14 February 2020

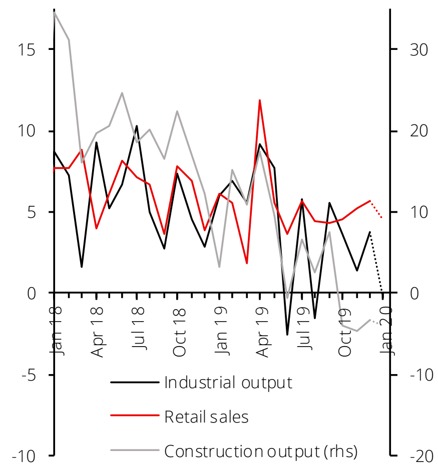
Weekly Economic Update

First data from the first quarter

What's hot next week

- In the coming week we will get flash PMIs for European economies, with further declines being widely expected due to coronavirus, among other factors. The data on German 4Q19 GDP showed stagnation and it seems we will need to wait a bit more to see a clearer rebound in Western Europe. Apart from this, we will see US real estate data and minutes from the January FOMC meeting.
- In Poland, there a broad set of economic data will be published, including industrial output, construction output and retail sales. In all cases the median market forecasts are relatively low, probably due to the negative surprises in December data. Our forecasts are a bit more positive than the market ones when it comes to industrial output and retail sales, but they still point to a continuation of the economic slowdown in 1Q. For all the other releases we are below consensus. Labour market data will also be out, but the employment data will be affected by the annual change of the enterprise sample, so will not be useful for assessing the current trends. Wage growth, in turn, will be affected by the large minimum wage hike - we estimate its effect at 1 percentage point to the y/y growth, so only a reading of c7%+ would mean an acceleration of the underlying wage growth, while a lower one would be a sign of a slowdown.
- Last week the Polish government sent its reply to the European Court of Justice regarding the changes in the Supreme Court. The decision to temporarily suspend the Disciplinary Chamber may be taken now by the ECJ deputy governor Rosario Silva de Lapuerta or she can pass it to the Grand Chamber of the Court for a hearing. However, there are no dates fixed yet for this case.

Monthly economic activity data, %y/y



Source: GUS, Santander

Market implications

- The coronavirus story remains a key factor for the zloty. The spread of the disease is hard to predict, but the recent change of diagnostic method and the sudden jump in the registered cases suggest in our view that the problem may stay for longer than it is currently priced by the market. Also the worsening domestic economic data should negatively impact the Polish currency, sending it towards 4.30 vs the euro. Weaker economic activity will lead to worse fiscal budget performance, which can cause a relative weakening of Polish bonds vs the German ones.

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Last week in economy

Inflation rate climbed to 4.4% in January from 3.4%, higher than we had expected. The jump was partly explained by prices of food and energy, but not entirely, as according to our estimate core CPI ex food and fuel rose to 3.3-3.5% y/y (the highest level since 2002) from 3.1%. We expect CPI to remain above 4% throughout 1Q20 and then to decline gradually towards 3% at the year-end. The upward risks for this scenario stem from the possible introduction of retail tax, potential second round of energy tariff hikes, and further disruptions in food supply.

Flash GDP data confirmed that the economic growth slowed substantially to 3.1% y/y in 4Q19. The data confirmed that a significant economic slowdown took place at the end of 2019, but on the other hand they did not add much more to what we had already known after the preliminary annual GDP estimate. We think that the data will not change the Polish central bank's rhetoric – the MPC will keep arguing that the slowing economy makes the inflation's rise unlikely to be persistent. More on January CPI and 4Q GDP in our Economic Comment.

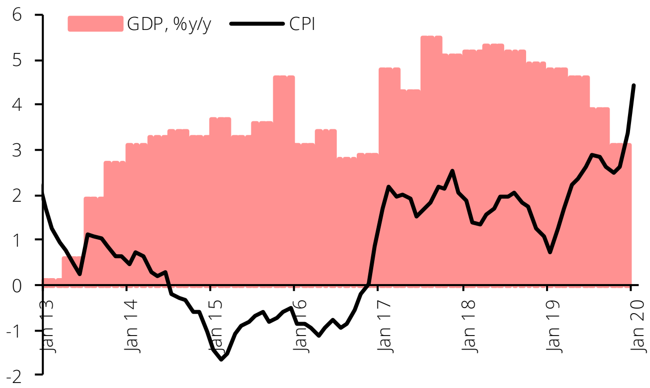
In December, Poland's **current account balance** showed a surplus of €990mn while the market expected c€500mn deficit. The main source of a surprise was solid trade balance: +€224mn vs -€1295mn in December 2018. Exports rose 10.6% y/y and imports by a mere 0.8% y/y and so the spread between these two growth rates was the biggest since December 2013. The remaining three components of the current account also improved. The annual current account showed a surplus of 1.1% GDP (the best result since the comparable data became available – that is from 2004) versus the deficit of 1.0% GDP in 2018. We think that in 2020 the current account will remain significantly positive because slowing internal demand will negatively contribute to imports growth. The surprisingly high surplus in trade of goods and services implies that the domestic demand in 4Q19 contributed less to economic growth than the preliminary annual GDP data had suggested.

Wages in the national economy rose by 6.9% y/y in 4Q19 as compared to 7.7% in 3Q19. This was the lowest reading since 1Q18, but on the other hand its deceleration was a bit smaller than in the enterprise sector (to 5.8% from 6.8% y/y). In real terms, wages rose by 3.9% y/y in 4Q19. In our view, 2020 wage growth will slow down to c.6% y/y (with minimum wage hike being responsible for c.1pp of this growth). Given the elevated inflation, the purchasing power of labour income will be slowing and this does not herald any acceleration in private consumption growth, which has been slowing for a couple of quarters already. Still, the consumer demand will remain the main driver of GDP growth this year.

In its winter forecasting round, the **European Commission** kept the GDP forecast for Poland at 3.3% in 2020 and 2021, while forecasts for Hungary and Romania went up (to 3.2% and 3.8%, respectively) and for the Czech Republic went down (to 2.1%). Such a result would place Poland fourth in 2020 (after Malta, Ireland and Romania) and third in 2021. The forecast of Poland's inflation went up to 2.7% in 2020 and was maintained at 2.5% in 2021 (in both years it is the third highest result in the EU, following Romania and Hungary).

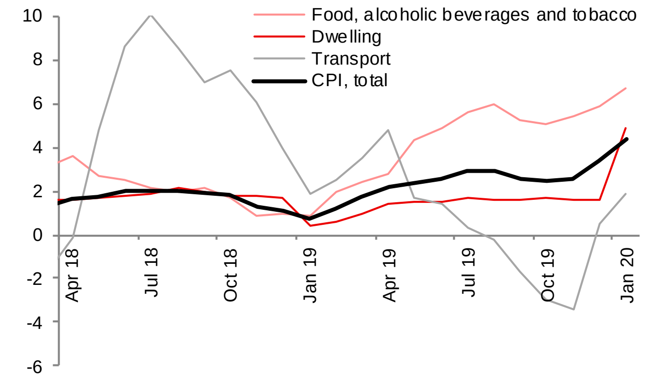
We estimated direct effects of disruption in Poland-China trade relations due to the spread of **coronavirus**. Assuming that trade would go down by 50% for one month (assuming no substation with other imports and lack of sufficient inventories), we estimate the impact on GDP growth at less than 0.1% (and at about 0.2-0.3% for 1Q20 growth). Disruptions lasting for 3 months would deduct 0.2 pp from the annual GDP growth. Full effects for the economy would also include indirect effects, stemming from possible slowdown in other European countries, and we do not account for these in this report. More on the impact of coronavirus in our Economic Comment.

Economic growth and inflation, %y/y



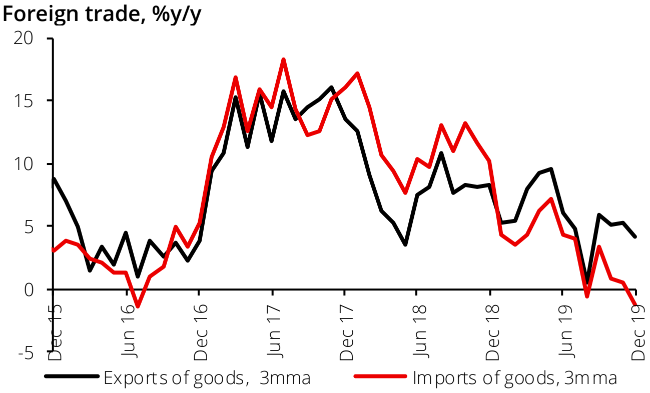
Source: GUS, Santander

CPI inflation and selected components, %y/y



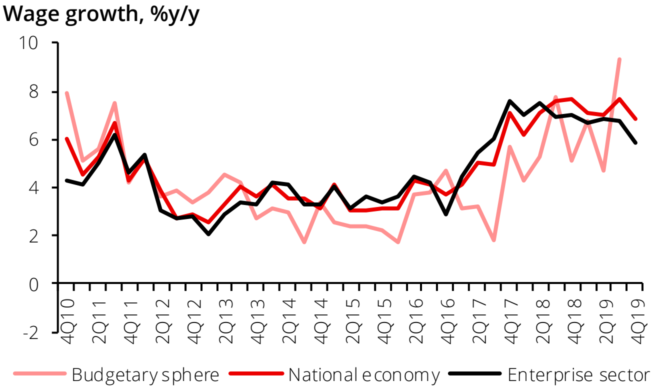
Source: GUS, Santander

Foreign trade, %y/y



Source: NBP, Santander

Wage growth, %y/y



Source: GUS, Santander

FX and FI market

Last week on the market

FX The coronavirus-related uncertainty and risk-aversion manifests itself in the global FX markets via stronger Swiss franc, yen and dollar (dollar index up 1.8% MTD, and 0.7% WTD). Zloty, however, as well as other regional currencies, have been consistently gaining vs euro in the past week, partly as a result of increasing expectations of improving prints of the important macroeconomic data. EURPLN decreased 0.8% to 4.240 by Friday morning. The Q4 GDP at 3.1% y/y (vs 3.0 expected) and January CPI (4.4% y/y vs 4.2 expected) have not managed to move the currency pair away from the level despite positive surprises. This suggests that most of the good news was priced in by the market in the previous days. Due to larger moves in the G10 FX, the PLN crosses have not moved lower: USDPLN and USDCHF remained unchanged w/w at 3.91 and 3.99 respectively, whereas GBPPLN actually increased 1.2% to 5.094.

FI Polish bond yields and IRS rates have been consistently increasing in the past week in the expectations of hawkish surprises on Friday. On Monday 10Y POLGB printed a yearly low of 2.07%, matching a 3 January one (a possible double yields dip) only to trade at 2.22% just ahead of the GDP and CPI publications of Friday after which, in a very "buy the rumor sell the fact" reaction the yields fell back to 2.18%. The positive expectations toward the data have also been seen in the FRAs market where both 9x12 and less liquid 21x24 ones have risen back to 3mth WIBORs (at 1.71%). Given surprisingly stable German Bund yields (and core yields in general) close to -0.39% throughout the week, the 10Y PL-DE spread widened back to the recent wides of 260bp. Ministry of Finance said that in January it sold PLN 2.49bn worth of retail government bonds.

Key events

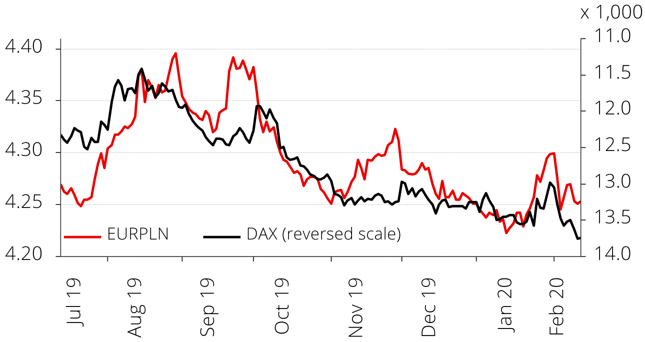
Next week, there are EZ and German ZEW indices on Tuesday, preliminary PMIs in EZ, Germany and France on Friday. In the US, another round of local FEDs manufacturing indices starts on Tuesday (Empire), there are PPI and FOMC minutes on Wednesday, Philly Fed on Thursday and existing home sales on Friday. China decides on rates on Thursday (10bp cut in 1yr Loan Prime Rate expected so far). In Poland there are numerous data releases next week (see calendar for details), on most of the data we are below market consensus as the economy remains in the slowdown.

Market implications

FX Making a call on the Polish assets in the nearest future necessarily requires an implicit bet on the evolution of the coronavirus story globally. The task is challenging in general but we assume that duration of it will be longer and an impact leading to slower economic growth stronger than currently priced by the market. With Jan CPI at 4,4%y/y and NBP rate at 1,5% the almost 3% negative real rate among slowing growth makes us expect EURPLN to rise to 4.30 in the nearest future.

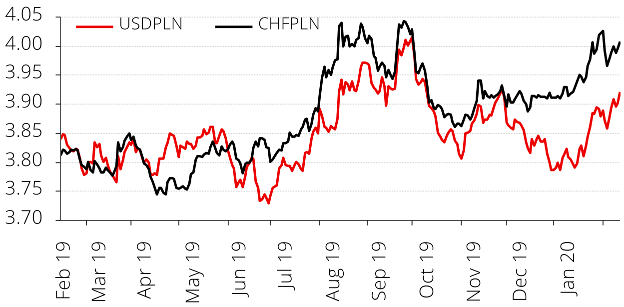
FI Decent (~70%) pre-financing of the 2020 gross borrowing needs, low 23.4% share of foreign investors in the POLGB market and decent numbers of retail bonds sale would normally suggest at least stable rates going forward. Especially assuming that the CPI at 4.4% y/y (above the NBP target) probably established a peak and should not change MPC view. Notwithstanding the above, with significant risks to global growth we think that the market will start to pay more attention to fiscal situation in Poland. The interview with esteemed ex-MinFin Sławomir Dudek sheds some light on the issue. Rising awareness of fiscal risks in the possibly lower growth environment makes us assume the 10Y PL-DE spread should widen going forward.

EURPLN and DAX index



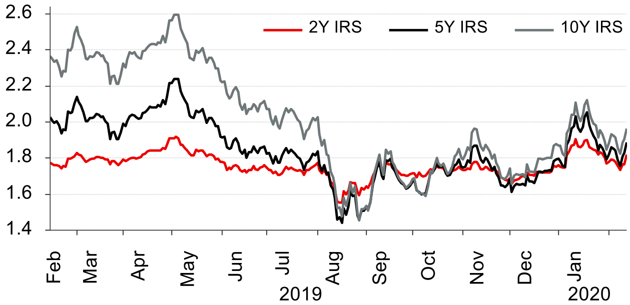
Source: Refinitiv Datastream, Santander Bank Polska

USDPLN and CHFPLN



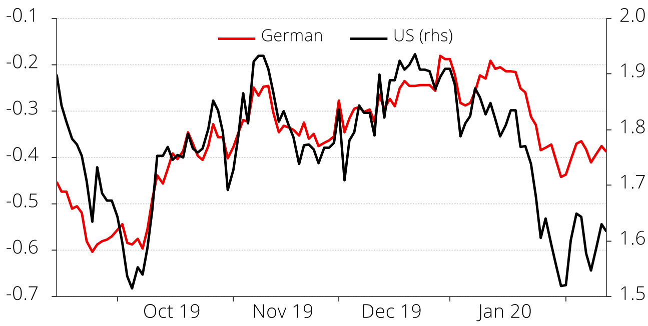
Source: Refinitiv Datastream, Santander Bank Polska

Poland IRS



Source: Refinitiv Datastream, Santander Bank Polska

10Y Bund and UST yields



Source: Refinitiv Datastream, Santander Bank Polska

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Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST SANTANDER	LAST VALUE
		TUESDAY (18 February)					
11:00	DE	ZEW Survey Current Situation	Feb	pts	-8.0		-9.5
		WEDNESDAY (19 February)					
10:00	**PL**	**Employment in corporate sector**	**Jan**	**% y/y**	**2.1**	**1.6**	**2.6**
10:00	**PL**	**Average Gross Wages**	**Jan**	**% y/y**	**7.0**	**6.1**	**6.2**
14:30	US	Housing Starts	Jan	% m/m	-12.94		16.9
20:00	US	FOMC Meeting Minutes	Jan.20		-		0.0
		THURSDAY (20 February)					
10:00	**PL**	**Sold Industrial Output**	**Jan**	**% y/y**	**-0.6**	**-0.1**	**3.8**
10:00	**PL**	**PPI**	**Jan**	**% y/y**	**1.0**	**0.5**	**1.0**
14:30	US	Initial Jobless Claims	Feb.20	k	210		205
14:30	US	Index Philly Fed	Feb		10.0		17.0
		FRIDAY (21 February)					
09:30	DE	Germany Manufacturing PMI	Feb	pts	44.8		45.3
09:30	DE	Markit Germany Services PMI	Feb	pts	53.6		54.2
10:00	EZ	Eurozone Manufacturing PMI	Feb	pts	47.5		47.9
10:00	EZ	Eurozone Services PMI	Feb	pts	52.2		52.5
10:00	**PL**	**Construction Output**	**Jan**	**% y/y**	**-3.2**	**-4.0**	**-3.3**
10:00	**PL**	**Retail Sales Real**	**Jan**	**% y/y**	**4.0**	**4.5**	**5.7**
11:00	EZ	HICP	Jan	% y/y	1.4		1.4
16:00	US	Existing Home Sales	Jan	% m/m	-1.17		3.55

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.