10 July 2020

Weekly Economic Update

Not-so-silly season

What's hot next week

- The main theme at the start of the week will be the **result of presidential elections**. The odds of both candidates seem to be almost even, so if the first exit polls show only slim victory of one of them, the final outcome will remain highly uncertain until the announcement of official results (probably on Tuesday at the latest).
- On Tuesday the **next MPC meeting** is scheduled – again with no press conference afterwards. At this meeting the Council should get to know the results of the new NBP projections. We do not know if the results of projections will be presented in detail at the NBP's press conference, but the main findings should be included already in the MPC communique. We do not expect any change in monetary policy this time. But we have to admit that we wrote the same before last few MPC meetings and the Council managed to surprise us almost every time. Last time, in June, by including the new phrase in the statement about only a small correction of zloty exchange rate, which we perceived as a signal of possible higher central bank's activity on the FX market. Since mid-June, when this phrase was included, EURPLN rose slightly but in general remained in horizontal trend. It will be interesting to see if the MPC focus on exchange rate will be modified in any way.
- The **new data releases** on the agenda: In Poland balance of payments on Tuesday, CPI on Wednesday, core inflation on Thursday, wages and employment on Friday. Abroad: German ZEW, production and inflation in the euro zone and USA. But we think that the releases will be market-neutral, in general.
- **ECB meeting** on Thursday is not expected to bring new important changes.
- On Friday, the **European Council special meeting** starts, at which the EU's medium-term budget and New Generation EU programme will be negotiated. The current proposal assumes a strong link between the access to EU funding and respect for rule of law. Tentative signals from Brussels and EU member states suggest that the final agreement is unlikely to be reached at this summit.

Inflation in CEE region, % y/y

Source: Refinitiv Datastream, Santander

Market implications

- Zloty at the start of the week could be affected by the election result (although it may be uncertain until Tuesday). Re-election of Andrzej Duda would confirm the status quo, so markets should focus on fundamentals, which, in our view, justify weaker zloty (EURPLN towards 4.50 and higher). Trzaskowski's victory could push EURPLN below 4.40, but rather not persistent, due to higher political uncertainty in mid-term. Data releases, MPC and ECB meetings would be probably neutral for currencies.
- The fixed income market still under the pressure of growing excess liquidity of banks, with pressure on yields moving gradually from the short end to belly of the curve. Long end under the impact of strengthening core debt markets.

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Last week in economy

Growth outlook keeps being revised lower, as the EC summer economic forecasts showed. The good news is that Germany, Poland's most important trade partner, saw a 2020 GDP forecast upgrade and that Poland is still seen as EU's growth outperformer. Polish central budget improved in June (but we express here some reservations) while registered unemployment saw a benign m/m rise.

According to the summer edition of **European Commission's forecasts,** euro zone GDP may drop this year by 8.7%, not by 7.7%, as estimated in May, and the rebound in 2021 could be slightly weaker than expected earlier (6.1% instead of 6.3%). The GDP forecasts for EU states became more diversified (the most affected economies saw further forecast downgrades, the less affected saw minor changes). The assessment of economic outlook for Europe was negatively influenced by the coronavirus spread in the USA and emerging countries.

According to EC, the risks for GDP forecasts are asymmetric to the downside, due to the threat of second wave of pandemic, for example. The estimates did not take into account the possible impact of the proposed Next Generation EU package (it has not been negotiated and approved yet, the next EU summit focused on this issue will be on 17-18 July).

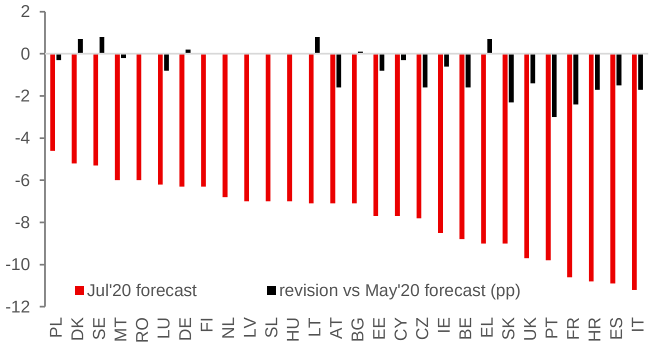
GDP forecast for Poland has been reduced from -4.3% to -4.6% in 2020 (which is still the highest of all EU countries) and improved from 4.1% to 4.3% in 2021. CPI forecasts have been barely changed, the estimate for Poland has been lifted from 2.5% to 2.7% in 2020 (third highest in the EU). As regards Poland, the report points to predicted collapse of investments in 2Q20, precautionary holding back of consumer spending, assumed faster rebound of imports than exports leading to more negative net exports contribution.

