Economic & Financial Analysis

Economics

14 July 2020

Emerging Markets

MonitorING Poland

Elections bring no change, MPC to stay vigilant.

The government decided for a large and very swift support to protect firms' liquidity and workers' incomes due to the pandemic. The NBP acted as an enabler with aggressive interest rate cuts to almost zero and a large-scale QE programme. This week the MPC should point to a slightly better outlook, but still high uncertainty. The QE is well advanced, but the NBP may signal its vigilance than discuss exit strategies proposed by the hawks recently. As costs of the crisis were shifted off the central budget, it is in better shape than feared with modest issuances of POLGBs expected in 2H20.

- According to results from 99.97% of electoral commissions, the incumbent President A. Duda received 51.2% of votes while his rival R. Trzaskowski 48.8%. Duda's re-election matches pre-election polls and point to a continuation of policies of the government from the same caucus. Also, because foreign investors are underweight Polish assets, this outcome will have a marginal impact on POLGB's and PLN.
- Given positive surprises is activity data we upgrade out 2020 GDP outlook. Still GDP is unlikely to fully recover Covid-19 losses before late 2021. Improving confidence can be associated with a huge government response to the pandemic. Polish firms and workers benefited from an anti-crisis shield of PLN114bn (5.7% of GDP). Half of it was transferred to SMEs. Another c.PLN30bn was spent from the newly created Covid-19 Counteraction Fund, financed from bonds of the state-owned BGK bank.
- The NBP created an enabling environment for the anti-crisis shield through aggressive rate cuts by 140bp altogether to almost zero, in three steps from mid-March, frontloading its large QE programme covering T-bonds and T-guaranteed bonds of the PFR and BGK development institutions, and cutting reserve requirements from 3.5% to 0.5%. We expect a QE exit in mid-2021 and no changes in policy rates to end-2021.

FX and Money Markets: The zloty should track the general CEE sentiment in the coming weeks. The MPC successfully convinced markets no rate changes are to be expected, so domestic data will play a lesser role. Any compensation from Gazprom to the Polish natural gas operator (US$1.5bn) looks unlikely to be converted via the market. Technical factors might encourage pessimism with regards to the zloty and so the risk of EUR/PLN moving back above 4.50 in July looks quite high.

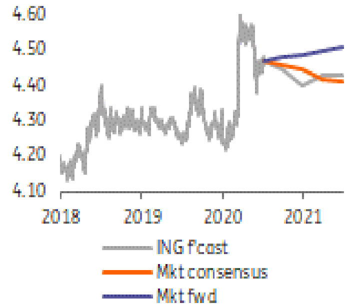
Domestic Debt and Rates: Prospects for POLGBs for the remainder of the month remain encouraging. The only outright sale auction is in the latter half of the month and should be small. Consensus expectations for 2020 GDP is slightly rising, which should be credit positive. All-in-all this should result in tighter POLGBs spread to Bund. Short end swaps should be stable, given no expectations for prompt rate shifts. Longer ones should track core developments.

Quarterly forecasts

	1Q20	2Q20	3Q20F	4Q20F	1Q21F	2Q21F	3Q21F	4Q21F
Real GDP (%YoY)	1.90	-8.0	-4.5	-3.7	-1.9	8.0	4.6	3.9
CPI (eop, % YoY)	1.90	-8.0	2.7	2.4	1.4	2.0	2.0	2.3
Central bank key rate (eop, %)	1.00	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3m interest rate (eop, %)	1.17	0.26	0.28	0.3	0.30	0.30	0.30	0.30
10yr yield (eop, %)	1.68	1.32	1.32	1.27	1.34	1.43	1.46	1.52

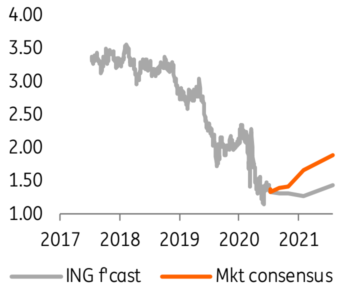
Source: Macrobond, ING estimates

EUR/PLN



Source: Macrobond, ING estimates

Local 10yr yields



Source: Macrobond, ING estimates

Latest indicator surprises

Output	Neutral
Consumption	Positive
Inflation	Higher
External	Neutral
Budget	Neutral

Source: Bloomberg

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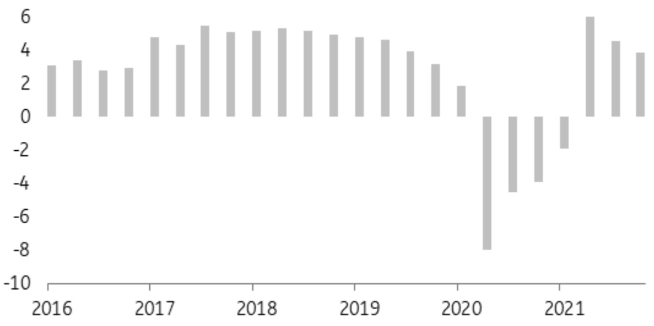
Fig 1 Real GDP (%YoY)

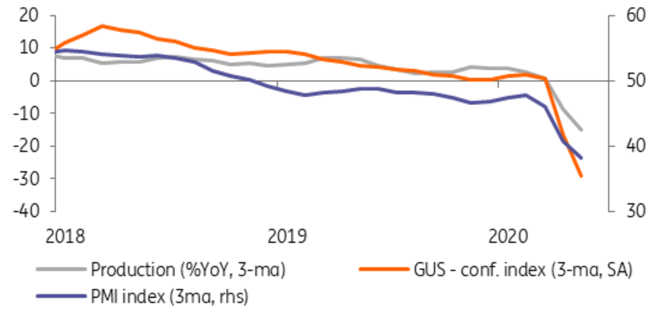


Source: Macrobond, ING forecasts

GDP recovery likely subdued until 2021

- We expect the economy to fully recover after the Covid-19 shock no sooner than in late 2021. Investment recovery should be a major issue. Corporate spending was weak even before the pandemic and the uncertainty that followed and tighter credit standards only made things worse.
- On the other hand, consumer spending and net exports may surprise on the upside – we upgrade our forecasts in both cases. Still we are yet to see the scale of recovery in demand for services. This category is poorly monitored by GUS and business surveys show lacklustre demand even after the lockdown was lifted. GDP performance in 2H20 is uncertain given expire of huge fiscal impulse as well as risk of second wave of Covid-19.

Fig 2 Production vs leading indicators

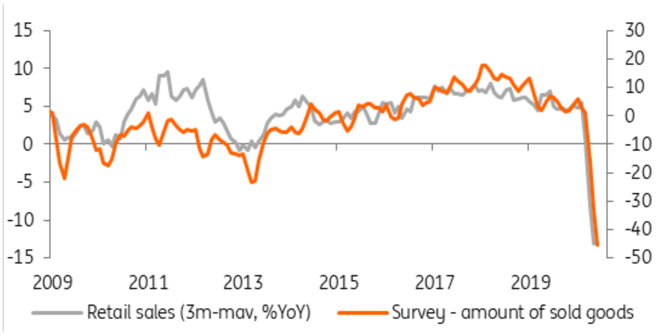


Source: Macrobond

Slow industrial recovery

- Industrial output declined by 17% YoY in May after the collapse in April (-24.6%). The decline in activity was generally softer in branches that entered a non-mandatory lockdown in April, due to the lack of components from foreign partners or insufficient demand, ie, production of vehicles (-58% YoY vs -78% in April) or furniture (-19.7% vs -50%).
- High frequency data, ie, electricity consumption, suggest a slow recovery ahead. Even though demand for electricity may be limited by tame weather (last year we had a heatwave), the underlying manufacturing activity is likely still weak. The outlook is supported by industrial leading indicators from the euro area.

Fig 3 Retail sales vs planned purchases

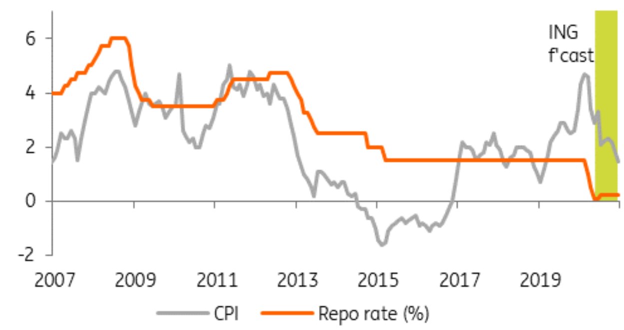


Source: Macrobond

Quick spending recovery after the lockdown was lifted.

- Real retail sales fell by 7.7% YoY in May, much less than in April (-22.9% YoY). This was likely a result of pent-up demand from the lockdown period. The scale of the rebound was somewhat surprising because the store traffic (eg, from Google mobility reports) was still down 30% YoY in May. Apparently, less frequent shopping was accompanied by higher value of purchases.
- By late June, Poles were back to pre-crisis shopping mall visits. This suggests that consumer spending may show a quick recovery past the pandemic, especially as this year Poles spend the holidays domestically. Recovery past 3Q20 should substantially slow given the deteriorating labour market.

Fig 4 CPI vs policy rate

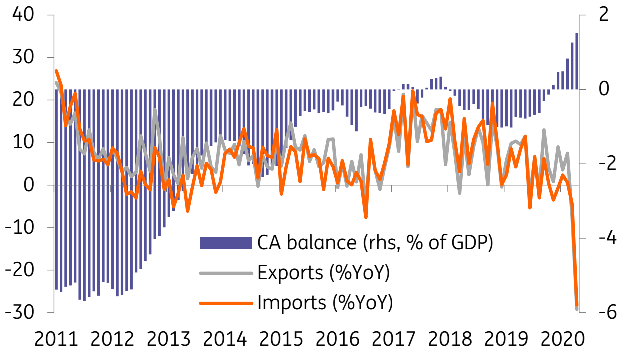


Source: Macrobond

CPI elevated in 3Q20, should decline later on.

- CPI should remain elevated throughout 3Q20. The core component is largely to blame, likely reflecting pent-up demand after the Covid-19 lockdown was lifted. This more so the case as Poles tend to spend the holidays domestically. After the holiday period CPI should decelerate, falling below the NBP target (2.5% YoY) in late 2020 / early 2021 on weak domestic demand.
- The high CPI reading in 1H20 should have a limited impact on the MPC. The council is largely focused on the real economy, while it expects cyclical CPI to drop. Additionally, the weakening labour market should curb CPI anyhow soon. We expect rates to remain unchanged at least until 2022.

Fig 5 CA balance (% of GDP) and foreign trade of goods

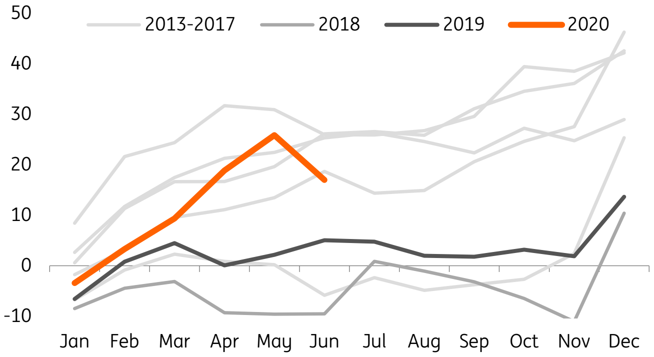


Source: Macrobond, ING calculations.

Narrowing CA surplus in April

- The April CA balance closed with a €1.2bn surplus, down from €2.4bn in March. However, its 12-month rolling improved to 1.5% of GDP. Trade and revenues balances were neutral, the CA surplus was supported by trade in services. We expect the CA surplus to shrink further in the coming months and turn into a small deficit late this year.
- April data reflect a collapse in foreign trade due to disruptions in supply chains and demand shock caused by the pandemic. Expressed in euro, exports of goods declined by 29% YoY, imports by 28% YoY. At the same time, exports of services fell by 41% YoY, while their imports by 44% YoY, mainly due to lower transport services and those associated with tourism.

Fig 6 Budget performance YTD (% of GDP)

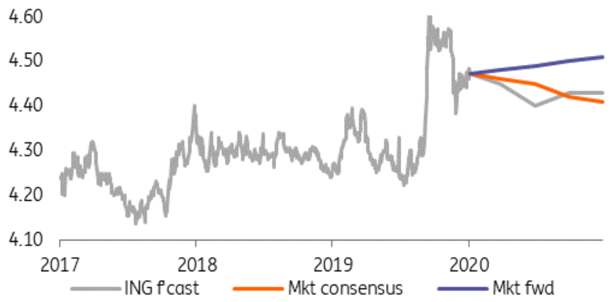


Source: Ministry of Finance

Budget revenues recovery due to one-off factors

- Budget revenues improved somewhat in June after a significant slump in April-May, but mostly due to one-off factors, not a structural recovery. The budget benefited from NBP profit payment (PLN7.6bn) and prolongation of annual CIT and PIT settlements. Budget revenues will slow again in the coming months. Budget bill amendment (expected in August) should show a PLN40bn shortfall in tax revenues (2% of GDP) and PLN25bn in other revenues. The central budget deficit should reach PLN60-80.
- However, most of the anti-crisis measures are financed via Polish Development Fund (PFR) and Bank (BGK), not by the budget. Thus, we expect the general government deficit to reach 10% of GDP in 2020.

Fig 7 FX: EUR/PLN – consensus and ING forecasts

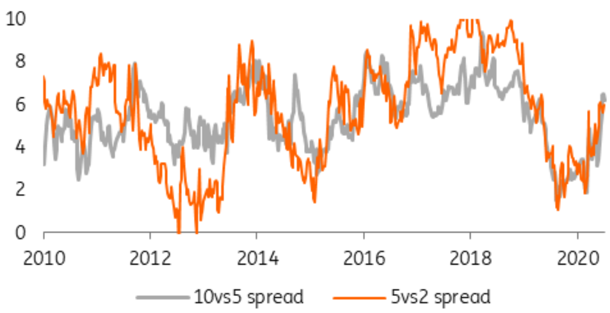


Source: Macrobond

€/PLN to remain above 4.40

- We see prospects of the zloty in the remainder of 2020 and possibly 2021 as mixed. €/PLN should mostly trade close to, but above 4.40. Poland has the lowest real rates in the CEE space and the MPC seems committed to prevent a pronounced PLN appreciation. Still Poland retains a solid current account surplus, largely owing to exports of anticyclical services. Also, it doesn't rely as much as CEE counterparts on exports most affected during the pandemic, such as autos.
- In case of appreciation of the zloty we rather expect the MPC to intervene verbally and extend the scale and length of the asset purchase programme, rather than interventions via the market.

Fig 8 POLGBs curve structure



Source: Macrobond

Low 3Q20 issuance suggests further ASW tightening

- The MoF reported a record cash buffer (PLN107bn) in July, up from PLN60-70bn prior to the pandemic. This suggests the Ministry will commit to announced low issuance for 3Q20 (PLN6-12bn). Local demand for bonds remains strong. Distribution of relief funds to corporates results in a further rise of deposits and over-liquidity among Polish banks.
- The situation is particularly problematic on the short end, as switching auctions only limit already low supply. Hence, we expect asset swap and Bund spread tightening throughout the quarter, as well as POLGBs curve steepening. Short swaps should stabilise, while longer follow core market developments.

Fig 9 Main macroeconomic recent releases

Indicator	Previous -2		Previous -1		Actual		Surprise	Consensus
PMI Manufacturing	Apr	31.9	May	40.6	Jun	47.2	+	46.1
Sold Industrial Output (YoY%)	Mar	-2.5	Apr	-24.6	May	-17.0	+	-18.0
Retail Sales (YoY%)	Mar	-7	Apr	-22.6	May	-8.6	+	-13.3
M3 Money Supply (YoY%)	Mar	11.8	Apr	14.0	May	16.0	+	14.6
Avg Gross Wages (MoM%)	Mar	6.3	Apr	1.9	May	1.2	-	1.6
Unemployment Rate (%)	Mar	5.4	Apr	5.8	May	6.0	+	6.1
GDP (QoQ%)	Q3	1.2	Q4	0.2	Q1	-0.5	+	-1.2
GDP (YoY%)	Q3	4	Q4	3.2	Q1	1.9	+	1.7
Core Inflation (YoY%)	Mar	3.6	Apr	3.6	May	3.8	-	3.7
CPI (YoY%)	Mar	4.6	Apr	3.4	May	3.3	-	2.8
PPI (YoY%)	Mar	-0.3	Apr	-1.3	May	-1.5		-1.5
Base Rate Announcement (%)	Apr	0.50	May	0.10	Jun	0.10		0.10
Trade Balance (€m)	Feb	1037	Mar	124	Apr	-33	+	-400
Current Account (€m)	Feb	949	Mar	1292	Apr	1163	-	1334
Current Account (€m)	Q3	-782	Q4	1924	Q1	4488		-
Official Reserves Total (US$bn)	Apr	118.3	May	132.8	Jun	129.1		-

Source: Bloomberg

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