18 January 2019

Weekly Economic Update

ECB to be more dovish?

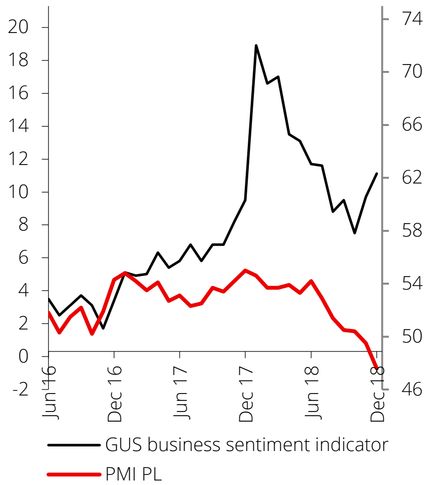
What's hot next week

- In the coming week investors will be focused mainly on external events, like new business sentiment indicators from Europe (ZEW, Ifo, flash PMIs), ECB meeting, UK PM's "plan B" for Brexit, IMF's update of economic forecasts and World Economic Forum in Davos where world leaders and policymakers will meet. The USA remains in the "government shutdown" state and it is hard to predict when this will end.
- **European sentiment indicators** are unlikely to signal an improvement in business activity, and Mario Draghi's press conference is probably going to be dovish (judging by his recent public remarks). This could push markets further into pessimism with respect to European economy's outlook. It could be, that Davos talks will concentrate around the upcoming slowdown.
- **Theresa May's "plan B"** will most likely not be a breakthrough in the Brexit process. The British parliament will be debating on the proposal for a week, and a vote will follow on 29 January. It is quite likely, that the government proposal will be scrapped again, so the uncertainty linked to Brexit will not disappear.
- **In Poland, there will be several new publications**: retail sales, unemployment, GUS leading indicators, money supply, GUS statistical bulletin. We do not expect them to have a material impact on the market, but for us this will be a set of important clues about the economic outlook for the coming months. Retail sales growth should be quite solid (7.3% y/y in constant prices), thanks to, among others, an expected rebound in car sales before the end of the year. The sentiment indicators from the stats office, which showed a nice improvement in the final months of 2018, could now send less optimistic signals. The unemployment rate is going to rise slightly in our view, to 5.9%, more less in line with the seasonal pattern.

Market implications

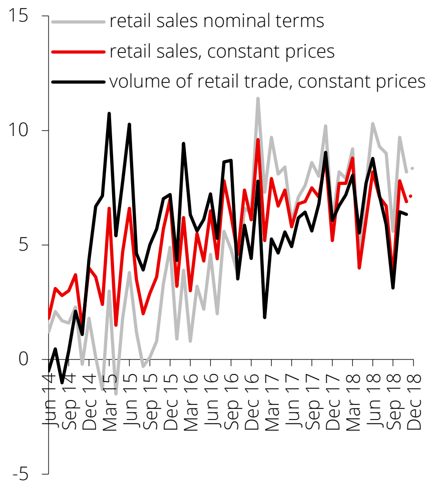
- After the recent slight upside correction, domestic bond yields might stay elevated at the start of the week. The expected weak European PMIs and dovish message from the ECB should make the bonds stronger. The zloty can remain under some negative pressure due to the Brexit uncertainty and weak data from Europe as well as a possible appreciation of the dollar vs the euro.

Industrial business sentiment indicators



Source: GUS, Markit, Santander

Polish retail sales, %y/y



Source: GUS, Santander

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Last week in economy

Data released last week was generally disappointing, but confirmed that the **economy was growing at or slightly below 5% in 4Q18** with likely high contribution from investment, despite recent disappointing data from Germany and China.

In December **Polish industrial output was below expectations** (2.8% y/y vs 5.0% consensus), but in our view this may have been due to calendar effect. While the nominal number of working days was the same as in December 2017, the pattern of holidays encouraged to go on a leave just before year-end. Thus, we view these numbers as one-off negative deviation from the trend of moderate slowdown. Especially, as export-driven sectors recorded a positive performance, confirming the message of the November **strong data on foreign trade turnover**: in November exports advanced by 7.1% y/y despite very weak performance of German industry and Chinese trade in that very month.

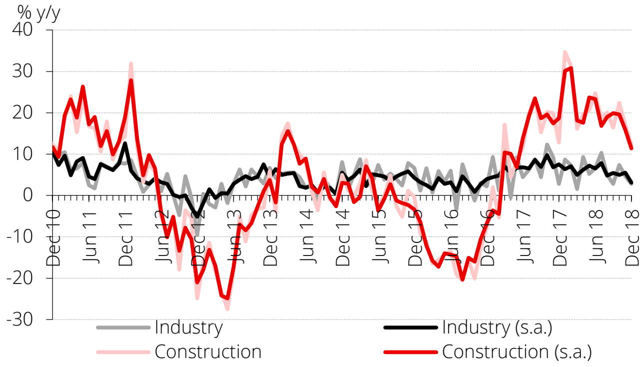
Data on October-November 2018 financial performance of **local governments showed deficit** of PLN5.0bn as compared to PLN1.1bn in the corresponding period of 2017. Based on these numbers, we estimate that: (1) general government deficit in 2018 is unlikely to fall below 0.5% of GDP; (2) local governments added 5-6 percentage points to total investment growth in 4Q18. **December's data on construction** (slowdown to 12.2% y/y) are a bit worrying in this respect, as they showed slowing growth in civil engineering and specialised works, which are closely correlated with public investment.

Wage statistics surprised to the downside in December, showing 6.1% y/y in December versus our forecast at 7.0% y/y. However, this disappointment does not change our expectations for a strong wage growth in 2019, which will be supportive for private consumption. In our view, the major slowdown versus November (7.7% y/y) was mostly due to earlier payment of bonuses in mining. Simultaneous **slowdown in employment growth** (to 2.8% y/y) was in line with our forecast and we expect the jobs creation to continue decelerating this year.

The **Sejm approved the 2019 budget** with central budget deficit at PLN28.5bn and general government deficit estimate at 1.7% of GDP. The bill now goes to Senate and should be ready for President's signature before the deadline on January 27. The Fitch Ratings (A-, stable) revised its GG deficit forecast for 2019 to 2.2% from 2.0% on assumption on higher pre-election spending. We do not see such risk as high, because: (1) the stabilising spending rule does not allow for higher expenditure this year, (2) the macro assumptions for the budget were quite cautious, so the budget revenue is not likely to fall substantially short of the plan.

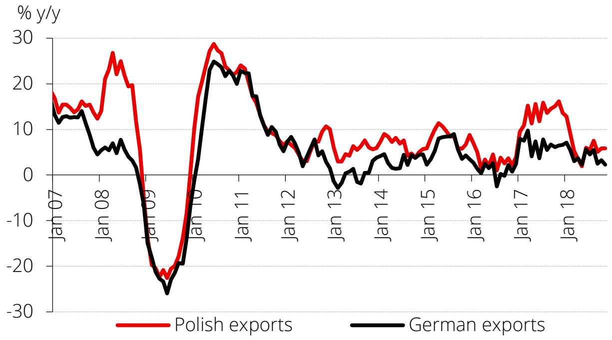
December CPI inflation amounted to 1.1% y/y, in line with the flash estimate. **Core inflation excluding food and energy** was 0.6% y/y in December versus 0.7% in the previous month. This means that the whole surprisingly strong rebound in August to 0.9% has already been offset. We think the December's 1.1% would be a through on the inflation path and CPI should move gradually up in 2019. We expect a peak in December 2019 at just below the 2.5% target. On average, inflation will be slightly below 2% this year which would not generate a pressure on the MPC to hike interest rates.

Output growth, %y/y



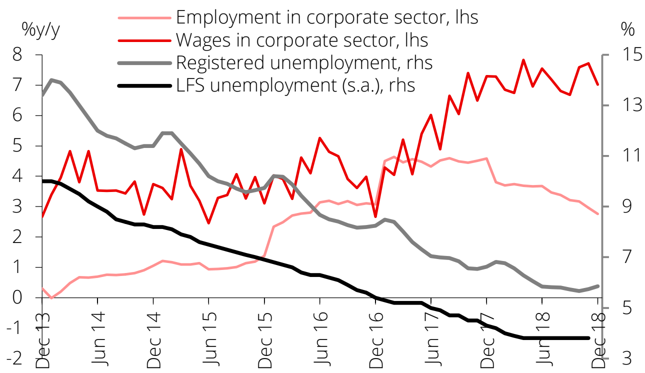
Source: GUS, Santander

Polish vs. German exports, % y/y



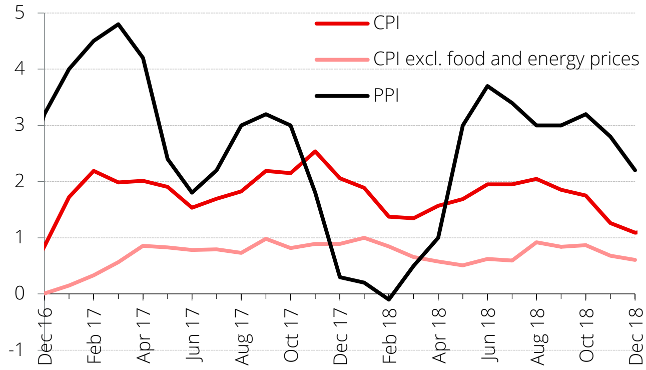
Source: Reuters, NBP, Santander

Labour market indicators



Source: GUS, Eurostat, Santander

Inflation measures, % y/y



Source: GUS, NBP, Santander

FX and FI market

Last week on the market

FX Over the last week, the CEE currencies, as well as PLN, gained. CZK and HUF were hit by hawkish comments of local central bankers. The PLN was supported by the market mood improvement, after the Brexit vote in the British Parliament.

FI At the beginning of the week the yields and IRS rates were decreasing strongly. The downside move was triggered by CEE inflation data release and 4Q18 release of German GDP (the readings surprised on the negative side). Moreover, waiting for the Brexit vote increased the demand for safe assets. In the second part of last week, the market rebounded strongly, owing to profit taking, after the rejection of the Brexit agreement by the British Parliament. As a result the domestic bond yield curve rose by 2-5bp while the IRS curve decreased by 1bp in the 5-10Y segment and returned to the level seen at the beginning of the week in 2Y segment. The domestic industrial production, wages, and employment data did not affect the market.

Key events

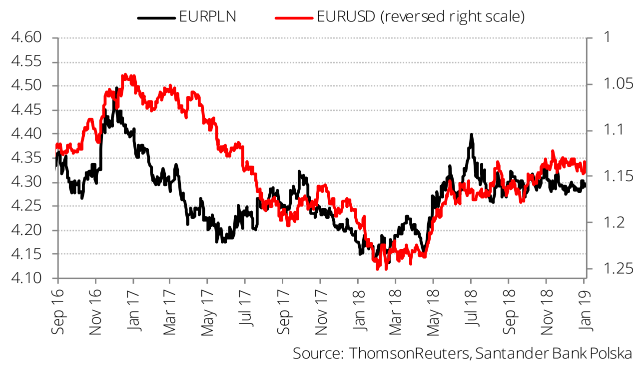
This week we will get to see retail sales numbers (we are slightly below market forecast), money supply (we see faster growth than our peers) and the unemployment rate (in our opinion the reading will be above the market consensus). In the core markets calendar, we have Eurozone PMI data (we do not see a big chance for a rebound). ECB conference is planned for Thursday, and we expect President Draghi to maintain his dovish tone. On Friday we have the regular bonds auction where the Ministry of Finance plans to sell PLN4-8bn.

Market implications

FX We believe that the upward trend of EURPLN will continue next week (the consequence of weaker Eurozone data and stronger US dollar). Moreover, we believe that the ECB conference will translate into lower IRS rates in EUR, which should also support the US dollar and consequently will hit the PLN. In the case of the CEE currencies, we believe that the recent increases in HUF and CZK will be reversed through the profit taking and the negative influence of the worsening Eurozone outlook.

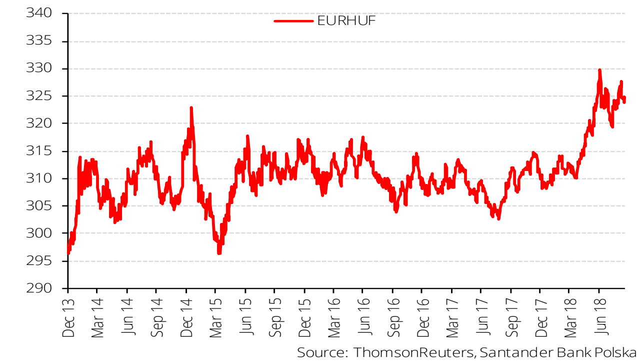
FI In our opinion, at the beginning of the week, the yields of bonds will remain at the current level. Later in the week, we expect the yields to decrease again. In our view bonds yields fall will be triggered by Eurozone PMI release. In our opinion, the ECB conference will be supportive to the yields decreases and will help to slide by 5-8bp in the 5-10 segment, vs. the level from Friday's closing. We believe that German GDP data recently released (increase of 1.5% y/y over the entire 2018, means that Germany in 4Q18 barely managed to reverse the decline recorded in 3Q18.) PMI data release will cause that the conference will be in dovish tone. The end of the week is unlikely to reverse this trend, owing to German Ifo data (we expect further deterioration of indices). Data from Poland should not have a major impact on debt prices.

EURPLN and EURUSD



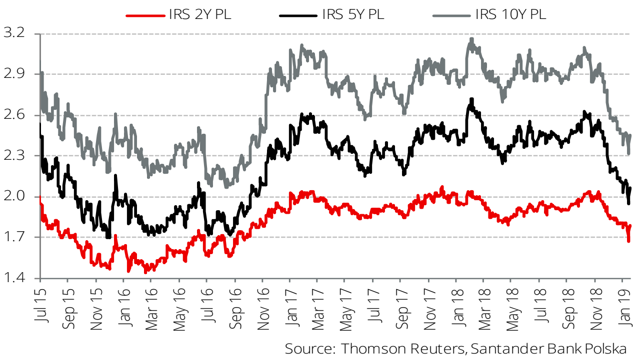
Source: ThomsonReuters, Santander Bank Polska

EURHUF



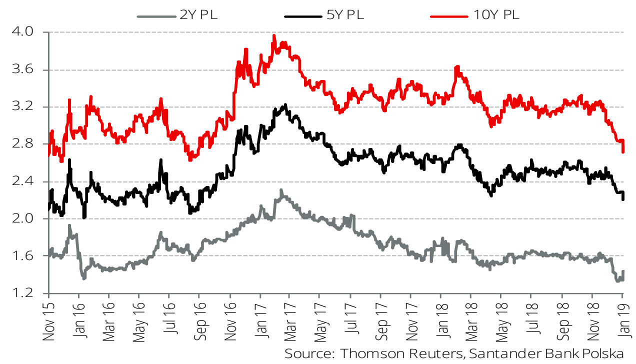
Source: ThomsonReuters, Santander Bank Polska

IRS rates (%)



Source: Thomson Reuters, Santander Bank Polska

Bond yields



Source: Thomson Reuters, Santander Bank Polska

Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST SANTANDER	LAST VALUE
			MONDAY (21 January)				
			No important events				
			TUESDAY (22 January)				
10:00	**PL**	**Retail Sales Real**	**Dec**	**% y/y**	**7.4**	**7.3**	**6.9**
11:00	DE	ZEW Survey Current Situation	Jan	pts	42.8		45.3
16:00	US	Existing Home Sales	Dec	% m/m	-0.94		1.92
			WEDNESDAY (23 January)				
14:00	**PL**	**Money Supply M3**	**Dec**	**% y/y**	**8.6**	**8.9**	**8.8**
			THURSDAY (24 January)				
09:30	DE	Germany Manufacturing PMI	Jan	pts	51.5		51.5
09:30	DE	Markit Germany Services PMI	Jan	pts	52.5		51.8
10:00	EZ	Eurozone Manufacturing PMI	Jan	pts	51.3		51.4
10:00	EZ	Eurozone Services PMI	Jan	pts	51.8		51.2
10:00	**PL**	**Unemployment Rate**	**Dec**	**%**	**5.8**	**5.9**	**5.7**
13:45	EZ	ECB Main Refinancing Rate	Jan-19	%	0.0		0.0
14:30	US	Initial Jobless Claims		k	220.0		216.0
			FRIDAY (25 January)				
	PL	**Central Budget Cumul.**	**Dec**	**mn PLN**	**-**		**11 060.1**
10:00	DE	IFO Business Climate	Jan	pts	100.9		101.0
11:30	**PL**	**Bond Auction**					

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg

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