

15 November 2019

Weekly Economic Update

Test of market optimism

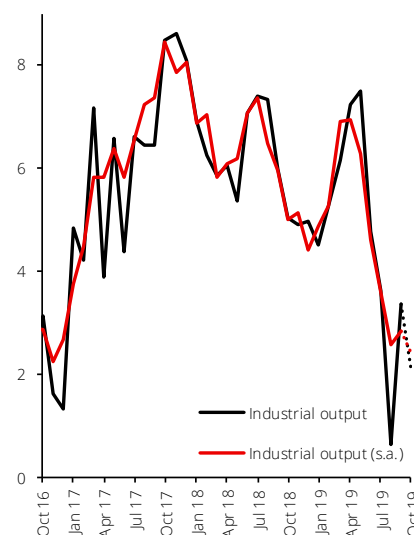
What's hot next week

- It seems that the upcoming week will start with a load of optimism – the German economy managed to avoid a recession and information on US-China trade talks still fuel hopes. Sentiments are unlikely to be undermined by October FOMC minutes, as US central bankers signalled that despite the end of the easing cycle, hikes are still distant. Flash November PMIs will tell us whether entrepreneurs also grew more sanguine. Markets gather that this is the case, as forecasts for these indicators point clearly up.
- This week there will be speech by the new ECB president together with the Bundesbank head. We will also see the first political battles in the starting campaign ahead of snap parliamentary elections in the UK. Also, there will be several hearings in the Donald Trump's impeachment procedure.
- In Poland, data on industrial and construction output for October will be out. The sudden deterioration of sentiment in manufacturing captured by the PMI index bodes ill, so is the intriguing weakness of imports in September (possibly due to poor volumes in intermediate goods serving as input for Polish industry). Wage growth in the corporate sector may also be relatively weak compared to the previous readings.

Market implications

- Taking under consideration the recently weaker fundamentals, like Q3 GDP, and strong **zloty** performance in the previous month, we expect that EURPLN will rise towards 4.32-4.34 in the coming weeks. The move might be exacerbated by a possible positive news about "phase 1" trade deal which is likely to raise core yields and put EM currencies under pressure.
- Polish **bond yields** may be now more sensitive to external factors rather than domestic issues. We think the possible rise of Bund yield will set the direction for the Polish market.

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



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

The economy slowed down in 3Q a bit more than had been expected. Risks to growth were also stressed in the new NBP projection with its downward revision of GDP path. C/A data surprised with import weakness, which goes against the view that domestic demand remains resilient. Inflation fell to the 2.5% y/y target in October.

GDP growth slowed to 3.9% y/y in 3Q19 vs 4.6% y/y in 2Q19, according to flash estimate. The slowdown was a bit more pronounced than we had expected (4.1% y/y), but data from 1H were revised upwards, so our forecast for the entire year remains intact (4.3%).

Final reading of **October CPI** confirmed a decline of inflation to 2.5% y/y from 2.6%. Services prices inflation stayed at 4.8% y/y, goods prices eased to 1.7% y/y from 1.8%. We estimate that core inflation was 2.4-2.5% in October vs 2.4% previously. We believe that by the end of the year inflation should rebound to almost 3% y/y. More on GDP and CPI in our [economic comment](#).

The **NBP inflation report** showed a slightly higher path of core inflation, raised by the cost effect of hike in minimum wage, higher-than-expected housing costs, but, on the other hand, limited by weaker expectations about the economic growth. Expectations about energy prices went down (NBP assumed that energy prices will go up by 8% in 2020). CPI is expected to peak in 1Q20 at 3.5% y/y, but in 3Q19 it is expected to move back to 2.5% y/y and stay there until the end of the forecasting horizon (2021). The Report acknowledged risks for the economic growth: GDP growth abroad was significantly revised down and so was the investment path (7.1% instead of 8.6% in 2019, 4.0% instead of 4.8% in 2020 and 1.9% instead of 2.6% in 2021) plus the GDP fan chart is clearly asymmetric to the downside.

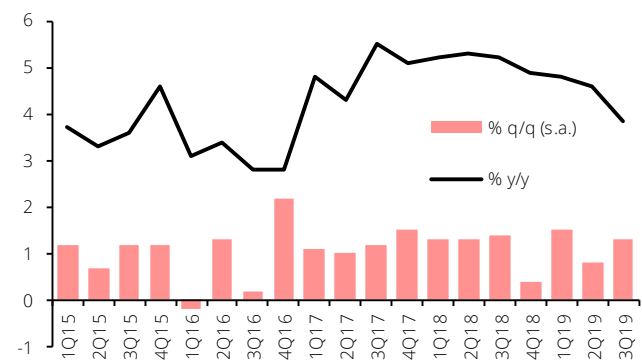
A **draft amendment to the excise law**, regarding alcohol and tobacco, was put forward by the government in the Sejm. The draft assumes the lump-sum excise to go up by 10% and the percentage excise duty on tobacco to go up to 32.05% from 31.41%. In our view, this move will increase average prices in this category by 4% in 2020 (with effect appearing gradually in 1Q20), which will add 0.25pp to headline CPI. The draft assumes the hike to yield PLN1.7bn for the state budget. The earlier proposal, put in the draft budget bill, assumed the excise duties to rise by 3% and yield PLN1.1bn, with marginal expected impact on CPI.

A group of PiS MPs put forward a draft bill abolishing the cap on social contributions in 2020. According to the draft bill, the legislation will support the Social Security Fund with PLN7bn per annum. MPs from Porozumienie, who are 18 out of the total of 235 in the ruling coalition Zjednoczona Prawica, announced they would not support the bill. Another PiS proposal assumes that the 13th pension will be financed by the Solidarity Fund, which would be created from the current Solidarity Fund for Support of the Disabled. The new fund would be able to take loans in order to finance payouts, and this would not burden the central budget and would not be subject to the spending rule limit, but would only increase the borrowing needs.

Poland **September current account** showed a surplus of EUR0.2bn while the consensus expected a deficit (-EUR0.2bn). Imports were the main source of surprise, as they grew by a mere 4.3% y/y, while exports added 9.3% y/y. Poland's balance of payments seems to behave counterintuitively, as the current account is improving amid weakening foreign demand and still strong domestic demand. More in our [economic comment](#).

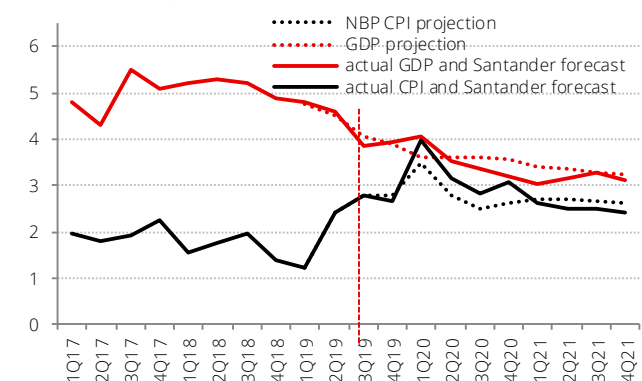
Results of **Monetary Policy Council** vote from 2 October 2019 showed that the motion to cut rates by 25bps was supported only by Eryk Łon. The data on GDP, CPI and the new NBP projections are, in our view, supporting the MPC's strategy of stable rates.

