09 November 2018

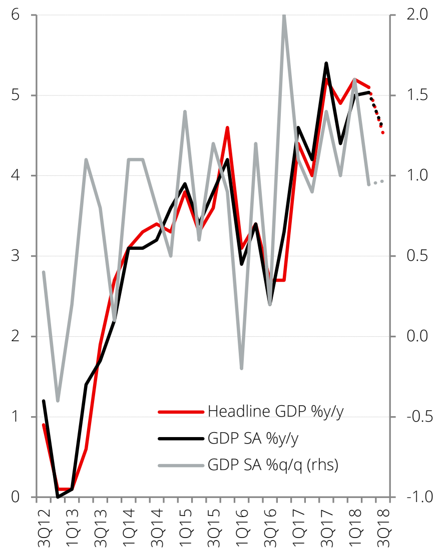
Weekly Economic Update

Conservative projection

What's hot next week

- At the very last moment, Polish politicians decided that there will be a holiday on Monday November 12th, but domestic investors will not miss any important global event as the Monday's agenda is almost empty.
- On Tuesday morning the NBP analysts will present the new Inflation report, discussing the details of the new projection, which shows much stronger inflation spike and slightly deeper economic slowdown than its earlier version. For the Monetary Policy Council such forecasts still do not provide arguments for interest rate hikes, as (1) higher inflation is triggered mainly by exogenous shock (energy prices), beyond the influence of monetary policy; (2) assumptions about the energy prices hike were – according to the NBP president – 'conservative' (read: exaggerated). It is hard to disagree, as we think that the energy market regulator will not agree for retail energy tariff increase higher than 3-4%. However, we think that the MPC is underestimating the indirect impact of higher energy costs on core inflation. The latter will be showing up only gradually, though, so the "wait-and-see" approach in monetary policy may hold for many months.
- On Tuesday afternoon the balance of payments data for September will be released, showing – according to our forecasts – a rebound in exports and imports and almost balanced current account balance (positive information overall, but we think they will be ignored by the market given other important events this week).
- On Wednesday the key data release of the week – flash GDP data for 3Q18. We expect to see the first reading well below 5% y/y for over a year (our forecast 4.5%, market consensus 4.7% y/y). For more detailed information about the breakdown of growth we will have to wait until the end of the month.
- Final CPI data for October should confirm the flash estimate at 1.7% y/y, consistent with core inflation at 0.9% y/y. The more significant upward move of inflation will start after the New Year, in our view.
- Apart from the domestic factors, the week will be full of data releases abroad, including inflation and activity indicators in Europe and USA. On Tuesday Italy should present its new version of 2019 budget, after the previous draft was rejected by the European Commission.

Economic growth in Poland



Source: Stats Office, Santander Bank Polska

Market implications

At the start of the week we expect to see slight PLN depreciation amid profit taking after the recent EURPLN drop, but in the second half of the week we expect improvement of sentiment on equity markets and weaker dollar, which should help the zloty. In case of debt market, the upward pressure on yields should be stopped in the middle of the week, after weaker Polish GDP data and lower US inflation.

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

Flash data on 3Q18 **GDP** is the most important release of the week. We are expecting the economic growth to show 4.5% after four quarters of around 5% growth in a row. We have to wait until end of month to see details, and in our view consumption remained the main driver of GDP growth, with investment posting moderate growth and net exports contributing negatively.

We expect final **CPI** to confirm the flash release, which showed a surprising fall to 1.7% y/y in October. Food prices were the main culprit. Although we see a number of reasons for food prices to grow (the drought effect impacting bread and vegetables and higher prices of food of pork meat) but for now the opposite factors seem to dominate (like oversupply of fruits). Energy and fuels rose as expected. The core inflation probably rose from 0.8% y/y to 0.9%. In our view, CPI could stay at or slightly below the October level for the rest of 2018, but early next year it could climb toward the 2.5% target.

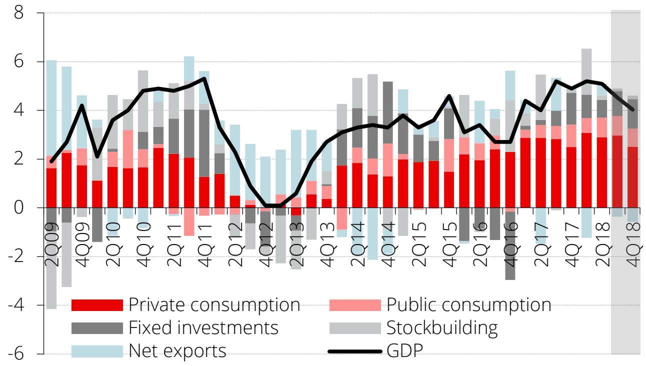
September **balance of payments** data are likely to show a major rebound in exports and imports after weak August. Still, we are expecting a trade deficit at about €235mn, which will be offset by a positive secondary income balance, resulting in a balanced current account. In our view, the current account deficit to be widening somewhat over the upcoming quarters. Foreign trade is likely to be under negative spell of trade wars.

Last two weeks in economy

The **PMI index for Polish manufacturing** fell to 50.4 pts from 50.5 pts. The reading is still near four-year lows and continues to point to slower growth going forward. The details showed that foreign orders fell yet again (five declines already registered this year, the one in October being the sharpest in six years), as did backlogs of work. Output expectations were adjusted downward (fifth successive decline of the indicator, to the lowest level since January 2013). For the first time since mid-2013, the employment component of the PMI slipped below the neutral level – in our view, it is beginning to look as if it is not just the supply side of the labour market that is restraining employment growth, but the demand side is softening too. At the same time, the output prices index eased somewhat despite input prices remaining at historically high levels. A sensitive issue is what is happening with new orders from abroad.

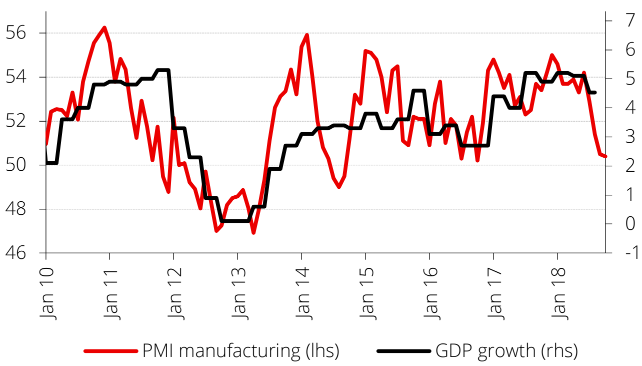
At the November's meeting **the Monetary Policy Council** received the updated NBP projection, showing significantly stronger spike of CPI inflation and slightly deeper GDP growth slowdown in 2019. Yet, by no surprise to us, such results did not trigger any material change in the central bank's approach or rhetoric, despite the fact that the discussion at the meeting was – according to the NBP Governor – "more lively than usual". The MPC still believes that "the current level of interest rates is conducive to keeping the Polish economy on a sustainable growth path and maintaining macroeconomic stability" and NBP Governor Adam Glapiński admitted the projection did not provide new arguments for a shift in monetary policy. Asked about conditions that could force the MPC to mull policy tightening Adam Glapiński said he would need to see evidence of a persistent process of inflation increase. We agree it is still a long time before such strong evidence prevails, but – unless economic slowdown proves to be much stronger than we think – we may arrive to this point at the very end of 2019, when both headline and core inflation rates will be already above the 2.5% target and forecasts for the coming quarters will be pointing further to the north. Until then the MPC will keep the interest rates stable, claiming (as Mr. Osiatyński just did after seeing November's projection) that it still needs more clarity about the future outlook, and hoping it will be revealed by future NBP projections.

Contribution of demand components to GDP growth, % y/y



Source: Stats Office, Santander Bank Polska

PMI vs GDP growth



Source: Stats Office, NBP, Santander Bank Polska

Inflation and GDP projections in subsequent *Inflation reports*

	GDP growth			
	Nov 17	Mar 18	Jul 18	Nov 18
2017	4.2 (±0.4)			
2018	3.7 (±0.8)	4.3 (±0.8)	4.6 (±0.6)	4.8 (±0.4)
2019	3.3 (±1.0)	3.8 (±1.0)	3.75 (±0.95)	3.55 (±0.85)
2020	-	3.6 (±1.0)	3.35 (±0.95)	3.25 (±0.95)
	CPI inflation			
2017	1.95 (±0.05)			
2018	2.3 (±0.7)	2.1 (±0.5)	1.8 (±0.3)	1.8 (±0.1)
2019	2.7 (±1.0)	2.7 (±1.0)	2.7 (±0.8)	3.25 (±0.65)
2020	-	3.0 (±1.1)	2.8 (±1.1)	2.9 (±1.0)

Middle points of GDP and CPI growth paths and width of 50-percent probability ranges
Source: NBP, Santander Bank Polska

FX and FI market

Last week on the market

FX The zloty appreciated last week, thanks to the better mood on the global financial markets. As a consequence, we observed strengthening of emerging market currencies, especially CEE currencies. Consequently, over the week EURPLN slid to 4.2870 from 4.3250. USDPLN moved to 3.7310 from 3.7980, pushed down by the weakening of USD. However USD strengthening (in the second part of the week) pushed USDPLN to 3.7840.

FI Last week yields of Polish bonds increased. This move was a rebound after the yields slid at the end of October (as a reaction to huge bonds redemptions and falls of equities). The second factor which pushes the yields up was a publication of new NBP inflation projection (on Wednesday, at MPC conference). Furthermore, yields were elevated by core market bond behaviour. The German curve was pulled up by industrial data (that beat expectation). The US curve upward move was a consequence of awaiting for FOMC decision. Over the week Polish bonds yield curve climbed by 2-5bp, while the IRS yield curve move was a little bigger, 2-6bp.

Key events

This week data on inflation, GDP and current account data will be released. In the case of inflation data, we do not expect any surprise vs. flash reading. We believe that GDP release will be below than the previous one and the market consensus. The labour market will likely be close to the consensus.

On Thursday, the Ministry of Finance scheduled switch auction. On the auction OK0521, PS0424, WZ0524, WS0428, WZ0528 bonds will be offered in exchange for WZ0119, OK0419, PS0719.

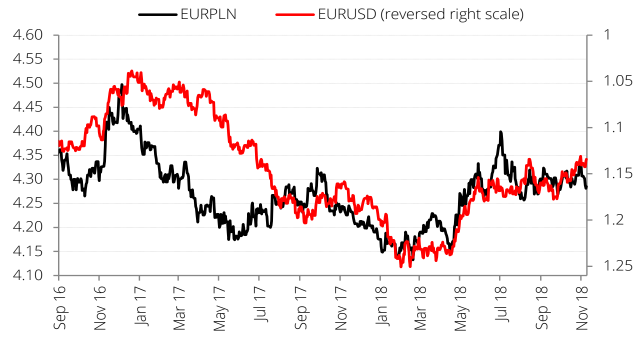
In the second half of the week, the in US inflation, retail sales data are scheduled in the calendar. We believe that this data will show some release of inflation tensions..

Market implications

FX The zloty might depreciate somewhat at the beginning of the week amid profit taking but we do not expect EURPLN to rise above 4.30. Later in the week, the sentiment on the stock market might improve which together with the October US inflation data might stabilize the Polish currency. As a result, EURPLN should hold below 4.30. The dollar appreciation that might be the case after the better-than-expected US retail sales data may threat this scenario.

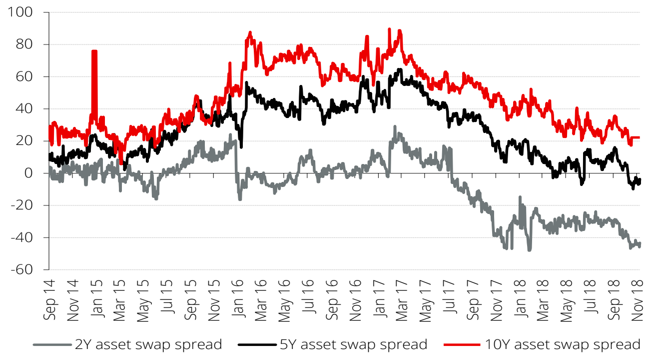
FI We expect the upside pressure on the Polish yields to hold at the beginning of next week, though at a smaller scale than in the recent days. We expect bonds to regain ground in the second part of the week when the Polish flash 3Q GDP and final October CPI will be released. In our view, the below-consensus GDP figure might terminate upward move of the yields. This should be supported also by the October US inflation data where we forecast the headline might be lower than expected amid lower oil and fuel prices. As a result, we assume Polish 2Y, 5Y and 10Y yields to end the week around 1.53%, 2.45% and 3.20%.

EURPLN and EURUSD

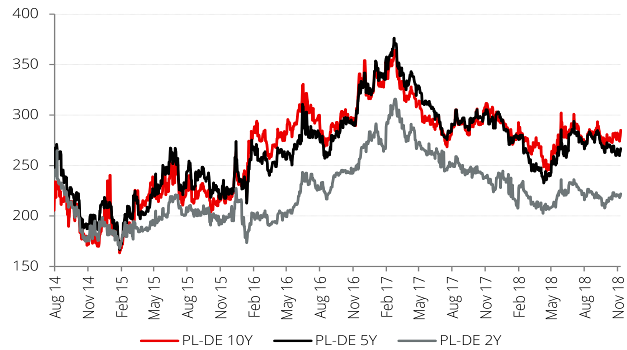


Source: ThomsonReuters, Santander Bank Polska

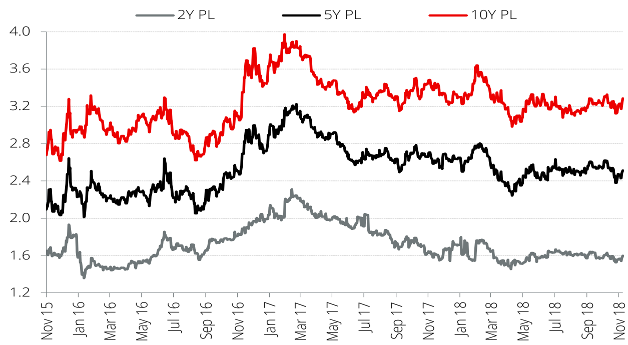
ASW spread bp



Spreads between Polish and German bonds



Polish bond yield



Source: Thomson Reuters, Santander Bank Polska

Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST SANTANDER	LAST VALUE
		MONDAY (12 November)					
		No important events					
		TUESDAY (13 November)					
08:00	DE	HICP	Oct	% m/m	0.1		0.1
09:00	**PL**	**Publication of NBP's Inflation report**					
11:00	DE	ZEW Survey Current Situation	Nov	pts	65.0		70.1
14:00	**PL**	**Current Account Balance**	**Sep**	**€mn**	**-376**	**-19**	**-549**
14:00	**PL**	**Trade Balance**	**Sep**	**€mn**	**-107**	**-236**	**-329**
14:00	**PL**	**Exports**	**Sep**	**€mn**	**18186**	**18125**	**17195**
14:00	**PL**	**Imports**	**Sep**	**€mn**	**18307**	**18361**	**17524**
		WEDNESDAY (14 November)					
08:00	DE	GDP WDA	3Q	% y/y	1.3		2.0
09:00	CZ	GDP SA	3Q	% y/y	2.6		2.4
09:00	HU	GDP	3Q	% y/y	4.35		4.8
10:00	**PL**	**CPI**	**Oct**	**% y/y**	**1.7**	**1.7**	**1.7**
10:00	**PL**	**GDP**	**3Q**	**% y/y**	**4.7**	**4.5**	**5.1**
11:00	EZ	GDP SA	3Q	% y/y	1.7		1.7
11:00	EZ	Industrial Production SA	Sep	% m/m	-0.4		1.0
14:30	US	CPI	Oct	% m/m	0.3		0.1
		THURSDAY (15 November)					
14:00	**PL**	**CPI Core**	**Oct**	**% y/y**	**0.9**	**0.9**	**0.8**
14:30	US	Initial Jobless Claims	Nov/18	k	215.0		214.0
14:30	US	Retail Sales Advance	Oct	% m/m	0.6		0.1
14:30	US	Index Philly Fed	Nov		20.6		22.2
		FRIDAY (16 November)					
11:00	EZ	HICP	Oct	% y/y	2.2		2.2
15:15	US	Industrial Production	Oct	% m/m	0.2		0.3

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.