03 July 2020

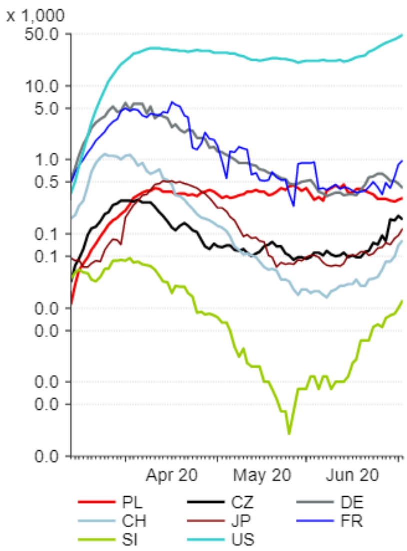
Weekly Economic Update

More optimism, more infections

What's hot next week

- Next week the agenda of events and economic publications is again very thin: in Poland the only data release will be FX reserves at the end of June, abroad only a few indicators including German production and exports, inflation in Czechia, Hungary, Russia, China, Eurozone retail sales, US ISM and PMIs.
- Very few events plus the start of summer holidays is normally a recipe for idle financial market. This time another argument for stabilisation in Poland could be the waiting for the final result of the presidential elections (July 12), as investors may prefer to avoid strong directional bets before they know the final outcome. Chances of both candidates seem to be quite even, although in the last few days of campaign everything can happen.
- The further development of pandemic remains an important issue. Financial markets seem to ignore the fact that new infections started rising in some countries again. But if this trend will continue/strengthen, market sentiment could be affected.

New Covid-19 cases, 7d MA (log scale)



Source: Refinitiv Datastream, Santander

Market implications

- We assume continuation of horizontal trend in EURPLN (4.45-4.50) before the second round of elections. Intraday volatility may remain elevated, as in the past week, which in our view is due to market positioning in FX options.
- In the fixed income space the short end of the curve should keep going down (2Y yields to 0.1%) under pressure of vast excess liquidity in the banking sector. The same factor will be increasingly weighing on the belly of the curve (5Y to 0.6%). We see also possibility of 10Y yields decline, after they failed to breach 1.45%.

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Last week in economy

Last week was not rich in Polish data, but we got to see a few important statistics: flash CPI and PMI for June. Both surprised to the upside

Flash CPI rose to 3.3% y/y in June, well above expectations. The main upward move came from core components of inflation, as food and energy prices were slightly lower than in May (both -0.1% m/m). Our estimate suggests that core inflation could have reached 4.3% y/y – its highest since 2001. The upward effect of epidemic on prices could be stronger and longer-lasting than we expected (partly due to Covid-related fees). The result does not cancel our call for medium-term disinflation trend, as it will be strongly justified by deeply negative output gap and faltering consumer spending in the nearest quarters (plus high base effects in 2021). We still believe CPI inflation is likely to drop below 2% y/y in 2-3 quarters. Still, the short-term CPI dynamics could at least weaken rumours about possibility of introducing negative interest rates in Poland.

In June **Polish manufacturing PMI** rose sharply to 47.2 pts from 40.6 in May, so already to more-or-less the 2H19 average. Output and new orders sub-indexes were also back to pre-pandemic levels, new export orders index increased to the highest level since February. Input purchases and employment remained in contraction, with smaller falls than in April-May. It seems the recovery is going smoothly, but the pandemic-related decline of industrial output was big and we think that production actually requires more time to recover to pre-pandemic levels than the PMI index, which is already at a level we would expect in this period if there was no global disease at all.

LFS unemployment rate for Poland declined in May to 2.8% from 2.9% in April, with the number of the unemployed down by 2k. While we generally treat LFS unemployment as a better measure than registered unemployment, in our view currently it is not drawing the whole picture, and we do not really believe that unemployment in Poland was falling during the epidemic period. We are eager to see full quarterly data for 2Q20, which are based on more refined data sources.

