

04 September 2020

# Weekly Economic Update

## Will ECB take cue from Fed?

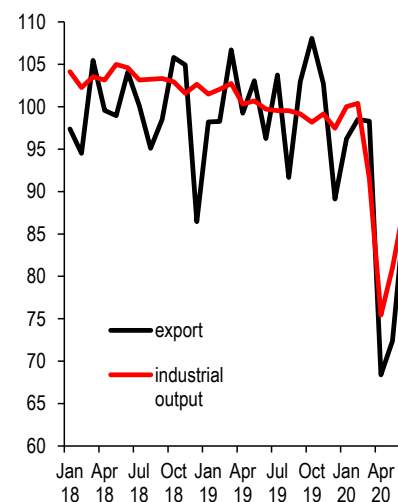
### What's hot next week

- We have just released the new **MACROscope Lite**, with the economic growth forecast slightly revised up, mainly due to the better starting point. It seems quite likely that the surprisingly strong pace of economic revival in its early stage may slow in the coming months, which is already signalled by some leading indicators, for example consumer confidence, Polish manufacturing PMI, or services PMIs in Europe.
- The most important event next week will be the ECB meeting (on Thursday). It will be interesting to see whether the European bank will refer anyhow to the change in monetary policy strategy announced recently by the US Fed (adoption of average inflation targeting = higher tolerance for inflation temporarily above 2%). It is worth recalling that the ECB is currently also reviewing its monetary strategy, which started in January. However, in April the deadline for the review has been postponed until mid-2021, due to pandemic, so now it could be too early to see any decisive declarations.
- The number of data releases in the coming week is not high, and will include some data on inflation (Hungary, Czechia, Germany, USA), production (Germany, France, Italy, Spain), plus final 2Q GDP data for European countries. There are no important data releases scheduled in Poland.
- It is worth tracing Covid-19 new cases in the first two weeks after the school opening, as they may tell us a bit about probability of tightening restrictions by governments.

### Market implications

- After the zloty failed to benefit from the solid macro data and positive global sentiment, while FX volatility fell significantly in August, we were expecting a correction and it seems that it has just started. We do not expect to see EURPLN rising above 4.50 in this correctional wave, though.
- Bond yields and IRS rates have been in an upward trend in the last few weeks. If the recent risk-off persists as we expect, then core yields are likely to trade flat to or to go down, while local yields (Polish, but we think other CEE bonds as well) might trade flat to higher, resulting in a widening of the spreads vs Bund. The steepening of the curve may be supported by any suggestion from the ECB that it may follow the path of the Fed as regards monetary strategy. We expect 10Y POLGB at 1.50% by the end of the quarter, partly due to increased issuance that we foresee by the year-end (PLN 20bn). Small part of the move might already take place in coming week.

German industrial output and export, 2019=100, sa



Source: Destatis, Santander

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## Last week in economy

Last week we got to see detailed GDP for 2Q20, flash CPI in August and PMI, with the latter showing some slide. The government also showed its financial plan for 2021.

**GDP growth in 2Q20** was confirmed at -8.2% y/y nsa, -8.9% q/q sa, in line with the flash estimate. Private consumption and investments fell by almost 11% y/y, while public consumption and net exports had positive impact on GDP. Investment was undermined mostly by lower outlays on machinery and transport equipment, deducting almost 10 percentage points in from the total number. Data more or less confirm the intuition about the nature of economic activity freeze in the peak of pandemic lockdown. At the same time, high frequency data show that since June the economy started getting back to life and the recovery process so far is quite effective. Moreover, the scale of deterioration in services less affected by lockdown restrictions in 2Q was smaller than we thought. Read more in our [Economic Comment](#).

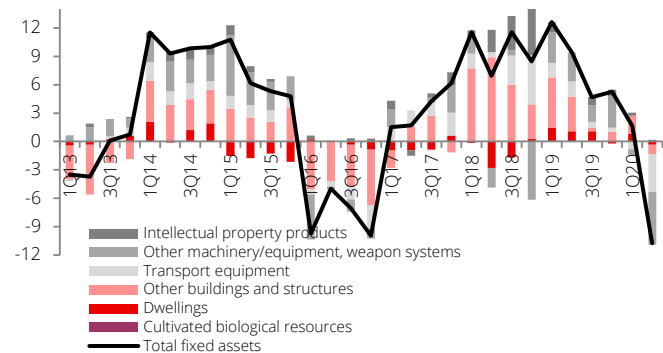
**CPI inflation** fell to 2.9% y/y in August, according to flash reading, slightly below our forecast and market consensus at 3.0%. Food prices fell 1.1% m/m, in line with our estimate, energy prices rose 0.1% m/m, while fuel prices rose 3.3% m/m, more than we had estimated. Thus, the downward surprise in headline CPI must have come from the core inflation. We think that CPI ex food and energy could have slowed to 4.1% y/y from July's peak 4.3%. Possibly, the disinflationary effects of pandemic-related demand collapse have finally started materialising. We keep our view that inflation will descend further, falling below 2.5% target by the end of this year and well below 2% in 2021.

