16 October 2020

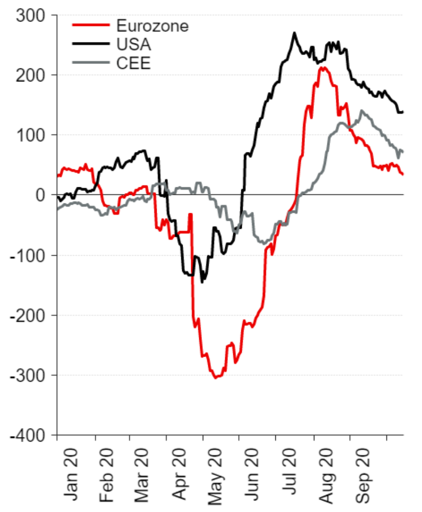
Weekly Economic Update

Restricted growth

What's hot next week

- The upcoming week will be full of Polish data. We will see September wages, employment, industrial and construction output, retail sales, money supply and unemployment rate. Also, the stat office will release revised quarterly GDP data after it corrected 2019 growth to 4.5% from 4.1%. These are all important information but refer to the period before we saw a sharp rise of COVID-19 cases. That is why we think that signals how the next wave of infections affects the business mood and consumer activity in coming months could be more important for the growth outlook. To measure this, the stat office business and consumer confidence indexes and flash PMIs could be useful.
- In our view, it is not the economic data that will be particularly observed but the information how the pandemic evolves, what is the situation in health care system and what is the risk that restrictions could be tightened further. The Polish government has just announced restrictions that shall not have much damage to the economic growth but this does not mean that they will be neutral. Our estimate based on the card payments shows that the current proportion of yellow and red zones (if maintained for the whole quarter) may reduce the 4Q GDP growth by 1.2pp (vs the scenario of no zones). This does not include the effect of recent tightening of restrictions. Nevertheless, should the number of cases and deaths continue to rise fast, the risk of further restrictions could rise resulting in larger decline in business and consumer activity. In our view, the risk of a broad lockdowns in Western Europe rises but is still rather moderate (owing to the fact that the number of deaths rises slowly despite spike of new cases) while in Central-Eastern Europe the trend is different and incapacity of the health care system may not the governments any other option than to limit activity further.

CESI: economic surprise index



Source: Refinitiv Datastream

Market implications

- On the FX market it is the local factors that start to play an even larger role. This can be seen in particular, by focusing on how the pandemic is evolving and monitoring its impact on the economies. Even if global markets calmed down a bit, zloty might remain under pressure of the quickly rising number of cases of Covid-19. We do not expect, however, the EURPLN to go above the 4.60-4.63 level next week.
- Bond yields have followed the ones on the core markets and only at the end of the week has the 10Y POLGB-Bund spread widened to above 190bp: despite the fact that German bond yields fell further, Polish long-end yields moved higher a bit. Increasing growth risks (and risks of further monetary and fiscal expansion and related increase in liquidity of the banking sector) point to the fact that bond yields, in case global moods won't improve soon, might test the new lows in the nearest future.

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Last week in economy

Inflation bounced back in September, while current account remained in large surplus in August. The most important story of the week, however, was further acceleration of Covid-19 pandemic and extension of the related restrictions by the government.

In response to quickly rising Covid-19 cases **the government extended restrictions** moving 152 counties (covering almost 50% of Poland's population) to red zones. The tightened restrictions in red zones include, among others, high-schools and universities switching to on-line classes, limiting the number of people in stores to 5 per cash desk, cancelling all events, closing gyms, swimming pools and aqua parks, allowing restaurants to open from 6AM to 9PM. According to our estimates based on card payments, extension of yellow and red zones to their current range (if persists for the entire quarter) could decrease GDP in 4Q by c.1.2pp (as compared to the scenario without yellow/red zones in place). The true impact could be even bigger, as the estimate does not take into account that restrictions in particular zones have been tightened as well.

