08 March 2019

Weekly Economic Update

To be, or not to be?

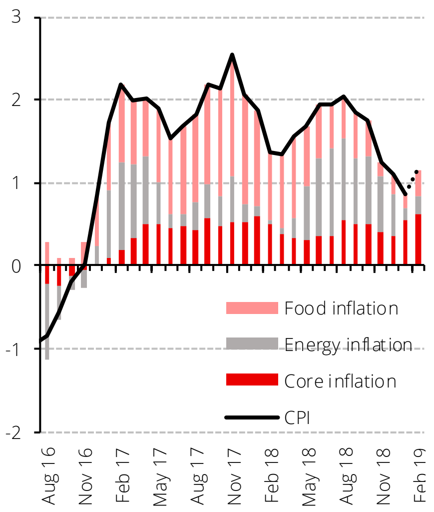
What's hot next week

- **Brexit** is likely to be the topic of the week. Over the weekend the Prime Minister Theresa May will be negotiating the deal with the European Commission and then we will see a chain of important events. On Tuesday the British Parliament is to vote whether to accept the new deal. If it fails (which is probable), then Hard Brexit option will be voted on Wednesday. However, this motion is also unlikely to gain support. Then, on Thursday the Parliament will vote on delaying the Brexit. In our view, the delay seems to be the most viable option, but there is some uncertainty about the length of the extended pre-Brexit period. Actually, we cannot rule out a scenario where none of the motions mentioned above gathers enough support and all the final decisions will be postponed until the very last moment. From the market perspective, this would mean an elevated risk of an uncontrolled Brexit.
- In Poland, release of **inflation data** on Friday is crucial. GUS is to reveal full data for January and February calculated based on new basket weights. Our forecast for February is 1.2% y/y, in line with the market consensus, so the release is unlikely to affect the market. According to our estimates, the basket reweighing may raise the inflation path slightly at the start of the year, but in general the impact should be minute. Also, we would not rule out a correction of January changes in energy prices. New GUS data will help us explain what the culprits behind the January rebound in core inflation to c1.0% y/y were. In our view, this was mostly attributable to changes in clothing prices, which, on the other hand, may be due to methodological issues.
- On Monday NBP will publish **Inflation Report**, which includes details of the updated staff economic projections. We will see what the central bank assumed about the fiscal package and its estimated impact on the economy.
- On Tuesday GUS releases **foreign trade data** for January. A rise of exports by 5-6% y/y and imports by c8% y/y should be recorded. In both cases this would be a slightly slower pace than the average for 2H18. However, for exports this would be quite a positive result, given the worrying signals about the external demand coming from business surveys.
- On Wednesday a session of the Polish parliament, starts, possibly with the Swiss franc bill on the agenda. If this is passed it can cause a negative (but maybe only short-term) response of the zloty.
- Abroad, we will have **important data** from Germany (exports, production), Euro zone inflation, but for the market the key releases will more likely be the ones regarding the USA: durable goods orders, retail sales, Michigan index. After the recent change of the ECB's stance, the market may be a bit more resilient to potentially weak readings from Europe. The US data, in turn, will mostly cover January, when there was a government shutdown. This may mean that market expectations are set rather low and there is room for positive surprises.

Market implications

- The more dovish tone of the ECB and poor European data should keep bond yields depressed. Domestic bonds, which lost significantly after the publication of PiS pre-election promises, may be slowly recovering thanks to, among others, demand of commercial banks and of foreign investors after the spreads to core markets and asset swap spreads had widened. We see a risk of a rebound of yields on the US data releases. For the domestic currency the most important issues will include Brexit and the Swiss franc bill. If the UK accepts the Brexit deal or decides to opt for a significant delay of Brexit (for example, by a year), then the zloty might gain. Otherwise, the domestic currency might be under selling pressure. If Sejm, the lower chamber of the parliament, approves the bill about fx-denominated mortgages, this could be used as an excuse for PLN sell-off, unless changes are introduced to significantly reduce the risks for the banking sector.

CPI inflation structure, % y/y



Source: GUS, NBP, Santander

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Last week in economy

There were no important data releases last week, but we still got to see some interesting information on changes in economic outlook by the OECD, ECB and NBP. We also got some further details on financing and schedule of the new fiscal stimulus in Poland.

OECD again cut global growth forecasts. Presentation attached to the new forecasts is focused on problems with weakening trade. The uncertainty (global and political in case of the euro zone) is undermining the business and consumer confidence, as well as companies' eagerness to invest and employ. Credit growth is also becoming weaker. Situation in China is another serious risk for the global growth. OECD suggested a coordinated fiscal stimulus in the euro zone, as many governments can afford such a move, given low debt and deficit profiles.

The ECB took cue and also cut its GDP and CPI forecasts. Moreover, the ECB Governing Council decided to ease its stance, by extending its forward guidance on rates (no hikes through the end of 2019 vs through summer previously), declaring it will reinvest payments from maturing securities bought under QE long after it start raising rates and announced the third round of the TLTRO programme.

On the contrary, **the NBP has raised its GDP forecasts**, probably at least partly due to taking into account the new fiscal stimulus package. Inflation forecast went down, but this is no surprise, as the November forecast was based on an unrealistic assumption of a big surge in energy tariffs. Now the mid-point of the CPI forecast is only slightly exceeding the 2.5% target on a three-year horizon. During the meeting, **the MPC kept interest rates unchanged**, with the main policy rate at 1.50%. The tone of the official MPC statement did not change. The NBP governor said that the looming fiscal does not increase the chances for monetary tightening. He repeated that rates could remain unchanged until the end of the MPC's term (2022). Overall, the message from the central bank remained broadly unchanged, as we expected. As long as inflation stays low, any change in rhetoric is unlikely, in our view. The situation may get more interesting by the end of this year, as we expect both CPI and core inflation to converge to the 2.5% target. But for now, stability is the name of the game.

The **government showed new information regarding PiS pre-election proposals**, naming several sources of their funding. Most of the sources are based on further closing of loopholes in the tax system, the pension system and the healthcare system. There was also reference to digitalization of public administration as a source of substantial savings as well as to the idea of taxing foreign companies which provide internet services. At the press conference, further details were given about the implementation schedule: 13th pension will be introduced in May, 500+ extension in July, lower PIT and zero PIT for the young with at the beginning of October. Draft bill on additional pension states that it is a one-off payment, so it will not be automatically extended into 2020. Prime Minister Mateusz Morawiecki stressed that **the extra spending will not push Polish general government deficit above the EU threshold of 3% of GDP**. In his view it will rise to 1.5-2.0% or slightly higher.

OECD economic growth forecasts – current vs November (in brackets)

	2019	2020
World	3.3 (3.5)	3.4 (3.5)
Euro zone	1.0 (1.8)	1.2 (1.6)
Germany	0.7 (1.6)	1.1 (1.4)
France	1.3 (1.6)	1.3 (1.5)
Italy	-0.2 (0.9)	0.5 (0.9)
UK	0.8 (1.4)	0.9 (1.1)
USA	2.6 (2.7)	2.2 (2.1)

Source: OECD, Santander

ECB economic forecasts – current vs December (in brackets)

	2019	2020	2021
GDP	1.1 (1.7)	1.6 (1.7)	1.5 (1.5)
CPI	1.2 (1.6)	1.5 (1.7)	1.6 (1.8)

Source: ECB, Santander

NBP growth forecasts

Source: NBP, Santander

Government assumptions effects of closing loopholes

	PLNbn
Social security loopholes	2.0-3.0
Health Fund loopholes	1.0-2.0
VAT compliance	4.0-6.0
CIT compliance	4.0-6.0
Excise duty compliance	1.0
Digitalisation of administration	2.0-3.0
Digital tax	1.0
Total	15.0-22.0

Source: Finance Ministry, Santander

FX and FI market

Last week on the market

FX Over the most part of the last week, EURPLN stayed relatively stable. Later in the week, EURPLN climbed to 4.3160 from 4.2990, after which it went down to 4.3090. This was a reaction to the ECB conference (the soft tone of the conference surprised the market), which strengthened US dollar (EURUSD slid to 1.1180 from 1.1390, then returned to 1.1220).

FI Last week the domestic yields were decreasing. In the first part of the week, domestic yields followed the falling stock markets, nervously reacting to the information from China (lower forecast for GDP growth and poor PMI-services release). Later in the week, the bond prices climbed fuelled by the tone of the ECB conference. At the conference, a new projection was presented (with the lower growth and inflation projections) and the third edition of targeted longer-term refinancing operations (TLTRO-III) was announced. As a result, the domestic yield curve declined by 5-12bp (mostly in the long end), following the European bonds market (yields of DE10Y decreased by 7bp to 0.05%, the lowest level since October 2016).

Key events

This week the bonds market players will be focused on the US data. Investors will be looking for signals of improving of US economic outlook before the next FOMC meeting (scheduled for the next week), with the new economic projection.

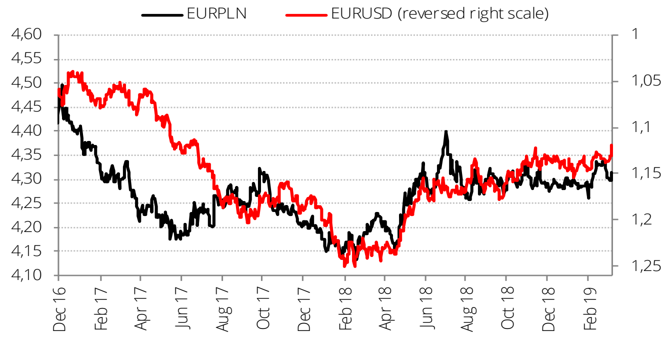
This week, the FX investors' eyes will be on the Brexit story and the attempts to pass the Swiss franc bill in the Polish parliament. At the end of the week, market players should focus on the US market information.

Market implications

FX In our opinion the uncertainty associated with the Brexit as well as the Swiss franc bill story in the Polish parliament could moderately negatively affect the zloty. Moreover EURPLN may be pushed up by the expectations for the better US data, before the FOMC conference scheduled next week (which may strengthen the dollar). Consequently we expect the zloty to stay in the range 4.2950-4.3400 with the higher risk of breaking the upper end.

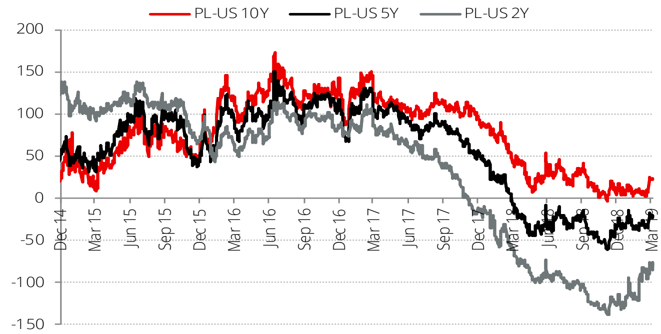
FI For the better part of the week, we expect domestic yields to remain close to the current level (while on the European market they should stay close to the historical lowest level) owing to the released European data (we believe that those data will remain poor). Closer to the end of the week, markets players should be focused on the US coming data. They will look for signs of a rebound, before the FOMC conference scheduled next week. Given that the presented data will cover January ("government shutdown" period), even slightly better-than-expected reading may negatively impact the bonds market. Consequently, we expect the bonds prices to decrease slightly (we believe the yield curve to increase by 2-3bp), and at the same time we anticipate the PL10Y/US10Y, PL10Y/DE10Y spreads and ASW spreads to narrow (by 5-7bp), after they have risen materially over the last weeks. The domestic inflation data, if do not deviate much from the consensus (at least by 0.2pp), will be ignored by investors.

EURPLN and EURUSD



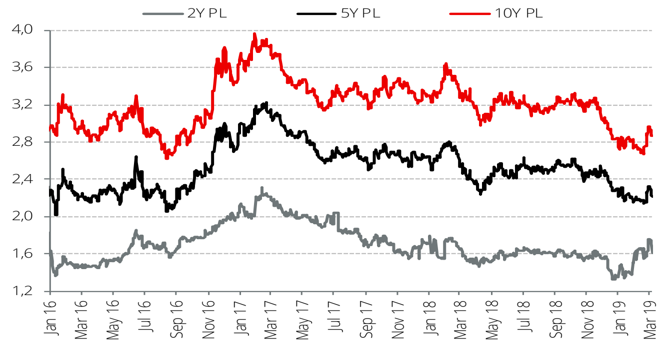
Source: ThomsonReuters, Santander Bank Polska

Spreads between Polish and US bonds



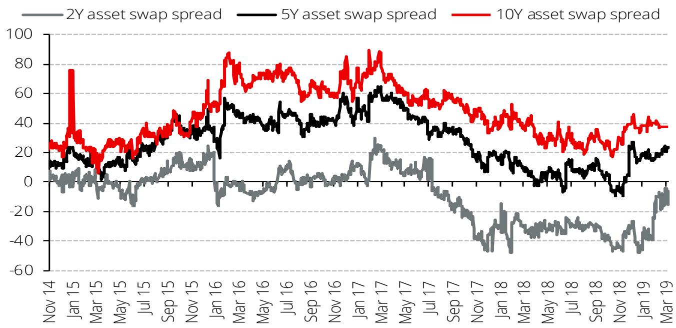
Source: Thomson Reuters, Santander Bank Polska

Poland bond yields



Source: Thomson Reuters, Santander Bank Polska

Poland asset swap spreads



Source: ThomsonReuters, Santander Bank Polska

Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST SANTANDER	LAST VALUE
			MONDAY (11 March)				
08:00	DE	Exports SA	Jan	% m/m	-0.5		1.5
08:00	DE	Industrial Production SA	Jan	% m/m	0.35		-0.4
09:00	CZ	CPI	Feb	% y/y	2.6		2.5
13:30	US	Retail Sales Advance	Jan	% m/m	0.0		-1.2
			TUESDAY (12 March)				
13:30	US	CPI	Feb	% m/m	0.2		0.0
			WEDNESDAY (13 March)				
11:00	EZ	Industrial Production SA	Jan	% m/m	0.5		-0.9
13:30	US	Durable Goods Orders	Jan	% m/m	-0.75		1.2
			THURSDAY (14 March)				
08:00	DE	HICP	Feb	% m/m	0.5		0.5
13:30	US	Initial Jobless Claims	Mar.19	k	225.0		223.0
15:00	US	New Home Sales	Jan	% m/m	1.04		3.7
			FRIDAY (15 March)				
09:00	CZ	Industrial Production	Jan	% y/y	1.6		-1.4
10:00	**PL**	**CPI**	**Feb**	**% y/y**	**1.2**	**1.2**	**0.9**
11:00	EZ	HICP	Feb	% y/y	1.5		1.5
14:15	US	Industrial Production	Feb	% m/m	0.6		-0.58
15:00	US	Michigan index	Mar	pts	95.8		93.8

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg

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