05 October 2018

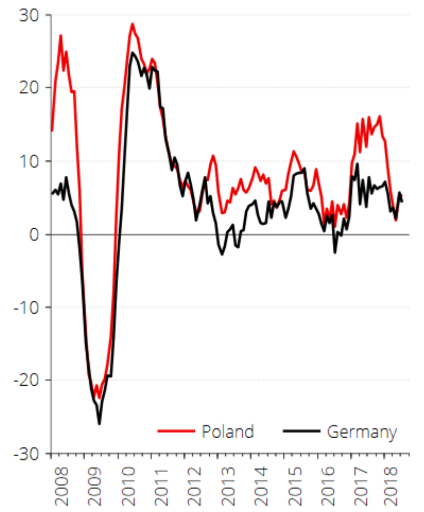
Weekly Economic Update

Markets do the samba

What's hot next week

- The calendar for the coming week is rather light. The only domestic data release will be the Stat office's **data on foreign trade for January-August** (virtually insignificant for the market). Abroad the number of publications will be also relatively small – the ones that may attract attention include German production and exports plus inflation in Czechia and Hungary.
- It does not mean that the week will be boring. Already this weekend **the first round of presidential elections in Brazil** will take place and their result may be very important for the emerging markets. If the outcome substantially scares investors, the EM currencies' seloff could potentially affect the zloty.
- A series of **Fed officials' speeches** is scheduled in the coming days. Please recall that FOMC members' comments were among triggers for the recent bond seloff, and be prepared for new impulses that may affect the market.
- Moreover, the 'last chance' European Council meeting – crucial from the Brexit deal point of view – is getting closer (October 18th), so any new information signalling chances for compromise could be watched with higher attention than before.
- At the end of the week, on Friday evening, **Fitch and S&P are scheduled to review Poland's rating**. The latter agency decided to improve the rating outlook to positive during the previous review in April. Nevertheless, we think that this time around there will be no change of assessment. Although the economic situation in Poland still looks very good as compared to other countries in the region, it is more and more clear that the peak of the cycle is behind and worries about the global economic slowdown are mounting. In thish environment the rating agencies will not hurry to improve the score for the country, where big improvement of fiscal situation was mainly due to the cyclical factor, while the structural fiscal balance is still among the worst in Europe. The second argument not to hurry with the rating upgrade is the deteriorating assessment of the institutional framework and the rule of law (see the the World Bank's Worldwide Governance Indicators – chart below) and the ongoing conflict with the EU.

Export growth, % y/y, 3M moving avg.

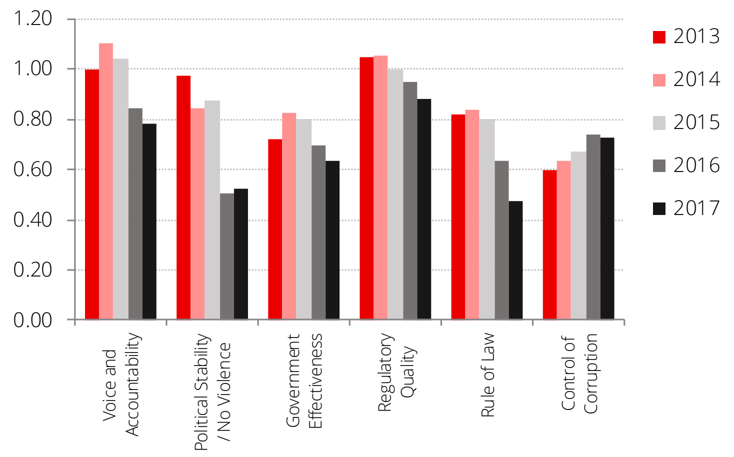


Source: Thomson Reuters Datastream, Santander Bank Polska

Market implications

There is a number of factors on the horizon that could potentially extend the recent correction of the zloty, triggered by dollar appreciation and debt market seloff. However, we do not assume that it could transform into a long-term trend of PLN depreciation. Debt market could be also under short-term negative influence of fluctuating moods abroad (for example, due to election outcome in Brazil), but in the end-of-month horizon we see the important stabilising factor: the large redemptions of government and road bonds and coupon payments, implying that the market could be flooded with over PLN28bn of cash.

