15 February 2019

Weekly Economic Update

Data abundance

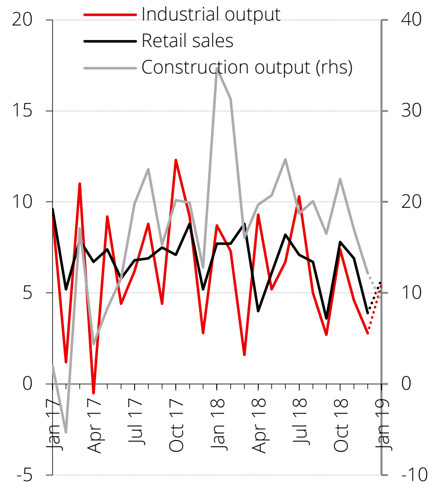
What's hot next week

- **The coming week will be full of domestic and foreign data** that could shed some light on the level of economic activity at the beginning of the year. In Poland, we will see wages and employment (Tuesday), industrial output (Wednesday), construction output and retail sales (Thursday), economic sentiment indexes, money supply and maybe the budget performance after January (Friday). Abroad, we will follow economic activity indexes (flash PMIs, Ifo, ZEW) and US durable goods orders and leading indicators as well as minutes from the last FOMC meeting when the US central bankers softened their rhetoric.
- After the disappointing December readings, **we expect most of the Polish data to show improvement.** Particularly, the seasonally adjusted industrial output should rebound to its average from several previous months ex December (c5% y/y), retail sales should reaccelerate to nearly 6% y/y and wages could rise again at the pace of c7% y/y. This would confirm our hypothesis that a significant deterioration at the very end of 2018 was partly due to the calendar effect that encouraged to take longer leaves. However, we expect the scale of January's improvement to be not enough to reject the scenario of the gradual slowdown we expect this year. 4Q18 GDP growth decelerated marginally below 5% and we expect this trend to gain steam in the quarters to come. 1Q19 growth should be still decent at c4.5% and the total 2019 would amount to 3.8%.
- **In Europe, political uncertainty is likely to persist** with the brand new element of the Spain snap general elections (scheduled for April 28). We shall not see any new information related to Brexit, at least until February 26 when the PM May is to present the progress she has made in negotiations with the EU. It seems that delaying Brexit by at least a year is the most likely option.

Market implications

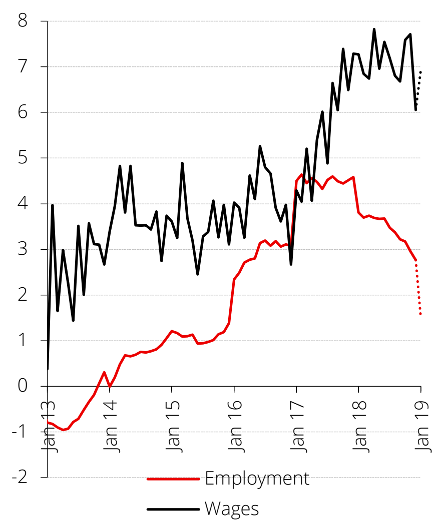
- The zloty could recover slightly in the coming weeks thanks to better Polish macro data, stabilization of economic indicators in Europe and a rebound of EURUSD. On the debt market, we expect yields to rise slightly driven by Polish and foreign data as well as likely rise of the US yields (thanks to postponing the threat of the next government shutdown and good orders data).

Indicators of real economic activity, % y/y



Source: GUS, Santander

Labour market data, corporate sector, % y/y



Source: GUS, Santander

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Last week in economy

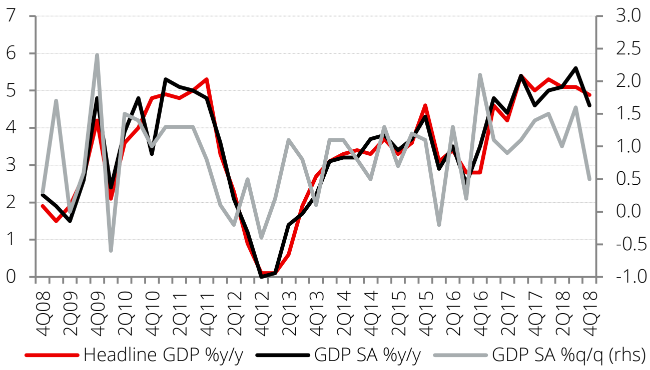
GDP growth in 4Q18 came in at 4.9% y/y, falling below the 5% mark for the first time since mid-2017. Seasonally-adjusted growth reached 0.5% q/q, the lowest since 2Q16, confirming that the Polish economy has finally entered a slowdown. Still, to some extent, 4Q18 results were negatively affected by a calendar effect (the Christmas date favouring extended leaves, so seasonal adjustment would not remove it). We expect a further mild economic slowdown down the road - to 3.8% y/y on average in 2019. The detailed release for 4Q with growth structure is due on 28 February. However, based on tentative full-year figures, it could be estimated that the final quarter saw a slowdown in private consumption and fixed investment (to 3.9% y/y and 6.9% y/y, respectively) and a surprisingly positive contribution from net exports despite the fact that monthly foreign trade data covering 4Q showed a clear deterioration in the balance of goods and services.

The 4Q sum of monthly balances on goods and services trade was €3.53bn in 4Q18 vs €4.22bn in 4Q17. Poland's **current account deficit** in December alone came in at €1.4bn, due to a highly negative trade balance (€-1.34bn, the lowest in seven years). Exports of goods were markedly lower than expected in December, expanding by a mere 2.3% y/y (6.9% was expected), while imports increased 3.0% y/y (vs 6.6% consensus). In our view, the economic slowdown in the euro zone will be a drag on Polish exports, which are likely to underperform in 2019. At the same time, the peak growth of domestic demand is most likely already behind us, which should also soften the growth rate for imports. The bottom line should be a c-0.5pp contribution of net exports this year.

The **preliminary reading of January CPI** was 0.9% y/y while the market consensus was 1% y/y. This does not make the reading a dovish outcome though. Our call was 0.7% y/y, and we assumed correctly that GUS would take into account a large, most likely 5-percent m/m decrease of electricity prices for households (it was not obvious as the legislation that froze electricity prices was questioned by the European Commission, and there were no Ministry-level detailed explanations of how the law should be applied). Food prices surprised us to the downside and yet the headline reading came 0.2pp above our call. This leads us to a conclusion that there was a significant rebound of core inflation in January, to c1% y/y from 0.6%. It seems that the build-up of pressure on margins in the course of 2018, led to widespread increase of price tags with the new year. The reading will be revised in March with new 2019 item weights, but this should not lead to big changes (there might be a slight upside revision). We assume that CPI will be climbing gradually this year together with core inflation, with both going above 2% y/y and possibly above 2.5% (especially core inflation), by the end of 2019.

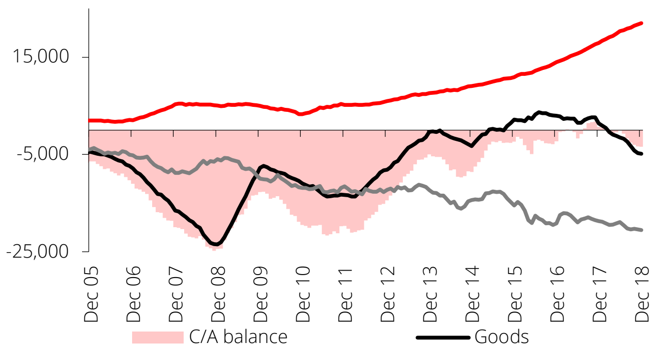
The **national economy wages** maintained a high growth rate, recording 7.7% y/y in 4Q18 (vs 7.6% y/y in 3Q18), even though the average wage growth in the corporate sector declined to 6.6% y/y from 6.9% y/y in 3Q18 and 7.5% y/y in 2Q18. In our view, 2019 will witness a still strong wage pressure, caused by positive unemployment gap and problems with obtaining new labour force. Wages in the national economy are likely to rise by about 7%.

Measures of economic growth in Poland



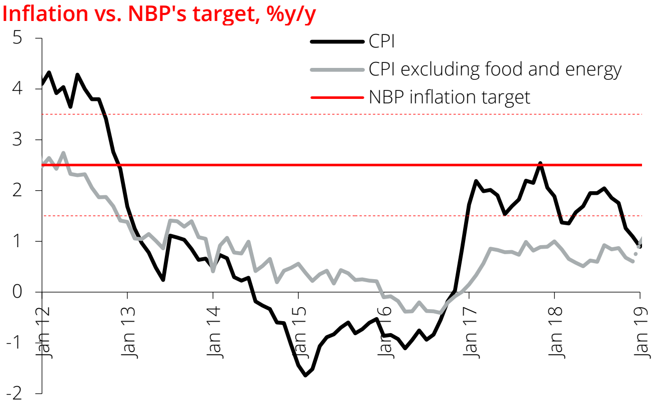
Source: GUS, Santander

Central budget deficit, PLNbn



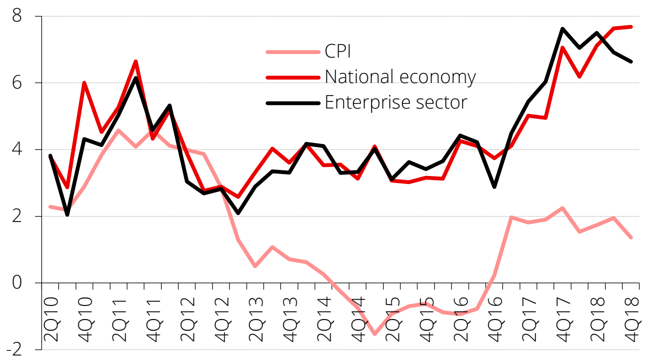
Source: Finance Ministry, Santander

Inflation vs. NBP's target, %y/y



Source: GUS, NBP, Santander

Wage growth measures, % y/y vs inflation



Source: GUS, Santander

FX and FI market

Last week on the market

FX EUR/PLN was rising over the last week, fuelled by the declining EUR/USD and poor European GDP data release. As a consequence, on Thursday, EUR/PLN hit the resistance at 4.34 (the highest level since autumn 2018). USD/PLN also beat the new local high reaching 3.8460 (the highest level since mid-2017).

FI Yields of Polish bonds decreased last week, following the German Bunds. The yields curve slid by 1-6bp across the curve, mostly on the long end of the curve. The yields decline was driven by the poor Eurozone data (German 4Q18 GDP) and US data (retail sales data release for December). The IRS market behaviour was slightly different. At the beginning of the week, IRS rates went up following the UST, while at the end of the week, rates dropped considerably more comparing to the yields of bonds. The 4Q18 Polish GDP data was roughly ignored by market players.

Key events

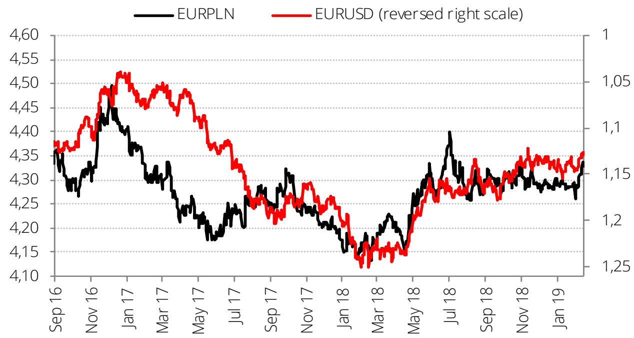
We believe that wages and industrial production data from Poland will be the most important in this week releases (we expect both to rebound after the weak December). Moreover, the switch auction of domestic T-bonds is scheduled for Thursday. The international calendar includes the scheduled flash PMI data for Eurozone, Ifo data from Germany (we expect stabilisation at low level) and US durable goods orders (we believe to have a positive surprise)..

Market implications

FX In our view, the upcoming week should be positive for the zloty. We expect EUR/USD to rebound after two weeks of declines, which could fuel recovery of the Polish currency. The supportive environment could be enhanced also by the Eurozone data (stabilization of economic activity indexes) and the tone of the minutes of the January FOMC meeting (containing broader explanation for the dovish shift). The data on the US durable goods orders, which could push the short end of the US IRS curve up which, in turn, could be negative for the EM currencies, constitute a risk factor.

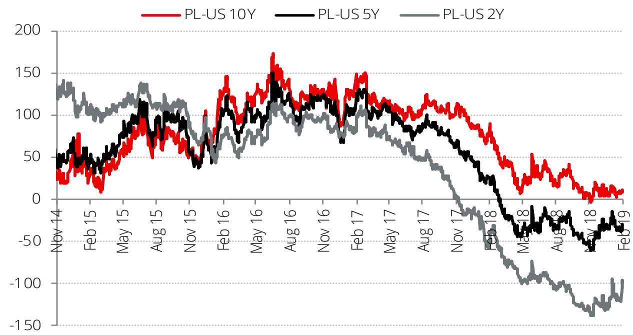
FI The upcoming week could bring some profit taking on the debt market amid Polish data pick-up vs December and the expected stabilization of the PMI and Ifo indexes in the Eurozone. Additionally, Polish bonds could be pressured by the trends on the UST market where yields could rise if the government shutdown is avoided and macro data surprise to the upside. In our view, the switch bond auction in Poland could only have a moderately negative impact on the market. As a result, we expect Polish yield curve to move 3-5 bps up in the 5-10Y segment. Publication of the dovish FOMC minutes is a risk factor for this scenario.

EURPLN and EURUSD



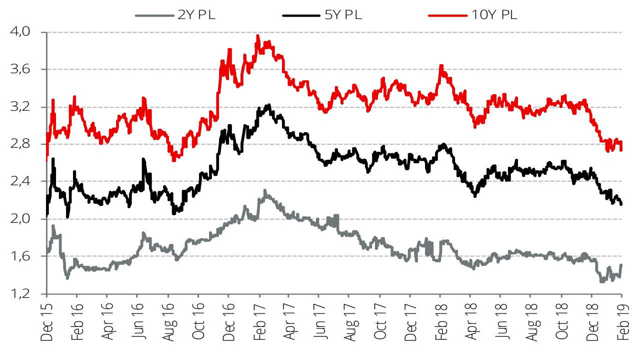
Source: ThomsonReuters, Santander Bank Polska

Spreads between Polish and US bonds



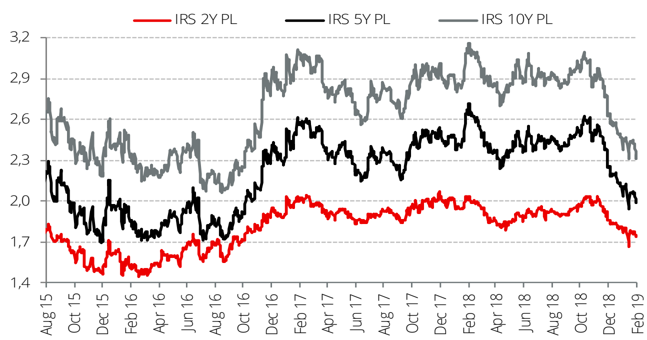
Source: Thomson Reuters, Santander Bank Polska

Bond yields (%)



Source: Thomson Reuters, Santander Bank Polska

IRS rates (%)



Source: Thomson Reuters, Santander Bank Polska

Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST SANTANDER	LAST VALUE
MONDAY (18 February)							
No important events							
TUESDAY (19 February)							
10:00	**PL**	**Employment in corporate sector**	**Jan**	**% y/y**	**1.8**	**1.5**	**2.8**
10:00	**PL**	**Average Gross Wages**	**Jan**	**% y/y**	**6.7**	**6.9**	**6.1**
11:00	DE	ZEW Survey Current Situation	Feb	pts	-		27.6
WEDNESDAY (20 February)							
10:00	**PL**	**Sold Industrial Output**	**Jan**	**% y/y**	**3.75**	**5.5**	**2.8**
10:00	**PL**	**PPI**	**Jan**	**% y/y**	**2.1**	**1.9**	**2.2**
20:00	US	FOMC Meeting Minutes	Jan/19		-		0.0
THURSDAY (21 February)							
08:00	DE	HICP	Jan	% m/m	0.0		-1.0
09:30	DE	Germany Manufacturing PMI	Feb	pts	0.0		49.7
09:30	DE	Markit Germany Services PMI	Feb	pts	0.0		53.0
10:00	EZ	Eurozone Manufacturing PMI	Feb	pts	50.5		50.5
10:00	EZ	Eurozone Services PMI	Feb	pts	51.4		51.2
10:00	**PL**	**Construction Output**	**Jan**	**% y/y**	**5.5**	**9.0**	**12.2**
10:00	**PL**	**Retail Sales Real**	**Jan**	**% y/y**	**4.9**	**5.7**	**3.9**
11:30	**PL**	**Bond Switch Auction**			**-**		
14:30	US	Durable Goods Orders	Dec	% m/m	1.65		0.7
14:30	US	Initial Jobless Claims		k	225		239
14:30	US	Index Philly Fed	Feb		14.5		17.0
16:00	US	Existing Home Sales	Jan	% m/m	0.2		-6.38
FRIDAY (22 February)							
	PL	**Central Budget Cumul.**	**Jan**	**bn PLN**	**-**	**7.0**	**-10.4**
08:00	DE	GDP WDA		% y/y	0.7		0.6
10:00	DE	IFO Business Climate	Feb	pts	99.0		99.1
11:00	EZ	HICP	Jan	% y/y	1.4		1.4
14:00	**PL**	**Money Supply M3**	**Jan**	**% y/y**	**9.4**	**9.4**	**9.2**

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg

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