30 August 2019

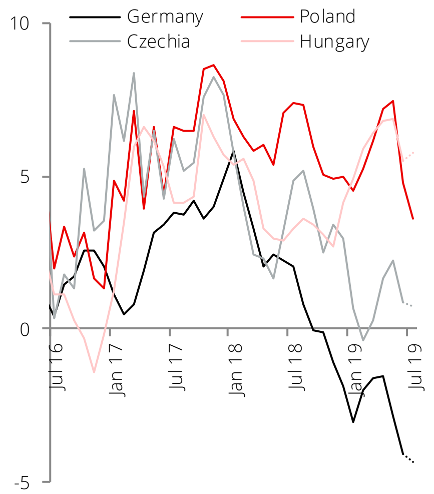
Weekly Economic Update

Volatility is not over yet

What's hot next week

- The summer holiday is coming to an end and market liquidity is about to rise. But it will not necessarily mean the end of elevated volatility and market turmoil. Concerns about the world economic outlook remain the main driver for asset markets. This is even magnified by geo-political concerns.
- In the coming week the US data releases will be probably in the spotlight: indicators of economic activity (ISM, factory orders), labour market data (NFP) and comments of Fed officials. Recent publications spurred worries about economic slowdown and if we do not see some symptoms of recovery now, risk aversion could even strengthen.
- In Poland the manufacturing PMI for August will be released. Our forecast and market consensus predict slight rebound, but index still well below 50. It is worth remembering that Polish PMI has been rather poor predictor of trends in industry recently.
- There are meetings of several central banks in the agenda (including Australia, Canada, Sweden, Chile, Russia). At least two latter are expected to cut rates, riding the wave of global monetary easing.
- On Tuesday the UK parliament returns to work from holiday break, but probably only for a while, as one week later it could be prorogued for another four weeks by the request of PM Johnson, who is trying to stop MPs from blocking the Hard Brexit. Thus, the nearest few days of UK parliamentary debates could be interesting and include a no confidence vote for the government, among others. Prepare for more GBP volatility.
- In Poland, we may learn the name of the new finance minister, after Marian Banaś has been appointed for the chief of Supreme Audit Office (NIK). Media speculate about three potential candidates: Tadeusz Kościński or Leszek Skiba (two deputy FinMins) or PM Mateusz Morawiecki (who used to join those two functions in the past). In our view, the decision will be irrelevant for the market. The budget draft for 2020 has been already prepared and the truth is that the key decisions in economic policy are currently made elsewhere, not in the Ministry of Finance.

Industrial output, 3M mov. av., % y/y



Source: Bloomberg, Santander

Market implications

- Zloty depreciation halted a bit and we think that in the nearest days EURPLN should not breach 4.40 persistently. The general global market sentiment and risk appetite will be key. Bond yields are near record lows and we do not see a persistent trend reversal near on the horizon. However, a short-term upward correction of yields is possible, unless data abroad disappoint once again.

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Last week in economy

Last week was rich in important macro releases: details of GDP growth, explaining the slowdown in 2Q19, flash CPI for August, showing a minute decline and draft central budget for 2020, with no deficit for the first time ever.

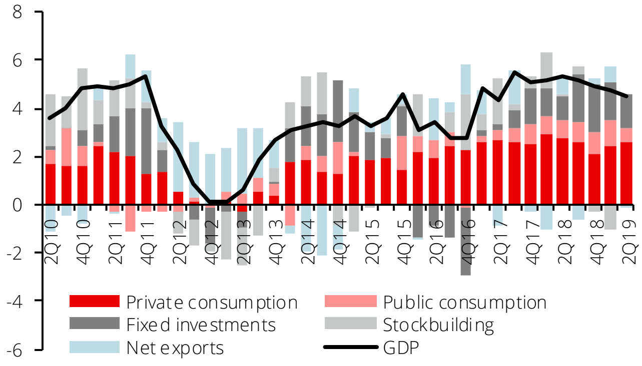
Poland's GDP growth reached 4.5% y/y in 2Q19, a bit above flash estimate 4.4%. The main components of growth were broadly in line with our expectations: private consumption rose 4.4% y/y (vs 3.9% in 1Q), fixed investments decelerated to 9% y/y (from 12.6% in 1Q). The main difference vs our assumption was that the GDP growth was slowed by worsening contribution of net exports (zero vs +0.7pp in 1Q). Overall, the data do not change our view on the economic outlook for Poland. In the coming quarters we expect to see a continuing gentle slowdown of GDP growth – to c.4.0% y/y and 4.3-4.4% average in the entire 2019. While private consumption will re-accelerate to c5% y/y boosted by fiscal package, investments will continue slowing and net exports' contribution will worsen further. As regards 2020, we stick to our forecast of 3.6% GDP growth, as the deteriorating global economy will still be limiting external demand, fiscal impulse for consumption will be fading and investment growth will moderate after the EU funds absorption peak.

August **flash CPI release** for Poland showed inflation declining from 2.9% y/y to 2.8%, in line with the consensus and our forecast. We estimate that core inflation also eased, from 2.2% y/y to 2.1%, possibly 2.0%. In August the CPI growth had to fight the negative base effect – the decline of the headline figure does not mean that inflationary pressure has eased. In 4Q inflation is likely to push above 3% y/y, possibly to 3.5% which is the formal upper bound of the tolerance range for the MPC, while core CPI may end the year in the 2.5-3% y/y area. Food price growth remained relatively strong in August in m/m terms, at -0.3% it was the strongest for this month since 2006. The rise of inflation this year is based on acceleration in services as well as food price growth due to adverse weather conditions and global factors (ASF). The reading is unlikely to affect the MPC rhetoric.

The government planned balanced 2020 budget, which was possible thanks to some increase in taxation, large one-off revenues, but also due to restricted spending, in line with the Stabilising Expenditure Rule. In general, this is good news for the market, implying low bond supply next year and confirming Poland's fiscal prudence. However, at least part of the deficit improvement is temporary and the general direction of changes in spending structure may raise concerns, as it generates temporary consumption boost and a permanent burden for the economy. Note also that a major part of new budget revenues was not yet enacted. The main risk for Polish public finances is deeper economic slowdown, especially that planned tax revenues already seem ambitious. Meanwhile, rising cost pressure on firms and restraining non-social spending may not help in maintaining long-term growth potential and weathering the global economic turmoil. Read more in our Economic Comment.

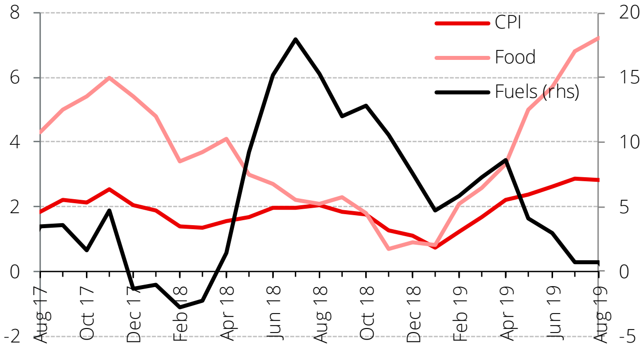
After July the central budget showed a deficit of PL4.8bn, i.e. slightly lower than after June (PLN5.0bn). Improvement of the central budget balance was primarily due to high tax receipts – VAT revenues jumped by 27% y/y in July, CIT by 29.2% y/y and PIT by 23.3% y/y. Such high growth rates could be explained partially by low statistical base from July 2018, yet PIT really gained momentum over the last months. Expenditures fell by 10% y/y due to high statistical base in July 2018 in debt servicing (when the Ministry carried out swap operations) and low subsidy to FUS (growth rate near to zero). In our view, tax revenues will grow at a solid pace in the months to come (yet PIT will be under negative spell of 3Q changes to decrease the tax wedge) and spending will remain under control, so the year is likely to end with a deficit close to PLN12bn.

GDP growth breakdown, % y/y



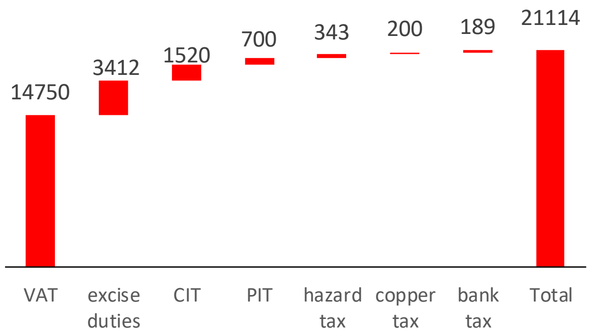
Source: GUS, Santander

CPI and main components, % y/y



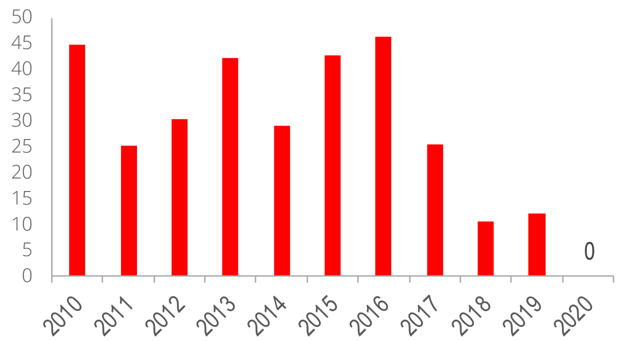
Source: GUS, Santander

Decomposition of tax revenues growth in 2020 budget, PLNm



Source: Ministry of Finance, Santander

Central budget deficit, PLNbn (our forecast for 2019, government plan for 2020)



Source: Finance Ministry, Santander

FX and FI market

Last week on the market

FX EURPLN remained at an elevated level reached in the previous week at slightly below 4.40. The pressure on the EM currencies was still there but the global market mood improved somewhat (global stock indexes rose) as the trade war temperature eased. The dollar gained on the global market and so USDPLN rose for the third week in a row, reaching c3.98 (its highest since April 2017). GBPPLN rose as well but the pace of move was slower than in the previous weeks since the pound depreciated amid rising concerns of a Hard Brexit.

Elsewhere in the CEE region, it is worth noticing that EURHUF reached its fresh all-time-high at above 331 amid EM currencies sell-off.

FI Information that there will be zero central state deficit assumed in the 2020 budget draft boosted Polish bonds in the first part of the week. Still, in the next days, yields rose and closed the week near the levels seen last Friday. The 5Y and 10Y IRS fell slightly on a weekly basis. 2-10Y spreads fell slightly in both cases, the 10Y asset swap spread remained unchanged and the 10Y spread vs Bund remained around 250-260bp.

Key events

Summer holiday period ends and we expect the proper liquidity and investors activity to reappear after the Monday market holiday in the US. We will see some crucial US data that have recently been on the weaker side and some voting FOMC members will speak.

In the next week's calendar, the key event, in our view, would be the release of the US monthly payrolls data and ISM. Both manufacturing and services indexes are in the free-fall mode while the flash German and euro zone manufacturing PMIs showed a minor rise in August. The market expects to see some improvement in manufacturing ISM and further deterioration in services index.

The change of the US monthly nonfarm payrolls has recently been rather below its 12-month average.

In Poland, the appointment of new finance minister could be announced but this should be market-neutral.

Market implications

FX The zloty depreciation vs the euro paused in the recent days and we assume EURPLN will not jump permanently above 4.40 in the days to come. In our opinion, the upcoming US data and sentiment on the EM market would be key for this to happen.

The US dollar index broke its local peak and may add gains in the short term, limiting the scope for the EM currencies recovery if the US data finally surprise on the positive side.

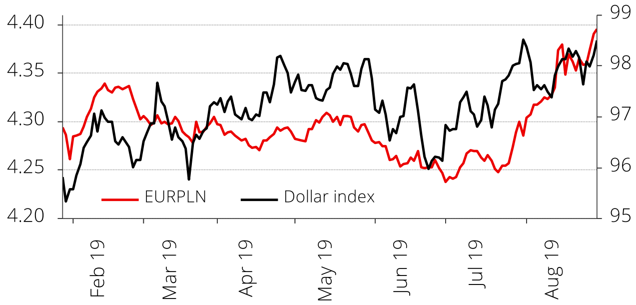
Nearly all major EM currencies depreciated vs the dollar in the passing week with the Argentine peso leading the decline. We assume USDARS would not resume the rise started earlier in August with the Argentine central bank trying to calm the market.

FI We think Polish bond yields and IRS might stay low in the weeks to come. Still decent GDP growth limits the (already low) credit risk and the plan of zero-central-state budget deficit shall curb potential for any material rise of yields.

However, last week we saw an only temporary market reaction to the positive internal news flow and we think that some yields rise – in a limited extent – could now evolve.

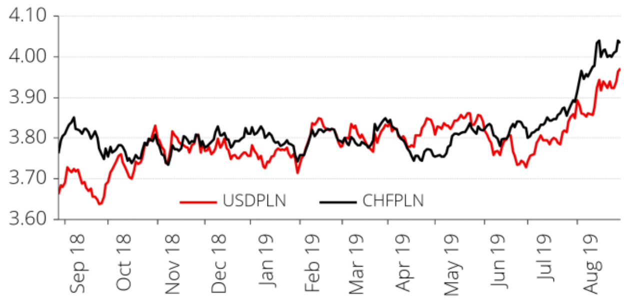
The 10Y PL-DE bond yield spread is currently trading around the lower end of the 250-300bp range in which it has been holding since mid-2017 and we expect it might rise in the short term.

EURPLN and dollar index



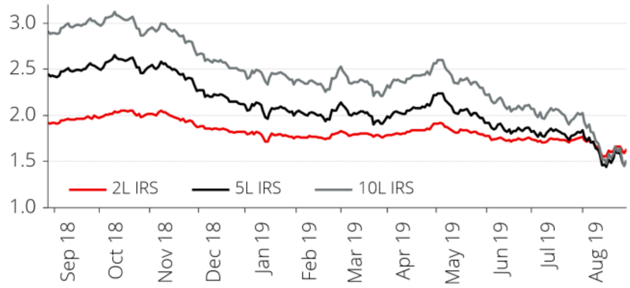
Source: Refinitiv Datastream, Santander Bank Polska

USDPLN and CHFPLN



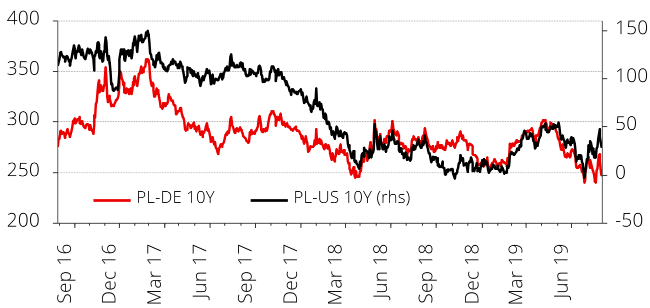
Source: Refinitiv Datastream, Santander Bank Polska

Polish IRS rates (bp)



Source: Refinitiv Datastream, Santander Bank Polska

10Y bond yield spreads



Source: Refinitiv Datastream, Santander Bank Polska

Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST SANTANDER	LAST VALUE
		MONDAY (2 September)					
	US	Market holiday					
09:00	**PL**	**Poland Manufacturing PMI**	**Aug**	**pts**	**47.7**	**47.6**	**47.4**
09:55	DE	Germany Manufacturing PMI	Aug	pts	43.6	-	43.6
10:00	EZ	Eurozone Manufacturing PMI	Aug	pts	47.0	-	47.0
		TUESDAY (3 September)					
16:00	US	ISM manufacturing	Aug	pts	51.4	-	51.2
		WEDNESDAY (4 September)					
03:45	CN	Caixin China PMI Services	Aug	pts	51.7	-	51.6
09:55	DE	Markit Germany Services PMI	Aug	pts	54.4	-	54.4
10:00	EZ	Eurozone Services PMI	Aug	pts	53.4	-	53.4
11:00	EZ	Retail Sales	Jul	% m/m	-0.4	-	1.1
20:00	US	Fed Beige Book					
		THURSDAY (5 September)					
08:00	DE	Factory Orders	Jul	% m/m	-1.4	-	2.5
14:15	US	ADP report	Aug	k	143	-	155
14:30	US	Initial Jobless Claims	week	k	214	-	215
16:00	US	Durable Goods Orders	Jul	% m/m	0.0	-	2.1
16:00	US	ISM services	Aug	pts	53.6	-	53.7
16:00	US	Factory Orders	Jul	% m/m	0.8	-	0.6
		FRIDAY (6 September)					
08:00	DE	Industrial Production	Jul	% m/m	0.4	-	-1.5
09:00	CZ	Industrial Production	Jul	% y/y	2.9	-	-3.8
09:00	HU	Industrial Production	Jul	% y/y	6.85	-	4.12
11:00	EZ	GDP SA	2Q	% y/y	1.1	-	1.1
14:30	US	Change in Nonfarm Payrolls	Aug	k	165	-	164
14:30	US	Unemployment Rate	Aug	%	3.7	-	3.7

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.