11 October 2019

Weekly Economic Update

It's the politics, stupid

What's hot next week

- **Results of parliamentary elections** are the first market driver after the weekend. Polls suggest that PiS winning an outright majority on both chambers of the parliament is the baseline scenario, and this should be neutral for PLN and POLGBs. In our view it is unlikely that PiS will gather enough votes to overturn the President's veto (3/5 or 276 mandates in the Sejm) or to change the constitution (2/3 or 307 mandates). The latter option could be PLN-negative in the short term, as it would raise worries about further escalation of conflict with the EU and new controversial legislative initiatives. We would also expect a negative market reaction when PiS falls markedly short of simple majority, as this could potentially mean problems with forming a new government, prolonging uncertainty and possibly new elections in the spring (or, alternatively, the coalition government of opposition parties with uncertain economic agenda). However, if PiS lacks only a few mandates (<5) to 50% threshold, the market reaction should be insignificant as the victorious party is likely to lure some MPs from the opposition into its faction.
- After we digest the results of Polish elections, **attention will focus on Brexit again**. On Thursday-Friday the European Council meeting is planned, which may decide about the Brexit deal. After Boris Johnson's meeting with Ireland's PM, hopes for reaching agreement with EU have risen substantially. If Johnson indeed secures a deal at the EU summit (which is still far from certain), then it still has to be approved by the UK's parliament, which will hold a special session on Saturday. If there is no deal, or the deal does not go through the parliament, then PM Johnson is theoretically obliged by the law to call for an extension of Brexit.
- On Friday, the annual **meeting of the IMF and World Bank** starts where we are likely to see plenty of comments regarding the persistence and severity of the global economic slowdown. The IMF will publish its fresh economic forecasts that are likely to be lower than the previous ones.
- **In Poland, numerous data** would be released – balance of payments, CPI and core inflation, wages and employment, industrial output. We do not expect these data to change our view for the Polish economic outlook significantly and so should be market-neutral. Abroad, the data releases calendar is rather poor but a lot of the central bank's representatives will give speech (including Fed and BoE).

Market implications

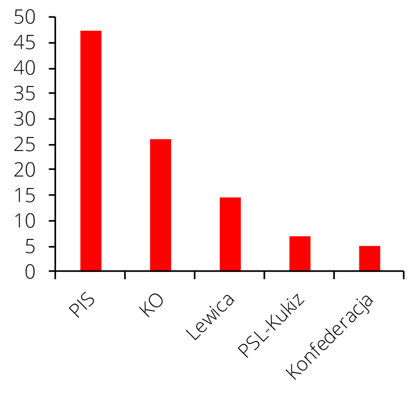
- If the Polish general elections do not bring any surprise (and we do not expect any), after the weekend the zloty might continue discounting positive news related to the global economy – step towards US-China trade deal and higher chances for a "soft Brexit". If EURPLN breaks 4.30, the next support would be at 4.27. The same factors, supporting global demand for the risky assets, could push bond yields further up.

Potential market implications of elections - summary

PiS wins simple majority:
neutral, nothing happens;
PiS wins more than 3/5 of seats:
neutral, nothing happens;
PiS wins more than 2/3 of seats:
short-term negative for PLN and bonds;
PiS wins slightly less than 50% of seats:
neutral because PiS will likely continue ruling and after elections it may try to lure MPs from smaller parties to join PiS; alternatively, PiS joins a coalition with a smaller party;
PiS fall markedly short of 50% mandates:
PLN- and POLGB-negative, as could mean a prolonged period of uncertainty: if the opposition forms a coalition government, there is uncertainty about its economic policy, 2020 budget, interest rates outlook; if the coalition fails to cooperate, we may be heading towards new elections;

Source: Santander

Average support in last five polls



Source: ewybory.pl

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 Luziński +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

The passing week was not very rich in macro releases, but we got to see some interesting comments from the MPC members.

Data on financial results of **companies employing 10+** showed that **margins deteriorated** slightly in 1H19 (5.1% versus 5.2% in 1H18). Smallest companies (employing 10-49) recorded some improvement in profitability, while bigger ones saw a deterioration. This was mostly achieved due to slower growth of costs of amortisation, taxes and energy/materials in smaller companies. Note however that quarterly data from bigger companies (50+) released earlier pointed to some improvement in margins in 2Q19. In our view, strong acceleration of CPI in 2H19 suggests that companies are trying hard to rebuild their profitability. While total investment in 10+ companies rose by 18.5% y/y in nominal terms in 1H19, this growth was mostly generated by the biggest companies employing 250+ people. **In companies with 10-49 employment investment rose by a mere 4.6% y/y**. Moreover, outlays were concentrated at buildings, while investment in machinery fell in annual terms, suggesting that problems with finding employees do not feed into higher investment in smaller companies.

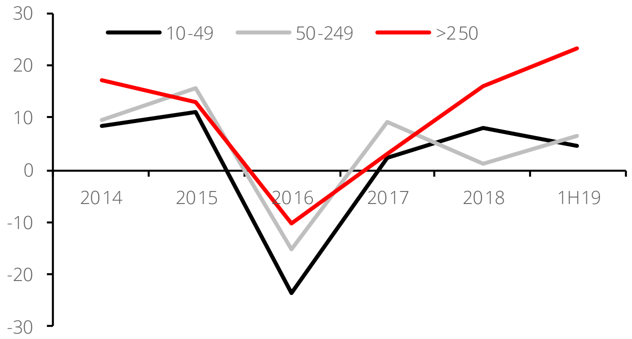
According to the Ministry of Labour, in September **the registered unemployment** rate decreased to 5.1% in line with our expectations. In our view September set this year's low for the indicator, the seasonal pattern should now be directing the unemployment rate slightly up, to 5.3% in December. We expect the final GUS reading for the unemployment rate to confirm the estimate of the Ministry.

Michał Dworczyk, chief of staff of PM's Chancellery said that there will be **no major jump in electricity prices in 2020** – the government will do all it can to keep them at current levels. The energy minister admitted in the parliament that various scenarios for the energy sector are mulled and implementation is possible near the year-end. No hike in electricity prices at the start of 2020 would deduct 0.5pp from our forecast of CPI in 2020 (currently at 3.4% on average).

The **Moody's rating agency** informed that it keeps its Polish GDP growth forecasts for 2019 and 2020 unchanged at 4.4% and 3.7%, respectively. In its view, domestic economy will be supported by the private consumption and inflow of the EU funds. At the same time, Moody's sees uncertainty related to the economic policy (that has recently became more interventionist, in the agency's view) and risk steaming from the FX mortgage loans as main challenges. Today Moody's and S&P could present their updates of Poland's credit rating.

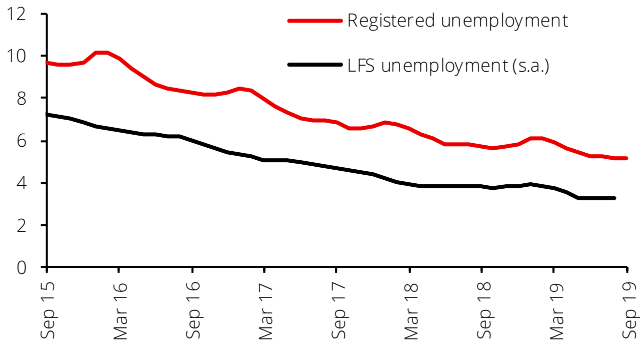
MPC's Eugeniusz Gatnar, Łukasz Hardt and Grażyna Ancyparowicz commented that the last ECJ ruling does not generate risks for the banking sector as its impact will be distributed in time, and thus should not be addressed by the monetary policy. Eugeniusz Gatnar was also worried about negative real interest rates in the Polish economy, reinforcing his view that hikes are still on cards. On the other hand, Eryk Łon reiterated that the MPC should react to worsening business sentiment with interest rate cuts and Grażyna Ancyparowicz were neither reasons to hike nor to cut interest rates. To sum up, MPC members are sticking to their views and we are expecting rates to remain unchanged in 2019 and 2020, though motions for both cuts and hikes are likely to emerge.

Investment by employment size, % y/y



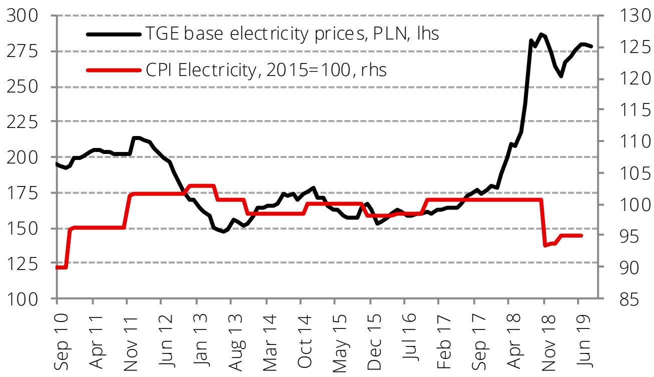
Source: GUS, Santander

Unemployment rate, %



Source: GUS, Eurostat, Santander

Wholesale electricity prices vs prices for households



Source: GUS, TGE, Santander

Quote of the week:

Eugeniusz Gatnar, 11 Oct, PAP: In Poland interest rate has been negative for the last 2 years. (...) For me, as a MPC member, this is a problem, as it is encouraging to take on new debt and discouraging from saving. Even destroying the paradigm adherent to our civilisation – we postpone consumption in order to build capital and savings.

FX and FI market

Last week on the market

FX After a noticeable appreciation seen after the ECJ verdict, the zloty extended gains in the passing week but at a smaller scale. EURPLN was long stable around 4.325 and only in the second part of the week the exchange rate managed to break 4.31. The zloty gained also vs the dollar (USDPLN fell to 3.91 from 3.95) and the franc (CHFPLN plummeted to 3.93 from 3.98) while it lost vs the pound (GBPPLN jumped to 4.90 after a temporary drop to 4.76). It seems that higher chances for at least a "small deal" in US-China talks and a lower risk of the hard Brexit were the main factors supporting the zloty.

Elsewhere in the CEE region, the forint and ruble gained slightly on weekly basis while the koruna depreciated. The main factor weighing on the Czech currency was the release of September CPI that showed a surprising drop of the annual inflation rate.

FI Domestic bond yields and IRS rates trended in the horizontal trend hovering around the last Friday's closing levels. This was enough though for the PL-DE 10Y bond yield spread to fall to its important support at c240bp. Bund and Treasuries yields rose as the global market mood improved thanks to the positive news from the US and UK.

Key events

In our view, the most awaited global event next week would be the European Council summit (starting on Thursday). October 19 is the deadline for the UK Parliament to approve the Brexit deal. If that does not happen, PM Johnson is obliged to ask for an extension. Recently, we have heard some positive comments that the Brexit deal could be reached before the deadline and the market has started to price in such option (the pound gained).

In our base case scenario, Poland Sunday parliamentary elections shall not have a meaningful market impact.

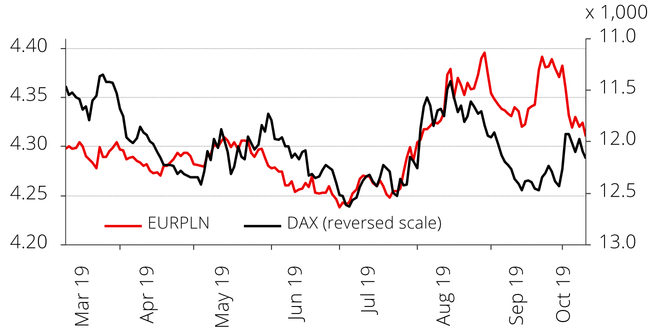
Market implications

On Sunday there will be parliamentary elections in Poland. According to the latest polls, PiS may count on keep more than half of all the seats in both chambers. In our view such a result would be market neutral. After PiS won 2015 elections the market was afraid that introduction of the pre-election promises of PiS would have had a negative effect on budget and that the MPC selected by PiS would be radically dovish, but these risk factors did not materialise. We think that two scenarios could be negative for the zloty and domestic bonds: (1) if PiS gets a majority large enough to change the constitution (at least 307 seats in Sejm – the Lower House of the Parliament) or (2) if it gets significantly less than 50% of mandates in Sejm which would prevent it from ruling on its own. Both alternative scenarios seem however unlikely to us.

FX At the end of the current week, EURPLN was testing the 4.30-4.31 support area and the global factors could set a direction for the zloty for the coming weeks. The euro gained vs the dollar taking EURUSD to its highest level since mid-September. Global stock indexes rose but held below their local peaks. It looks there is still room for the market to price in any positive news allowing the Polish currency to benefit from any improvement of the global market sentiment. Additionally, the zloty may be slightly supported by the release of Poland industrial output release – that will show a sharp improvement vs poor August – but only when the optimism persists on the global market, in our view. If EURPLN breaks 4.30, next support would be at 4.27.

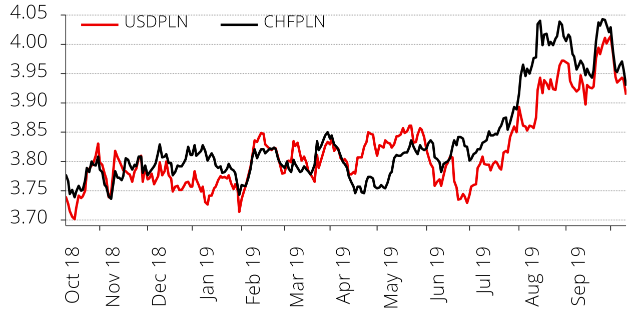
FI We expect Polish bond yields and IRS to stay above their multi-month lows, just like Bunds and Treasuries. There has been some reaction to the positive trade and Brexit news but core bonds are still pretty near their lows. This means that there is still room for yields to rise if more supportive information emerge while in case of any disappointment, the market reaction could be muted. Final Poland September CPI is likely to be confirmed at 2.6% while we and the market expect that industrial output rebounded noticeably after a contraction in August.

EURPLN and DAX index



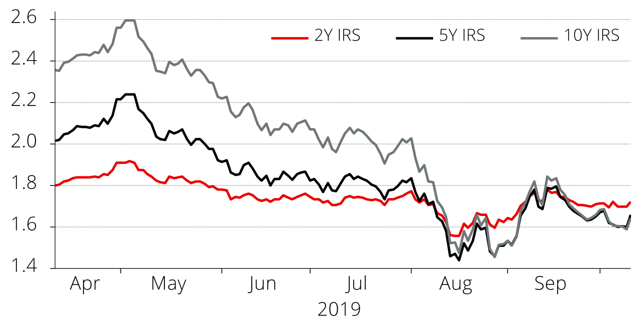
Source: Refinitiv Datastream, Santander Bank Polska

USDPLN and CHFPLN



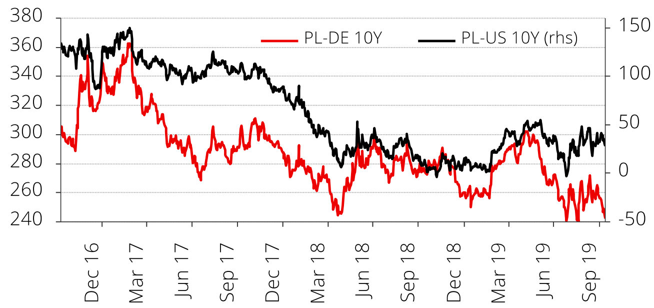
Source: Refinitiv Datastream, Santander Bank Polska

IRS rates (%)



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 MARKET	FORECAST SANTANDER	LAST VALUE
		MONDAY (14 October)					
11:00	EZ	Industrial Production SA	Aug	% m/m	0.3	-	-0.4
14:00	**PL**	**Current Account Balance**	**Aug**	**€mn**	**-567**	**-702**	**-814**
14:00	**PL**	**Trade Balance**	**Aug**	**€mn**	**-440**	**-360**	**-376**
14:00	**PL**	**Exports**	**Aug**	**€mn**	**17 650**	**17 240**	**19 239**
14:00	**PL**	**Imports**	**Aug**	**€mn**	**18 108**	**17 600**	**19 615**
		TUESDAY (15 October)					
10:00	**PL**	**CPI**	**Sep**	**% y/y**	**2.6**	**2.6**	**2.9**
11:00	DE	ZEW Survey Current Situation	Oct	pts	-25.0	-	-19.9
		WEDNESDAY (16 October)					
11:00	EZ	HICP	Sep	% y/y	0.9	-	0.9
14:00	**PL**	**CPI Core**	**Sep**	**% y/y**	**2.3**	**2.4**	**2.2**
14:30	US	Retail Sales Advance	Sep	% m/m	0.3	-	0.4
		THURSDAY (17 October)					
10:00	**PL**	**Employment in corporate sector**	**Sep**	**% y/y**	**2.6**	**2.6**	**2.6**
10:00	**PL**	**Average gross wages**	**Sep**	**% y/y**	**7.1**	**7.5**	**6.8**
14:30	US	Initial Jobless Claims	week	k	220	-	210
14:30	US	Housing Starts	Sep	% m/m	-3.2	-	12.3
14:30	US	Index Philly Fed	Oct	pts	7.1	-	12.0
15:15	US	Industrial Production	Sep	% m/m	-0.1	-	0.6
		FRIDAY (18 October)					
10:00	**PL**	**Sold Industrial Output**	**Sep**	**% y/y**	**5.0**	**5.0**	**-1.3**
10:00	**PL**	**PPI**	**Sep**	**% y/y**	**0.5**	**0.4**	**0.7**

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg

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.