Polish GDP growth



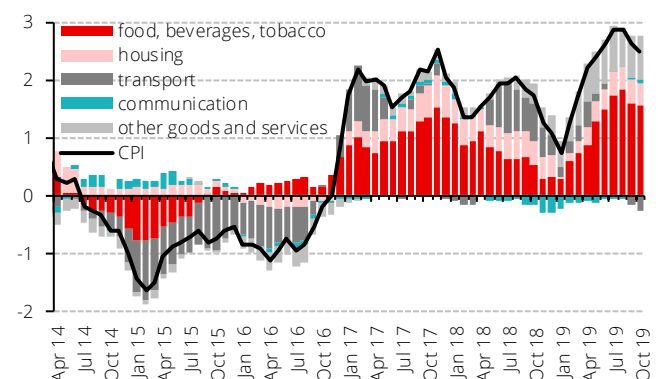
Source: GUS, Santander

November NBP projection vs Santander forecast



Source: NBP, GUS, Santander

Breakdown of annual CPI growth, %y/y



Source: GUS, Santander

International trade, %y/y



Source: NBP, Santander

FX and FI market

Last week on the market

FX Despite dollar index and EURUSD roughly unchanged over the previous week, the majority of emerging market currencies weakened vs the dollar (only rand and baht gained 0.5%). Except for Chilean and Colombian pesos which lost significantly (by 7.0% and 3.3%, respectively) the scale of the weakness was in general less than 1.0%. Zloty lost 0.3% counting Friday to Friday, however in the meantime (Thursday) traded as weak as 0.7% WTD. In particular the zloty lost on Wednesday even despite better than expected current account data, a fact which might be interpreted as a sign of further weakness to come. The currency behaviour was even worse on the crosses – CHFPLN rose 1.25% and GBPPLN 1.0% w/w.

Other currencies in the CEE3 region behaved in a similar fashion – both forint and koruna lost 0.3% w/w. The rouble has outperformed other EM currencies for another week - USDRUB have not changed vs dollar even this despite Brent oil lower by 1.0% over week. The behaviour might be explained by fixed income inflows related to a rapid disinflation and still relatively high real rates.

FI Last Friday Polish bond yields reached highest levels since July (10Y at c.2.20%) and have since retraced a bit, closely following price action on core markets. Core yields decreased after president Trump said during a speech in the Economic Club of New York that he'd increase tariffs significantly if the "phase 1" has not materialized. During the week both US 10Y and Bund yields fell by 10bp (to 1.83% and -0.34%) and so have 10Y POLGBs (to 2.06%) and swaps (to 1.86%). Both curves' 2x10 slopes flattened by c5bp (indicating that front end yields decreased as well but to a lesser extent). Polish asset swap has narrowed only marginally to 20bp, while the spread vs Bund just 3bp to 240bp.

Key events

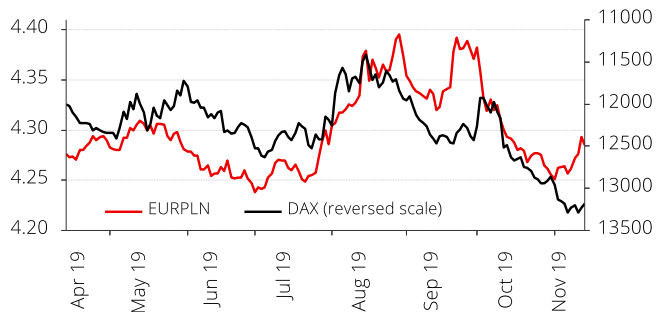
Next week, we will probably witness a symbolic change to China's 1Y Loan Prime Rate (on Wednesday) – likely a cut to 4.15% from 4.20%. Hungary rate decision is on Tuesday (plausibly unchanged at 0.9%), Eurozone consumer confidence on Thursday, preliminary PMIs for Eurozone, Germany and France and the US as well as University of Michigan consumer sentiment on Friday. In Poland, average gross wages and employment data will be known on Thursday, while sold industrial output, construction output and PPI on Friday. Fed speakers include Mester (Monday), Williams (Tuesday), Kashkari (Thursday). Also FOMC minutes will be published on Wednesday.

Market implications

FX After the zloty was best performing currency in October, we see no reasons for it to outperform EM currencies in the current month given the weaker Q3 GDP print, and the aforementioned over performance in the previous month. We expect the zloty to trade on the weaker side in the coming weeks with EURPLN likely reaching 4.32-4.34 area. The move might be exacerbated by a possible positive news about "phase 1" trade deal which is likely to raise core yields and put EM currencies under pressure.

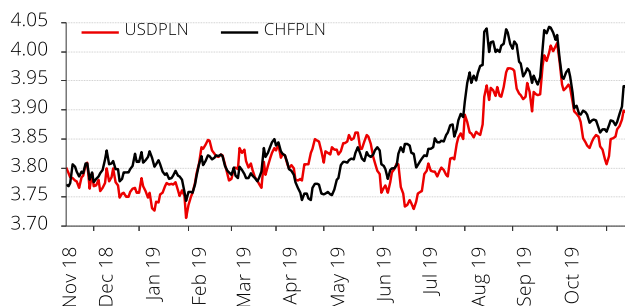
FI Polish 10Y bond yields retraced from the many month highs of 2.20% to 2.08% - a relief rally which we foresaw last week. Now that the correction is done, the next yield moves will depend heavily on the global factors. We closely watch Bund and think that move higher in yields is likely, especially if the -0.43% support level holds (if the yield does not breach -0.43% then the current correction would be smaller than the September one – a signal suggesting possible further yield increases possibly towards -0.20% for Bund and 2,20% for POLGBs). If we are right regarding the direction of the next move in core markets then asset swap spreads should widen a bit.

EURPLN and German DAX index



Source: Refinitiv Datastream, Santander Bank Polska

USDPLN and CHFPLN



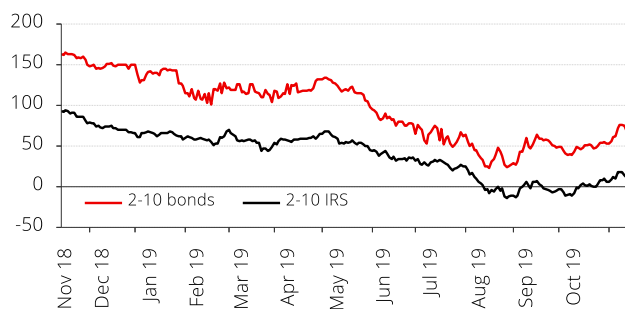
Source: Refinitiv Datastream, Santander Bank Polska

PLN IRS



Source: Refinitiv Datastream, Santander Bank Polska

2-10 spreads (bp)



Source: Refinitiv Datastream, Santander Bank Polska

Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE
				MARKET	SANTANDER	
TUESDAY (19 November)						
14:00	HU	Central Bank Rate Decision	Nov.19	%	0.9	0.9
14:30	US	Housing Starts	Oct	% m/m	4.9	-9.4
WEDNESDAY (20 November)						
20:00	US	FOMC Meeting Minutes	Oct.19		-	0.0
THURSDAY (21 November)						
10:00	PL	Employment in corporate sector	Oct	% y/y	2.6	2.6
10:00	PL	Average Gross Wages	Oct	% y/y	6.3	6.00099252875839.0
14:30	US	Initial Jobless Claims	Nov.19	k	215.0	225.0
14:30	US	Index Philly Fed	Nov		6.5	5.6
16:00	US	Existing Home Sales	Oct	% m/m	2.08	-2.18
FRIDAY (22 November)						
08:00	DE	GDP WDA	3Q	% y/y	0.45	0.5
09:30	DE	Germany Manufacturing PMI	Nov	pts	42.65	42.1
09:30	DE	Markit Germany Services PMI	Nov	pts	51.8	51.6
10:00	EZ	Eurozone Manufacturing PMI	Nov	pts	46.35	45.9
10:00	EZ	Eurozone Services PMI	Nov	pts	52.45	52.2
10:00	PL	Sold Industrial Output	Oct	% y/y	2.3	1.99
10:00	PL	Construction Output	Oct	% y/y	5.6	8.77
10:00	PL	PPI	Oct	% y/y	0.6	0.11
16:00	US	Michigan index	Nov	pts	95.65	95.7

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg

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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.