CEE Economics

Poland

Weekly Economic Update

28 September 2018

Inflation is to stay at 2%

The zloty gained vs the euro and franc and depreciated vs the dollar and pound. Polish bond yields remained fairly stable despite higher volatility of bonds abroad. In line with expectations, FOMC increased rates by 25bp confirming that one more hike is likely later this year. The tone of the statement was rather neutral and did not cause any long-lasting market reaction. The euro depreciated vs the dollar amid news that in 2019 Italy plans to have a bigger budget deficit than many expected.

What's hot next week

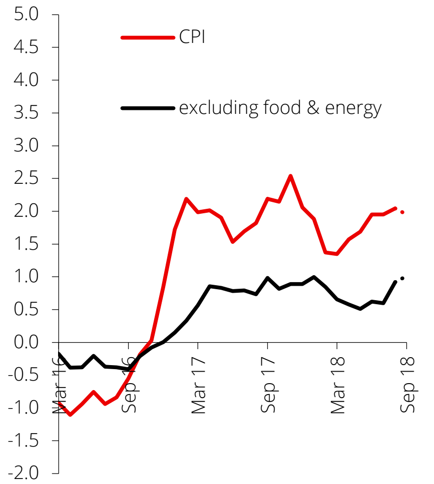
- We are expecting the **CPI inflation** at 2.0% y/y, for the fourth month in a row. In our view, the rise of commodities prices on the market pose a major risk for 2019 inflation (our forecast is at 2.5% y/y).
- In our view, **PMI** slid further in September, confirming the ongoing economic slowdown in 3Q18 and following trend recorded by PMI for Germany and the euro zone.
- The **MPC** is unlikely to change its policy. If core inflation keeps rising in the following months while headline CPI continues to oppose the negative base effect from 2H17, we could see more discussion of a possible rate hike next year.
- Globally, the market attention might focus on the US data with the manufacturing ISM and nonfarm payrolls in particular.

Market implications

- EURPLN has reached the lower end of the range where it has been moving since mid-August. In the last few days, the zloty deviated from EURUSD and bonds and became more sensitive to trend on the equity market. This week we should see important data on the US economic activity that could determine the sentiment on the global market. Polish events could be zloty-neutral.
- We think the long end of the Polish bond yield curve might go slightly up in the coming days holding comfortably below the September peak at 3.36%. Poland CPI staying at 2% y/y in September might generate only a mild upside pressure on the front end and belly of the curve. We do not expect any meaningful market reaction to the MPC rhetoric that should stay pretty unchanged.

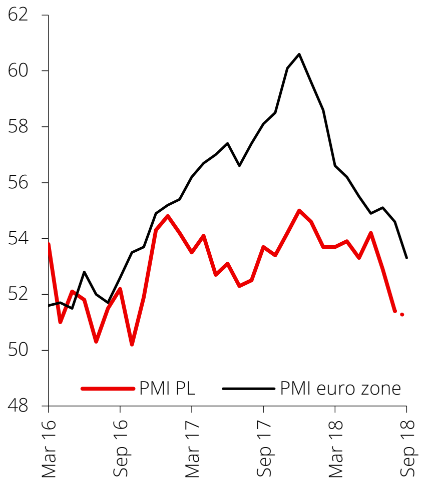
Graphs of the week

CPI and core inflation



Source: Stats Office, NBP, Santander Bank Polska

PMIs in manufacturing



Source: IHS Markit, Santander Bank Polska

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Last week in economy

The seasonally adjusted **GUS business climate** indicator showed a slight improvement in September, much smaller in scale than the August decline. On the positive side, construction recorded a better assessment of current and expected orders as well as output expectations. Mood in retail trade remained historically high: demand and sales expectations improved markedly. A minute rebound of seasonally adjusted indicators for manufacturing is not enough to overshadow worries about the economic slowdown, which are still being mitigated by positive sentiments in construction and trade. ESI indicators confirmed that business sentiment remained significantly weaker than in 1H18, while consumer inflation expectations rebounded to the highest level in four years.

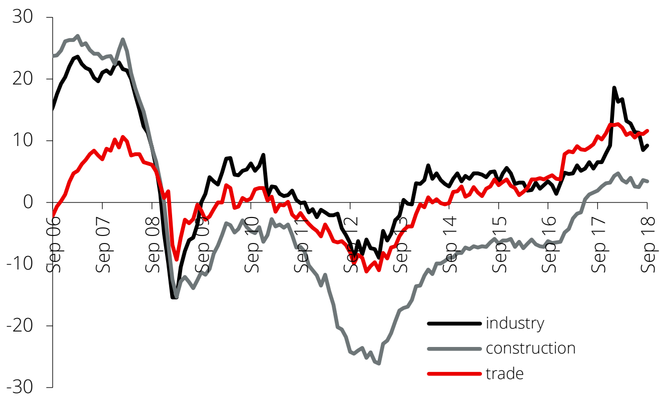
In August, **wage growth** excluding mining rose to 7.2% y/y from 7.0% in July. Significant acceleration was recorded among others in construction (+10.4% y/y, the fastest since 2008), which comes from increasing difficulties in the sector to find skilled labour. In August service sector wages also rose at a faster pace (6.9% vs. 6.2% in July). In our view it is still possible that wage growth accelerate from here, but a double-digit pace seems less likely now, as a slowdown is coming and may lead to a decrease of labour demand.

Registered unemployment rate fell in August to 5.8% and to 6.0% after seasonal adjustment. In our view, this measure will continue to go down in the months to come, yet at a slower pace.

M3 money supply rose in August by 7.5% y/y, in line with market expectations and slightly faster than in July (7.3%). Household deposits kept accelerating (from 7.0% to 7.4% y/y), similarly to corporate deposits (from 6.5% to 6.8% y/y). Total loan growth (FX adjusted) rose 6.0% y/y, which is the second best reading in the last three years. Corporate loan growth also was maintained above 6% y/y. Loans to local governments have been improving – since the start of the year it has accelerated from around zero to 3.8% y/y, following two years of contraction. PLN-denominated loans for private individuals (both mortgages and consumer loans) maintained pace above 10% y/y (reaching 10.4% and 11.2% y/y, respectively).

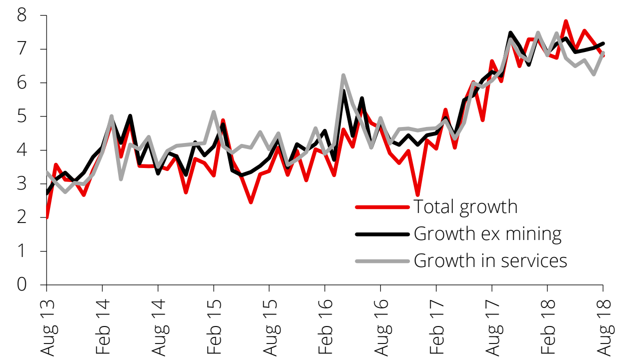
The European Commission (EC) decided to bring the Polish government's judiciary reforms before the EU Court of Justice, assessing that they are against the EU law (breach of judicial independence, including the irremovability of judges). At the same time, the EC has asked the Court to use expedited procedure and requested provisional measures in order to give this case the top priority. Decision to pass the issue to the Court is a step forward in the conflict between the Polish government and the EC. Procedure related to the Article 7 is unlikely to lead to any sanctions against Poland due to high probability of the Hungarian veto, while the ruling of the Court does not have to be approved by the EU governments. If a country does not comply with the Court ruling, the EC may ask the Court to impose a financial penalty related to the length of the breach or/and flat-rate fee.

Seasonally adjusted business climate indicators



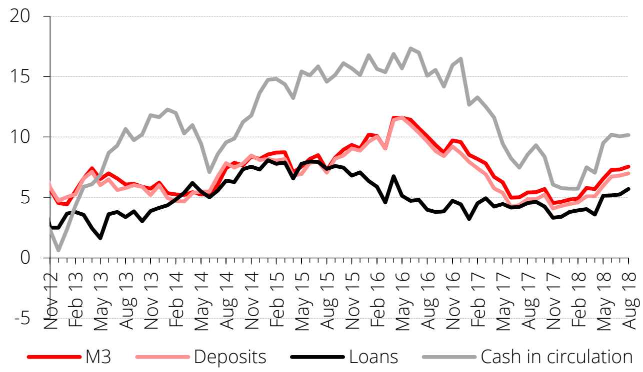
Source: Stats Office, Santander Bank Polska

Wage growth in the corporate sector, % y/y



Source: Stats Office, Santander Bank Polska

Money, loans and deposits, % y/y



Source: NBP, Santander Bank Polska

Quote of the week

Łukasz Hardt, MPC member, PAP, 24 September

Optimal strategy is still to keep rates unchanged, but raising interest rates may be necessary next year if pro-inflationary factors prevail. Core inflation nearing 2%, alongside ECB tightening, would be a very serious argument for a rate hike in Poland. It is too early to discuss rates in 2020.

Jerzy Kropiwnicki, MPC member, PAP, 25 September

The time perspective in which there could be a necessity to raise rates is now more distant, moving to 2019-end. Space for monetary tightening has been constrained by introduction of bank tax.

With signs of a turning point in inflation, the prospects of a rate hike in Poland next year may be changing. A positive trend in core CPI and stronger input to inflation from energy (plus some effect on food from drought), if confirmed in the next readings, may make some members more open to a possibility of monetary policy tightening in 2019. Łukasz Hardt assumes, as we also do, that if core inflation goes up to levels seen last time six years ago (we expect it to cross 2% he mentioned, in mid-2019) and conditional on the ECB hiking its rates first, the Council could consider tightening its policy. Dovish members, like Jerzy Kropiwnicki, do not go as far as naming the conditions under which they would see the necessity to hike rates in 2019.

FX and FI market

Last week on the market

FX The zloty gained in the last few days amid rather positive mood on the equity market and lack of negative market reaction after the FOMC meeting. At the time of writing, the zloty is running for its biggest weekly gain vs the euro since late July with EURPLN below 4.27, its lowest since late August. USDPLN fell in the first part of the week to 3.63 but the EURUSD drop in reaction to budget news from Italy pushed the exchange rate back up to 3.67.

As expected, the Czech central bank hiked rates by 25bp taking its main rate to 1.50%. Bank's governor Jiri Rusnok said after the decision that one more rate hike cannot be excluded and it could take place later this year or in early 2019. Before the decision, the market had been pricing three hikes, with the two of them to be delivered in 2019 so the comment of the bank governor might have sounded a bit dovish. As a result, the koruna depreciated last week vs the euro with EURCZK rising temporarily to 25.73 from 25.59.

FI Asset swap spreads narrowed when the IRS rates rose more than the bond yields. Polish debt remained pretty stable on the course of the passing week while the IRS rates moved 2-4bp up. Both curves steepened and the 10Y spreads vs Bund and Treasuries narrowed.

What to watch for next week

As regards Polish events, we will see the September PMI, flash CPI and the MPC will hold a meeting. We do not expect any meaningful changes in the Council's rhetoric as regards the monetary policy outlook. In our view, flash estimate of the September inflation might show that prices rose 2% y/y, keeping the pace observed in the previous three months. PMI index likely fell amid lower economic activity indexes aborad and other measures released in Poland pointing to the slower growth.

Globally, the market attention might focus on the US data with the manufacturing ISM and nonfarm payrolls being of a particular importance. We think those releases may influence the currencies rather thourgh the "equities channel" as the outlook for Fed rates shall not change significantly just a few days after the September hike.

Market implications

FX EURPLN has reached the lower end of the range where it has been moving since mid-August. In the last few days, the zloty deviated from EURUSD and bonds and became more sensitive to trend on the equity market. This week we should see important data on the US economic activity that could determine the sentiment on the global market. Also, stocks are likely to respond to any new comments on the "trade war".

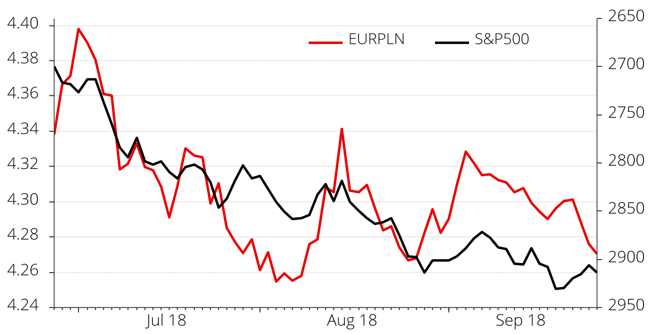
We shall not expect any meaningful market reaction to Polish PMI or flash CPI. The MPC is likely to maintain its stable-rates rhetoric and so internal factors should be zloty-neutral.

We think that the zloty is on track for a slight appreciation in the remainder of the year thanks to no hawkish surprise from the FOMC and stabilization of the situation on the EM markets.

FI The 10Y PL-DE and PL-US bond yield spreads neared their support levels at 266bp and c.15bp, respectively, showing the room for Polish debt outperformance is becoming smaller. Also, the 5Y and 10Y asset swap spreads got closer to their August lows.

