

02 August 2019

Weekly Economic Update

A breather after a hot week?

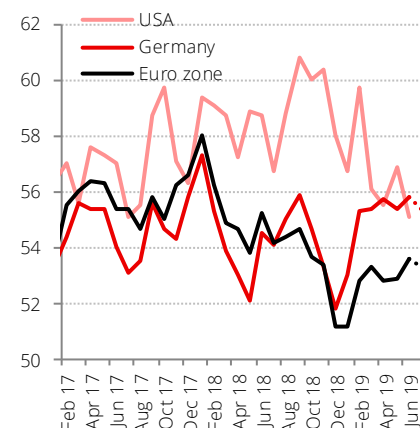
What's hot next week

- FOMC surprised the market with a „hawkish cut,” which reduced chances for further monetary easing in the USA. However, soon after Donald Trump announced an introduction of new tariffs against China, reinforcing bets for interest rate cuts in the USA. Interest rate outlook is currently the main issue for the global markets.
- Not many interesting data releases in the USA, but a few FOMC members are scheduled to speak (Bullard and Evans, considered to be rather dovish). Thus, there will be not that much substance to fuel the market play as last week. Still, we cannot rule out news coming from the trade wars front, e.g. Chinese retaliation.
- We will get to see a few important data releases from the euro zone and Germany – PMI for services, industrial output, factory orders, export. The recent leading indicators did not point to recovery, and these measures are likely to take a cue, supporting expectations for ECB easing just after the summer.
- In Poland no important data release. We may however get to see who will be appointed finance minister. The current minister Marian Banaś was put forward as candidate for Supreme Audit Office head. According to the media information, Tadeusz Kościński is likely to succeed him as head of Ministry of Finance.

Market implications

- The disappointment with what the ECB and the Fed delivered should still affect the markets next week and in general be PLN-negative, together with the escalation of Sino-US trade war. We believe however that the zloty might now try to stabilise around 4.30, with some prospect of strengthening if global monetary policy easing expectations start to be rebuilt.
- The FI market is currently really fragile as regards monetary policy outlook. The next week may start with more risk aversion and investors rebuilding policy easing expectations by main central banks, which should keep bond yields depressed for now.

Services PMIs w/flash readings for Jul 19



Source: Markit, Santander

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Last week in economy

The recent data have showed new arguments to expect high CPI in Poland: surprisingly high reading for July and low estimates of vegetables and fruit supply in Poland. At the same time, leading indicators point to a further slowdown.

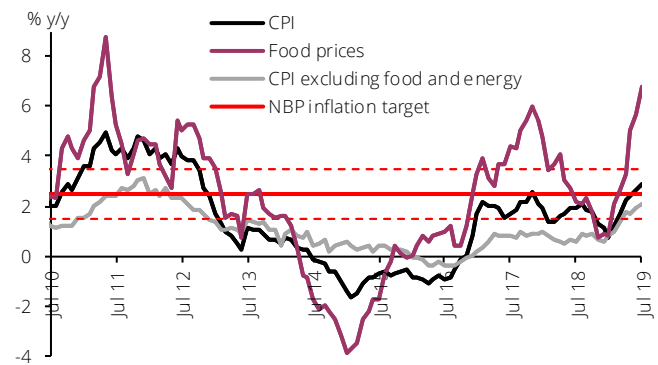
Flash estimate of Polish CPI for July showed a much stronger reading than expected: 2.9% y/y vs 2.6% market consensus and our 2.7% call. The rise of inflation from 2.6% was caused mainly by food price inflation pushing to 6.8% y/y (the highest since mid-2011) and by +0.3% m/m (the last time m/m food inflation was positive in July was in 2000). Fuel prices also surprised us to the upside in the flash reading by dropping m/m less than we had estimated. As a result, our estimate of core CPI points to 2.1% y/y in July vs 1.9% in June. The internal pressure due to strong domestic demand should push it even further up, to significantly above 2.5% by the end of the year. Headline CPI should reach (or even breach) 3% y/y in December and if household electricity prices were freed next year, it would go above 4% y/y in January.

High CPI encouraged numerous MPC members to speak. Jerzy Osiatyński, Łukasz Hardt, Kamil Zubelewicz and Eugeniusz Gatnar expressed their concerns about the rising CPI and clearly suggested they would mull hikes in late 2019. On the other hand, Rafał Sura downplayed the recent CPI spike and so did Adam Glapiński. In our view, the upward path of CPI will make MPC hawks feel uncomfortable, and a motion for a hike is highly probable in 4H19. However, we do not expect there will be a majority to support the hikes.

According to flash estimates of agricultural output, this year the output of field vegetables may fall by 9% y/y (mind that last year's output was historically low due to drought), output of fruit from trees decreased by 25% y/y and output of berries by 20% y/y. Crops were hit by high temperatures in June combined with droughts in April and June, as well as higher incidence of extreme weather conditions such as hailstorms and strong winds. Lower supply of vegetables and fruit should be supporting price growth in these categories in 2019.

Polish manufacturing PMI disappointed in July by dropping more than expected, to 47.4 pts. The decline was mostly driven by lower employment and stock of purchases indexes. New orders indexes remained below 50 pts, signaling that domestic and foreign demand is shrinking. The current purchasing activity component was the lowest in six years. **The ESI indicators** showed a further deterioration of economic climate in Poland in July. Over the month, all the business climate indicators went down, while consumer confidence stayed at the second highest level in the 18-year history of the survey. Industry saw a major drop in current output trend assessment and a decline of the expected output indicator to the lowest level in six years. New domestic and export orders also deteriorated. Decline of construction indicator was minute. The retail trade sector corrected lower its expectations about future orders despite incoming additional social transfers for the household sector, but at the same time did not revise its price expectations lower, while other sectors did. Consumers are still very positive about their current financial and economic situation and remain open for big purchases. At the same time, consumer inflation expectations went up: assessment of current and future price changes reached the highest levels in five-six years. In general, both the PMI and the ESI indicators are pointing out that the economy will slow down faster than we are currently expecting.

Inflation and inflation target, % y/y



Source: GUS, NBP, Santander

Quote of the week:

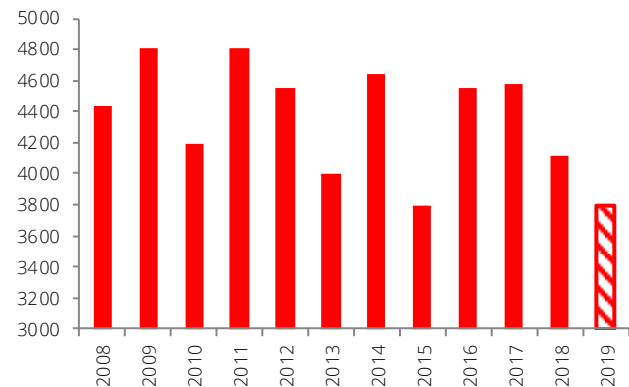
Jerzy Osiatyński, MPC member, PAP, 31/07/2019: we were not expecting such a strong CPI rise. This is worrying, not only as regards food.

Łukasz Hardt, MPC member, PAP, 31/07/2019: there is a rising probability that actual CPI will be higher than expected by the NBP staff. I still think that rate hikes could take place at the end of 2019.

Eugeniusz Gatnar, MPC member, PAP, 31/07/2019: if this upward trend of CPI and core inflation holds, then we need to mull our reaction in autumn.

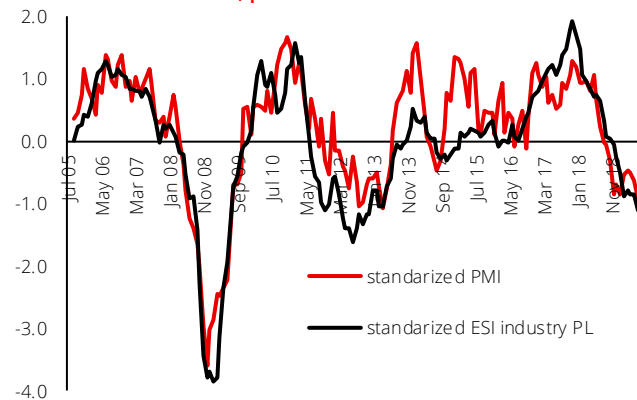
Kamil Zubelewicz, MPC member, PAP, 31/07/2019: flash CPI reading for July shows that inflation will be significant in 2019; though worrying, it is in line with my forecasts. However, I am not expecting CPI to go beyond 3.5%.

Output of field vegetables, thousand tonnes



Source: GUS, Santander

ESI and PMI indicators, pts



Source: European Commission, Markit, Santander

FX and FI market

Last week on the market

FX In a matter of the passing week, the zloty reversed all its June appreciation vs the euro and reached the worst levels vs the dollar and the Swiss franc in more than two years. At the same time, due to harsh no-deal Brexit rhetoric by the new British PM Boris Johnson, GBPPLN dipped below 4.70 for the first time since 1Q18. We anticipated that the outcome of the ECB meeting would be less dovish than the market had expected and the same story repeated for the Fed. FOMC delivered a rate cut, but its rhetoric, e.g. calling the cut a mid-term policy adjustment, cooled down market expectations for more easing. As a result, the depreciation of CEE currencies that had started after the ECB a week ago, continued because of Fed's actions. Highly disappointing July manufacturing PMIs for Poland, Czechia and Hungary also worked towards further losses of the regional currencies. What is more, Donald Trump's threat of imposing more tariffs on China issued on Thursday soured the environment for EM FX. In the middle of the week, after the much-higher-than-expected July flash CPI for Poland, the zloty managed to temporarily oppose the negative pressure from global factors.

FI The first part of the week saw a continuation of the post-ECB meeting rebound of domestic yields. Fed communication extended it further because of the hawkish disappointment it triggered on the markets. However, the news about extension of US tariffs on Chinese goods, coming after two days of trade negotiations triggered a massive drop of core market yields, that pulled Polish 10Y yield down 10bp from 2.20% in after a few hours of trading - pretty much to the opening level for the week. Polish IRS curve followed the same behaviour, rising on all tenors (after the CPI release and MPC hawks' comments the 2Y IRS even reached the highest levels since late May) until Thursday evening when Trump's tweet on China caused a rapid correction.

The Finance Ministry said it financed 83% of borrowing needs at the end of 2019. There is one switch auction planned for August (08.08). In 3Q19 the Ministry want to offer debt worth PLN13bn in total.

Key events

Next week, the events calendar is lighter and we may see the volatility go down. Some response of the Chinese officials to the Trump's tariff remarks is likely, but probably already priced in. The market attention may also focus on data from Europe. Services PMIs are the bright side of the euro zone economy, so might help stabilise the decline of yields. This seems less certain about real activity data from Germany.

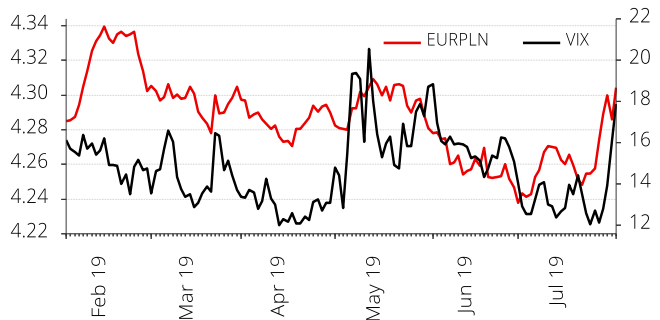
There will be no key releases from Poland, but possibly a change of the finance minister.

Market implications

FX The disappointment with what the ECB and the Fed delivered should still affect the markets next week and in general be PLN-negative. Trade war escalation will not help either. However, the news about extension of US tariffs on Chinese goods, coming after two days of trade negotiations, triggered a massive drop of core market yields that pulled Polish 10Y yield down 10bp from 2.20% in after a few hours of trading, pretty much to the opening level for the week. Polish IRS curve followed the same behaviour, rising on all tenors (after the CPI release and MPC hawks' comments the 2Y IRS even reached the highest levels since late May) until Thursday evening when Trump's tweet on China caused a rapid correction.

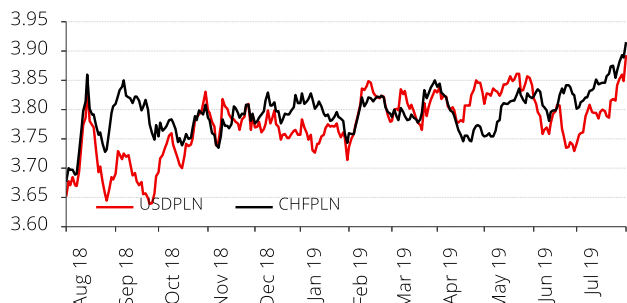
FI The market is currently really fragile as regards monetary policy outlook. With Fed doves scheduled to speak this week and US labour market data failing to deliver a directional signal, we believe that the week may start with more risk aversion and investors rebuilding policy easing expectations by main central banks, which should keep bond yields depressed.

EURPLN and VIX



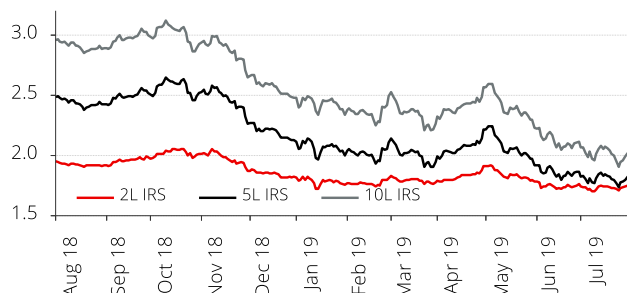
Source: Refinitiv Datastream, Santander Bank Polska

USDPLN and CHFPLN



Source: Refinitiv Datastream, Santander Bank Polska

Polish IRS rates (bp)



Source: Refinitiv Datastream, Santander Bank Polska

2-10 bond yield spreads (bp)



Source: Refinitiv Datastream, Santander Bank Polska

Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST
				MARKET	SANTANDER	VALUE
MONDAY (5 August)						
03:45	CN	Caixin China PMI Services	Jul	pts	52.0	52.0
09:55	DE	Markit Germany Services PMI	Jul	pts	55.4	55.4
10:00	EZ	Eurozone Services PMI	Jul	pts	53.3	53.3
16:00	US	ISM services	Jul	pts	55.5	55.1
TUESDAY (6 August)						
08:00	DE	Factory Orders	Jun	% m/m	0.2	-2.2
09:00	CZ	Industrial Production	Jun	% y/y	-3.05	3.2
WEDNESDAY (7 August)						
08:00	DE	Industrial Production SA	Jun	% m/m	-0.9	0.3
09:00	HU	Industrial Production SA	Jun	% y/y	6.7	6.1
THURSDAY (8 August)						
09:00	HU	CPI	Jul	% y/y	3.45	3.4
14:30	US	Initial Jobless Claims	Aug.19	k	214.0	215.0
FRIDAY (9 August)						
08:00	DE	Exports SA	Jun	% m/m	0.5	1.1

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg

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