15 March 2019

Weekly Economic Update

Third time's a charm

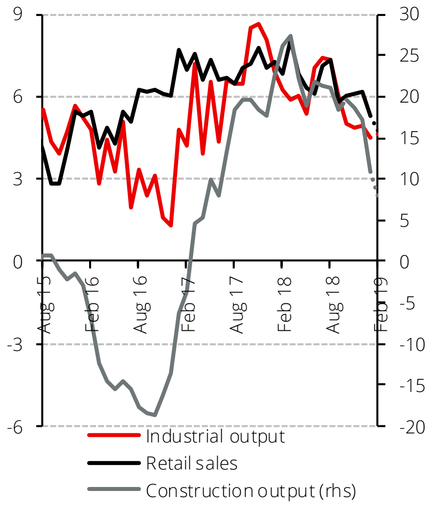
What's hot next week

- **Brexit** will remain on the headlines in the coming days. Here is, in short, what happened last week: on Tuesday the UK parliament rejected for the second time the Brexit deal, on Wednesday it rejected the possibility of a no-deal Brexit, on Thursday it instructed the government to try to delay the Brexit date. What is coming this week: on Tuesday the UK parliament will vote for the third time on the Brexit deal negotiated by the government. If it is accepted then PM May will ask the EU side for a 'technical' extension of the Brexit date to 30 June during the 21-22 March European Council meeting – which means the 'soft Brexit' scenario is materialising. If the deal is rejected again, the UK government will ask the EU for a 'long extension' of the date - it is still not known how long a delay would be sought, probably a year or two. The UK government will also have to justify clearly the request, for example by declaring snap elections or another referendum. To be precise: the Tuesday vote will still be about the same Brexit deal that was already rejected twice, which begs the question if it makes sense to expect a different outcome this time. The situation is however somewhat different, because after the last week's votes the hard Brexit scenario is much less probable while the most likely outcome is a significant delay of the Brexit date, possibly even a reversal of the whole process of leaving the EU. As a result, the pro-Brexit MPs, which up to now opposed the deal considering it as insufficient, might change their mind. The probability of such outcome would rise if by Tuesday there was a new opinion of the government's Attorney General stating that the unilateral withdrawal of the UK from the backstop mechanism will be possible. Summing up, for now we should focus on **two possible outcomes: (1) 'soft Brexit' around the middle of this year; (2) significant extension of the Brexit date** with a possible watering-down of the process or a complete halt. We think the latter option seems more likely. Hard Brexit is still theoretically possible, but its probability is decreasing.
- Another market-relevant event this week will be **Fed meeting** (decision on Wednesday evening), with a new set of economic forecasts. We assume a broadly unchanged rhetoric, which is already quite dovish. The market is pricing in rate cuts in the USA, which we do not find well justified.
- There will also be **plenty of data releases in Poland and abroad**. As for the domestic publications (output, retail sales, wages, employment, among others) we expect a confirmation of a slightly slower but still solid economic activity growth in 1Q, more less in line with the consensus. From the market perspective, the key releases may be European business sentiment indices, which will show us if the economy is trying to recover from a painful slowdown from late 2018.

Market implications

- Recently, the FX market volatility was limited due to Brexit-related uncertainty and hence no eagerness to open positions. This factor could disappear soon and both the soft Brexit and a major delay should be positive for EUR, PLN and GBP. In case of FI market, we are expecting both the European business confidence and the Fed meeting to support higher yields, as they are unlikely to confirm negative pictures of the European and US economies.

Output and sales growth, %y/y (3M moving average, constant prices)



Source: GUS, Santander

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Last week in economy

Last week started with the release of NBP staff's Inflation Report, including the details of the economic projections update, and ended with the publication of final January and February CPI. While GUS data signalled a recovery of core inflation thanks to accelerating services prices and a stronger than expected contribution from food, the NBP report showed a muted inflation outlook for 2019-2021, with a less steep path of core CPI.

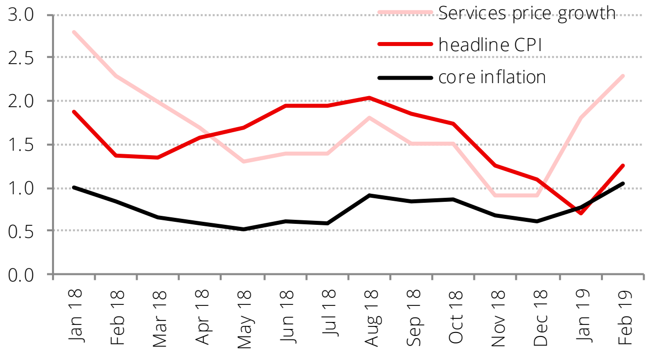
In February, **CPI** rose to 1.2% y/y, in line with expectations and despite a downward revision of January reading to 0.7% from 0.9%. We estimate that core inflation rose from 0.6% y/y in December to c0.7-0.8% y/y in January and 1.0-1.1% y/y in February – with the striking and broad-based acceleration of services' prices (reaching 0.9%, 1.8% and 2.3% respectively). The data do not change our outlook for inflation – we expect core CPI to climb to 2.5% y/y and headline CPI to slightly above 2.0% y/y at the year end.

The **new NBP projection** assumes a much lower inflation path than its previous forecast. CPI is projected to remain subdued in 2019, rising to slightly above 2.5% at the start of 2020 and returning to slightly below the target in 2021 – giving the MPC an argument to hold the interest rates stable for a long time (NBP governor Adam Glapiński reiterated that the rates could remain unchanged for the rest of his term in 2022). Interestingly, core inflation was also trimmed substantially by NBP vs. the previous forecast. Lower CPI was justified by the lack of energy price hikes, while lower core inflation resulted from a downward revision of the output gap (higher potential output). The report did not assume a freeze of electricity prices to hold after 2019, yet the inflation path does not look alarming, in our view. The report went even further by claiming there is asymmetric downside risk to the central CPI path. The upcoming fiscal stimulus is described as a growth-boosting measure (private consumption revised up significantly), but is expected to impact CPI in a negligible way. This conclusion was questioned by MPC's Łukasz Hardt, who thinks it is difficult to exclude the option of considering a rate hike in 2020 given the announced strong fiscal boost, that in his view will push CPI above the projected path next year. The impact of the fiscal package on GDP, together with a higher starting point, more than offset the significant downward revision of assumed growth among the main trade partners, leading to a higher path of economic growth than in November edition of the NBP report and higher than our current forecasts.

Fitch rating agency released its macroeconomic update soon after the NBP report, seeing some aspects of the Poland's outlook differently: in the next five years potential pace of Poland GDP growth would amount to 2.6% y/y on average, while in the March economic projection the NBP revised its estimates up to 3.4-3.6% for 2019-2021. According to the agency, deteriorating demography will curb the GDP growth. Fitch does not assume the participation rate could rise in the years to come, due to the lower retirement age and higher social transfers, which is in contrast to NBP' that expects it to rise systematically. On March 29, Fitch could review Poland credit rating, currently at "A-" with stable outlook.

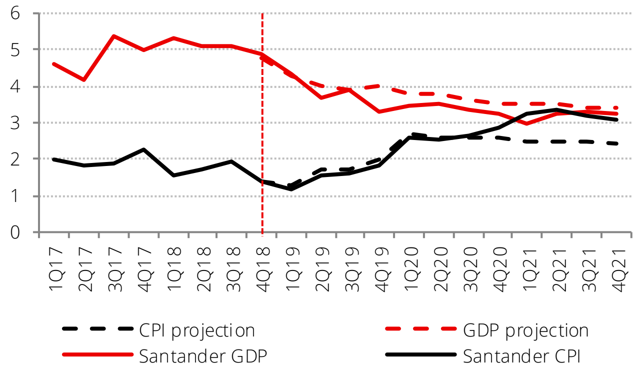
According to the **GUS data on foreign trade**, in January exports rose 2.4% y/y and imports 0.1% y/y while we expected 5-6% y/y and 8% y/y, respectively. Foreign trade turnover of goods appeared much lower than we expected while the balance surprised to the upside. We assumed that after poor December caused by long holidays, in January exports and imports would revive noticeably, despite negative signals on foreign demand in business surveys. Broader trade data, including services, will be released on Monday by the central bank.

CPI inflation, selected measures, %y/y



Source: GUS, Santander

NBP projections vs Santander forecasts



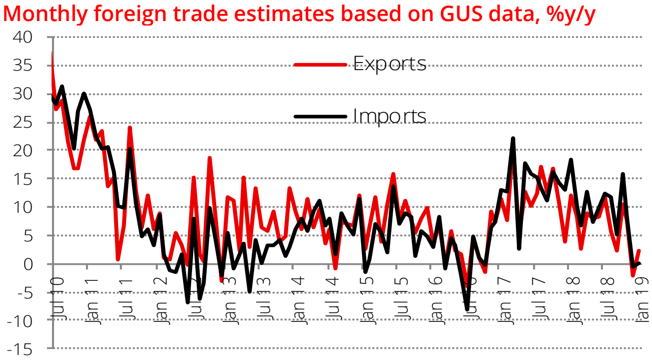
Source: NBP, Santander

NBP projections: Mar'19 vs Nov'18 (in brackets)

	2019	2020	2021
CPI	1.7 (3.2)	2.7 (2.9)	2.5
Core CPI	1.6 (2.1)	2.2 (2.7)	2.1
GDP	4.0 (3.6)	3.7 (3.4)	3.5
Potential GDP	3.4 (3.1)	3.6 (3.4)	3.6
GDP abroad	1.3 (1.9)	1.5 (1.6)	1.4
Private consumption	4.4 (3.8)	4.3 (3.4)	3.6
Participation rate	56.7 (56.6)	56.9 (56.7)	56.9

2021 was covered for the first time
Source: NBP, Santander

Monthly foreign trade estimates based on GUS data, %y/y



Source: GUS, Santander

FX and FI market

Last week on the market

FX Last week, EURPLN and CHFPLN remained pretty stable, USDPLN fell amid rising EURSD while GBPPLN was hovering in a wide range around 5.0. At the time of writing, the EURPLN weekly high-low spread is the lowest since June 1997 as the voting results in the UK parliament failed to trigger any persistent changes on the market.

FI Trading on the Polish interest rate market was also rather calm and IRS and bond yields recorded only a mild rise. Bunds and Treasuries stabilized after a strengthening recorded in the previous week and so there was no impulse for a meaningful change from the core market.

Key events

The EU summit likely devoted to Brexit, the FOMC decision and flash March PMIs are the most awaited events of the coming week.

PM May will try to postpone Brexit after the third meaningful vote will take place (currently scheduled for Tuesday).

FOMC members will have an updated CPI and GDP forecasts at their disposal at the March meeting after they have removed two rate hikes from the 2019 agenda in January.

In February, composite PMIs for the euro zone and Germany rose and gave hope that the trend of the slowing economic growth observed since early 2017 could be finally nearing an end. This month we may see if these hopes were justified.

In Poland, we will see numerous economic activity data that should rather not trigger any meaningful market reaction.

Market implications

FX We think that we could see at least some temporary solution of the Brexit issue this week and this would be the crucial factor for the market. If the risk for the hard Brexit is avoided (or reduced noticeably), investors would rather not care about any gloomy comments from the FOMC or any further drop of the PMIs. This would be the case if the British Parliament accepts the deal or PM May negotiates a long extension of the Article 50.

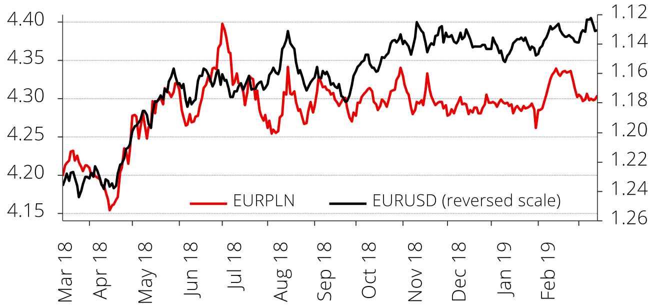
Such scenario should be positive for the zloty vs the euro, dollar and franc – as equities and EURUSD might rise. At the same time, the zloty might depreciate vs the pound. We think that the recent small changes on the market were the result of a higher uncertainty about how the Brexit case would evolve.

Important levels to watch for EURPLN are 4.32 (next resistance at 4.34) and 4.295 (next support at 4.26).

FI Polish 5Y bond recovered roughly a half, while the 10Y benchmark one third of losses suffered after the PiS presented their election promises. Decisions related to Brexit could be the main event also for the debt market. Should our base case scenario for the FX market materialize, we think this could be positive for bonds as the credit risk would fall. Later in the week, yields could rise if the FOMC sounds more confident as regards the US economic outlook and PMIs rise. However, we do not expect any correction to neutralize the potential gains recorded after the positive Brexit solution.

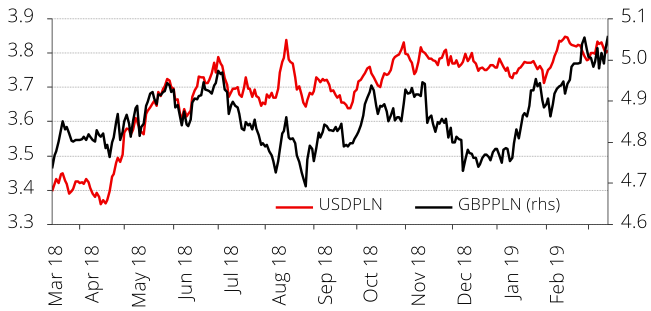
Additionally, some mild support for the Polish bonds could come from the domestic side as we expect February data to confirm that mild slowdown of growth is present at the beginning of the year.

EURPLN and EURUSD



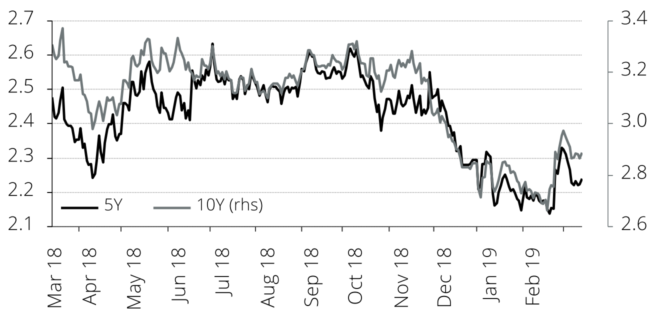
Source: Thomson Reuters Datastream, Santander Bank Polska

USDPLN and GBPPLN



Source: Thomson Reuters Datastream, Santander Bank Polska

Poland 5Y and 10Y bond yields



Source: Thomson Reuters Datastream, Santander Bank Polska

Poland asset swap spreads

Source: Thomson Reuters Datastream, Santander Bank Polska

Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST SANTANDER	LAST VALUE
		MONDAY (18 March)					
14:00	**PL**	**CPI Core**	**Jan**	**% y/y**	**-**	**0.8***	**0.6**
14:00	**PL**	**CPI Core**	**Feb**	**% y/y**	**1.0**	**1.0***	**-**
14:00	**PL**	**Current Account Balance**	**Jan**	**€mn**	**1 741**	**1 559**	**-1 400**
14:00	**PL**	**Trade Balance**	**Jan**	**€mn**	**-242**	**-493**	**-1 340**
14:00	**PL**	**Exports**	**Jan**	**€mn**	**18 694**	**18 694**	**16 005**
14:00	**PL**	**Imports**	**Jan**	**€mn**	**18 666**	**19 187**	**17 345**
		TUESDAY (19 March)					
10:00	**PL**	**Employment in corporate sector**	**Feb**	**% y/y**	**2.9**	**2.9**	**2.9**
10:00	**PL**	**Average Gross Wages**	**Feb**	**% y/y**	**7.2**	**7.5**	**7.5**
11:00	DE	ZEW Survey Current Situation	Mar	pts	13.0	-	15.0
15:00	US	Factory Orders	Jan	% m/m	0.0	-	0.1
		WEDNESDAY (20 March)					
10:00	**PL**	**Sold Industrial Output**	**Feb**	**% y/y**	**4.9**	**5.1**	**6.1**
10:00	**PL**	**PPI**	**Feb**	**% y/y**	**2.8**	**2.9**	**2.2**
19:00	US	FOMC decision		%	2.5	-	2.5
		THURSDAY (21 March)					
10:00	**PL**	**Construction Output**	**Feb**	**% y/y**	**4.5**	**8.0**	**3.2**
10:00	**PL**	**Retail Sales Real**	**Feb**	**% y/y**	**5.6**	**5.0**	**5.2**
11:00	**PL**	**Bond auction**					
14:00	**PL**	**Minutes RPP**					
13:30	US	Initial Jobless Claims	week	k	225	-	229.0
13:30	US	Index Philly Fed	Mar	pts	4.0	-	-4.1
		FRIDAY (22 March)					
09:30	DE	Flash Germany Manufacturing PMI	Mar	pts	48.1	-	47.6
09:30	DE	Flash Markit Germany Services PMI	Mar	pts	54.8	-	55.3
10:00	EZ	Flash Eurozone Manufacturing PMI	Mar	pts	49.5	-	49.3
10:00	EZ	Flash Eurozone Services PMI	Mar	pts	52.5	-	52.8
14:00	**PL**	**Money Supply M3**	**Feb**	**% y/y**	**9.1**	**9.1**	**8.8**
15:00	US	Existing Home Sales	Feb	% m/m	3.2	-	-1.2

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg

** Estimates after headline inflation release*

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.