24 May 2019

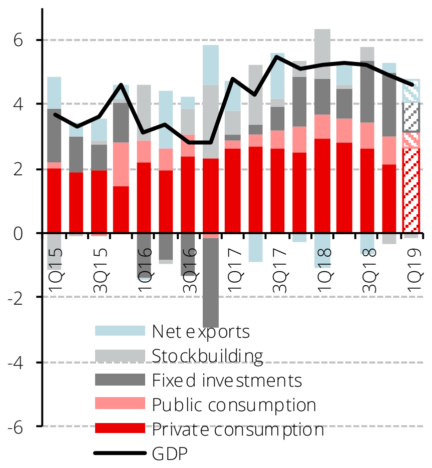
Weekly Economic Update

Personnel changes in Europe

What's hot next week

- This week **the breakdown of Polish GDP growth** in 1Q19 is due for release (preliminary reading was at 4.6% y/y). The recent data from large enterprises and local governments suggest that investments proved stronger than we had assumed. What is more, after the recent set of strong data for April we might see a new wave of upward revisions of growth forecasts for the next quarters. Still, global economy outlook is not exactly improving.
- **British PM Theresa May informed about her plans to resign**, which means we are entering a period of candidate names circulating, with consequences for the future relations of the country with the EU. The official date of the resignation is 7 June and this is when the Conservative Party will start the replacement process, which may last until September. The negotiations with the EU will likely be continued only in the autumn.
- The **European Parliament elections** are held this weekend. Exit polls in the Netherlands, where the election was held earlier, point to a good result of the pro-European parties. Similar results in other countries could support the euro. In Poland, if the ruling party loses the election, this could increase the risk that the scale of fiscal stimulus will go up.
- There will be only a short list of important data releases, with US GDP and consumer incomes and spending in the spotlight. On Monday the US and UK markets are closed which can decrease market liquidity.

GDP growth breakdown, %y/y



Source: GUS, Santander

Market implications

- We believe that the week will start from a slight sell-off (on Tuesday, as London and NY are closed on Monday), while investors are likely to discount the risk of greater fiscal expansion in Europe, owing to the uncertainty about economic consequences of Euro-election results. Later in the week we expect the yields to return to declines, thanks to the growing fears about economic slowdown in Europe. The yields downward move is unlikely to be strong due to the expected solid US consumer spending data release. We think the yields are going to fall in the first week of June in response to the German industry data and ECB conference tone.
- In case of EURPLN we expect a gentle rise at the start of the week and a return to oscillation within the current range of 4.29-4.315 later in the week. In our view the fx rate could finish the week close to the upper bound of the range as US consumer activity data could trigger USD appreciation. The following week will be dominated by the ECB meeting, which could turn out to be EUR- and PLN-negative.

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Last week in economy

April dataset on Polish economy proved to be quite optimistic, especially after some disappointments in March, showing that 2Q19 began on a high note. We also got to hear some new comments from the MPC members.

Two major upward surprises were the industrial output and retail sales. **Industrial output** rose 9.2% y/y in April, slightly more than expected and confirming our view that the weakness seen in March was mainly a calendar-related one-off. The seasonally adjusted growth reached 6.5% y/y, which confirms decent activity. What is important is that the growth was driven mainly by manufacturing and, in particular, by export-oriented branches. We expect the output to decelerate later in the year amid worsening outlook for global trade. GUS business confidence survey for May pointed again to the lowest industrial output expectations in almost three years.

Retail sales grew by a whopping 11.9% y/y in real terms. The Easter effect was the main reason for this result. Real retail sales, excluding the two categories most affected by the Easter calendar, rose 7.7% y/y in April vs. 7.8% in March and 5.0-6.5% readings in the previous three months. Sales in durable goods categories maintained a double-digit growth. The results thus confirm the strength of private consumption, which should allow an only gradual slowdown in economic growth this year, especially as fiscal stimulus measures will offer an additional support to households' finances starting in May (for pensions, while the extension of the child benefit program will start in July). Another support for private consumption will stem from the still strong labour incomes, as April numbers showed a positive surprise in **wage growth** at 7.1% y/y. The strong reading partially came from substantial increases in mining (18% y/y). Even though the **employment** was a notch weaker than expected (2.9% y/y), the real wage bill growth remains healthy (7.9% y/y). Consumer confidence index of current situation set a new record in May.

