28 August 2020

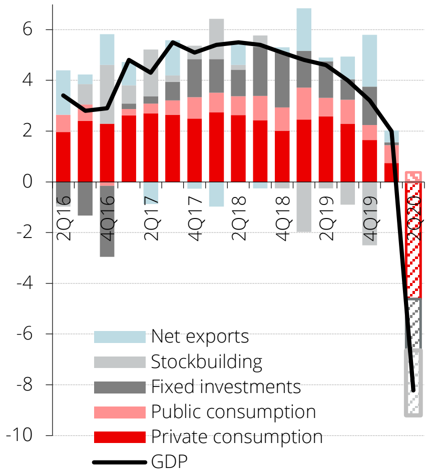
Weekly Economic Update

GDP breakdown to conclude holidays

What's hot next week

- The new week will start with the publication of detailed GDP data for 2Q2020: on Monday at 10:00 we will get to know which components of demand attributed the most to a sharp GDP contraction in the peak of pandemic (-8.2% y/y, -8.9% q/q s.a.). In our view, all main GDP components deteriorated in 2Q20 and the biggest, two-digit drop affected investments and foreign trade turnover.
- GDP data refer to already quite distant past, while the most important question right now is whether the recovery, which started since then, will hold. In this context, the flash manufacturing PMI due on Tuesday will be important. We expect the index to rise, but only slightly, following the improvement of other business sentiment indicators, which we already know (GUS, ESI); such result would confirm that the recovery continues but is losing pace.
- Flash CPI inflation data for August (also on Tuesday) will show a stabilisation at July's 3.0% y/y, according to our estimate. We still think that before year-end inflation will drop below the 2.5% target, and at the start of 2021 it may approach 1%.
- Abroad, investors' attention may be still focused on central banks at the start of the week. At the virtual symposium in Jackson Hole Fed governor Jay Powell announced shift of monetary policy strategy towards "average inflation targeting" and the discussion about change of policy paradigms may still last a while. Polish central bank seems to be still in the pandemic mode, as it has just announced that all the MPC meetings until the end of 2020 will be one-day only. We do not know whether it means the lack of press conferences until year-end.
- The agenda of data releases abroad is quite full and includes PMIs in manufacturing and services, GDP data in some countries, inflation, and US employment report.

Poland GDP structure, % y/y



Source:: GUS, Santander

Market implications

- Zloty has not managed to profit from the good macro data in the previous week nor further equity increases globally, as a result we see a risk of zloty depreciation in the coming week. The volatility of EURPLN has been very low of late, which also seems to predict that a higher volatility (a spike in EURPLN higher) is more probable.
- In August, Polish bond yields and IRS have increased following the core markets. There is scope for further increases, especially if one takes into account the upcoming and plausible further positive macro surprises (in the coming week it is the CPI rather than the GDP which – in the case of significant deviation from market expectations – has the potential to impact markets). The news about elevated fiscal deficit in this and the next year (12% of GDP and 6% of GDP, respectively) are not very likely to result in a big bond sell-off, as deficits are increasing almost everywhere in the world. However the factor might add to slightly higher yields in our opinion.

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Last week in economy

Last week was quite rich in macro information. All-time high GG deficit and debt is the most important piece of news. Moreover, we got some sectors information on investment, suggesting a deep slump in 2Q.

ESI indicator for Poland improved markedly in August. Indicators for all subsectors improved with an exemption of consumer confidence, which went down on growing worries about unemployment and economic situation.

Draft budget for 2021 assumes deficit at PLN83.2bn versus PLN109.3bn planned in 2020 budget amendment (on budget amendment read more here). Planned revenues are at PLN403.7bn (+1.3% y/y), with PLN1.3bn from NBP profit and PLN1.5bn from retail sales tax. Spending was planned at PLN486bn (-4.3% y/y). Deficit of the general government (GG) sector is to hit 12% of GDP in 2020 and 6% in 2021 and debt: 62.2% and 64.7% of GDP. A rise in public debt is unprecedented – it amounted to 45.9% of GDP, so will rise by almost 20 percentage points in two years.

President Duda signed the bill introducing **tax on sugar** in drinks and on small bottles of alcohol. The tax will become effective on 1 January 2021 and may lift inflation by c.0.3pp, according to our estimate.

The 2Q20 **gross financial result of corporate sector** (firms employing 50 people and more) amounted to PLN38.7bn and was down 16.6% y/y; net result fell by 19% (compared to -25.6% y/y and -28.6% in 1Q, respectively). Average profit margin was 5.5% (up from 3% in 1Q, it showed the usual seasonal rise despite the pandemic) – this compares to 5.7% in 2Q19 and 5.4% in 2Q18. Weakening of margins seems so far to be benign as compared to the global financial crisis or 2012-2013 slowdown. In Q2 2020, investments of big companies with 50 or more employees declined in real terms by 14% y/y.

