

Weekly Economic Update

To Brexit, or not to Brexit

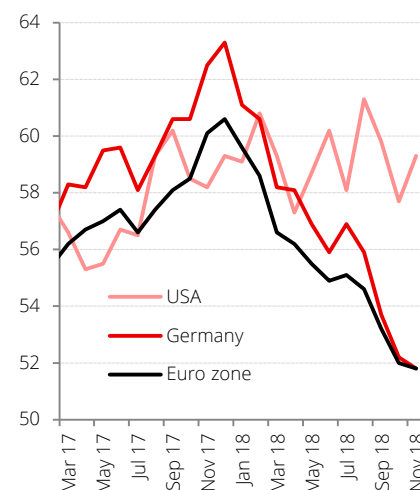
What's hot next week

- Two issues will dominate markets next week: Brexit and ECB monetary policy.
- **On Tuesday the UK parliament holds the meaningful vote on the Brexit Withdrawal Agreement.** If the deal is approved, it would be a great relief for markets, but unfortunately chances for such scenario seem to be low. Different scenarios are possible in case of deal rejection, depending, among other things, on the margin between yes and no votes:
 - Dismissal of PM May and/or early elections;
 - Repeat of the Brexit referendum;
 - Survival of PM May and her another attempt to vote the deal in the parliament, maybe after some minor tweaks;
 - Attempt to agree the "Norway Plus" arrangement – UK after the transition period stays in the customs union and retains access to the single market;
 - Disorderly Brexit.
- The good news is that during the ongoing debate most of the British MPs were quite clearly against the disorderly Brexit scenario. Also, it seems that the option of reversing the entire Brexit process is still on the table (at least theoretically). On Monday the European Court of Justice will judge whether the UK can unilaterally revoke the Article 50 notification (the ECJ spokesperson has suggested it is possible a few days ago). Still, the probability of such scenario does not seem to be high at the moment. Overall, we will probably face the prolonging uncertainty before the issue is decided.
- **On Thursday the market will focus on the ECB meeting.** The bank will present the updated economic forecasts and is likely to confirm termination of the QE programme. Investors will be looking for hints whether the recent news (oil price collapse, stock market selloff, weak European data, Brexit, Italy) changed the policy outlook somehow.
- The list of data releases is not extensive. Abroad, the flash European PMIs could be important, as next disappointing readings may deepen pessimism about the growth outlook. In Poland Friday will see **final inflation print for November and balance of payments data for October.** Flash CPI reading surprised, falling to 1.2% y/y but last time the final reading was a bit higher than the flash one and the story may repeat. Still, the domestic data should be overshadowed by other events.
- In the coming days **we should see the energy market regulator's decision about the energy price increase and the government's draft proposal how to compensate the higher energy bill to households.** It remains uncertain how this factor will impact inflation. The energy minister's declaration about full compensation for households could imply that impact on CPI would be zero. But the recent press articles (FinMin suggesting no money for compensation in the 2019 budget) still leave uncertainty about the final solutions. Overall, even if there are significant hikes of retail electricity tariffs and they trigger CPI rise next year, it is unlikely to change the central bank's rhetoric: in fact, the last NBP projection assumed such scenario and yet the MPC's policy bias has not changed at all.

Market implications

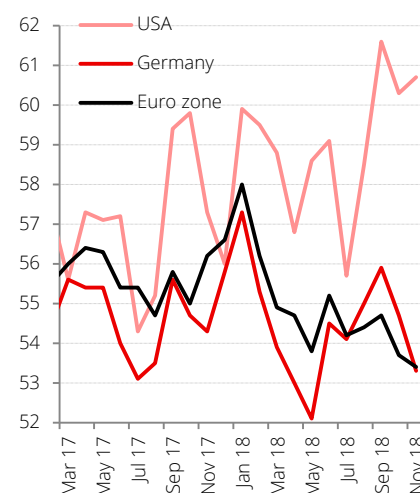
- We remain quite positive as regards the Polish zloty outlook for the rest of the year, although the Brexit vote remains the risk factor. If PM May's defeat is not overwhelming, the pound, euro and zloty may strengthen. Bond yields should remain low, supported by very good news about situation of the state budget and low debt supply. Possible slight upward revision of November's CPI should not be significant for the market.

