18 September 2020

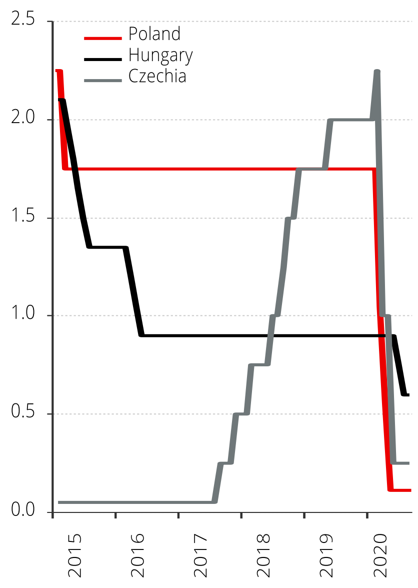
Weekly Economic Update

Plenty of data and politics

What's hot next week

- It's the politics, stupid! – this could be the theme of the next week in Poland. We were supposed to enjoy three years without election campaign, but those plans may be potentially outdated due to sudden conflict in the ruling coalition. PiS leaders suggested recently that among possible options is the breakdown of the coalition or even early elections. At this junction, we find it difficult to judge to what extent it is just a political game, and to what extent the risk of snap elections has increased indeed. We do not think the latter is a base-case scenario for now, but the next few days should reveal more clarity on this front (on Monday the PiS leadership will decide about further steps). If the risk of coalition breakdown increases, it could potentially push the economic data releases to the background, at least at the start of the week.
- There will be plenty of local publications: retail sales and construction output on Monday, money supply on Tuesday, Statistical Bulletin on Wednesday, including unemployment, business and consumer sentiment and more of detailed information about the economy. After the negative surprise from August industrial output, next indicators may also come below expectations in our view, confirming the moderation of the pace of recovery from the trough (which is what we had highlighted in our last MACROscope).
- Abroad, it is worth to mention flash PMIs and German Ifo index that will be the first to signal level of an economic activity in September. Euro zone's PMI has lost some momentum already in August, particularly in services and now, amid higher number of COVID-19 cases it is hard to expect further significant improvement. Czech and Hungarian central banks rate decision should not bring any changes.
- Friday is the Fitch rating review day for Poland. Last week, Fitch analyst said that the agency is monitoring very closely Poland public finance, mainly the debt path and noted much smaller deficit reduction planned for 2021 than the other countries. However, we do not expect any rating decision at this stage already. So far, Fitch has not been the frontrunner of such changes..

CEE central banks' interest rates (%)



Source: Refinitiv Datastream, Santander Bank Polska

Market implications

- Since the beginning of September we observe some correction of the zloty appreciation and it seems that the recent events (higher political uncertainty, next data showing moderation of an economic revival, rising COVID-19 cases in the region) support continuation of this trend. We do not exclude EURPLN could test 4.48 in the nearest future.
- We see potential for the bond curve flattening and lower yields on the long end, especially if poor PMI readings boost German bonds.

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Last week in economy

The set of recent data showed that the pace of industrial recovery moderated, stronger imports reduced the trade surplus, core inflation has likely switched to a downtrend. Nothing new from the MPC.

Industrial output grew by 1.5% y/y in August, less than we (2.9%) and the market (3.4%) had expected. The rebound of industrial activity is still led by durable consumer goods albeit with some moderation of the pace of the recovery. We expect the industrial recovery to proceed at a reduced pace now. More in Economic comment.

In August the average **employment** in the corporate sector improved to -1.5% y/y from -2.3% in July. Large part of the improvement came from the restoration of full-time employment where working time had been shortened after the outbreak of the pandemic – this would limit room for further recovery. **Wage** growth did not surprise, rising to 4.1% y/y from 3.8%. Read more in Economic comment.

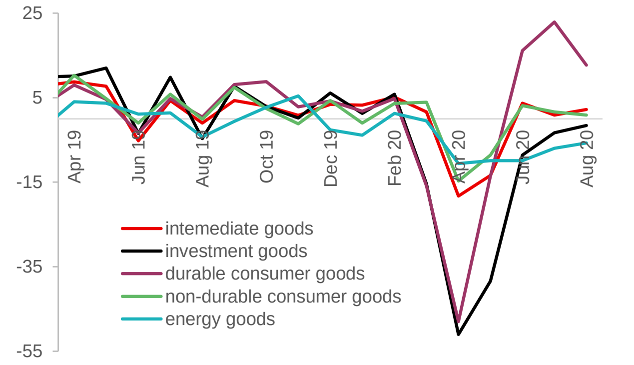
July **current account balance** reached EUR1.6bn, in line with our forecast (EUR1.6bn) and below market consensus (EUR2.8bn). Trade balance was lower than expected, with import surprising to the upside with a decline by only 3.9% y/y (from -10.7% y/y in June). Exports rose 2.7% y/y, similar to June (3.0% y/y). Trade in services also recorded a major revival in July with exports falling by 7.3% y/y and imports by 9.4% y/y versus about -30% to -40% in the preceding months. Apparently, this rebound was driven mostly by improving situation in travels abroad and transport. 12m current account balance improved to 2.7% of GDP from 2.3% in June, but we are expecting the pace of improvement to slow in the months to come amid recovering imports.

Final reading of Polish **CPI** inflation confirmed a decline in August to 2.9% y/y from 3.0%. Services price growth eased to 6.6% y/y from 7.3%. Core inflation dropped to 4.0% y/y from 4.3%, most likely marking a turning point in an upward trend that lasted since late 2018. We expect core inflation to keep falling now, below 3% still this year and possibly even below 1% around mid-2021 due to post-pandemic weakness of domestic demand. More in Economic comment.

Producer prices fell by 1.2% y/y, in manufacturing by 2.1% y/y (the second lowest reading in almost five years), amid quite broad-based reductions across branches. It confirms earlier signals from business surveys that firms are competing by cutting prices amid subdued demand.

The **Monetary Policy Council** kept interest rates unchanged, as expected. The post-meeting statement has barely changed versus its previous July edition. The MPC noticed the improvement in recent economic data but it seems that it has not changed its general assessment of economic outlook. NBP governor Adam Glapiński wrote in an article for Dziennik Gazeta Prawna daily that in 2021 inflation will likely keep falling and in the coming months the pace of economic recovery will be lower. In his view although "the worst is already behind us", the monetary policy must remain accomodative as economic activity is still below potential and as the government anti-crisis programs will be gradually phased out. We still expect the monetary policy parameters to remain on hold at least until the end of 2021.

Output in main industrial groups, %y/y

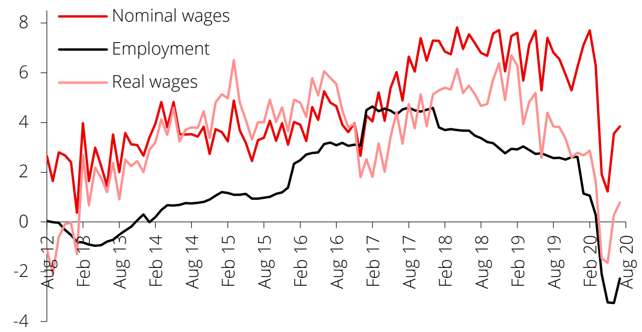


Source: GUS, Santander

International trade, in EUR, %y/y

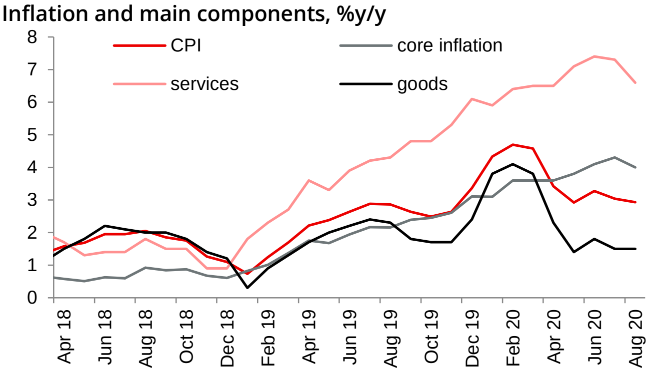
Source: NBP, Santander

Corporate sector data, %y/y



Source: GUS, Santander

Inflation and main components, %y/y



Source: GUS, NBP, Santander

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FX and FI market

Last week on the market

FX The passing weeks has been very calm on the FX market. EURPLN remained within the 4,425-4.47 range observed since first Friday of the month and the weekly high-low spread has been the narrowest since mid-August. USDPLN was trading around 3.76 and CHFPLN near 4.13. Only GBPPLN witnessed some directional move after it rose to 4.90 from 4.80 owing to the pound strengthening.

Elsewhere in the CEE region, the ruble proved the most stable with USDRUB trading around 75,0 despite c10% rebound of the oil price. EURHUF and EURCZK were on the rise and reached above 360 (close to the September peak) and 26,8 (its highest since late June). The koruna could have been pressured by information about a record high daily new COVID-19 detections (3123 cases on September 17).

FI Polish bond yields and IRS continued the down trend amid shaky sentiment on the equity market, below-consensus US data and dovish FOMC rhetoric. As a result, the 5Y bond yield fell below the August low and the 10Y neutralized more than half of August loses. The bond curve remained steep with the 2-10 spread at above 130bp, its highest since may-2019. The respective IRS spread narrowed by 4bp to 77bp. The 10Y asset swap spread rose slightly to 35pb from 30bp but remains near its pre-crisis low levels. The Ministry of Finance organized a bond switch auction after which it informed that this year's gross borrowing needs are covered in 98%.

Key event in the next week's calendar could be the release of the flash September services and manufacturing PMIs. August releases showed some moderation, especially in services, after a sharp rebound observed in the post-lockdown period.

In the CEE region, Hungarian and Czech central banks will announce their decisions about the interest rates. No changes are expected.

In Poland, retail sales data are to be published that we expect would confirm moderation of a pace of revival. Also, the internal conflict in the ruling coalition could attract some media attention.

Market implications

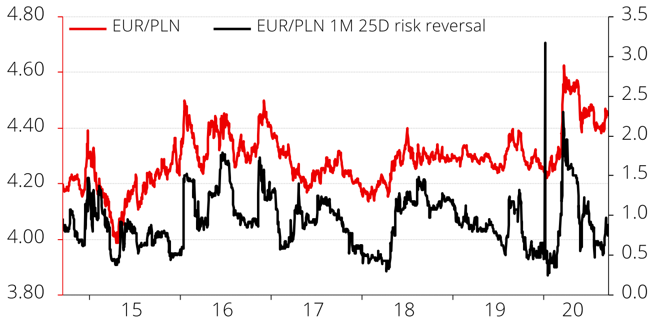
FX Volatility implied from EURPLN 1-month 25-delta risk reversal rose when the zloty lost vs the euro in September but the past observations suggest there is still room for further rise. Rise of volatility is typically negative for the EM currencies and we think it may take a while before the zloty starts to appreciate again.

The zloty did not benefit much from the dovish signals from the ECB and the Fed as well as from the fact that EURUSD remained above the upper end of its range. We think that a consolidation observed for the last two weeks after an increase seen in early September could be a good base for a one more upside leg and 4.48 could be tested in the nearest future.

Political tensions may not be directly negative for the zloty as long as the risk of a snap elections does not rise noticeably but together with the rise the COVID-19 cases in the region could make the Polish currency underperform its EM peers. So far this month, the zloty is the fifth weakest EM currency vs the euro and the dollar with its CEE peers also performing worse than the rest of the EM universe. In Hungary and Czechia we have recently seen spike of the new daily COVID-19 cases while in Poland the number is still holding at a stable high level. At the same time, in LatAm countries the situation has improved with the new coronavirus cases in a down trend.

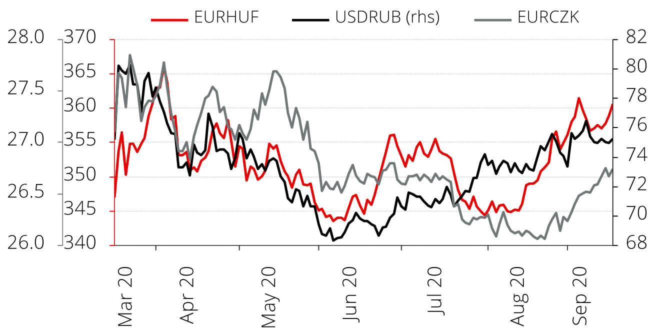
FI Looking through the steepness of the Polish bond curve, it seems there is still room for the long-term yields to fall, especially owing to the recent (and expected) signals of an economic growth moderation. If the flash euro zone PMIs also show slower revival the Bund could test the -0.50% support helping Polish yields to drop further, particularly on the long end of the curve.

EURPLN and risk reversal implied volatility



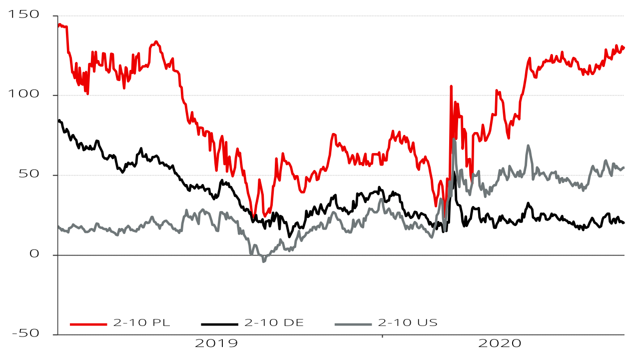
Source: Refinitiv Datastream, Santander Bank Polska

EURHUF, EURCZK and USDRUB



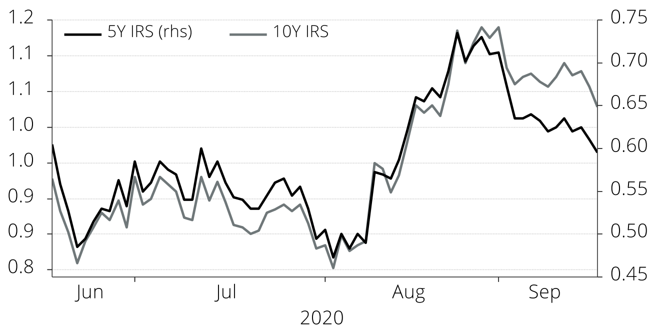
Source: Refinitiv Datastream, Santander Bank Polska

Slope of the bond curves



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	OSTATNIA WARTOŚĆ
		MONDAY (21 September)					
10:00	**PL**	**Real retail sales**	**Aug**	**% y/y**	**2.3**	**2.7**	**3.0**
10:00	**PL**	**Construction and assembly output**	**Aug**	**% y/y**	**-7.9**	**-11.7**	**-10.9**
		TUESDAY (22 September)					
14:00	**PL**	**Money supply M3**	**Aug**	**% y/y**	**16.4**	**15.9**	**16.8**
14:00	HU	Central bank decision		%	0.60	-	0.60
16:00	US	Home sales	Aug	% m/m	2.4	-	24.7
		WEDNESDAY (23 September)					
9:30	GE	Flash PMI – manufacturing	Sep	pts	52.1	-	52.2
9:30	GE	Flash PMI – services	Sep	pts	52.9	-	52.5
10:00	EZ	Flash PMI – manufacturing	Sep	pts	51.5	-	51.7
10:00	EZ	Flash PMI – services	Sep	pts	50.6	-	50.5
10:00	**PL**	**Unemployment rate**	**Aug**	**%**	**6.1**	**6.1**	**6.1**
14:30	CZ	Central bank decision		%	0.25	-	0.25
		THURSDAY (24 September)					
10:00	GE	Ifo index	Sep	pts	93.8	-	92.6
14:30	US	Initial jobless claims	week	k	880	-	901
16:00	US	New home sales	Aug	% m/m	-2.3	-	13.9
		FRIDAY (25 September)					
	PL	**Rating review by Fitch**					
	HU	Rating review by Moody's					
14:30	US	Durable goods orders	Aug	% m/m	1.0	-	11.4

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg