

01 March 2019

Weekly Economic Update

New projections, new promises

What's hot next week

- There is a chance that the coming MPC meeting will be way more interesting than usual. First of all, NBP projections will be refreshed, most likely with a much lower CPI path than in the November edition. Secondly, the Council needs to build an internal consensus on how to treat and respond to the freshly announced set of pre-election promises from the ruling party, which are likely to boost private consumption starting from 2Q19, at the expense of a greater fiscal imbalance. This might be interesting as one of the staunch doves criticized the government plans for possibly overheating the economy. Thirdly, our estimates point to a significant rebound of core inflation in January - which to some members may mean a materialization of the inflationary pressure stemming from the high pace of economic growth and cost pressures on enterprises that squeezed their markups in 2018. Add to this that the governor has recently become more open to further rates cuts, but the fiscal expansion in our view takes monetary easing off the table.
- Additionally, the next week calendar includes the ECB meeting and releases of foreign data, with non-farm payrolls being key. As regards ECB, it would be crucial whether the statement and "forward guidance" on future rate hikes change. Forecasts for the euro zone, due for release by the ECB, are likely to be revised down after last week data. We are expecting the statement to be eased somewhat, yet the ECB will not decide to postpone its first hike (due throughout summer).

Market implications

- Presentation of the new pre-election PiS program made bond yields jump by a dozen basis points. Recent government declarations there will be no budget amendment and the still dovish policy of the MPC are arguments to reverse this move, yet the room for bond strengthening may be limited by upward move of core yields. We see some potential for a stronger zloty, thanks to slightly more hawkish than expected tone of the ECB statement, which may push EURUSD higher.

November NBP projection vs Santander forecasts (in parentheses)

	2018	2019	2020
CPI inflation	1.8 (1.6)	3.2 (1.6)	2.9 (2.7)
GDP growth	4.8 (5.1)	3.6 (3.8)	3.4 (3.4)

Source: NBP, Santander

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

Last week in economy

Today the Chancellery of the Prime Minister presented further details on the **pre-election package**. These are roughly in line with our assumptions and estimated presented in our **Economic Comment**. The "thirteenth" pension is to amount to PLN1100 gross and be paid to all old-age and disability pensioners. The government put estimate for that measure at PLN9-10bn per annum. Higher tax deductible costs (at least twofold) and lower first PIT bracket are to be introduced in the summer, "for sure" in this year. Estimated cost: PLN7-10bn. Taxpayers up to 26 year of age will see their 18% tax rate go down to 0% (i.e. 32% rate stays unchanged). The government wants to introduce that measure in 2019, but this is not a strong pledge. Estimate cost: PLN2-3bn. In general, we think that changes of tax rates during the year are difficult as they make it harder for regular tax payers to calculate their taxes, so we would rather expect these changes to come into force with start of 2020 (there is a possibility to make them effective from the start of 2019 on, but we would not bet on that). Reintroduction of local buses is to cost PLN800mn per annum and extension of 500+: PLN18.5bn. The government reiterated its earlier words that no budget amendment is planned and stated "there is high probability that the current budget will accommodate the planned spending". Our estimate of 2019 programme sits at PLN21bn gross. Net cost for the central budget is below PLN10bn (assuming that the "thirteenth" pension is in the Social Security Fund budget), which is actually very likely to fit into this year's budget.

It seems straightforward that for the sake of proper policy mix a looser fiscal policy should be countered with more stringent monetary policy. Indeed, the announcement of fiscal measures triggered **several responses from the MPC** (Łukasz Hardt, Eugeniusz Gatnar, Jerzy Żyżyński – the latter being considered a dove) signalling more openness to discussing rate hikes within one year and one showing unchanged stance (Rafał Sura).

Data on **4Q18 GDP** confirmed the deceleration of growth shown in the preliminary release, to 4.9% y/y from 5.1% y/y and to 0.5% from 1.6% in SA q/q terms. The slowdown of private consumption was less pronounced than we had expected – from 4.5% y/y to 4.3% (and not below 4%). This category should be supported in the following quarters not only by strong labour market – with wage growth ex mining returning to 7.4% y/y, one of the highest growth rates since 2008 – and very high consumer optimism, but also by the newly announced pre-election package. Investments growth also declined in 4Q, from 9.9% y/y to 6.7% and we are still in the period of peak inflow of EU funds so there should not be a large slowdown down the road. Despite the deteriorating business sentiment in the euro zone, the main trading partner, there was no build-up of inventories in Poland (of unsold goods) and net exports contributed positively to GDP growth (by 0.2pp). The data confirm some economic slowdown, but are in line with our expectations that the slowdown in 2019 should be gradual, and GDP growth on average will come down not much below 4%.

The behaviour of **ESI business climate indicators** in February match our expectations about GDP path. There was a major improvement in consumer sentiment, but indices for manufacturing, services and retail trade remained at a low level. Only the construction sector showed an improvement in current operations, industry is now the most pessimistic about current and future output in two years. However the GUS measure of new export orders value showed a rebound at the start of the year (11% y/y after two weaker months). This is in contrast with February **PMI** report (down from 48.3 pts to 47.6, the lowest since early 2013), which stressed further deterioration of export orders, from Germany in particular, and a large build-up of inventories despite current production being reduced.

Cost estimates of pre-election package to public finances, PLNbn

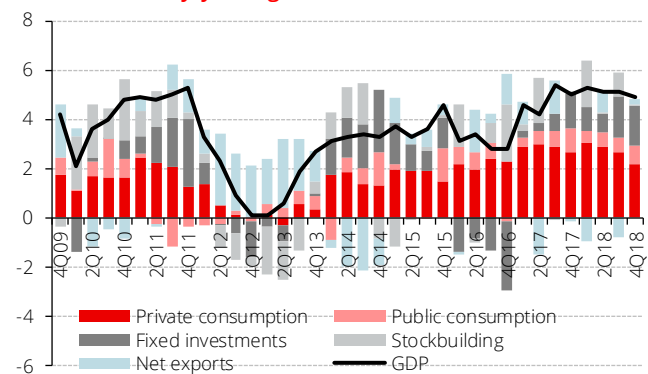
	Base case*		Maximum case**	
	2019	2020	2019	2020
Extension of 500+	9.2	18.5	9.2	18.5
13th pension	10.2	-	10.2	10.5
No PIT for the young	-	2.5	1.2	2.5
PIT 17%	-	8.0	3.0	8.0
Higher tax-deductible costs	1.7	3.5	1.7	3.5
Local buses	-	1.0	0.5	1.0
Gross total	21.1	33.5	25.8	44.0
To return in taxes	3.0	4.0	4.0	6.0
Net total (PLN bn)	18.1	29.5	22.0	38.0
Net total (% GDP)	0.8%	1.3%	1.0%	1.6%

* base case is what we consider the most likely implementation

** In the maximum case we assume all promises to be delivered by mid-2019, and in 2020 the 13th pension will be paid again.

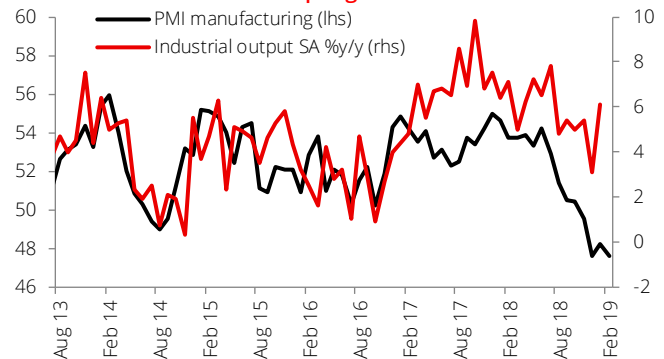
Source: Chancellery of the Prime Minister (KPRM), Santander

The structure of y/y GDP growth



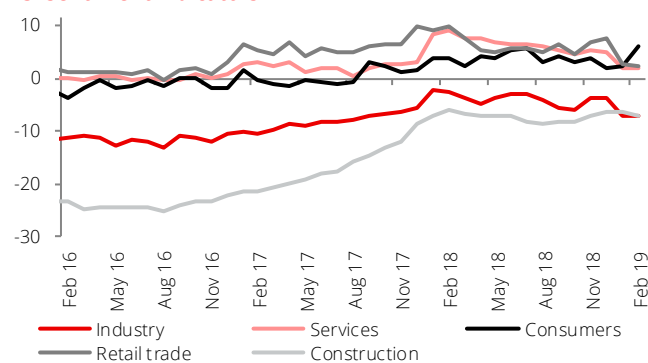
Source: GUS, Santander

PMI indications vs actual output growth



Source: GUS, IHS Markit, Santander

ESI sentiment indicators



Source: European Commission, Santander

FX and FI market

Last week on the market

FX EURPLN fell after five consecutive weeks of a rise and touched 4.30, USDPLN dropped to 3.77 from 3.82 and CHFPLN to below 3.79 from 3.82. GBPPLN rose temporarily above 5.05 reaching its highest since April 2017. The Polish currency gained vs the euro, dollar and franc thanks to the market stabilisation after the Saturday's PiS new spending proposals, rising EURUSD and hawkish rhetoric of the Hungarian central bank. GBPPLN rose as the pound was backed by the recent developments on the Brexit front.

FI The new spending plans presented by PiS on Saturday triggered a sharp jump of Polish bond yields at the beginning of the passing week. The long end and belly of the curve skyrocketed by c22bp and the 2Y segment moved 8bp up. The respective changes on the IRS curve were c23bp and 9bp. After the government said that there would be no need to amend the budget and the European Commission said it would not look at the spending proposals now, the pace of rise eased.

Key events

The ECB meeting and the US monthly job report should be the most awaited events of the coming week.

In January, Mario Draghi refrained from changing the ECB's forward guidance suggesting that central bankers would like to see the new economic projections first. In March, members of the ECB will have the updated estimates at their disposal and there should be no surprise if the GDP path will be revised down.

The market is expecting that the pace of job creation in the US faded somewhat after the very strong January.

Market implications

FX EURPLN rebounded from the key resistance level and now the risk of a more noticeable and persistent zloty depreciation has decreased. The exchange rate has returned to the 4.26-4.34 range we have been observing since August.

We are of the opinion that the EURUSD reaction to the outcome of the ECB meeting will be key for EURPLN this week. We think the tone could be somewhat more cautious than in the previous months but the central bank could try not to scare investors much. Particularly, we think the ECB will not withdraw from the scenario of a rate hike though it may suggest it could be delivered in late 2019 rather in 2Q/3Q.

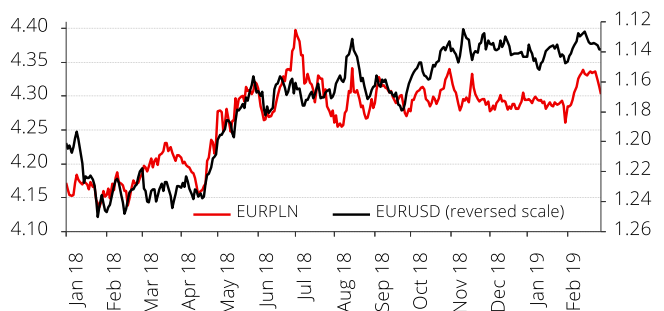
Should this be the case, EURUSD could jump and generate a pressure for EURPLN to fall.

FI Polish bond yields reached their fresh 2019 peaks but like we have written above, the IRS curve shifted at a similar scale and the assets swap spread did not rise meaningfully. Apparently, it seems that the rise in uncertainty related to the fiscal policy outlook (as more spending proposals may be on the table) did not make investors price more credit risk.

The European Commission said that it would not analyse the impact of the new spending plans now and the government officials still claim there will be no budget amendment. Recall that since PiS took the power in 2015, it has delivered generous social benefits that have been financed by the better tax collection. Perhaps investors still give the government some credit given this positive past performance.

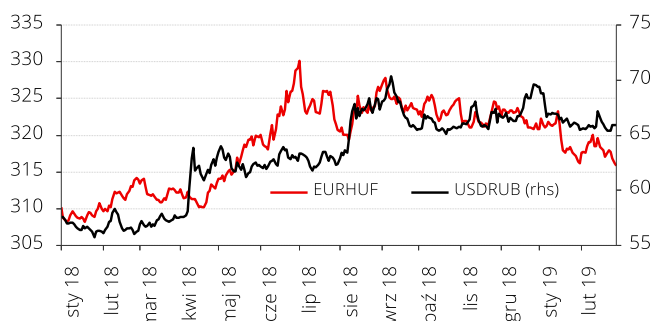
Nevertheless, we think that this week it could be tough for the Polish bonds to gain noticeably since we see risk that the outcome of the ECB meeting might generate an upside pressure on the global yields. However, we think the domestic debt could perform better than its core peers thanks to the still solid budget performance and the fact that this year's gross borrowing needs are covered in 52%.

EURPLN and EURUSD



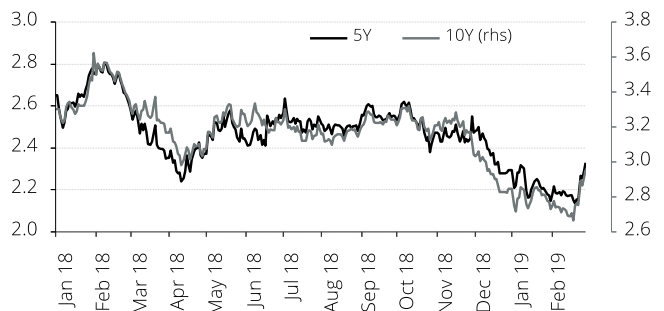
Source: Thomson Reuters Datastream, Santander Bank Polska

EURHUF and USDRUB



Source: Thomson Reuters Datastream, Santander Bank Polska

Poland bond yields



Source: Thomson Reuters Datastream, Santander Bank Polska

Poland asset swap spreads



Source: Thomson Reuters Datastream, Santander Bank Polska

Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD	FORECAST			LAST
				MARKET	SANTANDER	VALUE	
MONDAY (4 March)							
No important events							
TUESDAY (5 March)							
02:45	CN	Caixin China PMI Services	Feb	pts	54.0	-	53.6
09:55	DE	Markit Germany Services PMI	Feb	pts	-	-	55.1
10:00	EZ	Eurozone Services PMI	Feb	pts	-	-	52.3
11:00	EZ	Retail Sales	Jan	% m/m	-	-	-1.6
16:00	US	ISM services	Feb	pts	57.2	-	56.7
16:00	US	New Home Sales	Dec	% m/m	0.9	-	16.9
WEDNESDAY (6 March)							
	PL	MPC decision		%	1.50	1.50	1.50
14:15	US	ADP report	Feb	k	182	-	212
16:00	US	Durable Goods Orders	Feb	% m/m	-	-	1.2
16:00	US	Factory Orders	Feb	% m/m	0.6	-	-0.6
THURSDAY (7 March)							
09:00	HU	Industrial Production SA	Jan	% y/y	-	-	5.7
11:00	EZ	GDP SA	4Q	% y/y	-	-	1.2
13:45	EZ	ECB Main Refinancing Rate		%	-	-	0.0
14:30	US	Initial Jobless Claims	week	k	222	-	216
FRIDAY (8 March)							
08:00	DE	Factory Orders	Jan	% m/m	-	-	-1.6
09:00	HU	CPI	Feb	% y/y	-	-	2.7
14:30	US	Change in Nonfarm Payrolls	Feb	k	168	-	304
14:30	US	Unemployment Rate	Feb	%	3.8	-	4.0

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.