

26 October 2018

# Bi-Weekly Economic Update

## Hot start of November

### What's hot next two weeks

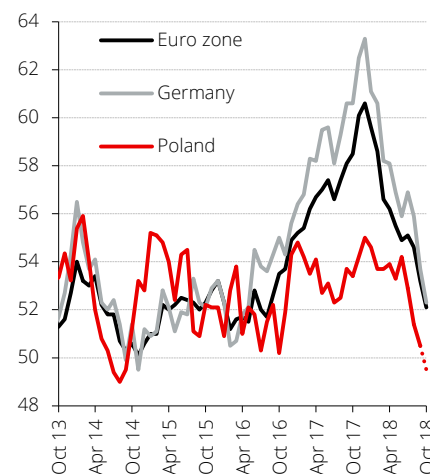
- The next two weeks can be extremely interesting from the investors' perspective. Much data will be released which can bring new insight into the outlook for the world economy. Furthermore, FOMC will hold a meeting and there will be some political events such as elections in Brazil and the US. Yet this Friday the S&P is to update the rating for Italy.
- On Tuesday 6th November mid-term elections to the US Congress are scheduled. These could trigger significant implications because potentially, if as a result of the elections, the Republicans would no longer control at least one Congress Chamber, the Democrats would be able to block some projects of Trump administration.
- On October 30th the Constitutional Tribunal will decide about the bill, removing the cap for social security contributions (currently at 30 times of average wage). The bill was sent to the Tribunal by the president Andrzej Duda. If the ruling is negative, which seems likely, the president may veto the bill.
- On domestic market there will be two important publications: flash CPI in October and industrial PMI. MPC's meeting on 7th November should not bring significant change to the rhetoric of the central bank despite new projections.

### Market implications

In our base case scenario, we assume that the market sentiment may stabilize giving a relief to the risky assets. As a result, we expect EURPLN to hold below 4.34.

Core bonds gained noticeably in the last several days and we think that some correction of this move could now take place. The room for higher core yields could be limited, in our view, if Republicans lose majority in the US Congress. Polish asset swap spreads rebounded from their multi-month lows and we expect this trend might continue as yields growth could be faster than in the case of the IRS (that are already relatively high).

### Manufacturing PMIs



Source: GUS, Santander Bank Polska

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### What's hot next two weeks

We think the flash release will show that **CPI** stayed at 1.9% y/y in October. The negative base effect in food and fuels may have been offset by a rise in core inflation, possibly to the highest level this year. Manufacturing **PMI** could slip below 50-pt neutral level for the first time in four years, following its eurozone counterparts and alternative domestic measures of business sentiment.

The **MPC meeting** on 7 November is unlikely to change the rhetoric despite the NBP projection update (including higher energy and commodity prices). We think the majority of MPC members is likely to favour keeping rates stable, underlining the risks to the GDP growth and pointing to the fact that the growth of inflation will be driven by factors beyond the influence of the monetary policy (energy). MPC hawk Eugeniusz Gatnar assumes the update might provide arguments for a rate hike in 1Q19, but we still expect it not earlier than in 4Q19.

### Last week in economy

Official results of October 21st **local elections** indicate that PiS won 254 seats in regional (voivodeship) councils while Koalicja Obywatelska (a coalition formed by PO and Nowoczesna) got 194. PiS will be able to govern six voivodeships (out of 16) on its own, in three more it will need to find a coalition partner. Koalicja Obywatelska has a clear majority in one voivodeship and will have to seek a partner to govern six more. The results do not change the political landscape enough to require a market adjustment. The ruling party considers the outcome satisfactory so we think at this stage it is too early to anticipate a change of its policy to a more aggressive before the next elections.

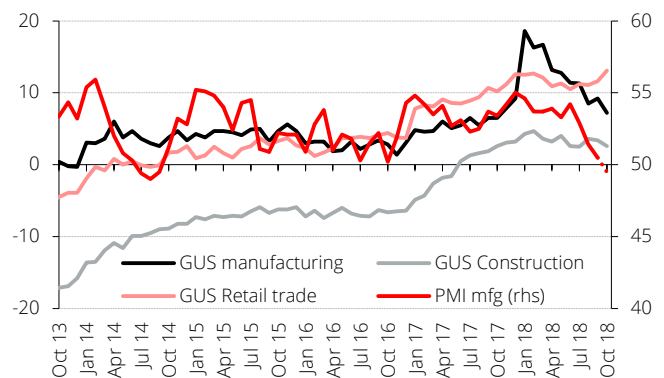
**Quarterly business sentiment survey conducted by the NBP** showed strong sales volumes in Q2-Q3. Still, companies are now more cautious in forecasting demand and output (but not exports). Despite higher costs (of materials and labour, among others), the profitability rose. Companies reported some easing of the wage pressure despite difficulties in finding new workers, and expect smaller wage hikes than in the previous survey. However, given a further rise in costs and expected energy price hikes, companies reduced their optimism as regards business performance in 2019. The perceived reduction of inventory shortages added to the negative picture. When asked about their reaction to the depleted spare capacity, companies mentioned 'selection of orders' and 'raising prices' more often than in the previous survey, but were less eager to invest.

The Stats Office published the results of the **semi-annual survey of company investment plans**. The industry signalled that this year's investments may be 2.1% higher than last year's vs 6.7% indicated in March. Industrial companies plan to push investments up by 5.5% in 2019, but SMEs will decrease their investment outlays.

Stats Office's **business sentiment indicators** corrected for seasonal effects showed a significant deterioration of mood in industry in October – the general index dropped by 2pts, to the lowest level in more than a year, and the component describing current output by almost 5pts to the lowest level in two years. Hotels and restaurants, as well as retail trade/repair sectors saw improvement of soft indicators (the latter has set a new record of optimism). Such pattern of results confirms our call that the outlook for industry for the months to come is not so rosy, while private consumption should still look decent.

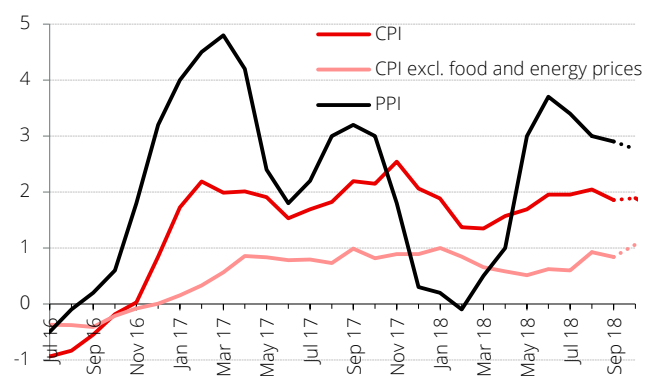
The **M3 money supply growth** accelerated in September to 7.9% y/y from 7.5% y/y. PLN-denominated loans for individuals still rose at a double-digit pace (c.10% y/y for consumption, c.11% y/y for mortgages). In our opinion, current trends are becoming strong enough to maintain the solid pace of private consumption growth from previous quarters (which joins the list of potential inflation drivers).

### Leading indicators, SA



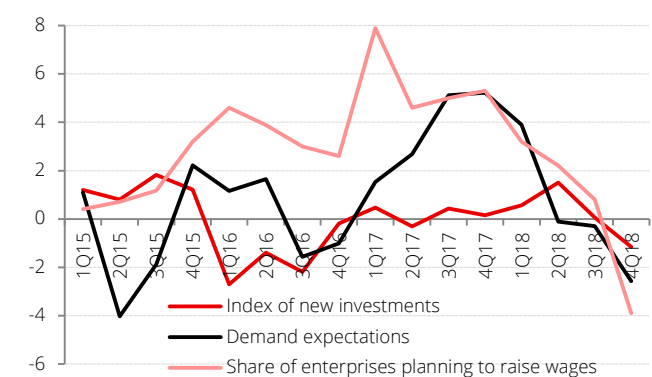
Source: GUS, NBP, Santander Bank Polska

### Inflation measures, %/y



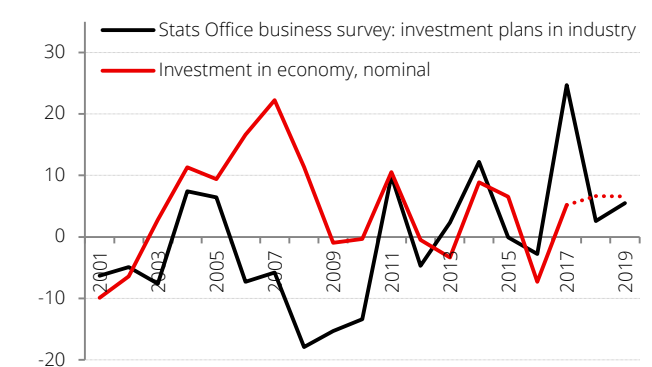
Source: GUS, Santander Bank Polska

### NBP's Quick Monitoring survey of business sentiment - y/y changes of indices



Source: NBP, Santander Bank Polska

### Stats Office investment survey - planned growth of outlays



Source: GUS, Santander Bank Polska

## FX and FI market

### Last week on the market

**FX** The zloty depreciated vs the euro, dollar and franc amid EURUSD drop and risk aversion persisting for the better part of the week. Still, EURPLN remained below 4.32 and at the time of writing, the October high-low spread was the lowest monthly range since November 1996 (according to Reuters data).

**FI** Polish bond yields fell thanks to strengthening recorded on the core debt market amid high risk aversion and thanks to very successful auction. The PL-DE 10Y bond yield spread rose above 280bp for the first time since mid-September despite the supportive liquidity conditions on the Polish market (large buybacks). IRS rates also fell but remain close to the highest levels recorded in the last two years.

### Key events

Yet this Friday, the S&P may downgrade Italy whose rating is only two notches above the “junk level”.

Locally, the MPC will have an updated forecasts at its disposal when they hold their meeting.

Abroad, numerous US data will be released (including the consumer sentiment index, monthly nonfarm payrolls and ISM) and the FOMC will hold a meeting. Results of the US mid-term elections will be also closely watched.

Emerging markets will be watching the second round of the Brazilian presidential elections.

### Market implications

**FX** As we mentioned above, the EURPLN trading range is pretty narrow and the exchange rate is waiting for a trigger. However, implied volatilities are trading above levels seen in April and therefore we do not assume that the current low trading range is an omen that a bigger move to the upside could take place soon (for the EM currencies, higher volatility usually means depreciation).

EURPLN is hovering only slightly below the first resistance at 4.32. Next important level to watch is the September peak at 4.34.

In our base case scenario, we assume that the market sentiment may stabilize giving a relief to the risky assets. We do not think the S&P will downgrade Italy to the below investment grade rating and the outcome of the Brazilian presidential elections should be at least neutral for the market (more market friendly candidate is leading the polls). As a result, we expect EURPLN to hold below 4.34.

**FI** Core bonds gained noticeably in the last several days and we think that some correction of this move could now take place. The yield of the 10Y Bund neared its support from early September at c0.35% while the 10Y UST is close to bottom from early October at 3.05%. Similarly, Polish 5Y and 10Y bond yields also neared their support levels at 2.40% and 3.15%.

We assume the US data will allow the FOMC to state in early November that the next rate hike is likely in December which might remind the market about the tightening cycle in the US.

The room for higher core yields could be limited, in our view, if Republicans lose majority in the US Congress.

The outcome of the Polish MPC meeting should be rather neutral for the market as rhetoric is unlikely to change noticeably, in our view.

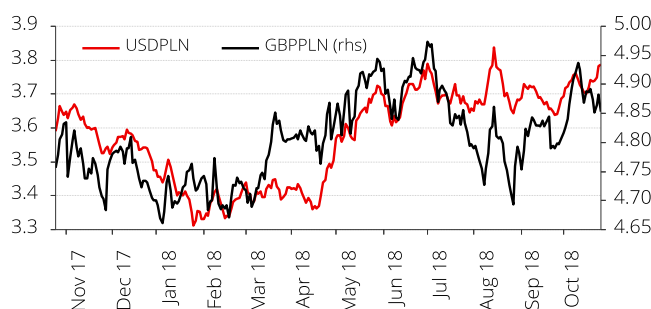
Polish asset swap spreads rebounded from their multi-month lows and we expect this trend might continue as yields growth could be faster than in the case of the IRS (that are already relatively high).

### EURPLN



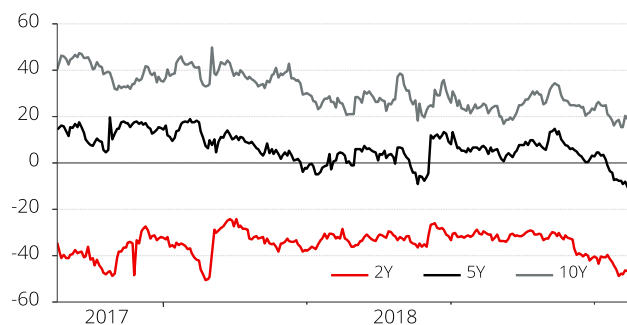
Source: Thomson Reuters Datastream, Santander Bank Polska

### USDPLN and GBPPLN



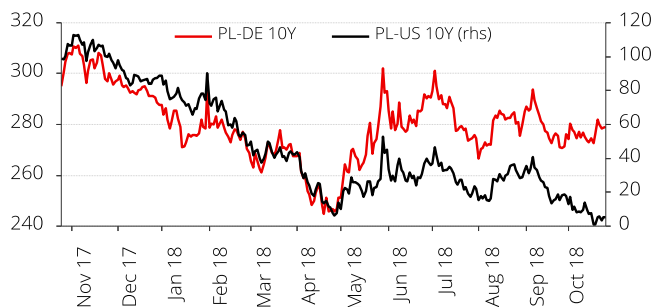
Source: Thomson Reuters Datastream, Santander Bank Polska

### ASW spread (bp)



Source: Thomson Reuters Datastream, Santander Bank Polska

### 10Y bond yield spread (bp)



Source: Thomson Reuters Datastream, Santander Bank Polska

## Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE
				MARKET	SANTANDER	
<b>MONDAY (29 October)</b>						
13:30	US	Personal Spending	Sep	% m/m	0.4	- 0.3
13:30	US	Personal Income	Sep	% m/m	0.4	- 0.3
13:30	US	PCE Deflator SA	Sep	% m/m	0.1	- 0.1
<b>TUESDAY (30 October)</b>						
11:00	EZ	GDP SA	3Q	% y/y	1.8	- 2.2
11:00	EZ	ESI	Oct	pct.	110.1	- 110.9
14:00	DE	HICP	Oct	% m/m	0.0	- 0.4
15:00	US	Consumer Conference Board	Oct	pts	136.5	- 138.4
<b>WEDNESDAY (31 October)</b>						
<b>10:00</b>	<b>PL</b>	<b>Flash CPI</b>	<b>Oct</b>	<b>% y/y</b>	<b>1.8</b>	<b>1.9 1.9</b>
11:00	EZ	Flash HICP	Oct	% y/y	2.1	- 2.1
11:00	EZ	Unemployment Rate	Sep	%	8.1	- 8.1
13:15	US	ADP report	Oct	k	190.0	- 229.6
<b>THURSDAY (1 November)</b>						
13:00	CZ	Central Bank Rate Decision		%	1.75	- 1.5
14:30	US	Initial Jobless Claims	week	k	215	- 215
15:00	US	ISM manufacturing	Oct	pts	59.5	- 59.8
<b>FRIDAY (2 November)</b>						
<b>09:00</b>	<b>PL</b>	<b>Poland Manufacturing PMI</b>	<b>Oct</b>	<b>pts</b>	<b>-</b>	<b>49.5 50.5</b>
09:55	DE	Germany Manufacturing PMI	Oct	pts	53.4	- 52.3
10:00	EZ	Eurozone Manufacturing PMI	Oct	pts	53.0	- 52.1
13:30	US	Change in Nonfarm Payrolls	Oct	k	190	- 134
13:30	US	Unemployment Rate	Oct	%	3.7	- 3.7
13:30	US	Durable Goods Orders		% m/m	-1.5	- 0.8
15:00	US	Factory Orders	Sep	% m/m	-0.3	- 2.3
<b>MONDAY (5 November)</b>						
02:45	CH	Caixin China PMI Services	Oct	pts	-	- 53.1
16:00	US	ISM services	Oct	pts	59.5	- 61.6
<b>TUESDAY (6 November)</b>						
08:00	DE	Factory Orders	Sep	% m/m	-	- 2.0
09:00	CZ	Industrial Production	Sep	% y/y	-	- 1.9
09:55	DE	Markit Germany Services PMI	Oct	pts	55.5	- 53.6
10:00	EZ	Eurozone Services PMI	Oct	pts	54.5	- 53.3
<b>WEDNESDAY (7 November)</b>						
	<b>PL</b>	<b>MPC decision</b>		<b>%</b>	<b>1.50</b>	<b>1.50 1.50</b>
08:00	DE	Industrial Production SA	Sep	% m/m	-	- -0.3
11:00	EZ	Retail Sales	Sep	% m/m	-	- -0.2
<b>THURSDAY (8 November)</b>						
08:00	DE	Exports SA	Sep	% m/m	-	- -0.1
09:00	HU	Industrial Production SA	Sep	% y/y	-	- 4.5
09:00	HU	CPI	Oct	% y/y	-	- 3.6
14:30	US	Initial Jobless Claims	week	k	-	- -
20:00	US	FOMC decision		%	2.25	- 2.25
<b>FRIDAY (9 November)</b>						
09:00	CZ	CPI	Oct	% y/y	-	- 2.3
16:00	US	Flash Michigan index	Nov	pts	-	- 99.0

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg

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