

27 September 2019

Weekly Economic Update

October 3rd: Judgement day

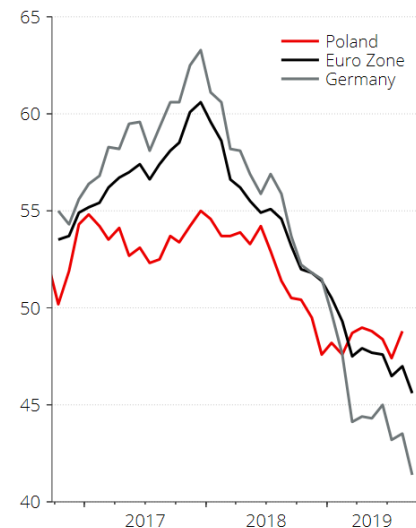
What's hot next week

- The key event of the week in Poland will be the **European Court of Justice ruling on FX mortgage loans**, which is to be announced on October 3rd at 9:30CET. In anticipation of the verdict, the market volatility may be elevated. However, few things need to be noted:
 - ECJ ruling will not trigger automatic and sudden decisions of domestic banks or courts. If it is negative for banks (another issue is: what "negative" means) it may trigger a wave of lawsuits against banks and potentially increase the share of court rulings in favour of clients. But this process will be spread over time.
 - The ECJ verdict will be probably long and complicated, so the full assessment of its implications may take time.
 - Just after the ruling it will be still difficult to assess the potential future burden for banks, as the scale of lawsuits, reaction of particular banks and reaction of regulators will remain uncertain.
- As a result, it is hard to know exactly what will be the market behaviour around the ECJ ruling, but we think that assuming catastrophic scenarios is not a good idea. While the zloty may still depreciate, the selloff should not be long-lived. The scale of upward EURPLN move will be limited by the demand from exporters (some are waiting for higher levels for a while), possibility of government/BGK intervention and profit taking by investors.
- Apart from that issue, there will be publication of **flash CPI and manufacturing PMI** for September. Inflation retreated to 2.6% y/y, according to our estimate, mainly due to lower food and fuel prices. But it will be a short-term correction and in the following months we should see continuation of upward trend, to above 4% in early 2020. Moreover, core inflation probably rose to 2.4% y/y in September. PMI fell to 48pt according to our forecast, reacting to deteriorating activity abroad. Recent data show increasingly clearly that the slowdown in Europe is passing through Polish industry,
- **MPC decision on Wednesday** – unsurprisingly, rates and the official communique will remain unchanged. Minutes from September's meeting revealed the motion to cut rates, after the hike was voted in July. But we do not think that it reflects a major shift in MPC's attitude. Rate cut was probably proposed by ultra-dovish E. Łon and had as small support and July's rate hike motion. E. Gatnar signalled earlier he was not going to repeat tightening proposals until November. In the following months the Council will probably discuss both rate hikes and rate cuts but the baseline scenario still assumes monetary policy stability at least until the end of next year.
- There will be **a number of data releases abroad**, hinting on economic activity in Europe, USA and Asia. The most important will be US non-farm payrolls, ISM, foreign trade. Central banks in Australia and India are expected to cut interest rates.

Market implications

- EURPLN could rise to c.4.50 amid speculation ahead of the ECJ verdict but this should not be a long-lasting move. Lack of clarity what next and technical demand for PLN should prevent the market from selling the zloty on a large scale. We think the FX mortgages factor could curb zloty gains in the remainder of the year.
- Polish 10Y bond yield reached 2% support level and we expect the down trend might decelerate in the short term. The uncertainty related to the impact of the ECJ verdict on the Polish banks could weigh on the domestic bonds but the front end could outperform thanks to the CPI release. Thin liquidity on the market might inflate the intraday changes. The IRS shall continue to decline given the persisting global growth uncertainty and so the asset swap spread might rise in the days to come.

Manufacturing PMI



Source: GUS, Santander

Economic Analysis Department:

al. Jana Pawła II 17, 00-854 Warszawa
 email: ekonomia@santander.pl
 website: santander.pl/en/economic-analysis
 Piotr Bielski +48 22 534 18 87
 Marcin Luźniński +48 22 534 18 85
 Wojciech Mazurkiewicz +48 22 534 18 86
 Grzegorz Ogonek +48 22 534 19 23
 Marcin Sulewski, CFA +48 22 534 18 84

Last week in economy

Construction output slowed to 2.7% y/y in August from 6.6% y/y in July. Slower growth rate was observed in specialised construction (-10.3% y/y versus -2.8% y/y in July) and civil engineering (7.7% y/y vs 19.9% y/y), while construction of buildings rebounded to 5.9% y/y from -3.9% y/y, mostly thanks to strong tendencies in the housing sector. We think that the sector will paint a similar picture in the months to come, as slowing public investment will undermine civil engineering and specialised construction, while strong demand for houses will continue. The data are in line with slowing GDP growth in Poland. We are expecting GDP growth to reach 4.0% y/y in 4Q19 as compared to 4.5% y/y in 2Q19.

In August, the **construction of residential buildings** strengthened further. Works on 17.7k new flats were finished, compared to 16.4k a year ago (+8.1% y/y), and the 12-month sum at 197.1k flats is the new record of activity. The 12M sum of building permits is at the highest level ever. The difference between housing starts and completions is still highly positive but falling for five months. This early signal of softening of the housing market is confirmed by the reported numbers of flats under construction, which in 4Q18 and 1Q19 recorded a growth rate of c5% y/y by since then slowed down to 3.4%, the lowest in two years.

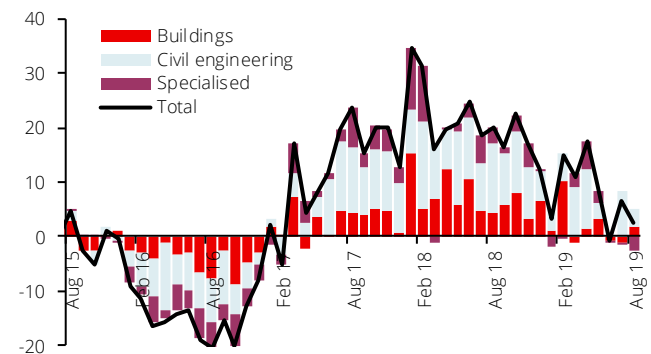
In August there was a **large decline of new orders in industry**. Total new orders rose by 5.3% y/y vs 10.7% in July and 10.2% on average in 1H19. Export orders declined by 2.5% y/y after rising 13.8% in July and 8.3% on average in 1H19. Seasonally adjusted **manufacturing business climate indicator declined** in September to the lowest level since late 2013. Industrial enterprises considered current production and employment prospects to be the worst in three years. For a few months there has been a rapid worsening of sentiment in the transport sector, which may signal further loss of momentum by the economy.

M3 money supply rose 9.9% y/y in August. Households' deposits were still growing at 11% y/y and companies' deposits slowed from 8.1% to 6.5% y/y. PLN-denominated consumer loans and mortgages maintained a solid pace (9.6% and 12% y/y, respectively), while loans for companies rose 6.2% y/y vs. 5.4% in July and 7% average in 1Q19.

The government approved 2020 budget draft. As in the preliminary version, it is assumed that expenditures and revenues will be equal and the general government deficit will be 0.3% GDP. The assumed economic growth in 2020 is 3.7% (our forecast is 3.5%) and average inflation is 2.5% (we expect 3.6%). We wrote more on the issue in our [Economic Comment](#).