According to the Ministry of Finance, in June the **central budget deficit** shrank to PLN17bn from PLN26bn recorded in May. The improvement of budget balance was possible because expenditures linked to countering the consequences of the pandemic were pushed outside the central budget (for some time now we are indicating that the informative value of budget data is reduced because of this), PLN7.4bn transfer of NBP profit (the transfer was possible thanks to a change in NBP reserve creation policy, which actually meant resignation from building reserves) and a rebound in tax revenues by 9% y/y in June. A quick rebound of tax revenues is generally good news, but we do not know its breakdown yet. We need to point out that the ministry extended the deadlines for tax paid on annual basis, including the income taxes, which might have changed the seasonal pattern of revenues. We are waiting for full data about central budget for June. We expect to see a record high GG deficit this year, possibly exceeding 10% of GDP, with most of it realised outside the central budget.

Registered unemployment rate rose to 6.1% in June from 6.0% in May. The number of unemployed increased m/m by 15.4k, less than expected, much less than in April and May.

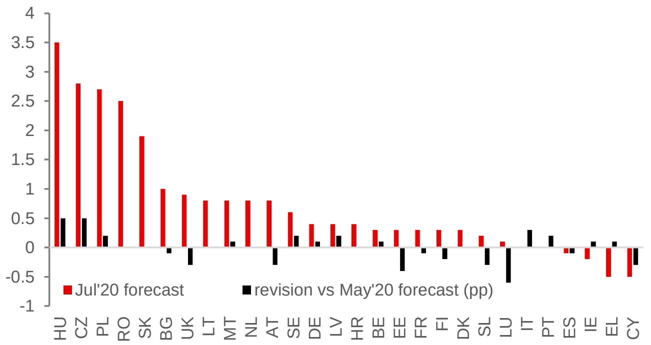
In April the NBP interest rate cut was backed by 7 **MPC members**, with one vote against (Hardt, moderate/hawk) and two members absent (Gatnar, Zubelewicz, both considered hawks). Łukasz Hardt in a recently published article (written before another rate cut was delivered by the MPC in May) stated that one way to normalize monetary policy could be to hike interest rates before withdrawing from the asset purchases. We think this is a minority view. Dovish member Eryk Łon said that stabilisation of NBP interest rates at the current level would be a good strategy, adding that monetary policy tightening in 2H20 or even in 2021 could be too risky.

European Commission's 2020 GDP growth forecasts



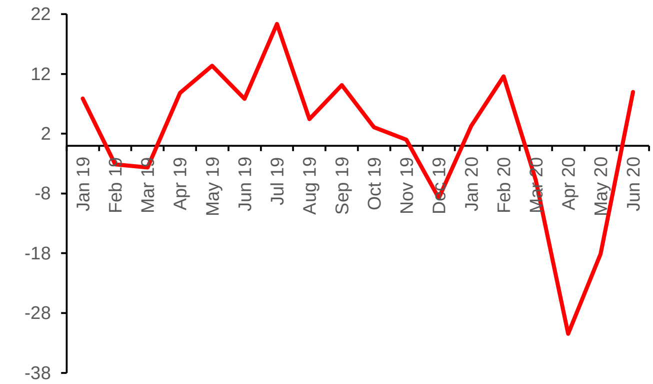
Source: European Commission, Santander

European Commission's 2020 inflation forecasts



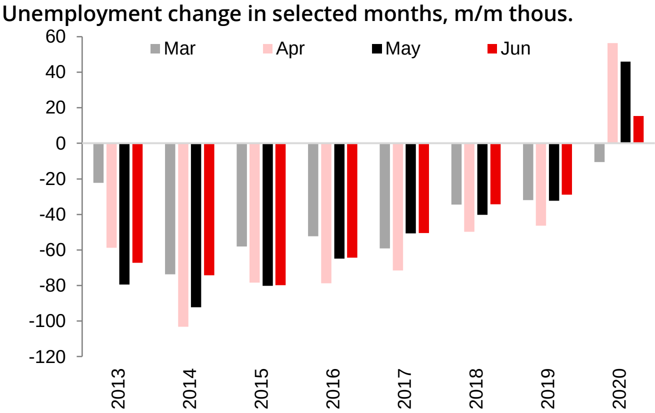
Source: European Commission, Santander

Monthly tax revenues, %y/y



Source: Ministry of Finance, Santander

Unemployment change in selected months, m/m thous.



Source: GUS, Ministry of Labour, Santander

FX and FI market

Last week on the market

FX The passing week has seen main stock indices and the VIX index almost unchanged. The Brent oil price declined by 2.5% to 41.7, while the dollar index by 0.5% to 96.7, which supported gold (up 1.8%) and, but only to a small extend, EM currencies in the CEE region vs the dollar. The CEE currencies lost vs the euro, however: EURPLN increased by 0.4% to 4.477, EURHUF 0.20% to 353.5 while EURCZK 0.1% to c26.70. The rouble basket declined by 0.2% to 71.2. During a week leading to the second round of Polish presidential elections the EURPLN remained calm with 1WK realized volatility closing the week at 5.5% (vs 1WK implied volatilities, which include elections, at 6.3%) and spent most of the time within a horizontal range of 4.46-4.48.

FI Polish bond yields followed core market yields lower in the passing week but declined by less (the 10Y PL-DE spread widened). Bund yield declined 6bp to -0.49%, while the 10Y UST even more to 0.58%. During the same time Polish 10Y bond yields finished the week at 1.33%, spread to Bund widened to 182bp. Declines of similar size were observed on the IRS curve hence the asset swaps remained stable. Front end of the both the bond and IRS curves remained stable at 0.105% and 0.28% respectively. As a result the 2x10 steepness declined to 122bp on the bond curve.

Key events of the upcoming week include US June CPI (Tuesday), June industrial production (Wednesday), June retail sales (Thursday) and from leading indicators July Philly Fed (Thursday) and University of Michigan sentiment (Friday). In the Eurozone there are industrial production (Tuesday), ECB meeting (Wednesday) and June HICP (Friday). In Germany July ZEW (Tuesday). In Poland MPC meets on Tuesday with no press conference planned. We are likely to see new economic forecasts. Current account is published on Tuesday as well. CPI on Wednesday, core CPI on Thursday. On Friday employment and wages data.

Market implications

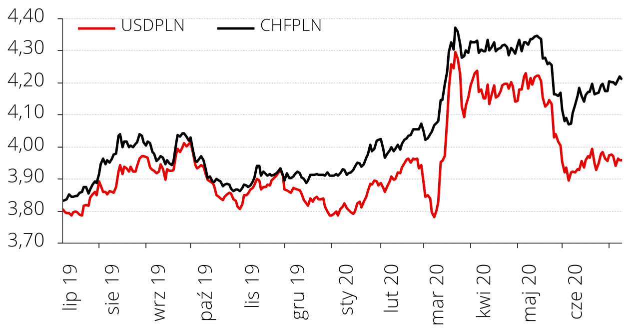
FX The behaviour of Polish currency next week will obviously depend on the outcome of the Sunday presidential elections. Most likely the outcome will be known from exit polls by Monday morning, but official announcement might be made as late as on Tuesday. In the case the incumbent President Andrzej Duda wins we expect markets to focus again on the fundamentals, where negative real rates should help push EURPLN slowly to 4.50 and higher in the following weeks. In the case Rafał Trzaskowski wins EURPLN might in a surprise move trade lower (up to 200d MA at 4.3750, we estimate) but the medium term reaction is not clear as his win might contribute to higher amount of political noise (and increased risk of early election, for example). Next week's ECB meeting is likely to be a non-event as most of the heavy lifting has taken place in June and now, even in the latest words of President Christine Lagarde, the bank is waiting for more macro data to come.

FI Our view is for the yields to keep slowly declining in the following week. The story for the yields to trade lower has not changed from previous week and the front end of the bond curve remains under pressure from over-liquid banking sector. After 2Y reached our target at 0.10% it is likely to decline lower towards single digit bps levels. Also our last week's call for 10Y POLGBs yields to decline to 1.30% has almost perfectly materialized. With core yields declining (we think US yields might decline even more) this probably means the 10Y POLGB can get into 1.25% area by the end of next week, assuming lack of surprises on the inflation front data. This would mean further bull flattening of the curve. The FRA markets remain stable and keep pricing no changes to main rates over the course of the next 2 years. Next week on Wednesday BGK will organize its 7th issuance of bonds FPC0725, FPC0630 which given scarcity of government bond supply might easily find buyers.

EURPLN

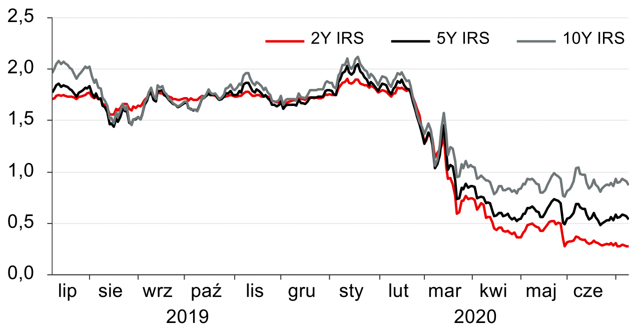
Source: Refinitiv Datastream, Santander Bank Polska

USDPLN and CHFPLN



Source: Refinitiv Datastream, Santander Bank Polska

Poland IRS



Source: Refinitiv Datastream, Santander Bank Polska

Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST VALUE
					MARKET	SANTANDER	
		TUESDAY (14 July)					
	PL	**MPC decision**		**%**	**0.1**	**0.1**	**0.1**
08:00	DE	HICP	Jun	% m/m	0.7		0.0
11:00	EZ	Industrial Production SA	May	% m/m	9.0		-17.1
11:00	DE	ZEW Survey Current Situation	Jul	pts	-62.5		-83.1
14:00	**PL**	**Current Account Balance**	**May**	**€mn**	**772**	**857**	**1163**
14:00	**PL**	**Trade Balance**	**May**	**€mn**	**176**	**-290**	**-33**
14:00	**PL**	**Exports**	**May**	**€mn**	**15960**	**15427**	**13779**
14:00	**PL**	**Imports**	**May**	**€mn**	**15915**	**15717**	**13812**
14:30	US	CPI	Jun	% m/m	0.6		-0.1
		WEDNESDAY (15 July)					
10:00	**PL**	**CPI**	**Jun**	**% y/y**	**3.3**	**3.3**	**2.9**
15:15	US	Industrial Production	Jun	% m/m	4.8		1.39
		THURSDAY (16 July)					
13:45	EZ	ECB Main Refinancing Rate		%	0.0		0.0
14:00	**PL**	**CPI Core**	**Jun**	**% y/y**	**4.1**	**4.3**	**3.8**
14:30	US	Initial Jobless Claims	week	k	1375		1314
14:30	US	Retail Sales Advance	Jun	% m/m	5.5		17.7
14:30	US	Index Philly Fed	Jul		20.0		27.5
		FRIDAY (17 July)					
10:00	**PL**	**Employment in corporate sector**	**Jun**	**% y/y**	**-3.9**	**-3.7**	**-3.2**
10:00	**PL**	**Average Gross Wages**	**Jun**	**% y/y**	**1.6**	**0.6**	**1.2**
11:00	EZ	HICP	Jun	% y/y	0.3		-0.1
14:30	US	Housing Starts	Jun	% m/m	21.2		4.3
16:00	US	Michigan index	Jul	pts	80.0		78.1

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

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