8 January 2021

# Poland Macro Update

## NBP's new FX focus limits downside for EUR/PLN near term but not permanently

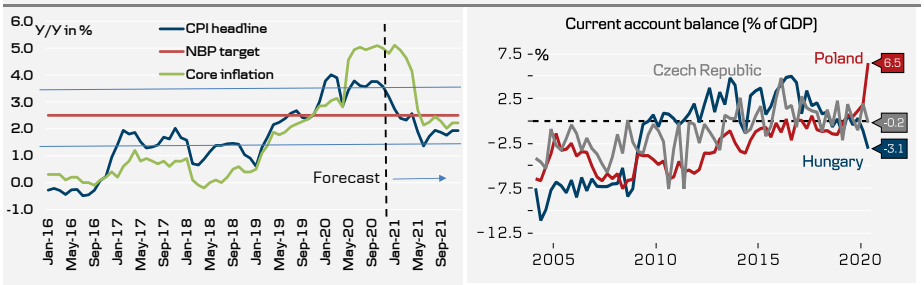
- The National Bank of Poland (NBP) seems to have informally introduced an FX target of around 4.50 and increased the focus on economic growth.
- We have difficulty seeing the reasons for explicitly weakening the PLN given the solid export growth and sizeable inflation pressures. We do not expect the central bank to cut rates at next week's meeting.
- Nevertheless, we believe the NBP will seek to maintain the EUR/PLN around current levels until the crisis is over, by mid-summer at the earliest.
- As a result we raise our profile for EUR/PLN to 4.50 in 1-3M and then as recovery gets underway see the cross falling to 4.40 in 6M and 4.35 in 12M.

### New explicit FX focus goes too far in our view

**The NBP had a negative surprise for the PLN for Christmas**, with the breaking of a Bloomberg news story that the central bank had intervened in the FX market to weaken the PLN, later confirmed by Governor Adam Glapiński. According to the governor, the intervention aimed to strengthen the impact of looser monetary policy on the PLN and the Polish economy as a whole. Further, late last week he hinted that while the central bank's benchmark interest rate is at the appropriate level a, rate cut would be in play if the economy were to worsen in Q1 20. This sent the EUR/PLN even higher, supported by comments from Monetary Policy Council (MPC) member Grazyna Ancyparowicz, who went as far as saying the 'optimal' EUR/PLN rate to support the Polish economy was '4.50 or higher'.

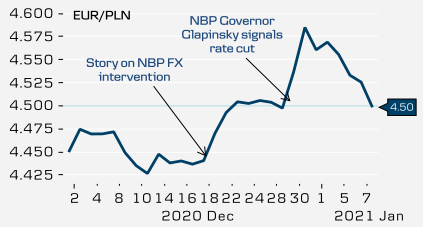
**This explicit focus on the PLN and economic growth by the MPC is new and noteworthy.** Yes, there have been hints before but not to this degree. With the new FX and economic growth focus, the NBP is moving towards the Hungarian central bank's dovish approach. However, we have difficulty seeing the reasons for the NBP's desire to weaken the PLN. Yes, the economy has been hit like many other European countries by a resurgence in the number of COVID-19 cases, which has led to the imposition of new restrictions, weighing especially on service sector activity. However, industrial production and employment remain relatively strong, supported by newfound global manufacturing strength. With the rollout of vaccines (although Poland has been relatively slow in doing this), there is light at the end of the tunnel, as we expect the global and Polish economy to see stronger growth from Q2 onward.

**No need for weaker PLN in our view – inflation pressure should abate but not to alarming levels and the current account surplus is surging**



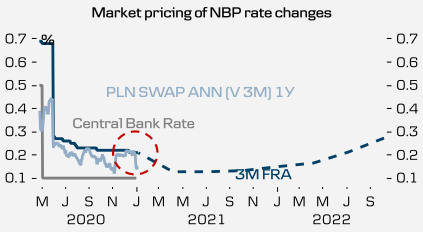

*Source: Macrobond Financial, Danske Bank*

**NBP's recent strategy to weaken PLN has worked**




*Note: Past performance is not a reliable indicator of current or future results*
*Source: Macrobond Financial, Danske Bank*

**Market has priced in a rate cut in Q1**




*Note: Past performance is not a reliable indicator of current or future results*
*Source: Macrobond Financial, Danske Bank*

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Furthermore, the risk of too low inflation is not apparent, with core inflation at 4.3% in November, significantly above even the upper range of the central bank's inflation band of 1.5-3.5%. There might be a tempering of inflation over the spring, as one-off factors currently boosting inflation cease, but, in our view, this will to some extent be offset by higher energy and oil prices and inflation will fall only to slightly below the main target.

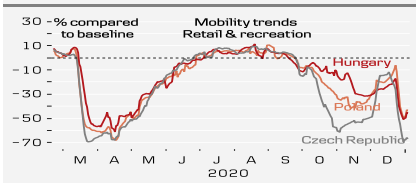
Finally, compared with other Eastern European peers, Poland is seeing quite a sharp improvement in external balances. The current account deficit is at a record high of 6.5% of GDP, driven in part by higher exports.

## Implications for monetary policy and the PLN

The uncertainty is what implications the new rhetoric will have for monetary policy and the PLN in 2021. On the monetary policy side, our base case would not be a cut in the central bank's policy rate. The governor has backtracked somewhat and there are other MPC members that are clearly against cutting interest rates. Furthermore, as long as new restrictions are not needed and the coronavirus situation does not worsen significantly again, the economy should do fairly well. However, the jump in new cases to 14,000 today should be watched very closely if related to the new and more infectious UK COVID-19 variant.

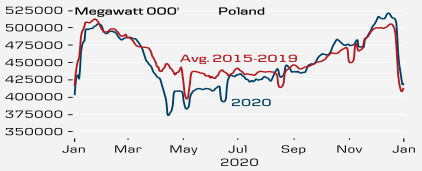
On the FX side, we believe that the central bank will stick to its new signal and prevent a sharp strengthening of the exchange rate in the short term. In our view, a new range for EUR/PLN may be formed in coming months (Q1 at least) at 4.48-4.60 but as the recovery in Poland and globally strengthens during the spring, we believe the central bank will be more open to letting the PLN strengthen and, therefore, we could see the EUR/PLN falling to 4.40 in 6M and 4.35 in 12M.

**Yes, restrictions are weighing on service sector activity...**



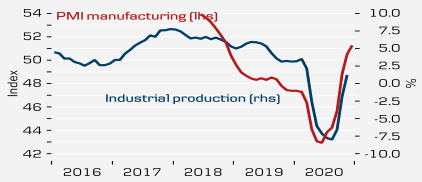

*Source: Macrobond Financial, Danske Bank*

**...but electricity consumption is on par with previous years...**




*Source: Macrobond Financials, Danske Bank*

**...as industrial production is rebounding amid improved confidence**



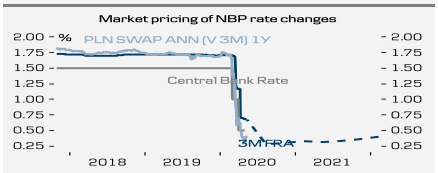

*Source: IMF World Economic Outlook database April 2020, Macrobond Financial, Danske Bank*

**Real rates have fallen deeply into negative territory...**




*Note: The real rate is found by subtracting headline inflation from the nominal policy rate*
*Source: National Bank of Poland, Danske Bank*

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




*Source: Macrobond Financial, Danske Bank projections*

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