13 March 2020

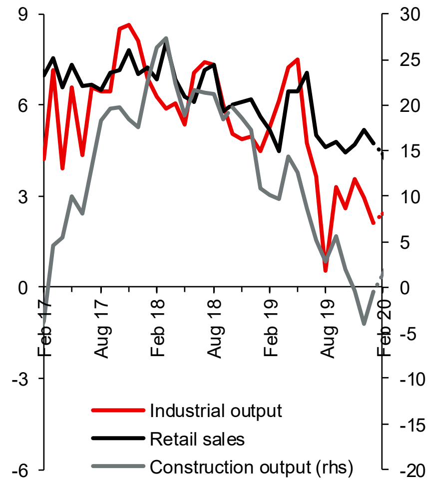
Weekly Economic Update

In search for a cure

What's hot next week

- The nearest week will be full of statistical data releases: in Poland core inflation, wages and employment, industrial and construction output, retail sales, PPI, balance of payments; abroad: German ZEW index, US retail sales and industrial production, among others. However, due to the events triggered by the coronavirus disease, those releases will be of secondary, or maybe tertiary importance. They will depict the economic situation just before the pandemics. Only the data for March and the following months will start showing the economic consequences of the recent day's events.
- Key issues for market sentiment in the coming days or weeks will be: (1) new information about the spread of the virus in the developed world and (2) about the preventive and supportive measures undertaken by governments and central banks.
- Meetings of central banks in the USA, Japan and China are scheduled for the upcoming week. Bear it in mind that recently some central banks did not wait for their scheduled meetings and made decisions in emergency mode (Fed, BoE, Norgesbank). It may be not the end of such surprises. The market is pricing-in further stimulus, including another 50bp rate cut by FOMC in March (and further 50bp in April). It seems that there is already a broad-based consensus among policymakers to provide unlimited liquidity support and lifelines for troubled companies. So far there were no coordinated actions on the fiscal front, but they may be coming; the European Commission head already suggested actions are being prepared.
- Today in the evening Moody's is scheduled to review Poland's sovereign rating. It cannot be excluded that given the high global uncertainty, the agency will refrain from issuing any comment. If there is one, we do not expect any changes in the credit rating.

Polish economic activity data, %y/y, 3M mov. av., constant prices



Source: GUS, Santander

Market implications

- In the recent days, we have seen a massive capital outflow of capital from the emerging markets and even if the central banks and governments manage to ease market tensions soon, it would be difficult to reverse the flow before more optimistic information about coronavirus spreading in the developed countries emerge.
- In the environment of high risk aversion, EURPLN could test important 4.40 resistance and should this be broken, 4.50 would be the next target.
- Polish bond yields decoupled from Bunds and we think the spread may rise further. Central bank actions could trigger some temporary correction but the trend shall depend mainly on the news-flow about the virus evolution.

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Last week in economy

As the virus was spreading in Poland, the government closed schools and cultural institutions for two weeks, banned mass events and signalled that a support package for enterprises and households is being prepared. Also, the sugar tax introduction will be postponed till year-end due to the virus spread. The head of Polish Development Fund (PFR) Paweł Borys said that this year's budget amendment may be justified given building risks for global economy, and that the expenditure rule "should be examined".

In February, **Polish CPI inflation** surged to 4.7% y/y from 4.3% (revised from 4.4%) in January. Services inflation continued to rise, to 6.4% y/y in February, while goods inflation pushed to 4.1% y/y from 2.4% in December. Core inflation ex food and energy rose to 3.4% and 3.6% in January-February, according to our estimate. Definitely the inflationary impulse at the start of the year was stronger and more broad-based than we expected. However, going forward, the spread of the virus triggered a large-scale price cuts in many kinds of services and the massive decline of crude oil prices should also put a downward pressure on inflation. Thus, we expect inflation to decrease in the coming months. More in our Economic Comment.

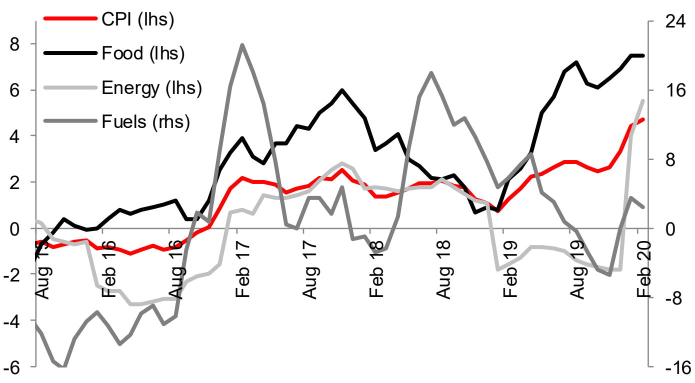
The March **NBP Inflation Report** showed a higher path of inflation and a lower path of GDP than predicted in November (CPI in 2020: 3.7% vs 2.8% in November, GDP: 3.2% vs. 3.6%). Forecast of private consumption was lowered (but it still remained quite strong amid solid households' income), as well as of investments (lower spending of local governments, weak external demand, decreasing absorption of EU funds). Net exports forecast went up thanks to higher robustness of Polish exports and lower imports due to weaker domestic demand. Forecasts of all main components: core, food and energy were revised up. NBP sees the probability of CPI running below 2.5% at 24% at the end of 2020, 52% at the end of 2021 and 61% at the end of 2022. Impact of the coronavirus on the Polish economy was reflected by NBP in higher financial markets volatility, lower prices of energy commodities and lower foreign demand, especially in the German manufacturing. Meanwhile, escalation of the epidemic is the main risk factor for the economic growth forecast.

Polish **exports** measured in EUR rose according to GUS by 0.5% y/y, in line with the gradual slowdown seen for over two years. Imports rose by 0.3% y/y and the trade balance recorded a surplus of EUR200mn. The results suggest worse tendencies in Polish foreign trade than our estimates based on the performance of industrial output and retail sales in January, among others. Bear in mind, the trade data come from the period before the epidemic, which has totally changed the economic outlook for this year.

Labour demand measured by the number of vacancies decreased in 4Q19 by 9.9% y/y (the fourth quarter with a negative growth). It seems enterprises adjusted in 4Q19 their labour demand down due to the economic uncertainty and the growing labour costs as well as difficulties to find new employees.

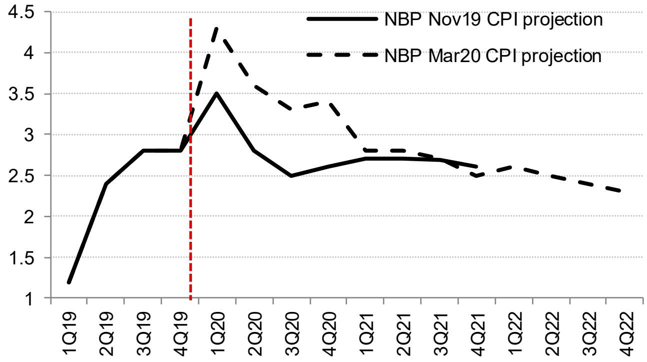
MPC's Cezary Kochalski considers stable rates the right policy given the current uncertainty. Łukasz Hardt, who in January voted for a rate hike, said that currently the best strategy is to stabilise rates and possibly ease policy with unorthodox tools as the coronavirus epidemic will decrease inflation and GDP growth (in his view 2020 growth will be below 3%). Rafał Sura would like to discuss rate cuts if the July NBP projection shows GDP growth going below 3%, while the current projection makes rate stabilisation the optimal scenario. Jerzy Żyżyński thinks the MPC may consider a rate cut (he prefers 50bp) already in May if GDP growth slides below 3% and inflation goes down by that time. Eryk Łon said that the coronavirus and the new NBP projections are arguments to cut rates quickly, preferably by 50bp and supplement this with QE measures. Governor Adam Glapiński stated that NBP and Financial Stability Committee will do the utmost to secure system stability. In our view, while the probability of rate cuts this year has gone up, the scale of deterioration of economic activity and the decrease of inflation forecasts would have to be very significant to make the MPC act.

CPI and selected items, %y/y



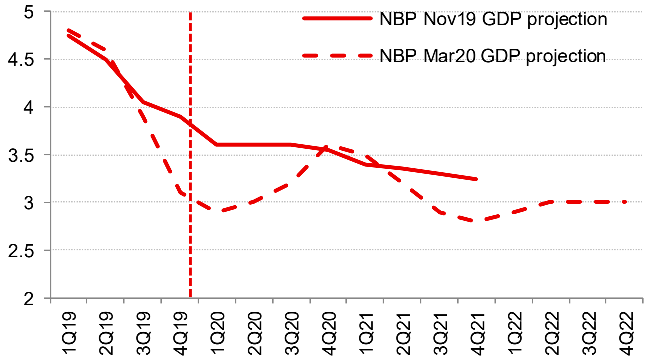
Source: GUS, NBP, Santander

NBP inflation projection, %y/y



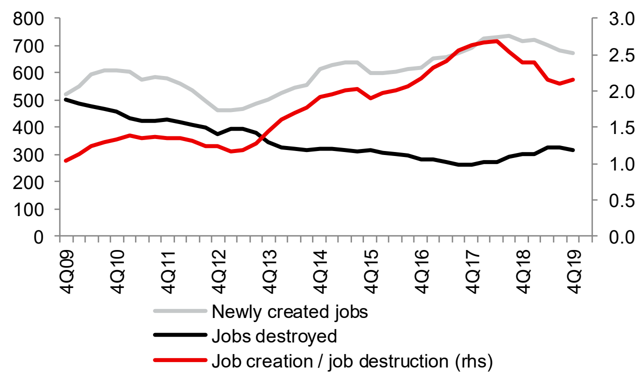
Source: NBP, Santander

NBP GDP growth projection, %y/y



Source: NBP, Santander

Job creation vs job destruction, 4Q mov. av., thous.



Source: GUS, Santander

FX and FI market

Last week on the market

FX The passing week will be remembered as one of the most volatile ones ever. The week started with the c30% oil price drop after failed OPEC+ talks. The emergency 50bp Fed cut from the week before has not helped (nor has the emergency 50bp BoE cut), equity markets sold off heavily (15-20% w/w) and the market entered panic mode (VIX up to 70 handle). On Thursday ECB has not changed rates going against market expectations of a 10bp deposit rate cut. As a result of the above the EM currencies sold off heavily and especially those of commodity exporters, like the Russian ruble. On the weekly basis, the dollar index gained 1.5%, EURPLN moved higher by 1.6% to 4.368 (correcting from above 4.38 after strong February CPI print at 4.7% y/y). USDPLN and CHFPLN moved to 3.90 and 4.14 (by +2.4% and +1.9%), respectively. Among the PLN crosses only GBPPLN traded lower by -1.1% due to the BoE move. CEE currencies lost as well: EURHUF up 0.7% to 337.7, EURCZK as much as 3.0% to 26.2 and USDRUB whopping 6.4% to 72.9.

FI markets have had a roller coaster week. On Monday open they were faced with 30% cheaper oil. As a result core yields (and global equity indices as well) collapsed: 10Y UST fell to 0.33% from 0.75% on Friday close, while Bund to -0.91% from -0.73%. Polish bond and swap yields followed suit e.g. 10Y POLGBs declined to 1.35% from 1.65%. It is worth noting that on Monday the 10Y PL-DE spread was still *narrowing* and actually printed a many days low at 222bp. On the following days core yields retraced a bit. Fast forward to Thursday (another leg in global coronavirus-induced risk sell-off and ECB which has not cut) and core yields increased even above the previous Friday close – 10Y UST to 0.88% while Bund to -0.63%. PL 10Y yields increased as well but, importantly, were *widening* versus cores (and IRS). On Thursday, on a very illiquid market – the spread increased to 277bp, by 55bp w/w. On Friday the Feb CPI surprised the market (and ourselves) printing at 4.7% y/y (vs 4.4% expected) and as a result yields started flying again, 10Y closed the week at 2.15%. FRAs 9x12 up to 1.10%.

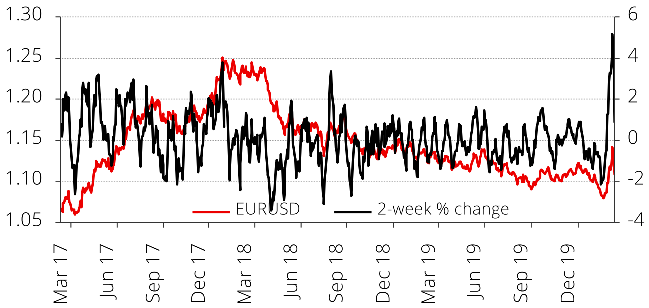
Key events Several central banks are deciding on rates next week – Fed on Wednesday (50bp cut priced in), BoJ on Thursday (more ETF purchases but rather no cut) and last but not least PBOC (1Y LPR to 3.95% from 4.05%). In the US we will get to see retail sales, industrial production, housing starts and existing home sales data for February and local Feds' manufacturing indices for March. Poland core CPI is published on Monday (we see it at 3.6% y/y in February after 3.4% in January), wages and employment data on Wednesday, industrial output and PPI on Thursday and retail sales on Friday.

Market implications

FX EURPLN has risen in the passing week but in the big scheme of things is still trading within a well-established horizontal range of 4.25-4.40 and the current account remains balanced. Next week's meetings of 3 important central banks (Fed, BoJ, PBOC) and expected monetary policy easing in theory should support risky assets, EM currencies included. However, the abruptness of the Thursday move and the widening of the asset swap and PL-DE spreads suggests this very move might have a stronger momentum than the previous ones. Next week we expect at the very least the 4.40 level to be thoroughly tested but also are prepared for the (less likely) possibility that if the level breaks we might see 4.50 (next important level) pretty soon as currency unhedged FI investors liquidate. Strengthening CHF (CHFPLN now at 4.15) and increasing pain for the mortgage borrowers might give bearish traders another reason to attack the PLN if the conditions are right (e.g. central banks not delivering as much as expected etc.) hence we are bearish on the zloty.

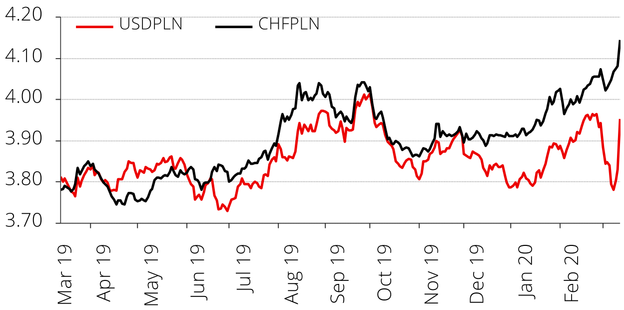
FI The repricing for POLGBS has brought yields to the levels last seen in mid-February, so roughly from before the coronavirus-related bond rally. It is honest to say that the uncertainty related to the coronavirus impact on the global and Polish economy is very high – we simply do not know how long and deep the impact will be. However we might draw some conclusions from the behaviour of assets on markets where the number of confirmed cases is higher than in Poland – the Italian and Spanish 10Y spreads vs Bund widened and we think it is rational to expect further widening in Poland. Assuming stable Bund and the spread widening to 300bp implies 10Y POLGBS at 2.25% and this is our base case for the coming week. We have less conviction on the front end but if anything would pay 21x24 FRA at 1.20% as we expect NBP to stay on hold.

EURUSD and its 2-week % change



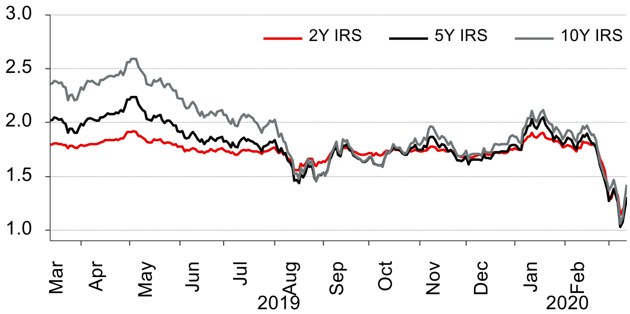
Source: Refinitiv Datastream, Santander Bank Polska

USDPLN and CHFPLN



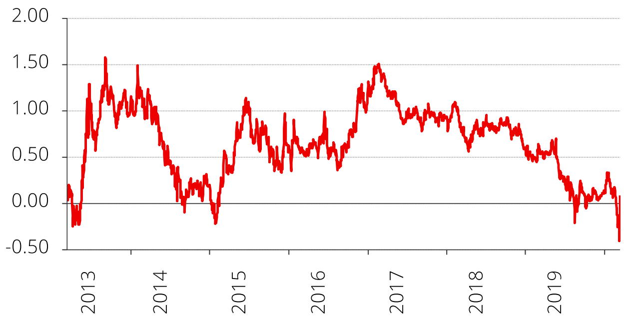
Source: Refinitiv Datastream, Santander Bank Polska

Poland IRS



Source: Refinitiv Datastream, Santander Bank Polska

5Y IRS – 6M WIBOR spread



Source: Refinitiv Datastream, Santander Bank Polska

Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST SANTANDER	LAST VALUE
		MONDAY (16 March)					
14:00	**PL**	**CPI Core**	**Feb**	**% y/y**	**3.4**	**3.6**	**3.1**
14:00	**PL**	**Current Account Balance**	**Jan**	**€mn**	**2880**	**3042**	**990**
14:00	**PL**	**Trade Balance**	**Jan**	**€mn**	**859**	**973**	**224**
14:00	**PL**	**Exports**	**Jan**	**€mn**	**19656**	**19640**	**17220**
14:00	**PL**	**Imports**	**Jan**	**€mn**	**18740**	**18667**	**16996**
		TUESDAY (17 March)					
11:00	DE	ZEW Survey Current Situation	Mar	pts	-25.0		-15.7
13:30	US	Retail Sales Advance	Feb	% m/m	0.2		0.3
14:15	US	Industrial Production	Feb	% m/m	0.4		-0.31
		WEDNESDAY (18 March)					
10:00	**PL**	**Employment in corporate sector**	**Feb**	**% y/y**	**1.1**	**1.0**	**1.1**
10:00	**PL**	**Average Gross Wages**	**Feb**	**% y/y**	**7.1**	**7.1**	**7.1**
11:00	EZ	HICP	Feb	% y/y	1.2		1.2
13:30	US	Housing Starts	Feb	% m/m	-4.28		-3.6
19:00	US	FOMC decision	Mar.20		0.75		1.25
		THURSDAY (19 March)					
10:00	**PL**	**Sold Industrial Output**	**Feb**	**% y/y**	**2.1**	**2.4**	**1.1**
10:00	**PL**	**PPI**	**Feb**	**% y/y**	**0.3**	**0.3**	**0.8**
13:30	US	Initial Jobless Claims	Mar.20	k	220.0		211.0
13:30	US	Index Philly Fed	Mar		10.0		36.7
		FRIDAY (20 March)					
10:00	**PL**	**Construction Output**	**Feb**	**% y/y**	**0.9**	**0.9**	**6.5**
10:00	**PL**	**Retail Sales Real**	**Feb**	**% y/y**	**4.5**	**4.1**	**3.4**
15:00	US	Existing Home Sales	Feb	% m/m	1.1		-1.3

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg

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