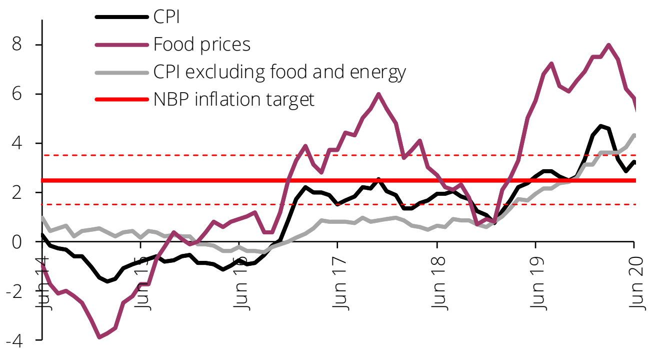
The NBP released revised **balance of payments** data for 1Q20. The central bank corrected the primary income balance down, as the previous estimates of foreign investors' loss were too high. We also got more details about epidemic's impact on the economy: export of transport services slowed down to 2.4% y/y from 10.4% in 4Q19, while export of touristic services slumped by 10.5% y/y after rising by 4.3% in 4Q19. Transfers of foreign workers' wages abroad remained roughly unchanged, but they are likely to fall markedly in 2Q20 as many foreigners left to their home countries.

Poland's gross external debt declined in 1Q20 to 55.9% of GDP from 62.1% in 1Q19. In nominal terms, debt fell to EUR299bn from EUR312bn. The decrease was mostly driven by falling government's external debt (as domestic banks were increasing their exposure to government bonds), but also monetary financial institutions saw falling foreign liabilities (in line with reduction of mortgage FX loans).

Poland's International Investment Position improved in 1Q20 to -43.8% of GDP from -54.8% of GDP in 1Q19 and to –EUR235bn from –EUR275bn in nominal terms. While the IIP was generally improving over the last years, the fast increase in IIP in 1Q20 was mostly due to declining value of foreign investment in Poland, which, in our view, was primarily caused by covid-related sell-off of assets and is likely to be corrected in the quarters to come.

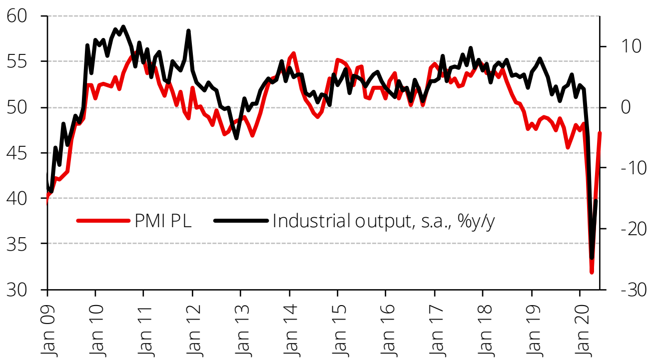
According to the **NBP housing market report**, in 1Q20 the epidemic did affect the market activity, but was not yet visible in hard data, with prices rising at a similar pace as in the previous quarter. In the upcoming quarters we expect the upward tendency in prices to halt or even reverse.

Inflation in Poland, % y/y



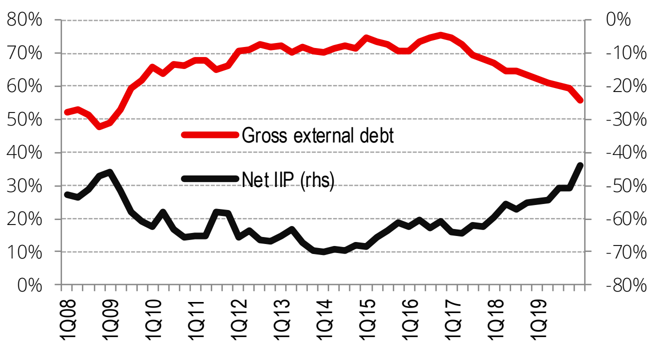
Source: GUS, NBP, Santander

PMI and industrial output



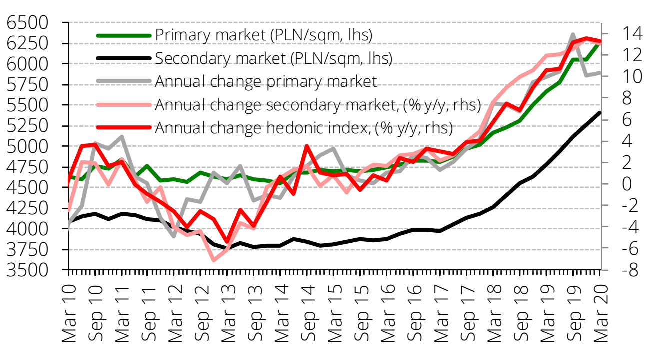
Source: GUS, Santander

Poland's external debt and IIP, % of GDP



Source: GUS, Santander

Housing market prices



Source: NBP, Santander

FX and FI market

Last week on the market

FX The passing week has seen main stock indices gain another 3.5-4.0%, VIX decline by a decent 7pp to 27.7, slightly weaker dollar (dollar index down 0.2% to 97.2) and gains in most (but not all) emerging markets currencies. EURPLN declined just 0.1% w/w but this masks a decent intraday volatility that has been observed – both the weekly minimum 4.4350 and maximum 4.48 were printed on the same day – Wednesday – and this might have to do with positions on FX options market. USDPLN declined even more, to 3.975, due to weaker dollar, CHFPLN barely changed at 4.20 while GBPPLN increased 0.8% to 4.955 due to stronger sterling. In the CEE3 region EURCZK declined 0.6% to 26.6 (majority of the move took place on Tuesday), EURHUF by as much as 1.5% to 351.4 as the currency pair has been correcting after previous week's EURHUF rally. It was only rouble which lost w/w with USDRUB up 1.1% to 70.55 and this despite Brent oil price up 4.2% w/w.

FI Polish bond yields kept declining at the front end where the abundant liquidity is slowly but surely pressing yields lower (2Y currently at 0.12%). The belly and long end also declined by 6bp and 7bp to 0.70% and 1.35% with the majority of the move happening at the end of the week and in line with the reversal in German Bund yields. 2Y IRS also declined – by 3bp to 0.27% however the long end remained unchanged at 0.89%. As a result the ASW narrowed on the long end. The spread vs German Bunds narrowed around 5bp along the curve.

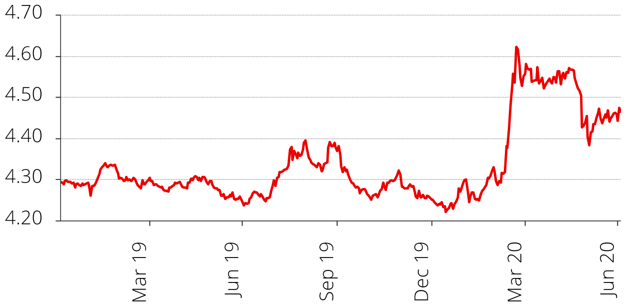
Key events of the upcoming week include US services PMI and ISM non-manufacturing (Monday) and US PPI (Friday). In Eurozone there is only retail sales (Monday). In Germany factory orders (Monday), industrial production (Tuesday) and trade balance (Thursday). France has industrial production at the end of the week (Friday). Polish calendar is relatively empty with only NBP official reserves publication (Tuesday). In the CEE3 region there are June CPIs being published in Russia (Tuesday), Hungary (Wednesday) and Czech Republic (Friday), market expectations are for rises to 3.2% y/y (+0.2p), 3.0% y/y (+0.8p) and 2.9% y/y (+0.0p).

Market implications

FX The period before the second round of presidential elections (scheduled for Sunday 12 July) might turn out to be calmer than average though as market participants avoid big directional bets on the currency. That is why we think the EURPLN is likely to remain range bound in the next week and oscillate within the 4.45-4.50 range. The elevated intraday volatility might continue for a while as the relative value trades like PLN/HUF remain popular and the FX options markets is probably short Gamma. Also in the FX options markets noticeably lower risk reversals might point to some bullish zloty bets being made by a HF community ahead of the elections.

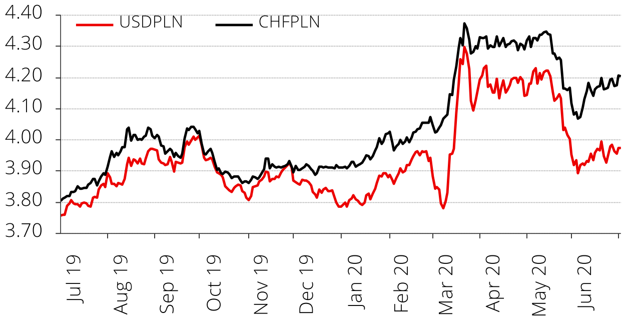
FI Our view is for the yields to keep declining in the following week. The yields at the front end of the bond curve are under immense pressure from over-liquid banking sector, we expect 2Y bonds to drift lower to 0.10% from current 0.12% over the coming week. The long end of the curve as usual is a function of a greater number of factors. If core market yields allow (e.g. do not increase a lot) we would read the fact that the Polish 10Y yields did not manage to break above 1.45% despite many attempts as bullish POLGBs and expect 10Y yields to decline to 1.30%. This would also meant the curve should bull flatten a bit. The belly of the curve might increasingly become under pressure from the short end liquidity moving up the curve and hence 5Y bond prices might outperform other tenors and we would not be surprised to see them at 0.60% by end of next week.

EURPLN



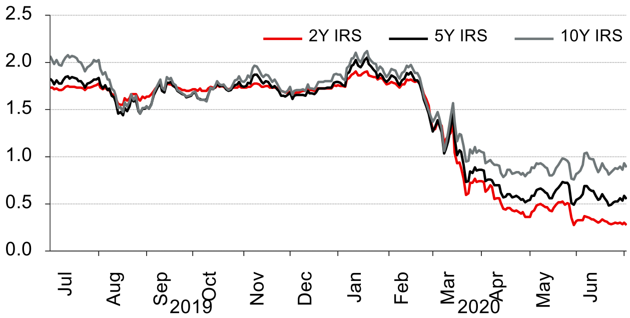
Source: Refinitiv Datastream, Santander Bank Polska

USDPLN and CHFPLN



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	LAST VALUE
		MONDAY (6 July)					
11:00	EZ	Retail Sales	May	% y/y	-19.6		-6.5
08:00	DE	Factory Orders	May	% y/y	-36.0		-26.0
09:00	HU	Retail Sales	May	%y/y	-10.2		-3.8
16:00	US	ISM non-manufacturing	Jun	pts	50.0		45.4
15:45	US	PMI services	Jun final	pts	47.0		46.7
		TUESDAY (7 July)					
09:00	CZ	Industrial Output	May	% y/y	-33.7		-22.4
10:00	**PL**	**Foreign Exchange Reserves**	**Jun**	**EUR bn**			**132.8**
08:00	DE	Industrial Production	May	% y/y	-19.3		-25.3
18:00	RU	CPI	Jun	% y/y	3.2		3.0
		WEDNESDAY (8 July)					
03:30	CN	CPI	Jun	%y/y	2.5		2.4
09:00	HU	CPI	Jun	%y/y	3.0		2.2
09:00	CZ	Retail Sales	May	%y/y	-21.2		-14.7
		THURSDAY (9 July)					
08:00	DE	Current Account	May	EUR bn			7.7
08:00	DE	Trade Balance	May	EUR bn			3.6
09:00	HU	Trade Balance	May	EUR bn			-0.56
10:00	CZ	Foreign Exchange Reserves	Jun	USD bn			149.0
14:30	US	Initial Jobless Claims	May	Level, k			1427
		FRIDAY (10 July)					
03:45	FR	Industrial Production	May	%y/y	-34.2		-26.2
09:00	CZ	CPI	Jun	%y/y	2.9		2.9
14:30	US	PPI Final Demand	Jun	%m/m	-0.2		-0.8

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg
***estimate after CPI inflation data*

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