

## Fiscal space

### Top macro theme(s):

- **Fiscal space (p. 2):** General government (ESA) deficit in 2q20 (4q rolling) rose to 5.5% of GDP (vs. 1.9% of GDP in 1q20). Fiscal deficit corrected for new public capital outlays, indicative of a short-term policy response to the pandemic, reached 3.5% of GDP (vs. 0.0% of GDP in 1q20). The strong policy response seems to be behind the relatively strong performance of the labour market so far during the crisis. Going forward, there is still some fiscal space available for the scenario of the pandemic worsening further.

### What else caught our eye:

- **CPI inflation in October** (flash estimate) dropped to 3.0% y/y (from 3.2% y/y in September). Core inflation moderated to 4.1-4.2% y/y (PKOe, vs. 4.3% y/y in Sept). Headline inflation was also reduced by lower food prices. October marks the beginning of a disinflationary wave, which will last at least until 1q20 and should drag CPI inflation below the NBP target.
- The government has announced **yet another, and relatively mild, set of restrictions** aimed at curbing the spread of pandemic. This weekend the cemeteries are to be closed preventing millions of Poles from visiting graves around All Saints' Day. Prime Minister have ordered all government employees to work from home (if possible) and advised private employers to do the same.

### The week ahead:

- **Manufacturing PMI in October** improved a tad, on our estimates, signaling a good condition of global production chains before the second wave.
- **MPC meeting** is likely to keep monetary policy parameters unchanged and adopt the wait-and-see approach.

### Number of the week:

- **4.64** – EURPLN intraday level on Thursday, the highest in 11 years.

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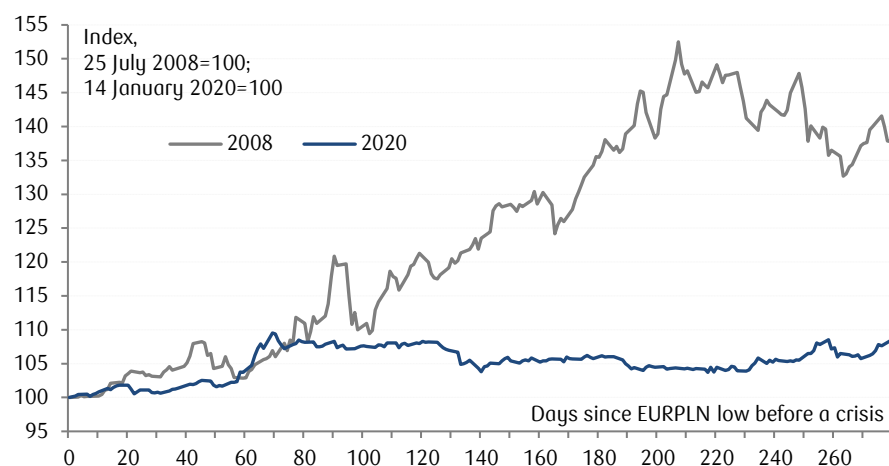
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Chart of the week: EURPLN now and in 2008/2009



Source: Macrobond, PKO Bank Polski.

	2019	2020†
Real GDP (%)	4.5	-2.9
Industrial output (%)	4.0	-3.3
Unemployment rate# (%)	5.2	6.4
CPI inflation** (%)	2.3	3.3
Core inflation** (%)	1.9	3.8
Money supply M3 (%)	8.3	13.9
C/A balance (% GDP)	0.5	3.0
Fiscal balance (% GDP)*	-0.7	-11.1
Public debt (% GDP)*	46.0	62.3
NBP reference rate## (%)	1.50	0.10
EURPLN‡	4.26	4.52

Source: GUS, NBP, MinFin, †PKO BP Macro Research team forecasts, ‡PKO BP Market Strategy team forecasts; \*ESA2010, \*\*period averages; †registered unemployment rate at year-end; ##at year-end.3

## Fiscal space

- General government (ESA) deficit in 2q20 (4q rolling) rose to 5.5% of GDP (vs. 1.9% of GDP in 1q20). Fiscal deficit corrected for new public capital outlays, indicative of a short-term policy response to the pandemic, reached 3.5% of GDP (vs. 0.0% of GDP in 1q20).
- The strong policy response seems to be behind the relatively strong performance of the labour market. Going forward, there is still some fiscal space available for the scenario of the pandemic worsening further.

General government (ESA) deficit in 2q20 (4q rolling) rose to 5.5% of GDP (see chart 1), lower than in our estimates (7.0% of GDP), vs. a deficit of 1.9% of GDP in 1q20. The fiscal result for 2q20 is a positive surprise. Early signals from local governments on revenue shortfalls in 2q20 and an inclusion of anti-crisis shields spending by off-budget entities into public sector accounts (Anti-Covid Fund located in the State Development Fund, BGK, as well as the Poland's Development Fund, PFR) didn't bode well for the fiscal stance. On the other hand, the state budget results barely deteriorate and started to improve as of June.

Fiscal data for 2q20, as well as state budget results after September (a relatively small deficit of PLN 13.4bn, see chart 2), signal a positive upside to our full-year fiscal balance forecast (-11.1% of GDP).

Public sector (ESA) revenues in 2q20 were up 4.4% y/y (vs -2.0% y/y in 1q20) with a drag mainly stemming from VAT (see chart 3, next page). That said, VAT in 3q20 rebounded, recording an increase of 14.3% y/y. The weakness of PIT and CIT during the first wave of the pandemic in spring hasn't been overly pronounced, as it partially stems from deferred payments, which are not recorded on accrual basis in ESA accounts. In other words, it was also a liquidity and not a lost revenue issue (the state budget liquid assets were at a record high during the first wave).

On the expenditure side, a total growth rate of expenditures was a stunning 40.8% y/y in 2q20 (vs 9.8% y/y in 1q20) with 'other' expenditures skyrocketing (32.7pp contribution, see chart 4, next page). Anti-crisis shields (=subsidies for enterprises) were the key driver behind the surge. It is also noteworthy that despite local governments' investment outlays weakness in 2q20, total public investments expanded in 2q20 by 14.1% y/y (vs. 11.5% in 1q, in nominal terms, see chart 5). It is a signal of a strong investment demand at the central government level, indicative of, among others, outlays on new infrastructure.

Poland's fiscal balance corrected for new public capital outlays (i.e. correction for public investments exceeding the consumption of fixed capital, see chart 6) reached -3.5% of GDP (4q rolling, NB new public investments can be perceived a proxy for long-term development policy, while corrected fiscal balance - a proxy for short-term policy response). That makes a 3.4% of GDP increase in corrected fiscal deficit in 2q20 alone and one of the most pronounced in the ex. EU28 (see chart 7). But, given the specific character of the recession - mostly concentrated on consumers and services - the size of short-term fiscal response in 2q20 also seems to reflect government policy priorities. The short-term policy response seems to be reflected by the local labour market performance: the more spending the better the labour market condition in the midst of the pandemic (chart 8).

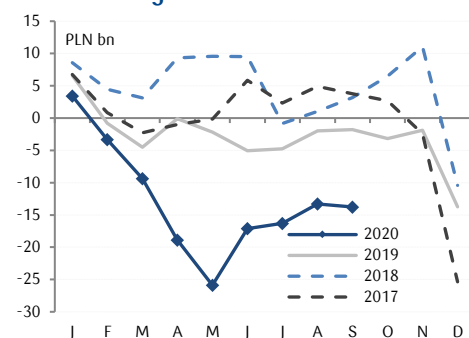
Last, but not least, (1) the size of the current and capital account surplus (ca 5% of GDP after September, 12 month rolling) and (2) the first decline in volume of loans ever (indicative of a negative credit impulse) suggests that there is still some fiscal space available for another policy response.

### 1. Public sector (ESA) deficit



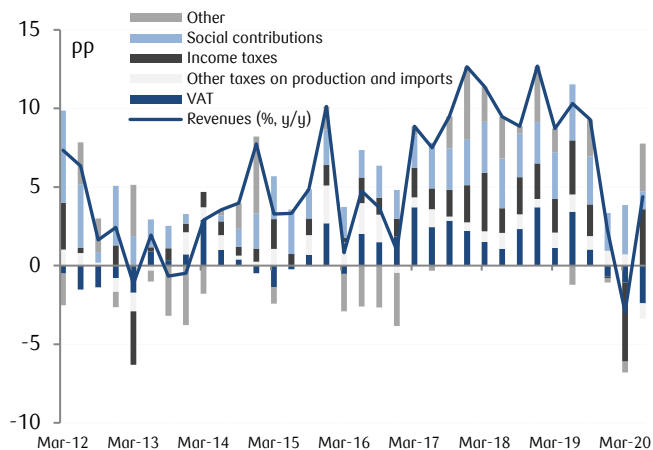
Source: Eurostat, PKO Bank Polski.

### 2. State budget deficit



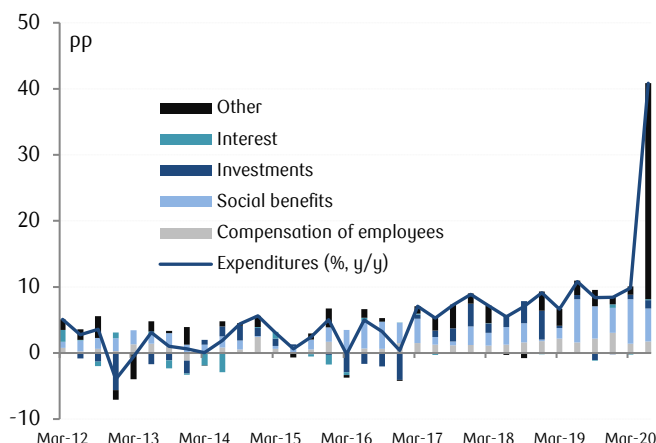
Source: MinFin, PKO Bank Polski.

### 3. Public sector (ESA) revenues



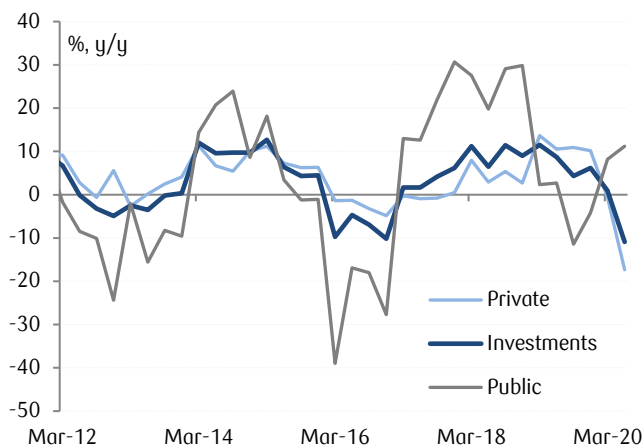
Source: Eurostat, PKO Bank Polski.

### 4. Public sector (ESA) expenditures



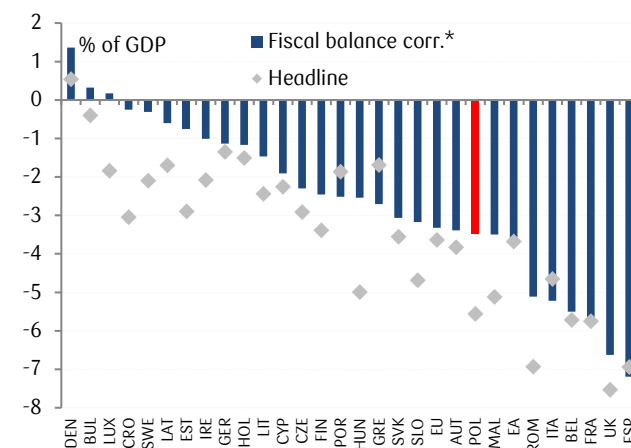
Source: Eurostat, PKO Bank Polski. \*correction for public investments exceeding the consumption of fixed capital.

### 5. Public sector investments



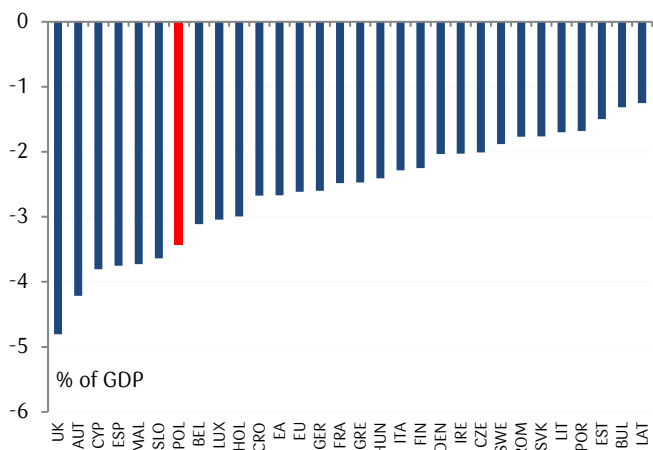
Source: Eurostat, PKO Bank Polski.

### 6. Fiscal balance: headline vs corrected\*



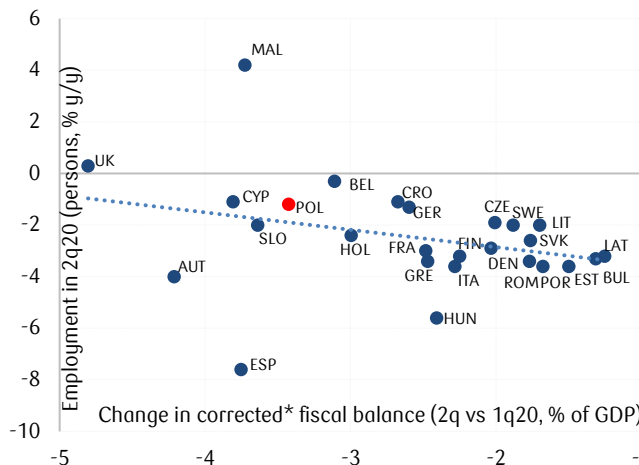
Source: Eurostat, PKO Bank Polski. \*correction for public investments exceeding the consumption of fixed capital.

### 7. Change in corrected\* fiscal balance (2q20 vs 1q20)



Source: Eurostat, PKO Bank Polski. \*correction for public investments exceeding the consumption of fixed capital.

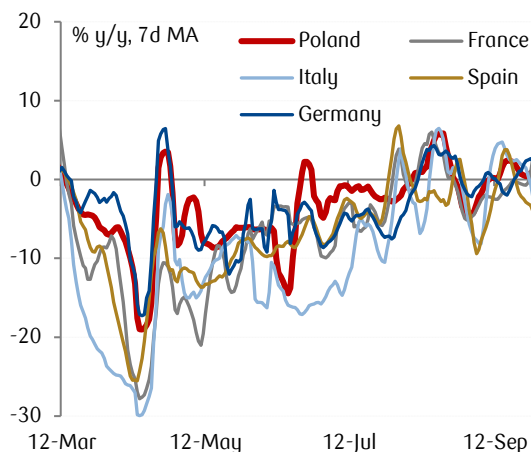
### 8. Employment vs fiscal response in 2q20



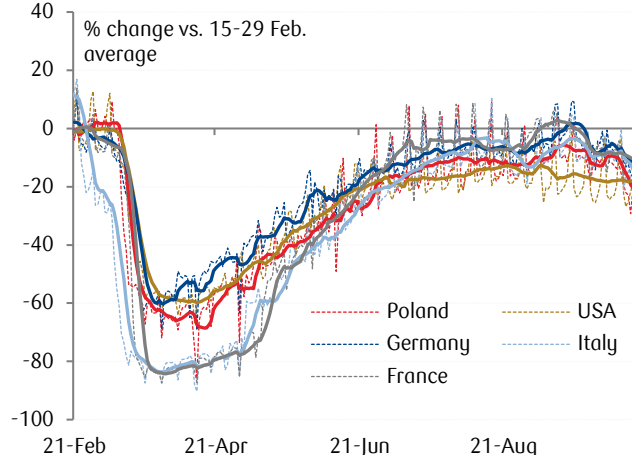
Source: Eurostat, PKO Bank Polski. \*correction for public investments exceeding the consumption of fixed capital.

## Macro monitoring with alternative data<sup>^</sup>

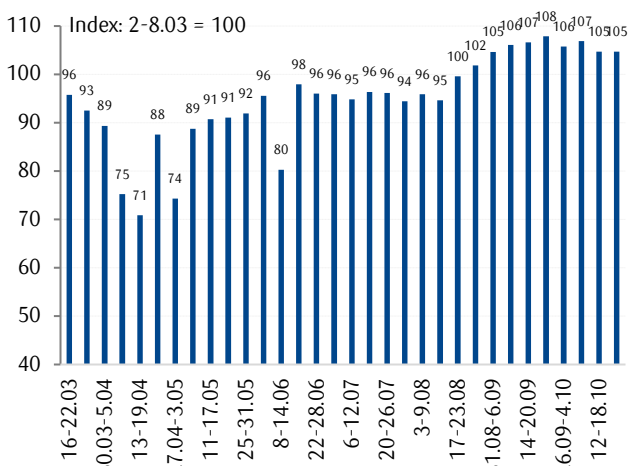
Electric energy consumption (total)



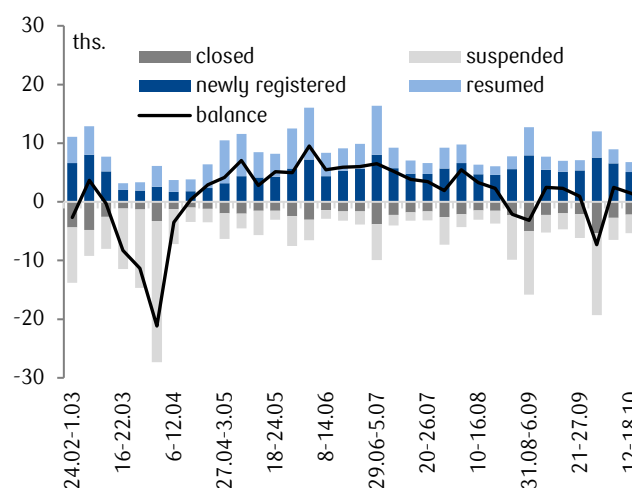
Mobility\*



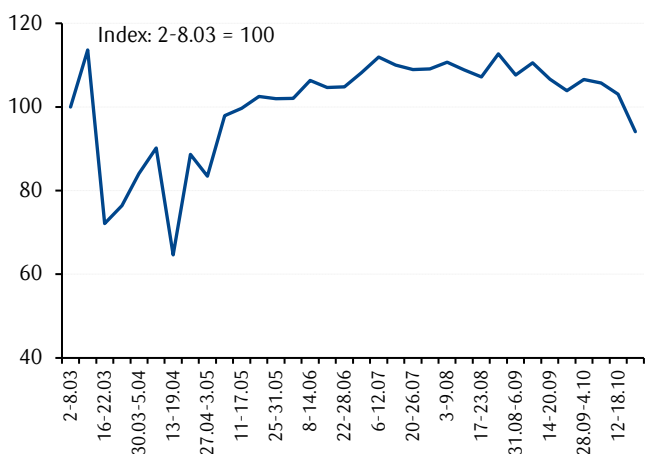
Heavy truck traffic



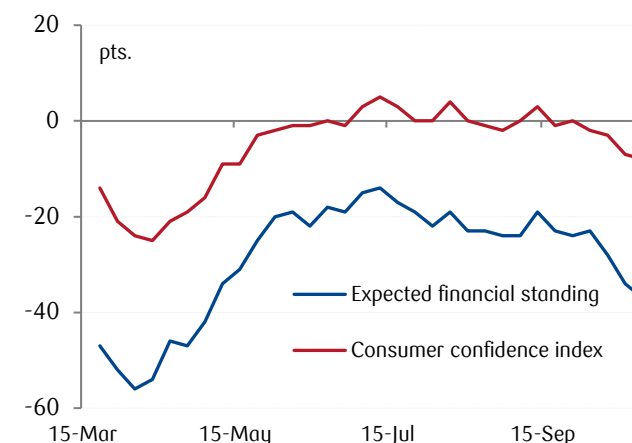
Economic activity status (acc. to CEiDG\*\*)



Consumption based on PKO BP card payments



Weekly consumer confidence survey



Source: PSE, Apple, Google, GDDKiA, CEiDG, Kantar, PKO Bank Polski, \*weighted with market share of iOS and Android, no new google data available, 7DMA, \*\*Central Registration and Information on Business.

## Weekly economic calendar

Indicator	Time (UK)	Unit	Previous	Consensus*	PKO BP	Comment
<b>Monday, 2 November</b>						
CHN: Manufacturing PMI (Oct)	1:45	pts.	53.0	52.8	--	--
<b>POL: Manufacturing PMI (Oct)</b>	<b>8:00</b>	pts.	<b>50.8</b>	<b>50.9</b>	<b>51.1</b>	<b>A good condition of global production chains signals some upside move of the index (same as German one).</b>
GER: Manufacturing PMI (Oct, final)	8:55	pts.	56.4	58.0	--	--
EUR: Manufacturing PMI (Oct, final)	9:00	pts.	53.7	54.4	--	--
USA: Manufacturing PMI (Oct, final)	14:45	pts.	53.2	53.3	--	--
USA: ISM Manufacturing (Oct)	15:00	pts.	55.4	55.3	--	--
<b>Tuesday, 3 November</b>						
USA: Factory orders (Sep)	15:00	% m/m	0.7	0.3	--	--
USA: Durable goods orders (Sep, final)	15:00	% m/m	0.4	1.9	--	--
<b>Wednesday, 4 November</b>						
GER: Services PMI (Oct, final)	8:55	pts.	50.6	48.9	--	--
EUR: Services PMI (Oct, final)	9:00	pts.	48.0	46.2	--	--
EUR: PPI inflation (Sep)	10:00	% y/y	-2.5	--	--	--
USA: ADP National Employment (Oct)	13:15	thous.	749	750	--	--
USA: Trade balance (Sep)	13:30	bn USD	-67.1	-69.6	--	--
<b>POL: NBP base rate</b>	--	%	<b>0.10</b>	<b>0.10</b>	<b>0.10</b>	<b>We bet on unaltered domestic monetary policy, in line with the majority of the MPC members view.</b>
<b>Thursday, 5 November</b>						
GER: Factory orders (Sep)	7:00	% y/y	-2.2% y/y	--	--	--
NOR: Norges Bank meeting	9:00	%	0.00	--	0.00	--
EUR: Retail sales (Sep)	10:00	% y/y	3.7% y/y	--	--	--
UK: BoE meeting	12:00	%	0.10	0.10	0.10	--
CZE: Central bank meeting	13:30	%	0.25	--	0.25	--
USA: Initial Jobless Claims (Oct)	13:30	thous.	751	--	--	--
USA: Fed meeting	19:00	%	0.00-0.25	0.00-0.25	0.00-0.25	--
<b>Friday, 6 November</b>						
GER: Industrial output (Sep)	7:00	% y/y	-9.6	--	--	--
USA: Non-Farm Payrolls (Oct)	13:30	thous.	661	650	--	--
USA: Unemployment Rate (Oct)	13:30	%	7.9	7.7	--	--
USA: Average Earnings (Oct)	13:30	% y/y	4.7	4.5	--	--

Source: GUS, NBP, Parkiet, PAP, Bloomberg, Reuters, PKO Bank Polski. Parkiet for Poland, Bloomberg, Reuters for others.

## Selected economic indicators and forecasts

	Aug-20	Sep-20	Oct-20	1q20	2q20	3q20	4q20	2019	2020	2021
<b>Economic activity</b>										
Real GDP (% y/y)	x	x	x	1.9	-8.4	-1.7	-3.3	4.5	-2.9	4.3
Domestic demand (% y/y)	x	x	x	1.0	-9.9	-2.2	-3.9	3.5	-3.5	4.5
Private consumption (% y/y)	x	x	x	1.2	-10.8	2.2	-2.0	4.0	-2.3	4.3
Gross fixed capital formation (% y/y)	x	x	x	0.9	-10.7	-7.4	-4.3	7.2	-5.6	3.7
Inventories (pp)	x	x	x	-0.3	-2.0	-2.8	-2.2	-1.3	-1.7	0.5
Net exports (pp)	x	x	x	0.9	1.1	0.4	0.3	1.1	0.4	0.1
Industrial output (% y/y)	1.5	5.9	1.0	0.9	-13.6	3.2	-2.3	4.0	-3.3	7.3
Construction output (% y/y)	-12.1	-9.8	-2.5	5.0	-2.8	-10.9	x	3.6	x	x
Retail sales (real, % y/y)	0.5	2.5	-2.0	0.8	-10.7	1.0	x	5.4	x	x
Nominal GDP (PLN bn)	x	x	x	556.4	528.2	567.3	628.3	2279	2263	2404
<b>Labour market</b>										
Registered unemployment rate‡(%)	6.1	6.1	6.1	5.4	6.1	6.1	6.4	5.2	6.4	5.4
Employment in enterprises (% y/y)	-1.5	-1.2	-1.0	0.8	-2.0	-1.9	-2.4	2.7	-1.6	1.0
Wages in enterprises (% y/y)	4.1	5.6	5.1	7.0	2.1	4.3	3.9	6.6	4.3	4.7
<b>Prices^</b>										
CPI inflation (% y/y)	2.9	3.2	3.0	4.6	3.2	3.0	2.4	2.3	3.4	1.9
Core inflation (% y/y)	4.0	4.3	4.1	3.4	3.8	4.2	3.8	1.9	3.8	1.7
15% trimmed mean (% y/y)	3.2	3.2	x	3.4	3.4	3.2	x	2.0	x	x
PPI inflation (% y/y)	-1.2	-1.6	-0.8	0.2	-1.3	-1.2	0.7	1.2	-0.3	1.9
<b>Monetary aggregates‡</b>										
Money supply, M3 (PLN bn)	1744.1	1762.2	1783.0	1624.9	1746.2	1762.2	1778.9	1565.6	1778.9	1912.3
Money supply, M3 (% y/y)	16.2	17.0	17.0	11.8	18.1	17.0	13.9	8.3	13.9	7.5
Real money supply, M3 (% y/y)	13.3	13.8	14.0	7.2	14.8	13.8	11.4	4.9	10.6	5.6
Loans, total (PLN bn)	1331.2	1337.7	x	1366.6	1341.1	1337.7	1353.2	1323.7	1353.2	1417.1
Loans, total (% y/y)	0.3	0.5	x	6.5	3.1	0.5	2.2	5.1	2.2	4.7
Deposits, total (PLN bn)	1615.9	1627.3	x	1485.1	1618.7	1627.3	1609.9	1406.6	1609.9	1683.7
Deposits, total (% y/y)	15.5	15.8	x	11.2	19.5	15.8	14.5	8.2	14.5	4.6
<b>Balance of payments</b>										
Current account balance (% GDP)	3.0	3.2	3.2	1.1	2.3	3.2	3.0	0.5	3.0	2.8
Trade balance (%GDP)	1.6	1.7	1.7	0.4	1.2	1.7	2.0	0.2	2.0	1.4
FDI (% GDP)	1.1	1.1	1.0	1.4	1.6	1.1	1.3	1.6	1.3	1.8
<b>Fiscal policy</b>										
Fiscal balance (% GDP)	x	x	x	x	x	x	x	-0.7	-11.1	-4.4
Public debt (% GDP)	x	x	x	x	x	x	x	46.0	62.3	63.0
<b>Monetary policy‡</b>										
NBP reference rate (%)	0.10	0.10	0.10	1.00	0.10	0.10	0.10	1.50	0.10	0.10
NBP lombard rate (%)	0.50	0.50	0.50	1.50	0.50	0.50	0.50	2.50	0.50	0.50
NBP deposit rate (%)	0.00	0.00	0.00	0.50	0.00	0.00	0.00	0.50	0.00	0.00
WIBOR 3M* (%)	0.23	0.23	0.23	1.17	0.26	0.22	0.25	1.71	0.25	0.25
Real WIBOR 3M* (%)#	-2.67	-2.67	-2.87	-3.43	-3.04	-2.78	-2.15	-1.69	-3.05	-1.65
<b>Exchange rates*‡</b>										
EUR-PLN	4.40	4.53	4.62	4.55	4.46	4.53	4.52	4.26	4.52	4.40
USD-PLN	3.73	3.87	3.95	4.15	3.98	3.87	3.90	3.80	3.90	3.67
CHF-PLN	4.10	4.19	4.32	4.30	4.18	4.19	4.22	3.92	4.22	4.04
EUR-USD	1.19	1.17	1.17	1.11	1.12	1.17	1.16	1.12	1.16	1.20

Source: GUS, NBP, PKO Bank Polski.

\*PKO BP Market Strategy team forecasts,

‡period averages for quarterly and yearly data,

#deflated with current CPI inflation,

‡period end values,

‡under revision.

## Monetary policy monitor

MPC Members	Hawk-o-meter*	Recent policy indicative comments
K. Zubelewicz	4.9	"I'm afraid a majority on the MPC will be focused on economic growth and ready to tolerate inflation around 3.5% for longer," he said. "A rate hike would be a nice surprise, but I don't expect it." (21.07.2020, Bloomberg)
E. Gatnar	4.7	"If the economy keeps the current pace of returning to the path of growth, inflation will also be elevated. In such conditions, with the current level of control over the pandemic situation, a gradual normalization of monetary policy from the beginning of next year should be considered" (02.09.2020, Reuters)
L. Hardt	4.1	"Inflation in Poland is the highest in the EU at the moment (...) In Poland, ... in a longer perspective, we should not forget about inflation, as it is NBP mandate. (...) I believe we cut rates too much and it's a petty we did not resort to more non-standard measures, taking into account the high inflation" (23.07.2020, PAP)
G. Ancyparowicz	2.5	"Unless very strong arguments come forward, I am in favor of maintaining interest rates at an unchanged level at least until the end of this crisis (...) When everything returns to normal, then MPC of the next term, certainly not the current one, at some point will hike interest rates; in this term in office I certainly don't see prospects for interest rate hikes" (20.10.2020, PAP)
C. Kochalski	2.4	"There are many arguments in favor of keeping such rates, while at the same time taking up other non-standard actions in the current conditions (...) The council reacts adequately to the situation, is looking at monetary easing in a broader context; interest rate cut is one of elements of realization of a broader package of monetary actions. (...) We cannot allow for inflation to go down below the inflation target mid-term (...) The decline of economic activity worldwide, including in Poland, weakening of demand, low commodity prices - these are only some arguments in favor of not allowing for the risk of inflation decline below the target to materialize." (03.06.2020, PAP).
J. Kropiwnicki	2.4	"Let's keep the ultra-low rate for a while. But then, in mid-2021, let's consider gradually returning it toward 1.5% " (30.09.2020, Bloomberg).
R. Sura	2.2	"Of course, the open question remains what the coming months will bring. However, for the time being the economy is functioning rather normally, we witness only punctual closures of some sectors so for now any actions when it comes to interest rates are out of question. The policy is well calibrated; I say it also in the context of some postulates concerning the possibility of introducing negative nominal interest rates. (...) Monetary policy has to remain loose longer-term to enable economic recovery." (14.10.2020, PAP).
A. Glapinski	1.9	"Although the worst is behind us, in the coming quarters we still need to support the economy and to keep accommodative monetary policy. The economic activity is still below the potential, unemployment is higher than before the crisis and further progress in the economic recovery could be more difficult to achieve than to date. (...) At the current level of interest rates, banks do not encounter limitations in developing lending." (18.09.2020, Dziennik Gazeta Prawna daily).
J. Zyzynski	1.9	"I see no prospects for monetary policy tightening in the current MPC term, that is until neighborhood of 2022 (...) and should the economy need further support in the crisis, rather lean on its asset purchase program to grease government rescue efforts." (26.10.2020, PAP)
E. Lon	1.0	"In my opinion, the level of interest rates should remain at their current level to the end of the term of the current Monetary Policy Council (...) I don't rule out that should a significant threat of strong decline in consumer moods arise, it would be possible that I would submit a motion for a reduction in interest rates of our central bank" (07.09.2020, PAP, Refinitiv)

\*the higher the indicator the more hawkish views. Due to the fact that the new MPC has not voted yet on interest rates changes, the positioning has been made based positively on PAP survey conducted among economists at banks in Poland (scale 1-5).

### Interest rates – PKO BP forecasts vs. market expectations

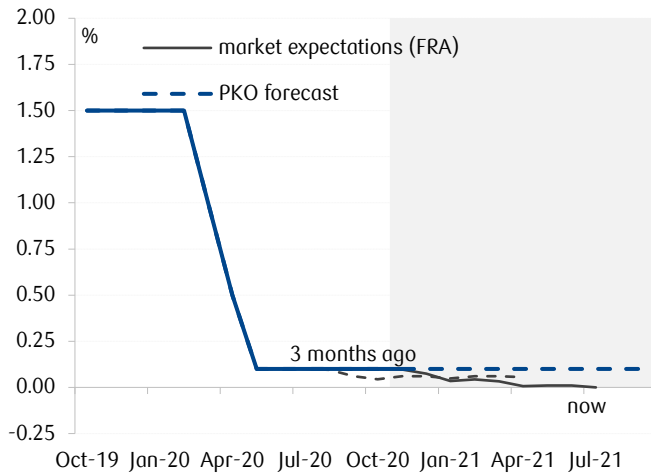
	1M	2M	3M	4M	5M	6M	7M	8M	9M	
<b>Date</b>	29-Oct	29-Nov	29-Dec	29-Jan	28-Feb	28-Mar	28-Apr	28-May	28-Jun	28-Jul
<b>WIBOR 3M/FRA†</b>	0.22	0.22	0.20	0.16	0.16	0.15	0.13	0.13	0.13	0.12
<b>implied change (b. p.)</b>		0.00	-0.03	-0.07	-0.06	-0.07	-0.09	-0.09	-0.09	-0.10
<b>MPC Meeting</b>	4-Nov	2-Dec	-	-	-	-	-	-	-	-
<b>PKO BP forecast*</b>	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
<b>market pricing*</b>		0.10	0.08	0.04	0.04	0.03	0.01	0.01	0.01	0.00

†WIBOR 3M from the last fixing, FRA transactions based on WIBOR 3M for subsequent periods, ‡in basis points, \*PKO BP forecast of the NBP reference rate.

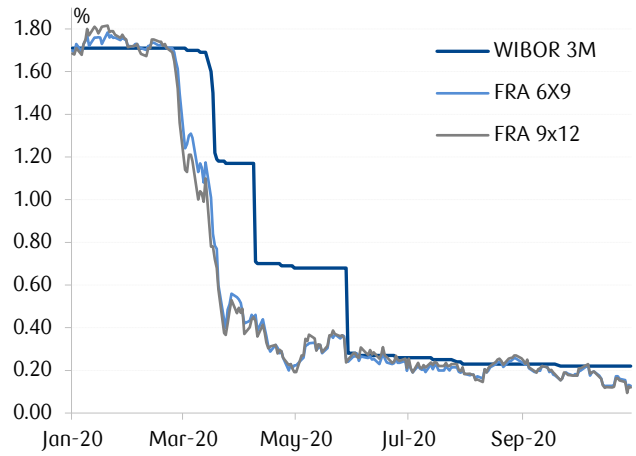


## Poland macro chartbook

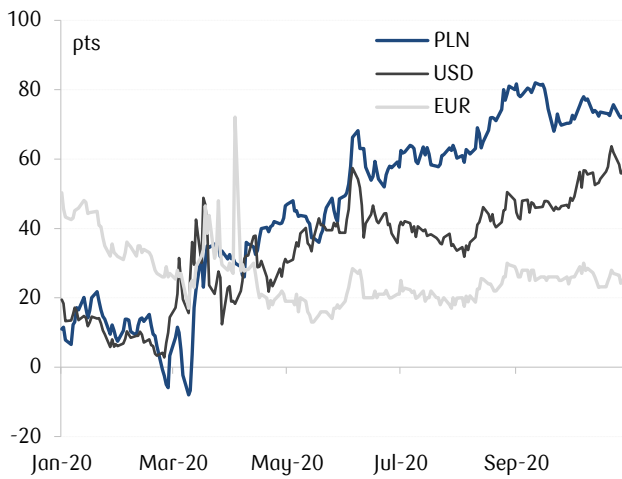
NBP policy rate: PKO BP forecast vs. market expectations



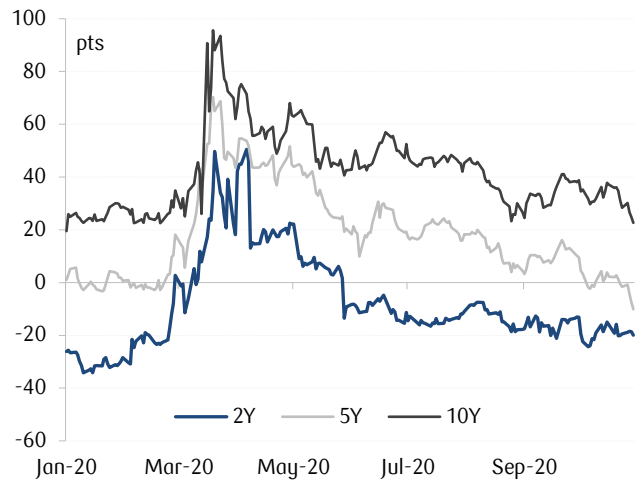
Short-term PLN interest rates



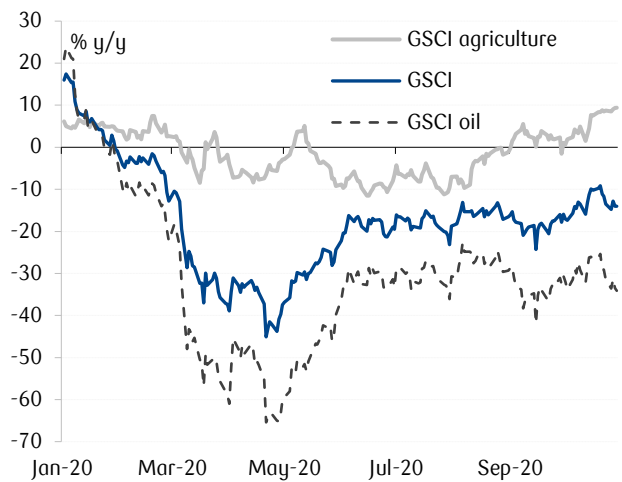
Slope of the swap curve (spread 10Y-2Y)\*



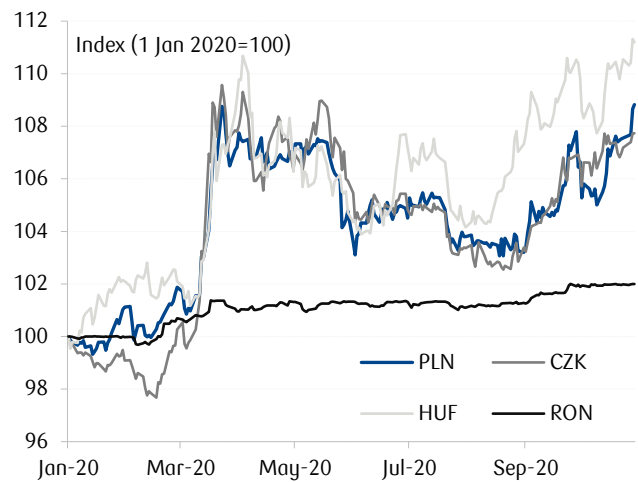
PLN asset swap spread



Global commodity prices (in PLN)



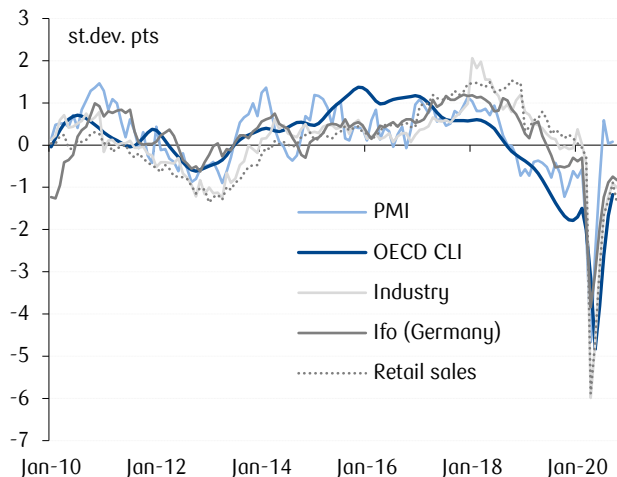
Selected CEE exchange rates against the EUR



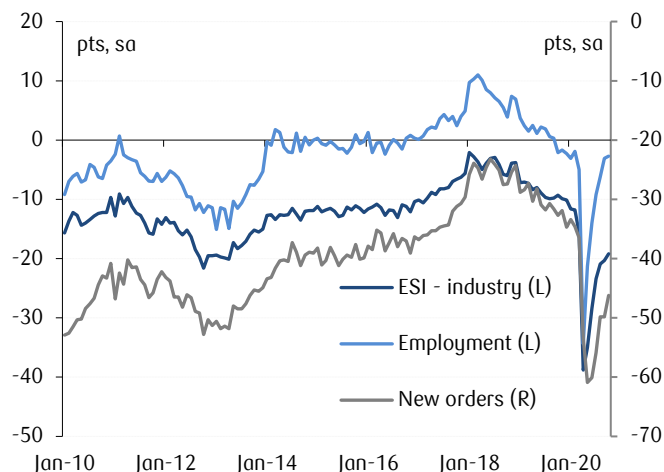
Source: Datastream, NBP, PKO Bank Polski. \*for PLN, and EUR 6M, for USD 3M.



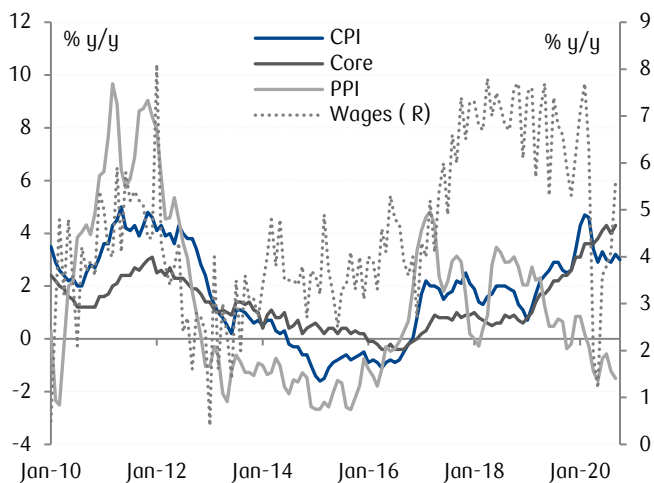
Economic sentiment indicators



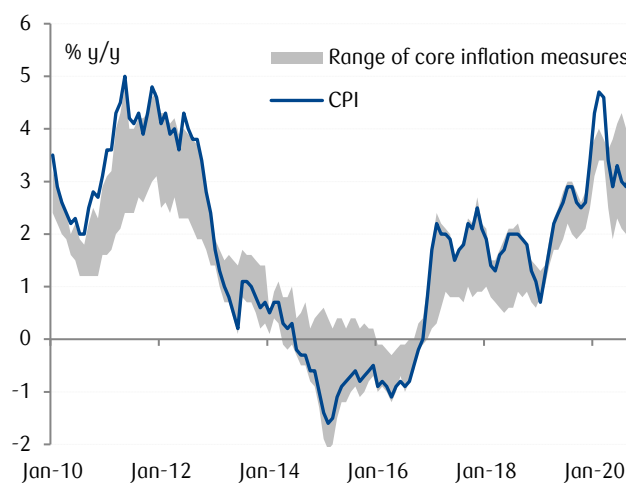
Poland ESI for industry and its components



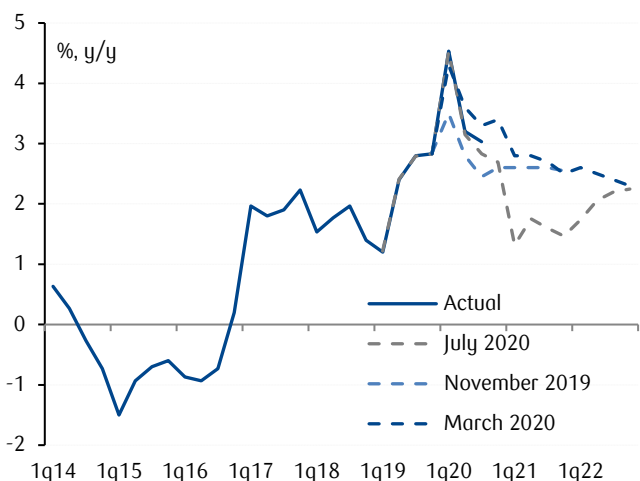
Broad inflation measures



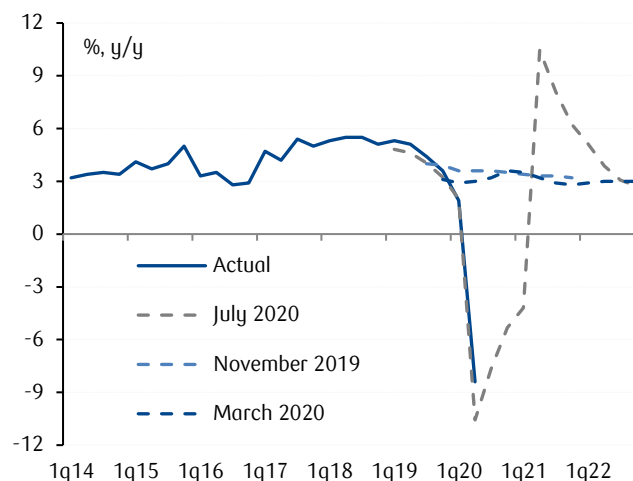
CPI and core inflation measures



CPI inflation - NBP projections vs. actual

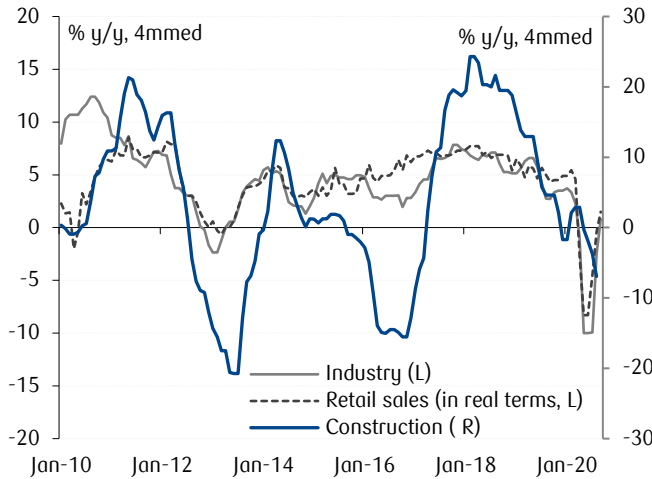


Real GDP growth - NBP projections vs. actual

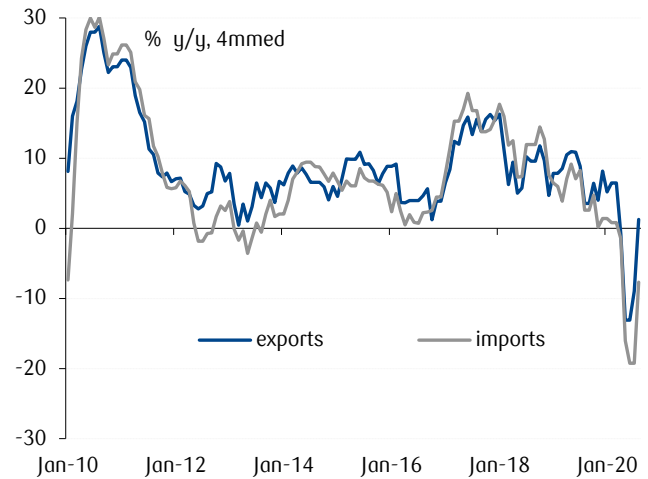


Source: Datastream, GUS, EC, NBP, PKO Bank Polski.

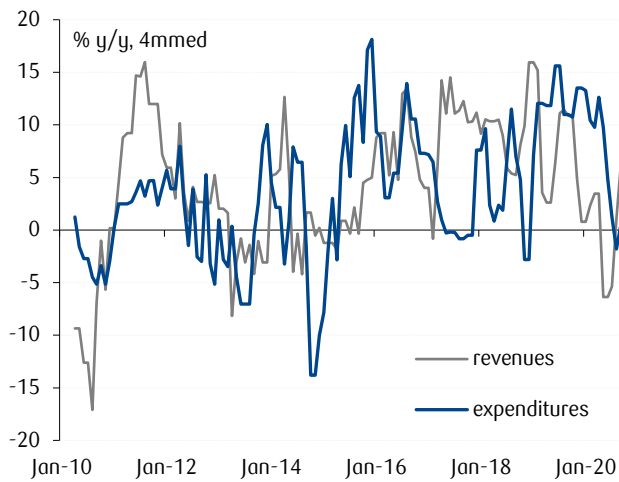
Economic activity indicators



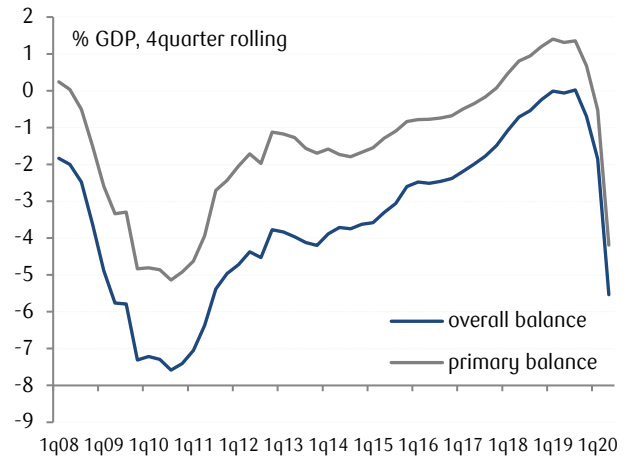
Merchandise trade (in EUR terms)



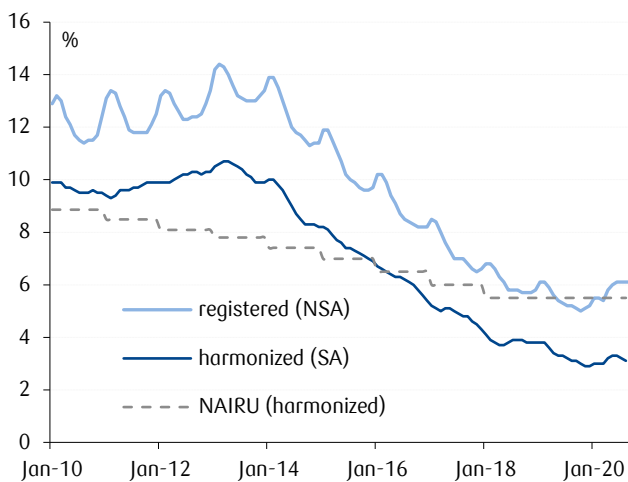
Central government revenues and expenditures\*



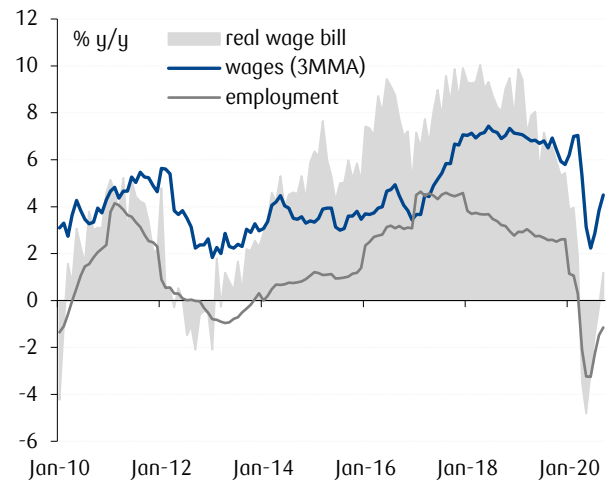
General government balance (ESA2010)



Unemployment rate

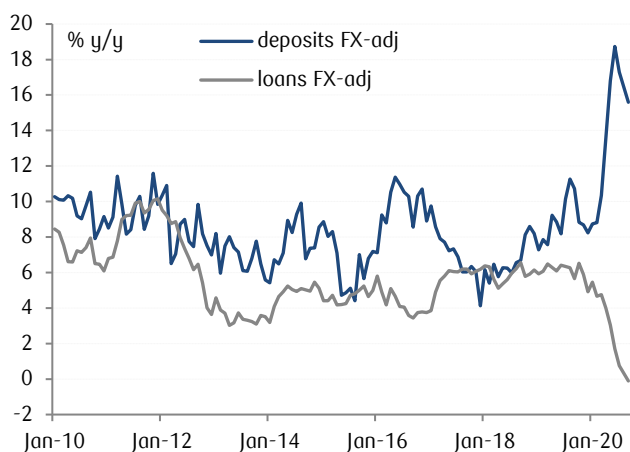


Employment and wages in the enterprise sector

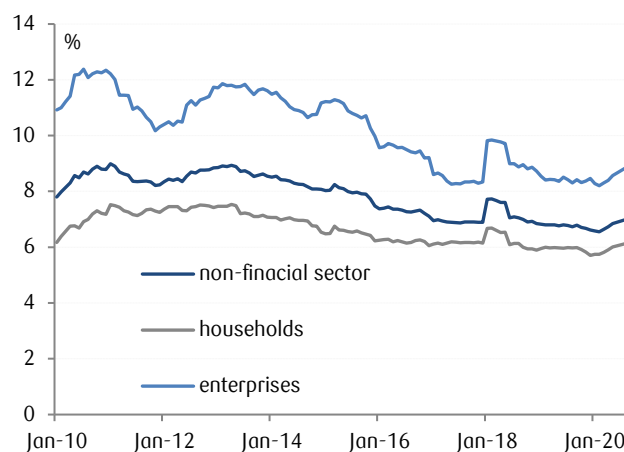


Source: NBP, Eurostat, GUS, MinFin, PKO Bank Polski. \*break in series in 2010 due to methodological changes.

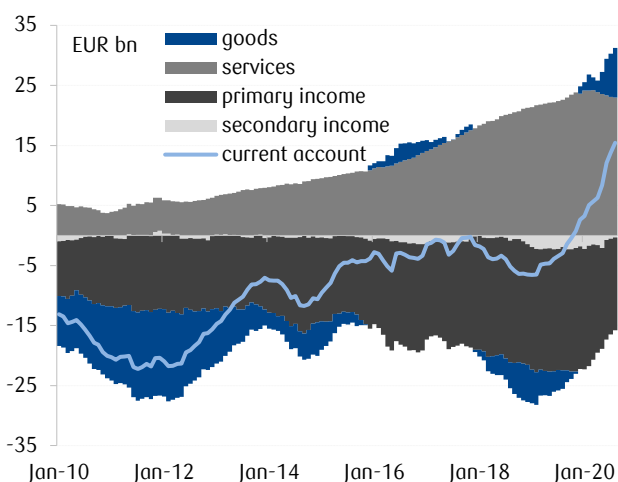
### Loans and deposits



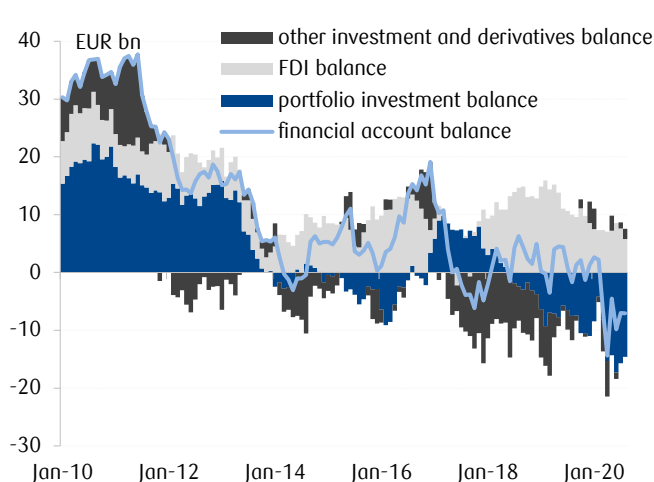
### Non-performing loans (NPLs) - by sectors\*



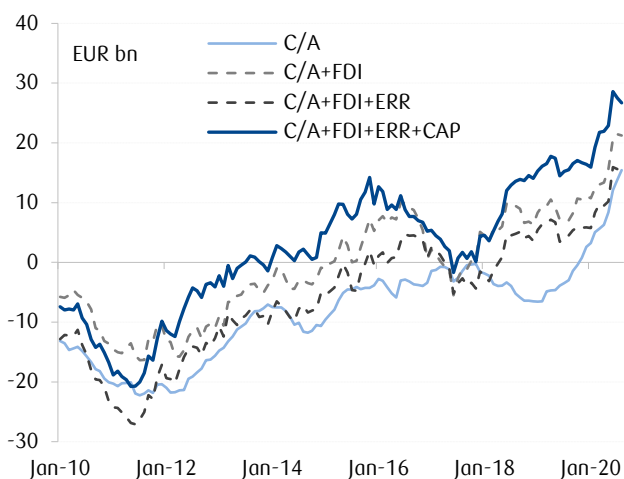
### Current account balance



### Financial account balance



### External imbalance measures



### NBP FX reserves (in EUR terms)



Source: NBP, PKO Bank Polski. \*break in series in Jan2018 due to methodological changes.

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## Poland's macro in a nutshell

	2019	2020	Comment
<b>Real economy</b>			
- real GDP (%)	4.5	-2.9	GDP bottomed out in 2q20 falling by 8.2% y/y. Both private consumption and investment declined by double-digit rates. High-frequency data points at significant rebound of economic activity in 3q. that said, the new wave of covid-19 infections may disturb the V-shaped recovery at year-end. We pencil in a second dip of the recession, this time much shallower than under lockdown conditions in Spring.
<b>Prices</b>			
- CPI inflation (%)	2.3	3.3	Disinflationary forces will prevail in subsequent quarters, but due to specific factors, inflation in Poland will not fall as much as in many other economies. As the supply-side factors related to the pandemic expire, core inflation will be affected by weaker demand. Administrative factors will also play an important role (postponed entry into force of the power fee and sugar tax, increase in the RTV subscription).
<b>Monetary aggregates</b>			
- M3 money supply (%)	8.3	13.9	Despite government guarantees, credit growth is likely to decelerate in the medium-term due to lower bank profitability resulting from lower rates. M3 will accelerate due to sovereign debt purchase of the central bank.
<b>External balance</b>			
- current account balance (% GDP)	0.5	3.0	A clear reduction of primary income deficit (lower FDI profits and remittances of Ukrainians) should support increasing net exports of goods. Thus, CA surplus will visibly widen. As the stimulus package proposed by the EC unwinds, it will also improve capital account balance, leading to further decline of the foreign debt to GDP ratio.
<b>Fiscal policy</b>			
- fiscal balance (% GDP)	-0.7	-11.1	The cost of the fiscal anti-crisis shield (incl. off-balance spending of the State Development Bank and the Polish Development Fund) and fiscal revenues loss caused by the recession will significantly widen the fiscal deficit. Strong fiscal stance in 2019 means that there exists a fiscal space when it comes to both deficit and debt.
<b>Monetary policy</b>			
- NBP reference rate (%)	1.50	0.10	The MPC cut NBP interest rates in three moves in March-May (key policy rate to 0.10%). Dovish and moderate MPC members claim NIRP is not an option for now. Our baseline scenario assumes that rates will remain flat until at least end-2021.

Source: GUS, NBP, Eurostat, PKO Bank Polski.

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