03 January 2020

Weekly Economic Update

The first test of market optimism

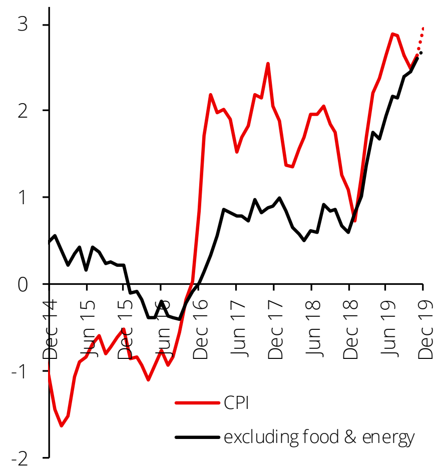
What's hot next week

- Late 2019 has been very supportive for risky assets with the main global stock indexes reaching their fresh all-time or multi-month peaks, yields moving up and the EM currencies holding or extending gains. However, the very beginning of 2020 could be challenging since the US airstrike in Baghdad spurred concerns about the situation in Middle East.
- The geopolitical factor could be key for the market, at least at the beginning of the week, in our view. However, if the tensions do not escalate and the economic activity data show that a shy improvement has continued in late 2019, the situation could stabilize. We will see important data from Germany (exports, industrial output, factory orders) and USA (nonfarm payrolls, factory orders, services ISM).
- In Poland, flash December CPI will be released on Tuesday and the next day the MPC will announce its decision about interest rates. We think inflation reached 3% y/y in the final month of 2019 and our estimate is above the consensus (2.8% y/y). This, however, should not affect the MPC rhetoric meaningfully. The tone of the statement shall sound similarly to the previous ones and the only potentially interesting issue will be if the newly appointed member Cezary Kochański is present during the post-meeting press conference so that we can get some clues on his attitude towards monetary policy. In our base case scenario, we expect MPC's status quo to be maintained.

Market implications

- We expect the zloty to depreciate somewhat in early 2020 after its "traditional" December strengthening. The trigger for EURPLN rise could be deterioration of the global market mood after the US military action that should prevent the exchange rate from breaking the lower end of the multi-month 4.24-4.40 range. The levels to watch in case of EURPLN are 4.29 and 4.31.
- We expect Polish yields to move further up next week with the 10Y bond yield touching 2.20% and possibly above. At the same time, the 10Y PL-DE spread could widen to 255bp since the Polish CPI might add pressure on bonds while core debt could benefit from weaker global market mood.

CPI inflation, %y/y



Source: GUS, NBP, Santander

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What's hot next week

In December the Polish **manufacturing PMI** increased again, to 48 pts. Best improvement was seen in the current output and new orders (albeit both remained below 50.0). Improvement was also seen in the production forecasts, while employment and purchasing activity of companies further deteriorated. The **GUS business cycle indicators** have not confirmed the improvement seen in the PMI – the current production and new orders indicators fell to the lowest levels seen in this cycle. Hard data on the value of new orders also showed a slowdown (total orders down 0.2% y/y in November, foreign orders down 1.1% y/y). We expect the trend in Polish industry to change this year into a positive one, but not yet.

Construction output in November declined by 4.7% y/y vs. market consensus -6.4% y/y and our forecast -2.4% y/y. After seasonal adjustment production increased 1% y/y, which was the second worst reading since February 2017. The biggest decline was recorded in companies dealing with civil engineering (-7% y/y) and specialised construction activities (-12.8% y/y). In our view the data confirm the significant slowdown in investment growth, mainly in infrastructure development. After almost full set of statistical data for November our nowcasting model suggests GDP growth in 4Q2019 could have slowed below 3.5% y/y (from 3.9% in 3Q19).

In the January-November, the 2019 **central budget result** was -PLN1.9bn, so in November alone there was a surplus of PLN1.3bn. It was the second month in a row when revenues did not show a meaningful y/y rise (in November total revenues were up 0.7% y/y while VAT revenues 1.8% y/y). On the spending side a double-digit growth rate was maintained (11.9% y/y after 15.1% in October and 21.1% in September). In the **new draft of 2020 budget**, planned VAT revenues for 2019 and 2020 have been revised lower vs the September version. The document still includes zero deficit, despite the fact that social security contributions' limit will not be removed and there will be a pay-out of the 13th pension. This has been achieved with some creative accounting (e.g. moving some expenses to the new Solidarity Fund) and an addition of large transfer of NBP profit. The GG balance is shown at -1.2% GDP vs -0.3% in the September's version.

