21 October 2019

Weekly Economic Update

Crucial Brexit moment

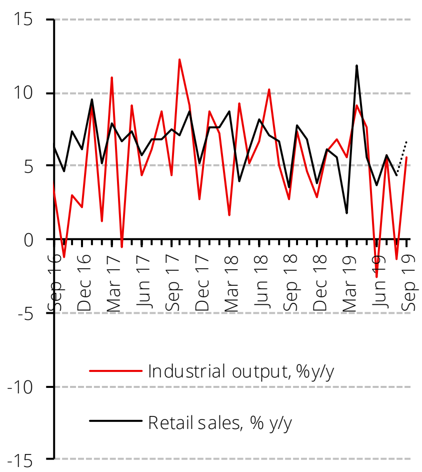
What's hot next week

- The fate of the next week's market mood is likely to be determined by the weekend voting of the new Brexit deal in the UK Parliament. Last week, the EU and the UK agreed to some modifications to the initial Withdrawal Act which was positively received by the market. However, the optimism was only short-lived since the Brexit deal still needs to be accepted by the UK Parliament. Last week, the DUP party said it would support the deal securing a minor majority for the government. However, the vote shall still be on the knife-edge.
- Thus, if the deal is not approved, this should not be a big disappointment for the market and we would expect only a mild negative reaction. The PM Johnson would then have to ask the EU to extend the Article 50 until January 31. However, if the deal is backed, we expect a wave of optimism to flood the market after the weekend and the risky assets could extend rally.
- On Thursday, the ECB holds a meeting and first flash PMIs for manufacturing and services will be released. The ECB has recently taken some bold decision to cut deposit rate and to restart the bond purchases programme and we do not expect the upcoming meeting to provide any significant information in terms of the monetary policy outlook in the euro zone. As far as the PMIs are concerned, indexes are in a strong down trend and the market (again) hopes for at least a minor rebound.
- In Poland, we will see some macro data, out of which the September retail sales (Monday) looks the most interesting. In our view, sales reaccelerated after some slowdown. We may also know who voted for a rate cut in September – if there was more than one supporter of this motion.

Market implications

- Performance of the zloty and Polish bond would strongly depend on the outcome of the UK voting, in our view.
- No deal and Article 50 extension – EURPLN to correct slightly higher to the 4.32 area and then consolidate there for a week, yields only to increase slowly and to a relatively small extent up to 2.2%.
- Brexit deal accepted – EURPLN temporarily toward support at 4.24, 10Y Poland bond yields increase as high as 2.4% on a temporary overshoot basis.

Output and retail sales, %y/y



Source: GUS, Santander

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Last week in economy

The **general elections result** was that PiS maintained a simple majority in the Sejm (235/460 mandates) and will be able to rule alone, but has lost its majority in the Senate (48/100 seats). This will not paralyse the legislative process, as the Sejm can overturn the Senate's veto with an absolute majority, but can make it longer. We think that the results are neutral for the financial market. According to deputy PM Jacek Sasin, the government can change slightly after the elections, but Mateusz Morawiecki will be a candidate for PM post. The new parliament is to meet on 12 November which means that by 26 November we should know the new government.

Rating agencies commented on the elections: Moody's warned that the economic policies of PiS and continuation of changes in the Polish judiciary will be credit-negative and it stressed the risk for the country's competitiveness due to strong hikes of minimum wage. Fitch signalled that the second term will be more challenging for PiS due to economic slowdown and receding boost from better tax collection enhancements. S&P thinks the elections outcome is rating-neutral. The agencies questioned the 2020 budget draft as overly optimistic.

The **IMF** raised its 2019 Poland GDP growth forecast to 4% from 3.8% forecasted in April despite less optimistic forecasts of global growth –3% in 2019 vs 3.3% and 3.4% from 3.6% in 2020. Polish CPI forecasts were also shifted up – to 2.4% from 2% in 2019 and to 3.5% (close to our call) from 1.9% in 2020.

Quarterly **business climate report by NBP** „Quick monitoring" showed that corporates feel weaker demand and expect further weakening in 4Q. Specialised exporters are particularly worried. The report also showed that labour costs are a growing obstacle to expansion – now even greater than labour shortages. In 2Q sales margins widely fell. The report underlines however that there are signals of weakening of the wage pressures and hence corporates do not expect that the pressure could increase in 4Q in response to high inflation.

September **wage growth** was lower than expected while employment remained sluggish. More in the economic comment

CPI inflation in September was confirmed at 2.6% y/y down from 2.9% y/y in August. Despite lower headline CPI, the core inflation excluding food and energy prices moved up to 2.4% in September from 2.2%, the highest level in more than seven years, and in our view will continue to climb in the months to come. Government decision on energy prices are crucial for the price developments in early 2020. In case these are unfrozen, CPI can easily break 4% y/y in early 2020. PPI inflation showed 0.9% y/y in September, markedly surprising to the upside (consensus at 0.5% y/y) - upward tendencies were broad-based, most likely reflecting the effect of PLN depreciation and build-up of corporate margins.

Polish **industrial output** rebounded more than expected in September, to 5.6% y/y after several poor readings. Still seasonally adjusted growth is far below 1H. More in this comment.

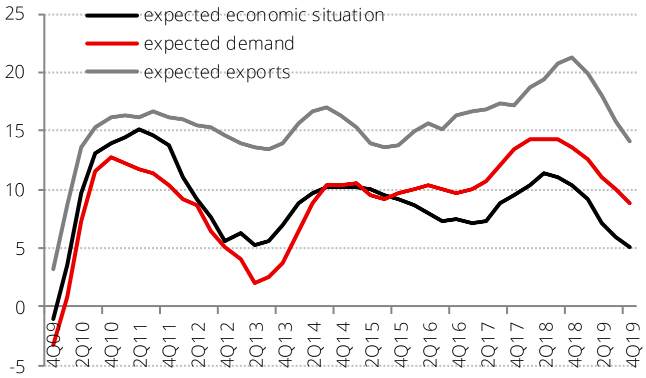
October **MPC minutes** revealed that for the second time in a row there was a motion to cut rates (rejected again). Description of the discussion was similar to the one from the previous month (weak growth abroad, especially in Germany, still relatively high albeit slowing Polish GDP growth). Majority of the MPC members were in favour of unchanged interest rates. Description of the views of the hawks changed somewhat – instead of mentioning that some of the MPC members see a risk of significant inflation rise which would enable interest rates increases, an additional sentence has been introduced that „the likelihood of such a scenario decreased". At the same time the document also mentioned the too high dynamics of consumer credit and money supply. The minutes have not changed our view of no interest changes in 2019-2020.

Official results of parliamentary elections

	SEJM: Percent of votes	SEJM: Number of seats	SENATE: Number of seats
PiS	43,59%	235	48
KO	27,40%	134	43
Lewica	12,56%	49	2
PSL	8,55%	30	3
Konfederacja	6,81%	11	0
Others		1	4

