29 March 2019

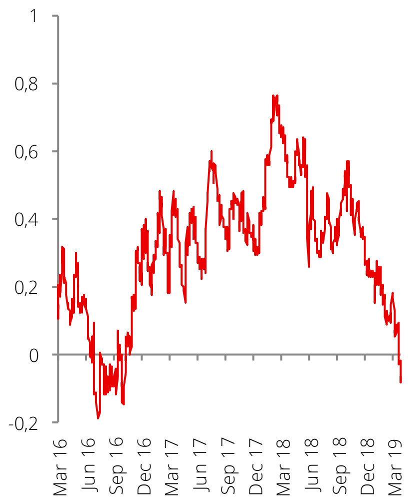
Weekly Economic Update

What does the Fitch say?

What's hot next week

- Today in the evening, **Fitch could release a review of the Polish credit rating**. In our view, the agency 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 could be reflected by the upside GDP growth forecast revision by Fitch announced last 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 today's statement would underline this even more. The change of the tone without a modified rating outlook shall not trigger any meaningful market reaction.
- **Brexit is still on cards**. The House of Commons has rejected the deal for the third time, so all the options are still open and further indicative votes are to take place on Monday. Default no-deal Brexit date is 12 April. Extraordinary European Council summit is scheduled for 10 April.
- **In Poland, the MPC meeting**. Rates are to remain unchanged, but the Polish monetary policy is getting more interesting. Recently as many as five MPC members (out of 10) stated that rates stability could not be guaranteed given the new stimulus package. Still, Governor Glapiński did not support this view and he is the main driver of the conference rhetoric. Thus, the official wording of the MPC is likely to remain unchanged and the Governor's declaration to keep the rates intact until 2022 could be repeated. **Moreover, GUS is releasing its estimate of general government debt and deficit.**
- We will get to see a lot of important data: **PMI for Poland** and other countries, statistics from Germany (orders, industrial output) and USA (non-farm payrolls, retail sales, durable goods orders). We are expecting the PMI to slide to 47 points and at the same we remind that this measure has not been a perfect indicator of industrial output over the last months. German PMIs are still pointing to a slowdown, but real data show some green shoots.

10Y Bund yield, %



Source: GUS, Santander

Market implications

- We believe that the Polish MPC post-meeting press conference, scheduled for Wednesday, will not affect the market, while the investors will focus on the global events. At the beginning of the week, we see a risk of profit-taking on the debt markets. In the middle of the week we expect some deceleration of yield increases owing to the German industrial production and industrial orders, where we do not expect any positive surprise. Later in the week, investors will be waiting for the US non-farm payrolls data, where we expect an improvement over a poor February. Strong headline could have a moderate impact on bonds, in our view.
- In the case of EURPLN, we expect a downward correction amid the expected rebound of EURUSD driven by profit-taking after the last week's drop. We think that the euro and zloty appreciation could be fuelled by the European PMIs, if they do not surprise to the downside. The US labour market data should surprise to the upside and, in turn, halt the EURUSD upside move and the zloty appreciation.

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Last week in economy

Last week we got to see some new information helping to assess **the investment outlook for 2019, which seems to be deteriorating.**

Finance Minister Teresa Czerwińska underlined **her determination to obey by the stabilising spending rule and 3% deficit limit**. In order to finance the new fiscal stimulus, the Ministry is scrutinising other revenues and spending categories. In our view, if spending is to cut to allow for the new lavish social programmes, then central budget investment is likely to be the first victim. Moreover, the Ministry is also likely to exert pressure on state-owned companies to disburse higher dividends and this may limit their propensity to invest.

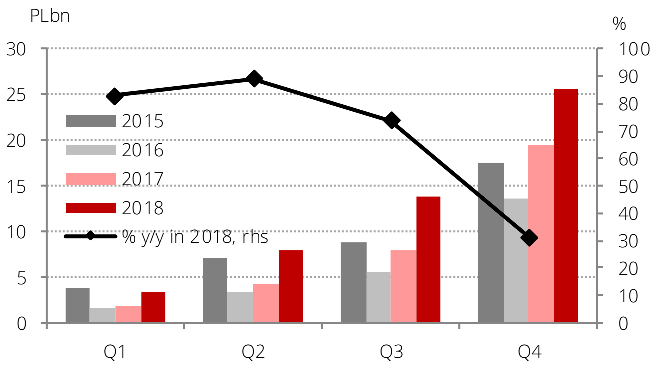
In 4Q18, **local governments reported a rise in investment by 31% y/y** and contributed about four percentage points to total investment growth in the economy (6.7% y/y). 60% out of that growth was due to a jump in EU funds utilisation. Momentum in local governments is high and this is likely to carry into the start of 2019. But in general the local governments' investment plans for this year are lower than for 2018, so we expect this sector to contribute negatively in total.

The semi-annual **investment survey** conducted by GUS showed a reduction of private companies' plans for 2019. According to the survey, investment is to grow by 4.1% instead of 5.5% expected in October. Companies employing 10-49 people recorded a major cut in spending (by 40%), and big companies with a headcount of 250-499 increased by 13.4% despite a slight cut was expected in October. The biggest companies are planning to markedly boost investment spending. Weaker investment survey results correspond with **financial results of non-financial companies**, which deteriorated sharply in 4Q18. Gross financial results fell 33.4% y/y, and net financial result slumped 40% y/y, the biggest drop since 2012. Revenue growth slowed to 5.6% y/y, visibly more than cost growth (7.5%), which was kept high by still rapid increase in costs of materials, energy and wages. The proxy for corporate profit margins (i.e., the ratio of gross financial result to total revenue) declined sharply to 2.9% (its lowest since 4Q14) from an average of 5.0% in the preceding quarters. The data confirm our view that the process of margin compression in Polish companies advances, which should support a gradual acceleration of inflation growth in the coming quarters. **Investment in the biggest companies** also slowed down somewhat, to 11.9% y/y from 15.7% y/y, mostly on the back of lower outlays on buildings amid a jump in spending on transport means.

Flash reading showed CPI inflation rising from 1.2% y/y to 1.7% in March, more than the market expected and in line with our estimates. We assumed unusually strong rise of food prices for this part of the year, but the outcome was even a notch higher at 0.4% m/m. From the limited information GUS delivered in the flash release, we estimate that core inflation rose from 1.0% y/y to 1.3%, the highest reading since October 2013, and certainly not the last rise we will see this year. We expect core inflation to reach 1.7% y/y by mid-year and c2.5% in December. Headline CPI could go up to 2-2.5% by the end of this year. The March CPI reading does not seem a game changer, and does not take inflation above the paths projected by NBP in March, but note that recently as many as **five (out of ten) MPC members said that prolonged stability of interest rates may no longer be guaranteed**, mostly due to expected inflationary effects of the fiscal stimulus.

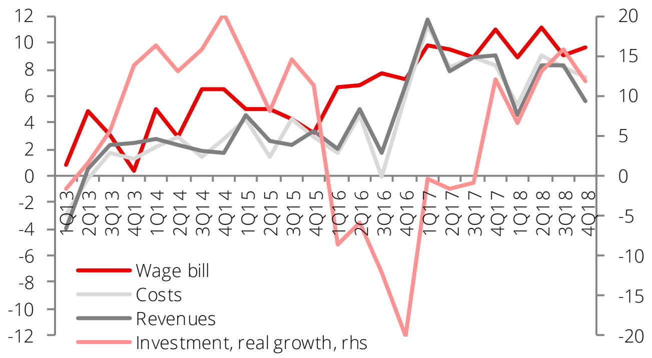
In 2018, **local governments recorded a deficit of PLN7.3bn** compared to PLN 0.3bn in 2017. In our view, the final reading of GG deficit may be a bit higher than 0.5% of GDP.

Quarterly investment in local governments, PLNbn



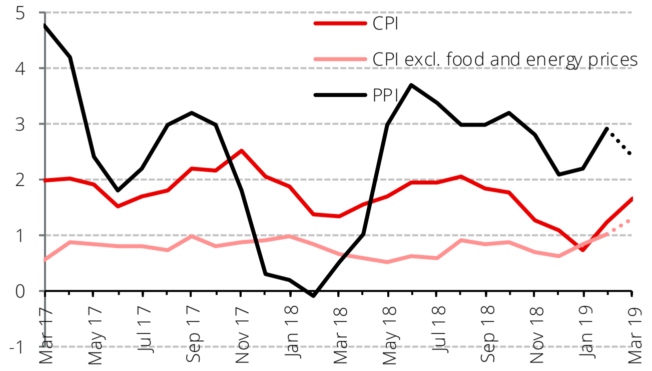
Source: Finance Ministry, Santander

Non-financial companies' results, % y/y



Source: GUS, Santander

Inflation measures, % y/y



Source: GUS, NBP, Santander

FX and FI market

Last week on the market

FX For the better part of the week, EURPLN stayed stable, not responding permanently to ECB governor's comments about detrimental side effects of negative rates on the banking sector. Also the USD appreciation (triggered by Draghi's comments) did not affect the EURPLN. At the end of the week, the zloty depreciated, which, in turn, made EURPLN move to 4.2930 from 4.3030 over the week.

FI Last week, yields were decreasing on the global and domestic debt market. The beginning of the downward move was provoked by flash PMI reading, but the strong reaction was triggered by the ECB governor Mario Draghi's, statement. He said that side effects of negative rates on the banking sector should be taken into account when shaping the monetary policy decision. Markets saw it as a sign of more serious worries about the European economic situation than the ECB had signalled previously. As a consequence, the yields on the core bonds market fell substantially. The domestic market slid by 5bp in the 5-10Y segment following the core peers. A part of this drop was erased at the end of the week, when investors were making profits. The short end of the curve climbed by 1-2bp.

Key events

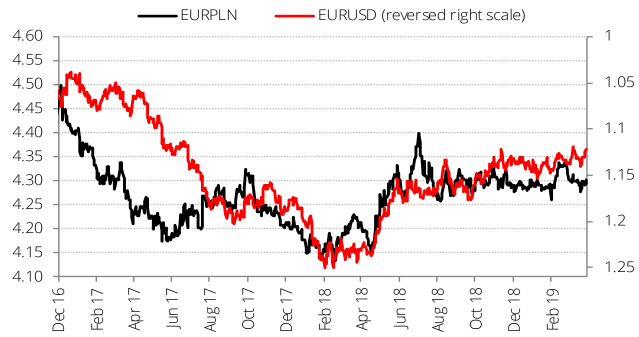
This week, the market players will focus on the non-farm payrolls data release (scheduled for Friday) and the ADP US labour market data (Wednesday). Germany industrial orders (Thursday) may also be of some importance. Investors may as well look at Eurozone PMI data release. We believe that the Polish MPC post-meeting press conference, scheduled for Wednesday, will not affect the market.

Market implications

FX In the case of EURPLN, we expect a downward correction amid the expected rebound of EURUSD, driven by profit-taking after the last week's drop. We think that the euro and zloty appreciation could be fueled by the European PMIs, if they surprise to the upside. The US labour market data should surprise to the upside and, in turn, halt the EURUSD upside move and the zloty appreciation.

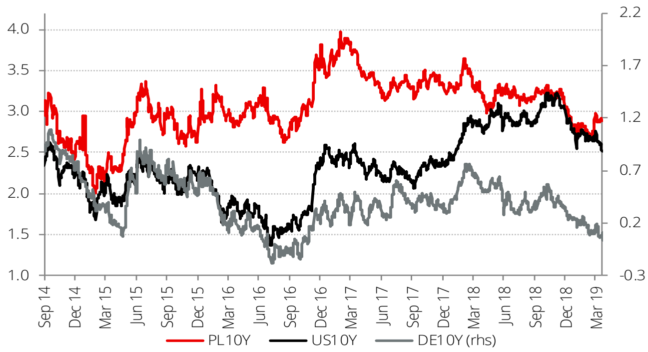
FI At the beginning of the week we see a risk of profit-taking on the core and domestic debt markets. In the latter case, the revision of rating, due on 29 March evening, may constitute a good background. In the middle of the week we expect some deceleration of yield increases owing to the German industrial production and industrial orders, where we do not expect any positive surprise. Later in the week, investors will be waiting for the US non-farm payrolls data, where we expect an improvement over a poor February. Strong headline could have a moderate impact on bonds, in our view. Next week, the ECB will hold a meeting and the press conference could help the positive mood to return to the debt market.

EURPLN and USDPLN

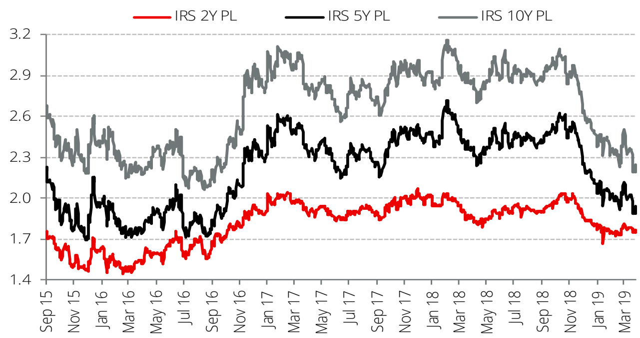


Source: ThomsonReuters, Santander Bank Polska

Yield of the Polish, German and US 10Y bonds

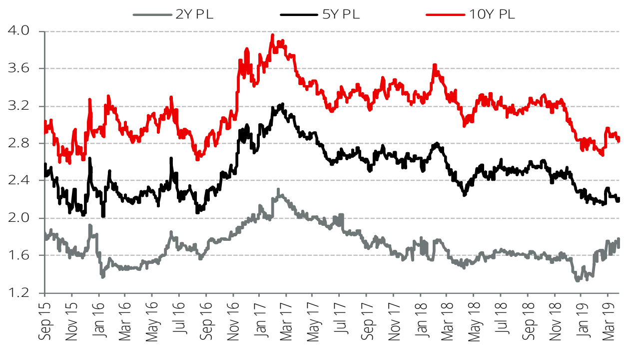


PLN IRS (%)



Source: Thomson Reuters, Santander Bank Polska

Yields of Polish bonds (%)



Source: Thomson Reuters, Santander Bank Polska

Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST SANTANDER	LAST VALUE
		MONDAY (1 April)					
09:00	**PL**	**Poland Manufacturing PMI**	**Mar**	**pts**	**47.3**	**47.0**	**47.6**
09:55	DE	Germany Manufacturing PMI	Mar	pts	44.7		44.7
10:00	**PL**	**General Government Deficit**	**2018**	**% of GDP**	**0.8**	**0.7**	**1.4**
10:00	**PL**	**General Government Debt**	**2018**	**% of GDP**	**-**	**48.5**	**50.6**
10:00	EZ	Eurozone Manufacturing PMI	Mar	pts	47.6		47.6
11:00	EZ	Flash HICP	Mar	% y/y	1.5		1.5
11:00	EZ	Unemployment Rate	Feb	%	7.8		7.8
14:30	US	Retail Sales Advance	Feb	% m/m	0.3		0.2
16:00	US	ISM manufacturing	Mar	pts	54.3		54.2
		TUESDAY (2 April)					
09:00	CZ	GDP SA	4Q	% y/y	2.8		2.8
14:30	US	Durable Goods Orders	Feb	% m/m	-1.2		0.3
		WEDNESDAY (3 April)					
	PL	**MPC decision**		**%**	**1.5**	**1.5**	**1.5**
03:45	CN	Caixin China PMI Services	Mar	pts	52.25		51.1
09:55	DE	Markit Germany Services PMI	Mar	pts	54.9		54.9
10:00	EZ	Eurozone Services PMI	Mar	pts	52.7		52.7
11:00	EZ	Retail Sales	Feb	% m/m	0.1		1.3
14:15	US	ADP report	Mar	k	180.0		183.0
16:00	US	ISM services	Mar	pts	58.0		59.7
		THURSDAY (4 April)					
08:00	DE	Factory Orders	Feb	% m/m	0.3		-2.6
14:30	US	Initial Jobless Claims	Mar.19	k	220.0		211.0
		FRIDAY (5 April)					
08:00	DE	Industrial Production SA	Feb	% m/m	0.5		-0.8
09:00	HU	Industrial Production SA	Feb	% y/y	0.0		5.0
14:30	US	Change in Nonfarm Payrolls	Mar	k	175.0		20.0
14:30	US	Unemployment Rate	Mar	%	3.8		3.8

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.