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## Polish Weekly Review

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### Time to say goodbye

Time to say goodbye. This is the last weekly report this year. This is also the last issue we will ever send.

From January on you will be receiving only one report per month, presenting an eagle's view of the markets and the economy; all in a more visual-friendly form. The first issue is scheduled for January 9th.

### Comment on the upcoming data and forecasts

Tomorrow Statistics Poland will release retail sales figures. We expect a weak print, mainly due to the impact of trading day count and high base on sales of food and in nonspecialized stores. The structural shift of Christmas purchases to November is unlikely to negate that. On Monday unemployment rate for November will be published. We expect 5.1% in line with Ministry of Family, Labor and Social Policy flash estimate. The same day Statistics Poland will release construction output reading. November should confirm slowdown in this category (our forecast -2.1%, last month -4.0%). Money supply M3 (published on Tuesday) also will follow the trend (slowdown in households' and acceleration in enterprise deposits).

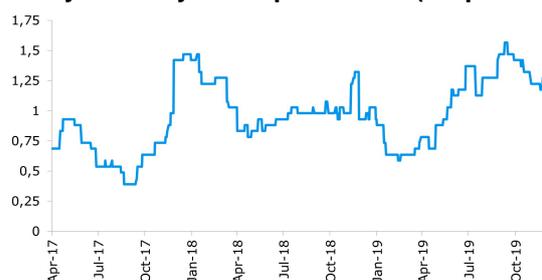
### Polish data to watch: December 13th to December 20th

Publication	Date	Period	mBank	Consensus	Prior
Real retail sales y/y (%)	20.12	Nov	1.1	4.2	4.6
Business confidence	20.12	Dec			
Unemployment rate (%)	23.12	Nov	5.1	5.1	5.0
Construction output y/y (%)	23.12	Nov	-2.1	-4.4	-4.0
Money supply M3 y/y (%)	23.12	Nov	9.0	9.2	9.3

### 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

Index moved because of the lower than expected PPI reading (another month with deflation in producer prices). Other releases were in line or close to market consensus. Tomorrow, the index can move after the publication of retail sales data, and on Monday after construction output data.

\* 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 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 occasional 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	3.1
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	5.6
Repo rate (end of period %)	1.5	1.5	1.5	1.5	1.5	1.5

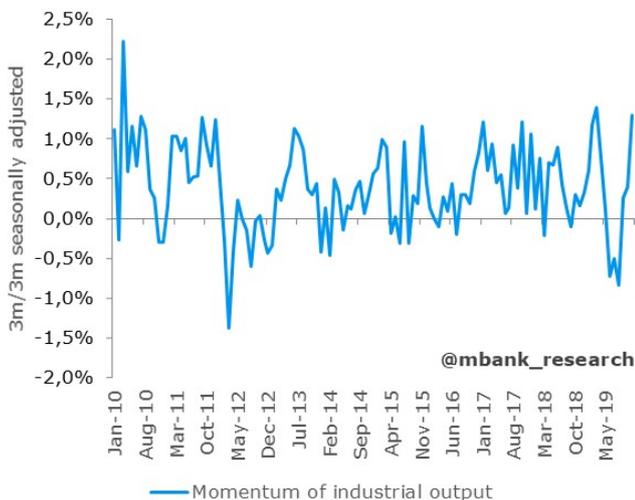
	2019 Q1	2019 Q2	2019 Q3 F	2019 Q4 F	2020 Q1 F	2020 Q2 F	2020 Q3 F	2020 Q4 F
GDP y/y (%)	4.8	4.6	3.9	3.7	3.2	2.7	2.6	2.6
Individual consumption y/y (%)	3.9	4.4	3.9	4.3	4.3	4.0	3.4	2.8
Public Consumption y/y (%)	6.3	3.1	4.7	5.0	3.0	3.0	3.0	3.0
Investment y/y (%)	12.2	9.1	4.7	2.5	-2.0	-3.0	-3.0	-3.0
Inflation rate (% average)	1.2	2.4	2.8	2.7	3.6	3.2	2.9	2.8
Unemployment rate (% eop)	5.9	5.2	5.1	5.2	5.3	5.0	5.2	5.6
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

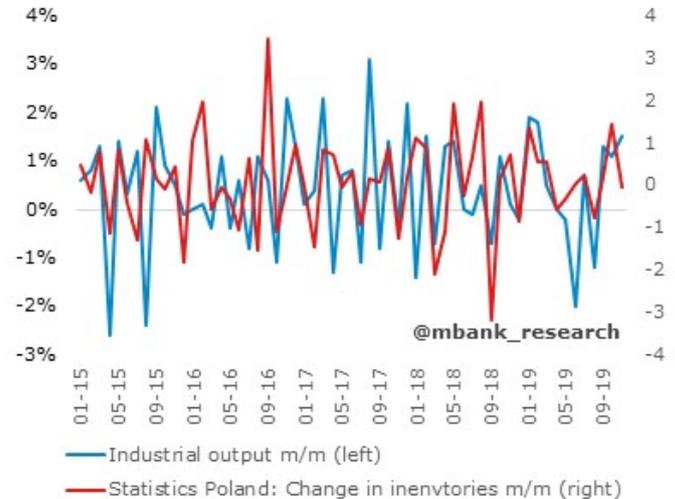
## Economics

### Industrial production surprised to the upside, producer prices to the downside

**Industrial production** increased in November by 1.4% y/y, above both the consensus (0.5% y/y) and our forecast (-1% y/y). Compared to October the slowdown was slight, especially when looking at difference in working days (decrease from 0 to -2 y/y). There are two reasons for our forecast error. First, mining and energy production was better than we expected (by about 11-12 pp.), which has added about 1.6 pp. to our overall industrial production forecast. It is quite surprising, especially in the energy sector, as warm November should have lowered output in this category. Second reason is the result of manufacturing – it was better than our forecast by about 1.5 pp and resulted in positive yearly dynamics (it managed to get over 0 to +0.2% y/y). But still it was one of the worst Novembers in time series history, mostly due to the calendar effects.



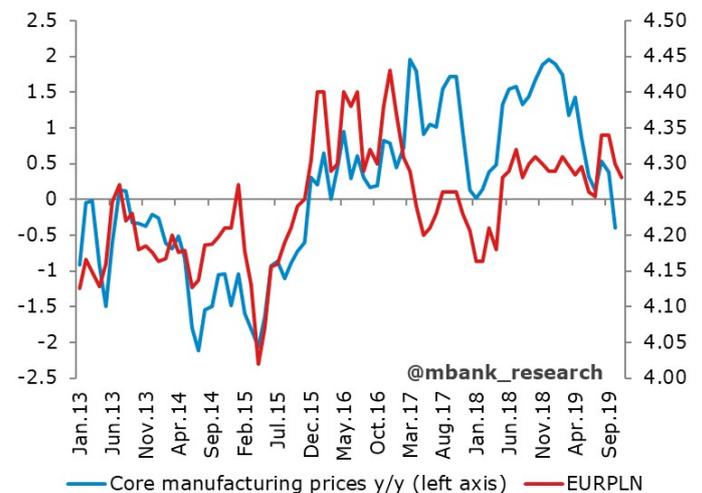
Production adjusted for the seasonal and calendar effects increased by 1.5% and it is the third such good month in a row. Therefore the industrial production momentum is back at the level last seen in March (see graph above). It is highly visible that fluctuations of monthly production readings increased this year (it is clear when looking at both momentum and quarterly means). Is there any fundamental explanation? Last month we had the hypothesis that the reason was in stockpiling because of Brexit. It had sense when analyzing data from the beginning of year – high industrial output could be seen in almost every European economy and higher inventories were reported in firms' surveys. In autumn, positive surprises did not repeat in Europe, but some signs of higher inventories were visible in Polish sentiment surveys (see graph below). But the November's reading goes beyond the period of possible stockpiling which questions our hypothesis. We should know more after December data, especially when analyzing them with exports structure.



Industrial production reading slightly increases out estimates of GDP in 4th quarter – with still just a few of monthly data we estimate its growth at 3,7% y/y. But the construction output will be crucial here (publication on Monday). Also output (or in more details investments) is the main reason of lower GDP dynamics in next quarters.

**Producer prices** surprised to the downside: -0.1% y/y. The reasons for surprise are three-fold: 1) revision of the last reading, 2) softness in overall pricing behavior (core manufacturing), 3) emerging softness in energy-related goods pricing. All in all deflation in core manufacturing deepens. It would be interesting to see how manufacturing firms respond to increases in minimum wage in January. The overall lack of pricing power suggests negligible pass-through.

The data should be viewed as a support for hawks. However, it would be a little hasty conclusion. It is true that the data are better at first sight. However, improvement in manufacturing data is negligible and pricing power seems to be continuing its decline. It is then fair to say that MPC may simply ignore the data and wait for another inflation projection when risks concerning investment activity may or may not materialize.



## Fixed income

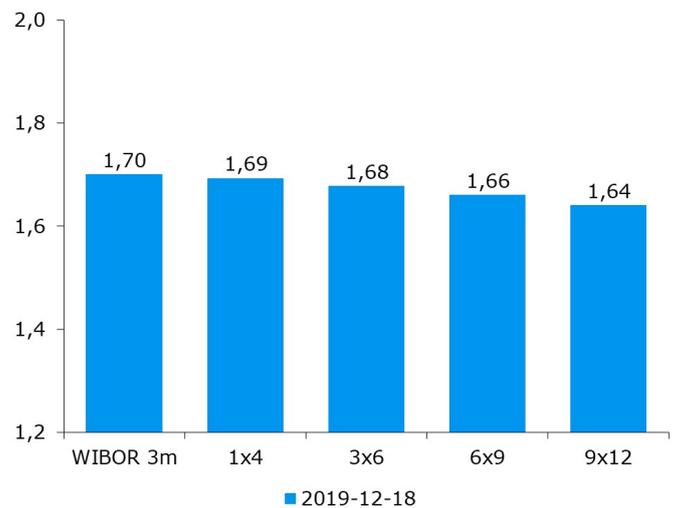
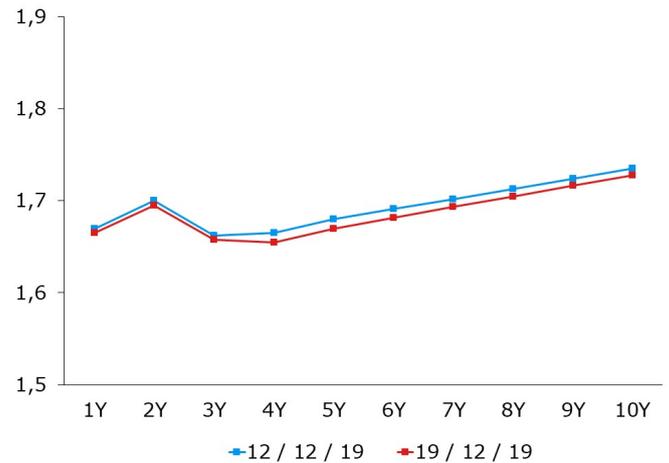
### End of the month approaching

As usual, as the month's end is approaching, several market anomalies can be seen on bonds, mostly due to the problems with covering short bonds positions. WS0428/DS1029 spread remains almost flat, PS0424/PS1024 flattened significantly despite whole yield curve steepening. We don't expect much action this year, however buying interest on ASWs is visible after ASWs widened a bit.

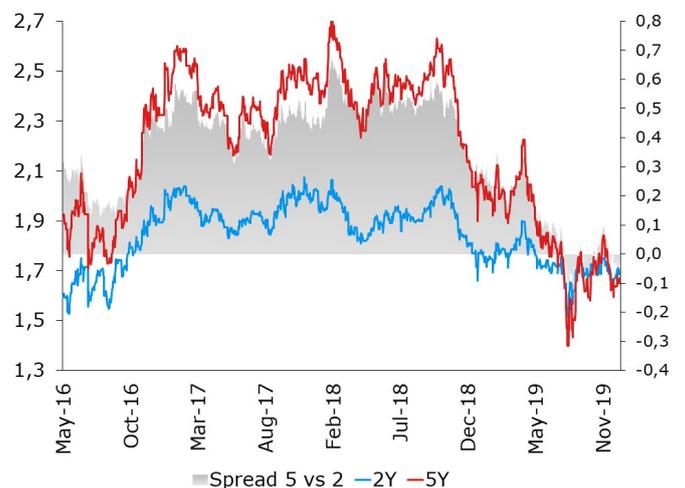
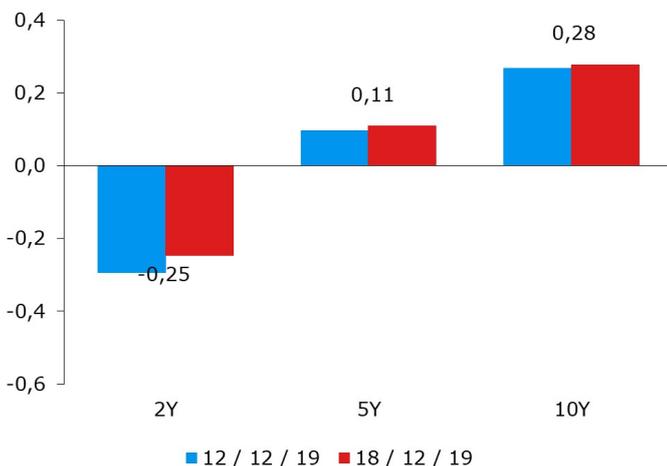
PS1024/5y is 9 bps, DS1029/10y is 30 bps. PS1024/DS1029 is 27.5 bps DS1029/Bund is 228 bps.

DS1021 is trading at 1.43% (5 bps up), PS1024 is trading at 1.80% (5 bps up) and DS1029 is trading at 2.07% (6 bps up).

IRS curve



Asset swaps

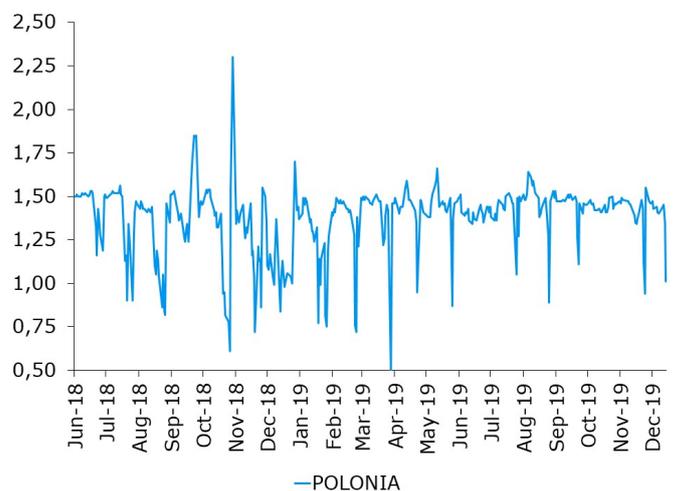
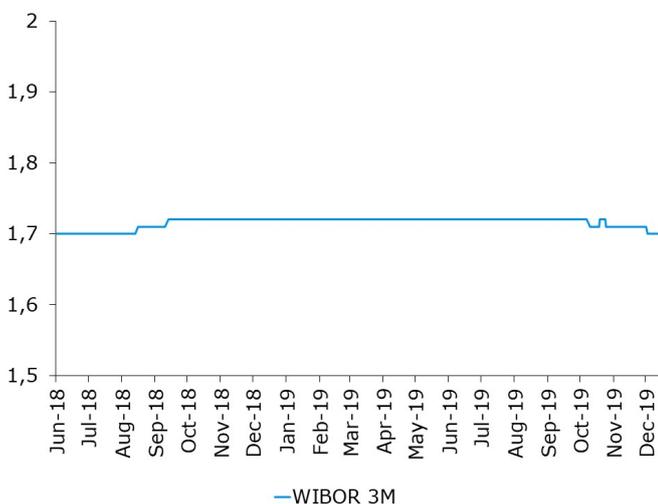
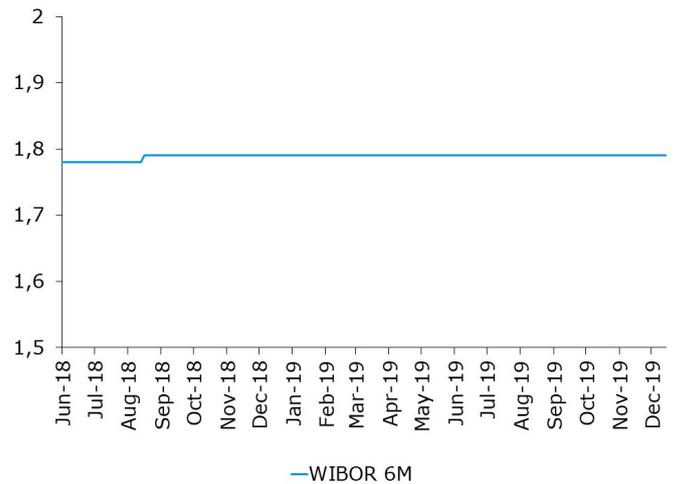


## Money market

### Yields climbing higher amid poor liquidity

Core yields are climbing higher each day and testing many month highs. It feels like a story for negative yields is fading, with central banks understanding they can not go further into negative territory. Bund is climbing towards 0% and 10y treasury is approaching 2%. Polish yields are following core markets with 5y reaching 1.71%.

Cash rates have been lower for last two days with lots of spare liquidity. We are entering Christmas and year-end period. It tends to be cheaper these days, but liquidity is so poor that any bigger amount can move the market significantly. Let me remind you of the last year, when PLN rates were trading at 100% for few days in late December.



## Forex

**Spot – Zloty stronger** In recent days the zloty gained. At the beginning of the week, global market sentiment was affected by an agreement on the terms of the "phase one" US - China trade deal and the conservative party's victory in general elections in the United Kingdom. In other words we have an improvement in global sentiment. Optimism affected the zloty. EURPLN fell to 4.25555 and USDPLN to 3.8110. EURPLN is currently testing the 4.26 support zone. We still expect the 4.25-4.30 range to cover most of the moves.

**Opts – volatility stable** Fast approaching Christmas, the lack of real thrill and fat theta bills were the reasons why the front end of volatility curve has collapsed. 2W EUR/PLN and USD/PLN dived by 1.0% and 2.0% respectively and fixed at 3.0% and 4.85%. The rest of the curve is quite stable. EUR/PLN 1 month ATM mid fixed today at 3.55% (0.2% higher), 3 months EUR/PLN are 3.75% (no change) and finally 1 year is 4.15% (no change). The skew is a little lower, along with a currency spread (difference between USD/PLN vol and EUR/PLN vol).

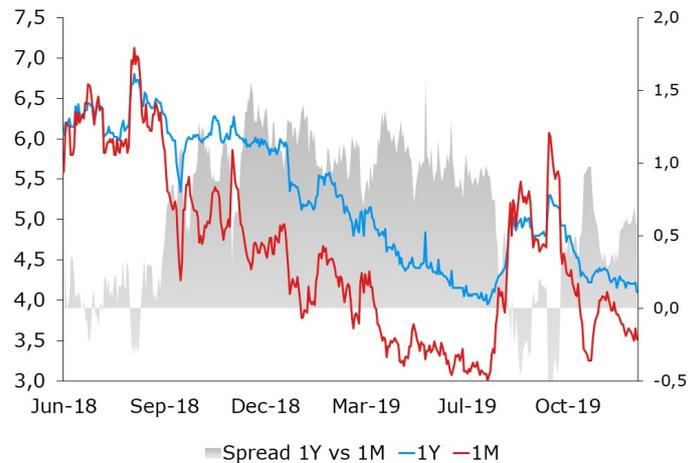
## Short-term forecasts

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

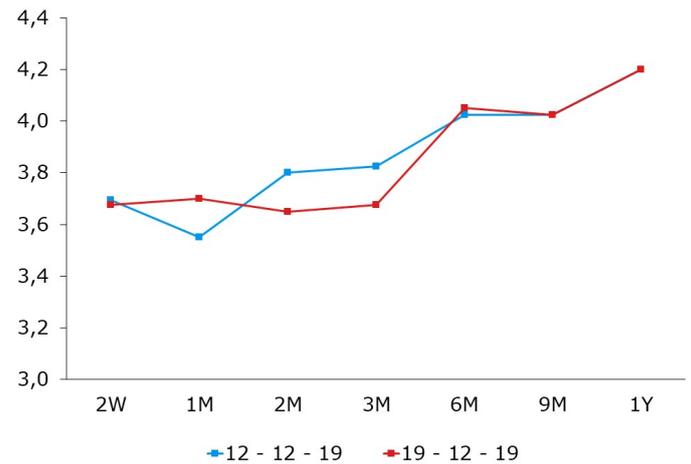
### Spot: Current position: None

At the moment we do not have any position, but we are ready to buy EUR / PLN near 4.25. We still believe in 4.25-4.30 range trading in EUR/PLN and do not expect to break this range during the holiday season

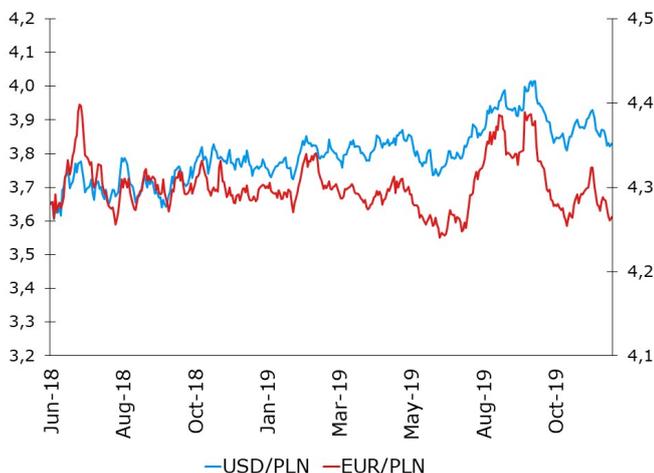
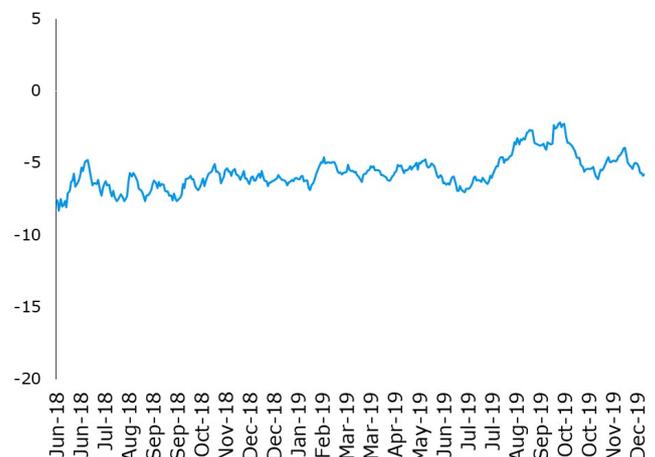
EURPLN volatility



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
12/12/2019	1.94	1.70	1.93	1.69	1.95	1.74	1.69	1.69	1.67	1.66	1.61	1.75
12/15/2019	1.92	1.70	1.93	1.69	1.96	1.74	1.69	1.69	1.67	1.64	1.62	1.75
12/16/2019	1.92	1.70	1.94	1.69	1.99	1.74	1.70	1.69	1.66	1.63	1.60	1.75
12/17/2019	1.84	1.70	1.86	1.69	1.90	1.74	1.70	1.69	1.66	1.64	1.60	1.73
12/18/2019	1.92	1.70	1.95	1.69	2.01	1.74	1.69	1.68	1.66	1.64	1.61	1.73

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
12/12/2019	1.740	0.828	1.700	1.406	1.680	1.777	1.735	2.003
12/15/2019	1.740	0.859	1.710	1.394	1.660	1.769	1.718	2.029
12/16/2019	1.740	0.883	1.690	1.428	1.655	1.777	1.705	1.995
12/17/2019	1.740	0.891	1.685	1.438	1.648	1.765	1.698	2.027
12/18/2019	1.740	0.884	1.695	1.448	1.670	1.779	1.728	2.006

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
12/12/2019	3.55	3.83	4.03	4.20	4.20	0.96	0.42
12/15/2019	3.50	3.85	4.00	4.20	4.20	0.96	0.42
12/16/2019	3.65	3.88	4.03	4.23	4.23	0.91	0.42
12/17/2019	3.51	3.85	3.99	4.10	4.10	0.91	0.41
12/18/2019	3.70	3.68	4.05	4.20	4.20	0.91	0.43

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
12/12/2019	4.2846	3.8505	3.9181	3.5426	1.3001	0.1679
12/15/2019	4.2747	3.8234	3.8919	3.4871	1.3000	0.1676
12/16/2019	4.2659	3.8311	3.8953	3.5015	1.2966	0.1673
12/17/2019	4.2605	3.8211	3.8850	3.4856	1.2892	0.1672
12/18/2019	4.2644	3.8302	3.9069	3.5001	1.2897	0.1674

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