

31 May 2019

Weekly Economic Update

Inflation to rise again

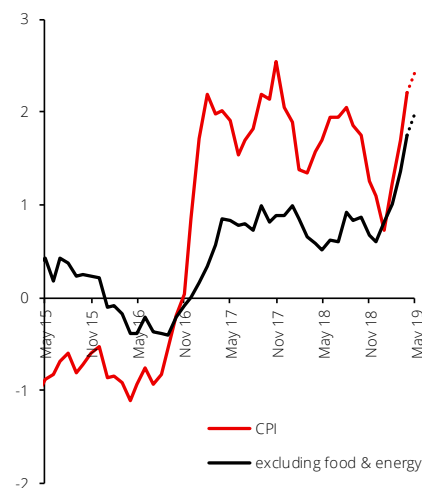
What's hot next week

- After the slight positive surprise from the GDP data side, this week we will see if there are any signals of a deeper economic slowdown in 2Q. Polish economy appears to be very resilient to the lower economic activity abroad and we think May manufacturing PMI will confirm that.
- However, in terms of a market-mover, the flash May CPI should be more important than PMI. We expect the pace of the prices growth accelerated further to 2.4% y/y in May. The headline estimate will be released just a day before the MPC meeting but this shall not have much impact on the Council's rhetoric.
- Globally, the outcome of the ECB meeting should be crucial for the market in the coming week. The euro zone central bankers last met in April and since then some crucial factors have emerged – Donald Trump' plans to impose tariffs on the European auto sector and on Mexican goods, rather poor manufacturing PMIs. Thus, one should not be surprised if the ECB wording remains cautious and soft.
- Next to the fresh update from the monetary policy front, we will see a number of the US data – manufacturing ISM and monthly nonfarm payrolls. The manufacturing index is now at its lowest since late 2016 where it fell after having been resilient for the better part of 2018 to the plummeting PMIs in Europe. Employment in the nonfarm sector recorded a healthy growth in the last two months.

Market implications

- We think the outcome of the ECB meeting and still shaky global market mood imply that EURUSD could move down further. As a result, stronger dollar, might be negative for the zloty and its EM peers.
- We think Polish IRS and bond yields could stay low in the coming days and any rise in response to the further rise of inflation should be only short-lived. The ECB rhetoric should remain dovish which could provide fuel for the rates down trend.

CPI and core inflation, %y/y



Source: GUS, 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

The streak of positive surprises with real activity has not ended. 1Q GDP growth managed to surprise positively again (the higher-than-expected flash reading was revised up in the final release). The tiny budget deficit after April was another positive surprise. Also, much happened on the political front: the European elections, details on OFE overhaul, PIT rate cut, and energy price freeze were released.

GDP growth in 1Q19 reached 4.7% y/y (vs 4.6% flash reading). There was a surge in fixed investments by 12.6% y/y (we assume private sector played an important part here) and net exports' contribution was positive (+0.7pp). Private consumption growth (3.9% y/y) disappointed with the worst result since 2Q16, but will be boosted in the coming quarters by higher social transfers so we do not worry about its outlook. We have recently revised our 2019 GDP growth forecast to 4.3% (see our May [MACROscope Lite](#)).

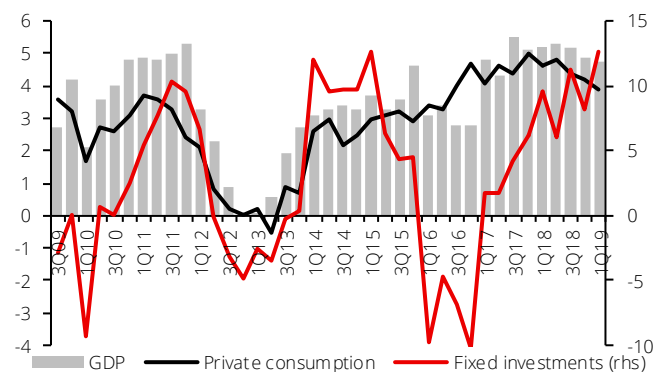
May MPC minutes confirmed no major changes in the Council's bias, despite the recent comments from several members questioning the forward guidance to keep rates unchanged until the end of the current term. The GDP data are also unlikely to change the MPC's view – growth is stronger than expected but the breakdown is less inflationary (slower consumption, higher investments implying higher productivity growth in future).

