28 June 2019

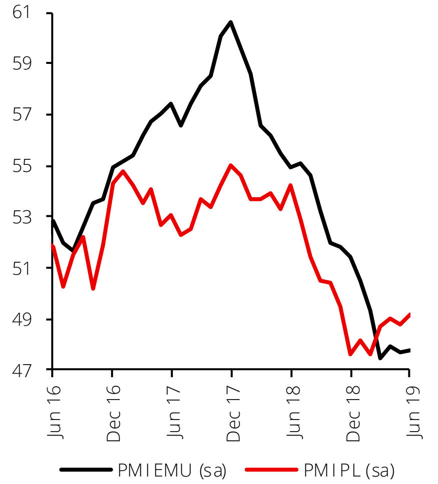
Weekly Economic Update

Post-summit blues

What's hot next week

- The beginning of July will likely be influenced mainly by comments after the G20 summit. Market sentiment after the weekend will depend on the results of US-China trade talks and whether the result will be further escalation of conflict or a (temporary) cease fire and bigger changes for a compromise. If talks fail, the new US tariffs on Chinese imports may jump in on July 2nd.
- Just after the summit in Osaka, the EU leaders are scheduled to meet in order to try to fill in the main posts in the European institutions. From the market point of view, the key issue is who will replace Mario Draghi as the new ECB governor. It seems quite likely, however, that the talks on this issue will be prolonged.
- As regards the data releases, the key publication will include the US non-farm payrolls on Friday, and before that indicators of US manufacturing activity: new orders and ISM. PMI indicators in Europe are not likely to introduce much more, as we already know the flash readings.
- In Poland the manufacturing PMI index will be released, and is likely to show a slight rebound to 49.2, in our view.
- On Wednesday, the MPC meeting will end. The result is quite obvious – interest rates will remain unchanged. The tone of the Council is likely to remain dovish and the NBP Governor Adam Glapiński will probably put even more emphasis than before on the uncertain outlook for global economy, which justifies stable interest rates in Poland. The MPC will get the new economic projection of the central bank, which in our view will show a bit higher GDP growth trajectory again. Inflation path is also likely to be revised up in the nearest quarters (due to higher starting point and incorporation of unfreezing of energy prices) and may even exceed the upper end of band around inflation target at the turn of 2019/2020. However, in the medium and long run the predicted inflation is likely to converge towards the NBP target, similarly as it did in the November's version of the projection.

Manufacturing PMIs



Source: Markit, Santander

Market implications

- We think that G20 summit will not bring a clear breakthrough in US-China trade talks, which may result in another wave of risk aversion and worries about world economic outlook. As a result, the zloty may weaken and bond yields could decline. Dovish tone of Polish MPC and NBP Governor should be supportive for debt market as well, although in general the local data and information are likely to be overshadowed by global trends.

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 two weeks in economy

CPI inflation climbed to 2.6% y/y in June (consensus: 2.4%, our forecast: 2.5%) and was above the NBP target for the first time since 2012. The rise from 2.4% y/y in May was mostly due to higher food prices and, most likely, hikes in communication prices (the GUS did not show this number yet). According to our estimate, core inflation excluding food and energy prices climbed from 1.7% /y to 1.8-1.9% and was also the highest since 2012. CPI path might flatten now but will later resume the upward trend to exceed 3% y/y at the turn of 2019 and 2020, in our view.

There was a strong acceleration in May of the value of **foreign new orders** from c10% y/y to 20.2%. Domestic orders were also growing decently as the total went up by 18.3%. Since the turn of the year domestic orders grew faster than foreign ones, the gap in their growth rates seems to be closing now. This suggests the underperformance of the euro zone economy may continue to have a limited impact on Polish industry.

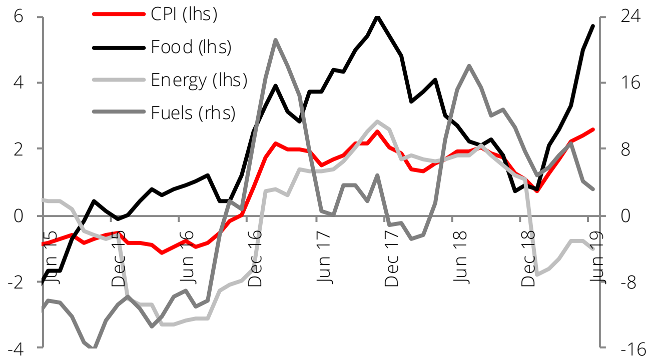
The June set of ESI **economic sentiment indicators** showed an improvement of the main index to 103pts from 101.1pts. This was due to a higher consumer optimism given new social transfers (expectations about own financial situation improved markedly) while business sectors showed mainly a continuation of downward trend. Some optimism was shown by the current industrial output trend indicator, which was at the year's top. GUS sentiment indicators confirmed these developments.

May data on **wages and employment** in the corporate sector seem a reflection of how tight the labour market has become. Employment growth surprised to the downside (2.7% y/y, the weakest since early 2016, in m/m terms this was the weakest May since 2009) while wages grew more than expected: 7.7% y/y vs. 7.1% market median. Wages ex mining rose from 7.0% to 7.7% y/y, the highest level so far in this cycle (such pace was previously seen in 2009). Real wage bill remained close to 8% y/y vs 9-percent average for 2018.

Retail sales disappointed by growing 5.6% y/y in real terms in May vs. 6.9% market consensus and our 6.5% forecast. What surprised us negatively were the non-durable goods categories (possibly more consumers chose to travel abroad during Poland's long weekend in early May). Once again, durable goods categories showed very strong performance, 16.6% y/y – the highest since April 2016. We see no reason to worry about the outlook for private consumption, as we expect a boost in the coming months from rising disposable income (new social transfers in addition to already rapidly rising labour income).

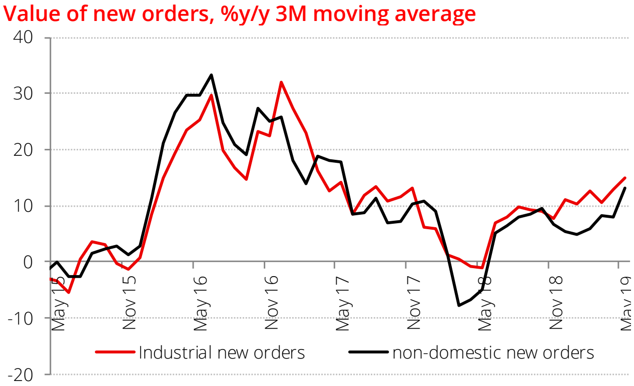
Industrial output in May rose by 7.7% y/y which was less than 7.5% market consensus and our 8.7% estimate. In seasonally-adjusted terms, growth of 5.1% y/y was recorded – the lowest this year. Interestingly, export-oriented auto production saw the highest growth since November 2017, 12.6% y/y. **Construction output** rose 9.6% y/y in May, well below market consensus (14% y/y) and our forecast (16.6% y/y). The slowdown comes after a series of very strong data and despite the help from calendar effects. We expect construction output growth to decelerate further in the coming months and quarters as a result of having passed the peak of EU funds absorption as well as the capacity limits of the sector. Together with below-expectations readings for industrial production and retail sales, the May data suggest that despite a strong performance in April, the pace of GDP growth in 2Q19 will be slightly lower than in the first quarter, likely around 4.5%.

Inflation and main components, %y/y



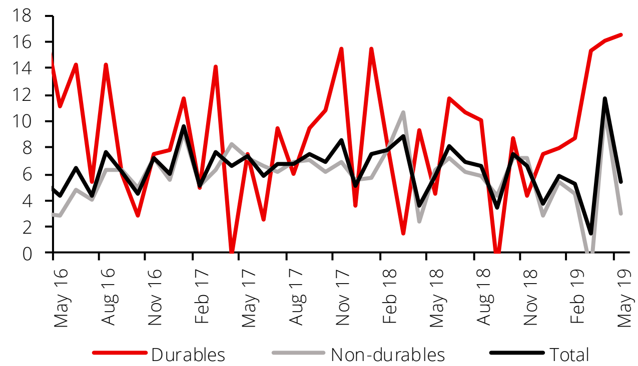
Source: GUS, Santander

Value of new orders, %y/y 3M moving average



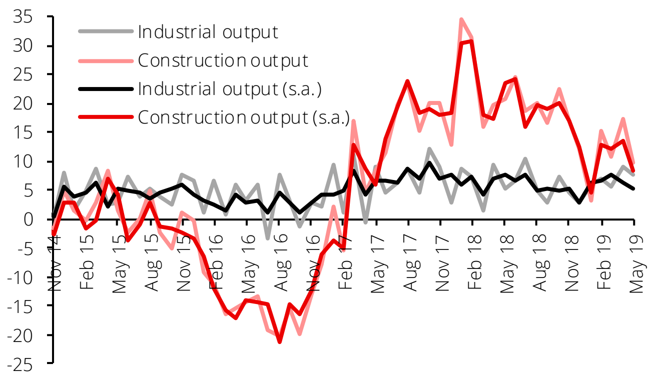
Source: GUS, Santander

Retail sales, constant prices, %y/y



Source: GUS, Santander

Production, %y/y



Source: GUS, Santander

FX and FI market

Last two weeks on the market

FX Over the course of last two weeks EURUSD climbed from below 1.12 to 1.14, driven mostly by better market sentiment connected to higher optimism about Sino-US trade talks as well as by weaker US data, supporting market bets for an interest rate cuts by the Fed. Draghi's suggestion of further stimulus in the euro zone and escalation of USA-Iran conflict had only temporary impact on the markets. EURPLN was oscillating in 4.25-4.27 range and ended the week close to the lower end of this range thanks to more sanguine investor sentiments.

FI in the previous week Polish bond yields were trending down, mostly thanks to expectations for rate cuts in the USA and further stimulus in the euro zone. The short end of the curve was relatively stable, while changes on the longer end were more visible, bringing 10Y yield to 2.30%, and the 2-10Y spread below 80pts, both being the lowest level since 2015. Some profit-taking took place and higher risk demand drove yields towards 2.40%. Changes on the IRS curve were less considerable.

Key events

G20 summit is the key event as Donald Trump and Xi Jinping are to hold talks on trade relations. Potential comments on tariffs are likely to affect the market sentiments. If talks fail, new tariffs may jump in on 2 July. The EU leaders are scheduled to meet in order to try to fill in the main posts in the European institutions, including the ECB. This week also the European Commission may decide to open a disciplinary procedure against Italy, but in our view it is more probable that this decision will be passed on to the new term. In the United Kingdom, Boris Johnson and Jeremy Hunt will continue their campaigns to become head of the Conservative Party. Johnson's victory will increase the market-perceived probability of a hard Brexit.

US non-farm payrolls will be the key release of the week, after the disappointment in May the analysts are not overly optimistic about the reading. Earlier we will get to see the ADP report and ISM-manufacturing. PMIs for Germany and the euro zone are also due for release, but they are unlikely to gather much attention as flash data was already released.

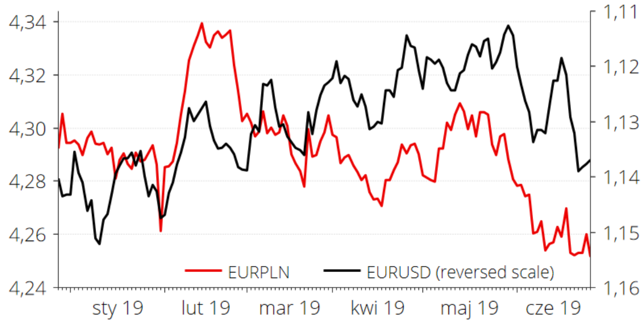
In Poland, we will get to see PMI in manufacturing (we are expecting a minute increase) and the MPC meeting. Flash CPI showed that inflation grew above the target for the first time since 2012, and MPC members will be surely asked about this fact during the press conference, but in our view the NBP president Adam Glapiński will stick to his usual rhetoric: rates are likely to remain unchanged until the end of the current MPC term. The MPC statement will reveal main assumptions of the July inflation projection. In our view, both CPI and GDP paths are likely to go up.

Market implications

FX Even though last week saw some optimism about Sino-US talks, there is not much evidence that a deal will be struck. Thus, a disappointment and rising probability of new tariffs are likely to increase the risk aversion and support the dollar, driving EURUSD lower and EURPLN higher. Especially as the zloty has gained over the last few years, creating an opportunity for some profit-taking.

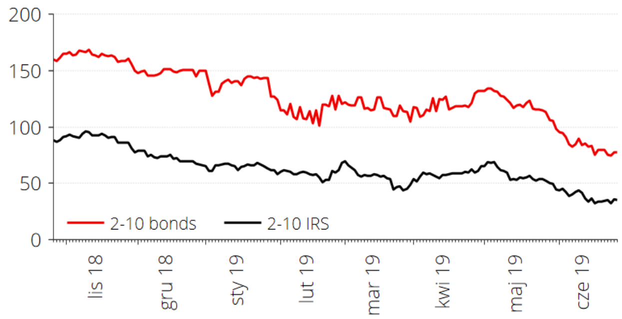
FI worries about trade wars and potential disappointments in US data could drag bond yields lower, especially given the recent rise of expectations for a deal after publications in the Chinese press that a "tentative truce" was agreed. A deal, on the other hand, could trigger a strong wave of risking take-on, but this is not our baseline scenario.

EURPLN and EURUSD



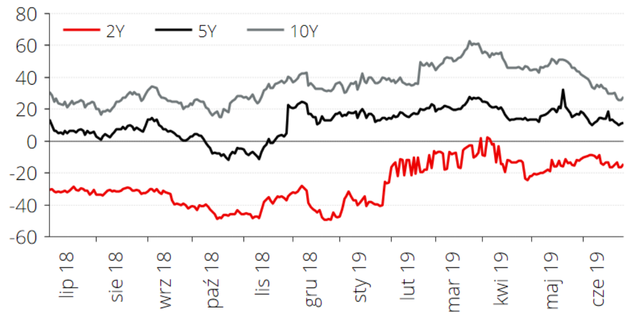
Source: Thomson Reuters Datastream, Santander Bank Polska

2-10 spreads (bp)



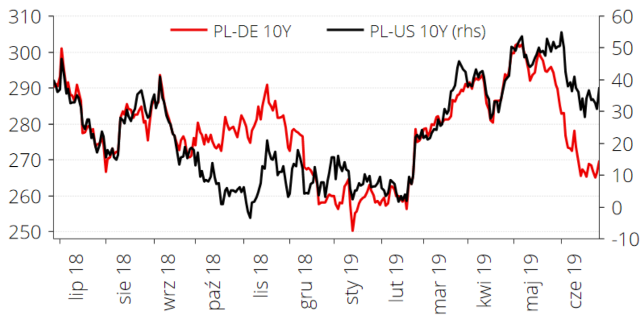
Source: Thomson Reuters Datastream, Santander Bank Polska

Asset swap spreads (bp)



Source: Thomson Reuters Datastream, Santander Bank Polska

10Y bond spreads to Bund and UST (bp)



Source: Thomson Reuters Datastream, Santander Bank Polska

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Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST SANTANDER	LAST VALUE
			MONDAY (1 July)				
03:45	CN	Caixin Manufacturing PMI	Jun	Pts	50.1		50.2
09:00	**PL**	**Poland Manufacturing PMI**	**Jun**	**pts**	**49.0**	**49.2**	**48.8**
09:55	DE	Germany Manufacturing PMI	Jun	pts	45.4		44.3
10:00	EZ	Eurozone Manufacturing PMI	Jun	pts	47.8		47.7
11:00	EZ	Unemployment Rate	May	%	7.6		7.6
16:00	US	ISM manufacturing	Jun	pts	51.2		52.1
			TUESDAY (2 July)				
08:00	DE	Retail Sales	May	% m/m	0.5		-1.0
			WEDNESDAY (3 July)				
	PL	**MPC decision**		**%**	**1.50**	**1.50**	**1.50**
03:45	CN	Caixin China PMI Services	Jun	pts	52.6		52.7
09:55	DE	Markit Germany Services PMI	Jun	pts	55.6		55.4
10:00	EZ	Eurozone Services PMI	Jun	pts	53.4		52.9
14:15	US	ADP report	Jun	k	140.0		27.4
14:30	US	Initial Jobless Claims	Jun.19	k	220		227
16:00	US	Durable Goods Orders	May	% m/m	-0.3		-1.3
16:00	US	ISM services	Jun	pts	56.0		56.9
16:00	US	Factory Orders	May	% m/m	-0.4		-0.8
			THURSDAY (4 July)				
11:00	EZ	Retail Sales	May	% m/m	0.4		-0.4
			FRIDAY (5 July)				
08:00	DE	Factory Orders	May	% m/m	-0.1		0.3
09:00	HU	Industrial Production SA	May	% y/y	5.0		6.0
14:30	US	Change in Nonfarm Payrolls	Jun	k	162.5		75.0
14:30	US	Unemployment Rate	Jun	%	3.6		3.6

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg