22 November 2019

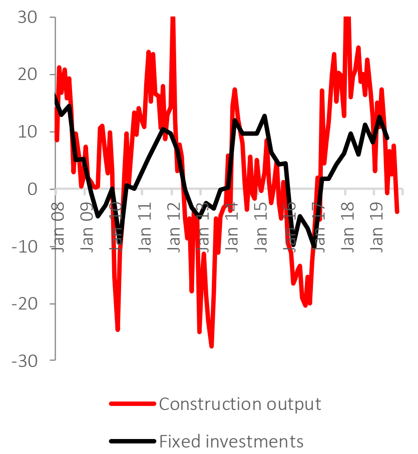
# Weekly Economic Update

## Rising worries about investments

### What's hot next week

- Polish data show more and more worrying signals (last week's news: drop of employment, slowing wages, lower consumers' confidence, falling business climate and companies' profitability, slump in construction output). It all shows that the economic slowdown gains momentum and may be worse than expected. The last week of November will bring only a few local data releases, but if they continue disappointing, we may see a wave of downward revisions of Poland's GDP forecasts. Today the Bloomberg consensus for GDP growth is at 4.3% in 2019 and 3.4% in 2020 (our forecast: 4.3% and 3.5%, respectively).
- Key data releases will include October's retail sales (on Monday) and 3Q GDP (on Friday). As regards the latter, we already know from the flash release that economic growth slowed to 3.9% but for investors the key information will be the breakdown of GDP. We see the risk that the data will show a clear worsening of investment growth, which – together with the slump of construction output in October and other warning signs we have mentioned in previous weeks – may boost worries about investment outlook for next quarters. The bright spot in the GDP breakdown should be net exports with slightly positive contribution to growth and solid private consumption. However, the outlook for the latter is becoming less rosy as well, due to weakening labour market and eroding consumer confidence. In this context, the October's retail sales data will be important – confirmation of our forecast, assuming acceleration to 4.8% y/y in constant prices (market consensus 4.3%) would ease worries about future a little bit.
- On Friday the flash CPI reading will be released. We predict inflation rise to 2.7% y/y, pushed up mainly by core inflation but also a rebound in fuel prices in recent weeks. We still believe the peak of inflation will take place at the start of 2020 when it can even reach 4% y/y unless energy tariffs are frozen again (but the government's declarations in this matter are increasingly vague). But soon after the trend will reverse and inflation should converge to the target amid slowing external and local economy. MPC investors seem to anticipate such scenario and thus the data about economic activity will be more important than about inflation. Next disappointments from Polish economy may trigger increased speculation for interest rate cuts.
- Abroad we will see numerous data releases in the USA and a couple of them in the euro zone. Investors will seek indications whether the global economic slowdown is likely to end soon. Any signals about progress in US-China trade negotiations will remain key for market sentiment. Therefore, also the developments in Hong Kong will be watched very closely.

**Construction output vs investments, % y/y**




*Source: GUS, Santander*

### Market implications

- EURPLN has been rising since the start of November, following earlier strong drop in October, and we do not expect the zloty to gain noticeably before end of November.
- Sharp rise of Bund yield after November's flash PMIs was short-lived and we think that bond yields may keep declining towards levels observed at the end of October.

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## Last week in economy

First hard data on 4Q19 seem to confirm that the Polish economy was in a downtrend. November business and consumer sentiment indicators are pointing in the same direction.

**Industrial production** rose 3.5% y/y in October, exceeding expectations, but staying below 1H19 average. It seems Polish manufacturing copes surprisingly well with the global slowdown and stagnation in Germany. However, **construction output** was a major disappointment, falling 4% y/y. The data suggest a collapse in infrastructural investments. We see growing risk that the investment and GDP slowdown in the coming quarters may be more pronounced than earlier expected. November **business climate survey** showed deepening worries of manufacturers about production outlook (the weakest reading in six years) and decreasing confidence in retail trade. More in our economic comment.

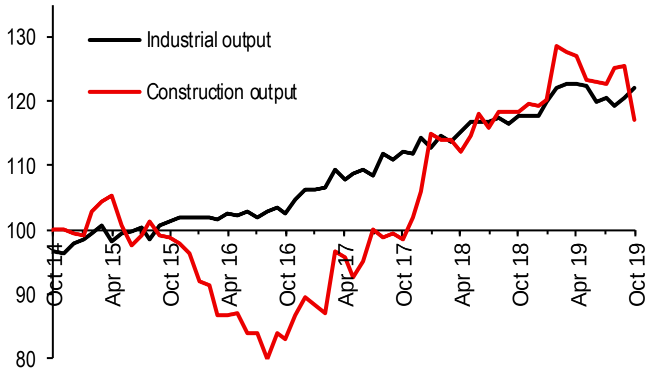
**Employment growth** in the corporate sector slowed to 2.5% y/y in October from 2.6% in September. In monthly terms employment fell by 2.7k and this was the first decline in October since 2012 and the third decline in a row. This suggests weaker labour demand. October wage growth in the corporate sector was at 5.9% y/y, again slightly below market expectations. In November, **Polish consumer sentiment indicators** declined again. Current situation index is the lowest in nine months, expectations index is the lowest in 11 months. The largest decline was recorded in expectations about economic situation and unemployment worries are growing. The gauge of households' financial situation and their appetite for major purchases are still historically high though. Note, however, that even despite a slowing labour income, household's disposable incomes will be supported by lower tax rates, expansion of 500+ programme and another payment of 13. pension, so in our view, the income growth will be supportive for private consumption. More on labour market and consumer confidence in this economic comment.

In 3Q19, **Polish companies employing 50+ saw revenues** rising by 6.0% y/y and costs by 6.4% y/y, which led to a compression of profit margins to 4.6% from 5.0% in 3Q18. Companies were still witnessing a major rise of labour costs, which increased by 12.0% y/y and were the main contributor to total cost growth. In our view, the margin compression will be an argument curbing wage growth and fuelling inflation in the quarters to come. **Investment outlays** in companies employing 50+ slowed down to 11.3% y/y in 3Q19 from 17.0% y/y in 2Q19. Slowing investment is in line with our expectations, given deteriorating economic climate and declining EU funds utilisation. We are expecting a further slowdown to come. We are expecting total investment in the economy to slow down to 6% y/y in 3Q19 from 9% y/y in 2Q19.

The PiS draft bill on **abolition of limit on social contributions was pulled away**, which may make it a bit more difficult to balance the 2020 budget. The PM suggested spending cuts in bureaucracy as an offsetting factor.

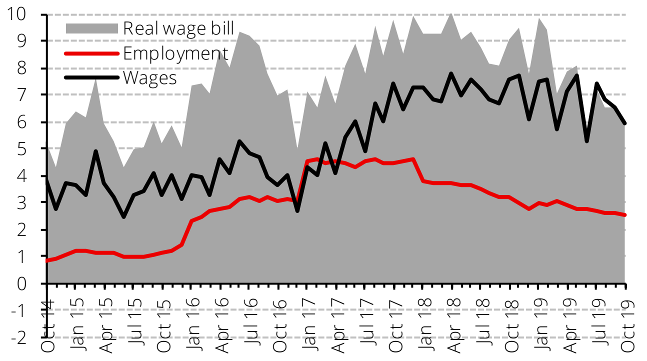
According to **MPC minutes**, during the November MPC meeting, the motion to cut rates appeared for the third time in a row and failed again. Most MPC members think that they agree with the new GDP forecasts, while some central bankers gathered that CPI forecasts are underestimated, given the strong demand pressure in the economy. Still, the MPC as a whole still sees keeping rates unchanged as an optimal solution.

**Seasonally adjusted output (2015=100)**



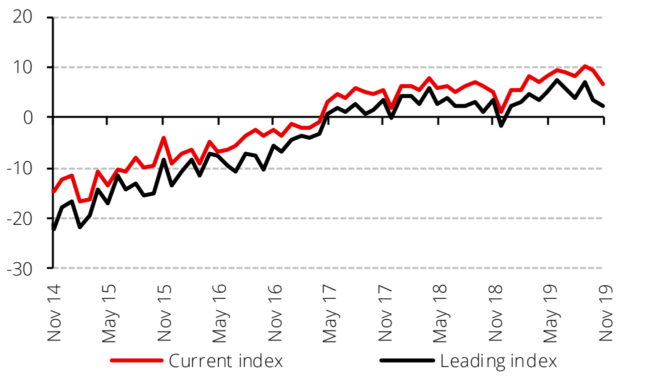

Source: GUS, Santander

**Labour market statistics, % y/y**



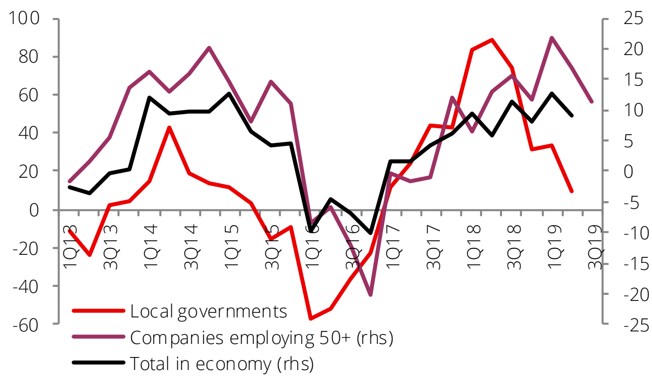

Source: GUS, Santander

**Consumer sentiment, pts**




Source: GUS, Santander

**Investment, % y/y**




Source: GUS, Santander

## FX and FI market

### Last week on the market

**FX** The passing week is likely to be the third in a row of the EURPLN rising. Mixed news flow related to the trade talks weighed on the global market sentiment which together with the profit taking after the zloty strong performance in October pushed EURPLN to the fresh November peak at c4.30. The zloty lost marginally also vs the dollar and remained stable vs the pound and franc.

Elsewhere in the CEE region, EURHUF was hovering just below its all-time-high of c336, USDRUB remained fairly stable at slightly above 63.6 and EURCZK eased marginally to 25.5 from 25.6.

The Central Bank of Hungary kept rates unchanged, including the main one at 0.90%. The bank sees its monetary policy as expansionary, and acknowledged that inflation pressures eased thanks to a slower growth abroad. In Czech Republic, Mr Vojtech Benda from CNB thinks that Czech rates should be increased. Currently, the main rate equals 2.00%. Last time the CNB changed rates was in May.

**FI** Polish IRS and bond yields traded down amid some deterioration of the global market mood and Bunds together with Treasuries holding at a strong level. Polish IRS curve shifted more than the debt curve and so the assets swap spreads narrowed marginally. Both curves flattened.

At the switch auction, the Ministry of Finance sold bonds for PLN4.1bn and said that the 2020 gross borrowing needs are covered in 33% (under assumption of the zero central budget deficit).

### Key events

In the coming days, we will see many US data but these releases shall be of a secondary importance. The most awaited information is still how the US-China trade talks are going and the market would be particularly sensitive to the news on that front.

In Poland, we will see flash November CPI and detailed 3Q GDP data. Our inflation forecast is above the consensus (2.7% vs 2.5%).

### Market implications

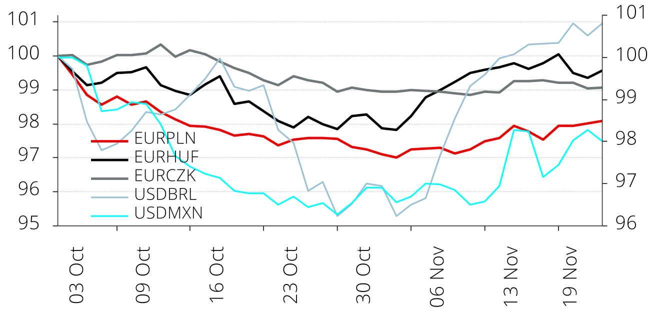
The passing week has been rather neutral in terms of macro data surprises and the rally on the global equity market paused while bonds gained slightly since we have also had no positive news regarding the trade talks progress.

**FX** Back in October, five of the major EM currencies gained vs the euro and 16 vs the dollar with the zloty being the strongest of them. Until now in November, only five currencies that gained vs dollar in October are not weaker (two are stable, and three are even stronger). Versus the euro, only one of the currencies that gained in October extended its gains (the Czech koruna). Apparently, it seems that in November the market favours the currencies that underperformed in October. EURPLN is on the rise since the start of November after the October sharp drop and we do not expect the zloty to recover at least by the end of the month.

**FI** We do not expect any big changes to take place on the Polish fixed income market in the coming days. The jump of the Bund yield after the flash November PMIs were released was very short-lived and we think that yields may ease towards levels seen in late October (1.76% for 5Y, 2% for 10Y, in case of Polish debt).

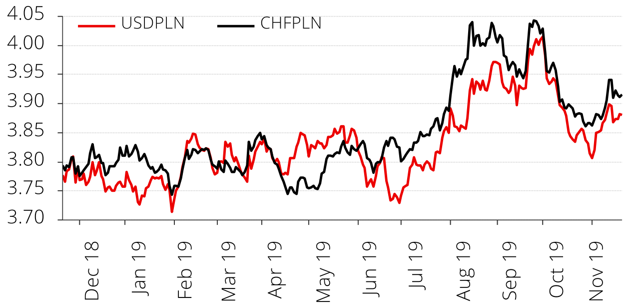
Taking a broader look, the current Bund/UST yields' upside wave that started in early September is already the biggest in the down trend observed since 2018. This might suggest that the balance is shifting towards higher yields in the weeks or months to come. However, the current upside move is for now only a 3-wave structure, typical for the corrective moves. To keep chances high for the Bund yields to rise in the coming weeks, the support at the September peak (c-0.434%) cannot be broken.

**EM currencies (Oct 1 = 100)**



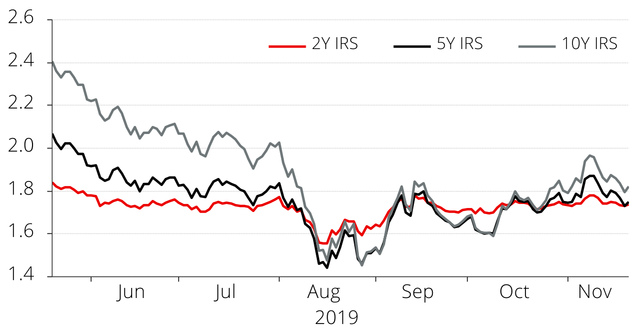

Source: Refinitiv Datastream, Santander Bank Polska

**USDPLN and CHFPLN**



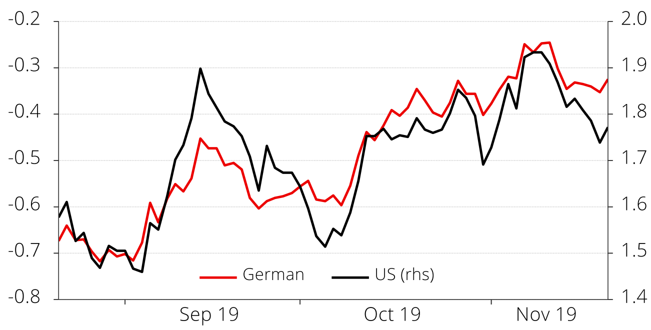

Source: Refinitiv Datastream, Santander Bank Polska

**PLN IRS**




Source: Refinitiv Datastream, Santander Bank Polska

**10Y Bund and UST yields**




Source: Refinitiv Datastream, Santander Bank Polska

## Economic Calendar

| TIME CET | COUNTRY | INDICATOR | PERIOD | | FORECAST MARKET | FORECAST SANTANDER | LAST VALUE |
|---|---|---|---|---|---|---|---|
| | | **MONDAY (25 November)** | | | | | |
| 10:00 | DE | IFO Business Climate | Nov | pts | 95.0 | - | 94.6 |
| **10:00** | **PL** | **Retail Sales Real** | **Oct** | **% y/y** | **4.3** | **4.8** | **4.3** |
| | | **TUESDAY (26 November)** | | | | | |
| **14:00** | **PL** | **Money Supply M3** | **Oct** | **% y/y** | **8.95** | **9.0** | **9.4** |
| 16:00 | US | Consumer Conference Board | Nov | pts | 126.7 | - | 125.9 |
| 16:00 | US | New Home Sales | Oct | % m/m | 0.78 | - | -0.7 |
| | | **WEDNESDAY (27 November)** | | | | | |
| **10:00** | **PL** | **Unemployment Rate** | **Oct** | **%** | **5.1** | **5.0** | **5.1** |
| 14:30 | US | Durable Goods Orders | Oct | % m/m | -0.5 | - | -1.2 |
| 14:30 | US | GDP Annualized | 3Q | % q/q | 1.9 | - | 1.9 |
| 14:30 | US | Initial Jobless Claims | week | k | 218 | - | 227 |
| 16:00 | US | Personal Spending | Oct | % m/m | 0.3 | - | 0.2 |
| 16:00 | US | Personal Income | Oct | % m/m | 0.3 | - | 0.3 |
| 16:00 | US | Pending Home Sales | Oct | % m/m | 0.2 | - | 1.5 |
| 16:00 | US | PCE Deflator SA | Oct | % m/m | 0.3 | - | 0.0 |
| 20:00 | US | Fed Beige Book | | | | | |
| | | **THURSDAY (28 November)** | | | | | |
| 11:00 | EZ | ESI | Nov | pct. | 101.0 | - | 100.8 |
| 14:00 | DE | HICP | Nov | % m/m | -0.6 | - | 0.1 |
| | | **FRIDAY (29 November)** | | | | | |
| 08:00 | DE | Retail Sales | Oct | % m/m | -0.1 | - | 0.0 |
| 09:00 | CZ | GDP SA | 3Q | % y/y | 2.5 | - | 2.5 |
| 09:00 | HU | GDP | 3Q | % y/y | 5.0 | - | 5.0 |
| **10:00** | **PL** | **Flash CPI** | **Nov** | **% y/y** | **2.5** | **2.7** | **2.5** |
| **10:00** | **PL** | **GDP** | **3Q** | **% y/y** | **-** | **3.9** | **3.9** |
| 11:00 | EZ | Flash HICP | Nov | % y/y | 0.8 | - | 0.7 |
| 11:00 | EZ | Unemployment Rate | Oct | % | 7.5 | - | 7.5 |

*Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg*



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