31 July 2020

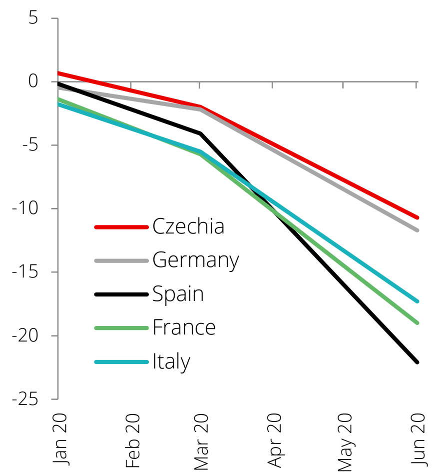
Weekly Economic Update

Markets torn between data and virus

What's hot next week

- Last week we got to know the advance Q2 GDP readings from the US and Eurozone. The market impact was slightly pessimistic despite the readings being not far away from the market consensus. In Europe, among the 10 countries which published the data so far, the steepest declines were in Spain (-22,1% y/y) and one should hope that the upcoming data will only come out better. Polish advance Q2 GDP will be published in 2 weeks.
- This week a lot of important data abroad: final PMI readings (initial readings were pretty good), industrial production, exports in Germany, non-farm payrolls in the US. Markets broadly expect the economic rebound that is why the forecasts for the upcoming months keep rising.
- Any information about the Donald Trump idea to postpone the November presidential elections and tensions between the US and China could also be important.
- In Poland, the only publication will be the July PMI index. We expect it could rise further to around 50pts and our call is in line with the consensus.
- It cannot be excluded that the market could focus on the rising number of COVID-19 cases that may be viewed in the context of next round of lockdown. So far, however, the equity market does not look excessively concerned since hardly anybody expects that strict lockdowns (like during the first wave) could be re-imposed. Also in Poland, recent data showed a record number of new infections – both in daily and weekly terms.

Change in GDP in selected countries, % y/y



Source: Eurostat, Santander

Market implications

- We think the EURUSD rally is overdone and the dollar could recover in the coming days or weeks. Stronger US currency may not be good for the zloty and its EM peers. Still, we do not expect any substantial weakening of the zloty. We think that after some upside move, EURPLN could resume the down move towards 4.35 at the end of the year.
- We do not expect the MPC to cut rates further which, together with ample liquidity in the Polish banking system should keep front end yields well anchored. The bigger potential for curve flattening is on the long end, in our view. Since early June, the 10Y bond yields is holding in a slow downtrend and we expect this to hold. In the short term, strengthening of the Polish bonds may be support by further drop of core bonds after the Bund yield broke the lower end of a consolidation.

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Last week in economy

Last week we got to see flash CPI reading as well as some data on agricultural output. MPC members spoke again, with NBP president reiterating the sentence mentioning that weaker PLN would be positive for the economy.

CPI declined in July to 3.1% y/y from 3.3% in line with market consensus. We estimate core inflation at 4.3% y/y, up from June's 4.1% which already was the highest reading in 18.5 years - this is significantly above market consensus which stood at 3.9% y/y (based on a survey among local analysts) ahead of the publication and our 4.1% call. The current mix of demand overhang created by the earlier lockdown and possibly still some supply issues is keeping inflation relatively high, but the hit to domestic demand should soon send CPI lower, most likely below the NBP 2.5% target still this year, while core CPI might ease to c.3% by the end of 2020.

