17 May 2019

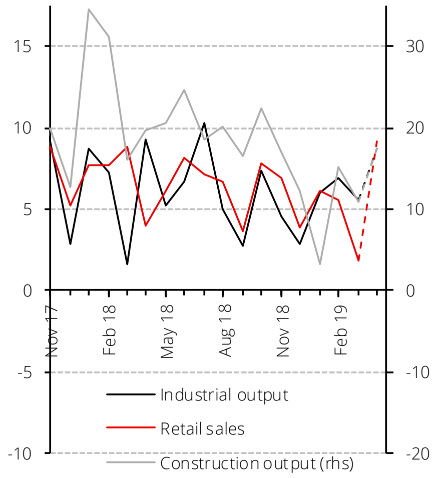
Weekly Economic Update

Strong start of 2Q

What's hot next week

- This week we will get some information how the Polish economy is performing at the start of 2Q after the slowdown recorded in 1Q. Our forecasts of April industrial output and retail sales are above the market consensus. These releases should confirm that the economic growth deceleration is very gradual and the Polish economy remains resilient to the lower economic activity in Europe.
- We forecast Poland April average wage growth in the corporate sector reaccelerated vs March fitting the picture of tensed labour market.
- The data on nonfinancial corporations' results for 1Q will help assess if the process of margin recovery has already started and how strong is the cost pressure, including the wage bill part of costs. The previous readings signalled a significant margin squeeze and a 40-percent drop of net financial result. This is a key factor for our forecast of rising inflation this year. Business and consumer sentiment indicators for May are also due in the coming week.
- As regards the European economic outlook, flash May manufacturing and services indexes are on the agenda. In April, manufacturing indexes for Germany and whole euro zone rose after eight consecutive months of a decline, giving hope that the bottom of the economic activity has already been reached. May's releases could be key if these hopes are to last.
- The FOMC minutes shall not convey much new information and should be rather market-neutral.
- European Parliament elections will be held in the coming week.

Output and sales (in real terms), % y/y



Source: GUS, Santander

Market implications

- Swings of the global market sentiment shall continue to play the main role on the Polish FX. If flash manufacturing PMIs rise, the euro might gain vs the dollar making room for lower EURPLN. Taking a broader look at the market, we do not expect EURPLN to leave the 4.24.4.36 range in the weeks to come.
- We do not expect the Polish yields free-fall to continue at the such high pace like in the previous days as the down impulse of the 10Y Treasury yield slowed at the 2.37% support level and Polish economic activity data may surprise to the upside.

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Last week in economy

The passing week has given us insight about were the economy stood at the turn of the quarter: the GDP growth in 1Q proved slightly stronger than expected and not much lower than in 4Q18. Also, the first month of 2Q was marked by a strong rise in inflation, including a further increase in core CPI growth. MPC stayed calm confronted with the data, sticking to the rhetoric of CPI likely to stay within the acceptable distance to the target in the monetary policy horizon of incoming slowdown to curb the upside move of inflation in the medium term.

According to a flash estimate, **GDP growth in Poland in 1Q19** was 4.6% y/y, slightly above forecasts (Santander: 4.5%, market consensus 4.4%) vs 4.9% in 4Q18. Seasonally adjusted growth was 1.4% q/q. The growth structure will be revealed on 31 May. We suspect that strong domestic demand played important role. We estimate that net export most likely had positive contribution to growth as well (near 1pp), as March balance of payments data (EUR+0.5bn C/A surplus vs. EUR-1.2bn market expectations plus a large revision of February deficit to EUR0.3bn from EUR1.4bn) showed that foreign trade balance improved substantially in 1Q in y/y terms. The Polish economy is so far quite resilient to the global economic slowdown, but we think GDP growth will decrease further in the coming quarters.

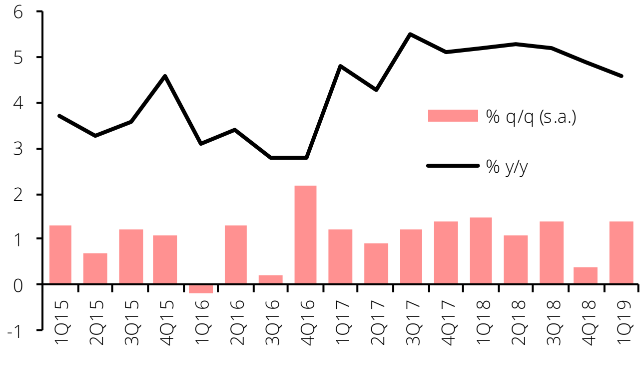
Final data on April CPI confirmed the surprisingly strong rise to 2.2% y/y. Services inflation accelerated significantly to 3.6% y/y from 2.7%. Prices of goods rose 1.7% y/y vs 1.3% y/y in March. Core inflation rose from 1.4% y/y to 1.7%, the highest level in more than six years. The price growth acceleration vs March was mainly an effect of three factors – higher food prices, dwelling costs and transport costs. Read more in our Economic Comment.

The **MPC** kept interest rates unchanged, as expected, with the main rate at 1.50%. Neither the official statement nor rhetoric changed, with the NBP president's views still dominating. The recent rise of CPI, despite coming as a surprise to the Council, was downplayed and said not to be enough to change the views of the policymakers. Glapiński did not rule out the possibility that CPI may exceed 3.5% at the end of this year, but he expected it would subsequently decline. Moreover, the MPC views the recent rise of core inflation as a mere normalisation, and does not expect a further increase. The argument against a persistent increase of inflation is based on expectations for an economic slowdown. In our view, core inflation will continue its upward march, and so will headline CPI. However, we are still quite far away from a point when a serious discussion about monetary tightening could start - it is possible in 1H20 at the earliest, in our view, assuming that inflation exceeds 3% and economic growth does not decelerate sharply.

Going back to **March data on current account balance,** imports were the main cause of a relatively high trade balance: March reading was EUR1.7bn lower than expected (growing only 1.4% y/y, the lowest since July 2016) and February data was revised down by EUR1bn. We have not recorded any unexpected weakness in domestic demand, so this is a bit puzzling. 12M rolling sum of C/A to GDP suddenly rose in March from -0.7% to -0.4%.

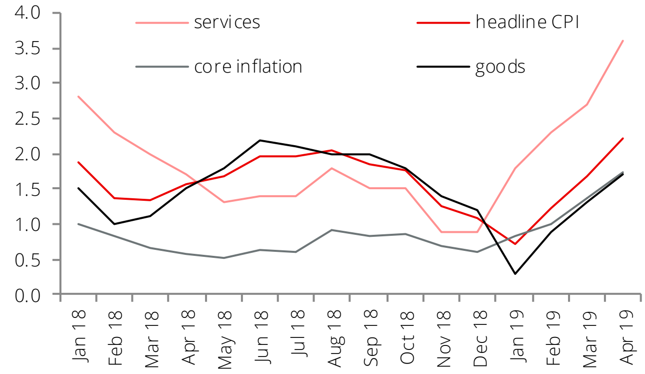
According to GUS, the **average growth of wages in the national economy in 1Q19** was 7.1% y/y. This is a bit below 4Q reading, 7.7% y/y, but still above average wage growth recorded in the enterprise sector (6.7% y/y), which covers a smaller sample of employees. The data support expectations that private consumption growth should remain decent in the coming quarters, being additionally boosted by higher social transfers. We do expect tensions on the labour market to persist, which should keep wage growth elevated, gradually adding to inflationary pressure.

GDP growth in Poland



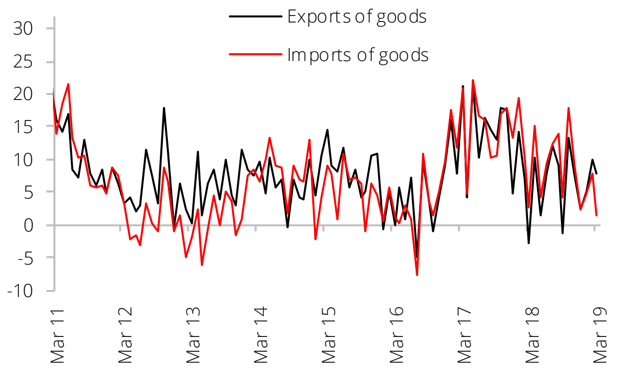
Source: GUS, Santander

Inflation measures, % y/y



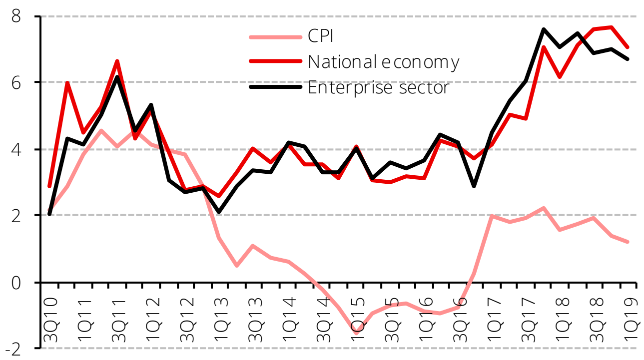
Source: GUS, NBP, Santander

International trade, %y/y



Source: NBP, Santander

Wage growth vs inflation, %y/y



Source: GUS, Santander

FX and FI market

Last week on the market

FX EURPLN was on the rise in the first part of the week amid the continued drop of the equity prices. The exchange rate reached its highest level since early March at c4.315 but at the end of the week the correction to 4.295 was recorded as the global mood improved. USDPLN held at an elevated level reached in the previous weeks at around 3.83, CHFPLN rose temporarily above 3.82 from 3.78 while GBPPLN fell to 4.90 from nearly 5.00.

FI Bond yields and IRS rates continued the free-fall started in early May as Bunds and Treasuries added gains amid the heightened concerns about the global economic growth. As a consequence, Polish 5Y and 10Y bonds neutralized all of the losses suffered in late April in response to the Polish and European inflation data.

Key events

In the coming week, we will see important Polish and European data while the Fed is to release minutes from the last FOMC meeting.

Poland industrial output and retail sales data will help to assess how the domestic economy is doing at the start of the 2Q after growth deceleration in 1Q. Our forecasts are well above the market consensus.

In Europe, flash May manufacturing PMIs are on the agenda. In April, indexes for Germany and whole euro zone rose after eight consecutive months of a decline, giving hope that the bottom of the economic activity has already been reached.

The FOMC minutes shall not convey much new information and should be rather market-neutral.

Market implications

FX Swings of the global market sentiment shall continue to play the main role on the domestic market. Looking at the data calendar, the flash May manufacturing PMIs should be the most watched. European stock indexes started to rebound after the biggest correction in the upside trend observed since last 2018. Should flash manufacturing PMIs rise for the second month in a row, market concerns about the economic growth in Europe could ease, the euro might gain vs the dollar making room for lower EURPLN.

On the domestic FX market, we do not expect any meaningful reaction to the Polish macro data but positive releases may allow the zloty to outperform its CEE peers.

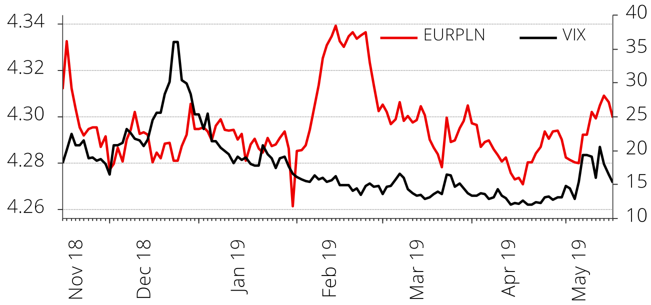
Taking a broader look at the market, we do not expect EURPLN to leave the 4.24.4.36 range in the weeks to come.

FI The market environment has recently become more positive for the debt as the concerns about the global economic growth strengthened. Polish bonds have clearly benefited from the elevated risk aversion but we do not expect the yields free-fall to continue at the such high pace like in the previous days.

Global stocks started to recover and the 10Y Treasury yield slowed the down impulse at the 2.37% support level. The 20-day Polish-US 10Y bond yield correlation rebounded from its cyclical low of -50% and is now at c43%. Should the 10Y UST does not break the support level and we assume the correlation could rise further towards its cyclical peak at c90%, the Polish long-term benchmark could give up part of its recent gains.

