

17 July 2020

Weekly Economic Update

Almost full set of 2Q data

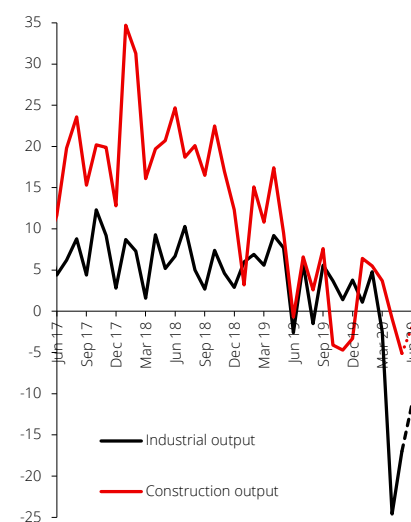
What's hot next week

- The next week will be dominated by the Polish June data releases: **industrial and construction output, retail sales, PPI, M3 money supply and unemployment rate**. The **Statistical Bulletin** will be also published and will include details regarding the economic situation and first business sentiment indexes for July. After these numbers are released, it will be easier to estimate the scale of the GDP contraction in 2Q20. Our forecasts of key indicators (output, sales) are well below the market consensus and if they prove correct, the mood could deteriorate. On the other hand, the June labour market data surprised to the upside which might mean that we are too pessimistic and the economy is recovering faster than we think.
- Abroad very few data releases next week. The key will be preliminary July PMIs (Friday) and central bank meetings in Hungary (Tuesday) and Russia (Friday). We expect that both central banks might further ease their monetary policies, while the PMIs both in manufacturing and services might rise but to a lesser degree compared to previous month (the room for positive surprises decreases).
- In the calendar there is also the last Sejm (lower house) sitting before the summer break (the next one in the middle of September). The schedule does not include the amendment of the public finance act to allow temporary deviation from the Stabilising Spending Rule which in turn would allow an amendment of the budgetary act. Perhaps changes to this year's budget will appear only in September, effectively in parallel with the 2021 budget draft.
- In late July, further negotiations on the new EU budget and recovery fund will take place. Poland and Hungary do not agree the access to funds to be conditioned by the rule of law and climate targets criteria and demand, among others, that their violation of the rule of law procedures are terminated.

Market implications

- We keep our call for weaker zloty in the coming weeks. Breaking 4.48 resistance supports our view. Should our forecasts for retail sales and output prove correct, this could be a reason for further EURPLN rise.
- On the fixed income market we expect further yields drop amid rising over liquidity in the banking system and strong core markets.

Poland industrial and construction output, % y/y



Source: GUS, Santander

Economic Analysis Department:

al. Jana Pawła II 17, 00-854 Warszawa
 email: ekonomia@santander.pl
 website www: skarb.santander.pl
 Piotr Bielski +48 22 534 18 87
 Marcin Luziński +48 22 534 18 85
 Grzegorz Ogonek +48 22 534 19 23
 Wojciech Mazurkiewicz +48 22 534 18 86
 Marcin Sulewski, CFA +48 22 534 18 84

Last week in economy

Last week we got to see CPI, current account and labour market statistics, with the latter showing some rebound. While the MPC meeting brought no new monetary policy decision, the new NBP staff projection proved to be rather pessimistic.

June **CPI inflation** was confirmed at flash 3.3% y/y. The increase from 2.9% y/y in May was driven mostly by higher fuel prices (+0.2pp to the headline) and core inflation, which jumped to 4.1% y/y from 3.8% y/y (highest since 2001). We are expecting inflation to go down in the months to come, below 2% y/y in early 2021, yet some short-term upward disruptions due to the coronavirus effect are possible (demand overhang, sanitary charges). Read more in our [Economic Comment](#).

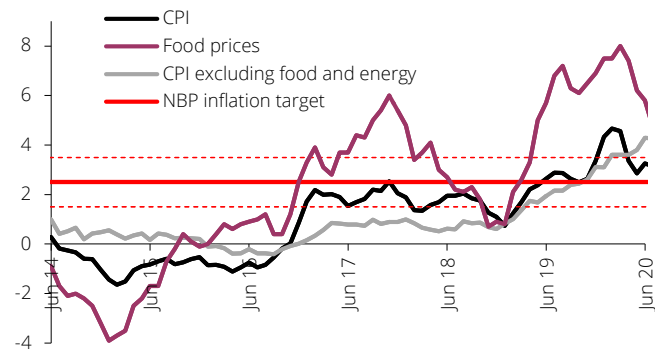
Poland's **May current account** showed a big surplus of EUR2.46bn (biggest since January 2017), way above market. Goods imports were the main culprit behind the surprise, as they fell by 27.2% y/y. Exports, on the other hand, decreased by 19.8% y/y (as compared to -29.1% in April) and some rebound was possible thanks to improving situation in consumer goods sector, as many European economies opened. We are expecting trade volumes to be rebounding in the months to come, yet they are unlikely to return to pre-covid levels anytime soon.

Poland's **labour market data** showed a light rebound in June, with employment rising by 0.2% m/m (-3.3% y/y) and wage growth jumping to 3.6% y/y from 1.2% y/y in May. Both numbers were better than expected (market: -3.9% y/y and +1.6% y/y, respectively). It seems that the labour market situation is normalising quicker than we had expected and this is positive news for the expected consumption path.

The Monetary Policy Council kept interest rates unchanged at the July meeting, with the main reference rate at 0.1%, Lombard rate at 0.5% and deposit rate at 0.0%. As always in July, the Council received the updated NBP economic projections, with the main results presented in the following paragraph. The official MPC press release was almost unchanged versus June. The statement that the pace of economic recovery may be limited by "the lack of visible zloty exchange rate adjustment to the global pandemic-driven shock and to the monetary policy easing introduced by NBP" was repeated. Minutes from the June meeting included also a statement that "monetary policy should limit the risk of zloty appreciation against the main currencies". There was no straightforward guidance regarding the next monetary policy decisions in the statement. However, we see the document as a confirmation of the view that after applying large scale monetary adjustment, there is little willingness in the MPC to go towards negative interest rates (unless there is further significant deterioration of economic outlook). We expect main interest rates to remain on hold in 2020-21.

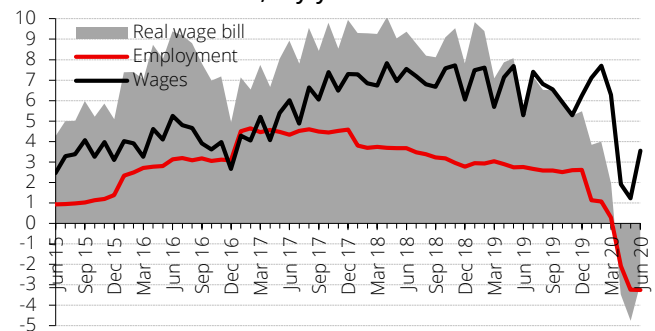
The NBP-expected CPI path seems rather far above zero, the lowest point is 1.3% y/y in 1Q21. The risk of going below zero in the course of 2021-2022 is around 20%. The far part of the CPI projection has a slight upward slope, and gets to 2.2% (vs 2.5% target) in 2H22. This all means the shape of the new projection does not urge the MPC to offer more stimulus. **The GDP numbers** are below market consensus and our forecasts. The report indicates that no second wave of intensified covid infections was assumed in the base scenario, so there is a negative bias shown in the balance of risks. Despite lack of second wave of pandemic, the NBP forecast assumes visibly slower economic recovery from -10.6% y/y expected in 2Q20 than most of other forecasts (including ours). The negative difference other forecasts seem to come from NBP's deep decline of investments in 2020 and no rebound in 2021 - NBP stresses very high uncertainty and financial distress of many companies.

CPI inflation measures, % y/y



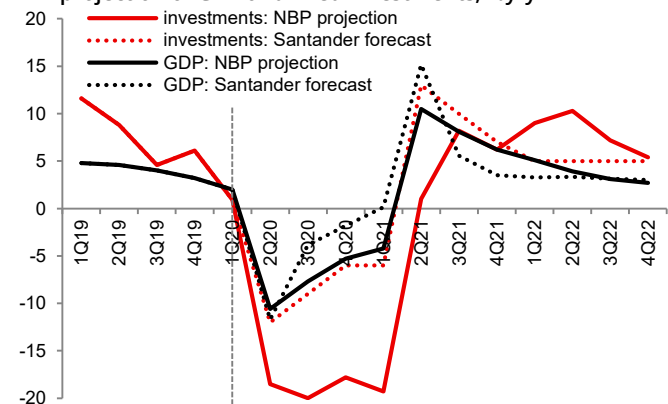
Source: GUS, NBP, Santander

Labour market statistics, % y/y



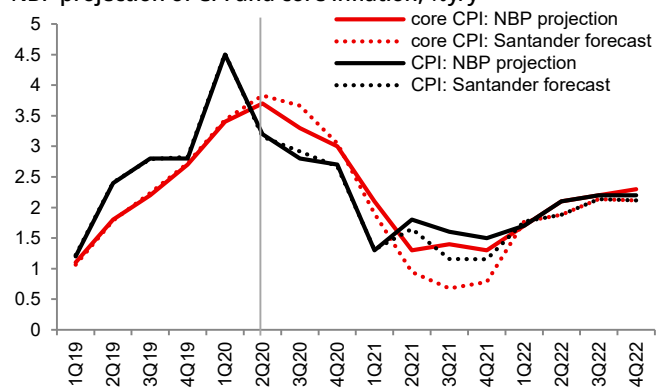
Source: GUS, Santander

NBP projection of GDP and fixed investments, % y/y



Source: NBP, GUS, Santander

NBP projection of CPI and core inflation, % y/y



Source: NBP, GUS, Santander

FX and FI market

Last week on the market

FX Last week, EURPLN continued the gradual up trend. The exchange rate broke the resistance at c 4.48 and neared 4.50, its highest since late May. We think the zloty depreciation was the effect of the market positioning ahead of the MPC meeting (due to the recent remarks from the Council about the zlotys' strength) rather than a reaction to the result of the presidential elections. At the same time, USDPLN dropped temporarily to 3.90 thanks to rising EURUSD. Weaker demand for the safe currencies allowed also CHFPLN to record a drop to 4.15 from 4.20 amid EURCHF rise to 1.08 from 1.06. GBPLN fell to 4.91 from nearly 5.0. Elsewhere in the CEE region, the exchange rates remained within the trading ranges determined in the previous days. EURCZK was hovering around 26.66, EURHUF close to 354 and USDRUB near 71. Since the beginning of June, EURCZK has been the most stable hovering within a 26.47-26.88 range (1.6%). In this period, EURHUF saw a temporary rise by 3.7% and USDRUB by 5.4%.

FI Polish IRS and bond yields followed core debt closely. At the start of the week, a sharp rise was recorded but in the next days the market recovered and rates returned below the Friday's closing levels. One of the factors that generated the down pressure on yields and IRS was the dovish rhetoric of the ECB. The central bank said it will likely use the whole planned capacity of the PEPP program (€1.35tr).

Key events of the upcoming week are the flash July PMIs (crucial for the global market) and decisions of the Hungarian and Russian central banks (could affect the mood in the CEE market).

Both services and manufacturing indexes have neutralized nearly the whole plunge recorded in reaction to the Covid-19 pandemic but are still below 50pt. We think the room for further rise and thus positive surprises is diminishing.

In late June, the Hungarian central bank surprised the market after it cut its main rate to 0.75% from 0.90%. The reduction of the main rate was called a one-off adjustment but the bank said that the one-week deposit rate could be lowered. This rate was hiked earlier this year to stop the forint weakening. Further easing of the monetary policy should be expected in Hungary to be announced this week. The same applies to the Russia central bank. Its governor, Elvira Nabiullina said that both a pause and a further rate reductions are possible after the last 100bp cut. The market consensus is for a 25bp but we think it could be bigger if any is delivered.

Market implications

FX We keep our call for weaker zloty in the coming weeks. The recent developments – breaking 4.48 resistance – support our view. Also, the last week saw next dovish remarks about the exchange rate. These were included in minutes from the June meeting and indirectly in the new central bank growth projections that showed deeper GDP contraction this year and slower rebound in 2021 than the consensus. Such scenario creates a good justification for maintaining dovish bias and (not only) verbal interventions on the FX market.

Also, the pressure on the zloty and its CEE peers may come this week from the Hungarian central bank that is likely to ease monetary policy in order to weaken the forint.

FI Polish bond yields and IRS rates are holding in a gradual downward trend amid excess liquidity in the banking system, central banks bond purchase program and low core bond yields. We do not expect any of these factors to disappear or reverse its impact. The 10Y Bund yield is remaining within -0.50/-0.40% range since mid-June given the still dovish approach of the main central banks and rather diminishing potential for positive surprises from the business sentiment indexes.

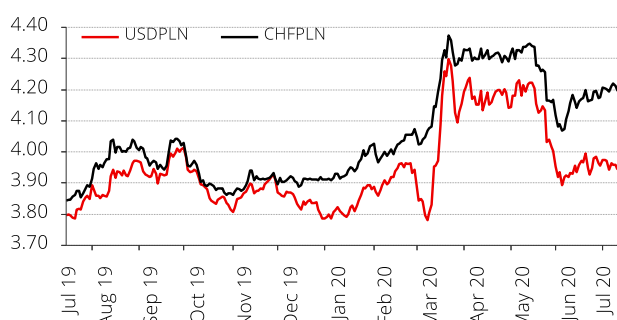
We would perceive any rise of Polish yields as a correction in the slow down trend we expect to see in the remainder of the year.

EURPLN



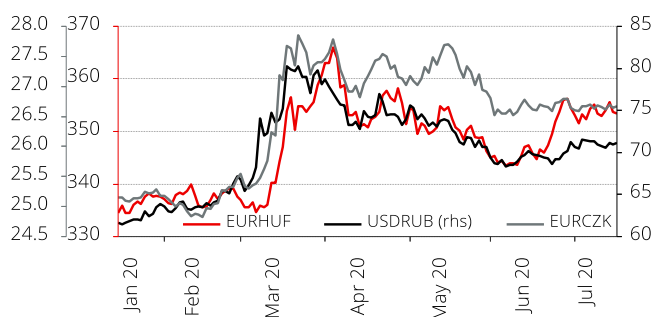
Source: Refinitiv Datastream, Santander Bank Polska

USDPLN and CHFPLN



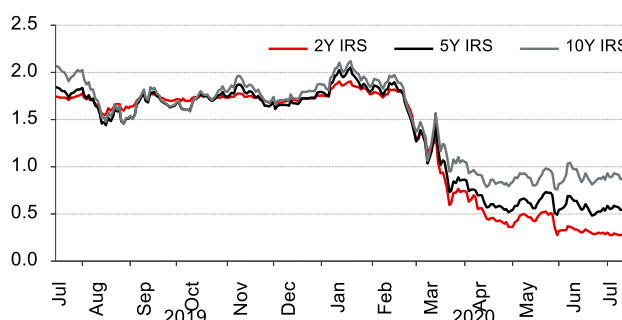
Source: Refinitiv Datastream, Santander Bank Polska

CEE currencies



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		
MONDAY (20 July)							
10:00	PL	Sold Industrial Output	Jun	% y/y	-6.4	-11.4	-17.0
10:00	PL	PPI	Jun	% y/y	-0.9	-1.0	-1.5
TUESDAY (21 July)							
10:00	PL	Construction Output	Jun	% y/y	-0.8	-2.0	-5.1
10:00	PL	Retail Sales Real	Jun	% y/y	-2.5	-4.1	-7.7
14:00	HU	Central Bank Rate Decision		%	0.6	-	0.75
WEDNESDAY (22 July)							
14:00	PL	Money Supply M3	Jun	% y/y	17.3	17.4	16.0
16:00	US	Existing Home Sales	Jun	% m/m	22.76	-	-9.7
THURSDAY (23 July)							
10:00	PL	Unemployment Rate	Jun	%	6.2	6.1	6.0
14:30	US	Initial Jobless Claims	week	k	1 250	-	1 300
FRIDAY (24 July)							
09:30	DE	Flash Manufacturing PMI	Jul	pts	47.0	-	45.2
09:30	DE	Flash Services PMI	Jul	pts	50.0	-	47.3
10:00	EZ	Flash Manufacturing PMI	Jul	pts	49.25	-	47.4
10:00	EZ	Flash Services PMI	Jul	pts	50.55	-	48.3
12:30	RU	Central bank decision		%	4.25	-	4.50
16:00	US	New Home Sales	Jun	% m/m	3.55	-	16.6

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

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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.