25 January 2019

Weekly Economic Update

Say goodbye to five percent growth

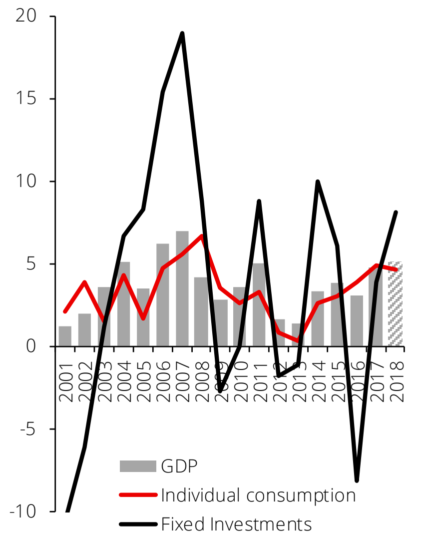
What's hot next week

- The highlights of the coming week are **US-China trade relations** with a month left before implementing a new set of tariff hikes by the USA. China is said to prepare new legislation on intellectual property protection, ahead of the deputy PM visit in Washington. This is a potential source of positive news for the markets. Jerome Powell may help to build a risk-on environment at the **FOMC press conference**, if he sounds dovish. It is uncertain if such rhetoric could lift the euro, as Mario Draghi's speech in the European Parliament may highlight the issue of negative risks to euro zone growth, while offering no looser monetary policy outlook. It would be an understatement to say that the vote on the (amended?) **Brexit Plan B** in UK will be a non-event, but it may attract less market attention than the previous attempt.
- **In Poland, the first estimate of 2018 GDP growth will show 5.1%**, in our view. It will be the highest annual reading since the peak year of 2007, and probably the last GDP print at five percent level for quite some time. Such result for the whole year would indicate c4.8% y/y growth in 4Q – so still solid, but below 5% y/y for the first time in 1.5 years. Domestic demand in 2018 was most likely even stronger than in 2017 (5.7% y/y vs 4.9%), with double pace of investment growth (8.1% vs. 3.9%), but slightly lower private consumption growth (down by 0.2pp to 4.3%). We also think the international trade turnover decelerated from c10% in real terms to 6-7%. We will also get **January manufacturing PMI** – possibly with an attempt to get back at least a bit closer to the neutral 50 pt mark after the massive slide in December. ESI indicators, based on broader sample and with larger sectoral coverage than PMI, should indicate some decline of forward-looking components, like expected output.

Market implications

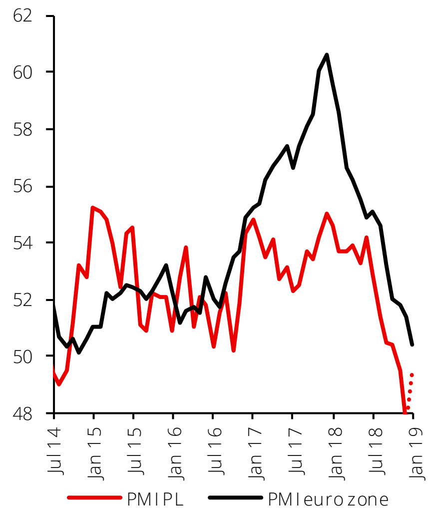
- We think the outcome of the FOMC meeting and press conference will be crucial for the markets this week. Should the FOMC adopt a more reserved approach, the dollar could give up part of the recent gains vs the euro. EURPLN has recently deviated somewhat from the reversed EURUSD but we think that the weaker dollar could be positive for the zloty. However, very low volatility This makes us cautious in assessing the chances for a significant zloty appreciation in the short term. All in all, we expect EURPLN to hold the 4.26-4.34 range.
- FI Polish bond yields and IRS resumed the down trend after a short correction recorded in the previous week. We expect the rates down impulse to hold in the coming days provided that the FOMC sounds even more cautious than in December.

GDP growth in Poland, % y/y



Source: GUS, Santander

PMI manufacturing, pts.



Source: Markit, Santander

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Last week in economy

What we have learned this week is that the number of signals that the Polish economy moved to a slowdown phase is growing. On the other hand, consumer and construction sentiment still look fine, so there should be no rapid deceleration as the economy enters 2019.

January set of GUS **confidence indicators** supports our scenario of a GDP growth slowdown this year, driven by weakening foreign demand. This is signalled by declining indices of expected output in the manufacturing sector (note however that construction sector stood out positively). Survey-based new orders measure declined as well, but remained at an elevated level. The pace at which the value of new orders received by the Polish industry grows actually accelerated in December to 16.6% y/y, albeit the export part looked rather soft (a second month of c2% y/y growth).

The expectations that the growth of economic activity is going to slow down this year are observed more broadly: **Euro zone flash PMIs** for January were yet another negative surprise. The composite indicator (at just 50.7 pts) is the weakest in more than five years and so is the index for German manufacturing (49.9 pts). International Monetary Fund, which has released an update of its **global growth forecasts**, is also now more bearish on the euro zone, slashing its estimate for its this year's GDP growth by 0.3pp to 1.6%, and Germany's by 0.6pp to 1.3%. The fund also indicated an general downside risk to its view, due to major sources of economic uncertainty (trade wars, Brexit, China's ability to maintain its growth). ECB also flagged downward risks to economic growth in Europe.

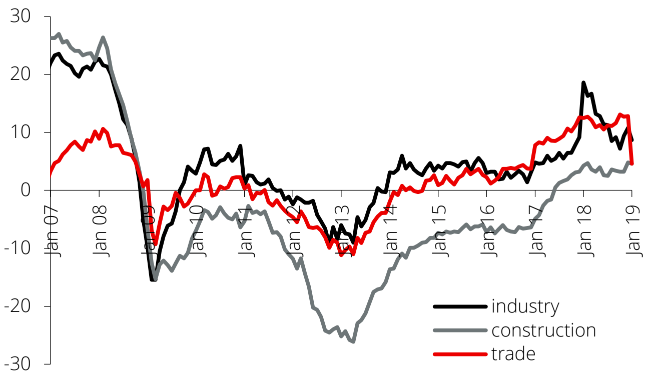
The **Polish retail sales** disappointed in December (3.9% y/y in real terms vs. 7% consensus), as did earlier the output and wages data for the month. This suits however our diagnosis that the dampened activity was caused by the timing of holidays in 2018 encouraged consumers to go on extended leave in late December. In case of retail sales there is another source of weakness, which has more to do with a change of habits than with overall consumer demand: we believe there may have been some acceleration of holiday shopping this year (please recall that November sales were unusually strong). Despite the negative surprise in December, quarterly average growth of retail sales in constant prices in 4Q (6.2% y/y) managed to beat the readings for 2Q (6.1%) and 3Q18 (5.8%).

What is more, the **consumer sentiment** survey for January found a clear rebound. It confirms that the surprising strike of pessimism in December was caused by the government's poor communication regarding the electricity price increase in 2019 and that the underlying consumer demand remains healthy. The expectations part of the consumer survey did not fully recover in January, though, suggesting a (gradual) slowdown in private consumption this year.

Notice also that M3 **money supply** rose faster than expected in December (9.2% y/y). Loans pace of growth corrected for the FX effect was the highest for six years (6.8% y/y), both business and households loans accelerated. Higher pace of credit creation should also act as a factor mitigating the response of the Polish economy to the lower global growth outlook.

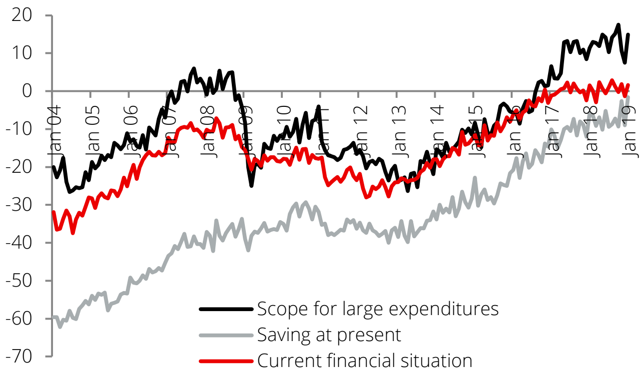
We do not think the recent **comments from MPC members** Eryk Łon, Eugeniusz Gatnar and Jerzy Osiatyński change anything in the monetary policy outlook. In our view interest rates will remain flat this year. Any market speculation for rate hikes would require a big positive surprise from economic activity data or inflation, which does not seem very likely in the near term, in our view. The latter two members indicated a possibility of a rate hike in 2019, naming at the same time several factors against such a scenario (including a lower inflation forecast, below the target throughout the year, and likely a delay in policy normalization by the ECB). While ultra-dovish Łon stated that the lower inflation outlook increases the room for interest rate cuts, Gatnar - one of the most hawkish members would need to see CPI above target to support policy tightening, adding that it is better to be late with a rate hike than too early.

Business sentiment indicators, SA



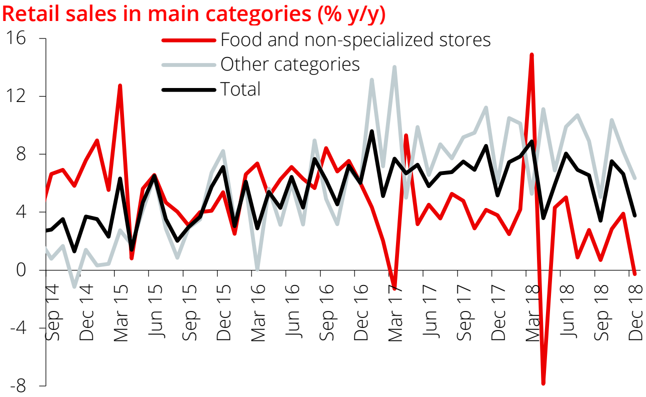
Source: GUS, Santander

Consumer confidence, selected components



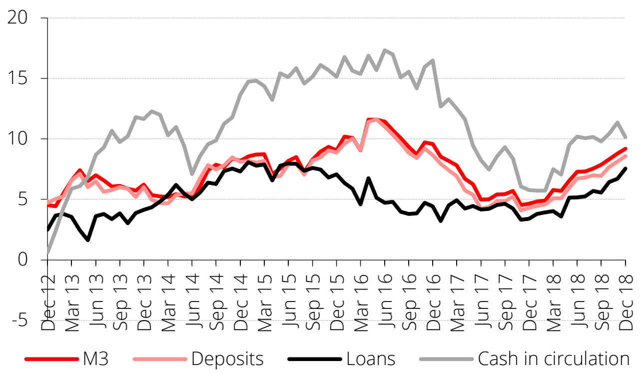
Source: GUS, Santander

Retail sales in main categories (% y/y)



Source: GUS, Santander

Money sypply and monetary aggregates, % y/y



Source: NBP, Santander

FX and FI market

Last week on the market

FX EURPLN remained in the horizontal trend hovering around 4.29. At the time of writing, the weekly high-low spread is the lowest since June 1997, according to the Thomson Reuters data. USDPLN and CHFPLN rose slightly while GBPPLN surged above 4.96 (its highest since June 2018) amid the pound being supported by hopes that there will be no hard Brexit.

FI Bond yields and IRS fell thanks to the next below-consensus Polish macro data and strengthening on the core markets in reaction to the more dovish ECB rhetoric. The 5Y and 10Y Polish asset swap spreads fell by c4bp.

At the bond auction, the Ministry of Finance sold debt for cPLN8.5bn (including PLN480mn at the top-up auction) amid total demand at PLN11.3bn. After the auction the Ministry informed that this year's gross borrowing needs are covered in 43%.

Key events

This week numerous important US data will be released, including the January nonfarm payrolls and manufacturing ISM. The release of the first estimate of 4Q GDP growth could be delayed due to the government shutdown. The FOMC will decide about the interest rates and the meeting will be concluded with Jerome Powell's press conference. In our view, the prolonging government shutdown, no progress in the US-China trade talks and the recent poor global data could influence the tone of the FOMC statement and Powell's message.

In Poland, we will see 2018 GDP release and January manufacturing PMI. The GDP release may help to assess how the economy performed in 4Q. The recent monthly data showed a noticeable weakening in economic activity at the very end of 2018.

Market implications

FX We think the outcome of the FOMC meeting and press conference will be crucial for the markets this week. In December, the Council's members removed one hike from the three expected for 2019, and we think in January the tone could be even more cautious as regards the pace of the monetary policy tightening.

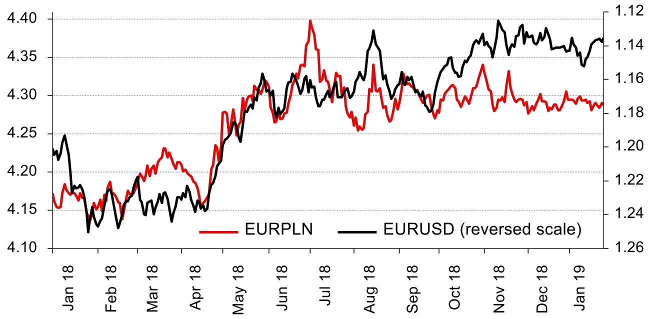
EURUSD has fallen for the second week in a row but the reaction to the dovish rhetoric of the ECB was only temporary. Should the FOMC adopt a more reserved approach, the dollar could give up part of the recent gains vs the euro.

EURPLN has recently deviated somewhat from the reversed EURUSD but we think that the weaker dollar could be positive for the zloty. On the other hand, note that the volatility of EURPLN is holding very low. Periods of a very low volatility are often followed by sharp jumps of price changes and a rise in volatility is usually a negative phenomenon for the EM currencies. This makes us cautious in assessing the chances for a significant zloty appreciation in the short term. All in all, we expect EURPLN to hold the 4.26-4.34 range.

FI Polish bond yields and IRS resumed the down trend after a short correction recorded in the previous week. We expect the rates down impulse to hold in the coming days provided that the FOMC sounds even more cautious than in December. Poland 2018 GDP should not trigger any meaningful market reaction. We think Polish PMI could have rebounded in January after poor performance in the final months of 2018 but this release should also be market-neutral.

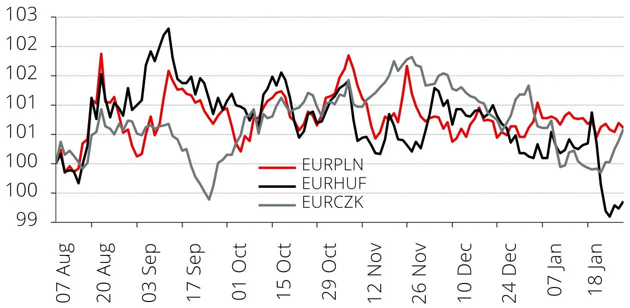
We think that the recent disappointing Poland macro data should push the asset swaps wider in the weeks to come as the outstanding state budget performance in 2018 was one of the main factors supporting the Polish bonds.

EURPLN and EURUSD



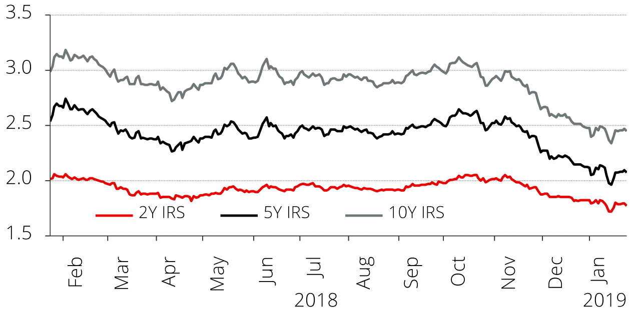
Source: Thomson Reuters Datastream, Santander Bank Polska

CEE currencies (August 1 = 100)



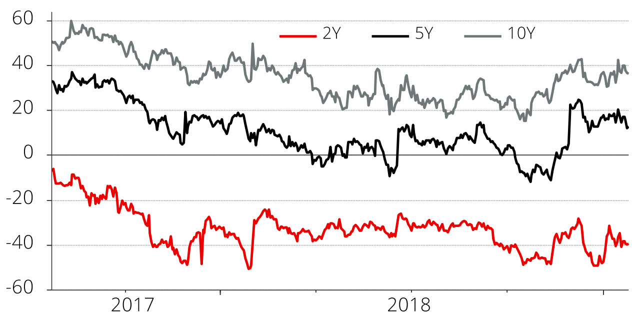
Source: Thomson Reuters Datastream, Santander Bank Polska

IRS rates (%)



Source: Thomson Reuters Datastream, Santander Bank Polska

Asset swap spreads (bp)



Source: Thomson Reuters Datastream, Santander Bank Polska

Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST SANTANDER	LAST VALUE
			MONDAY (28 January)				
		No important data releases					
			TUESDAY (29 January)				
14:00	HU	Central Bank Rate Decision	Jan-19	%	0.9		0.9
16:00	US	Consumer Conference Board	Jan	pts	124.95		128.1
			WEDNESDAY (30 January)				
11:00	EZ	ESI	Jan	pct.	106.95		107.3
14:00	DE	HICP	Jan	% m/m	-0.9		0.3
14:15	US	ADP report	Jan	k	170.0		271.3
14:30	US	GDP Annualized	4Q	% Q/Q	2.5		3.4
20:00	US	FOMC decision		%	2.5		2.5
			THURSDAY (31 January)				
08:00	DE	Retail Sales	Dec	% m/m	-0.6		1.6
10:00	**PL**	**GDP**	**Jul-05**	**% y/y**	**5.0**	**5.1**	**4.8**
11:00	EZ	GDP SA	4Q	% y/y	1.2		1.6
11:00	EZ	Unemployment Rate	Dec	%	7.9		7.9
14:30	US	Initial Jobless Claims	week	k	218.0		199.0
			FRIDAY (1 February)				
09:00	**PL**	**Poland Manufacturing PMI**	**Jan**	**pts**	**47.5**	**49.0**	**47.6**
09:55	DE	Germany Manufacturing PMI	Jan	pts	51.5		49.9
10:00	EZ	Eurozone Manufacturing PMI	Jan	pts	51.35		50.5
11:00	EZ	Flash HICP	Jan	% y/y	1.4		1.6
14:30	US	Change in Nonfarm Payrolls	Jan	k	162.5		312.0
14:30	US	Unemployment Rate	Jan	%	3.8		3.9
16:00	US	Michigan index	Jan	pts	0.0		90.7
16:00	US	ISM manufacturing	Jan	pts	54.25		54.1

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg

Additional information is available on request. Please contact Santander Bank Polska S.A. Financial Management Division. Economic Analysis Department. al. Jana Pawła II 17. 00-854 Warsaw. Poland. phone +48 22 534 18 87. email ekonomia@santander.pl. http://www.santander.pl.