

Poland: London trip notes

Our meetings indicate a large underweight in Polish government bonds amid limited supply. There is also great pessimism about global growth



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Last week we visited about 20 London clients for a regular roadshow. We presented the following forecasts:

1. 2019 GDP growth should exceed the National Bank of Poland's forecast from the last projection of 4.0%. We estimate growth of 4.3% to 4.5% year-on-year. After some moderation at the turn of the year, we recognise that the economy resumed strong growth in Mar/Apr-19 in reaction to the generous spending pledges by the ruling PiS (1.6% of GDP). This should extend the consumption boom into 2020. Mortgage sales resumed strong growth and corporate credit reaccelerated, while wages and high frequency activity data (i.e. retail sales) surprised slightly on the upside. Moreover, the resilience of the Polish economy to the eurozone slowdown should persist. Our analysis of manufacturing production based on principal components models shows that external demand has not suffered in the last year, the complete opposite to what we can see in the PMI components. The reason behind this is that Polish production benefits from strong German domestic demand much more than it suffers from the weakness of German manufacturing.
2. On CPI, our long-standing forecast, which assumes core CPI at 2.5% YoY in Dec-19, looks

much more compelling after a recent rise in prices. So far, the strong uptick in core CPI has been caused by regulatory (garbage collection) and methodology changes (clothing), one-offs (Easter shift) and higher electricity prices, rather than demand pressure. But wage costs should add to the core rate in coming quarters (our model shows about a three-quarter lag). Also, surveys show that companies plan to enact strong wage hikes, calling for pay to increase around 8% YoY in 2019. This is a reaction to a German scheme attracting low-cost Ukrainian workers (starting in 2020), but also companies' expectations that the generous fiscal package will extend the consumption boom. Corporate investments also boomed in 1Q19 after a long period of moderation. In the Polish extensive growth model, that creates extra demand for labour. So we expect core CPI to keep rising to about 2.5% YoY in Dec-19, while headline CPI should reach 2.5% in Jun-19, then moderate but again resume growth to above the 3% YoY level in 1H20.

3. The fiscal side and demand/supply balance is still very supportive for Polish government bonds (POLGBs), despite the generous pre-election spending pledges announced in Feb-19. The Ministry of Finance (MinFin) covered 73% of 2019 borrowing needs and in 2H19, POLGBs supply should be slightly lower in YoY terms. 2020 looks even better; the net borrowing needs should drop to PLN15-21 billion only vs PLN35 billion in 2019. The vast majority may be covered locally. We don't share MinFin's optimistic view presented in the Convergence Programme (MinFin expects a surplus in the central budget in 2020, in cash terms and a lack of borrowing needs), but even after our adjustment, the general government deficit should be subdued in 2020 (ING forecasts 1.3% of GDP, MinFin 0.9% of GDP ESA 2010) and borrowing needs cut by a half vs 2019.

The main take-aways from the meetings

The escalation in the US-China trade war was a surprise for many clients and they are in the process of adjusting their view. Pessimism surrounding global growth and trade is deeper than expected. Some investors even think that the widespread easing expectations in developed markets (DM) and emerging markets (EM) may be extended. The consensus is rising that the Federal Reserve may ease next year.

Still, the environment is positive for high yielding emerging markets due to the lack of deep macroeconomic and financial shocks. The trade conflict has strongly hit sentiment indicators (e.g. PMIs), but the impact on the real economy has been slow and less negative than PMIs reflect. Moreover, the main central banks in developed markets have reacted accordingly. That makes the risk environment very supportive for EM high yielders. At the same time, POLGBs are seen as one of the least attractive in the GBI index and are so-called "cheap shorts". Polish government bonds are low yielding assets in high yield benchmarks and additional inflation risk is another discouraging factor. That is why we think real money investors are strongly underweight POLGBs vs their benchmarks.

Our conclusion is that widespread easing expectations in many DM and EM economies more than offset local arguments calling for higher IRS rates. We think the favourable demand/supply conditions are not well recognised.

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