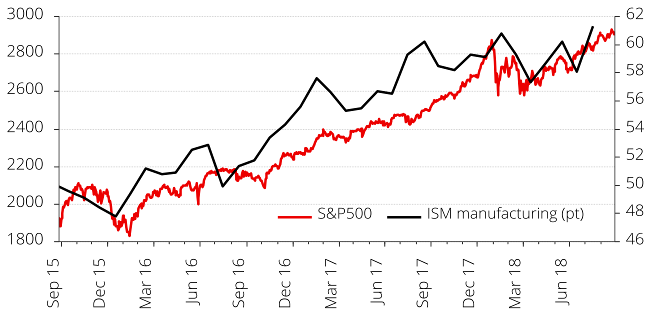
We think the long end of the Polish bond yield curve might go slightly up in the coming days holding comfortably below the September peak at 3.36%. Poland CPI staying at 2% y/y in September might generate only a mild upside pressure on the front end and belly of the curve. We do not expect any meaningful market reaction to the MPC rhetoric that should stay pretty unchanged.

EURPLN and S&P500



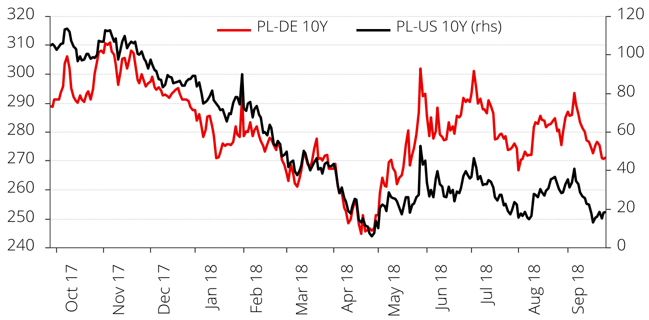
Source: Thomson Reuters Datastream, Santander Bank Polska

S&P500 and ISM manufacturing



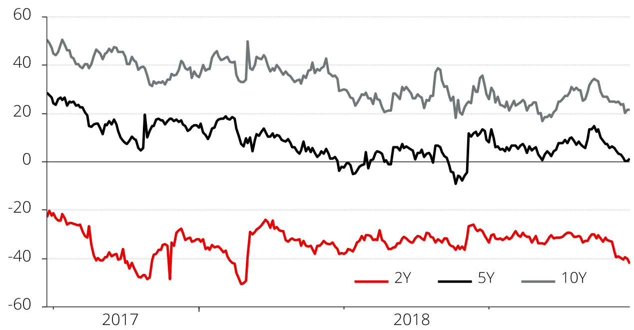
Source: Thomson Reuters Datastream, Santander Bank Polska

10Y bond yield spreads



Source: Thomson Reuters Datastream, Santander Bank Polska

Asset swap spreads



Source: Thomson Reuters Datastream, Santander Bank Polska

Santander

Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST Santander	LAST VALUE
		MONDAY (1 October)					
9:00	**PL**	**PMI – manufacturing**	**Sep**	**pts**	**51.5**	**51.2**	**51.4**
9:55	DE	PMI – manufacturing	Sep	pts	53.7	-	53.7
10:00	EZ	PMI – manufacturing	Sep	pts	53.3	-	53.3
10:00	**PL**	**Flash CPI**	**Sep**	**% y/y**	**1.9**	**2.0**	**2.0**
16:00	US	ISM – manufacturing	Sep	pts	60.1	-	61.3
		TUESDAY (2 October)					
9:00	CZ	GDP	Q2	% y/y	2.4	-	2.4
		WEDNESDAY (3 October)					
	PL	**MPC decision**		**%**	**1.50**	**1.50**	**1.50**
9:55	DE	PMI – services	Sep	pts	56.5	-	56.5
10:00	EZ	PMI – services	Sep	pts	54.7	-	54.7
14:15	US	ADP report	Sep	k	185	-	163
16:00	US	ISM – services	Sep	pts	58.0	-	58.5
		THURSDAY (4 October)					
14:30	US	Initial jobless claims	week	k	-	-	214
16:00	US	Industrial orders	Aug	% m/m	1.0	-	-0.8
		FRIDAY (5 October)					
8:00	DE	Industrial orders	Aug	% m/m	0.0	-	-0.9
14:30	US	Non-farm payrolls	Sep	k	190	-	201
14:30	US	Unemployment rate	Sep	%	3.8	-	3.9

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.