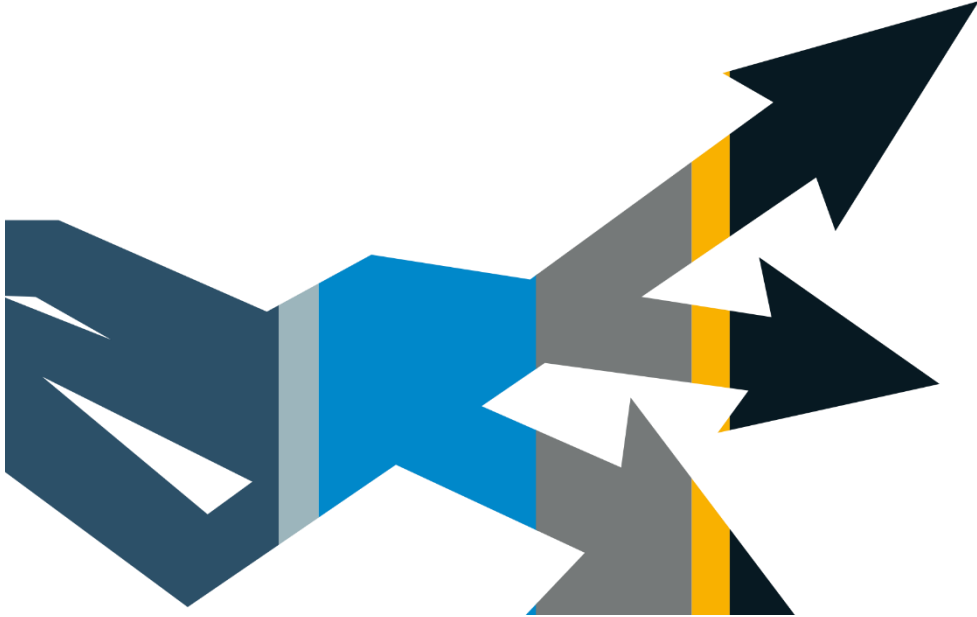


Monthly Pulse Check

Economy, FI, FX

March 5th 2020



mBank Research

For contact details and classification of the report see the [last page](#).



Our view in a nutshell ($\geq 1Y$ horizon) & major forecasts

Macro

- ❖ Until mid-January, global manufacturing had been recovering as trade tensions had receded and negative shocks faded. The coronavirus outbreak has, however, hit Chinese economy hard (reducing economic activity by $\sim 50\%$ in February). The full impact on global growth, while to a large extent temporary, is highly uncertain. Global economy is set to remain in doldrums for now but ultimately growth will reemerge, buoyed by monetary policy and also – upcoming fiscal measures.
- ❖ Polish economy is slowing. 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. No change here (so far). We are still below NBP projections and market consensus.

Monetary policy: Fed, ECB, NBP

- ❖ Fed: U.S. outlook is clouded and worse than one warranting stable rates. Fed has already done an emergency cut. We expect more easing as economy struggles with the global and domestic fallout from coronavirus.
- ❖ ECB: Expected to join the global effort to ease monetary policy. We do not expect much beyond targeted lending measures. QE and small deposit rate cut to be treated as emergency measures (to be implemented in severe stress).
- ❖ NBP: MPC pursues stable monetary policy, although risks are tilted to the downside. Rate hikes are definitely off the agenda.

FX Market

- ❖ 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. Currency proved to be stable even in a recent period of higher market volatility. A fierce battle-test was in place and PLN passed it.

		2019	2019	2019	2019	2020	2020	2020	2020
		Q1	Q2	Q3	Q4 F	Q1 F	Q2 F	Q3 F	Q4 F
GDP y/y	%	4.8	4.6	3.9	3.2	2.9	2.6	2.8	3.1
Individual consumption y/y	%	3.9	4.4	3.9	3.3	3.3	3.0	3.0	2.8
Public Consumption y/y	%	6.3	3.1	4.7	3.1	3.0	3.0	3.0	3.0
Investment y/y	%	12.2	9.1	4.7	4.9	-5.0	-5.0	-3.0	2.0
Inflation rate (average)	%	1.2	2.4	2.8	2.8	4.2	3.7	3.2	3.2
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	1.5	1.50	1.50	1.50	1.50
EUR/PLN (eop)	%	4.30	4.24	4.37	4.3	4.35	4.35	4.35	4.40
USD/PLN (eop)	%	3.84	3.73	4.01	3.8	3.88	3.85	3.82	3.83

F - forecast

Upcoming macro releases: March 2020

Publication	Date	Period	mBank	Consensus	Actual	Prior
PMI (pts.)	02.03	Feb	47.6	47.8	48.2	47.4
Unemployment rate (%)	05.03 ^[3] 24.03 ^[4]	Feb	5.5	5.5	5.5 ^[3]	5.5
CPI y/y (%)	13.03 ^[2]	Feb	4.6	4.4		4.4
Current account (mln EUR)	16.03	Jan	2683	2563		990
Employment y/y (%)	18.03	Feb	0.9	1.1		1.1
Wages y/y (%)	18.03	Feb	6.8	6.9		7.1
Industrial output y/y (%)	19.03	Feb	0.8	2.0		1.1
PPI y/y (%)	19.01	Feb	0.1	0.3		0.8
Construction output y/y (%)	20.03	Feb	2.7	0.9		6.5
Retail Sales y/y (%)	20.03	Feb	3	4.1		3.4
M3 y/y (%)	23.03	Feb	8.7	9.0		9.3

[1] Flash estimate

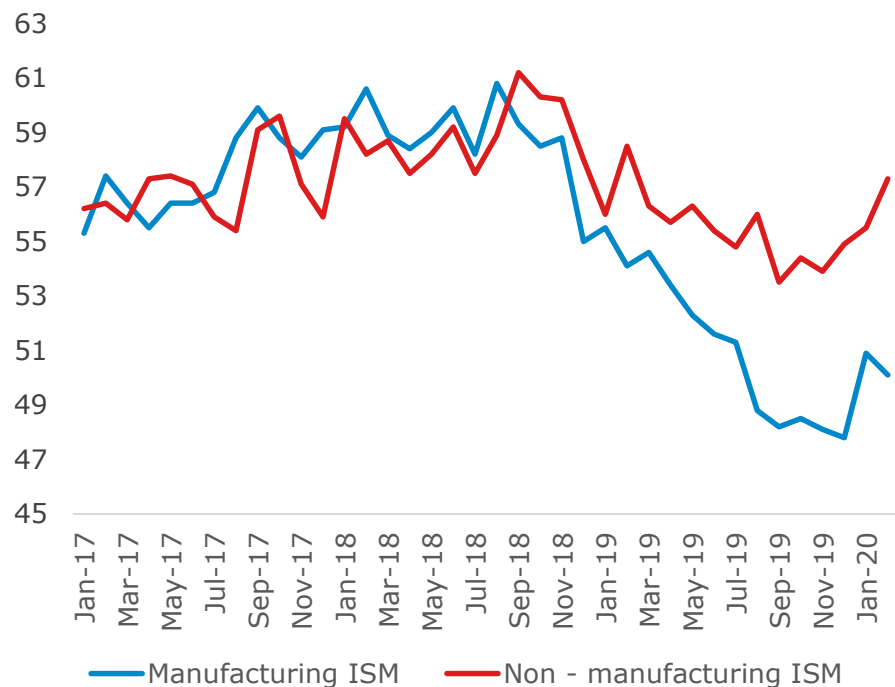
[3] Ministry of Family, Labour and Social Policy estimate

[2] Final reading

[4] Statistics Poland final reading

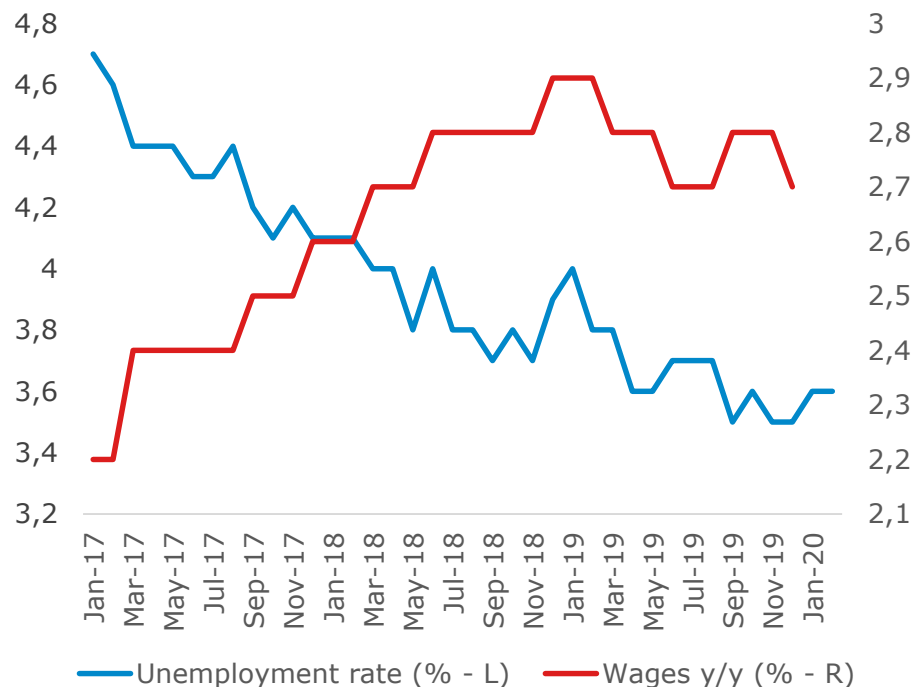
U.S. economy health check

ISM PMI: manufacturing & non-manufacturing



Source: ISM

Labor market: wages & unemployment rate

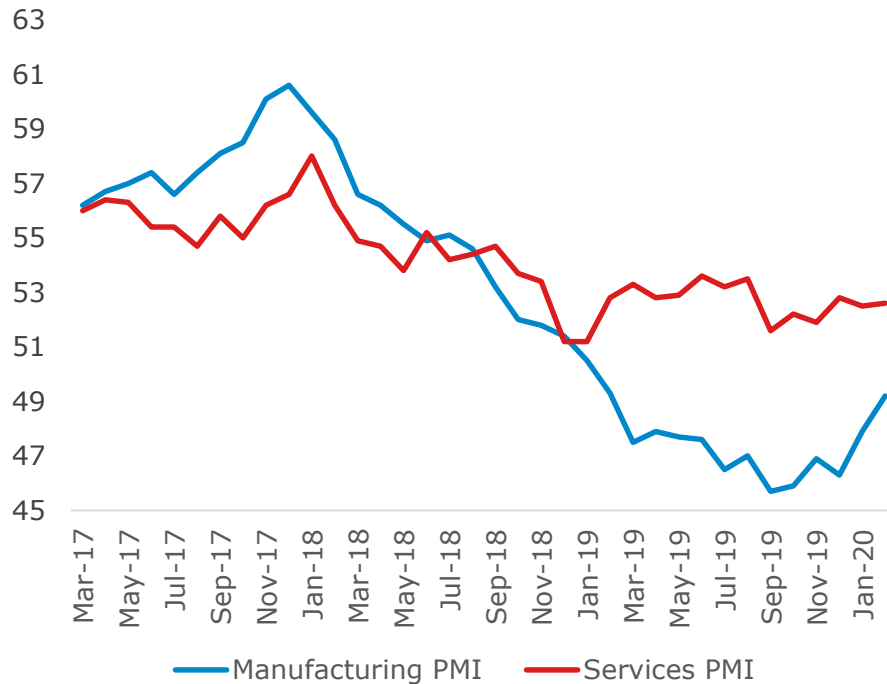


Source: FRED

- ❖ All manufacturing indices are affected by the coronavirus. Moreover, the interpretation of extended delivery times may be misleading. Both PMI and ISM treat them as a positive shock, which is not a case this time. So, overall indicators can be too optimistic. Non-manufacturing indices are not so obvious. While PMI also slows down, ISM surprised positively. Services still outperform manufacturing and following months should not change it. Manufacturing can suffer more due to problems with supply chains.
- ❖ There is considerable uncertainty regarding (1) spillovers into the US economy; (2) effects of late-February financial conditions tightening; (3) the extent and the impact of the local coronavirus outbreak on the economy.
- ❖ The Fed intervention on Tuesday seems to be just the first step in loosening monetary policy. We expect at least one more rate cut.

Euro area economy health check

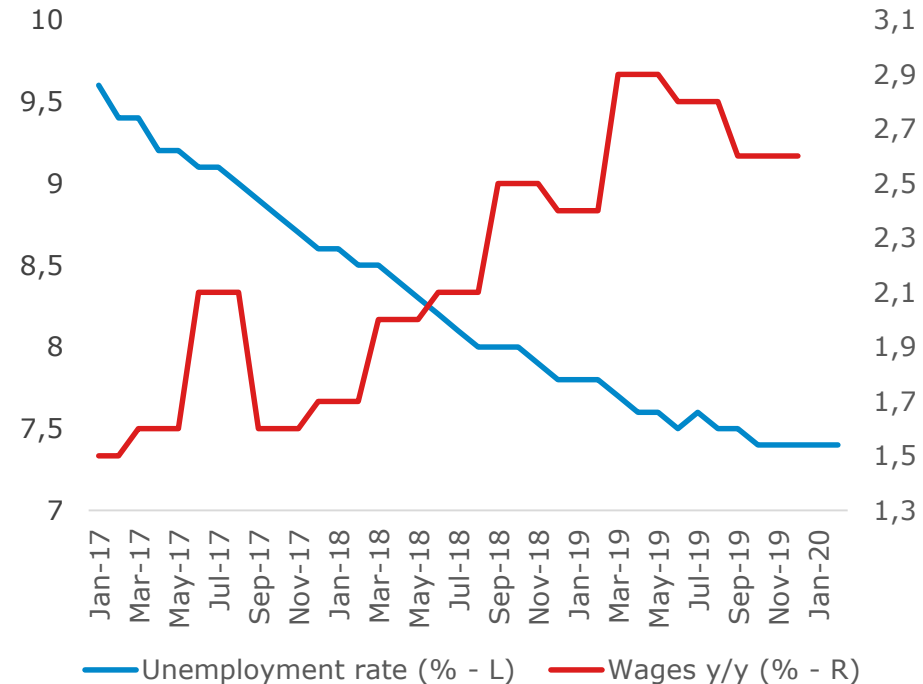
Markit PMI: manufacturing & services



Source: Markit

- ❖ PMI rose, but details of those readings were not so optimistic. First, longer delivery periods added some points (normally it would be treated as a sign of high demand). Second, exports orders in both German manufacturing and services are the lowest level for 3 months. Third, tourism and international travelling (also for business purposes) slow down.
- ❖ Whenever one considers the impact of the coronavirus outbreak on the euro area economy, one should remember about the starting point. The economy had been growing by $\sim 0.1-0.2\%$ q/q before economic disruptions started, and services has been mostly left intact by the 2018-2019 slowdown. Now services will likely bear the brunt of the shock, especially in Italy, where most drastic measures are taken. All in all, a proper recession is now firmly in the cards.
- ❖ The ECB is facing the same old political and operational constraints and its options are limited. First, targeted measures aiming at providing liquidity to enterprises hit by supply chain disruptions. Deposit rate cut and QE expansion reserved for a period of extraordinary stress.

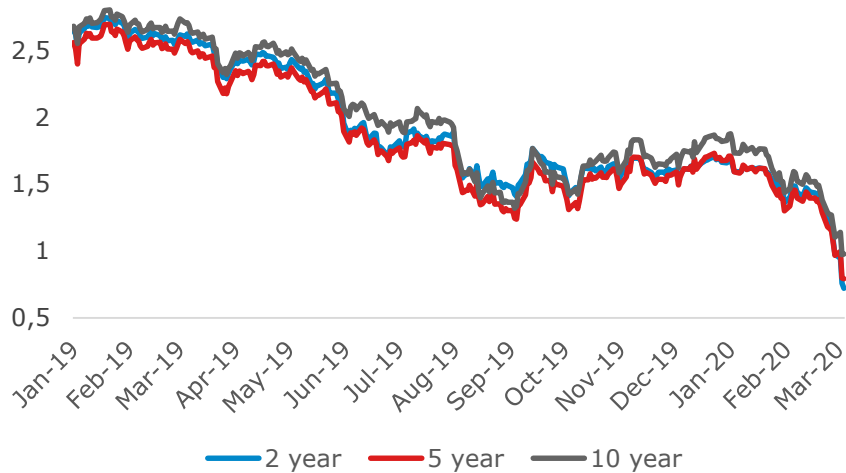
Labor market: wages & unemployment rate



Source: Eurostat

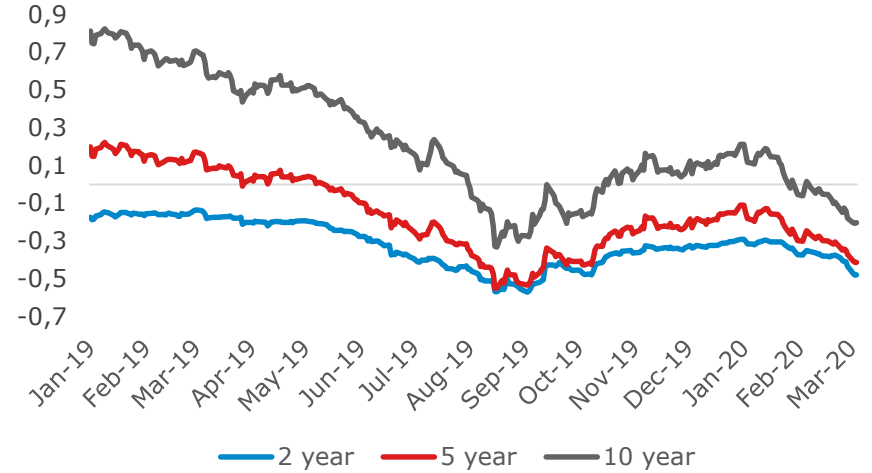
Global rates: Panic mode

US swap rates (%)



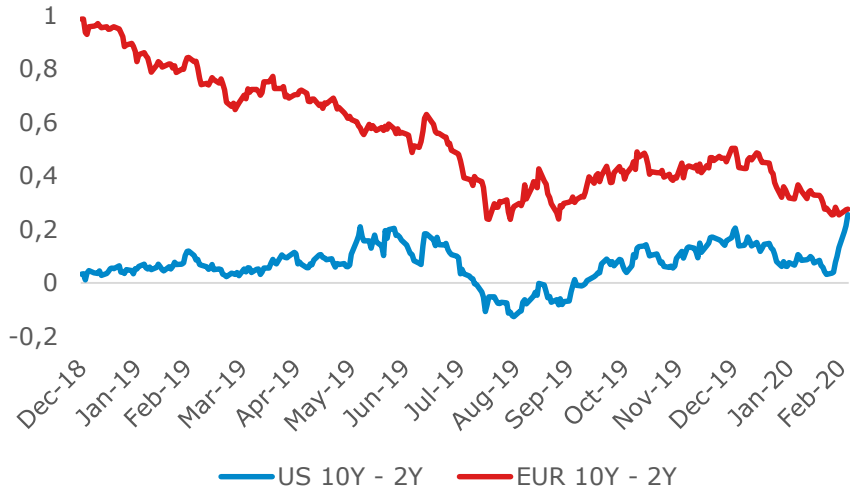
Source: Bloomberg

EU swap rates (%)



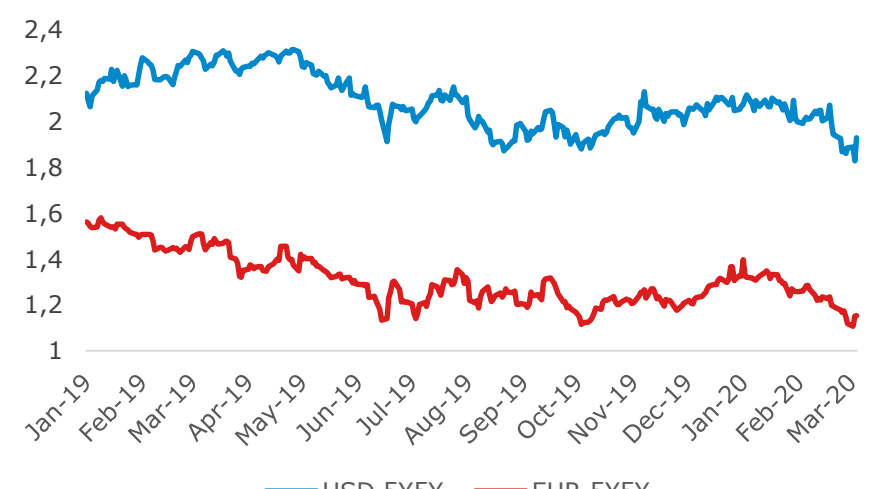
Source: Bloomberg

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



Source: Bloomberg

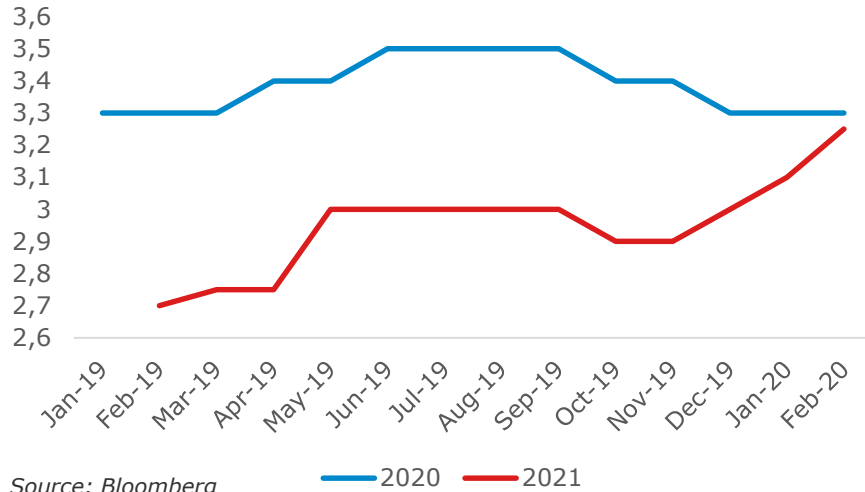
US and EZ inflation expectations (%)



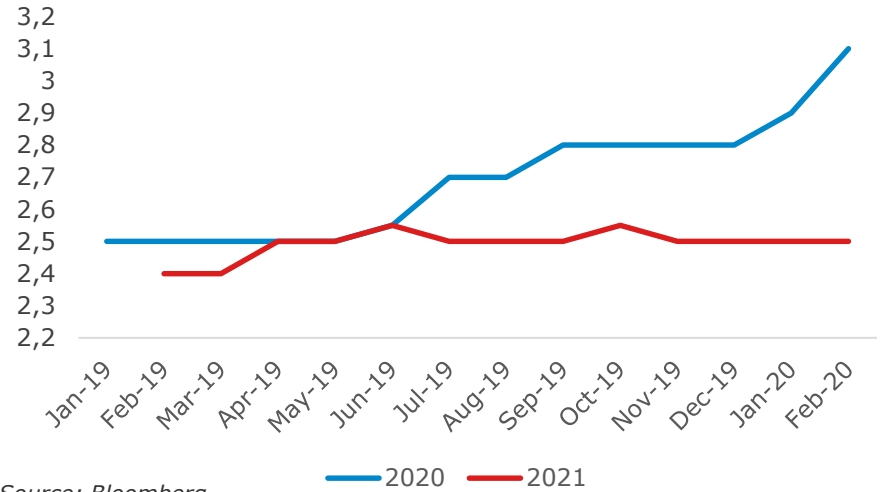
Source: Bloomberg

Consensus: what is expected in Poland?

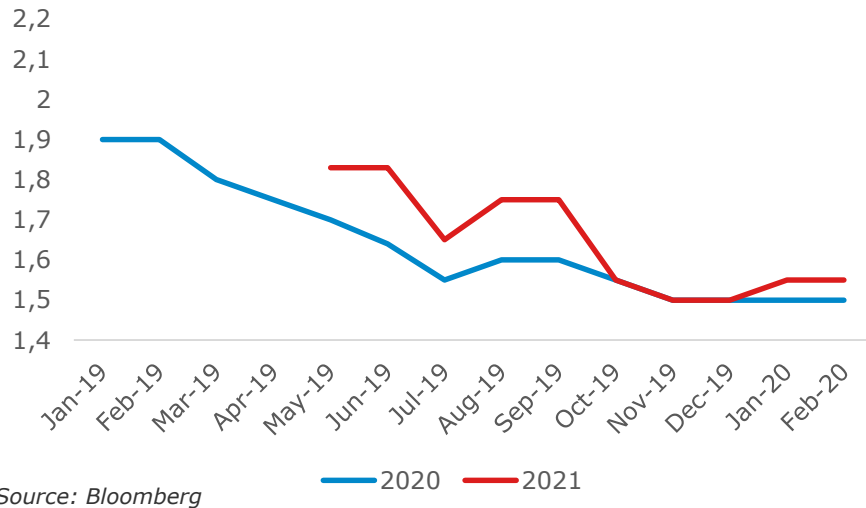
Consensus tracker: GDP growth (% y/y, annual avg)



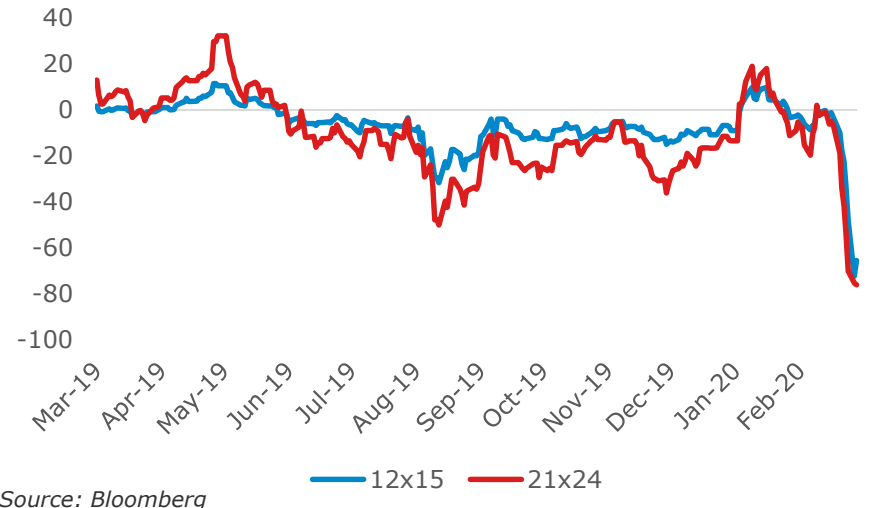
Consensus tracker: CPI inflation (% y/y, annual avg)



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

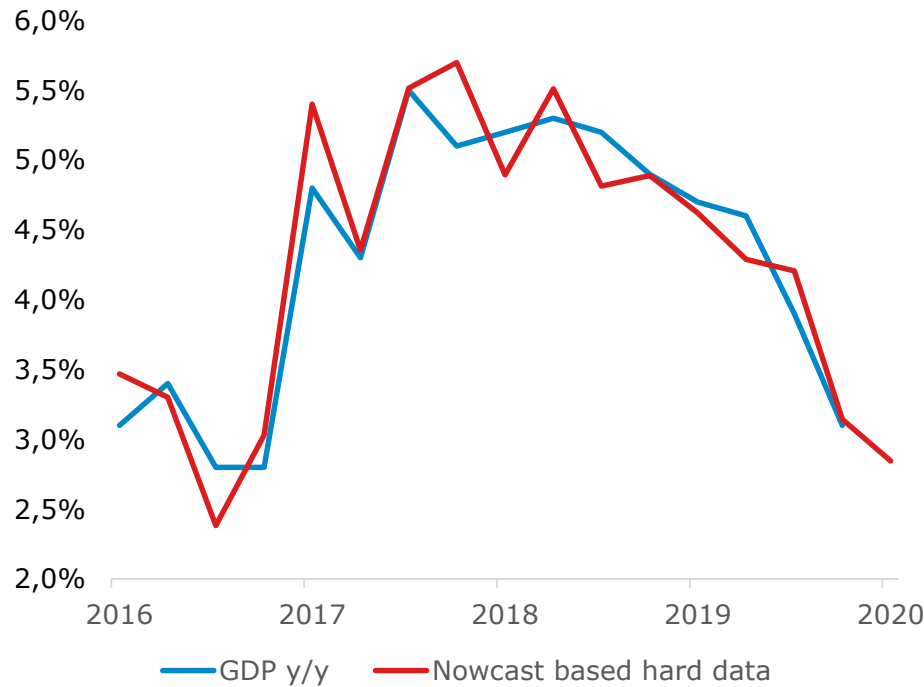


Rate changes priced in by FRA (bps)



Short-term GDP tracker

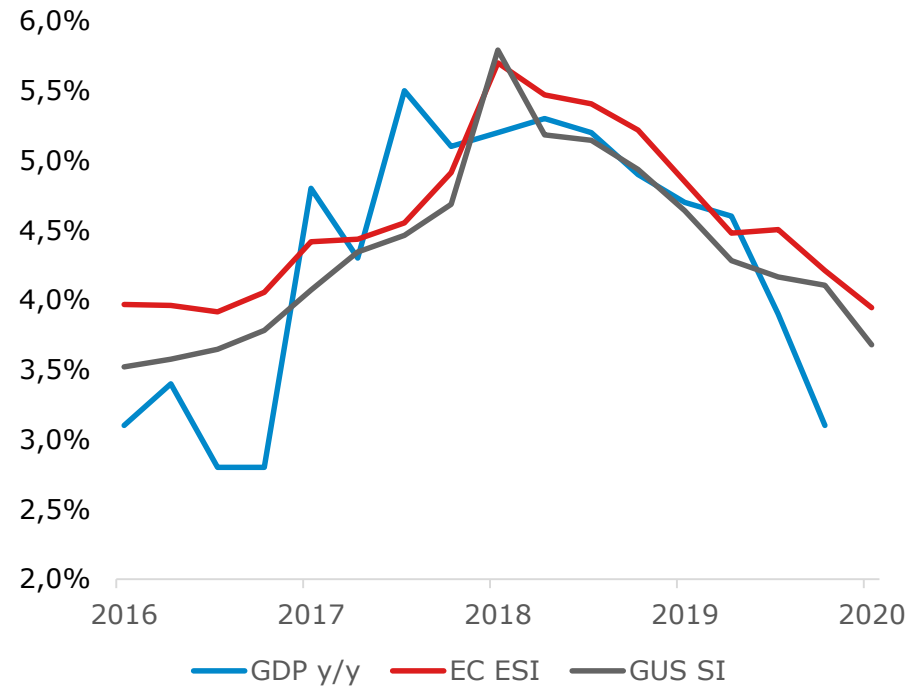
GDP nowcast based on hard data



Source: Statistics Poland, own elaboration

- ❖ GDP continued to slow down sharply towards the end of the year – in the fourth quarter the economy rose by 3.2% y/y. By the way, forecasts based on hard data (industrial and construction output) were spot on, as they usually are in slowdowns driven by public investment.
- ❖ One key takeaway from Q4 data is that household consumption failed to react to fiscal stimulus and was surprisingly weak in Q4. No reason to expect a rebound, especially now and in current circumstances.
- ❖ Early read on Q1 is not optimistic: business and consumer sentiment has continued to deteriorate, while massive statistical base in industry (related to pre-Brexit stockpiling last year) is a clear downside risk for activity growth in the first few months of the year.
- ❖ We continue to forecast 2.8% y/y growth this year, but there are risks to the downside at least for the beginning of the year.

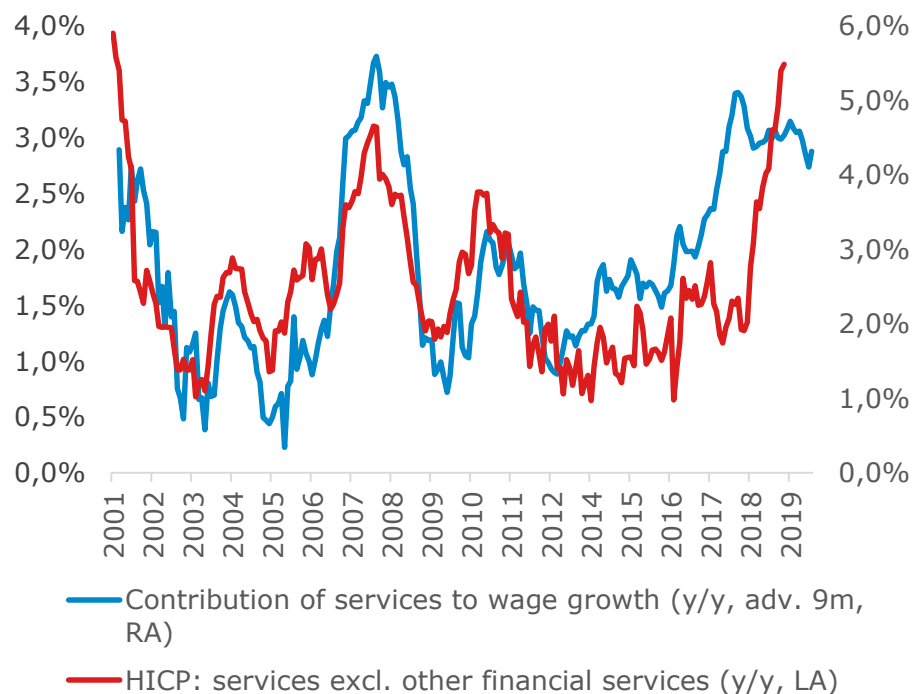
GDP nowcast based on business tendency indicators



Source: Statistics Poland, Eurostat, own elaboration

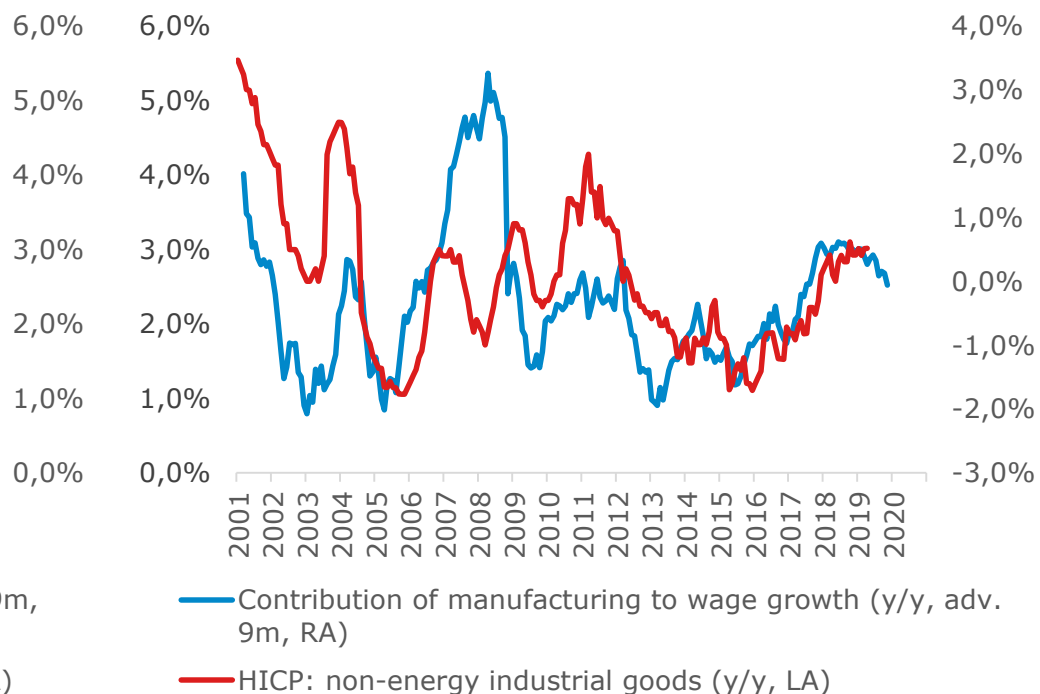
Short-term inflation tracker

Wages & consumer prices: services



Source: Statistics Poland, Eurostat, own elaboration

Wages & consumer prices: goods

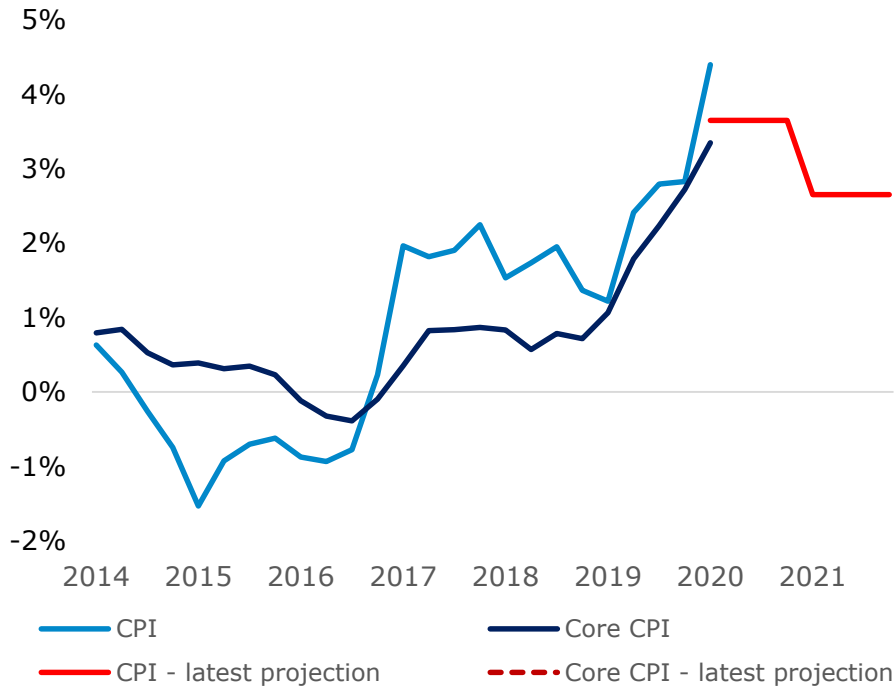


Source: Statistics Poland, Eurostat, own elaboration

- ❖ We are close to tipping points in services and goods inflation. Cyclical factors (lower wage growth, economic slowdown, high productivity growth) favor an incoming turnaround in inflation in 2020.
- ❖ However, the short term inflation path will be determined by exogenous factors (electricity, waste collection fees, excise taxes and food prices). There are two upside risks: overall inflationary environment which is encouraging firms to rebuild squeezed profit margins and inflation expectations (provided they translate into actual decisions and are not just hot air and reflection of past inflation).
- ❖ Overall, we expect CPI inflation to average 4.5% in Q1 and core inflation at 3.5%. Next months should bring inflation to a more moderate levels, although still above 3%. The coronavirus outbreak should be, on the margin, negative for inflation due to low prices of motor fuels, airline tickets and package holidays.

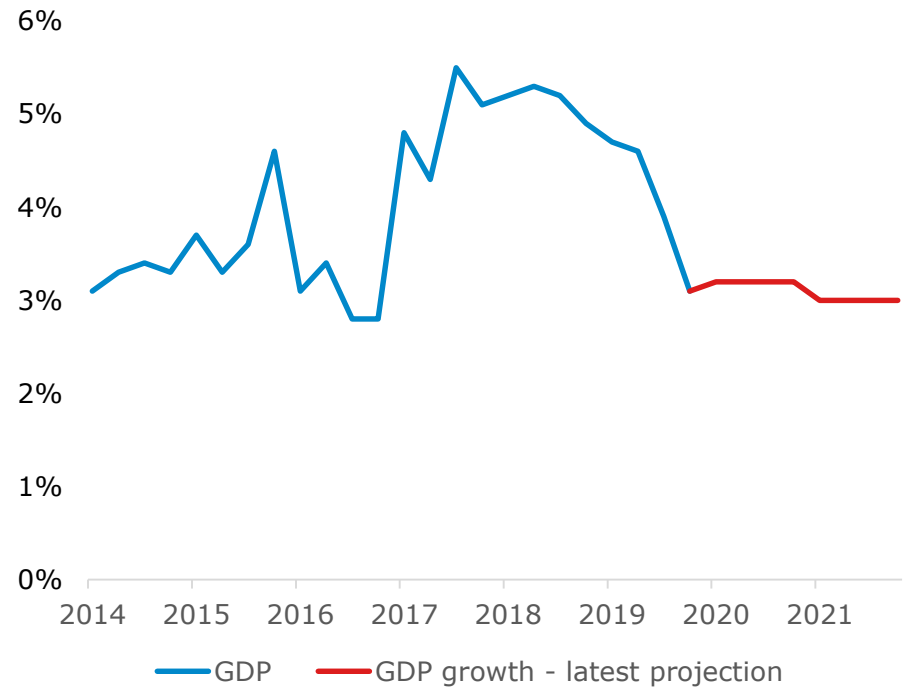
Polish monetary policy radar

NBP's latest projection: inflation



Source: NBP, Statistics Poland, own elaboration

NBP's latest projection: GDP growth

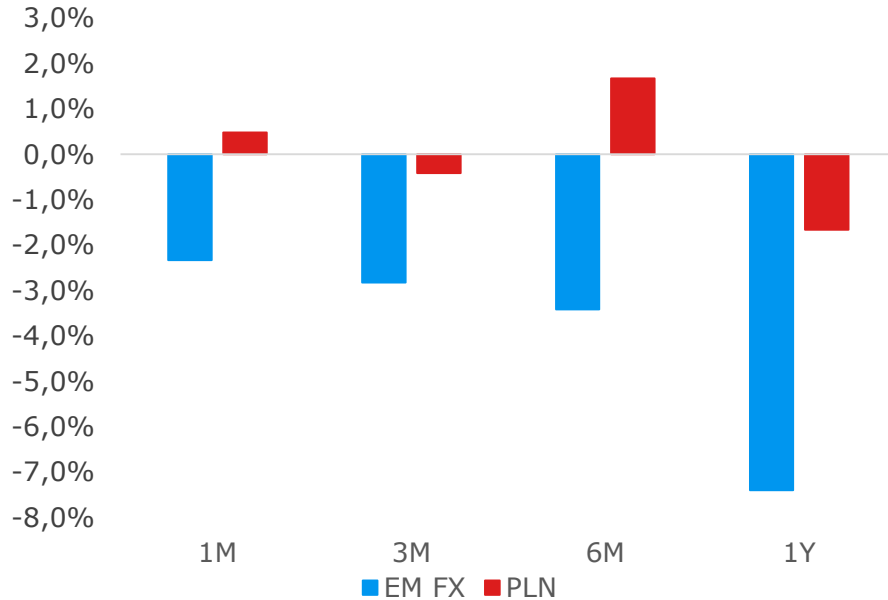


Source: NBP, Statistics Poland, own elaboration

- ❖ Even though FRA contracts are pricing almost three cuts, MPC's stance remains unchanged. During recent conference (early March 2020) governor was cooling expectations for interest rate cuts. The scenario preferred by the MPC is still stabilizing interest rates, with the balance of risks slightly shifted towards lower rates.
- ❖ As of March 2020, the spike in inflation and lower growth path have both been fully internalized by the MPC.
- ❖ Rate cuts are reserved for the period of high stress: sharp GDP slowdown & PLN depreciation. Even then MPC may seek coordination with fiscal policy and treat other cenbank actions as the ones supporting Polish economy, not necessarily the ones to be strictly followed „to the bottom“.

PLN is holding very well

PLN outperformed EM FX recently



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

Source: Bloomberg

Real effective exchange rate: mild appreciation

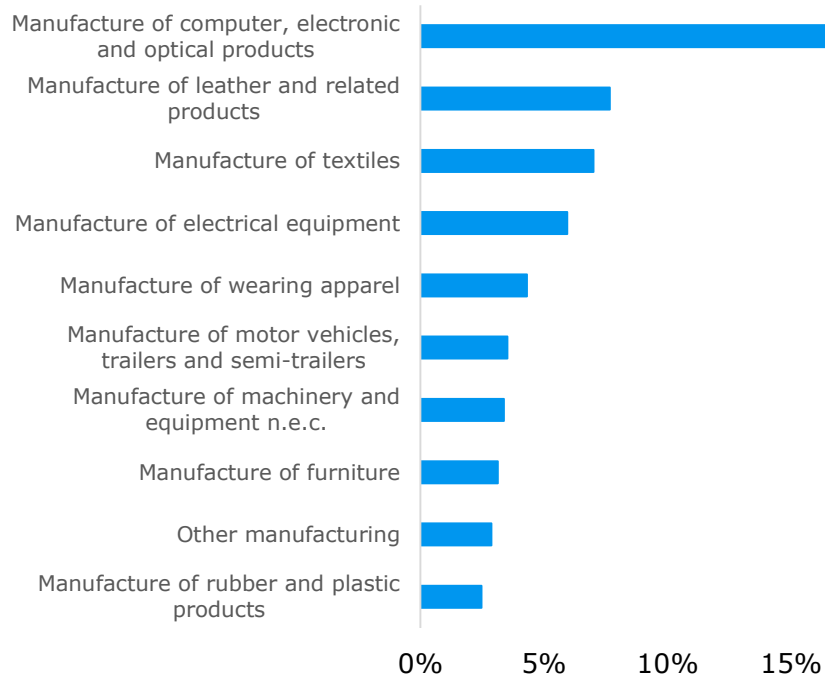


Source: BIS

- ❖ Zloty suffers from weak global sentiment but not as much as other emerging market currencies.
- ❖ Depreciating zloty was our baseline scenario for 2020 even before the coronavirus outbreak (due to lower growth, higher fiscal risks, constant need for depreciation to keep margins of exporters intact vs the spot rate). Now, this scenario is more and more probable. We bet that end 2020 exchange rate will be higher than current sport rate.
- ❖ Too early to claim that 4.20-4.40 range will be broken. PLN survived the period of higher volatility extremely well.

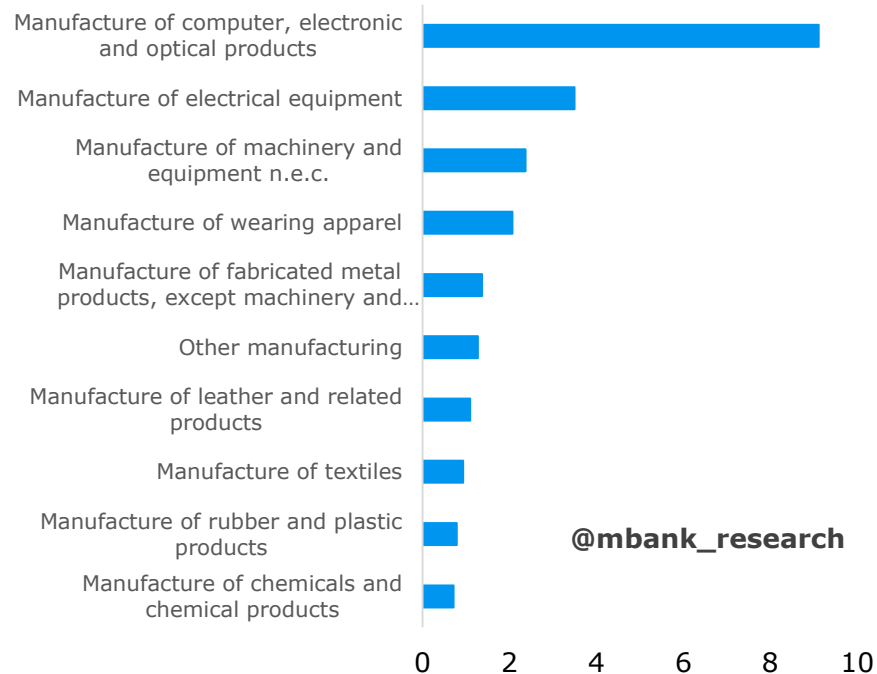
Mini-research note (1). What is the impact of coronavirus outbreak on the Polish economy?

10 industries with largest exposure to China (imports relative to output)



Source: own elaboration based on Statistics Poland data

Value of imports from China, 10 top industries in 2018 (bn EUR)



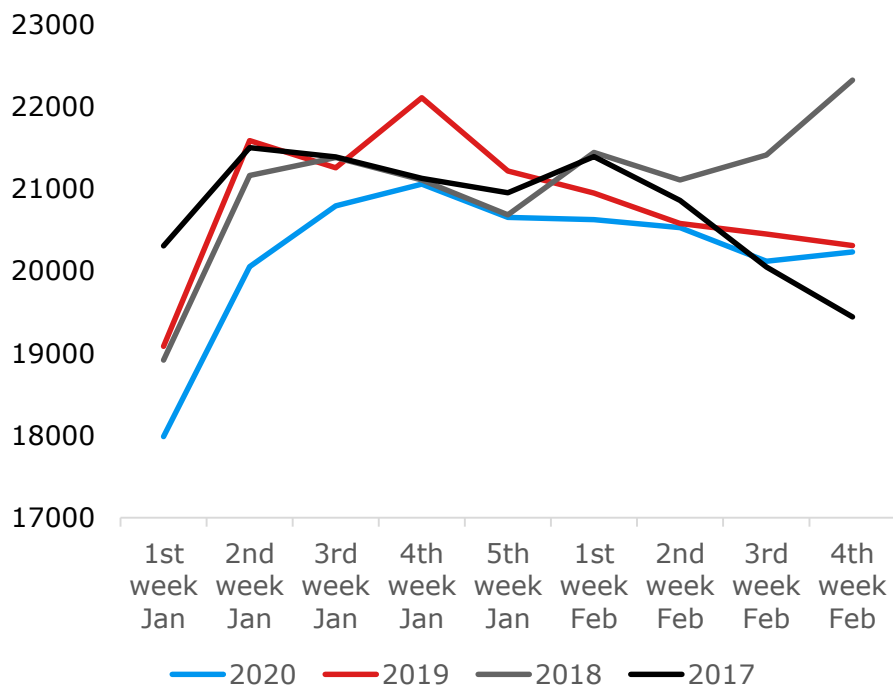
Source: own elaboration based on Statistics Poland data

@mbank_research

- ❖ Estimates of the impact the coronavirus-related disruptions might have on Poland are typically within the 0.1-0.3% range (in GDP terms). Given the size of the Poland-China trade links and the consensus estimate of coronavirus' impact on China itself, it is very difficult to come up with a different number.
- ❖ However, the error bars on this number are likely wide and asymmetric. While lost demand will be made up quickly once production and trade flows resume, the knock-on effects on supply chains are difficult to assess and may be more durable. Chinese tourism will not return to pre-outbreak levels for many quarters. For Poland it is a minor issue, though. The spread of the virus in Europe poses a greater and evolving threat.
- ❖ Macro impacts aside, there are industries heavily exposed to this negative shock. Our analysis points to several such sectors: manufacture of electronic products and electrical equipment, leather, textile and apparel products, etc.

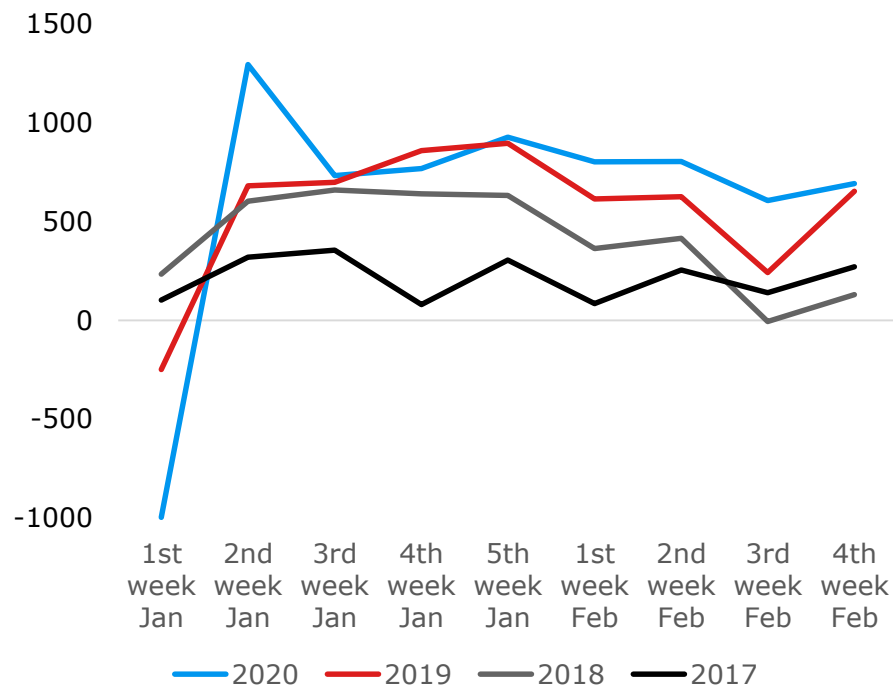
Mini-research note (2). Given the Chinese troubles, how can we monitor the economy in real time?

Electricity demand, weekly averages (MW)



Source: grid operator data

Electricity demand adjusted for weather conditions, months and working days (relations of curves matter, not level)



Source: own elaboration based on grid operator data

- ❖ Lags in data publication are hindering our ability to monitor the problem in a timely manner.
- ❖ Research on China itself resorts to unconventional indicators such as air pollution, road congestion, property sales, intercity travel and cinema ticket sales.
- ❖ It should be useful in monitoring business cycle developments in general.
- ❖ For Poland, we can use high-frequency data on electricity demand published by the grid operator. So far, there is no evidence of a large-scale decline in electricity demand in Poland.

Disclaimer and contact details

Note that research@mbank.pl is an e-mail address used exclusively for the distribution of mBank's publications. We advise to reply and send feedback directly to the authors. Otherwise, your message is **not** going to be read.

The document has been drafted at the Investor Relations, Group Strategy and Macro Research Department of mBank S.A. for the purpose of promotion and advertising in line with article 83c of the Act on Trading in Financial Instruments (Journal of Laws of 2017, item 1768, as amended). The document does not constitute investment research or marketing communication within the meaning of Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive. The document does not constitute investment advice, nor is it an offer within the meaning of Article 66 (1) of the Polish Civil Code.

The document has been drafted based on the authors' best knowledge, supported by information from reliable market sources. All assessments herein reflect outlooks as at the date of issue of this material and may be subject to change at the discretion of the authors without prior notification. Quotations presented herein are average closing levels of the interbank market from the previous day, they are obtained from information services (Reuters, Bloomberg) and serve information purposes only. Distribution or reprint of the full text or a part of it is allowed only upon obtaining a prior written consent of its authors.\\

Copyright © mBank 2020. All rights reserved.

mBank Research is:

Ernest Pytlarczyk, Ph. D., CFA
Chief Economist

Tel: +48 (22) 829 0166

Email: ernest.pytlarczyk@mbank.pl

Piotr Bartkiewicz, CFA

Senior Analyst

Tel: +48 (22) 526 7034

Email: piotr.bartkiewicz@mbank.pl

Marcin Mazurek, Ph. D.

Senior Analyst

Tel: +48 (22) 829 0183

Email: marcin.mazurek@mbank.pl

Maciej Zdrolik

Analyst

Tel: +48 (22) 829 0256

Email: maciej.zdrolik@mbank.pl