05 March 2021

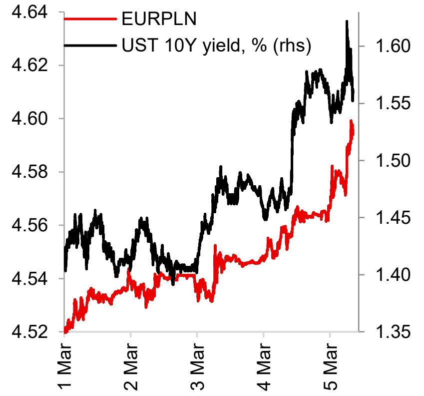
Weekly Economic Update

Projections have not influenced the MPC

What's hot next week

- The week will start with a **publication of NBP Inflation Report** and a presentation of the new NBP projections which - as we already know from the post-meeting MPC statement - were revised up from the November version, which prodded the financial market to price-in an even higher probability of rate hikes within the next few quarters.
- Today at the videoconference the NBP Governor Adam Glapiński referred to projection results, stressing that they did not change the monetary policy bias. In his view, the view the market is wrong and the **probability of rate hikes in the next two years is virtually zero**, as the headline inflation will remain very close to the official target and the core inflation will be falling (CPI being driven mainly by exogenous factors: prices of oil, energy, waste management). The NBP head asked about rising bond yields said they reflect rising optimism regarding economic outlook and he did not signal any intention to boost the NBP's QE to tame the trend. Also, he said he saw no possibility of ending QE in the coming years, and said that perhaps it will remain live forever. Glapiński's comments managed to tame market expectations regarding future rate hikes and lowered the short end of the curve. But for the long end the result may be eventually opposite – if investors get reinsured that the central bank will be waiting too long with the response to rebounding GDP and inflation, the yield curve may steeper further, as is currently the case in the USA.
- Apart from that, the next week's calendar mostly includes events abroad: data on inflation (Czechia, Hungary, Germany), production (Germany, Czechia, Eurozone) plus the **ECB meeting** and possibly the **final decisions regarding the next US fiscal package** (current social benefits expire on 14 March). Particularly important may be the latter two events: the ECB response to the current market situation, the final shape of the US stimulus package and its approval will be key to extension of the current rise of yields or their correction. In our view the former is more probable.

Performance of the złoty and US bonds



Source: Bloomberg, Santander

Market implications

- The general sentiment in the global financial markets (rising yields, falling equities, stronger dollar) is not favourable for EM currencies. Moreover, the risk of NBP intervention and the uncertainty ahead of the Supreme Court ruling in the FX loans case weigh on the zloty. Also, the CEE region again looks very bad on the map of Covid-19 infections in Europe. We do not rule out that EURPLN may test 4.65 in the coming days.
- The key for Polish bonds seems to be the trend in the US debt market. A clear correction of the strong upward trend cannot be ruled out if, for example, the final stage of work on the US fiscal package encounters a serious problem (a delay or reduction in size). But for now we see higher risk that the selloff in UST and POLGBs will continue.

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Last week in the economy

Apart from another surprisingly strong PMI print, last week brought the first news regarding the NBP projection update: the central bank now has one of the most bullish GDP forecasts on the market and expects inflation to stay above the target in 2021, 2022 and 2023 (albeit below the upper bound of tolerable deviations).

Polish **manufacturing PMI** pushed in February to 53.4 pts from 51.9 pts, the highest level since mid-2018. Increased demand, domestic and from abroad (highest reading of export orders index since September 2017), put additional pressure on the already strained supply chains. Output index came back to the expansion territory, companies searched for additional employees and intensified their purchasing activity, while utilising their stocks of input as new deliveries were facing delays. Such setup caused a steep rise in input costs and their transmission to clients – the output price index hit the highest level since May 2004. The material shortages are a growing upside risk to inflation outlook for this year, but at the same time we do not expect them to derail the further growth of industrial production.

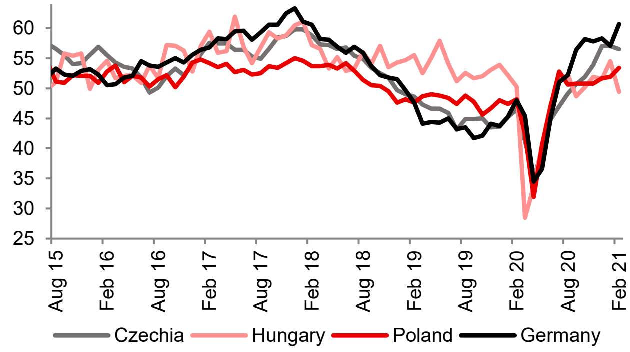
Seasonally adjusted **LFS unemployment rate** decreased in January to 3.1% from 3.2% in December, which means that it was only marginally higher than a year ago (3.0% in January 2020). What is more, it is now the lowest in the entire EU – so far Czechia was in the lead, but saw a rise to 3.2%. Average LFS unemployment rate in the EU is 7.3% vs 6.6% a year ago. In turn, according to the Labour Ministry's estimates, in February the **registered unemployment rate** was 6.6% after a rise of the number of the unemployed by 10.2k. This is quite surprising as in the previous years there was typically a m/m fall in February and the reopening of shopping malls and hotels should have encouraged more hiring.

In 2020, 406.5k **work permits for non-residents** were issued, 8.6% less than in 2019 (-8.7% y/y in 1H20, -8.5% in 2H20). Permits for Ukrainians fell by 10.6% y/y in 2H20 while for the next most popular nations rose (Belarussians +6.4%, Indian +7.5%).

The **Monetary Policy Council** kept all the policy parameters unchanged, with the main rate at 0.10%. The NBP staff projections update resulted in an even higher CPI path than in the November edition (the mid-point for 2021 up to 3.15% from 2.5%, 2022 up to 2.8% from 2.6%) and a substantial upgrade of 2021 GDP growth (3.95% vs 2.65% previously). For the first time the projection covered 2023 and showed that inflation is going to stay much above the official target then (mid-point at 3.2%) while GDP growth is going to be 5.4%, as in 2022. Despite this clearly bullish changes to the forecasts, the tone of the MPC statement did not change. We think that we will now hear much less about the possibility of rate cuts from the MPC. But at the same time, it still seems very far away until the central bank starts changing its rhetoric towards more hawkish. Overall, we do not change our view that interest rates will remain on hold at least until the end of the MPC's term of office (early 2022).

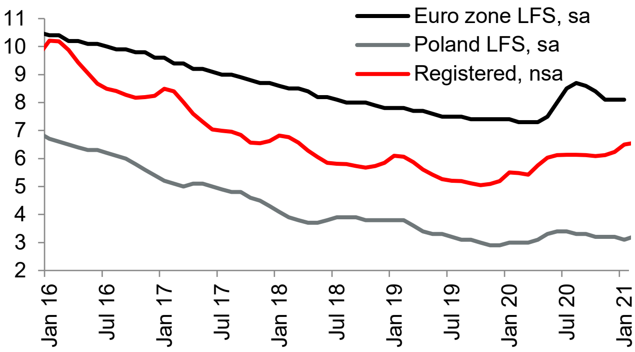
Moody's rating agency lowered Poland's GDP growth forecast in 2021 to 3.3% from 4% and in 2022 it expects a 3.8% growth. This is currently one of the lowest Polish growth forecasts on the market and the decrease goes against the current trend. The next Polish rating review by Moody's is planned for 30 April 2021.

Manufacturing PMIs



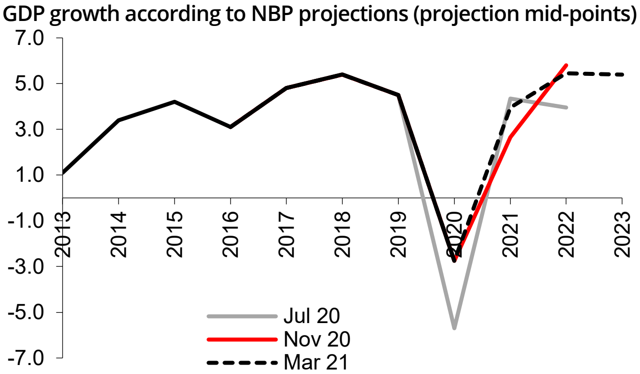
Source: Markit, Santander

Unemployment rate, %



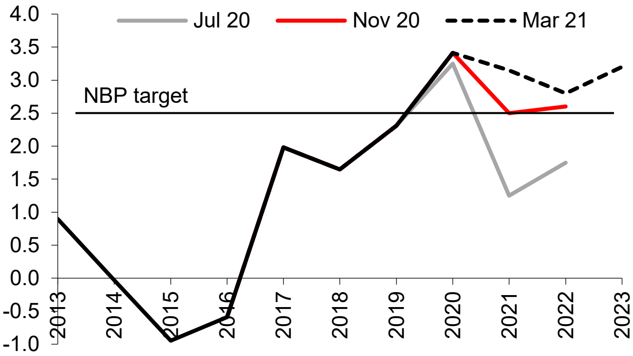
Source: Eurostat, Labour Ministry, Santander

GDP growth according to NBP projections (projection mid-points)



Source: NBP, Santander

CPI growth according to NBP projections (projection mid-points)



Source: NBP, Santander

FX and FI market

Last week on the market

FX The strengthening of the US dollar in the passing week (dollar index up 1.1%) put pressure on the EM currencies in general and the zloty was no exception. EURPLN increased to 4.576 or by 1.2% w/w while USDPLN to 3.837 or by 2.5%. CHFPLN has not changed much (4.125) due to the EURCHF rise, while GBPPLN also noticeably increased by 1.8% w/w to 5.313. EURPLN implied volatilities have barely increased however are very close to technical levels breaking of which would imply an exit from a low-volatility mode.

The other CEE currencies depreciated as well. EURHUF grew 1.2% to 366.5 and the local data was not helpful for the forint – February manufacturing PMI fell by 5.5pp to 49.4. EURCZK gained 0.6% as the Covid-19 situation in Czechia weighs on the currency despite decent manufacturing PMI at 56.5. USDRUB was the clear outperformer during the week – down 0.2% - oil prices marched higher as Saudi Arabia decided to limit supply by 1m barrels per day for another month (or perhaps even till end of April). Even rising US yields have not managed to weaken the rouble.

FI Polish IRS and bond yields surged another 10-20bp and the pace of the move accelerated towards the end of the week. The move happened despite the Bund being relatively stable throughout the week (near -0.30%) but rather in line with UST yields increase of c.15bp to 1.55% after Fed's Jerome Powell failed to assure markets that the Fed would help keep the yield curve in check if needed. The spread to Bund closed the week at 196bp, the Polish 10Y bond at 1.66%. 10Y ASW decreased to -0.23% as 10Y IRS moved above 1.90%. The 2x10 steepness of the IRS curve at 126bp is highest since 2013. The Ministry of Finance has held a switching bond auction on Thursday, at which it has bought back four series of bonds (PS0421, OK0521, PS0721, DS1021) worth PLN3.44bn in total and sold bonds worth PLN3.56bn (OK0423, PS1026, WZ1126, WZ1131). After the tender the budget's gross borrowing needs have been financed in 55%.

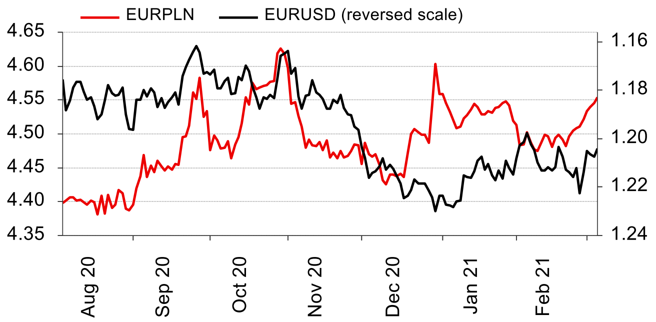
Next week the is no important data from Poland but details of the new central bank's GDP and CPI forecasts will be presented on Monday. Abroad, on Monday German industrial production, on Tuesday German exports. On Wednesday US CPI. Hungary and Czechia also publish February inflation numbers (on Tuesday and Wednesday, respectively). ECB decides on rates on Thursday, University of Michigan sentiment index and Eurozone industrial production are published on Friday.

Market implications

FX EUR/PLN is likely to continue its march higher in the coming week first of all as a function of the rising market-implied US real rates (10Y at -0.66% as we write, up 5bp w/w) but also as a function of local factors: the ruling regarding the CHF mortgages takes place on 25 March. Regardless of the outcome of the ruling, some investors might simply want to cut FX risk prior the even and perhaps reopen later on once the dust settles (uncertainty declines). Also, the FX volatility market is slowly waking up suggesting that we might soon exit the low-volatility mode. We expect EURPLN to trade above 4.60 in the upcoming week.

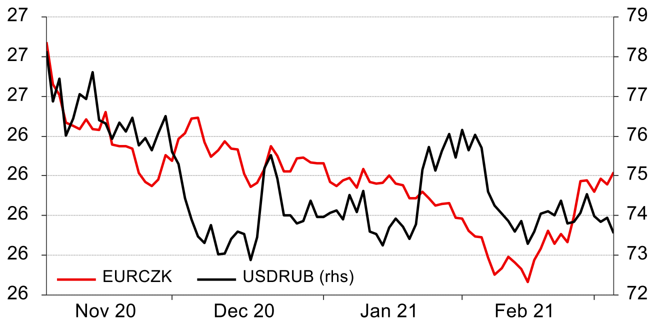
FI Polish market interest rates are likely to remain volatile as they follow the dynamically rising core market yields and the momentum persists. After a pretty decent moves have happened so far one cannot exclude a consolidation or even a small correction on the core markets. Especially in case that the widely expected US fiscal package becomes toned down a bit or delayed while on Thursday the ECB will react in some way to the bond market sell-off. We think, however, that the odds are slightly tilted to the continuation of the yield increases scenario and expect the IRS curve to steepen even more from current historically elevated levels.

EURPLN and EURUSD



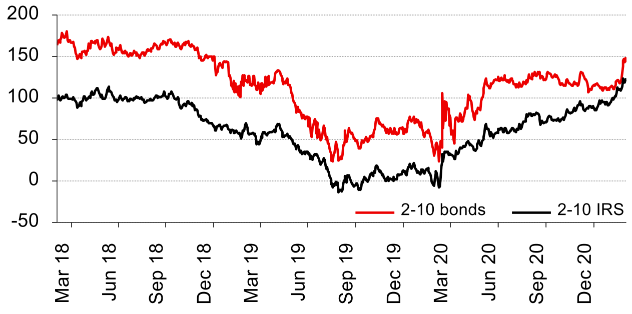
Source: Refinitiv Datastream, Santander Bank Polska

EURCZK and USDRUB



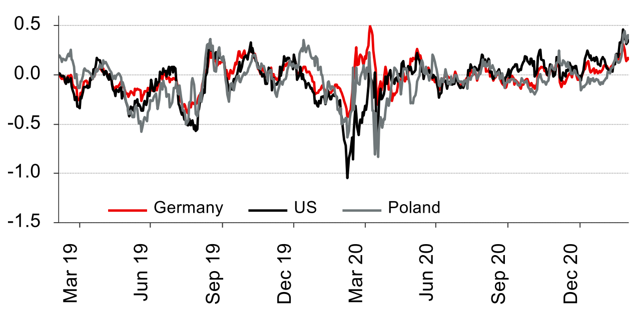
Source: Refinitiv Datastream, Santander Bank Polska

Poland 2-10 spreads



Source: Refinitiv Datastream, Santander Bank Polska

Nominal 4-week change of 10Y bond yields (pp)



Source: Refinitiv Datastream, Santander Bank Polska

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Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST SANTANDER	LAST VALUE
			MONDAY (8 March)				
08:00	DE	Industrial Production SA	Jan	% m/m	-0.5		0.0
10:00	**PL**	**NBP Inflation Report**					
			TUESDAY (9 March)				
08:00	DE	Exports SA	Jan	% m/m	0.0		0.1
09:00	HU	CPI	Feb	% y/y	3.1		2.7
11:00	EZ	GDP SA	4Q	% y/y	-5.0		-5.0
			WEDNESDAY (10 March)				
09:00	CZ	CPI	Feb	% y/y	2.2		2.2
14:30	US	CPI	Feb	% m/m	0.4		0.3
			THURSDAY (11 March)				
13:45	EZ	ECB Main Refinancing Rate	Mar.21	%	0.0		0.0
14:30	US	Initial Jobless Claims	Mar.21	k	750.0		745.0
			FRIDAY (12 March)				
08:00	DE	HICP	Feb	% m/m	0.5		0.6
09:00	CZ	Industrial Production	Jan	% y/y	-4.5		5.8
11:00	EZ	Industrial Production SA	Jan	% m/m	-0.5		-1.6
16:00	US	Michigan index	Mar	pts	78.0		76.8

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.