

04 January 2019

Weekly Economic Update

Inflation unplugged

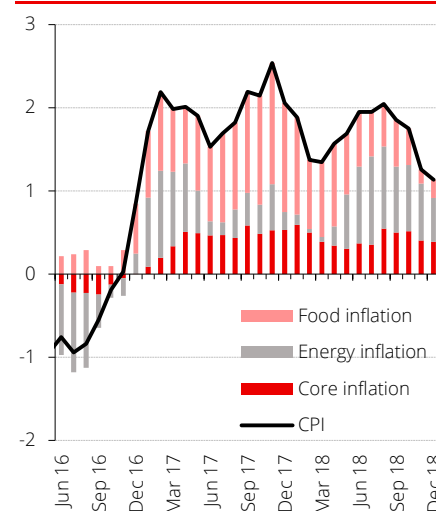
What's hot next week

- In the nearest week the financial markets will be mainly focused on events abroad – there is plenty of data releases in the euro zone and USA, which may deliver new hints regarding the scale of economic slowdown. We do not expect to see a reversal of negative trends from the past months. Investors will also watch the FOMC minutes from December meeting and the US administration's struggle to end the government shutdown.
- In Poland there are two events in the agenda: **MPC meeting (decision on Wednesday) and bond auction (Thursday)**.
- As regards the MPC meeting, there will be absolutely no surprise and the NBP Governor should repeat his declaration of interest rates stability at least until the end of 2019. The government's bill freezing electricity prices confirmed that the inflation forecast presented in the November's NBP projection was significantly exaggerated (which was quite obvious since the beginning). Our current inflation forecast predicts that both CPI and core inflation will be gradually mounting this year, but it may take even until December before they reach the 2.5% target. Therefore, the arguments for monetary tightening in Poland have definitely not grown any stronger since the previous meeting.
- The bond auction should not be the even that would shake the market, we think. The Ministry of Finance will offer bonds worth PLN3-6bn.

Market implications

- Financial markets have priced-in so much pessimism about the economic outlook that despite the likely next weak data releases we expect to see a profit taking on debt markets, resulting in upward move of bond yields. It could be additionally supported by hopes for a nearing compromise in ending the US government shutdown. As regards the FX market, weak European data should push EURUSD lower and so the zloty may weaken: EURPLN may move towards 4.34, although we do not expect this level to be breached in the nearest week.

Structure of inflation in Poland, % y/y



Source: GUS, Santander Bank Polska

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What's hot next week

MPC meeting will most likely be held once again in dovish tone. The law aimed at freezing electricity prices seems a good reason for the Council to turn away from the November projection (which assumed high path of energy prices, and yet it has not really affected the MPC stance) and to express satisfaction with the stability of monetary policy. What is more, the flash print of December CPI shows the internal inflationary pressure (due to GDP growth running above potential and tight labour market) is still not manifesting itself in higher core inflation.

Last two weeks in economy

Flash CPI was at 1.1% y/y in December, slightly above our forecast at 1% and vs 1.3% in November. Food prices accelerated to 0.9% y/y from 0.7%, probably mostly due to higher tendencies in grain products. According to our estimates, core inflation was at 0.6-0.7% y/y. In our view, this reading sets an inflation trough and CPI will climb throughout 2019, approaching 2.5% in December.

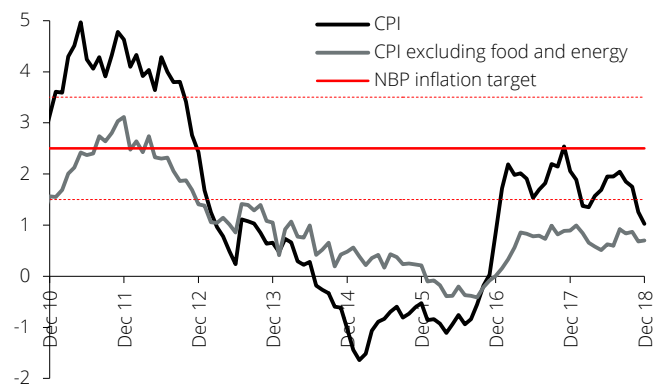
Polish PMI recorded a substantial decline in December, from 49.5 to 47.6, its lowest since April 2013. The report mentions a sharp decline in output and new orders. Respondents mentioned weaker demand from abroad, mainly from Germany. We expect the economic growth to decline somewhat in 2019 and the lower print of the PMI is coherent with this view. Still, we cannot exclude that a meaningful deterioration of mood in December was a result of other factors, like uncertainty related to the energy prices. Thus, in January the index may rebound somewhat. Notice that the GUS index of business sentiment in industry (based on broader sample than PMI) is enjoying a rebound after the August-October decline.

Data on **investment breakdown in 3Q18** showed a rebound in layouts on machinery and means of transport, which rose by 14.3% y/y, the fastest since the beginning of 2015. Investments in this category are strongly correlated with total enterprise investments, so the data suggest an improvement in investment activity in the private sector in 3Q18. Importantly, a similar conclusion could be drawn from data from large companies, with layouts growing c15% y/y in 3Q18. Investments in buildings rose 7.5% y/y (of which housing investments fell 4.1% y/y while other buildings rose 11.8% y/y with the latter category being connected mostly to public investments). We think that this year investments will be quite strong, mainly because of high expenditures from EU programs. At the same time, the outlook for private investments could worsen, so public institutions will remain the largest driver of investment growth in the Polish economy.

M3 money supply growth rose in November from 8.3% y/y to 8.8%. Household deposits grew the fastest in two years, by 9.5% y/y. Cash in circulation was up 11.3% y/y (the strongest pace in 1.5 years). FX-corrected loan growth was 6.4% y/y (strongest in almost four years). Consumer loans continued to grow at 9%+ y/y pace observed since February 2018. Mortgage loans grew at the strongest pace in four years (4.4% y/y, with PLN-denominated mortgage loans growing by 11.2% y/y). FX-corrected growth rate of enterprise credit stayed close to 6.5% y/y, the average for 2018. Rising credit should support the strong performance of the economy in 2019, but in our view will not prevent a gradual slowdown of private consumption, especially in 2H19.

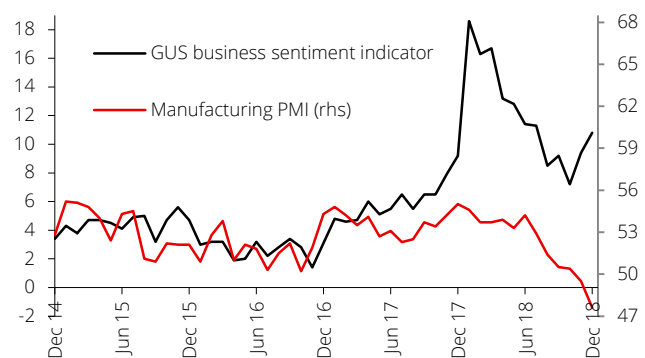
NBP data on **3Q balance of payments** showed a €2.53bn C/A deficit, €0.65bn larger than earlier NBP estimates. The data were different from the monthly estimates for the period mainly when it comes to primary income account (outflows were revised higher by more than €0.5bn). On the other hand, export of services was also revised higher by almost €0.5bn and import by €0.2bn. Revisions to trade balance of goods were more pronounced in 2Q18 (exports raised by €0.3bn and imports by €0.6bn) than in 3Q18 (slightly decreased exports and imports).

CPI and core inflation, %/y



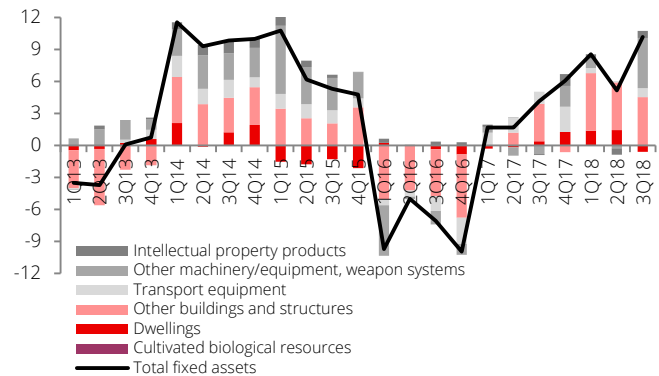
Source: GUS, NBP, Santander Bank Polska

Business sentiment measures for Polish industry



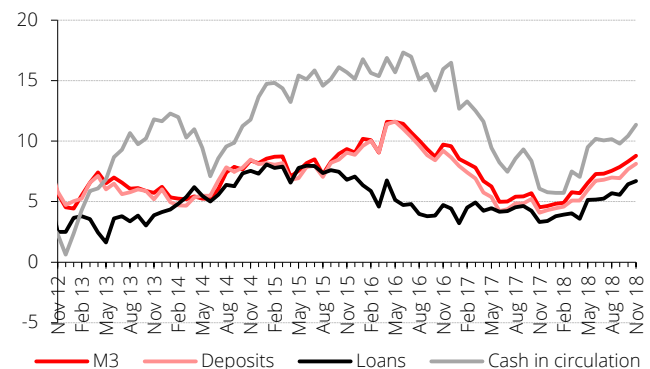
Source: GUS, IHS Markit, Santander Bank Polska

Structure of y/y investment growth



Source: Eurostat, Santander Bank Polska

Monetary aggregates, %/y



Source: NBP, Santander Bank Polska

FX and FI market

Last week on the market

FX EURPLN has been rising over the last two weeks, breaking through at a peak of 4.31, to quickly return slightly above the starting point. It was a reaction to low market liquidity and deterioration of global growth perspectives. As in the case of debt market, the zloty reacted most strongly to the increased volatility on stock exchanges around Christmas.

FI During Christmas yields of core and domestic markets bonds decreased dramatically. The bonds rally was fueled by high level of volatility of stocks market. The bond markets were also supported by decreases in oil prices as well as global growth fears, after most manufacturing surveys reading decreased. Domestic curve slid rapidly as a reaction to PMI-manufacturing data release for Poland (which dropped to 47.6pct). As a consequence over the last two-week period the yield curve has slid by 12-15bp in the 5-10Y segment. The front end of yield curve dropped by 10 bp. over Christmas, and then rebounded to the pre-Christmas level. The MoF announcement about low supply in January (PLN8-14bn) and 1Q19 (PLN20-30bn) created a positive background for domestic bonds..

Key events

This week we will get to see industrial orders and industrial production in Germany and Eurozone retail sales data. Most of released figures are likely to confirm the poor picture of Eurozone economy.

Across the pond, we will see the durable goods orders and FOMC minutes. Orders are likely to stay weak, where minutes should confirm switch in the FOMC stance to a less hawkish.

Domestic MPC conference will replicate the previous one.

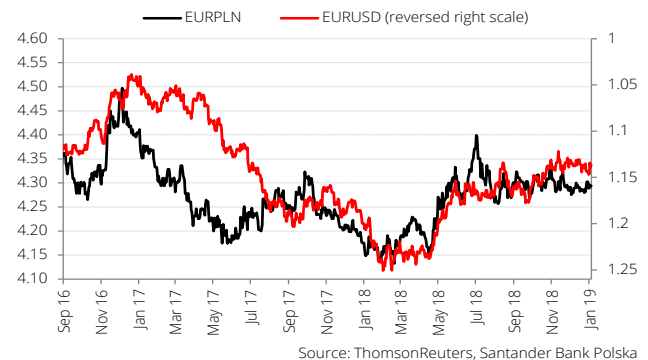
The Ministry of Finance plans to sell PLN3-6bn on the Thursday's auction, and they want to offer OK0521, PS0424, WZ0524, WS0428 and WZ0528 bonds.

Market implications

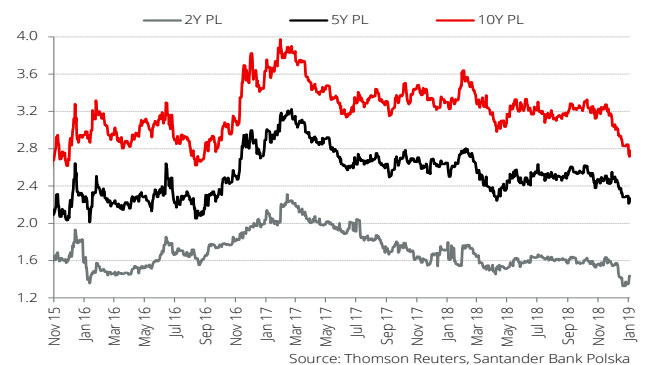
FX In our view EURUSD will be pushed down, owing to Eurozone poor macro data release and restore the confidence of market players in the interest rates hike in the US. Consequently we believe that the zloty will be negatively affected by lower EURUSD and poor Eurozone data. As a result, we think that EURPLN will march in the direction to 4.34, however we do not believe that this level will be beaten out in the coming week.

FI We believe that the data set scheduled for this week should support the further yields decreases, but in our opinion the market priced in most of poor news. Therefore, we believe that the publication of the data will be an opportunity for investors to take profits. In our opinion, the yields increases is likely to be supported by information about progress in talks to end of government shutdown. In our opinion, it should help to restore the market expectations for the interest rates hikes in the US (currently market prices in rate cuts). As a result, this should translate into increases of UST yields and, as a derivative, the increases of yields of domestic debt. In a month's perspective, we anticipate the domestic yield curve to move up by c10bps in the 5-10L segment in response to an expected end of government shutdown. The short end is likely to remain at the current level.

EURPLN and EURUSD



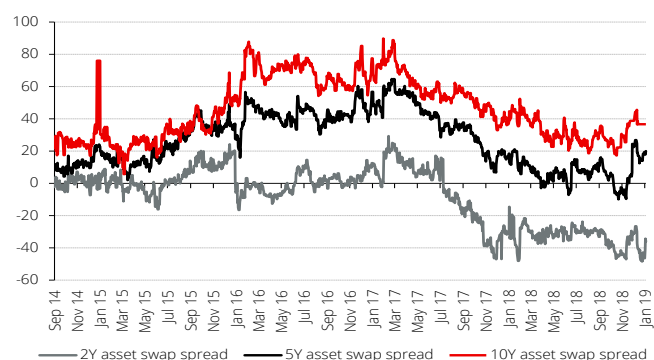
Yields of Polish t-bonds



Spread between Polish and German bonds



ASW spread (bp)



Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST		LAST VALUE
				MARKET	SANTANDER	
MONDAY (7 January)						
08:00	DE	Factory Orders	Nov	% m/m	-	0.3
08:00	DE	Retail Sales	Nov	% m/m	0.4	0.1
11:00	EZ	Retail Sales	Nov	% m/m	0.1	0.3
16:00	US	Durable Goods Orders	Nov	% m/m	0.0	0.8
16:00	US	ISM services	Dec	pts	-	60.7
16:00	US	Factory Orders	Nov	% m/m	0.3	-2.1
TUESDAY (8 January)						
08:00	DE	Industrial Production SA	Nov	% m/m	0.3	-0.5
09:00	CZ	Industrial Production	Nov	% y/y	4.9	6.7
09:00	HU	Industrial Production SA	Nov	% y/y	-	3.3
11:00	EZ	ESI	Dec	pct.	108.05	109.5
WEDNESDAY (9 January)						
	PL	MPC decision		%	1.5	1.5
08:00	DE	Exports SA	Nov	% m/m	-0.5	0.9
11:00	EZ	Unemployment Rate	Nov	%	8.0	8.1
20:00	US	FOMC Meeting Minutes	Dec-19		-	0.0
THURSDAY (10 January)						
09:00	CZ	CPI	Dec	% y/y	2.1	2.0
11:30	PL	Bond Auction			-	
14:30	US	Initial Jobless Claims	Jan-19	k	220.0	231.0
FRIDAY (11 January)						
09:00	CZ	GDP SA	3Q	% y/y	-	2.4
14:30	US	CPI	Dec	% m/m	-0.1	0.0

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg

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