

November 14, 2019

Polish Weekly Review

Authors:

Ernest Pytlarczyk, PhD, CFA
chief economist
tel. +48 22 829 01 66
ernest.pytlarczyk@mbank.pl

Marcin Mazurek, PhD
senior analyst
tel. +48 22 829 01 83
marcin.mazurek@mbank.pl

Piotr Bartkiewicz, CFA
senior analyst
tel. +48 22 526 70 34
piotr.bartkiewicz@mbank.pl

Maciej Zdrolik
analyst
tel. +48 22 829 02 56
maciej.zdrolik@mbank.pl

Follow us on Twitter:

[@mbank_research](https://twitter.com/mbank_research)

Business contacts:

Department of Financial Markets

Wojciech Dunaj
head of interest rates trading
tel. +48 22 829 07 51
wojciech.dunaj@mbank.pl

Marcin Turkiewicz
head of fx trading
tel. +48 22 829 01 67
marcin.turkiewicz@mbank.pl

Department of Financial Markets Sales

Inga Gaszkowska-Gebska
institutional sales
tel. +48 22 829 01 67
inga.gaszkowska-gebska@mbank.pl

Jacek Jarczyński
head of treasury sales
tel. +48 22 829 15 16
jacek.jarczyński@mbank.pl

mBank S.A.

18 Senatorska St.
00-950 Warszawa
P. O. BOX 728
tel. +48 22 829 00 00
fax. +48 22 829 00 33
<http://www.mbank.pl>

Table of contents

Our view in a nutshell

Economics

- Major disappointment in Q3 GDP
- Inflation squarely on target in October

Fixed income

- Volatile market

Money market

- Watch out for next week's coupon payments and the auction

FX market

- Spot - EUR/PLN - higher in the range
- Opts: EUR/PLN vols - tic higher

Comment on the upcoming data and forecasts

This Friday the NBP will publish official core inflation data for October. We expect inflation net of food and energy prices to rise slightly to 2.5% y/y, based on the details of today's CPI print (more in the Economics section). Next Thursday Statistics Poland will publish monthly labor market data. We expect employment growth to stall at 2.6% y/y, while high statistical base in mining will push wage growth down somewhat. At the same time consumer confidence data will be published (for November). Next Friday industry and construction data for October data will be published. Due to unfavorable working day count (0 vs. +1 y/y in the previous month) we expect activity to slow down, especially in industry. At the same time Statistics Poland's business sentiment indicators for November will be published.

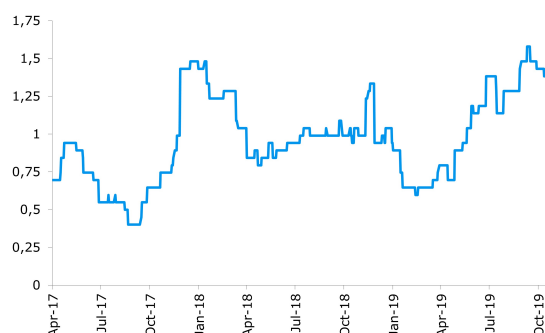
Polish data to watch: November 15th to November 22nd

Publication	Date	Period	mBank	Consensus	Prior
Core CPI y/y (%)	15.11	Oct	2.5	2.5	2.4
Average gross wage y/y (%)	21.11	Oct	5.9	6.2	6.6
Employment y/y (%)	21.11	Oct	2.6	2.6	2.6
Consumer confidence	21.11	Nov			
MPC minutes	21.11	Nov			
Business confidence	22.11	Nov			
Industrial output y/y (%)	22.11	Oct	1.8	2.5	5.6
PPI y/y (%)	22.11	Oct	0.2	0.3	0.4
Construction output y/y (%)	22.11	Oct	5.1	6.2	7.6

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	12/13/2019	300	1.445	7/26/2019
5Y T-bond PS1024	12/13/2019	2000	1.823	7/26/2019
10Y T-bond DS1029	12/13/2019	1500	2.100	7/26/2019
30Y T-bond WS0447	12/13/2019	60	3.180	4/25/2019
5Y floater WZ0525	12/13/2019	2500	-	7/26/2019
10Y floater WZ0529	12/13/2019	2100	-	7/26/2019

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



Comment

Unchanged - final CPI did not bring any revisions to the flash reading. GDP was surprisingly weak, but not enough to move the index. Next week, wage growth, industrial output and the PPI are the key events to watch.

* 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 slowdown 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

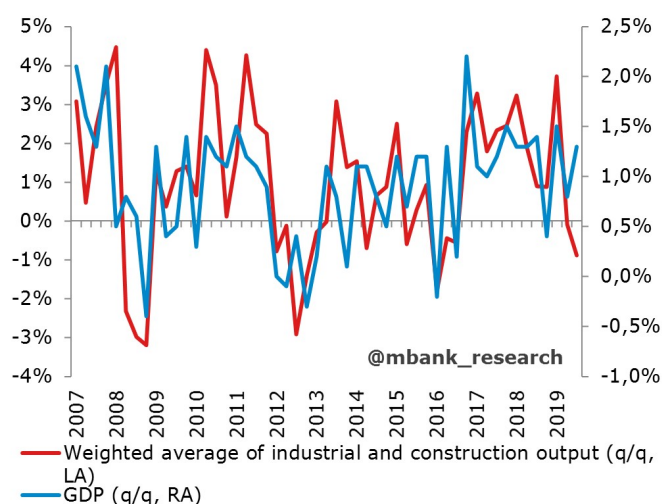
	2015	2016	2017	2018	2019 F	2020 F
GDP y/y (%)	3.8	3.1	4.9	5.1	4.3	3.2
CPI Inflation y/y (average %)	-0.9	-0.6	2.0	1.6	2.4	2.6
General government balance (%GDP)	-2.7	-2.2	-1.4	-0.2	-0.7	-1.1
Current account (%GDP)	-0.6	-0.5	0.2	-0.6	-1.2	-1.4
Unemployment rate (end of period %)	9.8	8.2	6.6	5.9	5.5	5.3
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	4.0	3.9	3.9	3.6	3.0	2.5
Individual consumption y/y (%)	3.9	4.4	4.1	4.8	4.6	4.2	3.4	2.8
Public Consumption y/y (%)	6.4	3.4	3.0	5.0	3.0	3.0	3.0	3.0
Investment y/y (%)	12.6	9.0	5.5	4.0	2.0	2.0	0.0	0.0
Inflation rate (% average)	1.2	2.4	2.8	3.0	3.3	2.6	2.2	2.3
Unemployment rate (% eop)	5.9	5.2	5.1	5.5	5.6	5.0	5.0	5.3
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	1.71	1.71	1.71	1.71	1.71
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	3.95	3.95	3.93	3.86	3.83
F - forecast								

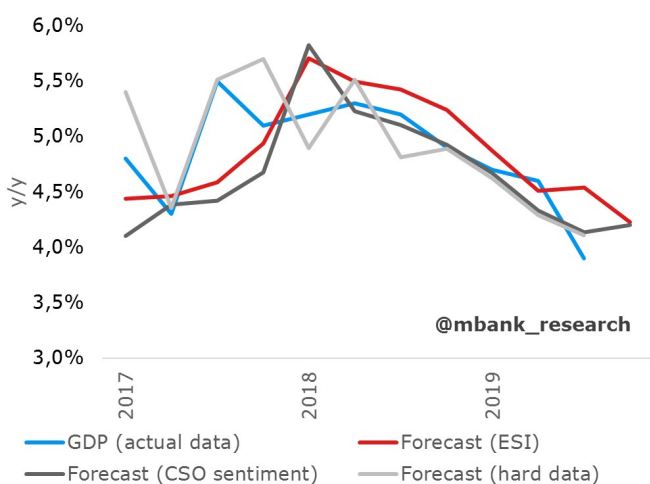
Economics

Major disappointment in Q3 GDP

Polish GDP rose by 3.9% y/y in the third quarter, below both market consensus and our forecast (4.1 and 4.3% y/y, respectively). Thus, Poland joined the club of countries in the region whose GDP prints disappointed today (Romania, Slovakia and Czechia; German and Hungarian data surprised to the upside, on the other hand). On a sequential basis GDP rose by 1.3% q/q and this is a peculiar print, given the decline in industrial and construction output in this period (see the graph below). It is evident that seasonally adjusted world looks better than the non-seasonally adjusted one.



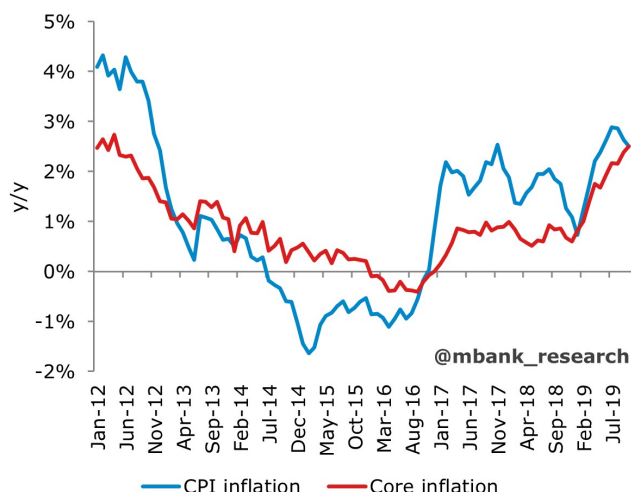
Q3 print ends the era of mostly positive surprises in Polish GDP – until now national accounts showed a gentle slowdown matching the forecasts from various nowcasting models to a tenth of a percentage point. The reasons for the surprise will be known in two weeks, when the details of Q3 GDP are released. We would be surprised neither by weak household consumption (we assumed a slight slowdown from 4.4 to 4.2% y/y) nor by a deeper retrenchment in investment (from 9 to 7% y/y). Curiously, Statistics Poland revised the first two quarters up by 0.1 p.p. each, which pushes GDP growth from that period closer to our original forecasts. As far as revisions are concerned, this is likely not over and perhaps future updates will show an above-4% growth last quarter. This is not relevant at the moment, though.



Early look at Q4 GDP suggests stable GDP growth and the annual average will likely end up at 4.3-4.4% y/y. The trajectory for 2020 is much more consequential and market consensus still has some potential to be revised, in our view. First, the assumption of structurally lower savings rate and high extent of consumption smoothing (as presented in the latest NBP inflation projection, for instance) might not hold water in different phase of the business cycle. Future consumer confidence prints are therefore of paramount importance. Second, while weak investment next year is becoming a consensus view, the inherent variability of the series suggests that gentle deceleration foreseen by market consensus will almost certainly not materialize. History favors bold calls, not conservative forecasts. Finally, while global growth prospects for next year are slightly better, their impact on Poland might be neutral if the bulk of additional global demand comes from distant United States and not from the euro area. Signs of higher activity in the euro area remain almost nonexistent.

Inflation squarely on target in October

Final CPI data confirmed the flash reading of 2.5% y/y, in line with market consensus and our forecast. Details of the release are generally very close to our assumptions: food prices rose by 0.3% m/m, fuel prices declined by 1.0% m/m and residential energy prices rose by 0.1% m/m. Among core categories there was no major surprise and core inflation rose by 2.5% y/y, although rounding might as well push it 2.4% (not a baseline scenario).



October marks a local bottom in CPI inflation and higher prints in the coming months can be expected. The fate of inflation in Q1 was sealed by the decision to extend the electricity price freeze for another year – thus, electricity prices will be unchanged on a monthly basis in January and low base will return its contribution to annual inflation back to zero from negative -0.4 p.p. Natural gas price will likely be cut, but the decision will be made by the regulator in December. The latter will be offset by the alcohol and tobacco excise tax hike (by 10%) announced today. Its cumulative impact on inflation is 0.4 p.p. in annual terms. CPI thus may or may not breach the upper side of the target band, but it doesn't matter for monetary policy considerations. What matters is what will happen afterwards and we expect inflation to return to target by mid-2020. Moreover, NBP's models will not show a different picture as most shocks are external and transitory and the upcoming slowdown will put a natural ceiling on core inflation.

