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Polish Weekly Review

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Comment on the upcoming data and forecasts

No macro releases scheduled for the week.

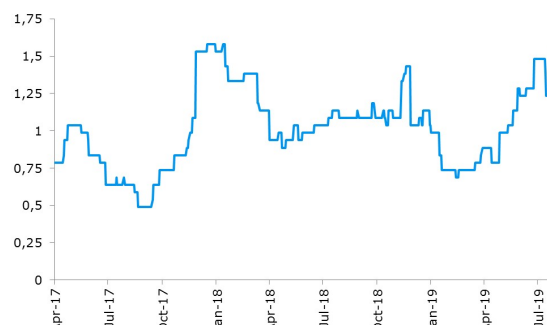
Polish data to watch: August 2nd to August 9th

Publication	Date	Period	mBank	Consensus	Prior
NO RELEVANT DATA					

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	9/5/2019	300	1.445	7/26/2019
5Y T-bond PS1024	9/5/2019	2000	1.823	7/26/2019
10Y T-bond DS1029	9/5/2019	1500	2.100	7/26/2019
30Y T-bond WS0447	9/5/2019	60	3.180	4/25/2019
5Y floater WZ0525	9/5/2019	2500	-	7/26/2019
10Y floater WZ0529	9/5/2019	2100	-	7/26/2019

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



Comment

Another strong CPI reading pushed inflation upward. There are no macro releases scheduled for the upcoming several days, so the index is set to remain quiet until the middle of the month.

* 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

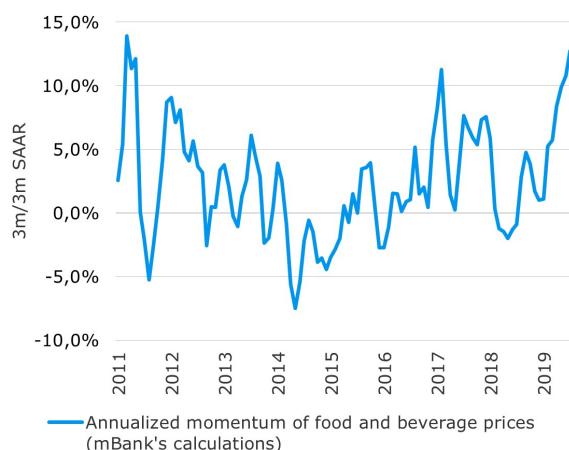
	2015	2016	2017	2018	2019 F	2020 F
GDP y/y (%)	3.8	3.0	4.8	5.1	4.9	4.0
CPI Inflation y/y (average %)	-0.9	-0.6	2.0	1.6	2.3	3.0
General government balance (%GDP)	-2.7	-2.2	-1.4	-0.2	-0.7	-1.1
Current account (%GDP)	-0.6	-0.5	0.2	-0.6	-1.2	-1.4
Unemployment rate (end of period %)	9.8	8.2	6.6	5.9	5.4	5.1
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	4.4	5.0	5.3
Individual consumption y/y (%)	4.6	4.8	4.4	4.2	3.9	4.1	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	8.5	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	1.56	1.56
10Y Polish bond yields (% eop)	3.18	3.22	3.24	2.83	2.84	2.39	2.35	2.50
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	3.67	3.64
F - forecast								

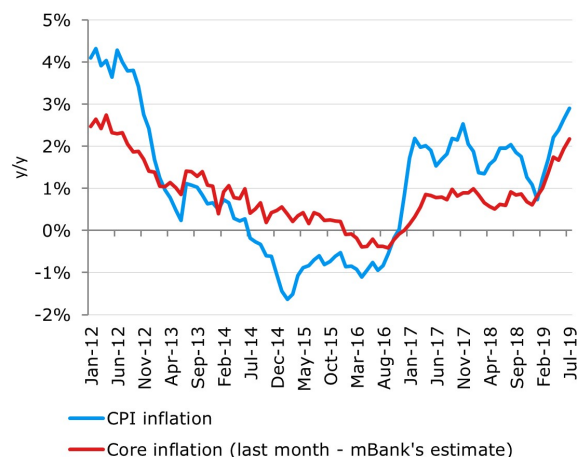
Economics

Inflation surprised again by rising to 2.9% y/y

CPI inflation surprised to the upside again (for the fifth time this year) and rose from 2.6% y/y last month to 2.9% y/y in July, beating our forecast (2.7% y/y) and market consensus (2,6-2,7% y/y). Food prices have beaten the historical all-time July high with +0.3% m/m growth (following a string of strong readings – momentum here is close to historical records). Energy prices did not change, while fuel prices decreased by 1.6% m/m. Our estimates of those categories were extremely correct this time. Once again, the inflation surprise was the effect of rising core inflation, which likely increased to 2.2% y/y, the level last seen in 2012.



What exactly were the reasons for the increase in core inflation? There are many candidates, but the most probable ones are: health (pharmaceuticals), airplane tickets (downside correction from last month's spike might not have realized), recreation and culture (package holidays – same reason as in previous category). For details, as always, we need to wait until the final reading (publication in 2 weeks). We are fairly certain, however, that the overall pattern of broad-based increase in services prices held again.



Despite reaching 7-year high, inflation still will not change the MPC's attitude. The staff projections of inflation will be revised upward, but both economic growth and global inflation prospects suggest that inflation should slow down which will keep the status quo in MPC. In addition, since the MPC sees the bulk of current inflation surge as a result of external factors and one-offs, it will be treated as a negative supply shock and a hit to house-

hold disposable income and hence consumption growth. This self-limiting nature of current inflationary episode coupled with the NBP's apparent inability to forecast a persistent increase in core inflation means that the consensus is intact. The flurry of statements from MPC members suggests as much - the hawks are concerned, while the rest of the Council sees no reason to act. Over the short term, the market may not share the same opinion, and adjust the expected rate path in accordance with global factors.

Fixed income

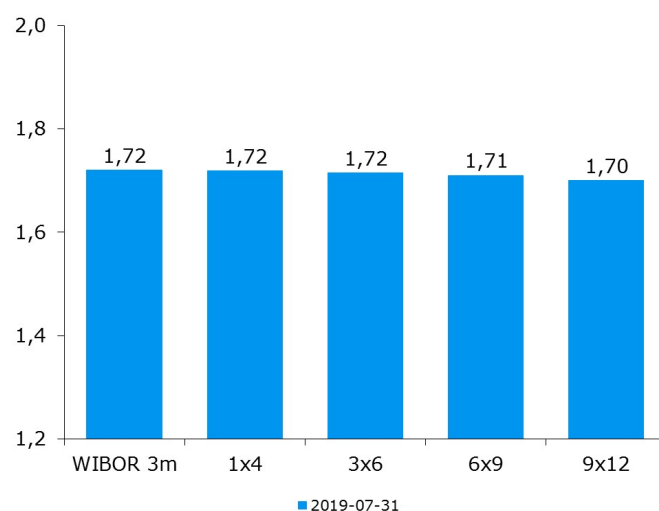
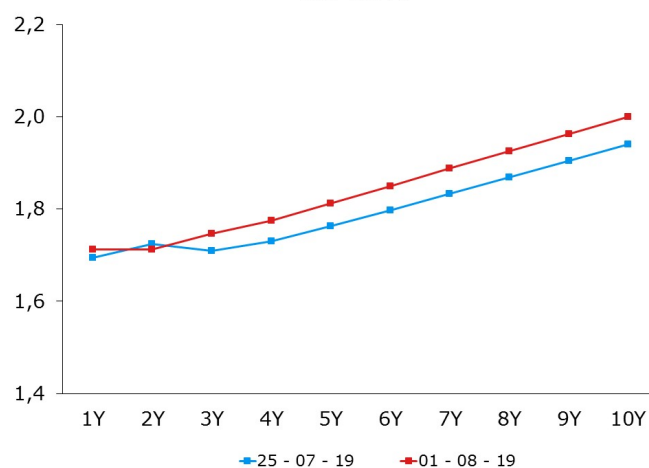
Earth calling

Finally, we have seen some normalization. After the crazy rally we came back to Earth last week. ECB was a big disappointment for the markets, Fed said "mid-cycle adjustment to policy", macro figures are seen as good. Curve is very flat, ASW spreads are very narrow, yields are very low, a lot is already priced in.

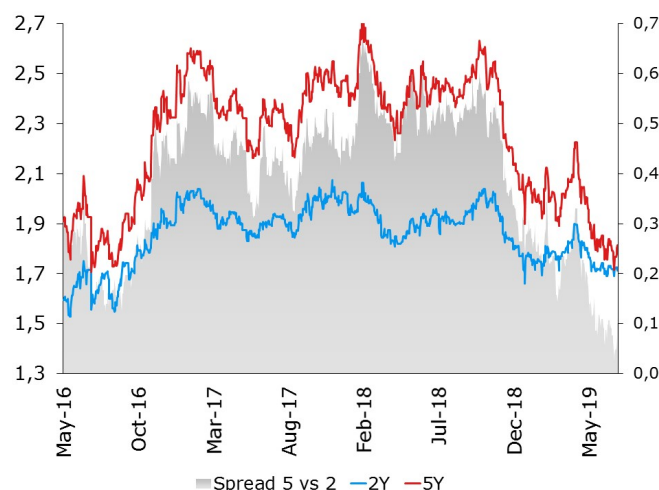
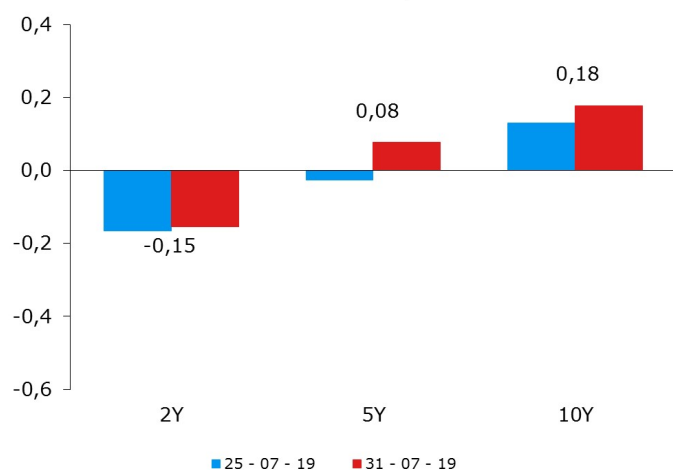
PS1024/5y is 6 bps, DS1029/10y is 15 bps. PS1024/DS1029 is 31 bps DS1029/Bund is 264 bps.

DS1020 is trading at 1.29% (4bps up), PS1024 is trading at 1.91% (16 bps up) and DS1029 is trading at 2.22% (25 bps up).

IRS curve



Asset swaps



Money market

The hunt for yield

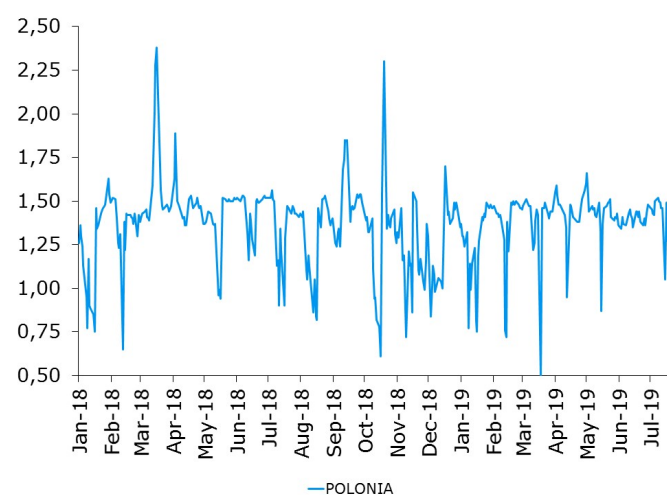
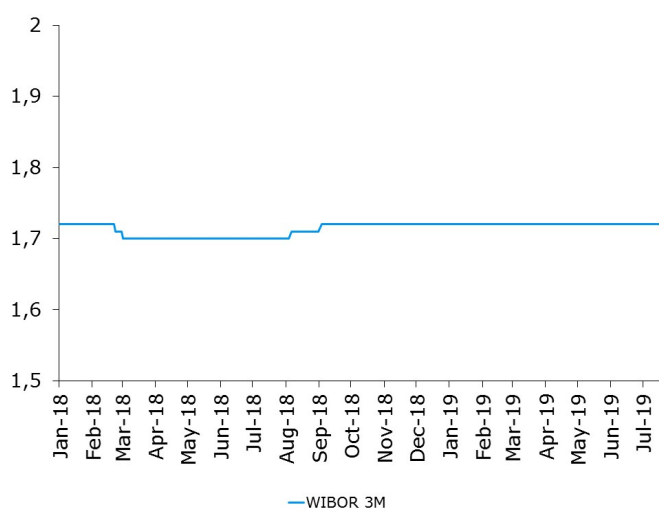
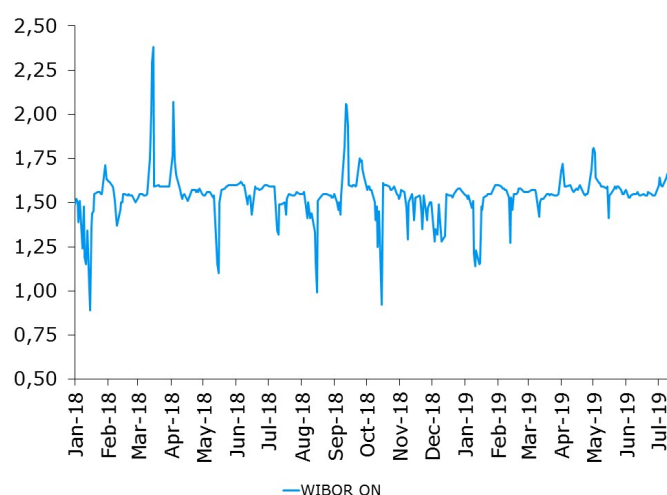
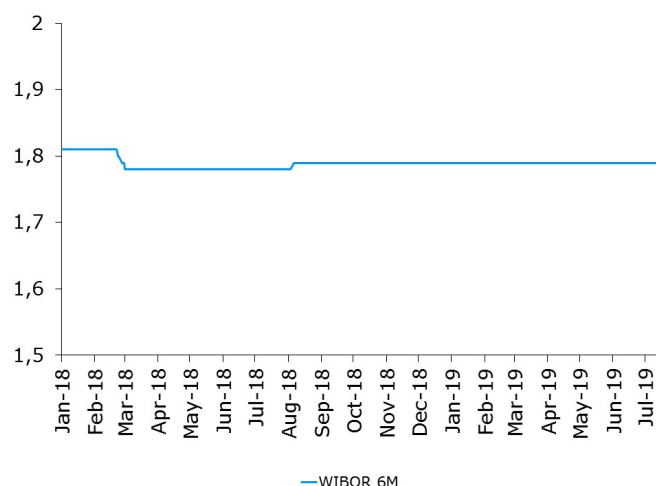
We've witnessed big swings on Polish rates recently. That's because currently we are in divergence with the global sentiment. While core rates are falling down on worsening economic outlook and lack of CPI pressure, current data from Poland are showing the opposite. GDP is expected grow robustly this year and CPI continues to accelerate. Nevertheless, FRA contracts are trading still below current WIBOR. Flat curve is mainly due internationals buying long end bonds in hunt for yield.

Stable end of the month. We are starting new with rates around 1.50%.

