22 February 2019

Weekly Economic Update

Awaiting negotiations' results

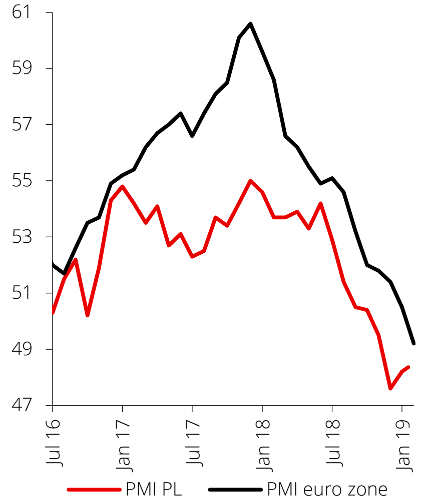
What's hot next week

- This week, we will get to see some interesting macro data that, however, should not trigger any meaningful market reaction. **Detailed 4Q18 GDP** will be released, of which much could have been concluded from the total 2018 release so this could excite only if some surprises appear. In case of the **PMI**, we have seen some improvement of the stat office indexes on the one hand and further drop of manufacturing PMIs in Germany and euro zone on the other hand. In these circumstances, stabilisation of the domestic PMI would be a quite good result (we assume the index rose slightly). The **Statistical Bulletin** could help to better assess the recent data, particularly those from the labour market. Moreover, the season of political **parties presenting their pre-elections programs** starts with the ruling Law and Justice meeting on Saturday 23 of February.
- March 1 is a deadline for the ongoing **US-China trade negotiations**. If there is no agreement reached, both sides will impose more bilateral tariffs. Information about the progress in talks has had some impact on the market. On Tuesday, PM **Theresa May is expected to report the progress** she has made re-negotiating the Withdrawal Agreement with the EU. Any suggestions that the Brexit date could be postponed might have been positively received by the market. Fed's governor will speak in the US Congress with his semiannual report on the central bank's activity and in the past this event was used to express a view on the monetary policy outlook. The market is already pricing a dovish shift so there could be a bigger reaction if Powell focuses on the positive side rather than stressing uncertainties. As regards the global data, investors are likely to focus on the US releases, particularly GDP, industrial orders and consumer incomes/spending. The impact of the government shutdown could be seen in these figures so the market would likely not be too optimistic ahead of these publications. In the euro zone, the flash inflation will be key.

Market implications

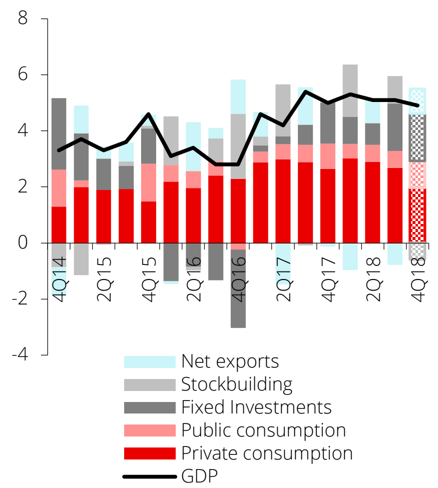
- EURPLN has stabilised after three weeks of a noticeable rise but given the fact that it is near crucial resistance (October's peak at c.4.35), the market may not remain clam for long. The recent domestic data may not be enough to pull the exchange rate lower while the global events (Brexit, trade talks) could make the market mood worse, pushing EURPLN up. On the debt market, this week may bring a correction after the recent yields' drop.

Manufacturing PMIs



Source: GUS, Santander

GDP growth breakdown, %



Source: GUS, Santander

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Last week in economy

Last week we got to see the **first data from the start of 2019**. So far they support our view that the Polish economy will be decelerating throughout 2019, wage growth and private consumption will remain quite strong and investment will be supported by public outlays. In our view, the Polish economy will face a rather soft landing in 1Q19 (we see GDP growth at 4.3% y/y versus 4.9% y/y in 4Q18), but the incoming data will be crucial to fine-tune the forecast. Such a development of economic situation will favour keeping interest rates unchanged throughout the year.

Actually, **comments of MPC members and minutes** from their February meeting support the view that rates are very likely to remain unchanged in 2019. It also seems that the MPC wants to strengthen the message that they can cut rates in case of a downturn rather than reverting to non-standard instruments. Especially, NBP president reiterated his earlier remarks that according to the newest studies, rate cuts would not hit the co-op banking sector as much as previously thought.

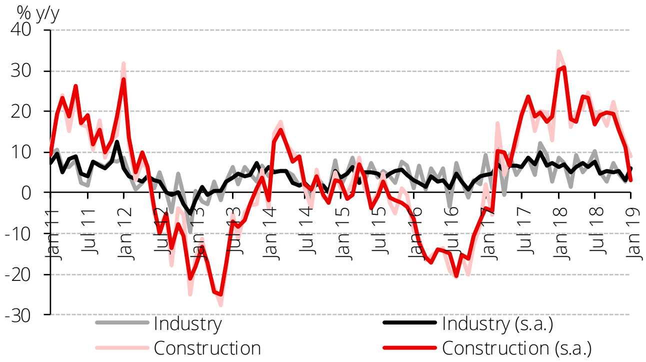
Based on the preliminary reading of CPI for January we know that: 1) electricity prices for households fell by about 5% m/m due to the 'electricity price freeze' act, 2) **core inflation jumped to 0.9-1.0% y/y**. The fall in energy prices is likely to be corrected soon, as the Parliament is amending the act after doubts expressed by the European Commission (it has already passed the lower chamber). As regards the core inflation, data on **deflator of retail sales** suggests that an unusual behaviour of clothing prices was responsible for the jump. Usually clothing prices fall by 3-4% m/m in January. This time, they remained most probably flat. In our view, this is either weather-related phenomenon (no price cuts of winter collections due to low temperatures) or a change in methodology. We assume that CPI will be climbing gradually this year along with core inflation, with both rising above 2% y/y and possibly above 2.5% (especially core inflation), by the end of 2019.

Industrial output expanded by 6.1% y/y in January. It was stronger than expected (consensus: 3.7%, our forecast: 5.5%) and in line with 2018 average. Seasonally-adjusted output advanced 1.7% m/m, confirming our call that the weak December (-0.4% m/m) was caused primarily by calendar effects. So far, Polish industry has not been affected much by the slowdown in Europe - export-oriented sectors had strong results and business sentiment index for industry improved in February. Still, we expect some slowdown to come, with output growth sliding to c3% y/y in 4Q19.

Construction output advanced by 3.2% y/y in January, markedly below expectations and 12.2% y/y in December. The result was most likely dragged lower by high statistical base of January 2018 as well as by severe weather conditions. Note however that civil engineering rose by 15.3% y/y and actually accelerated versus December (11.4% y/y). This is in our view mostly public investment related to EU funds, which we estimate to be close to its peak and to support construction in 1H19. Also, sectoral sentiment indicator was close to historical tops in both January and February.

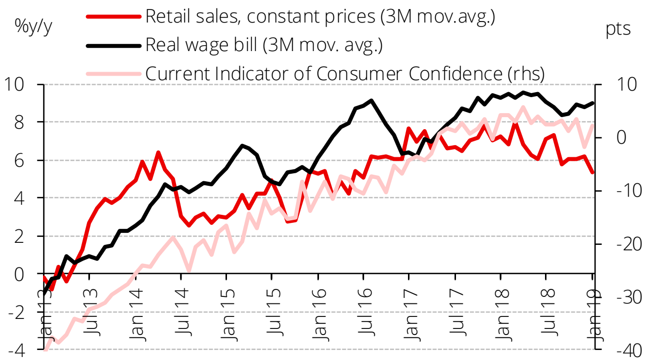
Retail sales in January also proved decent and added 5.2% y/y. Sales of durables returned to double-digit y/y growth. **Consumer sentiment indicators** increased slightly in February, continuing their rebound after a temporary decline at the end of 2018 (likely related to concerns regarding the surge in energy prices), and retail trade sector remains fairly optimistic about future demand. **Wage growth** also proved to be strong (6.5% y/y in constant prices in January, the highest since July 2008). In general, data suggest that private consumption will remain robust.

Output growth, % y/y



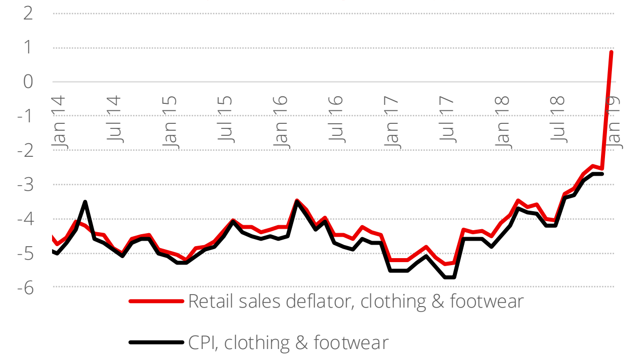
Source: GUS, Santander

Retail sales macroeconomic background



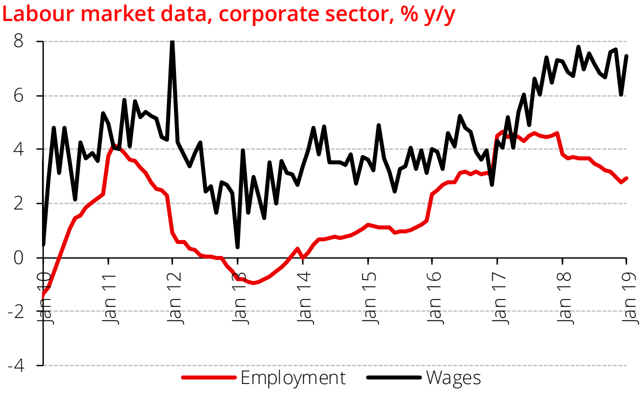
Source: GUS, Santander

Measures of clothing & footwear prices, %y/y



Source: GUS, Santander

Labour market data, corporate sector, % y/y



Source: GUS, Santander

FX and FI market

Last week on the market

FX EURPLN volatility was smaller than in the previous weeks, when the zloty was depreciating strongly, but EURPLN still managed to hit this year's high at 4.3450 during the last week. A halt of depreciation of the zloty was supported by EURUSD rebound (first in two weeks), growth in global stocks markets and solid domestic data releases. The potential for appreciation was limited by information about resumed work on the "CHF bill".

FI For the better part of last week, yields of domestic bonds have been decreasing, fuelled by euro zone central bankers remarks and poor macro data from Europe. At the end of the week, yields rebounded and wiped out part of weekly gains, owing to the news about some progress in the Sino-US trade negotiations. As a consequence, the domestic bond yield curve decreased by c4bp in the 5-10Y segment and increased by 1bp in the 2Y segment.

Key events

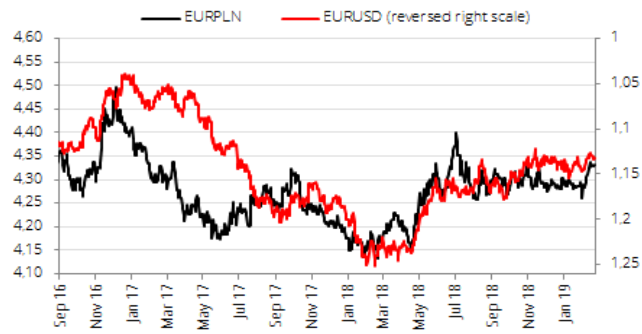
This week's calendar includes publication of Polish GDP data with its components for Q4 and domestic PMI for January. On the core markets we expect euro zone PMI data release and PCE price index in US. In our opinion, the GDP will not surprise the market, the domestic PMI should rebound slightly, while the PCE price index is likely to be below consensus. On Tuesday, the British PM Theresa May is to update MPs on EU-UK negotiations. A meeting of the Hungarian Central Bank is planned to take place on Tuesday, too. On Friday we will get to know ISM-manufacturing data.

Market implications

FX EURPLN has stabilised after three weeks of dynamic growth, but the proximity of important resistance might cause the stabilisation to be short-lived. In our opinion, the key factors for the zloty are Brexit voting, the US data and Hungary Central Bank meeting. Poland is expected to be one of the countries most affected by the "hard Brexit", and if the risk balance shifted in this direction the zloty could suffer. We see a potential for EURUSD growth, which would be beneficial for the zloty, but the US data will be important, especially PCE and ISM. A positive impulse may come from Hungary, where we expect further slight tightening of the central bank rhetoric. The meeting could result in the strengthening of the forint, which could be positive for the zloty. After a few months of stabilization, the increase in EURPLN was accompanied by an increase in implied volatility. We can still see the potential for further rebound of volatility, which may make EURPLN temporarily break important resistance.

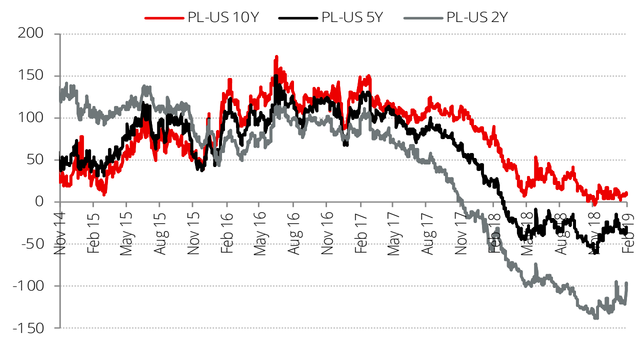
FI This week we expect a slight domestic yields rebound. GDP data is unlikely to be a surprise, but the breakdown of growth remains unknown. In our opinion, whether we are surprised to the upside by an investment growth or consumption growth, the reaction of the bonds market will be moderate. The serious bonds killer would be a strong rebound of domestic PMI, but we are afraid that due to the weak euro zone leading indicators data, the room for yields rebound is limited. As a result, we anticipate the domestic yield curve to tick up by 3-4bp with a little stronger move-up of the IRS curve. We believe that PCE price index data release (we do not expect surprise on the upside) will not have a major impact on the domestic bonds.

EURPLN and EURUSD



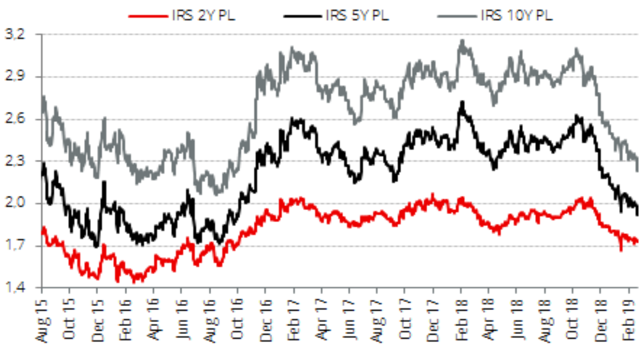
Source: ThomsonReuters, Santander Bank Polska

Asset Swap Spread (bps)



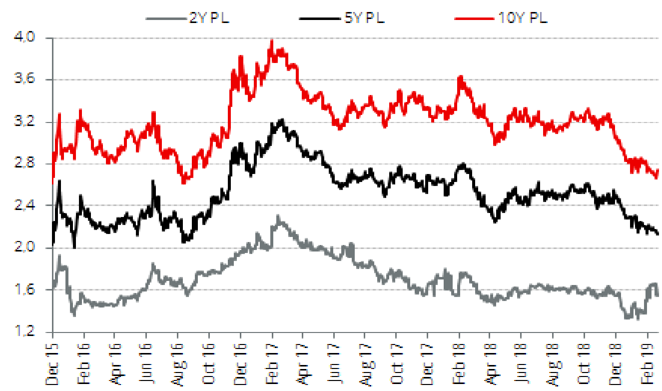
Source: Thomson Reuters, Santander Bank Polska

IRS rates (%)



Source: Thomson Reuters, Santander Bank Polska

Bond yields (%)



Source: Thomson Reuters, Santander Bank Polska

Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST SANTANDER	LAST VALUE
			MONDAY (25 February)				
10:00	**PL**	**Unemployment Rate**	**Jan**	**%**	**6.1**	**6.1**	**5.8**
			TUESDAY (26 February)				
14:00	HU	Central Bank Rate Decision		%	0.9	-	0.9
14:30	US	Housing Starts	Dec	% m/m	-0.5	-	3.2
16:00	US	Consumer Conference Board	Feb	pts	124.2	-	120.2
			WEDNESDAY (27 February)				
8:00	DE	Retail Sales	Jan	% m/m	1.6	-	-3.1
11:00	EZ	ESI	Feb	pct.	106.0	-	106.2
14:30	US	Durable Goods Orders		% m/m	1.7	-	1.2
16:00	US	Factory Orders	Dec	% m/m	1.4	-	-0.6
16:00	US	Pending Home Sales	Jan	% m/m	0.0	-	-2.2
			THURSDAY (28 February)				
08:00	DE	HICP		% m/m	-1.0	-	-1.0
10:00	**PL**	**GDP**	**4Q**	**% y/y**	**-**	**4.9**	**4.9**
14:30	US	GDP Annualized	4Q	% Q/Q	2.5	-	3.4
14:30	US	Initial Jobless Claims	week	k	228	-	216
			FRIDAY (1 March)				
09:00	CZ	GDP SA	4Q	% y/y	-	-	2.9
09:00	**PL**	**Poland Manufacturing PMI**	**Feb**	**pts**	**-**	**48.5**	**48.2**
09:00	HU	GDP	4Q	% y/y	0.0	-	5.0
09:30	DE	Germany Manufacturing PMI	Feb	pts	49.8	-	47.6
10:00	EZ	Eurozone Manufacturing PMI	Feb	pts	50.3	-	49.2
11:00	EZ	Flash HICP	Feb	% y/y	1.5	-	1.4
11:00	EZ	Unemployment Rate	Jan	%	7.9	-	7.9
14:30	US	Personal Spending	Dec	% m/m	0.3	-	0.4
14:30	US	Personal Income	Jan	% m/m	0.3	-	0.2
14:30	US	PCE Deflator SA	Dec	% m/m	0.0	-	0.1
16:00	US	Michigan index	Feb	pts	96.0	-	95.5
16:00	US	ISM manufacturing	Feb	pts	56.2	-	56.6

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg

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