Bank Zachodni WBK
Grupa Santander

WEEKLY ECONOMIC UPDATE

30 January – 5 February 2017

There will be only two domestic data releases this week, both quite important. The first estimate of GDP growth in 2016 will be, in our view, at 2.7%, which implies that 4Q16 was somewhere in the range 2.0%-2.4%. Yet, 2016 is a history and now markets are focusing on the economic outlook for 2017. In this regard, the most recent signals from the Polish economy were optimistic, showing a surge in business climate in January. We expect the manufacturing PMI to confirm that the industrial sector remains in expansion, even though the index may decrease slightly in January after a sharp rise in the two previous months.

Polish debt market has been recently under pressure of the situation abroad, where hopes for global economic recovery and reflation triggered an upward trend in yields. The trend is unlikely to reverse unless we see clear disappointment from the economic data or investors voice concerns that Donald Trump's policies may do more harm than good to the world economy. Still, we think that clear signs of business climate improvement in Poland justify a narrowing of yield spread vs. German Bunds at the long end of the curve. The short end may be under pressure of gradually-building speculation about possible rate hikes (even though recently NBP Governor has turned more dovish). The Polish zloty has already reacted positively to green shoots in domestic data and we think such trend may continue in near term.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (30 January)					
14:30	US	Personal income	Dec	% m/m	0.4	-	0.0
14:30	US	Consumer spending	Dec	% m/m	0.5	-	0.2
16:00	US	Pending home sales	Dec	% m/m	1.3	-	-2.5
		TUESDAY (31 January)					
10:00	**PL**	**Flash GDP**	**2016**	**%**	**2.7**	**2.7**	**3.6**
11:00	EZ	Advance GDP	Q4	% y/y	1.7	-	1.7
11:00	EZ	Flash HICP	Jan	% y/y	1.5	-	1.1
16:00	US	Consumer confidence	Jan	pts.	112.7	-	113.7
		WEDNESDAY (1 February)					
9:00	**PL**	**PMI – manufacturing**	**Jan**	**pts.**	**53.5**	**53.9**	**54.3**
9:55	DE	PMI – manufacturing	Jan	pts.	56.5	-	56.5
10:00	EZ	PMI – manufacturing	Jan	pts.	55.1	-	55.1
14:15	US	ADP report	Jan	k	170	-	153
16:00	US	ISM – manufacturing	Jan	pts.	55.0	-	54.7
20:00	US	FOMC decision		%	0.50-0.75	-	0.50-0.75
		THURSDAY (2 February)					
11:30	**PL**	**Bond auction**					
13:00	CZ	Central bank decision		%	0.05	-	0.05
14:30	US	Initial jobless claims	week	k	-	-	259
		FRIDAY (3 February)					
9:55	DE	PMI – services	Jan	pts.	53.2	-	53.2
10:00	EZ	PMI – services	Jan	pts.	53.6	-	54.7
14:30	US	Non-farm payrolls	Jan	k	163	-	156
14:30	US	Unemployment rate	Jan	%	4.7	-	4.7
16:00	US	Industrial orders	Jan	%	1.5	-	-2.4

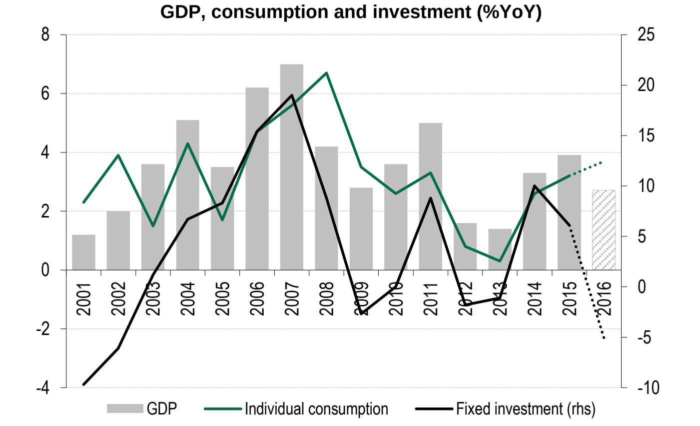
Source: BZ WBK, Reuters, Bloomberg

ECONOMIC ANALYSIS DEPARTMENT:
al. Jana Pawła II 17, 00-854 Warszawa fax +48 22 586 83 40
email: ekonomia@bzwbk.pl Web site: http://www.bzwbk.pl
Maciej Reluga (Chief Economist) +48 22 534 18 88
Piotr Bielski +48 22 534 18 87
Agnieszka Decewicz +48 22 534 18 86
Marcin Luziński +48 22 534 18 85
Marcin Sulewski +48 22 534 18 84

TREASURY SERVICES:
Poznań +48 61 856 5814/30
Warszawa +48 22 586 8320/38
Wrocław +48 71 369 9400

What's hot this week – GDP and PMI

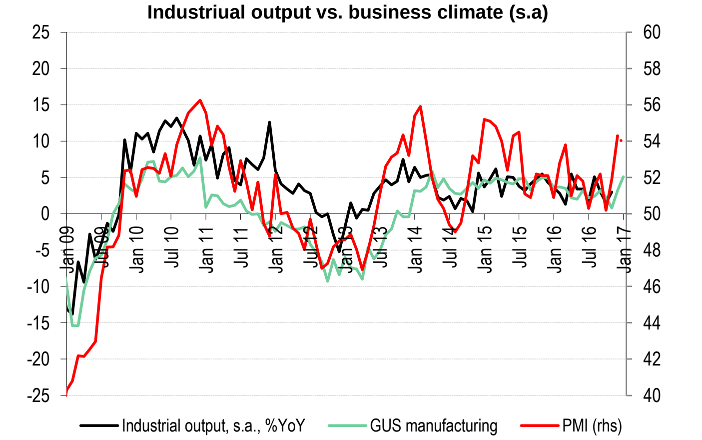
GDP, consumption and investment (%YoY)



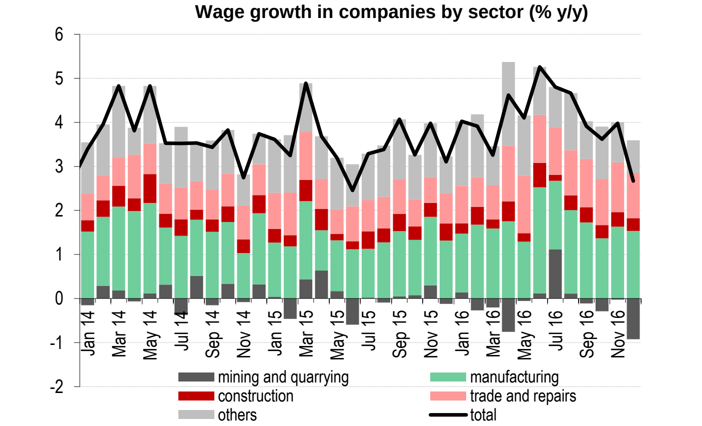
- On Tuesday, the Statistical Office is to release the first estimate of the annual GDP for 2016. In our view, the growth reached 2.7%, meaning that Q4 alone fell in 2.0-2.4% range (assuming no revisions in the earlier data). Data on consumption and investment will be crucial, as they will help to answer questions about the impact of the 500+ programme and rebound in investment. In our view, the economic growth bottomed out at the turn of 2016 and 2017 and will be accelerating gradually in the quarters to come.
- PMI fell slightly in January, in our view. The recent rises of other business climate indices may point to an upward potential of PMI, but, in our view, the last surge was excessive. Still, the reading just below 54 pts should confirm that the Polish industry remains in expansion.

Last week in economy – Rise in business climate indices

Industriual output vs. business climate (s.a)



Wage growth in companies by sector (% y/y)



- Business climate indicators released by the Polish Statistical Office (GUS) rose sharply in January across sectors. The most significant improvement took place in services – retail trade, transport, accommodation and catering – but manufacturing and construction also picked up. The GUS survey is yet another signal that after the fourth quarter, when the economic activity in Poland was quite weak, GDP growth should start accelerating from early 2017, supported by both domestic and external demand.
- The NBP survey on business sentiment showed that companies' condition improved in 4Q16 but forecasts for 1Q17 and whole 2017 have become less optimistic. A rebound in production and a rise in demand (mainly from abroad) is expected but the latter could be only temporary. Companies still plan to employ staff which could generate even higher wage pressure. High uncertainty prevents private companies from investment activity at the beginning of the year.
- Registered unemployment amounted to 8.3% in December, in line with expectations. Let us note that the number of new job offers is still strongly on the rise, but the number of people removed from the unemployment rolls after taking up a job decelerated. This suggests that the deepening shortage of workers can limit the employment growth and thus may slow the economic recovery in the upcoming months.
- Detailed data on wages confirmed that the surprisingly weak wage growth in the corporate sector in December (2.7% y/y vs 4.0% y/y in November) was due to the lower-than-usual bonus payments in mining and utilities, while in the remaining sectors, wages rose at a moderate pace. We think wages growth will continue to accelerate amid the rising mismatch between the demand and supply of workers.

Quote of the week – It is very important to stick to expansive monetary policy

Adam Glapiński, NBP president, PAP, 25.01

This year, we will touch the lower bound of tolerance range. This means that the MPC can consider rate hikes only in 2018. But rates can also stay unchanged if the economy does not gain steam in 2017.

Eugeniusz Gatnar, MPC member, PAP, 25.01

In baseline scenario, we will be stabilizing rates throughout 2017. If inflation approaches the target, we should consider hiking. If inflation exceeds 1.5%, real rates will be negative and such a situation can last for some time. However, if it lasts too long, we should take action.

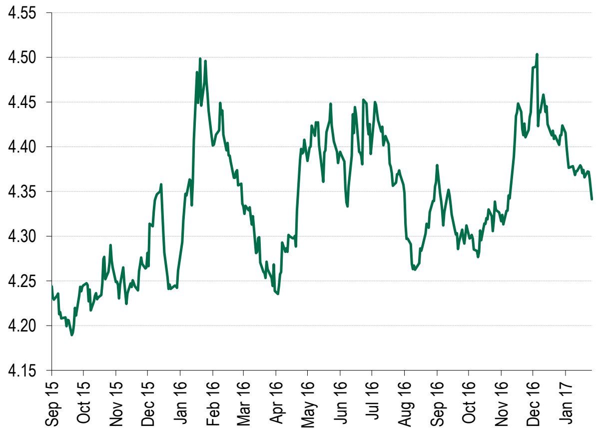
Eryk Łon, MPC member, PAP, 27.01

It is very important to stick to the expansive monetary policy. If there is a need to cut rates, I will not hesitate.

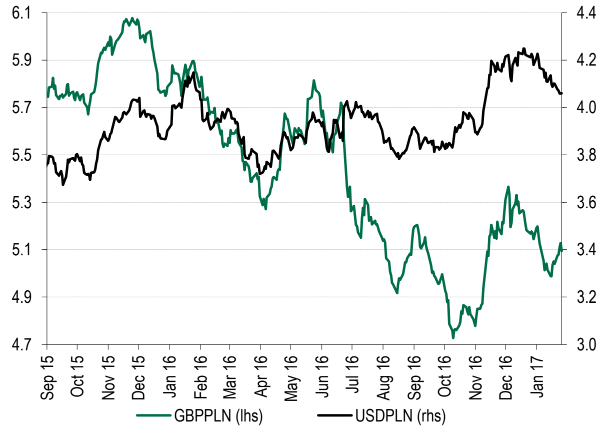
Minutes from the January MPC meeting included a mention that, according to some members, negative real rates will be an argument for policy tightening, and similar view was expressed by Eugeniusz Gatnar. On the other hand, Adam Glapiński suggested that the bank would tolerate negative rates until GDP growth is subdued, while Eryk Łon said explicitly that monetary policy should remain expansive and that he would not hesitate to cut rates if necessary. We think that the majority of the Council members will support a 'wait-and-see' approach and will not hurry with monetary tightening, especially when growth is still fragile and CPI rise is commodity-driven. However, the further rise of inflation (we forecast CPI to reach 2% in March/April) and strengthening signs of economic recovery may trigger a growing divergence in MPC member's views and thus will also encourage the interest rate market to price-in rate hikes in Poland.

Foreign exchange market – Eyeing important data

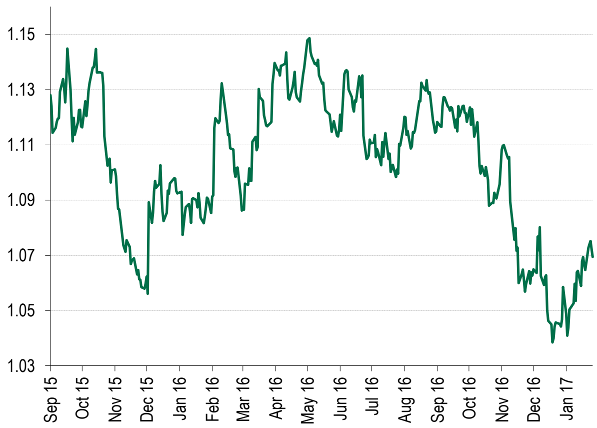
EUR/PLN



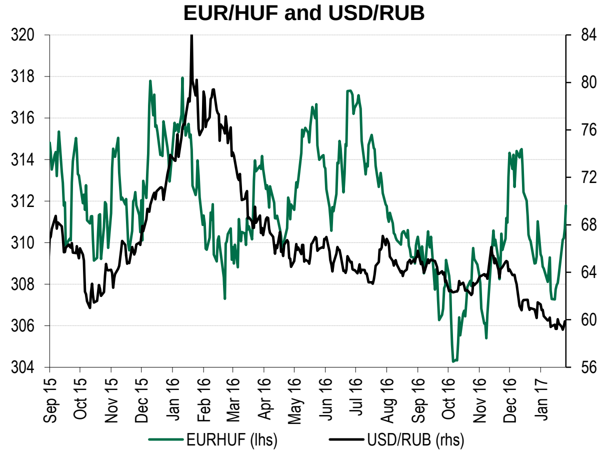
GBP/PLN and USD/PLN



EUR/USD



EUR/HUF and USD/RUB



Equities rally boosts zloty

- The zloty gained vs the euro, dollar and Swiss franc amid positive global market sentiment. As a result, EURPLN has fallen below 4.34, its lowest since early mid-November when the upside wave started after the US presidential elections. The Polish currency appreciated temporarily to 4.04 per dollar and Swiss franc but lost vs the pound (GBPPLN rose for a while to 5.14 after the pound gained as the UK High Court confirmed that the Parliament has to approve Brexit).
- Recent zloty's appreciation was accompanied by a sharp rally on the global equity market. EUR/PLN's 1-month correlations witch Polish WIG20 and the U.S. S&P500 are now at c-90% indicating that the worldwide shift to equities from bonds that gained pace after Donald Trump won the US presidential race may now have a key impact on the zloty. That could be the case particularly if the next macro data confirm solid growth of the global economy at the beginning of the year.
- This week's calendar is full of important releases with the US events being the most awaited ones. The FOMC should leave the interest rates unchanged in February (this is broadly expected by the market) and its assessment of the trends in the US economy should be in focus. At the end of the week, the monthly nonfarm payrolls will be released which may add volatility.
- EURPLN broke the 4.36 support and next level to watch is at 4.33.

EUR/USD waiting for important data

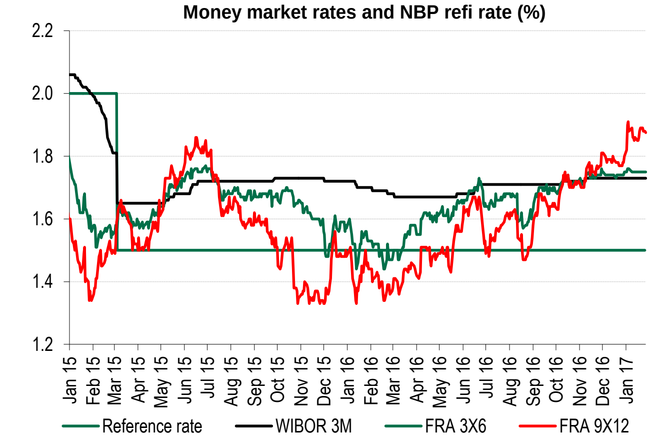
- After five consecutive weeks of an increase, the coming US macro data are likely to determine if the euro will gain versus the dollar in the days to come. EUR/USD rose to 1.077 after Donald Trump's inaugural speech as investors had become more worried about the impact of higher level of protectionism on the global economy rather than impressed by the outlook for faster growth in the US.
- The current upside wave for EUR/USD, which has been developing since the beginning of the year, is bigger than the previous one from November/December. However, in the recent days the pace of the increase has faded, suggesting that more euro-positive or dollar-negative news are needed to push EURU/USD higher.
- The US flash 4Q16 GDP figure and the next week's FOMC decision and monthly nonfarm payrolls could trigger direction for the exchange rate at last in the short term.

HUF and RUB underperform PLN

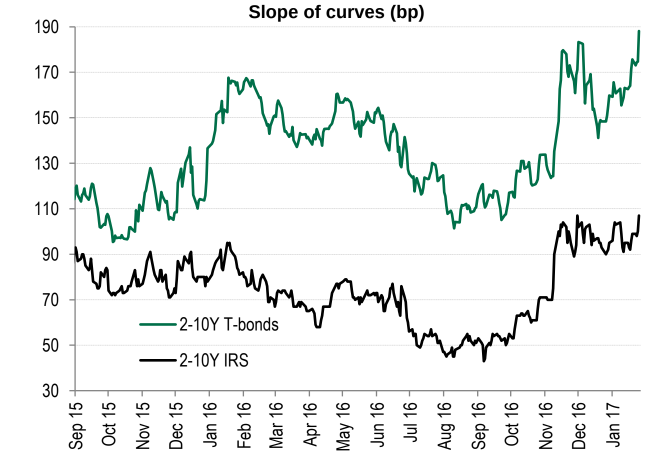
- Both forint and ruble depreciated last week despite quite positive global market sentiment and growing oil prices. EURHUF rose for the second week in a row and touched 312 (highest for five weeks) while USDRUB rebounded slightly from the local bottom and rose above 60 to its highest for two weeks. The ruble was pressured by the decision of the Russian Ministry of Finance to buy foreign currencies in order to rebuild its FX reserves.

Interest rate market – Core markets important again

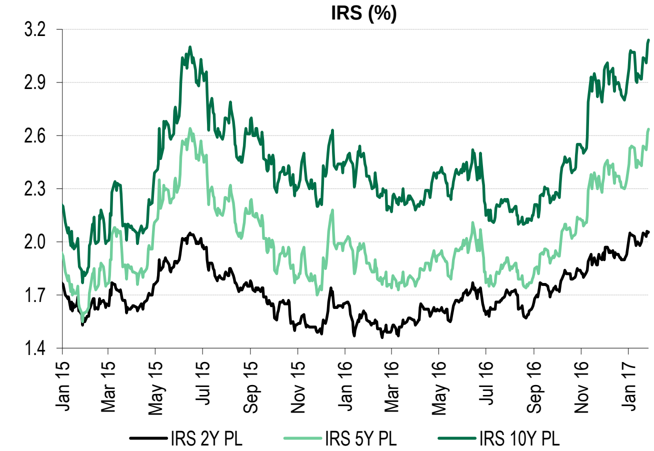
Money market rates and NBP refi rate (%)



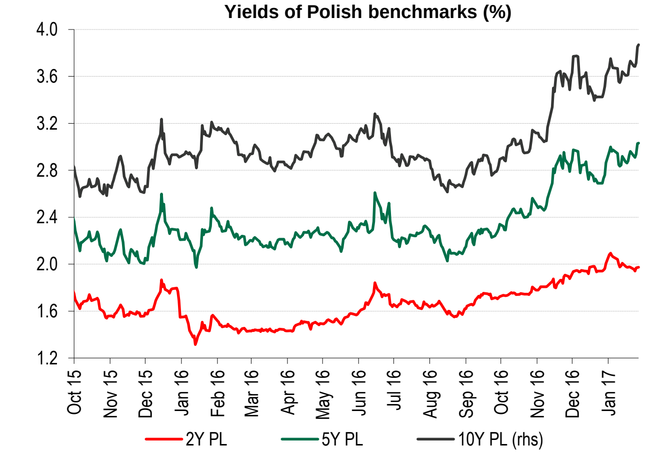
Slope of curves (bp)



IRS (%)



Yields of Polish benchmarks (%)



Higher demand for risk hits bonds

- High demand for risky assets persisting for the better part of the past week has clearly weighed on the global debt. Yields rose in Europe and in the US but the Polish and euro zone's bonds suffered much more. Domestic IRS curve increased by 4-8bp and the bond curve by 2-12bp with the biggest change on the long end in both cases. The 2Y IRS ended the week near 2.03%, the 5Y rate closed at around 2.60% and the 10Y at c3.12%. The 2-10 spreads widened sharply to 107bp and 188bp, respectively. The 10Y PL-DE spread rose 4bp to 336bp.
- Monday's bond auction was very successful. The Ministry of Finance sold debt for more than PLN10.6bn (including PLN9bn at the standard auction) amid total demand at PLN22bn and the upper band of the planned supply at PLN9bn. The 5Y and 10Y benchmarks PS0422 and DS0727 attracted the highest demand. The Ministry said that c35% of this year's borrowing needs are now covered after the Monday's auction.

Core markets important again

- We have recently pointed out that the 1-month correlation of the Polish 10Y bond with its German and US peers fell after the domestic debt was underperforming core markets and spreads rose. However, the last week saw a significant rise in 1-month correlation vs the Bund to 70% from 50%. Correlation with the US 10Y benchmark has also improved but is still as low as 20%.
- We do not expect significant surprises from the Polish macro data this week so the GDP and PMI should remain neutral for rates. At the same time, the bunch of European and US and the outcome of the FOMC meeting might be more meaningful, particularly after the recent rise in yield's correlation.
- The US central bankers are expected to leave interest rates unchanged at their February's meeting. However, the tone of the statement is rather unlikely to sound dovish as more hikes are expected to be delivered later this year.
- The last week's auction was successful and this bodes well for the auction scheduled for the first week of February. The Ministry of Finance will announce details on the planned supply and bond series offered on Tuesday. After the change in the rules, the Ministry declared it will offer, among others, 2Y, 5Y and 10Y benchmarks at each auction so now it can only modify the planned supply. Pretty high pre-financing ratio of the 2017 borrowing needs allows for lower supply. After the recent jump in yields, the 10Y bond may look attractive and so the demand could focus on the long-term debt, just like during the previous auction.

Additional information is available on request. Please contact Bank Zachodni WBK S.A., Economic Analysis Department, al. Jana Pawła II 17, 00-854 Warsaw, Poland, phone +48 22 534 18 88, email ekonomia@bzwbk.pl