12 July 2019

Weekly Economic Update

Summing up 2Q

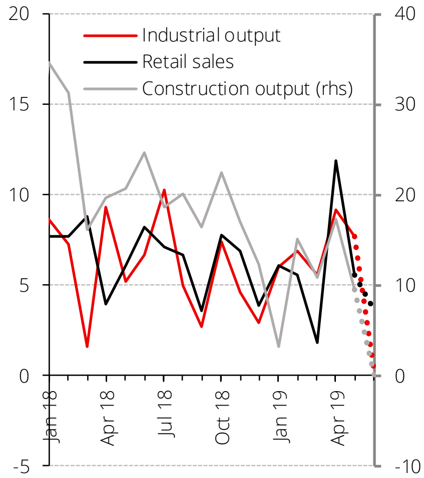
What's hot next week

- After the Fed's Powell speech in the US Congress and publication of the FOMC minutes, the market is pretty convinced that a 25bp Fed rate cut will be delivered as soon as in late July. This week, we will see a number of US data releases that are rather unlikely to change this view and should trigger only limited investor's reaction, in our view. The US data releases will be accompanied by some more speeches of the FOMC members.
- China will release its GDP data for 2Q19, which may be important for assessment of impact of the ongoing trade tensions.
- In Poland, we will see important June economic activity data that could help to assess the scale of the slowdown that we believe Polish economy recorded in 2Q. The June industrial output might look very bad at the first glance (only +0.2% y/y, according to our forecast) but this will largely be due to the negative effect of the number of working days (-2 vs June last year). This factor was also partly responsible for the slowdown in the retail sales growth, in our view. As long as we are positive regarding the outlook for the consumer demand in the remainder of the year (boosted by the more generous social transfers), industrial activity is likely to deteriorate amid still subdued growth in the euro zone economy.
- We expect the labour market data to provide more evidence that the situation is getting tighter – with pace of employment growth slowing further and the pace of the wage rise holding elevated.
- Final June CPI should not deviate much from the flash estimate (2.6%). We expect the core CPI rose slightly to 1.8% y/y from 1.7% y/y.

Market implications

- We think EURPLN could stay around its fresh July peak at c4.275 in the coming days. Dovish signals from the global centrals banks should support the demand for the risky assets. On the other hand, the upcoming Polish data might look rather poor (particularly industrial output).
- FI We are of the opinion that the upside correction of yields that has started on the core market might last in the days to come generating an upside pressure on the Polish yields. We would expect a "bearish steepener" on the Polish market to evolve in the days to come since the front end looks to be well anchored thanks to the MPC rhetoric.

Poland output and retail sales (% y/y)



Source: GUS, Santander

Economic Analysis Department:

al. Jana Pawła II 17, 00-854 Warszawa
email: ekonomia@santander.pl
website www: skarb.santander.pl
Piotr Bielski +48 22 534 18 87
Marcin Luziński +48 22 534 18 85
Grzegorz Ogonek +48 22 534 19 23
Marcin Sulewski, CFA +48 22 534 18 84

Last week in economy

In the last couple of days, we saw no important Polish data and only few figures abroad. As far as the latter are concerned, the majority of releases from the euro zone looked better than expected. In the US, Fed's governor did not give the market any reason to stop pricing in the July rate cut and the FOMC minutes from the last meeting showed that many Committee members favour cutting rates soon. Overall, as long as there is still high uncertainty related to the global economic growth, the dovish shift of the main central banks (including the expected Fed rate cut in July) could improve the sentiment, at least in the short term.

The NBP released the Inflation report (link), including the details of the new CPI and GDP projection. As was signalled in the last MPC statement, the projection update showed an increase of both inflation and GDP path in 2019-20 and almost unchanged forecast for 2021. According to the NBP the CPI growth will reach its local peak in 1Q20, at slightly below 3.5%, and then will gradually slow towards below 2.5% at the end of 2021. Core inflation is expected to stabilise near 2.5% in 2020 and to slow very slightly in 2021. The factors that would limit price growth include: quite high pace of potential GDP growth (revised up to 3.7%), low inflation abroad, appreciation of the zloty. Our forecast shows a similar trajectory of CPI inflation, although c50bp higher, which probably results from the assumption of higher food prices growth in the nearest months and bigger second-round effects in the medium run (also higher growth of wages and unit labour costs). Nevertheless, even in our scenario when inflation is approaching 4% at the start of 2020 it seems very unlikely that the MPC will decide to tighten monetary policy before the end of 2020, which results from very uncertain outlook for the global economy and a strong tilt towards more dovish policies by main central banks.

