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Polish Weekly Review

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Comment on the upcoming data and forecasts

Releases start with industrial output. We bet on meaningful acceleration due to working days effect and some mild assumptions regarding the making-up of some losses in automotive sector. Acceleration is our preferred scenario for retail sales as well. As usual since additional social transfers had been launched we are open to upside surprises. Construction data completes the real sphere set for Q3 GDP. The baseline still lies within 4.1-4.3% and the actual pattern of surprises is going to be decisive. The list of publications is completed by industrial pricing. We see another leg down in growth rate. As commodities stay mostly sidelined or even weaker and the zloty is stronger, this low-price equilibrium is going to be reinforced in coming months with downside risk being on the rise.

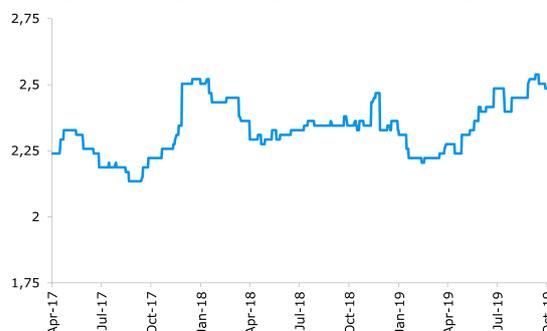
Polish data to watch: October 17th to October 25th

Publication	Date	Period	mBank	Consensus	Prior
Industrial Production y/y (%)	18.10	Sep	6.0	5.2	-1.3
PPI y/y (%)	18.10	Sep	0.6	0.5	0.7
Retail Sales y/y (%)	21.10	Sep	8.1	7.8	6.0
Construction Output y/y (%)	22.10	Sep	6.7	6.5	2.7
Money Supply M3 y/y (%)	22.10	Sep	9.8	9.9	9.9
Unemployment Rate (%)	23.10	Sep	5.1	5.1	5.2

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

No changes in the surprise index. Released data on inflation, labor market or current account were close enough to the market estimates. This week the rest of readings from Polish economy for this month will be published. Index can be changed by industrial production, retail sales and construction output.

* 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 environment.
- 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 slowing down 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

No surprise in Parliamentary elections

Last Sunday Polish parliamentary elections were held. As expected, the governing Prawo i Sprawiedliwość party (PiS) won the elections with 43,59% of votes. It gives them 235 seats in the new Sejm (the same number as 4 years ago, absolute majority is 231), so we can expect that the old-new government should continue the current policy. However PiS does not have the absolute majority in the second house of the parliament (Senate), so for the first time two houses of the Parliament are controlled by two different political options.

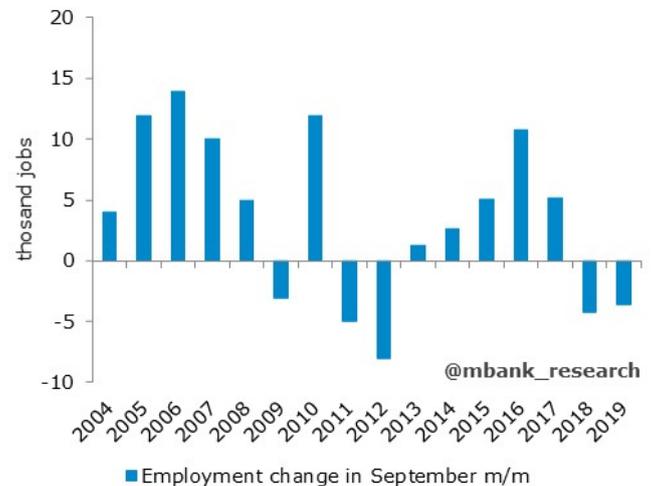
What are the main implications? As noted earlier, election results suggest a continuation of the current line in economic and fiscal policy. The coming weeks should be a period of intense legislative work (already announced in the campaign period), including introducing law on so-called 13th and 14th pension benefits, changes in social contributions for low-income entrepreneurs and changes in private pension funds. Secondly, there should not be much changes in the Budget Act for 2020, but in our view the final budget will not assume a zero deficit, as it will include 13th pension benefit and possible revision of ambitious income numbers. Thirdly it is not the end of the election campaign – presidential elections will take place in May 2020, and the current parliamentary results make the presidential veto a valuable option (there is no chance in building a 3/5 majority by either party which is necessary to reject it). From an economic point of view, it is a double-edged sword – higher uncertainty and higher likelihood of further fiscal stimulation. Fourthly, the scenario of rising electricity prices will not be realized, which together with the small budget deficit, implies maintaining the status quo in the monetary policy. Fifth, and finally, the status quo means no significant impact on the domestic assets or zloty – still the most decisive are global factors.

