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Polish Weekly Review

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Comment on the upcoming data and forecasts

A light week ahead of us. Next Friday, the Moody's and S&P will review Poland's sovereign ratings. We do not see any changes to the ratings or the outlook. The agencies, in a forward-looking manner, will likely want to see how Poland's public finances would fare in weaker macroeconomic environment.

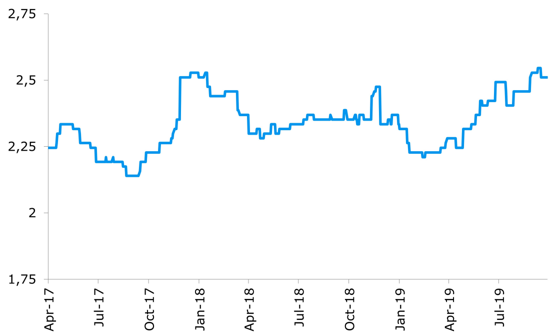
Polish data to watch: October 4th to October 11th

Publication	Date	Period	mBank	Consensus	Prior
S&P rating review	11.10	Oct			
Moody's rating review	11.10	Oct			

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	11/7/2019	300	1.445	7/26/2019
5Y T-bond PS1024	11/7/2019	2000	1.823	7/26/2019
10Y T-bond DS1029	11/7/2019	1500	2.100	7/26/2019
30Y T-bond WS0447	11/7/2019	60	3.180	4/25/2019
5Y floater WZ0525	11/7/2019	2500	-	7/26/2019
10Y floater WZ0529	11/7/2019	2100	-	7/26/2019

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



Comment

PMI didn't surprise significantly, but flash CPI was below expectations and, hence, lowered the Polish surprise index. No macro releases are scheduled for next week.

* 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 is set to slow down considerably next year. We have revised our 2020 forecasts from 4.0 to 3.2%. Waning effects of fiscal stimulus, unfavorable EU spending calendar, retrenchment of local government investment and weaker investment outlook are to blame. That being said, consumption will remain very resilient and this makes all the difference compared to 2011-2013 cycle.
- Core inflation is at multi-year high, but there is limited space for further acceleration. The pass-through from wages is working in services, but wage growth has stabilized there. In addition, deflation is likely to return to core consumer goods given the global envirnoment.
- 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 risks are to the downside.
- This year's fiscal deficit is set to widen due to brisk expenditure growth. Next year's balanced budget proposal is not realistic given the already announced spending (pension bonus made permanent) and ambitious revenue targets. Actual deficit will be small, though.

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 more or less stable 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. However, slowdown is slowdown and as the risks for monetary policy are tilted to the downside, the same applies to PLN valuation.

mBank forecasts

	2015	2016	2017	2018	2019 F	2020 F
GDP y/y (%)	3.8	3.0	4.8	5.1	4.5	3.2
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	4.3	4.3	3.9	3.5	3.0	2.5
Individual consumption y/y (%)	3.9	4.4	4.6	5.0	4.6	4.2	3.4	2.8
Public Consumption y/y (%)	6.4	3.4	5.0	5.0	3.0	3.0	3.0	3.0
Investment y/y (%)	12.6	9.0	6.0	5.0	2.0	2.0	0.0	0.0
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	1.52	1.51	1.55	1.55	1.55	1.55
10Y Polish bond yields (% eop)	2.84	2.39	2.00	1.95	2.10	2.24	2.27	2.30
EUR/PLN (eop)	4.30	4.24	4.37	4.35	4.35	4.40	4.40	4.40
USD/PLN (eop)	3.84	3.73	4.01	4.03	3.95	3.93	3.86	3.83

F - forecast

Economics

Polish MPC closes the door for rate hikes

In line with expectations, the October meeting of the Monetary Policy Council brought no changes to NBP's interest rate policy. The post-meeting statement was merely adjusted to account for the recent data releases.