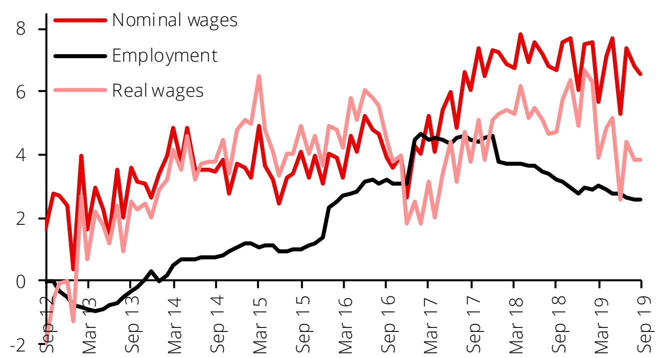
Source: PKW

NBP's "Quick monitoring" enterprise survey, selected results, pts



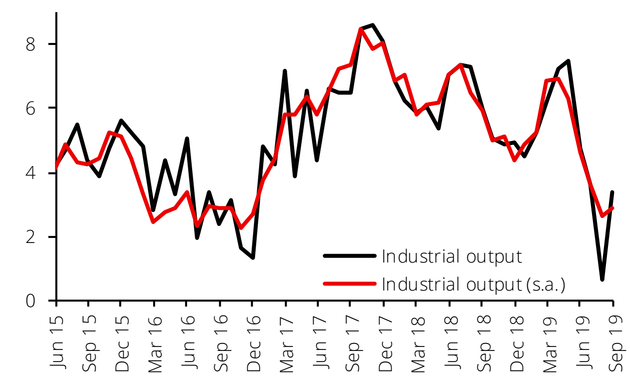
Source: NBP, Santander

Labour market data, %y/y



Source: GUS, Santander

Industrial production, %y/y, 3M moving average



Source: GUS, Santander

FX and FI market

Last week on the market

FX Zloty has had the best performance MTD among EM currencies: +2.1% vs euro and +4.1% vs dollar. Roughly half of the move happened just after ECJ ruling in the first days of October as the risk premium decreased. The other half of the appreciation happened only gradually over the remaining days as both US-China talks (possibility of a "small deal") and Brexit talks (new UK deal with EU at EC summit) injected more optimism into the global markets: zloty gained on a weekly basis +0.5% vs euro, +1.3% vs dollar, +0.4% vs Swiss franc and lost only vs British pound by -0.5%. It is worth noting that zloty appreciated in overwhelming majority of days this month. The EURPLN 3 week percentage change (here: drop) is the highest since March 2017.

Elsewhere in the CEE region the currencies also took advantage of better global sentiment. EURCZK fell by 0.5%, EURHUF by 0.3% while USDRUB by 0.5%. The latter is probably simply a function of EURUSD move higher by 0.9%. The ruble basket remained stable even despite brent oil price lower 1% w/w.

FI Domestic bond yields and IRS rates increased over the past week with a slight bear steepening bias (bond yield 2x10s to 53bp from 47bp). Yields followed closely the behaviour of core fixed income markets but traded slightly stronger on a relative basis (10Y Bund-POLGB spread narrowed to 242bp from 254bp). 10Y POLGBs finished the week at 2.04% or 6bp higher than last week. 10Y IRS at 1.77% or 4bp higher on the week (hence 10Y asset swaps widened by 2bp to 27bp).

Key events

In our view, events which most likely will become biggest market movers next week are an outcome of Saturday's voting over new UK deal with EU, Thursday's ECB meeting and the flash manufacturing and services PMIs on Thursday as well.

In Poland there is retail sales data on Monday, construction output and M3 money supply on Tuesday and unemployment rate on Wednesday. Around Thursday NBP will publish voting outcomes for the September MPC meeting where markets will be watching the number of people voting for a cut (if more than one).

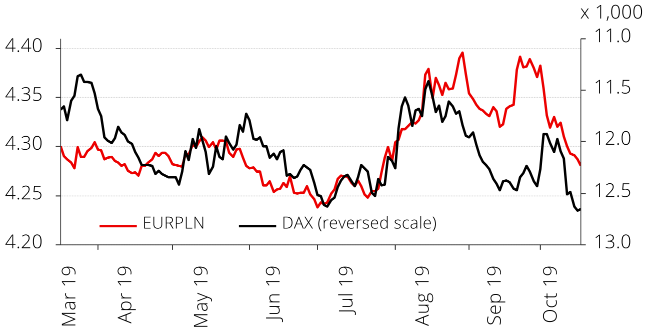
In the CEEMEA region there are central bank decisions in Hungary on Tuesday where rates are likely to remain unchanged at 0.9% and in Russia on Friday where the rates could be cut by 25bp or even as much as 50bp from the current 7.0% after recent CBR's governor Nabiullina comments. The Annual Meetings of IMF and WB conclude on Sunday 20 October.

Market implications

FX Zloty behavior next week will depend heavily on global factors and in particular on this Saturday's (19th October) parliamentary vote in the UK. If the deal is rejected we expect EURPLN to correct slightly higher to the 4.32 area (long due as the EURPLN looks pretty oversold) and then consolidate there for a week, as was the case back in March 2017 after a move of similar strength. In a deal scenario we expect a knee-jerk risk-on reaction which would temporarily push EURPLN toward current support at 4.24 (early July 2019 low).

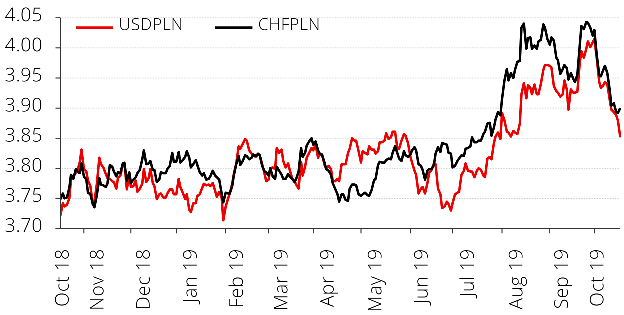
FI We expect Polish bond yields and IRS to increase regardless of the outcome of the vote. Target yields differ only to the scale of the move. In a no-deal scenario we expect the yields only to increase slowly and to a relatively small extent up to 2.2% - as they follow the global corrections higher in core markets yields. In a deal scenario we expect a significant sell-off on the core markets (core yields much higher) and hence the 10Y POLGB yields could increase more significantly even as high as 2.4% on a temporary overshoot basis. The 10Y spread versus Bund should remain within latest 240-270bp range.

EURPLN and DAX index



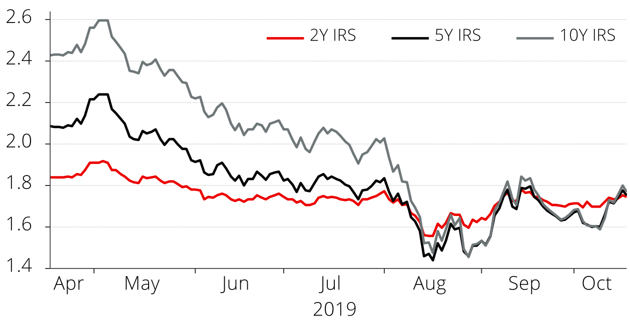
Source: Refinitiv Datastream, Santander Bank Polska

USDPLN and CHFPLN



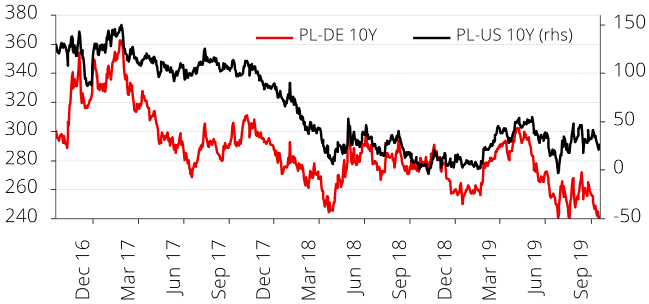
Source: Refinitiv Datastream, Santander Bank Polska

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 (21 October)					
10:00	**PL**	**Retail Sales Real**	**Sep**	**% y/y**	**6.2**	**6.7**	**4.4**
		TUESDAY (22 October)					
10:00	**PL**	**Construction Output**	**Sep**	**% y/y**	**6.5**	**6.0**	**2.7**
14:00	HU	Central Bank Rate Decision		%	0.9		0.9
14:00	**PL**	**Money Supply M3**	**Sep**	**% y/y**	**9.8**	**9.8**	**9.9**
16:00	US	Existing Home Sales	Sep	% m/m	-0.5		1.29
		WEDNESDAY (23 October)					
10:00	**PL**	**Unemployment Rate**	**Sep**	**%**	**5.1**	**5.1**	**5.2**
		THURSDAY (24 October)					
09:30	DE	Flash Germany Manufacturing PMI	Oct	pts	42.0	-	41.7
09:30	DE	Flash Markit Germany Services PMI	Oct	pts	51.7	-	51.4
10:00	EZ	Flash Eurozone Manufacturing PMI	Oct	pts	46.0	-	45.7
10:00	EZ	Flash Eurozone Services PMI	Oct	pts	52.0	-	51.6
13:45	EZ	ECB Main Refinancing Rate		%	0.0	-	0.0
14:30	US	Durable Goods Orders	Sep	% m/m	-0.5	-	0.2
14:30	US	Initial Jobless Claims	week	k	215	-	214
16:00	US	New Home Sales	Sep	% m/m	-0.4	-	7.1
		FRIDAY (25 October)					
10:00	DE	IFO Business Climate	Oct	pts	94.5		94.6
16:00	US	Michigan index	Oct	pts	96.0		96.0

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.