According to **detailed data on November wages**, the slowdown was widely observed. Wages ex mining grew 5.7% y/y vs 6.3% previously, which is the lowest reading since mid-2017. Possibly, the introduction of Employee Capital Plans (PPK) was treated as a substitute of wage hikes (participants receive extra contributions from employer and the state). The decline of job offers in November by 16.4% y/y caused a further fall of the job offers-per-unemployed ratio, measuring how tight the labour market is.

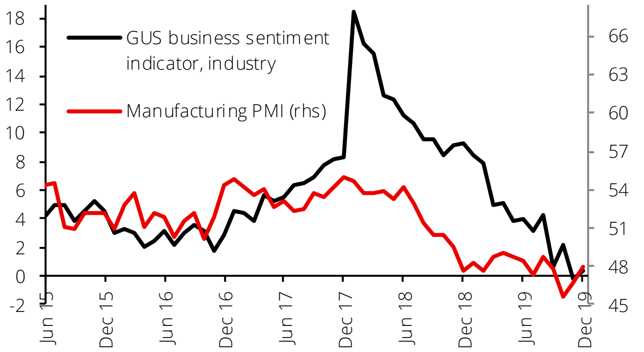
According to **quarterly balance of payments data**, in 3Q19 the C/A balance was -€181mn while monthly data were showing -€1284mn. The 2Q balance was also revised up, to +€859mn from +€430mn.

In November, **M3** rose by 9.4% y/y. Cash in circulation kept growing at c11% y/y, household deposits were up 10.2% y/y and firm deposits 9%+. Consumer credit weakened somewhat, from 9.1% y/y to 8.7% (the lowest in 1.5 years), mortgage credit (PLN-denominated at 12.3% y/y, total at 6,9% y/y) grew at a similar pace to previous months. Total credit growth adjusted for FX changes was 5.8% y/y (the lowest since August), with household credit rising 6.6% and corporate loans up 4.8% y/y.

In December, GUS **consumer inflation expectations** reached a seven-year high, most likely on electricity price hikes (the regulator approved a c10-12% rise of bills, the government is to propose a compensation scheme, but likely limited to low-earners) and signals that several other house maintenance services will go up strongly in 2020.

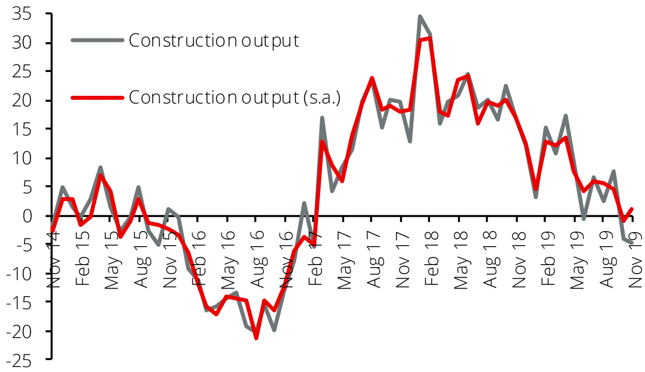
The President has officially nominated Cezary Kochalski for the **MPC** member. Łukasz Hardt is concerned about the services price growth and called for a 15bp rate hike in 1Q20. Grażyna Ancyparowicz is against rising the cost of credit (since the pace of credit growth is not worrying), she does not exclude rate cuts but only when the economic growth decelerates more than expected. Eryk Łon said he will stop submitting rate cuts motions when PMI returns above 50pts.

Business sentiment indicators, industry



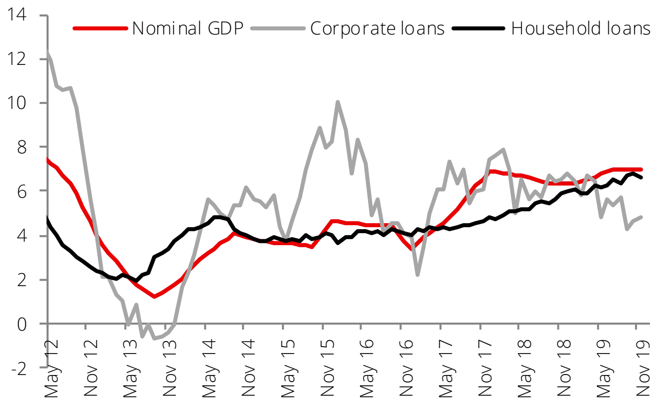
Source: GUS, Bloomberg, Santander

Construction output, %y/y



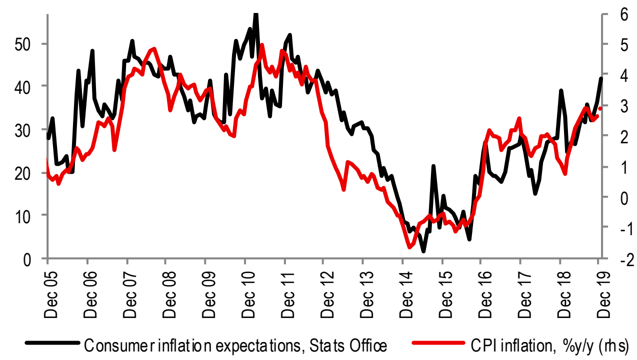
Source: GUS, Santander

Fx-adjusted credit growth, %y/y



Source: NBP, GUS, Santander

Consumer inflation expectations vs CPI



Source: GUS, Santander

FX and FI market

Last 2 weeks on the market

FX The last two weeks of the 2019 were relatively quiet on the currency markets as the announcement of the US-China deal to be signed on the 15th of January weakened the USD (the dollar index down 0.75%) and strengthened the EM currencies in general. EURPLN fell by 1.3% in December conforming to the usual seasonal pattern, and in the last two weeks strengthened by 0.3% to 4.25, briefly trading below 4.24. USDPLN fell even more – by 0.7% to 3.815 - due to weaker dollar. GBPPLN stayed unchanged at roughly 5.00, because of the GBP weakness. CHFPLN increased 0.3% to 3.925 as markets sought save havens after early January US strikes that killed an Iranian general. Over the last two weeks other regional currencies strengthened as well: EURHUF fell by 0.3% to 329.4, EURCZK by 0.4% to 25.35 and USDRUB by 0.7% to 62.0 but this was mainly due to weaker dollar – the RUB basket has not changed.

FI POLGBs 10Y yields followed the rising core market yields and remained at elevated levels for the most part of the second half of the December closing the year at 2.10% and briefly trading sub 2.15% in early January before falling to 2.07% on the increased risk-off mood. The FRA market remained stable - the 21x24 month FRA is still pricing around a half of a 25bp cut. The steepness of the POLGBs curve was barely changed with 2x10 in the vicinity of +60bp. The 10Y ASW narrowed by 4bp to 25bp.

Key events

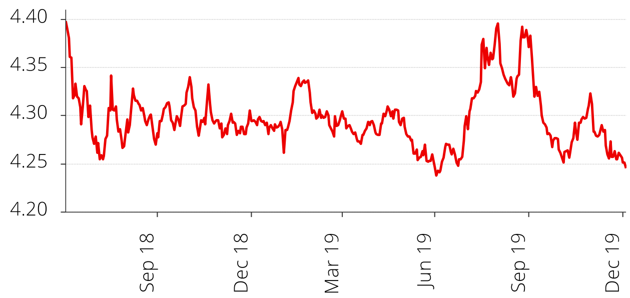
Monday 6th January is a bank holiday in Poland. On the data front, on Tuesday the December CPI will be published (our forecast is above market consensus) followed by a rate decision on Wednesday (we expect no change to interest rates at 1.50%). Elsewhere in the world, early in the week the EZ, German and Chinese services PMI will be published. On Tuesday there is EZ flash HICP and retail sales, and in the US ISM services, durable goods and factory orders. On Wednesday German factory orders are due and Hungarian industrial production, on Thursday German C/A and T/B data as well as Chinese PPI and CPI. On Friday US NFP and Czech Q3 GDP.

Market implications

FX EURPLN is still technically trading within the multi-month horizontal range (roughly 4.25-4.40), we expect the lower bound to hold for now and the EURPLN to trade higher next week towards 4.29 and then 4.31 as several factors should contribute to the zloty weakness. Firstly, the December 1.3-percent rally should reverse a bit on purely technical grounds. Secondly, as more and more positive expectations of the 15th Jan US-China deal are being priced in and the risk in general trades well, the EMFX might exhibit a "*buy the rumour, sell the fact*" pattern and weaken as the event itself approaches. Last but not least, the US – Iranian conflict risks escalating and inducing the proper risk-off mood on the markets (the likelihood of which is non-negligible given the increasing implied volatilities across the asset spectrum). The CHFPLN might move higher than EURPLN by as much as another 2pp in case EURCHF wants to test the 2017 lows at 1.064 (implying CHFPLN at 4.05).

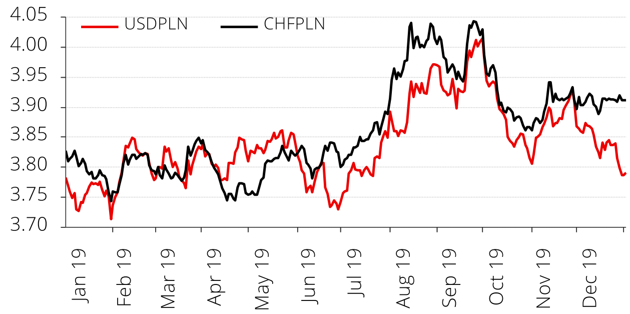
FI Polish bond yields have been trading in a range or slowly increasing since August, by and large following the core yields (where the yield rising trend is more pronounced). We expect continuation of the yield rising trend next week and expect the 10Y POLGB yields to move from the current 2.07% to 2.20%. We also expect the 10Y PL-DE spread to widen to 255bp from 235bp currently. The yield dynamics should be a function of higher December inflation print (Santander call is above the market consensus: 3.0% y/y vs 2.8%) and a risk-off mood possibly lowering the core market yields a bit, following the recent US – Iranian events.

EURPLN



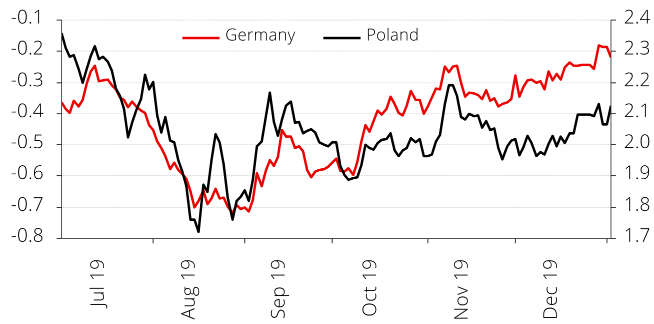
Source: Refinitiv Datastream, Santander Bank Polska

USDPLN and CHFPLN



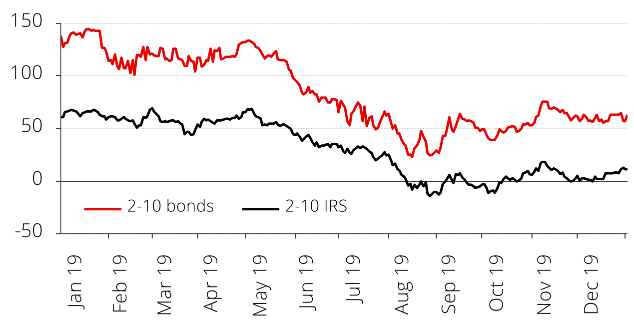
Source: Refinitiv Datastream, Santander Bank Polska

Poland and German 10Y bond yields



Source: Refinitiv Datastream, Santander Bank Polska

2-10 bond and IRS spreads



Source: Refinitiv Datastream, Santander Bank Polska

Santander

Economic Calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST SANTANDER	LAST VALUE
			MONDAY (6 January)				
	DE	Retail Sales	Nov	% m/m	1.0		-1.6
02:45	CN	Caixin China PMI Services	Dec	pts	53.2		53.5
09:55	DE	Markit Germany Services PMI	Dec	pts	52.0		52.0
10:00	EZ	Eurozone Services PMI	Dec	pts	52.4		52.4
			TUESDAY (7 January)				
10:00	**PL**	**CPI**	**Dec**	**% y/y**	**2.8**	**3.0**	**2.6**
11:00	EZ	Flash HICP	Dec	% y/y	1.3		1.0
11:00	EZ	Retail Sales	Nov	% m/m	0.5		-0.6
16:00	US	Durable Goods Orders	Nov	% m/m	-		-2.0
16:00	US	ISM services	Dec	pts	54.5		53.9
16:00	US	Factory Orders	Nov	% m/m	-0.7		0.3
			WEDNESDAY (8 January)				
	PL	**MPC decision**		**%**	**1.50**	**1.50**	**1.50**
08:00	DE	Factory Orders	Nov	% m/m	0.2		-0.4
09:00	HU	Industrial Production SA	Nov	% y/y	7.9		6.43
11:00	EZ	ESI	Dec	pct.	101.5		101.3
14:15	US	ADP report	Dec	k	165.0		66.9
			THURSDAY (9 January)				
08:00	DE	Exports SA	Nov	% m/m	-0.7		1.5
08:00	DE	Industrial Production SA	Nov	% m/m	0.8		-1.7
11:00	EZ	Unemployment Rate	Nov	%	7.5		7.5
14:30	US	Initial Jobless Claims	Jan.20	k	220.0		222.0
			FRIDAY (10 January)				
09:00	CZ	GDP SA	3Q	% y/y	2.5		2.5
09:00	CZ	Industrial Production	Nov	% y/y	-4.0		-3.0
14:30	US	Change in Nonfarm Payrolls	Dec	k	166.5		266.0
14:30	US	Unemployment Rate	Dec	%	3.5		3.5

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.