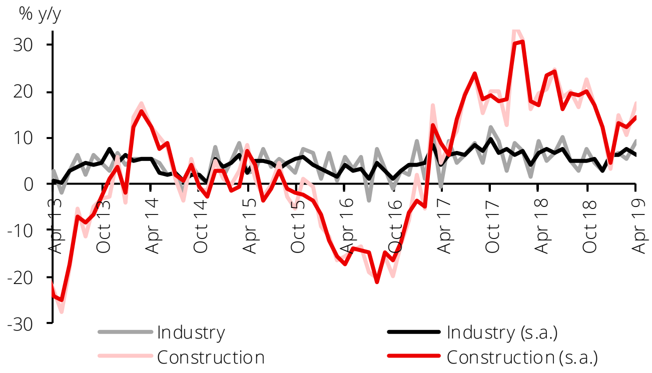
Construction output rose by 17.4% y/y in April, in line with our expectations. Growth was driven primarily by civil engineering (+ 32.7% y/y) and specialized construction activities (+18.2% y/y). We believe these two categories suggest a further recovery in public investment. In our view, construction is likely to remain strong in the months to come, driven by a high utilisation of the EU funds. On the other hand, we think the government's fiscal stimulus (and its need to cut nonessential spending to allow for new social benefits in the budget), along with rising prices in construction, could undermine the sector later in the year.

In terms of **investment**, numbers from local governments for 1Q19 showed outlays at PLN4.5bn, 33.8% higher y/y. This means local governments contributed c2 percentage points to overall investment growth. EU fund-based investment outlays amounted to PLN2.5bn, up 48.4% y/y. Data on 1Q19 gross financial results in biggest companies showed a massive 21.7% y/y surge in fixed investment outlays, which looks like the highest growth since 2007 and confirms our earlier observations of a recovery of investment in the private sector. In our view, these numbers generate some upward risk for our forecast of total investment in 1Q19.

As regards monetary policy, MPC's Eryk Łon maintained his view that the next change of interest rates could be a cut as he sees worrisome trends on the US stock markets. Grażyna Ancyparowicz thinks there is no cost pressure on companies, so CPI is unlikely to exceed 3.5% y/y and thus rates are likely to stay unchanged until 2022. On the other hand, Rafał Sura said that a rate hike cannot be ruled out in 2020, but so far there are no reasons to tighten the policy and a one-off jump in inflation (as in April) should not affect the Council. We expect inflation to keep rising, which will help build a consensus in the MPC that hikes cannot be ruled out in 2020.

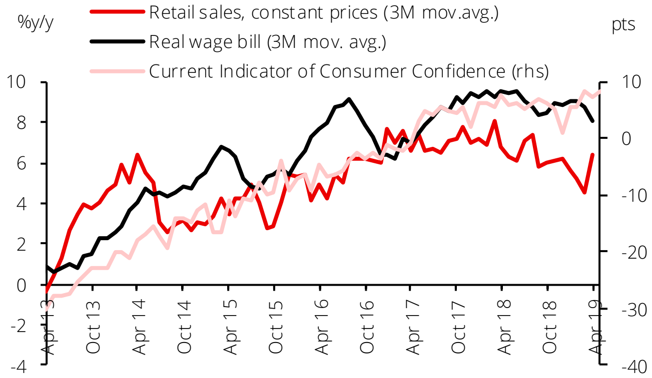
The NBP president Adam Glapiński **said that Poland will not enter the euro zone nor the ERM-2** during his term, as there are no economic or political reasons to do so.

Output in industry and construction, % y/y



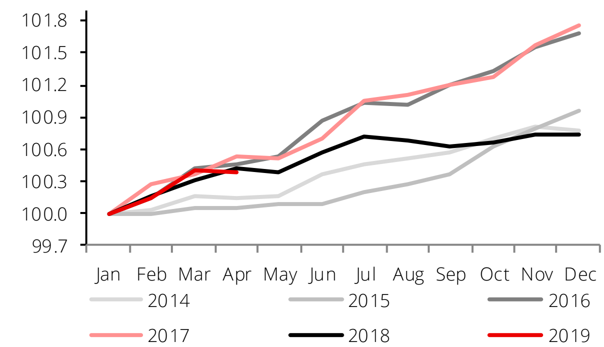
Source: GUS, Santander

Retail sales, consumer incomes and confidence



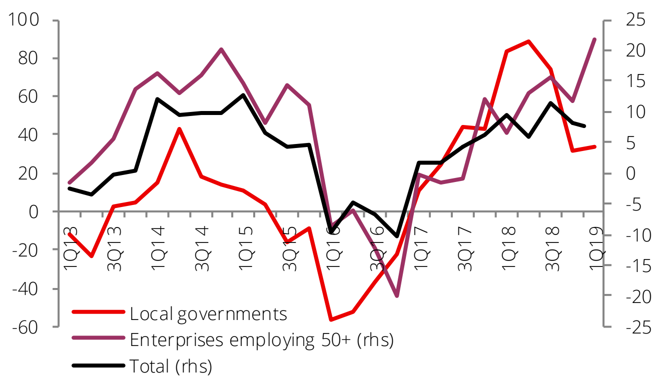
Source: GUS, Santander

Employment in corporate sector (Jan=100)



Source: GUS, Santander

Investment growth, %y/y



Source: GUS, Ministry of Finance, Santander

FX and FI market

Last week on the market

FX Over the last week EURPLN was hovering in the wider range, but at the end of the week gained against USD and EUR. Similarly to the debt market, EURPLN was affected by the fears about global growth and core markets currencies behaviour (EURUSD fell to 1,1110 last seen in mid-2017).

FI Last week we saw a strong rally on the core and Polish bonds markets. Domestic yield curve slipped by 8-9bp in the 5-10Y segment (UST yield curve dropped by a similar scale, while the German curve only by 2-3bp) and by 2bp in 2Y segment. The strong yield drop on the core bonds markets (10Y UST dropped to 2.29%, level last seen in the autumn of 2017) was a result of rising fears of negative impact that trade war escalation may have on global growth. Moreover the bonds market was supported by the dovish comments of Fed representatives and the dovish rhetoric of the ECB minutes. The domestic data did not have significant impact on the POLGBs.

Key events

This week will start from the Euro-election results. Further, we will see detailed Poland and US GDP data, US consumer income and spending data, as well as US PCE deflator (the Fed's favourite measure of inflation).

June will start from domestic and China PMI-manufacturing readings, next we will see the final Eurozone PMI-manufacturing reading. Then the calendar includes the ECB conference, during which the central bank will "remind" about the threats to Eurozone economy associated with trade war escalation.

FX In the case of EURPLN we expect a gentle rise at the start of the week and a return to oscillation within the current range of 4.29-4.315 later in the week. In our view the fx rate could finish the week close to the upper bound of the range as US consumer activity data could trigger USD appreciation. The following week will be dominated by the ECB meeting, which could turn out to be EUR- and PLN-negative.

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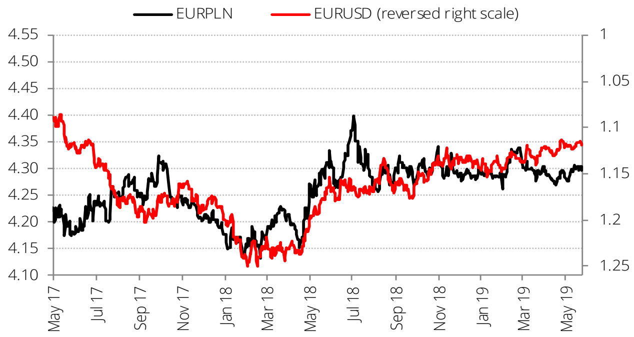
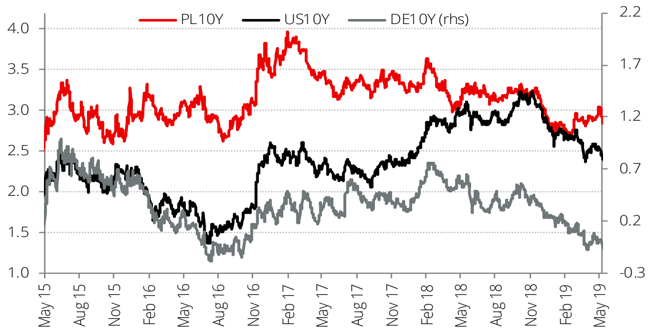
EURPLN and EURUSD



