Monthly Pulse Check
Economy, FI, FX

January 9th 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

- Trade tensions have reached the peak and are slowly receding. Manufacturing is stabilizing at contractionary levels; non-manufacturing sectors are still above expansion threshold, supported by the steady growth of wages and low interest rates. It seems global economy has reached a local bottom.
- Polish economy is slowing. Although prospects for export growth are looking somewhat less bleak, strong, exogenous component of EU-sponsored investment component is a major headwind for overall growth; elevated price pressures, slightly less optimistic consumers add to the downside risks. We expect Polish GDP to grow by 2.8% in 2020.

Monetary policy: Fed, ECB, NBP

- Fed: FOMC did its job and eased. We expect them to stay on the sidelines for a longer period of time as economy stabilized. The discussion on inflation goal makes easing the more likely option if events take an unexpected turn.
- ECB: Lagarde inherited a fully operational and comprehensive easing programme. Strategic review, along with some stabilization of the economy makes ECB the most boring cenbank for a moment.
- NBP: Rates on hold for long. Wait for presidential elections as the composition of the MPC (the 2022-28 term) may be crucial of determining the next movements of the body, especially when the path forward is not clear cut.

FX Market

- Zloty is boring. 4.20-4.40 range is all we can imagine for now and going forward. The enormous change in the structure of the economy allows the currency to be more immune to global shifts in moods and domestic shifts in GDP drivers. However, mind that such a range gives some potential to react when the spot is close to the band’s limit.

		2019 Q1	2019 Q2	2019 Q3	2019 Q4 F	2020 Q1 F	2020 Q2 F	2020 Q3 F	2020 Q4 F
GDP y/y	%	4,8	4,6	3,9	3,7	3,2	2,7	2,6	2,6
Individual consumption y/y	%	3,9	4,4	3,9	4,3	4,3	4,0	3,4	2,8
Public Consumption y/y	%	6,3	3,1	4,7	5,0	3,0	3,0	3,0	3,0
Investment y/y	%	12,2	9,1	4,7	2,5	-2,0	-3,0	-3,0	-3,0
Inflation rate (average)	%	1,2	2,4	2,8	2,8	4,6	4,0	3,5	3,5
Unemployment rate (eop)	%	5,9	5,2	5,1	5,2	5,3	5,0	5,2	5,6
NBP repo rate (eop)	%	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50
EUR/PLN (eop)	%	4,30	4,24	4,37	4,25	4,25	4,30	4,35	4,40
USD/PLN (eop)	%	3,84	3,73	4,01	3,79	3,86	3,84	3,82	3,83

F - forecast

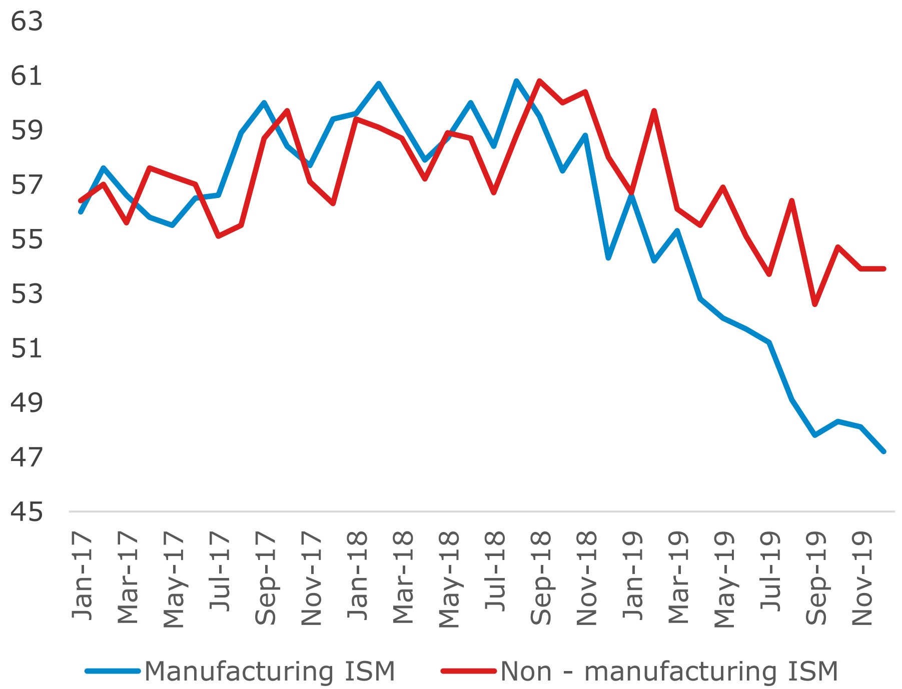
Upcoming macro releases: January 2020.

Publication	Date	Period	mBank	Consensus	Actual	Prior
PMI (pts.)	02.01	Dec	47.20	46.90	48.00	46.70
CPI y/y (%)	07.01[1] 15.01[2]	Dec	3.1%	2.9%	3.4% [1]	2.6%
Unemployment rate (%)	~09.01[3] 27.01[4]	Dec	5.1%	5.2%	5.2% [3]	5.1%
Current account (mln EUR)	13.01	Nov	777	250		529
Employment y/y (%)	21.01	Dec	2.7%	2.7%		2.6%
Wages y/y (%)	21.01	Dec	5.8%	6.1%		5.4%
Construction output y/y (%)	21.01	Dec	0.0%	0.6%		-4.7%
Industrial output y/y (%)	22.01	Dec	4.9%	6.0%		1.4%
PPI y/y (%)	22.01	Dec	1.3%	0.9%		-0.1%
Retail Sales y/y (%)	23.01	Dec	7.2%	5.8%		5.2%
M3 y/y (%)	24.01	Dec	9.4%	9.1%		9.4%