But, even though Polish Senate does not have many its own prerogatives and its amendments can be rejected by Sejm by a simple majority, the opposition majority in this house of parliament provides a few changes compared to the current situation. First of all it implies that legislative process will be longer (it includes also amending budget-related bills). Secondly, opposition will nominate members of certain institutions – from the markets perspective the most important one is the Monetary Policy Council, where Senate nominates 3 members. Terms of office of MPC members appointed by the Senate expires in January (Gatnar and Kropiwnicki) and December 2022 (Sura). Except to E. Gatnar, they are considered rather dovish, so the risk of changing the MPC composition to more hawkish in the next term increases.

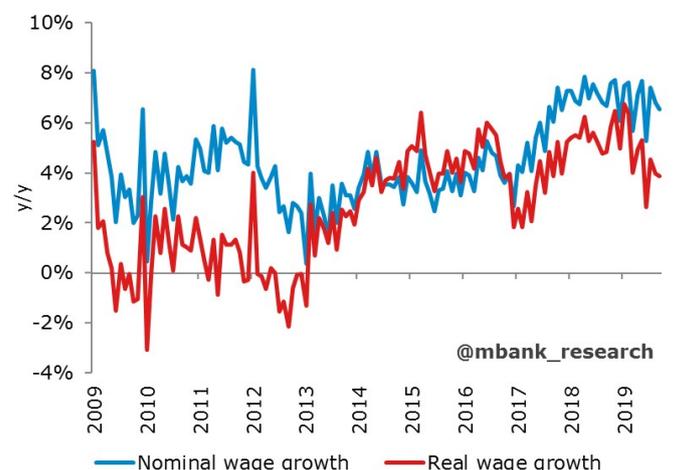
Stabilization in employment dynamics, lower wage growth

Employment in the enterprise sector stabilized in September at 2.6 y/y, matching both our and consensus forecasts. Although the dynamics was at the same level as month ago, there were almost 4 thousand jobs lost monthly, which is in line with the long-established downward trend in employment growth. The reasons are mostly the same as in previous months. There is an increasing impact of slowing labor demand (indicated by lower

industrial production or business climate indicators), but on the other hand supply barriers still exist (problems with staffing). There are no signals that those tendencies will change soon, so in the coming months we should expect further slowdown in the employment growth.



Average gross wage rose in September by 6.6% y/y, which is a lower result than both our forecast (7.0%) and consensus estimate (7.1%). As always for further details we need to wait until the publication of Statistical Bulletin. For now, the main suspects of negative surprise are categories Information and Communication and Manufacturing. Trend implies further slowdown in wage dynamics. There can be a slight positive impact of introducing higher minimum wage in January, but it should not change the overall long-term behavior of wages.



This reading is in line with the labor market situation described by enterprises in the Quick Monitoring Survey by NBP (slowdown of employment due to lower aggregate demand and less intense wage pressure). It should also change the attitude of the MPC, and stable interest rates are still the most probable scenario.

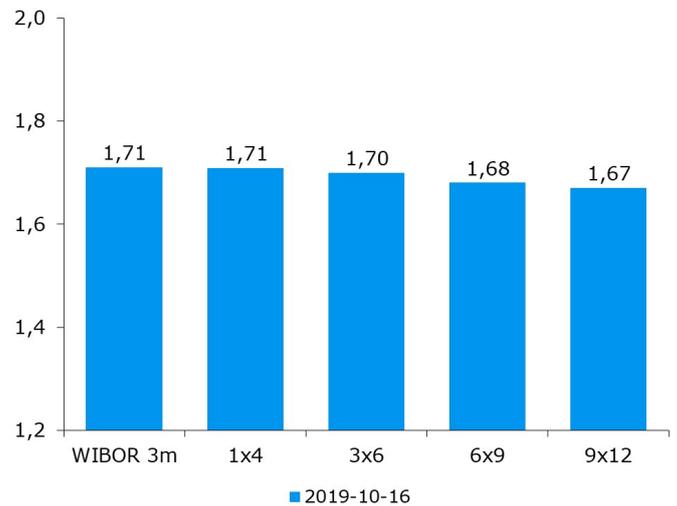
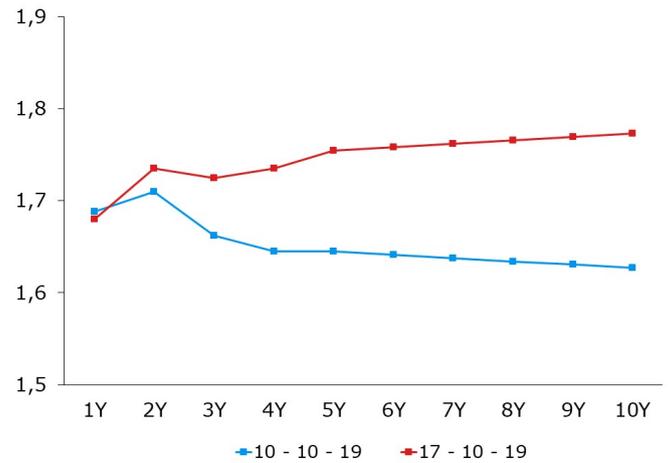
Fixed income

Yields low, ASW tight

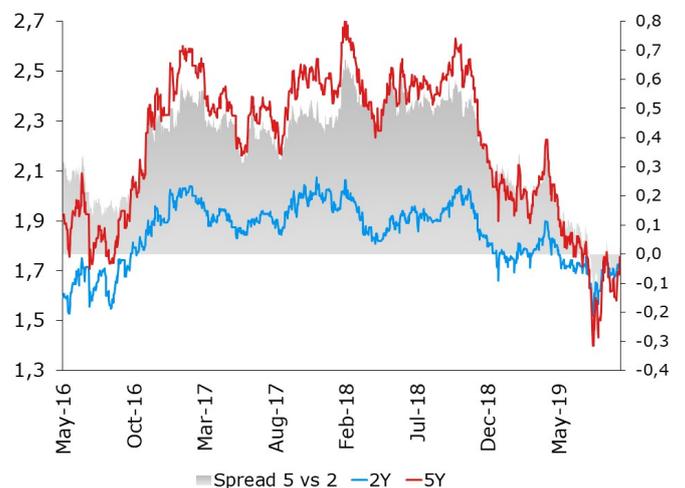
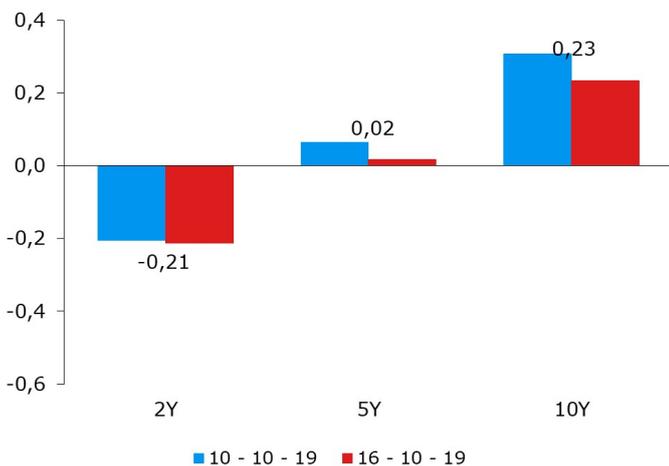
FRNs and ASWs have moved significantly last week. After range trading we finally moved higher in yields and curve starts to steepen a bit. Main flow was on 10y IRS, so 5v10 is positive again. Election results was not an event, market is focused on BREXIT and US-China trade talks. Yields are still close to lows, ASW are tight and the auction is looming.

PS1024/5y is -2bps, DS1029/10y is 20bps. PS1024/DS1029 is 25bps DS1029/Bund is 240bps. DS1021 is trading at 1.50% (3bps up), PS1024 is trading at 1.77% (8bps up) and DS1029 is trading at 2.02% (10bps up).

IRS curve



Asset swaps



Money market

Global sentiment in the driver's seat

Polish elections results came in line with recent polls. Therefore there was no major move afterward. Slight tightening in ASW might be a relief rally, plus stronger risk sentiment abroad. Swaps climbed higher following global yields reaching range top at 1.80% level on 5y. Global sentiment will decide whether we break this level or not.

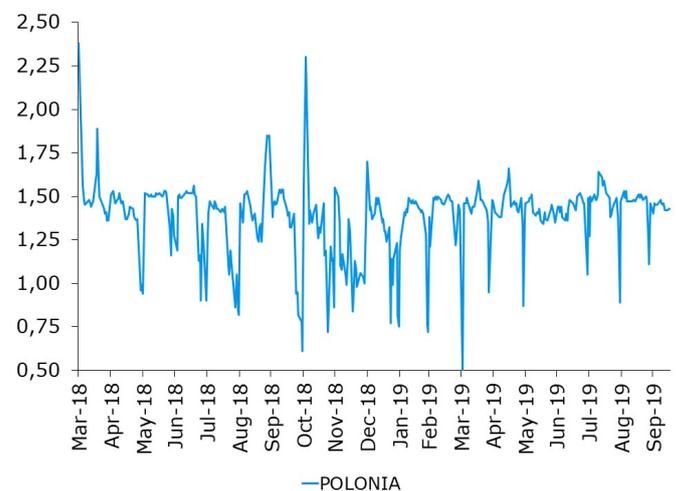
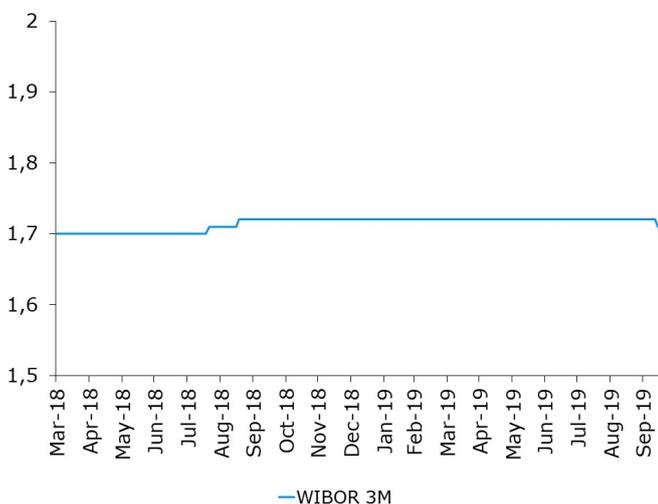
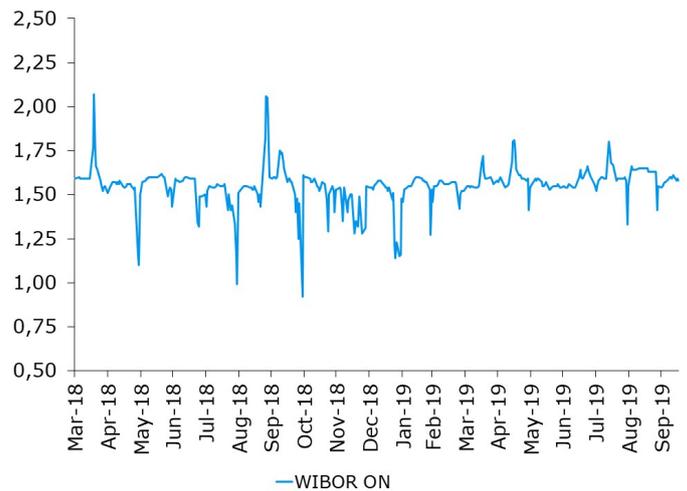
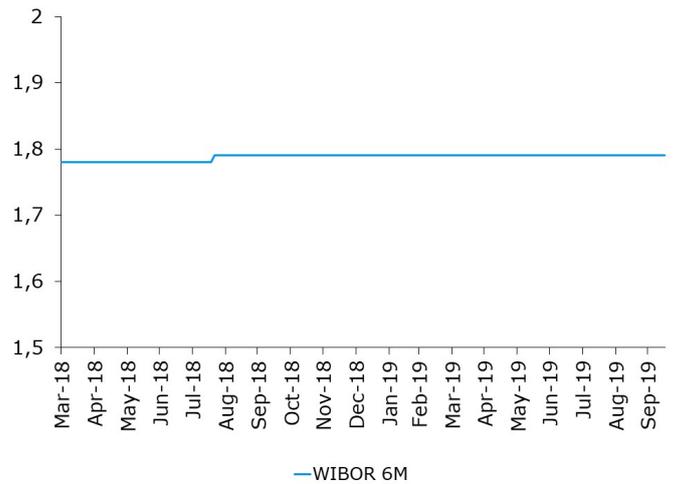
Cash is slightly lower recently due to underbid OMO. We have coupon payment coming next week which might add some volatility next week.

Worth mentioning is also that 3-month WIBOR fell 1 bp.

Ref rate vs Polonia averages:

30 day 6 bp

90 day 5 bp



Forex

Spot: Unstoppable Zloty. The PLN is getting stronger and stronger, even though the pace EURPLN decline is rather slow. The Polish general elections did not bring any majors surprises and translate into continuation of government's policy. There is still positive sentiment after the risk reduction experienced ahead of the ECJ ruling on CHF mortgages and enthusiasm on the market after the info that Brexit deal with EU seems done. All the above has contributed to PLN advances. EURPLN is currently testing the 4.28-4.29 support zone, USDPLN fell from 3.93 to 3.8410. On the other hand, US-China trade talks keep investors cautious. In our opinion, the EURPLN is likely to consolidate in the 4.27-4.32 range in the near future. Zloty's performance will be still determined by the global sentiment.

Opts: EUR/PLN vols – lower The vols are slightly lower, mostly because of the decreasing realized volatility and improving global investment sentiment. 1 month ATM mid is today 4.05% (almost 0.2% lower), 3 months are at 4.05% (0.25% lower) and finally 1 year fixed at 4.45% (0.25% lower). The skew and the currency spread (difference between USD/PLN and EUR/PLN) are lower than week ago too.

Short-term forecasts

Main supports / resistances:

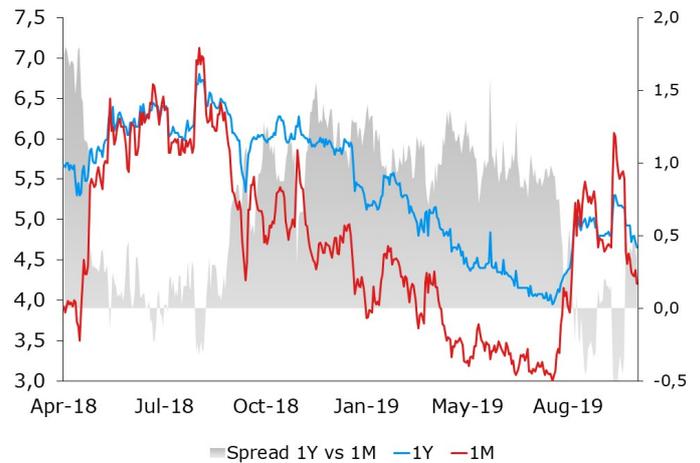
EUR/PLN: 4.3000 / 4.3600

USD/PLN: 3.8000 / 4.0000

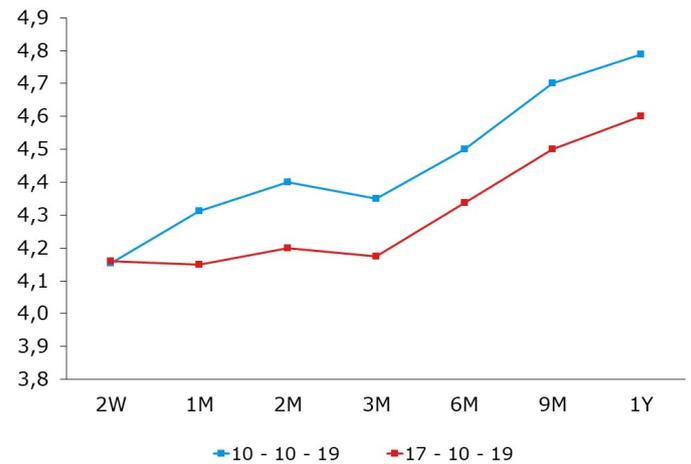
Current position: Long EUR/PLN at 4.28.

We activated our „buy on dips” strategy. We are long EURPLN at 4.28 and ready to add at 4.26 with the stop at 4.24. The 4.26/4.28 support zone seems to be the pivotal level, so we may revisit the levels above 4.30 relatively quickly.

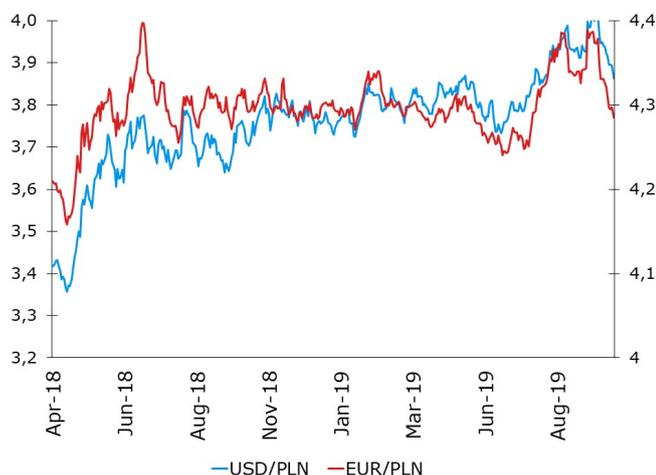
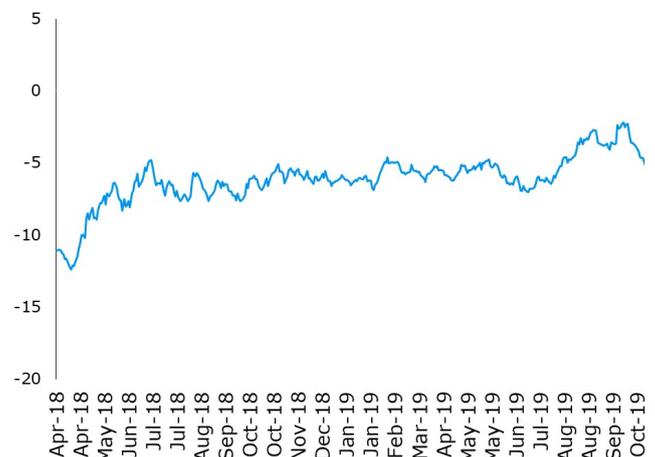
EURPLN volatility



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
10/10/2019	1.87	1.72	1.82	1.69	1.92	1.74	1.72	1.71	1.68	1.66	1.63	1.73
10/13/2019	1.85	1.72	1.89	1.69	1.94	1.74	1.72	1.71	1.68	1.66	1.64	1.73
10/14/2019	1.78	1.71	1.82	1.69	1.91	1.74	1.71	1.70	1.68	1.65	1.63	1.76
10/15/2019	1.69	1.71	1.73	1.69	1.81	1.74	1.71	1.71	1.68	1.66	1.63	1.75
10/16/2019	1.79	1.71	1.83	1.69	1.89	1.74	1.71	1.70	1.68	1.67	1.63	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
10/10/2019	1.740	1.203	1.710	1.505	1.645	1.710	1.627	1.934
10/13/2019	1.740	1.266	1.725	1.544	1.695	1.769	1.710	2.000
10/14/2019	1.740	1.217	1.715	1.515	1.685	1.754	1.688	1.991
10/15/2019	1.740	1.227	1.709	1.523	1.685	1.764	1.693	1.984
10/16/2019	1.740	1.244	1.735	1.523	1.755	1.772	1.773	2.006

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1Y	
10/10/2019	4.31	4.35	4.50	4.79	4.79	1.21	0.31	
10/13/2019	4.30	4.35	4.55	4.80	4.80	1.21	0.31	
10/14/2019	4.38	4.33	4.53	4.73	4.73	1.13	0.31	
10/15/2019	4.20	4.23	4.40	4.65	4.65	1.16	0.31	
10/16/2019	4.15	4.18	4.34	4.60	4.60	1.16	0.33	

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
10/10/2019	4.3217	3.9226	3.9538	3.6519	1.2954	0.1671
10/13/2019	4.3097	3.9145	3.9192	3.6246	1.2986	0.1668
10/14/2019	4.2969	3.8958	3.9104	3.5984	1.2962	0.1665
10/15/2019	4.2949	3.8952	3.9000	3.5953	1.2929	0.1663
10/16/2019	4.2970	3.8934	3.9041	3.5813	1.2920	0.1667

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