

29 May 2020

Weekly Economic Update

Waiting for a rebound

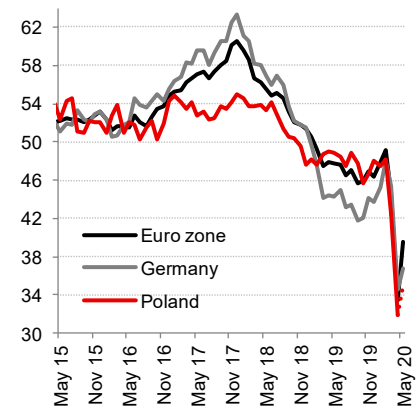
What's hot next week

- We have already seen data that showed us the state of the economy just before the pandemic and right after it hit Poland. While before it business climate seemed not so bad – 1Q GDP growth decelerated “mildly” to 2.0% y/y (albeit with private consumption and investments slowing down more abruptly), the scale of collapse of economic activity in April, the first full month of lockdown, exceeded expectations and generates risk that the whole 2Q will be worse than forecasts. The bright side of this is that April most likely marked the lowest point of the cycle and the gradual defrosting of areas of economy should make May and further data look slightly better (but still bad)... at least as long as there is no return of the pandemic and the restrictions.
- The first week of June in Poland will be almost empty as far as data releases and economic events are concerned. The next MPC meeting was rescheduled from 6 June to 16 June and will be a one-day event, just like the May one. May manufacturing PMI will be the only local release. We assume some improvement (to 35 pts), as suggested by, among others, the flash readings for other European countries and GUS business confidence indicators. However, manufacturing will remain in deep contraction. April's industrial output data revealed that the biggest contraction was recorded in sectors with high share of exports which indicates that without revival abroad and in the international trade it will be hard to see any noticeable improvement.
- Abroad, we will see more data: next to final PMIs for manufacturing and services, US and German factory orders will be released. Also, the US May nonfarm payrolls will be published.
- ECB meeting on Thursday may bring a decision to enlarge and extend in time the PEPP asset purchase program (related to the pandemic). If that happens, the significant investors optimism so far may further be boosted next week. ECB will also update its economic forecasts and is likely not to cancel the press conference due to the virus.
- As a background to economic events, in Polish parliament it will be decided when presidential elections will be held. The government hopes for the 28 June 2020.

Market implications

- The combination of a several factors (further rise of equity indexes, outlook for lifting lockdown restrictions, proposition of the new EU fund, stop-loss orders) pushed EURPLN down to 4.40 in mid-week. The pace of drop and the level from which the exchange rate rebounded after the unexpected NBP rate cut suggests that in our view this could be a start of a correction. As a result, we think the Polish currency could underperform its CEE peers in the nearest future.
- Polish bond yields plummeted after the MPC decision. In this new reality, the front end could head towards 0% under pressure of high excessive liquidity in the banking sector. On the long end, the room for further drop looks to be limited, particularly after a noticeable narrowing of PL-DE spread.

PMI indices, pts



Source: Markit, Santander

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Last week in economy

Last week we got to see many detailed data on economic performance in April: employment statistics, industrial orders, central budget. Most showed deep declines and we hope they have reached troughs and rebounds are imminent. Moreover, the MPC unexpectedly cut rates. We also got to know detailed GDP growth breakdown in 1Q20.

Polish 1Q **GDP growth** was 2.0% y/y at -0.4% q/q after seasonal adjustment. The slowdown was caused by a sharp deceleration of investments and private consumption. No fall of inventories (similar value of inventory changes as in 1Q19) and higher contribution from public consumption mitigated the decline of economic growth in 1Q. Such growth breakdown does not bode well for next readings. We fear that the 2Q GDP print, the most affected by the pandemic, could be at about -12% y/y, with downside risks due to the weakness of April data, and the full-year result could be around -4%. [Read more on GDP here.](#)

According to flash reading, **CPI inflation** went down to 2.9% y/y in May from 3.4% y/y in April. CPI was dragged lower by and fuel prices. We estimate that core inflation climbed to 3.7-3.8% y/y from 3.6% y/y in April. We would like to remind that a major part of the CPI basket was "frozen" (about 20% in April), as the Statistics Office had problems with recording prices, especially in services. Meanwhile, prices of freshly "unfrozen" services in May, like hairdressers, may have temporarily hiked their prices faced with strong postponed demand and higher costs of elevated sanitary regime. We are expecting further declines of inflation in the months to come given weaker total demand. Our estimate of December CPI inflation sits at 1.7%.

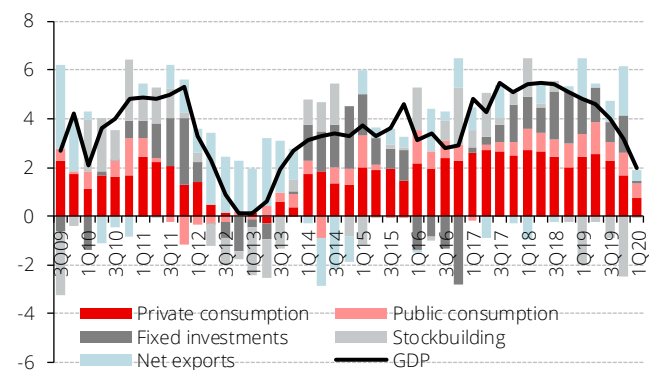
Registered unemployment rate increased in April to 5.8% from 5.4% in March. The increase results mainly from weaker outflows from unemployment, while the number of newly registered unemployed was lower than a year ago. Moreover, the data suggest that many workers in the retirement age have decided to leave the labour market. We estimate that a maximum of 1/3 of the decline in **corporate employment** was due to redundancies and employment contracts that were not extended, while the other 2/3 of the decline resulted from working time reductions, sick leaves and so on. **LFS data** suggest that in the last two weeks of March, as much as every fifth of the employed workers have not actually worked. The main reasons being the closure of the workplaces (1/3) and childcare (1/4). [Read more here.](#)

Industrial orders in April fell 30% y/y, while the foreign ones by 35.1% y/y. The negative dynamics of the total industrial orders is similar to the one recorded during the global financial crisis in 2009, while the foreign orders dynamics is even worse.

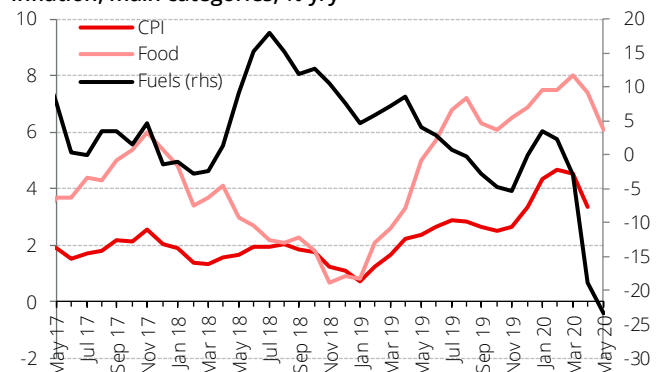
M3 money supply rose in April by 14% y/y vs 11.8% previously. This is the highest M3 pace since mid-2009. The accelerated money creation was caused by government fiscal expansion and purchases by the banking sector of bonds issued the Polish Development Fund (PFR). **The central budget** recorded a PLN18.9bn deficit in April year-to-date. In April alone the balance deteriorated by PN9.5bn due to a collapse of tax revenues and epidemic-related expenditures. We expect the deficit to balloon further in the months to come, with a probable increase of general government deficit to over 10% of GDP this year. In **1Q20 financial results of companies** employing 50+ persons worsened, but their investment outlays rose at a similar pace as in 4Q19. We expect the earnings of companies and their investment activity to fall in the coming quarters. [Read more here.](#)

The Monetary Policy Council unexpectedly **cut the main reference rate** by 40bp to 0.1%, the lombard rate by 50bp to 0.5%, and kept the deposit rate at 0.0%. The move was justified mainly by the risk of inflation going below the NBP target in mid-term. We think that once the rates were trimmed almost to zero, the conventional part of monetary easing is over and the NBP will focus now mainly on asset purchases and providing liquidity to the market. The next MPC meeting was rescheduled for 16 June. [Read more here.](#)

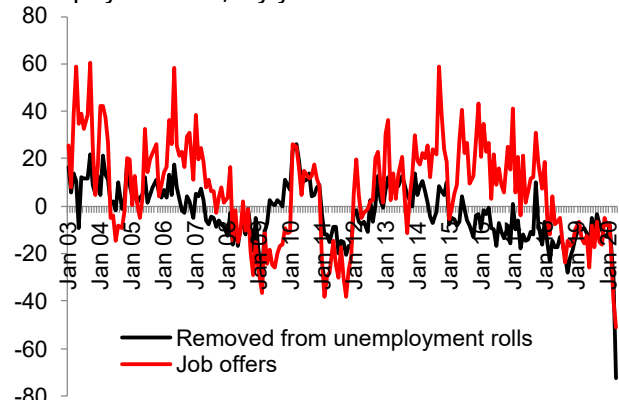
GDP growth: demand components, % y/y



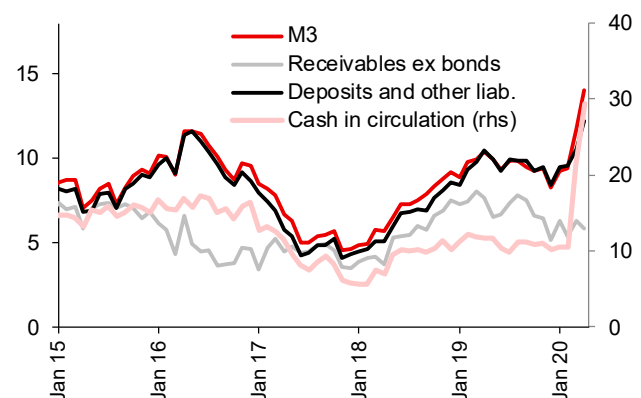
Inflation, main categories, % y/y



Unemployment data, % y/y



M3 money supply, % y/y



FX and FI market

Last week on the market

FX Weaker dollar, further jump of the global equity indexes and stop-loss orders pushed EURPLN down to 4.40 after its biggest weekly drop since late 2015. USDPLN plummeted to 4.0 from 4.15, CHFPLN to 4.14 from 4.26 and GBPLN to 4.91 from 5.05.

The other CEE currencies remained stable (forint) or gained much less than the zloty (koruna, ruble). The Hungarian central bank (MNB) kept interest rates unchanged with the main rate still at 0.90%. The statement from the meeting did not suggest that MNB intends to make any changes to its monetary policy strategy and will utilize bond purchases program sparingly.

Elsewhere, EURUSD broke 1.11 thanks to the optimism prevailing on the equity market and the EC proposition of the economic growth support program. EURCHF reached 1.07 its highest since early March vs 1.05 in mid-May. EURGBP remained at an elevated level near 0.90 amid lack of any positive news regarding the UK-EU negotiations.

FI After a rise of the bond yields and IRS in the previous week, the last five sessions saw a meaningful drop fueled by the surprising 40bp rate cut. The yield and IRS curve shifted 20-30bp down. The 10Y Bund yield rose which also contributed to the PL-DE spread drop to 160bp from 193bp last Friday. The central bank purchased bond for cPLN14bn but these were mainly those issued by the state owned BGK bank and the Polish Development Fund (PFR) to finance the anti-crisis programs.

Key events in the coming week would be the US May ISM and nonfarm payrolls data, the ECB decision and another round of UK-EU talks.

May PMIs showed a pick-up after poor April but the ECB's updated GDP forecasts might be enough to encourage the central bank to increase the size of the bond purchase program. Also, its functioning could be extended beyond the end of 2020.

The EU and UK will resume negotiations about terms of Brexit. Recently, the officials reported only little progress and the upcoming round is expected to be decisive on many areas, including foreign trade.

In April, the US manufacturing and services ISM collapsed to their lowest since 1H09. Flash euro zone PMI showed a rebound from their multi-month low levels and the market will seek if a similar recovery took place in the US. Some improvement on the labour market is expected.

Market implications

FX Pace of the recent EURPLN drop, the level at which it paused and rebounded from after the unexpected NBP rate cut suggests that the upside correction might have just started. The exchange rate stopped around the 50% retracement of its last upside wave, near the support at the double top from August/September 2019. The EURPLN 6-session % change shows that this has been the biggest drop within this time since 2015 and historically this would herald at a correction rebound. Additionally, the persistence of this recent down move could be questioned as it was largely driven by the stop-loss orders activated by investors who have been expecting weaker zloty. Finally, the interest rates in Poland are now the lowest in the CEE region and this may make the zloty underperform the forint, koruna and ruble at least in the short term.

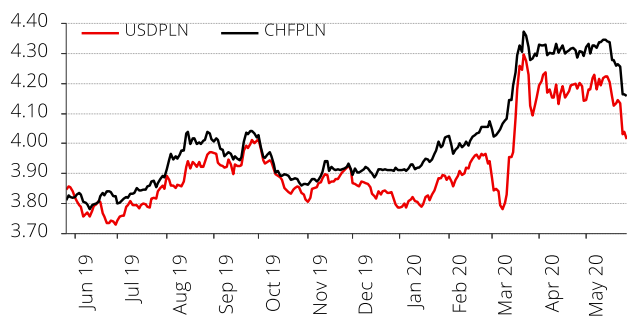
FI After the last NBP rate cut the 2Y bond yield fell to 0.20%, the 5Y to 0.70% and the 10Y to 1.15%. We think there is little room for the long end to move further down, particularly after the substantial drop of the 10Y PL-DE spread. Also, Polish 10Y bond yield fell below the Italian (c1.40%). At the same time, the front end of the bond curve may move closer to 0% given the substantial liquidity of the banking sector.

EURPLN



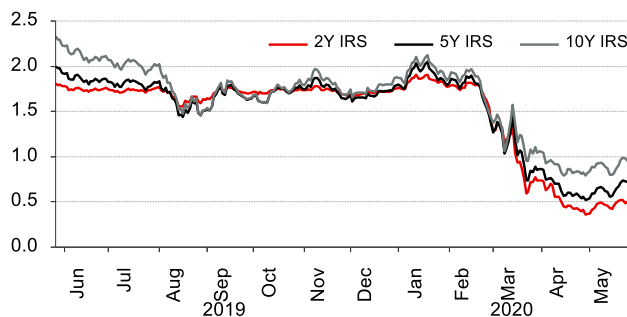
Source: Refinitiv Datastream, Santander Bank Polska

USDPLN and CHFPLN



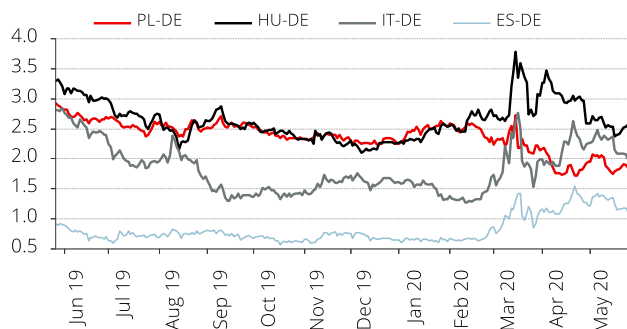
Source: Refinitiv Datastream, Santander Bank Polska

Poland IRS



Source: Refinitiv Datastream, Santander Bank Polska

10Y yield spreads vs Bund



Source: Refinitiv Datastream, Santander Bank Polska

Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST
					MARKET	SANTANDER	VALUE
MONDAY (1 June)							
09:00	PL	Poland Manufacturing PMI	May	pts	34.0	35.0	31.9
09:55	DE	Germany Manufacturing PMI	May	pts	36.8	-	36.8
10:00	EZ	Eurozone Manufacturing PMI	May	pts	39.5	-	39.5
16:00	US	ISM manufacturing	May	pts	43.5	-	41.5
TUESDAY (2 June)							
09:00	CZ	GDP	1Q	% y/y	-2.2	-	-2.2
WEDNESDAY (3 June)							
03:45	CN	Caixin China PMI Services	May	pts	47.3	-	44.4
11:00	EZ	Unemployment Rate	Apr	%	8.2	-	7.4
14:15	US	ADP report	May	k	-9 500	-	20 236
16:00	US	Durable Goods Orders	Apr	% m/m	-19.0	-	-17.2
16:00	US	ISM services	May	pts	44.0	-	41.8
16:00	US	Factory Orders	Apr	% m/m	-15.0	-	-10.4
THURSDAY (4 June)							
09:55	DE	Markit Germany Services PMI	May	pts	31.4	-	31.4
10:00	EZ	Eurozone Services PMI	May	pts	28.7	-	28.7
11:00	EZ	Retail Sales	Apr	% m/m	-18.0	-	-11.2
13:45	EZ	ECB Main Refinancing Rate		%	0.0	-	0.0
14:30	US	Initial Jobless Claims	week	k	2 100	-	2 123
FRIDAY (5 June)							
08:00	DE	Factory Orders	Apr	% m/m	-20.0	-	-15.6
09:00	HU	Industrial Production	Apr	% y/y	-24.3	-	-9.99
14:30	US	Change in Nonfarm Payrolls	May	k	-8 000	-	20 537
14:30	US	Unemployment Rate	May	%	19.5	-	14.7

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg
**estimate after CPI inflation data

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