21 March 2019

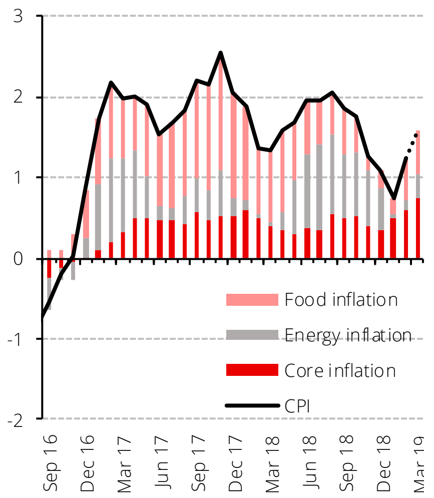
Weekly Economic Update

Where is Brexit?

What's hot next week

- We still do not have an answer if, when and how the Great Britain will leave the EU. At today's EC summit PM May will request for a "short extension" postponing Brexit until end of June or May but the EU leaders say the UK parliament will have to approve the Brexit deal first to accept this motion. So, it appears that there will be third "meaningful vote", likely on Tuesday. However, this is still uncertain if the voting will be successful. First, during the previous voting, the bill was rejected by a large margin. Second, speaker of the Chamber said he will not allow for the same bill to be voted twice if there are no meaningful changes made. **The thriller titled "Brexit" shall last until the very last moment** and the most severe scenario is still not off the table. Should the UK parliament fail to back the deal by Tuesday, then risk aversion could jump. We assume, however, this would be only temporary and before March 29 there would be some solution found to avoid hard Brexit, like long extension of the Brexit date. Donald Tusk did not exclude calling the EC summit just before the end of the next week.
- Next to Brexit, investors shall follow macro data from the US (GDP, consumer confidence and spending) and Europe (Ifo, inflation). Additionally, Czech and Hungarian central banks will decide about the interest rates. In Poland, we will see flash March CPI and Fitch could publish the rating review (both events on Friday).
- We expect CPI rose to 1.6% y/y in March but this should not be a big event for the market since will be due to the low base effect in services prices. However, that reading would confirm our scenario of a gradual inflation rise this year.
- Fitch will likely keep the rating and its outlook unchanged but the statement could elaborate more on the fiscal spending plan recently announced by the government. An initial comment was released in early March and suggested a clear deviation from fiscal consolidation path. Since then, the analysis could have broadened which might have been reflected by the upside GDP growth forecast revision by Fitch announced this week. At the occasion of the previous rating review in October, agency analysts stated that "any signals that the relevance of the 3% of GDP EU deficit criteria weakens as a fiscal anchor" could have a negative impact on the rating. We cannot exclude that the Friday's statement would underline this even more. The change of the tone without a change of rating outlook shall not trigger any meaningful market reaction.

Structure of y/y inflation



Source: GUS, Santander

Market implications

- Brexit uncertainty could pressure the zloty in mid-week, particularly if the UK parliament fails to approve the deal by Tuesday. In case of a positive developments, a wave of optimism should emerge. Polish bonds have been fairly stable but outperformed their core peers which might have been due to the fiscal outlook (media reporting Finance Minister submitted resignation, waiting for the rating agencies comments). Polish macro data shall not bring any breaking information but if European economic activity data surprise to the upside, yields in Poland could rise.

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Last week in economy

The recent days brought many positive surprises with the strength of economic activity. It seems that GDP growth deceleration in 1Q could be milder than we assumed, to c4.5% y/y. On balance, we get more and more signals that GDP growth slowdown in 2019 may be less significant than was expected.

In February, **industrial output** expanded by 6.9% y/y (market consensus was 4.8%) with a strong rise in manufacturing, 7% y/y, especially from export-oriented sectors (transport vehicles, electronics, chemicals). Polish industry remains robust to slowdown in the euro zone. Construction output delivered a massive positive surprise: 15.1% y/y vs 4.9% market expectations and our 8% call. The sector continues to face capacity constraints but also a strong demand due to EU-cofinanced infrastructural projects and booming housing investments.

January **current account balance**, +€2.3bn, beat expectations thanks to trade balance coming at €+0.28bn instead of €-0.34bn. Exports (4.1% y/y) outpaced imports (2.2% y/y) for the first time since October 2017, which is quite puzzling given the weaker condition of Poland's main trading partners and still strong domestic demand. In 2019, we believe the current account deficit is likely to remain very close to the level from 2018 (0.7% of GDP).

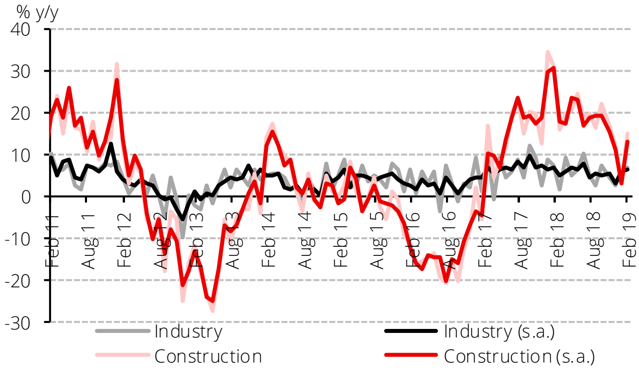
Real **retail sales** rose more than expected in February, 5.6% y/y vs 5.4% and saw a sizeable upward revision of January data – from 5.2% y/y to 6.1%. The January revision was all about reclassifying price growth to volume growth – we highlighted a month ago that retail sales deflators showed a historically high rise of car prices and shoes and clothing prices – this is no longer the case after the revision GUS has made. Jan-Feb average growth is still comparable to quarterly real retail sales averages from the previous quarters, suggesting limited slowdown in private consumption. Also, bear in mind the new fiscal package which will boost households' incomes in the next quarters while real wage bill growth is also not losing pace (7.6% rise of wages in February, 2.9% rise of employment). What is more, consumer confidence remains record-high.

The first reading of **consumer confidence index** after the ruling party announced its generous pre-election package brought plenty of new all-time records of optimism. In March, the synthetic indicator of current situation was the highest ever, while the leading indicator had the second highest result. Consumers have never felt more confident about their current and future financial situation. The 1Q19 averages of the main sentiment indicators were higher than in 2H18.

Core inflation rose from 0.6% y/y in December to 0.8% in January and 1.0% in February. Core inflation ex food and energy is now already the highest in almost five years, and we expect it to climb to c2.5% by the end of the year. Other measures of underlying inflation also rose, but still look mild vs 2018 values.

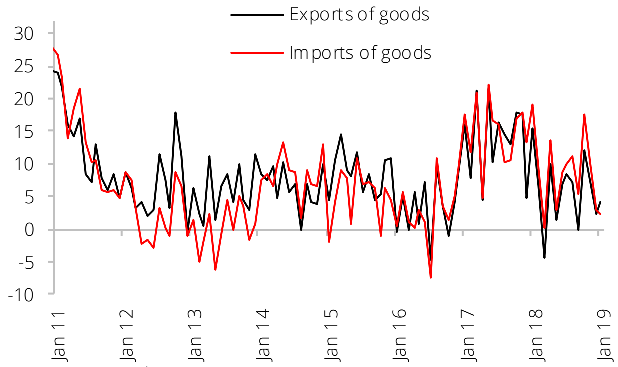
Poland's **central budget** showed a deficit of PLN0.8bn after February vs PLN6.6bn surplus in January. Deterioration of central budget results is typical for February but this time it was larger (PLN7.4bn) than in 2016-2018 on average (PLN5.0bn). Tax receipts rose at a healthy rate: PIT +9% y/y, CIT +14.5% y/y in February alone. VAT at -12% y/y was probably distorted by shifts in tax return flows around the turn of the year. We think that budget deficit at the end of this year could be close to the planned PLN28.5bn. Chances for lower budget gap have been undermined by the announced PiS spending package.

Output in industry and construction, %y/y



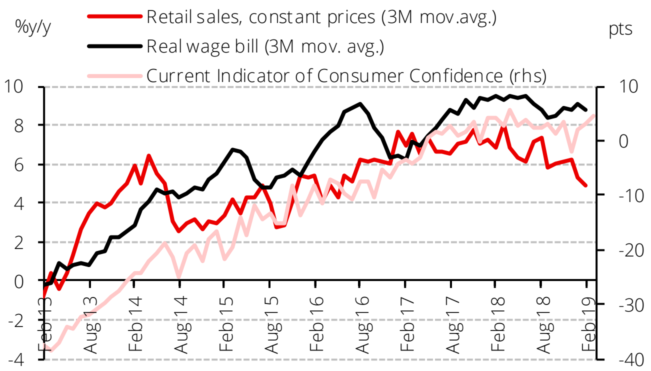
Source: GUS, Santander

International trade, %y/y



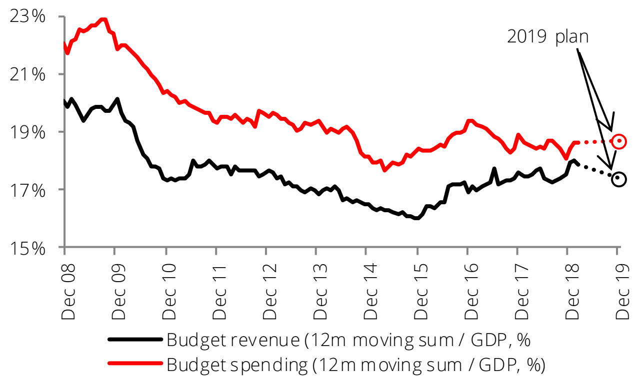
Source: NBP, Santander

Retail trade, consumer confidence and income growth



Source: GUS, Santander

Budget revenues and expenditures as % of GDP



Source: Ministry of Finance, GUS, Santander

FX and FI market

Last week on the market

FX EURPLN fell to 4.276, USDPLN to 3.74, GBPPLN to 4.93, CHFPLN to 3.77 this week amid a quite good market mood persisting on the global market, a sharp EURUSD rise in reaction to the dovish FOMC rhetoric and better-than-expected Poland output data. As the sentiment related to Brexit deteriorated, appreciation of the zloty stopped but since last Friday, only the ruble has gained more than the Polish currency vs the euro and the dollar in the CEE region.

FI Polish bonds traded in a range while the IRS rates fell. The market ignored Polish macro data and was driven by trends seen on the core markets. The dovish FOMC rhetoric pushed Treasuries and Bund yields down to their fresh 2019 lows. Poland debt underperformed due to media reporting Polish Finance Minister considering resignation.

Key events

The this week's EU summit is likely to end without any conclusions on the Brexit issue. The European leaders said they first needed to have the Brexit deal accepted by the UK parliament in order to approve the motion for an extension until June 30 submitted by PM May. Thus the UK parliament shall vote the Brexit deal third time.

Tomorrow, flash PMI indexes will be released in Europe. 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. Next week, numerous US data will be released.

In Poland, the market will focus on the flash March CPI and Fitch rating review. The agency will have the opportunity to comment on the recent fiscal spending plan announced by the government. We do not expect any adverse actions related to the rating.

Hungarian and Czech central banks are scheduled to announce their decisions about the interest rates.

Market implications

FX Market positive reaction to the more-dovish-than-expected outcome of the FOMC meeting proved only temporary as the Brexit case is still unsolved. As the March 29 is nearing, tensions could arise. A positive solution, i.e. avoiding or reducing the risk of hard Brexit, could boost the Polish currency.

The equity indexes have noticeably advanced since the beginning of the year despite rather poor or at least mixed global macro data and numerous global entities revising their growth forecasts down. There is a risk that high uncertainty related to Brexit could start a longer correction on the stock markets that, in turn, would weigh on the zloty.

Hungarian central bank is expected to announce the beginning of the monetary policy normalisation. In the recent weeks, the forint has seemed to have been pricing this scenario and some profit taking could take place if the central bank delivers. A clear shift in the Hungarian monetary policy could generate a negative pressure on the zloty amid still neutral bias of the Polish MPC.

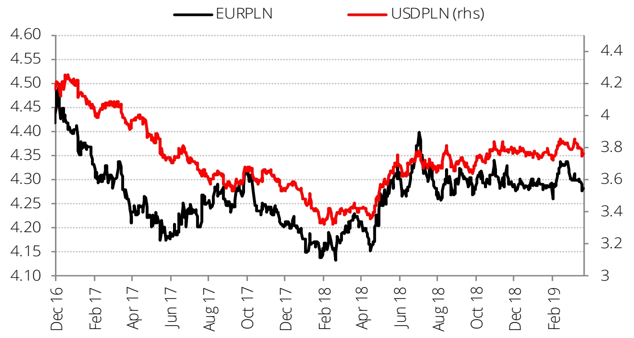
FI Polish bonds have been moving in a range since they recovered part of losses suffered after PiS announced its new spending plans.

We do not expect domestic events to have any persistent impact on the Polish debt this week. Core yields are trading low and there is a risk of a rebound if PMIs and Ifo surprise to the upside.

As long as the uncertainty related to Brexit could support core bonds, it might have a negative impact on the Polish debt.

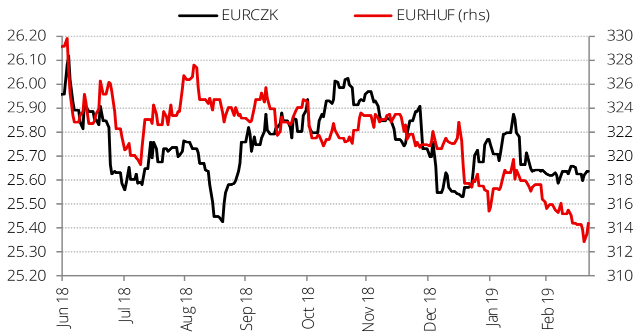
Fitch has revised Polish GDP forecast up this week citing the new fiscal package as a rationale. Next Friday evening, the agency may release its full rating review but we do not expect this to have any negative implications on the Polish bonds.

EURPLN and USDPLN



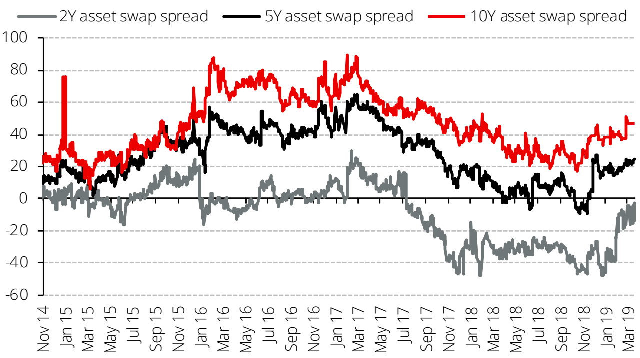
Source: ThomsonReuters, Santander Bank Polska

EURCZK and EURHUF



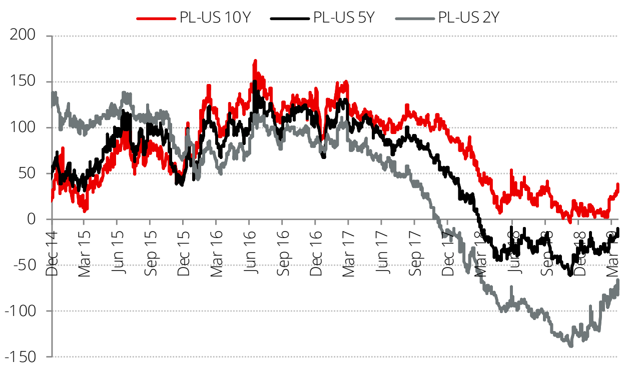
Source: ThomsonReuters, Santander Bank Polska

Asset swap spreads (bp)



Source: ThomsonReuters, Santander Bank Polska

Spreads between Polish and US bonds



Source: Thomson Reuters, Santander Bank Polska

Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST SANTANDER	LAST VALUE
		FRIDAY (22 March)					
09:30	DE	Flash Germany Manufacturing PMI	Mar	pts	48.0	-	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	52.7	-	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
		MONDAY (25 March)					
10:00	DE	IFO Business Climate	Mar	pts	98.5	-	98.5
10:00	**PL**	**Unemployment Rate**	**Feb**	**%**	**6.1**	**6.1**	**6.1**
		TUESDAY (26 March)					
13:30	US	Housing Starts	Feb	% m/m	-0.4	-	-14.0
14:00	HU	Central Bank Rate Decision		%	0.9	-	0.9
15:00	US	Consumer Conference Board	Mar	pts	132.0	-	131.4
		WEDNESDAY (27 March)					
8:00	DE	Retail Sales	Feb	% m/m	-0.1	-	2.9
		THURSDAY (28 March)					
11:00	EZ	ESI	Mar	pct.	-	-	106.1
13:00	CZ	Central Bank Rate Decision		%	1.88	-	1.75
13:30	US	GDP Annualized	4Q	% Q/Q	2.35	-	2.6
13:30	US	Initial Jobless Claims	week	k	225	-	229
14:00	DE	HICP	Mar	% m/m	0.0	-	0.5
15:00	US	Pending Home Sales	Feb	% m/m	0.5	-	4.6
		FRIDAY (29 March)					
	PL	**Fitch Rating Review**					
10:00	**PL**	**CPI**	**Mar**	**% y/y**	**-**	**1.6**	**1.2**
11:00	EZ	Flash HICP	Mar	% y/y	0.0	-	1.5
13:30	US	Personal Spending	Feb	% m/m	0.3	-	0.6
13:30	US	Personal Income	Feb	% m/m	0.3	-	-0.1
13:30	US	PCE Deflator SA	Jan	% m/m	0.02	-	0.1
15:00	US	Michigan index	Mar	pts	97.7	-	97.8
15:00	US	New Home Sales	Feb	% m/m	1.6	-	-6.9

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.