12 April 2019

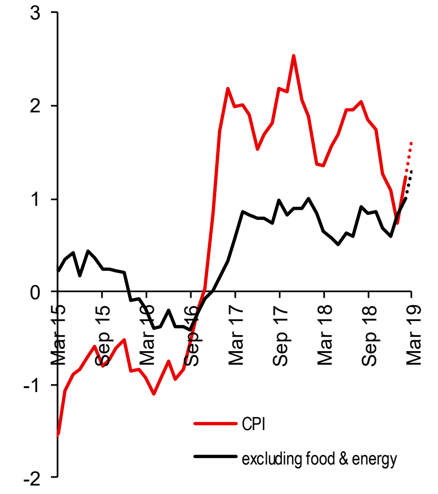
Weekly Economic Update

Can it get even worse?

What's hot next week

- Finally, we hope to **get some breath from Brexit** – the EU leaders agreed to extend Article 50 until Halloween (October 31st), unless the UK fails to hold the European Parliament elections in May, in which case the Brexit date will move to the Children's Day (June 1st), or the British Parliament finally backs the negotiated deal (which would also accelerate the exit process). Still, there is some hope that the issue will recede in the background.
- Markets will focus on **global growth outlook**. Recently we got to see numerous downward revisions of forecasts from international institutions so the incoming data on European and US economies will be eyed closely. This week's calendar includes **new leading indicators** (ZEW, flash PMI) and these readings may be key for global sentiment.
- In Poland, March CPI inflation, labour market data, industrial output, and business indicators for April will be released.
- Flash **March CPI** showed a noticeable rebound to 1.7% y/y from 1.2% y/y in February and the final data are likely to confirm that this was partly due to a rise of the core inflation (to 1.3%, the highest for over five years). Overall, this should not be a big surprise for the market given the known flash estimate. The industrial output data might look poor at the first glance (deceleration to c4%) but this would largely be due to the calendar and one-off factors, not the change of the underlying trend. At the same time, pace of wage growth is to stay high (our forecast at 7.4% y/y, slightly above consensus) confirming that tensions on the labour market are still in place. All in all, **the full set of data should not change outlook for the Polish economy** and should not affect the MPC stance.
- Yet this Friday, after the Polish session ends **the S&P is expected to review Poland's sovereign rating**. We think that S&P will take cue from the Fitch and leave both the rating and its outlook unchanged (A- with stable outlook). Moody's will probably do the same next week.

Inflation, % y/y



Source: GUS, NBP, Santander

Market implications

- The zloty gained slightly amid the dovish ECB rhetoric and delaying Brexit but the room for further appreciation looks limited, in our view. The debt market is still under the impact of the high pessimism regarding the global economic outlook and softer rhetoric of the global central banks. Thus, it seems that only a big positive surprise in the data may generate a noticeable rise of yields. There were some positive surprises in the most recent data releases but we are not fully convinced that the coming PMI and ZEW releases would give enough reason for much higher optimism. At the end of the week the market activity will start fading, especially that the Good Friday is market holiday in some countries.

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Last week in economy

Global financial institutions have revised their forecasts for the Polish economy upwards. This happens together with downward revision of global GDP and trade growth and, especially, of forecasts for Germany, the Poland's biggest trading partner.

The World Bank is expecting Poland to grow by 4.0% in 2019, 3.6% in 2020 and 3.3% in 2021. Main risks for growth named by the World Bank include the labour market squeeze and unfavourable global factors. General government deficit is expected at 1.4%, at 1.6% and 1.8% of GDP in 2019-2021 respectively, with moderate decline of debt-to-GDP. **The IMF has raised its estimates for Poland to 3.8%** from 3.5%. Expectations for 2020 are unchanged at 3.1%. The institution has markedly increased its expectations about GG deficit, which is forecasted to rise to 2.2% of GDP in 2019 and to stabilise at 3.1% in 2020-24. Thus, the public debt forecast also went up. Currently the Fund sees the debt approaching 50% of GDP in 2022 as compared to the previous forecast at 45%.

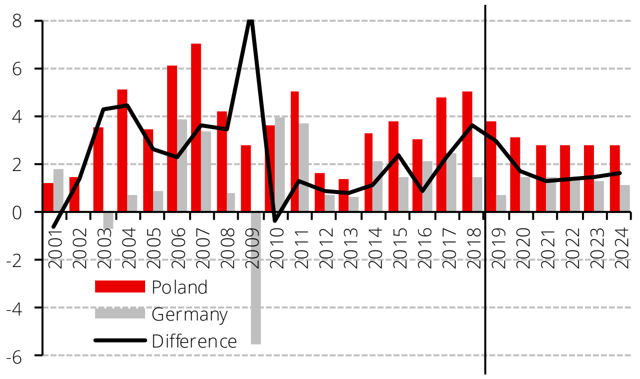
The European Council summit decided **to postpone Brexit** from April 12 to October 31, with an option to leave the EU earlier once the Great Britain approves the deal. The Council stressed that if the UK fails to leave the EU before the European Parliament election, then it has to organise it too. Otherwise it will be forced to leave the EU on June 1. The European Council repeated that content of the negotiated deal is unlikely to be altered. Lower risk of no-deal Brexit is positive for Poland's growth prospects in 2019.

Deputy finance minister Leszek Skiba said that the government's Standing Committee would approve the **Convergence Programme Update** next week. Publication will follow soon. According to Skiba, the fiscal path presented in the document will be "in line with the spending rule and recommendations of the European Commission."

MPC's Eryk Łon said in an interview for the Polish Press Agency (PAP) that he saw risk for further economic slowdown in the euro zone, which could be negative for the GDP growth in Poland. According to Łon, under such circumstances the MPC has to be ready to mull rate cuts. The MPC member said that the new fiscal stimulus or even inflation slightly above 3.5% are no hindrance for monetary easing. In our view, Eryk Łon's views remain isolated and should not affect the market.

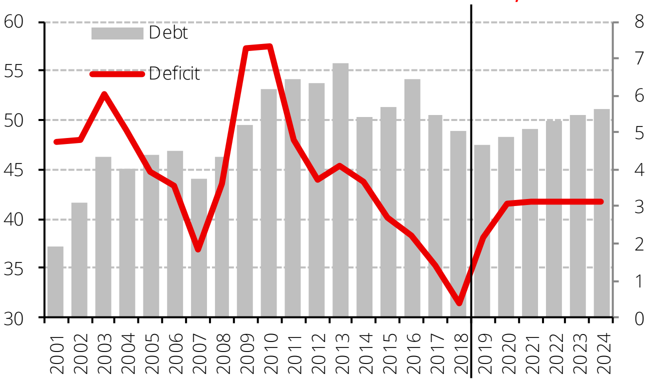
February C/A data for Poland, with balance at -€1386mn, showed a much higher than expected imports growth after several surprisingly weak months in this category. Exports also grew more than expected, but all in all, trade balance was €1bn lower than market median (and €0.8bn lower than our call). NBP comment accompanying the release mentions imports of oil (refineries seemed to have built larger supply buffers in late 2018 and imported less of the commodity at the turn of the year, suggesting the seasonal pattern has been distorted) and airplanes (looking like a one-off boost to imports). On the exports side the report signals high contribution of commercial vehicles, car parts, electronics and copper. Exports grew by 10% y/y, while imports by 13.4% y/y, both readings were the strongest since October 2018. The result has negative implications for 1Q GDP, indicating downside risk to our 4.5% y/y call. Given the strong domestic demand in Poland and the upcoming fiscal boost, we think imports may be outpacing exports this year, but the resulting trade gap will be moderate, compared to the same stages of the previous cycles. 12M rolling sum of C/A deficit grew in February to 0.9% GDP from 0.8% and might more or less double by the end of the year.

Poland & Germany – GDP growth: data and IMF forecasts, % y/y



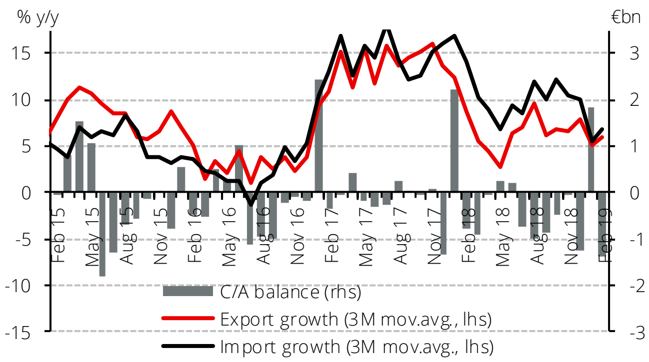
Source: IMF, Santander

Poland GG debt and deficit: data and IMF forecasts, % of GDP



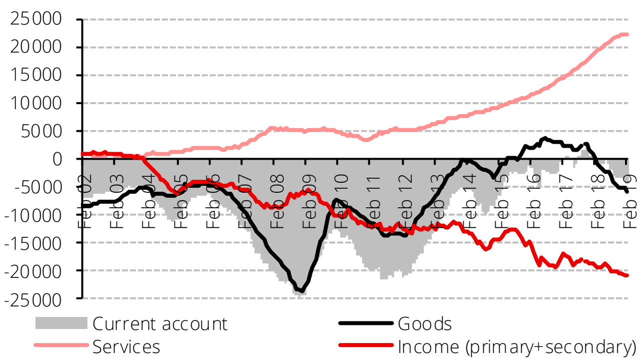
Source: IMF, GUS, Santander

Balance of payments data



Source: NBP, Santander

Balance of payments data, 12-month sum, €mn



Source: NBP, Santander

FX and FI market

Last week on the market

FX EURPLN fell for the second week in a row and neared the March low at 4.275 thanks to, among others, dovish ECB rhetoric. USDPLN fell to 3.79 from above 3.82, GBPPLN eased to 4.95 from 4.99 and CHFPLN to 3.78 from above 3.82.

FI Polish bonds also benefited from the ECB dovish rhetoric and yields fell 2-3 along the curve. The IRS rates fell at a similar scale. The 10Y PL-DE bond yield spread narrowed somewhat from its multi-month high at c293bp.

Key events

Yet this Friday, after the Polish session ends the S&P is likely to present its review of Poland sovereign rating. We think that S&P will take cue from the Fitch and leave both the rating and its outlook unchanged (A- with stable outlook). Moody's will comment on Polish rating in one week.

During the last week before Easter, we will see crucial economic growth indicators. Manufacturing PMIs are still in a freefall mode while indexes for services try to stabilize or show some signs of improvement. The market expects the former to improve in April. As regards ZEW, current situation index follows manufacturing PMIs while expectations index gives hope that the situation could improve in the months to come.

Among the Polish data, we will see March inflation, wages, employment and industrial output. In our view, the core CPI rose noticeably while the industrial output decelerated (however, mainly due to calendar and one-off factors). These readings should not encourage the MPC to change its rhetoric.

Market implications

FX Comfortably long Article 50 extension, dovish ECB rhetoric and rise of EURUSD have failed to push EURPLN below the first support level at 4.275. In our view, this indicates that there is little room for the zloty to continue the appreciation.

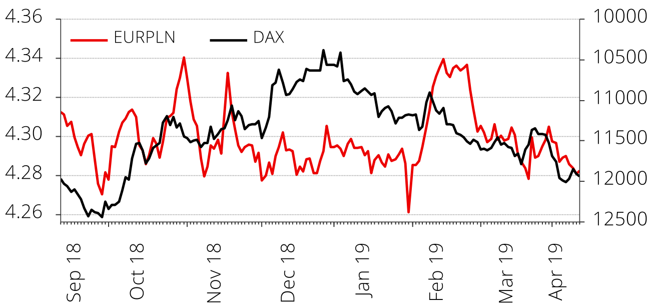
The outlook for the European economy is rather gloomy after the global institutions downgraded growth prospects and even if the euro zone PMIs look better-than-expected, this may still not be enough to change the market sentiment.

At the same time, however, EURUSD failed to break through the 2019 bottom at 1.117 established in March and is likely to end this week at c1.13. Since the euro resisted the recent pressure, we think EURUSD may not resume the down move and could even try to approach c1.14 in the days to come. The weaker dollar should limit the EURPLN upside potential and so we do not expect the exchange rate to break 4.30 in the short-term.

FI The 10Y bond yield has stabilized in the 2.80-2.95% range after the sharp rise in late February triggered by the government's presentation of its election program. We do not expect the pre-Easter week to change the picture on the debt market. A lot of the economic slowdown is already priced in by the market so the room for the yields to fall looks to be limited for now. On the other hand, if PMI/ZEW are only slightly above forecasts, this could be not enough to push yields meaningfully up.

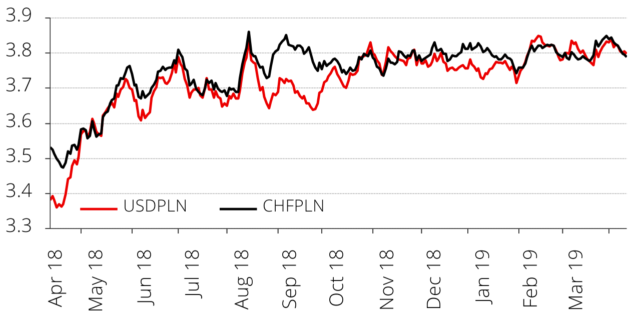
Global stock indexes stabilized after a strong start of the year when they were pricing in an economic revival. However, if no positive data is released soon, some profit taking could start supporting core and Polish bonds.

EURPLN and DAX



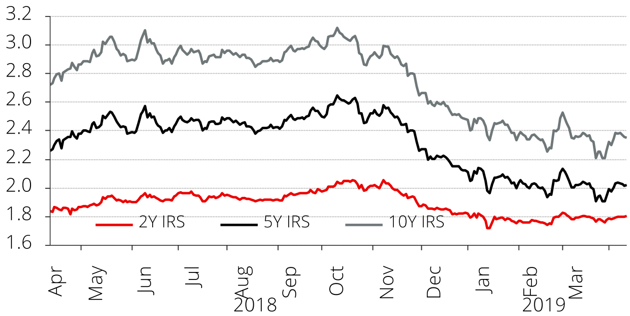
Source: Thomson Reuters Datastream, Santander Bank Polska

USDPLN and CHFPLN



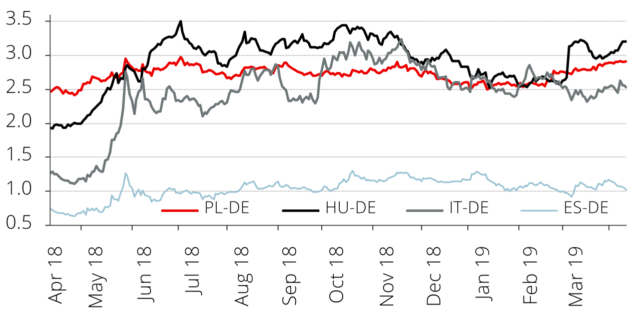
Source: Thomson Reuters Datastream, Santander Bank Polska

PLN IRS (%)



Source: Thomson Reuters Datastream, Santander Bank Polska

10Y spreads vs Bund



Source: Thomson Reuters Datastream, Santander Bank Polska

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Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST SANTANDER	LAST VALUE
			MONDAY (15 April)				
10:00	**PL**	**CPI**	**Mar**	**% y/y**	**1.7**	**1.7**	**1.7**
			TUESDAY (16 April)				
11:00	DE	ZEW Survey Current Situation	Apr	pts	8.0	-	11.1
14:00	**PL**	**CPI Core**	**Mar**	**% y/y**	**1.3**	**1.3**	**1.0**
15:15	US	Industrial Production	Mar	% m/m	0.3	-	0.0
			WEDNESDAY (17 April)				
10:00	**PL**	**Employment in corporate sector**	**Mar**	**% y/y**	**2.9**	**2.9**	**2.9**
10:00	**PL**	**Average Gross Wages**	**Mar**	**% y/y**	**7.3**	**7.4**	**7.6**
11:00	EZ	HICP	Mar	% y/y	1.4	-	1.4
			THURSDAY (18 April)				
09:30	DE	Flash Germany Manufacturing PMI	Apr	pts	45.0	-	44.1
09:30	DE	Flash Markit Germany Services PMI	Apr	pts	55.0	-	55.4
10:00	EZ	Flash Eurozone Manufacturing PMI	Apr	pts	47.8	-	47.5
10:00	EZ	Flash Eurozone Services PMI	Apr	pts	53.1	-	53.3
10:00	**PL**	**Sold Industrial Output**	**Mar**	**% y/y**	**4.3**	**4.1**	**6.9**
10:00	**PL**	**PPI**	**Mar**	**% y/y**	**2.6**	**2.4**	**2.9**
14:30	US	Initial Jobless Claims	week	k	210	-	196
14:30	US	Retail Sales Advance	Mar	% m/m	0.8	-	-0.2
14:30	US	Philly Fed Index	Apr	pts	11.0	-	13.7
			FRIDAY (19 April)				
14:30	US	Housing Starts	Mar	% m/m	5.8	-	-8.7

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.