09 August 2019

Bi-Weekly Economic Update

Nervous holidays

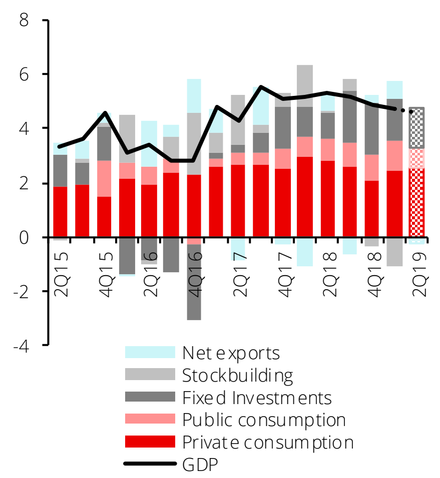
What's hot in the next two weeks

- Investors are more and more concerned about possible strong slowdown in the global economy due to a further escalation of trade and FX wars as well as political tension. Deep declines of US bond yields caused an inversion of yield curve at a scale that was always a harbinger of US recession, at least over the last fifty years. More and more central banks get on the easing bandwagon (last week: India, Thailand, New Zealand).
- In the upcoming two weeks there are **numerous US and euro zone data** releases scheduled. These can test the blooming expectations for further monetary easing globally. In details, we will get to see euro zone and US inflation and production, GDP in the euro zone, flash PMIs. Fed minutes from the July meeting are also to be released, and this was the first meeting with rate cuts. On 22 August the central bankers' conference in Jackson Hole starts.
- In Poland just before the long weekend we will see **data about June's balance of payments, July's full inflation figures and flash Q2 GDP growth**. Foreign trade data are likely to show clear slowdown in both exports and imports, driven by calendar effects (similar case was observed in industrial output), and still almost balanced current account, and should have no significant impact on the market. Data about inflation should confirm strong CPI rise to 2.9% y/y in July, which only partly resulted from surge in food prices. Core inflation (to be released on Friday) probably also rose significantly, to 2.1% y/y. This information is probably also already discounted by the market. As regards GDP growth, we expect to see slight deceleration in Q2 to 4.5% y/y, which is in line with market consensus. In the following week we will see first hints about economic activity at the start of Q3: **July's data about wages and employment, production in manufacturing and construction, retail sales**. Our forecasts suggest a clear improvement in most of those indicators versus June, which may have slight positive impact on the currency.
- In the last couple of days we've seen **comments of a few MPC members** (including NBP Governor Glapiński) mentioning possibility of rate cut if euro zone slowdown deepens. It looks like a response to earlier comments of hawks suggesting rate hike motions before the end of this year. It is possible that we will see more evidence of contradicting views in the MPC in the near future.

Market implications

- Zloty has been underperforming other CEE currencies recently, possibly influenced by uncertainty regarding the looming ECJ ruling regarding the Swiss franc loans. We see bigger chance for slight rebound in the near future than for further zloty weakening, assuming a rebuild of the global risk appetite and slightly positive impact of local macro data about activity in July (plus signals from the technical analysis).
- Domestic debt market will remain under influence of core markets, where it is still not obvious that we are nearing the end of downward trend in yields. The reversal of trend could be potentially triggered by strong positive surprises from US/European data or confirmation of rumours about German plans to ease fiscal policy. Domestic news will remain rather unimportant for Polish yields.

GDP growth and main components, % y/y



Source: GUS, Santander

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Last week in economy

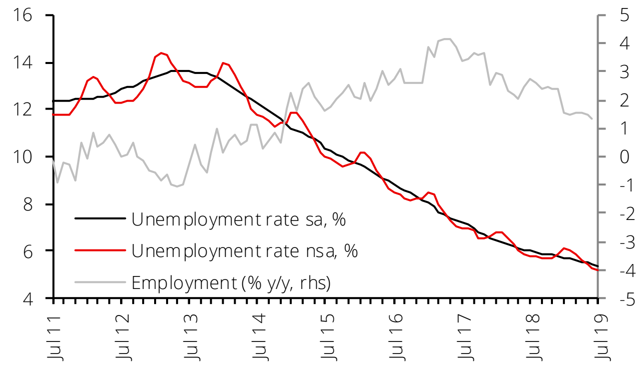
The last week was not rich in domestic data releases, but we got to see some new comments from the MPC members, especially from the NBP president Adam Glapiński who suggested that rate cuts are possible if the euro zone falls into recession, dragging Poland growth down.

The Labour Ministry informed that **the registered unemployment rate** fell in July to 5.2% from 5.3% in June, in line with our expectations. In our view, the final data due for release by the GUS will be in line with the Ministry's estimate. We are expecting the unemployment rate to go further down (in seasonally-adjusted terms) in the months to come but its downward momentum is decelerating. The unemployment data also revealed a further deceleration in employment growth, to 1.4% y/y in June.

The NBP credit survey showed that in 3Q19 banks are planning to tighten credit policies for companies and households. The banking sector is also expecting higher demand for credit from households and a steady demand from firms. In 2Q19 banks have tightened criteria for consumer loans given rising NPLs and deteriorating expectations about future economic situation. Criteria for companies were also tightened somewhat, mostly for long-term loans. Also mortgage credit conditions were tightened, as they saw rising margins and non-interest costs.

NBP President Adam Glapiński wrote in an article for Bank monthly that he was expecting the output gap and the core inflation to go down in 2021, which would favour keeping rates on hold. However, if the scenario of negative developments in the euro zone materialises, then the NBP **may mull policy easing**. According to Glapiński, the risk is skewed downwards. MPC's **Eryk Łon** was suggesting a widening of the NBP toolbox by QE-related measures such as purchases of stocks and corporate bonds. In his view, such measures would be helpful during a global recession. Another dovish member, **Jerzy Żyżyński** also supported an idea to consider QE. Żyżyński ruled out rate hikes and suggested that maybe cuts should be mulled in response to weaker global growth. Żyżyński also suggested easing the capital adequacy criteria for banks. **Grażyna Ancyparowicz** also spoke that banks are dealing with excessive burden, which should be eased. Interestingly, it seems that the MPC doves are amplifying their message at the same point of time, when hawks have gained new arguments of higher inflation. The division within the MPC is becoming increasingly more visible. In our view, worries about the banking sector remain one of the factor stopping the MPC from mulling rate cuts.

Unemployment and Employment



Source: GUS, Labour Ministry, Santander

Quote of the week:

Adam Glapiński, NBP President, Bank, 09/08/2019: In 2021 it [core inflation] will start to go down, similarly as the output gap. However, if this baseline scenario materialises, then there is no need to adjust monetary policy parameters, as inflation will remain within the NBP target. (...) Bear in mind the risk of negative economic outlook in the euro zone. If the negative scenario comes true, undermining the business climate in Poland, then we cannot rule out mulling monetary policy easing rather than tightening.

Eryk Łon, MPC member, PAP, 05/08/2019: It is worth widening the NBP tool box. In my view, this should happen when there are recessive tendencies in the global economy. I hope there is no recession, and I would like to wish it to all the inhabitants of Earth, and especially to inhabitants of my homeland on Earth, Poland. Still, we have to remember that everything is possible and we should be prepared for different scenarios. One of the most dramatic scenarios was outlined in the 5th vision of Saint Bernadette Soubirous.

Jerzy Żyżyński, MPC member, PAP, 08/08/2019: Given the last NBP forecasts, interest rate stabilisation or cut is the most probable scenario. I rule out rate hikes. I would have advocated for cuts earlier, but there are a few banks that are in difficult situation and could not survive a deeper rate cut, say more than 50bpps. From our point of view, rates should remain unchanged. But we could consider easing the capital adequacy criteria, combined with a rate cut stimulating the credit demand. I think this could be the optimal policy.

Grażyna Ancyparowicz, MPC member, Bloomberg, 06/08/2019: Polish banks are already burdened excessively with regulations. We should be cautious and refrain from imposing further burden on the banks, or even ease some policies in order not to destroy the banking sector.

FX and FI market

Last week on the market

FX EURPLN rose for the third week in a row and broke 4.32 (its highest since February), continuing the up move triggered after the disappointing outcomes of the ECB and Fed meetings. The rising tensions in the US-China trade did not help and the other major EM currencies also mostly depreciated vs the euro and the dollar. It seems that it was the last week's dovish comments made by the Polish central bankers that weighed on the zloty and made it weaker versus the forint and koruna. USDPLN retreated to 3.85 from 3.90, its highest level since April 2017, CHFPLN traded around 3.95 and GBPPLN remained stable around 4.68.

FI Polish 5Y and 10Y bond yields neared but held above their recent multi-month lows while the respective IRS rates resumed the down move, leading to a slight widening of the asset swap spreads. The 2Y rates did not move much. The 10Y PL-DE bond yield spread was fluctuating around 260bp while the PL-US spread rose temporarily to 35bp.

At the Thursday's bond switch auction, the Ministry of Finance issued debt for PLN5.6bn. According to the Ministry, this year's gross borrowing needs are now covered in 84% (under the budget bill assumptions).

Key events

In the next two weeks, in Poland we will see flash 2Q GDP and July final inflation, retail sales and industrial output. Our forecast assumes only mild pace of the GDP growth deceleration and improvement of the monthly readings after the subdued performance in June.

Abroad, numerous US data will be published and in the euro zone we will see flash August PMIs. In our view, the US could be more important for the market.

Market implications

FX We think there is a limited room for the zloty depreciation in the short term and the second half of August could be better than the first one.

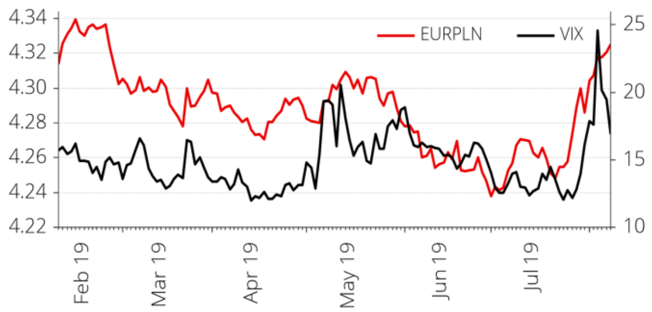
Investors were disappointed with the outcome of the July ECB and Fed meetings but the intensification of the US-China trade war and the interest rate cuts delivered by some Asian central banks again encouraged the markets to price in that more easing will be announced in the euro zone and US soon. Should this intensify in the weeks to come, the risky assets, including the zloty and its peers, might recover.

After the long weekend in Poland starting next week, the statistics office will release some important macro data. The July retail sales and industrial output are expected to show some improvement after weaker performance in June and out forecasts for the latter is above the market consensus. Decent macro data, combined with high inflation reading and flash 2Q GDP showing only a minor deceleration, could also be zloty-positive. Before that, we do not expect EURPLN to rise above 4.35.

FI For the better part of the passing week, the core bond yields were in the downward trend with the 10Y Bund reaching its fresh all-time-low at c-0.60% and the respective Treasury its lowest since late 2016, at c.1.70%. However, at the end of the week some correction was seen after the not-that-successful UST auction, good US initial jobless claims data and media reporting that Germany may abandon its balanced budget policy (this was soon denied by the Ministry of Finance).

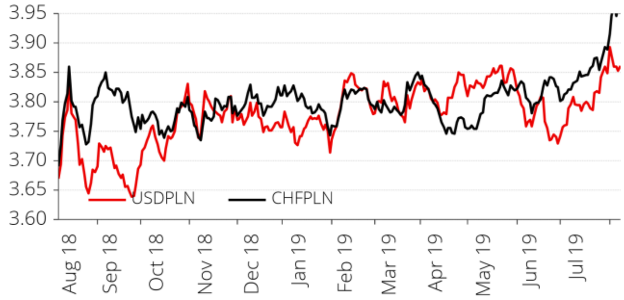
We think the core markets, that are now the main driver for the Polish bonds, would be very much data-sensitive in the coming weeks. In the second half of the month, we will see flash August manufacturing PMIs and numerous US data. It seems that there is a little chance that the ECB will not ease monetary policy after the summer but if the US data look decent, then the market could start to withdraw from its aggressive pricing of the Fed rate cuts. Under this scenario, Polish bond yields and IRS might rise.

EURPLN and VIX



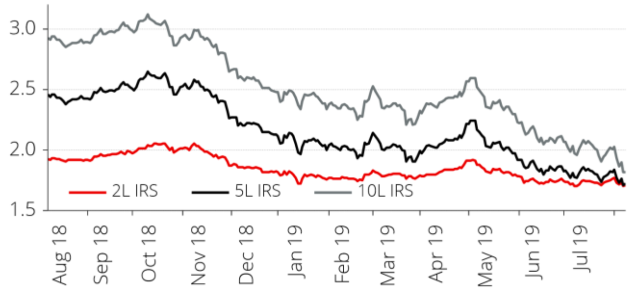
Source: Refinitiv Datastream, Santander Bank Polska

USDPLN and CHFPLN



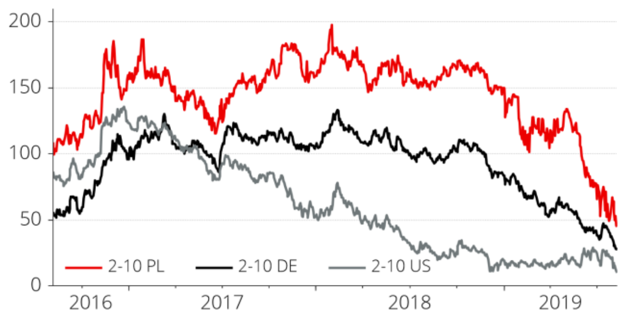
Source: Refinitiv Datastream, Santander Bank Polska

Polish IRS rates (bp)



Source: Refinitiv Datastream, Santander Bank Polska

2-10 bond yield spreads (bp)



Source: Refinitiv Datastream, Santander Bank Polska

Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST SANTANDER	LAST VALUE
		MONDAY (12 August)					
09:00	CZ	CPI	Jul	% y/y	2.7		2.7
		TUESDAY (13 August)					
08:00	DE	HICP	Jul	% m/m	0.4	-	0.4
11:00	DE	ZEW Survey Current Situation	Aug	pts	-3.7	-	-1.1
14:00	**PL**	**Current Account Balance**	**Jun**	**€mn**	**-75**	**-62**	**1 006**
14:00	**PL**	**Exports**	**Jun**	**€mn**	**18 470**	**18 050**	**19 703**
14:00	**PL**	**Imports**	**Jun**	**€mn**	**18 620**	**18 264**	**19 607**
14:30	US	CPI	Jul	% m/m	0.3		0.4
		WEDNESDAY (14 August)					
08:00	DE	GDP	2Q	% y/y	0.2	-	0.7
09:00	CZ	GDP	2Q	% y/y	2.6	-	2.8
09:00	HU	GDP	2Q	% y/y	4.5	-	5.3
10:00	**PL**	**CPI**	**Jul**	**% y/y**	**2.9**	**2.9**	**2.6**
10:00	**PL**	**GDP**	**2Q**	**% y/y**	**4.5**	**4.5**	**4.7**
11:00	EZ	GDP	2Q	% y/y	1.1	-	1.1
11:00	EZ	Industrial Production	Jun	% m/m	-1.0	-	0.9
		THURSDAY (15 August)					
14:30	US	Initial Jobless Claims	Aug.19	k	215.0		209.0
14:30	US	Retail Sales Advance	Jul	% m/m	0.2	-	0.4
14:30	US	Index Philly Fed	Aug	pts	10.0	-	21.8
15:15	US	Industrial Production	Jul	% m/m	0.2	-	0.0
		FRIDAY (16 August)					
14:00	**PL**	**CPI Core**	**Jul**	**% y/y**	**2.1**	**2.1**	**1.9**
14:30	US	Housing Starts	Jul	% m/m	0.56	-	-0.9
16:00	US	Flash Michigan index	Aug	pts	97.1	-	98.4
		MONDAY (19 August)					
11:00	EZ	HICP	Jul	% y/y	-	-	1.1
		TUESDAY (20 August)					
10:00	**PL**	**Employment in corporate sector**	**Jul**	**% y/y**	**-**	**2.74**	**2.8**
10:00	**PL**	**Average Gross Wages**	**Jul**	**% y/y**	**-**	**7.18**	**5.3**
		WEDNESDAY (21 August)					
10:00	**PL**	**Sold Industrial Output**	**Jul**	**% y/y**	**-**	**8.0**	**-2.7**
10:00	**PL**	**Construction Output**	**Jul**	**% y/y**	**-**	**5.3**	**-0.7**
10:00	**PL**	**PPI**	**Jul**	**% y/y**	**-**	**0.4**	**0.6**
16:00	US	Existing Home Sales	Jul	% m/m	1.3		-1.7
20:00	US	FOMC Meeting Minutes					
		THURSDAY (22 August)					
09:30	DE	Flash Germany Manufacturing PMI	Aug	pts	-	-	43.2
09:30	DE	Flash Markit Germany Services PMI	Aug	pts	55.4	-	54.5
10:00	EZ	Flash Eurozone Manufacturing PMI	Aug	pts	-	-	46.5
10:00	EZ	Flash Eurozone Services PMI	Aug	pts	53.3	-	53.2
10:00	**PL**	**Retail Sales Real**	**Jul**	**% y/y**	**-**	**5.6**	**3.7**
11:00	**PL**	**Bond auction**					
14:00	**PL**	**Minutes MPC**					
		FRIDAY (23 August)					
16:00	US	New Home Sales	Jul	% m/m	0.0	-	7.0

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.