September 26, 2019

Polish Weekly Review

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Comment on the upcoming data and forecasts

Tuesday brings flash inflation reading and PMI, both for September. As for the former, we see a quite decent drop in headline CPI driven by food (shifted seasonality in vegetables and fruits) and fuel prices. It might have been more pronounced if substantial base effects in core categories (tobacco, telecommunication) were absent. They are present, though, and core accelerates along with falling headline reading. Just an hour earlier the new reading on manufacturing pulse sees the light. We see a downward move lead be weaker PMI abroad and worse local business activity indicators published by other providers. The story that PMI overestimates the scale of the downturn by a wide margin is still valid, though. Finally, on Wednesday, MPC is going to announce its rate decision. The reaction function of majority of the Committee implies that the more pronounced the risk to real sphere, the less relevant core inflation is. We see a drift towards even more dovish stance. However, it would be fully contained to the wording during the conference, not the statement itself.

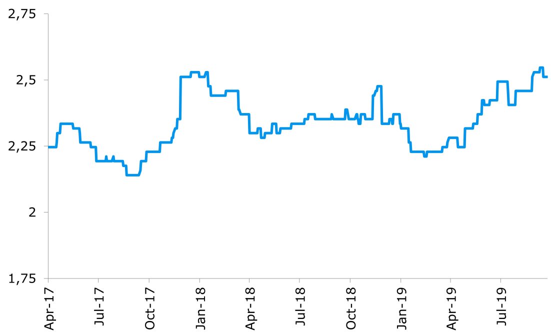
Polish data to watch: September 27th to October 4th

Publication	Date	Period	mBank	Consensus	Prior
PMI (pts.)	1.10	Sep	47.5		48.8
CPI y/y (%)	1.10	Sep	2.6		3
MPC decision (%)	2.10	2.10	1.5	1.5	1.5

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

Retail sales and construction output were in line with consensus forecasts so surprise index did not change. This week flash CPI and PMI for September can move the index.

* 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 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	2.7	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	4.35	4.30	4.25	4.25	4.25	4.25
USD/PLN (eop)	3.84	3.73	3.95	3.87	3.79	3.76	3.73	3.70

F - forecast

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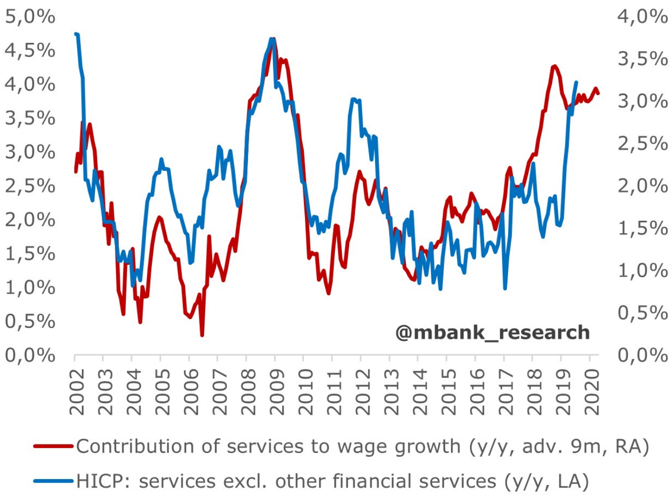
Economics

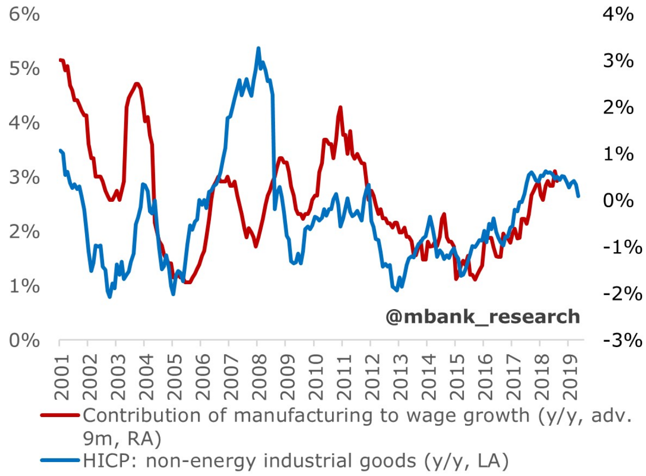
Signs of stability in underlying inflation picture

Next week Statistics Poland will publish the flash estimate of September inflation. It is set to become the first reading in many months with a more pronounced deceleration of overall consumer prices. Our forecast (2.6%) assumes a monthly decline in food and fuel prices (the former atypical) more than compensating for another increase in core inflation (to 2.4%).