Ref rate vs Polonia averages:

30 day 8 bp

90 day 12 bp



Forex

Spot – EUR/PLN – weaker Finally, we have lived to see some action on PLN. It started to weaken on the back of renewed Brexit story related to the election of the new prime minister as well as on growing China-US tensions. Additionally more hawkish than expected tone from Fed is still having its effect on markets. USD is regaining some of its long time not visited territory, and PLN is no exception. PLN basket (EUR and USD equally weighted against PLN) is weaker as a result. EUR/PLN is currently testing the 4.29-4.30 resistance zone, USD/PLN is trying to breach 3.90. Nevertheless, we still believe in the rangy nature of EUR/PLN. We still expect the 4.24-4.34 range to cover most of the moves.

Opts – EUR/PLN vols – higher The vols were on the rise with weaker Zloty, we even had realized volatility picking up, but we are skeptical whether it will last. Anyway we noticed some demand for Gamma as well for Vega: 1m and 1Y EUR/PLN were paid at 3.6% and at 4.15%, respectively. EUR/PLN 1 month ATM mid is today 3.5% (0.4% higher), 3 month is at 3.55% (0.15% higher) and, finally, 1 year fixed at 4.1% (0.15% higher). The skew was little higher, and the currency spread (difference between USD/PLN and EUR/PLN), frontend is also tic better bid.

Short-term forecasts

Main supports / resistances:

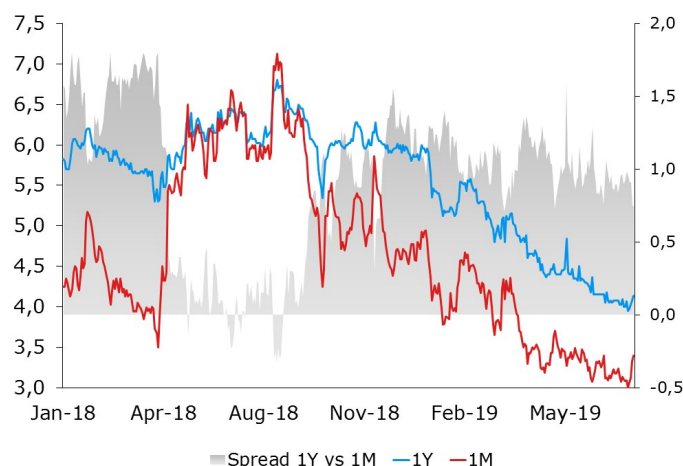
EUR/PLN: 4.2400 / 4.3400

USD/PLN: 3.7000 / 4.0000

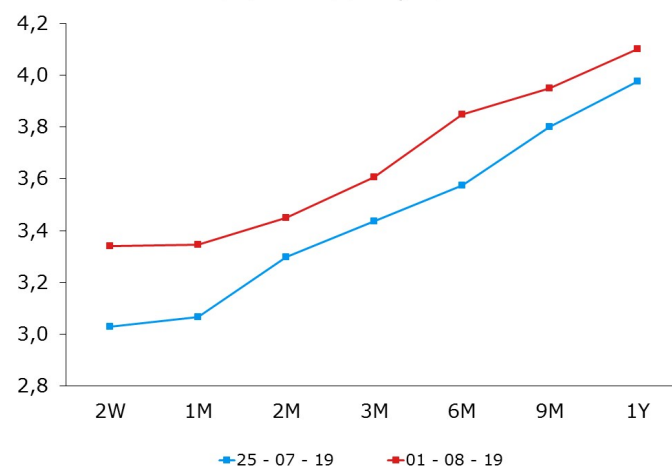
Spot – Short EUR/PLN

We closed our long in EUR/PLN from 4.2450 at 4.28 and reversed our position to the short at 4.2950. We are ready to add to short at 4.32 with the stop at 4.35. The 4.33/4.34 resistance zone seems to be the pivotal level, so we may revisit the levels below 4.30 relatively quick.

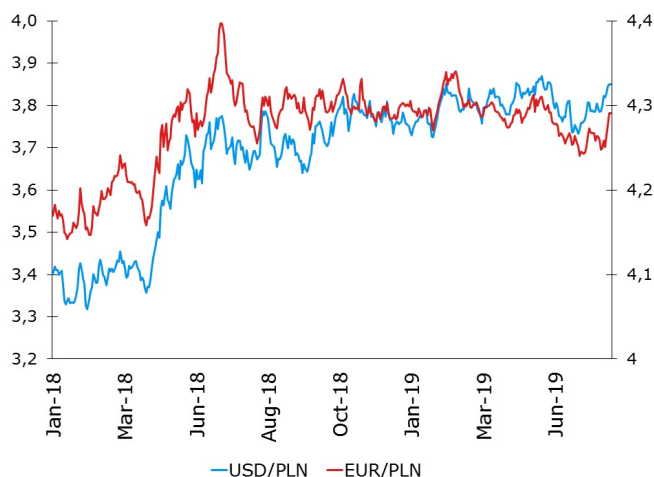
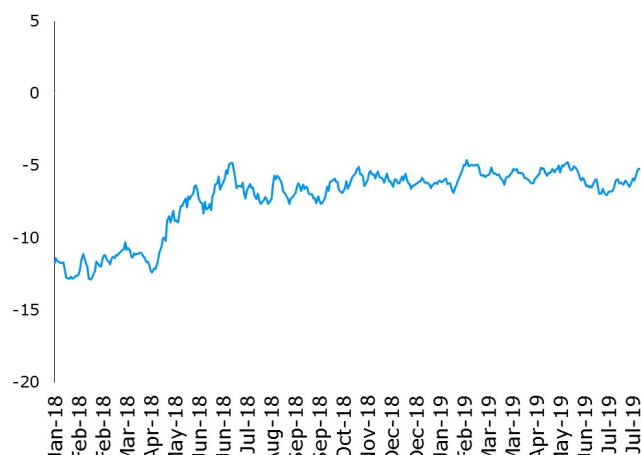
EURPLN volatility



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
7/25/2019	1.67	1.72	1.88	1.69	1.91	1.76	1.72	1.71	1.70	1.68	1.65	1.75
7/28/2019	1.68	1.72	1.95	1.69	1.99	1.76	1.72	1.71	1.69	1.68	1.66	1.75
7/29/2019	1.61	1.72	1.81	1.69	1.90	1.76	1.72	1.71	1.70	1.68	1.66	1.76
7/30/2019	1.47	1.72	1.68	1.69	1.77	1.76	1.72	1.71	1.70	1.69	1.68	1.77
7/31/2019	1.58	1.72	1.77	1.69	1.85	1.76	1.72	1.72	1.71	1.70	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	7/26/2019	5/25/2021	97.42	1.45	300	625	300
PS1024	7/26/2019	10/25/2024	102.10	1.82	2000	2330	1500
DS1029	7/26/2019	10/25/2029	105.91	2.10	1500	2248	1511

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0720	5Y IRS	PS0423	10Y IRS	WS0428
7/25/2019	1.760	1.201	1.725	1.559	1.763	1.736	1.940	2.070
7/28/2019	1.760	1.180	1.720	1.559	1.767	1.776	1.942	2.111
7/29/2019	1.760	1.186	1.725	1.539	1.777	1.805	1.962	2.147
7/30/2019	1.760	1.179	1.727	1.558	1.803	1.919	2.010	2.224
7/31/2019	1.760	1.188	1.712	1.558	1.813	1.890	2.000	2.177

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1Y	
7/25/2019	3.07	3.44	3.58	3.98	3.98	1.24	0.47	
7/28/2019	3.12	3.45	3.65	4.03	4.03	1.24	0.47	
7/29/2019	3.33	3.55	3.70	4.08	4.08	1.24	0.47	
7/30/2019	3.40	3.56	3.79	4.14	4.14	1.24	0.48	
7/31/2019	3.35	3.61	3.85	4.10	4.10	1.22	0.44	

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
7/25/2019	4.2514	3.8199	3.8735	3.5341	1.3072	0.1667
7/28/2019	4.2645	3.8296	3.8612	3.5238	1.3058	0.1670
7/29/2019	4.2773	3.8453	3.8774	3.5393	1.3084	0.1670
7/30/2019	4.2906	3.8493	3.8859	3.5452	1.3088	0.1672
7/31/2019	4.2911	3.8504	3.8856	3.5465	1.3119	0.1672

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