The press conference was dominated by the ECJ ruling regarding CHF-indexed loans, but monetary policy matters and outlook for GDP and inflation were also featured heavily. The MPC maintains a fairly optimistic economic outlook and sees economic growth at no risk of falling below the "safe" level of 3-3.5% within the forecast horizon. The inflation outlook is very similar to what private forecasters are drawing: CPI will spike in Q1'20, reach 3.5% or slightly more and then fall back towards the target by mid-year. In these circumstances governor Glapinski maintained his preference for stable rates until the end of his term (i.e. mid-2021). At the same time, the case for rate hikes is getting progressively weaker, he said. In our opinion, in light of these statement and the inflation outlook, the doors to rate hikes must be seen as closing. For market participants and forecasters this has for long been obvious. If the upcoming uptick in inflation does not force the MPC to raise rates, nothing will, since global trends and the return of inflation to target are likely to make the hawk's case completely groundless.

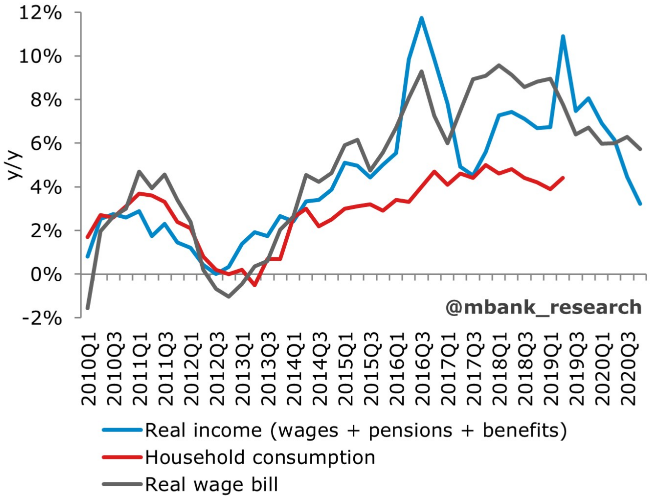
At the same time, the governor was equally cautious regarding rate cuts and even non-standard easing tools. Reading between the lines – the current level of interest rates in Poland does not constitute a floor and the MPC has ample room for conventional monetary easing if a need for such arises. One has to note that the MPC's baseline scenario might be too optimistic regarding growth and might underestimate the extent of the slowdown in 2020-2021. This is unlikely to alter the consensus within the MPC, but the risks to current rate path are clearly asymmetric and tilted to the downside. Expectations of monetary easing might intensify next year.

We are cutting 2020 growth forecast from 4.0 to 3.2% y/y

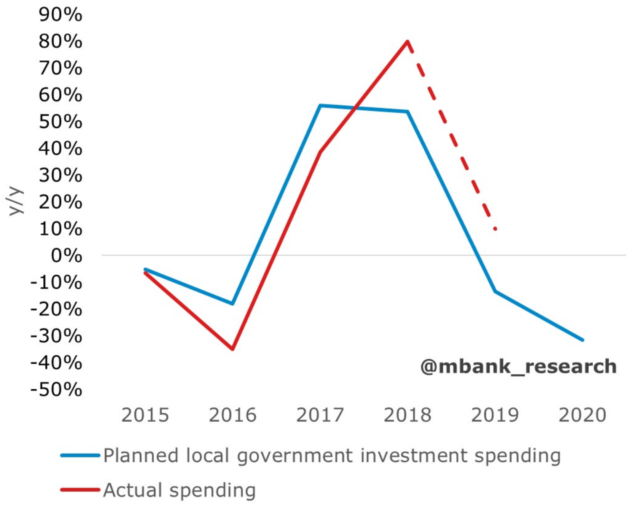
After several weeks of downside risks building up, the outlook for 2020 has deteriorated sufficiently enough to warrant a major downgrade of growth forecasts. It is less about the starting point and more about the domestic drivers of economic growth.

Before we delve into the details, we would like to correct one common misconception. Poland has not been immune to the Eurozone slowdown. On the contrary, economic growth has been slowing since late 2017 and business sentiment has been trending down since January 2018. Polish industry has slowed down mostly in lockstep with German one, but the overall deterioration was less pronounced and the Q1 bounce in industrial output was stronger in Poland. Industrial structure less exposed to external demand shocks, fiscal stimulation, sky-high consumer sentiment and EU-financed public investment all helped to insulate Poland from the worst of the current global slowdown. However, not all of the above factors will continue to work in 2020. Our current nowcasts point to GDP growth slowing from 4.5% y/y in Q2 to 4.2-4.3% in Q3. The bulk of stimulus-related spending will occur in Q4 and that will lift consumption growth and hence GDP growth back up at the end of the year. Overall, 2019 growth will be close to 4.5%. 2020 is a different story, though.