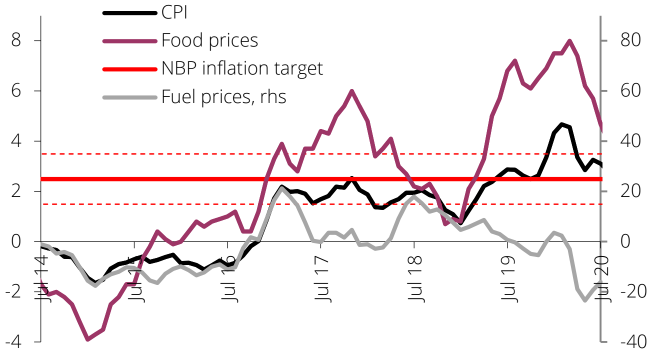
According to GUS estimates, **the grain output** this year will be around 11% y/y higher and beating even those from the pretty decent 2017 year. Output of fruit and vegetables are supposed to be 5-10% higher than in 2019, when the winter was much colder. In case of vegetables, this means that the production will come back to the 2018 level (when the production was below the previous year averages, however). In case of fruit, the output might still be 15-20% lower than in 2018. The April drought, subsequent frosts and storms have had an impact but only locally. Also, the IUNG-PIB reports that this year's draught has much narrower range than those from the previous years. It seems that this year's supply disruptions will not be strong enough in order to stop further gradual easing of food price growth in the CPI (from around 6% y/y in May-June to around 3% in mid-2021).

The July ESI indicators for Poland showed pronounced and faster than previous month's improvement in the retail trade sector, while improvement in services, manufacturing and construction was also strong but with the same pace as in June. It is the first reading during the pandemic with improving industrial orders, while inventories of finished goods and products index declined. For the first time the services employment change index also increased. On the other hand, consumers' willingness to spend on big items deteriorated (index fell to levels below the May and June ones) despite the pronounced improvement in the assessment of the current situation and the future financial conditions.

The government accepted the **macroeconomic assumptions for 2021 budget.** They are quite conservative in light of our forecasts. Interestingly, the government assumed another significant rise in the minimum wage: by 7.7% to PLN2800, while wage growth for the national economy was earmarked at 3.4%.

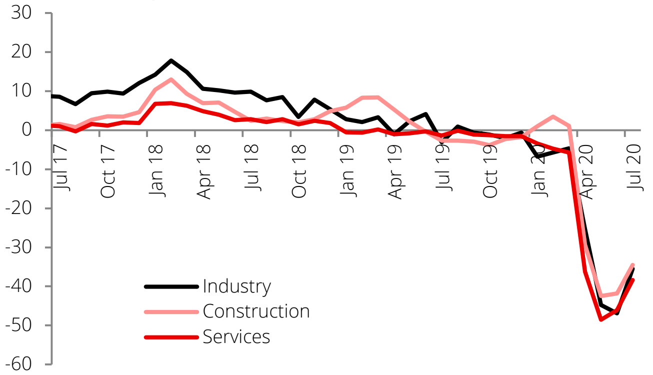
Adam Glapiński wrote in an article for *Dziennik Gazeta Prawna* daily that NBP still has room for easing monetary policy, in case the economic situation proves worse than the central bank expectations. The article repeats the idea that a weaker zloty would support faster economic rebound. Earlier also **Jerzy Żyżyński** commented on this statement and said that this was not an intervention but only a piece of information, as the MPC did not wish to create an impression that it wants a weaker zloty. To be honest, we find that communication confusing. In our view, the MPC itself and MPC members have repeated the claim too many times to assume it did not aim at keeping the zloty weaker and that it was just of informative nature. Moreover, the Glapiński's article appeared right after EURPLN reached 4.40, the level when the sentence popped up for the first time in Rafał Sura's comment. Either this is a mere coincidence, or the MPC does actually want to keep EURPLN above this level. **Grażyna Ancyparowicz** said that in her opinion "there will be no significant changes to monetary policy till the end of this year and probably in the next year". Jerzy Kropiwnicki would prefer rates to go up to 1.50% in 2020. In our view, rates will remain unchanged for at least a year.

CPI inflation, % y/y



Source: GUS, Santander

ESI indicators, pts



Source: GUS, Santander

Macroeconomic assumption for 2021 budget

	2020	2021
GDP	**-4.6**	**4.0**
Private consumption	**-4.2**	**4.4**
Export	-9.3	6.9
Import	-10.2	7.3
Inflation	3.3	1.8
Unemployment	8.0	7.5
Employment in NE*	-2.4	-0.7
Wages in NE	3.5	3.4

Source: PAP, Santander
**NE = National Economy*

FX and FI market

Last week on the market

FX The passing week was much calmer than the previous one. EURPLN traded in a 4.385-4.425 range and closed slightly below 4.41, near the previous week's close price. Continuation of a strong EURUSD upside trend pushed USDPLN further down to 3.70, its lowest since October 2018.

In case of the other CEE currencies, the ruble underperformed its peers despite weaker dollar and roughly stable oil price. USDRUB broke the upper end of 70-72 consolidation observed since early July and rose to nearly 74, its highest since mid-May. One of the reasons behind the ruble weakness could have been the dovish rhetoric of the Russian central bank after the last week's rate cut. Second, investors may have been wary ahead of the upcoming Caucasus-2020 military exercises near the Ukrainian border in September.

FI Polish bond yields fell by c10bp on the belly and long end while the respective IRS rates dropped by 3-4bp. The main factor behind these changes was strengthening of Bunds and Treasuries in anticipation of and after the dovish message from the July FOMC meeting. The 10Y PL asset swap spread reached its 45bp support but did not manage to stay below it for longer. The 10Y German bond yield fell below the lower end of -0.50/-0.40% range and fell to -0.55%, its lowest since mid-May.

Key event of the upcoming week could be the US monthly job report. In June, the pace of improvement slowed after the strong reading for May and now the market expects further normalization. Final PMIs shall not differ much vs the flash estimates and should be market-neutral. The US ISM readings could be more important.

Market implications

FX August is about to start and if we look at the historical pattern we see that this month has been usually negative for the zloty. In the last 20 years, EURPLN fell in August only five times, last in 2017.

We think the EURUSD rally is overdone and the dollar could recover in the coming days or weeks. Stronger US currency may not be good for the zloty and its EM peers. In July, only five of the EM currencies did not gain vs the dollar. At the same time, the zloty was the third strongest in the EM group, only after the forint and koruna.

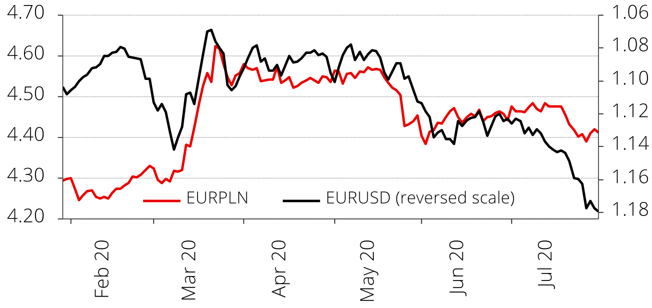
However, we do not expect any substantial weakening of the zloty. The risk of a central bank's intervention in the market seems to have fallen and we do not expect EURPLN to rise above 4.50 in the coming weeks. Although the COVID-19 pandemic does not show signs of slowing and some countries face a second wave of infections, the equity market does not look excessively concerned since hardly anybody expects that strict lockdowns (like during the first wave) could be re-imposed. Thus, the global market mood should remain relatively stable which could allow the zloty to make at least small gains. We think that after some upside move, EURPLN could resume the down move towards 4.35 at the end of the year.

The Czech central bank will decide about the interest rates on August 6 and we think that the monetary policy parameters will stay unchanged for a second month in a row.

FI The 2-10Y bond yield spread, although it fell 10bp since mid-July, is still holding close to its highest level since mid-2019. We think that such high spread is not too much justified given the high degree of monetary policy easing abroad, the bond purchase program run by the Polish central bank and expected drop of inflation.

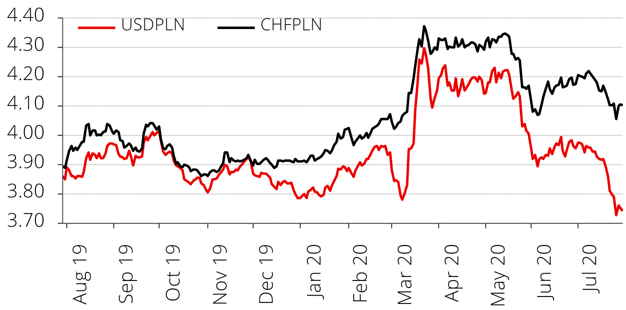
We do not expect the MPC to cut rates further which, together with ample liquidity in the Polish banking system should keep front end yields well anchored. The bigger potential for curve flattening is on the long end, in our view. Since early June, the 10Y bond yields is holding in a slow downtrend and we expect this to hold. In the short term, strengthening of the Polish bonds may be support by further drop of core bonds after the Bund yield broke the lower end of a consolidation.

