Monthly Pulse Check

Economy. FI. FX

October 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

- Economies dug up from bottoms ignited by quarantines. Second waves of infections came, though. National lockdowns are replaced by track&trace strategy supplemented by surgical closures of some forms of mass social activity. Stricter measures will be implemented if health care systems become stretched. 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 in Q3. The scale of monetary and fiscal support is unprecedented guaranteeing still quite smooth transition towards 2021. Due to the virus resurgence, we are about to see more support in the next months.
- In Poland, we expect 3.1% recession in 2020. Turn of the year is going to be weak after strong rebound in Q3 due to high wave of new infections and possible negative reaction of consumers and firms. Fiscal policy still has firepower to build safety net under most exposed sectors. 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, though. FX channel, QE expansion, forward guidance stay on the table if need be. Negative rates unlikely. Next meeting: 4th November (with new projections).

FX Market

- Low rates suggest that the swings in PLN triggered e.g. by risk aversion may be more pronounced. 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. Near-term spikes possible due to virus resurgence and ensuing higher market volatility.

		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	4,9
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	3,0	2,9	1,9	2,4	2,6	3,0	3,4	2,5
Unemployment rate (eop)	%	5,3	6,1	6,3	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	4,53	4,40	4,35	4,30	4,25	4,20	4,40	4,20
USD/PLN (eop)	%	4,13	3,96	3,87	3,67	3,57	3,47	3,40	3,36	3,67	3,36

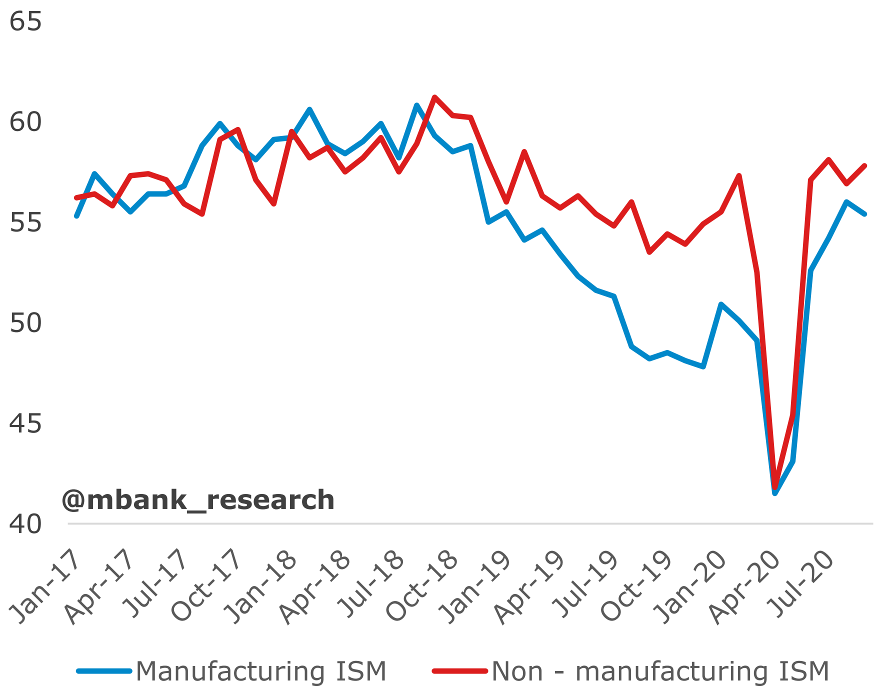
F - forecast

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, pressure from weaker labor markets and new wave of COVID-19 infections. Both central banks have much to worry about but the ECB is the one with greater miss in inflation expectations (see here) and it is euro zone economy that is more affected by the new wave of infections. Therefore we see more pressure on Christine Lagarde to act, although the Fed is still the only game in town in the absence of another fiscal package. Global rates are low but mild steepening pressure is to stay intact as greater monetary stimulus should improve expectations for the future.
- The drop of Polish GDP in Q2 was smaller than expected. Current data suggest that Q3 was much better. However, the recovery lost momentum already in September and new wave of infections poses downside risks but we do not feel compelled to change forecasts (see here and here). We shall wait until 2021 to state the economy is out of the woods.
- Inflation came off elevated levels but core measures are quite sticky. Having this developments in mind we increased our forecast for inflation in 2021 (see more here). It is still monetary policy neutral.
- Recent risks encouraged MPC to adjust its wording towards a bit more dovish. Our baseline is still for stable rates but all facilities introduced by MPC will stay in place, allowing for more fiscal leeway. Zloty depreciation will be also a welcome development. 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).
- We expect gradual appreciation of PLN due to strong fundamentals. In the short-term, given the resurgence of risks, more volatility is expected and we may see some spikes in EURPLN. NBP is unlikely to defend exchange rate in any direction for now. (see here).
- In a supplemental note, we deal with some labor market indicators. Although the worst is behind us, unemployment rate will be ticking upwards for some time as firms still adjust employment (see here and here).

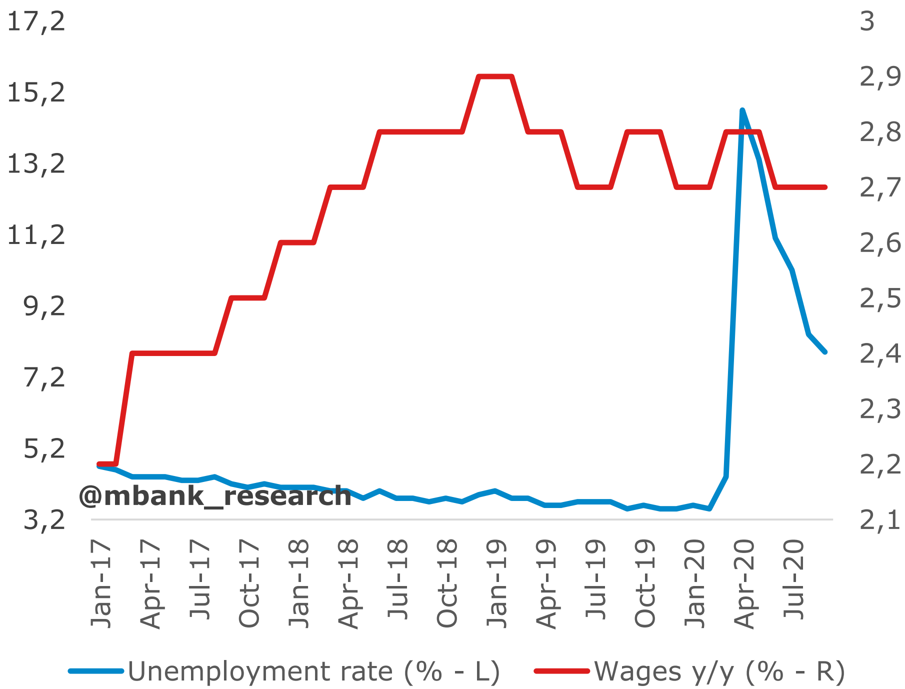
U.S. economy health check

ISM PMI: manufacturing & non-manufacturing



Source: ISM

Labor market: wages & unemployment rate

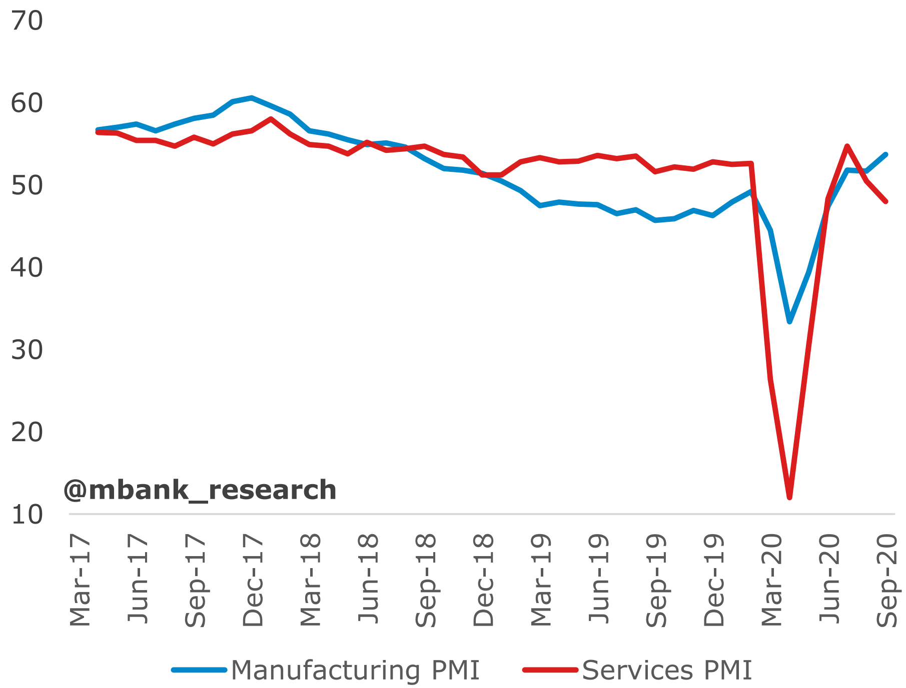


Source: FRED

- Services and manufacturing are still in fast-track recovery mode. The momentum of improvement in the economy is slowing down, though. Further recovery is still dependent on the situation with COVID-19, and prompt delivery of fiscal package.
- The stimulus package that supports consumption will most likely be announced after the presidential election. J. Biden is the favorite to win. However, Democrats are not expected to have 60 seat majority in the senate. This may cause problems with the introduction of Biden's stimulus package just after the elections in full. The package is coming, though. Every month of delay may cause more than proportional problems as labor market stays weak.
- In such circumstances, the Fed is the rescue force of first resort. After the introduction of AIT, QE programme seems to be heading the same way (to be conditioned upon economic outcomes). This is also - in our view - the most likely vehicle of delivering further stimulation, if needed.

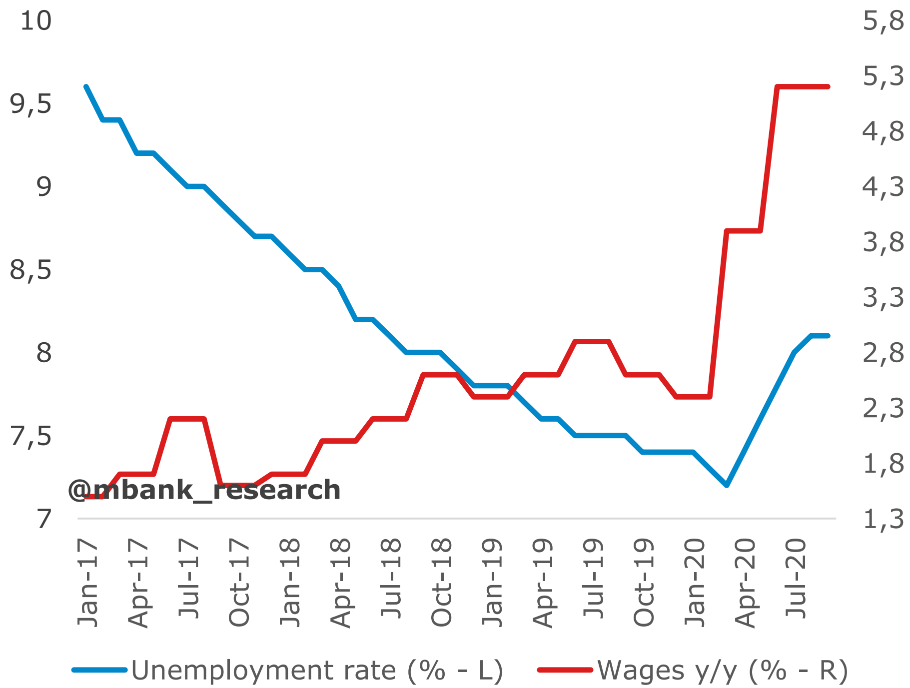
Euro area economy health check

Markit PMI: manufacturing & services



Source: Markit

Labor market: wages & unemployment rate

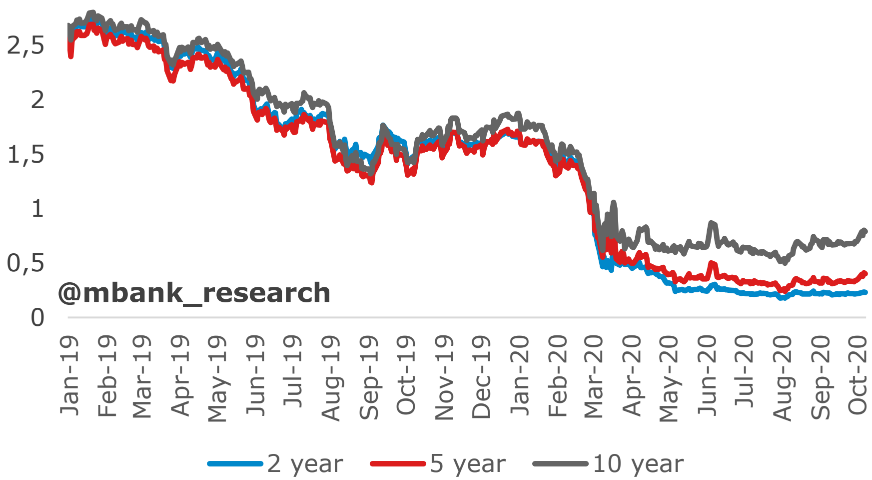


Source: Eurostat

- Negative signs are becoming clearly visible as business activity indicators for services decline. Second wave of infections continues to unfold in Europe casting shadow over expectations and crippling further recovery somewhat more than in the U.S.
- ECB officially shows little interest in additional stimulus. Rising uncertainty and second wave of infections can push ECB into action. We expect some additional easing measures in the next months (most likely PEPP, possible acceleration of changes in inflation targeting).
- The fate of NGEU package is uncertain due to haggles over rule-of-law principle attached to the disbursement of funds. However, we still expect positive solution allowing for smooth launch of the new mechanism.

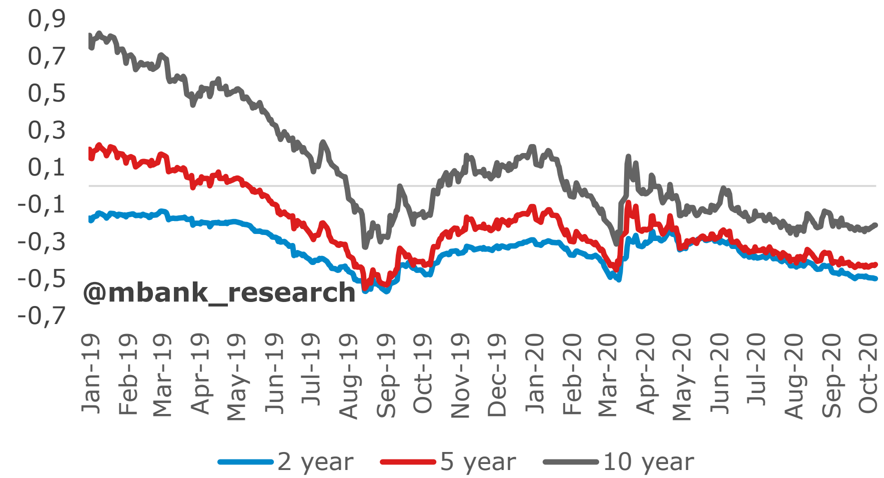
Global rates: Low for long but seeds for slow drift upwards have been sown

US swap rates (%)



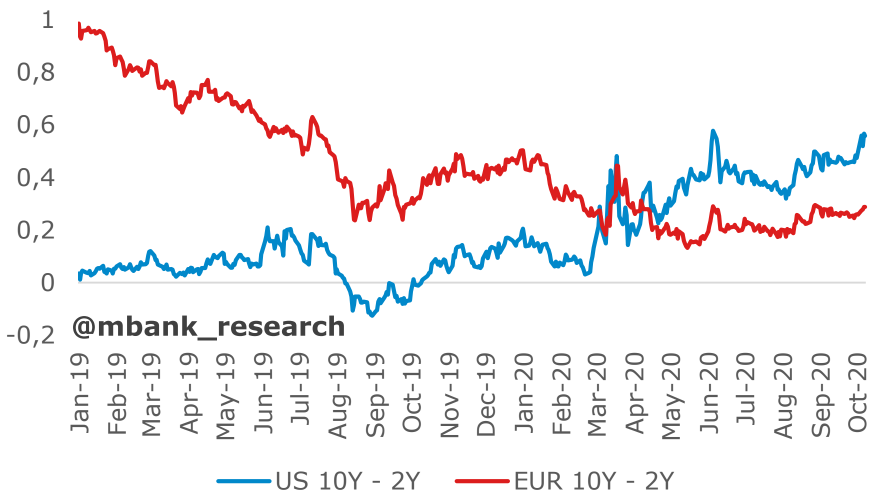
Source: Bloomberg

EU swap rates (%)



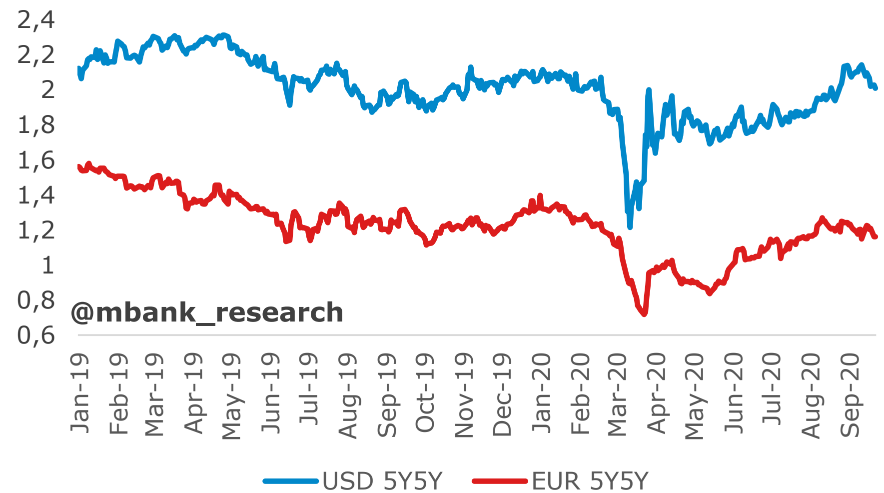
Source: Bloomberg

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



Source: Bloomberg

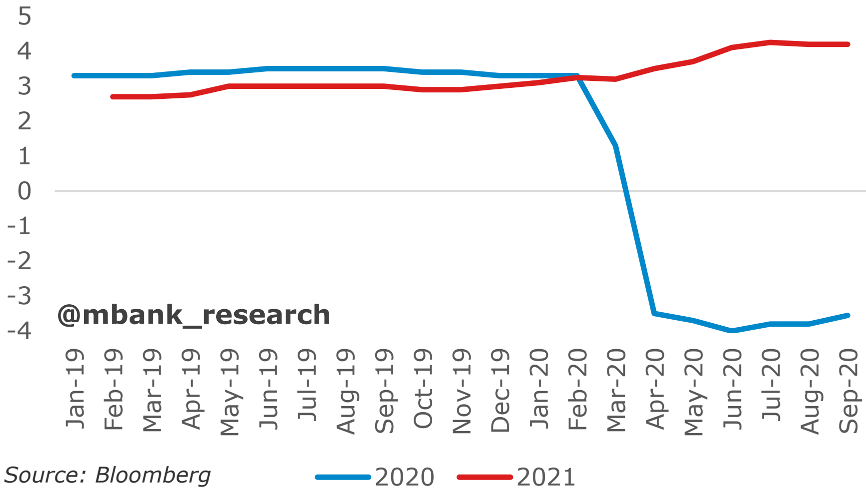
US and EZ inflation expectations (%)



Source: Bloomberg

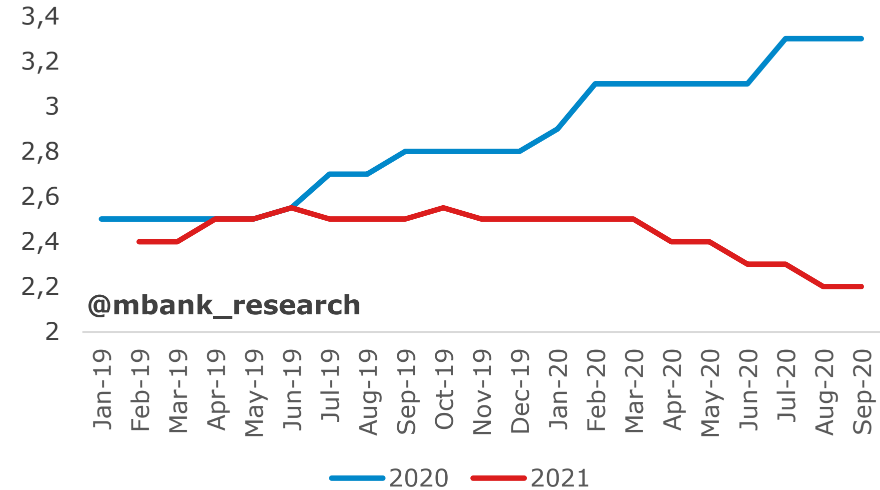
Consensus: what is expected in Poland?

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



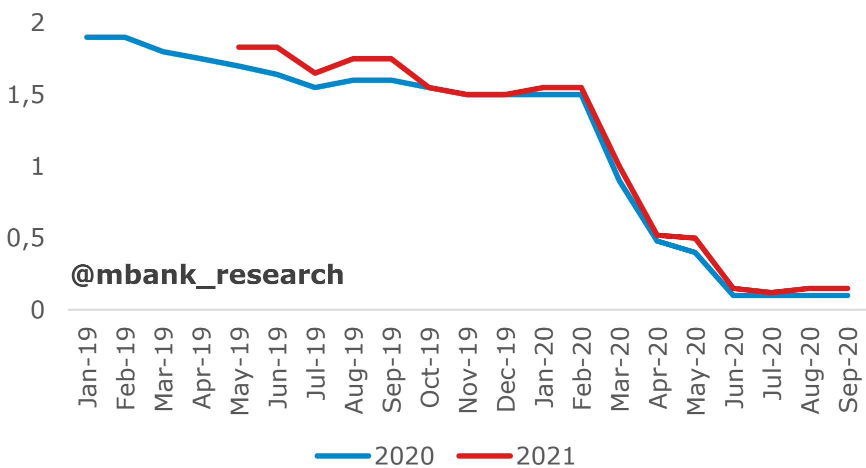
Source: Bloomberg

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



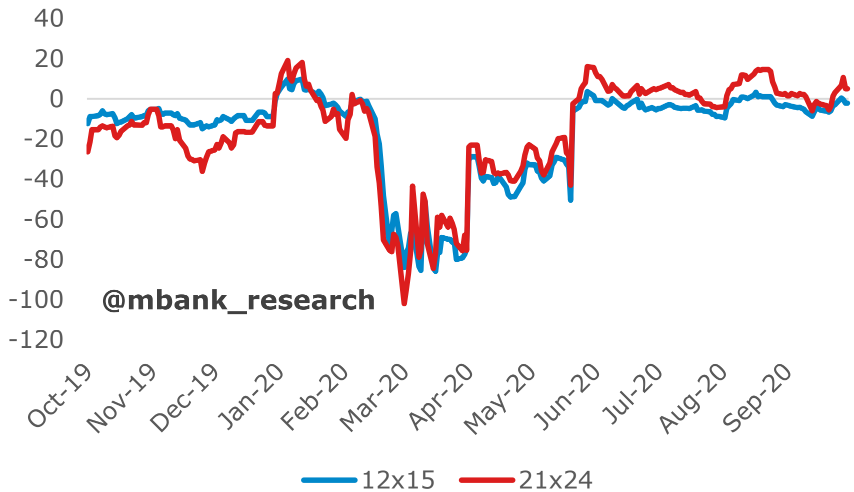
Source: Bloomberg

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



Source: Bloomberg

Rate changes priced in by FRA (bps)



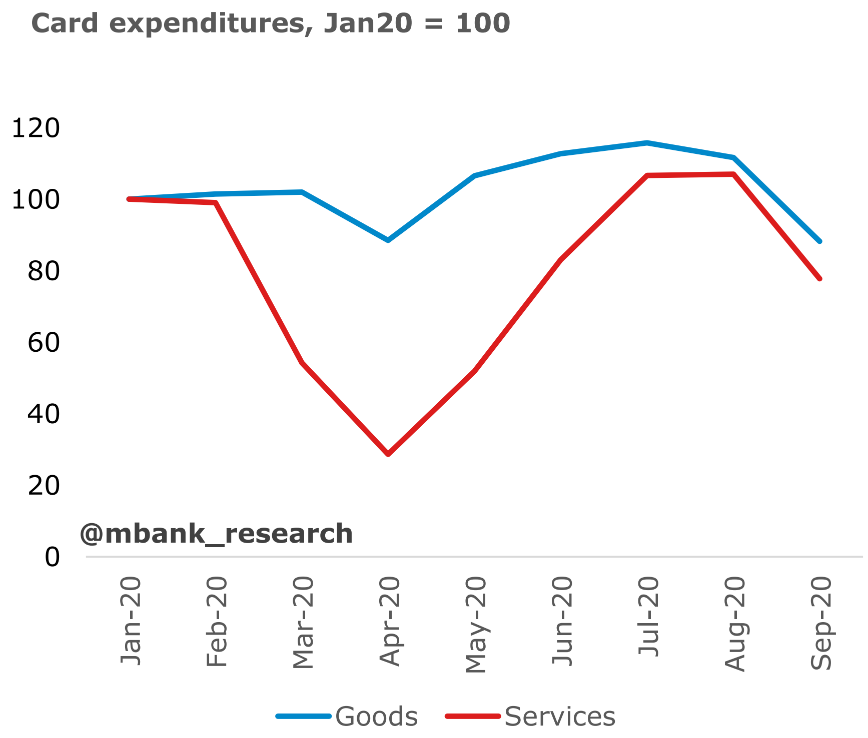
Source: Bloomberg

Upcoming Polish macro releases: October 2020

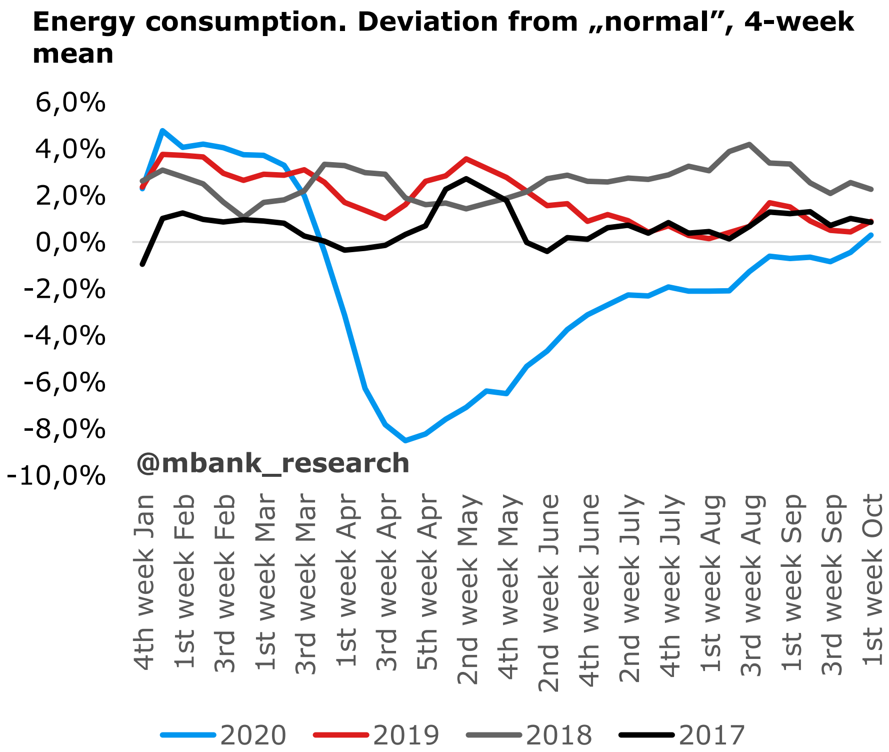
Publication	Date	Period	mBank	Consensus	Actual	Prior
CPI y/y (%)	1.10[1] 15.10[2]	Sep	3.1%	2.9%	3.2%	2.9%
PMI (pts.)	01.10	Sep	48.9	51.9	50.8	50.6
Unemployment rate (%)	05.10[3] 23.10[4]	Sep	6.3%	6.2%	6.1%	6.1%
Current account (m EUR)	14.10	Aug	1027	1200		1620
Employment y/y (%)	19.10	Sep	-1.1%	-1.1%		-1.5%
Wages y/y (%)	19.10	Sep	4.8%	4.4%		4.1%
Industrial output y/y (%)	20.10	Sep	3.7%	3.4%		1.5%
PPI y/y (%)	20.10	Sep	-1.4%	-1.4%		-1.2%
Retail sales y/y (%)	21.10	Sep	-1.5%	2.4%		0.5%
Construction output y/y (%)	21.10	Sep	-11.8%	-10.6%		-12.1%
M3 y/y (%)	22.10	Sep	16.0%	16.2%		16.2%

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

Almost there but recovery stalled (and now reverses)



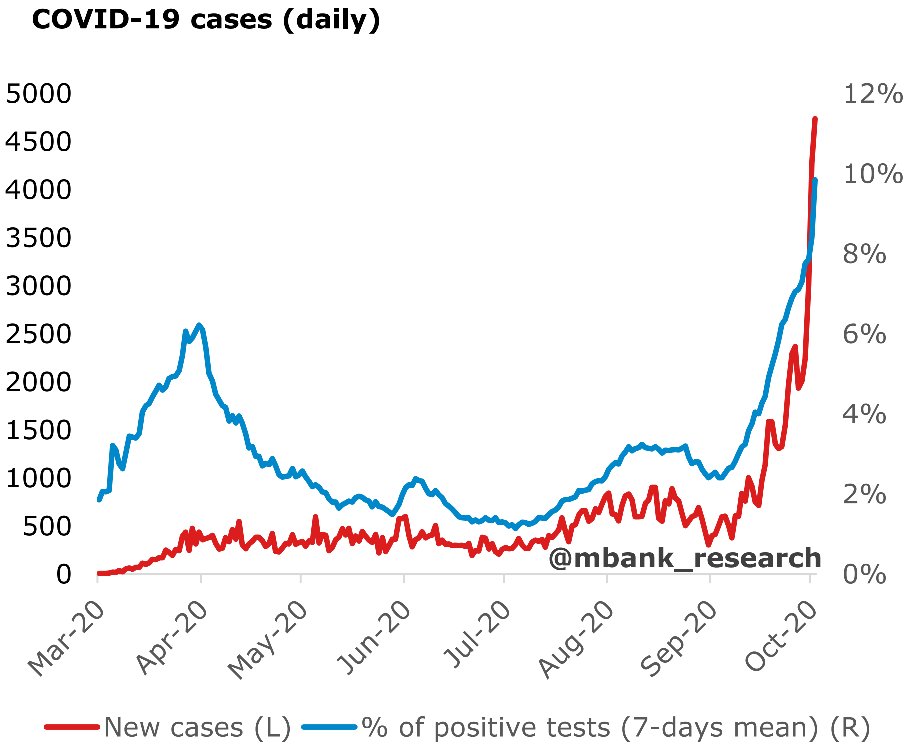
Source: mBank transaction data. Own elaboration.



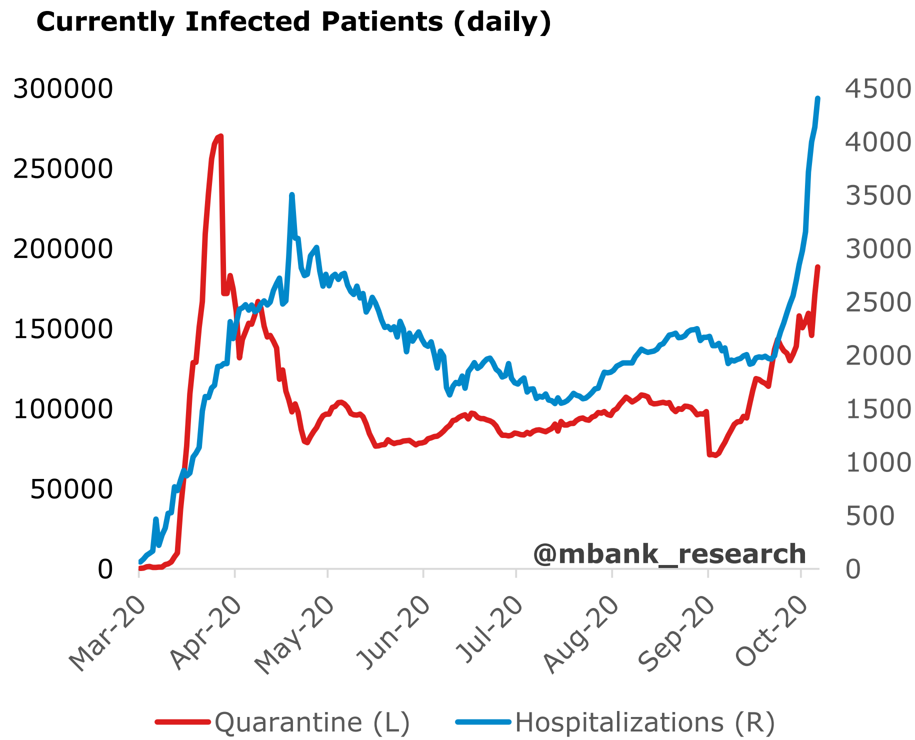
Source: electricity grid data & own elaboration

- After the rebound in Q3, consumer expenditures are turning to the downside. Electricity consumption is holding well, reflecting mostly better performance of manufacturing sector (pan-European phenomenon).
- As the number of infections is rising (see here), we are expecting to see more consumer retrenchment with possible minor distortions in the industry as well.
- The risks connected with second wave of infections were already (to some extent) put into our forecasts, we keep -3.1% GDP forecast for 2020 intact as we see some signs that Q3 performance should be given an upside risk assessment. This way upside risks for Q3 and downside for Q4 cancel each other out. We are carefully monitoring incoming data though and will correct forecasts promptly.

COVID-19 cases



Source: Own elaboration based on Ministry of Health and medonet.pl data

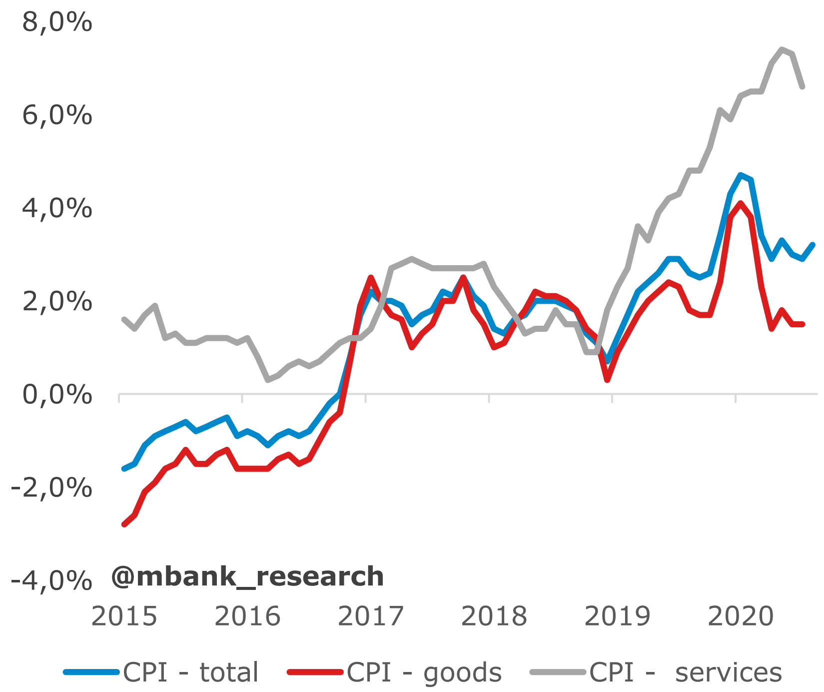


Source: Own elaboration based on Ministry of Health and medonet.pl data

- The number of positive COVID cases significantly increased in the last days. Both new cases and hospitalizations are above numbers we saw during the first wave.
- The government introduced the so called yellow zone in the whole country. Wearing masks outside the buildings is obligatory. There are some restrictions concerning number of participants in gathering and events.
- Some regions are classified as red zones –the rules there are more strict (lower limits, restaurants and bars must be closed at 10 pm).
- We do not see a large, direct economic effects so far. We take into account mostly indirect effects connected with weaker optimism among consumers and firms. We are far from the effects from Spring when full lockdown was introduced. The situation is dynamic and demands close monitoring, though. Any signs that health system gets overburdened will be followed by stricter restrictions with more pronounced economic effects.

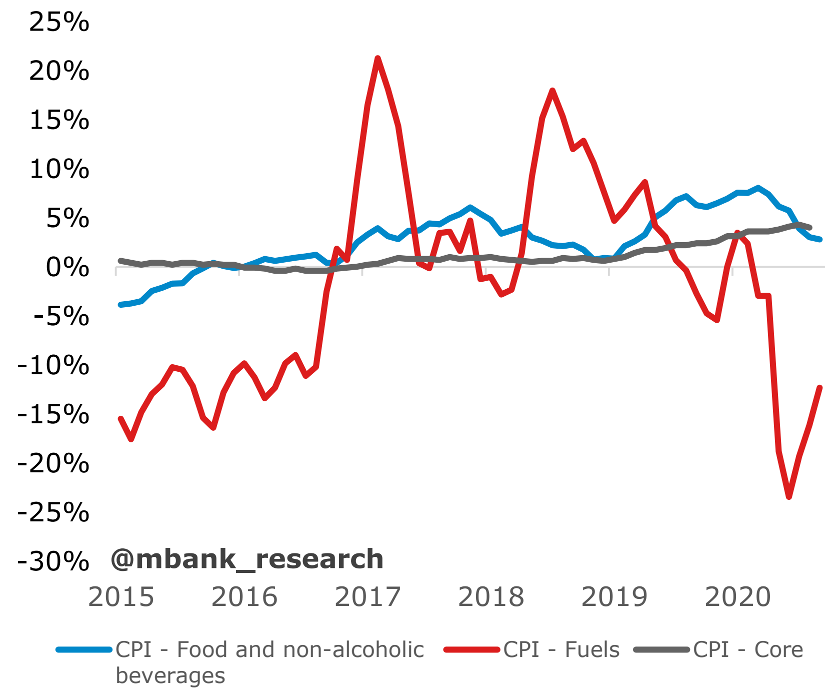
Short-term inflation tracker

Still little respite in services



Source: Statistics Poland. own elaboration

Inflation falls primarily driven by food and fuels, core inflation high and stable…

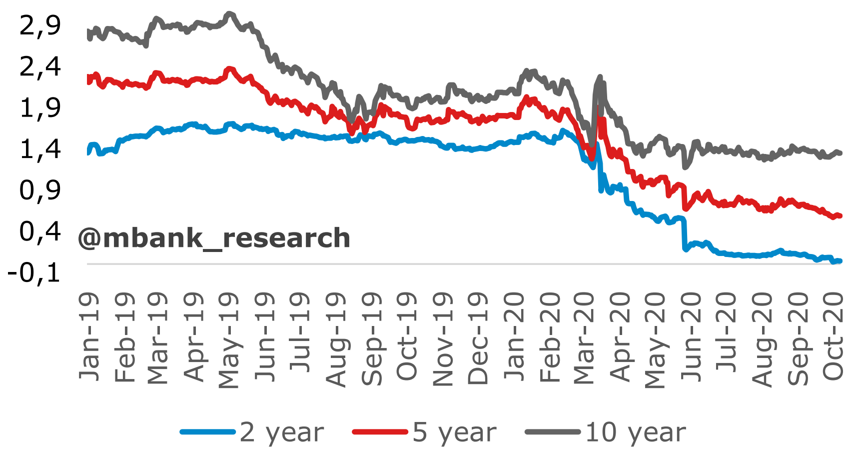


Source: Statistics Poland. own elaboration

- September unexpectedly brought back inflation to 3.2% (flash). As the details are not published yet, we speculate that it was mostly driven by volatile, one-off factors. Having said that it is worth to note that the move lower in core inflation is frustratingly slow.
- We still think inflation should decline in the coming months. However, resurgence of the virus speaks in favor of another price add-ons, especially in services enjoying non-elastic demand. The drop in economic activity was also smaller than expected due to quite fast recovery in Q3. All in all core inflation has potential to drop in coming months but not as substantial as we originally thought.
- Therefore next year inflation should be close to inflation target. It does not change perspectives for monetary policy, though. The behavior of inflation in H2 2021 is of utmost importance though as it will cast additional light on the prospects of monetary tightening starting form late 2022 (our baseline). We bet on substantial re-acceleration (not market baseline now).

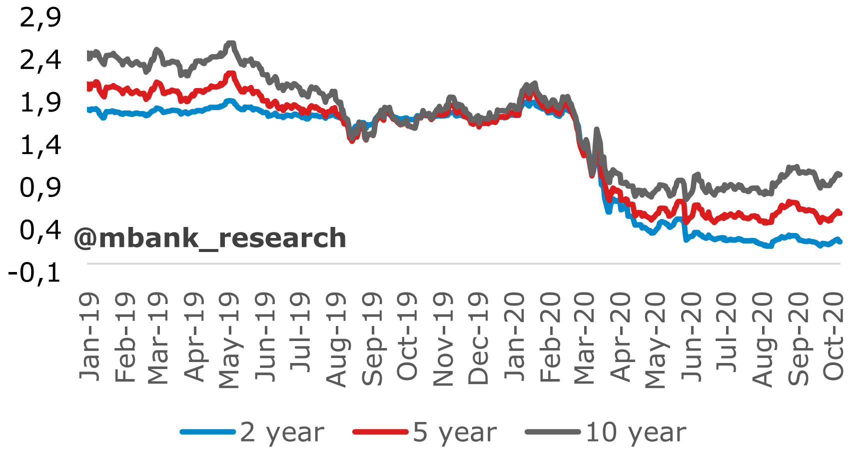
Polish rates, yields and spreads: still low, some steepening

POLGBs



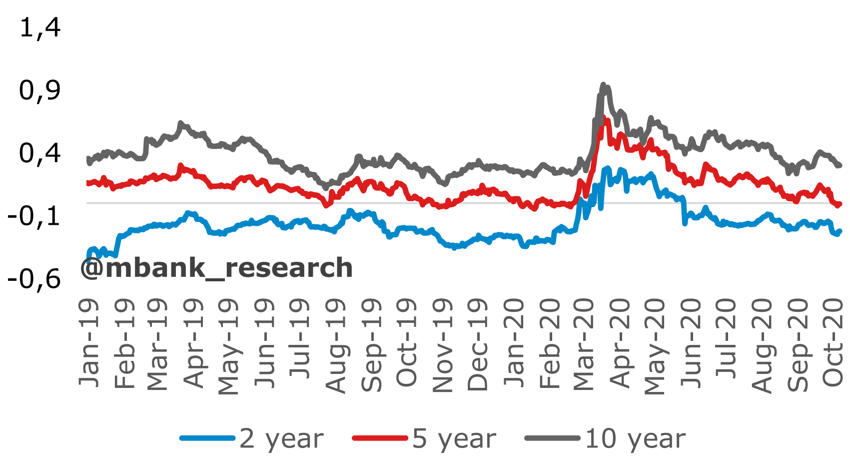
Source: Bloomberg

PL IRS



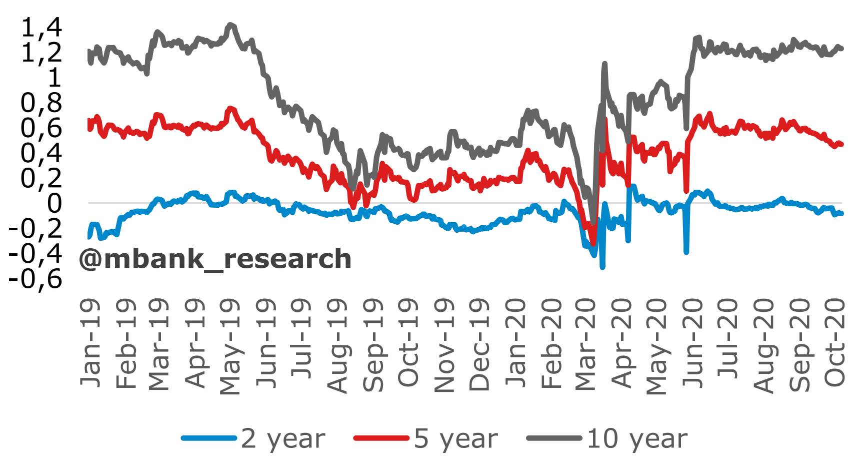
Source: Bloomberg

ASW spread



Source: Bloomberg

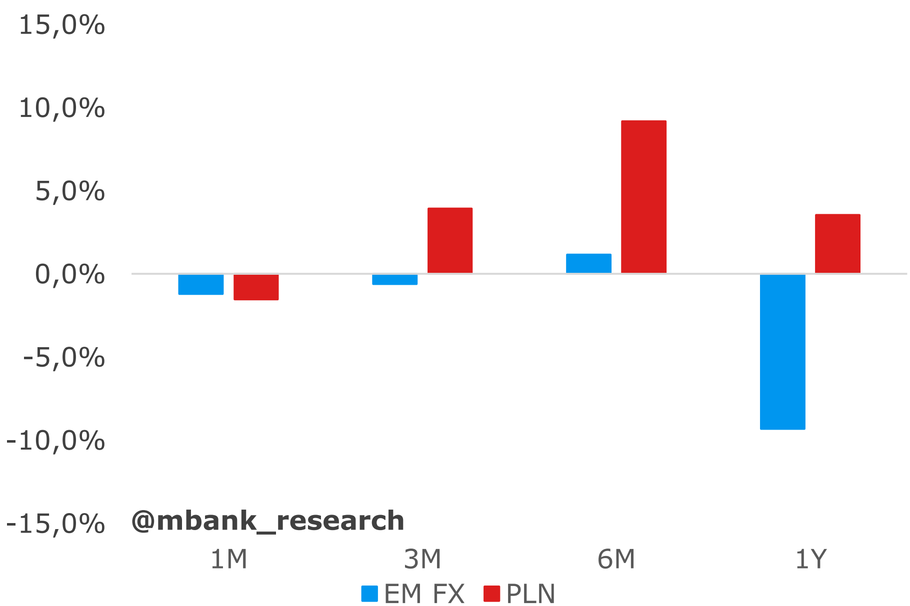
POLGB yield minus 3m WIBOR



Source: Bloomberg

PLN: the worst is over but spikes still possible due to increased uncertainty

Depreciation



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

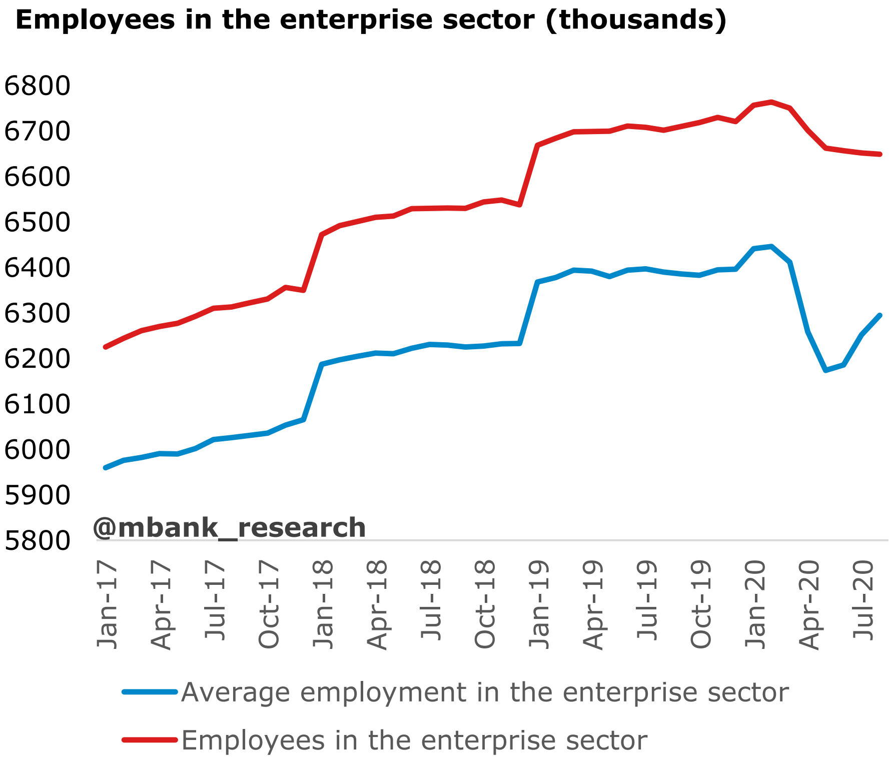
Source: Bloomberg

Real effective exchange rate

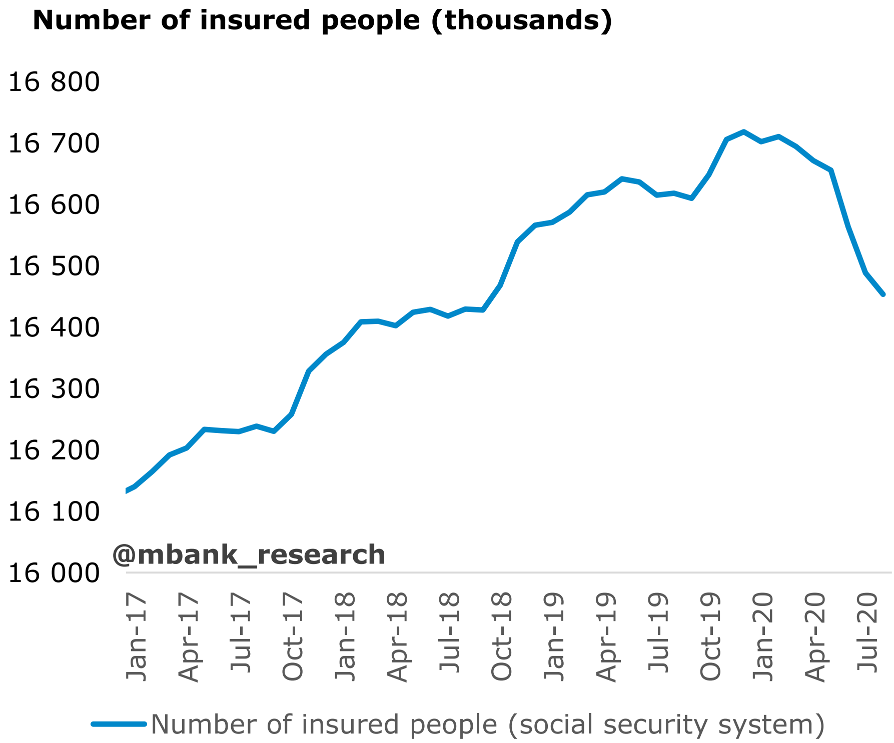
Source: BIS

- September was a month of weaker zloty. But other exchange rates in the region behaved the same – it was the result of global risk-off.
- In the long-run we expect stronger zloty (our EURPLN forecast for the end of 2021 is 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.
- MPC still claims that the pace of the current economic recovery could also be limited by the lack of visible and more durable zloty exchange rate adjustment. We do not expect that it is a signal of possible interventions (in both directions).

Additional note on labor market #1



Source: Statistics Poland

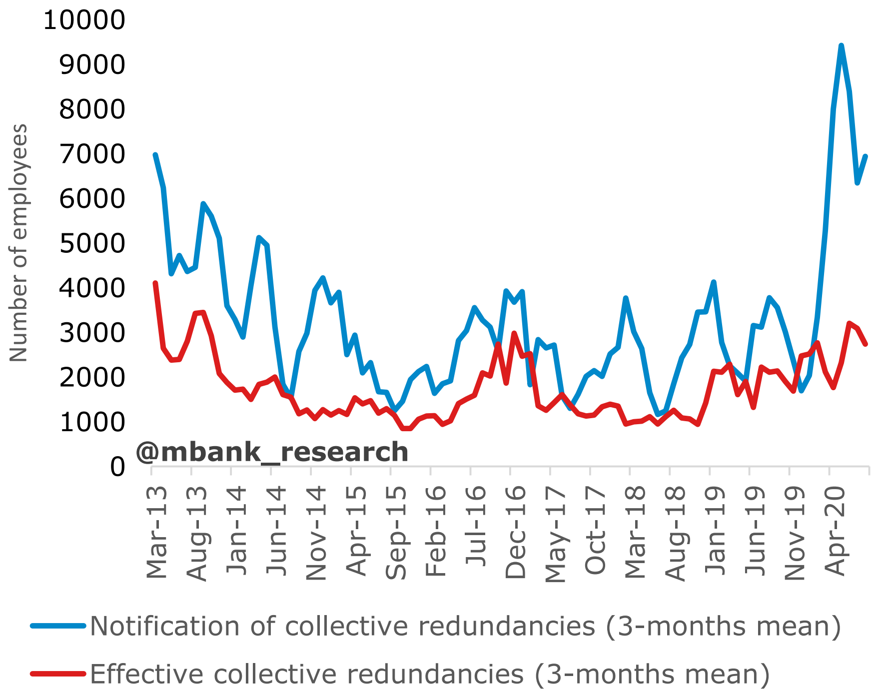


Source: Social Insurance Institution

- The pace of decline in employment in the enterprise sector has slowed down significantly. Average employment – on the other hand – improved. The latter most likely shows a return from part-time to full-time jobs. But the data on the number of the insured in the social security system are less optimistic. These data cover a wider group of people, specifically those not included in the data on employees in the enterprise sector. For example, self-employed or working in small businesses. Despite the drop in the number of insured persons, the unemployment rate remains unchanged. The change of status from „working" to „inactive" is one of the possible explanations here.
- Perhaps, and it is not completely separate explanation to the one above, it is the effect of layoffs of people who received retirement benefits while working (it is legally possible up to certain thresholds of income). After their dismissal, these people do not increase the number of registered unemployed.

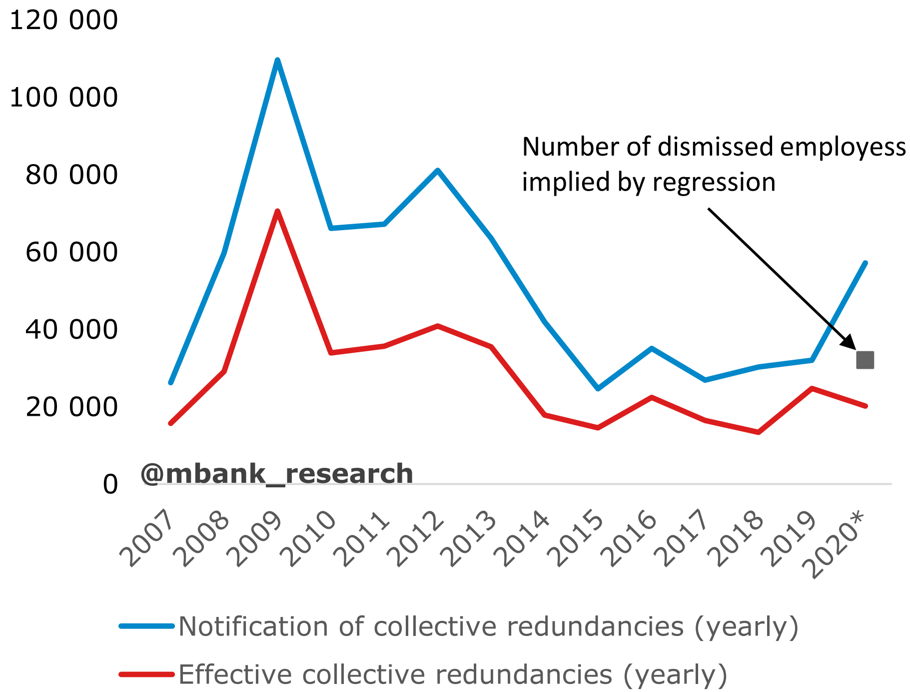
Additional note on labor market #2

Number of employees notified for collective redundancies and actually dismissed



Source: own elaboration based on the labor office data

Collective redundancies (yearly)



* Data for January – August period

Source: own elaboration based on the labor office data

- The number of employees notified for collective redundancies in August hit long standing records. It was even higher than in the pandemic peak in April (11.3k employees in August vs 10.9k in April). Notifications are not directly reflected in the number of workers actually dismissed (it is just a legal requirement), but they can be treated as a signal of future redundancies.
- Collective redundancies data showed historically a stable relationship between notifications and employees actually dismissed in the same year. Number of dismissed workers was systematically lower than notifications, but they moved in the same direction (see RHS graph). Therefore we think that current number of reported effective redundancies is too low. There is more to come. The grey square reflects our estimate consistent with past relations.
- This may be a signal that we will see further declines in employment in the following months. Current level of unemployment rate will move higher and 7% forecast for the end of the year is still valid.

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)
10.2020	660.9	7628.5	8289.4
11.2020	387.0		387.0
12.2020	364.0		364.0
01.2021	491.6	12196.4	12688.0
02.2021	508.4		508.4
03.2021	579.9	10920.3	11500.2
04.2021	619.5	18505.8	19125.3
05.2021	618.2	15090.78* 63090.78**	15709.0
06.2021	478.2		478.2
07.2021	550.0	27451.5	28001.5
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"*

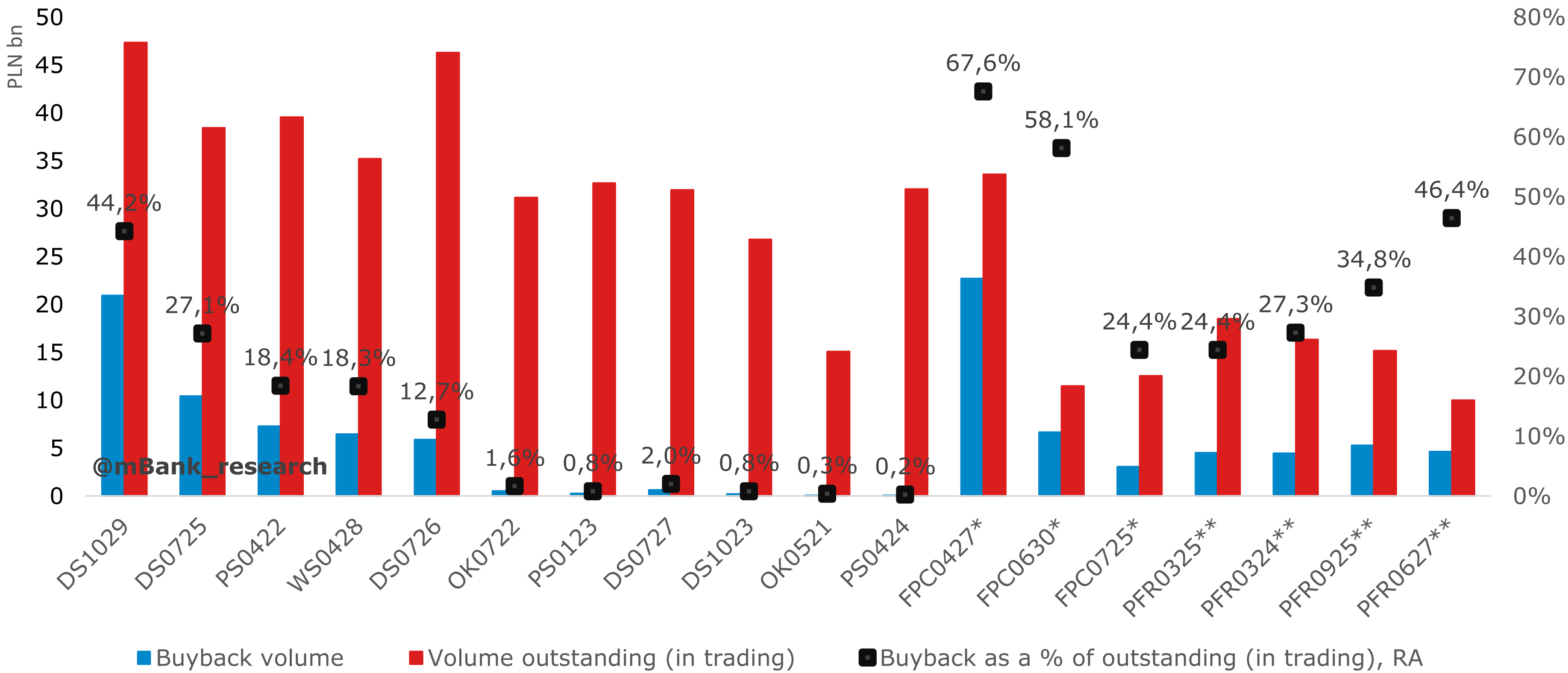
Eurobonds maturing stock

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 08.10.2020.
- This month there will be one more MinFin auction organized (22.10.2020) and one more NBP structural operation (14.10.2020)

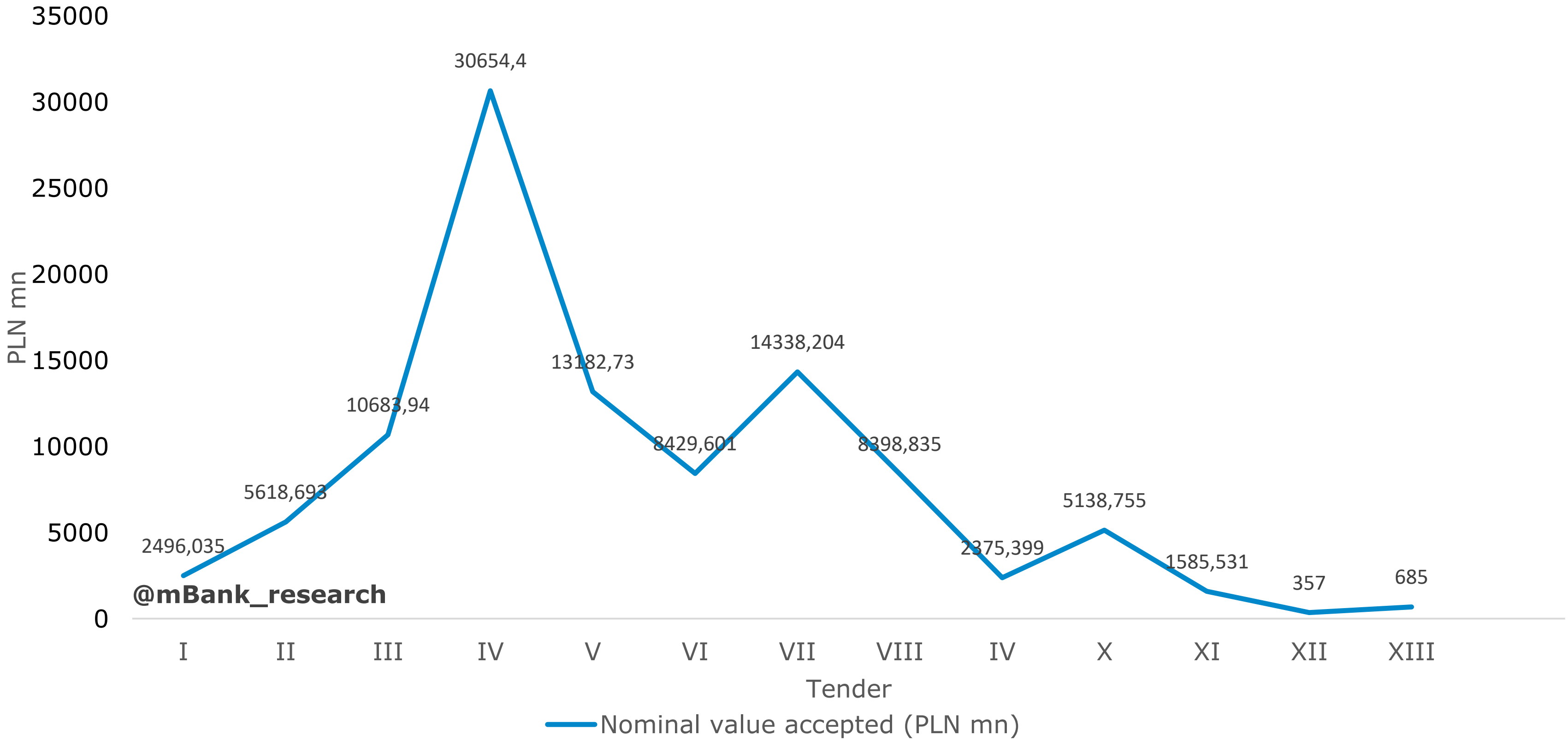
Appendix: NBP „structural" portfolio monitor



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

- The state for 08.10.2020. 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 08.10.2020.
- Total nominal value exceeded 103.9 bn PLN. Including 32.4 bn PLN in BGK bonds aka „covid bonds" and 18.8 bn PLN in PFR bonds.

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