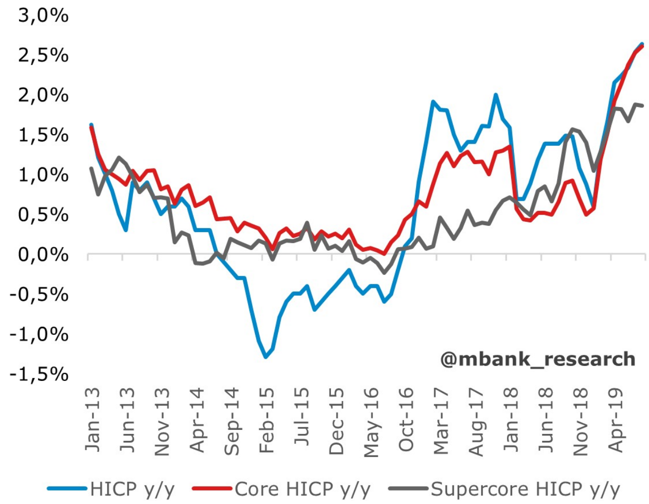
Full details of September print will not be made available until mid-October. However, we can slice and dice recent inflation prints to look for further clues. The non-core items are at the same time important and irrelevant for the broader picture (outsized weight in daily purchases and expectation formation vs. impact of supply shocks), we'll limit ourselves to commenting that the impulse from food prices appears to be waning, in no small part due to seasonal items and a slowdown in processed foodstuffs. Core inflation, as our readers are probably aware, reached a fresh 7-year high in August. Services prices remain the key driver there – the acceleration there has been broad-based and durable this year, but there is some positive contribution from more stable categories like refuse collection and telecommunications. Netting out financial services, HICP services are already growing by 4.1% y/y (10.5-year high!). In hindsight, the behavior of services should not come as a surprise given the strength of the labor market and steady nominal wage growth, but the reaction came later than we originally assumed. Because of this, one should assume that some price hikes were likely pent-up in 2018 and only now we are catching with wages (see the graph below). Using the same forward-looking relationship, we can now conclude that the upside in services price is limited at best, especially in the market-driven part.



Core goods are no longer in deflation, but their contribution to recent inflation increases was much smaller. The relationship with manufacturing wages is more tenuous than in the case of services, but it points to deceleration ahead nonetheless. Given the direction PPIs, intermediate good prices, yuan devaluation and manufacturing sentiment are all pointing to, it seems to be a reasonable assumption.



In one of our previous reports, we've presented a suite of "supercore" inflation indices, which stripped core inflation of several categories which we find susceptible to one-off factors or short-term fluctuations associated with oligopolistic market behavior. The "supercore" inflation has stabilized in recent months at ca. 1.8% y/y and the divergence vis-a-vis the overall core can be attributed to e.g. hikes in telecommunication prices. We can conclude from this that the underlying price pressure remained constant over the past months.



What lies ahead? As noted, food price growth likely peaked and will put downward pressure on headline inflation next year due to massive (high) base effects. Base effects (low) in electricity prices and motor fuels will counteract this at the turn of the year. At the same time, one should start looking for signs of stabilization in core categories. The overall path of inflation is one of temporary upshot in Q1 and return to target by the end of 2020. Durability of recent inflationary episode is also in question in light of weaker business environment and slowing growth, as already internalized by the MPC in their baseline scenario. As a result, stable rates are still the most likely path for Polish monetary policy – recent hike (in July) and cut (in September) motions must be seen as dissents of the hawkish and ultra-dovish minority, respectively.

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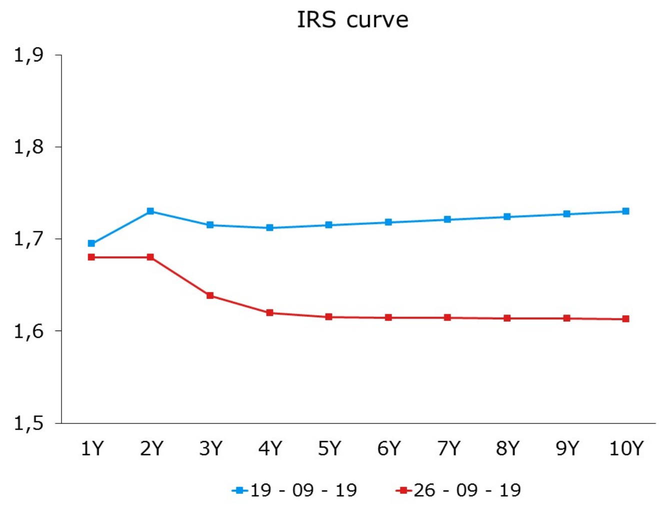
Fixed income

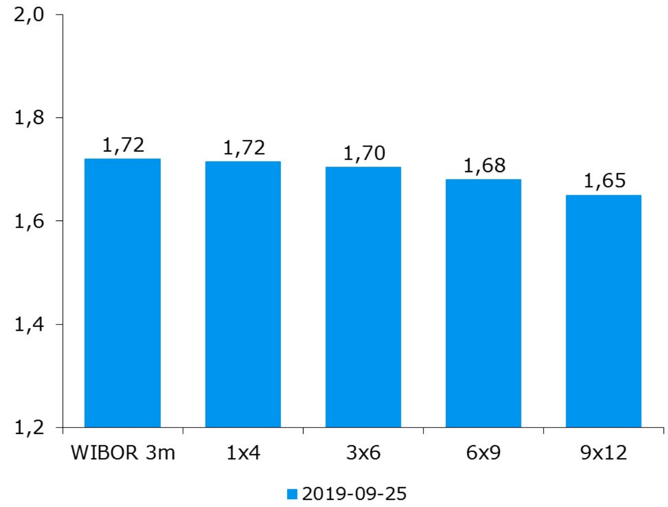
Global players flattened the curve

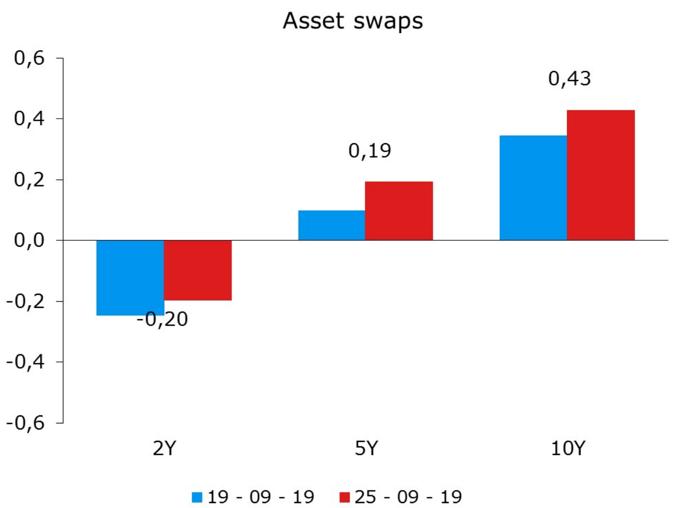
During the week we saw some take profit-taking behavior on ASWs which led them to widen a bit. Yield curve flattened slightly as fears of global recession attract bids on long-end.

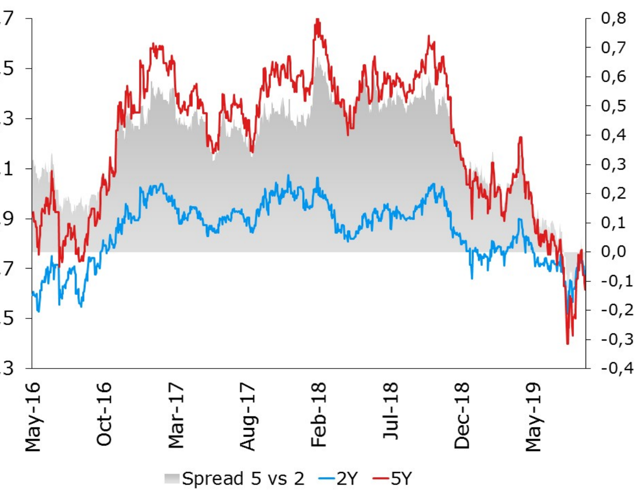
PS1024/5y is 16bps, DS1029/10y is 36bps. PS1024/DS1029 is 22bps DS1029/Bund is 259bps.

DS1021 is trading at 1.47% (5bps up), PS1024 is trading at 1.79% (2bps down) and DS1029 is trading at 2.00% (8bps down).









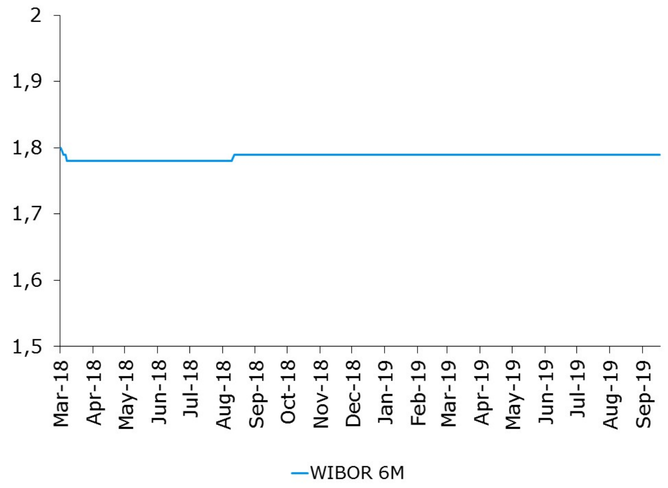
Money market

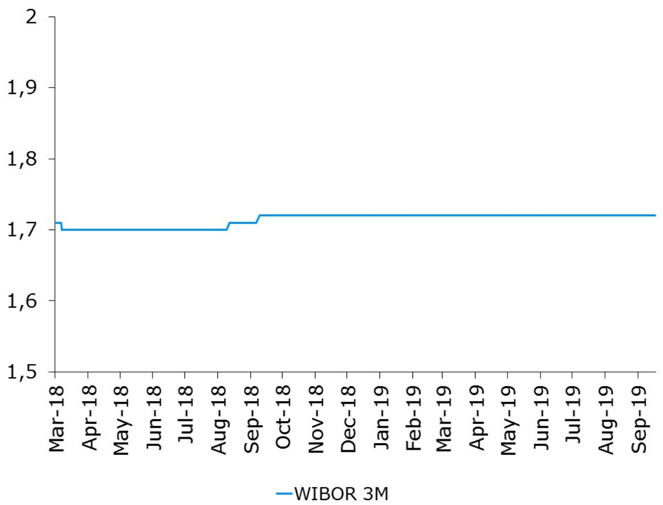
With MPCs like these, what can you do?

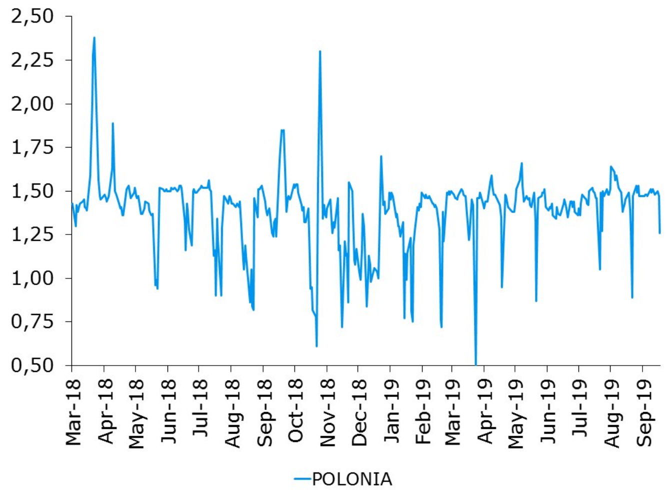
Polish rates fell last week following core markets. With the MPC committed to keep rates stable for an extended period, market participants are not likely to make strong directional bets. Asset swaps widened a bit which might be justified with local risks rising (elections, CHF loan verdict) .

Overnight rate was a bit lower after last OMO. Tomorrow we have the last day of the reserve period with two OMOs, therefore rates will be back to 1.50%.

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







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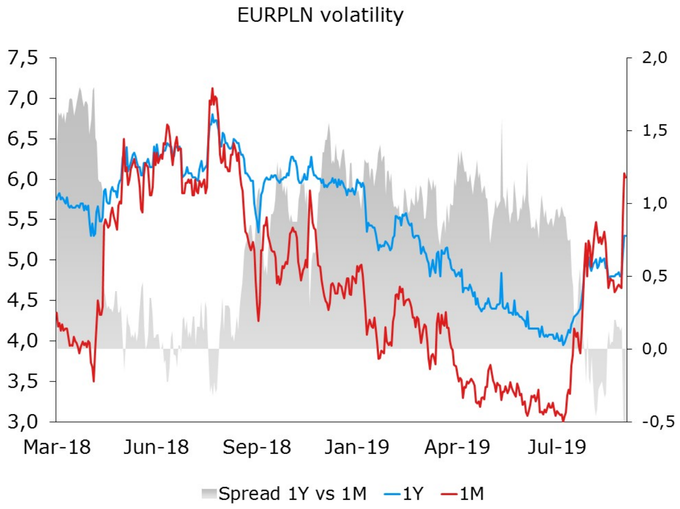
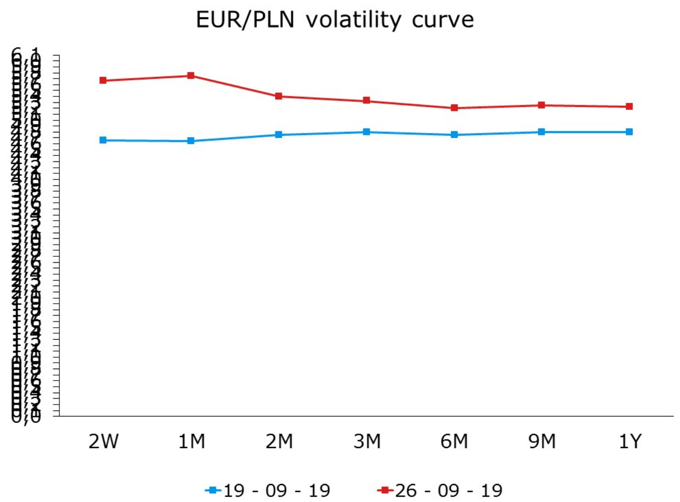
Forex

EURPLN – Zloty weaker On Monday EURPLN spiked to near 4.40 and USDPLN to 4.01, as a result of quoting the date of EU Court of Justice ruling on the FX-loans, scheduled for the 3rd of October. The zloty stays under pressure also because of global factors: weak German Manufacturing PMI data, which raised new fears of a slowdown in global growth, the trade war issue and Brexit worries. Anyway EUR/PLN was not able to break 4.40 so far, constituting the triple top formation. If a break occurs, it should trigger further PLN sell-off.



Opts: – EUR/PLN vols – gapped higher The risk off on Zloty is in full swing. The vols gapped higher – buyers of gamma were very active on the market. Especially there was big demand on the tenors after date of ECJ ruling on the FX-loans: 2w EURPLN atm was traded at 6.9% EUR/PLN. 1 month ATM mid is today 5.6% (almost 1.0% higher), 3 months are at 5.1% (0.4% higher) and finally 1 year fixed at 5.2% (0.5% higher). The skew as well as the currency spread (difference between USD/PLN and EUR/PLN) are also higher than week ago.

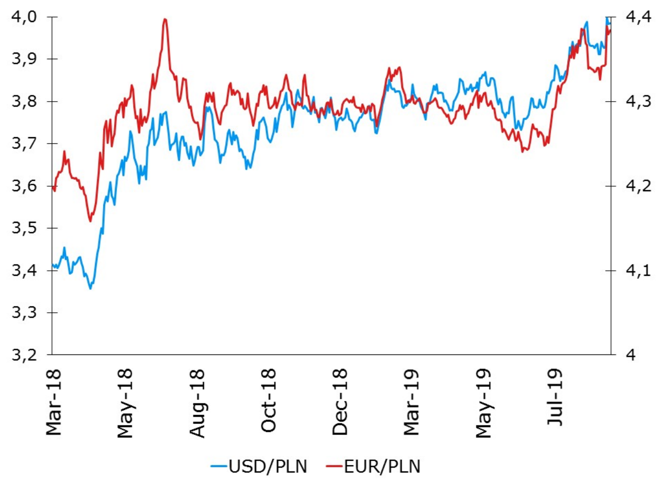


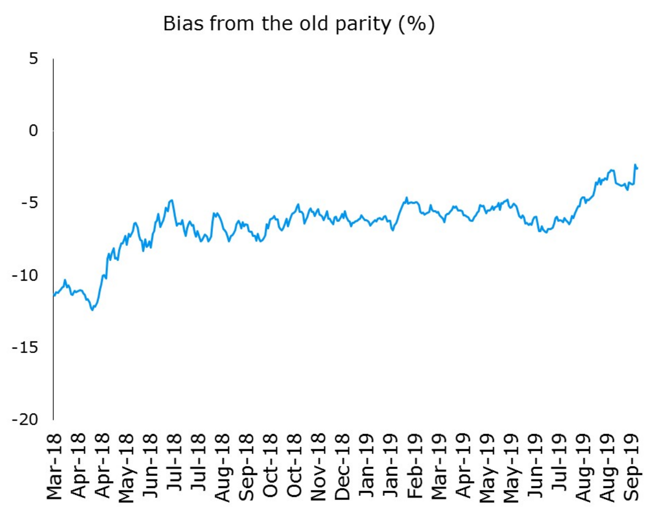
Short-term forecasts

Main supports / resistances:
EUR/PLN: 4.3000 / 4.4000
USD/PLN: 3.8000 / 4.1000

Spot – Current position: None

It was a good week for long EUR position. We cashed our position at 4.3920. The EU Court of Justice verdict and the sentiment of the global market shall continue to play the main role on the domestic market. If the verdict is not be too negative for the Polish banking system, we expect EURPLN to stay in the 4.32/4.40 range in the week to come. We prefer to be sideways at this moment, just in case.





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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
9/19/2019	1.59	1.72	1.64	1.69	1.79	1.74	1.72	1.71	1.69	1.67	1.64	1.74
9/22/2019	1.60	1.72	1.65	1.69	1.81	1.74	1.72	1.70	1.67	1.66	1.62	1.75
9/23/2019	1.62	1.72	1.69	1.69	1.81	1.74	1.72	1.71	1.68	1.66	1.61	1.73
9/24/2019	1.58	1.72	1.66	1.69	1.74	1.74	1.71	1.70	1.67	1.64	1.61	1.72
9/25/2019	1.73	1.72	1.79	1.69	1.86	1.74	1.72	1.70	1.68	1.65	1.61	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	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
9/19/2019	1.740	1.242	1.730	1.485	1.715	1.813	1.730	2.074
9/22/2019	1.740	1.257	1.710	1.467	1.675	1.801	1.683	2.038
9/23/2019	1.740	1.260	1.671	1.467	1.670	1.817	1.673	2.045
9/24/2019	1.740	1.231	1.692	1.478	1.643	1.824	1.661	2.050
9/25/2019	1.740	1.267	1.680	1.484	1.615	1.808	1.613	2.040

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
9/19/2019	4.65	4.80	4.75	4.80	4.80	1.40	0.43
9/22/2019	5.53	5.30	5.15	5.08	5.08	1.40	0.43
9/23/2019	6.08	5.48	5.30	5.30	5.30	1.53	0.36
9/24/2019	6.03	5.50	5.33	5.30	5.30	1.63	0.37
9/25/2019	5.75	5.33	5.20	5.23	5.23	1.60	0.36

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
9/19/2019	4.3425	3.9267	3.9612	3.6354	1.3053	0.1678
9/22/2019	4.3438	3.9319	3.9668	3.6424	1.3064	0.1677
9/23/2019	4.3891	3.9983	4.0399	3.7242	1.3105	0.1695
9/24/2019	4.3796	3.9838	4.0219	3.7010	1.3062	0.1694
9/25/2019	4.3844	3.9856	4.0437	3.7134	1.3110	0.1695

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