24 July 2020

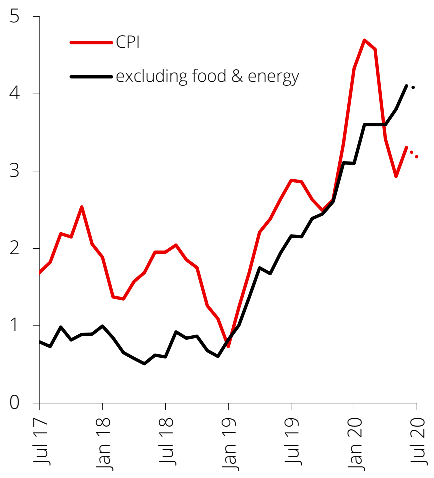
Weekly Economic Update

First 2Q GDP releases abroad

What's hot next week

- In the final week of July many data will come out abroad. The calendar includes flash GDP for 2Q (Germany, euro zone, the USA) and flash July inflation (also from Germany, euro zone, the USA), US June durable goods orders, incomes and expenditures of US consumers, German retail sales, but also several July business sentiment indicators like German Ifo, euro zone's ESI, Conference Board index and University of Michigan index. The picture these data will present may be mixed: 2Q GDP may look awful, but it is common knowledge that this was the worst period, which is already behind us and now the focus should be on the releases that signal what to expect next. We thus believe the message from sentiment indicators will be more important as well as further statistics describing the spread of the pandemic – especially that in some countries the rise of infections seems to inhibit the positive trends seen of late.
- Wednesday FOMC meeting is probably going to be a market-neutral event, as was the summer meeting of ECB.
- In Poland, the sole publication will be flash CPI for July. Our forecast of 3.2% y/y is slightly above the market consensus (3.1%) and slightly below the previous reading (3.3%).

CPI inflation, % y/y



Source: GUS, NBP, Santander

Market implications

- Significant EURPLN declines seen in recent days may continue for a while and a re-test of the 200 day moving average, currently residing at 4.38, can occur. But in general, a correction seems to be close, with the spark possibly coming from sentiment on equity markets and/or from a correction of the EURUSD rise. Excessive market optimism may be curbed by, for example, the unfolding US-China diplomatic conflict.
- Polish bond yields at the front end of the curve seem to have found an equilibrium and we do not expect them to change significantly in the following week, especially after governor Glapiński reiterated NBP rates are likely to remain stable going forward. On the long end of the curve there could be some temporary upward pressure especially if July inflation surprises to the upside.

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Last week in economy

June industrial output and retail sales data brought a huge positive surprise, suggesting that the economy started recovering from the Covid-related freeze much stronger and much faster than we had thought. The July business and consumer sentiment indexes – improving m/m in all aspects - support the view of V-shaped economic rebound (more in Economic Comment). Another good news was the result of EU summit, with minor adjustment of what Poland is to receive from Next Generation EU and the next multiannual financial framework (c.€125bn in grants plus c.€35bn in preferential loans).

Industrial production rose 0.5% y/y in June, well above market consensus (-6.4% y/y) and our forecast (-11.4% y/y). The seasonally adjusted output was still below zero, at -4.9% y/y though. More in Economic Comment. June also saw a major improvement in new industrial orders, which expanded by 19.8% m/m. Annual decline was reduced to -2.4% y/y from -30.2% y/y in April and -24.7% in May. New export orders increased by 26.7% m/m (-3.4% y/y).

In June Polish real **retail sales** growth surprised positively again at -1.3% y/y vs -7.7% y/y in May. This translates into 8.1% m/m rebound in seasonally adjusted terms, after adding 17.4% m/m in May. The y/y growth of durable goods sales turned positive, showing the influence of the demand overhang accumulated during lockdown. Construction output fell in June by 2.4% y/y, a bit below market consensus. More in Economic Comment.

Detailed data from the Statistical Bulletin showed that increase of **employment** in the corporate sector by 12k (measured in full-time equivalent) was mainly due to mining, which saw employment jumping by 8k (puzzling, as 12 coal mines were temporarily shut down) while in manufacturing it fell. Interestingly, the employees count in the corporate sector fell by 5k in June. This is in line with our expectations that as government lifeline funds are depleting the companies will be normalising their working time (employment up) and at the same time making decisions on layoffs (employee count down). For example, such behaviour was clearly visible in trade.

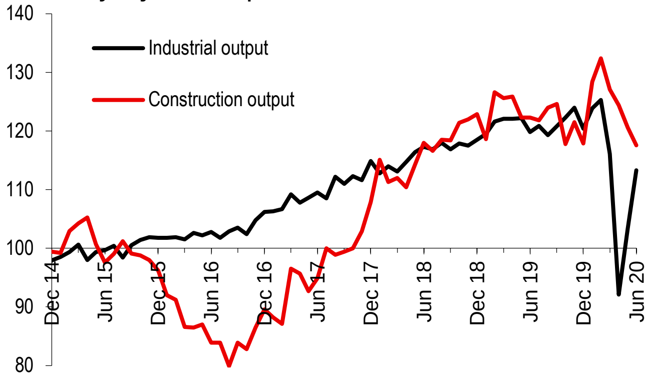
After June the **budget deficit** declined to PLN17.1bn vs PLN25.9bn in May due to payment of the NBP profit from 2019 and high inflows from income taxes (effect of prolonged payment deadline) on one revenues side and astonishingly low subsidy to Social Security Fund (only PLN2bn vs PLN5bn on average in last two months) on the spending side. Since a large chunk of spending was pushed outside the central budget, its performance does not show the full picture. We expect the GG deficit to exceed 10% of GDP this year.

M3 money supply accelerated in June to 18.1% y/y from 16.0% y/y in May (highest since Dec'08). Deposits increased by 16.4% y/y, with corporate deposits up by 30.1% y/y. The acceleration is a result of the Polish government actions related to Covid-19, namely the massive issuance of new money. Loan growth decelerated to 2.1% y/y from 3.3% y/y in May (FX adjusted data), with companies' loans declining by 1.0% y/y – for the first time since 2013. The largest decline was seen on working capital loans (-7.6% y/y), possibly crowded out by the state support.

There is an attempt to loosen the **fiscal spending rule**. It turned out that a change is being prepared not by means of modifying the public finance bill where the mechanism of the rule is described, but in an amendment to delegated employees bill, and introduced at a later stage of works (by Sejm's Social Policy and Family Committee). The modification places all 2021 investment spending (including from BGK programs) outside the scope of the rule and is a not-communicated-earlier addition to the already approved modification that gives the possibility to suspend the rule during pandemic and introduce a mechanism to restore the rule's limit gradually within a couple of years.

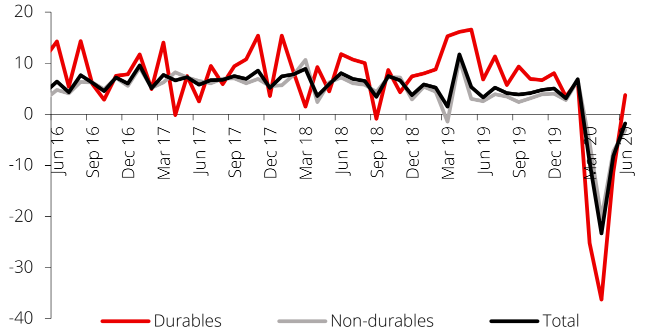
According to Dziennik Gazeta Prawna daily, MinFin's 2021 **budget draft** assumes a 4% rebound of GDP and CPI at 1.8% (vs -4.6%/3.3% assumed for 2020), no wage hikes in the budgetary sector and rise of minimum wage by 4.5% (the promise before 2019 general elections mentioned 15.4% in 2021). 13. and 14. pension will be included. There will be extra revenues from OFE transition charge, retail tax (currently suspended due to litigation in CJEU) and sugar tax.

Seasonally adjusted output (2015=100)



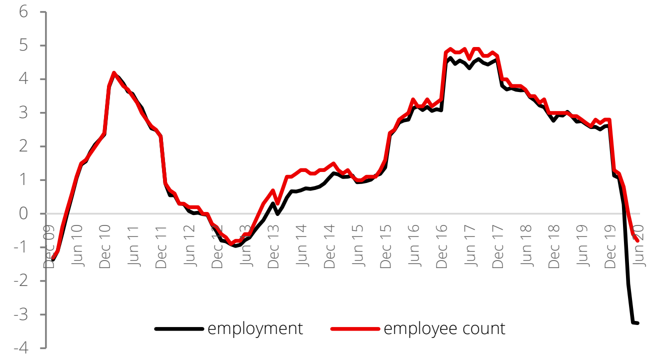
Source: GUS, Santander

Retail sales, constant prices, % y/y



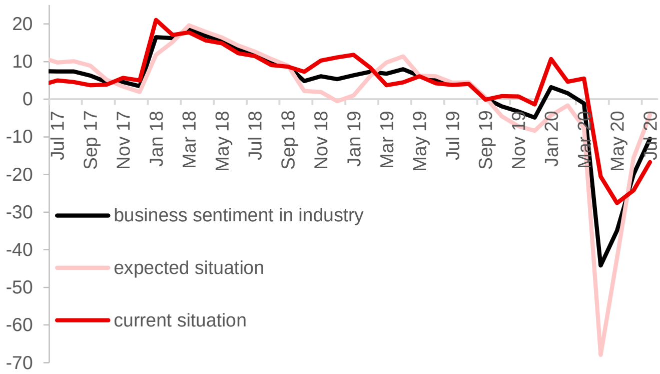
Source: GUS, Santander

Changes on the labour market, %y/y



Source: GUS, Santander

GUS business sentiment indicators, industry



Source: GUS, Santander

FX and FI market

Last week on the market

FX EURPLN has had one of the biggest weekly declines. The pair fell 1.5% in total, and was falling on each day of the week. A few factors contributed to the behavior of the currency, both global and local. As US real rates were declining further and pushing the dollar weaker, risky assets, including EM currencies, were well supported. Also, early in the week the milestone in the European integration process (EU budget deal) have been reached and Poland is likely to become one of its main beneficiaries. Last but not least, another round of Polish macroeconomic data were stronger than expected. With EURUSD higher 1.3% on the week, USDPLN declined by even more – 3.2% to 3.80.

Elsewhere in the CEE region, the exchange rates behaved in a similar way. EURHUF declined 1.6% to 347.5 and this even despite NBH cutting rates by another 15bp to 0.6% (the bank cut a total of 30bp at the last two meetings), EURCZK 1.3% to 26.3. It was only a ruble basket which has not changed on the week (but in the meantime has done a roundtrip down 1.7% and up again). On Friday the CBR cut rates but only by 25bp to 4.25%, less than expected (50pb).

FI Polish IRS and bond yields were stable on the front end of the curve. The 2Y bond has not declined further (trades at 0.1%) which might indicate that despite the abundant liquidity in the banking sector the market has found some short term equilibrium. Thursday comments of NBP governor Glapiński in Sejm (he expects rates to remain stable) have probably contributed to the low volatility. Yields on the long end of the curve increased at the end of the week as foreign investors adjusted positions, plausibly before the next week's July inflation print.

Key events of the upcoming week are Chinese industrial production, German retail sales and IFO indices as well as US Durables (Monday), US consumer confidence (Tuesday), pending home sales and FOMC meeting (Wednesday). On Thursday US and Germany publish its advance Q2 GDP, Eurozone consumer confidence. Friday finishes off with Chinese PMIs, Eurozone and Czech advance Q2 GDP, Eurozone and Polish CPI and US deflator and University of Michigan indicators.

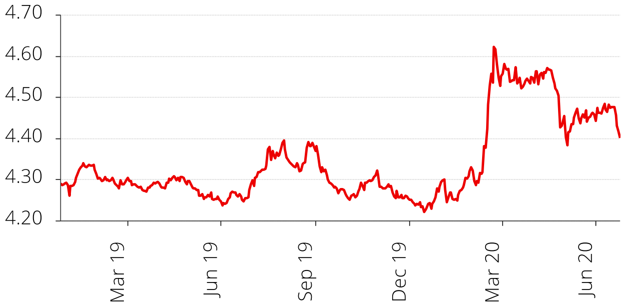
Market implications

FX We acknowledge the strength of recent EURPLN move lower. Even if some factors both global (e.g. the increasingly tired equities rally – in Europe the rebound currently stands at 66% of the March abrupt declines) and local (FX remarks in the MPC's statement) might point to some short-term rebound, we think the EURPLN declines should continue for a while and at the very least the pair should re-test (last time in early June) the 200 day moving average, currently residing at 4.38. Higher than market consensus (currently at 3.1%) inflation print on Friday might contribute to even sharper stop loss hunting lower. MPC Jerzy Żyżyński claims MPC did not aim at making an impression it wanted the currency to weaken. Because the EURUSD rally seems stretched already (up 3.8% in July alone), expect high USDPLN volatility in case likely EURUSD correction occurs.

FI Polish bond yields and IRS rates at the front end of the curve seem to have found an equilibrium and we do not expect them to change significantly in the following week, especially after governor Glapiński reiterated NBP rates are likely to remain stable going forward.

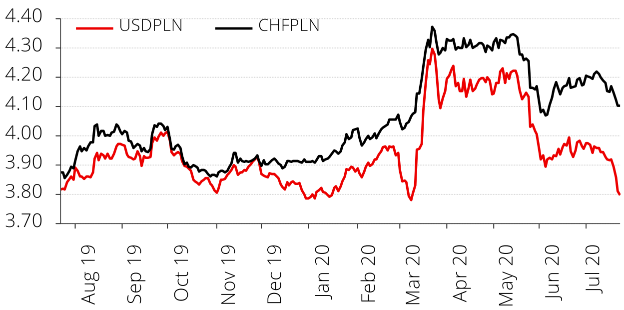
On the long end of the curve it is a different story. In the medium term we expect inflation to fall and Polish yields to follow core yields lower. However given next week July inflation print on Friday, we think some investors might want to postpone bond purchases till after the data (in case it surprises to the upside). The likely temporarily lower inflows from institutional investors, together with apparently declining NBP QE purchases which last week stood just at 1.6bn zloty (of which government bonds just 0.2bn zloty, the rest were the BGK bonds) suggests that 10L yields might march towards 1.40% and this even despite stable to falling yields in the core markets, implying widening of the PL-DE bond yield spreads.

EURPLN



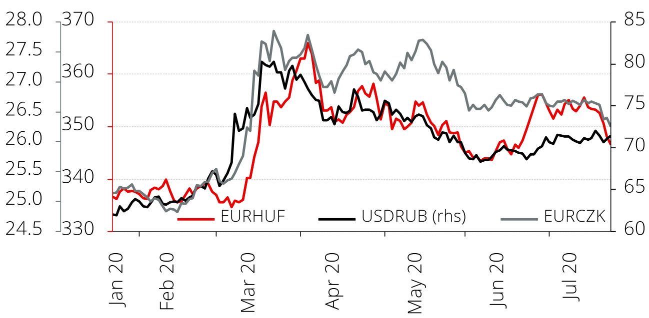
Source: Refinitiv Datastream, Santander Bank Polska

USDPLN and CHFPLN



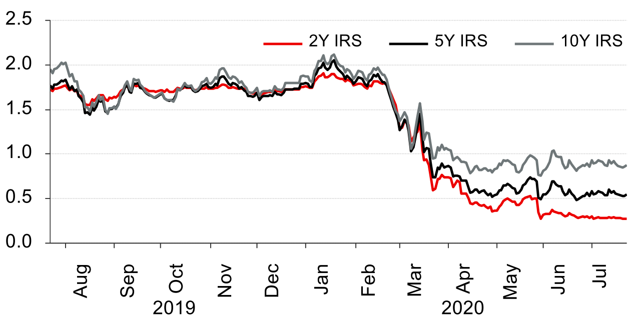
Source: Refinitiv Datastream, Santander Bank Polska

CEE currencies



Source: Refinitiv Datastream, Santander Bank Polska

Poland IRS



Source: Refinitiv Datastream, Santander Bank Polska

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Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST SANTANDER	LAST VALUE
			MONDAY (27 July)				
	DE	Retail Sales	Jun	% m/m	-3.0		12.7
10:00	DE	IFO Business Climate	Jul	pts	89.25		86.2
14:30	US	Durable Goods Orders	Jun	% m/m	7.0		15.7
			TUESDAY (28 July)				
16:00	US	Consumer Conference Board	Jul	pts	94.75		98.1
			WEDNESDAY (29 July)				
16:00	US	Pending Home Sales	Jun	% m/m	15.6		44.3
20:00	US	FOMC decision	Jul.20		0.25		0.25
			THURSDAY (30 July)				
08:00	DE	GDP WDA	2Q	% y/y	-10.9		-2.3
11:00	EZ	Unemployment Rate	Jun	%	7.6		7.4
11:00	EZ	ESI	Jul	pct.	82.5		75.7
14:00	DE	HICP	Jul	% m/m	0.0		0.7
14:30	US	GDP Annualized	2Q	% Q/Q	-34.0		-5.0
14:30	US	Initial Jobless Claims	Jul.20	k	1300		1416
			FRIDAY (31 July)				
09:00	CZ	GDP SA	2Q	% y/y	-12.5		-2.0
10:00	**PL**	**CPI**	**Jul**	**% y/y**	**3.1**	**3.2**	**3.3**
11:00	EZ	Flash HICP	Jul	% y/y	0.3		0.3
11:00	EZ	GDP SA	2Q	% y/y	-13.9		-3.1
14:30	US	Personal Spending	Jun	% m/m	5.5		8.2
14:30	US	Personal Income	Jun	% m/m	-0.5		-4.2
14:30	US	PCE Deflator SA	Jun	% m/m	0.5		0.1
16:00	US	Michigan index	Jul	pts	72.65		73.2

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

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