Monthly Pulse Check
Economy, FI, FX

May 7th 2020

mBank Research

For contact details and classification of the report see the last page.

Our view in a nutshell (≥1Y horizon) & major forecasts

Macro

- Pandemics changed economic picture abruptly. Deep recessions are fact as quarantines wreaked havoc with economic activity. Their magnitude and longitude is yet to be determined. The peak of new infections has come; yet the existence of second wave cannot be ruled out. 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 after the quarantine measures are relaxed. 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) + new LTRO.
- 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 low interest rates to depress the currency further. Stabilization of the economy and better market sentiment should help PLN return to somewhat stronger levels but in the medium term we may except overall weaker currency. The consensus is too optimistic.

		2019 Q1	2019 Q2	2019 Q3	2019 Q4	2020 Q1 F	2020 Q2 F	2020 Q3 F	2020 Q4 F
GDP y/y	%	4,8	4,6	3,9	3,2	1,8	-8,4	-5,7	-4,0
Individual consumption y/y	%	3,9	4,4	3,9	3,3	-0,8	-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	5,0	-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	10,2	10,2
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	4,16	4,00

F - forecast

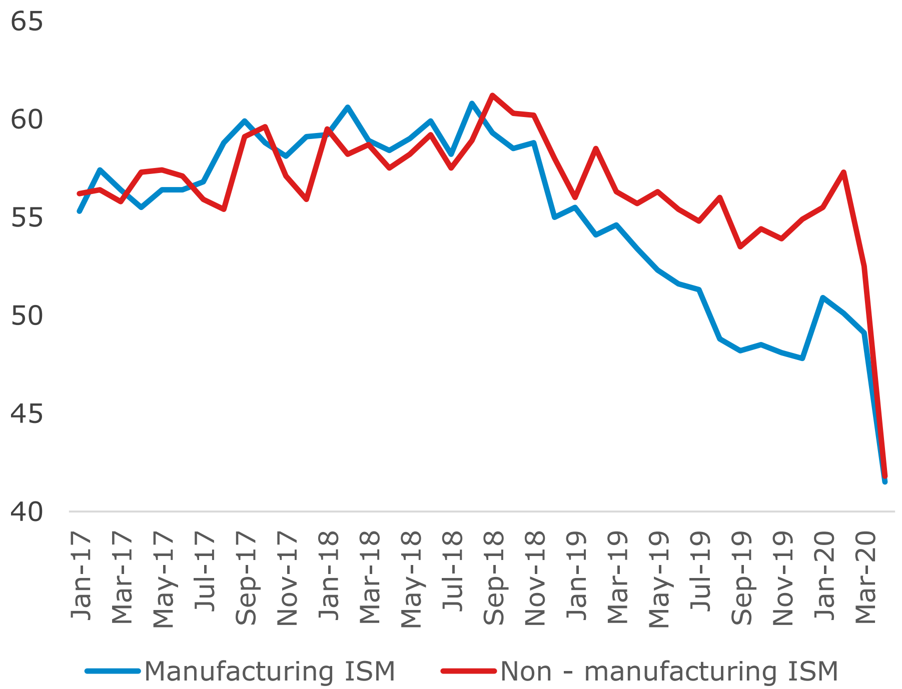
Upcoming macro releases: May 2020

Publication	Date	Period	mBank	Consensus	Actual	Prior
CPI y/y (%)	~30.04[1] 15.05[2]	Apr	3,1%	3,4%	3,4%	4,6%
PMI (pts.)	04.05	Apr	36,0	34,6	31,9	42,4
Unemployment rate (%)	~06.05[3] 26.05[4]	Apr	5,7%	5,7%	5,7%	5,4%
Current account (m EUR)	14.05	Mar	199	432		659
GDP flash (%)	15.05	Q1	1,8%	1,5%		3,2%
Employment y/y (%)	20.05	Apr	-0,9%	-0,6%		0,3%
Wages y/y (%)	20.05	Apr	3,8%	4,4%		6,3%
Industrial output y/y (%)	21.05	Apr	-12,4%	-12,4%		-2,3%
PPI y/y (%)	21.05	Apr	-1,4%	-1,4%		-0,5%
Construction output y/y (%)	23.04	Apr	-5,3%	-1,0%		3,7%
Retail Sales y/y (%)	22.04	Apr	-22,5%	-19,0%		-9,0%
M3 y/y (%)	23.04	Apr	13,7%	12,1%		11,8%

[1] Flash estimate
[2] Final reading
[3] Ministry of Family, Labour and Social Policy estimate
[4] Statistics Poland final reading

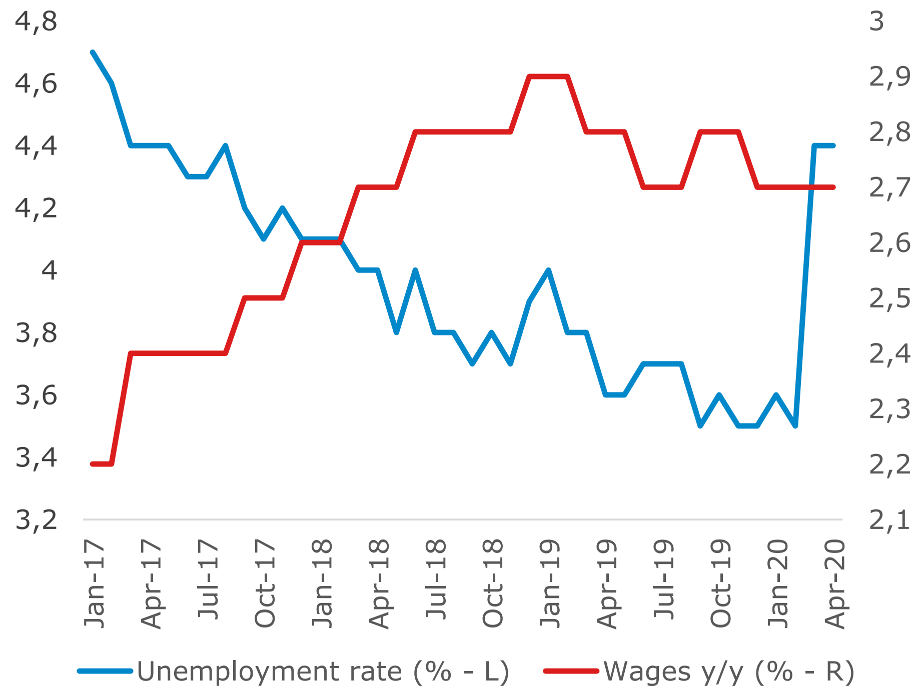
U.S. economy health check

ISM PMI: manufacturing & non-manufacturing



Source: ISM

Labor market: wages & unemployment rate

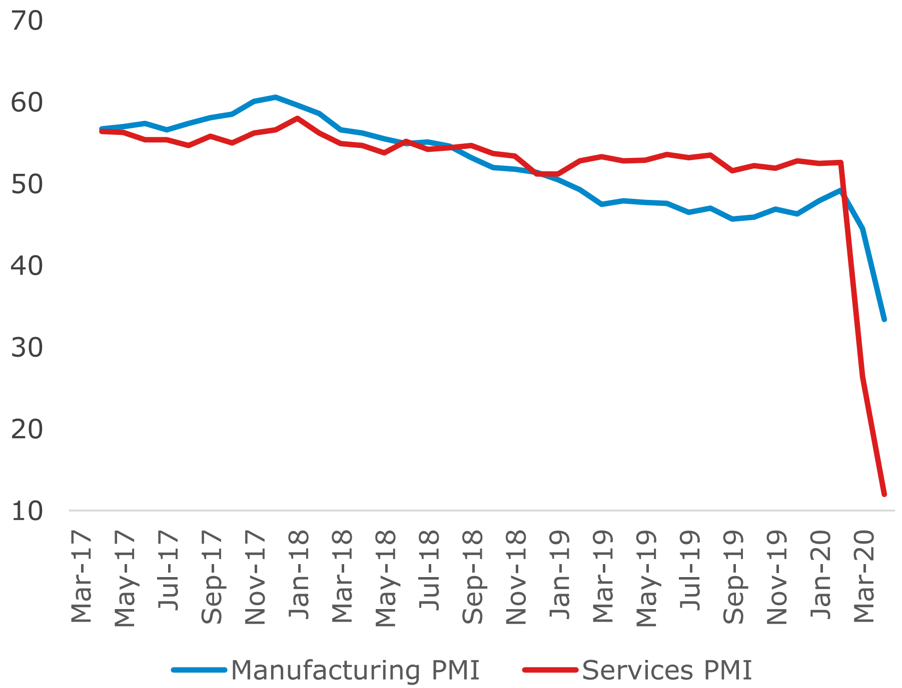


Source: FRED

- The trough is here as quarantine measures are set to be lifted slowly. However, the abrupt start of economic activity should not be the base scenario. It will be another muddle through recovery. Worth to note that services performance is similar to manufacturing. Europe tells a different story.
- Substantial fiscal package has been put into force (>10% GDP) 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”. Low interest rates for longer.
- 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.

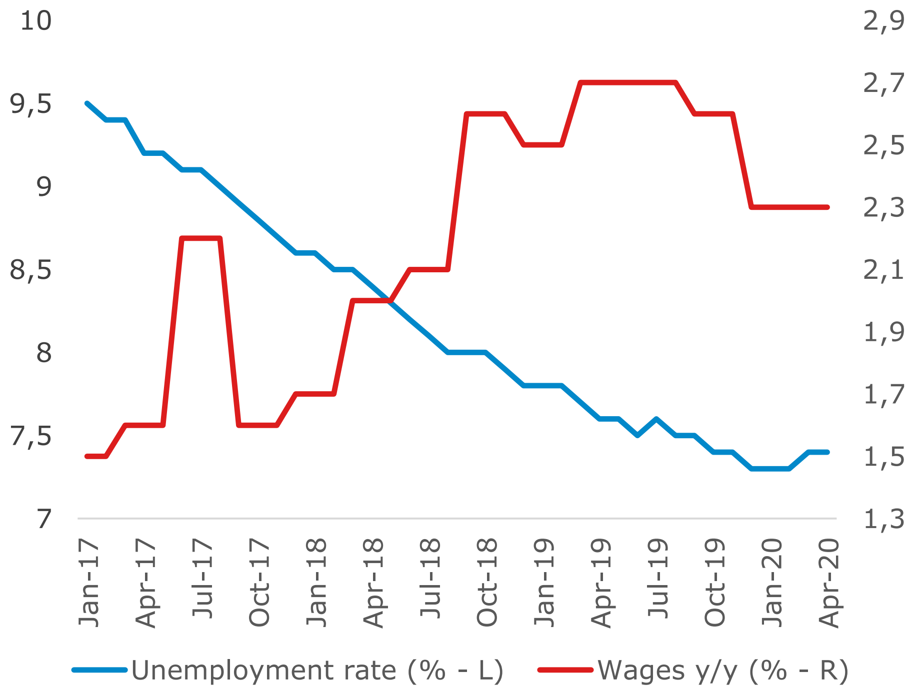
Euro area economy health check

Markit PMI: manufacturing & services



Source: Markit

Labor market: wages & unemployment rate

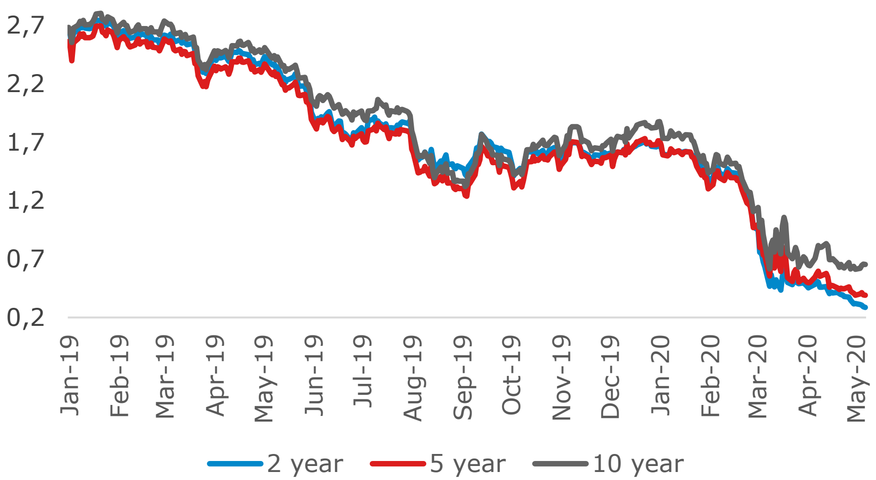


Source: Eurostat

- The trough is here as quarantine measures are set to be lifted slowly. A visible distinction between battered services and better performing manufacturing. Structural change is pending and second round effects are lurking around the corner. The crisis once again exposed that euro zone project can behave as if it is facing asymmetric shock even if the shock seems to be fully symmetric at first glance. North-South divide is to persist.
- The scope of national fiscal packages in 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). Low rates for a long 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. The skirmish between Bundesverfassungsgericht and ECJ only adds to the possible problems when the worst is over.

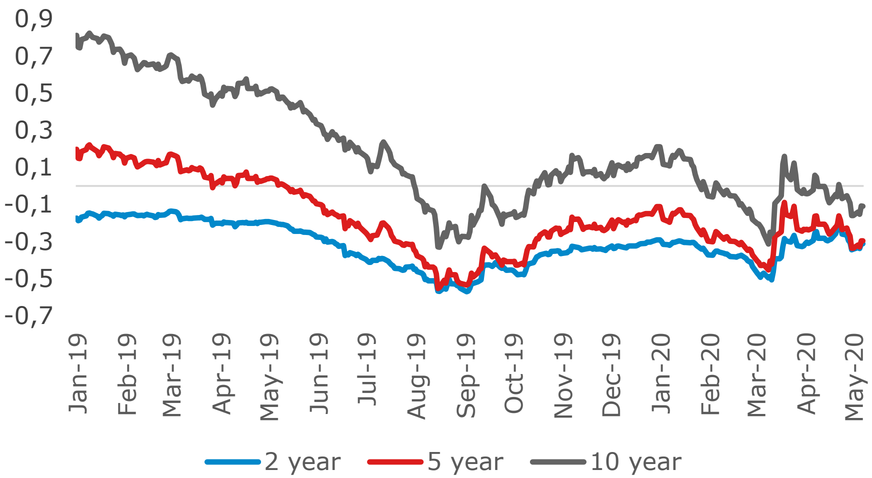
Global rates: Low for long

US swap rates (%)



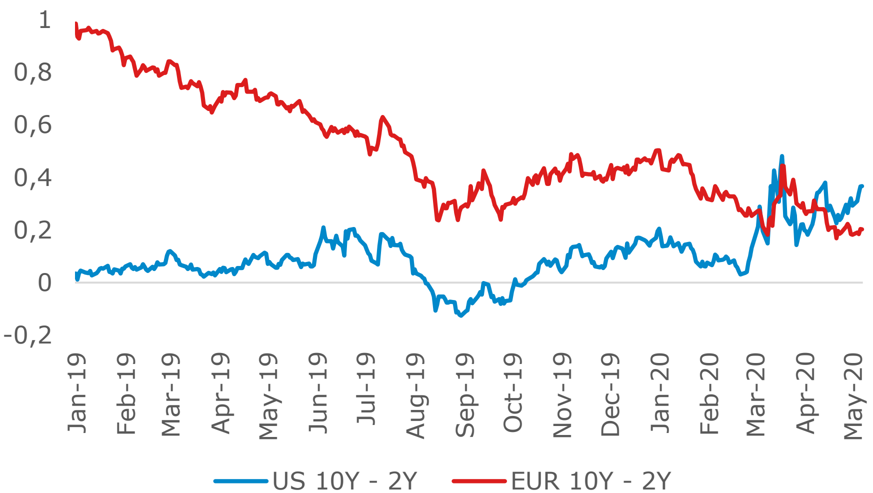
Source: Bloomberg

EU swap rates (%)



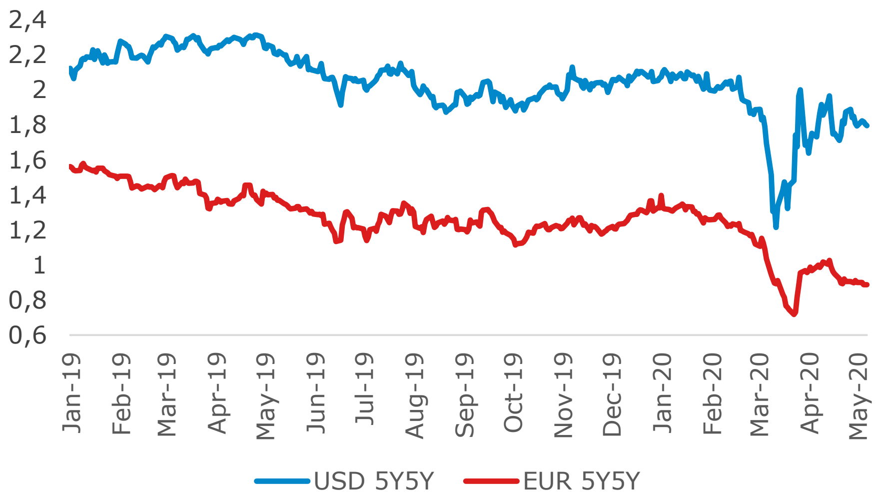
Source: Bloomberg

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



Source: Bloomberg

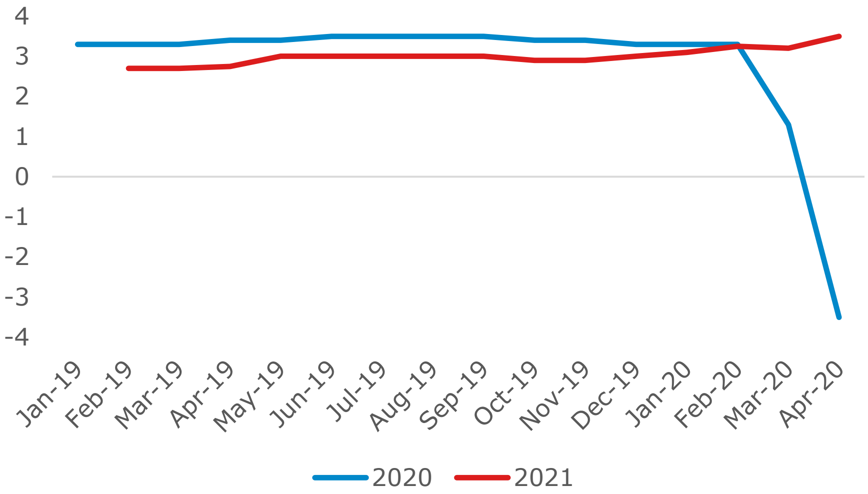
US and EZ inflation expectations (%)



Source: Bloomberg

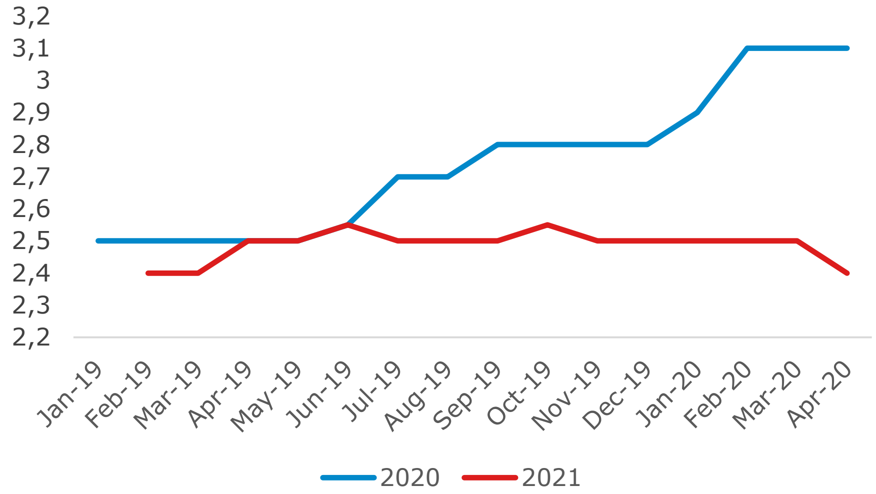
Consensus: what is expected in Poland?

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



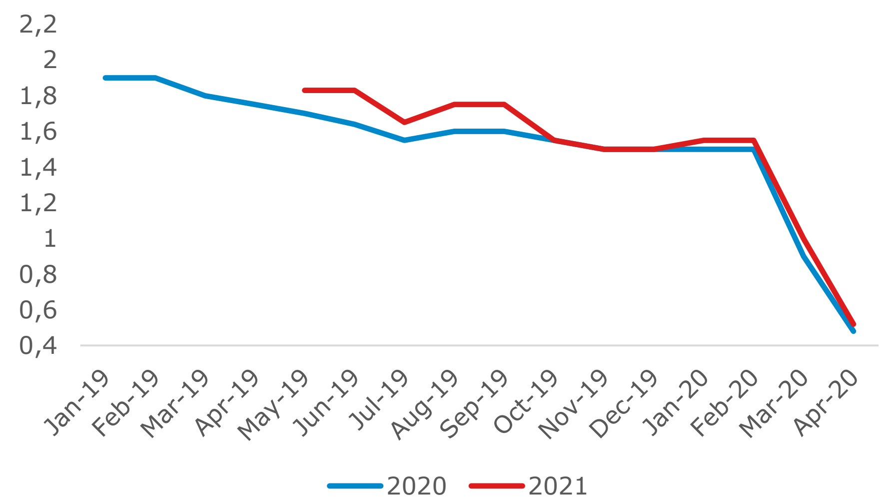
Source: Bloomberg

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



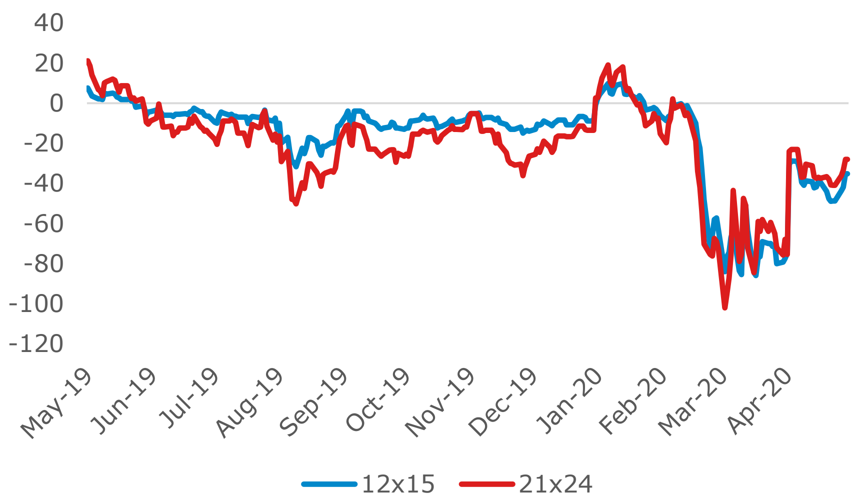
Source: Bloomberg

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



Source: Bloomberg

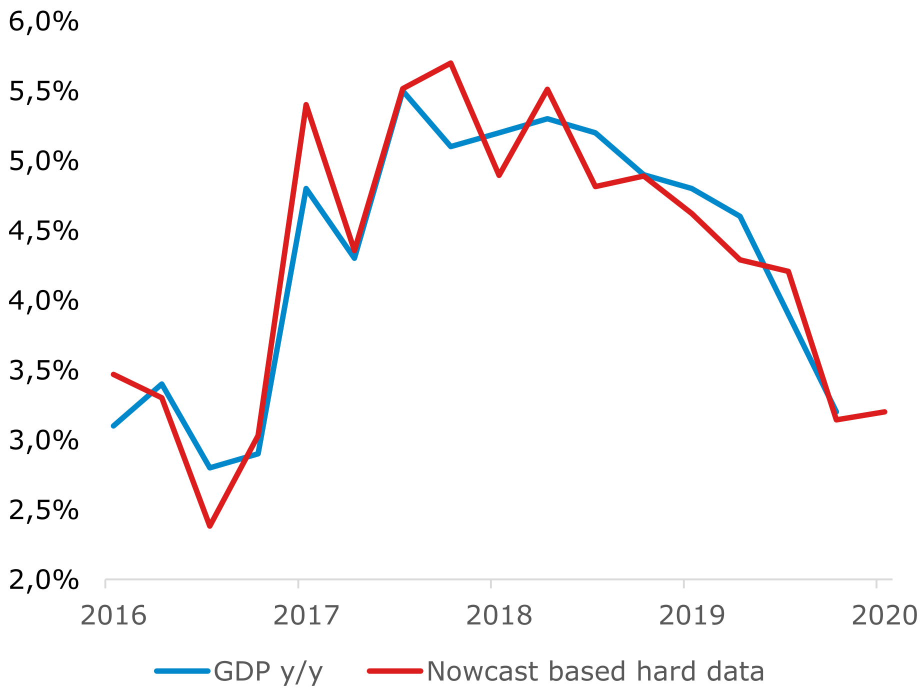
Rate changes priced in by FRA (bps)



Source: Bloomberg

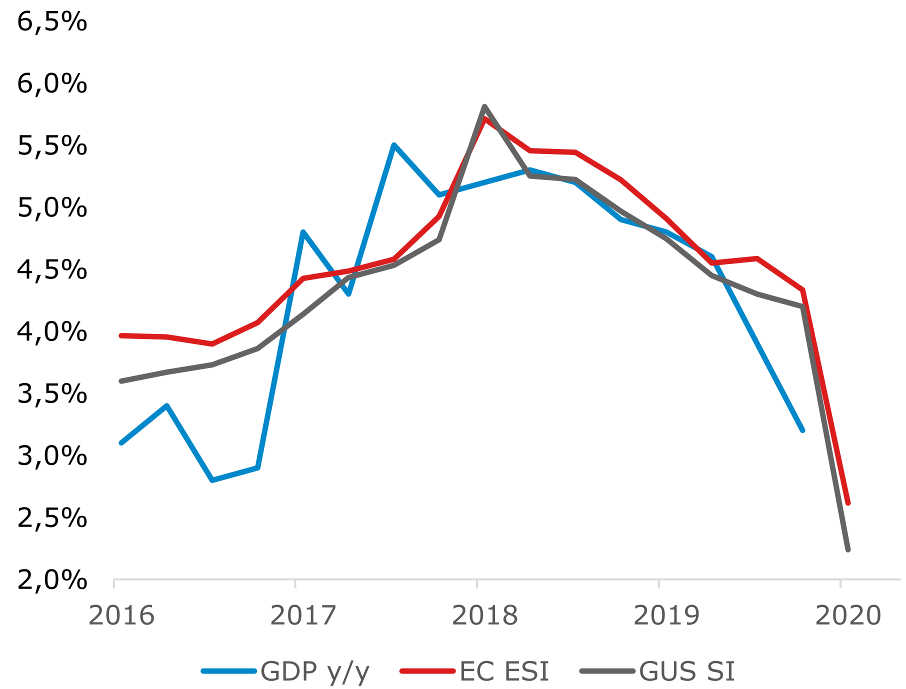
Short-term GDP tracker

GDP nowcast based on hard data



Source: Statistics Poland, own elaboration

GDP nowcast based on business tendency indicators

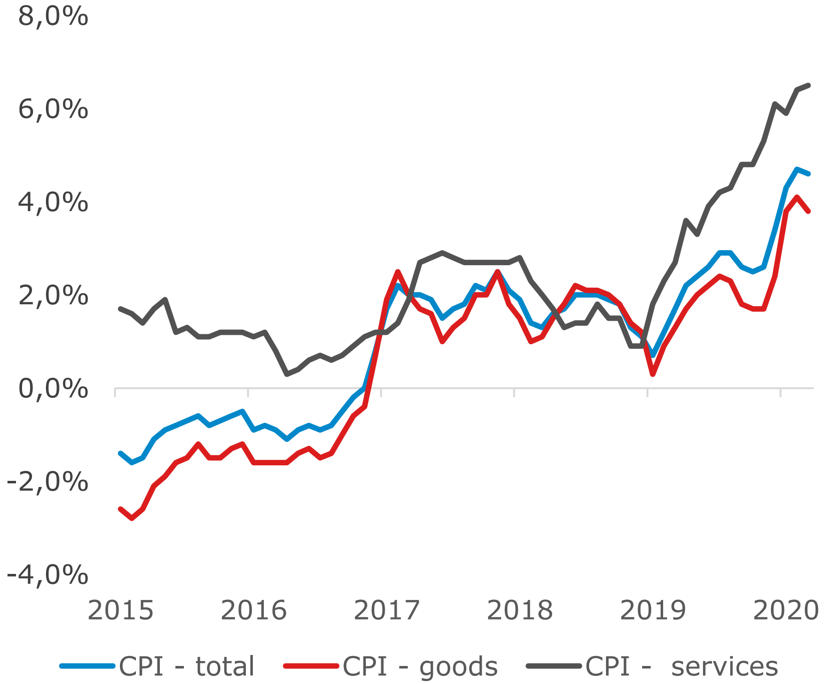


Source: Statistics Poland, Eurostat, own elaboration

- 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. But even after incorporating March data, GDP estimates overshoot upcoming reading (based on hard data we should expect 3.2% in Q1). It is mostly due to abysmal performance of services and therefore lower consumption. We see just a little part of consumption drop in industrial production data. It has to be corrected.
- Trackers based on business activity indicators have also upside bias: 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 is why we decided to take averages for March and April readings (presented above) – they are closer to our estimates, but even after the change in calculations we think that the scale of pencilled in slowdown is not sufficient.
- We decide to bring down the nowcast from manufacturing by simply subtracting services sectors that are under siege right now. 1.8% GDP growth forecast for Q1 emerges.

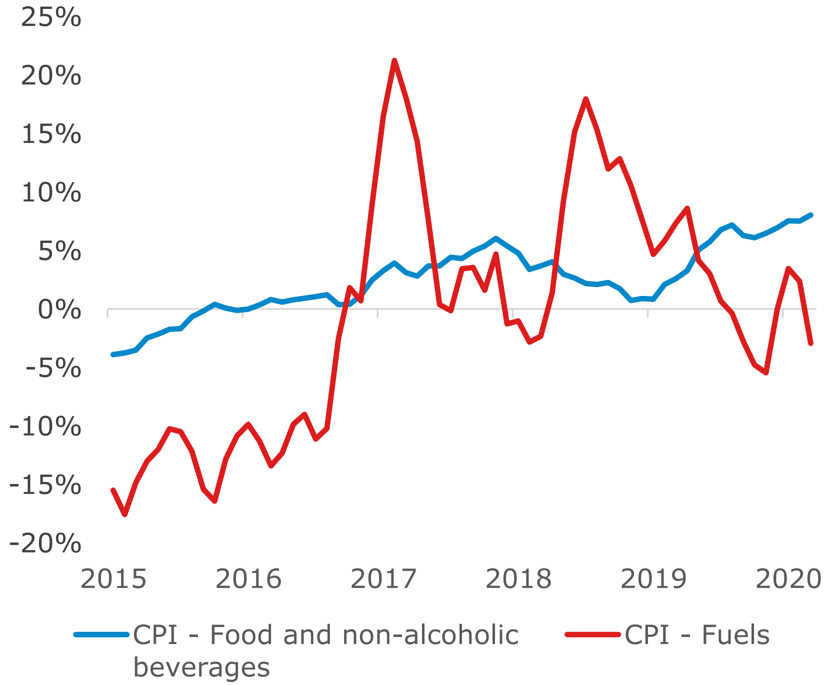
Short-term inflation tracker

Still little respite



Source: Statistics Poland, own elaboration

Fuels to the rescue. Food deceleration likely but not granted in substantial magnitude.

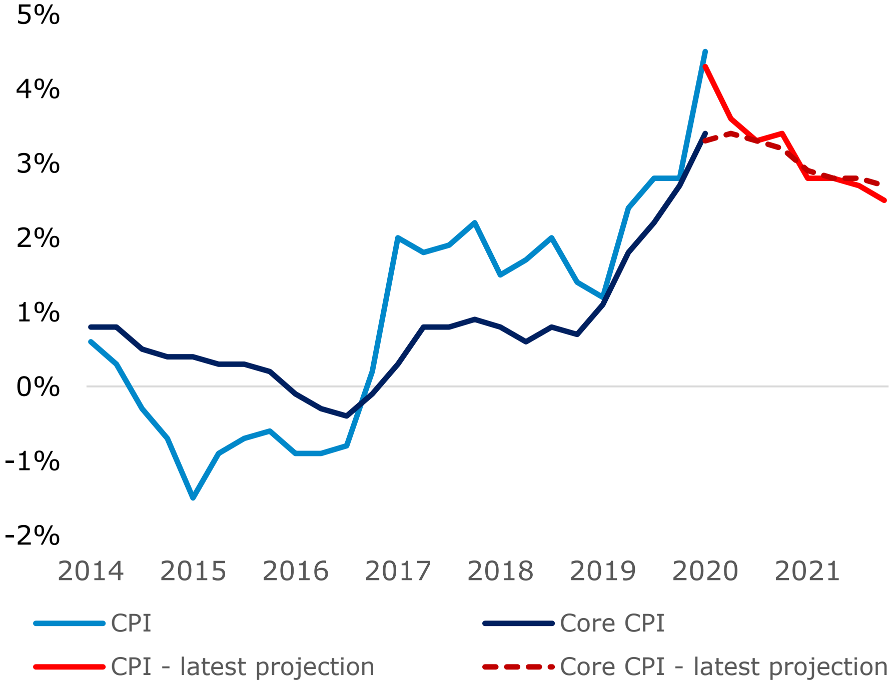


Source: Statistics Poland, own elaboration

- Q1 ended on a high note. The preliminary figures for April show that inflation seems to be more sticky on the core side than many have thought. Huge output gap implies constant push to the downside but the its scale is yet to be decided. As statistical offices are back to normal collection of data in May and June, the true scale of price adjustment will be visible. We will have more data to confirm or deny the stickiness of the core soon.
- Exogenous prices are different story. Food prices worldwide are coming off the elevated levels (as seen in the FAO). But the magnitude of the drop will be governed by local specifics, mainly the soil conditions in Poland. Another drought is highly possible. Fuel prices are different story. Another drop for May is granted but the story in the medium-term is rather of rising prices as oil traces the bottoms.

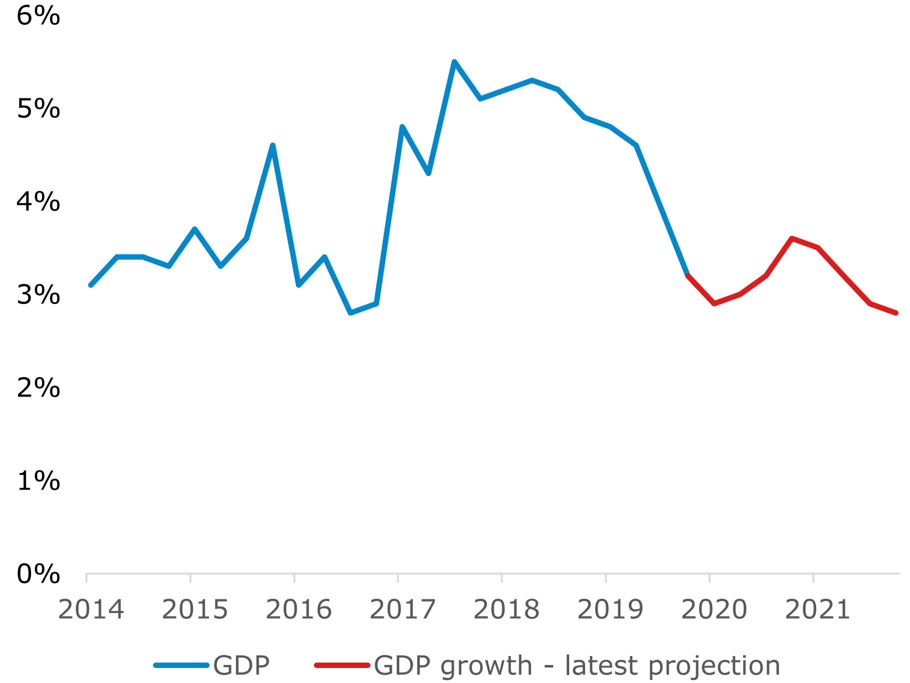
Polish monetary policy radar

NBP's latest projection: inflation (outdated)



Source: NBP, Statistics Poland, own elaboration

NBP's latest projection: GDP growth (outdated)

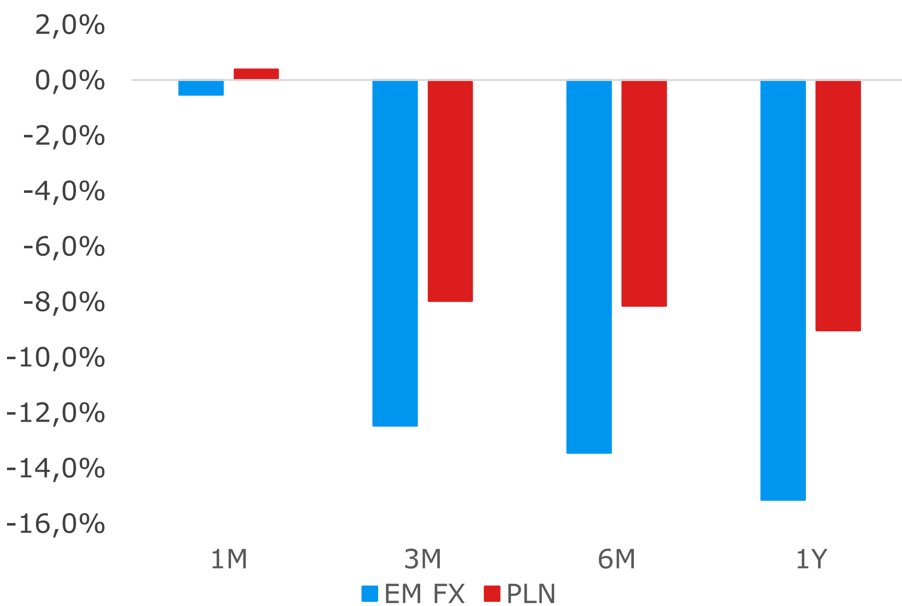


Source: NBP, Statistics Poland, own elaboration

- 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

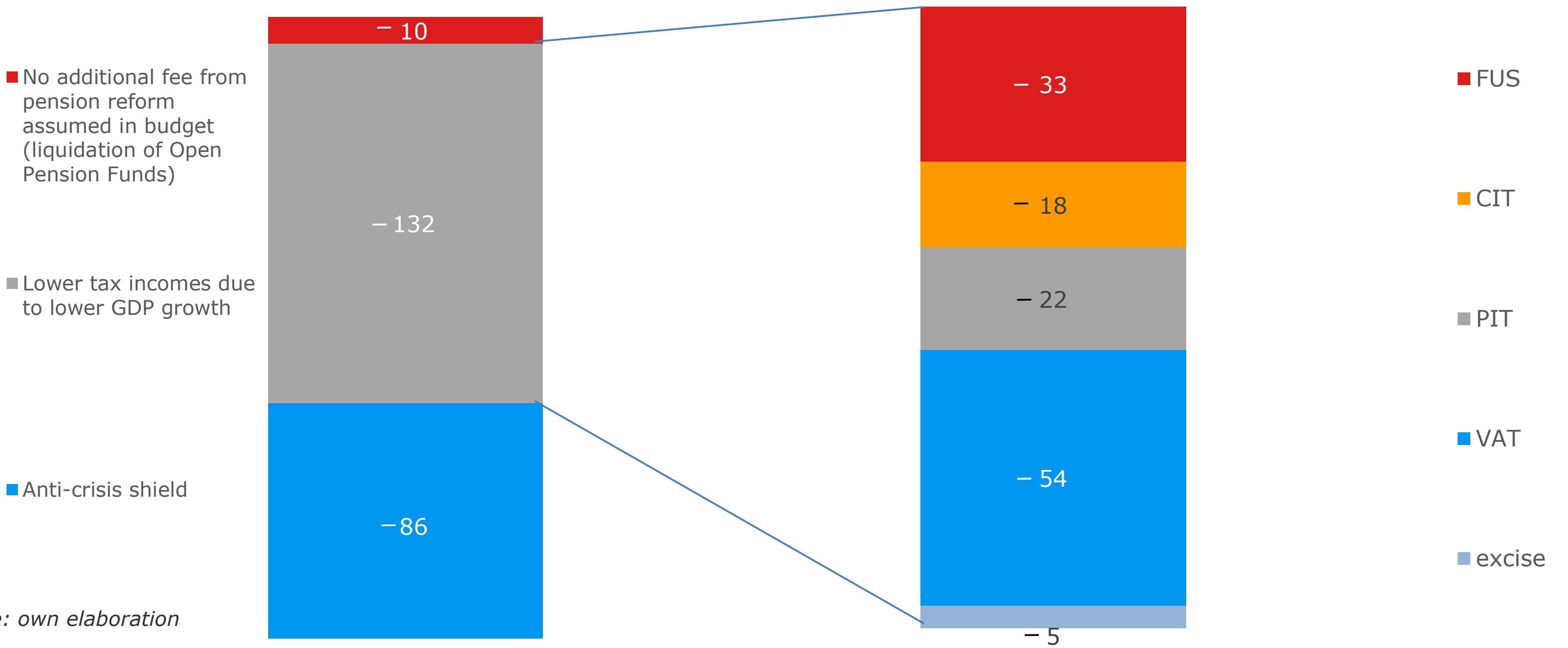
Real effective exchange rate: mild appreciation so far unlikely to be sustainable.

Source: BIS

- EURPLN was stable in April, remaining in 4.50-4.60 range
- We did not see any significant reaction after last month's interest rate cut. But incoming increase in the money supply and weak GDP data are still ahead of us. It should result in weak zloty.
- Stabilization of the economy and better market sentiment should help PLN return to somewhat stronger levels but in the medium term we may except overall weaker currency.

COVID-19 – fiscal effect

Impact on general government deficit (in PLN bn)

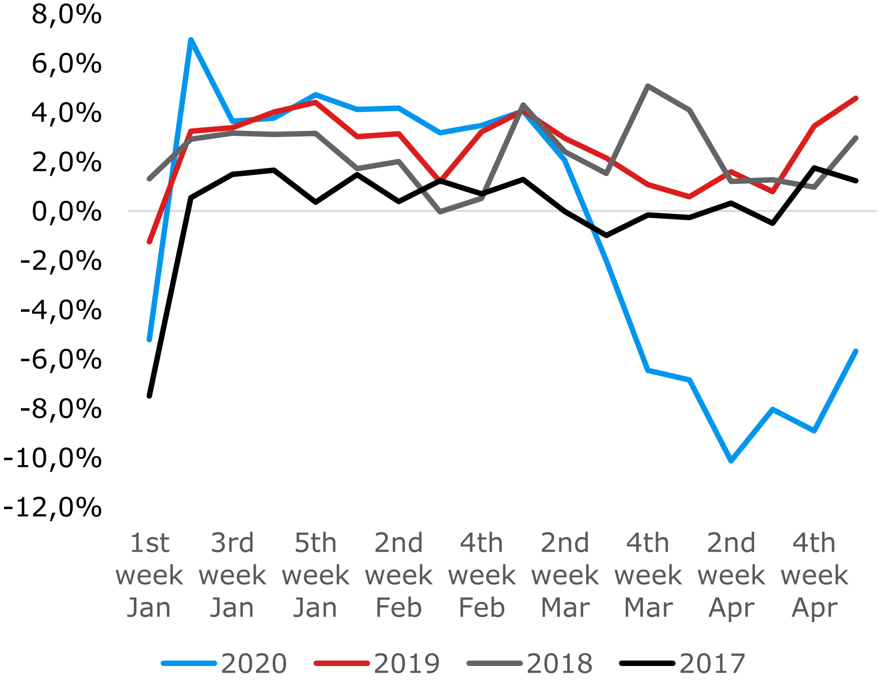


Source: own elaboration

- Two pillars: government fiscal shield and financial shield from PFR (Polish Development Fund). Fiscal effect of government anti-crisis shield for the public sector is -86bn zlotys (government's self-estimate). It includes co-financing of wages, social contribution vacations, benefits for employees on civil contracts, some guarantees and some forgone taxes. Value of PFR shield is 100bn zlotys – it is a system of loans to firms, which are reduced by 75% after meeting requirements (like keeping jobs).
- Pandemics will not only result in higher state expenditures but also lower tax incomes and contributions due to lower GDP growth. Realization of our forecast (-4.2%) implies loss of about 132 bn zlotys due only to cyclical reasons. But some expenditures will be also limited. We estimate that net borrowing needs of government would increase by 180 bn zlotys. Adding the PFR engagement gives a total of 280.
- That is why the total value of borrowing needs (government, PFR, and anti-crisis fund) increases by 280 bn zlotys. PLN 280 bn reflects more the total value of different bonds that will have to be absorbed (PFR+BGK+POLGBs) than the actual slicing of funds between the public sector and SPVs. Everything enjoys state guarantees and as such can be included in NBP's structural operations (aka QE).

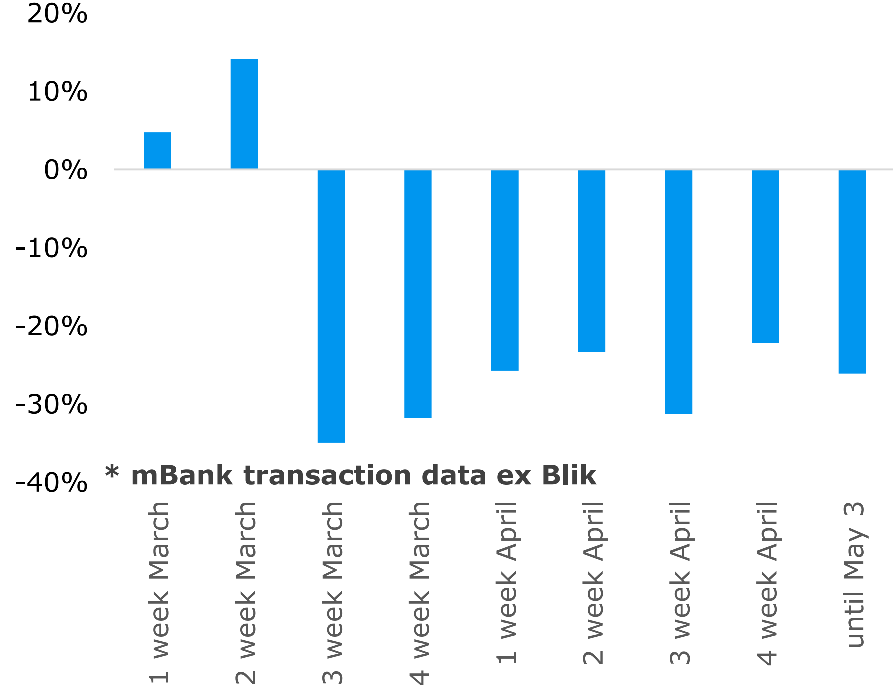
Mini-research note. Coronavirus impact on manufacturing and consumers.

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



Source: *own elaboration based on electricity grid operator data*

Average expenditures of mBank clients Feb average = 100% (excl. mondays)



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 – we will see it in upcoming industrial production readings. But electricity consumption started to rebound with the end of April. The worst is behind us. Easing sanitary restrictions will help coming back to normality. Government anti-crisis packages (financial package for firms was just introduced) should limit layoffs. Nonetheless there are heavy months ahead of manufacturing, but with possible improvement in export performance (weaker PLN + huge monetary and fiscal stimulation abroad)
- After weak March and most of April (about 20%- 30% of consumption evaporated), consumption also started to rebound. It is not clearly seen with weekly data (due to holiday 1th-3th May), but daily readings are more optimistic. Even though situation will improve in May (shopping centers have just opened; in next weeks we should see more an more defrosted services), the return to normality will be slower than in manufacturing's case (we think Q4 2019 stream will be reached again in 2022/2023).

Disclaimer and contact details

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