14 August 2020

Weekly Economic Update

Rebound from a shallower dip

What's hot next week

- The trough of the recession happened to be shallower than we have thought (GDP fell in 2Q20 "only" by 8.2% y/y or 8.9% q/q after seasonal adjustment) and now we are waiting for data from 3Q20 to see how quickly we are rebounding from the bottom. So far, the "soft" signals from various business climate surveys were indicating that this recovery is quite efficient. In the coming days we will see the first "hard" data for July, which will verify this claim. The upcoming releases include wages and employment (Wed), production in industry (Thu) and construction (Fri), retail sales (Fri). Our forecasts for most of those variables are well above market consensus and if they prove correct, the investors' optimism regarding economic outlook for Poland may rise substantially.
- On Monday core inflation data will be released. While the headline CPI fell in July to 3.0% y/y (slightly below the flash estimate), it was mainly due to food prices, while core inflation remained elevated (4.1% or maybe even 4.2%). The detailed numbers reveal, however, that services inflation started slowing and we think we are nearing the point when core inflation will go down as well.
- As regards calendar abroad, the flash PMIs for August will be crucial (due on Fri). After their clear rebound in the recent months, the scope for further improvement seems to be running out, in our view. Important factor will be also the agreement between Republicans and Democrats on the next rescue package. On Tuesday, the next round of Brexit talks begins.

Market implications

- Domestic macro data should be supportive for PLN, but on the other hand we do not rule out strengthening of the dollar in case of the agreement on US rescue deal; lower EURUSD is usually unfavourable for the zloty. Thus, we do not expect the EURPLN to leave the 4.385-4.425 range, in which it has been hovering since late July.
- On the interest rate market it is hard to assume that the recent downward tendency in yields will be maintained amid the opposite trend in core market yields and solid local data relaeses.

GDP in EU, % change, sa data

	2Q20 vs 1Q20	2Q20 vs 4Q19
Spain	-18.5	-22.7
Hungary	-14.5	-14.8
Portugal	-13.9	-17.2
France	-13.8	-18.9
Italy	-12.4	-12.9
Romania	-12.3	-12.0
Belgium	-12.2	-15.3
Cyprus	-11.6	-12.7
Austria	-10.7	-12.8
Germany	-10.1	-11.9
Bulgaria	-9.8	-9.5
Poland	-8.9	-9.3
Sweden	-8.6	-8.5
Netherlands	-8.5	-9.9
Czechia	-8.4	-11.5
Slovakia	-8.3	-13.1
Latvia	-7.5	-10.2
Denmark	-7.4	-5.5
Lithuania	-5.1	-5.4
Finland	-3.2	-5.0

Source:: Eurostat, Santander

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Last week in economy

Last week we got to see quite interesting Polish data, with 2Q20 GDP falling less than expected, current account balance showing a massive surplus and CPI slipping below flash estimate.

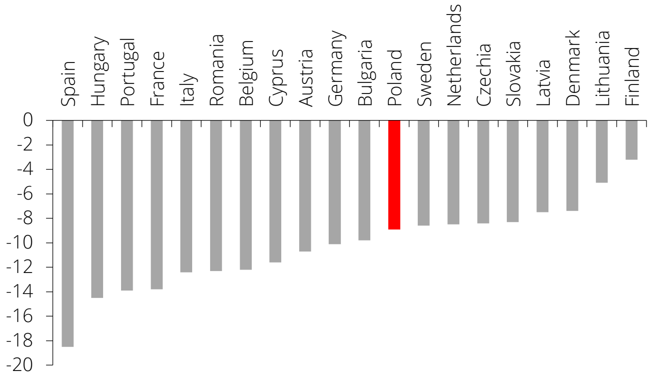
Poland's GDP fell by 8.2% y/y and 8.9% q/q (sa) in 2Q20, so the reading was a bit better than market expectations. Still, fall in GDP was the worst since early 90s and this was the second negative q/q reading in a row (-0.4% in 1Q20), so Poland fell into recession by definition. This reading compares quite well with other EU economies, as half (among 20 countries that already published the data) recorded a q/q decline stronger than 10%, with Spain suffering the worst decline of 18.5% q/q. We are waiting for details, due for release on 31st August. We are expecting a major decline in investment and a somewhat less pronounced fall in consumption. Contribution of net exports could prove positive, given data on balance of payments. It also seems that value added in services fell by about 10% y/y, which is not bad, as this sector seems to be the most vulnerable. In our view, there will be an improvement of GDP growth in the quarters to come, yet it is likely to remain in the negative territory in annual terms until end of 2020. The entire year result is likely to be better than we expected (-3.8%), and we will be revising this forecast upwards.

July CPI has shown 3.0% y/y vs the flash release of 3.1% y. We are correcting our estimate of core CPI to 4.1-4.2% y/y from 4.3% y/y, which – if confirmed by official release due on August 17 - would be still the highest reading in 18.5 years. Inflation of goods prices eased to 1.5% y/y from 1.8% and services prices to 7.3% y/y from 7.4%. The decline of y/y inflation from June's 3.3% was caused by lower growth of food prices (3.9% y/y vs 5.7% previously). As for core CPI: clothing and footwear prices grew significantly more in y/y terms than we assumed as did house maintenance costs, telecom services and 'other goods and services' (a category including hairdressing and insurance), on the other hand transport and leisure and cultural activities prices came below our expectations. It seems we are approaching the point where core inflation starts to decline (possibly already in August), yielding to the pressure of decreased domestic demand. After the July data it seems more likely CPI growth will get below the NBP target of 2.5% y/y by the end of this year.

June **current account balance** at €2.84bn was much better than expected, and also much better than the previous reading of €1.39bn. The surprise came from trade balance in goods, which showed €2.67bn. Export growth has already turned positive – much faster than we imagined when the lockdown was still in place – showing +3.0% y/y. At the same time, imports growth (-10.7% y/y) remained unusually far below export growth. This looks like a boost coming from accumulated unrealised demand for consumer durables in partner countries. On the imports side, once again significantly smaller oil bill weighed on the total value, with cars and car parts adding to the imports decline. However, as far as consumer goods are considered, data showed a noticeable rebound vs previous months. After the June release, 12M rolling C/A balance-to-GDP ratio rose to a new record high of 2.3% from 1.7% only a month earlier.

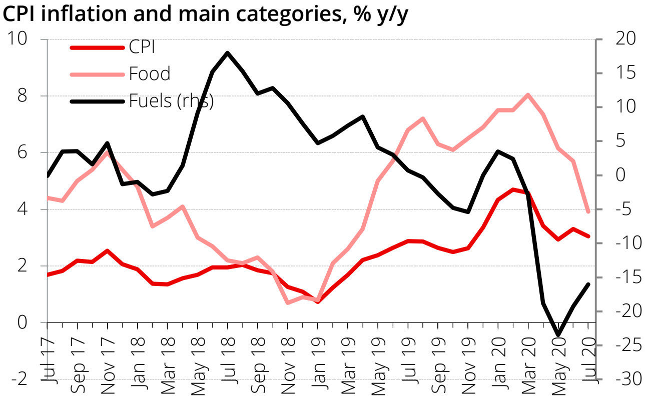
MPC's Jerzy Kropiwnicki and Eugeniusz Gatnar were worried that inflation will remain elevated in the months to come, with the former expecting CPI to hit even 4-5% this year. Kropiwnicki repeated his view that in 2021 rates should start going up gradually, while Gatnar suggested a hike in early 2021. On the other hand, Eryk Łon suggested rates should remain flat in 2020 and 2021 and put forward a proposal to widen the CPI tolerance band to 0.5-4.5% from current 1.5-3.5%. In our view, the idea of a prolonged rate stability will be shared by the majority of the Council.

GDP growth in 2Q y/y in EU countries, % q/q, sa



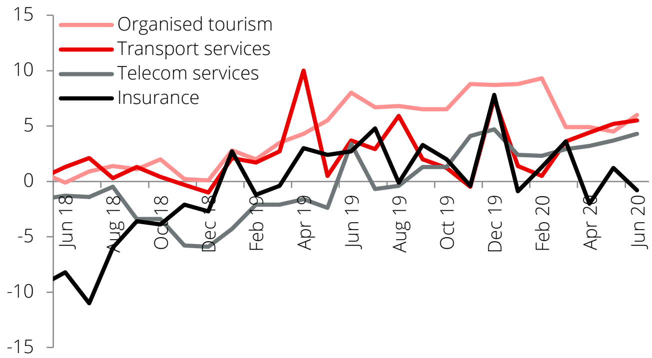
Source: Eurostat, Santander

CPI inflation and main categories, % y/y



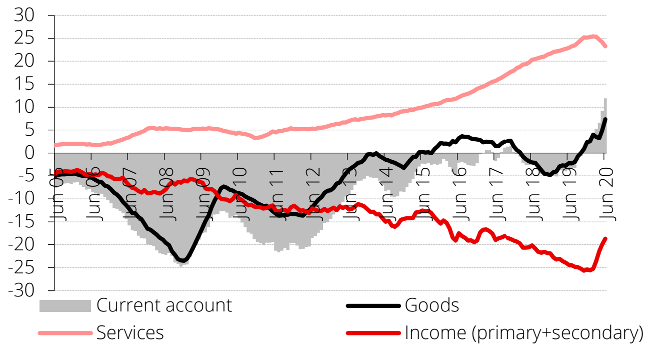
Source: GUS, Santander

CPI in selected services, % y/y



Source: NBP, Santander

Balance of payments, PLNbn, 12m sum



Source: NBP, Santander

FX and FI market

Last week on the market

FX EURPLN was creeping down during the last five sessions thanks to EURUSD holding at an elevated level, relatively positive global market mood and the better-than-expected Polish data. As a result, EURPLN eased to c4.39 from c4.42. Overall, the volatility was pretty low. USDPLN was hovering around 3.73, GBPPLN fell to 4.85 from 4.89 and CHFPLN was trading around 4.09.

Elsewhere in the CEE region, EURCZK and EURHUF remained close to their local lows thanks to the higher-than-expected July CPI prints. At the same time, USDRUB stayed at an elevated level and the ruble continued to underperform its CEE peers.

FI Spreads fell on the Polish market. The asset swap spread narrowed 5bp for the 10Y and 10bp for 5Y tenor mainly owing to the IRS jump triggered by a noticeable weakening on the core markets. The 10Y Bund and UST yields jumped by c10bp and 15bp respectively in response to the higher-than-expected US PPI and CPI data. At the same time, Polish bonds managed to recover after losses suffered at the start of the week and the 10Y yield returned to slightly below 1.30%. This allowed the 10Y PL-DE bond yield spread to fall to 170bp, its lowest since June.

Key event of the upcoming week could be the Friday's release of the flash August services and manufacturing indexes for Germany and the whole euro zone. After the March collapse, indexes returned to levels seen before the pandemic outbreak and we have already suggested that the potential for a positive surprises (like those seen in May and June) is diminishing. Indeed, now the market consensus points to a mild rise vs July. Also, there are some US economic activity data scheduled for a release.

Republicans and Democrats are still negotiating the final shape of an another round of support for the US economy. Extra support for the consumers expired at the end of July and if an agreement is reached, this could trigger positive market reaction. Next round of talks will be held this weekend.

On Tuesday, the next round of EU-UK Brexit talks will take place. So far, both sides reported rather poor progress but expressed hopes that some kind of a deal could be reached by October.

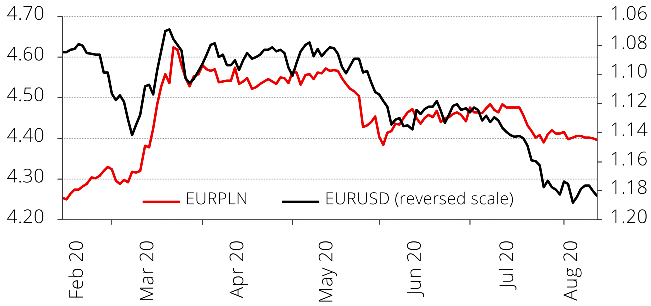
Polish July economic activity data will be released and our forecasts of industrial output and real retail sales are well above the consensus.

Market implications

FX EURPLN neared the lower end of the 4.385-4.425 range in which it has been holding since late July but we do not expect the exchange rate to leave this range next week already. The zloty gained temporarily after the release of Polish GDP data and the upcoming macro publications are likely to surprise positively as well. This could provide some slight support for the domestic currency. Globally, the result of talks between Republicans and Democrats could be crucial but its impact on the zloty could be inconsistent. Most recently, the dollar weakness was explained by the prolonging deadlock on the US political scene. We think that the deal in the USA is only a matter of time and when announced, the dollar may start to gain pushing EURUSD below the 1.17-1.19 range. This, in turn, could weigh on the zloty but the negative impact of a stronger US currency might be mitigated by likely positive reaction of the equity market.

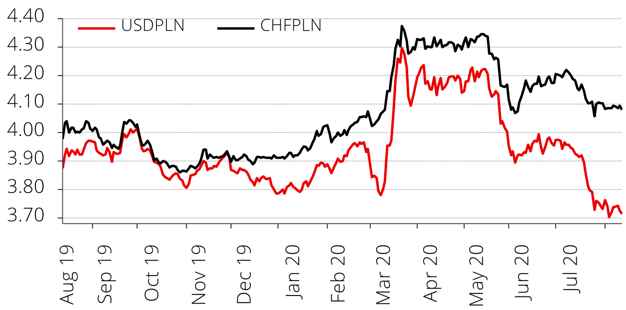
FI The 10Y Polish benchmark yield rebounded from the upper end of the downward trend channel observed since June. However, recently we saw more factors that could at least slow this tendency. First, rise of core bond yields that may continue shall Republicans and Democrats reach an agreement about the support package. Second, the market may start to price in the risk of higher inflation abroad translating into higher domestic CPI, particularly when more data will suggest that the economic revival in Poland is taking place faster than many, including the central bank, expected.

EURPLN and EURUSD



Source: Refinitiv Datastream, Santander Bank Polska

USDPLN and CHFPLN

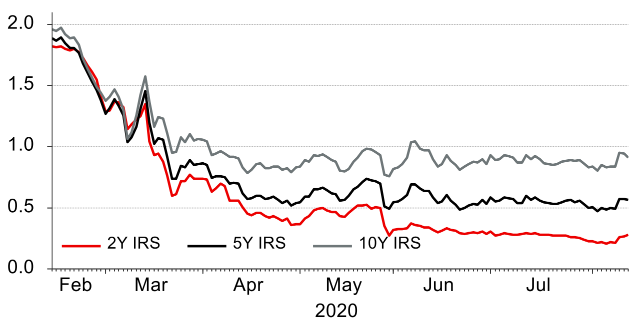


Source: Refinitiv Datastream, Santander Bank Polska

PL-DE bond yield spread

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 (17 August)					
14:00	**PL**	**CPI Core**	**Jul**	**% y/y**	**4.2**	**4.1***	**4.1**
		TUESDAY (18 August)					
14:30	US	Housing Starts	Jul	% m/m	3.7	-	17.3
		WEDNESDAY (19 August)					
10:00	**PL**	**Employment in corporate sector**	**Jul**	**% y/y**	**-3.0**	**-3.1**	**-3.3**
10:00	**PL**	**Average Gross Wages**	**Jul**	**% y/y**	**3.4**	**4.5**	**3.6**
11:00	EZ	HICP	Jul	% y/y	0.4	-	0.4
20:00	US	FOMC Meeting Minutes					
		THURSDAY (20 August)					
10:00	**PL**	**Sold Industrial Output**	**Jul**	**% y/y**	**-1.2**	**3.7**	**0.5**
10:00	**PL**	**PPI**	**Jul**	**% y/y**	**-0.5**	**-0.5**	**-0.8**
14:30	US	Initial Jobless Claims	week	k	1 100	-	963
14:30	US	Index Philly Fed	Aug	pts	21.0	-	24.1
		FRIDAY (21 August)					
09:30	DE	Flash Germany Manufacturing PMI	Aug	pts	52.5	-	51.0
09:30	DE	Flash Markit Germany Services PMI	Aug	pts	55.0	-	55.6
10:00	EZ	Flash Eurozone Manufacturing PMI	Aug	pts	53.1	-	51.8
10:00	EZ	Flash Eurozone Services PMI	Aug	pts	54.7	-	54.7
10:00	**PL**	**Construction Output**	**Jul**	**% y/y**	**-5.5**	**-4.5**	**-2.4**
10:00	**PL**	**Retail Sales Real**	**Jul**	**% y/y**	**-0.7**	**2.8**	**-1.3**
16:00	US	Existing Home Sales	Jul	% m/m	12.9	-	20.7

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg

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