After 2Q20 **local government units recorded a budget surplus** of PLN12bn (as compared to PLN13.5bn in the corresponding period of 2019). Investment outlays up by 2.1% y/y versus 11.3% y/y in 1Q20. Thus, in 2Q20 local governments delivered a slightly positive contribution to total investment growth, given probably strongly negative contribution of the private sector. We are expecting the growth rate of local government's investment to remain low or even slide below zero, as total annual investment plan of governments are lower than in 2019.

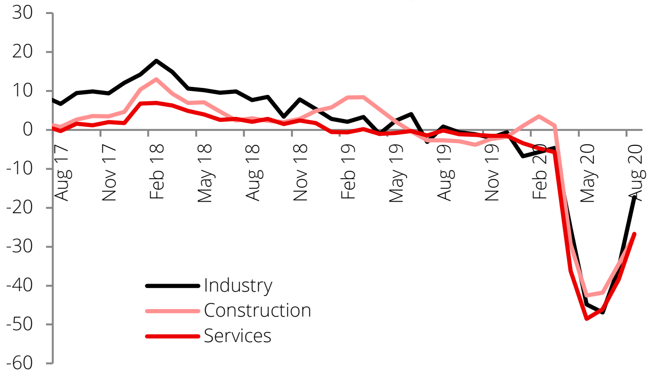
The registered unemployment rate in July remained unchanged at 6.1%, in line with expectations. The LFS unemployment rate in Q2 2020 also remained unchanged at 3.1%. The GUS analysts pointed to the fact that the decline of the number of employed was equal to the increase in the number of inactive people. As we indicated before, due to pandemic-related formal limitations, some people who lost jobs during the pandemic did not qualify for being regarded as unemployed (actively looking for a job, ready to take a job when offered).

The number of employed in July declined by 5 thousand, despite the fact that the average employment increased at a record pace this month (+66 thousand). This is in line with our expectations: companies are restoring the normal working times (which is increasing average employment) while at the same time are optimising total staff size (which lowers number of employed).

In July **M3 money supply** growth dropped to 16.8% y/y, following a rapid acceleration from 9.4% y/y in February to 18.1% in June. Total deposits shrank by 0.6% m/m – mainly of non-monetary financial institutions, which reduced their bank-held deposits by c.PLN7bn or 11.6% m/m. Total loans (FX-adjusted) grew in July by only 0.9% y/y vs 5% y/y on average still in 1Q, with the volume of company loans shrinking by 3.2% y/y. It seems that companies were repaying their debt with the use of accumulated state financial support. Credit demand likely remained depressed but data for the previous months showed that production of new loans for firms slowed less than for individuals.

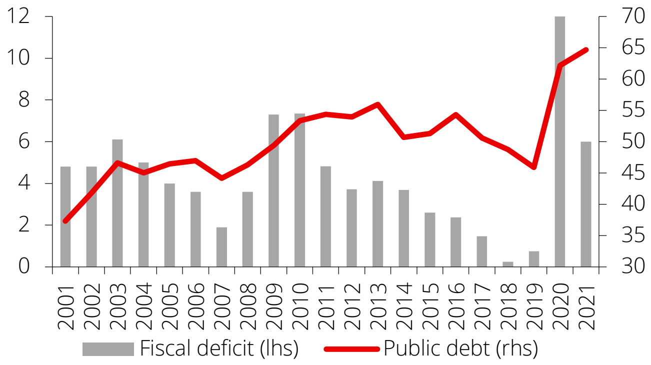
The NBP rate cut by 40bp in May was supported by six MPC members: Adam Glapiński, Grażyna Ancyparowicz, Cezary Kochalski, Eryk Łon, Rafał Sura and Jerzy Żyżyński. The same six voted for 50bp rate cut in March, and in April they were joined by Jerzy Kropiwnicki, when cutting rates again by 50bp.

ESI sectors business climate indicators, pts



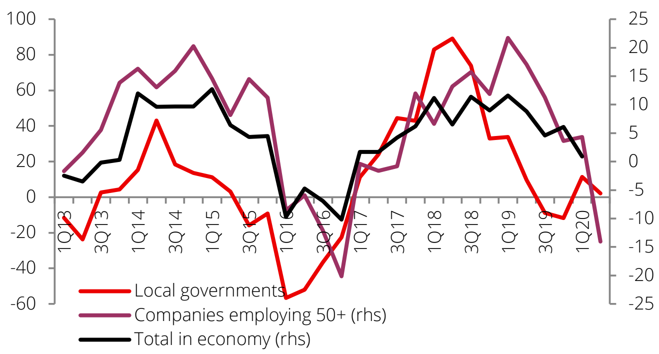
Source: GUS, Santander

General government debt and deficit, % of GDP



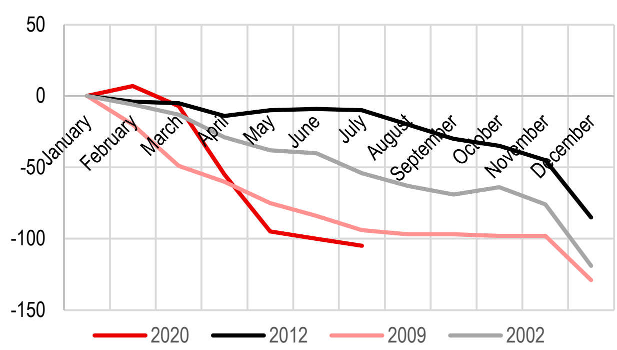
Source: GUS, Finance Ministry, Santander

Investment, % y/y



Source: GUS, Finance Ministry, Santander

Change in number of employed, Jan=100



Source: GUS, Santander

FX and FI market

Last week on the market

FX The passing week has been very calm on the Polish FX market with EURPLN hovering in a narrow 4.38-4.42 range while USDPLN fell to 3.69 from 3.75 only thanks to EURUSD rise.

The other CEE currencies underperformed the zloty since both EURCZK and EURHUF climbed to their fresh August peaks at 26.32 and 356.7, respectively. The Hungarian central bank left interest rates unchanged but said it will step up bond purchases on the market which pressured the forint. USDRUB was on the rise in the first part of the week and reached 76.0, its highest since early May. EURUSD rise after the Jerome Powell speech helped the Russian currency to erase earlier losses.

FI Polish bond yields and particularly the IRS rates followed the upside pattern dictated by the core markets. Bund and Treasury yields were on the rise (1) amid decent global market mood and (2) owing to the profit taking after the dovish speech delivered by Jerome Powell. As a consequence, the 5Y and 10Y Polish bond yields rose 7-10bp and the respective IRS rates moved 10-20bp. The 10Y PL-DE bond yield spread initially fell to 175bp but at the end of the week was back just above 180bp.

Key events of the upcoming week could be the US nonfarm payrolls and ISM index. The recent data showed some moderation in pace of job creation but the manufacturing ISM has climbed above the pre-covid levels. The equity market is still pricing a V-shaped rebound and even if we see slightly weaker m/m readings of the abovementioned data, this should not cause much harm to the global market mood.

We will see Poland detailed 2Q20 GDP and flash August CPI. When it comes to the market impact, we think the inflation release could prove more important when it surprises to the upside whereas deviation of the GDP print should be fairly neutral.

Market implications

FX The zloty failed to extend gains, despite the positive surprises in Polish macro data (seen in the previous week) and a further rise in global equity indexes. The fact that the zloty did not benefit from the general optimism suggests, in our view, that some profit taking could take place soon.

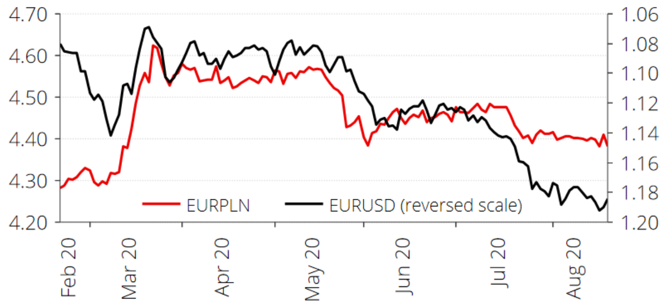
Also, note that volatility has declined significantly in recent weeks on the Polish FX market. This tends to be a cyclical phenomenon and periods of low volatility are typically followed by more pronounced swings that are negative for EM currencies like the zloty. Volatility, as measured by the 1M 25D risk reversal, is close to the levels that historically preceded spikes in EUR/PLN.

FI Polish bond yields and IRS rates are on the rise in August. The IRS curve is already 10-33bp higher than at the beginning of the month and the bond 5Y and 10Y yields +10bp (with stable 2Y).

However, in August the 10Y PL-DE bond yield spread has not changed much and was moving around 180bp. In our view, this might imply that there is still room for the domestic bond yields to rise and this trend might start to reverse when the spread vs Bund widens by c10bp. We think 1.45% could be the first stop for the 10Y bond yield where it try to seek balance. March towards this level could be fuelled by the flash August CPI if it proves higher than expected.

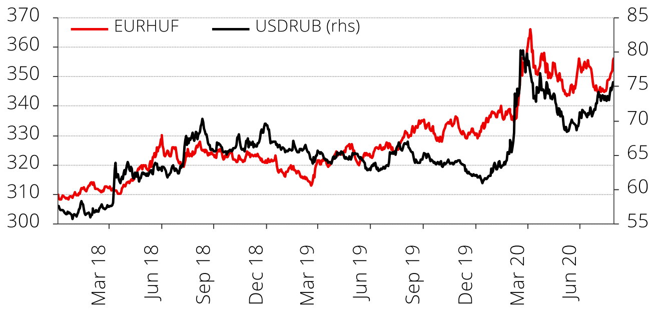
In case of the 10Y Bund, the yield failed to close the down gap from the first half of June at c-0.36% and we think this could be supportive for the German bond in the coming days also contributing to a spread rise.

EURPLN and EURUSD



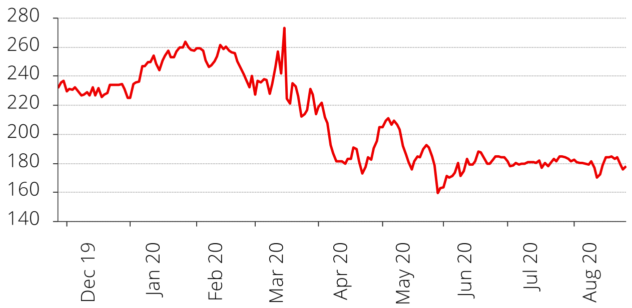
Source: Refinitiv Datastream, Santander Bank Polska

EURHUF and USDRUB



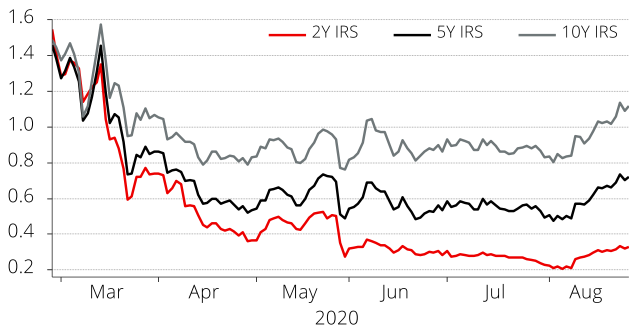
Source: Refinitiv Datastream, Santander Bank Polska

PL-DE bond yield spread



Source: Refinitiv Datastream, Santander Bank Polska

Poland IRS



Source: Refinitiv Datastream, Santander Bank Polska

Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST SANTANDER	LAST VALUE
		MONDAY (31 August)					
10:00	**PL**	**GDP**	**2Q**	**% y/y**	**-8.2**	**-8.2**	**2.0**
10:00	**PL**	**Private consumption**	**2Q**	**% y/y**	**-10.0**	**-8.0**	**1.2**
10:00	**PL**	**Investments**	**2Q**	**% y/y**	**-12.0**	**-12.0**	**0.9**
14:00	DE	HICP	Aug	% m/m	0.0	-	-0.5
		TUESDAY (1 September)					
09:00	CZ	GDP SA	2Q	% y/y	-10.7	-	-10.7
09:00	**PL**	**Poland Manufacturing PMI**	**Aug**	**pts**	**52.9**	**53.0**	**52.8**
09:00	HU	GDP	2Q	% y/y	-13.6	-	-13.6
09:55	DE	Germany Manufacturing PMI	Aug	pts	53.0	-	53.0
10:00	EZ	Eurozone Manufacturing PMI	Aug	pts	51.7	-	51.7
10:00	**PL**	**Flash CPI**	**Aug**	**% y/y**	**3.0**	**3.0**	**3.0**
11:00	EZ	Flash HICP	Aug	% y/y	0.2	-	0.4
11:00	EZ	Unemployment Rate	Jul	%	8.0	-	7.8
16:00	US	ISM manufacturing	Aug	pts	54.3	-	54.2
		WEDNESDAY (2 September)					
08:00	DE	Retail Sales	Jul	% m/m	0.5	-	-2.0
14:15	US	ADP report	Aug	k	900	-	167
16:00	US	Durable Goods Orders	Jul	% m/m	-	-	11.2
16:00	US	Factory Orders	Jul	% m/m	3.8	-	6.2
		THURSDAY (3 September)					
03:45	CN	Caixin China PMI Services	Aug	pts	54.0	-	54.1
09:55	DE	Markit Germany Services PMI	Aug	pts	50.8	-	50.8
10:00	EZ	Eurozone Services PMI	Aug	pts	50.1	-	50.1
11:00	EZ	Retail Sales	Jul	% m/m	1.0	-	5.7
14:30	US	Initial Jobless Claims	week	k	1 000	-	1 006
16:00	US	ISM services	Aug	pts	57.2	-	58.1
		FRIDAY (4 September)					
08:00	DE	Factory Orders	Jul	% m/m	6.0	-	27.9
09:00	HU	Industrial Production SA	Jul	% y/y	-9.5	-	-12.2
14:30	US	Change in Nonfarm Payrolls	Aug	k	1 518	-	1 763
14:30	US	Unemployment Rate	Aug	%	9.8	-	10.2

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg

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.