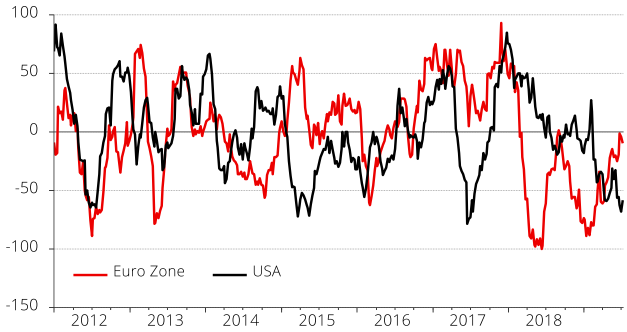
PM Mateusz Morawiecki said that next week the government will discuss the draft bill reducing the personal income tax from 18% to 17% and raising the tax-free income. Both measures are the elements of the big fiscal package presented in February (PiS Five). Interestingly, according to PAP, the changes are planned to be introduced in January 2020, while recently some government officials suggested it could be already 2H19. It implies lower potential pressure on this year's budget.

The European Commission revised Polish GDP growth forecast up for 2019 to 4.4% from 4.2%, and maintained at 3.6% for 2020. The EC sees an upside risk for this year and downside risk to the next year's economic growth. The Commission expects that private consumption will improve in 2H19 and early 2020 thanks to the new fiscal transfers. Additional support for the consumer confidence, according to the Commission, will come from strong labour market where wages are expected to grow. The EC assumes the EU funds would support investments performance this year before the slowdown in 2020. As regards inflation, the Commission expects Polish pace of prices growth to reach 2.1% y/y in 2019 on average and 2.7% in 2020.

The EC underlined that the economic outlook for the euro zone has deteriorated amid prolonging trade war and political uncertainty that weigh on the business confidence. The Commission maintained 2019 GDP growth forecast at 1.2%, and cut it to 1.4% from 1.5% for 2020. Eurozone's inflation forecasts were trimmed to 1.3% from 1.4% for both 2019 and 2020.

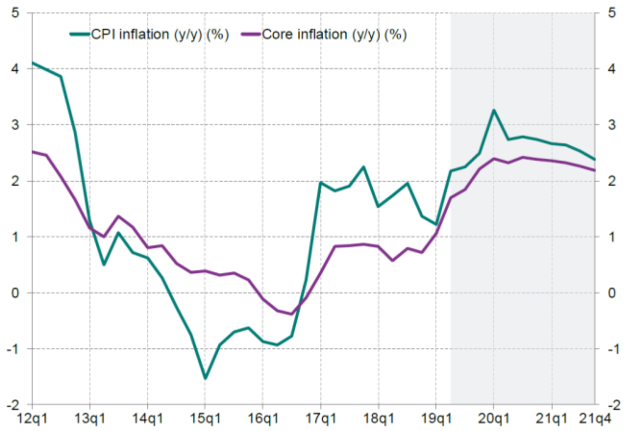
MPC member Eryk Łon wrote in the article that we should be prepared for interest rate cuts in Poland due to threat of deflation abroad. This opinion matches the tone of his earlier comments, and it should be remembered that Łon is the most extreme dove in the rate-setting panel. We think that interest rate reductions in Poland are very unlikely in the foreseeable future, due to still healthy economic growth and predicted inflation increase (according to our forecast, CPI will remain above the official target at least until the end of next year).

Citigroup Economic Surprise Index



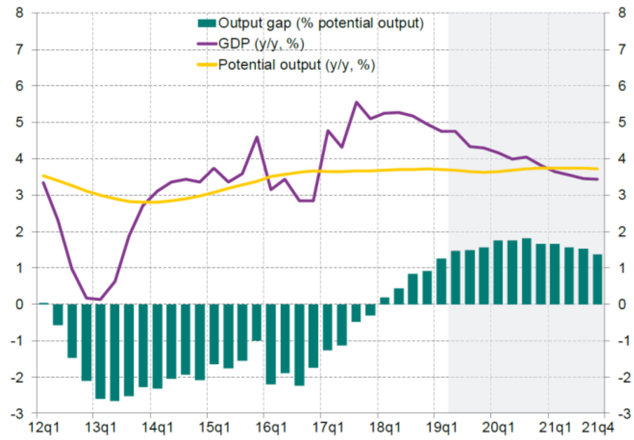
Source: Refinitiv Datastream, Santander Bank Polska

CPI and core inflation according to *Inflation report*



Source: NBP

Output gap according to *Inflation report*



Source: NBP

FX and FI market

Last week on the market

FX EURPLN rose for the second week in a row and touched 4.275, its highest level for in five weeks. Just like as we expected, we observed a profit taking after the recent exchange rate drop. The zloty was pressured by the dollar strengthening recorded in the first part of the week and the below-consensus Hungarian June inflation that weighed on the CEE currencies. The zloty and its peers did not benefit from the rise of the global stock indexes fuelled by the dovish signals from the Fed and ECB. USDPLN jumped above 3.81 but at the end of the week it pulled back to 3.78. Downside wave of GBPPLN paused after a nine weeks of a decline in a row and the exchange rate settled around 4.75. CHFPLN rose to 3.83 from below 3.82.

FI Polish bond yields and the IRS rates rose amid a noticeable jump of the market rates abroad. The Fed governor and the FOMC minutes delivered the dovish tone the market has been expecting and it seems that last week we have seen the second leg of the "buy the rumour, sell the fact" pattern with the decent euro zone and US data also adding an upside pressure on yields. Domestic debt curve shifted by c8bp on the belly and long end while the IRS by 5bp in case of 2Y rate and c10bp for 5-10Y segment. The 2-10 bond yield spread jumped by c20bp. The PL-DE 10Y bond yield spread neared 250bp, its lowest since January.

Key events

After the Fed's Powell speech in the US Congress and publication of the FOMC minutes, the market is pretty convinced that a 25bp Fed rate cut will be delivered as soon as in late July. This week, we will see a numerous US data that is rather unlikely to change this view and should trigger only limited investor's reaction, in our view. The US data releases will be accompanied by some more speeches of the FOMC members. We will also see China 2Q GDP data.

In Poland, we will see important June economic activity data that could help to assess the scale of the slowdown that we believe Polish economy recorded in 2Q. Our forecasts of the industrial output (0.2% y/y) is well below the market consensus.

Final June CPI should not deviate much from the flash estimate (2.6%). We expect the core CPI rose slightly to 1.8% y/y from 1.7% y/y.

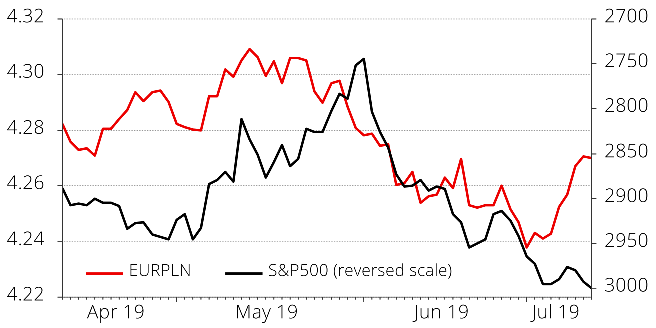
Market implications

FX We think EURPLN could stay around its fresh July peak at c4.275 in the coming days. Dovish signals from the global centrals banks should support the demand for the risky assets and the recent rise of the Polish bond yields may encourage investors to utilize the opportunity for the purchase. On the other hand, the upcoming Polish macro data might look rather poor (particularly industrial output) and the zloty's rally seen in the previous weeks might make investors cautious betting for the Polish currency further appreciation starting right now.

FI We are of the opinion that the upside correction of yields that has started on the core market might last in the days to come. The Fed is likely to deliver a 25bp rate cut in July but the market is still pricing-in more aggressive moves than presented in the June FOMC "dot plot". In our view, there is no reason for this, at least for now, and the profit taking after the recent core debt strengthening may continue, particularly after the not- that- bad macro data released last week in the US and euro zone.

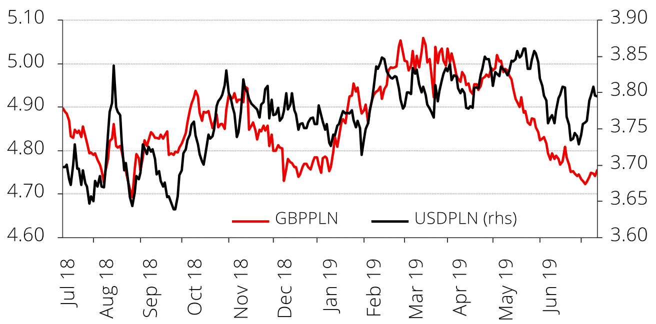
Polish bonds have been quite resilient to the global debt sell-off and yields rise accelerated only in the second half of the week. The 10Y PL-DE bond yield spread has neared the support level at c250bp (the January 2019 bottom) and the 2-10 bond spread rebounded from its lowest level since early 2015. Thus, we would expect a "bearish steepener" on the Polish market to evolve in the days to come since the front end looks to be well anchored thanks to the MPC rhetoric.

EURPLN and S&P500



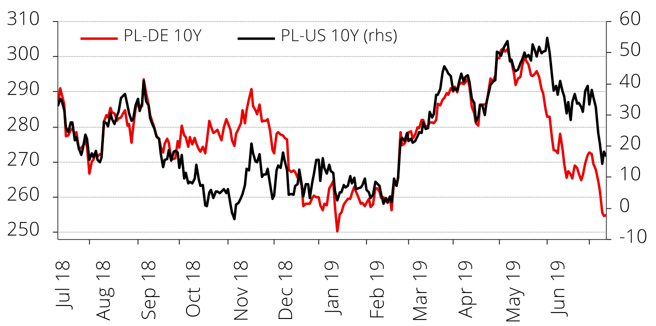
Source: Refinitiv Datastream, Santander Bank Polska

USDPLN and GBPPLN



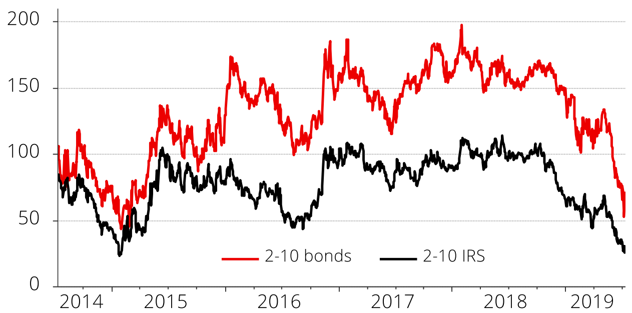
Source: Refinitiv Datastream, Santander Bank Polska

10Y PL-DE and PL-US bond yield spreads (bp)



Source: Refinitiv Datastream, Santander Bank Polska

2-10 spreads (bp)



Source: Refinitiv Datastream, Santander Bank Polska

Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST SANTANDER	LAST VALUE
			MONDAY (15 July)				
10:00	**PL**	**CPI**	**Jun**	**% y/y**	**2.6**	**2.6**	**2.6**
14:00	**PL**	**Current account balance**	**May**	**€mn**	**390**	**548**	**718**
14:00	**PL**	**Trade balance**	**May**	**€mn**	**167**	**-238**	**279**
14:00	**PL**	**Exports**	**May**	**€mn**	**19 167**	**19 082**	**19 440**
14:00	**PL**	**Imports**	**May**	**€mn**	**19 300**	**19 320**	**19 161**
			TUESDAY (16 July)				
11:00	DE	ZEW survey current situation	Jul	pts	0.0	-	7.8
14:00	**PL**	**Core CPI**	**Jun**	**% y/y**	**1.9**	**1.8**	**1.7**
14:30	US	Retail sales	Jun	% m/m	0.2	-	0.5
15:15	US	Industrial production	Jun	% m/m	0.2	-	0.4
			WEDNESDAY (17 July)				
10:00	**PL**	**Employment in corporate sector**	**Jun**	**% y/y**	**2.7**	**2.6**	**2.7**
10:00	**PL**	**Average gross wages in corporate sector**	**Jun**	**% y/y**	**7.1**	**7.0**	**7.7**
11:00	EZ	HICP	Jun	% y/y	0.0	-	1.2
14:30	US	Housing starts	Jun	% m/m	-0.7	-	-0.9
14:30	US	Building permits	Jun	% m/m	0.1	-	0.7
20:00	US	Fed's Beige Book					
			THURSDAY (18 July)				
10:00	**PL**	**Sold industrial output**	**Jun**	**% y/y**	**4.2**	**0.2**	**7.7**
10:00	**PL**	**PPI**	**Jun**	**% y/y**	**0.9**	**0.7**	**1.4**
14:30	US	Initial jobless claims	week	k	-	-	209
14:30	US	Index Philly Fed	Jul	pts	5.0	-	0.3
			FRIDAY (19 July)				
10:00	**PL**	**Real retail sales**	**Jun**	**% y/y**	**3.9**	**3.6**	**5.6**
16:00	US	Flash Michigan index	Jul	pts	98.4	-	98.2

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg