28 February 2020

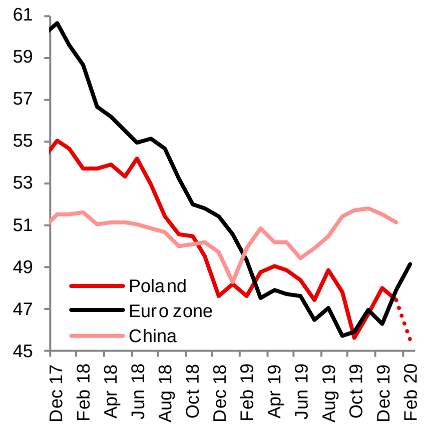
Weekly Economic Update

Virus still in focus

What's hot next week

- Last week was dominated by worries about expansion of SARS-CoV-2 and the upcoming week is likely to follow the same theme. On Monday and Wednesday we will get to see PMI indices, but these will not be particularly interesting in case of Germany and the euro zone, as we have already seen flash readings. The measure for Poland could prove more catchy, as it will show entrepreneurs' sentiments prior to expansion of the virus in Europe. However, let us pinpoint an interesting construction flaw of PMI: potentially longer delivery times would push the index up (as it happened in Germany). Moreover, we will get to see important data from the USA – industrial orders and non-farm payrolls. As the market has been overcome by pessimism, forecasts are depressed, indicating some risk of positive surprises.
- In Poland, except PMIs, there will be the MPC meeting. Although we do not expect any change of interest rates, the Council will be confronted with January's inflation jump to 4.4% y/y, which is well above central bankers' earlier expectations. We think that this inflation increase will be called "transitory" again and the MPC will focus on weaker economic data and risk of further economic slowdown. Possibly, we will hear again that the next rate decision is more likely to be a cut than a hike. At the March meeting the MPC will get to know the new NBP projections. We expect to see higher predicted inflation and lower economic growth. It is possible that once again motions to cut and to hike interest rates will be submitted at the very same meeting.

Manufacturing PMIs



Source: Bloomberg, Santander

Market implications

- We think the zloty depreciation could continue and we assume EURPLN could reach 4.35 before it stabilizes. As the same time, EURUSD could rise further helping USDPLN to move down.
- We expect some correction after the recent Polish bond weakening, particularly given the fact that the interest rate market has started to price in several rate cuts which is too pessimistic. Any information about fiscal stimulus from China or Germany could strengthen such market move. On the over hand, one cannot exclude that the number of Covid-19 infections rises further generating a down pressure on yields.

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Last week in economy

4Q GDP data are worrying due to the deeper-than-expected slowdown of domestic demand. ESI consumer sentiment worsened significantly again in February. Labour market stayed strong in 4Q according to LFS data. Credit data show that only mortgage loans are not slowing down.

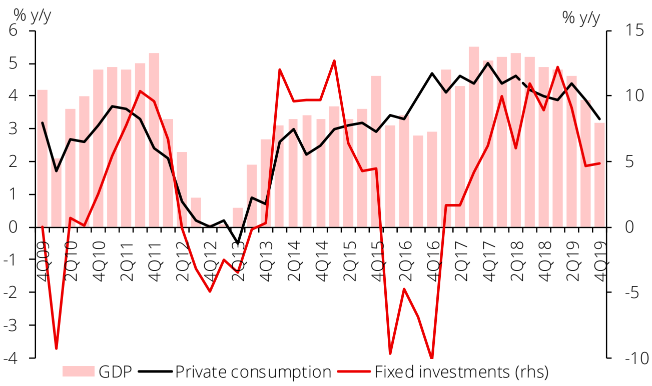
GDP growth in 4Q19 reached 3.2% y/y, and 0.3% q/q in seasonally adjusted terms. The results were 0.1pp above the flash estimate released two weeks ago. Also, the estimate for the entire year was moved from 4.0% to 4.1%. Private consumption slowed to 3.3% y/y in 4Q, its lowest since 2Q16 (despite the government money transfers worth over PLN20bn and still solid labour income), indicating a rise in households' saving rate. Investment growth reached 4.9% y/y (vs. 4.7% in 3Q), which means that the surprising rebound (to over 7%) suggested by earlier flash data did not materialise (but given that local governments' outlays dropped 10.7% y/y in 4Q, private investments must have grown by c15% y/y). The net export's contribution to GDP growth was boosted to 1.1pp, which is consistent with big improvement in international trade balance. On balance, even though the headline figure is slightly better than the flash estimate, the breakdown looks worrying, as the slowdown is fuelled mainly by domestic demand (its growth fell to merely 2.2% y/y, lowest since 2016). The coronavirus-related surge in uncertainty at the start of the year and disruptions in supply chains may depress consumption and investments even further. GDP growth is likely to slow further in 1Q, probably below 3%. More in our Economic Comment.

According to **ESI indicators for Poland**, in February there was a further deterioration of sentiment in business and among consumers. The main indicator and the aggregate employment index dropped to the lowest level in 3.5 years. Construction sector saw an improvement of current activity leading to a renewed rise of labour shortage problem. The services sector is signalling the worst conditions for current activity and expected demand in six years. The fear of the retail trade sector about future orders keeps growing. Consumers corrected lower their assessment and expectations regarding the economy and their future financial situation. As a result, the major purchases index dropped significantly. It does not seem that the spread of the epidemics has drastically affected the businesses and their views so far, however several consumer sentiment indicators have worsened quite fast.

In January, Poland **M3 money supply** rose by 9.3% y/y, more than the market had expected (8.8%). Household deposit growth weakened to 9.1% y/y, the lowest in more than a year, due to further drop in term deposits. Corporate deposits accelerated to 13% y/y, the highest since mid-2016. On the credit side, corrected for the FX changes, the data showed a y/y rise of 5.3% vs 5.2% previously – household credit kept increasing by 6.6% y/y (this was also the 2H19 average), while corporate credit accelerated from 3.3% y/y to 3.8% which however is still one of the weakest prints of the last three years. The growth of PLN-denominated consumer loans continues to fall gradually – to 8.6% y/y in January from almost 10% in September. At the same time PLN-denominated mortgage loans keeps growing at a similar pace to the previous months, 12.4% y/y - the strongest pace in more than four years.

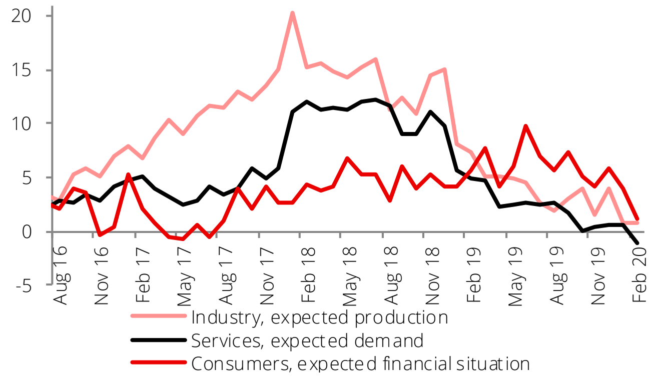
According to the **LFS data**, in 4Q19 the unemployment rate set a new all-time low at 2.9% versus 3.1% in 3Q19 and 3.8% in 4Q18, despite the fact that the monthly Eurostat estimates suggested a marginal rise in 4Q. The annual decline in the unemployment rate (0.9pp) was even more pronounced that previously. The jobless count fell by 163k (this was the fastest decline since 2Q18), which is 25.1% y/y. Working-age population shrank by 0.5% y/y, while the number of the employed increased by 0.4% y/y, recording the first significant increase since 3Q18. Still, the economic activity rate hit 56% in 4Q19, recording a fifth drop in a row in annual terms.

GDP and main components, %y/y



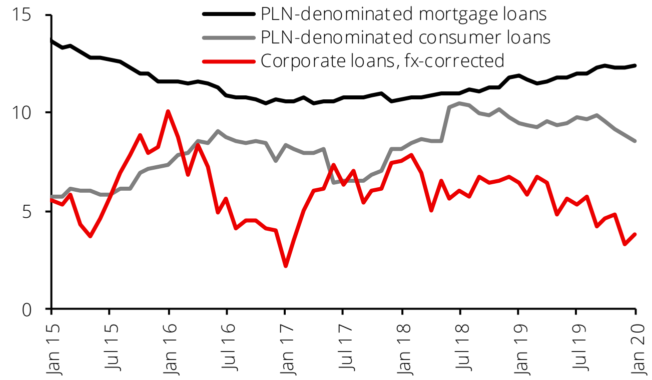
Source: GUS, Santander

Selected ESI indexes for Poland



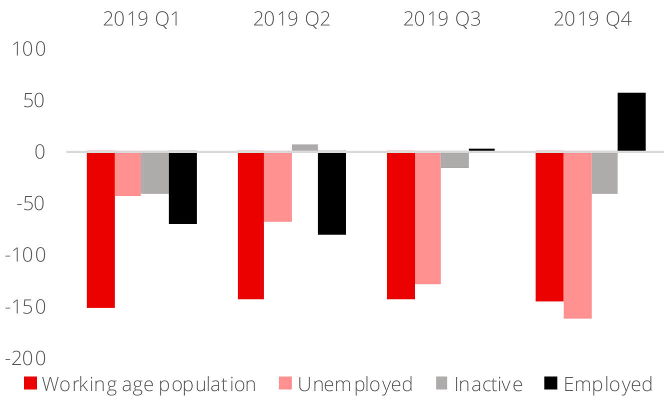
Source: European Commission, Santander

Credit growth, %y/y



Source: NBP, Santander

LFS - labour market status change, y/y (k)



Source: GUS, Santander

FX and FI market

Last week on the market

FX In the passing week, the zloty behaviour versus the main DM currencies has varied. EURPLN increased by 1.1% to 4.336 following other EM currencies in the context of increased risk-aversion. EURHUF went up 0.9% to 340.1, EURCZK by a significant 1.3% to 25.4 and rouble basket by a whopping 5.8% to 70.4 (not surprising given 13% w/w decline in oil price). In the meantime, however, the dollar index declined by 1.0% (EURUSD up by c 2%; GBPUSD down by 0.8%) and as a result the crosses declined as well: USDPLN by 0.6% to 3.93 while GBPPLN by 1.3% to 5.06. Realized volatility of the EURPLN has increased. More importantly, the implied volatilities have moved higher significantly (1Y ATM +0.5pp) for the first time in long.

FI Core market rallied relentlessly in the past week and, as is usually the case, the Polish fixed income followed. What is interesting though is that it was the US curve and not the usual suspect - the German one – that was more closely followed, especially on the long end. In the US both 2Y and 5Y bond yields fell below 1% while 10Y printed all-time low at 1.16% - the yield declines of above 30bp along the curve. German curved move lower by roughly half of that. The Polish 10Y yield declined 37bp to 1.69%. The 10Y asset swap widened to above 30bp as the swap curve trades below WIBOR 3mth. 10Y PL-DE spread kept narrowing – by 20bp to 228bp. On the front end of the curve currently there seems to be 1 full 25bp cut within a year priced in – the 9x12 FRA fell to 1.40% from 1.64% week ago, a 24bp change. The less liquid FRAs further out are pricing in even more cuts (e.g 21x24 is down 60bp to 1.03% w/w).

Key events

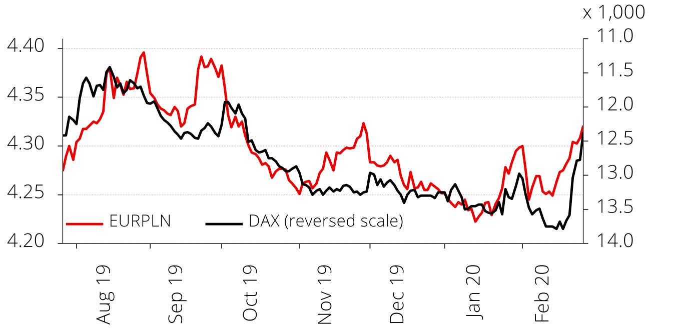
Next week, Polish manufacturing PMI for February will be published on Monday (we expect 46.8 after 47.4 in previous month), and the NBP rate decision is due on Wednesday (we expect no change to rates). Elsewhere in the world, the US, Eurozone and Germany manufacturing PMIs are due on Monday, while services PMIs on Wednesday. On Wednesday there also are Eurozone. January retail sales and US February ADP. In the US there are durables goods orders on Thursday. The week finishes off with Germany January factory orders and US February non-farm payrolls – market expects a reading of 195k vs 3mth- and 6mth- averages of 211k and 205.5k.

Market implications

FX Increased market risk-aversion across asset classes in the environment of coronavirus-related elevated uncertainty makes short horizon forecasting challenging in general, however we have some faith in the following. Firstly, zloty weakening trend should continue in the nearest future as it now firmly resides above 200d MA. EURPLN might first consolidate around 4.35 for a while (September's correction's low) and this is our base scenario for next week. Secondly, more hawkish Hungarian central bank and ~40bp higher forint funding costs make us believe the HUF will outperform its peers and PLNHUF should move lower towards 76. Thirdly, due to recent EURUSD volatility one has to be wary of PLN in the crosses – if EURUSD reaches 1.11 next week USDPLN likely settles around 3.90.

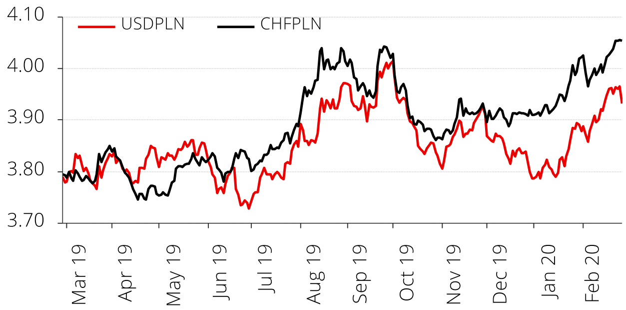
FI From the purely market perspective our scenario is that of a stabilisation and maybe slight retracement after the recent significant moves the reason being that quite a lot of bad news is already priced into the curve (1x 25bp cut in 1Y horizon and c3x25bp cuts in 2Y horizon). The risks to the outlook remain on both sides: first, further coronavirus-panic escalation could press yields lower; second (maybe even more important) a significant policy response of some kind (e.g. Chinese or European fiscal easing) would work in the opposite direction. We suggest less risk on the books and to wait till the market finds its new equilibrium.

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



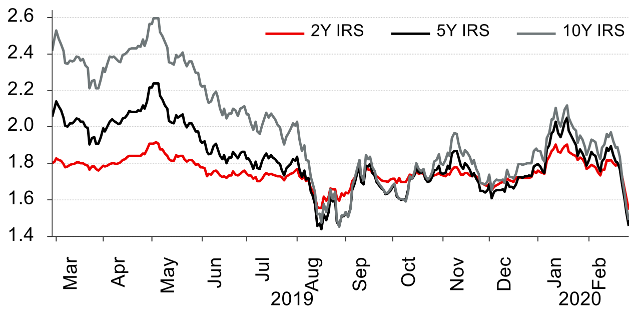
Source: Refinitiv Datastream, Santander Bank Polska

USDPLN and CHFPLN



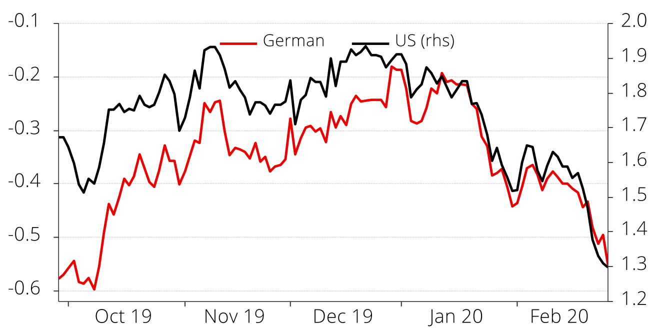
Source: Refinitiv Datastream, Santander Bank Polska

Poland IRS



Source: Refinitiv Datastream, Santander Bank Polska

10Y Bund and UST yields



Source: Refinitiv Datastream, Santander Bank Polska

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Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST SANTANDER	LAST VALUE
			MONDAY (2 March)				
	DE	Retail Sales	Jan	% m/m	0.8	-	-2.0
09:00	**PL**	**Poland Manufacturing PMI**	**Feb**	**pts**	**48,0**	**45,5**	**47.4**
09:55	DE	Germany Manufacturing PMI	Feb	pts	47.8	-	45.3
10:00	EZ	Eurozone Manufacturing PMI	Feb	pts	49.1	-	47.9
16:00	US	ISM manufacturing	Feb	pts	50.5	-	50.9
			TUESDAY (3 March)				
09:00	CZ	GDP SA	4Q	% y/y	1.7	-	1.7
11:00	EZ	Flash HICP	Feb	% y/y	1.2	-	1.4
11:00	EZ	Unemployment Rate	Jan	%	7.4	-	7.4
			WEDNESDAY (4 March)				
	PL	**MPC decision**		**%**	**1.50**	**1.50**	**1.50**
02:45	CN	Caixin China PMI Services	Feb	pts	48.0	-	51.8
09:55	DE	Markit Germany Services PMI	Feb	pts	53.3	-	54.2
10:00	EZ	Eurozone Services PMI	Feb	pts	52.8	-	52.5
11:00	EZ	Retail Sales	Jan	% m/m	0.5	-	-1.6
14:15	US	ADP report	Feb	k	170	-	291
16:00	US	ISM services	Feb	pts	55.5	-	55.5
			THURSDAY (5 March)				
14:30	US	Initial Jobless Claims	Feb.20	k	212	-	219
16:00	US	Durable Goods Orders	Jan	% m/m	-1.4	-	-0.2
16:00	US	Factory Orders	Jan	% m/m	-0.4	-	1.8
			FRIDAY (6 March)				
08:00	DE	Factory Orders	Jan	% m/m	1.5	-	-2.1
09:00	HU	Industrial Production SA	Jan	% y/y	0.0	-	-3.66
14:30	US	Change in Nonfarm Payrolls	Feb	k	195	-	225
14:30	US	Unemployment Rate	Feb	%	3.5	-	3.6

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.