

Weekly Economic Update

Growth leftovers

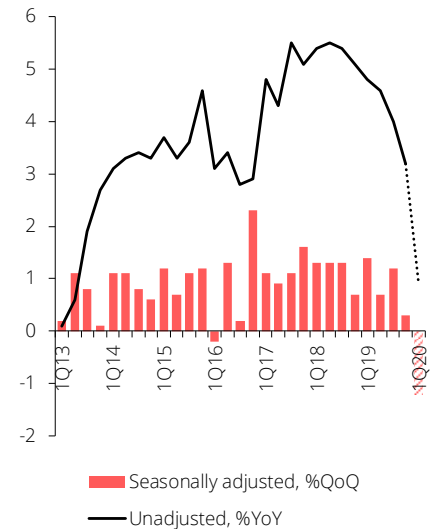
What's hot next week

- In the forthcoming week there will be a handful of inflation data e.g. in the US (Mon), European countries (Mon-Fri), including Poland (Fri). However currently inflation is not the main source of concern for the central banks and governments, which are focusing on how to keep companies and economies alive. Also, measuring inflation in the lockdown creates problems and is less accurate. That is why the economic activity data is of higher importance. Among data releases abroad it is worth mentioning flash GDPs in the European economies (Fri), March trade data in various countries (Mon-Fri) as well as April industrial production and retail sales in the US (Fri). The (very) bad news regarding the H1 2020 seem to be priced in by the markets to a large extent hence only the deterioration of the path of economic recovery after the crisis might bring about worse global market sentiment.
- On the domestic front, there will be three publications: March C/A (Thursday), April CPI and 1Q flash GDP (Friday). **The balance of payments** will show in our view the beginning of a slump in exports and imports, more pronounced in case of the latter, which will translate to a further improvement of trade balance (that said, our C/A balance forecast is below market consensus). **CPI inflation** dropped in April according to a flash release to 3.4% y/y, mostly on lower fuel prices. If there is no revision on Friday, this will imply stabilisation of core inflation at a high 3.6% y/y level, probably partly due to issues with price collection when parts of the economy are shut down (possibly previous year's m/m price changes were applied). We still think inflation should drop significantly later this year, especially after unfrozen trade and services start competing with prices for faltering consumer demand. We estimate **1Q GDP growth** at 0.9% y/y, which would mean a q/q decline by more than 1% in seasonally adjusted terms. The market consensus is higher. The GDP structure will not be shown before 29 May, but we suspect that private consumption and services were the first to suffer from the epidemic. It also seems quite clear that the GDP drop in 2Q will be much deeper.
- The presidential elections were initially scheduled for May 10th. In practice they will not take place on this date. Clarifying this situation will presumably take a few weeks' time and in the meantime the political situation might become (even) less relevant for markets. According to the government, the new presidential elections might be held within 60 days.

Market implications

- Zloty has been underperforming EM peers over the last 2 weeks. We think the pair is more likely to escape from the 4.50-4.60 range to the upside than the other way in the nearest future.
- We think two separate dynamics might shape the Polish bond yield curve in the near future. Front end bond yields are likely to remain low or even decline a bit as the banking sector remains overliquid and PFR starts to distribute even more funds to corporations. On the bond long end we might see a continuation of outflows and offers from foreign investors bringing the yield towards 1.60%. NBP's QE programme should limit the yield rise and we do not expect a major sell-off.

GDP growth in Poland, %y/y



Source: GUS, Santander

Economic Analysis Department:

al. Jana Pawła II 17, 00-854 Warszawa

email: ekonomia@santander.pl

website www: skarb.santander.pl

Piotr Bielski +48 22 534 18 87

Marcin Luziński +48 22 534 18 85

Grzegorz Ogonek +48 22 534 19 23

Wojciech Mazurkiewicz +48 22 534 18 86

Marcin Sulewski, CFA +48 22 534 18 84

Last two weeks in economy

This week European Commission released its Spring forecasts with 2020 marked by the deepest recession in EU history and huge fiscal deficits. Polish Convergence Programme Update drew a slightly more positive picture. Polish PMI collapsed more than expected in April and there was a record m/m rise of unemployment. A couple of MPC members said rate hike motions may appear once the economic situation is under control.

European Commission assumed that the EU economy will get out of hibernation in 2H20, but even in 2021 it will not be possible to return to the pre-Covid starting point for GDP and employment level. Average EU growth is to be -7.4% this year and +6.3% next year, with Poland being the "growth leader" at -4.3%. EC thinks the unemployment rate will rise by 2.3pp to 9.0% on average in the EU, the assumed rise by 4.2pp (to 7.5%) in Poland would be the second highest after Spain. In 2020 a huge rise of fiscal deficits is assumed by EC, with EU average going from 0.6% GDP to 8.3%, and the Polish deficit seen at 9.5% (including the part of the Polish Development Fund loans that are tem likely to be cancelled) is to be the fourth largest in the EU after Italy, Spain and France. The EC forecasts are similar to ours presented in the latest [MACROscope](#) released this week.

The government's **Convergence Program Update** assumes -3.4% GDP growth this year, rise of GG deficit to 8.4% of GDP and public debt at 55.2% of GDP. Private consumption was assumed at -3.0% and total investments at -11.4%. Public investment spending is to stay at 4.3% of GDP, i.e. dropping together with nominal GDP by -0.3%.

In April, Polish **manufacturing PMI** fell from 42.4pts to 31.9pts, the lowest in history of the survey (June 1998) and after the biggest monthly decline ever. All-time lows were also hit by sub-indices for output, new orders, stocks of purchases and suppliers' delivery times. Employment sub-index was very close to a record low. Declines in the index were caused by the Covid-related lockdown so we hope for some relief as the restrictions are gradually being lifted. Still, the coronavirus' economic toll is likely to last for a few quarters at least.

Labour minister Marlena Maląg said that **unemployment** increased in April by 58k, indicating a rise in unemployment rate to 5.7-5.8%, i.e. by 0.3-0.4pp. Usually April sees a drop by 0.3-0.5pp and 70-80k m/m (and c.50k in 2018-2019 as the labour supply was drying up).

According to flash release, **CPI** dropped in April to 3.4% y/y from 4.6%. The move was driven by further rapid decline of fuel prices, by 12.9% m/m. Core inflation most likely was 3.5-3.6% y/y vs 3.6% for March. No response to the hit to domestic demand from the epidemic and the lockdown may be due to methodological reasons – GUS may be filling the missing price data with previous values or applying the usual seasonal pattern (this was a flash release with no detailed breakdown, that could let us verify this, though). The next months are likely to see a rapid inflation decline.

Polish **central budget** finished March at PLN-9.4bn after PLN-3.3bn at the end of February. The deficit rise in March was higher than in 2017-2019 but close to the long-term average (slightly above PLN4.0bn). VAT revenues fell by 7% y/y, PIT by c.10% y/y while CIT by 22% y/y. Expenditures have not differed much from the seasonal pattern, however we reckon this is about to change soon. We expect a further decline in budget revenues in the following months and the general government deficit to increase even above 10% of GDP. However, most of the deficit will be pushed outside of the central budget.

MPC's Jerzy Kropiwnicki said that, in his view, in several months there could be rate hikes to at least the pre-epidemic levels. MPC hawk Kamil Zubelewicz said the MPC should not have cut interest rates and their current level is too low, risking PLN depreciation. In his opinion, the risk of inflation going higher in the long term is increasing and it is important for the MPC to react quickly to prevent this from happening. His attitude was criticised harshly by MPC's Rafał Sura. We think that if the economy will start recovering from the mid of this year, the first motions regarding rate hikes might occur still this year, but in our view are unlikely to be accepted by the majority of MPC.

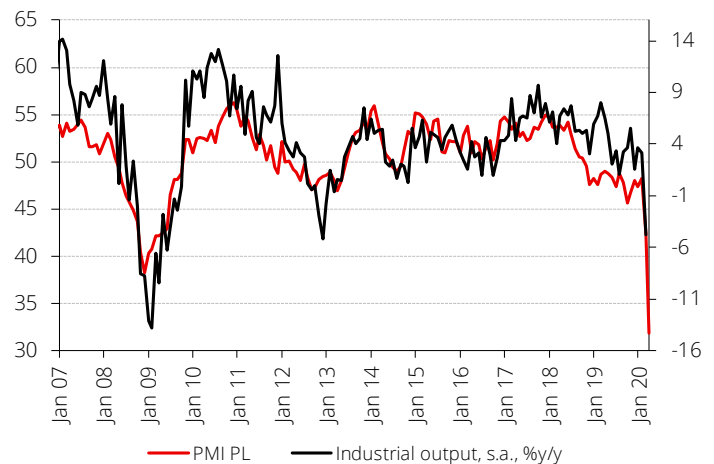
Fiscal forecasts: Poland's Convergence Programme Update and EC Spring Economic Forecasts

GG balance (% GDP)	2020	2021	GG debt (% GDP)	2020	2021
MF	-8.4	-	MF	55.2*	-
EC	-9.5	-3.8	EC	58.5	58.3
Santander	-10.2	-2.7	Santander	59.6	57.7

* MF did not include PFR loans in debt calculations

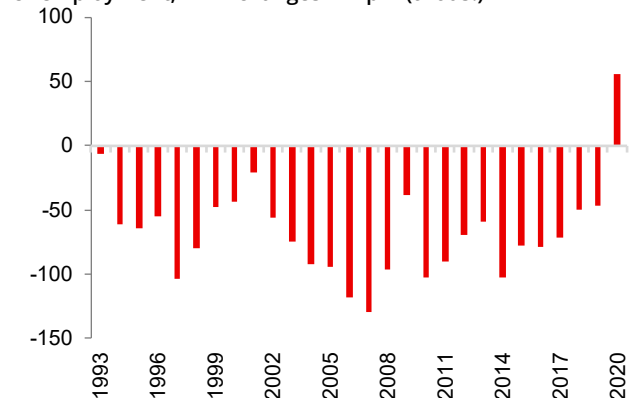
Source: Ministry of Finance, European Commission, Santander

Poland PMI and industrial output



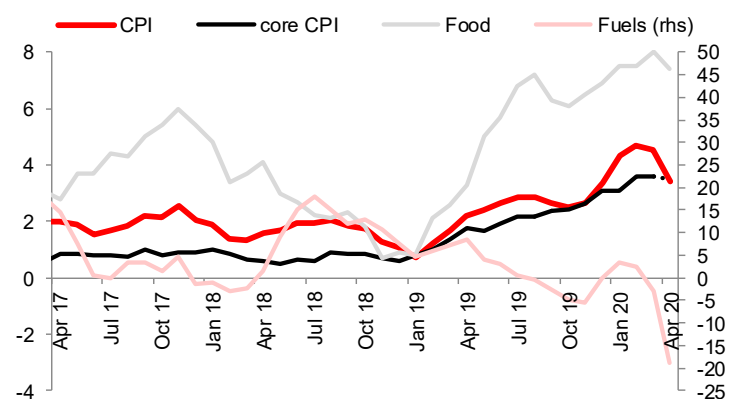
Source: GUS, Markit, Santander

Unemployment, m/m changes in April (thous.)



Source: GUS, Santander

Inflation and selected components, %/y



Source: GUS, NBP, Santander

FX and FI market

Last 2 weeks on the market

FX EURPLN edged higher 0.5% over the last 2 weeks. This move happened despite the continuation of a rebound in risky assets e.g. European stock indices up ~3.0% over the same period, VIX index down 2pp etc. Also, within the EM FX only currencies of countries with poor fundamentals (Turkey, Brazil, Argentine) fared worse. Despite the underperformance the FX options markets remain calm and the volatilities actually sold off (e.g. 1M by 0.9pp to 6.8%). The PLN crosses moved roughly by the same 0.5% as G4 FX spots remained relatively stable. Elsewhere in the CEE region, CNB cut rates by 75bp – more than expected – to 0.25% and EURCZK remained stable. EURHUF and USDRUB declined by 2% and 1%, respectively.

FI Polish IRS and bond yields increased. 10Y bond yields kept increasing consistently almost every day and the rise totalled 16bp to 1.53%. 10Y IRS increased but less so just 9bp to 0.93%. Given Bund yields which declined over the last 2 weeks by 8bp to -0.55%, the 10Y PL-DE spread widened to 208bp. Also the FRA contract increased but only recently (e.g. 9x12 now at 32bp), in the last days of April heavy receiving flows from abroad kept the curve floored at ~20bp. Of the two series of bonds issued at the end of April (BGK 7Y in PLN 13bn and PFR 4Y in PLN 16.3bn) the NBP bought PLN 8.8bn (68%) and PLN 3.7bn (23%) respectively at the 29 April auction and we think this pattern (e.g. PFR issuing bonds to banks and then NBP buying back the surplus in a few days) might hold in the near future.

Key events in the upcoming week there is US April CPI data on Tuesday, US April retail sales, industrial production on Friday as well as May University of Michigan consumer confidence. In the Eurozone there is March industrial production on Wednesday and Q1 GDP on Friday. Other countries publishing Q1 GDP on Friday include Germany Poland, Hungary and Czech Republic. Polish March C/A is published on Wednesday while on Friday final April CPI and said Q1 GDP. Santander forecasts are below market consensus for the C/A and GDP.

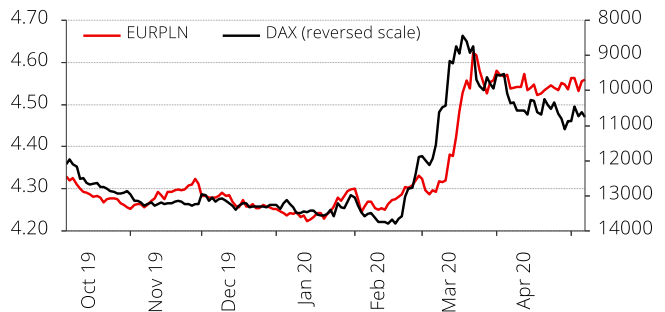
Market implications

After G4 central banks met in the last 2 weeks and promised necessary support for the economies, not surprisingly risky assets rallied with some stock indices (like NASDAQ) turning positive YTD. Going forward however we would be very careful with risky assets because some market behaviours, coronavirus situation notwithstanding, worry us including negative yields implied by Fed fund futures, accelerating Swiss National Bank FX interventions and widening 10Y IT-DE spreads after German constitutional court ruling.

FX Zloty has been underperforming EM peers over the last 2 weeks and this along strong global risk performance. So despite the fact that on the surface EURPLN remains range-bound within 4.50-4.60 level we think the pair might rise toward 4.60 and likely break above it in the nearest future. Cheap FX volatility and skew makes FX options a suitable tool to express bearish views. In CEE, Hungary has now the highest real rate +1.5% while Czechs the lowest -3.1% - this should be reflected in relative performances of FX rates.

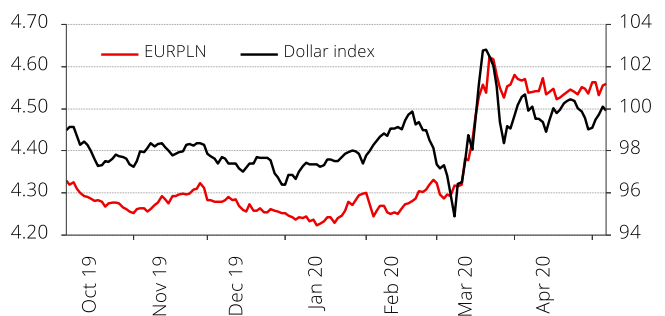
FI We think two separate dynamics might shape the Polish bond yield curve in the near future. Front end bond yields are likely to remain low or even decline a bit from current 0.52% as the banking sector remains over liquid and PFR starts to distribute even more funds to corporations (on 2 auctions it sold a total of PLN 34,8bn already). If market sentiment allows, 2Y IRS might increase further flipping ASW to +ve after 2 months in -ve. On the bond long end we might see a continuation of outflows and offers from foreign investors bringing the yield to 1.55 and then near 1.60%. The level of long term bonds might additionally be influenced by the Friday flash GDP Q1 reading.

EURPLN and German DAX index



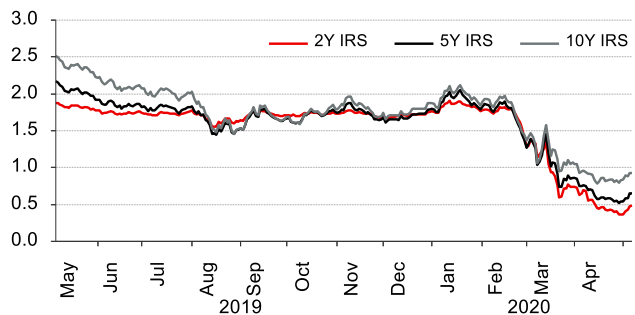
Source: Refinitiv Datastream, Santander Bank Polska

EURPLN and dollar index



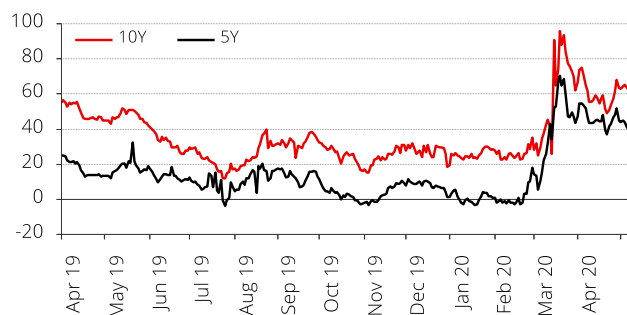
Source: Refinitiv Datastream, Santander Bank Polska

Poland IRS



Source: Refinitiv Datastream, Santander Bank Polska

Poland asset swap spreads



Source: Refinitiv Datastream, Santander Bank Polska

Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE
				MARKET	SANTANDER	
TUESDAY (12 May)						
14:30	US	CPI	Apr	% y/y	0.4	1.5
14:30	US	CPI	Apr	% m/m	-0.7	-0.4
WEDNESDAY (13 May)						
09:00	CZ	CPI	Apr	% y/y	3.1	3.4
11:00	EZ	Industrial Production SA	Mar	% m/m	-12.0	-0.1
	PL	NBP Bond Purchase Auction				
THURSDAY (14 May)						
08:00	DE	HICP	Apr	% y/y	0.8	0.8
08:00	DE	HICP	Apr	% m/m	0.4	0.4
14:00	PL	Current Account Balance	Mar	€mn	580.0	432.3
14:00	PL	Trade Balance	Mar	€mn	642.0	642.0
14:00	PL	Exports	Mar	€mn	18915.0	18915.0
14:00	PL	Imports	Mar	€mn	18470.0	18273.0
14:30	US	Initial Jobless Claims	May.20	k	3000.0	3169.0
FRIDAY (15 May)						
08:00	DE	Flash GDP WDA	1Q	% y/y	-2.0	0.4
09:00	CZ	Flash GDP SA	1Q	% y/y	-2.0	2.0
09:00	HU	Flash GDP	1Q	% y/y	2.2	4.5
10:00	PL	CPI	Apr	% y/y	-	3.4
10:00	PL	Flash GDP	1Q	% y/y	1.7	0.9
11:00	EZ	Flash GDP SA	1Q	% y/y	-3.3	-3.3
14:30	US	Retail Sales Advance	Apr	% m/m	-11.0	-8.4
15:15	US	Industrial Production	Apr	% m/m	-11.4	-5.4
16:00	US	Flash Michigan index	May	pts	67.5	71.8

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg

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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.