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Polish Weekly Review

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Comment on the upcoming data and forecasts

Next week we start with the publication of Polish manufacturing PMI. The estimated slight increase in October is just an effect of a delicate rebound in German indicators (Ifo and PMI). However, the overall picture remains unchanged, business climate indicators compiled by Statistics Poland are at the bottom, there is a lot of pessimism. On Wednesday, the MPC is going to announce its rate decision. There will be no surprises, neither in decision nor in the commentary. The new inflation projections will also be published, but the overall outline of the projections will be unchanged (gradual economic slowdown, inflation returning to target on its own).

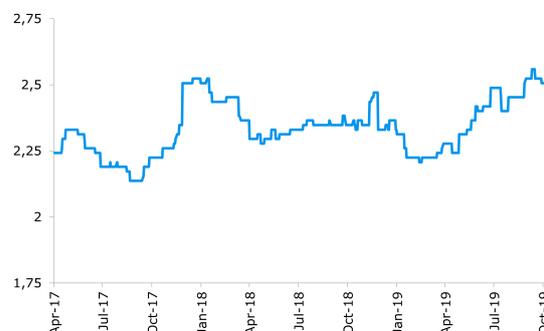
Polish data to watch: November 1st to November 8th

Publication	Date	Period	mBank	Consensus	Prior
PMI (pts.)	4.11	Oct	48.5	48.2	47.8
MPC decision (%)	6.11	Oct	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	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

The only publication this week did not surprise (flash CPI reading at the consensus level of 2.5%) so index remained unchanged. Next week, only the PMI reading can change it.

* 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. 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. Our revised 2020 forecasts call for 3.2% y/y growth.
- 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 and the lagged relationship with local manufacturing wages.
- 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. The revised budget will show a small deficit. General government deficit will remain low as local governments are set to cut investment considerably.

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. Breakeven exchange rates for exporters are, however, moving steadily higher with rising labor costs and that puts an ever-higher floor on EURPLN. No durable appreciation in current circumstances.

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	2019	2019	2019	2020	2020	2020	2020
	Q1	Q2	Q3 F	Q4 F	Q1 F	Q2 F	Q3 F	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

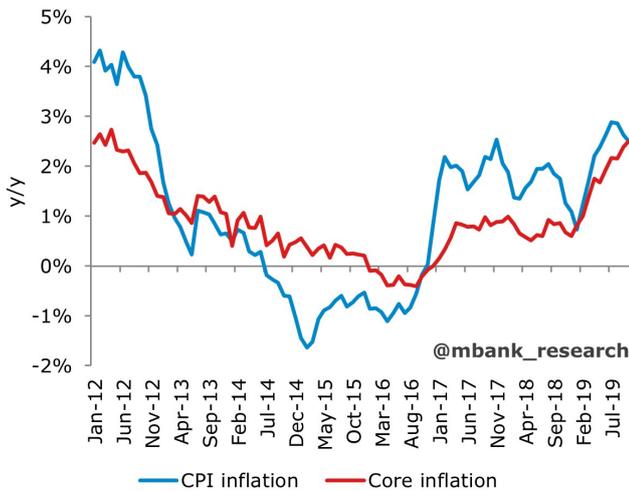
F - forecast

Economics

Headline and core inflation right on target.

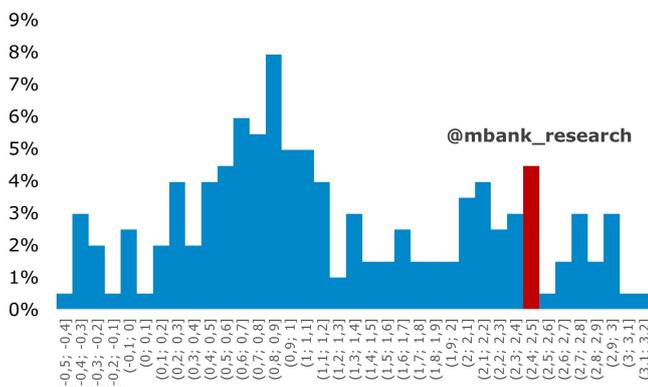
According to the flash reading, October inflation fell from 2.6 to 2.5% y/y, in line with our forecast and market consensus. Available details indicate that food price increased by 0.3% m/m (exactly as our estimate), fuel price decreased by 0.9% m/m (also exactly in line with our estimate) and energy price increased by 0.2% m/m (our estimate +0.1% m/m). This reading implies core inflation rising to 2.5% y/y, but the estimate is on a knife-edge and we would not be surprised if it will remain at 2.4% y/y.