World Governance Indicators for Poland (higher = better)



Source: World Bank, Santander Bank Polska

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What's hot next week

Fitch and S&P may **review sovereign rating of Poland** on 12 October, with an outcome of no change, in our view. Comparing the currently held grades of the agencies: BBB+ w. positive outlook by S&P, A-/stable by Fitch, it seems that the former may be more tempted to act now. An upgrade from S&P is a low probability scenario in our view. While the current macroeconomic and fiscal parameters look very nice and so does the outlook, the institutional erosion the agency is monitoring has not disappeared. Moreover, rising worries about global slowdown and risk factors on the horizon (hard Brexit) do not create favourable environment for rating upgrade. S&P upgraded Polish rating outlook this April, but historically it does not give a strong signal a rating upgrade is coming. An outlook upgrade to positive in 2015 resulted in a downgrade a year later. In 2006, the agency moved back to stable outlook six months after switching to positive. In 2005 the same thing happened, but after 12 months.

Stats Office release of August **international trade data** come at the time when there is a striking broad decline in foreign new orders, including in Polish manufacturing. The scale of the export slowdown will help assess the gravity of the phenomenon.

Last week in economy

In September, the Poland's **manufacturing PMI** fell to 50.5 from 51.4pts in August. The index was dragged lower by a fall in new orders (subindex below neutral mark of 50pts) and especially new export orders, which were at the lowest level in four years. Output, employment, backlog and price indices also went down. The index is probably suffering from impact of trade wars and is in line with our forecasts of economic slowdown in Poland in 2H18: 5%+ growth from 1H18 is unlikely to repeat.

CPI inflation dropped to 1.8% y/y in September after holding for three months at 2.0% y/y. This was a downside surprise. We estimate that core inflation stayed at 0.9% y/y or possibly decreased to 0.8%, instead of rising to 1% as we had previously thought. Without a clear upward trend in core inflation, the headline CPI growth may end the year below 2%.

In line with expectations, the **MPC did not change interest rates** with the main refi rate still at 1.50%. The tone did not change either despite the statement being shorter than the previous one. The press conference did not spur any doubts about the fact that majority of the Council's members does not see reasons to change the course in the monetary policy and the interest rates should stay on hold at least until late 2019.

The finance minister Teresa Czerwińska said that after August the **central budget** showed a surplus of PLN1.1bn. We were expecting the deficit to deepen from PLN0.9bn to PLN2.0bn, but revenues proved better than we had expected while spending was lower. VAT revenues in January-August grew by 4.7% y/y versus 2.8% y/y after July. August alone saw a VAT rise by 19.6% y/y, after over 6% y/y drop in July. Data on budget realization is a positive surprise after the last reading showed a worrying deterioration.

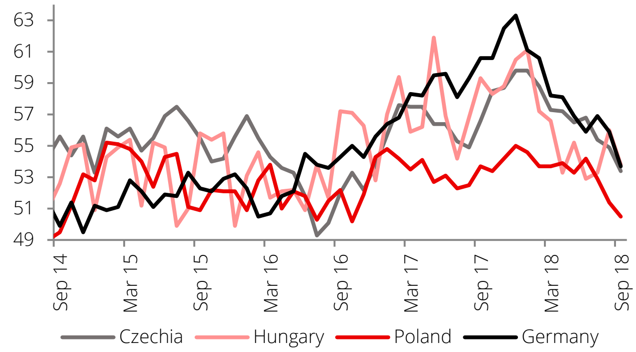
Stats Office **revised GDP data** for 2017 – growth rate was raised from 4.6% to 4.8%. The largest upgrade was seen in investments (by 0.5pp, to 3.9%), private and public consumption were also raised (by 0.1%, to 4.9% and 3.5%). We do not know how the revision affected quarterly readings (this information is to be released before the end of November), which adds uncertainty to the 3Q18 GDP forecast.

