10 January 2020

Weekly Economic Update

What was behind high inflation?

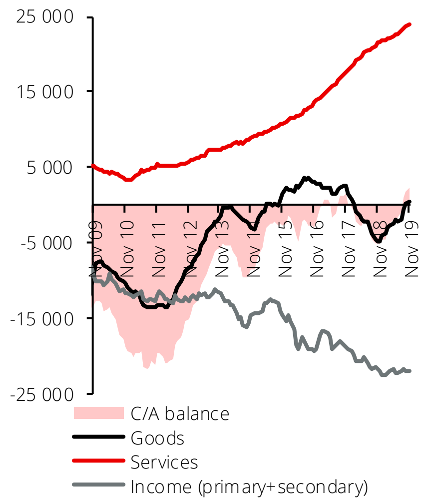
What's hot next week

- Situation on the Middle East has been a key driver for the global market sentiment in the passing week. After an initial risk aversion, the next days brought meaningful improvement since both sides claimed that war is not their aim. In effect, the stock indexes rose while the bonds lost somewhat. Most of the EM currencies are stronger vs the euro YTD but the zloty is lagging slightly.
- After the weekend, the market attention could turn to the data releases. The calendar is rich in important US releases that could be key for the dollar and core bonds.
- In Poland, we will get to see details of December CPI, including the core CPI ex food and energy prices, which – according to our estimates – hit the highest level in 17 years. November balance of payments data is to show current account surplus similar as in October amid some slowdown in foreign trade turnover.

Market implications

- EURPLN is now trading near the lower end of the 4.24-4.35 range in which it has mostly been holding since mid-2018. We think that the exchange rate will rather not move further down below 4.24 due to the risk of quicker conversion of FX mortgages to PLN. Also, it appears that the dollar could remain strong in the short term, particularly if the upcoming US data surprise to the upside.
- Strong rise of the Polish bond yields resulted in breaking important resistance levels and we think that the last days have shown the direction where the market could head in the coming weeks. After a very sharp sell-off recently suffered, bonds could try to recover and so the yields upwards move might be somewhat slower.

Balance of payments, 12m sum, EURmn



Source: GUS, NBP, Santander

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Last week in economy

Spike of CPI in December was the main domestic event of the last week, but it was again downplayed by the MPC.

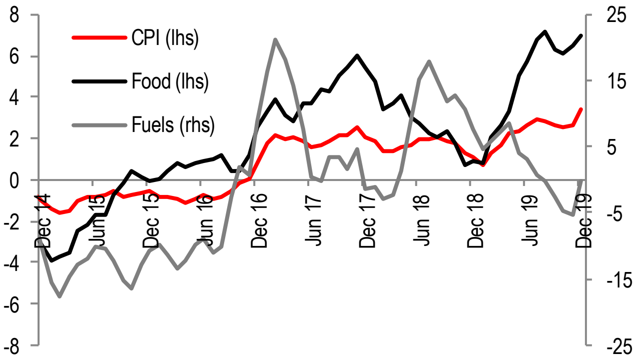
Flash CPI inflation reading for December showed a much higher-than-expected outcome: 3.4% y/y instead of 2.8% market consensus and our 3.0% forecast. We estimate that core inflation ex food and energy surged from 2.6% y/y to 3.2%, the highest in more than 17 years. After such a high December, CPI is in fact certain to be well above 4% y/y in 1Q2020 and may remain substantially above 3% for the better part of the year. More in our Economic Comment.

In line with expectations, **the MPC left interest rates unchanged** and the statement did not differ significantly in the key points vs the previous one. The relatively slow economic growth abroad and uncertainty related to the future developments were stressed again. The rise of CPI inflation in December was downplayed as caused by food, fuel and administered prices, and thus outside the scope of the monetary policy. The MPC stressed that the spike in CPI is temporary and is not expecting CPI to hit 4% in 2020. According to Governor Glapiński, the NBP staff forecasts just materialised a bit earlier so the expected path remained unchanged. Glapiński reiterated his opinion from November when he said that the next change of the interest rate was more likely to be a cut rather than a hike. New MPC member Cezary Kochalski was present at the press conference, and he said there are no reasons to change the rates. In our view, MPC will stick to its stable rate policy in 2020, even when it is surprised by CPI at the start of this year.

According to the Labour Ministry data, **the registered unemployment rate amounted to 5.2%**, in line with our and market expectations. Rise from 5.1% in November is a typical seasonal pattern and we are expecting the unemployment rate to climb further to 5.5% in January. In seasonally adjusted terms, the unemployment rate is still falling, but at an increasingly slower pace. In our view, the economic slowdown will stabilise the unemployment rate in the quarters to come.

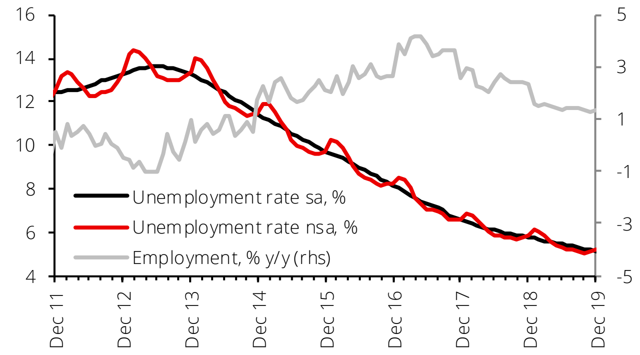
The December set of **ESI business climate indicators** showed a decline of general sentiment in Poland to the lowest level in three years. Sentiments deteriorated in industry and services but improved in retail sales and construction. In industry, indicators for new orders and employment deteriorated amid a rebound of expected prices and some improvement in expected output. Consumers seem to lose interest in making more considerable purchases. These numbers suggest a continuation of economic slowdown in Poland.

CPI Inflation, % y/y



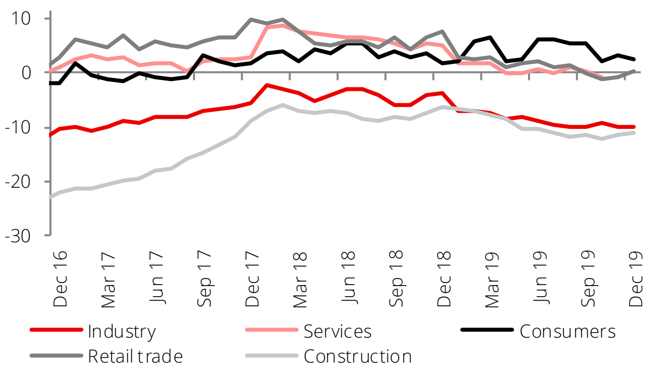
Source: GUS, Santander

Registered unemployment, %



Source: GUS, Labour Ministry, Santander

ESI indicators, pts



Source: European Commission, Santander

FX and FI market

Last week on the market

FX Last week did not bring any meaningful changes on the EURPLN market with the exchange rate trading in a narrow range of c4.23-4.25. EURPLN remained surprisingly stable despite the pretty volatile global market mood (driven by geopolitical factors) and a substantial sell-off of the Polish bonds. USDPLN rose above 3.82 from 3.78 while GBPPLN and CHFPLN remained fairly stable around 4.99 and 3.92, respectively.

In the case of the other CEE currencies, the koruna and ruble gained while the forint depreciated. EURCZK managed to break the support of 25.40 and reached its lowest since February 2018. The recent rise of the oil price and a pause of the dollar appreciation helped USDRUB get out of the nearly three-week range. The exchange rate fell to 61.0, its lowest since May 2018. EURHUF was on the rise for the whole week and after it broke the local December peak at 332.5, the next resistance level is its ATH at c337.

FI Polish bond yields and IRS rates skyrocketed amid higher yields on the core markets and a noticeable upside surprise in the inflation flash December reading. As a result, both Polish curves rose by 10-20bp with the 10Y bond yield moving even beyond our aggressive 2.20% target we mentioned last week. The 2-10Y spreads reached their highest since early November and the 10Y PL-DE bond yield spread rose to 250bp, its highest since early October.

At the bond auction, the Ministry of Finance sold bonds for PLN5.8bn (including PLN848mn at the top-up). The Ministry informed that 2020 gross borrowing needs have now been covered in 56%.

Key events

Next week, we will see Poland final December CPI and numerous US data. On Wednesday, the phase one US-China trade deal is about to be finally signed.

Market implications

FX EURPLN did not manage to stay below 4.24 for longer, at least for now, and the zloty did not benefit from return of optimism after the risk of the US-Iran conflict intensification eased. According to Bloomberg, year-to-date the majority of the main EM currencies gained vs the euro and the zloty appreciation is the second smallest in this group.

EURPLN is now trading near the lower end of the 4.24-4.35 range in which it has mostly been holding since mid-2018. We think that the exchange rate will rather not move further down below 4.24 due to the risk of quicker conversion of FX mortgages to PLN.

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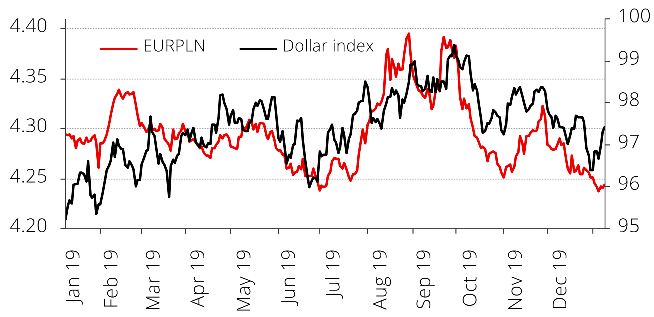
FI Strong rise of the Polish bond yields resulted in breaking important resistance levels and we think that the last days have shown the direction where the market could head in the coming weeks. After a very sharp sell-off recently suffered, bonds could try to recover and so the yields upwards move might be somewhat slower.

In mid-January, Poland final December CPI will be released and we do not expect any meaningful revision that could help bonds to recover at least part of the recent losses.

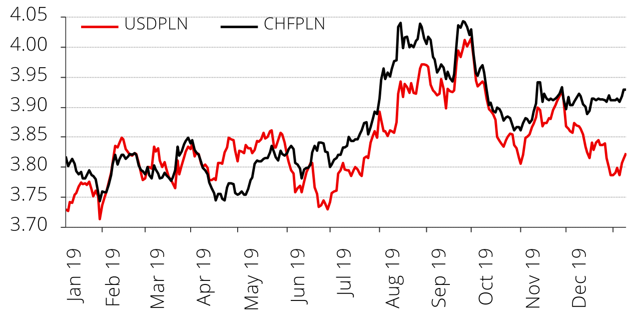
It seems that developments on the core debt market would be crucial. Both 10Y UST and Bund yields are trading near their very important resistance levels and are ready to resume the upside momentum. The US data scheduled for the coming days could be key.

EURPLN and dollar index



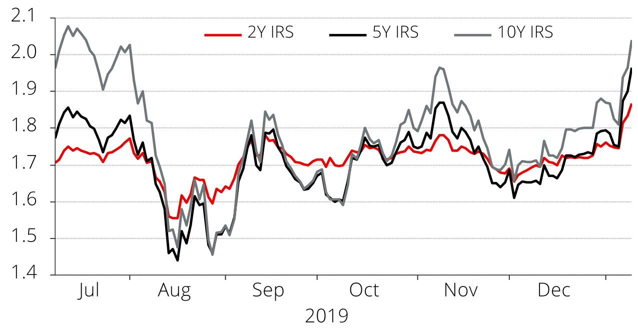
Source: Refinitiv Datastream, Santander Bank Polska

USDPLN and CHFPLN



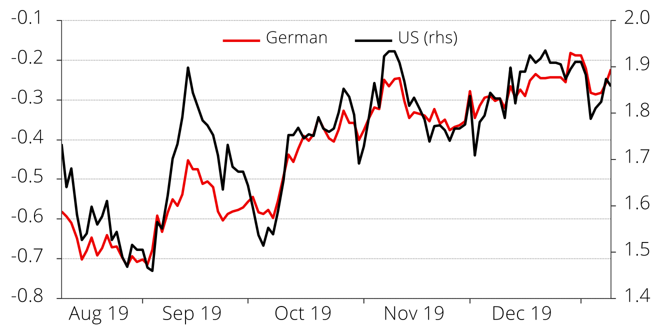
Source: Refinitiv Datastream, Santander Bank Polska

Poland 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 (13 January)				
09:00	CZ	CPI	Dec	% y/y	3.1	-	3.1
14:00	**PL**	**Current Account Balance**	**Nov**	**€mn**	**450**	**881**	**529**
14:00	**PL**	**Trade Balance**	**Nov**	**€mn**	**356**	**576**	**440**
14:00	**PL**	**Exports**	**Nov**	**€mn**	**20 652**	**21 529**	**21 791**
14:00	**PL**	**Imports**	**Nov**	**€mn**	**20 392**	**20 952**	**21 351**
			TUESDAY (14 January)				
09:00	HU	CPI	Dec	% y/y	4.0	-	3.4
14:30	US	CPI	Dec	% m/m	0.2	-	0.3
			WEDNESDAY (15 January)				
10:00	**PL**	**CPI**	**Dec**	**% y/y**	**3.4**	**3.4**	**2.6**
11:00	EZ	Industrial Production SA	Nov	% m/m	0.4	-	-0.5
20:00	US	Fed’s Beige Book					
			THURSDAY (16 January)				
08:00	DE	HICP	Dec	% m/m	0.6	-	0.6
14:00	**PL**	**CPI Core**	**Dec**	**% y/y**	**3.2**	**3.2**	**2.6**
14:30	US	Initial Jobless Claims	week	k	220	-	214
14:30	US	Retail Sales	Dec	% m/m	0.3	-	0.2
14:30	US	Index Philly Fed	Jan	pts	3.4	-	2.4
			FRIDAY (17 January)				
11:00	EZ	HICP	Dec	% y/y	1.3	-	1.3
14:30	US	Housing Starts	Dec	% m/m	1.1	-	3.2
15:15	US	Industrial Production	Dec	% m/m	0.0	-	1.1
16:00	US	Flash Michigan index	Jan	pts	99.1	-	99.3

Source: Santander Bank Polska, Reuters, Parkiet, Bloomberg