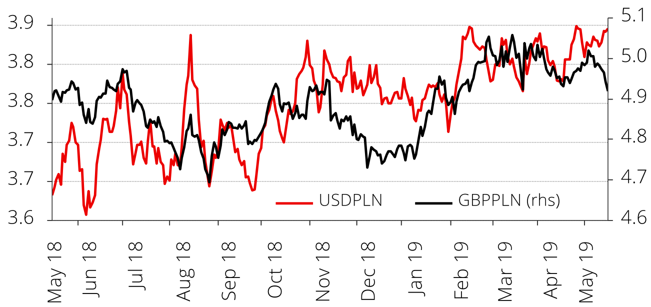
Poland flash 1Q19 GDP headline figure surprised to the upside only slightly and failed to trigger any meaningful market reaction. However, our forecasts of April industrial output and retail sales are well above the market consensus and if we are right, then domestic releases may add upside pressure on the Polish yields.

EURPLN and VIX



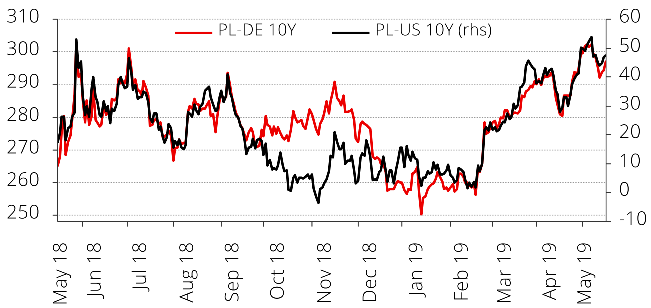
Source: Thomson Reuters Datastream, Santander Bank Polska

GBPPLN and USDPLN



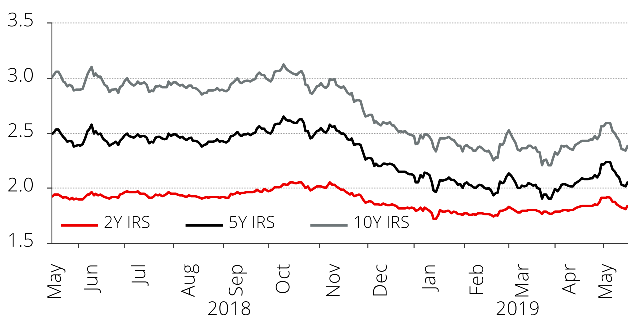
Source: Thomson Reuters Datastream, Santander Bank Polska

Poland 10Y bond yield spreads vs Bund and UST



Source: Thomson Reuters Datastream, Santander Bank Polska

Poland IRS rates (%)



Source: Thomson Reuters Datastream, Santander Bank Polska

Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST SANTANDER	LAST VALUE
			MONDAY (20 May)				
14:00	**PL**	**MPC minutes**					
			TUESDAY (21 May)				
10:00	**PL**	**Employment in corporate sector**	**Apr**	**% y/y**	**3.0**	**3.1**	**3.0**
10:00	**PL**	**Average gross wages in corporate sector**	**Apr**	**% y/y**	**6.5**	**6.7**	**5.7**
16:00	US	Existing Home Sales	Apr	% m/m	2.5	-	-4.9
			WEDNESDAY (22 May)				
10:00	**PL**	**Sold industrial output**	**Apr**	**% y/y**	**8.7**	**8.7**	**5.6**
10:00	**PL**	**PPI**	**Apr**	**% y/y**	**2.5**	**2.7**	**2.5**
20:00	US	FOMC meeting minutes					
			THURSDAY (23 May)				
08:00	DE	GDP	1Q	% y/y	0.7	-	0.7
09:30	DE	Flash manufacturing PMI	May	pts	44.8	-	44.4
09:30	DE	Flash services PMI	May	pts	55.4	-	55.7
10:00	DE	IFO Business Climate	May	pts	99.2	-	99.2
10:00	EZ	Flash manufacturing PMI	May	pts	48.2	-	47.9
10:00	EZ	Flash services PMI	May	pts	53.0	-	52.8
10:00	**PL**	**Construction output**	**Apr**	**% y/y**	**18.3**	**17.4**	**10.8**
10:00	**PL**	**Retail sales real**	**Apr**	**% y/y**	**8.5**	**9.2**	**1.8**
11:30	**PL**	**Bond switch auction**					
14:30	US	Initial jobless claims	week	k	220	-	212
16:00	US	New home sales	Apr	% m/m	-2.2	-	4.5
			FRIDAY (24 May)				
14:00	**PL**	**Money supply M3**	**Apr**	**% y/y**	**10.1**	**10.2**	**9.9**
14:30	US	Durable goods orders	Apr	% m/m	-2.0	-	2.8

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg

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