Ratings and ratings outlook in CEE

Country/Agency	Fitch	S&P	Moody's
Poland	A-/stable	BBB+/positive	A2/stable
Czechia	AA-/stable	AA-/stable	A1/positive
Hungary	BBB-/positive	BBB-/positive	Baa3/stable
Romania	BBB-/stable	BBB-/stable	Baa3/stable

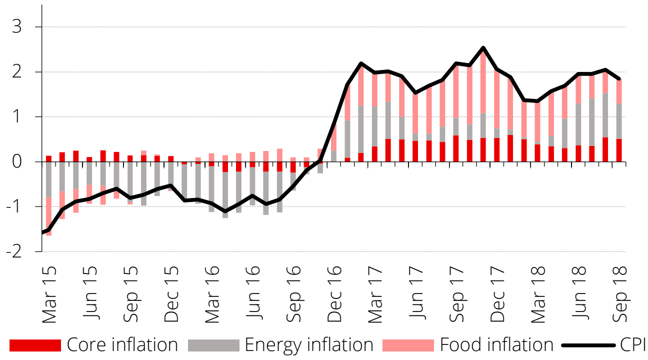
Source: Bloomberg, Santander Bank Polska

Manufacturing PMIs, CEE and Germany



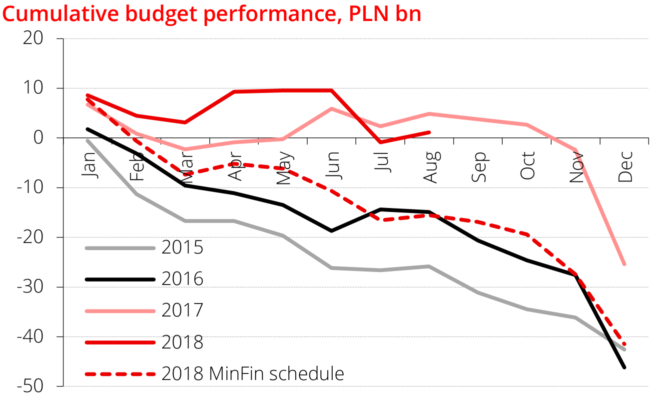
Source: IHS Markit, Santander Bank Polska

CPI inflation structure, % y/y



Source: Stats Office, Santander Bank Polska

Cumulative budget performance, PLN bn



Source: Ministry of Finance, Santander Bank Polska

FX and FI market

Last week on the market

FX Until Wednesday, the zloty had been pretty stable but then it started to depreciate amid global market mood deterioration after a significant dollar appreciation. As a result, EURPLN moved to 4.308 at the end of the week from 4.285 at the opening. USDPLN jumped to 3.75 from 3.688.

FI The passing week saw the core and Polish bonds sell-off triggered by the strong US data released in the mid-week (ADP, services ISM) and hawkish comments made by the FOMC members. As a result, the Polish yield curve moved 4-9bp up. Still, this move was well smaller compared to what we have seen on the core market. At the bond auction, the demand/supply ratio was not too high (1.45) but yields at the front end were below the market levels. PS0424 issued for the first time yielded 2.73%.

Key events

No important Polish data are on the agenda this week so the German exports and output data (where we expect weak readings) and outcome of the first round of Brazil presidential elections may have the key impact.

On Friday, S&P and Fitch might release review of the Polish rating. We do not expect any change in the assessment.

On October 24 and 25, National Road Fund bonds and government bonds will mature, triggering payments of PLN11.65bn principal + PLN0.78bn interest and PLN11.92bn principal + PLN3.98bn interest, respectively.

Market implications

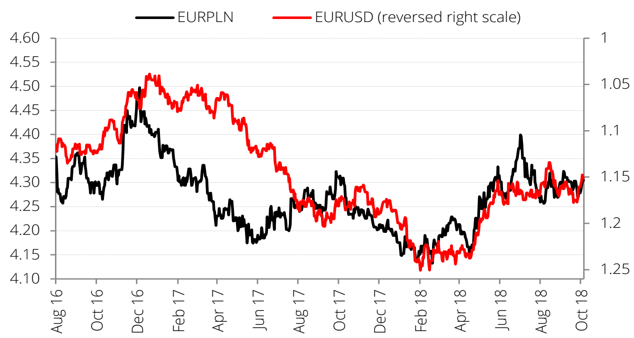
FX We think that poor German industrial data together with strong US labour market figures might weigh on the euro and thus on the zloty. The risk factor to this scenario are the attempts of Donald Trump to again express dissatisfaction with the Fed monetary policy.

Last week, EURPLN tested the 4.31 resistance. Should this level be broken, the next target for the exchange rate would be the August peak at c 4.34. Outcome of the first round of the Brazil presidential elections might trigger zloty depreciation but we do not expect any persistent weakening trend to start in the nearest future.

FI Higher yields on the core debt markets may weigh on the Polish bonds in the coming days. Additionally, Brazil elections might determine the market mood at the beginning of the week.

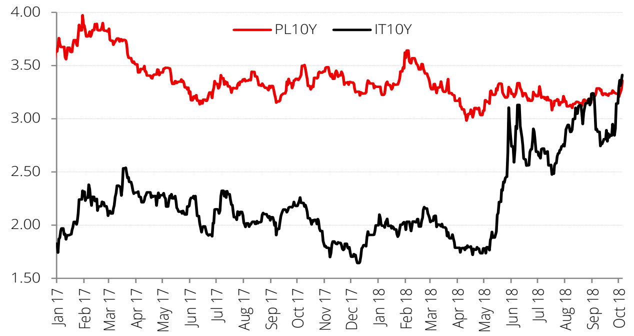
Later in the month, Polish bonds will be under the impact of the planned maturity of OK1018 and the Road Fund bonds. In our view, the positive impact of the cash inflow and holding the next bond auction after the abovementioned bonds' maturity should be supportive for the Polish debt in the second half of October.

EURPLN and EURUSD



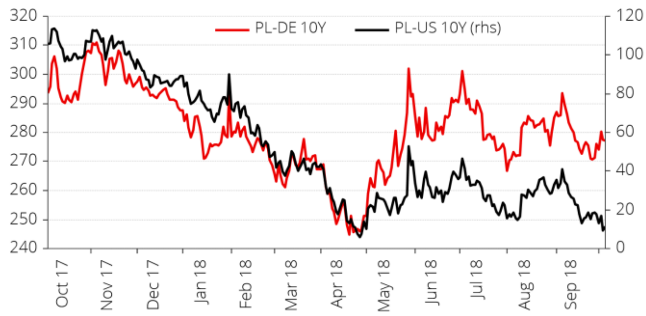
Source: ThomsonReuters, Santander Bank Polska

Polish and Italian 10Y bonds



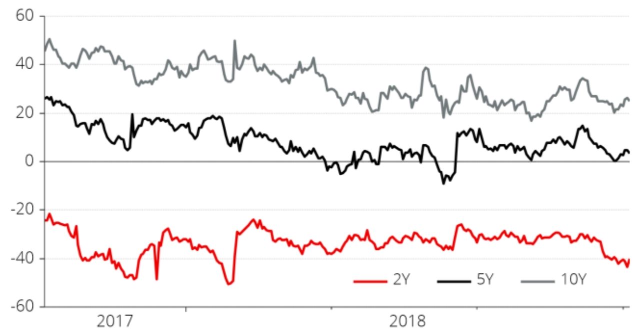
Source: Thomson Reuters, Santander Bank Polska SA

10Y bond yield spreads



Source: Thomson Reuters Datastream, Santander Bank Polska

Asset swap spreads



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 (8 October)					
3:45	CH	Caixin China PMI Services	Sep	pts	51.4		51.5
8:00	DE	Industrial Production SA	Aug	% m/m	0.5		-1.1
9:00	CZ	Industrial Production	Aug	% y/y	2.6		10.3
		TUESDAY (9 October)					
8:00	DE	Exports SA	Aug	% m/m	0.45		-0.8
9:00	CZ	CPI	Sep	% y/y	2.5		2.5
9:00	HU	CPI	Sep	% y/y	3.5		3.4
		WEDNESDAY (10 October)					
		No important events					
		THURSDAY (11 October)					
14:30	US	CPI	Sep	% m/m	0.2		0.2
14:30	US	Initial Jobless Claims	Oct/18	k	215.0		207.0
		FRIDAY (12 October)					
8:00	DE	HICP	Sep	% m/m	0.4		0.4
11:00	EZ	Industrial Production SA	Aug	% m/m	0.5		-0.8
16:00	US	Michigan index	Oct	pts	100.8		100.1
	PL	**S&P Rating Review**					
	PL	**Fitch Rating Review**					

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg