13 November 2020

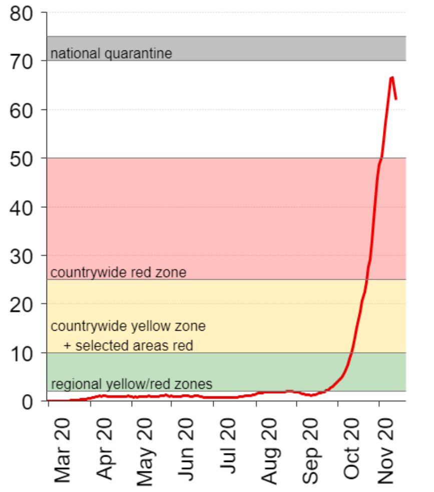
Weekly Economic Update

Vaccine against rule of law

What's hot next week

- The main theme of the last week was supposed to be the US election outcome, but it turned out that it was overshadowed by Pfizer's news about the positive tests of Covid-19 vaccine, which has moved the markets towards much lower risk aversion. Over time, the impact of this news started fading and if there is no new information of this kind in the coming days, other issues will return to the foreground. However, it cannot be ruled out that such positive news may be repeated, as other companies working on the vaccines may come up with their announcements, which may imply elevated market volatility in the coming weeks.
- There are some new data releases in the next week's agenda: Polish data about core inflation, labour market, industrial output for October, which in our view will be still not affected too much by the recent wave of pandemic. Also, data releases abroad should not be ground-breaking and market-moving. The meeting of the central bank in Hungary is unlikely to end with any policy changes, unlike in Turkey, where market expects a large interest rate increase in response to the recent lira's depreciation.
- Information about the pandemic spread are still important. As the number of officially reported cases in Poland has recently stabilised, the risk of "National Quarantine" introduction has decreased, at least for now.
- The issue to watch is the discussion on EU budget implementation. PM Morawiecki sent the letter to the heads of EU top institutions warning that if the EU pushes ahead with a plan to link European funding to the rule of law, the Polish parliament may not ratify the EU budget (it is not entirely clear, but it seems he meant the Next Generation EU part). The European Council videoconference is planned on Thursday, where this issue will be probably discussed.

7-day average number of new COVID-19 cases per 100k persons in Poland with thresholds for tighter/looser restrictions



Source: Refinitiv Datastream, Santander Bank Polska

Market implications

- We think that EURPLN may hover in 4.45-4.55 band. On one hand, the room for zloty strengthening seems to be constrained by the strong technical support, the looming economic slowdown in 4Q, or the treat of vetoing the EU budget. On the other hand, the new wave of optimism cannot be ruled out in case of more good news regarding the potential vaccines availability.
- Volatility may be elevated also on the debt market. Dovish ECB, smaller chances for a big fiscal package in the USA, likely economic slowdown in Q4 – all those factors call for lower yields, in our view. But all those factors could be negated by the news from the medical front, as could be seen in the last couple of days.

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Last week in economy

Last week we got to see data on GDP growth in 3Q20, which proved more or less in line with our expectations and confirmed that Poland was outperforming other EU countries. October CPI proved a bit higher than estimated tentatively, while NBP presented its updated forecasts.

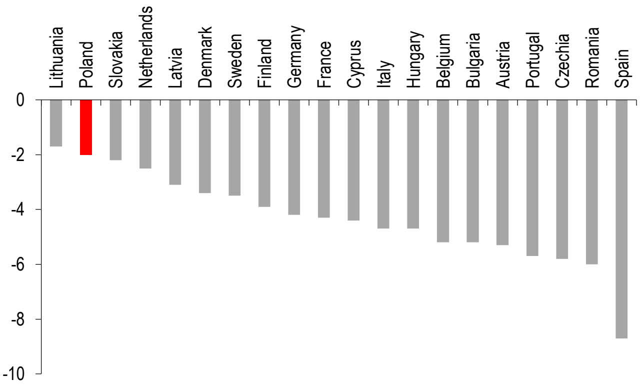
Polish GDP rebounded in 3Q to -1.6% y/y from -8.4% y/y in 2Q. The seasonally adjusted y/y growth was -2,0%, which was the second smallest drop among EU countries that have reported to date. The quarter-on-quarter rebound (s.a.) was 7.7% (very close to our forecast 8%) and came after -9% q/q drop in Q2. The data confirmed that the economic revival in the third quarter was impressive. Of course the positive trend observed in 3Q will not continue in 4Q, as the new wave of pandemic hit and the new restrictions were implemented, limiting business activity in some areas. However, it is quite likely that the GDP drop in 4Q will be much smaller than in 2Q, as the restrictions are (still) less severe than in the spring and, more importantly, manufacturing is less likely to suffer a major blow amid continuing external demand (as the European industry appears to be less affected this time). Overall, we keep our 2020 GDP forecast at around -3%, with a potential for some downward revision if the pandemic-related restrictions escalate much further.

October CPI inflation was revised to 3.1% y/y from 3.0% y/y in flash reading (and versus 3.2% in September). Inflation was dragged lower mainly thanks to easing food prices (2.4% y/y in October vs 2.8% y/y in September), which went down mostly due to developments on the meat market, partially due to spread of ASF disease in Germany. Communication was another negative contributor (4.6% y/y vs 5.5% y/y one month earlier), as September rise in communication services seems to have been reversed. Organised tourism services fell by 3.4% m/m. Other categories were more or less in line with their usual patterns, but there are some upward exceptions: 1) heat energy went up by 0.9% m/m (highest rise in more than 5 years) due to higher prices of coal and CO2 emissions. This trend is likely to continue and to affect energy prices in the months to come. 2) financial services prices went up by 2.5% m/m and the low interest rate environment supports hikes in this sector. Core inflation most likely remained unchanged at 4.3% y/y or went a notch lower. We are expecting inflation to go down to 2.5% in December amid muted demand and to remain contained in 2021, allowing the MPC to comfortably leave rates unchanged.

Fresh NBP forecasts include new restrictions introduced at the start of November. It was assumed that restrictions will not be as strict as in the spring and that they will last for a shorter time. In 2021-2022 the economic activity will be improving gradually, but this process is likely to be hindered by renewed waves of infections and restrictions. Until end of 2020 inflation is expected to remain elevated, but in 2021 will go down due to weaker demand and only small improvement in business activity. The NBP sees downward risks for both GDP and CPI due to pandemic-related uncertainty. As regards the illness: the central bank assumes it will be contained within one year and then the economy will return to business as usual. NBP estimated that interest rate cuts by 140bp in 2020 added 0.2pp to GDP growth and 0.1pp to CPI. Impact of bond purchases programme is estimated at 0.1pp for GDP and 0.2pp for CPI. We also got to see October MPC minutes, but this document did not carry any piece of information beyond what we already know from Friday meeting.

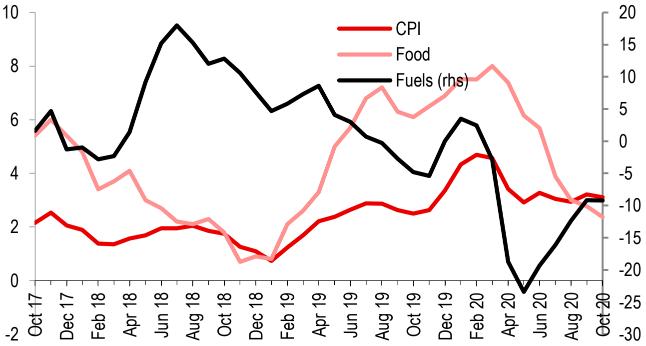
MPC's Eryk Łon, known for his dovish bias, thinks that November NBP forecasts support leaving NPB rates unchanged until end of 2022. In his view "it would be good to avoid negative interest rates".

GDP growth in 3Q2020, % y/y, sa



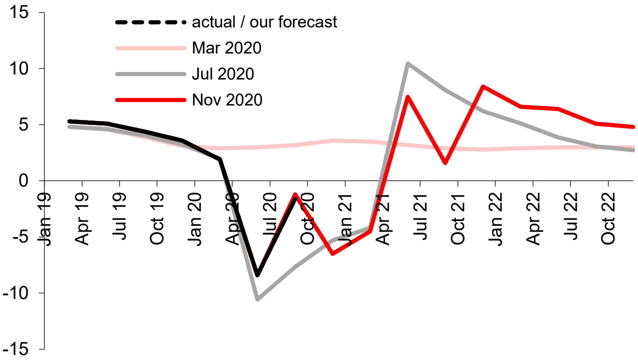
Source: Eurostat, Santander

CPI growth, main categories, % y/y



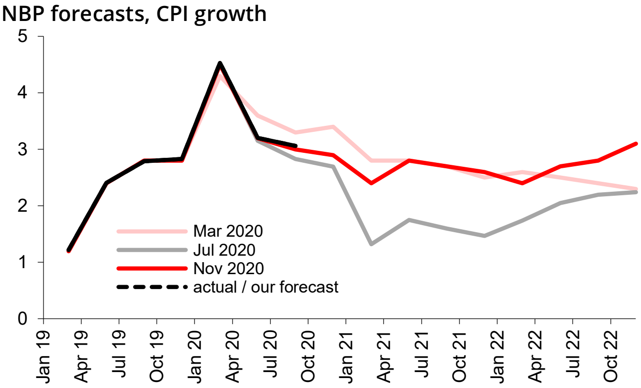
Source: GUS, Santander

NBP forecasts, GDP growth



Source: NBP, Santander

NBP forecasts, CPI growth



Source: NBP, Santander

FX and FI market

Last week on the market

FX Although the equity and bond markets showed a sharp response to the likely outcome of the US elections and to the information about vaccination for Covid-19, reaction of the FX market was rather muted. EURPLN fell below 4.46 for a while but at the end of the week was back near 4.48, only 0.3% below last Friday's low vs 2.15% drop recorded in the previous week. The passing week was also calm in the case of EURUSD – weekly trading range was the narrowest since mid-October. USDPLN was hovering in a tight range around 3.80 for the better part of the passing week. CHFPLN fell to 4.15 from 4.20, GBPPLN traded in a wide 4.95-5.05 range and closed the week near 5.0.

FI Polish IRS and bond yields jumped by 10-15bp on the belly and long end amid wide sell-off on the global bond market triggered by the news about the Covid-19 vaccination. By the end of the week, however, the 10Y yields neutralized around half of this move and closed at 1.21%. The 5Y bond recovered less and the IRS rates remained at an elevated levels. Despite a large moves seen during the week, the 10Y PL-DE bond yield spread traded in a narrow range around 176bp. The 10Y asset swap spread is in a down trend and this tendency has strengthened since the start of November taking the spread below 14bp, its lowest since July 2019.

Key factors to watch this week should still be new cases of Covid-19 and news from the US political scene. The last week showed that the news about the vaccination is not a protection against equity indexes drop but at the same time the outlook for it to be available in 2021 may limit the risk of an another wave of risk aversion amid rising number of coronavirus cases and next restrictions in some countries.

In Poland, we will see first economic activity data for October – labour market data and industrial output. Abroad, the market attention may focus on the US data releases.

In Hungary, the central bank will hold a meeting and we do not expect any changes. The outcome of the Turkey central bank may be more interesting since the market expects a 400bp rate hike.

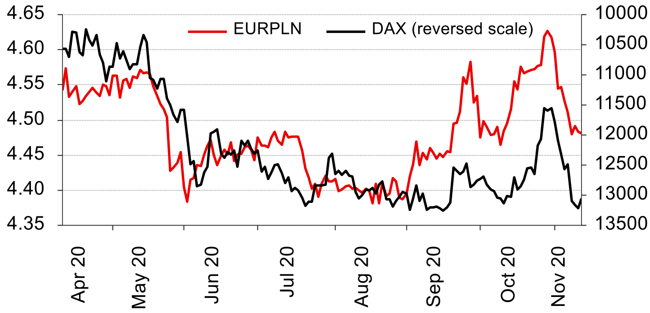
Market implications

FX This week's EURPLN low at 4.457 – close to the October low at 4.451 – and two moving averages (100- and 200-day) currently at c4.46-4.468 look to be a strong support for EURPLN that may limit the potential for further zloty appreciation in the short term. On the other hand, as long as we do not expect any substantial deterioration of the global market mood, there seems to be also little upside potential for EURPLN in the upcoming days. We think the exchange rate could stay in the 4.45-4.55 range next week.

The sentiment on the CEE FX market has been recently supported by a fast appreciation of the Turkish lira that gained more than 10% since it hit its fresh all-time-low vs the dollar on November 6. There is an option that the outcome of the Turkish bank meeting provides more support for the lira, which in turn might help its CEE peers.

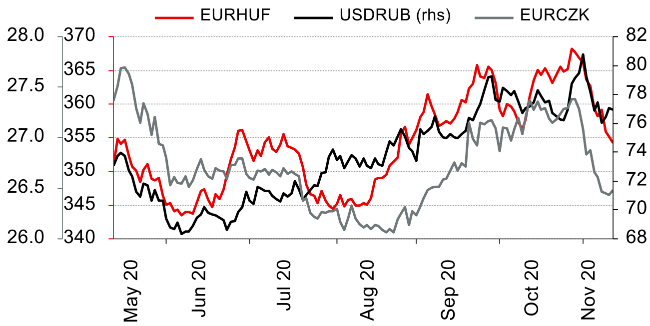
FI Both on the core and Polish fixed income market, the vaccination driven sell-off did not last long. However, this was the biggest upside correction in the yield's down move observed since August which may suggest it will take longer for the market to resume the strengthening trend. Dovish rhetoric of the ECB after the last meeting and outlook for a yet another leg of a slowdown amid anti-covid restrictions introduced in some countries should help bonds to recover gradually. Also, the likely result of the US elections – Joe Biden as a President and Senate under control of Republicans – makes the large fiscal stimulus less likely for now.

EURPLN and German DAX equity index



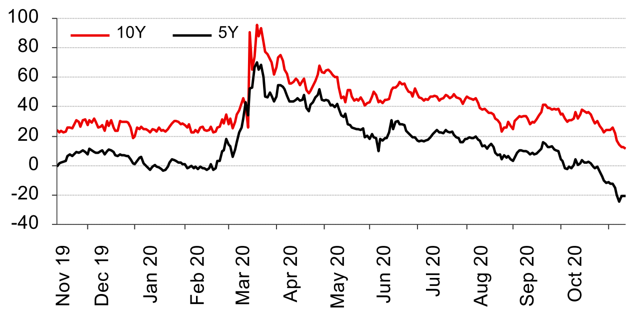
Source: Refinitiv Datastream, Santander Bank Polska

EURHUF, EURCZK and USDRUB



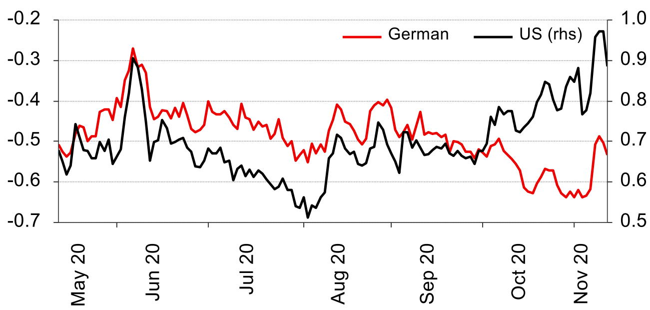
Source: Refinitiv Datastream, Santander Bank Polska

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 (16 November)					
14:00	**PL**	**CPI Core**	**Oct**	**% y/y**	**4.2**	**4.2**	**4.3**
		TUESDAY (17 November)					
14:00	HU	Central Bank Rate Decision		%	0.60	-	0.6
14:30	US	Retail Sales Advance	Oct	% m/m	0.5	-	1.9
15:15	US	Industrial Production	Oct	% m/m	1.0	-	-0.6
		WEDNESDAY (18 November)					
11:00	EZ	HICP	Oct	% y/y	-0.3	-	-0.3
14:30	US	Housing Starts	Oct	% m/m	2.1	-	1.9
		THURSDAY (19 November)					
10:00	**PL**	**Employment in corporate sector**	**Oct**	**% y/y**	**-1.1**	**-1.1**	**-1.2**
10:00	**PL**	**Average Gross Wages**	**Oct**	**% y/y**	**4.6**	**4.8**	**5.6**
14:30	US	Initial Jobless Claims	week	k	725	-	709
14:30	US	Index Philly Fed	Nov	pts	22.0	-	32.3
16:00	US	Existing Home Sales	Oct	% m/m	-1.6	-	9.36
		FRIDAY (20 November)					
10:00	**PL**	**Sold Industrial Output**	**Oct**	**% y/y**	**0.5**	**1.0**	**5.9**
10:00	**PL**	**PPI**	**Oct**	**% y/y**	**-0.8**	**-0.8**	**-1.6**

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg