

15 May 2020

Weekly Economic Update

Counting losses, looking for a rebound

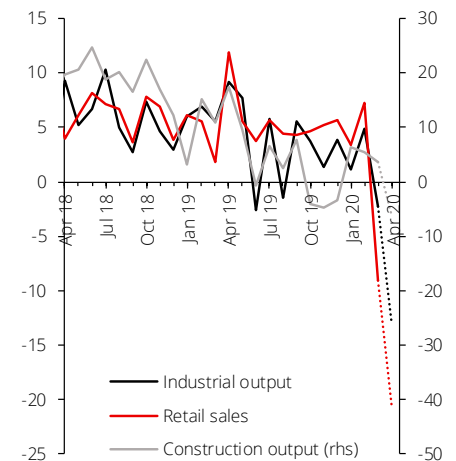
What's hot next week

- This week, flash PMIs for the euro zone seem to be the most awaited releases. In April, indexes pointed to a significant drop in economic activity and the market is waiting at least for the pace of contraction to slow. We will also see US real estate market data and FOMC minutes will be released. On Tuesday, Fed's Powell will give a speech. He recently excluded the option of negative interest rates in the USA leading to some market mood deterioration and this week he is rather unlikely to change the tone.
- In Poland, we will see numerous data – industrial and construction output, retail sales, core CPI, PPI and from the labour market. In May, some areas of the economy were allowed to resume activity, April could be the bottom of the recession. We expect double-digit drop of industrial output and retail sales while construction should be pretty resilient. Labour market data could be interesting, particularly about employment where we forecast a noticeable drop. We expect low wages growth but some positive surprise cannot be excluded – the example of the USA showed that the drop of employment may lead to a rise of average wage.
- The numbers related to the COVID-19 pandemic shall remain an important factor. The recent data suggest falling number of new cases in some Polish regions and a rise elsewhere. As a result, Poland started to distinguish negatively in the CEE region and vs main EU countries when the number of new cases is considered.

Market implications

- EURPLN has finally moved towards our 4.60 target we have been pointing to for the last few weeks already. We remain negative on the zloty and still expect the Polish currency to depreciate in the short-term.
- Polish bonds gained noticeably in the passing week but this was amid rather low trading volumes. In our view, the PL-DE bond yield spread fell too much in the recent weeks and thus we would expect yields to rise in the coming days.

Output and retail sales, % y/y



Source: GUS, Santander

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Last week in economy

Flash **GDP data** for 1Q20 confirmed that the recession in Poland has begun with seasonally-adjusted decline by 0.5% q/q. In annual terms, GDP growth slowed to 1.9% y/y in 1Q20, from 3.2% y/y in 4Q, with consensus around 1.7% and our estimate at 0.9%. This is the weakest print since 3Q13. The seasonally adjusted y/y growth was 1.6% y/y. For 2Q20 we expect a reading close to -12% q/q and below -10% y/y.

Overall, the data confirmed that a visible economic slowdown took place already in 1Q20, despite the fact that only the last two weeks of the quarter were covered by the lockdown period. We suspect that private consumption and services were the first to suffer from the epidemic. The full GDP data for 1Q20 will be released on 29 May.

April CPI inflation was confirmed at 3.4% y/y. The detailed reading showed there were no significant downward price pressures in the economy, apart from declining prices of fuels, books and insurance. Services prices rose by 1.4% m/m and remained unchanged at 6.5% y/y. In our view, this stability in price developments is mainly due to problems with measurement, which are likely to be receding soon as Covid restrictions are being relaxed and businesses are allowed to reopen. We guess that the Statistical Office chose to use typical seasonal factors of to use unchanged annual growth rates for prices that were difficult to collect. This resulted in counterintuitive readings like +0.4% m/m in restaurants, +2.2% in organised tourism or +24.8% in transport services. We expect CPI inflation to go down in the months to come to 1.5% in December. We estimate April core inflation at 3.4% y/y, down from 3.6% in March.

March balance of payments data showed a major improvement in current account balance to €2.4bn from €0.9bn in February versus expectations at €0.9bn. The surprise was mostly due to a major improvement in primary incomes balance.

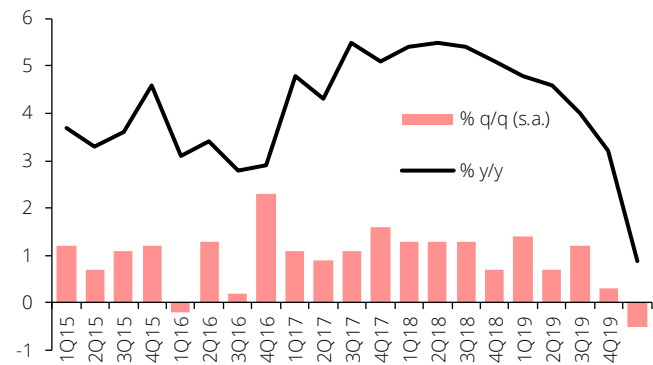
The improvement in primary income balance was caused by a significant decrease in outflows which totalled modest €125m versus 2019 monthly average at €2920mn. According to the NBP this number was due to an assumed deterioration in earnings of foreign-owned companies given the epidemic lockdown. The central bank noted that this is based on "fragmented data". Such a situation is likely to repeat in the incoming months, in our view.

Exports fell by 7.5% and imports by 4.5% with the strongest declines in automotive sector and in oil imports. GUS data on foreign trade suggest that in March there was a strong decline in exports to Italy, France, the Netherlands (and possibly Spain, as it fell off the reported 'top ten' list). We expect falls in exports and imports to deepen in the following months. In March, there was also a notable deterioration in service flows: exports down by 10.6% y/y and imports by 14.7% y/y.

In 1Q20 **average wage in the national economy** rose by 7.7% y/y, which is the highest pace recorded since 2Q08. We expect a sharp slowdown in the coming quarters due to the pandemic.

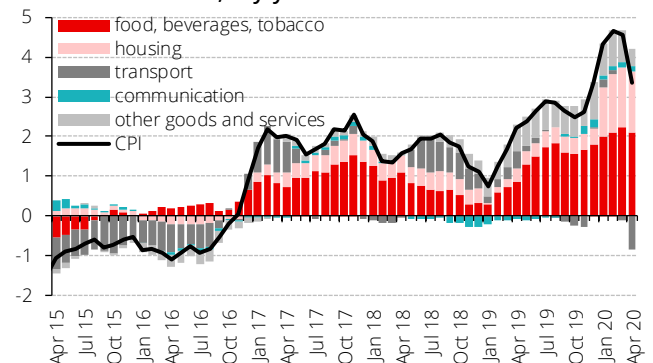
On 17 March the **MPC's rate cut** by 50bps was supported by 6 central bankers with 3 votes against. Hardt, Zubelewicz and Kropiwnicki were against that first cut, while another hawk, Gatnar, was absent. Interestingly, the same three members voted for a deeper cut in reserve requirement ratio (to 0.25%), while others opposed and finally a cut to 0.5% from 3.50% was agreed. Three weeks later reference rate was cut by another 50bp. The latest remarks by MPC members suggest that the support for further easing is now much lower. This could change if the pace of recovery would be slower than expected. For now, we expect that NBP rates remain unchanged until the end of the year.

Poland's GDP growth



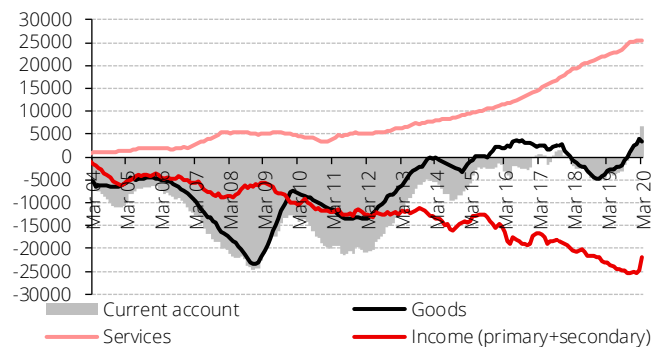
Source: GUS, Santander

Inflation breakdown, % y/y



Source: GUS, Santander

Current account, 12m sum, €mn



Source: NBP, Santander

Quote of the week:

Łukasz Hardt, MPC member, 12 May, PAP: We should be observing effects of the decisions taken in March and April and not rush to act again. The monetary policy should have been eased in response to the pandemics, but the reference rates should not have been cut by as much as 100bp.

Eryk Łon, MPC member, 13 May, PAP: Interest rates should remain low as long as we are sure that the Polish economy is back on track.

11 May, PAP: There is no need to cut rates further.

FX and FI market

Last week on the market

FX Volatility on the Polish FX market remained subdued. EURPLN has trended somewhat up to 4.57 amid deterioration of the global market mood. Stock indexes fell after investors realised that pricing of a fast economic revival might have been overly optimistic and Jerome Powell said that the growth revival may be slow and negative interest rates are currently not an option for the Fed. Weaker demand for risky assets and not too dovish signals from the US central bank supported the dollar helping USDPLN to rise above 4.24 (new May peak). CHFPLN rose to c4.35 (its highest since early April) while GBPPLN fell to 5.15 from 5.20.

The zloty performed better than its CEE peers. EURHUF rose c1.5% to 355, EURCZK 1.3% to 27.6 and USDRUB 1.1% to 74.3. Taking a broader look at the market, EURHUF and USDRUB are trading near the lower ends of consolidation seen since mid-March, while EURCZK is hovering already near the upper end of the respective range.

FI Last week's changes on the Polish bond market were influenced by thin liquidity that helped yields to fall noticeably: 5bp on the front end up to 20bp on the long end. IRS fell less which allowed the asset swap spread to narrow – to c50bp on the long end. Polish bonds performed better than Bunds and Treasuries that were temporarily hit by hints from the FOMC members saying that negative interest in the USA are rather unlikely. As a result, the 10Y PL-DE bond yield spread narrowed to 180bp, its lowest since late April.

The NBP repurchased bonds worth PLN9.4bn but only PLN100mn of it was a government bond (DS1023). The rest were bonds issued by the state-owned BGK bank and Polish Development Fund (PFR) that raised cash to fund the economy-support programmes. This was the sixth repurchase auction after which the size of the Polish QE programme rose to above PLN72bn.

Key events in the upcoming week could be the May sentiment indexes released in euro zone and Germany – ZEW and PMIs. Investors will be seeking whether economic contraction is at least loosing pace. After the last week's speech by Fed's Powell, we do not expect the market to put much attention to the FOMC minutes release.

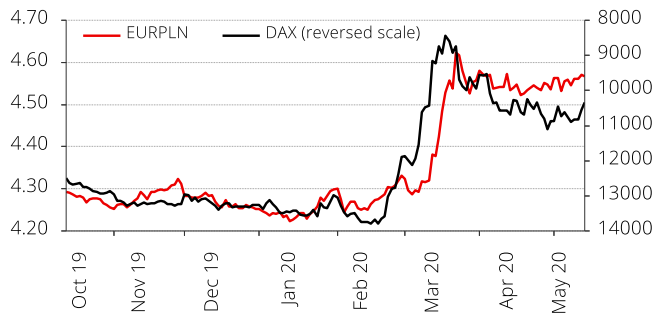
In Poland, we will see the first hard economic data for 2Q that might help to assess where the bottom of recession could be.

Market implications

FX EURPLN has finally moved towards our 4.60 target we have been pointing to for the last few weeks already. We remain negative on the zloty and still expect the Polish currency to depreciate in the short-term. The global market mood may now become even more unstable and the last week's short-term sell-off on the equity market may make investors more cautious. Since the beginning of the month, only the Brazilian real and the Argentine peso lost more than the zloty, koruna and forint in terms of the spot return in the EM universe. The Asian and LatAm currencies (+ruble) with higher interest rates outperformed their CEE peers. After the recent rate cuts in Poland and Czechia, majority of the regional currencies might have become less attractive.

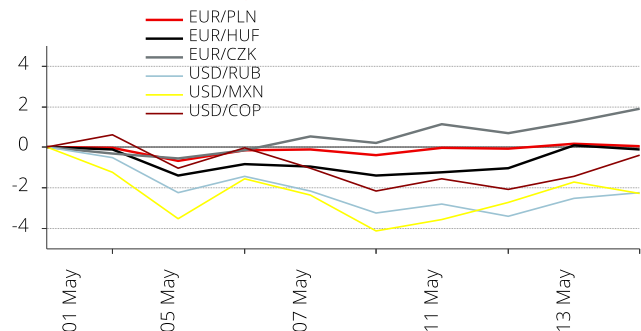
FI Polish bonds gained noticeably in the passing week but this was amid rather low trading volumes. At the same time, Bund gained only a little as signals from the Fed limited yields downside potential amid falling stock prices. During the last nine weeks, the 10Y PL-DE bond yield spread fell to c180bp from 260bp, that is by c30%. This was quite high pace of the spread tightening when compared to historical changes and in the past it would herald a profit taking after the Polish bonds rally. Bearing in mind that the last week's gains were driven by rather low investors' activity, we would expect yields to rise in the coming days.

EURPLN and German DAX index



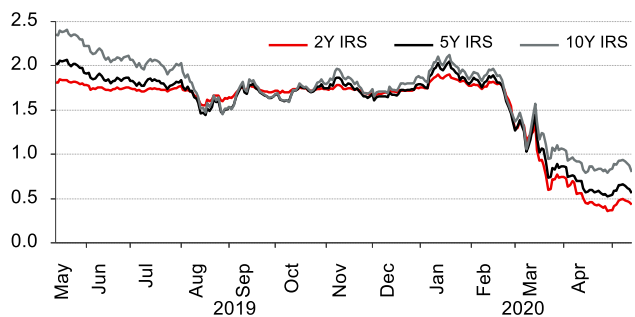
Source: Refinitiv Datastream, Santander Bank Polska

EM currencies (% change since May 1)



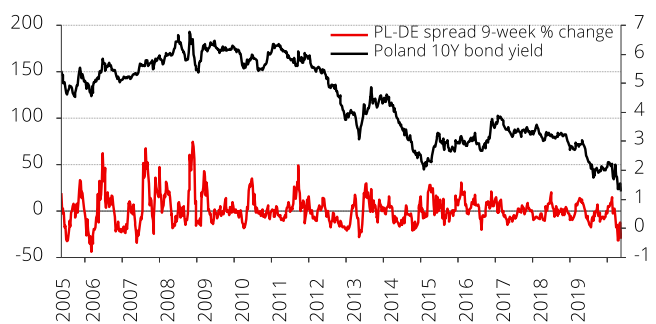
Source: Refinitiv Datastream, Santander Bank Polska

Poland IRS



Source: Refinitiv Datastream, Santander Bank Polska

Poland 10Y bond yield and 9-week % change of PL-DE spread



Source: Refinitiv Datastream, Santander Bank Polska

Economic Calendar

| TIME CET | COUNTRY | INDICATOR | PERIOD | FORECAST | | LAST VALUE |
|---------------------------|-----------|---|------------|--------------|--------------|---------------|
| | | | | MARKET | SANTANDER | |
| MONDAY (18 May) | | | | | | |
| 14:00 | PL | Core inflation | Apr | % y/y | 3.5 | 3.4** |
| TUESDAY (19 May) | | | | | | |
| 11:00 | DE | ZEW index | May | pts | 31.0 | - |
| 14:30 | US | Building permits | Apr | k | 1000 | - |
| 14:30 | US | House starts | Apr | k | 950 | - |
| WEDNESDAY (20 May) | | | | | | |
| 10:00 | PL | Wages in corporate sector | May | % y/y | 5.1 | 4.4 |
| 10:00 | PL | Employment in corporate sector | May | % y/y | -0.8 | -0.6 |
| 11:00 | EZ | CPI | Apr | % y/y | 0.4 | - |
| 20:00 | US | FOMC minutes | | | | 0.7 |
| THURSDAY (21 May) | | | | | | |
| 10:00 | PL | Industrial output | Apr | % y/y | -12.0 | -12.9 |
| 10:00 | PL | PPI | Apr | % y/y | -1.4 | -1.2 |
| 11:00 | PL | Bond auction | | | | |
| 14:00 | PL | MPC minutes | | | | |
| 14:30 | US | Philly Fed index | May | pts | -40.0 | - |
| 14:30 | US | Initial jobless claims | week | k | - | 2981 |
| 16:00 | US | Home sales | Apr | m | 4.38 | - |
| FRIDAY (22 May) | | | | | | |
| 9:30 | DE | Flash PMI – manufacturing | May | pts | 39.0 | - |
| 9:30 | DE | Flash PMI – services | May | pts | 24.0 | - |
| 10:00 | EZ | Flash PMI – manufacturing | May | pts | 38.0 | - |
| 10:00 | EZ | Flash PMI – services | May | pts | 23.8 | - |
| 10:00 | PL | Construction and assembly output | Apr | % y/y | -2.0 | -6.1 |
| 10:00 | PL | Real retail sales | Apr | % y/y | -20.1 | -20.5 |

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg

**estimate after CPI inflation data

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