PMI indices for industry



Source: IHS Markit, Santander Bank Polska

PMI indices for the services sector



Source: IHS Markit, Santander Bank Polska

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What's hot next week

Flash CPI for November was a major downside surprise, 0.2pp below the lowest of market forecasts. From the limited information known so far we estimate that core inflation had to decline as well. This resembles the February downside surprise, when one piece of core inflation suddenly tumbled without any observable reason (financial services, -10.1% m/m). Bear in mind final October CPI print was higher than its flash estimate. In general, the macro environment continues to support a rebound of core CPI next year, but the ongoing pull-back of global oil and food prices suggests there is still room for shrinkage of the non-core part of CPI in the months to come (its contribution was 1.6pp mid-year, down to c0.8pp in November).

October was a month of visible rebound in industrial output so we expect the C/A data to show a much higher trade turnover, with trade deficit shrinking to less than €0.4bn. Exports y/y growth could beat the year-to-date average while imports growth might return above 10% y/y.

Last week in economy

Polish PMI reached 49.5 in November, falling below neutral 50 mark for the first time since September 2014. Survey showed deterioration in new orders, production and employment. New export orders were in decline fourth month in a row, although the pace of slide slightly slowed. The PMI reading seems to signal clearly that worse business climate abroad is passing through to domestic manufacturing, however other Polish business surveys were not as pessimistic. We think that the economy finally started slowing, after five quarters of exceptionally strong growth, but the slowdown will be rather mild - from current c5% growth to c4% in 2019.

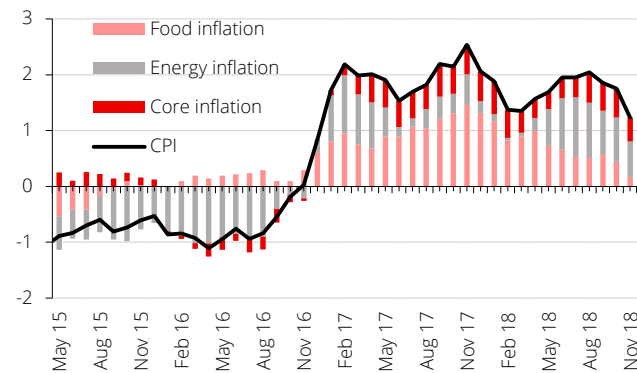
The Finance Minister Teresa Czerwińska said that the central budget recorded a surplus after November and maintained her declaration the fiscal deficit will not surpass 0.6% of GDP in 2018. According to Dziennik Gazeta Prawna daily, the government plans to reach as good fiscal metrics as possible this year in order to avoid any conflict with the European Commission regarding pace of reduction in the structural deficit. Thus, according to the daily, the Ministry will take no actions aimed at relieving the next fiscal year, like acceleration of VAT returns. If this is the case, then it is very probable that the deficit will be lower than 1% of GDP at the year-end. Meanwhile, the budget amendment, approved by the Sejm on Thursday, earmarked PLN11bn of this year's budget savings in expenditure for spending on other purposes (the government suggested to spend only PLN8bn). Additional means will be allocated to e.g., the National Health Fund (NFZ), construction of local roads, aid to farmers hurt by the drought. The amendment will make it harder for the finance ministry to reach the declared 0.6%.

According to Labour Ministry, the registered unemployment rate reached 5.8% in November vs 5.7% in October. The monthly rise in the number of the unemployed number (14.3k) was the highest in November since 2014, which confirms that positive trends on the labour market have been waning.

Quote of the week

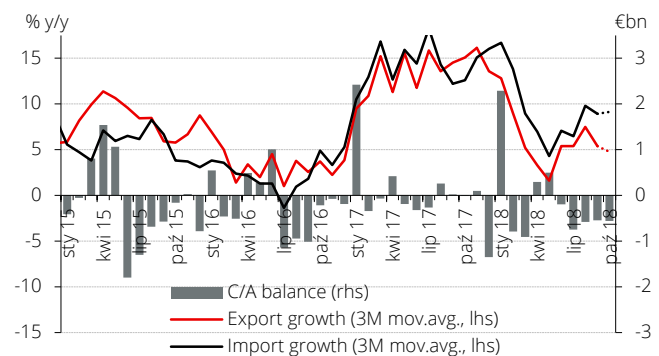
In line with expectations, the MPC kept interest rates unchanged with the main policy rate at 1.50%. The statement did not change much and the NBP president repeated the pledge to keep rates stable until the end of 2019. Overall, there is no change in the MPC policy outlook, in our view. Interest rates are going to stay on hold at least until the very end of 2019, and maybe even longer (if, for example, economic slowdown is deeper than expected and/or inflation fails to pick up visibly next year). Find more in our [Economic comment](#).

Breakdown of annual CPI growth, % y/y



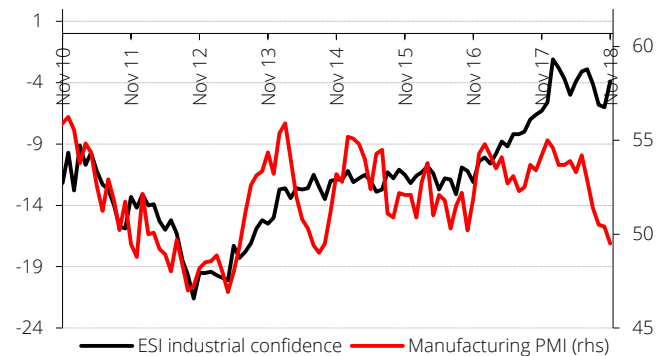
Source: GUS, Santander Bank Polska

Selected balance of payments data



Source: NBP, Santander Bank Polska

Business sentiment in industry



Source: European Commission, IHS Markit, Santander Bank Polska

Adam Glapiński, NBP head, MPC press conference 5 December

MPC keeps calm and remains in 'wait and see' position. There are no reasons to raise rates in 2019. The November motion to hike rates was an 'exotic' proposal, given the tone of the discussion and argumentation at the MPC meeting.

MPC statement, NBP, 5 December

Notwithstanding relatively high economic growth and wages rising faster than in the previous year, annual consumer price growth has declined and remains moderate. In 2019 inflation might be increased by rising energy prices, i.e. factor beyond the control of monetary policy. The scale of energy price growth in 2019 will probably be limited by the fall in oil prices seen in recent months.

FX and FI market

Last week on the market

FX The passing week is very likely to be yet another one with EURPLN holding within the 4.26-4.34 range. The exchange rate approached the support level in reaction to jump in demand for the risky assets after the G20 summit. However, in the next days the optimism evaporated but EURPLN climbed only slightly above 4.26 thanks to rise of EURUSD. USDPLN spent the week around 3.77. GBPPLN and CHFPLN did not move much either.

FI Poor sentiment on the global market amid concerns about the trade wars accompanied by some below-consensus US macro data boosted demand for the risk-free assets. As a result, noticeable strengthening of Bund and Treasuries pushed Polish yields and IRS down. The latter moved more leading to higher asset swap spreads.

Key events

On December 11, the UK Parliament is expected to vote on the Withdrawal Agreement. The PM May government does not have a majority to pass the bill and such result should not surprise. The key issue to watch would be the difference between the yes-no votes, in our view.

Two days later, the ECB will hold a meeting. The case of ending the QE program this year should not be discussed in detail. Much of attention might be devoted to the first Brexit vote. The ECB will show its updated GDP and inflation forecasts. Recent euro zone economic activity data have been not too encouraging and so the rhetoric about the timing for a first rate hike should stay ambiguous.

Last week, the US played a role on the EURUSD market and in the days to come we will see CPI and industrial output releases. In Europe, the flash December PMIs will be released.

Market implications

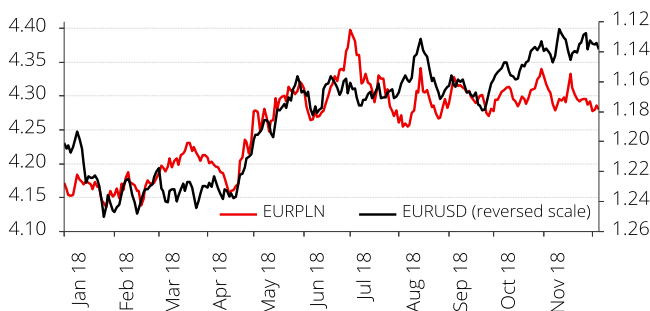
FX Our view on the zloty remains positive but the Brexit vote is the key risk factor to this scenario.

The zloty has remained resilient to the global mood deterioration, as higher EURUSD offered a support. We think the euro could gain versus the dollar in the days to come with the outcome of the ECB meeting likely to provide the upside impulse for the exchange rate. We assume Mario Draghi would not change the wording describing the outlook for the monetary policy and this could be viewed as slightly hawkish if the GDP forecasts are revised down. Upward revision could be euro-positive straightforward. Higher EURUSD might generate a downside pressure on EURPLN.

Furthermore, December started – this month is statistically positive for the zloty. In the last 19 years, EURPLN rose in the final month of the year only five times, the last time in 2014. Similarly positive statistics apply also to the equity market. Thus, we remain positive about the zloty in the year-end horizon.

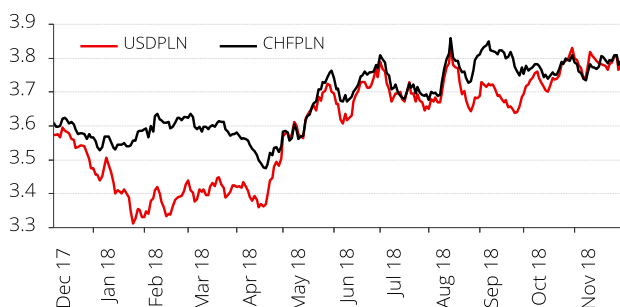
FI The 5Y and 10Y IRS rates have neared their lowest levels since late/mid 2017 and we think they could stay low in the days to come as the recent global data did not support rate hike expectations abroad and Polish MPC maintained dovish tone. We have recently seen supportive comments from the Ministry of Finance about this year's budget performance and this should start having a more positive impact on the domestic bonds. Poland assets swap spreads reached their multi-month peaks and we think there should be a correction of this move in the coming days.

EURPLN and EURUSD



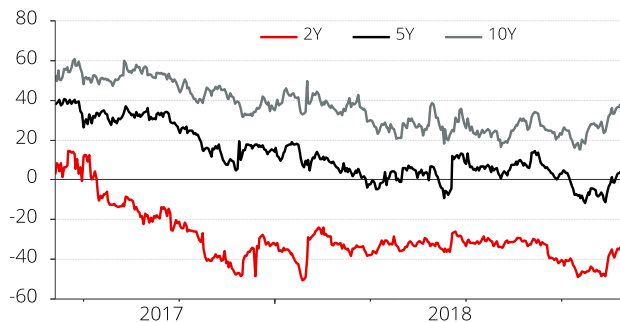
Source: Thomson Reuters Datastream, Santander Bank Polska

USDPLN and CHFPLN



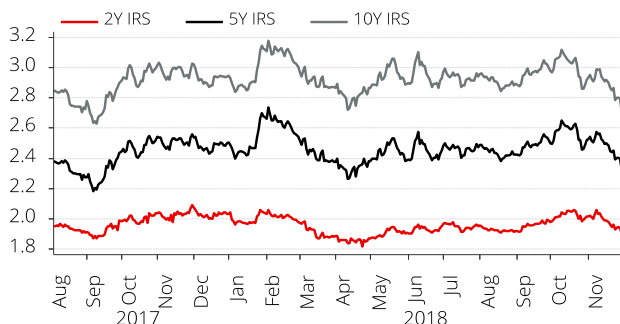
Source: Thomson Reuters Datastream, Santander Bank Polska

Asset swap spreads



Source: Thomson Reuters Datastream, Santander Bank Polska

IRS



Source: Thomson Reuters Datastream, Santander Bank Polska

Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST			LAST
				MARKET	SANTANDER	VALUE*	
MONDAY (10 December)							
08:00	DE	Exports SA	Oct	% m/m	0.4	-	-0.7
09:00	CZ	CPI	Nov	% y/y	2.0	-	2.2
TUESDAY (11 December)							
	UK	Withdrawal Agreement vote					
09:00	HU	CPI	Nov	% y/y	3.3	-	3.8
11:00	DE	ZEW Survey Current Situation	Dec	pts	55.6	-	58.2
WEDNESDAY (12 December)							
11:00	EZ	Industrial Production SA	Oct	% m/m	0.5	-	-0.3
14:30	US	CPI	Nov	% m/m	0.0	-	0.3
THURSDAY (13 December)							
08:00	DE	HICP	Nov	% m/m	0.1	-	0.1
13:45	EZ	ECB Main Refinancing Rate		%	0.0	-	0.0
14:30	US	Initial Jobless Claims	week	k	225	-	231
FRIDAY (14 December)							
09:30	DE	Germany Manufacturing PMI	Dec	pts	52.0	-	51.8
09:30	DE	Markit Germany Services PMI	Dec	pts	53.5	-	53.3
09:30	EZ	Eurozone Manufacturing PMI	Dec	pts	52.0	-	51.8
09:30	EZ	Eurozone Services PMI	Dec	pts	53.5	-	53.4
10:00	PL	CPI	Nov	% y/y	1.2	1.2	1.8
14:00	PL	Current Account Balance	Oct	€mn	-471	-559	-547
14:00	PL	Exports	Oct	€mn	18 723	19 530	17 683
14:00	PL	Imports	Oct	€mn	19 404	19 864	18 132
14:30	US	Retail Sales Advance	Nov	% m/m	0.2	-	0.8
15:15	US	Industrial Production	Nov	% m/m	0.3	-	0.1

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg

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