15 May 2020

Poland Macro Update

Relatively well placed to tackle the corona shock

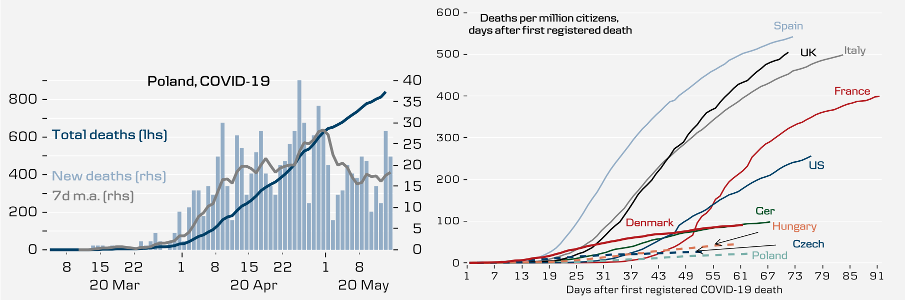
- The Polish authorities' fairly early lock-down measures to contain the coronavirus have paid off relatively well with a modest death rate.
- The authorities are now embarking on a gradual opening of the economy, which will pave the way for a gradual economic rebound in late Q2 and H2 2020.
- Despite the economy being caught in a recession this year, the economic setback will be more modest than in other countries in our view, not least because of the large fiscal and monetary support packages implemented swiftly.
- However, Poland has also some 'structural' advantages over other countries, notably a quite small tourism sector, a relatively large home market, and a quite important IT sector that stands to benefit from the crisis.
- We see the PLN staging a comeback in H2 as the economic recovery in the global and Polish economies take hold.

The COVID-19 shock: early lockdown, faster re-opening, renewed risks?

Poland implemented a quite strict lockdown relatively early on. The authorities started to close down the economy in mid-March, when the virus pandemic was still in its early stages. The measures implemented focused on transport and most of services, such as haircutting, restaurants and hotels, and restrictions on shopping mall and big supermarkets. Schools were also closed.

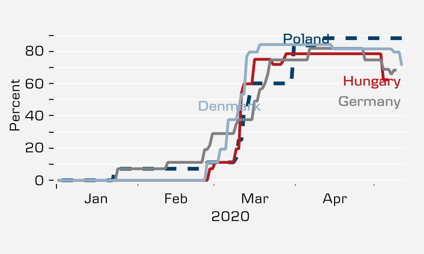
The virus has been relatively contained as a result. Compared to the problems witnessed in many western European countries, Poland together with Eastern European peers like Hungary and the Czech Republic has managed to keep the number of deaths per capita at a relative low levels (see graph). However, the virus has not been completely wiped out especially in the south-western part of the country in the mining areas, where in the past few days there have been quite a number of new cases. This serves as a reminder that the re-opening needs to proceed with caution.

While the number of deaths is not moving a lot lower, the level is still much smaller than in other countries in per capita terms



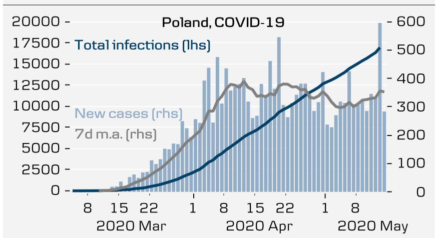
Source: Macrobond Financial, Danske Bank

Poland has been quite forceful in locking down its economy



Note: The index shows the comprehensiveness of lockdown measures where 100 is indicating a full lockdown
Source: Oxford University stringency index

Too early to open up? Daily new corona cases remain high with new outbreak in the south west of the country



Source: Macrobond Financial, European Center for Disease Prevention, Danske Bank

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The authorities have taken the first steps to re-open the Polish society and economy. The first steps were taken at end-April, when more people was allowed to shop in supermarkets. The lockdown was further partially lifted on 4 May with shopping malls opening up more, except restaurants (though take away is still possible). Schools will remain closed until end-June, but some kindergarten opened in early May. Further opening will be implemented on 18 and 25 May, allowing an increasing number of service and transportation sectors to resume normal activities (under more strict guidance).

Along with the lifting of the restrictions, economic activity is strengthening. High frequency indicators such as truck movements and payment data suggest that the economic trough was recorded in late March/early April but activity is now picking up. The demand for power is painting the same picture.

Although the indicators are pointing in the right direction, the economic setback is still large. PMI manufacturing slumped to its lowest level in April. Retail sales dropped 9% in March on average but probably about 20% in the latter half of month. In the labour market, although wages increased by 6.3% in March, this was partly due to bonuses paid in early March; hence, wages are set to fall when this factor disappears as companies are cutting wages in response to the economic crisis. Government measures are helping to mitigate the negative effect by scrapping social security contributions for the smallest companies and paying one-off allowances to people who are sent home from work in addition to the unemployment insurance.

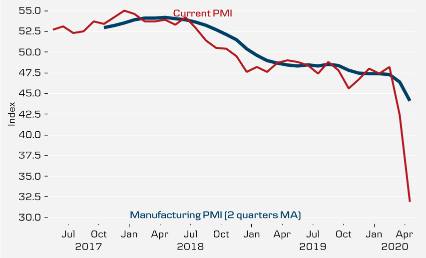
Forceful policy response will mitigate the hit to the economy

Poland came into the crisis with considerable policy space to counter the shock. Following the improvement in tax administration and high economic growth, the fiscal deficit had been brought to a balance, which had resulted in declining debt to GDP ratio, hovering just below 50% i.e. well below western European peers and the EU benchmark target of 60%. On the monetary policy side, the policy rate had been kept at 1.5% for several years, leaving room to cut rates if needed. Inflation had risen on the back of the economic expansion, but was not exceeding the target range on a permanent basis. On the external front, the current account balance was also in balance, mitigating fears of any balance of payment pressures on the back of the shock.

Both the government and central bank have acted early and vigilantly to mitigate the corona shock. Both entities acted in mid-March even as the scale and impact on the Polish economy were unknown. The efforts focused on providing liquidity to markets, households and companies to bridge the shock and to prevent it from turning from a liquidity to a solvency crisis.

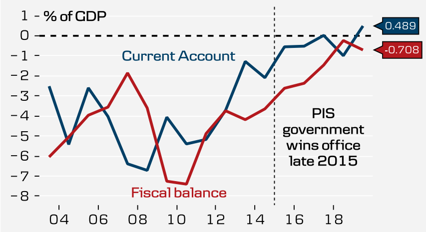
On the fiscal side, the government has embarked on one of the biggest fiscal easings in Europe and globally. In its recent convergence programme, the fiscal deficit is expected to widen to -8.4% of GDP for 2020. However, this does not include the effects of the potential cancellation of loans provided by the Polish development fund to companies hit by the crisis. The scheme is PLN100bn (or 5% of GDP) and in the design of the scheme 60% of the loans can be forgiven to companies. This would probably take place in 2021, but may be recorded in fiscal terms in 2020. It is currently too early to say to what extent the programme will be taken up, but conservatively the full extent of forgiveness should probably be taken into account, which would bring the fiscal deficit to -11.5% of GDP in 2020 (see table). Given the deterioration in the economy and higher unemployment payments and lower tax revenues, the automatic stabilisation would account for 4% of GDP.

Business confidence has slumped



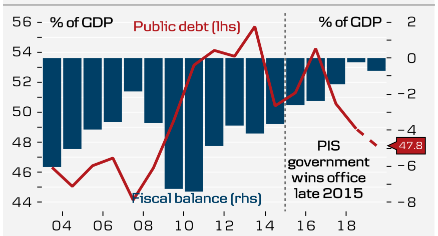
Source: PMI Markit, Macrobond Financial, Danske Bank

Fiscal and external imbalances had been annulled before the crisis...



Source: IMF World Economic Outlook database April 2020, Macrobond Financials, Danske Bank

...leaving public debt at moderate levels



Source: IMF World Economic Outlook database April 2020, Macrobond Financials, Danske Bank

The fiscal support to the economy is sizable

Measures	% of GDP
2020 Fiscal balance envisaged prior to crisis	-0.5
Postponement of pension fund measures	-0.6
Discretionary measures	-3.2
Loss on liquidity operations (60% on PLN100bn)	-3.0
Automatic stabilisers	-4.2
2020 fiscal balance after crisis	-11.5

Source: Danske Bank's own calculation

The fiscal package is one of the biggest compared with countries with similar levels of virus problems (Italy and Spain will have a much bigger hit to public finances as the their economies and societies have been much harder hit and their initial fiscal starting point was also much worse than Poland's).

On the monetary policy side, the central bank has also taken quite unprecedented actions. NPB was convinced it had to react very fast to avoid a tightening of financial conditions. On 17 March, the central bank cut its policy rate by 50bp to 1% and decreased the reserve requirements for banks from 3.5% to 0.5%. At the same time it launched a QE programme purchasing government bonds with a view to 1) increase liquidity of banking sector and 2) in government bond markets as well as 3) facilitating implementation of monetary policy. On 8 April, the central bank cut its policy rate by another 50bp and expanded its QE programme to include bonds guaranteed by the state with a possibility of also including treasury bills.

The monetary policy easing is aimed at both cushioning the economy and preventing a big fall in inflation. On inflation, the picture will be mixed. There is no doubt that inflation will fall as the shock will hurt the demand side of the economy. In addition energy prices will also be facing negative pressures following the sizable fall in oil prices. The exception is food prices which are increasing as a result of a drought for a third year in a row.

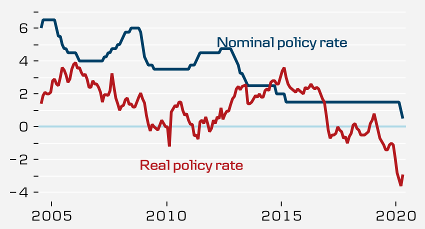
As the crisis evaporates and the economy opens up, we think it is necessary for the NBP to consider exit strategies from the unprecedented monetary policy easing. On the QE side, this is partly facilitated by first scaling back the QE and then reducing the holdings of government bonds, which will be helped by primarily buying at the shorter end of the yield curve. We think it will also be necessary to raise rates at some point as economic activity strengthens. However, the neutral interest rate will probably be lower for a considerable period due to lower investment and higher savings but also demographic reasons. Hence the rate may not be increased to its previous level.

Recession yes, but less deep than in other countries

The Polish economy will be in a tight spot in 2020. Despite the significant fiscal and monetary support, the Polish economy will not avoid experiencing a significant contraction in Q2. Not only is the economy directly impacted by the loss of output related to the lockdown, but also by the uncertainty generated by the virus (which will continue to linger for a while) as well as the global recession hitting external demand. Investment is set to contract significantly, as companies will remain cash-strapped and uncertainty about future earnings prospects lingers. The government support packages will mitigate the hit to household income and the self-employed, which will limit the hit to private consumption.

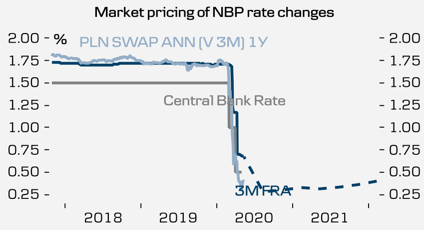
We see a gradual recovery starting in late Q2 and strengthening in the second half of the year. This is assuming that the virus is contained and no further lockdown is needed. The Polish economic recovery in the second half will also be supported by a global recovery, which will boost Polish exports. However, we expect the recovery to be u-shaped without a swift rebound because: 1) Uncertainty about the pandemic will continue to linger, weighing on investment decisions. People will also be uncertain about shopping and travelling. This effect will last for some time, probably until a vaccine or effective drug is found. 2) There will be a drop in wealth and the savings rate will be somewhat higher given the uncertainty. 3) Some restrictions will continue to be in place for some time. As a result, we see real GDP contracting about 4.0% in 2020, followed by a growth rate of 3.7% next

Real rates have fallen deeply into negative territory...



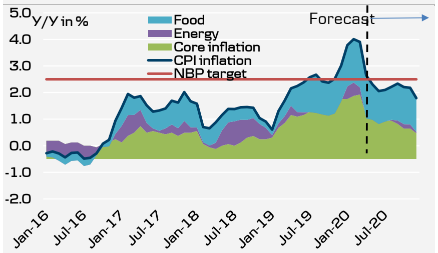
Note: The real rate is found by subtracting headline inflation from the nominal policy rate
Source: NBP, Danske Bank

...and the market is not pricing in any imminent exit from the new low rate level



Source: Macrobond Financial, Danske Bank projections

Inflation is set to fall



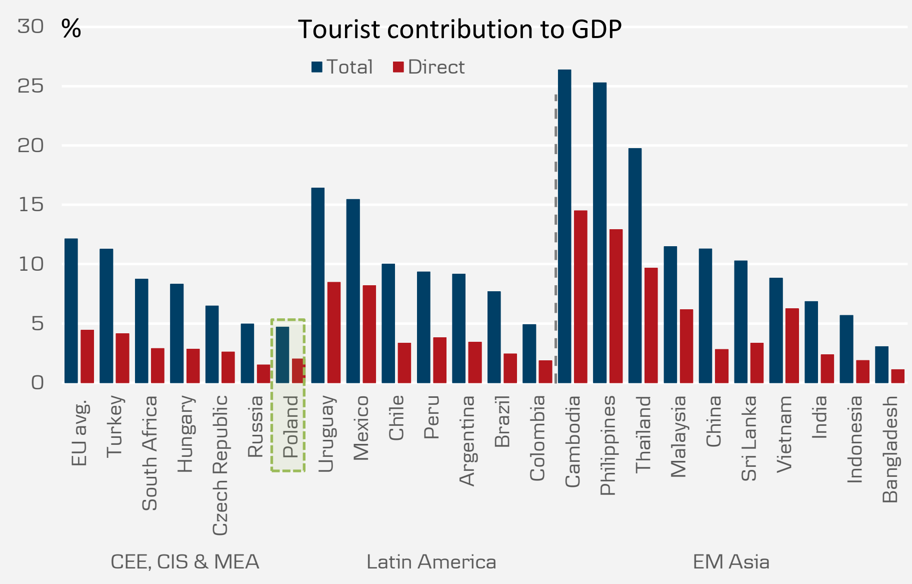
Note. Eurostat HICP numbers are used
Source: Eurostat, Macrobond Financial, Danske Bank projections

Consensus for a rather deep recession in 2020 followed by a rebound

Real GDP growth (%)	2020	2021
IMF	-4.6	4.2
EU	-4.3	4.1
EBRD	-3.5	4.0
Bloomberg consensus	-3.5	3.8
Danske Bank	-3.9	3.7

Source: EU Spring forecast, IMF WEO April 2020, EBRD spring update, Bloomberg, Macrobond Financial, Danske Bank projection year. This is slightly less than the median Bloomberg analyst forecast but less pessimistic than the EU and the IMF.

Tourism accounts for much less in the economy than in the EU and other regions



Source: WTTC, Danske Bank

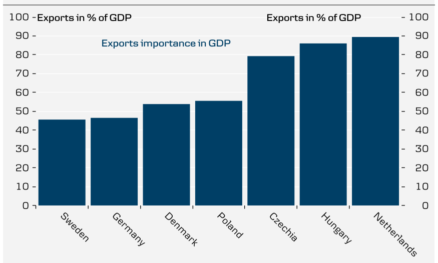
When compared to other (European) countries the downturn and persistent output loss (by end-2021) are less pronounced. The sizeable fiscal and monetary policy responses play a role, but we also think that Poland will benefit from having a much smaller tourism sector than many other countries. These countries will be hit hard by the contraction in global tourism over the next year. with many fewer people travelling due to fear of contracting the virus. As can be seen from the chart above, tourism in Poland accounts for much less than in southern European countries and the ratio is well below the EU average as well as other eastern European peers and other emerging markets. Given Poland's relatively big domestic market, it is less reliant on global trade and hence less exposed to the trade shock. While Poland will still be hit by the sizeable global recession, it is less sensitive to the global economy than its neighbouring countries. Finally, the country has built up a rather sizeable IT service and manufacturing sector which stands to benefit from the corona crisis given the need for telecommuting work services and robotic manufacturing production.

FX outlook – PLN will experience a modest recovery in H2 20

The PLN weakened significantly on the back of the sharp decline in global risk sentiment in March and the cuts in Polish central bank rates. While the PLN has recovered some ground since then, it is still trading at significantly weaker levels than prior to the crisis. We think it could stabilise now over the next month, perhaps moving a bit higher as the global and Polish economies work their way through a deep recession.

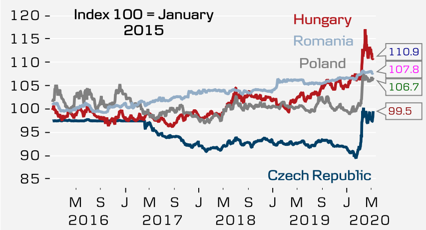
However over the summer and in the fall we would expect the EUR/PLN to resume its fall as the global and Polish economies recover and global risk sentiment strengthens. Furthermore, we think that the external balance will be strengthened during the economic shock as imports will contract more than exports, as the import sensitivity of exports is quite low. Hence on a net basis we see EUR/PLN falling from the current level of 4.57 to 4.45 in 3M, and further to 4.40 in 6M and 4.40 in 12M.

Exports are a much smaller share of GDP than in other CEE countries.



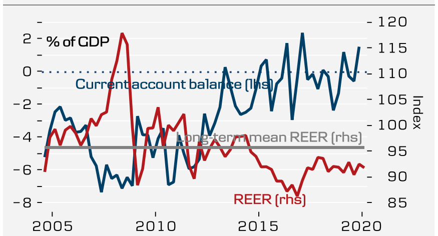
Source: Macrobond Financial, Danske Bank

The zloty has weakened along with CEE peer currencies



Source: Macrobond Financial, Danske Bank projections

The zloty is only marginally undervalued compared to long-term real effective exchange rate levels



Source: Macrobond Financial, Danske Bank

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This research report has been prepared by Danske Bank A/S ('Danske Bank'). The author of this research report is Jakob Christensen, Head of Macro & Emerging Markets Research.

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