20 September 2019

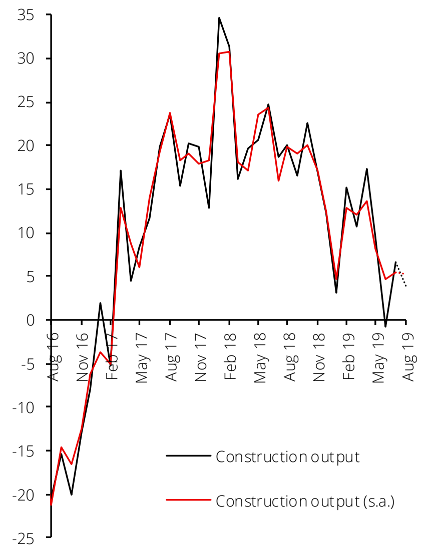
Weekly Economic Update

Slowdown confirmed by the data

What's hot next week

- Investors' concerns about the looming global recession have softened recently, but the new signals about the economic activity are still closely watched. In this context, the new publications of business sentiment indicators in Europe (flash PMIs, Ifo, ESI) and large set of macro data in US to be released in the coming week will be important hints about pace of economic expansion in the third quarter.
- Polish data released recently signalled that the domestic economy's famous resilience to the external shocks has been weakening and the pace of GDP growth is likely to slow. The data about **construction output**, to be released on Monday, and the monthly Statistical Bulletin on Tuesday, will help to verify this hypothesis. Our forecast of construction output growth (3.9% y/y) is above market consensus, but still assumes a deceleration, which is consistent with GDP growth slowing in the third quarter. Besides, the **minutes from the September MPC meeting** will be published, revealing if there was any motion to change interest rates submitted this time. Also, the Ministry of Finance may release data about state budget performance after August.
- In the CEE region, Czech and Hungarian central banks will hold meetings. In both cases no-change decisions are expected.
- The week will end with a **review of Polish credit rating by Fitch** – the decision is due on Friday after local trading hours. We do not expect any changes.

Construction output, % y/y



Source: GUS, Santander

Market implications

- The zloty depreciated late in the week after the information that ECJ ruling on CHF mortgage loans will be released on 3 October. We expect the upward move of EURPLN to continue, possibly to 4.40. Worries about Poland losing resilience to the EU slowdown can only support such move as well as the uncertainty around the ruling.
- We think Polish fixed income market should closely track core markets. We do not expect significant changes in neither spreads to German bonds (10Y at 255bp) nor asset swaps (10Y at 30bp). Technical picture for the core markets implies yield increases (up to 2.00% in case of UST, or 25bp from current level) which, by a rough measure, implies 10Y Polish government bonds going up to 2.20% or 2.30%.

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Last week in economy

The recent data confirmed that Polish economy is not entirely immune to the European slowdown. Industrial output showed a worrying unexpected decline y/y in August, retail sales also came below consensus. Despite a rise of PMI for Polish manufacturing in August, the set of GUS business sentiments indicators for September has shown further declines. Eurozone growth forecasts are being adjusted down recently and the consensus is no longer showing a rebound of Eurozone GDP growth next year. The only stable element is the record high optimism of Polish consumers.

In August Polish **industrial output** declined by 1.3% y/y, while the consensus was +1.3% y/y and our forecast was +0.9%. Correcting for seasonal and working day effects, output rose 1.7% y/y, the weakest growth in three years. Half of industries recorded a drop of output in August. Investment goods recorded the largest decline, -4.5% y/y, while consumer goods production rose marginally. With Europe slowing down it was hard to expect the Polish industry to remain resilient forever. And indeed, the August data from the manufacturing sector confirm, in our view, that the economic stagnation in the euro zone is finally taking its toll on Polish producers.

Retail sales slowed down in August from 5.7% y/y to 4.4% y/y, in line with our expectations and vs 5.3% expected by the market. Sales of cars was up only 3% y/y, the weakest reading this year), which corresponds to weaker results of car output in August.

Poland's August **employment** slowed down to 2.6% y/y, below consensus. In monthly terms, employment fell by 8k and this was the worst August performance since 2012. There is growing evidence that demand for labour in Poland is losing steam and this may translate into lower wage pressure in the upcoming quarters. Meanwhile, wages grew by 6.8% y/y, in line with expectations.

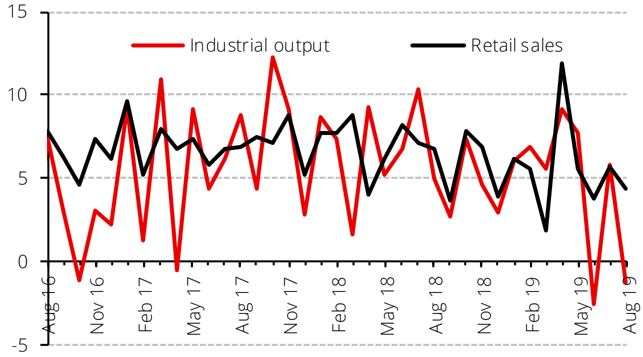
In September, **consumer confidence** remained record high. Most of the components are close to their historical tops or setting new records. Judging by the second highest reading of households' current financial situation gauge and the record high major purchases index, private consumption should be quite strong in 3Q19. It is interesting to see the retail trade sector perceive the situation far worse than consumers. **Business sentiment** indicators for September showed a further decline of the main synthetic indicator to the lowest level since early 2017. Retail trade saw the largest m/m deterioration, due to declining current sales index and rising pessimism when it comes to future sales. In industry, the current order book index declined a bit more (it is now the lowest in two years), the expectations about future production rose marginally, but remain around the weakest levels since 2013.

The government's initiatives aimed at boosting cash transfers to households sector should be mitigating the pace of economic slowdown, in our view, via stimulating private consumption (which might accelerate from 4.4% in 2Q to c5% in 2H19). However, we think it will not be enough to offset the weakening of external demand and likely investment slowdown. Thus, we expect GDP growth in 2H19 to continue slowing gently, towards 4.0% y/y in 4Q19 and 4.3% on average in 2019.

The **OECD updated its growth forecasts**. World's GDP expectations for 2019 were lowered to 2.9% from 3.2% shown in May and for 2020 to 3.0% from 3.4%. The organisation is no longer expecting the euro zone growth to rebound in 2020 (current forecast: 1.1% in 2019 and 1.0% in 2020, as compared to 1.2% and 1.4% previously).The ECB has also recently resigned from suggesting higher Eurozone growth in 2020 than in 2019 and no rebound has also already become the market consensus.

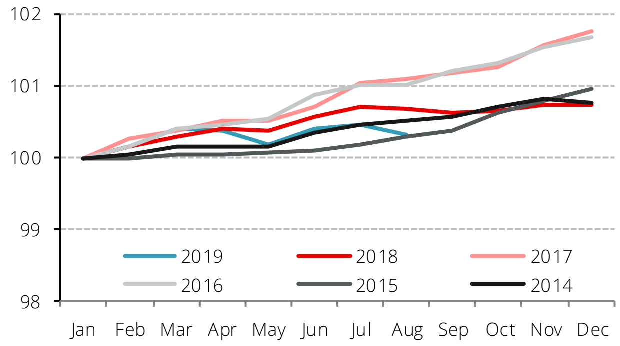
We had **several MPC speakers**, all convinced that minimum wage is not a problem from CPI perspective - Grażyna Ancyparowicz mentioned a +0.5pp response in 2020, but fading relatively quickly. Jerzy Kropiwnicki who, we thought, could join the hawks at some point, now seems to have aligned his view with governor Glapiński (global background as a reason to hold rates steady). Eugeniusz Gatnar is thinking of another rate hike motion in November due to CPI acceleration, while Łukasz Hardt mentioned that even a 15bp hike could serve well the NBP credibility, if inflation is to permanently stay at 3.5% next year. We assume Polish rates will be unchanged in 2019 and 2020.

Production and retail sales in Poland, %y/y



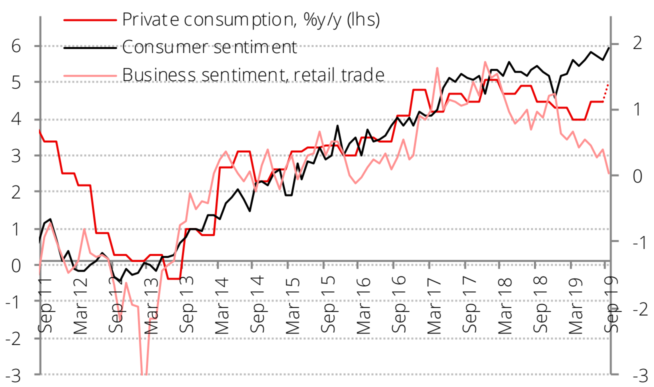
Source: GUS, Santander

Employment in the enterprise sector, Jan=100



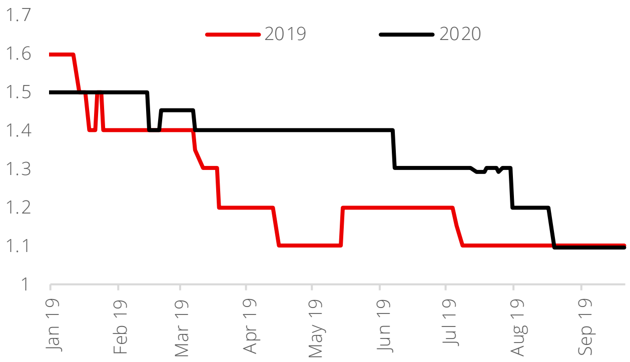
Source: GUS, Santander

Sentiment of consumers and retail trade sector vs private consumption growth



Source: GUS, Santander

Evolution of market consensus on euro zone GDP growth for 2019 and 2020



Source: Bloomberg, Santander

FX and FI market

Last week on the market

FX There was surprisingly little volatility in the FX markets last week given the importance of the FOMC meeting. The dollar index remained almost unchanged over the week at 98.2, trading just slightly stronger at 98.7 on Tuesday and then again on Wednesday just after the US rate decision. EURUSD followed suit and remained in a narrow 1.10-1.11 range throughout the week.

The zloty weakened: to 4.368 from 4.32 vs the euro, to 3.96, from 3.90 vs the dollar, to 4.95 vs 4.88 vs the pound and to 3.96 from 3.99 vs the Swiss franc.

Other CEE currencies lost as well: EURCZK only marginally to 25.9 from 25.85, whereas EURHUF 0.3% to 332.3 from 331.5, however with printing another all-time high at 334.3 in the meantime on Tuesday. The ruble was the outlier and USDRUB fell 0.6% because of higher oil prices (ca +7% w/w).

FI The week saw both core and Polish yields coming down given the bond-supportive environment of previous week's ECB QE programme, US FOMC's delivered cut and at best mediocre economic data out of Poland (August employment in corporate sector, industrial output) and Germany. As a result 10Y UST traded lower to 1.76% from 1.90%, Bunds to -0.51% from -0.45% whereas Polish bonds to 2.05% from 2.14% a week ago.

Key events

Next week we will see flash PMIs for Japan, Australia, Eurozone, Germany, France and US on Monday, Germany IFO on Tuesday, as well as Hungarian (Wednesday) and Czech (Thursday) rate decisions, both expected unchanged at 0.9% and 2.0%, respectively. Towards the end of the week we will see prices data from the US and Industrial Production from China.

In Poland, market awaits central bank minutes on Thursday and hopes to find out whether there was a motion for a rate change. On Friday Fitch Ratings will review the current Long-Term Foreign Currency Polish rating at A-/stable (kept by Fitch since 2013, 7th highest level of rating).

Market implications

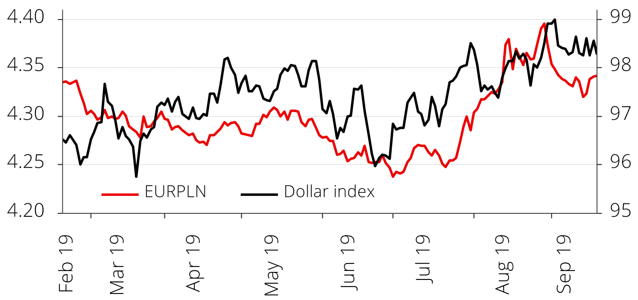
Having three big central bank meetings behind us, two of which (ECB and FED) eased and one of which (BOJ) is expected to act in October, it is tempting to think that risk assets should perform well into the future, especially in the forthcoming week as we are approaching the end of Q3. We think, however, that given decent US macro data (retail sales, housing starts, core CPI), risk of even higher oil prices as the uncertainty in the Gulf remains high and the fact that the core fixed income markets are technically overbought, there is a possibility of higher long-end yields and weaker EM currencies next week.

FX EURPLN was slowly grinding higher last week as it rebounded from the 4.3170 low the week before. We think the pair might gradually increase towards 4.40 next week.

EURUSD is currently trading close to its downtrend channel resistance and if it breaks it, it might test 1.118. If that happens, USDPLN should remain range bound in the low 3.90s. Otherwise (that is with EURUSD at or below 1.1050) the USDPLN should trade in the high 3.90s.

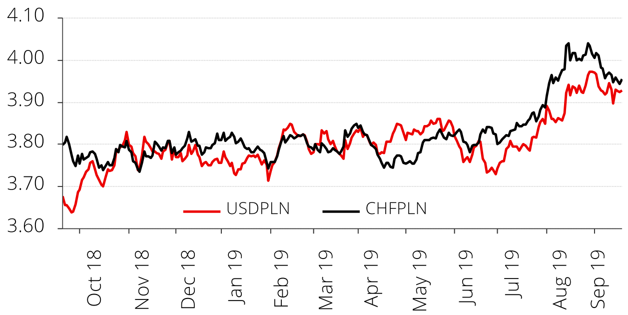
FI We think Polish fixed income market should closely track core markets as it has most recently. We do not expect significant changes in neither spreads to German bonds (10Y at 255bp) nor asset swaps (10Y at 30bp). As noted above, technical picture for the core markets implies yield increases (up to 2.0% in case of UST, or 25bp from current level) which, by a rough measure, should imply 10Y Polgbs testing their 2.20% highs from the end of July or even the 2.30% ones from early July.

EURPLN and dollar index



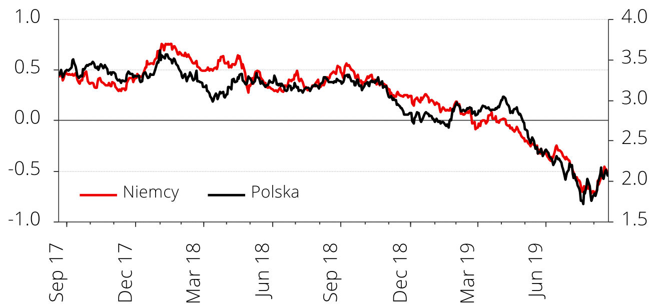
Source: Refinitiv Datastream, Santander Bank Polska

USDPLN and CHFPLN



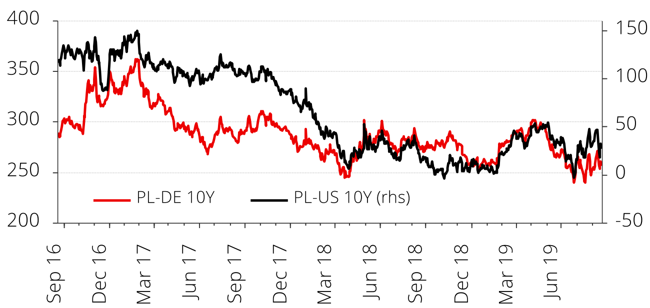
Source: Refinitiv Datastream, Santander Bank Polska

10Y bond yields



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 (23 September)					
09:30	DE	Flash Germany Manufacturing PMI	Sep	pts	44.3		43.5
09:30	DE	Flash Markit Germany Services PMI	Sep	pts	54.35		54.8
10:00	EZ	Flash Eurozone Manufacturing PMI	Sep	pts	47.3		47.0
10:00	EZ	Flash Eurozone Services PMI	Sep	pts	53.3		53.5
10:00	**PL**	**Construction Output**	**Aug**	**% y/y**	**1.9**	**3.91**	**6.6**
14:00	**PL**	**Money Supply M3**	**Aug**	**% y/y**	**10.0**	**10.09**	**9.9**
		TUESDAY (24 September)					
	PL	**Central Budget Cumul.**	**Aug**	**mn PLN**	**-**		**-4782.9**
10:00	DE	IFO Business Climate	Sep	pts	94.6		94.3
10:00	**PL**	**Unemployment Rate**	**Aug**	**%**	**5.2**	**5.2**	**5.2**
14:00	HU	Central Bank Rate Decision	Sep.19	%	0.9		0.9
16:00	US	Consumer Conference Board	Sep	pts	134.0		135.1
		WEDNESDAY (25 September)					
13:00	CZ	Central Bank Rate Decision	Sep.19		2.0		2.0
16:00	US	New Home Sales	Aug	% m/m	2.84		-12.8
		THURSDAY (26 September)					
14:30	US	GDP Annualized	2Q	% Q/Q	2.0		2.0
14:30	US	Initial Jobless Claims	Sep.19	k	213.0		208.0
16:00	US	Pending Home Sales	Aug	% m/m	0.95		-2.5
		FRIDAY (27 September)					
11:00	EZ	ESI	Sep	pct.	103.0		103.1
14:30	US	Durable Goods Orders	Aug	% m/m	-1.15		2.0
14:30	US	Personal Spending	Aug	% m/m	0.3		0.6
14:30	US	Personal Income	Aug	% m/m	0.4		0.1
14:30	US	PCE Deflator SA	Aug	% m/m	0.1		0.2
16:00	US	Michigan index	Sep	pts	92.1		92.0

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.