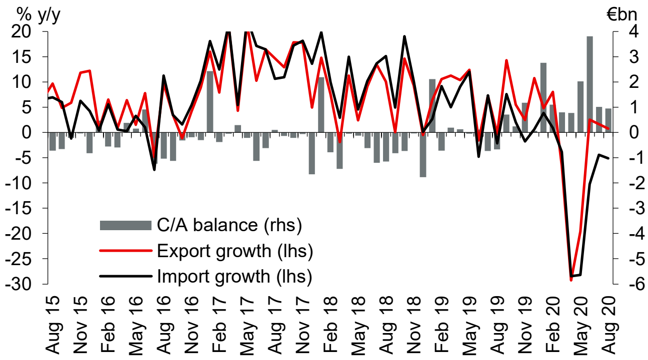
August **current account balance** was at EUR947mn, roughly in line with market expectations. In line with our assumptions foreign trade turnover slowed down a bit: export to 0.8% y/y from 1.7% y/y and import to -5.1% y/y from -4.4% y/y. While September is likely to see some improvement in foreign trade, further month can witness a renewed slowdown given rising wave of new infections and tighter restrictions across Europe. 12m current account balance went up to 3.0% of GDP and we are expecting it to improve further.

CPI inflation in September was confirmed at 3.2% y/y versus 2.9% y/y in August, with core inflation being the main culprit behind this jump. Core inflation excluding food and energy rose in September to 4.3% y/y, returning to its local peak from July (highest since 2001). Other measures gave mixed signals: 15% trimmed mean was stable at 3.2%, CPI ex most volatile prices fell to 3.2%, CPI ex administered prices rose to 2.3% y/y. The latter measure remains much lower than others and near its 18-months low, suggesting that main factor behind the recent inflation spike was not the surge of market-driven prices but rather administrative fees (waste management, for example). We keep predicting inflation to do down in the coming months and quarters, with both CPI and core inflation ex food and energy likely to be below 2% for the better part of 2021.

The IMF raised GDP forecast for Poland from -4.6% to -3.6% in 2020 and from 4.2% to 4.6% in 2021. For the world economy, the Fund expects milder recession in 2020 and slower rebound in 2021. The main reasons behind the 2020 upside revision were better-than-expected 2Q GDP readings, faster recovery after the lockdown and stronger-than-assumed data released in 3Q.

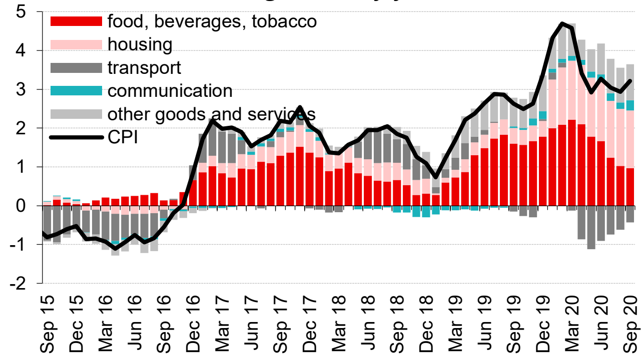
Several MPC members took floor in recent days: **Eugeniusz Gatnar** reiterated his opinion on the need to consider gradual rate hikes in 2021 should the economic recovery continue and consumer sentiment does not deteriorate. **Eryk Łon** said that falling consumer confidence due to the new coronavirus wave could be a reason to cut rates even below zero (albeit chances for such scenario are low). **Rafał Sura** said that the Polish currency needs currently no adjustments and should remain loose for a longer time in order to support the recovering economy.

Balance of payments data



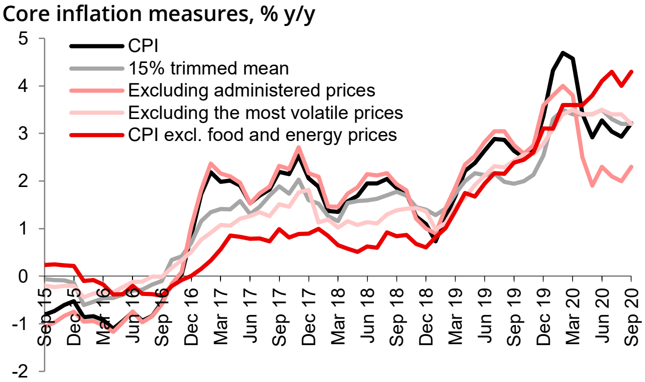
Source: NBP, Santander

Breakdown of annual CPI growth, % y/y



Source: GUS, Santander

Core inflation measures, % y/y



Source: NBP, Santander

IMF forecasts

GDP (% y/y), in brackets forecasts from June

	2020	2021
Poland	**-3.6 (-4.6)**	**4.6 (4.2)**
World	-4.4 (-5.2)	5.2 (5.4)
Euro zone	-8.3 (-10.2)	5.2 (6.0)
USA	-4.3 (-8.0)	3.1 (4.5)
China	1.9 (1.0)	8.2 (8.2)

Source: IMF, Santander

FX and FI market

Last week on the market

FX The zloty depreciated sharply vs main currencies amid sell-off on the global equity market, dollar strengthening and a jump of new COVID-19 cases in Poland and in CEE region that encouraged the government to impose more restrictions. As a consequence, EURPLN rose above 4.55, USDPLN to 3.90, GBPPLN to 5.03, CHFPLN to 4.26.

The other CEE currencies also depreciated due to the abovementioned factors. EURCZK rose 1% on weekly basis to 27.3, EURHUF 2.2% to 365, USDRUB 1.7% to c78.0, all reaching their fresh October peaks.

FI Retreat towards safe assets boosted Polish bonds and pulled the IRS rates down. The yield curved shifted 3-7bp down with the 2Y bond falling to c0% and the 10Y testing the August bottom at 1.26%. The IRS curve dropped 6-10bp with the 2Y and 5Y rates reaching their fresh all-time-lows. As a result, the asset swap spreads rose somewhat but remained within ranges observed in the previous two months. German 10Y Bund broke the lower end of the -0.55/-0.50% range and reached -0.63%, its lowest since March. The 10Y PL-DE bond yield spread increased by 6bp to 190bp, to the upper end of the range in which it has been holding since June.

Key factors to watch this week would be again pace of the coronavirus spreading, particularly in our region. In recent days, Poland, Czechia and Russia witnessed a record-high daily increase of new COVID-19 cases.

We will also get a fresh portion of economic data both from Poland and from abroad that will show how the economy is doing during the second wave of pandemic. It seems that the market has accepted the fact that the pace of a growth recovery could slower in the months to come given the recent spike in the COVID-19 cases which resulted in social distancing measured being introduced by some countries.

In Poland, we will see September industrial output and retail sales data and in both cases our forecasts are below the consensus.

Abroad, the market may be awaiting Friday's release of flash October PMIs. Investors expect a minor deterioration of business sentiment in services and manufacturing.

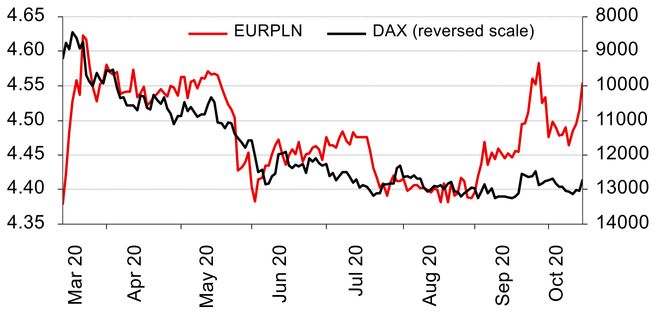
In Hungary, the central bank will decide about the interest rates. We do not expect any change in the main rate but recall that only a few days after the previous meeting the bank changed the deposit rate.

Market implications

FX We think that in case of the FX market, the focus could start shifting towards more country-specific factors. Although we see the potential for the global mood to stop deteriorating, the mounting number of new coronavirus case in Poland and the risk of further restrictions may keep the zloty under pressure. Also, our forecast of the domestic industrial output and retail sales data are below the consensus which might make the market more concerned about the economic outlook particularly a few days after the new anti-COVID restrictions were imposed. This may add pressure on the zloty. At the same time, we do not expect EURPLN to rise above 4.60-4.63.

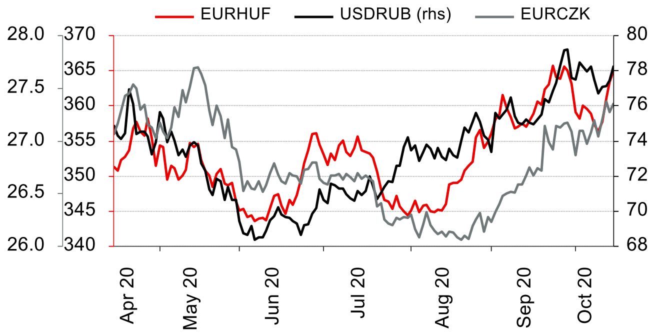
FI The 10Y bond yield tested the lower end of 1.26-1.40% range in which it has been holding since August but unsuccessfully, at least for now. However, mounting risk for growth (leading to larger fiscal and monetary policy expansion and further rise of liquidity in the banking sector) may allow for the recent lows to be tested again unless the global sentient improves. If the global market mood stabilizes, the Bund could stop gaining and this could translate into higher yields in Poland.

EURPLN and German DAX equity index



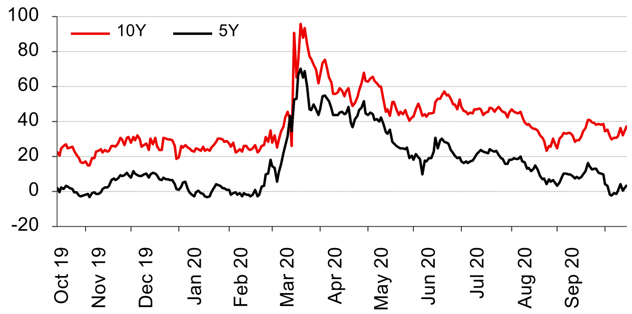
Source: Refinitiv Datastream, Santander Bank Polska

EURHUF, EURCZK and USDRUB



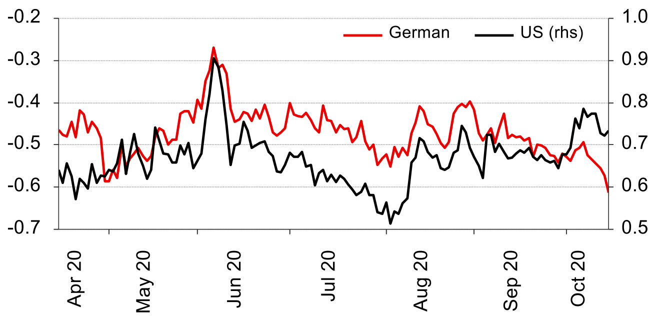
Source: Refinitiv Datastream, Santander Bank Polska

Poland asset swap spreads



Source: Refinitiv Datastream, Santander Bank Polska

10Y German and US bond yields



Source: Refinitiv Datastream, Santander Bank Polska

Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST SANTANDER	LAST VALUE
			MONDAY (19 October)				
10:00	**PL**	**Employment in corporate sector**	**Sep**	**% y/y**	**-1.1**	**-1.0**	**-1.5**
10:00	**PL**	**Average Gross Wages**	**Sep**	**% y/y**	**4.3**	**4.8**	**4.1**
			TUESDAY (20 October)				
10:00	**PL**	**Sold Industrial Output**	**Sep**	**% y/y**	**3.7**	**3.1**	**1.5**
10:00	**PL**	**PPI**	**Sep**	**% y/y**	**-1.5**	**-1.4**	**-1.2**
14:00	HU	Central Bank Rate Decision		%	0.6	-	0.6
14:30	US	Housing Starts	Sep	% m/m	2.5	-	-5.1
			WEDNESDAY (21 October)				
10:00	**PL**	**Construction Output**	**Sep**	**% y/y**	**-11.2**	**-15.1**	**-12.1**
10:00	**PL**	**Retail Sales Real**	**Sep**	**% y/y**	**2.6**	**0.3**	**0.5**
			THURSDAY (22 October)				
14:00	**PL**	**Money Supply M3**	**Sep**	**% y/y**	**16.2**	**15.6**	**16.2**
14:30	US	Initial Jobless Claims	week	k	825	-	898
16:00	US	Existing Home Sales	Sep	% m/m	3.33	-	2.39
			FRIDAY (23 October)				
09:30	DE	Flash Germany Manufacturing PMI	Oct	pts	55.2	-	56.4
09:30	DE	Flash Markit Germany Services PMI	Oct	pts	49.7	-	50.6
10:00	EZ	Flash Eurozone Manufacturing PMI	Oct	pts	53.0	-	53.7
10:00	EZ	Flash Eurozone Services PMI	Oct	pts	47.0	-	48.0
10:00	**PL**	**Unemployment Rate**	**Sep**	**%**	**6.1**	**6.1**	**6.1**

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.