Monthly Pulse Check
Economy, FI, FX

June 4th 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

- Economies entered deep recessions as quarantines kicked in. The peak of new infections has come; yet the existence of second wave still cannot be ruled out. It is rather unlikely that economies will be closed as much (or at all) as during the first wave, though. This recession carries substantial structural change. Therefore the return to normality will be slow even though we are about to temporarily see strong GDP numbers as economies jump start after the quarantine measures are relaxed. The scale of monetary and fiscal support is unprecedented, though. It may be a game changer.
- Polish economy is not an exception. We expect 4.2% recession in 2020 and falling inflation. The upcoming quarters are lost for economic activity as disinvestment kicks in and consumers are cautious. New EU programme is in the making (EUR 750bn in total, ~65bn for Poland) and may be important boost for growth 2021/22 and beyond.

Monetary policy: Fed, ECB, NBP

- Fed: ZIRP + QE + direct loans to firms. All in.
- ECB: NIRP (already there) + QE Expansion (maximum flexibility) + new LTRO. Not done with easing.
- NBP: Rates cuts (total 140bp). QE already in place (govvies + bonds with state guarantees). Polish TLTRO in the pipeline. Over to fiscal policy now. Not out of ammo. FX channel and QE expansion remain on the table. Negative rates unlikely.

FX Market

- Rates have been brought near zero by the MPC. It may not entail a direct blow to PLN as it is mostly driven by global sentiment. Lower rates mean higher volatility and the swings in EURPLN rate will be now more pronounced as sentiment changes, especially towards weakness. 4.40-4.60 is our favored range now.

		2019 Q1	2019 Q2	2019 Q3	2019 Q4	2020 Q1 F	2020 Q2 F	2020 Q3 F	2020 Q4 F	2021
GDP y/y	%	4,8	4,6	4,0	3,2	2,0	-9,0	-5,7	-4,0	4,6
Individual consumption y/y	%	3,9	4,4	3,9	3,3	1,2	-18,0	-13,0	-10,5	5,5
Public Consumption y/y	%	7,4	4,3	5,4	3,2	4,3	10,0	7,0	6,0	0,5
Investment y/y	%	11,6	8,8	4,6	6,1	0,9	-9,5	-17,0	-15,0	6,2
Inflation rate (average)	%	1,2	2,4	2,8	2,8	4,5	2,9	2,1	2,1	1,7
Unemployment rate (eop)	%	5,9	5,2	5,1	5,2	5,3	6,5	7,7	8,6	8,1
NBP repo rate (eop)	%	1,50	1,50	1,50	1,50	1,00	0,10	0,10	0,10	0,10
EUR/PLN (eop)	%	4,30	4,24	4,37	4,25	4,56	4,55	4,55	4,50	4,40
USD/PLN (eop)	%	3,84	3,73	4,01	3,79	4,13	4,10	4,03	3,91	3,83

F - forecast

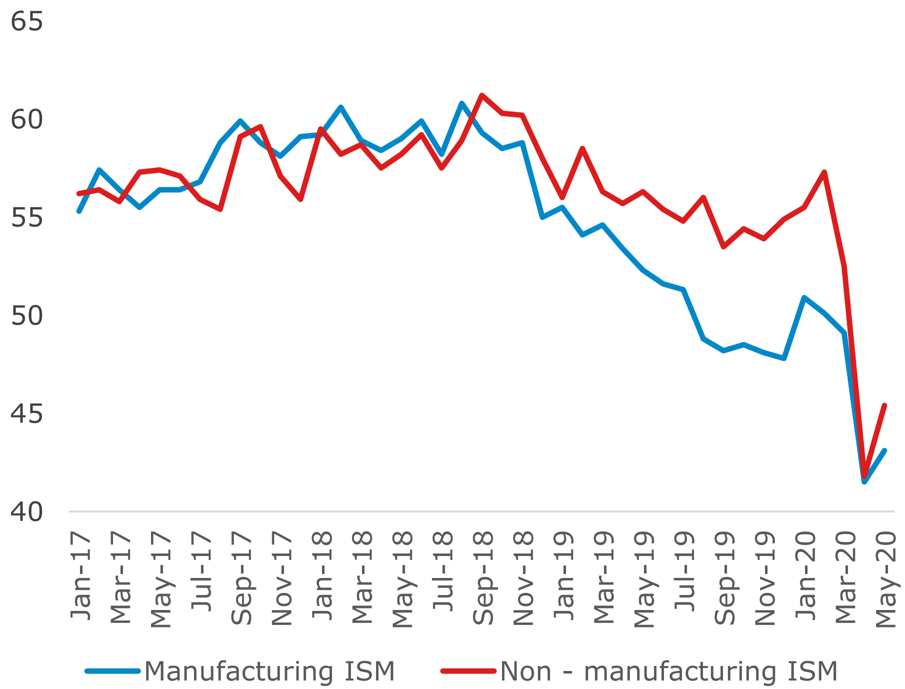
Upcoming macro releases: June 2020

Publication	Date	Period	mBank	Consensus	Actual	Prior
CPI y/y (%)	~30.05[1] 15.06[2]	May	2,9%	3,0%	2,9%	3,4%
PMI (pts.)	01.06	May	36,2	36,0	40,6	31,9
Unemployment rate (%)	~05.06[3] 24.06[4]	May	6,1%	6,1%		5,8%
Current account (m EUR)	15.06	Apr	2648	766		2438
Employment y/y (%)	18.06	May	-2,8%	-2,6%		-2,1%
Wages y/y (%)	18.06	May	-0,3%	1,5%		1,6%
Industrial output y/y (%)	19.06	May	-18,0%	-17,6%		-24,6%
PPI y/y (%)	19.06	May	-1,2%	-1,5%		-1,3%
Retail sales y/y (%)	22.06	May	-11,6%	-12,0%		-22,9%
Construction output y/y (%)	23.06	May	-3,7%	-0,5%		-0,9%
M3 y/y (%)	23.06	May	15,8%	15,0%		14,0%

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

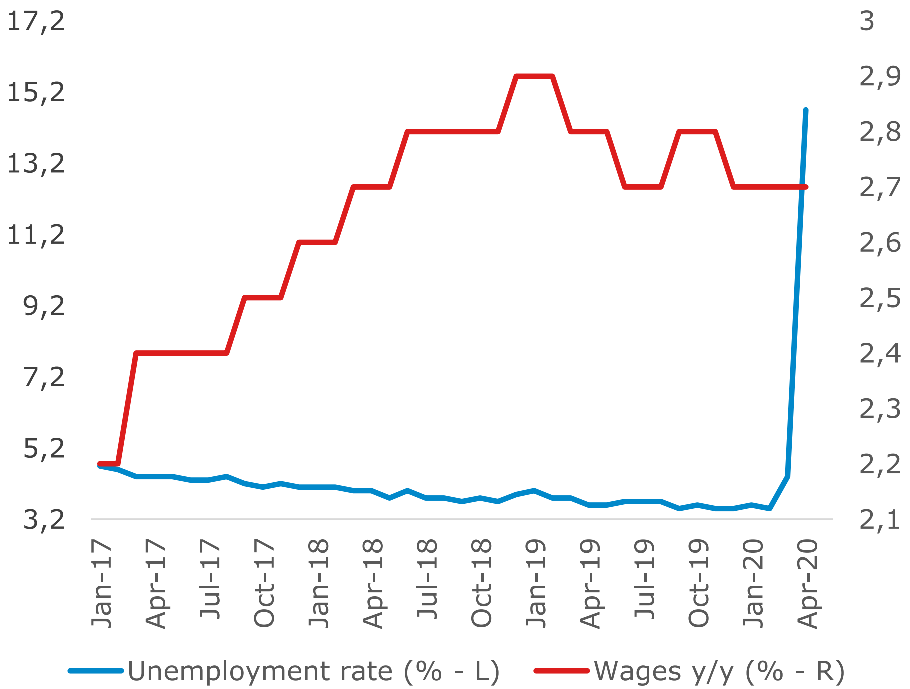
U.S. economy health check

ISM PMI: manufacturing & non-manufacturing



Source: ISM

Labor market: wages & unemployment rate

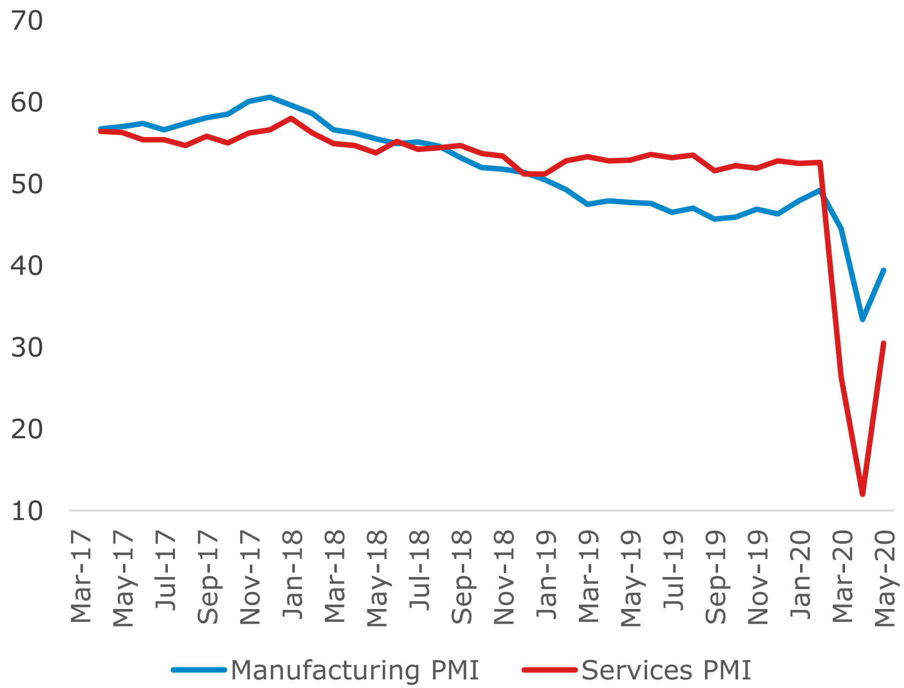


Source: FRED

- Sentiment indicators improved with quarantine measures lifted slowly. 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 ~5-10% in 2020. Risks are to the downside especially with respect to the speed of recovery and the depth of the bottom.

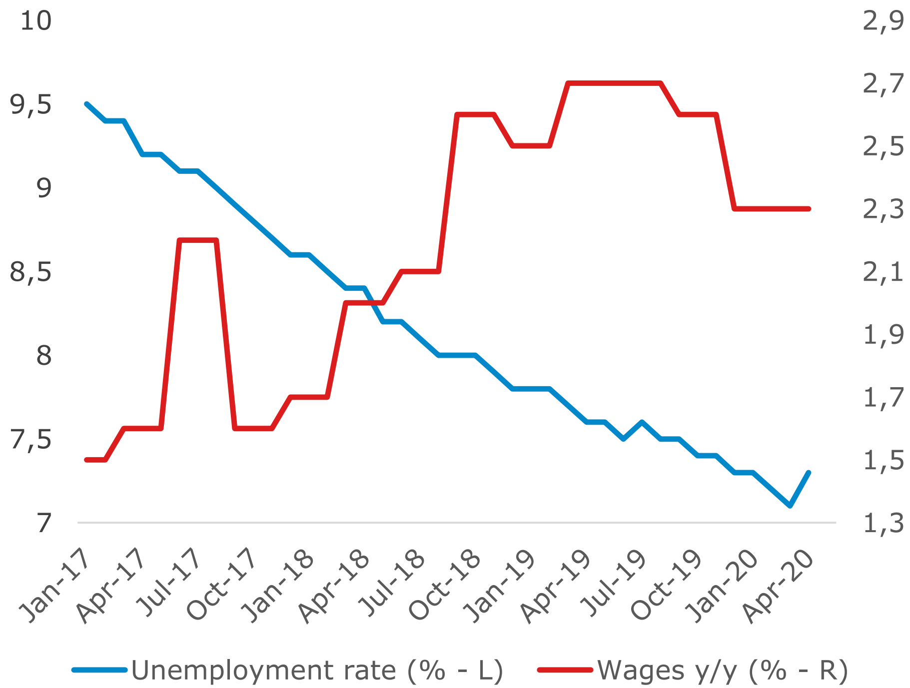
Euro area economy health check

Markit PMI: manufacturing & services



Source: Markit

Labor market: wages & unemployment rate

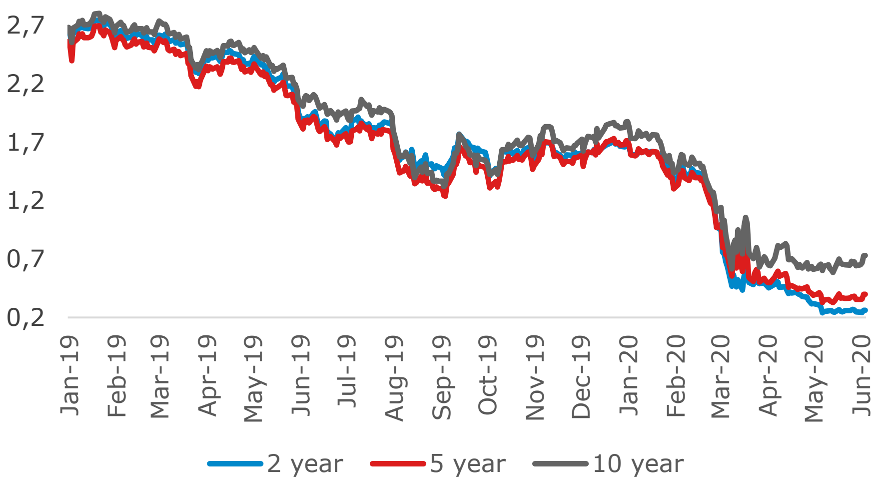


Source: Eurostat

- Both manufacturing and services indicators improved, as economies were slowly opened. But there is still 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.
- European Commision aid package (Next Generation EU) is a big deal. Program was published last week and is worth 750 bn EUR in grants and loans. The scope of national fiscal packages increased. 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%). 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.

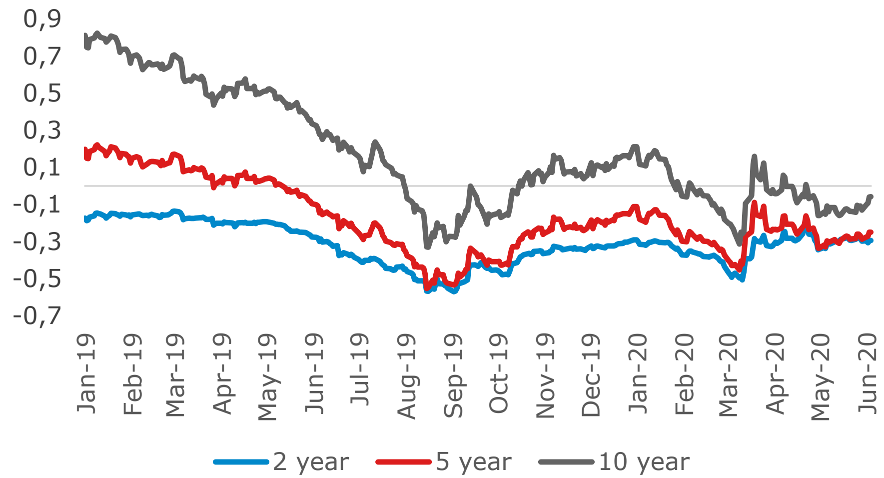
Global rates: Low for long

US swap rates (%)



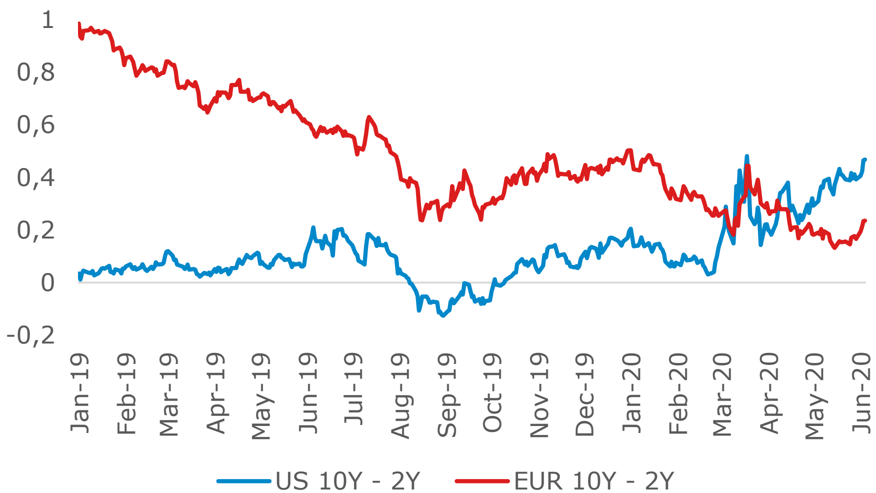
Source: Bloomberg

EU swap rates (%)



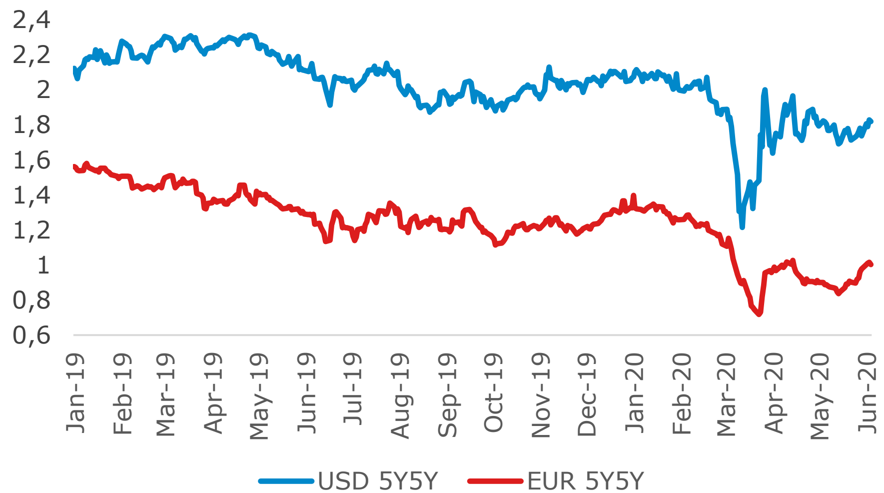
Source: Bloomberg

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



Source: Bloomberg

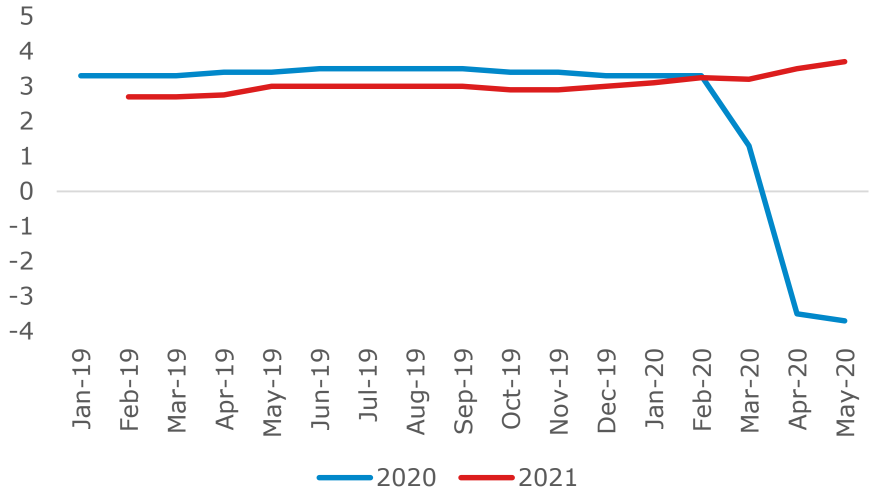
US and EZ inflation expectations (%)



Source: Bloomberg

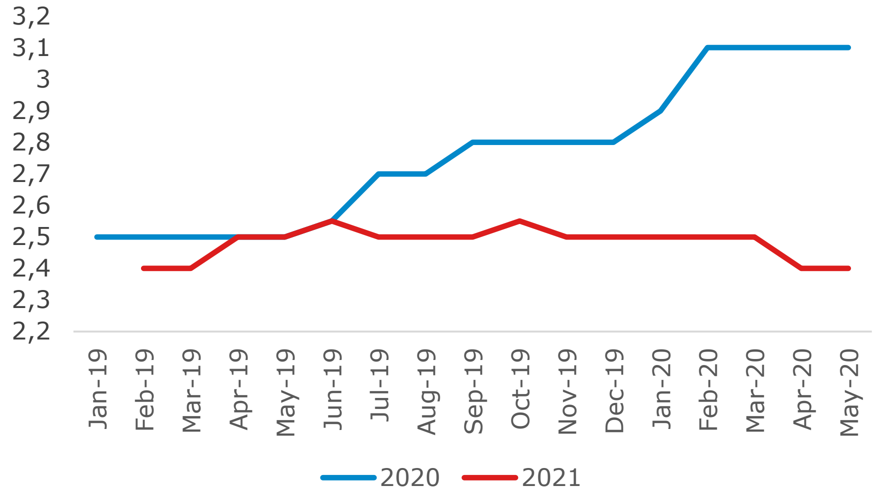
Consensus: what is expected in Poland?

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



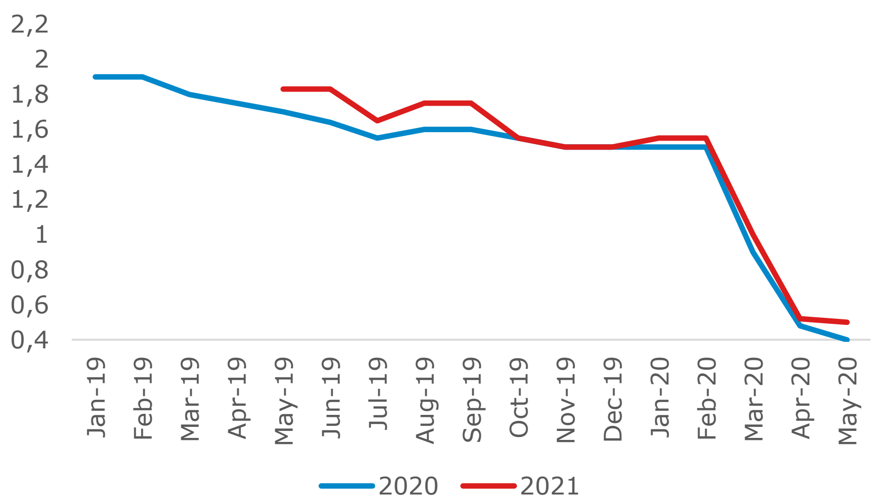
Source: Bloomberg

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



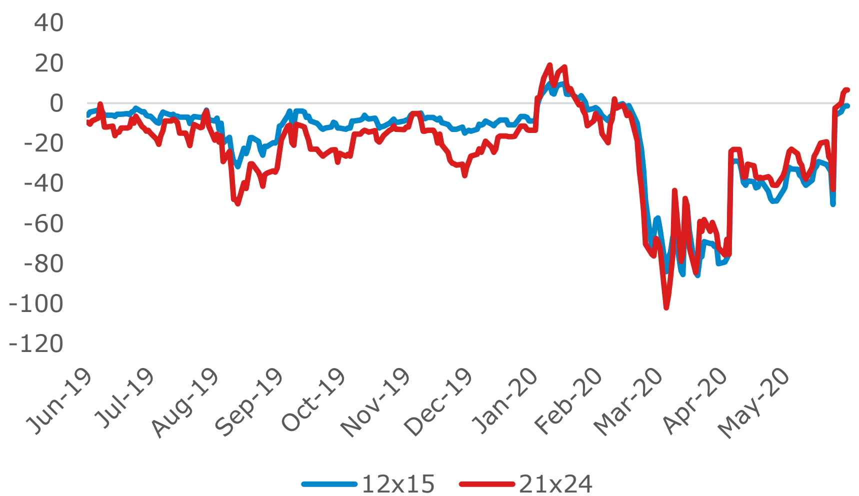
Source: Bloomberg

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



Source: Bloomberg

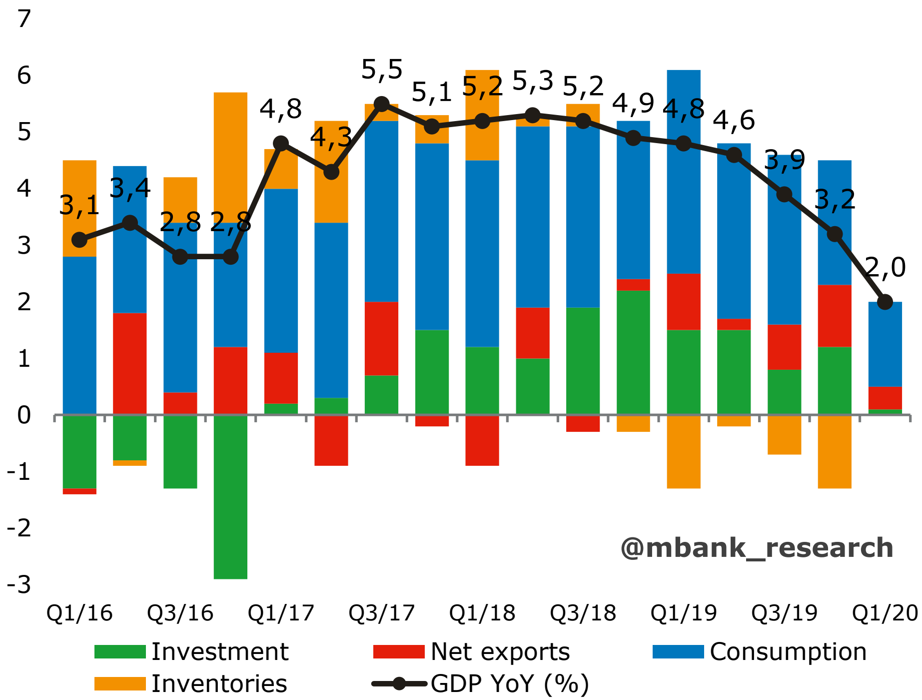
Rate changes priced in by FRA (bps)



Source: Bloomberg

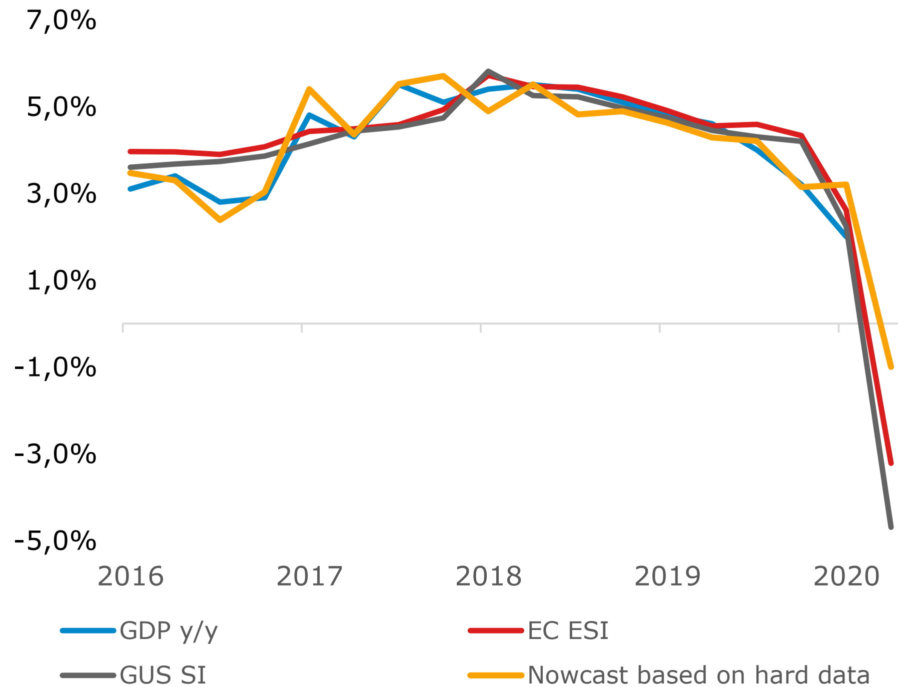
Short-term GDP tracker

GDP for Q1. Postcard from the past.



Source: Statistics Poland, own elaboration

GDP nowcasts possibly severely biased

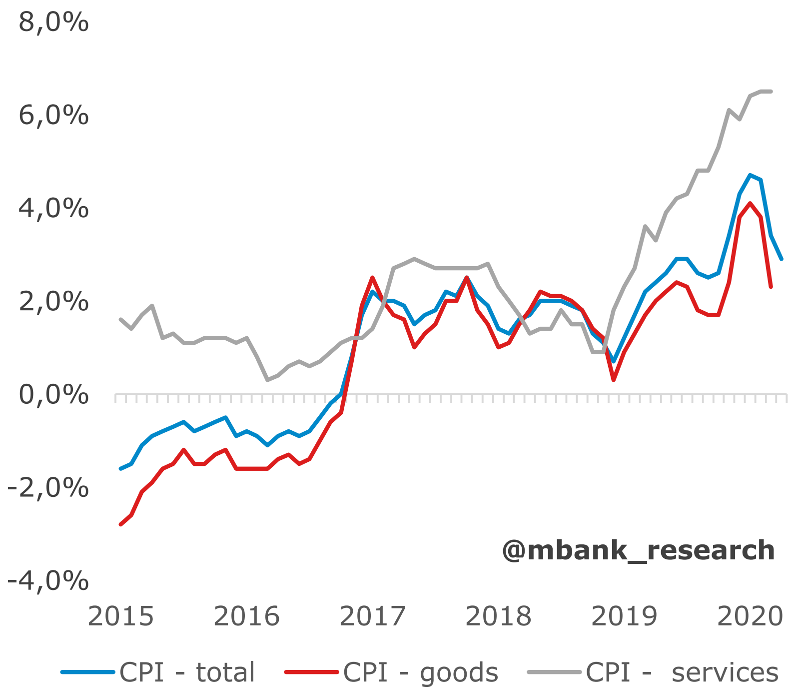


Source: Statistics Poland, Eurostat, own elaboration

- Poland enters recession from a high note. The nowcast models for Q2 – as based on historical correlations without recession in place – are biased and present overly optimistic picture. We think GDP will drop by 8-10% in Q2.
- Risks near term: - exports (will be able to make up without significant zloty depreciation?),
  - investment (both private and public on local lvl)
- Good news for 2021+ recovery stemming from new EU programme (+EUR 65bn for Poland). We revised GDP forecasts for 2021+ up.
- Under new EU spending programme the original problem of 2022 (sharp dip in the inflow of EU funds) is non-existent. New fiscal power granted for the governments also leaves much more room for the cycle smoothing worldwide.

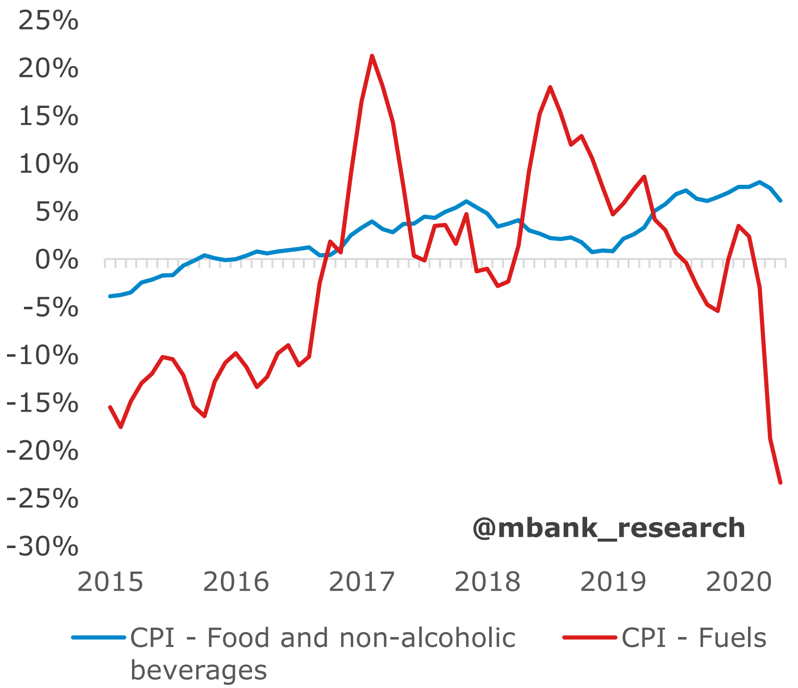
Short-term inflation tracker

Still little respite in services



Source: Statistics Poland, own elaboration

Inflation falls are mostly driven now by fuels and food

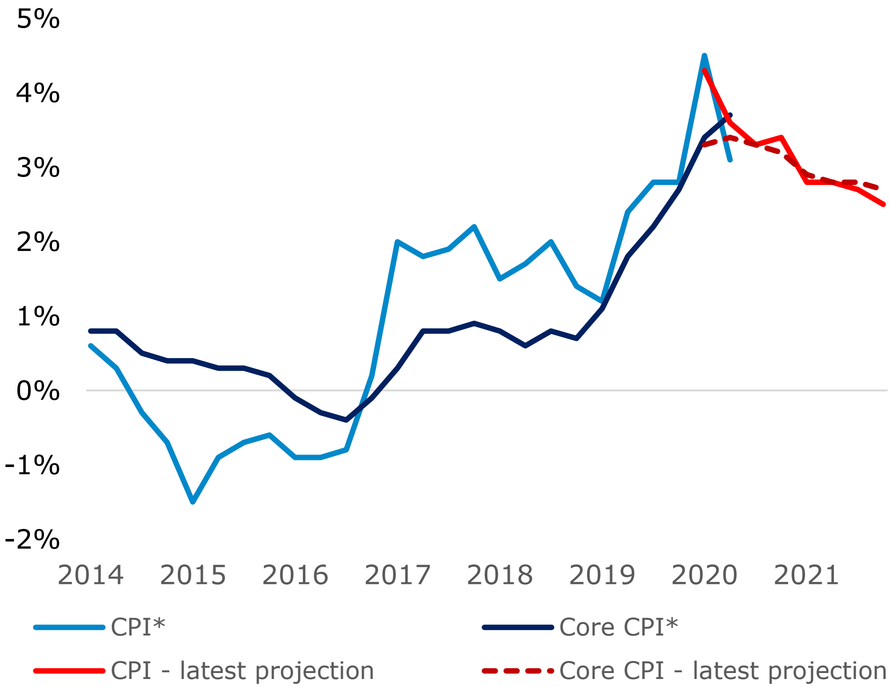


Source: Statistics Poland, own elaboration

- According to preliminary data for May, core inflation even rose that month to 3.7% (vs 3.6% in the previous month). As statistical offices are back to normal collection of data in June and July, the true scale of price adjustment will be visible. We will have more data to confirm or deny the stickiness of the core soon.
- Food prices worldwide are coming off the elevated levels (as seen in the FAO). Draught alert is off. Fuel prices are different story. Given the low levels of oil prices the medium-term scenario is rather of slowly rising prices.
- Q1 2021 will be a flirt with deflation (base effects). Afterwards the disinflationary picture is not that clear.

Polish monetary policy radar

NBP's latest projection: inflation (outdated)



** Q2 inflation data is an average of April and May readings*

Source: NBP, Statistics Poland, own elaboration

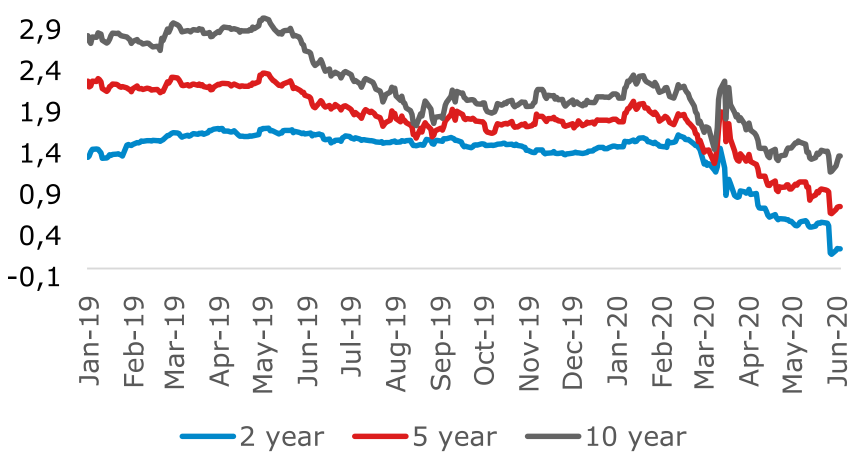
NBP's latest projection: GDP growth (outdated)

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 (140bp 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 rather of low probability but some form of interfering with FX or further QE expansion stay likely.
- 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.

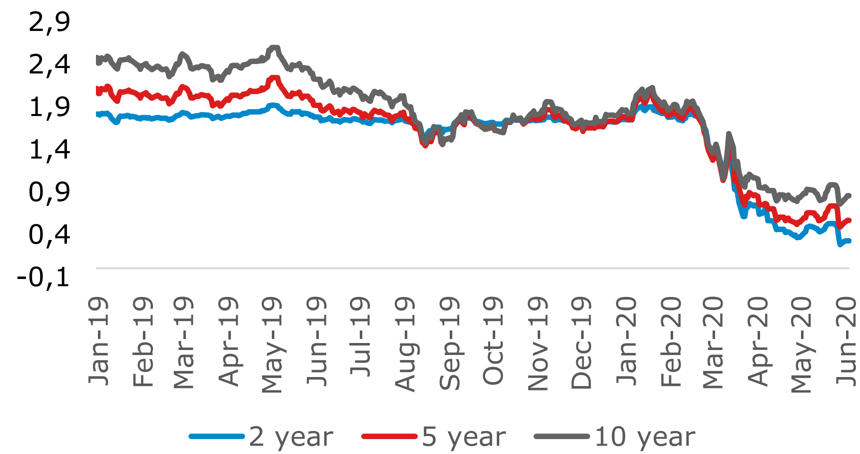
Polish rates, yields and spreads: low

POLGBs



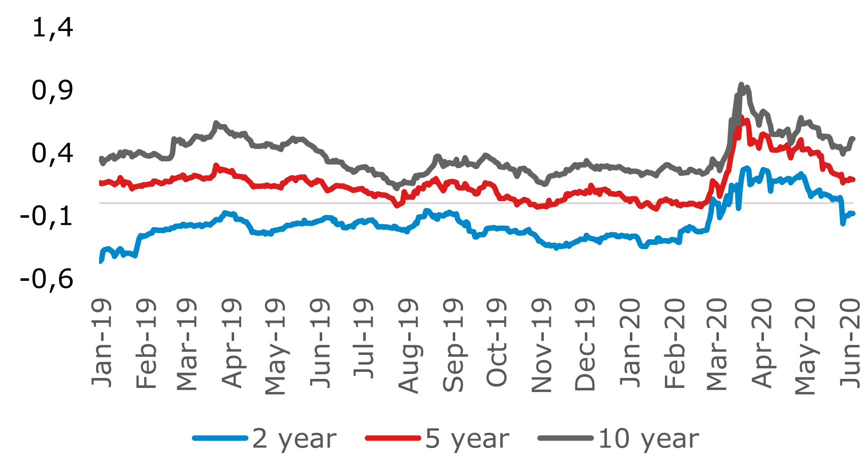
Source: Bloomberg

PL IRS



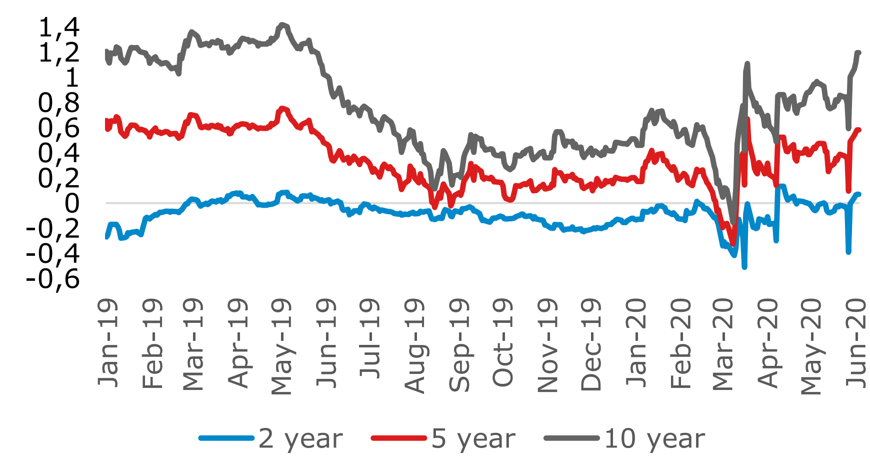
Source: Bloomberg

ASW spread



Source: Bloomberg

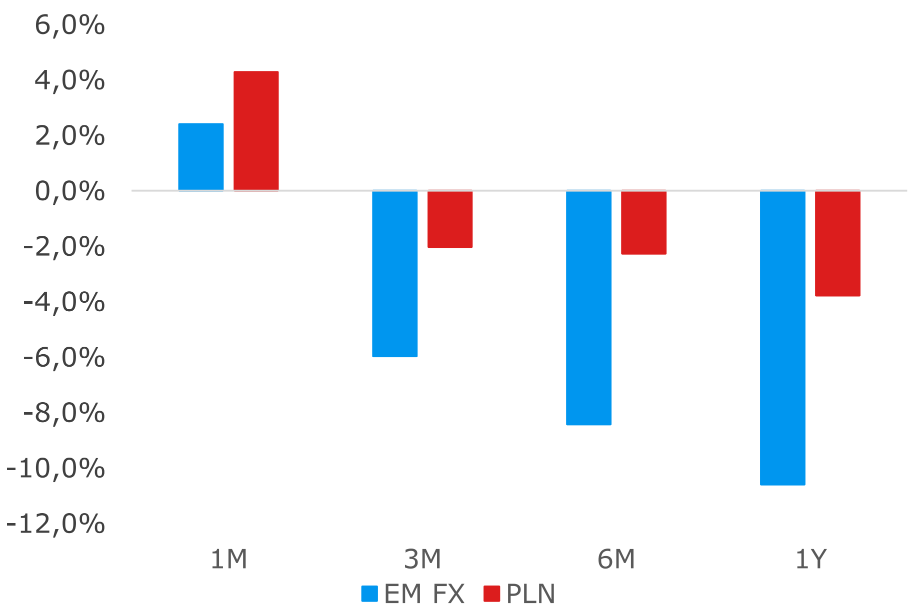
POLGB yield minus 3m WIBOR



Source: Bloomberg

PLN is holding still very well despite cuts

PLN holding well



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

Source: Bloomberg

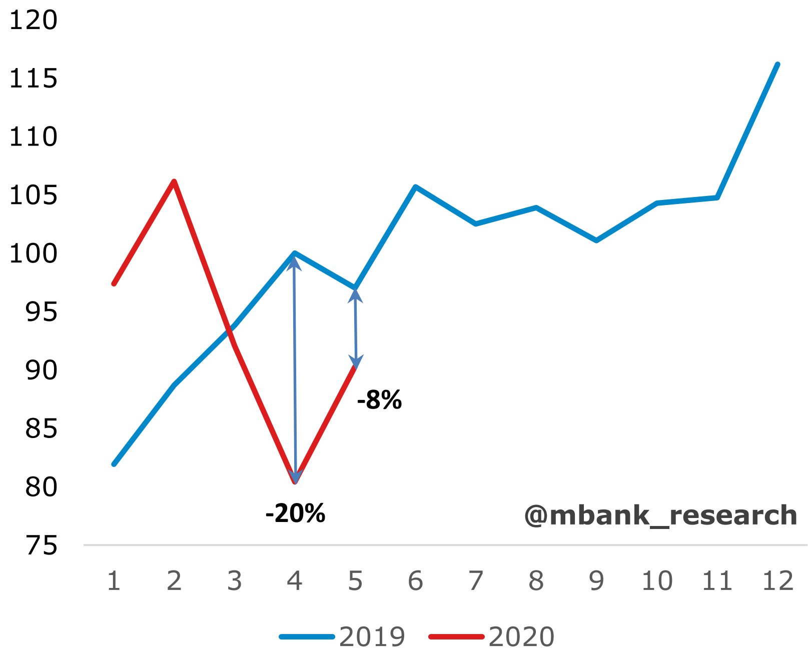
Real effective exchange rate: more or less stable

Source: BIS

- No significant and lasting reaction after interest rate cuts. Lower rates mean higher volatility and the swings in EURPLN rate will be now more pronounced as sentiment changes, especially towards weakness.
- Zloty is driven by the global sentiment.
- With significantly improved external position (C/A in balance + limited share of foreign investors in local debt) it would be hard to see much higher EURPLN exchange rate. We expect range 4.40-4.60 for now.
- New EU money improves the balance of flows further in 2021+

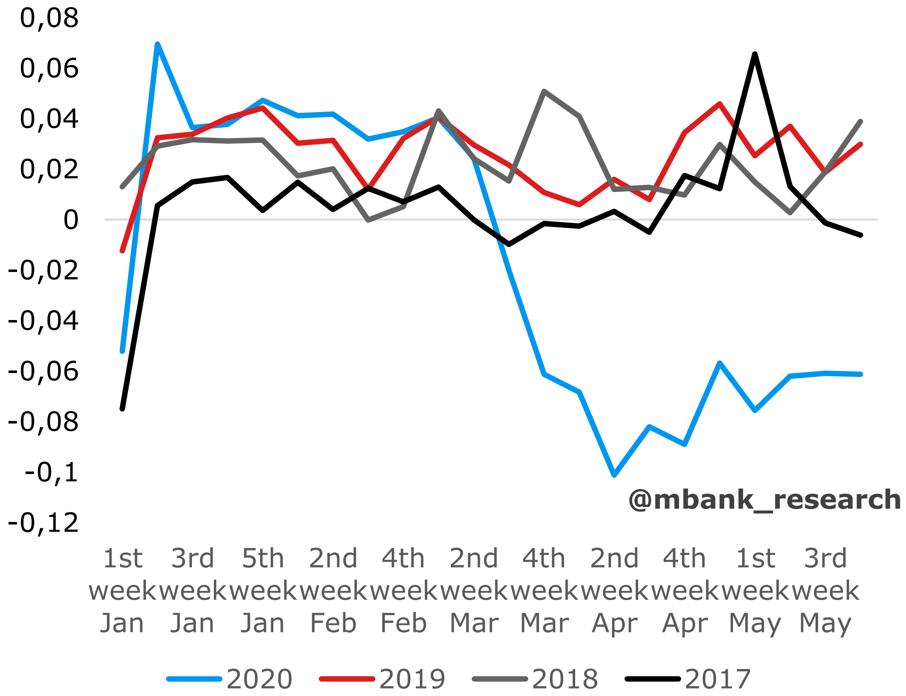
High frequency indicators suggest modest recovery since April

Average card expenditures.
April 2019 = 100. Data up to 24th May.



Source: mBank transaction data. Own elaboration.

Energy consumption. Deviation from „normal".

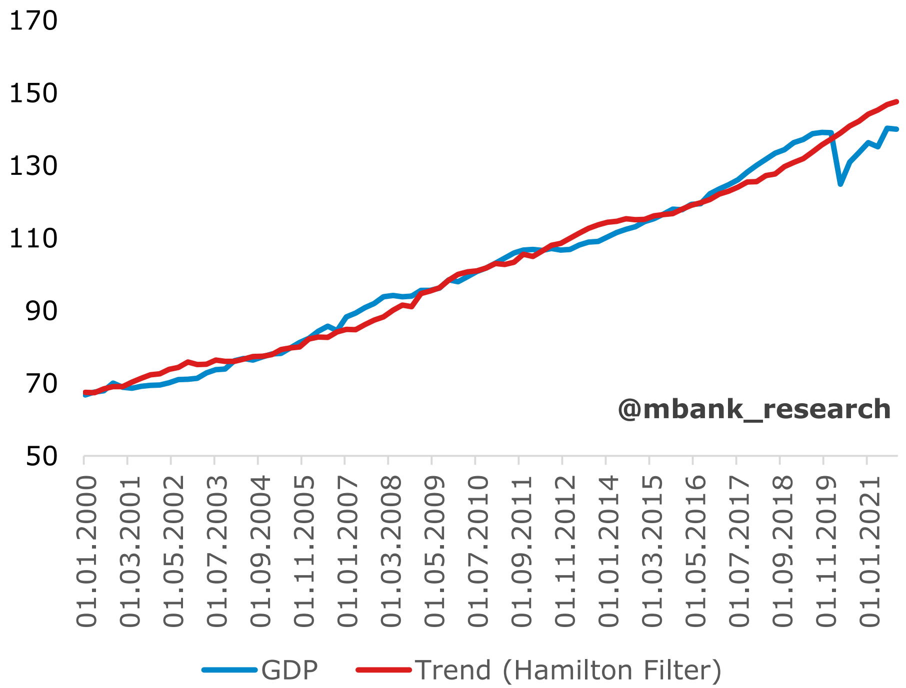


Source: electricity grid data & own elaboration

- Consumers are willing to spend and have higher deposits to use.
- We will see how fast the gap between 2019 and 2020 will be closed. So far our hypothesis is that mostly we see some pent-up demand and recovery will slow down further down the road. Consumers have to get used to new reality and second round effects of the economic dip may still appear (demand shock). Some services may not be coming to normal forever.
- The good news is, however, that the worst is over.

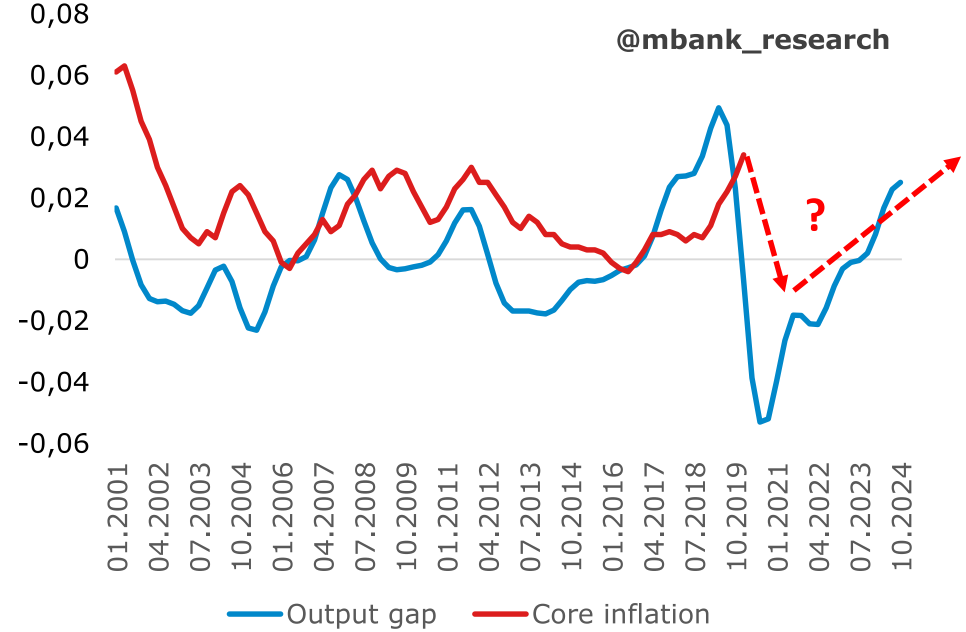
Mini-research note. Cyclically, inflation should be falling in the coming quarters. However, the picture for 2022/23+ is far less clear.

GDP dips below trend 2021-2022



Source: Statistics Poland, own elaboration

But trend is not given for a lifetime. As GDP accelerates, output gap closes. Inflation may emerge 2023+



Source: Statistics Poland, own elaboration

- The flirt with deflation should be taken for granted in 2021. However, it is still not perfectly clear if immediate dip in economic activity (comparable to a very long weekend) that was to large extent reimbursed to economic agents by the governments carries the same or comparable deflation risk as a normal recession of such magnitude. We should be aware of various COVID19 cost increases (firms will be working hard to pass them onto consumers). On the other hand strong, deflationary demand side effects stay intact.
- Output gap opens up and then closes in 2023-24. Inflation pressure may begin to mount again.
- Questions ahead: Is COVID-19 a destruction of potential GDP growth? Some people off the labor force (elderly and with pre-existing conditions), 100-150k Ukrainians left and may not be coming back fast, additional distancing measures may hamper productivity. Anti-covid, green and „climate" investments are not pushing technological frontier much – they will allow economy to function normally (current GDP+++, but potential?).
- Risks: to the downside. Less inflation, slower return to inflation pressure.

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