16 November 2018

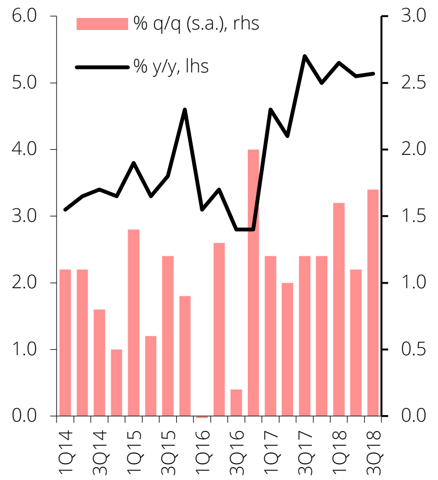
Weekly Economic Update

Slowdown that was not there

What's hot next week

- Last week we saw a bunch of surprising news from Poland. The biggest surprise in terms of economic data releases was the flash GDP data for 3Q18, showing growth of 5.1% y/y or in seasonal adjusted terms 1.7% q/q. We still don't know what was the breakdown of the growth (detailed data to be released at the end of November) or how to explain the fact that the data apparently show a sharp revival of economic activity in 3Q, while most of other indicators signalled a slowdown. The second surprise was data about wages in total economy, which accelerated in 3Q18 to 7.6% y/y (highest in a decade!), which may suggest – also against earlier signals – that wage pressure is not weakening. Both information allow to be a bit more optimistic about the outlook for Polish economy for the coming months/quarters.
- In the coming week we will see a number of new domestic data releases: October's corporate wages and employment (Monday), industrial and construction output (Wednesday), retail sales (Thursday), plus several indicators about November's business climate and consumer confidence. However, those releases may not help too much in explaining doubts regarding current economic situation and labour market situation. Our forecast of wage growth and construction output is above market consensus, others are below. Financial results of non-financial companies in 3Q18 (due on Wednesday) may cast some light on private sector's investment activity and margins.
- There are also some political events in the agenda: on Tuesday the hearing in the European Parliament regarding the rule of law in Poland and on Monday the one-month deadline for Poland for applying the interim measures imposed by the European Court of Justice. However, we think it will not be the main issue drawing investors' attention. On Wednesday the European Commission will release opinions to member states' budget proposals for 2019, including of course the controversial budget of Italy.
- On Sunday (25 November) the special EU Summit will take place to finalise the Brexit deal (that was approved by the British government this week). Nevertheless, it will not end the uncertainty over the Brexit, as the deal still has to be ratified by the UK parliament, which seems increasingly doubtful given the fights in the British political scene.

GDP growth in Poland



Source: GUS, Santander Bank Polska

Market implications

The start of the week may be still quite nervous on the FX market, among others due to uncertainty over Brexit. However, we expect to see dollar weakening against euro, which should limit the scale of EURPLN increase. Polish bond yields may remain elevated at the start of the week, amid activity of some domestic banks. Later on we expect to see market recovery, under influence of data confirming economic slowdown and still very good news about the Polish budget.

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What's hot next week

Plenty of local data coming this week. October output and retail sales might surprise negatively again, confirming that the strong 3Q GDP might have been a swan song and growth will head lower from here. Consumer and business sentiment indicators will give us the first insight into state of the economy in November. Corporate wages could have accelerated from September's 6.7% y/y, against the consensus view and employment growth may inch lower again, as the labour market is already very tight. Quarterly GUS report on corporate results will be of particular importance as we try to assess if the unexpectedly strong 3Q GDP was caused by higher investment activity outside local governments (which ran many projects due to elections). It will also show the overall cost structure, growth rates of cost components and implied margins. A further margin squeeze would increase risk of a strong rise of inflation with the start of 2019.

Last week in economy

GDP growth surprised to the upside in 3Q18 and showed 5.1% y/y as compared to average expectations at 4.6% and highest market forecast at 4.9% y/y. The GDP growth remained above 5% for the fifth time in a row and this is the best streak since 2006-2008 economic boom. We expect that in the next quarters GDP will decelerate, mainly owing to weakening trend in international trade.

September current account showed a deficit at €0.5bn. The negative surprise came mainly from **disappointing exports**, which advanced by mere 0.3% y/y. Imports rose by 5.4% y/y. Current account deficit is likely to widen from 0.4% of GDP in 3Q18 towards 1.0% of GDP in 2019.

The **final CPI reading for October** was 1.8% y/y vs. flash reading of 1.7% and September reading at 1.9%. Core inflation moved from 0.8% to 0.9%. A more visible rise of CPI and core inflation should come with the start of 2019.

November NBP inflation projection showed a significantly higher path of CPI, due to assumptions about energy prices. However, core inflation did not change vs July edition, meaning that there is no sign of second round effects in the projection. CPI path is sloping down in 2020, but core CPI is trending higher through the whole projection period (both path cross at c2.7% in 4Q20). NBP governor suggested at the post-MPC decision press conference that the energy assumptions were deliberately set quite high to have a 'conservative' assessment of where CPI could move due to the impulse from energy prices. However, the report shows an asymmetric upside risk to CPI. Apart from that the projection is slightly less upbeat about investments and wage growth, but more positive on export outlook.

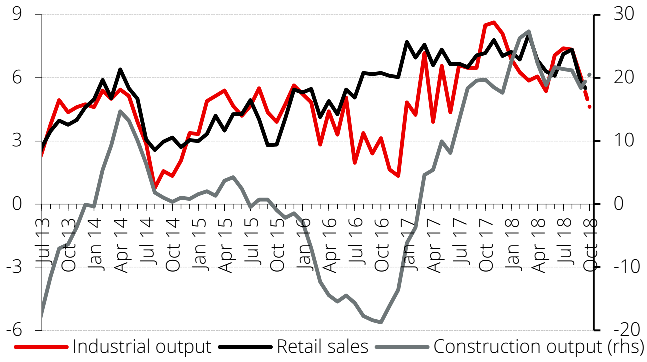
In Q3, **average wages in the national economy** increased by 7.6% y/y, reaching the highest dynamics for a decade. It seems that Q3 saw continuation of the 2-digit wage bill growth rate, supporting high growth of private consumption. Interestingly, the economy-wide data do not confirm wage pressure slowdown signals from enterprise sector data.

The **NBP opinion on fiscal budget 2019** suggests that it will be possible to reach public finance deficit below 1% of GDP in 2018 (in line with our baseline forecast) and its further decline in 2019 (thus net borrowing needs may be lower than PLN46bn outlined in the budget draft). The Ministry of Finance expects that public finance sector deficit will not exceed 0.5-0.6% GDP.

Quote of the week

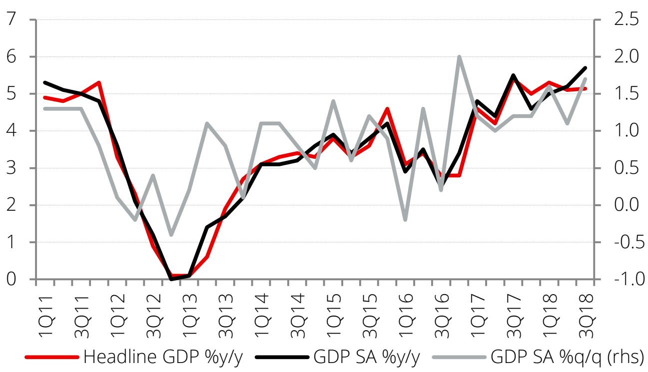
Jerzy Kropiwnicki, considered one of the most dovish MPC members, mentioned non-standard monetary tightening in response to cost-driven inflation. While we think the central bank could be indeed analyzing different alternatives in policymaking, the majority in the MPC does not seem to be supporting the non-conventional actions.

Output and sales growth, %y/y (3M mov. av., constant prices)



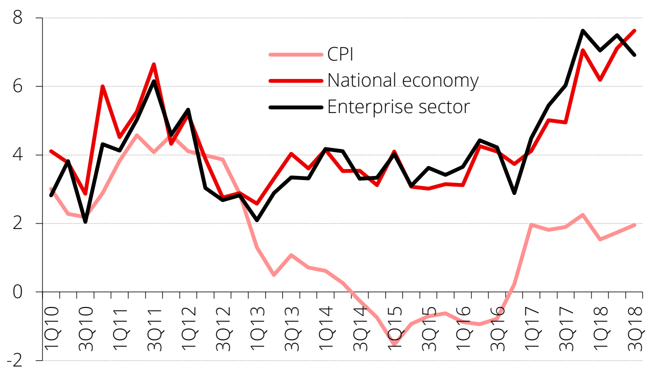
Source: GUS, Santander Bank Polska

Measures of economic growth in Poland



Source: GUS, Santander Bank Polska

Wage growth y/y vs. inflation



Source: GUS, Santander Bank Polska

Jerzy Kropiwnicki, MPC member, Bloomberg, 15 November

We have been working on non-standard measures we could use if we still want to refrain from raising borrowing costs, and yet we agree that some type of intervention is necessary. This year's surge in wholesale electricity prices will unavoidably be passed on to consumers, even if the government is promising some protection. The job market is also likely to stoke inflation, with Germany expected to ease access to its markets for Ukrainians by the end of next year, which could pull some migrant workers away from Polish companies and boost their costs as they seek replacements. All of this makes me less optimistic about inflation than the central bank's projection

Adam Glapiński, NBP governor, PAP, 15 November

There is absolutely no need for QE in Poland, no need to experiment.

Łukasz Hardt, MPC member, PAP/Bloomberg, 15 November

With the cost of money so low, it is hard to say if a further reduction could stimulate investment activity in any way. I am absolutely against using any unconventional actions in Poland at this point. The CPI projection seems exaggerated.

FX and FI market

Last week on the market

FX At the beginning of the last week, EURPLN marched up to 4.3050. The zloty weakening was a consequence of the stronger US dollar vs. the euro, the Italy deficit crisis and fall on the stocks market. In the second part of the week EURPLN went down, reflecting the weaker USD and stock market uptick. A good background for the strengthening of the zloty was unexpectedly high Polish GDP reading for 3Q18. The end of the week was marked by Brexit-driven sell-off.

FI The domestic debt market was rising in the first part of the week, which was a consequence of core markets yields drop (as a reaction to stocks market slide and dramatic oil prices decline). In the second part of the week, we saw yields rebound, this time fuelled by domestic factors. A surprisingly high 3Q18 GDP and a likely correction of bonds positions by domestic banks negatively affected domestic debt market. As a result, the domestic curve was shifted up by 2-4bp, the least in the middle of the curve.

Key events

This week will see a release of data on employment, wages, industrial production, money supply and retail sales. The most data will likely be below the market consensus (except for construction output and wages).

On the core markets, it will be worth paying attention to US durable goods orders (the data should not be surprising) and the euro zone PMI release (here we see some chance for a rebound in German industrial indices).

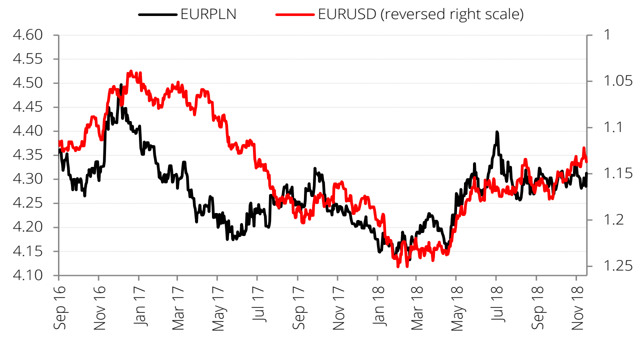
Market implications

FX We expect EURPLN to rise towards 4.35 after it broke 4.30 on Friday. We assume that the dollar depreciation vs the euro (after four consecutive weeks of appreciation) and better-than-average forecast flash German PMI (we expect a slight improvement amid recovery in the auto industry) should curb room for higher EURPLN and the exchange rate should hold below 4.34.

FI We think that yields may hold at an elevated level at the beginning of the coming week after a sharp sell-off recorded on Friday. In our view, the yields jump was triggered by some adjustment of liquidity needs in the Polish banking sector. We expect yields to stay high at least until the mid-week. In the next days, some recovery is likely thanks to the below-consensus Poland retail sales data. However, the room for recovery looks limited as we expect flash euro zone PMIs to surprise to the upside.

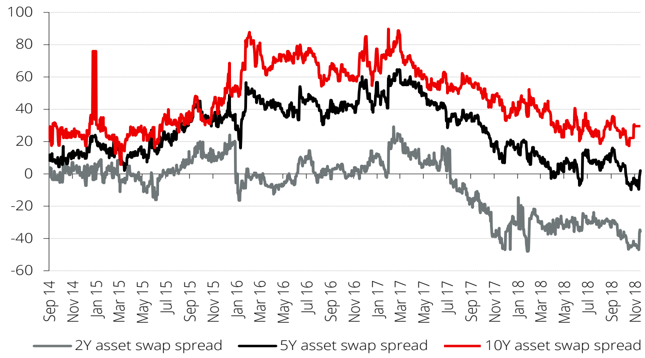
In the longer time horizon, we expect the 2Y, 5Y and 10Y yields to move back to 1.55%, 2.45% and 3.21%, respectively. This should be allowed by the persisting concerns about the economic slowdown, high demand for debt from the local banks and robust state fiscal performance.

EURPLN and EURUSD

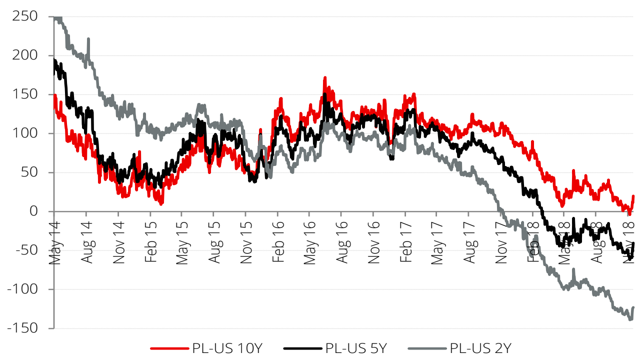


Source: ThomsonReuters, Santander Bank Polska

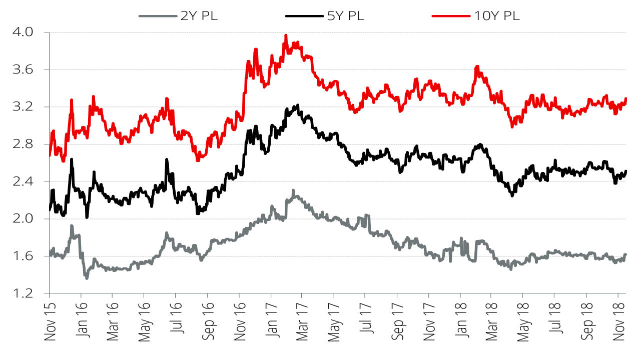
ASW spread bp



Spreads between Polish and US bonds



Polish bond yield



Source: Thomson Reuters, Santander Bank Polska

Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST SANTANDER	LAST VALUE
			MONDAY (19 November)				
10:00	**PL**	**Employment in corporate sector**	**Oct**	**% y/y**	**3.2**	**3.1**	**3.2**
10:00	**PL**	**Average Gross Wages**	**Oct**	**% y/y**	**6.5**	**6.9**	**6.7**
			TUESDAY (20 November)				
10:00	**PL**	**Sold Industrial Output**	**Oct**	**% y/y**	**6.6**	**6.0**	**2.8**
10:00	**PL**	**Construction Output**	**Oct**	**% y/y**	**21.0**	**25.0**	**16.4**
10:00	**PL**	**PPI**	**Oct**	**% y/y**	**3.0**	**3.0**	**2.9**
14:00	HU	Central Bank Rate Decision	Nov-18	%	0.9		0.9
14:30	US	Housing Starts	Oct	% m/m	1.995.0		-5.3
			WEDNESDAY (21 November)				
14:30	US	Durable Goods Orders	Oct	% m/m	-1.95		0.7
14:30	US	Initial Jobless Claims		k	213.0		216.0
16:00	US	Michigan index	Nov	pts	98.3		98.3
16:00	US	Existing Home Sales	Oct	% m/m	0.97		-3.38
			THURSDAY (22 November)				
10:00	**PL**	**Retail Sales Real**	**Oct**	**% y/y**	**5.6**	**5.4**	**3.6**
			FRIDAY (23 November)				
08:00	DE	GDP WDA	3Q	% y/y	1.1		1.1
09:30	DE	Germany Manufacturing PMI	Nov	pts	52.0		52.2
09:30	DE	Markit Germany Services PMI	Nov	pts	54.4		54.7
10:00	EZ	Eurozone Manufacturing PMI	Nov	pts	51.7		52.0
10:00	EZ	Eurozone Services PMI	Nov	pts	53.5		53.7
14:00	**PL**	**Money Supply M3**	**Oct**	**% y/y**	**8.0**	**8.0**	**7.9**

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg

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