**Polish manufacturing PMI** fell in August to 50.6 from July's 52.8, which was at odds with our forecast and market consensus (53.0 and 52.9, correspondingly), but also with other available business climate surveys (GUS, ESI), which had pointed to further improvement of companies' confidence in August. The index worsened mainly because of lower new orders. While companies were still reporting improvement of external demand, the domestic demand weakened. Employment was still declining, according to survey, but at slower pace. Upward pressure on production costs strengthened to its six-month high, while prices of finished goods were in decline. Overall, the survey suggests that after a sharp rebound in the first stage of recovery from the lockdown, the pace of improvement in economic activity in the following months may be lower.

**Draft budget 2021** assumed a central deficit at PLN82.3bn and general government deficit at 6% of GDP (as compared to 12% of GDP in 2020). The relatively high gap in public finance stems mostly from high spending of the central sector, which is expected to reach 20.6% of GDP, i.e. 2 percentage points less than in 2020, but still by about 2 percentage points more in 2018-2019. High spending in 2021 cannot really be blamed on the pandemic, especially as even in 2020 the lion share of Covid-related expenditure was pushed away from the budget. It is mostly due to changes in fixed spending, like rising social transfers, healthcare and defence. Incomes, based on conservative macroeconomic assumptions, seem to be quite realistic. Even though the deficit is expected to be lower than in 2020, 2021 borrowing needs are going slightly up. Still, the planned bond issuances are to decline with a major part of financing secured in external sources, like loans from EU SURE instrument. Read more in our [Economic Comment](#).

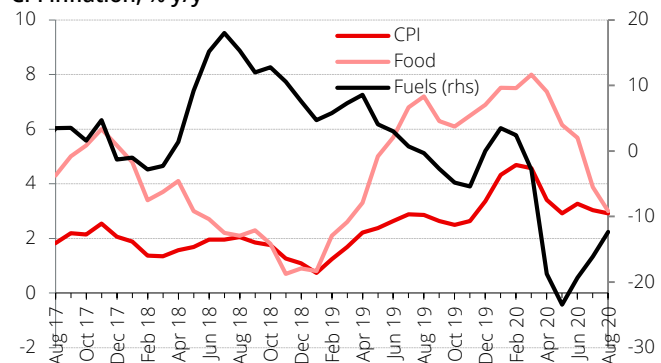
**MPC member** Eugeniusz Gatnar said that normalisation of interest rates should be considered in early 2021, should inflation remain elevated as the economy will be rebounding. Gatnar is expecting inflation to remain elevated throughout 2021, which we see unlikely and in our view rates will remain unchanged this and next year.

## Investment breakdown, % y/y



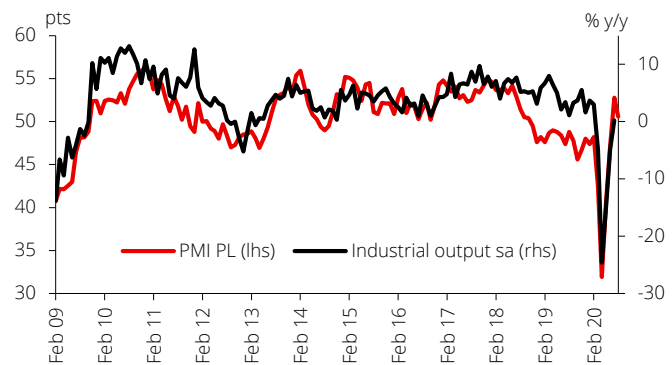
Source: Eurostat, Santander

## CPI inflation, % y/y



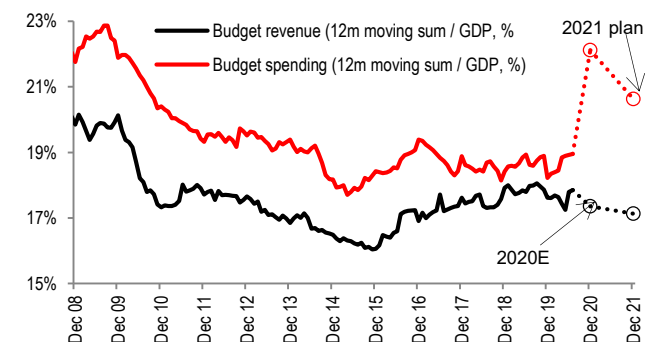
Source: GUS, Santander

## PMI index vs industrial output



Source: GUS, Markit, Santander

## Central budget revenues and spending, % of GDP



Source: Finance Ministry, Santander

## FX and FI market

### Last week on the market

**FX** The passing week has been interesting on the FX market given the increased EURUSD volatility. In the end EURUSD dropped 0.4% w/w to 1.185 however in the meantime traded briefly as high as 1.200 (post Jerome Powell's Jackson Hole speech) and as low as 1.179 (on the first signs of increased risk aversion). The dollar strengthening, led naturally to the weakness of EM currencies, including zloty. In the first half of the week EURPLN seemed to still remain in a narrow 4.38-4.42 range established at the end of July. The second part of the week saw EURPLN to rise to 4.45 from 4.39 or by 1.4% w/w. USDPLN gained 2.1% closing at 3.76, CHFPLN grew by 1.3% to 4.13 while GBPPLN by 1.6% to almost 5.00. The other CEE currencies also depreciated. EURHUF increased by 1.5% to 359.5, EURCZK by 1.1% to 26.4, USDRUB by 1.5% to 75.2 - not surprising given c 5.0% w/w decline in oil prices.

**FI** Polish bond yields and IRS rates came off local highs in the passing week, which we find as a healthy adjustment. 10Y bond yields declined by 4bp to 1.39%, IRS by 10bp to 1.05%. The Bund yields also dropped but by more than the Polish equivalent – 7bp – hence the 10Y spread widened. Front end of the curve also saw declines but smaller: 2Y bond yield just 2bp to 1.10% while 2Y IRS by 4bp to 0.28%. The 21x24 FRA came down 9bp to 0.28% and is not pricing any noticeable rate hike probability at the moment anymore.

**Key event** of the upcoming week is the September ECB meeting on Thursday. Given the new monetary policy announcement by the Fed and more worrisome data out of Europe lately (large drop in inflation, Italian and Spain services PMIs big drops to below 50.0 level etc) it will be interesting to watch if ECB is likely to follow suit and edge on the dovish side even more than currently anticipated by markets. There are also August inflation data scheduled for Wednesday (Hungary), Thursday (Czechia) and Friday (US and Germany). German July data is due on Monday (industrial production) and Tuesday (exports). Eurozone final GDP scheduled for Tuesday.

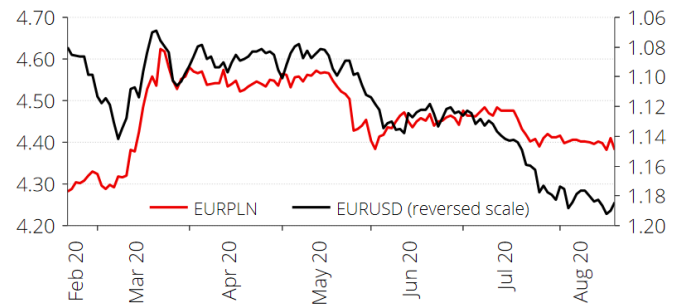
### Market implications

**FX** Given relatively scarce local data calendar, in the following week zloty is likely to be driven by global factors to a larger degree. The strength of US dollar should be of particular focus. The EURUSD has already risen c10% since May and we think a small correction towards the 50-day moving average (or 2% below current spot) is increasingly likely, especially after ECB officials tried to slow the EUR rise recently (e.g. Philip Lane) and ECB is plausibly thinking to act in a dovish fashion after recent negative data surprises (lower inflation and southern Europe services PMIs). We expect EURPLN to keep rising in the coming week but rather not to breach the 4.50 level (mid-July highs) or 1% away from the current spot. There is much more room for the USDPLN increase, in our opinion, and we would not be surprised to see it trade in the low 3.90s in the coming week.

**FI** We do not expect much action at the front end of the curve in the following week – the FRAs are currently pretty much aligned with 3m Wibor and it makes sense to us – we expect NBP to keep rates on hold till 2022. Short term bonds also seem to have found equilibrium and we expect 2Y bond yields to remain near 0.10%.

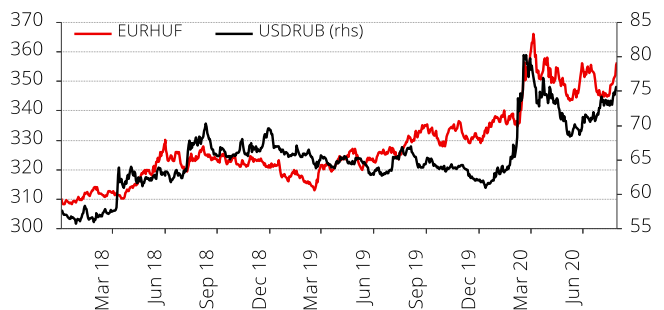
At the long end of the curve, if correction in risk persists as we expect, then core yields are likely to trade flat to lower while local yields (Polish, but we think other CEE bonds as well) might trade flat to higher, resulting in a widening of the spreads vs Bund. If the ECB were to follow Fed strategy change in some way (or at least announce a willingness to do so) then global yield curves would likely steepen from here which would be the case for Polish bonds as well. We expect 10Y POLGB at 1.50% by the end of the quarter, partly due to increased issuance that we foresee by the year-end (PLN 20bn). Small part of the move might already take place in coming week.

### EURPLN and EURUSD



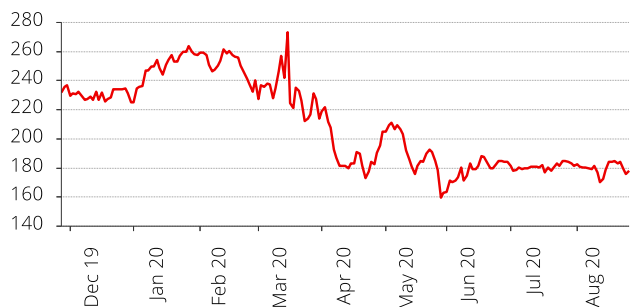
Source: Refinitiv Datastream, Santander Bank Polska

### EURHUF and USDRUB



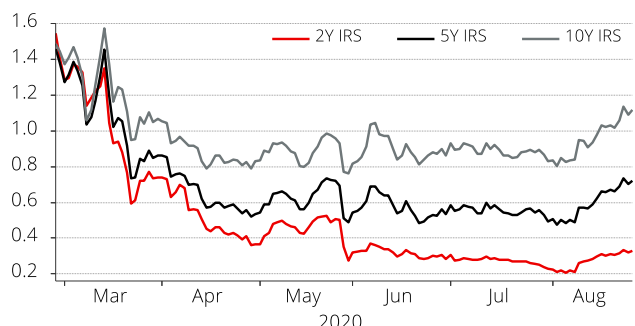
Source: Refinitiv Datastream, Santander Bank Polska

### 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		LAST VALUE
				MARKET	SANTANDER	
<b>MONDAY (7 September)</b>						
08:00	DE	Industrial Production SA	Jul	% m/m	4.25	8.9
09:00	CZ	Industrial Production	Jul	% y/y	-6.7	-7.0
<b>TUESDAY (8 September)</b>						
08:00	DE	Exports SA	Jul	% m/m	0.0	14.9
11:00	EZ	GDP SA	2Q	% y/y	-15.0	-15.0
<b>WEDNESDAY (9 September)</b>						
09:00	HU	CPI	Aug	% y/y	3.9	3.8
<b>THURSDAY (10 September)</b>						
09:00	CZ	CPI	Aug	% y/y	3.3	3.4
13:45	EZ	ECB Main Refinancing Rate	Sep.20	%	0.0	0.0
14:30	US	Initial Jobless Claims	Sep.20	k	950.0	881.0
	<b>PL</b>	<b>Moody's rating review</b>			<b>A2, stable</b>	<b>A2, stable</b>
<b>FRIDAY (11 September)</b>						
08:00	DE	HICP	Aug	% m/m	-0.2	-0.2
14:30	US	CPI	Aug	% m/m	0.3	0.6

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg

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