14 September 2018

# Weekly Economic Update

## Verifying the slowdown

### What's hot next week

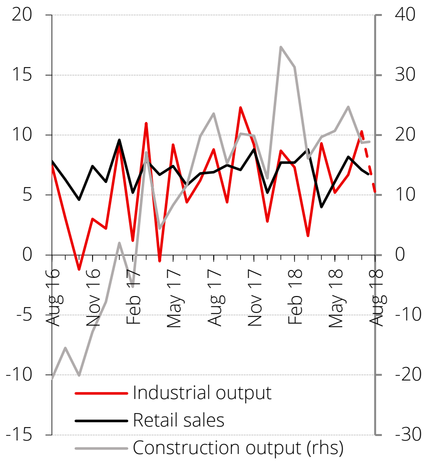
- The week will be dominated by Polish releases. We will get the whole set of readings about August economic activity plus business and consumer sentiment indicators for September. The second part of the hearing of Poland in the EU, regarding rule-of-law breaches is also on the agenda on Tuesday.
- August PMI for Polish manufacturing was a warning sign that things are about to get worse. This week we will be able to verify this not only by checking real data for August (output on Wednesday and retail sales on Friday), but also by taking a glimpse at Stats Office business sentiment indicators for September (due Friday). The latter also collapsed in August as far as the overall and industry indices are concerned. Industrial output, which positively surprised in July with a 10%+ y/y reading, the highest this year, might have decelerated to c5%. Retail sales were supported by payouts of the new school kit benefit, adding to the strong financial situation of households. Retail sales growth could nevertheless slip from 7-8% y/y from June and July to 6.5%. Construction output probably kept growing at a high pace (we forecast 19% y/y) given the looming local elections.
- While we still expect wages to accelerate this year, the upcoming August reading may be below 7% y/y for the first time since March due to working day differences. Corporate employment could also grow a bit slower than in July, 3.4% y/y vs 3.5% previously as the solid labour demand clashes with limited remaining labour force.
- On Tuesday the Article 7 procedure vs Poland continues, with the second part of the hearing regarding rule-of-law. The next step would be a vote on sanctions (with a likely veto of Hungary). Last week the European Parliament approved triggering the Article 7 procedure for Hungary. Until now, there has not been any major market reaction to starting the procedure against Poland as the market views the risk of sanctions being imposed as low (and this looks to be reasonable for now).
- There will not be many key data releases in major economies this week. Preliminary PMIs will be out on Friday. On Thursday the EU summit starts, devoted to Brexit issues.

**Market implications:**

- Polish output and retail sales data should be neutral for the zloty and could be moderately positive for bonds.
- The Turkish central bank hiked interest rates and this might improve the sentiment on the emerging markets at least in the short term with the zloty and bonds benefiting from this.
- We expect Polish yields/IRS to stabilize below the local peaks in the coming days and EURPLN will be waiting for the EURUSD reaction to the flash PMI data.

### Graph of the week

**Indicators of real economic activity, % y/y**




*Source: Stats Office, Santander Bank Polska*

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## Last week in economy

The final print of **August CPI** confirmed what we had seen in the flash publication: inflation stayed at 2% y/y. However, its breakdown changed markedly. In August, services' prices rebounded to 1.8% y/y from 1.4% y/y after their 1H18 descent from 2.8% to 1.4%, despite the tight labour market generating substantial wage pressure. Vegetable prices fell less than usual in August, reflecting the impact of the drought. Core CPI accelerated to 0.9% y/y in August from 0.6% y/y in July; we expect that this will be the beginning of an upward trend that could take core inflation to 1.3% y/y at the end of this year and around 2.5% at the end of 2019. At the same time, headline CPI could ease somewhat to 1.7% y/y in December due to the base effect in food and fuel prices, in our view.

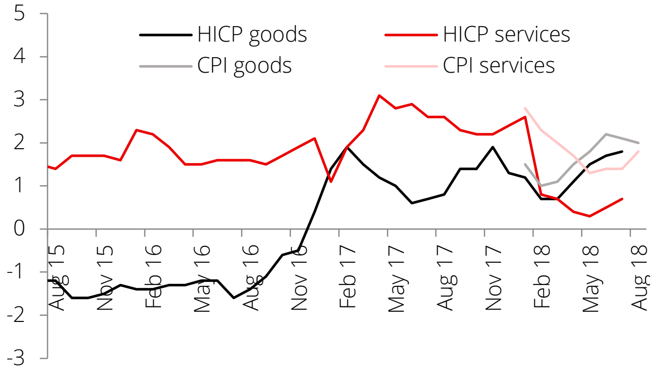
**July's current account** deficit, at EUR 809 million, was higher than expected (EUR 659 million). The trade balance, at a deficit of EUR 432 million, was some EUR 80 million below consensus. The deviation from forecasts was caused by stronger-than-expected imports. Imports grew 11.6% y/y, the fastest pace since February, and higher than the 1H18 average of 8.2%, but supported by working day differences. Exports grew 9.8% y/y (we estimated they would grow around 10%). We expect to see a slowdown in both in the months to come on deteriorating business sentiment (in August, new orders from abroad in the PMI survey suddenly collapsed to the weakest level in four years). Still, we expect imports to outpace exports thanks to strong support from domestic demand. The 12M moving sum of the C/A balance decreased from 0 to -0.1% of GDP, and the gap may widen to -0.6% at the end of the year. The NBP's comments on the trade data stresses some possibly one-off items boosting exports (helicopters and subway carriages), while on the imports side, the largest growth was recorded among various energy commodities as well as passenger cars.

**Labour demand in 2Q** stabilised in y/y terms. Number of newly created jobs rose by only 1.7% y/y vs 19.5% and 14.4% in the previous quarters. New jobs corrected for job destruction rose 4.8% y/y, while since mid-2016 the measure was growing by 15-42% (with an average of 28% y/y). At the same time, vacancy statistics show that the labour shortage has been intensifying. In 2Q, as much as 25.3% out of all newly created jobs remained vacant at the end of the quarter. This is a sizeable increase vs 1Q (14.4%) and given that, during the previous three years this indicator moved between 8% and 17%. As a result, the growth rate of total vacancies reached 25% y/y, up from 28% in 1Q, while the growth rate of vacancies among newly created jobs jumped from 35% y/y to 72%. This should support further acceleration of wages in the economy, albeit the August deterioration of business sentiment , if it were to last, it may decrease labour demand with time.

NBP released a draft of its **monetary policy guidelines for 2019**. The document does not include any meaningful changes compared to previous years, the inflation target is to stay at 2.5% y/y. According to the central bank, the biggest risk factor for the Polish economy would be the intensification of foreign trade tensions.

The government set the **2019 minimum wage** at PLN2250, up 7.1% vs this year's level, close to information in the local press from late August and higher than the original plan of the government to raise it by 5.7%. It is also a level that supports our c8% forecast of wage growth in national economy in 2019.

**Growth of goods and services prices, % y/y**

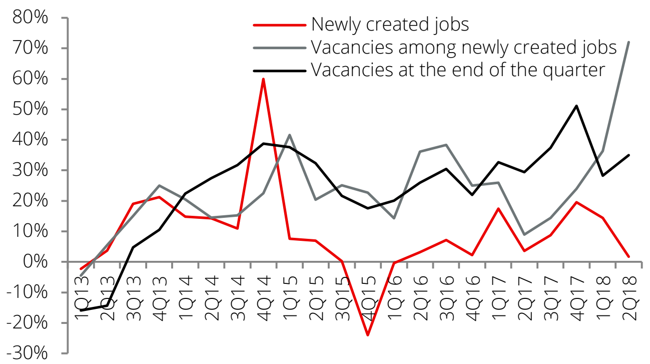



*Source: Stats Office, Eurostat, Santander Bank Polska*

**Growth of trade turnover, % y/y**

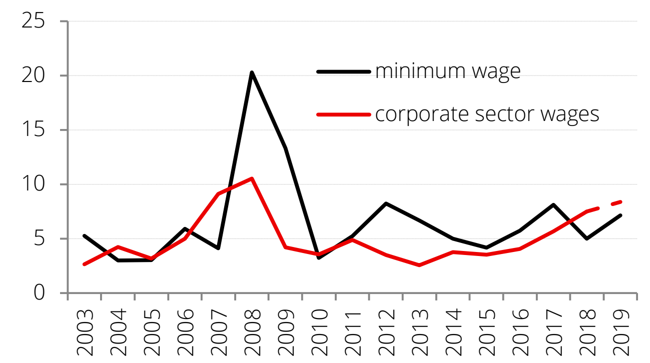

*Source: NBP, Santander Bank Polska*

**Labour demand and vacancies, % y/y**




*Source: Stats Office, Santander Bank Polska*

**Wage growth, % y/y**




*Source: Stats Office, Santander Bank Polska*

# FX and FI market

## Last week on the market

**FX** The passing week has been pretty positive for the Polish currency. The zloty gained versus main currencies thanks to the sharp rate hike delivered by the Turkish central bank and EURUSD rise triggered by the ECB rhetoric. As a result, EURPLN fell to 4.30 from 4.32, USDPLN to 3.68 from 3.75, CHFPLN to 3.80 from 3.86 and GBPPLN to 4.82 from 4.85.

**FI** Polish yields and IRS stabilized after the rise seen in the previous weeks, and belly and long end of the bond curve saw some strengthening. Both curves flattened while the asset swap spreads and the 10Y spreads vs Bund and Treasuries narrowed.

## What to watch for next week

Next Poland's macro data are on the agenda. Our forecasts for August industrial output and retail sales are below market consensus.

On the global market, we will see US real estate market data and flash estimates of September PMIs for the euro zone.

Next week will be the last before the FOMC decision.

Hungarian central bank will make a decision on the interest rates.

## Market implications

**FX** Our forecasts for Polish output and retail sales data are below the market consensus but not far enough to trigger a meaningful market reaction, in our view. We think domestic figures should be at least neutral for the zloty.

The Turkish central bank hiked interest rates and this might improve the sentiment on the emerging markets at least in the short term with the zloty benefiting from this.

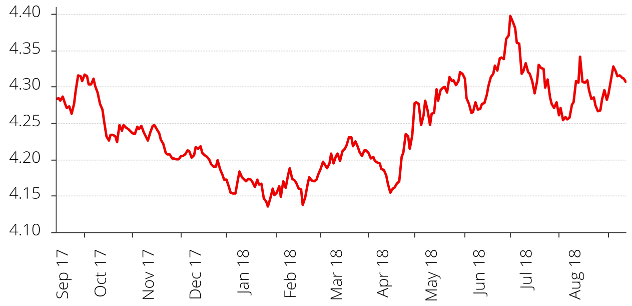
The euro zone manufacturing PMI index is holding at its multi-month low contributing to the euro weakness vs the dollar. Flash estimates for September to be released at the end of the next week could trigger EURUSD reaction. We see that EURPLN-EURUSD correlation is holding strong and so the European data might influence the zloty. The past week showed that even positive signals for the euro do not have to prevent the zloty from gaining vs the single currency.

**FI** We expect Polish yields/IRS to stabilize below the local peaks in the coming days. The situation on the emerging markets seems to have stabilized a bit (after the Turkish bank hiked rates) which could encourage investors to buy Polish bonds at attractive yields after the weakening seen in the previous weeks.

Polish retail sales and industrial output data should confirm the trend of a gradual economic slowdown reinforcing the view of a no rate hike in the coming quarters. We think the coming domestic macro data may be slightly supportive for the Polish bonds.

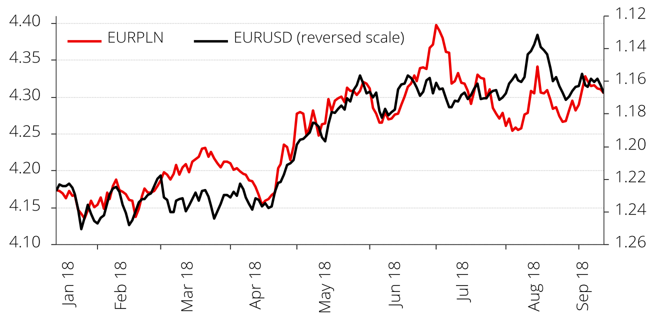
On the other hand, the negative pressure could come from the core market. The 10Y Bund yield broke its local peak from late August and this opens door for more upside waiting for the FOMC rate hike that is widely expected to be delivered in the final week of September.

### EURPLN



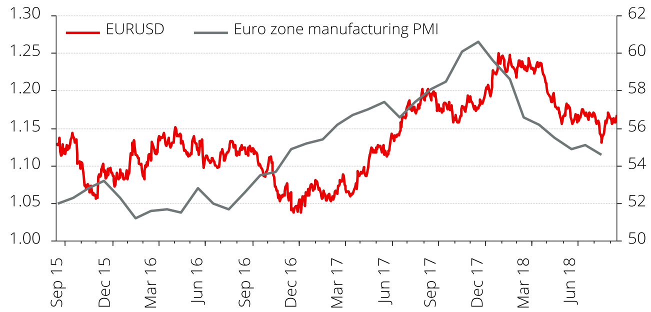

Source: Thomson Reuters Datastream, Santander Bank Polska

### EURPLN and EURUSD



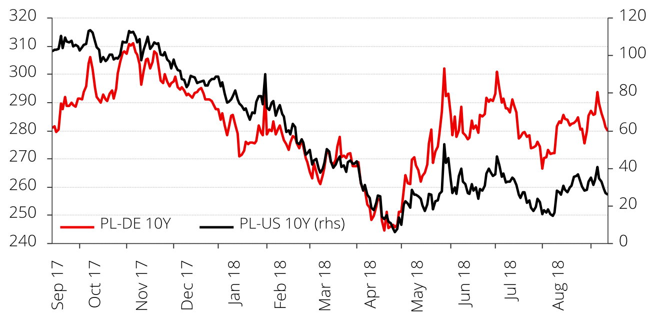

Source: Thomson Reuters Datastream, Santander Bank Polska

### EURUSD and Euro zone manufacturing PMI




Source: Thomson Reuters Datastream, Santander Bank Polska

### 10Y yield spread vs Bunds and Treasuries




Source: Thomson Reuters Datastream, Santander Bank Polska

Economic Calendar

| Time | Country | Indicator | Period | | Forecast | | Last |
|---|---|---|---|---|---|---|---|
| Cet | | | | | Market | Santander | value |
| | | Monday (17 September) | | | | | |
| 11:00 | EZ | HICP | Aug | % y/y | 2.0 | 2.0 | |
| | | Tuesday (18 September) | | | | | |
| **10:00** | **PL** | **Employment in corporate sector** | **Aug** | **% y/y** | **3.5** | **3.4** | **3.5** |
| **10:00** | **PL** | **Average Gross Wages** | **Aug** | **% y/y** | **7.0** | **6.9** | **7.2** |
| 14:00 | HU | Central Bank Rate Decision | | % | 0.9 | | 0.9 |
| | | Wendsday (19 September) | | | | | |
| **10:00** | **PL** | **Sold Industrial Output** | **Aug** | **% y/y** | **5.2** | **5.2** | **10.3** |
| **10:00** | **PL** | **Construction Output** | **Aug** | **% y/y** | **19.0** | **19.0** | **18.7** |
| 10:00 | PL | PPI | Aug | % y/y | 3.1 | 2.8 | 3.4 |
| 14:30 | US | Housing Starts | Aug | % m/m | 4.6 | - | 0.9 |
| | | Thursday (20 September) | | | | | |
| 14:30 | US | Initial Jobless Claims | week | k | 210 | - | 204 |
| 14:30 | US | Index Philly Fed | Sep | | 15.0 | - | 11.9 |
| 16:00 | US | Existing Home Sales | Aug | % m/m | 0.8 | - | -0.7 |
| | | Friday (21 September) | | | | | |
| 09:30 | DE | Flash Germany Manufacturing PMI | Sep | pts | 55.8 | - | 55.9 |
| 09:30 | DE | Flash Markit Germany Services PMI | Sep | pts | 55.0 | - | 55.0 |
| 10:00 | EZ | Flash Eurozone Manufacturing PMI | Sep | pts | 54.5 | - | 54.6 |
| 10:00 | EZ | Flash Eurozone Services PMI | Sep | pts | 54.4 | - | 54.4 |
| **10:00** | **PL** | **Retail Sales Real** | **Aug** | **% y/y** | **7.3** | **6.5** | **7.1** |

*Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg*
** in case of the revision the data is updated*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