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Polish Weekly Review

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Comment on the upcoming data and forecasts

Tomorrow, Statistics Poland will publish final CPI data for August. While the flash estimate was a tad below our forecast (2.8 vs. 2.9% y/y), we see a high chance of an upward revision, based on the details of the flash reading. On the same day the NBP will publish the latest monthly balance-of-payments statistics. We expect CA deficit to widen more than the consensus is currently forecasting along with the trade deficit as exports is set to fall short of expectations. On Monday NBP will publish core inflation reading (we expect 2.1% y/y growth based on CPI flash reading). Two days later Statistics Poland will publish labor market data. According to our forecast, both employment and wages slowed down: employment to 2.6% y/y (due to downward trend in employment dynamics) and wages to 6.7% (effect of negative working days difference and slowdown in mining). On the next day industrial production reading will be published. We expect dynamics of 1.5% – there is a significant risk of 0% result in manufacturing, because of working days, trend and base from the last year. Finally, on Friday Statistics Poland will publish retail sales reading (our forecast 4.0% y/y).

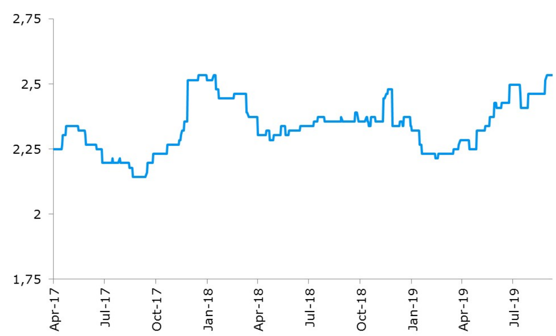
Polish data to watch: September 13th to September 20th

Publication	Date	Period	mBank	Consensus	Prior
CPI y/y *final* (%)	13.09	Aug	2.9	2.9	2.9
Current account balance (m EUR)	13.09	Jul	-765	-334	21
Exports (m EUR)	13.09	Jul	18800	19050	18068
Imports (m EUR)	13.09	Jul	19100	19106	18145
CPI core y/y (%)	16.09	Aug	2.1	2.2	2.1
Average gross wages	18.09	Aug	6.7	6.1	7.4
Empoyment	18.09	Aug	2.6	2.7	2.7
Industrial production	19.09	Aug	1.5	1.2	5.8
PPI	19.09	Aug	0.8	0.8	0.8
Retail sales	20.09	Aug	4.0	5.5	5.7

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	10/3/2019	300	1.445	7/26/2019
5Y T-bond PS1024	10/3/2019	2000	1.823	7/26/2019
10Y T-bond DS1029	10/3/2019	1500	2.100	7/26/2019
30Y T-bond WS0447	10/3/2019	60	3.180	4/25/2019
5Y floater WZ0525	10/3/2019	2500	-	7/26/2019
10Y floater WZ0529	10/3/2019	2100	-	7/26/2019

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



Comment

There were no data releases last week so index remain unchanged. Almost all the relevant readings on Polish economy will be published in the upcoming days, hence we can expect surprise index to change.

* 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 fiscal stimulus will hit consumers' wallets in the second half of the year. However, the protracted weakness in external demand and problems in the construction sector are forcing us to downgrade our GDP growth forecasts. The economy will grow by 4.6% this year (prev. 5.0%) and 4.0% in 2020 (unchanged).
- Core inflation is projected to rise steadily. The combination of high 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. It is more likely to be on the dovish side.
- 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

- Global growth worries, strong dollar and thin liquidity are a toxic combination for the PLN. The result was marked weakening in recent weeks. The worst is over in our view.
- 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	4.6	4.0
CPI Inflation y/y (average %)	-0.9	-0.6	2.0	1.6	2.4	3.1
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

	2019 Q1	2019 Q2	2019 Q3 F	2019 Q4 F	2020 Q1 F	2020 Q2 F	2020 Q3 F	2020 Q4 F
GDP y/y (%)	4.7	4.5	4.5	4.8	4.5	4.2	3.8	3.6
Individual consumption y/y (%)	3.9	4.4	4.4	4.7	4.7	4.2	3.9	3.7
Public Consumption y/y (%)	6.4	3.4	6.4	6.4	4.0	4.0	3.8	3.8
Investment y/y (%)	12.6	9.0	7.5	6.5	4.5	3.5	2.0	2.0
Inflation rate (% average)	1.2	2.4	2.8	3.3	3.7	3.2	2.7	2.7
Unemployment rate (% eop)	5.9	5.2	5.2	5.4	5.5	4.9	4.9	5.1
NBP repo rate (% eop)	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
Wibor 3M (% eop)	1.72	1.72	1.72	1.72	1.72	1.72	1.72	1.72
2Y Polish bond yields (% eop)	1.69	1.61	1.45	1.50	1.55	1.55	1.55	1.55
10Y Polish bond yields (% eop)	2.84	2.39	1.95	2.15	2.40	2.54	2.56	2.58
EUR/PLN (eop)	4.30	4.24	4.30	4.25	4.25	4.25	4.25	4.25
USD/PLN (eop)	3.84	3.73	3.91	3.79	3.76	3.73	3.70	3.66

F - forecast

Economics

The MPC keeps raising the bar for rate hikes

The Monetary Policy Council, as expected, held rates during the September meeting. The post-meeting statement was little changed and the NBP governor made it quite clear that in the face of a global economic slowdown the bar for any rate changes has been set high.

Both the press release and governor's own words indicate that the MPC is expecting inflation to hit the upper side of the target band (3.5% y/y) and not planning to react. Current inflationary pulse is attributed to external and supply factors, which also strengthens the case against any policy adjustment. The inflation spike is seen as temporary and the NBP is expecting inflation to fall below target in July '20 already. Mr. Glapinski was also not worried about the government's ambitious plans to raise the minimum wage (see the other text in this section for more details). Inflation will be lifted by no more than 0.1 p.p. next year and the impact on economic growth is broadly neutral.

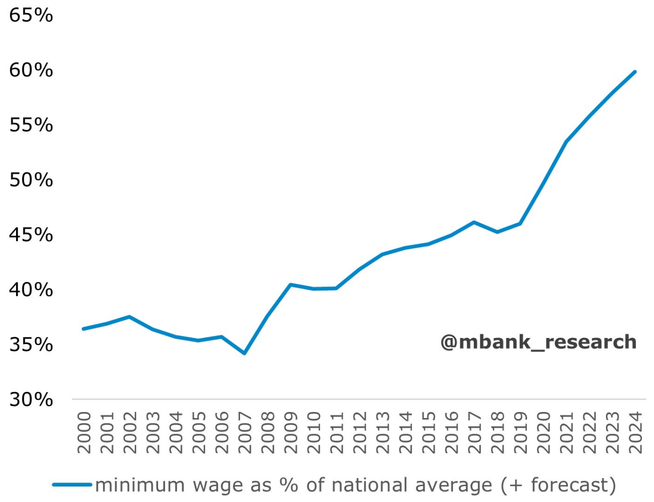
Referring to the July motion to raise rates, the governor suggested that this wasn't repeated in September and left open the possibility that there was a motion to cut rates. Nevertheless, the broad consensus within the Council is for stable rates (7 members for holding rates, 2 for raising, 1 for cutting).

All this suggests that unchanged rates should be the baseline scenario for the NBP. Global context of Polish monetary policy remains the key consideration and anchor for Polish policymakers. With major economies slowing down, inflation drifting away from targets and central banks preparing to launch monetary easing shortly, the MPC is unwilling to swim against the tide. This way, the NBP is betting that Polish exceptionalism (high growth and accelerating inflation) will not last and Poland will realign itself with global disinflationary trends. The more so, since local factors are not seen as inflationary. As a result, one should expect the MPC to be comfortable with an even higher CPI path than the one Mr. Glapinski hinted at. The status quo could only be upended by a durable increase in inflation, but the framework adopted by the Council makes it almost impossible to see that ex ante – we've written about it in July: [1], [2].

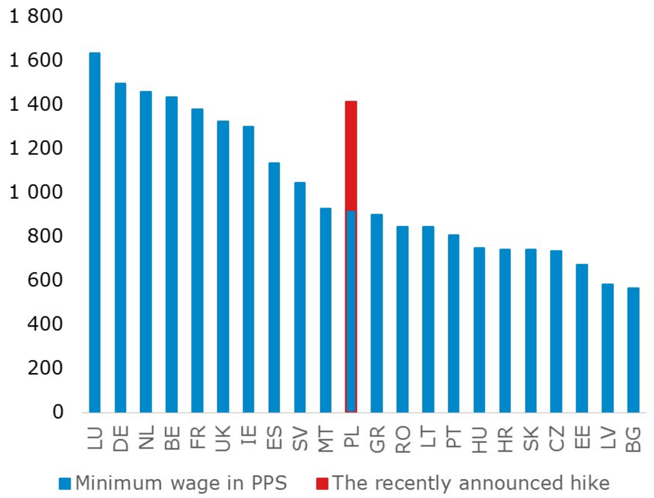
The Great Minimum Wage Experiment

Polish election campaign is now in full swing and the two major coalitions are presenting their economic programmes. Over the past week several proposals have been raised. The most fruitful of the two conventions was the one organized by the ruling PiS party. In addition to the fiscal package, which is being rolled out, additional measures were proposed.

First, the so called "pension bonus" introduced first this year will be made permanent (this was already proposed by the opposition) – note that the draft 2020 budget does not include it – and in 2021 will be topped up by yet another bonus. Second, CAP payments for farmers will be raised to match those received by their counterparts in Western Europe. Third, social security contributions for the self-employed and entrepreneurs will be tied to revenue instead of a lump sum (it was later clarified that this pertains only to those with the lowest revenue). Finally, the statutory minimum wage will be raised aggressively within the next few years and is projected to reach PLN 4000 per month in 2024 (up from PLN 2250 currently). The last proposal grabbed the headlines and deserves a more detailed comment, since it is the most consequential one.



The monthly minimum wage will rise by 78% in nominal terms and will reach ca. 60% of national average in 2024 (from 46% today). This is unprecedented in a lot of ways: Poland will have the highest minimum wage relative to average in the entire OECD; this will be the fastest increase in minimum wage in Poland's history. Exact and up-to-date data is hard to come by, but at present ca. 15% of workforce earns the minimum wage and the pace of the proposed hikes will very likely compress the entire wage distribution and enlarge this group, perhaps twofold. There might be knock-on effects for higher wage earners if wage schedules are tied to the minimum. Therefore, this move could potentially impact an even larger number of employees.



How will this affect the economy?

1. The unprecedented nature of this policy makes it difficult to assess using empirical evidence and the vast majority of estimates (including those for Poland) might not be easily extrapolated. In any case, similar moves in other countries (see the Hungarian example) suggest a complicated picture.
2. The fiscal effect of the minimum wage hike is clearly positive. In current circumstances, the 100 PLN hike in minimum wage generates ca. PLN 1.4 bn in general govern-

ment revenue from PIT and social security contributions. Additional public expenditures on wages and outsources services likely reduce this.

3. The full impact on the enterprise sector will play out over time and will be highly concentrated, i.e. impact low-wage regions and low-productivity sectors and companies the most. It will make some business models (e.g. average wage in the textile industry in Poland is a tad above the proposed 2021 minimum wage) obsolete and force consolidation and reallocation of resources over the medium term.
4. There is some speculation that it will foster business investment and accelerate automation in labor-intensive sectors. There are reasons to doubt this Panglossian interpretation. In particular, locally-owned enterprises and SMEs did not increase their investment in recent years in reaction to rapidly rising labor costs, and lagged behind foreign-owned ones. It remains to be seen whether this push will change their behavior.
5. Higher minimum wage should raise labor participation by attracting individuals of higher threshold wage (thereby negating the impact of higher social spending). To further attest to that, consider that Poland will have one of the highest minimum wages in purchasing power terms (see the graph above).
6. There will be job losses and bankruptcies in sectors and regions most exposed to the shock and / or least able pass higher costs onto their customers. The net impact on unemployment and employment will be determined by the interaction between the last two effects. Keep an open mind.
7. Some portion of the increased labor cost will be passed on to customers. The Hungarian example cited earlier suggest that as much as 75% of the minimum wage hike will be reflected in prices. This, in turn, implies a more persistent increase in core inflation than previously forecast. Back of the envelope calculations suggest a roughly 1% cumulative impact on GDP deflator by 2024.

To sum up, the government has picked up the gauntlet and raised the pre-election stakes. It is happening, however, with relatively muted impact on public finances, but implications for the economy are potentially much more profound. We will be updating our Readers on any changes in these plans.

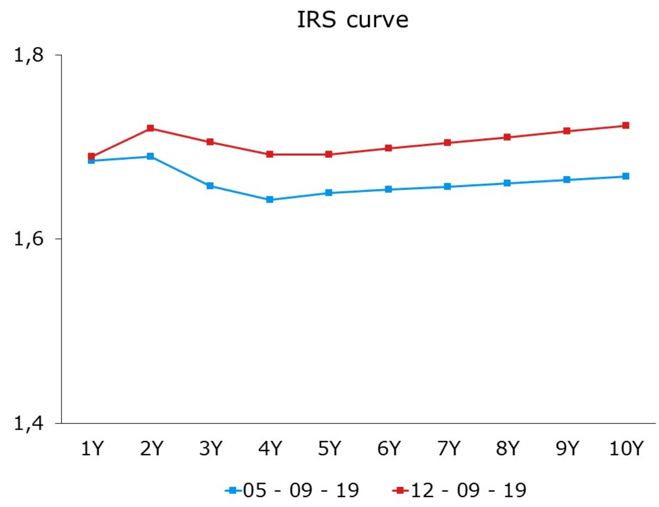
Fixed income

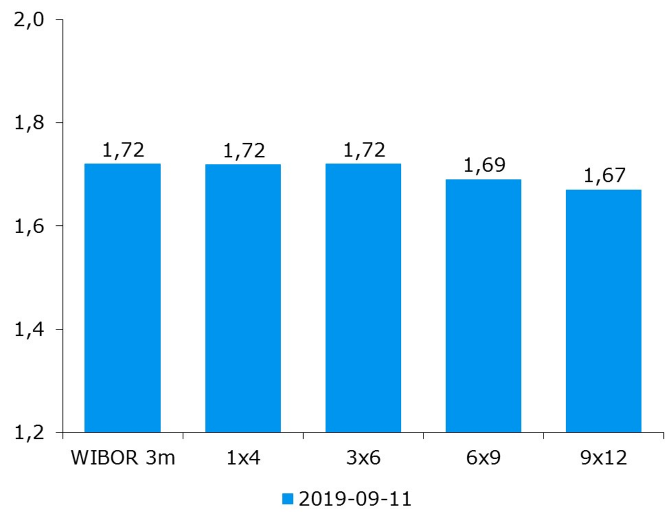
Following core markets again

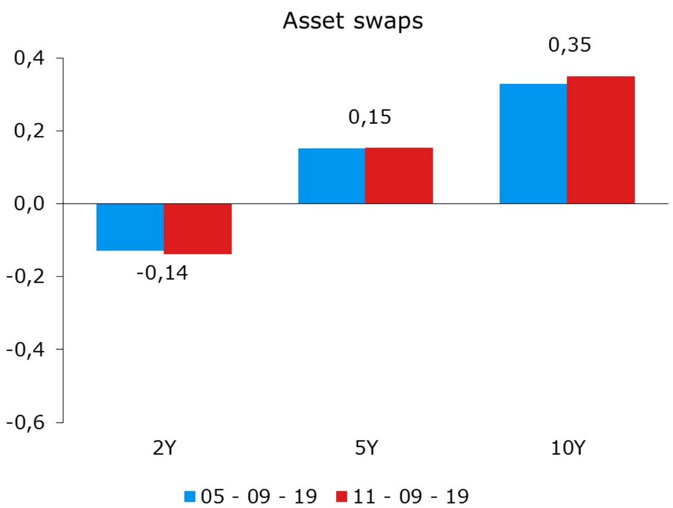
We touched 2.18% on DS1029 and it's 20 bps lower now. We are follow core markets again. I's not easy to predict where the market will move, ECB is behind us, the FOMC is meeting next Wednesday. Next week we have a switching auction in Poland. We'll see which way the market moves.

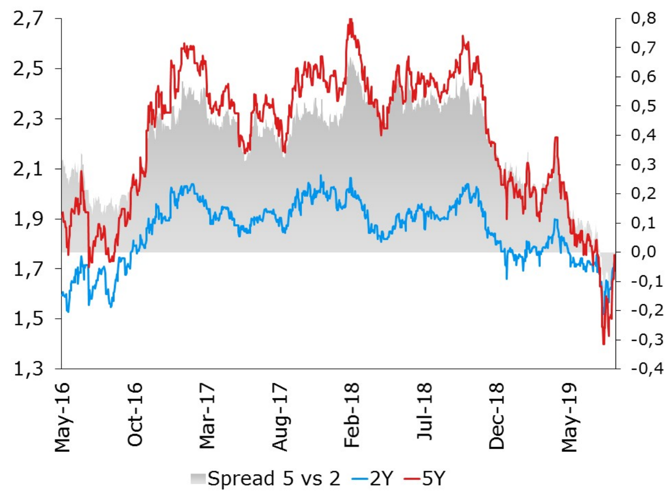
PS1024/5y is 12 bps, DS1029/10y is 30 bps. PS1024/DS1029 is 19 bps DS1029/Bund is 250 bps.

DS1020 is trading at 1.27% (3 bps down), PS1024 is trading at 1.77% (1 bps up) and DS1029 is trading at 1.96% (2 bps down)









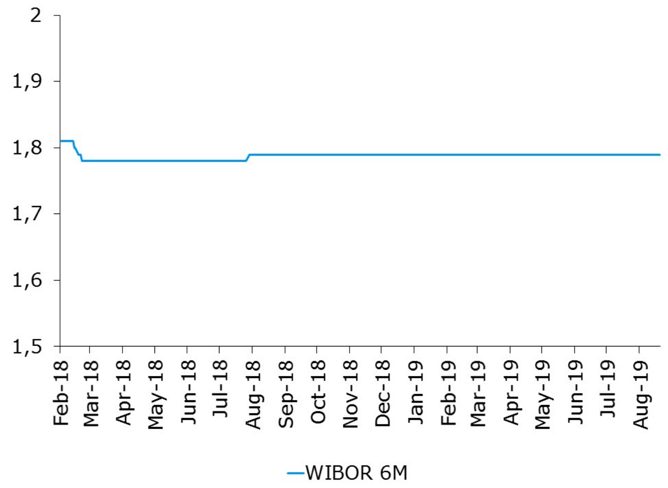
Money market

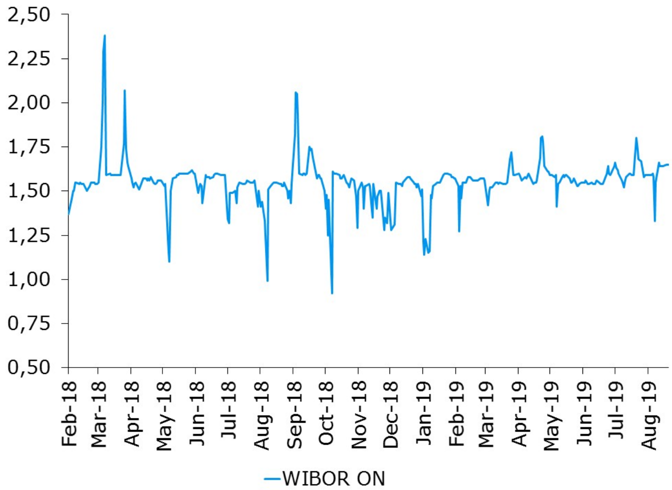
Upward correction

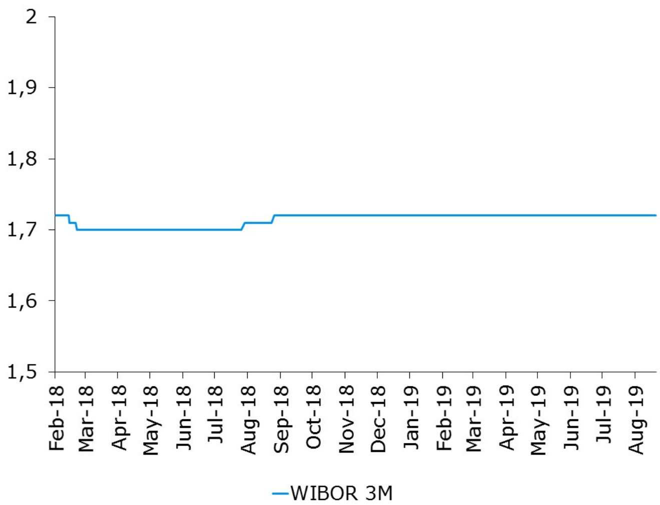
Last week brought a pretty drastic upward move on Polish rates. Suddenly everyone forgot about the "coming rate cuts" and we had a massive unwind of receiver positions. We reached 1.80% which proved to be the resistance. That's close to current 3m Wibor, also the a level where we used to hover before the global slide in yields this summer. Absent a new impulse, somewhere around here the new range might be established.

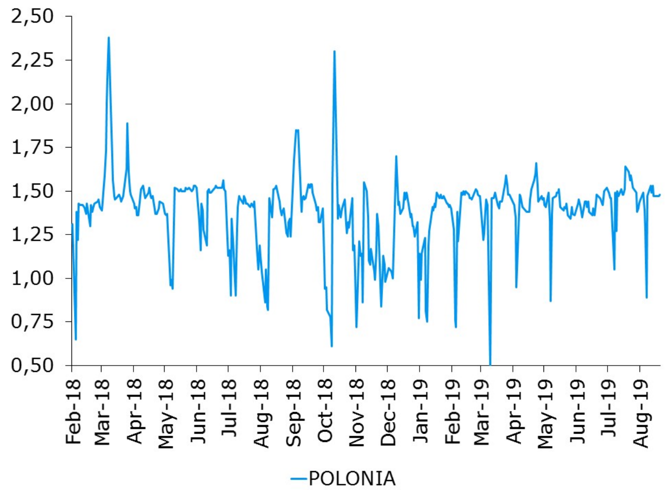
Cash rates were rather high last week. Tomorrow's OMO will set the tone for the next week.

Ref rate vs Polonia averages:
30 day 6 bp
90 day 8 bp



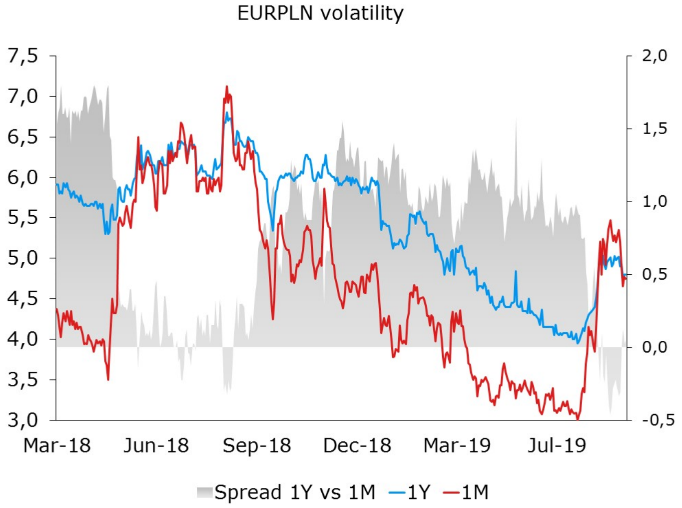






Forex

EURPLN – consolidation Last week EUR/PLN was locked in a narrow 4.3310-4.3420 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 as well as the next week FOMC meeting, both of which are expected to dictate the tempo for currencies in coming months. We already know that the ECB was very dovish and that should support the PLN going forward...



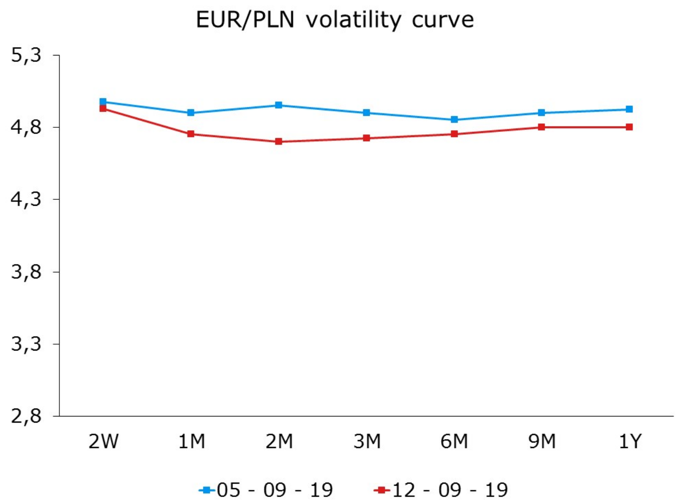
Opts: Implied volatility sliding. Next days seem to be packed with events, including the ECB and the FOMC. As the result, we started the week with a decent bid for gamma, especially in USD/PLN (1 week vol mid is 10%). However the EUR/PLN vol curve is very stable. EUR/PLN 1 month ATM mid fixed today at 4.75% (0.05% lower than week ago), 3 months EUR/PLN are 4.7% (0.1% lower) and 1 year is 4.7% (0.2% lower). The skew and the currency spread (difference between USD/PLN vol and EUR/PLN vol) are at same level as week ago.

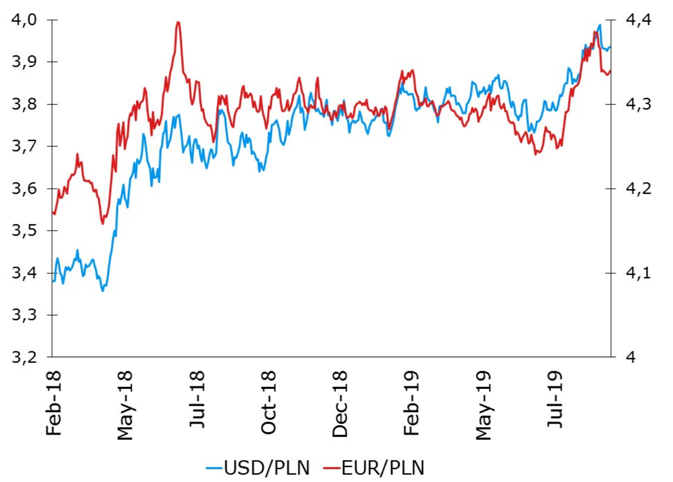
Short-term forecasts

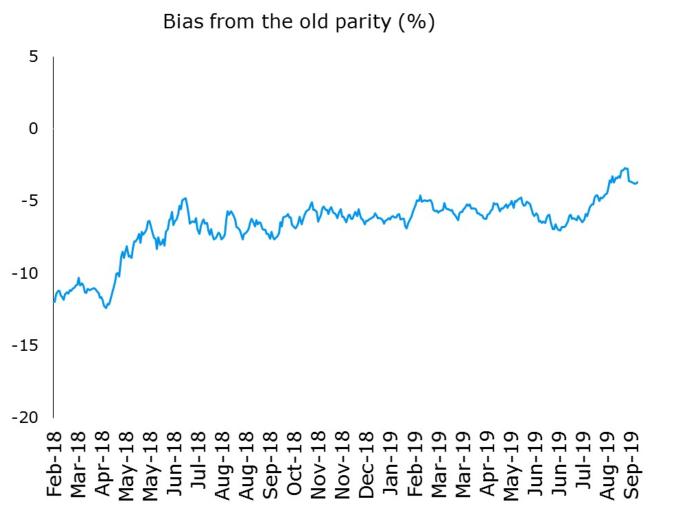
Main supports / resistances:
EUR/PLN: 4.3000 / 4.4000
USD/PLN: 3.7000 / 4.0000

Spot – Long EUR/PLN at 4.34

Our stop loss level 4.31 is still active. EUR/PLN is trading around 4.34 and can't break 4.33. It seems the market is sold out on this level, therefore we hope to see again 4.37/4.38. Generally, we still believe in range trading in EUR/PLN. Our strategy is unchanged, playing the range 4.33-4.38, ideally from the short PLN 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
9/5/2019	1.60	1.72	1.70	1.69	1.80	1.75	1.72	1.71	1.67	1.64	1.58	1.72
9/8/2019	1.68	1.72	1.73	1.69	1.78	1.75	1.72	1.71	1.68	1.66	1.61	1.74
9/9/2019	1.61	1.72	1.67	1.69	1.74	1.75	1.71	1.71	1.70	1.69	1.67	1.76
9/10/2019	1.61	1.72	1.66	1.69	1.73	1.75	1.71	1.72	1.70	1.69	1.67	1.77
9/11/2019	1.68	1.72	1.76	1.69	1.83	1.75	1.72	1.72	1.69	1.67	1.65	1.74

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
9/5/2019	1.750	1.282	1.690	1.563	1.650	1.801	1.668	1.996
9/8/2019	1.750	1.269	1.705	1.563	1.660	1.813	1.683	2.012
9/9/2019	1.750	1.278	1.735	1.562	1.730	1.876	1.750	2.088
9/10/2019	1.750	1.300	1.745	1.563	1.755	1.940	1.775	2.168
9/11/2019	1.750	1.243	1.720	1.583	1.692	1.845	1.724	2.073

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
9/5/2019	4.90	4.90	4.85	4.93	4.93	1.47	0.36
9/8/2019	4.65	4.75	4.73	4.78	4.78	1.47	0.36
9/9/2019	4.78	4.73	4.73	4.80	4.80	1.48	0.35
9/10/2019	4.75	4.73	4.70	4.80	4.80	1.47	0.35
9/11/2019	4.75	4.73	4.75	4.80	4.80	1.47	0.35

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
9/5/2019	4.3409	3.9330	4.0021	3.6909	1.3174	0.1679
9/8/2019	4.3392	3.9315	3.9753	3.6726	1.3156	0.1679
9/9/2019	4.3373	3.9310	3.9688	3.6744	1.3145	0.1677
9/10/2019	4.3350	3.9273	3.9620	3.6601	1.3092	0.1676
9/11/2019	4.3357	3.9324	3.9572	3.6491	1.3049	0.1677

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