08 February 2019

Weekly Economic Update

Inflation unplugged

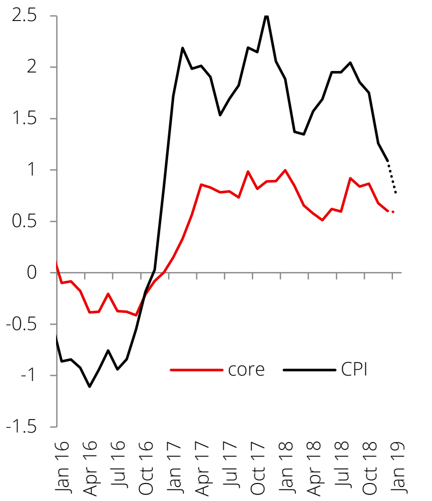
What's hot next week

- **This week we will see Poland's flash 4Q GDP, January CPI and December C/A**. After the total 2018, the 4Q GDP release is unlikely to surprise, with the headline likely below 5% for the first time since 2Q17. We estimate that the slowdown in investments and private consumption were behind the GDP deceleration, while net exports contributed positively.
- On Friday, we will see the flash **January CPI** (under 2018 weights) and this should be much more interesting. Apart from typical uncertainty related to economic forecasting, we do not know how is GUS going to treat changes in energy prices. We assume that the energy prices for households fell by about 5% m/m in January, which could bring the CPI down to 0.7%. Note, however, that the January reading will be revised in March when new basket weights are allocated by GUS. Higher level of uncertainty is clearly reflected in the spread of CPI forecasts – 0.6pp, the widest since May 2017 (0.7pp), according to Parkiet Daily forecasts ranking.
- We expect that a significant deceleration of the December industrial output took its toll on exports and imports leading to a noticeable widening of the foreign trade and current account deficits.
- **Globally**, a few FOMC members will give a speech; and we will see some US data, including CPI and retail sales.
- We should also get **more information from the Brexit front**. On Wednesday, PM May is expected to report what progress she has made in renegotiating the Withdrawal Agreement with the EU. No information on the progress has been released as yet. In the weeks after the UK Parliament had rejected the initial deal, the market has been pricing the lower risk for hard Brexit. However, if no progress is reached in the renegotiations , tension could arise.

Market implications

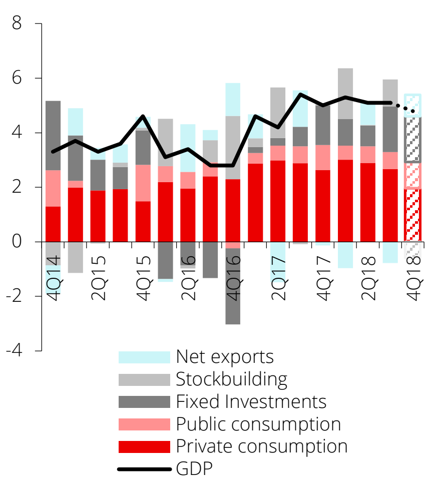
- EURPLN is now back in the range waiting for a stronger impulse that could initiate a persistent directional move. Given the fact that even the change in the FOMC rhetoric failed to trigger higher volatility for longer, it seems that only breaking news on the US-China trade talks or Brexit could trigger a persistent directional move.
- We think that Polish bond curve should not steepen in the coming days. The short-end is already pricing a scenario of stable rates in the next two years (in line with the MPC rhetoric) while the belly could be impressed by the January CPI reading (our forecast is noticeably below the market consensus).

Inflation in Poland, % y/y



Source: GUS, Santander

GDP growth breakdown, % y/y



Source: GUS, Santander

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Last week in economy

The MPC meeting was the highlight of the last week. There was a broad market consensus for no change in the monetary policy parameters but the very late decision announcement sparked some uncertainty. No breakthrough decisions were made and the issue of late announcement was not even brought up in the press conference. The German economic activity data we saw last week were poor, and the NBP credit survey showed how Polish commercial banks may respond to the fist signals of a weakening economic activity.

Unsurprisingly, the MPC left interest rates unchanged with the refi rate still at 1.50%. The February MPC meeting confirmed that we should not expect any change in the interest rates at least in 2019.

The decision was announced at 14:45CET. Last time we had to wait longer in 2010. The tone of the statement did not change and the press conference did not provide any game-changing information, either. Governor Glapiński maintained his view that interest rates may remain unchanged even until 2022 if the scenario presented in the last NBP projection materializes, whilst underlining the conditionality related to this approach and the high uncertainty regarding the global factors. His view was shared by E. Łon and G. Ancyparowicz. The latter MPC member underlined the importance of the upcoming March NBP forecasts, which are to show growth at about 4% and CPI slightly below 2%, according to Glapiński. These are very close to our estimates – we think the total 2019 GDP growth will amount to 3.8% and the annual inflation will rise slightly above only in December.

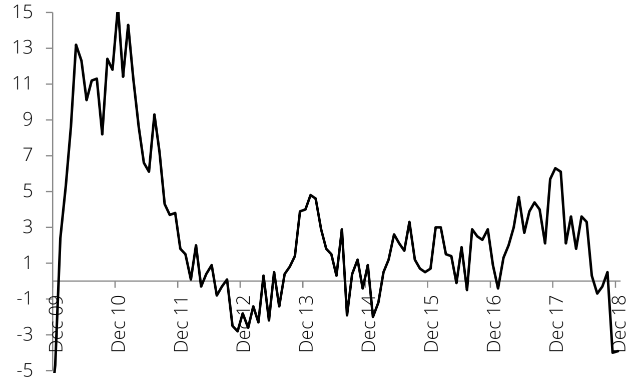
2018 budget closed with a PLN10.4bn deficit, in line with the earlier comments of the Finance Ministry. Reduction in 2017 deficit at PLN25.4bn was achieved mostly due to higher tax revenues, especially in the VAT line, and to lower spending on the Social Security Fund. Detailed data for December alone suggest VAT revenues rising by 60-70% y/y, and we guess that the Ministry decided to postpone some tax returns worth about PLN5bn, which will be booked in 2019 budget. In our view, 2019 will not see such a low deficit even though the government's macro assumptions are quite conservative.

According to the central bank's credit survey, in 4Q18 commercial banks tightened their criteria for mortgage and business loans, particularly for SMEs. This was due to the rising risk in some branches (construction, trade) and the expected capital situation of banks. In case of mortgage loans, stricter approach towards income calculation of individual entrepreneurs was applied. Banks did not report any meaningful change in the demand for loans while they expect it to fade somewhat for mortgages. Banks also expect a further tightening of criteria in this segment.

The International Monetary Fund is expecting a deceleration of Polish GDP growth to 3.6% y/y in 2019, 3.0% y/y in 2020 and to 2.8% y/y in 2021. The IMF cut its forecasts slightly for inflation and central budget deficit, but the scale of changes compared to the previous forecasts (October'18) was rather small. According to the IMF staff, the monetary policy should remain in the wait-and-see mode and respond to the incoming data. In the fiscal policy, IMF recommended further improvement in VAT compliance, better targeting of social benefits and retirement age hike. The European Commission also revised its Polish GDP forecasts – in 2019 to 3.5% from 3.7% expected in November and in 2020 to 3.2% from 3.3%.

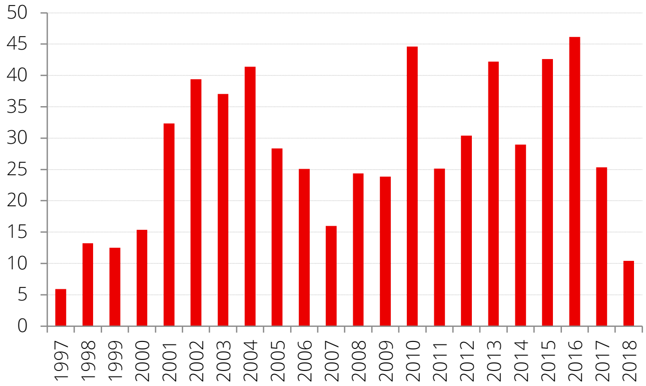
According to the Ministry of Labour, **the registered unemployment rate** rose to 6.2% in January from 5.8%. In monthly terms, the number of the unemployed increased by 55k, slightly more than a year ago (+52k). In our opinion, the GUS reading is likely to show a slightly lower rate (6.1%), but it is worth noting that seasonally adjusted data indicate deceleration of the pace of decline of unemployment.

German industrial output (% y/y)



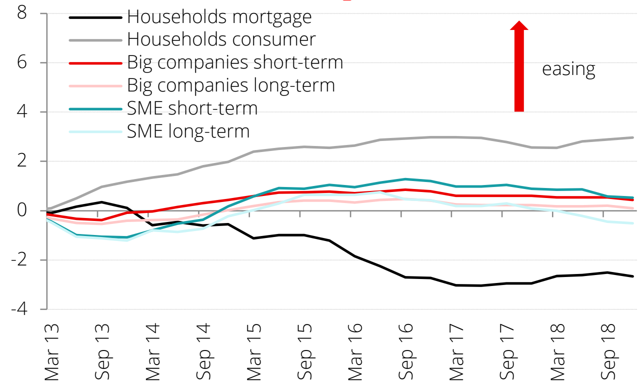
Source: Bloomberg, Santander

Central budget deficit, PLNbn



Source: Finance Ministry, Santander

Credit criteria, accumulated change (end 2012=0)



Source:NBP, Santander

IMF forecasts for Poland – current and change versus October

	2019	2020	2021
GDP	3.6 (+0.1)	3.0 (0.0)	2.8 (0.0)
CPI	2.3 (-0.5)	2.6 (+0.1)	2.5 (0.0)
GG Deficit	-0.8 (+0.7)	-1.3 (+0.1)	-1.7 (-0.4)
Public Debt	46.1 (-2.4)	44.7 (-2.5)	44.1 (-2.1)

Source: IMF, Santander

FX and FI market

Last week on the market

FX The zloty appreciation in reaction to the surprisingly less hawkish FOMC rhetoric has appeared to be very short-lived. Last week, EURPLN jumped to 4.30 from 4.26 (its lowest since early August) in response to the stronger dollar (EURUSD fell after a series of poor German data) and negative signals from the CEE region (the below-consensus Czech industrial output data). USDPLN rose to 3.80 from 3.74, CHFPLN to 3.79 from 3.75 while GBPPLN remained near 4.88.

FI Polish bond yields and IRS fell slightly benefiting from lower rates on the core market. However, Polish debt clearly underperformed Treasuries and to a smaller extent also Bunds. The asset swap spreads remained in the gradual upside trend. Polish IRS and bond yield curves flattened slightly. The general picture of the domestic debt market did not change and the 5Y and 10Y yields are still holding near their lowest levels since mid-2016.

At the auction, the Ministry of Finance sold bonds for PLN5.6bn (PLN5bn at the regular auction, with PLN10.2bn demand). According to the Ministry, the gross borrowing needs for 2019 are now covered in 47%.

Key events

Global factors should be of particular importance, in our view. It seems that the softer FOMC rhetoric has already had its chance to influence the market and there should be no significant reaction to speeches of the Committee members scheduled this week.

As a result, the next round of Brexit saga should attract most of the attention as the March 29 is nearing and there seems to be no progress at all in the negotiations.

We expect a bigger C/A deficit than the consensus and our CPI forecast is at the minimum of the market forecasts range. We do not expect these releases to have any meaningful impact on the zloty but would not provide any support either should the global sentiment deteriorate.

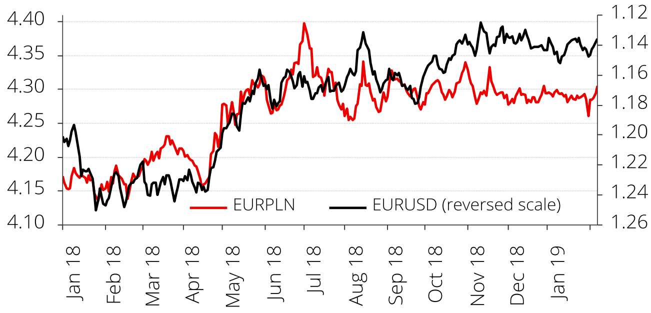
Market implications

FX EURPLN is now back in the range waiting for a stronger impulse that could initiate a persistent directional move. Given the fact that even the change in the FOMC rhetoric failed to trigger higher volatility for longer, it seems that only breaking news on the US-China trade talks or Brexit could trigger a persistent directional move. For the latter, we see the risk that the market could be less convinced pricing the happy end which could generate an upside pressure on EURPLN. EURUSD has neutralized nearly the whole rise recorded after the last FOMC meeting and we see room for the exchange rate to near its 2019 low at below 1.13 in the coming days. Further dollar appreciation may weigh on the zloty.

FI We think that Polish bond curve should not steepen in the coming days. The short-end is already pricing a scenario of stable rates in the next two years (in line with the MPC rhetoric) while the belly could be impressed by the January CPI reading (our forecast is noticeably below the market consensus). As a result, we would rather expect a down pressure on the 5Y yields to emerge in the coming week. The risk factor to the 5-10Y segment is progress in the US internal talks about avoiding the next government shutdown on February 15.

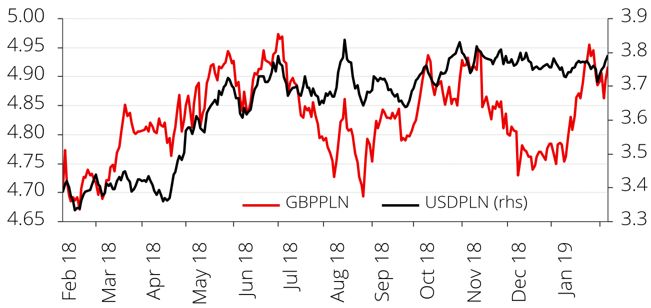
The 5Y and 10Y asset swap spreads are on the way to their 2019 peaks reached in early January at c20bp and 42bp.

EURPLN and EURUSD



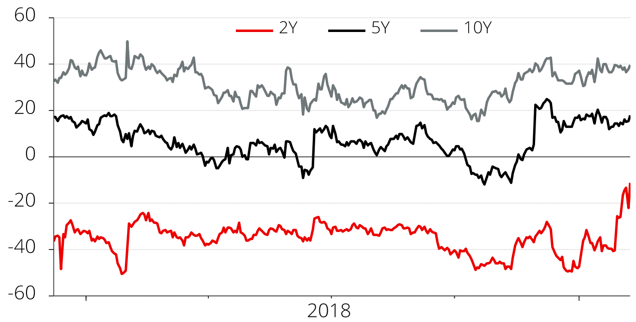
Source: Thomson Reuters Datastream, Santander Bank Polska

GBPPLN and USDPLN



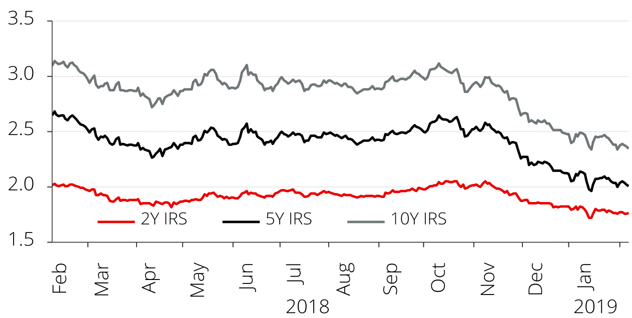
Source: Thomson Reuters Datastream, Santander Bank Polska

Asset swap spreads (bp)



Source: Thomson Reuters Datastream, Santander Bank Polska

IRS rates (%)



Source: Thomson Reuters Datastream, Santander Bank Polska

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Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST SANTANDER	LAST VALUE
		MONDAY (11 February)					
		No important events					
		TUESDAY (12 February)					
09:00	HU	CPI	Jan	% y/y	2.8	-	2.7
		WEDNESDAY (13 February)					
09:00	CZ	CPI	Jan	% y/y	2.1	-	2.0
11:00	EZ	Industrial production	Dec	% m/m	-0.4	-	-1.7
14:00	**PL**	**Current Account Balance**	**Dec**	**€mn**	**-944**	**-1 770**	**-221**
14:00	**PL**	**Trade Balance**	**Dec**	**€mn**	**-1 108**	**-1 640**	**-229**
14:00	**PL**	**Exports**	**Dec**	**€mn**	**16 656**	**16 303**	**20 025**
14:00	**PL**	**Imports**	**Dec**	**€mn**	**18 078**	**17 943**	**20 254**
14:30	US	CPI	Jan	% m/m	0.1	-	-0.1
		THURSDAY (14 February)					
08:00	DE	GDP	4Q	% y/y	0.8	-	1.1
09:00	HU	GDP	4Q	% y/y	4.7	-	4.9
10:00	**PL**	**GDP**	**4Q**	**% y/y**	**4.9**	**4.8**	**5.1**
11:00	EZ	GDP	4Q	% y/y	1.2	-	1.2
14:30	US	Initial Jobless Claims	week	k	221	-	234
14:30	US	Retail Sales	Dec	% m/m	0.1	-	0.2
		FRIDAY (15 February)					
09:00	CZ	GDP	4Q	% y/y	2.4	-	2.4
10:00	**PL**	**CPI**	**Jan**	**% y/y**	**1.0**	**0.7**	**1.1**
15:15	US	Industrial Production	Jan	% m/m	0.1	-	0.35
16:00	US	Flash Michigan index	Feb	pts	94.0	-	91.2

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.