Weekly Economic Update

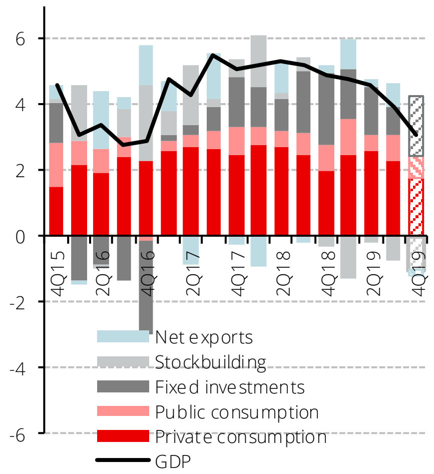
21 February 2020

How much did the private consumption slow?

What's hot next week

- The market players will plunge into the new week mulling the G20 representatives' thoughts on coronavirus impact on the global economy. On Monday we will also get to see Ifo for Germany and the euro zone, on Thursday ESI indices are due for release. In our view, this gauges can prove more precise in measuring the impact of SARS-CoV-2 on business sentiments than the PMI. PMI Germany improved markedly in February thanks to the coronavirus, as the PMI concept assumes longer delivery times as a positive. Market sentiments will also depend on spending and incomes of US consumers.
- In Poland on the last working day in February we will get to see detailed 4Q GDP data. We already know that economic growth for the quarter moved from 4% to around 3% y/y, and it will be important to know which of the subcomponents is responsible for the change. It would be particularly worrying if it turned out that the private consumption slowed down to below 3.5% y/y. On the other hand in 4Q the investment growth was probably stronger than in 3Q. In light of the December current account data it is likely that net exports contributed positively to GDP growth.
- Globally, it is worth to mention the Hungarian central bank (MNB) decision. Change of tone towards more hawkish in response to a fast rise of inflation would distinguish MNB from the reserved attitude of the Polish MPC.

GDP growth breakdown, % y/y



Source: GUS, Santander

Market implications

- The recent days showed that the dollar performance was crucial for the zloty and the positive trends on the equity market were of less importance. We expect EURUSD could stabilize a bit, particularly after it did not manage to break important support at c.1.08 last week. Should the dollar rally pause, the zloty could stop depreciating with EURPLN holding below the YTD peak at c4.31.
- The option market starts to see higher probability for lower Bund yield. If the 10Y Bund yield leaves the tight range and starts to fall fast, Polish debt may follow. Poland both 5Y and 10Y bond yields approached their support levels at 1.75% and 2.06%, respectively. In our view, these levels could be tested in the coming days.

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Last week in economy

This week was rich in first data from January 2020 and while these were generally a mixed bag, it seems that on average they were better than expected, with especially industrial and construction output coming out above the consensus. Still, in our view this week's data were suggesting a continuation of economic slowdown in 1Q20, especially as regards the private consumption.

Industrial output increased by 1.1% y/y in January vs 3.8% y/y in December, a bit stronger than we expected (-0.1% y/y). The annual growth rate was dragged lower by the negative working day effect, while the seasonally adjusted data showed an acceleration to 3.5% y/y from 2.1% y/y, which is close to the 2H19 average growth. Exporting sectors were doing quite well and surprisingly the intermediate goods output registered no slowdown vs December (this sector took the main hit as regards foreign demand in 2019). The upcoming months could prove challenging for the Polish industry, given still sluggish activity in Germany and potential impact of disruptions due to outbreak of SARS-CoV-2. Poland's textile and electronics sectors are the most vulnerable.

Construction output surprised to the upside, adding 6.5% y/y in January 2020 (while market expected a decline by 3.6% y/y). This was one of the mildest Januaries in many years: average temperature in January 2020 was by 3.5 Celsius degrees higher y/y, and there were hardly any days with temperature below 0°C (see side chart). While the sector could have benefitted from the favourable weather conditions, we could also see some rebound in construction-related industries, like manufacture of mineral products, so maybe the sector is trying to recover. We will be able to say more on this after February, when the y/y difference in weather conditions was less significant.

In February, all **GUS sectoral business sentiment indicators** declined m/m, except ICT. The sudden rise of optimism in industry in January (unconfirmed by other surveys) was almost entirely removed in the February print, bringing the index back to the 2H19 average. The broad-based m/m deterioration of business sentiment came from the current assessment part of the survey, while some improvement was recorded in the forward looking components across sectors.

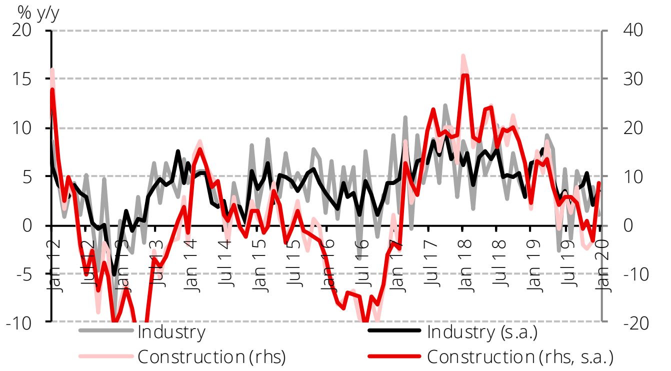
Corporate wage growth accelerated to 7.1% y/y with the minimum wage hike possibly adding 1 pp, and underlying momentum most likely remaining robust. **Corporate employment** rose in January by 1.1% y/y, less than expected, but note that the January data is under strong effect of change in the statistical sample. In our view, however, the demand for labour in Poland is weakening and this should also rein in the wage growth in the months to come. The accelerating inflation is consuming a large part of higher wage growth and this is translating into **falling consumer confidence.**

Real retail sales rose by 3.4% y/y vs 4.1% market expectations and the previous print of 5.7%. The categories that surprised us negatively are durables: cars, furniture, consumer electronics and white goods. Taken together, durable goods sales were up only 3.5% y/y, which is the lowest print since September 2018. The weaker pace of retail sales is consistent with slower real wage bill growth and declining consumer sentiment.

The MPC January motion to cut rates by 25bp was still supported only by E. Łon. The motion was repeated in February. Another January motion, to hike rates by 15bp, gained support of three members (Zubelewicz, Hardt, Gatnar), which shows that the current strong rise of CPI has not triggered anyone else to support monetary tightening. The motion was not repeated in February, but it might show up again in March – this is how we read the last interviews with Gatnar and Hardt.

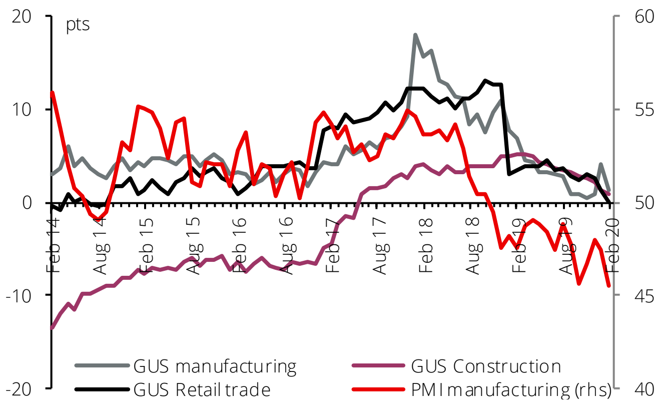
The February minutes mentioned the potential persistence of factors elevating inflation and that discussion on a rate hike will depend on the message of the new projection. The document also included a remark that the majority expects a larger GDP growth slowdown than earlier assumed – which is a reason to wait the current rise of inflation out as it should be back to the target still within the current monetary policy time horizon. The majority still considers the high inflation to come from supply and regulatory factors. Inflation expectations are seen by the majority as not problematic – their behaviour is seen as only adaptive and enterprises are expected to raise prices in a limited way due to the slowdown. We think that interest rates will not be changed in 2020.

Output in industry and construction, % y/y



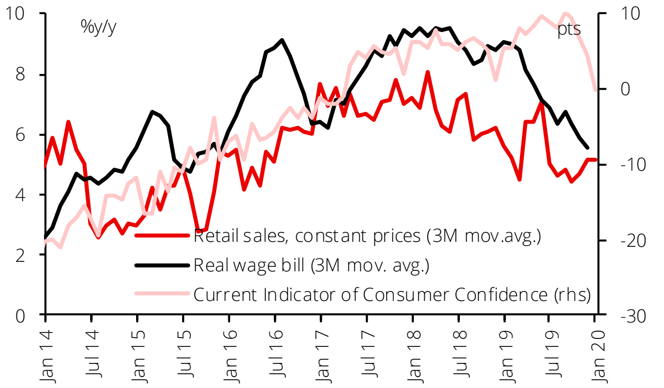
Source: GUS, Santander

GUS business sentiment indicators,



Source: GUS, Santander

Retail trade, consumer confidence and income



Source: NBP, Santander

Quote of the week:

Eugeniusz Gatnar, MPC member, 18 Feb, PAP: If March projection shows a higher CPI path than the November edition, with CPI in the upper area of tolerance band, then a motion to hike rates will be justified.

Łukasz Hardt, MPC member, 21 Feb, PAP: by hiking rates by 15bp, the central bank would show it holds a grip on the inflation target and its mandate. Such an action would boost the monetary policy credibility and rein in the inflation expectations. (...) If the NBP projection does not show inflation returning to the target shortly, amid persistence of factors elevating the price growth, it is likely we will consider a motion to hike rates in March.

FX and FI market

Last week on the market

FX In the passing week, the zloty depreciated vs main currencies – by around 1% vs EUR, USD and CHF, less than 0.1% vs the GBP. Among the EM currencies, only the Ukraine hryvna gained in the recent days. The zloty and its peers were pressured by the stronger dollar while the main equity indices mostly gained. EURPLN rose to nearly 4.30, our call from the previous week and the upper end of the 4.24-4.30 range observed since early February.

FI The IRS rates and bond yields fell by c10bp as the core yields were trending slowly down. PL-DE 10Y bond yield spread fell c5bp to 255bp. At the switch auction, the Ministry of Finance sold bonds worth PLN4.1bn and informed that this year's borrowing needs are already covered in 73%.

Key events

Next week, the Hungarian central bank will announce decision about interest rates and we will get to see important US data.

Hungarian inflation rose meaningfully in January to 4.7 %y/y vs 4% in December. National Bank of Hungary Deputy Governor Nagy said that the bank is going to use all tools in the bank's toolkit to ensure its price growth target but the central bank is likely to wait until March to have a better assessment of the coronavirus impact. Nevertheless, as early as in February the post-meeting rhetoric could be less dovish than in the previous months.

Market implications

FX The recent days showed that the dollar performance was crucial for the zloty and the positive trends on the equity market were of less importance.

EURUSD has been on the downside since the beginning of the year. The 8-week % change indicates that the pace of the exchange rate drop within this time frame has been the fastest since mid-2018. Back then, EURUSD stabilised for a few weeks after the greenback rally. The dollar gained recently thanks to the decent US data and we think that next releases would have to prove much better-than-expected to support the dollar further. We expect EURUSD could stabilise a bit, particularly after it did not manage to break important support at c.1.08 last week.

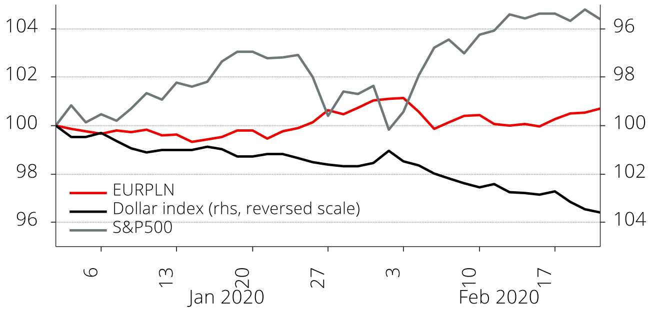
Should the dollar rally pause, the zloty could stop depreciating with EURPLN holding below the YTD peak at c4.31.

There is a chance that the forint could gain vs the zloty in the coming days if the National Bank of Hungary sustains market expectations for a less accommodative monetary policy. Should the Hungarian central bank sound at least a bit more hawkish, the zloty could be left alone in the CEE3 group with no outlook for tighter monetary policy amid high inflation.

FI After a stabilisation observed since the beginning of the month, the 10Y Bund yield tried to resume the down move but this was stopped by the much-better-then-expected flash February manufacturing PMIs for Germany and euro zone. However, according to the official comment to the German data released by IHS Markit "Almost half of the index's month-on-month gain was attributable to a deterioration in supplier delivery times" likely attributable to the coronavirus impact. Should the market realise that the headline index surprising jump does not tell the whole truth, demand for safe assets may return. The option market also starts to see higher probability for lower Bund yield. If the 10Y Bund yield leaves the tight range and starts to fall fast, Polish debt may follow.

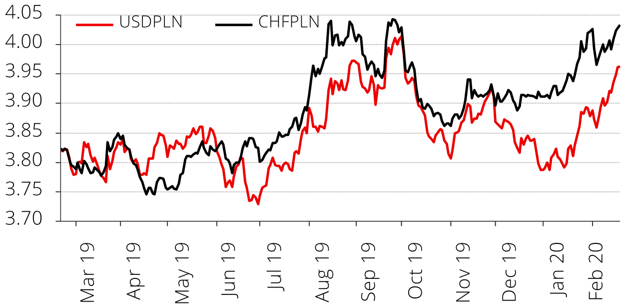
Poland both 5Y and 10Y bond yields approached their support levels at 1.75% and 2.06%, respectively. In our view, these levels could be tested in the coming days.

EURPLN, dollar index and S&P500 (1 Jan 2020=100)



Source: Refinitiv Datastream, Santander Bank Polska

USDPLN and CHFPLN



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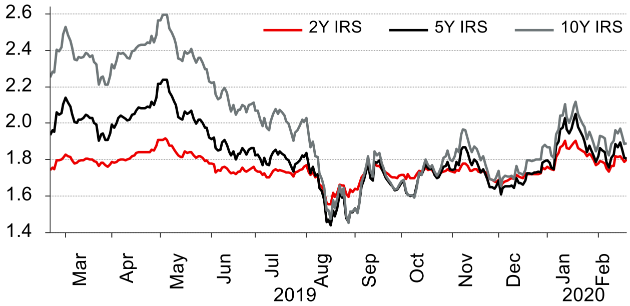
Poland IRS



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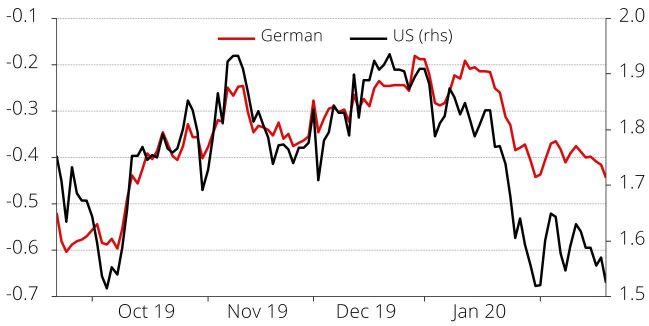
10Y Bund and UST yields



Source: Refinitiv Datastream, Santander Bank Polska

Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST SANTANDER	LAST VALUE
			MONDAY (24 February)				
10:00	DE	IFO Business Climate	Feb	pts	95.2	-	95.9
14:00	**PL**	**Money Supply M3**	**Jan**	**% y/y**	**8.8**	**9.0**	**8.3**
			TUESDAY (25 February)				
08:00	DE	GDP WDA	4Q	% y/y	0.4	-	0.4
10:00	**PL**	**Unemployment Rate**	**Jan**	**%**	**5.5**	**5.5**	**5.2**
14:00	HU	Central Bank Rate Decision		%	0.90	-	0.90
16:00	US	Consumer Conference Board	Feb	pts	132.1	-	131.6
			WEDNESDAY (26 February)				
16:00	US	New Home Sales	Jan	% m/m	2.3	-	-0.4
			THURSDAY (27 February)				
11:00	EZ	ESI	Feb	pct.	102.4	-	102.8
14:30	US	Durable Goods Orders	Jan	% m/m	-1.5	-	2.4
14:30	US	GDP Annualized	4Q	% Q/Q	2.2	-	2.1
14:30	US	Initial Jobless Claims	week	k	211	-	210
16:00	US	Pending Home Sales	Jan	% m/m	2.0	-	-4.9
			FRIDAY (28 February)				
09:00	HU	GDP	4Q	% y/y	4.5	-	4.5
10:00	**PL**	**GDP**	**4Q**	**% y/y**	**-**	**3.1**	**3.9**
10:00	**PL**	**Private consumption**	**4Q**	**% y/y**	**-**	**3.5**	**3.9**
10:00	**PL**	**Investments**	**4Q**	**% y/y**	**-**	**7.3**	**4.7**
14:00	DE	HICP	Feb	% m/m	0.4	-	-0.8
14:30	US	Personal Spending	Jan	% m/m	0.3	-	0.3
14:30	US	Personal Income	Jan	% m/m	0.3	-	0.2
14:30	US	PCE Deflator SA	Jan	% m/m	0.1	-	0.3
16:00	US	Michigan index	Feb	pts	100.6	-	100.9

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg

Additional information is available on request. Please contact Santander Bank Polska S.A. Financial Management Division. Economic Analysis Department. al. Jana Pawła II 17. 00-854 Warsaw. Poland. phone +48 22 534 18 87. email ekonomia@santander.pl. http://www.santander.pl.