

19 October 2018

Weekly Economic Update

Data in Europe and elections in Poland

What's hot next week

- Polish macro data calendar is almost empty this week with only money supply and unemployment rate. We expect both to be close to consensus. The Ministry of Finance might release September budget results, where we expect to see a rise of surplus to PLN2bn.
- This time the domestic source of market turbulence could be the weekend local elections. Also, on Friday the European Court of Justice called Poland to suspend the application of the law that lowered the retirement age of the Supreme Court as one of the interim measures before the final ruling is made. This could take time, but on the other hand Poland is to respond without delay to the interim measures. Negative market reaction could be triggered if the government refuses to obey the ECJ ruling.
- Globally, investors may focus on the euro zone - flash PMIs and ECB meeting. The former could get somewhat worse. The ECB conference can be held in dovish tone, given the recent weakness in European industry and its uncertain outlook. The markets may also feel further tension between EU and Italy due to the budget draft - non-compliant with EU regulations - the country sent to the European Commission.

Market implications

The relatively moderate reaction of the Polish debt market to UST sell-off in the USA and hawkish interpretations of FOMC minutes suggests that the upcoming week should be quite positive for the Polish bonds. Moreover, the FI market should be supported by weak PMI data from Europe and message of the ECB conference.

Local government elections remain a risk factor, as negative results for the ruling party could be slightly negative for the domestic debt (if it encourages the government to assume a more aggressive stance).

We do not expect this week to be very positive for the zloty. Both European data (ECB, PMI) and political risks (possible weak results of PiS in elections, rising tensions between Italy and the EU) will not be supportive for the zloty. Budget data could be the only support for the zloty.

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Main macro data for September, % y/y

Category	Previous reading	Market expectations	Actual outcome
Retail Sales	6.7	6.2	3.6
Employment	3.4	3.4	3.2
Wages	6.8	7.1	6.7
Industrial Output	5.0	4.5	2.8
Construction Output	20.0	18.5	16.4

Source: Stats Office, Santander Bank Polska

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What's hot next week

We are expecting the registered unemployment rate to stay unchanged at 5.8% in September. We have already seen flash data from the Labour Ministry, so a surprise is improbable. This week we will also get to see central budget data for September and we are expecting the budget surplus to improve a bit.

Last week in economy

On Friday evening, the S&P agency surprised with an **upgrade of the Polish sovereign debt to A-** from BBB+. The upgrade was explained by the balanced economic growth, improvement of fiscal situation and better competitiveness of the Polish economy. According to the S&P, the rating would be upgraded more, if real income growth stays above the growth of the main trading partners, the public debt falls, and the private savings rise (thanks to the introduction of Employee Capital Plans).

In August, **current account data** for both exports (+7.4% y/y) and imports (+11.2% y/y) beat expectations. This is an important positive outcome in the context of mounting global trade fears, but exports growth could soften in the remaining months of 2018.

Final **September CPI slowed down to 1.9% y/y** from 2% due to the base effect and high volatility in services prices. The main core inflation measure came in at 0.8% y/y in September vs. 0.9% y/y in the previous month, below market consensus. We believe that prices will accelerate in 2019 to 2.6% y/y, on average, vs. 1.8% y/y in 2017. Energy minister Krzysztof Tchórzewski said that the energy bill for households would not increase by more than 5% (the final decision will be taken by URE, the market regulator). Such a hike for retail customers would imply a rise in CPI inflation by 0.2-0.3pp in 2019.

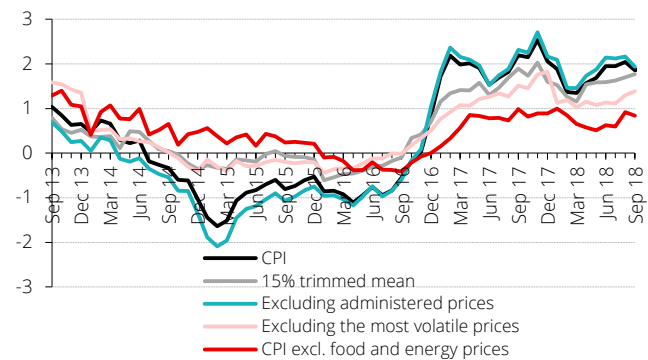
In September, **employment** in the corporate sector unexpectedly slowed down to 3.2% y/y from 3.4%. In m/m terms, we saw a decrease of 4.2k jobs, which is the weakest result for September since 2012. This is the third negative surprise in employment data in a row. **Wage growth** also showed the third negative surprise in a row, slowing to 6.7% y/y.

September's data on **industrial output** surprised to the downside but were close to our pessimistic calls, with industry adding 2.8% y/y and **construction** expanding by 16.4% y/y. The output data fit our expectations that the Polish economy has already recorded a business cycle peak and the slowdown has started in 2H18 with GDP growth well below 5% expected.

Retail sales disappointed in September. Instead of a robust 6.2% y/y real growth, we saw only +3.6% y/y. This was even below the lowest forecast on the market. Sharp deceleration in auto sales related to the new exhaust emission limits does not explain the whole negative effect. We do not view the September's sales disappointment as a harbinger for a long-lasting deceleration, given still low unemployment and high wage growth. Quote of the week

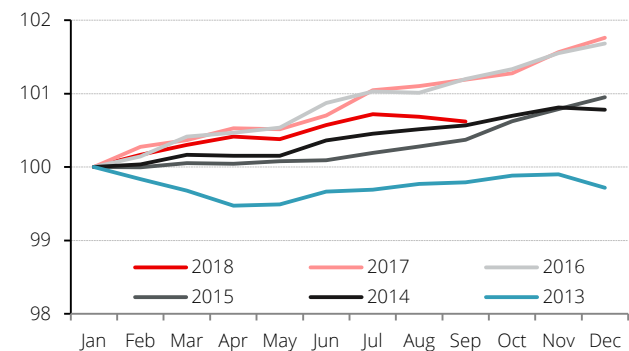
Jerzy Żyżyński is considered one of the most dovish members and has already suggested that the next rate change could be down rather than up, so we are not surprised about his comment that he saw space for lower rates. The central banker's remarks do not change our view on the monetary policy (a rate hike coming no sooner than in late 2019). We are quite surprised by the remark about inflation not being that important, as it goes against the current monetary policy guidelines (the statutory target is price stability). Moreover, we clearly do not agree with Żyżyński's views on inflation and on impact of energy prices on CPI. In our view, the central banker is clearly underestimating it. Two comments of Grażyna Ancyparowicz may seem to be contradictory, but in our view they are not: rates are optimal now, but may be hiked in late 2019. However, she is expecting 2019 GDP growth at 4.0-4.5% y/y. Realisation of our forecast (3.7% y/y) may make her less prone to hike rates.

Inflation measures, % y/y



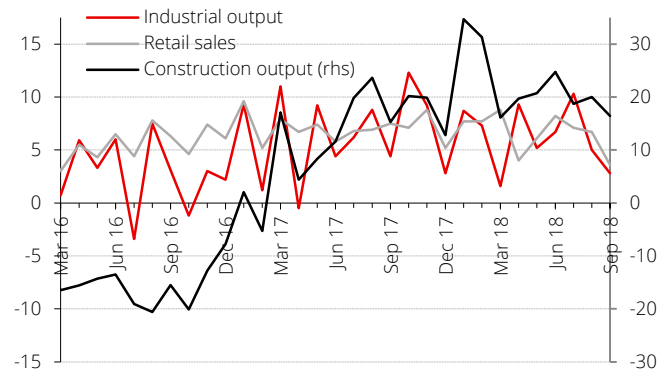
Source: Stats Office, NBP, Santander Bank Polska

Employment, January=100



Source: Stats Office, Santander Bank Polska

Production and retail sales growth (constant prices), % y/y



Source: Stats Office, Santander Bank Polska

Jerzy Żyżyński, MPC member, PAP, 18 October

I agree with president Glapiński that there are no reasons now to change interest rates. (...) An ECB rate increase would reduce the differential between the euro area and Poland. It wouldn't increase pressure to hike rates in Poland, but reduce the pressure to cut rates. Only overly strong credit expansion would trigger a need to tighten the monetary policy. Inflation plays second fiddle. There are no factors driving inflation up in one year horizon. Even rise of energy prices by 50% would add only 0.1-0.2pp to CPI inflation

