21 September 2018

Weekly Economic Update

Zloty and bonds gain ahead of FOMC

Polish macro data released last week confirmed the scenario of the gradual economic slowdown. The outlook for the euro zone has not improved either with flash manufacturing PMIs surprising to the downside. However, the global market sentiment has been pretty robust in the recent days as investors positively received next actions taken by the US and China in the "trade war". President Trump imposed a 10% tariff on China imports worth USD200bn while the market expected higher rate. China responded with retaliation tariffs on USD60bn of the US imports. Rising stock indexes helped the zloty to gain while the bond yields eased slightly thanks to domestic factors and despite weakness on the core markets.

What's hot next week

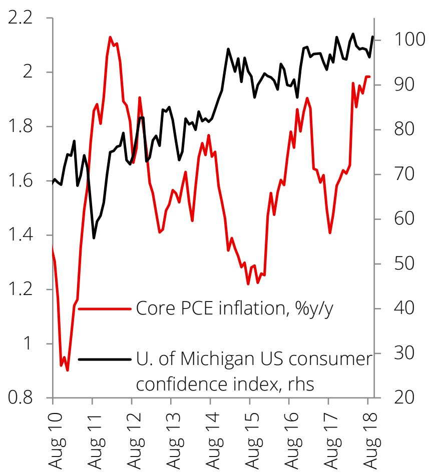
- Market attention is likely to shift to the US, where we will see important data and the FOMC is likely to hike rates by 25bp third time this year.
- As far as the data releases are concerned, the US consumer confidence index, PCE and final GDP could be of particular importance.
- The trade war is in progress but the temperature of the conflict dropped, at least in the market's view.

Market implications

- The market is already pricing-in the September 25bp rate hike and one more later this year so the outcome of the Fed meeting should not surprise to the hawkish side pressuring EM currencies. On the other hand, it is worth noticing that at the end of the week the zloty and its CEE peers did not benefit from the positive global market sentiment or the rising EURUSD. This might suggest that there is little room for lower EURPLN in the short term.
- We think that Polish long-term market rates may go up due to the US events. On the belly and front end we should see lower yields amid higher demand from local financial institutions. As a result, we expect the 10Y yield to rise 1-2bp while 2Y and 5Y debt should gain at a similar scale.

Graph of the week

US inflation and consumer sentiment



Source: Bloomberg, Santander Bank Polska

Economic Analysis Department:

al. Jana Pawła II 17, 00-854 Warszawa
email: ekonomia@santander.pl
website www: skarb.santander.pl
Piotr Bielski +48 22 534 18 87
Marcin Luziński +48 22 534 18 85
Grzegorz Ogonek +48 22 534 19 23
Konrad Soszyński +48 22 534 18 86
Marcin Sulewski, CFA +48 22 534 18 84

Last week in economy

In August, **industrial output** decelerated to 5.0% y/y from 10.3% y/y in July, in line with our expectations and market consensus. This major drop was primarily due to statistical factors, but we are expecting the Polish industry to be further gradually slowing down in the months to come, given the deterioration in European and Polish business sentiments. Construction output rose in August by 20% y/y, in line with our expectations and versus 18.7% y/y in July. In our view, construction is poised to a slowdown as the sector is operating almost at maximal capacity. In general, August output numbers support our forecast of a gradual economic slowdown below 5% y/y in 2H18.

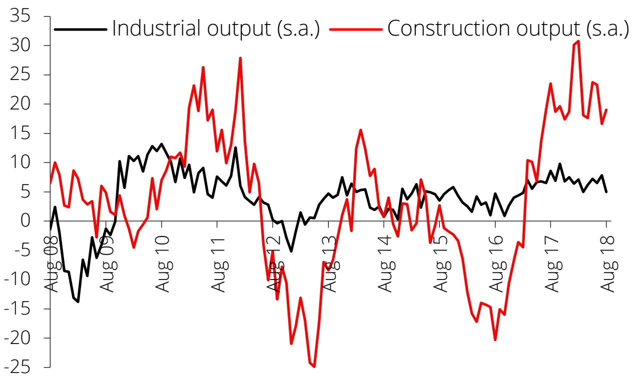
The Stats Office released August data on **corporate sector employment and wages**. Employment rose 3.4% y/y in August as we expected, (consensus saw 3.5%). Wages were growing slower than in July, 6.8% y/y vs 7.2% previously, partly due to trading day differences. We thought the slowdown would reach 6.9%, consensus pointed to 7%. We could see an acceleration to close 9% by year-end. Wage bill in the corporate sector corrected for inflation rose 8.2% y/y in August, the slowest pace since July 2017. However, we expect the wage bill growth to pick up in the months to come to above 10% y/y still in 2018. These are not readings that could affect the MPC or make us change our view on labour market outlook.

In September, the index of current **consumer sentiment** improved by 0.7pt m/m to 6.9 pt. It is 1.9pt higher than a year ago. The assessment of household situation (when it comes to finances and unemployment expectations) worsened somewhat, but on the other hand, consumers remained highly optimistic about the outlook for the economy. It caught our attention that the seasonal deterioration of financial situation in September, as the school year started, was deeper than a year ago despite the fact that households with students received an extra benefit for school kits this year. This could mean they feel less certain about further rise of income from work, against our assessment that labour demand remains strong and should lead to more acceleration of wage growth.

In August, **retail sales** rose 6.7% y/y in real terms, down from 7.1% previously. The result sits between the consensus (7%) and our forecast (6.4%). Nominal retail sales grew 9% y/y vs 9.3% y/y in July and 8% on average in 1H18. The details like sales in non-specialized stores (with y/y growth contribution still similar to the Jan-Jul average) and weighted growth of durable goods categories at 10.1% y/y vs 8.5% y/y on average in 2Q and 10.7% in July suggest the underlying consumer demand remains strong. Retail sales release, business sentiment in retail trade sector and very high consumer sentiment signal robust support from private consumption (still growing at c5% y/y) to economic growth also in 2H18.

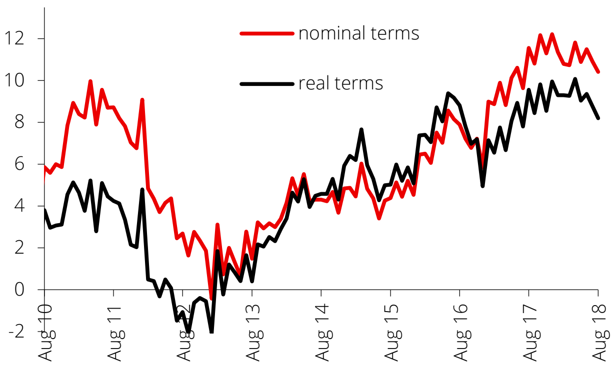
Moody's agency upgraded Poland 2018 GDP forecast to 5.0% from 4.3% and for 2019 to 4.2% from 4.0%. The agency is more optimistic than the market consensus (4.6% and 3.6%, respectively). On the other hand, Moody's forecast of general government deficit has been lowered to 1.4% of GDP from 1.8% in 2018 and to 1.7% from 2.3% for 2019. According to the rating agency, the Polish economy has already reached the peak of the business cycle and the slowdown anticipated later on will be driven by the situation on the labour market, demographic trends and a lower inflow of EU funds. The improved deficit assessment resulted mainly from the faster GDP growth, while the forecast of structural deficit is one of the highest in the region (above 2.0%, slightly less than for Hungary and Romania).

Output growth, % y/y



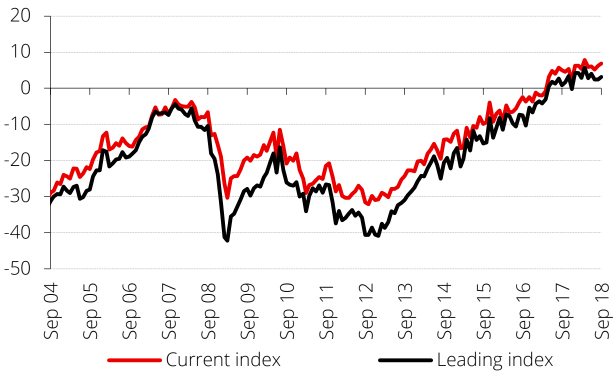
Source: Stats Office, Santander Bank Polska

Wage bill in corporate sector, % y/y



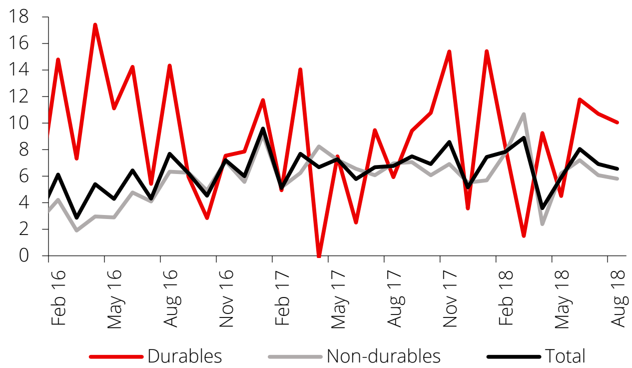
Source: Stats Office, Santander Bank Polska

Consumer sentiment



Source: Stats Office, Santander Bank Polska

Retail sales in main categories, % y/y



Source: Stats Office, Santander Bank Polska

FX and FI market

Last week on the market

FX Last week, the zloty and CEE currencies appreciated. The US president's decision to apply new duty to Chinese imports surprised on the positive side. The zloty appreciated despite weaker domestic data: slow wages, employment and industrial production growth y/y vs. July. Moody's decision to revise Poland GDP forecast upward and Poland general government deficit downward was neutral for the market. Over the week, EURPLN has slid to 4.2940 from 4.3030, setting the weekly low at 4.2860.

FI The rebound on the global financial market as well as Moody's forecast revision of domestic GDP and GG deficit, and cancellation of the switch auction by the Ministry of Finance translated into a slide of Polish sovereign yields. As a result, over the week the domestic curve has shifted down by 6, 3, 1pb for 2Y, 5Y, 10Y, respectively, which was translated into 7bp narrowing of 2Y ASW spread and spread stabilisation along the rest of the ASW curve.

What to watch for next week

We believe that this week investors will focus on the FOMC decision to hike interest rates (by 25bp, as the market expects) and tone of the FOMC conference (we expect some signals suggesting more aggressive path of interest rate hikes).

Also, investors will carefully observe the US personal spending and income data (we expect clear signal that income started to rise).

At the bottom of the market drivers list, we see Ifo data (we expect further deterioration) and ESI data (we expect falls of its indices).

Market implications

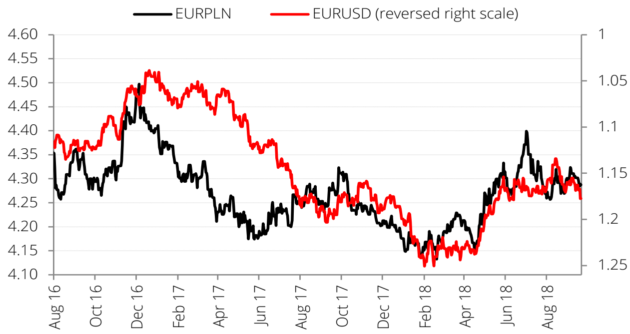
FX We do not expect any negative pressure to be generated on the zloty from the dollar front. In June, the FOMC said that in total four rate hikes might be delivered this year and this scenario is already priced in the market. We do not think that any material changes in this regard after the updated forecasts will be released at the September meeting. On the other hand, it is worth to notice that at the end of the week the zloty and its CEE peers did not benefit from the positive global market sentiment and rising EURUSD. This might suggest that there is little room for lower EURPLN in the short term. The exchange rate did not manage to break the September low at 4.284 reached in the first week of the month and we think it could now rise towards 4.32. The upside potential should be limited by weaker than in Western Europe signs of an economic slowdown. This is reflected in lower sensitivity of Polish economic activity indexes to trends observed in Europe.

FI We think that the US data due in the coming days and the FOMC decision might push the long term market rates up. The recent months showed that Polish debt is more sensitive to the demand/(limited) supply issues and local investors activity rather than to core markets. Nevertheless, we think the Fed rate hike might have a temporary and marginal negative impact on the Polish long term bonds. On the belly and front end, we should see lower yields. This could be due to the higher demand from local mutual funds as their clients transfer cash to less risky assets. As a result, we expect the 10Y yield to rise 1-2bp, while 2Y and 5Y debt should gain at a similar scale.

EURPLN

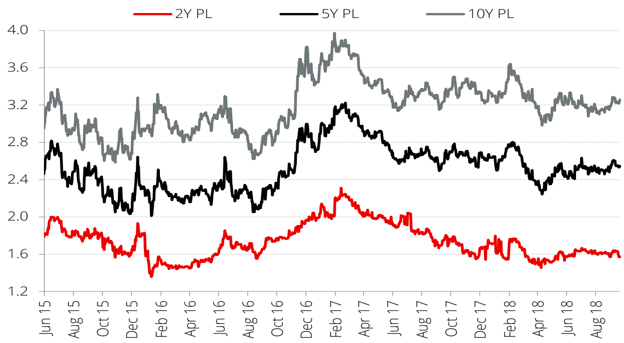
Source: Thomson Reuters Datastream, Santander Bank Polska

EURPLN and EURUSD



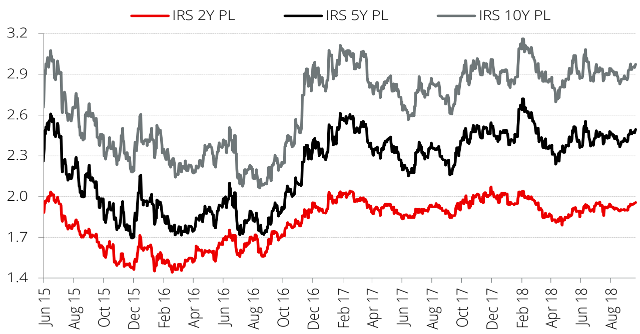
Source: ThomsonReuters, Santander Bank Polska

Polish benchmarks



Source: Thomson Reuters, Santander Bank Polska

PLN IRS (%)



Source: Thomson Reuters, Santander Bank Polska

Economic Calendar

Time Cet	Country	Indicator	Period		Forecast Market	Forecast Santander	Last value
		Monday (24 September)					
10:00	DE	Ifo index	Sep	pt	103.0	-	103.8
14:00	**PL**	**Money supply M3**	**Aug**	**% y/y**	**7.5**	**7.4**	**7.3**
		Tuesday (25 September)					
10:00	**PL**	**Unemployment rate**	**Aug**	**%**	**5.9**	**5.9**	**5.9**
16:00	US	Consumer confidence index	Sep	pt	131.0	-	133.4
		Wendsday (26 September)					
13:00	CZ	Central bank decision		%	1.50	-	1.25
16:00	US	New home sales	Aug	% m/m	0.8	-	-1.7
20:00	US	FOMC decision		%	2.25	-	2.0
		Thursday (27 September)					
8:00	DE	Retail sales	Aug	% m/m	0.5	-	-0.4
11:00	EZ	ESI	Sep	pt	0.0	-	111.6
14:00	DE	HICP	Sep	% m/m	0.0	-	0.0
14:30	US	Durable goods orders	Aug	% m/m	1.7	-	-1.7
14:30	US	GDP	2Q	% q/q	4.2	-	4.2
14:30	US	Initial jobless claims	week	k	210	-	204
16:00	US	Pending home sales	Aug	m/m	-0.4	-	-0.7
		Friday (28 September)					
11:00	EZ	Flash HICP	Sep	% y/y	2.0	-	2.0
14:30	US	Personal spending	Aug	% m/m	0.3	-	0.4
14:30	US	Personal income	Aug	% m/m	0.4	-	0.3
14:30	US	PCE	Aug	% m/m	0.1	-	0.1
16:00	US	Michigan index	Sep	pt	100	-	100.8

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg
** in case of the revision the data is updated*

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.