

13 September 2019

# Weekly Economic Update

## ECB restarts QE

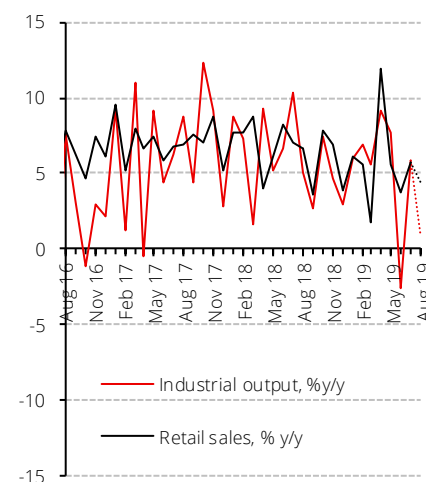
### What's hot next week

- The ECB lowered the deposit rate to -0.50% from -0.40% and announced that rates will not rise until inflation forecasts approach the target. The central bank resigned from indicating a probable end date for this forward guidance. What is more, from November on, the ECB will be buying euro zone members' debt again, €20bn/month, also without an end date. The overall dovish impression soon faded when it appeared that according to the tiering rules the negative depo rate for the banks' excess reserve would be less painful than it was until recently.
- One week after the ECB meeting, the FOMC will decide about the interest rates. The market is widely expecting a 25bp cut. However, comments of the FOMC members, including governor Powell, since the July "mid-cycle adjustment" were rather reserved. We think the Fed funds rate would be lowered by 25bp but the message from the meeting would not support market pricing of further cuts in 2020. The updated GDP and CPI forecasts will be presented and the "dot chart" shall also attract much of the market attention.
- In Poland, we will see August industrial output and retail sales data that we expect may disappoint. These releases, however, would only confirm that the widely expected economic slowdown in Poland is in progress and they should not be a market movers, in our view. Core inflation excluding food and energy prices is likely to inch down a bit to 2.1% y/y but to remain in the upward trend, which is likely to bring it towards 3% y/y at the start of 2020.

### Market implications

- EURPLN was testing 4.33 support aggressively at the end of last week and we think that the exchange rate might try to resume the down trend started in late-August. We think that the open-ended character of the ECB's forward guidance and the asset purchase program combined with the market pricing of the Fed rate cuts could be zloty-positive. Global stock indexes have recently recovered after the July-August correction and we think that the trends on the equity markets might also back the Polish currency.
- Polish bond yields are now trading above the levels seen when the draft of the zero-budget-deficit was announced and only less than 10bp below levels seen after the July Fed rate cut. The global sentiment seems to have improved as of recently (mainly thanks to less tensions on the US-China line) and the environment for bonds looks to be less supportive. In our view, Polish 10Y yield could near 2.20% resistance in the short-term.

Industrial output and retail sales, % y/y



Source: GUS, Santander

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## Last week in economy

Last week we got to see revised CPI reading, confirming a further acceleration in food and services prices, as well as balance of payments data, showing a quite higher growth of foreign trade. Moreover, the ruling party presented its new economic promises and MPC left rates unchanged, in line with the expectations.

**New election promises of the ruling party include:** the payout of two 13th pensions in 2021 (the second one limited to people with pension below 120% of average, about 80% of total), an increase of the minimum wage to PLN2600 in 2020 (currently PLN2250), PLN3000 in 2021, PLN4000 in 2024, increase of direct payments to Polish farmers to equal the transfers of their Western European peers. What is more, the minimum pension was promised to be increased to PLN1200 (from the current PLN1100), a PLN2bn fund for modernisation of hospitals will be created and another one for modernisation of schools. Another promise was to increase the limit on revenues for the use of a lump-sum income tax (from €250k to €1mn, and possibly to €2mn at a later date). We estimate total cost at cPLN25bn per annum (1% of GDP). Plans to raise the minimum wage sparked a heated public debate. As far as we know, there is no clear-cut conclusion among economic researchers what ratio of minimum wage to average wage is the threshold when costs start outweigh the benefits (yet 50% is often cited as a rule-of-thumb). What in our view is an economically risky project is the planning of minimum wage growth for the next five years without much knowledge what the economic situation might be.

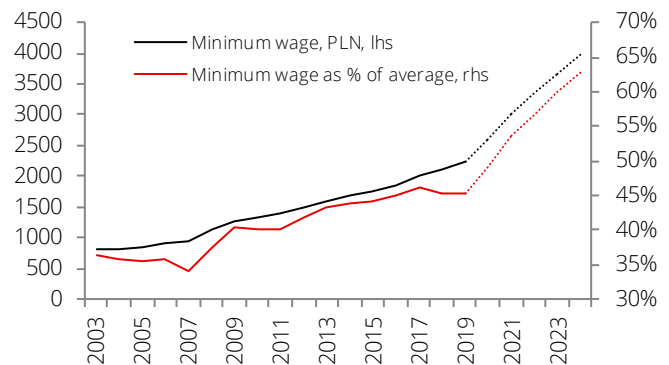
**CPI inflation in August** was revised to 2.9% y/y from 2.8% y/y, i.e. remained unchanged versus July. In our view the revision was actually insignificant, but enough to push the headline higher, as the flash was only a bit below the 2.8/2.9% tipping point. In our view mostly core categories were revised higher, with core inflation excluding food and energy prices most likely showing 2.1% y/y (vs 2.2% y/y in July). We are expecting both headline and core to climb further towards 4% and 3% at the start of 2020, respectively.

Food inflation was confirmed at -0.3% m/m, i.e. the lowest decline of prices in this month in 13 years. This was mostly due to high momentum in fruit and vegetables prices, which usually falls strongly in summer, but this development was distorted by draughts. Another factors putting an upward pressure on CPI were communication (most probably higher prices of mobile phones and services) and restaurants/hotels. Goods inflation eased to 2.3% y/y from 2.4% y/y while services inflation accelerated to 4.3% y/y from 4.2% y/y. We are expecting inflation in services and food to be the main drivers of CPI in the months to come. At the start of 2020 also an additional pressure from energy prices is likely to appear. What is more, the government-approved substantial rise of minimum wage since January 2020 (15.6% vs c7% expected average wage growth this year) will affect labour costs in the sectors which are currently driving the acceleration of inflation and are already transmitting higher costs to consumer prices (e.g. services, retail trade).

**July C/A release** for Poland surprised with the scale of economic activity. Exports of goods grew by 8.8% y/y and imports by 9.5% y/y. C/A balance was at €-814mn. We consider the stronger-than-expected growth of exports and imports as more important than the negative surprise in balances. After all, 12M rolling C/A balance to GDP is now just -0.1% vs -0.5% in January 2019 and compared to almost -7% in late 2008 (at a similar stage of that the business cycle). The relatively strong international trade turnover suggests Poland remains resilient to European slowdown.

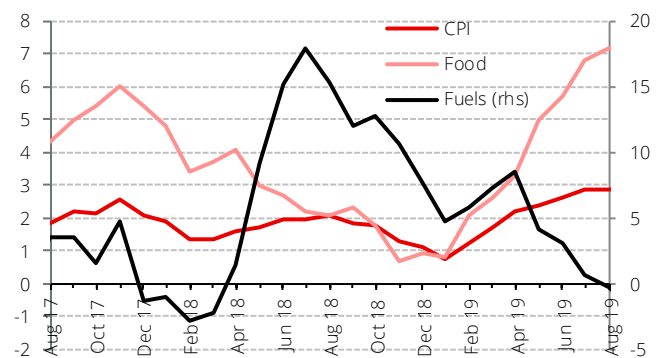
**MPC left rates unchanged.** The statement was changed a little: negative risks to (still respectable) growth have grown in the Council's opinion. Glapiński stressed the global context which he called "bad weather for the MPC hawks" (central banks easing policies, considerations of more QE, Germany probably in recession). Additionally, NBP governor mentioned the option of rate cuts in Poland without the usual remark that this would generate some risk to the banking system stability. Just like we expected, the rhetoric during the press conference was softened in order to diminish the information about the July rate hike motion. We still think the MPC will keep rates stable in 2019 and 2020.

## Minimum wage in Poland



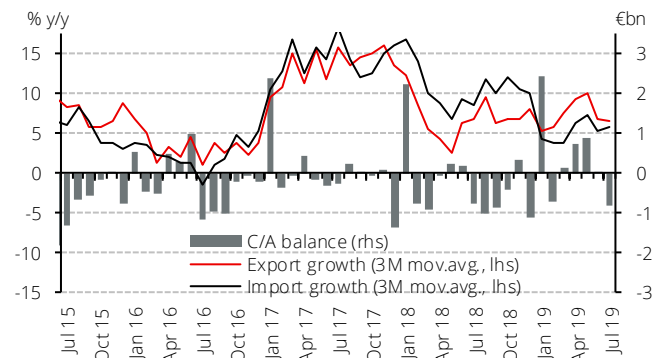
Source: Finance Ministry, GUS, Santander

## CPI inflation and main categories, % y/y



Source: GUS, Santander

## Balance of payments data



Źródło: NBP, Santander

## Quote of the week:

**Adam Glapiński, Head of NBP, 11 Sep, PAP:** [Hike in minimum wage] has a minute effect on inflation – max 0.1pp. There will be some demand effect, positive as regards the GDP growth and there could be some negative impact – they offset each other. (...) Inflation is likely to rise to 3.5% y/y in 1Q2020, but then to decline to 2.8% y/y. Core inflation will rise to 2.6% and then fall in 2Q2020. Forecast for July 2020 is at 2.3% for CPI and 2.2% for core.

**Eryk Łon, MPC member, 11 Sep, NBP conference:** If income differences between Poles will be diminishing, then Poles will feel as one Polish family. The lower the difference in earnings, the stronger the bond to the country.

## FX and FI market

### Last week on the market

**FX** There were no breaking changes recorded on the zloty market vs the euro, franc, pound while USDPLN fell thanks to higher EURUSD. The ECB eased monetary policy – it cut depo rate and announced that the bond purchases will be restarted from November – but the overall dovish impression soon faded when it appeared that according to the tiering rules the negative depo rate for the banks' excess reserve would be less painful than it was until recently. When the market realized that that the effect of keeping cash in the ECB would be less negative, the euro more than reversed initial losses vs the euro – EURUSD jumped to 1.11, its highest this month.

Elsewhere in the CEE region, EURHUF remained in the upside trend that accelerated after the slightly below-consensus Hungarian inflation reading and underperformance of the Budapest stock exchange. As a result, EURHUF reached its fresh all-time-high at c333.45.

**FI** Elevated volatility persisted on the Polish fixed income market in the recent week. Polish 10Y bond yield reached 2.15% for a while nearing the 2.20% resistance but ended the week around 2.10%. The outcome of the ECB meeting did not provide any persistent and noticeable boost for the domestic debt as the initial dovish impression was dominated by the effect of the tiering rules. Both bond and IRS curves steepened a bit while the 10Y PL-DE yield spread remained close to 270bp.

### Key events

One week after the ECB meeting, the FOMC will decide about the interest rates. The market is widely expecting a 25bp cut. However, comments of the FOMC members, including governor Powell, since the July "mid-cycle adjustment" were rather reserved. We think the Fed funds rate would be lowered by 25bp but the message from the meeting would not support market pricing of further cuts in 2020.

In Poland, we will see August industrial output and retail sales data that we expect may disappoint. These releases, however, would only confirm that the widely expected economic slowdown in Poland is in progress and they should not be a market movers, in our view.

### Market implications

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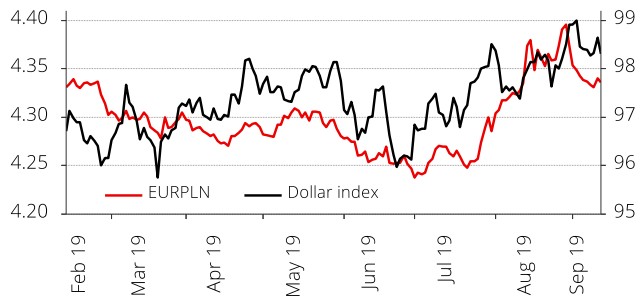
EURUSD is now trading at the level seen just after the July 25bp Fed rate "hawkish cut". However, just a few days after the decision we saw the exchange rate rising temporarily above 1.12. The real effect of the September ECB meeting looks to be rather on the hawkish side and so we think the bias is for higher EURUSD in the weeks to come, particularly if the market continues to price that more Fed rate cuts will be delivered in the coming months.

We think that the open-ended character of the ECB's forward guidance and the asset purchase program combined with the market pricing of the Fed rate cuts could be zloty-positive. Global stock indexes have recently recovered after the July-August correction and we think that the trends on the equity markets might also back the Polish currency.

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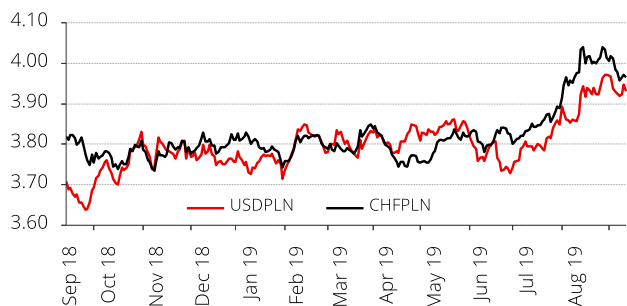
The current yield up wave is the biggest (in yields terms) since 3Q18 for the 10Y Bund and since 2Q16 for the Polish 10Y bond. This suggests that yields may hold above their all-time-lows in the weeks to come. In our view, Polish 10Y yield could near 2.20% resistance in the short-term.

### EURPLN and dollar index



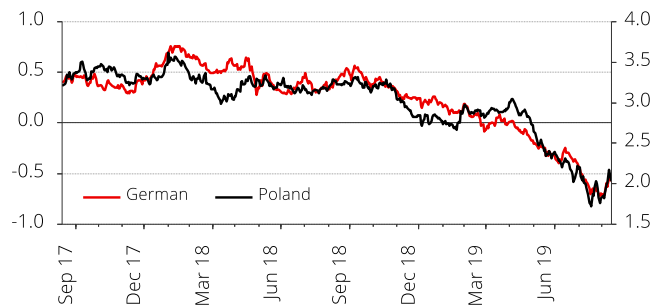
Source: Refinitiv Datastream, Santander Bank Polska

### USDPLN and CHFPLN



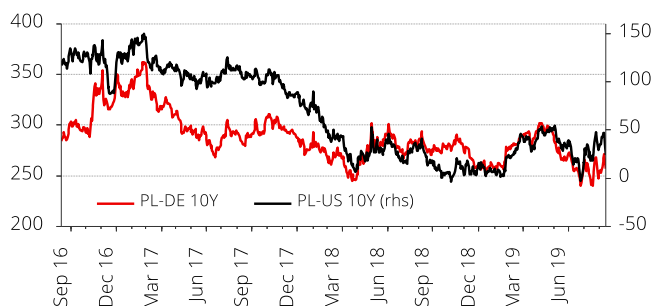
Source: Refinitiv Datastream, Santander Bank Polska

### 10Y bond yields



Source: Refinitiv Datastream, Santander Bank Polska

### 10Y bond yield spreads



Source: Refinitiv Datastream, Santander Bank Polska

## Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST	
				MARKET	SANTANDER	VALUE	
<b>MONDAY (16 September)</b>							
14:00	PL	CPI Core	Aug	% y/y	2.1	2.1	2.2
<b>TUESDAY (17 September)</b>							
11:00	DE	ZEW Survey Current Situation	Sep	pts	-13.0	-	-13.5
15:15	US	Industrial Production	Aug	% m/m	0.2	-	-0.22
<b>WEDNESDAY (18 September)</b>							
10:00	PL	Employment in corporate sector	Aug	% y/y	2.7	2.7	2.7
10:00	PL	Average Gross Wages	Aug	% y/y	6.7	6.7	7.4
11:00	EZ	HICP	Aug	% y/y	1.0	-	1.0
14:30	US	Housing Starts	Aug	% m/m	4.9	-	-4.0
20:00	US	FOMC decision		%	2.0	-	2.25
<b>THURSDAY (19 September)</b>							
10:00	PL	Sold Industrial Output	Aug	% y/y	1.3	0.9	5.8
10:00	PL	PPI	Aug	% y/y	0.8	0.9	0.6
14:30	US	Initial Jobless Claims	week	k	215	-	204
14:30	US	Index Philly Fed	Sep	pt	10.7	-	16.8
16:00	US	Existing Home Sales	Aug	% m/m	-0.5	-	2.46
<b>FRIDAY (20 September)</b>							
10:00	PL	Retail Sales Real	Aug	% y/y	5.2	4.4	5.7

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg

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