Speaking of which, it remains relatively high by post-2003 standards (see the graph below), but one has to remember: 1) it is normalized after a prolonged period of deflationary print; 2) low historical average is the function of central bank's reaction function – the NBP used to tighten monetary policy in reaction to negative supply shocks, thereby reducing core inflation; 3) part of this year's acceleration (ca. 0.3-0.4 p.p.) can be attributed to administered price hikes, including refuse collection.

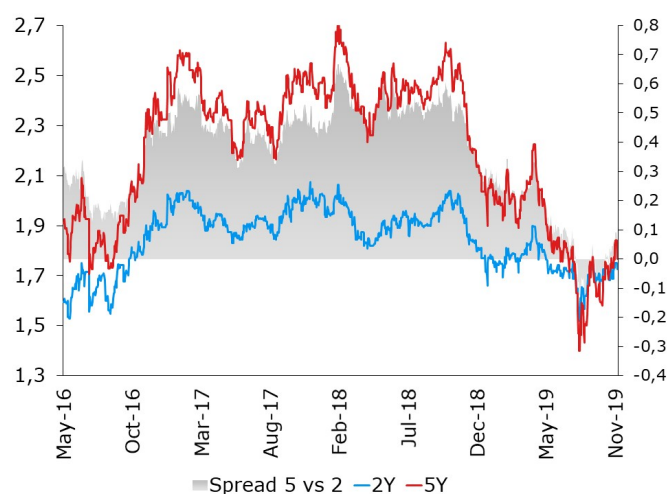
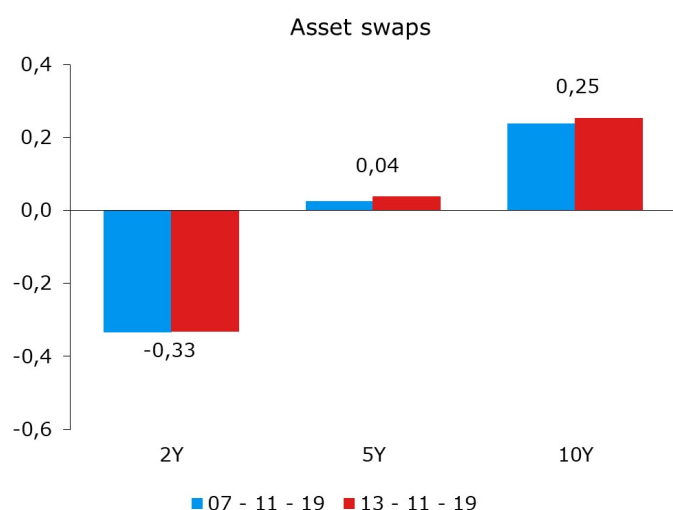
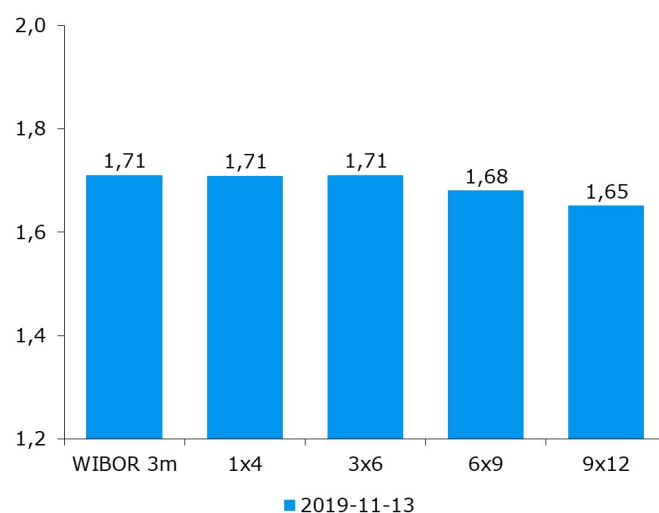
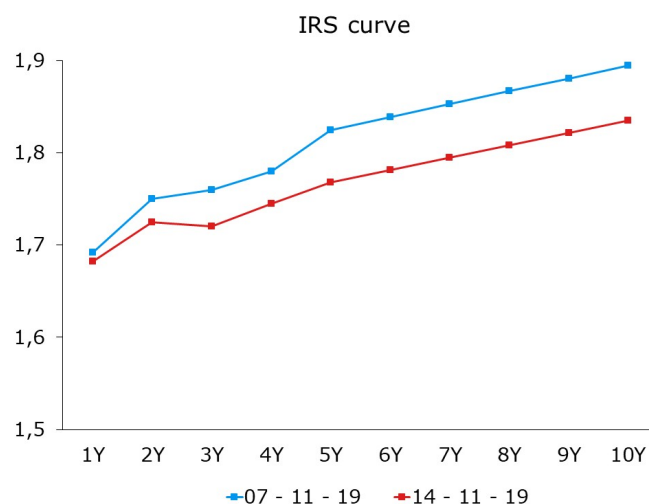
Fixed income

Volatile market

During last week we had some significant volatility, DS1029 moved from 2.02% to 2.24% and came back to 2.06% today. We still see some supply from foreign clients and locals are accumulating POLGBs. ASWs widened a bit close to average levels. Next Thursday we will have another switching auction, which for sure will be much bigger than the previous one (it was one of the smallest ever).

PS1024/5y is 0, DS1029/10y is 22 bps. PS1024/DS1029 is 28 bps DS1029/Bund is 239 bps.

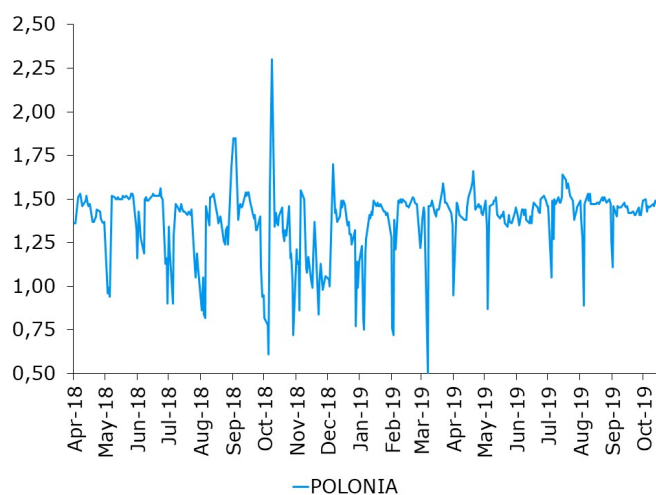
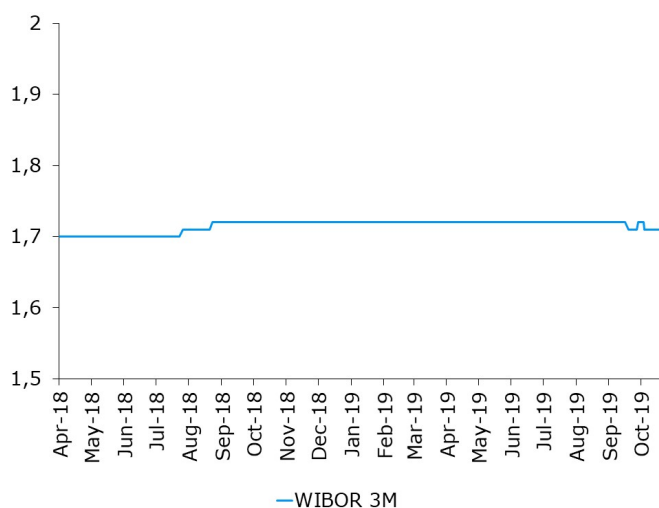
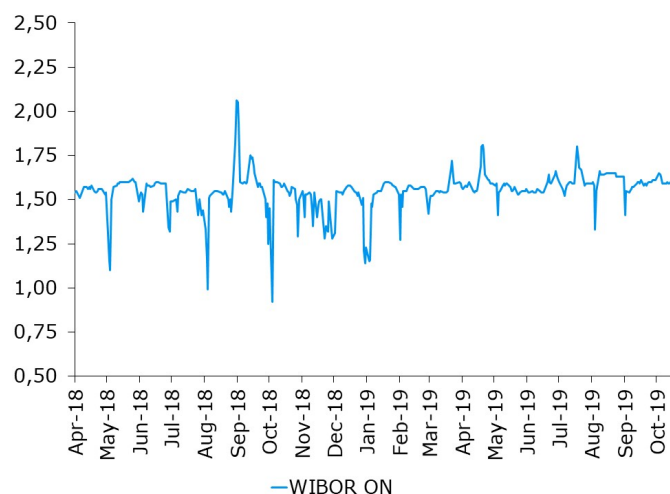
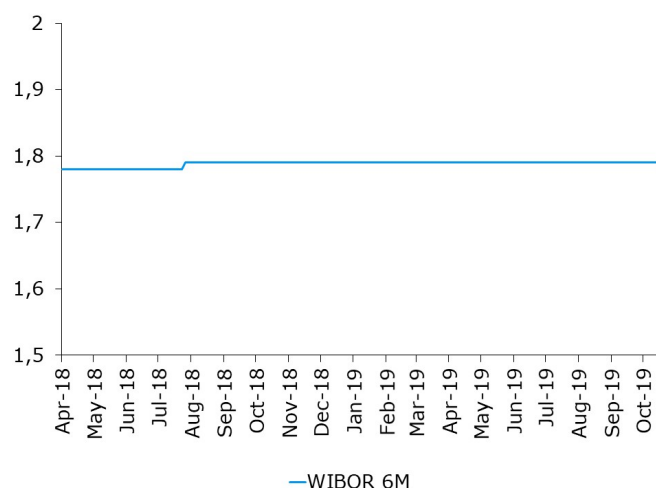
DS1021 is trading at 1.37% (no change), PS1024 is trading at 1.78% (2 bps up) and DS1029 is trading at 2.06% (4 bps up).



Money market

Watch out for next week's coupon payments and the auction

Overnight market was very stable again with Polonia below 1.50. On Friday's OMO banks bought PLN 83 bn bills out of 88 bn offered. Next week we will have coupon payments of November's papers (WZ1122, WZ0524, WZ0525, WZ0528 and WZ1129; recorded on November 20th and paid on November 25th). It could cause some moves on the overnight rate, but the impact of coupons will be rather limited. Next week on Thursday we will have bond auction. As it is another consecutive switching auction, switching bonds are trading at yields below 0.8



Forex

Spot - EUR/PLN - higher in the range This week the backdrop remained weak for Zloty with risk aversion gripped broader markets amid doubts about whether US – China can reach a trade agreement. It helped to lift safe-haven currencies, while pulling the emerging markets currencies lower. The EUR/PLN, from the lazy trading just above 4.25 support, spiked to 4.2970. Finally, it corrected lower on the day to 4.29ish. We are still firm in 4.25–4.30 range and our strategy to play that range still applies.

Opts: EUR/PLN vols - tic higher Slightly weaker PLN and positioning were the reasons why the vols kept on creeping higher. The gains are cosmetic and we need higher realized volatility and/or weaker PLN to support that gains. The buyers of options come back to the market. The big trades were: 2w EUR/PLN traded at 3.8% in good amount, 1 year was traded at 4.35%, 25RR 2m was traded at 0.65%. Finally, today 1 month EUR/PLN ATM is at 3.95% (0.25% higher than week ago), 3 months EUR/PLN are 3.95% (0.2% higher) and 1 year is 4.35% (unchanged). The skew is roughly higher than week ago, while the currency spread (difference between USD/PLN and EUR/PLN) is at the same level.

Short-term forecasts

Main supports / resistances:

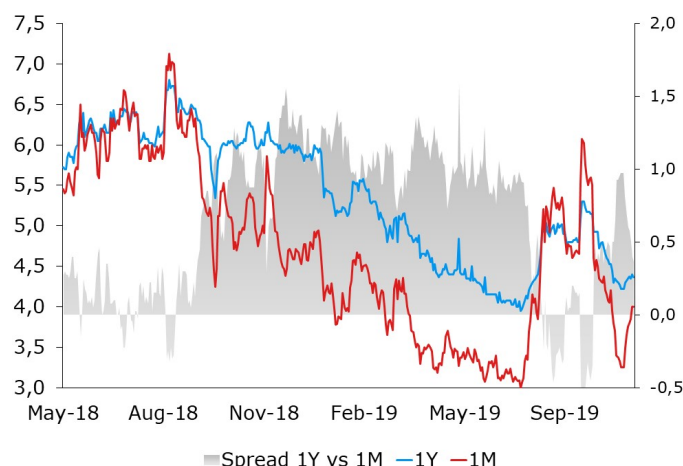
EUR/PLN: 4.2500 / 4.3000

USD/PLN: 3.7500 / 3.9500

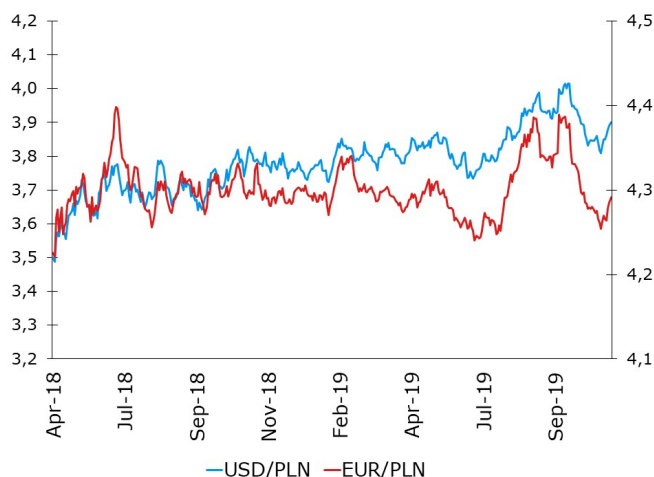
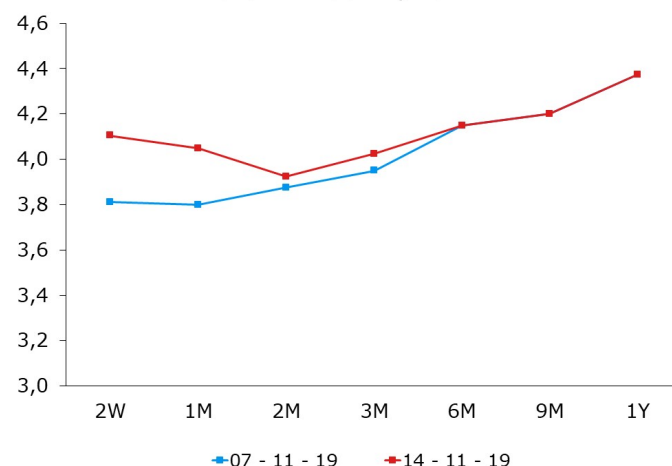
Current position: None.

We closed our long in EUR/PLN at 4.29 and are ready to reverse our position to the short EUR/PLN above 4.30. We still believe in 4.25-4.30 range trading in EUR/PLN.

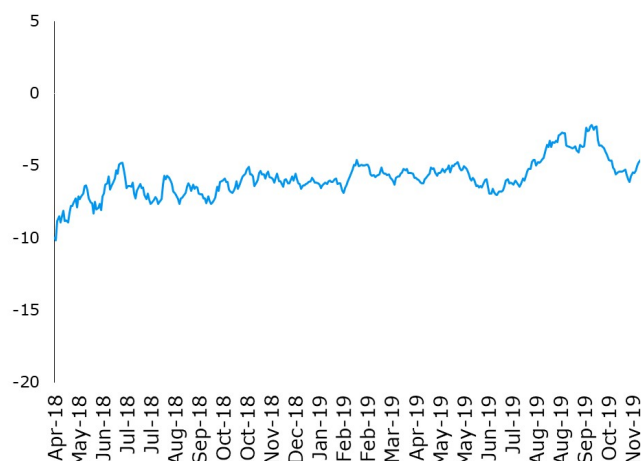
EURPLN volatility



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
11/7/2019	1.87	1.71	1.90	1.69	1.94	1.74	1.71	1.71	1.68	1.67	1.65	1.76
11/10/2019	1.90	1.71	1.91	1.69	1.94	1.74	1.71	1.71	1.69	1.69	1.67	1.77
11/11/2019	1.94	1.71	1.92	1.69	1.96	1.74	1.71	1.71	1.69	1.69	1.67	1.77
11/12/2019	1.84	1.71	1.82	1.69	1.86	1.74	1.71	1.70	1.68	1.67	1.66	1.76
11/13/2019	1.93	1.71	1.92	1.69	1.95	1.74	1.71	1.71	1.68	1.65	1.63	1.75

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
11/7/2019	1.740	0.848	1.750	1.416	1.825	1.849	1.895	2.132
11/10/2019	1.740	0.886	1.750	1.434	1.840	1.855	1.935	2.192
11/11/2019	1.740	0.886	1.750	1.434	1.840	1.855	1.935	2.192
11/12/2019	1.740	0.834	1.750	1.403	1.820	1.830	1.923	2.156
11/13/2019	1.740	0.820	1.725	1.393	1.768	1.806	1.835	2.088

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1Y	
11/7/2019	3.80	3.95	4.15	4.38	4.38	1.11	0.42	
11/10/2019	3.85	3.93	4.13	4.35	4.35	1.11	0.42	
11/11/2019	4.00	4.00	4.15	4.40	4.40	1.06	0.42	
11/12/2019	4.00	3.98	4.15	4.36	4.36	1.01	0.43	
11/13/2019	4.05	4.03	4.15	4.38	4.38	1.06	0.42	

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
11/7/2019	4.2653	3.8502	3.8767	3.5303	1.2824	0.1672
11/10/2019	4.2638	3.8625	3.8797	3.5324	1.2780	0.1669
11/11/2019	4.2638	3.8625	3.8797	3.5324	1.2780	0.1669
11/12/2019	4.2788	3.8780	3.8992	3.5521	1.2794	0.1677
11/13/2019	4.2850	3.8902	3.9299	3.5719	1.2793	0.1677

Disclaimer

Note that research@mbank.pl is an e-mail address used exclusively for the distribution of mBank's publications. We advise to reply and send feedback directly to their authors.

The document has been drafted at the Investor Relations, Group Strategy and Macro Research Department of mBank S.A. for the purpose of promotion and advertising in line with article 83c of the Act on Trading in Financial Instruments (Journal of Laws of 2017, item 1768, as amended). The document does not constitute investment research or marketing communication within the meaning of Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive. The document does not constitute investment advice, nor is it an offer within the meaning of Article 66 (1) of the Polish Civil Code.

The document has been drafted based on the authors' best knowledge, supported by information from reliable market sources. All assessments herein reflect outlooks as at the date of issue of this material and may be subject to change at the discretion of the authors without prior notification. Quotations presented herein are average closing levels of the interbank market from the previous day, they are obtained from information services (Reuters, Bloomberg) and serve information purposes only. Distribution or reprint of the full text or a part of it is allowed only upon obtaining a prior written consent of its authors.

©mBank 2019. All rights reserved.