First, household consumption will remain the key engine of economic growth. Therein lies the key difference of current cycle with the 2011-2013 period and one quick look at real wage growth should convince consumer skeptics of this. However, real income growth is likely to slow down in 2020 considerably since nominal wage growth is set to decline somewhat following every labor demand and hiring intention metric available. The minimum wage hike in January 2018 will raise wage growth by 1-1.5 percentage point, but it won't change the trend (unclear to what extent it will affect workers earning above the new minimum – this is an upside risk). Moreover, the below-inflation revaluation of pensions and benefits and the roll-off of current stimulus from y/y income growth will push overall household income growth downwards, effectively halving it in several months. Consumption smoothing will occur, but it nevertheless points to sub-4% consumption growth in 2019.



Second, investment outlook is also deteriorating. The biggest elephant in the room is local government investment spending, which will (according to latest plans) decline by 30% compared to the current year. This will create a drag of 4 p.p. on overall investment. Other parts of public investment universe are also looking weak – the EU-financed cycle has simply turned around and their contribution to growth will decline. Even though the current cycle is somewhat delayed compared to the previous one, there is little indication that the gas pedal will be pushed to the floor next year. This is not a new fact. However, it occurs in a more demanding business environment. Finally, private investment will be buoyed by foreign-owned companies until mid-year, but weaker demand outlook and higher operating costs of businesses are likely to impact the willingness and the capacity of the domestic business sector to invest. Overall, we wouldn't be surprised if total investment declined in the second half of the year.



Paradoxically, foreign demand might lend Poland a helping hand. We are assuming that global growth will be somewhat higher (but no surge) in 2020 due to the delayed effects of monetary and (in some countries) fiscal stimulus. That, coupled with lower imports, will lift net exports into positive territory. We do not expect fireworks, though.

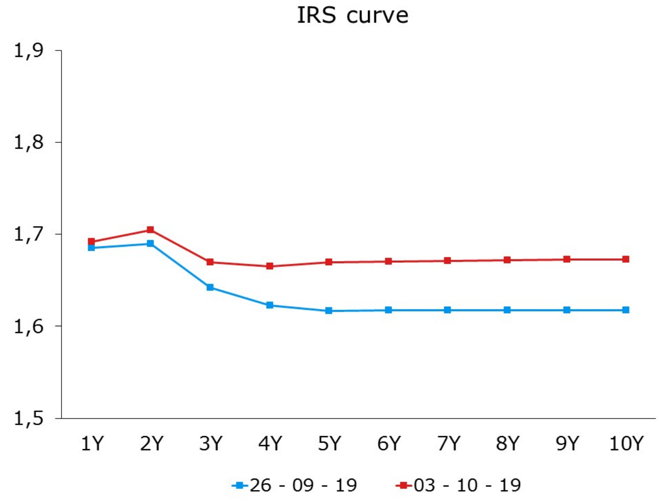
Fixed income

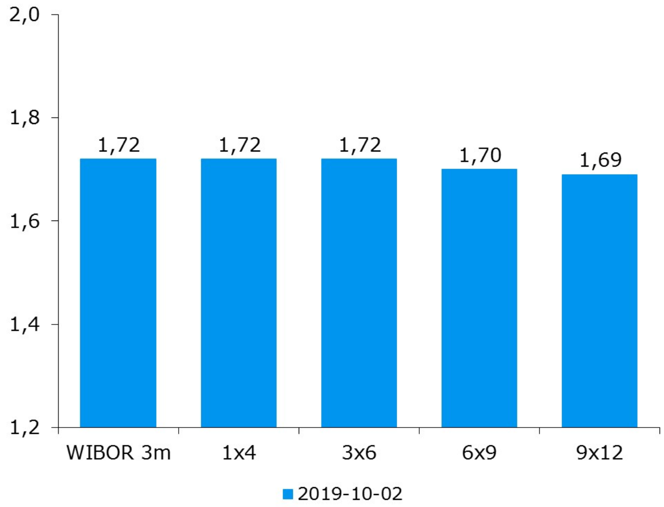
ECJ uncertainty resolved

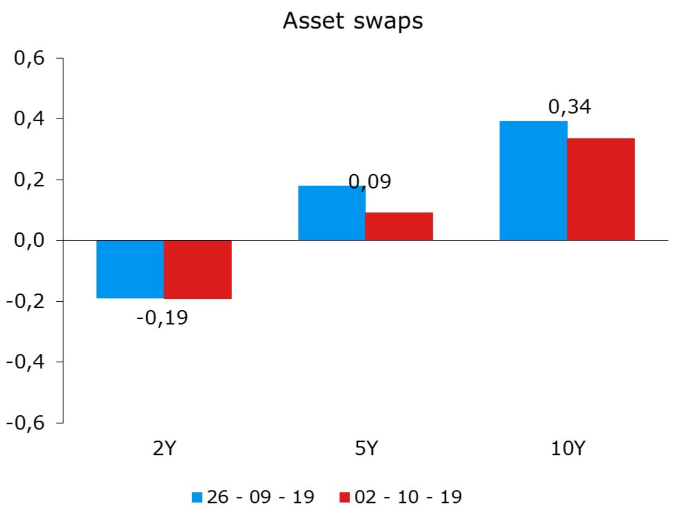
It seems that market participants were only waiting for ECJ to start buying bonds. Both floaters and fixed coupon bonds went up. ASWs narrowed significantly as small supply of bonds auction is now the main interest of investors.

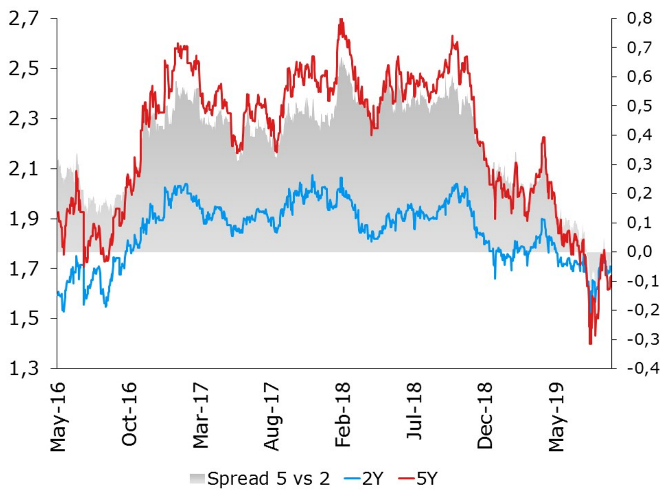
PS1024/5y is 5bps, DS1029/10y is 30bps. PS1024/DS1029 is 24bps DS1029/Bund is 252bps.

DS1021 is trading at 1,47% (no change), PS1024 is trading at 1,69% (10bps down) and DS1029 is trading at 1.94% (6bps down).









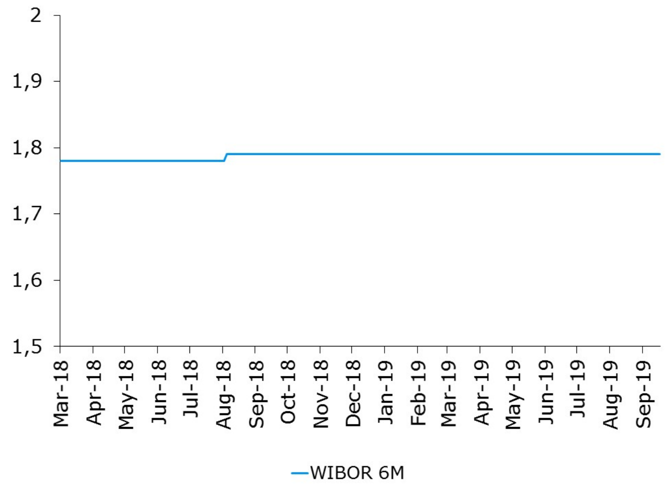
Money market

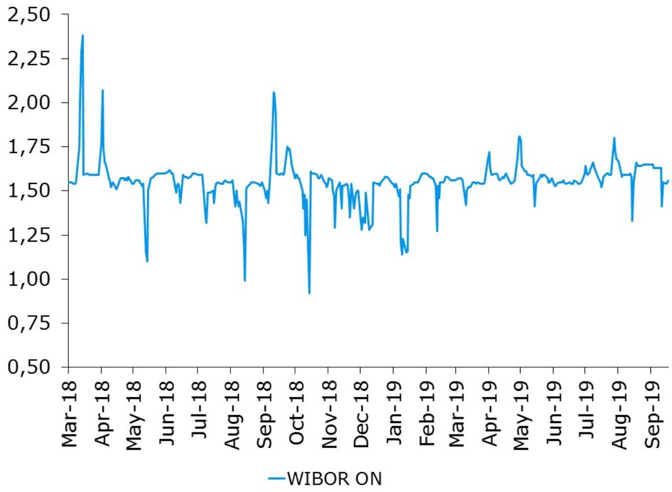
Stable week behind us

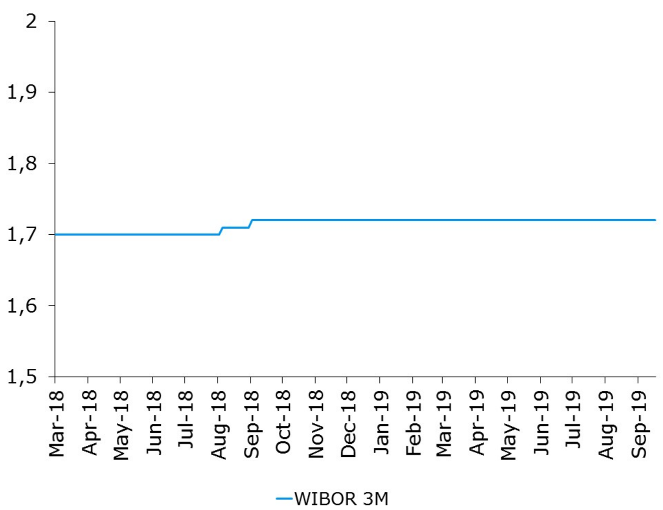
Yesterday the Monetary Council has maintained interest rates at the current level and did not see any need for changes in the near future. After the MPC's decision, swaps remained unchanged below the Wibor rate with a 1 bp spread 5-10 year IRS. In addition, the inflation reading on Tuesday turned out to be lower than expected (2.6% against 2.7%), which reduces expectations for a possible rate cut in the close future.

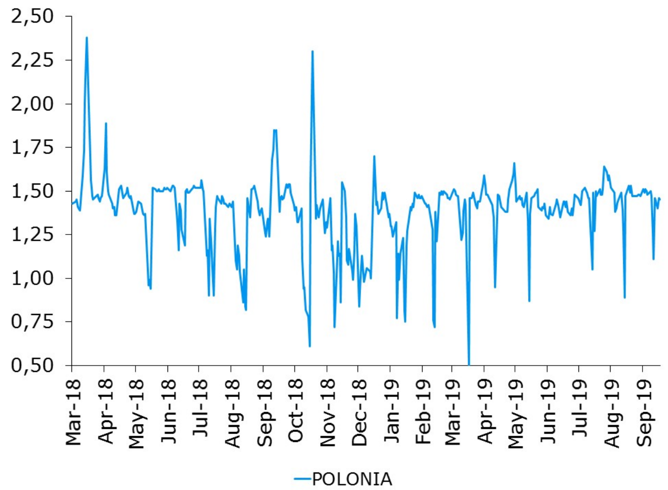
It was first week of mandatory reserve and polonia fluctuated around 1.50% for whole week as we had expected. On Friday's OMO banks bought PLN 81.7b of 7-day bills when PLN 88b would have squared the market. Tomorrow we will have a regular OMO and hence we do not expect any special move on next week founding, Polonia should remain on this week's level.

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









Forex

EURPLN – Zloty stronger The Polish zloty gained after the ECJ ruling on Swiss franc mortgages, but we are not too optimistic. This verdict may trigger a wave of lawsuits against banks and in the result could cut into bank's profits and therefore could encourages bets Zloty depreciation. On the other hand, this process will be spread over time. Besides, keep in mind the persistent global tensions: a slowdown in global growth, the trade war issue and Brexit worries. Taking all this together, in our opinion the Zloty should be more likely to depreciate.

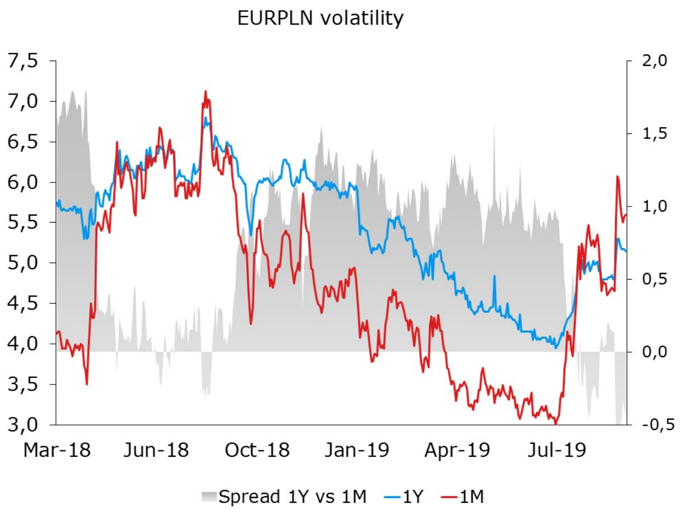
Opts: – EUR/PLN vols – the volatility of the volatility The volatility of the volatility, especially in the frontend of the curve, it is something we haven't seen for months. At the beginning of the week EURPLN 1 month ATM was traded at 6.0% and on Thursday, after the announcement of ECJ's ruling on FX mortgages, 1m atm was offered at 4.6%. We are shocked with the speed in which the vols have melted in EUR/PLN and USD/PLN. The entire volatility curve has turned around and returned to its standard shape. 1 month ATM mid is today 4.45% (almost 1.15% lower), 3 months are at 4.6% (0.5% lower) and finally 1 year fixed at 4.9% (0.3% lower). The skew is also lower while the currency spread (difference between USD/PLN and EUR/PLN) is at the same level as week ago.

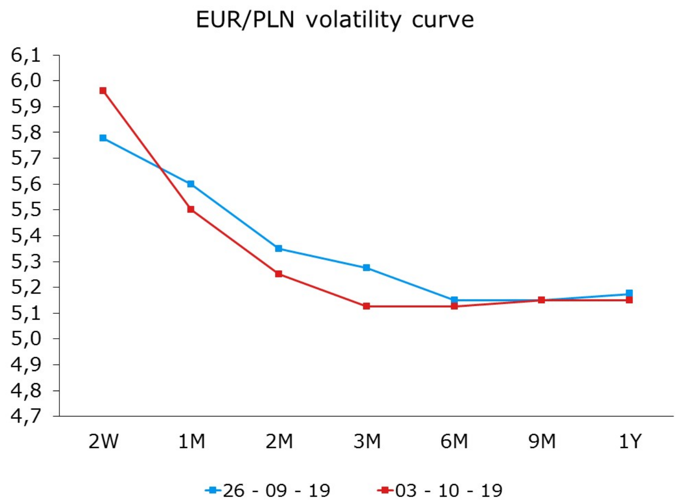
Short-term forecasts

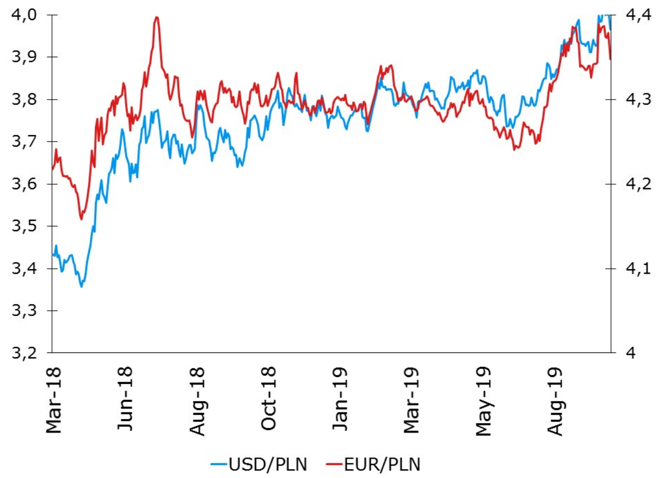
Main supports / resistances:
EUR/PLN: 4.3000 / 4.4000
USD/PLN: 3.8000 / 4.1000

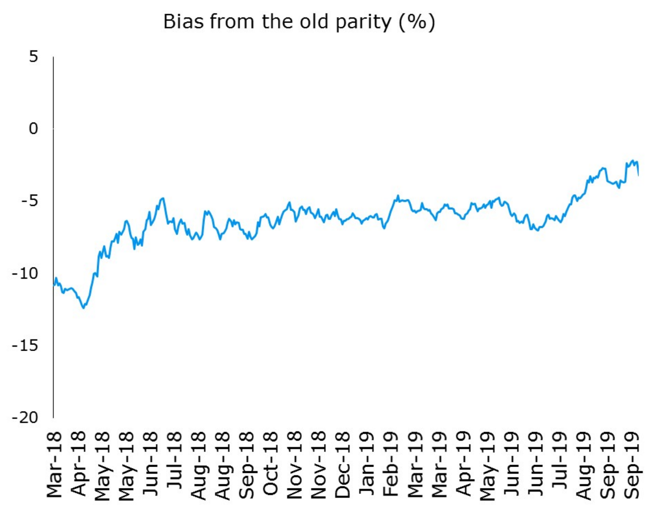
Spot – Current position: None. Buy on dips.

We don't have a position at the moment, but we are ready to buy on dips. The global market sentiment is getting worse, there are some local (autumn parliamentary elections) and global (trade war, Brexit) political risks. All this will probably stop further Zloty appreciation.









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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
9/26/2019	1.71	1.72	1.80	1.69	1.85	1.74	1.71	1.70	1.68	1.64	1.60	1.75
9/29/2019	1.63	1.72	1.71	1.69	1.74	1.74	1.73	1.71	1.71	1.69	1.67	1.77
9/30/2019	1.89	1.72	1.81	1.69	1.89	1.74	1.72	1.71	1.68	1.65	1.60	1.73
10/1/2019	1.83	1.72	1.75	1.69	1.82	1.74	1.72	1.72	1.69	1.65	1.63	1.75
10/2/2019	1.83	1.72	1.77	1.69	1.86	1.74	1.72	1.72	1.70	1.69	1.64	1.76

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
9/26/2019	1.740	1.261	1.690	1.500	1.617	1.795	1.618	2.008
9/29/2019	1.740	1.220	1.685	1.496	1.620	1.793	1.623	2.001
9/30/2019	1.740	1.243	1.695	1.518	1.630	1.783	1.637	1.995
10/1/2019	1.740	1.237	1.710	1.515	1.665	1.787	1.668	2.007
10/2/2019	1.740	1.262	1.705	1.514	1.670	1.762	1.673	2.008

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
9/26/2019	5.60	5.28	5.15	5.18	5.18	1.62	0.36
9/29/2019	5.50	5.20	5.13	5.18	5.18	1.62	0.36
9/30/2019	5.58	5.20	5.13	5.18	5.18	1.47	0.35
10/1/2019	5.60	5.18	5.10	5.15	5.15	1.47	0.34
10/2/2019	5.50	5.13	5.13	5.15	5.15	1.57	0.34

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
9/26/2019	4.3861	4.0092	4.0352	3.7257	1.3114	0.1701
9/29/2019	4.3866	4.0154	4.0439	3.7209	1.3057	0.1697
9/30/2019	4.3736	4.0000	4.0278	3.7071	1.3068	0.1693
10/1/2019	4.3734	4.0147	4.0116	3.7033	1.3063	0.1697
10/2/2019	4.3788	4.0152	4.0167	3.7298	1.3079	0.1701

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