Grażyna Ancyparowicz, MPC member, PAP

15 October I can't rule out that in 2H19 there will be a strong need to start discussion on rate hikes. Maybe in 4Q19. **18 October** In my opinion, interest rates are at the optimal level. (...) I hope 2019 GDP growth will be no weaker than this year, maybe 4.0-4.5% y/y.

FX and FI market

Last week on the market

FX Last week opened with strengthened zloty, but the hawkish market interpretation of the FOMC minutes hit the domestic currency. As a result, EURPLN was pushed up again above 4.30.

FI Yields on Polish T-bonds were decreasing over the last week, while temporary increases (triggered by core markets sell-offs) were rather rickety. The strong position of domestic bonds was driven by negative issuance-redemptions balance of this month (-PLN8bn). Moreover, the bright background for Polish T-bonds was created by the unexpected upgrade of Poland's sovereign debt rating by the S&P.

Key events

The domestic calendar for this week was rather empty. The unemployment as well as money supply data are not likely to cause a faster heart beat among investors. Maybe budget deficit data, possibly due on Thursday, can prove more important.

Investors will focus on the bond auction (the event will be preceded by the National Road Fund bonds redemptions – PLN11.7bn principal and PLN0.8bn interest payment, and OK1018 redemptions – PLN11.9 principal and sovereign bonds interest payments – cPLN4bn). We expect that the Ministry will manage to sell the maximum expected amount of bonds (PLN10bn), while investors will carefully look at the prices.

The situation is quite different as regards the foreign calendar. Market players will cautiously monitor the European flash PMI-manufacturing readings. The publication scheduled for Wednesday will likely show further deterioration. On Thursday, the market focus will move towards the ECB press conference. We expect that the communique and press conference language will be rather weighted given the internal tensions across the EU and weak European industrial data.

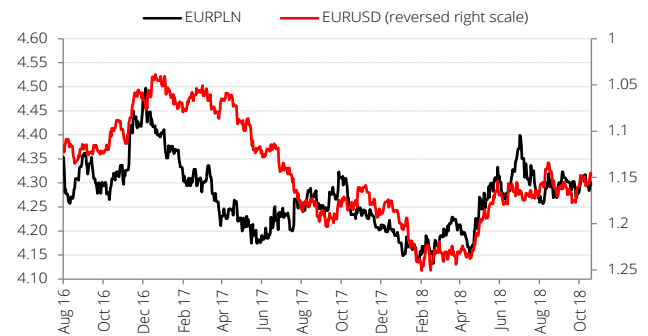
Market implications

FI The last week yields decreases as well as relatively mild influence of US bonds market sell-off on the domestic bonds allow us to remain relatively calm about the domestic bonds pricing this week. POLGBs should be supported by important events and releases scheduled for this week.

Bonds redemptions and auctions will leave us with unsatisfied demand for bonds. Flash European PMI-manufacturing data will have little chance to surprise on the positive side. The PMI data will be under influence of the trade war as well as of the automotive sector problem with new WLTP emission standards. As a consequence the ECB conference is unlikely to include a hawkish tone. The additional fuel could be delivered by the domestic budget data release if the Ministry of Finance manages to release it on Thursday. In this scenario, we expect the yield curve to decrease by 4-5bp.

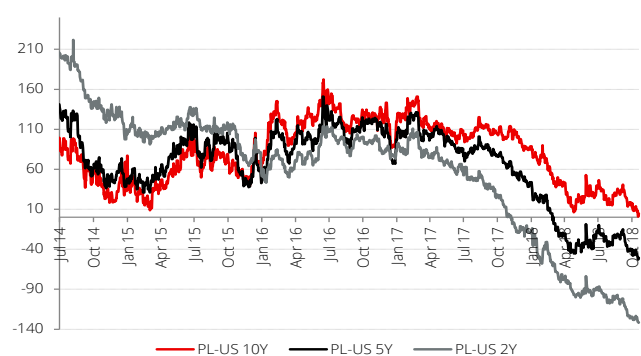
FX Zloty is likely to stay under expectations for further interest rates hikes in the USA and negative sentiments towards emerging market currencies and other risky assets. The ECB conference is likely to be rather dovish, so it will not generate a positive signal for CEE currencies. The potential postponing of ECB monetary policy normalisation is tantamount to the postponing the domestic interest rate hikes and growing concerns about growth in Europe. Despite this, we think that EURPLN will not go above 4.34.

EURPLN and EURUSD

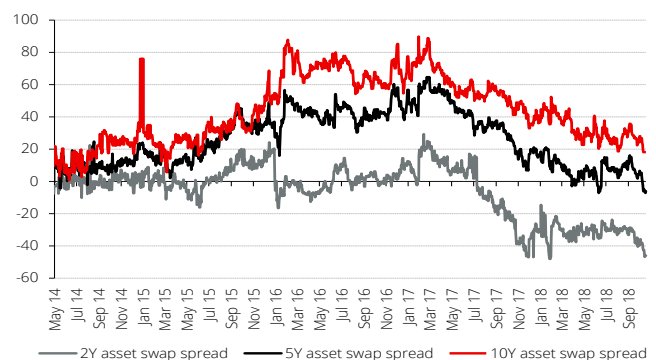


Source: ThomsonReuters, Santander Bank Polska

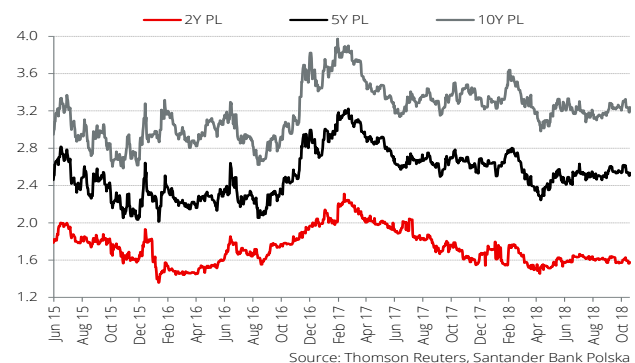
Spreads between Polish and US bonds



ASW spread bp



Yields of Polish bonds



Source: Thomson Reuters, Santander Bank Polska

Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE
				MARKET	SANTANDER	
MONDAY (22 October)						
14:00	PL	M3 Money Supply	Sep	% y/y	7.5	7.5
TUESDAY (23 October)						
10:00	PL	Unemployment Rate	Sep	%	5.8	5.8
WEDNESDAY (24 October)						
09:30	DE	Germany Manufacturing PMI	Oct	pts	53.45	53.7
09:30	DE	Markit Germany Services PMI	Oct	pts	55.5	55.9
10:00	EZ	Eurozone Manufacturing PMI	Oct	pts	53.0	53.3
10:00	EZ	Eurozone Services PMI	Oct	pts	54.5	54.7
16:00	US	New Home Sales	Sep	% m/m	-0.64	3.5
THURSDAY (25 October)						
	PL	Central Budget Cumul.	Sep	PLNbn	2.3	1.1
	PL	BuybackOK1018 (PLN11.9bn)	Oct			
10:00	DE	Ifo Business Climate	Oct	pts	103.15	103.7
13:45	EZ	ECB Main Refinancing Rate	Oct-18	%	0.0	0.0
14:30	US	Durable Goods Orders	Sep	% m/m	-1.15	4.4
14:30	US	Initial Jobless Claims	Oct-18	k	214.0	210.0
16:00	US	Pending Home Sales	Sep	% m/m	-0.05	-1.8
FRIDAY (26 October)						
11:30	PL	Bond Auction			-	
14:30	US	GDP Annualized	3Q	% Q/Q	3.4	4.2
16:00	US	Michigan index	Oct	pts	99.0	99.0

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg

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