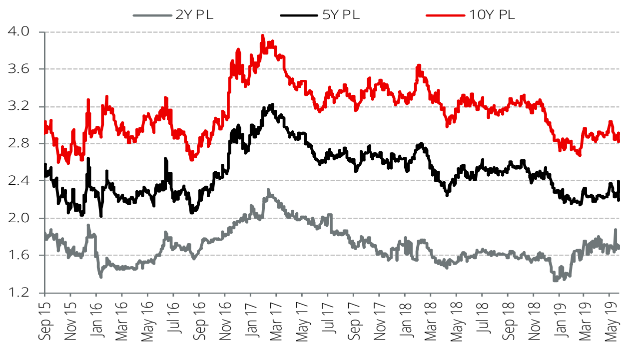
Source: ThomsonReuters, Santander Bank Polska

Yield of the Polish, German and US 10Y bonds



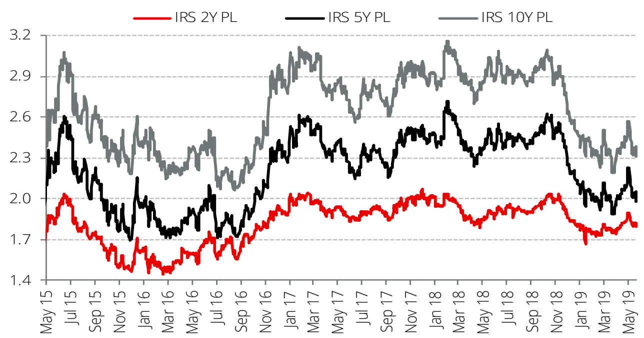
Source: Thomson Reuters, Santander Bank Polska

Poland bonds yield (%)



Source: Thomson Reuters, Santander Bank Polska

Poland IRS rates (%)



Source: Thomson Reuters, Santander Bank Polska

Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST SANTANDER	LAST VALUE
			MONDAY (27 May)				
10:00	**PL**	**Unemployment Rate**	**Apr**	**%**	**5.6**	**5.61**	**5.9**
			TUESDAY (28 May)				
11:00	EZ	ESI	May	pct.	103.9		104.0
14:00	HU	Central Bank Rate Decision	May/19	%	0.9		0.9
16:00	US	Consumer Conference Board	May	pts	130.0		129.2
			WEDNESDAY (29 May)				
		No important events					
			THURSDAY (30 May)				
14:30	US	GDP Annualized	1Q	% Q/Q	3.1		3.2
14:30	US	Initial Jobless Claims	May/19	k	214.5		211.0
16:00	US	Pending Home Sales	Apr	% m/m	0.8		3.8
			FRIDAY (31 May)				
08:00	DE	Retail Sales	Apr	% m/m	0.4		0.0
09:00	CZ	GDP SA	1Q	% y/y	2.5		2.5
09:00	HU	GDP	1Q	% y/y	5.3		5.3
10:00	**PL**	**GDP**	**1Q**	**% y/y**	**4.6**	**4.6**	**4.9**
14:00	DE	HICP	May	% m/m	0.3		1.0
14:30	US	Personal Spending	Apr	% m/m	0.2		0.9
14:30	US	Personal Income	Apr	% m/m	0.3		0.1
14:30	US	PCE Deflator SA	Apr	% m/m	0.3		0.2
16:00	US	Michigan index	May	pts	102.0		102.4

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.