Polish budget deficit shrank from PLN4.5bn after March to just PLN0.08bn after April. Total revenues in April alone were up 8.1% y/y, with another strong rise in CIT (34.5% y/y), but a marginal nominal y/y decline in VAT collection (for now we assume that the 2019 budget will be close to the planned amount of PLN28.5bn, but the VAT part adds some uncertainty). Total expenditures were 15.6% higher y/y due to a 66% higher transfer from the central budget to the Social Security System.

The large, almost 7pp advantage of the ruling party vs KE, the coalition of opposition parties, in **the European Parliament election** (45.38% vs 38.47%) theoretically means there is no need for the government to augment the fiscal package before autumn general elections. Still, government officials have just explained that a more generous version of the promised PIT cut will be implemented (with full replacement of the 18% bracket with a 17% rate, this would cost PLN2.1bn more than the version shown in the Convergence Program Update). A draft bill on pension system overhaul was also released, complementing the earlier proposals with some details that suggest higher asset transfers from equity markets to bonds.

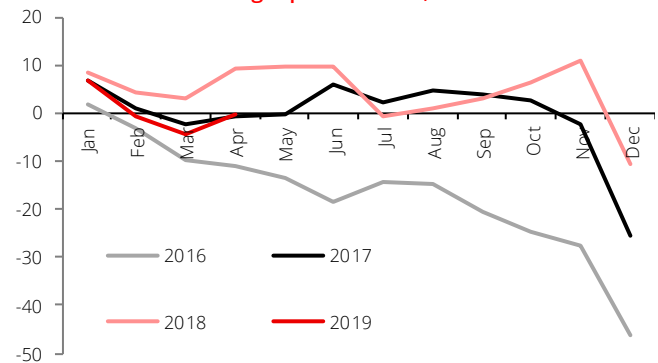
After talks with the European Commission, the Ministry of Energy announced that in 1H19 energy suppliers will be obliged to maintain prices from mid-2018 and compensate consumers for any **energy price hikes**. Energy suppliers, on the other hand, will be compensated from a state fund. In 2H19, households will still pay net prices at 2018 levels and the same will apply to the public sector and micro/small companies. Medium and big companies (employing 50 people or more on average and recording revenues above EUR10mn total in two years) will be charged with market prices and then will be eligible to apply for a state compensation based on the *de minimis* rule. According to the latter, the state help granted to a company cannot exceed EUR200k in three years. So far, we had assumed that companies will see rising energy costs in 2020. Thus, these changes pose upward risk for our CPI forecast, which assumes reaching 3% y/y at the end of 2019 and with the 2020 average close to 3% y/y.

