06 September 2019

Weekly Economic Update

ECB vs market expectations

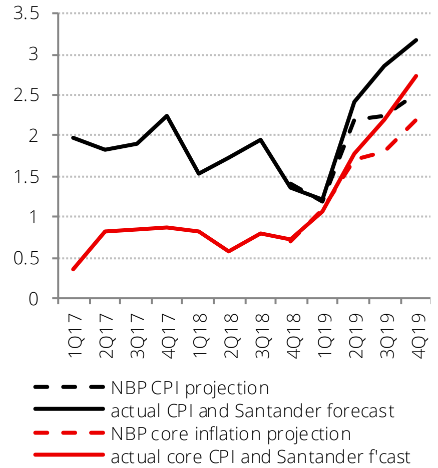
What's hot next week

- The ECB is expected to ease its policy this week. The August claim by its member Olli Rehn that the bank is ready to deliver a package of measures so big that it will exceed market expectations was followed by remarks by his colleagues who are less enthusiastic about making monetary policy looser. We assume that the ECB might not turn out as dovish as expected.
- Out of the global data releases we see US CPI (core CPI in particular) and retail sales as the most relevant for the market, as these could have an impact on Fed's approach to further rate cuts.
- Polish MPC meets after the summer break. As far as CPI is concerned, the previous time the Council met it only had information on flash reading for June (2.6% y/y vs 2.4% consensus). Now it will have to discuss another significant (0.3pp) positive surprise in July (2.9% y/y) and the August decline to 2.8%. These developments pushed inflation above the path from the July NBP projection: the 2Q average was 2.4% vs the projected 2.2%, while the 3Q average could be 2.8-2.9% instead of 2.2-2.3% indicated by NBP staff. Core inflation is also visibly above the projected path. Still, we do not expect to see any change of rhetoric to the hawkish side. The global growth uncertainty and monetary easing abroad gives the MPC good reasons to stick to wait-and-see approach and keep rates stable for longer. NBP governor Adam Glapiński has an extra task this time – to discredit the July motion of two members to hike rates by 25bp (likely to be repeated this time) as being far from the MPC consensus view. He might even soften his stance somewhat and elaborate more on the possibility to cut rates to provide a counterweight to the rate hike motion. We continue to expect unchanged rates this year and next.
- The September MPC meeting is special because this is the time when the Council decides on introducing changes to the monetary policy assumptions (the document will be released at a later date). MPC's Jerzy Żyżyński revealed there was a heated debate in July on a proposal regarding NBP profit transfer to the central budget, which would increase the flow to the government.
- Polish data to be released this week include August CPI details, July C/A and foreign trade (showing if growth of exports to Germany still declined), 2Q labour demand (signs of softening appeared in 1Q).

Market implications

- If the ECB turns out not as dovish as expected, a temporary market disappointment will possibly drive core and Polish bond yields higher. At the same time, for technical reasons we expect the zloty to hold on to or even increase the recent gains.

July NBP projection, % y/y



Source: NBP, GUS, Santander

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Last week in economy

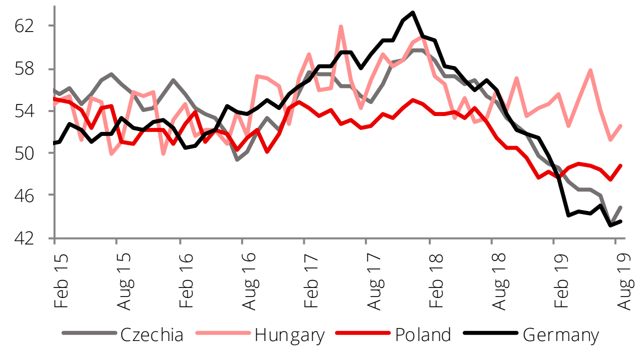
Last week we saw a ray of hope for the European economy in the form of a rebound in CEE PMIs. We also heard two rating agencies representatives expressing reservations about the Polish government's plans to deliver a balanced budget next year. MPC's Jerzy Kropiwnicki said he would rather see rate hikes than cuts, while PFR head Paweł Borys fears the approaching ECJ ruling (date unknown) on CHF mortgage loans could trigger an economic crisis in Poland.

Polish **manufacturing PMI** rose in August to 48.8 pts, its highest since May, exceeding our forecast and market consensus by c.1pp. The index remains below the neutral level 50, which means that economic activity is still contracting, albeit at a slower pace. This refers to new orders and output: they were falling at the slowest pace since May, according to the survey. Firms also reported slight cuts in employment, rising spare capacity and weak cost pressures. Please recall that PMI has not been a good predictor of trends in Polish manufacturing over the past two or three years. Nevertheless, it is good to note that in August other business climate surveys also pointed to some rebound, which suggests that Polish industry is still coping relatively well with global economic slowdown. Still, the headline production figures for August are going to be quite weak again, in our view, due to negative calendar effects. As regards the CEE region, PMI for manufacturing increased to 52.6pts from 51.2pts, a multi-month low in Hungary and to 44.9pts from 43.1pts in Czechia (the first rise since June 2018). Decreases were recorded in Russia: to 49.1pts from 49.3pts, but the index was still above the local minimum at 48.6pts.

Fitch Ratings director Arvind Ramakrishnan said that Poland may fail to eliminate fiscal deficit in 2020 because revenue growth assumptions may prove too optimistic. In his view the budget draft was designed to show fiscal discipline ahead of elections and may be changed afterwards. According to Fitch, VAT revenues seem too optimistic given that the VAT gap is already reduced to 13%. What is more, PIT revenues were seen as at risk of missing the estimate, being based on high growth of employment and wages; in case of a rapid slowdown these values would not be met. **S&P** representative Marcin Petrykowski also said that budget revenues assumptions are too optimistic, especially VAT, and the general government deficit may reach 2% of GDP. Fitch may issue Poland's review on 27 September while S&P may do so on 11 October. Also this week, Japanese rating agency R&I upgraded Poland when it comes to foreign currency debt (from A- to A) while keeping the score for PLN debt at A/stable.

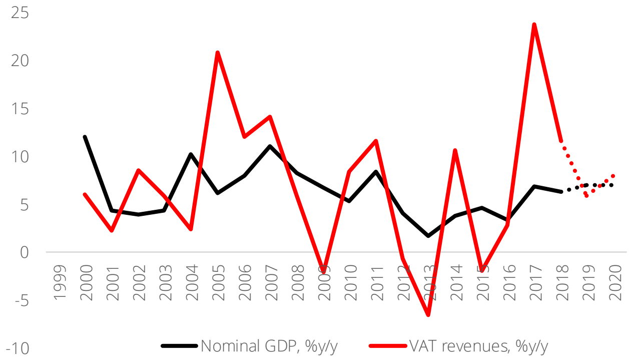
MPC member **Jerzy Kropiwnicki** in his interview to PAP (Polish Press Agency) said that he thinks that the best monetary policy strategy at the moment is still the "wait-and-see" approach, however the balance of risks is tilted more towards rate hikes. Kropiwnicki's rate hike view is being softened by the fact that the GDP growth is slowing and his view on CPI (he does not expect it to rise above 3.5%). We think that this last assumption will prove wrong at the turn of the year.

Manufacturing PMIs, CEE and Germany



Source: Markit, Bloomberg, Santander

VAT revenues and government forecast, % y/y



Source: MF, GUS, Santander

Quote of the week:

Paweł Borys, head of NBP Polish Development Fund (PFR), 2 Sep, DGP: The largest internal risk for Polish economy is the European Court of Justice's verdict on Swiss franc loans. It may even cause an economic crisis. If the verdict goes in the direction of ordering a conversion of CHF loans to PLN but with keeping CHF LIBOR rates it will put a substantial pressure on our banks. This could be a black swan (…) GDP growth will go from this year's 4.5%+ to over 3.5% in 2020.

FX and FI market

Last week on the market

FX CEE currencies traded stronger last week as some of the biggest global risk factors receded: US and China resumed trade talks, Hong Kong's extradition bill was withdrawn, a no-deal Brexit chances diminished, Italy managed to create a more budget-friendly coalition and Eurozone August PMIs were slightly stronger vs expectations. EURPLN came down from 4.38 a week earlier and closed the week at 4.34. The dollar index declined ca 0.6% hence USDPLN corrected lower by 1.2% to 3.937. GBPPLN closed the week unchanged (around 4.85) due to the Brexit-related GBPUSD volatility. Elsewhere in the CEE, the HUF and CZK also gained versus the euro, both by around 0.5%. RUB gained 1.5% vs USD as oil temporarily increased c 4.0% and the CBR cut 25bp as expected to 7.00%.

FI In Poland the zero central state deficit news has long been digested and even contested by some (Fitch Ratings, S&P). Despite this, the yields increased following the German curve. The core rates move higher should be viewed mainly as a technical one – after the strong rally and before the next week's ECB meeting on Thursday.

Key events

As the September progresses into its 2nd trading week, the market will increasingly focus on the ECB rate decision meeting on Thursday (12 Sep) and a FOMC rate decision on the following week on Wednesday (18 Sep). Regarding market expectations for the former meeting it seems that a (1) rate cut of 10bp, a (2) strengthened and prolonged forward guidance (currently till mid-2020) and (3) deposit tiering for European banks are on the cards. The open question remains regarding (4) renewal of the government bond purchases in order to increase the ECB balance sheet (from the current EUR 4.7 tn). The market will likely focus on the latter. The ECB might not turn out as dovish as expected and if that happens the market is set for a slight temporary disappointment.

On the data front, on Tuesday there is a China August CPI and PPI which we monitor for signs of weakness and JOLTS jobs openings in the US. On Thursday there is CPI in Germany and France as well as in the US (CPI expected to grow 1.8 from 1.7 yoy, while CPI core to 2.3 from 2.2 yoy). On Friday, US August retail sales are expected at 0.2 mom.

