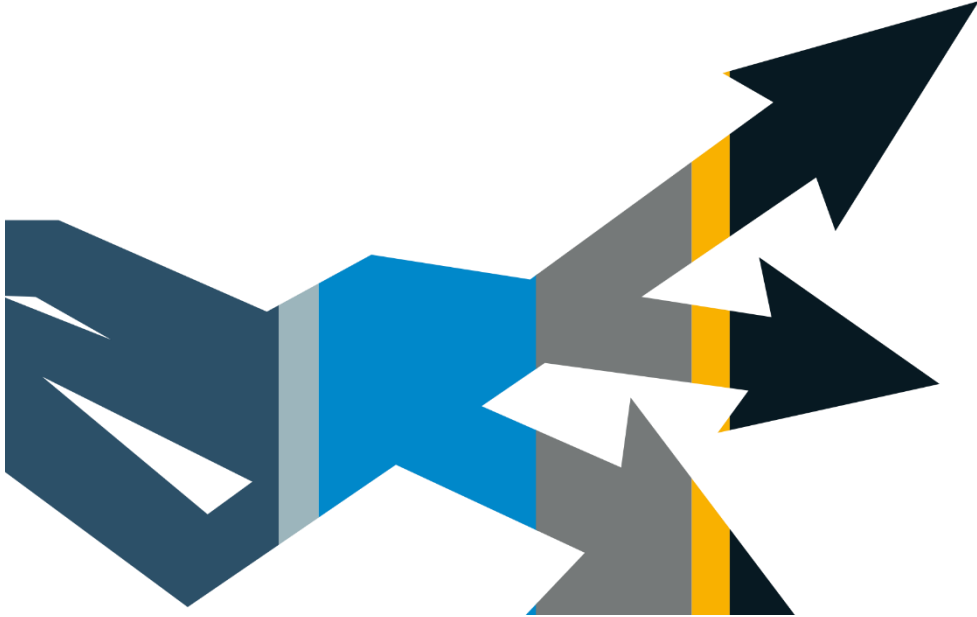


Monthly Pulse Check

Economy, FI, FX

April 9th 2020



mBank Research

For contact details and classification of the report see the [last page](#).

Our view in a nutshell ($\geq 1Y$ horizon) & major forecasts

Macro

- ❖ Pandemics changed economic picture abruptly. Deep recessions in major economies are in the cards. It is forecast that the peak in the numbers of infected is to come in May/June. It is yet to be seen how fast various restrictions will be lifted and how the economies are going to be affected. We argue that it is not a normal recession but a one carrying substantial structural change. Therefore the return to normality will be painfully slow even though we are about to temporarily see strong GDP numbers as economies jump start. Fiscal policy gets actively involved along with central bank support.
- ❖ Polish economy is not an exception. We expect 4.2% recession in 2020 and substantial drop of core inflation into year's end. Seemingly high CPI inflation results from high food prices and possible (delicate) turnaround in oil prices in H2. Q4 2019 GDP level is not to be reached until 2022.

Monetary policy: Fed, ECB, NBP

- ❖ Fed: ZIRP + QE + direct loans to firms. All in.
- ❖ ECB: NIRP (already there) + QE Expansion (maximum flexibility).
- ❖ NBP: Rates cuts (total 100bp). QE already in place (govvies + bonds with state guarantees. Polish TLTRO in the pipeline. Over to fiscal policy now and no more rate cuts.

FX Market

- ❖ 4.40 breached and it will take time for EURPLN to correct lower. In the meantime we expect GDP slowdown and interest cuts to depress the currency further. We should allow some temporary overshooting with regard to EOP rates values presented in the table. Stabilization of the economy and better market sentiment should help PLN return to somewhat stronger levels but in the medium term we may expect overall weaker currency.

		2019	2019	2019	2019	2020	2020	2020	2020
		Q1	Q2	Q3	Q4	Q1 F	Q2 F	Q3 F	Q4 F
GDP y/y	%	4.8	4.6	3.9	3.2	1.5	-8.4	-5.7	-4.0
Individual consumption y/y	%	3.9	4.4	3.9	3.3	-1.0	-18.0	-13.0	-10.5
Public Consumption y/y	%	6.3	3.1	4.7	3.1	6.0	10.0	7.0	6.0
Investment y/y	%	12.2	9.1	4.7	4.9	4.0	-9.5	-17.0	-15.0
Inflation rate (average)	%	1.2	2.4	2.8	2.8	4.5	2.9	2.1	2.1
Unemployment rate (eop)	%	5.9	5.2	5.1	5.2	5.3	8.6	12.0	13.0
NBP repo rate (eop)	%	1.50	1.50	1.50	1.50	1.00	0.50	0.50	0.50
EUR/PLN (eop)	%	4.30	4.24	4.37	4.25	4.56	4.70	4.70	4.60
USD/PLN (eop)	%	3.84	3.73	4.01	3.79	4.13	4.20	4.09	3.93

F - forecast

Upcoming macro releases: April 2020

Publication	Date	Period	mBank	Consensus	Actual	Prior
PMI (pts.)	01.04	Mar	45.0	45.0	42.4	48.2
Unemployment rate (%)	~10.04[1] 24.04[2]	Mar	5.4%	5.6%		5.5%
Current account (m EUR)	14.04	Feb	676	370		2265
CPI y/y (%)	15.04[3]	Mar	4.6%	4.4%		4.7%
Employment y/y (%)	20.04	Mar	1.0%	0.8%		1.1%
Wages y/y (%)	20.04	Mar	6.4%	6.4%		7.7%
Industrial output y/y (%)	21.04	Mar	-5.8%	-2.1%		4.9%
PPI y/y (%)	21.04	Mar	-0.7%	-0.5%		0.1%
Construction output y/y (%)	23.04	Mar	-0.5%	0.8%		5.5%
Retail Sales y/y (%)	22.04	Mar	-11.0%	-2.0%		7.3%
M3 y/y (%)	23.04	Mar	9.8%	9.3%		9.4%