GDP growth structure, %/y



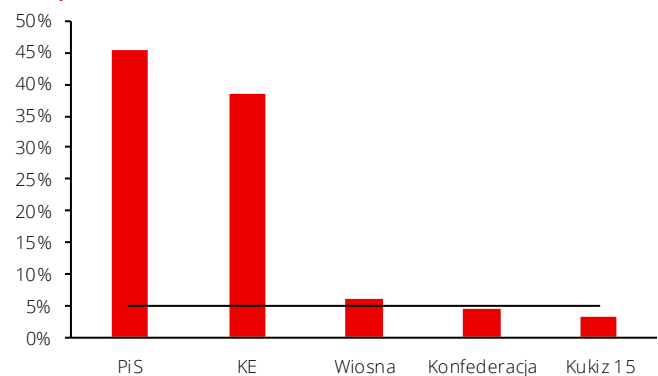
Source: GUS, Santander

Cumulative central budget performance, PLNbn



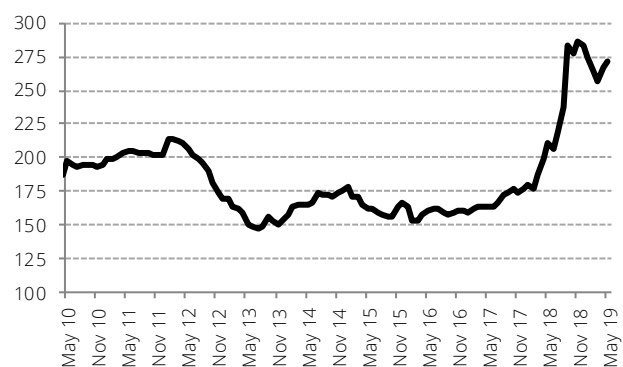
Source: Ministry of Finance, Santander

European Parliament election results in Poland



Source: PKW, Santander

Forward contracts for electricity, PLN/MWh



Source: PKW, Santander

FX and FI market

Last week on the market

FX Swings of the global market sentiment were the main driver for the zloty in the passing week. Since waves of optimism were interrupted by the resurfacing concerns about the global economic growth, EURPLN was moving sideways around 4.29. USDPLN rose above 3.86 for a while as the dollar gained vs main currencies. GBPPLN remained low close to 4.85 as the pound was under pressure of market pricing higher risk of a hard Brexit after the PM May announced she will resign.

FI Polish bond yields and IRS remained in the down trend amid poor global market mood that pushed the 10Y Bund yield to the new all-time low at c-0.21% and thanks to the positive state budget data. As a result, Polish 10Y IRS has neared this year's low at below 2.2% from March, and the 5Y rate is slightly above its 2019 bottom at 1.89%.

Key events

The outcome of the ECB meeting should be crucial for the market in the coming week. The euro zone central bankers last met in April and since then some important factors have emerged – Donald Trump's plans to impose tariffs on the European auto sector and on the Mexican goods, rather poor manufacturing PMIs. Thus, one should not be surprised if the ECB wording remains cautious and soft.

Next to the fresh update from the monetary policy front, we will see a number of the US data: manufacturing ISM and monthly nonfarm payrolls. The manufacturing index is now at its lowest since late 2016 where it fell after being resilient for the better part of 2018 to the plummeting PMIs in Europe. Employment in the nonfarm sector recorded a healthy growth in the last two months.

Poland flash May CPI should be more important than the manufacturing PMI. Pace of the prices growth gained steam in the last couple of months and this should be in the centre of attention of the domestic investors.

Market implications

FX We think the outcome of the ECB meeting could weigh on the euro and EURUSD – hovering relatively not that much below the levels seen before the last central bank sitting – could near this year's low at 1.11 that was reached in the previous week. Stronger dollar, in turn, might be negative for the zloty and its EM peers.

Aside of that, the global market mood remains shaky and only robust hard data from Europe and US could try to ease tensions. However, the survey indicators do not give much hope for this to happen at least in the coming week.

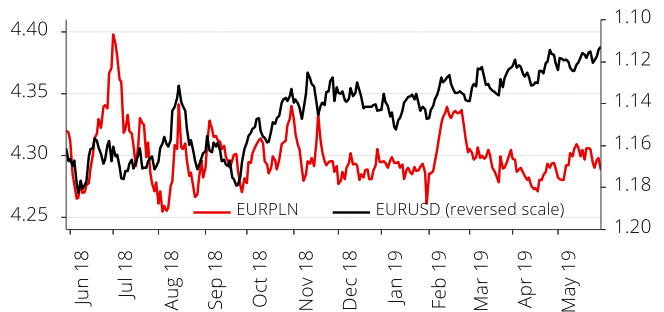
FI In the recent weeks, Polish bonds rallied amid strengthening on the core markets, solid state budget performance and still robust internal macro data that reduced the credit risk in light of a rise of spending announced by the government.

We think Polish IRS and bond yields could stay low in the coming days and any increase in response to the further rise of inflation should be only short-lived.

The ECB rhetoric should remain dovish which could provide fuel for the rates down trend.

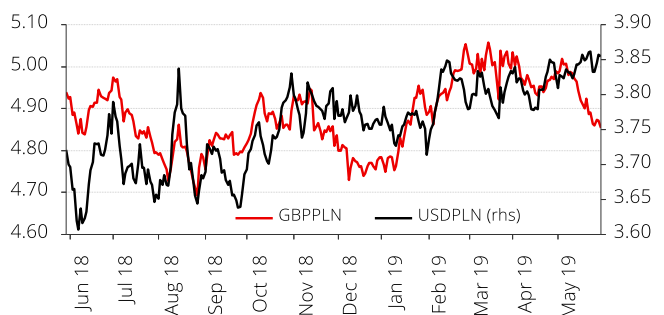
The 5Y and 10Y bond yields set their fresh 2019 lows and now have the door open for the further drop. The 2016 bottoms at 2% and 2.57% are now the first levels where the yields downward move could pause.

EURPLN and EURUSD



Source: Thomson Reuters Datastream, Santander Bank Polska

GBPPLN and USDPLN



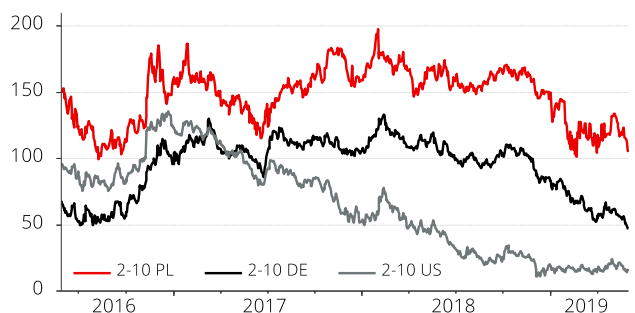
Source: Thomson Reuters Datastream, Santander Bank Polska

Asset swap spreads (bp)



Source: Thomson Reuters Datastream, Santander Bank Polska

2-10 yield spreads (bp)



Source: Thomson Reuters Datastream, Santander Bank Polska

Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST		LAST
					MARKET	SANTANDER	VALUE
MONDAY (3 June)							
09:00	PL	Poland Manufacturing PMI	May	pts	49.0	49.4	49.0
09:55	DE	Germany Manufacturing PMI	May	pts	44.3	-	44.3
10:00	EZ	Eurozone Manufacturing PMI	May	pts	47.7	-	47.7
16:00	US	ISM manufacturing	May	pts	53.0	-	52.8
TUESDAY (4 June)							
10:00	PL	CPI	May	% y/y	2.4	2.4	2.2
11:00	EZ	Flash HICP	May	% y/y	1.3	-	1.7
11:00	EZ	Unemployment Rate	Apr	%	7.7	-	7.7
16:00	US	Durable Goods Orders	Apr	% m/m	0.0	-	-2.1
16:00	US	Factory Orders	Apr	% m/m	-1.0	-	1.9
WEDNESDAY (5 June)							
	PL	MPC decision		%	1.50	1.50	1.50
03:45	CN	Caixin China PMI Services	May	pts	54.2	-	54.5
09:55	DE	Markit Germany Services PMI	May	pts	55.0	-	55.0
10:00	EZ	Eurozone Services PMI	May	pts	52.5	-	52.5
11:00	EZ	Retail Sales	Apr	% m/m	-0.4	-	0.0
14:15	US	ADP report	May	k	180	-	275
16:00	US	ISM services	May	pts	55.7	-	55.5
THURSDAY (6 June)							
08:00	DE	Factory Orders	Apr	% m/m	0.0	-	0.6
09:00	CZ	Industrial Production	Apr	% y/y	2.7	-	0.1
09:00	HU	Industrial Production	Apr	% y/y	6.7	-	8.0
11:00	EZ	GDP	1Q	% y/y	1.2	-	1.2
13:45	EZ	ECB Main Refinancing Rate		%	0.0	-	0.0
14:30	US	Initial Jobless Claims	week	k	215	-	215
FRIDAY (7 June)							
08:00	DE	Exports	Apr	% m/m	-0.9	-	1.6
08:00	DE	Industrial Production	Apr	% m/m	-0.5	-	0.5
09:00	HU	CPI	May	% y/y	3.8	-	3.9
14:30	US	Change in Nonfarm Payrolls	May	k	185	-	263
14:30	US	Unemployment Rate	May	%	3.6	-	3.6

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.