EURPLN and EURUSD



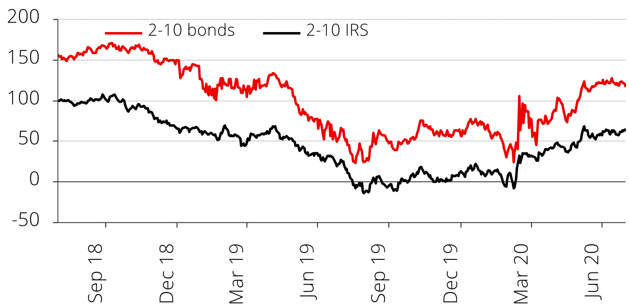
Source: Refinitiv Datastream, Santander Bank Polska

USDPLN and CHFPLN



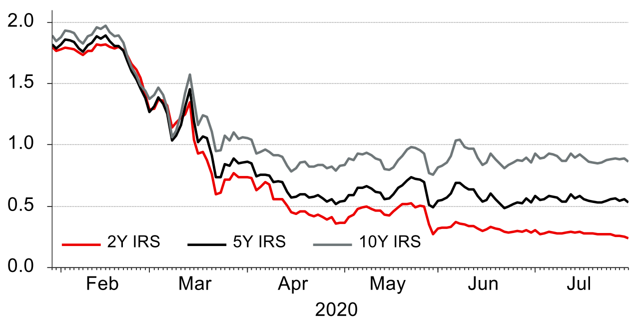
Source: Refinitiv Datastream, Santander Bank Polska

Slope of Polish curves



Source: Refinitiv Datastream, Santander Bank Polska

Poland IRS



Source: Refinitiv Datastream, Santander Bank Polska

Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST SANTANDER	LAST VALUE
			MONDAY (3 August)				
09:00	**PL**	**Poland Manufacturing PMI**	**Jul**	**pts**	**50.0**	**50.0**	**47.2**
09:55	DE	Germany Manufacturing PMI	Jul	pts	50.0	-	50.0
10:00	EZ	Eurozone Manufacturing PMI	Jul	pts	51.1	-	51.1
16:00	US	ISM manufacturing	Jul	pts	53.6	-	52.6
			TUESDAY (4 August)				
16:00	US	Durable Goods Orders	Jun	% m/m	0.0	-	7.3
16:00	US	Factory Orders	Jun	% m/m	4.95	-	8.0
			WEDNESDAY (5 August)				
03:45	CN	Caixin China PMI Services	Jul	pts	57.9	-	58.4
09:55	DE	Markit Services PMI	Jul	pts	56.7	-	56.7
10:00	EZ	Markit Services PMI	Jul	pts	55.1	-	55.1
11:00	EZ	Retail Sales	Jun	% m/m	7.0	-	17.8
14:15	US	ADP report	Jul	k	1 200	-	2 368
16:00	US	ISM services	Jul	pts	55.0	-	57.1
			THURSDAY (6 August)				
08:00	DE	Factory Orders	Jun	% m/m	12.25	-	10.4
09:00	CZ	Industrial Production	Jun	% y/y	-9.1	-	-29.4
09:00	HU	Industrial Production	Jun	% y/y	-15.15	-	-27.63
14:30	US	Initial Jobless Claims	week	k	1 445	-	1 434
14:30	CZ	Central Bank Rate Decision		%	0.25	-	0.25
			FRIDAY (7 August)				
08:00	DE	Exports SA	Jun	% m/m	0.0	-	8.9
08:00	DE	Industrial Production SA	Jun	% m/m	7.2	-	7.8
14:30	US	Change in Nonfarm Payrolls	Jul	k	1 635	-	4 800
14:30	US	Unemployment Rate	Jul	%	10.5	-	11.1

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.