malized after periods of low levels and 2) it has historically been kept quite low due to the restrictive central bank policy, which reacted to the negative supply shocks. The structure of the Polish economy (more stable exchange rate, structure of debt in foreign currencies and investors of debt denominated in PLN), as well as foreign investors' perception (it is no longer a classic EM, but on its way to be a DM), makes the relatively loose monetary policy (compared to previous standards) more sustainable. So far, MPC recognized those changes quite well. Global low interest rates is also supporting the current NBP policy, making current Polish monetary policy appear as quite a restrictive one (compared e.g. to the euro area).



October reading is a local minimum in inflation. Next months should come with further increases. The precise inflation level in 1st quarter will depend on the decision on (un)freezing energy price for households (for now we assume that this price will not change) and expected natural gas price decreases (regulator did not provide any details on providers price applications, we will know more in December). However, it does not matter if inflation at the beginning of the year is closer to 3 or 4%. More important is its trajectory – there we expect quick decrease. None of models in NBP will show a permanent effect of inflationary shock as a result of utilities or food prices.

Distribution of core inflation (2003-2019) and Oct'19 print



What about core inflation? It is at a quite high level, compared to its empirical distribution since 2003 (see graph above). However, one needs to remember that: 1) core inflation finally nor-

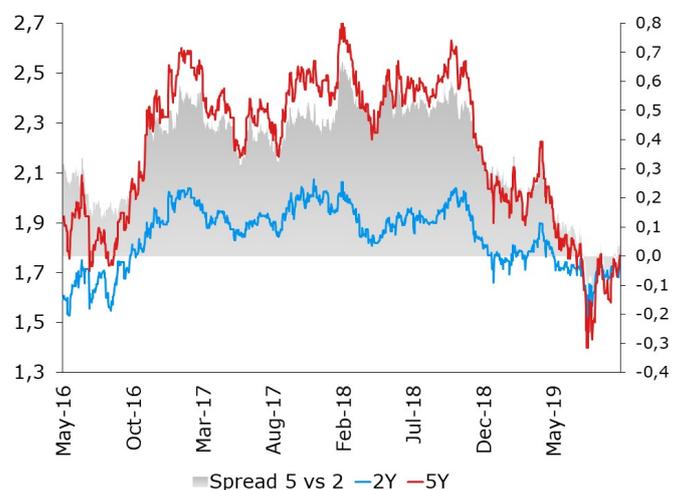
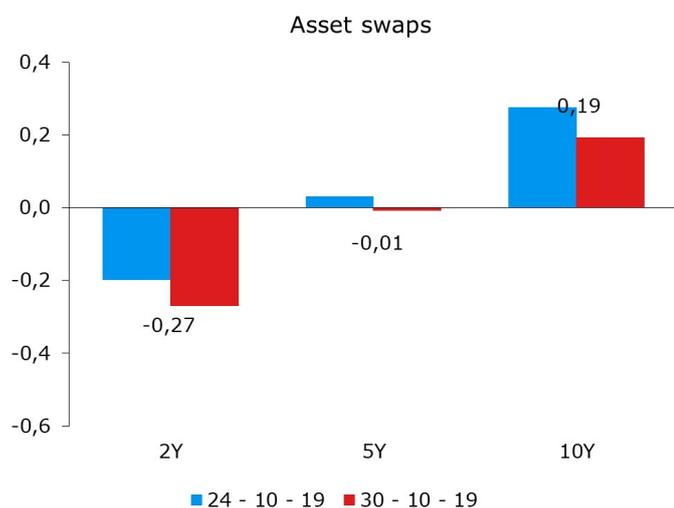
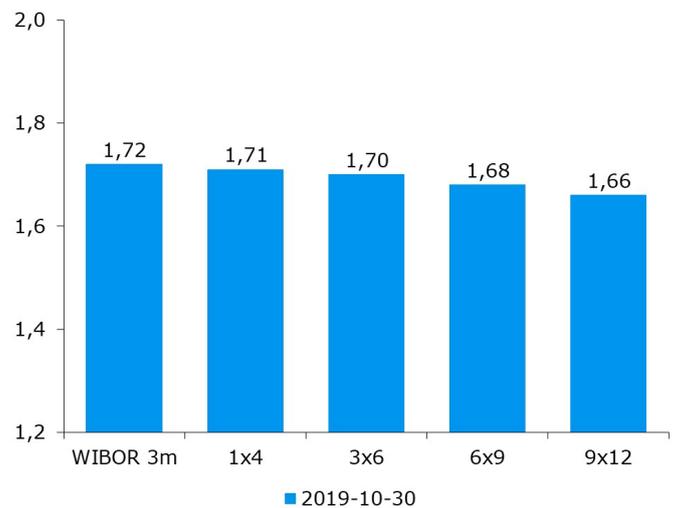
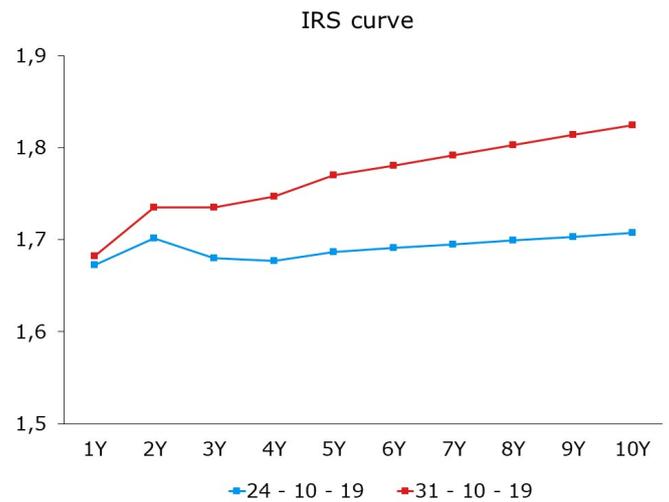
Fixed income

Tight ASW spreads

Volatility and turnover remains relatively small, especially comparing to core markets. ASWs narrowed a bit due to the month-end effects and the need to cover short positions. We are near the lows in ASW spreads and some investors might rethink this ahead of the presidential elections. Moreover, the Ministry of Finance still needs to find some sources of 2020 budget's financing.

PS1024/5y is -3 bps, DS1029/10y is 18 bps. PS1024/DS1029 is 25 bps DS1029/Bund is 237 bps.

DS1021 is trading at 1.42% (3 bps down), PS1024 is trading at 1.73% (2 bps up) and DS1029 is trading at 1.98% (2 bps up).



Money market

Holiday moods

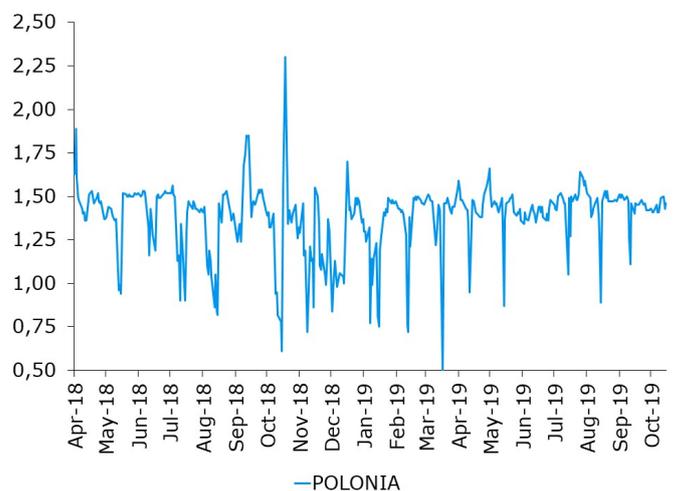
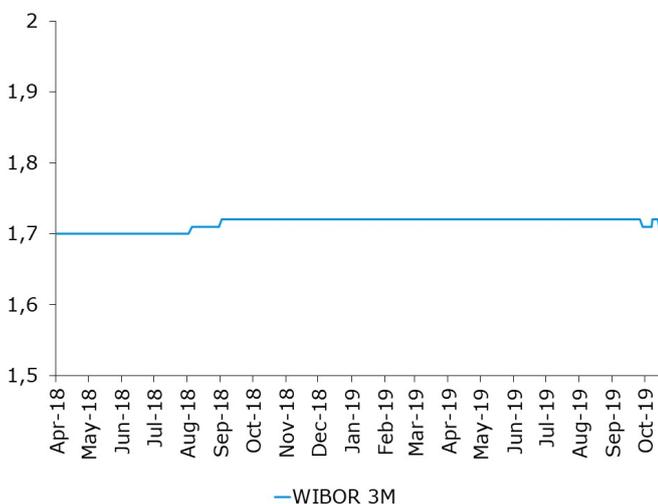
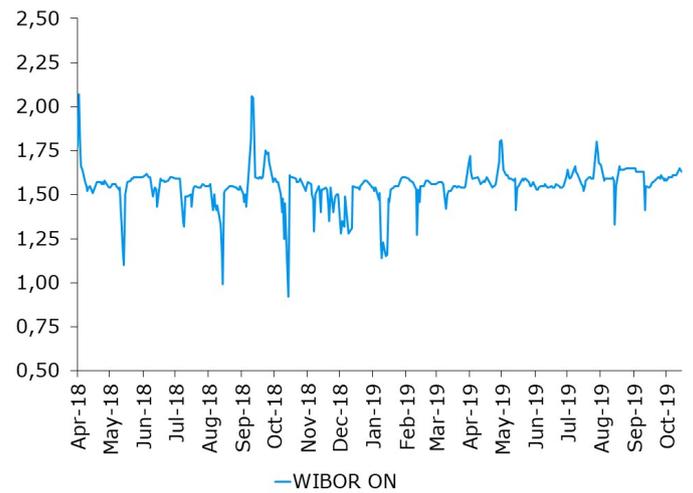
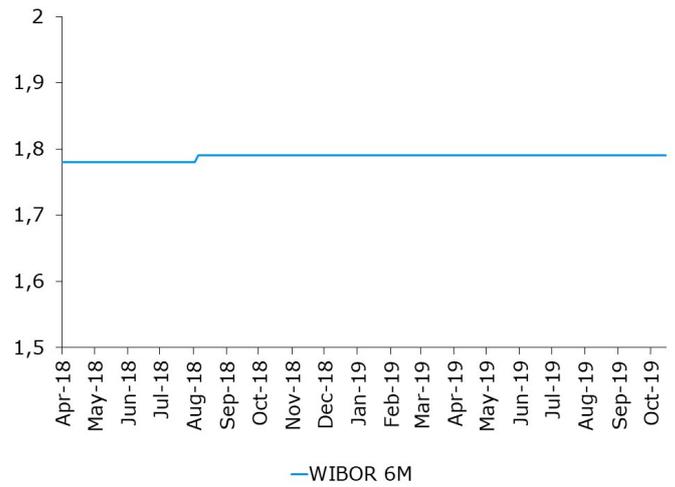
After touching sub 1.70% levels, 5y swap reversed its course and started grinding higher. With good sentiment regarding Polish bonds, ASW tightened again. Liquidity is quite poor, and it feels like everyone is looking already for year end.

Cash rates stable in the last week of the month. Today we have 8-day OMO due to holidays. Nonetheless, cash rates should stay stable around 1.50 due to new reserve period.

Ref rate vs Polonia averages:

30 day 6 bp

90 day 5 bp



Forex

Spot - EUR/PLN - The optimistic mood - how long?

The zloty firmed in last days with risk sentiment boosted by the EU's decision to grant the UK a Brexit extension until January 31st 2020 and positive news from the China-US trade talks. The Federal Reserve cut interest rates for the third time this year by 25 basis points, as expected. At the same time the FOMC indicated it may pause rate cuts from here. EURPLN came down from 4.2840 and closed at 4.2570, now is trading above 4.26. USDPLN moved in the range of 3.81-3.8650. It looks like the Zloty may still be influenced by signals from the global markets.

Options - implied volatility dropped. The optimistic mood did its job! Both volatility curves (EUR/PLN and USD/PLN) are again on the move down. 1 month EUR/PLN atm is today at 3.40% (0.30% lower than a week ago), 3 months is at 3.60% (0.20% lower), 1 year is at 4.25% (unchanged). The currency spread (difference between USD/PLN and EUR/PLN) is slightly lower than one week ago.

Short-term forecasts

Main supports / resistances:

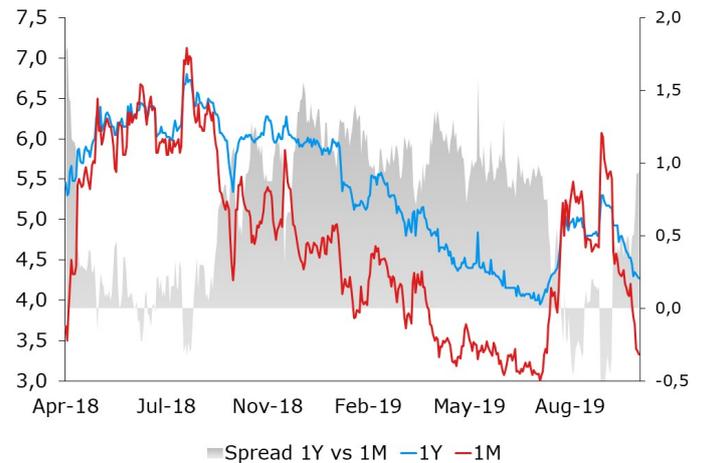
EUR/PLN: 4.2500 / 4.3400

USD/PLN: 3.7500 / 3.9500

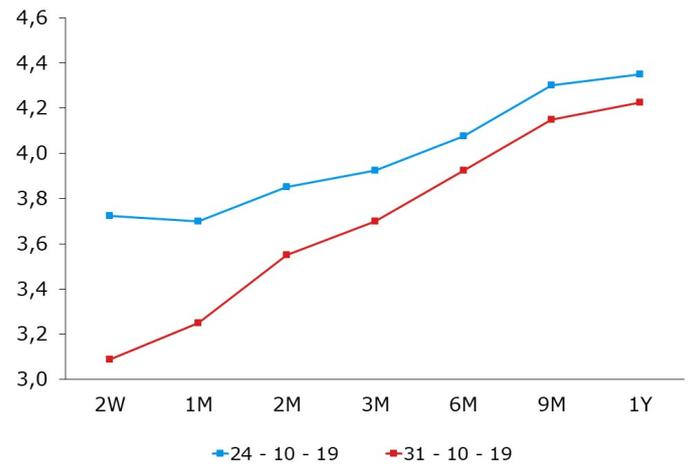
Current position: long EUR/PLN.

According to our trade idea we are long EURPLN at 4.27 (on average) with 4.24 stop and hopes to revisit 4.30. This week, the market has tested local support zone at 4.26. Overall, we still believe in range trading in EUR/PLN. Our strategy is unchanged, playing the range 4.26-4.30, ideally from the short PLN side.

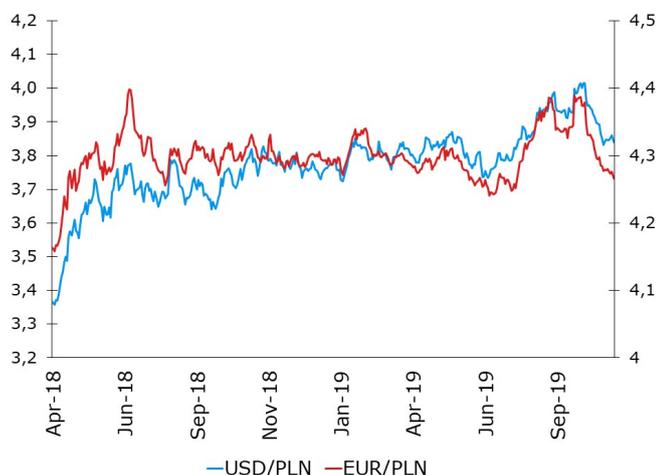
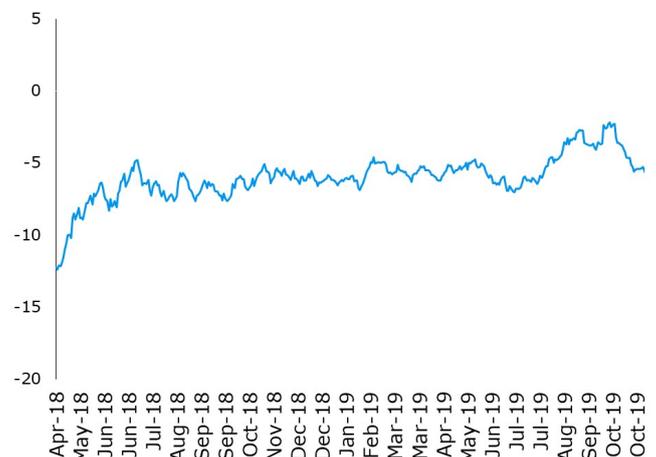
EURPLN volatility



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
10/24/2019	1.87	1.72	1.87	1.69	1.90	1.74	1.72	1.71	1.67	1.64	1.60	1.74
10/27/2019	1.90	1.72	1.89	1.69	1.92	1.74	1.72	1.72	1.69	1.66	1.61	1.76
10/28/2019	1.93	1.72	1.91	1.69	1.94	1.74	1.72	1.71	1.69	1.65	1.61	1.76
10/29/2019	1.78	1.71	1.78	1.69	1.81	1.74	1.71	1.71	1.68	1.66	1.62	1.75
10/30/2019	1.86	1.71	1.86	1.69	1.91	1.74	1.71	1.70	1.68	1.66	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
10/24/2019	1.740	1.154	1.702	1.505	1.687	1.718	1.708	1.983
10/27/2019	1.740	1.168	1.681	1.488	1.715	1.726	1.735	1.991
10/28/2019	1.740	1.127	1.720	1.483	1.747	1.759	1.802	2.020
10/29/2019	1.740	1.099	1.725	1.471	1.747	1.746	1.790	2.008
10/30/2019	1.740	1.096	1.735	1.465	1.770	1.763	1.825	2.018

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
10/24/2019	3.70	3.93	4.08	4.35	4.35	1.11	0.33
10/27/2019	3.40	3.75	4.00	4.33	4.33	1.11	0.33
10/28/2019	3.38	3.70	3.98	4.30	4.30	1.11	0.33
10/29/2019	3.33	3.73	3.85	4.28	4.28	1.00	0.35
10/30/2019	3.25	3.70	3.93	4.23	4.23	1.05	0.35

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
10/24/2019	4.2800	3.8448	3.8816	3.5370	1.2995	0.1671
10/27/2019	4.2762	3.8452	3.8799	3.5412	1.2994	0.1671
10/28/2019	4.2732	3.8529	3.8701	3.5446	1.3001	0.1673
10/29/2019	4.2757	3.8598	3.8763	3.5455	1.3011	0.1672
10/30/2019	4.2655	3.8388	3.8693	3.5264	1.2934	0.1671

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