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

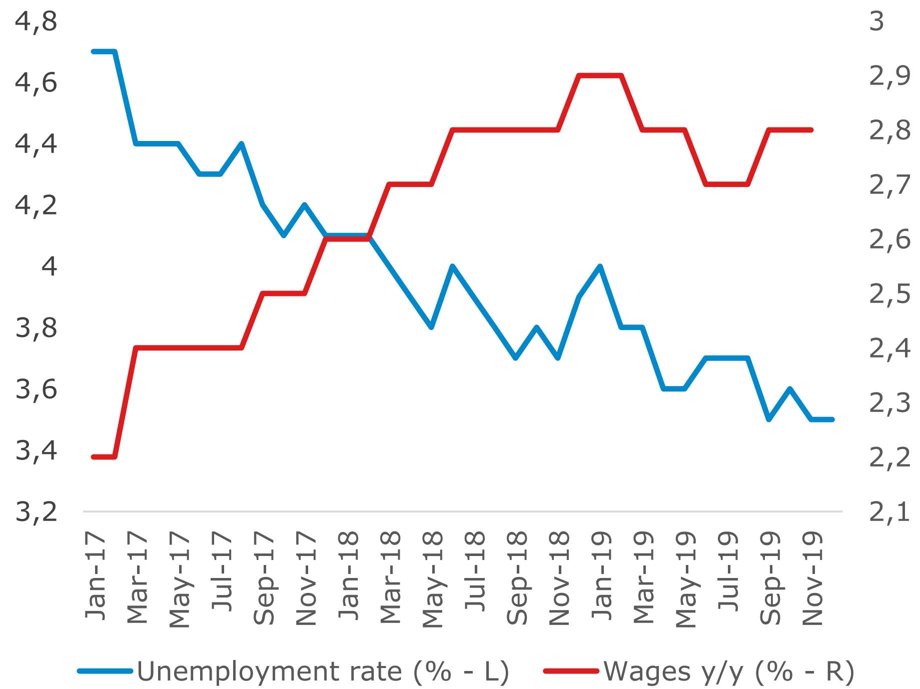
U.S. economy health check

ISM PMI: manufacturing & non-manufacturing



Source: ISM

Labor market: wages & unemployment rate

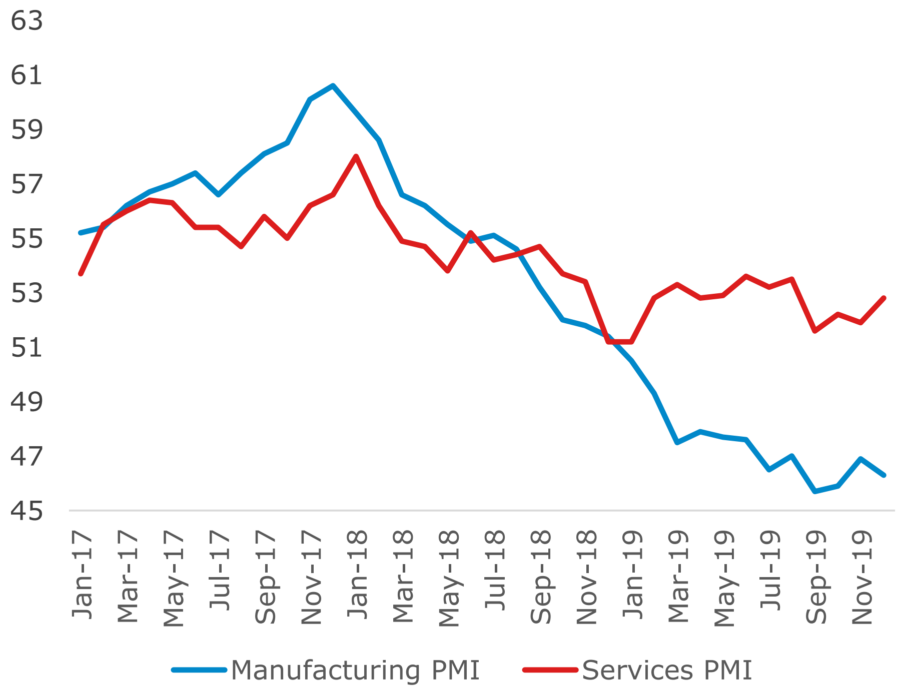


Source: FRED

- Services are constantly outperforming manufacturing that is suffering from global trade slowdown. As there are plenty of indications that global economy is going to at least stabilize in the coming months, we see potential for manufacturing in the U.S. to follow. The worst is behind us.
- After the doldrums in the first part of the year, employment growth re-accelerated and wages keep on growing at moderate pace. Solid labor market, moderate wage growth and improving business activity in services are enough to keep U.S. economy on growth path with moderate inflation.
- The case for near term recession is more and more unlikely. The bar for both rate cuts and rate hikes is set high. Fed is to err on the side of caution as the discussion on inflation target's symmetry progresses.

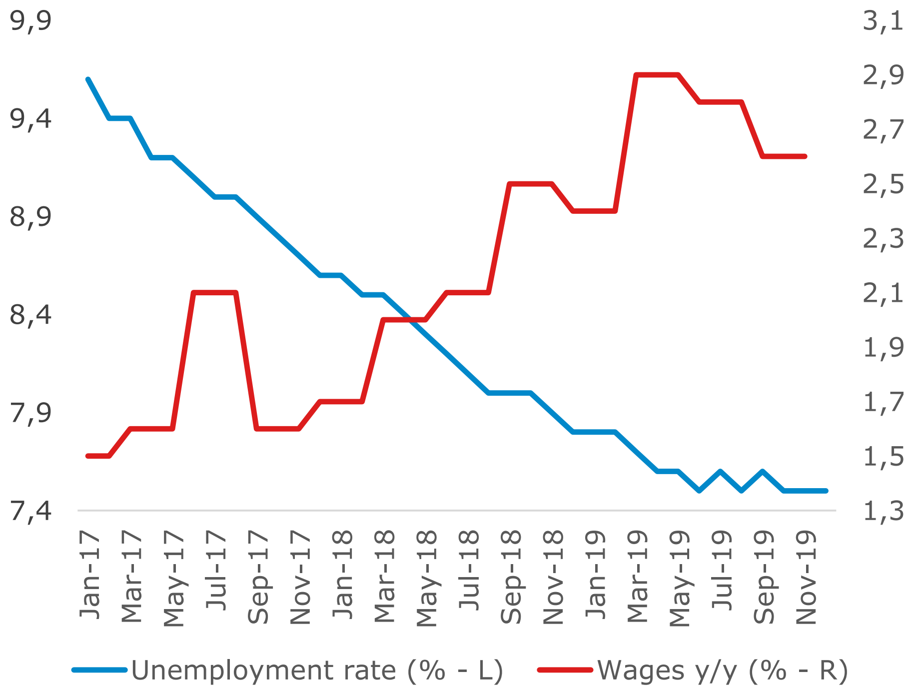
Euro area economy health check

Markit PMI: manufacturing & services



Source: Markit

Labor market: wages & unemployment rate

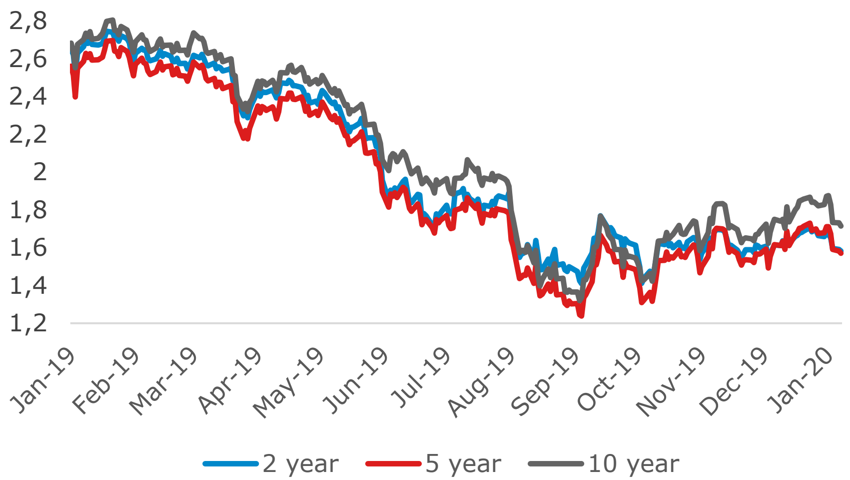


Source: Eurostat

- Bottom fishing. Both manufacturing and services are looking for support. With some evidence that the global economy stabilized, we see potential to turnaround in business activity. The story seems the same as in the U.S. case but 1) euro zone is starting from lower levels, 2) interest rates are lower, 3) economy is much more opened.
- Acceleration of growth from 0-0.2% q/q to 0.3-0.4 q/q is likely. It is not going to be a game changer for inflation, though.
- Easy monetary policy is here to stay. The systemic review of monetary policy is under way. It is safe to assume nothing is going to change until it is completed.

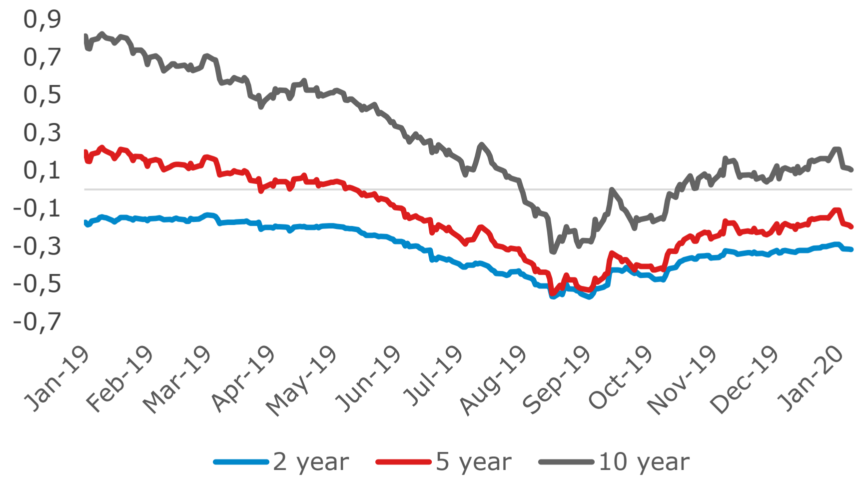
Global rates: off the bottoms and at least temporarily on the rise.

US swap rates (%)



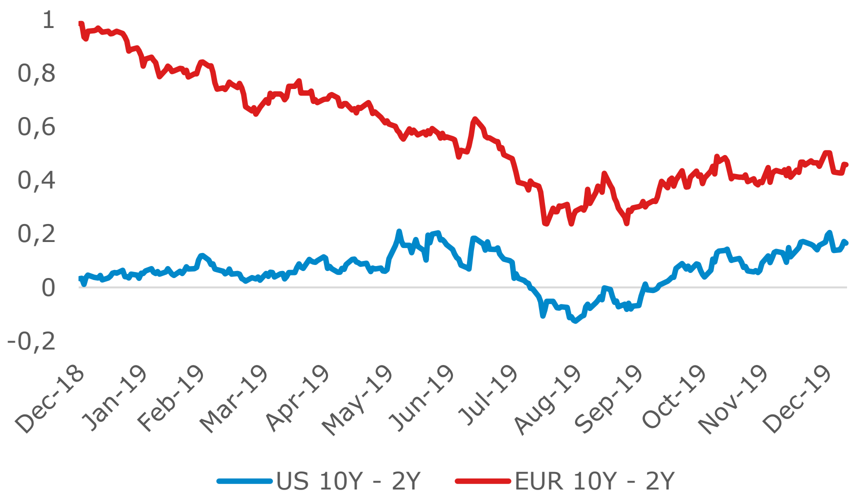
Source: Bloomberg

EU swap rates (%)



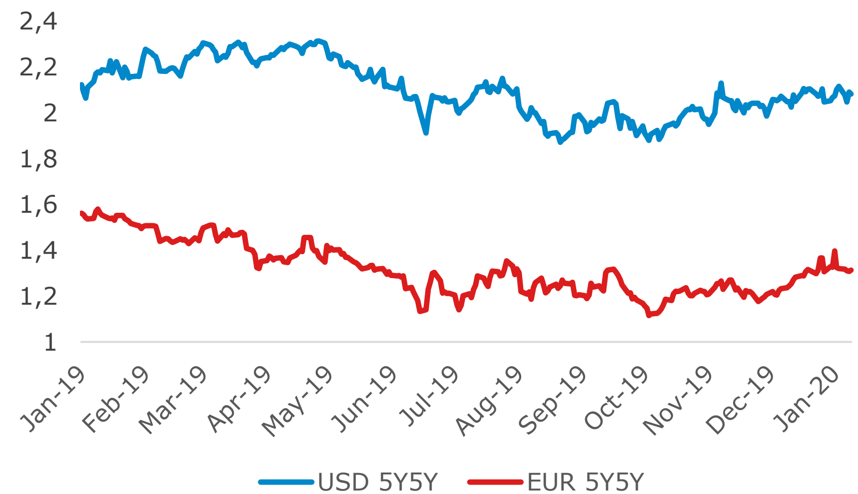
Source: Bloomberg

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



Source: Bloomberg

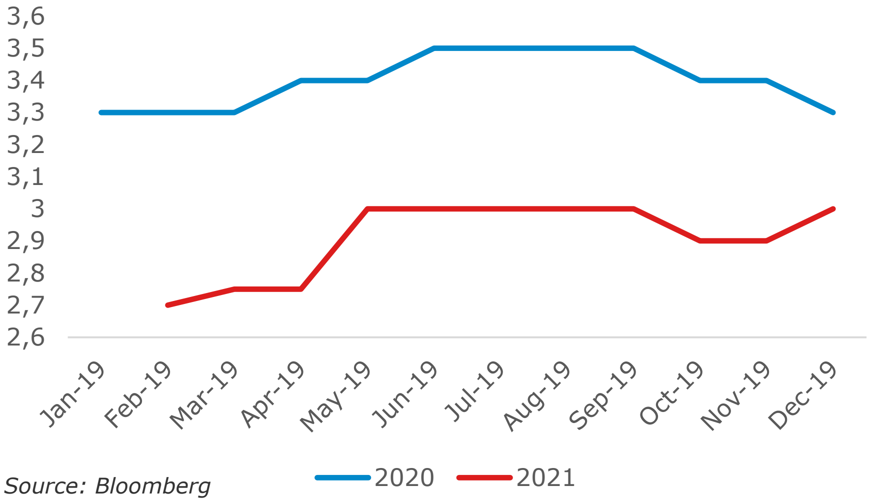
US and EZ inflation expectations (%)



Source: Bloomberg

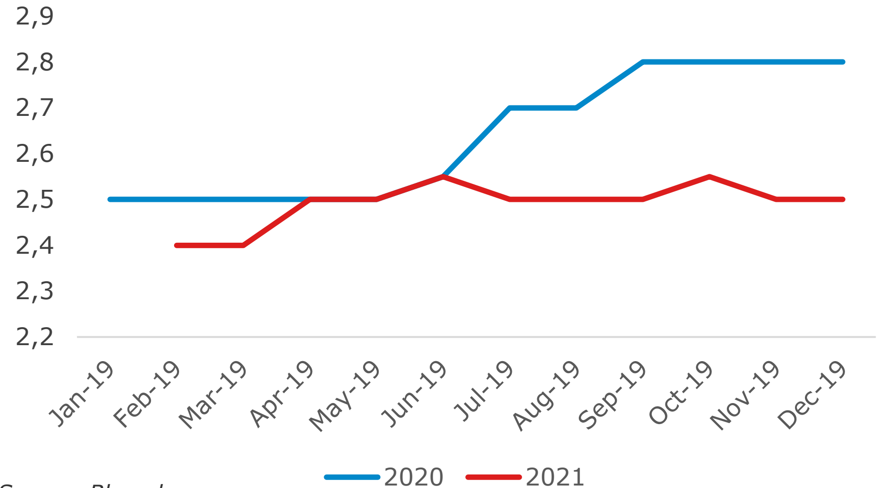
Consensus: what is expected in Poland?

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



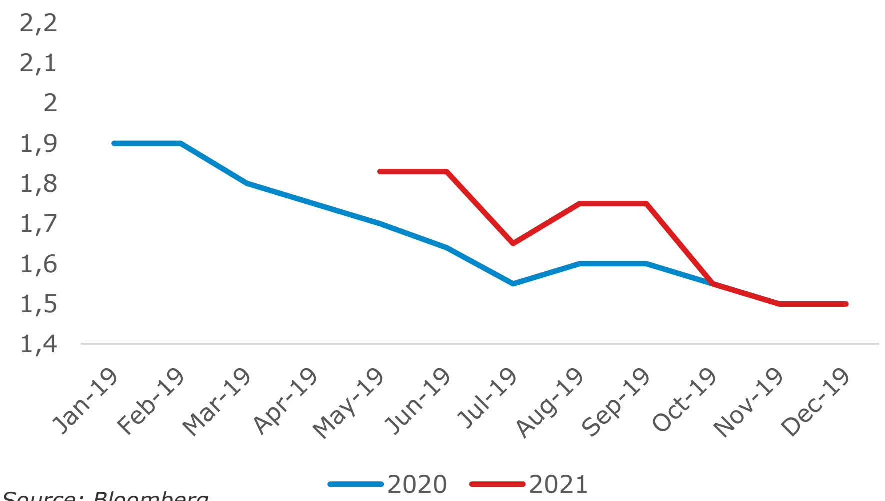
Source: Bloomberg

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



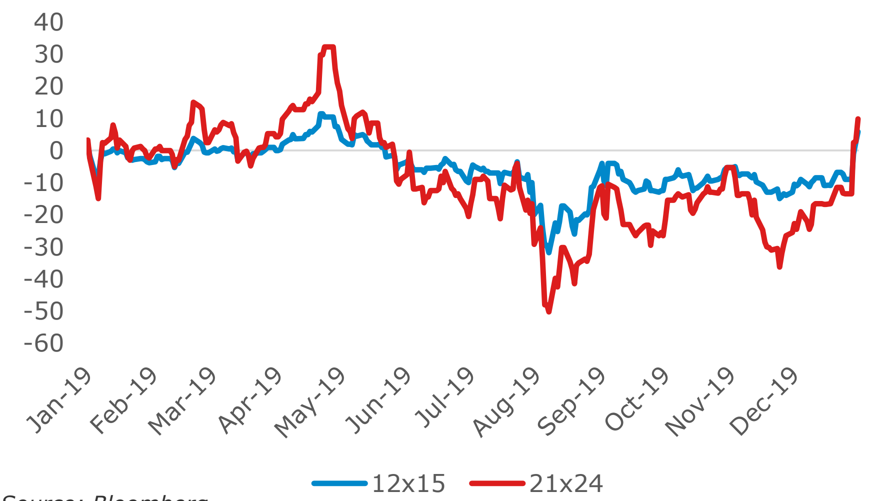
Source: Bloomberg

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



Source: Bloomberg

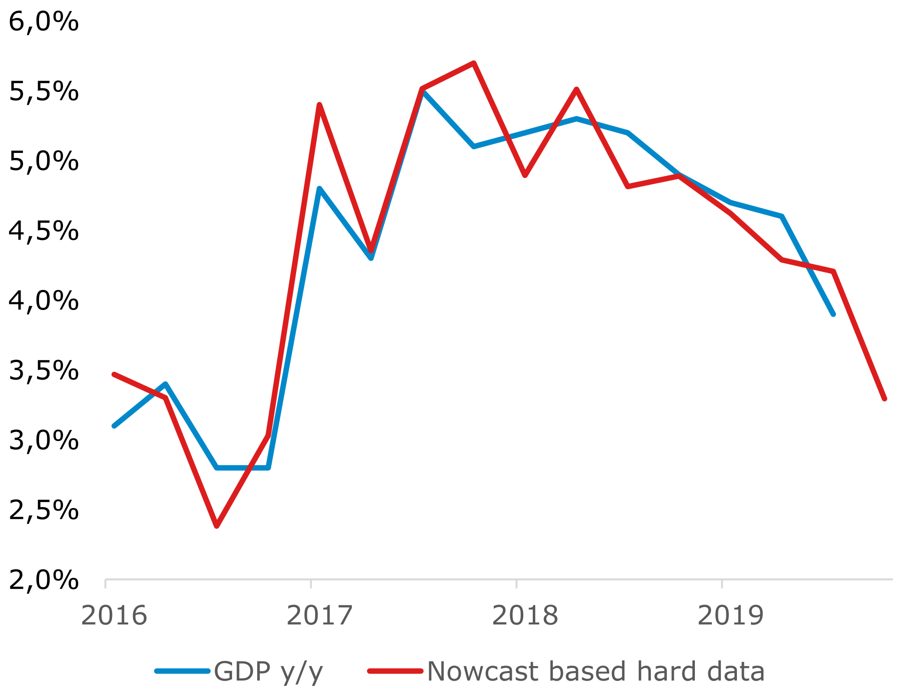
Rate changes priced in by FRA (bps)



Source: Bloomberg

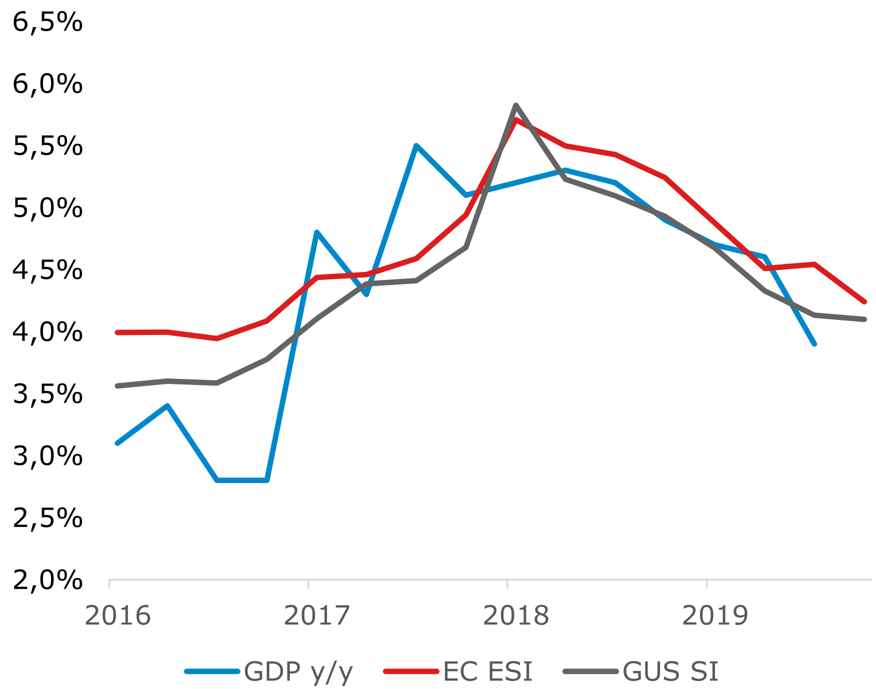
Short-term GDP tracker

GDP nowcast based on hard data



Source: Statistics Poland, own elaboration

GDP nowcast based on business tendency indicators



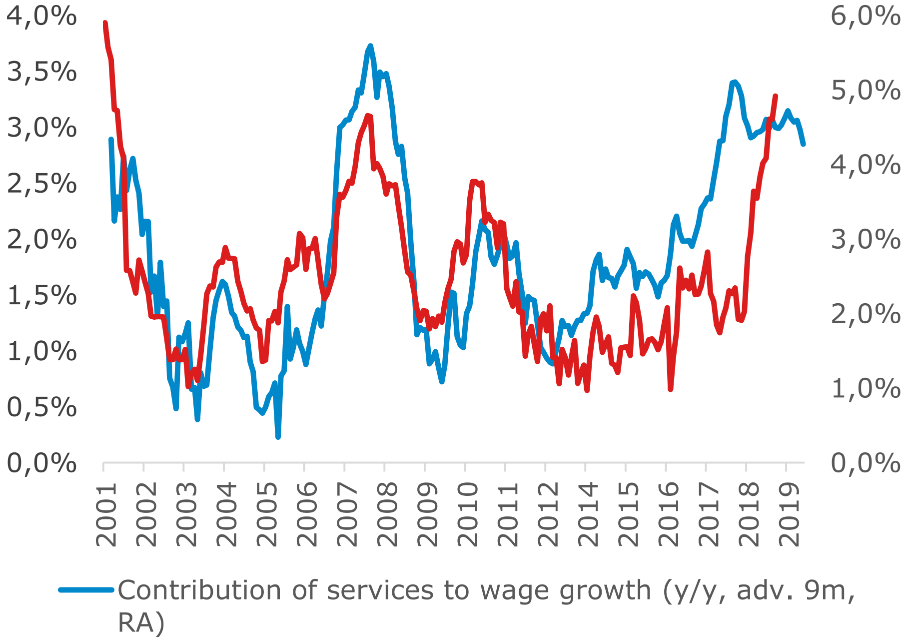
Source: Statistics Poland, Eurostat, own elaboration

- Last month of the year ends with better-looking monthly indicators (with an exception of industrial output*) but all in all GDP growth slows down to 3.3-3.5% in Q4 determined by construction data and EU-sponsored investment cycle. That is the reading from hard data. Business tendency indicators give somewhat less gloomy view on the Polish economy and it seems fair although with regard only to the private sectors. So far the brake pedal from EU cycle has been pressed and it will take some time to see a turnaround there.

* We target somewhat below-consesus industrial output due to the possibility that it will be a repeat of 2013 when a seemingly good-looking working days count translated into a negative surprise give the fact that the arrangement of holidays favored longer that unusual production hold-on periods in manufacturing.

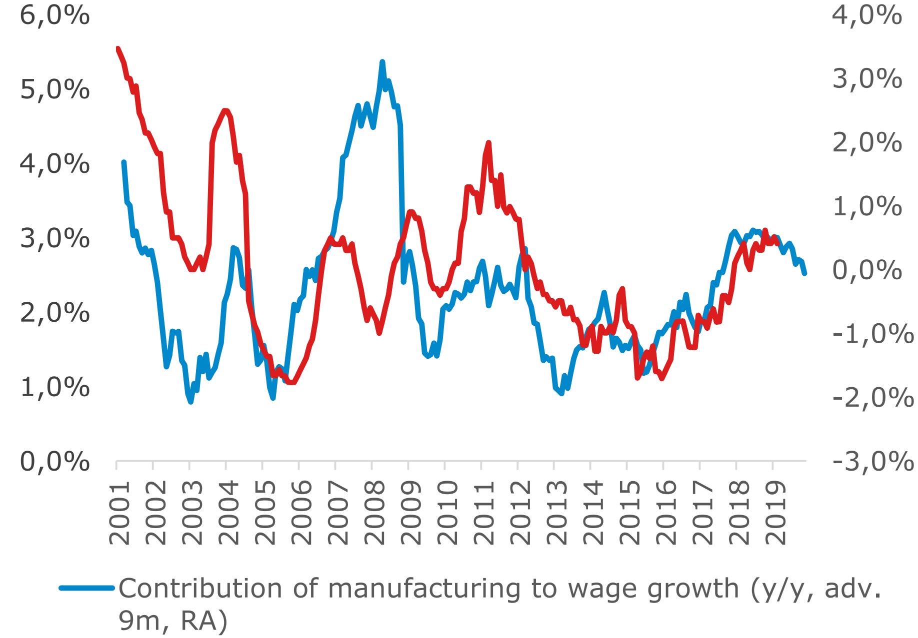
Short-term inflation tracker

Wages & consumer prices: services



Source: Statistics Poland, Eurostat, own elaboration

Wages & consumer prices: goods

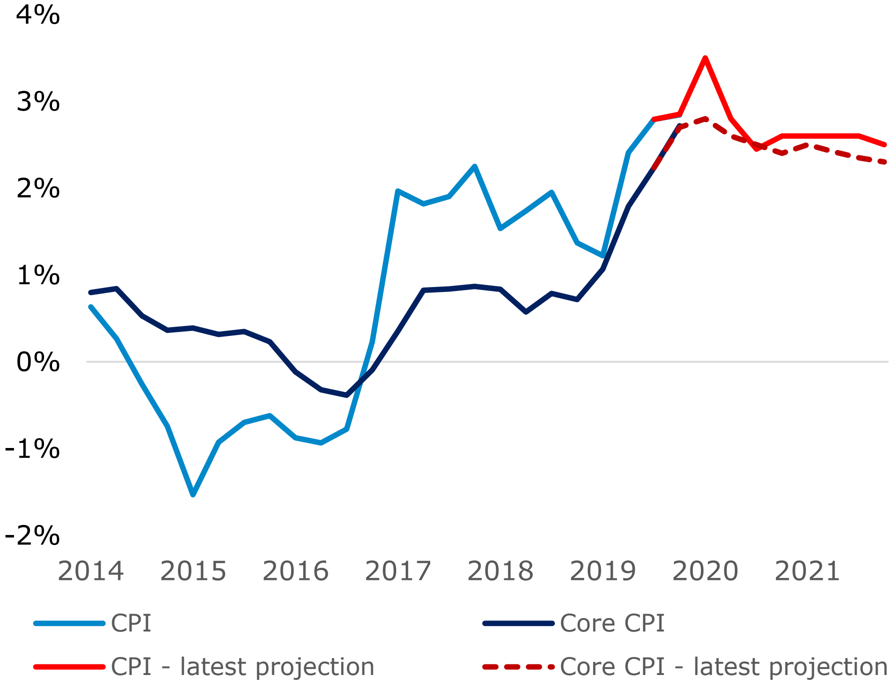


Source: Statistics Poland, Eurostat, own elaboration

- We are close to tipping points in services and goods inflation. Wages favor an incoming turnaround in inflation in 2020.
- However, the short term inflation path will be determined by exogenous factors (electicity, waste collection fees, excise taxes, food prices and somewhat higher fuel prices) and endogenous, those connected with the unusual switch to new prices in the new year that happens in January. Record high minimum wage increase connected with the overall perceptions of high inflation and still at least better than average state of the economy may encourage retailers to test quite an abrupt change in pricing.
- That is why we expect CPI inflation to average 4.6% in Q1 and core inflation at 3.7%. Next months should bring inflation to a more moderate levels, although still above 3%.

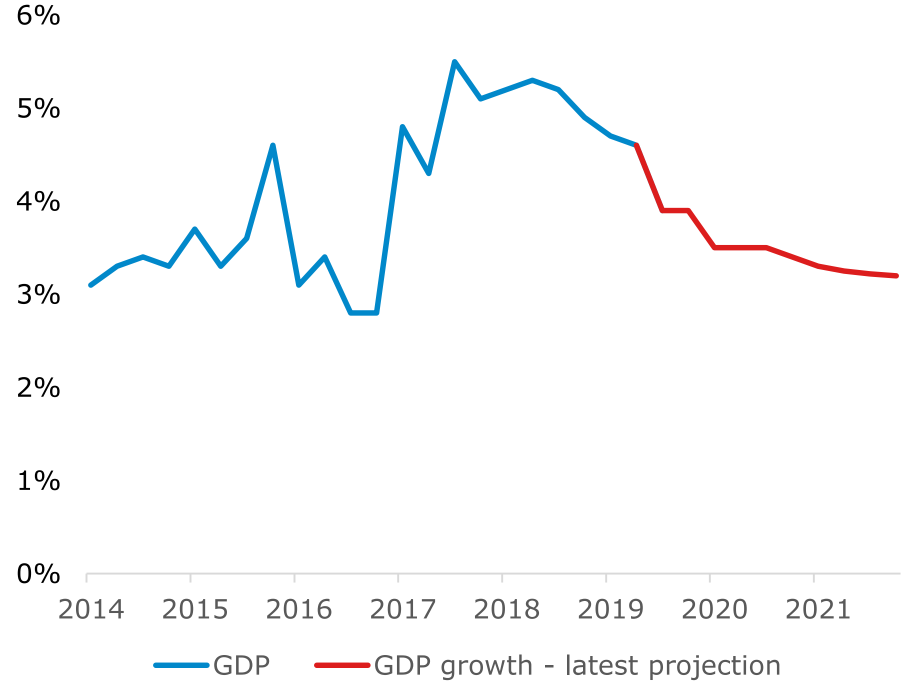
Polish monetary policy radar

NBP's latest projection: inflation



Source: NBP, Statistics Poland, own elaboration

NBP's latest projection: GDP growth

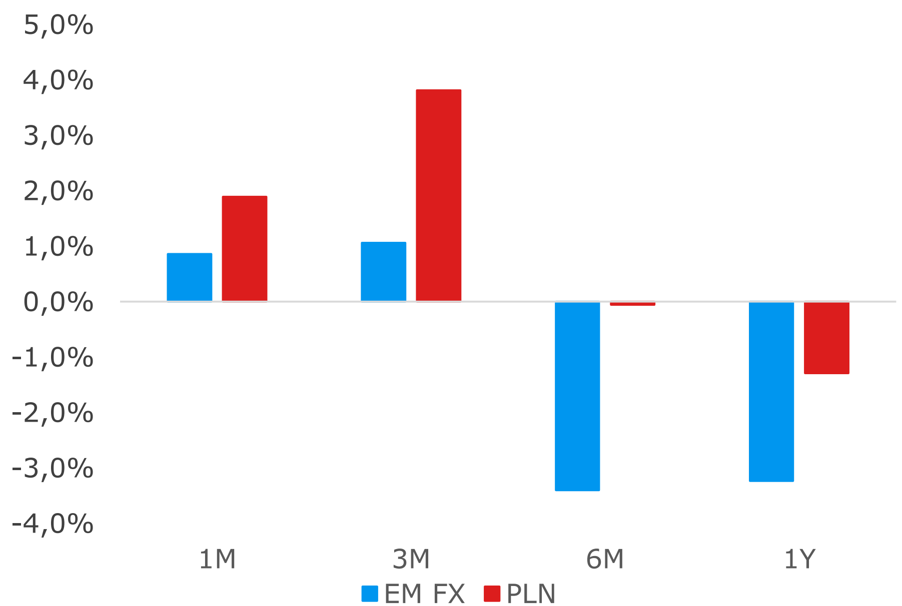


Source: NBP, Statistics Poland, own elaboration

- Among the many options governor Glapiński had recently on hand, he chose the way of diminishing the importance of the recent acceleration in inflation (3.4% in December, >4.5% in Q1 in our forecast; NBP forecast is much lower 3.6-3.8%).
- It seems a strong signal that MPC is unwilling to increase rates and will stick to slowdown scenario to support this notion. And given the assumptions that are likely to be incorporated into the projection (like low wage growth, as indicated by the NBP governor), the return of inflation to target seems warranted but may take more time.
- Stable rates scenario stays intact. Markets may overshoot in the meantime carried away by high inflation in Q1.

EURPLN

PLN outperformed EM FX recently



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

Source: Bloomberg

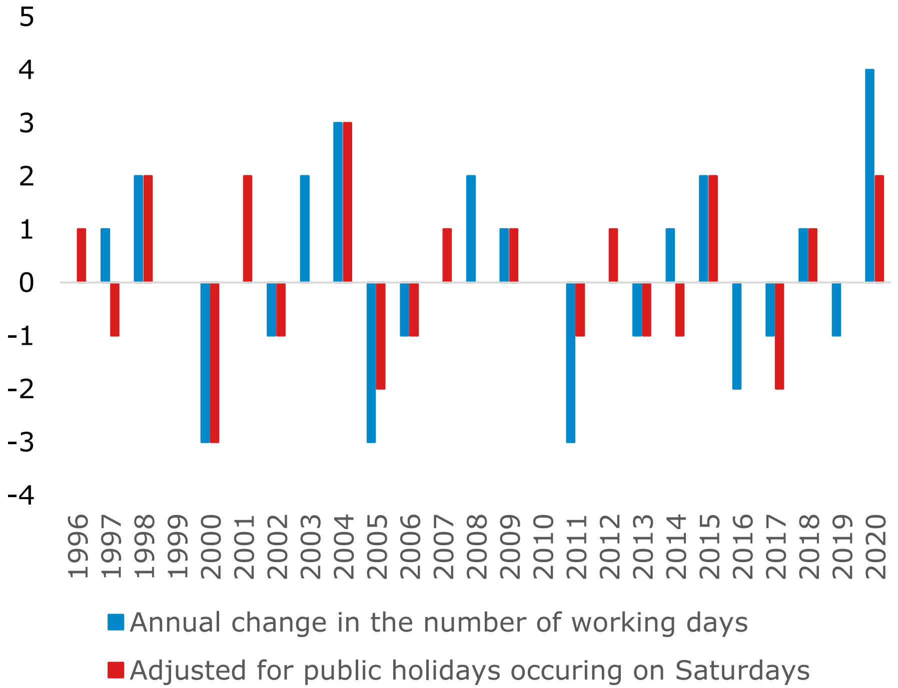
Real effective exchange rate: broadly stable

Source: BIS

- Accelerating inflation and rising market rates bode well for PLN, at least temporarily. It should be rather clear until April/May that MPC is going to sleep through higher inflation and do not raise rates. It may be the beginning of zloty's demise: lower growth, somewhat higher fiscal risks, constant need for depreciation to keep margins of exporters intact vs the spot rate.
- We see depreciating zloty as a baseline for 2020 i. e. we bet that end 2020 exchange rate will be higher than current sport rate. In the meantime the undershoot below 4.25 is likely, especially when inflation surprises.

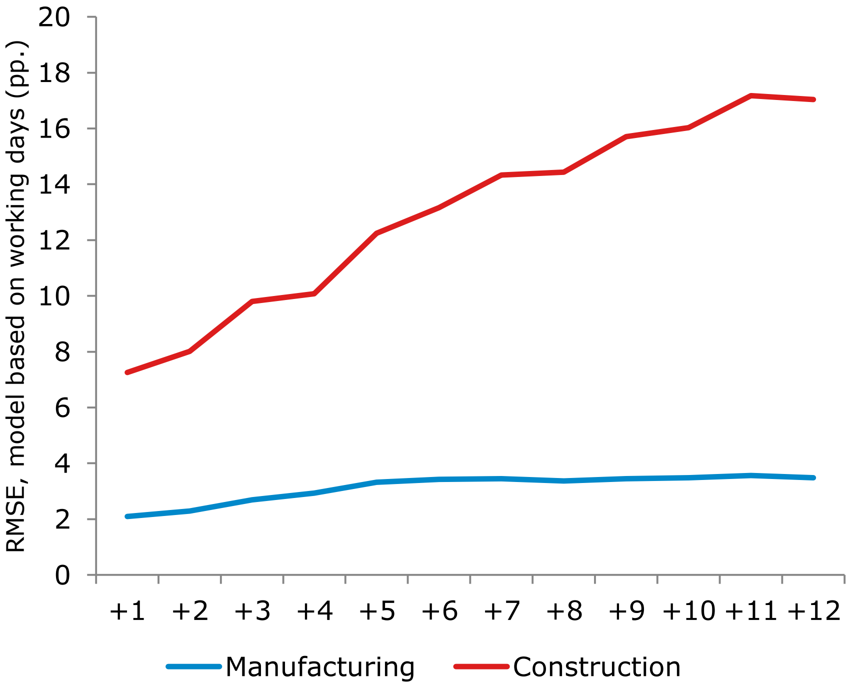
Mini-research note. Will hard work save Polish GDP in 2020?

Unusual public holiday arrangement in 2020…



Source: own elaboration

… is not very predicitive in 12-month horizons



Source: own elaboration based on Statistics Poland data

- In 2020 the number of working days will rise sharply (by 4) – this fact is highlighted by some analysts as strongly supporting GDP growth this year. However, we have doubts.
- Polish labor law mandates that for every public holiday occurring on Saturday (there will be 2 of them this year compared to 0 in 2019) employees receive one day of paid vacation. Adjusted for this, the change in working day count in 2020 is not really exceptional.
- The more important question is whether working days are actually useful in predicting economic variables over longer horizons. To test this, we decided to compute 1-12 month ahead forecasts of y/y growth in construction and industrial output for each month in the 2010-2019 period. As it turns out, mean forecast errors are quite substantial and, translated into GDP growth, exceed 1 p.p.
- This means that guessing the cycle is much more important than counting working days.

Disclaimer and contact details

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