In Poland, Wednesday (11 Sep) will see an MPC rate decision and press conference. where we expect no change to rates. However, the meeting is the first one after the July's motion to raise rates so it might be interesting to see whom of the MPC members the governor Glapiński picks up for comments on the press conference .

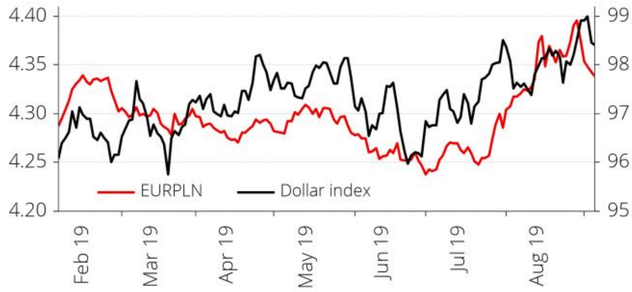
Market implications

The fundamental reasons for lower yields and more risk aversion (i.e. lower global growth) have not dissipated (and German factory orders actually point to their acceleration) but given the size and speed of the market moves, the markets next week are likely to be driven by the technical factors which imply a long due correction in levels and less volatility as the markets await the major central banks' meetings ahead.

FX The zloty appreciation vs the euro reached first important technical level at 4.34 and we believe the pair might consolidate at this level for a bit or even test the next more bullish one at 4.30. Similarly, the US dollar index might correct lower to 98.0/97.5 area (0.2-0.7% from current level).

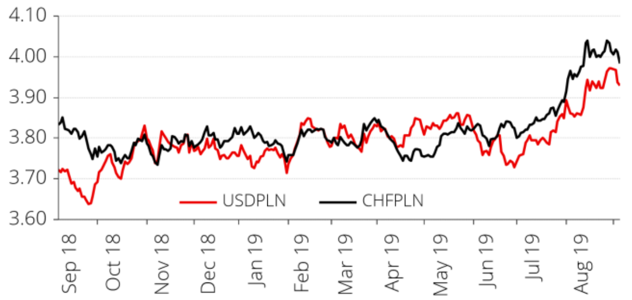
FI We think Polish bond yields and IRS might correct higher in line with core yields in the week. Given the Bund likely correction to -50 bp from the current -62 bp, we would expect the Polish 10Y benchmark to breach 2.0% (August peak) and move towards 2.1%. The 10Y PL-DE bond yield spread is currently trading around the lower end of the 250-300bp range and we expect it might widen a bit above 260 bp

EURPLN and dollar index



Source: Refinitiv Datastream, Santander Bank Polska

USDPLN and CHFPLN

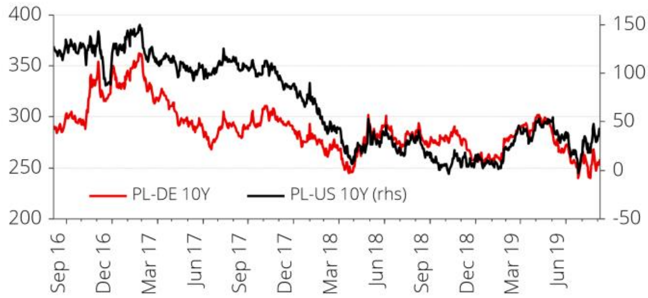


Source: Refinitiv Datastream, Santander Bank Polska

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 (9 September)				
08:00	DE	Exports SA	Jul	% m/m	-0.7		-0.1
			TUESDAY (10 September)				
09:00	CZ	CPI	Aug	% y/y	2.8		2.9
09:00	HU	CPI	Aug	% y/y	3.2		3.3
			WEDNESDAY (11 September)				
	PL	**MPC decision**		**%**	**1.50**	**1.50**	**1.50**
			THURSDAY (12 September)				
08:00	DE	HICP	Aug	% m/m	-0.1		-0.1
11:00	EZ	Industrial Production SA	Jul	% m/m	-0.05		-1.6
13:45	EZ	ECB Main Refinancing Rate	Sep.19	%	0.0		0.0
14:30	US	CPI	Aug	% m/m	0.1		0.3
14:30	US	Initial Jobless Claims	Sep.19	k	215		217
			FRIDAY (13 September)				
10:00	**PL**	**CPI**	**Aug**	**% y/y**	**2.8**	**2.8**	**2.8**
14:00	**PL**	**Current Account Balance**	**Jul**	**€mn**	**4**	**-401**	**21**
14:00	**PL**	**Trade Balance**	**Jul**	**€mn**	**-80**	**-14**	**-77**
14:00	**PL**	**Exports**	**Jul**	**€mn**	**19046**	**18845**	**18068**
14:00	**PL**	**Imports**	**Jul**	**€mn**	**18956**	**18859**	**18145**
14:30	US	Retail Sales Advance	Aug	% m/m	0.2		0.7
16:00	US	Michigan index	Sep	pts	90.2		89.8

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg