07 June 2019

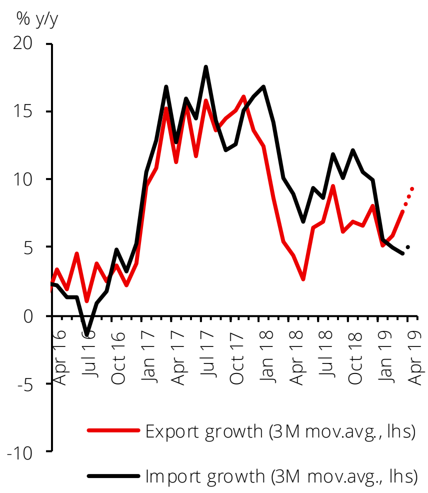
Weekly Economic Update

Central banks ready to act

What's hot next week

- After a pretty interesting week – with the ECB presenting updated economic forecasts, Donald Trump giving a strong hint that the new front in the trade war could be opened soon and the US market becoming even more aggressive in pricing rate cuts – the coming days could be somewhat calmer. There will be only a limited number of data releases.
- We forecast **Polish exports and imports reaccelerated** in April after the March slowdown. Domestic April industrial output surprised to the upside after it had recorded its highest y/y growth since July 2018, even though, German exports disappointed strongly in April. The boost of Polish retail sales should help imports to rebuilt after a sharp deceleration in March. All in all, the C/A balance improved further, in our view, and recorded a nearly €1bn surplus in April. **Final May CPI** release shall not surprise much but will help us to fine-tune our core inflation estimate (currently at 1.6-1.7% y/y).
- Abroad, the market attention shall focus on the US releases, particularly May inflation. The market expects pace of the prices growth decelerated first time since February. The retail sales and industrial output have been trending somewhat down in the recent months while the Michigan consumer confidence index is at its highest since September. The US interest rate market is pricing more than 25bp rate cut in next 6 months, a 50bp cut in next nine months, and a 75bp cut in 12 months fuelled by growth concerns related to the ongoing trade wars.

Export and import, %y/y



Source: NBP, Santander

Market implications

- EURPLN has neared the lower end of the 4.26-4.34 range in which it has been holding since August. So far in the 2Q, the zloty is in the top four of the strongest EM currencies vs the euro and the dollar but we do not think there is much room for more gains. Global economic outlook remains gloomy and the Polish MPC is rather not eager to respond to further rise of inflation. Thus, we think that EURPLN is more likely to rise rather than to fall from the current levels.
- Polish 5Y and 10Y bond yields are now at their lowest levels since April 2015 and the 10Y yield spread vs Bund has reached its lowest since February 2019. Global stock indexes rebounded somewhat after the May sell-off but so far this did not prevent core bonds from gaining. This week, we are rather unlikely to see any signals that could improve the global economic outlook and trigger profit taking after the recent yield's free-fall. In Poland, the bond switch auction will be held. Lack of standard auction scheduled for June should favour demand at the Thursday's switch which in turn could be a positive factor for the market. Longer FRAs are now trading below the 3M WIBOR but we do not think any further drop could be justified.

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

Data released in the passing week in Poland did not provide us any strong reason to change our view regarding the economic and monetary policy outlook. CPI stayed in the gradual up trend and has been downplayed by the MPC. Polish May manufacturing PMI ticked down but it has not been following the industrial output for a long time already. At the same time, core debt markets became more aggressive in pricing Fed rate cuts amid Donald Trump plans to open the new front in the trade war (with Mexico). Interestingly, global equities rose despite these concerns. The ECB has apparently also resisted the market pressure as the 2019 GDP forecast have been revised up and 2020 and 2021 have been cut only slightly.

The MPC kept interest rates unchanged, as expected, with main rate at 1.50%. The conference did not bring much to the monetary policy picture: the NBP President Adam Glapiński reiterated that rates are likely to remain unchanged until 2022. Glapiński is optimistic about the economic growth and sees above 4.5% this year, but at the same time acknowledges risks stemming from abroad. NBP president is expecting CPI inflation to climb to about 3% at the end of the year and then to decline. In our view, **in 2020** CPI will hold above the target longer than the MPC assumes and this might **spur some discussion about the rate hike** or the market could start pricing such scenario.

In May, **Polish manufacturing PMI** fell to 48.8, from 49.0. The three main components: new orders, production and employment rose vs the previous month but held below 50pts. The factors that were responsible for index decline were: shortening of delivery times and drop of inventories. As regards the new orders, external ones are still lagging behind domestic. The survey also shows weakening of inflationary pressure. The PMI survey still paints quite gloomy outlook for the Polish industrial sector but we have to remember that it has been a very poor predictor for trends in real data over the past two years. Therefore, we are not very much concerned about the Polish manufacturing, and believe that **industrial output growth** remained close to 9% y/y in May and should be **above 5% in 2H19**.

Poland flash May CPI was at 2.3% y/y, less than consensus and our forecast (2.4%). The rise from 2.2% y/y in April was caused mainly by food prices; their contribution to y/y CPI growth increased by 0.4pp to 1.2pp. GUS also noted a slight decline in energy prices and a mild rise in fuel prices. These data suggest core inflation stabilised or fell to 1.6% y/y from 1.7% y/y. Before the flash May release we assumed there would be a rise of core inflation to 2.0% y/y. The poor supply of vegetables, bad weather for this year's crops, and ASF disease are pushing food prices higher. The likely decline in core inflation may be linked to the surprisingly sharp increase of transport services prices in April, probably a holiday-related one-off, that could already disappear from the data. We think CPI growth **could approach 3% y/y at the end of 2019,** with upside risk caused by government plans not to provide significant financial support for energy purchases by mid-sized and large enterprises in 2H19.

Finance minister Teresa Czerwińska was replaced by Marian Banaś, who served as deputy finance minister and chief of National Revenue Administration (tax police).

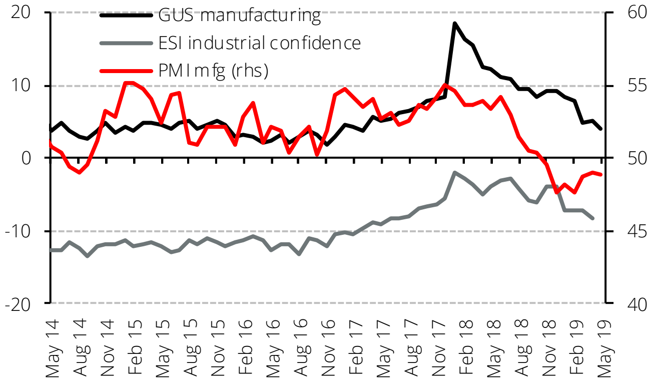
Dziennik Gazeta Prawna daily informed that the government wants to introduce changes in PIT earlier than outlined in the Convergence Programme Update and in a way that they will be felt by taxpayers immediately (so costs weigh on this year's budget – at least PLN2.5bn, according to the newspaper). At the same time, the government is still mulling by how much to increase the tax-deductible expenses and it is likely that the final proposal will be less generous than planned. Furthermore, PM Morawiecki informed that expectations about further benefits from improved tax collection went up and can reach PLN30bn (vs total of PLN17bn assumed for 2019-2020 in the April's Convergence Programme Update) thanks to the GDP growth and the government's rising ambitions in this respect.

ECB projections: Jun'19 vs Mar'19 (in brackets)

	2019	2020	2021
GDP	1.2 (1.1)	1.4 (1.6)	1.4 (1.5)
CPI	1.3 (1.2)	1.4 (1.5)	1.6 (1.6)

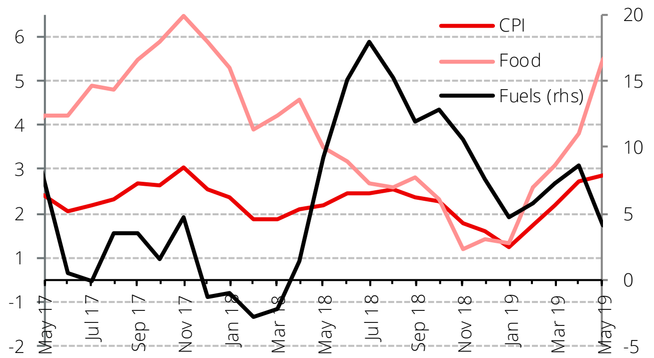
Source: ECB, Santander

Activity in Polish manufacturing



Source: Markit, European Commission, GUS, Santander

Inflation indicators, % y/y



Source: GUS, Santander

FX and FI market

Last week on the market

FX Rise of EURUSD, pretty good mood on the global equity market and significant strengthening of the Polish bonds pushed EURPLN down to 4.27 and USDPLN to 3.78, both to their lowest since mid-April. The zloty appreciated also vs the pound (for the fifth week in a row) and the franc (to 3.81).

FI Polish bond yields stayed in the strong down-trend amid the core market pricing rate cuts in the US as president Trump intends to open the new front in the trade war (with Mexico). Domestic factors did not have a direct impact on the market but the unexpected drop of PMI and below-consensus flash May CPI provided convenient environment for the Polish bonds. Change of the finance minister was ignored by the market.

Key events

The next week's calendar is pretty light in terms of the data releases. In Poland, we will see April balance of payments and final May CPI and these should be fairly market-neutral.

Abroad, the investors' attention shall focus on the US releases, particularly May inflation. The market expects pace of the prices growth decelerated first time since February. The retail sales and industrial output have been trending somewhat down in the recent months while the Michigan consumer confidence index is at its highest since September. The US interest rate market is pricing more than 25bp rate cut in next 6 months, a 50bp cut in next nine months, and a 75bp cut in 12 months fuelled by growth concerns related to the ongoing trade wars.

Market implications

FX EURPLN has neared the lower end of the 4.26-4.34 range in which it has been holding since August. So far in the 2Q, the zloty is in the top four of the strongest EM currencies vs the euro and the dollar but we do not think there is much room for more gains.

Global economic outlook remains gloomy and the Polish MPC is rather not eager to respond to further rise of inflation. Thus, we think that EURPLN is more likely to rise rather than to fall from the current levels.

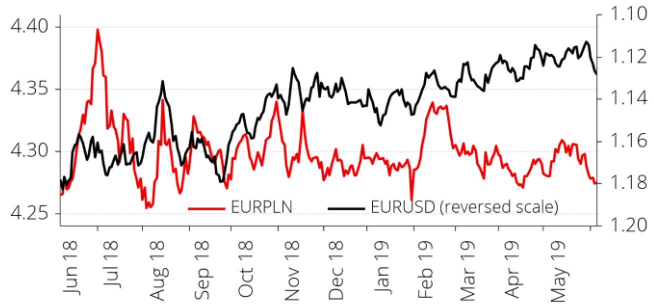
EURPLN fell for the third week in a row and last time that series was longer was in March 2017.

FI Polish 5Y and 10Y bond yields are in the down trend since early May already and have reached their lowest levels since April 2015. The 10Y yield spread versus Bund has reached its lowest since February 2019.

Global stock indexes rebounded somewhat after the May sell-off but so far this did not prevent core bonds from gaining. This week, we are rather unlikely to see any signals that could improve the global economic outlook and trigger profit taking after the recent yield's free-fall. In Poland, the bond switch auction will be held. Lack of standard auction scheduled for June should favour demand at the Thursday's switch which in turn could be a positive factor for the market.

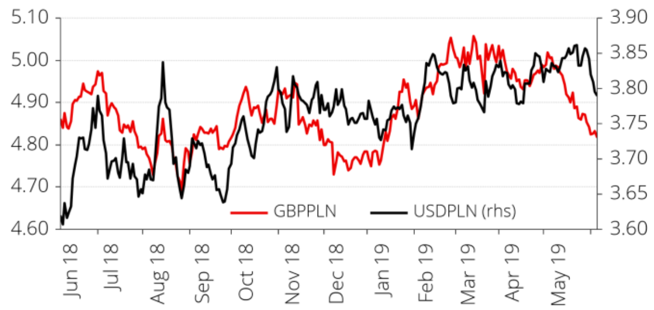
Longer FRAs are now trading below the 3M WIBOR but we do not think any further drop could be justified.

EURPLN and EURUSD



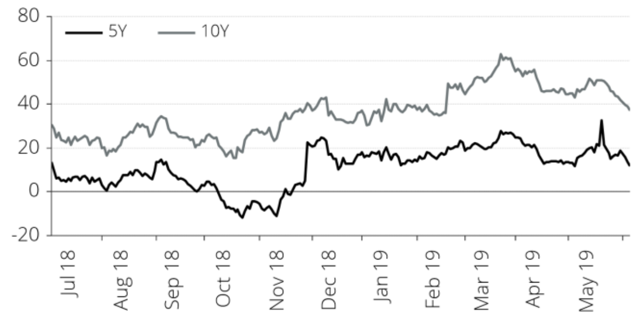
Source: Thomson Reuters Datastream, Santander Bank Polska

GBPPLN and USDPLN



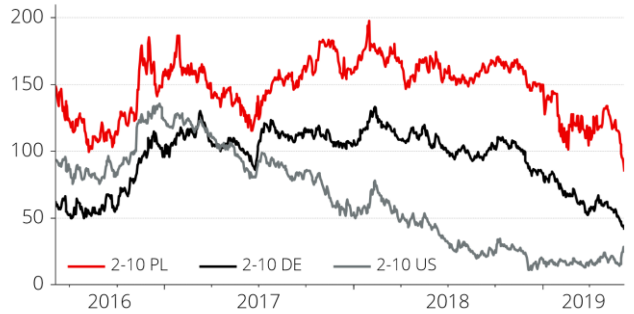
Source: Thomson Reuters Datastream, Santander Bank Polska

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 MARKET	FORECAST SANTANDER	LAST VALUE
			MONDAY (10 June)				
			No important events				
			TUESDAY (11 June)				
09:00	CZ	CPI	May	% y/y	2.8	-	2.8
			WEDNESDAY (12 June)				
14:30	US	CPI	May	% m/m	0.1	-	0.3
			THURSDAY (13 June)				
11:00	EZ	Industrial production	Apr	% m/m	-0.2	-	-0.3
14:00	**PL**	**Current Account Balance**	**Apr**	**€mn**	**595**	**944**	**533**
14:00	**PL**	**Trade Balance**	**Apr**	**€mn**	**425**	**499**	**589**
14:00	**PL**	**Exports**	**Apr**	**€mn**	**19 517**	**19 430**	**19 654**
14:00	**PL**	**Imports**	**Apr**	**€mn**	**19 104**	**18 931**	**19 065**
14:30	US	Initial Jobless Claims	week	k	-	-	218
			FRIDAY (14 June)				
10:00	**PL**	**CPI**	**May**	**% y/y**	**2.3**	**2.3**	**2.2**
14:30	US	Retail Sales Advance	May	% m/m	0.6	-	-0.2
15:15	US	Industrial Production	May	% m/m	0.2	-	-0.5
16:00	US	Flash Michigan index	Jun	pts	97.0	-	100.0

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg

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.