Monthly Pulse Check
Economy. FI. FX

September 11th 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 creep up from bottoms ignited by quarantines somewhat faster than expected. Some countries report second waves of infections as they open up, though. National lockdowns are replaced by track&trace strategy supplemented by surgical closures of some forms of mass social activity. This recession carries substantial structural change for some sectors. Therefore the return to overall normality will be slow even though we are about to temporarily see strong GDP numbers as economies jumps start. The scale of monetary and fiscal support is unprecedented guaranteeing quite smooth transition towards 2021.
- Polish economy behaves better than expected. We now expect only 3.1% recession in 2020. Consumers, supported by government programmes, fared relatively well. However, second wave challenges lie ahead and investment activity, after partial rebound in Q3, will be muted for some time. The New EU programme may be important boost for growth 2021/22 and beyond.

Monetary policy: Fed. ECB. NBP

- Fed: ZIRP + QE + direct loans to firms. Not done with easing.
- 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). Over to fiscal policy now. Not out of ammo. FX channel, QE expansion, forward guidance stay on the table if need be. Negative rates unlikely. Easing bias but on hold for now (next meeting September 15th) as June projections became outdated in just one month.

FX Market

- The worst for PLN is over. Low rates suggest that the swings in PLN triggered e.g. by risk aversion may be more pronounced but after economies stabilized, the risk of such developments is lower. Return to growth path supports PLN, along with C/A surplus that Poland is currently running. We expect gradual, although possibly very volatile appreciation path.

		2020 Q1 F	2020 Q2 F	2020 Q3 F	2020 Q4 F	2021 Q1 F	2021 Q2 F	2021 Q3 F	2021 Q4 F	2020 Q1-Q4	2021 Q1-Q4
GDP y/y	%	2.0	-8.2	-3.3	-2.9	-1.2	9.9	4.4	5.9	-3.1	4.8
Individual consumption y/y	%	1.2	-10.9	-1.0	-2.0	-1.0	0.0	1.0	2.0	-3.6	4.7
Public Consumption y/y	%	4.3	4.8	3.0	3.6	3.3	3.0	2.6	2.3	3.9	2.8
Investment y/y	%	0.9	-10.9	-7.0	-7.0	-5.1	9.3	7.7	10.4	-6.0	5.6
Inflation rate (average)	%	4.5	3.2	2.8	2.6	1.1	1.3	1.3	1.7	3.3	1.4
Unemployment rate (eop)	%	5.3	6.1	6.4	7.0	7.3	7.0	7.0	6.9	7.0	6.9
NBP repo rate (eop)	%	1.00	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
EUR/PLN (eop)	%	4.56	4.45	4.45	4.40	4.35	4.30	4.25	4.20	4.40	4.20
USD/PLN (eop)	%	4.13	3.96	3.77	3.67	3.57	3.47	3.40	3.36	3.67	3.36

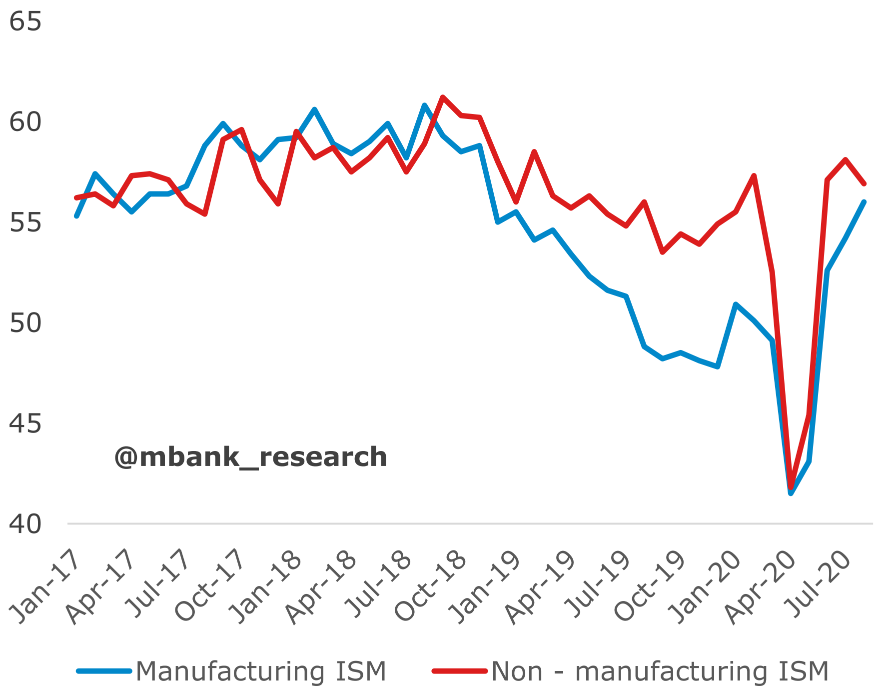
F - forecast

Highlights

- U.S. (see here) and eurozone (see here) are mostly out of the bottoms. However, the pace of recovery is slowing down reflecting mostly petering out of fiscal effects and pressure from weaker labor markets. Euro zone has also more things to worry about: strong EUR and developing second wave of infections. Whereas the Fed is ready to increase monetary policy further (introduction of AIT), ECB seems happy with the measures taken so far. This divergence is visible in inflation expectations (see here). Overall rates are still low, though, and recent movements are hardly a problem for monetary policy makers.
- The drop of Polish GDP was smaller than expected. Given the recent developments, we decided to upgrade our GDP forecasts (see the table here and the comments here). The notion that Polish economy almost fully rebounded from the bottom is corroborated by other sets of data (see here). Recovery seems to be stalling, though. It would be hard to get positive GDP growth already in H2. Apart from some stalling in recovery rate we see lagging services and lagging investment. Also, to some extent, the boost from net exports is going to be lesser (rebound implies lesser gains from trade due to higher share of imports). Having said that it is worth to note that current (expected and more optimistic than earlier) GDP growth paints still a darker picture than was seen in each of recent cyclical slowdowns. We shall wait until 2021 to state the economy is out of the woods.
- Inflation is coming off elevated levels. It finally gives up also in core measures. We see this trend to continue and await the trough to happen in 2021 (see more here).
- Even though NBP published inflation projection late, it overblew the scale of the slowdown. It has to be corrected in November (see here). We do not think it materially changes the outlook for Polish rates with one exception: further easing (via any tool) is very unlikely at this stage. However, the amount of output gap is still sufficient to keep inflation in check in 2021 and most part of 2022. MPC is not going to embark on pre-emptive tightening unless we see a sharp PLN depreciation (not our baseline). That is why we think any tightening is unlikely before late 2022. Market rates are low and short end is going to be anchored by dovish MPC. Longer rates may follow global developments. However, we do not think there is a burst in rates lurking on the horizon. We would bet rather on a slow drift as recovery is not going to follow a straight line from now, at least for some time (see here for recent developments).
- NBP purchases are at low levels for now (see here and here). We are skeptical as for the need to close down the program, though. We think NBP will keep this option until the economy will be out of the woods (2021).
- The worst is over for PLN. We expect gradual depreciation. See here.

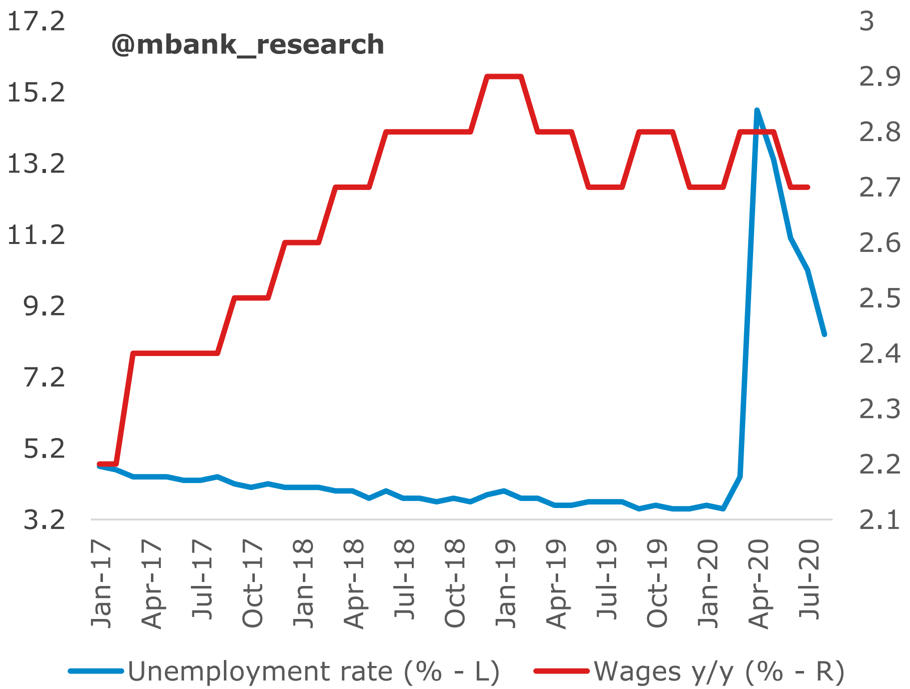
U.S. economy health check

ISM PMI: manufacturing & non-manufacturing



Source: ISM

Labor market: wages & unemployment rate

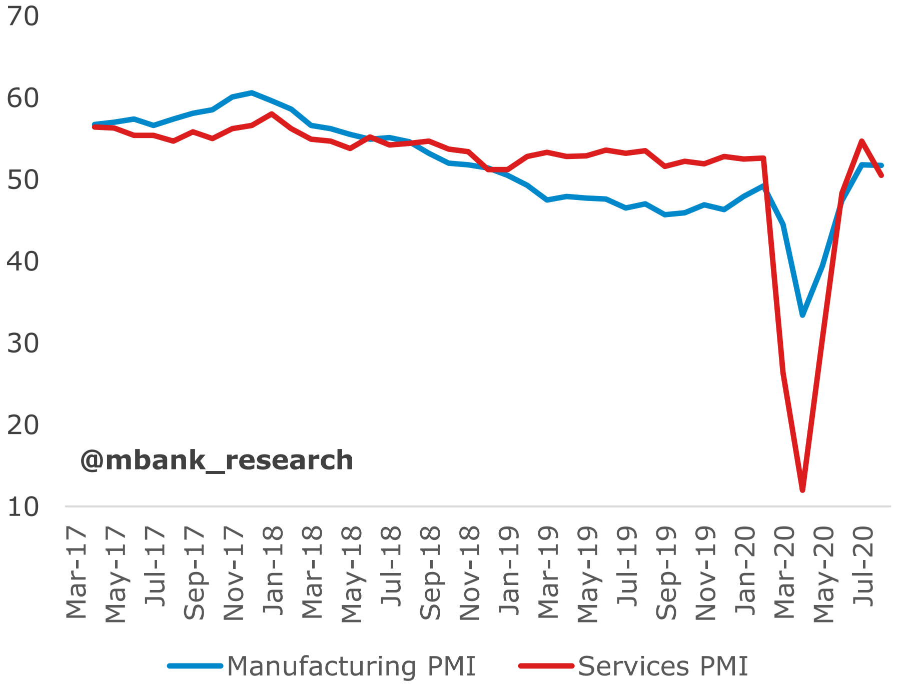


Source: FRED

- Recovery in manufacturing is spectacular. The worst is over for services too. Growth rate in the economy will be definitely positive in Q3. However, the momentum of improvement is petering out as additional fiscal support wanes and effects of large layoffs are taking their toll. Even if spectacular, recovery is still fragile.
- The Fed changed inflation goal towards Average Inflation Targeting (AIT). Rates will stay low for a long time then, possibly well past the time unemployment rate reaches levels normally regarded as close to neutral. Fed is going to formally introduce stronger guidance on rates and expand QE purchases as market implied rate path is too high given the new principle of inflation targeting. It is the only way to make the change in inflation target credible.
- Fiscal policy is sidelined until presidential elections. Any bi-partisan compromise right now would end up with a rather small package (USD 500-1000bn) or nothing at all.

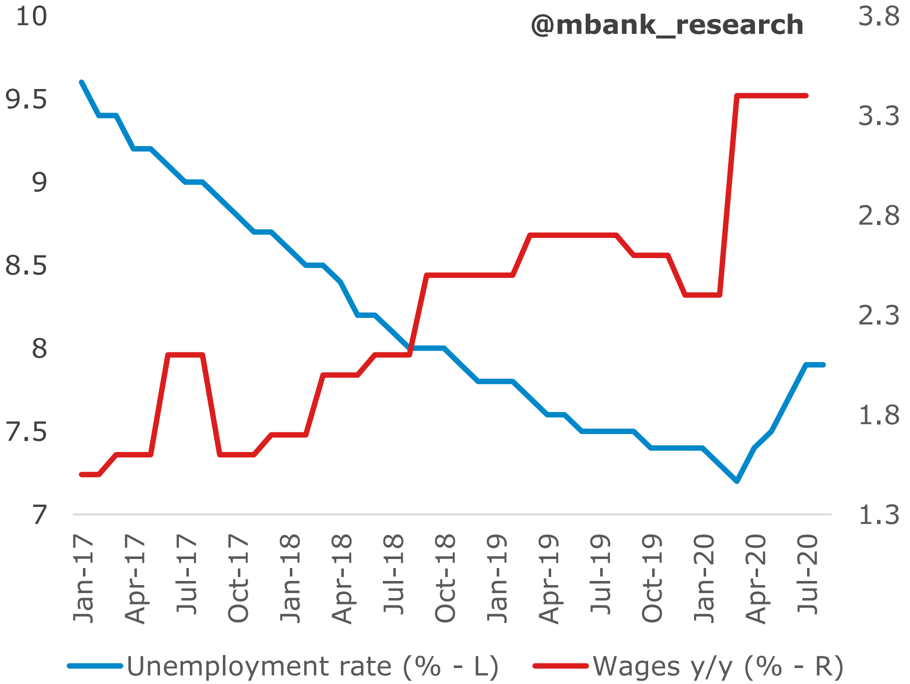
Euro area economy health check

Markit PMI: manufacturing & services



Source: Markit

Labor market: wages & unemployment rate

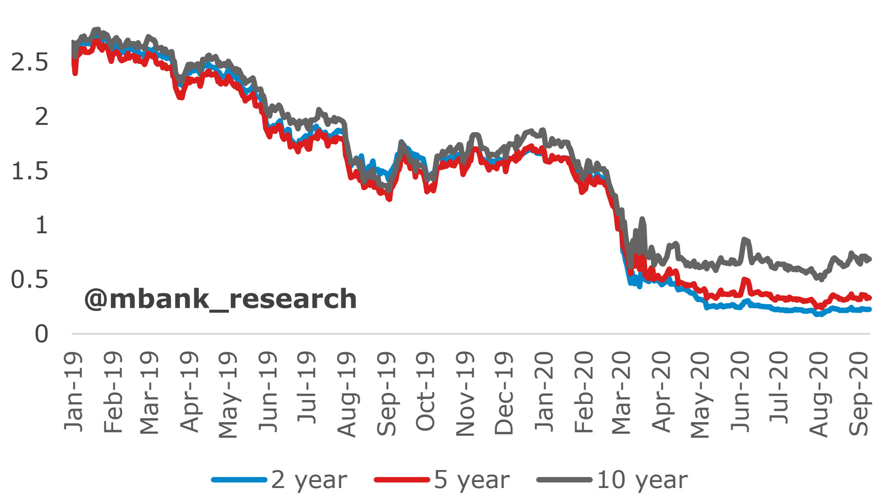


Source: Eurostat

- Almost the same story as in the U.S. Two distinctive features, though: currency is much stronger than at the start of the pandemics, second wave of infections is already unfolding in Europe. This may cripple further recovery somewhat more than in the U.S. and some negative signs are already visible in business activity indicators.
- ECB is some steps behind the Fed with respect to the monetary policy review. At the same time there is some easing fatigue visible among the rate setters. We think that further easing is warranted given expected under-delivery of inflation target, though. It is possible then the EBC will be rather forced to ease after some tightening of financing conditions.
- Times of pan-European aggressive fiscal policy are over. Some countries are preparing individual packages (e. g. France 100 bn EUR) but it is new EU perspective and NGEU package that are expected to supply economy with public investment and support.

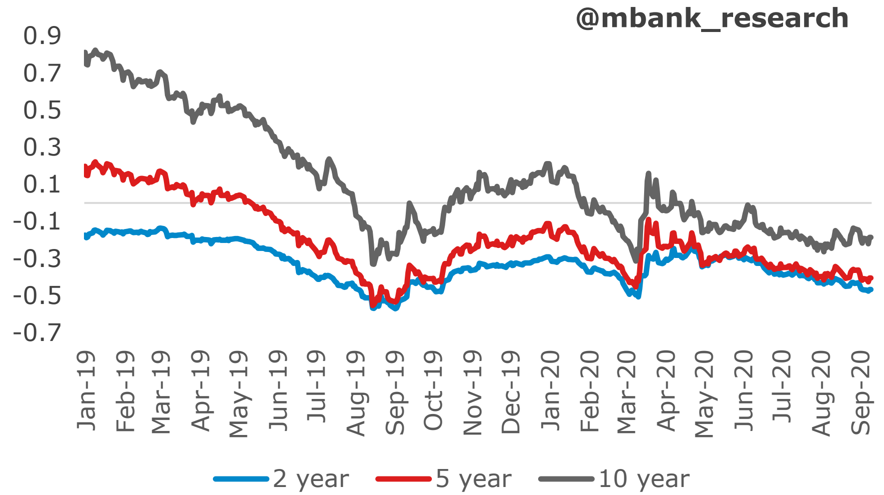
Global rates: Low for long but seeds for slow drift upwards have been sown

US swap rates (%)



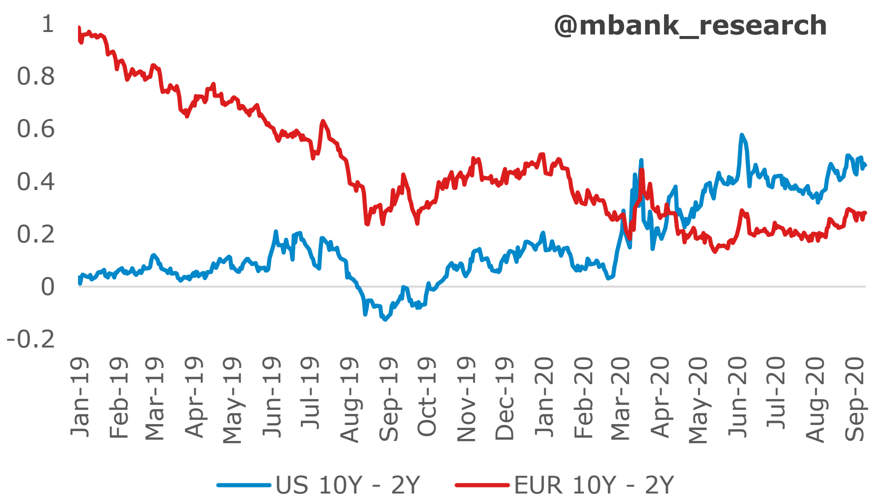
Source: Bloomberg

EU swap rates (%)



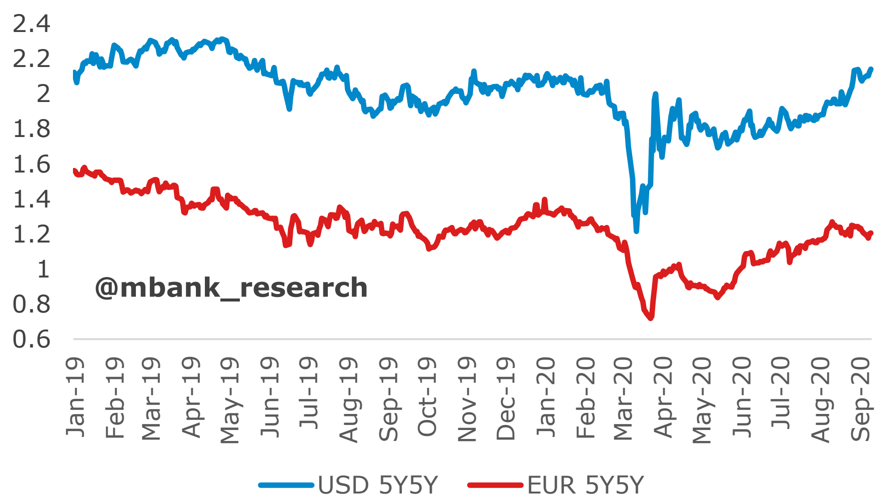
Source: Bloomberg

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



Source: Bloomberg

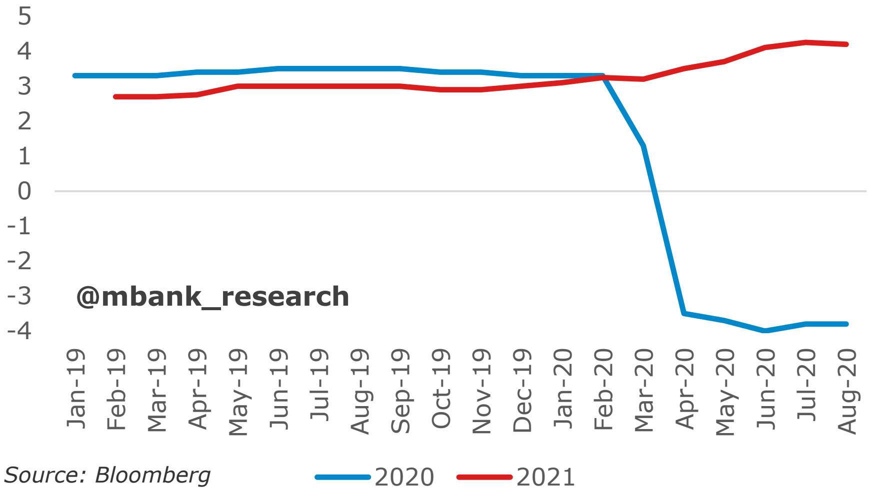
US and EZ inflation expectations (%)



Source: Bloomberg

Consensus: what is expected in Poland?

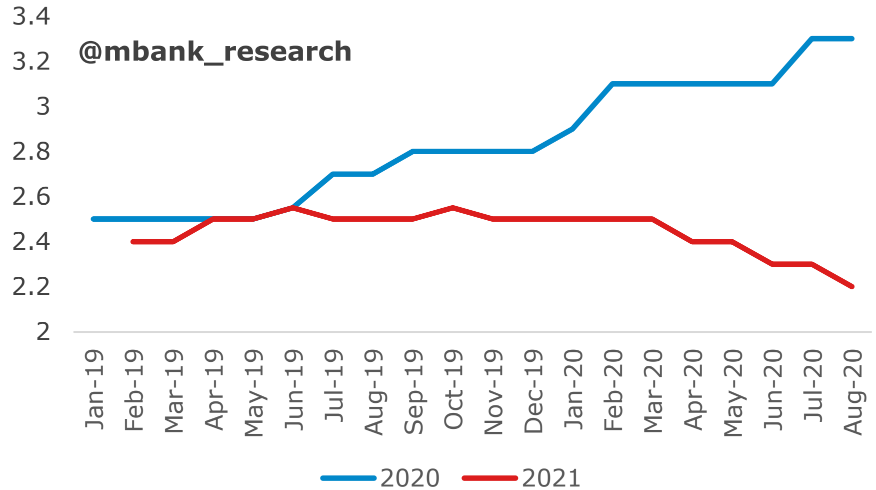
Consensus tracker: GDP growth (% y/y. annual avg)*



Source: Bloomberg

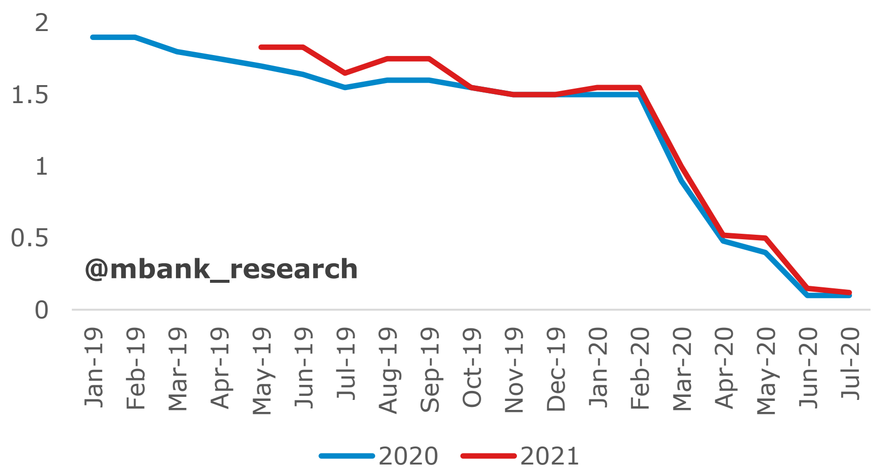
**First week of September ended with upward revisions of GDP growth for 2020. The actual consensus is hence higher than presented above.*

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



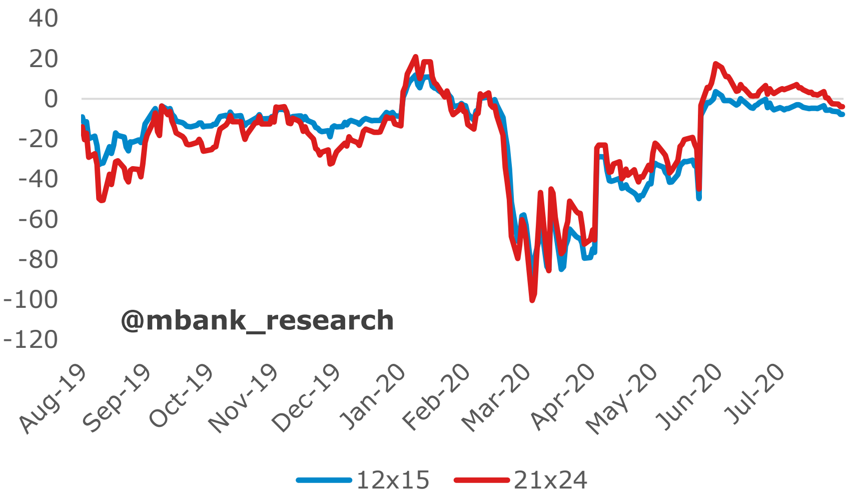
Source: Bloomberg

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



Source: Bloomberg

Rate changes priced in by FRA (bps)



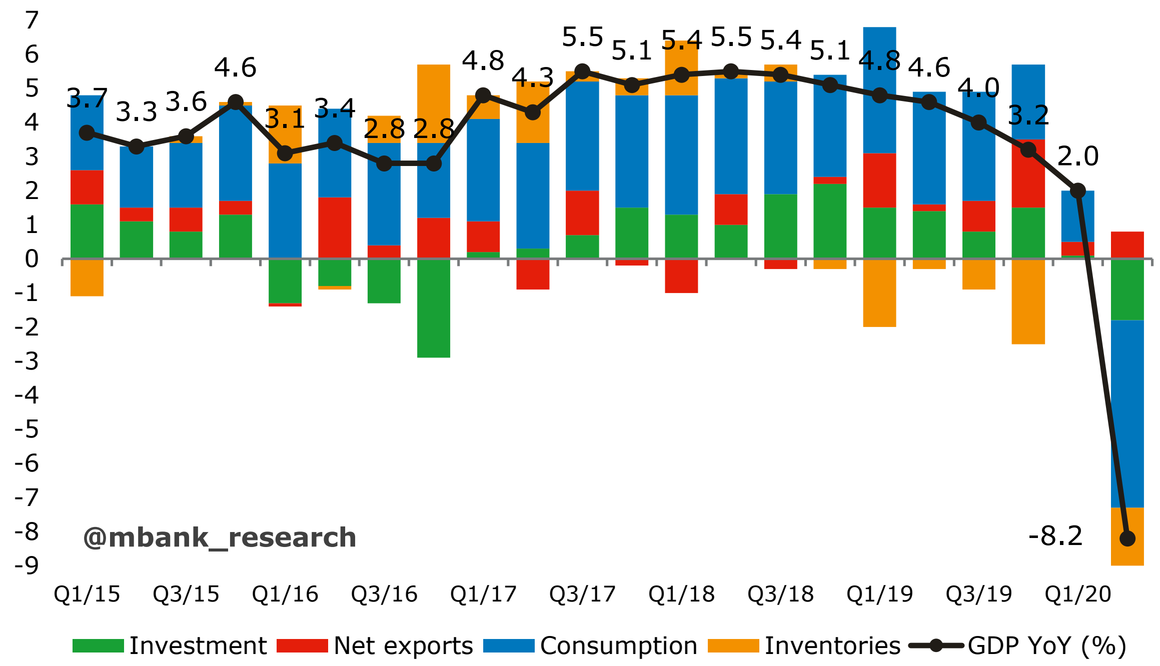
Source: Bloomberg

Upcoming Polish macro releases: September 2020

Publication	Date	Period	mBank	Consensus	Actual	Prior
CPI y/y (%)	~1.09[1] 15.09[2]	Aug	2.9%	3.0%	2.9%	3.0%
PMI (pts.)	01.09	Aug	52.0	52.7	50.6	52.8
Unemployment rate (%)	~03.09[3] 23.09[4]	Aug	6.1%	6.1%	6.1%	6.1%
Current account (m EUR)	14.09	Jul	2785	1797		2842
Employment y/y (%)	17.09	Aug	-1.2%	-1.7%		-2.3%
Wages y/y (%)	17.09	Aug	4.0%	4.0%		3.8%
Industrial output y/y (%)	18.09	Aug	3.6%	2.8%		1.1%
PPI y/y (%)	18.09	Aug	-1.2%	-0.9%		-0.6%
Retail sales y/y (%)	21.09	Aug	0.0%	2.6%		3.0%
Construction output y/y (%)	21.09	Aug	-7.8%	-9.5%		-10.9%
M3 y/y (%)	22.09	Aug	16.4%	16.3%		16.8%

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

GDP in Q2 decreased by 8.2% y/y

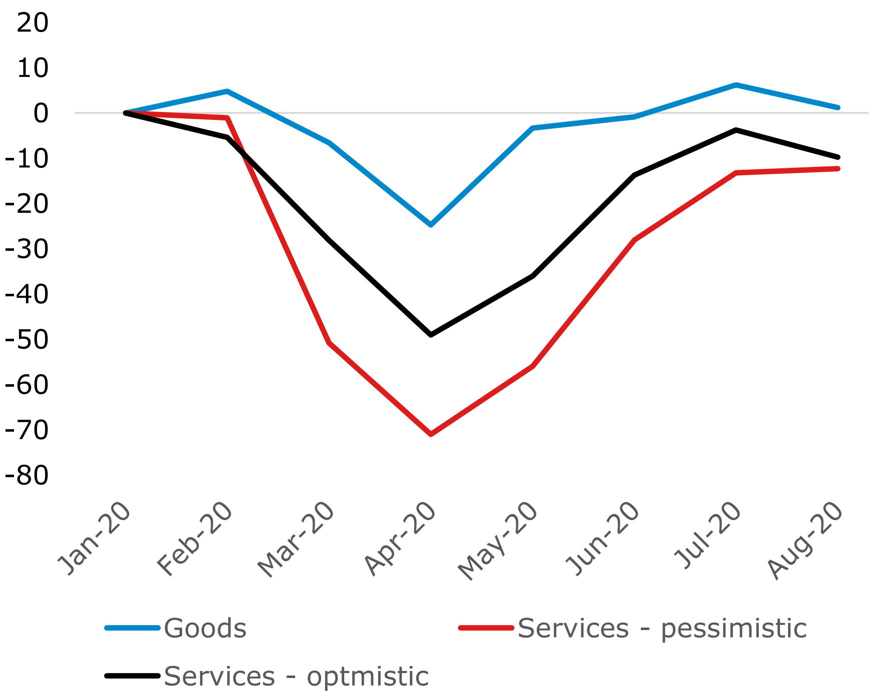


Source: Statistics Poland. own elaboration

- Polish GDP dropped in Q2 by 8.2% y/y, mostly due to lower individual consumption. The result was slightly more optimistic than consensus forecast (-9% y/y). Both consumption and investment decreased by 10.9% y/y.
- What to expect in the next quarters? Consumption should rebound quickly (as retail sales or card transactions data suggest) - we expect -2% y/y in Q3. But it will slow down in Q4 (our forecast -2.5% y/y), as consumer problems will be more visible (no significant wage growth, higher unemployment rate, end of state aid for tourism and closure of some support programmes that were available earlier).
- Contrary to what we expected beforehand, investment may have already reached a trough in Q2 2020. Afterwards it will recover (-7% y/y in both Q3 and Q4). What made us revise the forecast? Both more optimistic initial point for Q2 and monthly data on investment goods production suggest a significant improvement. The big question mark hangs over construction activity but we believe we are at or very close to the trough there too.

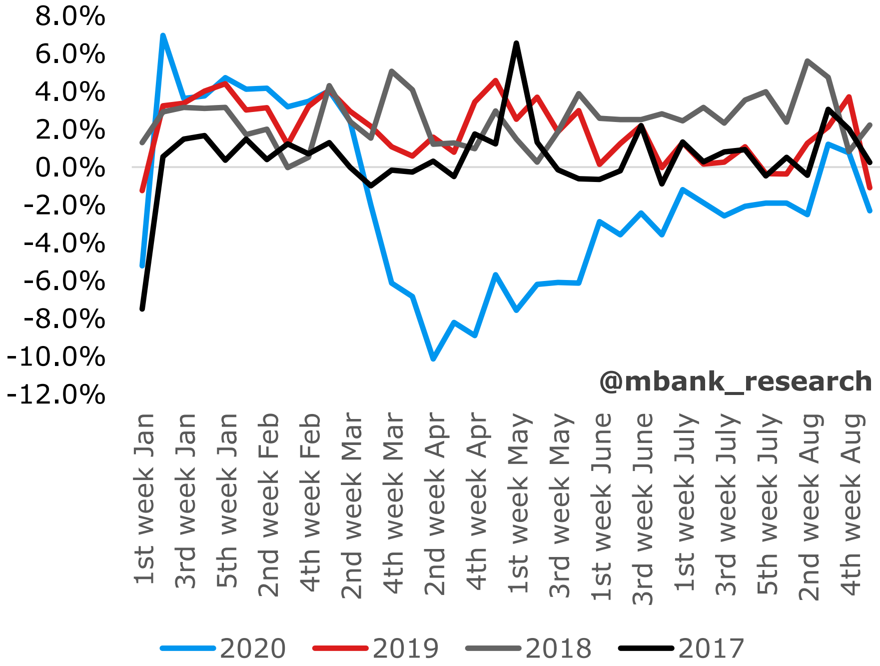
Almost there but recovery stalled.

The deviation from growth implied by 2019 in control groups of expenditures, by type.



Source: mBank transaction data. Own elaboration.

Energy consumption. Deviation from „normal".

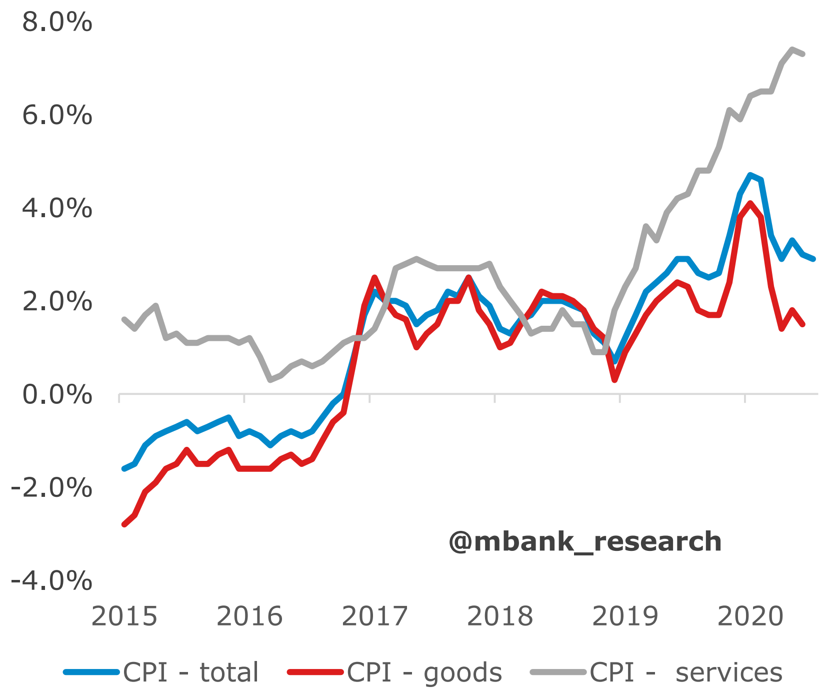


Source: electricity grid data & own elaboration

- The data on card expenditures suggest a V-shaped recovery in consumption of goods and somewhat lesser (but of similar shape) recovery in services. However, it is possible that in fact services recovered even less than implied by cards since due to corona alertness the share of non-cash transactions rose. We think it makes Q3 real consumption growth slightly below zero in annual terms. However, at the same time it seems that further progress stalled (or even reversed a bit).
- The same story is told by electricity consumption. We are almost at normal levels but volatility is high.
- All the data suggest that low hanging fruits were taken. From now on further progress will be more volatile and depends on the virus and more on the growth of disposable incomes which is getting lower and lower as easier labor market bites and slow withdrawal from fiscal support wanes.

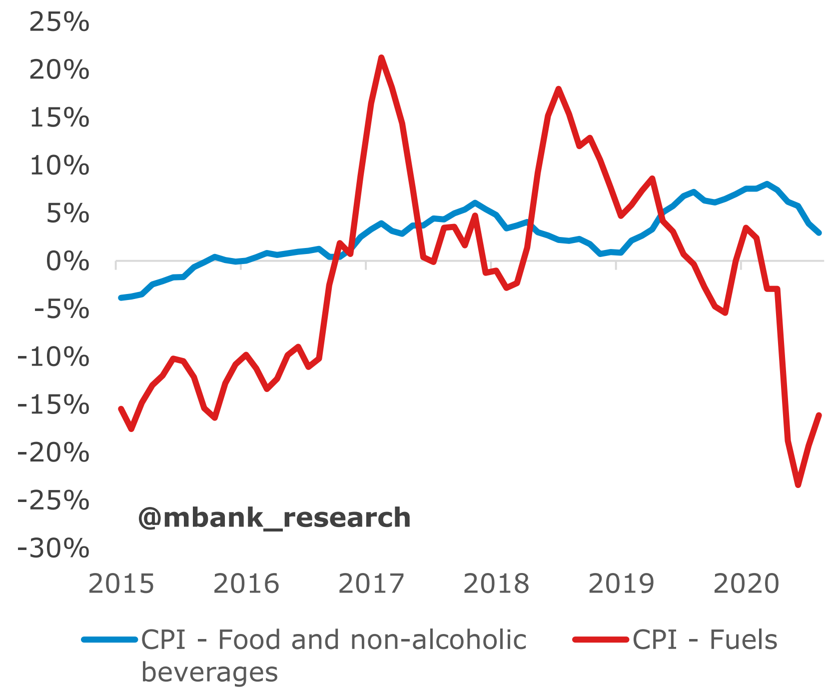
Short-term inflation tracker

Still little respite in services



Source: Statistics Poland. own elaboration

Inflation falls primarily driven by food and fuels, core inflation is slowly joining the party

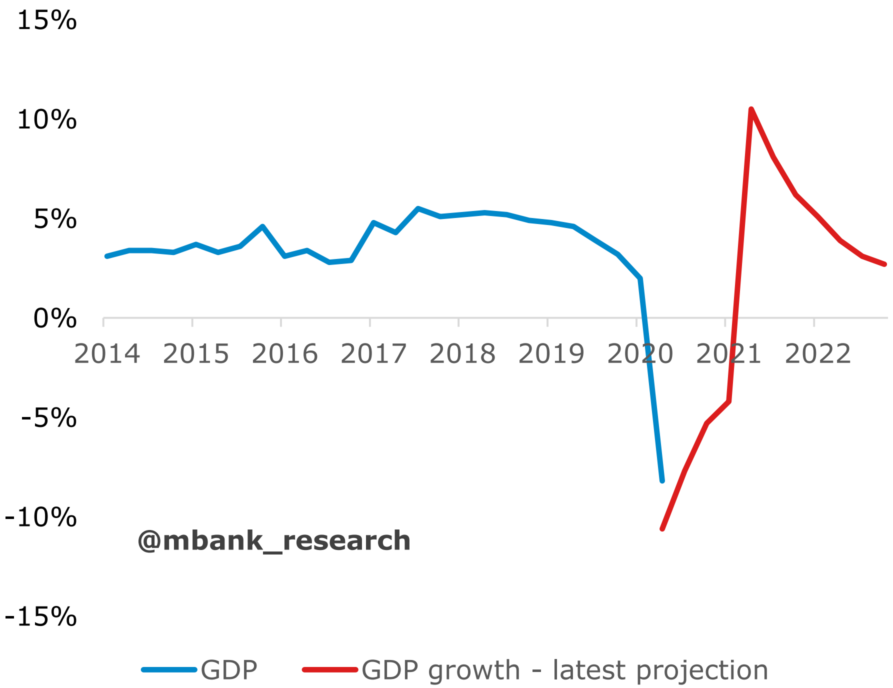


Source: Statistics Poland. own elaboration

- CPI in August slowed down to 2.9%. But more important was the decline in core inflation from 4.3% to 4-4.1% y/y. For the first time since the beginning of pandemic, yearly dynamics of core prices turned back.
- Inflation should decline in the coming months. Current growth in services prices is mostly the result of additional COVID fees (related to the sanitary regime) or tourism prices (tourism is now concentrated in the country, but this effect will decrease in the upcoming months).
- Next year inflation should be close to the lower bound (1.5%) of inflation target, due to high base and slower pace of core prices growth.

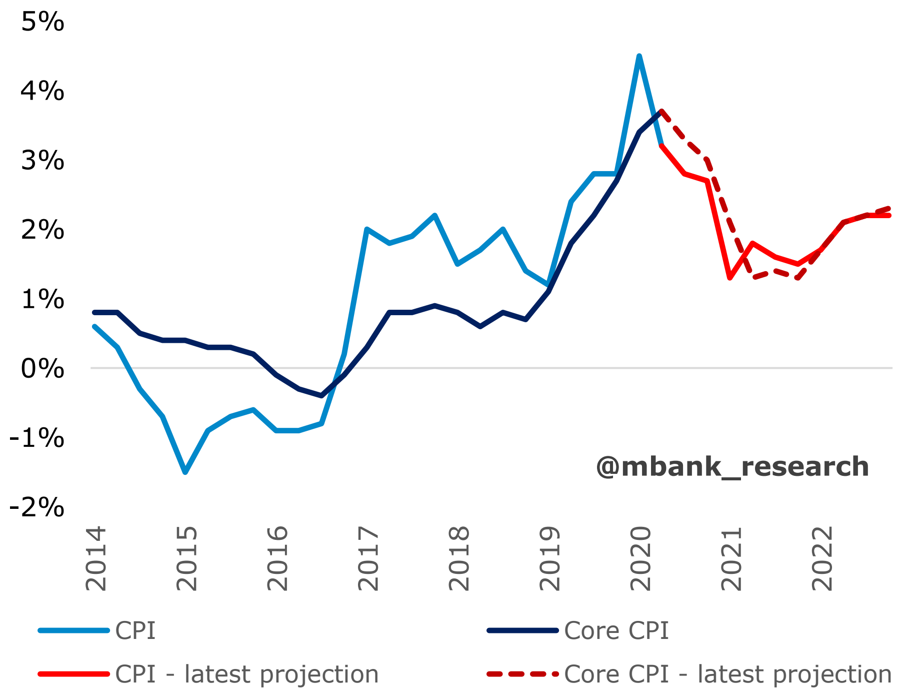
NBP projections

NBP's latest projection: GDP growth



Source: Statistics Poland. own elaboration

NBP's latest projection: inflation

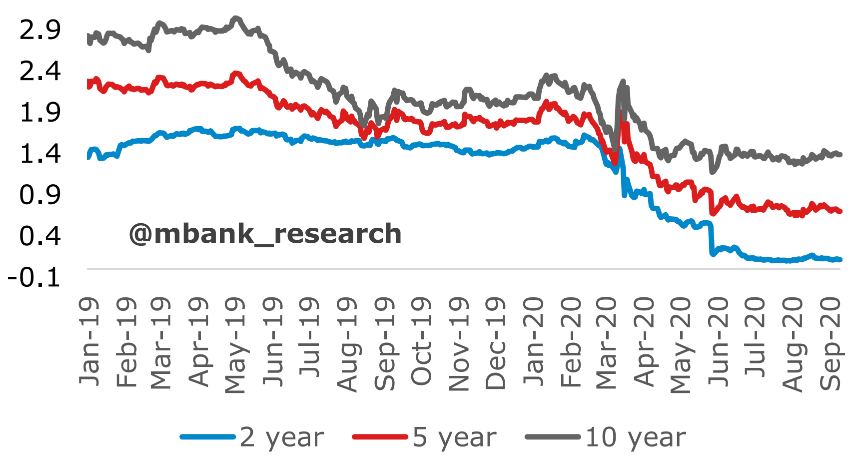


Source: Statistics Poland. own elaboration

- Latest NBP projections turned out to be overly pessimistic. NBP analysts expected the 10.6% decline of GDP in Q2 (reading: -8.2%). It should change the starting point for the whole projected path. Therefore in upcoming months the revision of NBP forecasts are highly probable.
- Such a revision could imply higher inflation paths. However, as inflation is currently forecasted not only using the raw model results, but mostly with the expert knowledge, we do not expect such a significant change in its projected path.
- GDP reading will not change the MPC's attitude. The decline of 8.2% y/y compared to projected -10% y/y will not be treated as a significant difference.

Polish rates, yields and spreads: still low, some steepening

POLGBs

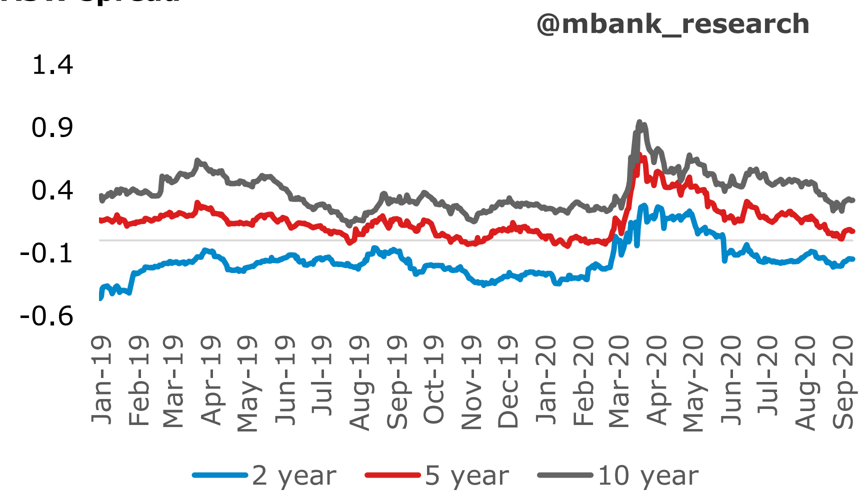


Source: Bloomberg

PL IRS

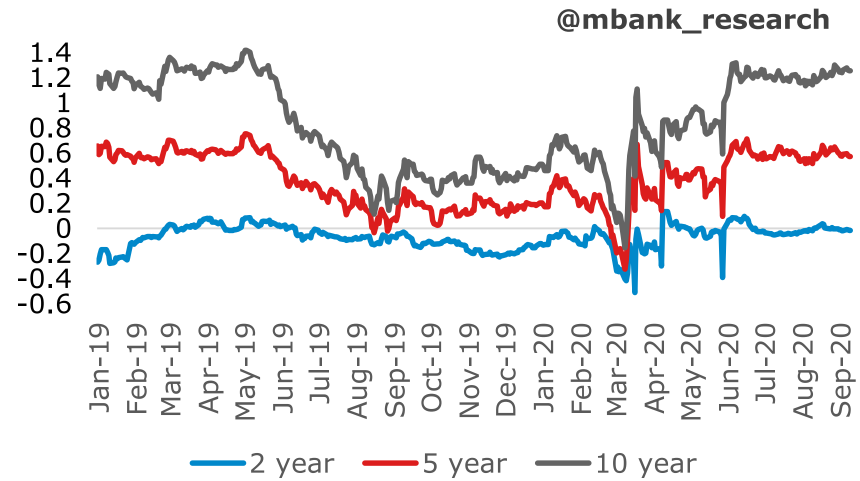
Source: Bloomberg

ASW spread



Source: Bloomberg

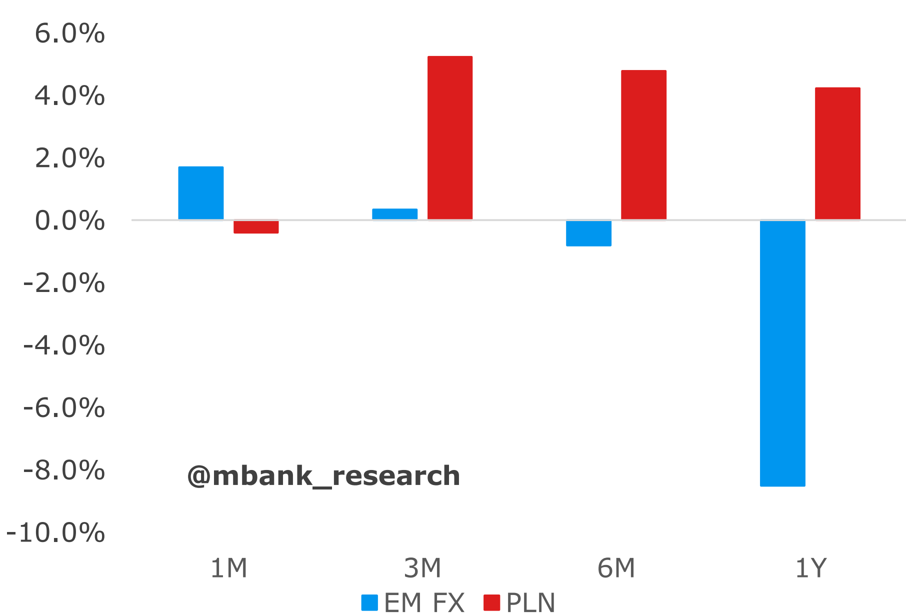
POLGB yield minus 3m WIBOR



Source: Bloomberg

PLN: the worst is over

Appreciation stalled but also no abrupt return to weaker levels visible.



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

Source: Bloomberg

Real effective exchange rate

Source: BIS

- There were no significant moves of EURPLN in August. September started with a bit weaker zloty but it was mostly due to the global risk appetite (e.g. EURCZK moved in the same manner).
- In the long-run we expect stronger zloty (we revised our EURPLN forecast for the end of 2021 to 4.20), which will be supported by good situation on the current account, recovery in the Polish economy and higher EU transfers.
- Low interest rates should not be the problem. Everyone is in the same place with the exception that PLN rate expectations may be built easier due to better growth prospects.

Appendix: Monitor of maturing bonds and bills

Treasury bonds and bills (PLN) total maturing stock (total: retail + wholesale bonds)

Maturity Date	Retail bonds (PLN mn)	T-bonds & T-bills (PLN mn)	Total (PLN mn)
09.2020	879.9	1321.0	2200.9
10.2020	660.9	8983.4	9644.3
11.2020	387.0		387.0
12.2020	364.0		364.0
01.2021	491.6	13071.8	13563.4
02.2021	508.4		508.4
03.2021	579.9	10920.3	11500.2
04.2021	619.5	20201.8	20821.3
05.2021	618.2	15801.3* 63801.3**	16419.5
06.2021	478.2		478.2
07.2021	550.0	29058.9	29609.0
08.2021	592.5		592.5
09.2021	491.1		491.1
10.2021	674.6	16181.6	16856.2
11.2021	607.9		607.9
12.2021	560.4		560.4

*Source: * According to data from the Ministry of Finance*
*** According to data from the NDS"*

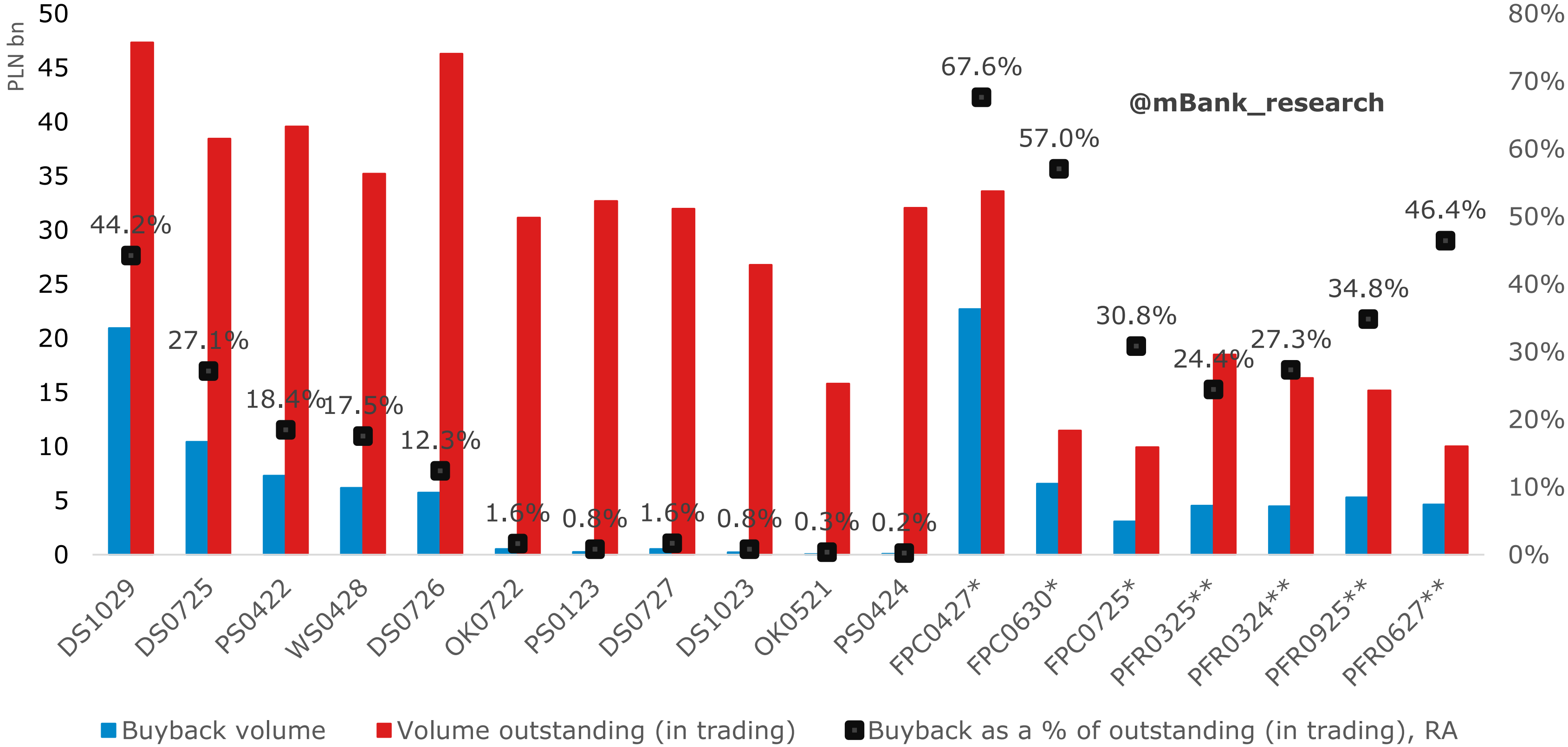
Eurobonds maturing stock

Maturity Date	EUR mn	USD mn	CHF mn	JPY mn
11.2020				10000
01.2021	200			
02.2021				50000
03.2021	2000			
04.2021		1721		
09.2021			500	
10.2021	1750			
12.2021	750			

Source: Ministry of Finance.

- The state for 10.09.2020.
- This month there will be one more MinFin auction organized (17.09.2020) and one more NBP structural operation (16.09.2020)

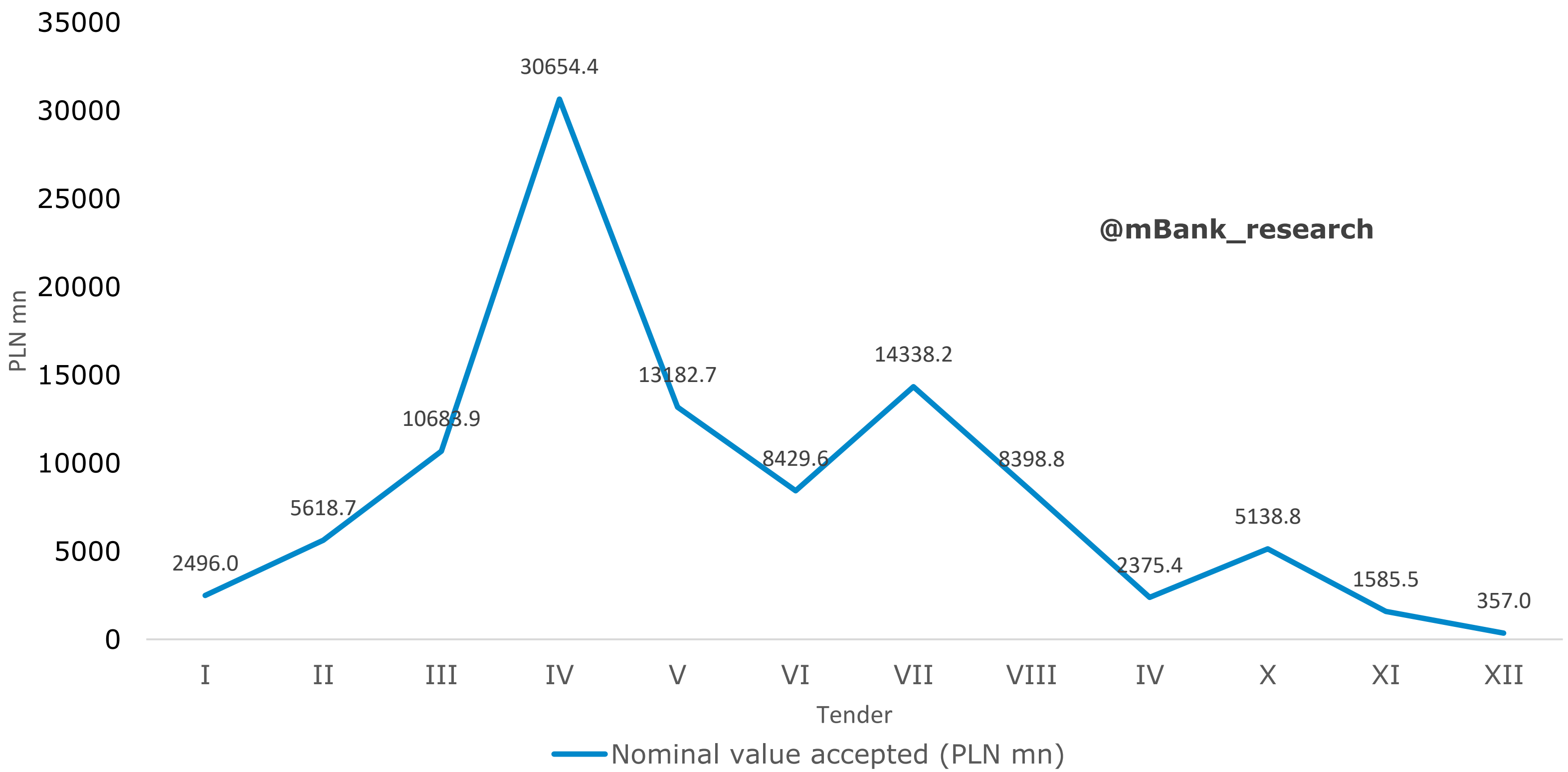
Appendix: NBP „structural" portfolio monitor



Source: Own elaboration on MF, NBP, NDS data.

- The state for 10.09.2020. We present cumulative numbers.
- NBP launched structural open market operations in March and they constitute a purely new instrument introduced to fight the crisis.
- So far NBP managed to achieve significant share in some series of government bonds (DS1029: 44.2%), BGK bonds aka „covid bonds" (up to 67.6%) and PFR bonds (up to 46.4%).

Appendix: NBP purchases, the timeline



Source: Own elaboration on NBP data.

- The state for 10.09.2020.
- Total nominal value exceeded 103.25 bn PLN. Including 32.2 bn PLN in BGK bonds aka „covid bonds” and 18.8 bn PLN in PFR bonds.

Disclaimer and contact details

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