06 March 2020

Weekly Economic Update

CPI overshadowed by the virus

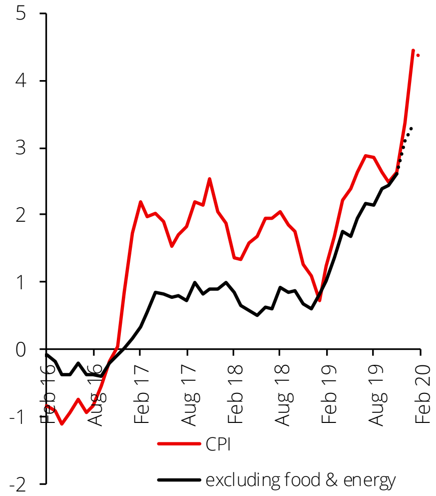
What's hot next week

- The pace of the coronavirus spreading among the developed countries would be the most watched figure in the coming days, in our view. Any improvement of the global market mood could take place when we will see the slowing pace of new infections, as it is already the case in China and South Korea. The epidemic will be also the main topic of the German ruling coalition meeting on Sunday – the new week may then start with the market assessing whether the planned action would be enough to avoid significant economic slowdown in this country. Recall that in the passing week we have already seen some actions aimed at reviving the economic growth – central banks of the US and Canada cut rates by 50bp, some action was taken also outside the G7 group (Malaysia, Australia). The Italian government decided to provide €7.5bn for the companies suffering from the coronavirus case to support families. The European Commission told the EU countries that spending aimed at limiting the negative impact of the coronavirus will be outside the fiscal rules. The US Congress approved USD8.3bn to fight the coronavirus. This still has to be signed by Donald Trump who initially proposed 6-7 times smaller amount and was broadly criticized for downplaying the risk related to the virus. We will know his current opinion on Monday when he will speak at the global heath conference.
- The market is waiting how the ECB will respond to the current situation – the decision will be announced on Thursday. Perhaps the central bank will try to turn the attention toward the states action adding that the monetary policy is still highly accommodative. We think that the ECB rate cut is rather unlikely. In the euro zone, this instrument has already done its job and the bank could actually take some action aimed at preventing companies from losing liquidity.
- In Poland, February CPI is the key macroeconomic release. We will also get to see reweighed January reading (we are expecting no major impact from new basket). We estimate February CPI at 4.4% y/y, unchanged versus January. In the following months inflation is likely to go down, inter alia thanks to declining oil prices (Brent below 50$ as compared to 65-70$ in the first weeks of the year). On Monday the new Inflation Report is due for release, and it is to show detailed forecasts of CPI and GDP prepared by the NBP staff. The MPC statement has already revealed that CPI path went up for 2020, but will be back at target in 2021 and even below that mark in 2022. GDP forecasts were revised down. Moreover, GUS data on foreign trade in January and on labour demand in 4Q19 are due for release. On 9 March the ECJ is conducting a hearing on the Disciplinary Chamber of the Supreme Court (Polish government can be punished financially).
- Other important factors for the zloty include comments from the Hungarian authorities (PM, central bank head, finance minister). Recently the Hungarian central bank was quite hawkish given rising inflation, but now it could ease its stance given the epidemic risk.

Market implications

- EURPLN is holding in the up-trend since mid-January and recently the rise has lost the momentum somewhat. However, we do not think that the zloty could gain much the short term since the risk aversion is rather unlikely to disappear for good anytime soon. Also, the rise of EURUSD looks a bit overdone to us and shall the dollar regain ground, this could pressure the zloty.
- The global market mood is likely to remain unstable in the coming weeks or even months, helping yields to stay at current or lower levels. However, we think that in the very short term some upside correction of yields could take place this week as we think the ECB may disappoint.

Manufacturing PMIs



Source: Bloomberg, Santander

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Last week in economy

The last week was not really rich in important macroeconomic releases. MPC meeting with new economic projections was the most important event of the week, as investors started to price-in rate cuts in Poland given more dovish stance of global central banks.

PMI for Polish manufacturing rose in Feb to 48.2 pts from 47.4, mainly due to longer delivery times – not really a sign of improvement. Output and new orders improved a bit m/m, but are still below 50 mark. The expected level of activity was corrected downwards and employment index declined. There is clear evidence the SARS-CoV-2 virus has started to affect business conditions.

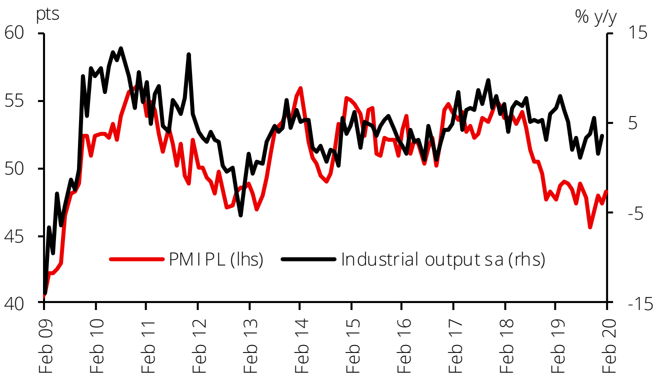
Poland central state budget recorded PLN3.4bn surplus after January. Revenues rose by 4.0% y/y with VAT collections rising by 6% y/y while PIT and CIT shrank by 3.6% y/y and 1.6% y/y, respectively. Expenditures rose 14.6% y/y. As long as January's data do not give much ground to conclude about the whole year's budget performance, we think the government's assumptions of tax collections (VAT: +8%, CIT +3,8%, PIT: +1,1%) look overly optimistic given the slowing economic growth.

The Labour Ministry informed that **the registered unemployment rate** remained unchanged at 5.5% in February. The jobless count fell by 1.2k m/m, i.e. considerably less than in the same month of 2017-2019. We are expecting the unemployment rate to slide slightly below 5% in the summer. January **LFS unemployment rate** remained unchanged at all-time 2.9% for the third month in a row.

Detailed breakdown of investment growth in 4Q19 showed that the acceleration versus 3Q19 was driven by outlays on non-transport machinery, equipment and weapons (8.0% y/y vs 5.6% y/y in 3Q19), while other categories showed a deceleration of stabilisation. This is in line with suggestions that 4Q19 investment growth was dragged higher by military outlays. We stick to our view that 2020 investment prospects are rather negative.

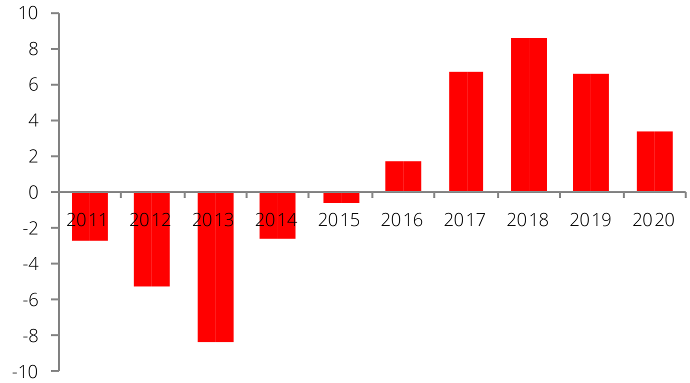
The Monetary Policy Council kept interest rates unchanged, with the main reference rate at 1.5%. The official statement did not show much signs of coronavirus-related worries. As expected, the new NBP projection shows inflation higher (mid-point +0.8pp in 2020) and GDP growth lower (-0.35pp in 2020) than previously predicted. However, the Council still believes the economic outlook is favourable (although GDP will slow slightly), and inflation will converge to the official target in the medium term, after the factors remaining beyond the monetary policy's influence dissipate. NBP Governor Adam Glapiński confirmed the earlier view that rates' stability until the end of the MPC's term of office is the baseline scenario. Such a view was supported by two MPC members present at the conference (Ancyparowicz, Sura). To sum up, the MPC still sees a big virtue in interest rate stabilization and does not seem to be concerned about the possible virus implications. Any change in the policy bias towards more dovish would require, in our view, a clear evidence that the economic growth is slowing much more than currently anticipated. On the other hand, any considerations about monetary tightening are off the table, even though CPI will remain above the target in 2020-2021.

PMI and industrial output



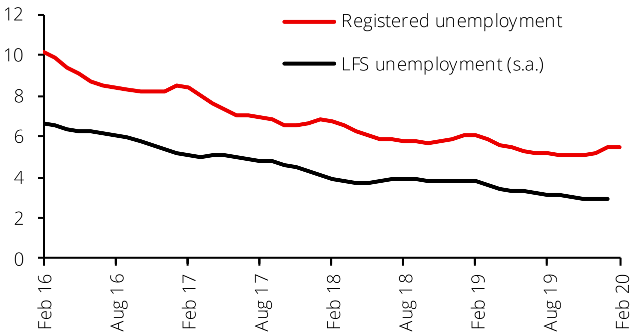
Source: GUS, Markit, Santander

Central budget result after January, PLNbn



Source: MF, Santander

Unemployment rate in Poland



Source: Eurostat, GUS, Santander

Main results of NBP f-casts (mid-points and 50% confidence range)

	GDP growth			
	Mar 19	**Jul 19**	**Nov 19**	**Mar 20**
2020	3.65 (±0.95)	3.9 (±0.9)	3.55 (±0.85)	3.2 (±0.7)
2021	3.35 (±0.95)	3.35 (±0.95)	3.25 (±0.95)	3.0 (±0.9)
2022	-	-	-	2.75 (±0.95)
	CPI inflation			
2020	2.65 (±0.95)	2.8 (±0.9)	2.85 (±0.75)	3.65 (±0.55)
2021	2.4 (±1.1)	2.4 (±1.1)	2.6 (±1.0)	2.65 (±0.95)
2022	-	-	-	2.35 (±1.05)

Source: NBP, Santander

Santander

FX and FI market

Last week on the market

FX In the recent days, the zloty has performed pretty well despite the wave of the risk aversion that spilled in the market amid information that the coronavirus is spreading. On a weekly basis, the zloty has been the 2nd strongest EM currency (only after the forint) of 21 we compared. In YTD terms, nearly all of the main EM currencies have lost vs the euro and the dollar with the zloty recording the 5th smallest loss among them.

Last week, EURPLN started the week at 4.33, dropped to 4.29 and pulled back to 4.32. The emergency 50bp Fed rate cut pushed EURUSD up to its fresh YTD peak at above 1.13. Weaker dollar dragged USDPLN down to c3.81 from 3.92. GBPPLN also recorded a weekly drop (to 4.95 from 5.02) while CHFPLN stayed above 4.0.

FI Polish bonds and IRS have benefited from the shift towards safe assets and now the 2Y, 5Y and 10Y rates/yields are trading at or near their new all-time-lows in yield terms and the FRA market is pricing a full 25bp rate cut as soon as in three months and a total 50bp in nine months. With IRS rates at their lowest levels ever and roughly stable WIBOR, the 5Y IRS-6M WIBOR spread fell below 25bp, its highest since early 2013.

At the bond auction, the Ministry of Finance sold bonds for PLN5bn and an additional PLN773mn at the top-up auction. The Ministry informed after the auction that this year's gross borrowing needs were covered in c77%.

According to the Ministry of Finance, in January nonresidents continued to sell Polish PLN marketable bonds. Foreign investors sold debt for more than PLN2.8bn in nominal terms, mainly "other entities" (-PLN1.8bn) and pension funds (-PLN1.1bn). At the same time, the foreign commercial banks purchased bonds for PLN2bn. Under the geographical criteria, sellers were from Asia excluding Middle East (-PLN1.2bn) and North America (-PLN714mn). Polish banks bought bonds for PLN13bn and individuals for PLN1.4bn. Mutual funds sold bonds for PLN2.8bn.

Key events

Several central banks, including the US, Canada and even Australia responded to the spreading of the coronavirus and cut rates last week. On Thursday, the ECB will announce its decision. We do not expect the 0% rate to be cut but even if, it would rather not boost the market mood as the emergency Fed rate cut failed to prevent equities from falling.

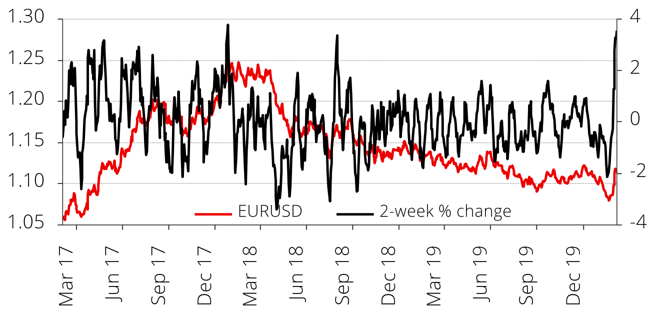
Poland CPI is expected to show stabilization at 4.4% y/y, rather unlikely to affect the market in the current environment.

Market implications

FX EURPLN is holding in the up-trend since mid-January and recently the rise has lost the momentum somewhat. However, we do not think that the zloty could gain much the short term since the risk aversion is rather unlikely to disappear for good anytime soon. Also, the rise of EURUSD looks a bit overdone to us given the high demand for the safe assets. The exchange rate has been climbing rapidly for the second week in a row and the two-week % change indicates it was the quickest upward move since 1Q2016. Back then, the upside move paused and some correction was recorded in the next few weeks. Shall the dollar regain ground, this could pressure the zloty.

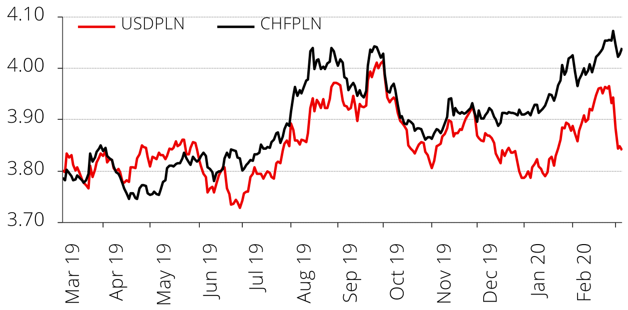
FI The global market mood is likely to remain unstable in the coming weeks or even months, helping yields to stay at current or lower levels. However, we think that in the very short term some upside correction of yields could take place this week as we think the ECB may disappoint. What could make the market revert to higher yields for longer could be a large scale of coordinated fiscal expansion but we are not at this stage yet. The 10Y PL-DE bond yield spread narrowed in February to c230bp from 260bp and we expect this spread could correct higher in the coming weeks.

EURUSD and its 2-week % change



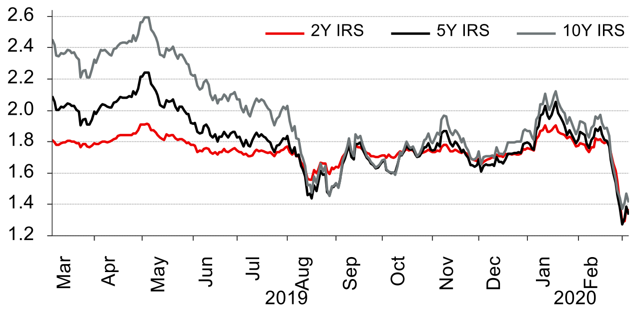
Source: Refinitiv Datastream, Santander Bank Polska

USDPLN and CHFPLN



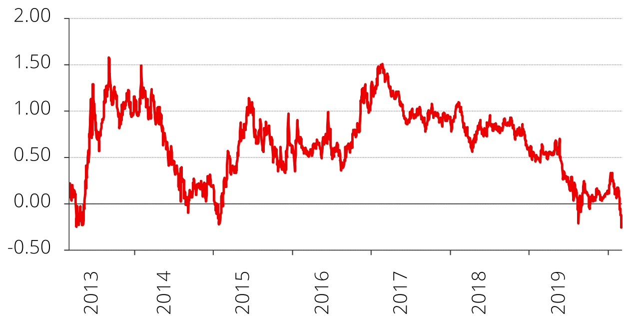
Source: Refinitiv Datastream, Santander Bank Polska

Poland IRS



Source: Refinitiv Datastream, Santander Bank Polska

5Y IRS – 6M WIBOR spread



Source: Refinitiv Datastream, Santander Bank Polska

Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST SANTANDER	LAST VALUE
			MONDAY (9 March)				
08:00	DE	Exports SA	Jan	% m/m	1.0	-	0.2
08:00	DE	Industrial Production SA	Jan	% m/m	1.65	-	-3.5
			TUESDAY (10 March)				
09:00	CZ	CPI	Feb	% y/y	3.6	-	3.6
09:00	HU	CPI	Feb	% y/y	4.3	-	4.7
11:00	EZ	GDP SA	4Q	% y/y	0.9	-	0.9
			WEDNESDAY (11 March)				
13:30	US	CPI	Feb	% m/m	0.0	-	0.1
			THURSDAY (12 March)				
09:00	CZ	Industrial Production	Jan	% y/y	-1.3	-	-0.9
11:00	EZ	Industrial Production SA	Jan	% m/m	1.4	-	-2.1
13:30	US	Initial Jobless Claims	Mar.20	k	215	-	216
13:45	EZ	ECB Main Refinancing Rate	Mar.20	%	0.0	-	0.0
			FRIDAY (13 March)				
08:00	DE	HICP	Feb	% m/m	0.6		0.6
10:00	**PL**	**CPI**	**Feb**	**% y/y**	**4.4**	**4.4**	**4.4**
15:00	US	Michigan index	Mar	pts	96.4		101.0

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.