Monthly Pulse Check

Economy. FI. FX

June 27th 2022

mBank Research

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

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

Macro

- Global economy is slowing. Interest rate increases, local covid outbursts, still broken supply chains, high prices of oil, food and energy are expected to more and more visibly take their toll in sequential growth rates amidst accelerating inflation.
- Polish economy is exposed to trade, price and uncertainty shocks. However, data for the 1Q were really good. We keep our GDP forecast for the 2022 at 4.8% y/y. Substantial average growth masks substantial, sequential slowdown, though, exacerbated by rate hikes. After the slowdown kicks in, we see no easy way out. Therefore 2023 growth is close to only 1%. The composition of inflation should switch form demand/commodity driven (2022) towards energy driven (2023).

Monetary policy: Fed. ECB. NBP

- Fed: Lift-off. We think that Fed will end ~3% at the turn of the year (and rather prefer 50bp hikes). Potential for under-delivery grows substantially in 2023 (rate cuts most likely scenario).
- ECB: Very close to lift-off. Hikes will start in July (25bp). However, substantial potential for under-delivery in 2023 due to growth slowdown and still moderate wage growth. We expect a pause in 2023 (at 0.75%), no cuts but no further hikes.
- NBP: Sending hawkish messages in the middle of tightening cycle. We see rates at ~7.0% to be reached within next months (last hike in September). Afterwards the realized and expected GDP slowdown is going to stop further rate increases. The composition of inflation matters as well.

FX Market

- The promise to release of EU funds helped to tame zloty depreciation and even propelled some strengthening. Situation on the exchange rate market is far from stable or determined, though. We still shall await volatility around inflation prints and MPC meetings. Slight appreciation stays our baseline scenario in the mid term.

		2021 Q4 F	2022 Q1 F	2022 Q2 F	2022 Q3 F	2022 Q4 F	2023 Q1 F	2023 Q2 F	2023 Q3 F	2023 Q4 F	2021 Q1-Q4	2022 Q1-Q4	2023 Q1-Q4
GDP y/y	%	7,6	8,5	6,3	3,5	1,7	-0,1	0,2	0,9	1,6	5,9	4,8	0,7
Individual consumption y/y	%	8,0	6,6	5,5	2,2	3,1	2,0	-1,0	-1,4	-0,5	6,1	4,5	-0,5
Investment y/y	%	5,2	4,3	8,0	5,5	2,3	-1,0	2,0	2,0	2,0	3,8	5,0	1,3
Inflation rate (y/y)	%	7,8	9,7	13,9	16,4	15,6	17,5	11,3	7,6	5,9	5,1	14,0	9,8
Unemployment rate (eop)	%	5,4	5,4	5,0	4,8	4,9	5,0	4,9	5,0	5,2	5,4	4,9	5,2
NBP repo rate (eop)	%	1,75	3,50	6,00	7,00	7,00	7,00	7,00	6,00	5,00	1,75	7,00	5,00
EUR/PLN (eop)	%	4,59	4,65	4,60	4,55	4,55	4,55	4,55	4,55	4,55	4,59	4,55	4,55
USD/PLN (eop)	%	4,04	4,20	4,38	4,42	4,42	4,33	4,21	4,14	4,06	4,04	4,42	4,06

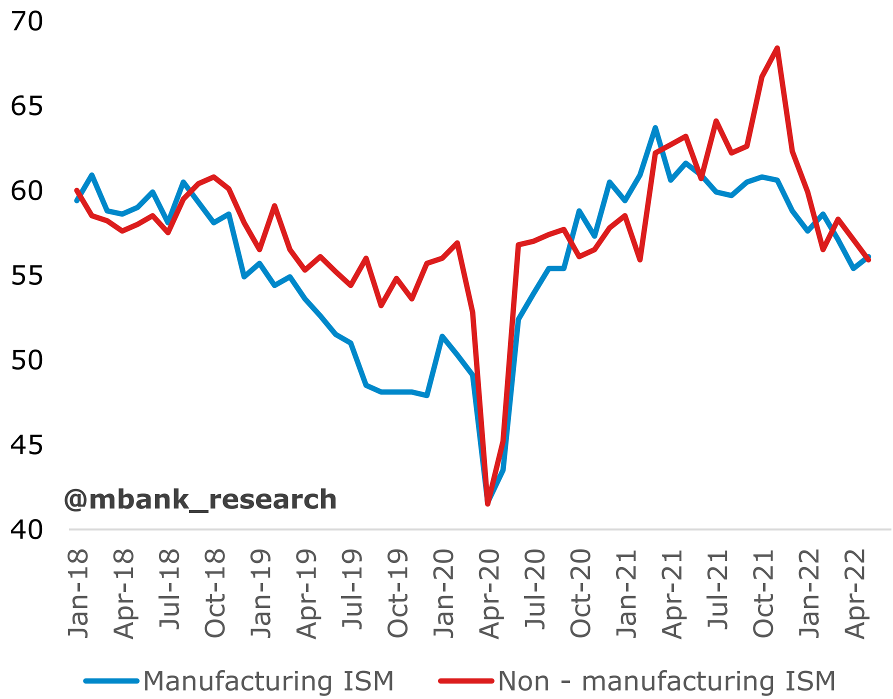
F - forecast

Highlights

- Fed is in the hiking cycle and ECB is set to start its own in July. Regarding the U.S. it seems that nothing can stop the Fed from further hikes (at least for some time). Labor market is strong, inflation remains elevated, there are no clear symptoms suggesting the instant stop of GDP growth (slowdown is coming, though, but will need time to develop). Another (few) 50bp hikes are coming (see here), but 2023 will mark a top in rates. In the eurozone C. Lagarde provided very clear forward guidance. Net purchases under APP will end in the beginning of Q3, hikes will start in July, and by the end of Q3 ECB wants to exit negative interest rates (see here). Investors are somewhat relieved (curve steepening stopped) that ECB acknowledged there is no need to wait. At the same time, we see a turnaround is swap rates in the U.S. For a short review of global rates click here. It seems that as CBs entered no-mercy-mode for inflation, markets started to price in more recession risks.
- Polish central bank moves in the same direction. Higher inflation path, strong real data, and fiscal actions (which will weaken interest rates transmission channel) convinced us to revise up interest rates forecast some time ago. However, we think that MPC will end with rates at around 7% in 3Q (the exact level depends on the size of the next two steps, in July and September). The cycle will end when inflation stops growing this year (next year is less relevant since the composition of inflation is going to be much different). This will coincide with weaker data from the real sphere. Even after recent correction, Polish interest rates price in a decent monetary tightening. More details here.
- Although we are still living great GDP figures for Q1 (8.5% y/y GDP growth, see here) there are mounting symptoms that economy is going south (as forecast). Even MPC starts to see those symptoms but – alike other central banks – tries to combat inflation now (but not disregarding the cost). This is going to evolve over time, both globally and locally. Inflation is still rising, and we have not reached the peak yet. The most problematic (for MPC) is acceleration in core inflation (see here and here). Given the state of commodity markets and given the developing GDP slowdown, there are signs of hope that inflation is going to indeed top within the next 2-3 months and then become less broad based (visibly slowing core in 2023) even if another round of energy prices increases for households is still ahead of us at the start of 2023.
- Since we added some new sections, it is high time to elaborate more on them. Starting from GDP tracking (see here), estimates are going down. Industrial output is losing momentum (here). Its primarily about energy generation now but given the state of business tendency indicators and faltering global momentum, we see manufacturing weakening in the months ahead. Construction is zig-zaging down (here). Retail sales (here) seems to be strong (with weak composition) but as real wage growth entered negative territory and credit creation is falling, there may not be much fuel left (although we think that consumption will be the last to fall). Labor market (here and here) is flashing some encouraging signals that labor demand is on the decline (so far it is very early evidence but consistent with business tendency indicators). Recently sketched timing of slowdown is still valid: construction (investment) -> retail sales -> manufacturing -> consumption (as w whole).
- Current account deficit is creeping higher reflecting mostly unfavorable terms of trade (see here). We expect some rebalancing as economy slows down and (maybe) commodities continue correction lower. Nothing new of the fiscal side (see here and following links).
- EURPLN is still weak, reflecting right now more slowdown risks and repricing on rates (see here). We do not expect major changes here but still maintain an appreciation bias.

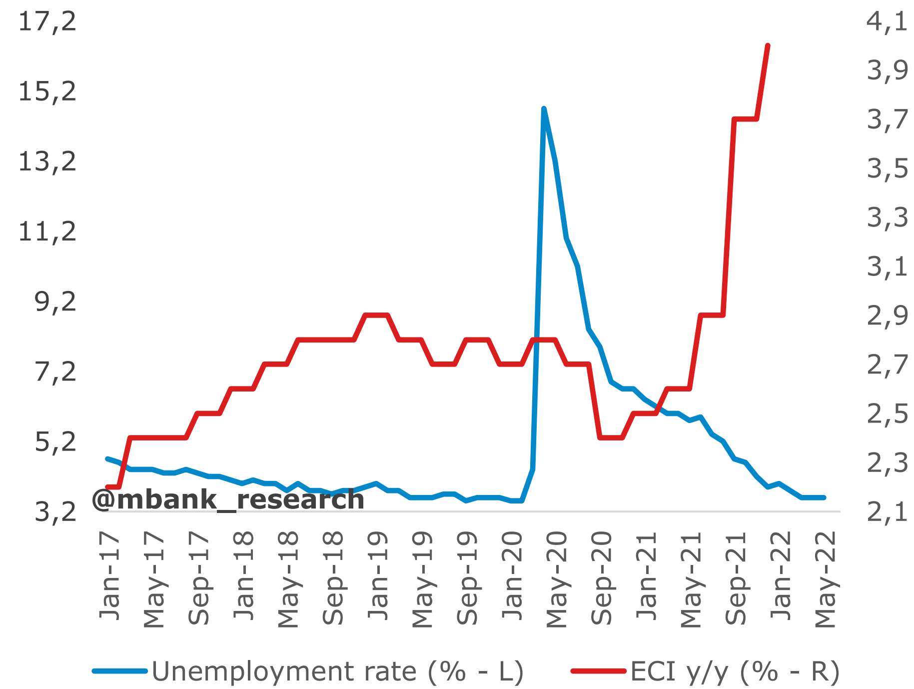
U.S. economy health check

ISM PMI: manufacturing & non-manufacturing



Source: ISM

Labor market: wages & unemployment rate

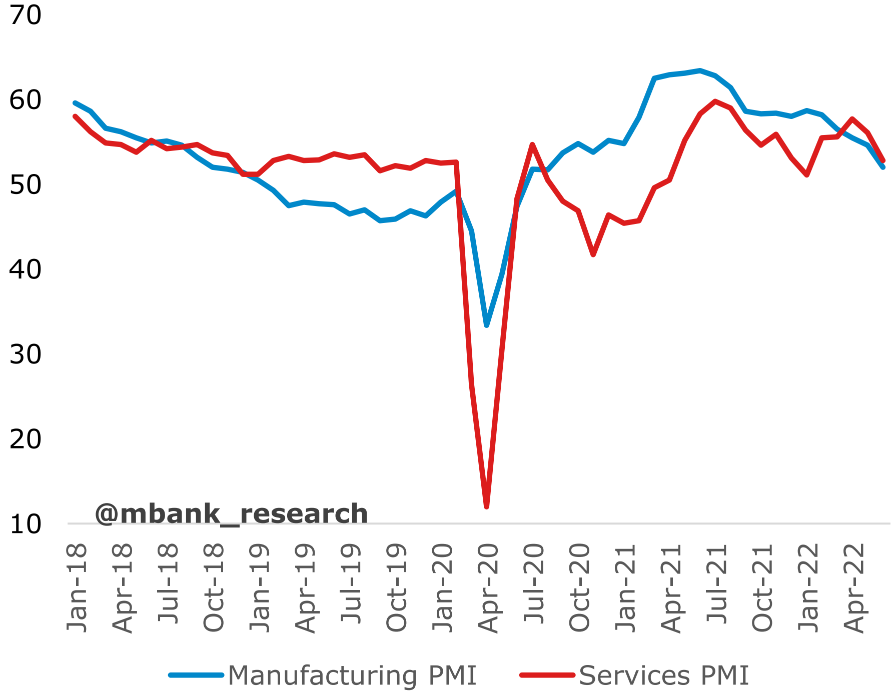


Source: FRED

- Recession is on the horizon. Sentiment indicators in the manufacturing sector suggest shrinking current production (below 50pts in PMI). New orders also decelerate. We do not see it in the current data yet, but we will. Those are obvious signs of rising problems with the demand side.
- Fed see the possibility of the recession, but it is not its base scenario. FOMC is focusing on inflation, as labor market data are still solid (and they will be – even if we see some increase in unemployment rate it will still be relatively low given the historical values).
- In June FOMC decided on the highest rate hike since 1994 (+75bp). J. Powell announced that next meetings are going to be a 50/75bp split. It is clearly a restrictive monetary policy and lowering inflation is now the main objective of the Fed. They want to see series of inflation falling m/m for a few months. Signals from projections are clearly hawkish (median of „dots” at the end of 2022 at 3.4%, and year later at 3.8%). We think that early 2023 will mark a top in rates. Recession (signs already seen in the hard data) will be the main argument against further hikes.

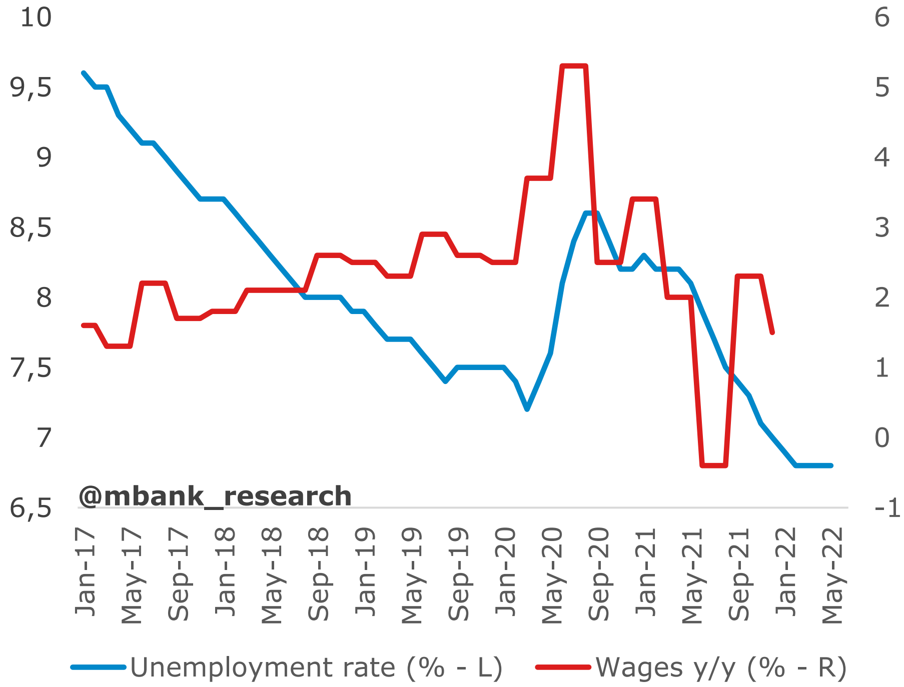
Euro area economy health check

Markit PMI: manufacturing & services



Source: Markit

Labor market: wages & unemployment rate

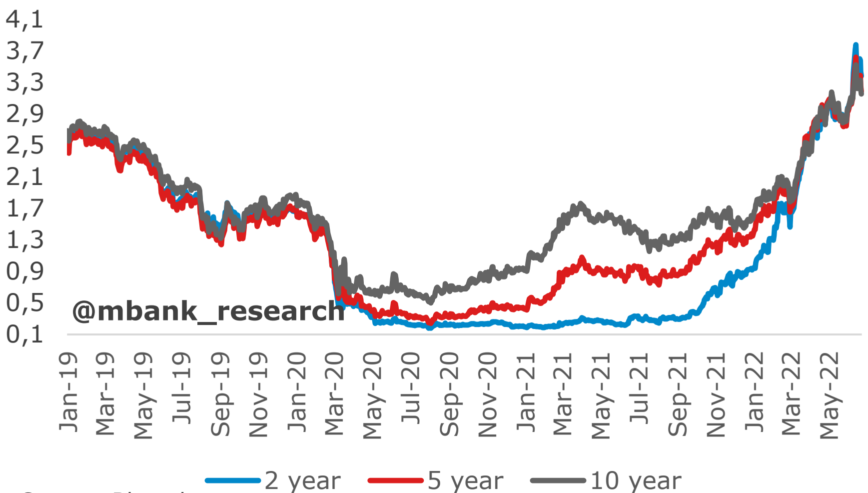


Source: Eurostat

- Sentiment in the manufacturing sector is just slightly better than in the U.S. Slowdown is not so visible, but we still think it is inevitable. Eurozone is much more mired into energy problems that are set to escalate soon.
- C. Lagarde was very clear when presented the forward guidance during June's press conference. In fact, one can think that now we know everything regarding next few months. ECB intends to raise interest rates by 25bp at its July meeting and repeat this move in September (the scale of the move was not announced but 25bp hike is the most probable option). As expected, ECB decided to end the APP programme as of 1 July 2022. We think the ECB is set to start, but will be forced to end soon (no reversal, rates just stuck at positive territory). Slowdown is going to play the key role.
- But it seems that it is not the end of asset programmes in the eurozone. As the risk of the fragmentation was more and more visible, the Governing Council decided to meet again and announced flexibility in reinvesting of PEPP assets and acceleration of work on new anti-fragmentation instrument (briefly: sell core and buy periphery).

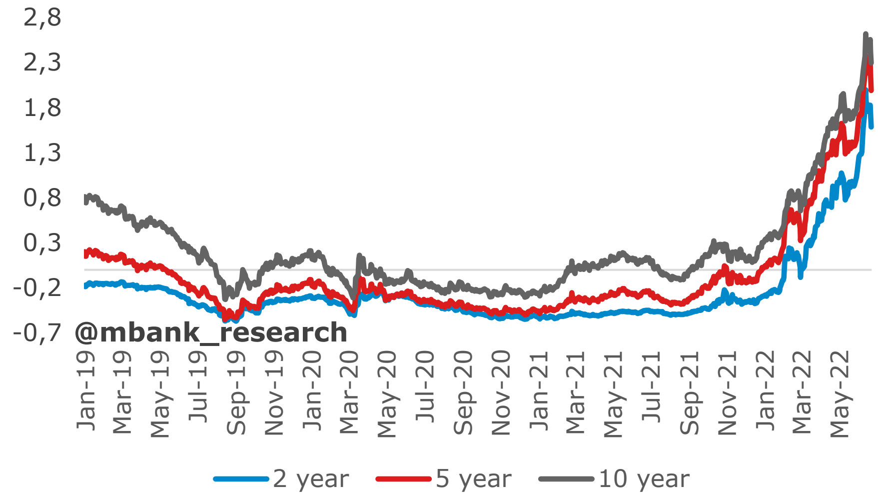
Global rates

US swap rates (%)



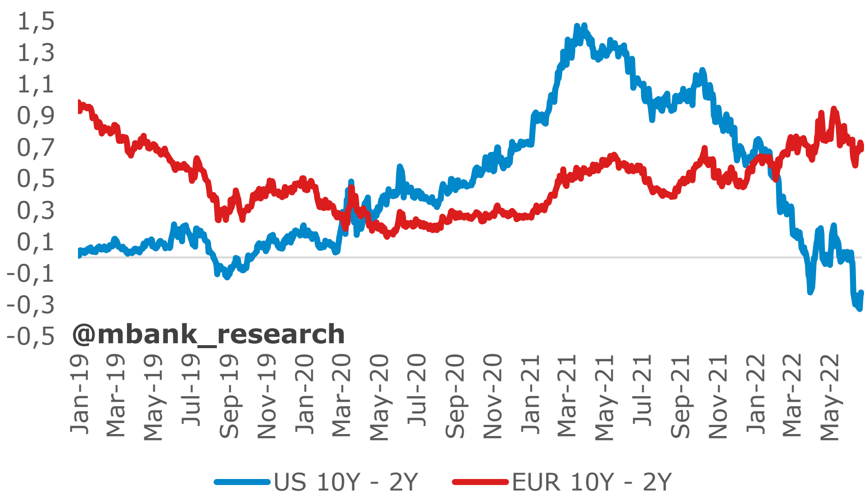
Source: Bloomberg

EU swap rates (%)



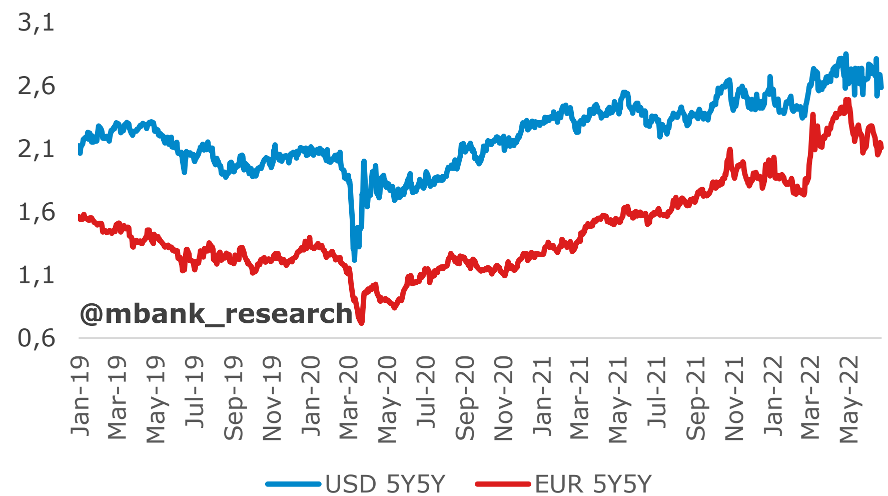
Source: Bloomberg

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



Source: Bloomberg

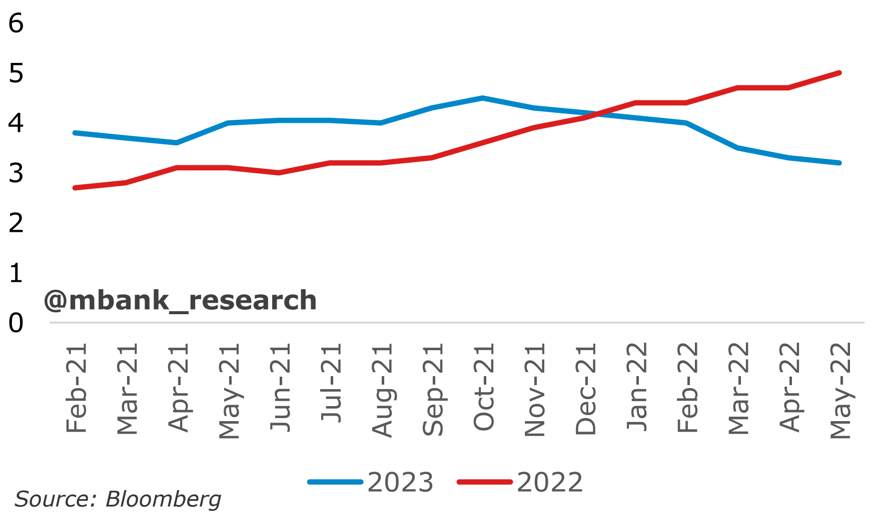
US and EZ inflation expectations (%)



Source: Bloomberg

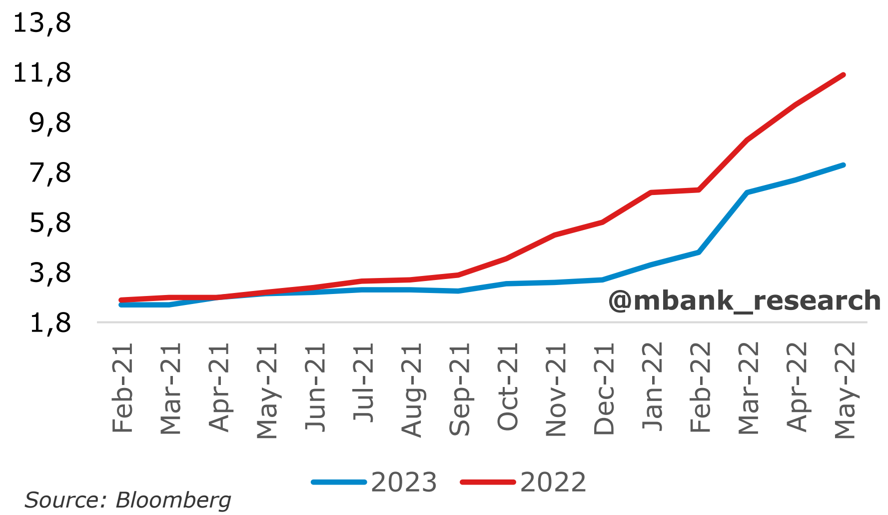
Consensus: what is expected in Poland?

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



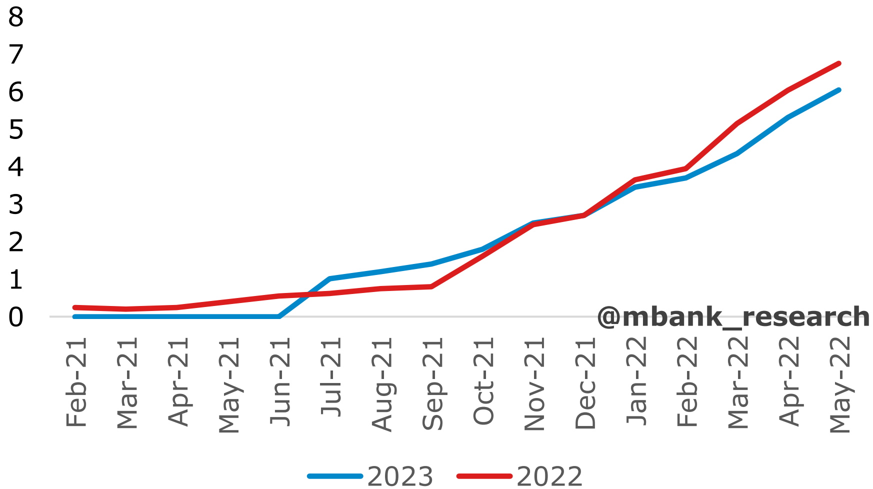
Source: Bloomberg

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



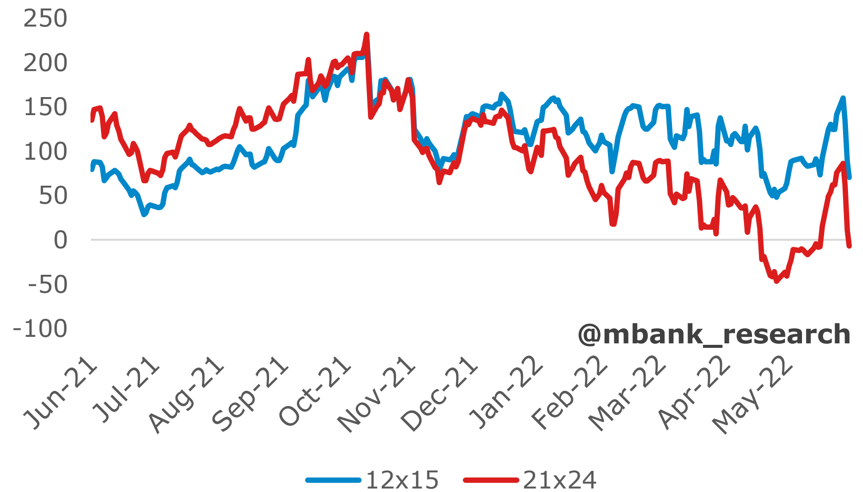
Source: Bloomberg

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



Source: Bloomberg

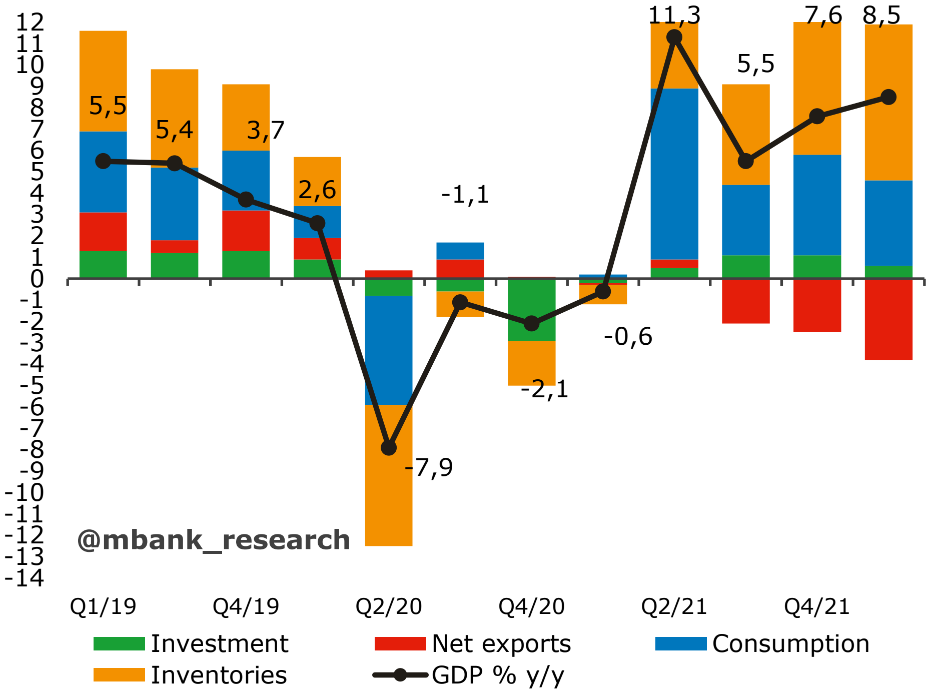
Rate changes priced in by FRA (bps)



Source: Bloomberg

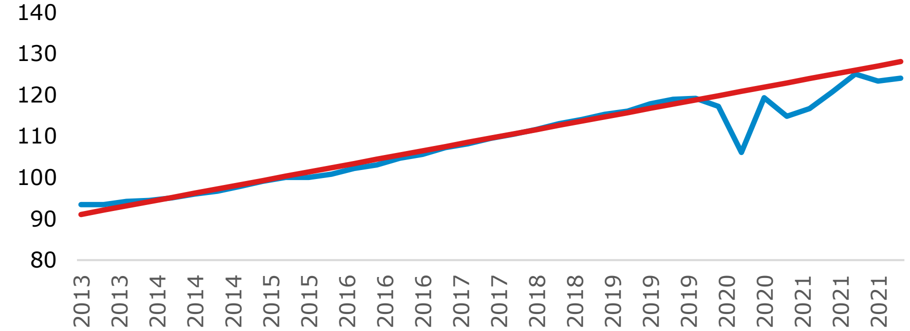
Poland: 8.5% GDP growth in 1Q2022

GDP growth decomopsition

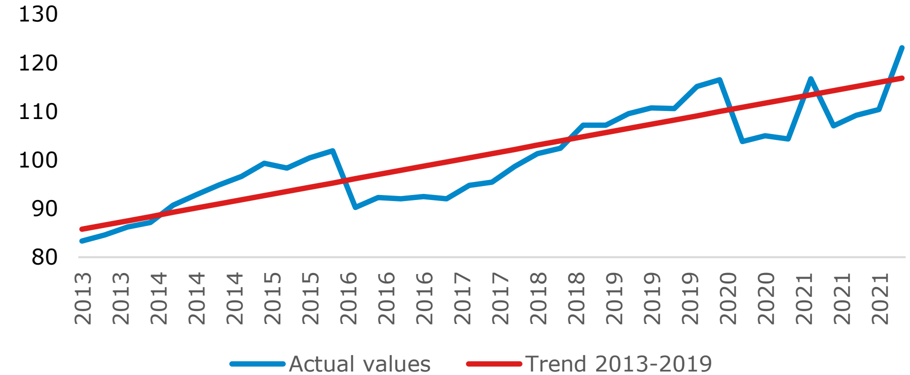


Source: Statistics Poland, NBP, own elaboration

Consumption (index 2015=100, sa)



Investment (index 2015=100, sa)

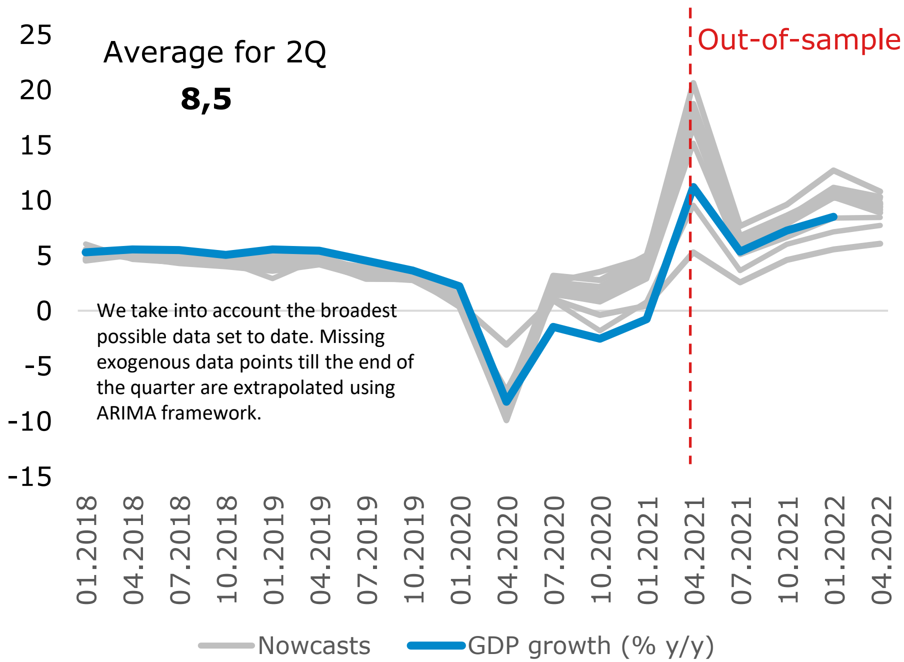


Source: Statistics Poland. own elaboration

- Final data regarding GDP growth in 1Q2022 were in line with the flash estimate (8.5% y/y). But contributions were quite surprising. Most of the growth was due to the increase in inventories (they added 7.7 pp). Please dot not correct GDP numbers by this figure. It was inflated by inventories but overall, not on such high scale.
- Consumption growth by 6.6% y/y was a negative surprise. The most probable explanation is methodology. Formally Statistics Poland should assign expenses of refugees to net exports (not consumption, as they are not residents) and apparently, they did it (but we do not know how it was technically possible). We may see revisions here.
- Investments increased by 4.3% y/y (consensus was above 10% y/y). Here explanation is much simpler – the production that we supposed to go into investments, went into inventories (so accumulation vs fully fledged capital goods). High base from the year before also played a role.
- Inventories were built up stronger than economic cycle would imply. This (ceteris paribus) means weaker GDP results in the future. On the top of that there will be also demand/supply shocks. We still forecast the entire year GDP growth at + 4.8%, and next year only + 0.7%.

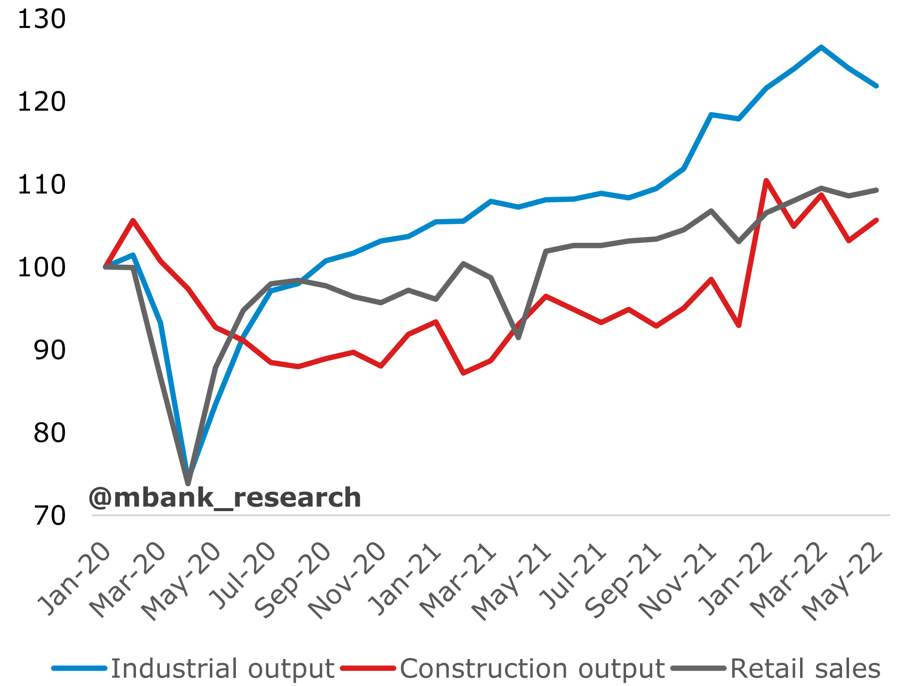
Poland: Monthly data – overview (and GDP nowcast)

GDP nowcasting (based only on monthly hard data)



Source: own evaluation

Seasonally adjusted, Jan20 = 100

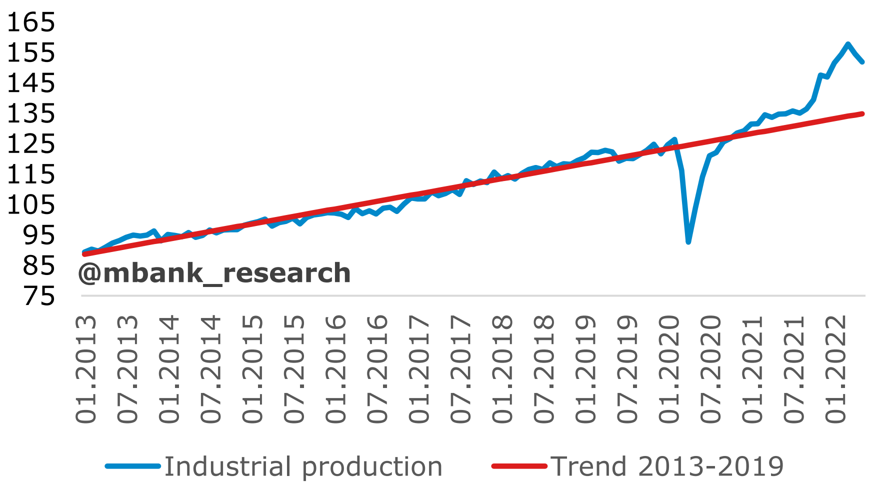


Source: mBank, Statistics Poland

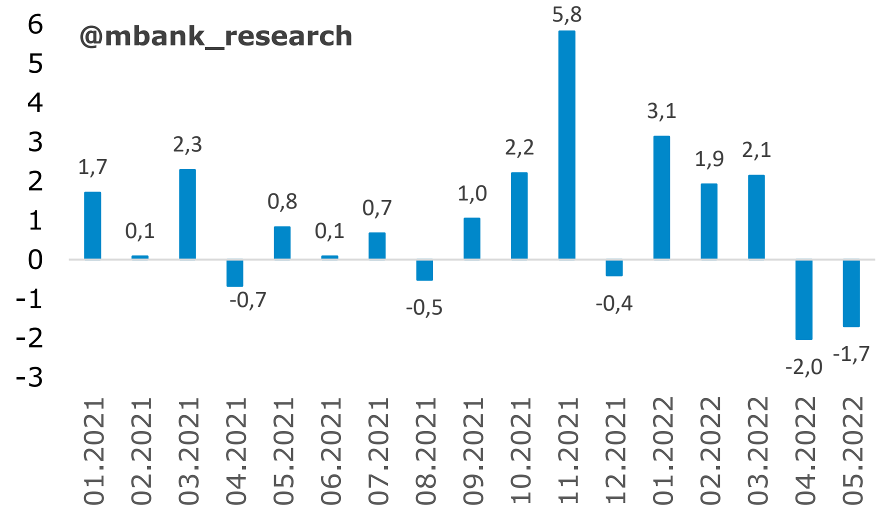
- GDP nowcast decreased by 1pp since last month. Presented above 8.5% estimate is only a technical one (resulting only from tight range of hard data). Actual growth (and our forecast) for 2Q2022 is expected to be weaker (6-7% y/y).
- Monthly data suggest that economy is slowing down. Industrial production seems to be the most apparent example, but here the fall of production was mostly due to energy (quite volatile last time). But even without it (considering only manufacturing) production is going to slow down (index follows the linear trend so dynamically it is set to end up in slower growth)
- Construction surprised positively but still its behavior follows the zigzag trend. And this trend is downward. There are many signs that construction will decelerate further (interest rates, housing construction started, sentiment, signals from the labor market, prices of construction materials – all of them suggest that construction will fall).
- In retail sales after increases at the beginning of the year, now the indices are starting to turn back (in most every category, except for the food and pharmacy but here we see refugees' impact). The impact of declining consumers' real purchasing power (inflation) is more and more visible, and it will play an important role in consumption slowdown.

Poland: Monthly data - industrial production

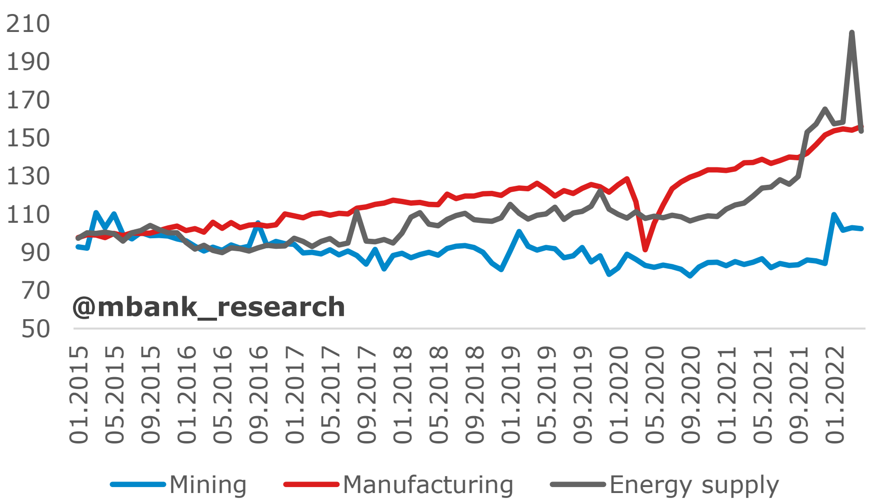
Industrial production (index 2015 = 100, sa)



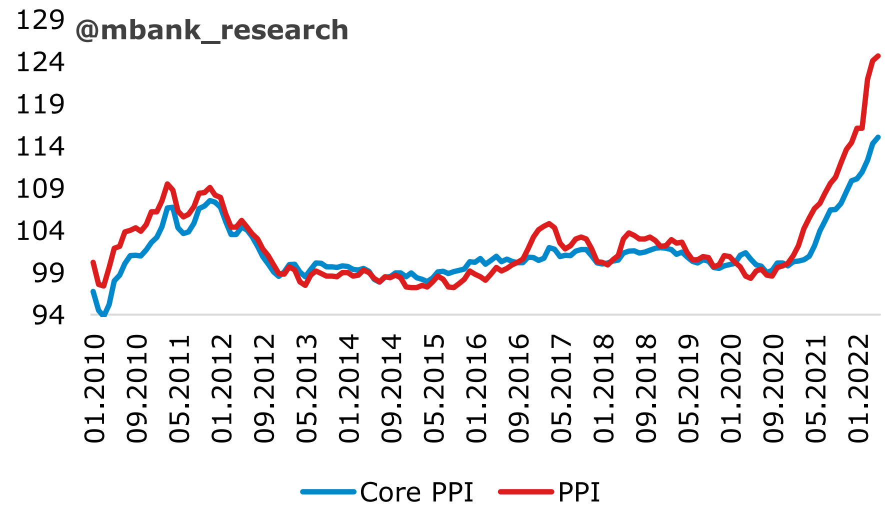
Momentum (m/m growth, seasonally adjusted)



Main categories (index 2015 = 100, sa)



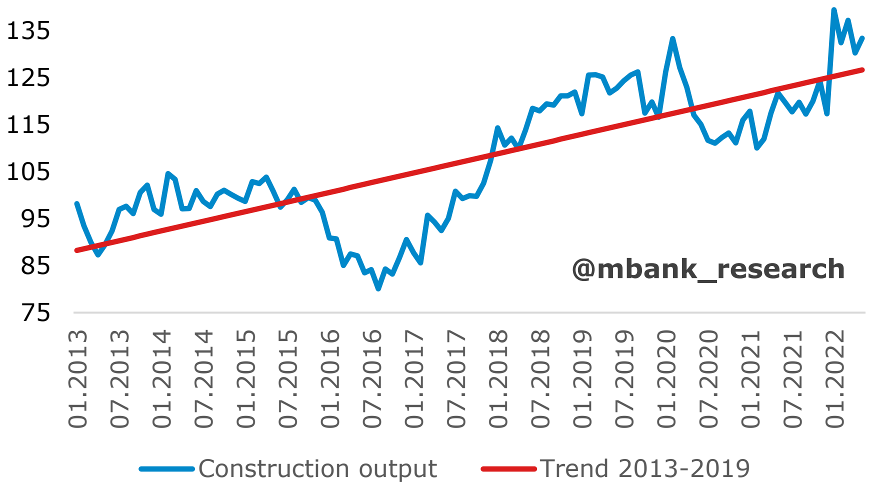
Producer prices (previous year = 100)



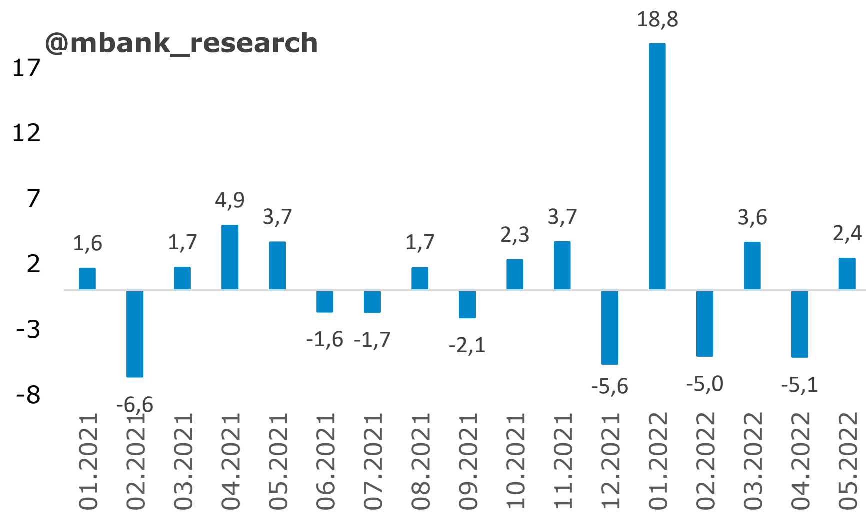
Source: Statistics Poland data. Own elaboration.

Poland: Monthly data - construction

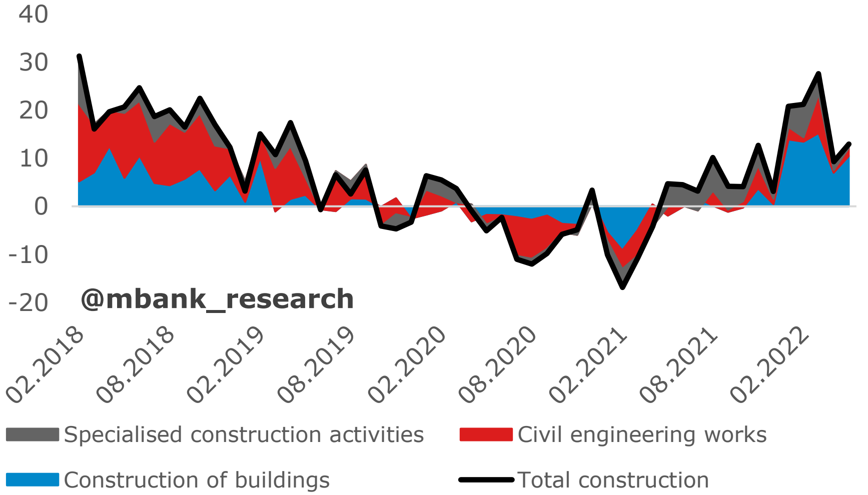
Construction output (index 2015 = 100, sa)



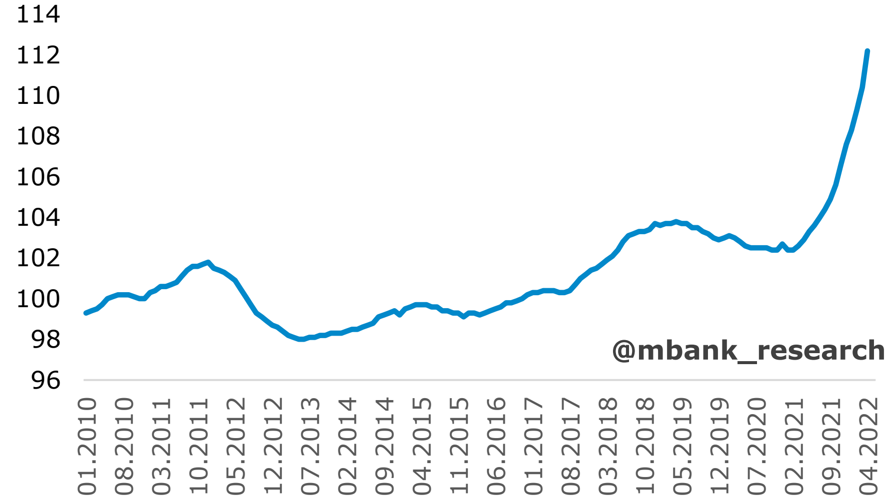
Momentum (m/m growth, seasonally adjusted)



Contribution to y/y growth



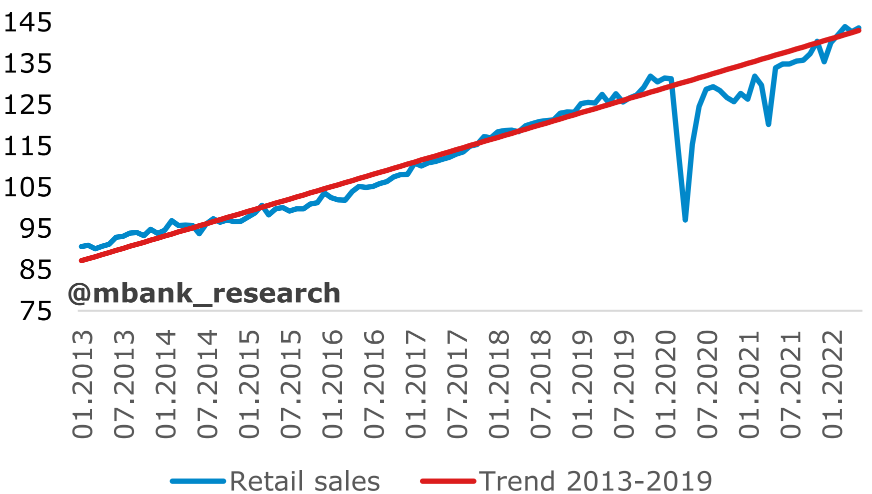
Construction prices (previous year = 100)



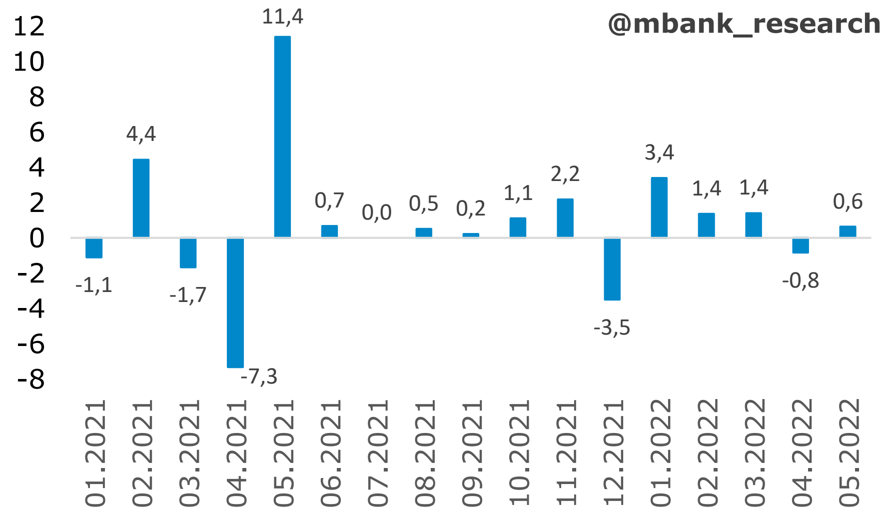
Source: Statistics Poland data. Own elaboration.

Poland: Monthly data - retail sales

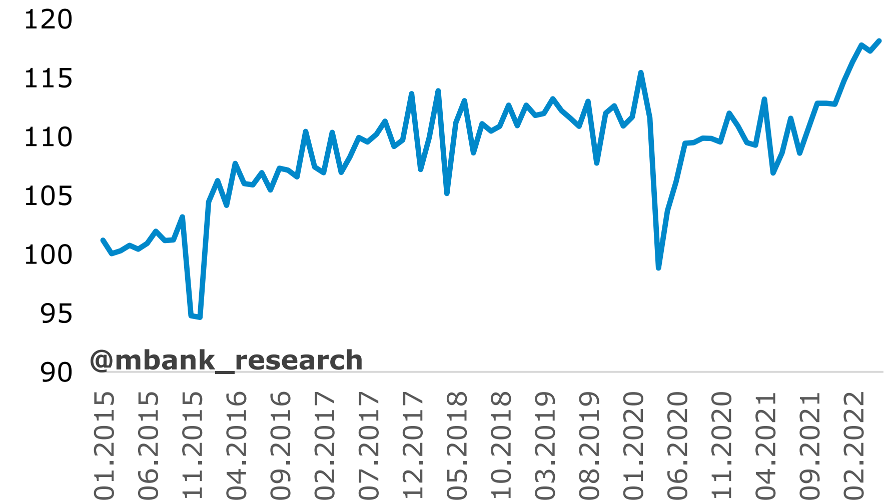
Retail sales (index 2015 = 100, sa)



Momentum (m/m growth, seasonally adjusted)



Retail sales - Food, beverages and tobacco products (index 2015 = 100, sa)

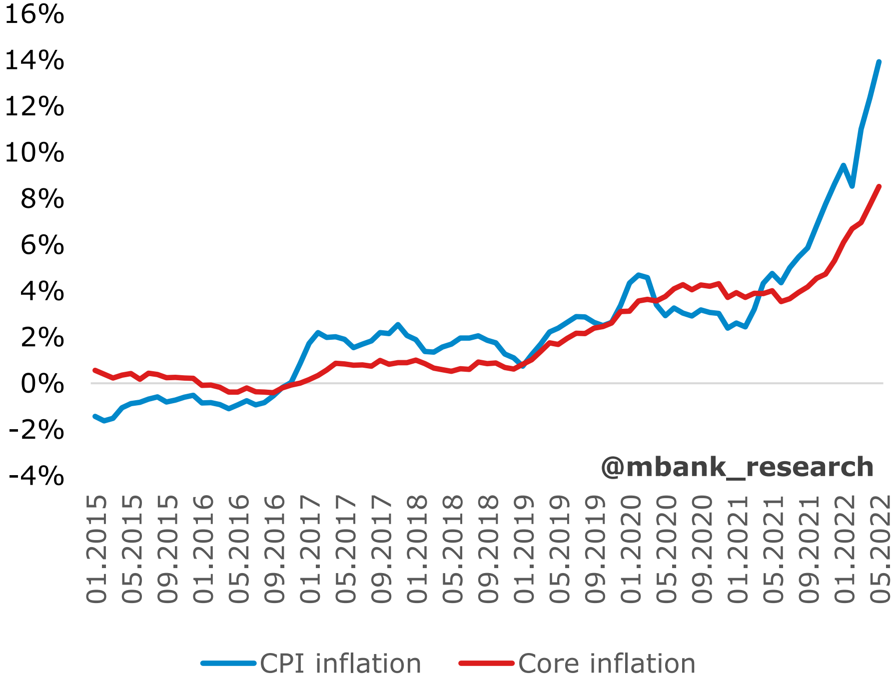


Retail sales - Solid, liquid and gaseous fuels (index 2015 = 100, sa)

Source: Statistics Poland data. Own elaboration.

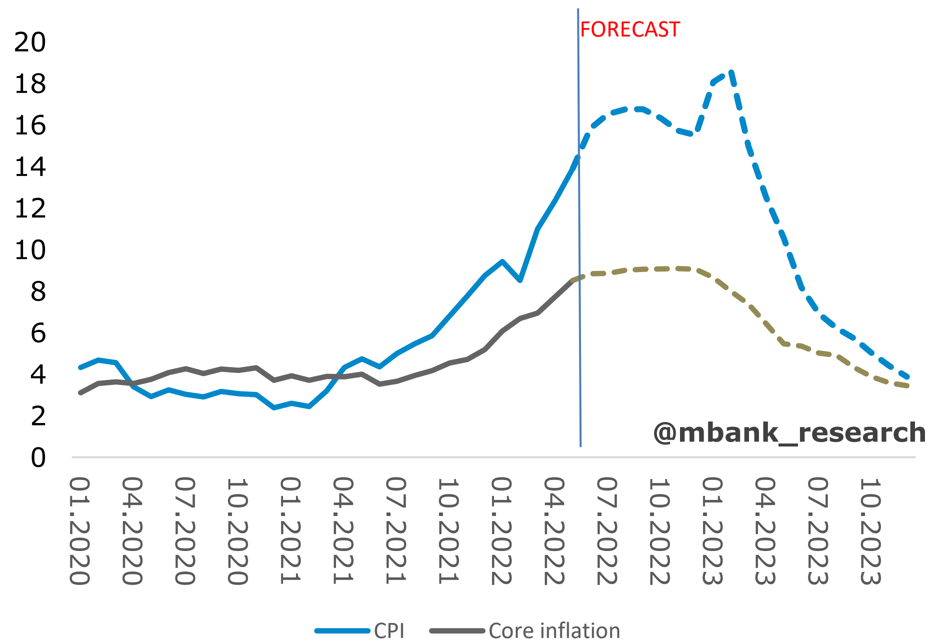
Poland: Inflation tracker #1

CPI and core inflation (% y/y)



Source: Statistics Poland, NBP, own elaboration

Core and headline inflation forecast

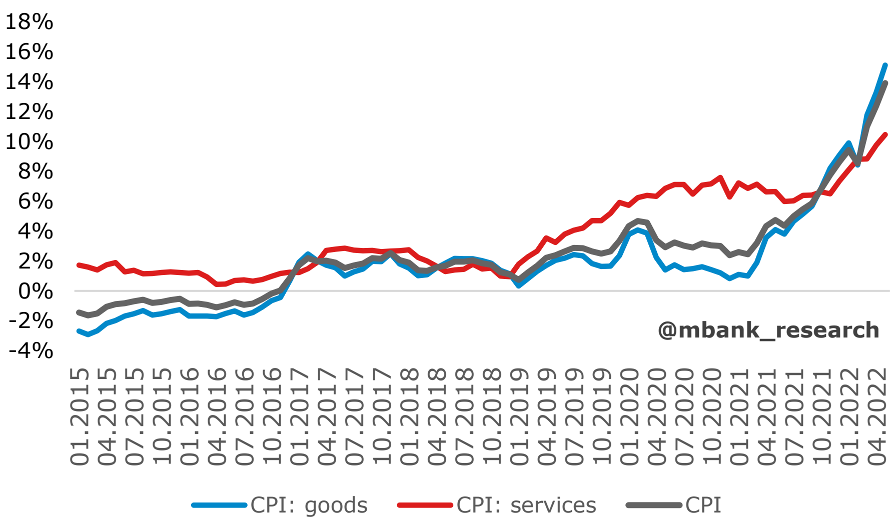


Source: Statistics Poland. own elaboration

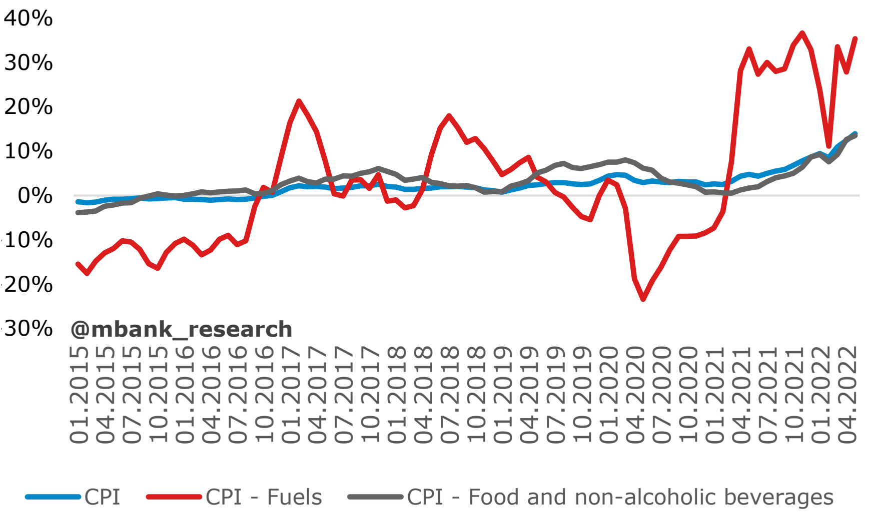
- May’s reading was not a surprise, but some details were worrying. The second category comprises of acceleration of the core inflation. We think it is one of the arguments for the MPC for another rate hikes (in July and September).
- Just another „hard” month, and later on it should be easier. We expect that CPI reading for June will bring another increase (to ~16% y/y). In next months changes should not be so spectacular – we are slowly coming off the peak. If food, fuel and coal prices remain on the current levels, June’s reading will be already the highest one.
- Next year, structure of inflation should be different. We should see lower contribution of core inflation (as the economy is set to slow down), and still high contribution of energy prices (changes in consumers’ bills in January, and some upside risks for coal and natural gas).

Poland: Inflation tracker #2 (unorthodox, additional measures)

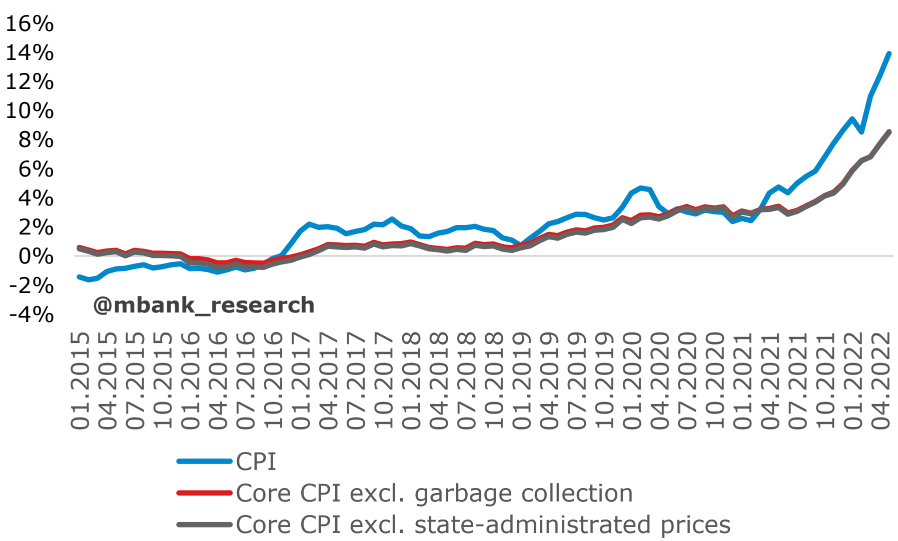
Goods and services prices (% y/y)*



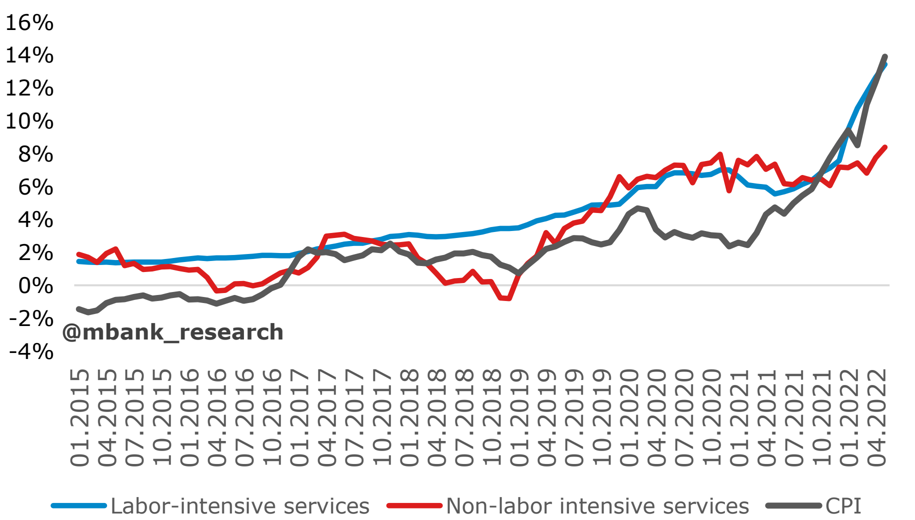
Food and fuel prices (% y/y)



Core inflation without garbage collection fees and without administrated prices (% y/y)



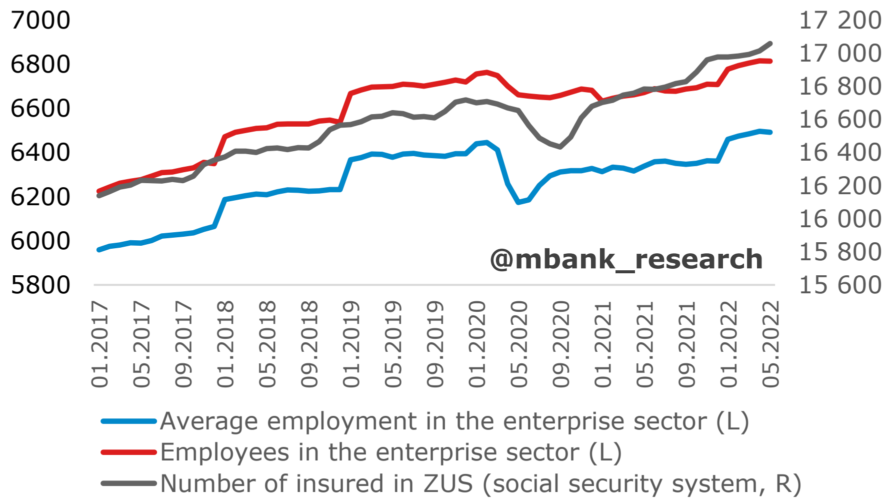
Services (% y/y)



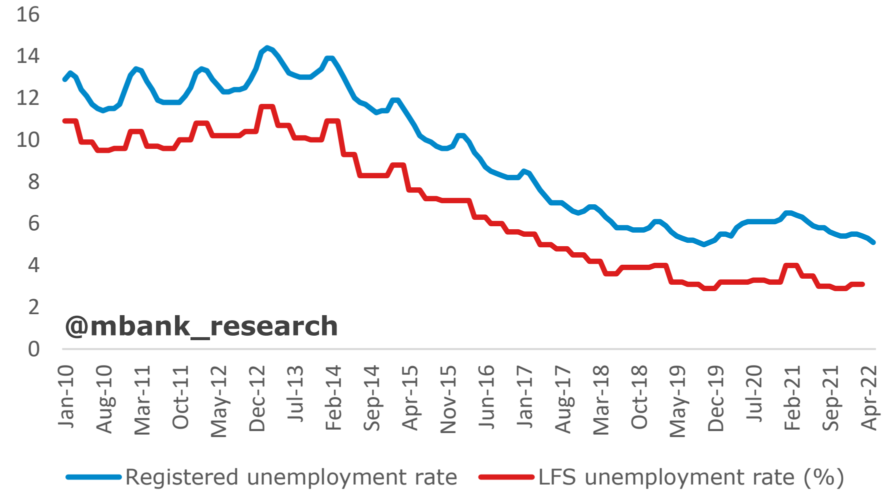
Source: Statistics Poland, own elaboration

Poland: Labor market tracker #1: Employment

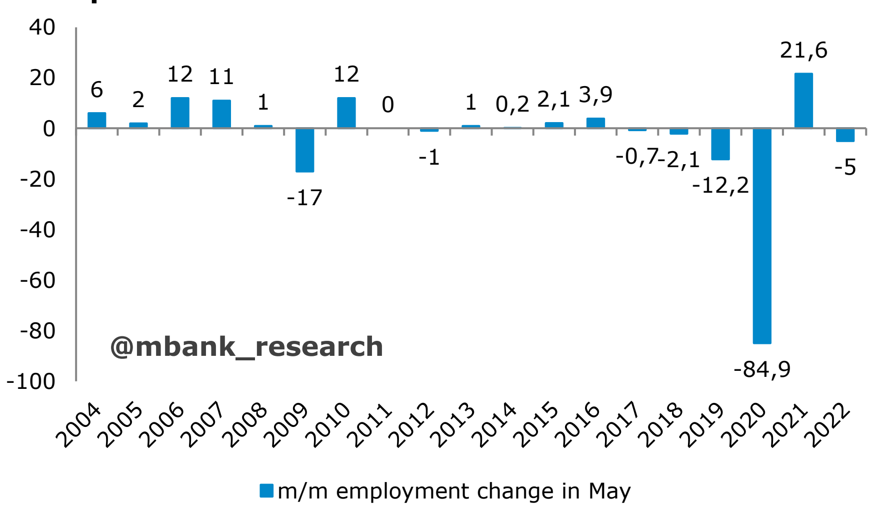
Employment



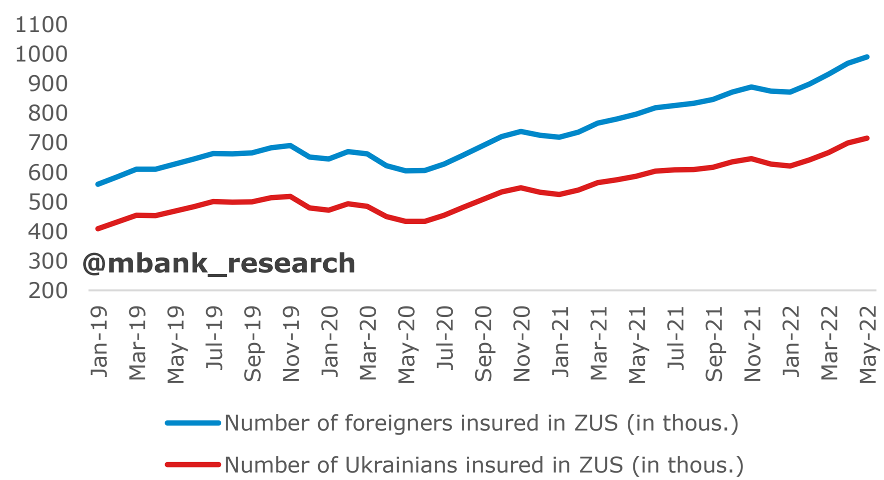
Unemployment rate



Monthly employment change (in thousand jobs), enterprise sector



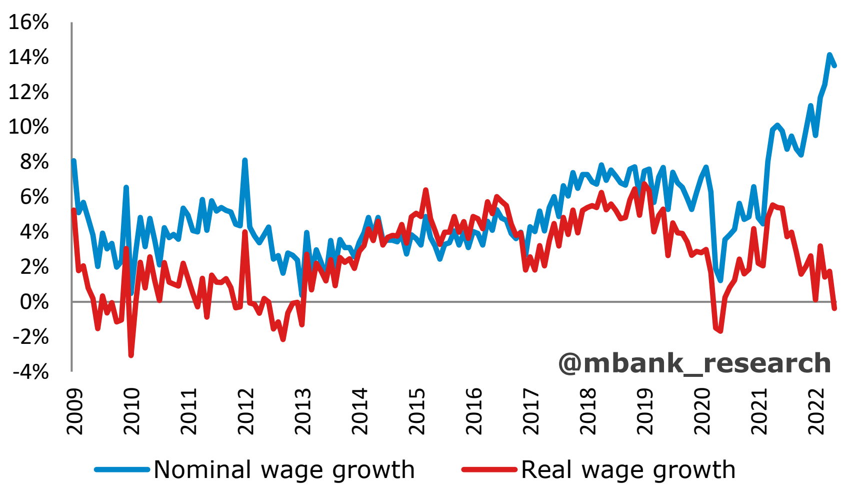
Immigration in the labor force



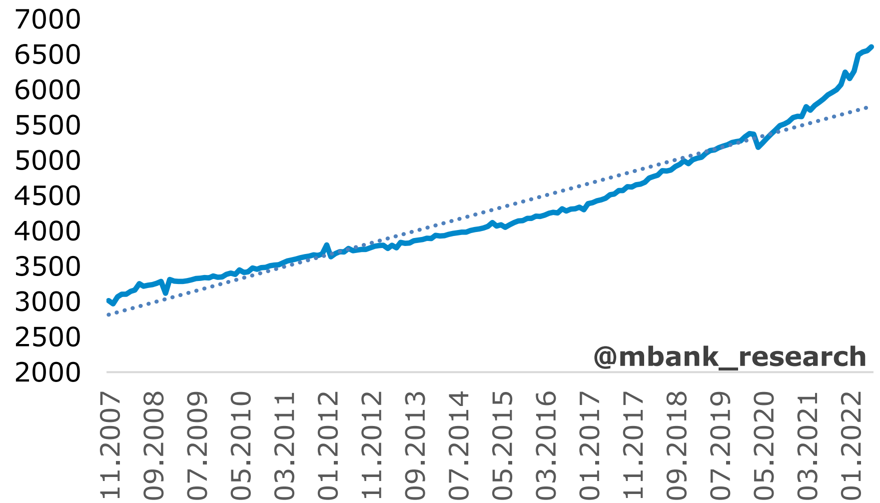
Source: Statistics Poland, ZUS Statistical Portal, own elaboration

Poland: Labor market tracker #2: Wages

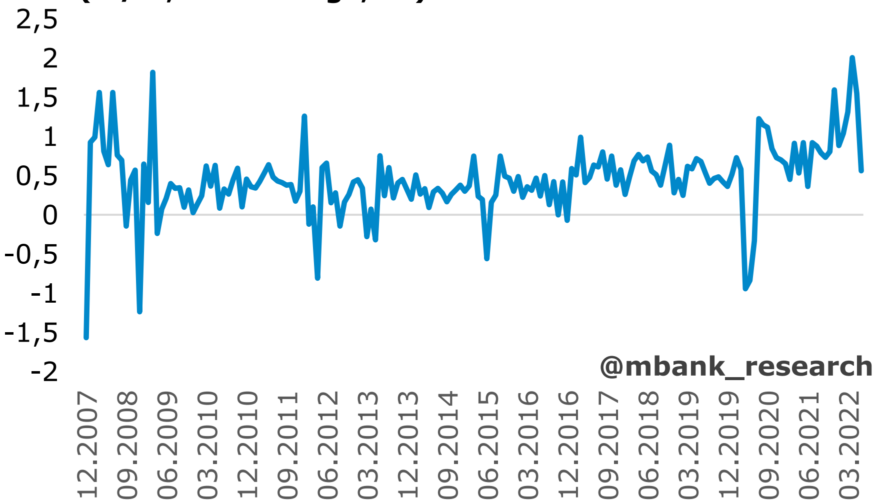
Wage growth (y/y, nsa)



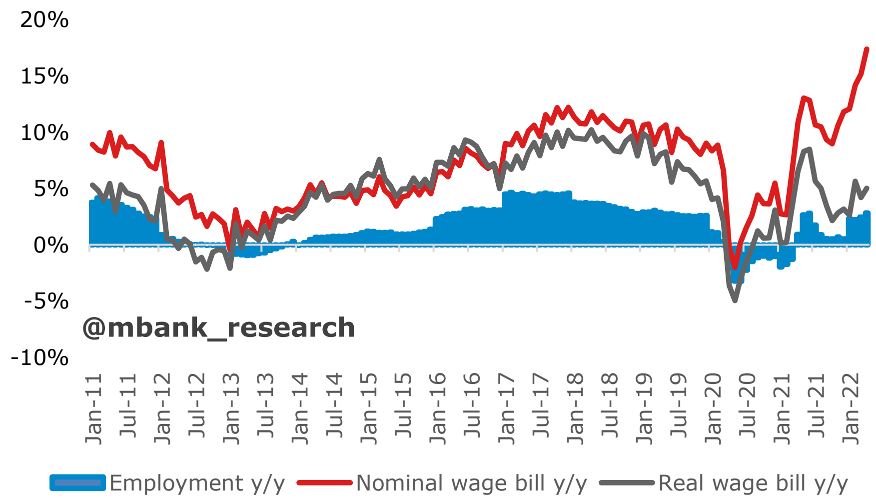
Average monthly wage in enterprise sector (in PLN, sa)



Momentum of average monthly wage in enterprise sector (m/m, 3m average, sa)



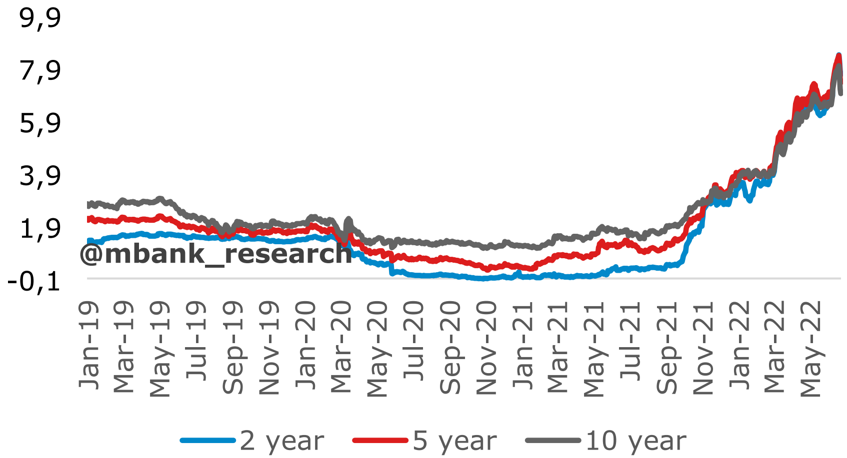
Wage bill



Source: Statistics Poland, ZUS Statistical Portal, own elaboration

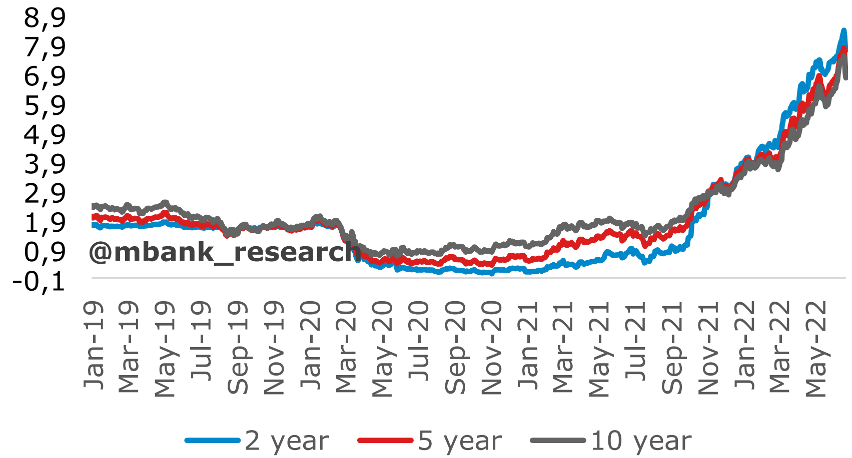
Polish rates, yields and spreads

POLGBs



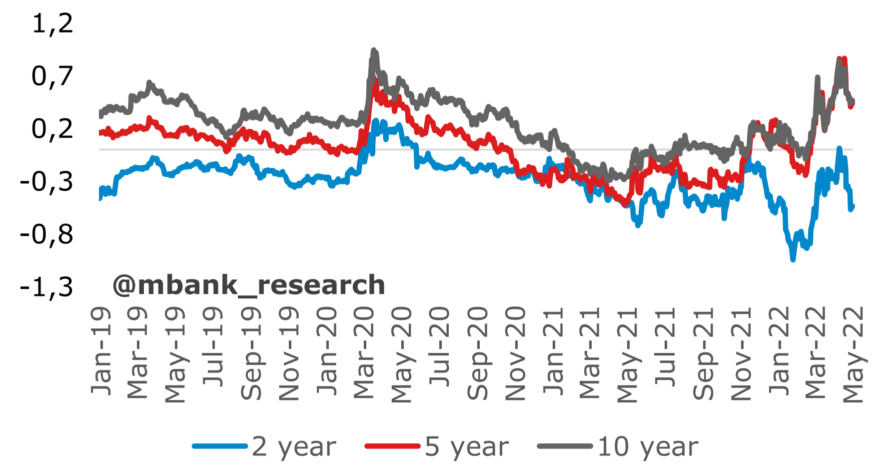
Source: Bloomberg

PL IRS



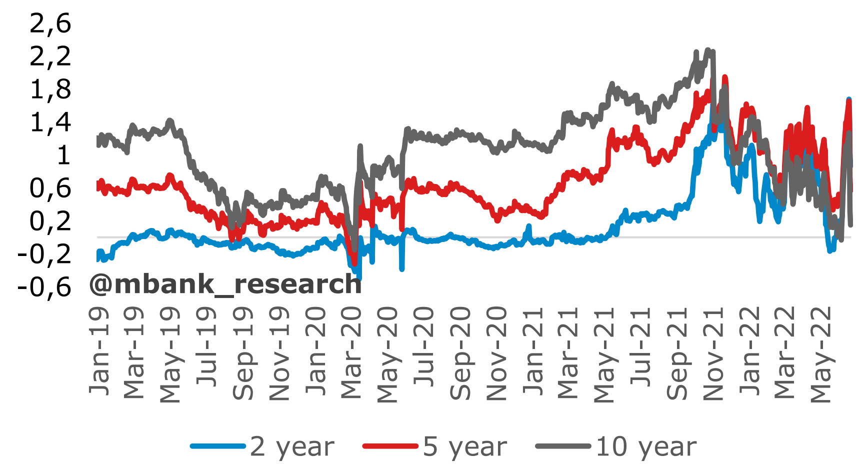
Source: Bloomberg

ASW spread



Source: Bloomberg

POLGB yield minus 3m WIBOR



Source: Bloomberg

Poland: Fiscal balance

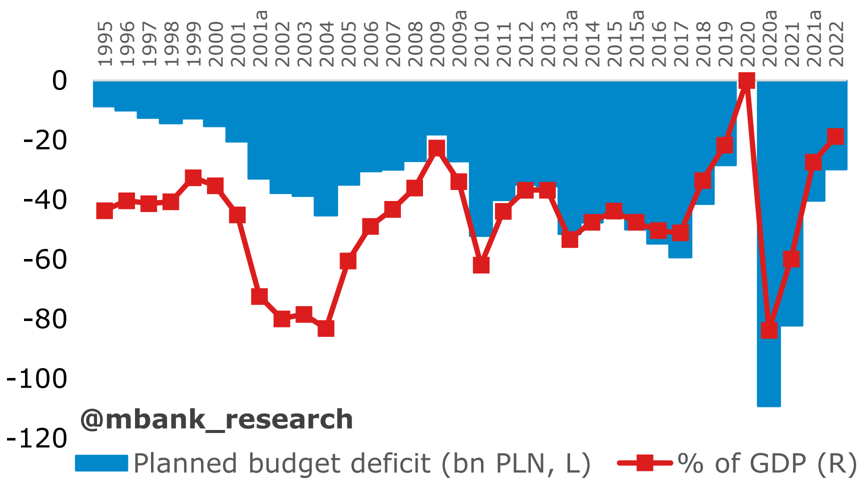
- There is nothing new in the hard data. Poland recorded ca. 12.1 bn PLN of central budget surplus at end-May. We advise to mostly look at central budget from income side, as a proxy for nominal economy. There was a few important fiscal news last weeks, though.
- Government wants to change the stabilizing fiscal rule (towards less restrictive). First, they propose to replace the inflation target to inflation forecast in the mathematical formula for maximum spending. Second, they want to exclude some investment outlays from it. Remember that the rule sets the maximal growth rate, no the desired (chosen) one.
- On the other hand, both, ministry of finance and prime minister announced some consolidation in the next year's budget (we do not know the details). Summing up we think that we will see some tightening but not as strong as the actual fiscal rule would imply (the one with lower inflation). Especially that the next year is a year of parliamentary elections.
- Ministry of financed presented economic assumptions for the next year's budget. MF expects 3.2% y/y GDP growth and 7.8% y/y CPI. In our opinion GDP forecast is much too optimistic. Also, inflation is going to be higher (according to our estimates).
- Graphical summary of current fiscal data in next two slides (here and here).

Poland: External Balance

- The deficit in the current account deepened in April. The main reason was a higher deficit in goods. The ratio of exports of goods to imports slightly improved in April. However, the trend seem to be relentless and easily explains the major part of current account deficit. Additionally, there was a higher-than-expected deficit in primary income.
- What's next? In the short-term exports is going to stay relatively low (supply chains problems + low exports to the East because of war and sanctions), while high raw material prices will have a positive (in mathematical sense) impact on imports. In the longer term, the economic slowdown should be more and more visible, which will have an impact on weaker imports (weaker domestic demand -> weaker imports in real terms). On the other hand, exports will benefit from unblocking supply chains. The further the slowdown goes, the more visible the recovery from the deficit in CA will be. Each and every Polish GDP slowdown implied a major improvement in current account.
- Graphical summary here.

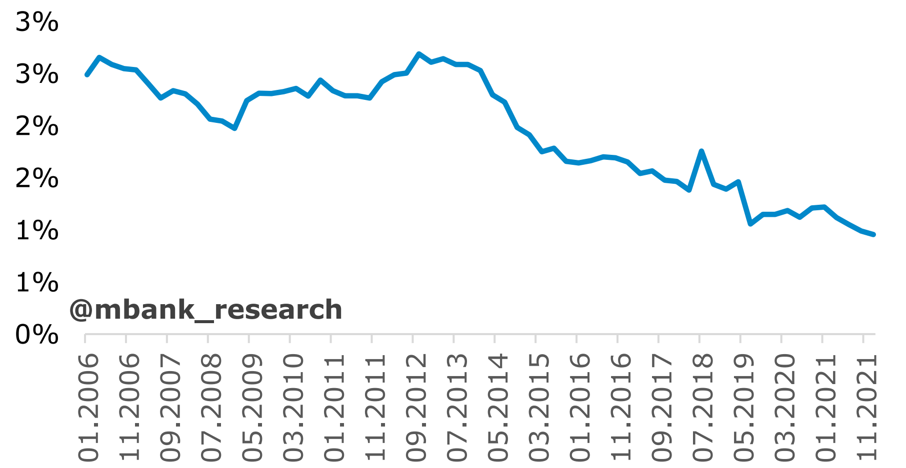
Poland: Fiscal monitor #1

Planned budget deficit



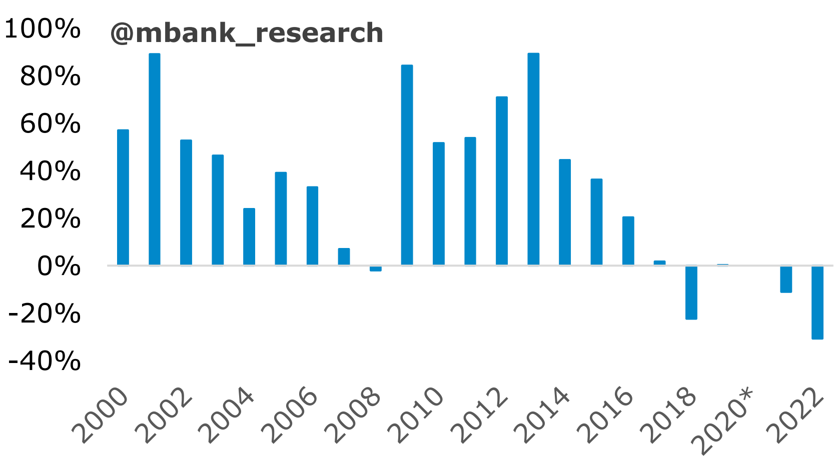
Source: Ministry of Finance, a – budget novel

State debt servicing costs (% GDP)



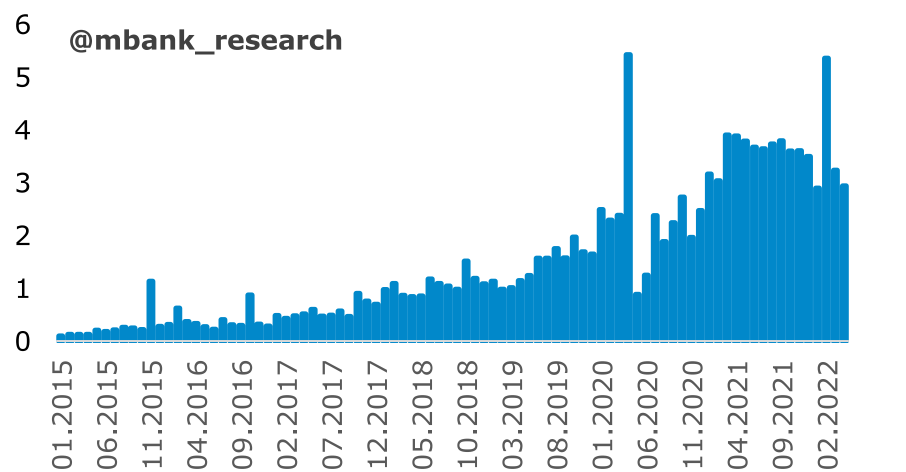
Source: Macrobond

Central budget deficit in April vs yearly planned deficit



*Source: Macrobond, * in 2020 there was 0 budget deficit planned, negative value means surplus*

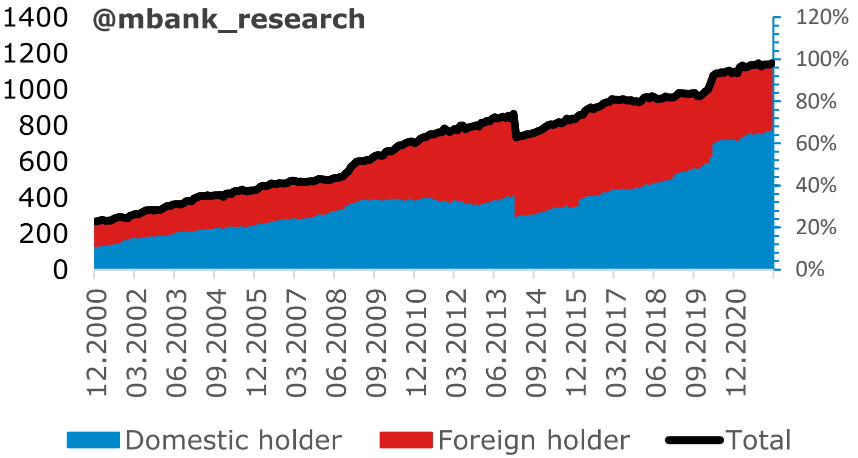
Retail bonds sold per month (PLN bn)



Source: Ministry of Finance

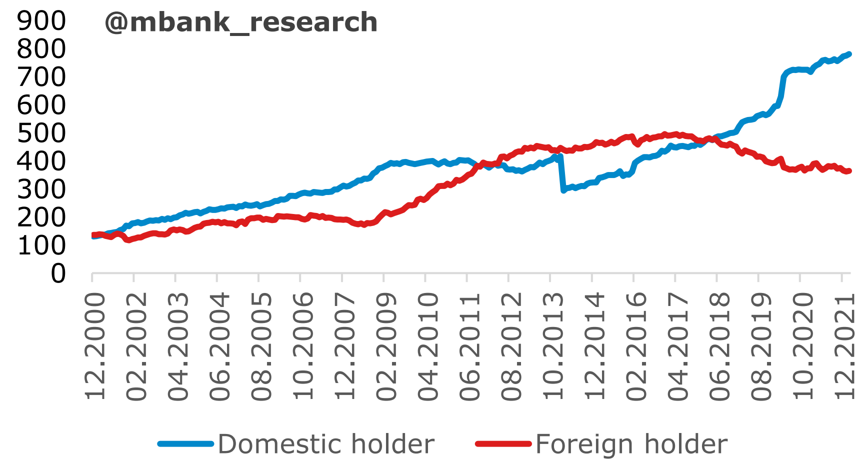
Poland: Fiscal monitor #2

State treasury debt by holder #1



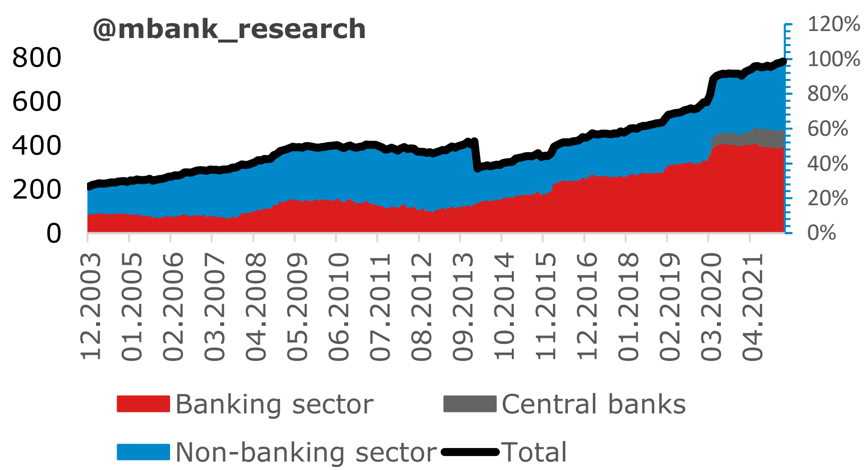
Source: Macrobond

State treasury debt by holder #2



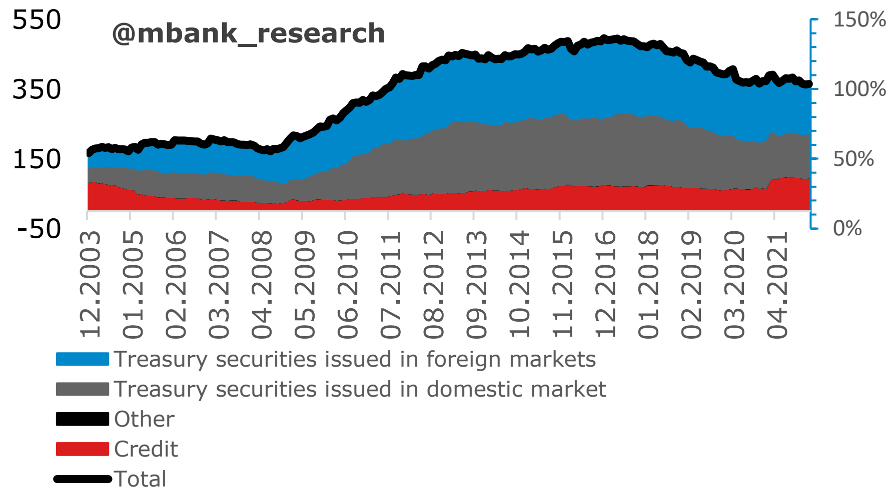
Source: Macrobond

State treasury debt – domestic holders



Source: Macrobond

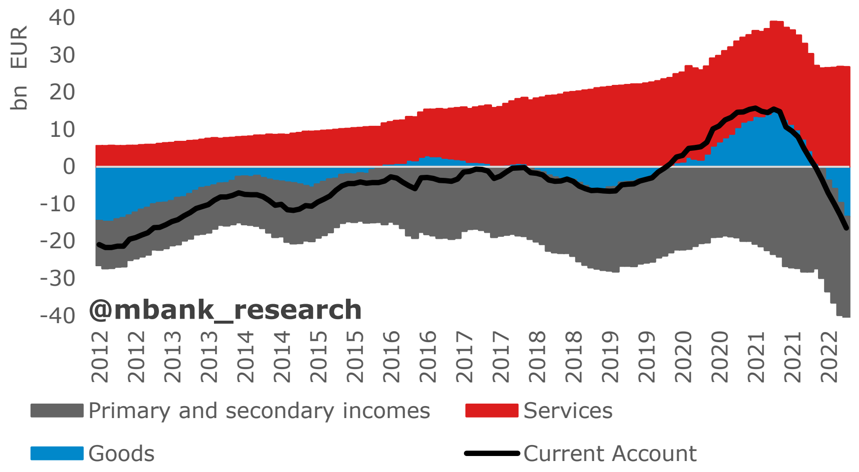
State treasury debt – foreign holders



Source: Macrobond

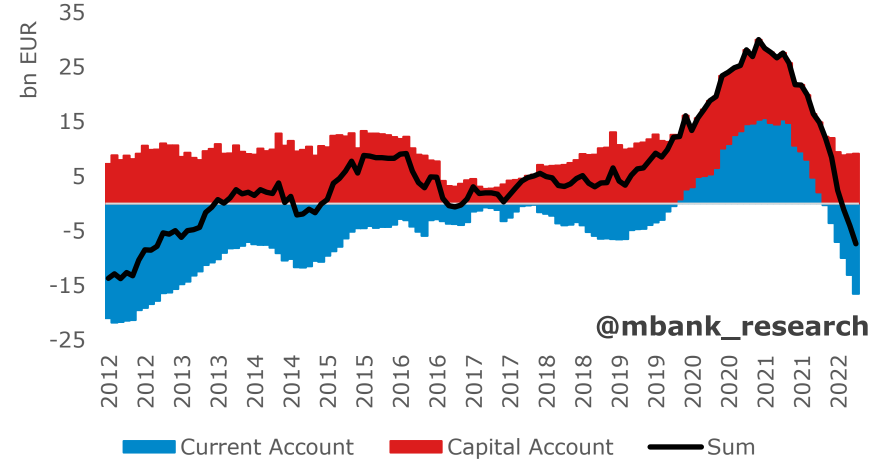
Poland: External balance

C/A decomposition – 12m rolling sum



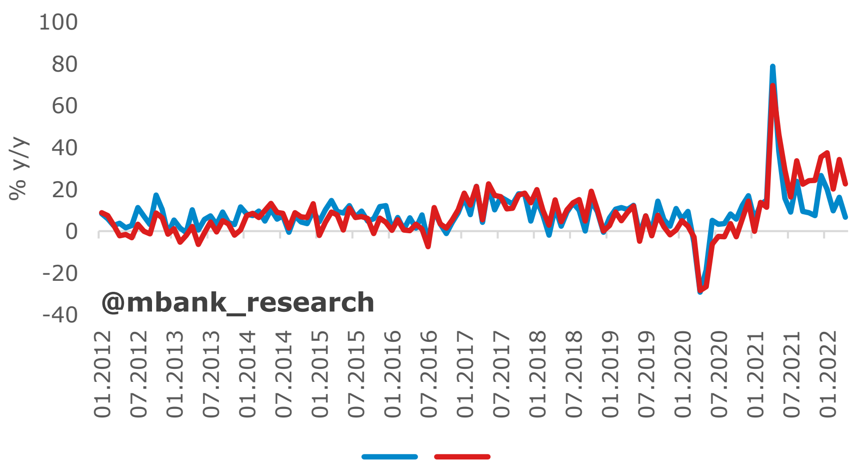
Source: NBP, own evaluation

Current and Capital Account – 12m rolling sum



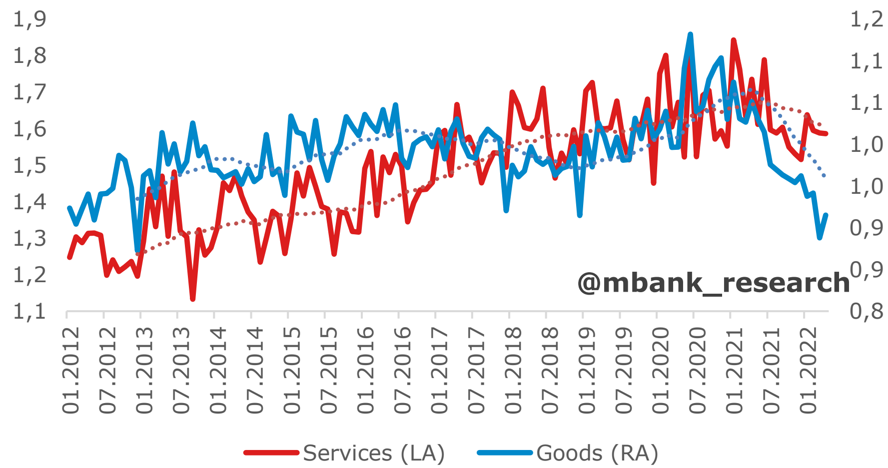
Source: NBP, own evaluation

Exports and imports dynamics



Source: NBP, own evaluation

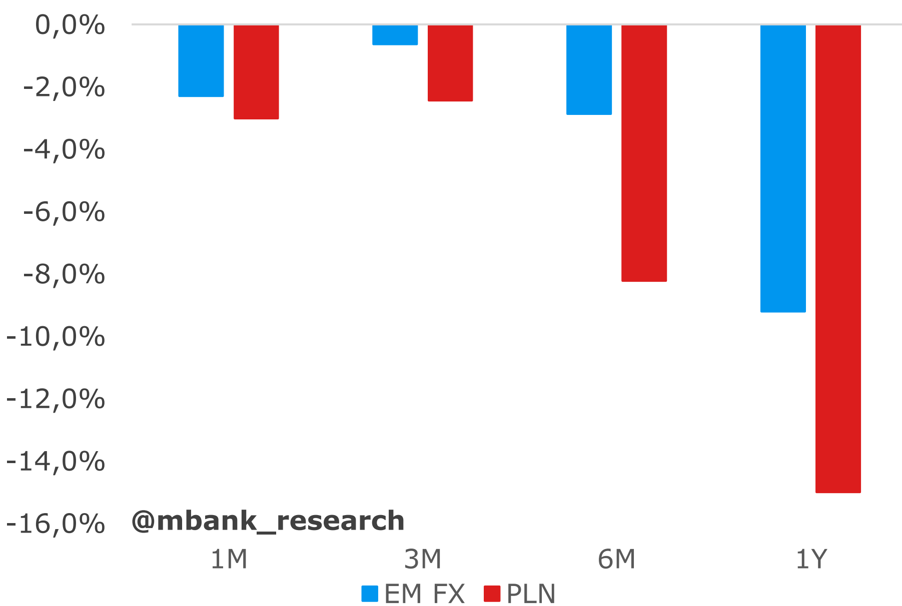
Exports to imports ratio



Source: Macrobond

EURPLN – still weak

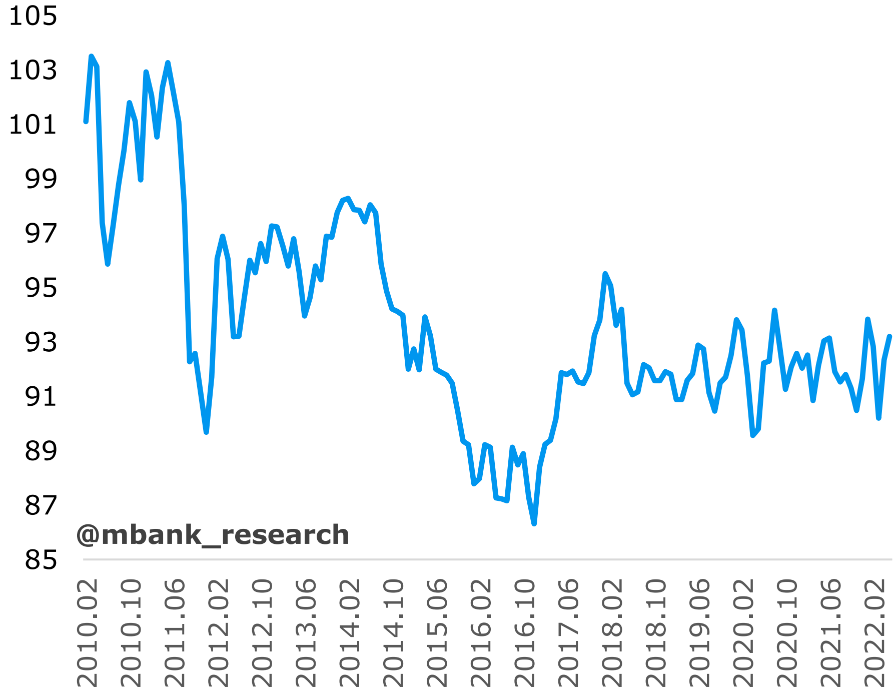
Some weakening after previous slight appreciation



Note: Increase = appreciation to dolar. Decrease = depreciation to dolar

Source: Bloomberg

Real effective exchange rate (mind the dates)



Source: BIS

- Quite optimistic beginning of the month (unblocked EU funds) did not last for long. First, MPC did deliver only 75bp (rather negative surprise), moreover EBC announced hikes, SNB decided to hike (quite a surprise), Fed decided on a more restrictive policy than previously expected, and even CNB was very hawkish. Summing up, other central banks were more aggressive. Moreover, fiscal news (changes in the fiscal rule) did not help.
- But the most important was global risk-off. Markets see the upcoming recession and tend to prefer safe heavens. Polish zloty is definitely not one of them.
- We maintain the view that as inflation is going to top, so are the bets against the zloty. We stay a bit construction on the local currency in the medium-term. Short-term there will be lots of volatility.

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