

12 October 2018

Weekly Economic Update

Core yields key for other assets

What's hot next week

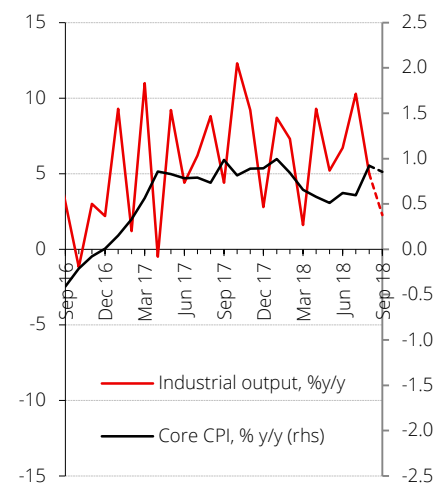
- Numerous Polish data are on the agenda in the coming days with the September industrial output and retail sales being the most awaited. Our forecast for the former is clearly below the market consensus, while for the retail sales were are close to what the market expects. We also expect a slight decrease of core inflation.
- Globally, investors are likely to focus on the US data and the beginning of the quarterly earnings publication season starting this Friday.
- The EU summit devoted to Brexit will be held on 17-18 October. A negative result would be a tough test for the pound, which was appreciating for several weeks on hopes that the negotiations are almost finished. Euro zone member states have to deliver draft 2019 budgets to the European Commission by Monday. This will remind investors of the Italy-EU spat regarding compliance with fiscal rules, that proved painful for the Italian debt.
- In the CEE region, the Hungarian central bank will make a decision on the interest rates.

Market implications

The core bond yields stabilized after a strong jump observed in the previous weeks. In our view, trends on the bond market had a large impact on the equity prices that in turn determined trends on the EM currency market. We observed a similar phenomenon in early 2018.

Should the bond market reaction be the same in scale as what we saw in early 2018, we could now see a relief on the stock market. The risk factor to this scenario are the US data that could push yields higher if they surprise to the upside. However, we expect any upside pressure on yields from the core markets to have a limited impact on Polish debt. We expect EURPLN to remain in the 4.26-4.34 trading range with the trends on the core debt market determining the direction in the short-term.

Output and inflation measures



Source: Stats Office, NBP, 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

What's hot next week

Final reading of September's **CPI** will cast more light on price developments. We are curious to know which subcategory was the main culprit behind decline of CPI to 1.8% from 2.0% in August. Fuels was one force driving CPI down, but in our view core categories also showed some decline, so **core inflation** is likely to fall in 0.8-0.9% range (versus 0.9% in August). Still, in our view the price pressure will be building up in the months to come. **PPI** inflation is likely to inch down in September, but in our view mostly due to high base effect. We expect PPI to remain close to 3% y/y in the months to come.

We are rather pessimistic about September output, with our forecasts for **industry and construction** considerably below market consensus. In our view, industry may begin to suffer from weaker growth in global trade and follow disappointing August results of German industry and exports. Construction, on the other hand, will be under growing pressure of lack of qualified workforce.

We are also not very optimistic about **labour market data**. Employment growth has been gradually losing its momentum and wage growth will be kept in check by negative working-day effect.

Real **retail sales** growth in August should in our view reach 6.5% y/y, slightly less than in previous months, but the pace would be high enough to secure a higher average growth in 3Q (6.8% y/y) than in 2Q (6.1%). Consumer confidence for October should be scanned for signs of further fall in households' financial situation outlook.

Last week in economy

According to Rzeczpospolita daily, the government has been working on the system of **compensation for higher energy prices** for businesses and households. The draft version envisages spending one third of the inflows from CO2 permits sale (c. PLN5bn in 2018) on supporting energy-consuming businesses and two thirds on households. We think that the very existence of such a project increases the probability that energy prices for households will go up (the tariff is approved by the governmental Energy Regulatory Office, URE). Recently, we have revised our CPI forecast for 2019 to 2.6% from 2.3%, but we assumed URE may wait with energy price rises for households. If URE does otherwise, increased energy prices will drive CPI up higher and faster than we expect.

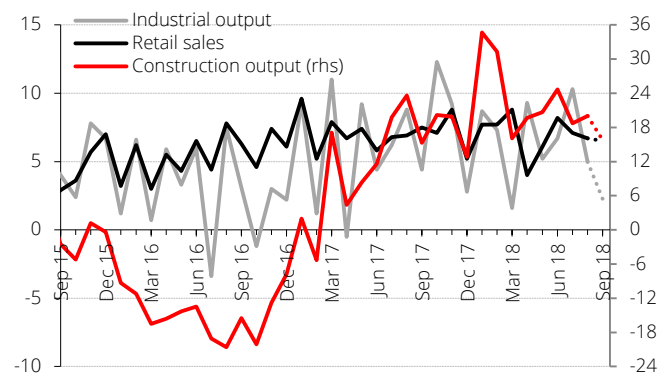
Stats office data on **foreign trade** showed a rise in exports in August by 7.8% y/y and imports by 11.4%. Both growth rates are c2pp higher than our forecast for NBP data (due 15 October, similar but not exactly the same as the Stats Office numbers).

S&P rating agency, which on Friday, 12 October is to review Poland (at the same time as Fitch), revised the country's 2018 fiscal deficit forecast to 0.9% GDP from 2%. Other agencies have also revised recently their estimates for Poland towards higher growth and better fiscal stance.

Quote of the week

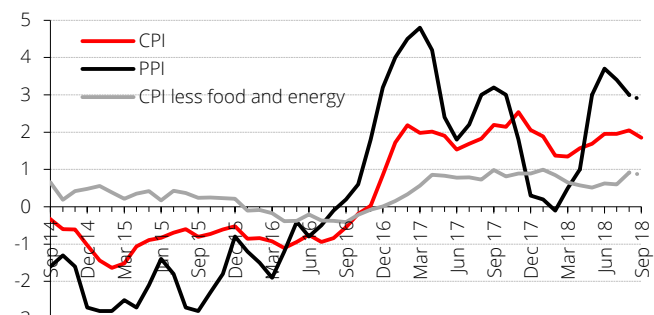
NBP president **Adam Glapiński** said in an interview with PAP (Polish Press Agency) that MPC had not changed the interpretation of the inflation target. Glapiński's remark after the last MPC meeting ("as long as we are within the range, we meet the target") may have suggested that the Council has begun to perceive the target as a range and not a spot. We warned in our [October MACROscope](#) against going too far with the interpretation of that press conference remark. It seems we were right. In Kamil Zubelewicz's view, some members really consider the tolerance band to be the policy target. The hawkish member reminded that he still wants rates to go up, but thinks MPC could refrain from such move until the end of the term. Central bankers' comments from last week do not change our call: we think that MPC will start to hike rates at the end of 2019 at the earliest.

Production and retail sales growth (constant prices), % y/y



Source: Stats Office, Santander Bank Polska

Inflation measures, % y/y



Source: Stats Office, NBP, Santander Bank Polska

Energy prices, contracts, PLN/MWh



Source: TGE, Santander Bank Polska

Adam Glapiński, NBP president, PAP, 10 October

There has been no change in level or approach to understanding NBP's inflation target.

Kamil Zubelewicz, MPC member, PAP, 12 October

The fact that some MPC members understand inflation goal in terms of range targeting raises my serious doubts. In practice this would mean MPC is ready to accept higher inflation ... MPC is running adaptive policy, it risks reacting to late to rising inflation ... I stick to the view that the Council should have raised interest rates to avoid the risk of inflation going above the target. Current forecasts show that the risk can materialize in 2-3 quarters ... I still fear rates could stay unchanged for the whole term of the Council.

FX and FI market

Last week on the market

FX The passing week has been pretty calm with EURPLN holding in a c4.30-4.32 range for most of days and falling to 4.29 on Friday. The Polish currency benefited from strengthening of the domestic bonds and a weaker dollar. The zloty gained vs the franc, but lost vs the pound (which gained amid speculation about higher chance for a soft Brexit).

FI Bond yields fell more than the IRS rates. Polish bonds benefited from pause in yields rise on the core market and investors purchasing Polish 10Y bonds with yields at 3.30% resistance.

Key events

Globally, investors are likely to focus on the US data at the beginning of the quarterly earnings publication season. Also, the trends on the core bond market will be closely watched as in our view yields changes have been a key driver for other assets in the recent days.

Numerous Polish data are on the agenda in the coming days with the industrial output and retail sales being the most awaited. Our forecast for the former is clearly below the market consensus. We also expect bigger August C/A deficit.

In the CEE region, the Hungarian central bank will make a decision on the interest rates.

Market implications

The core bond yields stabilized after a strong jump observed in the previous weeks. In our view, trends on the bond market had a large impact on the equity prices that in turn determined trends on the EM currency market. We observed a similar phenomenon in early 2018 when higher bond yields pushed stock prices down as investors were pricing in downward revisions of stock target prices as the higher discount rates would be potentially put in the analysts' DCF models. We think that the current situation resembles what we have seen in early 2018 with additional stress factor related to start of the quarterly earnings publication.

FI Should the bond market reaction be the same in scale as what we saw in early 2018, we could now see a relief on the stock market. The risk factor to this scenario are the US data that could push yields higher if they surprise to the upside. The market is now pricing in the December 25bp Fed rate hike but is far from discounting three hikes in 2019 (as expected by the FOMC members).

However, we think any upside pressure on yields from the core markets will have a limited impact on Polish debt. The 10Y bond yield has been holding below the May peak at just above 3.30% and we expect this resistance to work in the days to come. The most recent past has showed that when yields approach that level, investors take opportunity to buy at a local dip. Realisation of our below-consensus forecast on Polish industry output should support this scenario.

FX As outlined above, trend on the core bond market and its impact on equities and on the dollar (high UST yields have tended to support the greenback in the recent days) could be the key for the zloty in the coming days. At the end of this week, EURPLN is hovering in the middle of the 4.26-4.34 trading range and in our base scenario we do not expect any meaningful changes to take place in the days to come.

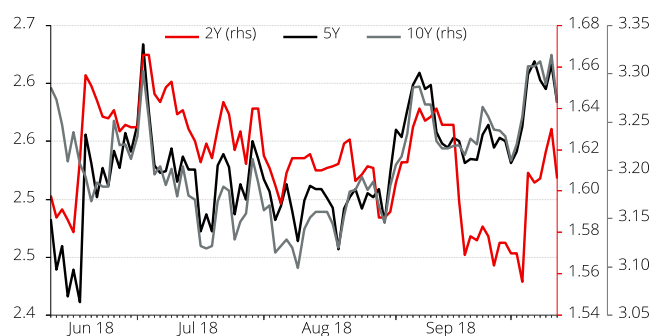
The Hungarian central bank will hold a meeting on Tuesday. Last month, the bank introduced slightly less dovish rhetoric that supported the forint. Hungarian 10Y bond yield soared above 3.90% (the highest since mid-2015) and that may prevent the central bank from adopting even more hawkish tone. As a result, we do not expect the outcome of the bank meeting to have a positive impact on the forint.

EURPLN



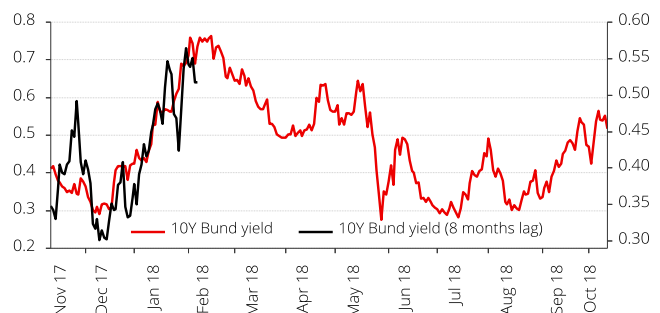
Source: Thomson Reuters Datastream, Santander Bank Polska

Polish bond yields



Source: Thomson Reuters Datastream, Santander Bank Polska

10Y Bund yield



Source: Thomson Reuters Datastream, Santander Bank Polska

S&P500 index



Source: Thomson Reuters Datastream, Santander Bank Polska

Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST	
				MARKET	SANTANDER	VALUE	
MONDAY (15 October)							
10:00	PL	CPI	Sep	% y/y	-	1.8	1.8
14:00	PL	Current Account Balance	Aug	€mn	-396	-287	-809
14:00	PL	Trade Balance	Aug	€mn	-321	-415	-432
14:00	PL	Exports	Aug	€mn	16 944	16 874	17 115
14:00	PL	Imports	Aug	€mn	17 254	17 289	17 547
14:30	US	Retail Sales Advance	Sep	% m/m	0.7	-	0.1
TUESDAY (16 October)							
10:00	PL	Employment in corporate sector	Sep	% y/y	3.4	3.4	3.4
10:00	PL	Average Gross Wages	Sep	% y/y	7.1	6.9	6.8
11:00	DE	ZEW Survey Current Situation	Oct	pts	74.3	-	76.0
14:00	HU	Central Bank Rate Decision		%	0.9	-	0.9
14:00	PL	CPI Core	Sep	% y/y	0.8	0.9	0.9
15:15	US	Industrial Production	Sep	% m/m	0.3	-	0.41
WEDNESDAY (17 October)							
10:00	PL	Sold Industrial Output	Sep	% y/y	4.5	2.3	5.0
10:00	PL	Construction Output	Sep	% y/y	18.5	15.8	20.0
10:00	PL	PPI	Sep	% y/y	2.8	2.9	3.0
11:00	EZ	HICP	Sep	% y/y	2.1	-	2.1
14:30	US	Housing Starts	Sep	% m/m	-5.04	-	9.2
20:00	US	FOMC Meeting Minutes					
THURSDAY (18 October)							
14:30	US	Initial Jobless Claims	week	k	206		214
14:30	US	Index Philly Fed	Oct		21.0		22.9
FRIDAY (19 October)							
10:00	PL	Retail Sales Real	Sep	% y/y	6.2	6.5	6.7
16:00	US	Existing Home Sales	Sep	% m/m	-0.6	-	0.0

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg

This publication has been prepared by Santander Bank Polska S.A. for information purposes only. It is not an offer or solicitation for the purchase or sale of any financial instrument. Information presented in the publication is not an investment advice. All reasonable care has been taken to ensure that the information contained herein is not untrue or misleading. But no representation is made as to its accuracy or completeness. No reliance should be placed on it and no liability is accepted for any loss arising from reliance on it. Forecasts or data related to the past do not guarantee future prices of financial instruments or financial results. Santander Bank Polska S.A. its affiliates and any of its or their officers may be interested in any transactions, securities or commodities referred to herein. Santander Bank Polska S.A. or its affiliates may perform services for or solicit business from any company referred to herein. This publication is not intended for the use of private investors. Clients should contact analysts at and execute transactions through a Santander Bank Polska S.A. entity in their home jurisdiction unless governing law permits otherwise. Copyright and database rights protection exists in this publication.

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.