05 July 2019

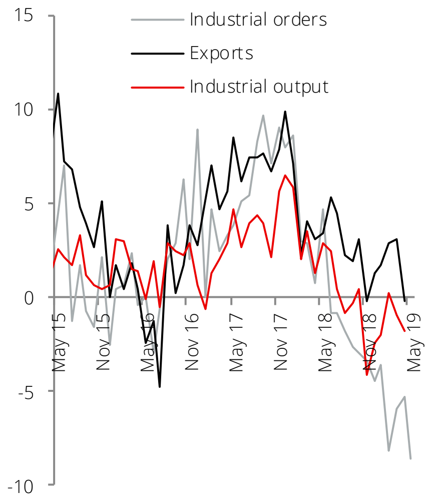
Weekly Economic Update

Time for profit taking

What's hot next week

- The sigh of relief after G20 summit where Donald Trump made half a step back in the US trade dispute with China by easing restrictions vs. Huawei, putting on hold the next tranche of tariffs and heralding continuation of talks, did not last long. First of all, soon after the event a news came about new US tariff threats against the EU. Secondly, there were further weak data from Europe and the USA which strengthened expectations of global monetary policy easing. Thirdly, these expectations were boosted by information on nominees for key posts at the ECB (Lagarde) and the Fed (Shelton, Waller). As a result, the wave of bond yield declines prevailed, before it crashed against today's stronger-than-expected US employment data.
- The next week calendar of foreign data publications will be rather sparing. At the start of the week the attention will focus on data from Germany (May's exports and production), which might be disappointing, thus further fuelling hopes for ECB policy easing. Then the market will turn attention to signals from central banks (FOMC minutes, Jerome Powell's speech in the Senate). Much better than expected June data about the non-farm payrolls which just have appeared suggest that the moment of the first interest rates cut by Fed may be more distant that the market was expecting. We assume that neither FOMC minutes nor Powell's speech will be sufficiently dovish to awake again expectations for a July cut.
- There are no important data releases in Poland next week, but on Monday the central bank will publish its *Inflation report*, including the new projections of GDP and inflation. We already know that both forecasts have increased slightly in 2019-20 but remained almost unchanged in 2021, but it will be interesting to see the rationale behind it. In our view inflation will rise more than the central bank predicts, to almost 4% y/y at the start of 2020 – we wrote about it in the MACROscope report released few days ago. Nevertheless, the MPC is unlikely to change interest rates in 2019-2020, as it will use arguments that inflations' spike is short-lived, concerns about global economic growth are rising, and other central banks in the world are going towards policy easing, not tightening.
- Yet this weekend ruling PiS party will hold a convention where it is expected to present a draft of a program for the next term. Given their recent victory in the EP elections and considerable lead in the polls, we do not expect next propositions to be announced that would mean imminent high costs for the public finances.

German economic activity, %y/y



Source: Bloomberg, Santander

Market implications

- The much better NFP data could be a signal for the market to correct its recent aggressive pricing of a high chances for July Fed rate cut (some market participants mentioned even 50bp cut). As a result, this week we could see a short-term up yield's correction. The same factor – less chances for Fed rate cuts supporting the dollar – would be behind profit taking after the recent zloty appreciation. However, at the end of the year bond yields and EURPLN could be below the current levels.

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Last week in economy

June **manufacturing PMI** went down to 48.4 pts from 48.8 instead of climbing to 49.0 as the market had expected (we forecasted 49.2 pts). The June report mentions larger declines in output and new orders as well as one of the strongest decline of backlogs of work in six years. This time it was domestic demand that pulled down the new orders component, while foreign orders improved (although their measure stayed in the contraction territory). The index of 12M outlook of manufacturers was the lowest in six years. Yet, there was a rise of employment component in June and the 2Q average of headline PMI was 48.7 pts vs 48.2 for 1Q, while Germany and Czechia saw further declines. It should be noted that all business climate surveys pointed recently to a moderate slowdown of manufacturing activity, but the actual real growth of output was surprisingly strong (with the exception of May).

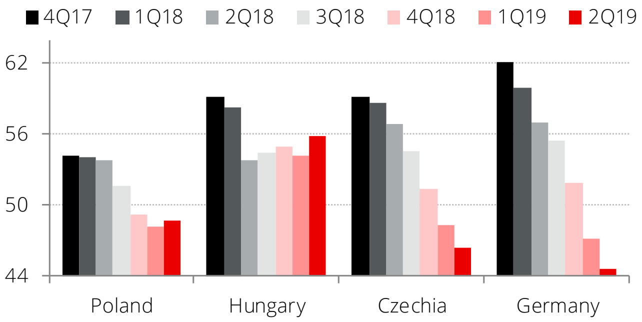
According to the Labour Ministry, in June the **registered unemployment rate** fell to 5.3%, setting a new post-transformation low. At the same time, despite the positive economic climate, the decline in unemployment (which is typical for June) is weaker than in the previous years (-27.6k as compared to -62.4k average in 2011-2018). Moreover, the Ministry's statement acknowledged a major fall in the number of job offers, way stronger than suggested by the seasonal pattern. This happened at the time of disappointing macro data, but we do not view this as a harbinger of a more significant GDP growth deceleration, as fiscal stimulus is already on the way.

Poland's **MPC kept interest rates unchanged**, as expected. Reference rate still at 1.50%. New NBP GDP and CPI forecasts were slightly tilted upwards for 2019 and 2020, while 2021 remained fairly unchanged. At the conference the NBP president Adam Glapiński maintained his view that rates are likely to remain flat until the end of 2021, inflation will probably rise "slightly" at the start of 2020, but then will fall again, and remain within the tolerance band around the target (1.5-3.5%) throughout the forecasting horizon. We think that inflation rise in the coming months/quarters will be faster than anticipated by the central bank (CPI will reach almost 4% in January 2020, partly due to 'unfreezing' energy tariffs), but it will not trigger the MPC's reaction due to a very dovish turn in global monetary policy. Thus, the NBP reference rate will remain unchanged at least until the end of 2020.

The Sejm enacted the amendment of **debtors' support act** by removing provisions on the FX conversion. Thus, the act does not include regulations proposed earlier by the President, which were the most costly for the banking system.

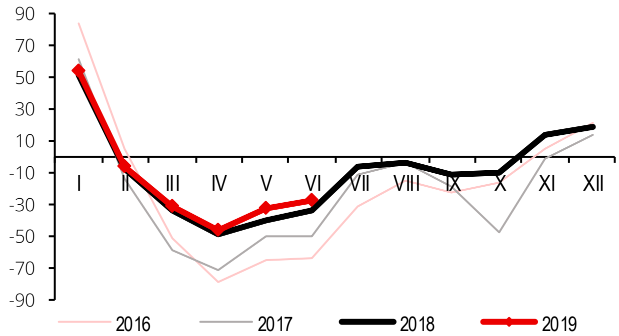
We have released our **new quarterly MACROscope** (link) where we put why we are not revising our GDP growth forecasts significantly up and elaborating on the main risk factors for the Polish economy. In the report you can read about the drivers for the expected further rise of inflation and implications for the Polish monetary policy taking into account that the main central banks are preparing to re-enter emergency easing mode. We also present revised FX forecasts.

Manufacturing PMIs, quarterly average



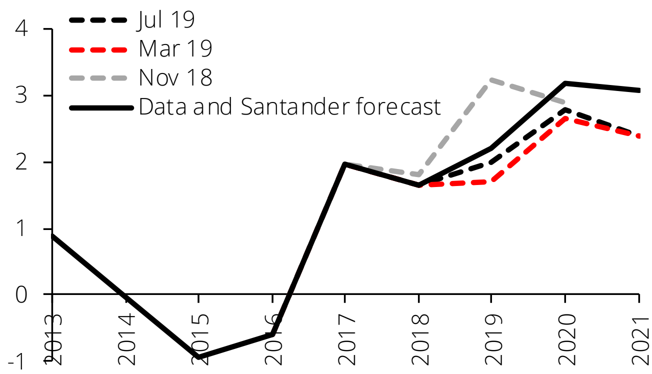
Source: Markit, Santander

M/m change of unemployment, thousand persons



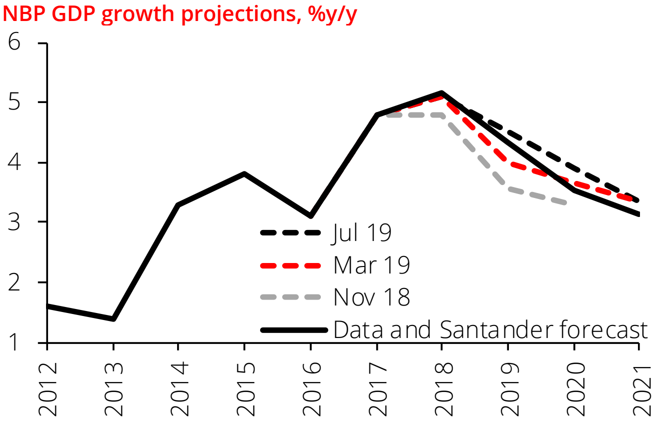
Source: GUS, Santander

NBP inflation projections, %y/y



Source: NBP, Santander

NBP GDP growth projections, %y/y



Source: NBP, Santander

FX and FI market

Last week on the market

FX In the past week, the zloty appreciation impulse vs the euro observed since mid-May faded somewhat despite the noticeable rise of the global stock prices and further strengthening of the Polish bonds. The zloty did not benefit from the persisting risk appetite which might have been due to some dollar appreciation, weaker-than-expected Polish PMI and still neutral rhetoric of the MPC despite rising CPI. As a result, EURPLN was testing 4.24 – its lowest since May 2018 – but did not manage to stay below this level for longer. USDPLN jumped to 3.76 at the start of the week and moved forward to 3.78 after the Friday EURUSD drop. GBPPLN fell for the ninth week in a row nearing 4.71, its lowest since late 2018. CHFPLN did not move much hovering above 3.80.

FI Bond yields and the IRS rates resumed the down trend after a short pause recorded in the previous week. Polish debt followed the Bunds and Treasuries that were benefiting from expectations for continuation of the highly accommodative monetary policy in Europe and rate cuts in the US. These expectations were supported by some below-consensus German (retail sales, factory orders) and US (services ISM and ADP) data. Additionally, nominations of Lagarde for the ECB head and two Fed board members were also received as dovish. In Poland, the IRS rates fell less than the bond yields leading to a slight widening of the asset swap spread. The 2-10 spreads held in the down trend in both cases.

Key events

The data release calendar for the coming week is pretty light so the market attention could focus on the tone of the FOMC minutes and speeches of the US central bankers with governor Powell delivering a testimony before the Senate Banking Committee.

In the recent weeks, the market has started to aggressively price in the Fed rate cuts and some correction was recorded after a strong NFP data. Strong US data may mean that the the tone of the speeches will not be soft enough to justify investors' expectations for a rate cut already in July.

Important data will be released in Germany. The recent PMI releases showed little improvement in the economic activity and this week we will see May exports and industrial output. Retail sales and factory orders (released last week) disappointed.

In Poland, the Ministry of Finance will hold a bond switch auction.

Market implications

FX We do not expect the EURPLN down wave to continue and assume that some profit taking from the recent zloty appreciation could start soon.

Already this week, EURPLN did not manage to stay below 4.24 for longer despite the sharp rise of the global equity indexes. This suggests that some fresh impulse is needed to push the exchange rate further down and we do not see any on the horizon.

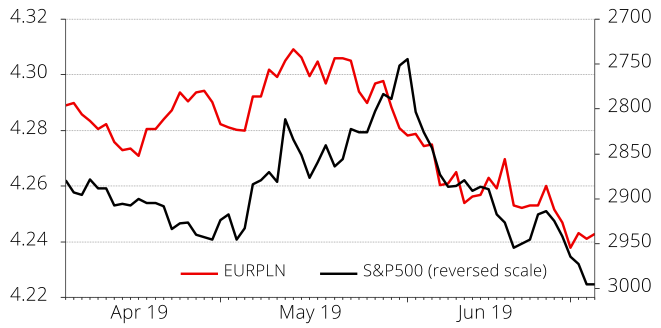
We think that the tone of the FOMC minutes and speeches of the US central bankers might be not dovish enough to support the market expectations for the July rate cut. If this is the case, then the dollar may gain further which would weigh on the EM currencies.

We expect EURPLN to rise in the one-month horizon but do not think the exchange rate could rise much above 4.27.

FI The Bund and Treasuries market look overbought and so we would be cautious as regards chances for the yields free-fall to continue. Yield's rise after the Friday's NFP could be the start of a longer move that could be fuelled by the FOMC members speeches.

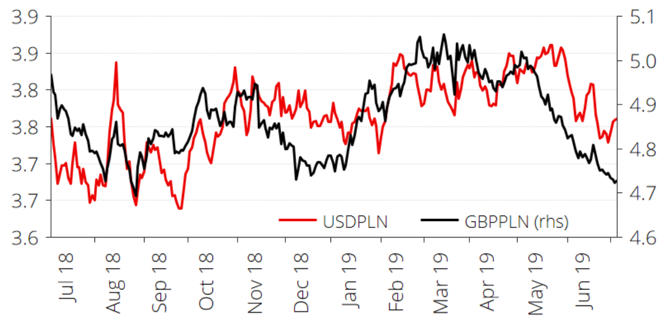
However, any yields rise – that might last longer than for a one week – may be only a correction since the recent date were discouraging and upcoming releases could still look poor.

EURPLN and S&P500



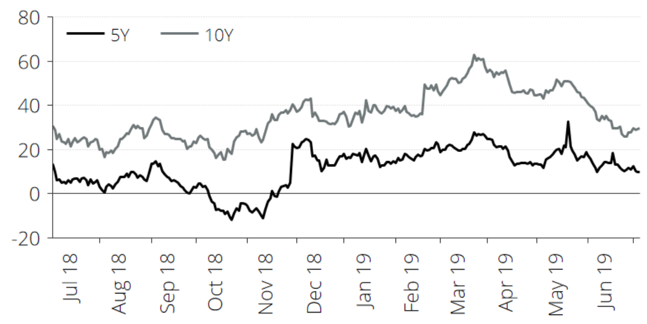
Source: Thomson Reuters Datastream, Santander Bank Polska

USDPLN and GBPPLN



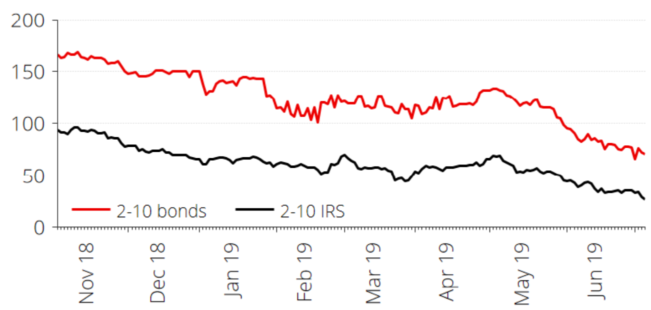
Source: Thomson Reuters Datastream, Santander Bank Polska

Asset swap spreads (bp)



Source: Thomson Reuters Datastream, Santander Bank Polska

2-10 spreads (bp)



Source: Thomson Reuters Datastream, Santander Bank Polska

Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST SANTANDER	LAST VALUE
			MONDAY (8 July)				
08:00	DE	Exports	May	% m/m	1.6	-	-3.4
08:00	DE	Industrial Production	May	% m/m	0.5	-	-1.9
09:00	CZ	Industrial Production	May	% y/y	1.0	-	3.3
			TUESDAY (9 July)				
09:00	HU	CPI	Jun	% y/y	3.6	-	3.9
			WEDNESDAY (10 July)				
20:00	US	FOMC Meeting Minutes					
			THURSDAY (11 July)				
08:00	DE	HICP	Jun	% m/m	0.1	-	0.1
09:00	CZ	CPI	Jun	% y/y	2.6	-	2.9
11:00	**PL**	**Bond switch auction**					
14:30	US	CPI	Jun	% m/m	0.0	-	0.1
14:30	US	Initial Jobless Claims	week	k	222	-	221
			FRIDAY (12 July)				
11:00	EZ	Industrial Production SA	May	% m/m	-0.1	-	-0.5

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg