

August 8, 2019

Polish Weekly Review

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Comment on the upcoming data and forecasts

All you would like to know about Polish macroeconomic data in June and July sees the light in the next two weeks. Apart from employment, everything boils down to working-days count. 3 days more translate into much better output, sales, construction and wages. It is also worth to note that the first most comprehensive measure of economic activity in Q2 is published as well. We expect GDP growth to temporarily fall to 4.5% before re-acceleration fueled by the fiscal package in Q3 and Q4. Pricing behavior stays divided between almost-no-growth industry and much quicker consumer inflation. Ongoing correction in oil prices and signs that at the onset of August vegetable prices began to fall suggest both price indices may stabilize or even go lower in coming months.

Polish data to watch: August 9th to August 23rd

Publication	Date	Period	mBank	Consensus	Prior
Current Account Balance (m EUR)	13.08	Jun	-233	243	1006
Exports (m EUR)	13.08	Jun	18400	18650	19703
Imports (m EUR)	13.08	Jun	18800	18800	19607
GDP y/y (%)	14.08	Jul	4.5	4.5	4.7
CPI y/y (%)	14.08	Jul	2.9	2.9	2.9
CPI core y/y (%)	16.08	Jul	2.2	2.1	1.9
Average Gross Wages y/y (%)	20.08	Jul	7.8	7.1	5.3
Employment y/y (%)	20.08	Jul	2.7	2.7	2.8
Sold Industrial Production y/y (%)	21.08	Jul	7.2	6.3	-2.7
Construction Output y/y (%)	21.08	Jul	10.9	7.3	-0.7
PPI y/y (%)	21.08	Jul	0.6	0.7	0.6
Retail Sales y/y (%)	22.08	Jul	7.5	6.2	3.7
Money Supply M3 y/y (%)	23.08	Jul	9.1	9.5	9.3

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

There were no macro releases so surprise index has remained unchanged. It will surely change in upcoming 2 weeks when almost all Polish macro data, scheduled for this month, 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

- Risk-off mood dominates and zloty trades on the weaker side of the range.
- We see stronger PLN along the way. New wave of global monetary easing makes Polish rates relatively higher and the economy is holding very well given the global slowdown of economic activity.

mBank forecasts

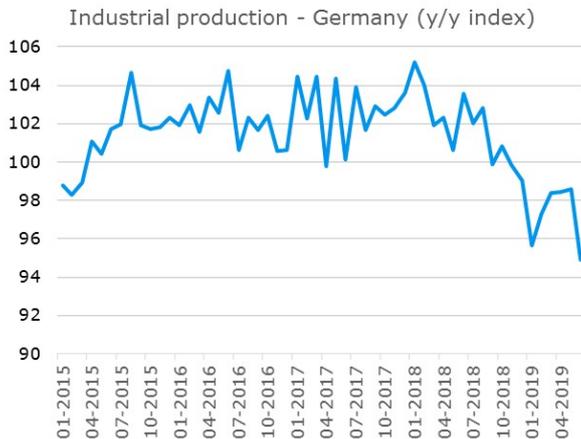
	2015	2016	2017	2018	2019 F	2020 F
GDP y/y (%)	3.8	3.0	4.8	5.1	5.0	4.0
CPI Inflation y/y (average %)	-0.9	-0.6	2.0	1.6	2.3	3.0
General government balance (%GDP)	-2.7	-2.2	-1.4	-0.2	-0.7	-1.1
Current account (%GDP)	-0.6	-0.5	0.2	-0.6	-1.2	-1.4
Unemployment rate (end of period %)	9.8	8.2	6.6	5.9	5.4	5.1
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	4.5	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	1.52	1.52
10Y Polish bond yields (% eop)	3.18	3.22	3.24	2.83	2.84	2.39	2.00	2.20
EUR/PLN (eop)	4.21	4.37	4.28	4.29	4.30	4.24	4.20	4.20
USD/PLN (eop)	3.42	3.74	3.69	3.74	3.84	3.73	3.67	3.64
F - forecast								

Economics

Some facts about Polish exports

The latest pessimistic data from Germany bother an increasing number of economic analysts. There are more and more negative records, with a slowdown since 2017 and production contraction since 2018.

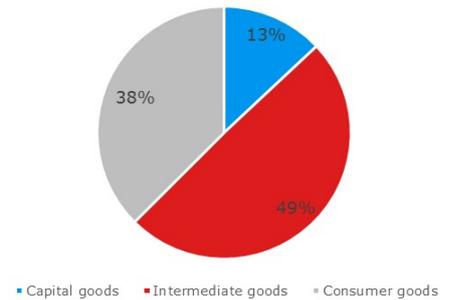


The view on inevitable impact of German slowdown on Polish data was strengthened by June's industrial production figures. However, negative difference of working days and the associated problems of typical models that combine production from other data suggest that its implications on state of the economy should be approached with caution.

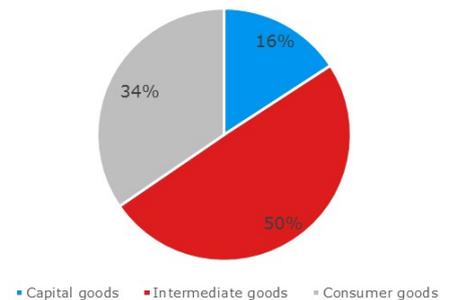
In Poland, delicate and gradual slowdown of business climate indicators is a fact (except PMI but it is another and not-compelling story). They imply 4.4-4.5% growth of the GDP in 2Q. Key question for the second half of the year is: will German slowdown have such a negative impact on Polish exports that it will offset the positive effects of fiscal stimulation (about 1% of GDP) and all time high consumer confidence? Details on exports data suggest that the pessimism in this matter may be exaggerated. Given the sorry state of German industrial output (a proxy for the whole GDP) which lingers for several months, Polish exports seems bulletproof. If links with German economy would not cause, somehow out of the blue, a significant demand decline there will be no reason for private and individual investment demand to capitulate as well (especially that individual investment demand has just re-appeared). Obviously, public investment contribution to growth will slow down, as a direct effect of EU funds cycle but is mostly exogenous story and not part of the current problem. Below you find some comments on Polish exports channeled to Germany and elsewhere.

1. Polish exports structure: half of it is intermediate goods category, the other half both capital and consumer goods (according to BEC groups methodology). There are no major differences in structure between Polish exports to Germany and to the rest of the world. Poland exports to Germany between 24 to 30% of total exports in above mentioned categories. Although Germany constitutes a large chunk alone, the potential for the rest of the world is obviously 3 times higher. Arithmetically, if exports to Germany declines, say, by 12%, the rest of the world will compensate for it with only 4% growth.

Exports to Germany (2018)

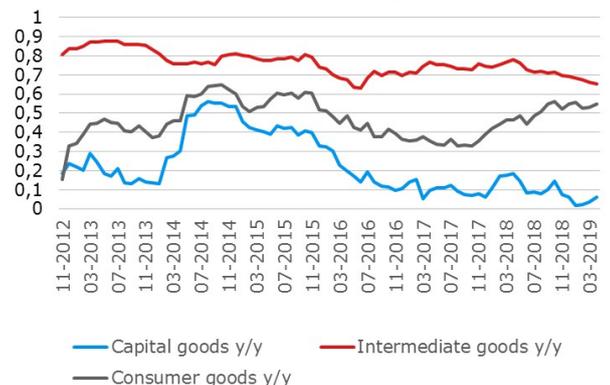


Exports to the rest of the world (2018)



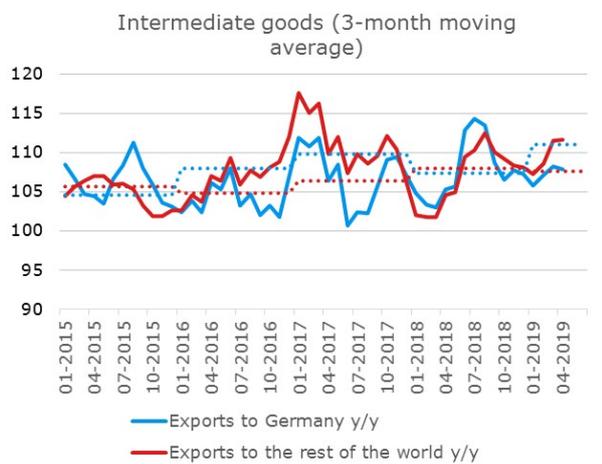
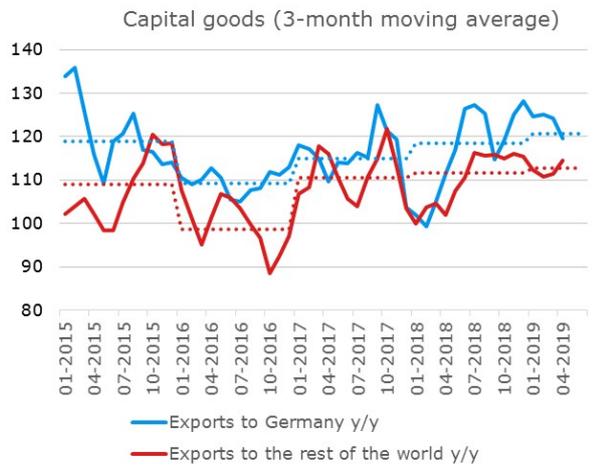
2. Correlations: intuitively the most correlated with German industrial production cycle is Polish exports of intermediate goods. But this correlation declines over time (a simple result of diversification of intermediate goods suppliers in Germany?). Links with exports of consumption goods have increased. Capital goods exports is practically not correlated with the German cycle.

36-months moving correlation coefficients with German industrial production



3. Exports to Germany and to the rest of the world: in case of capital goods there is no confirmation of apparent slowdown resulting from the cycle of German industrial production (growth rates are still solid 10-20%). There is a significant slowdown in the case of consumer goods exported to Germany. It is against popular opinions about Polish exports of consumer goods. Consumer goods exported to Germany push Polish exports downwards (zero y / y in terms of 3mma) but there is a strong compensation effect in the form of an increase in exports to the rest of the world (over 10% y / y in terms of 3mma). Also in case of intermediate goods there are no signs of a significant slowdown. However, unlike the other two categories, this type of exports is strongly correlated between Germany and the rest of the world. Therefore there is no hope

for any compensation mechanism during a slowdown, but now exports of intermediate goods to the rest of the world is growing faster than to Germany.



Fixed income

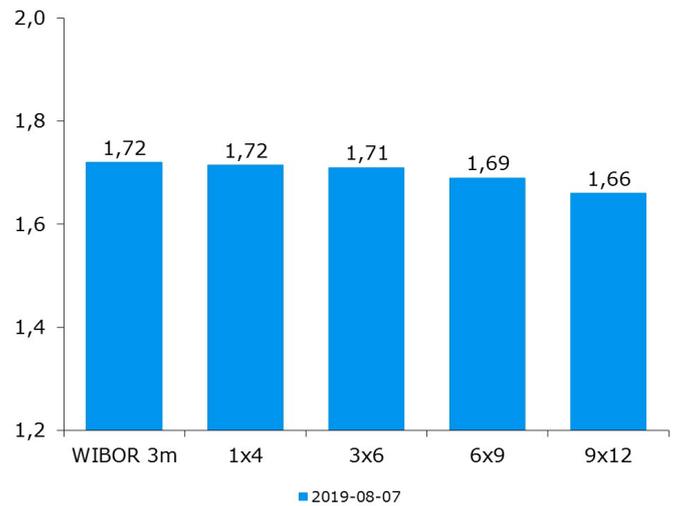
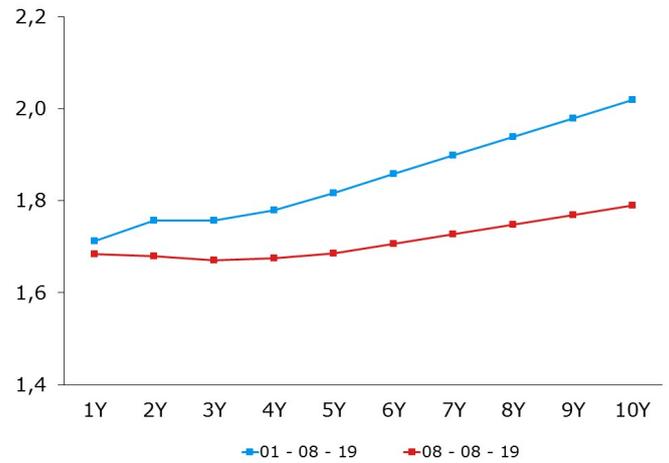
Dive in yields continues

After short sell-off, core markets went to the lowest yields since 2015. POLGBs rebounded 4bps despite switch auction. Yield curve is almost flat and the market is still in buying mood to secure yield for an upcoming future.

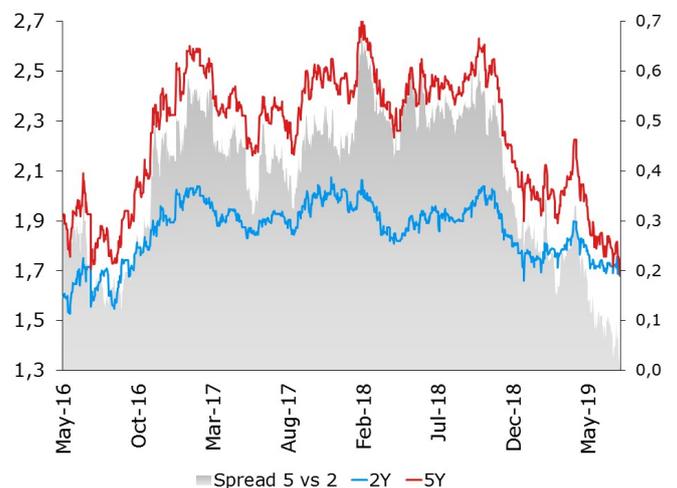
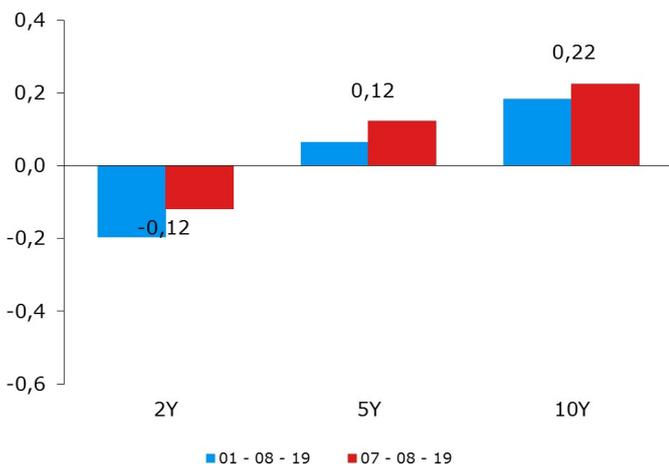
PS1024/5y is 5bps, DS1029/10y is 20bps. PS1024/DS1029 is 21bps DS1029/Bund is 255bps.

DS1020 is trading at 1.25% (4bps down), PS1024 is trading at 1.78% (13bps down) and DS1029 is trading at 2.00% (22bps down).

IRS curve



Asset swaps



Money market

Global easing expectations continue

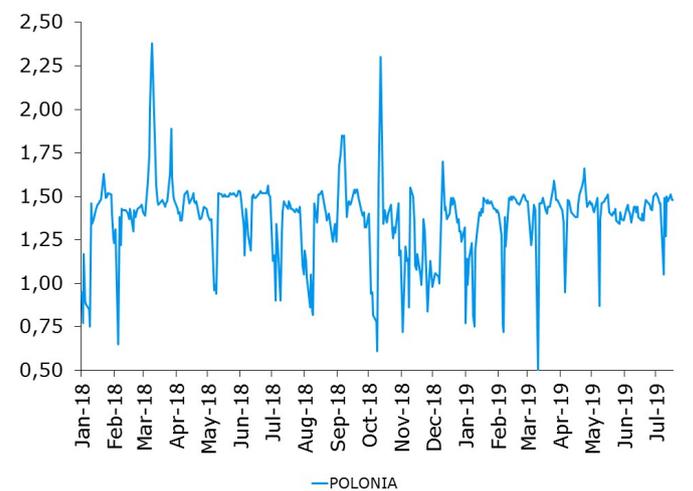
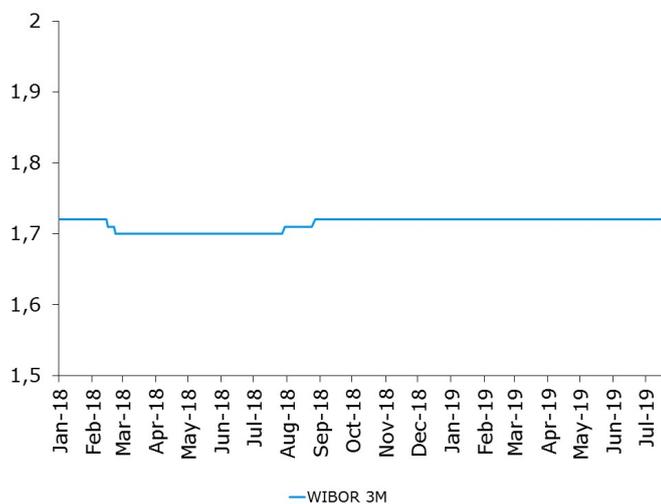
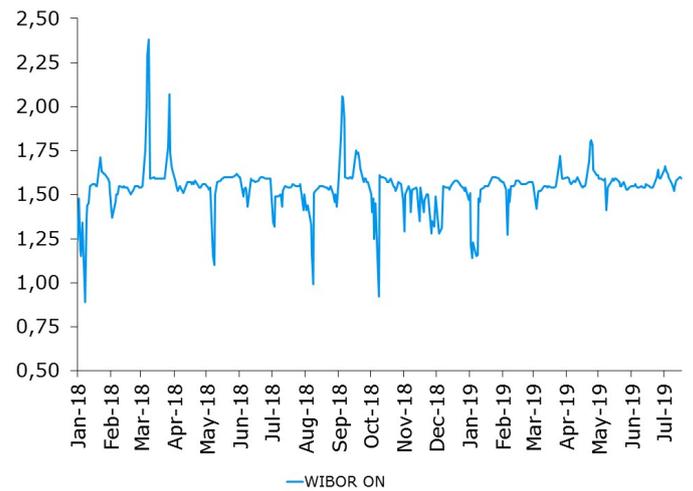
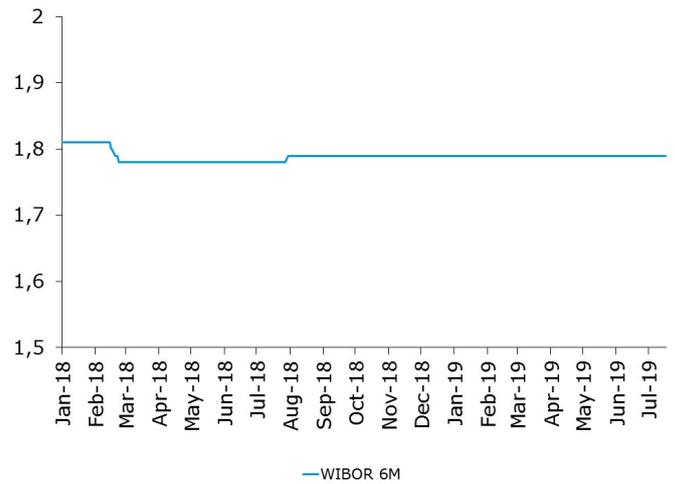
Global markets continue to trade with easing sentiment. This week a few Asian central banks lowered rates following market expectations. Polish curve is extremely flat with 2v5 trading as low as 0bp and 5v10 trading around 9 bp. That's all global. 25bp interest rate cut is priced in in 2y swap as a by-product. Hence, another leg down in global rates would mean the market may price in even more.

Cash stable around 1.50% for the whole week. We have holiday next Thursday although that shouldn't impact market very much.

Ref rate vs Polonia averages:

30 day 6 bp

90 day 8 bp



Forex

Spot – EUR/PLN – weaker but still in the range

EUR/PLN scrambled the top range level hitting on Wednesday 4.3246. Depreciation of the zloty is mostly driven by global sentiment, which is not encouraging lately. The escalation of the trade conflict between the USA and China raises fears of a currency war and serious economic downside risks. This is causing considerable uncertainty on the financial markets. The Polish factor is not really helping neither, with worries over possible outflows in the zloty related to Swiss mortgages, depending on the ruling of European Court of Justice, which is expected within weeks. Nevertheless we still believe in the rangy nature of EUR/PLN. We still look for 4.24-4.34 to cover most of the moves.

Opts – EUR/PLN vols – gapped higher The risk off is in full swing. The vols gapped higher – buyers of gamma and vega were very active on the market. EUR/PLN 1 month ATM mid is today 4.1% (0.6% higher), 3 months are at 4.15% (0.6% higher) and finally 1 year fixed at 4.4% (0.3% higher). The skew was little higher, while the currency spread (difference between USD/PLN and EUR/PLN) is at the same level as week ago.

Short-term forecasts

Main supports / resistances:

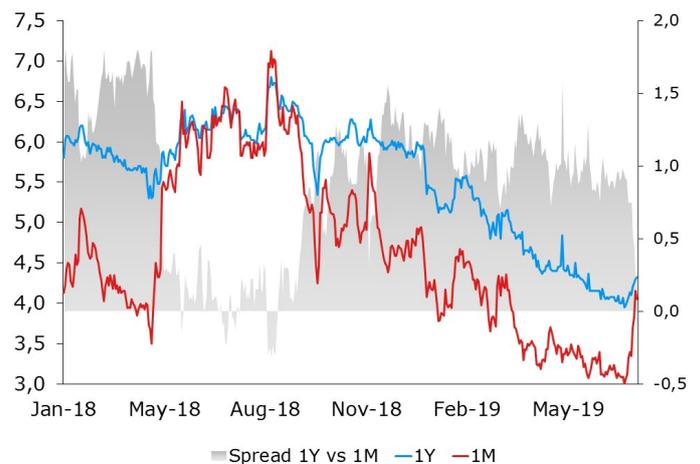
EUR/PLN: 4.2400 / 4.3400

USD/PLN: 3.7000 / 4.0000

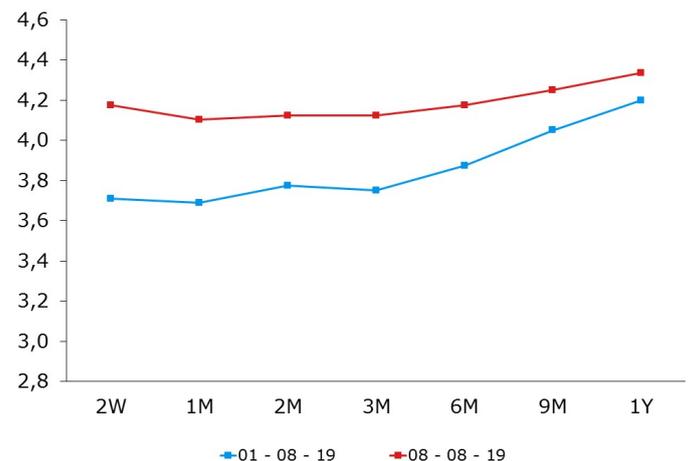
Spot – Current position: Short EUR/PLN

We have small tactical short that was built at average price of 4.3075, with 4.35 stop. The 4.33/4.34 resistance zone seems to be the pivotal level, so we may revisit the levels below 4.30 relatively quickly.

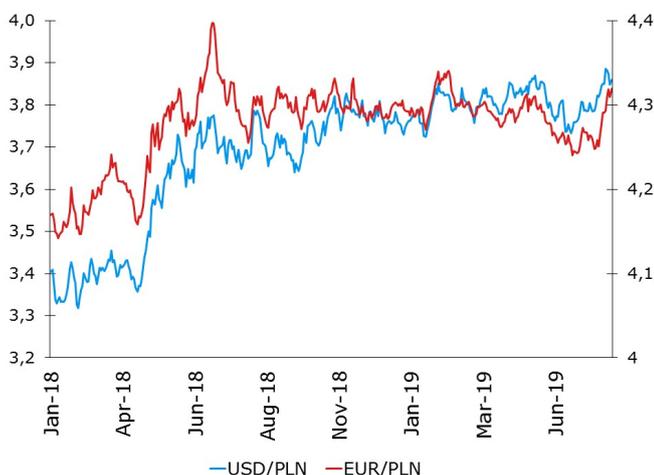
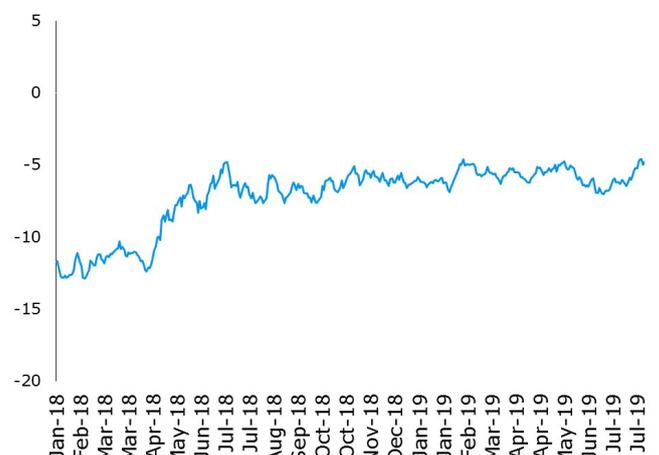
EURPLN volatility



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
8/1/2019	1.59	1.72	1.72	1.69	1.85	1.76	1.72	1.71	1.71	1.70	1.69	1.77
8/4/2019	1.63	1.72	1.71	1.69	1.74	1.76	1.73	1.71	1.71	1.69	1.67	1.77
8/5/2019	1.59	1.72	1.75	1.69	1.88	1.76	1.72	1.72	1.69	1.67	1.64	1.74
8/6/2019	1.50	1.72	1.65	1.69	1.77	1.76	1.72	1.71	1.70	1.68	1.64	1.77
8/7/2019	1.73	1.72	1.76	1.69	1.81	1.76	1.72	1.71	1.69	1.66	1.62	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	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
8/1/2019	1.760	1.213	1.757	1.562	1.818	1.882	2.020	2.202
8/4/2019	1.760	1.184	1.688	1.543	1.757	1.824	1.940	2.095
8/5/2019	1.760	1.131	1.705	1.541	1.717	1.783	1.855	2.040
8/6/2019	1.760	1.127	1.717	1.561	1.747	1.852	1.883	2.090
8/7/2019	1.760	1.136	1.680	1.561	1.685	1.807	1.790	2.014

EUR/PLN 0-delta stradle				25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y
8/1/2019	3.69	3.75	3.88	4.20	4.20	1.29
8/4/2019	3.82	3.88	3.98	4.25	4.25	1.29
8/5/2019	4.15	4.03	4.20	4.30	4.30	1.34
8/6/2019	4.05	4.10	4.19	4.33	4.33	1.35
8/7/2019	4.10	4.13	4.18	4.34	4.34	1.33

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
8/1/2019	4.2931	3.8860	3.9058	3.5623	1.3152	0.1670
8/4/2019	4.3085	3.8829	3.9363	3.6308	1.3149	0.1671
8/5/2019	4.3182	3.8739	3.9724	3.6564	1.3188	0.1675
8/6/2019	4.3096	3.8482	3.9489	3.6160	1.3230	0.1675
8/7/2019	4.3194	3.8597	3.9474	3.6333	1.3280	0.1678

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