76	1.72	1.71	1.70	1.68	1.66	1.76
7/23/2019	1.51	1.72	1.71	1.69	1.83	1.76	1.72	1.72	1.69	1.67	1.66	1.74
7/24/2019	1.62	1.72	1.81	1.69	1.89	1.76	1.71	1.71	1.68	1.65	1.62	1.73

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
7/18/2019	1.760	1.250	1.720	1.557	1.810	1.899	2.029	2.266
7/21/2019	1.760	1.250	1.717	1.557	1.793	1.899	1.998	2.266
7/22/2019	1.760	1.250	1.717	1.557	1.783	1.899	1.978	2.266
7/23/2019	1.760	1.250	1.715	1.557	1.760	1.899	1.954	2.266
7/24/2019	1.760	1.250	1.690	1.557	1.715	1.899	1.880	2.266

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
7/18/2019	3.13	3.39	3.71	4.10	4.10	1.22	0.47
7/21/2019	3.10	3.27	3.63	4.00	4.00	1.22	0.47
7/22/2019	3.08	3.32	3.64	4.00	4.00	1.21	0.47
7/23/2019	3.09	3.35	3.60	4.07	4.07	1.22	0.47
7/24/2019	3.00	3.28	3.56	3.95	3.95	1.22	0.47

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
7/18/2019	4.2635	3.7933	3.8505	3.5209	1.3055	0.1665
7/21/2019	4.2592	3.7855	3.8480	3.5162	1.3079	0.1667
7/22/2019	4.2480	3.7869	3.8571	3.5109	1.3073	0.1663
7/23/2019	4.2492	3.7997	3.8589	3.5123	1.3045	0.1663
7/24/2019	4.2581	3.8229	3.8775	3.5377	1.3068	0.1667

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