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Polish Weekly Review

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Comment on the upcoming data and forecasts

Next week only final CPI for November will be published. According to flash reading, inflation in November increased to 2.6% y/y. It was a lower result than out forecast (2.7%), but taking into account previous revisions and fact that the result of 2.6% is very close to 2.65% (if our estimate of core inflation is correct) we still forecast the final reading at 2.7%. y/y. In details, energy and fuel prices were in line with our expectations (accordingly +0.2% m/m and +0.1% m/m). But food price surprised to the downside (+0.3% m/m instead of +0.7% m/m). We think that this element can be revised upwards in the final reading, especially since prices from food markets suggested upside risks in this category and price indicators from retail sales tendencies are weak predictors in November.

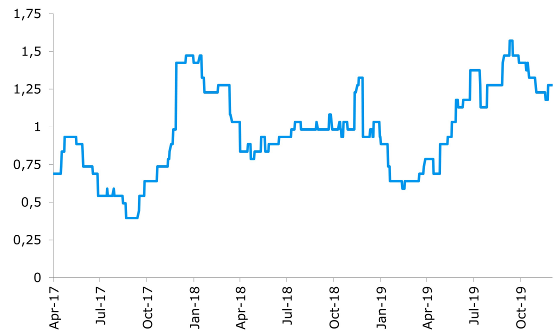
Polish data to watch: December 7th to December 13th

Publication	Date	Period	mBank	Consensus	Prior
CPI *final* y/y (%)	13.12	Nov	2.7	2.6	2.5

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	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

Neither flash CPI nor the manufacturing PMI did surprise this week. The next one should not change the index either, as there will be no publications until next Friday (final CPI will be published then).

* 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 is set to slow down considerably next year. Waning effects of fiscal stimulus, unfavorable EU spending calendar, retrenchment of local government spending (both consumption and especially investment) and weaker demand outlook are to blame. That being said, consumption will remain very resilient and this makes all the difference compared to 2011-2013 cycle. Our current 2020 forecasts call for 2.8% y/y growth. Downward revision is due to Q3'19 surprise and faster slowdown in investment.
- 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 wage growth.
- 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. Bypassing the expenditure rule via off-balance vehicles changes little in the overall assessment of the fiscal stance. General government deficit will remain low as local governments are set to cut investment considerably.

Financial markets

- In general, PLN remains very stable. Most swings are generated by global growth worries, dollar strength (or weakness) and the occassional local factor bubbling up into the surface (like the CHF loan rulings).
- 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, a slowdown is a 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	2.8
CPI Inflation y/y (average %)	-0.9	-0.6	2.0	1.6	2.3	2.6
General government balance (%GDP)	-2.7	-2.2	-1.4	-0.2	-1.2	-0.3
Current account (%GDP)	-0.6	-0.5	0.1	-1.0	-0.2	-0.4
Unemployment rate (end of period %)	9.8	8.2	6.6	5.9	5.2	5.0
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 (%)	4.8	4.6	3.9	3.7	3.2	2.7	2.6	2.6
Individual consumption y/y (%)	3.9	4.4	3.9	4.3	4.3	4.0	3.4	2.8
Public Consumption y/y (%)	6.3	3.1	4.7	5.0	3.0	3.0	3.0	3.0
Investment y/y (%)	12.2	9.1	4.7	2.5	-2.0	-3.0	-3.0	-3.0
Inflation rate (% average)	1.2	2.4	2.8	2.7	3.1	2.6	2.1	2.4
Unemployment rate (% eop)	5.9	5.2	5.1	5.2	5.3	4.7	4.8	5.0
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	1.35	1.50	1.53	1.53	1.54
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

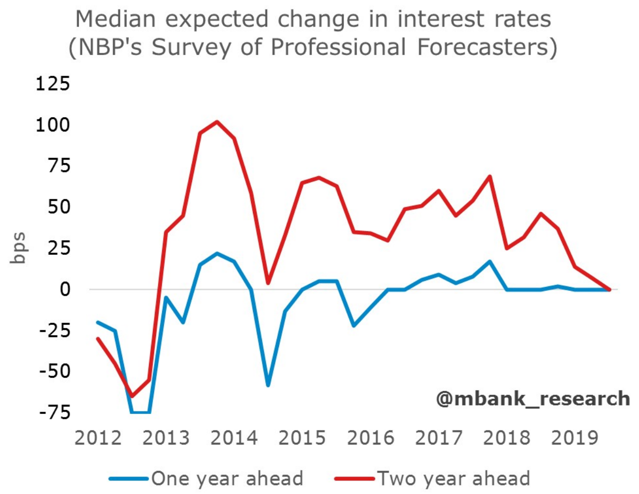
F - forecast

Economics

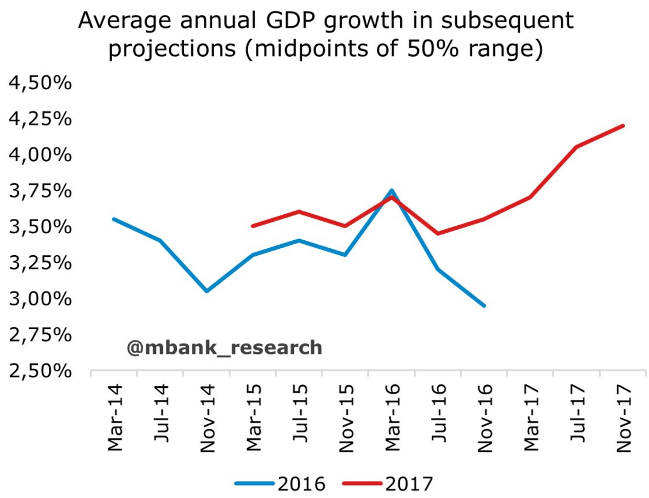
NBP starts pushing back against rate cut expectations

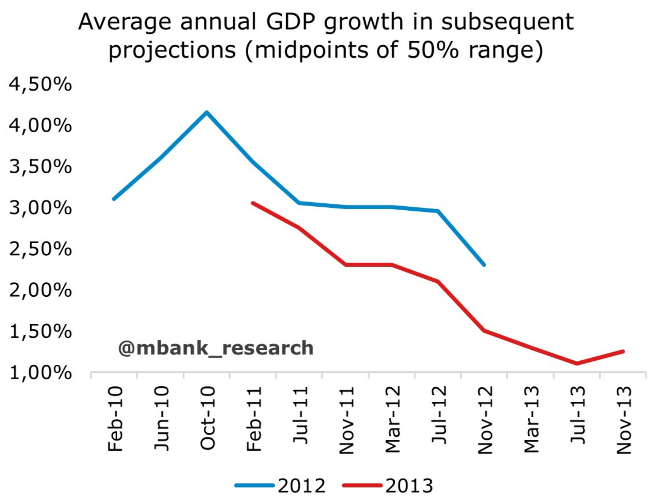
The Polish MPC, just as every analyst expected, left interest rates unchanged and maintained its current stance. The post-meeting statement still describes current interest levels as optimal.

Even though holiday mood is settling in (in addition, Mr. Osiatynski's term is ending this month and we don't yet know his successor), but that doesn't mean that the press conference was devoid of monetary policy-relevant signals. In particular, the NBP governor struck a hawkish tone and pushed back against rate cut expectations appearing in the media and among some forecasters. He was also visibly more optimistic than market consensus and claimed that the current slowdown is entirely of external nature.



The NBP's newfound optimism must be seen as part of an old communications strategy, which has previously been successful. To remind our readers, current MPC was quite hawkish in 2016, when economic growth was slowing sharply, inflation was negative and rate cut expectations were common and ambitious. Once the economy recovered, the MPC became more and more dovish, countering rate hike expectations. Eventually the economy slowed down again, rendering rate hike calls moot. Given the Council's overarching preference for stable rates, this slowdown is likely treated in exactly the same way as the previous one. The wager with the market might as well succeed â€“ after all, nobody can force the NBP to cut rates and stable rates are still the baseline scenario for the overwhelming majority of forecasters (including us – see the graph above). However, the balance of risks clearly is tilted to the downside. The dichotomy between external and internal causes of slowdown is quite frankly irrelevant and the NBP is forecasting lower GDP growth in future years anyway. Staff forecasts have historically been, of course been as accurate as forecast generally are, but one has to remember that they are subject to the same surprises and information updates as the consensus of private forecasters. Current figures will almost certainly be revised when new information comes to light (see the graphs below). At business cycle turning points, GDP forecasts can miss quite substantially.





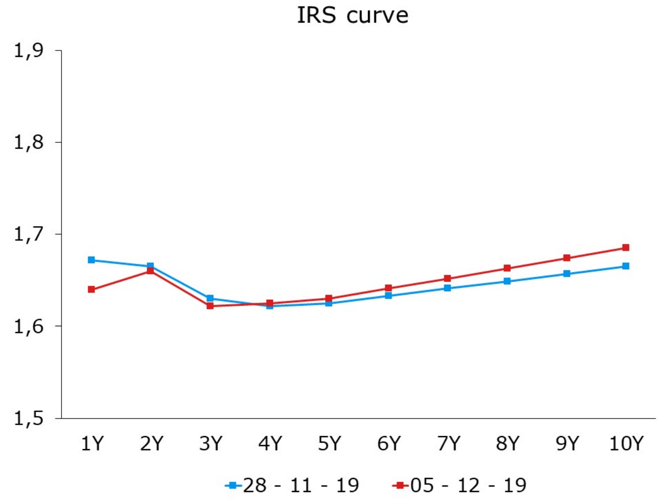
Fixed income

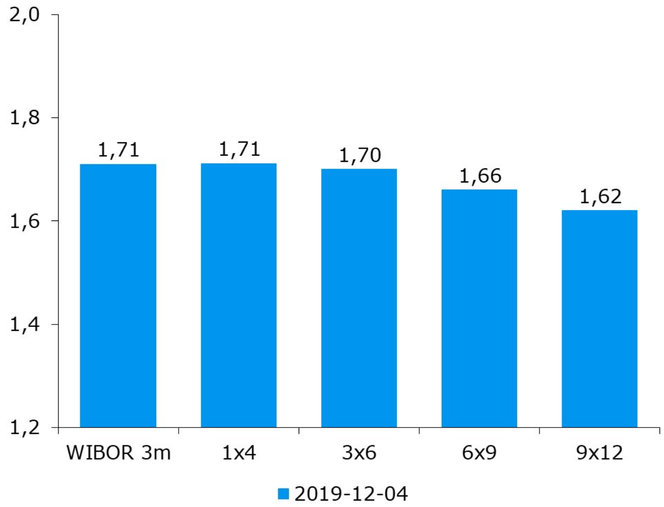
Feel the flow

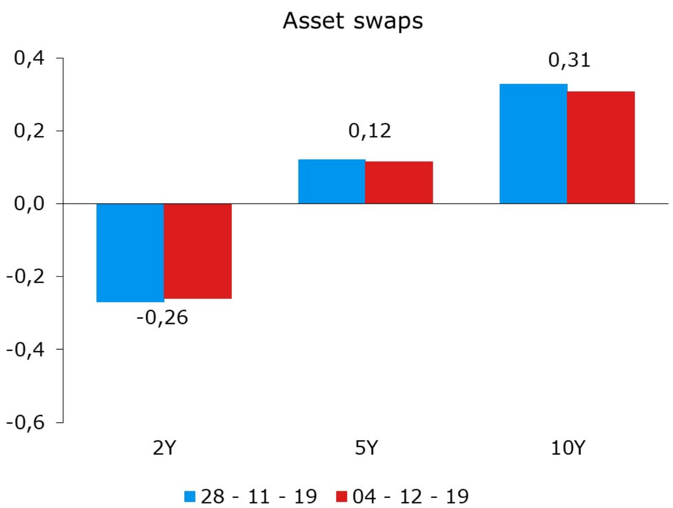
Christmas is coming, volatility and liquidity are very low. Market is driven only by the flows, we aren't following core markets, we aren't following CEE. Next week we have this year's last auction and it will be main event of the coming days. ASWs have cheapened relative to FRNs. Keep in mind that the 2020 bond supply will stay low.

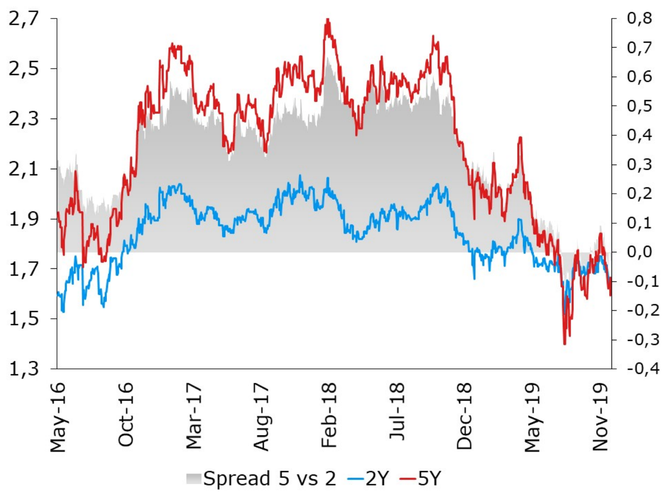
PS1024/5y is 10 bps, DS1029/10y is 32 bps. PS1024/DS1029 is 27 bps DS1029/Bund is 231 bps.

DS1021 is trading at 1.37% (2 bps up), PS1024 is trading at 1.75% (2 bps up) and DS1029 is trading at 2.02% (4 bps up).







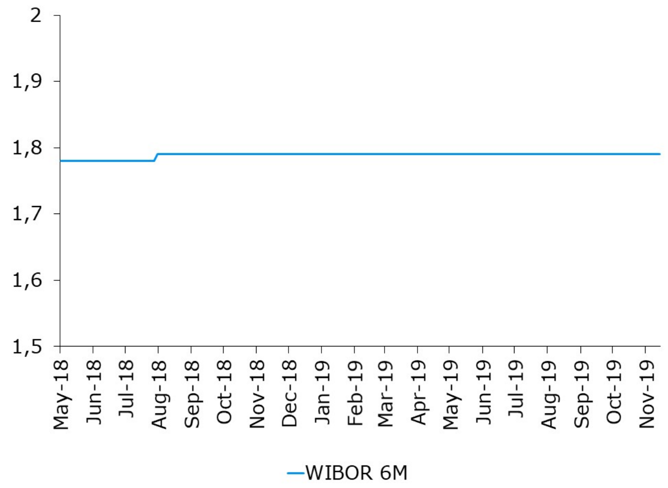


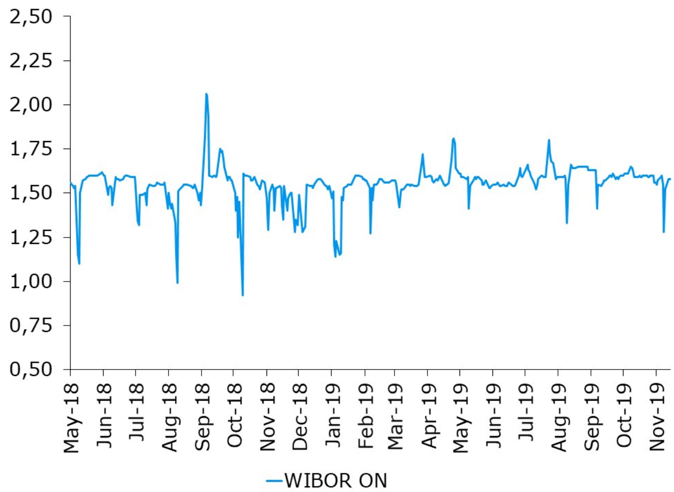
Money market

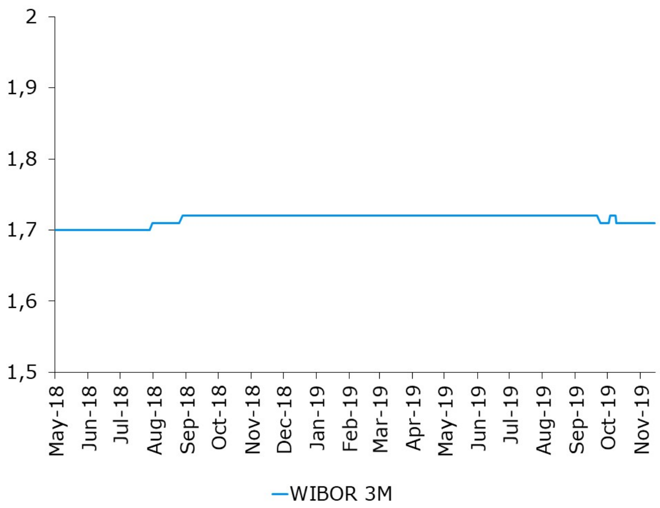
End of the year is coming fast

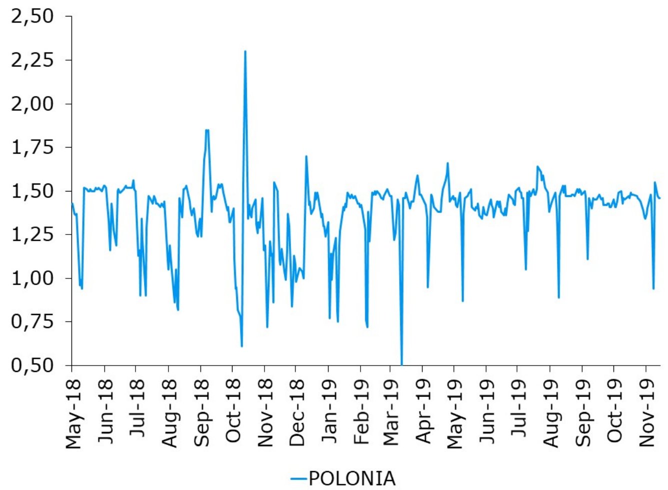
Polish rates have recently fallen significantly, with 5y reaching 1.60%. We found support there and are now slowly grinding higher following core rates. Customer activity remains muted and looks like year end mood is settling in. Asset swaps have widened.

Cash rates stable for last week. Liquidity will be disappearing as we head into year end. Secure your funding over year end as soon as possible.



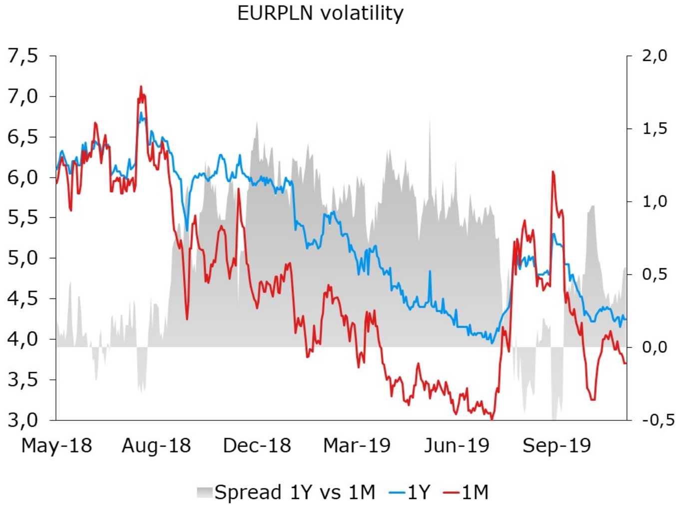






Forex

Spot - zloty stronger On Monday after an unexpected rebound in Chinese manufacturing activity, hopes of a brighter outlook for the world economy were raised. This gives reason for cautious optimism, but investors are still waiting to see what happens in phase 1 of the U.S.- China trade talks. Meanwhile, the U.S. President Donald Trump said a trade deal with China might have to wait until after the 2020 U.S. presidential election. Consequently, the zloty gained violently, rebounding after hitting 4.3280 against the euro. EUR/PLN is currently testing the 4.27-4.28, a local support zone, USD/PLN fell from 3.9330 to 3.85. The risk sentiment is somehow better, but the trade war and political tensions are keeping us all on our toes.

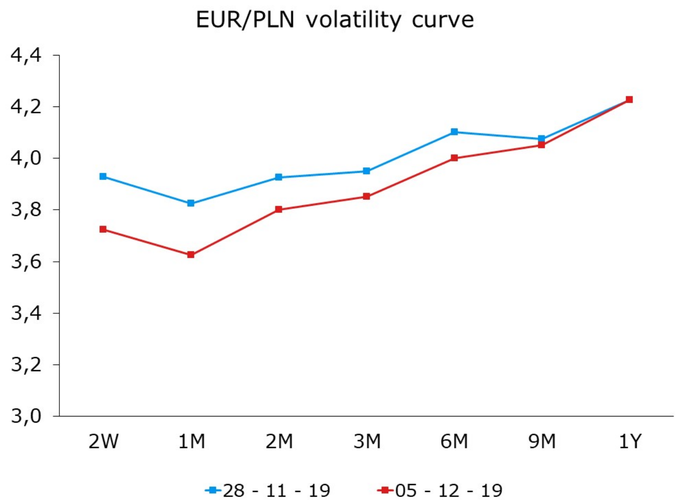


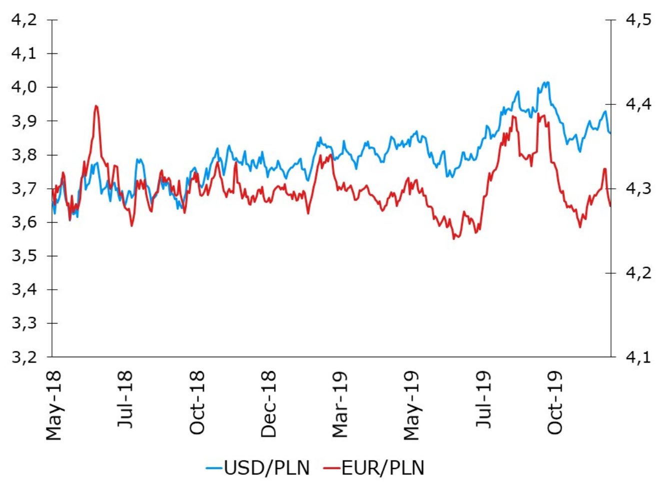
Opts - Implied volatilities stable Zloty is stronger than week ago but implied volatilities are not lower - correlation between stronger zloty and lower volatility is not working this time. The reason is really impressive realized volatility. Today 1 month EUR/PLN mid fixed at 3.5% (unchanged), 3 months are at 3.75% (unchanged) and 1 year is 4.1% (0.05% lower). The skew is roughly unchanged.

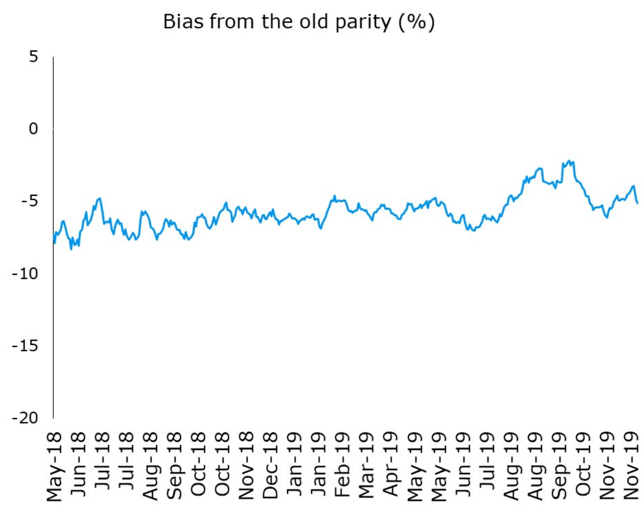
Short-term forecasts

Main supports / resistances:
EUR/PLN: 4.2500 / 4.3000
USD/PLN: 3.7500 / 3.9500

Spot: Current position: : Small short
We believe in the potential opportunity to make a profit and close our position at 4.26 level. Overall, our strategy is unchanged, playing the range 4.26-4.31. It looks like the Zloty may still be influenced by signals from the global markets.







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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
11/28/2019	2.14	1.71	2.07	1.69	2.02	1.74	1.71	1.71	1.69	1.63	1.54	1.75
12/1/2019	2.17	1.71	2.07	1.69	2.00	1.74	1.73	1.71	1.71	1.69	1.67	1.77
12/2/2019	2.18	1.71	2.07	1.69	1.99	1.74	1.71	1.70	1.67	1.63	1.56	1.74
12/3/2019	2.00	1.71	1.89	1.69	1.83	1.74	1.71	1.70	1.67	1.61	1.54	1.73
12/4/2019	1.61	1.71	1.66	1.69	1.71	1.74	1.71	1.70	1.66	1.62	1.57	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
11/28/2019	1.740	1.043	1.665	1.395	1.625	1.745	1.665	1.994
12/1/2019	1.740	1.009	1.630	1.399	1.627	1.750	1.646	2.014
12/2/2019	1.740	0.958	1.665	1.400	1.665	1.763	1.691	2.018
12/3/2019	1.740	0.961	1.640	1.401	1.595	1.725	1.638	1.967
12/4/2019	1.740	0.992	1.660	1.401	1.630	1.746	1.685	1.992

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
11/28/2019	3.83	3.95	4.10	4.23	4.23	1.01	0.44
12/1/2019	3.78	3.95	4.10	4.30	4.30	1.01	0.44
12/2/2019	3.70	3.88	4.03	4.25	4.25	1.01	0.42
12/3/2019	3.70	3.75	4.03	4.25	4.25	1.06	0.43
12/4/2019	3.63	3.85	4.00	4.23	4.23	1.11	0.42

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
11/28/2019	4.3230	3.9252	3.9298	3.5870	1.2840	0.1691
12/1/2019	4.3236	3.9288	3.9300	3.5857	1.2918	0.1692
12/2/2019	4.3008	3.9047	3.9047	3.5611	1.2898	0.1684
12/3/2019	4.2900	3.8706	3.9126	3.5499	1.2910	0.1679
12/4/2019	4.2792	3.8647	3.9081	3.5540	1.2914	0.1677

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