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Economic Comment

Non-inflationary Growth

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Flash CPI surprised to the downside again, showing 1.2% y/y. The surprise is mostly to blame on food prices, but core inflation also fell, to 0.7% y/y, reaching the lowest level since July. Data on 3Q18 GDP confirmed that growth at 5.1% y/y was achieved thanks to a major acceleration in investment and positive contribution of inventories. In the upcoming quarters, we are expecting some slowdown in economic activity. The data is likely to support views of the MPC majority that no rate changes are necessary, given low supply of strong signals of rising inflationary pressure despite fast economic growth.

Inflation is playing cat and mouse

Flash CPI inflation in November was at 1.2% y/y versus 1.8% y/y in October, markedly surprising to the downside (Bloomberg consensus 1.6% y/y, our call 1.5% y/y). This outrageously low print comes at a time when markets have been trying to guess how high will CPI go on energy prices in 2019 and shortly after MPC voted whether to hike rates (the first vote concerning main rates since March 2015). Clearly, inflation is playing cat and mouse.

Food was the main culprit of the low reading, deducting 0.3pp from the headline CPI. This is especially surprising for us, given upward tendencies in bread, meat and vegetables prices due to droughts. Downward pressure on CPI was also put by fuels and energy. This was in line with our expectations, yet fuel prices rose in monthly terms. Data from gas stations show that prices were going up in the first half of the month and then fell, so we cannot rule out that the final reading will show lower fuel prices. According to our estimates, core inflation fell to 0.7% y/y from 0.9% y/y in October and still shows no build-up of price pressures. This supports the NBP Governor's call of no changes in rates until end of 2019 or longer. Still, we are expecting 2019 inflation to go up, among others, due to upward tendencies in energy prices.

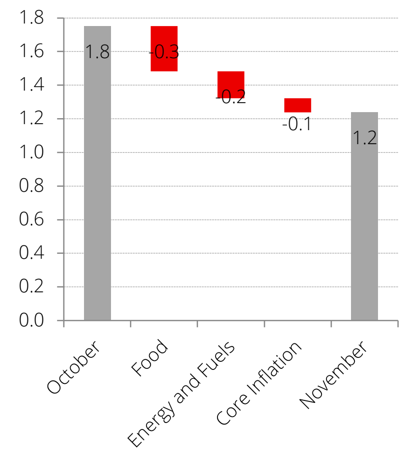
Investments beat forecasts, consumption disappointed

3Q18 GDP rose by 5.1% y/y and by 1.7% q/q sa, and confirmed the flash reading released in the mid of month. Quarterly GDP readings for the last two years were slightly revised up.

When it comes to the 3Q growth breakdown, private consumption surprised negatively by decelerating to 4.5% y/y, the lowest growth rate since 1Q17. On the other hand, investments were stronger than expected, growing 9.9% y/y – the fastest since the start of 2015. The earlier information about local governments showed that investment outlays of this sector contributed c7pp to the total which means that the growth rate of other sectors of the economy remained moderate. The change of inventories added as much as 1pp to y/y GDP growth. It is important to note that this category often sees large revisions and has a 'residual' nature – large increases of inventories may come from difficulties to categorise some expenditures and might be corrected later (this is what happened with the inventories data for the previous three quarters). Net exports contributed negatively to GDP growth in 3Q18 (-0.9 pp). Exports slowed down to 4.9% y/y while imports accelerated to 6.9% y/y. On the supply side, we saw some slowdown in value added in industry and construction, but an acceleration in services.

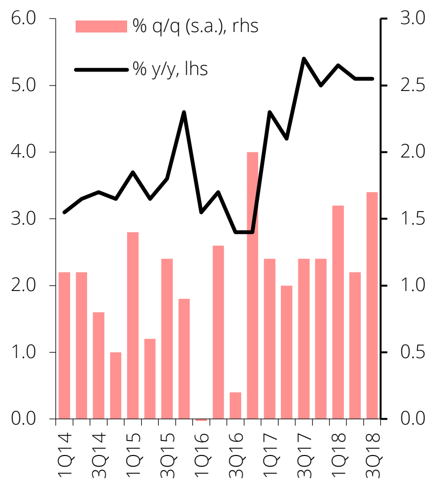
We are still of the opinion that pace of the GDP growth should decelerate in the quarters to come amid weaker economic performance abroad (implying negative net exports contribution will hold) and intensifying internal supply shortages (drying up labour force that curbs business expansion, among others, in construction). However, deceleration should be only gradual. 4Q18 result will largely depend on investments. Should the c10% pace of growth hold, the headline GDP could stay near 5% even if consumption does not pick up. However, investments slowdown is a more likely scenario for us amid high base effect and very high capacity utilization rate in construction. We are not concerned about the private consumption at the moment.

Breakdown of changes in annual CPI



Source: Stats Office, Santander Bank Polska

GDP growth



Source: Stats Office, Santander Bank Polska

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High wage growth and all-time low unemployment and interest rates should favour households expenditures.

GDP growth and its components (% y/y)

	2016	2017	3Q17	4Q17	1Q18	2Q18	3Q18
GDP	3.1	4.8	5.4	5.0	5.3	5.1	5.1
Domestic demand	2.3	4.9	4.2	5.3	6.6	4.4	6.2
Total consumption	3.5	4.5	4.5	5.2	4.3	4.5	4.2
Private consumption	3.9	4.8	4.8	5.3	4.7	4.9	4.5
Public consumption	1.9	3.5	3.6	4.8	3.0	3.5	3.6
Gross accumulation	-2.0	6.2	3.3	5.6	21.1	4.2	14.6
Fixed investment	-8.2	3.9	4.1	6.0	8.2	4.7	9.9
Stockbuilding *	1.2	0.5	-0.1	0.1	1.9	0.0	1.0
Net export *	0.8	0.1	1.3	-0.1	-1.0	0.9	-0.9

* contribution to GDP growth (percentage points)

GDP growth breakdown(% y/y)