

14 December 2018

Weekly Economic Update

Fed, Brexit and new data

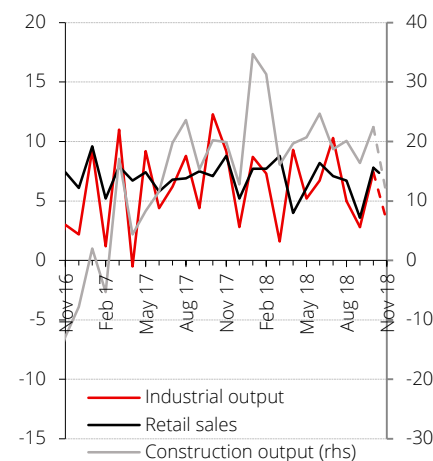
What's hot next week

- In the last week before Christmas we will see a number of domestic data releases, including November's figures for: **core inflation, wages and employment, production, retail sales, unemployment**. Their overall tone should be quite "dovish" in our view with core inflation falling to 0.7% y/y, production and sales rising at slower pace than recently (among others, due to working days effect), wage growth stabilising near 7% y/y. After negative signals from PMI indicators, it could even strengthen market scepticism about economic outlook for 2019. Especially if next data releases abroad fail to show a rebound.
- Abroad, market attention will focus on **FOMC meeting**, at which interest rates are likely to be lifted once again. The key issue will be not the decision (already priced-in) but the accompanying statement, updated economic forecasts and (potentially) changes in the expected future interest rates path.
- The UK government will continue seeking ways to **contain Brexit-related chaos**. PM May's efforts to tweak the Withdrawal Agreement apparently met with cold reception among EU leaders which has raised fears of no-deal scenario. It seems that either the UK turns last minute towards reversal of the entire process (which would benefit everyone) or it really goes towards the disorderly Brexit
- At home, we are still waiting for **the final solution to the energy price hikes issue**. Last few days we have seen so many contradicting proposals that it is impossible to predict what's next. However, we still think it is rational to assume that in the election year the government will not allow for a significant increase of energy costs for households, so the direct impact on CPI inflation should be minimal, if any.

Market implications

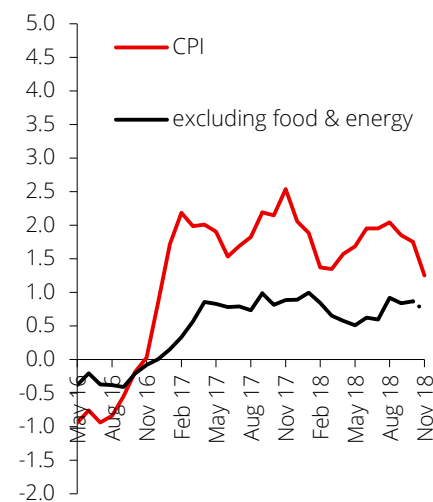
- Low inflation, weaker data about economic activity and still excellent fiscal situation are favouring low Polish yields and it seems that such situation should not change before Christmas. However, after the New Year yields may pick up a little due to rising supply of POLGBs. PLN may fluctuate in a horizontal band and the room for zloty appreciation will be limited by high Brexit uncertainty (and resulting investors' unwillingness to take directional positions) and a risk of speculative play for hawkish FOMC message just before its meeting.

Indicators of real economic activity, % y/y



Source: GUS, Santander Bank Polska

Inflation measures, %/y



Source: GUS, 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

The week is packed with important domestic data releases, with November **industry** and **construction** output most probably gathering the most attention. In our view, results in these sectors will be markedly worse than in October. This deterioration will be mostly due to working-day effect, additionally aggravated by a one-off holiday on 12 November. Still, given the inflow of disappointing information from the German industry, we are expecting the Polish sector to slow down in 2019.

Retail sales data will show a continuation of strong growth, in our view. It seems that the negative impact of new emission norms on car sales took its toll in September and no further negative effects will be visible.

We still predict the **registered unemployment rate** to be at 5.7% in November. The Labour Ministry's estimate sits at 5.8%, but the stat office's numbers about the unemployed are usually a bit lower than Ministry's flash estimates and in our view this will be enough to turn the first decimal to 7. Other labour market statistics: **wages** and **employment** will show a bit weaker growth than in October. In general, the labour market improvement seems to be losing steam.

Last week in economy

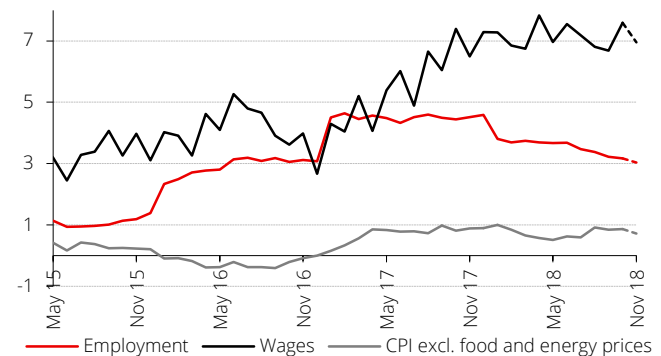
The final November **CPI** was 1.3% y/y vs. 1.8% in October. The second time in a row the flash reading was revised up by 0.1pp. Inclusion of the revisions of non-core components led us to estimates of November **core inflation** of 0.7% y/y (so down vs October print). The services inflation decreased to 0.9% y/y from 1.5% y/y in October and 2.8% y/y in January, despite this part of CPI seemed highly vulnerable to the transmission of wages pressures to consumer prices. In our view, core CPI should reach 0.8% y/y in December and will rise to c2.5% y/y at the end of this year. The headline inflation could ease further at the end of this year. Should there be only small impact of higher energy prices, in 2019, we expect CPI to reach 2% in mid-year and settle above 2.5% target in December. The data strengthen the MPC view that there are still no reasons to consider rate hikes.

October results of **foreign trade** proved higher than expected, with both exports and imports surprising strongly upwards and climbing to all-time highs (export: €20.1bn vs consensus €19.3bn, import: €20.7bn vs consensus €19.8bn), in line with suggestions from Stats Office data released earlier. Annual growth rate was at 10.2% y/y in case of exports and 15.7% y/y in case of imports, both were the highest since January. Foreign trade values were underpinned by strong performance in industry in October, but in our view the upcoming quarters will be more challenging for Polish exports, given deteriorating business sentiment in Europe and especially Germany. As the surprise in exports offset the surprise in imports, the current account deficit was in line with expectations (€457mn).

Quote of the week

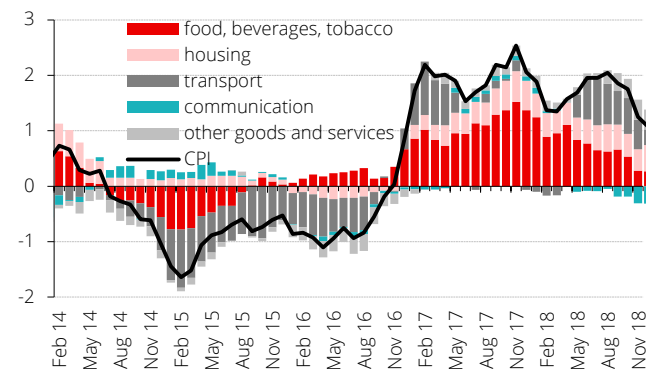
The energy prices rollercoaster continues. We will not be commenting on every element of this drama, even though the amount of plot swings is really inspiring. Words of PM Morawiecki ("no hikes") set a baseline scenario and currently the Energy Minister Tchórzewski is working on a solution. According to unofficial information cited by *Rzeczpospolita* daily, the current idea assumes that energy companies hike prices but the government lowers excise duties. However, excise is equal to 20 PLN per MWh, so even its total abolition is not enough to cover for the entire rise in energy prices. Thus, more is coming in this matter. One way or another, CPI is unlikely to see a direct effect of higher energy prices.

Employment and wages in corporate sector and core inflation, %/y



Source: GUS, NBP, Santander Bank Polska

Breakdown of annual CPI growth



Source: GUS, Santander Bank Polska

International trade, %/y



Source: GUS, Santander Bank Polska

Mateusz Morawiecki, Prime Minister, 12 December, PAP

There will be no energy price hikes.

Krzysztof Tchórzewski, Energy Minister, 13 December, PAP

Analysis of URE (energy regulator) questions shows that the energy companies will not withdraw their motions to increase prices. There are no grounds to do that. Companies are independent. I assumed they will withdraw these motions, but I never told them to do so, I just cannot do that.

FX and FI market

Last week on the market

FX EURPLN was rising for the better part of the last week, PLN gained only temporarily on Thursday. EURPLN was pushed up by poor European macro data and strengthening of USD. Moreover, PLN was negatively affected by turmoil in the British parliament, where PM May postponed Withdrawal Agreement vote. As a consequence EURPLN rose to 4.3050 from 4.2970.

FI The domestic yields were decreasing over the last week amid concerns about global economic growth, lower ECB growth forecasts, weaker European PMI data, and publication of Poland final domestic November's CPI. As a consequence, Polish bond yield curve slid by 8-12bp, mostly on the ends of the curve. The Polish yield curve moved down despite quite high volatility of core markets yields (on the weekly basis the German and US curves slipped).

Key events

This week we will get to see domestic industrial production, construction output, wages, employment, and retail sales. In the international calendar, the last FOMC meeting will be held, where we expect next interest rate hike by 25bp.

Market implications

FX EURPLN should stay near the current level. The low pre-Christmas volatility (as some foreign entities have already closed and some are about to close the year soon) should stabilise the zloty. EURPLN should hold above the lower end of the range amid uncertainty regarding Brexit that limits traders' activity and may overshadow the expectations for the state-owned BGK bank activity (zloty-positive) on the market at the very year-end.

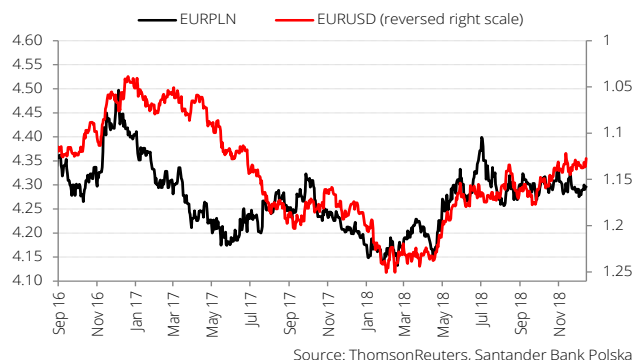
We think the risk factor to the stabilisation scenario is the Fed conference (see details below).

FI In our view, Polish data due to be released next week will show some deceleration of the economic activity, already seen in some survey indexes. As a result, we do not see much room for the yields rise. The 2Y and 10Y yields are at their lowest since 2016, i.e. before the yield's jump after Donald Trump won the presidential elections. Also the results of the last bond auction (debt for PLN4.6bn was sold) should keep yields low as the pricing proposed by the Finance Ministry was far from the market (this reflects strong liquidity position of the Ministry).

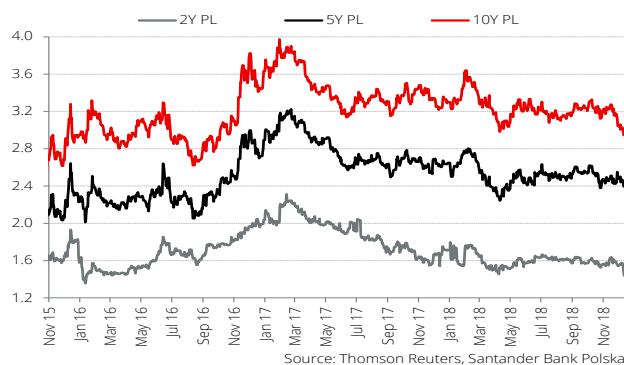
Wednesday's FOMC decision is a risk factor as there could be attempts to push US curve up before the meeting. Market will speculate how the updated economic forecasts will change vs the previous ones. However, the lack of strong positive trend in the recent month US data seems to give little chances for this scenario to materialize.

The beginning of the year may see some yields rise due to expectations for a higher net debt issuances than in late 2018. However, the scale of a potential rise should be limited amid expected low budget deficit at the end of 2018 and signals from the Ministry of Finance that the budget liquidity is very positive.

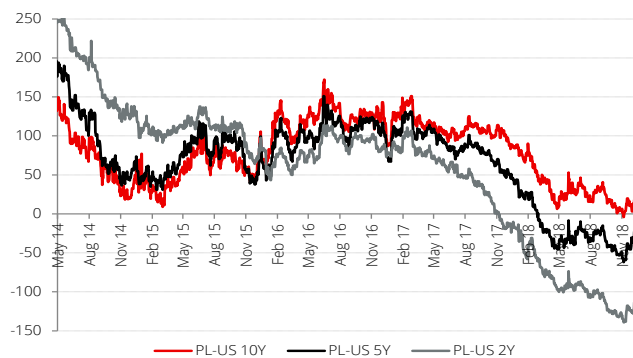
EURPLN and EURUSD



Yields of Polish t-bonds



Spread between Polish and US bonds



Spread between Polish and German bonds



Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE	
				MARKET	SANTANDER		
MONDAY (17 December)							
	PL	Central Budget Cumul.	Nov	PLNbn	-	3.1	6.5
11:00	EZ	HICP	Nov	% y/y	2.0	-	2.0
14:00	PL	CPI Core	Nov	% y/y	0.7	0.7	0.9
TUESDAY (18 December)							
10:00	DE	IFO Business Climate	Dec	pts	101.8	-	102.0
10:00	PL	Employment in corporate sector	Nov	% y/y	3.0	3.0	3.2
10:00	PL	Average Gross Wages	Nov	% y/y	7.2	7.0	7.6
14:00	HU	Central Bank Rate Decision	Dec-18	%	0.9	-	0.9
14:30	US	Housing Starts	Nov	% m/m	0.36	-	1.5
WEDNESDAY (19 December)							
10:00	PL	Sold Industrial Output	Nov	% y/y	4.6	3.3	7.4
10:00	PL	Construction Output	Nov	% y/y	18.4	10.8	22.4
10:00	PL	PPI	Nov	% y/y	3.2	2.8	3.2
16:00	US	Existing Home Sales	Nov	% m/m	-0.38	-	1.4
20:00	US	FOMC decision	Dec-18		2.5	-	2.25
THURSDAY (20 December)							
13:00	CZ	Central Bank Rate Decision	Dec-18		1.75	-	1.75
14:30	US	Initial Jobless Claims	Dec-18	k	226.49	-	206.0
14:30	US	Index Philly Fed	Dec		15.0	-	12.9
FRIDAY (21 December)							
10:00	PL	Retail Sales Real	Nov	% y/y	6.8	6.8	7.8
10:00	PL	Unemployment Rate	Nov	%	5.8	5.7	5.7
14:30	US	Durable Goods Orders	Nov	% m/m	2.0	-	-4.3
14:30	US	GDP Annualized	3Q	% Q/Q	3.5	-	3.5
16:00	US	Michigan index	Dec	pts	97.5	-	97.5
16:00	US	Personal Spending	Nov	% m/m	0.3	-	0.6
16:00	US	Personal Income	Nov	% m/m	0.3	-	0.5
16:00	US	PCE Deflator SA	Nov	% m/m	0.0	-	0.2

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg

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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.