Bank Zachodni WBK
Grupa Santander

# WEEKLY ECONOMIC UPDATE

## 6 – 12 February 2017

**According to the preliminary data, the GDP growth in Poland slowed to 2.8% in 2016 from 3.9% in 2015. This may imply that GDP growth in 4Q16 was similar to the one reported in 3Q16 and reached 2.5% y/y. While the GDP growth was slightly better than expected, its structure disappointed, both in terms of private consumption (3.6% in the entire year) and investments (-5.5%). However, it seems more and more likely that the bottom of the cycle is already behind us, as all available business climate indicators (including the PMI) rose sharply in January, and we see growing evidence that inflow of external orders is accelerating.**

**The calendar for the nearest week is almost empty. The only relevant domestic event will be the Monetary Policy Council meeting. We are not expecting any major turn in the Council's rhetoric, as the economic situation has not changed much since the last meeting. There were new signals that economic activity started improving at the start of the year, but there was little news on the inflation front. The MPC tone has softened a bit already in January when the NBP Governor Adam Glapiński ensured that there would be no rush with monetary tightening and the Council was ready to tolerate negative real interest rates for some time. However, the recent comments by some MPC members suggest, in our view, that differences of opinions about the policy outlook may intensify within the Council if inflation picks up quickly. This may fuel market speculation about rate hike probability once inflation approaches 2% y/y in 1Q17 (even though the NBP president will probably try to tame such expectations). However, this may be the theme for the next months rather than for the next week, and the February MPC meeting will not be very exciting, in our view.**

**There are not many events abroad in the agenda. The data from Germany (factory orders, production, exports) should confirm positive trends, implying positive outlook for Polish industry and exports. But the next decisions made by Donald Trump, as well as comments made by FOMC members, or news from Italy (risk of early elections) and Greece (renewing worries about the crisis) may prove more important for the sentiment on the core markets, .**

**Less-hawkish-than-expected FOMC comment and doubts regarding Trump's first decisions have stopped the upward trend in bond yields abroad in recent days, but we do not know for how long. The base case scenario is still the weakening of core debt markets in the coming months. In such environment, the room for strengthening of Polish debt is limited, although we think the spread versus German Bunds may tighten further. For the FX market, we see a rising risk of a correction after the recent quite significant zloty appreciation.**

### Economic calendar

| TIME CET | COUNTRY | INDICATOR | PERIOD | | FORECAST MARKET | FORECAST BZWBK | LAST VALUE |
|---|---|---|---|---|---|---|---|
| | | **MONDAY (6 February)** | | | | | |
| 8:00 | DE | Industrial orders | Dec | % m/m | 0.5 | - | -2.5 |
| **11:30** | **PL** | **T-Bills Auction** | | | | | |
| | | **TUESDAY (7 February)** | | | | | |
| 8:00 | DE | Industrial output | Dec | % m/m | 0.4 | - | 0.4 |
| 9:00 | CZ | Industrial output | Dec | % y/y | 5.6 | - | 7.0 |
| | | **WEDNESDAY (8 February)** | | | | | |
| | **PL** | **MPC decision** | | **%** | **1.50** | **1.50** | **1.50** |
| | | **THURSDAY (9 February)** | | | | | |
| 8:00 | DE | Exports | Dec | % m/m | -1.6 | - | 3.9 |
| 14:30 | US | Initial jobless claims | week | k | - | - | 246 |
| | | **FRIDAY (10 February)** | | | | | |
| 9:00 | CZ | CPI | Jan | % y/y | 2.1 | - | 2.0 |
| 16:00 | US | Flash Michigan | Feb | Pts. | 97.8 | - | 98.5 |

Source: BZ WBK, Reuters, Bloomberg

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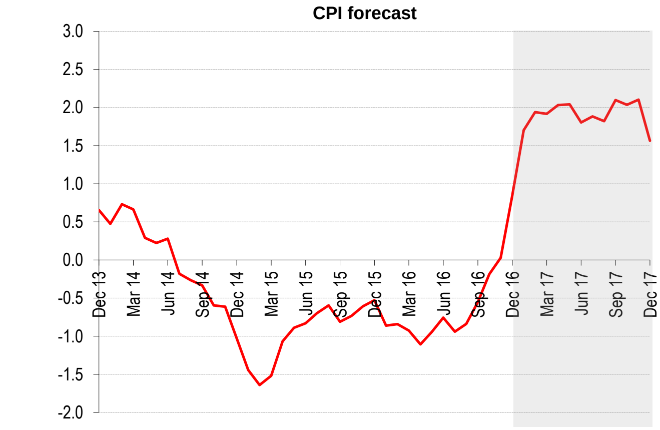
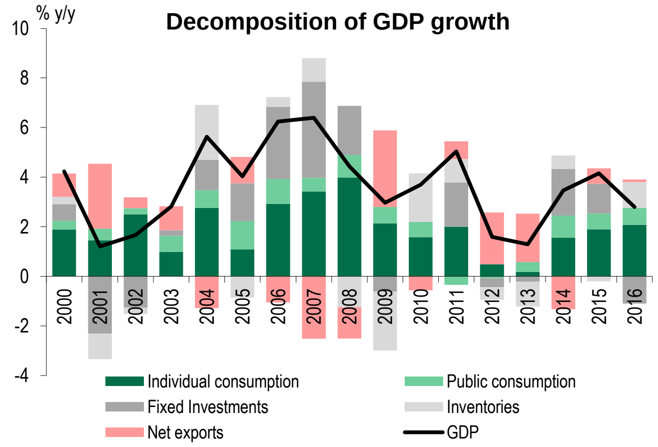
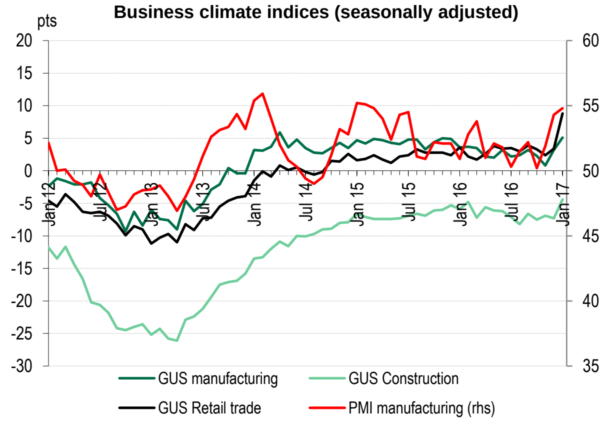
## What's hot this week – Monetary policy still not very exciting




- The Monetary Policy Council meeting is the only important domestic event this week. However, we are not expecting any substantial turn in the Council's statement this time, as the economic situation has not changed significantly since the last meeting. There were new signals that economic activity started improving early this year, but there was little news on the inflation front.
- The recent comments by some MPC members suggest, in our view, that differences of opinions about the policy outlook may intensify within the Council if inflation grows quickly. This may fuel market speculation about rate hike probability once inflation approaches 2% y/y in 1Q17 (even though the NBP president will probably try to tame such expectations). However, this is the theme for the next months, and the February MPC meeting will be not too exciting.

## Last week in economy – GDP in 4Q above expectations, PMI up




- According to the flash reading of GDP in 2016, economic growth amounted to 2.8% versus 3.9% in 2015. This proved better than we and the market had expected (2.7%). Based on the data for the whole year and earlier releases on the first three quarters of 2016 (assuming no revisions in the earlier data), we estimate that the GDP growth in 4Q16 was close to 2.5% y/y, i.e. similar to the one recorded in 3Q.
- Private consumption was the main engine of growth in 2016, rising 3.6% in real terms despite some disappointment in 4Q, when it reached c4.0% y/y, only slightly more than in 3Q. Inventories added as much as 1pp to the growth in 2016 and even 1.3pp in 4Q. This is an interesting phenomenon, as usually during the economic slowdown inventories were a negative, and not a positive contributor to the economic growth. Another interesting fact is that, contrary to our expectations, the public consumption growth remained positive in 4Q (in 2-3% y/y range) despite the very high "base" from the last year. Data on budget delivery suggest that the government may have moved some spending from 2017 to December 2016. Investment fell by 5.5% in the entire 2016, which means -5.8% y/y in 4Q (we were expecting a slightly better reading, at -4.5% y/y). Net exports contributed 0.1pp to the growth in 2016 and 0.4pp in 4Q.
- Poland's manufacturing PMI index strongly accelerated in January 2017 and reached 54.8 pts (from 54.3 pts in December), exceeding forecasts. It indicates the strongest overall improvement in Poland's business conditions since March 2015. This mainly stemmed from sharp growth in output, which rose at the fastest pace in nearly three years. What is more, sub-index of new orders reached the highest level since July 2015. On the other hand, inflationary pressures remained strong.

## Quote of the week – GG deficit near 2.8-2.9% in 2016 and 2017

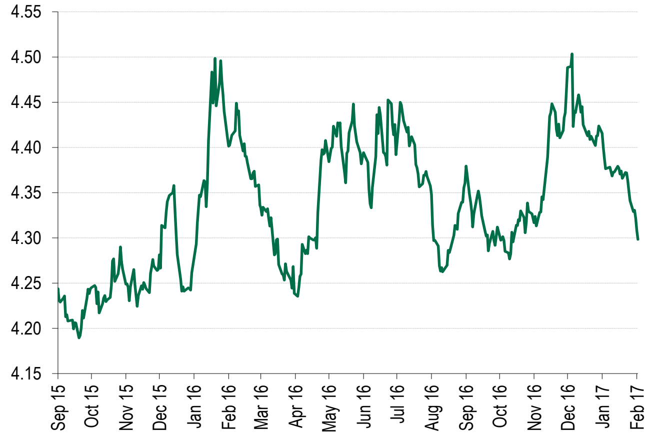
**Leszek Skiba, deputy finance minister, PAP, 02.02 and 31.01**

Our forecast of GG deficit for 2017, based purely on macroeconomic assumptions, would be 2.9%, but this Eurostat change brings us closer to 2.8% of GDP. Revenues from the LTE auction will be spread for many years as a rent, not as a one-off. There will be some corrections for the previous years, but generally the impact will be positive for the upcoming years. Thus, there is a correction of GG deficit: our current estimate sits at 2.8-2.9% of GDP.

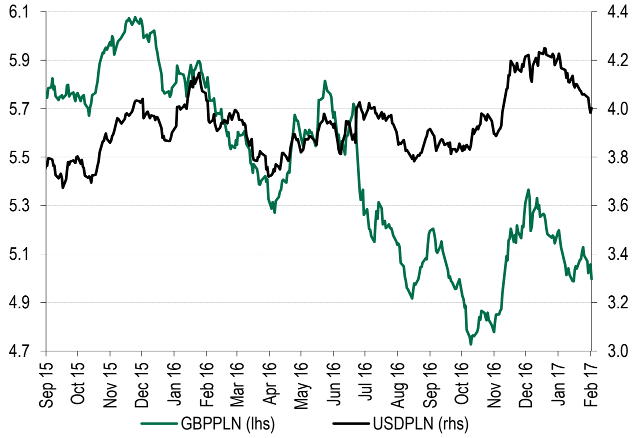
The Finance Ministry informed that budget deficit amounted to PLN46.3bn in 2016 as compared to 54.7bn planned in the budget act and versus PLN42.6bn in 2015. Data after November suggested a much better delivery of the budget, both on the revenue and spending side. Some spending from 2017 may have been moved to 2016, as it was suggested by government representatives. This may justify the relatively high public consumption in 4Q. Also, VAT incomes were very disappointing in December (down by about 50% y/y). It seems that this was due to the refund of overpaid VAT. According to Skiba, GG deficit amounted to 2.8-2.9% of GDP, i.e. considerably above forecasts. This is due to the fact that Eurostat decided not to classify inflows from the LTE auction (PLN9.2bn) as one-off budget revenues, but as 15-year rent. In our view, this adds 0.5% of GDP to the deficit.

## **Foreign exchange market** – Risk for correction rises

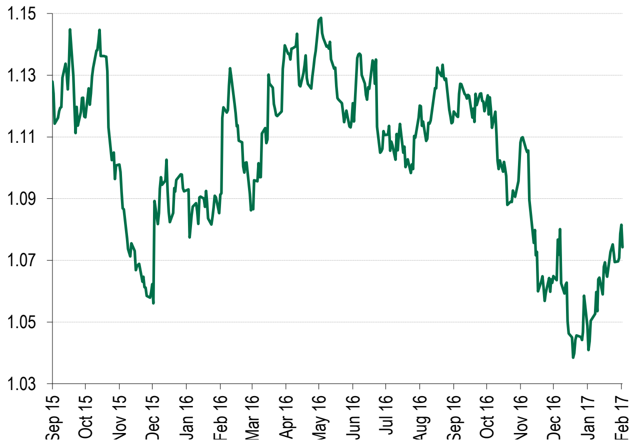
EUR/PLN



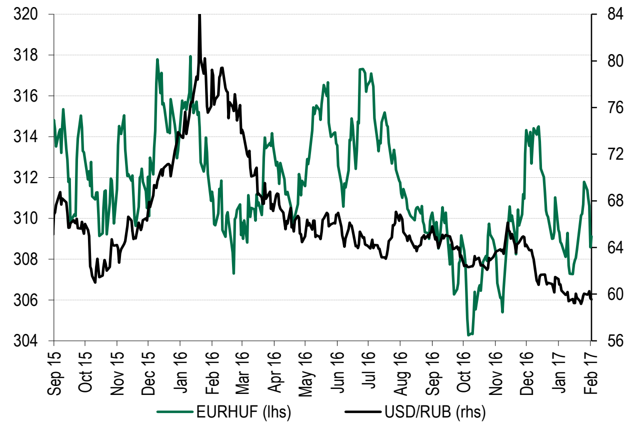

GBP/PLN and USD/PLN




EUR/USD




EUR/HUF and USD/RUB




### Zloty outperforms EM and G10 currencies

- The zloty gained for the third week in a row vs the euro and Swiss franc and for the seventh week in a row vs the dollar. Positive mood persisted on the global market and pushed EUR/PLN to 4.30, its lowest since early November. USD/PLN fell below 4.0 also thanks to higher EUR/USD. GBP/PLN eased to 5.0 from 5.10 and CHF/PLN neared 4.0.
- This week's economic calendar is almost empty and only a few FOMC members will speak next to the very limited number of macro data releases.
- In January the zloty was the best performing EM currency vs the euro, dollar, Swiss franc and British pound. In our view, more positive impulses may be needed for the zloty to continue its appreciation trend or, at least, to help keep the recent gains. As there seem to be no important events on the agenda this week, there is a risk that some profit taking after the EUR/PLN recent fall could take place, in our view. This may be the case particularly when investor's attention turns to the euro zone peripheries (market talking about Grexit and early elections in Italy).
- At the end of the week, EUR/PLN was testing first important support area at just below 4.30. The next level to watch is at 4.26, while the first resistance is at c4.35.

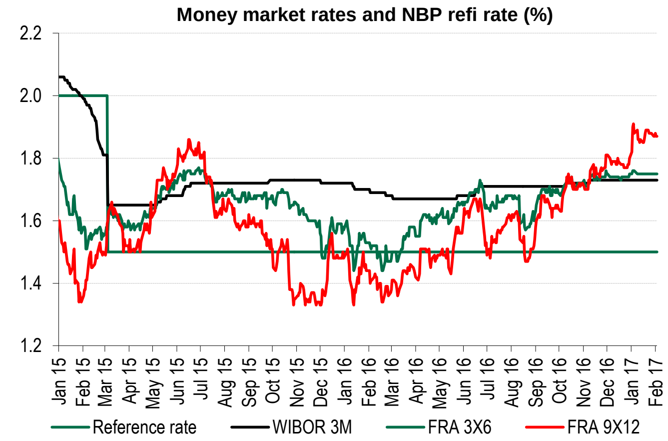
### More fuel needed

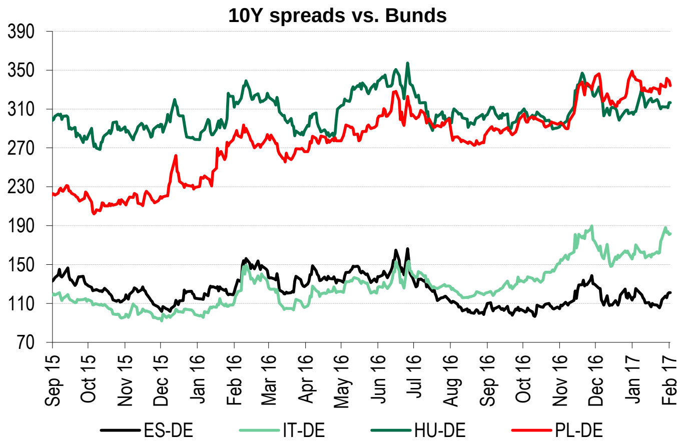
- EUR/USD rose to nearly 1.085 last week with the comments from the Donald Trump administration and dovish message from the FOMC meeting being the core driver for the dollar's weakening. US central bankers presented an optimistic view for the US economy but refrained from signaling looming rate hikes which may have disappointed the market after the recent quite sound macro data.
- The past week is likely to be the seventh in a row of the euro gaining against the dollar. Last time the same length or longer streak was observed in 2004, when EUR/USD climbed for eight weeks in a row.
- As we mentioned above, this week's economic calendar does not contain a large number of an important macro data and this could be the reason for investors to focus on some other issues, including rising risk for early elections in Italy and resurfacing worries about Grexit, which could lead to a pause in EUR/USD rise.

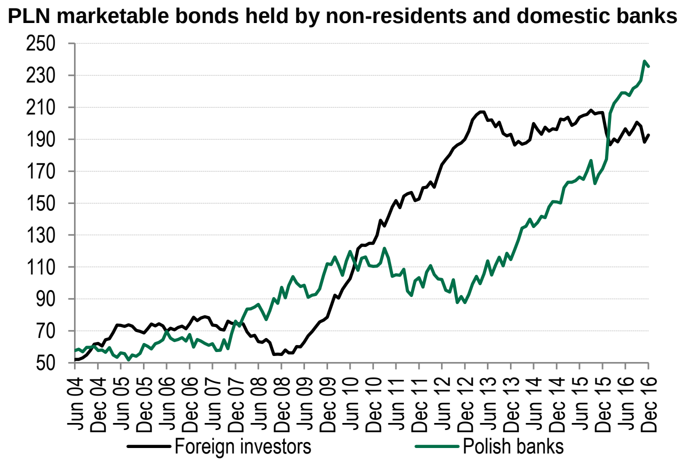
### Forint gains, no big changes on RUB market

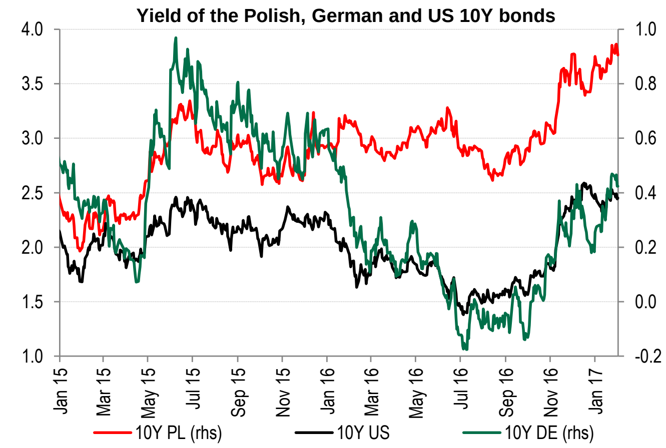
- The forint gained vs the euro, benefitting from high demand for risky assets. EURHUF fell temporarily to 308 after two consecutive weeks of increase. At the same time, USD/RUB reached its fresh 2017 low at c58.55 but the ruble's appreciation proved only temporary and at the end of the week the exchange rate was back near 59.5.
- The Central Bank of Russia left interest rates unchanged in February, the main refi rate is still at 10%, in line with expectations. The bank acknowledged that inflation is falling in line with its forecasts while the economy is reviving faster than expected. In its view, somewhat slower growth of CPI is due to one-off factors. The bank concluded that "considering the change in the external and internal environment, the Bank of Russia's capability to downgrade its key rate in the course of the first half of 2017 has diminished." There was no significant market reaction to the decision and the tone of the statement.

## **Interest rate market** – Limited room for further strengthening




### Situation on core market and debt auction support bonds

- The turn of January and February was favourable for the domestic interest rate market. Both the yields and IRS rates fell considerably over the past week, following core market trends and good domestic auction results (details below). Core market gained visibly in response to the less hawkish FOMC and, as a consequence, yield of the 10Y Bund returned to 0.40% (as January US job market report showed gradual decline in wages), after reaching nearly 0.50% at the start of the week. This helped Poland's assets to revive and the yield of 10Y benchmark declined below 3.80%. On the other hand, the market's response to domestic macro data (a bit higher-than-expected flash GDP growth in 2016) was muted.
- Both the yield and IRS curves shifted down and flattened somewhat on weekly basis as the long end of the curves outperformed other sectors. The 2-10Y spread for T-bonds tightened to nearly 160bp, down from 181bp at the end of the previous week. Risk premia (measured by spread over Bunds ) also tightened gradually over the past week. However, in our view, there are still at elevated level (not so far from 340pb).
- On the money market, WIBORs remained unchanged at the turn of January-February, while FRAs for longer tenors gradually increased. This resulted from quite hawkish comments from some the MPC members. The market upholds its view that NBP rates would be hiked by 25bp in 12 months horizon.

### YTD bond issuance completion near 40%

- Thursday's bond auction was very successful. The Ministry of Finance sold debt for nearly PLN6bn including PLN5bn at the standard auction and amid total demand at over PLN15bn. Bid-to-cover ratio increased to nearly 2.51 from 2.16 at the last auction in January (or 2.37 average for January). Just like we supposed, the 10Y benchmark again attracted the highest demand and PLN2.2bn was collected from the sale of DS0727. Like in late January, the demand for OK0419 was low. The Ministry said that 38.8% of this year's gross borrowing needs were covered after Thursday's auction.
- The structure of T-bonds sold at the first auction this month suggests that foreign investors were on the bid side. The Ministry of Finance reported that non-residents increased their holdings in Poland's Treasury papers in December by PLN4.4bn to PLN192.6bn and continued to increase their exposure also in January. They were mainly focused on the belly and the long end of the curve.

### Core market still sets direction

- This week macro calendar (both domestic and external) is light. The main event will be Poland's MPC meeting. It is broadly expected the Council to keep the interest rates unchanged. Moreover, the rhetoric will not change much in comparison with the one in January, with the MPC Chair Glapiński cooling down expectations for fast monetary tightening. This should be supportive for the front end of the curves.
- The belly and the long end of the curves should remain more vulnerable to the situation on the core market. In the short run, we foresee yields to move sideways or even slightly down, but the room for further strengthening is limited. Our base line scenario assumes higher yields on the core markets in the upcoming months, which will spill over into Poland's higher yields. However, in our view, there is stillroom for spread-over-Bund tightening.

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