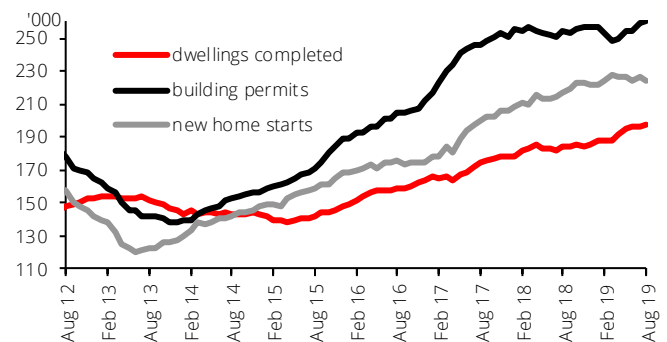
The MPC minutes revealed that in September a motion to cut interest rates was submitted (and rejected). Please recall that at the previous MPC meeting in July there was a motion to hike rates (supported by two hawks: Gatnar and Zubelewicz). Minutes stated that their hawkish opinions have softened due to increased uncertainty about growth outlook, but we would like to remind that Eugeniusz Gatnar, who filed the motion in July, has recently stated he is unlikely to repeat his hike motion before November. Thus, the lack of hike motion does not necessarily mean that hawks no longer consider raising rates. We guess that the rate cut motion came from ultra-dovish Eryk Łon and probably gained support of no more than 1-2 members (detailed results of the vote are due for release 6 weeks after the meeting, i.e. on 24 October). It does not change our expectations about monetary policy outlook but confirms our earlier call that in the coming months the MPC may discuss both rate cuts and rate hikes. While the doves would focus on the ongoing economic slowdown, hawks may be under the spell of rising inflation, which will jump above 4% at the start of 2020, in our view. But the most likely scenario is still keeping rates hold at least until the end of next year, which will be supported by majority led by governor Głapiński.

Construction output decomposition, % y/y



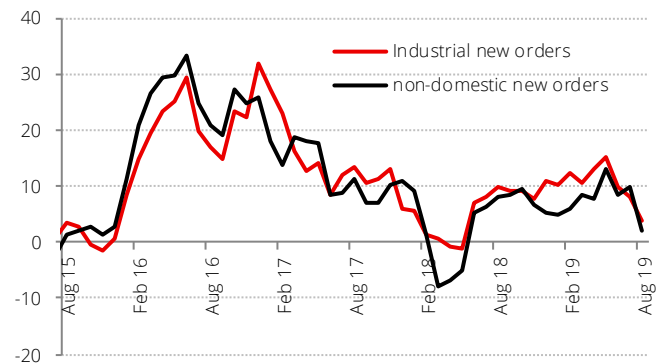
Source: GUS, Santander

Housing market tendencies, 12 sums



Source: GUS, Santander

New orders in industry, % y/y



Source: GUS, Santander

Quote of the week:

NBP minutes, 26 Sep, NBP: Certain Council members pointed to factors that might boost inflation higher than indicated by the current forecasts. They noted that should there be a significant rise in inflation that would jeopardise meeting the inflation target in the medium term, it might be justified to consider an increase in the NBP interest rates in the coming quarters. In the opinion of these Council members, uncertainty about the economic outlook and future price growth had risen.

Grażyna Ancyparowicz, MPC member, 26 Sep, PAP: According to forecasts, GDP growth in 2019 will be above 4%. In my view, there are no reasons why this number would go down. There are currently no tensions that could possibly distort the Polish economy, both as regards internal and external risk factors.

FX and FI market

Last week on the market

FX EURPLN, CHFPLN and GBPLN remained near their local peaks while USDPLN continued to rise. Nearly all main EM currencies lost versus the dollar and the zloty was the third weakest among them (only after the forint and Chilean peso). It seems that the uncertainty ahead of the October 3rd European Court of Justice verdict was one of the factors driving the zloty in the recent days.

The Czech koruna was the best performer in the CEE3 group. EURCZK fell temporarily to 25.75 thanks to the hawkish rhetoric of the Czech central bank. The interest rates were left unchanged last week but the decision was not unanimous (5:2). Central bankers might resume rate hike talks in the coming months.

FI Polish bond yields and the IRS rates fell last week amid stronger Bund and Treasuries. The IRS curve moved more and so the 10Y asset swap spread neared its local peak from August at 42bp. The 10Y and 5Y IRS fell already c20bp from their local peaks in mid-September. The 10Y PL-DE bond yield spread rose temporarily to 265bp from 255bp but at the end of the week was below 260bp.

Key events

On October 3rd the European Court of Justice will announce its verdict regarding Polish FX mortgages and this is likely to be the main event on the Polish market not only next week. The ECJ ruling will not be binding for the Polish courts and would not trigger automatic loans conversion but if it is positive for the mortgage borrowers, then we could see a rise in lawsuits against banks. Furthermore, the pace of any FX purchases would depend on the timing of individual rulings announced by the Polish courts and decisions of the commercial banks and banking system supervisor. The verdict might mean that banks would now have to include some part of the future losses in their balance sheets but we would probably not know this already in early October.

As far as Polish data is concerned, we will see flash September CPI and manufacturing PMI. We expect inflation pulled back noticeably from the 2.9% seen in the previous two months while the PMI fell pressured by low readings in Europe. The MPC will meet second time in the last three weeks and there shall be no new message for the market.

On Friday September 27 Fitch agency could review Poland's rating but we do not expect any change, particularly before the ECJ verdict.

Abroad, the market should focus on the US nonfarm payrolls release and numerous speeches of the FOMC members. In the recent months, the rise of the nonfarm payrolls was rather sluggish, it was higher than 200k only once in the last seven months.

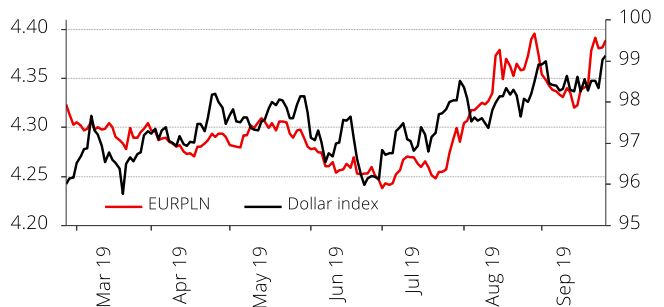
Market implications

Uncertainty ahead of the ECJ verdict could have an adverse impact on the Polish assets in the short term.

FX There could be some speculative activity on the market against the zloty ahead of the verdict (with EUR/PLN rising to c4.50) but this should not last long given the likely legal complexity of the verdict and little straightforward evidence of what the ruling actually means for banks. Lack of clarity should prevent the market from selling the zloty on a large scale. We think the FX mortgages factor could curb zloty gains in the remainder of the year.

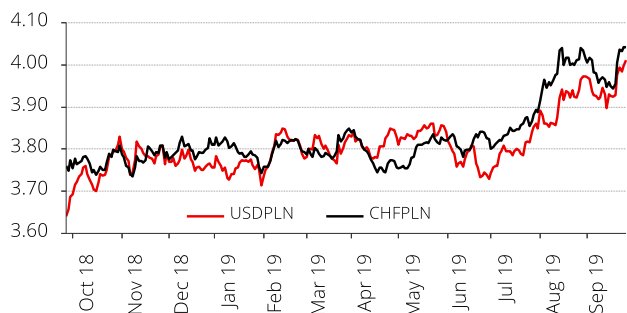
FI Polish 10Y bond yield reached 2% support level and we expect the down trend might decelerate in the short term. The uncertainty related to the impact of the ECJ verdict on the Polish banks could weigh on the domestic bonds but the front end could outperform thanks to the CPI release. Thin liquidity on the market might inflate the intraday changes. The IRS shall continue to decline given the persisting global growth uncertainty and so the asset swap spread might rise in the days to come. The 10Y PL-DE bond yield spread is holding in the slow uptrend and we expect this might continue in the weeks to come.

EURPLN and dollar index



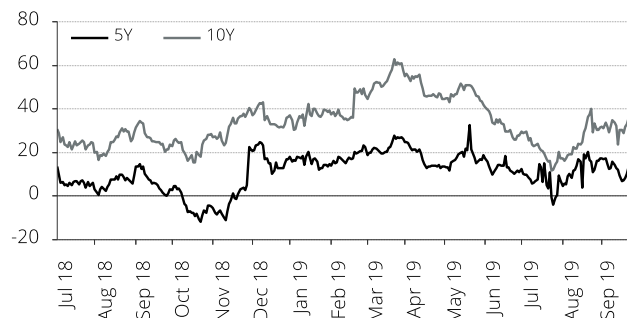
Source: Refinitiv Datastream, Santander Bank Polska

USDPLN and CHFPLN



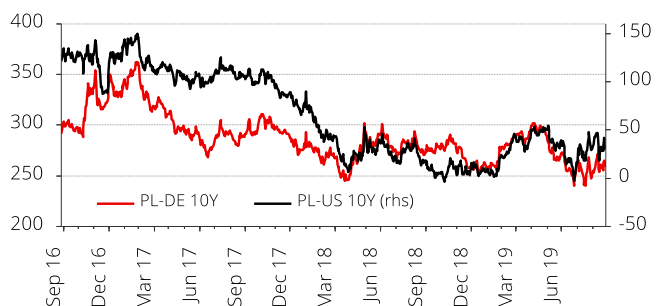
Source: Refinitiv Datastream, Santander Bank Polska

Asset swap spreads (bp)



Source: Refinitiv Datastream, Santander Bank Polska

10Y bond yield spreads (bp)



Source: Refinitiv Datastream, Santander Bank Polska

Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	SANTANDER		
MONDAY (30 September)							
11:00	EZ	Unemployment Rate	Aug	%	7.5	-	7.5
14:00	DE	HICP	Sep	% m/m	0.0	-	-0.1
TUESDAY (1 October)							
09:00	CZ	GDP SA	2Q	% y/y	2.7	-	2.7
09:00	PL	Poland Manufacturing PMI	Sep	pts	47.3	48.0	48.8
09:55	DE	Germany Manufacturing PMI	Sep	pts	41.4	-	41.4
10:00	EZ	Eurozone Manufacturing PMI	Sep	pts	45.6	-	45.6
10:00	PL	Flash CPI	Sep	% y/y	2.7	2.6	2.9
11:00	EZ	Flash HICP	Sep	% y/y	1.0	-	1.0
16:00	US	ISM manufacturing	Sep	pts	50.5	-	49.1
WEDNESDAY (2 October)							
	PL	MPC decision		%	1.50	1.50	1.50
14:15	US	ADP report	Sep	k	137	-	195
THURSDAY (3 October)							
9:30	PL	ECJ verdict					
09:55	DE	Markit Germany Services PMI	Sep	pts	52.5	-	52.5
10:00	EZ	Eurozone Services PMI	Sep	pts	52.0	-	52.0
11:00	EZ	Retail Sales	Aug	% m/m	0.3	-	-0.6
11:00	PL	Bond auction					
14:30	US	Initial Jobless Claims	week	k	211	-	213
16:00	US	ISM services	Sep	pts	55.0	-	56.4
16:00	US	Factory Orders	Aug	% m/m	-0.5	-	1.4
FRIDAY (4 October)							
14:30	US	Change in Nonfarm Payrolls	Sep	k	140	-	130
14:30	US	Unemployment Rate	Sep	%	3.7	-	3.7

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg

This publication has been prepared by Santander Bank Polska S.A. for information purposes only. It is not an offer or solicitation for the purchase or sale of any financial instrument. Information presented in the publication is not an investment advice. All reasonable care has been taken to ensure that the information contained herein is not untrue or misleading. But no representation is made as to its accuracy or completeness. No reliance should be placed on it and no liability is accepted for any loss arising from reliance on it. Forecasts or data related to the past do not guarantee future prices of financial instruments or financial results. Santander Bank Polska S.A. its affiliates and any of its or their officers may be interested in any transactions, securities or commodities referred to herein. Santander Bank Polska S.A. or its affiliates may perform services for or solicit business from any company referred to herein. This publication is not intended for the use of private investors. Clients should contact analysts at and execute transactions through a Santander Bank Polska S.A. entity in their home jurisdiction unless governing law permits otherwise. Copyright and database rights protection exists in this publication.

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.