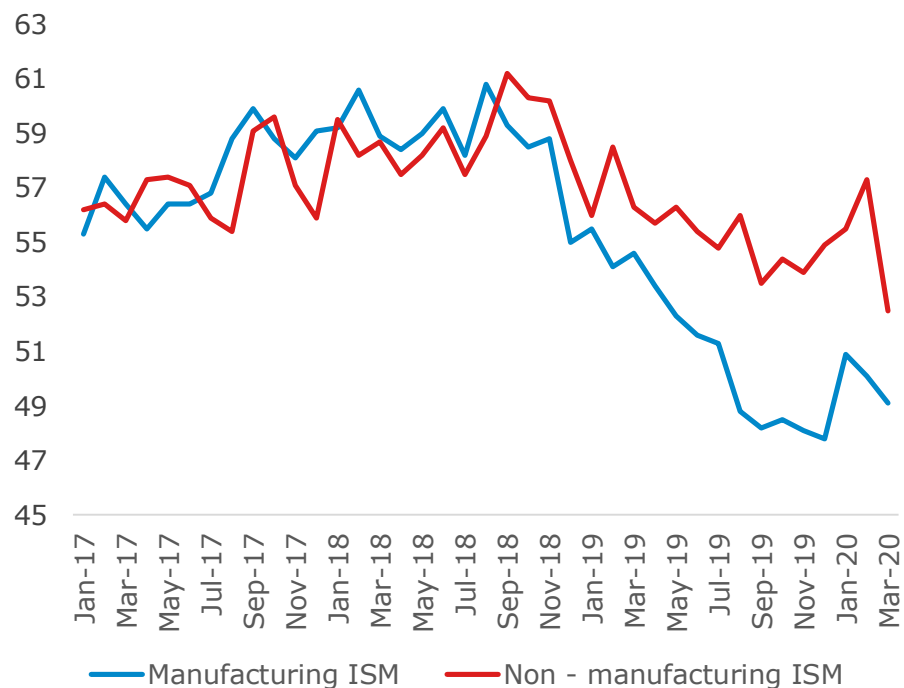
[1] Ministry of Family, Labour and Social Policy estimate

[2] Statistics Poland final reading

[3] Final reading

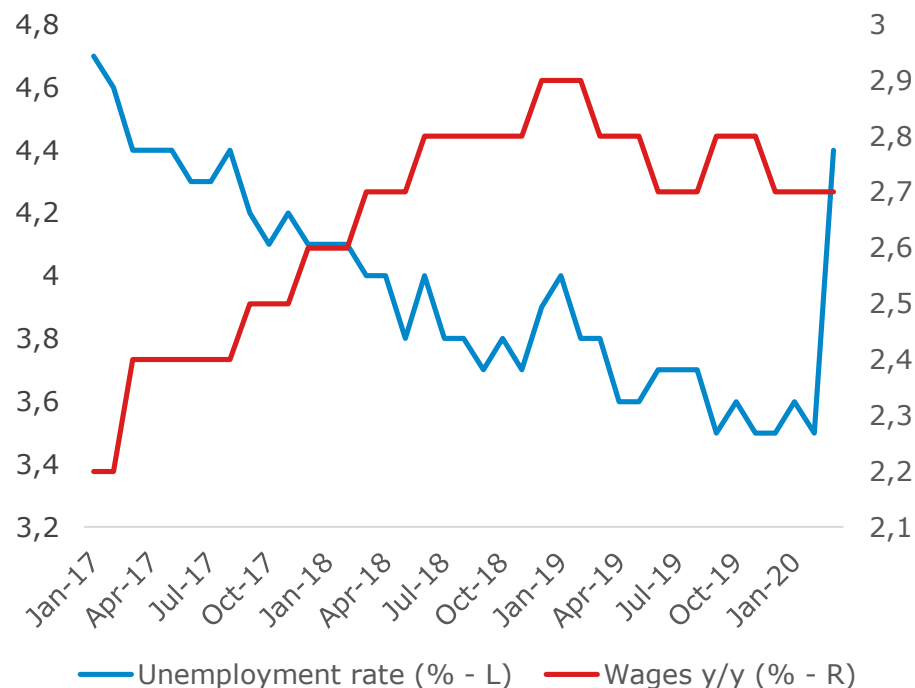
U.S. economy health check

ISM PMI: manufacturing & non-manufacturing



Source: ISM

Labor market: wages & unemployment rate

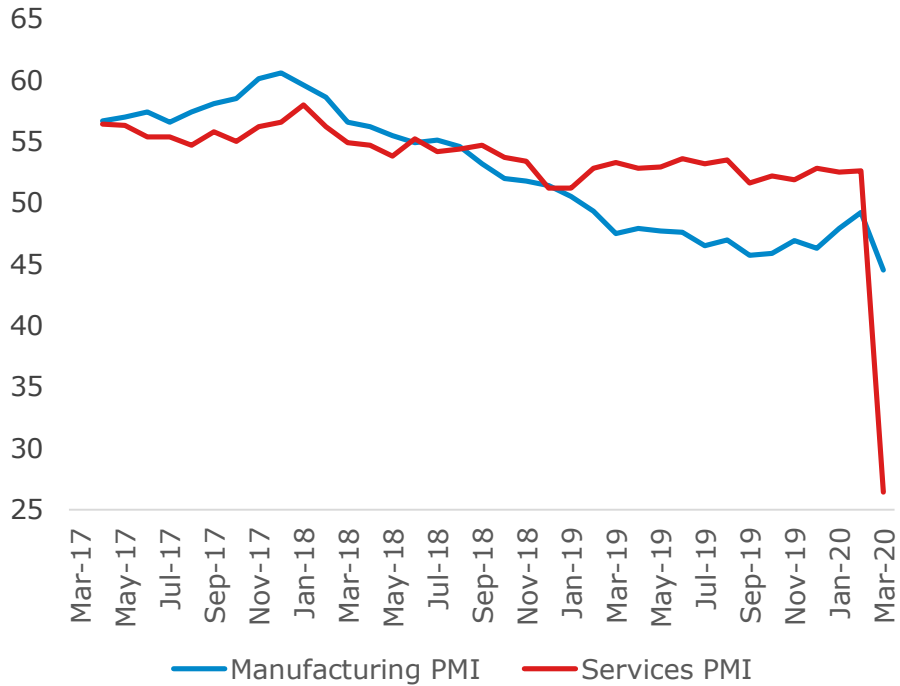


Source: FRED

- ❖ Business activity indicators have not adapted yet to new economic reality. We are going to see substantial drops in April data (publ. end of May). The best indicator to use now are initial jobless claims. Some of it has already filtered to monthly data from household survey (as presented by www.bls.gov) but more is to come. Rough estimate suggest at least 10-15% of labor force is going to lose job almost on the spot. And we are still not out of the woods since COVID-19 outbreak is in full throttle.
- ❖ Substantial fiscal package has been put into force (10% GDP and yet there are rumors on another 5%) coupled with Fed action (ZIRP on the spot, open ended QE (bonds + c bonds), additional repo, measures aimed at channeling direct flow of credit to economy. Fed to keep extraordinary measures until it is "confident the economy has weathered recent events".
- ❖ The most recent estimates put GDP into recession of ~5% in 2020. So far forecasts assume something close to V-shape. Risks are to the downside especially with respect to the speed of recovery on the depth of the bottom.

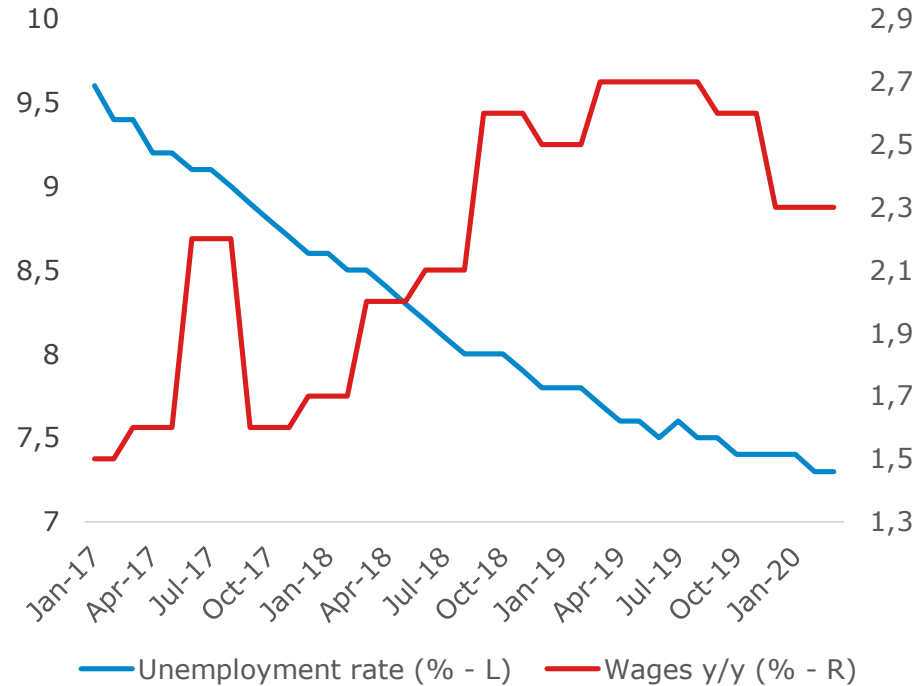
Euro area economy health check

Markit PMI: manufacturing & services



Source: Markit

Labor market: wages & unemployment rate

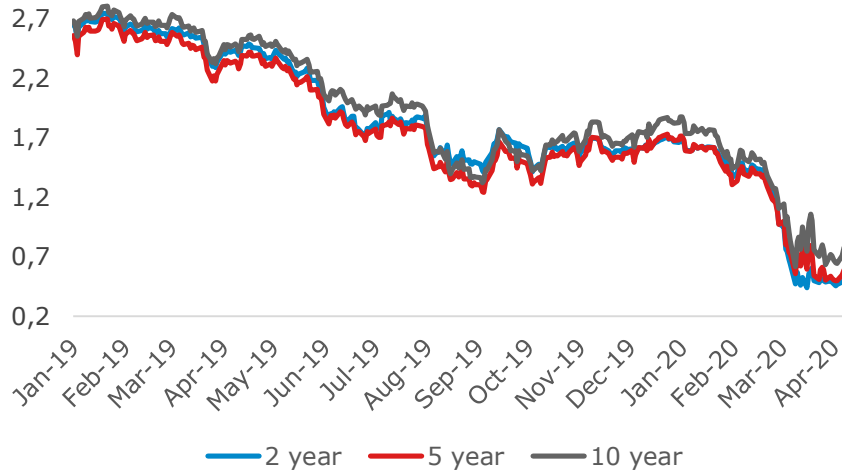


Source: Eurostat

- ❖ The left graph is not broken. It just shows how service sector is battered. Unemployment rates are slower to respond than in the U.S. but they will. Fiscal packages delivered in various countries (the pan-European grand solution is still missing) are set to contain mass layoffs but still pandemics is not over, structural change is pending and second round effects are lurking around the corner. It will be much worse before it gets better.
- ❖ The scope of national fiscal packages is not uniform and changes fast (2-5% GDP range so far). They concentrate on keeping firms afloat by providing liquidity. No direct cash handouts as in the U.S. Stability and Growth Pact temporarily and effectively suspended. ECB response was grand (another big QE with almost full flexibility). It is ECB job to keep spreads in check until some euro area wide solution is adopted (that is going to take time).
- ❖ Consensus assumes euro area wide recessions (-4-8%) in 2020 but still rebound seen as close to V-shape. Risks are tilted to the downside especially with respect to the speed of recovery.

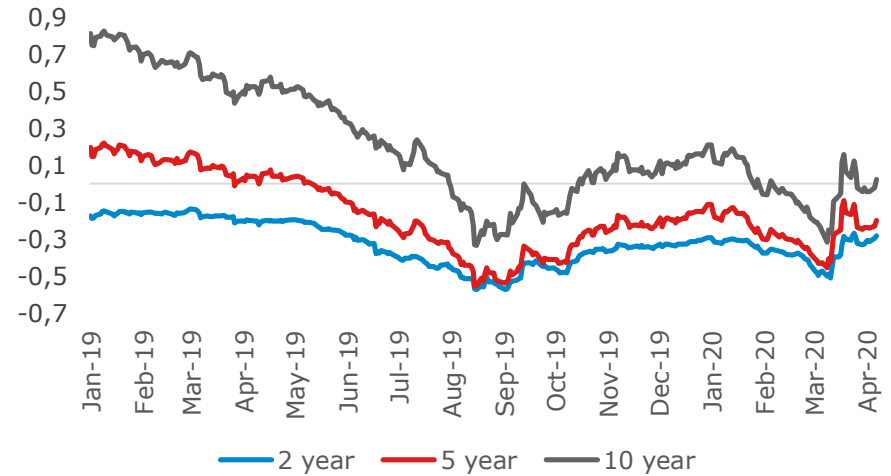
Global rates: Low for long

US swap rates (%)



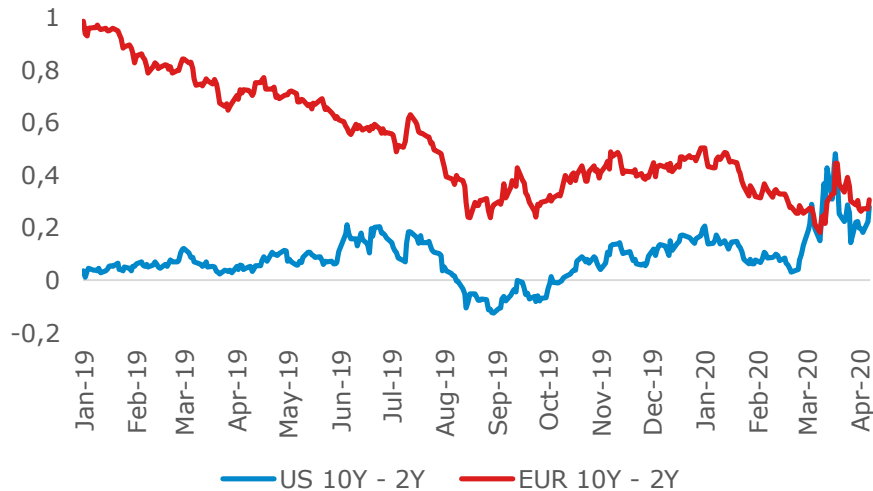
Source: Bloomberg

EU swap rates (%)



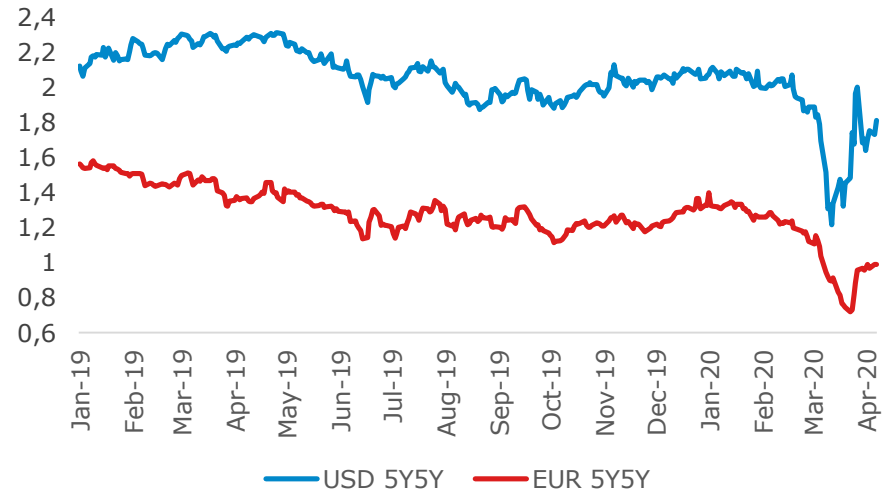
Source: Bloomberg

Swap spreads (10Y-2Y, p.p.)



Source: Bloomberg

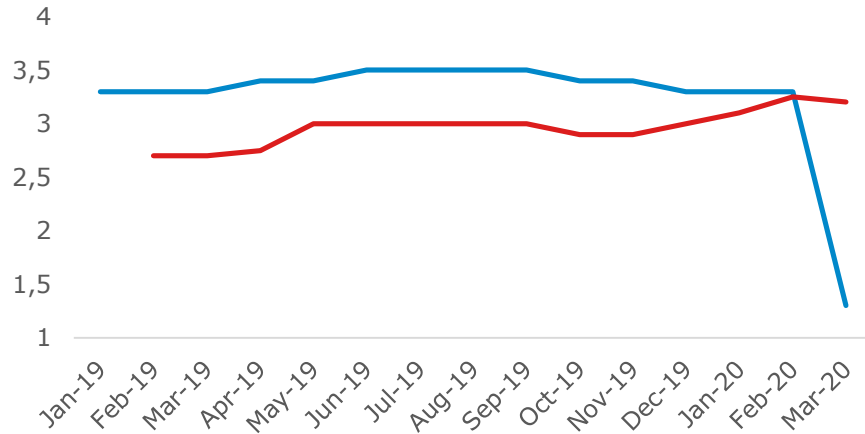
US and EZ inflation expectations (%)



Source: Bloomberg

Consensus*: what is expected in Poland?

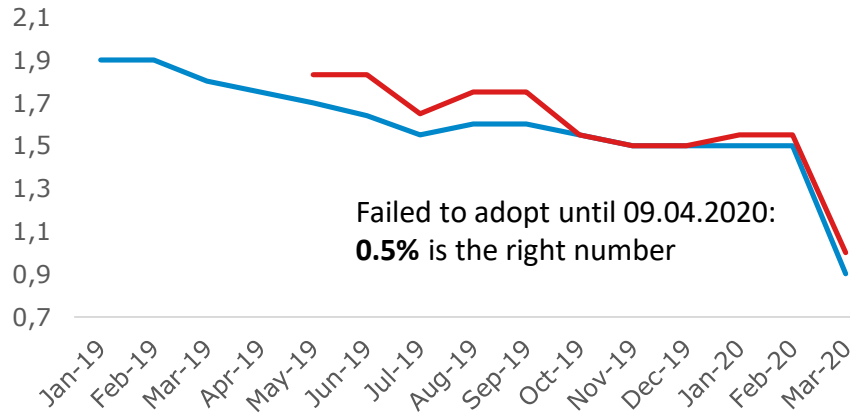
Consensus tracker: GDP growth (% y/y, annual avg)



Source: Bloomberg

— 2020 — 2021

Consensus tracker: NBP ref. rate (% , end of period)

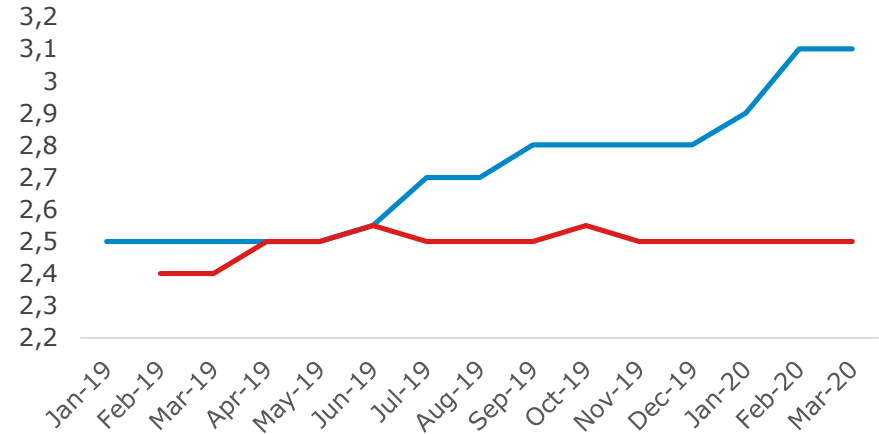


Source: Bloomberg

— 2020 — 2021

Failed to adopt until 09.04.2020:
0.5% is the right number

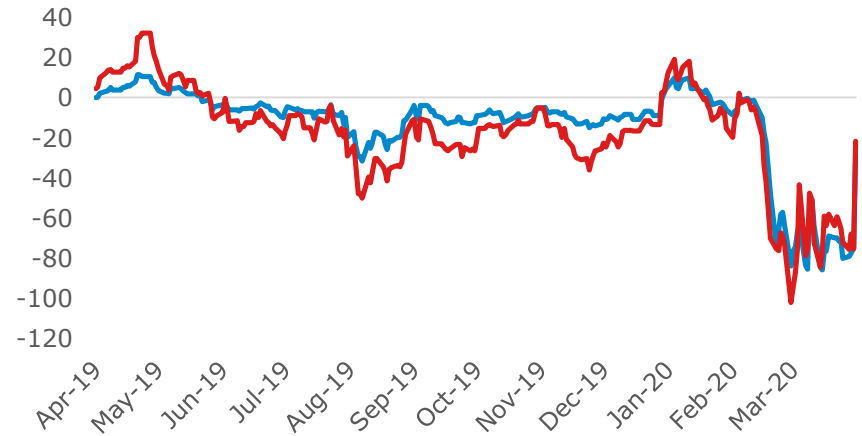
Consensus tracker: CPI inflation (% y/y, annual avg)



Source: Bloomberg

— 2020 — 2021

Rate changes priced in by FRA (bps)



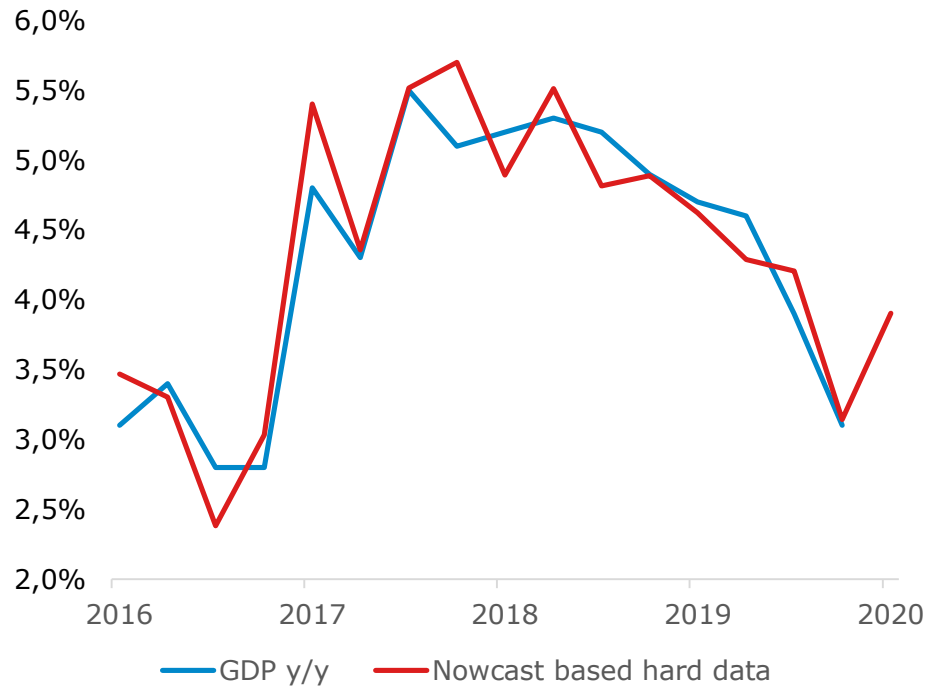
Source: Bloomberg

— 12x15 — 21x24

*Current consensus values at Bloomberg seem to underestimate the scale of recession (they were compiled in March). According to NBP Survey of Professional Forecasters GDP growth in 2020, with a 50% probability will be in the range of -4.5% - -0.5% (90% probability: -9.4% - 2.2%), and 1.1% - 4.7% next year (-1.7% - 9.2% with 90% prob.) According to forecasters, inflation in 2020 will be in the range of 2.5% - 3.8% (50% prob.) and in the 2021 in 1.6% - 3.3% (50% prob.).

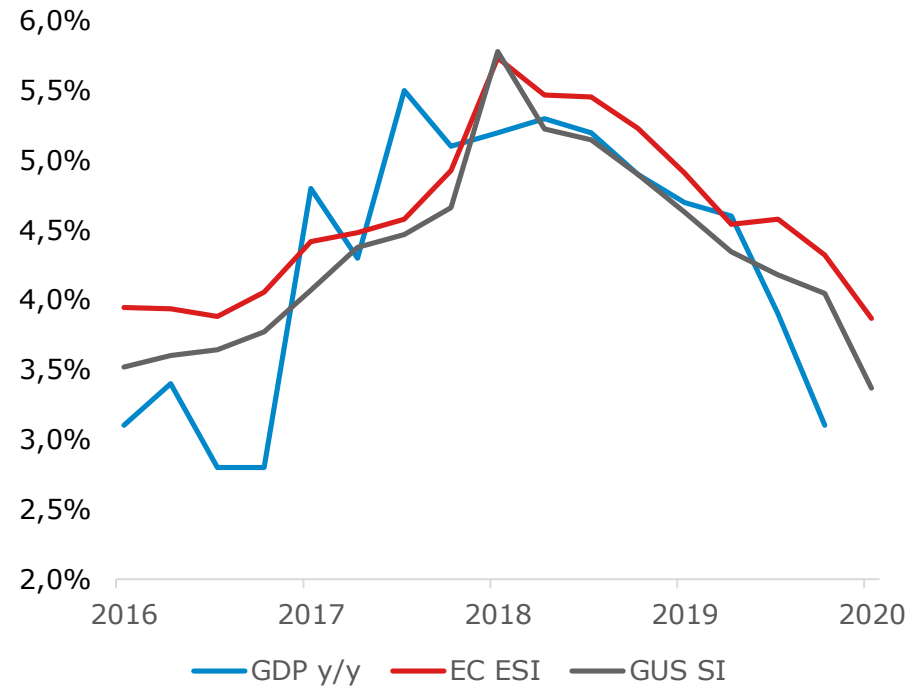
Short-term GDP tracker

GDP nowcast based on hard data



Source: Statistics Poland, own elaboration

GDP nowcast based on business tendency indicators

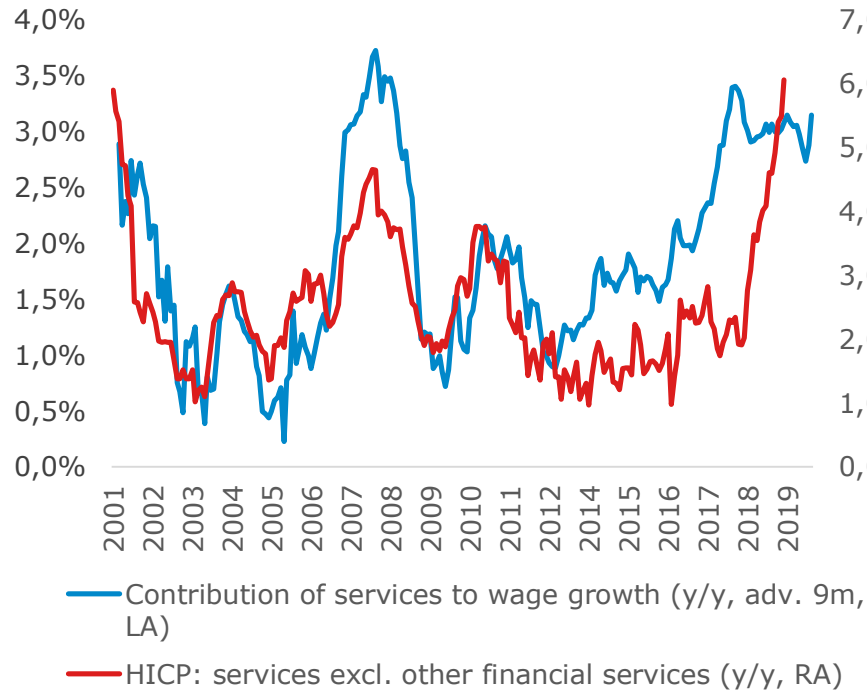


Source: Statistics Poland, Eurostat, own elaboration

- ❖ Trackers based on hard data suggest that business activity was even better than in Q4. It is true but only for the first two months of the year. Incorporation of march data is going to depress the reading. However, it is also true that the slowdown in economic activity is happening from quite a high „base“.
- ❖ Trackers based on business activity indicators have also upside bias right now: 1) they encompass mostly first part of March when activity was rather ok, 2) they cannot account properly for the slowdown in consumption and especially services that drives the dip.
- ❖ Therefore we estimate Q1 2020 GDP growth at 1.5% y/y – much below nowcasting models.

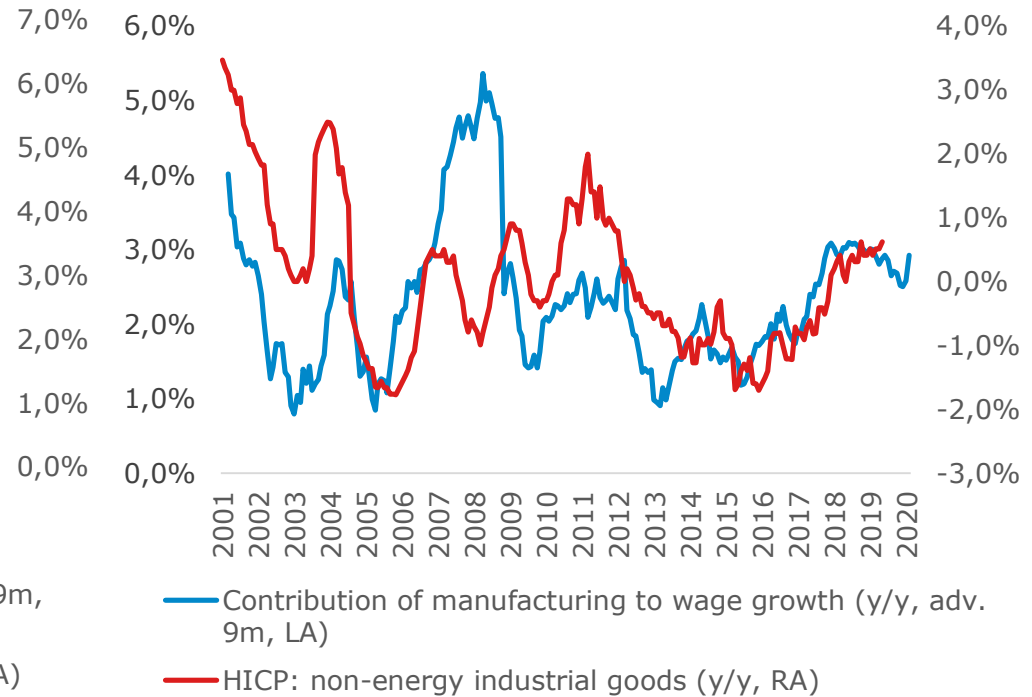
Short-term inflation tracker

Wages & consumer prices: services



Source: Statistics Poland, Eurostat, own elaboration

Wages & consumer prices: goods

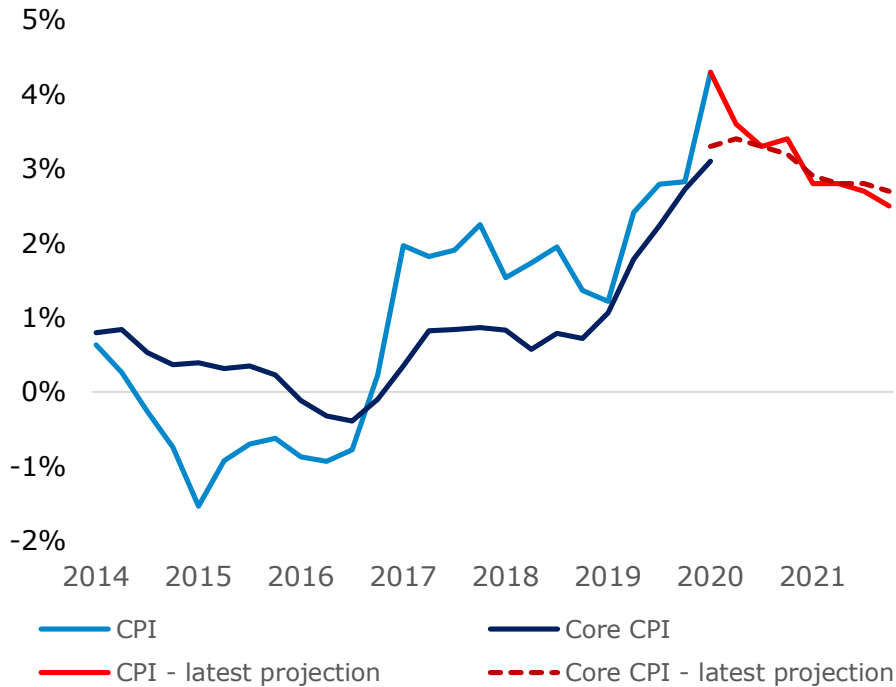


Source: Statistics Poland, Eurostat, own elaboration

- ❖ Wages point to gradual deceleration of inflation and it is the same story that has been in place even before the pandemics started. This process is set to accelerate now.
- ❖ March inflation is going to be still elevated. However, the drop in fuel prices, clothing prices and services prices (tourism, recreation and culture, restaurants) is set to lead CPI closer to 2% in the next 6 months. This marks a swift turnaround in inflation. We see food prices elevated (supply factors – we are heading towards another drought) therefore the drop of inflation is not going to be even more rapid.
- ❖ Our models based on GDP gap suggest ~-1-0% core inflation in 2020-2021.

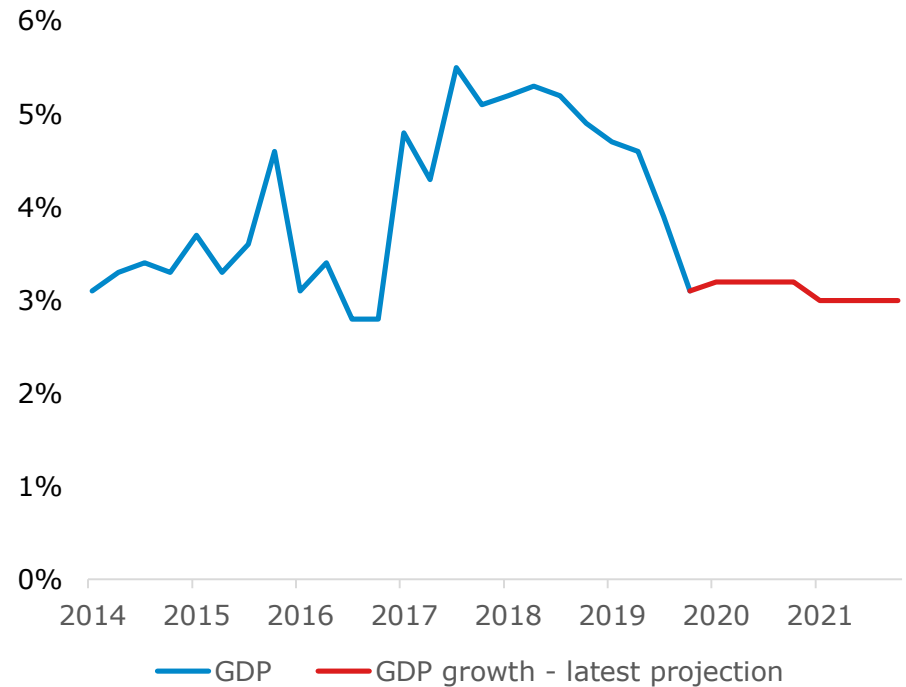
Polish monetary policy radar

NBP's latest projection: inflation (outdated)



Source: NBP, Statistics Poland, own elaboration

NBP's latest projection: GDP growth (outdated)

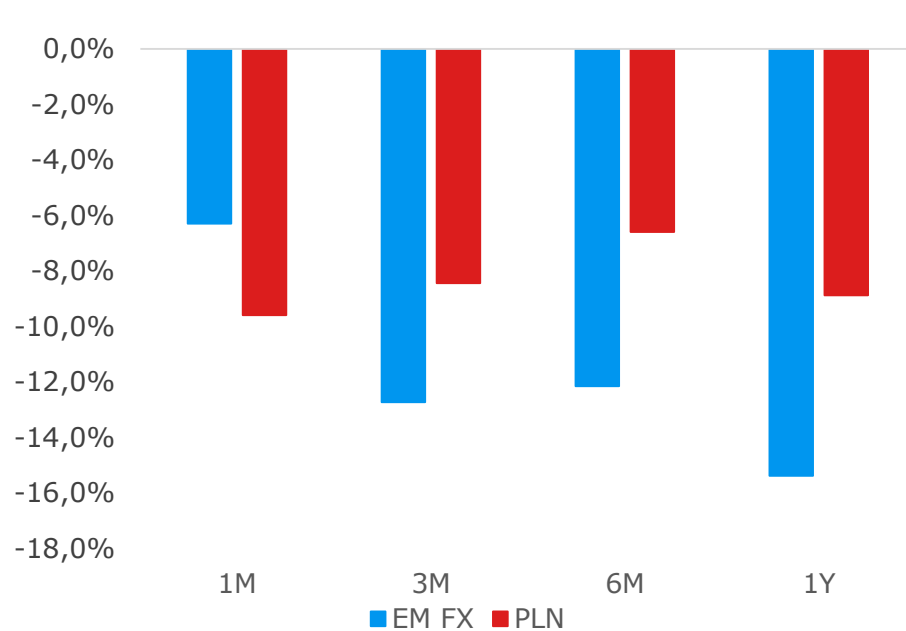


Source: NBP, Statistics Poland, own elaboration

- ❖ Of course everything from February projections is severely outdated. More useful gauge is provided by the Survey of Professional Forecasters, as compiled by the NBP. GDP growth in 2020, with a 50% probability will be in the range of -4.5% – -0.5% (90% probability: -9,4% – 2,2%), and 1.1% – 4.7% next year (-1.7% – 9.2% with 90% prob.) According to forecasters, inflation in 2020 will be in the range of 2.5% – 3.8% (50% prob.) and in the 2021 in 1.6% – 3.3% (50% prob.).
- ❖ Latest interest rate cuts (100bp cumulatively) mark the end of swift monetary policy adjustment by interest rates. We think that MPC internalized quite proper economic scenario and will not be spooked by the incoming data. Further rate cuts are not as unequivocally supporting the economy as the former ones and are not going to be treated as first best solution by MPC.
- ❖ NBP has new tools: QE. With cooperation with Polish Development Fund (PFR) they can generate up to PLN 100 bn new money supply that can be directly distributed to firms. Helicopter money is finally here. With such a new firepower the NBP may be relying more on fiscal policy to steer the economy out of the woods. It is much more effective tool than rate cuts.

PLN is holding still very well

PLN started to lose more recently but still performs relatively well.



Note: Increase = appreciation to dolar, decrease = depreciation to dolar

Source: Bloomberg

Real effective exchange rate: mild appreciation so far unlikely to be sustainable.

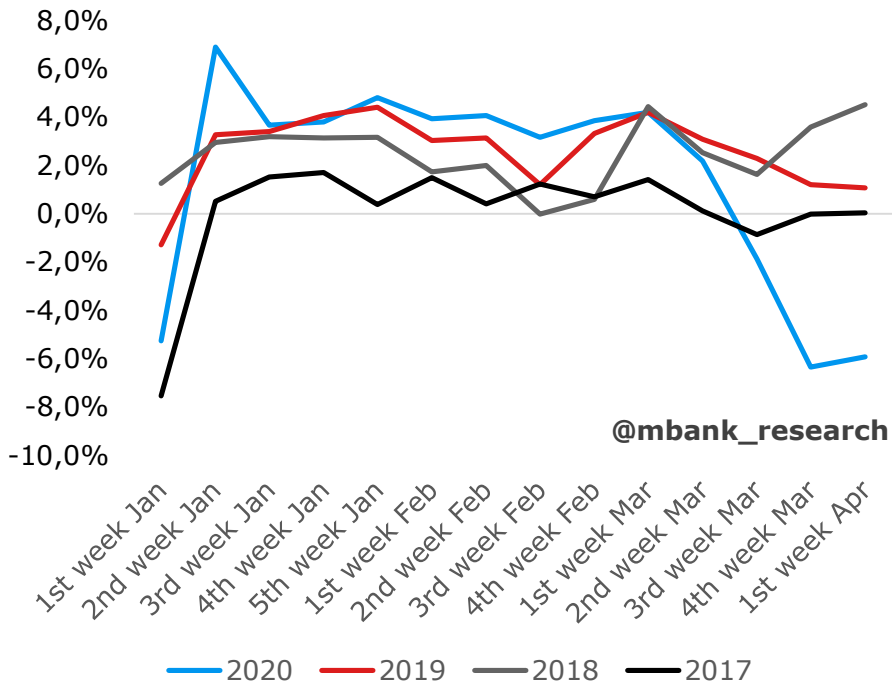


Source: BIS

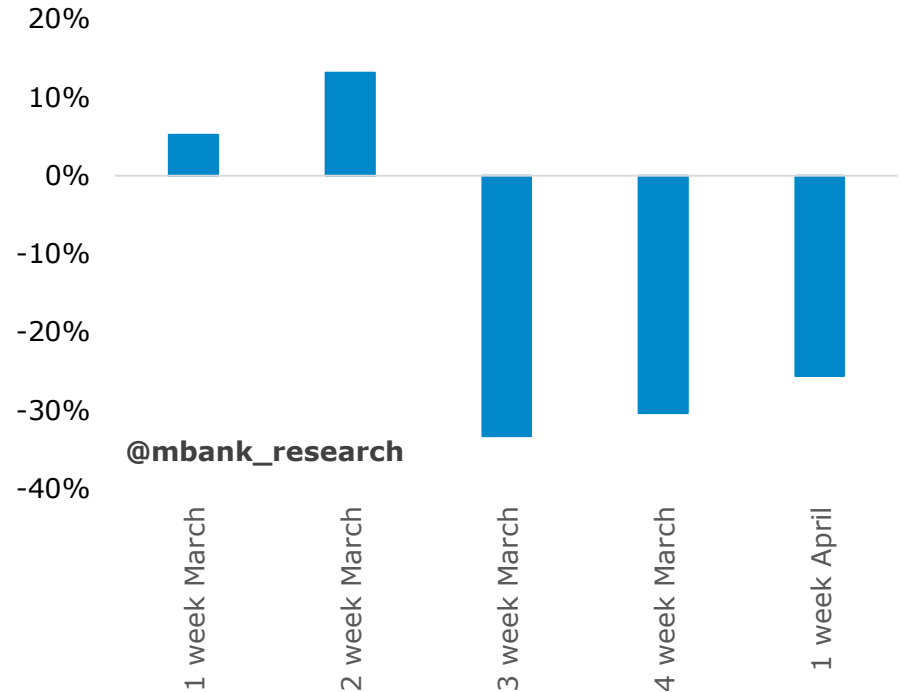
- ❖ 4.40 breached and it will take time for EURPLN to correct lower.
- ❖ In the meantime we expect GDP slowdown and interest cuts to depress the currency further. Massive increase in the money supply lies ahead of us.
- ❖ We should allow some temporary overshooting with regard to EOP rates values presented in forecasts. Stabilization of the economy and better market sentiment should help PLN return to somewhat stronger levels but in the medium term we may expect overall weaker currency.
- ❖ So far EUPLN depreciated by 7% in nominal terms. It's not a lot given the scale of the projected GDP slowdown. PLN hold through cut in interest rates also very well. It is best to assume at this very moment that it is only calm before the storm. 4.70 is within reach.

Mini-research note. Coronavirus impact on manufacturing and consumers.

Electricity consumption – percentage deviation from theoretical values implied by weather and working days.



30% drop in transactions' value during lockdown. Feb average = 100%.



Source: own elaboration based on electricity grid operator data

Source: own elaboration based on mBank transactions data excl. Blik, PayU

- ❖ Our system of tracking the economy relies on two pillars: electricity consumption and in house transaction value meter.
- ❖ The former is a proxy for manufacturing performance. The latter reflects the state of consumption.
- ❖ Manufacturing activity is down but holding relatively well. The worst is ahead of us but the support for the sector and possible improvement in export performance (weaker PLN + huge monetary and fiscal stimulation abroad) are set to improve manufacturing conditions meaningfully in the next months.
- ❖ Consumption is under the spell of the lockdown. We may safely assume that 0.2-0.3% consumption expenditures evaporated and this is reflected in our forecast. Situation is not going to improve soon and the return to normality will be slower than in manufacturing's case (we think Q4 2019 stream will be reached again in 2022/2023). We see current low levels of consumption to linger until the end of April.

Disclaimer and contact details

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