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Emerging Markets

Poland: US trip notes

€/US$ upside potential favours POLGBs, CEE FX&FI

Last week we visited about 20 US clients for a regular roadshow on the East and West Coast. In the US we presented our following views:

- The Polish economy is gradually slowing but GDP growth should remain resilient for the next 1.5 years; we forecast 4.2% YoY growth in 2019 and close to potential 3.3% YoY in 2020. The main GDP driver is the extended consumption boom, due to high election spending at about 2.2% of GDP gross (less in net terms as some new spending would be offset by new tax revenues, but not all – 1.3% of GDP are one-off revenues in 2020). Poland is also very resilient to a recession of German manufacturing and slowdown of overall economies in Eurozone. We attribute this phenomenon to a mix of factors, ranging from low reliance of Polish exports on non-EU markets (eg, Asia), which suffered strongly during recent trade wars. Polish input is less re-exported by German counterparties (than other CEE peers), it is rather consumers locally in Germany and the Eurozone. That makes Poland less sensitive to a German manufacturing recession due to resilient conditions in the Eurozone and German domestic demand. The recent evidenced of domestic demand softening there should start to affect Polish production and GDP. Still local election spending should last until 3Q20 and support domestic demand. We are rather worried about 2021 GDP growth. After the peak of election spending, EU-cofunded investments and German recession should hit the Polish economy with some lag. We think the PiS government would again deliver a spending boost, but rather via big public-private investments, partially funded by state governed utilities. More on the entire CEE resilience to Eurozone/German slowdown in the forthcoming ING Directional Economics to be released next week.
- On CPI, our long-standing forecast assuming core CPI at 2.5% YoY in Dec-19 looks very near after a 2-3Q19 rise of prices. Headline CPI peaked in 3Q19 at 2.9% YoY and should temporarily drop in 4Q19 on base effects and reversal of food prices gains caused by the summer drought. Still, 1Q20 should bring another peak, with CPI flirting with the ceiling above the NBP target (2.5%+/-1%). The generous minimum wage hike (first out of a series of hikes, in 2020 by 15.6%) should add about 0.2-0.3pp to CPI in 2020. Still we do think the Monetary Policy Council should hold flat rates even if average CPI in 2020 reaches 4% YoY (not our scenario; INGF 2020 COI average 2.8% YoY).
- The 2019 general government deficit should be sustained at a low level of 0.9% of GDP, despite aggressive pre-election spending. In 2020, the gap will be filled by one-off revenues, so the sector deficit should reach 0.5% of GDP. The post-election rationalisation of the 2020 budget (adding missing spending and deducting business unfriendly hike of pension contribution for most skilled) should cause an upward revision of 2020 net borrowing needs, but from an ultra-low (PLN7bn) to low (PLN15bn) level. On the other hand, household deposits should keep outpacing credit, so local banks are well funded and remain the main POLGBs buyers.
- This favourable supply-demand condition calls for further tightening of the POLGB-Bund and asset swap spread in 2H19. In 2021, the supply-demand conditions should change, and the deficit should rise to 2.0-2.5% of GDP after the one-off revenues deplete.
- We see two factors that could keep the Polish zloty slightly undervalued over the coming quarters, ie, Swiss (CHF) loans conversion risk and the sale of a local bank by a Eurozone financial institution; the buyer may be local so it should cover EUR/PLN shorts.

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- So far, the twofold ruling of local courts is likely to prevent a significant spike in new cases (in the first instance the prevailing jurisdiction approach is to side with clients, but the final verdicts are less client supportive so far, even after the European Court of Justice guidance). Also, the prevailing provisions policy of local banks is likely to be on a case-by-case basis rather than all FX loans/loses being provisioned upfront. Both factors should ensure that the negative pressure of CHF loans conversion on PLN is spread across time as the likely pre-emptive hedges of banks' CHF/PLN short should be spread over time too.
- That is why in the short term, better EM sentiment and possible upside risk for €/US$ should mitigate the abovementioned PLN-negative factors. Therefore €/PLN should trade within a 4.25 and 4.35 range for the remainder of 2019 and likely close to 4.35 in 2020, in our view. The two key factors to watch in the coming months, which are important to determine whether CHF loans conversion risk is materializing are: (1) growth of new CHF loans cases in the courts and (2) local banks provision policy.

The main take-aways from the meetings

The consensus seems to be that the global slowdown risk is well priced and there are some factors limiting further downside risk, which can extend the tactical rise of DM yields. The factors preventing more negative scenarios for global growth are: (1) progress in US-China negotiations and which may even lead to extending the "narrow deal", as there are rising expectations than President Trump may abandon the December tariffs round and (2) mitigating risk of a hard Brexit. Investors are very EM positive, due to the ongoing easing cycle in DM and EM economies and lack of global financial shocks hitting this asset class.

US clients seem to present a neutral to positive bias to POLGBs and PLN as opposed to London clients, who are mainly underweight POLGBs vs respective benchmarks. The more constructive approach of US clients to POLGBs may come from their expectations of €/US$ upside potential, which generally supports CEE FX&FI. The arguments in favour of euro is that markets well price in weak Eurozone growth, while US data started to surprise on the downside only recently. The fading US exceptionalism should undermine the recent strong dollar position, which is positive for POLGBs and CEE FX&FI.

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