Monthly Pulse Check
Economy. FI. FX

September 9th 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

- The global economy keeps losing momentum along with continued and relentless monetary tightening. In China, the macro outlook is in stark contrast to what is going on elsewhere (zero-COVID policy is here to stay, the housing market is bursting).
- Looking at the Polish economy we were offered a disappointing print of GDP for Q2. Nevertheless, the devil is in the details. Although the economy marked a huge slowdown (in seasonally adjusted terms) it was chiefly driven by a change in inventories. Other components turned out quite strong. Looking ahead, we expect the economy to keep losing pace on the back of strong monetary tightening kicking in, simmering geopolitical uncertainty as well as stubbornly high inflation (demand destruction is happening here and there).

Monetary policy: Fed. ECB. NBP

- Fed: Rate tightening to continue. We expect the Fed to lift rates close to the levels currently priced in by the market (sub-4%). This is especially true given the fact that the labor market has not slowed down yet. We deem rate cuts in H2 2023 are possible.
- ECB: Time to say goodbye for negative rates. A degree of „hawkishness” among the Governing Council has increased. We look for further hikes until the year-end, then a pause, and subsequently a resumption of tightening.
- NBP: We are getting closer to the end of monetary tightening. After another 25bps hike in September, we expect the same magnitude move next month. After reaching 7%, we do not think there will be a consensus to push rates yet higher. Simultaneously, we do not expect any rate cuts in 2023.

FX Market

- Volatility in the FX market remains elevated. The greenback keeps flexing its muscles which acts to the detriment of the zloty. Moreover, Poland is still a long way off from tapping EU funds (legal hurdles have not been addressed yet). The fiscal outlook, and thereby borrowing needs, also remains a challenge. Thus, some depreciation is what we expect from now on.

		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	%	8,5	5,5	2,0	0,3	-2,3	-0,1	1,1	2,1	5,9	4,0	0,4
Individual consumption y/y	%	6,6	6,4	3,5	4,5	4,2	2,8	2,4	2,5	6,1	5,3	3,0
Investment y/y	%	4,3	7,1	5,0	3,0	-4,0	-2,0	1,0	3,0	3,8	4,9	-0,5
Inflation rate (eop)	%	11,0	15,5	16,6	16,6	18,6	15,6	13,5	10,8	5,1	14,1	15,9
Unemployment rate (eop)	%	5,4	4,9	5,1	5,5	5,7	5,6	5,5	5,9	5,4	5,5	5,9
NBP repo rate (eop)	%	3,50	6,00	6,75	7,00	7,00	7,00	7,00	7,00	1,75	7,00	7,00
EUR/PLN (eop)	%	4,65	4,70	4,80	4,90	4,80	4,80	4,70	4,60	4,59	4,76	4,73
USD/PLN (eop)	%	4,20	4,48	4,75	4,85	4,66	4,57	4,27	4,11	3,94	4,57	4,40

F - forecast

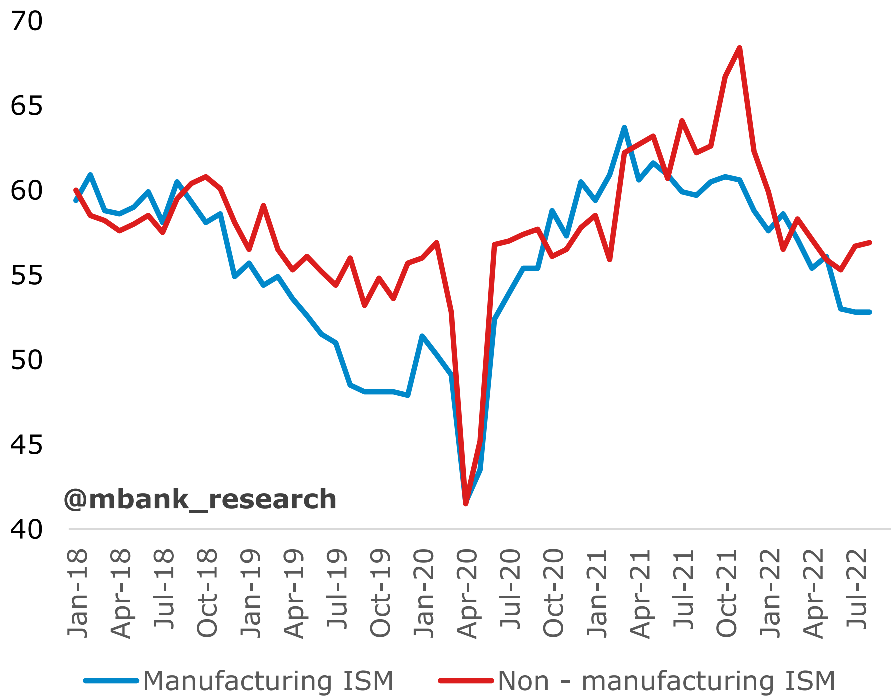
* yearly average for inflation rate, EUR/PLN and USD/PLN

Highlights

- Both the Fed and the ECB are likely to continue their monetary tightening cycles in the coming months. In case of the US, we have not yet received clear signals of slowing the labor market. The overall outlook, except the housing market, has also been quite resilient as of yet. Thus, we do not see any reasons for the Fed to stop hiking rates any time soon. Nevertheless, given the current inflation outlook, we think the Fed is much closer of making its job done than the ECB. In case of the Eurozone, the economy has tough times ahead. The energy crisis has yet to fully filter through the economy. As a result, more pain is on the cards. However, the ECB sees the glass as half full, hence allowing itself to continue tightening at least by the year-end. The Polish central bank moves in the same direction. Higher inflation path, strong real data, and fiscal actions (which will weaken the interest rates transmission channel) convinced us to revise up interest rates forecast some time ago.
- Rates in Poland continued increasing in the past months. Inflation has proved to be stickier than we thought, which encouraged us to revise CPI forecasts up. On the other hand, economic activity has lost some steam recently, which in our view will be an important aspect to factor in by the MPC. Therefore, we do not expect rates to overshoot much above 7% (we forecast the end of the cycle at that level). Of course, much hinges on the fiscal outlook. If a generous spending spree continues, coupled with all of support we have got thus far, it could skew the odds toward even tighter policy. Nonetheless, that is not our base-case scenario.
- Quite a sharp growth slowdown in Poland, marked in the Q2, stemmed primarily from an adjustment in inventories. Their contribution to growth in annual terms shrank four-fold. At the same time, the gross investment turned out to be quite solid as consumption did. Going forward, we expect a continued adjustment in case of inventories, which have been amassed during the post-pandemic economic rebound.
- Moving to the fiscal side, we were offered a new budget draft bill for 2023 foreseeing a general government deficit in excess of 4%. Taking into considerations very widespread fiscal packages, aimed at helping people overcome rampant inflation, we perceive this estimate as optimistic. Moreover, the government plans to issue only (net) 17 billion PLN of POLGBs in 2023 hoping finance borrowing needs chiefly by retail bond sales (almost 58 billion PLN in net terms). Given the likely further squeeze of real incomes of households we doubt it could be feasible. Thus, we see upside risk for asset-swap spreads.
- The PLN has lost more steam lately, underperforming its EM peers. At this stage, we do not think there is space for the zloty to appreciate. Instead, we expect some depreciation from now on followed by a rebound in 2023.

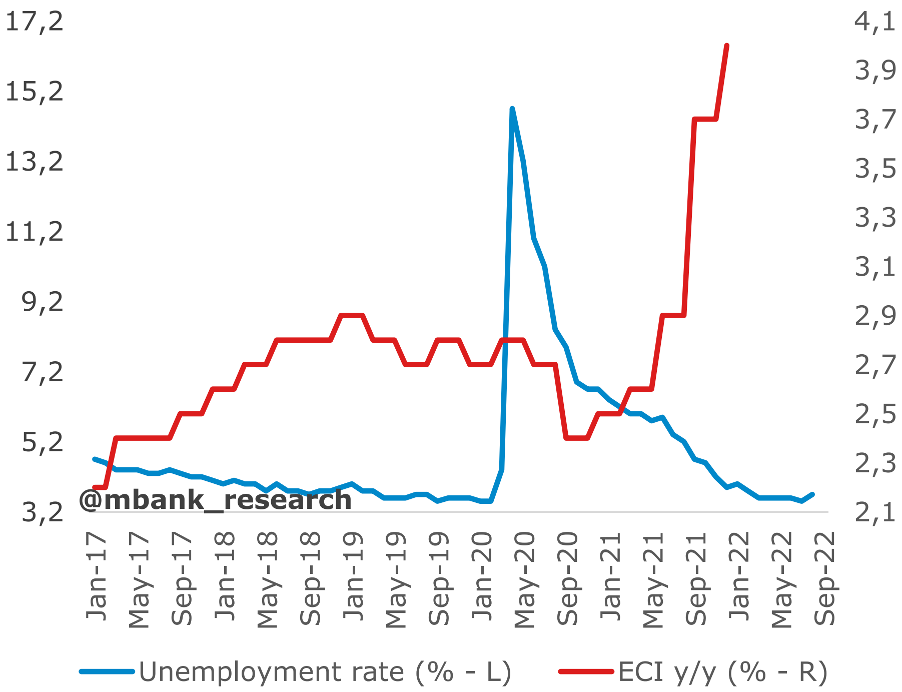
U.S. economy health check

ISM PMI: manufacturing & non-manufacturing



Source: ISM

Labor market: wages & unemployment rate

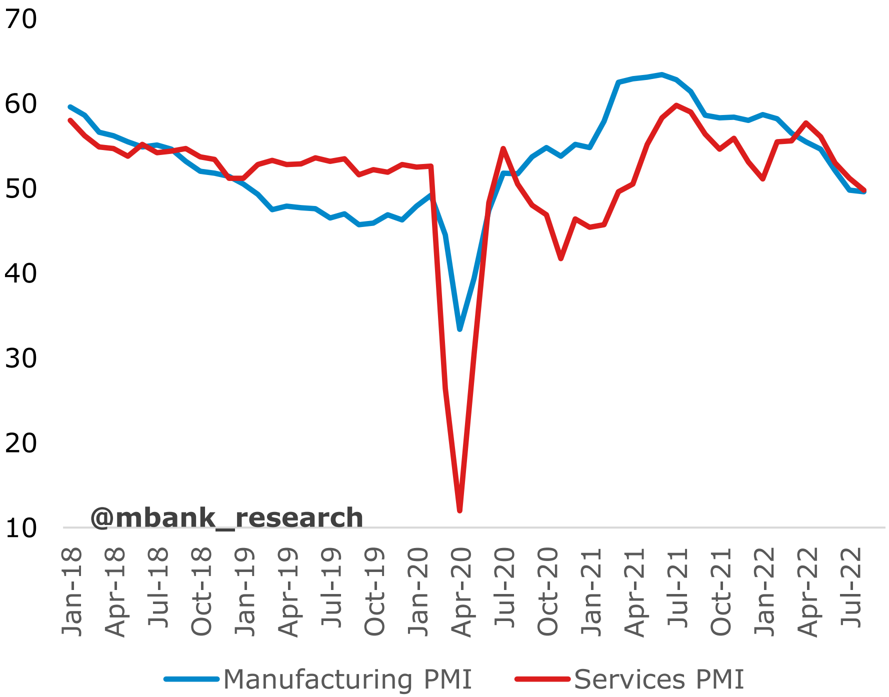


Source: FRED

- The US economy continued its deceleration over the past three months, at least in soft indicators. This is especially true for manufacturing, as evidenced by further declines in ISM. On the other hand, the services sector has been more resilient as of yet, albeit we do expect it will start stuttering in a while (the housing market deterioration could add to it).
- On the face of it, the labor market remains strong. However, some scratches are discernible when we delve into details. First of all, JOLTS have moderated since June and the last pick-up does not change the overall outlook. Furthermore, the August jobs report showed wage growth staying unfazed in annual terms and falling quite notably after excluding executives. Finally, we got a rise in labor activity which, if continued, should bode well for the 'stickiest' components of inflation.
- Powell delivered his hawkish speech in Jackson Hole last month. He directly referred to Volcker suggesting that fighting inflation has its price. That means a step backwards regarding a soft-landing scenario. He said that households would need to incur some (transitory) costs of tighter monetary policy in order to avoid much bigger costs of high and persistent inflation if the Fed sat on its hands. In effect, market pricing implies rates rising toward sub-4%. More or less, we concur.

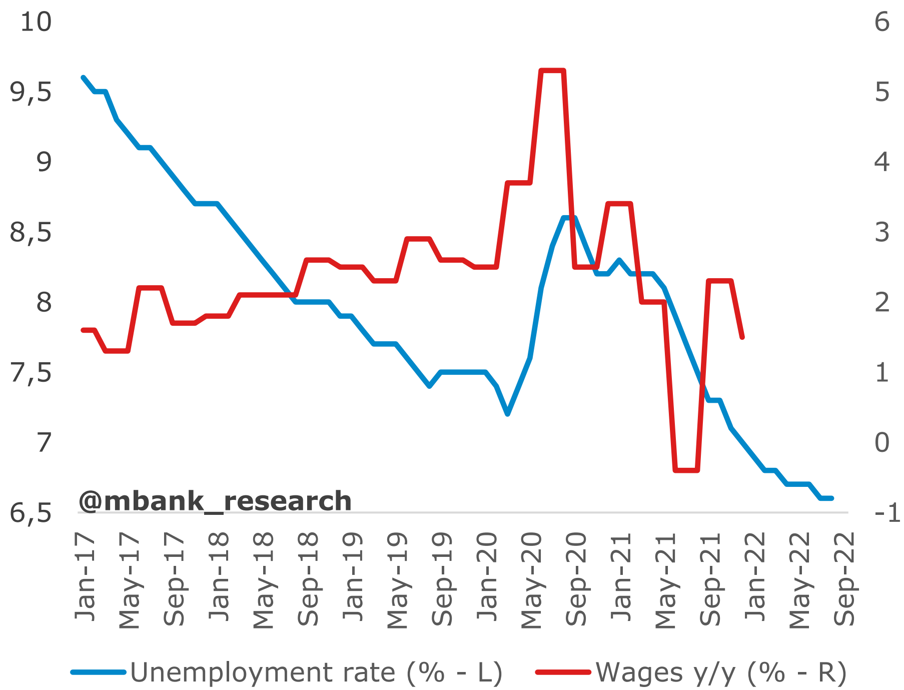
Euro area economy health check

Markit PMI: manufacturing & services



Source: Markit

Labor market: wages & unemployment rate



Source: Eurostat

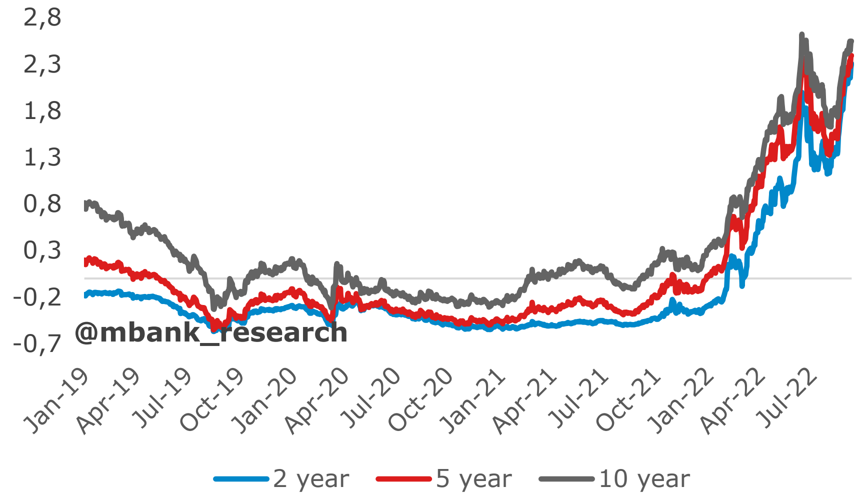
- We have seen a further deterioration in sentiment both in manufacturing and services. On the other hand, the material slowdown has not been yet seen in „hard" data (e.g. Q2 GDP surprised to the upside). Looking forward, there is no doubt that the Eurozone economy is on track to a recession taking into account the simmering energy crunch. Ultimately, a lot will depend on further gas flows (these have been substantially curbed lately) and… weather during the oncoming winter.
- The ECB hiked rates by 50bps in July and then by as much as 75bps in September. It also announced a new tool (Transmission Protection Instrument) aimed at dealing with a possible fragmentation risk. Lagarde said that the ECB has not reached the neutral rate yet setting the stage for further rate increases. We agree with this assessment, though look for a pause in the Q1.
- What to expect next? The energy crisis is taking its toll. While governments are attempting to help firms and households survive tough times, continued fiscal support should act towards higher inflation going forward. One needs to keep in mind that the world will not end after the winter. The green transition is not a short-term issue but a long-term journey (it is an inflationary phenomenon). That is why we think the ECB might return to monetary tightening after the Q1 2023.

Global rates

US swap rates (%)

Source: Bloomberg

EU swap rates (%)

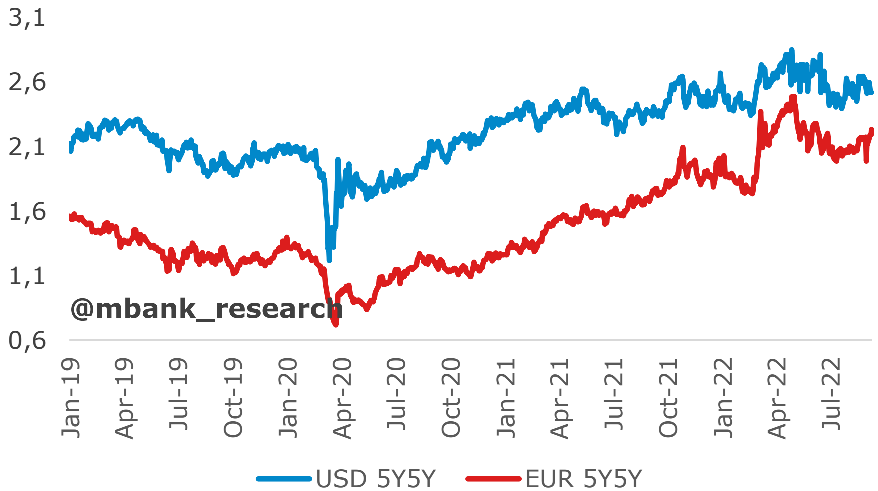


Source: Bloomberg

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

Source: Bloomberg

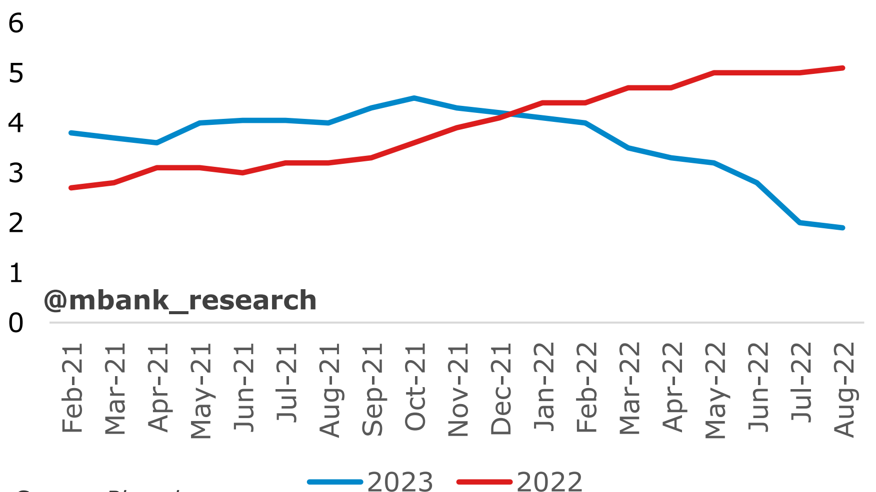
US and EZ inflation expectations (%)



Source: Bloomberg

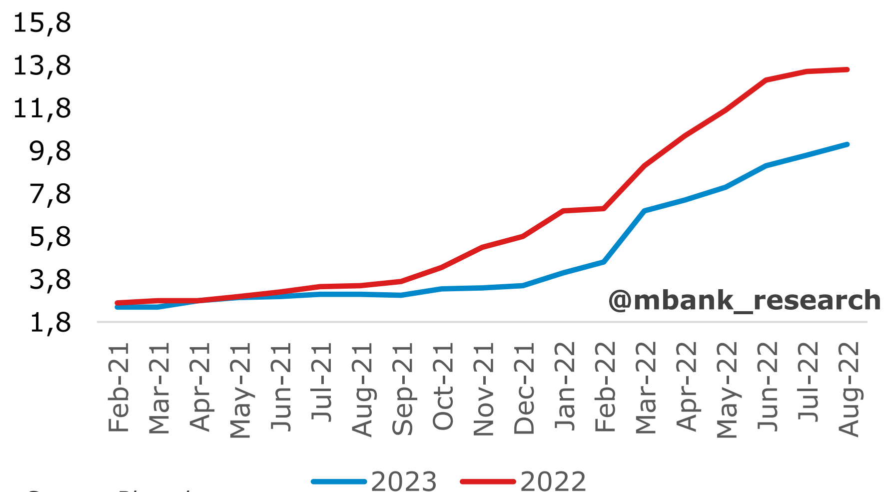
Consensus: what is expected in Poland?

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



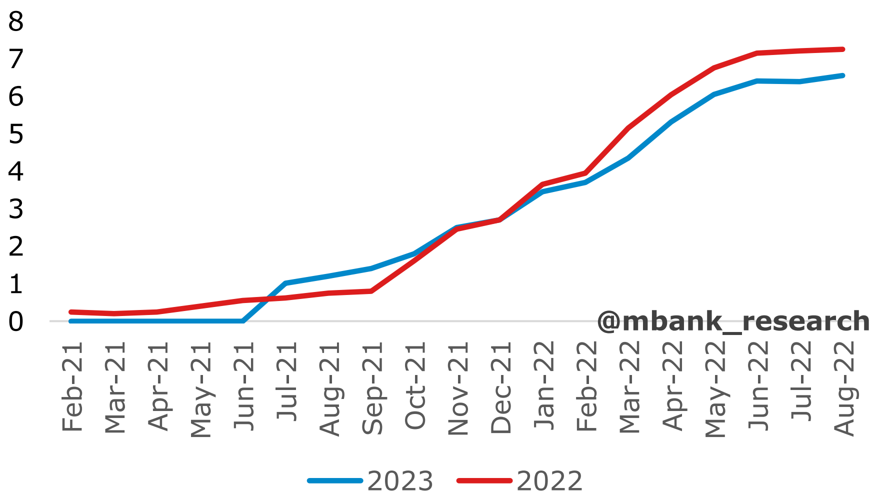
Source: Bloomberg

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



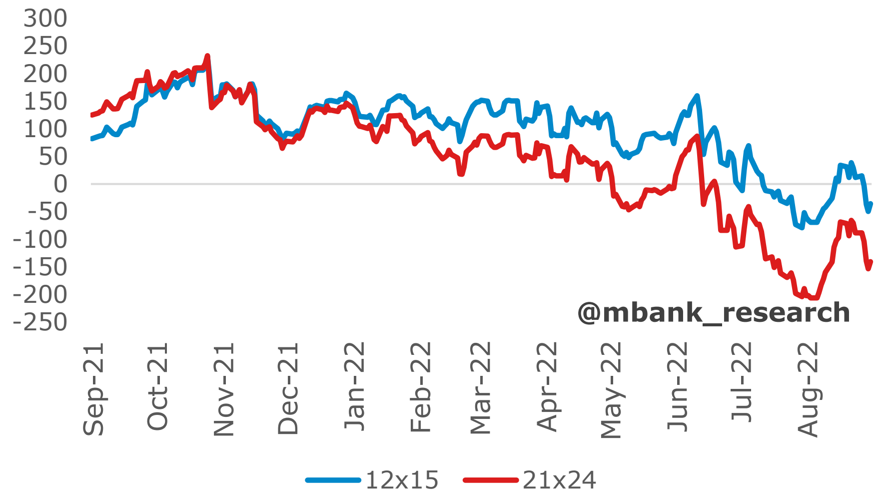
Source: Bloomberg

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



Source: Bloomberg

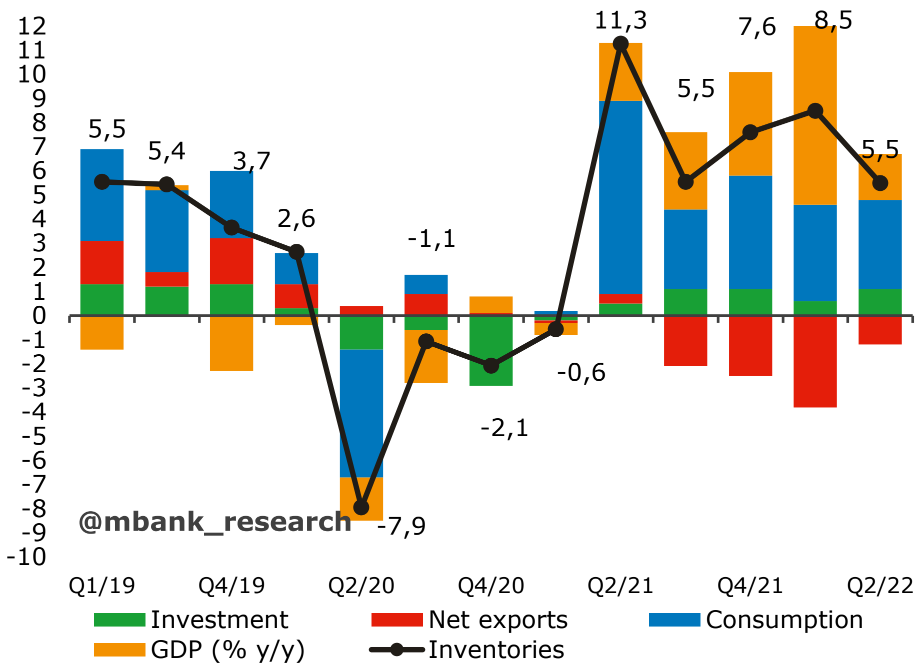
Rate changes priced in by FRA (bps)



Source: Bloomberg

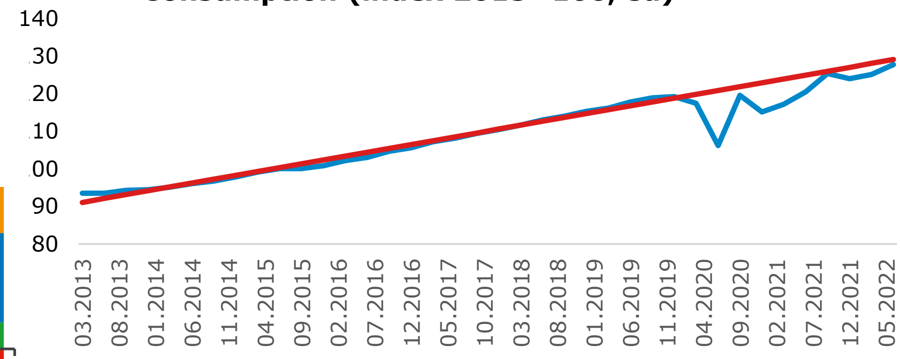
Poland: 5.5% GDP growth in 2Q2022

GDP growth decomopsition

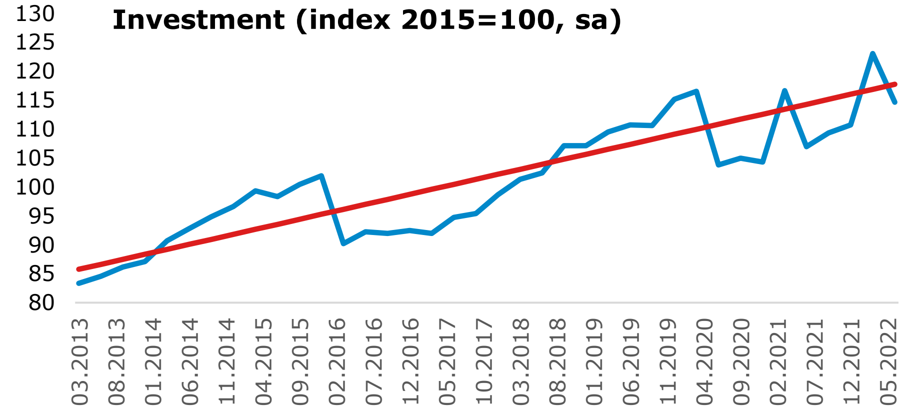


Source: Statistics Poland, NBP, own elaboration

Consumption (index 2015=100, sa)



Investment (index 2015=100, sa)

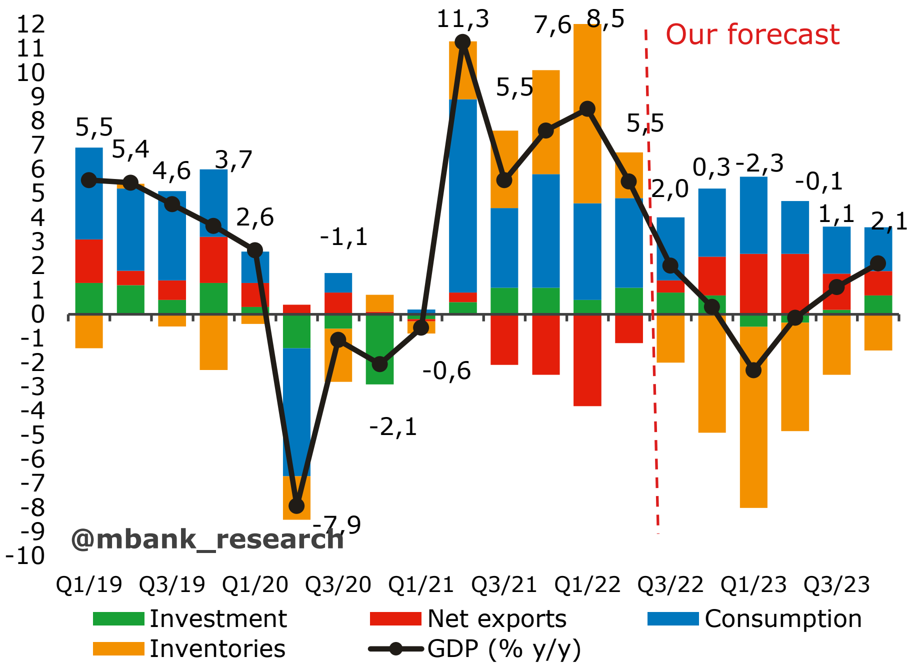


Source: Statistics Poland. own elaboration

- GDP in 2Q declined by 2.1% q/q (seasonally adjusted). We have yet to see this in annual terms (because of bases from previous years) which produced a 5.5% increase. But it is obviously a signal of an incoming slowdown. The GDP index fell below the trend. The q/q growth rate is one of the lowest in history (excluding the covid period).
- The change of inventories was the main source of lower annual growth. While inventories added to growth 7.7pp in 1Q, they contributed „only" 1.9pp in 2Q. Further declines can be expected, albit we will not see it in GDP (it was already produced).
- Something strange happens with investment – probably some seasonal patterns have changed, and seasonally adjusted data has not „noticed" it. On average, the investment index os close to the trend and in our opinion is likely to slow down going forward. Consumption was still solid, mainly due to the strong labor market and probably refugees (or just part of their consumption, theoretically it should be in net exports).
- Structure of GDP in 2Q is rather a result of lags in economic processes (e.g., investments) not the signal of immunity of Polish economy. Next quarters will be worse.

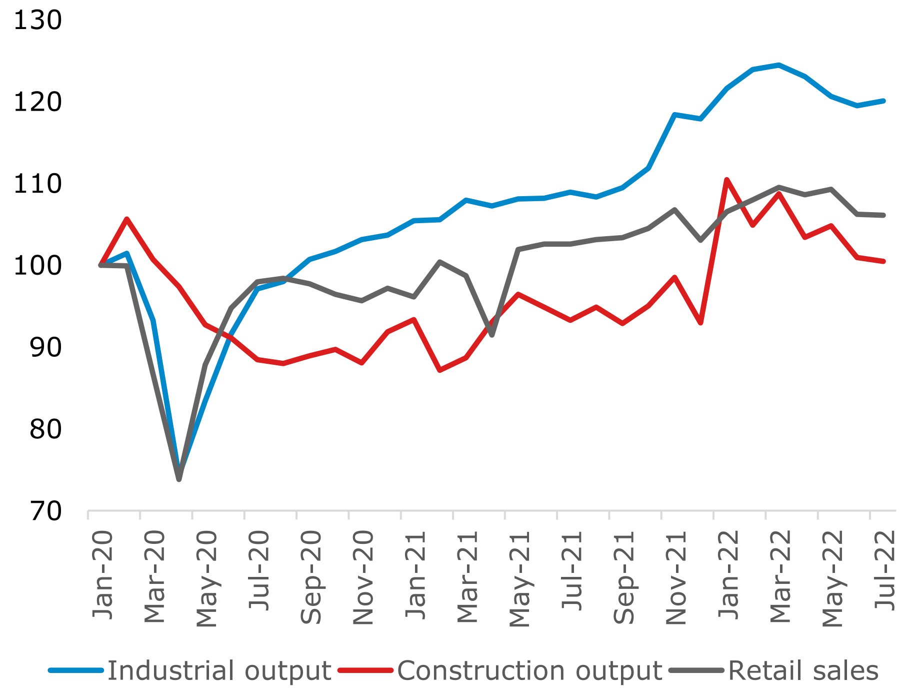
Poland: Monthly data – overview (and GDP nowcast)

GDP forecast



Source: own evaluation

Seasonally adjusted, Jan20 = 100

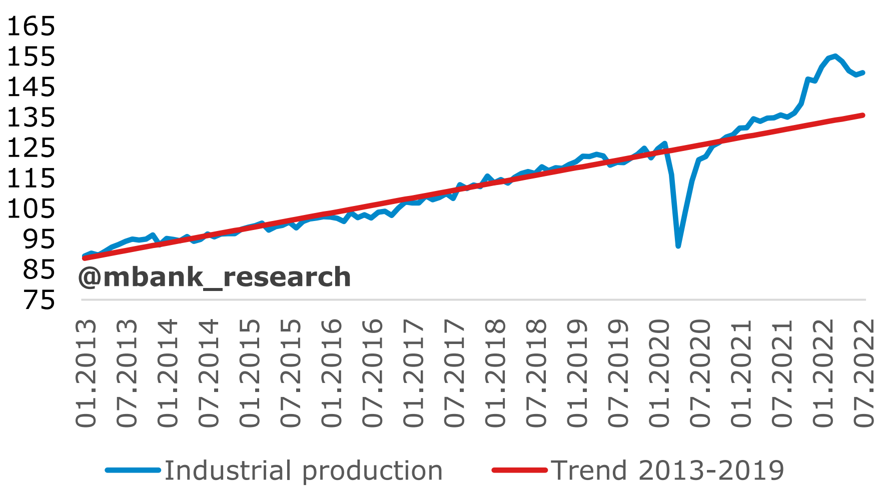


Source: mBank, Statistics Poland

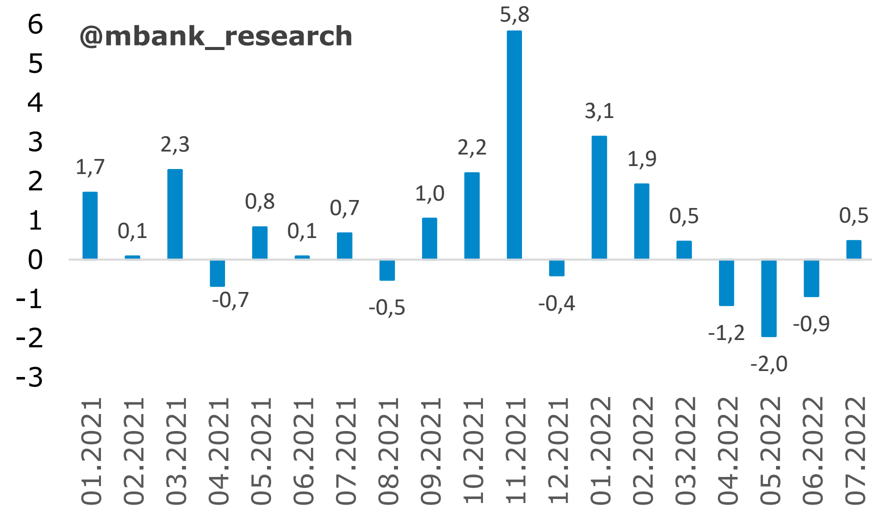
- After a series of weaker m/m dynamics, there was a slight uptick in August (looking at the seasonally adjusted data). As a result, the index of industrial production stopped its return to the trend. We think it is just a temporary pause. Production will continue to slow down.
- Construction output follows a downward move from previous months – nothing will change here, as high interest rates and therefore low investments are probably the most important obstacles. The outlook for retail sales is not so obvious – wage growth tend to surprise to the upside, last months we saw some additional bonuses because of high inflation (and we could see more of them next months). Together with governmental transfers it should help consumption in the short-term. After all, the impact of the cycle seems to be unavoidable, and a slowdown could affect consumers too.
- The nowcast we used to present in previous reports provides definitely too high number for GDP growth in 3Q (it is just a technical result from July's data). Our forecast is around 2% y/y next quarter. Later on it will be only slower.

Poland: Monthly data - industrial production

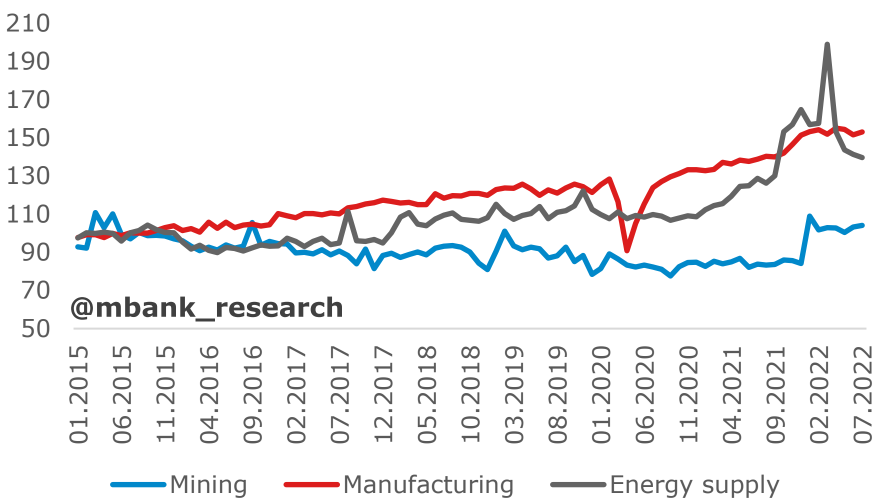
Industrial production (index 2015 = 100, sa)



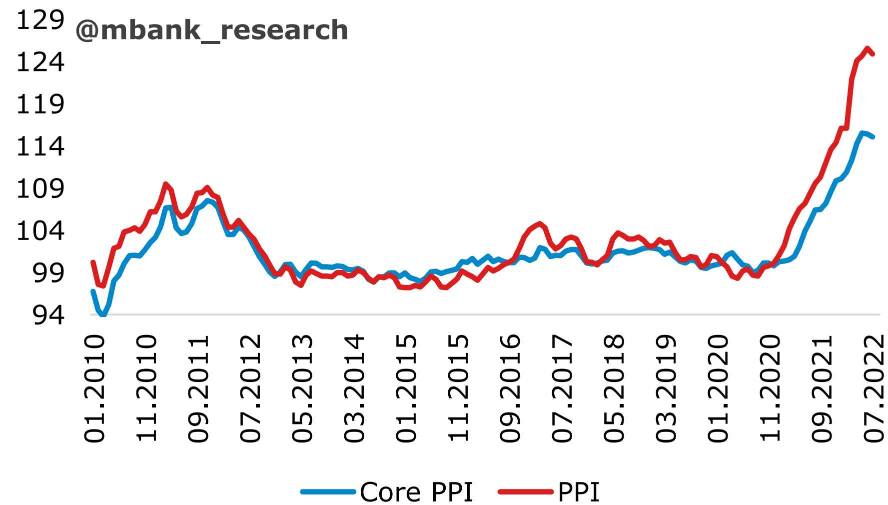
Momentum (m/m growth, seasonally adjusted)



Main categories (index 2015 = 100, sa)



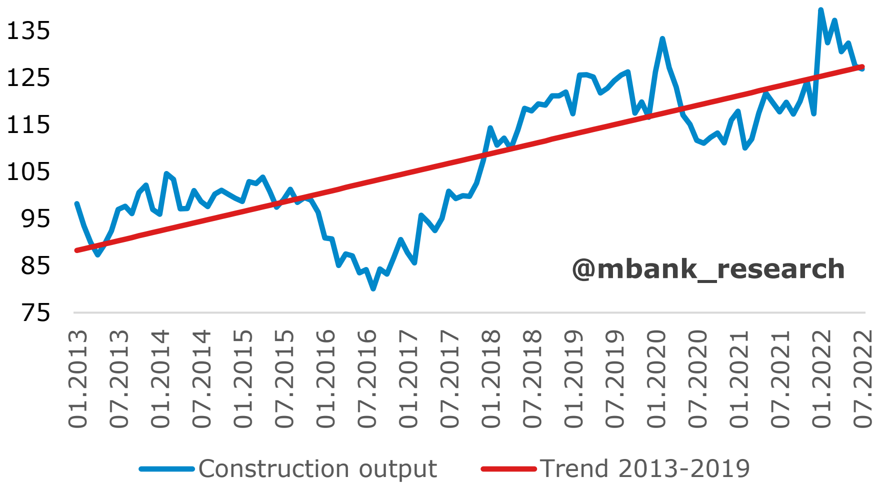
Producer prices (previous year = 100)



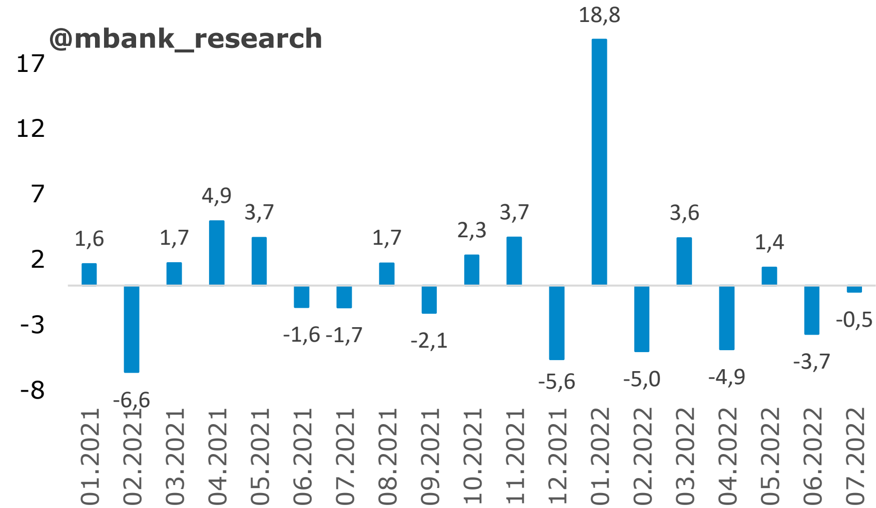
Source: Statistics Poland data. Own elaboration.

Poland: Monthly data - construction

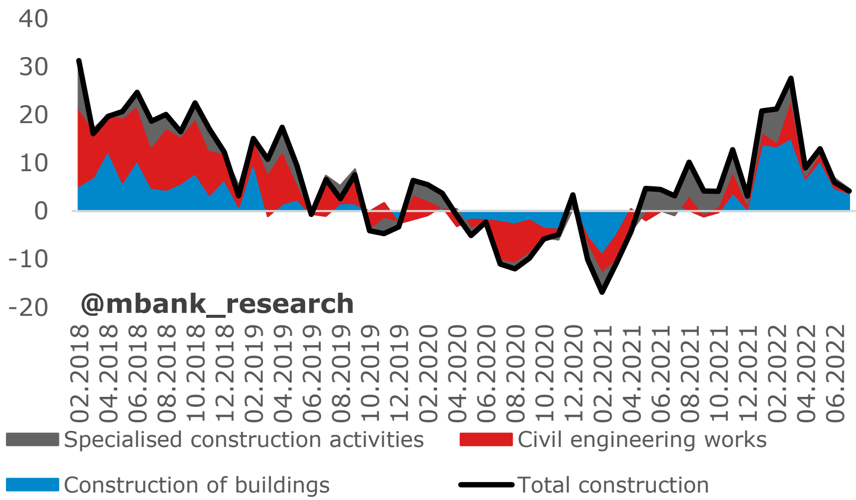
Construction output (index 2015 = 100, sa)



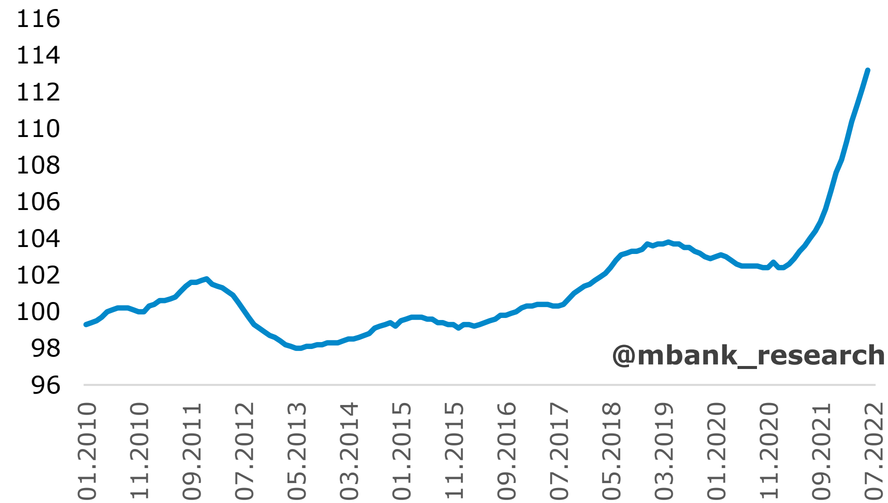
Momentum (m/m growth, seasonally adjusted)



Contribution to y/y growth



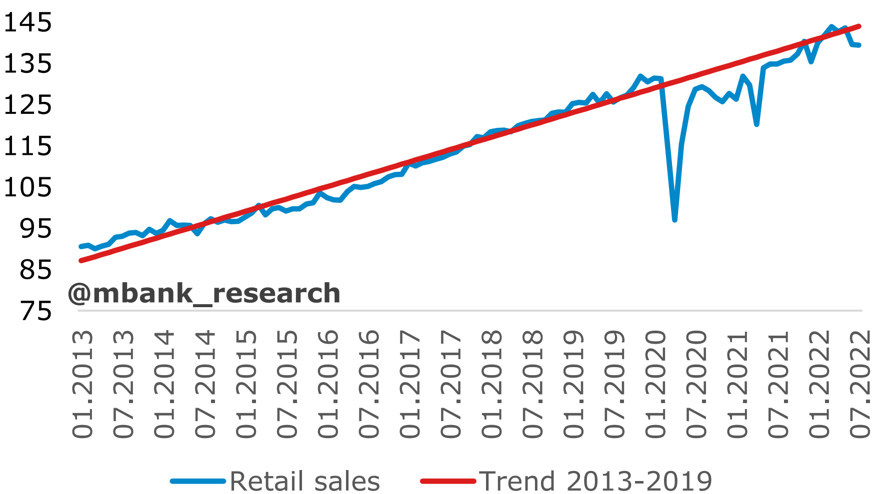
Construction prices (previous year = 100)



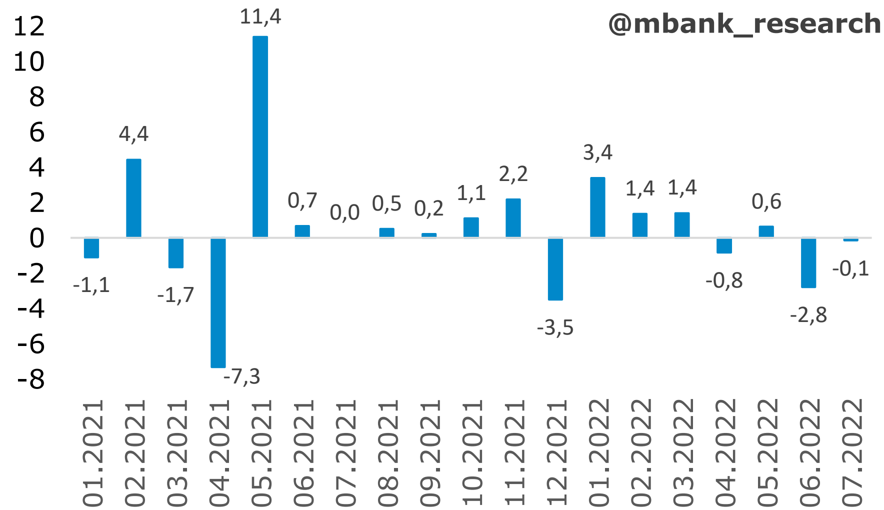
Source: Statistics Poland data. Own elaboration.

Poland: Monthly data - retail sales

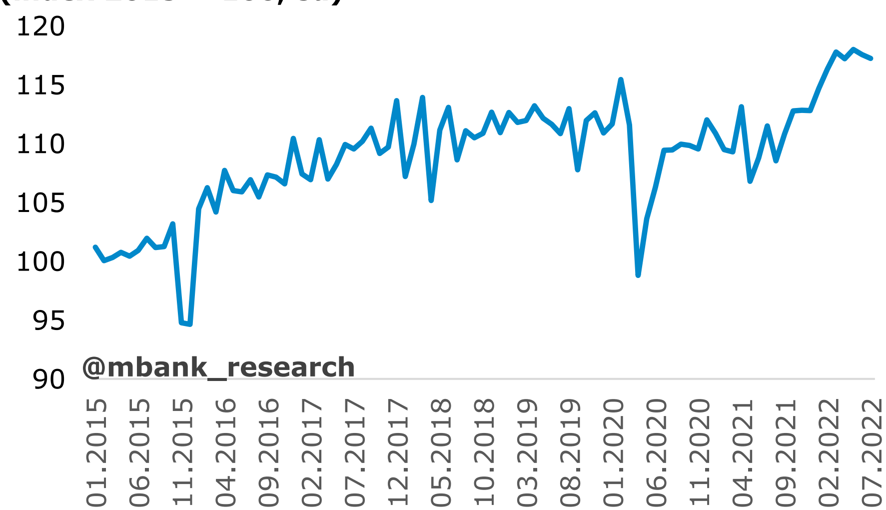
Retail sales (index 2015 = 100, sa)



Momentum (m/m growth, seasonally adjusted)



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

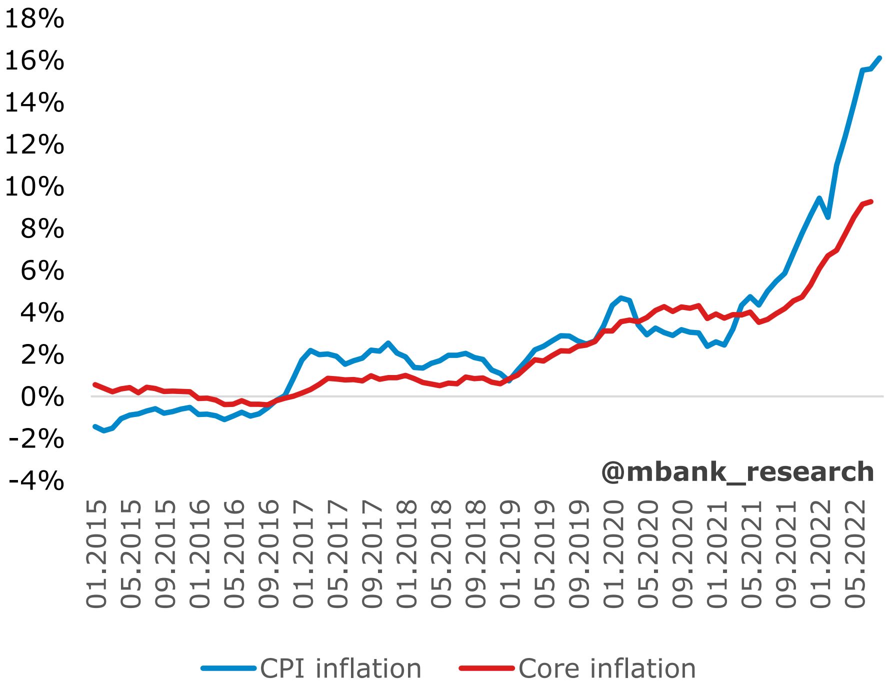


Retail sales - Solid, liquid and gaseous fuels (index 2015 = 100, sa)

Source: Statistics Poland data. Own elaboration.

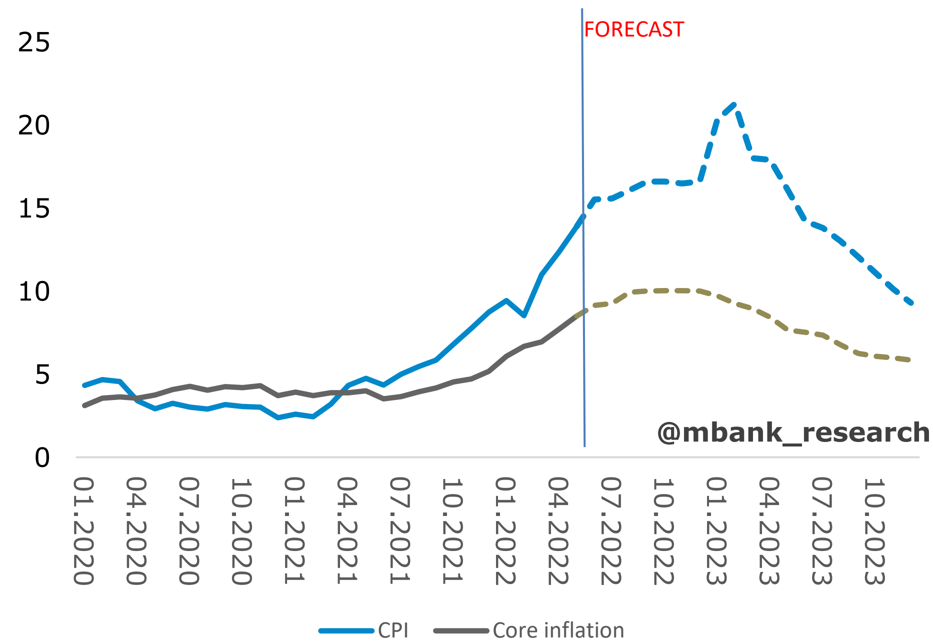
Poland: Inflation tracker #1

CPI and core inflation (% y/y)



Source: Statistics Poland, NBP, own elaboration

Core and headline inflation forecast

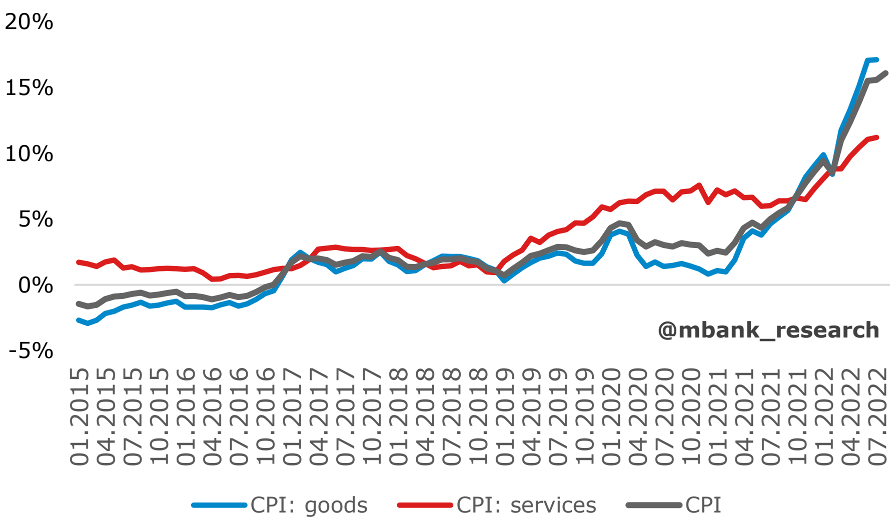


Source: Statistics Poland. own elaboration

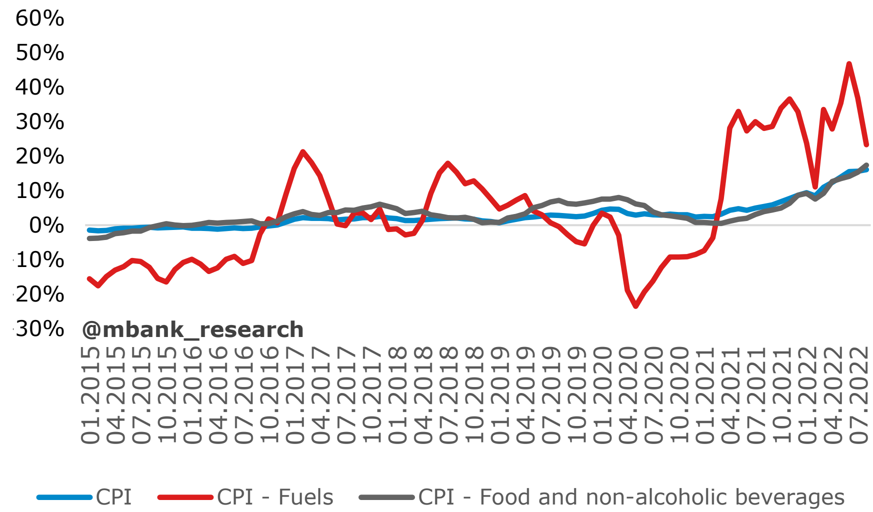
- According to a flash estimate, inflation accelerated to 16.1% y/y in August, compared to 15.6% y/y in the previous month. It was a surpris for economists. We had expected almost no change in annual terms. Moreover, the most problematic seems to be the acceleration of core inflation. It increased by 1% m/m (seasonally adjusted) and does not seem to stop.
- Inflation is therefore more persistent and will be probably a greater challenge for the MPC. Fiscal policy will not help here. Namely, there are plans of further reducing the impact of price increases on households (and probably firms) – it means that further transfers are probable. We mean either keeping some energy prices unchanged and transfers to firms, or direct transfers to households (some of them have already happened regarding prices of coal).
- On the other hand, the MPC is and will remain cautious because of the risks to GDP growth. It does not want to hurt the real economy too much. The MPC decided to raise interest rates by 25bp in September. Future moves will depend on data (we think that there will be another 25bp hike, and then a stop). Governor Glapiński did not exclude cuts in the 2nd half of 2023, but we do not think it is a highly probable scenario. Inflation will remain high (due to reasons sketched out above), and it does not seem that conditions for rate cuts will be met until then.

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

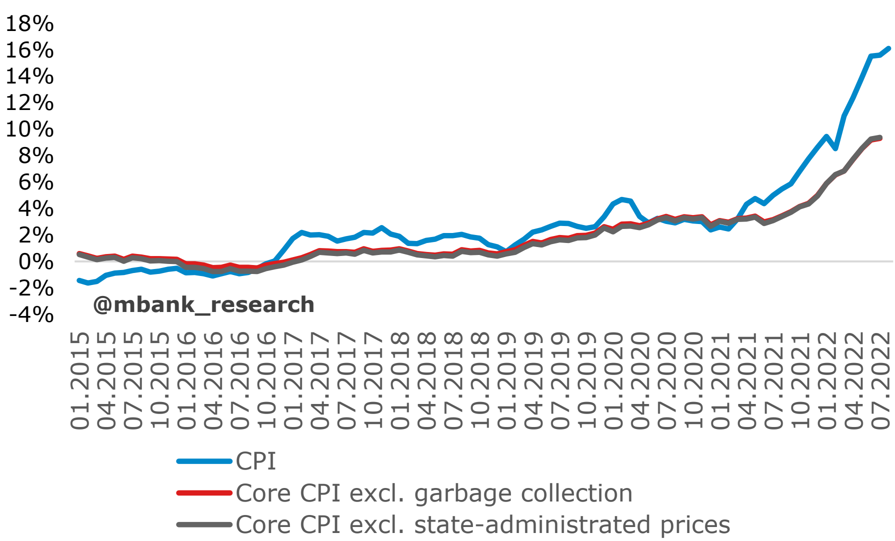
Goods and services prices (% y/y)*



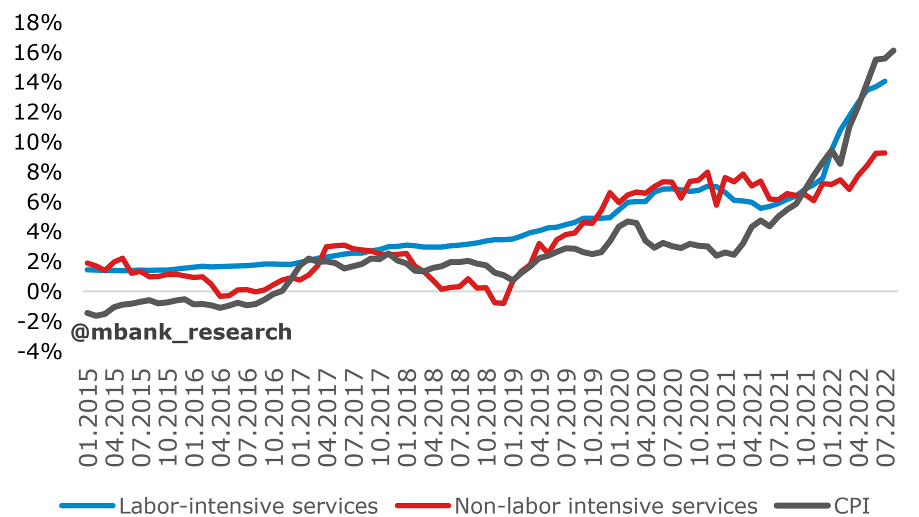
Food and fuel prices (% y/y)



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



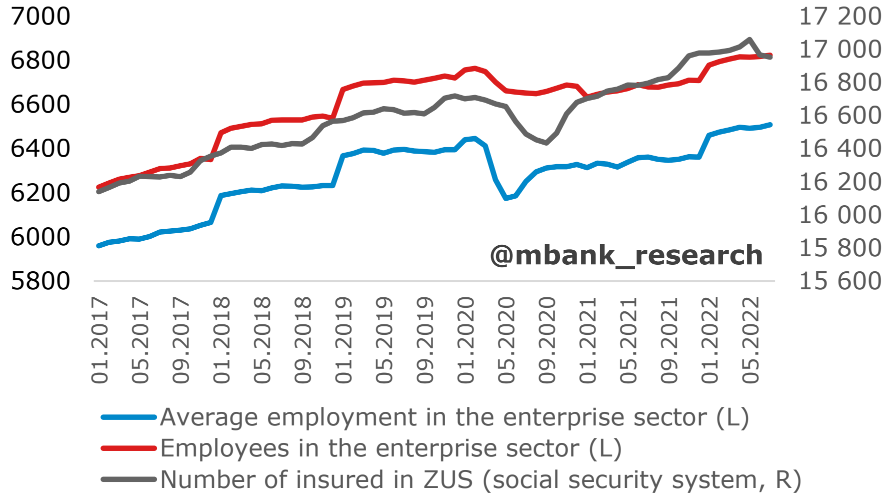
Services (% y/y)



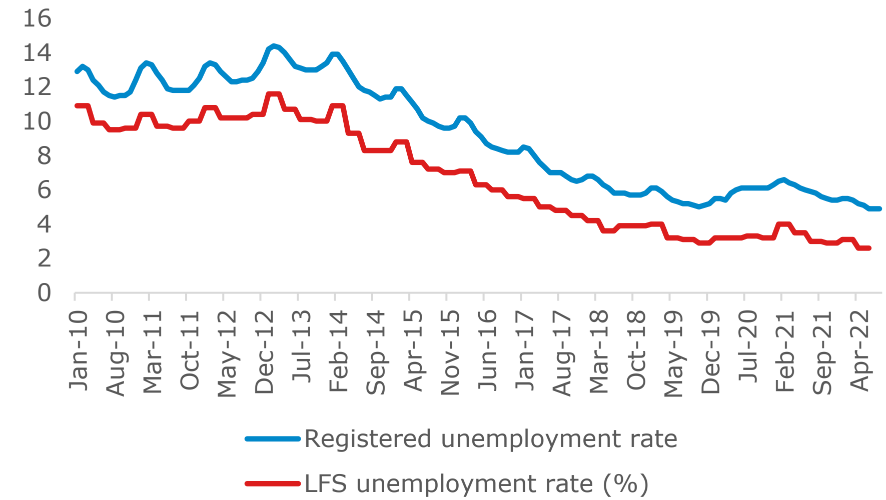
Source: Statistics Poland, own elaboration

Poland: Labor market tracker #1: Employment

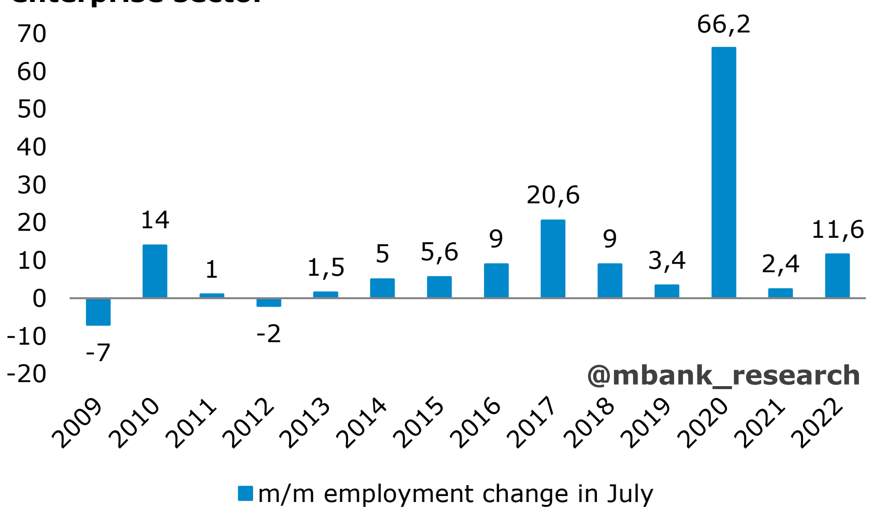
Employment



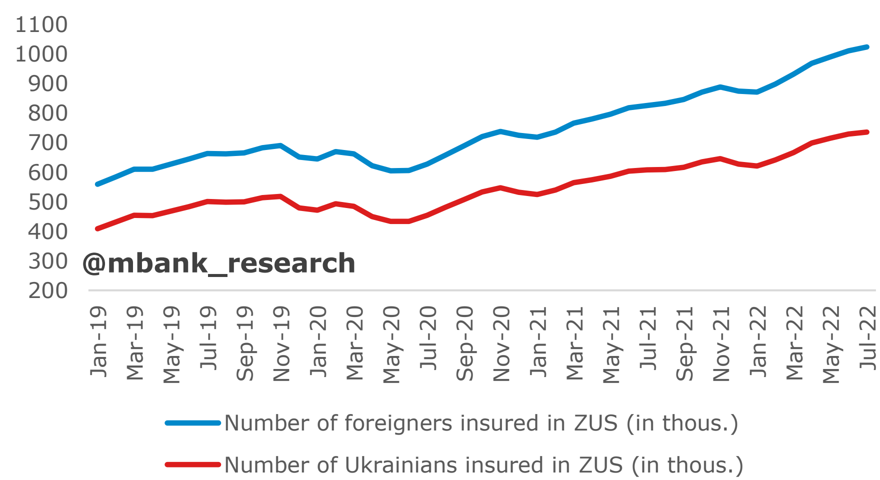
Unemployment rate



Monthly employment change (in thousand jobs), enterprise sector



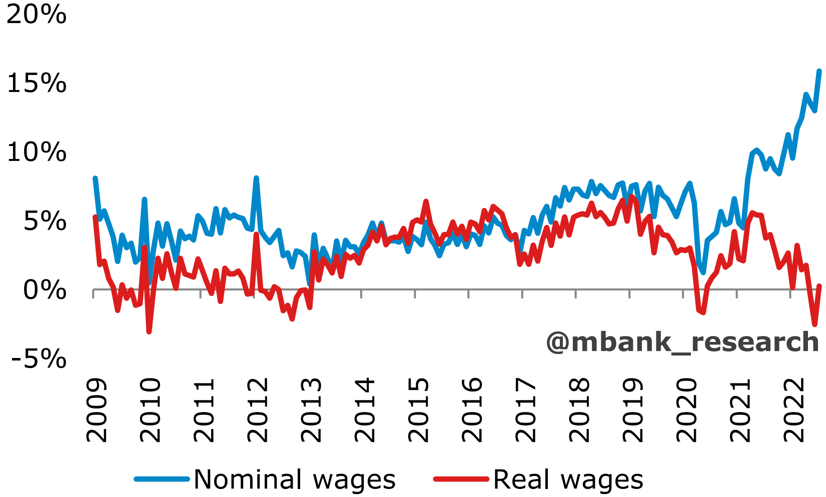
Immigration in the labor force



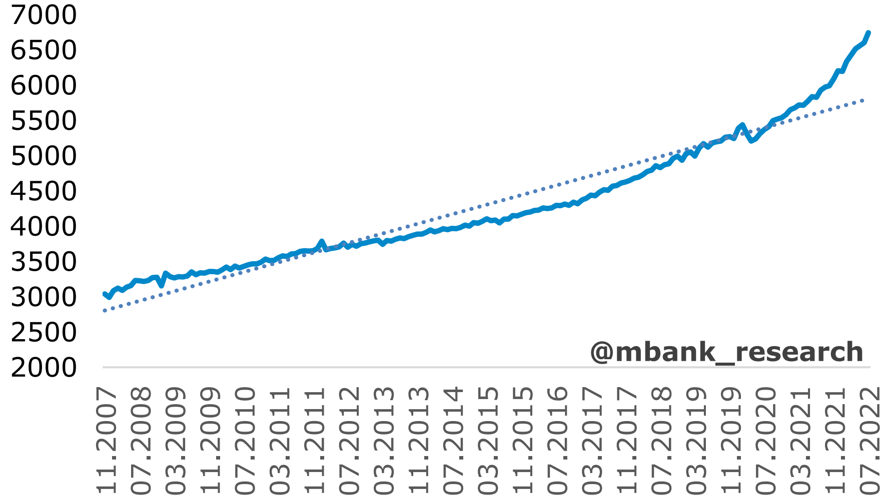
Source: Statistics Poland, ZUS Statistical Portal, own elaboration

Poland: Labor market tracker #2: Wages

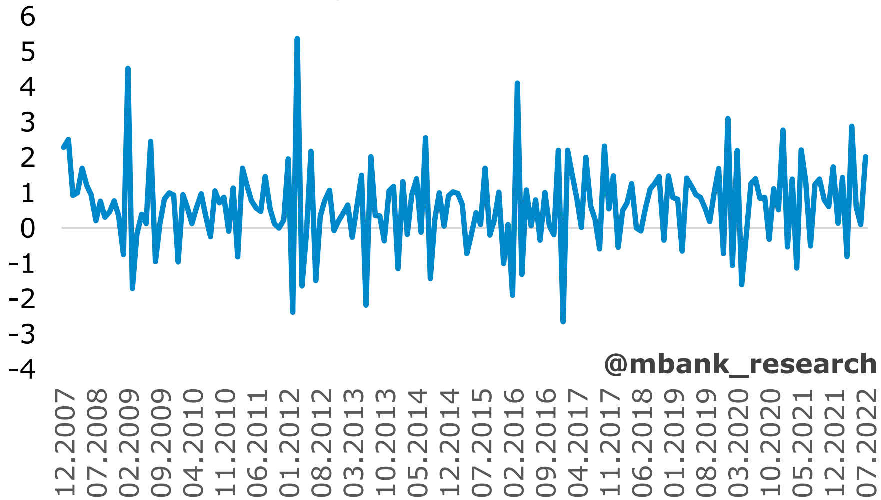
Wage growth (y/y, nsa)



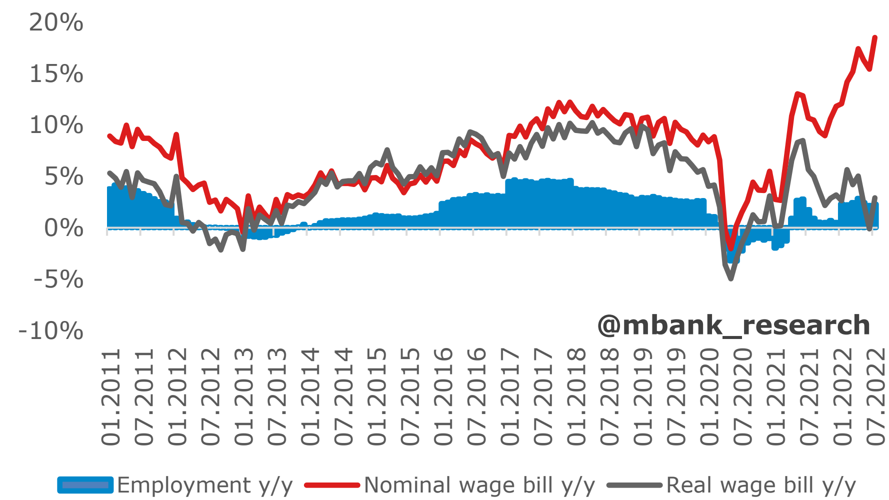
Average monthly wage in enterprise sector (in PLN, sa)



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



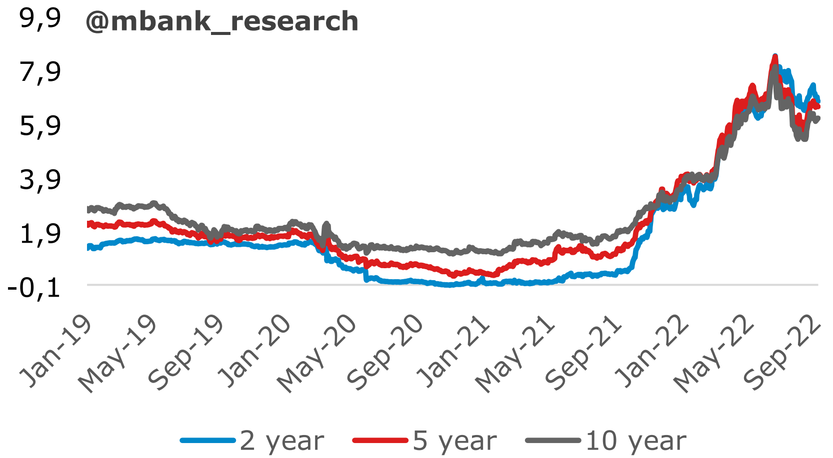
Wage bill



Source: Statistics Poland, ZUS Statistical Portal, own elaboration

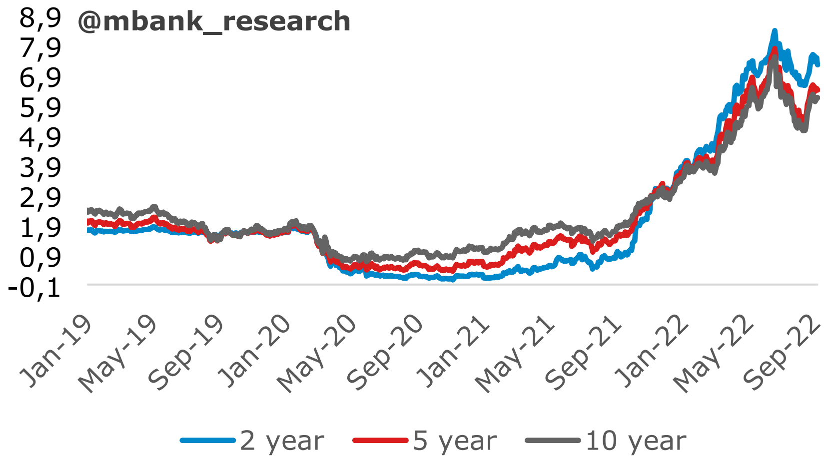
Polish rates, yields and spreads

POLGBs



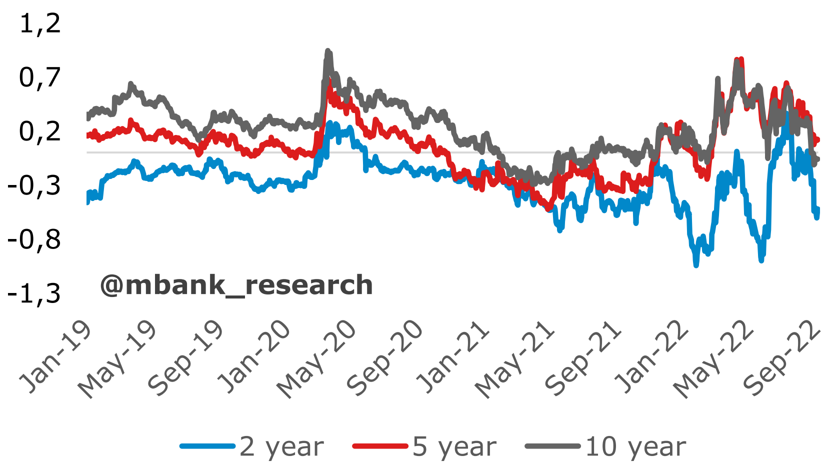
Source: Bloomberg

PL IRS



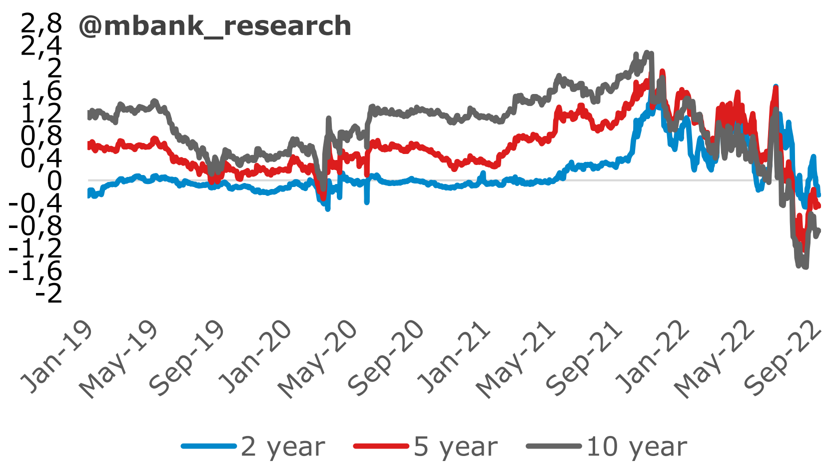
Source: Bloomberg

ASW spread



Source: Bloomberg

POLGB yield minus 3m WIBOR



Source: Bloomberg

Poland: Fiscal balance

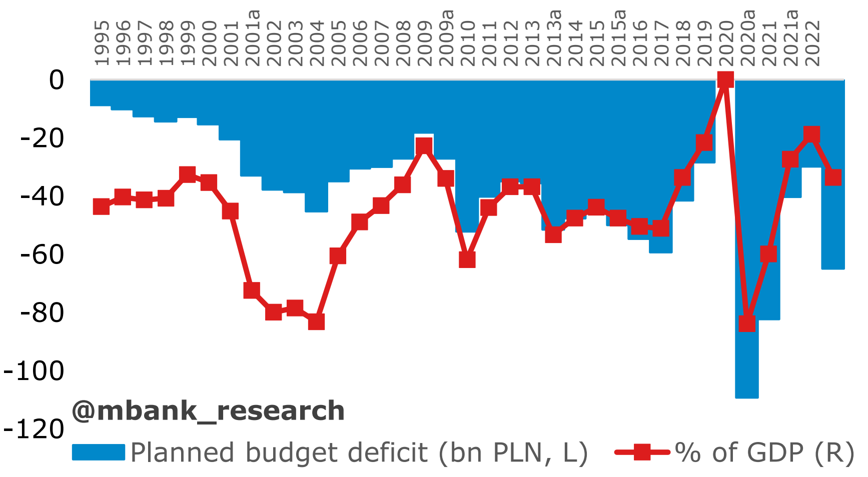
- The government accepted a draft budget for 2023. It assumes revenues of PLN 604.4 billion and expenditures of PLN 669.4 billion. The state budget deficit at the end of 2023 is expected to be no more than PLN 65 billion. But the budget does not include a possible extension of the anti-inflation shield. Now it is formally supposed to function until the end of this year, but in our opinion the probability of its extension next year is very high. There are also no expenditures on compensations of gas and electricity included (there are some plans to freeze them).
- The 2023 buget is "similar" to that of 2022. Not because of the numbers (revenues and expenditures are going to increase significantly), but because of its nature. Real expenditures and revenues will differ quite a lot, due to the changes introduced during the year (the shield, allowances, etc.), which will directly affect both the deficit and the borrowing needs.
- Retail bonds linked to the NBP reference rate, introduced since June, have enjoyed a sizeable take-up so far. Also, for the next year, the government plans to finance a chunk of its needs in this way.
- The current state budgetary outlook looks quite well – but as presented above, the state budget itself is not the best gauge of the public finance situation these days.
- Graphical summary of current fiscal data in next two slides (here and here).

Poland: External Balance

- Almost nothing has changed in current account trends. The services balance has been growing. The goods balance has been improving regularly (since March, when it recorded a sizable minus), although it is still negative. The next few months should bring a further relief with the deficyt likely to diminish - mainly due to the cycle (a growth slowdown, the zloty exchange rate). However, this will take some time to adjust.
- As for June's numbers, they are mainly the result of strong increases in transaction prices on both exports and imports (as in previous months). Exports to Ukraine (mainly fuels and used cars) increased. In imports, on the other hand, there were some changes in details due to the lack of oil and gas imports from Russia and an increase in oil imports from Saudi Arabia.
- Graphical summary here.

Poland: Fiscal monitor #1

Planned budget deficit

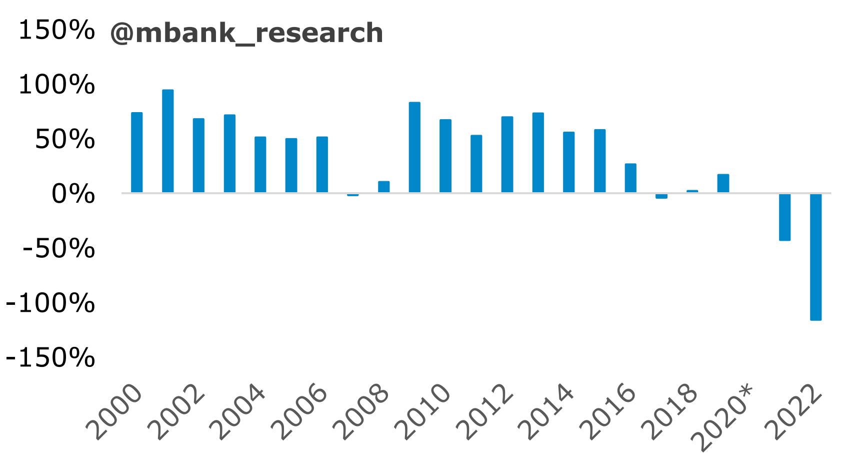


Source: Ministry of Finance, a – budget novel

State debt servicing costs (% GDP)

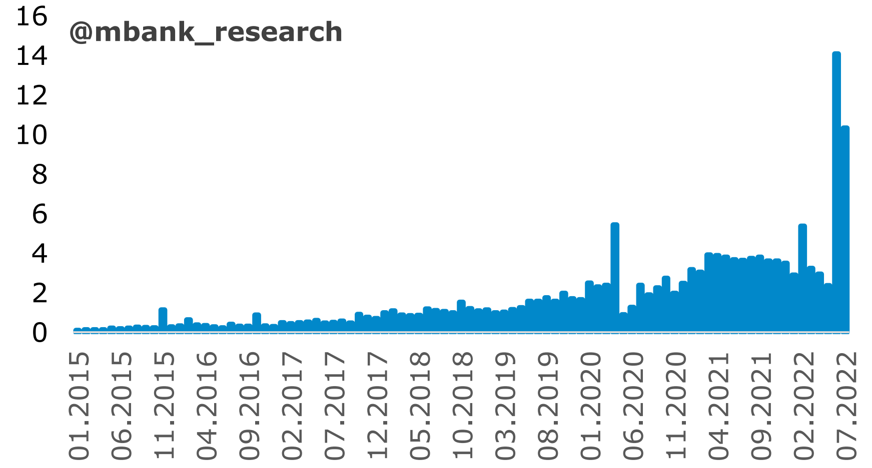
Source: Macrobond

Central budget deficit in July vs yearly planned deficit



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

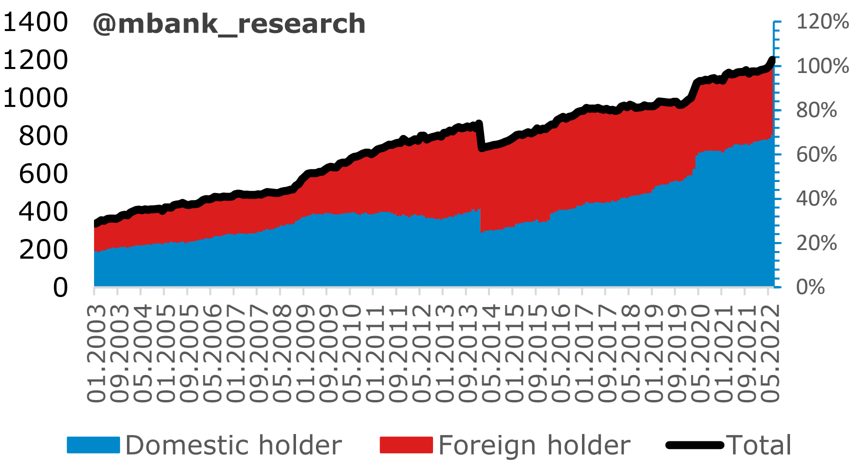
Retail bonds sold per month (PLN bn)



Source: Ministry of Finance

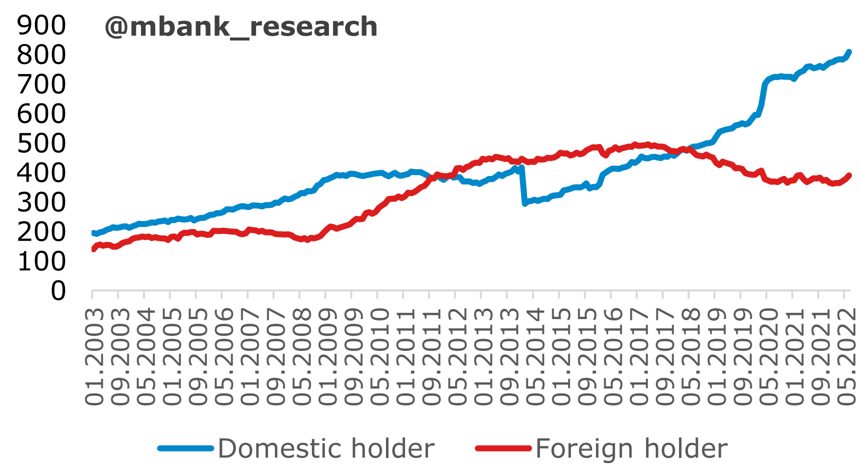
Poland: Fiscal monitor #2

State treasury debt by holder #1



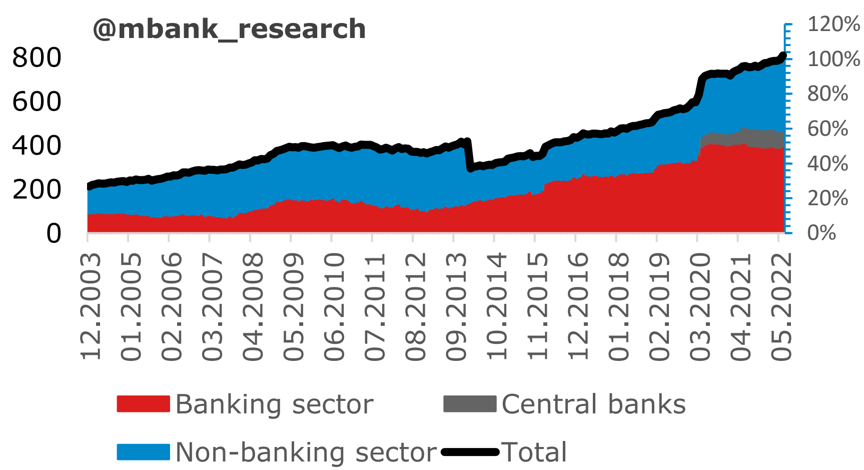
Source: Macrobond

State treasury debt by holder #2



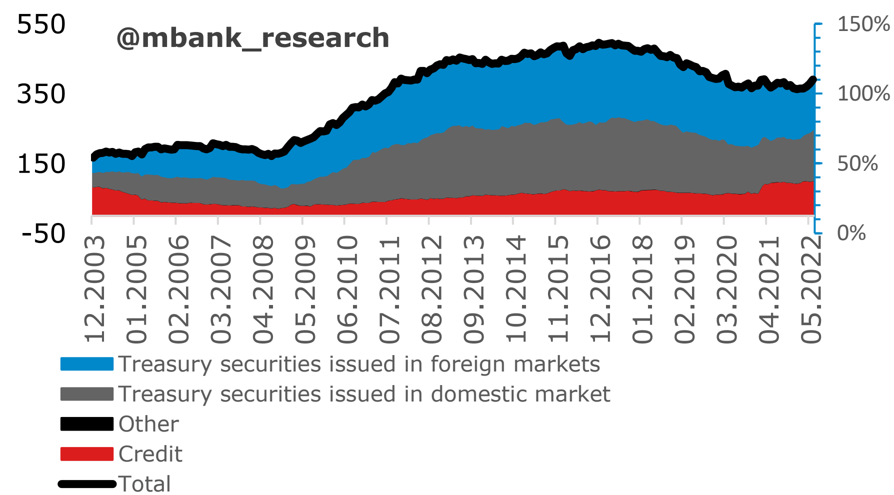
Source: Macrobond

State treasury debt – domestic holders



Source: Macrobond

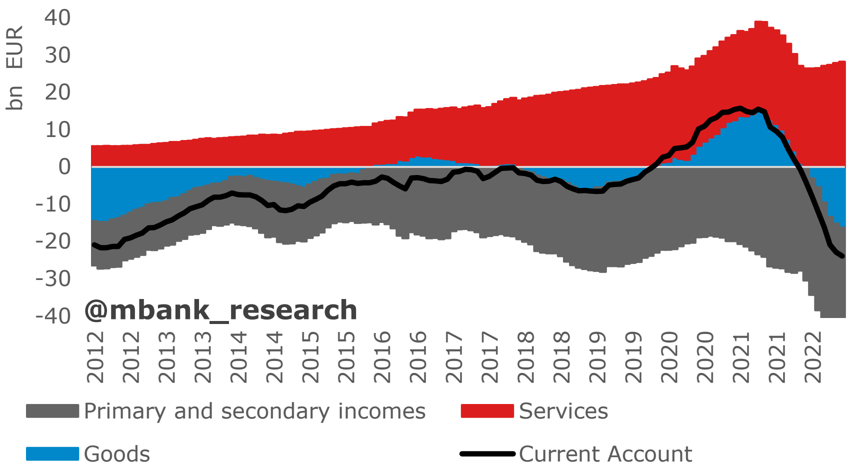
State treasury debt – foreign holders



Source: Macrobond

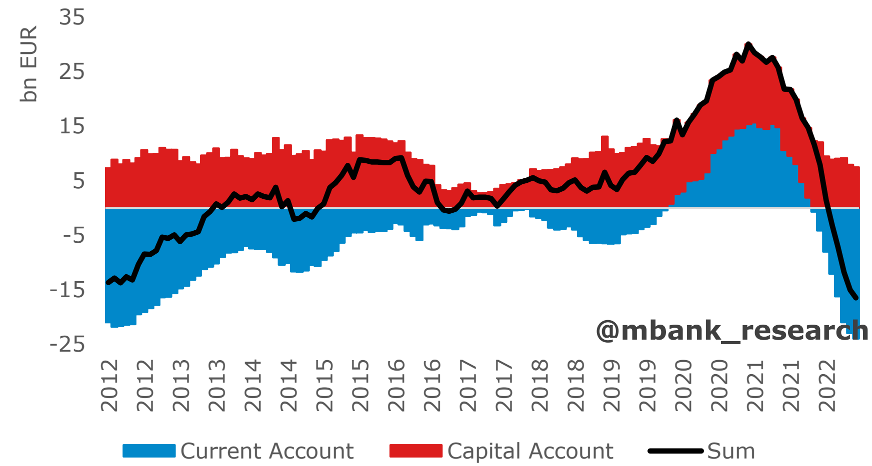
Poland: External balance

C/A decomposition – 12m rolling sum



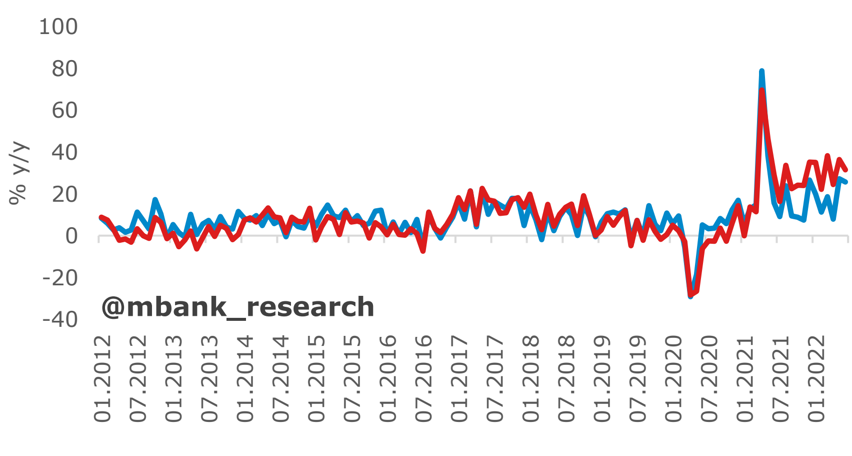
Source: NBP, own evaluation

Current and Capital Account – 12m rolling sum



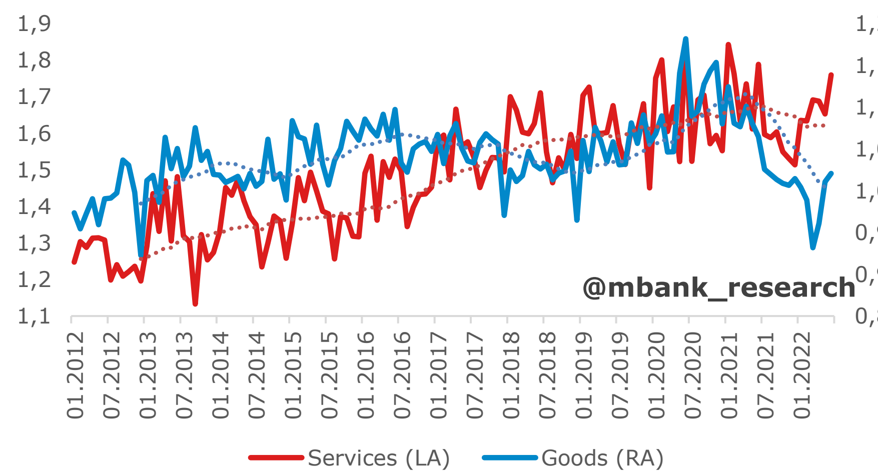
Source: NBP, own evaluation

Exports and imports dynamics



Source: NBP, own evaluation

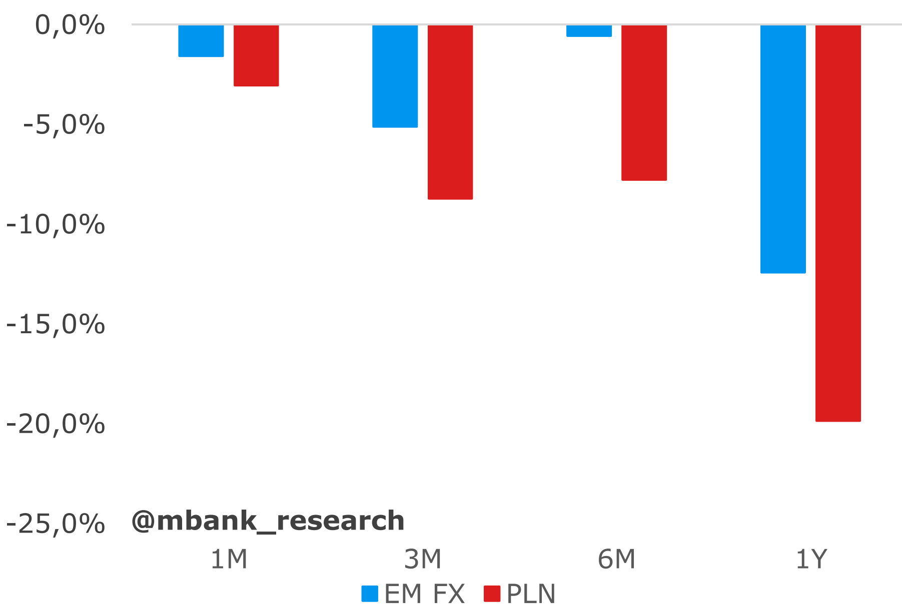
Exports to imports ratio



Source: Macrobond

EURPLN – still weak

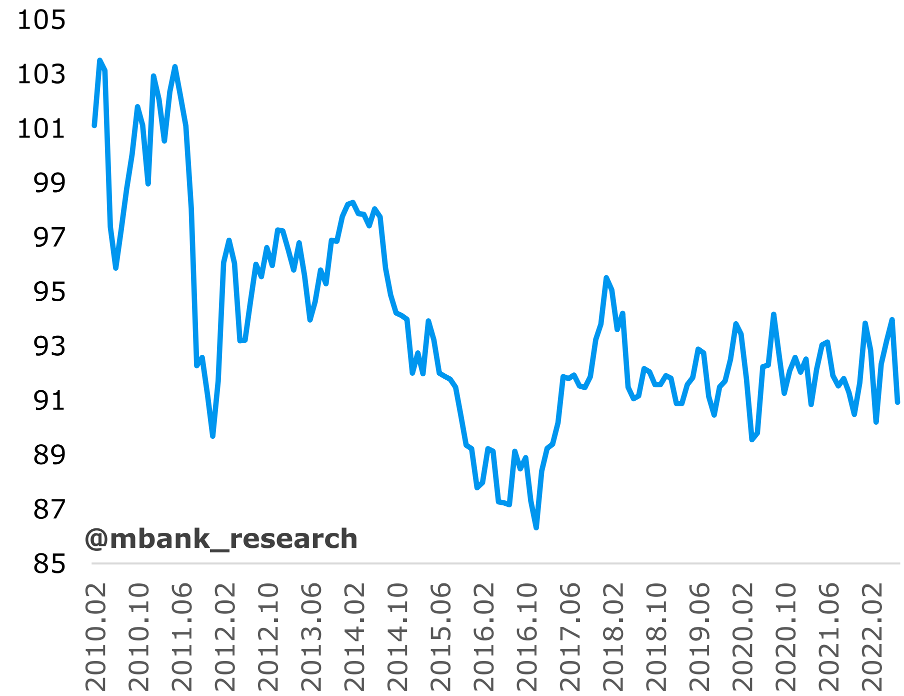
Some weakening after previous slight appreciation



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

Source: Bloomberg

Real effective exchange rate (mind the dates)



Source: BIS

- Three months passed from our latest edition of the *Monthly Pulse Check*. Since then, the PLN has depreciated against the US dollar quite substantially. In fact, it has been one of the weakest EM currencies in the world. Lack of progress in terms of EU funds, further inflation acceleration as well as a buoyant fiscal response have been among reasons behind the zloty's decline.
- The Polish central bank hiked rates twice – by 50bps in July and by 25bps in September. Monetary tightening continued both in the US and the euro area, where the ECB officially escaped the negative rate environment. At the same time, the Czech Republic held rates unchanged last month, suggesting we could have ended tightening there.
- We have changed our view to some extent since June. First, we now expect the zloty to depreciate more against the euro until the year-end to roughly 4.9. Second, inflation seems to be more persistent than we thought. As a result, we expect inflation to increase toward 20% in the first quarter of 2023 (mostly due to higher energy bills). Third, although we decided to keep our NBP forecast intact (7%), we dismissed the previous idea of rate cuts in late 2023.

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